Monthly Report of Prospects for Japan's Economy

February 2025

Macro Economic Research Center
Economics Department

The Japan Research Institute, Limited

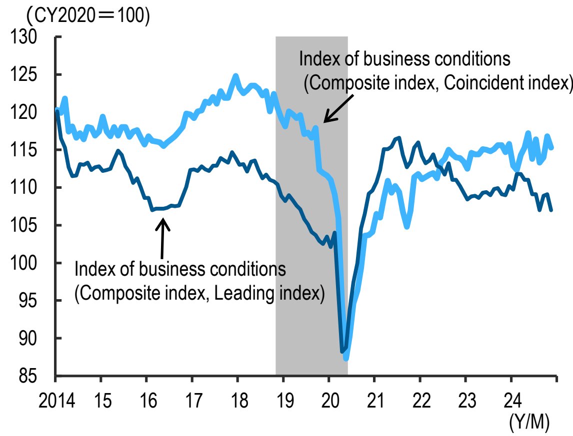
https://www.jri.co.jp/english/periodical/

This report is the revised English version of the January 2025 issue of the original Japanese version.

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

Figure 1-1 Economic Activity

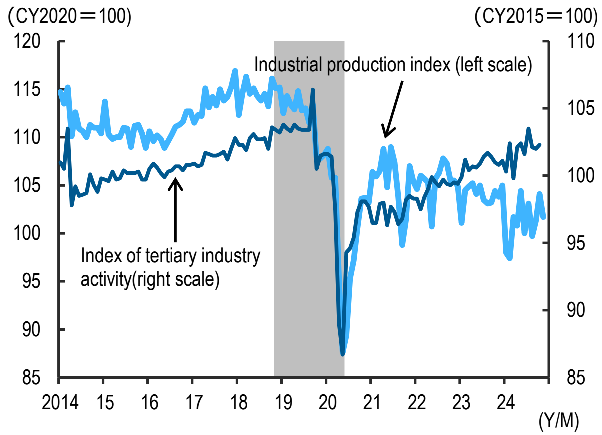
Both coincident and leading indices of business conditions are fluctuating.



Source:The Cabinet office.

Figure 1-2 The Corporate Sector

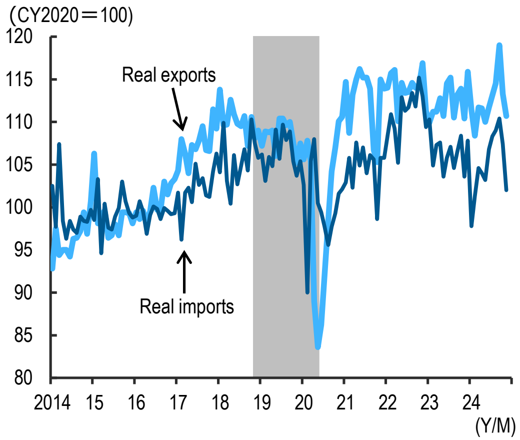
Industrial production is weak.
Economic activity in the service sector is on the recovery track.



Source:The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

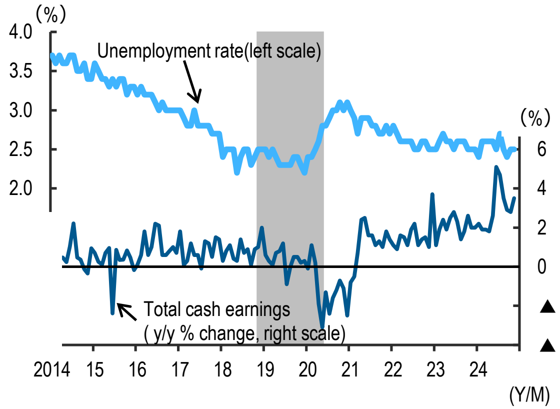
The trend for both exports and imports is recovery, but they have been declining recently.



Source:The Bank of Japan.

Figure 1-4 Employment and Income

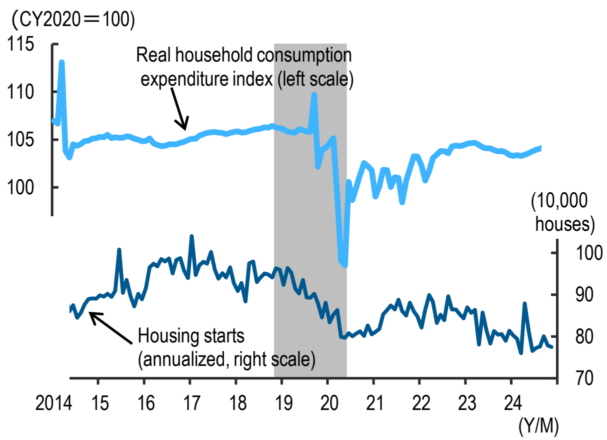
The unemployment rate remains more or less flat in the mid-2% range.
Nominal wage growth is hovering at around 3% year over year.



