Monthly Report of Prospects for Japan's Economy

April 2023

Macro Economic Research Center

Economics Department

The Japan Research Institute, Limited

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This report is the revised English version of the March 2023 issue of the original Japanese version.

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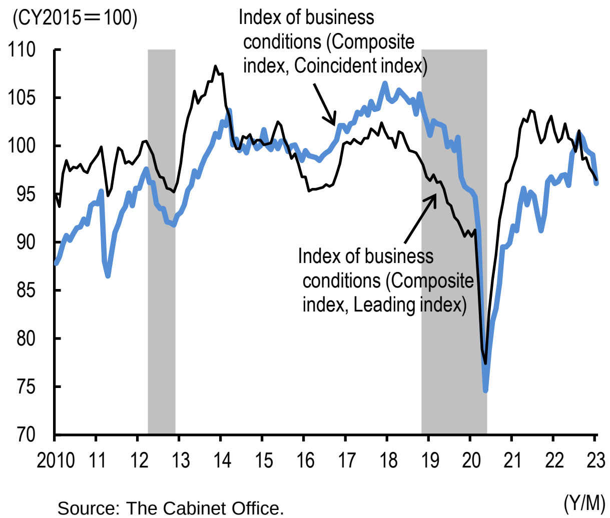
The General Situation – The economy is slowly picking up despite weakness in certain areas

Figure 1-1 Economic Activity

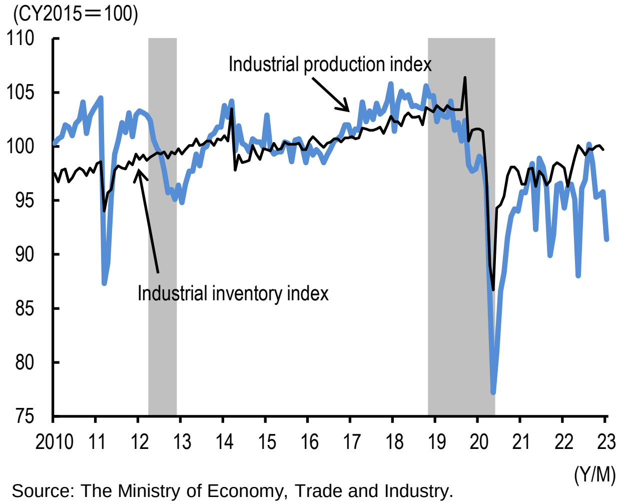
Both coincident and leading indices of business sentiment are falling.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

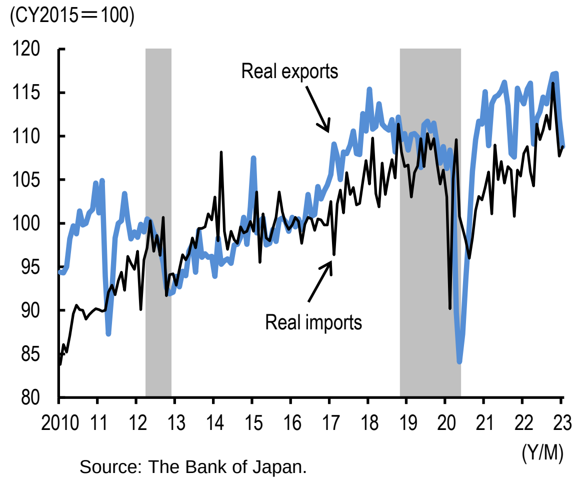
Industrial production is weakening, while tertiary industry activity is picking up.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

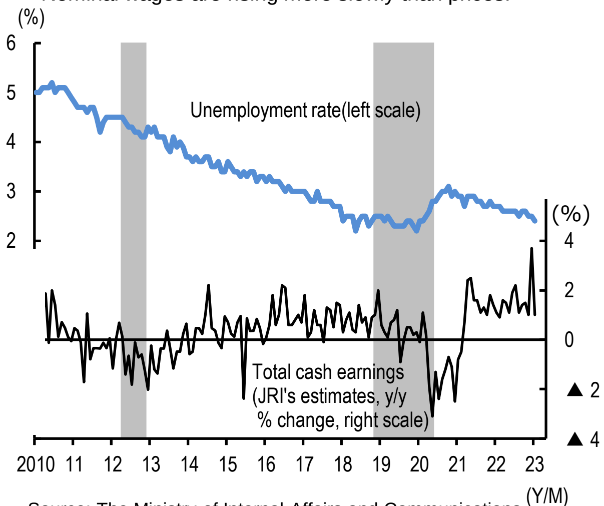
Exports are down due to the slowdown in overseas economies. Imports, mainly from those from Europe and North America, are down.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate has fallen to 2.4%.
Nominal wages are rising more slowly than prices.

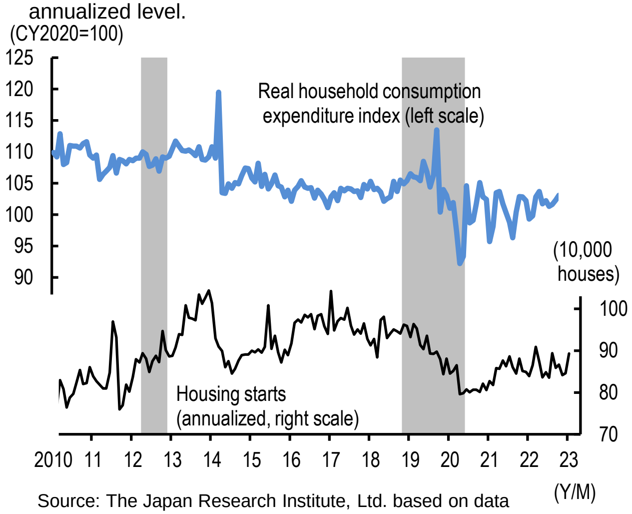


Source: The Ministry of Internal Affairs and Communications,
The Ministry of Health, Labor and Welfare.

＊The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

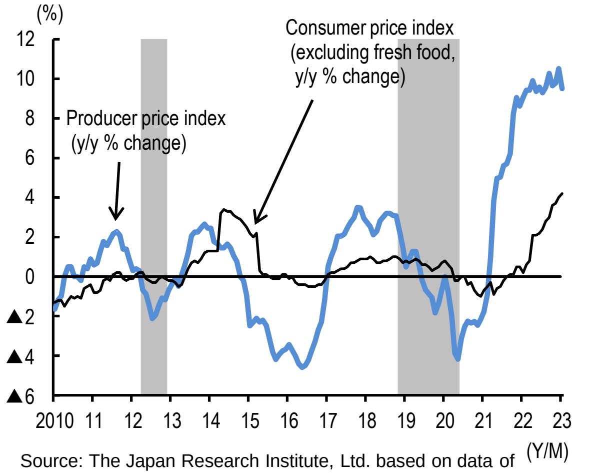
Consumption is fluctuating, but gradually rising overall.
Housing starts are in the high-800,000 units range at an annualized level.



