

Monthly Report of Prospects for Japan's Economy

November 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 October 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.
Leading indicators are unchanged.

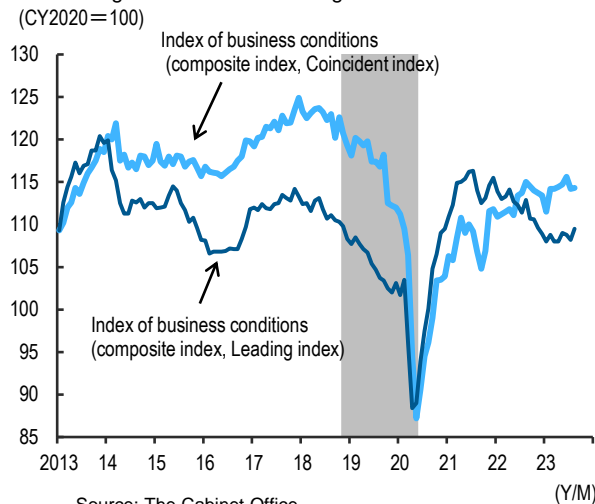


Figure 1-2 The Corporate Sector

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

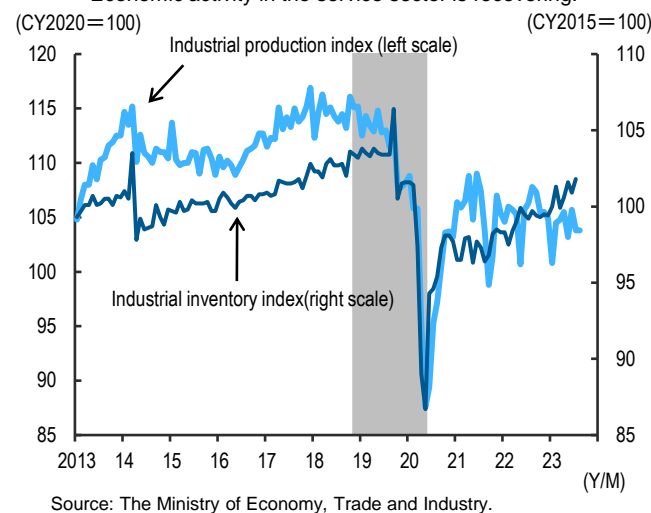


Figure 1-3 Overseas Demand

Exports are weak due to tepid demand for goods.
Imports, especially energy-related, are sluggish.

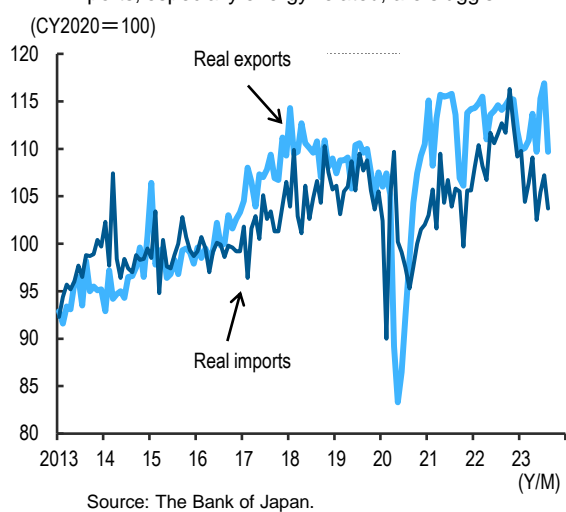
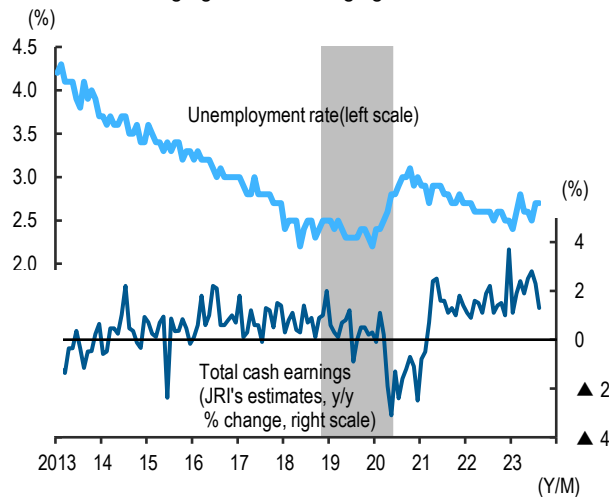


Figure 1-4 Employment and Income

The unemployment rate is hovering in the mid-2% range.
Nominal wage growth is averaging around 2%.



* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

Consumption is gradually rising.
Housing starts are currently weak.

