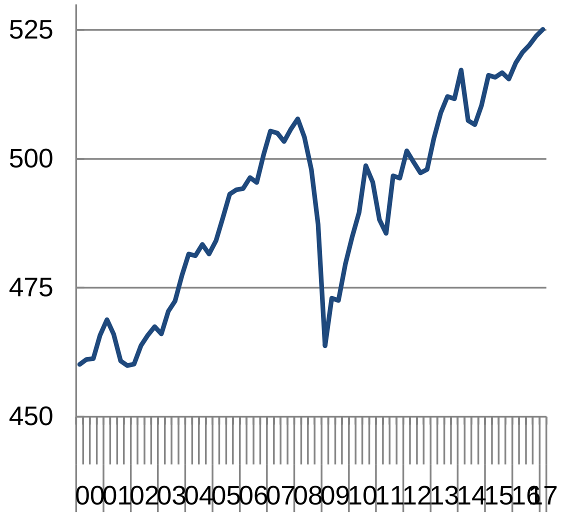
MGSSI Japan Economic Quarterly — June 2017

Global Economic & Political Studies Division
Mitsui Global Strategic Studies Institute

Economic Recovery Continues

Real Gross Domestic Product

at 2011 Price, Annualized, Trillion Yen



Source: CAO

Real GDP in the first quarter of 2017 rose by 0.3% (1.0% annualized) from the previous quarter, maintaining positive growth for five consecutive quarters and reaching all-time highs.

Exports of goods and services saw a quarter-over-quarter growth of 2.1%, continuing to serve as a driving force of growth. By region, the volume of exports to NIEs and China, which posted significant growth in the previous quarter, again increased in the first quarter of 2017, seeing a quarter-over-quarter growth of 3.3% and 1.9%, respectively. By item, exports of digital-related products such as semiconductors and their production equipment continued a high quarter-over-quarter increase of 9.7%, while exports of general machinery such as engines (excluding for automobiles) and construction machines grew by 5.7% from the previous quarter.

Meanwhile, imports of goods and services rose by 1.4% from the previous quarter. The import volumes of clothes and shoes, telecommunication devices such as smartphones, and electric home appliances appear to have increased. Net exports (exports minus imports) worked to boost real GDP growth by 0.1% point.

Private non-residential fixed investment increased by 0.6% from the previous quarter. According to the Financial Statements Statistics of Corporations, nominal non-residential fixed investment by the non-manufacturing industry (including software investment and excluding banking and insurance businesses) recorded a quarter-over-quarter growth of 3.2%, marking a third consecutive quarterly increase. The construction sector continued to post double-digit growth following the previous quarter, while the real estate sector also grew for two consecutive quarters. The retail sector and the information and communications sector, whose amount of investment are usually relatively large, also contributed to the growth. Meanwhile, nominal non-residential fixed investment by the manufacturing industry saw a quarter-over-quarter decline of 4.3%, led by the general machinery sector, while it has been on a moderate recovery since 2014.

Private residential investment rose by 0.3% from the previous

Real Gross Domestic Product (GDP)

at 2011 Price, Calendar year

	2016	2016		2017
		7-9	10-12	1-3
	y/y%	q/q%	q/q%	q/q%
Real Gross Domestic Product	1.0%	0.3%	0.3%	0.3%
Private Consumption	0.4%	0.4%	0.0%	0.3%
Private Housing Investments	5.6%	2.6%	0.2%	0.3%
Private Non-Resi. Fixed Investments	1.3%	-0.2%	1.9%	0.6%
Public Investments	-3.0%	-1.3%	-3.0%	-0.1%
Government Consumption	1.3%	0.2%	0.0%	-0.0%
Exports of Goods & Services	1.2%	1.9%	3.4%	2.1%
(less) Imports of Goods & Services	-2.3%	-0.2%	1.3%	1.4%

Source: CAO

* All Subsequent references to GDP demand items are in real terms unless otherwise indicated.

quarter. In addition, the number of new housing starts increased by 2.3% from the previous quarter, the first positive growth in three quarters thanks to the recovery in rental housing starts. While private residential investment grew for five consecutive quarters, it likely will decline in coming months due to a fall in the number of new housing starts in the latter half of 2016.

