Annual Report on the Japanese Economy and Public Finance 2019
(Report by Minister of State for Economic and Fiscal Policy)

— Japanese Economy in the New Reiwa Period —
Summary

July 2019
Cabinet Office, Government of Japan
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: Current State of Japanese Economy and Challenges to Address

- The Japanese economy continues to be on a moderate recovery path, centering on domestic demand. However, it is necessary to bear in mind that some export and production activities are weak denoted by China’s economic slowdown.
- Sluggish exports are due mainly to decreases in exports to China since 2018, as global demand for IT-related goods has lost steam and China's economy has slowed. Some production has slumped on weak exports. Worldwide semiconductor shipments are expected to decline in 2019 and the adjustments of demand for IT-related goods are likely to continue for some time to come.
- China’s economic slowdown has an adverse effect on manufacturing of production machinery, electronic parts and devices, etc. whose overseas shipment ratios are high.

(Notes)
Chart 1: Compiled based on System of National Accounts, Cabinet Office.
Charts 2 and 3: Compiled based on Foreign Trade Statistics, MoF and Indices of Industrial Production, METI. Seasonally adjusted by Cabinet Office. 3-month moving average.
Chart 4: Compiled based on Semiconductor Market Forecast, WSTS.
Chart 5: Compiled based on Breakdown of Mining and Manufacturing Shipments, METI. Seasonally adjusted. 3-month moving average.
The gradual increase in capital investment is attributable partly to high corporate profits and increasing sense of labor shortage. However, as a decline in export reduces capital investment mainly in manufacturing industries, we need to keep an eye on overseas economic trends. While the production-age population dwindles, the number of workers has increased thanks to the progress of women’s and elderly people’s participation in the workplace, then real total wage income of employees continues to grow. So consumer spending remains on a recovery track. However, with young people spending less, the pace of consumer spending growth is slower than that the overall employment and income environment improves.
In order to increase consumption on a sustainable basis, it is necessary to stabilize the employment and income environment not only at present but also for the future. Furthermore, reducing the burden of education expenditure and shortening work hours are considered effective measures for increasing young people's spending.

People, chiefly young people, are highly motivated to buy full self-driving cars, while mainly working women, to buy housekeeping robots. Further enhancement of Society 5.0 initiatives are expected to stimulate consumer spending.

Cashless payment increases the convenience of consumers and helps business operators to increase productivity. Nearly half of consumers frequently use cashless payment systems. It is important to make the advantages of cashless payments well known to consumers who do not use cashless payment systems at present.
A survey on companies about a shortage of workers by age group reveals that they find it more difficult to hire young workers. Companies whose sales are growing and those with high staff turnover as well as those paying low wages have a higher sense of workforce shortage. The major solution to labor shortage is to secure employees by increasing employment and improving the working conditions. Only about 20% of companies with a labor shortage make labor-saving investments. Greater sense of labor shortage comes with lower labor productivity and a lower capital equipment ratio. It is crucial to raise labor productivity, thereby mitigating the workforce shortages and achieving wage growth.

Companies which are active in introducing AI, etc. allow their employees to choose more flexible work styles. It is important to enhance Society 5.0 initiatives including RPA that has a significant impact on labor productivity and actively promote labor-saving investments and flexible working.

Chart 21: Sense of Shortage of Workers by Age Group
Chart 22: Reasons for Labor Shortage
Chart 23: Solutions to Labor Shortage
Chart 24: Levels of Labor Productivity and Capital Equipment Ratio by Sense of Labor Shortage
Chart 25: Effect on Growth Rate of Wage per Worker
Chart 26: Ratio of Companies Actively Promoting Use of AI, etc. and Flexible Working
Chart 27: Effect of Labor-saving Investment in RPA, etc. on Labor Productivity

(Notes)
Charts 21-25 and 27: Compiled based on Survey on Corporate Awareness of Diversified Workforce, Cabinet Office.
Chart 26: Compiled based on Survey on Corporate Awareness of Work Style, Education, Training, etc., Cabinet Office.
Charts 22, 24, 25 and 27: The signs ***, ** and * denote the 1%, 5% and 10% levels, respectively and indicate that the result has statistical significance.
• Primary fiscal balance as a ratio to GDP shows that fiscal deficits shrank thanks largely to an increase in tax revenues.
• Impacts by the consumption tax hike on the economy will be limited to about 2 trillion yen due mainly to measures to make preschool education free. The government will also implement new economic stimulus measures worth 2.3 trillion yen to respond to the consumption tax hike.
• In developed countries, prices are less likely to go up despite labor market improvement and monetary easing measures are maintained owing to weaker performance in some economies.

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**Chart 28 Primary Fiscal Balance of National and Local Governments as Ratio to GDP**

- Greater burden worth about 5.2 trillion yen
- Greater benefits worth about 3.2 trillion yen

**Chart 29 Impacts by Consumption Tax Hike and Responses Thereto**

- Impacts by the consumption tax hike (including reduced burden deriving from reduced tax rate, revision of tobacco tax, etc.)
- New economic stimulus measures to respond to the consumption tax hike
- Budget scale, etc.
- Support through making preschool education free, enhancing social security, etc.