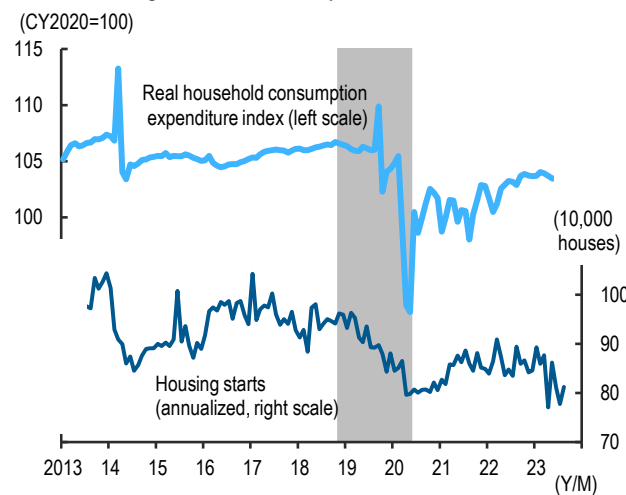
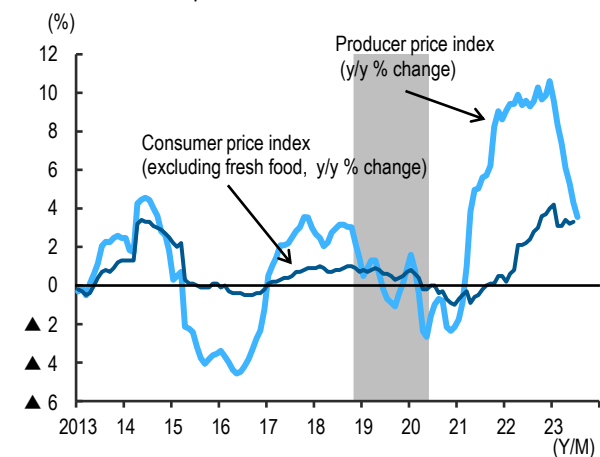


Figure 1-6 Prices

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



Business confidence among large companies is improving in both the manufacturing and non-manufacturing sectors

◆ Business confidence in the manufacturing sector has bottomed out

In the Bank of Japan's September Tankan survey, the diffusion index (DI) for business conditions for large manufacturing enterprises increased by four percentage points, rising for the second straight quarter. Confidence improved across a wide range of industries despite worsening demand for general-purpose machinery against a backdrop of sluggish foreign demand. For example, sentiment in the automobile industry climbed as supply constraints eased.

The DI for large non-manufacturing enterprises also rose for the sixth consecutive quarter, increasing by four percentage points. Confidence in the lodging and food/beverage service sectors recovered thanks to a rebound in inbound demand, while sentiment among companies engaged in wholesale and retail sales also improved as a result of widespread price pass-through.

◆ Production in the manufacturing sector is fluctuating

In August, the Industrial Production Index was unchanged from the previous month. By industry, production of automobiles declined due to temporary plant shutdowns

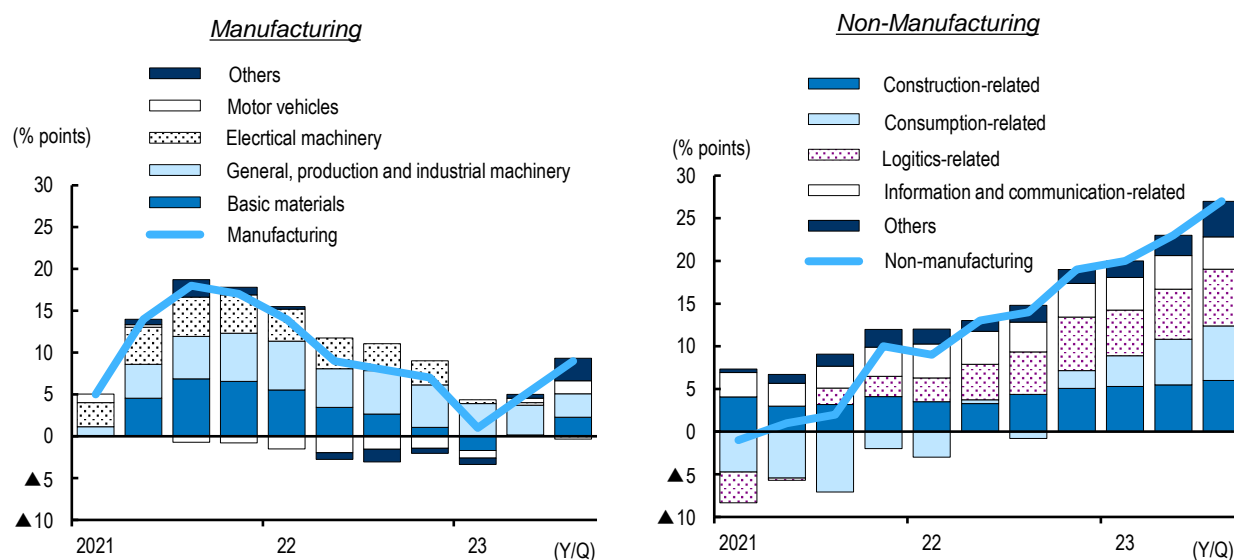
by some manufacturers, while output of petroleum/coal products and electrical and information and telecommunications equipment increased.

Near-future production plans indicate substantial increases in output in September (+5.8% month on month (MoM)) and October (+3.8% MoM). Production is expected to increase in a wide range of industries, and especially of transportation machinery, for which the figures in plans are high following lower output in August. However, due to the ongoing global slump in demand for goods, it is unlikely that the increase will be as high as planned.

