Monthly Report of Prospects for Japan's Economy

October 2024

Macro Economic Research Center

Economics Department

The Japan Research Institute, Limited

https://www.jri.co.jp/english/periodical/

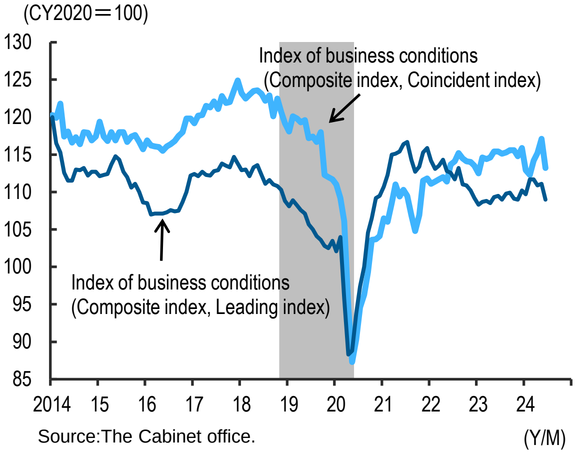
This report is the revised English version of the September 2024 issue of the original Japanese version.

Disclaimer:

The General Situation – The economy is gradually recovering, though the recovery has stalled in some areas

Figure 1-1 Economic Activity

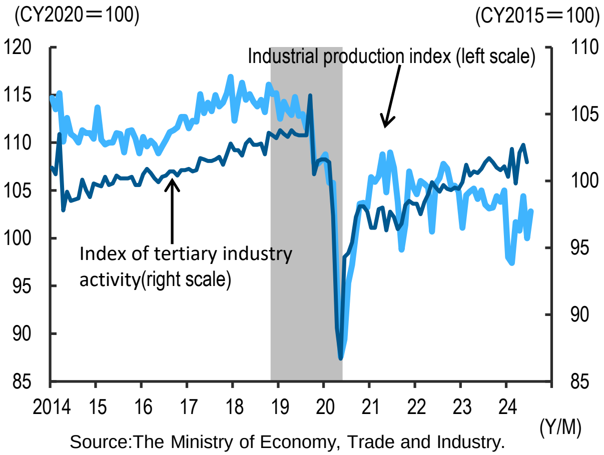
Both coincident and leading indices of business conditions have worsened recently.



Source:The Cabinet office.

Figure 1-2 The Corporate Sector

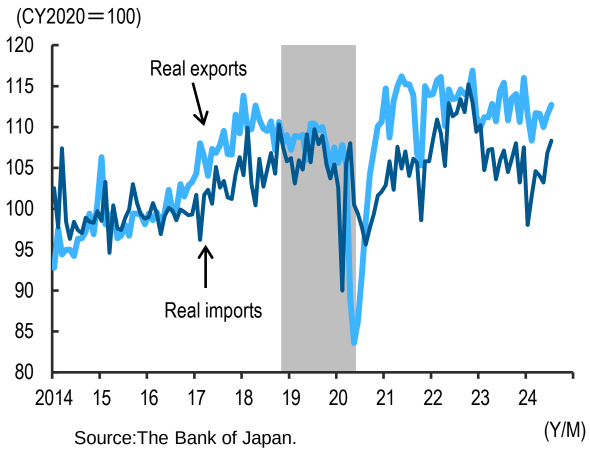
Industrial production is fluctuating.
Economic activity in the service sector is on the recovery track.



Source:The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

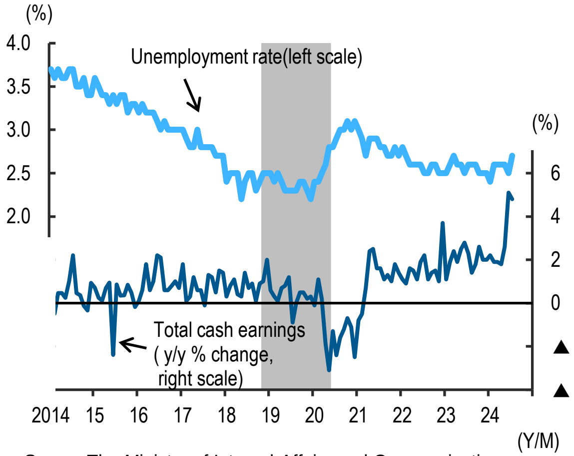
Goods exports are fluctuating.Imports continue to pick up following the slump at the start of the year.



Source:The Bank of Japan.

Figure 1-4 Employment and Income

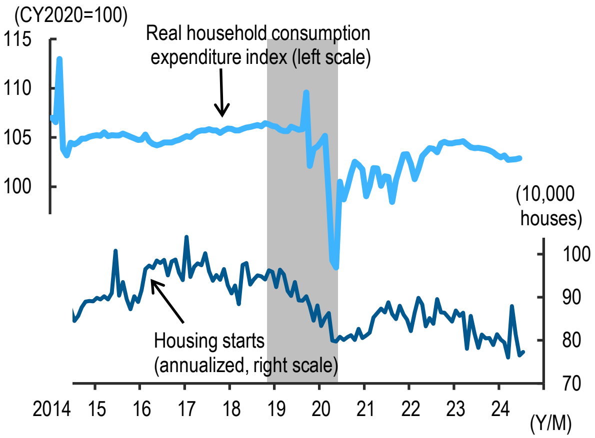
The unemployment rate is up slightly.
Nominal wage growth has risen sharply recently.



