Economist Letter

Japan's Economic Outlook for Fiscal Years 2023 to 2025 (November 2023)

Taro Saito, Executive Research Fellow, Economic Research Department,
tsaito@nli-research.co.jp

<Real growth rate: FY 2023: 1.4%, FY 2024: 1.3%, FY 2025: 1.1%>

1. In the July–September quarter of 2023, Japan's real GDP experienced negative growth for the first time in three quarters, contracting 2.1% on an annualized basis from the previous quarter. This decline was attributed to reductions in private consumption, private residential investment, and the fixed investment of businesses. A decrease in foreign demand exerted additional downward pressure on growth.
2. Projections indicate that real GDP growth will reach 1.4% in FY 2023, followed by a slight moderation to 1.3% in FY 2024 and a further decline to 1.1% in FY 2025. Exports are not expected to be the primary engine for economic expansion in the foreseeable future. By contrast, private consumption, business fixed investment, and other domestic demand factors are likely to remain robust. The economy is expected to sustain its recovery momentum, albeit in the face of substantial risk in domestic and foreign demand.
3. Nominal GDP continues to outpace real GDP growth, with the forecast for FY 2023 suggesting nominal GDP growth at 5.4%, the most substantial increase in 33 years. The estimated nominal GDP is set to surpass 600 trillion yen in FY 2024.
4. Consumer prices (excluding fresh food) are expected to increase by 2.8% in FY 2023, with a moderation in that level to 2.0% in FY 2024 and a further decline to 1.4% in FY 2025. The anticipated slowdown in the rate of increase in goods prices is attributed to an appreciation of the yen amidst a diminishing interest rate differential between Japan and the U.S. Nevertheless, service prices are expected to remain elevated as companies continue to pass on increased labor costs from wage hikes in the form of price hikes.

1. Economic Performance in the July–September Quarter of 2023

During the July–September quarter of 2023, Japan's real GDP experienced a decline of −0.5% from the previous quarter, resulting in annualized negative growth of −2.1% and marking the first contraction in three quarters.

This decline was accompanied by a second consecutive quarter of private consumption remaining muted (−0.0% from the previous quarter) due to the adverse impact of high prices. Simultaneously, there were declines in both business fixed investment (−0.6% from the previous quarter) and private residential investment (−0.1% from the previous quarter), resulting in a downturn across all components of domestic private demand.

Although exports increased for the second successive quarter (up 0.5% from the previous quarter), imports surged for the first time in three quarters with an increase of 1.0%, surpassing export growth. This led to a negative foreign demand contribution to growth of −0.1% from the previous quarter (−0.5% on an annualized basis).

The negative growth, reflects, in part, the significant expansion observed in the April–June quarter (4.5% on an annualized basis). What is concerning, however, is the stagnation seen in domestic private demand, including in consumption and business fixed investment, despite the normalization of socioeconomic activities.

While nominal GDP had its first decline in four quarters (−0.0% from the previous quarter; −0.2% on an annualized basis), the nominal GDP growth rate was higher than the real GDP growth rate. This is seen in the GDP deflator's rise of 0.5% from the previous quarter (as compared to 1.4% in the April–June quarter) and a substantial 5.1% increase from the previous year (against 3.5% in the April–June quarter). The growth in the GDP deflator was driven by a 0.3% increase in the domestic demand deflator from the previous quarter (versus 0.7% in the April–June quarter) and a 2.8% surge in the export deflator, which surpassed the growth in the import deflator (1.9% from the previous quarter), contributing to the boost in the GDP deflator.

Global Economic Trends and Projections

Despite global economic growth holding steady at around 3%, based on our estimates, global trade volume has, exhibited a consistent downward trend since its year-on-year decline in the October–December quarter of the previous year. The non-manufacturing sector has displayed signs of recovery, attributed partly to pent-up demand in the post-COVID-19 period. However, a full-scale rebound is impeded by ongoing stagnation in the manufacturing sector resulting from IT-related inventory adjustments and other factors. While the global Purchasing Managers' Index (PMI) indicates business confidence for the non-manufacturing sector above the neutral level of 50, the manufacturing sector has remained below that level since September 2022.

