Monthly Report of Prospects for Japan's Economy

July 2024

Macro Economic Research Center
Economics Department

The Japan Research Institute, Limited

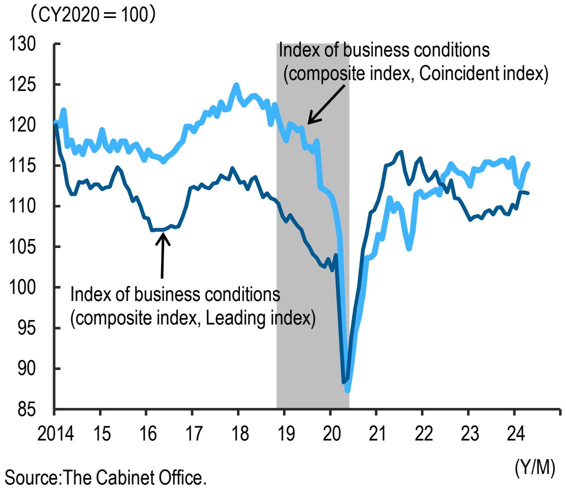
https://www.jri.co.jp/english/periodical/

This report is the revised English version of the June 2024 issue of the original Japanese version.

The General Situation – The economic recovery has stalled

Figure 1-1 Economic Activity

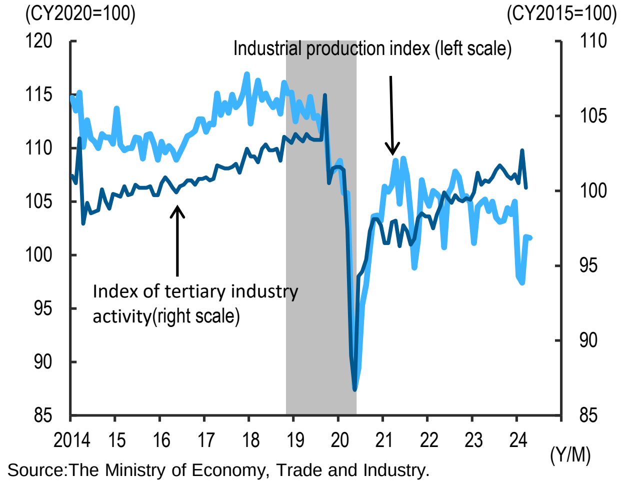
The Coincident index of business conditions are picking up.
The Leading index is also on the rise.



Source:The Cabinet Office.

Figure 1-2 The Corporate Sector

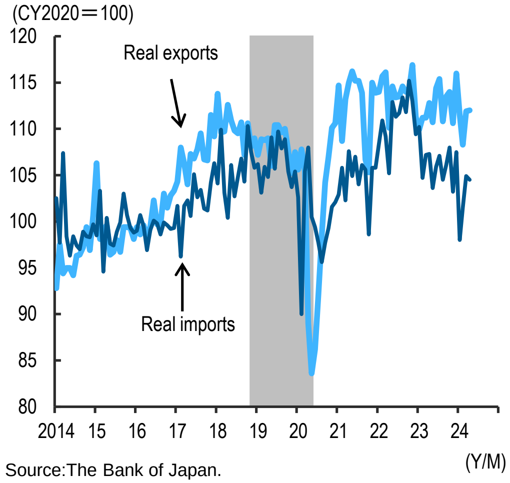
Industrial production is rebounding, centered on automobiles.
Economic activity in the service sector is on the recovery track.



Source:The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

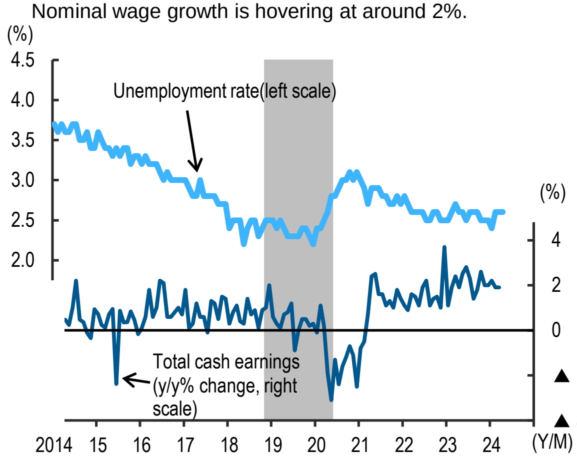
Goods exports are fluctuating.
The slump in energy-related imports has paused.



Source:The Bank of Japan.

Figure 1-4 Employment and Income

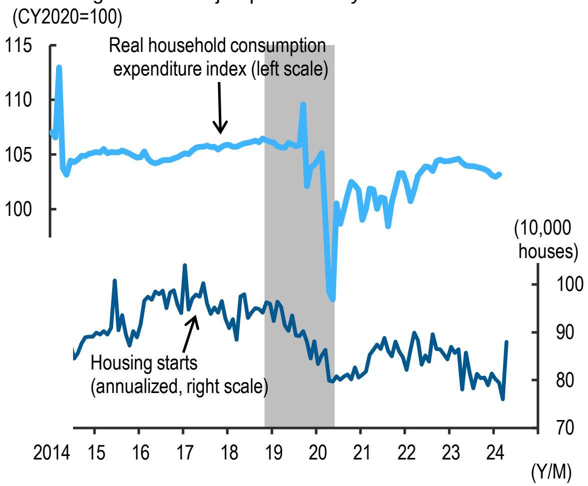
The unemployment rate is in the mid-2% range.
Nominal wage growth is hovering at around 2%.



