

Annual Report on the Japanese Economy
and Public Finance

2015

—Japan Is in the Best Condition in A Quarter
Century and Achieving Economic
Revitalization—

Summary

August 2015

Cabinet Office
Government of Japan

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This material has been tentatively prepared to explain the “Annual Report on the Japanese Economy and Public Finance.” For quotations and other purposes, please refer to the text of the “Annual Report on the Japanese Economy and Public Finance.”

Chapter 1 Economic Conditions and the Progress of Virtuous Circle

Section 1 Ongoing Economic Revival and Recent Economic Conditions

- The Japanese economy has been recovering on the whole, led by domestic demand, mainly personal consumption, since its turnaround in late 2012. Amid the waning deflation, nominal GDP in the January-March quarter of 2015 recorded the strongest growth rate since 1994, the earliest year for which data are available in the current format.
- Corporate earnings in FY2014 hit a record high, as they did in FY2013.

Figure 1-1-1 Changes in real GDP

(1) Cumulative real GDP growth rate

(Contribution in October-December of 2012, %)

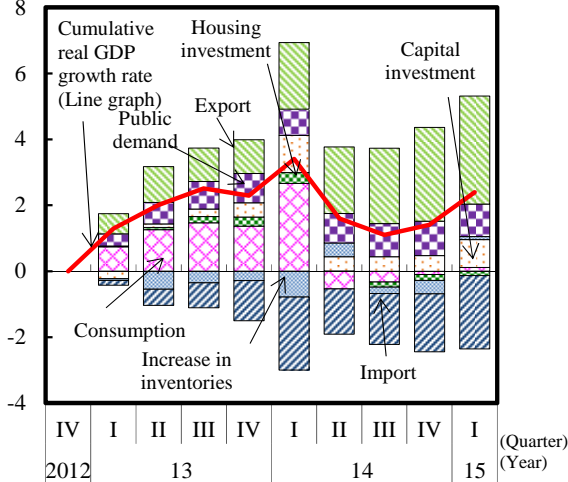
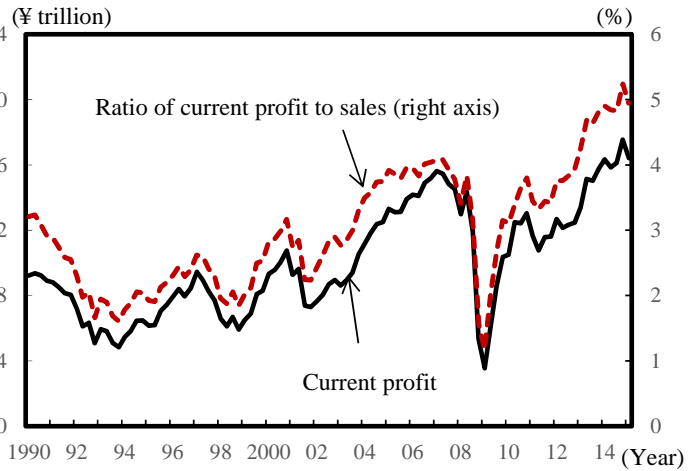


Figure 1-1-2 Trends in corporate and household income

(1) Current profit and the ratio of current profit to sales



(Notes) 1. (Left) Compiled based on the System of National Accounts, the Cabinet Office.

2. (Right) Compiled based on the Financial Statements Statistics of Corporations by Industry, the Ministry of Finance.

- Moreover, the virtuous economic circle is starting to steadily turn, as shown by improvements in the employment and income environments. The economic conditions are the best in nearly a quarter century.
- Following the crude oil price decline since late 2014, the terms of trade have improved and trade gains have made positive contributions, and as a result, real GNI has been increasing since the October-December quarter of 2014.

