Monthly Report of Prospects for Japan's Economy

January 2023

Macro Economic Research Center
Economics Department

The Japan Research Institute, Limited

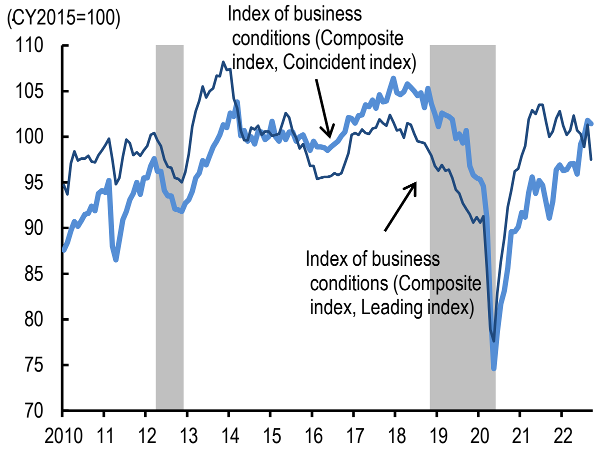
https://www.jri.co.jp/english/periodical/

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

The General Situation – The economy is slowly picking up

Figure 1-1 Economic Activity

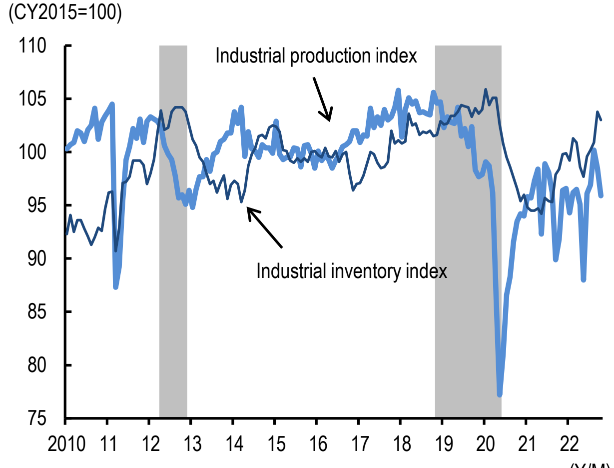
Among indices of business sentiment, coincident indices are on an upward trend, while leading indices are declining.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

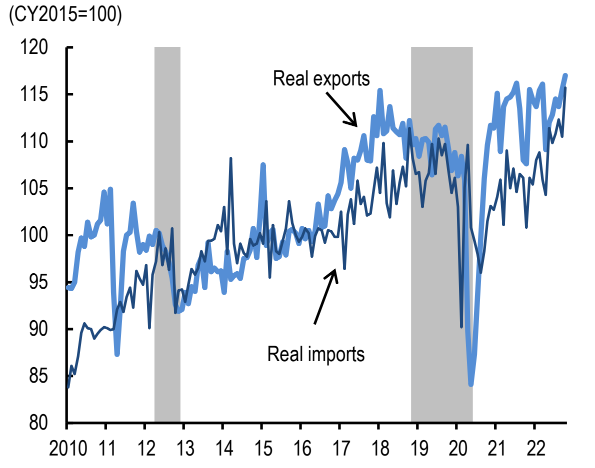
Industrial production is expected to increase, despite a lull in the rapid recovery that has been underway since this summer.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

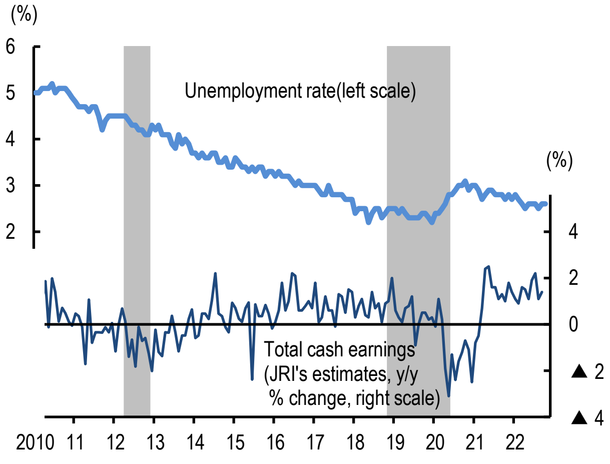
Exports of automotive and capital goods are rising.
Imports remain high due to a recovery in domestic demand.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate is hovering in the mid-2% range.
Nominal wages are rising more slowly than prices.

