



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

Contents

- Chapter 1: Current State of Japanese Economy and Challenges to Address p.1

- Chapter 2: Diversification of Labor Market and the Challenges p.6

- Chapter 3: Japan’s Economic Challenges amid Ongoing Globalization p.10

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 dented 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.

Chart 1 Real GDP Growth Rate

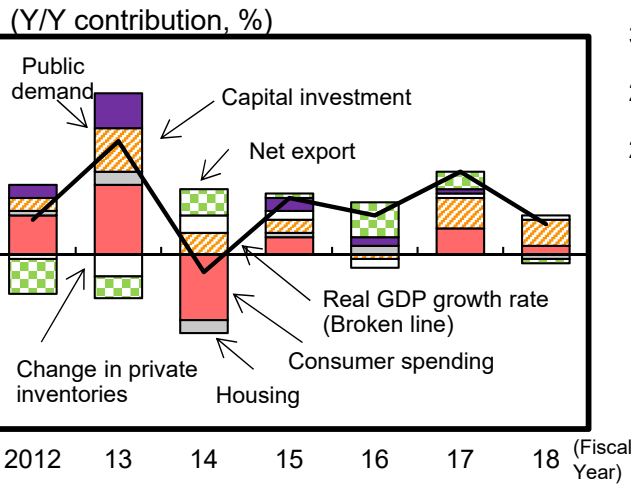


Chart 3 Japan's Exports to China

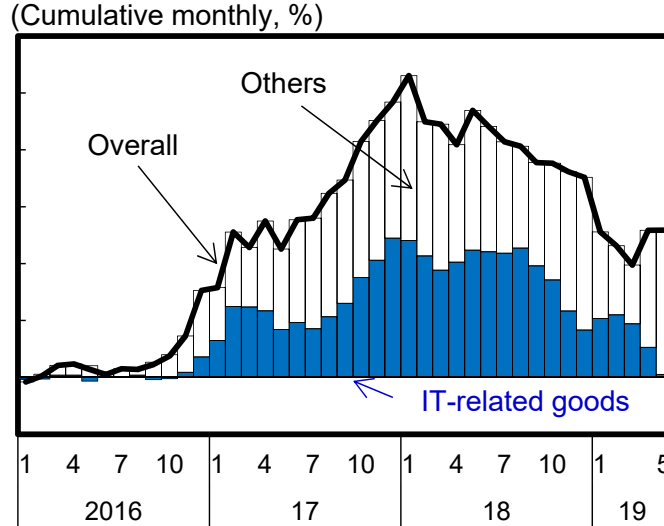


Chart 5 Overseas Shipment Ratios by Industry

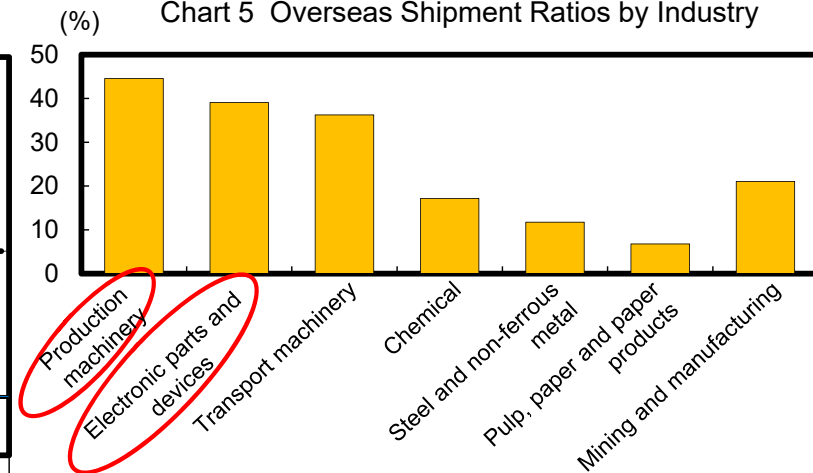


Chart 2 Japan's Exports and Production

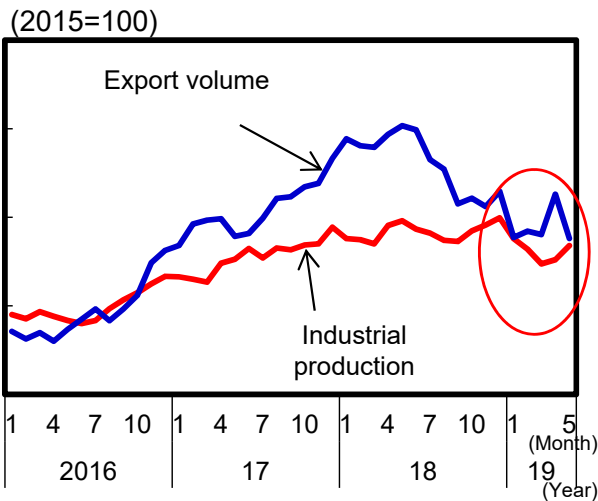


Chart 4 Outlook for Worldwide Semiconductor Shipments

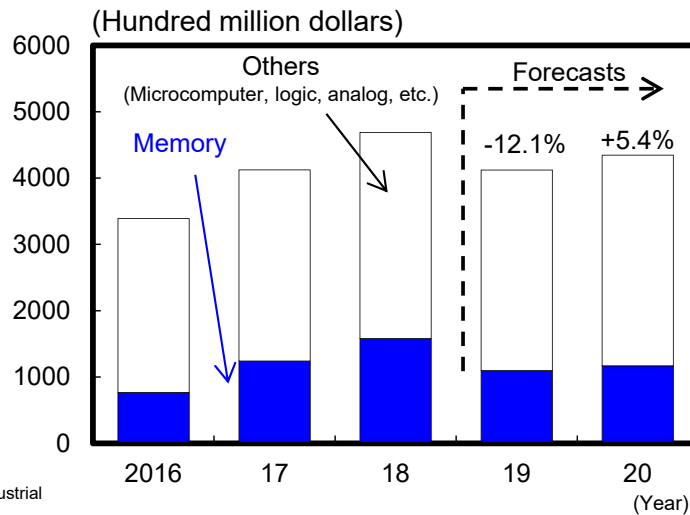
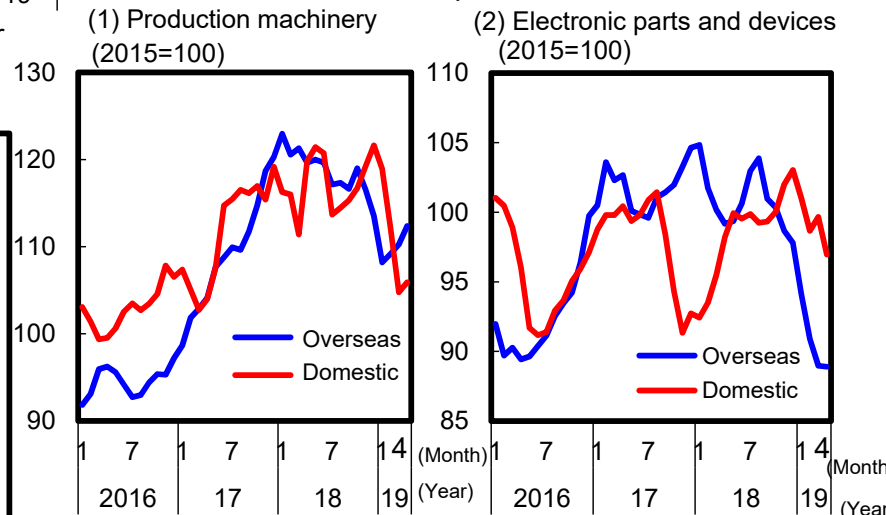


Chart 6 Major Industries' Domestic and Overseas Shipments



(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.

(Notes)
 Chart 4: Compiled based on Semiconductor Market Forecast, WSTS.
 Chart 5: Compiled based on Breakdown of Mining and Manufacturing Shipments, 2015, METI.
 Chart 6: 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.