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

Figure 1-5 The Household Sector

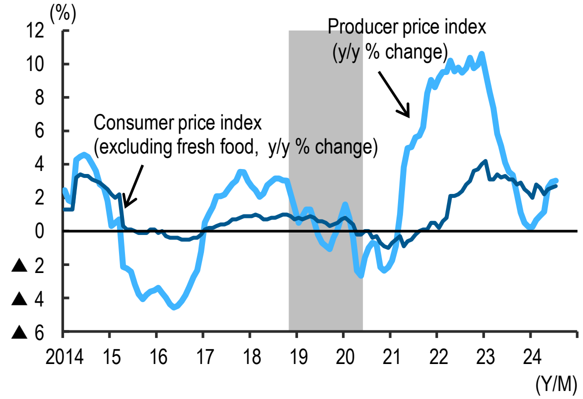
Consumption is sluggish.
Housing starts are at a low level once more.



Source:The Cabinet Office, The Ministry of Land,Infrastructure, Transport and Tourism.

Figure 1-6 Prices

Corporate price inflation is accelerating again.
Consumer price inflation is hovering in the 2% range.



Source:The Ministry of Internal Affairs and Communications,
The Bank of Japan.

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＊The shaded area indicates the recession phase.

Real GDP for April-June 2024 has been revised slightly downward

◆ Personal consumption has been revised slightly downward

In the second QE (quarterly estimate) for April-June 2024, real GDP growth was put at +2.9% on an annualized quarter-over-quarter (QoQ) basis (+0.7% QoQ), a slight downward revision from the +3.1% in the first QE. Looking at the breakdown, personal consumption and capital investment have been revised slightly downward.

◆ Production in the manufacturing sector is fluctuating

In July, the Industrial Production Index increased by 2.8% month over month (MoM). Supported by higher domestic shipments, output increased across a wide range of sectors, but especially in high-tech fields such as electrical machinery, information and communications equipment, and electronic parts/devices.
Looking at production plans for August and September, fluctuations are expected. In the transportation machinery sector, where production has been sluggish recently, output looks set to remain more or less flat, and there is little hope for an early full-scale recovery in automobile-related sectors.

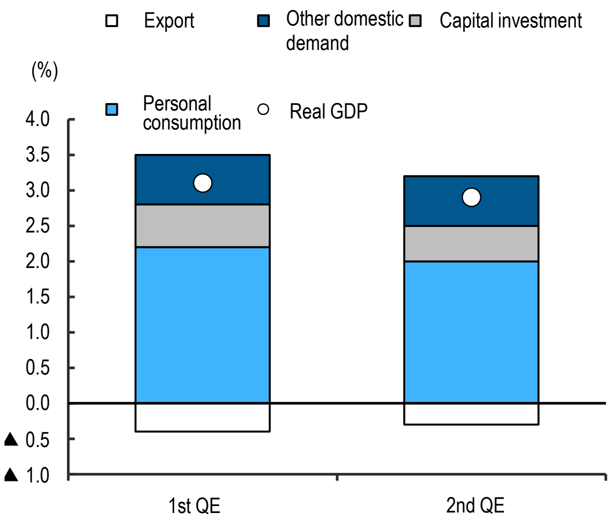
◆ Exports are increasing moderately

In July, real exports increased by 1.0% MoM. Supported by a rebound in global demand for semiconductors, exports of IT-related goods showed signs of picking up. Exports of capital goods also rose moderately, mainly thanks to a recovery in overseas capital investment. However, automobile-related exports remained weak.

◆ Inbound tourism demand is holding firm

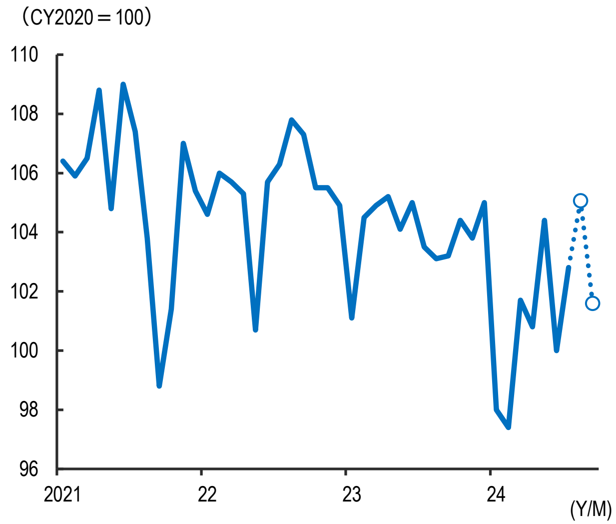
In July, 3.27 million foreign visitors came to Japan, as the number has continued to exceed the levels recorded before the COVID pandemic since the second half of 2023. Buoyed by the protracted weakness of the yen, inbound tourism consumption is now well above the pre-COVID level.