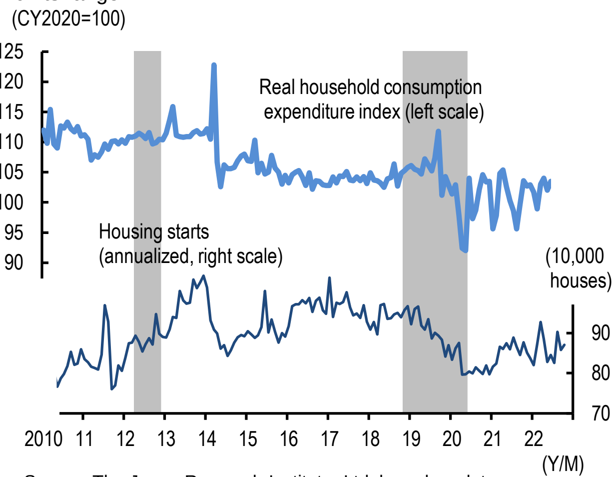


Source: The Ministry of Internal Affairs and Communications,
The Ministry of Health, Labor and Welfare.

＊The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

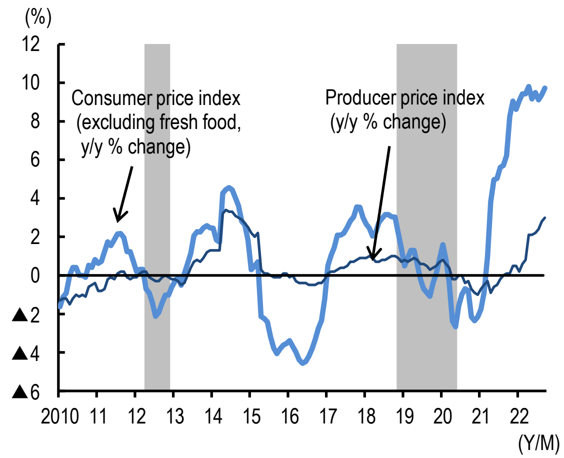
Consumption is fluctuating, but gradually rising overall.
Housing starts are at an annualized level in the mid-800,000 units range.



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 easing slightly but remains high.
Consumer price inflation has reached the mid-3% range.



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

Real GDP is currently negative but the economy is picking up

◆ Despite negative growth, domestic demand remains strong

Real GDP growth in the July-September quarter was -0.8% year on year (YoY), the first negative growth in two quarters. A significant increase in imports of services was the main factor pushing down the growth rate. However, domestic demand and exports remain on the rise, and the economy looks to still be on the road to recovery.

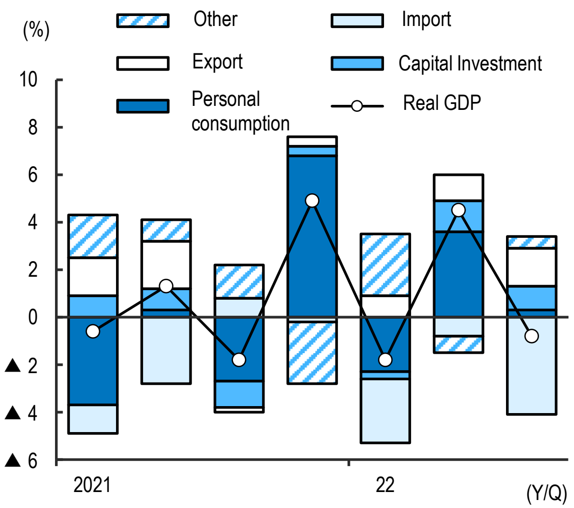
◆ Manufacturers plan to increase production going forward despite a lull in the recovery

In October, the Industrial Production Index fell for the second straight month, slipping 2.6% from the previous month. By industry, production of automobiles continued to increase due to easing supply constraints, but production of electronic components/devices declined due to a drop in global demand for semiconductors. On the other hand, according to future production plans, companies are planning to increase output. While production of electronic components/devices will continue to be weak, output of production machinery and electrical/ICT equipment, for which order backlogs are accumulating, is expected to rise. Automobile production is also set to increase as makers' operations return to normal.

◆ Consumption activity is recovering

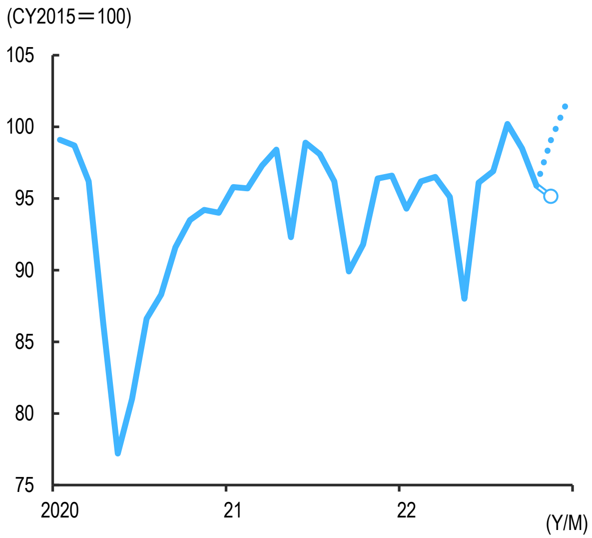
In October, the Consumption Activity Index rose for the second consecutive month, climbing 2.1% from the previous month. The government's new nationwide travel discount program stimulated travel-related demand, and services consumption bounced back. Automobile sales also recovered as the supply crunch eased, and durable goods consumption also increased.

