

Monthly Report of Prospects for Japan's Economy

March 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 February 2025 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 are fluctuating
(CY2020=100)

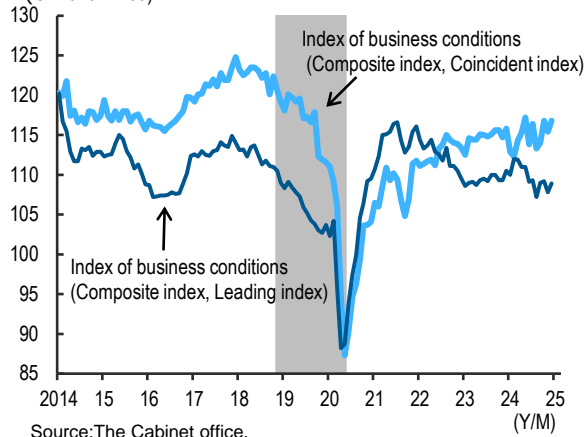


Figure 1-2 The Corporate Sector

Industrial production is weak
Economic activity in the service sector is on the recovery track
(CY2020=100)

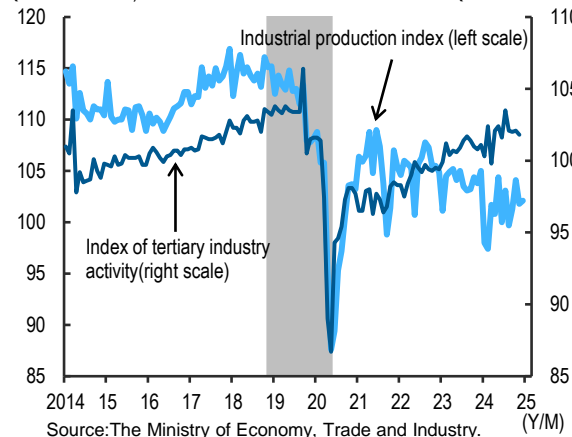


Figure 1-3 Overseas Demand

Exports are rebounding, while imports are fairly flat overall
(CY2020=100)

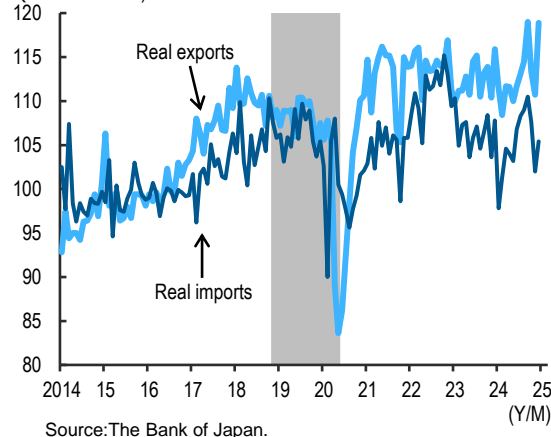


Figure 1-4 Employment and Income

The unemployment rate is in the mid-2% range
The rate of nominal wage growth is gradually rising
(%)

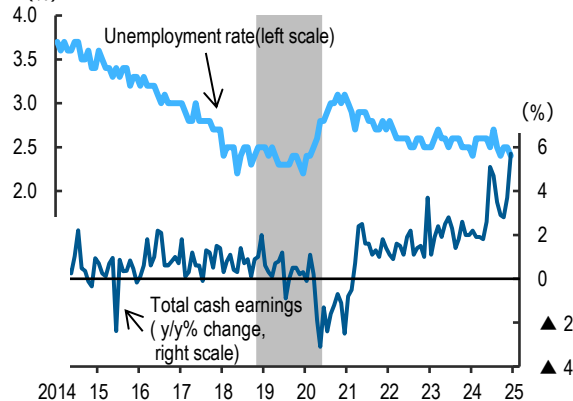


Figure 1-5 The Household Sector

Consumption is picking up
Housing starts remain at a low level

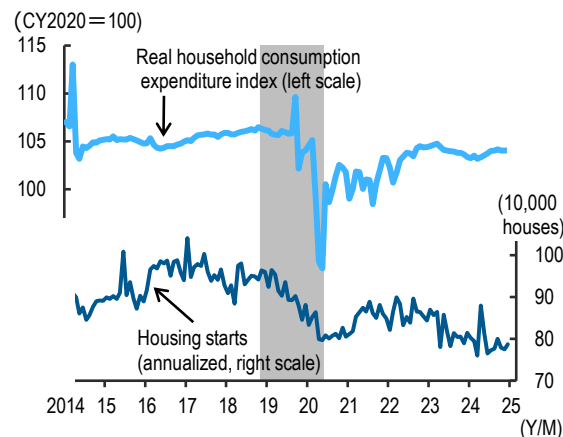
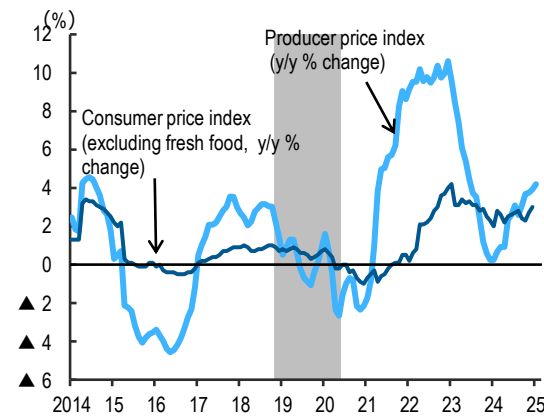


Figure 1-6 Prices

Corporate price inflation is accelerating
Consumer price inflation is accelerating again



* The shaded area indicates the recession phase.