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

Figure 1-5 The Household Sector

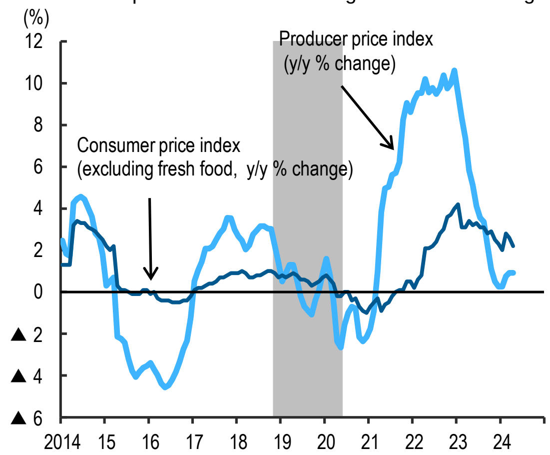
Consumption is showing signs of recovery.
Housing starts have jumped recently.



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

Figure 1-6 Prices

Corporate price inflation is accelerating slightly.
Consumer price inflation is hovering in the mid-2% range.



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

＊The shaded area indicates the recession phase.

Real GDP for January-March 2024 was revised slightly upward

◆ Capital investment was among GDP components revised upward

In the second QE (quarterly estimate) for January-March 2024, real GDP growth was put at -1.8% year over year (YoY) (-0.5% quarter over quarter (QoQ)), up from -2.0% in the first QE, so the margin of negative growth appears to have been a little smaller than initially estimated. Breaking this down, while personal consumption came in lower than in the first QE, both capital investment and other domestic demand were revised upward.

◆ Production activity in the manufacturing sector is recovering

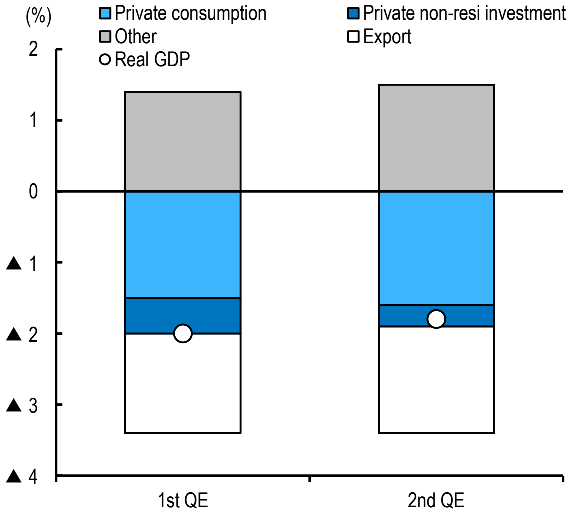
In April, the Industrial Production Index fell for the first time in two months, dropping 0.1% from the previous month. The backdrop was a temporary downturn in automobile output. However, vehicle sales and exports have been steadily recovering recently.

Looking ahead, output is expected to pick up as production/shipment of automobiles increasingly resumes. Production plans for May indicated increased output, particularly in the auto sector. Going into June, new cases of vehicle certification irregularities were discovered at five automakers, though not many models are affected, so the impact on overall production is expected to be limited.

◆ Coincident indicators are rising

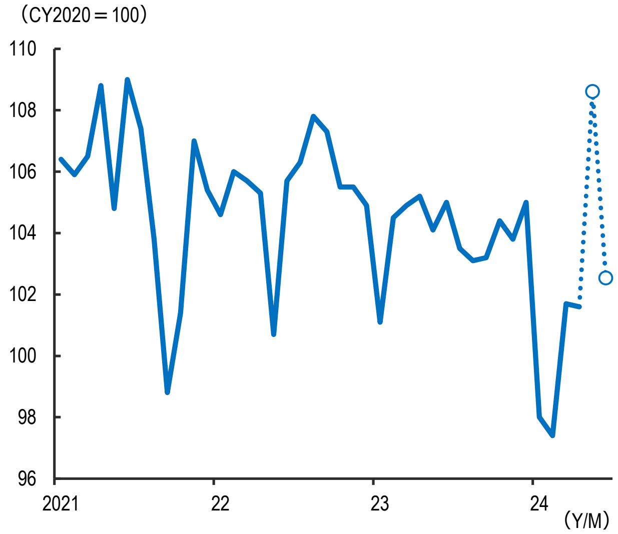
In the Indexes of Business Conditions for April, the coincident index (composite of coincident indicators) climbed by 1.0 points from the previous month for the second consecutive monthly increase. Breaking this down, although a drop in the effective job offer rate made a negative contribution, many of the other component indicators saw rises. In contrast, the leading index (composite) was largely unchanged, slipping by 0.1 points. While there was a lift from an increase in the total floor area of new housing construction started, the other components saw falls.