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 remains high.
Consumer prices are more than 4% 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.

Real GDP saw positive, albeit modest, growth for the first time in two quarters

◆ Final demand is strong

Real GDP in October-December 2022 grew at an annualized rate of 0.1%. Although the increase was small, this marked the first growth in two quarters. While a decline in inventory investment significantly reduced the growth rate, final demand increased. Personal consumption increased thanks to the nationwide travel discount program, and a recovery in inbound tourism demand boosted services exports, so net exports also made a positive contribution.

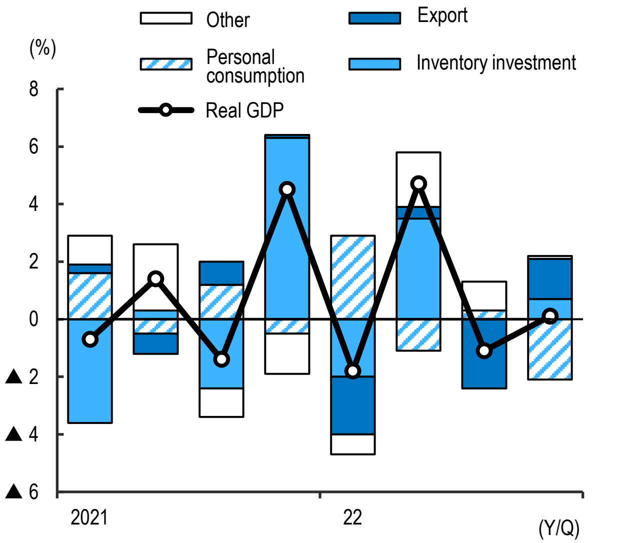
◆ Manufacturing has weakened

In January 2023, the Industrial Production Index fell for the first time in three months, dropping 4.6% month on month (MoM). By industry, output declined across a wide range of industries, including automobiles and production machinery. A decline in exports due to slowdowns in overseas economies and the effect of the Chinese New Year was a background factor. Among shipments in January 2023, those headed overseas fell sharply by 9.7% MoM. Near-future production plans indicate increases in output in February (+8.0% MoM) and March (+0.7% MoM). However, the slowdown in overseas economies and other factors are expected to put downward pressure on production activities, and production is unlikely to rise by as much as the plans would suggest.

◆ Business confidence has improved

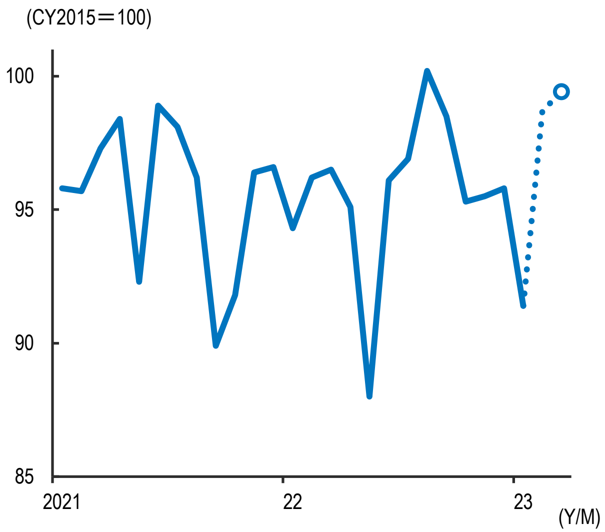
The DI for current conditions in the Economy Watchers Survey for February 2023 rose by 3.5 points MoM, the first increase in four months. The household, corporate, and employment DIs all improved, reflecting the normalization of economic activity as the COVID pandemic recedes.

Figure 2-1 Real GDP Growth Rate



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

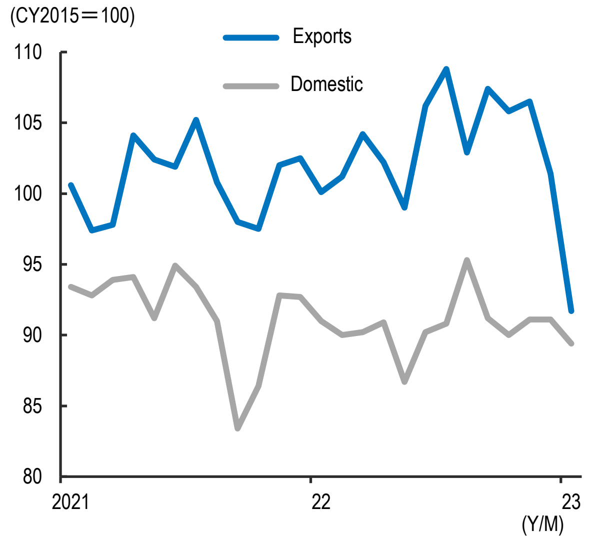
Figure 2-2 Industrial Production Index <seasonally adjusted>



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 (February and March).

Figure 2-3 Industrial Shipment Breakdown <seasonally adjusted>



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

A decline in goods exports was offset by an increase in services exports

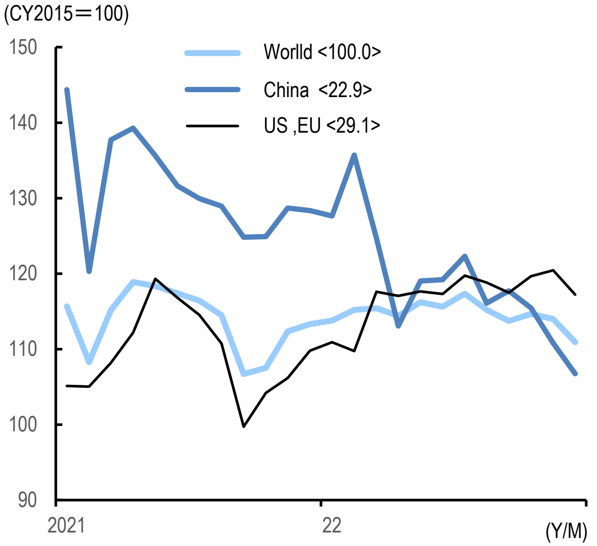
◆ Goods exports to China have declined sharply

Real exports declined in January. The impact of the global slowdown in demand for goods is also affecting Japan's exports. Information-related exports declined as stay-home-related demand for products such as smartphones and PCs petered out. The momentum of global capital investment is also weakening, and exports of capital goods have reached a plateau. In addition to this, a large drop in exports to China due to the effect of the Chinese New Year also pushed down exports in January. Exports to the U.S. and Europe, where the momentum of goods consumption is slowing, also declined. Looking ahead, exports of goods are expected to remain stagnant against a backdrop of weak global demand for goods. However, a further fall is likely to be avoided as exports to China, where economic activity is normalizing, pick up. In February, China's manufacturing PMI stayed above 50, the threshold for improvement or deterioration, for a second month.

