

Monthly Report of Prospects for Japan's Economy

November 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 October 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

Regarding indices of business sentiment, the coincident index is rising, while the leading index is trending downward.

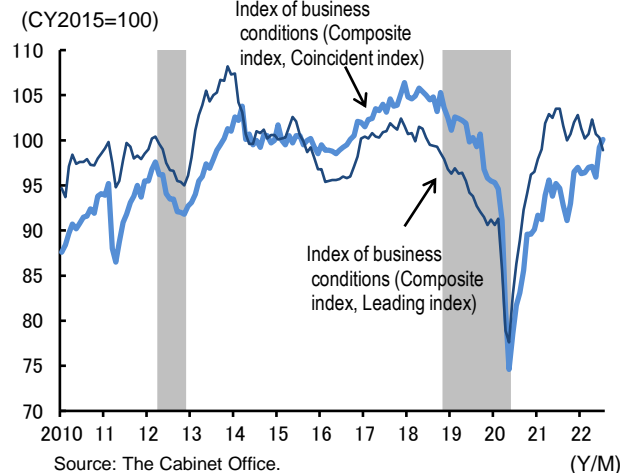


Figure 1-2 The Corporate Sector

Industrial production is increasing, mainly in the production machinery and steel/nonferrous metals sectors.

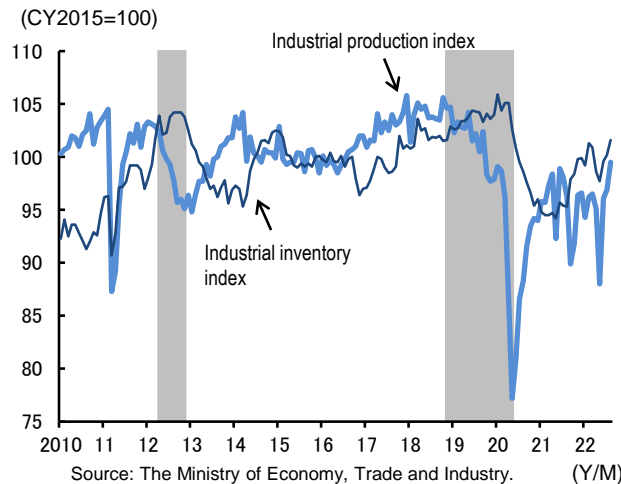


Figure 1-3 Overseas Demand

Exports of automobiles and capital goods are increasing. Imports are rising sharply on the back of a pickup in domestic demand.

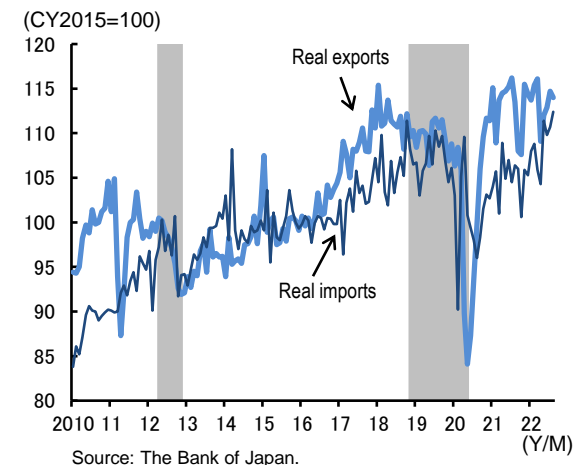
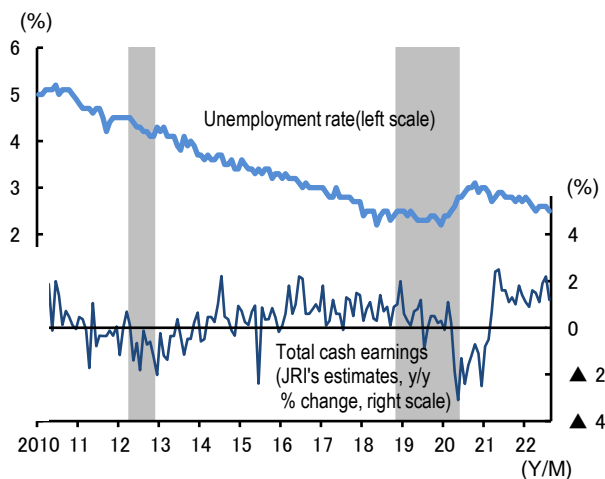


Figure 1-4 Employment and Income

The unemployment rate is in the mid-2% range and nominal wages are rising mainly due to higher fixed wages.



* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

Personal consumption is bobbing up and down, while housing starts have recovered to an annualized level of 900,000 units.

