

Monthly Report of Prospects for Japan's Economy

August 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 July 2024 issue of the original Japanese version.

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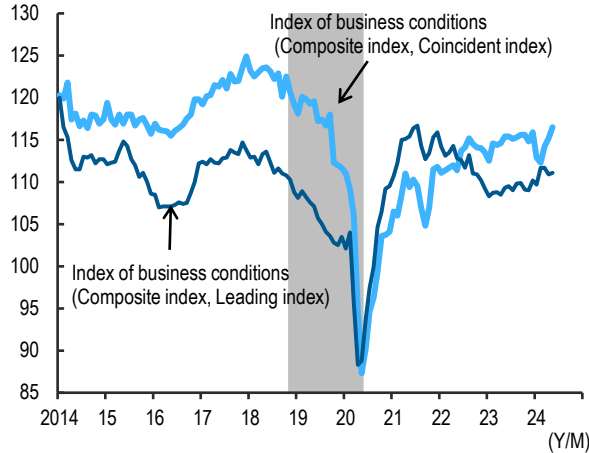
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The General Situation – The economic recovery has stalled

Figure 1-1 Economic Activity

Coincident economic indicators are improving.
Leading indicators are sluggish.

(CY2020=100)



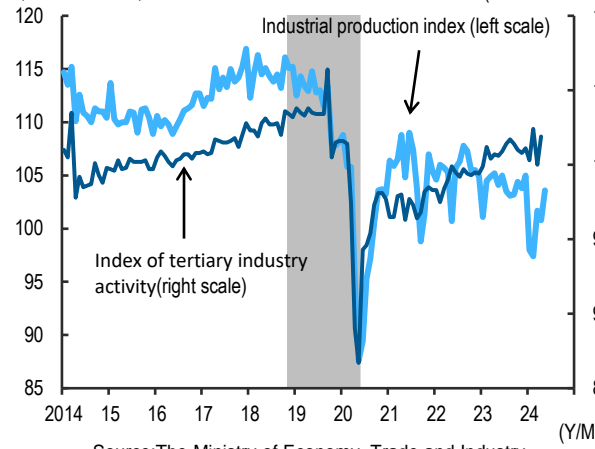
Source: The Cabinet office.

Figure 1-2 The Corporate Sector

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

(CY2020=100)

(CY2015=100)

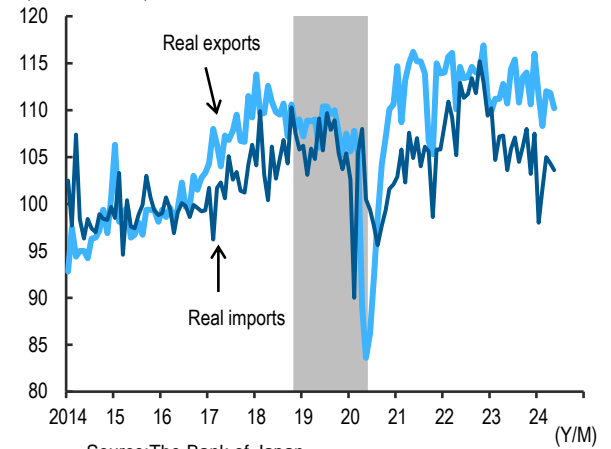


Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

Goods exports are fluctuating.
Imports are on a downward trend.

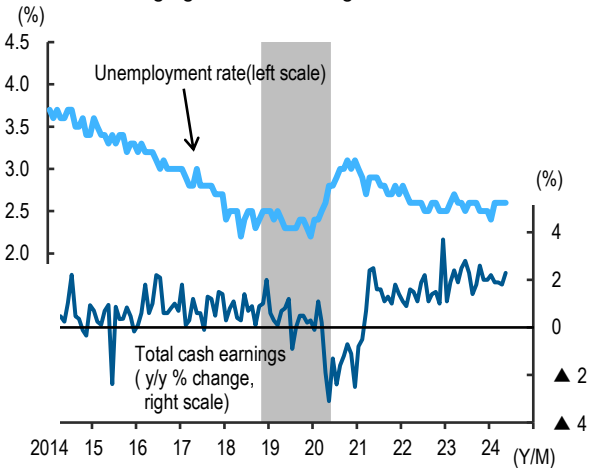
(CY2020=100)



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%.



