

Manufacturers' Domestic Capital Expenditures Continue to Improve

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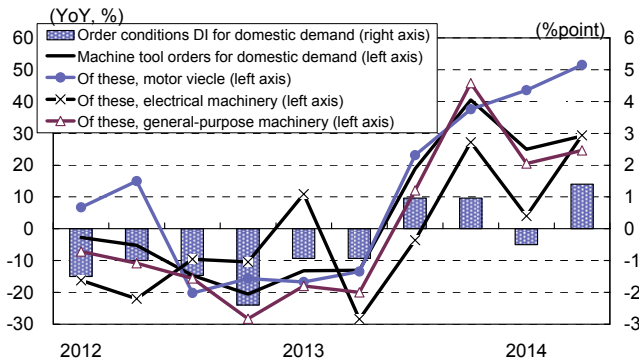
1. The Real Economy

Domestic capital expenditures among manufacturers are showing signs of continued improvement. Machine tool orders for domestic demand—tightly linked to manufacturer capital expenditures—jumped +29.1% YoY in Apr-Jun, the fourth straight quarter of expansion (Figure 1). A survey among machine tool builders also showed that the ratio of respondents anticipating an increase in domestic orders has been growing. BoJ's Tankan released in July indicated that manufacturers of all scales plan to increase capital expenditures (including land purchasing expenses and excluding software investment) by +10.1% YoY in FY2014, a +6.1%pt rise from the March survey.

The capital expenditures recovery among manufacturing appears to be largely due to demand of capital expenditures that had been put off, or pent-up demand. Manufacturers had been cutting back on capital expenditures since the collapse of Lehman Brothers in 2008, and as a result, equipment has been aging. Approximately 60% of production equipment is at least 10 years old. Production efficiency has consequently been impacted by failure frequency. Further, amidst a growing sense of a labor shortage, capital expenditures appear to be increasingly necessary in order to rationalize and improve efficiencies. As such, improving corporate profits due to the weaker JPY as well as policy supports like investment tax credits seem to be stoking more companies to make capital expenditures.

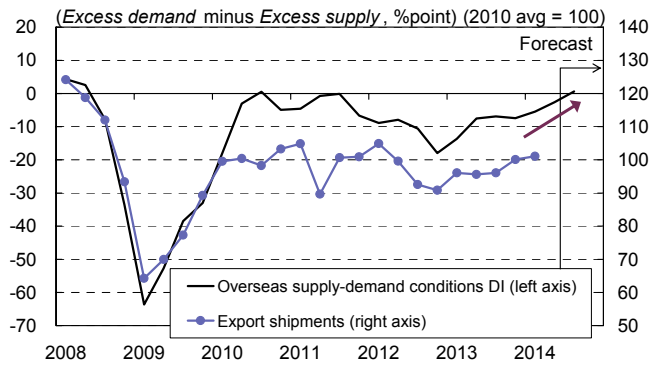
Export growth as overseas economies improve is expected to support capital expenditures among manufacturers going forward. The BoJ's Tankan reported that the overseas supply-demand conditions DI among exporting industries (transport machinery, general-purpose/production/business oriented machinery, and electrical machinery combined) was expected to reflect an excess of demand for the first time in four years in Jul-Sept, pointing to expanding production for forward exports (Figure 2). The aforementioned machine tool orders also portend rising orders among such exporting industries, and manufacturing capital expenditures are forecasted to continue to expand.

Figure 1: Machine Tool Orders and Order Conditions DI for Domestic Demand



Note: Order conditions DI for domestic demand is Rising responses minus Declining responses.
Source: Compiled by BTMU Economic Research Office from Japan Machine Tools Builders' Association data.

Figure 2: Overseas Supply-Demand Conditions DI and Export Shipments among Exporting Industries



Note: Export industries is total of transport machinery, general-purpose/production/business oriented machinery, and electrical machinery. Overseas supply-demand conditions DI is among large enterprises.
Source: Compiled by BTMU Economic Research Office from BoJ, METI data.

