

Monthly Report of Prospects for Japan's Economy

June 2019

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

<http://www.jri.co.jp/english/periodical/>

This report is the revised English version of the May 2019 issue of the original Japanese version.

Disclaimer:

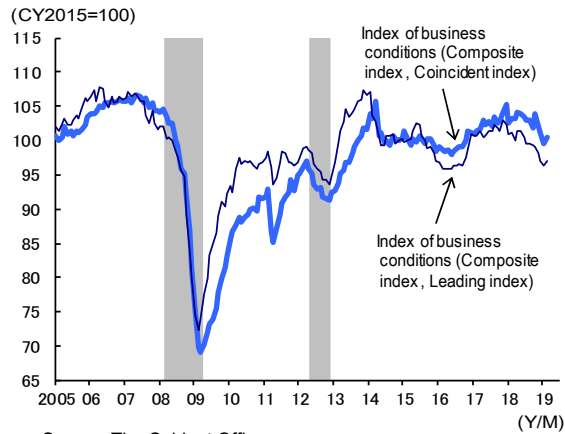
This report is intended solely for informational purposes and should not be interpreted as an inducement to trade in any way.

All information in this report is provided "as is", with no guarantee of completeness, accuracy, timeliness or of the results obtained from the use of this information, and without warranty of any kind, express or implied, including, but not limited to warranties of performance, merchantability and fitness for a particular purpose. In no event will JRI, its officers or employees be liable to you or anyone else for any decision made or action taken in reliance on the information in this report or for any damages, even if we are advised of the possibility of such damages. JRI reserves the right to suspend operation of, or change the contents of, the report at any time without prior notification. JRI is not obliged to alter or update the information in the report, including without limitation any projection or other forward looking statement contained therein.

The General Situation of Japan's Economy – A Sense of Standstill Is Felt in Economic Activity

Figure 1-1 Economic Activity

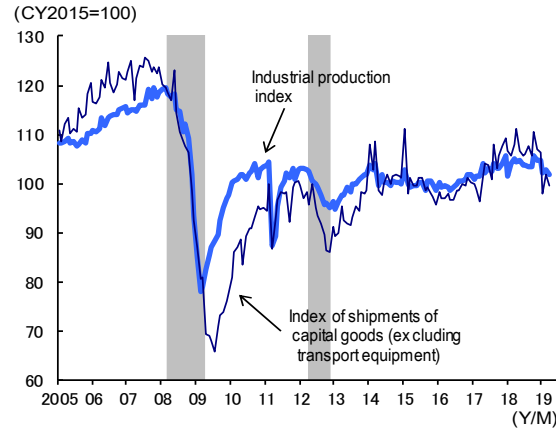
The CI coincident index remained at a lower level against the backdrop of stagnant production and shipments.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

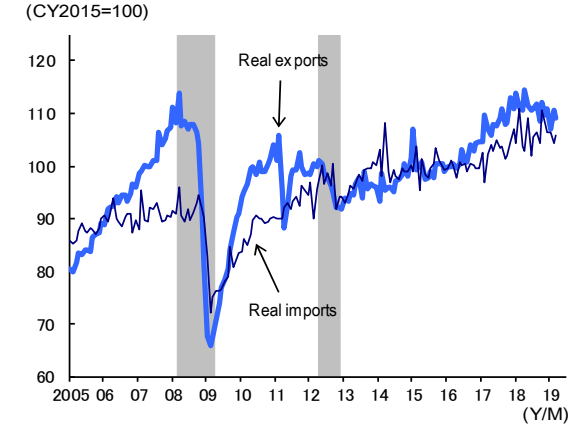
Industrial production was sluggish reflecting weaker exports to China.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

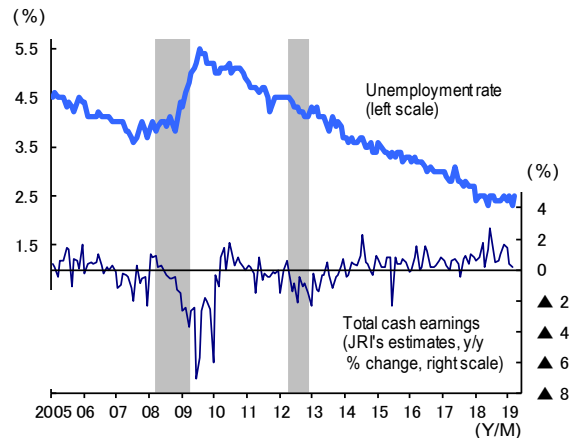
Exports declined, mainly to Asia. Declining import trend continuing since winter came to a halt.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate is hovering around the lowest level since 1993. Nominal wages diminished due to a decline in special salaries.

