

29 Oct 2019 (No. of pages: 15)

Japanese report: 23 Oct 2019

Japan's Economy: Monthly Outlook (October 2019)

Was last minute demand and reactionary decline associated with the consumption tax hike avoided?

Economic Research Dept.
Shunsuke Kobayashi
Yutaro Suzuki

Summary

- The US-China trade negotiations having taken a step forward was good news for both the global and Japanese economies. However, considering the fact that both sides made claims at variance with the facts, and that there are no signs that China might accept the full-fledged structural reform demanded by the US, it would be difficult pin one's hopes on future developments in the negotiations. Completely aside from the US-China problem, the global economy is in a cyclical downturn. Of course, the situation does not lack its bright side. In many countries, there are signs in the economically sensitive industries, which entered the adjustment phase early on, that they are about to bottom out. Meanwhile, in countries which still have some leeway for the implementation of fiscal and monetary policy, steady growth is continuing. These are factors providing support for Japanese exports.
- Cause for concern regarding the Japanese economy is, rather, the effect of sluggish overseas demand spilling over into domestic employment and income, with little room to move in terms of policy. Notably, in the area of monetary policy, the Bank of Japan has no more policy tools left to lead the economy upward in a big way all alone. Now, to this situation is added the effects of the consumption tax hike. This year's tax increase, along with the net fiscal tightening effect of enhancing social security, come to approximately two-trillion yen. Although it is a minor amount in comparison to the eight-trillion yen experienced the last time the consumption tax was increased, it is still at a scale which can't be ignored.
- In addition, there is the issue of last minute demand and reactionary decline which are factors expected to cause economic fluctuation in the short-term. In this report, we make use of currently available macro-economic statistics as well as industry statistics to examine two important facts associated with last minute demand occurring up through the month of September, just before the consumption tax hike went into effect. The first of these is the fact that in comparison to the last two times the consumption tax was increased, the scale of last-minute demand was kept under control to a certain degree. One of the reasons behind this was government measures implemented to keep demand at an even keel, such as reduction of the automobile tax and reward points for using cashless payment. However, the other fact that was discovered is that last minute demand did indeed take place. Demand grew just before the tax hike went into effect in a variety of areas, including automobiles – especially regular vehicles and light vehicles – while in the area of housing, demand grew for owned dwellings and those built for sale. Meanwhile, in the area of retailing, demand grew especially for department stores. Last-minute demand occurred most prominently in those areas that fell through the cracks in the government's countermeasures.
- Now we must be vigilant regarding the future, with the expectation not only of a reactionary decline in response to last-minute demand, but reaction to last-minute shipments as well, which appeared before last-minute demand. Last-minute shipments were especially prominent in industries including household electronics, pulp, paper & paper products, and chemicals. Though this phenomenon may have contributed to growth initially, that effect will disappear in the future and likely shift into a reactionary decline.

US-China trade friction – tensions relieved for a fleeting moment, but then what?

After the US-China trade talks between top negotiators on October 11, the additional tariff originally planned to go into effect on October 15 was shelved. (This was a measure to raise the tariff rate by 5%pt from the current 25% to 30% on the equivalent of 250 billion dollars in annual imports from China.) US-China leaders will meet again at the APEC summit meeting scheduled for November 16-17. Some are of the opinion that an agreement will be exchanged at that time.

Naturally this was good news not only for the US and China, but for the global economy as well. However, it goes without saying that it cannot be assumed that this one instance means tensions have been fundamentally resolved. First of all, both sides made claims at variance with the facts. The US insists that China agreed to increase the amount of US products it purchases significantly in the area of agricultural products, while also making concessions on intellectual property rights, financial services, and foreign exchange. On the other hand, China has avoided making any clear statements and has not stepped away from the stance of excluding any stipulations calling for the removal or structural reform of existing tariffs from the trade negotiations.

Looking at it from a different angle, it's possible that this recent agreement was more for the purpose of buying some time. China isn't the only negotiating partner the US has. The deadline for a decision on how to handle the automobile industry in accordance with Section 232 of Trade Expansion Act of 1962 (in other words whether or not to impose additional tariffs) is November 13. Hence the USTR, which handles trade issues, will be busy for some time negotiating with Europe. With limited human resources, the USTR may have decided to put Chinese negotiations on the side for the time being, making a quick agreement this time around merely to buy some time. This interpretation seems to add up when you consider that it takes three to five weeks to write up a partial agreement.

Of course, the US does want to increase exports of its agricultural products to China. In anticipation of the 2020 presidential election, there is a strong incentive to find ways of keeping the farming vote. But American public opinion is not naïve enough to be bought off by the China trade policy alone. As was pointed out in one of our past reports, the role of China-bashing in American politics goes beyond party affiliation. It seems that both parties are generally in agreement here. The two parties come to the same conclusion from different directions. As the saying goes, "same bed, different dreams". The major interest here are maintaining military supremacy (the Pentagon), protecting religious rights (Vice-President Pence and others), human rights (Democrats), and fairness of international trade (USTR Lighthizer)¹.

What brought together the anti-China block was China President Xi Jinping's propaganda speech at the 2017 National Congress of the Communist Party where he introduced two programs – "Made in China 2025", and the "Belt & Road" initiative. More recently is how the Hong Kong riots have been handled by the government, as well as sensitive issues surrounding the January 11, 2020 elections in Taiwan. A bill was passed by the Congress to support Hong Kong human rights and democracy. In response, the Chinese Ministry of Foreign Affairs said that there would be retaliatory measures if the bill passes. The rumor now is that even the partial agreement to be signed at the November APEC summit isn't looking so good at this point. The conflict between the two countries remains basically unchanged.

Global inventory adjustment phase continues

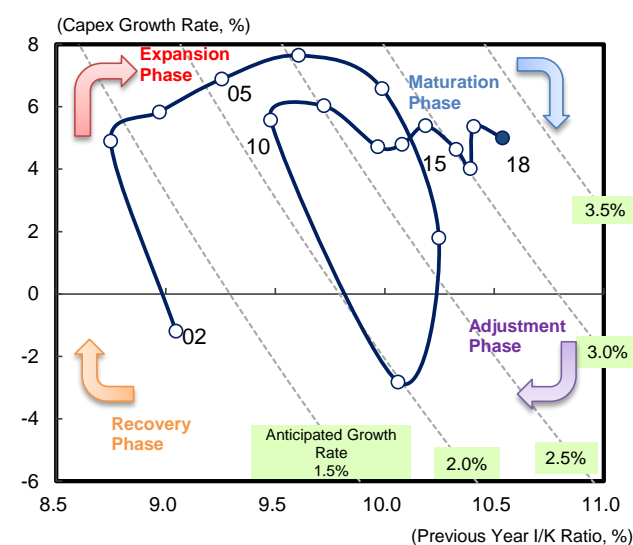
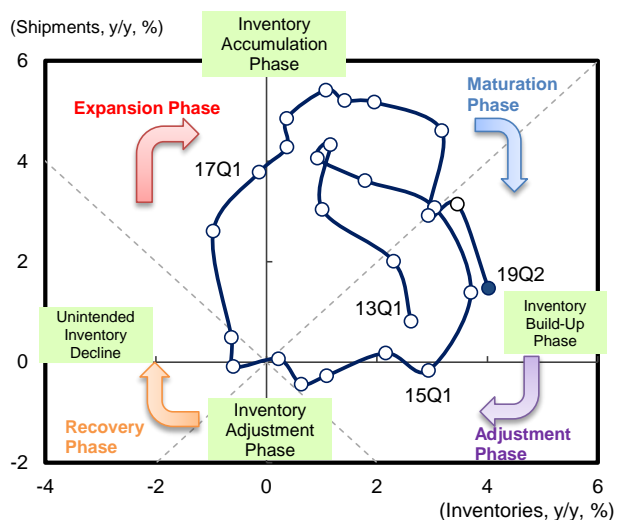
Completely aside from the US-China problem, the global economy is in a cyclical downturn. As is shown in Chart 1, whether we look at the short-term Kitchin Cycle (the inventory cycle) or the