Figure 1-1-2 Trends in corporate and household income

(3) Gross income of employees

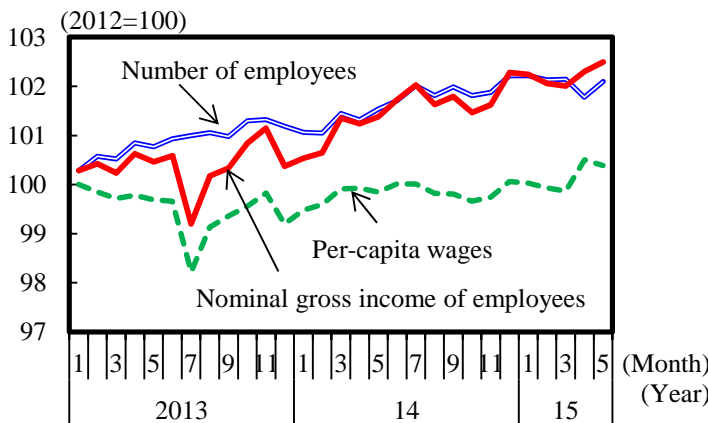
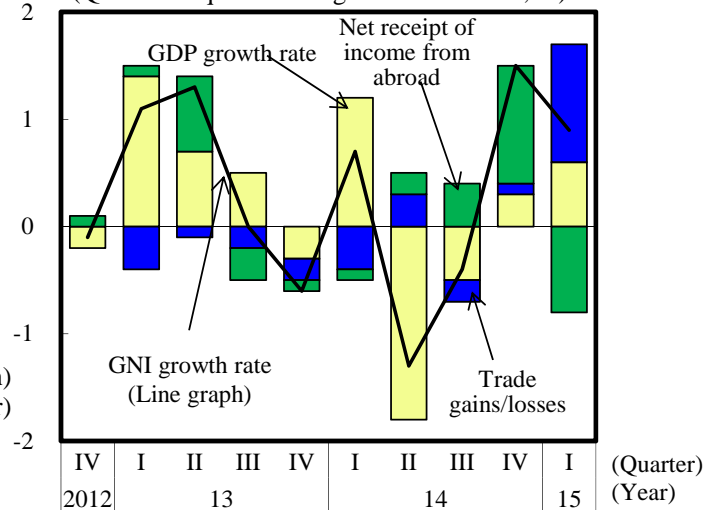


Figure 1-1-3 Trend in real GNI

(Quarter-to-quarter change in contribution, %)



(Notes) 1. (Left) Compiled based on the Labour Force Survey, the Ministry of Internal Affairs and Communications; and the Monthly Labour Survey, the Ministry of Health, Labour and Welfare.

2. (Right) Compiled based on the System of National Accounts, the Cabinet Office.

- Compared with at the time of the previous consumption tax hike, the number of employed people increased by a similar margin this time, while the growth in nominal wages was lower amid the lingering deflationary mindset. Income as a whole grew less than at the previous time. On the other hand, real gross income of employees declined because the tax hike margin was large and also because the consumer price growth rate was higher this time due to a rise in import prices, and as a result, consumption was curbed.
- One factor behind the weak recovery in consumption is a delay in the recovery in consumption by working-age generations aged less than 60 among low-income people. Since the beginning of 2015, consumption by both elderly and working-age generations has been on an uptrend.

Figure 1-1-6 Variable factors of personal consumption as compared with at the time of the previous consumption tax hike

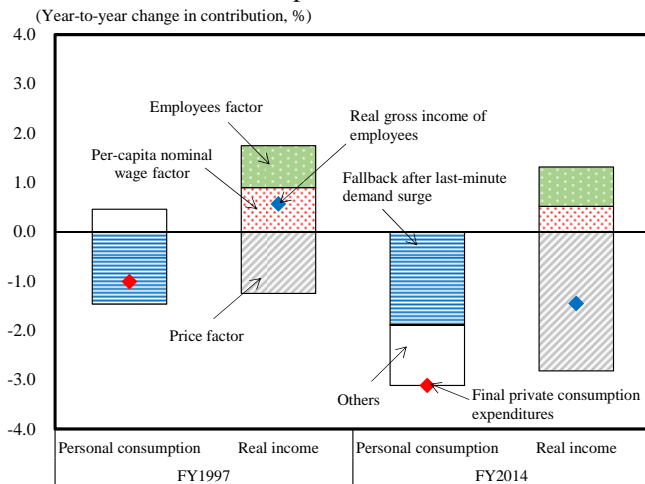
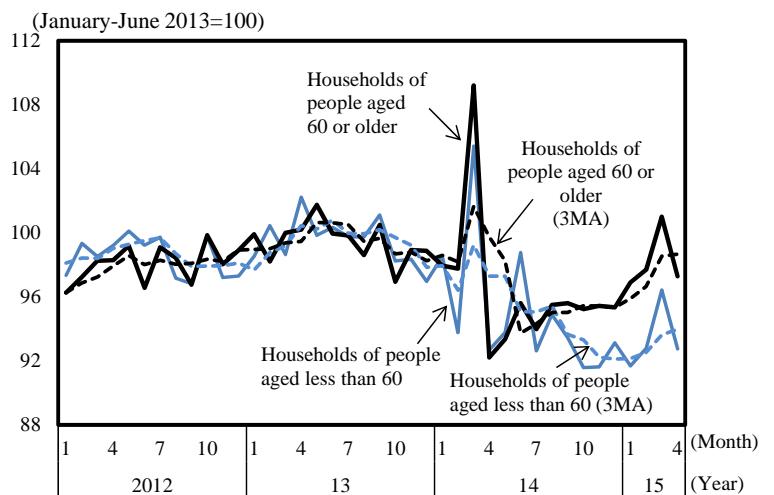