2. Monetary Policy and Financial Markets

(1) MONETARY POLICY & LONG-TERM YIELDS

The BoJ agreed to hold current monetary policy intact at its July 14-15 Monetary Policy Meeting. At the same meeting, the BoJ also conducted an interim assessment of the outlook for Economic Activity and Prices, maintaining its view that the growth rate of consumer prices index will rise by the targeted 2% rate by the midpoint of the forecast period through FY2016.

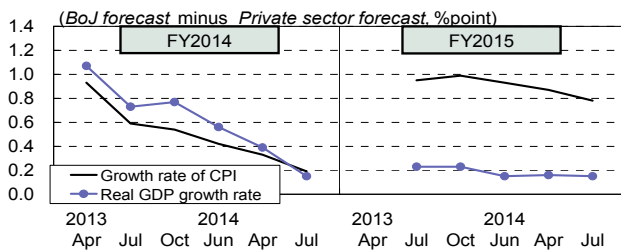
The BoJ's consumer prices index forecast is fairly bullish compared to private sector forecasts. The disparity between private sector and BoJ real GDP growth forecasts has shrunk this fiscal year as private sector real GDP growth forecasts have been revised upward, and this has also aligned their consumer prices index forecasts more (Figure 3). On the other hand, the real GDP growth forecasts for FY2015 differ by no more than 0.2%pt, so as the supply-demand gap improves more than the private sector has forecasted, the private sector and BoJ's consumer prices index forecasts are unlikely to converge like this year. The BoJ's consumer prices index forecast has been 0.8%pt higher than the private sector's, and the expected inflation rate—another factor impacting the growth rate of consumer prices index—would have to rise significantly in order for the forecast to be achieved.

The long-term yield has been low in the 0.5% range recently due to growing speculation among the market that the BoJ will extend monetary easing.

(2) EXCHANGE RATES

USD/JPY is expected to remain in a narrow range around the USD/JPY102 mark as geopolitical risks heighten and JPY-buying pressures build. However, the JPY-weakening/USD-strengthening momentum has not been lost. The US-Japan monetary base ratio (Japan ÷ US)—which has been tightly correlated to USD/JPY since the collapse of Lehman Brothers—has been rising as the BoJ has maintained large-scale monetary easing while the FRB has embarked on an orderly tapering of asset purchases (Figure 4). The disparity in the scales of monetary easing in Japan and the US is clear. Further, the US-Japan 2Yr yield spread (US – Japan) has been gradually expanding as US yields rise. Although any risk-averse JPY buying bears watching, JPY weakening/USD strengthening pressures will likely persist as the exchange rate remains deadlocked.

Figure 3: Disparities between BoJ and Private Sector Forecasts

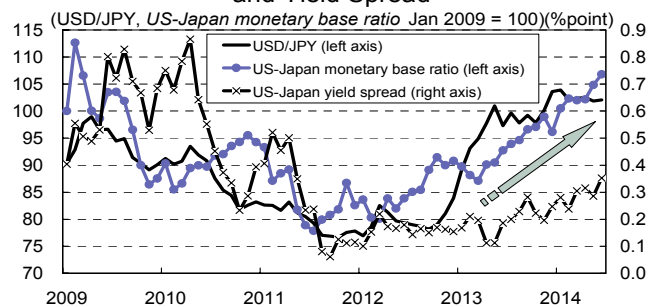


Notes: 1) *BoJ forecast* is median forecast of Monetary Policy meeting members; *Private sector forecast* is average of forecasts by private institutions surveyed (approximately 40) in ESP Forecast Survey.

2) *The growth rate of CPI* is total excluding fresh foods and direct impact of consumption tax hike.

Source: Compiled by BTMU Economic Research Office from BoJ, Japan Center for Economic Research materials.

Figure 4: USD/JPY, US-Japan Monetary Base Ratio, and Yield Spread



Notes: 1) *US-Japan monetary base ratio* is Japan monetary base divided by US monetary base. Index using Jan 2009 base date = 100.
2) *US-Japan yield spread* is the 2Yr US Treasury yield minus the 2Yr Japan JGB yield.