¹ For details see the 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 and Yota Hirono.

midterm Juglar Cycle (the capital stock cycle), we can see that the global economy has completed its economic expansion phase, and is now moving from the maturation phase into an adjustment phase. The unfavorable situation in the external environment, centering on global trade, will likely continue for some time.

That said, adjustment won't last forever. At least, if we limit ourselves to looking at inventory adjustment, in many countries there are signs in the economically sensitive industries, such as electronic parts and devices, which entered the adjustment phase early on, that they are about to bottom out. This factor brings some peace of mind. Currently it seems to be capital goods and durable goods delaying progress in adjustment. In the current phase, pressure to adjust is moving into the midstream and downstream industries in response to the decline in the factory operating ratio and the slowdown of improvement in employee compensation, situations initially brought on by early inventory adjustment in the economically sensitive industries, and the US-China trade friction.

Left: Global Inventory Cycle (US, Japan, Europe & China), Right: Capital Stock Cycle **Chart 1**



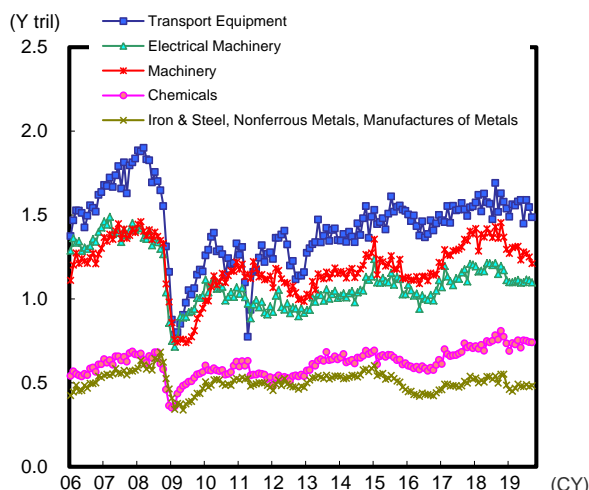
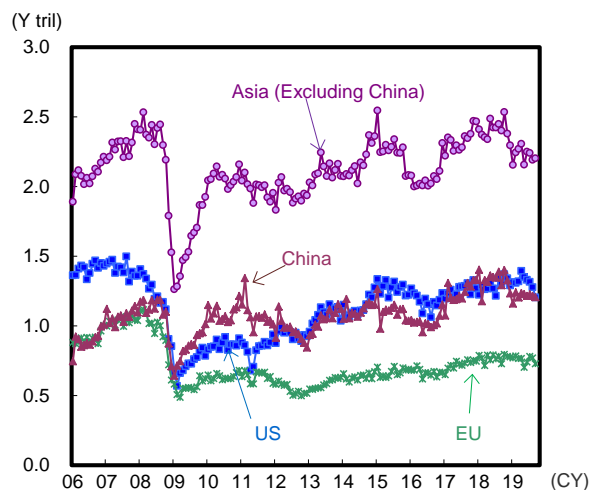
Source: Ministry of Economy, Trade and Industry, U.S. Department of Commerce, European Commission, Haver Analytics, National Bureau of Statistics of China, and CEIC; compiled by DIR.

Source: Cabinet Office, Bank of Japan, BEA, European Commission, National Bureau of Statistics of China, Haver Analytics, CEIC; compiled by DIR.

Note: Calculated according to weight in GDP. European data uses EU28, DI for inventories, and production figures for shipments. Chinese data uses production figures for shipments, and for inventory, manufacturing industry PPI was used and expressed as real values.

Note: Calculated according to weight in GDP.

Left: Export Value by Major Region or Country, Right: Export Value by Major Product **Chart 2**



Source: Ministry of Finance; compiled by DIR.
Note: Seasonal Adjustment by DIR.

Three differentiating factors in Economic performance by country

The same tendency as noted in the previous section can be detected when looking at exports from Japan (Chart 2). In addition, uneven distribution is notable in export trends by region and country. Exports to China and the rest of Asia began a major downturn in the second half of 2018 and are now continuing to cruise at a low altitude. Meanwhile, exports to the US and EU began to show signs of softening just recently, but are still maintaining a high level.

There are three possible factors behind this situation. First of all, the effect of having raised tariffs on certain products in the trade friction between the US and China has manifested quite clearly in China and Asia, which has a close linkage to the Chinese economy. The second factor is the fact that China and other Asian countries have a high degree of dependency on manufacturing and foreign trade, and hence are easily influenced by inventory adjustment in the manufacturing industry worldwide, as well as the downturn in trade. The third factor is that economic performance is greatly affected by the amount of leeway available for the implementation of fiscal and monetary policy, which differs from country to country. The best example of this phenomenon is the US. Though it is one of the parties in the current trade friction, it can offset damage by increasing fiscal expenditure, or by implementing a policy of monetary easing in order to maintain a high economic growth rate. Or to put it another way, the US economy is gaining support from the Trump put option.

In Japan, with limited policy leeway, dark clouds gather over the old assumption that when overseas demand is weak, domestic demand will be favorable

In this context Japan's policy leeway is limited. Notably, in the area of monetary policy, the Bank of Japan has no more policy tools left to lead the economy upward in a big way all alone. As was mentioned previously, pressure to adjust associated with overseas demand is moderate, which brings some peace of mind, but there is still a big worry factor in that there is major downside risk to the Japanese economy with the limited policy leeway. This risk could be triggered if the effects of sluggish overseas demand spill over into domestic employment and income².

What is worrisome here is the fact that growth in gross national income has continued a downward path since 2018 (Chart 3). Growth in nominal gross national income was just over 1% y/y most recently. This is a major drop when we consider the fact that its most recent peak it was at around 4% during the first half of 2018.

The main causes of sluggish growth in gross national income are (1) sluggish growth in employment and (2) a decline in working hours per person. Of these two, the latter is also affected by factors having nothing to do with the business cycle, for instance the increase in days off associated with the new imperial era and the effects of new overtime regulations. However, the former is unrelated to these kinds of special factors. But one certainly can't say that it is unrelated to the economic slowdown in which overseas demand was the leader in the slump. Meanwhile, the trend of corporations changing the status of non-regular employees to that of regular employees has lost its momentum.