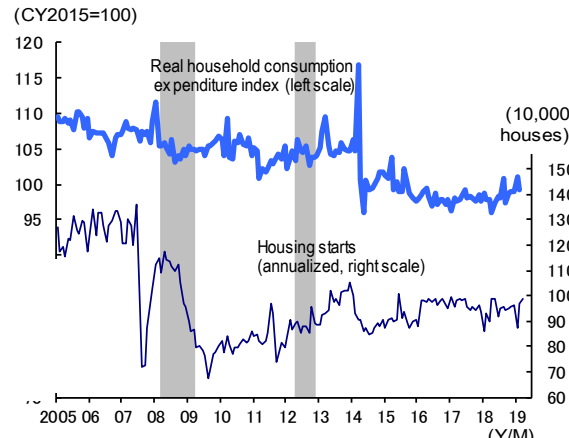


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

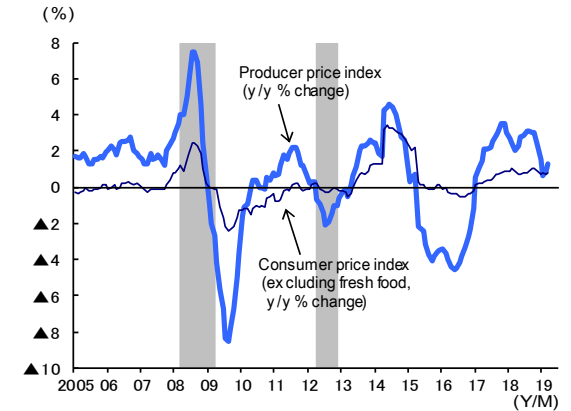
Real household consumption has picked up despite fluctuations. Housing starts increased for owner-occupied houses and subdivision housing.



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office, The Ministry of Land, Infrastructure and Transport.

Figure 1-6 Prices

Decline in the rate of year-on-year increases in producer prices came to a halt. Consumer prices stayed virtually flat.



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

Monthly Report of Prospects for Japan's Economy June 2019
The Japan Research Institute, Limited

Domestic Demand Is Firm, While Overseas Demand Is Sluggish

◆ Industrial Production Has Been Stagnant

Industrial production has remained weak. The industrial production index for March was down 0.6% from the previous month reflecting a decline in production of automobiles and production machinery, despite an increase in production of electronic parts and general purpose machinery. The outlook for April is -0.5% on a month-over-month basis (METI's estimate, after correcting for a bias error in the forecasting index) with a slight decline in production, while that for May is +3.6% on a month-over-month basis with a significant increase in production. However, the increase in production entails some uncertainties.

As for its background, there is a deterioration in the export environment. Real exports on average have continued to decline even after the beginning of this year. Looking at exports by region, while exports to the United States and EU have remained robust, the decline in exports to China has not stopped. Weakness is

observed especially for exports of metal processing machinery and electronic parts such as semiconductors.

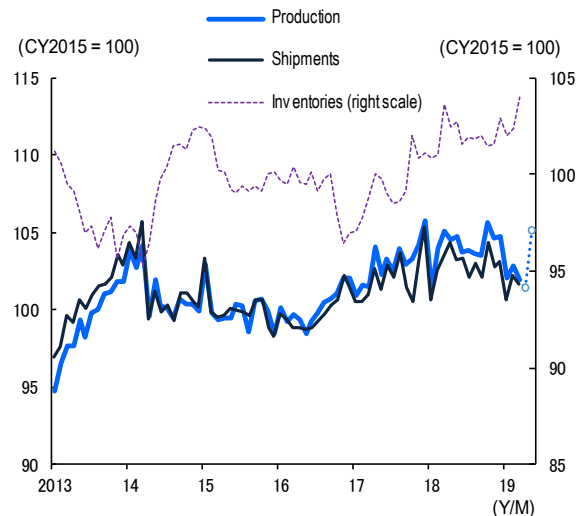
◆ Signs of Recovery Are Witnessed in Public Investment

Public investment, which had been diminishing since the latter half of the previous year, has picked up as the supplementary budget for FY2018 started to be executed. Against this backdrop, the DI for business conditions improved for the construction and real estate sectors in the BoJ's Tankan March 2019 Survey.

◆ The Household Sector Has Been Robust

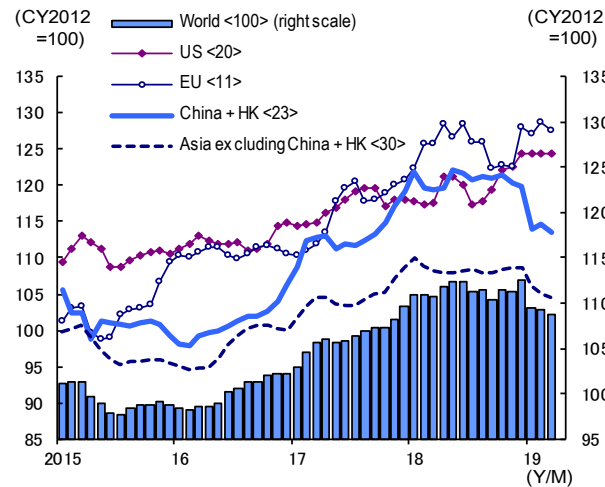
Employment and income conditions continued to improve. The unemployment rate in March was 2.5%, remaining at a low level. The active job opening ratio was 1.63 times, indicating that labor supply demand conditions remain tight. As the wage growth rate for 2019 also remained at a higher level as in the previous year, nominal compensation for employees continued to increase.

Figure 2-1 Industrial Production Index <seasonally adjusted>



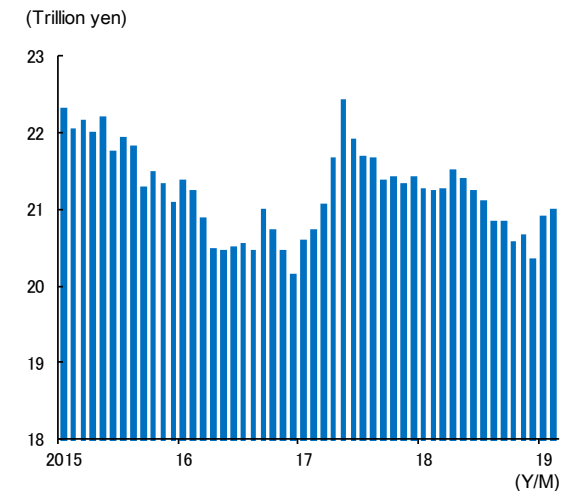
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.
 Note: The latest two figures in the industrial production index are forecasts for April and May based on METI's estimate and the production forecast index, respectively.

