

Japan Economic Monthly

Tug-of-War between Driving Forces and Downward Pressures Wages On

Economic Research Office

The Bank of Tokyo-Mitsubishi UFJ, Ltd.

1. The Real Economy

As Japan's economic tug-of-war between driving forces and downward pressures wages on, the former appears to have taken the upper hand of late. According to the Bank of Japan's most recent Tankan survey (the March survey; responses collected between February 23 and March 30), the Business Conditions DI for companies of all sizes and across all industries rose by 1ppt from the previous survey in December (Table 1). The DI for non-manufacturers rose for the third straight quarter, by 2ppt from December to -5ppt, the highest level since the collapse of Lehman Brothers. Business sentiment for the construction industry in particular improved among companies of all sizes, boosted by reconstruction demand following the earthquake in March 2011. The Business Conditions DI for the industry reflected a steady increase from December: +1ppt up for large companies, +3ppt up for medium-sized companies, and +4ppt up for small companies.

On the other hand, although manufacturer business sentiment continues to deteriorate, sentiment among processing industries like electrical machinery and motor vehicles companies is improving. The Business Conditions DI for processing industries rose by 2ppt from December among large companies and was unchanged among companies of all sizes; the DI for large electrical machinery companies rose by 4ppt and by 8ppt for motor vehicles companies. This suggests that downward pressures from the global economy slowing and the JPY's appreciation appear to be easing temporarily. Meanwhile, new concerns have emerged. One such concern is higher crude oil prices, and the Business Conditions DI dropped by a sizeable 5ppt from the December survey for basic materials companies, both large and of all sizes. The DI for large chemicals companies dropped by 8ppt and by 7ppt for large iron and steel enterprises. According to a Cabinet Office estimate, the 20% climb in oil prices over the past half year has the same downward pressure as a three percent decrease in global demand or a 10% appreciation in the JPY against the USD (Figure 1).

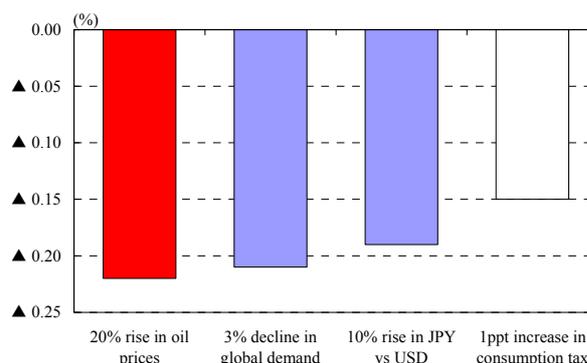
On top of further changes in the global economy and exchange rates, electric power shortages this summer will be downward pressures jeopardizing our Main Scenario that the economy will gain speed as driving forces—reconstruction and restoration activities—get fully underway. These risk factors warrant continued close attention.

Table 1: BoJ Tankan – Business Conditions DI

	(Diffusion index of "Favorable" minus "Unfavorable," % points)				
	Mar. 2011 Survey	Jun. 2011 Survey	Sept. 2011 Survey	Dec. 2011 Survey	March 2012 Survey
All Industry	▲ 9	▲ 18	▲ 9	▲ 7	▲ 6 ○
Manufacturing	▲ 4	▲ 15	▲ 5	▲ 5	▲ 7 ×
Processing	▲ 3	▲ 16	▲ 3	▲ 5	▲ 5 →
Electrical machinery (Large Enterprises)	1	▲ 16	▲ 5	▲ 21	▲ 17 ○
Motor vehicles (Large Enterprises)	23	▲ 52	13	20	28 ○
Basic materials	▲ 5	▲ 15	▲ 9	▲ 7	▲ 12 ×
Motor vehicles (Large Enterprises)	14	2	1	▲ 6	▲ 14 ×
Iron & Steel (Large Enterprises)	▲ 22	▲ 21	▲ 16	▲ 10	▲ 17 ×
Nonmanufacturing	▲ 11	▲ 20	▲ 12	▲ 7	▲ 5 ○
Construction	▲ 23	▲ 26	▲ 21	▲ 17	▲ 14 ○
Large Enterprises	▲ 16	▲ 15	▲ 11	▲ 8	▲ 7 ○
Medium-sized Enterprises	▲ 24	▲ 20	▲ 16	▲ 16	▲ 13 ○
Small Enterprises	▲ 23	▲ 29	▲ 24	▲ 19	▲ 15 ○

Note: ○ indicates improvement from December survey; X indicates worsening; → indicates no change.
Source: Compiled by BTMU Economic Research Office from BoJ data.