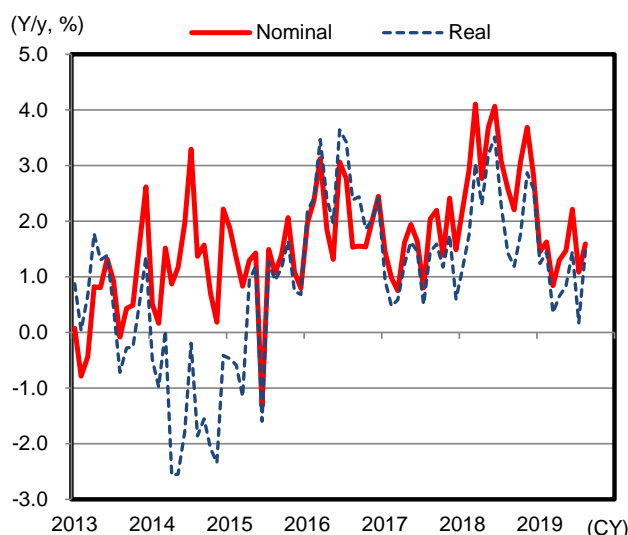
Favorable consumption despite sluggish income: due to last-minute demand?

In addition to the issues mentioned above, the effects of the consumption tax hike will soon begin to appear. For a detailed analysis of the issue, see our previous monthly report dated September 20, 2019 (*Japan's Economy: Monthly Outlook (September 2019): Thorough analysis of consumption tax hike countermeasures; estimate of effects of rising crude oil price*, by Shunsuke Kobayashi and Yutaro Suzuki). However, in this report we would like to emphasize the fact that one of the factors behind

² For more detail on the mechanism of sluggish external demand spreading to domestic demand and leading to adjustment, see the DIR Report dated 25 June 2019, *Japan's Economy: Monthly Outlook (June 2019): No recovery for domestic demand without growth in overseas demand*, by Shunsuke Kobayashi and Yota Hirono.

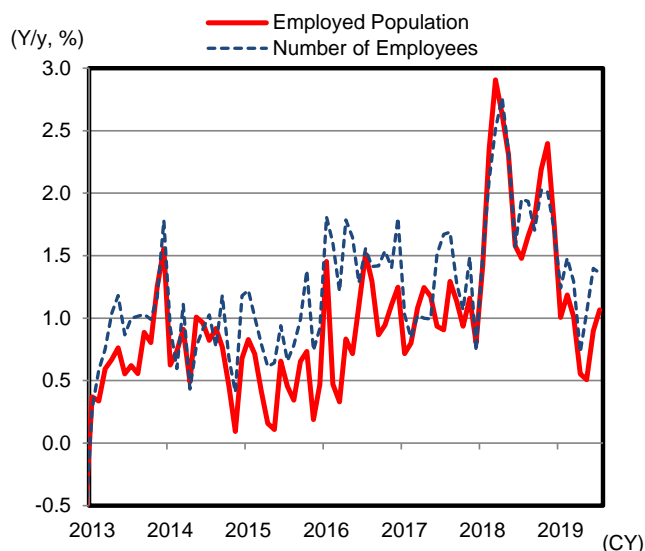
favorable domestic demand lead by household consumption, which occurred despite sluggish gross national income, was last-minute demand prior to the increase in the consumption tax – something that is impossible to ignore. With the awareness of this problem as a starting point, in the next sections we make use of currently available macro-economic statistics as well as industry statistics to examine two important facts associated with last minute demand occurring up through the month of September, just before the consumption tax hike went into effect.

Changes in Japan's Gross National Income
Chart 3



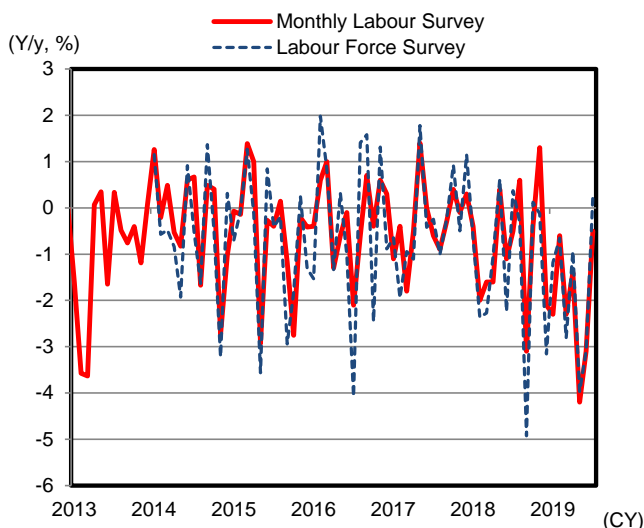
Source: Cabinet Office; compiled by DIR.

Changes in Employment
Chart 4



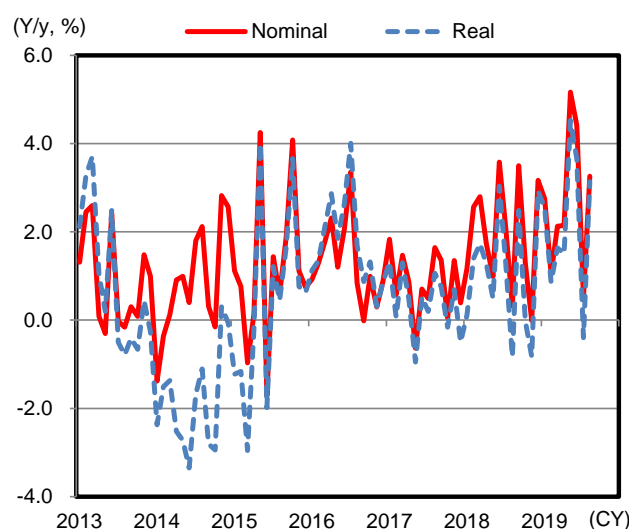
Source: Ministry of Internal Affairs and Communications; compiled by DIR.

Changes in Working Hours per Person
Chart 5



Source: Ministry of Internal Affairs and Communications, Ministry of Health, Labour and Welfare; compiled by DIR.
Note: Monthly Labour Survey uses common data set.

