

Monthly Report of Prospects for Japan's Economy

August 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 July 2023 issue of the original Japanese version.

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The General Situation – The economy is gradually recovering

Figure 1-1 Economic Activity

The coincident index of business conditions is improving, and the leading index has stopped falling.

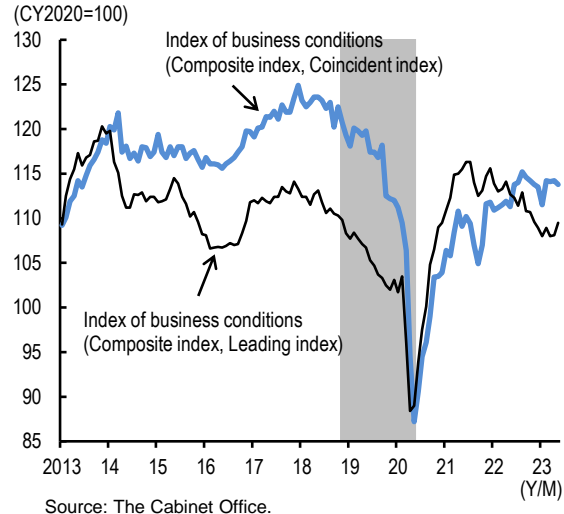


Figure 1-2 The Corporate Sector

Industrial production is slowly picking up. Tertiary industry activity is recovering.

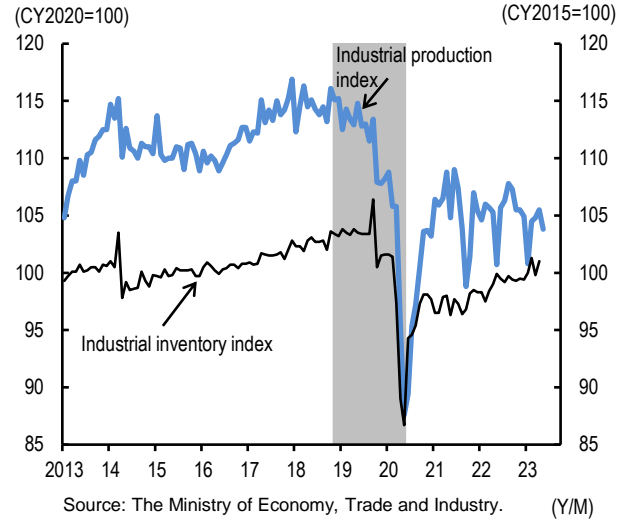


Figure 1-3 Overseas Demand

Exports, particularly to Asia, are falling. Imports from Asia have been decreasing recently.

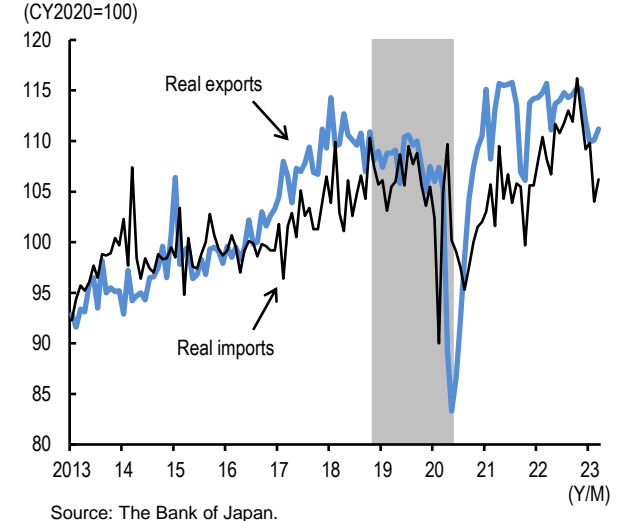


Figure 1-4 Employment and Income

The unemployment rate is hovering around the mid-2% range. The rate of nominal wage growth is gradually rising.

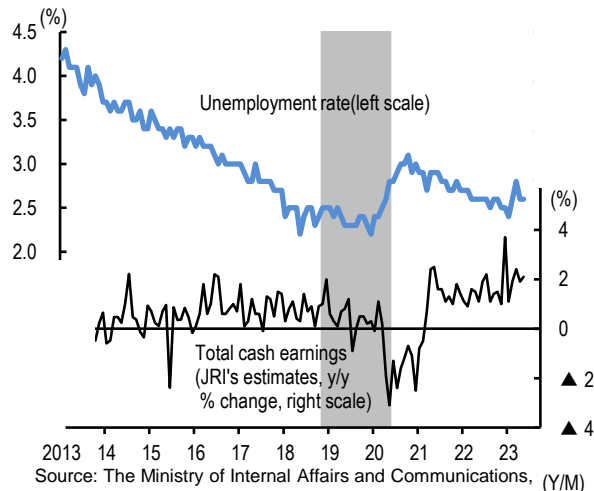


Figure 1-5 The Household Sector

Consumption is fluctuating, but gradually rising overall. Housing starts have picked up following a significant decline.

