

Monthly Report of Prospects for Japan's Economy

November 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 October 2024 issue of the original Japanese version.

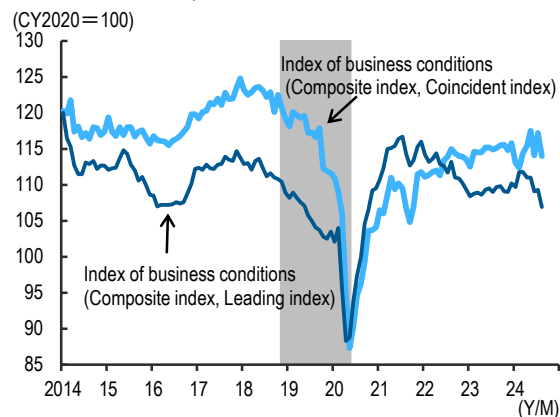
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The General Situation – The economy is gradually recovering, though activity has slowed in some areas

Figure 1-1 Economic Activity

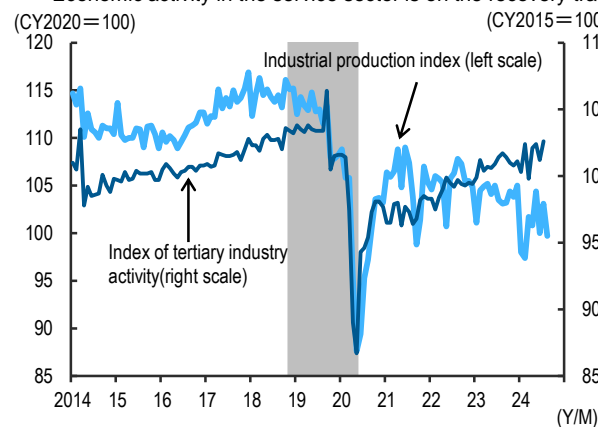
Both coincident and leading indices of business conditions have worsened recently.



Source: The Cabinet office.

Figure 1-2 The Corporate Sector

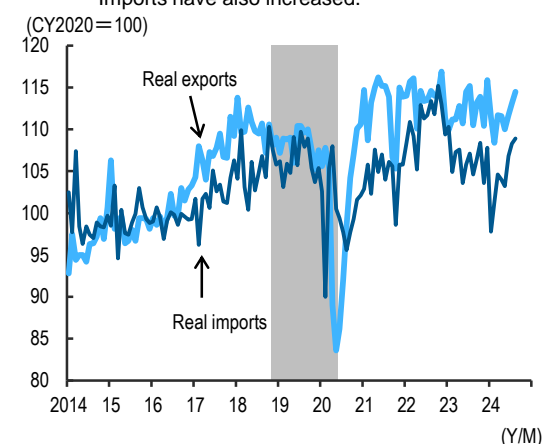
Industrial production is fluctuating.
Economic activity in the service sector is on the recovery track.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

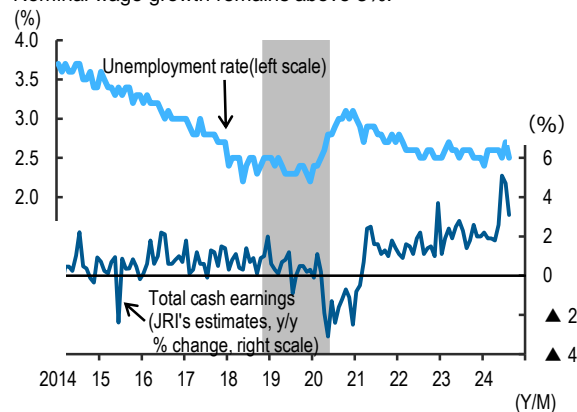
Exports have picked up following the slump at the start of the year.
Imports have also increased.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

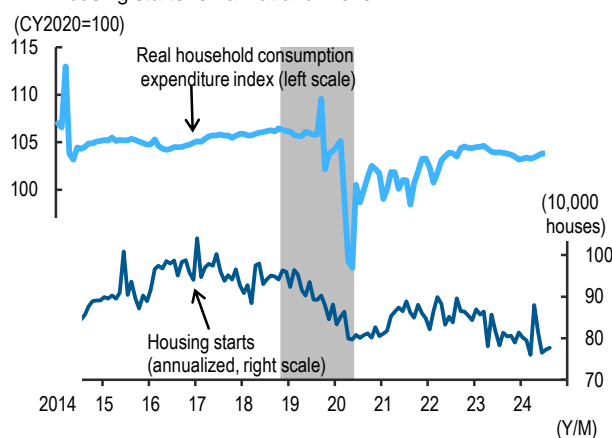
The unemployment rate remains more or less flat in the mid-2% range.
Nominal wage growth remains above 3%.



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

Figure 1-5 The Household Sector

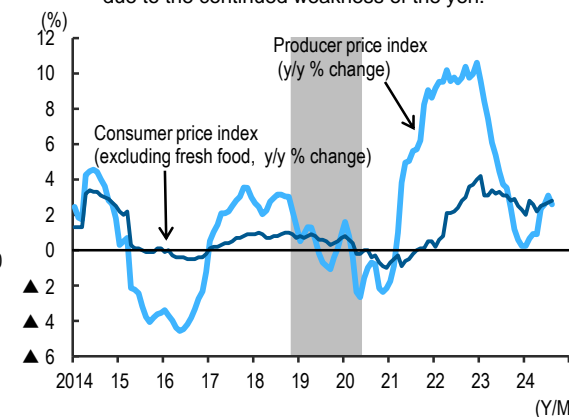
Consumption has begun to rise slowly.
Housing starts remain at a low level.