We expect the U.S. real GDP from 4.9% on an annualized basis in the July–September quarter of 2023 to 1.0%in the October–December quarter of 2023 and 0.4% in the January–March quarter of 2024. Meanwhile, the Eurozone which grew at -2.0 on an annualized basis from the previous quarter, is expected to sustain near-zero growth at 0.3% year-on-year in the October–December quarter of 2023. Despite China's real GDP growth being expected to rise from 3.0% in 2022 to the 5% range in 2023, it is anticipated to dip to the 4% range in 2024 and 2025.

Consequently, the rate of growth of the global economy, calculated based on Japan's export weights, is projected to decelerate significantly from approximately 6% in 2021 to around 3% from 2023 to 2025, remaining below the average rate of 4% achieved since 1980. In line with this trend, Japan's exports are expected to taper from 4.5% in FY 2022 to 3.2% in FY 2023, further declining to 1.8% in FY 2024 and slightly rebounding to 2.4% in FY 2025. This signifies that exports are unlikely to drive the economy in the foreseeable future.

Limitations of Economic Stimulus Measures

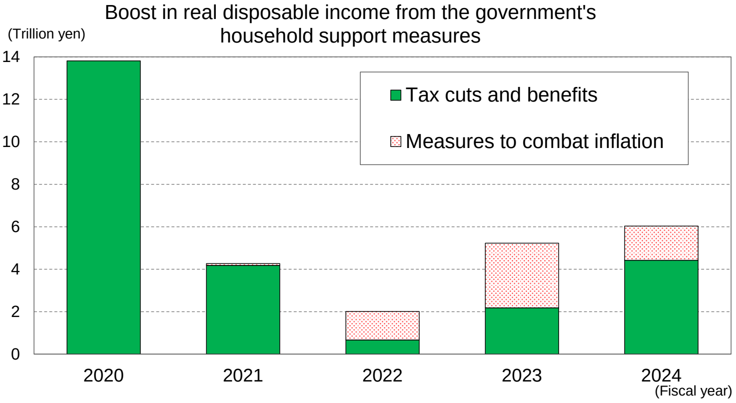
The government recently approved "Comprehensive Economic Measures to End Deflation Completely" and proposed additional general account expenditures of 13.1 trillion yen for the FY 2023 supplementary budget. These measures are intended to address multiple issues, including protecting against high prices, promoting sustainable wage increases, encouraging domestic investment, addressing population decline, and bolstering national resilience and disaster prevention.

The government's estimation of a 1.2% boost in potential real GDP per year over the next three years might be overly optimistic. The size of the supplementary budget has been shrinking since FY 2021, and it is likely that the budget may not be fully utilized, given the significant unspent amounts in previous fiscal years.

However, measures such as reductions in income and inhabitant taxes, additional benefits for low-income earners, and enhanced efforts to reduce electricity, city gas, gasoline, and kerosene costs are expected to contribute to increases in household's real disposable incomes. These initiatives are estimated to elevate real disposable income by 5.2 trillion yen in FY 2023 and by 6.0 trillion yen in FY 2024.

Nonetheless, the temporary nature of tax cuts and benefits might limit their impact on consumption compared to more permanent increases in income, like wage hikes. Past analyses by the Cabinet Office indicate that previous flat-rate benefits and regional development coupons had a consumption-boosting effect of approximately 20 to 30% of the benefit amount. Despite combined income and inhabitant tax cuts and benefits amounting to around 5 trillion yen, the anticipated boost to personal consumption might reach only around 0.4%, equivalent to 0.2% of GDP.

Boost in real disposable income from the government's household support measures



Note: Tax cuts and benefits include flat-rate tax cuts, the special fixed benefits, and benefits for tax-free and child-rearing households.
Measures to mitigate the impact of drastic changes in prices of, for example, electricity, city gas, gasoline, and kerosene

