

Japan's Business Sentiment Rises Amid Improvements in Corporate Earnings

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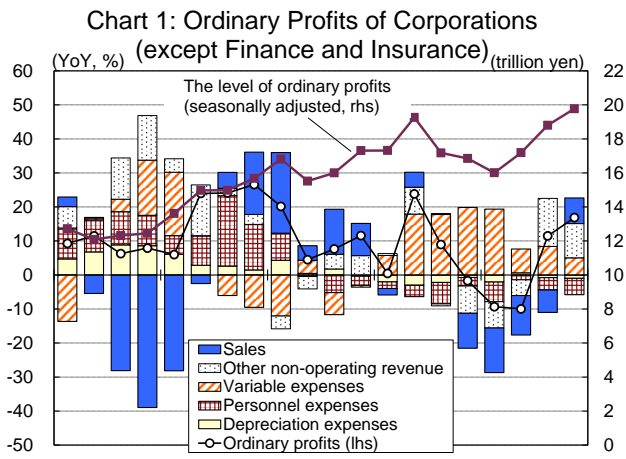
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1. The Real Economy

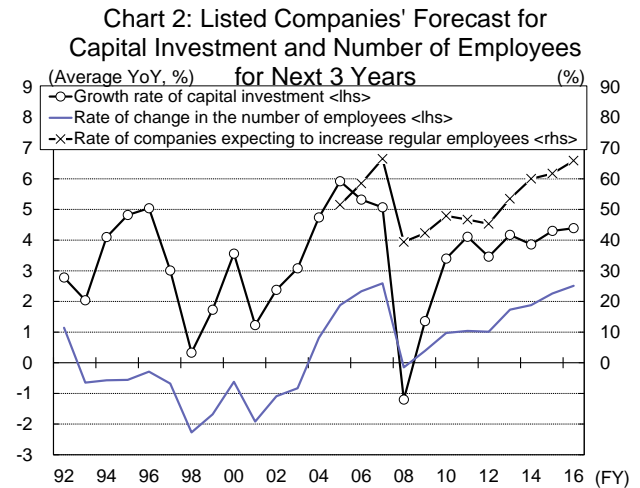
Ordinary profits of Japanese companies (excluding financial and insurance companies) for the Oct-Dec 2016 quarter rose by 16.9% YoY, marking the second consecutive quarter of significant increase and hitting a record fourth-quarter high (see Chart 1). The breakdown of contributions to the growth of ordinary profits shows that an increase in “sales” and “non-operating revenue”, in which dividends received from overseas subsidiaries are recorded, boosted the profit, absorbing the increases in “labor costs” and “depreciation costs” to secure an increase in profit. This can be taken as “balanced expansion”, different from profit increases achieved mainly by cost reduction that were seen after the global financial crisis and 2012.

Amid improving earnings, Japanese companies' business sentiment has improved, showing a more proactive stance to increase capital expenditure and employment. According to the Annual Survey of Corporate Behavior released by the Cabinet Office on Feb. 28, companies' forecast for increase/decrease rate of capital investment and the number of employees over the next three years marked highest after the global financial crisis (see Chart 2). In particular, regarding questions on employment, the percentage of companies expecting to increase regular employees among their employees is significantly higher than the previous survey, suggesting that the tightening labor market conditions have led to an improvement in quality of employment.

Japanese companies' positive stance on future investment and employment serves as a favorable factor for predicting the sustainability of the current moderate economic recovery. Capital expenditure is expected to remain stable on the back of strong corporate earnings and increasing production activity. Besides, companies' stance to increase the number of employees and shift non-regular employment to regular employment, as described above, would help push up employee compensation, which would underpin private consumption in the future. On the other hand, the preliminary figures from a survey on wage increase conducted ahead of annual spring wage negotiations show that the wage increase rate is likely to be lower than last year, and CPI is expected to increase in response to rising oil prices. Despite such headwinds, private consumption would continue a moderate recovery backed by an improvement in quality and quantity of employment.



