

Monthly Report of Prospects for Japan's Economy

October 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 September 2023 issue of the original Japanese version.

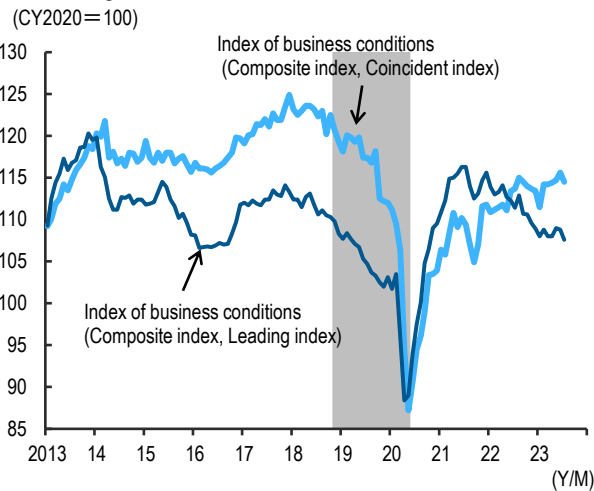
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The General Situation – The economy is gradually recovering

Figure 1-1 Economic Activity

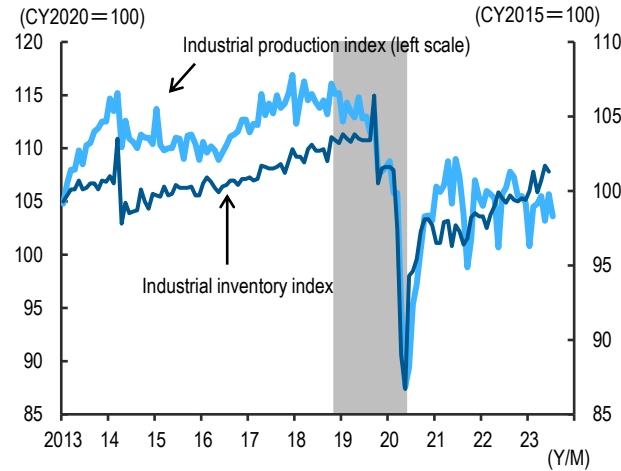
Coincident economic indicators are improving, and leading indicators are falling.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

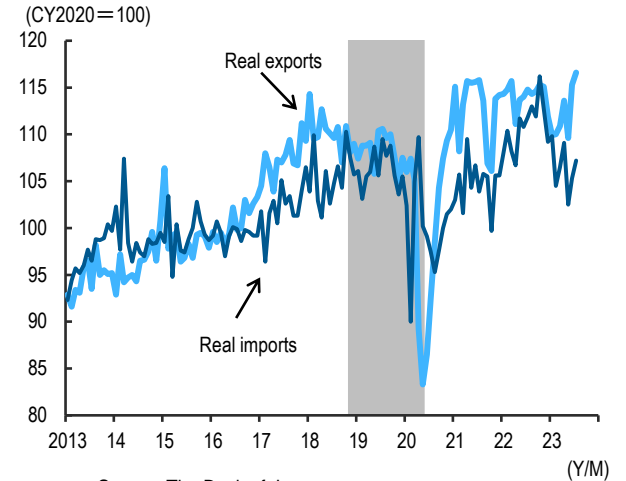
Industrial production is fluctuating.
Economic activity in the service sector is recovering.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

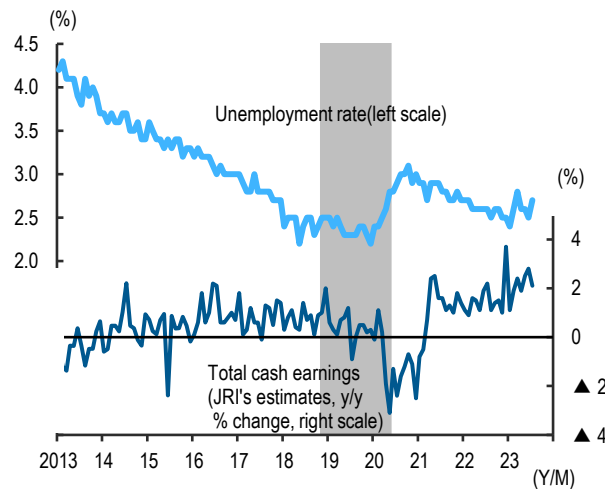
Exports, particularly of transportation machinery, are increasing.
Imports, especially energy-related, are sluggish.



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 rising at over 2%.