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

Figure 1-5 The Household Sector

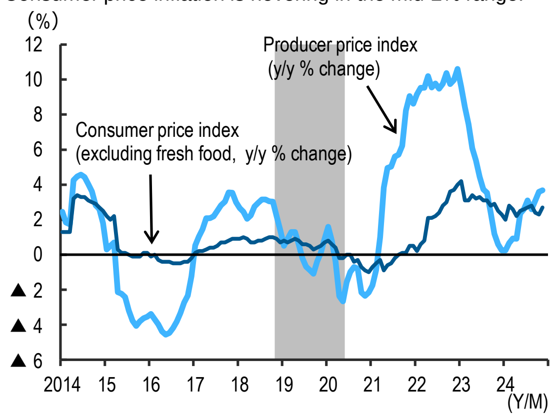
Consumption is picking up.
Housing starts remain at a low level.



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

Figure 1-6 Prices

Corporate price inflation is accelerating due to the continued weakness of the yen.
Consumer price inflation is hovering in the mid-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.

Business confidence among companies is favorable

◆ Business confidence among companies is favorable

In the December 2024 Tankan survey from the Bank of Japan (BOJ), the diffusion index (DI) for business conditions for large manufacturing enterprises increased by one percentage point from the previous survey. Business confidence in sectors such as production machinery improved against the backdrop of firm demand for semiconductors, and confidence also rose in materials-related sectors such as petroleum and coal products due to such factors as falling resource prices.

The DI for large non-manufacturing enterprises fell slightly, by one percentage point, but remained high. Although confidence remained weak in consumption-related sectors due to prolonged inflation and other factors, it improved in logistics- and construction-related sectors.

◆ Production in the manufacturing sector is fluctuating

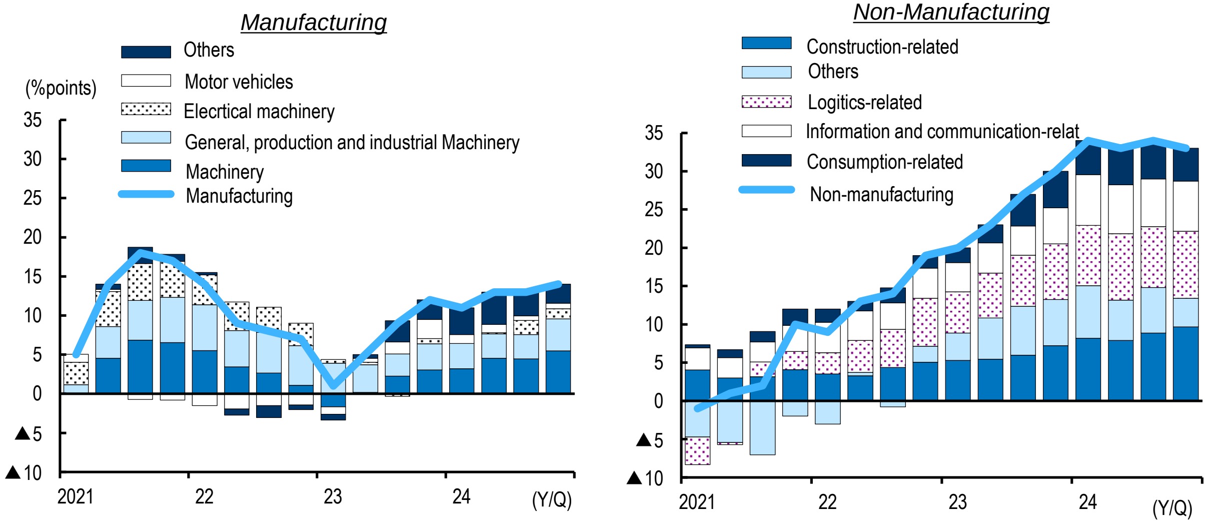
In November 2024, the Industrial Production Index dropped by 2.3% month over month (MoM). Due to such factors as temporary inventory adjustments, output of production machinery, including semiconductor manufacturing equipment, and automobiles decreased.

Production is expected to start picking up going forward. Production plans indicate increases in output of production machinery in December 2024 and transportation machinery in January 2025.

◆ Consumer confidence is static

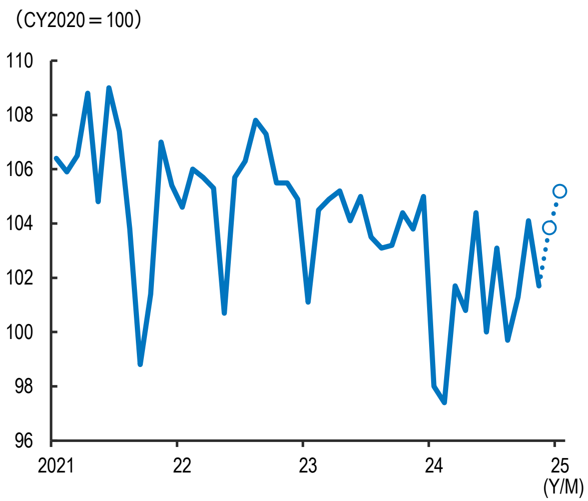
The improvement in consumer confidence has stalled. As a result of widespread wage increases due to labor shortages and other factors, the perception index for income growth has remained resilient. However, in response to rising prices of services and food, the index for overall livelihood has been declining since the spring of 2024 and continues to be weak.