Chart 7 Trend in Capital Investment

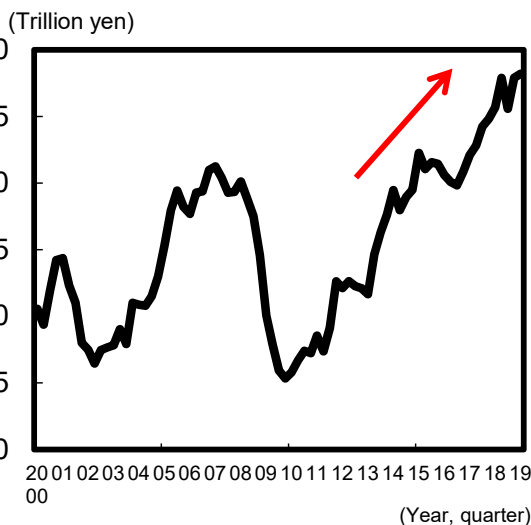


Chart 9 Sense of Labor Shortage and Trend in Capital Investment

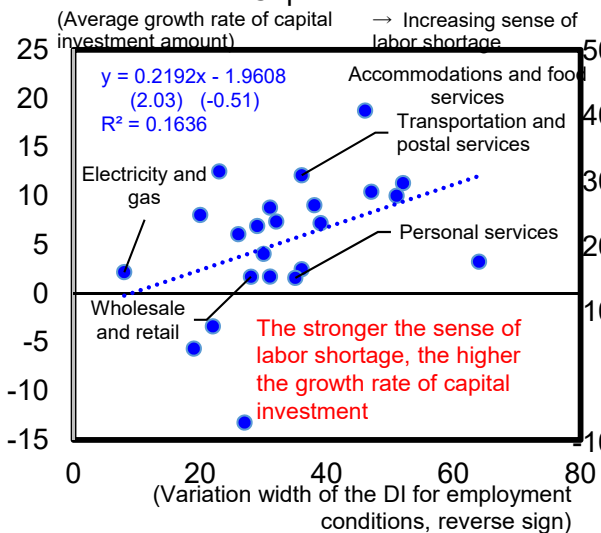


Chart 11 Total Number of Workers

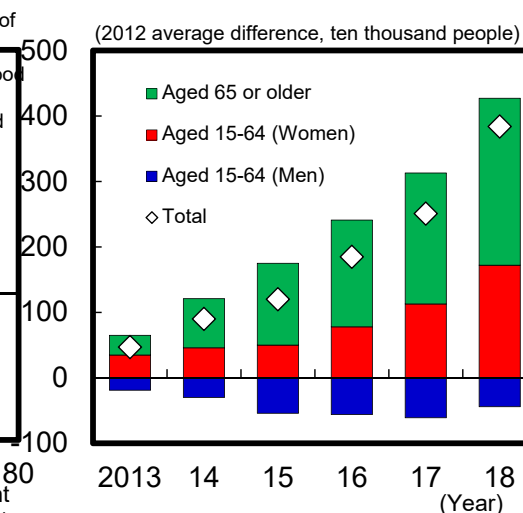


Chart 13 Real Private-sector Final Consumption Expenditure

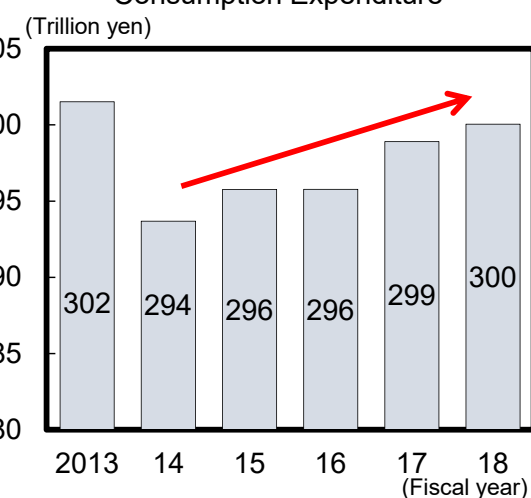


Chart 8 Trend in Corporate Earnings

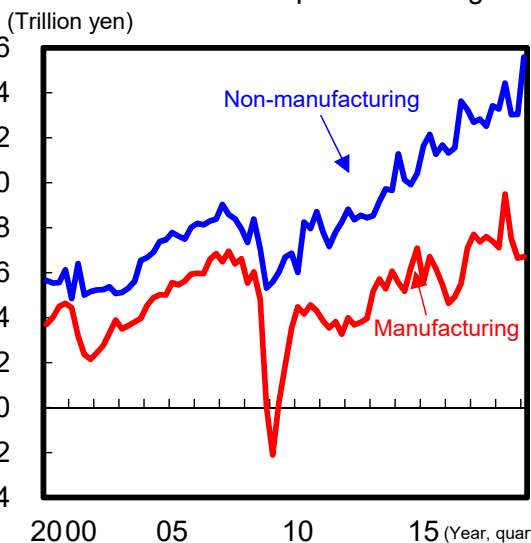


Chart 10 Effect of Export on Capital Investment

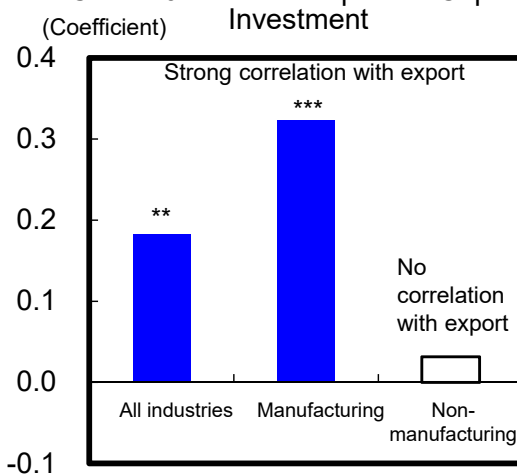


Chart 12 Real Total Wage Income of Employees

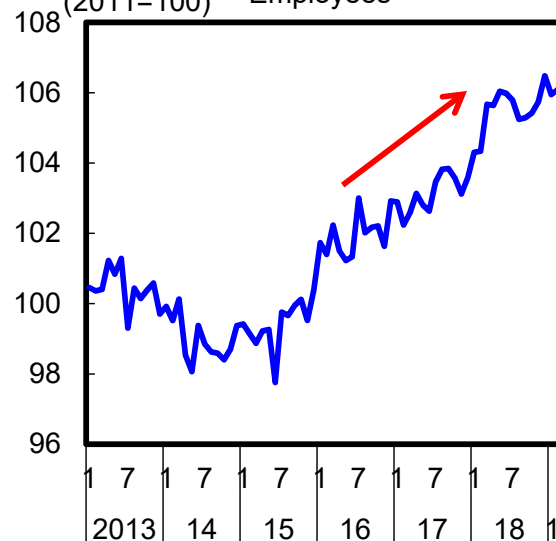
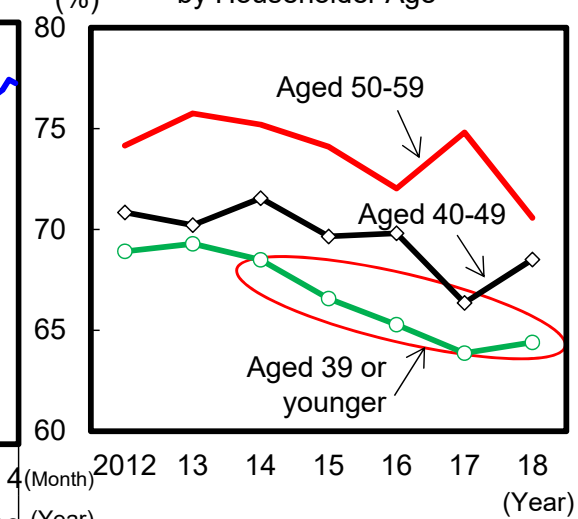


Chart 14 Average Propensity to Consume by Householder Age



(Notes) Charts 7 and 8: Compiled based on Financial Statements Statistics of Corporations by Industry (Quarterly), MoF and Jan.-Mar. 2019 GDP Estimates (the 1st preliminary), Cabinet Office.

Chart 9: Compiled based on Short-term Economic Survey of Enterprises in Japan, BoJ.

Chart 10: Compiled based on Corporate Statistics, MoF, and Real Export Price Index and Short-term Economic Survey of Enterprises in Japan, BoJ. The signs *** and ** denote the 1% and 5% levels, respectively and indicate that the result has statistical significance.

(Notes)

Chart 11: Compiled based on Labor Force Survey (Detailed Tabulation), MIC.

Charts 12 and 13: Compiled based on Labor Force Survey, MIC, System of National Accounts, Cabinet Office and Monthly Labour Survey, MHLW.
Chart 14: Compiled based on Family Income and Expenditure Survey, MIC. Figures for workers' households with two or more members.

- 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.

Chart 15 Environmental Changes Required to Increase Consumption (Ratio of Respondents)

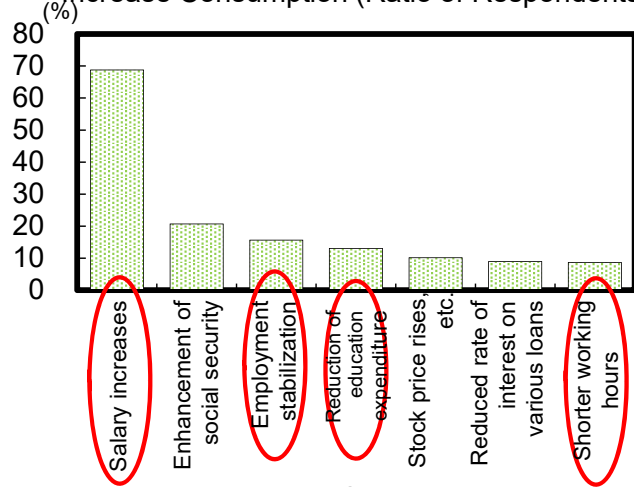


Chart 17 Intention to Buy Full Self-driving Cars and Housekeeping Robots (%)

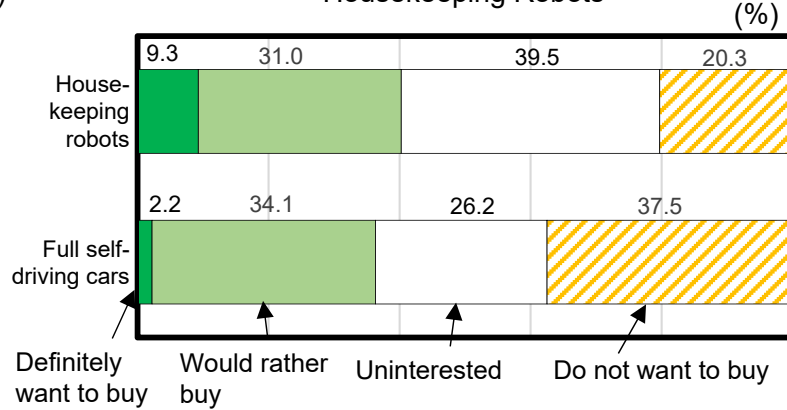


Chart 19 Trend in Cashless Payments (%)

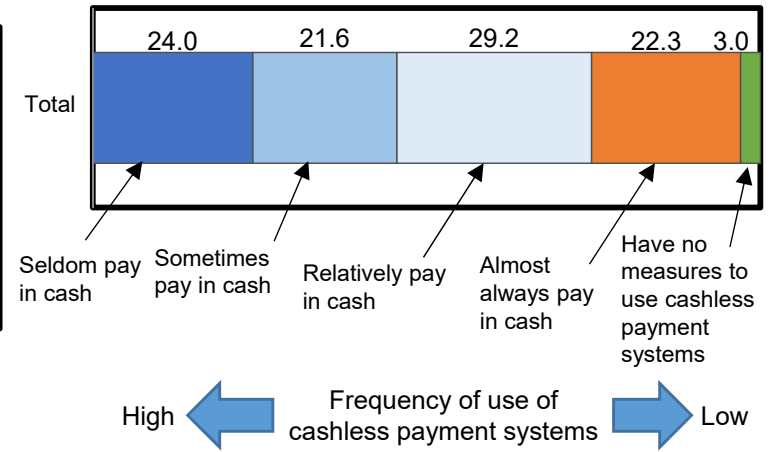
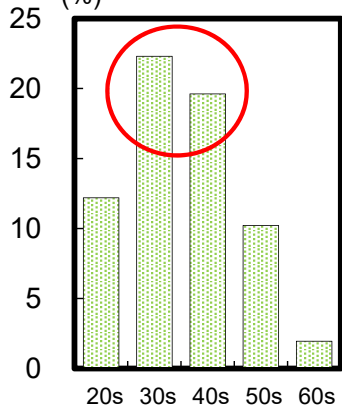


Chart 16

(1) Ratio of respondents who say that in order to increase consumption, it is necessary to reduce education expenditure (%)



(2) Ratio of respondents who say that in order to increase consumption, it is necessary to shorten working hours (%)

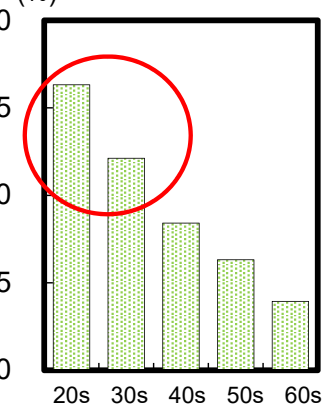
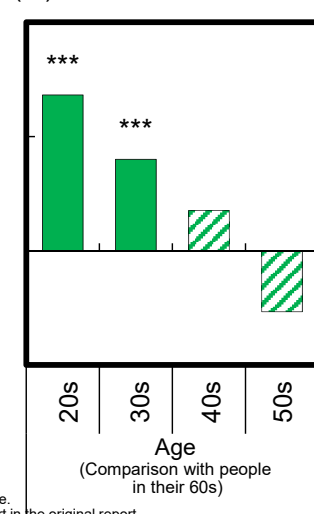


Chart 18

(1) Motivation to buy full self-driving cars (%)



(2) Motivation to buy housekeeping robots (%) (Analysis of women respondents)