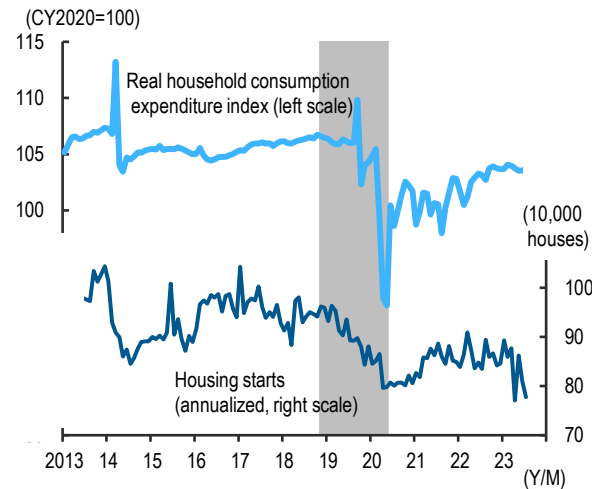


Source: The Ministry of Internal Affairs and Communications,
The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

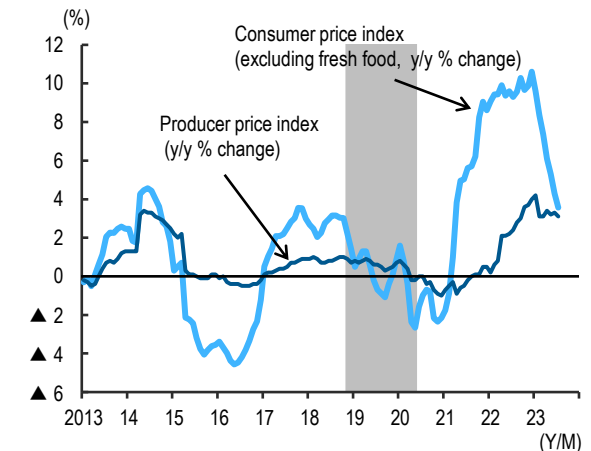
Consumption is fluctuating, but gradually rising overall.
Housing starts are currently weak.



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 rapidly.
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.

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Real GDP growth in April-June was substantially positive

◆ Foreign demand is boosting the growth rate

Annualized real GDP growth in the April-June 2023 quarter was +4.8% year over year (YoY), with growth staying in positive territory for three straight quarters. Foreign demand is boosting the growth rate, with automobile exports, for example, increasing thanks to the easing of supply constraints. On the other hand, against the backdrop of the end of stay-home-related demand and rising prices, private consumption declined for the first time in three quarters. Capital investment fell for the first time in two quarters due to a decrease in machinery investment.

◆ Production in the manufacturing sector is fluctuating

In July, the Industrial Production Index fell for the first time in two months, dropping 2.0% from the previous month. By sector, automobile output increased as supply constraints eased, but companies in a wide range of industries, and manufacturers of production machinery in particular, reduced output in response to a worldwide slump in demand for goods.

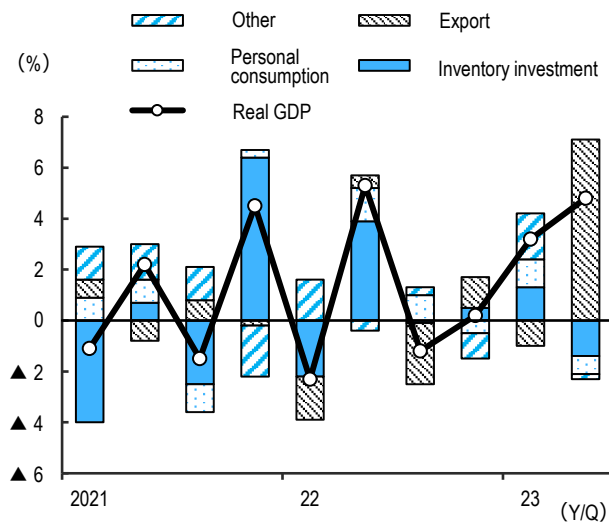
Near-future production plans indicate increases in output in August (+2.6% month

on month (MoM)) and September (+2.4% MoM), but the recovery is unlikely to be as strong as these figures would suggest. Output of electrical machinery and information and telecommunications equipment, for which large increases in production are planned against the backdrop of heavy order backlogs, is trending lower than the figures in the plans. Furthermore, production of transportation machinery may also turn out to be lower than planned due to the temporary suspension of automakers' plant operations in August.

◆ The improvement in business confidence has paused

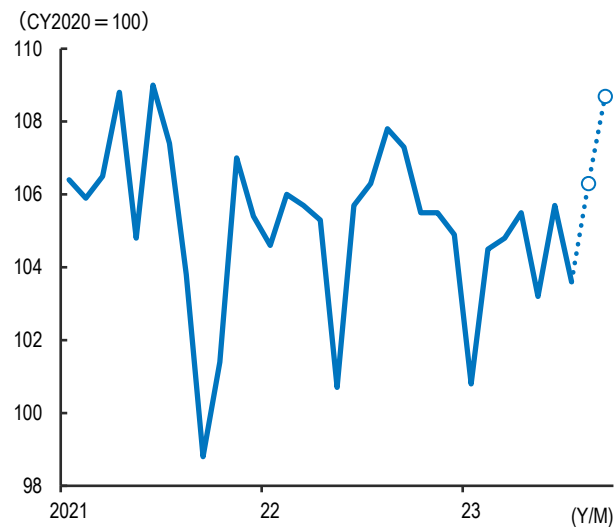
The diffusion index (DI) for current economic conditions in the Economy Watchers Survey for August dropped for the first time in two months, falling 0.8 points from the previous month. Breaking this down, the household activity-, corporate activity-, and employment-related DIs all declined. In household activity-related, there was an increase in respondents expressing concern about rising prices reducing the willingness of consumers to make purchases.