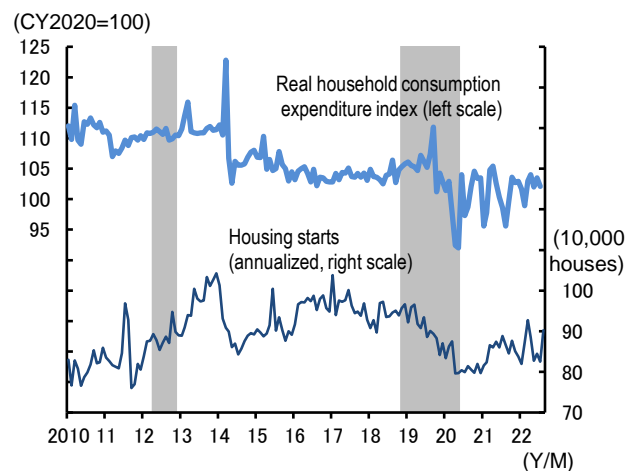
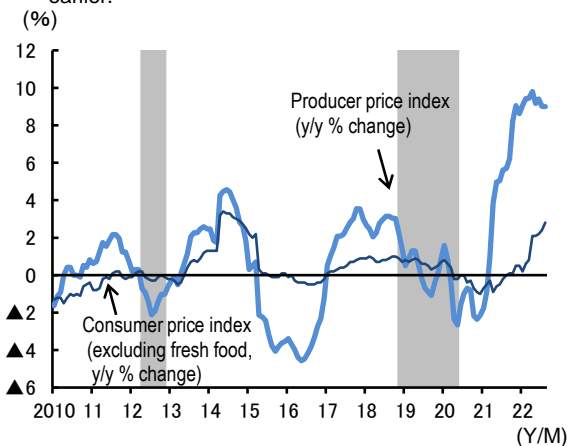


Figure 1-6 Prices

Corporate price inflation is still running high. Core consumer prices are almost 3% higher than a year earlier.



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications, The Bank of Japan.
Monthly Report of Prospects for Japan's Economy November 2022
 The Japan Research Institute, Limited

Business confidence has deteriorated in the manufacturing sector, but improved in the non-manufacturing sector

◆ Business confidence is polarized

In the Bank of Japan's September Tankan survey, the DI for business conditions for large manufacturing enterprises fell by one percentage point, worsening for the third straight quarter. The increase in raw material costs due to high resource prices and the weak yen put downward pressure on business confidence in the materials sector. Meanwhile, the DI for large non-manufacturing enterprises increased by one percentage point, improving for the second quarter in a row. Although consumption was tepid due to a lull in the recovery of services consumption as a result of a flare-up in COVID cases, an improvement was seen in a wide range of sectors, including construction and logistics.

◆ Production activity in the manufacturing sector is picking up

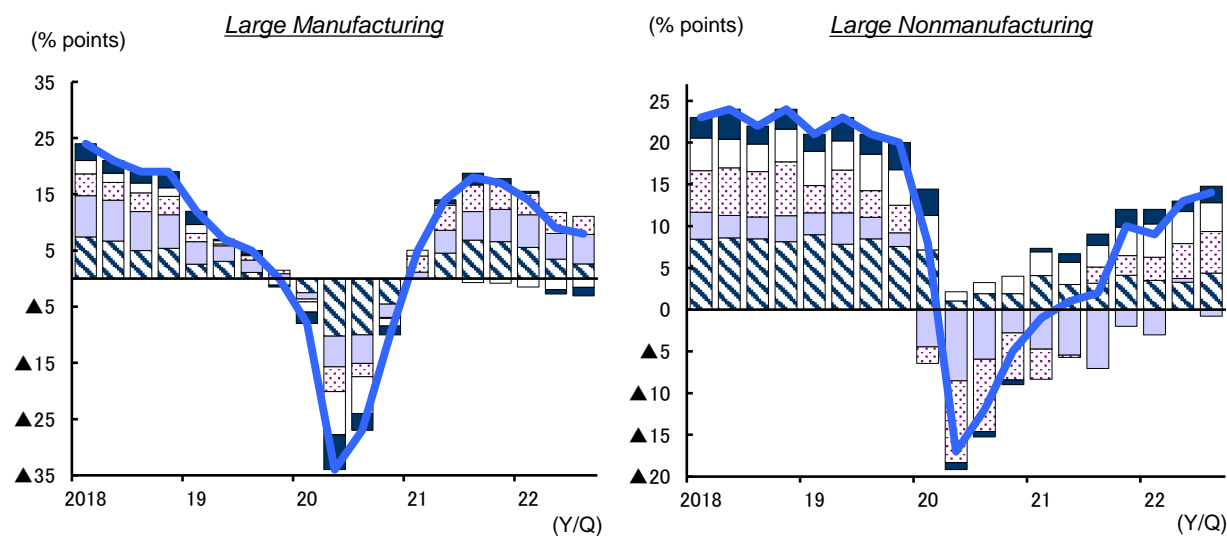
The Industrial Production Index rose in August, up 2.7% from the previous month,

climbing for the third consecutive month. By industry, the index increased in 10 of the 15 sectors, including the production machinery and steel/nonferrous metal industries. Near-future production plans indicate increases in output in September (+2.9% month on month (MoM)) and October (+3.2% MoM). However, supply constraints have intensified again due to a series of major typhoons in September that forced some plants to suspend operations, the ongoing lockdowns in China, and other factors. The increases are therefore unlikely to be as high as projected.