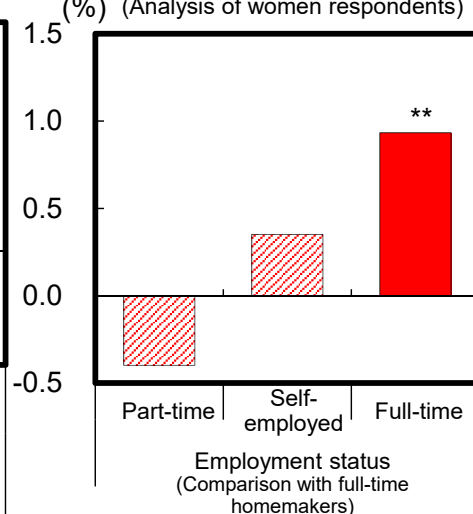
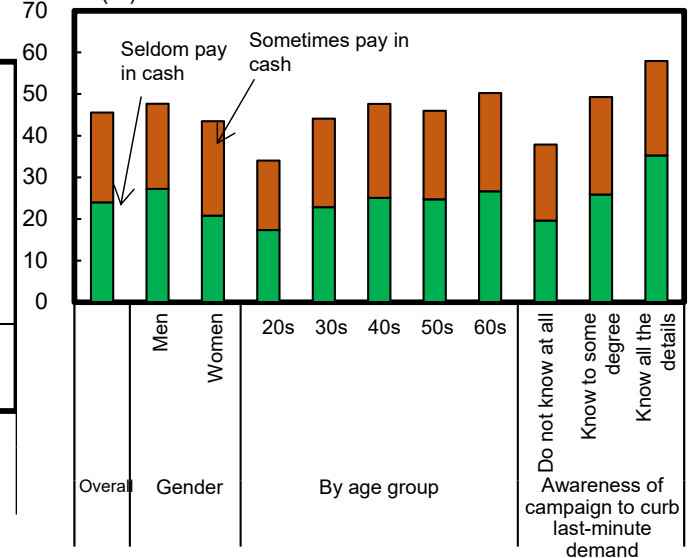
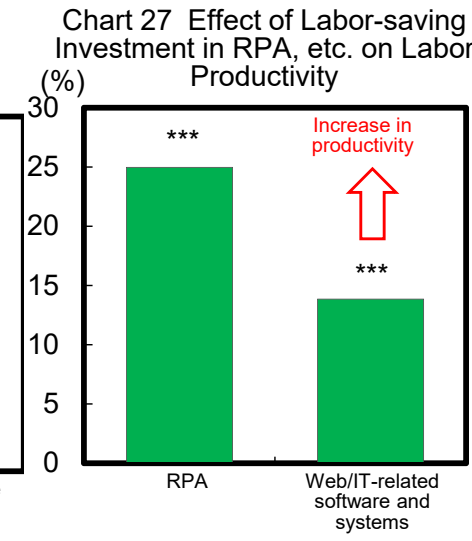
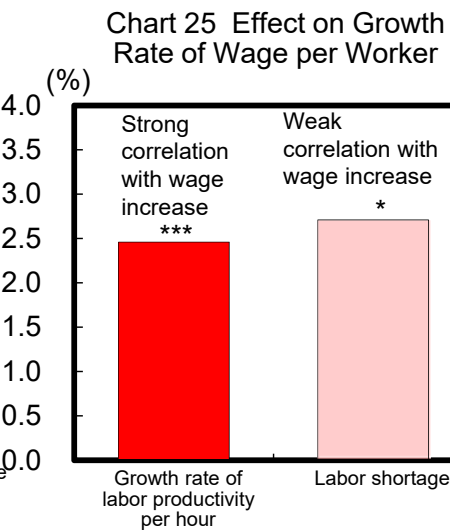
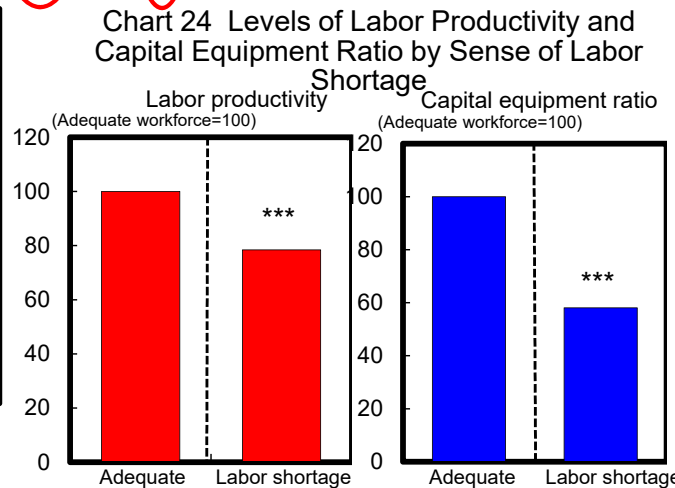
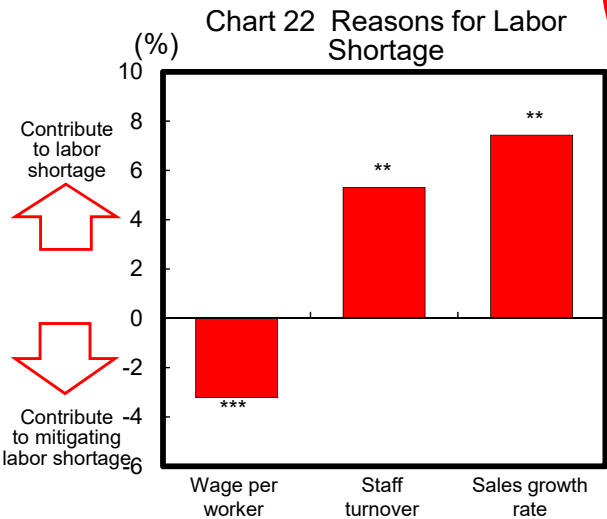
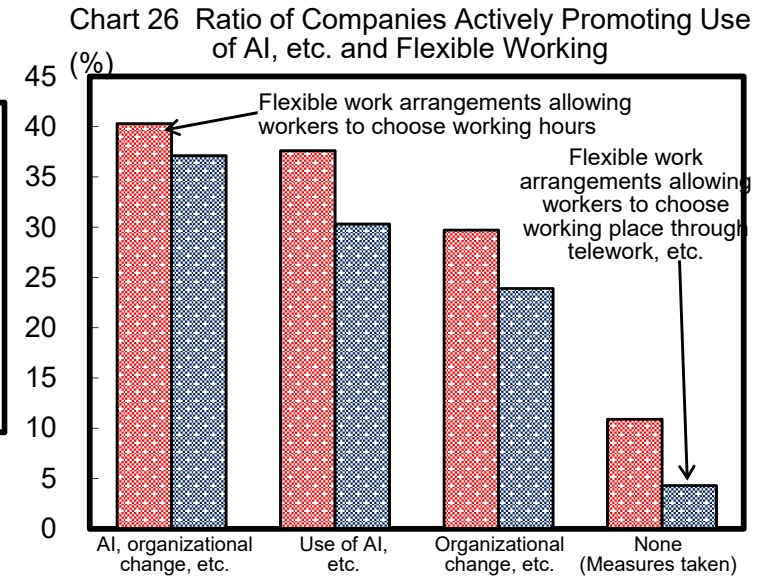
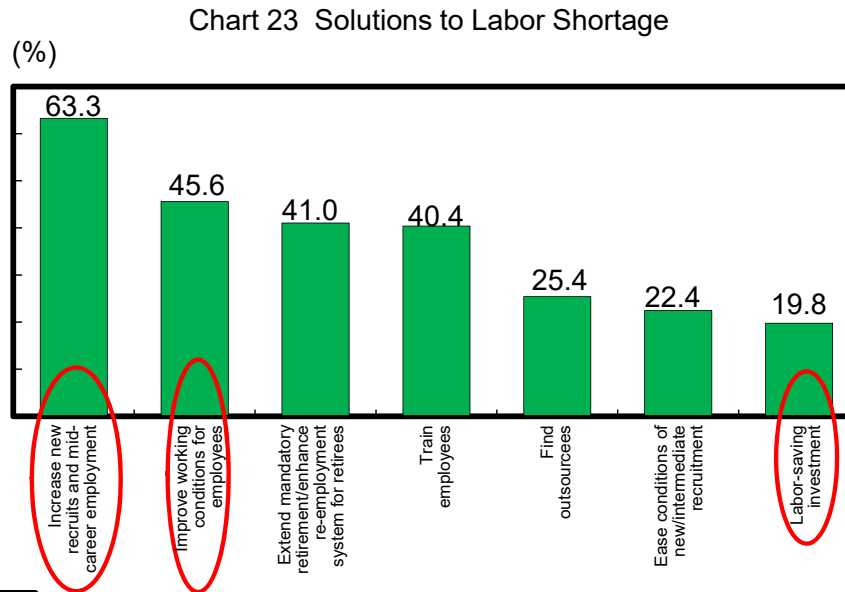
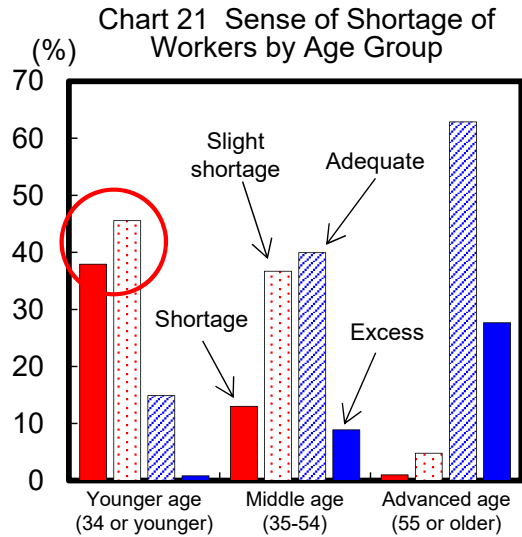


Chart 20 Ratio of Consumers Who Frequently Use Cashless Payment Systems (%)



(Notes)
 Charts 15-20: Compiled based on Questionnaire Survey concerning Consumers' Behavioral Change, Cabinet Office.
 Chart 17: The response classification is partially different from that of the actual survey. For details, refer to the chart in the original report.
 Chart 18: The signs *** and ** denote the 1% and 5% levels, respectively and indicate that the result has statistical significance.

- 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.



(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.