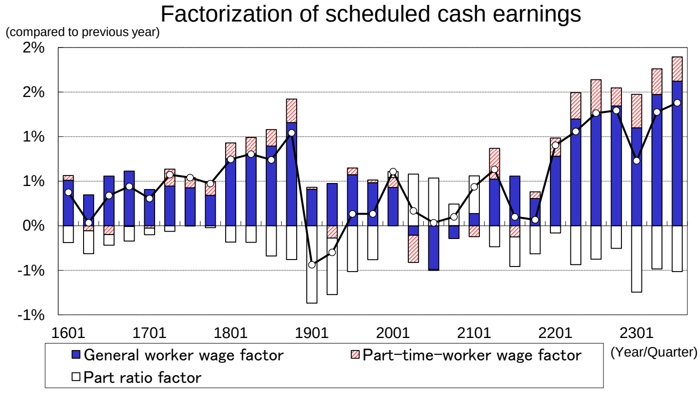
Wage Growth and Economic Implications

In 2023's Spring Labor Offensive, the rate of wage increases reached 3.60%, marking the highest level in 30 years, according to data from the Ministry of Health, Labour, and Welfare. Looking at the environment surrounding the spring labor offensive in 2024, labor supply and demand have remained tight, with the ratio of job offers to applicants remaining well above 1 and the unemployment rate in the mid 2% range. Ordinary profits are at a record high level and consumer prices have remained high. The conditions for continued wage hikes appear favorable.

RENGO raised its demand for a wage increase in the 2023 spring offensive to around 5%; this level is higher than the previous year's demand of around 4% (including the portion equivalent to regular salary increases). Their basic plan for the 2024 spring offensive suggests a slight increase in demand to 5% or more. We anticipate a 3.70% wage increase rate for the 2024 Spring Offensive, slightly exceeding the increase in the previous year.

Compared to the previous year, nominal wages showed growth of 2.0% in the April–June quarter of 2023 and 1.0% in the July–September quarter of 2023, which is low despite the fact that the spring wage increase rate in 2023 was the highest in 30 years. Stagnation in non-scheduled cash earnings, reflective of sluggish production activities, and a rising proportion of part-time workers with lower wages have subdued average wage growth.

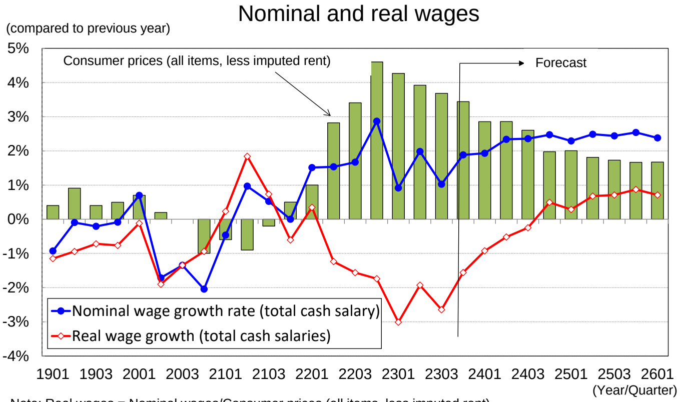
Factorization of scheduled cash earnings



Source: "Monthly Labor Survey(business establishment size of 5 or more)," Ministry of Health, Labor and Welfare.

However, according to the Labour Force Survey by the Statistics Bureau of Internal Affairs and Communications, there has been a decline in the ratio of non-regular to all employees for two consecutive quarters – April–June and July–September of 2023. The decline in this ratio in recent quarters indicates a potential halt in the increase of part-time workers, while special cash earnings are expected to rise as a result of robust corporate earnings. Moreover, as production activities recover, non-scheduled cash earnings are anticipated to pick up gradually. Nonetheless, real wages have been declining since April 2022 due to accelerated consumer price inflation, and it is anticipated that the rate of change in real wages will only turn positive in the latter half of FY2024 when the inflation rate is projected to drop below 2%.

Nominal and real wages



Note: Real wages = Nominal wages/Consumer prices (all items, less imputed rent)

Source: "Monthly Labor Survey(business establishment size of 5 or more)," Ministry of Health, Labor and Welfare.

2. Projection of Real GDP Growth

The anticipated real growth rates stand at 1.4% for FY 2023, 1.3% for FY 2024, and 1.1% for FY 2025.

Continued Emphasis on Domestic Demand

The July–September quarter of FY 2023 exhibited sluggishness in domestic and foreign demand, leading to negative growth (−2.1% on an annualized basis from the previous quarter) for the first time in three quarters. In the latter half of FY 2023, services exports are expected to rise, driven primarily by inbound-tourist demand; goods exports might remain sluggish due to the global economic slowdown. However, it is not anticipated that exports will be the primary engine of economic growth in the foreseeable future.

Meanwhile, private non-residential investment is expected to maintain its upward trajectory, supported by robust fixed investment by businesses. Additionally, a recovery in private consumption, especially in face-to-face services, is expected with the improvement in the employment and income environment, consistent with the normalization of socioeconomic activities. The growth of the Japanese economy is forecast to remain centered on domestic demand.

