

## ***Economic stimulus package for the autumn should aim to balance Japan's economic growth and fiscal consolidation***

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### 1. The Real Economy

Prime Minister Abe's ruling coalition won a Upper House election on July 10 by gaining 70 seats to exceeds the majority of contested seats (61 seats), which was a hurdle set by Mr. Abe for grab. At the interview immediately held after the release of elections result, Mr. Abe proudly announced that his administration won public trust, it will implement the "*Comprehensive Stimulus Economic Package*" as focusing on "*investment in future*". Amid the rising concern over the downturn of external demands and corporate earning stemming from the uncertainty over the future global economy, the government-led fiscal actions in addition to the delayed consumption tax hike to underpin domestic demands will give favorable impacts on Japanese Economy in the near future.

Even so, it seems that financial resource to stimulate the economy seems limited for the current FY. Let us provide specific analysis of it. It is predicted the negative interest rate introduced by BOJ will reduce debt service cost by 2 trillion yen from the initial estimate (mostly interest payment cost). Approximately 1.2 trillion yen excluding 778 billion yen reserved for recovery from Kumamoto Earthquake is already available (Chart 1). Additionally, Japanese government has disposed the shares of approximately 270 billion yen in June. Even with them, financial resources is likely to be approximately 2 trillion yen, which will decrease by half from the previous FY, since surplus and increase in tax revenue in the previous FY will contract to about several hundred billion yen primarily due to the sluggish growth in corporate tax revenue (Chart 2).

In this respect, to implement the large-scale Economic Stimulus Package under consideration to be adjusted at approximately 20 trillion yen on business scale, the further issuance of government bonds in supplementary budget formulation will become mandatory for the first time after FY 2012. On the other hand, two consecutive times delay in consumption tax hike is causing the uncertainty over the fiscal consolidation initiative. The government is required to present its firm intention to make economic growth and fiscal consolidation balanced by alleviating future fiscal burden to be incurred by the increase in issuance of government bonds, with a focus on specific areas, for which the fiscal resources seem mandatory to improve potential growth power of Japan and increase tax revenue, such areas include child care, nursing care, development of growth industry, and support for small and medium – sized enterprises.

Chart 1: Reduction in Debt Service Cost(DSC) from initial budget and changes in Long-Term Interest Rate(LTIR)

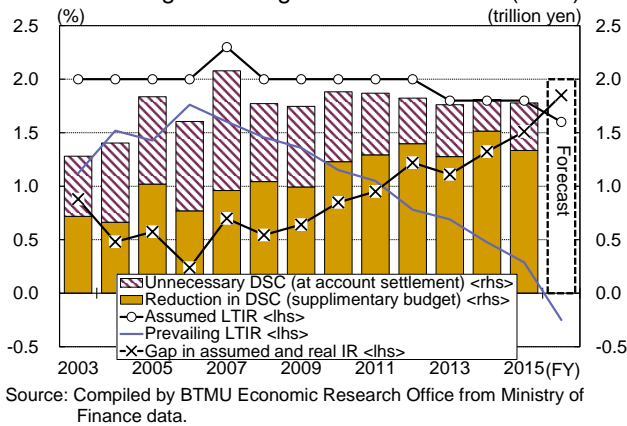
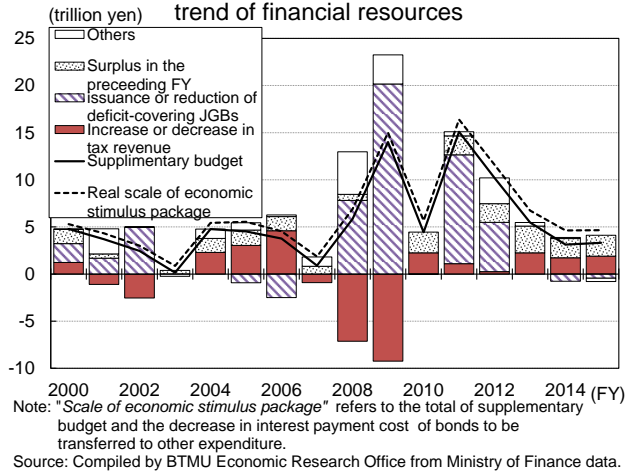


