

## Economic Report

## Global Watch October 2016

### 1. Overview of the Japanese Economy: Remains Virtually Flat with Some Signs of Improvement

By Shinichiro Kobayashi, Principal Economist

The economy remains virtually flat, although some indications of improvement have emerged.

The first reason for asserting that there are signs of improvement is that industrial production has begun to show indications of improvement. In August, industrial production (preliminary figure) began to rise and increased 1.5% over the previous month. Moreover, the surveys of industrial production forecasts call for a steady increase of 2.2% in September, followed by a 1.2% rise in October. Transportation equipment industries are showing an improved rising trend, reflecting the comeback in automobile output, and production of electronic components and devices and other products that are mainly linked to smartphone production is increasing. Even taking account of the fact that actual production often falls below the results of surveys of production plans, it is certain that industrial production in the July-September quarter will be the second consecutive quarter of positive figures, and it is expected that production is on an improving trend.

The second reason is that exports, which had been nearly flat and fluctuating within a narrow range, are showing signs of improvement. Real exports in August rose 1.2% over the previous month, and it seems that an increase in items linked to smartphone production was behind this.

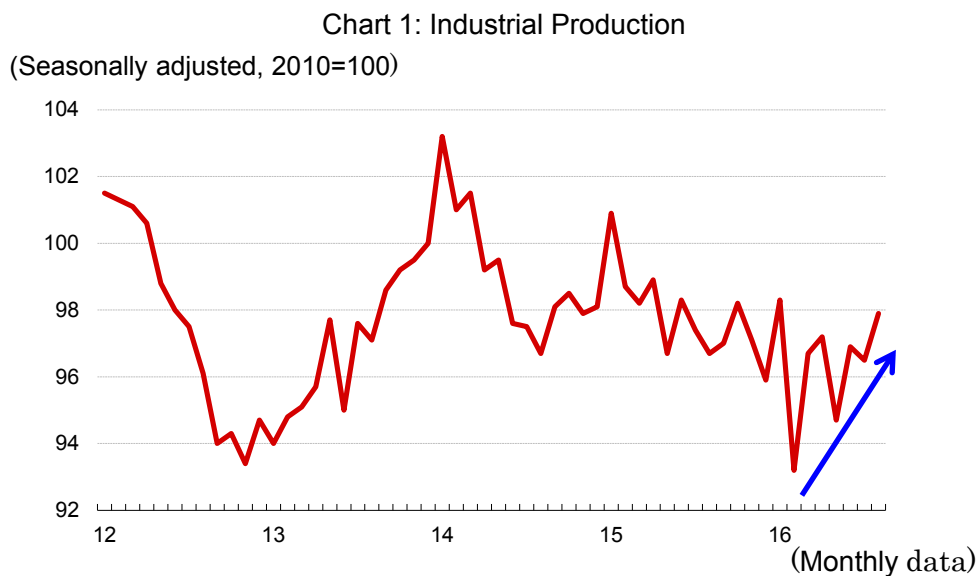
In addition, the brakes are being applied to the deterioration in corporate performance. The Bank of Japan's *Tankan* survey of corporate sentiment for September shows that the diffusion index (DI) that measures corporate appraisals of business conditions among major manufacturing companies stood at 6, which was unchanged from the previous survey. Amid further movement toward the appreciation of the yen, this indicator has remained at the same level for three consecutive quarters, suggesting that the adverse impact of the stronger yen on corporate performance is weakening. The *Tankan* survey of large non-manufacturing enterprises for September shows a deterioration in the DI of one point, but the level remains high at 18.

In the midst of these conditions in the corporate sector, although capital investment is moving within a narrow range, signs of a more -positive, forward-looking outlook are emerging.

Turning to the household sector, although the employment situation continues to be favorable, with the unemployment ratio in August standing at a low 3.1%, and the ratio of job openings to job seekers for the same month reaching 1.37 times, the improvement in wages has paused. In August, total per capita cash compensation of workers (preliminary figures) decreased 0.1% year on year, thus moving back to the negative region for the first time in three months. The boosting impact from bonuses in June and July has run its course. In addition, consumer confidence remains stagnant and the tendency toward frugality among households is still deep-rooted. Also, as a result of unseasonable weather during the summer months, consumer spending is fluctuating within a narrow range. Real consumption expenditures in the August *Survey of Family Income and Expenditures* (covering households of two or more persons, seasonally adjusted) showed a sharp decline of 3.7% from the previous month. Moreover, sales across the board at such retailers as department stores and supermarkets in August were below the same month of the previous year.

