

Monthly Report of Prospects for Japan's Economy

June 2024

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 May 2024 issue of the original Japanese version.

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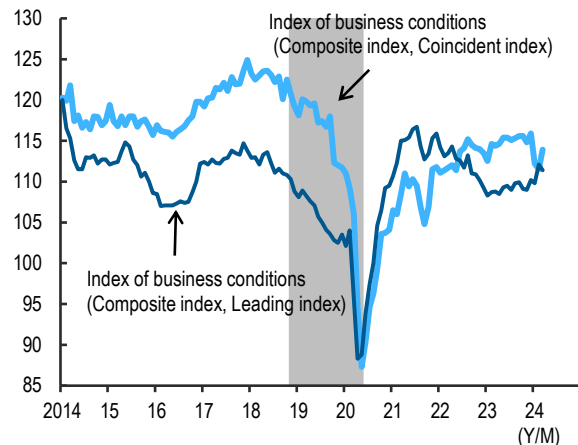
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The General Situation – The economic recovery has stalled

Figure 1-1 Economic Activity

The coincident index of business conditions is picking up.
The leading index is improving.

(CY2020=100)

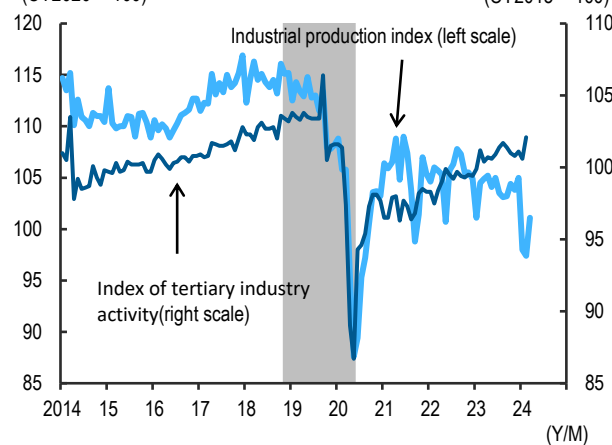


Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

Industrial production is rebounding, centered on automobiles.
Economic activity in the service sector is brisk.

(CY2020=100)

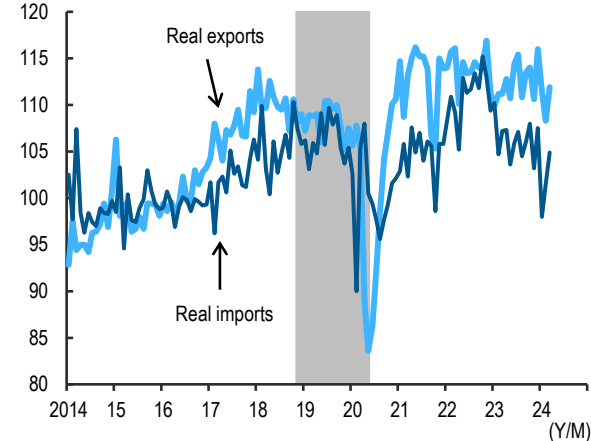


Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

Goods exports are fluctuating.
The slump in energy-related imports has paused.

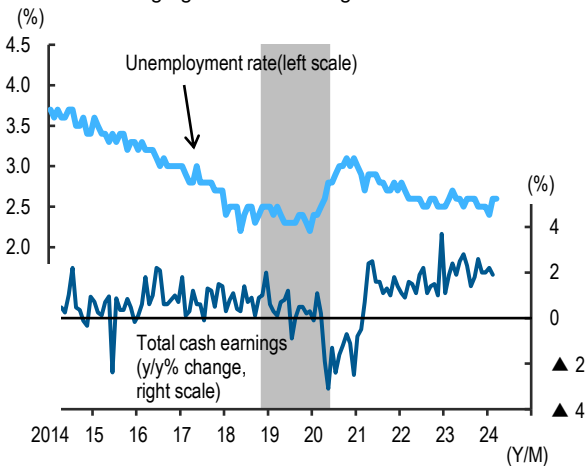
(CY2020=100)



Source: The Bank of Japan.

Figure 1-4 Employment and Income

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



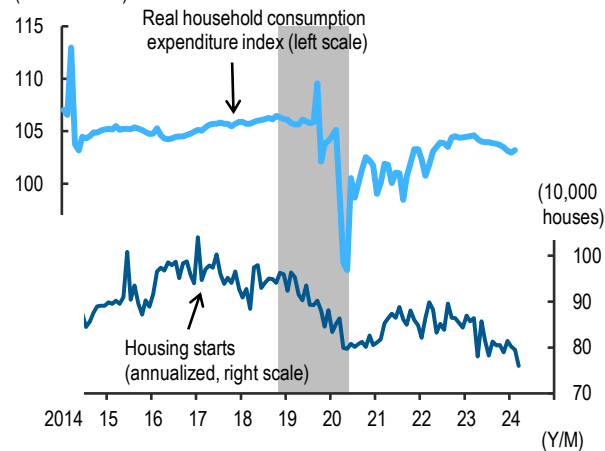
Source: The Ministry of Internal Affairs and Communications,
The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

Consumption is showing signs of recovery.
Housing starts are at a lower level.

