

# Monthly Report of Prospects for Japan's Economy

August 2019

Macro Economic Research Center  
Economics Department



The Japan Research Institute, Limited

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

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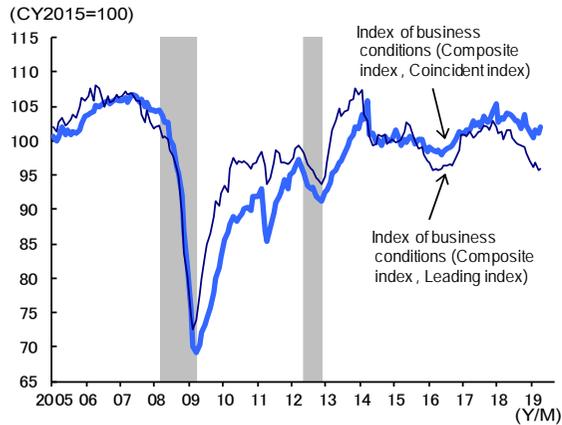
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# The General Situation of Japan's Economy – A Sense of Standstill Is Felt in Economic Activity

**Figure 1-1 Economic Activity**

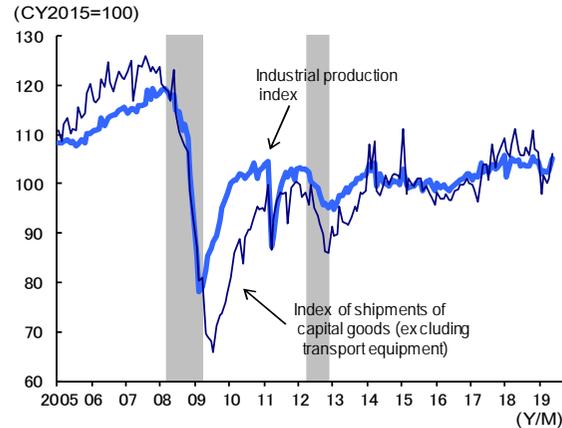
The CI coincident index picked up, reflecting increases in shipments of durable goods and wholesale distribution.



Source: The Cabinet Office.

**Figure 1-2 The Corporate Sector**

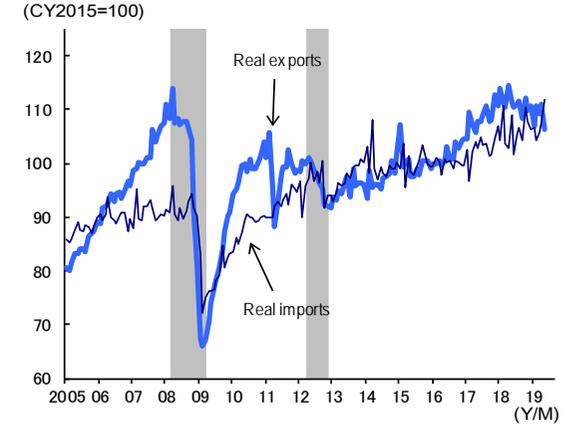
Industrial production increased mainly for transportation equipment and machinery for production.



Source: The Ministry of Economy, Trade and Industry.

**Figure 1-3 Overseas Demand**

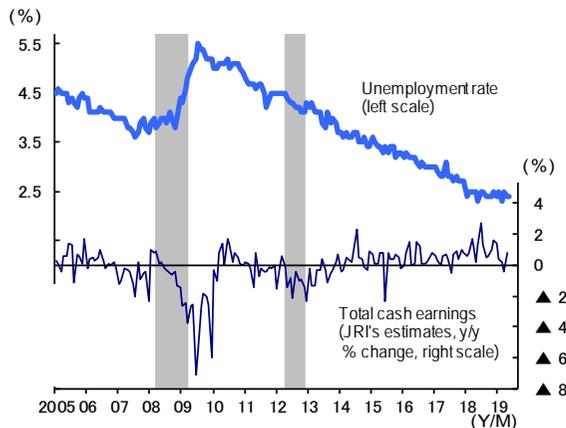
Exports, mainly to Asia, declined. Imports increased, particularly for electrical equipment and transportation equipment.



Source: The Bank of Japan.

**Figure 1-4 Employment and Income**

The unemployment rate is hovering around its lowest level since 1993. Nominal wages increased for the first time in two months.

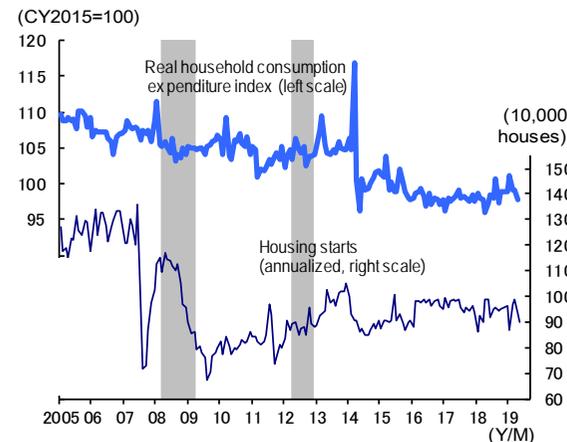


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

\* The shaded area indicates the recession phase.

**Figure 1-5 The Household Sector**

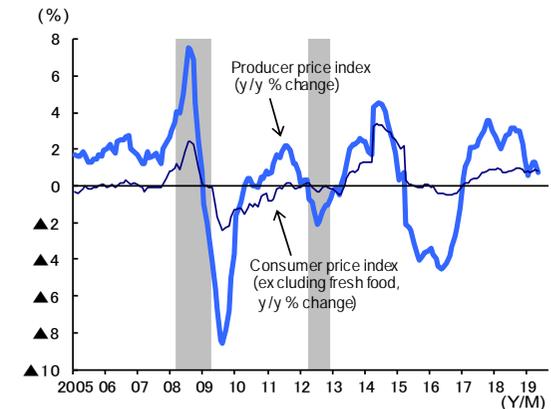
Real household consumption diminished mainly for clothing products. Housing starts decreased due to the effects of the 10 consecutive holidays.



