

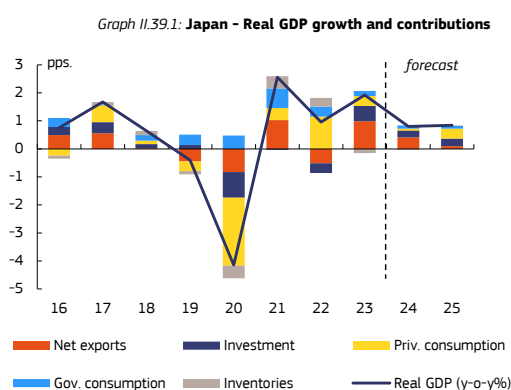
39. JAPAN

Following solid growth in 2023, economic activity in Japan is expected to soften to below 1% in 2024 amid weak private consumption growth. Real GDP growth is set to remain at the same level in 2025 as net exports' contribution is slowing down while domestic demand strengthens. Headline consumer inflation is expected to decline towards the central bank target of 2% over the forecast horizon.

Economic activity is likely to slow down in 2024 after a strong outturn in 2023

After a strong first half of 2023 with quarterly growth averaging 1% q-o-q, economic activity in Japan surprised on the downside in the second half of the year. Real GDP contracted by 0.8% q-o-q and increased by 0.1% q-o-q in the third and fourth quarter of 2023, respectively. This decline was driven by shrinking private demand, reflecting high inflation and elevated business and consumer uncertainty. At the same time, rising tourism revenues supported growth. Overall, GDP growth reached 1.9% in 2023.

Going forward, economic activity is expected to decelerate in 2024, amid subdued growth in domestic demand and a moderate recovery in exports. On the domestic side, the still high inflation is set to impinge on private consumption growth, despite a relatively tight labour market and rising wages. Private investment growth is projected to decelerate amid persistent uncertainty, despite accommodative financing conditions. On the external side, imports are set to increase moderately, after shrinking in 2023, while exports' growth is expected to pick up pace as global demand rises. This should result in a slightly positive contribution of external trade to growth, with real GDP growth forecast to reach 0.8% in 2024.



Growth prospects are subdued in 2025 as well

Private consumption growth is expected to pick up gradually in 2025, driven by rising real wages and low unemployment. However, the moderating dissaving of households and limited scale of fiscal support are likely to constrain the rebound. Private investment growth rate is expected to remain moderate, hindered by rising labour costs and the somewhat less accommodative monetary policy. At the same time, public spending growth is set to remain muted reflecting the limited size of new fiscal measures. On the external side, export growth is forecast to moderate due to an expected slower increase in tourist inflows and a stabilising currency. Import growth is projected to continue rising reflecting delayed demand from export-oriented manufacturing companies for foreign components. Overall, net exports are set to be broadly neutral to growth in 2025, with the current account surplus projected to remain stable at around 4% of GDP over the forecast horizon. Real GDP growth is expected to remain at 0.8% in 2025 as the slightly stronger domestic demand growth compensates for the weaker contribution of external trade.

Risks to the outlook are broadly balanced. On the upside, additional fiscal measures might boost domestic demand, while a further rise in tourist numbers, notably from China, might support stronger export growth. On the downside, a more pronounced slowdown in China might hamper export growth, while a more persistent domestic wage pressure might sustain inflationary pressure for longer, leading the Bank of Japan to additional hikes in interest rates thereby clouding the outlook for domestic demand.

Inflationary pressures are expected to subside gradually

After peaking at 4.3% in January 2023, headline inflation gradually subsided to 2.7% in March 2024 due to lower energy prices and gradual disinflation in durable goods. However, headline inflation excluding energy and fresh food remains elevated (at around 2.9% in March 2024), reflecting higher pass-through of input costs to goods' prices, the impact of yen depreciation and rising labour costs. Going forward, headline inflation is expected to gradually decrease from 3.3% on average in 2023 to 2.2% in 2025 on weak domestic demand, only partly counterbalanced by rising wage pressures and continued yen weakness.