Private consumption rose by 0.3% from the previous quarter. Spending on non-durable goods declined for four quarters in a row, while spending on durable and semi-durable goods increased, contributed by services, cellphones and clothes, etc. Spending on durable goods rose for six consecutive quarters, reaching a record high excluding the first quarter of 2014 just before the consumption tax hike.

While public investment remained almost unchanged, it posted a third consecutive quarterly decline. However, the contract amount for public works projects, which reflects the trends of order placement, turned around in the first quarter of 2017 and grew by 14.3% from the previous quarter after seeing a decline in the latter half of 2016. In the supplementary budget passed in October 2016, the central government increased investment-related spending by 2 trillion yen, which apparently led to the turnaround. Given this, public investment is highly likely to increase in the short term. However, in the fiscal 2017 budget, 9.1 trillion yen is allocated for investment-related spending, which is still at a high level but smaller than the 10.5 trillion yen allocated in the fiscal 2016 (including the supplementary budget). It will be difficult to expect high growth in public investment going forward.

Moderate Growth Is Expected to Continue

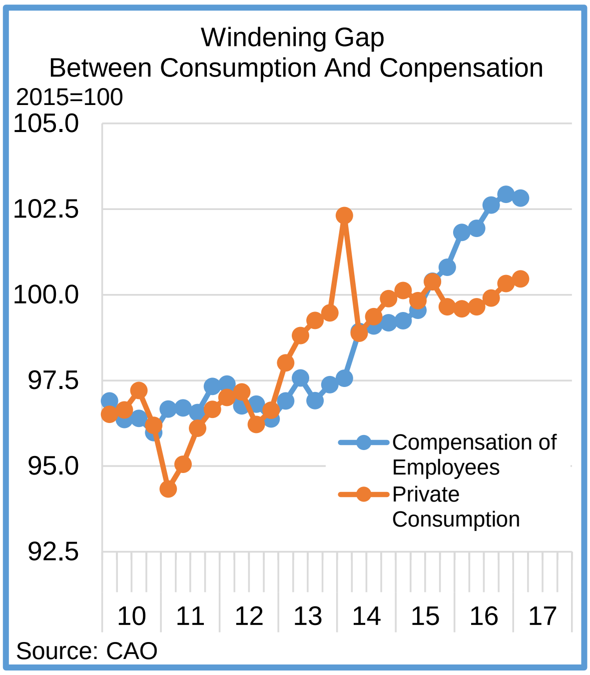
Spurred by the growth in exports, industrial production activities became active. The Industrial Production Index in the first quarter of 2017 grew by 0.2% from the previous quarter. To date, the index had posted a quarter-over-quarter growth of the late 1 percent range for two consecutive quarters. In addition, it grew by 3.8% in April compared with the average in the first quarter of 2017, and its momentum appears to continue to be strong. The growth rate for the electronic parts and devices industry was in the range of 5% for two consecutive quarters. The transport equipment industry saw a decline in the first quarter of 2017, but in April, it posted an increase of 11.6% compared with the average in the first quarter of 2017. On the other hand, the information and communication electronics equipment industry as well as petroleum and coal products industry posted a decline.

For the future, exports are expected to continue to grow. The world's real GDP has been continuing a quarter-over-quarter growth of around 3% annualized (based on market rates) since the second quarter of 2016. According to statistics from the Netherlands Bureau for Economic Policy Analysis (CPB), the world's trade volume in the first quarter of 2017 grew by 1.4% from the previous quarter, maintaining relatively high growth for two consecutive quarters. The recovery in trade is a phenomenon not only in Japan but also around the world. Growth in exports is expected to give a boost to industrial production activities and further facilitate non-residential fixed investment. Profits of Japanese corporations are at a record high level, which would also encourage investment.

