Monthly Report of Prospects for Japan's Economy

April 2025

Macro Economic Research Center

Economics Department

The Japan Research Institute, Limited

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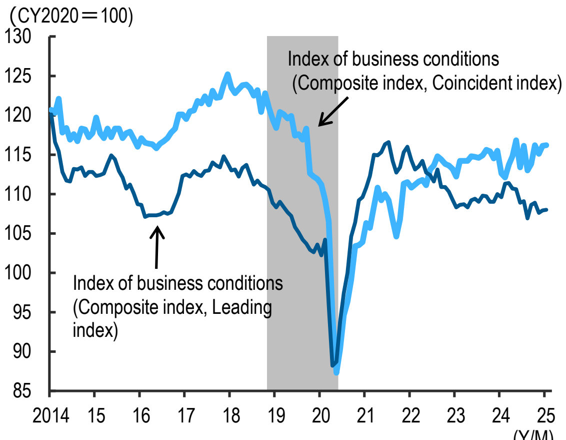
The General Situation –The economy is gradually recovering, though activity has slowed in some areas

Figure 1-1 Economic Activity

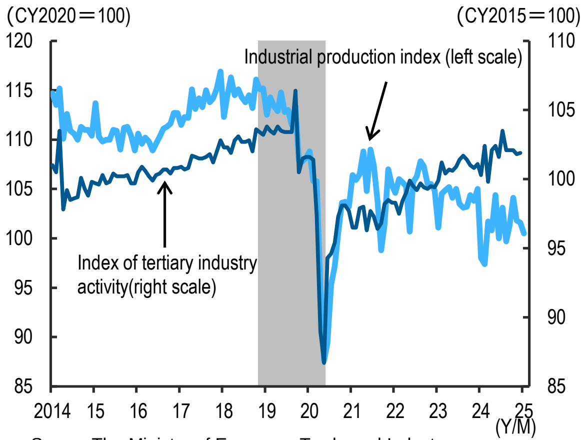
Coincident economic indicators are improving, but leading indicators are weak.



Source:The Cabinet office.

Figure 1-2 The Corporate Sector

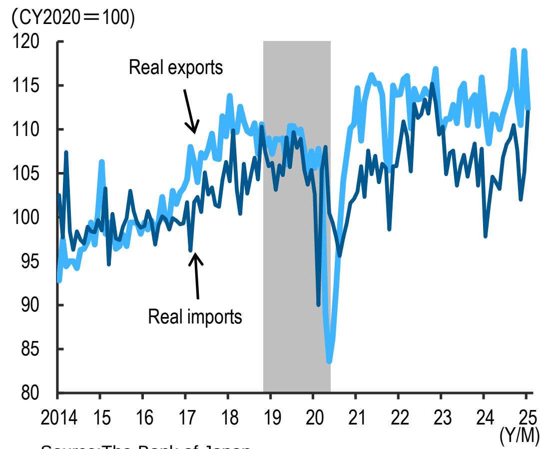
Industrial production is weak.
Economic activity in the service sector is on the recovery track.



Source:The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

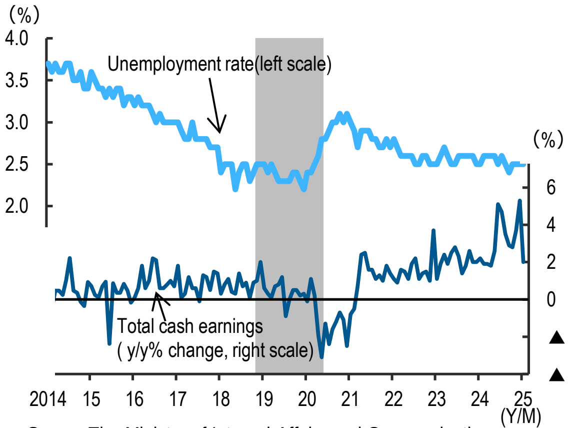
Exports are picking up.
Imports are at high levels.



Source:The Bank of Japan.

Figure 1-4 Employment and Income

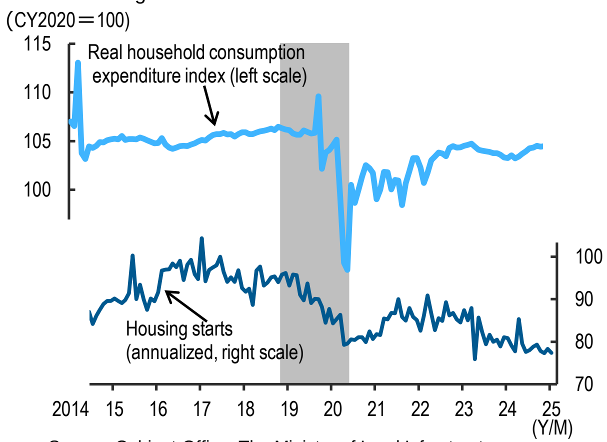
The unemployment rate is in the mid-2% range.
Nominal wage growth has slowed recently.