Figure 2-2 Real Exports by Destination <seasonally adjusted, 3-month moving averages>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
 Note: Figures in the angled brackets show the shares in total nominal exports in CY2018.

Figure 2-3 Completed Amount of Public Works <annualized, seasonally adjusted, 3-month moving averages>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Land, Infrastructure and Transport.
 Note: Non-dwelling.

Monthly Report of Prospects for Japan's Economy June 2019
 The Japan Research Institute, Limited

Exports Expected to Pick up

◆ Exports of Goods Expected to Pick up

Exports of goods lacked strength. Amid a global decline in demand, exports of electronic parts and devices continued to fall. Exports of intermediate goods and capital goods to China and ASEAN countries also saw a significant decline against the backdrop of the economic slowdown in China.

As for future prospects, exports are anticipated to pick up, mainly to China, as the economic slowdown in the country will likely come to a halt thanks to economic stimulus measures by the Chinese government. Looking at Manufacturing PMIs for Asian nations in March, those for China and ASEAN countries recovered to a level exceeding the 50-point mark, which indicates expansion. While Manufacturing PMIs for Korea and Taiwan were below the 50-point mark, the declining trend came to a halt.

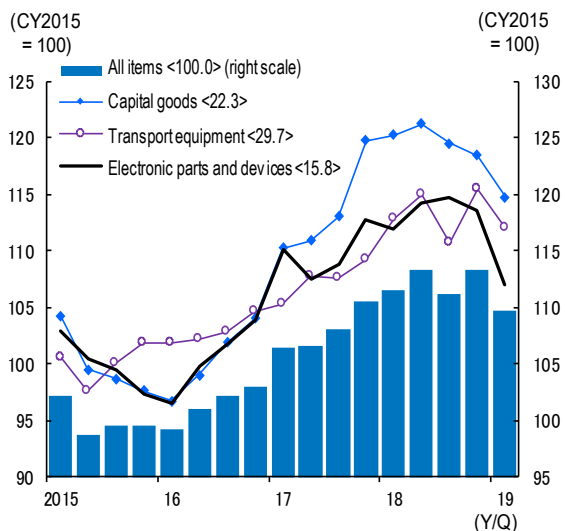
Japan-U.S. trade friction remains as a concern. With the start of Japan-U.S. talks on a Trade Agreement on Goods (TAG), higher automobile tariffs, quantitative restrictions on automobile exports and/or foreign exchange provisions incorporated into this agreement could have a significant impact on Japan's exports.

◆ Demand Related to Inbound Tourism Is Expanding

Looking at demand related to inbound tourism, both the number of tourists and the amount of consumption have continued to pick up. However, reflecting a slowdown in the increasing trend for the number of tourists visiting Japan, the growth rate in March was +5.8% on a year-on-year basis, declining to single-digit growth.

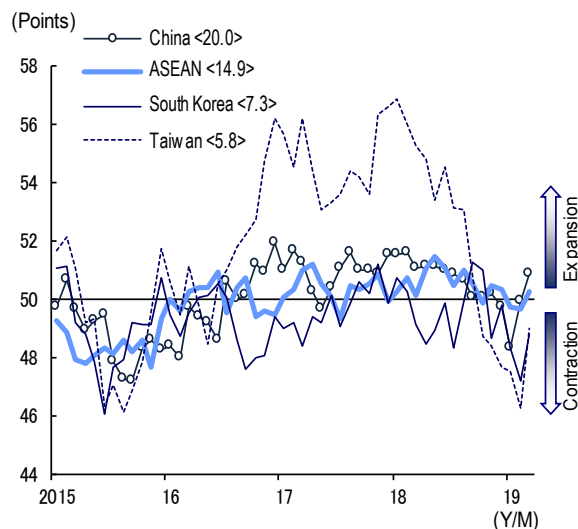
In terms of future outlook, demand related to inbound tourism is expected to continue growing moderately, driven by an expanding middle class in emerging Asian countries and better infrastructure and services for receiving tourists in Japan.

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



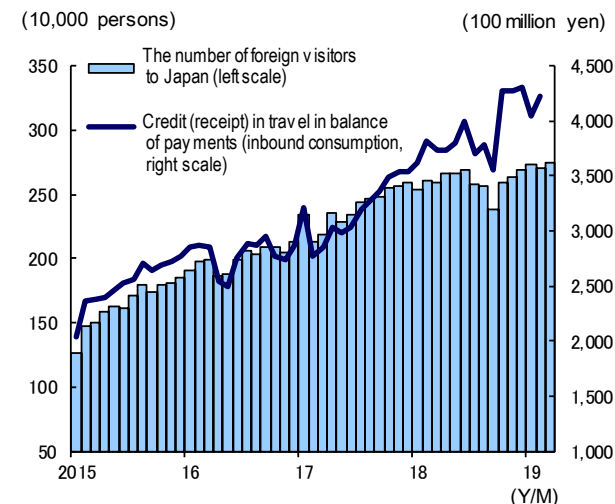
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.
Note: Figures in the angled brackets show the shares in total nominal exports in CY2018.