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

Figure 1-6 Prices

Corporate price inflation has risen slightly.
due to the continued weakness of the yen.



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

* The shaded area indicates the recession phase.

Business confidence among companies is favorable overall

◆ Business confidence among companies is favorable overall

In the September Tankan survey from the Bank of Japan (BOJ), the diffusion index (DI) for business conditions for large manufacturing enterprises was unchanged from the previous survey. While business confidence in the electrical machinery sector improved thanks to higher global high-tech demand, in the automobile sector it deteriorated slightly as a result of the impact of suspensions of plant operations due to a major typhoon in late August.

The DI for large non-manufacturing enterprises rose slightly, edging up by one percentage point. Against the backdrop of a strong recovery in inbound tourism demand and progress with price pass-through, business confidence improved slightly in lodging and food/beverage service, as well as in retailing. Thanks to progress with digitalization, business confidence in the information/communications and logistics-related sectors remains high.

◆ Production in the manufacturing sector is fluctuating

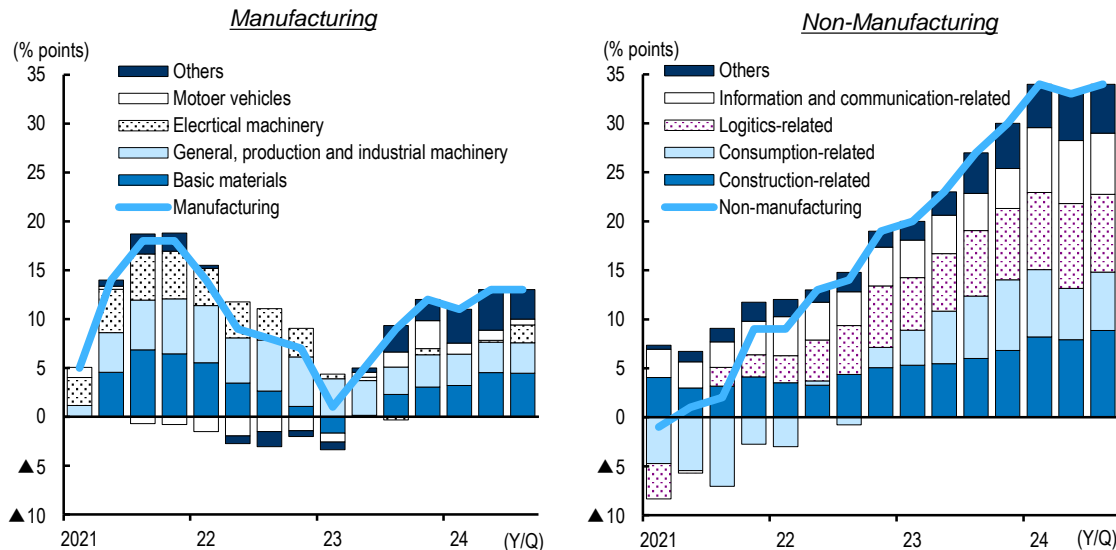
In August, the Industrial Production Index dropped by 3.3% month over month (MoM). A background factor was intensified pressure to cut production in sectors such as automobiles in response to the suspension of plant operations by some manufacturers due to the impact of the large typhoon.

According to production plans for September and October, output is expected to increase in a wide range of sectors, centered on automobiles and production machinery.

◆ The Ishiba government will maintain the economic policies of the previous administration

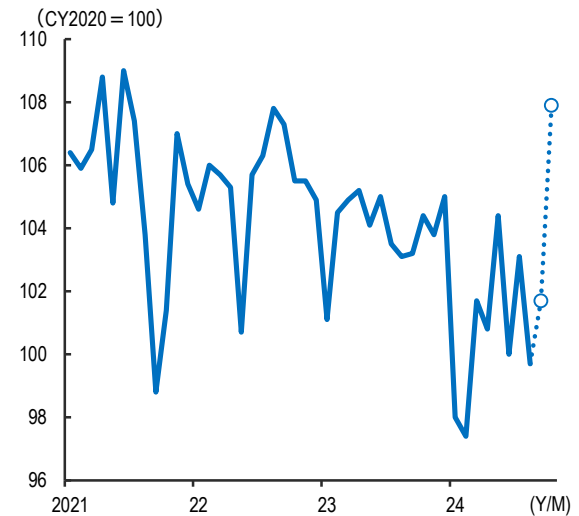
Japan's new prime minister, Shigeru Ishiba, delivered his inaugural speech as prime minister to the Diet on October 4, announcing the future policy direction for his cabinet. On the economic policy front, his government looks set to maintain most of the policies of the previous one. He declared that the national average minimum wage would be raised to 1,500 yen by the end of the 2020s, and also unveiled plans to expand support for low-income households to help them deal with higher prices.

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 <seasonally adjusted>



Source: The Ministry of Economy, Trade and Industry.

Note: Dotted lines are postponed based on the forecast index of manufacturing production (September and October).

