

AT A GLANCE | Japan

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Uncertainty in the Future of Capital Investment Reflected in Orders for Machinery

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Positive Outlook for Capital Investment, Along With Some Concerns

The June Bank of Japan Tankan, i.e., the Business Short-Term Economic Sentiment Survey released on July 3, gives a broad impression of economic recovery. The outlook is bright not only for business conditions, but also for the economic diffusion index (DI), which is a weighted average of the capital and labor share ratios of equipment and personnel judgments that approximate the output gap. In addition, companies were positive about their capital investment plans.

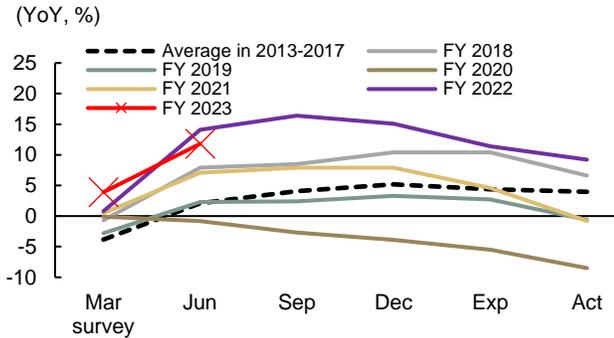
If we look at the capital investment plan, we can see that a recovery is expected in fiscal year 2023 (Figure 1). The capital investment plan for all sizes and industries (including land-based) is +11.8%, and although it is necessary to discount the fact that there is a rebound increase from the suppression since fiscal year 2020, the outlook for fiscal year 2023 remains strong. Even on a software-based basis, including land, which is highly correlated with GDP capital investment, solid growth in GDP private capital investment is expected in fiscal year 2023 (Figure 2).

In terms of manufacturing and non-manufacturing sectors (including land-based sectors), the manufacturing sector is expected to grow by 15.1%, slightly higher than usual. Compared to the usual pattern, the non-manufacturing sector is leading the way at +9.9% (Figures 3, 4). As for capital spending, it seems likely that drivers will shift from manufacturing to non-manufacturing with the transition to the "with-coronavirus" model.

The above is the outlook for Japanese capital investment from a Tankan perspective. When we look at the details, it will be necessary to analyze construction investment separately, but the projected construction start and construction cost (for non-residential use in the private sector), which is a leading indicator of construction investment, has maintained an increasing trend, so there seems to be no major problem for the future.

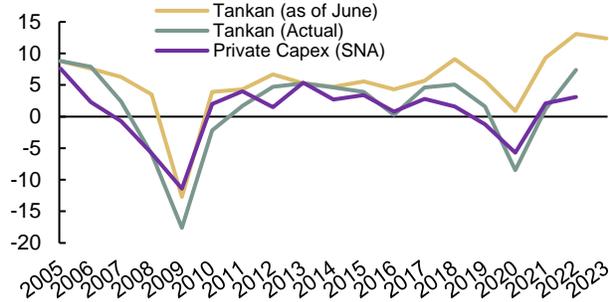
The downturn in May machinery orders, announced on July 12, has raised concerns about the outlook. In the following section, we consider the downside risks to Japan's capital investment outlook by focusing on the May machinery orders.

Figure 1: Capital Investment Plan in Tankan (all industries)



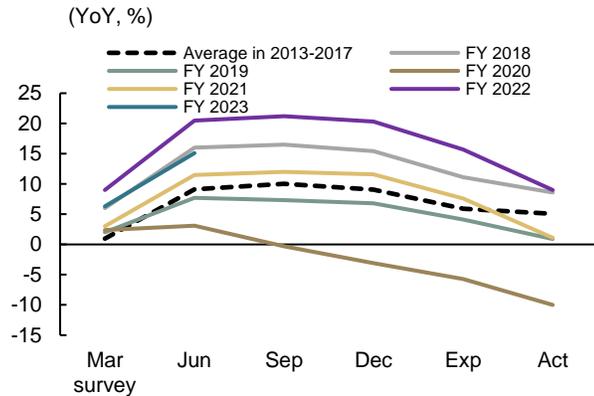
Note: Includes land investment
Source: BOJ

