

# Monthly Report of Prospects for Japan's Economy

January 2020

Macro Economic Research Center  
Economics Department



The Japan Research Institute, Limited

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

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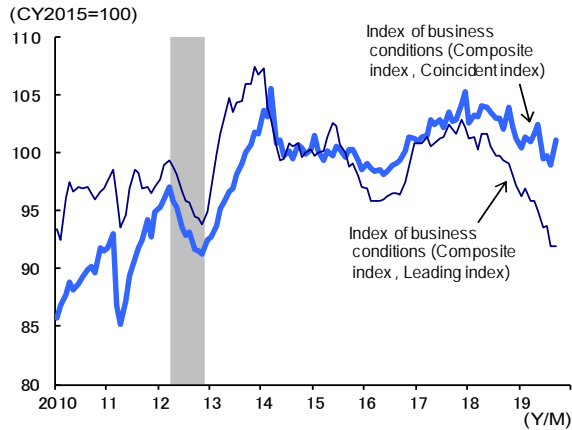
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# The General Situation of Japan's Economy – A Sense of Standstill Is Felt in Economic Activity

**Figure 1-1 Economic Activity**

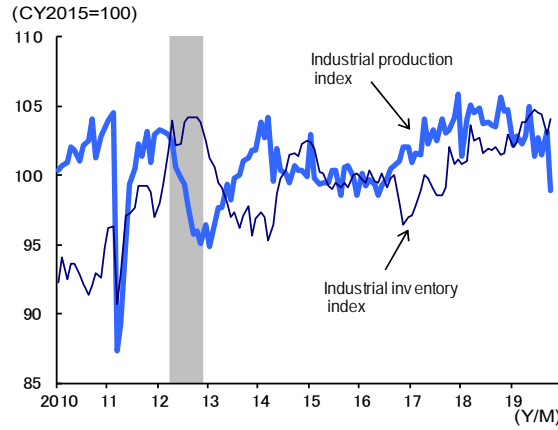
Among indices of business conditions, the CI coincident index rose thanks to an increase in retail sales, while the leading index remained on a declining trend.



Source: The Cabinet Office.

**Figure 1-2 The Corporate Sector**

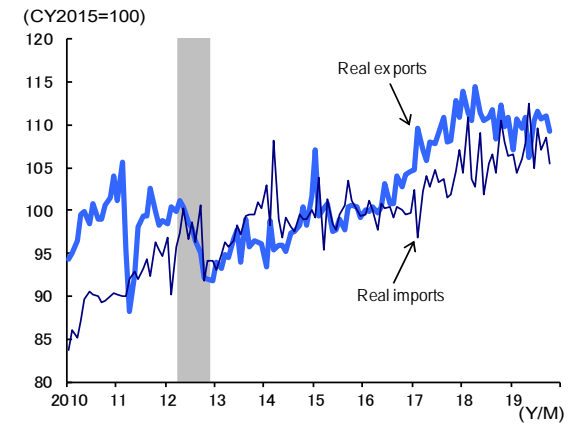
Industrial production plunged considerably, mainly for automobiles and general machinery, due to factors including the impact of natural disasters such as major typhoons.



Source: The Ministry of Economy, Trade and Industry.

**Figure 1-3 Overseas Demand**

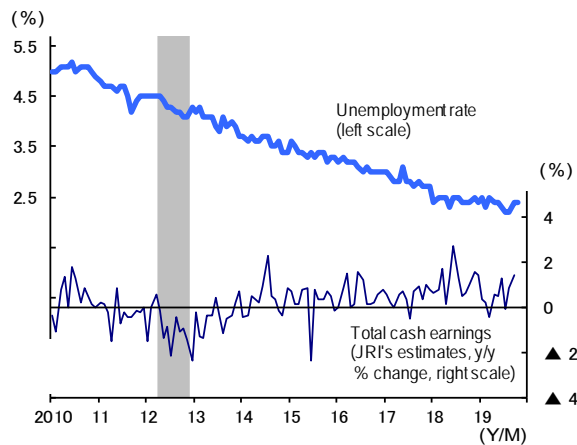
There was a decline in exports, mainly to the United States and Europe. Imports also decreased due to a fall in crude oil prices.



Source: The Bank of Japan.

**Figure 1-4 Employment and Income**

The unemployment rate is hovering around its lowest level since 1992. Nominal wages have been on a rising trend despite some ups and downs.