Figure 1-1-7 Consumption trend by income bracket (2) Consumption expenditure by age among low-income people

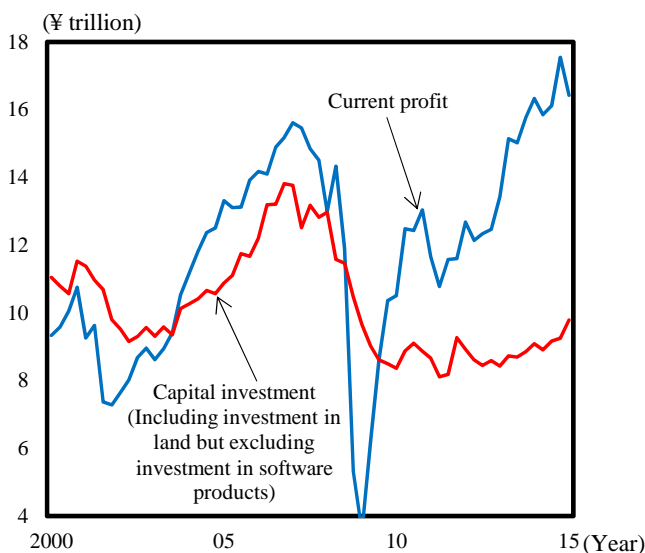


- (Notes) 1. (Left) Compiled based on the System of National Accounts, the Cabinet Office; the Labour Force Survey, the Ministry of Internal Affairs and Communications; and the Monthly Labour Survey, the Ministry of Health, Labour and Welfare.
2. (Right) Family Income and Expenditure Survey, the Ministry of Internal Affairs and Communications.

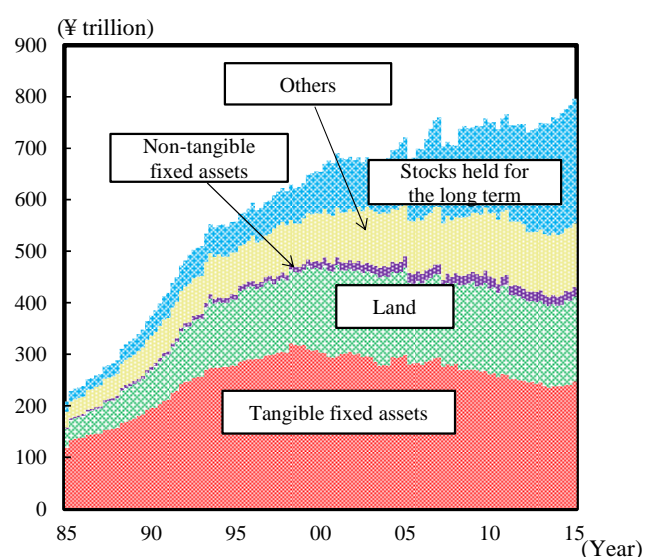
- In the corporate sector, the recovery in capital investment has been weak relative to corporate earnings, which are at a record high level. There are also moves to increase non-tangible assets, including R&D, and overseas investments.
- As capital investment has been made in an amount larger than depreciation expenses since around late 2013, domestic tangible fixed assets are starting to increase.

Figure 1-1-10 Capital investment trend

(1) Current profit and capital investment



(3) Composition of corporate fixed assets



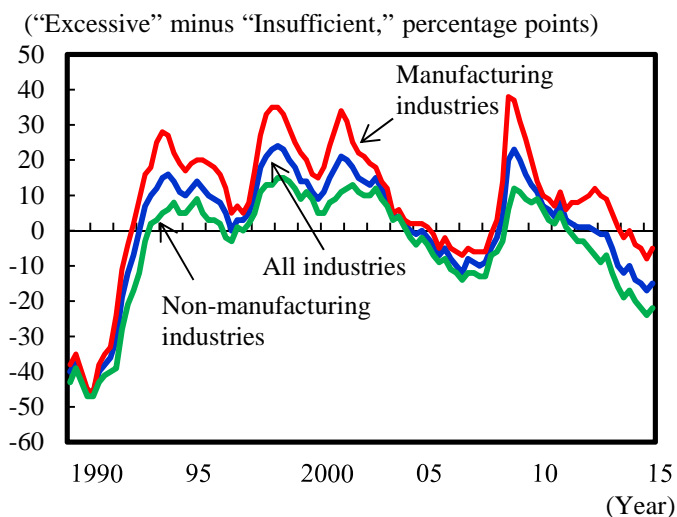
- (Note) Compiled based on the Financial Statements Statistics of Corporations by Industry, the Ministry of Finance.

