

Monthly Report of Prospects for Japan's Economy

September 2022

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

<https://www.jri.co.jp/english/periodical/>

This report is the revised English version of the August 2022 issue of the original Japanese version.

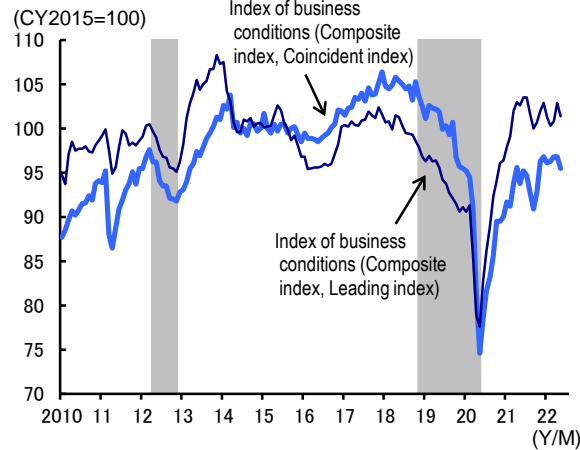
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The General Situation – The economy is slowly picking up

Figure 1-1 Economic Activity

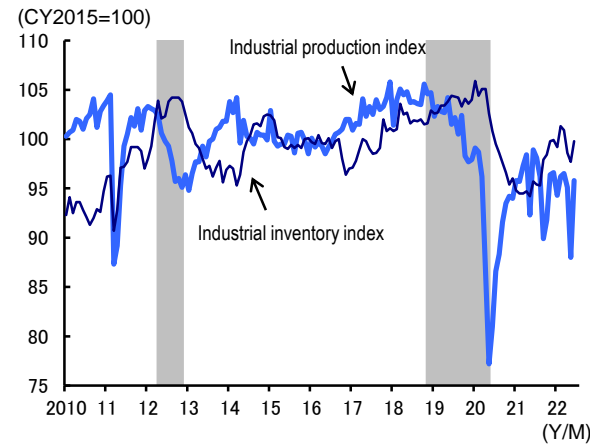
Both coincident and leading indices of business sentiment are flat.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

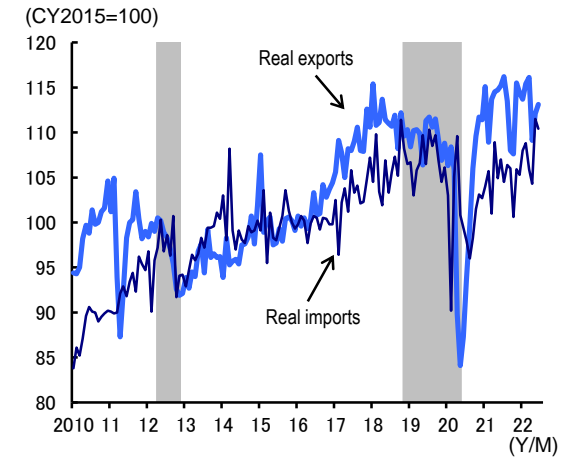
Industrial production is rising in the automobile, electrical/ICT machinery, and other sectors following the lifting of the Shanghai lockdown.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

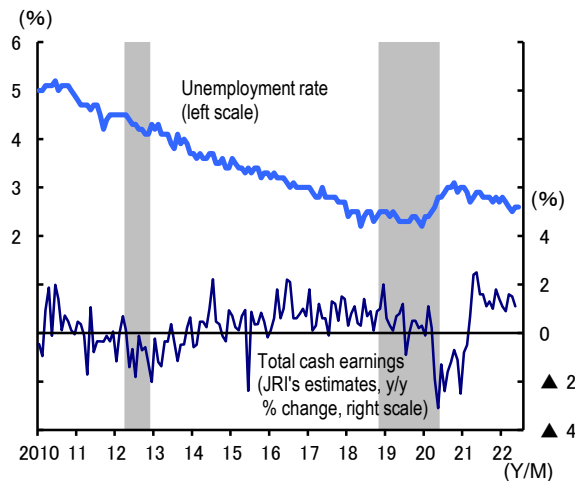
Exports to China are picking up. Imports remain high.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate is unchanged. Nominal wages are rising mainly due to overtime pay.

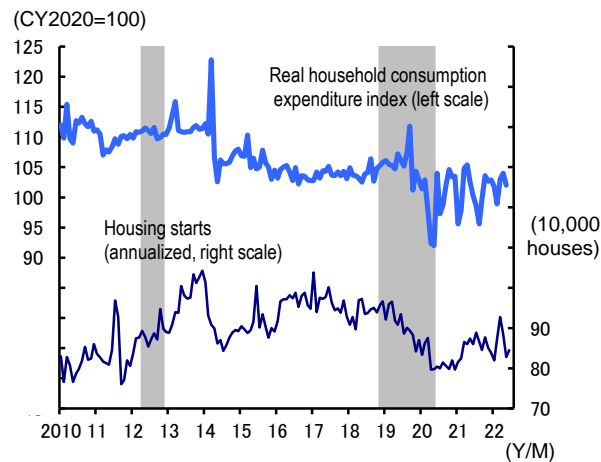


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

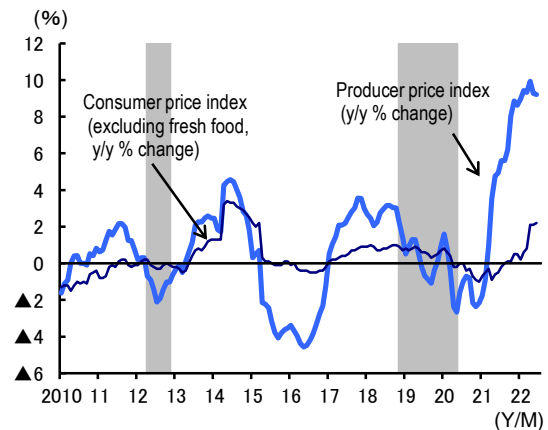
Real consumption is on an upward trend as people are moving around again. Housing starts are hovering in the mid-800,000 range.