◆ Activity in the service sector is increasingly brisk

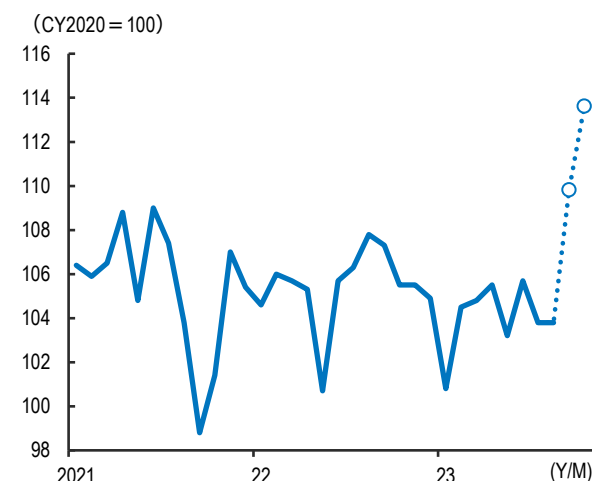
In July, the Tertiary Industry Activity Index rose 0.9% from the previous month. Transportation and postal services saw higher activity on the back of rises in retail and wholesale trade, and there was also an improvement in face-to-face services such as lodging and food/beverage services, for which demand is recovering.

Figure 2-1 DI for Business Conditions of Large Companies



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

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 (September and October).

Goods exports are sluggish, but inbound demand continues to recover

◆ Exports are weak due to tepid foreign demand

In August, real exports decreased for the first time in three months. By product category, exports of transportation machinery, which experienced a temporary downturn in production, declined, as did those of capital goods, reflecting a worldwide softening in appetite for capital investment.

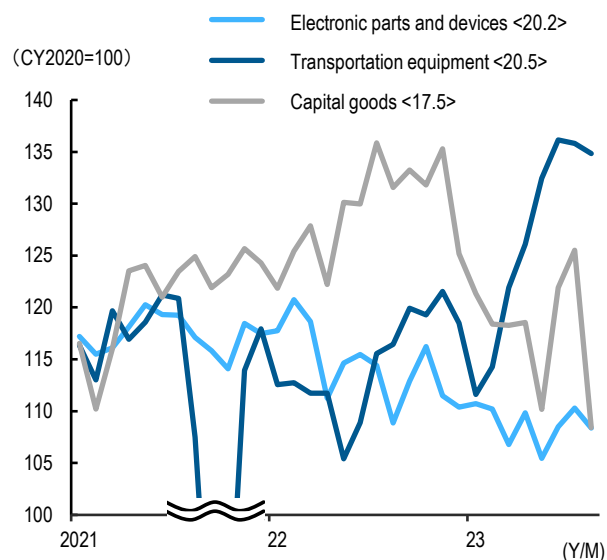
Looking ahead, goods exports are expected to be lackluster, against a backdrop of weak global demand for goods. According to the Bank of Japan's Tankan survey, the DI for supply and demand conditions for general-purpose, industrial, and commercial machinery turned negative (excess supply), and that for electrical machinery is also expected to stay in negative territory. However, a significant decline in exports as a whole is expected to be avoided in the near term as increases in exports of transportation machinery will provide support.

◆ The number of foreign visitors to Japan continues to recover

The number of foreign visitors to Japan in August rebounded to just over 80% of the 2019 level, with 2.16 million travelers coming to Japan. Tourists from East Asian countries other than China (e.g., South Korea) and places such as the U.S. increased in number, driving up the overall figure. Although the Chinese government lifted its ban on group travel to Japan on August 10, the number of Chinese tourists is still less than 40% of the 2019 level, so the pace of recovery is slow.

Going forward, inbound demand should continue its recovery. Chinese tourists have been slow to return to Japan, yet while the scrapping of the group-travel ban is expected to have some effect, 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 watched closely.

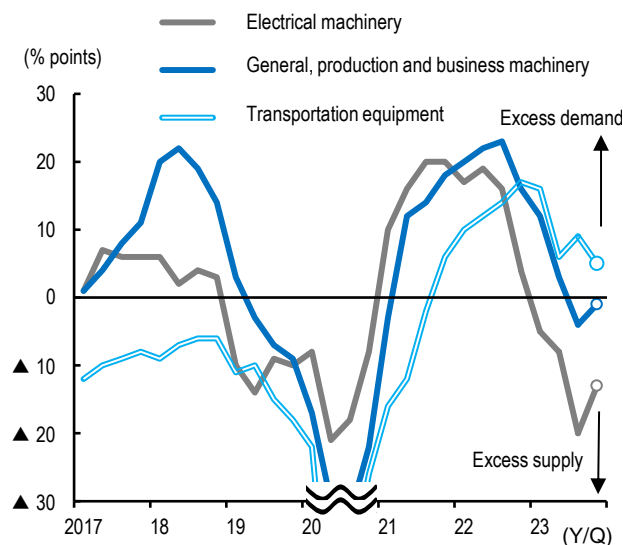
Figure 3-1 Real Export by Area
<seasonally adjusted>



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.

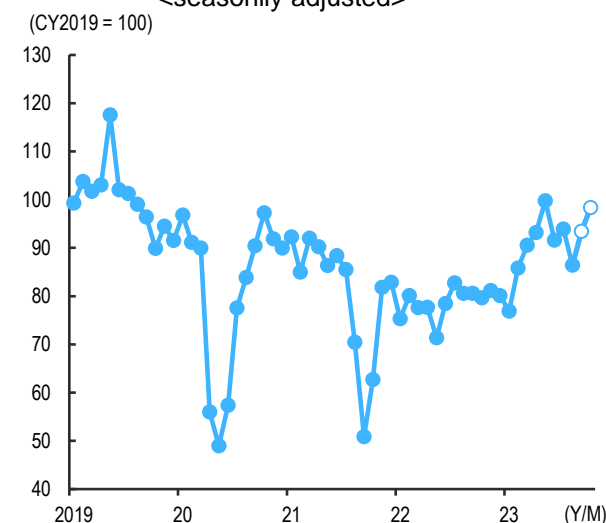
Figure 3-2 DI for Supply-Demand Judgment of Products Overseas <large companies>



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

Note: White markers indicate the outlook as of the September survey.

