

## ***Manufacturers Rethink Domestic Investing, Production Activities as Yen Weakens***

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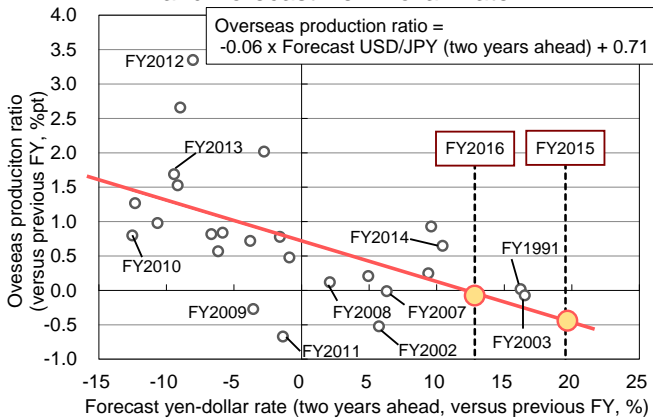
## 1. The Real Economy

The JPY currently stands at approximately the USD/JPY120 level, versus the USD/JPY81 average mark of November 2012, just prior to the launch of the second Abe Administration. Japan's currency has fallen by approximately 50% against the USD in two and a half years. A weaker JPY generally boosts the price competitiveness of Japanese manufactured goods and tends to encourage Japanese manufacturers to continue or even increase production at home. To compare manufacturers' overseas production ratio with forecast yen-dollar rate, in the Cabinet Office's *Annual Survey of Corporate Behavior*, it can be seen that the overseas production ratio becomes more limited two years after the forecast yen-dollar rate starts to point to a weaker JPY (Figure 1). The effects of the sudden drop in the JPY will appear this fiscal year and next; domestic production is projected to expand, with more overseas production moving to domestic shores.

In fact, domestic and overseas capital spending, which has a big impact on shifts in production systems over the medium to long terms, shows that the overseas capital expenditures ratio (capital expenditures for overseas local affiliates divided by total capital expenditures for overseas local affiliates and domestic companies) has started to decline slowly after peaking out around 2013 (Figure 2). Further, the Bank of Japan's March Tankan survey reported that Japanese large manufacturers have increased capital expenditures by the biggest margins in March since the collapse of Lehman Brothers, based on FY2014 figures and FY2015 plans. Companies appear to have been steadily restoring their domestic plants and are expected to maintain and even expand their domestic production.

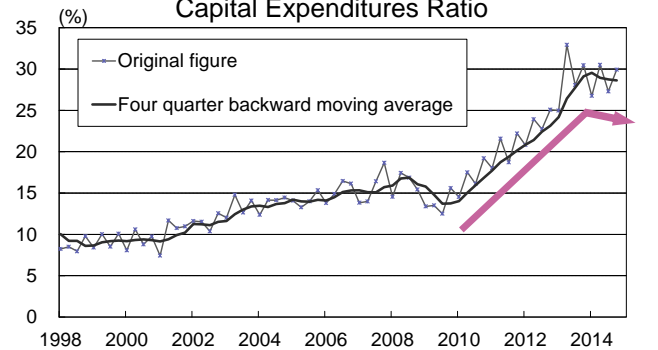
The general trend of focusing on local production, especially in emerging markets where demand is expected to expand, is not expected to change. However, signs of change are clearly starting to appear in Japanese manufacturers' production and investment behavior. Whether such signs of change will intensify—through an integrated government-private growth strategy for example—will be a litmus test for raising the country's growth momentum.

Figure 1: Manufacturers' Overseas Production Ratio and Forecast Yen-Dollar Rate



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

Figure 2: Manufacturers' Overseas Capital Expenditures Ratio



Notes: 1) Overseas capital expenditures ratio is overseas local affiliate capital expenditures divided by total of overseas local affiliate capital expenditures and domestic corporate capital expenditures.  
2) Companies with more than JPY100 million capital.

Source: Compiled by BTMU Economic Research Office from MoF, METI data.