Figure 3-2 Manufacturing PMIs for Asian Countries or Area



Source: The Japan Research Institute, Ltd. based on data of Caixin / IHS Markit, The Ministry of Finance.
Note: Figures in the angled brackets show the shares in total nominal exports in CY2018.

Figure 3-3 Receipt in Travel in Balance of Payments
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, Japan National Tourism Organization (JNTO).

Corporate Profit Growth and Business Fixed Investment Have Stalled

◆ Momentum in Corporate Profit Growth Has Stalled

While corporate earnings have remained at a high level, a slight sluggishness is currently being observed. According to the Financial Statements Statistics of Corporations by Industry quarterly report, current profits for the period of October-December 2018 declined for the second consecutive quarter, albeit an increase in sales value for the same period for the fifth consecutive quarter. Profits in manufacturing, in particular, saw a substantial drop of 10.6% from the preceding quarter. While the increase in labor costs has been curtailed, a rise in variable costs, due to higher crude oil prices which had continued until the beginning of the fall, pushed down profitability.

Nonetheless, it is unlikely that corporate profits will continue to decline. The future outlook indicates that corporate earnings will likely start increasing again as variable costs are anticipated to start declining due to a drop in crude oil prices, while sales

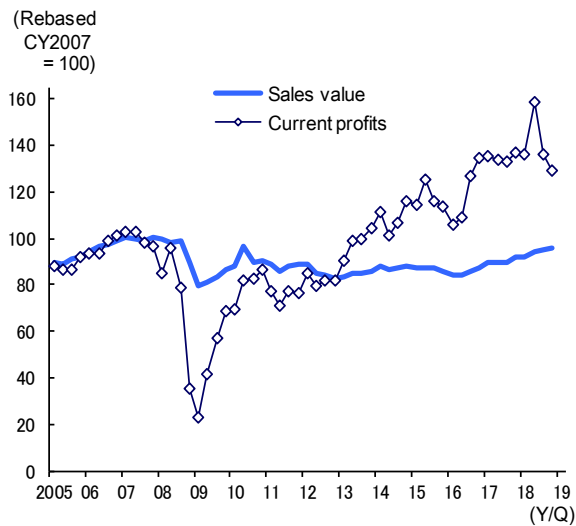
remaining robust. According to the earnings plan of the BoJ's Tankan Survey, current profits are anticipated to improve toward the latter half of FY2019.

◆ Business Fixed Investment Has Stalled

Capital investment has been weak recently. Sluggish overseas demand reflecting the slowing Chinese economy among other factors contributed to the curtailment of capital investment by exporting companies. As the construction of new plants has run its course, machinery orders declined, mainly in the manufacturing sector.

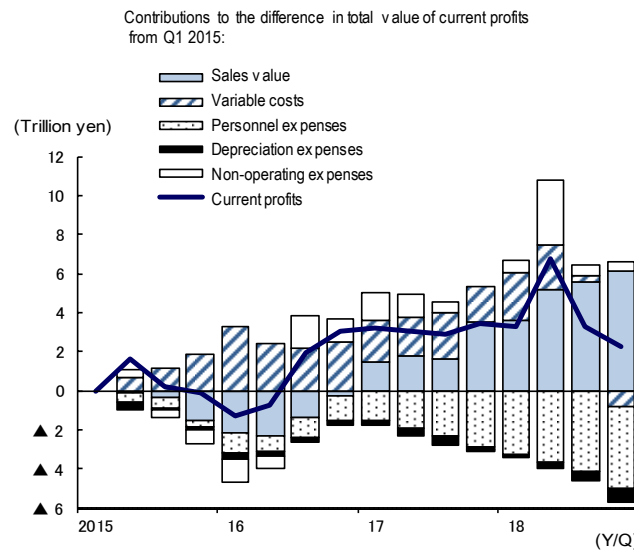
Despite the foregoing, it is very unlikely that capital investment will slump in the future. According to the capital investment plan of the BoJ's Tankan Survey, the appetite for business fixed investment by companies has remained positive. As concerns over the slowdown of the Chinese economy ease and companies start to implement postponed capital investments, business fixed investment is expected to pick up again.

Figure 4-1 Sales Value and Profits of Japanese Enterprises
<seasonally adjusted>



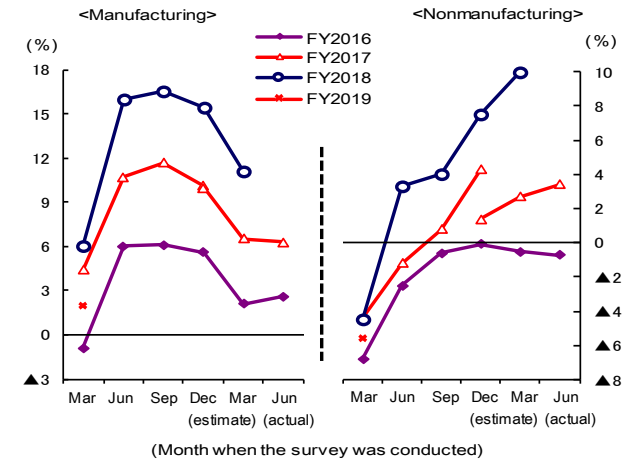
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All industries except for financial services and insurance.