Figure 2-1 DI for Business Conditions of Large Companies



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

Figure 2-2 Industrial Production Index <seasonally adjusted>



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

Note:Dotted lines are postponed based on the forecast index of manufacturing production (December 2024 and January 2025).

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

◆ Foreign demand is on the recovery track

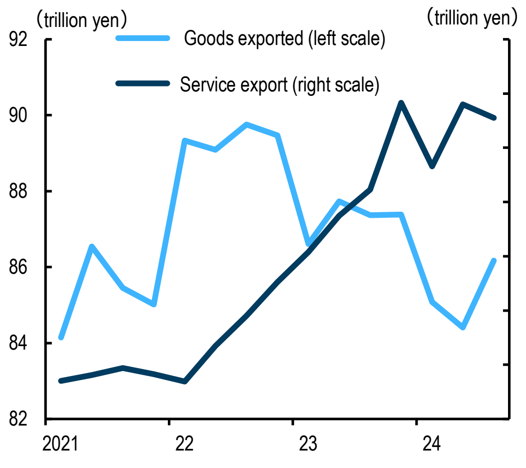
Japan's exports of both goods and services are on the recovery track. Driven by such factors as the recovery in inbound demand, service exports have been rising steadily. And exports of goods, especially IT-related goods, which had been trending downward, are also picking up, reflecting the cyclical recovery in goods demand. However, exports in October-November declined, with the fall centered on transportation machinery bound for the West and intermediate goods.

Looking ahead, service exports should remain firm, thanks largely to the continued weakness of the yen, though the recovery in goods exports is expected to be weak. Exports of IT-related goods look set to be strong due to the growing demand for AI-related products, but the slowdown in the Chinese economy and the trade policies of the incoming U.S. administration are likely to weigh on the economy.

◆ Appetite for capital investment is strong

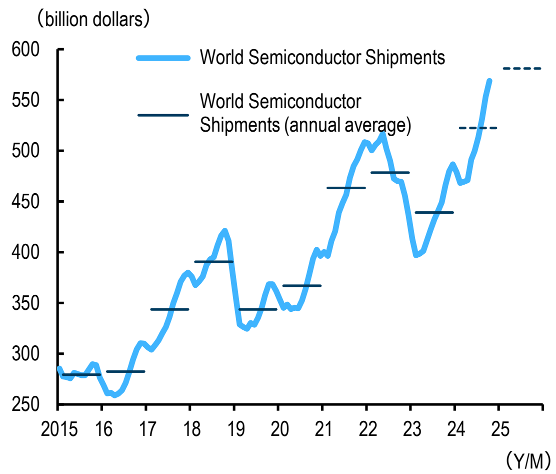
Capital investment is holding steady overall despite weakness in certain categories. By type, machinery investment remains tepid, but construction investment is starting to bottom out and software investment is still at a high level. Capital investment is also expected to hold firm going forward. According to the BOJ Tankan, planned capital investments (including software but excluding land) for FY2024 are up 11.2% 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. Notably, demand for software investment for labor-saving applications is expected to remain brisk. Looking at capital investment plans by industry, appetite for software investment is especially strong in sectors facing serious labor shortages, such as lodging and food/beverage services.

Figure 3-1 Exports by Goods and Services <Real seasonally adjusted>



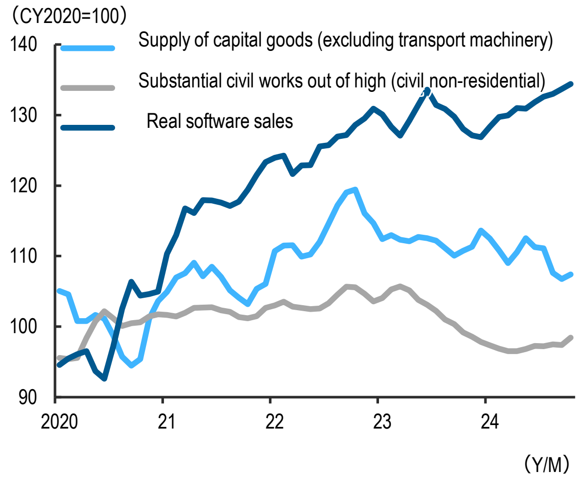
Source: Cabinet Office.

Figure 3-2 World Semiconductor Shipments



Source:World Semiconductor Statistics（WTST）.
Note:Dashed line shows WSTS annual average forecast (as of December 2024)
Global semiconductor shipments are backward-looking three-month averages.

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



Source: The Japan Research Institute, Ltd. based on the data of Ministry of Economy, Trade and Industry.
Note:Backward Three Months Average.

