

Corporate Sentiment Firm, Capital Expenditures Growth to Accelerate Gradually

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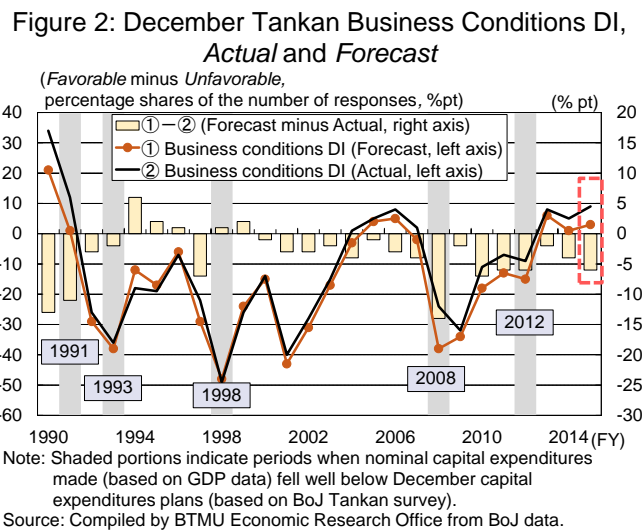
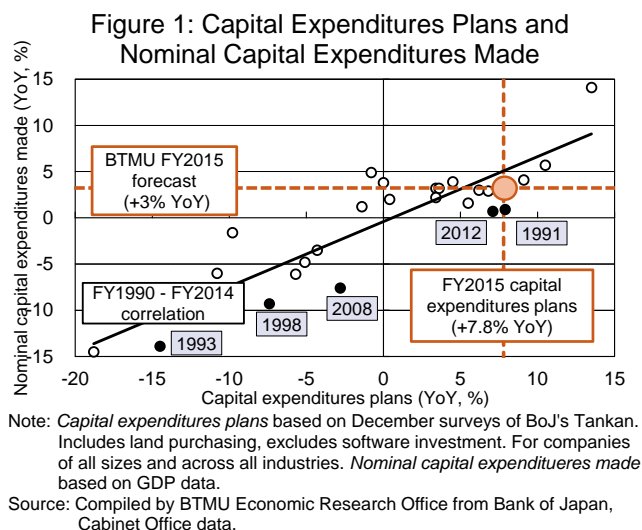
1. The Real Economy

The December 2015 survey of BoJ's Tankan, released December 14, once again pointed to firm willingness to invest by companies. Companies of all sizes and across all industries plan to raise capital expenditures by +7.8% YoY in FY2015, the biggest increase reported in a December survey since FY2006.

The strong figure suggests that nominal capital expenditures in GDP data could rise +5% YoY this fiscal year, based on the past correlation between the BoJ's Tankan and GDP statistics (Figure 1). But actual nominal capital expenditures rose just annualized +1.6% compared to previous period in 1H FY2015, a striking disparity with the plans. This is because companies became increasingly cautious about making capital expenditures as uncertainties about China and other emerging economies suddenly increased, even as companies reported record high profits. Final nominal capital expenditures have sometimes fallen well short of December capital expenditures plans in past fiscal years.

Even so, the *Business Conditions DI* ("Favorable" minus "Unfavorable" responses) in this December Tankan suggests that conditions in this fiscal year are different from the past. Planned and actual capital expenditures have differed markedly five times in the past, but both the actual and forecast *Business Conditions DI* were considered pessimistic in December Tankan surveys in FY1993, FY1998, FY2008, and FY2012 (Figure 2). Also, the Bubble Economy was in the midst of collapsing in FY1991, and the deterioration of business conditions in the future was recognized clearly. Conversely, the actual *Business Conditions DI* in this December Tankan was a favorable 9% points, with the forecast DI by no means weak at 3% points. However, the gap between actual and forecast DI reflects "sense of caution" and bears watching.

Structural adjustments in China and weak resource prices will also weigh on the economies of emerging markets for some time, but the recovery momentum in advanced countries, mainly the US and Europe, is firm. With the global economy as a whole once again on a stable growth trajectory, companies are expected to increase capital expenditures again after holding off for some time. Nominal capital expenditures are likely to expand by +3% YoY in FY2015.



