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1. **Implications of US-China negotiations resuming, and deeper significance of G20**
2. **Overtime regulations with penalties go into effect – are corporations prepared?**
3. **Checking on status quo of last minute demand prior to consumption tax hike**

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Summary

- **Implications of US-China negotiations resuming, and deeper significance of G20:** US-China trade negotiations resumed after the US-China summit meeting, and the US delayed implementation of its fourth round of tariff increases. The effects of the new round of tariffs on the economies of the China, US , and Japan were estimated as follows: China -0.11%pt, US -0.26%pt, and Japan -0.09%pt, so having avoided this step was good news. However, as it turns out, all this meant was that the two parties were back to square one. As for the structural reforms demanded by the US, the possibility remains that negotiations could break down if China is unable to provide an acceptable response.

- The temporary truce between the US and China will be a crucial moment for Japan. There is a very good possibility that US-Japan negotiations on automobile tariffs, which are scheduled for a decision on November 13, will go into full swing. If, hypothetically, a tariff of 25% is imposed on all automobiles and automobile parts, an additional increase of taxes totaling 1.2 tril yen could be generated annually. The outcome of US-Japan negotiations will be a life and death situation for Japan, and an important key to predicting the future of Japan's economy.

- **Overtime regulations with penalties go into effect – are corporations prepared?:** The new limitations on overtime work went into effect since April 2019. However, preparations for the change on the part of Japanese corporations are insufficient. The problem of extremely long overtime hours worked by over three million employees in Japan must be resolved over the next 1-2 years. The impact will effect approximately 1.13 billion hours annually, or approximately 0.9% of total labor input.

- Preparations for the change in labor law on the part of Japanese corporations may be insufficient, but since 2015 when the momentum for correcting long working hours increased, Japanese corporations have managed to resolve the problem of excessively long hours worked by 510,000 employees, though total labor input increased during those three years. The major approach taken was to increase the number of part-time workers and to make use of the concept of work-sharing. Workers used for this purpose were mostly students, the elderly, and women. However, there are limits to this approach. In order to continue this method in the future, it will be necessary to take in re-employed seniors, the non-working population (members of the "employment ice age generation"), and foreign workers.

- **Checking on status quo of last minute demand prior to consumption tax hike:** Last minute demand prior to consumption tax hike cannot yet be detected at this time as far as the purchasing of various goods is concerned. On the other hand, last minute demand for housing has been detected. Considering the effect of demand leveling measures and the fact that last minute demand has already occurred before the consumption tax hike in 2014, activity is limited in comparison to the last two times the consumption tax was increased. Of course, the more essential problem is what happens after the consumption tax hike, mainly the negative income effect. Consumption is expected to be restrained throughout FY2020 in association with the coming consumption tax increase.

1. Implications of US-China negotiations resuming, and significance of G20

Damage avoided in association with US fourth round of tariffs on Chinese goods (China -0.11%pt, US -0.26%pt, and Japan -0.09%pt)

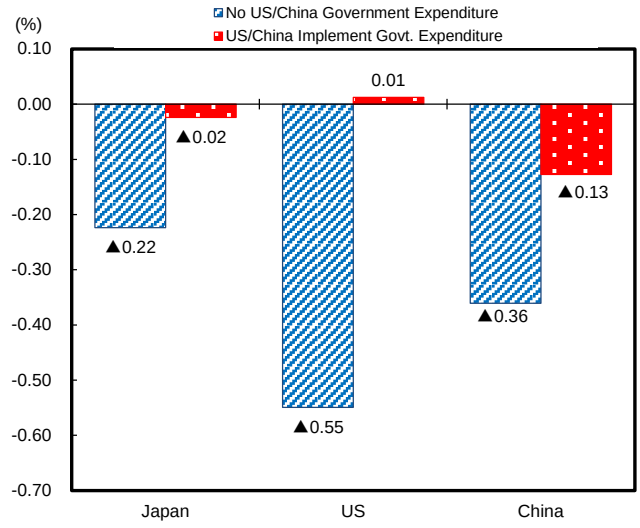
After the US-China summit meeting which took place in conjunction with the G20 summit in Osaka, which held on June 28, 29, the two countries resumed trade negotiations. The feared US fourth round of tariffs on Chinese goods was therefore postponed for the present, and the economies of the two countries, as well as the global economy, were able to avoid a further slowdown for the time being.

We have dealt with this question a number of times in previous monthly outlooks[1], in other words the cumulative effect of damage incurred by the economies of various countries when all instances of the imposing of tariffs, including the fourth round, have been implemented. The effects are estimated as follows: China -0.36%, US -0.55%, and Japan -0.22% (see Charts 1 & 2). On the other hand, tariffs already implemented up through round three are estimated to have a cumulative effect as follows: China -0.25%, US -0.29%, and Japan -0.13% (Charts 3 & 4).

The difference between these two estimates is the effects of the fourth round of tariffs (China -0.11%pt, US -0.26%pt, and Japan -0.09%pt), which was avoided this time around. Meanwhile, it is difficult to produce a quantitative estimate for this type of thing, but it is not difficult to imagine how the effects of tariffs on the economies of various countries could expand if there were an executive order calling for a halt in transactions with China's major telecommunications companies as had been rumored before the US-China summit.

Therefore, the fact that additional damage was avoided was of course good news for both the global economy and Japan's economy.

Estimation of Effects of Tariffs (Rounds 1 - 4) **Chart 1**



Source: Estimates produced using the DIR macro model.
Notes: 1) Estimated effects assuming US imposes additional tariff of 25% on all Chinese imports excluding pharmaceuticals and rare earth, and China imposes tariff of 25% on 50 billion dollars' worth of imports from the US, and average 14.5% on $60 billion worth.
2) All figures are real. Rate of deviation from baseline (%).

Effects of Tariffs on Japan, US, and China (Detailed Version) **Chart 2**

Effects on Chinese Economy		Real GDP	Personal Consumption	Capex	Government Expenditure	Exports	Imports
No US/China Govt. Expenditure	Deviation Rate	▲0.36	▲0.43	▲0.12	0.00	▲1.11	▲0.51
	Contribution Rate		▲0.17	▲0.05	0.00	▲0.23	0.09
US/China Implement Govt. Expenditure	Deviation Rate	▲0.13	▲0.43	▲0.05	1.16	▲0.81	▲0.35
	Contribution Rate		▲0.17	▲0.02	0.17	▲0.17	0.06
Effects on US Economy		**Real GDP**	Personal Consumption	Capex	Government Expenditure	Exports	Imports
No US/China Govt. Expenditure	Deviation Rate	▲0.55	▲0.98	▲0.73	0.00	▲0.14	▲1.69
	Contribution Rate		▲0.68	▲0.12	0.00	▲0.02	0.28
US/China Implement Govt. Expenditure	Deviation Rate	0.01	▲0.98	0.02	4.03	▲0.11	▲0.14
	Contribution Rate		▲0.68	0.00	0.68	▲0.01	0.02
Effects on Japan's Economy		**Real GDP**	Personal Consumption	Housing Investment	Capex	Exports	Imports
No US/China Govt. Expenditure	Deviation Rate	▲0.22	▲0.02	▲0.02	▲0.81	▲1.66	▲1.04
	Contribution Rate		▲0.01	▲0.00	▲0.13	▲0.31	0.19
US/China Implement Govt. Expenditure	Deviation Rate	▲0.02	▲0.00	▲0.00	▲0.09	▲0.18	▲0.11
	Contribution Rate		▲0.00	▲0.00	▲0.01	▲0.03	0.02

Source: Estimates produced using the DIR macro model.
Notes: 1) Estimated effects assuming US imposes additional tariff of 25% on all Chinese imports excluding pharmaceuticals and rare earth, and China imposes tariff of 25% on 50 billion dollars' worth of imports from the US, and average 14.5% on $60 billion worth.
2) All figures are real. Rate of deviation from baseline (%) and rate of contribution to GDP (%pt).

