MGSSI Japan Economic Quarterly October 2017

Global Economic & Political Studies Division
Mitsui & Co. Global Strategic Studies Institute

Positive Growth for Six Consecutive Quarters

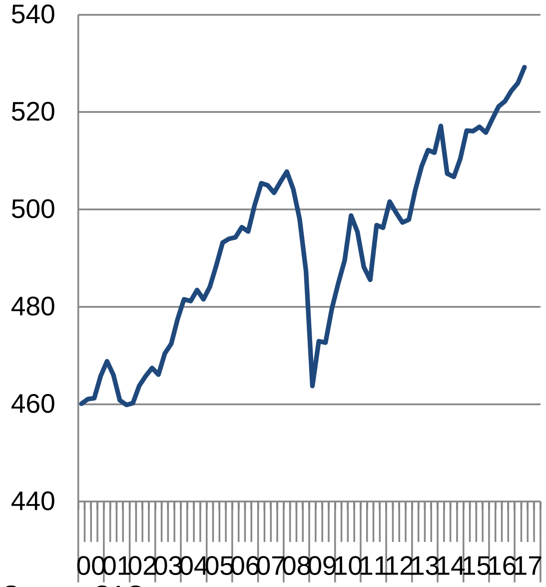
Real GDP in the second quarter of 2017 rose by 0.6% (2.5% annualized) from the previous quarter, securing positive growth for six consecutive quarters.

Private consumption* rose by 0.8% from the previous quarter, apparently the main contribution to this growth was from spending on automobiles, household appliances, and food and drinking services. Car sales (including light (kei) cars) amounted to 4.5 million annualized units, reaching the level recorded in the first quarter of 2014, just before the consumption tax hike. While some media continue to report that consumption is sluggish, private consumption rose for six consecutive quarters, just like the real GDP. The growth of wages per worker is still slow. However, the ratio between consumption expenditure and the compensation of employees, which corresponds to the total amount of wages paid by corporations, bottomed out in the third quarter of 2016, making it easier to reflect the growth of compensation of employees, which is supported by an increase in the number of workers. It is likely that the compensation of employees will continue to recover because companies claim labor shortage are getting severer, so consumption is expected to continue to grow moderately while being affected by weather and other factors.

Private non-residential fixed investments saw a quarter-on-quarter growth of 0.5%, increasing for three consecutive quarters, although at a moderate pace. According to the Financial Statements Statistics of Corporations, nominal non-residential fixed investments (including software investment) by the manufacturing industry declined by 3.9% from the previous quarter,

Real Gross Domestic Product

at 2011 Price, Annualized, Trillion Yen



Source: CAO

Real Gross Domestic Product (GDP)

at 2011 Price, Calendar year

	2016	2016 10-12	2017 1-3	2017 4-6
	y/y%	q/q%	q/q%	q/q%
Real Gross Domestic Product	1.0%	0.4%	0.3%	0.6%
Private Consumption	0.4%	0.1%	0.4%	0.8%
Private Housing Investments	5.6%	0.2%	1.0%	1.3%
Private Non-Resi. Fixed Investments	1.3%	2.0%	0.5%	0.5%
Public Investments	-3.0%	-2.4%	0.4%	6.0%
Government Consumption	1.3%	0.0%	-0.1%	0.4%
Exports of Goods & Services	1.2%	3.1%	1.9%	-0.5%
(less) Imports of Goods & Services	-2.3%	1.4%	1.3%	1.4%

Source: CAO

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

recording negative growth for two consecutive quarters. Those by the non-manufacturing industry, excluding the financial and insurance sector, saw a slight quarter-on-quarter decline of 0.7% for the first time in a year. The manufacturing industry was affected by a decline in the transport machinery sector, while the decline in the non-manufacturing industry was caused by a drop in the retail and wholesale sectors. As a rule of thumb, the current non-residential fixed investments level corresponds to an annualized real GDP growth rate of around 1%. An abundant cash flow will give a boost to investments, but higher growth is not expected.

Public investments rose by 6% from the previous quarter, recording the highest growth since the first quarter of 2012, when the restoration and reconstruction investments began in full scale after the March 2011 Great East Japan Earthquake. In the supplementary budget passed in October 2016, the central government increased investment-related spending by 2 trillion yen, which apparently led to high growth. However, the contract amount for public works projects, which reflects the trends of order placement, has declined for three months in a row since May 2017. The central government's investment-related spending in the Fiscal 2017 Budget is 9.1 trillion yen, which is still at a high level but smaller than the 10.5 trillion yen allocated in the Fiscal 2016 Budget (including the supplementary budget). High growth in public investment is not expected.

Private housing investments rose by 1.5% from the previous quarter. The number of new housing starts increased by 2.3% from the previous quarter to 1.0 million annualized units, the highest growth since the third quarter of 2008 when the world financial crisis occurred, except for the fourth quarter of 2013, just before the consumption tax hike. The number of homes built for sale, mainly condominiums, recorded high growth. However, continued attention will be needed for an excess supply of rental housing and overvalued condominiums. While there is strong demand mainly in major cities, further growth in demand is unlikely.

