

January 5, 2012

(Original Japanese version released on December 29, 2011)

Japan Economic Monthly

**~Despite Dull Economy,
Steady Recovery Expected Over Near Term~**

Economic Research Office
The Bank of Tokyo-Mitsubishi UFJ, Ltd.

1. The Real Economy

(1) Overview of the Economy

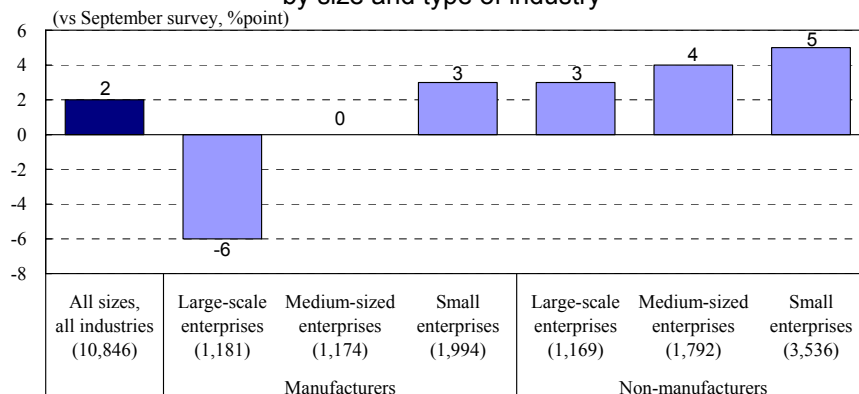
Despite economy
dulling, recovery
scenario intact

The Japanese economy has appeared to become unstable over the last few months. The effects of overseas economies, mainly in Europe, slowing down, and the JPY's appreciation have appeared gradually. For example, Japanese export volume flattened in July and August and decreased clearly in October and November. Domestic industrial production has also see-sawed since the summer.

On the other hand, recovery and restoration demand from the March earthquake, expected to drive the economy, is clearly appearing. Though the above-mentioned downward pressures related to external demand will persist, the economy is likely to gain more force going forward with the implementation of the large FY11 third supplementary budget passed in November.

According to the Bank of Japan's Tankan December survey, the Business Conditions DI dropped among large-scale manufacturers but rose among non-manufacturers (Figure 1). In the former, exporting industries suffering from deteriorating conditions downgraded their assessments. Among non-manufacturers, construction industries upgraded their assessments, indicating that reconstruction-related demand is building. The result showed that the Japanese economy is recovering gradually as a whole, though both strong and weak factors persist.

Figure 1: December BoJ Tankan Business Conditions DI, by size and type of industry



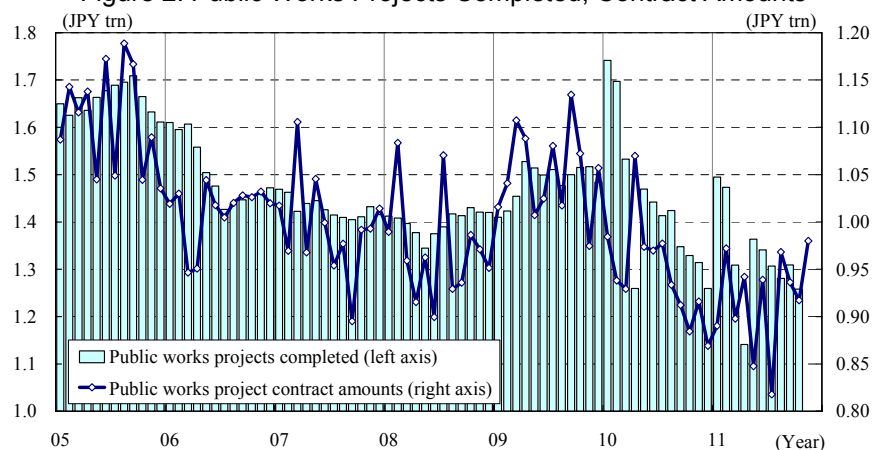
Note: 1. Actual Business Conditions DI is Favorable minus Unfavorable (survey conducted Nov 14 - Dec 14).
 2. Figures in parentheses are number of survey respondents.
 Source: Compiled by BTMU Economic Research Office from BoJ data.

(2) Fiscal

Signs of more widespread reconstruction appearing

Signs of growing public investment for reconstruction have appeared. November public works contract amounts stood at the highest level in one and a half years, driven by jumps in Iwate, Miyagi and Ibaraki prefectures (Figure 2). Because contract amounts lead public works completed volume by approximately three months, demand is very likely to build from early 2012 and support the economic recovery.