In October-December, annualized real GDP growth was +2.8% quarter over quarter (QoQ)

◆ Foreign demand drove the positive growth

Annualized real GDP growth in the October-December 2024 quarter was +2.8% QoQ, with growth staying in positive territory for three straight quarters. Imports dropped following a period of large increases, while exports climbed, centered on inbound demand. The growth was therefore driven by foreign demand. Domestic demand was pushed down overall by lower inventories, but personal consumption remained positive and capital investment was firm on the whole.

◆ Production in the manufacturing sector is fluctuating

In December 2024, the Industrial Production Index increased by 0.3% month over month (MoM). Although output of transportation machinery fell due to such factors as inventory adjustments, production in the industrial machinery and electronic component/device sectors rose.

Near-future production plans indicate recoveries in output of transportation machinery in January and general-purpose and business-oriented machinery in February.

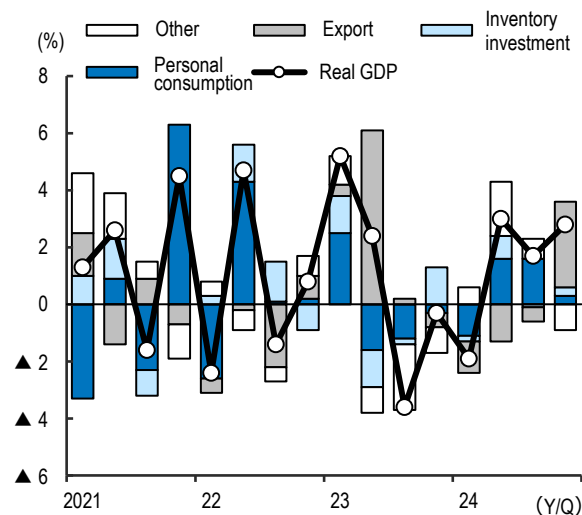
◆ Face-to-face services consumption is holding firm

Against the backdrop of the recovery in demand in the wake of the COVID pandemic, consumption of face-to-face services remains solid. The food/beverage service sector has been temporarily weak recently as consumers tighten their purse strings, but consumption in this sector is more or less back to pre-COVID levels. Lodging has also been firm since the end of 2022, supporting services consumption overall.

◆ Housing starts are on a downward trend

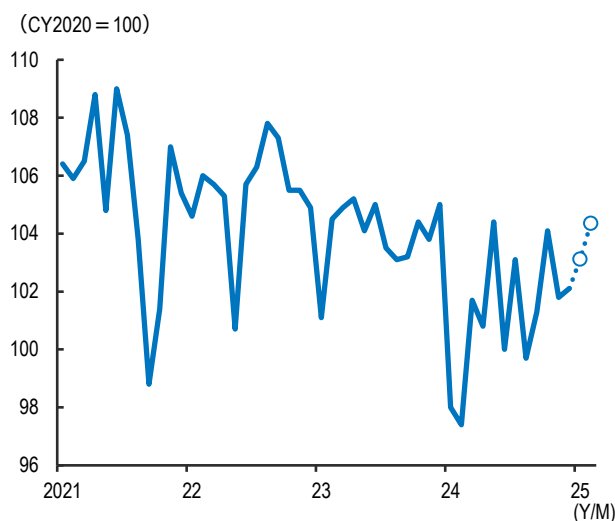
Housing starts are on a downward trend. Soaring home prices, which are chiefly the result of rising construction costs, and the belief that mortgage interest rates will increase going forward are among the factors pushing down demand for new homes.

Figure 2-1 Real GDP Growth Rate



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

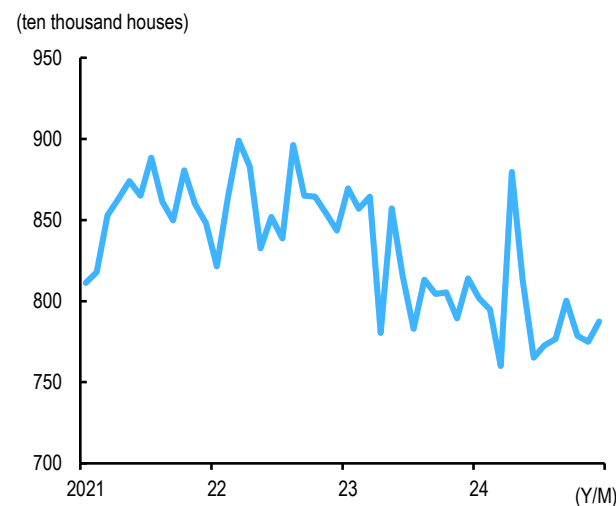
Figure 2-2 Industrial Production Index <seasonally adjusted>



Source: The 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 (January and February).

Figure 2-3 New Residential Construction <seasonally adjusted>



Source: Ministry of Land, Infrastructure, Transport and Tourism.

Goods exports are lacking strength, but inbound demand is firm

◆ Goods exports are increasing, though with fluctuations

Goods exports are gradually increasing, though with fluctuations. By product category, exports of transportation machinery remain sluggish, but capital goods exports are recovering. Exports of electronic components/devices are also bottoming out.

