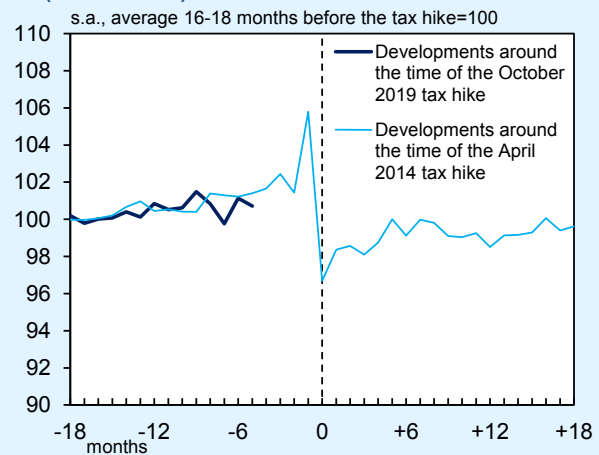


(Box 2) Developments in Household Spending prior to the Consumption Tax Hikes

While Japan's economic growth rate is expected to be pushed up before the scheduled consumption tax hike in October 2019 through the front-loaded increase in demand led mainly by household spending, it is then likely to be pushed down after the tax hike as a result of the subsequent decline in demand and a decrease in households' real disposable income due to price rises.³⁷ The negative impact of the scheduled tax hike on the growth rates is expected to be smaller than that of the previous tax hike in fiscal 2014, partly because the increase in the consumption tax rate is smaller and the government will take support measures. However, there are some uncertainties. With regard to the front-loaded increase in demand prior to the tax hike scheduled in October 2019, this box examines recent developments in indicators related to household spending by comparing them with developments seen before the previous tax hike in April 2014.

Starting with the Consumption Activity Index (CAI, travel balance adjusted), which comprehensively captures developments in private consumption in Japan, this has been increasing at around the

Chart B2-1: Consumption Activity Index (CAI, Real)



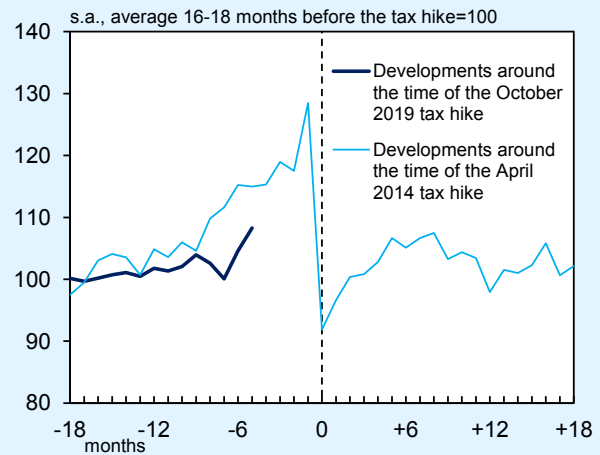
Source: Bank of Japan.

Notes: 1. Month 0 is the month in which the consumption tax rate was or is scheduled to be raised – namely, April 2014 or October 2019. Regarding developments around the time of the October 2019 tax hike, the latest figure is for May 2019. The CAI is based on staff calculations (as of July 12).
2. Figures exclude inbound tourism consumption and include outbound tourism consumption.

³⁷ While the front-loaded increase and subsequent decline in demand prior to and after the consumption tax hike occur mainly in household spending, they also can take place in part in business fixed investment among those eligible for the simplified tax system or the tax exemption (primarily family-owned firms and small firms). Meanwhile, when there is a front-loaded increase in demand, inventories are drawn down, and thus inventory adjustments push down GDP. In addition, part of the front-loaded increase in demand brings about a rise in imports, which are deducted from GDP, and this consequently pushes down GDP. These developments in inventories and imports are expected to reduce the fluctuations in overall GDP brought about by the tax hike.

