

## ***Private Consumption Showing Signs of Recovery***

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26 OCTOBER 2016

(ORIGINAL JAPANESE VERSION RELEASED ON 29 SEPTEMBER 2016)

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### 1. The Real Economy

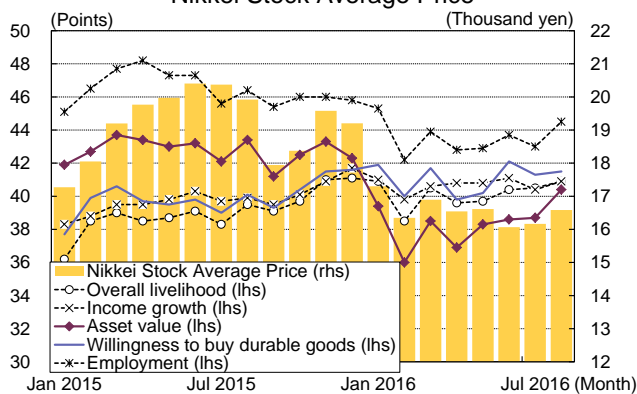
According to the second preliminary GDP report released September 8, private consumption rose an annualized +0.7% QoQ in Apr-Jun. This was the second straight quarter of positive expansion, following the +2.8% QoQ pace of Jan-Mar. Adjusted for the leap year effect, private consumption has continued to expand steadily, by more than 1.5% for a second straight quarter. The Cabinet Office also raised its view on spending in the Monthly Economic Report released September 16, another indication that private consumption is starting to recover.

We think personal spending has been picking up because, first of all, household employment and income conditions continue to improve as falling prices due to a stronger yen and cheaper oil have boosted real incomes. Moreover, stock prices have started to stabilize again after plunging at the start of the year due to uncertainty about economies overseas. The Cabinet Office's *Consumer Confidence Survey* shows that consumer sentiment regarding asset prices suddenly worsened between January and February, and at the same time views on living circumstances and other indicators also deteriorated considerably (Figure 1). This shows that volatility in the financial markets caused consumer sentiment to chill. Thereafter as well, the strengthening yen in the wake of Brexit vote in the UK hurt corporate profits, weighing on stock prices. However, the stock market has remained fairly firm overall, suggesting that the adverse impact on consumer sentiment has started to diminish.

There are also signs that a reactionary drop in demand for durable goods caused by the April 2014 consumption tax hike and various stimulus measures has started to ease. This is a promising sign for private consumption going forward. The Ministry of Economy, Trade, and Industry's *Indices of Industrial Production* showed that durable consumer goods shipments rose for two straight months, in June and July (Figure 2). The views when purchasing durable consumption goods indicator in the *Consumer Confidence Survey* has also started to improve, however gradually.

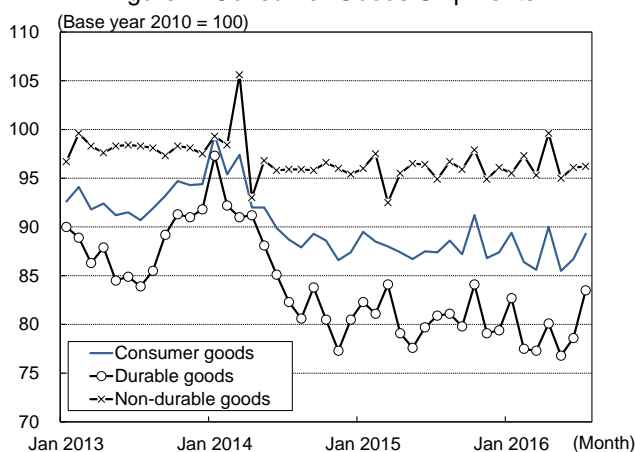
We expect private consumption to grow increasingly firm as economic effects start to appear following the Government's decision in June to postpone the next consumption tax hike and economic measures announced in August.