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Foreign demand is on the recovery track, and capital investment is firm

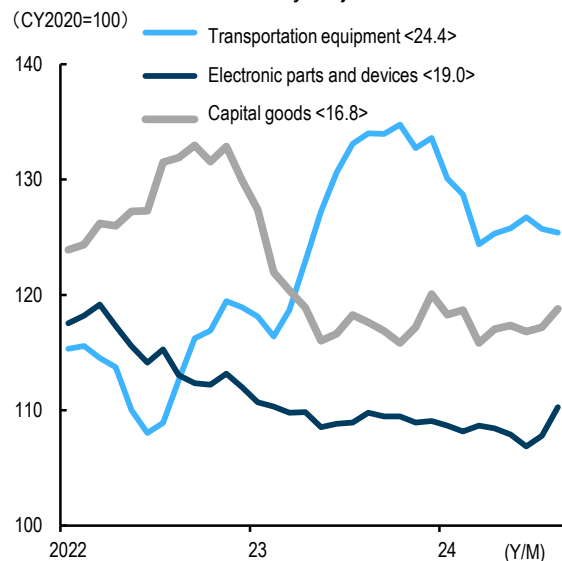
◆ Goods exports are picking up

Foreign demand is bouncing back. In August, real exports increased by 1.3% MoM, rising for the third consecutive month. In terms of major goods, exports of transportation machinery were weak, but those of electronic components/devices and capital goods looked to be bottoming out. Going forward, exports of goods, particularly electronic components/devices and capital goods, are expected to begin to recover. Factors such as brisk AI-related demand and the arrival of the timing for replacement of the PCs and smartphones purchased during the pandemic are giving a boost to global demand for semiconductors. The World Semiconductor Trade Statistics (WSTS) expects the semiconductor market to expand steadily through 2025. In addition, as major overseas central banks move to cut interest rates, companies worldwide are feeling more inclined to make capital investments. Capacity utilization rates have also stopped declining. This has led to an uptick in orders received overseas by Japanese machinery makers, which is expected to help give a lift to goods exports.

◆ Appetite for capital investment is strong

Capital investment is holding steady despite weakness in certain categories. By type, machinery investment remains sluggish, but construction investment is starting to bottom out and software investment is still at a high level. Capital investment is also expected to hold firm going forward. According to the BOJ Tankan survey, planned capital investments (including software but excluding land) for FY2024 are up 11.5% year over year (YoY), so while the rate of growth is lower than in the previous fiscal year, it is still high when compared with typical years. In response to worsening labor shortages and progress with digitalization, companies' appetite for software investment is strong, and capital investment will also enjoy the tailwind of a rebound in investment for increasing capacity due to a cyclical pick-up in overseas demand.

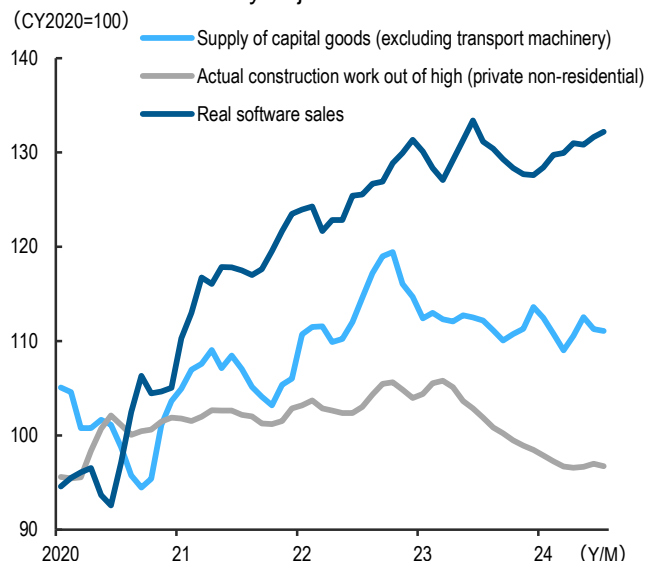
Figure 3-1 Real Exports by Category
<seasonally adjusted>



Source: The Bank of Japan.

Note: Backward 3-month moving average. <> Figures in parentheses represent the share of total nominal exports in 2023.

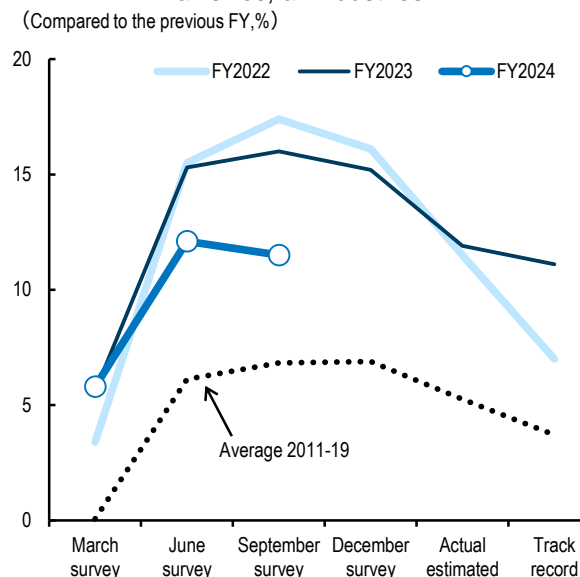
Figure 3-2 Private Capital Investment Related Indicators
<seasonally adjusted>



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

Note: Backward 3-month moving average.

Figure 3-3 Capital Investment Plan
<all sizes, all industries>



Source: The Bank of Japan.

Note: Including software, excluding land.