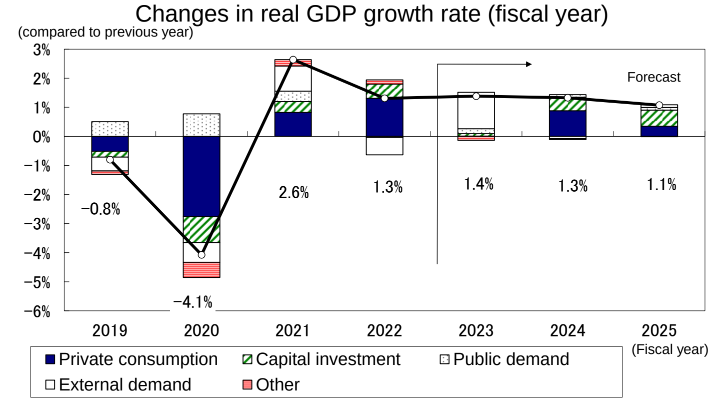
Future Growth Patterns

Real GDP is predicted to return to positive growth, reaching 1.7% in the October–December quarter of 2023 (on an annualized basis from the previous quarter). However, this growth is anticipated to slow, hovering around the zero range at 0.7% in the January–March quarter of 2024, primarily due to weakened exports.

The scheduled tax cut included in the ongoing economic stimulus package is set to be implemented in June 2024, propelling a high rate of growth in private consumption of 2.8% on an annualized basis from the previous quarter in the July–September quarter of 2024. The effect of this tax cut is, however, expected to be temporary, with growth maintaining a steady pace of around 1% on an annualized basis from the October–December quarter of 2024 onwards.

Projections indicate that real GDP growth will persist at 1.4% in FY 2023, 1.3% in FY 2024, and 1.1% in FY 2025.

Changes in real GDP growth rate (fiscal year)



Source: "Quarterly Estimates of GDP," Economic and Social Research Institute, Cabinet Office.

Shifts in Demand and Inbound Tourism

Inbound tourist demand, previously diminished due to the COVID-19 pandemic, has experienced rapid recovery following the phased relaxation and eventual elimination of border measures by April 2023. In

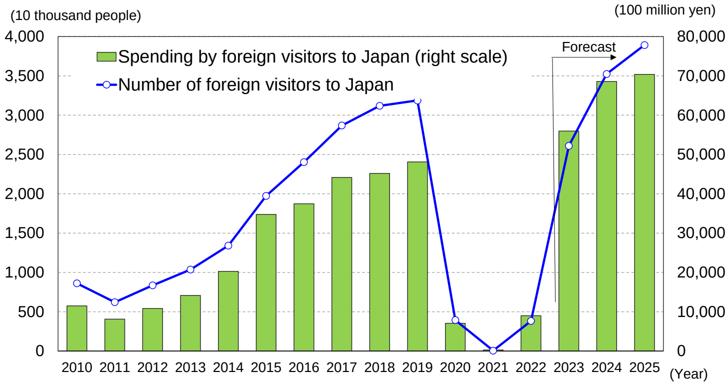
October 2023, inbound visitors to Japan reached 2,516,500, surpassing 2019 levels for the same month and demonstrating a rebound in demand.

The share of visitors from China remains low, at 35.1% in October 2023 compared to the same month in 2019 and constituting about 30% of the total before the pandemic. However, an expected improvement in Japan–China relations could accelerate the overall growth in foreign visitors to Japan.

More notably, spending by foreign visitors surged: In the July–September quarter of 2023, their spending totaled 1.39 trillion yen, marking a 17.7% increase from the same period in 2019 and significantly surpassing pre-pandemic levels. This surge is attributed to factors such as a weaker yen and increased stays by business and other visitors.

The number of foreign visitors to Japan is expected to surpass 2019 levels by 2024 and exceed 31.88 million. Due to an increase in per capita spending attributed to the weak yen, inbound foreign travel consumption is expected to exceed the government target of 5 trillion yen by 2023 and expand to 7 trillion yen by 2025.