However, in view of the increase in real income owing to the decline in prices and rising workforce participation, going forward, consumer spending is expected to improve gradually. In August, the consumer price index (comprehensive index, excluding fresh food) had decreased to -0.5% compared with the same month of the previous year. However, after the index continues below the previous year for the rest of the calendar year, the pace of increase after the beginning of 2017 is also expected to be moderate, and this may provide a tailwind and give some impetus to consumer spending. Also, recovery in the world economy is likely to bring a gradual increase in exports, and the implementation of the government's supplementary budget for fiscal 2016 will give an additional boost to the economy approaching the end of fiscal 2016. As a result, there is a strong possibility of moderate recovery in the economy.

Nevertheless, it will be difficult for the tempo of improvement in the economy to increase suddenly. The comeback production in automobiles and increase in exports of materials for use in smartphones will run their course by the end of calendar 2016, and there are concerns that the high level of inventories will restrain production. Moreover, although the impact of the departure of the United Kingdom from the European Union on the economy may be marginal, speculation about the timing of increases in interest rates in the United States, may cause financial market turmoil, and, if trends toward deceleration in the world economy grow stronger, both production and exports may weaken. As a result, the economy as a whole will go back to fluctuating within a narrow range again. The Bank of Japan's newly introduced quantitative and qualitative easing policies, with the manipulation of long and short term interest rates, will make it easier to maintain monetary easing for the longer term through changes in the monetary framework, but positive effects on boosting prices and the economy cannot be expected. (2016.10.20)



Source: Ministry of Economy, Trade and Industry, Indices of Industrial Production