◆ The number of foreign visitors to Japan continues to recover

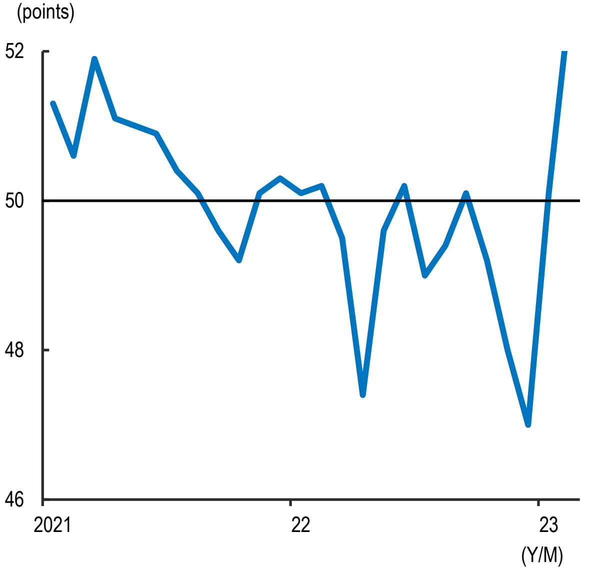
The number of foreign visitors to Japan in January was 1.49 million, rebounding to more than 50% of the 2019 level. Visitors from East Asian countries excluding China were the main drivers of the recovery. The number of visitors from South Korea and Taiwan returned to 60-70% of pre-COVID levels. However, the number of visitors from China, who accounted for 30% of travelers to Japan before COVID, has remained sluggish due to the requirement that they present proof of a negative test result and the fact that the Chinese authorities are still not allowing them to take group tours to Japan. Inbound tourism demand is expected to continue to recover. As the rules are eased on both the Japanese and Chinese sides, the number of Chinese visitors to Japan is likely to begin to recover.

Figure 3-1 Real Export by Area
<seasonally adjusted>



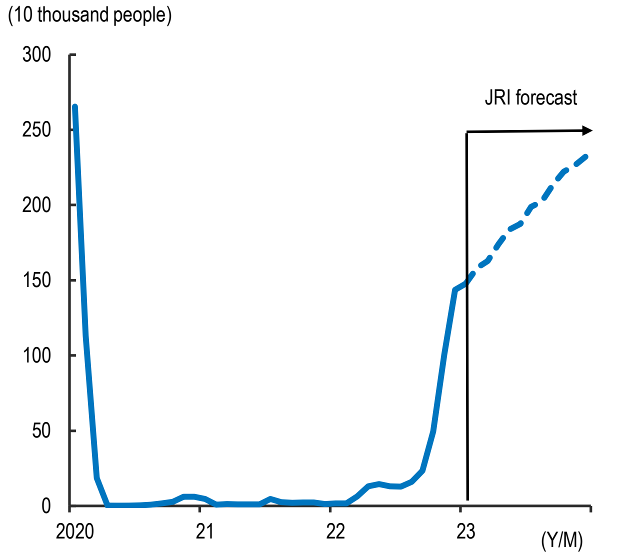
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: <>Figures in parentheses represent the share of total nominal exports in 2022.

Figure 3-2 China's Manufacturing PMI



Source: The Japan Research Institute, Ltd. based on data of The China National Bureau of Statistics.

Figure 3-3 Japan National Tourism Organization



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, Japan National Tourist Organization.
Note: Chinese tourists are assumed to recover in stages from April onward.

Capital investment is on the rise thanks to high corporate earnings

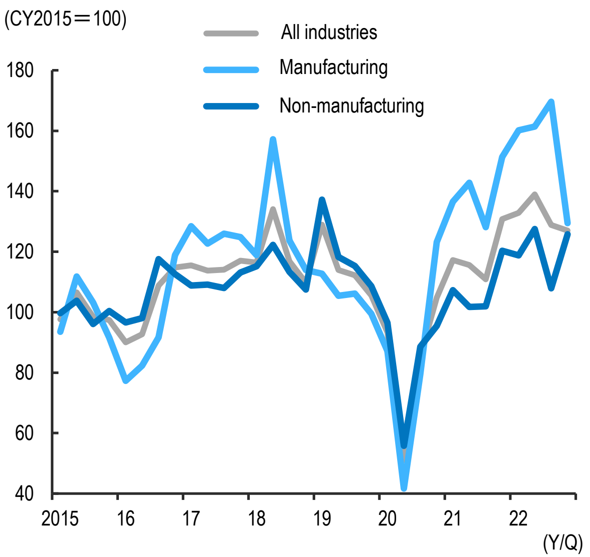
◆ Corporate earnings vary from industry to industry

According to the Financial Statements Statistics of Corporations by Industry, ordinary profit for October-December 2022 declined for the second consecutive quarter, though it remained at a high level, at 22 trillion yen. In the manufacturing sector, rising costs due to ongoing factors such as high resource prices and the weak yen weighed on the industry, resulting in a significant decrease in profits, especially in materials manufacturing. On the other hand, the non-manufacturing sector saw profit growth on the back of the recovery in services consumption and inbound tourism demand. Corporate earnings are expected to remain at high levels. Earnings in the non-manufacturing sector look set to improve further as economic activity normalizes. The manufacturing sector's earnings, meanwhile, are expected to weaken against a backdrop of sluggish exports, though as the yen stops depreciating and resource prices stop rising, cost pressures should abate.