Figure 2-1 Real GDP Growth Rate
< annualized quarter-on-quarter basis >



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

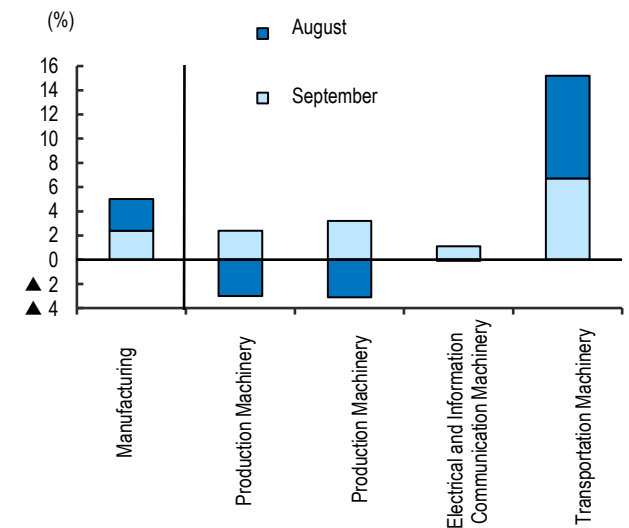
Figure 2-2 Industrial Production Index



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 (August and September).

Figure 2-3 Production Plan by Industry



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

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

◆ Exports of transportation machinery are providing support

In July, 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 machinery due to the easing of supply constraints pushed up goods exports overall.

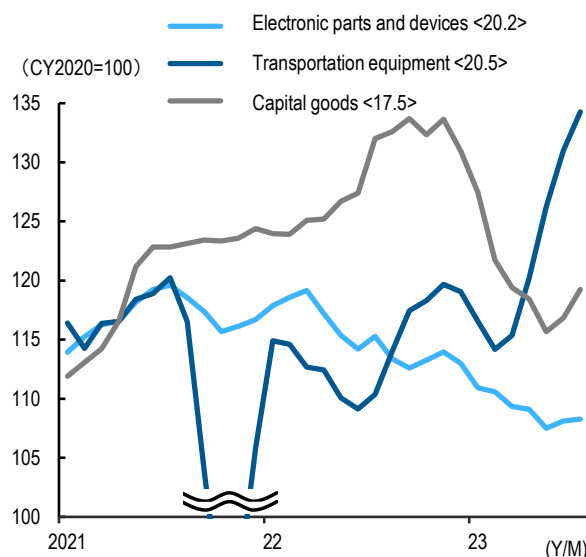
Looking ahead, goods exports are expected to be lackluster, against a backdrop of slowdowns in overseas economies. U.S. and European growth rates are sub-potential due to monetary tightening, and a strong recovery in the Chinese economy is not expected to occur as the real-estate market in China is in a slump. With capital investment weak worldwide, exports of capital goods, for which order books are thin, also look set to continue to decline.

◆ The number of foreign visitors to Japan continues to recover

The number of foreign visitors to Japan in July reached around 80% of the 2019 level. Although the number of tourists from China has been slow to recover, reaching only about 30% of the pre-COVID level, visitors from East Asian countries other than China and from places like the U.S. are increasing.

Going forward, inbound demand should continue its recovery. In August, the Chinese government abolished its restrictions on group travel to Japan, so the number of foreign tourists visiting Japan, especially ones from China, are expected to rise. However, political developments surrounding the release of treated water from the Fukushima Daiichi nuclear power plant may dampen the desire to travel to Japan among the Chinese, so this is a risk that needs to be kept in mind.