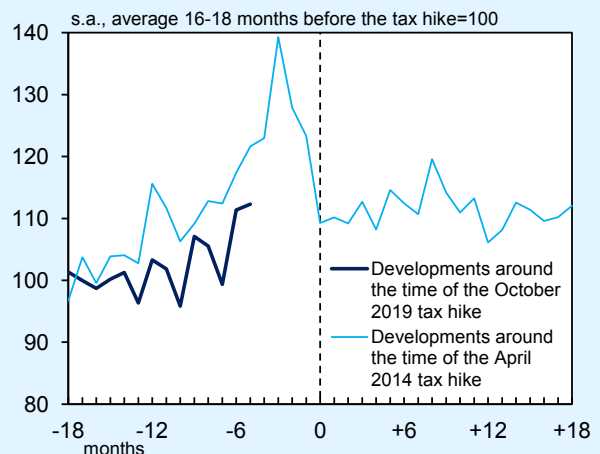
same pace as that prior to the previous tax hike, albeit with fluctuations (Chart B2-1). However, this increase is attributable to some extent to an increase in services consumption reflecting a rise in travel demand associated with the long holiday period from end-April through early May, and therefore is not only due to the front-loaded increase in demand. Looking at developments by type of consumption and focusing on durable goods, which are more susceptible to the front-loaded increase in demand, such increase in demand can be observed in some items, but the overall degree of the increase is limited compared with that of the tax hike in April 2014 (Chart B2-2). Taking a more detailed look, while sales of automobiles have been increasingly volatile recently, partly due to supply constraints, the pace of increase currently is accelerating somewhat. Although the degree may not be as much as that before the tax hike in April 2014, this seems to be due partly to the effects of the front-loaded increase in demand, which has been supported by the introduction of new car models as well (Chart B2-3). In addition, the front-loading of demand is gradually starting to materialize, as seen in favorable sales of air conditioners that partly reflect the stimulative effects brought about by the front-loading of demand for housing, which will be discussed later, as well as in an increase in replacement demand for personal computers that partly are due to the expiration of support for certain software products (Chart B2-4). On the other hand, with regard to nondurable goods, there has been essentially no front-loading of demand at the moment, as indicated by sales at department stores, supermarkets, and convenience stores (Chart 31). This is because nondurable goods are unlikely to experience the front-loaded increase in demand until immediately

Chart B2-2: Durable Goods (CAI, Real)



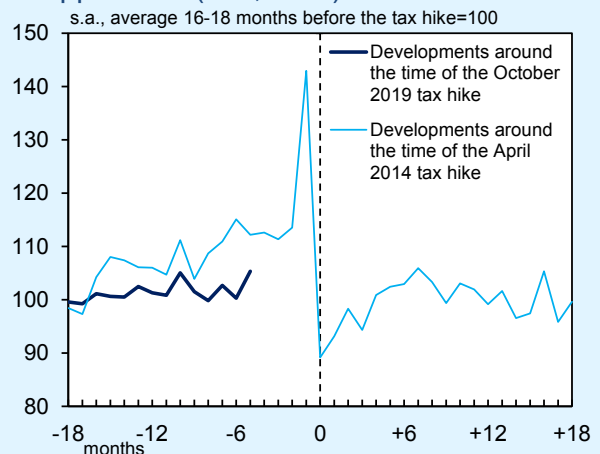
Source: Bank of Japan.
Note: Month 0 is the month in which the consumption tax rate was or is scheduled to be raised – namely, April 2014 or October 2019. Regarding developments around the time of the October 2019 tax hike, the latest figure is for May 2019. The CAI is based on staff calculations (as of July 12).

Chart B2-3: Automobiles (CAI, Real)



Source: Bank of Japan.
Note: Month 0 is the month in which the consumption tax rate was or is scheduled to be raised – namely, April 2014 or October 2019. Regarding developments around the time of the October 2019 tax hike, the latest figure is for May 2019. The CAI is based on staff calculations (as of July 12).

Chart B2-4: Household Electrical Appliances (CAI, Real)



Source: Bank of Japan.
Note: Month 0 is the month in which the consumption tax rate was or is scheduled to be raised – namely, April 2014 or October 2019. Regarding developments around the time of the October 2019 tax hike, the latest figure is for May 2019. The CAI is based on staff calculations (as of July 12).