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



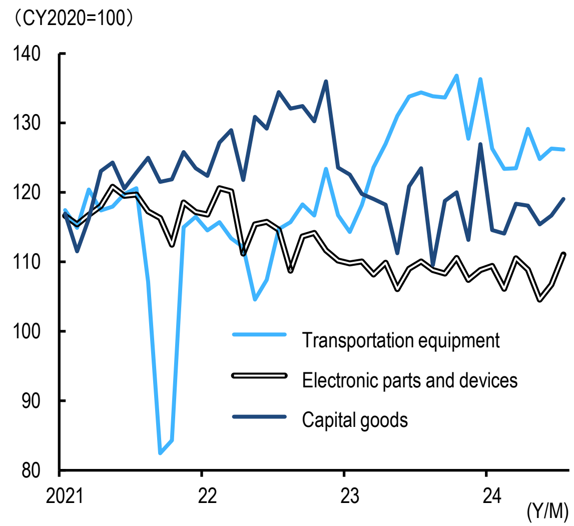
Source:The Japan Research Institute, Ltd. based on data of The Cabinet Office.

Figure 2-2 Industrial Production Index
<seasonally adjusted>



Source: 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 Real Exports
<seasonally adjusted>



Source: The Bank of Japan

Corporate earnings are strong, boosting capital investment

◆ Corporate earnings are strong

Ordinary profit for the April-June quarter increased by 6.6% QoQ for the second consecutive quarterly rise. Ordinary profit as a percentage of net sales, an indicator of corporate profitability, was 7.9%, its highest level ever. This can be attributed to the following two background factors:

The first is higher sales. With some automakers resuming shipments and the yen continuing to sag, net sales for all industries increased by 1.7% QoQ, the first rise in two quarters. The second is lower cost ratios. Progress with passing on higher costs to prices and a pause in the rise of raw material prices helped improve cost ratios.

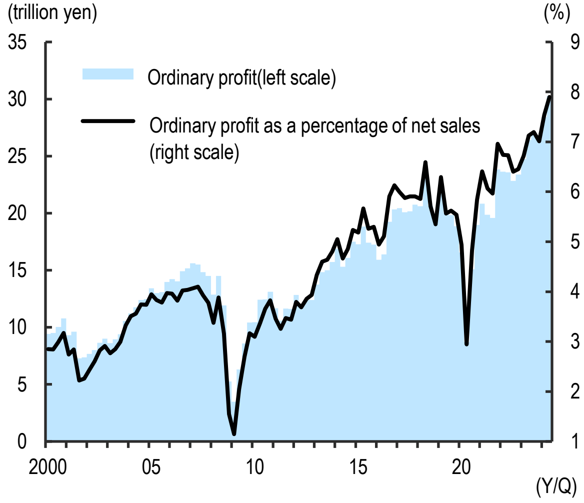
Corporate earnings are also expected to remain resilient going forward. Although the reversal of the yen's depreciation will exert downward pressure on export industries, a pick-up in domestic demand thanks to an improvement in the income situation of households will support corporate earnings.

◆ Appetite for capital investment is strong

All-industry capital investment, including software investment, in April-June was up 1.2% QoQ, rising for the first time in two quarters. Looking at capital investment by type, software investment remained at high levels despite a continuing post-boom fall-off, and other investment stayed strong, so companies are maintaining a healthy appetite for investment.

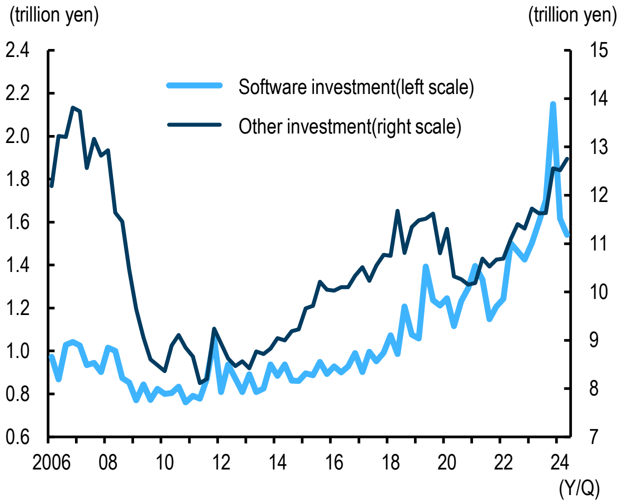
Capital investment is also expected to hold firm going forward. According to a survey by the Development Bank of Japan, planned capital investments by large companies in FY2024 are up significantly. Estimating based on the pattern of revisions to initial plans seen in typical years, FY2024 is expected to see a 7% year-over-year (YoY) rise, which is far higher than pre-COVID levels of increase. Semiconductor-related investment demand continues to be strong, and there is also a lot of demand for investment in future-oriented fields such as green and digital.