Figure 2-1 Real GDP Growth Rate for January-March 2024 <YoY annual growth rate>



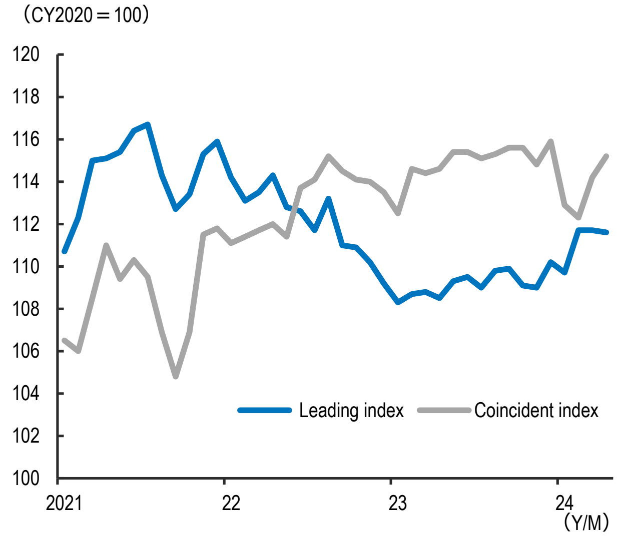
Source: The Cabinet Office

Figure 2-2 Index of Industrial Production <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.
.Note:Dotted lines are postponed based on the forecast index of manufacturing production (May and June).

Figure 2-3 Index of Business Conditions



Source: The Cabinet Office

Capital investment is firm, supported by strong corporate earnings

◆ Corporate earnings are at all-time highs

Corporate earnings are strong. Ordinary profit for the January-March quarter increased 6.7% QoQ, the first rise in three quarters. Ordinary profit as a percentage of net sales is 7.5%, its highest level ever. Although the impact of the suspension of production and shipments by some automobile manufacturers added downward pressure, earnings were boosted by an increase in dividends from overseas thanks to the depreciation of the yen and by higher profit margins due to price pass-through.

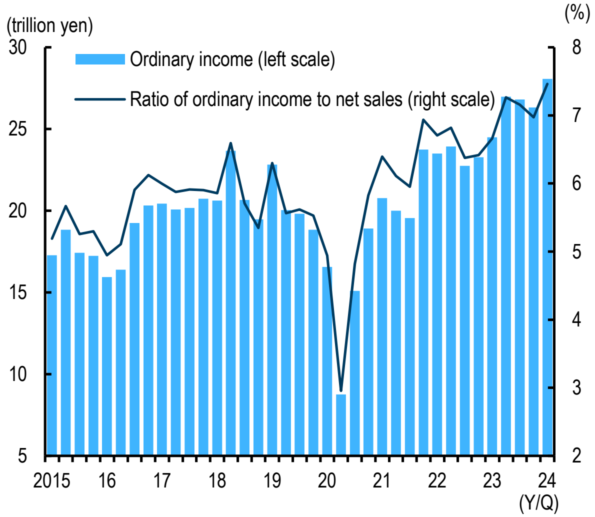
Corporate earnings are also expected to hold firm going forward. For the time being, the resumption of production and shipments by automakers will lift earnings, and later, a recovery in domestic demand will support further improvement in corporate performance.

◆ Appetite for capital investment among companies is strong

Capital investment is holding firm. Capital investment in January-March was down 4.2% QoQ, but remains at a high level overall. By industry, software investment fell back following a sharp rise in the previous quarter, but investment in other categories is trending upward. Appetite for capital investment among companies remains strong.

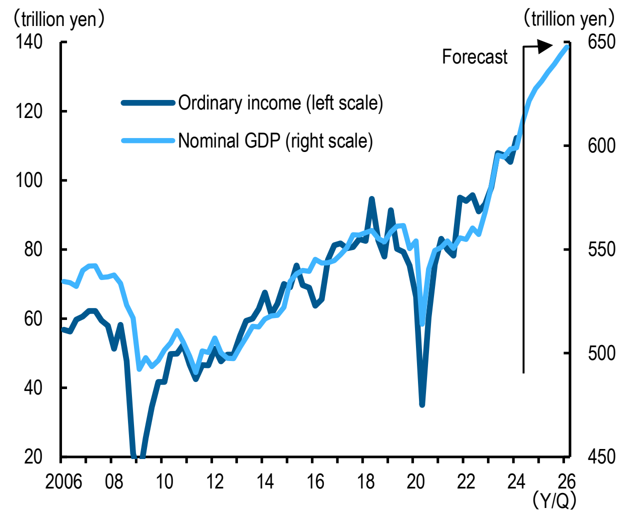
Capital investment is also expected to stay firm going forward. According to a survey conducted by the Bank of Japan (BOJ) on matters such as corporate behavior since the mid-1990s, more than 70% of companies say they are becoming more enthusiastic about capital investment than they have been in the past. Notably, large companies need to invest heavily in areas such as decarbonization and DX, while small and medium-sized enterprises are having to invest to deal with labor shortages. These needs are expected to drive capital investment into the future.