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The income environment is improving and personal consumption is starting to pick up

◆ Wages continue to increase at an accelerating pace

Wages are growing faster. In August, the YoY increase in basic salaries of regular workers accelerated to 2.8%. Meanwhile, the hourly pay of part-time workers climbed 4.9% YoY, continuing to rise at a rapid clip. However, the rise in total cash payrolls for employees as a whole was lower than the rate of price increases, so real wages dropped 0.7% YoY for the first month of YoY negative growth in three months.

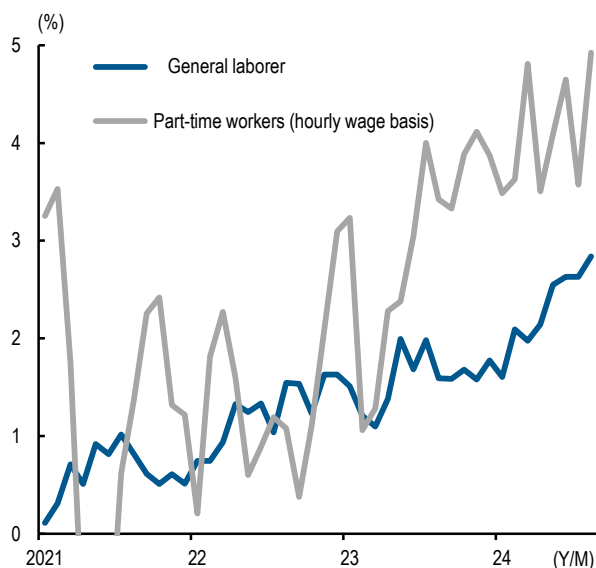
Going forward, wage rises are expected to continue to accelerate, heralding a return to positive real wage growth. Against the backdrop of a tight job market, nominal wage growth is expected to climb above 3%. On the other hand, due to an easing of imported inflationary pressures and the temporary resumption of government subsidies for electricity and gas bills in August-October, the pace of rising prices is projected to slow, and this should push up real wages through this winter.

◆ Consumer confidence is improving

Personal consumption has been tepid recently. In August, the Consumption Activity Index slipped 0.2% from the previous month. Breaking this down by component, there were signs of a pick-up in consumption of non-durable goods such as food products, but services consumption growth was sluggish as the rebound demand that followed the COVID pandemic ran its course. In addition, consumption of durable goods, particularly automobiles and home appliances, decreased.

Looking ahead, personal consumption is expected to gradually pick up, supported by an improvement in the income environment. Consumer confidence has been improving since around the spring of this year, reflecting the more favorable income/employment environment, and this will underpin the recovery in personal consumption.

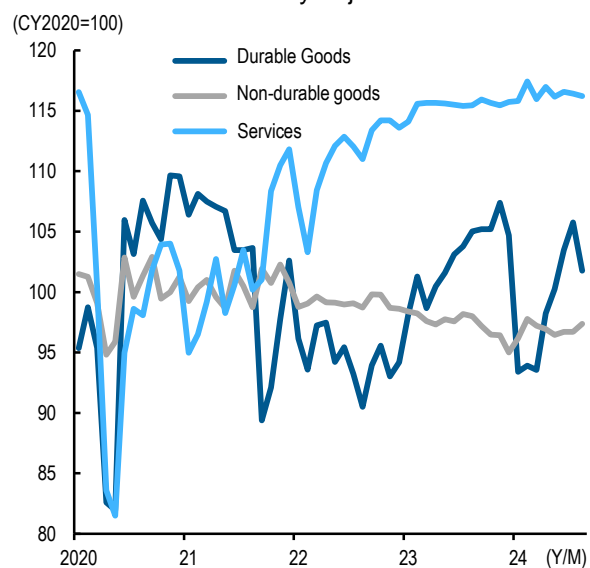
Figure 4-1 Basic Salary<YoY>



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

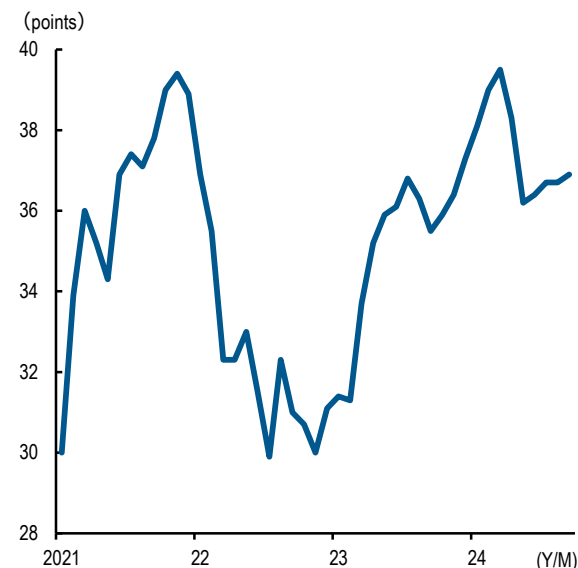
Note: Adjusted for data fault caused by the replacement of surveyed firms.

Figure 4-2 Quarterly Consumption Activity Index <seasonally adjusted>



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

Figure 4-3 Consumer Attitude Index



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

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 August, core consumer price inflation accelerated from the previous month to 2.8%. Energy prices rose due to the government temporarily halting subsidies for electricity and gas bills, while a sharp rise in market prices and the persistent weakness of the yen led to increases in the prices of one food product after another, notably chocolate and rice.