Figure 3-1 Ordinary Profit and Ordinary Profit as a Percentage of Net Sales



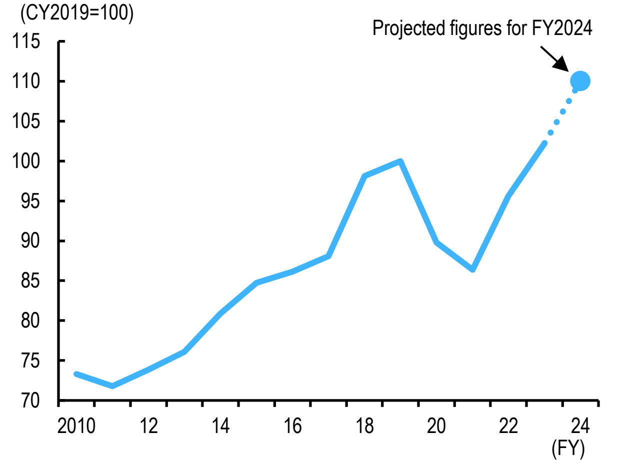
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.
Note:All sizes, all industries (excluding finance and insurance).

Figure 3-2 Capital Investment by Corporations <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 3-3 Actual and Projected Capital Investment <large companies>



Source: The Japan Research Institute, Ltd. based on data of The the Development Bank of Japan.
Note:The projected figures for FY2024 are calculated based on the initial plan as of June and the average of the realization rates for FY2018-23.

The situation for households is gradually improving

◆ The job market will tighten substantially

Unemployment has fallen as far as it can. The unemployment rate in July was 2.7%, up from the previous month but still at a low level. While the number of workers rose moderately in response to the economic recovery, an increase in the labor force participation rate pushed up unemployment.

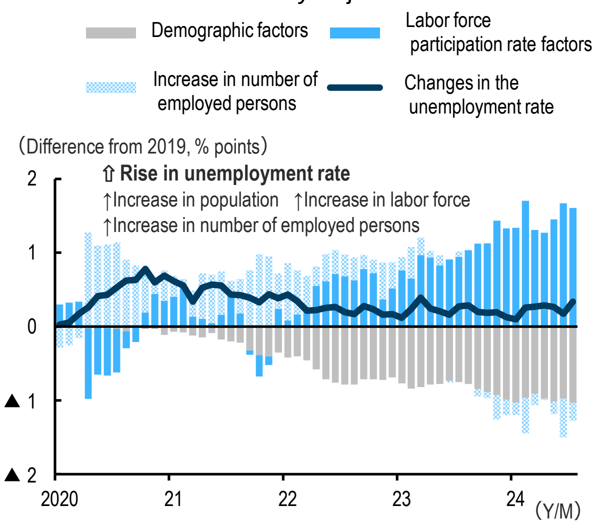
The job market is expected to become increasingly tight in the near term. Looking at the trend, the number of people seeking employment from the non-labor force population has declined significantly due to the expansion in elderly and female workforce participation. While demand for labor is expected to increase as economic activity recovers, there is limited room for additional enlargement of the labor supply.

◆ Positive real wage growth will become firmly established

Wages are rising. Total cash payrolls in July rose 3.6% YoY, a high rate of increase. As in June, significant rises in special payments such as regular and one-time bonuses lifted the overall increase. In addition, more companies have been implementing the wage hikes agreed during the shunto (spring wage negotiations), and basic salaries have been rising at a fast pace. As a result, YoY real wage growth was +0.4%, staying positive for the second month in a row.

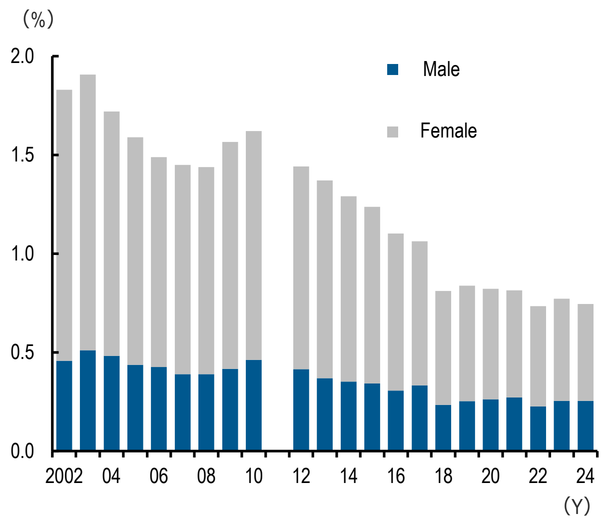
Going forward, wage rises are expected to continue to spread through the economy, with positive real wage growth becoming firmly established. Companies are stepping up moves to raise wages in order to secure workers, and according to an annual survey on wage increases conducted by the Ministry of Health, Labour and Welfare, in FY2023 the proportion of firms emphasizing the recruitment and retention of workers when raising wages reached 16.1%, the highest figure recorded since the bubble era. Given that the job market is expected to tighten further, wages look set to grow even faster.