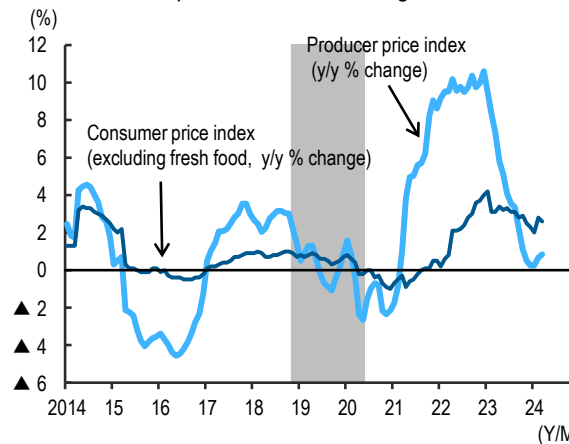
(CY2020=100)



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 accelerating slightly.
Consumer price inflation is hovering in the mid-2% range.



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 contracted for the first time in two quarters

◆ Suspension of automobile shipments has been a factor in the downward pressure on the economy

Real GDP growth in the January-March 2024 quarter was -2.0% on an annualized basis quarter over quarter (QoQ), the first negative growth in two quarters. The impact of the suspension of automobile production/shipment by certain carmakers was felt across the economy, pushing down the growth rate. As for foreign demand, exports of goods, particularly automobiles, declined. Regarding domestic demand as well, durable goods, especially automobiles, saw lower demand, while demand for nondurable goods remained weak due to the effects of rising prices.

◆ Production in the manufacturing sector is recovering

In March, the Industrial Production Index increased for the first time in three months, rising 3.8% from the previous month. Production/shipments by some automakers, which had been suspended due to performance test irregularities, resumed, helping the index to rise. In addition, production of machinery increased in response to higher orders from overseas.

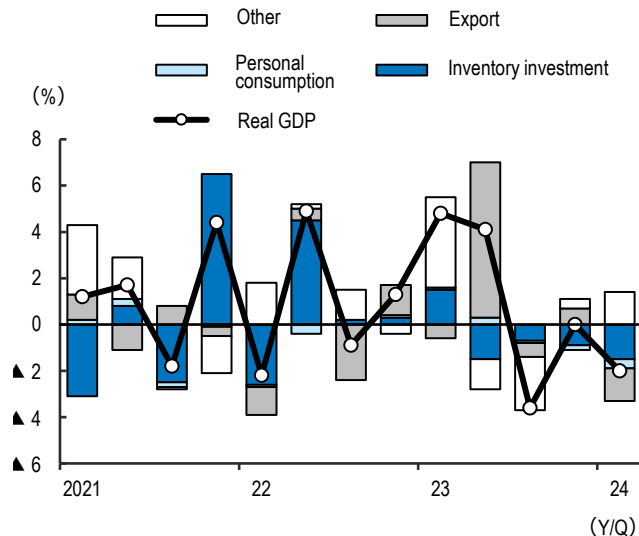
Near-future production plans indicate increases in output in April (+4.1% month over month (MoM)) and May (+4.4% MoM). Besides the ongoing rebound in the

automotive industry, output is expected to increase in the production machinery sector against the backdrop of higher orders from overseas. The slump in production since the start of the year looks likely to have been only temporary.

◆ Consumer confidence is improving

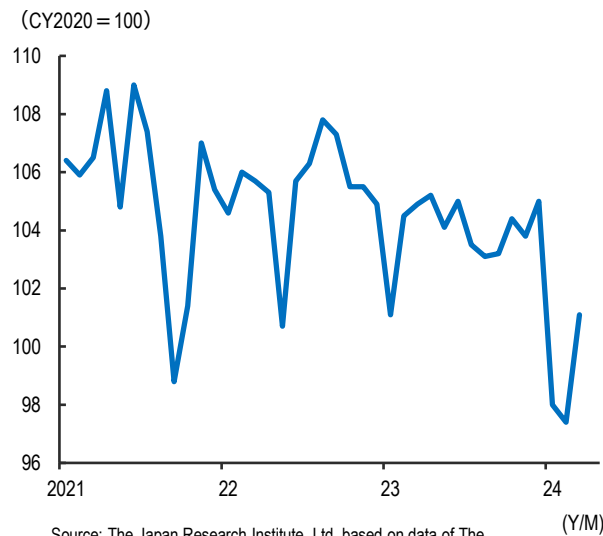
In April, the Consumer Confidence Index fell by 1.2% MoM, yet remained at a high level. While willingness to buy durable goods declined, optimism about asset values increased thanks to factors such as rising stock prices.