◆ Proactive stance toward capital investment remains unchanged

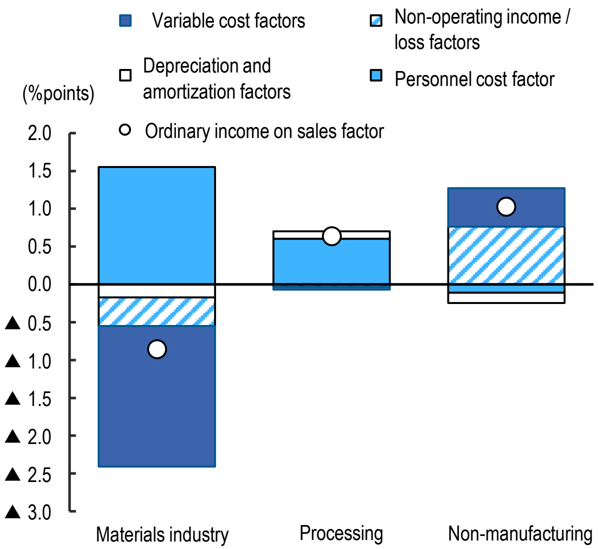
Capital investment is increasing moderately. Capital investment in October-December 2022 increased for the fifth consecutive quarter (+0.5% year on year (YoY)), according to the Financial Statements Statistics of Corporations by Industry. There are moves to resume capital investment, especially in the face-to-face service sector, where demand is recovering. Capital investment is expected to continue rising in the future. According to the Cabinet Office's Annual Survey of Corporate Behavior, 75.4% of companies say they are going to increase capital investment over the next three years. This is the highest percentage since 1990, and indicates a healthy appetite for capital investment among companies. Investment related to decarbonization and digitalization will be the driving force. However, the slowdown in overseas economies is expected to curtail investment in capacity expansion in the manufacturing sector. In fact, machinery orders, a leading indicator of machinery investment, have weakened in the manufacturing sector.

Figure 4-1 Ordinary Income <all sizes, seasonally adjusted>



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

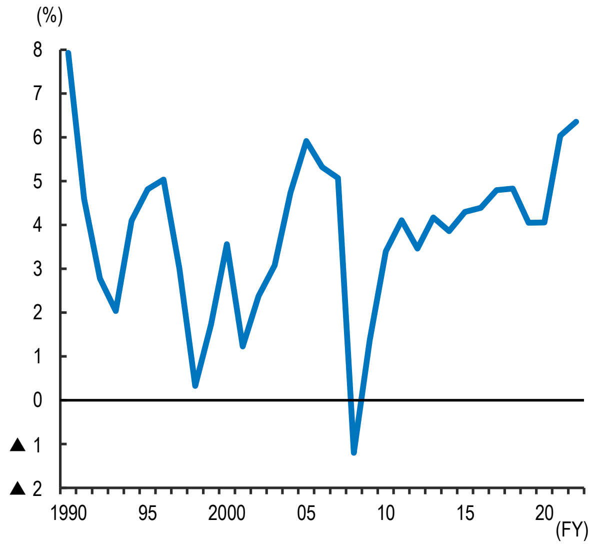
Figure 4-2 Factor Decomposition of Changes in Ratio of Ordinary Income to Net Sales



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

Note1: Difference between Oct-Dec 2022 and Oct-Dec 2018.

Figure 4-3 Projected Rate of Change in Capital Expenditure over the Next Three Years



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

Note: Value for all industries.

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

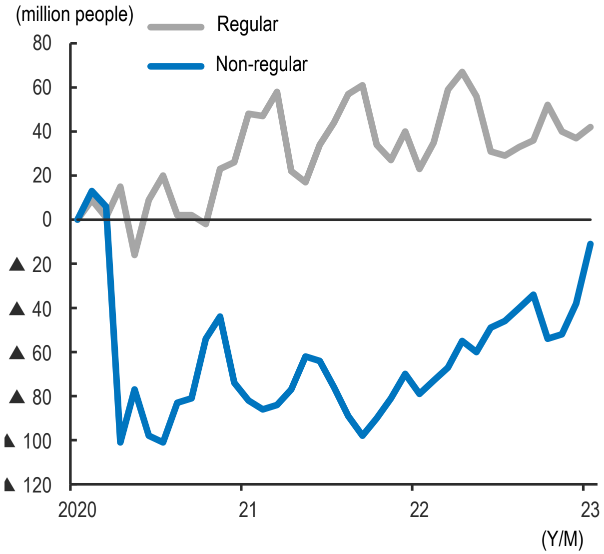
◆ Personnel shortages are evident

The employment situation is improving. The unemployment rate remained low at 2.5% in December 2022. The number of workers has maintained a gradual upward trend, with some fluctuations. A recovery is now occurring in the number of workers in the lodging and food/beverage services, where headcounts had been slow to bounce back. Labor shortages are becoming more serious, with less than 10% of full-time job openings being filled. The labor supply-demand crunch is expected to intensify further in the future. Labor demand is expected to strengthen further as economic activity normalizes. However, the labor participation rate has already risen beyond its pre-COVID level, limiting the scope for new labor-market participation from women and the elderly.

◆ Large companies especially are moving to raise wages

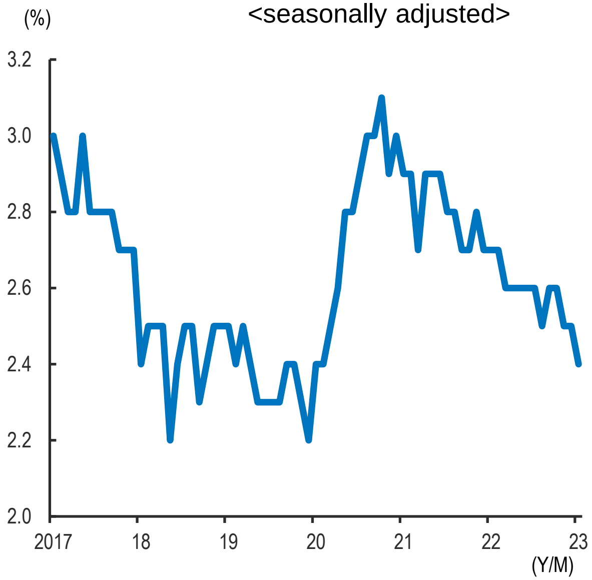
Total cash payrolls in December 2022 increased 3.3% YoY, staying in positive territory. Wage hikes in sectors such as face-to-face services and transportation, which are recovering from the slump induced by COVID, led the overall increase in wages. Some companies, especially large ones, are paying their employees special allowances to help them cope with inflation. Looking ahead, wages are expected to rise in a wide range of industries due to hikes in basic wages in response to higher prices and because labor shortages are perceived as becoming more serious. The average rate of wage increase during the 2023 shunto spring wage offensive is projected to be about +2.7%, up 0.5 percentage points from last year. Wages of full-time employees are expected to increase. Wages for non-regular workers are also expected to rise due to the impact of the growing labor shortages and increases in minimum wages. However, for the time being, a cautious stance on wage setting is expected to be maintained by SMEs, for which the earnings environment has been slow to recover.