Figure 1: Consumer Sentiment Index and Nikkei Stock Average Price



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

Figure 2: Consumer Goods Shipments



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

## 2. Financial Markets

### (1) MONETARY POLICY

At its September 21-22 meeting, the Bank of Japan announced a new policy framework based on its comprehensive assessment of the developments in economic activity and prices under "QQE" and "QQE with a Negative Interest Rate". The new framework, "QQE with Yield Curve Control" is intended to bolster monetary easing. The focus of the new quantitative and qualitative monetary easing is combined with "Yield curve control" that controls on long-short interest rate and "Inflation-overshooting commitment" that clarify the planned duration of monetary easing (Table 1). It could be some time before inflation expectations rise as the adaptive mechanism following the comprehensive assessment, so the BoJ felt it must focus more on forming forward-looking expectations and adopt a more sustainable, flexible monetary policy. "Yield curve control" involves not only the negative interest rates introduced early this year, but also guiding the yield on newly-issued 10Yr JGBs to around 0%. The BoJ will continue to increase its long-term JGB holdings by around JPY80 trillion a year, but will abandon the increase target itself and shift from a focus on quantity to interest rates. As such, any additional easing will likely involve cutting negative rates even further. BoJ Governor Haruhiko Kuroda has also noted that lowering the target yield for long-term JGBs is another policy option, but the comprehensive assessment noted the deleterious effects of a flattening yield curve. Thus, the hurdles to cutting target level of a long-term interest rate will be high. The BoJ has determined that the current yield curve is optimal under current economic conditions, and we expect the central bank to maintain current monetary policy without any additional easing as long as external conditions do not change considerably.

### (2) Long-Term Yields & Exchange rate

The yen reacted to the BoJ decision by weakening, while yields rose. USD/JPY hit the upper 102 level at one point, before JPY started to rally against the USD again after the Fed deferred on a rate hike. USD/JPY is currently trading at around 100.

The yield on the 10Yr JGB hit 0.005% at one point, the first time in positive territory since March, before once again turning negative. The yield curve overall is now lower than before the BoJ meeting (Figure 3).

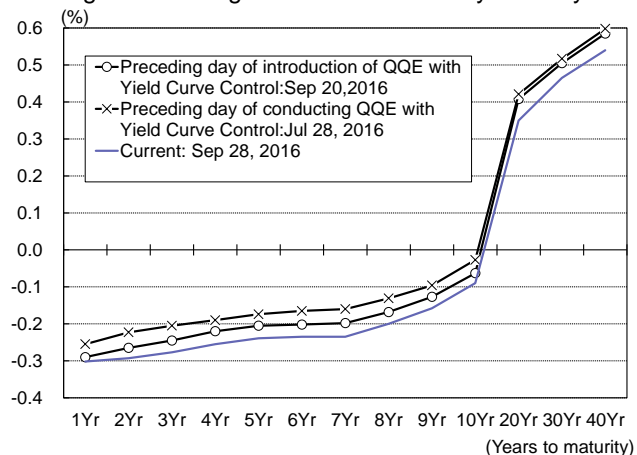
Table 1: Framework of Qualitative and Quantitative Easing with Long-Term Yield Control

Easing method		Details	
Yield curve control	Short-term interest rates	The short-term policy interest rate	-0.1%
	Long-term interest rates	The long-term interest rate: 10-year JGB yields (increase in the amount outstanding of its JGB holdings)	Around 0% (Increase by approximately JPY80trn, <u>but abandon quantitative target for pace of increase</u> )
Guidelines for asset purchases		Increase J-REIT purchases	By JPY90bn
		Increase ETF purchases	By JPY6tn
		Corporate bonds	Maintain JPY3.2trn
		CP	Maintain JPY2.2trn
inflation-overshooting commitment		<u>expanding the monetary base until the year-on-year rate of increase in the observed CPI exceeds the price stability target of 2 percent and stays above the target in a stable manner</u>	

Note: Underlined portions indicate changes from previous framework.