Figure 2-1 Real GDP Growth Rate
<YoY annual growth rate>



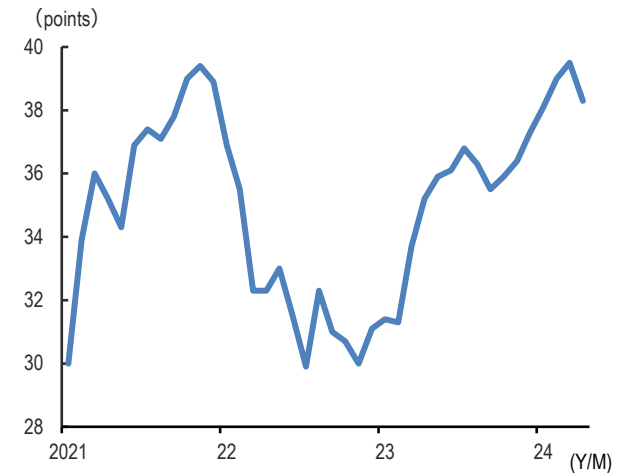
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.

Figure 2-2 Index of Industrial Production
<seasonally adjusted>



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

Figure 2-3 Consumer Attitude Index
<seasonally adjusted>



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

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Capital investment will increase thanks to strong corporate earnings

◆ Corporate earnings remain high overall

According to the Financial Statements Statistics of Corporations, net sales for the October-December 2023 quarter edged up 0.9% QoQ, rising for the 11th consecutive quarter. Sectors such as transportation machinery, production and exports of which have increased thanks to the evaporation of supply constraints, are now the main driver. However, ordinary profit dipped 2.6% QoQ, falling for the second quarter in a row. Increased labor costs and other factors are putting pressure on earnings.

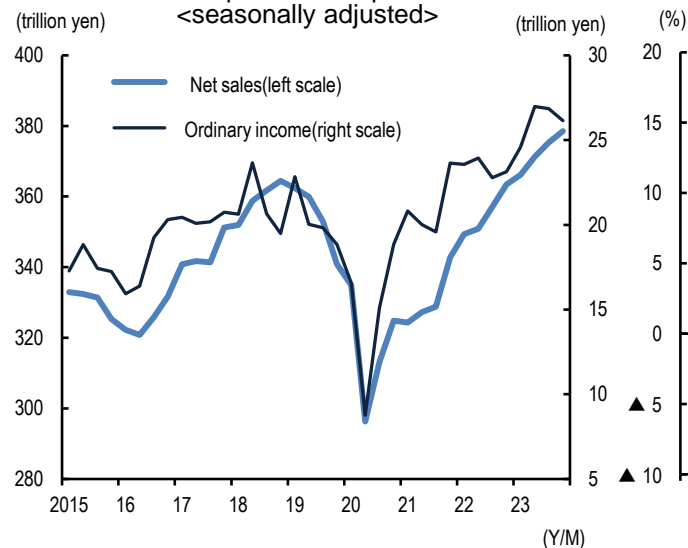
Corporate earnings in the January-March 2024 quarter seem to have held firm on the whole. While the suspension of shipments by some automakers acted to push down financial performance, the depreciation of the yen and increased profit margins due to price pass-through helped shore up earnings. Corporate earnings for FY2024 are expected to maintain their moderate upward momentum, supported by a recovery in domestic demand, though some firms have been exercising caution in their initial forecasts for the fiscal year.

◆ Capital investment is expected to increase

Capital investment has been weak recently. While software investment has remained at a high level, construction investment has been sluggish due to continued high construction costs. Furthermore, the impact of certain automakers' suspension of vehicle shipments has led to temporary reticence to take on capital investment, particularly in the automobile sector.

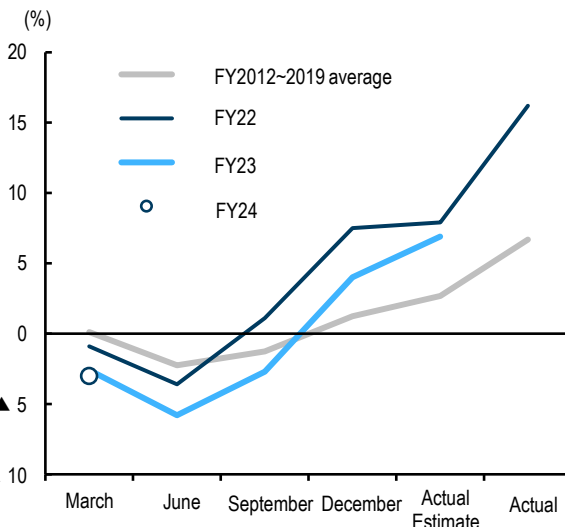
Capital investment is expected to get back on the recovery track going forward. Supported by strong earnings, companies are maintaining proactive stances on capital investment. According to the Bank of Japan's March Tankan survey, planned capital investments for FY2024 are substantially higher than they normally are at this stage of the fiscal year. Notably, against the backdrop of worsening labor shortages, companies are eager to invest in software for labor-saving. In addition, a pickup in global demand for goods is providing a tailwind for capital investment.