Figure 3-3 Industrial Production Index for Transportation Equipment
<seasonally adjusted>



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

Note: Figures are based on the production forecast index. White markers indicate planned production.

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Corporate earnings are strong, and software is driving capital investment

◆ Corporate earnings remain at high levels

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. Operating profit climbed, thanks chiefly to post-COVID rebound demand in the automobile and face-to-face service sectors, and non-operating income also boosted earnings overall. Against the backdrop of the yen's ongoing depreciation, dividend and interest income received by Japanese companies from their overseas subsidiaries are at record high levels.

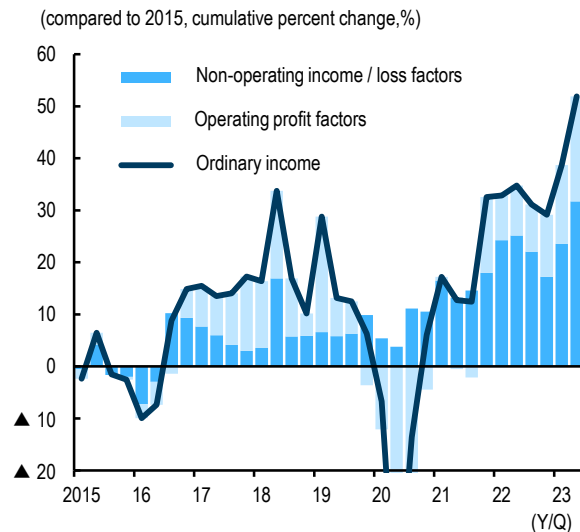
Looking ahead, corporate earnings are expected to remain high overall. While the worldwide slump in demand for goods will put downward pressure on earnings in the manufacturing sector, earnings overall should continue to rise, with non-manufacturing profits the primary contributor as services consumption by Japanese consumers and foreign tourists still has further room for recovery.

◆ Software is driving capital investment

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

Capital investment is also expected to hold firm going forward. According to the Business Outlook Survey for the July-September quarter, planned capital investments (all companies, all industries) in the current fiscal year are up 12.3% from the previous year, a high rate of increase compared to typical years. A look at where this spending is being directed reveals that at both large companies and small and medium enterprises (SMEs), there is strong investment demand for software and information equipment. Digital investment for labor-saving and data-related applications will drive future capital investment.

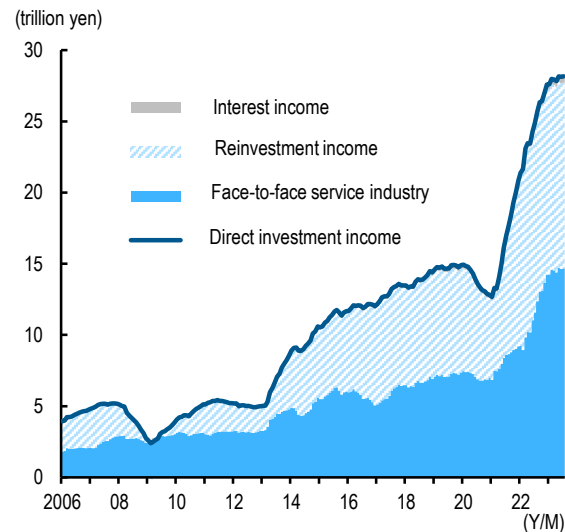
Figure 4-1 Factor Decomposition of Ordinary Income <all sizes, seasonally adjusted>



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

Note: Excluding finance and insurance.

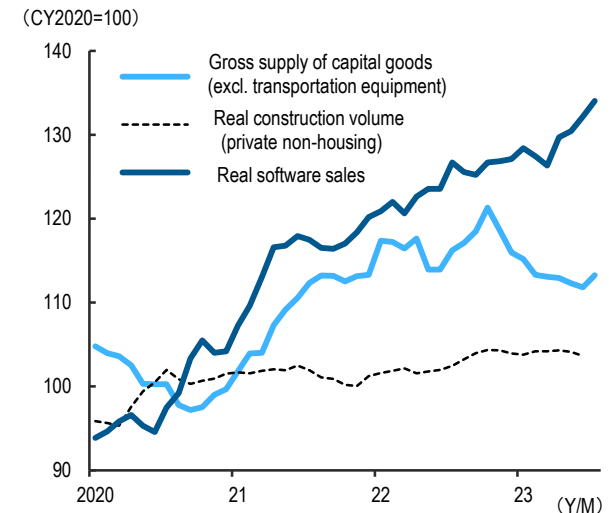
Figure 4-2 Direct Investment Income <receipts>



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

Note: Annualized, backward 12-month average.

Figure 4-3 Private Capital Investment Indicators <seasonally adjusted>



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

Note: Backward 4-month moving average.