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

**Figure 1-6 Prices**

Producer prices declined mainly for nonferrous metals. Consumer prices remained virtually flat.



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

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# Domestic Demand Stays Firm, While Overseas Demand Remains Sluggish

## ◆ Industrial Production Has Seen Some Ups and Downs

The Industrial Production Index for May increased for the second consecutive month, up 2.0 percent from the previous month. The automobile industry, electrical and information communication machinery industry and production machinery industry contributed to the rise in industrial production. However, industrial production remained lackluster against the backdrop of sluggish overseas demand and inventories remaining at a high level. The outlook for June is -1.7 percent on a month-over-month basis (METI's estimate, after correcting for a bias error in the forecasting index) with a decrease in production. Then, industrial production is anticipated to slightly increase in July, up 0.3 percent on a month-over-month basis.

As the background for the aforementioned results, there has been a delay in improvement in the export environment. Exports in May remained stagnant, mainly to Asia.

## ◆ Public Investment Has Picked up

Public investment, which had been diminishing since the middle of the previous

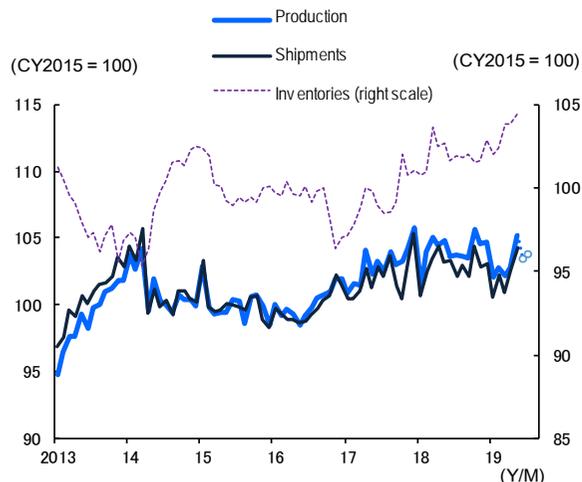
year, has been on the rise as the supplementary budget for FY2018 began to be executed in full scale. The contract amount for public works projects, which serves as a leading indicator, was up 10.5 percent year-on-year in May, recording an increase for four straight months.

## ◆ The Household Sector Has Seen a Moderate Recovery

Employment and income conditions continued to improve. The unemployment rate in May was 2.4%, remaining at a low level. The active job opening ratio was 1.62 times, indicating that labor supply demand conditions remain tight. Wages also saw a moderate increase mainly for scheduled salaries.

Underpinned by favorable income conditions, signs of recovery were also witnessed in private consumption. The Synthetic Consumption Index in April grew robustly, up 1.7 percent on a month-over-month basis. While temporary boosting effects occurred due to the 10 consecutive holidays, the overall trend shows that private consumption has been recovering moderately.

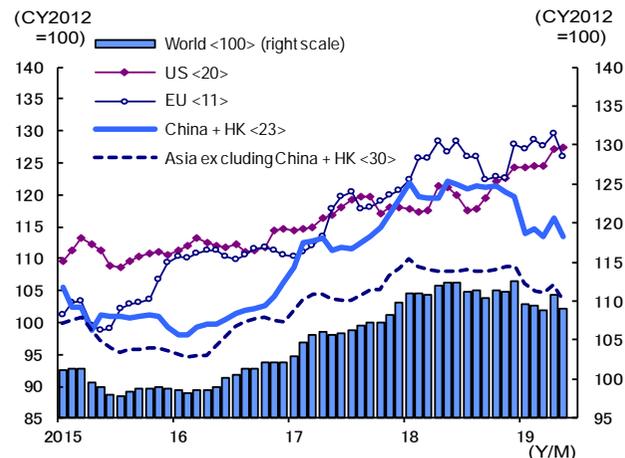
Figure 2-1 Industrial Production Index  
<seasonally adjusted>



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 June and July based on METI's estimate and the production forecast index, respectively.

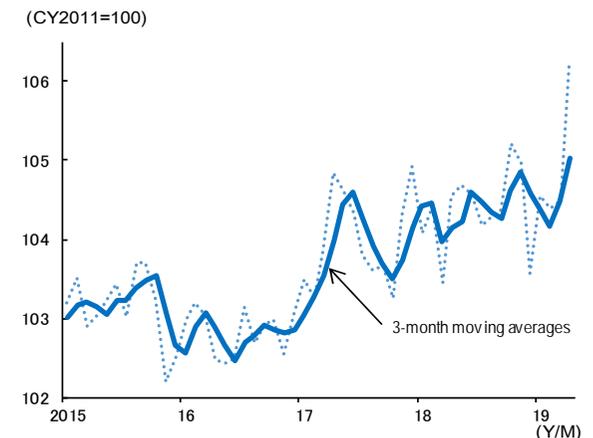
Figure 2-2 Real Exports by Destination  
<seasonally adjusted, 3-month moving averages>



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 Synthetic Consumption Index  
<seasonally adjusted>



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

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# BoJ's Tankan Survey - While Business Sentiment Deteriorated, Business Investment Remained Solid

## ◆ The DI for Business Conditions Turned Downward

In the Tankan June 2019 Survey, large manufacturers' DI for business conditions was down 5 percentage points from the previous survey, showing a significant decline. This reflected a downswing in earnings in line with sluggish exports. In particular, DI deteriorated significantly in export related industries such as machinery for production, electrical machinery and automobiles.