Changes in Hourly Wage
Chart 6



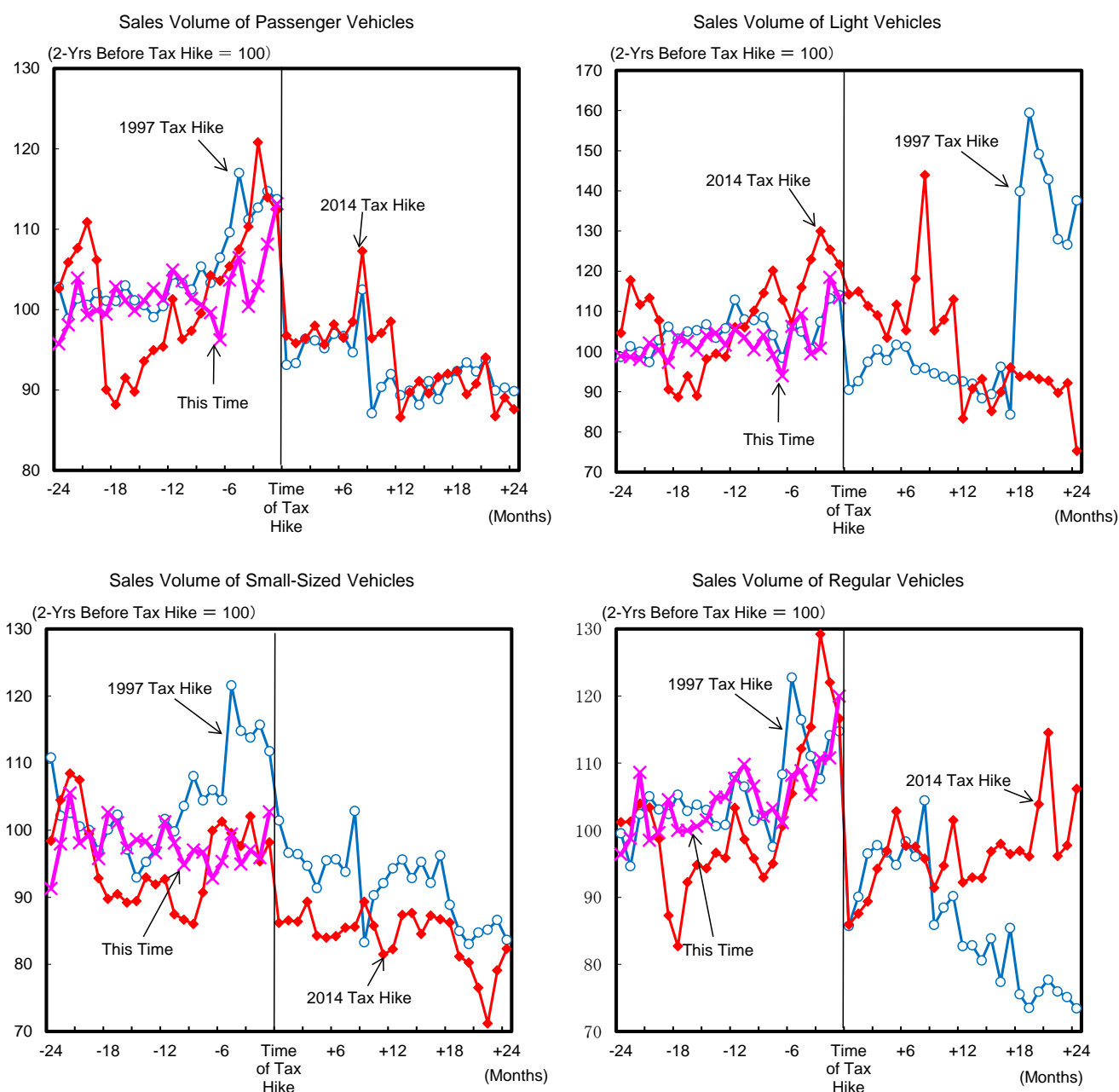
Source: Cabinet Office, Ministry of Internal Affairs and Communications, Ministry of Health, Labour and Welfare; compiled by DIR.
Note: Reverse calculation taking Cabinet Office total and dividing by Ministry of Internal Affairs and Communications total and Ministry of Health, Labour and Welfare total.

Was last-minute demand and reactionary decline associated with consumption tax hike avoided?

From the following section on we will take a look at automobiles, housing, and retail stores to confirm whether last-minute demand actually took place. First of all, two general facts were discovered. The first of these is that last-minute demand did indeed take place. Demand grew just before the tax hike went into effect in a variety of areas, including automobiles – especially standard-sized cars and light vehicles – while in the area of housing demand grew for owned dwellings and those built for sale. Meanwhile, in the area of retailing, demand grew especially for department stores. One more thing is that in comparison to the last two times the consumption tax was increased, the scale of last-minute demand was kept under control to a certain degree. One of the reasons behind this was government measures implemented to keep demand at an even keel, such as reduction of the automobile tax and reward points for using cashless payment.

Sales Volume of Passenger Vehicles (Comparison with Last Two Tax Hikes)

Chart 7



Source: Japan Automobile Dealers Association, Japan Mini Vehicles Association; compiled by DIR.

Note: Figures are seasonally adjusted. Seasonal adjustment by DIR.

Passenger Vehicles: Last-Minute Demand Appeared for Regular and Light Vehicles

In this section and the sections that follow, we examine the occurrence of last-minute demand. First of all, looking at Chart 7 to confirm whether last-minute demand occurred, we can see from total sales volume (upper left) that last-minute purchases did occur. However, the amount is limited in comparison to the last two times the consumption tax was increased. Now looking closer by type of vehicle, we see that in the case of regular vehicles (lower right) and light vehicles (upper right), last-minute purchases occurred at pretty much the same rate as the last two times the consumption tax was increased. On the other hand, small-sized vehicles (lower left) hardly experienced last-minute purchases at all.

Differences in last-minute purchasing behaviors based on the type of vehicle can be attributed to the government's policies implemented to level out demand. The major leveling measures in relation to automobile sales introduced to match the tax hike are as follows: (1) reduction of the automobile tax, and (2) introduction of an environmental performance discount, as well as a repeal of the vehicle excise tax. Further data on reduction of the automobile tax (tax payable by car owners on an annual basis) is shown in Chart 8. The benefits of purchasing a small-sized vehicle are great (in other words, on purchases made on and after October).

Concretely speaking, taking a closer look at the tax reduction, we see that on purchases of small-sized vehicles (2,000cc and below) on and after October 2019, the purchaser receives an annual tax reduction of somewhere between 3,500 to 4,500 yen. However, in the case of purchasing a regular vehicle of over 2,000cc, tax reduction would be between 1,000 and 1,500 yen. In most cases, it will be difficult to offset the increase in the purchase amount resulting from the consumption tax increase. Light weight vehicles are not eligible for the tax reduction.

Comparison of Old and New Automobile Tax					Chart 8				
Class	Engine Displacement	Through September 2019	After Tax Cut (Oct. 2019 and beyond)	Reduction	Class	Engine Displacement	Through September 2019	After Tax Cut (Oct. 2019 and beyond)	Reduction
Light Vehicles	660cc and below	10,800	10,800	0	Regular Vehicles	2000cc or more	45,000	43,500	1,500
	660cc or more	29,500	25,000	4,500		2500cc and below	51,000	50,000	1,000
Small-Sized Vehicles	1000cc and below	34,500	30,500	4,000		3000cc and below	58,000	57,000	1,000
	1000cc or more	39,500	36,000	3,500		3000cc or more	66,500	65,500	1,000
	1500cc and below					3500cc and below	76,500	75,500	1,000
	1500cc or more					4000cc and below	88,000	87,000	1,000
	2000cc and below					4000cc or more	111,000	110,000	1,000
						4500cc and below			
						4500cc or more			
						6000cc and below			
						6000cc or more			

Source: Japan Automobile Manufacturers Association; compiled by DIR.

Note: Tax rates for registered privately owned passenger vehicles.

Next we take a look at the introduction of the environmental performance discount. The environmental performance discount replaces the vehicle excise tax and the Eco-Car tax reduction. It affects the tax burden at the time of purchase. Charts 9 & 10 present a comparison of tax rates occurring at time of purchase with the introduction of this new program. In most cases, the tax exemption does not offset the 2%pt increase in the consumption tax.

