Monthly Report of Prospects for Japan's Economy

September 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 August 2023 issue of the original Japanese version.

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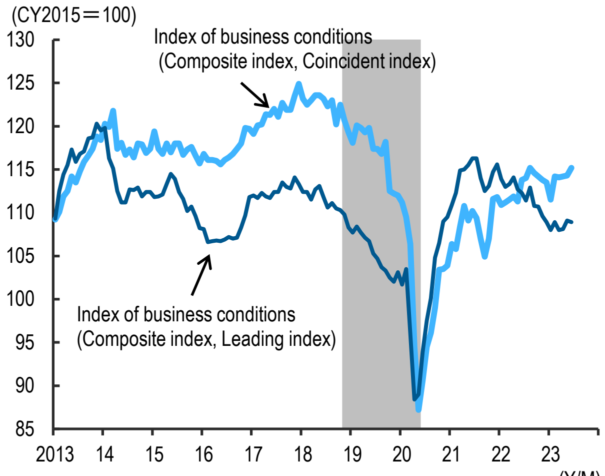
The General Situation – The economy is gradually recovering

Figure 1-1 Economic Activity

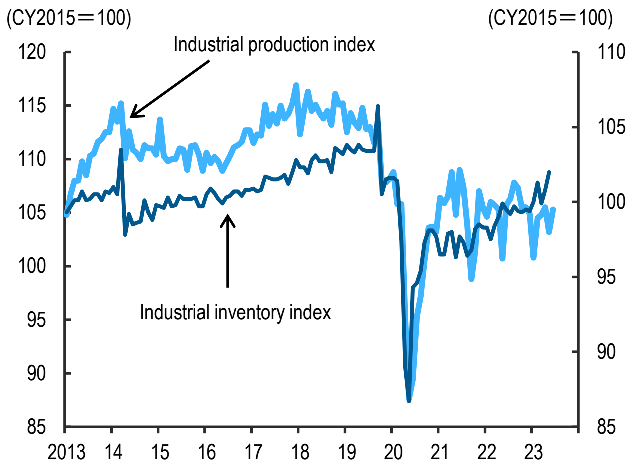
Coincident economic indicators are improving, and leading indicators are unchanged.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

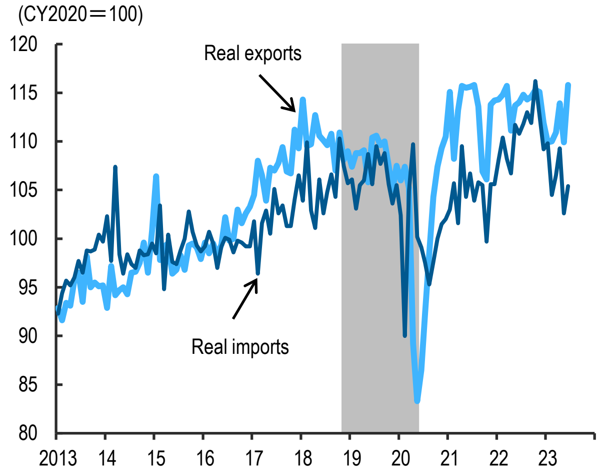
Industrial production is slowly picking up.
Economic activity in the service sector is recovering.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

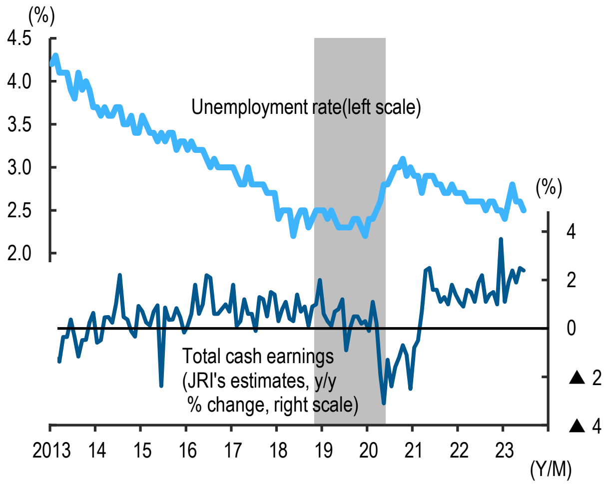
Exports of transportation machinery are bouncing back.
Imports, especially high-tech related, are sluggish.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

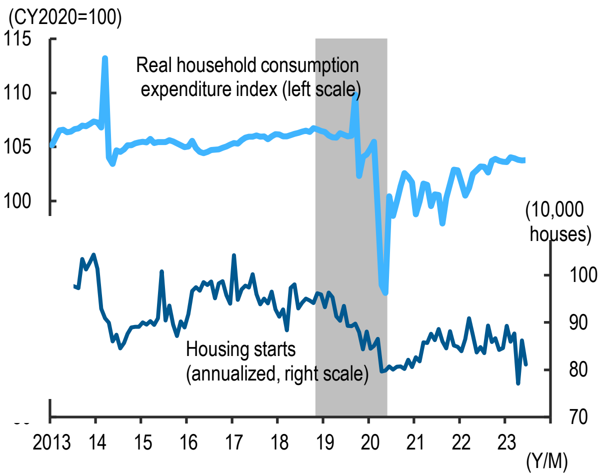
The unemployment rate is hovering in the mid-2% range.
The rate of nominal wage growth is gradually rising.



