

Monthly Report of Prospects for Japan's Economy July 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 June 2023 issue of the original Japanese version.

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The General Situation – The economy is gradually recovering

Figure 1-1 Economic Activity

Both coincident and leading indices of business conditions are weak.

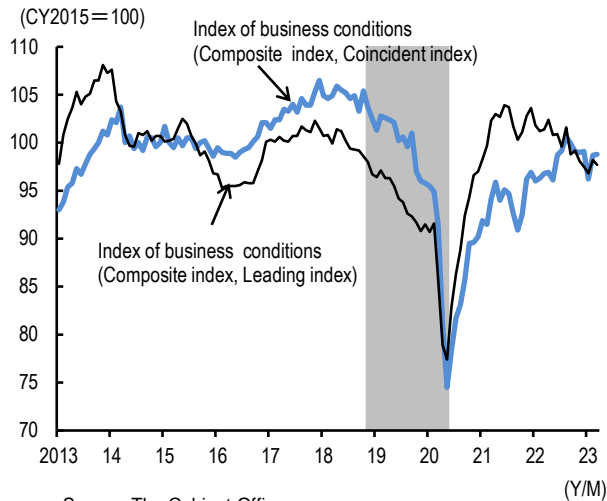


Figure 1-2 The Corporate Sector

Industrial production is showing signs of picking up.
Tertiary industry activity is recovering.

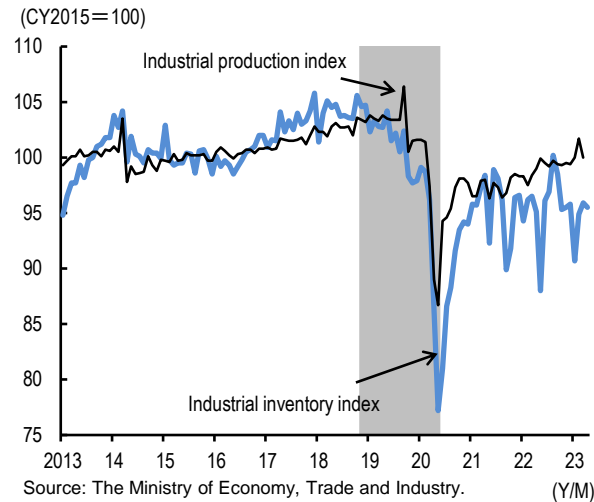


Figure 1-3 Overseas Demand

Both exports and imports are picking up following a substantial decline.

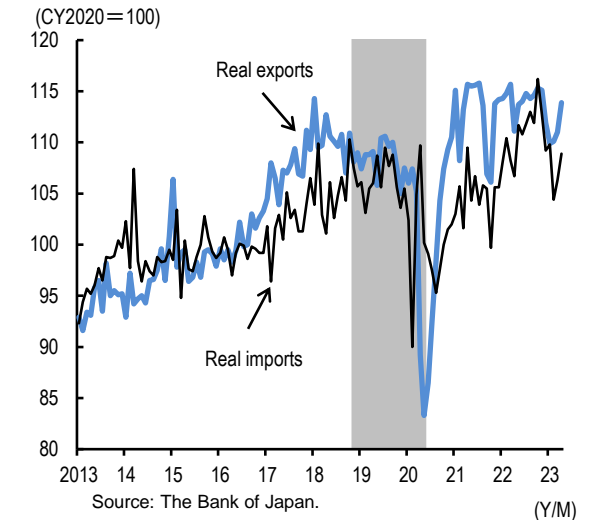
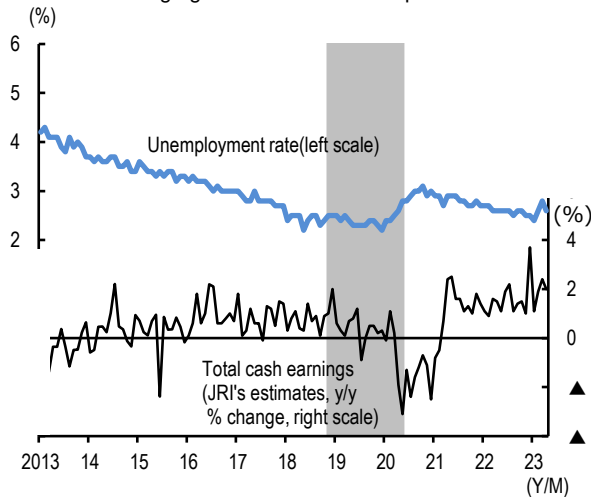


Figure 1-4 Employment and Income

The unemployment rate is hovering around the mid-2% range
Nominal wage growth is below that of prices.



* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

Consumption is fluctuating, but gradually rising overall.
Housing starts have decreased recently.