Figure 3-1 Ordinary Income and Ordinary Income to Net Sales <seasonally adjusted>



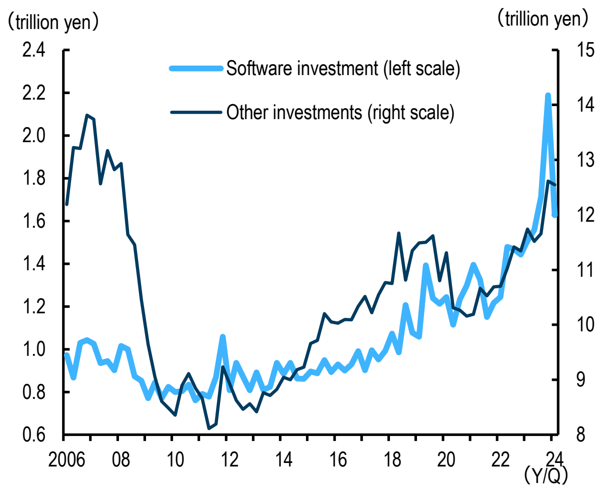
Source: The Japan Research Institute, Ltd. based on data of Ministry of Finance.

Figure 3-2 Current Income and Nominal GDP<annualized seasonally adjusted>



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

Figure 3-3 Capital Expenditures of Corporate Businesses <seasonally adjusted>



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

The employment/income situation is gradually improving

◆ The job market is tightening substantially

The employment environment is favorable. The unemployment rate for April remained low at 2.6%. The number of involuntary unemployed people has been decreasing recently, and is now down to its pre-COVID level. The number of workers has been gradually rising, mainly in the information and communications sector, where demand for personnel is strong, as well as in the medical and welfare fields.

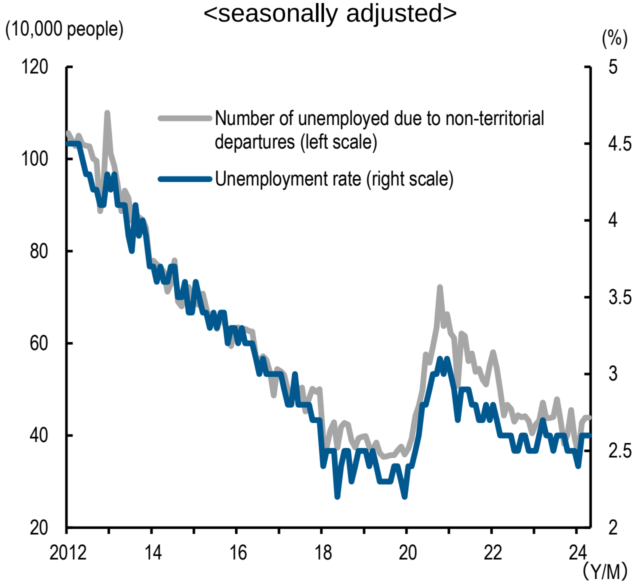
The job market is expected to become increasingly tight in the near term. While demand for workers is expected to increase as the economy recovers, the number of women and elderly people seeking employment is declining, so there is less room for additional expansion in the supply of labor.

◆ Real wage growth will turn positive in the summer

In April,the YoY increase in basic salaries of ordinary workers accelerated to 2.1%. Meanwhile, the hourly pay of part-time workers climbed 3.5% YoY, continuing to rise at a rapid clip. However, the average rise in workers' wages is still not keeping pace with consumer price inflation, with real wages falling 0.7% for the 25th consecutive month of negative growth.

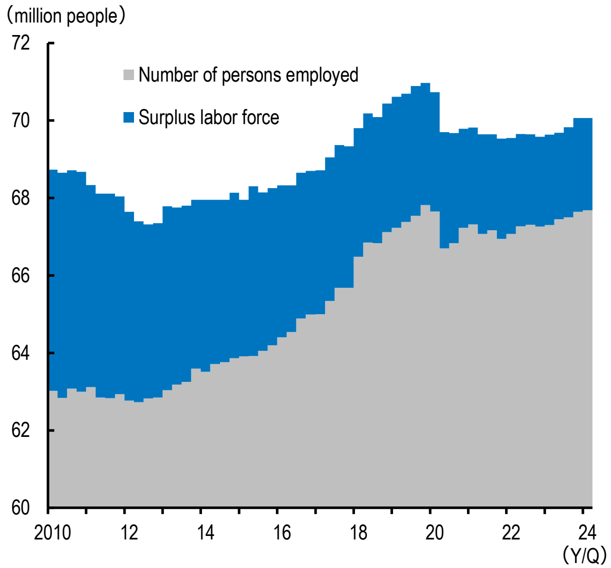
Going forward, wage growth rates are expected to increase. According to the sixth announcement by Rengo (Japan's largest union group) on the outcome of the shunto (annual pay negotiations), the companies surveyed are hiking wages by 5.08% (including regular salary increases) on average in 2024, marking the highest rise in 33 years. Background factors that can be pointed to include strong corporate profits, rising prices, and intensifying labor shortages. Over the summer, more companies will be implementing the wage hikes agreed during the shunto, and nominal wage growth rates are expected to quicken, with the basic salaries of ordinary workers as the main beneficiary. This should result in YoY real wage growth turning positive from the July-September quarter.