The income situation for households is beginning to gradually improve

◆There is conspicuous variation across sectors in terms of increases in numbers of workers

The employment environment is generally favorable. The number of workers is continuing to rise gradually overall. However, the pace of recovery differs depending on the sector. The number of workers in the non-manufacturing sector is continuing to increase steadily but the number in the manufacturing sector is stagnant. The Tankan diffusion index for employment conditions also indicates that labor shortages are not being felt as strongly in manufacturing as in the non-manufacturing sector, and that among small and medium-sized enterprises, the perception that there is a shortage of workers is easing.

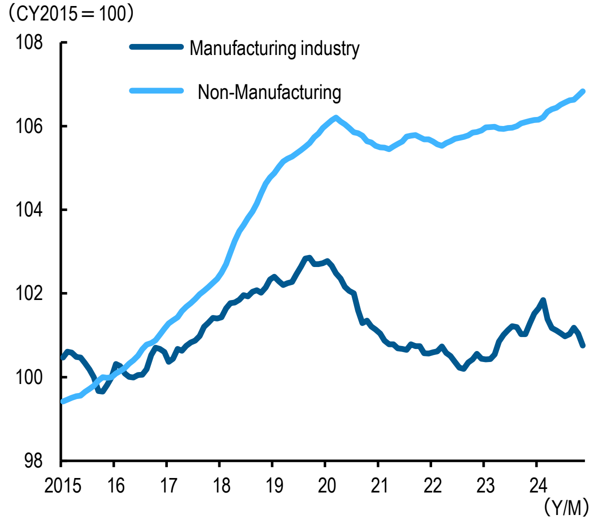
Overall, the job market is expected to become much tighter in the near term. The background to this is that room for expansion in the labor supply is shrinking even though demand for workers will increase as economic activity recovers. However, with a strong rebound in the manufacturing sector unlikely against the backdrop of sluggish foreign demand, the pace of recovery is expected to continue to vary depending on factors such as sector and company size

◆Positive real wage growth should start to become firmly established

Wages are increasing at an accelerating pace. In November, basic salaries of ordinary workers increased by 2.6% YoY, and the hourly pay of part-time workers also climbed 4.7% YoY, maintaining a rapid pace of increase. However, the rise in total cash payrolls for employees as a whole failed to keep up with the rate of price increases, so real wages dropped for the first month of YoY negative growth in two months.

Going forward, wages are expected to continue to rise at a fast clip, with positive YoY real wage growth becoming firmly established sooner or later. Companies are becoming more aggressive in raising pay to secure workers, so as in 2024, the 2025 shunto (spring wage negotiations) should result in substantial wage hikes. Wages of part-time workers, whose pay is less affected by shunto trends, look set to continue rising fast amid increases in minimum wages and a tightening labor market.

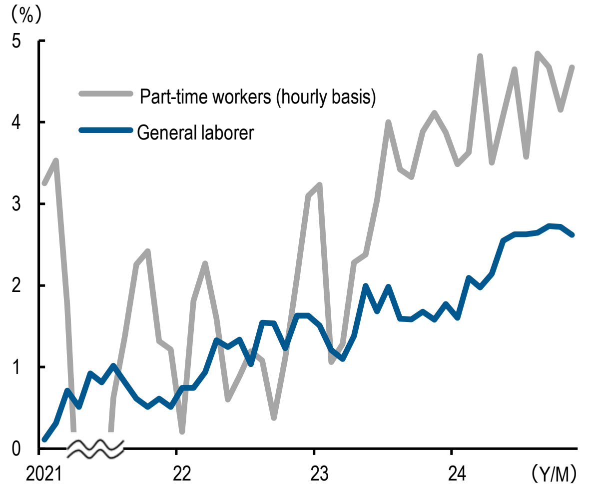
Figure 4-1 Number of Employed Persons



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

Note:Backward 12-month average.

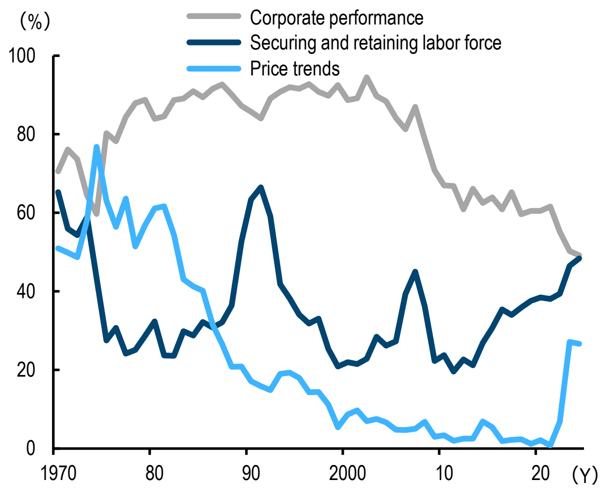
Figure 4-2 Fixed Salary<YoY>



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

Note: Adjusting for data faults caused by adjustments to the surveyed companies.