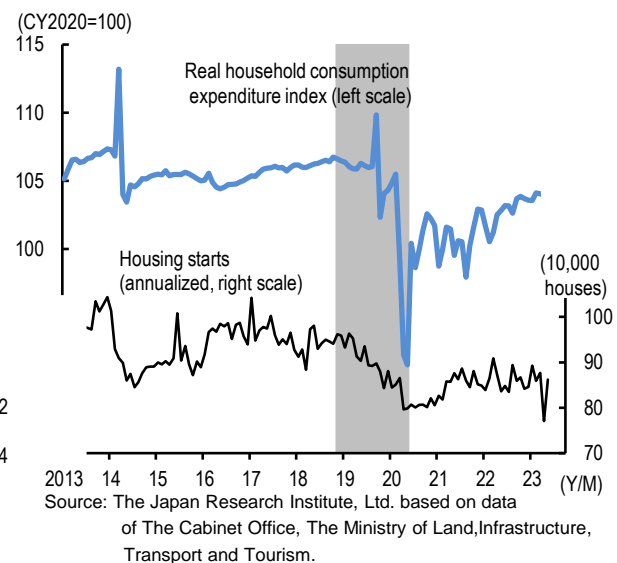
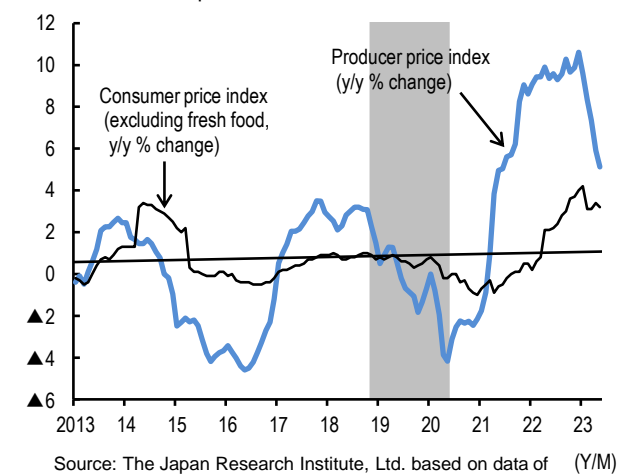


Figure 1-6 Prices

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



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* The shaded area indicates the recession phase.

Business confidence among large manufacturers has improve for the first time in seven quarters

◆ Business confidence is improving in both the manufacturing and non-manufacturing sectors

In the Bank of Japan's June Tankan survey, the diffusion index (DI) for business conditions for large manufacturing enterprises increased by four percentage points, rising for the first time in seven quarters. Looking at each industry, business confidence in the automobile industry turned positive thanks to the easing of component shortages, and that in the materials industry also picked up as raw materials prices fell.

The business conditions DI for large non-manufacturing enterprises also rose for the fifth consecutive quarter, increasing by three percentage points. Business confidence in consumption-related sectors, especially lodging and food/beverage service, improved.

◆ Industrial production is slowly picked up

In May, the Industrial Production Index fell for the first time in four months,

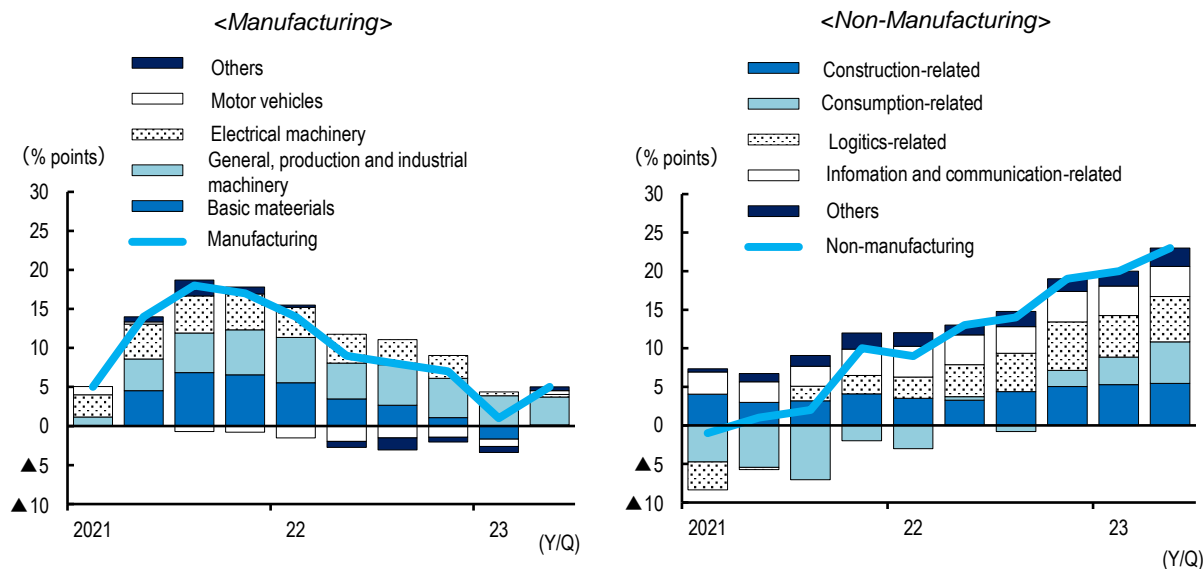
dropping 1.6% from the previous month, but overall, the figure is gradually picking up. Looking at each sector, while the recovery in automobile production paused, there were increases in output of production machinery and other transportation machinery.