◆ Non-manufacturing production activity is also showing signs of recovery

In July, the Tertiary Industry Activity Index recovered to 96% of its pre-COVID level. This can be attributed to the boom in the information and telecommunications industry, which has seen robust demand for DX- and 5G-related products.

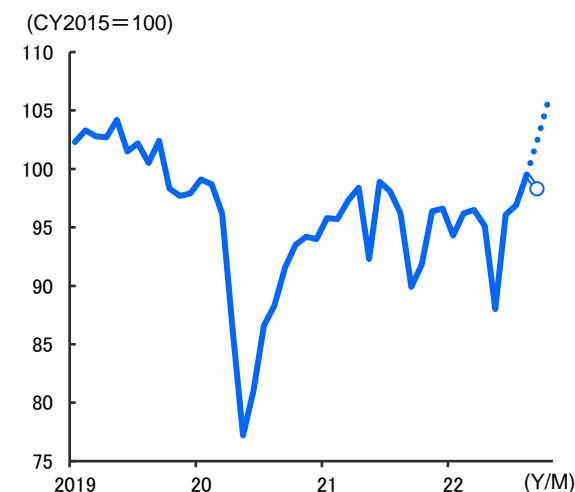
Figure 2-1 Contributions to the Business Conditions Diffusion Index by Industry
<diffusion index of "favorable" minus "unfavorable," and percentage point contribution to total DI points>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, "The Tankan September 2022 Survey".

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

Figure 2-2 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.

Monthly Report of Prospects for Japan's Economy November 2022
The Japan Research Institute, Limited

Goods exports are firm, and inbound tourism demand is gradually recovering

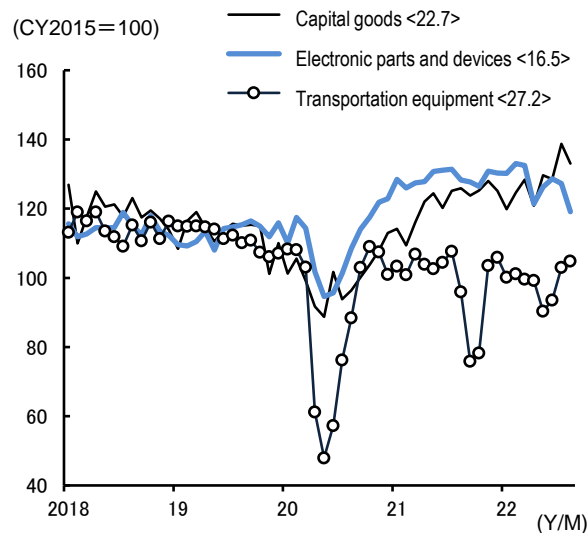
◆ Exports of electronic components/devices have weakened

Exports as a whole stayed on an upward track. Although exports of electronic components/devices declined due to sluggish global smartphone sales, those of transportation machinery increased as supply constraints eased, and capital goods exports remained at high levels on the back of strong capital investment worldwide. Looking ahead, export growth is expected to remain moderate. According to the Bank of Japan's September Tankan survey, the DI for overseas supply and demand conditions for large manufacturing enterprises' products indicates a decline going forward, so there may be a slowdown in foreign demand. By product, there is room for a considerable increase in automobile exports, as order backlogs have built up in the aftermath of supply constraints, but a drop in demand for electronic components/devices is expected to push down exports overall.

◆ The government has eased border-control measures

The number of foreign visitors to Japan in August was 169,000, less than 30% of the government's cap on arrivals. On October 11, the government further relaxed border-control measures by (1) scrapping the cap on the number of people entering the country, (2) lifting the ban on individual travel, and (3) waiving visa requirements for short-term visitors. The yen's depreciation should also provide a tailwind, and inbound tourism demand is expected to gradually increase. However, a rapid recovery in the number of tourists from China and Hong Kong, who accounted for nearly 40% of all foreign visitors to Japan in 2019, is unlikely due to restrictions on overseas travel under China's zero-COVID policy..

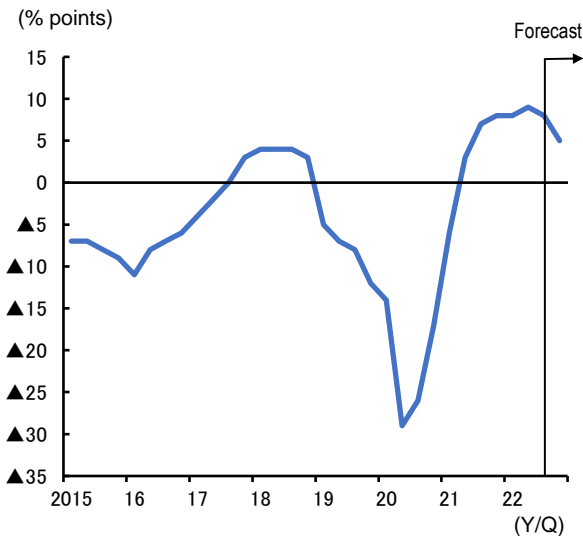
Figure 3-1 Real Exports by Item
<seasonally adjusted>



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.