## 2. Monetary Policy and Financial Markets

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

At its April 7-8 Monetary Policy Meeting, the Bank of Japan agreed to keep current monetary policy intact. At the post-meeting press conference, Governor Haruhiko Kuroda once again explained his view that the expected inflation rate is rising overall over the long term. In fact, core CPI (all items, less fresh foods) has been slowing after peaking in mid-2014 because of falling oil prices, in seasonally-adjusted terms and excluding the direct effect of the consumption tax hike. Even so, CPI (all items, less fresh foods and energy) continues to gradually rise (Figure 3). The household expected inflation rate has been firm of late, and we think this is because prices have been rising on trend, discounting short-term fluctuations. Further, household inflation expectations have been steady, and we think this has been supporting price increases.

Although the 10Yr JGB yield rose to the mid-0.4% level at one point in mid-March, the yield now stands at around the 0.3% level again because of lower US and European yields on diminished the prospect for raise in interest rate by the FRB and quantitative monetary easing by the ECB.

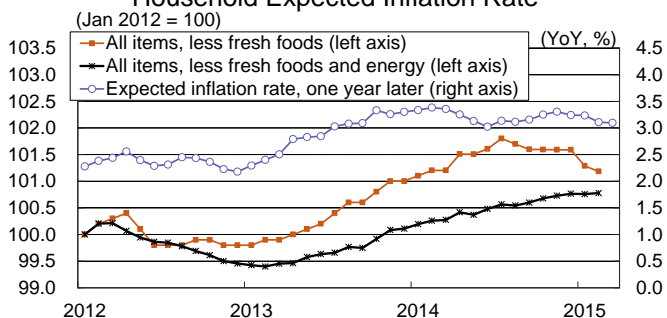
### (2) EXCHANGE RATES

The JPY is currently trading at around the USD/JPY120 mark as the JPY's weakening has paused. USD buying and JPY selling based on expanding degrees of US and Japanese monetary easing have slowed as prospects for raise in US interest rate have diminished.

The Nikkei Stock Average rose to the 20,000 mark for the first time in 15 years in late April, as the linkage between stock prices and USD/JPY (weaker JPY ↔ higher stock prices) has loosened (Figure 4). The rise in stock prices has so far been largely due to stronger corporate profits because of the weaker JPY. More recently, however, the rise of stock prices has been driven by expectations of improved earnings because of recovering domestic demand, including from expectations that the spring wage negotiations will deliver bigger wage hikes than last year. Further, we think stock prices will rise due to various corporate governance

reforms (including the introduction of corporate governance codes) that are expected to result in bigger corporate profits and stockholder returns, as well as inflows of capital from expanded monetary easing around the world.

Figure 3: CPI Level and Household Expected Inflation Rate

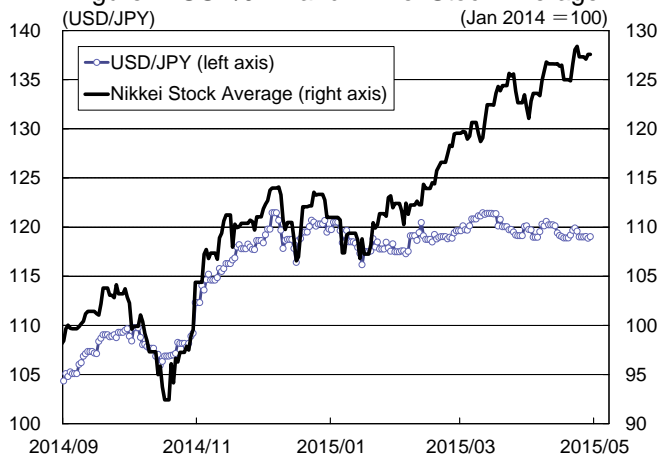


Notes: 1) All items, less fresh foods and All items, less fresh foods and energy exclude the direct impact of the consumption tax hike and are adjusted for seasonality.

2) Expected inflation rate, one year later is weighted average expected inflation rate from Cabinet Office data.