Looking ahead, goods exports are expected to recover. The background to this is a cyclical pick-up in demand for goods. Thanks to strong demand for semiconductors across the globe, exports of IT-related goods look set to increase, and with capacity utilization rates having bottomed out worldwide, the balance between shipments and inventories of capital goods is improving.

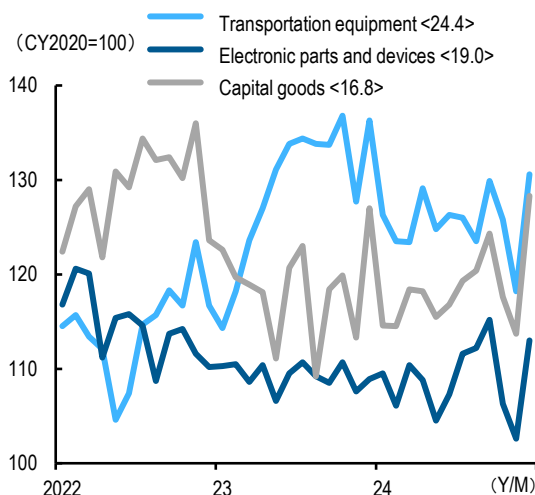
However, the pace of the rise in exports is likely to be slow. The U.S. government's tariff policies and the slowdown in the Chinese economy will exert downward pressure, and the shift to overseas production, particularly of transportation machinery, will also weigh on exports

◆ Inbound demand is firm

In December 2024, the number of foreign visitors to Japan exceeded the pre-COVID level by a large margin. The number of foreign visitors to Japan for the full year of 2024 was over 36 million, surpassing the pre-pandemic number recorded in 2019, which had been the highest figure ever, by just shy of five million. The numbers of visitors from South Korea, Taiwan, and Western countries have held steady, while the number coming from China, who had been slow to return, has recently recovered to above 80% of the pre-COVID level.

Inbound demand is also expected to hold firm going forward. The yen remains weak, which will continue to boost the desire among foreign travelers to visit Japan, and per-person spending by visitors should stay at a high level. However, there is a risk that the stagnation of China's economy will put a damper on the increase in visitors to Japan.

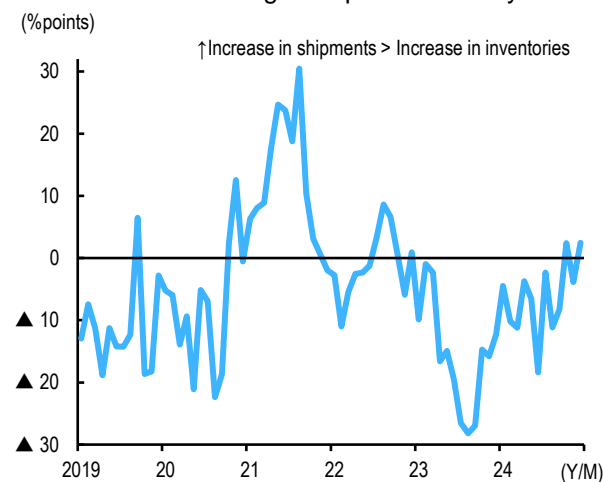
Figure 3-1 Real Exports by Category
<seasonally adjusted>



Source: Bank of Japan.

Note: <> figures in parentheses represent the share of total nominal exports in 2022.

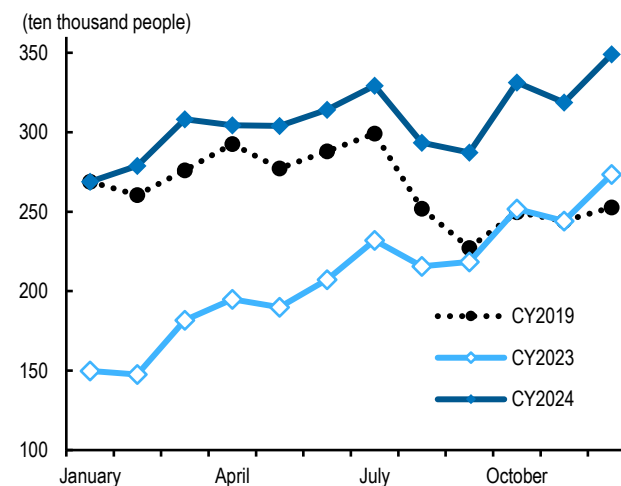
Figure 3-2 Balance of Shipments and Inventories of
Capital Goods
<excluding transport machinery>



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

Note: Shipment/Inventory Balance = Shipment (y/y) - Inventory (y/y).

Figure 3-3 Number of Foreign Visitors to Japan



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

The income situation for households is beginning to gradually improve

◆Special payments are pushing up wages

Wages are growing faster. Total cash payrolls in December 2024 rose 5.8% year over year (YoY), a high rate of increase. Significant rises in special payments such as regular and one-time bonuses lifted the overall increase. Winter bonuses increased against the backdrop of factors such as improved corporate earnings.

Going forward, wage growth rates are expected to remain high. Although the effect of the hefty increases in special payments will no longer be felt, big-percentage rises in wages, centered on basic salaries, look set to become firmly established. Against the backdrop of worsening labor shortages, companies are becoming more aggressive in boosting base pay to secure workers, so as in 2024, the 2025 shunto (spring wage negotiations) should result in substantial wage hikes. Hourly pay for part-time workers, which is less affected by shunto trends, is also expected to continue rising fast amid increases in minimum wages and a tightening labor market.