[1] For details see the DIR Report dated 30 May 2019, *Japan's Economy: Monthly Outlook (May 2019): Resumption of US-China "cold war" could cause Japanese exports to suffer a maximum decline of around 1.3 tril yen*, by Shunsuke Kobayashi & Yota Hirono. Furthermore, it should be noted that estimates shown in the section of this report on effects on Japan were not merely performed mechanically using a macro model, but took into consideration secondary effects as well, such as the decline of demand for capital goods and component parts necessary for production in China, which would mean a decline in Japan's exports.

No change in US government's hardline stance toward China

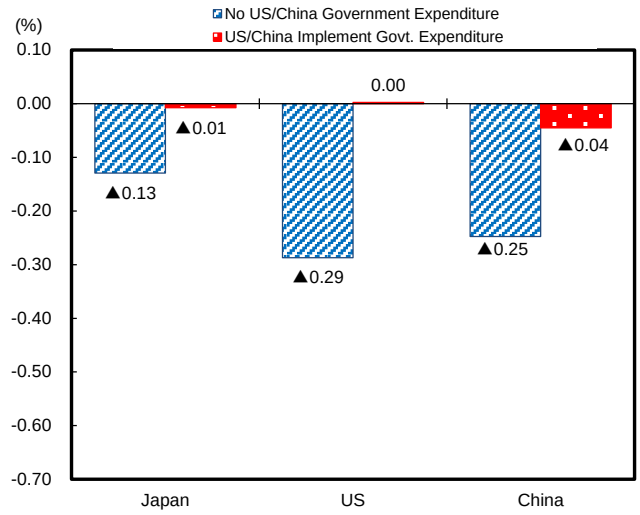
The problem with the resumed negotiations is their sustainability. First of all, as was pointed out in one of our past reports, *Japan's Economy: Monthly Outlook (Oct. 2018): The true nature of the US-China Trade War: The end of "the end of history" (or a new beginning?)*[2], there is non-partisan agreement in Congress when it comes to China-bashing, and no change has been seen in this situation of late.

Meanwhile, how the US suddenly discontinued negotiations in May, deciding instead to strengthen its third round of tariffs. There may actually be two aspects of policy reinforcing each other here. In other words, the assumptions behind the national strategy of carrying out a cold war with China include two policy areas – financial policy and fiscal policy – and these are supported on both the economic front and the national strength front.

In this context, the FRB is bringing an early halt to quantitative tightening (reduction of asset holdings), and has also indicated its willingness to lower the interest rate. Meanwhile, in regard to the problem of the "fiscal cliff", which is causing concern in some circles, the Republicans and Democrats have agreed to meet halfway, and the problem is expected to be quickly resolved[3]. By raising both the debt cap and the discretionary spending cap, an expansionary fiscal policy will become maintainable in FY2020 (whose accounting year will begin in October) and FY2021.

These developments are good news for the US economy, while at the same time it is something that should cause a headache for the Chinese economy. Since the US economy has energy to spare, it also has plenty of room to continue its hardline stance toward China.

Estimation of Effects of Tariffs (Rounds 1 - 3) **Chart 3**



Source: Estimates produced using the DIR macro model.
Notes: 1) Estimated effects assuming US imposes additional tariff of 25% on all Chinese imports excluding pharmaceuticals and rare earth, and China imposes tariff of 25% on 50 billion dollars' worth of imports from the US, and average 14.5% on $60 billion worth.
2) All figures are real. Rate of deviation from actual value (%) and rate of contribution to GDP (%pt).

Effects of Tariffs on Japan, US, and China (Detailed Version) **Chart 4**

Effects on Chinese Economy		Real GDP	Personal Consumption	Capex	Government Expenditure	Exports	Imports
No US/China Govt. Expenditure	Deviation Rate	**▲0.25**	▲0.43	▲0.09	0.00	▲0.57	▲0.43
	Contribution Rate		▲0.17	▲0.04	0.00	▲0.12	0.08
US/China Implement Govt. Expenditure	Deviation Rate	**▲0.04**	▲0.43	▲0.02	1.16	▲0.41	▲0.27
	Contribution Rate		▲0.17	▲0.01	0.17	▲0.09	0.05
Effects on US Economy		**Real GDP**	Personal Consumption	Capex	Government Expenditure	Exports	Imports
No US/China Govt. Expenditure	Deviation Rate	**▲0.29**	▲0.50	▲0.38	0.00	▲0.13	▲0.88
	Contribution Rate		▲0.35	▲0.06	0.00	▲0.02	0.14
US/China Implement Govt. Expenditure	Deviation Rate	**0.00**	▲0.50	0.00	2.07	▲0.09	▲0.08
	Contribution Rate		▲0.35	0.00	0.35	▲0.01	0.01
Effects on Japan's Economy		**Real GDP**	Personal Consumption	Housing Investment	Capex	Exports	Imports
No US/China Govt. Expenditure	Deviation Rate	**▲0.13**	▲0.01	▲0.01	▲0.47	▲0.96	▲0.60
	Contribution Rate		▲0.01	▲0.00	▲0.08	▲0.18	0.11
US/China Implement Govt. Expenditure	Deviation Rate	**▲0.01**	▲0.00	▲0.00	▲0.03	▲0.06	▲0.04
	Contribution Rate		▲0.00	▲0.00	▲0.00	▲0.01	0.01

Source: Estimates produced using the DIR macro model.
Notes: 1) Estimated effects assuming US imposes additional tariff of 25% on all Chinese imports excluding pharmaceuticals and rare earth, and China imposes tariff of 25% on 50 billion dollars' worth of imports from the US, and average 14.5% on $60 billion worth.
2) All figures are real. Rate of deviation from baseline (%) and rate of contribution to GDP (%pt).

[2] DIR Report dated 26 October 2018, *Japan's Economy: Monthly Outlook (Oct. 2018): The true nature of the US-China Trade War: The end of "the end of history" (or a new beginning?)*, by Shunsuke Kobayashi & Yota Hirono.
[3] "Trump, Congress Clinch Debt-Limit Deal After Tense Negotiations" (Bloomberg, 2019/7/22)
https://www.bloomberg.com/news/articles/2019-07-22/trump-says-lawmakers-reach-bipartisan-debt-limit-suspension-deal

US-China trade negotiations back at square one

But the above arguments are not at all comparable to the much larger problem of the resumption of negotiations, meaning that in actual fact no progress has been made. In short, the negotiations are now back at square one. The US demand which China is unable to respond to sufficiently is the demand to implement structural reforms regarding forced technology transfer, protection of intellectual property rights, non-tariff trade barriers, and cyber-attacks. If China is unable to provide a response that is acceptable to the US, the US may break off negotiations.