Chart 2: size of supplementary budget and trend of financial resources



## 2. Financial Markets

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

The rate of increase in Consumer Price Index (CPI), policy objectives of BOJ, has been weak. core CPI excluding fresh food has turned downward in March, followed by the further fall in May, stood at -0.4% YoY, the rate of increase in consumer prices released by BOJ excluding fresh foods and energy also decelerated due to the vanishing upward pressure exerted by depreciating yen (Chart 3). Furthermore, expected inflation rate of enterprises, BOJ regard as an index to view consumer price trends, has continued declining. Tankan, conducted by BOJ, of corporate goods prices Inflation forecast for one year ahead was +1.5% YoY in March 2014, when the Survey started, however, declined to +0.7% YoY in June 2016. Expected inflation rate of households is also rapidly declining, break-even inflation rate to show inflation expectation of market participants has further declined after the Brexit. Amid such circumstance, the expectation for additional monetary easing is intensifying. However, not all investors in bond markets are enthusiastic about further easing. According to the monthly market survey on bond, conducted by QUICK in June, with regard to the question, "How should BOJ implement future monetary policy?" Among respondents, 40% chose "Should downscale easing" over 23% of "Scale up monetary easing" The considerable number of respondents also pointed out "the deterioration in function of bond market" and "the deterioration in pension financing" as possible side effects of negative interest rates, in this regard, BOJ is required to balance such good and reverse effects when deciding on its future policy.

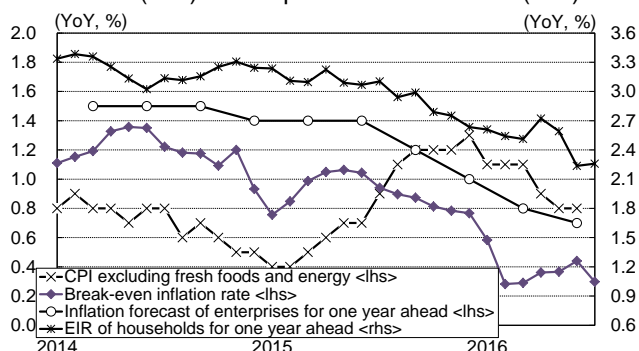
The yield of 10- year JGB has drastically fell after the Brexit, hit the record low of -0.3% on July 8, currently hovering around the lower of 0.2%.

### (2) Exchange rate

USD/JPY trend had been in line with the gap in real interest rate between US and Japan. However, the strengthening yen buying pressure caused by risk-aversion behavior after the Brexit, changed their typical development, JPY once appreciated to USD/JPY 99 (Chart 4).

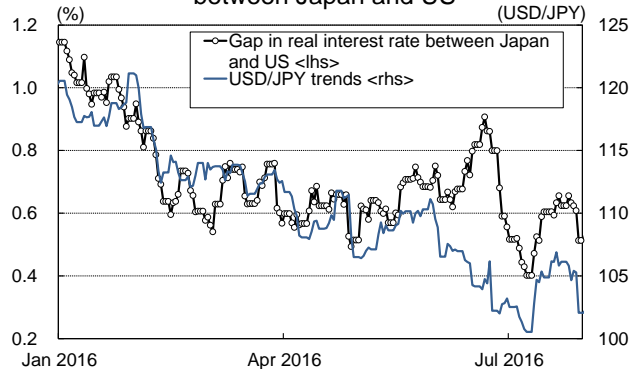
Nevertheless, as monetary market gradually regained its stability, USD/JPY trends and gap in real interest rate returned to the normal correlation, and the expectation for BOJ's additional monetary easing increased, USD/JPY trends returned to pre-Brexit level, at approximately USD/JPY 106. Even so, should BOJ's action taken at the Policy Setting Meeting on July 28-29 turn out different from the rising expectation of the markets for further easing, JPY might once again start appreciating against USD.