Figure 4-1 Decomposition of The Factors Behind Changes in The Unemployment Rate <seasonally adjusted>



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

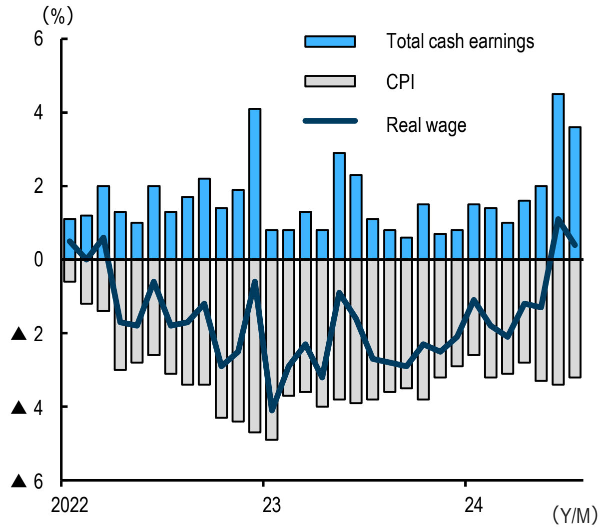
Figure 4-2 Of The Non-Labor Force Population, Those Who Want to Work



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

Note:The number of "those who want to work and can find a job" in the non-labor force population. The percentage of the population aged 15 and over. The period from April to June in 2024. The results for 2011 are not published due to the effects of the Great East Japan Earthquake.

Figure 4-3 Real Wages<YoY>



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

Core inflation will remain above 2% for the time being

◆ The government's scaling back of its measures to ease the pain of inflation is pushing up prices

In July, core consumer price inflation accelerated from the previous month to 2.7%. Energy prices rose due to the government temporarily cutting subsidies for electricity and gas bills, while the persistent weakness of the yen caused imported inflationary pressures to mount, pushing up goods prices.

For the time being, the core CPI is expected to keep rising at an annual pace of above 2%. Recently, the downward slide in the yen has halted, and goods price inflation is expected to slow. From this winter, however, when government measures to soften the blow of inflation expire and the energy price suppression effect disappears, moves to pass on higher wages to selling prices will likely gather momentum, and the pace of service price rises is expected to gradually increase as a result.

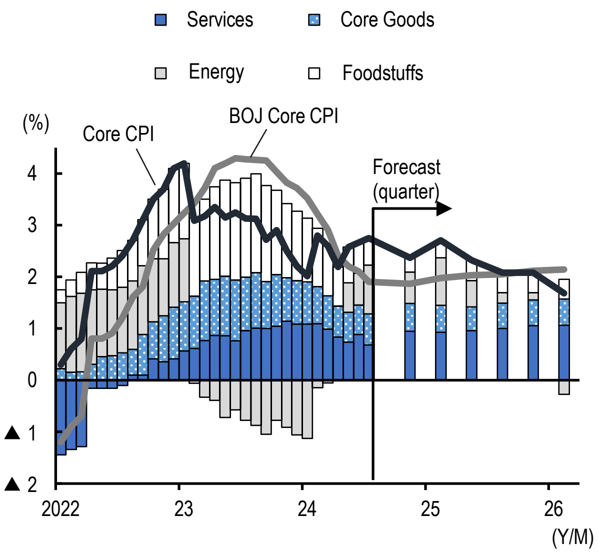
◆The Bank of Japan (BOJ) has raised its policy interest rate

At its monetary policy meeting at the end of July, the BOJ hiked its policy rate to around 0.25%. It also decided to gradually reduce, between now and the beginning of 2026, the amount of its regular Japanese government bond (JGB) purchases to under three trillion yen.

In August, long-term interest rates fell sharply at the beginning of the month. As a background factor, expectations of an additional interest rate hike by the BOJ faded in response to a plunge in stock prices and the halt in the yen's depreciation.

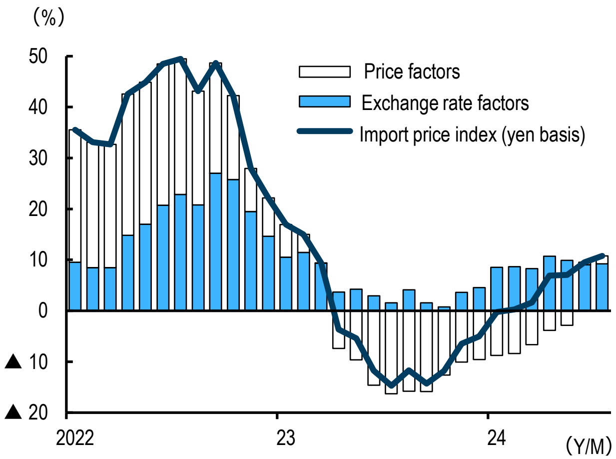
Looking ahead, the BOJ is expected to increase interest rates again at its meeting at the start of next year, and to then continue raising them in small increments, while keeping a close eye on the impact of money and capital market fluctuations on the economy. Long-term interest rates look set to rise gradually due to policy rate hikes and a recovery in the domestic economy.