Figure 5-1 Number of employees by employment type <seasonally adjusted>



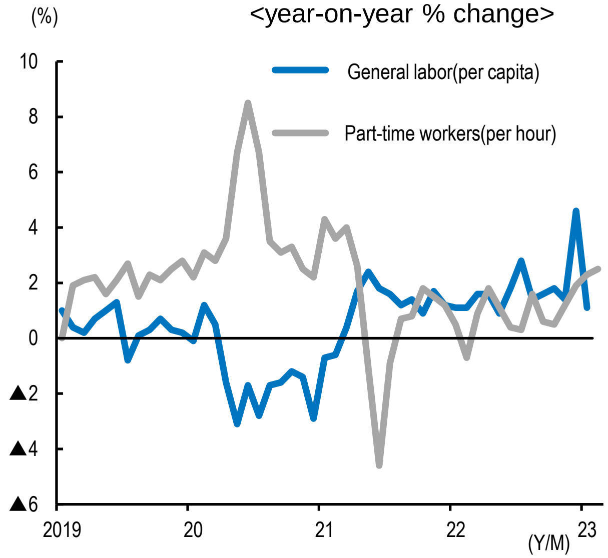
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.
Note: Compared to January 2020.

Figure 5-2 Unemployment Rate <seasonally adjusted>



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

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



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Health, Labour and Welfare.
Note: Based on common establishments.

With consumption continuing to bounce back from the COVID pandemic, personal consumption is on the road to recovery

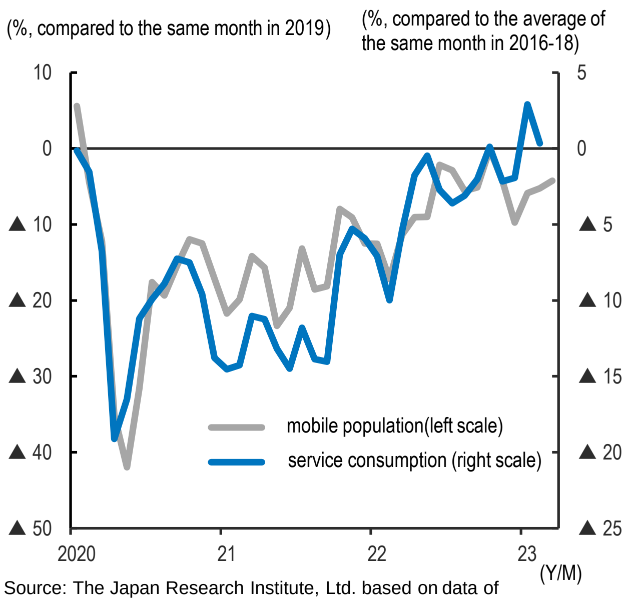
◆ Personal consumption is on the recovery track

Personal consumption is recovering. Services consumption, including travel and dining out, is leading the recovery. Events of various types are being revived after a three-year absence, which is encouraging more people to get out and about. The travel discount program is also providing a tailwind. Goods consumption also remains steady. With supply constraints easing, an increase in passenger car sales is boosting overall consumption.

◆ Consumption continues to bounce back from the COVID pandemic

Personal consumption is expected to gradually recover going forward. Households' average propensity to consume is still below the pre-COVID level, leaving plenty of room for an expansion in consumption. The legal status of COVID is set to be downgraded to Class 5 on May 8, and as the living-with-COVID lifestyle takes root, people will be less likely to stay at home, so consumption should rise. Wage hikes, especially at major companies, are also expected to support the recovery in consumption. Although consumer-perceived inflation has reached 10% for the first time since 2008, the proportion of consumers saying that they are going to reduce their consumption is limited compared to 2008. Therefore, the recovery trend in personal consumption looks set to remain intact even as high prices put downward pressure on household purchasing power.

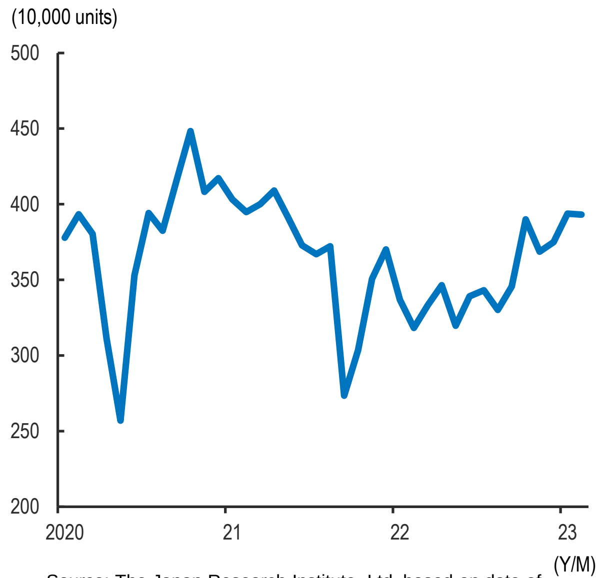
Figure 6-1 Mobile Population and Service Consumption



Source: The Japan Research Institute, Ltd. based on data of The JCB Consumption now.

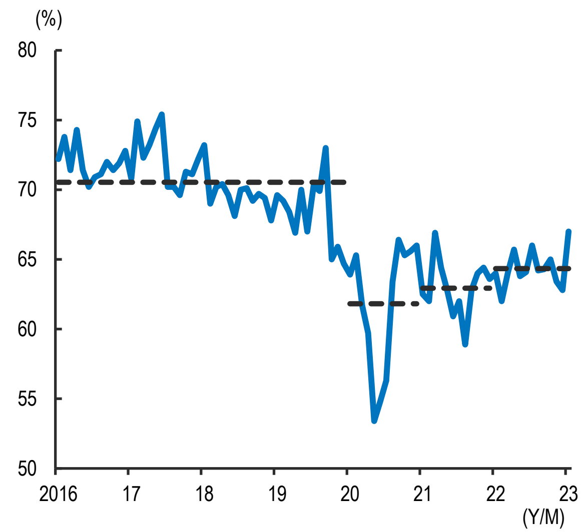
Note1: Service consumption (right scale) is compared to the FY2016-18 average to eliminate the impact of the rush demand associated with the consumption tax hike.

Figure 6-2 New Vehicle Registrarions <annualized, seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on date of The Japan Mini Vehicles Association, Japan Automobile Dealers Association.

Figure 6-3 Consumption Propensity of Working Households<seasonally adjusted>



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

Note: Households with two or more persons. Black dotted lines are simple averages for each period.