Figure 1: Impact of Economic Events on Real GDP



Note: Rates of deviation from standard case in the first year. Estimates based on the ESRI Short-Run Macroeconometric Model of the Japanese Economy (2011 version).
Source: Compiled by BTMU Economic Research Office from Cabinet Office material.

2. Financial Markets

(1) Monetary Policy, Long-Term Yields & Stock Prices

Risk-averse behavior has emerged again in the financial markets since the latter half of March. The yield on newly-issued 10Yr JGBs started to fall after hitting a peak of 1.06% on March 15 and has been below 1% since (Figure 2). The Nikkei Stock Average has also been around JPY9,500, approximately JPY700 below the March peak. There has been a change in the air of optimism in financial markets. This is attributed to difficulty in shrinking the Spanish fiscal deficit triggering renewed caution about the European debt problems, while the pace of improvement in US employment conditions has slowed and the Chinese economy's growth has decelerated.

The BoJ voted to leave monetary policy unchanged at its April 9-10 monetary policy meeting. Some market participants had expected additional monetary easing, and the decision caused stock prices to fall. However, the Monetary Policy Committee is scheduled to meet again this month on April 27, when the BoJ will release *The Outlook Report* featuring the central bank's projections for the economy and prices through 2013. The BoJ may, after reviewing its outlook, determine that stronger monetary policy support is needed to achieve its medium- to long-term price stability goal and decide to implement additional monetary easing.

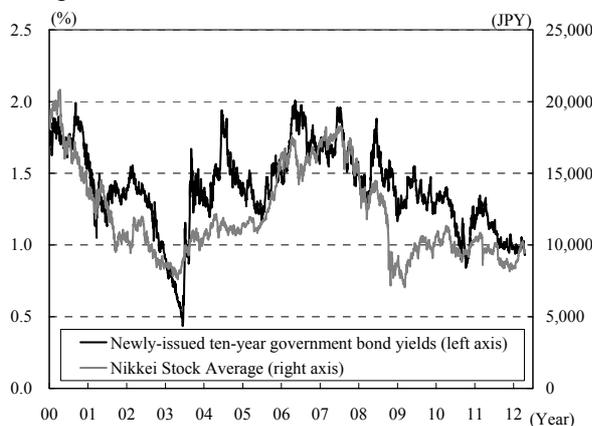
(2) Exchange Rates

Optimism has receded in the foreign exchange market and the JPY has bounced back. Since late March, the USD has fallen from the USD/JPY84 level to around USD/JPY81, while the EUR has dropped from the EUR/JPY111 level to EUR/JPY106~107.

According to the March Tankan survey, large manufacturers predict an exchange rate of USD/JPY78.14 for FY12 (USD/JPY78.04 for H1 and USD/JPY78.24 for H2, Figure 3). This

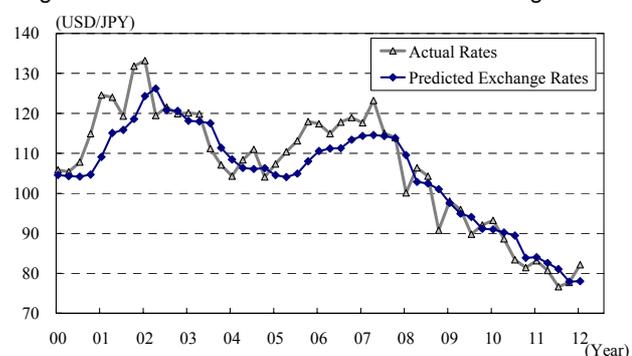
reflects a stronger JPY than recent levels, so corporate profits are likely to be revised up if the JPY avoids further appreciation. However, because of persisting potential JPY-lifting factors like the European debt problems and speculation of additional monetary easing in the US, expectations should not be high.

Figure 2: 10Yr JGB Yields and Stock Prices



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

Figure 3: USD/JPY Actual and Predicted Exchange Rates



Note: 1. Predicted Exchange Rates expected by large manufacturing enterprises. Mar and Jun figures are H1; Sept and Dec figures are H2.
2. Actual rates as of end of each quarter.