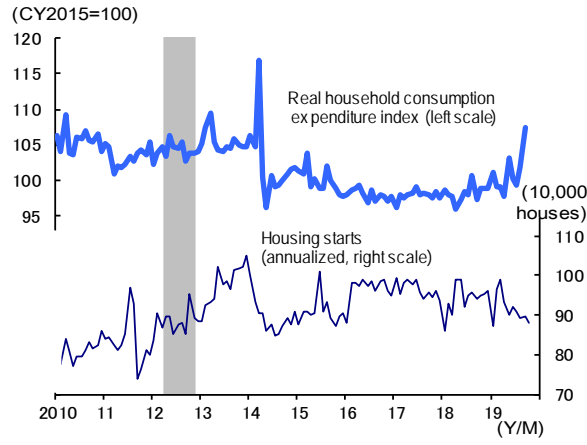


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

\* The shaded area indicates the recession phase.

**Figure 1-5 The Household Sector**

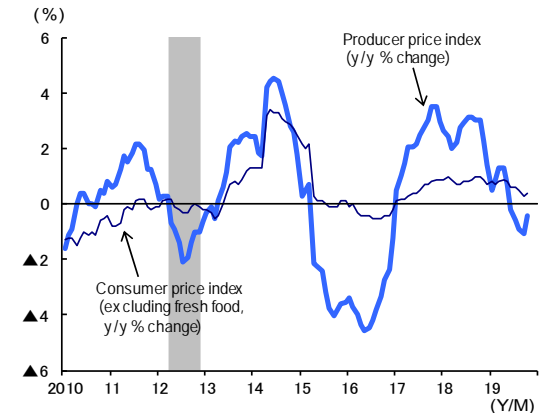
Real household consumption surged due to the rush in demand prior to the consumption tax hike. Housing starts saw a moderate decline.



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 remained on a declining trend in line with a fall in crude oil prices. The pace of increase in consumer prices has slowed down.



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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# Manufacturing Production Stalled Due to Sluggish Overseas Demand, Despite Brisk Domestic Demand

## ◆ Real GDP Grew by 1.8% in the July–September Period

According to the 2nd QE, Japan's real GDP for the July–September 2019 period was revised to +1.8% on an annualized quarter-on-quarter change basis, which was higher than the 1st QE (+0.2%) due primarily to the upward revision of capital investment. A drop in consumption related to inbound tourism (export of services) and a decrease in inventory investment put downward pressure on the growth rate. On the other hand, final domestic demand, including personal consumption, capital investment and public works spending, was firm.

## ◆ Industrial Production Saw a Significant Decline

The Industrial Production Index for October plunged 4.5% from the previous month. Production was cut in a wide range of industries, including general-purpose and business-use machinery, which were severely impacted by typhoons for parts

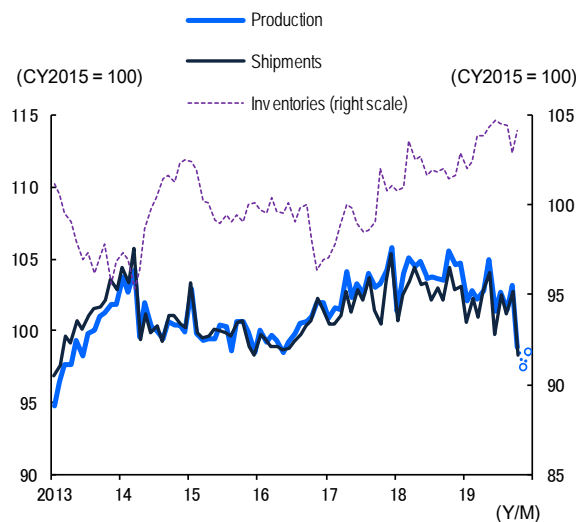
procurement. Also declining was the automobile industry, where some manufacturers suspended production. The future outlook calls for production plans to likely remain weak, as industrial production is forecast to decline by 1.5% month-over-month in November and to increase by 1.1% month-over-month in December.

The slowdown in production can be attributed to sluggish exports. Exports to China and other Asian countries are showing signs of bottoming out, while those to the United States are on a downward trend, particularly for automobiles.

## ◆ Public Investment Remained Firm

Public investment remained on a rising trend as public works projects, which had accumulated prior to the consumption tax hike, have been implemented in earnest. The contract amount of public works projects, which serves as a leading indicator, saw a further increase in October.

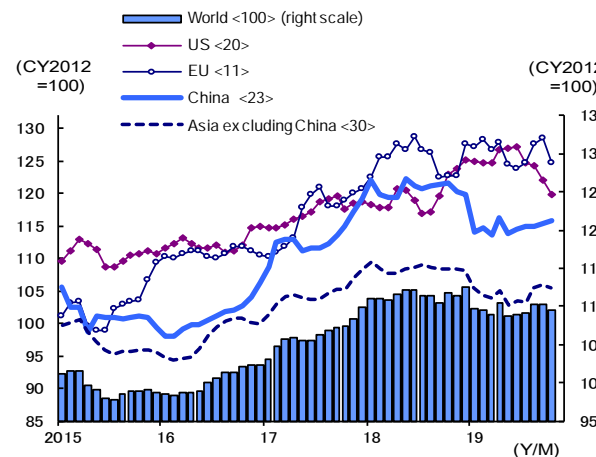
Figure 2-1 Industrial Production Index <seasonally adjusted>



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 November and December based on the production forecast index.