Chart 3: Rate of increase in core Consumer Price Index (CPI) and Expected Inflation Rate (EIR)



Note: "Expected inflation rate of households" refers to weighted average of projected inflation rate calculated based on replies of consumers regarding forecast on consumer prices one year ahead.  
 Source: Compiled by BTMU Economic Research Office from BOJ, Ministry of Internal affairs and communications, Bloomberg data.

Chart 4: USD/JPY trends and gap in real interest rate between Japan and US



Note: "Real interest rate" is calculated based on the formula, 10-year JGB yield minus break-even inflation rate.  
 Source: Compiled by BTMU Economic Research Office from Bloomberg data.

## MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

### 1. Main Economic Indicators

As of July. 22, 2016

	Fiscal	Fiscal	2015		2016	2016				
	2014	2015	3Q	4Q	1Q	FEB	MAR	APR	MAY	JUN
Real GDP Growth Rate <% changes from previous period at SA annual rate>	-0.9	0.8	1.7 (1.8)	-1.8 (0.7)	1.9 (0.1)	***	***	***	***	***
Index of All Industries Activity	-1.1	0.9	0.0 (1.2)	-0.2 (0.6)	0.0 (0.4)	-0.9 (1.6)	0.4 (0.3)	0.8 (-0.2)	-1.0 (0.5)	
Industrial Production Index	-0.5	-1.0	-1.0 (-0.9)	0.1 (-0.8)	-1.0 (-1.6)	-5.2 (-1.2)	3.8 (0.2)	0.5 (-3.3)	-2.6 (-0.4)	
Production										
Shipments	-1.2	-1.2	-0.7 (-0.8)	0.4 (-0.8)	-2.0 (-2.4)	-4.1 (-1.6)	1.8 (-0.7)	1.6 (-3.4)	-2.6 (-1.0)	
Inventory	6.1	1.8	-0.5 (2.0)	-0.5 (0.0)	2.4 (1.8)	-0.2 (-0.9)	2.9 (1.8)	-1.7 (0.1)	0.4 (0.8)	
Inventory/Shipments Ratio (2010=100)	112.0	115.0	114.7 [113.2]	114.9 [113.8]	116.3 [113.0]	114.5 [113.5]	118.3 [114.0]	115.7 [113.7]	117.8 [114.8]	[112.8]
Domestic Corporate Goods Price Index	2.7	-3.2	-1.1 (-3.7)	-1.4 (-3.7)	-1.4 (-3.4)	-0.3 (-3.4)	-0.1 (-3.8)	-0.4 (-4.2)	0.1 (-4.3)	-0.1 (-4.2)
Consumer Price Index(SA, total, excl.fresh foods)	2.8	0.0	0.0 (-0.1)	0.0 (0.0)	-0.8 (-0.1)	-0.1 (0.0)	-0.1 (-0.3)	-0.1 (-0.3)	0.0 (-0.4)	
Index of Capacity Utilization (2010=100)	100.6	98.0	97.6 [99.1]	97.9 [100.7]	97.3 [101.4]	94.5 [100.5]	97.5 [99.9]	96.5 [99.3]	94.2 [96.8]	[98.0]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	0.8	4.1	-6.5 (-0.9)	2.6 (2.1)	6.7 (3.4)	-9.2 (-0.7)	5.5 (3.2)	-11.0 (-8.2)	-1.4 (-11.7)	
Manufacturing	7.0	6.2	-9.6 (-1.1)	-3.0 (-3.1)	13.7 (4.3)	-30.6 (-12.3)	19.7 (2.7)	-13.3 (-14.8)	-6.4 (-21.5)	
Non-manufacturing Excl.Electric Power & Ship building	-3.3	2.5	-4.9 (-0.8)	5.6 (6.3)	3.5 (2.6)	10.2 (8.7)	-6.9 (2.7)	-3.9 (-3.0)	-0.3 (-2.5)	
Shipments of Capital Goods (Excl.Transport Equipment)	4.4	-2.3	-1.8 (-1.3)	-1.7 (-4.2)	-2.4 (-5.5)	-8.1 (-1.5)	2.6 (-4.8)	5.2 (-3.7)	-1.4 (-1.1)	
Construction Orders	8.2	-0.9								
Private	4.8	7.9								
Public	22.9	-15.6								
Public Works Contracts	-0.3	-3.8								
Housing Starts 10,000 units at Annual Rate, SA	88.0 (-10.8)	92.1 (4.6)	91.7 (6.2)	86.8 (-0.7)	94.7 (5.5)	97.4 (7.8)	99.3 (8.4)	99.5 (9.0)	101.7 (9.8)	
Total floor										
Sales at Retailers	-1.2	0.8								
Real Consumption Expenditures of Households over 2 persons (SA)	-5.1	-1.2	0.5 (0.7)	-2.1 (-3.3)	0.5 (-2.6)	1.7 (1.2)	0.5 (-5.3)	0.2 (-0.4)	-1.5 (-1.1)	
Propensity to Consume (SA, %)	74.2	73.6	73.4 [74.6]	73.1 [74.4]	72.8 [74.3]	74.6 [72.9]	71.5 [75.4]	74.2 [73.6]	75.2 [74.8]	[74.3]
Overtime Hours Worked (All Industries, 5 employees or more)	2.0	-1.3	0.1 (-0.9)	-0.2 (-0.9)	-1.2 (-2.1)	-1.0 (-1.9)	-0.2 (-1.8)	0.7 (-0.9)	-0.9 (-1.8)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	0.5	0.2								
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	77	98	95	104	98	94	102	94	91	
Ratio of Job Offers to Applicants (SA, Times)	1.11	1.23	1.22 [1.10]	1.26 [1.12]	1.29 [1.15]	1.28 [1.15]	1.30 [1.16]	1.34 [1.17]	1.36 [1.18]	[1.19]
Unemployment Rate (SA, %)	3.5	3.3	3.4	3.3	3.2	3.3	3.2	3.2	3.2	
Economy Watcher Survey (Judgment of the present condition D.I.%)	46.6	48.8	49.5 [48.7]	47.7 [43.6]	45.6 [49.3]	44.6 [50.1]	45.4 [52.2]	43.5 [53.6]	43.0 [53.3]	41.2 [51.0]
Bankruptcies (Number of cases)	9,543 (-9.4)	8,684 (-9.0)	2,092 (-14.1)	2,152 (-3.1)	2,144 (-5.6)	723 (4.4)	746 (-13.1)	695 (-7.0)	671 (-7.3)	763 (-7.4)