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

Figure 1-5 The Household Sector

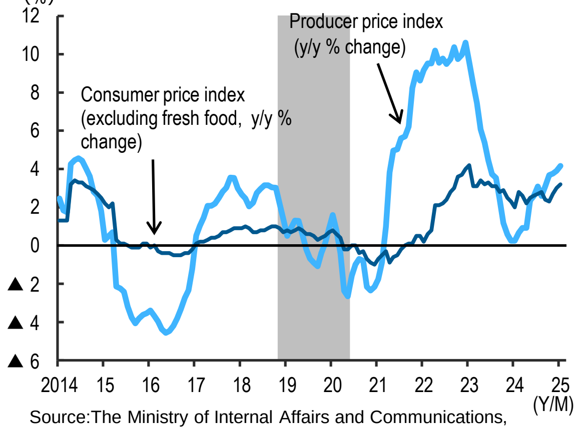
Consumption is picking up.
Housing starts remain at a low level.



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

Figure 1-6 Prices

Producer price inflation is increasing again, with the acceleration centered on agricultural products.
Consumer price inflation is also accelerating.



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

＊The shaded area indicates the recession phase.

GDP for October-December has been revised downward

◆ Personal consumption has been revised slightly downward

The government's second preliminary estimates for October-December 2024 revised annual real GDP growth down to +2.2% from the +2.8% calculated in the first preliminary estimates. Quarter-on-quarter growth was revised to +0.6%. Capital investment was revised slightly upward, while personal consumption and inventory investment saw downward revisions.

◆ Production activity in the manufacturing sector is weak

In January, the Industrial Production Index fell for the third straight month. This reflected a slump in output of production machinery, particularly semiconductor manufacturing equipment. Compounding the weak recovery in global demand for goods, especially in China and Europe, mounting competitive pressure worldwide, notably from Chinese companies, may be leading to repeated production cuts across the entire manufacturing industry.

Near-future production plans indicate a recovery in February on the back of a rebound in production machinery output, but a return to weakness in March, particularly in the transportation machinery sector.

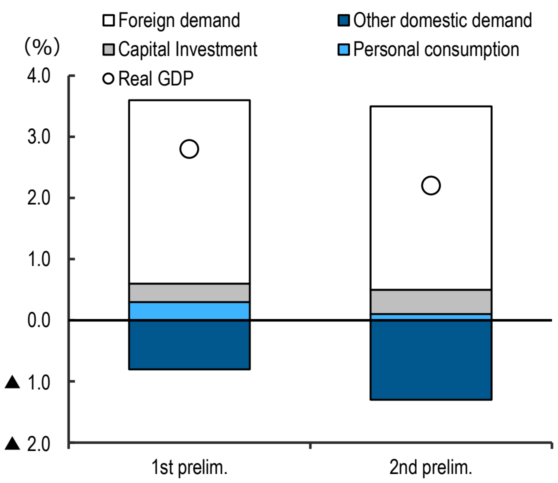
◆ The service sector is on the recovery track

The recovery in the service sector is being maintained. Looking at the breakdown, in services for individuals, rebounds can be seen in lifestyle-related services, thanks to the recovery in demand in the wake of the COVID pandemic, while the lodging, and food and beverage industries are benefitting from strong demand from inbound tourists. And services for companies, particularly information and communications, are also experiencing steady recoveries.

◆ The number of foreign visitors to Japan has increased significantly

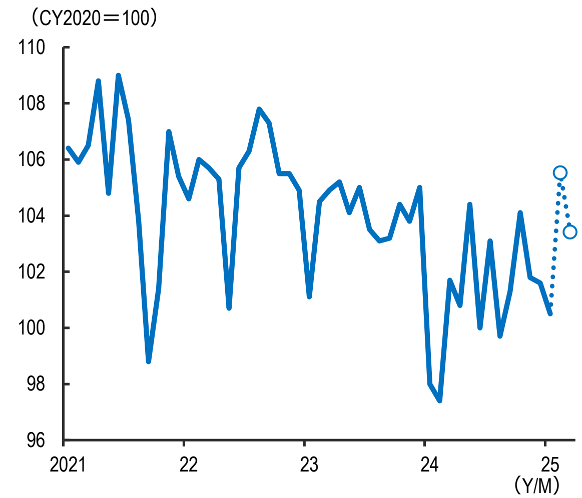
The number of foreign visitors traveling to Japan now exceeds pre-COVID levels by a large margin. In January 2025, the number of tourists from China, who had been slow to return, soared past the pre-COVID level. Chinese New Year, which had fallen in early February in most recent years, arrived at the end of January this year, so the calendar was also a factor in the rise.