Figure 2-1 Real GDP Change Rate by Demand Item <the first preliminary estimate, on an annualized q/q change basis>



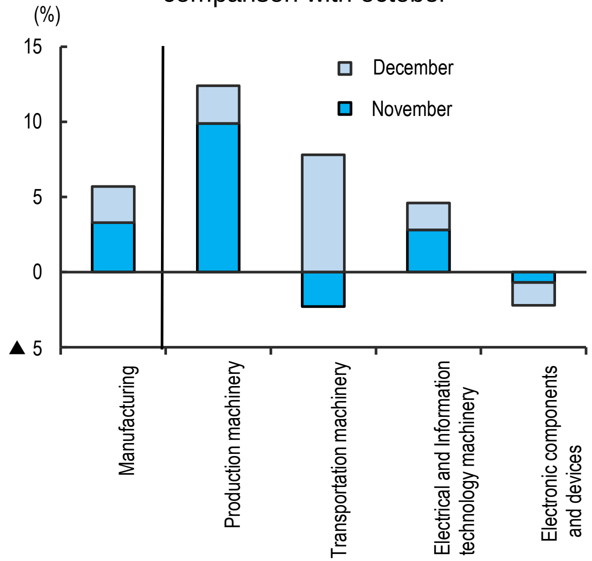
Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.

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: Dotted lines are postponed based on the forecast index of manufacturing production (November and December). White lines are postponed based on corrected figures (Nov.) from METI.

Figure 2-3 Manufacturing Industry Production Forecasting Index <comparison with october>



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

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

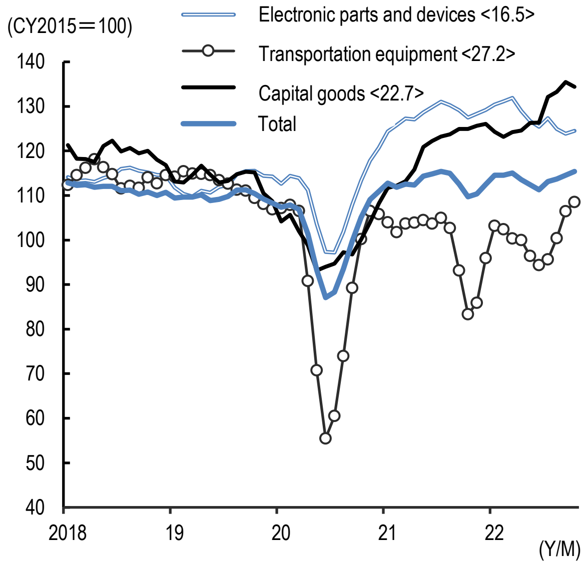
◆ Goods exports increased for the second month in a row

Real exports increased moderately. By product category, exports of capital goods remained at high levels on the back of strong capital investment worldwide, and exports of transportation machinery continued to recover as domestic production rebounded. Looking ahead, export growth is expected to weaken. While exports of transportation machinery are expected to see an increase due to the continued recovery of production as supply constraints ease, exports of capital goods look set to slow down as a result of a decrease in exports of electronic components and weakening momentum in capital investment worldwide. The new export order index is below 50, which is the dividing line between improvement and deterioration.

◆ Foreign visitors to Japan surged from the previous month

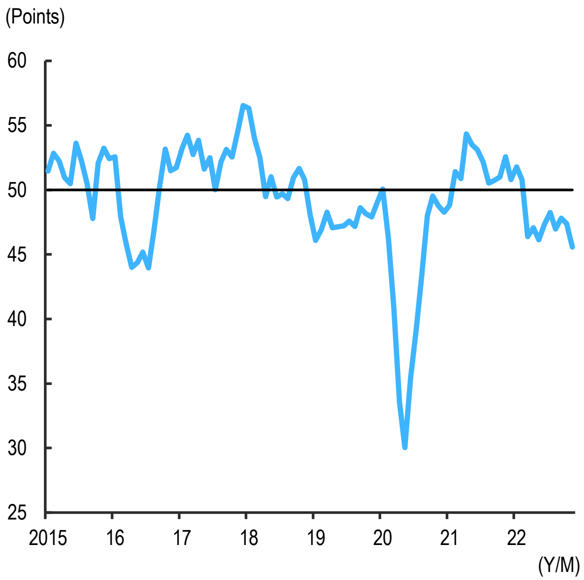
The number of foreign visitors to Japan in October more than doubled from the previous month to 498,000. This was a consequence of the government's significant relaxation of border control measures, which included the lifting of the ban on individual travel by visitors to Japan in October. Inbound demand is expected to continue to recover. In addition to a recovery in the number of visitors to Japan due to the easing of waterfront measures, the yen's depreciation is expected to boost per capita travel spending. In 2019, more than 30% of foreign visitors to Japan came from China, and although overseas travel for the Chinese is currently restricted, the pace of recovery in the number of visitors to Japan is expected to further accelerate if China’s lifting of its zero-COVID policy spurs a further relaxation of border control measures by the Japanese government.

