18 April 2017

Economic Report

Global Watch March 2017

1. Overview of the Japanese Economy:Showing Moderate Improvement

By Shinichiro Kobayashi, Principal Economist

The Japanese economy is gradually showing improvement. According to the latest GDP statistics (second preliminary estimate), the economy expanded 0.3% in real terms over the previous quarter in the October–December period of 2016 (+1.2% at an annualized rate). This was the fourth consecutive quarter-to-quarter increase.

The driving force for improvement in the economy is the corporate sector. According to the *Financial Statements Statistics of Corporations by Industry* for the October–December quarter, ordinary profit of corporations in all industries and all size categories (seasonally adjusted) expanded 5.2% for the third consecutive quarter-to-quarter increase, and stood at the highest level in history for a single quarter. By sector, manufacturing companies reported a 17.0% increase in ordinary profit over the previous quarter, thus showing a sharp improvement, mainly because of the strong performance of exporting corporations, which was boosted by the cheaper yen. The outlook is for the rising trend in profit to continue in the January–March quarter of 2017, and ordinary profit in fiscal 2016 will set a new record high. In part because of this improvement in profit performance, the private capital investment component of real GDP rose 2.0% in the October–December quarter, and this and other indicators suggest that corporate capital investment is on a moderate improvement trend.

However, there is a possibility that, since the beginning of 2017, the momentum of corporate activities has slowed somewhat. The index of industrial production (preliminary estimate) in January 2017 decreased 0.6%, the first decline in six months. The surveys of production forecasts for February call for recovery to 3.5% expansion over the previous month, but, then, a sharp decline of 5.0% in March. The increasing trend in the production of smartphone-related parts against a background of rising demand is continuing, but expansion in automobile production has paused and is expected to be lower than the 2.0% growth reported in the October–December quarter.

These same movements are also evident in exports. Real exports in January decreased 1.1% from the previous month, the second consecutive monthly decline. On average, the trend toward improvement is continuing, and, although the level of exports is high, momentum is weakening. As in the case of production, exports of smartphone-related parts are favorable, but movements in the production of automobiles and car parts are becoming weaker.

In the household sector, improvement is still lagging. Employment conditions continue to be favorable, with the unemployment ratio in January at a low 3.0% and the ratio of job openings to job seekers standing at 1.43 times. In addition, total cash compensation of workers (preliminary figure) in January rose a somewhat high 0.5% over the same period of the previous year, and scheduled wages were up 0.8% year on year for the seventh consecutive monthly increase, suggesting that wages are rising at a moderate pace.

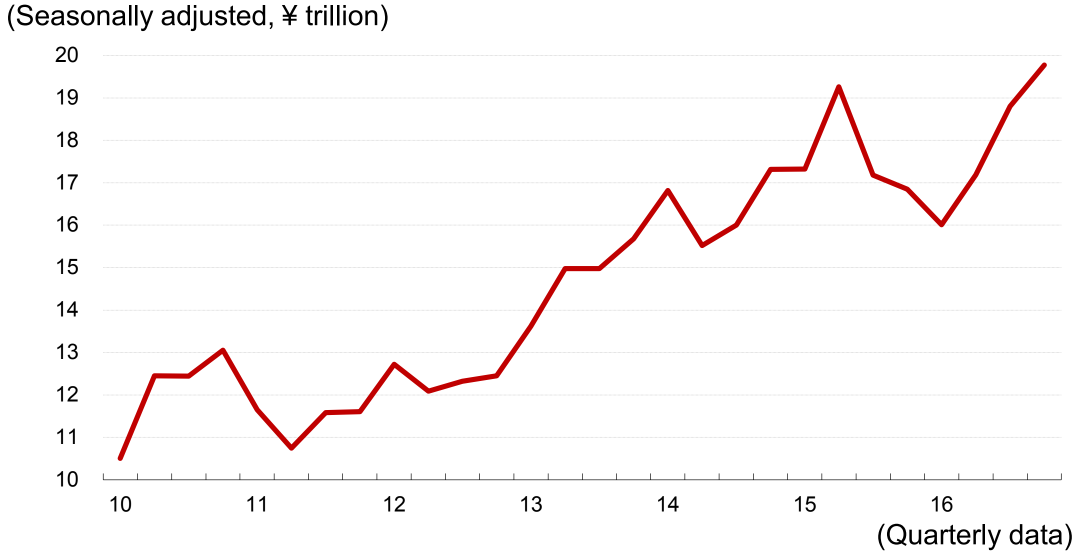
However, consumer spending is still fluctuating within a narrow range. According to the January *Survey of Family Income and Expenditures* (covering households of two or more persons, seasonally adjusted), real consumption increased 0.5% over the previous month, for the first time in four months, but the level remains low. Moreover, what is of concern is the growing upward pressure on prices. As a result of the bottoming out of energy prices and the weakening of the yen, the consumer price index in January (comprehensive, excluding fresh foods) was up 0.1% over the previous month, which was the first rise in 13 months.

In the 2017 spring labor offensive, which began in earnest in February 2017, corporations are insisting on raising wages on an annual basis, and, while bonuses may rise on the one hand, it appears that the margin of increase in base wages may fall below the margin last year. If we consider the outlook that the margin of increase in consumer prices will expand gradually over the previous year, the rate of increase in real wages may stagnate, and there is a risk that this will be a factor restraining consumption. In addition, worker cash compensation in January in real terms was level with the previous year.

Going forward also, since the recovery in the world economy is expected to sustain the upward trend in exports and since capital investment will continue to recover moderately against a background of improvement in corporate performance, the outlook is for continued improvement in the economy. In addition, although there is concern that a rise in the price level may restrain the purchasing power of households, as improvement in employment and incomes continues to move forward, consumer spending is expected to continue to hold firm. Moreover, approaching the fiscal year-end, the positive effects of the supplementary budget for fiscal 2016 will grow stronger.