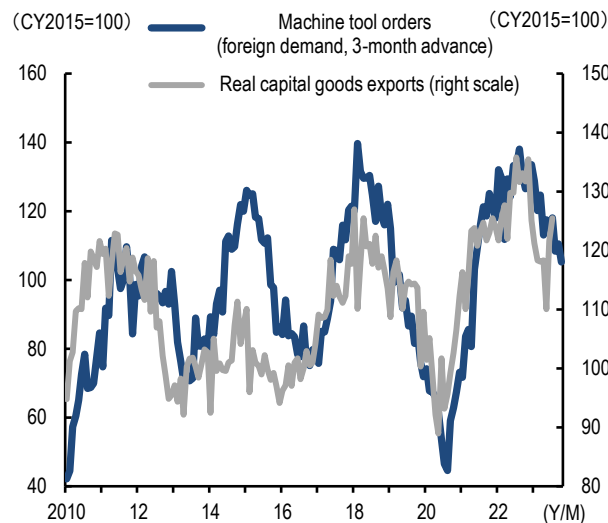
Figure 3-1 Real Export by Area
<seasonally adjusted>



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

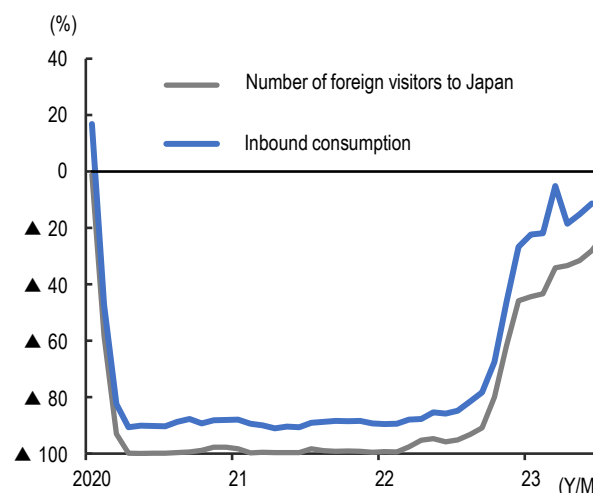
Note: <>Figures in parentheses represent the share of total nominal exports in 2022. Backward 3-month moving average.

Figure 3-2 Machine Tool Orders and Exports of Capital Goods<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, Japan Machine Tool Builders' Association.

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.

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Corporate earnings are strong, but capital investment is seeing a temporary lull

◆ Corporate earnings are strong thanks to rebound demand

According to the Financial Statements Statistics of Corporations, ordinary profit for the April-June quarter increased 9.5% YoY across all industries, rising for the second consecutive quarter. Ordinary profit as a percentage of net sales is over 7%, its highest level ever. Higher non-operating income, such as interest and dividend income, was a factor in driving up profits. By sector, many manufacturing companies, and particularly ones in the automobile industry, reaped higher profits from recoveries in production and exports as supply constraints eased. Earnings in the non-manufacturing sector also remained strong on the back of such factors as higher revenues in lodging and other face-to-face services.

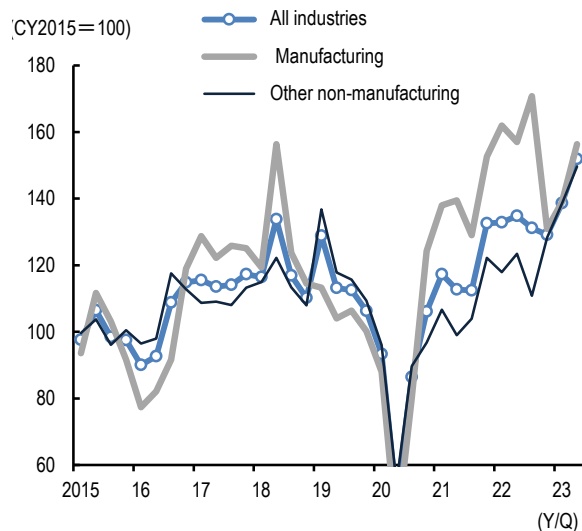
Looking ahead, corporate earnings are expected to remain high overall. While the slowdown in overseas economies will put downward pressure on earnings in the manufacturing sector, non-manufacturing profits are expected to be pushed up by increased demand for services from Japanese consumers and foreign tourists.

◆ Capital investment is seeing a temporary lull

According to the Financial Statements Statistics of Corporations, capital investment in April-June was down 1.2% YoY, falling for the first time in five quarters. While capital investment in the manufacturing sector held firm, driven by strong earnings in industries such as automobiles, it fell back in the non-manufacturing sector following due to reversals of the large increases of the previous quarter in face-to-face services such as lodging and food/beverage service.

Capital investment is expected to increase going forward. Companies are maintaining proactive stances on capital investment. According to the Bank of Japan's June Tankan survey, planned capital investments for FY2023 are substantially high compared with typical years. The appetite for capital investment in labor-saving and digitalization is strong, and this is expected to drive growth going forward.