Figure 4-2 Contributions of Factors to Change in Total Value of Current Profits
<seasonally adjusted>



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

Figure 4-3 Change over Time in Planned Business Fixed Investment for Each Fiscal Year
<year-on-year, %>



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

Note: Including land purchasing expenses, excluding software and R&D investment.

Monthly Report of Prospects for Japan's Economy June 2019
The Japan Research Institute, Limited

Income Is Recovering Steadily

◆ Employment and Income Conditions Continue to Improve

The pace of improvement in the employment situation has slowed down. While there was an improvement in the telecommunications industry due to a response to IoT, mainly among regular employees, the pace of improvement declined in the manufacturing sector due to sluggish industrial production.

However, labor shortages across all industries at a level exceeding those during the bubble economy have helped accelerate the pace of nominal wage growth. After eliminating the effects of sample switchover, scheduled salaries for full-time workers have risen more than 1% on a year-on-year basis even after the beginning of 2019.

◆ Real Income Is Likely to Increase Firmly

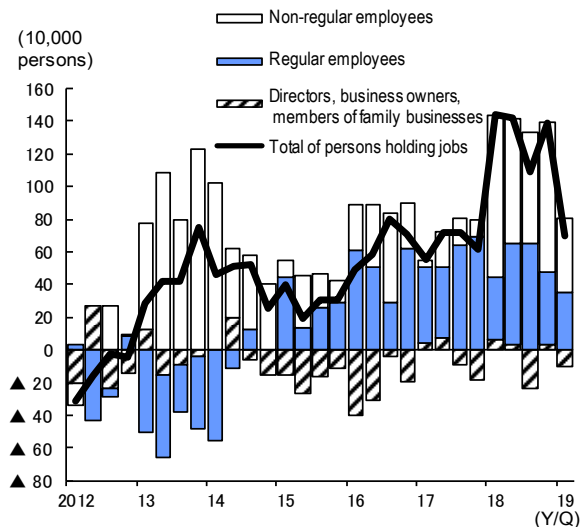
A look at future prospects shows a high likelihood that both the moderate economic recovery and continued population decline will keep labor supply demand conditions tight. As a result, both employment conditions and nominal wages are expected to

continue improving.

Despite the foregoing, the pace of improvement in employment conditions is expected to remain moderate. While new openings have recently started to rise, actual growth in the number of persons holding jobs will likely remain moderate as the openings are concentrated in industries such as construction, transportation and postal services where job seekers matching the openings cannot easily be found.

Given the above, the pace at which real compensation for employees has been improving is expected to ease somewhat from FY2019 onward due primarily to a slowdown in the increase of the number of employees. Nevertheless, because of rising nominal wages and the prospect that provision of free education and nursery care is expected to minimize price increases due to a hike in the consumption tax, growth at around the 2 percent level will likely be maintained.

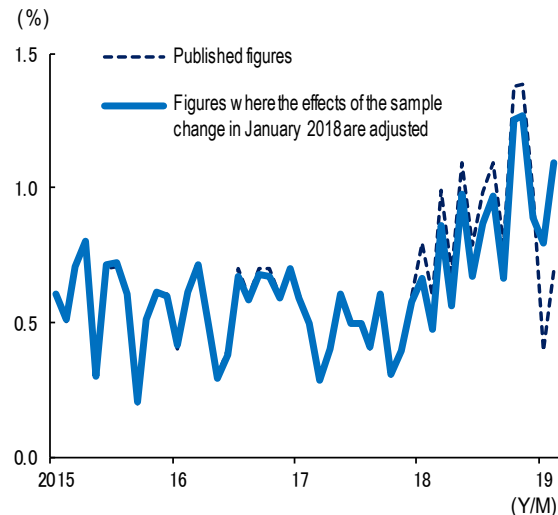
Figure 5-1 Number of Persons Holding Jobs
<difference from a year earlier>



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

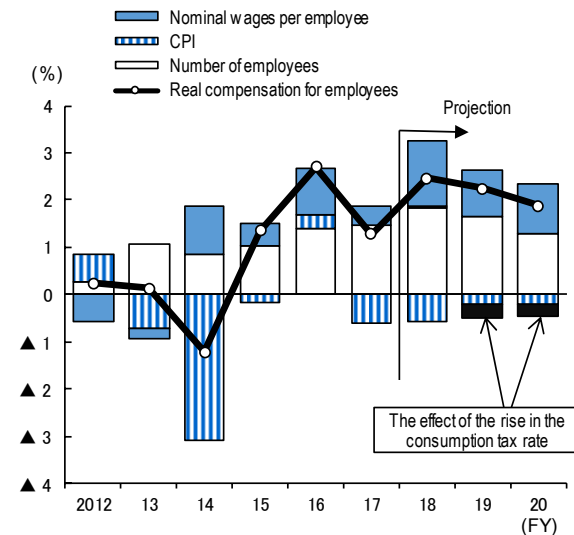
Note: Regular employees are persons employed for an indefinite period.

Figure 5-2 Scheduled Salaries for Full-time Workers
<year-on-year % change>



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

Figure 5-3 Real Compensation for Employees
<year-on-year % change>



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

Monthly Report of Prospects for Japan's Economy June 2019
The Japan Research Institute, Limited

Private Consumption Expenditure Is Increasing Moderately

◆ Private Consumption Is Increasing Moderately

Private consumption on the whole maintained the trend of mild recovery. While consumer sentiment has been deteriorating as a result of increasing uncertainties over the economic outlook, robust employment and income conditions positively contributed to the recovery.