Source: Compiled by BTMU Economic Research Office from BoJ data and Bloomberg.

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MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Apr. 26, 2012

	Fiscal 2009	Fiscal 2010	2011			2011		2012		
			2Q	3Q	4Q	NOV	DEC	JAN	FEB	MAR
Real GDP Growth Rate <% changes from previous period at SA annual rate>	-2.1	3.1	-1.2 (-1.7)	7.1 (-0.4)	-0.7 (-0.6)	***	***	***	***	***
Index of All Industries Activity	-4.2	2.0	-0.4 (-1.7)	2.0 (-0.4)	0.1 (-0.4)	-1.0 (-1.1)	1.6 (-0.2)	-1.0 (-0.1)		
Industrial Production Index	-8.8	9.3	-4.2 (-5.8)	5.4 (-0.9)	0.4 (-1.6)	-1.7 (-2.9)	2.3 (-3.0)	0.9 (-1.6)	-1.6 (1.5)	
Production										
Shipments	-8.3	9.4	-5.5 (-8.3)	7.0 (-1.6)	0.3 (-2.2)	-1.9 (-4.1)	3.3 (-2.4)	-1.1 (-1.5)	0.3 (1.5)	
Inventory	-6.1	3.9	3.1 (4.6)	1.8 (6.0)	-1.4 (3.8)	-0.5 (8.6)	-1.7 (3.8)	2.1 (2.5)	-0.5 (1.0)	
Inventory/Shipments Ratio (2005=100)	120.4	108.2	121.1 [106.5]	116.5 [108.7]	115.0 [111.0]	115.6 [108.0]	112.7 [108.0]	113.5 [108.4]	110.4 [105.9]	[108.8]
Domestic Corporate Goods Price Index	-5.2	0.7	1.2 (2.5)	-0.1 (2.6)	-0.9 (1.5)	0.0 (1.6)	-0.1 (1.1)	0.0 (0.5)	0.2 (0.6)	0.6 (0.6)
Consumer Price Index(SA, total, excl.fresh foods)	-1.6	-0.8	0.5 (-0.3)	-0.1 (0.2)	-0.2 (-0.1)	0.0 (-0.2)	0.0 (-0.1)	0.1 (-0.1)	0.2 (0.2)	
Index of Capacity Utilization (2005=100)	80.0	88.0	79.8 [89.8]	87.5 [88.4]	89.3 [88.4]	88.1 [88.2]	89.9 [90.2]	92.8 [91.4]	91.2 [93.3]	[73.1]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	-20.4	9.1	2.5 (9.8)	1.5 (5.8)	-2.6 (6.7)	14.8 (12.5)	-7.1 (6.3)	3.4 (5.7)	4.8 (8.9)	
Manufacturing	-27.9	18.3	-0.2 (17.2)	2.5 (4.4)	-2.8 (4.1)	4.7 (7.1)	-7.1 (3.0)	-1.8 (-0.6)	16.0 (6.7)	
Non-manufacturing Excl.Electric Power & Ship building	-14.7	2.7	5.0 (4.2)	5.0 (7.2)	-2.3 (8.6)	6.2 (16.0)	-6.0 (9.0)	2.3 (11.7)	2.3 (10.8)	
Shipments of Capital Goods (Excl.Transport Equipment)	-24.2	21.4	3.4 (9.0)	1.4 (4.0)	1.2 (2.1)	0.6 (2.6)	1.9 (2.4)	-3.5 (2.2)	-0.8 (6.4)	
Construction Orders	-14.2	-5.2	(18.0)	(-0.6)	(13.1)	(21.0)	(1.5)	(24.6)	(-1.8)	
Private	-15.3	-2.6	(20.1)	(-2.1)	(9.7)	(18.0)	(5.8)	(22.6)	(-7.1)	
Public	-11.1	-12.1	(15.1)	(21.7)	(19.6)	(-10.7)	(-0.6)	(39.0)	(18.6)	
Public Works Contracts	4.9	-8.8	(-9.3)	(-3.4)	(3.6)	(6.8)	(0.6)	(8.5)	(16.8)	(8.0)
Housing Starts 10,000 units at Annual Rate, SA	77.5 (-25.4)	81.8 (5.6)	82.4 (4.1)	88.3 (7.9)	79.6 (-4.5)	82.4 (-0.3)	78.3 (-7.3)	82.2 (-1.1)	91.7 (7.5)	
Total floor	(-21.5)	(9.0)	(3.8)	(8.6)	(-4.4)	(-0.1)	(-7.3)	(-2.7)	(6.8)	
Sales at Retailers	-0.4	0.8	(-1.7)	(-1.0)	(0.8)	(-2.2)	(2.5)	(1.8)	(3.4)	
Real Consumption Expenditures of Households over 2 persons (SA)	1.0	-0.9	0.1 (-2.1)	0.4 (-2.8)	0.4 (-1.0)	-0.4 (-3.2)	-0.1 (0.5)	-0.1 (-2.3)	1.8 (2.3)	
Propensity to Consume (SA,%)	74.7	73.4	74.0 [72.3]	73.1 [75.2]	74.2 [74.0]	74.1 [75.7]	74.5 [74.3]	73.7 [75.9]	72.3 [72.3]	[72.4]
Overtime Hours Worked (All Industries, 5 employees or more)	-7.8	7.9	-2.2 (-1.0)	1.6 (0.3)	1.4 (1.9)	0.0 (1.0)	1.8 (2.8)	-1.2 (0.6)	1.0 (0.6)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	3.4	0.5	(-0.6)	(-0.4)	(-0.1)	(-0.2)	(0.0)	(-1.2)	(0.1)	
Employment Index(Regular Employees Only; All Industries, 5 employees or more) (Change over the M/Q/Y)	-77,894	23,384	28,033 10,188	27,711 21,464	25,350 28,038	28,986 28,971	25,572 27,087	128,676 32,797	126,431 32,772	35,975
Ratio of Job Offers to Applicants (SA,Times)	0.45	0.56	0.62 [0.50]	0.66 [0.54]	0.69 [0.57]	0.69 [0.57]	0.71 [0.58]	0.73 [0.60]	0.75 [0.61]	[0.62]
Unemployment Rate (SA,%)	5.2	5.0	4.7 [5.1]	4.4 [5.0]	4.4 [5.0]	4.5 [5.0]	4.5 [4.8]	4.6 [4.9]	4.5 [4.7]	[4.7]
Economy Watcher Survey (Judgment of the present condition D.I,%)	39.9	44.2	38.0 [48.3]	48.4 [45.4]	46.0 [43.0]	45.0 [43.6]	47.0 [45.1]	44.1 [44.3]	45.9 [48.4]	51.8 [27.70]
Bankruptcies (Number of cases)	14,732 (-8.7)	13,065 (-11.3)	3,312 (-0.3)	3,108 (-3.8)	3,103 (-5.9)	1,095 (3.2)	1,032 (-6.3)	985 (-5.3)	1,038 (5.1)	1,161 (-1.8)