In this context, China announced a policy to deregulate foreign capital after the summit meeting with the US[4]. This development can be assumed to be a sign of progress in US-China negotiations. However, the question of how far China will have to go in its reforms in order to satisfy the US is an unknown, since a specific target has not been established. If China is unable to continue carrying out reforms until it reaches the standards desired by the US, relations will again become strained.

US-China Summit Meeting: US Proposals **Chart 5**

Statement from the Press Secretary Regarding the President's Working Dinner with China

1st, Dec 2018

The President of the United States, Donald J. Trump, and President Xi Jinping of China, have just concluded what both have said was a "highly successful meeting" between themselves and their most senior representatives in Buenos Aires, Argentina.

Very importantly, President Xi, in a wonderful humanitarian gesture, **(1) has agreed to designate Fentanyl as a Controlled Substance, meaning that people selling Fentanyl to the United States will be subject to China's maximum penalty under the law.**

On Trade, President Trump has agreed that **on January 1, 2019, he will leave the tariffs on $200 billion worth of product at the 10% rate, and not raise it to 25% at this time**. **(2) China will agree to purchase a not yet agreed upon, but very substantial, amount of agricultural, energy, industrial, and other product from the United States** to reduce the trade imbalance between our two countries. China has agreed to start purchasing agricultural product from our farmers immediately.

President Trump and President Xi have agreed to **(3) immediately begin negotiations on structural changes with respect to forced technology transfer, intellectual property protection, non-tariff barriers, cyber intrusions and cyber theft, services and agriculture**. **Both parties agree that they will endeavor to have this transaction completed within the next 90 days. If at the end of this period of time, the parties are unable to reach an agreement, the 10% tariffs will be raised to 25%.**

(4) It was also agreed that great progress has been made with respect to North Korea and that President Trump, together with President Xi, will strive, along with Chairman Kim Jong Un, to see a nuclear free Korean Peninsula. President Trump expressed his friendship and respect for Chairman Kim.

(5) President Xi also stated that he is open to approving the previously unapproved Qualcomm-NXP deal should it again be presented to him.

President Trump stated: "This was an amazing and productive meeting with unlimited possibilities for both the United States and China. It is my great honor to be working with President Xi."

Source: https://www.whitehouse.gov/briefings-statements/statement-press-secretary-regarding-presidents-working-dinner-china/
Note: Colors, underlining, and numbers provided by DIR. Number (3) in the text was quoted.

[4] http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3863019/index.html

Concerns that automobile tariff negotiations will intensify when there is a pause in US-China Negotiations

Negotiations are now back to square one. While Chinese structural reform is progressing, the US will soften its touch, but if reform stops, the US will continue with its attacks. This general scenario remains unchanged from the past. There is a very good possibility that trade friction will continue as US-China relations go back and forth between tension and easing.

Of course, it is probably safe to say that we are now in an easing period. That in itself is good news. However, there is just one point that we need to be careful about, and that is the fact that when there is an interlude in US-China negotiations, it means that intensification of pressure associated with automobile tariffs is about to begin. And in this case the target is not China, but Japan and the EU.

The US has already completed its survey on imports of automobiles and automobile parts in accordance with Article 232 of the Trade Expansion Act of 1962, and there is some risk that the current tariff rate of 2.5% could be raised to 20%, or as much as 25%.

Most recently the 2.5% tariff rate was applied to a total of 4.5 tril yen in passenger cars and 0.9 tril yen in auto parts (based on 2018 performance). If the above risk scenario becomes a reality, the total of the above, or 5.5 tril yen, could become the target of additional tariffs. If a tariff of 25% were to be applied across the board to these items, the amount of increase in tariffs is estimated at 1.2 tril yen (Chart 6).

Influence on Sales of Japanese Cars if US Imposes Additional Tariffs on Automobiles **Chart 6**

		Volume (Units)	Amount (Y100 Mil)	Amount of Tariff Hike (Y100 Mil)
①	Japanese cars sold in domestic US	6,623,908		
②	Japanese cars produced in domestic US	3,773,993		
③	Japanese cars exported from factories in domestic US	423,415		
④	Direct exports from Japan (excluding parts)	1,742,307	44,903	9,946
①-[②-③]-④=⑤	Exports from third countries	1,531,023	39,458	
⑥	Exports Automobile Parts from Japan		9,295	2,091
④＋⑤＋⑥	**Total Automobile Related Exports of Japanese Corporations to US**		**93,656**	**12,037**

Source: Automotive News, Haver Analytics, JAMA, Ministry of Finance; compiled by DIR.

Notes: 1) Volume and amount based on 2018 results. However, export amount from third countries estimated by multiplying unit price of direct exports (4) with number of units.

2) Third countries include Canada and Mexico, but since they are member countries of the USMCA agreement, it is assumed that there will be no additional tariff as shown in (5).

3) Amount of tariff hike assumes (4): 2.5% ⇒ 25% and (5): 0% ⇒ 25%, (6): 2.5% ⇒ 20%.

US demands in negotiations are shown in Chart 7. As stated in Article 5, demands cover largely two areas. The first demand calls for the reduction of tariffs on agriculture, forestry, and fishery products. The second calls for actions which will help to create more manufacturing and employment in the automobile industry in the US. This means applying the concession of market access as promised in past economic partnership agreements to the maximum degree. This point is clearly underlined. But there is no clear target set for the latter. In other words, as was the case in the negotiations with China, it is unknown how far Japan needs to go in making concessions in order to satisfy the US.

The questions of whether or not the US will impose additional automobile tariffs, as well as the question of what the tariff rate might be, were originally to have been decided by May. But the US has exceeded its own deadline by 180 days, and has now set a new deadline of November 13. The return to US-Japan negotiations surrounding the question of automobile tariffs, which are expected to get into full swing in the future when US-China negotiations have hit an interlude, will be a life and death situation for Japan, and an important key to predicting the future of Japan's economy.

Complete Text of US-Japan Joint Statement

Chart 7

1. On the occasion of our Summit Meeting in New York on September 26, 2018, we, President Donald J. Trump and Prime Minister Shinzo Abe, affirmed the importance of a strong, stable, and mutually beneficial trade and economic relationship between the United States and Japan, recognizing that our economies together represent approximately 30 percent of global Gross Domestic Product. The President reiterated the importance of reciprocal trade, as well as reducing the trade deficit with Japan and other countries. The Prime Minister emphasized the importance of free, fair, and rules-based trade.

2. Against this backdrop, we reaffirmed our determination to further expand trade and investment between the United States and Japan in a mutually beneficial manner, including through further concrete steps, as well as to realize free, fair, and open development of the global economy.

3. The United States and Japan will **enter into negotiations, following the completion of necessary domestic procedures, for a United States–Japan Trade Agreement on goods, as well as on other key areas including services, that can produce early achievements**.

4. The United States and Japan also **intend to have negotiations on other trade and investment items following the completion of the discussions of the agreement mentioned above**.

5. The agreement mentioned above is designed to be mutually beneficial, and, in conducting those negotiations, the United States and Japan will respect positions of the other government:
For the United States, market access outcomes in the motor vehicle sector will be designed to increase production and jobs in the United States in the motor vehicle industries; and
For Japan, with regard to agricultural, forestry, and fishery products, outcomes related to market access as reflected in Japan's previous economic partnership agreements constitute the maximum level.