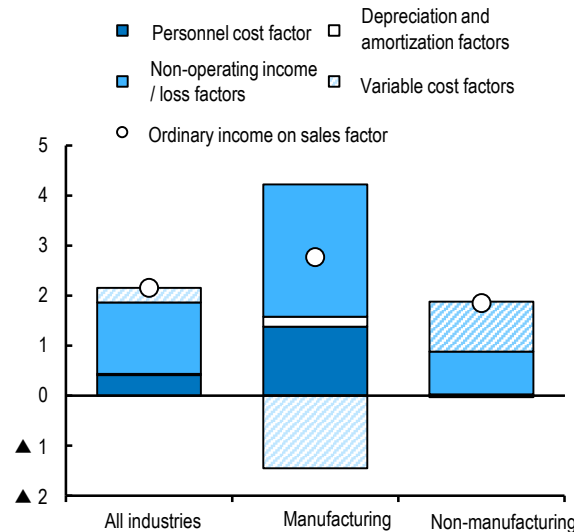
Figure 4-1 Corporate Ordinary Income
<all sizes, seasonally adjusted>



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

Note: Non-manufacturing excludes finance and insurance.

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

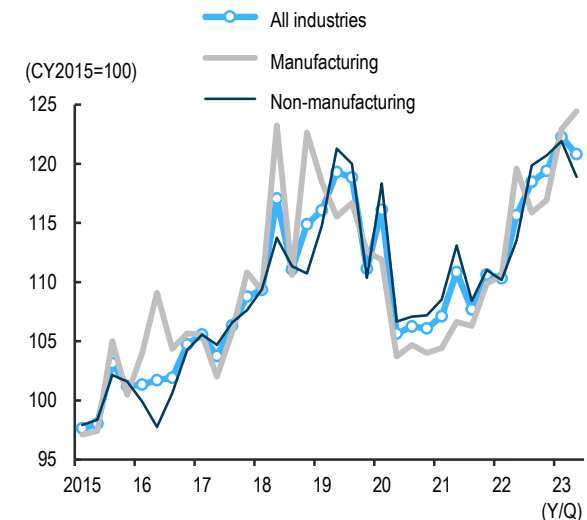


Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.

Note: Non-manufacturing excludes finance and insurance.

Note2: Difference between Apr-Jun 2023 and the same period in 2007.

Figure 4-3 Capital Investment by Corporate Clients
<all sizes, seasonally adjusted>



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

Note: Including software. Excluding financial and insurance industries.

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

◆ The employment environment is getting better

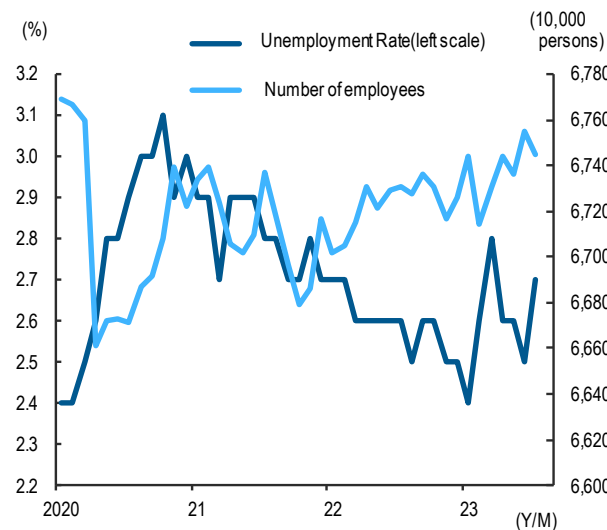
The number of workers is rising gradually. By industry, the higher headcounts are being driven by sectors where demand is recovering, such as lodging and food/beverage service, healthcare, and welfare services. The unemployment rate for July was 2.7%, up slightly from the previous month. Although unemployment edged up, the rise was mainly due to increases in the number of people quitting their jobs voluntarily to search for work with better conditions as well as in the number of new job seekers. 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

Nominal wages are gradually rising, though with some fluctuation. Total cash payrolls in July increased 2.1% YoY. More companies are implementing the wage hikes agreed at this year's shunto spring wage offensive, and the basic salaries of ordinary workers have increased at a rate of over 2%. However, the rise did not keep pace with the rate of price increases, with real wages falling 1.8% for the 16th consecutive month of negative growth.

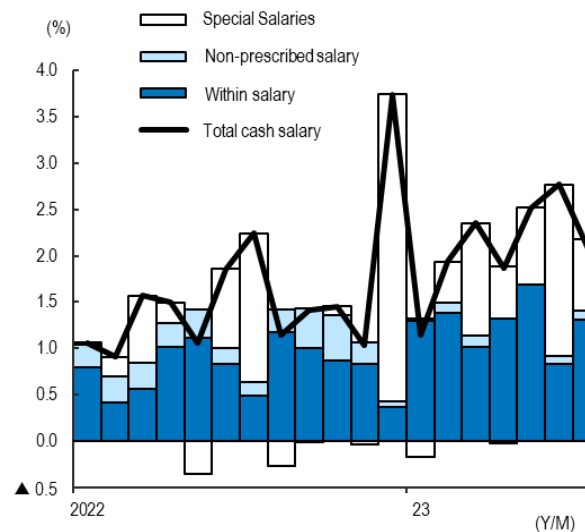
Looking ahead, the year-on-year drops in real wages should narrow, with real wage growth turning positive during 2024. Wages for non-regular workers are also expected to climb due to the growing labor shortage and higher minimum wages. The national average minimum wage will increase to 1,004 yen per 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>