Figure 4-3 Items Focused on by Companies in Wage Revisions



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

Note: Percentage of firms planning or implementing wage revisions. Percentage of companies that have answered more than one question, up to a maximum of three.

Core inflation will fluctuate at around 2% for the time being

◆Policy factors are causing significant fluctuation

In November, core inflation accelerated from the previous month to 2.7%. Energy prices climbed due to the government temporarily withdrawing subsidies for electricity and gas bills, and rises in the prices of goods quickened as a result of the persistent weakness of the yen.

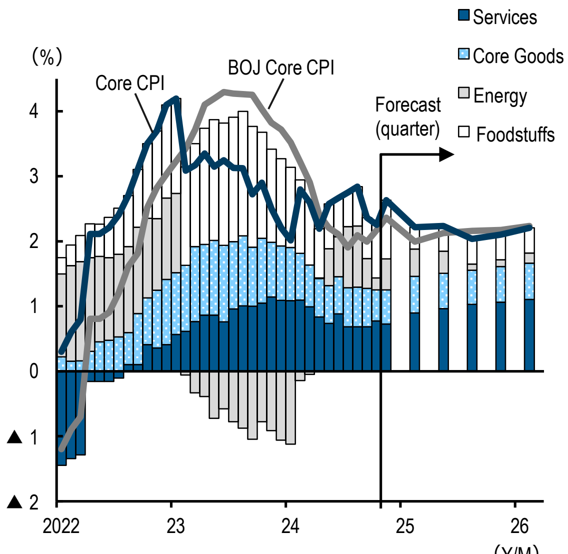
Looking ahead, the core CPI is expected to keep rising at an annual pace of around 2%, though the figure will be affected by policy factors. At the beginning of 2025, the government will resume electricity and gas subsidies, which were temporarily halted in October, and it has also decided to extend subsidies for gasoline, which had only been supposed to last until the end of 2024. Although these measures will keep energy prices in check for the time being, the inflation-suppressing effect of the subsidies will evaporate once they are withdrawn in the spring. On the other hand, food prices, which have been rising conspicuously of late, are expected to gradually stabilize. Regarding the underlying trend, since the yen is expected to remain weak, imported inflationary pressure on goods prices looks set to linger going forward. Furthermore, moves to pass on higher wages to selling prices will gather momentum, and prices of services are forecast to rise even faster.

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

At its monetary policy meeting in December 2024, the Bank of Japan (BOJ) decided to keep its policy rate unchanged.
Long-term interest rates rose from the beginning of January 2025. Due to speculation over Mr. Trump's economic policies, U.S. long-term interest rates have risen, with long-term interest rates in Japan being pulled up alongside them.

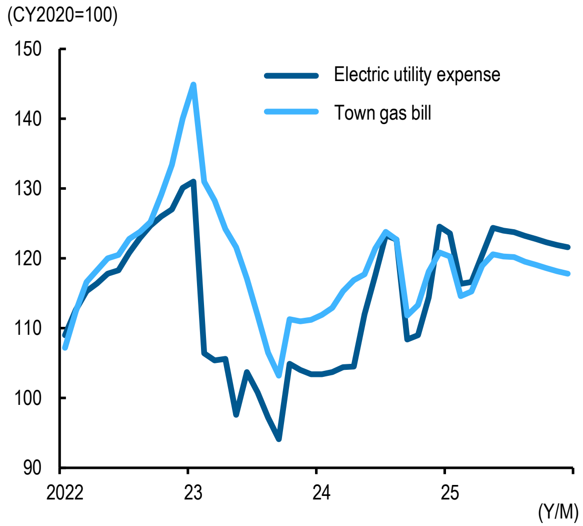
The BOJ is expected to increase interest rates again at its meeting in January, and to then continue raising them in stages. Long-term interest rates look set to rise gradually due to policy rate hikes and a recovery in the domestic economy.

Figure 5-1 Consumer Price Index <YoY>



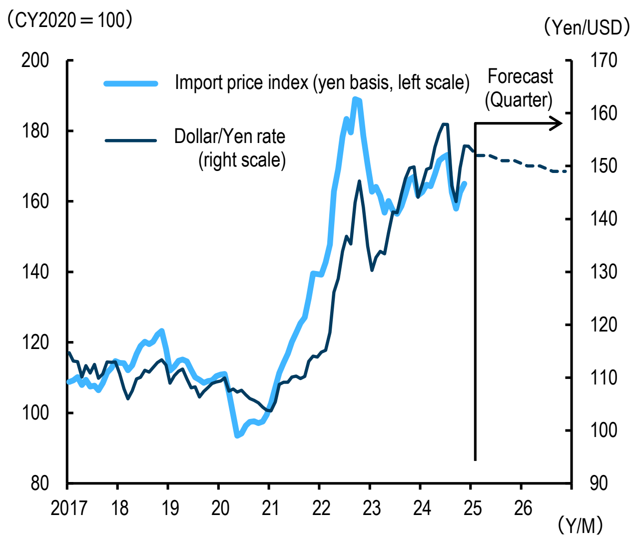
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Figure 5-2 CPI City Gas and Electricity Bills



Source: The Japan Research Institute, Ltd. based on the data of Ministry of Internal Affairs and Communications, Agency for Natural Resources and Energy.
Note:Electricity and gas cost containment measures will temporarily end in September 2024 and then resume temporarily for usage from January to March 2025.