At the same time, DI for large non-manufacturers improved for the first time in two quarters, up 2 percentage points from the previous survey. Behind this, there has been a recovery in private consumption reflecting favorable employment and income conditions. In addition to hotel and food services, which had benefited from the positive effects of the 10 consecutive holidays, DI saw significant improvement in consumption related industries, including transportation, postal, retail and wholesale sectors.

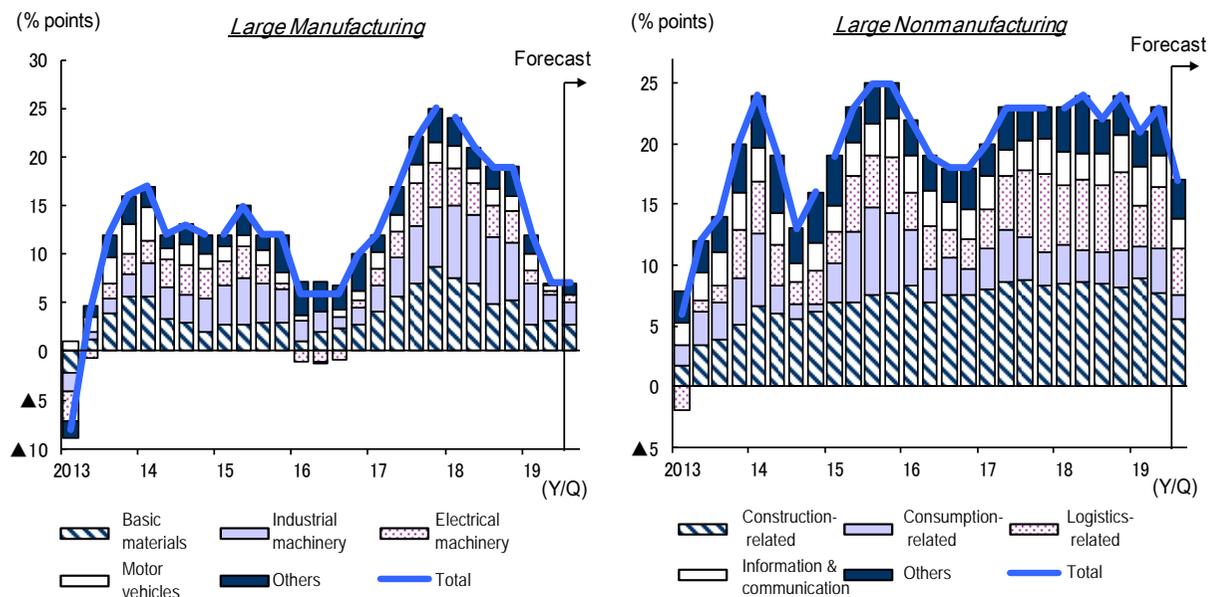
In terms of future outlook, DI is anticipated to deteriorate, dropping 6 percentage points across businesses of all sizes and in all industries. Uncertainties remained in the overseas situation owing to the intensification of the trade friction between the United States and China, which will likely apply downward pressure.

## ◆ Appetite for Business Fixed Investment Is Strong

While business sentiment has deteriorated, the appetite for business fixed investment has remained resilient on the back of the deepening of labor shortages and the response to the workstyle reforms. The capital investment plan in FY2019 was up 7.7 percent year on year for the manufacturing industry and down 0.8 percent year on year for the non-manufacturing industry, indicating a high level of growth for the year following the previous year, which also demonstrated high growth. There have also been movements to significantly boost software investment, which contributes considerably to labor saving and rationalization.

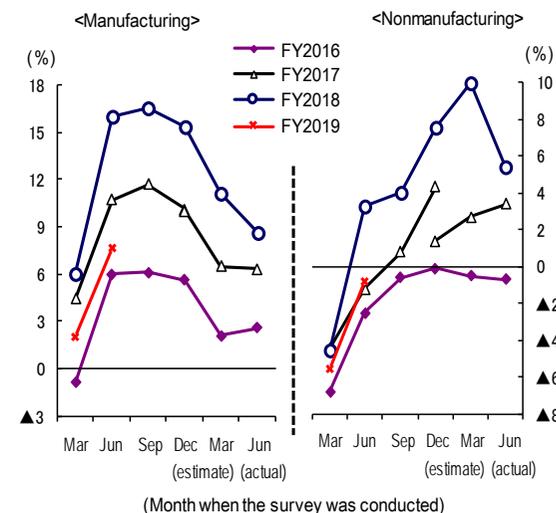
Figure 3-1 Contributions to the Business Conditions Diffusion Index by Industry

<diffusion index of "favorable" minus "unfavorable," and percentage point contribution to total DI points>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, "The Tankan June 2019 Survey".

Figure 3-2 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.

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# Exports Are Expected to Pick up

## ◆ Exports of Goods Are Expected to Pick up

The declining trend for goods exports came to a halt overall. In May, exports of capital goods such as semiconductor production equipment significantly decreased, mainly to ASEAN countries, South Korea and Taiwan. However, this reflected temporary downward factors including the postponement of investments in line with large elections scheduled in May in ASEAN countries such as Thailand and the Philippines, in addition to the negative effects of the reduction in the number of business days due to the 10 consecutive holidays in Japan.