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



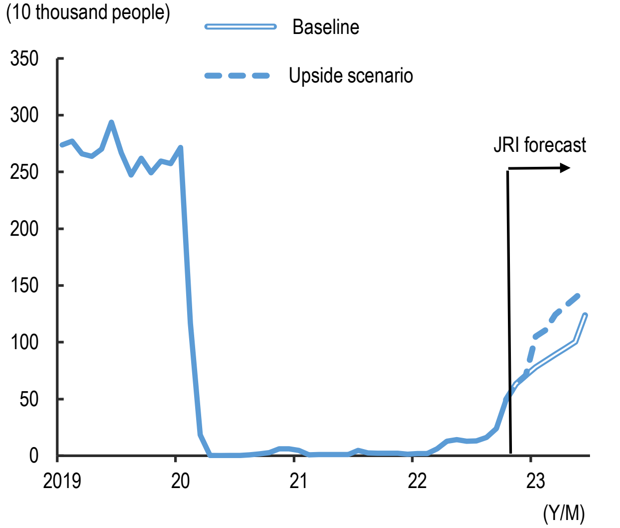
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angled brackets show the shares in total nominal exports in CY2021.

Figure 3-2 New Export Orders Index



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

Figure 3-3 Foreign Visitors to Japan
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of the Japan National Tourism Organization, various media reports.
Note: The baseline and upswing scenarios assume that China's waterfront measures are relaxed starting in June 2023 and January 2023, respectively.

Supported by high corporate earnings, capital investment will continue to increase going forward

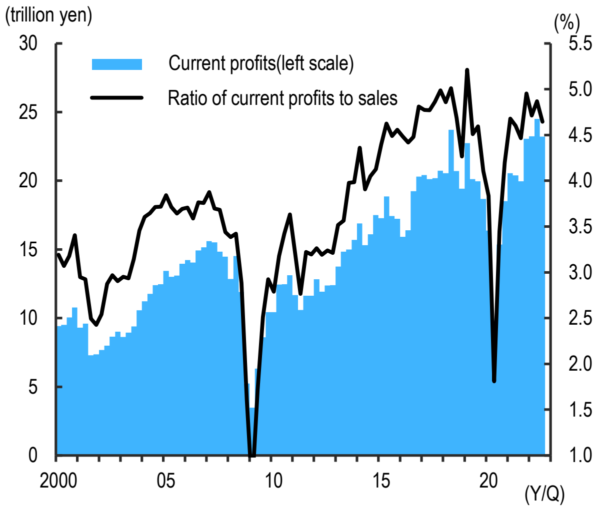
◆ Corporate earnings remain high

According to the Financial Statements Statistics of Corporations, ordinary profit for the July-September quarter declined 5.3% YoY for the first drop in four quarters, though it remained at a high level. The weak yen boosted the non-operating earnings of large companies with offshore operations through higher dividends from overseas subsidiaries. However, the earnings environment for small and medium-sized enterprises (SMEs) has worsened due to insufficient price pass-through, as high raw materials costs stemming from previous yen depreciation and high commodity prices have piled downward pressure on earnings.
Corporate earnings are expected to continue to rise. The recovery in services consumption and inbound demand is expected to trigger a rebound in earnings in consumption-related sectors such as lodging and food/beverage service.

◆ Companies seem to be considerably short of equipment

Companies are gradually implementing investment plans that they had postponed due to the COVID pandemic, and capital investment is picking up. Capital investment in the July-September quarter increased for the second consecutive quarter (+2.4% YoY), according to the Financial Statements Statistics of Corporations. Capital investment is expected to increase in the future. The Bank of Japan’s Tankan survey for December showed no change in the plans for large increases in capital investment in the current fiscal year. Capital investment is expected to increase in the face-to-face service sector, where investment has been limited until now, due to the recovery in demand for services. There is also a strong appetite for post-COVID investment aimed at decarbonization and digitalization. The continued high levels of corporate earnings and the accumulation of cash and deposits by companies are boosting capital investment by making it easier to pay for.

Figure 4-1 Current Profit and Ratio of Current Profits to Sales
<seasonally adjusted>

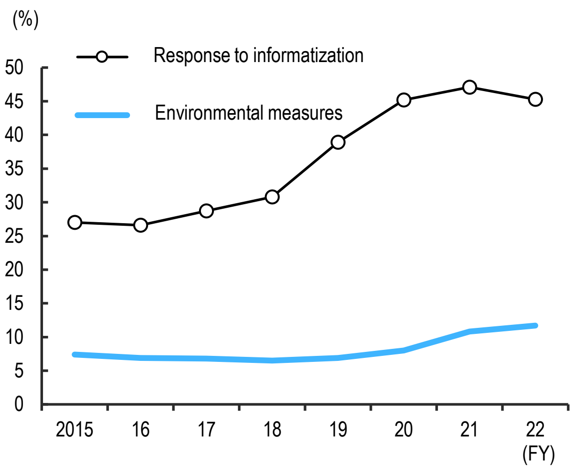


Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All sizes and all industries (excluding finance and insurance) .