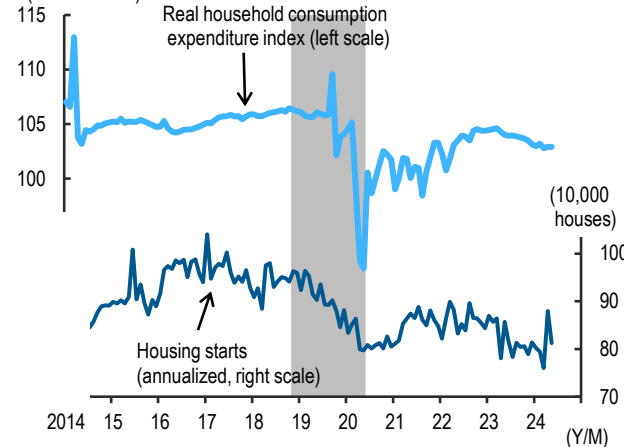
Source: The Ministry of Internal Affairs and Communications,
The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

Consumption is sluggish.
Housing starts have declined following a significant rise.

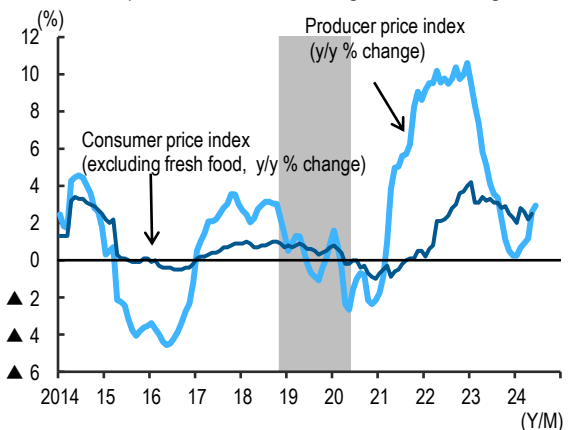
(CY2020=100)



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 again.
Consumer price inflation is hovering in the 2% range.



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 August 2024
The Japan Research Institute, Limited

Business confidence among companies is favorable overall

◆ GDP for January-March has been revised downward

In the revised second preliminary estimate for the January-March quarter, announced on July 1, real GDP growth was revised downward to -2.9% year over year (YoY) from -1.8% in the original second preliminary estimate, which was announced in June. By demand component, the contribution of public fixed capital formation was revised downward substantially, by 1.0 percentage points. This was because in the government's general construction statistics, which form the basis for GDP estimates, recent data for public works completed was retroactively revised downward.

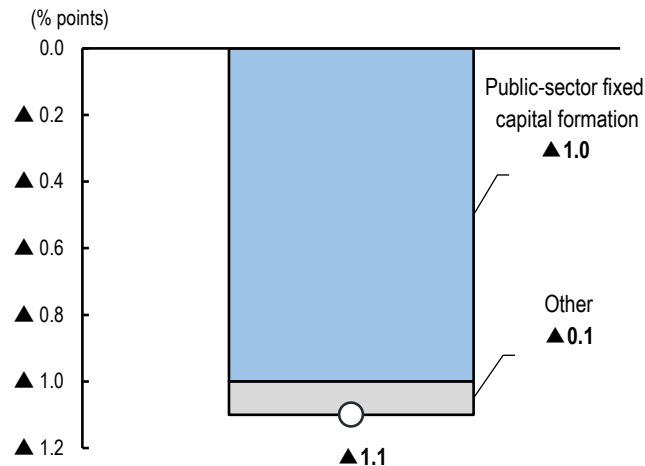
◆ Business confidence among companies is favorable overall

In the June Tankan survey from the Bank of Japan (BOJ), the diffusion index (DI) for business conditions for large manufacturing enterprises increased by two percentage points from the previous survey, rising for the first time in two quarters. In the automotive sector, the impact of the suspension of automobile

production/shipment by certain manufacturers due to performance test irregularities eased. Business confidence also improved as progress was made with price pass-through, particularly in the materials sector. The DI for large non-manufacturing enterprises fell slightly, by one percentage point, but remained high. Business confidence in consumption-related sectors, especially retail, weakened as a result of factors such as sluggish growth in personal consumption due to high prices.