As for future prospects, exports, mainly to Asia, are anticipated to pick up, as the Chinese economy will likely rebound thanks to economic stimulus measures taken by the Chinese government, on top of IT demand bottoming out. In fact, the rate of

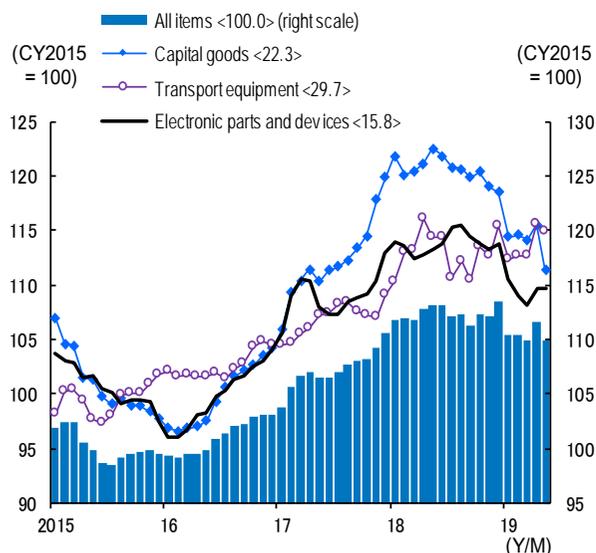
decline in global shipments of semiconductors and orders for machine tools bound for China recently significantly diminished.

However, if the trade friction between the United States and China further intensifies, downward pressure on Japan's exports to China will likely grow.

## ◆ Demand Related to Inbound Tourism Is Picking up

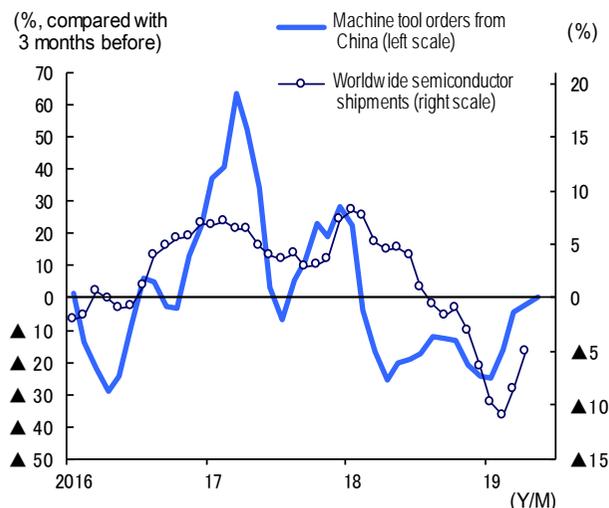
Demand related to inbound tourism has continued to pick up. The number of tourists that visited Japan in May increased by 1.7 percent over the previous month. In terms of future outlook, demand related to inbound tourism is expected to continue growing moderately, driven by an expanding middle class in emerging Asian countries and better infrastructure and services for receiving tourists in Japan.

Figure 4-1 Real Exports by Item  
<seasonally adjusted,  
3-month moving averages>



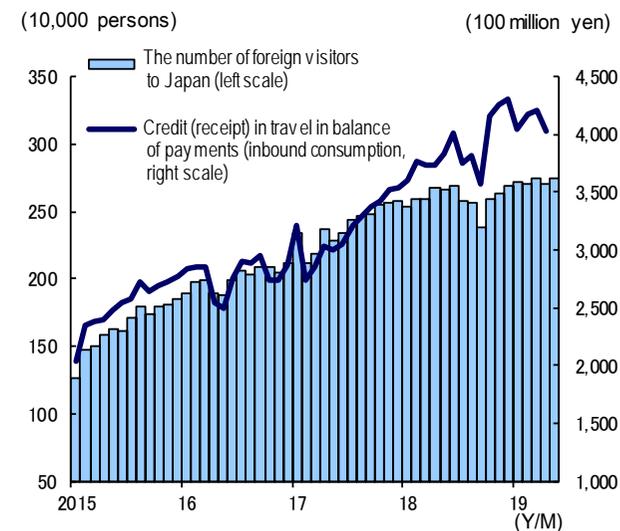
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.  
Note: Figures in the angled brackets show the shares in total nominal exports in CY2018.

Figure 4-2 Machine Tool Orders from China  
and Worldwide Semiconductor  
Shipments <seasonally adjusted,  
3-month moving averages>



Source: The Japan Research Institute, Ltd. based on data of Japan Machine Tool Builders' Association, World Semiconductor Trade Statistics.

Figure 4-3 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).

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# Business Fixed Investment Will Likely Pick up

## ◆ Momentum in Corporate Profit Growth Has Stalled

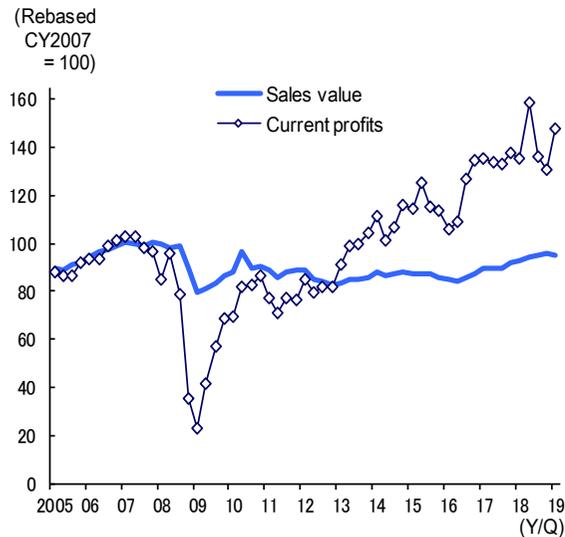
Corporate earnings have seen some ups and downs, while remaining at a high level. According to the Financial Statements Statistics of Corporations by Industry quarterly report, sales value for the period from January-March 2019 declined for the first time in one and a half years, reflecting a downswing in the manufacturing industry against the backdrop of sluggish exports to China. Current profits increased for the first time in three quarters thanks to improvement in profitability due to a decline in crude oil prices and large dividends from pure holding companies.