(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 July, 22, 2016

	Fiscal	Fiscal	2015		2016	2016				
	2014	2015	3Q	4Q	1Q	FEB	MAR	APR	MAY	JUN
Customs Clearance (Exports in Yen Terms)	5.4	-0.7	(3.7)	(-4.6)	(-7.9)	(-4.0)	(-6.8)	(-10.1)	(-11.3)	
Value	3.9	2.1	(6.8)	(-0.6)	(-4.7)	(-4.2)	(-5.8)	(-5.7)	(-9.1)	
Volumes	1.3	-2.7	(-2.9)	(-4.1)	(-3.2)	(0.2)	(-1.0)	(-4.6)	(-2.4)	
Imports (In Yen terms)	-1.0	-10.3	(-5.9)	(-13.9)	(-15.7)	(-14.2)	(-14.9)	(-23.3)	(-13.8)	
Value	1.2	-8.5	(-4.1)	(-11.8)	(-14.9)	(-12.0)	(-19.0)	(-17.0)	(-16.8)	
Volumes	-2.1	-1.8	(-1.9)	(-2.5)	(-0.8)	(-2.4)	(-2.5)	(-7.5)	(3.6)	
Current Account (100 mil. yen)	87,245	180,028	48,709	34,479	59,636	23,874	29,862	18,785	18,091	
Goods (100 mil. yen)	-65,890	5,419	-3,488	954	8,534	4,023	8,828	6,971	399	
Services (100 mil. yen)	-27,252	-11,451	-2,238	-5,212	2,414	1,653	2,623	-4,012	1,174	
Financial Account (100 mil. yen)	137,595	238,095	54,646	49,065	90,136	30,107	52,380	14,793	40,994	
Gold & Foreign Exchange Reserves (\$1mil.)	1,245,316	1,262,099	1,248,936	1,233,214	1,262,099	1,254,149	1,262,099	1,262,509	1,253,967	1,265,402
Exchange Rate (¥/\$)	109.92	120.13	122.23	121.48	115.45	115.02	113.07	109.88	109.15	105.49