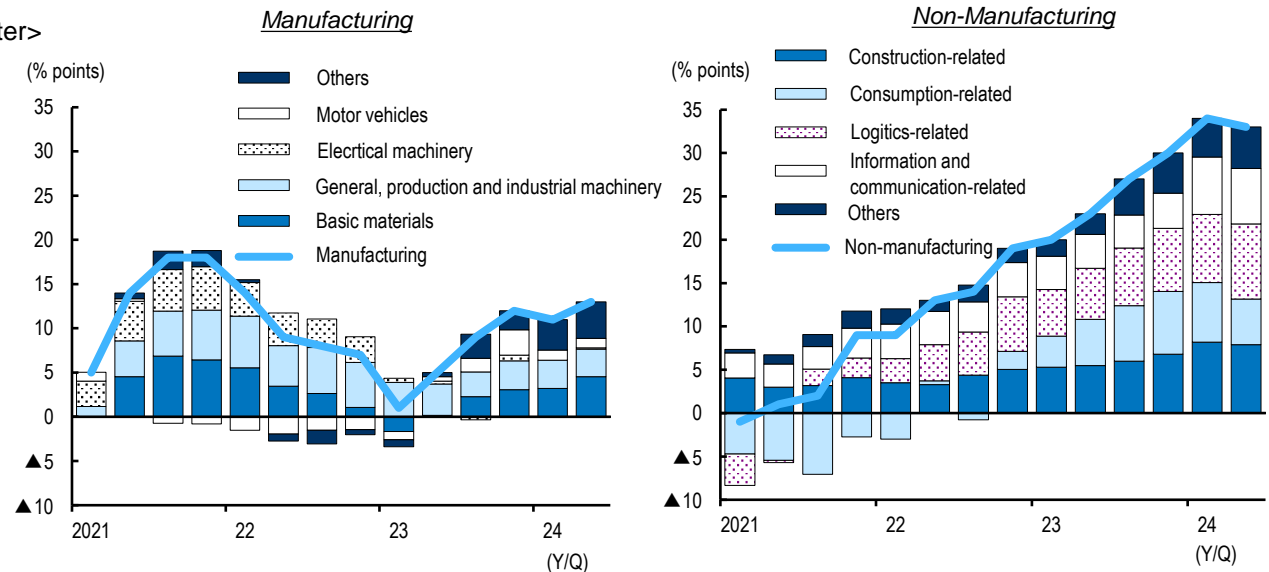
In the logistics sector, however, it improved against the backdrop of progress with price pass-through and an increase in online transactions. Business confidence is also favorable in the information and communications sector, in response to an increase in DX-related investment.

Figure 2-1 Change in Real GDP Growth in The January-March Period of 2024 Between the Second Preliminary Estimate and The Revised Estimate
<annualized contribution from the previous quarter>



Source: The Cabinet Office

Figure 2-2 DI for Business Conditions of Large Companies



Source: The Bank of Japan

Goods exports are bottoming out, providing a tailwind for capital investment

◆ Goods exports are expected to bottom out

Exports of goods remained weak. Recovery is slow across most product categories, though exports of transportation machinery have started to pick up due to the resumption of automobile production/shipments. In addition, capital and IT-related goods exports have now remained flat for a long time.

Looking ahead, exports of goods, especially capital goods and IT-related goods, are expected to increase moderately, reflecting the cyclical recovery in goods demand. According to the BOJ Tankan survey, the diffusion index (DI) for supply and demand conditions for key manufacturing sectors has already bottomed out, and overseas demand should gain momentum in the near term.

◆ Capital investment plans are firm

Capital investment is firm overall. Looking at capital investment by type, construction investment is declining due to factors such as higher construction costs, but software investment is still at a high level. Coming into 2024, there have also been signs of recovery in machinery investment, which had slumped temporarily.

Capital investment is also expected to hold firm going forward. According to the BOJ Tankan, planned capital investments by companies (including software but

excluding land) for FY2024 are 12.1% higher than in the previous year, indicating that firms intend to further expand investments, which had already increased significantly the previous year. In addition to companies' strong appetite for software investment in response to the worsening labor shortage and progress with digitalization, capital investment will also enjoy the tailwind of higher capacity investment due to a cyclical pick-up in overseas demand.