Figure 2-1 Real GDP growth rate for Oct-Dec 2024 <YoY annual growth rate>



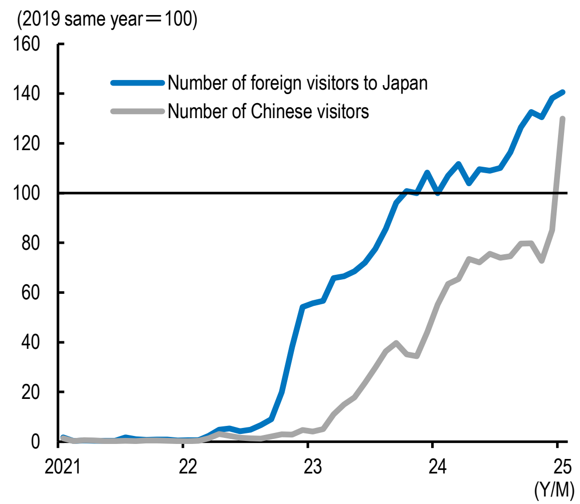
Source: The Japan Research Institute, Ltd. based on data of the Cabinet Office.

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.

Figure 2-3 Number of Foreign Visitors to Japan



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

Bumper corporate profits are supporting capital investment

◆ Corporate earnings are strong

Ordinary profit for the October-December 2024 quarter increased by 12.1% quarter over quarter (QoQ) and 13.5% year over year (YoY), rebounding from the previous quarter's temporary slump, which was due to such factors as an appreciation of the yen. Not only did net sales continue to rise as companies passed on higher costs to their customers, but with the yen remaining weak, manufacturing firms, which are active overseas, saw significant increases in dividend income from abroad (booked as non-operating income), which boosted their ordinary profit.

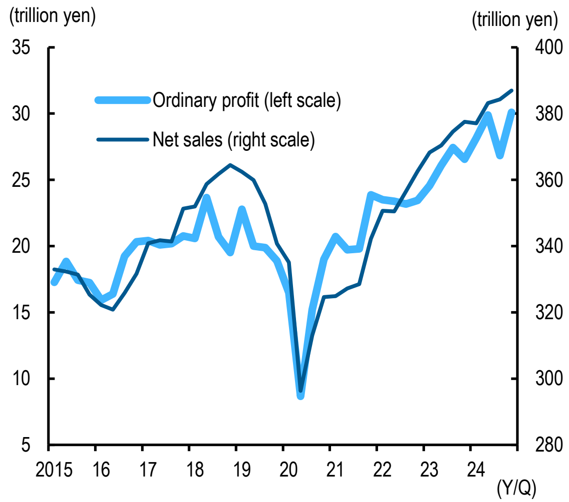
As for the future outlook for corporate earnings, although rising personnel expenses will keep applying downward pressure as wage hikes continue, a pick-up in domestic demand thanks to an improvement in the income situation of households coupled with continued yen weakness will provide support, so earnings are expected to remain solid.

◆ Appetite for capital investment among companies is strong

Capital investment (including software investment) was up 0.6% QoQ, climbing for the third quarter in a row. Buoyed by brisk demand for labor-saving, software investment has been holding firm and other types of capital investment have continued to rise.

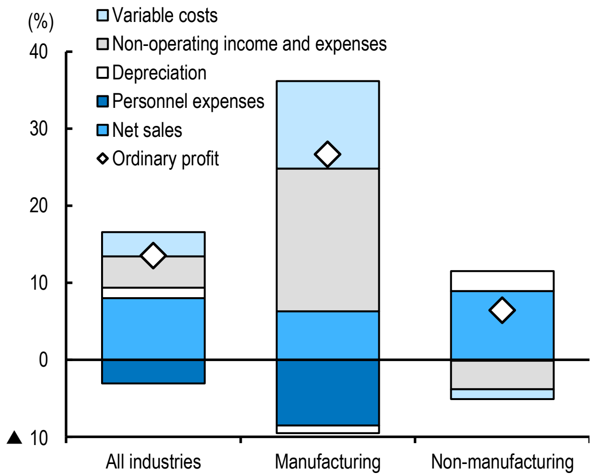
Capital investment is also expected to gradually increase going forward. According to a survey on corporate behavior conducted in FY2024, the annual average growth rate of corporate capital investment over the next three years (FY2025-27) is projected to be +6.3%, which is lower than the previous year yet still on the high side. The expected growth rate is also trending slightly upward. Particularly high growth is expected in the machinery sector, which includes semiconductor-related products, for which an expansion in demand is anticipated, as well as in the transportation and retail sectors, which are suffering from serious labor shortages.