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

Figure 1-5 The Household Sector

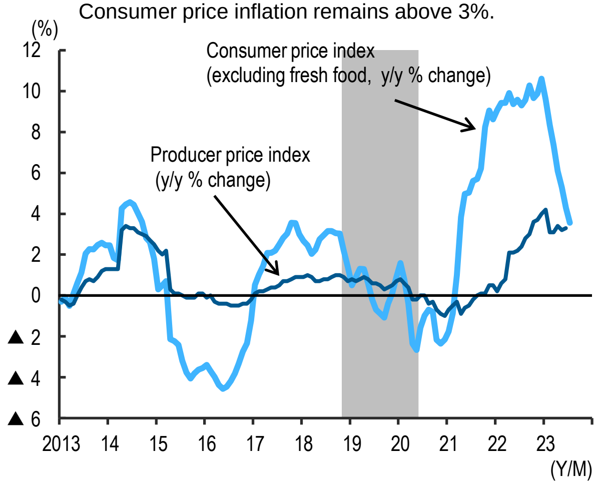
Consumption is fluctuating, but gradually rising overall.
Housing starts are in the 800,000-unit range.



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 slowing.
Consumer price inflation remains above 3%.



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

＊The shaded area indicates the recession phase.

Economic activity in the non-manufacturing sector is much brisker

◆ Industrial production is slowly picking up

In June, the Industrial Production Index increased for the first time in two months, rising 2.0% from the previous month. By sector, companies in a wide range of industries, and particularly ones in the automobile industry, boosted production as supply constraints eased.

Near-future production plans indicate a decrease in output in July (-0.2% month on month (MoM)) and an increase in August (+1.1% MoM). A strong recovery is unlikely, as the slowdown in global demand for goods will exert downward pressure on output in Japan, especially that of production machinery.

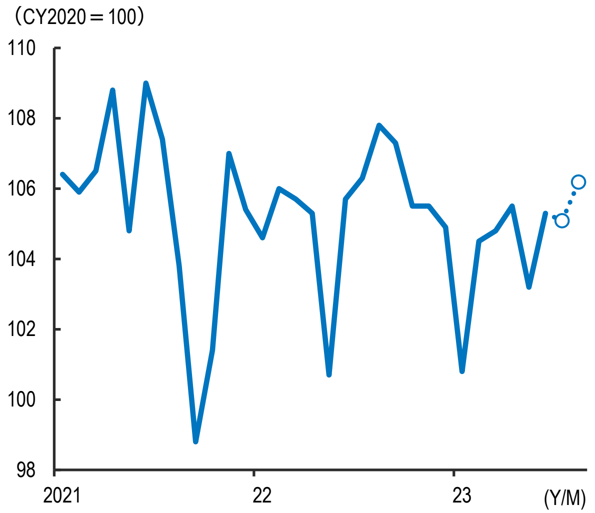
◆ Business activity in the non-manufacturing sector is recovering

In May, the Tertiary Industry Activity Index rose for the second month in a row, increasing 1.2% from the previous month. By sector, activity in living and amusement-related services picked up as opportunities to get out and about increased after the Japanese government downgraded COVID-19 to a less severe disease category.

◆ Business confidence is improving

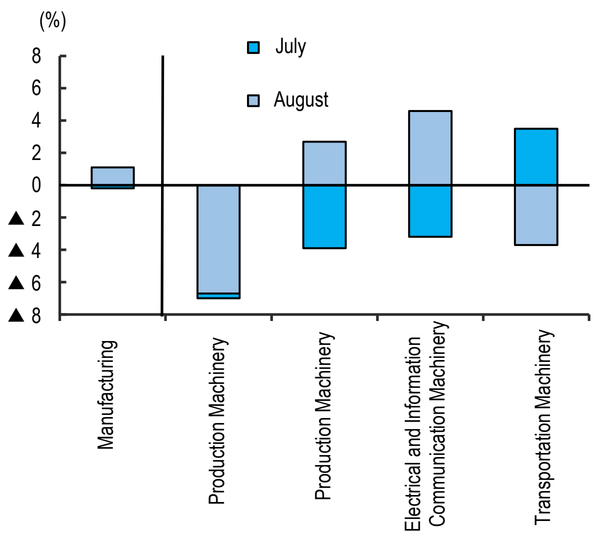
The diffusion index (DI) for current economic conditions in the Economy Watchers Survey for July climbed for the first time in two months, edging up 0.8 points. Breaking this down, the household activity-, corporate activity-, and employment-related DIs all rose. In household activity-related, business confidence improved in the retail sector. Continued high temperatures helped lift sales of seasonal products and air conditioners.