Figure 2: Public Works Projects Completed, Contract Amounts



Note: Adjusted for seasonality by BTMU.
 Source: Compiled by BTMU Economic Research Office from MLIT, guarantee business companies' data.

Government approves FY11 4th supplementary budget draft in cabinet meeting

At the December 20 Cabinet meeting, the government finalized the FY11 fourth supplementary budget draft (Table 1). The draft is mainly comprised of extensions to existing measures and financial support for companies, so direct increases in public demand will be limited. However, measures to support greater usage of environmentally-friendly vehicles (subsidies for eco-friendly cars) are expected to bolster private demand.

Table 1: FY11 Fourth Supplementary Budget Outline

(JPY bn)

Fiscal Demand		Resources	
1. Additional mandatory costs, etc.	140.6	1. Tax revenue	1,103.0
(1) Disaster management costs	6.7		
(2) Costs for livelihood protection, etc.	133.9		
2. Other expenses	2,033.1	2. Non-tax revenue	8.8
(1) Elderly medical care, childcare, welfare, etc.	493.9		
•One-year extension to reduced elderly medical care burden (funds)	271.9		
•One-year extension to safe child funds	127.0		
•One-year extension to cervical cancer, etc., vaccination funds	52.6		
•One-year extension to funds to support healthy pregnancy checks	18.1		
•Purchases of H1N1 flu vaccine	9.1		
•One-year extension to funds to support handicapped independent living	15.2		
(2) International burden costs, contributions	187.5		
•UN contribution	68.4		
•Afghanistan support contribution	52.1		
•Other	67.0		
(3) Funds needed to revitalize food and agricultural, forestry, and fishery ind	157.4	3. Cutbacks in already-set expenses	1,422.7
(4) Support for SME funding support	741.3	(1) Unused JGB expenses	1,292.3
(5) Funds to promote increased use of eco-friendly cars	300.0	(2) Other	130.4
(6) Other	153.0		
3. Local tax allocations	360.8		
Total	2,534.5	Total	2,534.5

Source: Compiled by BTMU Economic Research Office from MoF materials.

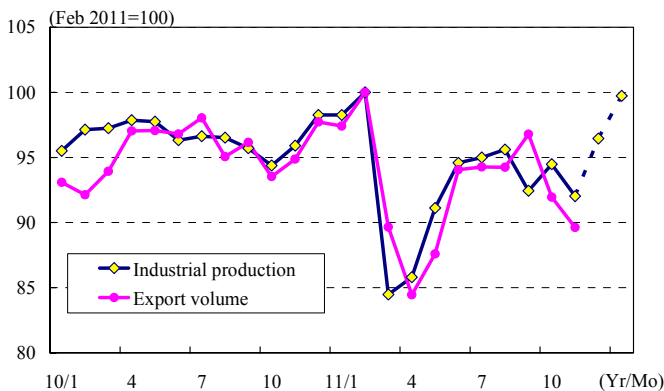
(3) Corporate Sector

① Production, Exports

Production and exports likely to remain at a standstill

Export volume fell for two straight months, -5.0% MoM in October and -2.7% MoM in November (Figure 3). Industrial production has also been seeing a standstill through the end of the year, as manufacturers' PMIs for China and Europe are both still on a downward trend and the December Tankan survey's DI for overseas supply and demand conditions among manufacturers is expected to get worse in the next three months (Table 2).

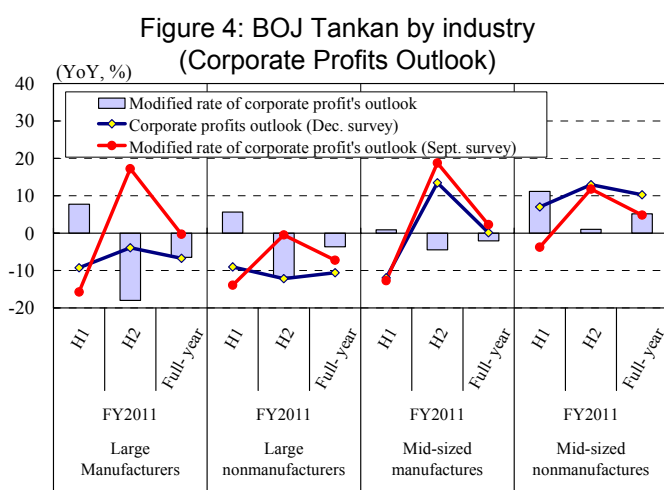
Figure 3: Industrial Production and Export Volume



