

## ***Companies Still Eager to Invest as Capital Stock Returns Improve***

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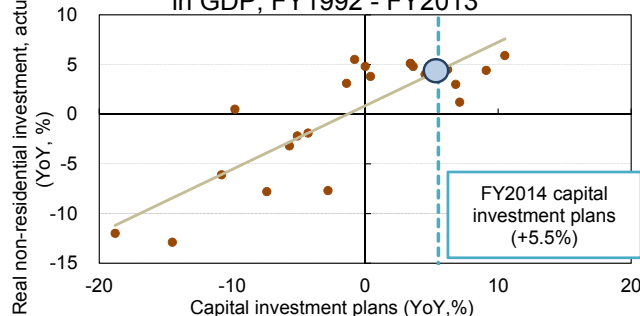
## 1. The Real Economy

The Cabinet Office's second preliminary GDP estimates released December 8, 2014 showed that real private non-residential investments fell for a second straight quarter in Jul-Sep, by an annualized -1.5% QoQ. The GDP results have raised concerns about capital investments going forward because many economists had forecasted that the figure was revised upward to on-quarter positive growth in the second preliminary estimates due to the results of Financial Statements Statistics of Corporations by Industry. However, companies are still eager to make capital investments. The Bank of Japan's December Tankan survey released December 15, 2014 showed that enterprises of all sizes and across all industries revised their capital investments plans for FY2014 by +5.5% YoY, a +1.2%pt upward revision from the September survey. The increase was especially marked among non-manufacturers. Capital investment plans in the BoJ's December Tankan survey are closely correlated to real private non-residential investments in GDP figure for that fiscal year (Figure 1). Thus, the +5.5% increase, the planned value reported in the BoJ's December survey, would correspond to a nearly 5% increase in real non-residential investments.

Companies appear to be increasingly eager to invest because of better returns on capital stock. Return on domestic real investment, or operating profit (considered to reflect profit from domestic business) divided by total non-financial assets (equivalent to domestic capital stock), has improved to approximately 6% even amidst the sluggish economic conditions following the consumption tax hike in April (Figure 2). Further, in addition to the improved profit, the sense of a capital stock excess has been diminishing of late. A virtuous cycle of improved corporate profits and increased capital investments is easy to function.

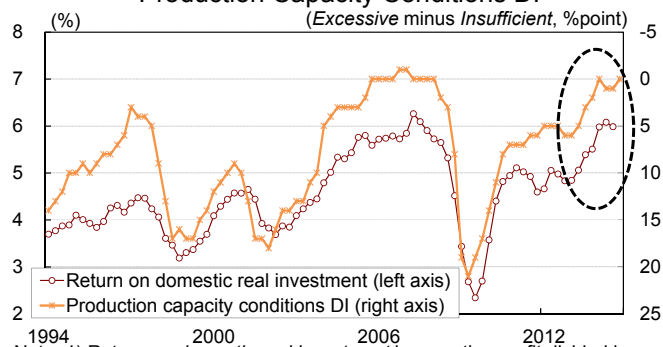
Sluggish capital investments in the first half of FY 2014 was likely partly due to a temporary reaction to demand brought forward ahead of the consumption tax hike as well as demand generated by expiring software support. The capital expenditures recovery is likely to become even clearer as companies steadily implement their investment plans maintaining a high level.

Figure 1: Capital Investment Plans from December Tankan Survey and Real Non-residential Investments in GDP, FY1992 - FY2013



Notes: *Capital investment plans* from December Tankan surveys and covering enterprises of all sizes and across all industries, including land investment but excluding software investment. *Real non-residential Investments* based on GDP data.  
Source: Compiled by BTMU Economic Research Office from BoJ, Cabinet Office data.

Figure 2: Return on Domestic Real Investment and Production Capacity Conditions DI



Note: 1) Return on *domestic real investment* is operating profit divided by total non-financial assets. All industries excluding financial and insurance industries.  
2) *Production capacity conditions DI* is for enterprises of all sizes and across all industries.  
Source: Compiled by BTMU Economic Research Office from MoF, BoJ data.