As for the outlook for corporate earnings, while a downward trend is anticipated as the temporary factors seen during the January-March period dissipate, overall corporate earnings will likely continue to expand in line with firm domestic demand and the rebound in exports.

## ◆ Business Fixed Investment Will Likely Pick up

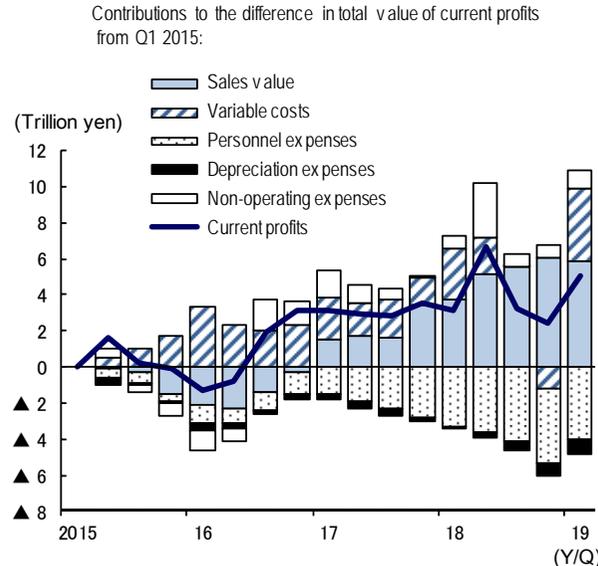
Capital investment is anticipated to return to a moderate recovery path. Amid a strong appetite for investments in the fields of rationalization and labor saving as well as maintenance and upgrade demand due to labor shortages and dilapidated equipment, postponed investment projects are likely to be executed as exports pick up. In fact, machinery orders, which had been sluggish since the end of last year, significantly grew in April. The outlook for the April-June period also indicates ongoing recovery for the future. However, the increased outlook for machinery orders was as of March, and it is therefore necessary to factor in the flare-up in U.S.-China trade friction after the beginning of May.

Figure 5-1 Sales Value and Profits of Japanese Enterprises <seasonally adjusted>



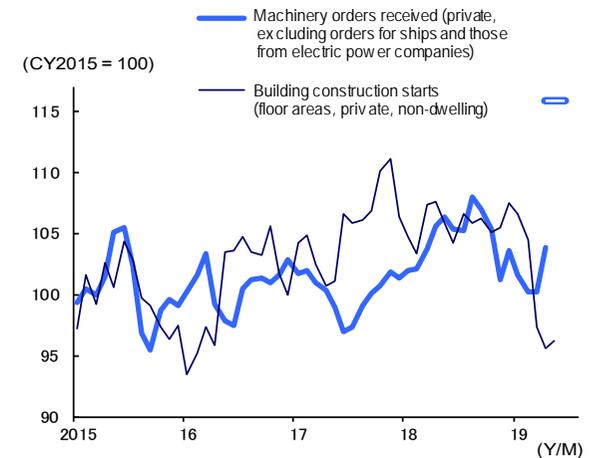
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.  
Note: All industries except for financial services and insurance.

Figure 5-2 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 5-3 Machinery Orders and Building Starts <seasonally adjusted, 3-month moving averages>



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

Note: The figure in Q2 2019 in machinery orders is a forecast as of the end of March 2019.

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# Income Is Recovering Steadily

## ◆ Employment and Income Conditions Continue to Improve

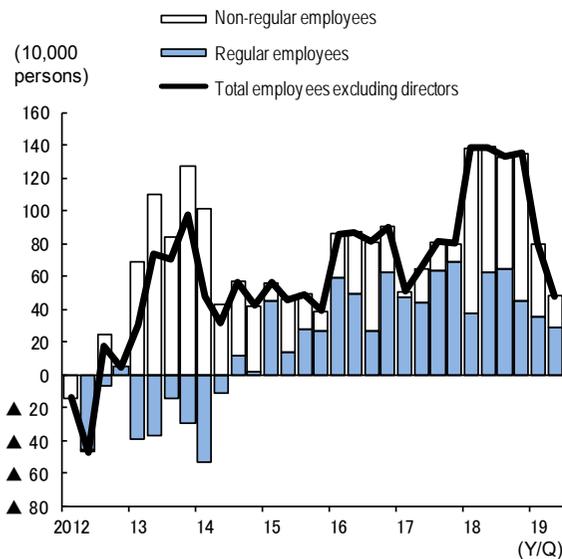
The pace of improvement in the employment situation has slowed down. While momentum expanded in the hotel and food services sector on the back of the rebound in private consumption and inbound demand, the employment situation remained weak in the manufacturing industry due to stagnant production.

Meanwhile, nominal wages remained on a rising trend against the backdrop of labor shortages at levels exceeding those during the bubble economy. Looking at scheduled salaries for full-time workers, growth at around 1 percent on a year-on-year basis has been maintained since the beginning of 2019 when excluding the effects of sample switchover.