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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 employees increased slightly, up 0.1% from the previous month. 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. In the Bank of Japan's September Tankan survey, the diffusion index (DI) for employment conditions for all company sizes in all industries dropped by one percentage point from the previous survey, with labor shortages seemingly becoming more severe. Labor shortages are even more serious in the non-manufacturing sector, particularly in lodging and food/beverage service, than they were in 2019, the pre-COVID peak.

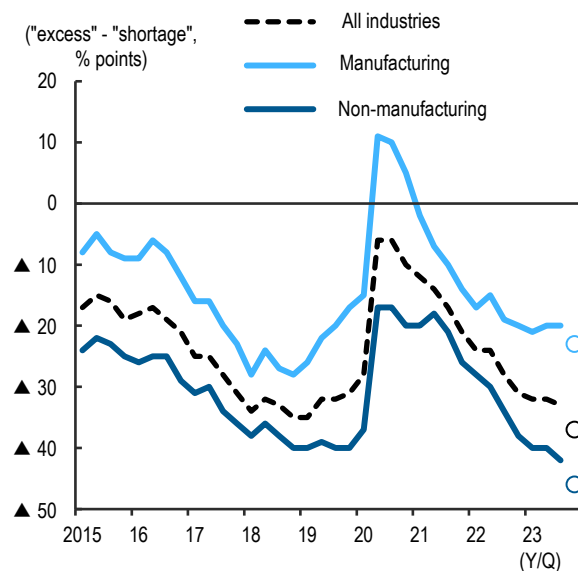
The job market is expected to become increasingly tight in the near term. Demand for labor will increase as economic activity recovers, but there is limited room for expansion in the labor supply. Regarding the size of the labor force, the number of elderly workers has already peaked, and growth in female workforce participation has also slowed compared to before the pandemic.

◆ The rate of nominal wage growth is rising

In August, basic salaries of regular employees increased by 1.5% YoY, and the hourly pay of part-time workers also continued to grow at a fairly rapid clip, rising 3.4% YoY. By industry, wage growth was high in lodging and food/beverage services, transportation, and postal services, and tended to be higher in sectors facing serious labor shortages. However, the rises failed to keep pace with the rate of price increases, with real wages falling 2.5% in August, down for the 17th consecutive month.

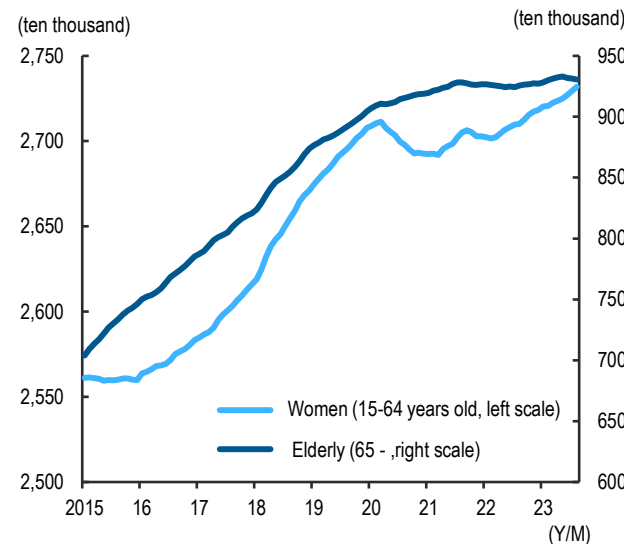
Going forward, real wage growth is expected to turn positive during 2024. Wage growth rates look set to increase in a wide range of industries as labor shortages intensify and minimum wages rise.

Figure 5-1 Employment DI



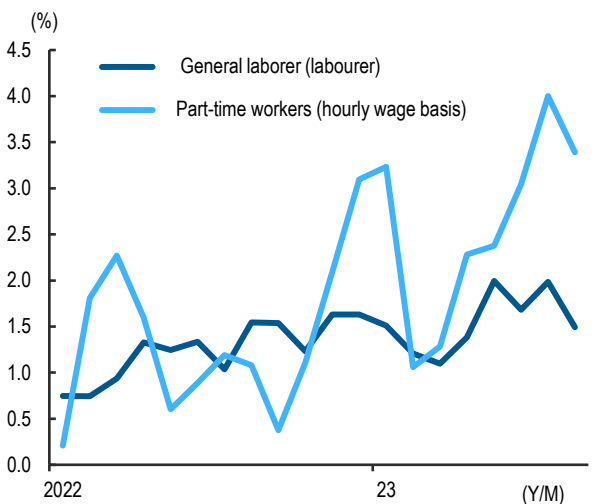
Source: The Japan Research Institute, Ltd. based on the data of The Bank of Japan.
Note: White markers indicate the outlook as of the September 2023 survey.

Figure 5-2 Labor Force
<backward 12-month moving



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

Figure 5-3 Response to Minimum Wage Increase



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

Note: Adjusted for data fault caused by the replacement of surveyed companies.