**Chart 30 Factors Affecting Changes of Primary Fiscal Balance as Ratio to GDP**

- Change of primary balance (national and local governments) as ratio to nominal GDP compared with previous year (Broken line)

**Chart 31 Policy Interest Rates**

- Japan
- Euro area
- U.S.

**Chart 32 International Comparison of Consumer Prices (General)**

- The rise in prices remains moderate in all countries and regions

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(Notes)


Chart 29: Compiled based on the meeting of Council on Economic and Fiscal Policy (December 20, 2018).

Chart 31: Compiled based on data provided by BoJ, FED, ECB and Bloomberg.

Chapter 2: Diversification of Labor Market and the Challenges

- From the employees' perspective, establishment of an environment for diverse human resources can encourage active participation of women and elderly people with desire to work and meets the demand from the diversification of the set of values.
- A lot of companies make more use of diverse human resources such as women, elderly people, foreigners and the challenged. From the corporates' perspective, the diversity in the workplace are increasing, based on severe labor shortage and demand for employees with innovative ideas or professional knowledge. However, some companies are concerned that the diversity complicates labor management.

(Note) Compiled based on Survey on Corporate Attitude toward Diverse Work Styles, Cabinet Office, Survey on Attitude of Working Period Elongation, Cabinet Office and Report on Comprehensive study on problems concerning work-family balance support.
In order for companies to make active use of diverse human resources, it is especially important for them to achieve work style reform by introducing flexible work arrangements and promoting better work-life balance for their employees, revise Japanese employment practices such as long-term employment and promotion by seniority, and have their management level employees manage the workplace in an appropriate manner.

Many employees voice their opinion that it is necessary, when working with people from diverse groups, for companies to establish flexible work arrangements and clarify the scope of their work. It corresponds to measures companies consider is necessary.

For promoting diversity in the workplace, companies are also required to review their recruitment systems including introduction of year-round recruitment of new graduates.

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**Chart 38** Measures Taken to Promote Diversity in Workplace (Companies)

- Flexible work arrangements
- Promotion of Work-Life Balance
- Review of assessment systems
- Enhancement of education and training systems
- Med- to long-term plans/vision
- Goal setting for female ratio
- Establishment of diversity promoting department
- No measures taken

**Chart 39** Correlation between Measures Taken and Diversity

(Chart indicating measures taken and diversity levels)

**Chart 40** Japanese Employment Practices and Diversity

(Chart showing degree of commitment to Japanese employment practices and diversity levels)

**Chart 41** Systems Necessary to Work Efficiently among Diverse Workers (Employees’ perspective)

(Chart showing systems necessary for diverse workers)

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(Note) Compiled based on Survey on Corporate Attitude toward Diverse Work Styles, Cabinet Office, Survey on Attitude of Working Period Elongation, Cabinet Office.
In order to help employees aged 65 or older stay active at work, it is essential that we review mandatory retirement age and the employment continuation system. In particular, a sharp decrease in wages and long working hours are highly likely to significantly reduce elderly people’s willingness to work.

Companies also want to hire people with a high level of expertise and healthy and motivated workers, even if they are 65 years old or older. In addition, many companies state that they need to introduce flexible work arrangements, clarify employee roles and responsibilities, re-establish career models, etc.

Chart 44: What Matters to Employees When Choosing to Work after Age 65

Chart 45: Desirable Mandatory Retirement Age (Employees’ perspective)

Chart 46: Skills and Attributes Employers Look For When Hiring People Aged 65 or Older (Companies’ perspective)

Chart 47: Measures Necessary to Promote Employment of People Aged 65 or Older (Companies’ perspective)

(Note) Compiled based on Survey on Corporate Attitude toward Diverse Work Styles, Cabinet Office, Survey on Attitude of Working Period Elongation, Cabinet Office.
The increase in diverse human resources is expected to improve productivity and eliminate labor shortages. However, when hiring people from diverse groups, it is extremely important to simultaneously take measures to help them stay active at work. Companies which have diverse human resources but have not taken such measures are likely to become less productive than those without diverse human resources.

As for the increase in the number of elderly employees, younger workers welcome it saying that it mitigates labor shortage and that they can obtain advice from elderly employees. On the other hand, some express concern that it may affect their pay and promotion. Nevertheless, results of the analysis do not show that the increase in the number of elderly employees has any negative impact on younger workers' pay and employment.

While the number of employees increases in general, that of foreign workers also increases.

(Note) Compiled based on Survey on Corporate Attitude toward Diverse Work Styles, Cabinet Office, Survey on Attitude of Working Period Elongation, Cabinet Office and CSR Survey, Toyo Keizai.
Although Japan has run a current account surplus for many years, the breakdown of the current account has changed significantly; whereas trade surplus has decreased sharply, income receipts from the overseas investment, etc. has increased steadily. Under these circumstances, Japan has had a competitive advantage in the manufacturing of highly sophisticated products such as machinery and also improved competitiveness in service trade as evidenced by the increase in international technology transactions and the number of inbound tourists.