Figure 3-1 Ordinary Profit and Net Sales <seaonally adjusted>



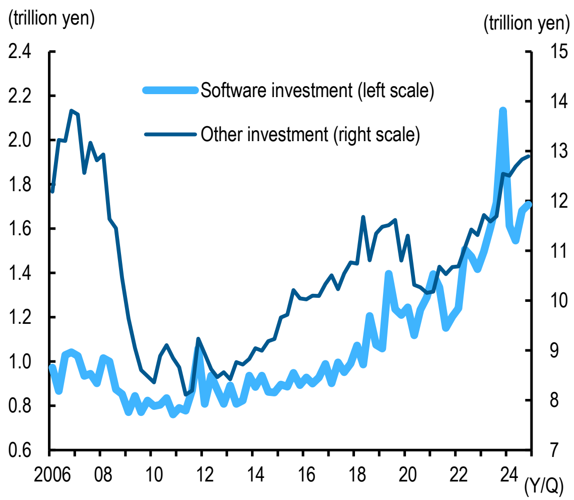
Source: The Ministry of Finance.
Note:All sizes and all industries (excluding the finance and insurance industries).

Figure 3-2 Ordinary Profit for Oct-Dec 2024<YoY>



Source:The Japan Research Institute, Ltd. based on data of The Ministry of Finance.
Note:All scales. All industries and non-manufacturing industries exclude the finance and insurance industries.

Figure 3-3 Capital Investment by Corporate Enterprises<seasonally adjusted>



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

The income situation for households is beginning to gradually improve

◆ This year's spring wage negotiations is also expected to produce big wage hikes

Wages are increasing at an accelerating pace. In January, basic salaries of ordinary workers increased by 3.1% YoY, and the hourly pay of part-time workers also climbed 4.6% YoY, so both measures maintained a rapid pace of increase.

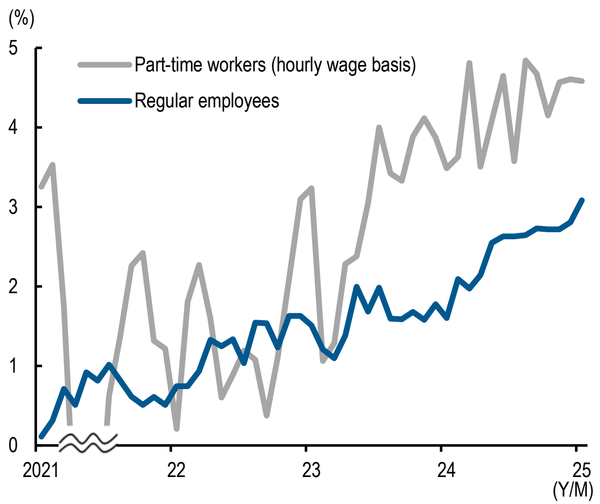
Going forward, wage growth rates are expected to remain high. And like last year, substantial wage increases are also predicted to be delivered at this year's spring wage negotiations. According to a tally from RENGO (Japanese Trade Union Confederation), labor unions are demanding wage hikes of 6.09% on average, a bigger increase than they called for last year (5.85%). And partly because labor shortages are intensifying, companies are also becoming more aggressive in raising pay. More and more firms, mainly large corporations, are willing to agree to the full amount of increase demanded by their respective unions, and the number of small and medium-sized enterprises (SMEs) expecting to boost the wages of their regular employees is also on the rise.

◆ A recovery in consumption will become clearcut from the summer

Personal consumption is picking up. Consumption of non-durable goods such as food is weak amid high prices and a growing desire among households to save money. Meanwhile, durable goods consumption has returned to the level it was before the temporary dip in automobile sales at the end of last year. Consumption of services, especially face-to-face services, is also continuing to recover, and this is supporting consumption overall.

Personal consumption is expected to begin recovering soon. In the near term, the uptick in prices will weigh on consumption, but from the summer, rising real wages should become firmly established, and this ought to provide support. However, if food prices remain high, consumption could slide as consumer confidence is sapped.