According to an ESP Forecast survey, the average of forecasts of private economists on real GDP growth, real GDP will continue a quarter-over-quarter growth of more than 0.25% (1% annualized), and see a year-on-year growth of 1.4% in 2017 and 1.2% in 2018. The Japanese economy is likely to continue to grow moderately.

Sluggish Consumption

"Sluggish consumption" is frequently cited in commentaries on the Japanese economy. In real term, private consumption rose for five quarters in a row, while it remains below the level in the second quarter of 2013. At a glance, the cause for the stagnant consumption may be identified as the only 0.4% growth of the wage per worker in fiscal 2016 compared with the previous fiscal year. Ordinary profits of Japanese corporations rose 7.2% from the previous fiscal



year, while the unemployment rate fell to 2.8% in March 2017. Given these facts, it is difficult not to feel that wage growth is relatively slow.

However, since the number of workers increased, compensation of employees, which corresponds to the total amount of wages paid by corporations, increased by 1.9% in fiscal 2016 compared to the previous fiscal year, the highest growth since fiscal 1997. On the other hand, nominal private consumption grew by only 0.3% from the previous fiscal year. In other words, the gap between compensation of employees and private consumption has been widening.

More interestingly, in a comparison between real compensations of employees in Japan, the U.S, and the Euro zone, there has been no major difference among them since around 2015. Japan's real compensation of employees in the first quarter of 2017 grew by 3.3% compared to the average in 2015, which is comparable to 3.5% in the US and 3.3% in the Euro zone. Given this, it seems to be impossible to cite low wage growth as the cause for sluggish consumption in Japan, though a decline in prices, instead of increase of the number of workers or of the wage per worker, should be noted as a major factor of pushing up compensation of employees in real term in Japan.

So, why is consumption sluggish? While several reasons are pointed out, in fact there is no decisive reason for it. For example, if pension benefits are reduced and burdens such as taxes and social insurance premiums are increased, disposable income will fall even though the compensation of employees increases, which could suppress consumption. However, in fiscal 2015, for which the latest statistics are available, disposable income grew by 1% from the previous fiscal year, which is lower than 1.5% in the compensation of employees. However, the growth rate for consumer spending was further lower at 0.5%.

On the other hand, there is a possibility that a decline in capital gains from the sales of stocks and real estates, which are not included in "income" due to their definitions, serves as a factor to suppress consumption. According to data from the National Tax Agency, the total sum of income from stock transfer seems to have had declined dramatically from 12.2 trillion yen in 2013 to 5.1 trillion yen in 2014. But it seems to have remained subsequently in the range of 6 trillion yen in 2015 and 2016 without a significant change. Compared with the fact that the gap between the compensation of employees and private consumption began widening in 2015, there appeared to be a time lag.

A popular hypothesis is that concerns over

Growth Rates of Income and Consumption
in Japan, United States and Euro Area (2017 Q1)

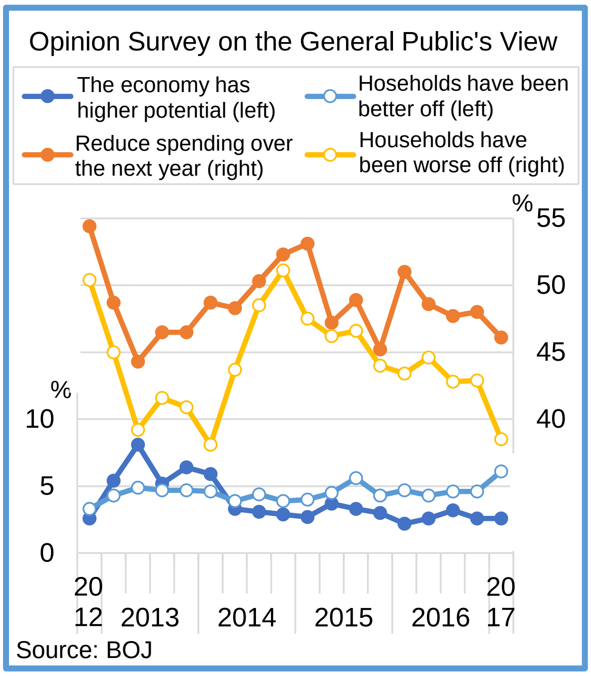
compared with the average of 2015, %

	Japan	U.S.	Euro Area
Nominal Compensation of Employees	2.8	5.9	4.9
The Number of Employees	1.4	2.8	2.3
Compensation per Employee	1.4	3.1	2.5
Consumer Prices (Inflation Rates)	-0.4	2.4	1.5
Real Compensation of Employees	3.3	3.5	3.3
Real Private Consumption	0.9	4.2	3.0
Nominal Private Consumption	0.5	6.7	4.5