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office, The Ministry of Land, Infrastructure, Transport and Tourism.

Figure 1-6 Prices

Corporate price inflation is running high at more than 9% per year. Consumer prices were over 2% higher than a year earlier for the third consecutive month.



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications, The Bank of Japan.

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Personal consumption is bobbing up and down, while exports and production are picking up

◆ Consumer sentiment is still being affected by the infection situation

The Real Consumption Activity Index rose for the third straight month in May, up 0.7% from the previous month. Looking at the breakdown, durable goods declined due to reduced production of automobiles and other factors, but services consumption increased as the flow of people recovered. Meanwhile, the consumer confidence index declined for the second consecutive month in July. Price hikes of daily necessities and the COVID flare-up have made consumers more cautious.

◆ Production is picking up thanks to the lifting of the Shanghai lockdown

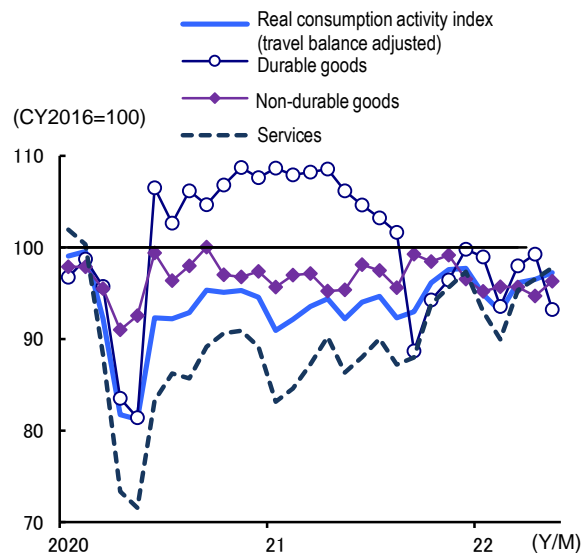
The Industrial Production Index rose in June, up 8.9% from the previous month. With the lifting of the lockdown Shanghai, many industries, including automobiles and electrical/ICT machinery, have boosted output. Near-future production plans indicate increases in output in July (+3.8% month-on-month (MoM)) and August (+6.0% MoM). However, there is still a strong sense of uncertainty surrounding

supply chain function, particularly with regard to developments in China, and there is a risk that plans will be revised downward due to difficulties in procuring components and materials.

◆ Exports continue to recover

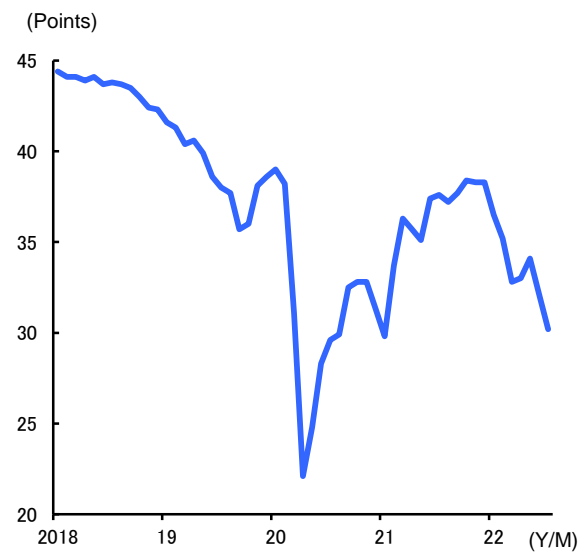
Real exports increased in June for the second month in a row. By region, shipments to China increased on the back of the lifting of the Shanghai lockdown, and those to Europe and Asia held firm.

Figure 2-1 Real Consumption Activity Index
<seasonally adjusted>



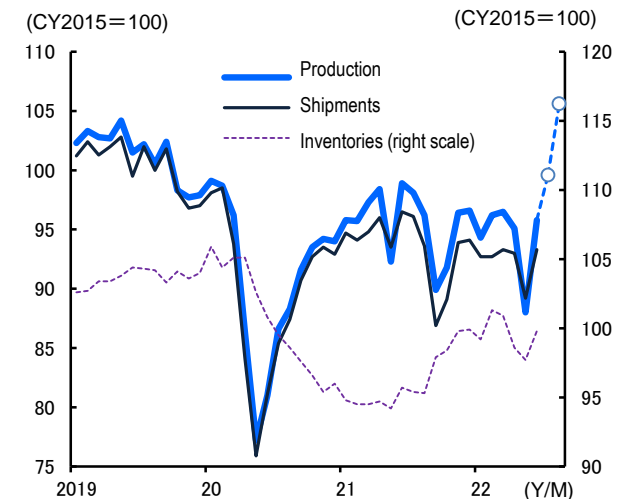
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.

Figure 2-2 Consumer Confidence Index
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Cabinet office.

Figure 2-3 Industrial Production Index
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.

Note: The latest two figures in the industrial production index are forecasts.

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Goods exports are rising, and inbound demand is set for a gradual recovery

◆ Transportation machinery exports have picked up

Looking at real exports by category, exports of capital goods and electronic components/devices stayed at high levels, while those of transportation machinery increased as the lifting of the Shanghai lockdown eased parts supply shortages.