Figure 4-1 Indicators of Unemployment <seasonally adjusted>



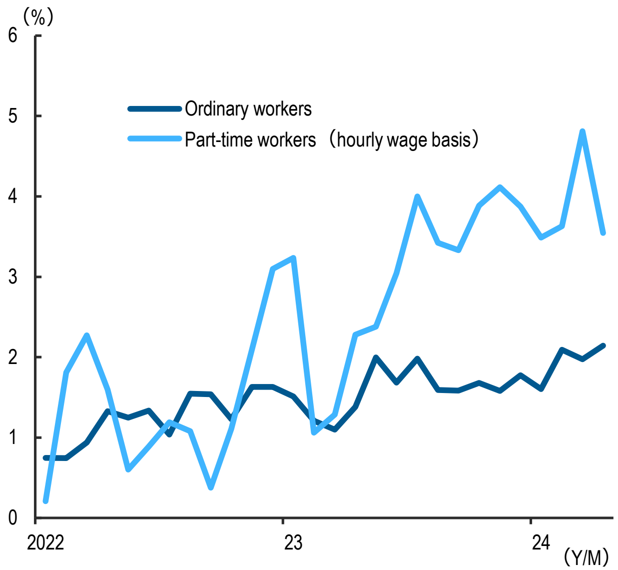
Source:The Japan Research Institute, Ltd. based on data of Ministry of Internal Affairs and Communications .

Figure 4-2 Potential Labor Force <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labour and Welfare, The Ministry of Internal Affairs and Communication.
Note:Consumer prices are composite, excluding imputed rent of owner-occupied houses.

Figure 4-3 Scheduled Cash Earnings <YoY>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labour and Welfare.
Note:Adjusted for data fault caused by the replacement of surveyed companies.

Price hikes are spreading across private-sector services

◆ Core inflation remains above 2%

In April, core inflation slowed from the previous month to 2.2%. With pass-through of higher raw material prices to sale prices pausing, the pace of rising prices of food and core goods has slowed. However, prices of services are still rising fairly rapidly. The cost of eating out and services for households are continuing to rise at a pace of just under 3%, and prices associated with educational and recreational activities are also increasing rapidly. Hotel charges and overseas package tours are becoming much more expensive, and while these are the current drivers of service price inflation, various other services are also becoming dearer. On the other hand, the Tokyo Metropolitan Government has basically eliminated high school tuition fees, which has pushed down education expenses, and rents and public service charges remain unchanged.

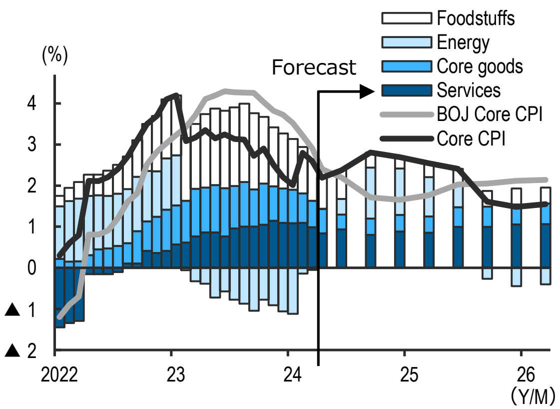
For the time being, the core CPI is expected to keep rising at an annual pace of above 2%. Moves to pass on higher wages to selling prices will become more widespread, so prices of services will continue to rise. In addition, energy price inflation is expected to increase going into the summer. And projections indicate that the government's reduction/termination of its measures to ease the pain of rising prices will push up the core CPI by as much as one percentage point.

◆The BOJ could raise interest rates again in October

At its April monetary policy meeting, the BOJ decided to keep its policy rate unchanged. Long-term interest rates also rose in May. One reason was that the weakening yen spurred the view that the BOJ would raise interest rates again to halt the depreciation. Another was the BOJ's decision to reduce its purchases of government bonds.