Near-future production plans indicate an increase in output across a broad range of sectors in June (+5.6% month on month (MoM)). However, the plans call for reduced production in July (-0.6% MoM).

◆ Economic activity in the service sector is brisk

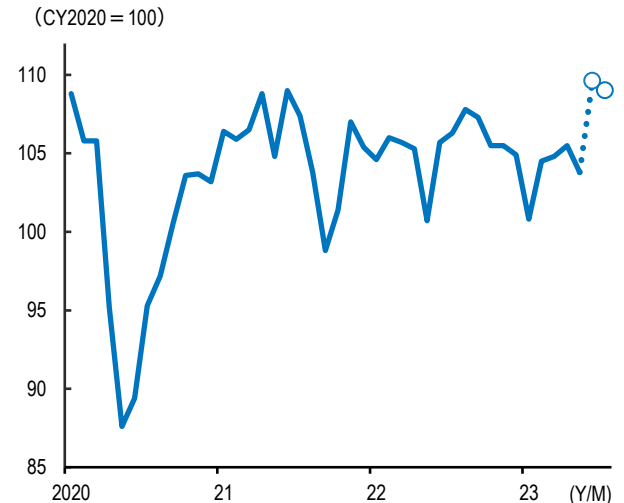
In April, the Tertiary Industry Activity Index rose for the first time in two months, increasing 1.2% from the previous month. Services for the manufacturing sector are seeing a rapid rebound. Breaking this down, the index for road freight transport bounced back from a slump in the previous month. And services for the non-manufacturing sector, such as information and communications, are also recovering steadily.

Figure 2-1 Contributions to the Business Conditions Diffusion Index by Industry Index by Industry
<the first preliminary estimate, on an annualized q/q changed basis>



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: Dotted lines are postponed based on the forecast index of manufacturing production (June and July).

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Goods export are sluggish, but inbound tourism demand continues to recover

◆ Exports of capital goods are falling

Real exports decreased from the previous month. While automobile exports continued to pick up thanks to the easing of supply constraints, capital goods exports dipped due to less appetite for capital spending worldwide. Exports of electronic components and devices also remained weak as a result of a cyclical decline in semiconductor demand.

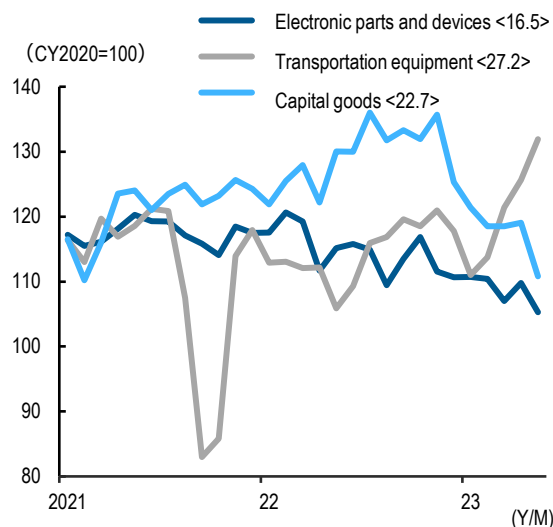
Looking ahead, goods exports are expected to be lackluster, against a backdrop of slowdowns in overseas economies. According to the Bank of Japan's Tankan survey, the DI for supply and demand conditions for large manufacturing enterprises is expected to remain negative (excess supply) in the near term. However, a significant decline in exports as a whole is expected to be avoided as continued increases in exports of transportation machinery will provide support.

◆ Per-person spending by visitors to Japan is also rising

The number of foreign visitors to Japan in May rebounded to 70% of the 2019 level. The bulk of the increase has been tourists from East Asian countries other than China and the U.S. Per-person spending by visitors to Japan is also far higher than it was before COVID. Prices in Japan have become less expensive for foreign tourists, resulting in longer stays and higher spending per day. Total spending by foreign visitors to Japan has already reached around 90% of the pre-COVID level.

Going forward, inbound tourism demand is expected to continue its recovery. Chinese visitors to Japan have been slow to return because of such factors as the Chinese government having yet to abolish its restrictions on group travel to Japan, but the number of Chinese tourists should gradually begin to recover.