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

Figure 4: USD/JPY and Nikkei Stock Average



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

## MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

### 1. Main Economic Indicators

As of May. 28, 2015

|   | Fiscal<br>2013          | Fiscal<br>2014             | 2014                       |                            | 2015                     | 2014                       | 2015                       |                          |                         |                  |
|---|-------------------------|----------------------------|----------------------------|----------------------------|--------------------------|----------------------------|----------------------------|--------------------------|-------------------------|------------------|
|   |                         |                            | 3Q                         | 4Q                         | 1Q                       | DEC                        | JAN                        | FEB                      | MAR                     | APR              |
| Real GDP Growth Rate <% changes from previous period at SA annual rate>                                 | 2.1                     | -1.0                       | -2.1<br>(-1.4)             | 1.1<br>(-0.9)              | 2.4<br>(-1.4)            | ***                        | ***                        | ***                      | ***                     | ***              |
| Index of All Industries Activity  | 1.9                     | -1.4                       | 0.4<br>(-1.7)              | 1.0<br>(-1.3)              | 0.3<br>(-1.8)            | 0.2<br>(-0.9)              | 0.4<br>(-1.8)              | 0.2<br>(-1.2)            | -1.3<br>(-2.4)          |                  |
| Industrial Production Index   | 3.2                     | -0.4                       | -1.4<br>(-0.8)             | 0.8<br>(-1.5)              | 1.5<br>(-2.1)            | 0.2<br>(-0.1)              | 4.1<br>(-2.6)              | -3.1<br>(-2.0)           | -0.8<br>(-1.7)          |                  |
| Production  |                         |                            |                            |                            |                          |                            |                            |                          |                         |                  |
| Shipments   | 2.9                     | -1.1                       | -0.5<br>(-0.8)             | 0.9<br>(-1.9)              | 1.7<br>(-2.4)            | -0.2<br>(-0.1)             | 5.5<br>(-2.1)              | -4.4<br>(-2.9)           | -0.6<br>(-2.3)          |                  |
| Inventory   | -1.2                    | 6.2                        | 1.1<br>(4.1)               | 0.9<br>(6.2)               | 1.0<br>(6.2)             | -0.1<br>(6.2)              | -0.4<br>(5.6)              | 1.1<br>(7.0)             | 0.4<br>(6.2)            |                  |
| Inventory/Shipments Ratio<br>(2010=100)   | 106.3                   | 112.0                      | 113.2<br>[109.4]           | 113.8<br>[104.6]           | 112.3<br>[103.1]         | 112.7<br>[104.1]           | 109.0<br>[99.9]            | 113.4<br>[104.2]         | 114.4<br>[105.3]        | 105.6<br>[105.6] |
| Domestic Corporate Goods Price Index  | 1.9                     | 2.8                        | 0.5<br>(4.0)               | -1.3<br>(2.4)              | -1.7<br>(0.4)            | -0.5<br>(1.8)              | -1.3<br>(0.3)              | -0.1<br>(0.4)            | 0.3<br>(0.7)            | 0.1<br>(-2.1)    |
| Consumer Price Index(SA, total, excl.fresh foods)   | 0.8                     | 2.8                        | 0.2<br>(3.2)               | -0.1<br>(2.7)              | -0.7<br>(2.1)            | 0.0<br>(2.5)               | -0.3<br>(2.2)              | -0.1<br>(2.0)            | 0.2<br>(2.2)            |                  |
| Index of Capacity Utilization<br>(2010=100)   | 100.0                   | 100.6                      | 99.1<br>[97.8]             | 100.7<br>[100.2]           | 101.7<br>[104.7]         | 101.2<br>[101.4]           | 104.3<br>[106.3]           | 101.0<br>[103.8]         | 99.8<br>[104.1]         | 102.2<br>[102.2] |
| Machinery Orders(Private Demand,<br>Excl.Electric Power and Ship building)                              | 11.5                    | 0.8                        | 3.8<br>(2.4)               | 0.7<br>(-2.6)              | 6.3<br>(3.3)             | 5.6<br>(11.4)              | 2.5<br>(1.9)               | -1.4<br>(5.9)            | 2.9<br>(2.6)            |                  |
| Manufacturing   | 10.2                    | 7.0                        | 10.7<br>(10.2)             | 2.4<br>(8.6)               | 2.3<br>(5.2)             | 10.4<br>(27.1)             | -3.2<br>(7.3)              | -0.6<br>(13.8)           | 0.3<br>(-0.1)           |                  |
| Non-manufacturing<br>Excl.Electric Power & Ship building  | 12.1                    | -3.3                       | -3.4<br>(-2.7)             | -1.1<br>(-9.6)             | 8.5<br>(1.4)             | 5.0<br>(2.0)               | 8.0<br>(-1.9)              | -5.0<br>(0.5)            | 4.7<br>(3.6)            |                  |