Looking ahead, core inflation is expected to slow gradually. As for the underlying trend, it is expected that inflationary pressures in services will intensify as wage hikes are increasingly passed on to selling prices. On the other hand, with imported inflationary pressures predicted to abate as the yen's slide comes to an end, the recent spate of food price hikes should ease off sooner or later. As for energy price inflation, it is expected to quicken temporarily heading into early next year, as the government terminates its measures to ease the pain of inflation. After that, however, downward pressure should build as a result of falling oil prices, leading to a sustained period of slower energy price rises.

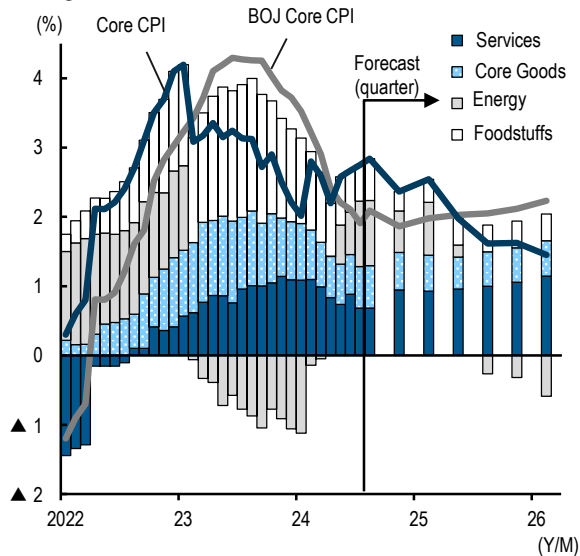
◆ The BOJ will begin to raise interest rates gradually and continuously

At its September monetary policy meeting, the BOJ decided to keep its policy rate unchanged.

Long-term interest rates were more or less flat in September. While expectations of a BOJ rate hike by the end of the year persist, the drop in U.S. long-term interest rates due to jitters about a possible slowdown in the U.S. economy is exerting downward pressure on Japanese rates, and the future direction is unclear.

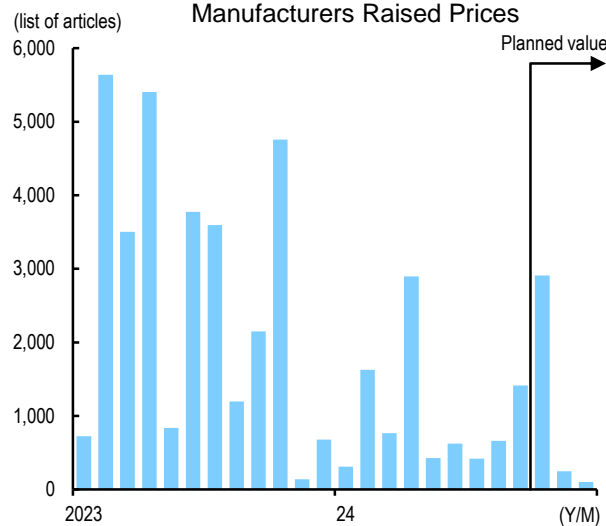
Looking ahead, the BOJ is expected to increase interest rates again at its first meeting next year, and then to continue raising them in small increments, while keeping a close eye on the impact of money and capital market fluctuations on the economy. Long-term interest rates look set to rise gradually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

Figure 5-1 Consumer Price Index <YoY>



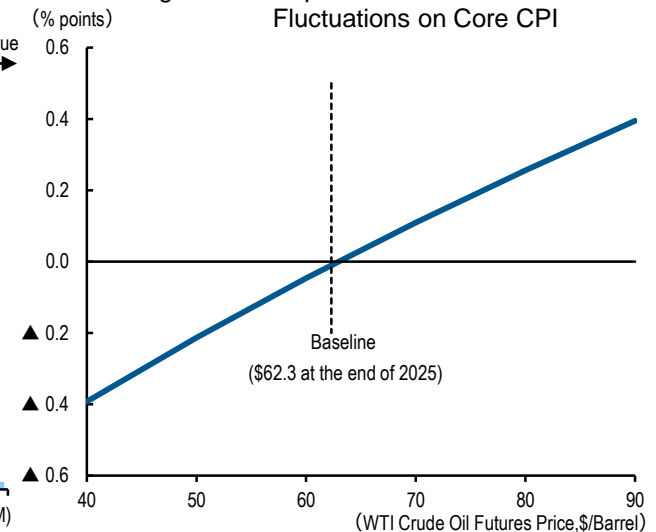
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Figure 5-2 Number of Items for Which Food Manufacturers Raised Prices



Source: The Japan Research Institute, Ltd. based on data of Teikoku Databank.
Note: Price revision plans of 195 major food manufacturers, as of September 30.

Figure 5-3 Impact of Crude Oil Price Fluctuations on Core CPI



Source: The Japan Research Institute, Ltd. based on data of Nihon Keizai Shimbun, Inc.
Note: Estimated based on the NEEDS Japan economic model; range of change in core CPI due to changes in WTI crude oil futures prices. Compared with the baseline (forecast by NRI).

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Topic①: Wage growth at micro-enterprises is sluggish

◆Wages at micro-enterprises have hardly risen

Wage growth at micro-enterprises has been limited. According to the Ministry of Finance's Financial Statements Statistics of Corporations, wages (as measured by per-employee personnel expenses) have been increasing at mid-tier enterprises and small and medium-sized enterprises (SMEs), which have capital of between 10 million yen and 1 billion yen, while growth has been sluggish at micro-enterprises, which have capital of less than 10 million yen.