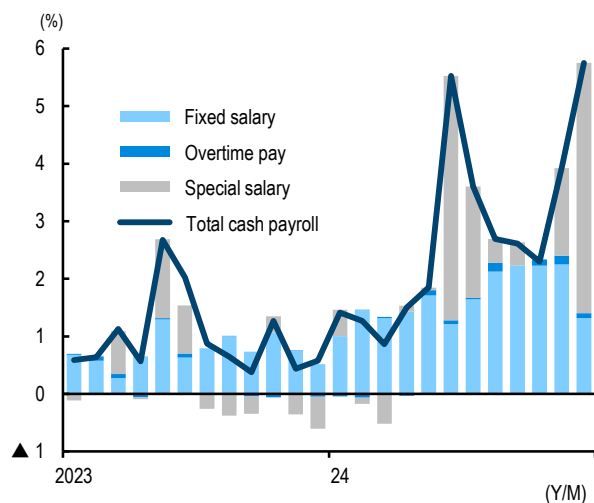
◆An uptick in prices is weighing on the recovery in consumption

Personal consumption is slowly picking up. Consumption of goods, mainly non-

durable items such as food, is stagnating amid high prices and a growing desire among households to save money. However, consumption of services, especially face-to-face services such as lodging and food/beverage service, continue to recover, and this is supporting consumption overall.

Personal consumption is expected to begin recovering soon. In the near term, the uptick in prices due to the temporary suspension of government subsidies for energy and soaring food prices will weigh on consumption. From the summer, however, a clear recovery in consumption should be seen as inflation slows and rising real wages become firmly established.

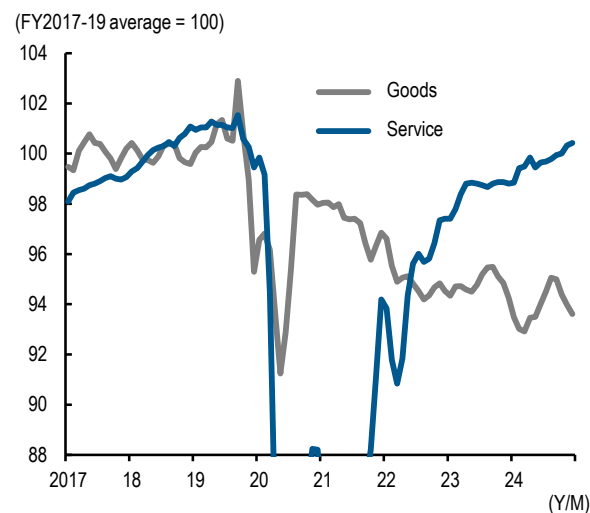
Figure 4-1 Total Cash Salaries <YoY>



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

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

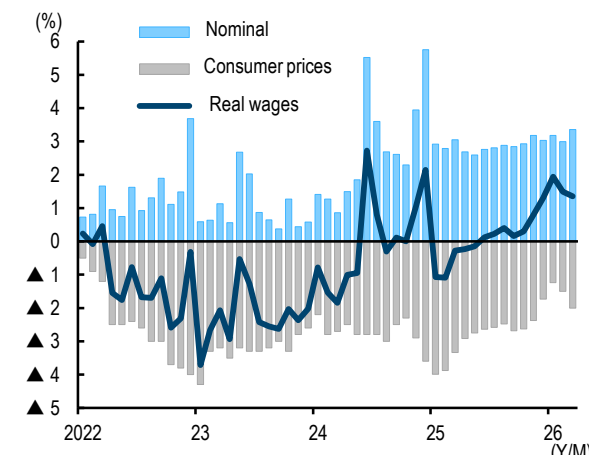
Figure 4-2 Consumption Activity Index <seasonally adjusted>



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

Note: Backward three-month moving average.

Figure 4-3 Real Wages <YoY>



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

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

Nominal wages are the total cash salaries of all workers. Consumer prices are comprehensive.

Monthly Report of Prospects for Japan's Economy March 2025
The Japan Research Institute, Limited

Core inflation will hover in the low-2% range

◆ Policy factors will cause significant fluctuation

December 2024, core inflation accelerated from the previous month to 3.0%. Energy prices were pushed up by the government temporarily withdrawing subsidies for electricity and gas bills and reducing subsidies for gasoline. Food prices also rose faster in response to soaring prices of rice and fresh food.

Looking ahead, the core CPI is expected to increase at an annual pace in the low-2% range, though the figure will be affected by policy factors. Although the resumption of subsidies for electricity and gas bills will keep energy prices in check heading into the spring, their inflation-suppressing effect will evaporate later once they are withdrawn. On the other hand, the ascent of food prices is expected to gradually slow. Regarding the underlying trend, since the yen is projected to remain weak, imported inflationary pressure on goods prices looks set to continue to linger. Furthermore, moves to pass on higher wages to selling prices will gather momentum, and the pace of rises in prices of services is forecast to gradually increase.