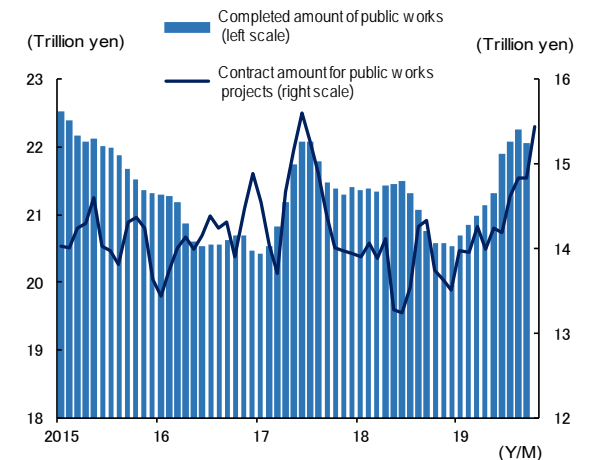
Figure 2-2 Real Exports by Destination <seasonally adjusted, 3-month moving averages>



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

Note: 1. Figures in the angled brackets show the shares in total nominal exports in CY2018.  
2. China including Hong Kong.

Figure 2-3 Completed and Contract Amounts 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, East Japan Construction Surety Co., Ltd.

Note: Non-dwelling.

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# Exports Remain Lackluster

## ◆ Exports of Goods Continue to Stagnate

Exports of goods have been sluggish. Looking at exports by category, while exports of electronic parts and devices remained brisk as global IT demand had bottomed out, exports of capital goods to Asia including China continued to stagnate. In addition, exports of transportation machinery to the United States, which has a higher proportion in exports, declined sharply. It seems that there has been progress with the shift toward local production of finished vehicles which had previously been exported from Japan.

In future prospects, Japan's exports of transportation machinery to the United States are anticipated to remain lackluster, and amid the lack of momentum for the global economy on the whole, a strong recovery of overall exports will be difficult to achieve. However, there have been signs of changes in the trend of restraint in global capital investments, such as a rebound in machinery orders, in addition to a

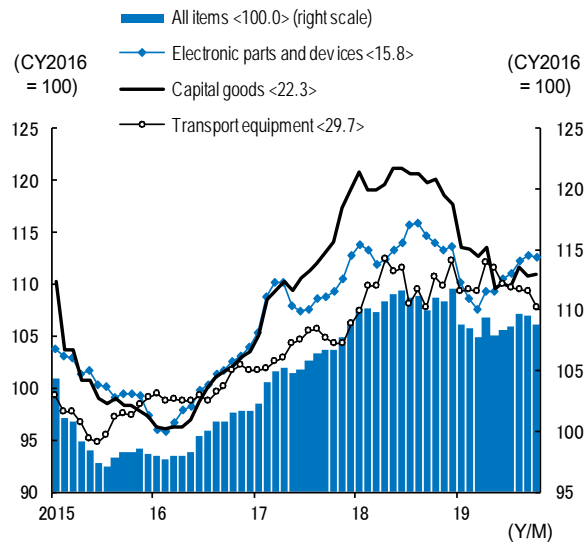
recovery in semiconductor demand. Consequently, exports will likely pick up moderately, mainly for electronic components and capital goods.

## ◆ Demand Related to Inbound Tourism Declines

The number of tourists that visited Japan in October decreased by 1.8% from the previous month. While the number of visitors from participating countries increased during the Rugby World Cup 2019, the number of South Korean tourists visiting Japan continued to decline against the backdrop of the deterioration in the relationship between Japan and South Korea. Flight cancellations caused by Typhoon No. 19 also contributed to the decline.

Although the impact of natural disasters is expected to come to an end, demand related to inbound tourism is expected to remain weak due to the prolonged slump in the number of South Korean visitors to Japan.

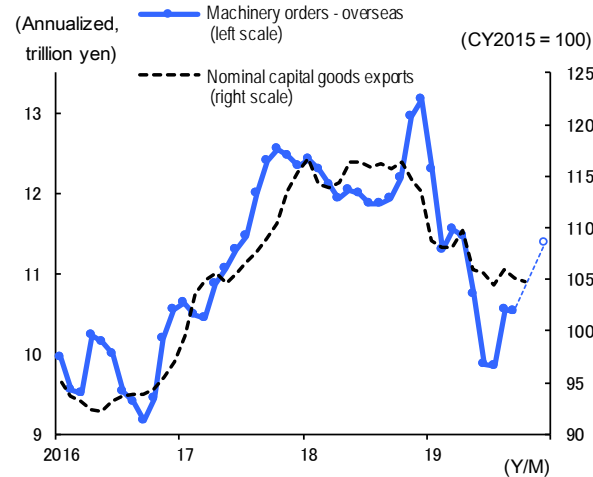
Figure 3-1 Real Exports by Item  
<seasonally adjusted,  
3-month moving averages>



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

Note: Figures in the angled brackets show the shares in total nominal exports in CY2018.