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

Figure 3: Changes in Yields of JGB by Maturity



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

## MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

### 1. Main Economic Indicators

As of Sep. 29, 2016

	Fiscal	Fiscal	2015	2016		2016				
	2014	2015	4Q	1Q	2Q	APR	MAY	JUN	JUL	AUG
Real GDP Growth Rate <% changes from previous period at SA annual rate>	-0.9	0.8	-1.7 (0.7)	2.1 (0.2)	0.7 (0.8)	***	***	***	***	***
Index of All Industries Activity	-1.1	0.9	-0.2 (0.6)	0.0 (0.4)	0.4 (0.1)	0.9 (-0.2)	-1.3 (0.3)	1.0 (0.1)	0.3 (-0.7)	
Industrial Production Index	-0.5	-1.0	0.1 (-0.8)	-1.0 (-1.6)	0.2 (-1.8)	0.5 (-3.3)	-2.6 (-0.4)	2.3 (-1.5)	-0.4 (-4.2)	
Production										
Shipments	-1.2	-1.2	0.4 (-0.8)	-2.0 (-2.4)	0.2 (-2.0)	1.6 (-3.4)	-2.6 (-1.0)	1.7 (-1.7)	0.7 (-4.0)	
Inventory	6.1	1.8	-0.5 (0.0)	2.4 (1.8)	-1.3 (0.0)	-1.7 (0.1)	0.4 (0.8)	0.0 (0.0)	-2.4 (-1.8)	
Inventory/Shipments Ratio (2010=100)	112.0	115.0	114.9 [113.8]	116.3 [113.0]	116.5 [113.8]	115.7 [113.7]	117.8 [114.8]	116.0 [112.8]	117.3 [112.7]	116.3
Domestic Corporate Goods Price Index	2.7	-3.2	-1.4 (-3.7)	-1.4 (-3.4)	-0.6 (-4.3)	-0.4 (-4.2)	0.1 (-4.3)	-0.1 (-4.2)	0.0 (-3.9)	-0.3 (-3.6)
Consumer Price Index(SA, total, excl.fresh foods)	2.8	0.0	0.0 (0.0)	-0.7 (-0.1)	0.4 (-0.4)	0.0 (-0.4)	-0.1 (-0.4)	0.1 (-0.4)	-0.2 (-0.5)	
Index of Capacity Utilization (2010=100)	100.6	98.0	97.9 [100.7]	97.3 [101.4]	95.4 [98.0]	96.5 [99.3]	94.2 [96.8]	95.6 [98.0]	96.2 [97.7]	97.4
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	0.8	4.1	2.6 (2.1)	6.7 (3.4)	-9.2 (-6.5)	-11.0 (-8.2)	-1.4 (-11.7)	8.3 (-0.9)	4.9 (5.2)	
Manufacturing	7.0	6.2	-3.0 (-3.1)	13.7 (4.3)	-13.4 (-12.9)	-13.3 (-14.8)	-6.4 (-21.5)	17.7 (-3.8)	0.3 (-1.4)	
Non-manufacturing	-3.3	2.5	5.6 (6.3)	3.5 (2.6)	-5.0 (-1.0)	-3.9 (-3.0)	-0.3 (-2.5)	2.1 (1.8)	8.6 (11.3)	
Excl.Electric Power & Ship building										
Shipments of Capital Goods (Excl.Transport Equipment)	4.4	-2.3	-1.7 (-4.2)	-2.4 (-5.5)	3.4 (-2.7)	5.2 (-3.7)	-1.4 (-1.1)	1.0 (-2.9)	0.6 (-4.9)	
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	88.0	92.1	86.8	94.7	100.5	99.5	101.7	100.4	100.5	
10,000 units at Annual Rate, SA										
Total floor	(-10.8)	(4.6)	(-0.7)	(5.5)	(4.9)	(9.0)	(9.8)	(-2.5)	(8.9)	
Sales at Retailers	-1.2	0.8								
Real Consumption Expenditures of Households over 2 persons (SA)	-5.1	-1.2	-2.2 (-3.3)	0.5 (-2.6)	-0.2 (-1.2)	0.3 (-0.4)	-1.4 (-1.1)	-1.3 (-2.3)	2.5 (-0.5)	
Propensity to Consume (SA, %)	74.2	73.6	73.1 [74.4]	72.8 [74.3]	72.9 [74.2]	74.2 [73.6]	75.2 [74.8]	69.4 [74.3]	69.3 [71.9]	74.1
Overtime Hours Worked (All Industries, 5 employees or more)	2.0	-1.3	-0.2 (-0.9)	-1.2 (-2.1)	0.0 (-1.2)	0.7 (-0.9)	-0.9 (-1.8)	1.4 (-1.0)	-0.9 (-1.9)	
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	104	98	93	94	91	95	97	
Ratio of Job Offers to Applicants (SA, Times)	1.11	1.23	1.26 [1.12]	1.29 [1.15]	1.36 [1.18]	1.34 [1.17]	1.36 [1.18]	1.37 [1.19]	1.37 [1.21]	1.22
Unemployment Rate (SA, %)	3.5	3.3	3.3	3.2	3.2	3.2	3.2	3.1	3.0	
Economy Watcher Survey (Judgment of the present condition D.I.%)	46.6	48.8	47.7 [43.6]	45.6 [49.3]	42.6 [52.6]	43.5 [53.6]	43.0 [53.3]	41.2 [51.0]	45.1 [51.6]	45.6 [49.3]
Bankruptcies (Number of cases)	9,543 (-9.4)	8,684 (-9.0)	2,152 (-3.1)	2,144 (-5.6)	2,129 (-7.2)	695 (-7.1)	671 (-7.3)	763 (-7.4)	712 (-9.5)	726 (14.9)