②Capital Expenditures

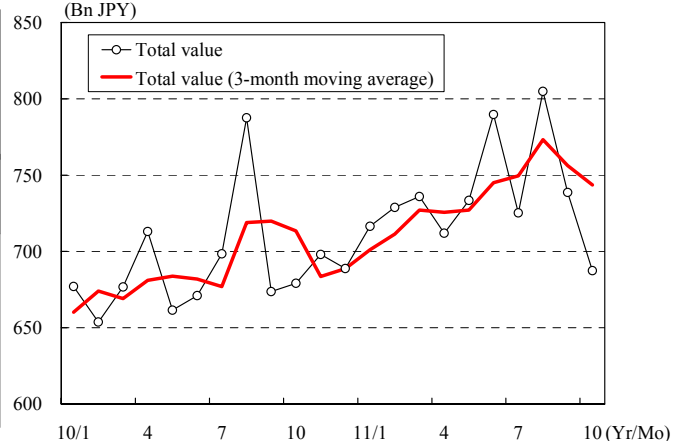
Large manufacturers in particular have revised down earnings outlooks for H2 FY11

According to the December Tankan survey, companies have cut their earnings outlooks for H2 FY11 considerably, especially among large manufacturers (Figure 4). A persistently-strong JPY and slowdowns by overseas economies have forced companies to revise their rapid recovery scenarios made three months ago. Machinery orders (private demand, excluding shipbuilding and power generating companies) plunged both in September and October. Although reconstruction demand is expected to propel capital expenditures, if external demand slows or worse-than-expected corporate profits due to a still-strengthening JPY worsens or is prolonged, fundamental investment demand will plunge and the probability of a risk scenario being realized will likely increase. The direction of capital spending will bear close watching.



Note: Modified rate of corporate profit's outlook is from September to December.
Source: Compiled by BTMU Economic Research Office from BOJ materials.

Figure 5: Machinery Orders from Private Sector excl. shipbuilding and power generation industries (Bn JPY)



Source: Compiled by BTMU Economic Research Office from Cabinet Office data.

(4) Household Sector

①Employment, Private Consumption

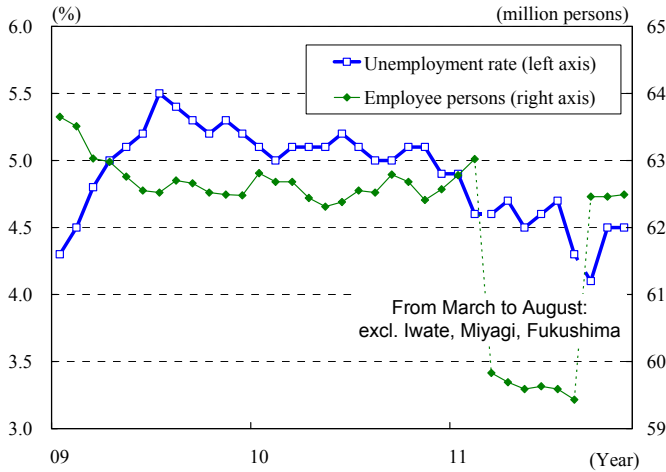
Employment conditions improving, private consumption gradually recovering

Employment conditions continue to improve. According to the Labor Force Survey, the unemployment rate is still recovering, keeping its level lower than the pre-quake level although it shows monthly fluctuations and employee numbers have not increased (Figure 6). The job-openings-to-applicants ratio also continues to rise and improve.

On the back of these trends, consumption has been recovering gradually. The consumption composite index increased in October on a year-over-year basis for the first time since June, and the degree of decline in real consumption expenditures slowed in September and October (Table 3). By retail sales category, convenience store sales have been firm, and new/used car registrations have also been increasing. Further, though consumer confidence has been declining recently, the level remains higher than last summer. We

believe that private consumption is likely to stabilize as consumer sentiment and incomes improve.

Figure 6: Unemployment Rate and Employee Persons



Source: Compiled by BTMU Economic Research Office from MIC

Figure 3: Consumer-Related Statistics

	2011 (YoY, %)					
	JUN	JUL	AUG	SEP	OCT	NOV
Private Consumption Intergrated Estimates Index	0.6	▲ 0.1	▲ 0.9	▲ 1.1	1.8	
Real Consumption Expenditures per household	▲ 3.5	▲ 2.1	▲ 4.1	▲ 1.9	▲ 0.4	▲ 3.2
Commercial Sales (sales value)	3.1	2.3	3.1	0.3	1.1	▲ 2.5
Wholesale	3.8	3.0	5.2	0.8	0.8	▲ 2.6
Retail	1.2	0.6	▲ 2.6	▲ 1.1	1.9	▲ 2.3
Convenience store	8.3	8.9	6.6	▲ 4.1	13.5	7.3
Domestic sales of new cars	▲ 21.9	▲ 25.6	▲ 26.0	▲ 2.1	27.5	25.1
Domestic sales of used cars	▲ 3.4	▲ 7.0	▲ 1.7	▲ 5.5	▲ 3.3	1.7
Domestic tour gross billing	▲ 10.0	▲ 7.6	2.0	1.6	0.5	
Consumer Confidence Index	35.3	37.0	37.0	38.6	38.6	38.1