Figure 2-1 Industrial Production Index



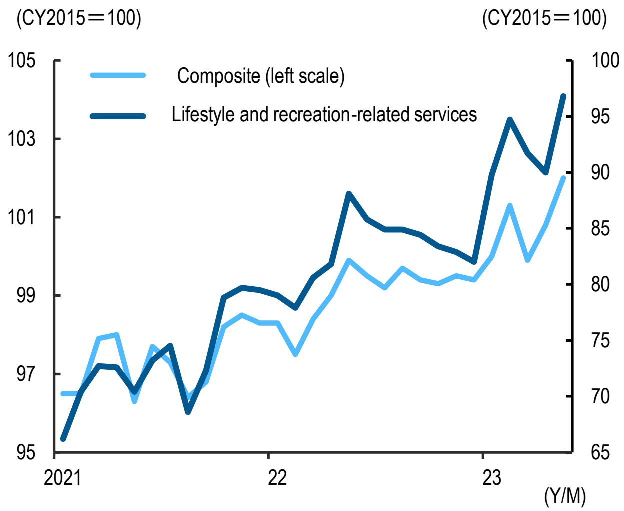
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.
.Note:Dotted lines are postponed based on the forecast index of manufacturing production (July and August).

Figure 2-2 Production Plan by Industry



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

Figure 2-3 Tertiary Industry Activity Index



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

Goods exports are rebounding as supply constraints ease, and inbound demand is recovering

◆ Exports of transportation machinery are providing support

In June, real exports increased from the previous month. Exports of electronic components and devices remained weak due to a cyclical decline in semiconductor demand, but higher exports of transportation machinery due to the easing of supply constraints pushed up goods exports overall.

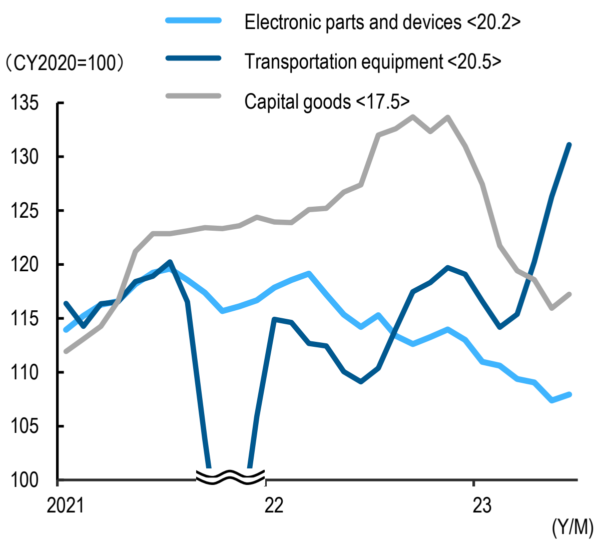
Looking ahead, despite support from rising machinery exports, goods exports are expected to be lackluster, against a backdrop of slowdowns in overseas economies. U.S. and European growth rates are sub-potential due to monetary tightening, and a strong recovery in the Chinese economy is not expected to occur as the real-estate market in China is in a slump. The new export orders index remained below 50, which is the dividing line between improvement and deterioration.

◆ Per-person spending by visitors to Japan is rising

The number of foreign visitors to Japan in June reached 70% of the 2019 level. Per-person spending by visitors to Japan in the April-June quarter was 1.3 times the 2019 figure. Prices in Japan have become less expensive for foreign tourists due to the cheap yen, resulting in higher spending on things like hotels. Total spending by foreign visitors to Japan has reached a little under 90% of the pre-COVID level.

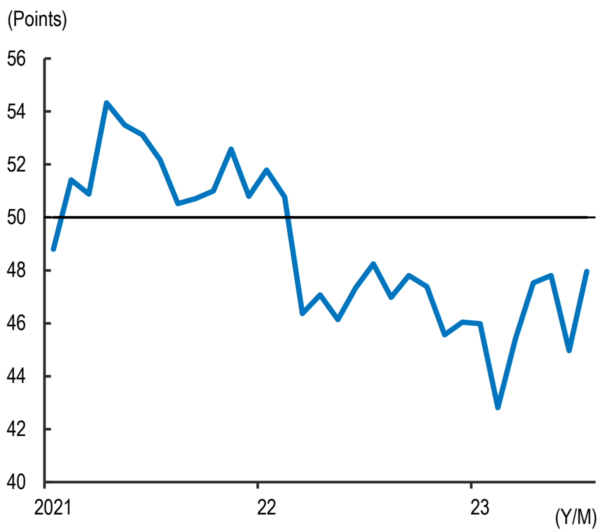
Going forward, inbound demand should continue its recovery. This is because spending is expected to remain above the pre-COVID level and the number of foreign tourists is expected to further increase. In August, the Chinese government abolished its restrictions on group travel to Japan, so the number of Chinese tourists, which has so far been low, should begin to recover.