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

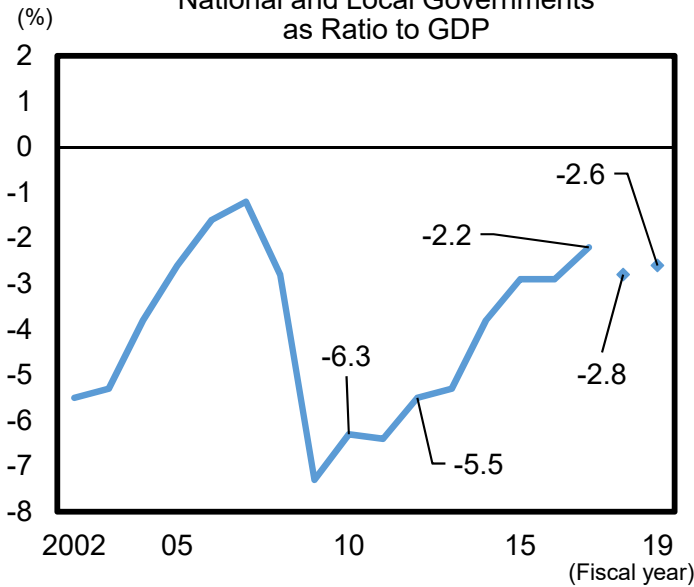


Chart 30 Factors Affecting Changes of Primary Fiscal Balance as Ratio to GDP

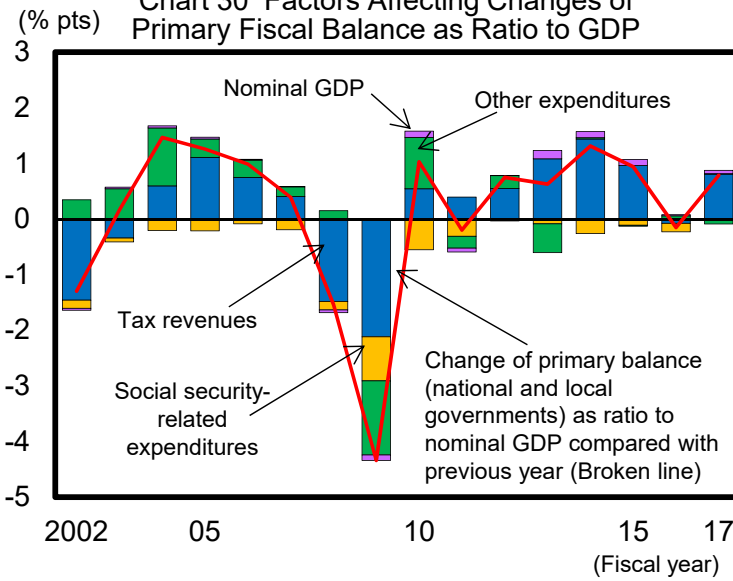


Chart 31 Policy Interest Rates

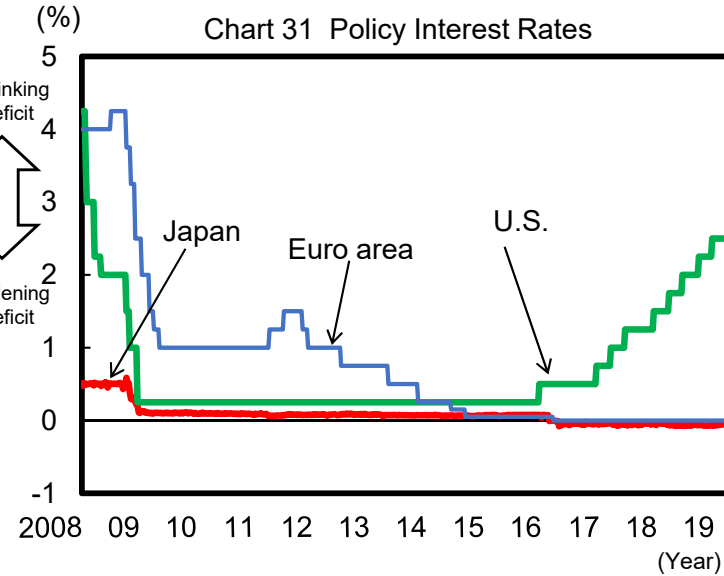


Chart 29 Impacts by Consumption Tax Hike and Responses Thereto

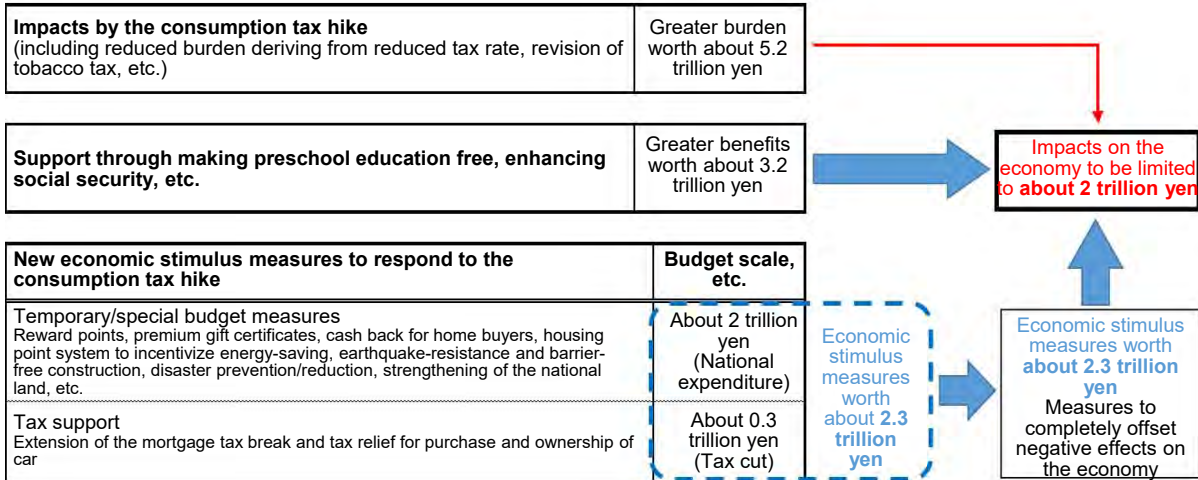
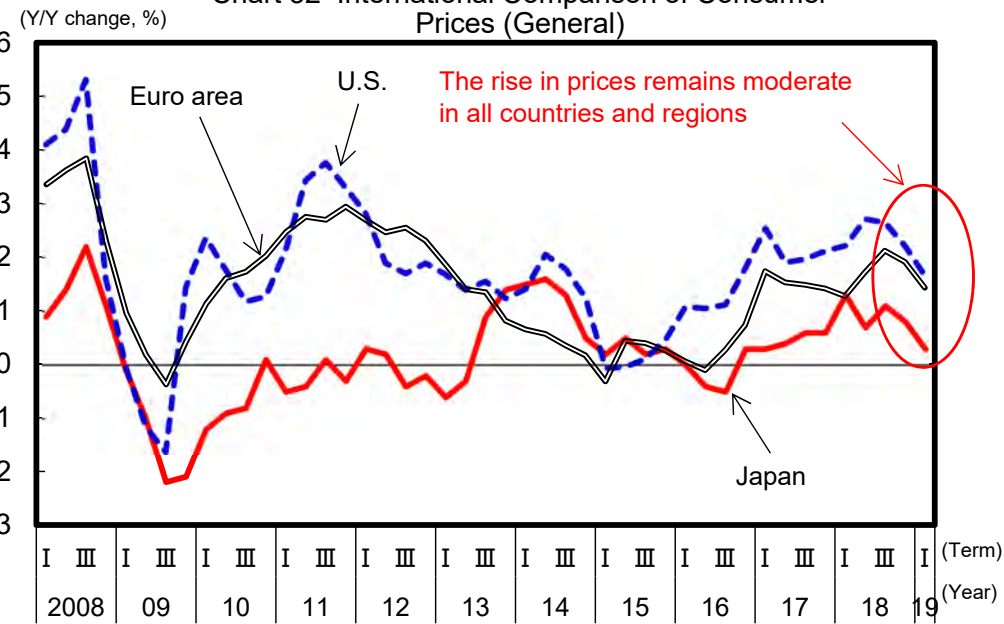


Chart 32 International Comparison of Consumer Prices (General)



(Notes)
 Charts 28 and 30: Compiled based on Annual Report on National Accounts for 2017 and Estimates of Medium- to Long-term Economy and Fiscal Policy (submitted to Council on Economic and Fiscal Policy on January 30, 2019), Cabinet Office.
 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.
 Chart 32: Compiled based on Consumer Price Index, MIC, Bureau of Labor Statistics "Current Employment Statistics" and "Consumer Price Index" and Eurostat.

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.

Chart 33 Reason(s) to Quit a Job during Pregnancy/ after Giving Birth

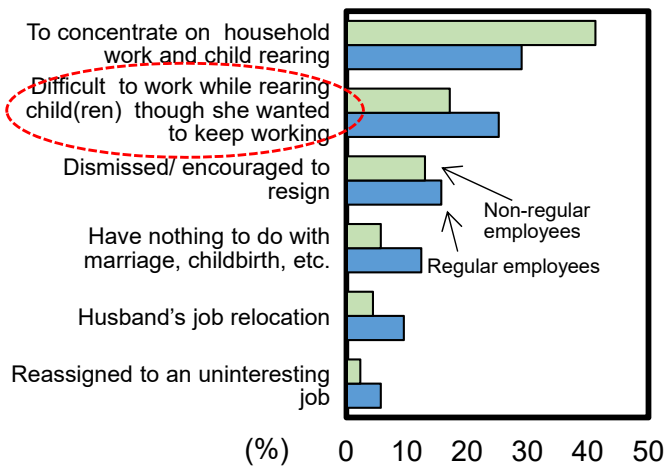


Chart 34 Expected Age to Retire (Among the currently employed)



Chart 36 Change in Various Employees at Companies

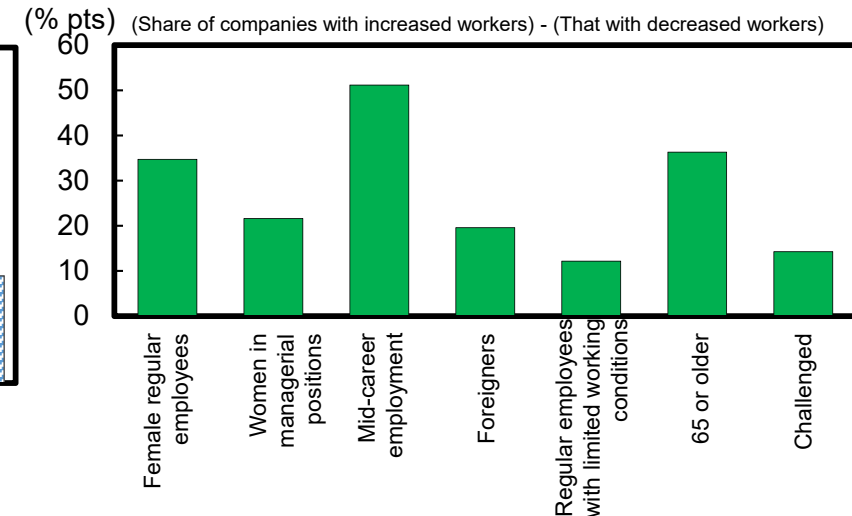


Chart 35 Diversification of the Set of Values (Reason(s) to work, other than earning a living)

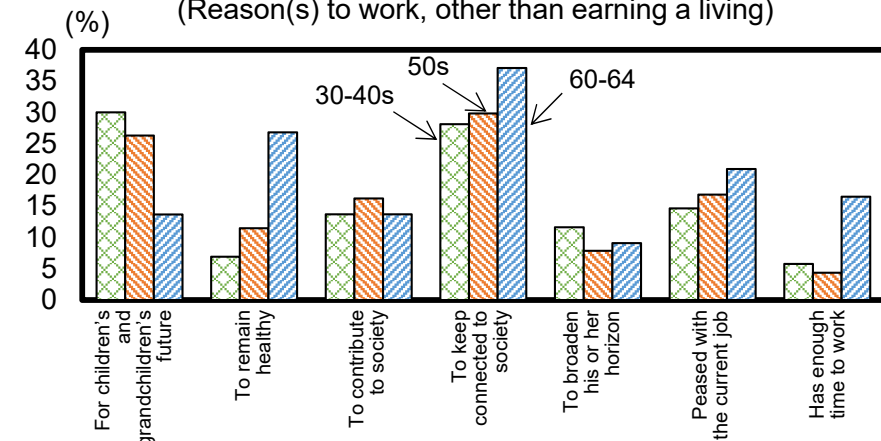
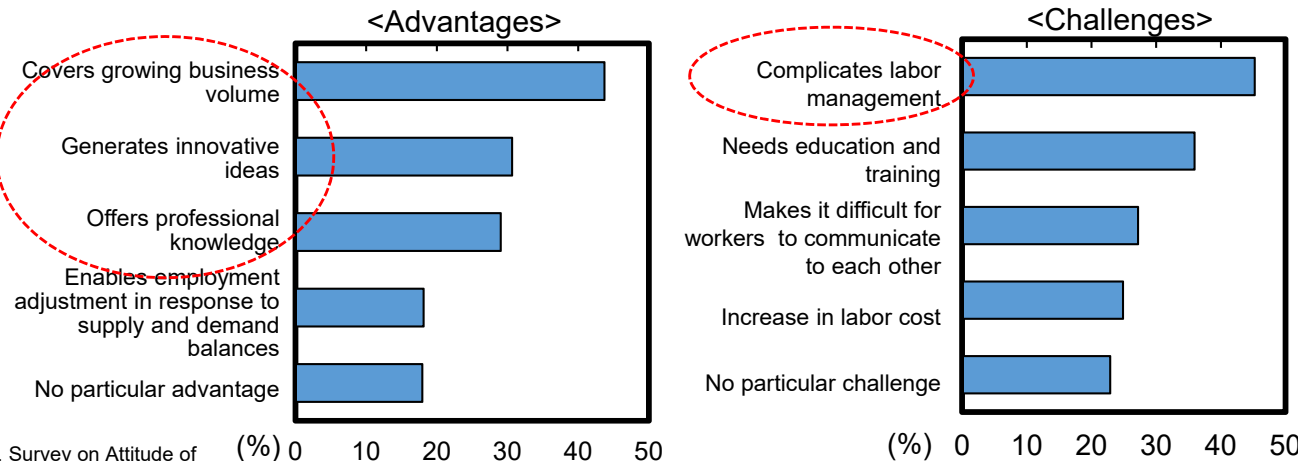


Chart 37 Advantages of and Challenges in Using Diverse Human Resources



(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 considers 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.

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

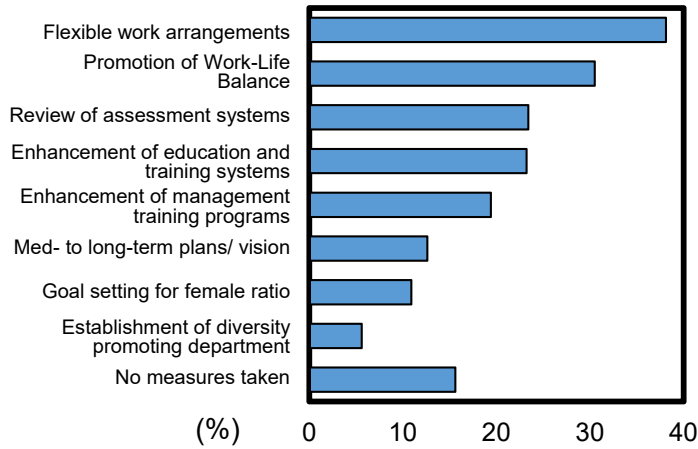


Chart 39 Correlation between Measures Taken and Diversity (The sign ○ indicates that there is statistically significant relationship)

Measures taken	Overall diversity	Regular women employees	Women in managerial positions	Mid-career employment	Foreigners	Regular employees with limited working conditions	Elderly employees
Flexible work arrangements	○	○	○	○	○	○	○
Promotion of Work-Life Balance	○	○	○			○	
Review of assessment systems	○		○			○	
Enhancement of education and training systems							○
Enhancement of management training programs	○	○	○				
Med- to long-term plans/ vision	○			○	○	○	
Goal setting for female ratio	○	○	○	○	○		
Establishment of diversity promoting department	○	○	○	○	○		○