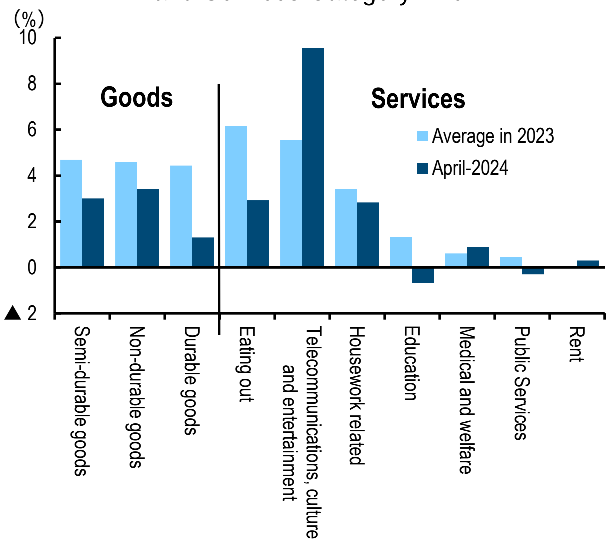
Looking ahead, the BOJ is expected to raise interest rates further in the autumn, once it confirms that wage and price increases are being sustained, and to keep steadily hiking rates from then on. Long-term interest rates look set to rise gradually due to policy rate hikes and a recovery in the domestic economy.

Figure 5-1 Consumer Price Index <YoY>



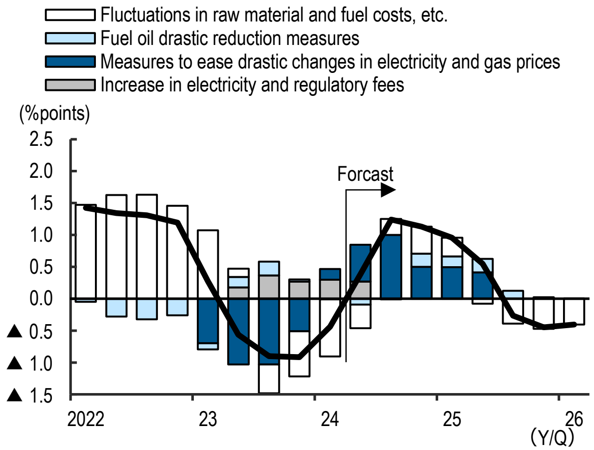
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.
Note:The forecast period is for the quarter.

Figure 5-2 Consumer Price Inflation by Goods and Services Category <YoY>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications,Trade and Industry.
Note:Assuming that the fuel price relaxation measures will end in June, and that the electricity and gas price relaxation measures will halve the discount in May and end in June.

Figure 5-3 Year-on-Year Contribution to Core CPI from Energy Prices



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications, Ministry of Economy, Trade and Industry.
Note:Electricity and gas price mitigation measures are assumed to be halved in May 2024 and terminated in June 2024, and fuel oil price mitigation measures are assumed to be phased out starting in June 2024.

Topic①: Inbound demand will continue to expand

◆ Inbound demand has topped the pre-COVID level

Inbound demand is brisk. In April, the number of foreign visitors to Japan continued to exceed the pre-COVID level. With the slump in the yen as a backdrop, travel spending per visitor has also risen, and consumption by inbound tourists now stands at over 1.5 times the figure prior to COVID.

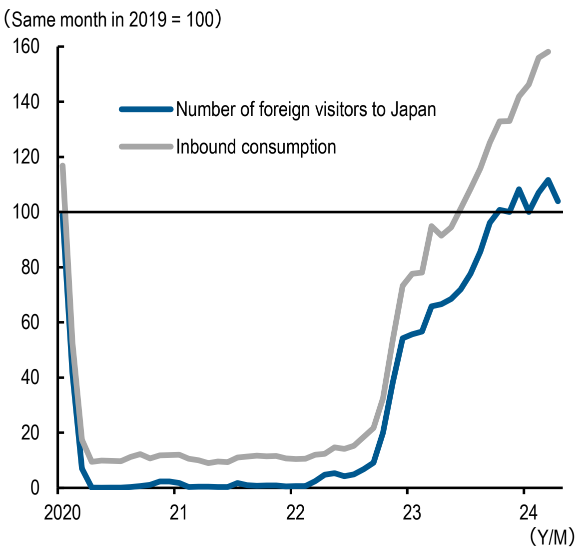
◆ Expansion expected to continue over the medium to long term

Going forward, inbound demand should continue to expand. In the near term, the return of Chinese tourists, the numbers of which had been slow to recover, will be the driving force, and over the medium to long term, inbound demand will be boosted by two factors:

The first will be increased demand for overseas travel in emerging countries, which are expected to see high rates of economic growth. In general, countries with higher income levels tend to have higher departure rates (i.e., the proportion of the population who travel abroad). There are many countries, particularly Asian countries that are close to Japan, whose income levels still have room to rise, so the potential demand for travel to Japan is large.