Topic 1 : SMEs have limited room to raise wages

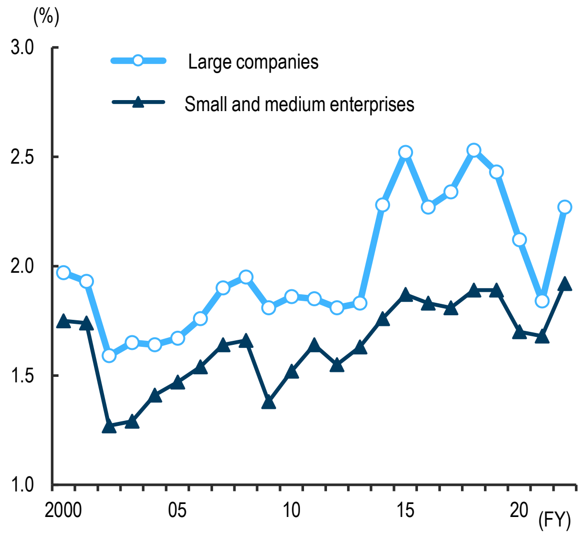
◆ There are differences in terms of profitability and scope to increase labor's share of income

Although there is growing momentum for wage increases amid history-making inflation, SMEs are expected to raise wages at a lower rate than large corporations during this year's shunto. This is because SMEs have limited capacity to raise wages, and there are two reasons for this: First, the profitability gap is widening. While earnings of large corporations, for which overseas operations account for a large share of their overall business, have been boosted by the depreciation of the yen, few SMEs have passed on rising import costs stemming from the weaker yen and higher resource prices to selling prices, and this has put pressure on their earnings. Second, there are differences in terms of scope to increase labor's share of income. Even as their value-added has increased steadily, large corporations have for many years kept personnel expenses down in favor of Western-style management styles that emphasize shareholder returns, which now gives them plenty of leeway to hike wages. On the other hand, SMEs have not seen much of a decline in labor's share of income, leaving them little room for wage increases.

◆ Improved productivity and appropriate price pass-through are essential

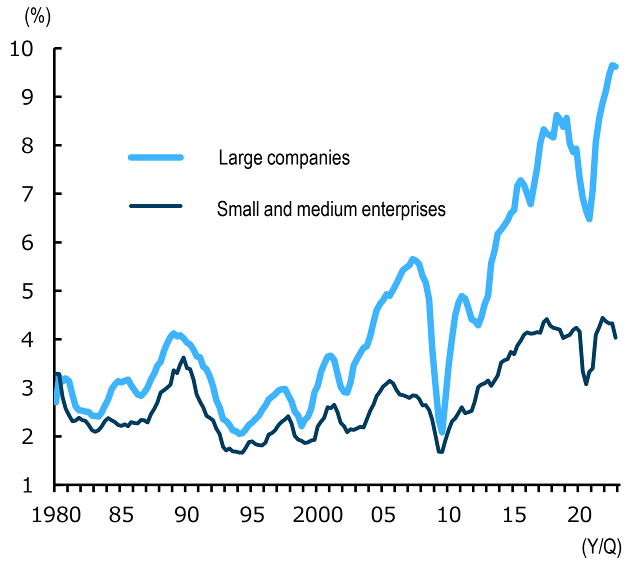
Shaping If wages at large corporations rise following this year's shunto, pressure to increase pay is expected to spread to SMEs, which are suffering even more serious labor shortages than large corporations. For SMEs to secure the resources to raise wages, 1) they must improve labor productivity through digitalization etc., and 2) an environment that allows them to appropriately pass on higher costs, including personnel expenses, must be created.

Figure 7-1 Wage Growth Rate for Large and



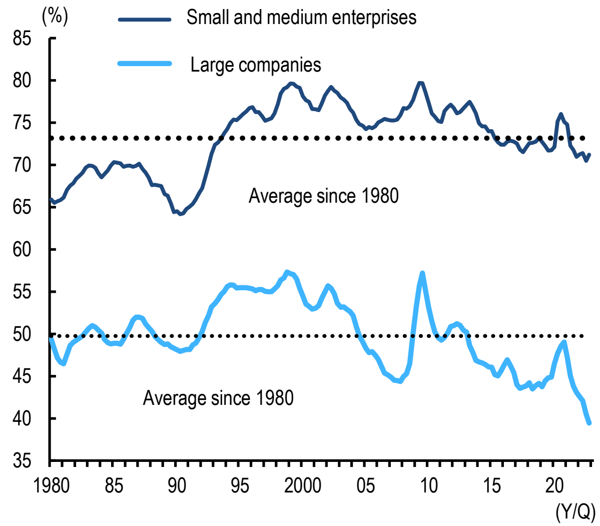
Source: The Japan Research Institute, Ltd. based on data of The Keidanren.
Note1: Wage increase rates include regular salary increases.

Figure 7-2 Ratio of Current Profits to Net Sales



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.
Note1: Backward-looking four-quarter moving average. Small and medium enterprises are capitalized between 10 million yen and 100 million yen, large enterprises are capitalized at 1 billion yen or more.

Figure 7-3 Labor's Share



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note1: Backward 4-quarter moving average of labor cost/value added.

Topic2: Changes in business and household sentiment are causing price hikes to spread to a wide range of goods and services

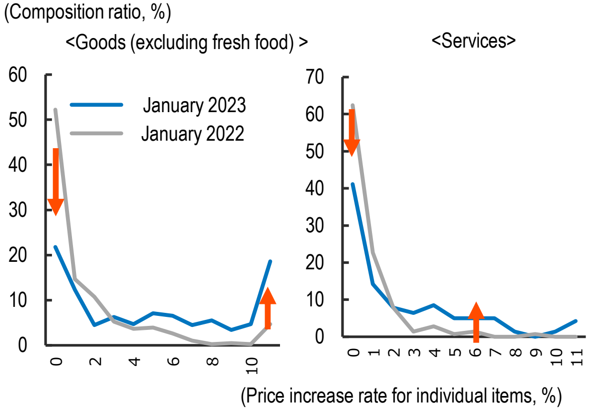
◆ Price increases are spreading to encompass a wide range of goods and services

Although there is growing momentum for wage increases amid history-making inflation, SMEs are expected to raise wages at a lower rate than large corporations during this year's shunto. This is because SMEs have limited capacity to raise wages, and there are two reasons for this: First, the profitability gap is widening. While earnings of large corporations, for which overseas operations account for a large share of their overall business, have been boosted by the depreciation of the yen, few SMEs have passed on rising import costs stemming from the weaker yen and higher resource prices to selling prices, and this has put pressure on their earnings. Second, there are differences in terms of scope to increase labor's share of income. Even as their value-added has increased steadily, large corporations have for many years kept personnel expenses down in favor of Western-style management styles that emphasize shareholder returns, which now gives them plenty of leeway to hike wages. On the other hand, SMEs have not seen much of a decline in labor's share of income, leaving them little room for wage increases.