Figure 2: Corporate Capital Investment and Capital Investment Plan



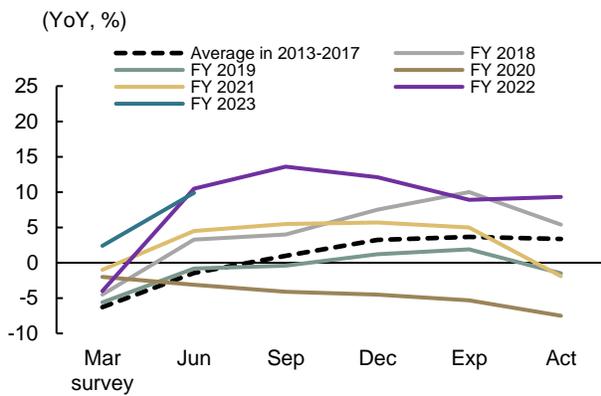
Note: For Tankan, excluding land, including software
Sources: BOJ, CAO, SMBC

Figure 3: Capital Investment Plan in Tankan (manufacturing)



Note: Includes land investment
Source: BOJ

Figure 4: Capital Investment Plan in Tankan (non-manufacturing)



Note: Includes land investment
Source: BOJ

Machinery Orders Fell Sharply in May

Needless to say, the machinery order statistics are indicators with large fluctuations in a single month. Although this point needs to be kept in mind, orders for core machinery (private demand excluding ships and electric power) in May dropped 7.6% from the previous month (Figure 5). In general, orders for core machinery are thought to precede capital investment by about six months. According to media reports, there was one large case in May, compared with zero in April, for which the order amount per case was 10 billion yen or more. In other words, the downside in May was not caused by large projects. Even if we break it down by quarter, April to May was down 2.7% from January to March. The results are a little unsettling, not just because of the month-long swing, but also because they are even.

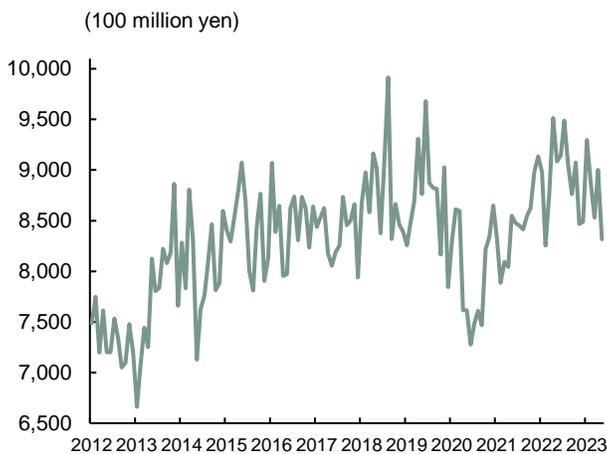
If we look again at the monthly movements by type of consumer, we note that the manufacturing sector increased by 3.2% month over month for the first time in three months, while the non-manufacturing sector decreased by 19.4% month over month (Figure 6). Similarly to the above, the manufacturing sector was almost flat, while the non-manufacturing sector was down 8% (Figures 7, 8). It is worrisome to note that while there has been a significant decline in the non-manufacturing sector, the manufacturing sector has also remained largely flat.

Within the manufacturing industry, the number of automobiles, accessories, and electrical machinery increased, while the number of general purpose, production, and business machinery and information and communication machinery decreased. According to the Bank of Japan’s April outlook report, the decline in the industrial sector is a cause for concern.

In the non-manufacturing sector, the construction sector showed a significant decline, while the transportation, postal and communication sectors showed a significant decline. In the construction and transportation industries, labor shortages and the need for labor-saving investments have been pointed out since before the COVID-19 pandemic. Although it is unlikely that these labor-saving investments will decline, they may have reached a plateau once they have run their course.

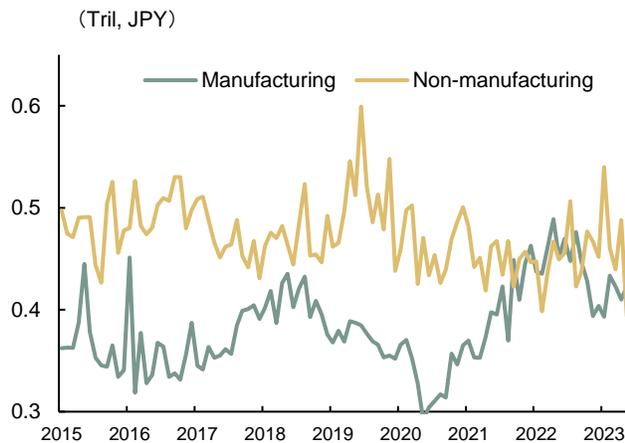
Repeatedly, machinery orders fluctuate significantly on a month-by-month basis, and the above does not constitute a downward revision to Japan’s capital investment forecast and, consequently, its economic outlook. For now, the bullish capital investment outlook, as suggested by the Tankan, will be maintained. However, it would be better to assume that the downside risks to the future of capital investment have come out in line with the machinery order statistics.