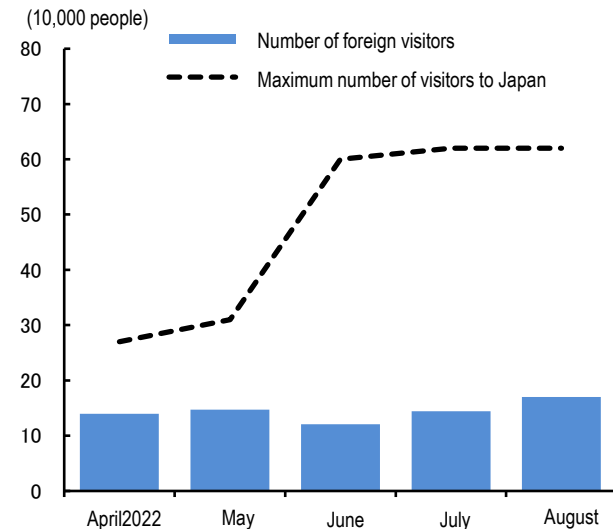
Figure 3-2 DI for Overseas Supply and Demand Conditions for Products



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

Note: The latest figures are forecasts based on September 2022 Tankan Survey.

Figure 3-3 Upper limit on the Number of Visitors to Japan and the Number of Foreign Visitors



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

Monthly Report of Prospects for Japan's Economy November 2022
The Japan Research Institute, Limited

High corporate earnings are supporting capital investment

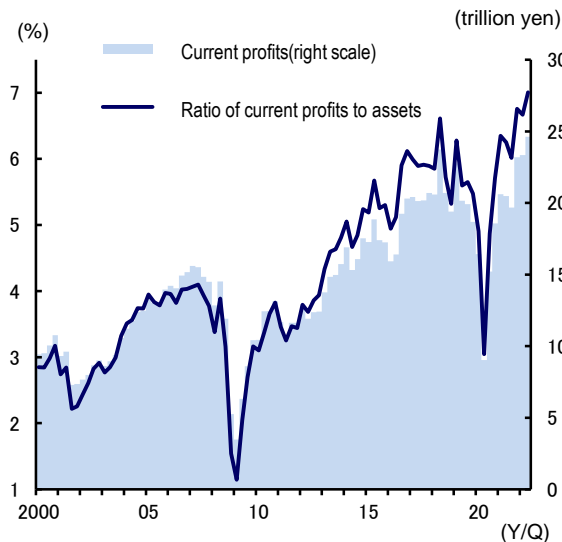
◆ Corporate earnings are increasing

According to the Financial Statements Statistics of Corporations, ordinary profit for all industries in the April-June quarter rose by 5.5% from the previous quarter, meaning that profits have climbed for three quarters in succession. The ordinary profit to net sales ratio was 7%, the highest level ever. While raw material costs increased due to the weak yen and high resource prices, companies kept a lid on variable costs such as SG&A and personnel expenses. The yen's depreciation also boosted earnings through foreign exchange gains and dividend income, leading to a substantial increase in non-operating income, especially at large companies with significant overseas operations. Looking ahead, corporate earnings are expected to remain at high levels against the backdrop of the domestic economic recovery.

◆ Capital investment is picking up

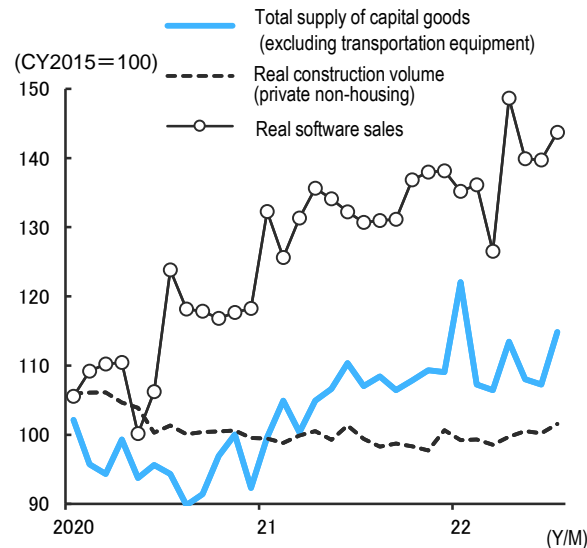
Capital investment in July maintained the upward trend of the April-June quarter. Investment in software and machinery remained strong, and construction investment also edged up. Going forward, capital investment is expected to continue to recover, supported by high corporate earnings. In the Bank of Japan's Tankan survey, capital investment plans for FY2022 showed a 17.4% increase for companies of all sizes in all industries, the highest growth ever predicted in the September survey. Companies are continuing to invest heavily.

Figure 4-1 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.