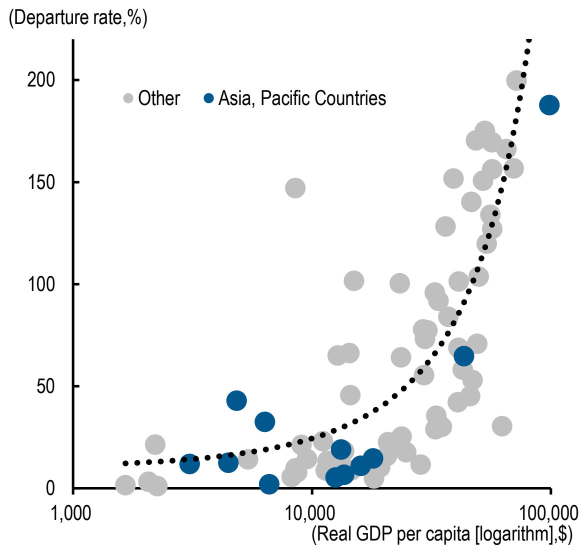
The second is support from the policy side. In recent years, the government has been taking steps to make it easier to visit Japan, such as offering visa-free travel or relaxing requirements for obtaining visas. The government's Tourism Nation Promotion Basic Plan, formulated in March 2023, also declares that visa-free travel and relaxed visa requirements will increasingly be offered going forward, and the expansion of such measures will provide a tailwind for boosting the number of visitors to Japan.

Figure 6-1 Number of Foreign Visitors to Japan



Source:The Japan Research Institute, Ltd. based on data of The Bank of Japan,Japan National Tourism Organization, Ministry of Finance.
Note:Inbound consumption is the amount of travel receipts in the balance of services.

Figure 6-2 Emigration Rate and Real GDP per Capita



Source:The Japan Research Institute, Ltd. based on data of UNWTO, World Bank.
Note:2019. Departure rate = number of departures (excluding day trips)/population. Real GDP per capita is in 2017 purchasing power parity dollars.

Figure 6-3 Post-Corona Tourist Visa Relaxation Trends

Target Countries	Mitigation measure
United Arab Emirates (2022/11/1～)	IC passport visa waiver
Qatar (2023/4/2～)	Visa waiver through IC passport pre-registration system
Mongolia (2023/6/30～)	①Relaxation of a multiple-entry visa for commercial purposes purposes, cultural and intellectuals ②Relaxation of a multiple-entry visa ③Relaxation of the number of numerical visas for high-income earners
Brazil (2023/9/30～)	IC passport visa waiver
Saudi Arabia (2023/12/4～)	Relaxation of a multiple-entry visa for high-income earners
Panama (2024/4/1～)	IC passport visa waiver

Source:The Japan Research Institute, Ltd. based on data of Ministry of Foreign Affairs.
Note:A multiple-entry visa is a visa that allows re-entry to Japan within a certain period of time.

Topic②: Downside pressure on housing investment from both the supply and demand sides

◆ Housing investment is sluggish due to high prices and rising interest rates

Real private residential investment (quarterly adjusted) is tepid. Real private residential investment (RPRI) in the January-March quarter was down 9.7% QoQ at an annualized rate, which was the second consecutive quarterly fall and put RPRI at its lowest level since the global financial crisis.

◆ The slump is likely to continue for the time being

This can be attributed to the three background factors detailed below. These trends are likely to continue, and the underlying weakness in housing investment is expected to persist.

The first is the difficulties faced by families in acquiring housing. Home prices are going up against the backdrop of soaring material prices and rising labor costs, and mortgage interest rates are also increasing. It is becoming harder for people to purchase a home, with housing nearly 20% less affordable than it was at the most recent peak. Mortgage rates will probably rise in the future due to factors such as interest rate hikes by the BOJ, and this is expected to suppress housing demand.

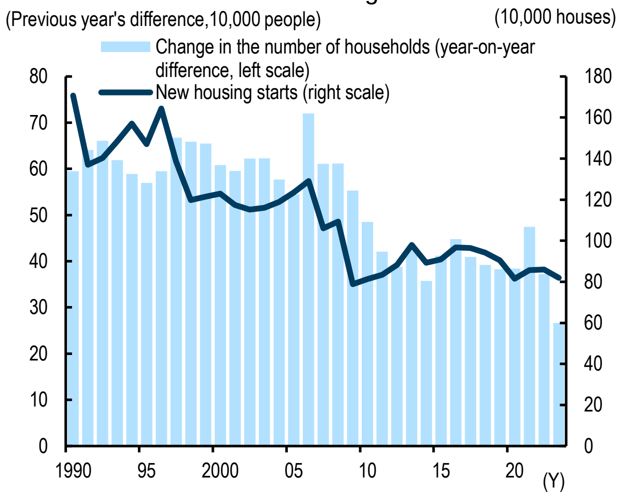
The second is a decrease in the number of households. The number of households in Japan has been increasing at a slower pace recently. According to estimates by the National Institute of Population and Social Security Research, the number of households is expected to peak in 2030 and then start to decline, and this will contribute to a fall in housing demand.

The third is growing propensity to purchase second-hand housing. Pre-owned homes as a proportion of housing sold increased to more than 40% in 2022. As the prices of new builds soar, used homes seem relatively cheap, and this impression among prospective home buyers is expected to grow going forward, increasing the demand for second-hand housing.