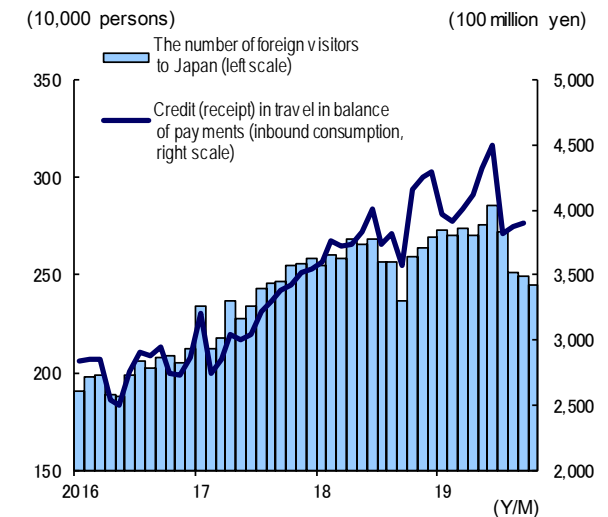
Figure 3-2 Machinery Orders from Overseas Destinations and Nominal Exports of Capital Goods  
<seasonally adjusted,  
3-month moving averages>



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

Note: The latest figure of machinery orders is a forecast.

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).

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# While Corporate Profits Are at a Standstill, Business Fixed Investment Is Projected to Remain on the Rise

## ◆ Corporate Profits Have Stalled

Corporate profits have been sluggish while remaining at a high level. According to the Financial Statement Statistics of Corporations by Industry quarterly report, current profits for the period from July–September 2019 declined for the second consecutive quarter, down 1.1% from the previous quarter. In the manufacturing sector, against a backdrop of a slowdown in global capital spending, earnings deteriorated among steelmakers, chemical and other materials companies, as well as production machinery and information and communications equipment manufacturers. In the non-manufacturing sector, profits increased for the retail industry driven by the rush in demand prior to the consumption tax rate hike. However, profits fell in the information and communications industry, which slashed mobile phone charges, and in the hotel and food services industries, which were negatively affected by a decrease in South Korean visitors to Japan.

Corporate profits for the October–December period are expected to fall further

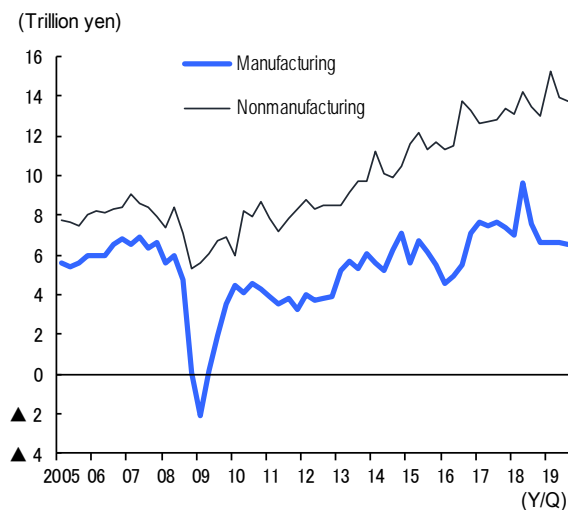
owing to a reactionary decline due to the rush in demand triggered by the consumption tax rate hike as well as sluggish production and sales caused by a series of natural disasters including major typhoons. Corporate profits, however, will likely return to the recovery path as exports subsequently pick up.

## ◆ Business Fixed Investment Is Expected to Remain on a Rising Trend

On the other hand, capital investments have remained on an increasing trend. Looking at business fixed investments (excluding software investments) for the July–September 2019 period, investments have increased in both the manufacturing and nonmanufacturing industries.