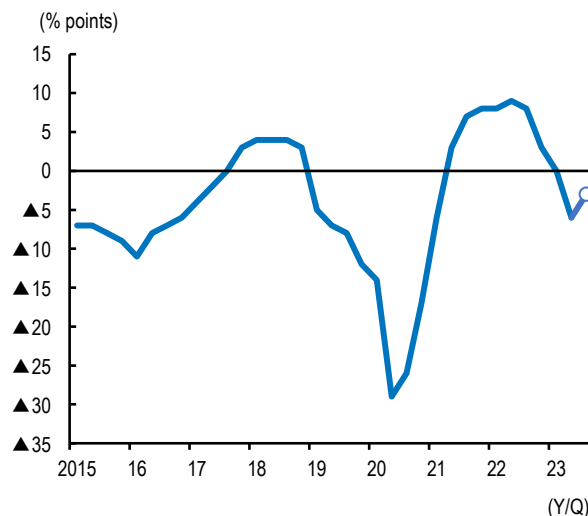
Figure 3-1 Real Exported by Item
<seasonally adjusted>



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

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

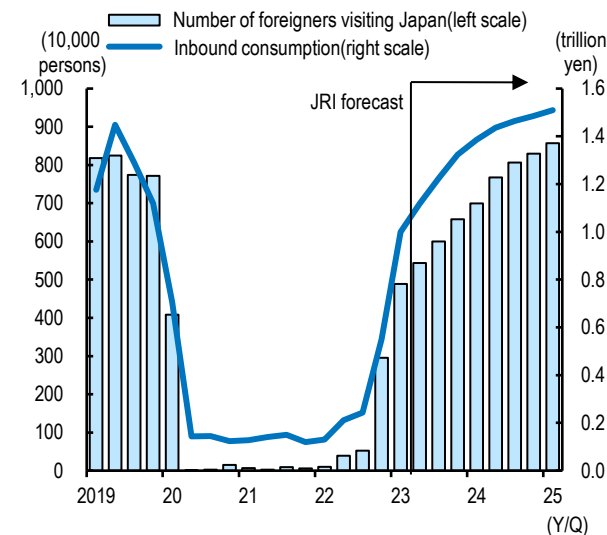
Figure 3-2 DI of Supply-Demand for Products
Manufactured Overseas



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

Note: Large company, manufacturing.
White markers indicate the outlook as of the March survey.

Figure 3-3 Outlook for Inbound Demand
<seasonally adjusted>



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

Note: Inbound consumption is travel service receipts in the Balance of Payment statistics.

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Capital investment is increasing as investment plans that had been postponed are executed and companies pursue digitalization

◆ 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.

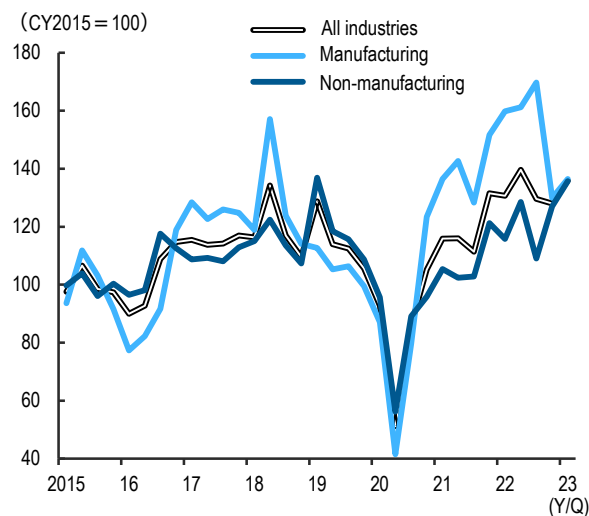
And the outlook is for continued high levels of corporate earnings overall. While the slowdown in overseas economies will put downward pressure on earnings in the manufacturing sector, non-manufacturing earnings are expected to rise in response to a recovery in private consumption and inbound tourism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

◆ Looking ahead, more and more investments that had been postponed will be executed

Capital investment is slowly increasing. Looking at capital investment by type, machinery investment continued to be weak, but software investment is brisk against the backdrop of increasing digitalization.