## ◆ Real Income Is Likely to Increase Firmly

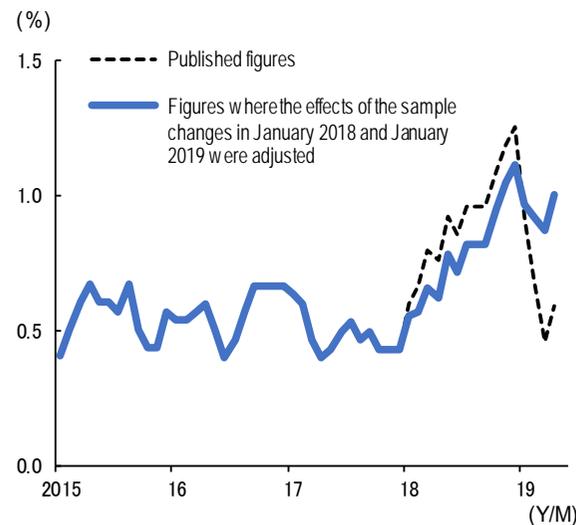
A look at future prospects shows a high likelihood that growth in the number of employees will slow down as the population continues to decline and labor participation approaches the upper limit of supply. At the same time, nominal wages will likely remain on a steady rise given the tight labor supply demand conditions. In addition, there is a possibility that the provision of free education and nursery care will minimize price increases as a result of the hike in the consumption tax. As a result, growth at around the mid-1 percent level will likely be maintained in real compensation for employees, although a slight slowdown in the pace of improvement is possible.

Figure 6-1 Number of Employees  
<difference from a year earlier>



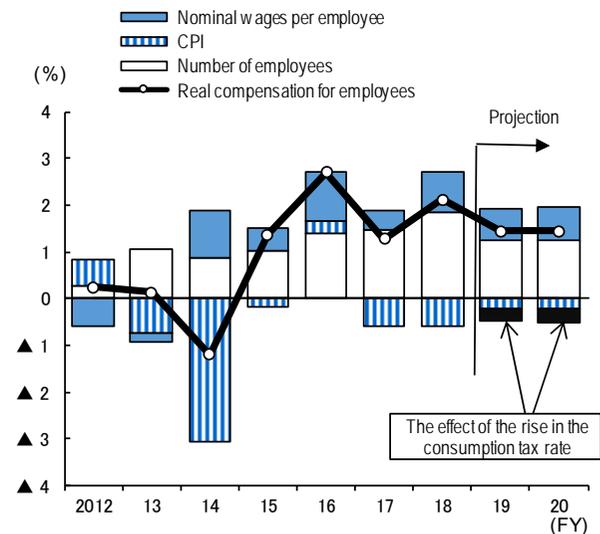
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.  
Note: The figures in Q2 2019 are for April-May 2019.

Figure 6-2 Scheduled Salaries for Full-time Workers  
<year-on-year % change, 3-month moving averages>



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

Figure 6-3 Real Compensation for Employees  
<year-on-year % change>



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

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# Private Consumption Expenditure Is Increasing Moderately

## ◆ Private Consumption Is Increasing Moderately

Private consumption continued to expand moderately, underpinned by favorable employment and income conditions, despite downward factors including an increasingly cautious consumer mindset and unseasonable weather.

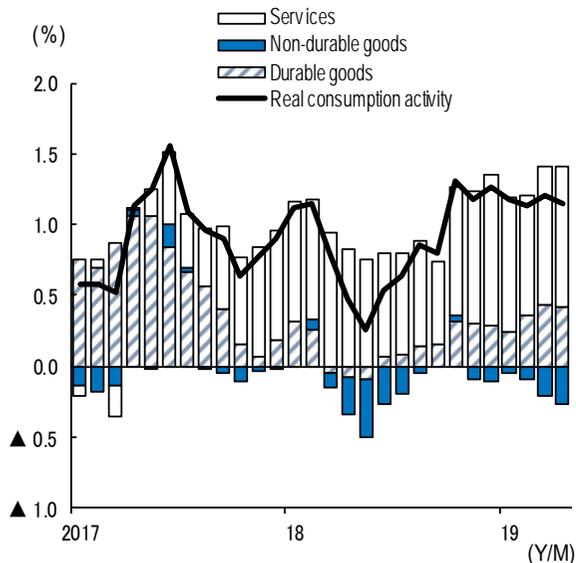
While consumption of early summer clothing turned out to be sluggish due to lower temperatures caused by the inflow of cold air, consumption of services and durable goods continued to rebound. Food services and travel consumption remained robust in particular thanks to the favorable effects of the 10 consecutive holidays from the end of April to early May. In addition, sales of home appliances such as air conditioners and washing machines increased rapidly on the back of the launch of new products and a rush in demand prior to the consumption tax rate hike.

## ◆ Mild Recovery Is Anticipated for the Future

As for future prospects, while an increasingly cautious consumer mindset ahead of a hike in the consumption tax rate will negatively weigh on private consumption, the mild recovery will likely continue, underpinned by improvement in employment and income conditions.

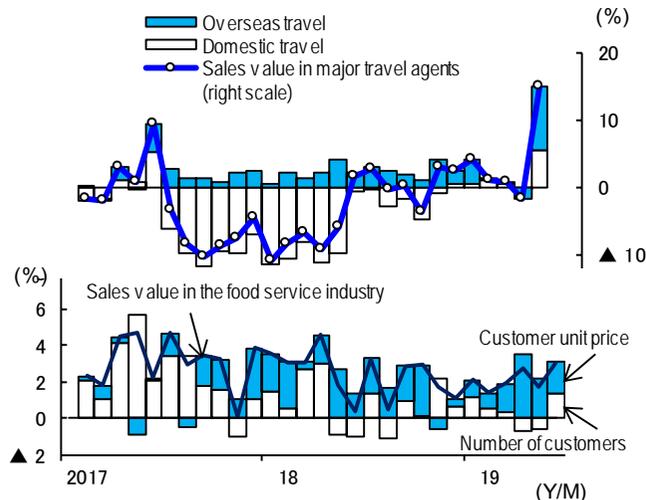
In terms of the effects of a hike in the consumption tax rate scheduled for October 2019, a significant decline, which was witnessed at the time of previous tax rate hike, is likely to be avoided, as an increase in nominal income will likely exceed the growth of consumer prices as a result of the provision of free education and nursery care and benefits targeting low-income households in addition to the introduction of the reduced tax rate.