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Personal consumption is slowly recovering, and an improving income environment will provide support going forward

◆ Services consumption is slowly increasing

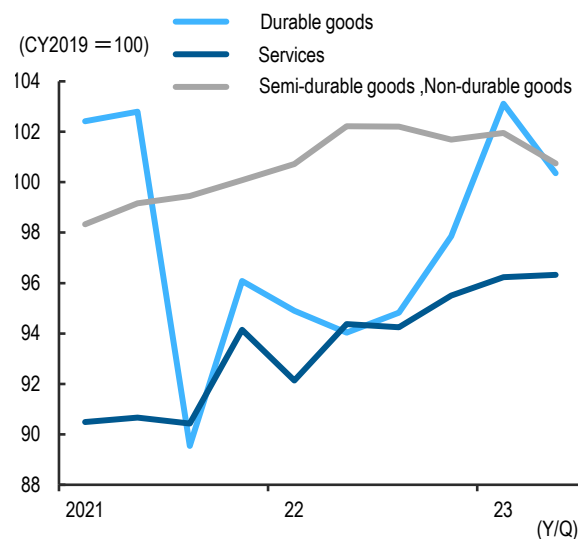
Personal consumption is gradually recovering despite weakness in certain categories. The normalization of economic activity has led to a gradual increase in consumption of services such as dining out and travel. In dining out, there has been a recovery recently as customers finally return in numbers to izakayas (traditional Japanese pubs). Non-durable goods consumption, however, is tepid due to the impact of rising prices of items such as clothing and footwear. 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.

◆ Risk of downswing in personal consumption due to high oil prices

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.

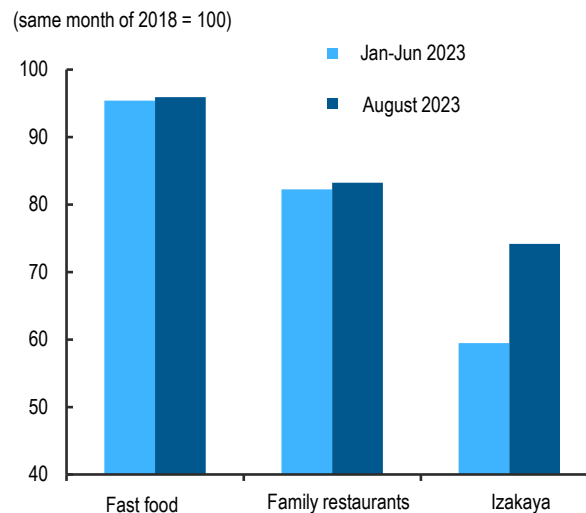
However, if oil prices rise further, there is a risk of a downturn in personal consumption due to sluggish real wages. Estimates suggest that if crude oil prices rise to their most recent peak (\$130 a barrel), private consumption would fall by 0.2 percentage points.

Figure 6-1 Personal Consumption by Form



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

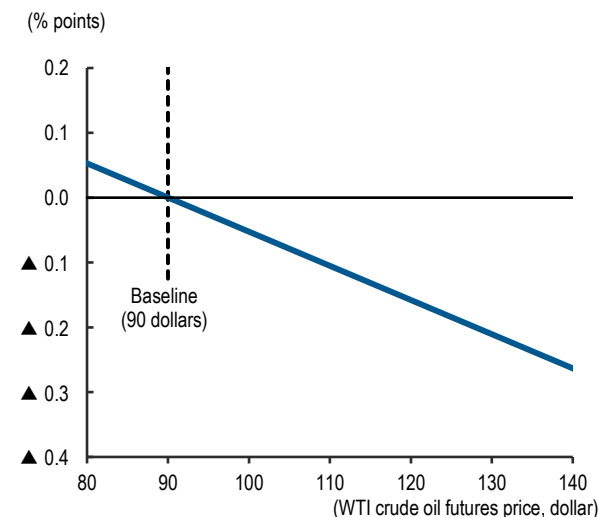
Figure 6-2 Number of Restaurant Industry



Source: The Japan Research Institute, Ltd. based on date of The Japan Food Service Association.

Note: To eliminate the impact of the rush demand associated with the consumption tax rate hike, the same month in 2018 = 100.

Figure 6-3 Impact of Crude Oil Prices on Personal Consumption



Source: The Japan Research Institute, Ltd. based on date of The Nihon Keizai Shimbun, Inc.

Note: Estimated based on NEEDS Japan economic model.

Topic①: Challenges in expanding the acceptance of foreign workers

◆ Increasing dependence on foreign workers

Japan faces a serious labor shortage, and foreigners are becoming a key component of the labor force. Although the inflow of foreign workers temporarily ground to a halt due to the waterfront measures imposed during the COVID pandemic, the number of foreign workers began to rise once the measures were eased, and had reached 1.82 million at the end of October 2022. With Japan's population expected to plummet in the future, dependence on foreigners in the workforce will keep rising.

◆ Foreign workers boost the potential economic growth rate by around 0.1%

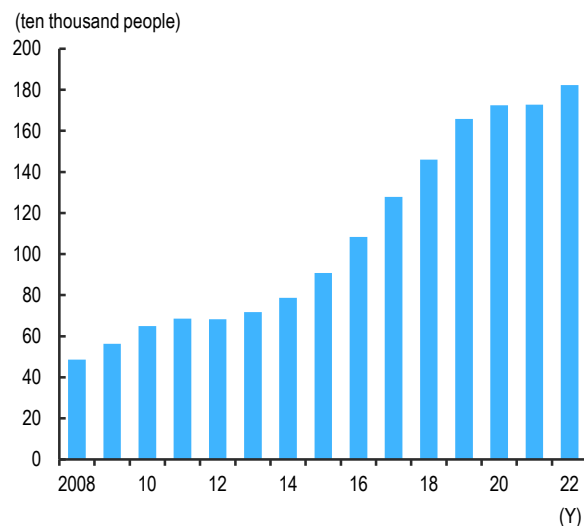
Given the worsening labor shortage, the government plans to expand the acceptance of foreign workers. This spring, the government decided to 1) add new fields to the list of jobs covered by the Type-2 Specified Skilled Worker visa and 2) create a new system to replace the Technical Intern Training Program aimed at

securing and developing human resources.