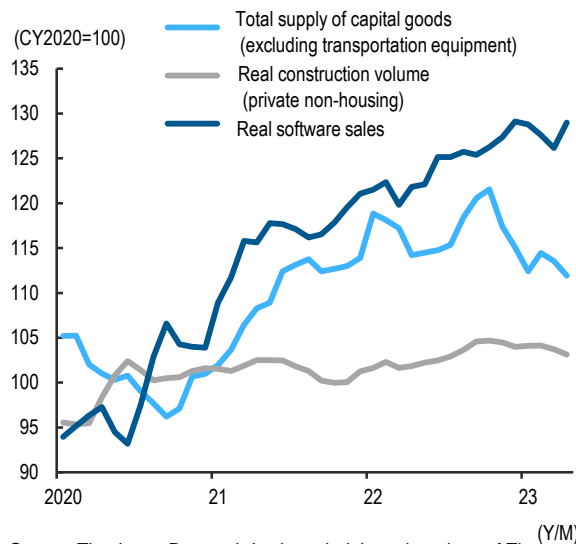
Capital investment is also expected to increase going forward. According to the Bank of Japan's June Tankan survey, planned capital investments (including software but excluding land) for FY2023 are 15.3% higher than in the previous year, indicating higher growth than usual. For the time being, capital investment is expected to be driven by projects that had been postponed due to supply constraints and rising investment costs. Capital investment for decarbonization, digitalization, and addressing labor shortages is also expected to increase.

Figure 4-1 Ordinary Income
<seasonally adjusted>



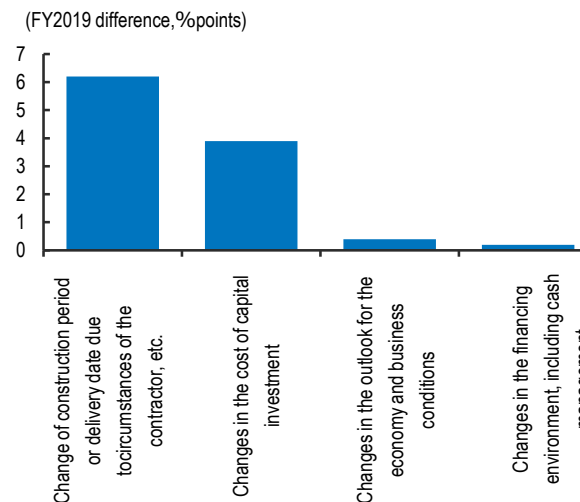
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.

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



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.
Note: Backward 3-month moving average.

Figure 4-3 Reasons for Deviations between Capital Investment Plans and Actual Forecasts



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

Note: Value in FY2022.

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The employment situation is improving, and real wage growth will turn positive soon

◆ The job market will tighten in the near term

The employment situation is improving overall. In May, the number of workers increased 0.2% year over year (YoY) for the 10th consecutive monthly rise. By industry, headcounts rose in face-to-face services and information and communications. The unemployment rate remained low at 2.6%. The job orders filling rate was 11.4%, well below the pre-COVID level. There is a serious shortage of construction workers and sales clerks.

Looking ahead, the job market is expected to become increasingly tight as economic activity normalizes. The potential for additional elderly and female workforce participation is diminishing.

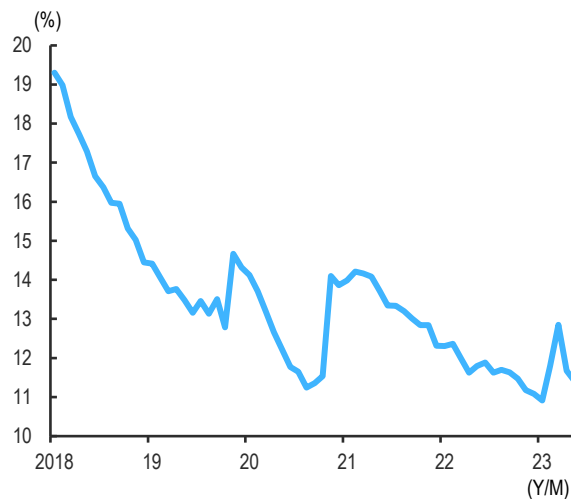
◆ Wage hikes are becoming more widespread

Total cash payrolls in May increased 2.3% YoY. Higher basic salaries for regular employees were the driver. This was likely due to the wage hikes agreed during this year's shunto spring wage offensive being implemented at some companies.

However, the rises did not keep pace with the rate of price increases, with real wages falling 1.4% for the 14th consecutive month of negative growth.

Looking ahead, the year-on-year drops in real wages should narrow and real wage growth should turn positive during 2024. Over the summer, more companies are expected to implement the wage hikes agreed at this year's shunto, and the basic salaries of regular employees look set to increase at a faster pace. Wages for non-regular workers also look set to climb due to the growing labor shortage and higher minimum wages. In addition, this summer's bonuses seem to have increased substantially, especially at large companies. According to data from Keidanren (Japan Business Federation), they were up 3.9% from the previous year, the second consecutive year of growth.