Estimates of number and spending of foreign visitors to Japan



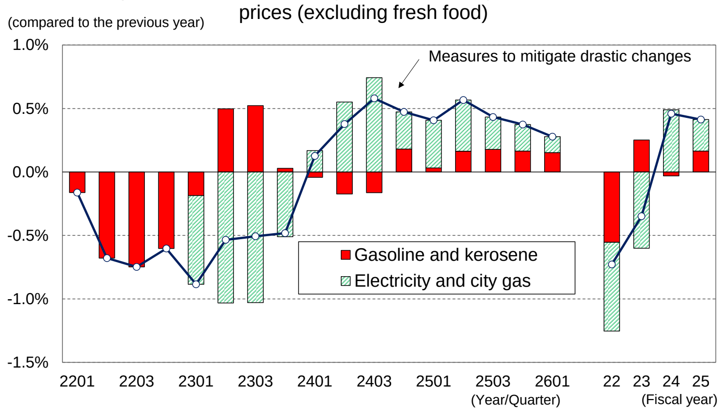
Sources: "Statistics on foreign visitors to Japan," Japan National Tourism Organization (JNTO); "Survey of foreign visitors' spending," Japan Tourism Agency.

Price Outlook and Consumer Inflation

The core CPI rose to 4.2% in January 2023, the highest level in 41 years, but settled in the low 3% range from February onwards due to government measures to alleviate the pressure of electricity and city gas bills. In September, the CPI dipped to 2.8% year-on-year while the core CPI, excluding energy and fresh food, maintained a high level in the upper 4% range for six consecutive months, indicating persistent upward price pressure.

Measures to mitigate the effect of increases in fuel oil prices were extended due to yen depreciation and renewed increases in crude oil prices. These measures are expected to impact the core CPI, depressing its rate of increase until the October–December quarter of 2023 but boosting it from the January–March quarter of 2024 onwards.

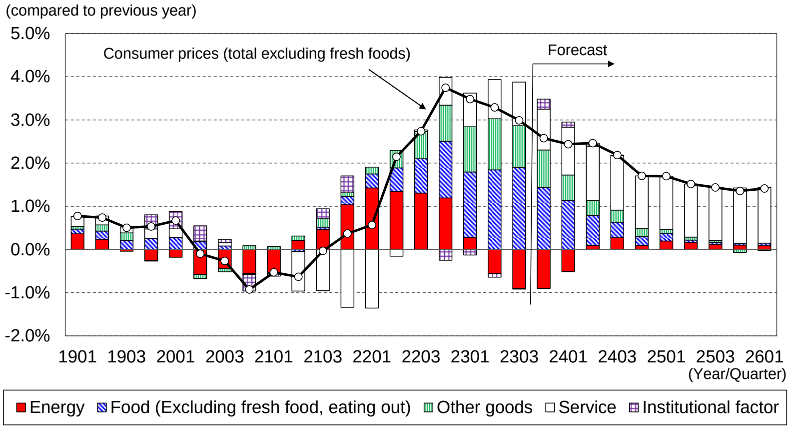
Impact of measures to mitigate drastic changes in consumer prices (excluding fresh food)



Source: "Consumer Price Index," Statistics Bureau, Ministry of Internal Affairs and Communications.

Forecasts indicate a core CPI of 2.8% in FY 2023, 2.0% in FY 2024, and 1.4% in FY 2025. Similarly, the core CPI is projected to be 3.9% in FY 2023, 2.0% in FY 2024, and 1.4% in FY 2025, reflecting a gradual decline from the 3.0% recorded for FY 2022.

Forecast of consumer prices (total excluding fresh foods)



Note: Factors influencing the system include consumption tax, free education, Go To Travel Campaign, and nationwide travel support.
Source: "Consumer Price Index," Statistics Bureau, Ministry of Internal Affairs and Communications.

Outlook for the Japanese economy

(Units,%) Previous forecast(2023.9)