Figure 7-1 Real Private Housing Investment

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

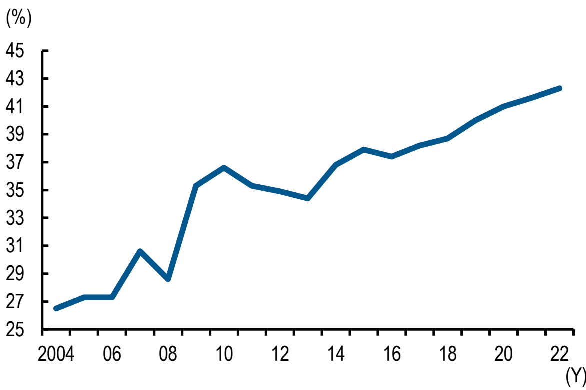
Figure 7-2 Change in Number of Households and New Housing Starts



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

Note:Households after 2013 include foreign households

Figure 7-3 Percentage of Existing Homes in Circulation



Source:The Japan Research Institute, Ltd. based on data of The Ministry of Land, Infrastructure, Transport and Tourism, Real Estate Marketing Management Association

Note:Existing Housing Distribution/(Existing Housing Distribution + New Housing Starts). Existing home sales volume is estimated by the Association of Real Estate Association.

The economy will gradually recover, driven by domestic demand

◆ Strong corporate earnings will serve as a launchpad

Looking ahead, the Japanese economy is expected to get back to a moderate recovery track, led by domestic demand. Bumper corporate profits will likely lead to a proactive stance on spending among firms, characterized by wage hikes that outpace inflation and an expansion in capital investment.

Thereafter, personal consumption is expected to gradually recover, supported by an improved employment/income environment and the wealth effect of rising stock prices. As the wage hikes agreed during the shunto are applied by more and more firms, real wage growth is forecast to enter positive territory in the summer. Wages for non-regular workers, which are less affected by shunto trends, are also expected to rise at a faster pace due to intensifying labor shortages and higher minimum wages.

Capital investment should 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 contribute to the expansion of capital investment.

◆ The growth rate for FY2024 will be +0.9%

Growth is projected to be +1.0% in FY2024 and +1.3% in FY2025. Due to the impact of the weak economy in the second half of FY2023, growth will slow somewhat in FY2024, but steady growth should return in FY2025. Although the potential growth rate is currently estimated to be around the 0.5% mark, it should rise to close to 1% in 2025 as labor productivity improves.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of June 10, 2024)

(%, changes from the previous fiscal year)

	CY2024				CY2025				CY2026	FY2023	FY2024	FY2025
	1～3	4～6	7～9	10～12	1～3	4～6	7～9	10～12	1～3			
	(Actual)	(Projection)								(Actual)	(Projection)	
Real GDP	▲ 1.8	3.6	2.2	1.4	1.2	1.2	1.2	1.1	1.2	1.2	1.0	1.3
Private Consumption Expenditure	▲ 2.9	3.2	2.5	1.7	1.2	0.9	0.8	0.8	0.8	▲ 0.6	0.7	1.2
Housing Investment	▲ 9.7	▲ 0.1	▲ 0.1	▲ 0.1	▲ 0.2	▲ 0.2	▲ 0.3	▲ 0.3	▲ 0.3	0.6	▲ 2.8	▲ 0.2
Business Fixed Investment	▲ 1.7	3.3	2.5	2.3	2.1	2.3	2.4	2.4	2.4	0.5	2.3	2.3
Private Inventories (percentage points contribution)	(1.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.2)	(0.0)	(▲ 0.0)
Government Consumption Expenditure	0.6	0.2	0.1	0.1	0.0	0.2	0.2	▲ 0.3	0.0	0.1	0.2	0.1
Public Investment	12.5	1.1	1.0	0.8	0.8	0.8	0.4	0.4	0.4	4.0	2.7	0.7
Net Exports (percentage points contribution)	(▲ 1.4)	(1.4)	(0.4)	(0.0)	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)	(1.5)	(0.2)	(0.2)
Exports of Goods and Services	▲ 19.0	14.5	6.0	2.2	2.7	2.9	3.1	3.4	3.5	3.0	2.4	3.1
Imports of Goods and Services	▲ 12.7	7.8	4.2	2.2	1.9	1.9	1.9	2.1	2.0	▲ 3.2	1.6	2.1

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

	CY2024 1～3	4～6	7～9	10～12	CY2025 1～3	4～6	7～9	10～12	CY2026 1～3	FY2023	FY2024	FY2025
Nominal GDP	3.3	2.7	4.8	4.9	5.6	3.7	2.9	2.5	2.7	5.2	4.5	2.9
GDP deflator	3.4	3.1	3.8	3.7	3.4	2.2	1.6	1.4	1.5	4.0	3.5	1.7
Consumer Price Index (excluding fresh food)	2.5	2.4	2.8	2.7	2.5	2.4	1.6	1.5	1.5	2.8	2.6	1.8
Unemployment Rate (%)	2.5	2.5	2.5	2.4	2.4	2.4	2.3	2.3	2.3	2.6	2.5	2.3
Exchange Rates (JY/US$)	148	155	151	148	145	143	141	139	136	145	150	140
Import Price of Crude Oil (US$/barrel)	83	88	88	83	82	80	78	77	75	86	84	78

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.