6. The United States and Japan will also strengthen cooperation to better protect American and Japanese companies and workers from non-market oriented policies and practices by third countries. We will therefore **work closely together, through United States–Japan as well as United States–Japan–European Union cooperation, to promote discussions on World Trade Organization reform and e-commerce and to address unfair trading practices including intellectual property theft, forced technology transfer, trade-distorting industrial subsidies, distortions created by state-owned enterprises, and overcapacity**.

Source: "Joint Statement of the United States and Japan" (September 26, 2018)
https://www.whitehouse.gov/briefings-statements/joint-statement-united-states-japan/
Note: Colors, underlining provided by DIR.

2. Overtime regulations with penalties go into effect – are corporations prepared?

The new limitations on overtime work went into effect since April 2019.

The problem with this policy is that it leaves many questions unanswered. The maximum number of overtime hours according to the new regulations is said to be 720 hours per year. However, hours worked on holidays are not included. Monthly average overtime hours including holidays are set at a maximum of 80 hours, so logically speaking, this should mean that there are a total of 960 overtime hours allowable per year.

Meanwhile, the new regulations will only become applicable to small and middle-sized corporations a year from later April 2020, and certain types of businesses will have another five years before the rules become applicable in April 2024 (these include drivers of motor vehicles, construction, and doctors).

In this chapter we will review how well-prepared Japanese corporations are for the revised labor standards, while at the same time touching upon exceptions to the rule.

Preparations are insufficient. Over three million people may be in conflict with the new standards

The most recent data available on overtime is from FY2018 (Chart 8-9). This data tells that, with the exception of businesses which become applicable to new regulations five years later as mentioned above, there were 5,260,000 employees whose monthly working hours averaged over 220 hours (with monthly overtime hours averaging 60, putting annual overtime hours at 720). These employees are considered to be workers with long work hours. Then there are the workers with excessively long work hours. These are the employees who put in a monthly average of 240 hours (with monthly overtime hours averaging 80, putting annual overtime hours at 960). There were 3,160,000 people putting in excessively long work hours in 2018.

Japan's Employment Situation (Summary: Change Between FY2015 and FY2018) **Chart 8**

	FY2018					FY2015					Change Between FY2015 and FY2018				
	Workers with Long Work Hours	Workers with Excessively Long Work Hours	Total Number of Workers	Average Monthly Work Hours	Total Work Hours (100 mil)	Workers with Long Work Hours	Workers with Excessively Long Work Hours	Total Number of Workers	Average Monthly Work Hours	Total Work Hours (100 mil)	Workers with Long Work Hours	Workers with Excessively Long Work Hours	Total Number of Workers	Average Monthly Work Hours	Total Work Hours (100 mil)
Total Industries	727	438	6,538	158	103.2	797	500	6,250	162	101.1	-70	-70	288	-3.9	2.1
Industries Effected by New Regulations	526	316	4,887	156	76.1	588	367	4,653	160	74.4	-62	-51	234	-4.2	1.7
Mining and Quarrying of Stone and Gravel	0	0	2	175	0.0	0	0	2	174	0.0	0	0	0	0.7	0.0
Construction	75	43	488	176	8.6	80	49	488	179	8.7	-5	-5	0	-2.6	-0.1
Manufacturing	99	50	1,045	170	17.8	113	62	1,022	171	17.5	-14	-14	23	-1.1	0.3
Electricity, Gas, Heat Supply and Water	2	1	27	165	0.4	2	1	28	166	0.5	0	0	-1	-1.4	-0.0
Information and communications	20	11	219	171	3.7	26	16	204	177	3.6	-6	-6	15	-5.7	0.1
Transport and postal activities	81	53	336	184	6.2	83	57	329	188	6.2	-2	-2	7	-3.3	0.0
Wholesale and retail trade	114	69	1,051	152	16.0	135	86	1,038	158	16.4	-21	-21	13	-5.2	-0.3
Finance and insurance	12	6	161	165	2.6	13	8	154	166	2.6	-1	-1	7	-1.1	0.1
Real estate and goods rental and leasing	12	7	126	145	1.8	13	8	119	150	1.8	-1	-1	7	-4.2	0.1
Scientific research, professional and technical services	27	17	233	163	3.8	29	19	213	168	3.6	-2	-2	20	-4.8	0.2
Accommodations, eating and drinking services	56	40	405	135	5.5	62	45	378	144	5.4	-6	-6	27	-8.9	0.0
Living-related and personal services and amusement services	30	18	232	147	3.4	37	22	227	156	3.5	-7	-7	5	-9.1	-0.1
Education, learning support	46	31	315	151	4.7	45	30	298	152	4.5	1	1	17	-1.8	0.2
Medical, health care and welfare	45	26	827	148	12.3	46	27	780	151	11.8	-1	-1	47	-2.5	0.5
Compound services	4	2	55	163	0.9	4	2	59	167	1.0	0	0	-4	-3.9	-0.1
Services, N.E.C.	35	20	438	145	6.3	37	22	399	148	5.9	-2	-2	39	-3.6	0.4
Government, except elsewhere classified	26	16	236	170	4.0	27	18	226	171	3.9	-1	-1	10	-1.8	0.1
Services, not elsewhere classified	10	6	123	146	1.8	6	4	68	153	1.0	4	4	55	-7.1	0.8

Source: Ministry of Internal Affairs and Communications; compiled by DIR.
Note: Number of workers expressed in units of 10,000.

These figures are the data for corporations of all sizes. Therefore, it is not possible to differentiate between people putting in long work hours as defined above, and who work at companies which must comply with the Revised Labor Standards Act which went into effect in April 2019, and people who work for businesses which will not be applicable to the new regulations until after April 2020. However, both large corporations and small and middle-sized corporations will be expected to correct the problem of long work hours beginning in FY2020. By that time the figure of 3,160,000 for the number of people putting in excessively long work hours will take on a whole new meaning, and not necessarily a positive one.

Corporations must eliminate 1.13 billion overtime hours over the next 1-2 years

Next, working with certain assumptions[5], we calculate the impact of reducing the overtime hours of 3,160,000 people who put in excessively long work hours to 960, the legal number of overtime hours. This means reducing work hours by 1.13 billion hours per year. The average annual work hours per employee in FY2018 based on actual results was 1,894 hours. In other words, 1.13 billion hours is the equivalent of the work hours of 600,000 people. This is the equivalent of approximately 0.9% of the total number of employees in Japan.

Of course some corporations will respond to the new regulations by producing a large number of managers in name only, or by insisting on unpaid overtime work. However, if we assume that most companies will comply with the new regulations, it means that the labor shortage, which has already become apparent, will become even more serious, and the potential growth rate of Japan's economy could be pushed down due to supply constraints in labor input.

Despite this situation, overtime has actually declined in comparison to three years ago, with the number of people putting in long work hours down by -620,000, and the number of people putting in excessively long work hours down by -510,000

As has already been pointed out, major efforts are still to be made by Japanese corporations in terms of handling the new labor standards. That said, many corporations had already been making efforts on their own to restrict overtime, so that the number of people putting in long work hours has already declined in comparison to past years. Looking at the figures for FY2015 when the momentum for correcting long working hours increased, we see that, with the exception of businesses which become applicable to new regulations five years later, people putting in long work hours totaled 5,880,000, while workers putting in excessively long work hours numbered 3,670,000. These two figures declined over a period of three years by 620,000 and 510,000 respectively. Of course, when one considers the fact that there are still over 3,160,000 employees putting in excessively long work hours the pace of decline is of course insufficient, but even so, the fact that the number of people putting in long work hours is declining by approximately 200,000 per year is a major social phenomenon.