Figure 4-2 Capital Investment by Corporate Enterprises
<seasonally adjusted>

Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All sizes, all industries (excluding finance and insurance).

Figure 4-3 Capital Investment Stance of Companies
<large companies, all industries>



Source: The Japan Research Institute, Ltd. based on the data of The Cabinet office and The Ministry of Finance.
Note1: Questions about important items for capital investment in the current fiscal year.
Note2: Composition of the number of companies that responded to the question with multiple answers.

The employment situation is improving, and the outlook is for higher wages, especially at large companies

◆ Personnel shortages are becoming more apparent

The employment situation is improving. The number of workers has increased moderately. The unemployment rate remained low at 2.6% in October, and the ratio of new full-time job openings to new full-time job seekers exceeded the pre-COVID peak level, indicating that labor shortages are becoming more apparent. The number of workers is expected to continue to increase moderately. The recovery in services consumption is expected to further increase labor demand in the face-to-face service sector, which includes lodging and food/beverage service. However, the labor participation rate has already recovered to its pre-COVID level, limiting the scope for additional labor supply from women and the elderly. Going forward, the labor market is expected to tighten, and upward pressure on wages will increase.

◆ Large companies especially are moving to raise wages

Total cash payrolls in October increased 1.8% YoY, staying in positive territory. 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) the provision of inflation allowances etc. to help employees cope with rising prices. The average rate of wage increase during the 2023 shunto spring wage offensive is projected to be +2.7%, up 0.5 percentage points from last year. However, for the time being, a cautious stance on wage setting is expected to be maintained by SMEs that cannot secure the resources to raise wages.

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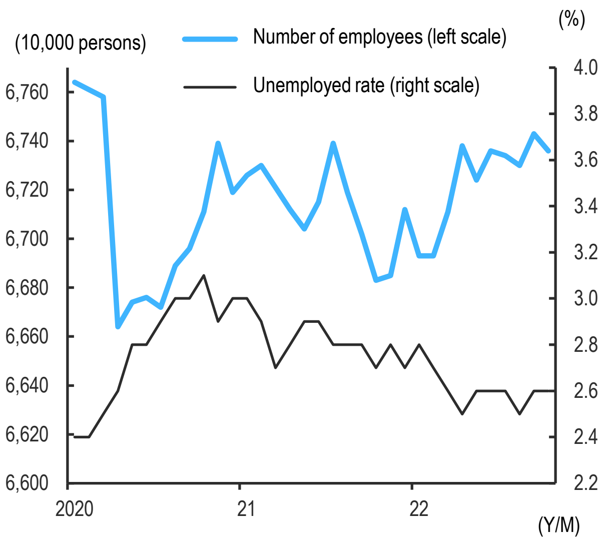
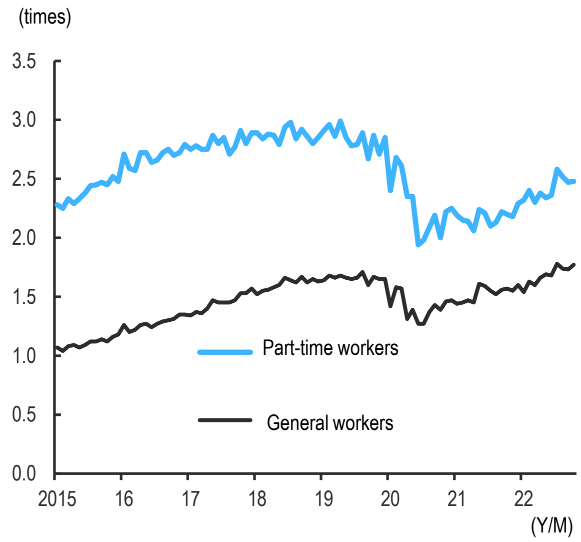
Figure 5-1 Number of Employees and Unemployed Rate<seasonally adjusted>



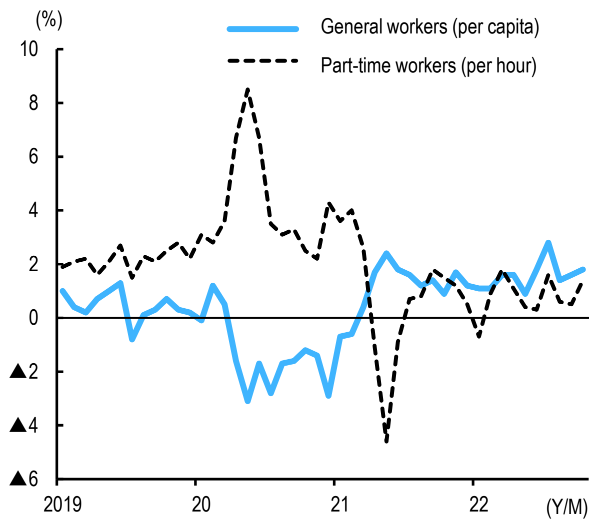
Source: The Japan Research Institute, Ltd. based on data of The Minustry of Internal Affairs and Communications.