With headline inflation still hovering above the 2% target and taking into account recent announcement of significant wage hikes as well as a weakened yen, the Bank of Japan (BOJ) tightened monetary policy in March 2024. It abolished its negative interest rate policy, effectively hiking interest rates in Japan for the first time in 17 years, ended the yield curve control (YCC) programme and finished purchases of exchange traded funds (ETFs) and real-estate investment trusts (J-REITs). However, monetary policy is likely to remain broadly accommodative going forward, as further interest rate hikes are projected to be rather limited given the decelerating inflation and subdued growth outlook, unless the yen depreciation and wage pressure turn out to be more persistent than expected.

Additional fiscal spending keeps deficit at elevated level

The general government deficit is set to have reached around 5.4% of GDP in 2023 reflecting a large package of measures introduced to counterbalance rising costs of living and a slippage in fiscal revenues. The general government deficit is expected to increase further to 6% of GDP in 2024, reflecting rising military spending, additional child support and the November 2023 fiscal stimulus package, which includes temporary cuts to income and residential taxes, payouts to low-income households and an extension of subsidies to curb gasoline and utility bills. The deficit is projected to decline somewhat to 5.4% of GDP in 2025 as the energy subsidies are discontinued and revenues rise marginally. Public debt is forecast to decline gradually from around 257% of GDP in 2022 to around 248% of GDP in 2025.

Table II.39.1:

Main features of country forecast - JAPAN

	2023			Annual percentage change						
	bn JPY	Curr. prices		% GDP	04-19	2020	2021	2022	2023	2024
GDP	591881.2	100.0	0.7		-4.1	2.6	1.0	1.9	0.8	0.8
Private Consumption	322410.8	54.5	0.5		-4.4	0.8	2.2	0.6	0.1	0.7
Public Consumption	123888.8	20.9	1.3		2.4	3.4	1.7	0.9	0.6	0.5
Gross fixed capital formation	152419.3	25.8	0.2		-3.6	-0.1	-1.4	2.1	1.0	1.1
Exports (goods and services)	128660.0	21.7	3.7		-11.6	11.9	5.3	3.0	3.4	2.6
Imports (goods and services)	137921.3	23.3	2.8		-6.8	5.1	7.9	-1.3	1.4	2.0
GNI (GDP deflator)	625824.7	105.7	0.9		-4.4	3.7	2.2	1.6	0.8	1.1
Contribution to GDP growth:										
Domestic demand			0.6		-2.9	1.1	1.2	1.1	0.4	0.7
Inventories			0.0		-0.5	0.4	0.3	-0.1	0.0	0.0
Net exports			0.2		-0.8	1.0	-0.5	1.0	0.4	0.1
Employment			0.4		-0.5	-0.1	0.2	0.4	0.2	0.1
Unemployment rate (a)			3.9		2.8	2.8	2.6	2.6	2.5	2.5
Compensation of employees / head			0.0		-0.8	2.0	1.9	3.2	3.2	2.4
Unit labour costs whole economy			-0.4		2.9	-0.7	1.1	1.6	2.6	1.6
Saving rate of households (b)			10.3		18.0	15.0	11.8	13.6	14.5	13.3
GDP deflator			-0.3		0.9	-0.2	0.3	3.8	2.3	1.7
Consumer price index			0.3		0.0	-0.2	2.5	3.3	2.8	2.2
Terms of trade goods			-2.2		6.8	-9.1	-13.3	6.5	-0.8	-2.0
Trade balance (goods) (c)			0.7		0.5	0.3	-2.8	-1.1	-1.3	-1.6
Current-account balance (c)			3.0		3.0	3.9	1.9	3.8	4.0	3.9
General government balance (c)			-5.3		-9.1	-6.2	-4.1	-5.4	-6.0	-5.4
Structural budget balance (d)			:		:	:	:	:	:	:
General government gross debt (c)			209.1		258.4	253.9	257.2	249.8	248.7	248.4

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.