Source: Ministry of Finance, BTMU Economic Research Office



Source: Cabinet Office, BTMU Economic Research Office

2. Financial Markets

(1) Monetary Policy and Long-Term Yields

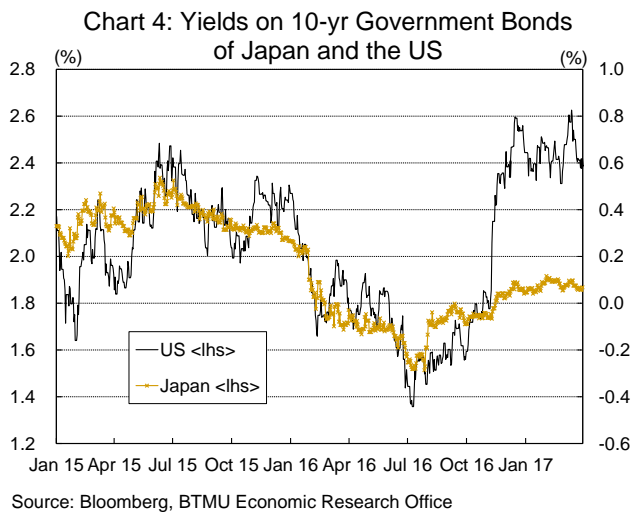
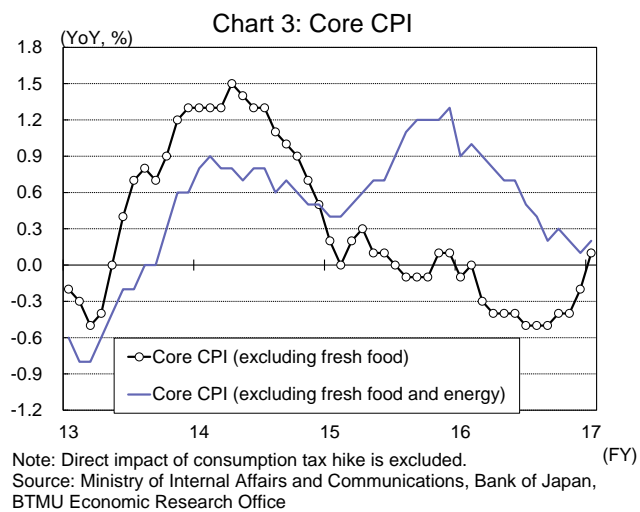
CPI continued to improve with core CPI (excluding fresh food) rising by 0.1% YoY in January, the first upturn in 13 months, while the BoJ announced its decision to keep its monetary policy unchanged at its two-day monetary policy meeting ended on March 16. CPI is expected to rise to around +1% YoY in the second half of the year and there is a possibility that the BoJ would discuss raising its yield target for 10-year JGBs. However, the recent increase in CPI is mainly attributed to the rise in oil prices. In fact, core CPI (excluding fresh food and energy), which was frequently used by the BoJ to explain the trends of CPI when oil prices declined in 2015, continues to show weak growth (see Chart 3). If CPI continues to rise mainly due to external factors such as oil prices, it should be a temporary increase and does not represent an improvement in trend of CPI. In that case, the BoJ would decide not to increase its yield target. The BoJ is expected to maintain its current monetary policy for the time being.

Yields on 10-year JGBs soared temporarily to 0.15% on February 3, but after the fixed-rate operation was conducted, the yields declined and remain at around 0.1% (see Chart 4). However, considering the fluctuation of long-term interest rate by about 0.3% in the US during the last one month, the fluctuation of interest rate in Japan is small due to the BoJ's yield curve control.