## 2. Monetary Policy and Financial Markets

### (1) MONETARY POLICY & LONG-TERM YIELDS

At its December 18-19 Monetary Policy Meeting, the Bank of Japan agreed to hold current monetary policy intact. Governor Haruhiko Kuroda, at the post-meeting press conference, spoke that the probability of achieving the Price Stability Target—its goal of 2% inflation—in or around FY 2015 is high. He pointed out that, although falling oil prices will weigh on inflation over the short term and inflation may not pick up in 1H 2015, lower oil prices will rather work to boost inflation over the longer term by stoking a virtuous cycle of economic activity.

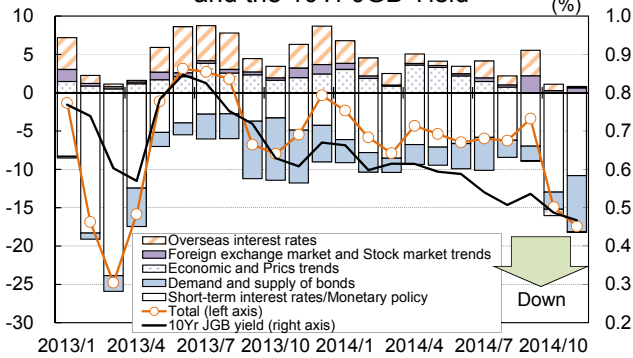
The 10Yr JGB yield has fallen further since the BoJ decided to increase monetary easing at its October 31 meeting. The 10Yr JGB yield dipped to 0.3% at one point, matching the record low set immediately after the BoJ introduced quantitative and qualitative monetary easing last April, one year and eight months ago. Because of the BoJ purchases huge amounts of JGBs, demand and supply of bonds are focused on by market participant for factors weighing on the yield as well as short-term interest rates and monetary policy (Figure 3). Moreover, yield-lifting pressures, including overseas interest rates in the US and elsewhere abroad, as well as the domestic economic and price trend, have been easing. The 10Yr JGB yield has been falling recently as these various factors overlap.

### (2) EXCHANGE RATES

The JPY has weakened further against the USD since the BoJ's additional quantitative easing, with USD/JPY hitting the USD/JPY121 mark in early December for the first time since July 2007. Thereafter, the JPY swung back and strengthened temporarily, but now trades at about USD/JPY120, or JPY10 weaker than before the BoJ amplified quantitative easing. The USD/JPY has passed purchasing power parity based on corporate prices (approximately JPY96) recently and is now nearing PPP based on consumer prices (approximately JPY129), which had marked the upper limit for USD/JPY in the past (Figure 4). Further, the JPY's real effective exchange rate—the weighted average using exchange rates with currencies of trading partner countries and adjusted for inflation—also shows that the JPY has weakened

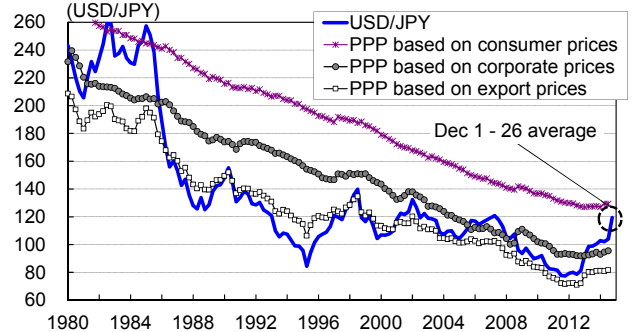
to the lowest point in November since Japan shifted to a floating exchange rate system in 1973. The JPY is expected to continue weakening, given the different directions of US and Japanese monetary policy. However, the possibility of a temporary reversal, a strengthening by the JPY in reaction to a sudden drop, bears watching.

Figure 3: Factors Affecting Bond Yields and the 10Yr JGB Yield (%)



Note: Determined by combining market participants' responses for *Feel most strongly could cause bond prices to fluctuate (response rate) and Impact (indexed) of change factor on yield.*  
 Source: Compiled by BTMU Economic Research Office from QUICK Monthly Market Survey (Bonds) and Bloomberg data.