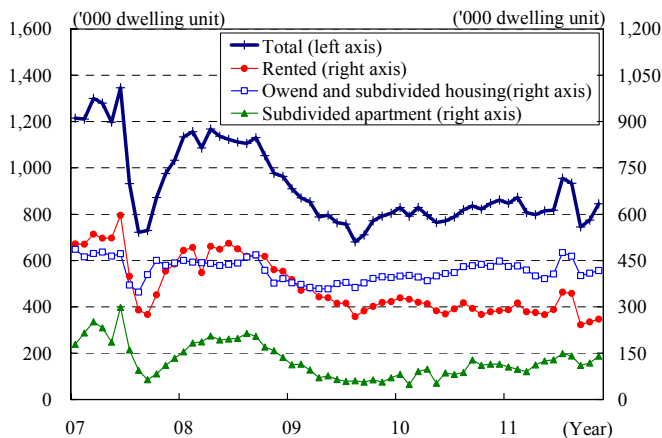
Source: Compiled by BTMU Economic Research Office from MIC, CAO, MITI, JTA etc.

② Residential Investment

Housing starts recovering due to reconstruction demand and policy effects

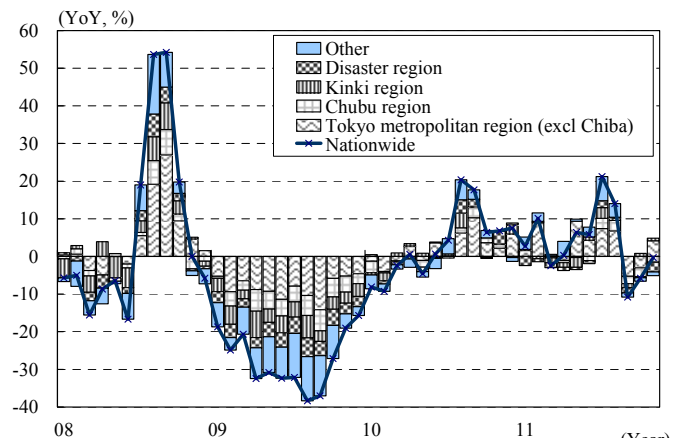
Residential investment continues to recover from the earthquake shock. New home starts, a leading indicator, surged in July and August (Figure 7). After dipping in September, home starts rose again in October and November. By type of occupancy and region, both reconstruction and restrained demand have been being boosted by political aid (Figure 8). Looking forward, not only is reconstruction activity expected to continue, but home purchase assistance programs, like the Flat 35S preferential interest rate program and the Housing Eco-point program (which was restarted in the third supplemental budget), will also drive residential purchases.

Figure 7: New Housing Starts by Type of Occupancy



Note: Subdivided housing and Condominium Apartment adjusted for seasonality by BTMU. Source: Compiled by BTMU Economic Research Office from MLIT

Figure 8: Residential Construction Starts by Region



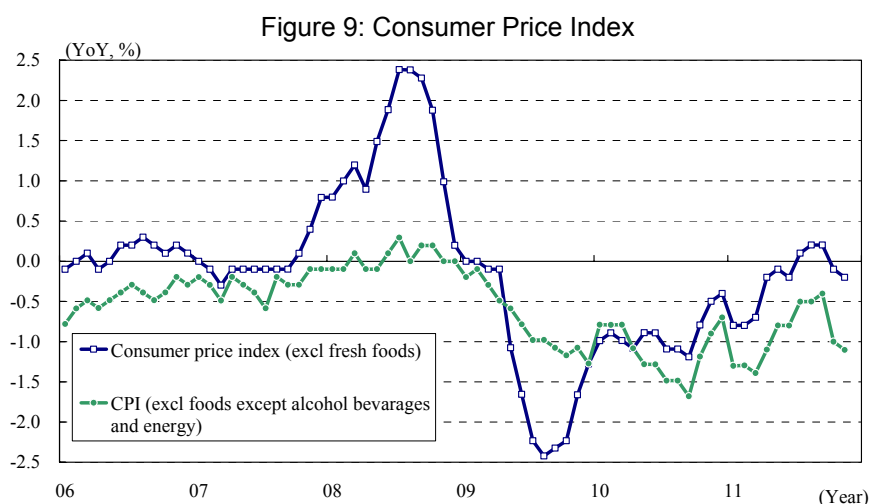
Note: Disaster area is Iwate, Miyagi, Fukushima, Chiba, Ibaragi, and Tochigi Prefectures. Source: Compiled by BTMU Economic Research Office from MLIT data.