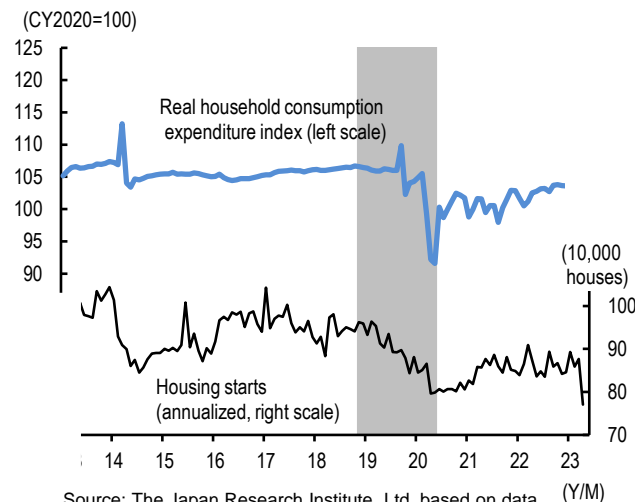
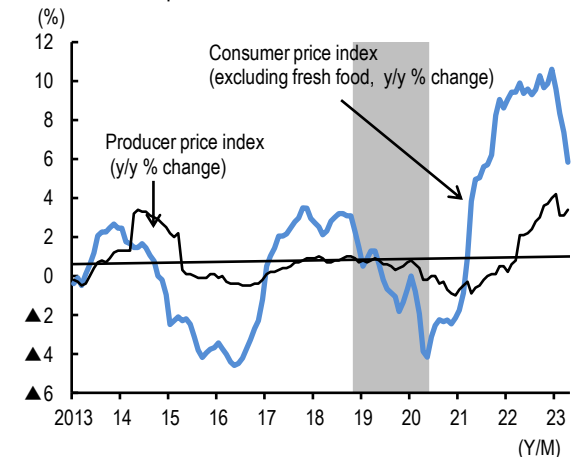


Figure 1-6 Prices

Corporate price inflation is slowing.
Consumer price inflation remains above 3%.



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Growth in the January-March quarter was positive for the first time in three quarters

◆ Real GDP increased as domestic demand climbed in a broad range of categories

Real GDP growth in the January-March 2023 quarter was +1.6% quarter on quarter on an annualized basis, the first positive growth in three quarters. While exports of goods fell sharply due to the slowdown in overseas economies, domestic demand, including private consumption and capital investment, increased in a wide range of areas as the Japanese economy returned to normal. The positive contribution of private consumption, especially for services and automobiles, was an especially big factor.

◆ The economic slowdown overseas is weighing on the manufacturing sector

In April, the Industrial Production Index fell for the first time in three months, dropping 0.4% from the previous month. By industry, the automobile sector boosted production as supply constraints eased. Output in the production machinery sector,

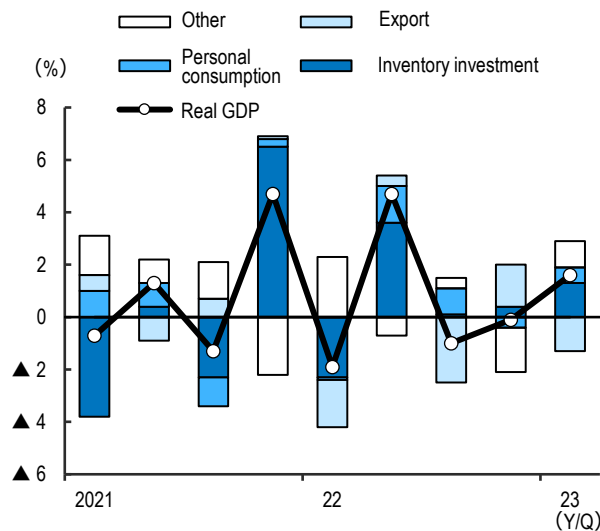
however, decreased, with semiconductor and display manufacturing equipment the main area of decline as orders from Japan and overseas dropped due to sluggish demand for chips.

Near-future production plans indicate increases in output in May (+1.9% month on month (MoM)) and June (+1.2% MoM). Although these plans call for higher output across a wide range of sectors, it is unlikely that the output increase will be as high as planned, as the slowdown in overseas economies will put downward pressure on production.

◆ Business confidence in the non-manufacturing sector is recovering

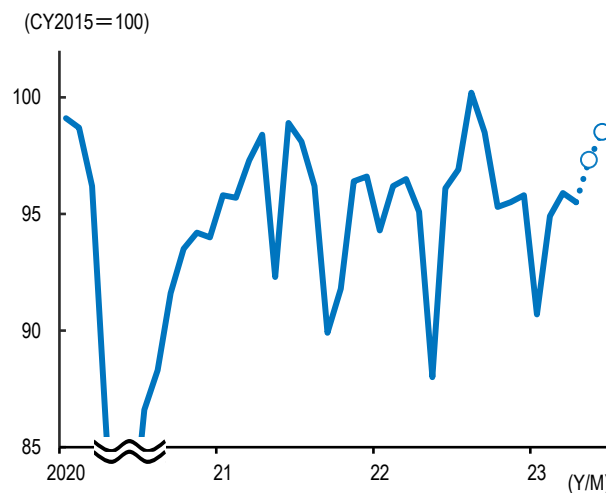
The diffusion index (DI) for current business conditions in the Economy Watchers Survey for April was 54.6, up for the third consecutive month. Breaking this down, the household activity-, corporate activity-, and employment-related DIs all rose. The corporate activity-related DI for the non-manufacturing sector improved on the back of factors such as a recovery in inbound tourism demand.