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

MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Aug. 13, 2014

	Fiscal 2012	Fiscal 2013	2013	2014		2014				
			4Q	1Q	2Q	MAR	APR	MAY	JUN	JUL
Real GDP Growth Rate <% changes from previous period at SA annual rate>	0.7	2.3	-0.2 (2.5)	6.1 (3.0)	-6.8 (-0.1)	***	***	***	***	***
Index of All Industries Activity	0.1	1.9	0.3 (1.9)	1.6 (3.2)		1.7 (3.8)	-4.6 (-1.2)	0.6 (-1.6)		
Industrial Production Index	-2.9	3.2	1.8 (5.8)	2.9 (8.2)	-3.8 (2.7)	0.7 (7.4)	-2.8 (3.8)	0.7 (1.0)	-3.4 (3.1)	
Production										
Shipments	-1.8	2.9	2.6 (6.5)	4.6 (7.4)	-6.8 (1.3)	-0.2 (6.5)	-5.0 (2.4)	-1.0 (-0.8)	-1.9 (2.2)	
Inventory	-3.0	-1.4	-1.9 (-4.3)	0.2 (-1.4)	4.6 (2.8)	1.4 (-1.4)	-0.5 (-1.9)	3.0 (0.8)	2.0 (2.8)	
Inventory/Shipments Ratio (2010=100)	114.4	106.2	104.6 [117.7]	102.6 [113.4]	107.7 [108.3]	105.4 [112.9]	103.7 [108.2]	107.8 [106.3]	111.5 [110.3]	[109.2]
Domestic Corporate Goods Price Index	-1.1	1.9	0.2 (2.5)	0.2 (1.9)	3.2 (4.4)	0.0 (1.7)	2.9 (4.2)	0.3 (4.4)	0.2 (4.6)	0.3 (4.3)
Consumer Price Index(SA, total, excl.fresh foods)	-0.2	0.8	0.3 (1.1)	-0.1 (1.3)	2.7 (3.3)	-0.1 (1.3)	2.1 (3.2)	0.3 (3.4)	0.2 (3.3)	
Index of Capacity Utilization (2010=100)	95.4	100.0	100.2 [93.1]	106.0 [95.1]	101.4 [96.3]	105.3 [95.4]	103.0 [96.0]	102.3 [97.0]	98.9 [96.0]	[97.8]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	-3.0	11.5	1.9 (13.3)	4.2 (16.4)		19.1 (16.1)	-9.1 (17.6)	-19.5 (-14.3)		
Manufacturing	-10.1	10.2	2.0 (14.8)	3.9 (22.1)		23.7 (29.5)	-9.4 (19.3)	-18.6 (-3.8)		
Non-manufacturing Excl.Electric Power & Ship building	2.8	12.1	4.9 (12.4)	-1.0 (11.8)		8.5 (6.6)	0.9 (16.7)	-17.8 (-19.9)		
Shipments of Capital Goods (Excl.Transport Equipment)	-6.0	5.6	4.8 (10.8)	10.8 (16.8)	-8.0 (8.1)	2.2 (14.9)	-6.9 (9.1)	-1.5 (5.1)	-0.1 (10.0)	
Construction Orders	2.4	20.1								
Private	2.6	14.2								
Public	5.3	31.2								
Public Works Contracts	10.3	17.7								
Housing Starts 10,000 units at Annual Rate, SA	89.3 (6.2)	98.7 (10.6)	102.6 (12.9)	93.9 (3.4)	88.8 (-9.3)	89.5 (-2.9)	90.6 (-3.3)	87.2 (-15.0)	88.3 (-9.5)	
Total floor	(4.8)	(9.9)	(13.8)	(0.5)	(-13.4)	(-6.2)	(-6.9)	(-19.4)	(-13.6)	
Sales at Retailers	0.3	2.9								
Real Consumption Expenditures of Households over 2 persons (SA)	1.6	0.9	-0.2 (0.6)	4.6 (2.3)	-9.0 (-5.2)	10.8 (7.2)	-13.3 (-4.6)	-3.1 (-8.0)	1.5 (-3.0)	
Propensity to Consume (SA,%)	74.8	75.5	74.6 [74.5]	78.8 [76.2]	73.8 [74.0]	85.1 [77.1]	74.2 [73.6]	70.3 [74.0]	74.8 [73.0]	[73.4]
Overtime Hours Worked (All Industries, 5 employees or more)	-0.3	4.4	1.6 (6.0)	2.1 (7.1)	0.2 (4.8)	2.3 (8.4)	-0.4 (6.4)	-0.5 (4.9)	-2.1 (2.9)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	-0.7	0.1	(0.4)	(0.1)	(0.5)	(0.7)	(0.7)	(0.6)	(0.4)	
Employment Index(Regular Employees Only;'All Industries, 5 employees or more) (Change over the M/Q/Y)	107	45	49	54	65	55	62	65	68	
Ratio of Job Offers to Applicants (SA,Times)	0.82	0.97	1.01 [0.82]	1.05 [0.85]	1.09 [0.90]	1.07 [0.87]	1.08 [0.88]	1.09 [0.90]	1.10 [0.92]	[0.94]
Unemployment Rate (SA,%)	4.3	5.0	3.9	3.6	3.6	3.6	3.6	3.5	3.7	
Economy Watcher Survey (Judgment of the present condition D.I.%)	46.3	54.0	53.7 [41.6]	55.2 [53.3]	44.8 [55.1]	57.9 [57.3]	41.6 [56.5]	45.1 [55.7]	47.7 [53.0]	51.3 [52.3]
Bankruptcies (Number of cases)	11,719 (-7.7)	10,536 (-10.0)	2,571 (-11.0)	2,460 (-11.4)	2,613 (-8.0)	814 (-12.3)	914 (1.6)	834 (-20.1)	865 (-3.5)	882 (-13.9)