Figure 5-3 Import Price Index and Exchange Rates



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

Topic①: Trump tariffs will exacerbate the global oversupply of goods

◆A goods glut is affecting global trade

It appears that world trade is already being impacted by an oversupply of goods. Global export prices have been on a downward slide recently. Compounding a pause in the rise in resource prices, China's excess production has also been pushing prices down. Against a backdrop of sluggish domestic demand and improved competitiveness, China has been expanding exports of low-price products, accelerating the trend of "exporting deflation."

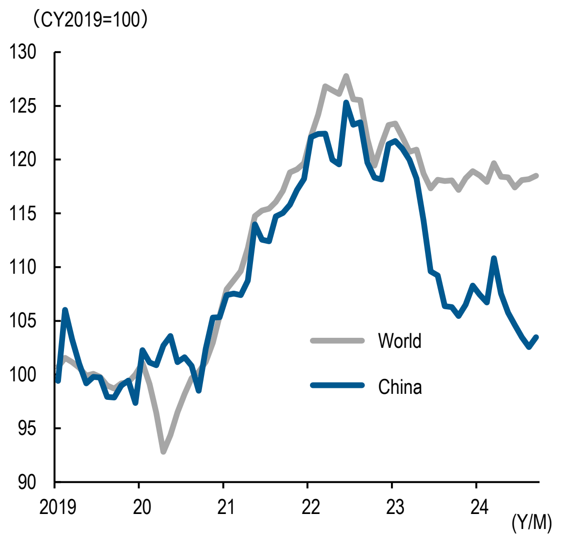
Competition in world trade has intensified amid the goods oversupply, and overall, the manufacturing sectors of developed nations have been the losers. In recent years, the production volume of developed countries has been trending downward. This is in contrast to emerging economies, where output has been consistently rising. Among developed nations, the production slumps in Japan and Germany are particularly striking, as their manufacturing sectors have been hit hard by price competition from Chinese products.

◆Chinese goods could flow into Japan

If the U.S. raises tariffs on Chinese products and U.S.-China trade is curtailed, Chinese companies will redirect exports that would have gone to the U.S. to other parts of the world, so a substantial exacerbation of the global goods glut is a strong possibility.

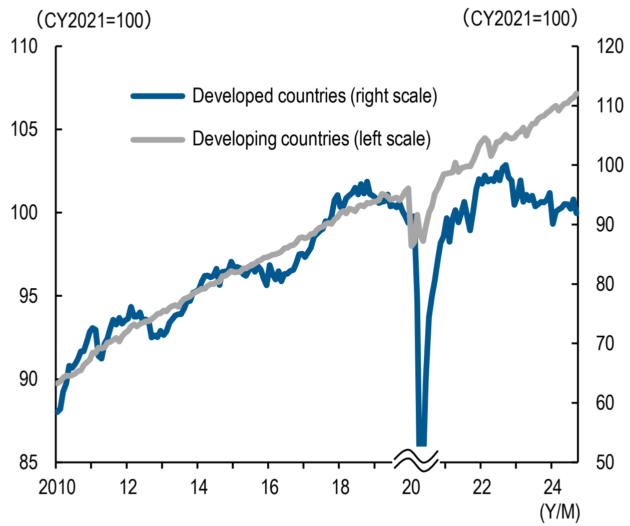
Looking at U.S.-China trade by item, China exports large quantities of consumer goods to the U.S., and these include daily necessities, clothing, and home appliances. Consumer products also make up the lion's share of imports from China in Japan and Europe, and there are fears that most of the Chinese consumer goods that can no longer be sent to the U.S. will find their way to other developed countries such as Japan and the nations of Europe. In Japan, imports of clothing account for a large share of consumer goods imports, so there is a possibility that such products will flow into Japan in large quantities. Although an increase in low-price imports would be positive for households, it would pose a major threat to competing domestic manufacturers.

Figure 6-1 Export Price



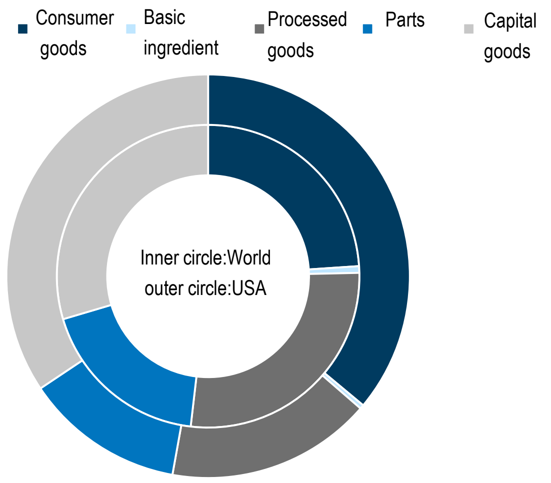
Source:Netherlands Bureau for Economic Policy Analysis.