◆ Business and household sentiments are changing

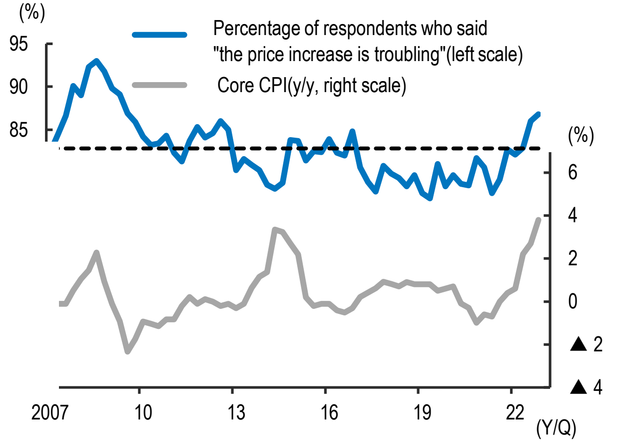
The following two points can be identified as providing the backdrop for this expansion in the range of goods and services seeing price increases: First, companies are becoming bolder about passing on higher costs. It is likely that companies have become more certain of the view that their current high costs will continue, and they intend to raise output prices (selling prices) over the medium to long term. According to the Tankan survey from the Bank of Japan (BoJ), the five-year inflation outlook (output prices) among companies is +4.3% for all industries, a considerably higher figure than was predicted prior to the COVID pandemic. Willingness to raise prices is evident not only in manufacturing, but also in downstream sectors such as retail and face-to-face services. Second, households have become more willing to accept price hikes. The current inflationary phase is partly due to the contingency of the invasion of Ukraine, and it is possible that price rises were seen as inevitable by many, which encouraged companies to pass on their higher costs to consumers. According to a BoJ questionnaire survey, the percentage of respondents who said they were troubled by price hikes was lower than during the period of soaring prices in the late 2000s. Households' expectations for medium- to long-term inflation are also rising, suggesting that there is growing recognition that they have no choice but to accept higher prices.

Figure 8-1 Frequency Distribution of Consumer Price Inflation



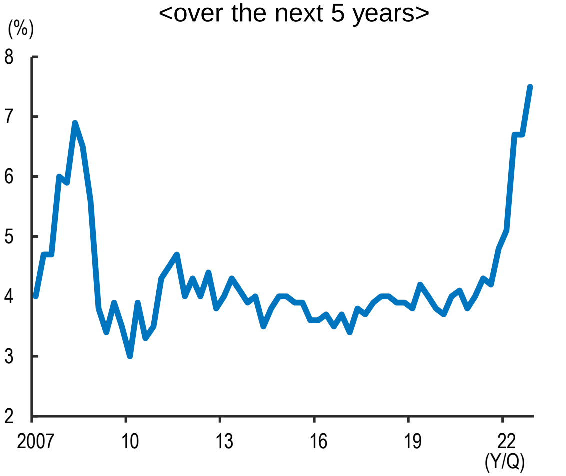
Source: The Japan Research Institute, Ltd. based on data of The Ministry of The Ministry of Internal Affairs and Communications.
Note1: Histograms are 1 percentage point wide (range of 1% at the center is 0.5% to 1.5% y/y). The left end of the histogram is the percentage of i tems less than 0.5%, and the right end is the percentage of items greater than 10.5%.

Figure 8-2 Household Reaction to Price Increases and Core CPI



Source: The Japan Research Institute, Ltd. based on data of The Ministry of The Bank of Japan,Ministry of Internal Affairs and Communications.
Note1: The black dotted line in the figure is the average from 2007 to 2022.

Figure 8-3 Households' Expected Inflation Rate <over the next 5 years>



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

Topic 3 : Price hikes are spreading to the service sector

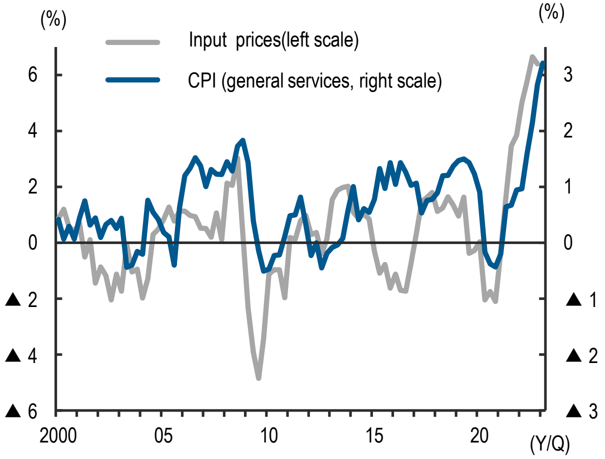
◆ Soaring raw material costs are the main factor

The trend of price increases now also extends to the service sector. Consumer prices for general services (excluding rent and policy factors) have risen more than 3% YoY for the first time since April 1993. This is due to higher raw material costs being passed on to prices. According to estimates based on input-output tables, wages, and corporate goods prices, input prices in the service sector are currently more than 5% higher than a year ago. This is the largest increase in the past 20 years. It reflects the soaring prices of intermediate inputs of goods and services. In the service sector, personnel expenses account for 50% of intermediate inputs, while goods, such as foodstuffs, make up about 20%. Electricity and gas as a percentage of inputs is the same as in other industries. Rates of price increases are high in food service and housing-related services, sectors that use a lot of these goods and services as inputs.

◆ Future wage hikes will put upward pressure on prices

Higher personnel expenses are expected to be the main factor putting upward pressure on service prices going forward. In the service sector, while demand is rebounding from the COVID pandemic, employment levels have not fully recovered and the labor market is tight. For example, in the food/beverage service sector, the growth of hourly wages for non-regular employees has accelerated to over 5% YoY. During the shunto, it is likely that base pay will be hiked more than in typical years, especially at large corporations, so wages of regular employees are expected to rise. Therefore, there is a possibility that price hikes will spread beyond food service and housing-related services to other parts of the service sector in the future.

Figure 9-1 Input Prices and Consumer Prices of Services, % of Previous Year

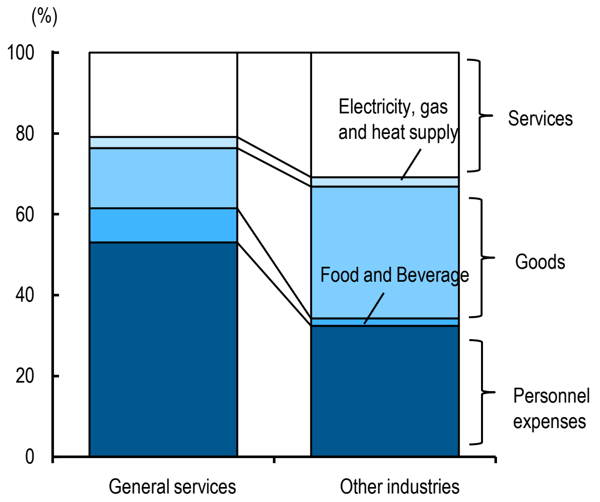


Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications, The Bank of Japan.