(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 Sep. 29, 2016

	Fiscal	Fiscal	2015	2016		2016				
	2014	2015	4Q	1Q	2Q	APR	MAY	JUN	JUL	AUG
Customs Clearance (Exports in Yen Terms)	5.4	-0.7	(-4.6)	(-7.9)	(-9.5)	(-10.1)	(-11.3)	(-7.4)	(-14.0)	(-9.6)
Value	3.9	2.1	(-0.6)	(-4.7)	(-8.3)	(-5.7)	(-9.1)	(-10.1)	(-11.9)	(-10.4)
Volumes	1.3	-2.7	(-4.1)	(-3.2)	(-1.3)	(-4.6)	(-2.4)	(3.1)	(-2.4)	(0.9)
Imports (In Yen terms)	-1.0	-10.3	(-13.9)	(-15.7)	(-18.8)	(-23.3)	(-13.7)	(-18.7)	(-24.7)	(-17.3)
Value	1.2	-8.5	(-11.8)	(-14.9)	(-17.6)	(-17.0)	(-16.7)	(-19.1)	(-21.5)	(-20.3)
Volumes	-2.1	-1.8	(-2.5)	(-0.8)	(-1.3)	(-7.5)	(3.6)	(0.4)	(-4.0)	(3.8)
Current Account (100 mil. yen)	87,245	180,028	34,479	59,636	46,620	18,785	18,091	9,744	19,382	
Goods (100 mil. yen)	-65,890	5,419	954	8,534	15,006	6,971	399	7,636	6,139	
Services (100 mil. yen)	-27,252	-11,451	-5,212	2,414	-4,514	-4,012	1,174	-1,676	-2,223	
Financial Account (100 mil. yen)	137,595	238,095	49,065	90,136	70,264	14,793	40,994	14,478	36,737	
Gold & Foreign Exchange Reserves (\$1mil.)	1,245,316	1,262,099	1,233,214	1,262,099	1,265,402	1,262,509	1,253,967	1,265,402	1,264,750	1,256,053
Exchange Rate (¥/\$)	109.92	120.13	121.48	115.45	108.17	109.88	109.15	105.49	103.90	101.27