Figure 4-1 Basic Salary<YoY>



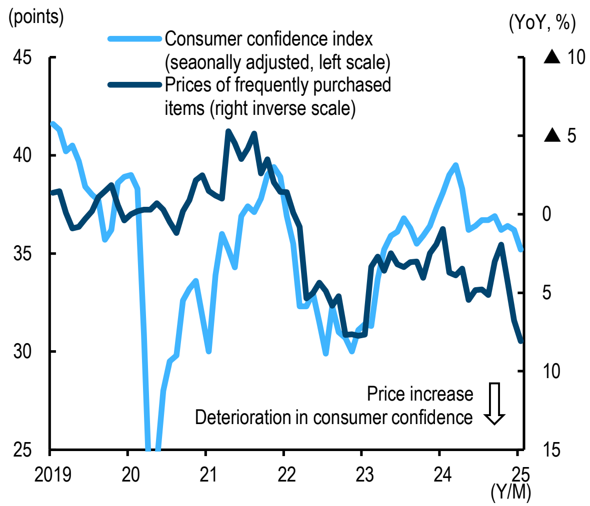
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labour and Welfare.

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

Figure 4-2 New Vehicle Registrations

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

Figure 4-3 Prices and consumer confidence for frequently purchased items



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

Note: Consumer confidence index is for households of two or more persons.

Frequently purchased items are those purchased about once a month.

Core inflation will hover at around 2%

◆ Policy factors will cause significant fluctuation

In January, consumer price inflation (all items) jumped to 4.0%. Core inflation (all items, less fresh food and energy) also accelerated from the previous month to hit 3.2%. Prices of rice and fresh foods stayed high, and ripple effects from upward price pressures also spread to dining out and processed foods. However, if food and energy are excluded, consumer price inflation was just 1.5%, as it continued to trend downward, so once the pace of food price rises subsides, it should slow toward around 2%.

Heading into early spring, energy prices are expected to drop as the government resumes subsidies for electricity and gas bills. And starting in April, the government will basically eliminate high school tuition fees, which will serve to push down service prices. Still, the fundamental trend is that moves to pass on higher wage costs to consumers are gathering momentum, and service prices are forecast to rise at a slightly quicker pace.

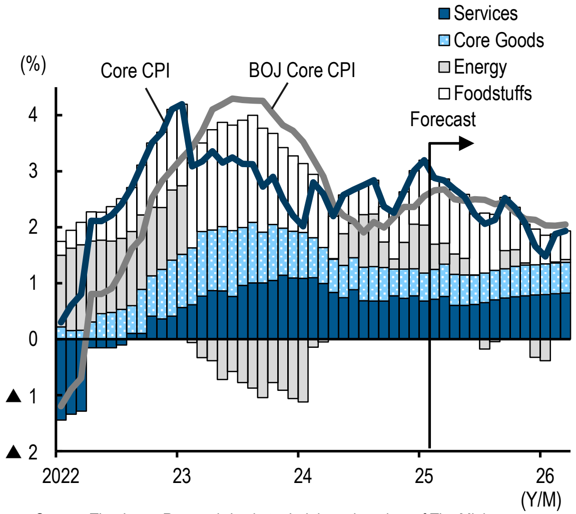
◆ The BOJ will continue to raise interest rates in phases

At its monetary policy meeting in January, the Bank of Japan (BOJ) hiked its policy rate to around 0.50%.

Long-term interest rates have also been moving higher. At one point, they topped 1.5%, partly as a result of expectations of an early additional interest rate hike.

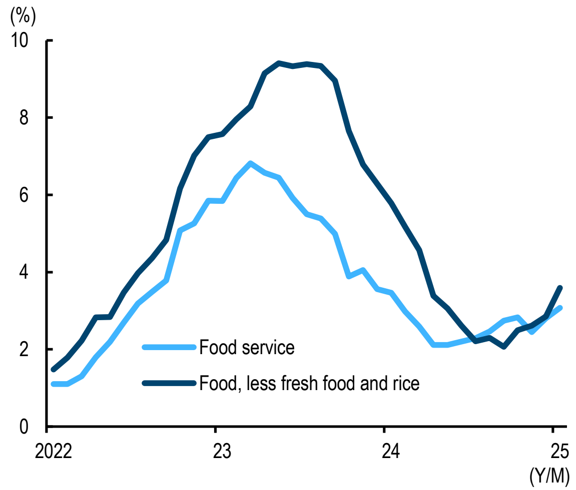
Looking ahead, the BOJ is expected to continue to raise interest rates incrementally in phases as it confirms that wage and price increases are being sustained. Long-term interest rates look set to rise gradually due to policy rate hikes and a recovery in the domestic economy.