Figure 6-2 Manufacturing Output



Source:Netherlands Bureau for Economic Policy Analysis.

Figure 6-3 Share of Imports from China



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

Topic②: Political instability casts a shadow over demand from South Korean visitors to Japan

◆South Korean tourists help drive inbound demand in Japan

The Inbound demand in Japan is strong. The number of foreign visitors to Japan in 2024 was 36.87 million, the highest figure ever and surpassing the pre-pandemic number recorded in 2019 (31.88 million). By country/territory, the numbers of travelers from the U.S. and Australia have increased markedly, but so has the number coming from South Korea.

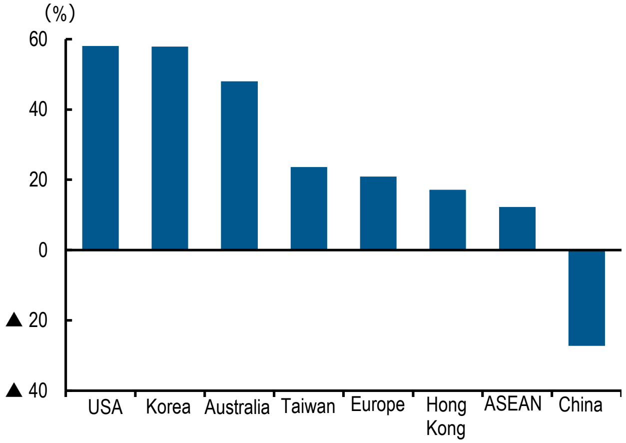
One of the reasons for the rise in the number of South Koreans visiting Japan is that Japan-South Korea relations have improved significantly in recent years under the Yoon Suk-yeol administration. According to a public opinion survey conducted jointly by the Genron NPO and the Institute of East Asian Studies, 42% of South Koreans said they had a good impression of Japan, the highest level since the survey began in 2013.

◆Feelings toward Japan are at risk of deteriorating in the event of a change of administration

However, a change of administration in South Korea could deter the country's citizens from visiting Japan. Domestic criticism of President Yoon's sudden declaration of martial law in early December 2024 has intensified pressure on him to resign. Lee Jae-myung, leader of the largest opposition party, the Democratic Party of Korea, is considered the front-runner for the next presidential election, as he is ahead of other candidates in polling by major media organizations. He has been known for his hardline political stance toward Japan, and if he assumes the presidency, there is a possibility that the trend of improving Japan-South Korea relations seen in recent years will change.

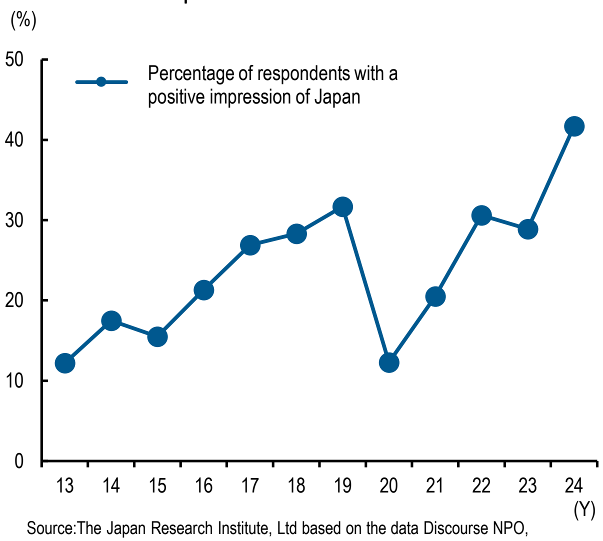
Should this happen, there is a risk of Japan seeing a drop in inbound demand from South Koreans. In 2019, when tensions between Japan and South Korea flared over the Japanese government's restrictions on the export of semiconductor materials, the number of visitors from South Korea to Japan decreased significantly.

Figure 7-1 Change in the Number of Visitors to Japan before and after the Corona Disaster by Major Countries and Regions



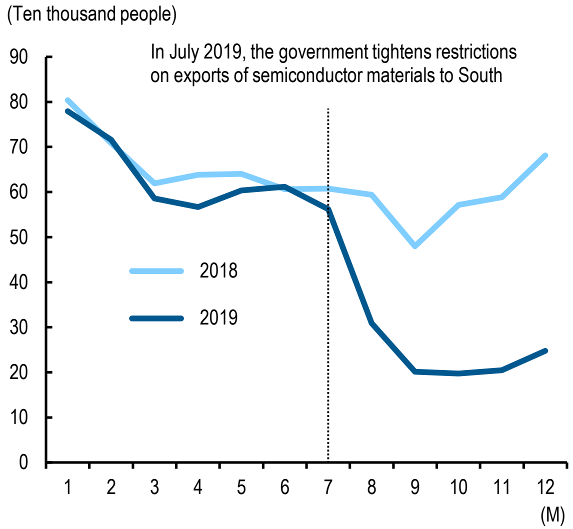
Source:The Japan Research Institute, Ltd based on the Japan National Tourism Organization.
Note:Comparing 2019 and 2024.Europe: England, France, Germany, Italy, Spain.