Figure 5-1 Consumer Price Index <YoY>



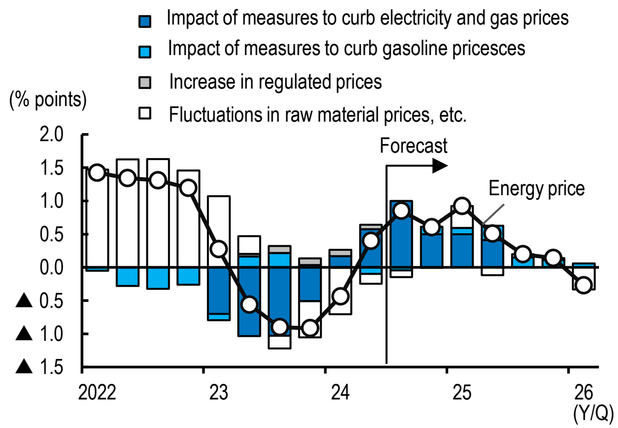
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Figure 5-2 Factor Decomposition of Import Price Index <YoY>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.
Note:Price factors are the percentage change in the import price index in contract currency terms.

Figure 5-3 Core CPI Pushed Up by Energy Prices <YoY>



Source: The Japan Research Institute, Ltd. based on data of The the Ministry of Internal Affairs and Communications and the Ministry of Economy, Trade and Industry.
Note:The measures to reduce electricity and gas bills were reduced for use in May 2024, and after ending temporarily in June, they were temporarily reinstated for use in August to October. The measures to reduce gasoline prices are expected to continue to be appl throughout 2024, and then to be gradually reduced after the beginning of 2025.

Topic①: Manufacturing investment could be curtailed amid concerns about the drop in exports to China

◆ Exports to China are sagging

Japan's exports to China are sluggish. Since peaking at the beginning of 2021, the volume of Japan's exports to China has been in continuous decline, with the figure for 2023 down by nearly 20% from the pre-COVID level. The breakdown shows particularly marked drops in exports of materials, such as metals and non-metallic minerals, and machinery products, especially transportation machinery. This can be attributed to the following two background factors:

The first is the slump in real-estate investment in China. In response to a sharp cooling of housing demand, Chinese investment in property development has plummeted recently. This has led to a fall in demand for metals and steel for construction.

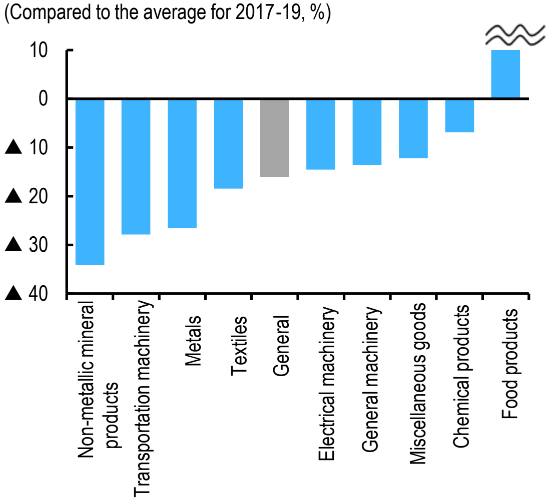
The second is the rise in the competitiveness of Chinese companies. An examination of changes in the "trade specialization coefficient," a measure of degrees of comparative advantage on the export side, before and after the pandemic reveals that competitiveness has improved across a wide range of items, notably chemical and machinery products, and that China has seen progress with local procurement and in-house production. The rise in the coefficient for transportation machinery thanks to rapid growth in EV exports in recent years has stood out.

◆ Earnings deterioration risks causing restraint in capital investment

The decline in exports to China is exerting downward pressure on corporate earnings. According to estimates, a 10% drop in exports to China results in a 4.7% fall in ordinary profits in Japan's manufacturing industry. The machinery sector, where exports to China account for a large proportion of sales, is particularly prone, with electrical machinery manufacturers looking at a 9.2% negative profit effect.

This sort of deterioration in corporate earnings could dampen enthusiasm for capital investment. The estimates point to a 10% decline in exports to China reducing manufacturing capital investment by 1.1%, with the negative effect in the electrical and general machinery sectors being as much as 1.6-1.7%.

Figure 6-1 Export Volume Index by Product Category <2023>

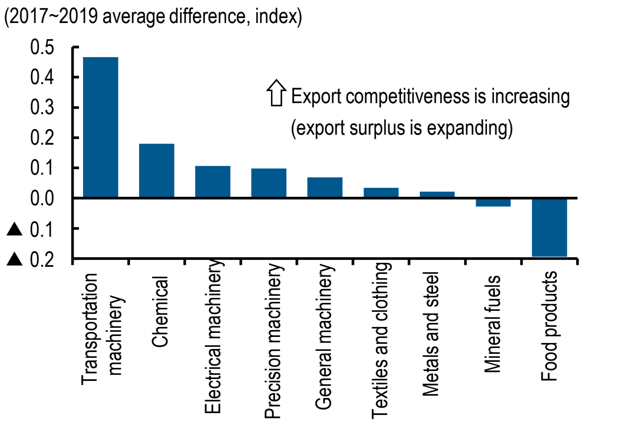


Source:The Japan Research Institute, Ltd. based on data of The Ministry of Finance.
Note:Export volume for general machinery, electrical machinery, and transportation machinery is calculated by dividing the export value by the export unit price of machinery and equipment.

Figure 6-2 Metal Exports to China and Real Estate Investment in China <YoY>

Source:The Japan Research Institute, Ltd. based on data of The Ministry of Finance,Wind.
Note: The export volume of metals and non-metallic mineral products is a weighted average based on monetary value.