Chart 42 Introduction of Year-round Recruitment of New Graduates

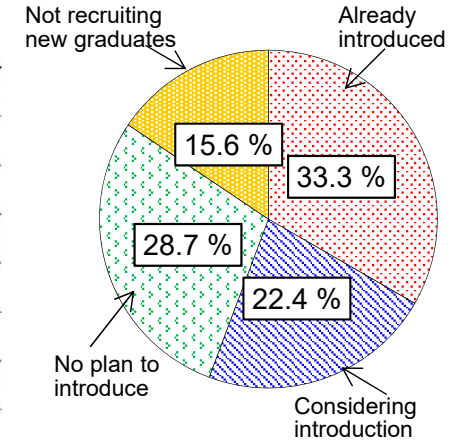


Chart 40 Japanese Employment Practices and Diversity (Index reflecting high diversity)

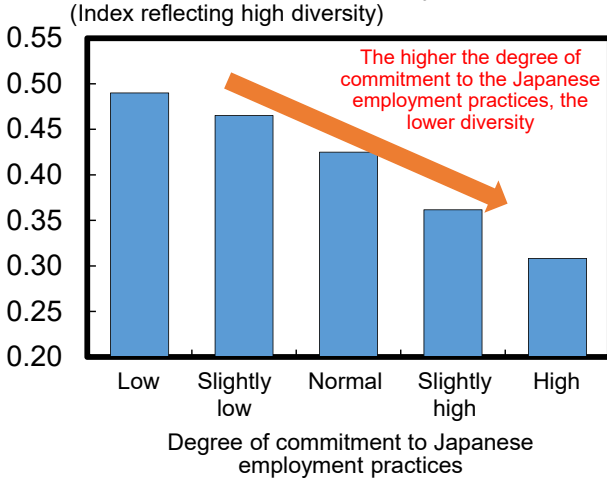


Chart 41 Systems Necessary to Work Efficiently among Diverse Workers (Employees' perspective)

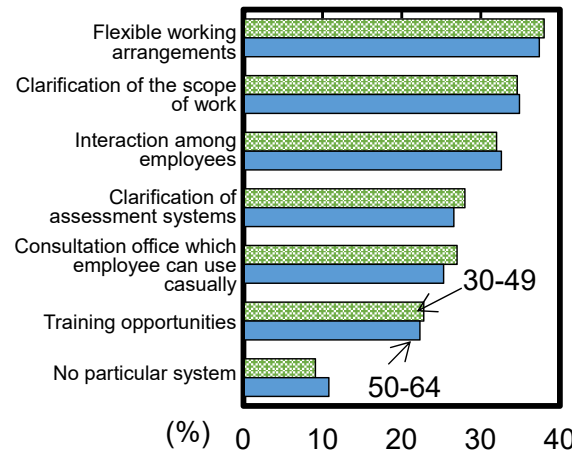
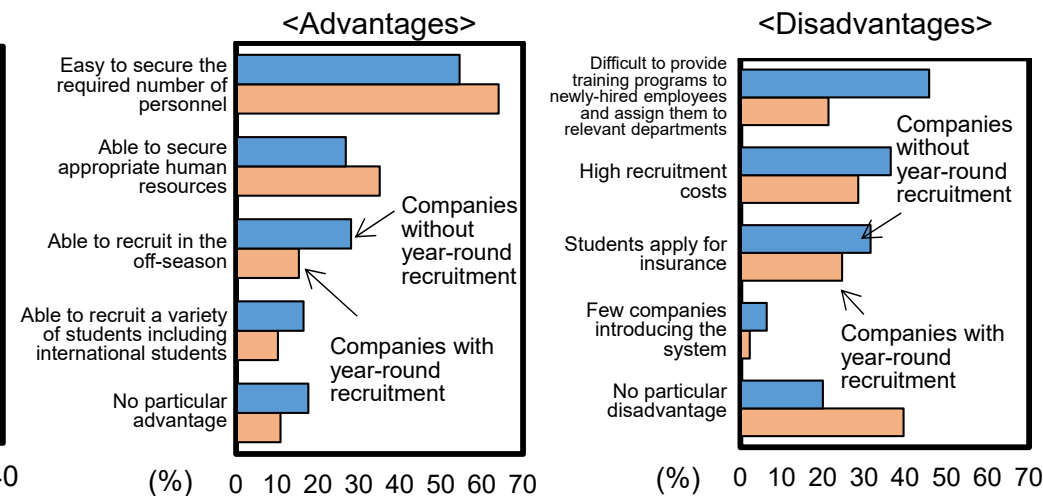


Chart 43 Advantages and Disadvantages of Year-round Recruitment



(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

<Change in Satisfaction (Utilities) Calculated in Conjoint Analysis>

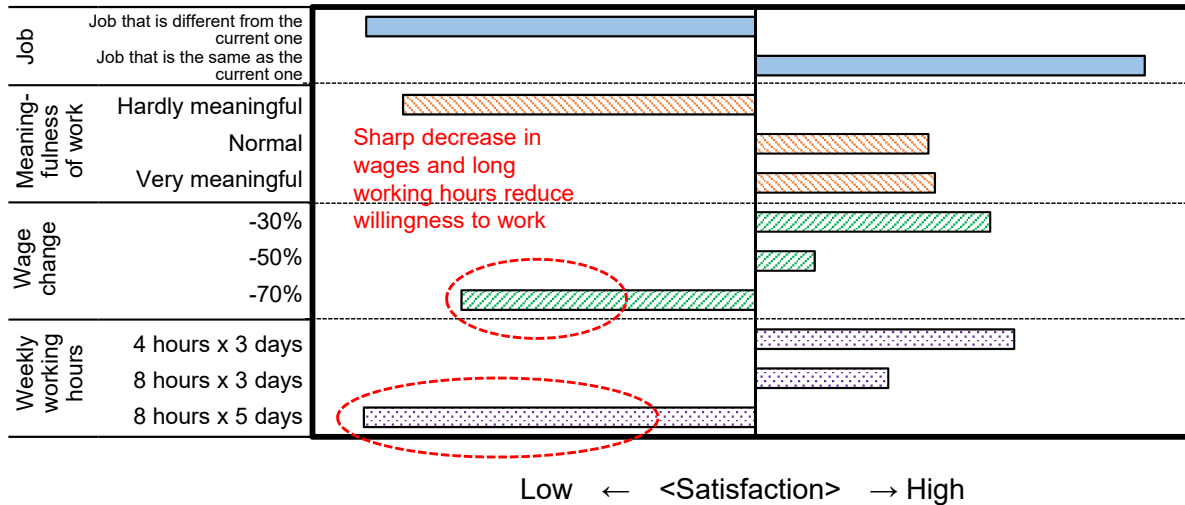
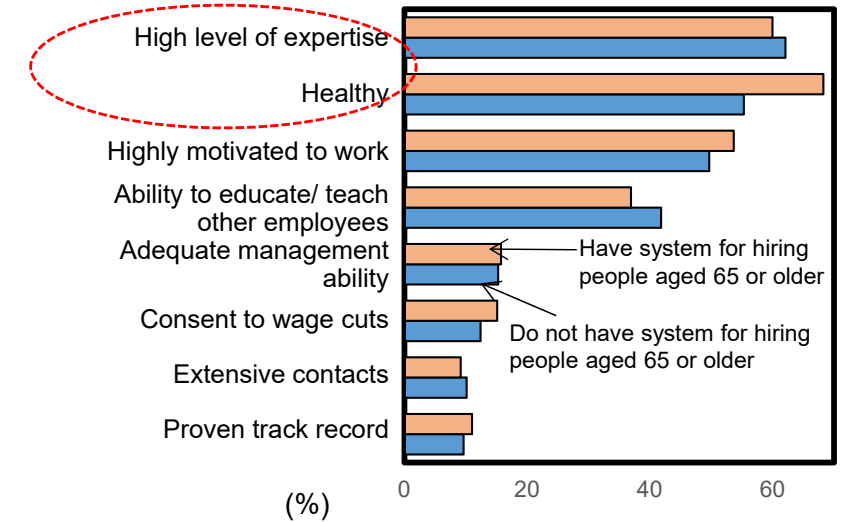


Chart 46 Skills and Attributes Employers Look For When Hiring People Aged 65 or Older (Companies' perspective)



<Degree of Importance>

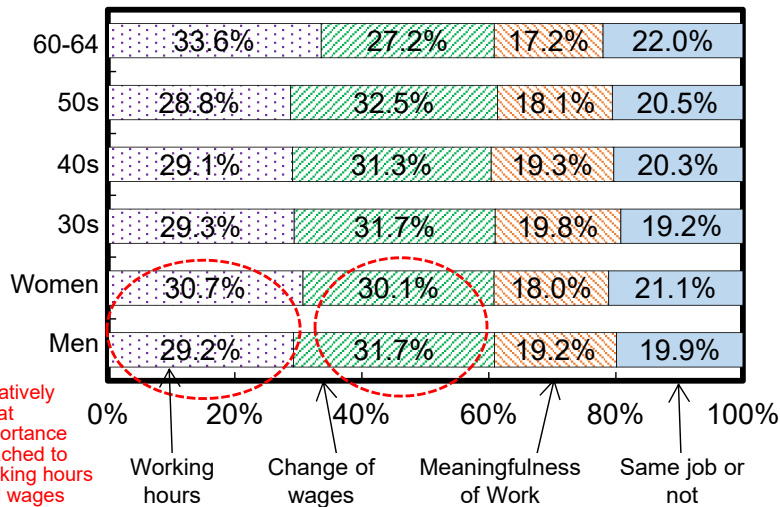


Chart 45 Desirable Mandatory Retirement Age (Employees' perspective)

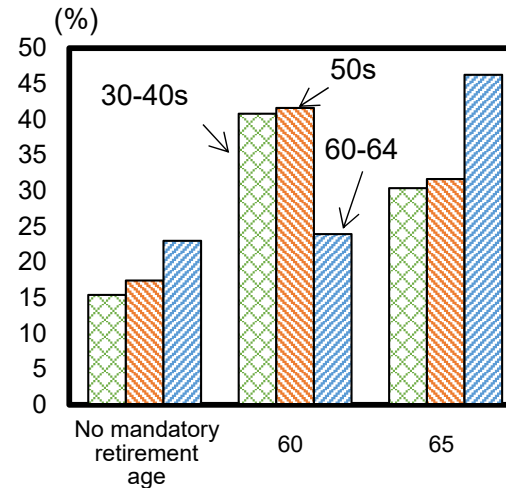
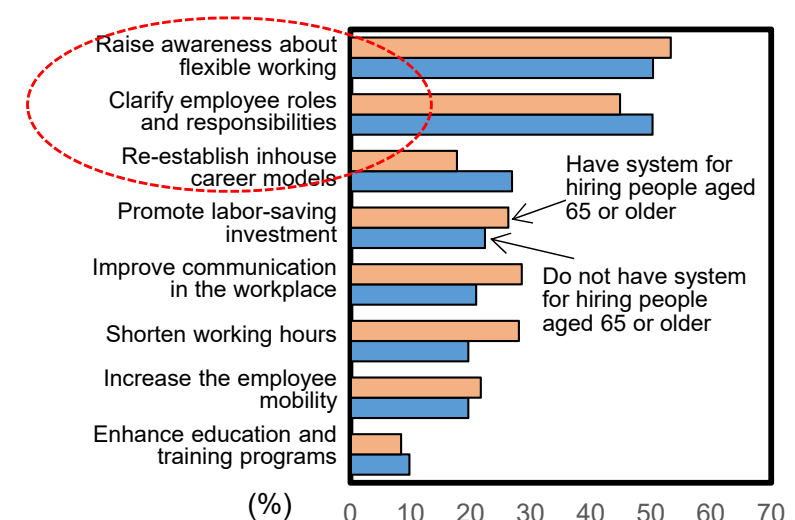


Chart 47 Measures Necessary to Promote Employment of People Aged 65 or Older (Companies' perspective)



(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.