Figure 7-2 Korea Public Opinion Poll: Impressions of Japan



Source:The Japan Research Institute, Ltd based on the data Discourse NPO, East Asia Research Institute.
Note:Total of "have a good impression" and "have a rather good impression.

Figure 7-3 Number of Korean Visitors to Japan



Source:The Japan Research Institute, Ltd based on the Japan National Tourism Organization.

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 profits 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 pick up 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 become more permanent.

Capital investment looks set 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 economic and foreign policies of President-elect Trump and the ensuing implications for other economies. And worsening labor shortages may weaken the economy's ability to recover.

◆ The growth rate for FY2025 is expected to be +1.0%

Real GDP growth is projected to have been +0.4% in FY2024 and to reach +1.0% in FY2025. Due to the impact of the weak economy in the second half of FY2023, growth decelerated to just above 0% in FY2024, but is expected to return to around 1% in FY2025. Although the potential growth rate is currently estimated to be around the 0.5% mark, it should rise toward the end of FY2025 as labor productivity improves.

Figure 8　Projections for GDP Growth and Main Indicators of Japan（as of January 15, 2025）

(%, changes from the previous fiscal year)

	CY2024		CY2025				CY2026		FY2023	FY2024	FY2025	FY2026
	7～9	10～12	1～3	4～6	7～9	10～12	1～3	4～6				
	(Actual)	(Projection)							(Actual)	(Projection)		
Real GDP	1. 2	1. 2	1. 1	1. 0	1. 0	1. 0	0. 9	1. 0	0. 7	0. 4	1. 0	0. 9
Private Consumption Expenditure	2. 7	1. 1	0. 9	0. 8	0. 8	0. 8	0. 8	0. 9	▲ 0. 4	0. 7	0. 9	0. 8
Housing Investment	1. 4	▲ 0. 2	▲ 0. 3	▲ 0. 3	▲ 0. 4	▲ 0. 4	▲ 0. 4	▲ 0. 5	0. 8	▲ 1. 3	▲ 0. 2	▲ 0. 4
Business Fixed Investment	▲ 0. 5	1. 8	1. 9	2. 1	2. 3	2. 4	2. 4	2. 5	▲ 0. 1	2. 0	2. 0	2. 5
Private Inventories (percentage points contribution)	(0. 6)	(0. 0)	(0. 0)	(0. 0)	(0. 0)	(0. 0)	(0. 0)	(0. 0)	(▲ 0. 3)	(0. 1)	(0. 0)	(▲ 0. 0)
Government Consumption Expenditure	0. 6	0. 5	0. 3	0. 4	0. 2	0. 4	0. 2	0. 4	▲ 0. 8	1. 5	0. 3	0. 3
Public Investment	▲ 4. 3	0. 4	0. 2	0. 2	0. 2	0. 2	0. 2	0. 2	▲ 0. 3	1. 6	0. 0	0. 2
Net Exports (percentage points contribution)	(▲ 0. 8)	(0. 0)	(0. 1)	(0. 1)	(0. 1)	(0. 0)	(0. 0)	(▲ 0. 0)	(1. 5)	(▲ 0. 8)	(▲ 0. 0)	(▲ 0. 0)
Exports of Goods and Services	4. 5	2. 5	2. 5	2. 4	2. 5	2. 4	2. 4	2. 3	2. 8	1. 3	2. 6	2. 3
Imports of Goods and Services	7. 4	2. 3	2. 1	2. 1	2. 1	2. 2	2. 2	2. 3	▲ 3. 3	4. 6	2. 5	2. 3

(% changes from the previous fiscal year)

	CY2024 7～9	10～12	CY2025 1～3	4～6	7～9	10～12	CY2026 1～3	4～6	FY2023	FY2024	FY2025	FY2026
Nominal GDP	2. 9	2. 7	3. 9	3. 4	3. 3	3. 2	3. 5	3. 2	4. 9	2. 9	3. 3	3. 4
GDP deflator	2. 4	2. 3	2. 4	2. 3	2. 3	2. 4	2. 5	2. 3	4. 2	2. 6	2. 4	2. 4
Consumer Price Index (excluding fresh food)	2. 7	2. 3	2. 2	2. 2	2. 0	2. 1	2. 2	2. 0	2. 8	2. 4	2. 1	2. 1
Unemployment Rate (%)	2. 5	2. 5	2. 5	2. 5	2. 5	2. 4	2. 4	2. 3	2. 6	2. 5	2. 4	2. 3
Exchange Rates (JY/US$)	149	152	152	152	151	151	150	150	145	152	151	149
Import Price of Crude Oil (US$/barrel)	87	77	75	72	71	72	73	74	86	82	72	75

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.