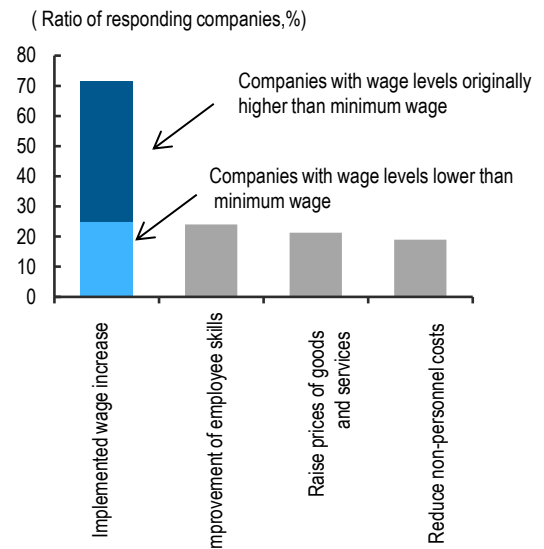
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

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, and an improving income environment will provide support going forward

◆ Goods consumption is tepid

Personal consumption is gradually recovering despite weakness in certain categories. The normalization of economic activity has led to a gradual increase in consumption of services such as dining out and travel. In durable goods consumption, automobile purchases are trending upward thanks to the easing of supply constraints, but purchases of products such as consumer electronics are declining against the backdrop of the end of stay-home-related demand. Non-durable goods consumption, however, is trending downward due to the impact of rising prices.

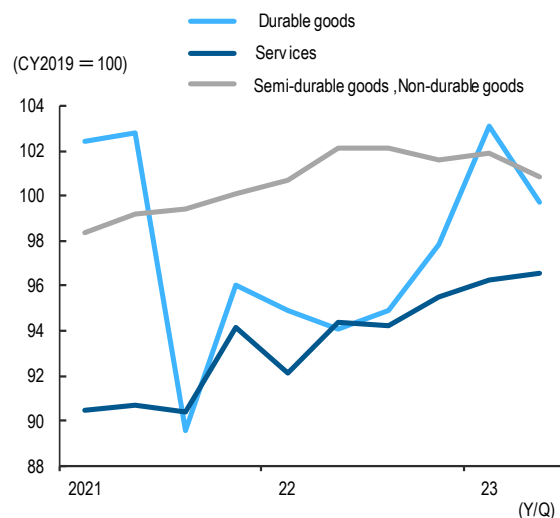
◆ Consumer confidence is improving

Personal consumption, particularly of services, is expected to continue its gradual recovery going forward. 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. According to estimates, a 1% increase in real income lifts personal consumption by 0.8%. Breaking this down, the expansionary effect on spending is slightly greater for services than goods.

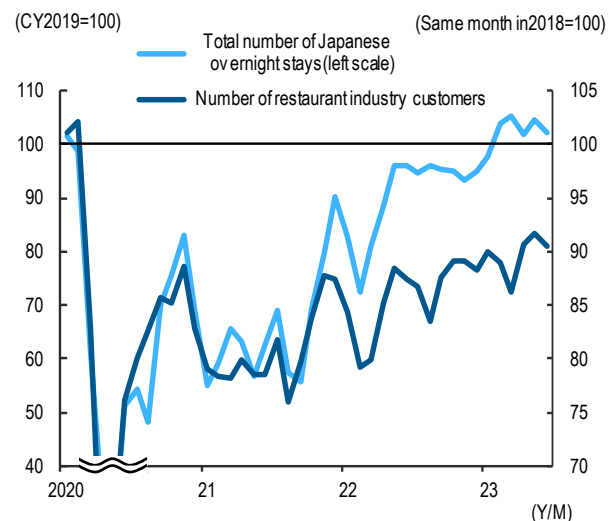
Improved consumer confidence will also help consumption rebound. The Consumer Confidence Index has been improving since last winter. This improvement is being helped by the favorable employment environment supported by the normalization of economic activity boosting the desire to consume, and also by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

Figure 6-1 Personal Consumption by Form



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

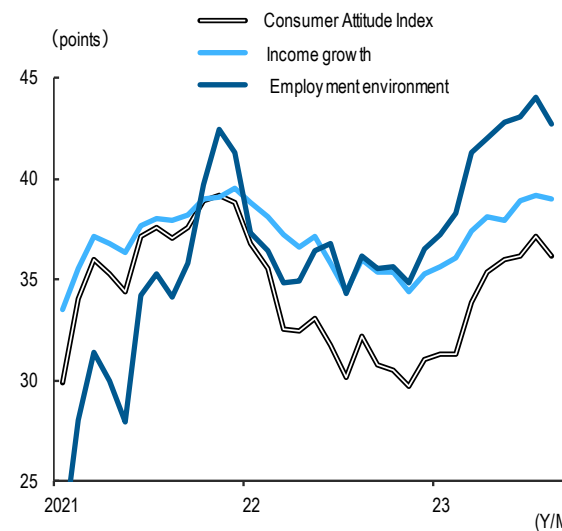
Figure 6-2 Number of Overnight Guests and Food Service Industry Customers