Figure 6-3 China's Trade Specialization Coefficient <2023>



Source:The Japan Research Institute, Ltd. based on data of The General Administration of Customs of China, Japan External Trade Organization.
Note:Trade specialization coefficient = (exports - imports) / (exports + imports).
The closer to "1", the more specialized in exports, and the closer to "-1", the more specialized in imports. The item classification is based on the HS 2-digit classification and conforms to the "JETRO World Trade and Investment Report".

Topic②: Inbound tourism consumption being given a lift by tax-free shopping for tourists

◆ Consumption tax exemption system is boosting inbound tourism consumption

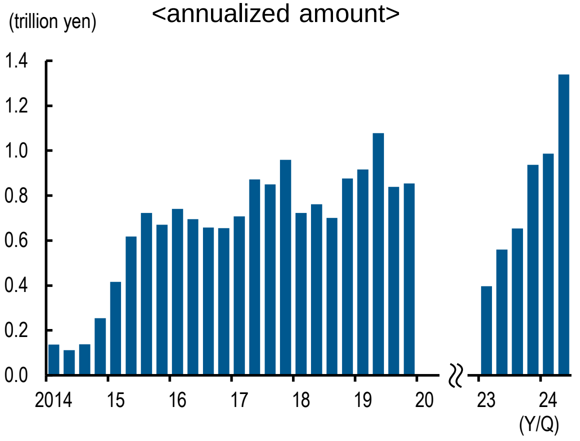
In Japan, the duty-free sales market targeting foreign tourists is expanding. The consumption tax exemption system is a scheme that allows non-residents to make tax-free purchases of goods that they intend to take out of the country. Participating outlets are licensed by the tax authorities, and exempt from levying the consumption tax. Japan introduced the system in 2014 as part of a drive to expand consumption by visitors to the country, and has since expanded it in phases, increasing the range of eligible items and lowering the minimum purchase amount.

As a result of these steps, the value of duty-free goods bought by visitors to Japan has been steadily increasing and, according to estimates, has recently exceeded one trillion yen on an annualized basis. A breakdown shows that tourists from nearby Asian countries such as China, Taiwan, and South Korea are the main users of the system, which has been boosting consumption of luxury items such as cosmetics, perfumes, and leather goods.

◆ An overhaul is required to eliminate fraudulent use

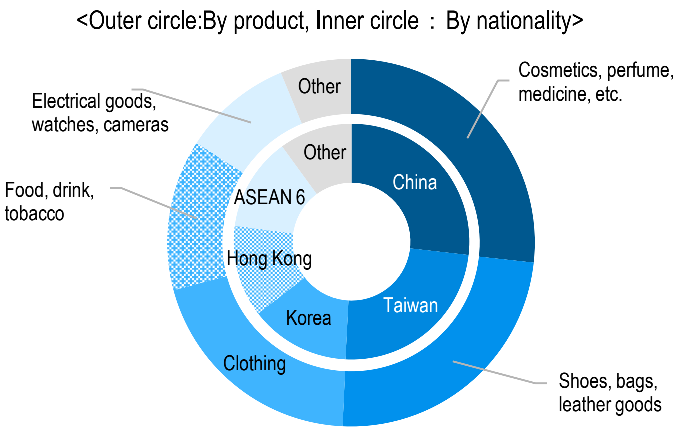
While the expansion of duty-free sales has helped lift inbound tourism consumption, fraudulent use of the system has become a problem. The system is based on the premise that travelers take their purchases out of Japan, but the reality is that resale within Japan is on the rise. As a result, on the business operator side, the number of cases of fraudulent consumption tax refunds has been increasing since FY2012, and the amount of additional taxes imposed in response to fraudulent refunds reached a record high in FY2022. To ensure fairness and equity in the sharing of the consumption tax burden, a swift overhaul of the system is needed, and this could entail the adoption of the "refund method" used in other countries (i.e., refunding the tax after confirming possession of the actual item at the time of departure rather than at the time of purchase).

Figure 7-1 Total Amount of Consumption Tax-Free Purchases by foreign visitors to Japan <annualized amount>



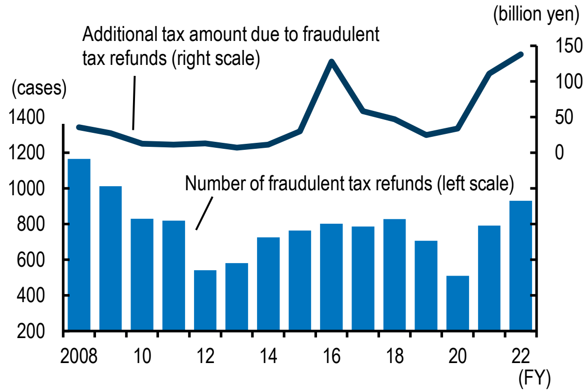
Source:The Japan Research Institute, Ltd. based on data of The the Japan Tourism Agency's Survey of Consumption Trends of Foreign Visitors to Japan.
Note:Amounts exclude consumption tax. The amount of tax-free purchases is calculated as the number of general customers x the tax-free purchase rate (the percentage of general customers who go through tax-free procedures) x the amount of tax-free purchases per tax-free purchaser. The survey was suspended due to the coronavirus pandemic from 2020 to 2022.