Figure 2-1 Real GDP Growth Rate



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

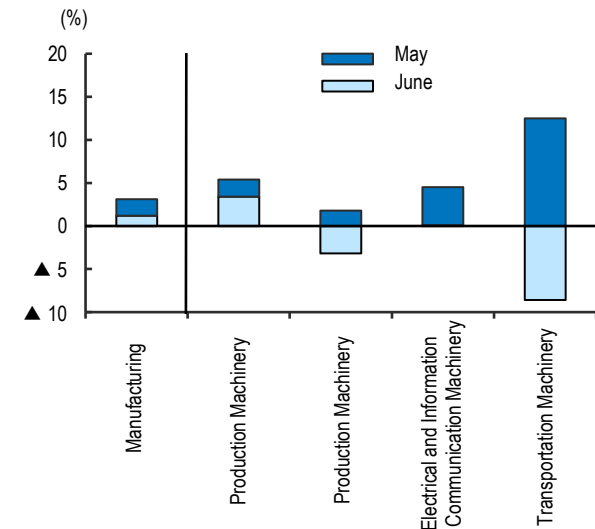
Figure 2-2 Industrial Production Index



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 (May and June).

Figure 2-3 Production Plan by Industry <MoM>



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

Goods exports are picking up, and inbound tourism demand continues to recover

◆ Exports of transportation machinery are bouncing back

Real exports increased from the previous month. A pickup in automobile exports due to the easing of supply constraints boosted overall goods exports. However, exports of electronic components and devices remained weak due to a cyclical decline in semiconductor demand, and exports of capital goods also stayed at low levels.

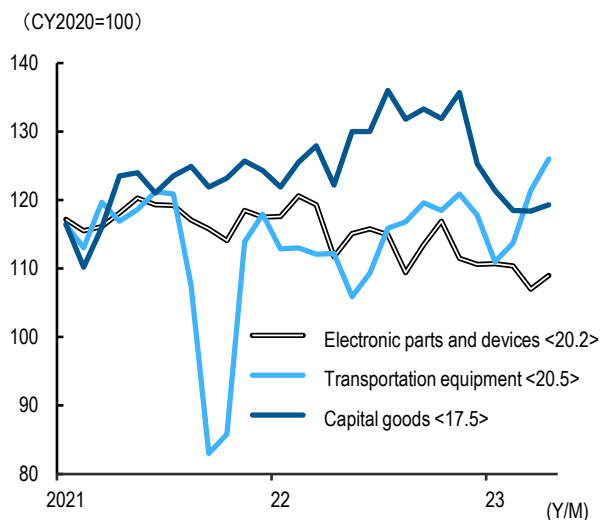
Looking ahead, goods exports are expected to be lackluster, against a backdrop of weak global demand for goods. The new export orders index in the manufacturing PMI remained below 50, which is the dividing line between improvement and deterioration. However, a significant decline is expected to be avoided as exports of transportation machinery, production of which is expected to continue to increase, will provide support.

◆ The number of foreign visitors to Japan continues to recover

The number of foreign visitors to Japan in April rebounded to just under 70% of the 2019 level. Although the number of tourists from China has been slow to recover, reaching only about 20% of the pre-COVID level, visitors from East Asian countries other than China and the U.S. are increasing. Per-person spending by visitors to Japan has risen on the back of a weak yen and the release of pent-up demand, and inbound tourism spending has recovered rapidly to approximately 90% of the pre-COVID level.

Going forward, inbound tourism demand is expected to continue its recovery. The Japanese government lifted its COVID-related controls on entrants in April. At present, the Chinese government has yet to abolish its restrictions on group travel to Japan, but direct flights between China and Japan are gradually being resumed, so the number of Chinese tourists should begin to recover.

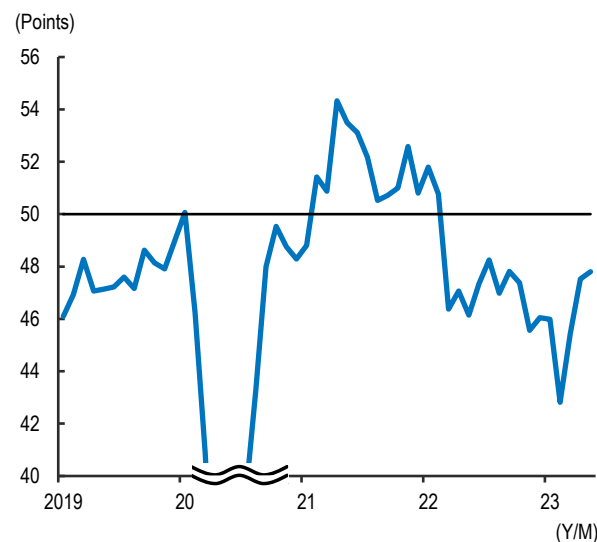
Figure 3-1 Real Export by Area
<seasonally adjusted>