Figure 3-1 Net Sales and Ordinary Income of Corporate Enterprises <seasonally adjusted>



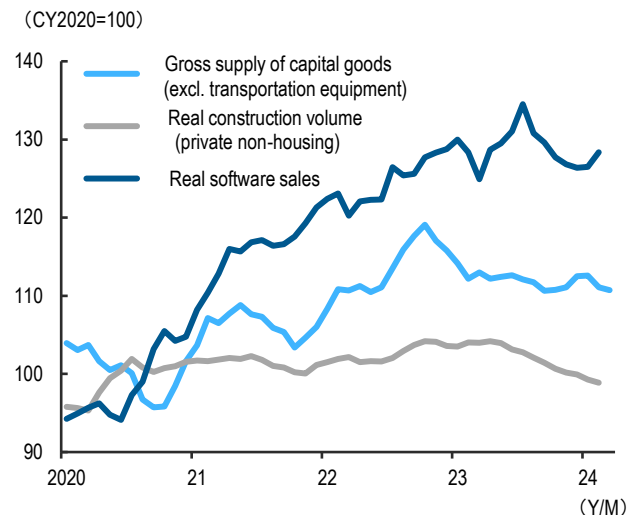
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.
Note: All sizes, all industries (excluding finance and insurance).

Figure 3-2 Ordinary Income Plan <YoY>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.
Note: All sizes, all industries.

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



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

Note: Backward 4-month moving average.

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The income situation for households is expected to gradually improve

◆ Real wage growth will turn positive in the summer

In March, basic salaries of regular employees continued to rise moderately, increasing by 1.9% year over year (YoY), and the hourly pay of part-time workers also carried on growing at a rapid clip, rising 4.9% YoY. However, the average rise in workers' wages is still not keeping pace with consumer price inflation, with real wages falling 2.5% YoY for the 24th consecutive month of negative growth.

Going forward, wage growth rates are expected to increase. According to the fifth announcement by RENGO (Japanese Trade Union Confederation, Japan's largest union group) on the outcome of the shunto (annual pay negotiations), the companies surveyed are hiking wages by 5.17% (including regular salary increases) on average in 2024, marking the highest rise in 33 years. Background factors that can be pointed to include strong corporate earnings, willingness among firms to help their workers cope with rising prices, and intensifying labor shortages. Heading into the summer, more companies will be implementing the wage hikes agreed during the shunto, and

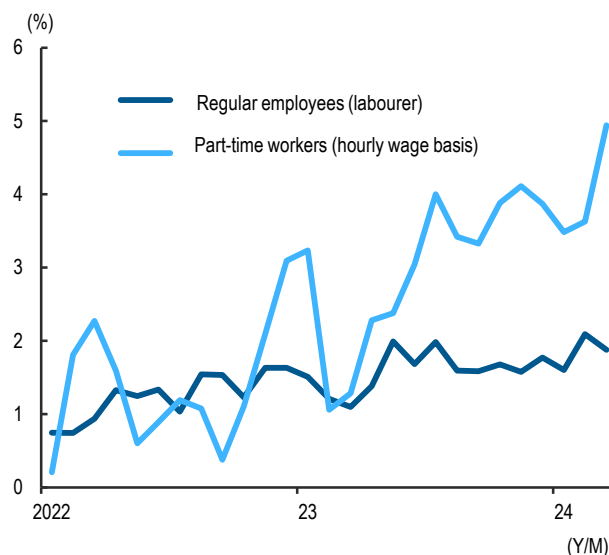
nominal wage growth rates are expected to quicken, with the basic salaries of regular employees the main beneficiary. This should result in YoY real wage growth turning positive from the July-September quarter.

◆ New car sales have bottomed out

In April, sales of new cars increased by 12.7% MoM, rising for the first time in six months. The background to this is the fact that the suspension of automobile production/shipment by certain manufacturers due to performance test irregularities has run its course.

Looking ahead, as the impact of these shipment halts disappears, car sales are expected to recover. Boosted by an increase in wage growth and lump-sum reductions in income and resident taxes that will come into effect in June, overall personal consumption looks set to recover.