Figure 7-2 Amount of Consumption Tax-Free Purchases by Foreign Visitors to Japan



Source:The Japan Research Institute, Ltd. based on data The Japan Tourism Agency.
Note:2023. The amount of tax-free purchases by item is calculated as the number of general customers x tax-free purchase rate x average spending per visitor by item.

Figure 7-3 Inappropriate Refund of Consumption Tax by Corporations That File for Consumption Tax Refunds



Source:The Japan Research Institute, Ltd. based on data of The National Tax Agency.
Note:Fiscal year is the administrative year (July to June of the following year). Corporations that file for tax refunds under the export tax refund system include not only duty-free shop operators but also exporters and other businesses that conduct transactions with overseas companies.

The economy will gradually recover, driven by domestic demand

◆ Strong corporate earnings will kick-start a virtuous cycle

Looking ahead, the Japanese economy is expected to stay on a moderate recovery track, led by domestic demand. With bumper corporate earnings serving as a springboard, a proactive stance on spending will likely spread among companies, which will be manifested in wage hikes that outpace inflation and an expansion in capital investment.

Personal consumption is expected to recover moderately, supported by an improved employment/income environment. As the generous wage hikes agreed during the shunto are applied by more and more firms, positive YoY real wage growth should gradually become more permanent. Wages for part-time 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. Companies are eager to invest in solutions for decarbonization, DX, and labor-saving. The reshoring of production bases to Japan against the backdrop of heightened geopolitical risks will also provide a boost to capital investment.

However, as downside risk factors, attention will need to be paid to the Chinese economy and the result of the U.S. presidential election. And worsening labor shortages may weaken the economy's ability to recover.

◆ The growth rate for FY2024 will be +0.6%

Growth is projected to be +0.6% in FY2024 and +1.2% in FY2025. Due to the impact of the weak economy in the second half of FY2023, growth will be somewhat slower in FY2024, but is expected to return to the 1% range in FY2025. Although the potential growth rate is currently estimated to be around the 0.5% mark, it should rise to about 1% toward the end of FY2025 as labor productivity improves.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of September 9, 2024)

(%, changes from the previous fiscal year)

	CY2024				CY2025				CY2026	FY2023	FY2024	FY2025
	1～3	4～6	7～9	10～12	1～3	4～6	7～9	10～12	1～3			
	(Actual)	(Projection)								(Actual)	(Projection)	
Real GDP	▲ 2.4	2.9	1.9	1.6	1.2	1.2	1.2	1.0	1.1	0.8	0.6	1.2
Private Consumption Expenditure	▲ 2.3	3.7	2.4	1.7	1.2	0.9	0.8	0.8	0.8	▲ 0.6	1.0	1.1
Housing Investment	▲ 10.1	7.1	▲ 0.1	▲ 0.1	▲ 0.2	▲ 0.2	▲ 0.3	▲ 0.3	▲ 0.3	0.3	▲ 1.2	▲ 0.2
Business Fixed Investment	▲ 1.9	3.1	2.4	2.3	2.1	2.3	2.4	2.4	2.4	0.3	2.3	2.3
Private Inventories (percentage points contribution)	(1.2)	(▲ 0.5)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.2)	(▲ 0.1)	(▲ 0.0)
Government Consumption Expenditure	1.1	0.4	0.1	0.1	0.0	0.2	0.2	▲ 0.3	0.0	▲ 0.5	0.4	0.1
Public Investment	▲ 4.4	17.2	▲ 0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.7	2.1	0.2
Net Exports (percentage points contribution)	(▲ 1.7)	(▲ 0.3)	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(1.4)	(▲ 0.4)	(0.2)
Exports of Goods and Services	▲ 17.3	6.1	4.7	3.0	2.7	2.9	3.1	3.2	3.2	2.8	0.8	3.1
Imports of Goods and Services	▲ 9.6	6.9	4.0	2.1	1.9	1.9	1.9	2.1	2.0	▲ 3.2	2.3	2.1

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

	CY2024 1～3	CY2024 4～6	CY2024 7～9	CY2024 10～12	CY2025 1～3	CY2025 4～6	CY2025 7～9	CY2025 10～12	CY2026 1～3	FY2023	FY2024	FY2025
Nominal GDP	2.5	2.1	3.6	3.8	4.9	3.7	3.0	2.5	2.7	4.9	3.6	3.0
GDP deflator	3.4	3.2	3.1	3.1	2.9	2.3	1.7	1.4	1.6	4.0	3.1	1.7
Consumer Price Index (excluding fresh food)	2.5	2.5	2.6	2.4	2.7	2.3	2.1	2.1	1.7	2.8	2.5	2.0
Unemployment Rate (%)	2.5	2.6	2.6	2.5	2.5	2.4	2.4	2.4	2.4	2.6	2.5	2.4
Exchange Rates (JY/US$)	148	155	150	146	144	142	140	138	136	145	149	139
Import Price of Crude Oil (US$/barrel)	83	87	86	81	82	81	80	79	78	86	84	79

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.