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

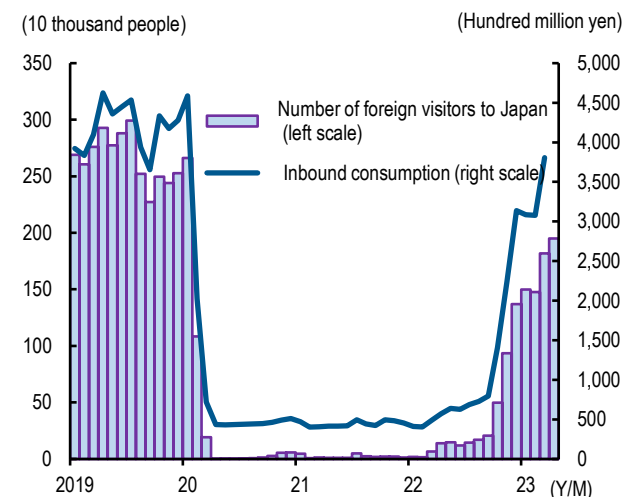
Note: <>Figures in parentheses represent the share of total nominal exports in 2022.

Figure 3-2 New Export Orders Index



Source: The Japan Research Institute, Ltd. based on data of The S&P Global.

Figure 3-3 Number of Foreign Visitors to Japan and Inbound Consumption



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

Note: Inbound consumption is travel receipts in the balance of payments.

Capital investment will increase in the near term thanks to strong corporate earnings

◆ First increase in profits in three quarters

According to the Financial Statements Statistics of Corporations, ordinary profit for the January-March quarter increased 6.2% from the previous quarter across all industries, the first rise in three quarters. In the manufacturing sector, non-operating income, such as interest and dividend income, climbed significantly, despite a decline in revenue due to sluggish external demand. As for the non-manufacturing sector, earnings increased especially in face-to-face services, thanks to the resumption of economic activities after the COVID pandemic.

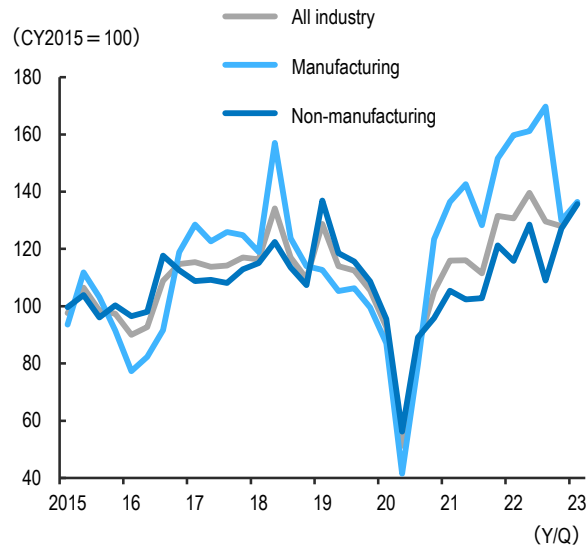
And the outlook is for continued high levels of corporate earnings overall. While the slowdown in overseas economies will put downward pressure on earnings in the manufacturing sector, non-manufacturing earnings are expected to rise in response to a recovery in private consumption and inbound tourism demand.

◆ Appetite for capital investment remains strong

Capital investment is slowly increasing. According to the Financial Statements Statistics of Corporations, capital investment (including software) in January-March was up 2.3% quarter on quarter, rising for the fourth quarter in succession. The pace of increase accelerated from the previous quarter in the manufacturing sector, while in the non-manufacturing sector, a substantial rise was seen in face-to-face services, where demand is recovering.

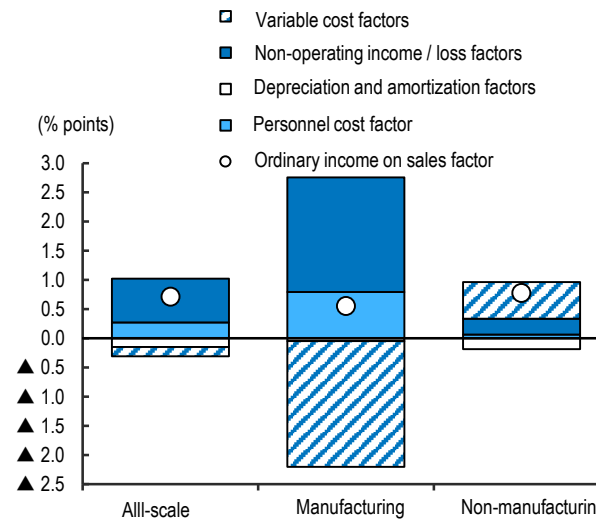
Capital investment is also expected to increase going forward. According to the Bank of Japan's March Tankan survey, planned capital investments (including software but excluding land) for FY2023 are 5.6% higher than in the previous year, indicating higher growth than usual. Software investment will continue to drive growth, as the appetite for capital investment in labor-saving and digitalization is strong.