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

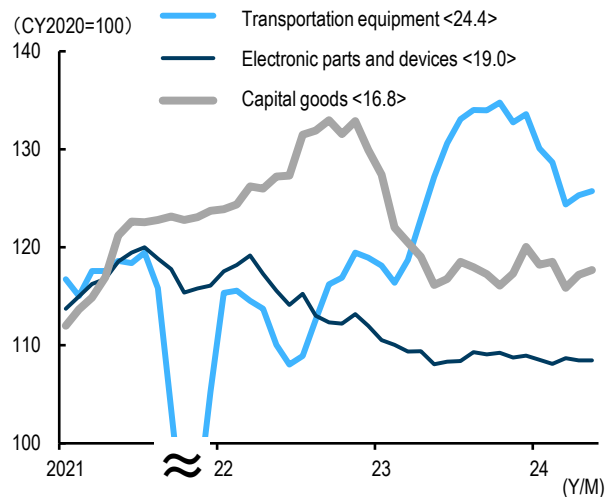


Figure 3-2 DI for Supply-Demand Judgment of Products Overseas

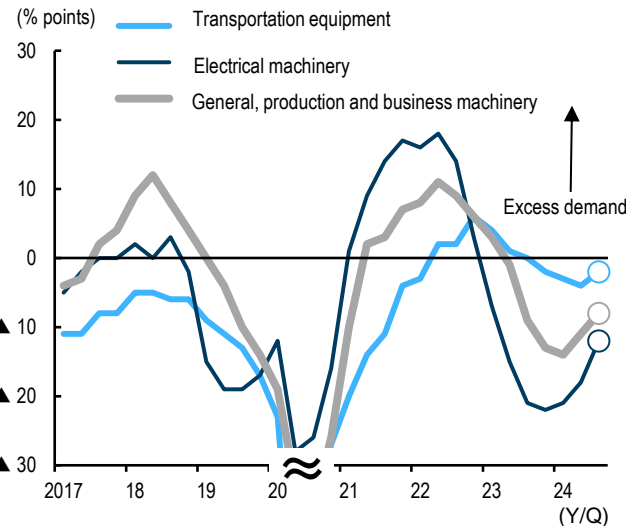
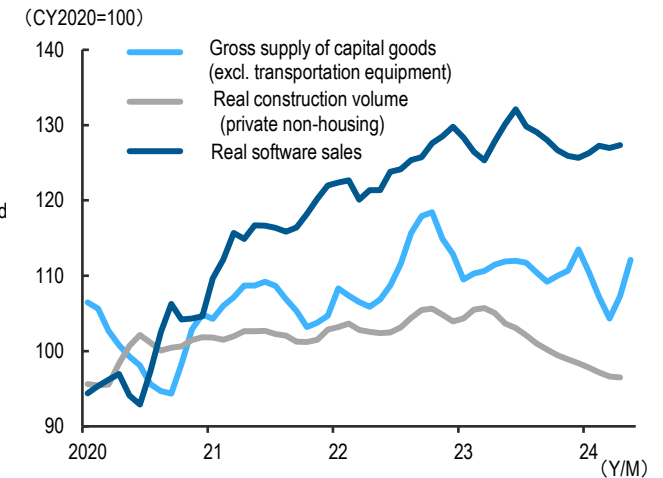


Figure 3-3 Private Capital Investment by Type <seasonally adjusted>



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 August 2024

The Japan Research Institute, Limited

Consumption is picking up thanks to an improved income environment and the wealth effect

◆ Households are becoming more cautious about consumption

Personal consumption is tepid. Consumption of durable goods is picking up against the backdrop of the resumption of automobile production/shipments. However, consumption of non-durable goods continues to decline gradually due to a growing desire to save money in response to high prices, and services consumption is also sluggish as rebound demand from the pandemic peters out.

Consumer confidence is worsening again. The Consumer Confidence Index, which had been improving since the beginning of this year, has stalled since early spring. As wage growth has not kept pace with rising prices for a long time, households have become cautious about consumption.

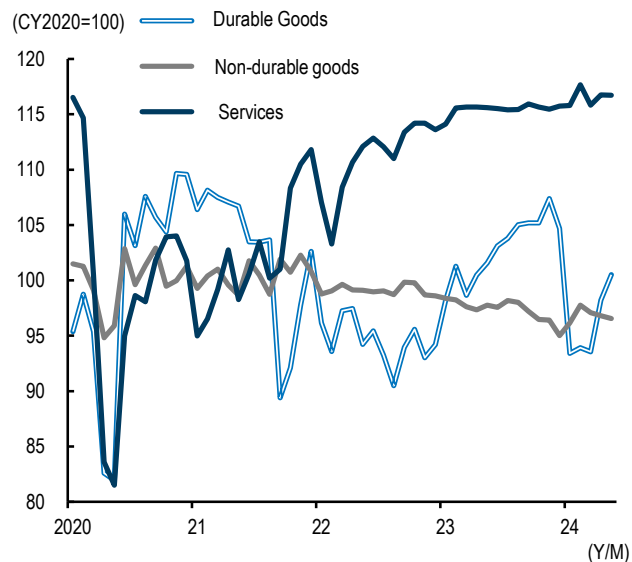
◆ Personal consumption will pick up

Personal consumption is expected to pick up soon. This can be attributed to the three background factors detailed below:

The first is an improvement in the environment for incomes. Because the generous wage increases agreed at this year's shunt have begun to be implemented by some companies, the basic salaries of both ordinary and part-time workers are rising steadily. As wage hikes spread, YoY real wage growth is expected to stay positive.