Figure 7-1 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.

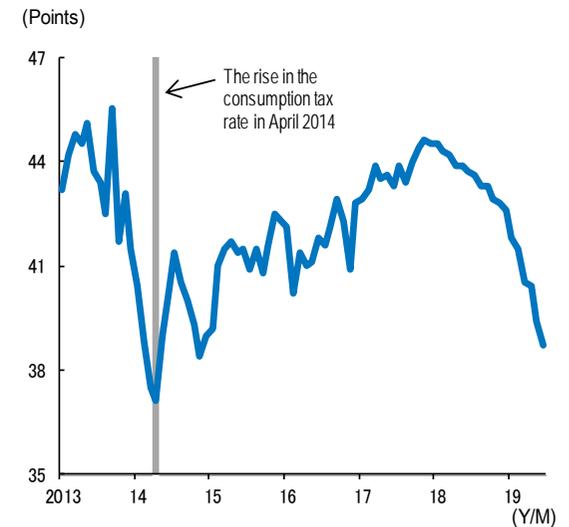
Figure 7-2 Sales Values in Major Travel Agents and the Food Service Industry <year-on-year % change>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Land, Infrastructure and Transport, Japan Food Service Association.

Note: Excluding travel sales for inbound international visitors to Japan.

Figure 7-3 Consumer Confidence Index <seasonally adjusted>



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

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# Topic: Reconstruction of Plants in the Manufacturing Industry Is Expected to Expand in the Future

## ◆ Plant Construction Remains Strong

Since the beginning of the 2010s, capital investment of Japan's manufacturing industry has been on a rising trend. In particular, construction-related investments have been brisk. The following two points can be listed as reasons behind this trend.

The first point is a rise in the need for large-scale plants. In Japan, while labor demand has grown on the back of economic recovery, labor shortages have emerged as an increasingly serious problem due to a decline in the working age population, reflecting rapid progression of a declining birthrate and an aging society. Against this backdrop, companies aggressively pursued the construction of cutting-edge large-scale plants to promote labor saving measures.

The second point is revitalization of the reconstruction of dilapidated plants. Since construction investments by the manufacturing industry had been restrained at a low level for a long period of time since the collapse of the bubble economy, plant aging

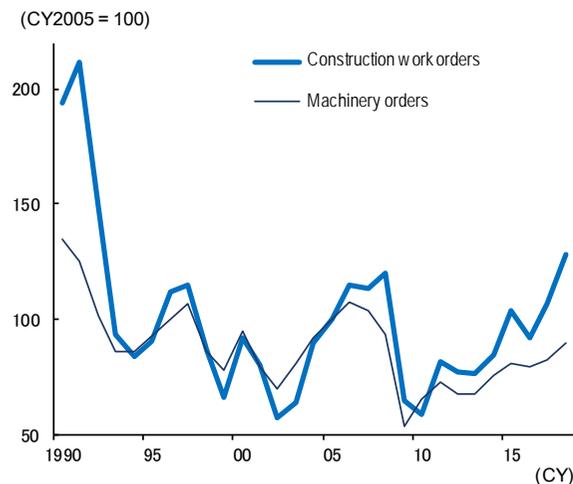
accelerated. In recent years, movements to fully upgrade these superannuated plants have taken place.

## ◆ Demand for Plant Reconstruction Will Further Increase

As for future prospects, demand for the reconstruction of dilapidated plants will continue to expand. By calculating latent upgrade demand for plants based on the actual demolition record by property age in the past, reconstruction demand is expected to reach approximately 1.6 times as much as the current level by the 2030s.

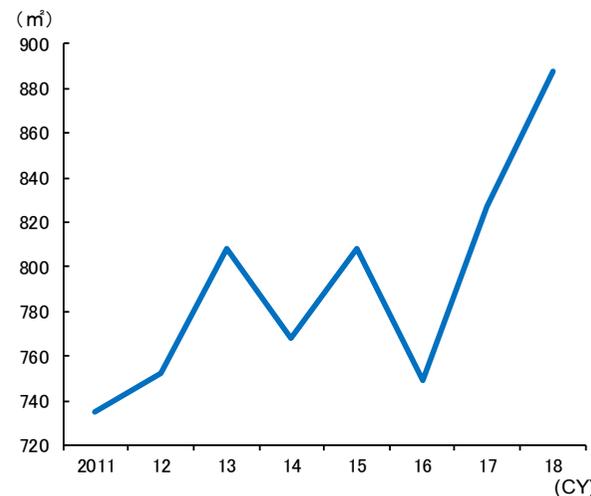
However, if the environment surrounding Japan's manufacturing industry deteriorates due to contraction of the domestic market, spreading protectionist trade policies, intensification of competition as a result of a rise in foreign enterprises and a shortage of successors, there is a possibility that companies will choose to close down plants or relocate them overseas rather than reconstruct them.

Figure 8-1 Construction Work Orders and Machinery Orders from the Manufacturing Industry



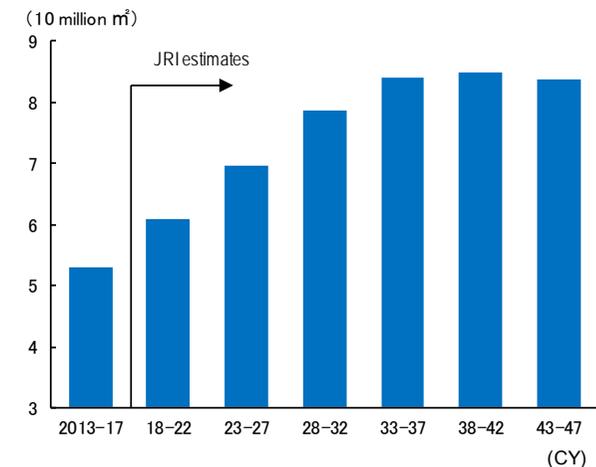
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Land, Infrastructure and Transport, The Cabinet Office.