(5) Inflation

Core CPI once again dropped into negative territory as temporary boosting factors fell off

The consumer price index (excluding fresh foods, core CPI) was positive for three consecutive months from July through September, but turned negative to -0.1% YoY in October and -0.2% YoY in November (Figure 9). Boosting up factors from a year earlier — hikes to both the cigarette tax and casualty insurance premiums — fell away, causing the drop. Core-core CPI (excluding foods except alcoholic beverages and energy) also moved in negative territory. Both the October (-1.0% YoY) and November (-1.1% YoY) figures fell faster than the July-Sept average (-0.5% YoY). The deflationary trend has been stubbornly persistent.

The core CPI is likely to remain in negative territory because of a persistent deflationary gap. In addition, with a reactionary drop in reaction to high energy prices a year earlier, it is even possible that larger year-on-year falls will occur.



Source: Compiled by BTMU from MIC data.

2. Financial Markets

(1) Monetary Policy & Long-term Interest Rates

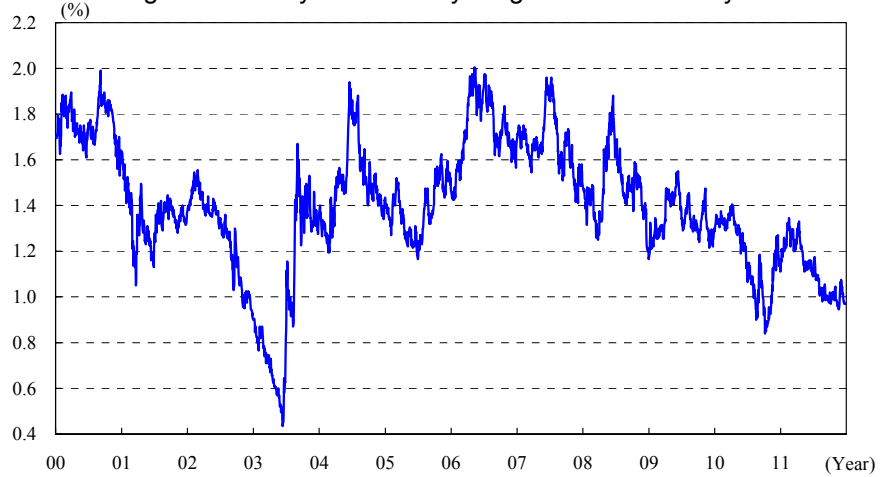
BoJ downgrades assessment of current economic conditions

The Bank of Japan decided to maintain its current monetary policy at the December 20-21 Monetary Policy Meeting. However, in the policy statement, the BoJ cut its assessment of current economic conditions to *the pick-up in Japan's economic activity has paused* from the previous *Japan's economic activity has continued picking up*.

Newly-issued 10Yr JGB yields stay around 1%

Against increasing uncertainty about the economy's future, flight to quality moves have resulted in long-term yields remaining stable at a low level. From late November to early December, JGB selling related to weak bidding in the German government bond auction triggered a rise in newly-issued 10Yr JGB yields to near 1.1%. That, however, was short-lived (Figure 10).

Figure10: Newly-issued ten-year government bond yields



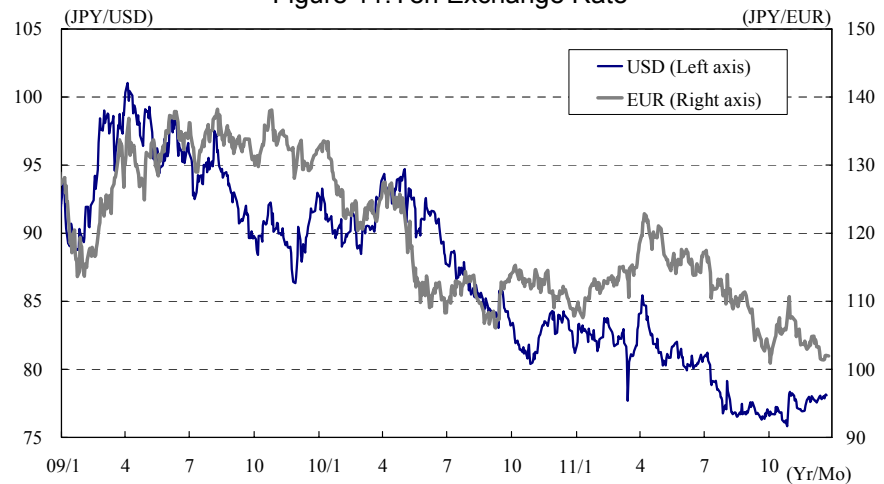
Source: Compiled by BTMU Economic Research Office based on Bloomberg data.