Figure 5-1 Consumer Price Index <YoY>



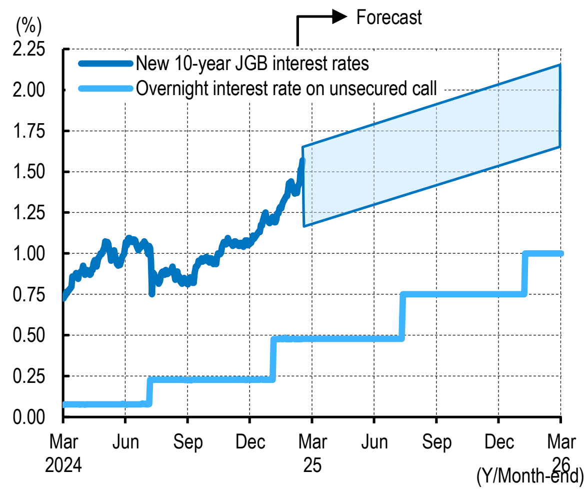
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.

Figure 5-2 Food service and processed food prices <YoY>



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

Figure 5-3 Outlook for Japan's Main Interest Rates



Source: NEEDS-FinancialQUEST.

Topic ①: SMEs continue to struggle to raise wages

◆ Wage hikes won by labor unions at SMEs are expected to be lower than last year

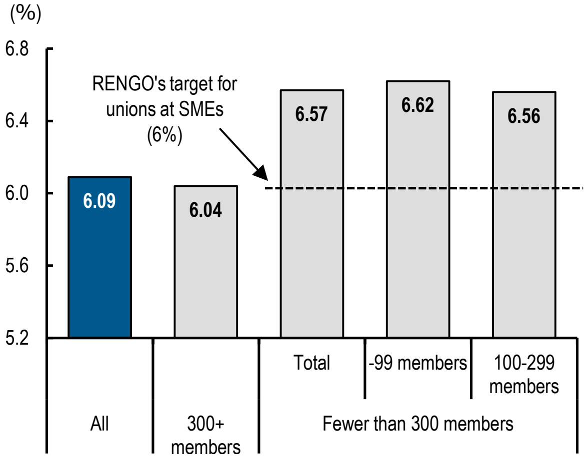
SME labor unions (fewer than 300 members) are demanding wage increases of 6.57% on average in the 2025 spring wage negotiations, exceeding the target of 6% previously set by RENGO. However, it is highly likely that management will only agree to hikes that are lower than those called for by the unions. SMEs tend to be less able than large companies to fully meet union wage demands. If the wage increases agreed upon are lower than the unions' demands by a similar margin as the previous year, SME unions with 100-299 members will win an average pay raise of 5.20%, while those with 99 or fewer members will get 4.66%. These figures fall short of the 5.39% average hike expected at large firms with 300 or more union members.

◆ Gaining acceptance among consumers of price pass-through is vital

SMEs are unable to raise wages as much as large companies because of the harsh business environment they find themselves in. Their earnings are easily impacted by higher raw material/ingredient costs stemming from the yen's depreciation, and they are often incapable of sufficiently passing on these increased costs in the form of higher prices. According to a survey by the Japan Chamber of Commerce and Industry, over 60% of SMEs that raised wages in FY2024 did so for "defensive" reasons, meaning that the hikes were not the result of improved corporate earnings, so there are question marks over the sustainability of wage increases.

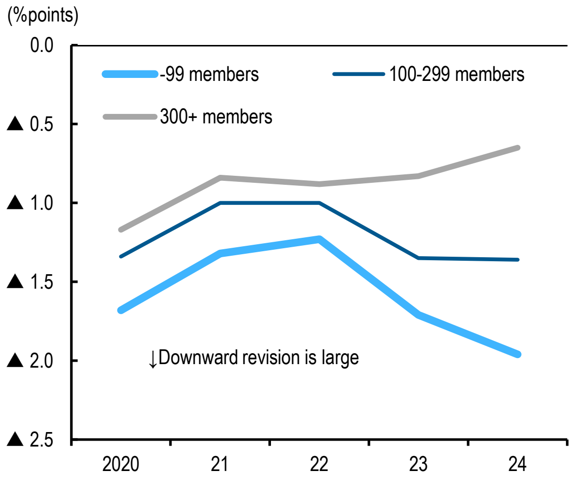
For sustainable wage rises at SMEs, the firms will need to increase productivity and pass on prices appropriately. But for progress to be made with price pass-through, it will not only be necessary to bring rationality to business-to-business transactions, but also to gain understanding of pass-through among consumers. And getting consumers to accept price increases will require the companies to work continuously on making their product and service offerings more attractive.

Figure 6-1 Union Demands in the 2025 spring wage negotiations (by union size)



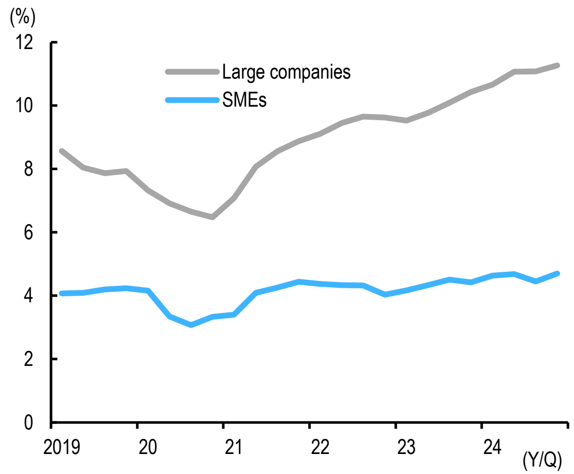
Source:RENGO.