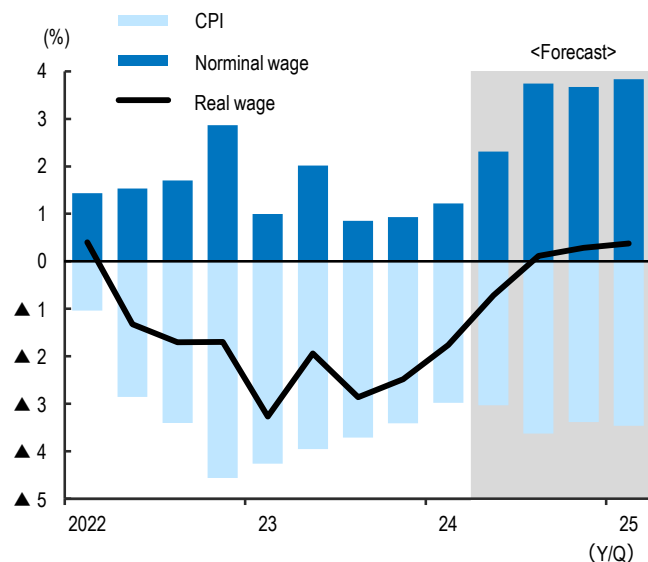
Figure 4-1 Basic Salaries <YoY>



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

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

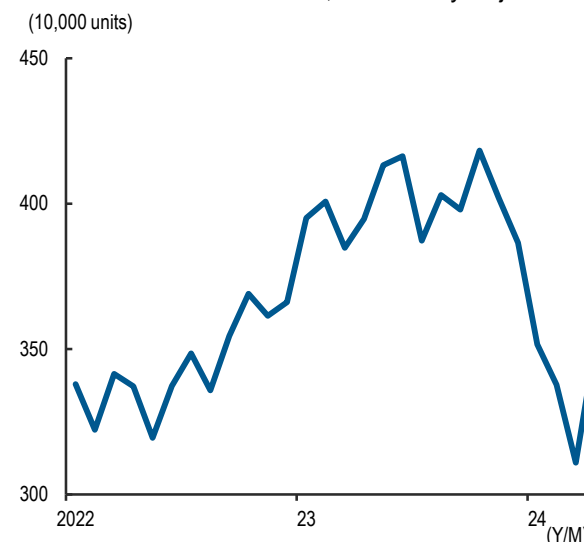
Figure 4-2 Real Wage Outlook <YoY>



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

Note: Consumer prices are composite, excluding imputed rent of owner-occupied houses.

Figure 4-3 New Vehicle Registrations <annualized, seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Japan Automobile Dealers Association, etc.

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Price hikes reflecting rising wages are spreading to private-sector services

◆ Core inflation remains above 2%

In March, core inflation fell from the previous month to 2.6%. With pass-through of higher raw material prices to sale prices pausing, the pace of rising prices of food and core goods has slowed. However, prices of services are still rising rapidly. While prices for most public-sector services remain unchanged, an increasing number of private-sector services are seeing YoY price rises of over 3%. Among private-sector services, there are growing moves to pass on wage increases to prices in the education and entertainment sectors, which are highly susceptible to the effects of changes in personnel expenses. For the time being, the core CPI is expected to keep rising at an annual pace of above 2%. Services will continue to become more expensive due to rapid wage growth. In addition, energy price inflation is expected to increase going into the summer. Estimates indicate that the government's reduction/termination of its measures to ease the pain of rising prices will push up core inflation by as much as one percentage point.

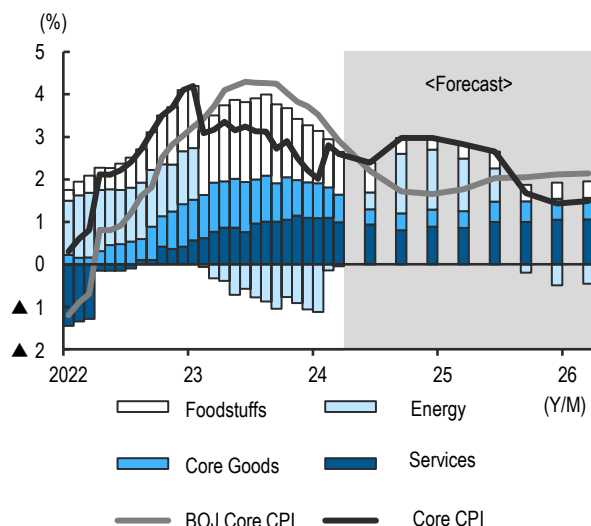
◆ The Bank of Japan (BOJ) could raise interest rates again in October

At its April Monetary Policy Meeting, the BOJ decided to keep its policy rate unchanged.

Long-term interest rates rose in April. This reflected the view that the BOJ may hike interest rates again to counter the yen's depreciation, as well as the rise in U.S. long-term interest rates following the retreat of expectations that the Federal Reserve will move to cut rates soon.

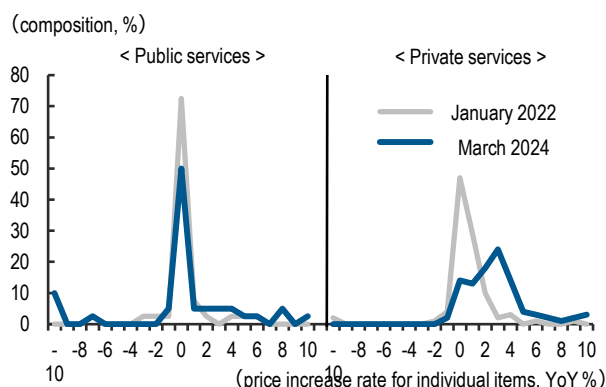
Looking ahead, the BOJ is expected to raise interest rates in the autumn, once it confirms that wage and price increases are being sustained, and to keep steadily hiking rates from then on. Long-term interest rates look set to rise gradually due to policy rate hikes and a recovery in the domestic economy.

Figure 5-1 Consumer Price Index <YoY>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.
Note: The forecast period is for the quarter.