Figure 4: Purchasing Power Parity and USD/JPY



Notes: 1) Purchasing power parity = Reference year rate (1973 average USD/JPY271.4) x (Japan inflation index/US inflation index).  
 2) Data for export prices are the averages of those based on corporate prices and those based on GDP deflator.  
 Source: Compiled by BTMU Economic Research Office from MIC, BoJ, Cabinet Office, US Department of Labor, US Department of Commerce, and Bloomberg data.

## MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

### 1. Main Economic Indicators

As of Feb. 2, 2015

	Fiscal 2012	Fiscal 2013	2014			2014				
			2Q	3Q	4Q	AUG	SEP	OCT	NOV	DEC
Real GDP Growth Rate <% changes from previous period at SA annual rate>	1.0	2.1	-6.7 (-0.3)	-1.9 (-1.3)		***	***	***	***	***
Index of All Industries Activity	0.1	1.9	-3.4 (-0.9)	-0.1 (-1.6)		-0.1 (-2.5)	1.3 (-0.7)	0.1 (-0.9)	0.1 (-1.9)	
Industrial Production Index	-2.9	3.2	-3.8 (2.7)	-1.9 (-1.0)	1.8 (-1.4)	-1.9 (-3.3)	2.9 (0.8)	0.4 (-0.8)	-0.5 (-3.7)	1.0 (0.3)
Production										
Shipments	-1.8	2.9	-6.8 (1.3)	-0.8 (-0.5)	2.2 (-1.5)	-2.1 (-3.7)	4.4 (1.7)	0.6 (-0.4)	-1.4 (-4.5)	1.1 (0.4)
Inventory	-3.0	-1.4	4.6 (2.8)	1.1 (4.0)	0.2 (6.1)	0.9 (4.6)	-0.7 (4.0)	-0.4 (3.8)	1.1 (6.5)	-0.4 (6.1)
Inventory/Shipments Ratio (2010=100)	114.4	106.2	107.7 [108.3]	113.0 [109.4]	113.8 [104.6]	118.5 [110.7]	111.4 [108.2]	112.3 [105.5]	117.0 [104.3]	112.2 [104.1]
Domestic Corporate Goods Price Index	-1.1	1.9	3.0 (4.3)	0.5 (4.0)	-1.2 (2.5)	-0.2 (3.9)	0.0 (3.6)	-0.8 (2.9)	-0.3 (2.9)	-0.4 (1.9)
Consumer Price Index(SA, total, excl.fresh foods)	-0.2	0.8	2.7 (3.3)	0.2 (3.2)	-0.1 (2.7)	-0.1 (3.1)	-0.1 (3.0)	0.0 (2.9)	0.0 (2.7)	0.0 (2.5)
Index of Capacity Utilization (2010=100)	95.4	100.0	101.4 [96.3]	98.1 [97.8]		96.4 [96.7]	99.9 [98.9]	100.6 [99.4]	99.8 [99.9]	
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	-3.0	11.5	-10.4 (-0.4)	5.6 (2.4)		4.7 (-3.3)	2.9 (7.3)	-6.4 (-4.9)	1.3 (-14.6)	
Manufacturing	-10.1	10.2	-8.5 (4.1)	12.6 (10.2)		-10.8 (2.5)	12.0 (13.4)	-5.5 (2.9)	-7.0 (-4.8)	
Non-manufacturing Excl.Electric Power & Ship building	2.8	12.1	-6.7 (-3.1)	-1.2 (-2.7)		10.7 (-7.0)	1.7 (3.5)	-7.5 (-10.2)	0.5 (-21.2)	
Shipments of Capital Goods (Excl.Transport Equipment)	-6.0	5.6	-8.0 (8.1)	0.1 (7.2)	3.7 (5.3)	-7.7 (2.0)	2.7 (7.9)	6.2 (6.2)	-2.8 (2.0)	1.2 (7.5)
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 Total floor	89.3 (6.2) (4.8)	98.7 (10.6) (9.9)	89.1 (-9.3) (-13.4)	86.8 (-13.6) (-17.9)	86.8 (-13.8) (-19.3)	85.5 (-12.5) (-16.9)	87.7 (-14.3) (-18.6)	88.6 (-12.3) (-17.6)	87.3 (-14.3) (-20.7)	88.3 (-14.7) (-19.5)
Sales at Retailers	0.3	2.9								
Real Consumption Expenditures of Households over 2 persons (SA)	1.6	0.9	-9.0 (-5.2)	-0.5 (-5.4)		-0.3 (-4.7)	1.5 (-5.6)	0.9 (-4.0)	0.4 (-2.5)	0.4 (-3.4)
Propensity to Consume (SA,%)	74.8	75.5	73.8 [74.0]	74.7 [74.8]		73.0 [74.3]	75.5 [75.6]	74.2 [75.3]	75.8 [74.9]	
Overtime Hours Worked (All Industries, 5 employees or more)	-0.3	4.4	0.6 (5.1)	-2.0 (2.2)		-1.4 (1.0)	1.5 (2.9)	0.0 (1.8)	-0.7 (0.0)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	-0.7	0.1								
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	107	45	65	76		77	75	73	74	
Ratio of Job Offers to Applicants (SA,Times)	0.82	0.97	1.09 [0.90]	1.10 [0.95]	1.12 [1.01]	1.10 [0.95]	1.09 [0.96]	1.10 [0.98]	1.12 [1.01]	1.15 [1.03]
Unemployment Rate (SA,%)	4.3	3.9	3.6	3.6	3.5	3.5	3.6	3.5	3.5	3.4
Economy Watcher Survey (Judgment of the present condition D.I,%)	46.3	54.0	44.8 [55.1]	48.7 [52.1]	43.6 [53.7]	47.4 [51.2]	47.4 [52.8]	44.0 [51.8]	41.5 [53.5]	45.2 [55.7]
Bankruptcies (Number of cases)	11,719 (-7.7)	10,536 (-10.0)	2,613 (-8.0)	2,436 (-8.5)	2,222 (-13.5)	727 (-11.2)	827 (0.8)	800 (-16.5)	736 (-14.6)	686 (-8.5)