Turning to the impact of U.S. President Trump’s policies, in his inaugural speech in January and his addresses to Congress in February, the president did not touch on specific policies, and there have been no new comments on economic and fiscal policies. Even so, in part because the U.S. economy is continuing to show steady improvement, there are still deep-rooted favorable expectations about the positive impact of the president’s policies. However, if his comments and behavior bring turmoil to financial markets again, the risk remains that these positive expectations may come to an end. (2017.3.31)

Chart 1:Trends in Ordinary Profit of Incorporated Enterprises



Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry*

2. Topic of the Month: Differences in the Meaning of "Improvement" in Japanese and U.S. Labor Conditions

By Miki Ohata, Economist

The employment situation that deteriorated suddenly after the collapse of Lehman Brothers Holdings is currently described in both Japan and the United States as "improving." In January 2017, the unemployment rate in Japan was 3.0%, which was 2.5 percentage points below the peak of 5.5% in July 2009. The United States has an unemployment rate of 4.8%, which represents a decline of 5.2 percentage points from the peak of 10.0% reached in October 2009. At present, both economies are close to full employment.

However, the nature of the "improvement" in the labor situation in Japan and the United States is different. Even if the unemployment rate in Japan has declined, there is still a trend toward shifting hiring non-regular employees. On the other hand, in the United States, shortly after the beginning of 2010, the ratio of part-timers began to decline (Chart 2). In the United States, immediately after the collapse of Lehman Brothers, the number of full-time employees fell significantly, and there was a shift to part-timers, but, along with the improvement in labor market conditions, the increase in employment has been mainly accounted for by full-time employees.

Moreover, in the United States, improvement in the labor situation has been accompanied by increases in wages. Since 2010, wages in the United States have been increasing at about 2.0% annually. Whereas, in Japan, wages have been virtually level. Over this period, prices in the United States have been rising at an annual rate of about 1.8% (consumer price index, core items), and, even on a real basis, wages have been increasing moderately.

In Japan, the reason for the overall decline in wages is that the ratio of part-timers who receive lower wages is rising because of the shift to hiring non-regular employees. In fact, if we analyze the factors influencing the rate of change in wages, from 2000 through 2016, we find that the wage levels of regular full-time employees and part-time employees have risen by a small margin, but, at the aggregate level, the increase in the ratio of part-time employees has cancelled out the positive impact of these wage increases (Chart 3). On the other hand, in the United States, the margins of increase in wages of full-time (regular) employees have been large, and the number of such full-time higher-paid employees has increased thus boosting the overall wage level.

The two countries have different conditions and other circumstances for hiring and firing, and it is impossible to compare the good and bad points in discussing what improvement in labor conditions means. However, because expectations about future growth are stronger in the United States than in Japan, U.S. companies may be likely to take a more-positive view of increases in employment costs, and this may make it easier for improvement in employment conditions to lead to wage increases. (2017.3.31)

Chart 2: Ratio of Part-Time Workers

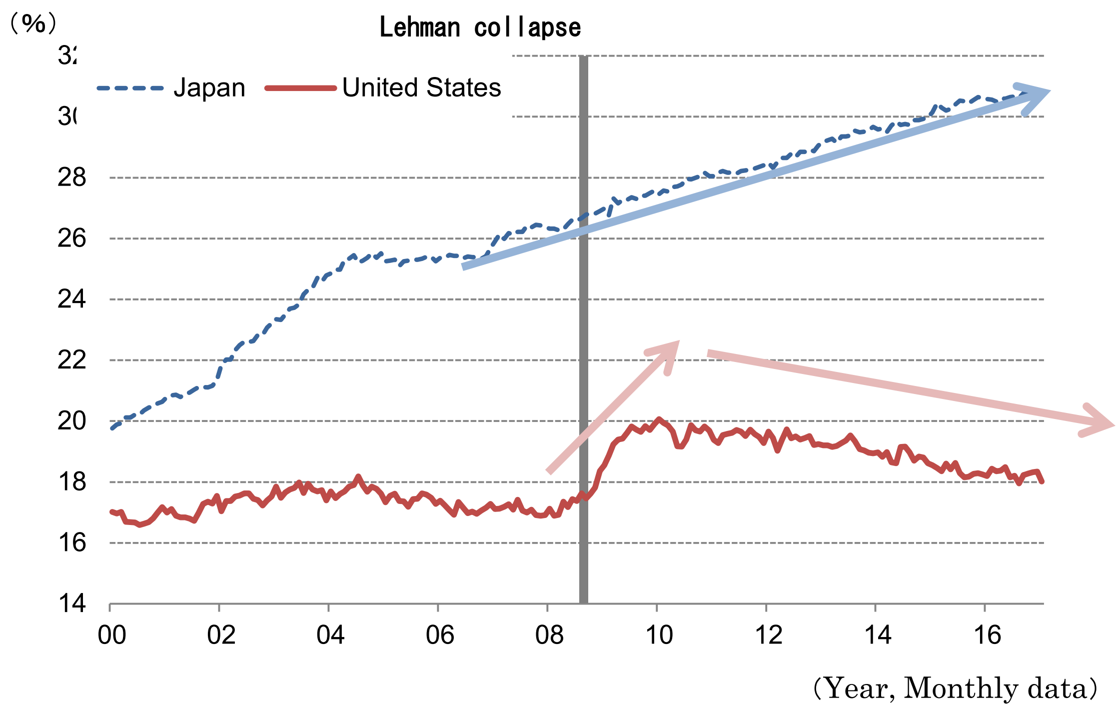


Chart 3: Analysis of Factors Affecting Rates of Change in Wages