Chart 48 Effect of Increasing Diversity on Productivity

(Growth of productivity (TFP) during FY2013-17, % pts)

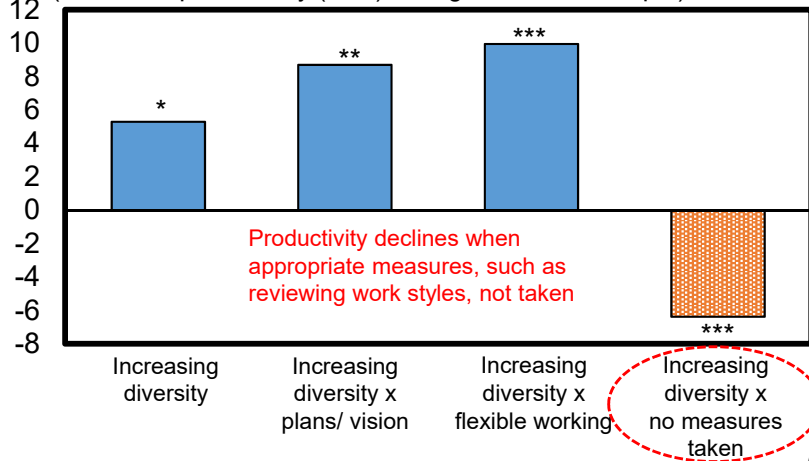


Chart 50 Opinion about Increase in Number of Workers Aged 65 or Older (by Regular Employees)

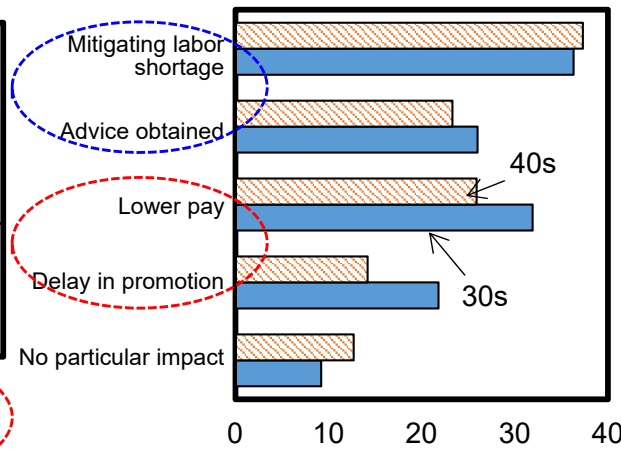


Chart 52 Relationship between Ratio of Employees Aged ≥60 and Hiring Rate



Chart 49 Effect of Increasing Diversity on Vacancy Ratio (%)

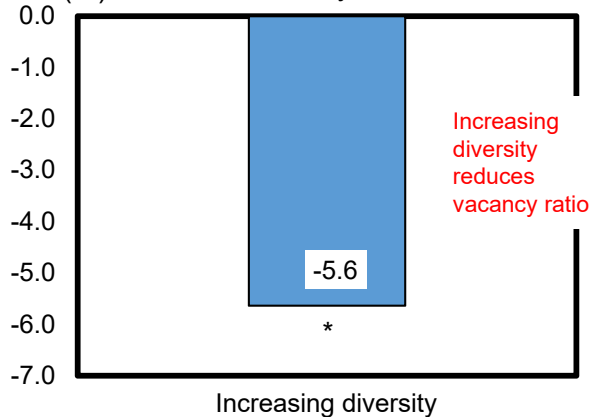
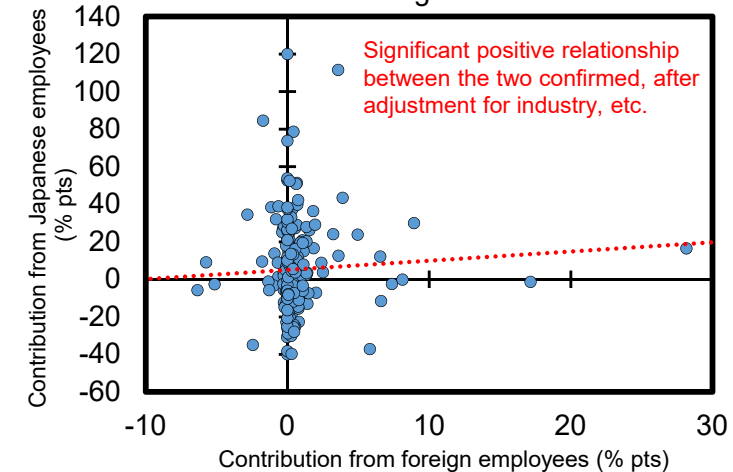


Chart 51 Relationship between Ratio of Employees Aged ≥60 and Average Wage for Employees Aged 30



Chart 53 Employment of Japanese and Foreigners



Chapter 3: Japan's Economic Challenges amid Ongoing Globalization

- 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.

Chart 54 Breakdown of Current Account

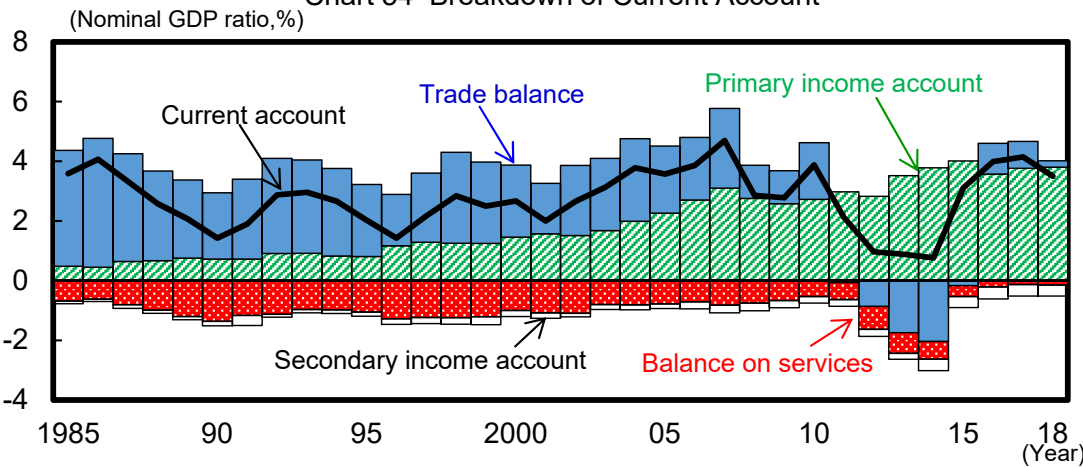


Chart 55 Export Value Share of Highly Sophisticated Products (2010-15)

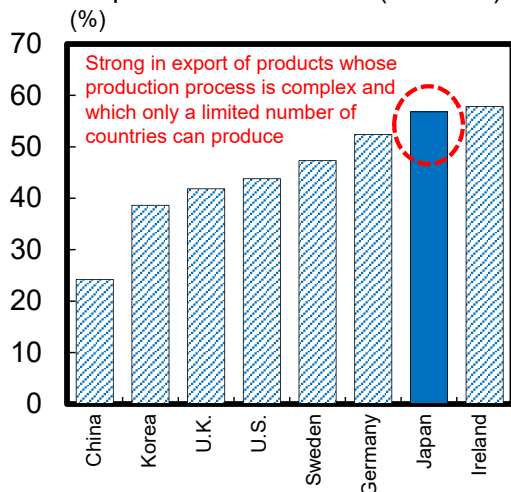


Chart 56 International Technology Transactions and Inbound Tourists

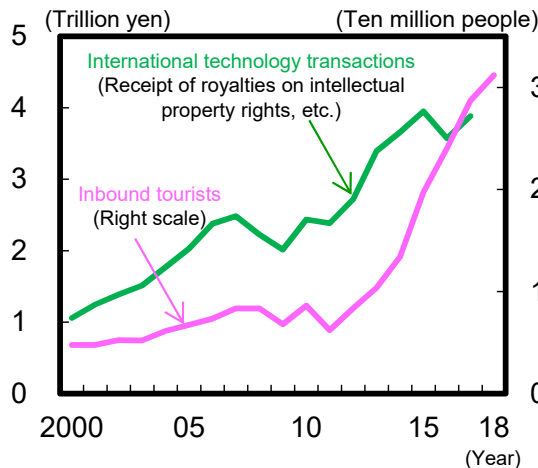
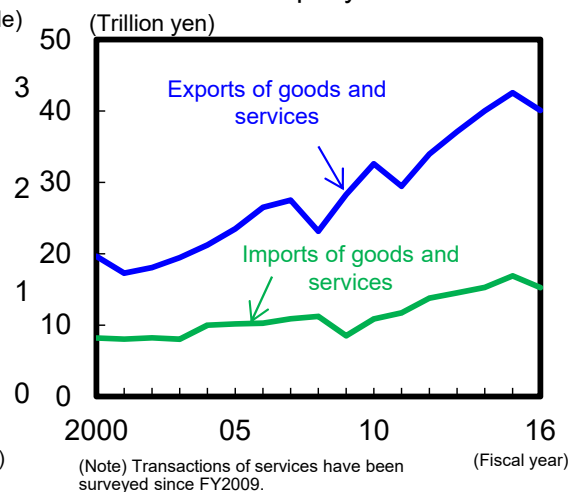
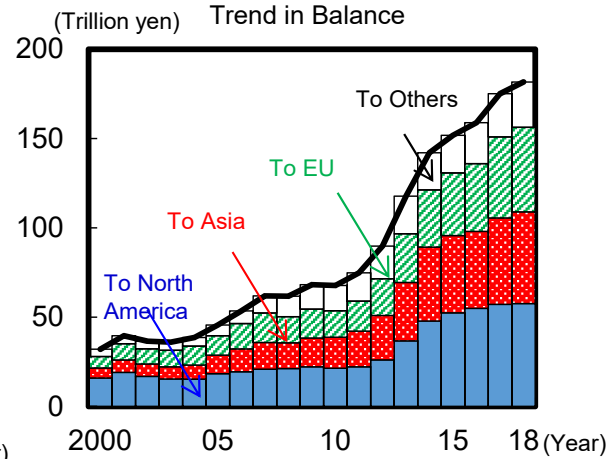


Chart 58 Japanese Companies' Cross-border Intra-company Transactions



(Note) Transactions of services have been surveyed since FY2009.

Chart 57 Outward FDI



Composition Ratio by Investment Purpose (2017)

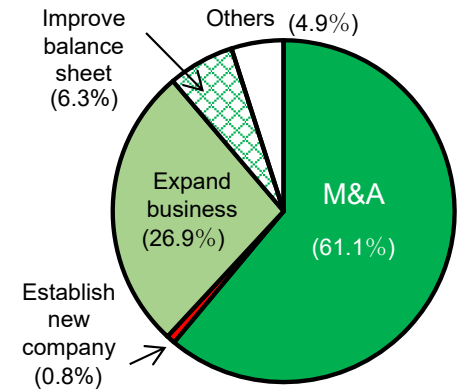
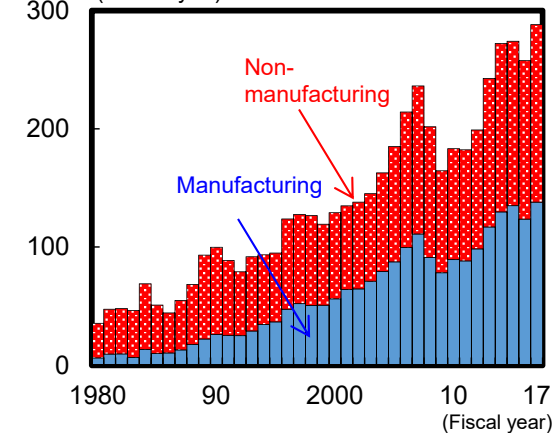


Chart 59 Japanese Companies' Overseas Subsidiary Sales



- 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.

Chart 60 World Trade Volume and Global GDP

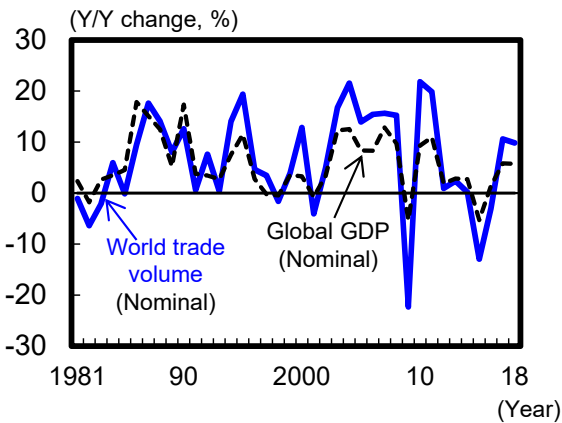


Chart 61 Average Tariff Rate and Rate of Participation in GVC

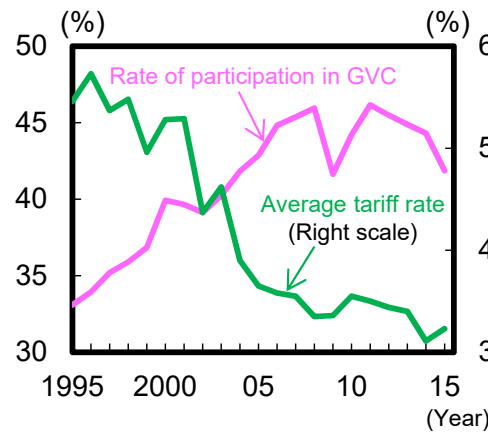


Chart 63 Nominal Import Value of Asian Countries and Regions and U.S.