| Shipments of Capital Goods<br>(Excl.Transport Equipment)  | 5.5                     | 4.3                        | 1.0<br>(7.2)               | 2.7<br>(5.0)               | 1.2<br>(-1.1)            | -0.4<br>(6.7)              | 10.7<br>(3.0)              | -12.0<br>(-3.2)          | 0.0<br>(-2.3)           |                  |
| Construction Orders   | 20.1                    | 8.2                        |                            |                            |                          |                            |                            |                          |                         |                  |
| Private   | 14.2                    | 4.8                        |                            |                            |                          |                            |                            |                          |                         |                  |
| Public  | 31.2                    | 22.9                       |                            |                            |                          |                            |                            |                          |                         |                  |
| Public Works Contracts  | 17.7                    | -0.3                       |                            |                            |                          |                            |                            |                          |                         |                  |
| Housing Starts<br>10,000 units at Annual Rate, SA<br>Total floor  | 98.7<br>(10.6)<br>(9.9) | 88.0<br>(-10.8)<br>(-15.2) | 86.8<br>(-13.6)<br>(-17.9) | 86.8<br>(-13.8)<br>(-19.3) | 89.8<br>(-5.4)<br>(-9.0) | 88.3<br>(-14.7)<br>(-19.5) | 86.4<br>(-13.0)<br>(-17.3) | 90.5<br>(-3.1)<br>(-6.3) | 92.0<br>(0.7)<br>(-2.1) |                  |
| Sales at Retailers  | 2.9                     | -1.2                       |                            |                            |                          |                            |                            |                          |                         |                  |
| Real Consumption Expenditures<br>of Households over 2 persons (SA)                                      | 0.9                     | -5.1                       | 0.4<br>(-5.4)              | 1.7<br>(-3.4)              | 1.4<br>(-6.5)            | 0.2<br>(-3.4)              | -0.3<br>(-5.1)             | 0.8<br>(-2.9)            | 2.4<br>(-10.6)          |                  |
| Propensity to Consume<br>(SA,%)   | 75.5                    | 74.2                       | 74.6<br>[74.4]             | 74.5<br>[75.1]             | 74.6<br>[78.3]           | 73.8<br>[75.2]             | 74.6<br>[75.3]             | 72.9<br>[75.3]           | 76.5<br>[84.4]          | 74.6<br>[74.6]   |
| Overtime Hours Worked<br>(All Industries, 5 employees or more)  | 4.8                     | 2.0                        | -1.1<br>(2.6)              | 0.1<br>(0.9)               | 0.3<br>(-0.6)            | -0.3<br>(0.3)              | 1.9<br>(1.3)               | -1.9<br>(-0.7)           | -0.1<br>(-2.4)          |                  |
| Total Cash Earnings (Regular Employees<br>Only; All Industries, 5 employees or more)                    | -0.2                    | 0.5                        |                            |                            |                          |                            |                            |                          |                         |                  |
| Employment Index(Regular Employees Only;All Industries,<br>5 employees or more) (Change over the M/Q/Y) | 45                      | 77                         | 76                         | 76                         | 90                       | 80                         | 90                         | 95                       | 84                      |                  |
| Ratio of Job Offers to Applicants<br>(SA,Times)   | 0.97                    | 1.11                       | 1.10<br>[0.95]             | 1.12<br>[1.01]             | 1.15<br>[1.05]           | 1.14<br>[1.03]             | 1.14<br>[1.04]             | 1.15<br>[1.05]           | 1.15<br>[1.07]          | 1.08<br>[1.08]   |
| Unemployment Rate<br>(SA,%)   | 3.9                     | 3.5                        | 3.6                        | 3.5                        | 3.5                      | 3.4                        | 3.6                        | 3.5                      | 3.4                     |                  |
| Economy Watcher Survey<br>(Judgment of the present condition D.I.%)                                     | 54.0                    | 46.6                       | 48.7<br>[52.1]             | 43.6<br>[53.6]             | 49.3<br>[55.2]           | 45.2<br>[55.7]             | 45.6<br>[54.7]             | 50.1<br>[53.0]           | 52.2<br>[57.9]          | 53.6<br>[41.6]   |
| Bankruptcies (Number of cases)  | 10,536<br>(-10.0)       | 9,543<br>(-9.4)            | 2,436<br>(-8.5)            | 2,222<br>(-13.5)           | 2,272<br>(-7.6)          | 686<br>(-8.5)              | 721<br>(-16.5)             | 692<br>(-11.5)           | 859<br>(5.5)            | 748<br>(-18.1)   |