Figure 6-2 Range of Deviation between Demands and Responses in the spring wage negotiations (by union size)



Source:The Japan Research Institute, Ltd. based on data of RENGO.
Note:Range of Deviation is the difference between demands and final responses, including regular salary increases.

Figure 6-3 Ratio of ordinary profits to sales



Source:The Ministry of Finance.
Note:Backward 4 quarters average.

Topic②: Trump tariffs pose a downside risk to Japan's auto sector

◆ U.S. government hits Mexico and Canada with tariffs

On March 4, the U.S. government imposed additional tariffs of 25% on imports from Mexico and Canada. Measures like this have a major impact on Japanese companies, especially those in the automobile industry, which produce large quantities of vehicles in both countries. As of the time of writing, the introduction of the tariffs on automobiles has been paused for one month, but uncertainty about the future is palpable.

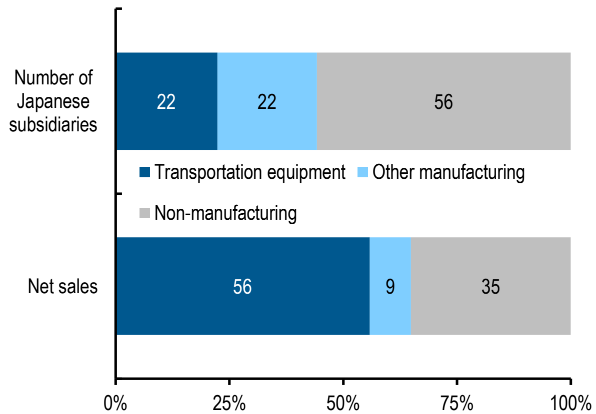
Until now, Japanese automakers have taken advantage of trade arrangements such as preferential tariff treatment under the U.S.-Mexico-Canada Agreement (USMCA) to build North America-wide supply chains for automobile production. Nearly 20% of the cars sold in the U.S. by Japanese manufacturers are imported from Mexico and Canada. If the automakers are unable to sufficiently pass on the higher import costs resulting from the increase in tariffs to selling prices, their earnings will come under pressure.

Higher tariffs on imports from Mexico and Canada could have adverse ripple effects on the Japanese economy. Within Japan's manufacturing sector, the auto industry is especially reliant on North America for sales. A deterioration in the earnings environment originating from the North American market could have negative repercussions within Japan, such as job losses and reluctance to make capital investments.

◆ Automobile tariffs pose a further downside risk

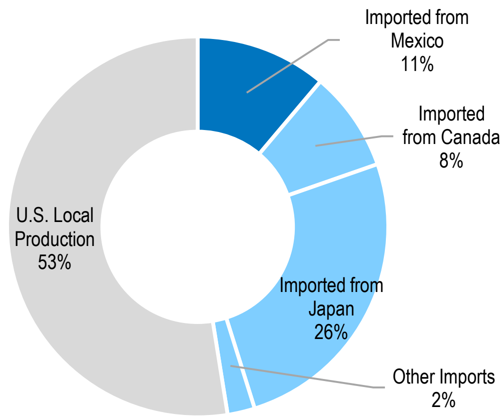
Furthermore, President Trump has hinted at imposing an additional tariff of 25% on vehicles imported into the U.S. Such added duties would put further pressure on the Japanese auto sector to cut production. According to estimates, a 25% automobile tariff would lead to a 4.3% drop in passenger car production in Japan. Intermediate inputs such as automobile components would also be impacted, and overall industrial output would be reduced by around 0.6%.

Figure 7-1 Percentage of Japanese subsidiaries in Mexico and Canada by industry



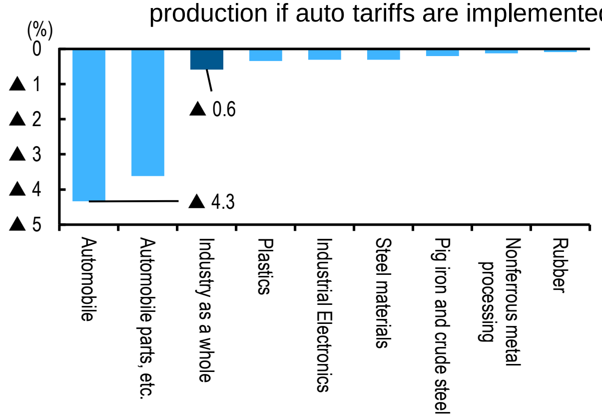
Source:The Japan Research Institute, Ltd based on data of The Ministry of Economy, Trade and Industry.
Note:FY2022.