(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 2Q to 3Q 2011.

2. Balance of Payments

As of Apr. 26, 2012

	Fiscal	Fiscal	2011			2011		2012		
	2009	2010	2Q	3Q	4Q	NOV	DEC	JAN	FEB	MAR
Customs Clearance(Exports in Yen Terms)	-17.1	14.9	(-8.1)	(0.5)	(-5.5)	(-4.5)	(-8.0)	(-9.2)	(-2.7)	(5.9)
Value	-7.0	0.1	(0.0)	(1.6)	(-0.5)	(-0.1)	(-1.5)	(1.0)	(1.2)	(2.1)
Volumes	-9.9	14.7	(-8.1)	(-1.1)	(-5.0)	(-4.4)	(-6.6)	(-10.1)	(-3.8)	(3.8)
Imports(In Yen terms)	-25.2	16.0	(10.5)	(13.8)	(12.4)	(11.5)	(8.2)	(9.6)	(9.3)	(10.6)
Value	-18.4	3.4	(7.4)	(12.1)	(10.9)	(12.5)	(8.9)	(6.3)	(5.8)	(7.2)
Volumes	-7.3	12.4	(2.8)	(1.5)	(1.3)	(-1.0)	(-0.7)	(3.1)	(3.2)	(3.1)
Current Balance(100 mil. yen)	163,383	166,595	15,372	31,007	9,257	1,261	2,657	-4,373	11,778	
Trade Balance(100 mil. yen)	65,996	64,955	-10,534	-1,762	▲ 9,446	-5,889	-1,468	-13,816	1,021	
Services(100 mil. yen)	-18,185	-12,730	-5,040	-5,146	-6,658	-1,262	-1,981	-930	-1,304	
Capital and Financial Accounts(100 mil. yen)	-123,113	-97,221	8,947	4,590	83,422	77,436	10,171	901	-6,806	
Gold & Foreign Exchange Reserves(\$1mil.)	1,042,715	1,116,025	1,137,809	1,200,593	1,295,841	1,304,763	1,295,841	1,306,668	1,302,877	1,288,703
Exchange Rate(¥/\$)	92.80	85.69	81.70	77.84	77.39	77.54	77.85	76.97	78.45	82.43