(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 May. 28, 2015

|  | Fiscal    | Fiscal    | 2014      |           | 2015      | 2014      | 2015      |           |           |           |
|--|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
|  | 2013      | 2014      | 3Q        | 4Q        | 1Q        | DEC       | JAN       | FEB       | MAR       | APR       |
| Customs Clearance (Exports in Yen Terms)   | 10.8      | 5.4       | (3.2)     | (9.1)     | (9.0)     | (12.8)    | (17.0)    | (2.5)     | (8.5)     | (8.0)     |
| Value                                      | 10.2      | 3.9       | (2.9)     | (6.6)     | (5.0)     | (8.6)     | (5.3)     | (4.7)     | (5.1)     | (6.0)     |
| Volumes                                    | 0.6       | 1.3       | (0.3)     | (2.4)     | (3.8)     | (3.9)     | (11.1)    | (-2.1)    | (3.2)     | (1.8)     |
| Imports (In Yen terms)                     | 17.4      | -0.9      | (2.4)     | (1.2)     | (-9.3)    | (1.9)     | (-9.1)    | (-3.6)    | (-14.4)   | (-4.2)    |
| Value                                      | 14.6      | 1.2       | (3.1)     | (4.9)     | (-5.1)    | (3.8)     | (-3.0)    | (-7.7)    | (-4.6)    | (-4.3)    |
| Volumes                                    | 2.3       | -2.1      | (-0.7)    | (-3.5)    | (-4.6)    | (-1.8)    | (-6.3)    | (4.5)     | (-10.3)   | (0.1)     |
| Current Account (100 mil. yen)             | 14,715    | 78,100    | 16,310    | 15,124    | 42,968    | 2,259     | 614       | 14,401    | 27,953    |           |
| Goods (100 mil. yen)                       | -110,187  | -65,708   | -24,221   | -17,782   | -3,359    | -3,821    | -8,642    | -1,431    | 6,714     |           |
| Services (100 mil. yen)                    | -34,448   | -28,102   | -9,221    | -6,656    | -3,421    | -3,583    | -4,013    | -1,087    | 1,678     |           |
| Financial Account (100 mil. yen)           | -17,549   | 137,492   | 28,075    | 22,468    | 68,297    | 6,270     | -3,584    | 23,402    | 48,479    |           |
| Gold & Foreign Exchange Reserves (\$1mil.) | 1,279,346 | 1,245,316 | 1,264,405 | 1,260,548 | 1,245,316 | 1,260,548 | 1,261,103 | 1,251,112 | 1,245,316 | 1,250,073 |
| Exchange Rate (¥/\$)                       | 100.23    | 109.92    | 103.92    | 114.56    | 119.07    | 119.40    | 118.24    | 118.57    | 120.39    | 119.55    |