Figure 8-2 Average Floor Area per Building Start for the Manufacturing Industry



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

Figure 8-3 Estimated Loss of Floor Areas in Factories and Warehouses



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

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

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

(1) As for future prospects, Japan's economy will likely return to its recovery trend as overseas demand bottoms out and domestic demand picks up.

(2) The declining trend for exports is anticipated to come to a halt on the back of the recovery of the global economy, mainly in China. Latent demand for business fixed investments has also remained robust, including upgrade investments for dilapidated equipment as well as investments in the fields of rationalization and labor saving due to labor shortages. As concerns over the slowdown of the global economy subside, business fixed investment will likely return to a rising trend along with the execution of postponed investment projects.

(3) At the same time, personal consumption is also anticipated to increase moderately, underpinned by a favorable income environment. While a hike in the consumption tax rate is scheduled in October, a significant drop in consumption will likely be avoided, as measures to minimize the impact of the consumption tax rate hike, such as the introduction of a reduced tax rate and the provision of free education and nursery care, are expected to reduce the burden on households.

(4) However, attention must be paid in particular to the United States' protectionist stance on trade, as the outlook for the overseas economy remains increasingly uncertain. However, if China's domestic demand heads downward as a result of further increases in items subject to retaliatory tariffs by the United States, downward pressure on the Japanese economy will increase. In addition, there are risks that the United States will impose quantitative restrictions on automobile exports by Japan and demand the inclusion of a clause related to exchange rate matters.

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

(5) The pace of rise in the core CPI, which excludes fresh food, decelerated slightly mainly because of the reactionary fall in accommodation charges, despite the rise in food prices. 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, communication charges for smartphones will have been reduced and the pace of rise in energy prices will likely continue to slow down.

Figure 10 Projections for GDP Growth and Main Indicators of Japan ( as of July 3, 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)	(Actual)	(Projection)	(Projection)							
Real GDP	2.2	0.8	1.9	▲ 2.5	1.7	1.6	1.0	0.4	1.1	0.7	0.8	0.8
Private Consumption Expenditure	▲ 0.2	2.6	2.8	▲ 5.9	2.7	2.3	▲ 0.3	1.0	1.0	0.4	0.6	0.6
Housing Investment	2.5	3.2	0.0	▲ 4.5	▲ 3.1	0.8	1.6	2.3	1.5	▲ 4.3	1.4	▲ 0.3
Business Fixed Investment	1.4	1.5	3.6	▲ 1.4	2.3	2.1	2.0	2.0	1.8	3.5	1.9	1.8
Private Inventories (percentage points contribution)	( 0.2)	(▲ 0.1)	(▲ 0.4)	( 0.1)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	( 0.1)	( 0.0)	(▲ 0.0)
Government Consumption Expenditure	▲ 0.4	0.8	0.7	0.7	0.9	1.0	2.2	▲ 0.6	1.0	0.9	0.8	0.9
Public Investment	4.7	6.2	1.9	0.8	▲ 1.8	▲ 1.6	0.7	1.5	1.9	▲ 3.9	1.6	▲ 0.1
Net Exports (percentage points contribution)	( 1.6)	(▲ 1.3)	(▲ 0.1)	( 0.9)	(▲ 0.2)	(▲ 0.1)	( 0.3)	(▲ 0.5)	(▲ 0.0)	(▲ 0.1)	(▲ 0.1)	( 0.0)
Exports of Goods and Services	▲ 9.3	0.2	4.1	2.6	1.4	1.5	2.7	▲ 1.3	1.6	1.3	▲ 0.5	1.6
Imports of Goods and Services	▲ 17.2	8.0	4.6	▲ 2.7	2.4	2.2	0.8	1.6	1.8	2.0	0.3	1.4
(Ref.) Domestic Private Demand (percentage points contribution)	( 0.4)	( 1.6)	( 1.8)	(▲ 3.5)	( 1.8)	( 1.6)	( 0.2)	( 0.9)	( 0.9)	( 0.8)	( 0.7)	( 0.6)
(Ref.) Public Demand (percentage points contribution)	( 0.2)	( 0.4)	( 0.2)	( 0.2)	( 0.1)	( 0.1)	( 0.5)	(▲ 0.1)	( 0.3)	(▲ 0.0)	( 0.2)	( 0.2)

	(% changes from the same quarter of the previous year)									(% changes from the previous fiscal year)		
Nominal GDP	1.0	1.0	2.3	1.7	1.4	1.7	1.3	1.7	1.5	0.5	1.6	1.6
GDP deflator	0.1	0.3	0.6	1.1	1.1	1.0	0.9	0.5	0.5	▲ 0.2	0.8	0.7
Consumer Price Index (excluding fresh food)	0.8	0.8	0.4	0.8	0.9	0.9	1.1	0.8	0.8	0.8	0.7	0.9
(excluding fresh food, consumption tax, education free of charge)	0.8	0.8	0.4	0.5	0.5	0.6	0.8	0.8	0.9	0.8	0.5	0.8
Unemployment Rate (%)	2.5	2.4	2.4	2.4	2.4	2.4	2.3	2.3	2.3	2.4	2.4	2.3
Exchange Rates (JY/US\$)	110	109	107	106	106	106	106	106	106	111	107	106
Import Price of Crude Oil (US\$/barrel)	63	72	67	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.