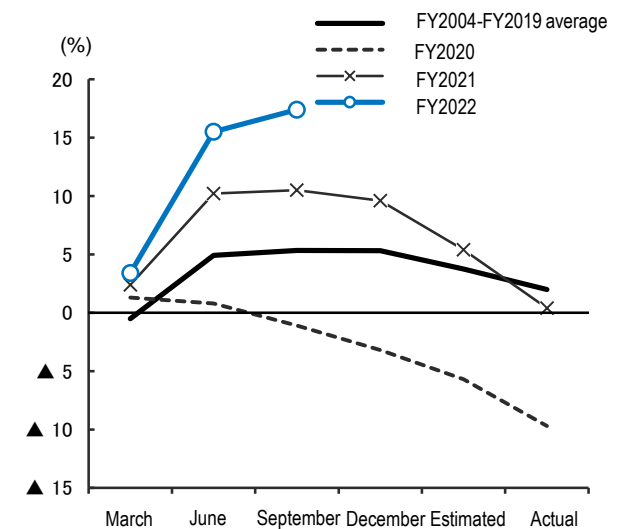
Figure 4-2 Private Capital Investment by Type
<seasonally adjusted>



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

Note: All industries except for financial services and insurance.

Figure 4-3 Capital Investment Plan <all scale>



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

Note: Includes software and excludes land and R&D investment.

Monthly Report of Prospects for Japan's Economy November 2022
The Japan Research Institute, Limited

High prices are putting downward pressure on real wages

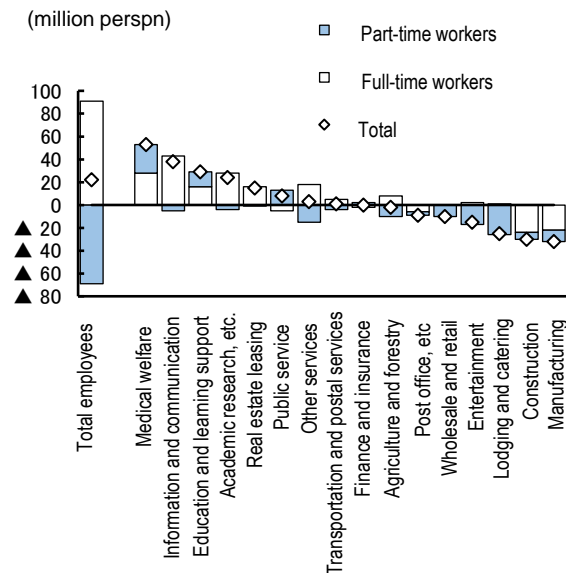
◆ Personnel shortages are becoming more apparent

The employment environment has improved as the economy picks up. The number of workers has recovered to pre-COVID levels. In the face-to-face service industry, which includes accommodation/food services, the recovery of non-regular employment has been slow, while the number of workers in the construction and manufacturing industries, which are making progress with labor-saving measures, has also declined. Regular employment, on the other hand, has increased elsewhere in the service sector, such as in healthcare/welfare and ICT. The number of workers is expected to slowly rise as the labor shortages felt by companies are approaching their pre-COVID peak. By industry, workers in the accommodation/food service sector are projected to increase as services consumption rebounds.

◆ Real wages have fallen

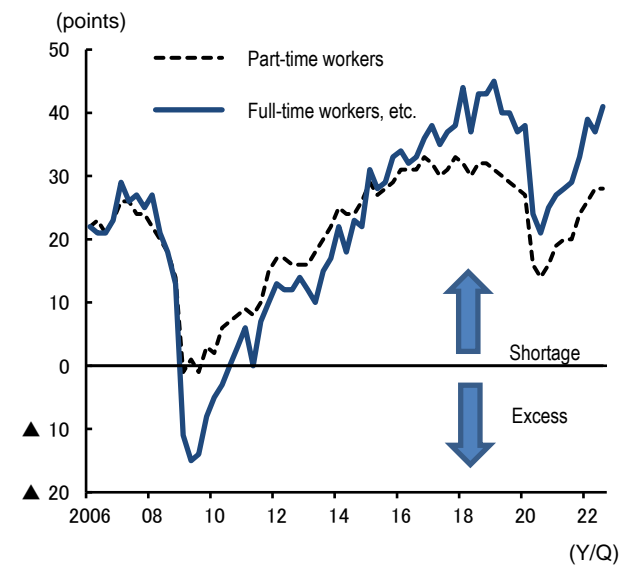
Total cash payrolls in August increased 1.2% year on year (YoY), staying in positive territory with fixed wages the main driver. Real wages, however, declined 0.9% YoY due to the downward pressure of rising prices. Although the rates of wage increases awarded this spring were higher than last year due to larger basic wage hikes, this was largely a reaction to the tepid wage growth of the previous year, so while the trend is upward, the pace is weak. Looking ahead, nominal wages, both for regular and part-time workers, are expected to continue to rise moderately against a backdrop of 1) a growing sense of labor shortages, 2) increases in minimum wages, and 3) moves to reflect higher prices in basic wage hikes. However, given the strong sense of uncertainty about the outlook for the domestic and overseas economies, and because many companies will remain cautious when setting wages, the expectation is that wage increases will not outstrip price rises.