2. Monetary Policy and Financial Markets

(1) MONETARY POLICY & LONG-TERM YIELDS

At the December 17-18 Monetary Policy Board meeting, the BoJ voted to introduce supplementary measures for quantitative and qualitative monetary easing. Specifically, the average remaining maturity of JGB purchases will be extended to about 7-12 years from about 7-10 years, and a new JPY300 billion framework will be added for ETF purchases (Table 1). At the post-meeting press conference, BoJ Governor Haruhiko Kuroda explained that extending the average duration of JGB purchases is a preventative measure to ensure smooth operations by expanding the bank's capacity for buying longer-term JGBs as large-scale redemptions loom in 2016. He also explained that the new ETF framework would support corporate capital and personnel investments and help monetary easing permeate the real economy more effectively. The timing of the new measures was not widely expected, based on a Bloomberg survey, and the decision appears to have surprised the markets.

The 10Yr JGB yield hit 0.270% following the BoJ decision, declining by 2.5 bps. On the other hand, although the Nikkei Average rocketed by more than 500 points immediately following the decision announcement, the index subsequently fell more than 300 points from the previous day's close amidst high volatility.

(2) EXCHANGE RATES

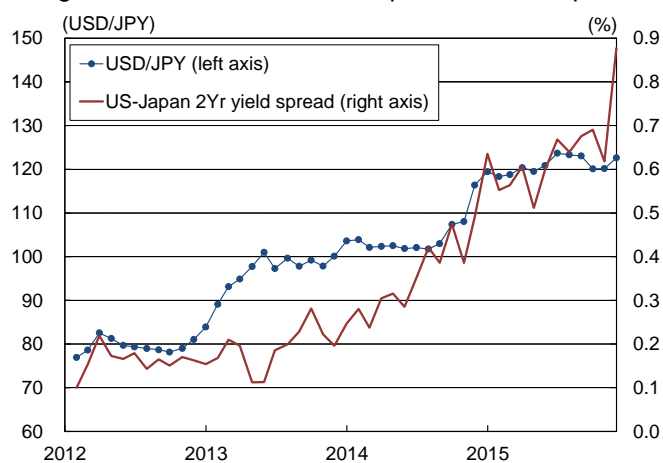
USD/JPY remained in the lower 120 range even after the BoJ's announcement. On December 16, the US FRB hiked interest rates for the first time in nearly a decade. In the past USD has frequently weakened against JPY after the US began hiking interest rates due to concerns about the direction of the US economy. The same pattern may materialize again, but this time the pace of US rate hikes is expected to be more gradual and major concerns about the US economy are unlikely to arise for some time. Also, the US-Japan yield gap is expected to widen as the FRB continues to hike interest rates, supporting USD buying and JPY selling (Figure 3).

Table 1: Supplementary Measures for Quantitative and Qualitative Monetary Easing

Objective	Measure	Details
Support for companies actively making physical, personnel investments	Establishing a new program for purchases of ETFs	Expand purchases of ETFs by JPY30 billion/year, directed at companies actively making investment physical and human capital
	Enhancing the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth	Add a new category "Firms that are proactively making investment in physical and human capital" as eligible
	Extending the application periods for the Loan Support Program and other measures	Extend acceptance period for funds supply to support expanded lending by one year
Smooth implementation of qualitative and quantitative monetary easing	Extending the average remaining maturity of JGB purchases	Extend average remaining maturity from current 7-10 years to 7-12 years from 2016
	Expanding eligible collateral for the Bank's provision of credit	Allow foreign currency-denominated loans on deeds and financial institution home loan receivables to be accepted as collateral
	Increasing the maximum amount of each issue of J-REIT to be purchased	Raise purchase ceiling for individual issues from 5% or less to 10% or less