Figure 5-2 New Job Opening Ratio <seasnally adjusted>



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.

Personal consumption is picking up, supported by excess savings and measures to ease the burden of inflation

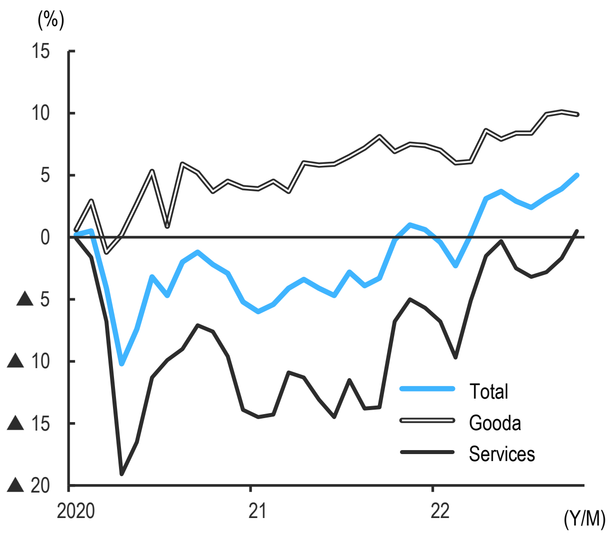
◆ Personal consumption is recovering

Personal consumption, mainly in services, has bounced back due to the nationwide decline in the number of new infections since the fall. Goods consumption is also gradually recovering. Department store sales have risen as opportunities to go out increase. Automobile sales, which had been sluggish, have begun to pick up as delays in the supply of components due to the impact of lockdowns in China have started to dissipate. However, the elderly remain reluctant to get out and about, so the pace of the consumption recovery is moderate.

◆ High prices and a resurgence of infections are concerns

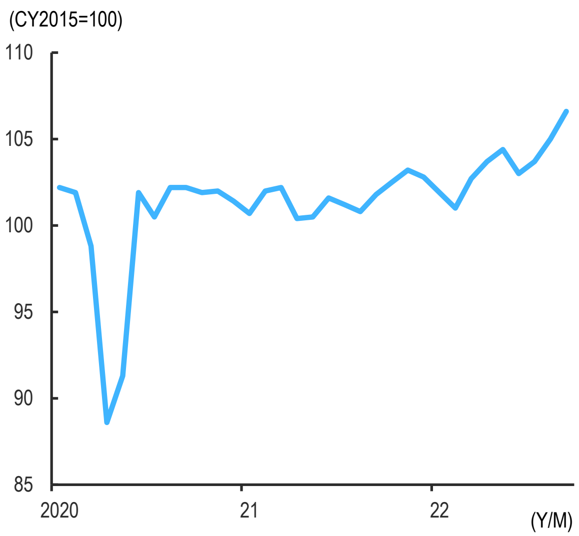
Personal consumption is expected to continue its gradual recovery in the near term as pent-up demand for services is released. Consumption of face-to-face services such as travel, transportation, and eating out is still well below pre-COVID levels, and there is plenty of room for recovery. Although high prices are putting downward pressure on the purchasing power of households, the excess savings accumulated as a result of them cutting back on services consumption during the COVID pandemic and the government measures to ease the pain of inflation are expected to support the recovery in consumption. While higher prices are expected to have increased the financial burden on households by 87,000 yen in FY2022, excess savings average 600,000 yen for working households and just under 700,000 yen for retired households, levels sufficient to offset the higher burden caused by inflation. In addition, measures to reduce the burden of rising electricity and city gas bills are also expected to alleviate the negative impact, especially for low-income households.

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



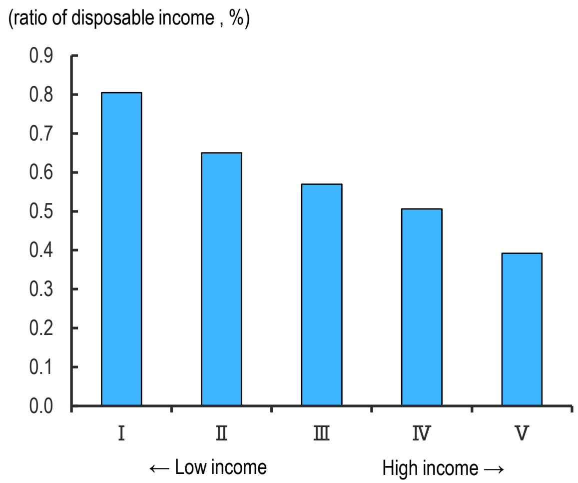
Source: The Japan Research Institute, Ltd. based on data of JCB consumption Now, Google.
Note: Consumption statistics based on credit card spending.