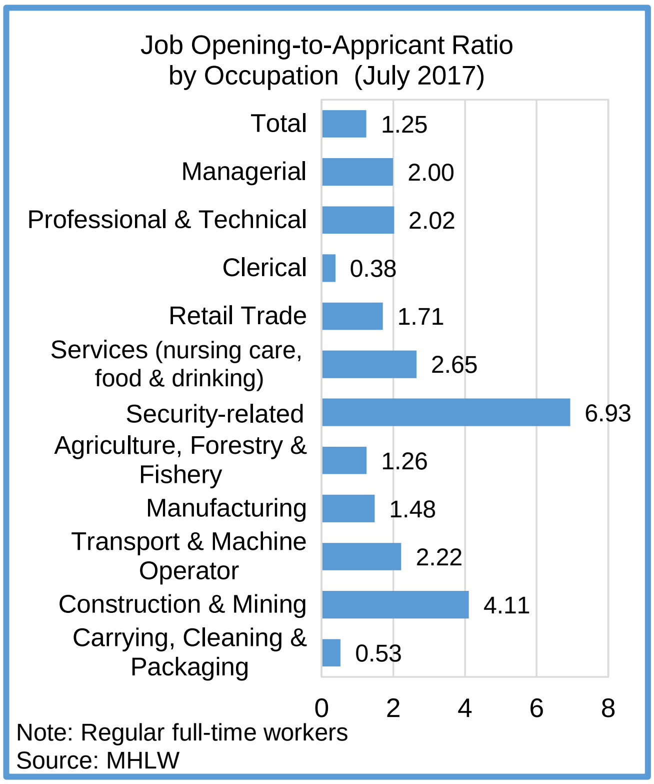
Exports of goods and services declined by 0.5% from the previous quarter, while remaining at a high level following the first quarter of 2017 when exports of goods and services marked a record high. Exports of digital-related products such as electronic components declined, but exports of general machinery such as engines (excluding those for vehicles) and construction machines rose for three consecutive quarters, along with an increase in exports of automobiles. World trade expanded for four quarters in a row, and the world economy is expected to continue to grow. Under such circumstances, it is highly likely that Japan's exports will increase again in the near future.

Meanwhile, imports of goods and services rose by 1.3% from the previous quarter, working to push down real GDP growth by 0.2% points. Imports of some specific items among general machineries appear to have increased. As long as the Japanese economy continues to grow, no matter how moderately, imports are expected to increase.

Ordinary profits of Japanese corporations rose by 21.7% year on year, recording a double-digit growth for two consecutive quarters. Net profits of listed companies this fiscal year are expected to increase by more than 5%. There is a small risk that business sentiment would deteriorate again, and the economy is highly likely to continue to expand moderately, supported by consumption and exports. According to an ESP Forecast survey, the average of forecasts of private economists on real GDP growth, real GDP will see a year-on-year growth of 1.5% in 2017 and 1.3% in 2018.

Employment Mismatch Suggested by the Effective Job Opening-to-Applicant Ratio

The labor market continues to improve. The unemployment rate declined to 2.8% in July 2017 from 5.5% in July 2009. The effective job opening-to-applicant ratio was 1.52, which exceeds the level in the late 1980s' bubble economy period and reached the highest level since February 1974 (1.53). By location, there



are differences between prefectures, with the ratio ranging from 2.15 in Fukui Prefecture to 1.14 in Hokkaido. However, the ratio surpassed 1.0 for all prefectures. Since job openings outnumber job seekers, it is possible for everyone to find a job unless they are choosy.

However, the effective job opening-to-applicant ratio is remarkably high for some job categories: for example, 6.93 for "security-related jobs (security officers, etc.)"; 4.11 for "construction and mining jobs"; and 2.65 for "service jobs (nursing care, food and drinking services, etc.)" On the other hand, the ratio is low for some job categories, such as 0.38 for "clerical jobs," and 0.53 for "carrying, cleaning, packaging and other jobs." The effective job opening-to-applicant ratio is calculated by dividing the number of job openings by the number of job seekers. Therefore, the difference in the ratio between job categories suggests that there is an employment mismatch.

When the effective job opening-to-applicant ratio increases, the average recruitment salary also increases, although moderately. While wage growth per worker continues despite the tight labor supply and demand, rationality is working to a certain extent. However, there are some job categories with large outliers, such as "security-related jobs (security officers, etc.)" and "construction framing jobs (shuttering carpenters, construction workers, and concrete reinforcement workers)."

Japan's population has been declining since peaking in 2008, and the working age population (15 to 64 years of age) has been declining since peaking in 1995. Nevertheless, there is still a large number of openings for some jobs. It is needed to eliminate mismatches between job seekers and employers.