Figure 5-1 Breakdown of Change in Number of Employees<August 2019 to August 2022>



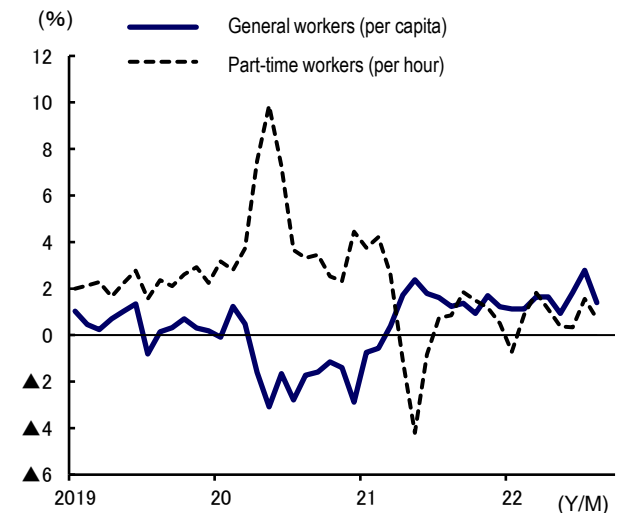
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
Note: Employers excluding directors.

Figure 5-2 Excess/Deficiency DI <shortage minus Excess>



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

Figure 5-3 Nominal Wages <year-on-year % change>



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

Monthly Report of Prospects for Japan's Economy November 2022
The Japan Research Institute, Limited

Consumption is picking up as infections fall

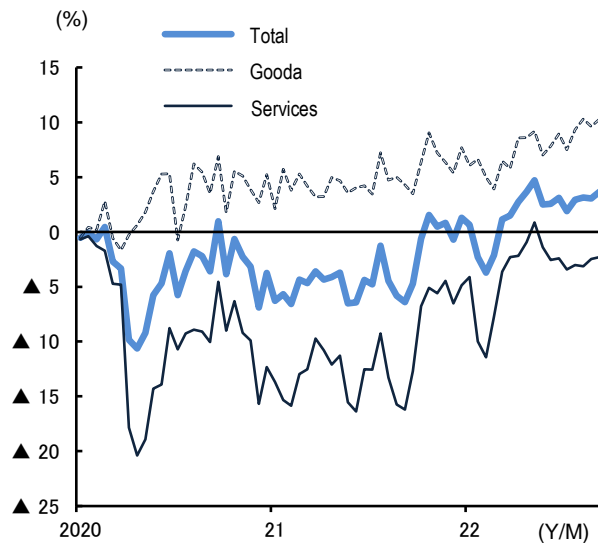
◆ Personal consumption is recovering

Personal consumption has picked up since September due to a nationwide decline in the number of new infections. 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 travel spending. However, typhoons and other bad weather put downward pressure on services consumption. As for goods consumption, although the view that prices are going to keep rising has boosted sales of luxury items at department stores, automobile sales are stagnant. Delayed deliveries have become the norm due to supply chain turmoil caused by such factors as lockdowns in China.

◆ High prices are a concern

Personal consumption is expected to recover in the near term as pent-up demand for services is released. The new National Travel Discount Program launched on October 11 is expected to boost travel spending. However, consumer prices are rising in earnest, especially prices of daily necessities such as food and energy. Price hikes are also spreading to other products, such as certain home appliances, increasing the burden on households. Although the excess savings accumulated unexpectedly during the COVID pandemic and measures taken by the government look set to offset the negative impact of higher prices, attention needs to be paid to the risk of the consumption recovery being derailed by thrifty spending habits among consumers.

Figure 6-1 Consumption Statistics Based on Credit and Spending
<compared to 2016-2018 average>



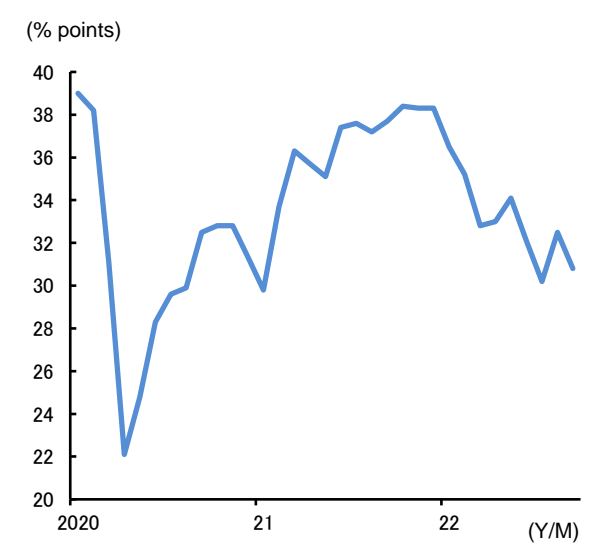
Source: The Japan Research Institute, Ltd. based on data of JCB consumption Now, Google.