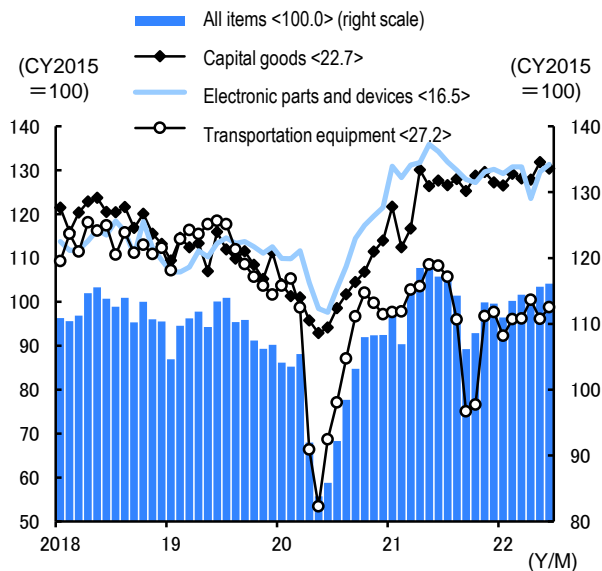
And looking ahead, the gradual recovery in exports is expected to continue as supply constraints ease. Although overseas economies are expected to cool going forward, the DI for the overseas supply-demand balance for manufactured goods remains significantly positive (excess demand) for large manufacturing companies. Among product categories, transportation machinery exports are expected to give a lift to overall exports as component shortages are steadily resolved. However, attention needs to be paid to the risk of another downturn in exports if supply constraints intensify due, for example, to the re-imposition of lockdowns in China.

◆ The government has eased waterfront measures

The number of foreign visitors to Japan in June was 120,000, which was still down more than 90% from the pre-COVID level. Although the government resumed accepting foreign tourists on June 10, a rapid recovery in the number of tourists is unlikely as a cap has been set on the number of visitors entering the country.

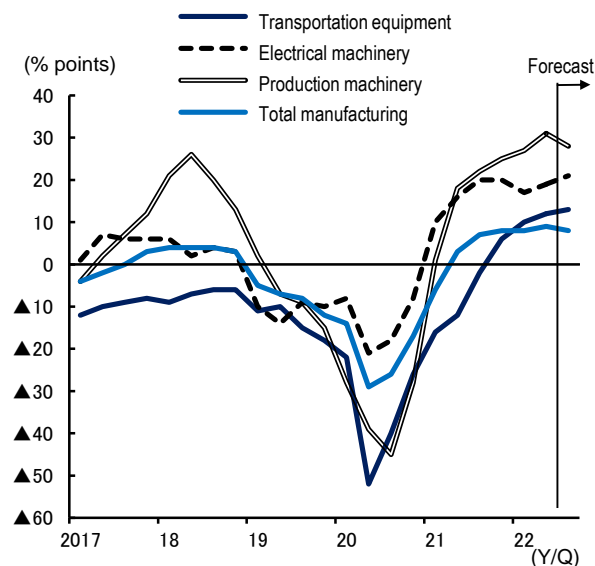
At the global level, passenger traffic is bouncing back, and the International Civil Aviation Organization (ICAO) expects it to rev up to around 90% of pre-COVID levels by the end of 2022. Here in Japan, too, a recovery of inbound demand is expected to become more apparent as progress is made in terms of readiness to accept inbound visitors.

Figure 3-1 Real Exports by Item
<seasonally adjusted>



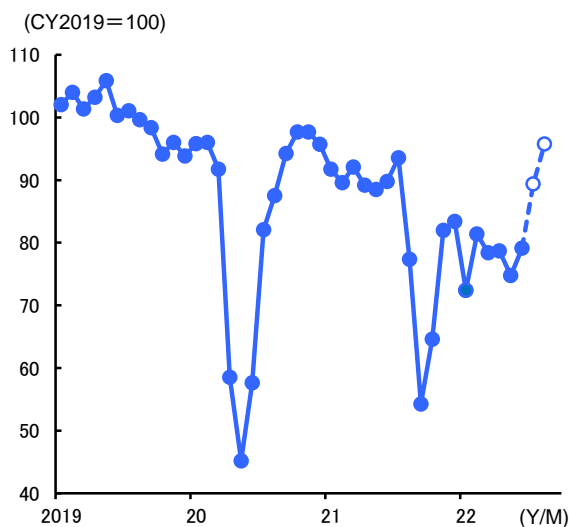
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angled brackets show the shares in total nominal exports in CY2021.

Figure 3-2 DI for Overseas Supply and Demand Conditions for Products



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.
Note: The latest figures are forecasts based on June 2022 Tankan Survey.

Figure 3-3 Industrial Production Index for Transportation Equipment
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of the Japanese National Tourism Organization.

High corporate earnings are supporting capital investment

◆ Corporate earnings are increasing

According to the Financial Statements Statistics of Corporations, ordinary profit for all industries in January-March rose by 0.2% from the previous quarter. The increase was small, but profits have climbed for two months in succession. April-June may have been the third consecutive quarter of profit growth, as revenues from accommodation/food services and lifestyle-related services recovered on the back of a rebound in services consumption following the relaxation of activity restrictions.

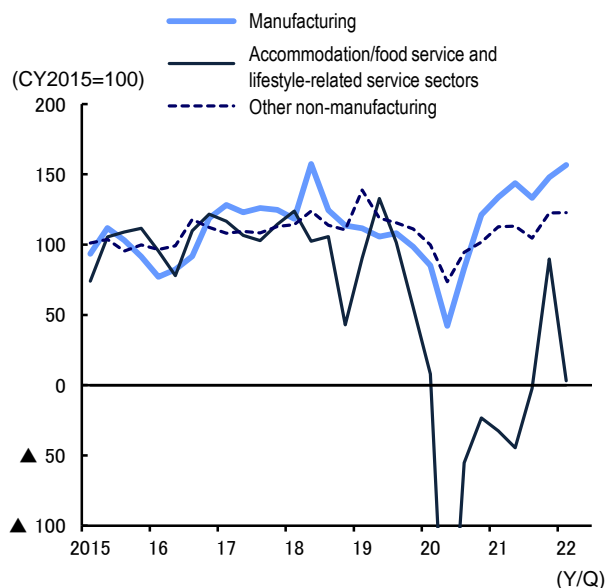
Looking ahead, corporate earnings are expected to remain at a high level, though the pace of profit growth will slow compared to the previous fiscal year. Companies have absorbed some of the cost increases associated with higher resource prices and a weaker yen by, for example, improving business efficiency. The recovery of people flows has also helped lift earnings, especially in the non-manufacturing sector.