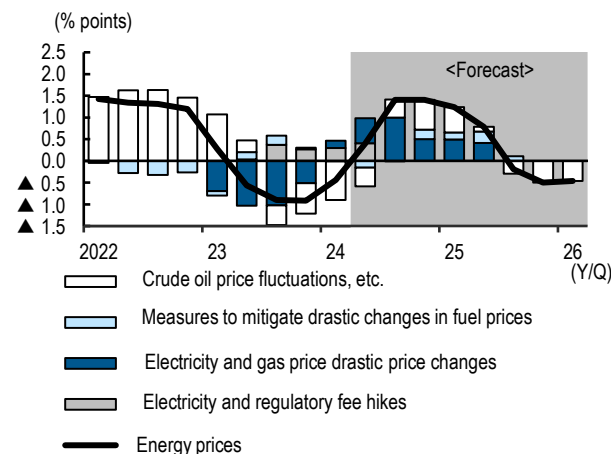
Figure 5-2 Frequency Distribution of Consumer Price Inflation



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

Note: The histogram is 1 percentage point wide (the central 0% range is from -0.5% to +0.5%). The left end of the histogram shows the percentage of items that were less than -9.5% of the previous year's level, while the right end shows the percentage of items that were more than 9.5% of the previous year's level.

Figure 5-3 Year-on-Year Contribution of Energy Prices to Core CPI



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

Note: Electricity and gas price mitigation measures are assumed to be halved in May 2024 and terminated in June 2024, and fuel oil price mitigation measures are assumed to be phased out starting in June 2024.

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Topic①: Expansion of overseas production is a curtailing factor for automotive exports

◆ Expansion of foreign output suppresses automobile exports

Japan's automobile exports have been sluggish due to the suspension of shipments by some manufacturers. Although they are expected to start picking up in the future, momentum could be moderate. Domestic automobile production capacity has declined significantly in recent years, which has worked to curtail exports. This is in contrast to other machinery sectors, which are expanding domestic output in response to the depreciation of the yen and the restructuring of supply chains.

◆ The trend of strengthening overseas production will continue in the future

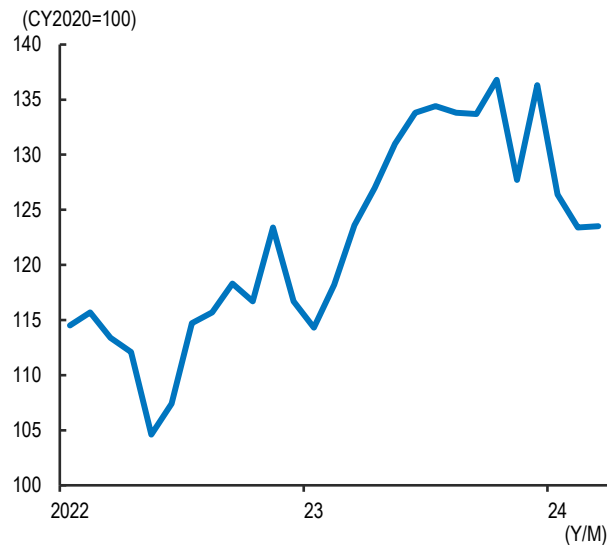
The decline in domestic automobile production capacity owes a great deal to the intensification of the shift to foreign output. Going forward, this trend is likely to continue for the following two reasons:

The first reason is that automakers are working to capture demand in emerging

economies, which are seen as offering high growth potential. In emerging countries such as India and the ASEAN nations, where Japanese carmakers have been expanding their sales networks in recent years, tariff rates on automobiles tend to be higher than on other goods, as governments wish to protect domestic industry. Japanese automakers are thus keen to expand local production in order to enhance their price competitiveness in those markets by reducing costs associated with trade.

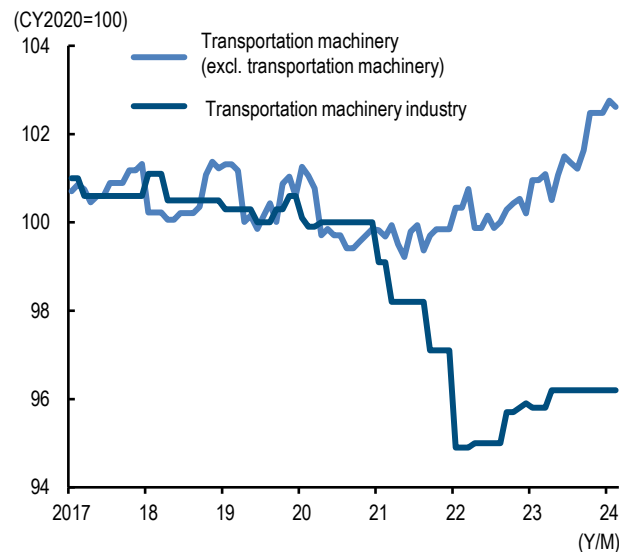
The second reason is that they are endeavoring to adapt to the increasingly protectionist industrial policies of Western countries. The Inflation Reduction Act, which was signed into law in the U.S. in August 2022, provides tax incentives for EVs (electric vehicles) and automotive batteries manufactured in North America. In response, major automakers have been increasing their investments to expand production capacity in North America.