In the past, the vehicle excise tax was, in principle, 3% on vehicles subject to automobile registration tax, and 2% on light vehicles and commercial vehicles. Then on vehicles with advanced environmental performance, there was a tax exemption in the form of the Eco-Car tax reduction. This would reduce tax by anywhere from 20% to 100%. The environmental performance discount is essentially the same program, the only differences being the fuel efficiency standard and the amount of the tax exemption.

But the complicated thing is that at the same time the program is being changed, there is also the demand leveling measures valid for only a limited time. For a short time a purchaser can therefore take advantage of both. For automobiles which do not have especially high environmental performance, the tax rate at time of purchase will be reduced by 1%pt between October 1, 2019 and September 30, 2020. In either case, as was mentioned previously, in most cases, the tax exemption does not offset the 2%pt increase in the consumption tax.

Tax Rate Upon Purchasing a Regular Vehicle (Private Use)

Chart 9

	2020 Fuel Efficiency Standard					
	Not Achieved	Achieved	+10%	+20%	+30%	+40%~
Till consumption tax hike (Oct. 2019) Eco-Car tax reduction (75% reduction in 2005 emission regulations, or 50% reduction in 2018 regulations)	3%	2.4%	2.25%	1.5%		0%
After consumption tax hike (Oct. 2019) Environmental performance discount: Items in parenthesis are valid until Sept. 30, 2020.	3% (2%)	2% (1%)	1% (0%)	0%		
Difference: Items in parenthesis are valid until Sept. 30, 2020.	0% (1%)	0.4% (1.4%)	1.25% (2.25%)	1.5%	1.5%	0%

Source: Japan Automobile Manufacturers Association, Ministry of Economy, Trade and Industry; compiled by DIR.

Tax Rate Upon Purchasing a Light Vehicle

Chart 10

	2020 Fuel Efficiency Standard					
	Not Achieved	+5%	+10%	+15%	+20%	+25%~
Till consumption tax hike (Oct. 2019) Eco-Car tax reduction (75% reduction in 2005 emission regulations, or 50% reduction in 2018 regulations)	2%	1.6%	1.2%	0.8%	0.4%	0%
After consumption tax hike (Oct. 2019) Environmental performance discount: Items in parenthesis are valid until Sept. 30, 2020.	2% (1%)	1% (0%)	0% (0%)			
Difference: Items in parenthesis are valid until Sept. 30, 2020.	0% (1%)	0.6% (1.6%)	1.2%	0.8%	0.4%	0%

Source: Japan Automobile Manufacturers Association, Ministry of Economy, Trade and Industry; compiled by DIR.

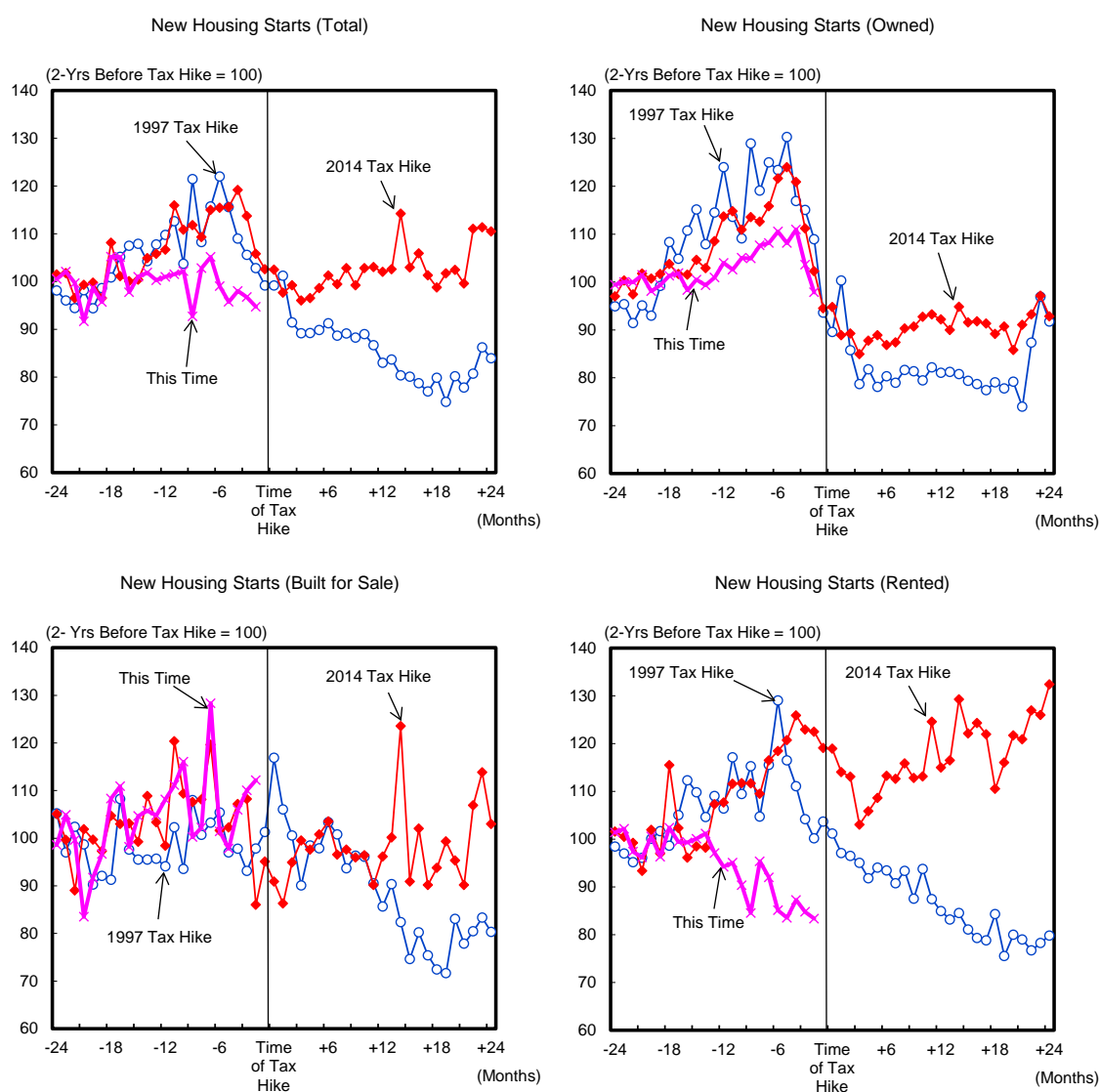
Housing: Last-minute demand was manifest for both owned dwellings and those built for sale

Looking at Chart 11 to confirm last-minute demand in housing, we see the same uneven distribution as was found in data on automobiles. Looking at owned dwellings (top right of the chart) we see that last-minute housing starts occurred here. Meanwhile, in the built for sale category (lower left), buying behavior shows wide fluctuations from month to month making it difficult to tell for sure whether last-minute demand actually took place, but the overall trend shows housing starts to have been generally prevalent. On the other hand, in the case of rented (lower right), no last-minute housing starts were detected at all. In this case of course, demand leveling measures are not applicable to rentals in the first place.