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



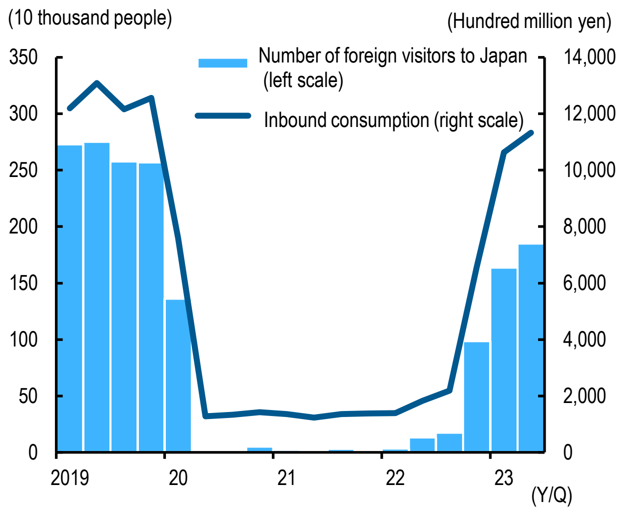
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: <>Figures in parentheses represent the share of total nominal exports in 2022.

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 continue to increase in the near term thanks to strong corporate earnings

◆ Corporate earnings are at high levels

According to the Financial Statements Statistics of Corporations, ordinary profit (all industries) for the January-March quarter increased 6.2% YoY, the first rise in three quarters. In the manufacturing sector, non-operating income, such as dividend income from overseas subsidiaries, lifted overall earnings, offsetting a decline in revenue due to sluggish external demand. As for the non-manufacturing sector, earnings also increased, especially in face-to-face services, thanks to the resumption of economic activities in the wake of the COVID pandemic.

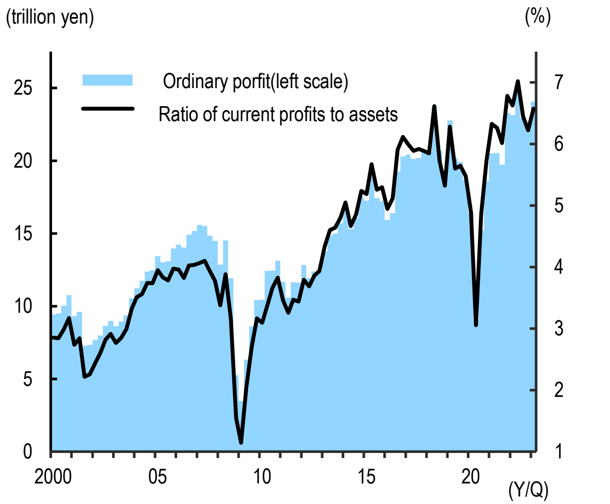
Even after April-June, the upward trend in corporate earnings is expected to continue. While the slowdown in overseas economies will put downward pressure on earnings in the manufacturing sector, non-manufacturing profits are expected to be pushed up by recoveries in services consumption and inbound demand.

◆ Appetite for capital investment remains strong

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

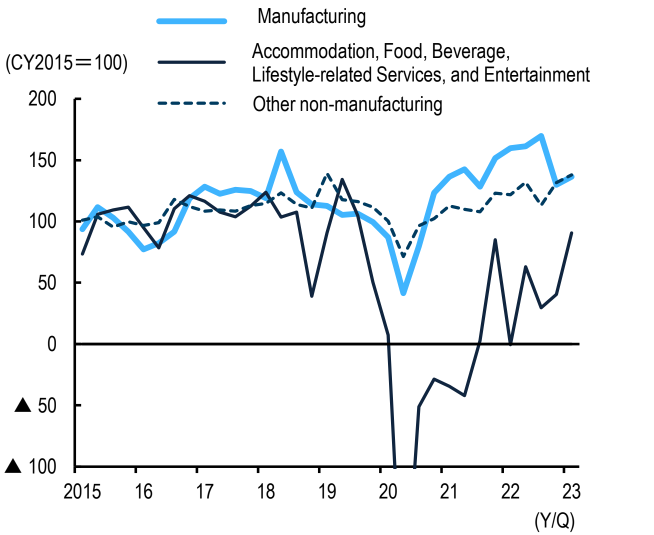
Capital investment is also expected to increase going forward. According to a survey by the Development Bank of Japan, planned capital investments by large companies in the current fiscal year are up 20.7% from the previous year, a high rate of increase compared to typical years. For the time being, capital spending is expected to be driven by the resumption of investments that had been postponed due to supply constraints or high costs. Furthermore, in the manufacturing sector, there is strong demand for investment to increase output capacity for products such as semiconductors. In the non-manufacturing sector, meanwhile, redevelopment projects centered on the Tokyo area and digital investments for labor-saving look set to expand.