(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.

2. Balance of Payments

As of Aug. 13, 2014

	Fiscal	Fiscal	2013	2014		2014				
	2012	2013	4Q	1Q	2Q	MAR	APR	MAY	JUN	JUL
Customs Clearance (Exports in Yen Terms)	-2.1	10.8	(17.4)	(6.6)	(0.1)	(1.8)	(5.1)	(-2.7)	(-1.9)	
Value	4.0	10.2	(12.5)	(6.0)	(1.1)	(4.4)	(3.0)	(0.7)	(-0.3)	
Volumes	-5.8	0.6	(4.3)	(0.7)	(-1.0)	(-2.5)	(2.0)	(-3.4)	(-1.6)	
Imports (In Yen terms)	3.4	17.4	(24.1)	(17.6)	(2.6)	(18.2)	(3.4)	(-3.5)	(8.4)	
Value	2.5	14.6	(18.4)	(10.3)	(2.1)	(5.9)	(4.8)	(0.5)	(1.2)	
Volumes	1.0	2.3	(4.8)	(6.5)	(0.4)	(11.6)	(-1.3)	(-4.0)	(7.2)	
Current Account (100 mil. yen)	42,233	8,312	-14,311	-8,187	3,112	1,597	1,874	5,228	-3,991	
Goods (100 mil. yen)	-52,474	-109,709	-31,002	-41,190	-19,934	-11,554	-7,804	-6,759	-5,371	
Services (100 mil. yen)	-41,864	-34,522	-11,319	-6,194	-9,586	-554	-6,597	-682	-2,306	
Financial Account (100 mil. yen)	20,255	-23,521	-28,031	-13,285	3,543	1,180	-16,342	9,056	10,829	
Gold & Foreign Exchange Reserves (\$1mil.)	1,254,356	1,279,346	1,266,815	1,279,346	1,283,921	1,279,346	1,282,822	1,283,920	1,283,921	1,276,027
Exchange Rate (¥/\$)	83.08	100.23	100.45	102.78	102.13	102.27	102.56	101.79	102.05	101.72