Japanese corporations handling the problem by increasing the number of part-time workers, and through work-sharing

Now the question is how did Japanese corporations handle the decline in work hours? The choices are (1) reduce the size of operations, (2) personnel recruitment, or (3) work-sharing. Of these, (1) doesn't really apply on a macro basis even if we assume that all sorts of things were going on at individual companies. Chart 8 shows that total work hours nationwide have actually increased over the last three years. The monthly average has grown by 210 million hours (10.11 bil hrs → 10.32 bil hrs), and the annual average has grown by 2.52 billion hours.

[5] Average overtime hours worked by employees whose monthly work hours are 241-260 hours is assumed to be 90 hours (with 10 hours of overtime requiring reduction). If monthly work hours are 261-280 hours, the amount requiring reduction is 30 hours, and for work hours of 281 hours or more, overtime is 130 hours with 50 hours requiring reduction.

Japan's Employment Situation (Details: Change Between FY2015 and FY2018) Chart 9

FY2018

Monthly Work Hours	0	1-20	21-40	41-60	61-80	81-100	101-120	121-140	141-160	161-180	181-200	201-220	221-240	241-260	261-280	281-
Industries covered	100	98	212	265	352	337	348	407	1,138	1,141	920	493	289	173	97	168
Mining and Quarrying of Stone and Gravel	0	0	0	0	0	0	0	0	0	1	1	0	0	0	0	0
Construction	6	6	10	10	13	12	17	22	74	78	113	52	32	19	9	15
Manufacturing	11	5	11	14	25	33	43	59	222	237	185	101	49	24	12	14
Electricity, Gas, Heat Supply and Water	0	0	0	0	0	1	1	3	8	6	4	2	1	0	0	1
Information and communications	4	1	2	3	3	4	7	14	57	50	35	19	9	4	3	4
Transport and postal activities	4	2	4	7	11	12	14	17	44	51	54	35	28	19	12	22
Wholesale and retail trade	12	12	37	54	84	75	61	63	153	168	139	79	45	27	16	26
Finance and insurance	3	1	1	2	5	5	6	14	41	35	24	12	6	3	2	1
Real estate and goods rental and leasing	2	7	6	6	7	7	7	8	20	19	16	9	5	3	1	3
Scientific research, professional and technical services	4	4	7	6	9	9	11	16	49	41	32	18	10	6	4	7
Accommodations, eating and drinking services	5	10	32	43	45	40	30	22	30	33	36	23	16	14	7	19
Living-related and personal services and amusement services	3	6	13	15	18	16	16	14	26	28	30	17	12	8	4	6
Education, learning support	8	13	19	18	17	14	18	19	46	40	34	23	15	11	7	13
Medical, health care and welfare	16	10	25	38	51	47	48	58	171	182	96	40	19	10	6	10
Compound services	1	0	1	1	2	1	2	4	15	13	8	3	2	1	1	0
Services, N.E.C.	6	8	19	24	33	30	31	32	76	66	53	25	15	8	5	7
Government, except elsewhere classified	3	1	2	2	4	5	12	20	63	56	27	15	10	6	4	6
Services, not elsewhere classified	7	3	7	6	8	7	7	7	24	17	13	7	4	2	1	3

FY2015

Monthly Work Hours	0	1-20	21-40	41-60	61-80	81-100	101-120	121-140	141-160	161-180	181-200	201-220	221-240	241-260	261-280	281-
Industries covered	83	80	173	232	308	324	345	387	1,028	1,092	900	501	297	191	111	198
Mining and Quarrying of Stone and Gravel	0	0	0	0	0	0	0	0	0	1	1	0	0	0	0	0
Construction	6	5	9	10	12	12	19	23	71	73	112	56	31	20	10	19
Manufacturing	9	4	11	16	26	33	45	61	202	223	179	100	51	29	15	18
Electricity, Gas, Heat Supply and Water	0	0	0	0	0	0	1	3	9	7	4	2	1	0	0	1
Information and communications	3	1	2	2	3	3	7	13	46	45	33	20	10	6	4	6
Transport and postal activities	3	1	4	6	9	12	14	15	44	49	54	35	26	19	12	26
Wholesale and retail trade	10	10	29	47	72	78	67	62	142	162	142	82	49	32	19	35
Finance and insurance	3	1	1	2	5	6	7	13	33	34	22	14	5	4	2	2
Real estate and goods rental and leasing	2	5	6	5	7	6	7	7	18	18	16	9	5	4	2	2
Scientific research, professional and technical services	3	3	5	6	7	8	11	15	41	38	29	18	10	7	4	8
Accommodations, eating and drinking services	4	7	23	35	39	38	30	22	30	32	33	23	17	14	9	22
Living-related and personal services and amusement services	2	5	10	12	15	16	15	13	23	27	33	19	15	10	5	7
Education, learning support	7	12	18	16	16	13	16	17	43	42	31	22	15	11	7	12
Medical, health care and welfare	15	9	22	33	44	43	44	53	157	177	97	40	19	11	6	10
Compound services	1	0	0	1	2	2	2	4	15	14	10	4	2	1	1	0
Services, N.E.C.	4	7	16	20	28	28	28	27	65	63	50	26	15	9	5	8
Government, except elsewhere classified	3	1	2	2	3	5	11	19	58	56	24	15	9	6	4	8
Services, not elsewhere classified	5	1	2	3	4	3	4	4	13	11	8	4	2	2	1	1

Change Between FY2015 and FY2018

Monthly Work Hours	0	1-20	21-40	41-60	61-80	81-100	101-120	121-140	141-160	161-180	181-200	201-220	221-240	241-260	261-280	281-
Industries covered	17	18	39	33	44	13	3	20	110	49	20	-8	-8	-18	-14	-30
Mining and Quarrying of Stone and Gravel	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Construction	0	1	1	0	1	0	-2	-1	3	5	1	-4	1	-1	-1	-4
Manufacturing	2	1	0	-2	-1	0	-2	-2	20	14	6	1	-2	-5	-3	-4
Electricity, Gas, Heat Supply and Water	0	0	0	0	0	1	0	0	-1	-1	0	0	0	0	0	0
Information and communications	1	0	0	1	0	1	0	1	11	5	2	-1	-1	-2	-1	-2
Transport and postal activities	1	1	0	1	2	0	0	2	0	2	0	0	2	0	0	-4
Wholesale and retail trade	2	2	8	7	12	-3	-6	1	11	6	-3	-3	-4	-5	-3	-9
Finance and insurance	0	0	0	0	0	-1	-1	1	8	1	2	-2	1	-1	0	-1
Real estate and goods rental and leasing	0	2	0	1	0	1	0	1	2	1	0	0	0	-1	-1	1
Scientific research, professional and technical services	1	1	2	0	2	1	0	1	8	3	3	0	0	-1	0	-1
Accommodations, eating and drinking services	1	3	9	8	6	2	0	0	0	1	3	0	-1	0	-2	-3
Living-related and personal services and amusement services	1	1	3	3	3	0	1	1	3	1	-3	-2	-3	-2	-1	-1
Education, learning support	1	1	1	2	1	1	2	2	3	-2	3	1	0	0	0	1
Medical, health care and welfare	1	1	3	5	7	4	4	5	14	5	-1	0	0	-1	0	0
Compound services	0	0	1	0	0	-1	0	0	0	-1	-2	-1	0	0	0	0
Services, N.E.C.	2	1	3	4	5	2	3	5	11	3	3	-1	0	-1	0	-1
Government, except elsewhere classified	0	0	0	0	1	0	1	1	5	0	3	0	1	0	0	-2
Services, not elsewhere classified	2	2	5	3	4	4	3	3	11	6	5	3	2	0	0	2

Source: Ministry of Internal Affairs and Communications; compiled by DIR.
Note: Number of workers expressed in units of 10,000.