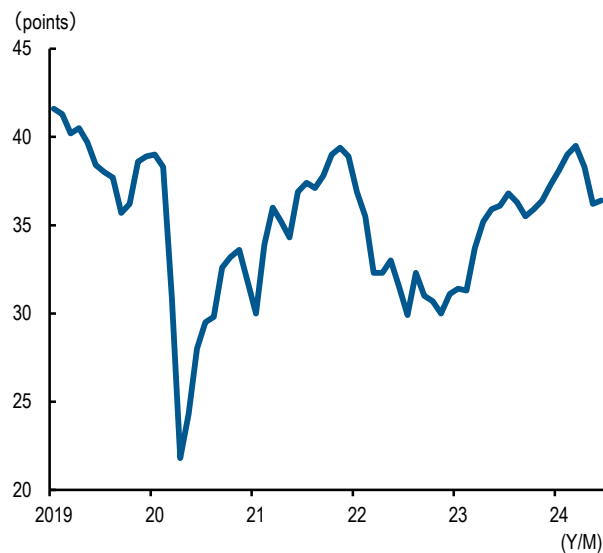
The second is the wealth effect of high stock prices. As a result of rising stock prices, financial assets such as shares and mutual funds held by households have been accumulating unrealized gains, increasing in value by nearly 160 trillion yen compared to before the pandemic. Personal consumption will therefore be given a boost as households earn more from their assets and their confidence improves.

Figure 4-1 Consumption Activity Index
<seasonally adjusted>



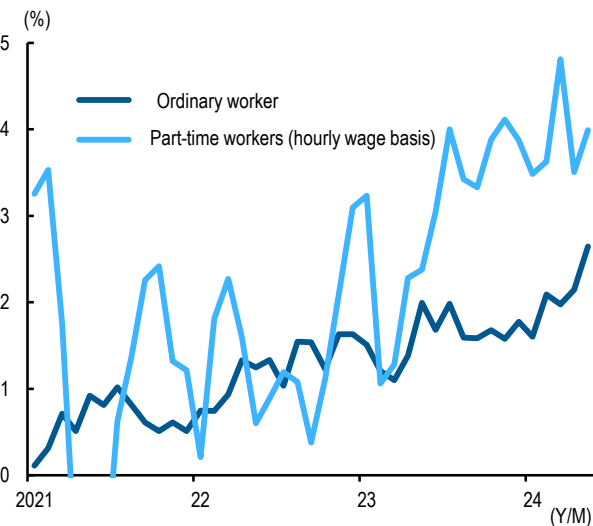
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.

Figure 4-2 Consumer Attitude Index
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.
Note: Households with two or more persons.

Figure 4-3 Basic Salary<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

◆ The government's scaling back of its measures to ease the pain of inflation is pushing up prices

In May, core consumer price inflation accelerated from the previous month to 2.5%. By CPI component, prices of food and core goods rose at a slower pace as imported inflationary pressures abated. Service price increases also slowed. As background factors, it can be pointed out that a pause is occurring in the rapid ascent of prices related to travel, and in sectors such as eating out, cost pressures from ingredients have eased. On the other hand, energy prices have risen since the government cut subsidies for electricity and gas bills in May.

For the time being, the core CPI is expected to keep rising at an annual pace of above 2%. Furthermore, persistently high crude oil prices and the government's scaling back of its measures to ease the pain of inflation will act to push up energy prices. As for the underlying trend, it is expected that services-led inflationary pressures will intensify as wage hikes are increasingly passed on to sale prices. In sectors such as lodging, food/beverage service, and retail, where personnel expenses account for a high proportion of intermediate inputs, price increases will

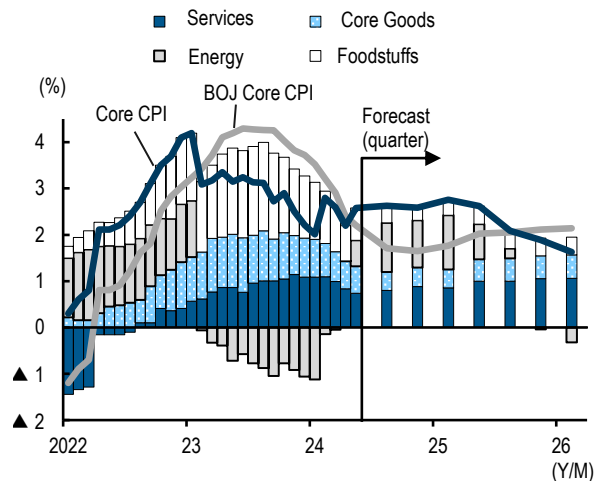
likely be sustained.

◆ The BOJ could raise interest rates again in October

At its June monetary policy meeting, the BOJ kept its policy rate unchanged, and also decided to reduce the amounts of its regular purchases of government bonds. Long-term interest rates rose toward the end of June due to such factors as expectations that the BOJ would lift interest rates at an early stage in response to the depreciation of the yen.