3. Financial Market Indicators

	Fiscal	Fiscal	2013	2014		2014						
	2012	2013	4Q	1Q	2Q	MAR	APR	MAY	JUN	JUL		
Uncollateralized Overnight Call Rates	0.083	0.073	0.072 [0.084]	0.074 [0.083]	0.067 [0.073]	0.072 [0.078]	0.065 [0.072]	0.068 [0.073]	0.067 [0.074]	0.066 [0.073]		
Euro Yen TIBOR (3 Months)	0.312	0.223	0.220 [0.318]	0.215 [0.270]	0.211 [0.228]	0.212 [0.250]	0.212 [0.228]	0.210 [0.228]	0.210 [0.228]	0.210 [0.228]		
Newly Issued Japanese Government Bonds Yields (10 Years)	0.560	0.640	0.735 [0.795]	0.640 [0.560]	0.565 [0.855]	0.640 [0.560]	0.620 [0.600]	0.570 [0.860]	0.565 [0.855]	0.530 [0.795]		
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.184	1.077	1.102 (-0.023)	1.077 (-0.025)	1.067 (-0.010)	1.077 (-0.016)	1.078 (0.001)	1.077 (-0.001)	1.067 (-0.010)			
The Nikkei Stock Average (TSE 225 Issues)	12,398	14,828	16,291 [10,395]	14,828 [12,398]	15,162 [13,677]	14,828 [12,398]	14,304 [13,861]	14,632 [13,775]	15,162 [13,677]	15,621 [13,668]		
M2(Average)	(2.5)	(3.9)	(4.2)	(4.0)	(3.3)	(3.6)	(3.5)	(3.3)	(3.0)	(3.0)		
Broadly-defined Liquidity(Average)	(1.0)	(3.7)	(4.3)	(3.9)	(3.1)	(3.6)	(3.3)	(3.0)	(3.0)	(3.1)		
Principal Figures of Financial Institutions												
Loans and Discount (Average)	Banks & Shinkin		(0.9)	(2.0)	(2.2)	(2.2)	(2.2)	(2.1)	(2.0)	(2.2)	(2.3)	(2.2)
	Banks		(1.1)	(2.3)	(2.4)	(2.4)	(2.4)	(2.3)	(2.2)	(2.4)	(2.5)	(2.3)
	City Banks etc.		(-0.2)	(1.7)	(1.8)	(1.6)	(1.3)	(1.3)	(1.1)	(1.3)	(1.4)	(1.0)
	Regional Banks		(2.9)	(3.3)	(3.3)	(3.4)	(3.7)	(3.4)	(3.5)	(3.6)	(3.8)	(3.7)
	Regional Banks II		(0.8)	(1.4)	(2.0)	(2.4)	(2.5)	(2.4)	(2.5)	(2.5)	(2.6)	(2.8)
	Shinkin		(-0.7)	(0.3)	(0.5)	(0.9)	(1.2)	(0.9)	(1.1)	(1.2)	(1.3)	(1.5)
Deposits and CDs (Average)	Total(3 Business Condition)		(2.2)	(3.8)	(3.9)	(3.6)	(2.8)	(3.1)	(3.0)	(2.9)	(2.6)	(2.6)
	City Banks		(1.8)	(3.7)	(3.7)	(3.2)	(2.1)	(2.5)	(2.3)	(2.4)	(1.7)	(2.0)
	Regional Banks		(2.8)	(4.3)	(4.5)	(4.2)	(3.6)	(3.8)	(3.9)	(3.6)	(3.4)	(3.2)
	Regional Banks II		(1.8)	(2.5)	(3.2)	(3.1)	(3.0)	(3.0)	(3.0)	(3.0)	(3.1)	(3.3)

(Notes)

Newly Issued Japanese Government Bonds Yields and 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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