(2) Exchange Rates

JPY appreciation against USD has paused

In foreign exchange markets, the JPY's appreciation against the USD has paused, with the USD/JPY rate remaining in the 77- 78 range (Figure 11). The more the European sovereign debt problem deepens, the more demand for the USD as a settlement currency increases. This has caused the JPY's appreciation pressure to ease. On the other hand, the EUR/JPY has risen to the 101~102 level, the highest since October.

Figure 11: Yen Exchange Rate



Source: Compiled by BTMU Economic Research Office based on Bloomberg data.

For further details, please contact the Economic Research Office
(Chief Manager DATE) Tel: 03-3240-3204

Directed by Yasuhiro Ishimaru <yasuhiro_ishimaru@mufg.jp>

Written by Shin Takayama (Fiscal, Financial Markets) <shin_takayama@mufg.jp>

Written by Hayato Nakamura (Corporate Sector) <hayato_nakamura@mufg.jp>

Written by Yuka Maehara (Household Sector) <yuka_maehara@mufg.jp>

Written by Mikiko Nishimura (Inflation) <mikiko_nishimura@mufg.jp>

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MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Jan. 5, 2012

	Fiscal 2009	Fiscal 2010	2011			2011				
			1Q	2Q	3Q	AUG	SEP	OCT	NOV	DEC
Real GDP Growth Rate <% changes from previous period at SA annual rate>	-2.1	3.1	-6.6 (-0.2)	-2.0 (-1.7)	5.6 (-0.7)	***	***	***	***	***
Index of All Industries Activity	-4.2	2.0	-1.9 (-0.5)	-0.4 (-1.7)	2.1 (-0.4)	-0.3 (0.2)	-0.7 (-0.6)	0.8 (0.2)		
Industrial Production Index	-8.8	8.9	-2.0 (-2.5)	-4.0 (-6.8)	4.3 (-2.1)	0.6 (0.4)	-3.3 (-3.3)	2.2 (0.1)	-2.6 (-4.0)	
Production										
Shipments	-8.3	9.3	-1.9 (-2.6)	-5.9 (-8.4)	6.6 (-2.0)	0.2 (0.2)	-2.0 (-2.9)	0.2 (-0.3)	-1.5 (-4.5)	
Inventory	-6.1	3.5	1.0 (3.5)	3.2 (4.0)	1.9 (5.5)	2.1 (5.8)	-0.1 (5.5)	0.9 (7.0)	-0.8 (8.0)	
Inventory/Shipments Ratio (2005=100)	120.4	108.2	106.9 [106.3]	119.1 [106.5]	116.8 [108.7]	114.8 [108.0]	119.2 [109.1]	118.1 [117.0]	116.1 [108.0]	[108.0]
Domestic Corporate Goods Price Index	-5.2	0.7	1.2 (1.8)	1.2 (2.5)	-0.1 (2.6)	-0.2 (2.6)	-0.1 (2.5)	-0.8 (1.6)	0.1 (1.7)	
Consumer Price Index(SA, total, excl.fresh foods)	-1.6	-0.8	-0.3 (-0.8)	0.5 (-0.3)	-0.1 (0.2)	0.0 (0.2)	-0.2 (0.2)	-0.1 (-0.1)	0.0 (-0.2)	
Index of Capacity Utilization (2005=100)	80.0	88.0	86.1 [89.5]	80.4 [89.8]	87.2 [88.4]	89.0 [88.5]	85.8 [88.1]	89.3 [86.7]		[90.2]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	-20.4	9.1	5.6 (8.9)	2.5 (9.8)	1.5 (5.8)	11.0 (2.1)	-8.2 (9.8)	-6.9 (1.5)		
Manufacturing	-27.9	18.3	5.3 (16.3)	-0.2 (17.2)	2.5 (4.4)	13.7 (5.0)	-17.5 (4.8)	5.5 (2.4)		
Non-manufacturing Excl.Electric Power & Ship building	-14.7	2.7	1.4 (3.5)	5.0 (4.2)	5.0 (7.2)	-6.1 (-0.1)	8.5 (13.2)	-7.3 (1.0)		
Shipments of Capital Goods (Excl.Transport Equipment)	-24.2	21.3	-2.4 (6.6)	6.1 (9.0)	-0.1 (4.1)	-3.0 (8.1)	-6.0 (-1.3)	3.5 (1.0)	0.9 (3.4)	
Construction Orders	-14.2	-5.2								
Private	-15.3	-2.6								
Public	-11.1	-12.1								
Public Works Contracts	4.9	-8.8								
Housing Starts 10,000 units at Annual Rate, SA	77.6 (-25.4)	81.9 (5.6)	84.2 (3.2)	81.0 (4.1)	87.8 (7.9)	93.4 (14.0)	74.5 (-10.8)	77.4 (-5.8)	84.5 (-0.3)	
Total floor										
Sales at Retailers	-0.4	0.8								
Real Consumption Expenditures of Households over 2 persons (SA)	1.0	-0.9	-2.8 (-3.0)	0.4 (-2.1)	0.9 (-2.8)	-0.1 (-4.1)	0.9 (-1.9)	0.3 (-0.4)	-1.3 (-3.2)	
Propensity to Consume (SA,%)	74.7	73.4	71.9 [74.1]	74.1 [72.4]	73.0 [75.2]	73.8 [75.5]	74.3 [75.1]	71.8 [70.8]	73.7 [75.6]	[74.1]
Overtime Hours Worked (All Industries, 5 employees or more)	-8.5	6.8	1.2 (1.7)	-2.6 (-2.0)	1.3 (-0.6)	-1.0 (-2.1)	1.1 (1.0)	-0.1 (1.0)	-1.0 (-0.9)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	-3.3	0.6								
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	-77,894	23,384	33,848 1,683	28,033 10,188	27,711 21,464	29,735 18,928	24,538 24,836	21,493 28,054	25,300 28,971	27,087
Ratio of Job Offers to Applicants (SA,Times)	0.45	0.56	0.62 [0.47]	0.62 [0.50]	0.66 [0.54]	0.66 [0.55]	0.67 [0.55]	0.67 [0.56]	0.69 [0.57]	[0.58]
Unemployment Rate (SA,%)	5.2	5.0	4.7	4.7	4.4	4.3	4.1	4.5	4.5	
Economy Watcher Survey (Judgment of the present condition D.I,%)	39.9	44.2	40.1 [42.8]	38.0 [48.3]	48.4 [45.4]	47.3 [45.1]	45.3 [41.2]	45.9 [40.2]	45.0 [43.6]	[45.10]
Bankruptcies (Number of cases)	14,732 (-8.7)	13,065 (-11.3)	3,211 (-7.3)	3,312 (-0.3)	3,108 (-3.8)	1,026 (-3.5)	1,001 (-9.1)	976 (-14.0)	1,095 (3.2)	