◆ Capital investment is seeing a moderate recovery

Companies are gradually resuming investments that they had been postponing, and capital investment is picking up. Both machinery orders and construction orders, leading indicators of capital investment, are continuing to rise. Large companies' capex plans for FY2022 are also substantially higher than pre-COVID levels as companies maintain a positive investment stance.

And going forward, capital investment is expected to continue to recover, supported by high corporate earnings. However, there is a strong sense of uncertainty surrounding future developments with respect to Russia's invasion of Ukraine and China's action on COVID, and attention needs to be paid to the risk of caution on the part of more and more investors.

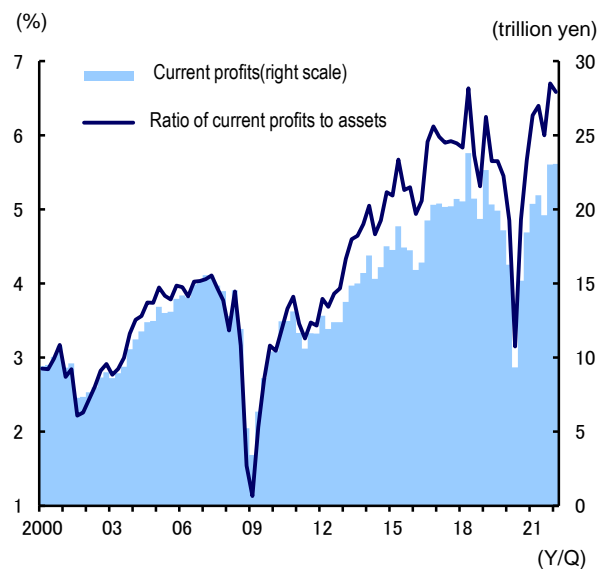
Figure 4-1 Current Profits of Japanese Corporations by Type <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

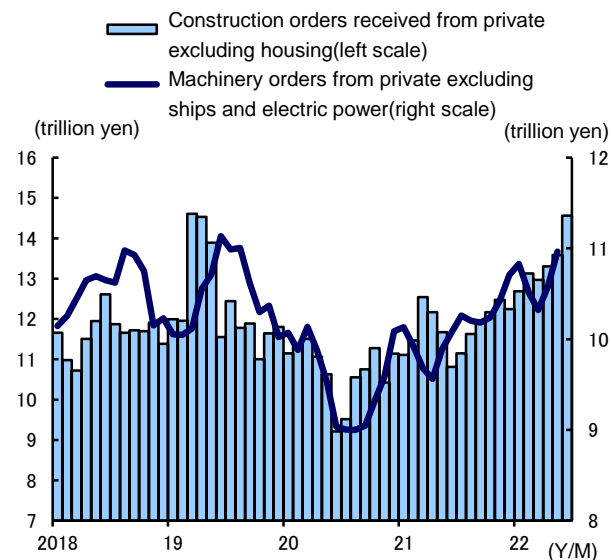
Note: All industries except for financial services and insurance.

Figure 4-2 Current Profit and Ratio of Current profits to Assets <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Figure 4-3 Machinery orders and construction orders <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Land, Infrastructure, Transport and Tourism, The Cabinet Office.

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High prices are putting downward pressure on real incomes

◆ The improvement in the employment situation is gradual

The number of workers in June increased only slightly from the previous month, while the unemployment rate remained unchanged from the previous month at 2.6%. The number of job openings is slowly increasing, but the recovery is still not powerful enough to reduce the number of job seekers.

Looking ahead, the pace of improvement in the employment situation is expected to remain moderate as the COVID resurgence is exacerbating uncertainty about the future.

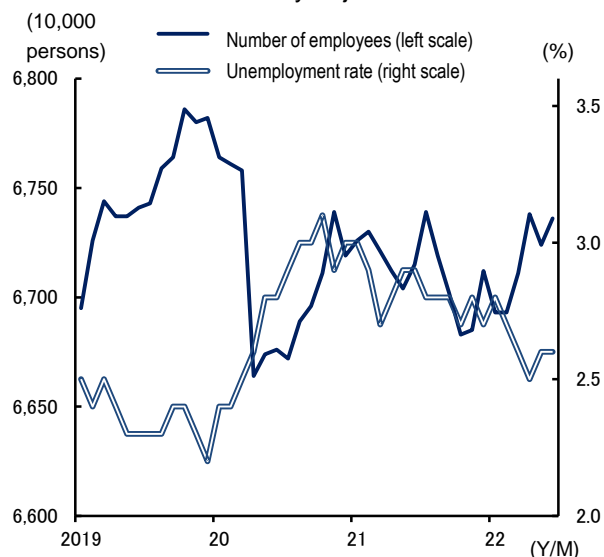
◆ Real wage growth rate has turned negative

Total cash payrolls in June increased 1.8% year on year (YoY), staying in positive territory. The rise is mainly due to the slow recovery in non-regular, i.e., part-time, employment, for which wage levels are low, so wage growth is actually weak. To compound matters, real wages declined by 1.8% YoY amid rising prices. While this

summer's pay bonuses are thought to have recovered almost to pre-COVID levels at large companies, small and medium-sized enterprises are still being affected by the pandemic, so overall bonus growth was probably minor.