**Figure 5: Machinery Orders
(private demand, excluding trams)**



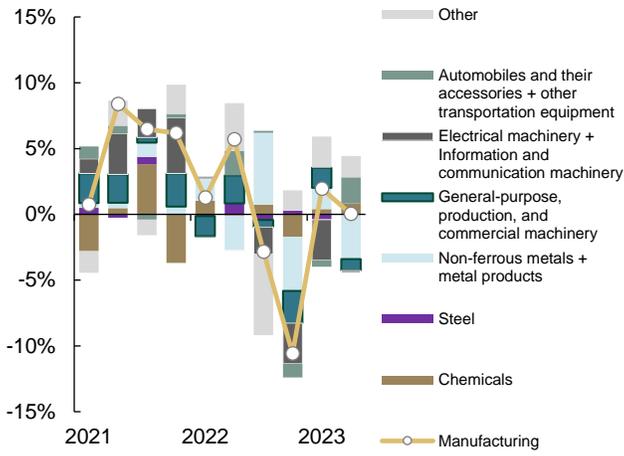
Source: METI

**Figure 6: Machinery Orders
(manufacturing and non-manufacturing)**



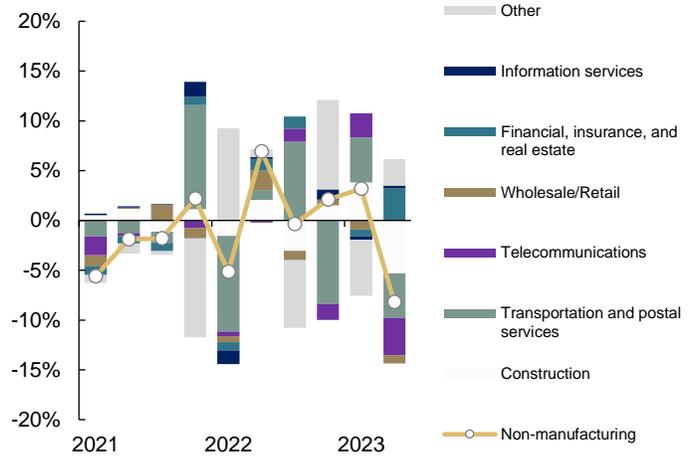
Source: METI

Figure 7: Machinery Orders (manufacturing, YoY)



Source: METI

Figure 8: Machinery Orders (non-manufacturing, YoY)



Source: METI

Economic Outlook: 2023-2024 Forecast

Figure 1: Forecasts for Economic Growth, Inflation, and Unemployment Rates

		2022			2023				2024				2021	2022	2023	2024
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
US	Real GDP	-0.6	3.2	2.6	2.0	1.5	-0.8	0.6	0.9	1.4	1.8	2.2	5.9	2.2	1.4	1.0
	Inflation	5.0	4.9	4.8	4.8	4.6	4.2	3.9	3.2	2.8	2.5	2.2	3.3	5.0	4.4	2.7
	Unemployment	3.6	3.6	3.6	3.5	3.5	3.7	4.3	4.6	4.7	4.7	4.6	5.4	3.7	3.7	4.7
Euro Area	Real GDP	0.8	0.4	-0.1	0.0	0.3	0.2	0.1	0.2	0.3	0.3	0.2	5.3	3.3	0.6	0.9
	Inflation	8.0	9.3	10.0	8.0	6.2	4.8	3.2	3.1	2.9	2.7	2.5	2.6	8.4	5.6	2.8
	Unemployment	6.7	6.7	6.7	6.6	6.6	6.6	6.7	6.8	6.8	6.9	6.9	7.7	6.7	6.6	6.9
Japan	Real GDP	5.6	-1.5	0.4	2.7	1.7	1.0	0.9	0.9	0.8	0.8	0.7	2.3	1.1	1.0	0.9
	Inflation	2.1	2.7	3.8	3.5	3.2	3.0	2.5	3.0	2.8	2.5	2.1	-0.2	2.3	3.1	2.6
	Unemployment	2.6	2.5	2.5	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.8	2.6	2.4	2.3
China	Real GDP	0.4	3.9	2.9	4.5	6.3	5.0	5.7	4.7	5.0	5.0	5.0	8.4	3.0	5.8	4.9
	Inflation	2.2	2.8	1.8	1.3	0.2	1.4	1.5	1.6	1.9	2.0	2.0	0.8	1.7	1.1	1.9
	Unemployment	5.8	5.4	5.6	5.5	5.2	5.3	5.2	5.1	5.0	5.0	5.0	5.1	5.1	5.3	5.0