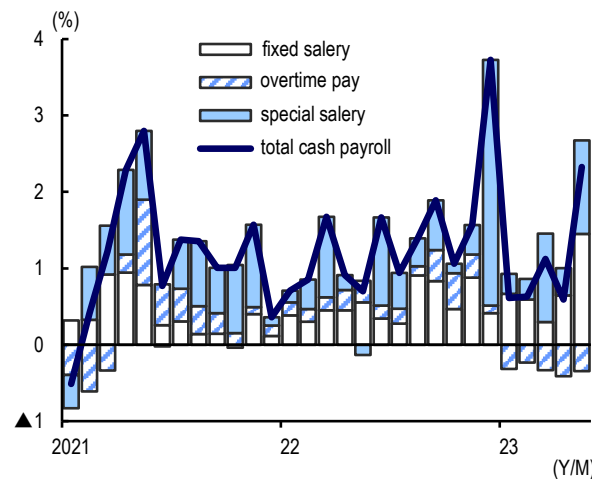
Figure 5-1 Job Fill Rate
<seasonally adjusted>



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

Note: Number of jobs / Number of new applicants
General workers including part-time workers.

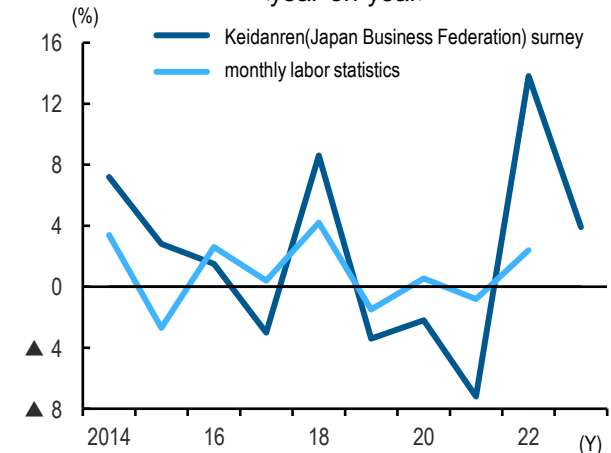
Figure 5-2 Contribution Decomposition of Nominal Wages



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

Note: Adjustment for data fault caused by the replacement of companies surveyed in January of each year.

Figure 5-3 Summer Bonus
<year-on-year>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Health, Labour and Welfare, Keidanren (Japan Business Federation).

Note: Keidanren (Japan Business Federation) survey for 2023 is preliminary.

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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. Events of various types are being revived for the first time since before the COVID pandemic, so more people are getting out and about. As a result, services consumption, e.g., dining out and travel, is gradually expanding. Retail sales at department stores and convenience stores are also firm as customers return. Furthermore, the number of automobiles sold is rising as supply constraints ease.

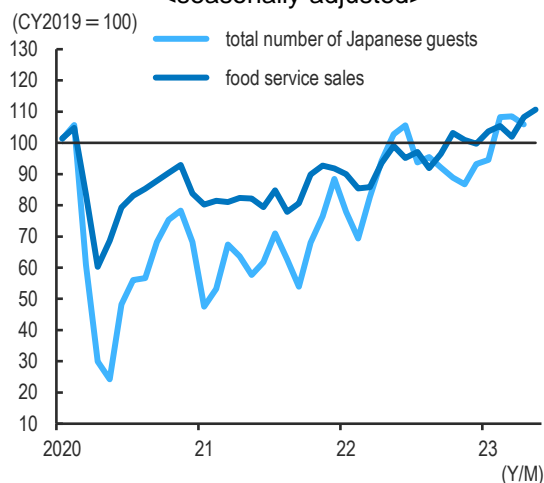
◆ Consumer confidence is improving

Private consumption is expected to continue its gradual recovery going forward. Excess savings accumulated during the COVID pandemic are equivalent to almost 10% of GDP. Although rising prices have reduced the purchasing power of households, the excess savings built up during the COVID pandemic should allow

private consumption to keep rising. For the time being, rebounded demand for services, such as lodging and food/beverage service, will drive the recovery. And even after this rebounded demand peters out, the recovery in consumer spending is expected to be maintained, especially in services, supported by wage increases.

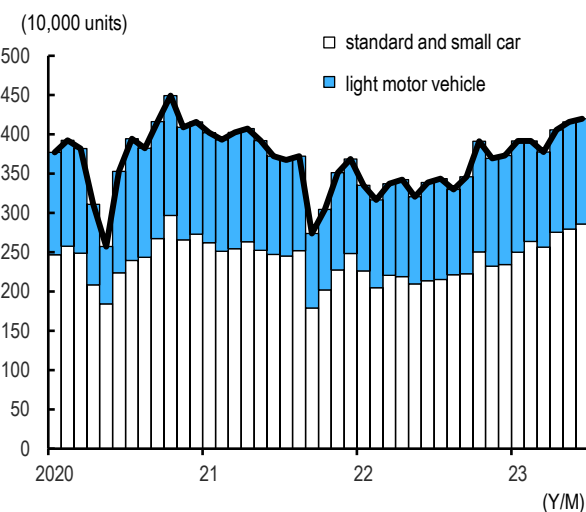
Improved consumer confidence will also help consumption rebound. In June, the Consumer Confidence Index improved from last winter. The improvement was driven especially by the perception index for employment, reflecting the normalization of economic activity. The perception index for income growth also rose as wage increases became more widespread.