Service consumption including food service and travel, in particular, remained on a rising trend. Consumption of durable goods also remained firm. In addition to strong sales of automobiles with the positive effects of the launch of new vehicle models, there has been replacement demand for refrigerators and TVs which went through a purchasing boom at the time of introduction of the eco-point system ten years ago.

Meanwhile, sluggish sales of seasonal merchandise as a result of the negative effects of warm winter temperatures from the end of the previous year to the

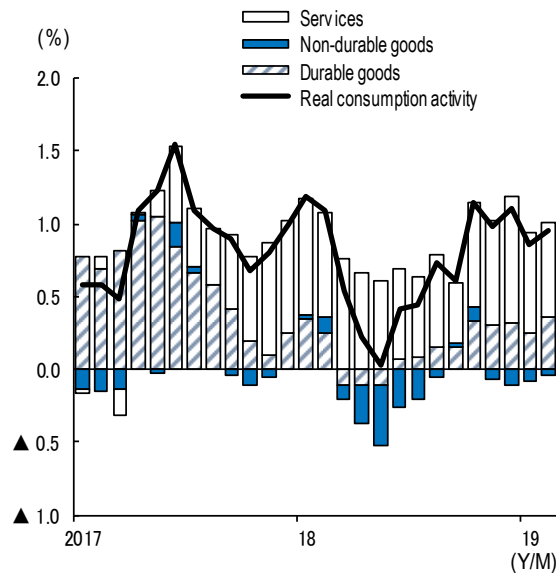
beginning of this year have recently levelled off. Signs of a recovery in sales have been observed mainly for spring clothes thanks to a rise in average temperatures since March.

◆ Private Consumption Will Likely Remain on a Mild Recovery Path

The future outlook shows that private consumption will maintain a mild recovery as employment and income conditions continue to improve.

In terms of the effects of a hike in the consumption tax rate scheduled in October 2019, a significant downward shift in private consumption expenditure is likely to be avoided as the household burden will be roughly half that incurred in 2014 thanks to measures to limit the impact, including the provision of free education and nursery care.

Figure 6-1 BoJ's Consumption Activity Index <year-on-year % change, 3-month moving averages>



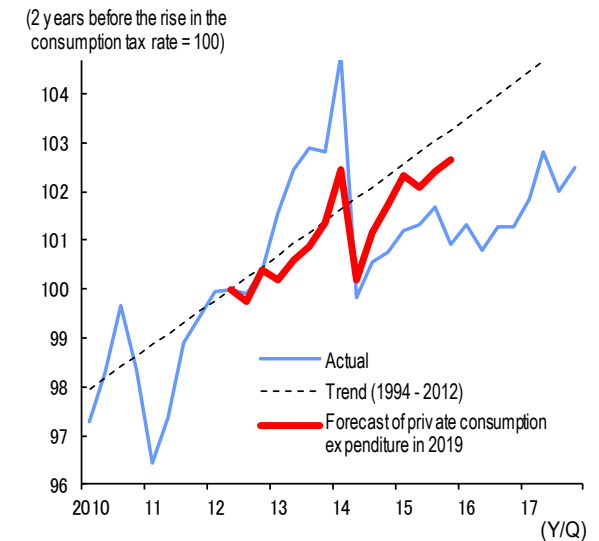
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.

Figure 6-2 The Increase in Household Burdens When the Consumption Tax Rate Was Raised or Will Be Raised

(Minus indicates an increase in burdens) (Difference from the previous year)	(Trillion yen)		
	April 2014		October 2019
	FY2014	FY2015	One year from October 2019
The increase in the burden due to price changes	-6.6	+0.2	-4.3
Due to the rise in the consumption tax rate	-5.1	±0.0	-2.9
The increase in the burden related to income tax and social security premium	-1.4	-1.3	-0.3
Enhancement of social security	+0.1	+0.0	+1.3
Economic measures in response to the consumption tax rise	+0.4	-0.2	+1.1
Total increase in the burdens of households	-7.5	-1.4	-2.2

Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office, The Ministry of Finance, and so on.

Figure 6-3 Forecast of Private Consumption Expenditure in 2019



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

Monthly Report of Prospects for Japan's Economy June 2019
The Japan Research Institute, Limited

Topic: Japan's Trade Balance Has Fallen into Deficit

◆ Japan Has Fallen into a Trade Deficit

Looking at Japan's trade balance, the trade surplus has been diminishing since the beginning of 2017. This was attributable to an increase in imports reflecting the rebound in domestic demand which more than offset a rise in exports in line with solid growth of the global economy. Imports of capital goods and consumer goods expanded in particular.

As for capital goods, imports of cargo handling machinery and construction machinery increased triggered by urban redevelopment and the construction of accommodation facilities aimed at incorporating inbound demand. In terms of consumer goods, imports were driven by an increase in food products with the purpose of diversifying procurement of fresh food products in the food service industry.