Moreover, with an increasing number of Japanese companies making inroads into overseas markets, outward foreign direct investment (FDI) including acquisition of foreign corporations has grown. In addition to trade in goods and services, Japan has been increasing its ability to earn in the international arena, by boosting income received from overseas operating bases and companies having been acquired around the world.
World trade volume had increased significantly until the 2000s, spurred by trade liberalization including tariff reduction and global value chain (GVC) development. However, after a sharp increase in 2017, the pace of the growth has decelerated since 2018 due to China’s gradual economic slowdown and increasing uncertainty over the global economy.

In Asia, a supply chain in which China imports and processes parts and materials, and produces finished products has been developed and expanded rapidly over the past 20 years. Under these circumstances, Japan’s manufacturing, mainly that of IT-related goods, depends heavily on final demand from China. We have to keep an eye on U.S.-China trade issues and the Chinese economy going forward.

(Note) Compiled based on data provided by WTO and IMF (2019), Inter-Country Input-Output Tables and Trade in Value Added (December 2018, December 2016), OECD and data provided by Bloomberg.
With regard to the effect of U.S.-China trade issues on Japanese-affiliated companies in Asia, the issues do not have a significant effect on those based in China, as they sell products mostly within China and more than half of their exports are directed to Japan. Meanwhile, it is pointed out that those based in other countries and regions in Asia that are closely related to China are negatively affected. With the future of the trade issues highly uncertain, we need to continue watching the situation.

The U.K. has established with the EU a strong supply chain. While some Japanese-affiliated companies in the U.K. have taken concrete measures to prepare for Brexit, many are not quick in responding to the issue due to great uncertainty surrounding it.

Some industries such as the automotive industry express concerns over the negative effect of the new agreement among the U.S., Mexico and Canada (USMCA).
A look at benefits of globalization for business finds that companies engaging in export and FDI, although remaining a minority, are more productive, have a larger number of employees and pay employees more on average than those companies not engaging in export and FDI. Furthermore, starting to export and joint researches and personnel exchanges with foreign companies are likely to improve corporate productivity.

On the other hand, conducting trade increases demand for skilled labor within the industry, which may lead to a pay gap between highly skilled workers and low-skilled ones. It is crucial for companies to maintain competitiveness amid ongoing globalization of economy and at the same time, to enhance employee education and training programs, secure employee mobility and build a safety net for employees in order to overcome the pay gap.

Chart 72: Characteristics of Japanese Exporting Companies (FY2016)

- Share of export value accounted for by top exporters:
  - Top 5-10% exporters (6.9%)
  - Top 1-5% exporters (23.0%)
  - Others (8.8%)

- Premium of exporting companies (Comparison of average values with those of non-exporting companies):
  - Average values of exporting companies are higher than those of non-exporting companies

Chart 74: Impact of Globalization on Domestic Employment

- Ratio of exporting companies’ and related companies’ employees in terms of numbers (% of total)
- Employment increased by Japanese companies’ start of export (Rate of change in the number of employees, % pts)

Chart 75: Globalization and Domestic Pay Gap

- Relative wage and supply volume of college-educated and high-school-educated workers (Times)
- Distribution of salaries paid by Japanese companies (FY2016) (Probability density)

(Note) Compiled based on Basic Survey of Japanese Business Structure and Activities, METI, Survey on Corporate Awareness of Diversified Workforce commissioned by Cabinet Office in FY2018, Trade in Employment (March 2019), OECD, etc.
The analysis used data on the hourly floating population (aged 20-59) in Tokyo 23 wards on a weekday in February estimated based on mobile phone information. The growth in the nighttime population is lower than that in the daytime population (the difference between the year-on-year change in the daytime population and that in the nighttime population is minus). It appears that men in their 20s and 30s are benefiting especially from work style reforms.

After classifying grid cells into 4 regions by industry composition, the daytime and nighttime populations of each region were examined. In business districts where financial companies, etc. are mainly located, the growth in the nighttime population is far lower than that in the daytime population. Meanwhile, in entertainment districts where the restaurant industry, etc. flourish, the nighttime population does not decrease sharply, indicating that people spend more time on dining-out and shopping thanks to reduction of overtime work. In addition, the heatmap of the difference between the year-on-year change in the daytime population and that in the nighttime population shows that many areas experience a decline. In particular, a decreasing trend is found in business districts (Ⓐ-Ⓒ), while an increasing trend, in entertainment districts (Ⓓ-Ⓕ).

### Chart I Hourly Population in Tokyo 23 Wards and Rate of Change

(Y/Y change, %)

### Chart II Difference between Y/Y Change in Daytime Population and That in Nighttime Population by Region (Median)

%)

### Chart III Heatmap of Difference between Y/Y Change in Daytime Population and That in Nighttime Population and Rate of Decrease in Major Grid Cells

(%)