Section 2 The Progress of Virtuous Circle and Move toward Overcoming Deflation

- The labor supply-demand balance is tightening, mainly in non-manufacturing industries.
- As robust corporate earnings have had spillover effects on wages, the virtuous economic circle makes progress.

Figure 1-2-1 Trend in labor supply-demand balance

(2) Employment DI by industry



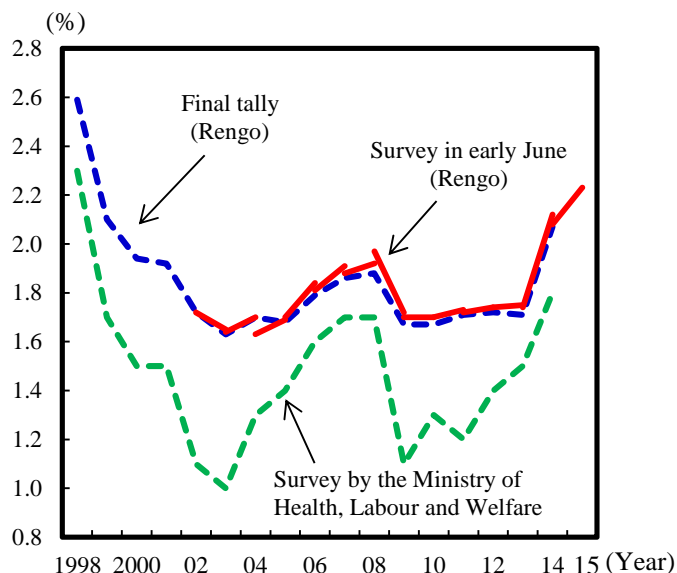
(Notes) 1. (Left) Compiled based on the Tankan Survey, Bank of Japan.

2. (Right) Compiled based on the Survey on Wage Increase, Ministry of Health, Labour and Welfare; Spring Offensive, Japanese Trade Union Confederation (Rengo), etc.

3. As Rengo conducts a series of surveys until the final tally, the figure for 2015 is based on the survey results compiled as of June 1.

Figure 1-2-3 Wage hikes by companies

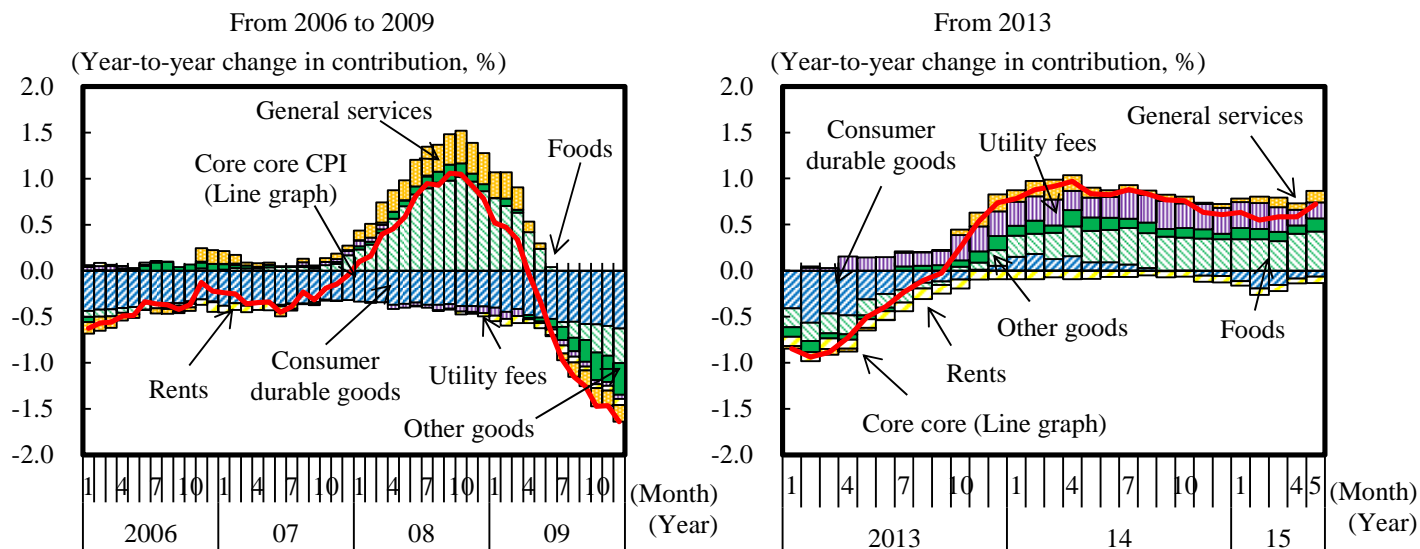
(1) Growth rate of wages including regular increase



- Regarding the price trend, consumer prices (core core CPI) have generally been rising moderately since the spring of 2013. Compared with the situation in the spring of 2006, when deflation waned last time, what is notable this time is that service prices are making positive contributions in a stable manner.