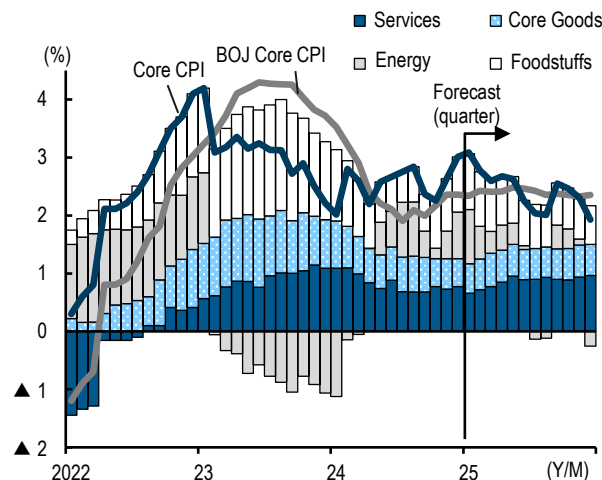
◆ The Bank of Japan (BOJ) has raised its policy interest rate

At its monetary policy meeting in January, the BOJ hiked its policy rate to around 0.5%.

Long-term interest rates rose through early February. As a background factor, expectations of an early additional interest rate hike by the BOJ grew in response to such factors as statements made by senior BOJ officials.

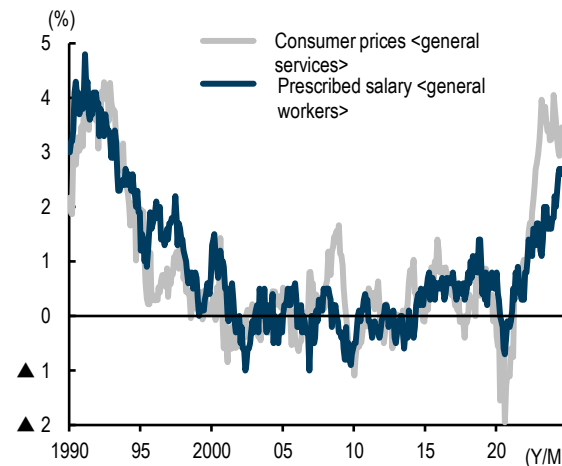
The BOJ is expected to continue to raise interest rates incrementally in phases. Long-term interest rates look set to rise gradually due to policy rate hikes and a recovery in the domestic economy.

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.

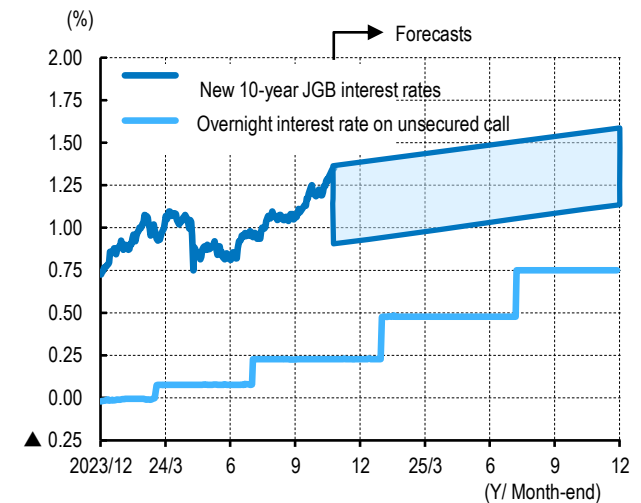
Figure 5-2 Wages and Service Prices



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

Note: General service prices exclude rent; after April 2020, telecommunication charges (cell phones), accommodation costs, and the impact of consumption tax hikes, which are highly variable due to policy factors, etc. Prescribed salaries after 1993 include part-time workers.

Figure 5-3 Outlook for Japan's Main Interest



Source: NEEDS-FinancialQUEST.

Topic ①: Japan's import penetration rate rises

◆ Import dependence in information and communications equipment is increasing

Since the COVID pandemic, Japan's import penetration rate (the proportion of imported goods in the overall supply) has risen significantly. A look at different industries reveals that compared to before the pandemic, import penetration has also increased in the information and communications equipment and electronic components/devices sectors, which have seen rises in total supply. Notably, imports of information and communications equipment, which are centered on smartphones, servers, and PCs, have increased compared to before the pandemic, whereas domestic production has declined by about 40%. This sector now relies heavily on imports to meet the huge domestic demand.

The increase in imports of information and communications equipment is partly due to Japan's poor international competitiveness in this field. Japan's share of the world's total exports of information and communications equipment has recently dropped below 1%. While China raised its profile in the 2010s thanks to low labor

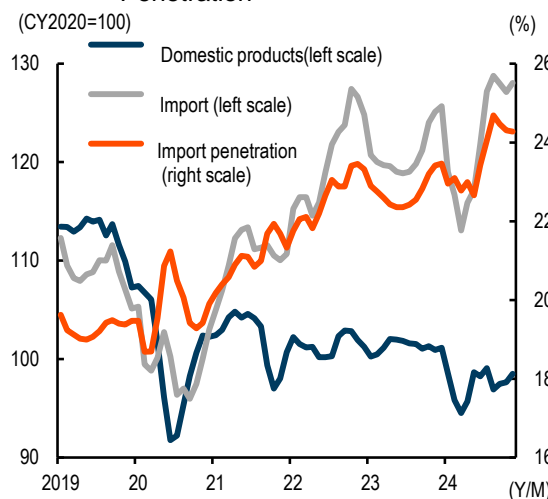
costs and improving technological capabilities, Japan's share has fallen dramatically over the past two decades. In recent years, Chinese products have accounted for just under 70% of Japan's imports of information and communications equipment.