## 3. Financial Market Indicators

	Fiscal	Fiscal	2015	2016		2016						
	2014	2015	4Q	1Q	2Q	APR	MAY	JUN	JUL	AUG		
Uncollateralized Overnight Call Rates	0.068	0.063	0.076 [0.064]	0.035 [0.073]	-0.050 [0.067]	-0.037 [0.061]	-0.059 [0.069]	-0.055 [0.072]	-0.043 [0.074]	-0.043 [0.076]		
Euro Yen TIBOR (3 Months)	0.194	0.157	0.169 [0.184]	0.122 [0.171]	0.060 [0.169]	0.060 [0.170]	0.060 [0.169]	0.059 [0.169]	0.058 [0.169]	0.058 [0.169]		
Newly Issued Japanese Government Bonds Yields (10 Years)	0.400	-0.050	0.270 [0.330]	-0.050 [0.400]	-0.230 [0.455]	-0.085 [0.340]	-0.120 [0.390]	-0.230 [0.455]	-0.195 [0.410]	-0.070 [0.380]		
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.006	0.924	0.956 (-0.013)	0.924 (-0.032)	0.886 (-0.038)	0.914 (-0.010)	0.904 (-0.010)	0.886 (-0.018)	0.885 (-0.001)			
The Nikkei Stock Average (TSE 225 Issues)	19,207	16,759	19,034 [17,451]	16,759 [19,207]	15,576 [20,236]	16,666 [19,520]	17,235 [20,563]	15,576 [20,236]	16,569 [20,585]	16,887 [18,890]		
M2(Average)	(3.3)	(3.6)	(3.4)	(3.2)	(3.4)	(3.4)	(3.4)	(3.5)	(3.4)	(3.3)		
Broadly-defined Liquidity(Average)	(3.3)	(4.0)	(3.8)	(3.5)	(2.4)	(2.8)	(2.3)	(2.1)	(1.9)	(1.7)		
Principal Figures of Financial Institutions												
Loans and Discount (Average)	Banks & Shinkin		(2.3)	(2.4)	(2.3)	(2.2)	(2.1)	(2.2)	(2.2)	(2.0)	(2.1)	(2.0)
	Banks		(2.5)	(2.5)	(2.3)	(2.2)	(2.1)	(2.2)	(2.2)	(2.0)	(2.1)	(2.0)
	City Banks etc.		(1.4)	(1.2)	(1.0)	(0.9)	(0.8)	(1.0)	(0.9)	(0.6)	(0.7)	(0.5)
	Regional Banks		(3.8)	(3.7)	(3.7)	(3.4)	(3.4)	(3.4)	(3.4)	(3.4)	(3.5)	(3.5)
	Regional Banks II		(2.9)	(3.2)	(3.2)	(3.2)	(3.2)	(3.4)	(3.2)	(3.1)	(2.9)	(2.8)
Shinkin		(1.4)	(2.2)	(2.3)	(2.3)	(2.2)	(2.2)	(2.2)	(2.3)	(2.3)	(2.2)	
Deposits and CDs (Average)	Total(3 Business Condition)		(3.3)	(3.7)	(3.2)	(3.0)	(3.3)	(3.2)	(3.3)	(3.3)	(3.5)	(3.3)
	City Banks		(3.4)	(4.5)	(3.6)	(3.6)	(4.7)	(4.6)	(4.7)	(4.6)	(4.9)	(4.4)
	Regional Banks		(3.3)	(3.0)	(3.0)	(2.4)	(1.9)	(1.8)	(1.7)	(2.1)	(2.1)	(2.2)
	Regional Banks II		(3.1)	(2.5)	(2.3)	(2.1)	(1.9)	(2.0)	(1.8)	(1.8)	(1.8)	(1.9)

(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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