However, it is unclear whether these measures will increase the number of foreign workers in line with the government's objectives. The wage gap between Asian countries and Japan is narrowing, and foreign workers are likely to choose countries with higher wages than Japan. If the influx of foreign workers stays at the same level as before COVID, the increase in labor input will only raise the potential growth rate by an average of 0.1% per year through 2030. This effect is much lower than that of the decrease in Japanese labor input (-0.3%).

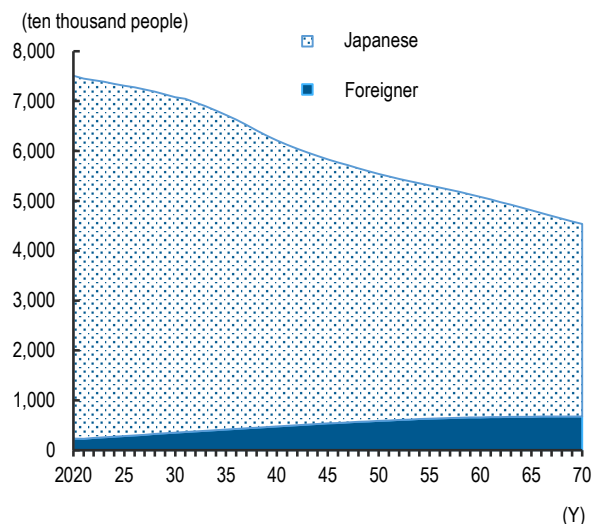
For Japan to become a country that foreign workers choose as a place to work, it will be necessary to continue to improve their treatment, including by raising their wages. The monthly wages of general factory workers in Japan's manufacturing sector are lower than those in South Korea and Australia, so foreigners may choose these countries over Japan as a place to work.

Figure 7-1 Foreign Workers



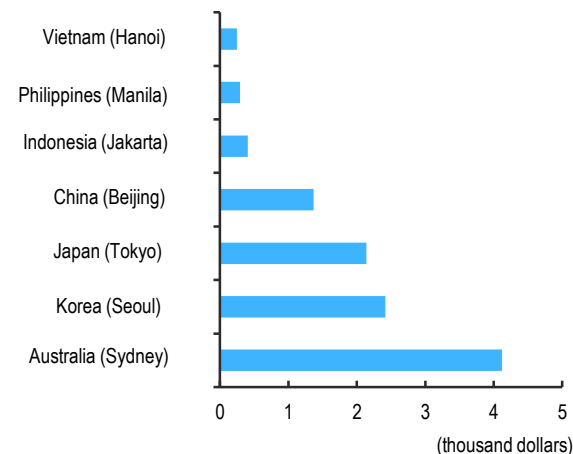
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labour and Welfare.

Figure 7-2 Projected Working-Age Population <15-64 years old>



Source: The Japan Research Institute, Ltd. based on data of The National Institute of Population and Social Security Research.
Note: Births (deaths) are estimated as the median births (median deaths).

Figure 7-3 Wages in Japan and Asia/Oceania



Source: The Japan Research Institute, Ltd. based on data of The Japan External Trade Organization.

Note: Monthly wages for manufacturing and general engineering workers. The figures for South Korea and China are for 2021, and those for other countries are for 2022.

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Topic②: "Annual income barrier" bridging measure is unlikely to resolve labor shortages

◆ The effects may be limited

In October, the government introduced measures to address the "annual income barrier" issue. Although the measures are intended to relieve labor shortages caused by the "annual salary barrier," they may be of limited effectiveness for two reasons.

First, even if the so-called "work and lose" problem (i.e., becoming poorer after working more hours) is eliminated, the advantages of spousal support (i.e., being classified as a dependent of one's spouse) remain substantial. Under the new measures, workers whose annual income exceeds 1,060,000 yen and who thus become ineligible for spousal support, will receive a subsidy to offset the reduction in their take-home. However, many working-hours adjusters (i.e., married workers who consciously limit the hours they work to maintain spousal support) do so for reasons other than take-home pay, such as to continue receiving the spousal tax deduction and remaining insured under their spouse's health insurance.

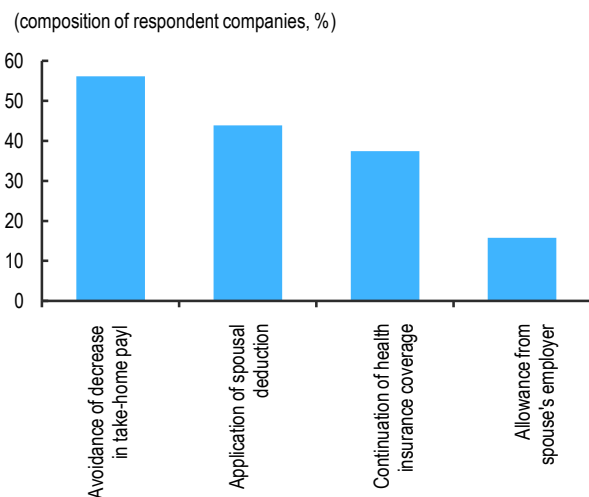
Second, it is unclear how many more working hours the measure to tackle the so-called "1.3 million yen barrier" will allow. With this measure, even if their income

temporarily increases due to extended working hours, the worker can retain spousal support. However, according to questionnaire surveys and other data, working-hours adjusters would like to increase their working hours by 20-40% if the "annual income barrier" were eliminated. Even if working-hours adjusters increased their overtime hours to the same level as regular employees, their working hours would only increase by 10%, and it is unclear whether a 20-40% increase in income would be considered temporary.