Now to interpret these results, it seems that demand leveling measures were insufficient, leading to last-minute housing starts for both owned dwellings and those built for sale. The scale of last-minute demand was limited in comparison to the last time the consumption tax was raised, but this appears not to have been due to the government's demand leveling measures. Rather, persons who purchased houses the previous time there was last-minute demand are no longer in need, and the housing investment market, which had been showing signs of maturation in recent years, was hit by scandals, causing investors to shy away from purchases. For these reasons the appetite for investment had declined.

New Housing Starts (Comparison with Past Two Tax Hikes)

Chart 11



Source: Ministry of Land, Infrastructure, Transport and Tourism; compiled by DIR.
Note: Seasonally adjusted.

Largely speaking, there are two types of demand leveling measures introduced which are applicable to owned dwellings and those built for sale. These are (1) extension of tax reduction period on housing loans, and (2) increase in amount of housing cash payments (called “*sumai kyufu*”). The housing loan tax reduction is summarized in Chart 12. First of all, there was already a 1% tax exemption from the local resident’s tax on a maximum of 40 million yen of the balance on a housing loan for a period of 10-years. This tax exemption period was extended for another three years beyond that after the consumption tax hike, making it possible to receive a tax exemption for a period of 13-years. In the case of general housing, a maximum of four million yen in tax exemptions was applied over a ten-year period. For purchases taking place after the increase in consumption tax, there will be a maximum of 4.8 million yen in tax exemptions applied³. So the incentive to wait till after the tax hike to purchase a house is this difference of 800,000 yen. However, this incentive is not necessarily all that large considering the 2% increase in consumption tax charged at the time of purchase.

A summary of the housing cash payments is shown in Chart 13. According to this measure, the lower a household’s income is, the larger the amount of benefits they can receive. For instance, if one’s income was 4.25 million yen, one could receive 300,000 yen in benefits according to the old version of this program. After the increase in consumption tax, this amount will grow to 500,000 yen, or an additional 200,000 yen. However, there is not necessarily much advantage in taking this benefit⁴.

Housing Loan Tax Reduction (Summary)

Chart 12

Deduction Period	Annual Deduction Limit Between 11th & 13th Year after Application (General Housing)
3-Year Extension (from 10-yrs to 13-yrs)	Smaller of the below amounts ① 1% of year-end balance of loan (maximum of 40 million yen) ② 2-3% of building purchase price (maximum 40 million yen) (2% ÷ 3-yrs) * In case of a certified home, maximum of 50 million yen of year-end balance, and 50 million yen of building purchase price.

Source: Ministry of Land, Infrastructure, Transport and Tourism; compiled by DIR.

Note: To be applied on housing purchases where 10% in consumption tax has been paid, and purchaser has resided in said residence between October 1, 2019 and December 31, 2020.

Housing Cash Payments (Summary)

Chart 13

Consumption Tax Rate of 8%

Income Guideline	Local Taxes, Taxation on Income Basis	Basic Benefit Amount
Y4.25 mil or less	Y68,900	Y300,000
Y4.25 mil or more	Y68,900 or more	Y200,000
Y4.75 mil or less	Y83,900 or less	
Y4.75 mil or more	Y83,900 or more	Y100,000
Y5.1 mil or less	Y93,800 or less	

Consumption Tax Rate of 10%

Income Guideline	Local Taxes, Taxation on Income Basis	Basic Benefit Amount
Y4.5 mil or less	Y76,000 or less	Y500,000
Y4.5 mil or more	Y76,000 or more	Y400,000
Y5.25 mil or less	Y97,900 or less	
Y5.25 mil or more	Y97,900 or more	Y300,000
Y6 mil or less	Y119,000 or less	
Y6 mil or more	Y119,000 or more	Y200,000
Y6.75 mil or less	Y140,600 or less	
Y6.75 mil or more	Y140,600 or more	Y100,000
Y7.75 mil or less	Y172,600 or less	

Source: Ministry of Land, Infrastructure, Transport and Tourism; compiled by DIR.

Note: Kanagawa Prefecture has a different tax rate than other prefectures, so even where the income guideline is the same, the discount differs from the above.

³ Regarding the extension to the anywhere from the 11th to 13th year: The tax reduction is the lowest of the two amounts (1) 1% of the year-end balance of the housing loan (a maximum of 40 million yen), or (2) purchase price of the building (a maximum of 40 million yen) x 2/3%. Therefore the total amount of the tax reduction over a period of three years would be maximum 800,000 yen.

⁴ In addition, housing differs from a purchase such as an automobile in that last-minute housing starts occur not just before the increase in the consumption tax, but around six months earlier. This is because consumption tax is applied to housing using the tax rate valid at the point the keys are handed over to the purchaser, or when the service agreement is signed. More concretely speaking, in the case of this most recent increase in consumption tax, if the keys were handed over by September 30th, or if the service agreement was signed by March 31st, then the consumption tax rate applied would be 8%.

Retail Stores: Last-minute demand appeared in September just before the consumption tax hike

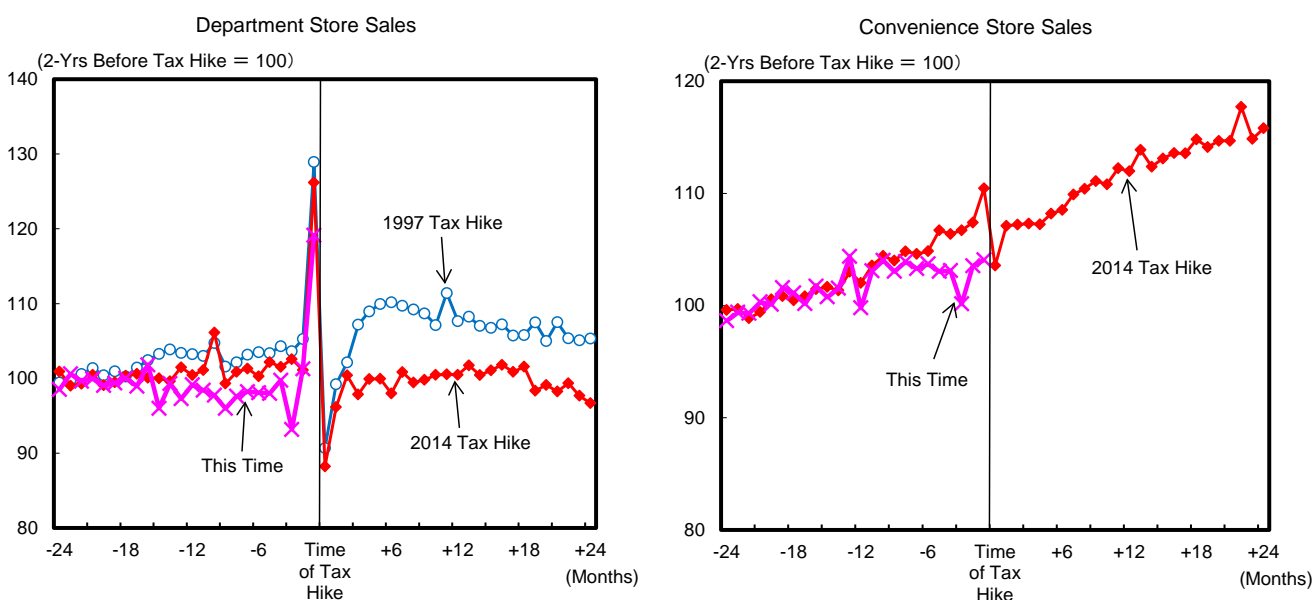
Finally we confirm the manifestation of last-minute demand in the area of retailing as shown in Chart 14. Last-minute demand became especially noticeable in September, the month before the consumption tax hike. This tendency is the same as occurred the last two times the consumption tax was raised. However, in the case of convenience stores, last-minute demand was much smaller in comparison to the last two times the consumption tax was raised. One reason for this is the unavoidable fact that consumption as such is not exactly strong with income growth dull as a result of the recent economic environment. But an additional reason is that this may actually indicate a certain level of effectiveness in the reduce tax rate measures affecting food purchases, and the reward points program for using cashless payment.