Figure 1-2-5 Consumer price trend

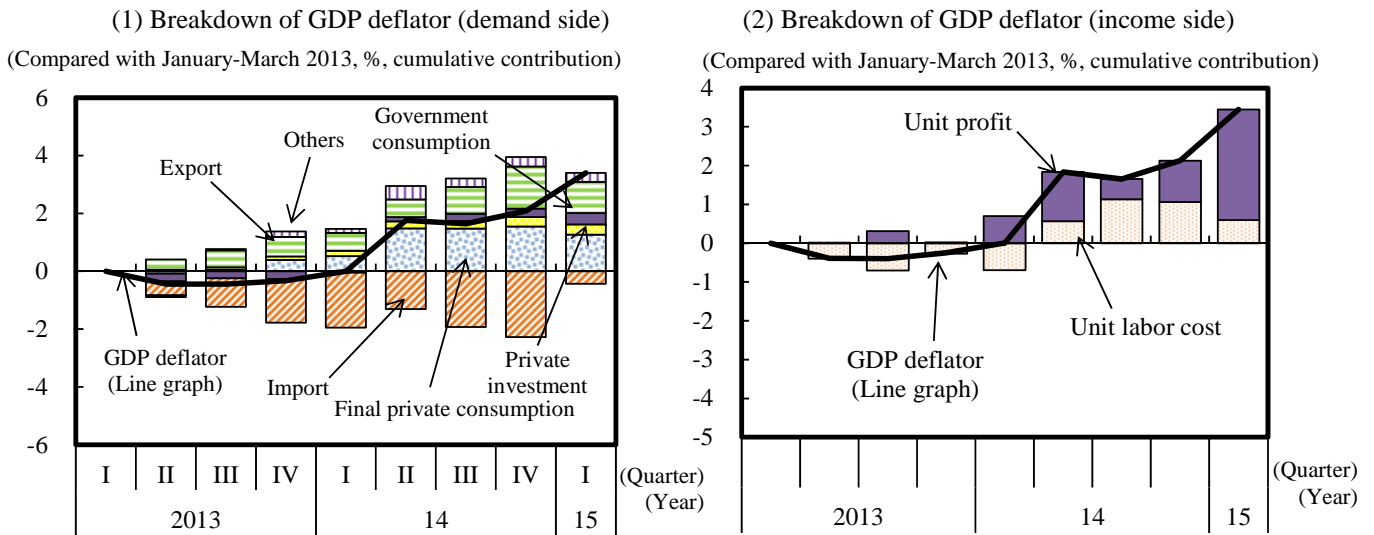
(3) Breakdown of consumer prices (core core CPI)



(Note) Compiled based on the Consumer Price Index, the Ministry of Internal Affairs and Communications. Chain-linking method. The effects of the consumption tax hike are excluded from the figures for April 2014 and thereafter.

- The GDP deflator is on an uptrend. On the demand side, private final consumption has been making positive contributions since the July-September quarter of 2013.
- On the income side, unit labor cost has been making positive contributions since the April-June quarter of 2014. As unit profit has been making positive contributions since the January-March quarter of 2014, distribution of profits to employees is expected to lead to a rise in wages.