So how did Japanese corporations maintain and expand labor input? The answer is by using (2) personnel recruitment and (3) work-sharing. Chart 9 shows that the number of employees in both of these categories is growing significantly. First of all, monthly work hours for these two categories never reaches 100 hours. During the three years depicted here, the number of part-time workers grew by 1,350,000 (with the exception of businesses which become applicable to new regulations five years later). At the same time, the number of employees putting in monthly work hours of 141-180 hours (regular employees who do almost no overtime) grew by 1,300,000.

As was pointed out in our earlier report, *Has the Phillip's Curve Lost its Validity? Outlook for the Labor Market: The Big Picture*[6], it appears that corporations handled these needs by hiring younger people and the elderly as temporary workers, while handling the work-sharing category by changing the status of non-regular workers to regular workers with the focus on women employees. However, there are limits to this approach. As Japan's working-age population declines, and with the necessity of eliminating an additional 1.13 billion hours of overtime due to the strengthening of regulations, Japanese corporations are now faced with the necessity of moving into new policy territory. In order to increase employment under current conditions, corporations will have to extend their search beyond temporary workers and women, and take in re-employed seniors, the non-working population (members of the "employment ice age generation"), and foreign workers.

Unpaid overtime continues to decline

Now we examine unpaid overtime[7]. As is shown in Chart 10, unpaid overtime at Japanese corporations is estimated as having a monthly average of around 16.2 hours. This figure stood at 17.2 hours in FY2015, meaning that unpaid overtime decreased by around 0.9 hours over the previous three years. This phenomenon began in the early 2000s, and its basic features do not appear to have changed much.

Change in Unpaid Overtime by Industry (Estimated Value, FY2018, FY2015, Change) **Chart 10**

Hours per Month in Unpaid Overtime	FY2015	FY2016	FY2017	FY2018	Change (FY2015 → FY2018)
Industries covered	17.2	17.2	16.8	16.2	-0.9
Mining and Quarrying of Stone and Gravel	6.4	9.6	11.3	11.7	5.3
Construction	7.3	5.9	5.9	6.2	-1.1
Manufacturing	8.0	8.7	8.0	7.2	-0.7
Electricity, Gas, Heat Supply and Water	9.4	10.2	11.6	9.4	0.0
Information and communications	13.7	13.7	15.2	15.4	1.7
Transport and postal activities	16.1	14.5	13.4	15.7	-0.4
Wholesale and retail trade	20.6	20.6	20.1	18.8	-1.9
Finance and insurance	17.5	19.2	19.8	17.3	-0.2
Real estate and goods rental and leasing	-	-	-	-	-
Scientific research, professional and technical services	12.6	12.5	9.6	7.0	-5.6
Accommodations, eating and drinking services	40.8	38.9	38.2	37.2	-3.6
Living-related and personal services and amusement services	19.9	21.4	19.0	18.9	-1.0
Education, learning support	26.3	27.8	25.7	24.2	-2.0
Medical, health care and welfare	15.0	14.9	14.1	14.2	-0.8
Compound services	15.8	14.9	14.9	12.3	-3.5
Services, N.E.C.	3.5	2.3	3.7	2.8	-0.7

Source: Ministry of Health, Labour and Welfare; compiled by DIR.

[6] DIR Report dated 27 July 2018, *Has the Phillip's Curve Lost its Validity? Outlook for the Labor Market: The Big Picture*, by Shunsuke Kobayashi & Yota Hirono.
[7] DIR Report dated 23 March 2018, *Japan's Economy: Monthly Outlook (Mar 2018), Will Spring Labor Offensive bring wage hikes, thus leading to growth in consumption?*, by Shunsuke Kobayashi.

3. Checking on status quo of last minute demand prior to consumption tax hike

Last minute demand not detected as far as the purchasing of various goods is concerned

The consumption tax hike planned for October this year is considered to be a definite go at this time. In this chapter we report on the outlook for the Japanese economy, including observations on future trends in consumption, last minute demand and reactionary decline, and manifestation of the negative income effect.

As is shown in Chart 11, last minute demand as seen in sales of consumer electronics, department stores and supermarkets appeared one or two months before the implementation of the consumption tax hike during the previous two times the tax was increased (in April 2014 and April 1997). However, this time around, last minute demand has not been observed in the most recently available statistics from the month of May.

In the previous two cases when the consumption tax was increased, last minute demand in automobile sales began to appear one or two quarters before implementation of the tax, but this time around, leveling measures have been implemented to avoid extreme fluctuations. One of these measures was to schedule the tax hike after April 2019 (decrease in tax reduction measures). Clear signs of last minute demand have not been observed at this time (Chart 12).

Clear signs of last minute demand have been seen in housing. However, this is limited in comparison to the last two times the tax was raised.

The area where last minute demand has definitely been detected is in housing. After the consumption tax is raised, various types of housing assistance programs are to be strengthened. However, in many cases one can save more by avoiding the higher consumption tax than by depending on the post-consumption-tax-hike housing assistance (Chart 12). But in this case as well, the volume of last minute demand is limited in comparison to what it was during the previous two instances of a consumption tax hike. The strengthening of housing assistance programs after the tax hike is likely contributing to the leveling effect of demand, while in addition, households which had been considering the purchase of a new home in the near future the last time the consumption tax was raised purchased their home at that time, and hence have already experienced a round of last minute demand.

The negative income effect is a bigger problem

There is of course a more fundamental problem than last minute demand and reactionary decline, and that is the appearance of the negative income effect after an increase in the consumption tax.