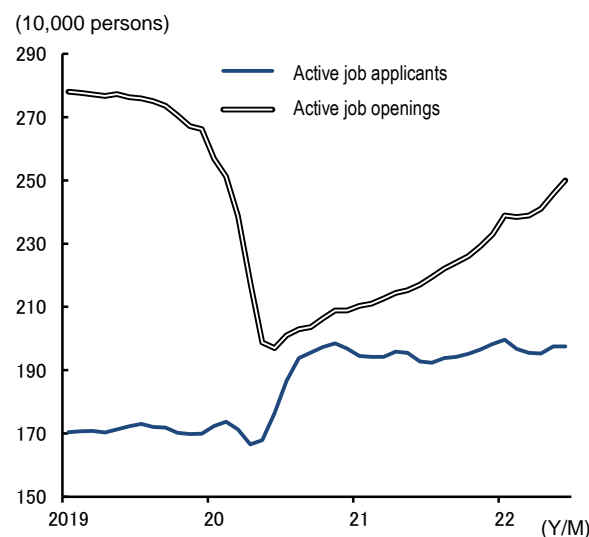
Looking ahead, with consumption beginning to normalize, non-regular employment with low wage levels is expected to increase again, piling downward pressure on average wages, and because inflation will continue for the time being, real wages look set to keep falling.

Figure 5-1 Number of Employees and Number of Unemployment rate <seasonally adjusted>



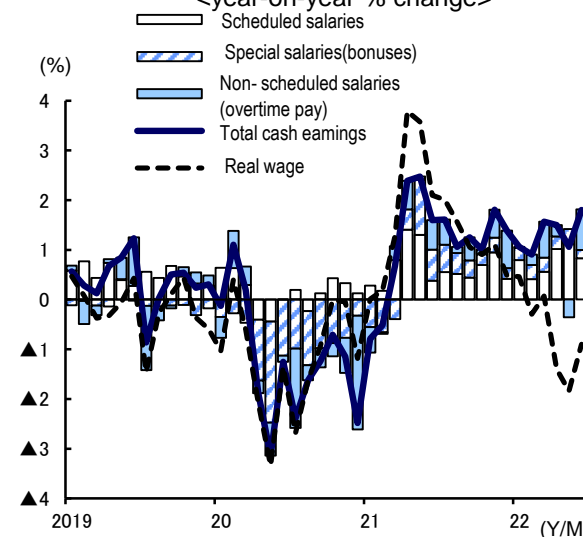
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.

Figure 5-2 Active Job Openings and Active Job Applicants <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, labor and Welfare.

Figure 5-3 Contributions to Change Rate of Nominal Wages <year-on-year % change>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, labor and Welfare.

Consumption slowdown due to infection flare-up is expected to be modest

◆ Personal consumption continues to pick up

Regarding personal spending, services consumption is rebounding in tandem with the easing of restrictions on activities. The “prefectural residents discount” program, which provides subsidies for travel within one’s own prefecture, and the “regional block discount” program, which extends the subsidies to travel to neighboring prefectures, have propelled a rebound in travel spending. In late June, food service expenditures also recovered to a level close to pre-COVID amid rising average customer spends.

◆ The infection resurgence is weighing down on services consumption.

With COVID spreading again recently, the pace of recovery is expected to slow somewhat, especially in services consumption. Since late July, some of the measures to support local tourism have also been suspended, and the national rollout of tourism support measures has been pulled from the government’s agenda.

Crowds at retail and recreational facilities have thinned out again.

However, compared to past waves of infection, the decrease in the number of people getting out and about has been limited. Services consumption is not expected to fall as low as it did last summer.

As for goods consumption, although the view that prices are going to keep rising has spurred some people to rush to department stores to purchase luxury items, automobile sales have stalled. The supply chain issues triggered by Shanghai lockdown are continuing to take their toll. Customers have to wait a long time to take delivery of vehicles they order, and this is hammering sales. The impact of supply chain disruptions has spread to other products, such as certain consumer appliances. The outlook for the COVID situation is highly uncertain, and caution is needed regarding the risk that lockdowns will be imposed again in China’s cities, prolonging the adverse effects on production and sales.