Figure 4-1 Ordinary Profit and Ratio of Ordinary Profit to Net assets
<all sizes, seasonally adjusted>



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

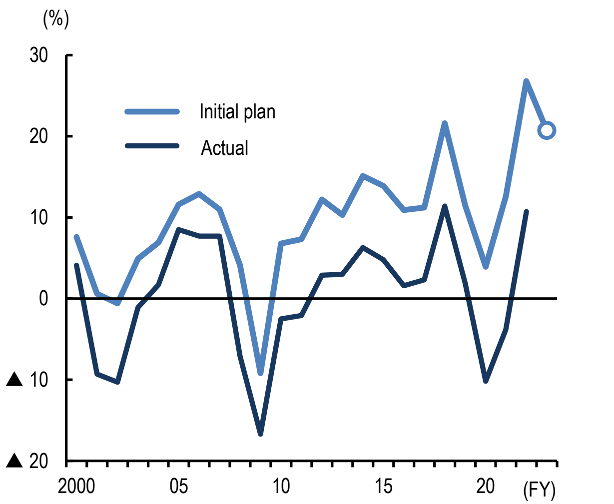
Figure 4-2 Ordinary Income
<by industry,sesonally adjusted>



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

Note: Non-manufacturing excludes finance and insurance.

Figure 4-3 Capital Investment Plans
<large companies, YoY>



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

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

◆ The employment environment is getting better

The unemployment rate for June was 2.5%, down slightly from the previous month. The number of employees increased 0.3% MoM for the first rise in two months. By industry, headcounts rose in sectors where demand is recovering, such as lodging and food/beverage service, healthcare, and welfare services.

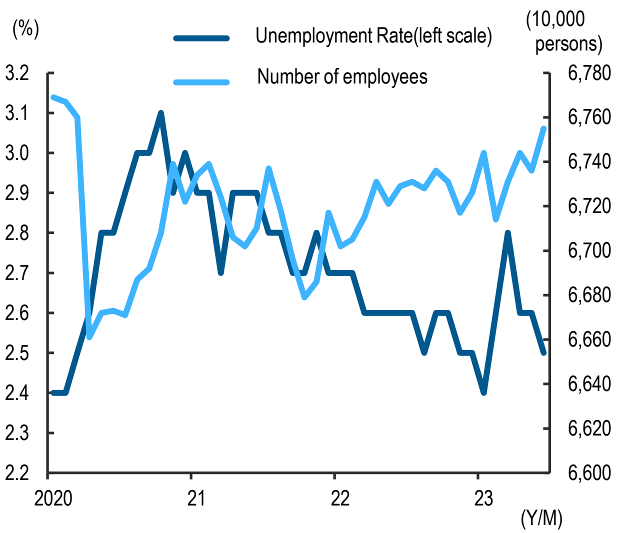
The job market will become increasingly tight in the near term. Demand for labor will increase as economic activity recovers, but there is limited room for expansion in the labor supply. A substantial rise in elderly and female workforce participation is unlikely.

◆ Wage increases are spreading to non-regular employees

The rate of nominal wage growth is gradually rising. Total cash payrolls in June increased 2.1% YoY. However, the rise did not keep pace with the rate of price increases, with real wages falling 1.6% for the 15th consecutive month of negative growth.

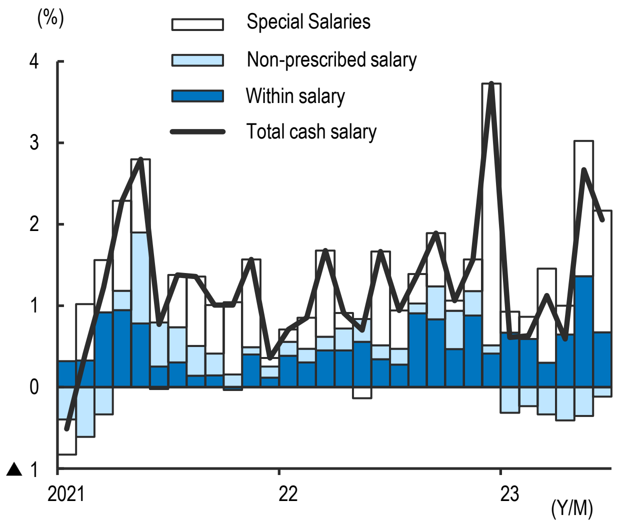
Looking ahead, the year-on-year drops in real wages should narrow, with real wage growth turning positive during 2024. Going forward, more companies are expected to implement the wage hikes agreed at this year's shunto (spring wage negotiations), and the basic salaries of regular employees look set to increase at a faster pace. Wages for non-regular workers are also expected to climb due to the growing labor shortage and higher minimum wages. The Central Minimum Wages Council has decided to raise its guideline national average minimum wage to 1,002 yen per hour this fiscal year. According to a survey by Teikoku Databank, about 70% of companies plan to increase wages in response to the minimum wage hike.