3. Financial Market Indicators

	Fiscal	Fiscal	2011			2011		2012			
	2009	2010	2Q	3Q	4Q	NOV	DEC	JAN	FEB	MAR	
Uncollateralized Overnight Call Rates	0.102	0.091	0.067 [0.093]	0.078 [0.093]	0.079 [0.090]	0.077 [0.091]	0.078 [0.087]	0.080 [0.085]	0.085 [0.093]	0.084 [0.085]	
Euro Yen TIBOR (3 Months)	0.516	0.356	0.332 [0.388]	0.330 [0.364]	0.329 [0.336]	0.329 [0.335]	0.329 [0.335]	0.331 [0.335]	0.332 [0.335]	0.332 [0.336]	
Newly Issued Japanese Government Bonds Yields (10 Years)	1.353	1.127	1.160 [1.208]	1.043 [0.987]	1.030 [1.072]	1.065 [1.185]	0.980 [1.110]	0.965 [1.215]	0.955 [1.255]	0.985 [1.255]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.449	1.357	1.349 (-0.008)	1.315 (-0.034)	1.292 (-0.023)	1.313 (-0.004)	1.292 (-0.021)	1.294 (0.002)	1.280 (-0.014)		
The Nikkei Stock Average (TSE 225 Issues)	11,090	9,755	9,816 [9,383]	8,700 [9,369]	8,455 [10,229]	8,435 [9,937]	8,455 [10,229]	8,803 [10,238]	9,723 [10,624]	10,084 [9,755]	
M2(Average)	(2.9)	(2.7)	(2.8)	(2.8)	(3.0)	(3.0)	(3.2)	(3.1)	(2.9)	(3.0)	
Broadly-defined Liquidity(Average)	(0.5)	(0.6)	(-0.0)	(0.5)	(0.3)	(0.3)	(0.4)	(0.4)	(0.5)	(0.7)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin		(0.8)	(-1.9)	(-0.8)	(-0.5)	(0.2)	(0.2)	(0.4)	(0.6)	(0.8)
	Banks		(0.8)	(-2.0)	(-0.8)	(-0.5)	(0.3)	(0.2)	(0.5)	(0.7)	(0.9)
	City Banks etc.		(-0.4)	(-4.2)	(-2.8)	(-2.6)	(-1.3)	(-1.4)	(-1.0)	(-0.6)	(-0.2)
	Regional Banks		(2.4)	(0.6)	(1.5)	(1.9)	(2.1)	(2.1)	(2.2)	(2.3)	(2.3)
	Regional Banks II		(1.3)	(-0.4)	(0.9)	(1.2)	(1.2)	(1.1)	(1.2)	(1.2)	(1.1)
Deposits and CDs (Average)	Shinkin		(0.8)	(-1.3)	(-0.7)	(-0.5)	(-0.4)	(-0.4)	(-0.5)	(-0.5)	(-0.3)
	Total(3 Business Condition)		(2.9)	(2.6)	(2.7)	(2.3)	(3.0)	(3.0)	(3.3)	(3.3)	(2.9)
	City Banks		(3.0)	(2.6)	(2.3)	(1.0)	(2.1)	(2.2)	(3.0)	(2.9)	(1.4)
	Regional Banks		(3.1)	(3.1)	(3.4)	(3.9)	(4.0)	(4.0)	(3.8)	(3.8)	(3.6)
Regional Banks II		(1.8)	(0.6)	(2.0)	(2.8)	(3.1)	(3.1)	(3.1)	(3.3)	(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.

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