Figure 6-1 Domestic Household Consumption
<JCB consumption now>

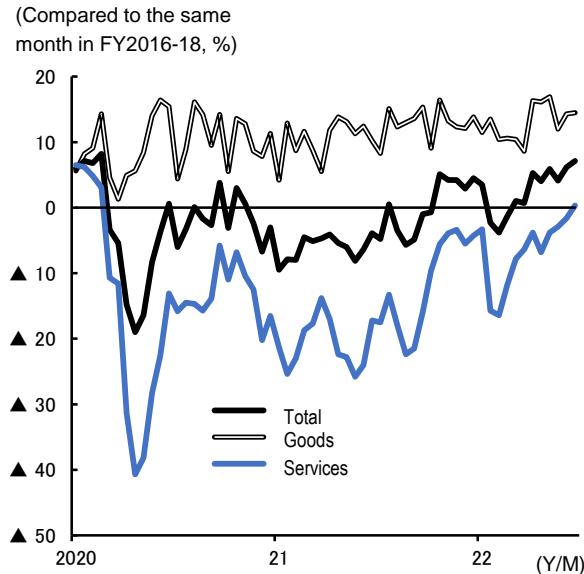


Figure 6-2 Domestic Household Consumption
of Service <JCB consumption now>

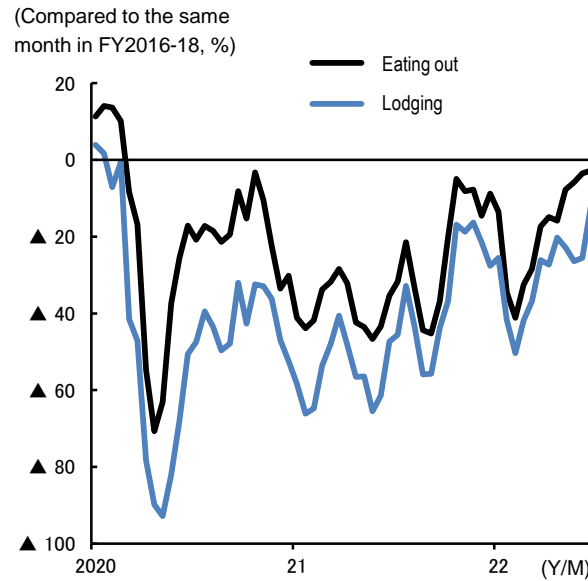
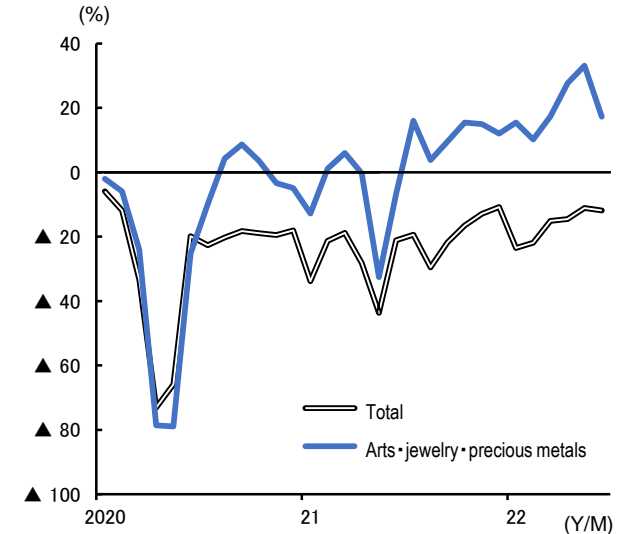


Figure 6-3 Department Store Sales
<compared to the same month in 2018>



Topic: Hot weather boost to consumption ebbs away

◆ Consumption has been boosted by a heat wave

This summer, many areas have experienced extremely hot days since the end of June. According to forecasts from the Japan Meteorological Agency, temperatures are expected to remain high through October. Estimates indicate that a 1 °C increase in average temperature in the July-September quarter would boost real personal consumption by +0.19%. Among the biggest beneficiaries are alcoholic beverages and traditional Japanese summer attire. Considering that real personal consumption has only increased by an annualized average of 0.4% during the same period, the impact of high summer temperatures on consumption is substantial.

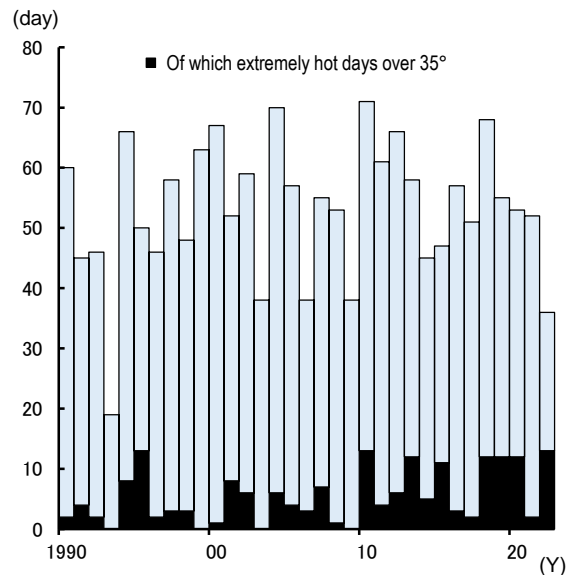
◆ This summer, there are also factors that are suppressing consumption

However, the heat effect on consumption is weaker than it used to be. According to estimates, the effect of the heat waves since 2005 has been less than half that of the previous period (1990-2004). In the background to this is that 1) with the

number of extremely hot days increasing, the excessive heat has actually deterred people from engaging in outdoor leisure activities, and that 2) weather factors other than temperature, such as disasters caused by torrential rain, have offset the boost in consumption from the heat wave effect.

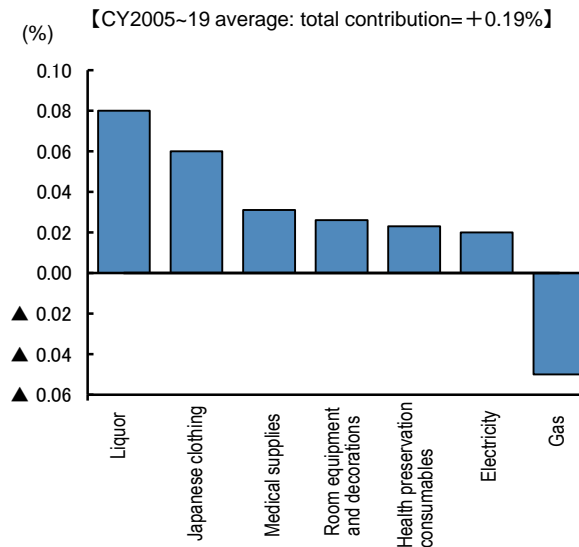
Furthermore, the following factors have reduced the effect of the heat wave this summer: 1) Households' purchasing power has declined due to rising energy and food prices, and 2) air conditioners, demand for which rises significantly during hot spells, have been in short supply due to component shortages and other factors. Therefore, the effect of the heat wave on overall consumption is expected to be smaller than in previous years.

Figure 7-1 Number of Midsummer Days with a Maximum Temperature of 30°C or Higher



Source: The Japan Research Institute, Ltd. based on the data of The Japan Meteorological Agency.

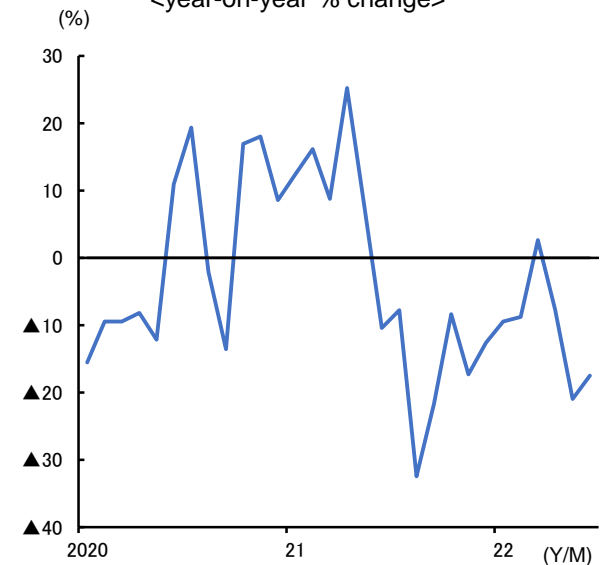
Figure 7-2 15% Impact on Consumption of 1°C Rise in Average Temperature during July-September



Source: The Japan Research Institute, Ltd. based on the data of The Japan Meteorological Agency, The Ministry of Internal Affairs and Communications.