(2) Exchange Rate

JPY temporarily depreciated against USD, reaching 115 yen level per USD. The Fed raised interest rates at the March 15 FOMC meeting as expected, while expectations for acceleration of interest rate hikes were diminished since the median of the Fed's dot plot chart, which shows the board members' projections for interest rate, remained almost unchanged from the previous meeting. In addition, there was growing concern over the ability of Trump's administration to implement economic and fiscal policies. Under such environment, JPY strengthened further against USD, rising to 111 yen level. Going forward, although the widening gap in interest rates between Japan and the US is expected to push JPY lower against USD, the fiscal and trade policies of Trump's administration and elections in various

European countries could increase investors' risk aversion, depending on the outcome. Therefore, JPY would lack direction at around 112 yen per USD.



MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Mar. 23, 2017

	Fiscal	Fiscal	2016			2016			2017	
	2014	2015	2Q	3Q	4Q	OCT	NOV	DEC	JAN	FEB
Real GDP Growth Rate <% changes from previous period at SA annual rate>	-0.4	1.3	2.2 (0.9)	1.2 (1.1)	1.2 (1.6)	***	***	***	***	***
Index of All Industries Activity	-1.1	0.9	0.4 (0.1)	0.5 (0.7)	0.3 (1.0)	0.0 (-0.4)	0.4 (2.2)	-0.2 (1.2)	0.1 (1.3)	
Industrial Production Index	-0.5	-1.0	0.2 (-1.8)	1.3 (0.4)	2.0 (2.1)	0.0 (-1.4)	1.5 (4.6)	0.7 (3.2)	-0.4 (3.7)	
Production										
Shipments	-1.2	-1.2	0.2 (-2.0)	0.7 (-0.6)	3.3 (1.7)	2.0 (-2.0)	1.0 (5.1)	-0.4 (2.3)	0.3 (4.3)	
Inventory	6.1	1.8	-1.3 (0.0)	-2.6 (-2.0)	-3.1 (-4.6)	-2.1 (-3.0)	-1.6 (-4.8)	0.6 (-4.6)	-0.1 (-4.4)	
Inventory/Shipments Ratio (2010=100)	112.0	115.0	116.5 [113.8]	115.3 [114.7]	110.5 [114.9]	114.2 [113.0]	107.8 [115.5]	109.5 [116.3]	111.1 [116.2]	114.5
Domestic Corporate Goods Price Index	2.8	-3.3	-0.6 (-4.5)	-0.3 (-3.8)	0.4 (-2.1)	-0.1 (-2.7)	0.4 (-2.3)	0.7 (-1.2)	0.6 (0.5)	0.2 (1.0)
Consumer Price Index(SA, total, excl.fresh foods)	2.8	0.0	0.4 (-0.4)	-0.2 (-0.5)	0.2 (-0.3)	0.1 (-0.4)	0.1 (-0.4)	0.1 (-0.2)	0.3 (0.1)	
Index of Capacity Utilization (2010=100)	100.6	98.0	95.4 [98.0]	97.2 [97.6]	100.2 [97.9]	98.1 [98.4]	101.0 [98.2]	101.6 [97.2]	101.7 [99.9]	94.5
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	0.8	4.1	-6.4 (-6.5)	5.5 (6.5)	0.3 (3.6)	3.4 (-5.6)	-2.8 (10.4)	2.1 (6.7)	-3.2 (-8.2)	
Manufacturing	7.0	6.2	-8.5 (-12.9)	1.9 (-0.5)	2.7 (3.5)	0.4 (-9.0)	8.1 (8.3)	0.8 (10.9)	-10.8 (-22.0)	
Non-manufacturing Excl.Electric Power & Ship building	-3.3	2.5	-3.5 (-1.0)	6.2 (11.8)	-1.0 (3.3)	2.7 (-3.9)	-5.6 (11.6)	2.1 (3.5)	0.7 (5.7)	
Shipments of Capital Goods (Excl.Transport Equipment)	4.4	-2.3	3.4 (-2.7)	1.0 (0.4)	3.3 (4.7)	2.1 (1.7)	2.1 (7.6)	-1.5 (4.9)	0.5 (4.7)	
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)	99.1 (5.4)	97.9 (7.1)	95.3 (7.9)	98.1 (13.1)	95.4 (6.7)	92.3 (3.9)	100.1 (12.8)	
Total floor										
Sales at Retailers	-1.2	0.8								
Real Consumption Expenditures of Households over 2 persons (SA)	-5.1	-1.2	0.0 (-1.2)	-0.4 (-2.4)	-0.9 (-0.7)	-0.6 (-0.4)	-0.1 (-1.5)	-0.8 (-0.3)	0.5 (-1.2)	
Propensity to Consume (SA, %)	74.2	73.6	72.8 [74.2]	70.7 [73.6]	71.8 [73.1]	71.1 [73.3]	72.4 [72.6]	71.8 [73.2]	71.0 [72.3]	74.0
Overtime Hours Worked (All Industries, 5 employees or more)	2.0	-1.3	-0.2 (-1.2)	-0.2 (-1.5)	0.1 (-1.2)	-0.1 (-0.9)	-0.3 (-0.9)	-0.7 (-1.8)	2.0 (0.7)	
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	93	102	105	101	106	107	109	
Ratio of Job Offers to Applicants (SA, Times)	1.11	1.23	1.35 [1.18]	1.37 [1.22]	1.41 [1.26]	1.40 [1.24]	1.41 [1.26]	1.43 [1.28]	1.43 [1.29]	1.29
Unemployment Rate (SA, %)	3.5	3.3	3.2	3.0	3.1	3.0	3.1	3.1	3.0	
Economy Watcher Survey (Judgment of the present condition D.I.%)	46.6	48.8	42.6 [52.6]	45.2 [49.5]	48.7 [47.7]	46.2 [48.2]	48.6 [46.1]	51.2 [48.7]	48.6 [46.6]	48.5
Bankruptcies (Number of cases)	9,543 (-9.4)	8,684 (-9.0)	2,129 (-7.3)	2,087 (-0.2)	2,086 (-3.1)	683 (-8.0)	693 (-2.5)	710 (1.6)	605 (-10.4)	688 (-4.8)