Figure 6-1 Real Exports of Auto-Related Products <seasonally adjusted>



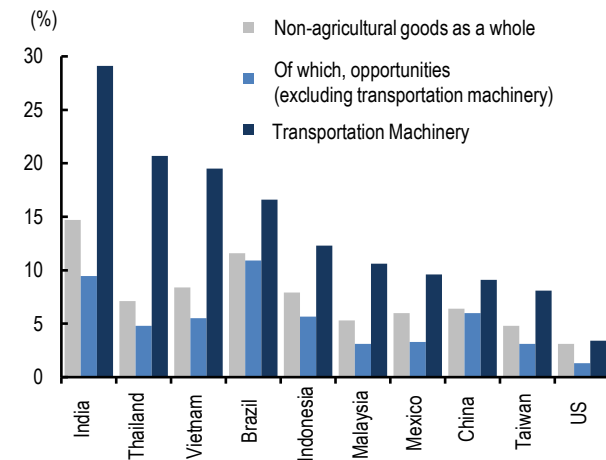
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.

Figure 6-2 Production Capacity Index for Machinery Industry



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

Figure 6-3 Tariff Rates on Imports <CY2022>



Source: WTO.

Note: MFN run rate, simple average. The top 10 countries with the largest number of four-wheel vehicle production plants of Japanese automakers.

Topic②: The BOJ will raise interest rates again as the depreciation of the yen accelerates

◆ Risk of soaring inflation due to yen depreciation

The yen has been losing value in the foreign exchange market. The dollar-yen exchange rate temporarily topped 160 yen at the end of April, putting the yen at its weakest level since April 1990. In May, it briefly returned to the 151-yen level due to what appeared to be foreign exchange intervention by the government and the BOJ, but has recently been hovering around 155 yen.

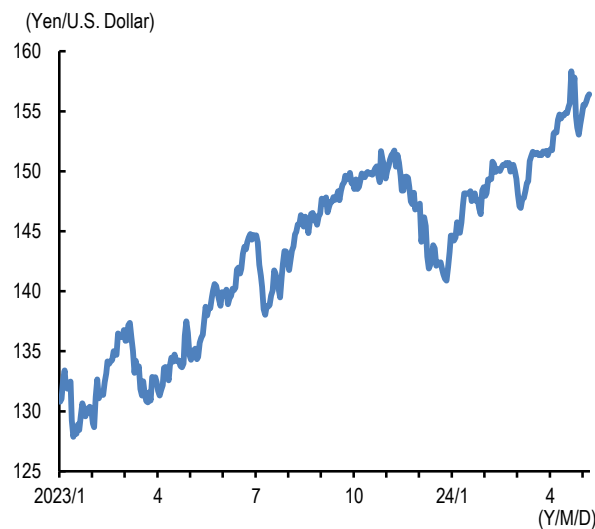
If the yen's depreciation continues, inflation may soar again. According to estimates, if the yen were to slide to 160 yen to the dollar, consumer price inflation (composite excluding fresh food and energy) would be 0.2 percentage points higher than the baseline. And if it were to lose even more ground, depreciating to 170 yen/dollar, this inflationary effect would increase to 0.4 percentage points.

If the yen's weakness becomes established, there is a high possibility of a delay in the timing of real wage growth turning positive. Estimates indicate that with an exchange rate of 160-170 yen to the dollar, real wage growth would not enter positive territory until next fiscal year or even later.

◆ Early additional interest rate hikes could be in the works

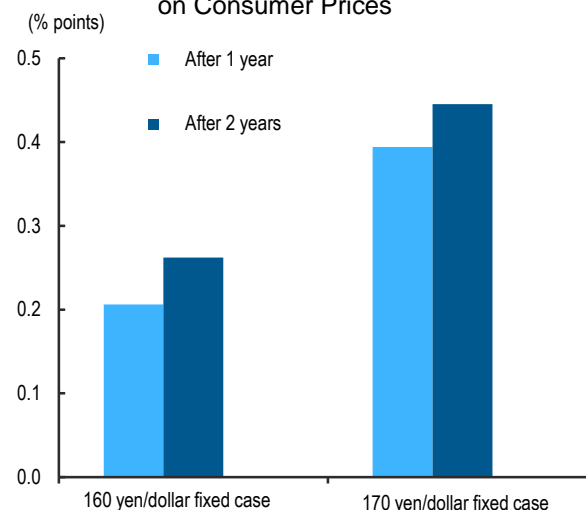
To prevent cost-push inflation from becoming entrenched due to yen depreciation, the BOJ may consider raising interest rates again earlier than previously thought. During the 1980s and the early 1990s, when the BOJ employed a flexible approach to its policy rate, it would raise the rate by about 1.2 percentage points in response to an increase of one percentage point in consumer price inflation. If the BOJ adopts the same tactics during this current phase, it may be pressed into an additional rate hike of 0.25 percentage points one year after the yen falls to 160 yen/dollar, or 0.5 percentage points if it drops to as low as 170 yen/dollar.

Figure 7-1 Dollar-Yen Exchange Rate



Source:Bloomberg L.P.