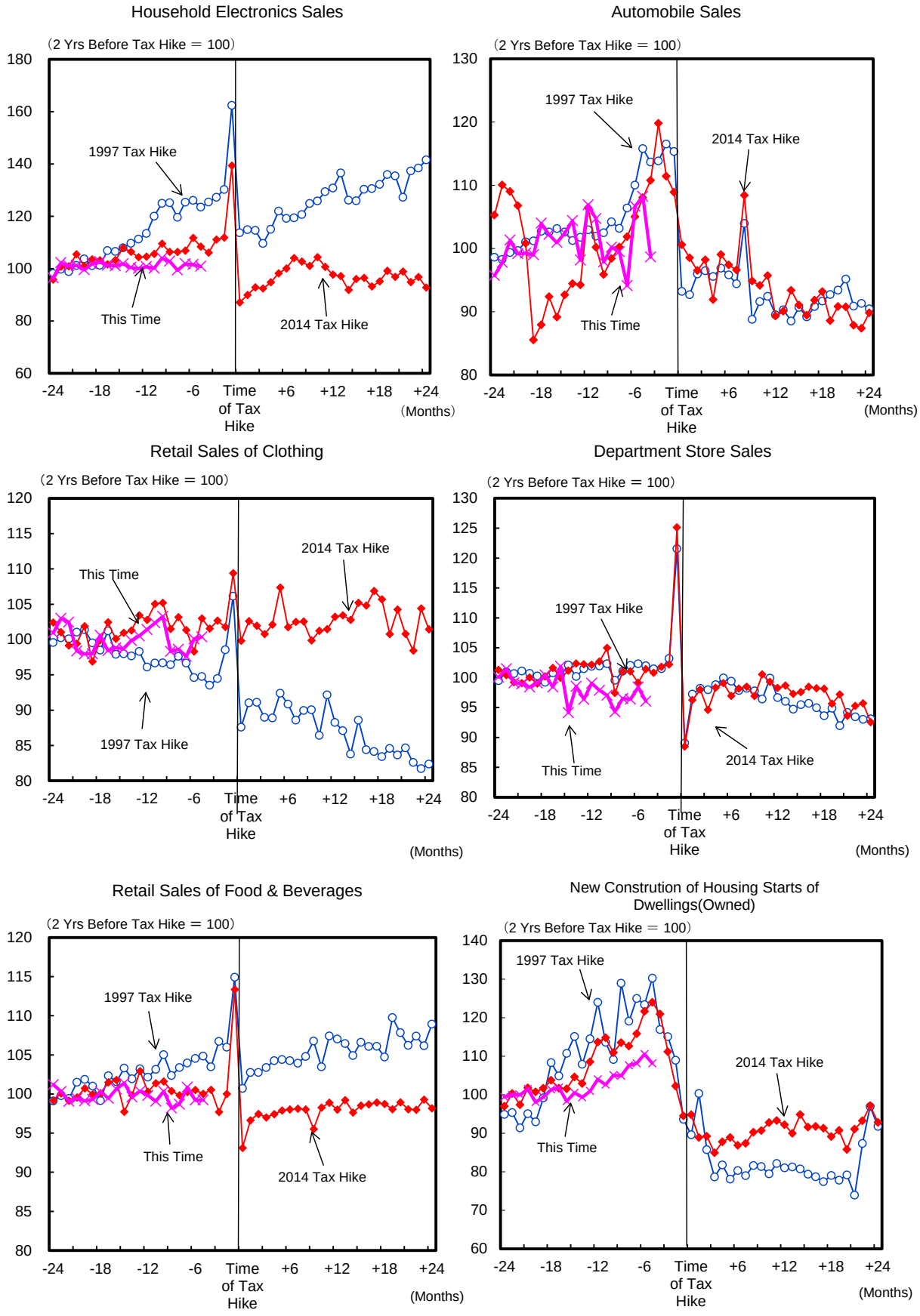
The increase in financial burden due to the raising of the consumption tax rate is estimated at around 5.7 tril yen on the national and local (regional) levels. In addition, the increase in financial burden associated with the securing of financial resources such as reviewing the tobacco tax and income tax is said to be at around 0.6 tril yen. The burden is offset somewhat by implementation of a reduced tax rate policy which reduces financial burden by around 1.1 tril yen, which is expected to bring the total amount of tax burden to around 5.2 tril yen.

To this is added an expected 3.2 tril yen in increased benefits such as free early childhood education and social security enhancements. To sum it all up, the net reduction in Japan's budget (the fiscal austerity effect) is estimated to be at around 2.0 tril yen. In addition to this, a variety of economic measures will also be implemented. Overall, the amount is expected to be at around 2.3 tril yen – an amount which is larger than six months' worth of the fiscal austerity effect (Oct. 2019 – Mar 2020, approximately 1.0 tril yen).

However, more than half of the consumption tax-hike countermeasures will go toward public investment in areas such as disaster prevention and reduction, and national resilience (a total of 1.35 tril yen). Therefore, the emphasis is expected to be more on construction and related areas rather than on benefits going directly to households.

Change in Demand for Items Affected by Tax Hike (Comparison with Tax Hikes in 1997 and 2014)

Chart 11



Source: Japan Automobile Dealers Association, Ministry of Economy, Trade and Industry, Ministry of General Affairs and Communications, Ministry of Land, Infrastructure, Transport and Tourism; Compiled by DIR.

Note: Seasonally adjusted. Automobile sales seasonally adjusted by DIR. For all other items, the Consumer Price Index was used, and real values deflated.

This year's consumption tax hike is expected to bring a long period of moderate constraint on consumption lasting through FY2020

Considering the above, fiscal factors including the consumption tax hike are expected to have a slightly negative impact on consumption in FY2019, while at the same time having a clearly positive effect on public investment, and a slightly positive effect on overall domestic demand. But of course, the effects of the various consumption tax hike countermeasures will have disappeared by FY2020.

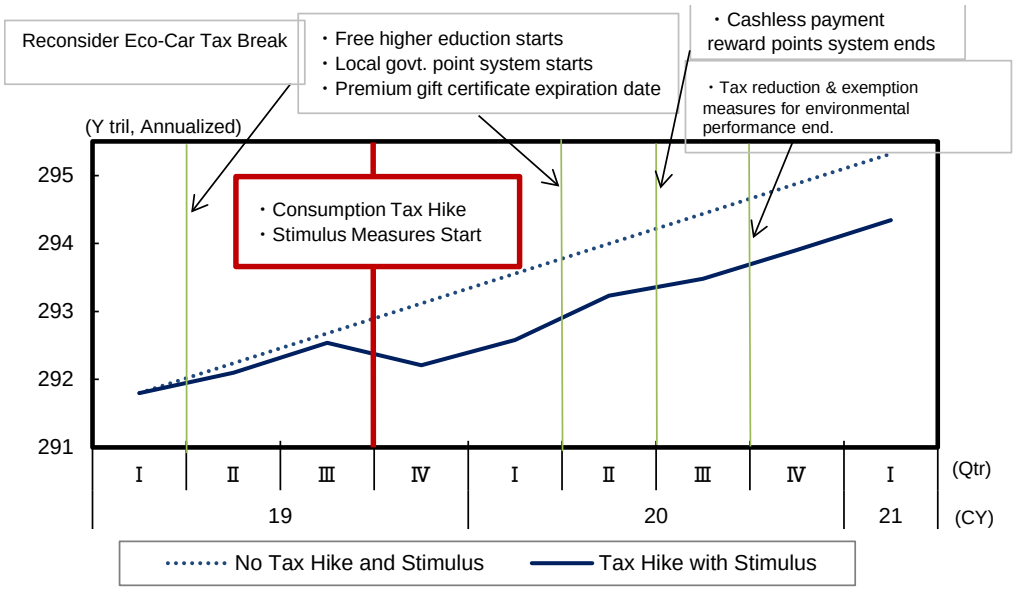
Considering the above arguments, consumption is expected to experience intermittent restraint throughout FY2020 once the effects of consumption tax hike countermeasures disappear. This will also be due to the major negative income effect expected to be generated in association with the consumption tax increase in October 2019.