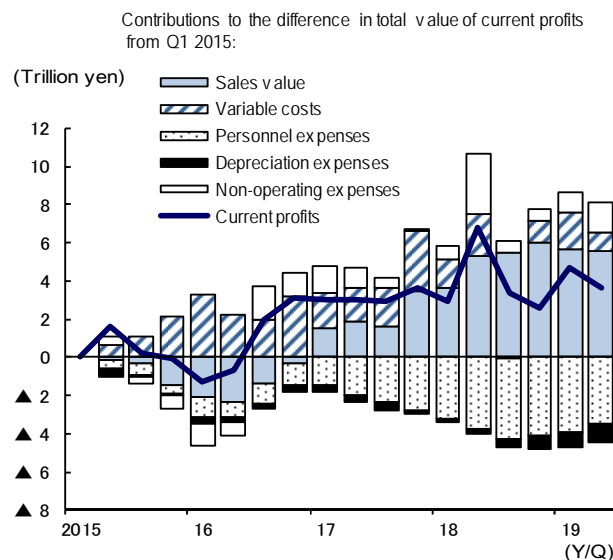
In the future outlook, capital expenditures are forecast to remain on a rising trend, reflecting strong demand for investments for rationalization and labor saving driven by labor shortages as well as investments for maintenance and replacement related to aging facilities.

Figure 4-1 Current Profits of Japanese Corporations by Type <seasonally adjusted>



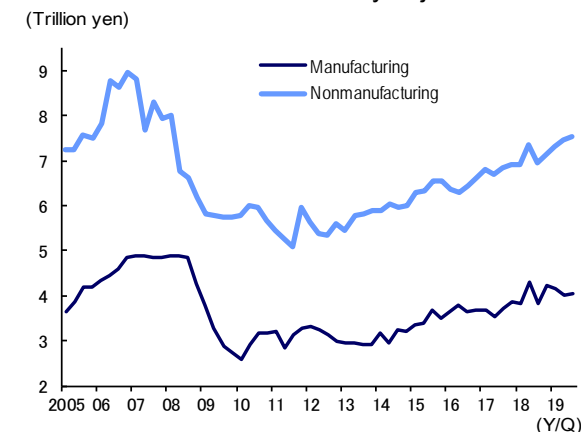
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.  
Note: All industries except for financial services and insurance.

Figure 4-2 Contributions of Factors to Change in Total Value of Current Profits



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

Figure 4-3 Value of Business Fixed Investment Based on Financial Statements Statistics of Corporations by Industry <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.  
Note: 1. All industries except for financial services and insurance.  
2. Excluding software investment.

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# Income Is Expected to Increase Steadily

## ◆ The Income Situation Continues to Improve

While the pace of growth in the number of workers has declined compared with the previous year, the rising trend has continued with the number of workers increasing by around 600,000 year-on-year. Although labor demand in the manufacturing sector was somewhat weak against the background of sluggish exports, brisk labor demand in the nonmanufacturing sector positively affected the increase in the number of workers. By industry, the number of jobs increased in the food services, medical and welfare industries, where labor shortages are pronounced. In addition, the number of work hours per employee has been decreasing due to the effect of workstyle reforms among other factors, which has also contributed to boosting the number of workers.

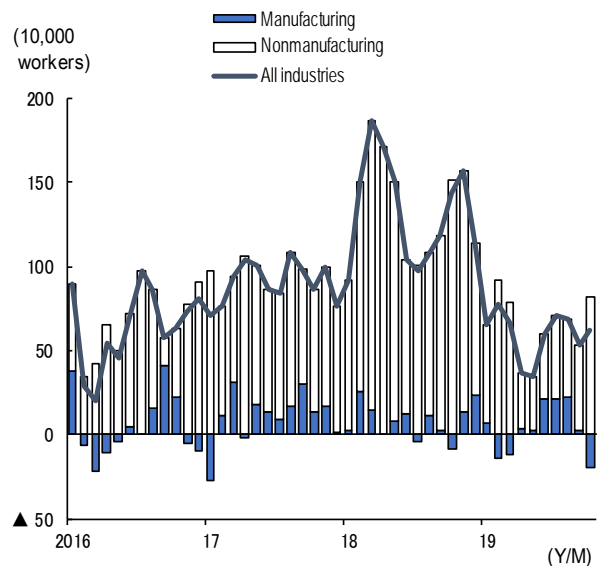
Meanwhile, on the wages front, nominal wages have remained on a rising trend.

Excluding the effects of sample changes, the total sum of cash earnings of full-time workers in September rose 1.6% from the previous year. Scheduled salaries remain on a rising trend driven by the implementation of pay scale increases, which has contributed to the upward trend in nominal wages.