In the latter half of 2018, Japan fell into a trade deficit in conjunction with a rise in

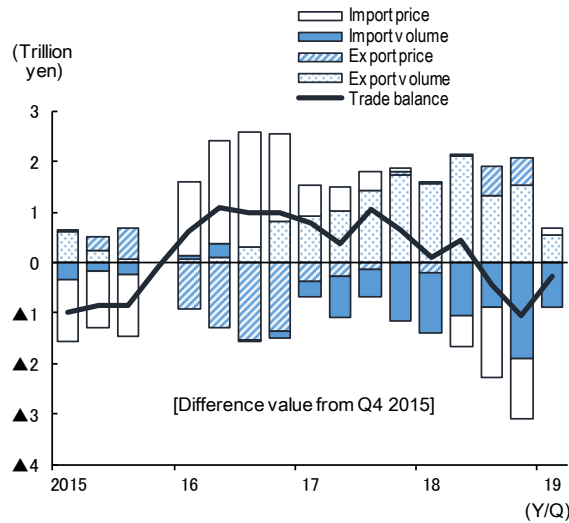
import prices as a result of higher crude oil prices.

◆ Trade Deficit Will Likely Continue

As for the future prospects, the trade deficit will likely continue. While exports are expected to remain sluggish against the backdrop of a moderate slowdown of the global economy, imports will likely increase steadily thanks to the expansion of domestic demand among other factors.

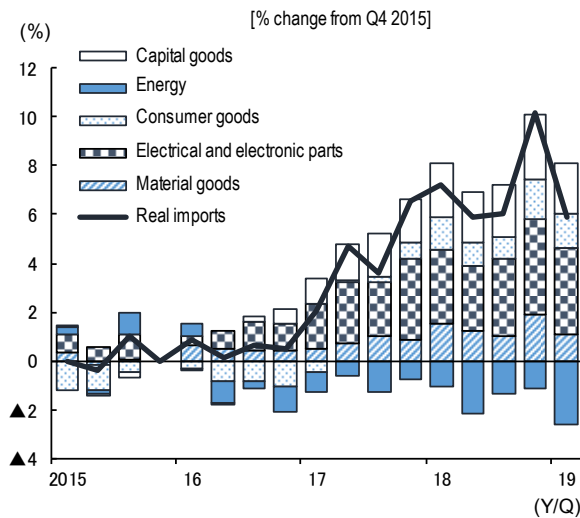
For the time being, imports of consumer goods in particular will likely expand. In light of rush demand prior to the hike in consumption tax scheduled in October 2019, imports of durable goods and semi-durable goods are expected to increase in addition to those of food products. Furthermore, imports of capital goods will continue to grow. This is attributable to the fact that the corporate stance toward business fixed investment has remained positive, while machinery orders have been weak recently.

Figure 7-1 Contributions to the Change in Trade Balance <seasonally adjusted>



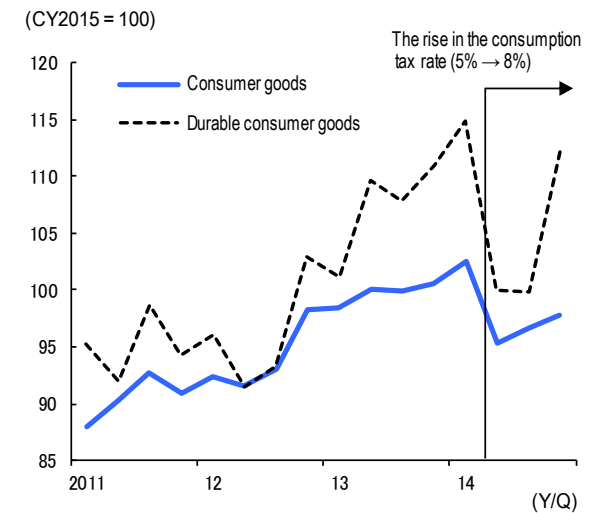
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Figure 7-2 Contributions to the Change in Real Imports <seasonally adjusted>



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

Figure 7-3 Import Volume before and after the Previous Rise in the Consumption Tax Rate



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

Monthly Report of Prospects for Japan's Economy June 2019
The Japan Research Institute, Limited

Prospects for Japan's Economy - Projected Real GDP Change; 0.8% in FY2019 and 0.9% in FY2020

◆ Japan's Economy Is Likely to Return to its Recovery Path as Foreign Demand Bottoms out and Domestic Demand Picks up

(1) Japan's real GDP for the January-March 2019 period increased by 2.1% on an annualized quarter-on-quarter change basis (up 0.5% from the preceding quarter), achieving positive growth for the second consecutive quarter. However, the higher growth was due mainly to a significant decline in imports. Looking at other demand items, exports primarily to China saw a close to double-digit decline on an annualized basis. Personal consumption and business fixed investment slightly decreased partially reflecting temporary negative elements such as warm winter temperatures and a reaction to higher growth recorded in the previous quarter. The results indicate that Japan's economy has stalled.

(2) As for the future prospects, Japan's economy will likely return to its recovery trend against the backdrop of the bottoming-out of foreign demand and a rebound in domestic demand. Looking at the trend of the overseas economy, the Chinese economy seems to have bottomed out thanks to economic stimulus measures by the government and the decline in exports will likely come to a halt any time soon. Meanwhile, as for business fixed investment in the corporate sector, latent demand remains strong including upgrade investment for dilapidated equipment and investments in the fields of labor saving and rationalization against the backdrop of labor shortages. With the bottoming-out of exports, postponed investment projects in the manufacturing industry are likely to be executed gradually.