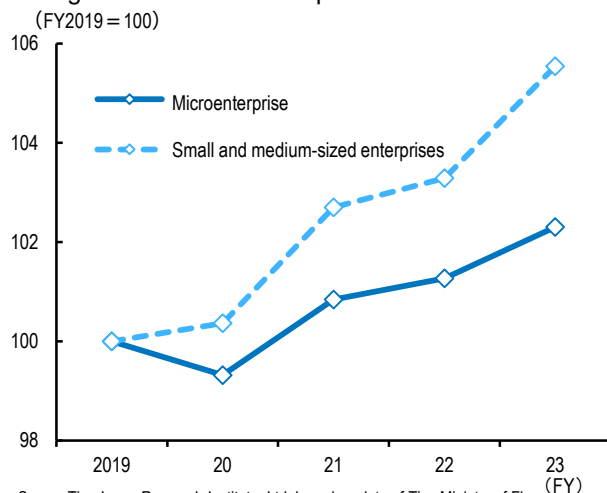
Micro-enterprises have been unable to raise wages because of the severe business situation they face. At micro-enterprises, labor productivity (i.e., the value added per worker) is low, and they are inferior to larger companies in terms of "earning power." In the questionnaire survey, too, many micro-enterprises mentioned "increased costs due to inflation" and "difficulty in passing on price increases" as reasons for their inability to raise wages.

◆Improving profitability and productivity is an urgent task

For micro-enterprises, investment aimed at generating cash to fund wage increases is also limited. Most micro-enterprises cite cost reductions as a measure to raise wages, with only a few mentioning productivity improvement through capital spending. Capital investment relative to cash flow has been low at micro-enterprises, and is far below that seen at mid-tier companies and SMEs. Micro-enterprises may be trapped in a vicious cycle where their reluctance to invest leads to further deterioration in productivity.

Since workers at micro-enterprises account for 21% of the total labor force, a "virtuous cycle of rising wages and prices" can only be achieved if these firms also increase wages." And for them to raise wages, improving profitability and productivity is an urgent task. It will thus be important for the government to take steps to further encourage micro-enterprises to embark on appropriate price pass-through and to take advantage of systems for assisting them in raising wages and making investments.

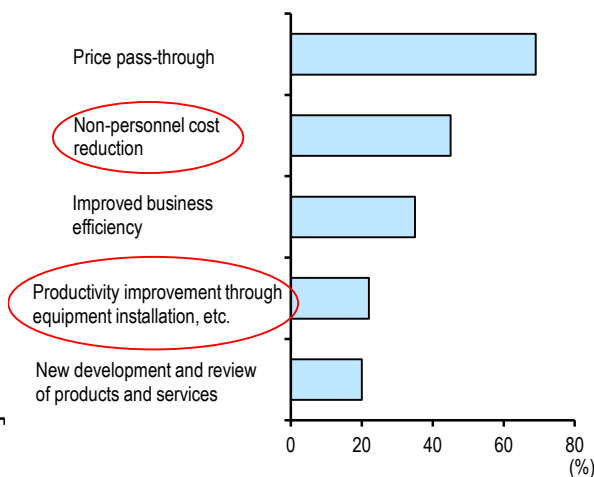
Figure 6-1 Labor Cost per Person



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

Note: All industries (excluding finance and insurance). Medium-sized companies are those with capital of 100 million yen or more but less than 1 billion yen, small and medium-sized companies are those with capital of 10 million yen or more but less than 100 million yen, and micro companies are those with capital of less than 10 million yen. Labor cost per employee = labor cost/(number of directors + number of employees). Personnel cost is the sum of salaries and bonuses of employees and directors, plus benefit costs.

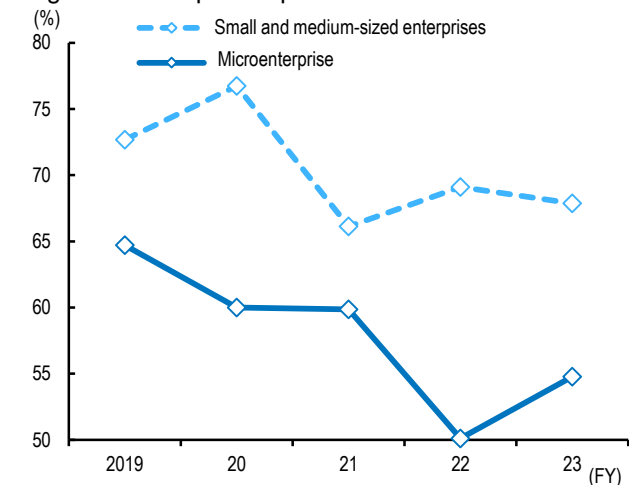
Figure 6-2 Measures to Raise Wages



Source: Compiled by NRI based on the National Federation of Societies of Commerce and Industry.

Note: Percentage of responding firms that selected each item. Multiple selections allowed.

Figure 6-3 Capital Expenditure/Cash Flow Ratio



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

Note: All industries (excluding finance and insurance).

Percentage is capital investment including software divided by cash flow.

Cash flow = net income - (interim dividend + dividends) + depreciation.

Topic②: Wage inflation pressure is mounting in the service sector

◆Progress with raising wages and passing them on to prices is being made in the service sector

Service price inflation is slowing. In August, general service price inflation (adjusted to exclude the effects of policy factors) was 1.3%, down from the most recent peak at the beginning of 2023. As a background factor, in services where goods account for a large share of inputs, such as eating out, cost pressures from ingredients have eased thanks to lulls in the continued fall of the yen and rise of resource prices.