Source: The Japan Research Institute, Ltd. based on date of The Ministry 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: Even as wages rise, the "annual income barrier" will reduce the labor supply by 2% five years from now

◆ Hours worked by non-regular workers are being suppressed

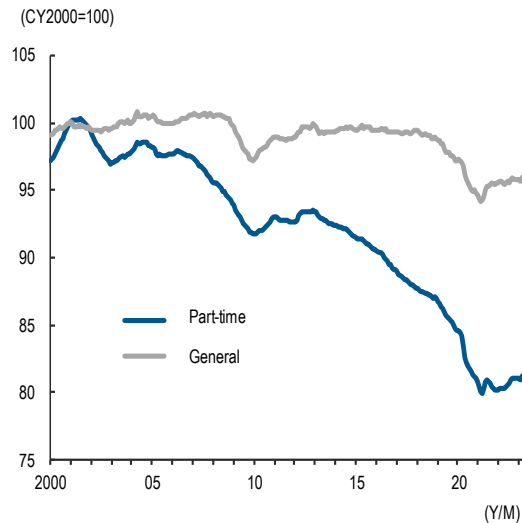
The working hours of non-regular employees are falling as they adjust the amount of time they work due to the so-called "annual income barrier." In 2022, 5.5 million non-regular workers reduced their working hours to keep their income below thresholds for paying taxes and social insurance premiums. 70% of these working-hours adjusters are married persons, mainly women, and 90% are part-timers or casual workers. This reflects the fact that spousal support (i.e., being classified as a dependent of one's spouse) is a criterion for determining taxes and social insurance premiums, and also the fact that part-time and casual workers are forms of employment that allow working hours to be easily adjusted.

◆ The impact is large in urban areas

This working-hours adjustment strongly constricts the labor supply across the economy. According to estimates, the reduction in hours worked due to working-hours adjustment pushes total working hours in Japan down by 1.4%. Furthermore, if wages continue to rise in the future, there is a danger of working-hours adjustment further intensifying. If wages for non-regular workers increase at an annual rate of 3%, it is estimated that the constraining effect on total hours worked of working-hours adjustment will expand to -1.9% in 2027.

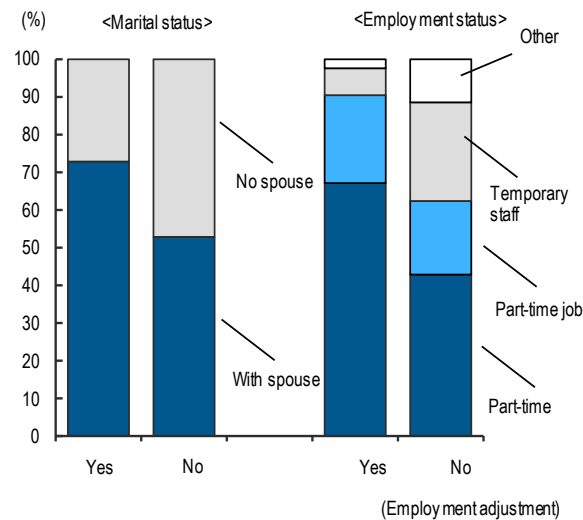
The impact of working-hours adjustment is large in urban areas. In the cities, the large numbers of non-regular workers in the service sector and the higher wage levels increase the extent of the reductions in working hours. The constraining effect (in 2022) of working-hours adjustment seems to have approached nearly 2% in urban areas such as Osaka and Kanagawa prefectures.

Figure 7-1 Total Actual Hours Worked <per worker>



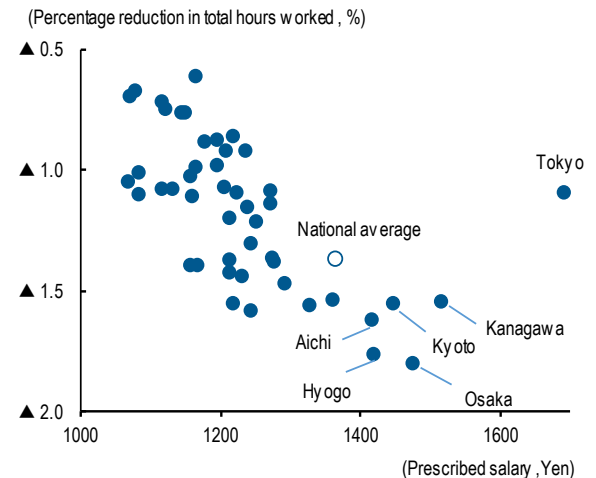
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labour and Welfare.
Note: Establishments with 5 or more permanent workers. 12-month backward moving average.