Figure 7-2 U.S. Seller Procurement Status for Japanese Auto Manufacturers



Source:The Japan Research Institute, Ltd based on data of Marklines.
Note: FY2021. Passenger cars including light trucks, etc.
Counted as local production = new vehicle sales - import sales

Figure 7-3 Downward pressure on domestic production if auto tariffs are implemented



Source:The Japan Research Institute, Ltd based on data of Marklines, The Ministry of Internal Affairs and Communications and Japan Automobile Manufacturers Association, etc.
Note:Downward pressure on Japanese production caused by a decrease in passenger car exports to the U.S. if the U.S. imposes a 25% additional tariff on imported automobiles. Sum of direct and indirect effects based on the regression series counts in the Input-Output table. Price elasticity of demand for automobiles in the U.S. is estimated using passenger car sales as the explained variable and passenger car prices and real disposable income as explanatory variables.

The economy will gradually recover, driven by domestic demand

◆ Corporate earnings will spur a rebound in domestic demand

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 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 Trump and the ensuing implications for other economies. Higher tariffs on automobiles and Chinese goods, in particular, will deal an additional blow to Japan's already struggling manufacturing sector, and there are fears that this could lead to a loss of momentum for wage increases, and even trigger layoffs.

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

Growth of 1.0% is forecast for 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 around 1% in FY2025.

Figure 8　Projections for GDP Growth and Main Indicators of Japan（as of March 11, 2025）

(%, changes from the previous fiscal year)

	CY2024	CY2025				CY2026				CY2027	FY2024	FY2025	FY2026
	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3			
	(Actual)	(Projection)									(Projection)		
Real GDP	2.2	0.5	0.7	0.8	0.9	0.9	0.9	1.0	1.0	1.1	0.8	1.0	0.9
Private Consumption Expenditure	0.1	0.0	0.2	0.5	0.6	0.7	0.8	0.8	0.9	0.9	0.8	0.5	0.8
Housing Investment	▲ 0.8	▲ 0.4	▲ 0.1	0.0	0.0	▲ 0.0	▲ 0.1	▲ 0.1	▲ 0.2	▲ 0.2	▲ 1.3	▲ 0.1	▲ 0.1
Business Fixed Investment	2.3	2.1	2.2	2.3	2.4	2.4	2.5	2.5	2.6	2.6	2.0	2.1	2.5
Private Inventories (percentage points contribution)	(▲ 1.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.1)	(▲ 0.1)	(▲ 0.0)
Government Consumption Expenditure	1.6	0.4	0.4	0.2	0.4	0.2	0.4	0.3	0.4	0.5	1.6	0.5	0.3
Public Investment	▲ 2.7	0.7	0.6	0.3	0.2	0.2	0.1	0.1	0.1	0.0	1.6	▲ 0.1	0.2
Net Exports (percentage points contribution)	(2.9)	(0.0)	(0.1)	(0.1)	(0.0)	(0.0)	(▲ 0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.3)	(0.4)	(0.0)
Exports of Goods and Services	4.1	2.1	2.4	2.5	2.4	2.4	2.3	2.4	2.3	2.3	1.8	2.8	2.4
Imports of Goods and Services	▲ 8.3	2.1	2.1	2.1	2.2	2.2	2.3	2.3	2.3	2.3	3.0	1.1	2.2

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

	CY2024 10~12	CY2025 1~3	4~6	7~9	10~12	CY2026 1~3	4~6	7~9	10~12	CY2027 1~3	FY2024	FY2025	FY2026
Nominal GDP	4.0	5.1	3.9	3.6	2.8	2.7	2.7	2.8	2.9	3.1	3.7	3.2	2.9
GDP deflator	2.9	3.0	2.5	2.4	2.2	1.8	1.9	1.9	2.0	2.1	2.8	2.2	2.0
Consumer Price Index (excluding fresh food)	2.7	3.0	2.5	2.2	2.0	1.8	1.7	1.7	1.9	1.9	2.7	2.1	1.8
Unemployment Rate (%)	2.5	2.4	2.4	2.4	2.4	2.3	2.3	2.2	2.2	2.2	2.5	2.4	2.2
Exchange Rates (JY/US$)	152	154	153	151	151	148	147	144	143	142	153	150	145
Import Price of Crude Oil (US$/barrel)	77	80	72	71	72	73	74	74	75	75	83	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.