However, service prices are expected to increase again going forward as inflationary pressures from the wage side build. With labor shortages intensifying, companies are becoming more aggressive in raising pay to secure workers. The link between labor supply/demand and wages, which had weakened during the deflationary period, has become stronger again recently. Given that the job market is expected to tighten further, wages look set to continue rising rapidly.

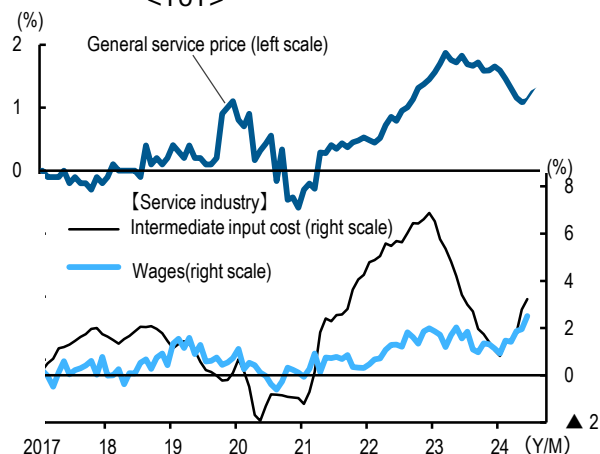
And companies will pass on these increases in input costs to selling prices.

According to the BOJ Tankan survey, companies in the service sector have lately become more willing to pass on higher costs, creating a situation in which higher labor costs are more likely to push up service prices.

◆The medium- to long-term expected inflation rate among companies has also risen

In anticipation of a sustained rise in personnel expenses, an increasing number of firms expect to increase their selling prices over the medium to long term. Selling price increases will likely continue for the next five years, particularly in sectors such as lodging, food/beverage service, and wholesaling/retailing, where personnel expenses account for a high proportion of intermediate inputs.

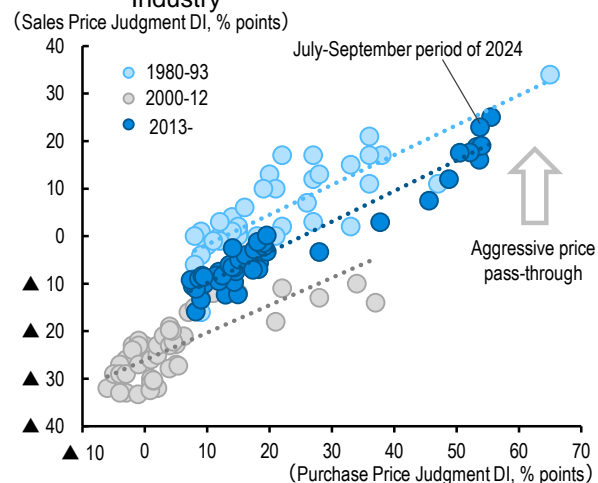
Figure 7-1 Service Prices and Service Input Costs <YoY>



Source: Ministry of Internal Affairs and Communications, Ministry of Land, Infrastructure, Transport and Tourism, Bank of Japan, Ministry of Health, Labour and Welfare.

Note: General service prices exclude telecommunication charges (cell phones), which are highly volatile due to policy factors, and travel-related services after April 2020. Intermediate input costs are weighted by the intermediate input weights in the Input-Output table (2022 basis). Wages and salaries in the service sector (for all permanent workers before 1999 and for general workers after 2000).

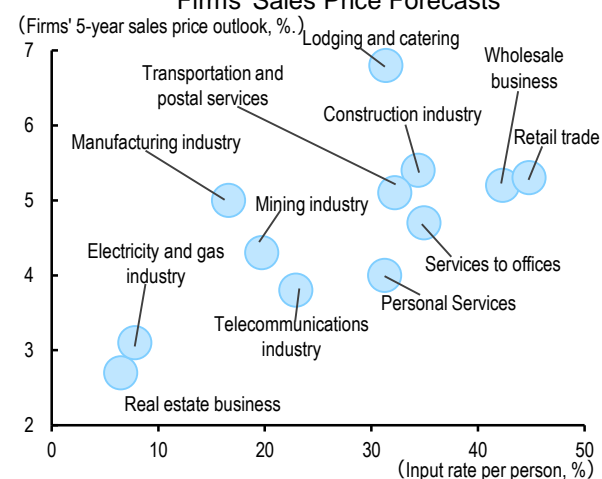
Figure 7-2 Price-shifting Attitude of the Service Industry



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

Note: Full scale. Coverage of services is the weighted average of the old standard until 2009 and the weighted average of goods rental, office services, and personal services since 2010. Excluding 2009, the year immediately after the Lehman Shock.

Figure 7-3 Labor Cost Input Ratio and Firms' Sales Price Forecasts



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

Note: Labor input ratio = calculated based on employment income, domestic output, and the Input-Output table (2020 base). Sales price forecasts are the result of the Bank of Japan's Tankan September survey.

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Topic③:The sharp rise in rice prices will have a limited impact on prices overall

◆ Rice prices have soared

In August, the price of rice sold in stores jumped by 28.3% YoY. Background factors included tight supply due to last year's harvest being adversely affected by that summer's extreme heat and stockpiling amid heightened concerns about a potentially imminent megaquake in the Nankai Trough. The rice price surge occurred in contrast to an easing of price pressures on food products overall, as prices of imported ingredients stopped rising.