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



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

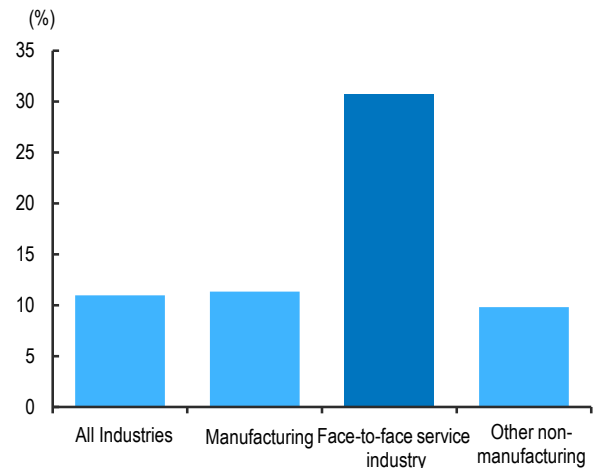
Figure 4-2 Factor Decomposition of Changes in Ratio of Ordinary Income to Net Sales



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

Note: All sizes and all industries (excluding finance and insurance). Difference between Jan-Mar 2023 and Jan-Mar 2018.

Figure 4-3 Capital Investment
<including software, y/y>



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

Note: Face-to-face service industry includes lodging, food services, lifestyle-related services, and entertainment.

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The employment situation is improving

◆ The number of workers is rising

The employment situation is improving. The unemployment rate for February was 2.6%, up from the previous month. The rise was mainly due to increases in the numbers of new job seekers and people quitting their jobs for personal reasons in the wake of the COVID pandemic. The labor market is tight, with the proportion of vacancies filled dropping to 11.8% in February, well below the pre-COVID level. Construction-related and sales workers are in especially short supply.

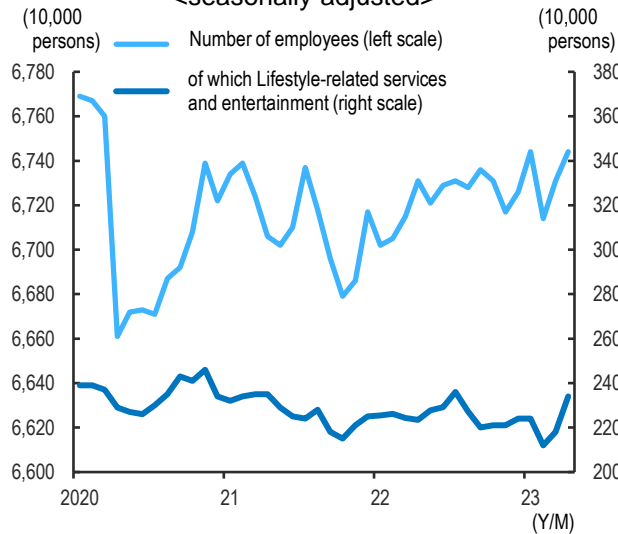
The labor supply-demand crunch is expected to intensify further in the future as economic activity normalizes. The labor participation rate has already risen beyond its pre-COVID level, limiting the scope for fresh supplies of labor from new labor-market participation by women and the elderly.

◆ Wage hikes are becoming more widespread

Total cash payrolls in April increased 2.0% year over year (YoY). The rate of increase in basic salaries, especially for regular employees, edged up. This was likely due in part to the wage hikes agreed during this year's shunto spring wage offensive being implemented at some companies. However, they did not keep pace with the rate of price increases, with real wages falling 3.0% for the 13th consecutive month of negative growth.

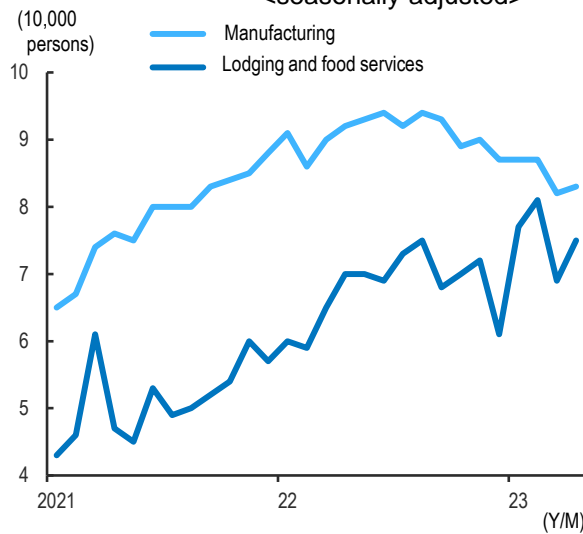
Going forward, real wage growth is expected to turn positive. Given the deepening labor shortages and rising prices accompanying the normalization of economic activities, basic salaries for regular employees are likely to rise in 2024 as many companies increase base pay. Wages for non-regular workers also look set to climb due to the growing labor shortage and the government's goal of achieving a minimum wage of 1,000 yen per hour.