(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 Feb. 2, 2015

	Fiscal	Fiscal	2014			2014				
	2012	2013	2Q	3Q	4Q	AUG	SEP	OCT	NOV	DEC
Customs Clearance (Exports in Yen Terms)	-2.1	10.8	(0.1)	(3.2)	(9.2)	(-1.3)	(6.9)	(9.6)	(4.9)	(12.8)
Value	4.0	10.2	(1.1)	(2.8)	(6.6)	(1.6)	(4.0)	(4.6)	(6.7)	(8.6)
Volumes	-5.8	0.6	(-1.0)	(0.3)	(2.4)	(-2.9)	(2.8)	(4.8)	(-1.7)	(3.9)
Imports (In Yen terms)	3.4	17.4	(2.7)	(2.4)	(1.2)	(-1.4)	(6.3)	(3.1)	(-1.6)	(1.9)
Value	2.5	14.6	(2.1)	(3.1)	(4.8)	(3.3)	(3.2)	(4.9)	(5.8)	(3.8)
Volumes	1.0	2.3	(0.5)	(-0.6)	(-3.5)	(-4.5)	(3.0)	(-1.7)	(-7.0)	(-1.8)
Current Account (100 mil. yen)	42,233	8,312	3,571	16,345		2,498	9,830	8,334	4,330	
Goods (100 mil. yen)	-52,474	-109,709	-20,230	-24,227		-8,520	-7,107	-7,666	-6,368	
Services (100 mil. yen)	-41,864	-34,522	-8,970	-9,198		-2,678	-1,995	-2,165	-1,063	
Financial Account (100 mil. yen)	20,255	-23,521	18,909	27,583		5,044	16,649	12,077	5,064	
Gold & Foreign Exchange Reserves (\$1mil.)	1,254,356	1,279,346	1,283,921	1,264,405	1,260,548	1,278,011	1,264,405	1,265,925	1,269,079	1,260,548
Exchange Rate (¥/\$)	83.08	100.23	102.13	103.92	114.56	102.96	107.09	108.06	116.22	119.40