Figure 7-2 Breakdown of Part-time Employees <in 2022>



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

Figure 7-3 Percentage Reduction in Working Hours Due to Job Adjustment, etc.



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

Note: Value in 2022.

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Japan economic forecast: FY23: +2.1%, FY24: +1.2%

◆ The gradual recovery will continue

Looking ahead, Japan's economy is expected to continue to slowly recover in the near term, driven by rebound demand in the wake of the COVID pandemic. The three drivers of the economy are personal consumption, capital investment, and inbound demand. Personal consumption should continue its recovery, especially for food/beverage service and other services. Capital investment is also expected to rise, with the execution of postponed investments the main factor. Inbound demand is also expected to hold firm. The Chinese government has abolished its restrictions on group travel to Japan, so the number of Chinese tourists, which has so far been low, is increasing. However, there is a risk that political developments surrounding the release of treated water from the Fukushima Daiichi nuclear power plant may dampen the desire to travel to Japan among the Chinese.

Consumer price inflation is expected to slow. Although inflationary pressures from rising wages will intensify, price hikes caused by high raw material prices look set to subside. The government's extension of measures to mitigate sharp rises in bills for fuel oil, electricity, and gas will also help to push down energy prices. The recovery in personal consumption should continue as real wages stop falling.

◆ The growth rate for FY2023 will be +2.1%

Growth is expected to be +2.1% in FY2023 and +1.2% in FY2024, remaining above the potential growth rate, which is in the mid-0% range.

◆ The Bank of Japan's version of the core CPI is continuing its rapid rise

In July, core inflation slowed from the previous month to 3.1% (YoY). The extent of decline in electricity and gas prices increased following drops in resource prices. The Bank of Japan's version of the core CPI, which excludes fresh food and energy, continued its rapid ascent, rising 4.3% YoY. While the surge in durable goods prices has slowed, the pace of increases in non-durable goods prices and cellphone communication charges quickened. Recently, the speed of price increases for items that are closely linked to wages is also getting faster, and there is a growing tendency to pass on increased labor costs to prices.

Looking ahead, core CPI growth is expected to slow. Although inflationary pressures from rising wages will further intensify, price hikes caused by high raw material prices look set to subside. The government's extension of measures to mitigate sharp rises in bills for fuel oil, electricity, and gas will also help to push down energy prices.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of September 11, 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	3.2	4.8	0.9	1.2	1.1	1.1	1.1	1.0	1.0	1.4	2.1	1.2
Private Consumption Expenditure	2.4	▲ 2.5	1.7	1.5	1.4	1.2	1.2	1.0	1.0	2.5	0.5	1.3
Housing Investment	2.7	8.1	0.1	0.1	0.0	▲ 0.1	▲ 0.1	▲ 0.1	▲ 0.2	▲ 3.0	3.0	▲ 0.1
Business Fixed Investment	6.6	▲ 4.0	3.6	3.2	2.8	2.6	2.4	2.2	2.2	3.1	1.4	2.6
Private Inventories (percentage points contribution)	(1.4)	(▲ 0.6)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.2)	(▲ 0.1)	(▲ 0.0)
Government Consumption Expenditure	0.3	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.7	0.2	0.1
Public Investment	5.8	1.0	1.6	1.4	1.2	1.2	1.0	0.8	0.8	▲ 3.1	2.1	1.1
Net Exports (percentage points contribution)	(▲ 1.0)	(7.1)	(▲ 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	12.9	1.9	1.6	1.7	1.7	1.7	2.0	2.2	4.5	2.1	1.8
Imports of Goods and Services	▲ 8.7	▲ 16.5	3.9	1.8	1.7	1.5	1.4	1.6	2.0	7.2	▲ 3.9	1.7

(% changes from the same quarter of the previous year)										(% changes from the previous fiscal year)		
Nominal GDP	4.0	5.1	7.3	6.0	5.1	2.9	2.8	2.7	2.4	2.0	5.9	2.7
GDP deflator	2.0	3.5	5.0	3.6	2.8	1.7	1.6	1.6	1.2	0.7	3.7	1.5
Consumer Price Index (excluding fresh food)	3.5	3.3	2.9	2.2	3.2	3.1	2.6	2.1	1.2	3.0	2.9	2.3
Unemployment Rate (%)	2.6	2.6	2.6	2.5	2.4	2.3	2.3	2.3	2.2	2.6	2.5	2.3
Exchange Rates (JY/US\$)	132	138	144	142	139	137	135	133	132	135	141	134
Import Price of Crude Oil (US\$/barrel)	87	83	84	91	89	86	82	79	78	103	87	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.