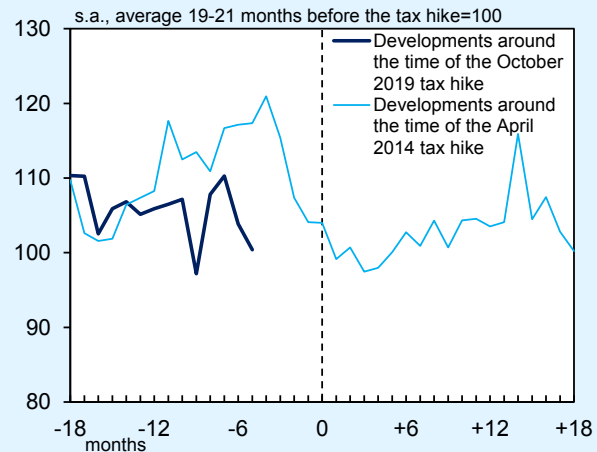
before the consumption tax hike.

Next, looking at housing starts, which is a leading indicator of housing investment, hardly any increase prior to the scheduled tax hike can be observed, unlike before the previous tax hike in 2014 (Chart B2-5[1]). However, looking at the breakdown, there has been a clear increase recently in housing starts of owned houses and detached houses built for sale, although this is not as pronounced as before the previous tax hike (Chart B2-5[2]). The likely reason for this clear increase is that there was a rush to make contracts before March 2019, to which the current tax rate was applied even if the handover of the property is after the October 2019 tax hike, and houses under these contracts have entered the construction stage. On the other hand, while there was a substantial increase in housing starts of housing for rent prior to the previous tax hike, they instead have been decreasing this time, reflecting waning demand for tax saving and asset management as well as somewhat cautious lending attitudes of financial institutions compared to a while ago.

In sum, while some types of household spending, such as durable goods consumption and housing starts of owned houses and detached houses built for sale, seem to be experiencing the front-loaded increase in demand, the degree is likely to be limited compared with that of the previous consumption tax hike.³⁸ However, it should be noted that, (1) with regard to the observed increase in demand, it is difficult to

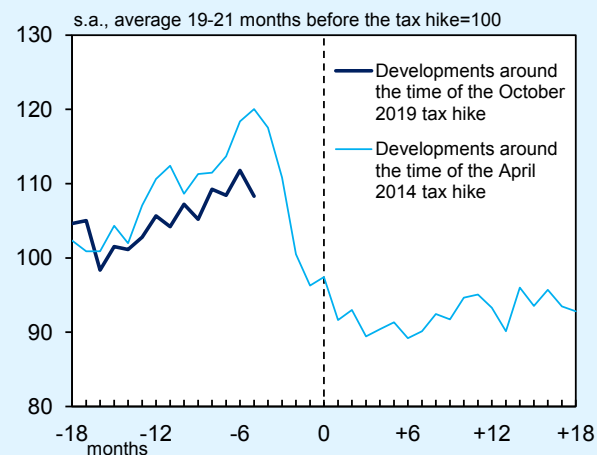
Chart B2-5: Housing Starts

1. Overall



Source: Ministry of Land, Infrastructure, Transport and Tourism.
 Note: Month 0 is the month in which the consumption tax rate was or is scheduled to be raised – namely, April 2014 or October 2019. Regarding developments around the time of the October 2019 tax hike, the latest figure is for May 2019.

2. Owned Houses + Detached Houses Built for Sale



Source: Ministry of Land, Infrastructure, Transport and Tourism.
 Notes: 1. Month 0 is the month in which the consumption tax rate was or is scheduled to be raised – namely, April 2014 or October 2019. Regarding developments around the time of the October 2019 tax hike, the latest figure is for May 2019.
 2. Figures for detached houses built for sale are based on staff calculations.

³⁸ This assessment is in line with the majority view of firms, which is summarized in the July 2019 *Regional Economic Report*.

distinguish the front-loading of demand from the underlying trends in real time, (2) the degree of the front-loaded increase in demand is easily affected by household sentiment and retailers' stance on sales promotions at the time, and (3) this time, new measures will be implemented, such as a reduced tax rate, a point reward program when using cashless payments, and flexibly passing on the rise in the consumption tax to sales prices. Taking these factors into consideration, as there are uncertainties regarding the impact of the scheduled consumption tax hike, this continues to warrant close examination.