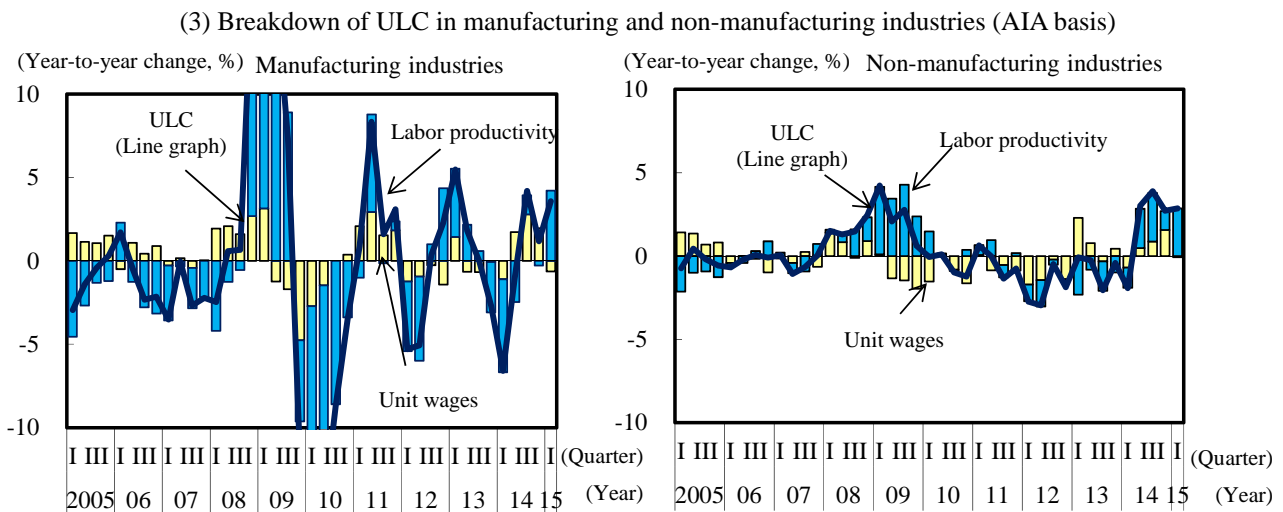
Figure 1-2-8 GDP deflator trend



(Note) Compiled based on the System of National Accounts, the Cabinet Office.

- Unit wages generally made positive contributions to unit labor cost (ULC) in manufacturing industries both last and this time. As positive contributions by unit wages were significant this time, unit labor cost has mostly been growing since the April-June quarter of 2014.
- In non-manufacturing industries, unit wages, which made negative contributions last time, generally made positive contributions this time.

Figure 1-2-10 Trend in unit labor cost (ULC)



(Note) Compiled based on the Indices of All Industry Activity, the Ministry of Economy, Trade and Industry; the Monthly Labour Survey, the Ministry of Health, Labour and Welfare; and the Labour Force Survey, the Ministry of Internal Affairs and Communications.

Section 3 Progress in Quantitative and Qualitative Monetary Easing and Its Effects Toward Integrated Economic and Fiscal Reforms

- The expected rate of inflation has been rising since around the time when quantitative and qualitative easing was introduced.
- The yield curve has flattened in whole.

Figure 1-3-2 Trend in expected rate of inflation
Short term (1 year)

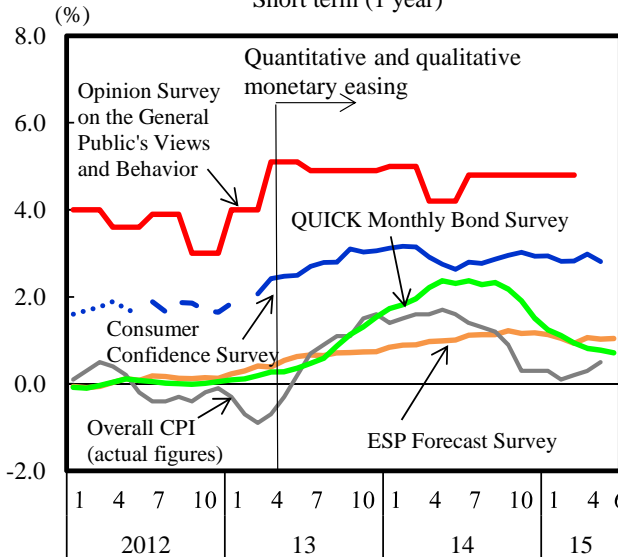
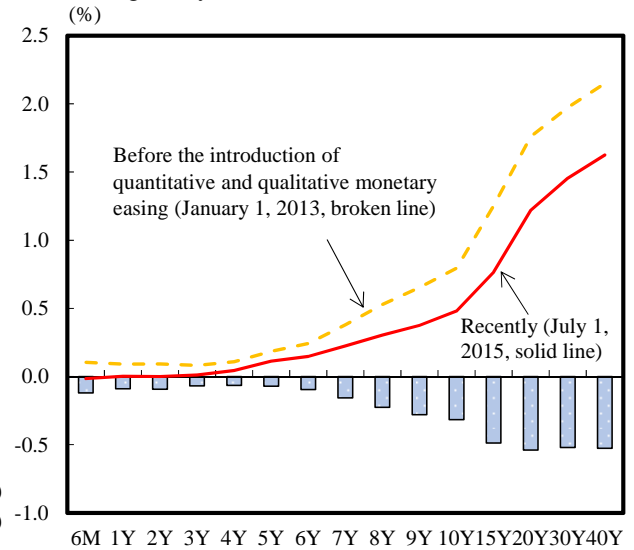