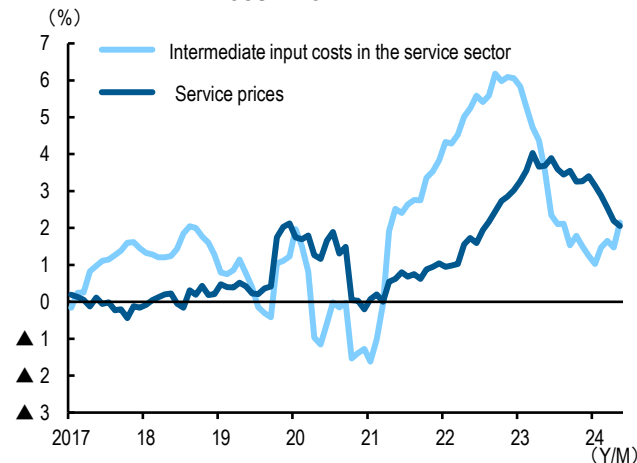
Looking ahead, the BOJ is expected to raise interest rates further in the autumn, once it confirms that wage and price increases are being sustained, and to keep steadily hiking rates from then on. Long-term interest rates look set to rise gradually due to policy rate hikes and a recovery in the domestic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

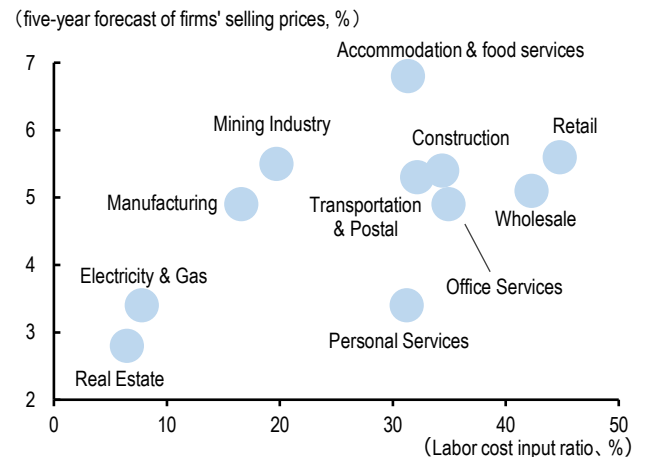
Figure 5-2 Service Input Costs and Service Prices <YoY>



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

Note: Service prices are general services excluding rent, but excluding communication charges (cell phones) and accommodation charges from April 2020. Intermediate input costs are calculated as the weighted average of firm prices and prices of services to firms for each of the intermediate input goods and services sectors (broad categories) in the Input-Output table (the 2020 standard).

Figure 5-3 Labor Input Cost Ratio and Firms' Sales Price Forecasts



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

Note: Labor cost input ratio = employment income / domestic output, produced based on the Input-Output table. Sales price forecasts are from the Bank of Japan's Tankan survey in June 2024.

Topic①: The yen's weakness is nipping the virtuous cycle in the bud

◆ The depreciation of the yen is creating downward pressure on profits in the non-manufacturing sector and at small and medium-sized enterprises (SMEs)

The adverse impact on earnings of the weak yen is being especially felt in the non-manufacturing sector and at SMEs. In the case of the non-manufacturing sector and SMEs, the share of imports in purchases far exceeds the share of exports in sales, so when the yen is losing value, they are subject to immense upward cost pressures. According to estimates, a 10% depreciation of the yen increases profits by about 8% for large manufacturing enterprises, but for the non-manufacturing sector and SMEs, it cuts profits by around 2%.

◆ There are fears of downward pressure on wages mounting due to profit deterioration

If profits decline in this way because of the yen's depreciation, it will pour cold water on the motivation of companies to raise wages, which poses the risk of

obstructing the establishment of a virtuous cycle for Japan's economy. If firms are unable to fully absorb cost increases caused by the weakening of the yen through price pass-through or by improving productivity, they may try to deflect the downward pressure on profits by curtailing personnel expenses. Estimating the impact of changes in earnings on wages, a 10% depreciation of the yen would push up wages at large manufacturing enterprises by nearly 6%, while wages at non-manufacturing mid-tier enterprises and SMEs would be pushed down by about 2%.