Figure 6-1 Food Service Industry Sales and Number of Guests <seasonally adjusted>



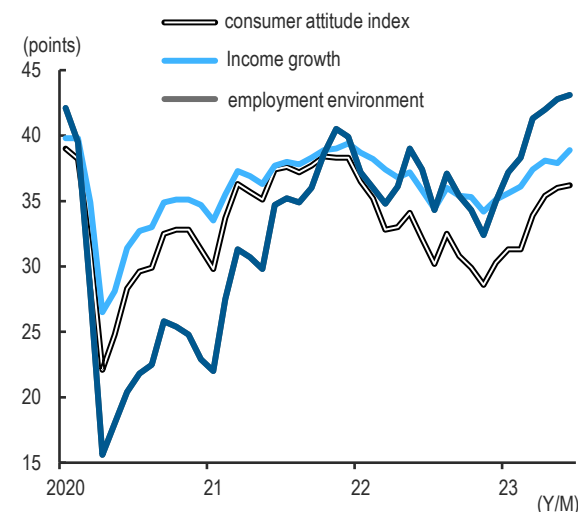
Source: The Japan Research Institute, Ltd. based on data of Japan Food Service Association, Japan Tourism Agency.
Note: Food service industry sales are substantiated using the Food Service CPI.

Figure 6-2 Number of New Car Registrations <annualized seasonally adjusted>



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

Figure 6-3 Consumer Attitude Index



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

Note: Income growth and employment environment are consumer attitude indicators that comprise the Consumer Attitudes Index.

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Topic : Impact of export restrictions on semiconductor manufacturing equipment

◆ It seems that only a few products will be subject to controls

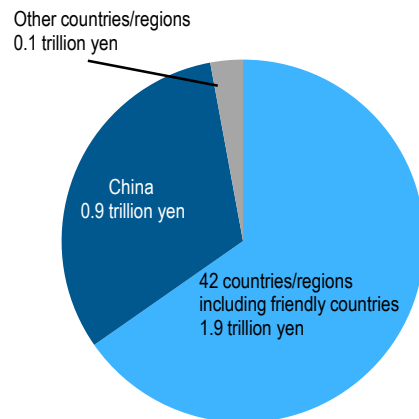
The Japanese government has added 23 semiconductor manufacturing equipment items to its list of products subject to export restrictions. Beginning in July, exports of these products to countries/territories other than friendly countries will require government permission on a transaction-by-transaction basis. The countries/territories for which such permission will be necessary buy around 30% of Japan's exports of semiconductor manufacturing equipment.

However, the impact of the export controls on Japanese exports as a whole will be limited. This is because the regulations apply only to manufacturing equipment for advanced semiconductors. And prices of the equipment exported to the regions covered by the regulations are only about half of the prices of the equipment sold to friendly countries. Hence, it seems that the level of exports to such regions of high value-added products that are subject to the controls is low.

◆ The impact of retaliatory measures is a concern

However, there are concerns about the impact on Japan's economy of retaliatory measures taken by the countries affected. In August, the Chinese government tightened controls on the export of certain rare metals (germanium and gallium) that are used in semiconductors. Japan relies on imports for its supplies of these rare metals, and the share of imports from China is substantial, so unless progress is made with finding alternative sources, semiconductor manufacturing could be adversely affected. To prepare for the possibility of such retaliatory moves spreading, it is imperative to make the supply chain more resilient, such as by diversifying suppliers.

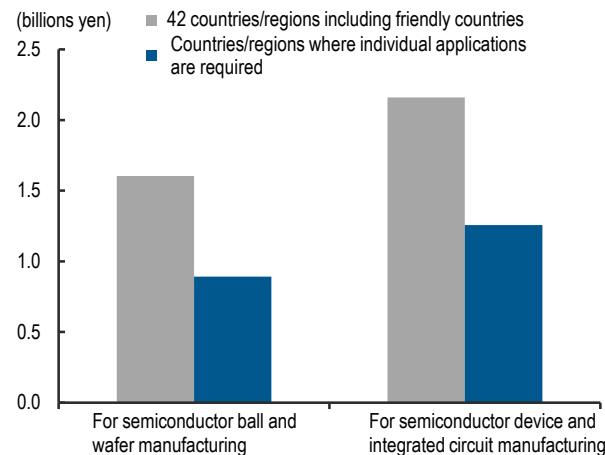
Figure 7-1 Share of Semiconductor Equipment Exports by Region