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

Figure 3: USD/JPY and US-Japan 2Yr Yield Spread



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

MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Jan. 7, 2016

	Fiscal 2013	Fiscal 2014	2015			2015				
			1Q	2Q	3Q	JUL	AUG	SEP	OCT	NOV
Real GDP Growth Rate <% changes from previous period at SA annual rate>	2.0	-1.0	4.4 (-1.1)	-0.5 (0.7)	1.0 (1.6)	***	***	***	***	***
Index of All Industries Activity	2.2	-1.1	1.1 (-1.2)	-0.3 (1.4)	-0.1 (1.3)	-0.1 (1.5)	0.0 (1.6)	-0.2 (0.6)	1.0 (0.9)	
Industrial Production Index	3.2	-0.4	1.5 (-2.1)	-1.4 (-0.5)	-1.2 (-0.4)	-0.8 (0.0)	-1.2 (-0.4)	1.1 (-0.8)	1.4 (-1.4)	-1.0 (1.6)
Production										
Shipments	2.9	-1.1	1.7 (-2.4)	-2.4 (-0.3)	-0.6 (-0.6)	-0.4 (-0.8)	-0.7 (0.6)	1.4 (-1.5)	2.1 (-0.8)	-2.5 (0.6)
Inventory	-1.2	6.2	1.0 (6.2)	1.1 (4.0)	-0.9 (2.1)	-0.8 (2.7)	0.3 (2.1)	-0.4 (2.1)	-1.9 (0.2)	0.4 (-0.5)
Inventory/Shipments Ratio (2010=100)	106.3	112.0	112.3 [103.1]	114.0 [108.7]	115.6 [113.2]	112.2 [110.2]	119.2 [117.9]	115.5 [111.5]	112.0 [112.6]	115.2 [116.1]
Domestic Corporate Goods Price Index	1.9	2.8	-1.6 (0.5)	0.3 (-2.2)	-1.0 (-3.6)	-0.3 (-3.1)	-0.6 (-3.6)	-0.6 (-4.0)	-0.6 (-3.8)	-0.1 (-3.6)
Consumer Price Index(SA, total, excl.fresh foods)	0.8	2.8	-0.7 (2.1)	0.6 (0.1)	0.0 (-0.1)	0.0 (0.0)	0.0 (-0.1)	-0.1 (-0.1)	0.0 (-0.1)	0.1 (0.1)
Index of Capacity Utilization (2010=100)	100.0	100.6	101.7 [104.7]	97.6 [101.2]	96.8 [99.1]	96.9 [98.8]	96.0 [98.3]	97.4 [100.3]	98.7 [100.6]	
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	11.5	0.8	6.3 (3.3)	2.9 (12.4)	-10.0 (-0.9)	-3.6 (2.8)	-5.7 (-3.5)	7.5 (-1.7)	10.7 (10.3)	
Manufacturing	10.2	7.0	2.3 (5.2)	12.1 (27.5)	-15.3 (-1.1)	-5.3 (3.8)	-3.2 (4.5)	-5.5 (-8.7)	14.5 (5.8)	
Non-manufacturing Excl.Electric Power & Ship building	12.1	-3.3	8.5 (1.4)	-1.7 (2.3)	-6.5 (-0.8)	-6.0 (1.8)	-6.1 (-9.5)	14.3 (3.0)	10.7 (14.4)	
Shipments of Capital Goods (Excl.Transport Equipment)	5.5	4.3	1.2 (-1.1)	-2.1 (2.5)	-1.9 (-0.8)	0.7 (0.4)	-5.6 (0.6)	0.8 (-2.8)	2.2 (-4.2)	-0.6 (-1.1)
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 10,000 units at Annual Rate, SA	98.7 (10.6)	88.0 (-10.8)	89.8 (-5.4)	95.8 (7.6)	92.3 (6.2)	91.4 (7.4)	93.1 (8.8)	90.0 (2.6)	86.2 (-2.5)	88.6 (1.7)
Total floor										
Sales at Retailers	2.9	-1.2								
Real Consumption Expenditures of Households over 2 persons (SA)	0.9	-5.1								
Propensity to Consume (SA,%)	75.5	74.2								
Overtime Hours Worked (All Industries, 5 employees or more)	4.8	2.0								
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	-0.2	0.5								
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	45	77								
Ratio of Job Offers to Applicants (SA,Times)	0.97	1.11								
Unemployment Rate (SA,%)	3.9	3.5								
Economy Watcher Survey (Judgment of the present condition D.I.%)	54.0	46.6								
Bankruptcies (Number of cases)	10,536 (-10.0)	9,543 (-9.4)								

(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 Jan. 7, 2016

	Fiscal	Fiscal	2015			2015				
	2013	2014	1Q	2Q	3Q	JUL	AUG	SEP	OCT	NOV
Customs Clearance (Exports in Yen Terms)	10.8	5.4	(9.0)	(6.7)	(3.7)	(7.6)	(3.1)	(0.5)	(-2.2)	(-3.3)
Value	10.2	3.9	(5.0)	(7.3)	(6.8)	(8.4)	(7.5)	(4.6)	(2.5)	(-0.3)
Volumes	0.6	1.3	(3.8)	(-0.6)	(-2.8)	(-0.7)	(-4.1)	(-3.9)	(-4.6)	(-3.1)
Imports (In Yen terms)	17.4	-0.9	(-9.3)	(-5.1)	(-5.8)	(-3.1)	(-3.1)	(-11.0)	(-13.3)	(-10.2)
Value	14.6	1.2	(-5.1)	(-3.1)	(-4.0)	(-0.2)	(-2.4)	(-9.2)	(-9.9)	(-11.7)
Volumes	2.3	-2.1	(-4.6)	(-2.2)	(-1.9)	(-2.9)	(-0.7)	(-1.9)	(-3.8)	(1.6)
Current Account (100 mil. yen)	14,715	79,309	44,177	37,637	49,301	18,086	16,531	14,684	14,584	
Goods (100 mil. yen)	-110,187	-65,659	-3,311	-678	-3,519	-1,080	-3,261	823	2,002	
Services (100 mil. yen)	-34,448	-27,482	-2,801	-6,266	-1,710	-1,836	578	-452	-3,373	
Financial Account (100 mil. yen)	-17,549	133,088	63,894	46,954	58,588	9,170	19,384	30,034	3,966	
Gold & Foreign Exchange Reserves (\$1mil.)	1,279,346	1,245,316	1,245,316	1,242,935	1,248,936	1,242,316	1,244,150	1,248,936	1,244,211	1,233,008
Exchange Rate (¥/\$)	100.23	109.92	119.07	121.35	122.23	123.23	123.23	120.22	120.06	122.54