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



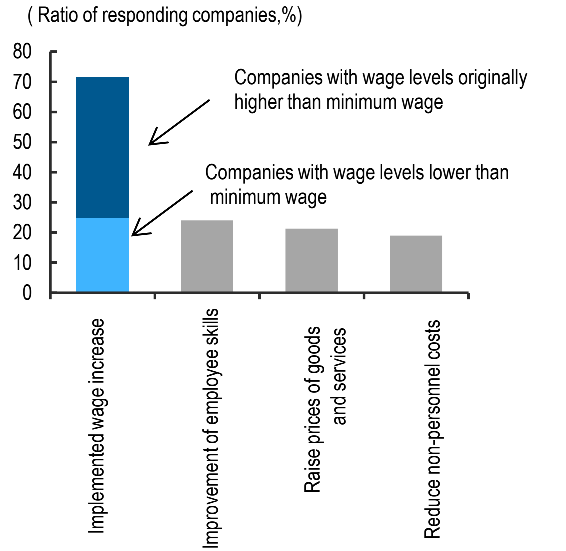
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Figure 5-2 Contribution Decomposition of Nominal Wages <YoY, seasonally adjusted>



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

Figure 5-3 Response to Minimum Wage Increase



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

Personal consumption is slowly recovering, but will be funded by excess savings for the time being

◆ Consumption of durable goods as well as services is rebounding

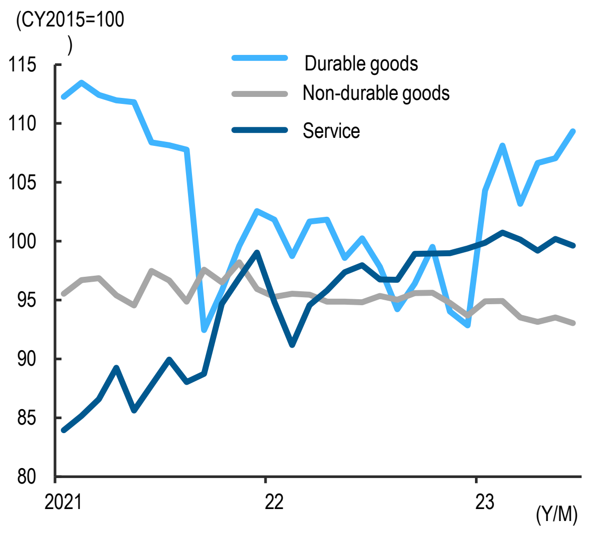
Personal consumption is gradually recovering despite weakness in certain categories. The normalization of economic activity has led to a gradual pickup in consumption of services such as dining out and travel. Consumption of durable goods is also increasing, especially with automobiles, sales of which have recovered thanks to easing supply constraints. Non-durable goods consumption, however, is trending downward due to the evaporation of stay-home-related demand and rising prices.

◆ Consumer confidence is improving

Personal 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 spending of excess savings built up during the pandemic should stave off a slump in personal consumption. For the time being, rebound demand for services, such as food/beverage service, will drive the recovery. And even after this rebound demand peters out, the recovery in personal consumption is expected to be maintained, supported by the favorable income environment.

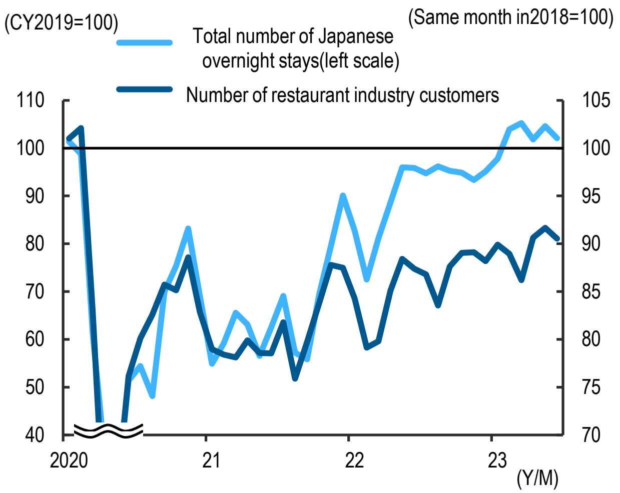
Improved consumer confidence will also help consumption rebound. The Consumer Confidence Index is continuing the improvement that began last winter. This improvement is being helped by the favorable employment environment supported by the normalization of economic activity boosting the desire to consume, and also by higher incomes as wage hikes spread through the economy.