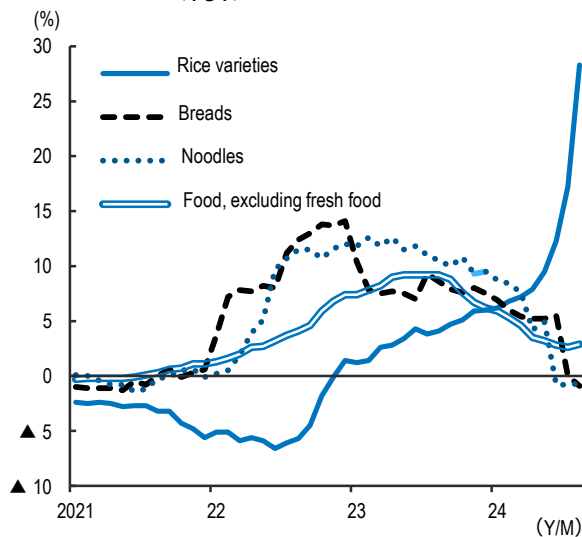
Rice prices could remain high for some time. Since September, the rice shortage has been easing with the arrival of newly harvested rice, but the estimated amount paid by agricultural cooperatives to rice farmers for major brands is about 20% higher than last year.

The higher rice prices have hit low-income households especially hard, as rice purchases account for a large share of their spending. Low-income households have already been squeezed by the inflation of recent years, so the surge in rice prices has dealt them a further blow.

◆ The impact on overall prices will be limited

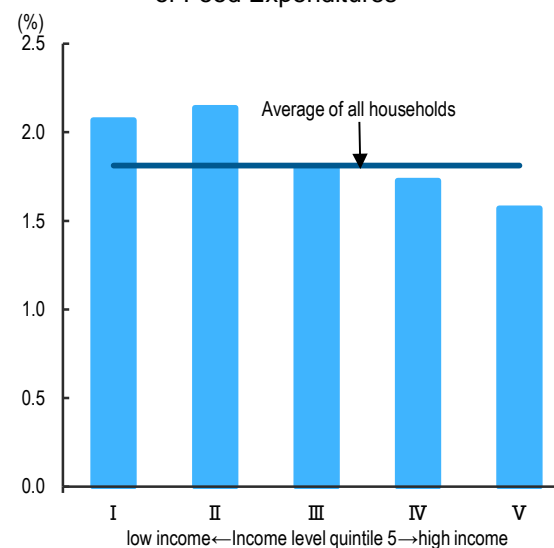
However, the rice price increase is not sufficient to push up prices overall. Even if rice prices continue to climb at the current pace, the margin of increase in headline inflation would be expected to be limited to 0.2 percentage points. Ripple effects on the prices of processed products made with rice will also be limited, though rice crackers are an exception. With most processed rice products, the rice only accounts for a small proportion of the total cost, and it is often foreign rice. Hence, while the prices of these products are greatly affected by the cost of imported ingredients and fuel, they do not move in step with domestic rice prices.

Figure 8-1 Consumer prices for rice and other food <YoY>



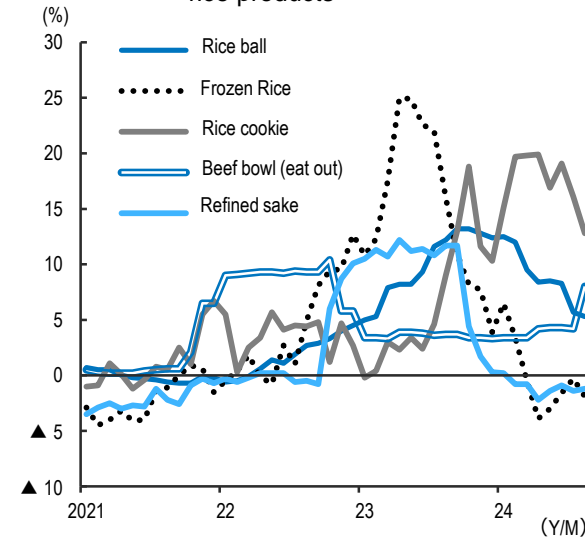
Source: The Japan Research Institute, Ltd. based on data of Ministry of Internal Affairs and Communications.

Figure 8-2 Rice Expenditures as a Percentage of Food Expenditures



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

Figure 8-3 Consumer prices of processed rice products



Source: The Ministry of Internal Affairs and Communications.

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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. With labor shortages intensifying, companies are becoming more aggressive in raising pay to secure workers, so wages are expected to continue growing at a rapid pace. As a result, positive YoY real wage growth should gradually become more permanent.

Capital investment is expected to 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.

Figure9 Projections for GDP Growth and Main Indicators of Japan (as of October 11, 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)

Nominal GDP	2.5	2.1	3.6	3.7	4.7	3.5	2.8	2.4	2.6	4.9	3.5	2.8
GDP deflator	3.4	3.2	3.1	3.0	2.7	2.1	1.5	1.3	1.4	4.0	3.0	1.6
Consumer Price Index (excluding fresh food)	2.5	2.5	2.6	2.4	2.5	2.0	1.6	1.6	1.5	2.8	2.5	1.7
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	149	144	141	139	137	135	133	145	147	136
Import Price of Crude Oil (US\$/barrel)	83	87	86	76	74	72	71	70	68	86	81	70

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.