Figure 6-2 Department Store Sales
<compared to the same month in 2018>



Source: The Japan Research Institute, Ltd. based on data of Japan Department Stores Association.

Figure 6-3 Consumer Attitude Index
<seasonally adjusted>



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

Topic: The positive effect of yen depreciation on the trade balance has declined

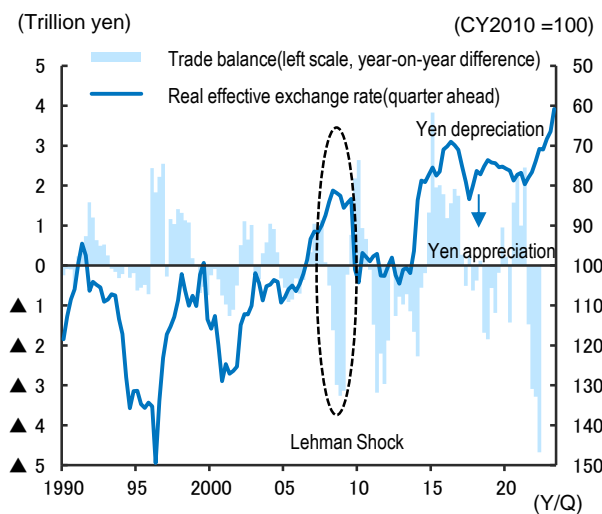
◆ Export volume has not increased despite the weakening of the yen

The connection between exchange rates and the balance of trade is fading. A weak yen has the effect of boosting export volume by lowering export prices in foreign currency terms, but this effect has receded in recent years. According to estimates, the effect of a 1% depreciation of the yen on export volume was about 0.1% in the 2010s, a quarter of what it was in the 2000s. Most notably, the effect on machinery exports has ebbed significantly. One of the reasons is the high value-added nature of export goods. With production of low value-added products shifting overseas, export goods produced in Japan are becoming higher value-added. As goods that are less subject to price competition have become the main exports, the impact of exchange rate fluctuations on export volume is now limited.

◆ The trade-balance improvement effect has weakened

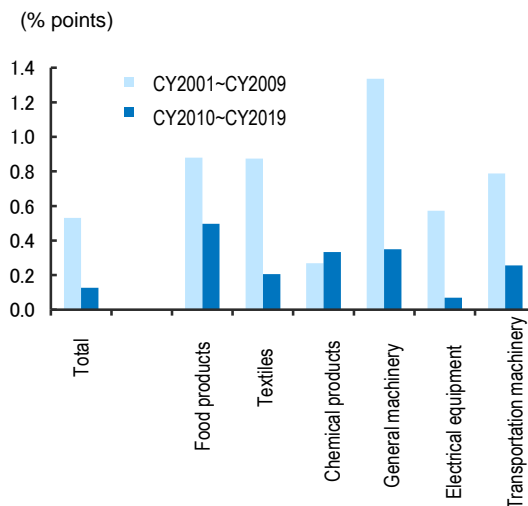
Just as the ability of a weak yen to boost export volume has subsided, so has its ability to push down import volume. This can be attributed to an increase in imports of components and materials that are less susceptible to the impact of price fluctuations due to the expansion of global supply chains. As a result, the economy is now prone to experience a growing trade deficit when the yen weakens. Theoretically, if the absolute sum of the increase in exports and the decrease in imports resulting from a 1% depreciation of the yen exceeds 1%, the trade balance improves (Marshall-Lerner condition). But estimates indicate that unlike in the 2000s, in the 2010s a weaker yen had the effect of worsening the trade balance. The weak yen leads to a trade deficit, which increases pressure for further yen depreciation from the real demand side.

Figure 7-1 Real Effective Exchange Rate and Trade Balance



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

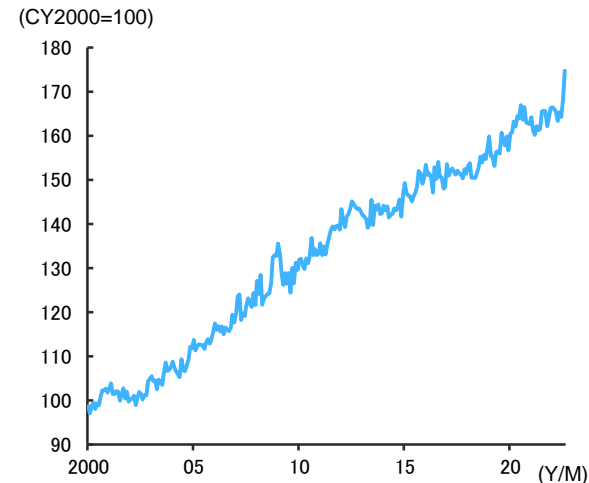
Figure 7-2 Response of Export Volume to 1% Yen Weakness



Source: The Japan Research Institute, Ltd. based on the data of The Netherlands Bureau for Economic Policy Analysis, Ministry of Finance.

Note: Estimated from the impulse response function of a three-variable VAR model consisting of world import volume, real effective exchange rate, and export volume.