## ◆ Compensation for Employees Is Likely to Increase Firmly

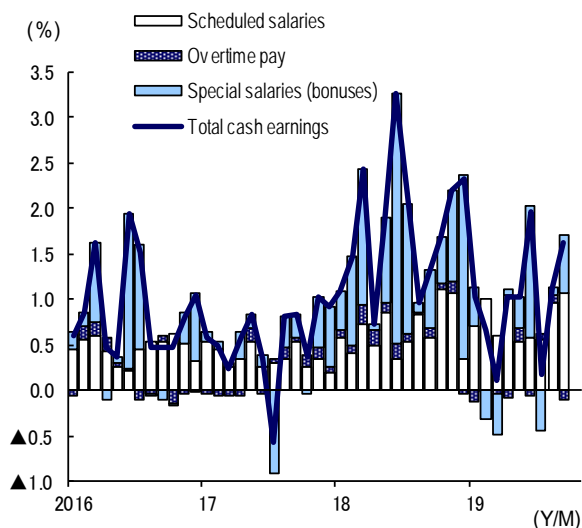
As for future prospects, it is highly likely that moderate growth in the number of employees will continue as a strong sense of the labor shortage is still being felt by many industries, particularly in the nonmanufacturing sector. Nominal wages will likely remain on a steady rise given the tight labor supply/demand conditions. As a result, growth at around the 2% level will likely be maintained in nominal compensation for employees.

Figure 5-1 Number of Employees by Type  
<difference from a year earlier>



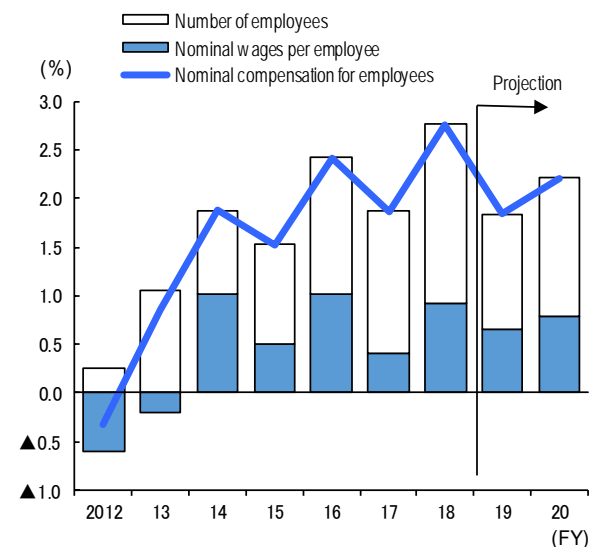
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.

Figure 5-2 Total Cash Earnings of 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.  
Note: The effects of the sample changes in January 2018 and January 2019 were adjusted.

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



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

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# Topic: What Will Happen to Private Consumption Expenditure After the Consumption Tax Rate Hike?

## ◆ Retail Sales Saw a Sharp Drop in October

Looking at the consumption trend after the tax hike, retail sales in October plunged 7.1% from the previous year. By type of store, sales were down 17.3% year-on-year for department stores, down 17.0% year-on-year for car dealers, and down 14.2% year-on-year for large consumer electronics stores. In addition to a drop in sales following the consumption tax rate hike, various downside factors also contributed to the decline.

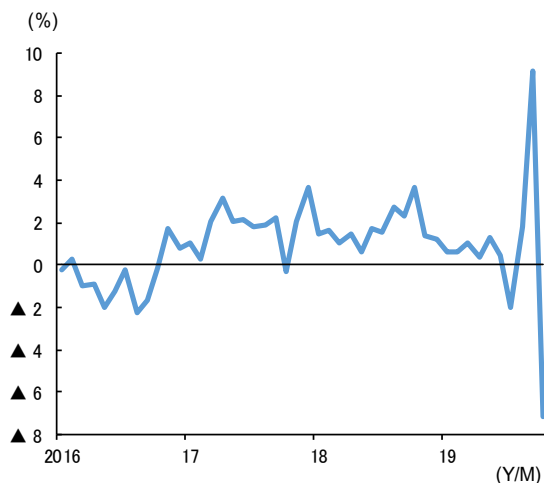
Sales at department stores and electronics retailers were negatively affected by temporary closures due to typhoons, while automobile sales were affected by production suspensions at some makers due to parts supply problems. Meanwhile, at supermarkets, the drop in sales was minor, partly due to reduced tax rates on their mainstay food products. Moreover, sales at convenience stores, which can enjoy the

benefits of the point refund system in cashless payments successfully, increased from the previous year.

## ◆ The Recovery in Consumer Spending Will Remain Intact

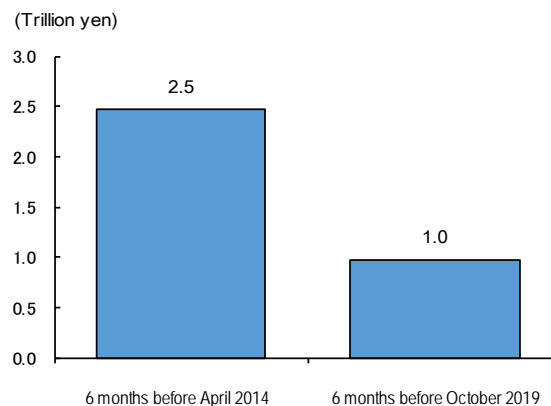
In future prospects, the drop in personal consumption is not expected to be prolonged, as the temporary negative effects such as weather factors will end and the reactionary decline due to the surge in demand will likely be limited to around 40% of that after the 2014 tax rate hike. Looking at consumer prices after the tax increase, the introduction of a reduced tax rate, the provision of free child education and nursery care, and a decline in energy prices positively contributed to downward pressure on prices. Consequently, inflation has been limited despite the increase in tax. Personal consumption is expected to return to a moderate growth trend as household real income remains positive even after the tax rate hike.