## 3. Financial Market Indicators

	Fiscal	Fiscal	2015		2016	2016					
	2014	2015	3Q	4Q	1Q	FEB	MAR	APR	MAY	JUN	
Uncollateralized Overnight Call Rates	0.068	0.063	0.074 [0.067]	0.076 [0.064]	0.035 [0.073]	0.033 [0.076]	-0.003 [0.070]	-0.037 [0.061]	-0.059 [0.069]	-0.055 [0.072]	
Euro Yen TIBOR (3 Months)	0.194	0.157	0.169 [0.210]	0.169 [0.184]	0.122 [0.171]	0.098 [0.171]	0.098 [0.170]	0.060 [0.170]	0.060 [0.169]	0.059 [0.169]	
Newly Issued Japanese Government Bonds Yields (10 Years)	0.400	-0.050	0.350 [0.525]	0.270 [0.330]	-0.050 [0.400]	-0.065 [0.330]	-0.050 [0.400]	-0.085 [0.340]	-0.120 [0.390]	-0.230 [0.455]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.006	0.924	0.969 (-0.018)	0.956 (-0.013)	0.924 (-0.032)	0.943 (-0.011)	0.924 (-0.019)	0.914 (-0.010)	0.904 (-0.010)		
The Nikkei Stock Average (TSE 225 Issues)	19,207	16,759	17,388 [16,174]	19,034 [17,451]	16,759 [19,207]	16,027 [18,798]	16,759 [19,207]	16,666 [19,520]	17,235 [20,563]	15,576 [20,236]	
M2(Average)	(3.3)	(3.6)	(4.0)	(3.4)	(3.2)	(3.2)	(3.2)	(3.4)	(3.4)	(3.4)	
Broadly-defined Liquidity(Average)	(3.3)	(4.0)	(4.4)	(3.8)	(3.5)	(3.5)	(3.2)	(2.7)	(2.3)	(1.9)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin	(2.3)	(2.4)	(2.6)	(2.3)	(2.2)	(2.2)	(2.0)	(2.2)	(2.2)	(2.0)
	Banks	(2.5)	(2.5)	(2.7)	(2.3)	(2.2)	(2.2)	(2.0)	(2.2)	(2.2)	(2.0)
	City Banks etc.	(1.4)	(1.2)	(1.6)	(1.0)	(0.9)	(1.0)	(0.7)	(1.0)	(0.9)	(0.6)
	Regional Banks	(3.8)	(3.7)	(3.9)	(3.7)	(3.4)	(3.5)	(3.2)	(3.4)	(3.4)	(3.4)
	Regional Banks II	(2.9)	(3.2)	(3.4)	(3.2)	(3.2)	(3.2)	(3.3)	(3.4)	(3.2)	(3.1)
Deposits and CDs (Average)	Shinkin	(1.4)	(2.2)	(2.1)	(2.3)	(2.3)	(2.3)	(2.3)	(2.2)	(2.2)	(2.3)
	Total(3 Business Condition)	(3.3)	(3.7)	(4.3)	(3.2)	(3.0)	(3.1)	(3.0)	(3.2)	(3.3)	(3.3)
	City Banks	(3.4)	(4.5)	(5.4)	(3.6)	(3.6)	(4.0)	(3.8)	(4.6)	(4.7)	(4.6)
	Regional Banks	(3.3)	(3.0)	(3.3)	(3.0)	(2.4)	(2.3)	(2.1)	(1.8)	(1.7)	(2.1)
	Regional Banks II	(3.1)	(2.5)	(2.7)	(2.3)	(2.1)	(2.1)	(1.9)	(2.0)	(1.8)	(1.8)

(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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