Summary of Consumption Tax Hike Countermeasures **Chart 12**

Consumption Tax Hike Countermeasures		Description	Period	Scale (Yen Tril)
Auto Related	Tax Rate Cut for Environmental Tax	Tax rate to be reduced by 1% on motor vehicles including light-weight vehicles purchased for private use during the period.	For period of one year starting at time of tax hike. (Till Sept. 2020)	0.11
	Motor VehicleTax Cut	Reduction of tax rate on vehicles not including light-weight vehicles purchased during the period.	Permanent tax reduction starting at time of consumption tax hike.	
	Reduction of Eco-Car Tax Break (tax hike)	Reduction of tax break on acquisition tax. Review ratio of reduction of weight tax. Tax-free second car registration to be limited to electrical and hybrid vehicles.	Reduction of tax break on acquisition tax: Apr.-Sept. 2019.Reduction of tax break on weight tax: Starting in May 2019 (Permanent)	
Housing Related	Tax Reduction on Housing Loans	Write-off period extended on residences where move-in has taken place between Oct. 1, 2019 and end December 2020.	Current 10-year period extended to 13 years.	0.11
	Benefits for Housing Purchase "Sumai Kyu -fu kin"	Maximum benefit increased from current 300,000 yen to 500,000 yen. Annual income guideline increased from under 5.1 mil yen to under 7.75 mil yen.	Two years and three months from time of tax hike on current period (till end December 2021).	0.08
	Point Reward System for Promoting Innovative Housing	Points rewarded for remodeling projects oriented toward energy-saving, earthquake safety, barrier-free performance, and improvements for ease of housework and nursing care.	Start-time unknown as no information has appeared in news. Application period lasts through FY2019.	0.13
Point Rewards to Consumers via Small and Medium-sized Retail Businesses, etc.		Reward points for users of cashless payment will be 5% at small to middle-sized stores, and 2% at major chain-store franchises.	Period of 9-months starting at time of tax hike. (Till end June 2020).	0.28
Vouchers with premiums for Low-income and Child-rearing Households		Gift certificates worth 20,000 yen on shopping of up to a maximum of 25,000 yen available to low-income households and households with children age 0-2 who do not have to pay local tax.	Validity period of gift certificates is six months starting at time of tax hike (till end March 2020).	0.17
Local Shopping District Stimulus		Support provided to local shopping districts set up to effectively handle new demand source in inbound tourism.	FY2019	0.01
Public Investment		National land resilience countermeasures against natural disasters.	Implementation focuses on 3-year period beginning in FY2018.	1.35
Total				**2.24**

Source: Ministry of Finance, News Reports; compiled by DIR.
Notes: 1) Budget measures are total of FY2019 draft budget proposal. Tax measures are for tax reduction on a fiscal year basis.
2) Scale of auto related measures is the net tax reduction amount after subtracting amount of tax increase due to reduction of Eco-Car tax break.

Effects of Consumption Tax Hike and Related Countermeasures on Consumption (for Illustrative Purposes Only) **Chart 13**



Source: Cabinet Office, News Reports; compiled by DIR.
Notes: 1) The effect of local government points is assumed to be the same as premium gift certificates.
2) Stimulus Measures associated with tax hike do not take last minute demand or reactionary decline into consideration.

Japan's Economic Outlook No.201 Update

	FY18	FY19 (Estimate)	FY20 (Estimate)	CY18	CY19 (Estimate)	CY20 (Estimate)
Main economic indicators						
Nominal GDP (y/y %)	0.5	1.6	1.2	0.7	1.5	1.4
Real GDP (chained [2011]; y/y %)	0.7	0.6	0.5	0.8	0.8	0.5
Domestic demand (contribution, % pt)	0.8	0.5	0.6	0.8	0.7	0.5
Foreign demand (contribution, % pt)	-0.1	0.1	-0.0	-0.0	0.1	0.0
GDP deflator (y/y %)	-0.2	0.9	0.7	-0.1	0.7	0.9
Index of All-industry Activity (y/y %)*	0.7	0.5	0.6	1.0	0.5	0.7
Index of Industrial Production (y/y %)	0.2	-0.2	1.1	1.1	-0.8	1.3
Index of Tertiary Industry Activity (y/y %)	1.1	0.8	0.5	1.2	0.9	0.5
Corporate Goods Price Index (y/y %)	2.2	1.7	2.0	2.6	1.0	2.8
Consumer Price Index (excl. fresh food; y/y %)	0.8	0.5	0.2	0.8	0.6	0.3
Unemployment rate (%)	2.4	2.4	2.4	2.4	2.4	2.4
Government bond yield (10 year; %)	0.04	-0.04	-0.04	0.07	-0.04	-0.04
Balance of payments						
Trade balance (Y tril)	1.8	5.1	5.2	1.2	4.8	5.3
Current balance ($100 mil)	1,792	2,135	2,143	1,741	2,087	2,154
Current balance (Y tril)	19.9	23.2	23.3	19.2	22.7	23.3
(% of nominal GDP)	3.6	4.1	4.1	3.5	4.1	4.1
Real GDP components (Chained [2011]; y/y %; figures in parentheses: contribution, % pt)						
Private final consumption	0.4 (0.2)	0.3 (0.1)	0.5 (0.3)	0.4 (0.2)	0.3 (0.2)	0.5 (0.3)
Private housing investment	-4.3 (-0.1)	2.1 (0.1)	-1.7 (-0.0)	-5.8 (-0.2)	2.5 (0.1)	-1.9 (-0.1)
Private fixed investment	3.5 (0.6)	1.2 (0.2)	0.8 (0.1)	3.9 (0.6)	1.7 (0.3)	0.8 (0.1)
Government final consumption	0.9 (0.2)	0.8 (0.2)	0.9 (0.2)	0.8 (0.2)	0.9 (0.2)	0.9 (0.2)
Public fixed investment	-3.9 (-0.2)	3.6 (0.2)	0.7 (0.0)	-3.3 (-0.2)	1.4 (0.1)	2.1 (0.1)
Exports of goods and services	1.3 (0.2)	-0.5 (-0.1)	1.0 (0.2)	3.3 (0.6)	-1.6 (-0.3)	1.3 (0.2)
Imports of goods and services	2.0 (-0.3)	-1.4 (0.2)	1.2 (-0.2)	3.4 (-0.6)	-2.1 (0.4)	1.1 (-0.2)
Major assumptions:						
1. World economy						
Economic growth of major trading partners	3.7	3.3	3.4	3.9	3.3	3.5
Crude oil price (WTI futures; $/bbl)	62.9	54.0	54.0	64.9	54.2	54.0
2. US economy						
US real GDP (chained [2012]; y/y %)	3.0	2.3	1.8	2.9	2.6	1.9
US Consumer Price Index (y/y %)	2.3	2.3	2.3	2.4	2.1	2.4
3. Japanese economy						
Nominal public fixed investment (y/y %)	-2.3	4.8	1.3	-1.6	2.7	3.0
Exchange rate (Y/$)	110.9	108.2	108.2	110.4	108.7	108.2
(Y/€)	128.3	122.6	122.6	130.0	123.3	122.6

Source: Compiled by DIR.
Note: Due to rounding, actual figures may differ from those released by the government.
* Excl. agriculture, forestry, and fisheries.
Estimate: DIR estimate.