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

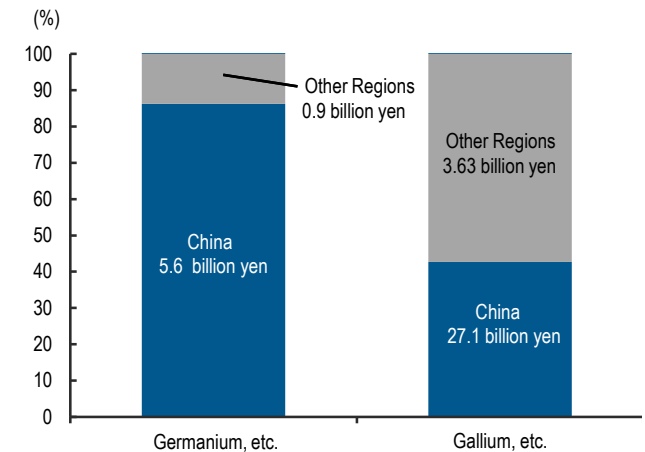
Note: Value for 2022.

Figure 7-2 Export Unit Price of Semiconductor Production Equipment Size <in 2022>



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

Figure 7-3 Share of Germanium and Gallium Imports by Region



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

Note: Value for 2022.

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

◆ Even after rebounded demand runs its course, the recovery will continue, led by domestic demand

Looking ahead, Japan's economy is expected to continue to slowly recover in the near term, driven by rebounded demand. The three drivers of the economy are private consumption, capital investment, and inbound tourism 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. Capital investment is also expected to remain strong as more and more postponed investments are executed. Capital investment plans that had been postponed due to longer construction/delivery times and higher investment costs look set to be implemented.

Inbound tourism demand is also expected to continue its recovery. Prices in Japan have become less expensive for foreign tourists, which is boosting inbound tourism demand through longer stays and higher spending per person.

Even after rebounded demand fades, the recovery trend is expected to continue, led by domestic demand. Wage increases will support private consumption. Capital investment for decarbonization, digitalization, and labor-saving is also expected to continue rising.

◆ 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 May, core inflation slowed from the previous month to 3.2%. The negative contribution of energy prices expanded as electricity bills dropped following a reduction in the renewable energy levy. However, the Bank of Japan's version of the core CPI, which excludes fresh food and energy, increased at a quicker pace. Goods saw large price increases, and price hikes also spread to services such as dining out and culture/entertainment.

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. According to the Bank of Japan's Tankan survey, many firms in services-related sectors are planning to raise their selling prices.

Figure 10 Projections for GDP Growth and Main Indicators of Japan (as of July 7, 2023)

(seasonally adjusted, annualized % changes from the previous quarter)										(% changes from the previous fiscal year)		
	CY2023				CY2024				CY2025	FY2022	FY2023	FY2024
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	(Projection)
	(Actual)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Actual)	(Projection)	(Projection)
Real GDP	2.7	1.9	1.7	1.4	1.3	1.3	1.3	1.1	1.1	1.4	1.4	1.3
Private Consumption Expenditure	2.1	2.3	1.9	1.6	1.4	1.3	1.3	1.1	1.1	2.4	1.8	1.4
Housing Investment	▲ 0.3	▲ 5.0	5.5	0.2	0.0	▲ 0.1	0.0	▲ 0.1	0.0	▲ 4.4	▲ 0.3	0.3
Business Fixed Investment	5.6	2.1	2.6	3.0	3.2	2.8	2.7	2.6	2.6	3.1	2.7	2.8
Private Inventories (percentage points contribution)	(1.6)	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.2)	(0.1)	(0.0)
Government Consumption Expenditure	0.5	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.0	1.1	0.3	0.1
Public Investment	6.3	1.0	1.6	1.4	1.2	1.2	1.0	0.8	0.8	▲ 3.0	2.2	1.1
Net Exports (percentage points contribution)	(▲ 1.4)	(0.2)	(▲ 0.1)	(▲ 0.1)	(▲ 0.1)	(▲ 0.0)	(0.0)	(0.0)	(▲ 0.0)	(▲ 0.6)	(▲ 0.2)	(▲ 0.0)
Exports of Goods and Services	▲ 15.9	6.1	1.6	1.6	1.4	1.6	1.7	2.0	2.2	4.4	0.4	1.7
Imports of Goods and Services	▲ 8.9	4.2	1.8	1.8	1.7	1.5	1.4	1.6	2.0	7.2	1.3	1.6

(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	3.9	3.5	5.1	4.8	3.8	3.4	3.1	2.4	2.3	2.0	4.3	2.8
GDP deflator	2.0	2.7	3.6	3.1	2.1	1.9	1.8	1.2	1.0	0.6	2.8	1.5
Consumer Price Index (excluding fresh food)	3.5	3.2	2.3	2.1	2.5	2.4	2.5	1.8	1.5	3.0	2.5	2.1
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	138	143	141	139	137	135	133	131	135	140	134
Import Price of Crude Oil (US\$/barrel)	87	82	79	83	83	81	81	79	78	103	82	80

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.