Figure 5-1 Number of Workers
<seasonally adjusted>



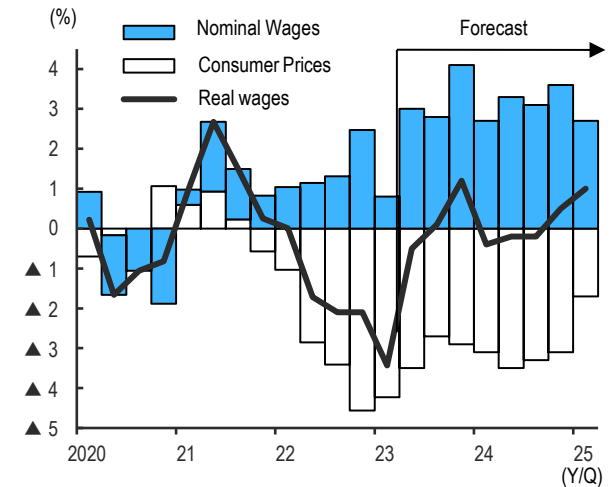
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Figure 5-2 New Job Openings
<seasonally adjusted>



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

Figure 5-3 Real Wage Forecast<YoY>



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

Private consumption is on the recovery track, but will be funded by excess savings for the time being

◆ Private consumption is gradually recovering

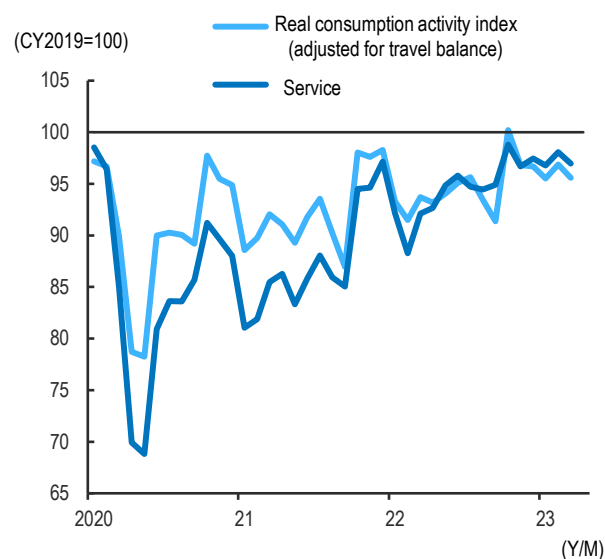
Private consumption remains on the recovery track. Services consumption, including dining out and travel, is driving the rebound. With the lifting of activity restrictions, events of various types are being revived for the first time since before the COVID pandemic, so more people are getting out and about. The number of domestic travelers during the Golden Week period recovered to the pre-COVID level. And in food service, people are steadily returning to restaurants. Goods consumption is also holding firm. Department store sales to domestic customers remain robust, and the number of automobiles sold is recovering as supply constraints ease.

◆ Consumer confidence is improving

Private consumption, particularly of services, is expected to continue its gradual recovery going forward. For the time being, rising prices will reduce the purchasing power of households, but the excess savings built up during the COVID pandemic will fund consumption. Excess savings have been accumulated mainly by high-income households. Even over the longer term, rising wages are expected to support consumption.

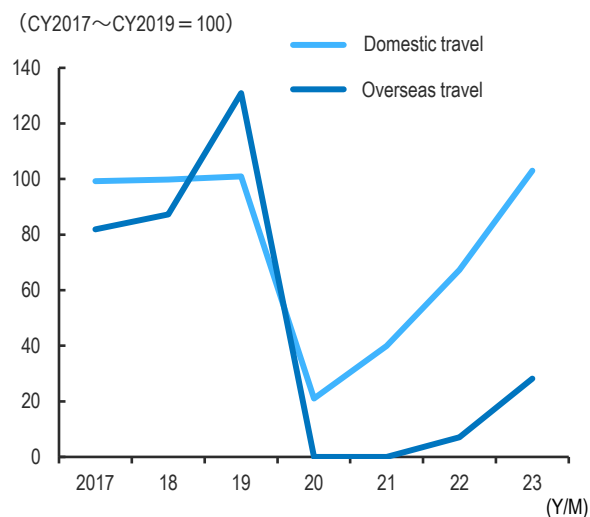
Improved consumer confidence will also help consumption rebound. In May, the Consumer Confidence Index was 36.0, so it has continued to recover from the bottom recorded in November last year. The improvement was driven especially by the perception index for employment, reflecting the normalization of economic activity.