Figure 7-3 Higher Value Added Index of Export Goods



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

Ministry of Land, Infrastructure, Transport and Tourism.

Note: High Value Added Index = Export Price Index / Export Price Index.

Monthly Report of Prospects for Japan's Economy November 2022
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Prospects for Japan's Economy - Projected Real GDP Change; 1.9% for FY2022 and 1.4% for FY2023

◆ Consumption and capital investment will drive the recovery

In the July-September quarter, the pace of recovery, especially in personal consumption, slowed. This was mainly due to sluggish services consumption caused by the nationwide COVID rebound during the summer. From the October-December quarter, the economy is expected to gradually recover, led by domestic demand. Personal consumption is expected to bounce back in earnest as the COVID situation settles down. Although rising energy and food prices will weigh heavily on household purchasing power, excess savings accumulated during the COVID pandemic and government measures to ease the pain of higher prices will support personal consumption. Capital investment is expected to continue rising thanks to strong corporate earnings. R&D investment for decarbonization and ICT investment for digitalization and labor-saving will rev up. But exports are expected to increase only moderately due to the slowdown in overseas economies. By product, in sectors such as automobiles, output will be boosted to make up for past shortfalls, which should give exports a lift, while exports of electronic components are predicted to weaken.

◆ The growth rate for FY2022 will be +1.9%

The growth rate for FY2022 is expected to be strongly positive at +1.9% as the economy rebounds from the COVID pandemic slump. In FY2023, growth is expected to cool to +1.4%, a pace that will still exceed the potential growth rate. However, the speed of recovery will be moderate due to the slowdown in overseas economies. Real GDP is not expected to recover to its pre-COVID peak (April-June 2019) until FY2024.

◆ Rising goods prices are becoming more widespread

The core CPI for August was +2.8% YoY, exceeding the BOJ's inflation target of 2% for the fifth consecutive month. Rising food and energy prices are pushing up overall prices, and even prices of durable goods are climbing. The share of goods whose prices are rising has increased to nearly 70%.

Core inflation is expected to top 3% by the end of the year. Although the extension of gasoline subsidies and other measures will restrain energy price growth, food prices, which are vulnerable to the effects of a depreciating yen, are predicted to continue to rise.

Core CPI growth is then expected to contract to below 1% toward the end of next year. As the pace of rising resource prices and the yen's depreciation slows, the recent trend of raising prices in response to higher import costs will likely weaken. With wage growth remaining limited, there is little prospect of labor costs rousing inflation.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of October 13, 2022)

(seasonally adjusted, annualized % changes from the previous quarter)										(% changes from the previous fiscal year)		
	CY2022				CY2023				CY2024	FY2021	FY2022	FY2023
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	(Projection)
	(Actual)		(Projection)									
Real GDP	0.2	3.5	1.1	2.2	1.8	1.4	1.1	0.9	0.9	2.3	1.9	1.4
Private Consumption Expenditure	1.2	4.8	0.8	2.4	1.8	1.2	1.0	0.8	0.8	2.6	3.0	1.3
Housing Investment	▲ 5.6	▲ 7.3	3.4	1.8	1.8	1.6	0.2	0.0	▲ 0.1	▲ 1.6	▲ 3.0	1.2
Business Fixed Investment	▲ 0.5	8.3	4.0	3.6	3.4	2.8	2.4	2.2	2.2	0.6	3.1	2.9
Private Inventories (percentage points contribution)	(2.2)	(▲ 1.1)	(▲ 0.4)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	(0.0)	(▲ 0.0)
Government Consumption Expenditure	1.6	2.8	0.5	0.5	0.4	0.4	0.2	0.2	0.2	2.0	1.3	0.3
Public Investment	▲ 12.3	3.8	3.4	2.8	2.0	1.4	0.8	0.2	0.2	▲ 7.5	▲ 2.6	1.4
Net Exports (percentage points contribution)	(▲ 1.7)	(0.4)	(▲ 0.0)	(▲ 0.1)	(▲ 0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.8)	(▲ 0.2)	(▲ 0.0)
Exports of Goods and Services	3.6	3.7	1.8	1.6	1.6	1.4	1.4	1.2	1.2	12.5	2.6	1.5
Imports of Goods and Services	14.8	2.7	1.6	1.6	1.6	1.2	1.2	1.0	1.0	7.2	3.6	1.3

(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	0.2	1.2	2.2	2.8	3.0	2.8	2.5	1.9	1.7	1.3	2.3	2.2
GDP deflator	▲ 0.5	▲ 0.3	0.1	0.9	0.7	1.0	0.9	0.6	0.6	▲ 1.0	0.4	0.8
Consumer Price Index (excluding fresh food)	0.6	2.1	2.7	3.2	2.7	1.7	1.2	0.7	0.5	5.7	3.4	4.0
Unemployment Rate (%)	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\$)	116	130	138	145	143	142	141	140	138	112	139	140
Import Price of Crude Oil (US\$/barrel)	85	109	109	93	94	90	91	89	85	76	101	89

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.