	FY 2022 Actual	FY 2023 Forecast	FY 2024 Forecast	FY 2025 Forecast	23/4-6 Actual	23/7-9 Actual	23/10-12 Forecast	24/1-3 Forecast	24/4-6 Forecast	24/7-9 Forecast	24/10-12 Forecast	25/1-3 Forecast	25/4-6 Forecast	25/7-9 Forecast	25/10-12 Forecast	26/1-3 Forecast	FY 2023 Forecast	FY 2024 Forecast
Real GDP	1.3	1.4	1.3	1.1	1.1	- 0.5	0.4	0.2	0.4	0.7	0.3	0.2	0.2	0.2	0.3	0.2	1.5	1.4
					4.5	- 2.1	1.7	0.7	1.4	2.8	1.2	0.8	0.9	1.0	1.1	0.9		
					1.7	1.2	1.6	1.0	0.5	1.6	1.5	1.6	1.4	1.0	0.9	1.0		
Contribution to domestic demand	(1.9)	(0.1)	(1.4)	(1.0)	(- 0.7)	(- 0.4)	(0.5)	(0.3)	(0.4)	(0.6)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.6)	(1.5)
Private demand	(1.9)	(- 0.0)	(1.3)	(0.9)	(- 0.7)	(- 0.4)	(0.5)	(0.3)	(0.4)	(0.6)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.5)	(1.4)
Public demand	(- 0.0)	(0.2)	(0.1)	(0.1)	(0.0)	(0.0)	(- 0.0)	(0.0)	(0.0)	(- 0.0)	(0.0)	(0.0)	(0.0)	(- 0.0)	(0.0)	(0.0)	(0.2)	(0.1)
Contribution to external demand	(- 0.6)	(1.3)	(- 0.1)	(0.1)	(1.8)	(- 0.1)	(- 0.1)	(- 0.1)	(- 0.0)	(0.1)	(0.1)	(- 0.0)	(0.0)	(0.0)	(0.0)	(- 0.0)	(0.8)	(- 0.1)
Private final consumption expenditure	2.5	0.0	1.7	0.7	- 0.9	- 0.0	0.5	0.4	0.5	0.8	0.1	0.1	0.2	0.2	0.1	0.2	0.7	1.8
Private residential investment	- 3.2	2.0	- 0.4	- 0.1	1.8	- 0.1	- 0.8	- 0.6	- 0.1	0.5	0.6	- 0.4	- 0.4	0.3	0.1	- 0.5	2.0	- 0.1
Private nonresidential investment	3.0	0.5	2.9	3.3	- 1.0	- 0.6	1.2	0.6	0.6	0.8	0.8	1.0	0.8	0.8	0.9	0.7	1.1	3.1
Government final consumption expenditure	0.7	0.3	0.1	0.2	0.0	0.3	- 0.1	- 0.1	0.1	- 0.0	0.1	0.1	0.1	- 0.1	0.1	0.0	0.2	0.2
Public investment	- 3.2	1.7	1.3	0.8	0.3	- 0.5	0.5	0.8	0.4	0.0	0.1	0.5	0.2	- 0.1	0.1	0.9	2.1	0.8
Exports of goods & services	4.5	3.2	1.8	2.4	3.9	0.5	0.6	- 0.1	0.3	0.7	0.8	0.5	0.5	0.7	0.6	0.6	2.0	1.7
Import of goods & services	7.2	- 2.7	2.3	2.1	- 3.8	1.0	1.0	0.7	0.5	0.2	0.4	0.6	0.5	0.6	0.5	0.7	- 2.0	2.4
Nominal GDP	2.0	5.4	2.8	2.1	2.5	- 0.0	1.1	0.6	0.7	1.0	0.4	0.5	0.6	0.6	0.1	0.5	4.7	2.9

Note: The upper column of real GDP is compared with the previous period, the middle column is annual growth over the previous period and the lower column is compared with the previous year. All other demand items are compared with the previous period.

< Key economic indicators >

(Units,%)