Figure 1-3-4 Trends in yield curve and real interest rates

(1) Changes in yield curve



(Notes) (Left) Compiled based on data published by Bloomberg; the Consumer Price Index, the Ministry of Internal Affairs and Communications; the Consumer Confidence Survey, the Cabinet Office; the Opinion Survey on the General Public's Views and Behavior, the Bank of Japan; the ESP Forecast Survey, the Japan Center for Economic Research; and the QUICK Monthly Bond Survey, QUICK Corp.
(Right) Compiled based on data published by Bloomberg

- Institutions other than the Bank of Japan are generally shifting from Japanese government bonds (JGBs) to other assets. At domestic banks, portfolio rebalancing is proceeding albeit at a moderate pace.
- Small and medium-size enterprises (SMEs) are raising more and more funds, mainly working capital, and they are expanding their business activities.

Figure 1-3-5 Trend in portfolio rebalancing
(1) Investment flow for institutions other than the Bank of Japan

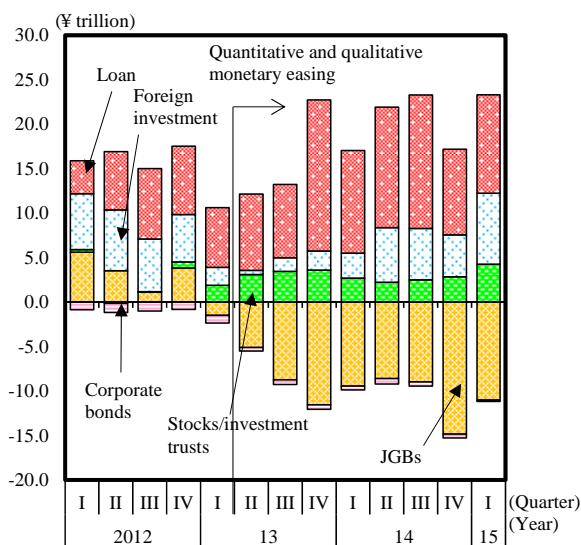
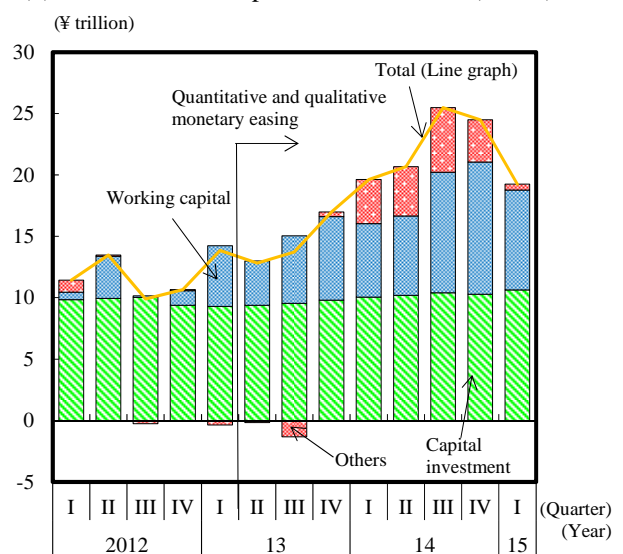


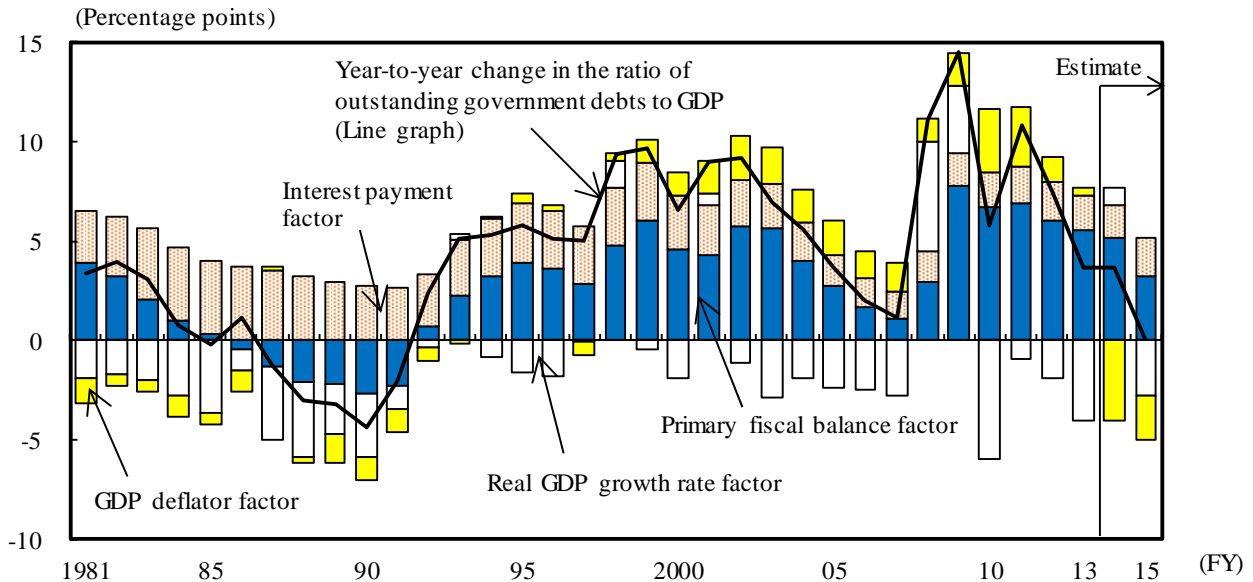
Figure 1-3-6 Impact of quantitative and qualitative monetary easing on corporate activities
(5) Breakdown of corporate fund demand (SMEs)