Figure 6-1 Consumption Activity Index



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

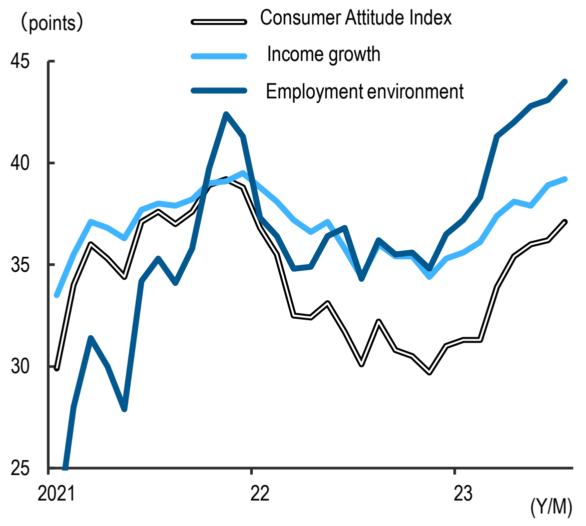
Figure 6-2 Number of Overnight Guests and Food Service Industry Customers



Source: The Japan Research Institute, Ltd. based on date of The inistry of Land, Infrastructure, Transport and Tourism, Japan Food Service Association.

Note:The number of restaurant industry customers (right scale) is 100 for the same month of 2018 in order to eliminate the impact of rush demand associated with the consumption tax hike.

Figure 6-3 Consumer Attitude Index



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

Topic: Downward pressure on capital investment due to higher interest rates will be limited

◆ Long-term interest rates have hit a nine-year high

Japanese interest rates are rising. The yield on 10-year Japanese government bonds (JGBs) is currently around 0.6%, the highest level seen in nine years, having risen in response to the Bank of Japan's modification of its approach to managing long- and short-term interest rates, so-called yield curve control (YCC). Market participants are assuming that long-term interest rates will continue to rise gradually.

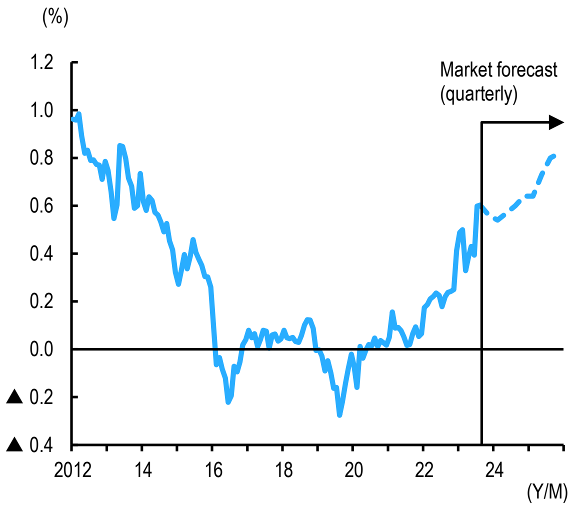
◆ Interest-rate sensitivity of capital investment has fallen

While these higher interest rates will push up corporate borrowing costs, the downward pressure on capital spending is expected to be limited. According to estimates, a 1% increase in the cost of capital would result in a 0.5% annual decrease in capital investment. This negative effect is just a quarter of what it was before the bursting of Japan's "bubble economy" in the early 1990s. This fall in the sensitivity of capital investment to changes in interest rates can be attributed to the following two factors:

First, reliance on borrowing has declined. Since the 2000s, companies have reduced their borrowing from financial institutions. By building up their equity capital and increasing their holdings of cash and deposits, they are increasingly able to finance their investments by dipping into internal funds. This will curtail any increases in costs stemming from higher loan interest rates.

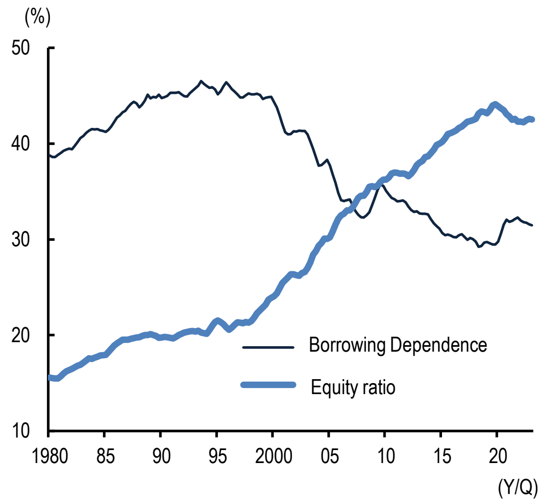
Second, the capital investment cycle has become shorter. The rate of depletion of capital stock has risen due to an increase in capital that becomes obsolete faster, such as information and communication equipment and software. This has increased demand for investment in upgrades, the level of which is less susceptible to fluctuations in the economy and interest rates.