	FY 2022	FY 2023	FY 2024	FY 2025	23/4-6	23/7-9	23/10-12	24/1-3	24/4-6	24/7-9	24/10-12	25/1-3	25/4-6	25/7-9	25/10-12	26/1-3	FY 2023	FY 2024
Industrial production (QoQ)	- 0.3	- 0.8	1.0	1.5	1.4	- 1.2	0.5	0.1	0.5	0.4	0.4	0.4	0.4	0.3	0.3	0.2	0.2	1.7
Domestic Corporate Goods Prices (YoY)	9.5	2.2	- 0.4	0.3	5.0	3.0	0.6	0.2	- 0.1	- 0.3	- 0.5	- 0.7	0.0	0.3	0.4	0.5	2.5	0.5
Consumer Prices (YoY)	3.2	2.9	2.0	1.4	3.3	3.2	2.8	2.4	2.5	2.2	1.7	1.7	1.5	1.4	1.4	1.4	2.8	1.6
Consumer Prices (excluding fresh food)	3.0	2.8	2.0	1.4	3.3	3.0	2.6	2.4	2.5	2.2	1.7	1.7	1.5	1.4	1.4	1.4	2.8	1.6
Current account balance (¥trillion)	8.3	26.2	25.1	21.4	23.5	24.6	28.2	28.6	25.7	24.2	25.5	25.1	23.6	21.6	20.6	20.0	19.5	17.6
(Ratio to nominal GDP)	(1.5)	(4.4)	(4.1)	(3.4)	(4.0)	(4.2)	(4.7)	(4.8)	(4.3)	(4.0)	(4.2)	(4.1)	(3.8)	(3.5)	(3.3)	(3.2)	(3.3)	(2.9)
Unemployment rate (%)	2.6	2.6	2.5	2.3	2.6	2.7	2.6	2.6	2.6	2.5	2.5	2.4	2.4	2.4	2.3	2.3	2.5	2.3
Housing starts (10 thousand)	86.1	80.9	81.4	81.4	81.5	79.7	81.5	80.9	80.9	81.3	81.9	81.6	81.2	81.5	81.6	81.2	82.9	83.7
Call Rate (target rate)	--	--	--	0.1	--	--	--	--	--	--	--	--	0.1	0.1	0.1	0.1	--	--
10-year government bond rate (over-the-counter quotation)	0.3	0.7	0.9	1.0	0.4	0.6	0.9	0.8	0.9	0.9	0.9	0.9	1.0	1.0	1.0	1.0	0.6	0.8
USD/JPY	135	144	138	132	137	145	150	146	142	139	137	135	133	132	131	130	142	134
Crude oil price (CIF, Dollar/Barrel)	102	85	91	92	83	83	92	84	88	92	92	92	92	92	92	92	91	98
Ordinary profit (YoY)	8.8	8.3	8.0	6.2	11.6	8.0	9.4	3.7	2.5	11.8	10.4	9.4	6.0	6.2	6.3	6.3	7.0	8.4

Note: 10-year government bond rate, Foreign exchange rates and Crude oil prices are average data of the period. Oridinary profit of 23/7-9 is forecast.

Sources: "Quarterly Estimates of GDP," Economic and Social Research Institute, Cabinet Office; "Indices of Industrial Production," Ministry of Economy, Trade and Industry; "Consumer Price Index," Ministry of Internal Affairs and Communications; "Financial Statements Statistics of Corporations by Industry, Quarterly," Ministry of Finance and others.

Outlook for the U.S. economy

		2022	2023	2024	2025	2023				2024				2025			
						1-3	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3	4-6	7-9	10-12
		Actual	Forecast	Forecast	Forecast	Actual	Actual	Actual	Forecast	Actual	Actual	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Real GDP	Annual rate,% QoQ	1.9	2.4	1.4	1.6	2.2	2.1	4.9	1.0	0.4	1.1	1.2	1.4	1.7	2.0	1.7	1.7
FF rate target	End of period, Upper,%	4.50	5.75	5.25	4.00	5.00	5.25	5.50	5.75	5.75	5.75	5.50	5.25	4.75	4.50	4.25	4.00
10-year government bond rate	Average,%	3.0	4.0	4.2	3.6	3.6	3.7	4.1	4.6	4.4	4.2	4.1	3.9	3.8	3.7	3.6	3.4

Outlook for the European (Euro area) economy

		2022	2023	2024	2025	2023				2024				2025			
						1-3	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3	4-6	7-9	10-12
		Actual	Forecast	Forecast	Forecast	Actual	Actual	Revised	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Real GDP	Annual rate,% QoQ	3.4	0.4	1.0	1.6	0.2	0.6	- 0.2	0.3	1.2	1.4	1.8	1.9	1.7	1.5	1.3	1.3
ECB Refinancing rate	End of period,%	2.50	4.50	3.50	2.25	3.50	4.00	4.50	4.50	4.50	4.50	4.00	3.50	3.00	2.50	2.25	2.25
10-year German govt. bond rate	Average,%	1.1	2.5	2.3	2.0	2.3	2.4	2.6	2.7	2.6	2.4	2.2	2.0	2.0	2.0	2.0	2.0
EUR/USD	Average, Dollars	1.05	1.08	1.09	1.12	1.07	1.09	1.09	1.06	1.08	1.09	1.09	1.10	1.10	1.11	1.12	1.13