Figure 6-2 Retail Sales<seasonally adjusted>



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

Figure 6-3 Effects of Reducing the Burden of Electricity and City Gas by Income Group



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
Note:Households with two or more workers. Estimated if electricity and city gas bills were reduced by 20%.

Topic: From imported inflation to homemade inflation

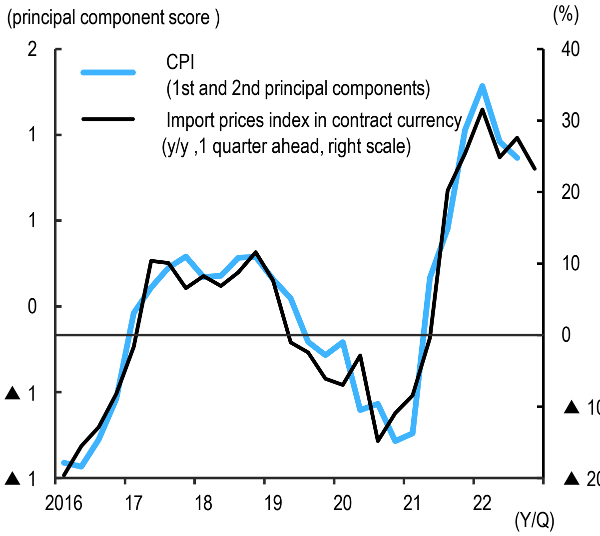
◆ Imported inflationary pressures are gradually abating

Recent price increases have been driven by imported inflation. When principal component analysis is employed for CPI items, the composite of movement common to the first and second (first and second principal components) is linked to import prices (denominated in foreign currency), while movement common to the third (third principal component) is linked to the exchange rate six months earlier. This means that most of the change in consumer prices can be attributed to higher resource prices and the depreciation of the yen. Imported inflationary pressure is expected to weaken gradually going forward Import prices (denominated in foreign currency) are already showing signs of peaking out. Although the yen's depreciation has slowed, the effect on consumer prices occurs about six months later, so inflationary pressure caused by the yen's depreciation is expected to remain until the middle of 2023.

◆ Prices to rise with wage increases in 2024

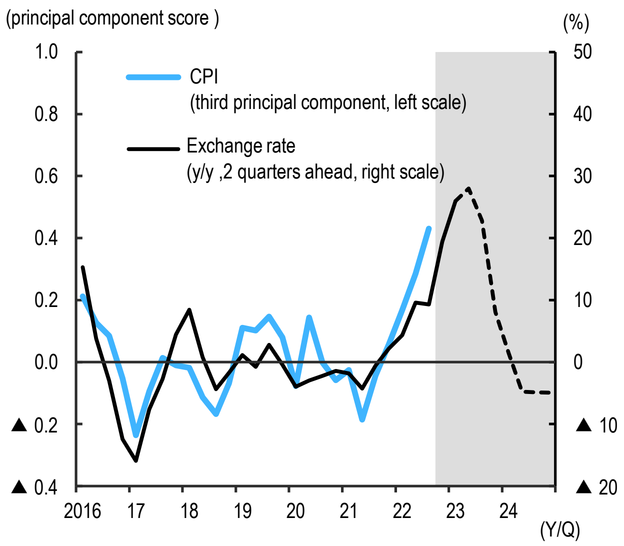
Homemade inflationary pressures from wage increases are expected to intensify through 2024. It is expected that the labor shortage will become more severe and pressure to raise wages will increase. Prices of services, which are susceptible to higher labor costs, are predicted to rise. Given the relationship between wages and prices since the 1990s, if wage growth per capita approaches 3%, core CPI inflation will rise to the mid-1% range.

Figure 7-1 CPI (1st and 2nd principal components) and Import Prices (y/y)



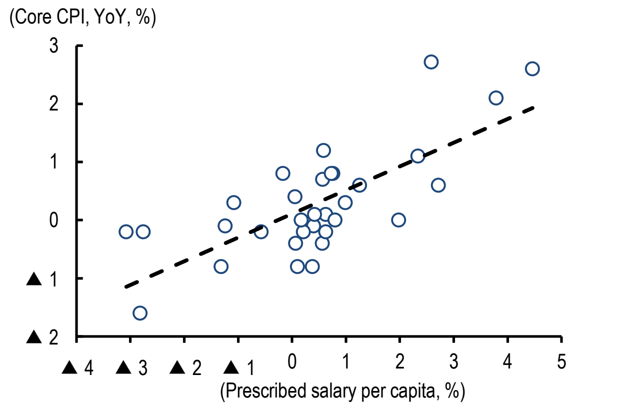
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications, The Bank of Japan.
Note: Principal component analysis covers medium-category items of the consumer price index. The period is from January 2010 to September 2022.

Figure 7-2 CPI (third principal component) and Exchange Rate (y/y)



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications, The Bank of Japan.
Note: Outlook for the dollar-yen market is forecast by the Japan Research Institute.