Note: Japanese clothes include yukata.

Figure 7-3 Domestic Shipments of Air Conditioners in Homes <year-on-year % change>



Source: The Japan Research Institute, Ltd. based on the data of The Japan Refrigeration and Air Conditioning Industry Association.

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Topic: Power shortages pose downside risks to future production

◆ The electricity supply-demand balance will remain tight

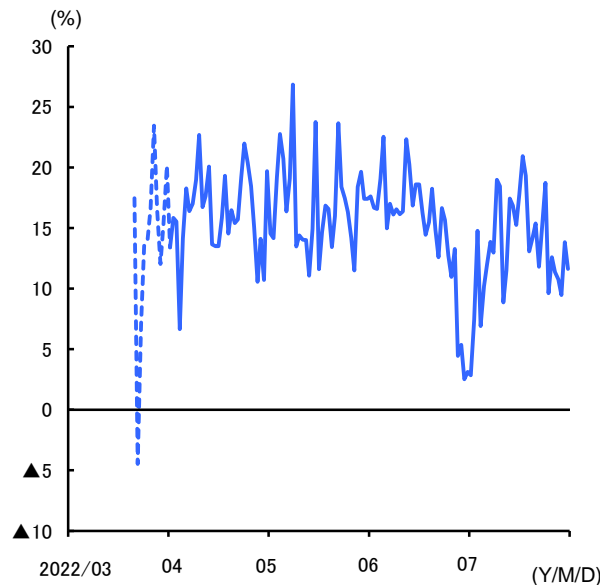
The risk of power shortages in Japan is increasing. The wide-area reserve ratio (for the Tokyo area), which shows how much spare electricity supply capacity there is relative to demand, dropped to around zero percent in March and June, so the balance between power supply and demand is on a knife edge. The supply-demand crunch is predicted to continue, and should this winter's temperatures turn out to be the lowest in a decade, the reserve ratio in many areas would be expected to fall below 3%, which is the criterion for stable supply.

Background factors include not only the shutdown of nuclear power plants, but also lower thermal power generation supply capacity. The 2016 deregulation of electricity retailing led to a deterioration in the profitability of power companies as numerous new players entered the market. This made it tough for them to continue operating and owning surplus facilities with low profitability, prompting them to suspend aging thermal power stations or do away with them altogether.

◆ If the situation gets serious, supply to companies could be rationed

The government has responded by urging users to save energy and cut their electricity consumption (though numerical targets have not been set). If the supply-demand crunch becomes severe and restrictions on the use of electricity are imposed, the economy could falter. Estimates based on input-output tables suggest that a 1% cut in electricity supply to businesses would result in an annual decrease of 961.6 billion yen in domestic production. The negative impact would be widespread, affecting more than just the power and manufacturing industries, with the drop in production in the service industry exceeding 100 billion yen.

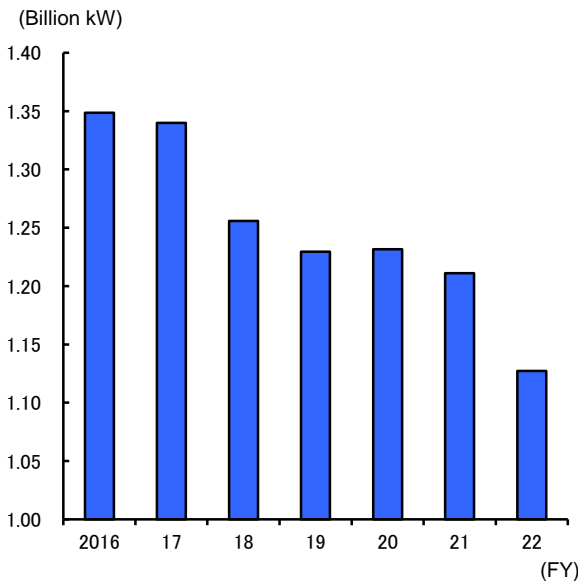
Figure 8-1 Tokyo Area Wide Reserve Ratio



Source: The Japan Research Institute, Ltd. based on the data of The Organization for Promotion of Wide-Area Management of Electricity.

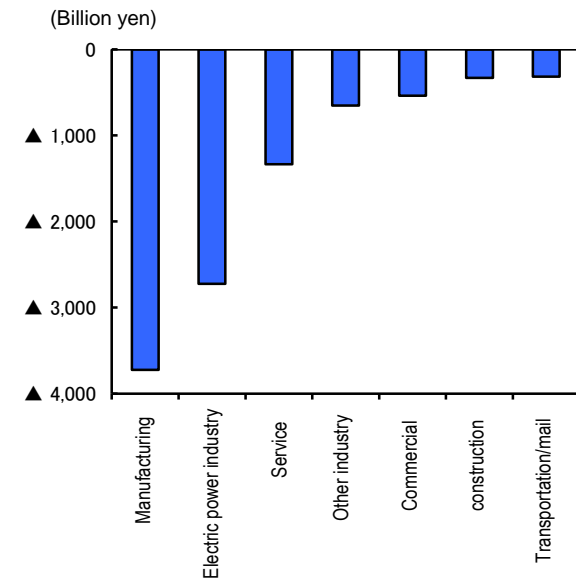
Note: Data through March 31 are for reference only.

Figure 8-2 Thermal Power Plant Supply Capacity



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Economy, Trade and Industry.