◆ There are fears that IT adoption will be less likely to lead to growth

Against the backdrop of the digitalization of the economy and society and deepening labor shortages, demand for IT-related goods such as information and communications equipment is expected to remain firm going forward.

While IT adoption can be expected to contribute to boosting Japan's economic growth rate in the future by raising productivity, it is unlikely to lead to higher domestic production of IT-related goods as long as Japan is reliant on imports from China and elsewhere. So for the time being, any uplift to the Japanese economy will be limited.

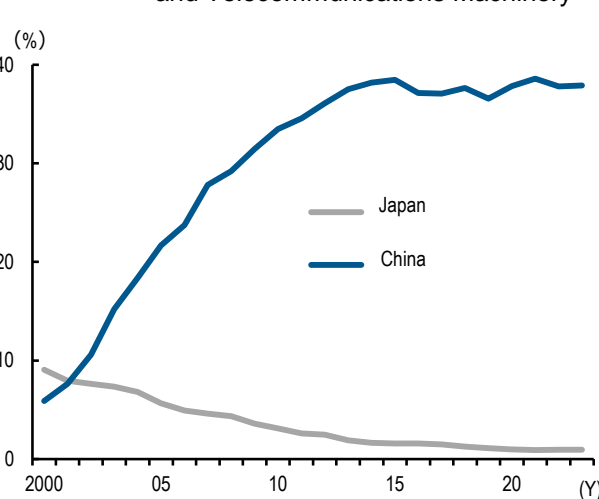
Figure 6-1 Total Manufacturing Supply and Import Penetration



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

Note: Backward 3 months play. Import Penetration = (Import Index x Import Weight) / (Total Supply Index x Total Supply Weight).

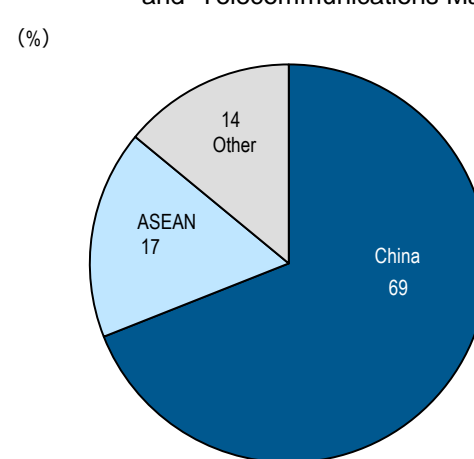
Figure 6-2 Share of Global Exports of Information and Telecommunications Machinery



Source: The Japan Research Institute, Ltd. based on United Nations.

Note: Share is calculated in nominal amounts. Information and communication equipment is the total of computer equipment (HS8470,71), communication equipment (8517-22), and audio visual equipment (8523-29).

Figure 6-3 Japan's Import partners of Information and Telecommunications Machinery



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

Note: Calculated based on imports from January 2020 to November 2021.

Monthly Report of Prospects for Japan's Economy March 2025
The Japan Research Institute, Limited

Topic②: Fears of a stall in consumption due to soaring prices of fresh foods

◆Skyrocketing food prices are sapping consumer confidence

Food prices are soaring. Consumer prices for fresh foods were up 17.2% YoY in December 2024. The rise was driven by a jump in prices of fresh vegetables (+27.3%).

And the reason vegetable prices soared was unfavorable weather. According to a survey conducted by the Ministry of Agriculture, Forestry and Fisheries involving interviews in major producing areas and with wholesalers, low rainfall toward the end of last year hampered the growth of leafy greens such as cabbage, lettuce, and hakusai (napa cabbage), causing the volume shipped to be lower than in typical years.

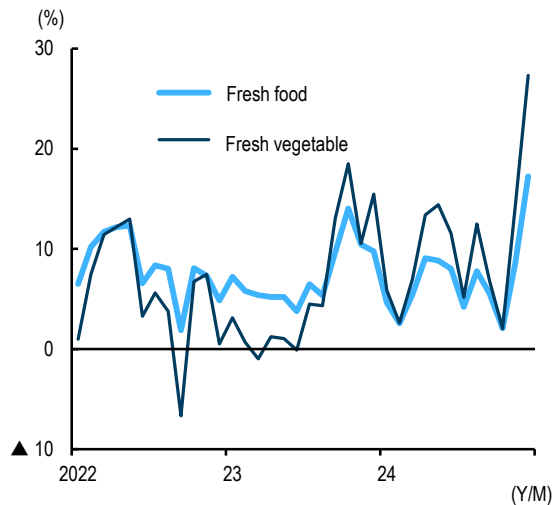
Ripple effects from the surge in fresh food prices have impacted prices as a whole. Leading food manufacturers have been raising prices for processed foods in response to increases in prices of ingredients. And restaurants, too, are passing on their higher purchasing costs to customers in the form of higher menu prices. These increases in food prices are sapping consumer confidence. Higher prices for frequently purchased items such as food impose a heavy toll on household finances,

and tend to lead to lower consumer confidence. Consumer confidence was already weak, so concerns about the outlook for consumption are growing.