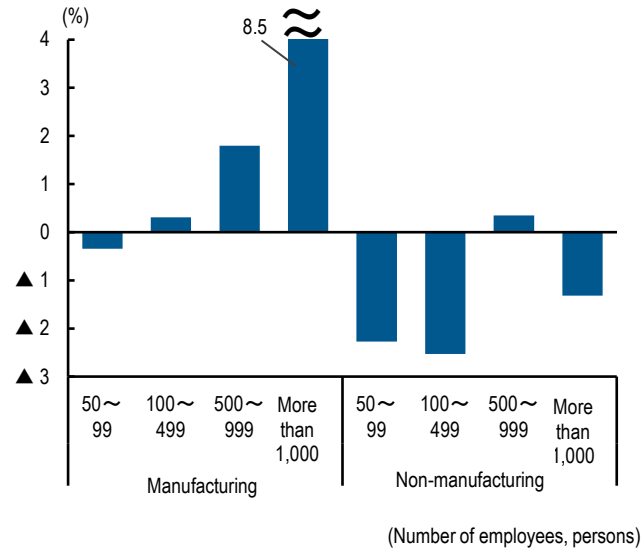
Looking at the economy as a whole, if this were to occur, downward pressure on wages would mount. While wages at large manufacturing enterprises have risen significantly in response to the weak yen, less than 10% of all workers are employed by such companies. More than 60% of them work for non-manufacturing mid-tier enterprises or SMEs, which are under pressure to reduce wages due to the weak yen, so the impact felt at these latter companies will be substantial.

Figure 6-1 Ration of Exports and Imports<FY2022>



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

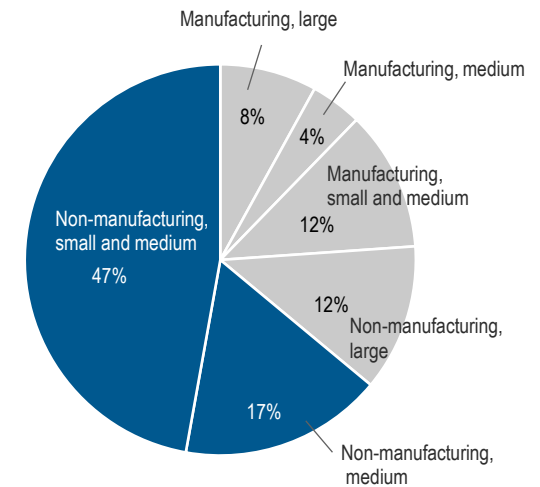
Figure 6-2 Impact of a 10% Depreciation of The Yen on Earning



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

Note: Impact on gross profit if exports as a percentage of sales and imports as a percentage of purchases each increase by 10%.

Figure 6-3 Composition of Employees <2023>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.
 Note: Small and medium-sized companies are those with capital of 100 to 100 million yen, medium-sized companies are those with capital of 100 to 1 billion yen, and large companies are those with capital of 1 billion yen or more.

Monthly Report of Prospects for Japan's Economy August 2024
 The Japan Research Institute, Limited

Topic②: Large enterprises are continuing to curtail the wages of older workers

◆ At large enterprises, wage growth for middle-aged and elderly workers is sluggish

According to the Ministry of Health, Labour and Welfare's Monthly Labour Survey, basic salaries at large enterprises with 500 or more regular employees are growing more slowly than at SMEs. This is chiefly because SMEs are feeling more of the pinch from the labor shortage, and because large companies with big headcounts are curtailing the wages of older workers. In terms of age bracket, wages for younger workers are being substantially increased regardless of the size of the firm, but for older workers, wage growth is generally slower the larger the size of the enterprise.

◆ Employment practices, job switching, and labor market conditions are background factors

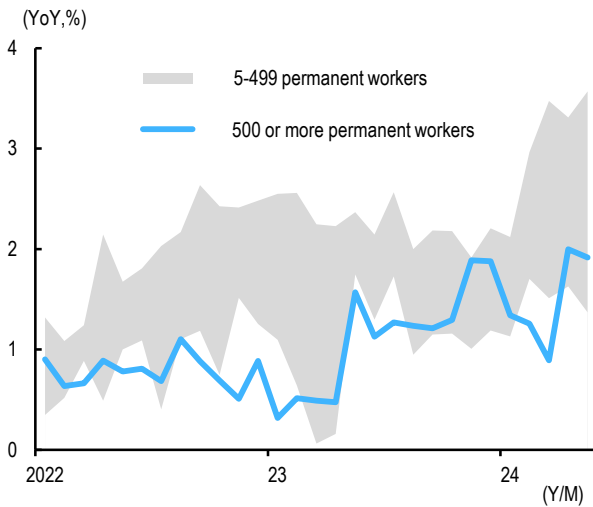
There are three background factors behind the curtailment of wages for older workers at large enterprises: The first is that ongoing adjustments are being made to

a traditional Japanese employment practice, the "deferred wage system." Aimed at securing workers for the long term, this practice involves setting wages for young people lower than their actual productivity would imply, while setting wages for older people at high levels. Although this wage-setting approach is gradually being revised, it seems that there is still room for adjustment of the wages of older workers at large companies.