(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 Mar. 23, 2017									
	Fiscal	Fiscal	2016			2016			2017	
	2014	2015	2Q	3Q	4Q	OCT	NOV	DEC	JAN	FEB
Customs Clearance (Exports in Yen Terms)	5.4	-0.7	(-9.5)	(-10.2)	(-1.9)	(-10.3)	(-0.4)	(5.4)	(1.3)	(11.3)
Value	3.9	2.0	(-8.3)	(-11.1)	(-6.3)	(-9.0)	(-7.3)	(-2.7)	(1.6)	(2.8)
Volumes	1.3	-2.7	(-1.3)	(1.0)	(4.7)	(-1.4)	(7.4)	(8.4)	(-0.3)	(8.3)
Imports (In Yen terms)	-1.0	-10.2	(-18.7)	(-19.3)	(-9.3)	(-16.3)	(-8.7)	(-2.5)	(8.4)	(1.2)
Value	1.2	-8.4	(-17.5)	(-18.8)	(-10.7)	(-14.1)	(-11.9)	(-5.9)	(1.9)	(5.7)
Volumes	-2.1	-1.9	(-1.3)	(-0.7)	(1.6)	(-2.5)	(3.6)	(3.6)	(6.3)	(-4.3)
Current Account (100 mil. yen)	87,245	180,028	45,955	58,430	42,476	17,199	14,155	11,122	655	
Goods (100 mil. yen)	-65,890	5,419	14,959	15,221	17,079	5,876	3,134	8,068	-8,534	
Services (100 mil. yen)	-27,252	-11,451	-4,951	-3,365	-3,847	-1,719	738	-2,866	-2,357	
Financial Account (100 mil. yen)	137,595	238,095	71,315	105,334	22,206	7,446	10,963	3,796	-15,351	
Gold & Foreign Exchange Reserves (\$1mil.)	1,245,316	1,262,099	1,265,402	1,260,145	1,216,903	1,242,792	1,219,291	1,216,903	1,231,573	1,232,340
Exchange Rate (¥/\$)	109.92	120.13	108.17	102.40	109.32	103.82	108.18	115.95	114.73	113.06