Figure 8-3 Impact of a 1% Decrease in Electricity Supply on Production



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Prospects for Japan's Economy - Projected Real GDP Change; 2.0% for FY2022 and 1.6% for FY2023

◆ High growth will be sustained for the time being, driven by capital investment and exports

(1) Real GDP in April-June grew from the previous quarter at an annualized rate of 2.2% (increasing 0.5% from the previous quarter), marking the third consecutive quarter of positive growth. On the demand side, the recovery in personal consumption, especially services consumption, became clearer following the easing of activity restrictions. Complementing a rise in capital investment on the back of high corporate earnings, public investment also picked up as authorities splashed the cash allocated in last fiscal year's supplementary budget for "national land resilience," i.e., infrastructure investment.

(2) Looking ahead, higher-than-anticipated growth is expected to continue, driven by the recovery in capital investment and exports. Corporate earnings are set to remain strong, supporting capital investment. Higher profits have owed a great deal to the absorption, through improved business efficiency and other tactics, of part of the cost increases caused by rising resource prices and the flagging yen. Capital investment, meanwhile, has benefitted from a heartier appetite for investing in growth ahead of the post-COVID era, with decarbonization a prime target for corporate spend. Exports are expected to continue to recover as supply constraints ease, though slowdowns in overseas economies will weigh on them.

(3) The outlook for personal consumption will hinge on the situation with COVID. After slowing in the July-September quarter in response to soaring infections, consumer spending is likely to accelerate again in October-December and beyond as the flare-up subsides. Although rising energy and food prices due to the weaker yen and higher resource prices are putting downward pressure on household purchasing power, many households have significantly increased their savings as a result of staying home during the COVID pandemic, making them more resilient to rising prices. Personal consumption is therefore expected to stay on the recovery track.

(4) The growth rate for FY2022 is set to be strongly positive at +2.0%, as a resurgence in economic activity in the wake of the COVID pandemic delivers high positive growth. In FY2023, growth is projected to cool to +1.6%, a pace that will still exceed the potential growth rate. As a result, GDP is not expected to recover to its pre-COVID peak until the January-March quarter of 2024.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of August 15, 2022)

	(seasonally adjusted, annualized % changes from the previous quarter)											(% changes from the previous fiscal year)		
	CY2021		CY2022				CY2023				CY2024	FY2021	FY2022	FY2023
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3			
	(Actual)				(Projection)							(Actual)	(Projection)	
Real GDP	▲ 2.1	4.0	0.1	2.2	2.6	3.3	2.0	1.2	1.1	0.9	0.9	2.3	2.0	1.6
Private Consumption Expenditure	▲ 3.5	10.1	1.2	4.6	1.2	2.6	1.8	1.0	1.0	0.8	0.8	2.6	3.1	1.4
Housing Investment	▲ 7.1	▲ 4.5	▲ 5.6	4.9	4.2	2.0	2.0	1.8	0.2	0.0	▲ 0.1	▲ 1.6	2.9	1.4
Business Fixed Investment	8.2	0.3	▲ 1.1	4.1	6.4	6.4	3.1	2.4	2.4	2.0	2.0	0.6	3.1	3.1
Private Inventories (percentage points contribution)	(0.4)	(▲ 0.3)	(2.1)	(▲ 1.7)	(▲ 0.4)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	(▲ 0.1)	(▲ 0.0)
Government Consumption Expenditure	4.4	▲ 1.2	2.0	1.2	1.2	1.2	0.4	0.2	0.2	0.2	0.2	2.0	1.4	0.4
Public Investment	▲ 12.6	▲ 14.2	▲ 12.3	3.8	5.4	7.4	5.2	1.4	0.8	0.2	0.2	▲ 7.5	▲ 1.5	2.6
Net Exports (percentage points contribution)	(0.4)	(0.4)	(▲ 1.7)	(0.4)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.0)	(▲ 0.0)
Exports of Goods and Services	0.1	2.6	3.6	3.7	3.8	3.6	3.2	2.8	2.8	2.4	2.4	12.5	3.3	3.0
Imports of Goods and Services	▲ 4.3	1.7	14.8	2.7	0.6	2.8	2.8	2.4	2.0	2.0	2.0	7.2	3.8	2.3
(Ref.) Domestic Private Demand (percentage points contribution)	(▲ 3.0)	(4.8)	(2.4)	(1.5)	(1.5)	(2.6)	(1.6)	(1.0)	(1.0)	(0.8)	(0.8)	(1.5)	(1.9)	(1.3)
(Ref.) Public Demand (percentage points contribution)	(0.1)	(▲ 1.0)	(▲ 0.3)	(0.7)	(0.5)	(0.6)	(0.3)	(0.1)	(0.1)	(0.1)	(0.1)	(0.0)	(0.2)	(0.2)

	(% changes from the same quarter of the previous year)											(% changes from the previous fiscal year)		
Nominal GDP	0.0	▲ 0.7	0.2	0.7	2.1	2.8	3.3	3.1	2.6	1.7	1.4	1.3	2.2	2.2
GDP deflator	▲ 1.2	▲ 1.3	▲ 0.5	▲ 0.4	▲ 0.1	0.7	0.6	0.7	0.6	0.4	0.4	▲ 1.0	0.2	0.5
Consumer Price Index (excluding fresh food)	▲ 0.0	0.4	0.6	2.0	2.3	2.6	2.4	1.7	1.5	1.0	0.7	0.1	2.3	1.2
Unemployment Rate (%)	2.8	2.7	2.7	2.6	2.5	2.5	2.5	2.5	2.4	2.4	2.3	2.8	2.5	2.4
Exchange Rates (JY/US\$)	110	114	116	130	135	136	134	133	131	129	128	112	134	130
Import Price of Crude Oil (US\$/barrel)	73	80	85	108	112	106	104	108	108	106	103	76	108	106

Source: The Cabinet Office; The Ministry of Internal Affairs and Communications; The Ministry of Economy, Trade and Industry; The Ministry of Finance.

The projection figures are based on those of The Japan Research Institute, Ltd.

Note : "▲" indicates minus.