Figure 6-1 Consumption Activity Index



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

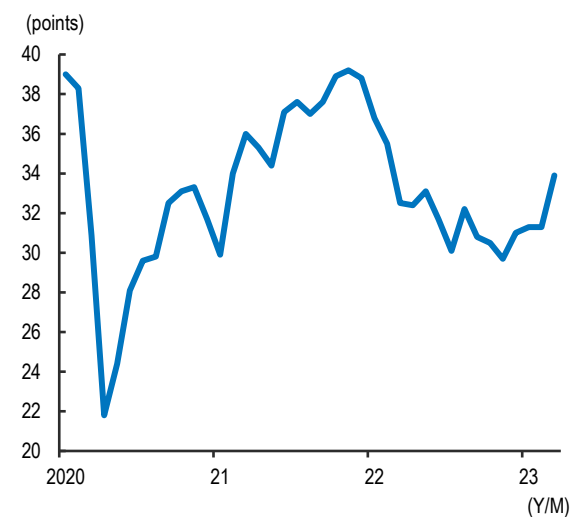
Figure 6-2 Number of Travelers During GW



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

Note: Estimates based on questionnaire surveys, etc.

Figure 6-3 Consumer Attitude Index



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

Topic: Services drive recovery in consumer spending

◆ Wage increases will support services consumption in the near term

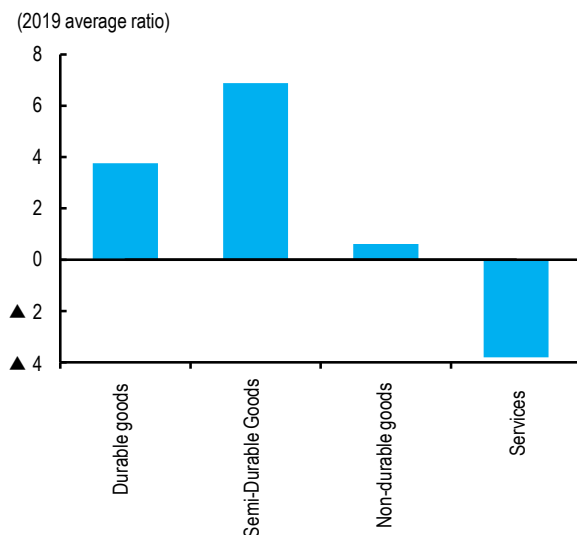
In Japan, where the resumption of economic activity has been slower than in Western countries, private consumption is still recovering from the COVID pandemic. The services component of consumption is particularly worthy of attention. Services consumption is currently 4% below the pre-COVID level (2019), so there is still plenty of room for growth. As economic activity continues to normalize further, rebounded demand for food/beverage service and lodging is expected to drive a recovery in private consumption. And even after this rebounded demand peters out, the recovery in consumer spending should be maintained, especially in services, supported by wage increases. According to estimates, increases in real income have a greater effect on services consumption than goods consumption.

◆ Changes in lifestyles and behaviors are also creating headwinds

However, it is unclear whether services consumption can return to its pre-pandemic trend. Even in the U.S., where the normalization of economic activity occurred earlier, services consumption has not returned to its trend before COVID.

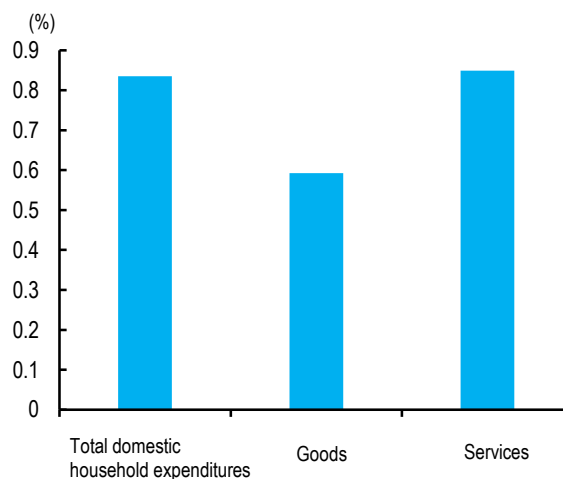
Changes in consumers' lifestyles and behaviors due to the pandemic can be pointed to as a background factor. A breakdown of U.S. services consumption reveals that the recovery in transportation and entertainment is lagging. With remote working taking root, a good many workers have not gone back to the commuting lifestyle, and the return of customers to movie theaters and other entertainment facilities has been slow due to the popularity of subscription-based video streaming services. In some respects, this situation also applies to Japan, and services consumption trends may turn out to be similar to those of the U.S.

Figure 7-1 Domestic Household Real Consumption Expenditure by Form <Jan-Mar>



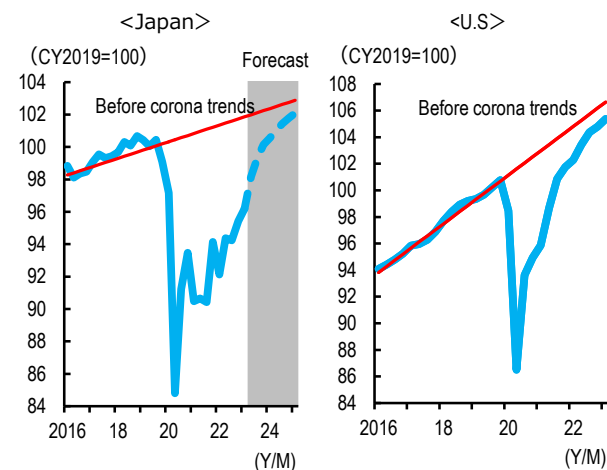
Source: The Japan Research Institute, Ltd. based on data of The Cabinet office.