(Notes) 1. (Left) Compiled based on the Flow of Funds Accounts and the Financial Institutions Accounts, the Bank of Japan
2. (Right) Compiled based on the Financial Statements Statistics of Corporations by Industry, the Ministry of Finance.

- The ratio of outstanding debts to GDP has continuously been rising amid deflation. Although the rise has been gradually curbed since FY2011, it is necessary to continue strengthening efforts to overcome deflation and achieve economic revitalization and fiscal consolidation in an integrated manner.

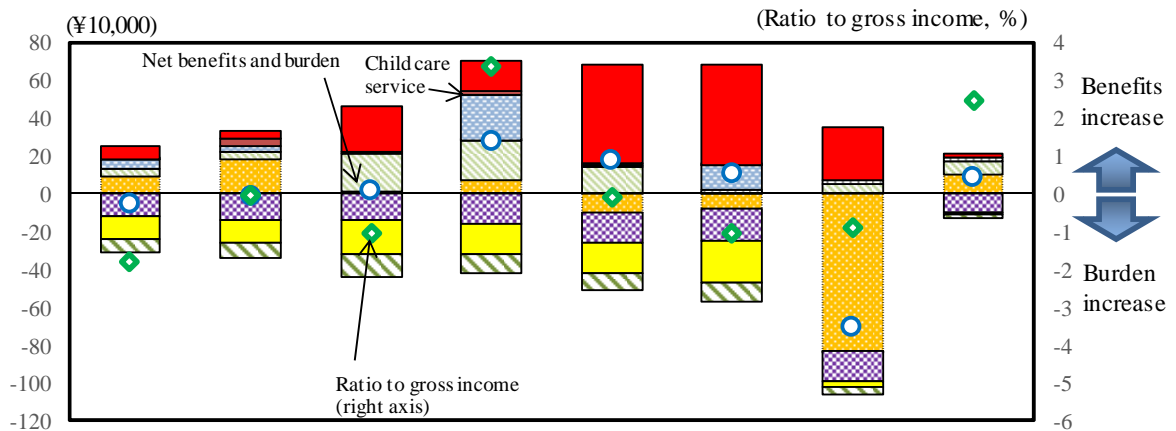
Figure 1-3-7 Trend in the ratio of outstanding government debts to GDP
(2) Factors that raise the ratio of outstanding government debts to GDP



(Note) Compiled based on the System of National Accounts and the Economic and Fiscal Projections for Medium to Long Term Analysis (announced in February 2015), the Cabinet Office.

- Notable changes in the structure of the benefits and burden based on the tax and social security systems in the past 20 years or so included that (1) among elderly people, who are currently receiving significant benefits, people in their 60s saw a decrease in pension benefits as a result of a rise in the starting age of pension payment while people in their 70s saw an increase; and (2) among working-age generations, the burden on households with children increased while benefits for such households, including education services, grew.

Figure 1-3-11 Structure of benefits and burden by household type
(2) Breakdown of change in benefits and burden by household type (from 1994 to 2015)



Gender and age of household head	Man in 30s	Man in 30s	Man in 40s	Man in 40s	Man in 50s	Man in 50s	Man in 60s	Woman in 70s
Married or single	Married	Married	Married (double-income)	Married (double-income)	Married	Married	Married	Single
Number of children	1	2	None	2	None	1	None	None
Average gross income	-450,000 yen	-490,000 yen	-570,000 yen	-790,000 yen	-1,130,000 yen	-1,230,000 yen	-1,290,000 yen	+40,000 yen

(Note) Compiled based on the National Survey of Family Income and Expenditure, the Ministry of Internal Affairs and Communications.