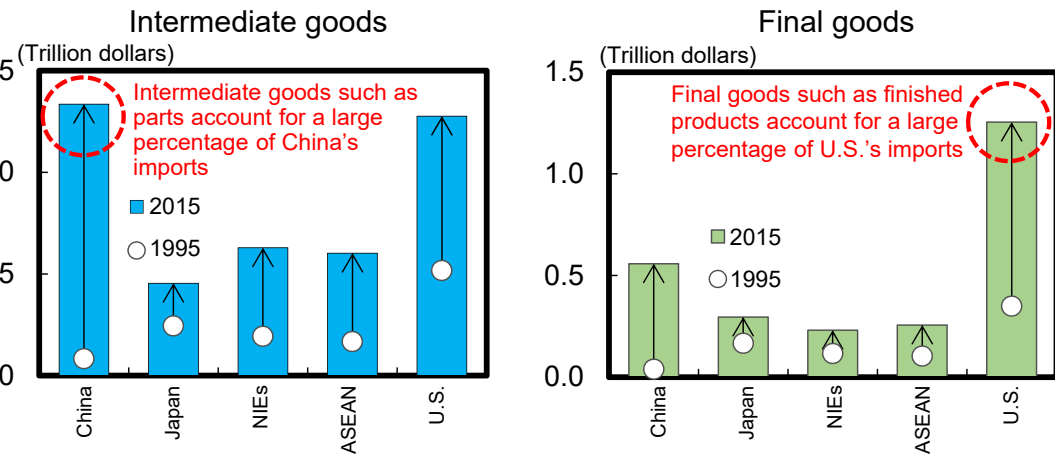


Chart 62 Increasing Uncertainty over Global Economy (Japan Economic Policy Uncertainty Index)

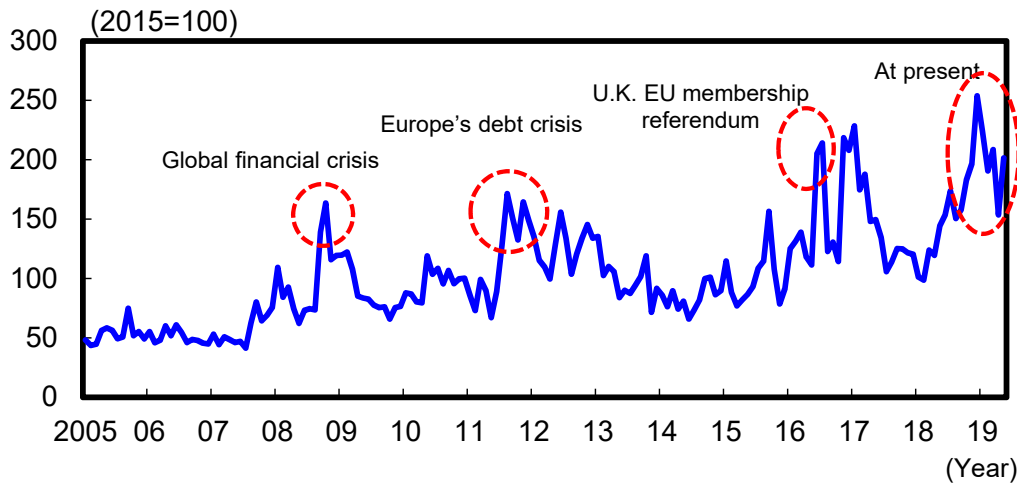


Chart 64 Composition of Added Value of Industrial Products Exported from China (2015)

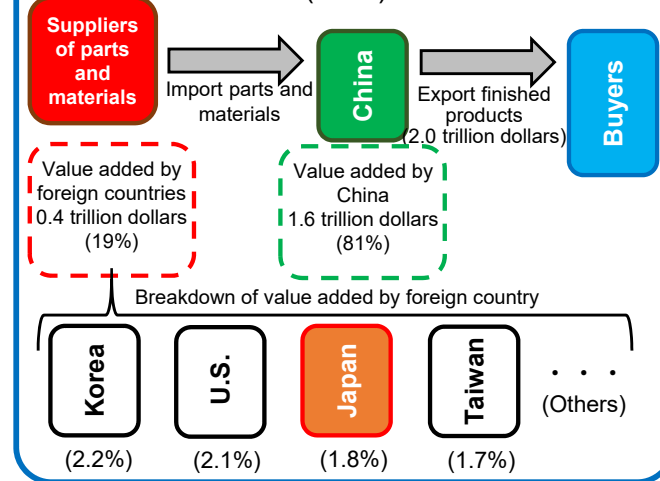
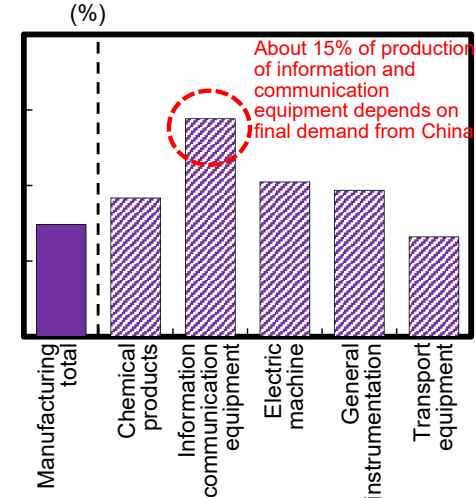


Chart 65 Rate of Dependency of Japan's Production Value on Final Demand from China

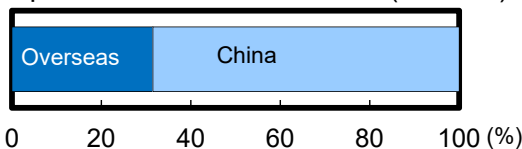


(Note) Compiled based on data provided by WTO and IMF (2019), Inter-Country Input-Output Tables and Trade in Value Added (December 2018, December 2016), OECD and data provided by Bloomberg.

- 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).

Chart 66 Business Activities of Japanese-affiliated Companies in China

Composition of sales destination (FY2018)



Composition of export destination (FY2018)

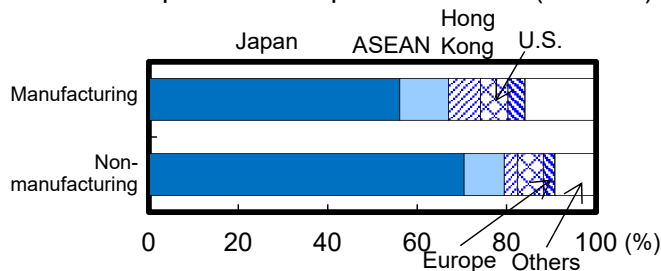


Chart 67 Opinions of Japanese-affiliated Companies in Asia about Effect of U.S.-China Trade Issues (%)

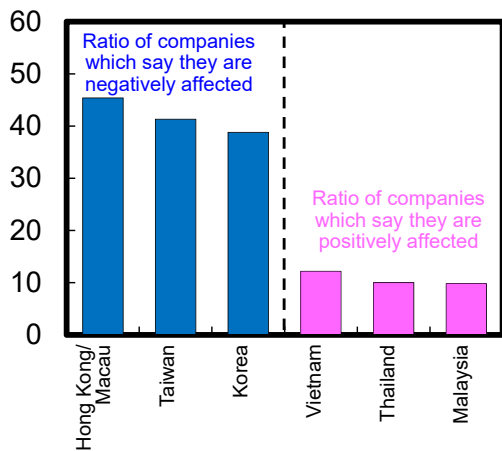


Chart 68 Automotive Supply Chain Centering on U.K. (2015)

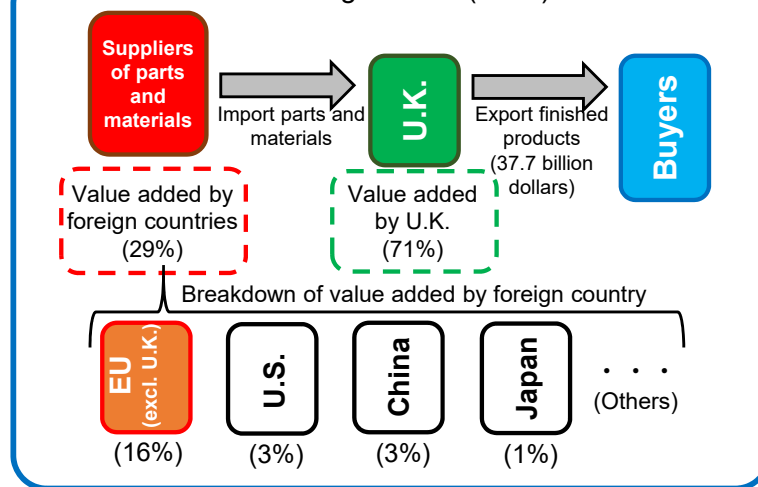


Chart 70 Sales, Local Production and Imports of Japanese Cars in U.S. Market (2017)

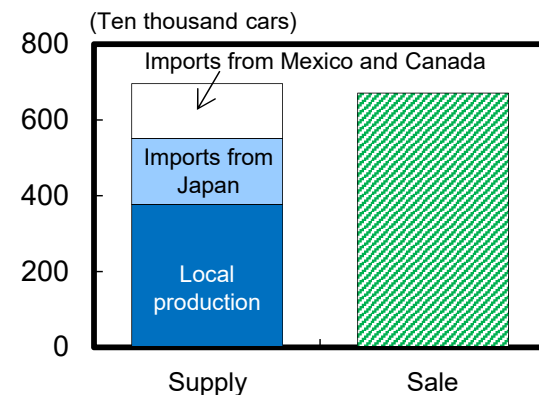


Chart 69 Response to Brexit by Japanese-affiliated Companies in U.K.

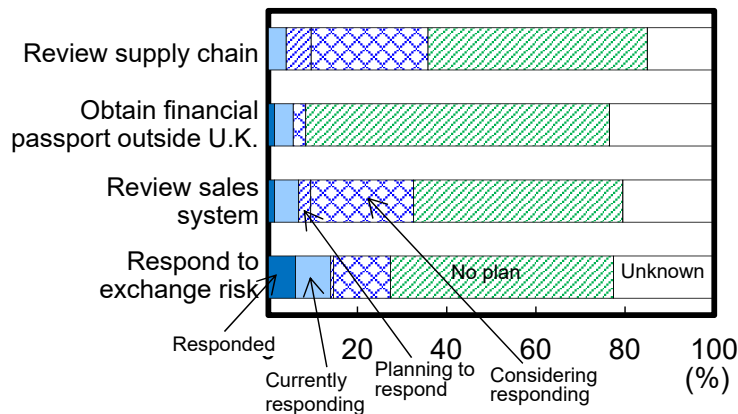
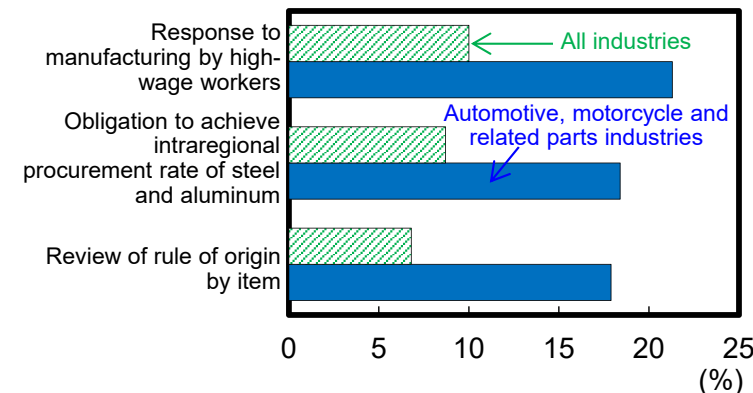


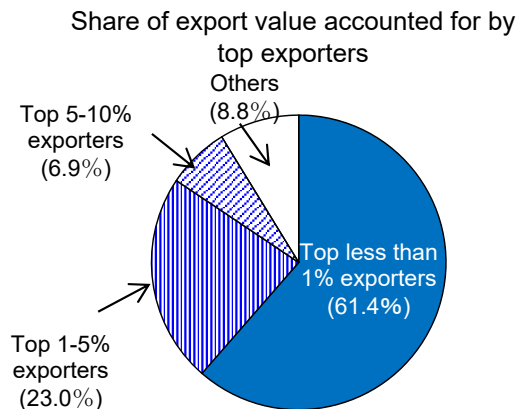
Chart 71 Opinions of Japanese-affiliated Local Companies about Enforcement of USMCA (Response ratio of items pointed out as having a negative effect)



(Note) Compiled based on data provided by JETRO, METI, JAMA, and Trade in Value Added (December 2018), OECD.