## 2. Topic of the Month:

### Expanding Demand in the World's Air Transport Industry and Conditions in Japan

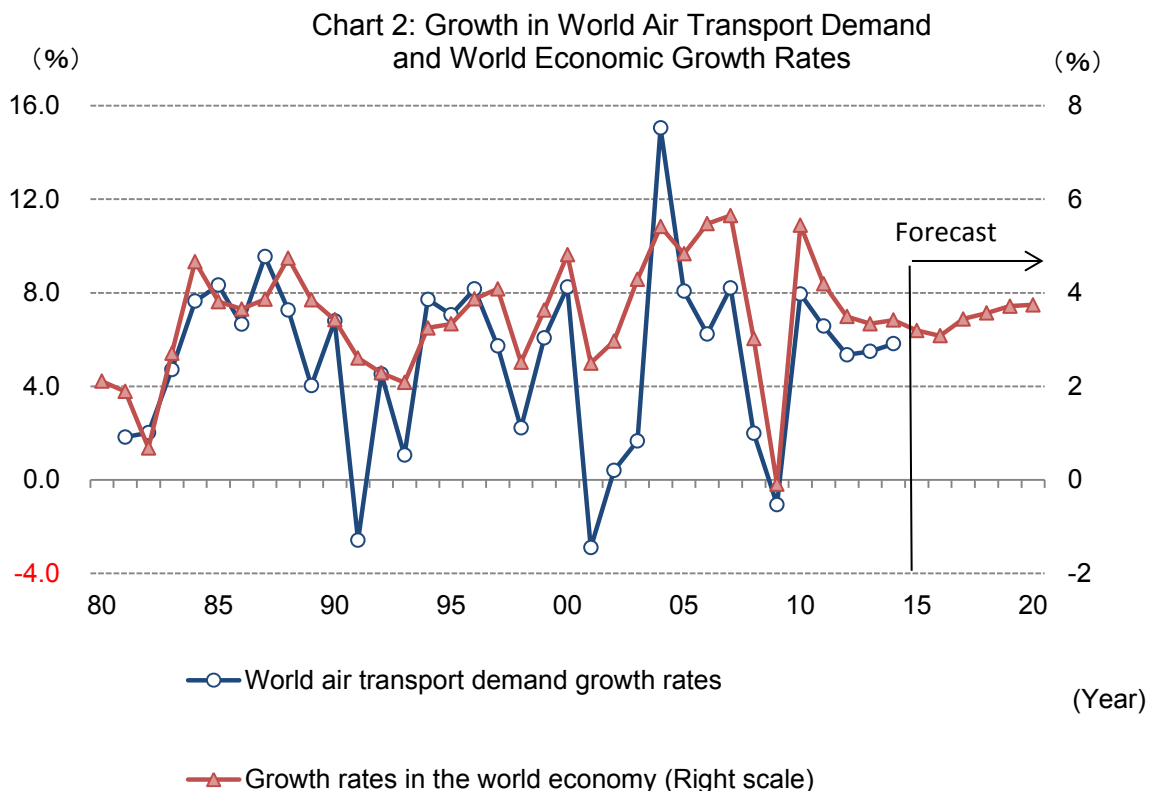
By Miki Ohata, Economist

Along with growth in movements of persons accompanying expansion in the world economy, demand for air transport is increasing rapidly. The index used to measure air transport demand is revenue passenger kilometers (RPKs), which is defined as the number of paying air transport passengers times the number of miles flown. Over the last 30 years, the world RPK has increased over fivefold and had risen to more than 6 trillion passenger kilometers in 2014. However, the level of RPKs tends to be closely linked to world economic growth and is influenced by external factors that include deterioration in economic conditions and terrorism, which may bring a sudden drop in air transport demand (Chart 2). For this reason, although there is a possibility that there may be temporary declines in demand for air transport, world demand for passenger air transport is viewed as likely to remain on a rising trend along with expansion in the world economy.

As the number of persons moving internationally grows even more substantially, the outlook is for Japan's air transport demand to rise. In particular, in recent years, the number of foreign tourists visiting Japan has risen sharply, and the number of takeoffs and landings at major domestic international airports as well as the number of persons using these facilities has risen. However,

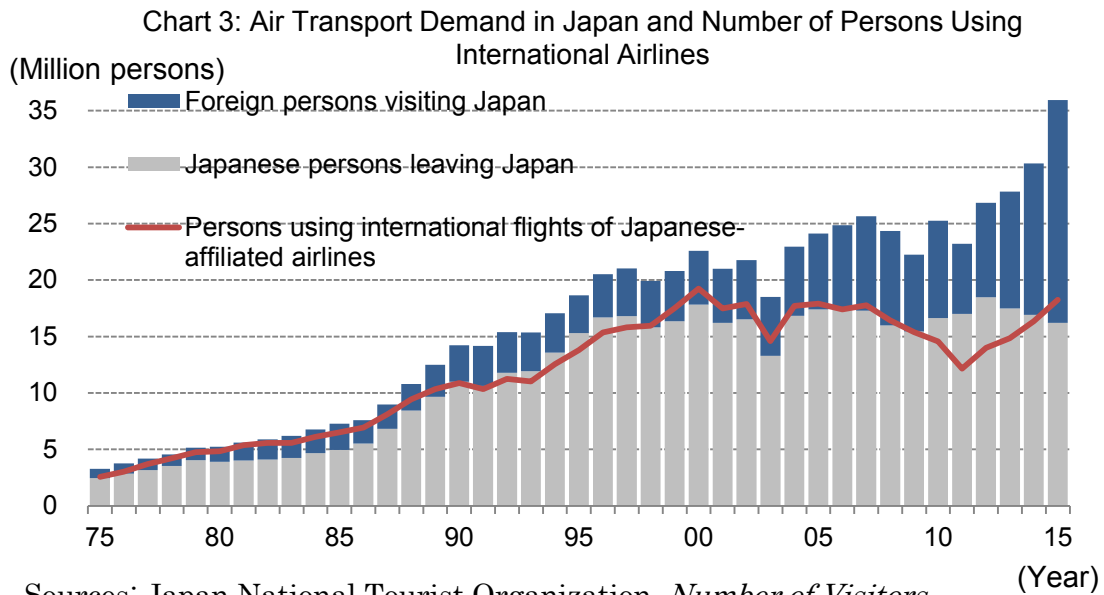
examination of international travelers on Japanese-affiliated airlines shows that after the beginning of the 2000s the number has remained constant at about 17 million (Chart 3). The principal customers of Japanese airlines are Japanese persons leaving (and returning to) Japan, but one of the factors behind this is that the number of Japanese persons leaving Japan since the latter half of the 1990s has shown little growth. On the other hand, most persons visiting Japan from overseas use their own national airlines, and Japanese airlines are not benefiting sufficiently from the rise in visitors to Japan.

The Japanese government has raised its goal for the annual number of foreign visitors to Japan to 40 million by 2020, but to persuade many foreigners to visit Japan, which is an island country, improvement in the air travel environment will be needed. In addition, for Japanese airlines, it is difficult to expect an increase in the number of Japanese persons leaving Japan because of the decline in Japan's population and slow growth in incomes. Therefore, an issue to be addressed going forward will be how to capture air transport demand of foreign tourists that Japanese airlines are not tapping sufficiently at present. (2016.10.20)



Note: Air transport demand is measured in RPKs. World economic growth forecasts were prepared by the IMF.

Sources: IMF, *World Economic Outlook*; Japan Aeronautic Association, *Aviation Statistics Catalogue*



Sources: Japan National Tourist Organization, *Number of Visitors to Japan*, *Number of Japanese Traveling from Japan*; Ministry of Land, Infrastructure, Transportation and Tourism, *Air Transport Statistics Survey*

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