Figure 7-3 Relationship between Prescribed Salary per Capita and Core CPI



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications,The Ministry of Health and Welfare Ministry of Labor.
Note: Period is since 1990. Prescribed payrolls are the total of employment patterns based on establishments with 30 or more employees. Core CPI excludes the effect of the consumption tax hike.

Prospects for Japan's Economy - Projected Real GDP Change; 1.7% for FY2022 and 1.3% for FY2024

(1) The Japanese government’s second quarterly estimate (QE) for the July-September quarter saw the real GDP growth rate revised upward to an annualized -0.8% compared with the previous quarter (-0.2% compared with the same quarter the previous year) from the first QE figures (-1.2% and -0.3%). By demand category, personal consumption was revised downward, while exports and inventory investment saw upward revisions. The assessment at the time of the first QE remains unchanged, with the view being that the economy is recovering, mainly thanks to domestic demand, despite having fallen into negative growth, primarily as a result of substantial increases in imports of services.

(2) The economy is expected to recover in the October-December quarter and beyond, driven by demand for services, including inbound travel. The rebound in personal consumption will move into full swing, with the release of pent-up demand for services the key driver. The travel discount program, which was extended to all areas of the country in October, has helped leisure consumption recover. Inbound demand, which has remained sluggish, is also expected to bounce back. The number of visitors to Japan is set to rise due to the easing of border control measures, such as the removal of the cap on the number of visitors and the lifting of the ban on individual travel, and the depreciation of the yen is expected to increase travel spending per capita.

(3) Capital investment is expected to continue to increase. Capital investment is expected to increase in the face-to-face service sector, where investment has been limited until now, due to the recovery in services consumption and inbound demand. High corporate earnings and cash deposits will boost capital investment by making it easier to fund.

(4) The growth rate for FY2022 is expected to have been strongly positive at +1.7% as the economy rebounded from the COVID pandemic slump. The growth rate is expected to slow to +1.5% in FY2023 and +1.3% in FY2024 as the demand shortfall shrinks, but should still exceed the potential growth rate, which is in the mid-0% range.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of December 12, 2022)

	CY2022		CY2023				CY2024				CY2025	FY2022	FY2023	FY2024
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3			
	(Actual)	(Projection)										(Projection)		
Real GDP	▲ 0.8	3.9	1.5	1.4	1.3	1.3	1.1	1.2	1.4	1.4	1.4	1.7	1.5	1.3
Private Consumption Expenditure	0.5	2.5	1.4	0.9	1.0	1.0	1.1	1.1	1.2	1.2	1.3	2.6	1.2	1.1
Housing Investment	▲ 2.0	4.2	3.0	2.5	0.8	0.2	0.0	▲ 0.1	0.0	▲ 0.1	0.0	▲ 3.9	1.8	0.1
Business Fixed Investment	6.2	3.6	3.3	3.1	3.0	3.0	2.0	2.4	2.8	2.8	2.5	3.5	3.3	2.6
Private Inventories (percentage points contribution)	(0.4)	(▲ 0.2)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.3)	(0.0)	(0.0)
Government Consumption Expenditure	0.5	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.0	1.1	0.1	0.1
Public Investment	3.8	3.0	2.0	1.6	1.4	1.2	1.2	1.0	0.6	0.6	0.6	▲ 2.6	1.8	0.9
Net Exports (percentage points contribution)	(▲ 2.5)	(2.3)	(▲ 0.2)	(▲ 0.0)	(▲ 0.1)	(0.0)	(0.0)	(0.1)	(0.2)	(0.2)	(0.2)	(▲ 0.5)	(0.0)	(0.1)
Exports of Goods and Services	8.6	4.0	2.2	2.2	1.8	2.0	2.4	3.4	3.8	4.2	4.4	4.9	2.7	3.2
Imports of Goods and Services	22.7	▲ 5.0	2.8	2.0	1.8	1.6	2.0	2.6	2.6	2.8	3.0	7.1	2.3	2.3

(% changes from the same quarter of the previous year) (% changes from the previous fiscal year)

Nominal GDP	1.3	3.3	3.8	3.4	4.5	2.2	1.7	1.8	2.2	2.6	3.4	2.1	3.6	1.5
GDP deflator	▲ 0.3	1.4	1.4	2.0	2.5	0.9	0.5	0.6	1.0	1.3	2.0	▲ 0.8	0.4	0.4
Consumer Price Index (excluding fresh food)	2.7	3.8	2.5	2.4	1.7	1.1	2.2	1.6	1.6	1.4	1.7	▲ 0.1	0.8	0.7
Unemployment Rate (%)	2.6	2.5	2.5	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.3	2.7	2.5	2.3
Exchange Rates (JY/US$)	138	142	138	137	135	133	132	130	131	130	129	112	116	116
Import Price of Crude Oil (US$/barrel)	112	96	91	90	91	91	94	93	94	94	92	74	74	70

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.