3. Financial Market Indicators

	Fiscal	Fiscal	2016			2016			2017			
	2014	2015	2Q	3Q	4Q	OCT	NOV	DEC	JAN	FEB		
Uncollateralized Overnight Call Rates	0.068	0.063	-0.050 [0.067]	-0.046 [0.074]	-0.043 [0.076]	-0.037 [0.078]	-0.049 [0.078]	-0.044 [0.075]	-0.045 [0.074]	-0.038 [0.033]		
Euro Yen TIBOR (3 Months)	0.194	0.157	0.060 [0.169]	0.057 [0.169]	0.056 [0.169]	0.056 [0.169]	0.056 [0.169]	0.056 [0.169]	0.056 [0.169]	0.056 [0.098]		
Newly Issued Japanese Government Bonds Yields (10 Years)	0.400	-0.050	-0.230 [0.455]	-0.085 [0.350]	0.040 [0.270]	-0.050 [0.300]	0.020 [0.300]	0.040 [0.270]	0.085 [0.095]	0.050 [-0.065]		
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.006	0.924	0.886 (-0.038)	0.865 (-0.021)	0.853 (-0.012)	0.866 (0.001)	0.864 (-0.002)	0.853 (-0.011)	0.855 (0.002)			
The Nikkei Stock Average (TSE 225 Issues)	19,207	16,759	15,576 [20,236]	16,450 [17,388]	19,114 [19,034]	17,425 [19,083]	18,308 [19,747]	19,114 [19,034]	19,041 [17,518]	19,119 [16,027]		
M2(Average)	(3.3)	(3.6)	(3.4)	(3.4)	(3.9)	(3.7)	(3.9)	(4.0)	(4.0)	(4.2)		
Broadly-defined Liquidity(Average)	(3.3)	(3.9)	(2.2)	(1.6)	(1.9)	(1.5)	(1.9)	(2.2)	(2.3)	(2.6)		
Principal Figures of Financial Institutions												
Loans and Discount (Average)	Banks & Shinkin		(2.3)	(2.4)	(2.1)	(2.1)	(2.5)	(2.4)	(2.4)	(2.6)	(2.5)	(2.8)
	Banks		(2.5)	(2.5)	(2.1)	(2.1)	(2.5)	(2.4)	(2.4)	(2.6)	(2.6)	(2.9)
	City Banks etc.		(1.4)	(1.2)	(0.8)	(0.7)	(1.4)	(1.1)	(1.2)	(1.8)	(1.7)	(2.1)
	Regional Banks		(3.8)	(3.7)	(3.4)	(3.5)	(3.6)	(3.6)	(3.6)	(3.5)	(3.5)	(3.6)
	Regional Banks II		(2.9)	(3.2)	(3.2)	(2.9)	(3.1)	(3.1)	(3.1)	(3.1)	(3.1)	(3.2)
Shinkin		(1.4)	(2.2)	(2.2)	(2.3)	(2.3)	(2.3)	(2.3)	(2.3)	(2.3)	(2.5)	
Deposits and CDs (Average)	Total(3 Business Condition)		(3.3)	(3.7)	(3.3)	(3.4)	(4.2)	(3.9)	(4.2)	(4.3)	(4.5)	(4.4)
	City Banks		(3.4)	(4.5)	(4.7)	(4.8)	(6.0)	(5.6)	(6.1)	(6.3)	(6.4)	(6.1)
	Regional Banks		(3.3)	(3.0)	(1.9)	(2.2)	(2.3)	(2.2)	(2.5)	(2.3)	(2.6)	(2.7)
	Regional Banks II		(3.1)	(2.5)	(1.9)	(1.9)	(2.2)	(2.2)	(2.2)	(2.2)	(2.3)	(2.4)

(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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