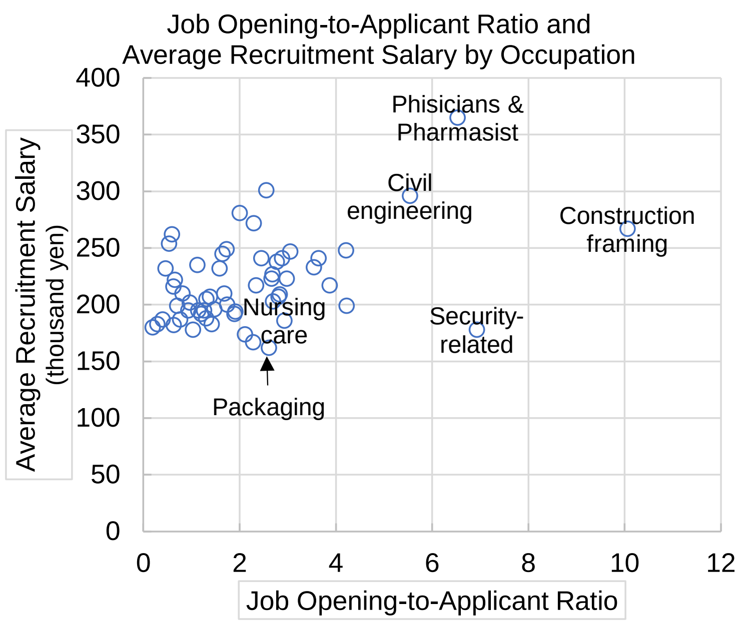
An idea that comes to mind is to raise wages. In sectors where companies find it difficult to pass costs onto prices due to excessive competition with rival companies in the same business and weak pricing power, the treatment of workers has been deteriorating, while there have been signs of recovery recently. Meanwhile, as for "nursing care service jobs," the average recruitment salary is not extremely low compared to the effective job opening-to-applicant ratio. However, the sector is expected to face further labor shortages in the future. The Ministry of Health, Labour and Welfare estimates that there will be a shortage of about 380,000 nursing care workers nationwide in 2025, while the Ministry of Economy, Trade and Industry forecasts a shortage of 680,000 nursing care workers in 2035. Since it is difficult to expect significant pay hikes under the current long-term care insurance system, there is no prospect of securing nursing care workers.

Improving work conditions, such as working hours, work locations and benefit packages, is one way to address the situation. The recent work-style reforms by the government and the trend among companies of accepting employees' sideline businesses are part of the above. Furthermore, in order to unearth latent workforce such as senior citizens and housewives, it is important to separate skilled and unskilled jobs and establish forms of operations in the future.

Efforts to improve the productivity of nonregular workers are also important. Among these efforts is the provision of employment assistance for middle-aged people with little experience as permanent workers by the Ministry of Health, Labour and Welfare and municipal governments. One study found that, of people whose first job after graduation was irregular, only around 20% found a permanent job after that. It is necessary to take measures to increase employment mobility without fixing jobs among those who could and those who could not find a job in the collective hiring of new graduates.

Unless the government and companies work together to resolve the employment mismatch, it will become difficult to secure a workforce and meet the needs of a super-aging society, which could result in hindering the growth of the Japanese economy.

(Yusuke Suzuki, Akiko Fujii)



Note: Regular full-time workers. Job opening-to-applicant ratio for July 2017 and average recruitment salary for fiscal 2016.
Source: MHLW, MGSSI

Selected Economic Indicators

	Fiscal Year		2016		2017	
	2015	2016	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun
GDP at current prices (SAAR, Trillion Yen)	532.0	538.0	536.6	539.4	538.8	542.8
Real GDP at 2011 prices (SA, q/q%)	1.3%	1.3%	0.2%	0.4%	0.3%	0.6%
Industrial Production Index (SA, 2010=100)	97.5	98.6	98.0	99.8	100.0	102.1
Exports (SA, Trillion Yen)	74.1	71.5	17.0	18.0	19.2	19.0
Imports (SA, Trillion Yen)	75.2	67.5	16.2	17.0	18.3	18.6
Balance on Current Account (SA, Trillion Yen)	17.9	20.4	4.9	5.1	5.4	4.7
Corporate Bankrupcies	8,684	8,381	2,087	2,086	2,079	2,188
Unemployment Rate (SA, %)	3.3%	3.0%	3.0%	3.1%	2.9%	2.9%
Wage Index (SA, 2010=100)	100.2	100.6	100.8	100.5	100.9	100.7
Consumer Prices (y/y%)	0.2%	-0.1%	-0.5%	0.3%	0.3%	0.4%
Nikkei Stock Average	18,841	17,520	16,497	17,933	19,241	19,503
Japanese Government Bond Yields (%)	0.29	-0.05	-0.13	0.00	0.07	0.04
Foreign Exchange Rate (Yen/ Dollar)	120.1	108.4	102.4	109.3	113.6	111.1

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