Let us confirm the trend in actual retail sales. First we take a look at department store sales on a nationwide basis. September sales saw a y/y increase of +22.8%, or +17.6% in comparison to the previous month (seasonally adjusted by DIR). Looking at sales by product we see that the following items contributed to growth: sundry goods, including art, jewelry, and precious metals, clothing, and personal items. These goods all attracted last-minute demand the last time the consumption tax was raised and the same patterns were seen again this time around.

On the other hand, looking at convenience store sales on an existing outlet basis, last-minute demand was noticeably weak, with September recorded a decline of -1.1% y/y, with growth of just +0.5% m/m (seasonally adjusted by DIR). Even averaging out sales performance by including the entire Jul-Sep period, we still see a y/y decline of -0.9%. This contrasts greatly with sales performance the last time the consumption tax was raised, when sales registered growth of +5.9% y/y. Part of the reason for the uninspiring performance is the fact that a large portion of convenience store sales are accounted for by food items, which get the reduced tax rate. In addition, the reward points program for using cashless payment began during the same month the consumption tax was raised.

Change in Retail Sales (Comparison with Past Two Tax Hikes)

Chart 14



Source: Japan Department Store Association, Japan Franchise Association; compiled by DIR.
Note: Figures are seasonally adjusted. Seasonal adjustment was performed by DIR.

As was mentioned above, the trend in convenience store sales is unavoidably associated with the reward points program for using cashless payment, which is part of the government's demand leveling measures. These measures were implemented in October after the consumption tax hike both as a means of evening out demand and promote the use of cashless payment.

Under the reward points program for cashless payment, small and medium-sized retailers (including service businesses and restaurants) give reward points to consumers who use a credit card, electronic money or QR code in their purchase. The expense to do so is handled by the government. Small and medium-sized retailers give a 5% reduction rate for points to customers. The rate is 2% in the case of major chain store franchises. Therefore the advantage of shopping at a small to medium-sized retailer has increased for the consumer since the raising of the consumption tax.

However, this policy measure is only temporary. It will last for a period of nine months from October 2019 till June 2020. It should be noted that, although demand was leveled out by these measures around the time of the consumption tax hike, there is a possibility that another bout of last minute-demand could occur just before the points reward program ends.

The thing to watch out for is reactionary decline in relation to last-minute shipments

Considering the above arguments we can conclude that although last-minute demand was avoided by these demand leveling measures around the time of the consumption tax hike, last-minute demand was still detected as having occurred. For this reason, there is a good possibility that reactionary decline will occur.

In addition, there remain two more issues which we must be aware of. It goes without saying that one of these is the negative income effect. A detailed analysis of this situation can be found in the DIR report dated 2019 September 20, *Thorough analysis of consumption tax hike countermeasures and their effects: Comprehensive examination of income effect and substitution effect by age group, and industry*, by Shunsuke Kobayashi and Yutaro Suzuki. When we look at this problem from the viewpoint of macro impact, after October 2019 households will face a net fiscal austerity effect of around two-trillion yen. This figure is about eight-trillion yen less than that experienced the last time the consumption tax was raised, but it is still clearly at a scale which cannot be ignored.

One more worry remains. This is the problem of last-minute shipments. As is shown in Chart 15, growth in shipments of household electronic products was stronger than that of sales. This likely occurred in expectation of the points rewards system which would go into effect in October, so to hand this, retailers accumulated store inventory. Even if this inventory were all successfully sold, production and shipments which had been increased up to this point could very possibly move into an adjustment phase in the future.

Pulp, paper and paper products, and chemicals (excluding medicine) also moving toward inventory accumulation

To confirm the situation of production, shipments and inventory by industry we look at Chart 16. The first industry that catches the eye is pulp, paper and paper products. Inventory has gradually accumulated in this industry over the past few months, and plans for production in the future are extremely confident. Inventory accumulation is apparently in anticipation of last-minute demand prior to the October increase in consumption tax centering on tissue and toilet paper.

Another industry which catches the eye for the same reasons is chemicals (excluding medicine). The area in this industry which is experiencing inventory accumulation is cosmetics, and it has been pointed out that this may be due to the handling of last-minute demand prior to the increase in consumption tax. However, inventory growth in this industry began in 2017, and since 2018 the

process has actually accelerated. Behind this development is the fact that demand for cosmetics products was strong in inbound consumption and in e-commerce (this indicates stock build-up, or intentional inventory accumulation). Since 2018, growth in demand of this sort has come to a standstill (unintentional stock build-up is most likely the reason here)⁵. In other words, inventory growth in this industry is due to more than just measures to handle last-minute demand.

In either case, we must remain cautious in the future regarding both reactionary decline in response to last-minute demand and the reaction to last-minute shipments. Demand related items to watch out for include regular vehicles and light weight vehicles, as well as single family dwellings and condominiums. In the area of shipments there is household electronics products, pulp, paper and paper products, and chemicals. Caution in regard to reactionary decline in all of these areas is required.