(3) Personal consumption is also anticipated to pick up, supported by an improvement in income conditions and rush demand prior to the hike in the consumption tax rate. While personal consumption will likely drop temporarily following the hike in the consumption tax rate due to a reaction to the rush demand, measures to minimize the impact of the consumption tax rate hike, such as the introduction of a reduced tax rate and provision of free education and nursery care, are expected to reduce the burden on households. Therefore, we believe that a downward shift in consumer spending is likely to be avoided. After the reactionary decline runs its course, private consumption is forecast to return to a moderately rising trend.

(4) Consequently, the Japanese economy is expected to grow moderately in FY2019 and FY2020 at around the 1.0% level, which is close to its potential growth rate.

(5) However, attention must be paid particularly to the United States' protectionist stance to trade as the outlook for the overseas economy remains increasingly uncertain. As for the impact of the raising of tariffs on \$200 billion worth of Chinese goods in May, negative impact on Japan will likely be limited given the fact that (i) Japan's added value included in China's exports to the United States is as low as 0.2% of Japan's GDP; and that (ii) the negative impact on the Chinese economy can be fully offset by economic stimulus measures which have already been scheduled to be implemented. However, if China's personal consumption and private investment head downward as a result of further increases in items subject to retaliatory tariffs, a certain degree of negative effects on the Japanese economy will not be able to be avoided. In addition, the Trump administration's future actions related to automobile tariffs and quantitative restrictions on automobile exports will remain as a major risk factor.

◆ The Year-on-year Change Rate in the Core CPI Will Likely Continue to Be Slightly below 1 Percent

(6) The pace of rise in the core CPI, which excludes fresh food, accelerated slightly mainly because the extent of increase in energy prices widened. Looking ahead, it is predicted that the year-on-year increase rate in the core CPI will continue to be slightly less than 1 percent. This is because, while the upward pressure will likely strengthen from the supply-demand perspective due to improvement in employment and income conditions, the pace of rise in energy prices will likely slow down gradually.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of May 20, 2019)

	(seasonally adjusted, annualised % changes from the previous quarter)									(% changes from the previous fiscal year)		
	CY2019				CY2020				CY2021	FY2018	FY2019	FY2020
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	(Projection)
	(Actual)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Actual)	(Projection)	(Projection)	
Real GDP	2.1	1.3	2.2	▲ 3.9	2.0	1.6	2.3	▲ 0.6	1.3	0.6	0.8	0.9
Private Consumption Expenditure	▲ 0.3	2.6	4.2	▲ 8.5	3.4	2.1	2.5	▲ 0.6	1.2	0.4	0.5	0.8
Housing Investment	4.5	3.2	0.0	▲ 4.5	▲ 3.1	0.8	1.6	2.0	2.0	▲ 4.2	1.8	▲ 0.3
Business Fixed Investment	▲ 1.2	0.8	4.3	▲ 1.4	2.6	2.3	2.2	2.0	2.0	3.2	1.4	1.9
Private Inventories (percentage points contribution)	(0.5)	(▲ 0.3)	(▲ 0.4)	(0.2)	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.2)	(0.0)	(0.0)
Government Consumption Expenditure	▲ 0.7	0.6	0.7	0.7	0.9	1.0	2.2	▲ 1.1	1.2	0.8	0.7	0.9
Public Investment	6.2	4.4	1.6	0.5	▲ 1.8	▲ 1.6	0.0	0.0	0.0	▲ 3.8	1.4	▲ 0.6
Net Exports (percentage points contribution)	(1.6)	(▲ 0.3)	(▲ 0.6)	(1.0)	(▲ 0.4)	(▲ 0.1)	(0.1)	(▲ 0.4)	(0.0)	(▲ 0.1)	(0.0)	(▲ 0.0)
Exports of Goods and Services	▲ 9.4	4.9	2.2	1.8	1.7	1.7	3.4	▲ 1.4	1.8	1.3	0.2	1.7
Imports of Goods and Services	▲ 17.2	6.9	5.9	▲ 3.8	3.8	2.2	2.9	0.8	1.8	2.0	0.2	1.9
(Ref.) Domestic Private Demand (percentage points contribution)	(0.3)	(1.3)	(2.6)	(▲ 4.9)	(2.3)	(1.6)	(1.8)	(0.1)	(1.0)	(0.8)	(0.6)	(0.7)
(Ref.) Public Demand (percentage points contribution)	(0.2)	(0.3)	(0.2)	(0.2)	(0.1)	(0.1)	(0.4)	(▲ 0.2)	(0.2)	(▲ 0.0)	(0.2)	(0.2)

	(% changes from the same quarter of the previous year)									(% changes from the previous fiscal year)		
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	FY2018	FY2019	FY2020
Nominal GDP	0.9	1.1	2.4	1.5	1.4	1.5	1.4	2.0	1.8	0.5	1.6	1.7
GDP deflator	0.2	0.4	0.7	1.1	1.1	1.1	1.0	0.6	0.6	▲ 0.2	0.8	0.8
Consumer Price Index (excluding fresh food)	0.8	0.8	0.5	0.8	1.0	0.9	1.1	0.8	0.8	0.8	0.8	0.9
(excluding fresh food, consumption tax, education free of charge)	0.8	0.8	0.5	0.5	0.6	0.6	0.8	0.9	0.9	0.8	0.6	0.8
Unemployment Rate (%)	2.5	2.4	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.4	2.3	2.2
Exchange Rates (JY/US\$)	110	110	110	109	109	108	108	107	107	111	110	108
Import Price of Crude Oil (US\$/barrel)	63	71	68	68	68	68	68	68	68	72	69	68

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.

Note : "▲" indicates minus.