Note: Real (Inflation-adjusted) compensation of Employees shrink when consumer price inflation rise.
Source: CAO, MIC, BEA, BLS and Eurostat

the future are the cause for the sluggish consumption. One example is a result of a questionnaire asking about the growth potential of the Japanese economy which shows there is no sign of an answer that anticipates higher growth in the long term increasing. While there were some changes in 2017 in the questionnaire results, nearly 50% of respondents said they would reduce spending over the next 12 months and the number of respondents saying that they were better off compared to a year ago remains low, although the number of respondents saying that they were worse off declined. In other words, it would be reasonable to assume that, while income is increasing at least, people would not increase spending due to concerns over the future.

According to the Bank of Japan, net household assets decreased by 1.7% in June 2016 from a year earlier. After posting a year-on-year decline of 8.0% in September 2008 when the world financial crisis deepened, it reached an all-time high in 2013 again but lost momentum in 2015. If households have concerns over the future, it looks reasonable to increase savings by suppressing consumption. Net household savings in financial assets such as deposits and equity investments (financial surplus) is 10.5 trillion yen in fiscal 2015 and 18.3 trillion yen in fiscal 2016, respectively, after climbing to 19.3 trillion yen in fiscal 2014 when consumption tax rate raised to 8% from 5%.



Aging surely put concerns over the future in Japan. But the Japanese economy has maintained positive growth for five consecutive quarters and it is widely expected to continue to grow until the next consumption tax rate hike from 8% to 10%, which is scheduled in October 2019. Anticipation for higher growth are expected to be improved and it may make consumption less suppressed.

(Yusuke Suzuki, Senior Economist)

Selected Economic Indicators

	Fiscal Year		2016			2017
	2015	2016	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar
GDP at current prices (SAAR, Trillion Yen)	531.8	537.5	536.4	536.8	539.0	537.4
Real GDP at 2011 prices (SA, q/q%)	1.2%	1.2%	0.9%	1.1%	1.6%	1.3%
Industrial Production Index (SA, 2010=100)	97.5	98.6	96.5	98.0	99.8	100.0
Exports (SA, Trillion Yen)	74.1	71.5	17.1	17.1	18.0	19.1
Imports (SA, Trillion Yen)	75.2	67.5	16.0	16.1	17.0	18.4
Balance on Current Account (SA, Trillion Yen)	17.9	20.2	4.7	4.9	5.1	5.2
Corporate Bankrupcies	8,684	8,381	2,129	2,087	2,086	2,079
Unemployment Rate (SA, %)	3.3%	3.0%	3.2%	3.0%	3.1%	2.9%
Wage Index (SA, 2010=100)	100.2	100.6	100.2	100.8	100.5	100.9
Consumer Prices (y/y%)	0.2%	-0.1%	-0.3%	-0.5%	0.3%	0.3%
Nikkei Stock Average	18,841	17,520	16,408	16,497	17,933	19,241
Japanese Government Bond Yields (%)	0.29	-0.05	-0.12	-0.13	0.00	0.07
Foreign Exchange Rate (Yen/ Dollar)	120.1	108.4	108.2	102.4	109.3	113.6

Note: SAAR means Seasonally Adjusted Annual Rate. SA means Seasonally Adjusted.
q/q% means %change from a quarter earlier. y/y% means %change from a year earlier.
Source: CAO, METI, MOF, Tokyo Shoko Research, MIC, MHLW, Nihon Keizai Shimbun, CEIC, BOJ