Figure 6-1 Retail Sales Value  
<year-on-year % change>



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

Figure 6-2 Rush in Demand during 6 Months prior to the Consumption Tax Rate Rise <JRI estimates>

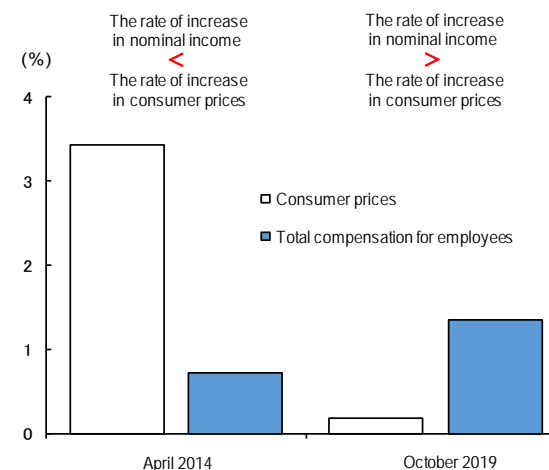


Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.

Note: The figures are estimated based on the following equation:  

$$\text{Real household consumption} = \text{constant} + \alpha * \text{real compensation for employees} + \beta * \text{consumer confidence index} + \text{rush and reaction dummy variable}$$

Figure 6-3 Nominal Income and Consumer Prices When the Consumption Tax Rates were Raised <year-on-year % change>



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



## Prospects for Japan's Economy - Projected Real GDP Change; 0.9% in FY2019 and 1.0% in FY2020

### ◆ Mild Recovery of the Japanese Economy Will Continue After Overcoming the Effects of the Consumption Tax Rate Hike

(1) According to the Second Preliminary Quarterly Estimates of GDP (2nd QE), Japan's real GDP for the July-September 2019 period was revised to +1.8% on an annualized quarter-on-quarter change basis, which was higher than the First Preliminary Quarterly Estimates of GDP (1st QE) (+0.2% on an annualized quarter-on-quarter change basis) due primarily to the upward revision of capital investment. In the latest GDP revision, the growth rate since the beginning of 2019 has been revised upward on the whole. This suggests that the Japanese economy has been recovering steadily since the slowdown in 2018.

(2) Looking ahead, the Japanese economy is expected to post negative growth for the first time in five quarters in the October-December quarter, due mainly to the consumption tax rate hike. Personal consumption dropped sharply due to a reactionary decline following the rush in demand as well as the effects of natural disasters such as typhoons. With regard to the GDP statistics, the shift in the burden of user fees from households to the government due to the provision of free early childhood education and nursery care is another factor pushing down personal consumption(\*).

However, a prolonged slump in consumption will likely be avoided given (i) the level of the sudden increase in demand was smaller than just prior to the previous tax increase in 2014, and (ii) inflation following the tax increase has been limited and real income has remained positive. Consumer spending is expected to return to a moderate uptrend as the reactionary decline due to the rush in demand and the impact of natural disasters come to an end.

\* The impact on GDP will be neutral as personal consumption decreases while government consumption increases.

(3) On the other hand, business fixed investment may slow down temporarily as a result of the reaction to the relatively high growth and other factors. However, capital investment is likely to remain on an upward trend, reflecting robust investment in information technology and research and development against the backdrop of labor shortages, the response to workstyle reforms and the use of new information

technologies. A recovery in the global semiconductor market and subsequent halt to the decline in exports will also have a positive effect on investment sentiment in the manufacturing sector.

(4) At a Cabinet meeting on December 5, the government decided to draw up an economic stimulus package worth 26 trillion yen. In this projection, we revised upward the growth rate for fiscal 2020, taking into account the effects of the economic stimulus measures of the government.

However, the growth rate increase is expected to be limited, given that (i) public works projects for economic measures include projects that had already been planned as the "Three-Year Emergency Response Plan for Disaster Prevention, Disaster Mitigation, and Building National Resilience" and (ii) the construction industry's manpower shortage could prolong the construction period for public works projects and increase budget carryover to the next fiscal year.

(5) Consequently, Japan's economy is forecast to return to a moderate recovery path from the beginning of 2020. With the growth rate expected to be around +1.0% for the FY2019-FY2021 period, moderate growth is anticipated to continue after overcoming the effects of the consumption tax rate hike.