◆Signs that fresh food prices have peaked

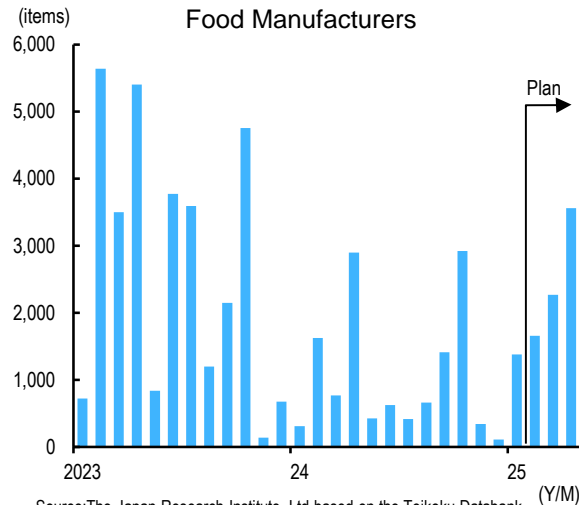
However, the impact of higher prices for fresh foods is expected to be temporary. Recently, signs have emerged that vegetable prices have hit their peak. Shipments of most vegetables have been recovering in February, so the rise in fresh food prices is projected to gradually slow.

Figure 7-1 Fresh Food Prices<YoY>



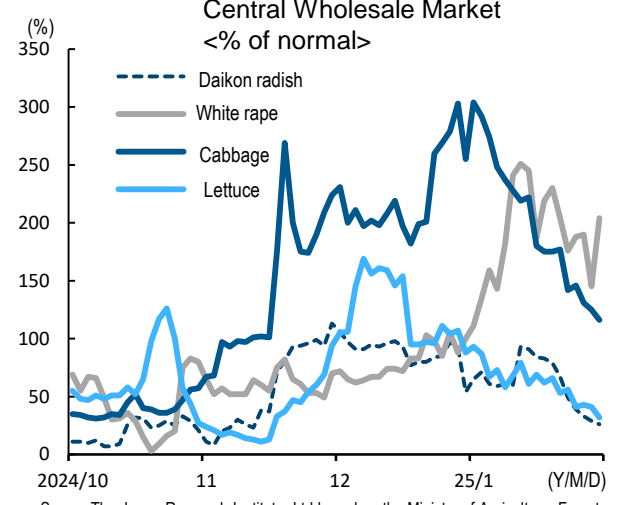
Source: The Japan Research Institute, Ltd based on the Ministry of Internal Affairs and Communications.

Figure 7-2 Number of Price Increases by Major Food Manufacturers



Source: The Japan Research Institute, Ltd based on the Teikoku Databank.
Note: Price revision plans of 195 major food product manufacturers, as of the January 31 survey.

Figure 7-3 Vegetable Prices in the Tokyo Central Wholesale Market <% of normal>



Source: The Japan Research Institute, Ltd based on the Ministry of Agriculture, Forestry and Fisheries.

Note: The average is the average of the past five years, and the top four commodities with the highest price growth as of December 2024 (excluding broccoli, which is not listed).

Monthly Report of Prospects for Japan's Economy March 2025
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Topic③: Rice prices expected to stabilize with the release of stockpiled rice

◆Rice prices remain high

The price of rice, which soared last summer, has stayed high since then. In December 2024, consumer prices for rice were still much higher than a year earlier, as they were up 64.6% YoY.

This can be attributed to the ongoing excess demand for rice. Despite rice seeming increasingly expensive compared to products derived from other grains, such as bread and noodles, demand for rice remains relatively strong. Demand may be being pushed up by a greater tendency among households to want to stock up on rice, which reflects worries about the possibility of an earthquake in the Nankai Trough or a recurrence of the rice shortages that occurred last summer. Evidence for this is that home rice hoards have been rising at a faster pace than in typical years since last summer.

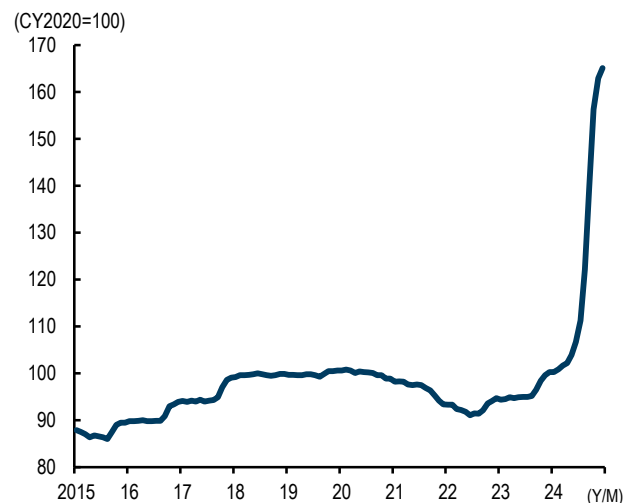
Supply is failing to keep up with the huge demand, and the rice stockpiles of private-sector vendors are at record low levels as their inventories have been depleted. As vendors scramble to replenish their stocks with newly-harvested rice, wholesale prices have risen sharply.

◆The government authorizes a one-time release of stockpiled rice

In response to this pressure in the rice market, the government has decided to release some of the rice it has stockpiled in a one-off move to facilitate the distribution of rice. If the issue of excess demand for rice starts to be resolved through the distribution of this stockpiled rice, it ought to help to bring rice prices under control.