(Notes)

Unless otherwise indicated, tabulated figures and those in parentheses show % changes from previous quarter/month as applicable.

The figures in () indicate % changes from previous year.

[] show the comparable figure of the previous year.

Unemployment Rate excludes Iwate, Miyagi, and Fukushima prefectures from March to August 2011.

2. Balance of Payments

As of Jan. 5, 2012

	Fiscal	Fiscal	2011			2011				
	2009	2010	1Q	2Q	3Q	AUG	SEP	OCT	NOV	DEC
Customs Clearance(Exports in Yen Terms)	-17.1	14.9	(2.5)	(-8.1)	(0.5)	(2.8)	(2.3)	(-3.8)	(-4.5)	
Value	-7.0	0.2	(-0.0)	(0.2)	(1.6)	(1.9)	(0.9)	(0.2)	(-0.1)	
Volumes	-9.9	14.6	(2.4)	(-8.3)	(-1.1)	(0.9)	(1.5)	(-3.9)	(-4.4)	
Imports(In Yen terms)	-25.2	16.0	(11.4)	(10.4)	(13.8)	(19.2)	(12.2)	(17.9)	(11.4)	
Value	-18.4	3.3	(4.0)	(7.4)	(12.1)	(12.5)	(11.1)	(11.3)	(12.5)	
Volumes	-7.3	12.4	(7.2)	(2.8)	(1.5)	(6.0)	(1.0)	(6.0)	(-1.0)	
Current Balance(100 mil. yen)	157,817	161,255	39,866	15,372	29,825	4,075	15,848	5,624		
Trade Balance(100 mil. yen)	65,996	64,955	5,577	-10,534	-1,982	-6,947	3,732	-2,061		
Services(100 mil. yen)	-18,185	-12,730	-771	-5,040	-6,068	-1,826	-1,180	-2,754		
Capital and Financial Accounts(100 mil. yen)	-123,113	-97,221	-34,301	8,947	5,578	31,005	-17,896	-5,277		
Gold & Foreign Exchange Reserves(\$1mil.)	1,042,715	1,116,025	1,116,025	1,137,809	1,200,593	1,218,501	1,200,593	1,209,882	1,304,763	
Exchange Rate(V\$)	92.80	85.69	82.32	81.70	77.84	77.22	76.84	76.77	77.54	