## 3. Financial Market Indicators

	Fiscal	Fiscal	2014			2014					
	2012	2013	2Q	3Q	4Q	AUG	SEP	OCT	NOV	DEC	
Uncollateralized Overnight Call Rates	0.083	0.073	0.067 [0.073]	0.067 [0.073]	0.064 [0.072]	0.069 [0.073]	0.066 [0.072]	0.059 [0.070]	0.065 [0.073]	0.068 [0.074]	
Euro Yen TIBOR (3 Months)	0.312	0.223	0.211 [0.228]	0.210 [0.228]	0.184 [0.220]	0.210 [0.228]	0.210 [0.228]	0.192 [0.221]	0.182 [0.220]	0.179 [0.220]	
Newly Issued Japanese Government Bonds Yields (10 Years)	0.560	0.640	0.565 [0.855]	0.525 [0.680]	0.330 [0.735]	0.490 [0.720]	0.525 [0.680]	0.450 [0.590]	0.420 [0.600]	0.330 [0.735]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.184	1.077	1.067 (-0.010)	1.048 (-0.019)		1.061 (-0.005)	1.048 (-0.013)	1.041 (-0.007)	1.037 (-0.004)		
The Nikkei Stock Average (TSE 225 Issues)	12,398	14,828	15,162 [13,677]	16,174 [14,456]	17,451 [16,291]	15,425 [13,389]	16,174 [14,456]	16,414 [14,328]	17,460 [15,662]	17,451 [16,291]	
M2(Average)	(2.5)	(3.9)	(3.3)	(3.0)	(3.4)	(3.0)	(3.1)	(3.2)	(3.6)	(3.6)	
Broadly-defined Liquidity(Average)	(1.0)	(3.7)	(3.1)	(3.1)	(3.4)	(3.1)	(3.3)	(3.3)	(3.4)	(3.5)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin	(0.9)	(2.0)	(2.2)	(2.2)	(2.5)	(2.2)	(2.3)	(2.3)	(2.7)	(2.6)
	Banks	(1.1)	(2.3)	(2.3)	(2.3)	(2.7)	(2.3)	(2.4)	(2.4)	(2.8)	(2.7)
	City Banks etc.	(-0.2)	(1.7)	(1.3)	(1.1)	(1.7)	(1.0)	(1.2)	(1.3)	(2.0)	(1.7)
	Regional Banks	(2.9)	(3.3)	(3.6)	(3.7)	(3.8)	(3.6)	(3.7)	(3.7)	(3.8)	(3.8)
	Regional Banks II	(0.8)	(1.4)	(2.5)	(2.9)	(3.1)	(2.9)	(3.0)	(3.0)	(3.2)	(3.2)
	Shinkin	(-0.7)	(0.3)	(1.2)	(1.4)	(1.5)	(1.4)	(1.4)	(1.5)	(1.5)	(1.6)
Deposits and CDs (Average)	Total(3 Business Condition)	(2.2)	(3.8)	(2.8)	(2.8)	(3.8)	(2.8)	(2.9)	(3.3)	(4.0)	(4.2)
	City Banks	(1.8)	(3.7)	(2.1)	(2.4)	(4.4)	(2.4)	(2.7)	(3.4)	(4.8)	(5.1)
	Regional Banks	(2.8)	(4.3)	(3.6)	(3.2)	(3.2)	(3.2)	(3.2)	(3.2)	(3.2)	(3.3)
	Regional Banks II	(1.8)	(2.5)	(3.0)	(3.1)	(3.3)	(3.2)	(3.0)	(3.3)	(3.3)	(3.2)

(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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