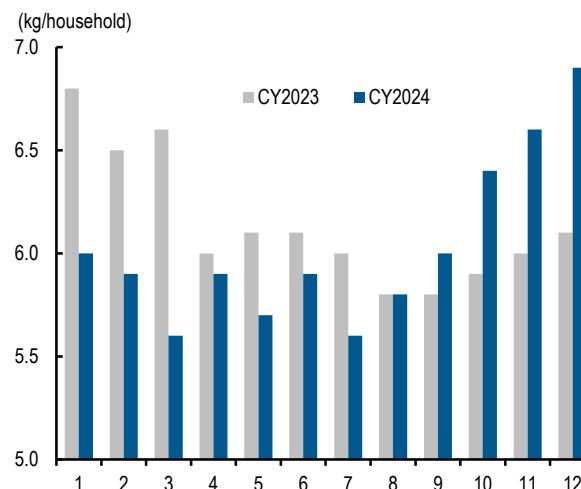
However, should the propensity of households to stock up on rice remain strong for longer than anticipated, rice prices could stay high for a long time. If this turns out to be the case, it will weigh on consumption, particularly by low-income households, for whom rice purchases account for a large share of their spending. Communication to ease households' anxiety about rice supplies will also be crucial.

Figure 8-1 Rice Price



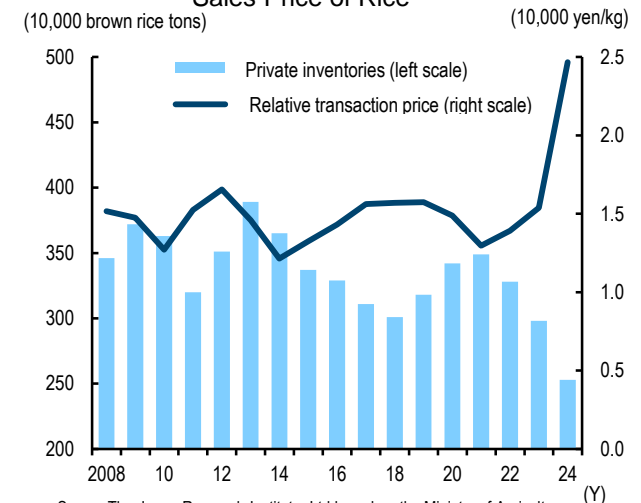
Source: The Japan Research Institute, Ltd based on the Ministry of Internal Affairs and Communications.

Figure 8-2 Month-end Inventory Quantity of Rice in Households



Source: The Japan Research Institute, Ltd based on U.S. Organization to Assure Stable (M) Supplies.

Figure 8-3 Private-Sector Inventory Volume and Sales Price of Rice



Source: The Japan Research Institute, Ltd based on the Ministry of Agriculture, Forestry and Fisheries.

Notes: Private inventory volume is as of the end of the year. Shipment + sales stage. Relative transaction prices are as of year 12 for the year in question.

Monthly Report of Prospects for Japan's Economy March 2025
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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 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 will begin to pick up, 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 from the summer onward.

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 economic and foreign policies of President 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 +1.1%

Growth of 1.1% is forecast for FY2025. Due to the impact of the weak economy in the second half of FY2023, growth was 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 toward the end of FY2025 as labor productivity improves.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of February 17, 2025)

(%, changes from the previous fiscal year)

	CY2024	CY2025				CY2026			FY2024	FY2025	FY2026
	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9			
	(Actual)	(Projection)	(Projection)								
Real GDP	2.8	0.6	0.7	0.8	0.9	0.9	0.9	1.0	0.8	1.1	0.9
Private Consumption Expenditure	0.5	0.2	0.3	0.5	0.6	0.7	0.8	0.8	0.8	0.6	0.8
Housing Investment	0.4	▲ 0.3	▲ 0.1	0.1	0.0	▲ 0.0	▲ 0.1	▲ 0.1	▲ 1.1	0.1	▲ 0.1
Business Fixed Investment	1.9	1.9	2.1	2.3	2.4	2.4	2.5	2.5	2.0	2.0	2.5
Private Inventories (percentage points contribution)	(▲ 0.8)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.0)	(▲ 0.1)	(▲ 0.0)
Government Consumption Expenditure	1.1	0.3	0.4	0.2	0.4	0.2	0.4	0.3	1.5	0.4	0.3
Public Investment	▲ 1.3	1.1	0.6	0.3	0.2	0.2	0.1	0.1	1.9	0.1	0.2
Net Exports (percentage points contribution)	(2.9)	(0.1)	(0.1)	(0.1)	(0.0)	(0.0)	(▲ 0.0)	(0.0)	(▲ 0.3)	(0.4)	(0.0)
Exports of Goods and Services	4.3	2.5	2.4	2.5	2.4	2.4	2.3	2.3	1.9	2.9	2.3
Imports of Goods and Services	▲ 8.0	2.1	2.1	2.1	2.2	2.2	2.3	2.3	3.1	1.2	2.2

(% changes from the previous fiscal year)

Nominal GDP	4.1	5.3	4.1	3.7	3.1	3.1	3.2	3.2	3.7	3.5	3.2
GDP deflator	2.8	3.0	2.5	2.3	2.3	2.2	2.3	2.3	2.8	2.3	2.3
Consumer Price Index (excluding fresh food)	2.7	2.8	2.5	2.2	2.2	2.1	2.1	2.0	2.6	2.3	2.0
Unemployment Rate (%)	2.5	2.4	2.4	2.4	2.4	2.3	2.3	2.2	2.5	2.4	2.2
Exchange Rates (JY/US\$)	152	155	154	154	153	153	152	152	153	153	151
Import Price of Crude Oil (US\$/barrel)	77	78	72	71	72	73	74	74	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.