◆ Higher wages increase the constraining effect on the supply of labor

If the effect of the "bridging measures" is weak, as indicated by the above discussion, the labor shortage may not be fully eliminated. According to estimates, working-hours adjustment caused by the "annual income barrier" pushes the economy as a whole down by 1.4%. In contrast, these new policies will only boost total hours worked by 0.1%. Going forward, if wages increase, it is highly likely that the constraining effect on total hours worked of working-hours adjustment will expand.

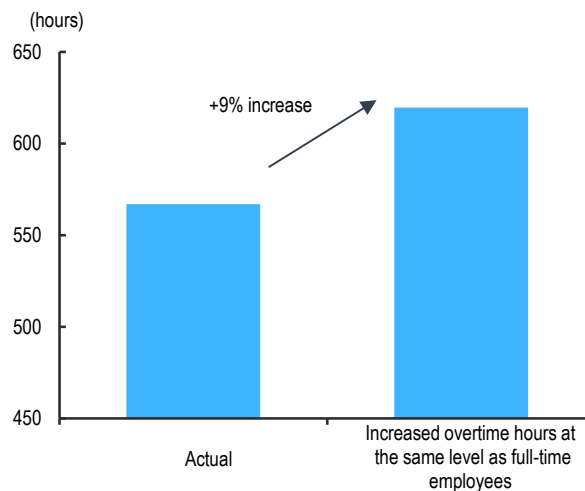
Figure 8-1 Reason for Employment Adjustment



Source: The Japan Research Institute, Ltd. based on data of The Japan Institute for Labour Policy and Training

Note: Multiple responses. The subjects are the workers who implemented job adjustment among the short-time workers to whom the coverage of employees' pension and health insurance was extended in October 2022.

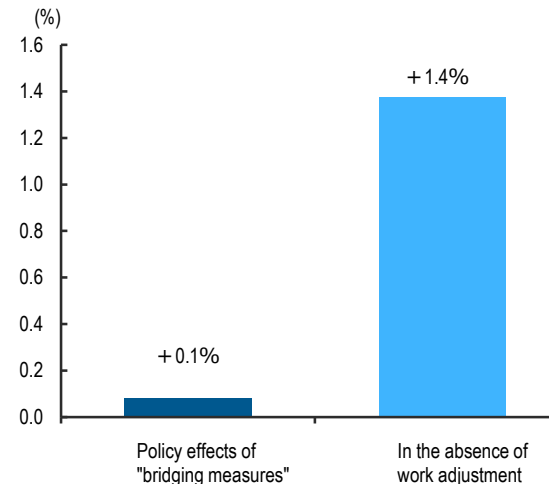
Figure 8-2 Annual Working Hours of Employment-Adjusted Workers <in 2022>



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

Note: If overtime hours are increased to the same level as regular employees, it is assumed that the ratio of overtime hours to regular working hours is increased to the same level as that of regular workers.

Figure 8-3 Percentage Increase in Total Hours Worked in The Economy as a Whole



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

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

◆ The growth rate for FY2023 will be +2.1%

Looking ahead, Japan's economy is expected to continue to slowly recover, driven by domestic demand. With rebound demand providing much of the impetus, personal consumption should continue its recovery, especially for food/beverage service and other services. And even after this rebound demand peters out, personal consumption is expected to be supported by an improved income environment. Wage growth rates look set to increase against the backdrop of severe labor shortages, and real wages should stop falling next year.

Capital investment is expected to rise, with the execution of postponed investments the main factor. Furthermore, investment demand for software and information devices is brisk, and digital investment for labor-saving and data-related applications will drive future capital investment. The real economic growth rate 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.

◆ Rise in oil prices poses risks for the near term

However, there is a risk of an economic downswing if oil prices go even higher. Prolonged imported inflation has caused real wages to stagnate and the recovery in personal consumption to falter. It is feared that a decline in corporate earnings could reduce the appetite for capital investment.

◆ Core inflation remains above 3%

In August, core inflation stayed at 3.1%, the same as the previous month. Reflection in the core CPI of the drops in resource prices that occurred in the first half was delayed due to the effect of the government's fuel cost adjustment system (which adjusts electricity charges according to import prices of raw materials). As a result, electricity and gas bills fell by a larger margin. However, hotel room charges rose. Prices of non-durable goods, particularly food, continued their steep ascent. In addition, the speed of price increases for items that are closely linked to wages such as services 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. According to the Bank of Japan's September Tankan survey, fewer firms in goods-related sectors are planning to raise their selling prices. However, there is a risk of a fresh intensification of imported inflationary pressures if there is a continuation of rising oil prices and a falling yen.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of October 6, 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.