### ◆ The Extent of Increase Year-on-year in the Core CPI Will Likely Widen Slightly

(6) In October 2019, core CPI growth slowed to +0.2% year-on-year mainly because the acceleration of the pace of decline in energy prices weighed, excluding the impact of the consumption tax rate hike and the provision of free education. As for future prospects, as the extent of decline in energy prices is predicted to narrow, the year-on-year increase rate in the core CPI will likely rise to around the mid-0% level.

Figure 8 Projections for GDP Growth and Main Indicators of Japan ( as of December 9, 2019 )

	(seasonally adjusted, annualised % changes from the previous quarter)											(% changes from the previous fiscal year)		
	CY2019		CY2020				CY2021				CY2022	FY2019	FY2020	FY2021
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Projection)	(Projection)	(Projection)
	(Actual)	(Projection)	(Projection)				(Projection)				(Projection)	(Projection)	(Projection)	(Projection)
Real GDP	1.8	▲ 3.7	0.9	2.3	2.0	1.0	1.2	0.5	0.5	0.7	0.7	0.9	1.0	0.8
Private Consumption Expenditure	2.2	▲ 6.9	2.0	2.4	0.0	1.2	1.0	0.8	0.8	0.7	0.7	0.4	0.4	0.8
Housing Investment	6.5	▲ 5.1	▲ 3.8	▲ 2.9	0.0	0.8	0.0	▲ 2.0	▲ 1.2	0.0	0.0	2.3	▲ 1.6	▲ 0.6
Business Fixed Investment	7.3	▲ 3.8	1.6	2.3	2.3	2.1	1.9	1.7	1.7	1.5	1.5	2.3	1.7	1.8
Private Inventories (percentage points contribution)	(▲ 0.7)	(▲ 0.1)	( 0.1)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	( 0.0)	(▲ 0.1)	(▲ 0.0)	( 0.0)
Government Consumption Expenditure	2.7	1.6	0.0	3.0	4.2	▲ 0.7	1.0	0.5	0.5	0.5	0.5	2.4	1.9	0.7
Public Investment	3.6	2.0	0.0	2.6	5.9	7.7	2.2	▲ 2.9	▲ 3.8	0.0	0.3	3.3	3.5	0.0
Net Exports (percentage points contribution)	(▲ 0.7)	( 0.8)	(▲ 0.5)	(▲ 0.1)	( 0.5)	(▲ 0.3)	( 0.0)	(▲ 0.1)	(▲ 0.1)	(▲ 0.0)	(▲ 0.1)	(▲ 0.3)	( 0.0)	(▲ 0.0)
Exports of Goods and Services	▲ 2.5	3.8	▲ 0.8	2.4	3.8	▲ 0.6	1.9	2.0	2.0	1.8	1.6	▲ 0.9	1.5	1.7
Imports of Goods and Services	1.3	▲ 1.0	2.0	2.8	0.8	1.0	1.7	2.4	2.4	1.9	1.9	0.8	1.4	1.9
(Ref.) Domestic Private Demand (percentage points contribution)	( 1.8)	(▲ 4.7)	( 1.4)	( 1.6)	( 0.4)	( 1.0)	( 0.9)	( 0.7)	( 0.7)	( 0.6)	( 0.6)	( 0.6)	( 0.4)	( 0.7)
(Ref.) Public Demand (percentage points contribution)	( 0.7)	( 0.4)	( 0.0)	( 0.8)	( 1.2)	( 0.2)	( 0.3)	(▲ 0.0)	(▲ 0.1)	( 0.1)	( 0.1)	( 0.6)	( 0.6)	( 0.1)

	(% changes from the same quarter of the previous year)											(% changes from the previous fiscal year)		
Nominal GDP	2.3	2.4	1.3	1.3	1.3	1.7	2.0	1.6	1.3	1.2	1.1	1.8	1.6	1.3
GDP deflator	0.6	1.7	1.1	1.0	1.0	0.2	0.3	0.5	0.5	0.5	0.5	1.0	0.6	0.5
Consumer Price Index (excluding fresh food)	0.5	0.6	0.8	0.7	0.9	0.6	0.6	0.8	0.8	0.8	0.9	0.7	0.7	0.8
(excluding fresh food, consumption tax, education free of charge)	0.5	0.3	0.4	0.4	0.6	0.7	0.7	0.8	0.8	0.8	0.9	0.5	0.6	0.8
Unemployment Rate (%)	2.3	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.1	2.1	2.1	2.3	2.2	2.1
Exchange Rates (JY/US\$)	107	109	109	109	109	109	108	108	108	108	107	109	109	108
Import Price of Crude Oil (US\$/barrel)	66	64	66	67	68	68	68	68	68	68	68	67	68	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.