## 3. Financial Market Indicators

|   | Fiscal                      | Fiscal            | 2014               |                    | 2015               | 2014               | 2015               |                    |                    |                    |       |       |       |
|---|-----------------------------|-------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|-------|-------|-------|
|   | 2013                        | 2014              | 3Q                 | 4Q                 | 1Q                 | DEC                | JAN                | FEB                | MAR                | APR                |       |       |       |
| Uncollateralized Overnight Call Rates   | 0.073                       | 0.068             | 0.067<br>[0.073]   | 0.064<br>[0.072]   | 0.073<br>[0.074]   | 0.068<br>[0.074]   | 0.074<br>[0.073]   | 0.076<br>[0.077]   | 0.070<br>[0.072]   | 0.061<br>[0.065]   |       |       |       |
| Euro Yen TIBOR<br>(3 Months)  | 0.223                       | 0.194             | 0.210<br>[0.228]   | 0.184<br>[0.220]   | 0.171<br>[0.215]   | 0.179<br>[0.220]   | 0.173<br>[0.220]   | 0.171<br>[0.212]   | 0.170<br>[0.212]   | 0.170<br>[0.212]   |       |       |       |
| Newly Issued Japanese Government Bonds Yields<br>(10 Years)   | 0.640                       | 0.400             | 0.525<br>[0.680]   | 0.330<br>[0.735]   | 0.400<br>[0.640]   | 0.330<br>[0.735]   | 0.275<br>[0.620]   | 0.330<br>[0.580]   | 0.400<br>[0.640]   | 0.340<br>[0.620]   |       |       |       |
| Average Contracted Interest Rates<br>on Loans and Discounts(City Banks)<br>(% changes from previous period) | 1.077                       | 1.006             | 1.048<br>(-0.019)  | 1.025<br>(-0.023)  | 1.006<br>(-0.019)  | 1.025<br>(-0.012)  | 1.024<br>(-0.001)  | 1.021<br>(-0.003)  | 1.006<br>(-0.015)  |                    |       |       |       |
| The Nikkei Stock Average<br>(TSE 225 Issues)  | 14,828                      | 19,207            | 16,174<br>[14,456] | 17,451<br>[16,291] | 19,207<br>[14,828] | 17,451<br>[16,291] | 17,674<br>[14,915] | 18,798<br>[14,841] | 19,207<br>[14,828] | 19,520<br>[14,304] |       |       |       |
| M2(Average)   | (3.9)                       | (3.3)             | (3.0)              | (3.5)              | (3.5)              | (3.6)              | (3.4)              | (3.5)              | (3.6)              | (3.6)              |       |       |       |
| Broadly-defined Liquidity(Average)  | (3.7)                       | (3.3)             | (3.1)              | (3.4)              | (3.4)              | (3.5)              | (3.3)              | (3.4)              | (3.3)              | (3.1)              |       |       |       |
| Principal Figures of Financial Institutions   |                             |                   |                    |                    |                    |                    |                    |                    |                    |                    |       |       |       |
| Loans and<br>Discount<br>(Average)  | Banks & Shinkin             |                   | (2.0)              | (2.4)              | (2.2)              | (2.5)              | (2.5)              | (2.6)              | (2.5)              | (2.5)              | (2.6) | (2.6) |       |
|   |                             | Banks             |                    | (2.3)              | (2.5)              | (2.3)              | (2.7)              | (2.6)              | (2.8)              | (2.6)              | (2.6) | (2.7) | (2.7) |
|   |                             |                   | City Banks etc.    | (1.7)              | (1.4)              | (1.1)              | (1.7)              | (1.4)              | (1.7)              | (1.4)              | (1.3) | (1.5) | (1.6) |
|   |                             |                   | Regional Banks     | (3.3)              | (3.8)              | (3.7)              | (3.8)              | (4.0)              | (3.9)              | (3.9)              | (4.1) | (4.1) | (4.1) |
|   |                             |                   | Regional Banks II  | (1.4)              | (2.9)              | (2.9)              | (3.1)              | (3.1)              | (3.2)              | (3.2)              | (3.2) | (3.0) | (3.0) |
|   | Shinkin                     | (0.3)             | (1.4)              | (1.4)              | (1.5)              | (1.6)              | (1.5)              | (1.5)              | (1.6)              | (1.7)              | (1.9) |       |       |
| Deposits<br>and CDs<br>(Average)  | Total(3 Business Condition) |                   | (3.8)              | (3.3)              | (2.8)              | (3.8)              | (3.9)              | (4.2)              | (3.8)              | (3.9)              | (3.9) | (4.0) |       |
|   |                             | City Banks        | (3.7)              | (3.4)              | (2.4)              | (4.4)              | (4.7)              | (5.1)              | (4.7)              | (4.7)              | (4.7) | (5.0) |       |
|   |                             | Regional Banks    | (4.3)              | (3.3)              | (3.2)              | (3.2)              | (3.1)              | (3.3)              | (2.9)              | (3.1)              | (3.2) | (3.1) |       |
|   |                             | Regional Banks II | (2.5)              | (3.1)              | (3.1)              | (3.3)              | (3.1)              | (3.2)              | (3.1)              | (3.2)              | (3.1) | (2.9) |       |

(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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