- 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)



Premium of exporting companies (Comparison of average values with those of non-exporting companies)

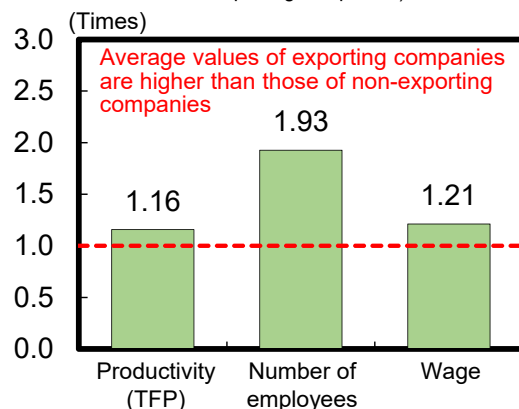
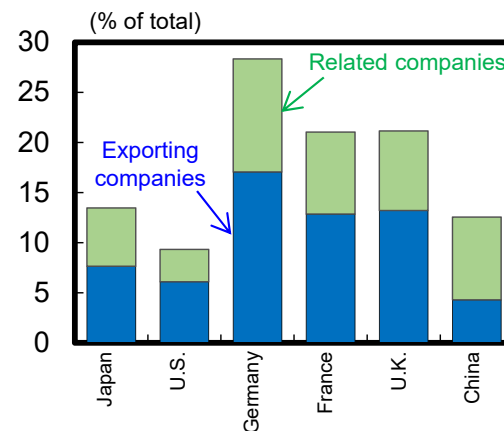
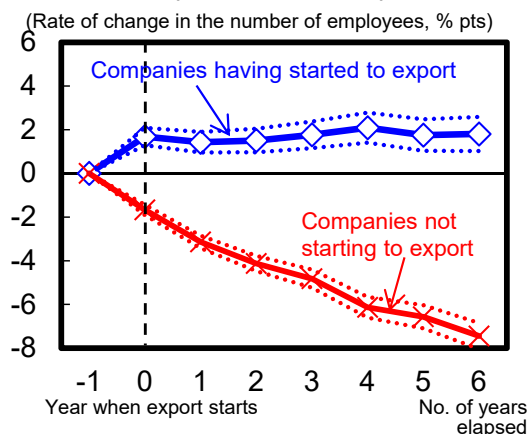


Chart 74 Impact of Globalization on Domestic Employment

Ratio of exporting companies' and related companies' employees in terms of numbers

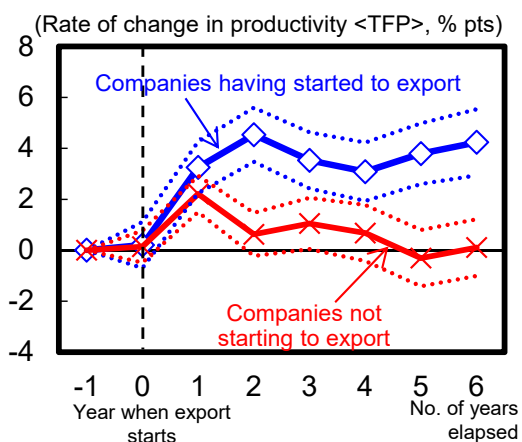


Employment increased by Japanese companies' start of export



Chapter 73 Increasing Productivity of Japanese Companies Due to Globalization

Effect of start of export



Effect of joint researches and personnel exchanges with foreign companies

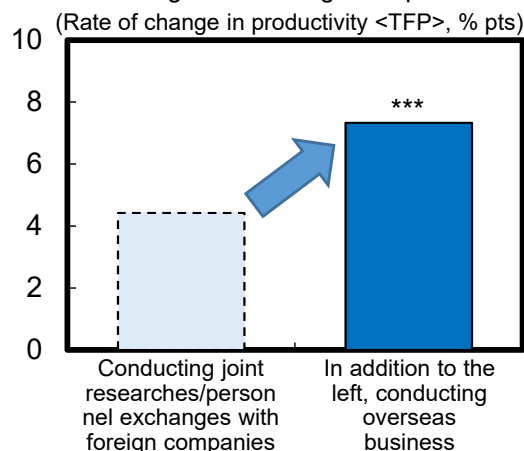
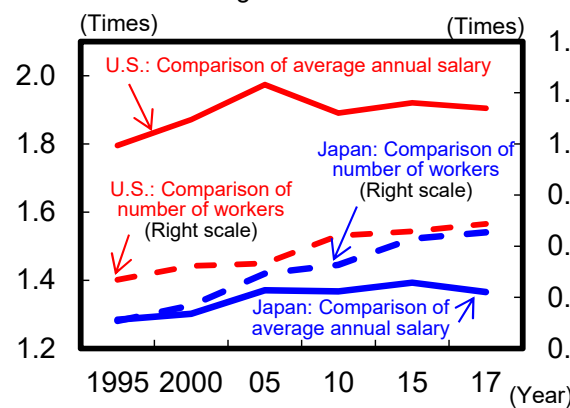
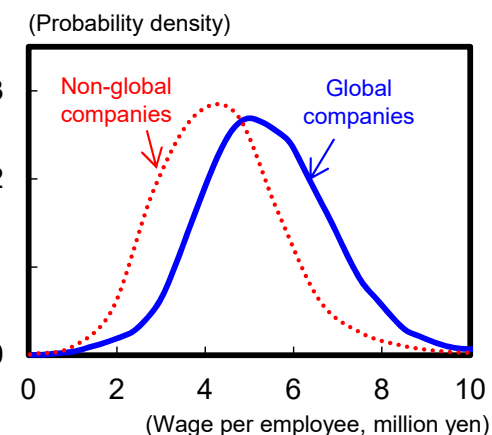


Chart 75 Globalization and Domestic Pay Gap

Relative wage and supply volume of college-educated and high-school-educated workers



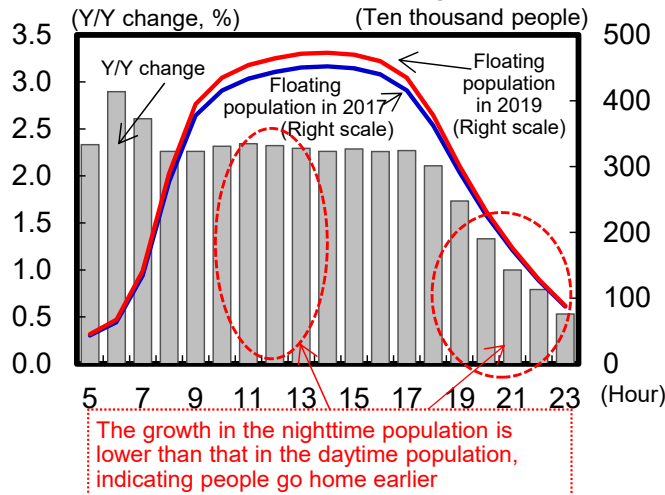
Distribution of salaries paid by Japanese companies (FY2016)



Reference: Example of Analysis of Work Style Reform Utilizing Mobile Location Data

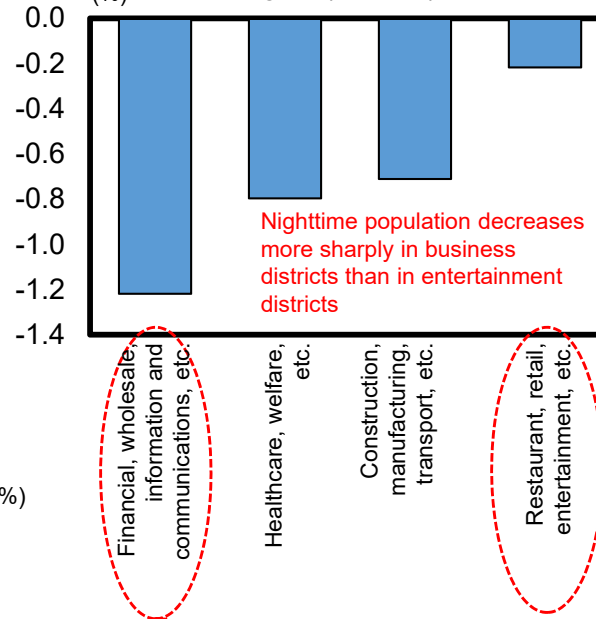
- The analysis used data on the hourly floating population (aged 20-59) in Tokyo 23 wards on a weekday in February estimated based on mobile phone information. The growth in the nighttime population is lower than that in the daytime population (the difference between the year-on-year change in the daytime 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 (A-C), while an increasing trend, in entertainment districts (D-F).

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



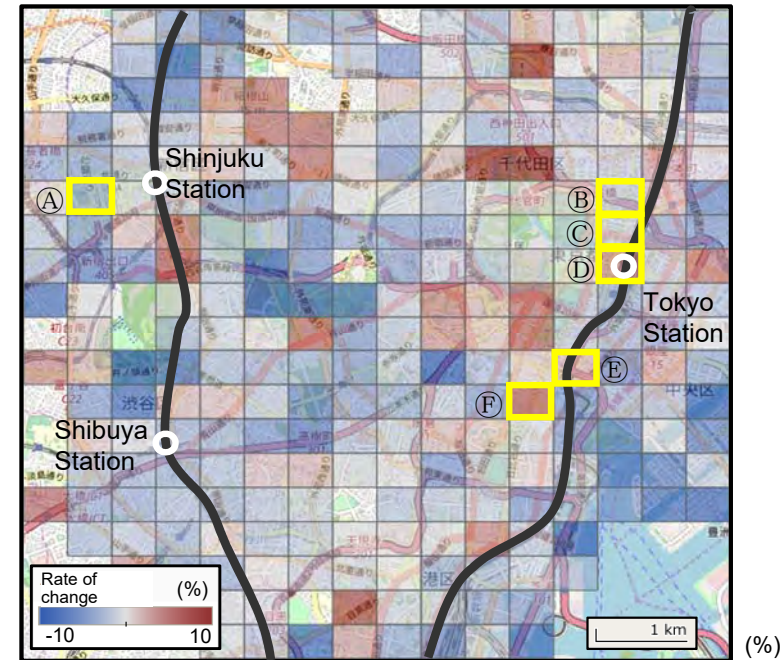
	Men and women total			Men	Women
	Y/Y change in daytime population	Y/Y change in nighttime population	Difference	Difference	Difference
Overall	2.3	1.2	-1.1	-1.2	-0.7
20s	3.9	2.7	-1.2	-1.6	-0.7
30s	-1.1	-2.6	-1.5	-1.6	-0.9
40s	2.4	1.6	-0.8	-0.6	-1.3
50s	5.3	5.3	0.0	0.2	-0.4

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



<Industries flourishing in respective regions>

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



Business districts	Y/Y change in daytime population	Y/Y change in nighttime population	Difference
Ⓐ Nishi-shinjuku	8.2	4.2	-3.9
Ⓑ Uchikanda	7.2	5.3	-1.9
Ⓒ Otemachi	14.4	13.1	-1.2

Entertainment districts	Y/Y change in daytime population	Y/Y change in nighttime population	Difference
Ⓓ Marunouchi	-2.3	1.8	4.1
Ⓔ Ginza	1.0	2.9	1.8
Ⓕ Nishi-shimbashi	6.5	13.4	6.9

(Note) Compiled based on Mobile Spatial Statistics®, NTT DoCoMo Insight Marketing and FY2016 Economic Census, MIC.