Consumer Electronics Sales & Shipments **Chart 15**

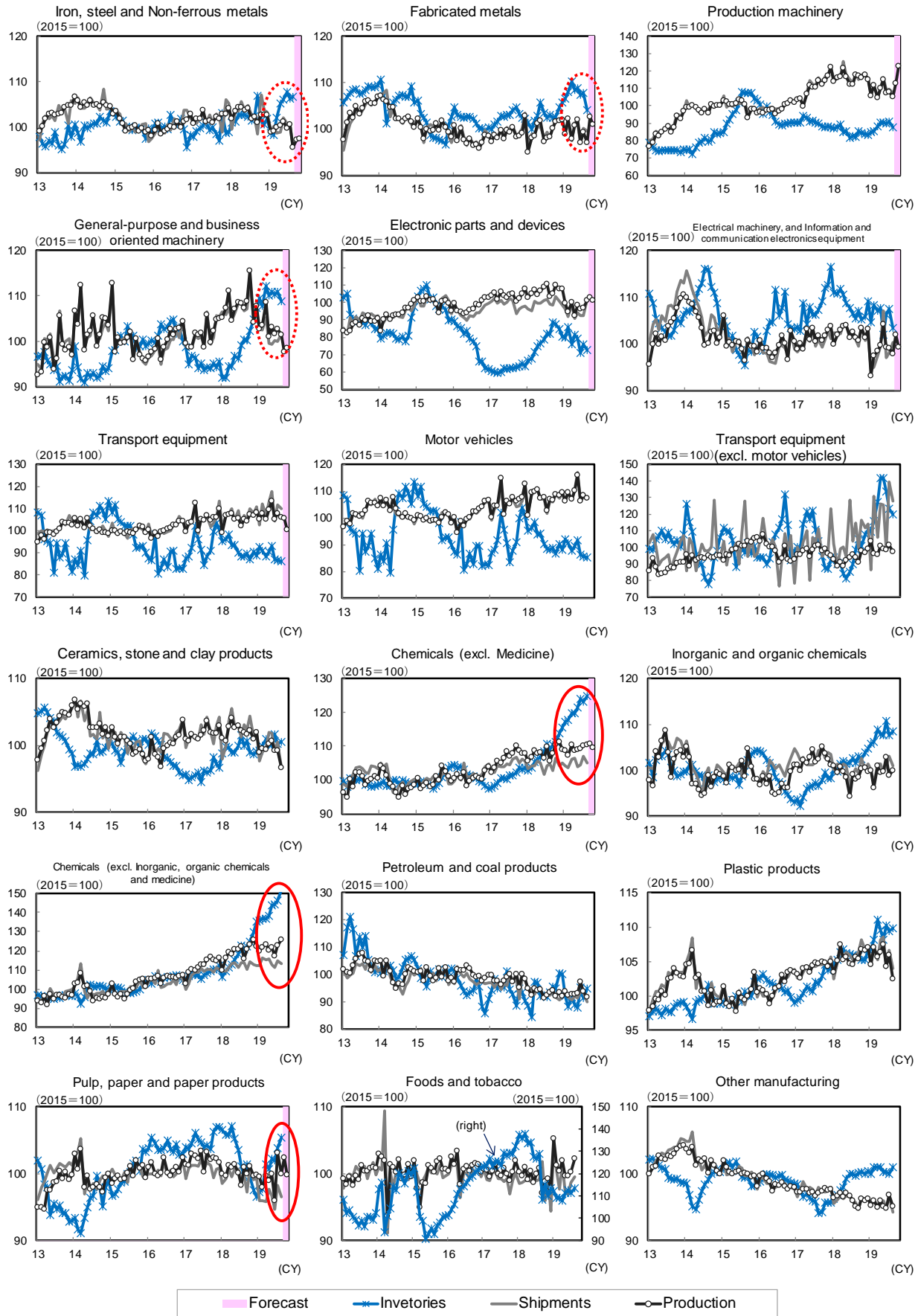


Source: Ministry of Economy, Trade and Industry, Japan Refrigeration and Air Conditioning Industry Association, Japan Electronics and Information Technology Industries Association; compiled by DIR.

Note: Seasonally adjusted. Figures for air conditioners, flat panel display TVs, and PCs were seasonally adjusted by DIR.

⁵ Unintentional stock build-up has been observed in the iron, steel and non-ferrous metals industries, as well as the fabricated metals industry and the general-purpose and business oriented machinery industry. This is due to declining demand associated with the global economic slowdown centering on China.

Production, Shipments, and Inventory by Industry Chart 16



Source: Ministry of Economy, Trade and Industry; compiled by DIR.
 Note: The expected value of the Indices of Industrial Production is from the Manufacturing Industry Production Forecast Survey. The expected value for the chemicals industry (excluding medicine) is from the forecast figures for the entire chemical industry.

Japan's Economic Outlook No.202 Update

	FY18	FY19 (Estimate)	FY20 (Estimate)	CY18	CY19 (Estimate)	CY20 (Estimate)
Main economic indicators						
Nominal GDP (y/y %)	0.5	1.3	0.8	0.7	1.4	0.8
Real GDP (chained [2011]; y/y %)	0.7	0.8	0.4	0.8	0.9	0.3
Domestic demand (contribution, % pt)	0.8	1.1	0.4	0.7	1.2	0.4
Foreign demand (contribution, % pt)	-0.1	-0.3	-0.0	-0.0	-0.2	-0.1
GDP deflator (y/y %)	-0.2	0.6	0.5	-0.1	0.5	0.5
Index of All-industry Activity (y/y %)*	0.8	0.6	0.5	1.1	0.6	0.5
Index of Industrial Production (y/y %)	0.2	-1.4	0.8	1.1	-1.7	0.6
Index of Tertiary Industry Activity (y/y %)	1.1	1.0	0.4	1.2	1.1	0.5
Corporate Goods Price Index (y/y %)	2.2	1.8	2.0	2.6	1.0	2.8
Consumer Price Index (excl. fresh food; y/y %)	0.8	0.6	0.3	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	-0.16	-0.20	0.07	-0.12	-0.20
Balance of payments						
Trade balance (Y tril)	0.7	-1.1	-1.1	1.2	-0.7	-1.1
Current balance (\$100 mil)	1,735	1,778	1,780	1,741	1,759	1,780
Current balance (Y tril)	19.2	19.3	19.2	19.2	19.1	19.0
(% of nominal GDP)	3.5	3.5	3.4	3.5	3.4	3.4
Real GDP components (Chained [2011]; y/y %; figures in parentheses: contribution, % pt)						
Private final consumption	0.4 (0.2)	0.7 (0.4)	0.3 (0.2)	0.3 (0.2)	0.7 (0.4)	0.3 (0.2)
Private housing investment	-4.3 (-0.1)	0.6 (0.0)	-0.8 (-0.0)	-5.8 (-0.2)	1.3 (0.0)	-1.2 (-0.0)
Private fixed investment	3.5 (0.6)	1.1 (0.2)	0.7 (0.1)	3.9 (0.6)	1.7 (0.3)	0.7 (0.1)
Government final consumption	0.9 (0.2)	1.3 (0.3)	0.6 (0.1)	0.8 (0.2)	1.3 (0.3)	0.7 (0.1)
Public fixed investment	-4.0 (-0.2)	3.4 (0.2)	0.6 (0.0)	-3.3 (-0.2)	1.3 (0.1)	2.0 (0.1)
Exports of goods and services	1.5 (0.3)	-1.9 (-0.3)	0.3 (0.0)	3.4 (0.6)	-2.2 (-0.4)	-0.2 (-0.0)
Imports of goods and services	2.1 (-0.4)	-0.2 (0.0)	0.4 (-0.1)	3.4 (-0.6)	-0.9 (0.2)	0.6 (-0.1)
Major assumptions:						
1. World economy						
Economic growth of major trading partners	3.6	3.2	3.4	3.9	3.1	3.4
Crude oil price (WTI futures; \$/bbl)	62.9	57.0	56.0	64.9	56.7	56.0
2. US economy						
US real GDP (chained [2012]; y/y %)	2.9	2.2	1.9	2.9	2.4	2.0
US Consumer Price Index (y/y %)	2.3	2.0	2.1	2.4	1.8	2.2
3. Japanese economy						
Nominal public fixed investment (y/y %)	-2.3	4.9	1.5	-1.6	2.8	3.1
Exchange rate (Y/\$)	110.9	107.7	107.0	110.4	108.5	107.0
(Y/€)	128.3	119.5	118.0	130.0	121.3	118.0

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.