Note1: Input prices are calculated by multiplying input weights in the input-output table by the rate of change in prices and wages. Target industries are education and research, medical care and welfare, and personal services.

Note2: Input prices are calculated by multiplying input weights in the input-output table by the rate of change in prices and wages. Target industries are education and research, medical care and welfare, and personal services.

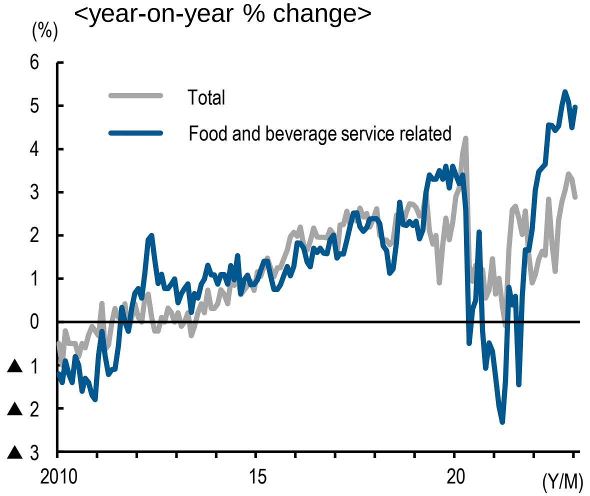
Figure 9-2 Breakdown of Intermediate Inputs



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

Note1: General services include education and research, health and welfare, and personal services.

Figure 9-3 Average Hourly Wage at the Time of Recruiting Part-timers and Part-timers <year-on-year % change>



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

Note1: Data for three major metro/politan areas.

Japan economic forecast: FY22: +1.4%, FY23: +1.5%, FY24: +1.3%

◆ The normalization of economic activity will boost the economy

Looking ahead, Japan's economy is expected to recover, mainly due to rebound demand in the service sector, as economic activity normalizes further. The recovery in personal consumption appears set to continue as the trend of refraining from consumption-related activities fades away. During this year's shunto, it is likely that base pay will be hiked more than in typical years, especially at large corporations, and the higher wages are expected to offset the impact of rising prices. Inbound tourism demand is also expected to continue to increase. As the rules are eased on both the Japanese and Chinese sides, the number of Chinese visitors to Japan should recover in earnest. However, a slowdown in overseas economies, and those of Western countries in particular, is expected to weigh on the Japanese economy. Goods exports are likely to lack strength, and capital investment in the manufacturing sector is likely to be restrained.

◆ The growth rate for FY2023 will be +1.5%

The growth rates for FY2022 and FY2023 are expected to be strongly positive at +1.4% and +1.5%, respectively, as the economy rebounds from the COVID pandemic. In FY2024, the growth rate is projected to be +1.3%, above the potential growth rate, which is in the mid-0% range.

◆ Moves to pass on prices are spreading to downstream industries

The core CPI in January was up 4.2% YoY, rising at their highest rate in 41 years. Price growth accelerated from the previous month, with a reduction in the government's nationwide travel discounts a contributing factor. Core inflation is expected to slow from February onward. The main reason is that measures to reduce the burden of rising electricity and gas bills will push down energy prices. However, BoJ Core CPI growth, which excludes energy and fresh food, is likely to increase at an accelerated pace until the spring. The background to this is the fact that moves to pass on prices are spreading to downstream industries. Prices of consumer goods traded between businesses continued to rise fast, with the YoY increase hitting 7.2% in January. In response to these higher procurement costs, April of this year will likely see a rush of price hikes by retailers. In the second half of 2023, inflationary pressure from higher wages will gradually mount, though price increases stemming from higher resource prices are expected to subside.

Figure 10 Projections for GDP Growth and Main Indicators of Japan (as of March 13, 2023)

		CY2023				CY2024				CY2025	FY2022	FY2023	FY2024
	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	0.1	3.9	1.8	1.2	1.1	1.3	1.3	1.5	1.6	1.7	1.4	1.5	1.3
Private Consumption Expenditure	1.3	2.8	2.4	1.2	1.0	1.2	1.5	1.6	1.6	1.7	2.5	1.7	1.4
Housing Investment	▲ 0.0	3.0	2.5	0.8	0.2	0.0	▲ 0.1	0.0	▲ 0.1	0.0	▲ 4.3	1.3	0.1
Business Fixed Investment	▲ 2.0	0.8	1.5	2.8	3.2	3.0	2.8	2.7	2.6	2.6	2.8	1.8	2.8
Private Inventories (percentage points contribution)	(▲ 2.1)	(0.7)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	(▲ 0.1)	(▲ 0.0)
Government Consumption Expenditure	1.0	0.2	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.0	1.1	0.2	0.0
Public Investment	▲ 1.2	3.0	3.0	1.6	1.4	1.2	1.2	1.0	0.8	0.8	▲ 3.4	1.9	1.1
Net Exports (percentage points contribution)	(1.4)	(1.3)	(▲ 0.1)	(▲ 0.2)	(▲ 0.1)	(▲ 0.0)	(▲ 0.2)	(0.1)	(0.1)	(0.2)	(▲ 0.5)	(0.1)	(▲ 0.0)
Exports of Goods and Services	6.0	1.3	1.6	1.5	1.8	2.3	2.0	3.3	3.5	4.0	5.3	2.6	2.6
Imports of Goods and Services	▲ 1.6	▲ 3.8	2.0	2.2	2.1	2.3	2.4	2.5	2.5	2.6	7.4	1.7	2.4

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

Nominal GDP	1.6	4.0	3.1	4.3	3.9	2.6	2.6	3.0	2.5	2.8	2.1	3.5	2.7
GDP deflator	1.2	2.0	1.8	2.6	2.0	1.2	1.4	1.7	1.1	1.2	0.6	1.9	1.4
Consumer Price Index (excluding fresh food)	3.8	3.6	2.6	1.6	1.6	2.1	2.3	2.5	1.5	1.4	3.1	2.0	1.9
Unemployment Rate (%)	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.3	2.2	2.2	2.5	2.3	2.2
Exchange Rates (JY/US$)	141	133	133	131	129	128	126	124	122	122	136	130	124
Import Price of Crude Oil (US$/barrel)	99	86	88	90	90	92	92	91	90	89	102	90	91

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.