The second is that not many older workers at large enterprises switch jobs (i.e., move to different companies), so the likelihood of such companies suffering an outflow of personnel is relatively low. At large companies, generous treatment of workers in the form of wages, corporate pensions, and fringe benefits serves to deter employees from quitting for alternative pastures.

The third is that tightness in the job market for older workers is relatively low. The number of people in the labor force aged 45-54 has increased by three million since 2010, contrasting with a significant decline in the number of workers in their 20-30s.

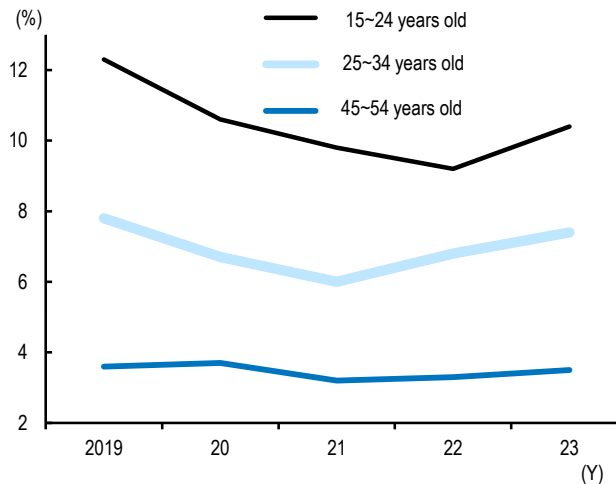
Figure 7-1 Prescribed Salaries by Size of Firm



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

Note: General workers.

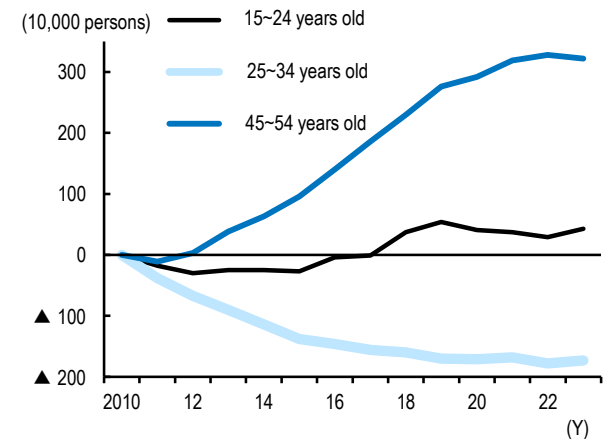
Figure 7-2 Ratio of Workers Changing Jobs <by age group>



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

Note: Percentages are calculated by dividing the number of workers who wish to change jobs, etc., by the number of workers.

Figure 7-3 Labor Force Participation by Age Group <difference from 2010>



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

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. Specifically, as the wage hikes agreed during the shunto, which were at high levels, are applied by more and more firms, real wage growth is forecast to enter positive territory. 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 provide a boost to capital investment.

◆ The growth rate for FY2024 will be +0.7%

Growth is projected to be +0.7% in FY2024 and +1.2% in FY2025. Due to the impact of the weak economy in the second half of FY2023, growth will slow somewhat in FY2024, but it is expected to return to the 1% range 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 July 12, 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)								(Actual)	(Projection)	
Real GDP	▲ 2.9	3.5	2.2	1.3	1.2	1.2	1.2	1.1	1.2	1.0	0.7	1.2
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	▲ 10.9	▲ 0.1	▲ 0.1	▲ 0.1	▲ 0.2	▲ 0.2	▲ 0.3	▲ 0.3	▲ 0.3	0.3	▲ 3.2	▲ 0.2
Business Fixed Investment	▲ 1.6	3.3	2.5	2.3	2.1	2.3	2.4	2.4	2.4	0.4	2.4	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	▲ 7.3	▲ 0.7	▲ 0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.8	▲ 3.1	0.2
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)		
	2023	2024	2024	2024	2025	2025	2025	2025	2025	2023	2024	2025
Nominal GDP	2.6	2.3	4.4	4.5	5.6	3.7	2.8	2.5	2.7	5.0	4.2	2.9
GDP deflator	3.4	3.2	3.8	3.8	3.4	2.2	1.6	1.3	1.5	4.0	3.5	1.7
Consumer Price Index (excluding fresh food)	2.5	2.5	2.6	2.6	2.8	2.6	2.1	1.9	1.6	2.8	2.6	2.1
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	156	155	151	148	146	144	142	139	145	152	143
Import Price of Crude Oil (US\$/barrel)	83	87	87	85	84	82	80	79	77	86	85	80

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.