Figure 7-1 Long-Term Interest Rates in Japan
<10-year JGB yield>



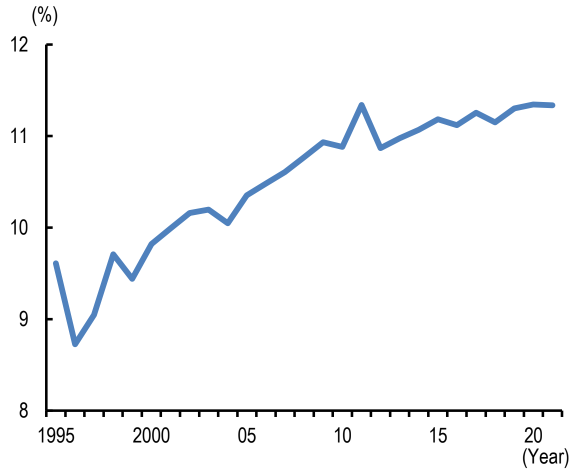
Source: The Japan Research Institute, Ltd. based on data of The Bloomberg L.P.

Figure 7-2 Financing Structure of Corporations
<all sizes, all industries>



Source: The Japan Research Institute, Ltd. based on data of The Cabinet office.
Note: Excluding finance and insurance industry. Backward 4-period moving average. Borrowing dependence = (long-term and short-term debt + corporate bonds)/total assets. Equity ratio = Net assets/Total assets.

Figure 7-3 Rate of Depletion of Capital Stock



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office
Note: Depletion at the end of the current year / Net capital stock at the end of the previous year.

Japan economic forecast: FY23: +2.5%, FY24: +1.2%

◆ Adverse effects due to higher interest rates will be limited

Looking ahead, Japan's economy is expected to continue to slowly recover in the near term, driven by rebound demand. The three drivers of the economy are personal consumption, capital investment, and inbound demand. Personal consumption should increase, especially for food/beverage service and other services. Capital investment is also expected to hold firm, with the execution of postponed investments the main factor. Inbound demand is also expected to continue its recovery. The Chinese government has abolished its restrictions on group travel to Japan, so the number of Chinese tourists, which has so far been low, should begin to recover. Even after rebound 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.

Long-term interest rates are expected to rise moderately to around 1%, but the adverse impact of this on the economy is expected to be limited. Although housing investment will be pushed down by higher borrowing costs, the downward pressure on capital investment will be lower than in the past, as companies have reduced their reliance on borrowing.

◆ The growth rate for FY2023 will be +2.5%

Growth is expected to be +2.5% in FY2023 and +1.2% in FY2024, remaining above the potential growth rate, which is in the mid-0% range.

◆ Prices are going up across the board

In June, core inflation accelerated slightly from the previous month to 3.3% (YoY). The negative contribution of energy prices shrank as electricity bills rose. The Bank of Japan's version of the core CPI, which excludes fresh food and energy, continued its rapid ascent, rising 4.2% YoY. Goods continued to see 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.

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Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of August 15, 2023)

(%, 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)							(Actual)	(Projection)	
Real GDP	3.7	6.0	0.9	1.2	1.1	1.1	1.1	1.0	1.0	1.4	2.5	1.2
Private Consumption Expenditure	2.5	▲ 2.1	1.9	1.7	1.4	1.2	1.2	1.0	1.0	2.5	0.7	1.3
Housing Investment	2.8	7.7	0.1	0.1	0.0	▲ 0.1	▲ 0.1	▲ 0.1	▲ 0.2	▲ 3.0	2.9	▲ 0.1
Business Fixed Investment	7.6	0.1	3.0	2.8	2.6	2.6	2.4	2.2	2.2	3.1	2.5	2.5
Private Inventories (percentage points contribution)	(1.5)	(▲ 0.7)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.2)	(▲ 0.1)	(▲ 0.0)
Government Consumption Expenditure	0.4	0.4	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.7	0.3	0.1
Public Investment	7.1	5.0	1.6	1.4	1.2	1.2	1.0	0.8	0.8	▲ 3.1	3.5	1.1
Net Exports (percentage points contribution)	(▲ 1.0)	(7.2)	(▲ 0.5)	(▲ 0.1)	(▲ 0.0)	(0.0)	(0.1)	(0.1)	(0.0)	(▲ 0.6)	(1.5)	(▲ 0.0)
Exports of Goods and Services	▲ 14.4	13.6	1.9	1.6	1.7	1.7	1.7	2.0	2.2	4.5	2.2	1.8
Imports of Goods and Services	▲ 8.7	▲ 16.2	3.8	1.8	1.7	1.5	1.4	1.6	2.0	7.2	▲ 3.8	1.7

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

Nominal GDP	4.0	5.4	7.5	6.5	5.2	2.9	2.7	2.4	2.4	2.0	6.2	2.6
GDP deflator	2.0	3.4	4.8	3.6	2.6	1.7	1.4	1.2	1.2	0.7	3.6	1.4
Consumer Price Index (excluding fresh food)	3.5	3.3	2.7	2.4	2.9	2.8	2.5	1.6	1.3	3.0	2.8	2.0
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$)	132	138	143	141	138	136	134	132	130	135	140	133
Import Price of Crude Oil (US$/barrel)	87	83	82	89	89	84	81	79	78	103	86	81

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.