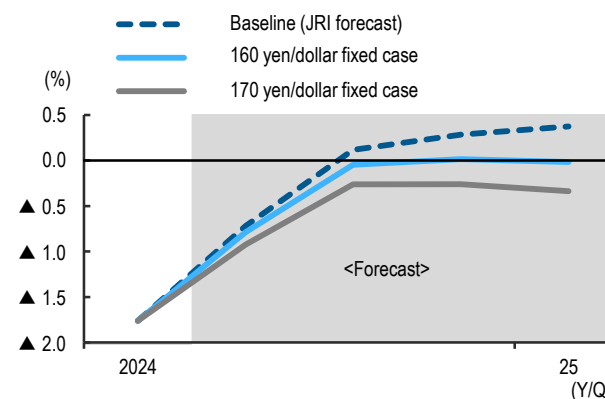
Figure 7-2 Positive Effect of Yen Depreciation on Consumer Prices



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

Note:Consumer prices are the BOJ's version of the core CPI (composite excluding fresh food and energy), estimated based on the NEEDS Japan economic model. Upside from the exchange rate baseline (forecast by JRI).

Figure 7-3 Forecast for Real Wages <YoY>



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

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

Note:Consumer prices are composite excluding imputed rent of owner-occupied houses.

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The economy will gradually recover, driven by domestic demand

◆ Strong corporate earnings will serve as a launchpad

Looking ahead, the Japanese economy is expected to get back on a moderate recovery track, led by domestic demand. Bumper corporate earnings will likely lead to a proactive stance on spending among firms, characterized by wage hikes that outpace inflation and an expansion in capital investment.

Thereafter, personal consumption is expected to gradually recover, supported by an improved employment/income environment and the wealth effect of rising stock prices. As the wage hikes agreed during the shunto, which were at the highest level for 33 years, are applied by more and more firms, real wage growth is forecast to enter positive territory in the summer. Wages for non-regular workers, which are less affected by shunto trends, are also expected to rise at a faster pace due to intensifying labor shortages and higher minimum wages. Capital investment should continue to increase thanks to strong corporate earnings. In addition to stepping up digital investment for labor-saving amid increasingly severe labor shortages, companies are expected to accelerate moves to relocate production back to Japan.

◆ The growth rate for FY2024 will be +0.9%

Real growth is projected to be +0.9% in FY2024 and +1.3% in FY2025. Due to the weak economy in the second half of FY2023, the growth rate is expected to remain in the upper zero-percent range in FY2024, but it should return to the 1% level in FY2025.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of May 16, 2024)

(%, changes from the previous fiscal year)

	CY2023		CY2024			CY2025				CY2026	FY2023	FY2024	FY2025
	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	
	(Actual)		(Projection)										
Real GDP	0.4	▲ 1.8	3.6	2.2	1.4	1.2	1.2	1.2	1.1	1.2	1.2	1.0	1.3
Private Consumption Expenditure	▲ 1.4	▲ 2.9	3.2	2.5	1.7	1.2	0.9	0.8	0.8	0.8	▲ 0.6	0.7	1.2
Housing Investment	▲ 5.4	▲ 9.7	▲ 0.1	▲ 0.1	▲ 0.1	▲ 0.2	▲ 0.2	▲ 0.3	▲ 0.3	▲ 0.3	0.6	▲ 2.8	▲ 0.2
Business Fixed Investment	7.8	▲ 1.7	3.3	2.5	2.3	2.1	2.3	2.4	2.4	2.4	0.5	2.3	2.3
Private Inventories (percentage points contribution)	(▲ 0.3)	(1.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.2)	(0.0)	(▲ 0.0)
Government Consumption Expenditure	▲ 0.4	0.6	0.2	0.1	0.1	0.0	0.2	0.2	▲ 0.3	0.0	0.1	0.2	0.1
Public Investment	▲ 0.7	12.5	1.1	1.0	0.8	0.8	0.8	0.4	0.4	0.4	4.0	2.7	0.7
Net Exports (percentage points contribution)	(0.9)	(▲ 1.4)	(1.4)	(0.4)	(0.0)	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)	(1.5)	(0.2)	(0.2)
Exports of Goods and Services	11.6	▲ 19.0	14.5	6.0	2.2	2.7	2.9	3.1	3.4	3.5	3.0	2.4	3.1
Imports of Goods and Services	7.3	▲ 12.7	7.8	4.2	2.2	1.9	1.9	1.9	2.1	2.0	▲ 3.2	1.6	2.1

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

(% changes from the previous fiscal year)

Nominal GDP	5.1	3.3	2.7	4.8	4.9	5.6	3.7	2.9	2.5	2.7	5.2	4.5	2.9
GDP deflator	3.9	3.4	3.1	3.8	3.7	3.4	2.2	1.6	1.4	1.5	4.0	3.5	1.7
Consumer Price Index (excluding fresh food)	2.5	2.5	2.5	2.6	2.6	2.8	2.6	2.1	1.9	1.6	2.8	2.6	2.1
Unemployment Rate (%)	2.5	2.5	2.5	2.5	2.4	2.4	2.4	2.3	2.3	2.3	2.6	2.5	2.3
Exchange Rates (JY/US\$)	148	148	155	151	148	145	143	141	139	136	145	150	140
Import Price of Crude Oil (US\$/barrel)	93	83	88	85	83	82	80	78	77	75	86	84	78

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.