

## Will a Gradual Recovery Continue?

### Examining the Downward Risk of the Japanese Economy

While most analysts expect that the Japanese economy will follow a gradual recovery path this fiscal year, estimates are emerging that the real GDP growth for the April–June quarter was virtually zero. The average of the ESP Forecast for the quarter (the outlooks of 37 leading economists) announced by the Japan Center for Economic Research on July 9 was an annualized increase of 0.01% on a quarter-on-quarter basis, marking the fifth consecutive monthly downward revision. The average view of economists is that the Japanese economy will turn to a recovery from the October–December quarter and the growth for the fiscal year will settle at around 0.5%, but will that happen, or will the downward risk materialize? One might say that the Japanese economy is approaching a watershed moment. This article attempts to list the downward factors and the supporting factors for the economy and clarify the viewpoint for the future.

A slump in exports directly impacted by additional US tariffs can be noted as a downward factor for the future. According to the Trade Statistics of Japan for May, exports turned to a year-on-year decline for the first time in eight months due partly to a decrease in automobile exports to the US. If the Japan-US trade negotiations become prolonged without reaching a conclusion, the negative impacts on the Japanese economy will accumulate.

The worsening investment and consumption confidence caused by the sense of uncertainty over the Trump administration's trade policy and anxiety regarding the future can also be noted. Looking at the main data, however, the confidence is not all worsening at present. In fact, while the most recent June Consumer Confidence Index remains low in terms of absolute value with year-on-year declines for seven consecutive months, it has turned to an improvement over the past two months (see Figure). The business conditions DI (all enterprises, all industries; "favorable" – "unfavorable") in the *Short-Term Economic Survey of Enterprises in Japan (Tankan)* by the Bank of Japan (BOJ), which shows corporate business sentiment, was at 15 in the June survey, the same level as the March survey. What may be pointed out as a cause for concern is the worsening of the outlook for the business conditions DI, which was at 9 for all enterprises and all industries (1 for automobiles, which is strongly af-

ected by the Trump tariffs; see Table). The focus is on whether that will worsen further.

On the other hand, what can be mentioned as a factor supporting personal consumption, which is the largest demand item, is the increase in wages. Large wage hikes exceeding those last year were achieved in this year's *shunto* spring wage negotiations. However, the increase in nominal wages did not keep pace with the rise in prices, and it is a fact that real wages have been below the previous year's level for five consecutive months. In that sense, future price developments will be the key issue. The most recent May consumer price increase rate was 3.5% year-on-year, and upward price pressure remains strong at present. Most analysts expect that the inflation rate will drop below 2% into next year and a rise in real wages will become established. But will that actually come to pass? In that a slump in real consumption expenditure has been averted even with real wage growth in negative territory (see Figure), if the rise in food and energy prices eases, then consumer spending will likely show firm growth.

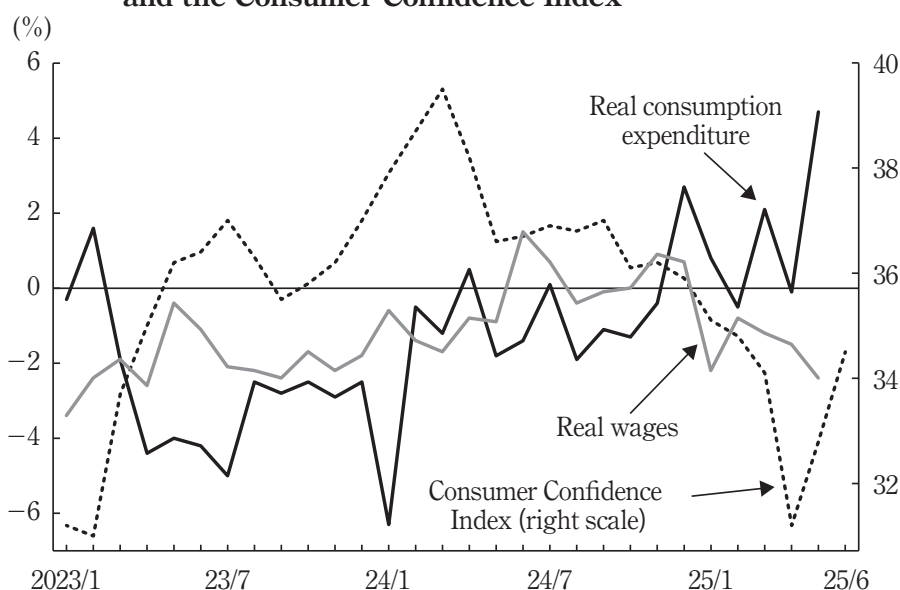
Regarding capital investment, the strength of the corporate propensity to invest can be noted as a supporting factor. Enterprise investment appetite remains robust. The capital investment plans for the current fiscal year in the BOJ's *Tankan* (including software and research and development, excluding investment in land) show a year-on-year increase of 8.7%, revised upward from the March Survey (in increase of 2.2%), pointing to strong investment appetite among enterprises (see Table). Business investment plans are normally revised downward through the second half of the fiscal year, but the extent to which plans are realized will depend on corporate sentiment, the labor shortage, and outlook for increase in material prices.

As noted above, downward factors and supporting factors coexist, but it is necessary to recognize that because Japan's potential growth rate remains at only around 0.5%, the economy could fall into negative growth if the downward factors are even slightly dominant. In determining the outlook, while the future price developments will naturally be a major focus, what should be stressed here is that companies have

accumulated substantial cash and deposits on their balance sheets, reflecting the high profits to date. President Trump is presently showing an increasingly harsh stance toward Japan, and views have emerged suggesting that corporate earnings will decline in fiscal 2025, indicating that the headwinds blowing against the Japanese economy are certainly intensify-

ing. Nevertheless, even under such an environment, enterprises are being sought to maintain wage hikes and steadily implement capital investment that will contribute to increased competitiveness in the future. We should not forget that the positive activities of individual enterprises will become a major force maintaining the momentum of economic growth.

**Figure: Trends in Real Consumption Expenditure, Real Wages, and the Consumer Confidence Index**



Note: Real consumption expenditure and real wages show the rate of increase versus the same month of the previous year.

Sources: *Family Income and Expenditure Survey* by Ministry of Internal Affairs and Communications, *Monthly Labour Survey* by Ministry of Health, Labour and Welfare, *Consumer Confidence Survey* by Cabinet Office

**Table: Trends in BOJ *Tankan* Business Conditions DI and Capital Investment Plans**  
("favorable" – "unfavorable", %)

	Mar. 2024	June 2024	Sep. 2024	Dec. 2024	Mar. 2025	June 2025	
						Most recent	Sep.
Business conditions DI (all enterprises, all industries)	12	12	14	15	15	15	9
Business conditions DI (all enterprises, automobile industry)	4	6	8	9	10	8	1
FY 2024 capital investment plans (all enterprises, all industries)	4.5	10.6	10.1	10.0	8.4	6.9 (Results)	
FY 2025 capital investment plans (all enterprises, all industries)	—	—	—	—	2.2	8.7	

Note: Capital investment plans include software and research and development expenses and exclude land investment (rate of increase versus previous fiscal year).

Source: *Short-Term Economic Survey of Enterprises in Japan (Tankan)* by Bank of Japan