3. Financial Market Indicators

	Fiscal	Fiscal	2015			2015							
	2013	2014	1Q	2Q	3Q	JUL	AUG	SEP	OCT	NOV			
Uncollateralized Overnight Call Rates	0.073	0.068	0.073 [0.074]	0.067 [0.067]	0.074 [0.067]	0.074 [0.066]	0.076 [0.069]	0.073 [0.066]	0.076 [0.059]	0.078 [0.065]			
Euro Yen TIBOR (3 Months)	0.223	0.194	0.171 [0.215]	0.169 [0.211]	0.169 [0.210]	0.169 [0.210]	0.169 [0.210]	0.169 [0.210]	0.169 [0.192]	0.169 [0.182]			
Newly Issued Japanese Government Bonds Yields (10 Years)	0.640	0.400	0.400 [0.640]	0.455 [0.565]	0.350 [0.525]	0.410 [0.530]	0.380 [0.490]	0.350 [0.525]	0.300 [0.450]	0.300 [0.420]			
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.077	1.006	1.006 (-0.019)	0.987 (-0.019)	0.969 (-0.018)	0.982 (-0.005)	0.980 (-0.002)	0.969 (-0.011)	0.969 (0.000)	0.965 (-0.004)			
The Nikkei Stock Average (TSE 225 Issues)	14,828	19,207	19,207 [14,828]	20,236 [15,162]	17,388 [16,174]	20,585 [15,621]	18,890 [15,425]	17,388 [16,174]	19,083 [16,414]	19,747 [17,460]			
M2(Average)	(3.9)	(3.3)	(3.5)	(3.9)	(4.0)	(4.0)	(4.2)	(3.8)	(3.7)	(3.3)			
Broadly-defined Liquidity(Average)	(3.7)	(3.3)	(3.5)	(4.3)	(4.5)	(4.6)	(4.7)	(4.3)	(4.3)	(4.0)			
Principal Figures of Financial Institutions													
Loans and Discount (Average)	Banks & Shinkin		(2.0)	(2.3)	(2.5)	(2.5)	(2.6)	(2.6)	(2.7)	(2.6)	(2.5)	(2.3)	
		Banks		(2.3)	(2.5)	(2.6)	(2.6)	(2.7)	(2.6)	(2.8)	(2.7)	(2.5)	(2.3)
			City Banks etc.	(1.7)	(1.4)	(1.4)	(1.4)	(1.6)	(1.4)	(1.7)	(1.5)	(1.4)	(0.9)
			Regional Banks	(3.2)	(3.7)	(4.0)	(4.0)	(3.9)	(3.9)	(3.8)	(3.8)	(3.7)	(3.7)
			Regional Banks II	(1.4)	(2.9)	(3.1)	(3.1)	(3.4)	(3.4)	(3.4)	(3.3)	(3.2)	(3.2)
	Shinkin	(0.3)	(1.4)	(1.6)	(1.9)	(2.1)	(2.0)	(2.1)	(2.3)	(2.3)	(2.2)		
Deposits and CDs (Average)	Total(3 Business Condition)		(3.8)	(3.3)	(3.9)	(4.3)	(4.3)	(4.3)	(4.5)	(4.0)	(3.6)	(3.2)	
		City Banks	(3.7)	(3.4)	(4.7)	(5.4)	(5.4)	(5.5)	(5.8)	(4.8)	(4.2)	(3.6)	
		Regional Banks	(4.3)	(3.3)	(3.1)	(3.3)	(3.3)	(3.4)	(3.3)	(3.3)	(3.1)	(3.0)	
		Regional Banks II	(2.5)	(3.1)	(3.1)	(2.9)	(2.7)	(2.8)	(2.6)	(2.6)	(2.3)	(2.2)	

(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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