Figure 7-2 Impact of a 1% Increase in Real Income on Personal Consumption



Source: The Japan Research Institute, Ltd. based on data of The Cabinet office.
Note: The estimation period is from January-March 2000 to October-December 2019.

Figure 7-3 Real Services Consumption in Japan and U.S.



Source: The Japan Research Institute, Ltd. based on the data of The Cabinet office, U.S. Department of Commerce.

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

◆ Wage increases will also boost domestic demand

Looking ahead, Japan's economy is expected to continue to slowly recover in the near term, driven by rebounded demand. Private consumption should increase, especially for food/beverage service, lodging, and other services. Although rising prices are reducing the purchasing power of households, the excess savings built up during the COVID pandemic will fund consumption. Inbound tourism demand is also expected to continue its recovery. Visitors from China have so far not yet returned in numbers, but they are likely to do so with the resumption of direct flights between Japan and China.

Even after rebounded demand fades, the recovery trend is expected to continue, led by domestic demand. Wage increases driven by factors such as labor shortages will support private consumption. Capital investment should rise, with software investment for labor-saving and digitalization the main target of spending.

However, the slowdown in overseas economies will weigh on Japan's economy. Goods exports will lack strength, and investment in capacity expansion in the manufacturing sector is expected to be restrained.

◆ The growth rate for FY2023 will be +1.4%

Growth is expected to be +1.4% in FY2023 and +1.3% in FY2024, remaining above the potential growth rate, which is in the mid-0% range.

◆ Prices are going up across the board

In April, core inflation accelerated from the previous month to 3.4%. While the rate of decline in energy prices increased, the start of the new fiscal year in Japan prompted price hikes for many goods, particularly food items. Moves to pass on higher costs expanded, not just in goods but also in services.

Looking ahead, core CPI growth is expected to slow. Price rises driven by upstream pressures have already passed their peak, so price hikes caused by high raw material prices should gradually subside. Going forward, moves to pass on higher wages to selling prices will gather momentum, and prices of services are expected to rise even faster.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of June 6, 2023)

(%, changes from the previous fiscal year)

	1~3	CY2023				CY2024				CY2025	FY2022	FY2023	FY2024
		4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3		(Actual)	(Projection)	
		(Projection)											
Real GDP	1.6	2.7	1.8	1.5	1.3	1.2	1.3	1.2	1.3		1.2	1.4	1.3
Private Consumption Expenditure	2.4	2.3	2.2	1.6	1.4	1.3	1.3	1.2	1.2		2.4	1.8	1.4
Housing Investment	0.7	1.5	0.8	0.2	0.0	▲ 0.1	0.0	▲ 0.1	0.0		▲ 4.4	0.7	0.1
Business Fixed Investment	3.8	3.0	2.8	3.2	3.0	2.8	2.7	2.6	2.6		3.0	2.6	2.8
Private Inventories (percentage points contribution)	(▲ 0.4)	(▲ 0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)		(▲ 0.1)	(▲ 0.1)	(0.0)
Government Consumption Expenditure	▲ 0.0	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.0		1.1	0.2	0.1
Public Investment	10.1	1.0	1.6	1.4	1.2	1.2	1.0	0.8	0.8		▲ 2.6	3.0	1.1
Net Exports (percentage points contribution)	(▲ 1.3)	(▲ 0.7)	(▲ 0.1)	(▲ 0.1)	(▲ 0.1)	(▲ 0.2)	(▲ 0.0)	(0.0)	(▲ 0.1)		(▲ 0.6)	(▲ 0.1)	(▲ 0.1)
Exports of Goods and Services	▲ 15.6	6.5	2.4	2.3	2.3	2.0	2.9	3.1	3.4		4.4	0.8	2.5
Imports of Goods and Services	▲ 9.0	2.7	2.3	2.3	2.5	2.5	2.6	2.5	2.6		7.1	1.1	2.5

(% changes from the previous fiscal year)

(% changes from the same quarter of the previous year)												
Nominal GDP	3.4	3.3	5.0	4.6	3.8	3.1	2.9	2.4	2.6	1.9	4.2	2.8
GDP deflator	2.0	2.6	3.6	3.0	1.9	1.7	1.6	1.2	1.3	0.7	2.8	1.5
Consumer Price Index (excluding fresh food)	3.5	2.9	2.2	2.4	2.7	3.1	2.9	1.8	1.5	3.0	2.6	2.3
Unemployment Rate (%)	2.6	2.6	2.5	2.5	2.4	2.3	2.3	2.3	2.2	2.6	2.5	2.3
Exchange Rates (JY/US\$)	132	137	136	134	132	131	129	127	125	135	135	128
Import Price of Crude Oil (US\$/barrel)	87	83	83	86	88	85	86	84	83	103	86	85

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.