Real GDP growth is in QoQ annualized for U.S. and Japan, QoQ for euro area and YoY for China and India. Inflation rate is in YoY%. Inflation rate is YoY, % of core index (ex. fresh food) for Japan, YoY % of PCE deflator for U.S., and total YoY% for the rest.

Figure 2: Forecast for Rates

Interest rate		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
US	Policy rate	4.25	4.75	5.00	5.25	5.25	5.00	4.75	4.50	4.25	4.25	5.25	4.25
		~4.50	~5.00	~5.25	~5.50	~5.50	~5.25	~5.00	~4.75	~4.50	~4.50	~5.50	~4.50
	2yr	3.43	4.03	4.90	4.20	4.00	3.80	3.60	3.40	3.20	3.43	4.00	3.20
	10yr	3.87	3.47	3.84	3.60	3.60	3.60	3.60	3.50	3.50	3.87	3.60	3.50
Germany	Policy rate	2.50	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	2.50	4.25	3.75
	Deposit rate	2.00	3.00	3.50	3.75	3.75	3.75	3.75	3.50	3.25	2.00	3.75	3.25
	2yr	2.50	2.68	3.20	3.20	3.00	2.80	2.60	2.40	2.30	2.50	3.00	2.30
	10yr	2.20	2.29	2.39	2.30	2.30	2.30	2.20	2.10	2.10	2.20	2.30	2.10
Japan	Policy rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	0.10	0.10	0.10	-0.10	-0.10	0.10
	2yr	0.04	-0.06	-0.07	0.10	0.15	0.20	0.30	0.30	0.30	0.04	0.15	0.30
	10yr	0.42	0.35	0.40	0.75	0.75	0.75	0.90	0.90	0.90	0.42	0.75	0.90
China	Policy rate	2.75	2.75	2.65	2.55	2.55	2.55	2.55	2.55	2.55	2.75	2.55	2.55
	2yr	2.39	2.41	2.11	2.16	2.24	2.32	2.39	2.49	2.59	2.39	2.24	2.59
	10yr	2.83	2.85	2.64	2.64	2.69	2.74	2.79	2.84	2.89	2.83	2.69	2.89

Figure 3: Forecast for FX and Oil Price

		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
USD/JPY	Range	130.58	127.23	130.64	128.00	125.00	121.00	119.00	116.00	116.00	113.47	125.00	116.00
		~151.95	~137.91	~145.07	~147.00	~138.00	~135.00	~133.00	~130.00	~130.00	~151.95	~147.00	~135.00
	End of quarter	131.12	132.86	144.31	137.00	133.00	130.00	128.00	126.00	123.00	131.12	133.00	123.00
EUR/USD	Range	0.9633	1.0806	1.0635	1.0300	1.0200	1.0100	1.0000	1.0100	1.0100	0.9536	1.0200	1.0000
		~1.0735	~1.1033	~1.1095	~1.1300	~1.1200	~1.1100	~1.1000	~1.1100	~1.1100	~1.1495	~1.1300	~1.1100
	End of quarter	1.0705	1.0839	1.0909	1.0700	1.0600	1.0500	1.0500	1.0600	1.0600	1.0705	1.0600	1.0600
EUR/JPY	Range	138.81	124.40	142.55	145.00	136.00	131.00	128.00	127.00	123.00	124.40	136.00	123.00
		~148.40	~145.67	~158.00	~159.00	~150.00	~145.00	~142.00	~141.00	~137.00	~150.00	~159.00	~145.00
	End of quarter	140.41	144.01	157.43	146.59	140.98	136.50	134.40	133.56	130.38	140.41	140.98	130.38
Crude Oil Prices (WTI)		82.64	75.99	73.67	75.00	80.00	80.00	75.00	77.00	78.00	98.74	76.17	77.50

※ Crude oil prices are averages for each period. Source: SMBC.

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