3. Financial Market Indicators

	Fiscal	Fiscal	2011			2011				
	2009	2010	1Q	2Q	3Q	AUG	SEP	OCT	NOV	DEC
Uncollateralized Overnight Call Rates	0.102	0.091	0.088	0.067	0.078	0.081	0.080	0.081	0.077	
			[0.098]	[0.093]	[0.093]	[0.095]	[0.091]	[0.091]	[0.091]	[0.087]
Euro Yen TIBOR (3 Months)	0.516	0.356	0.336	0.332	0.330	0.329	0.329	0.329	0.329	0.329
			[0.443]	[0.388]	[0.364]	[0.363]	[0.355]	[0.336]	[0.335]	[0.335]
Newly Issued Japanese Government Bonds Yields (10 Years)	1.353	1.127	1.242	1.160	1.043	1.030	1.020	1.045	1.065	
			[1.337]	[1.208]	[0.987]	[0.975]	[0.930]	[0.920]	[1.185]	[1.110]
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.449	1.357	1.357	1.349	1.315	1.337	1.315	1.317	1.313	
			(-0.025)	(-0.008)	(-0.034)	(-0.001)	(-0.022)	(0.002)	(-0.004)	
The Nikkei Stock Average (TSE 225 Issues)	11,090	9,755	9,755	9,816	8,700	8,955	8,700	8,988	8,435	8,455
			[11,090]	[9,383]	[9,369]	[8,824]	[9,369]	[9,202]	[9,937]	[10,229]
M2(Average)	(2.9)	(2.7)	(2.4)	(2.8)	(2.8)	(2.7)	(2.7)	(2.8)	(3.0)	
Broadly-defined Liquidity(Average)	(0.5)	(0.6)	(-0.3)	(-0.0)	(0.5)	(0.4)	(0.3)	(0.1)	(0.2)	
Principal Figures of Financial Institutions										
Loans and Discount (Average)	Banks & Shinkin	(0.8)	(-1.9)	(-1.8)	(-0.8)	(-0.5)	(-0.5)	(-0.3)	(-0.0)	(0.2)
	Banks	(0.8)	(-2.0)	(-1.9)	(-0.8)	(-0.5)	(-0.5)	(-0.3)	(0.1)	(0.2)
	City Banks etc.	(-0.4)	(-4.2)	(-4.6)	(-2.8)	(-2.6)	(-2.6)	(-2.3)	(-1.6)	(-1.3)
	Regional Banks	(2.4)	(0.6)	(1.2)	(1.5)	(1.9)	(1.8)	(1.9)	(2.0)	(2.1)
	Regional Banks II	(1.3)	(-0.4)	(-0.0)	(0.9)	(1.2)	(1.2)	(1.2)	(1.2)	(1.1)
	Shinkin	(0.8)	(-1.3)	(-1.1)	(-0.7)	(-0.5)	(-0.5)	(-0.4)	(-0.4)	(-0.2)
Deposits and CDs (Average)	Total(3 Business Condition)	(2.9)	(2.6)	(2.2)	(2.7)	(2.3)	(2.1)	(2.3)	(2.5)	(3.0)
	City Banks	(3.0)	(2.6)	(1.8)	(2.3)	(1.0)	(0.6)	(0.9)	(1.2)	(2.2)
	Regional Banks	(3.1)	(3.1)	(3.1)	(3.4)	(3.9)	(3.8)	(4.0)	(4.1)	(4.0)
	Regional Banks II	(1.8)	(0.6)	(0.9)	(2.0)	(2.8)	(2.7)	(2.9)	(3.2)	(3.1)

(Notes)

Interest rates are averages. The Nikkei Stock Average is as of month-end.

Unless otherwise indicated, tabulated figures and those in parentheses show % changes from previous quarter/month as applicable.

The figures in () indicate % changes from previous year.

[] show the comparable figure of the previous year.

(Sources) Cabinet Office, National Accounts, Machinery Orders; METI, Indices of Tertiary Industry Activity, Industrial Production, Current Survey of Commerce; MOF, Trade Statistics, Balance of Payments; MPMHAPT, Consumer Price Index, Family Income and Expenditure Survey, Labour Force Survey; MHLW, Monthly Labour Survey; Ministry of Land, Infrastructure, and Transport, Economic Construction Statistics; BOJ, Corporate Price Index, Financial and Economic Statistics Monthly, etc.