

Japan Economic Monthly

Higher Risks of Prolonged and Deepening Stagnation

Economic Research Office

The Bank of Tokyo-Mitsubishi UFJ, Ltd.

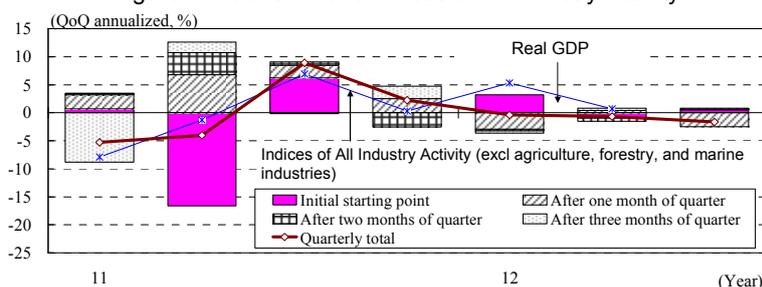
1. The Real Economy

Japan's economic weakness has been increasingly apparent. The economy, which had been recovering from the March 2011 disaster in the Tohoku Region, appeared to be stagnating from last fall through the end of 2011. Real GDP growth was a strong +6.9% QoQ annualized in Jul-Sept 2011, then fell to +0.3% QoQ annualized in Oct-Dec (Figure 1). Thereafter, the economy re-accelerated once again to +5.3% QoQ annualized in Jan-Mar as the stalling phase ended relatively quickly. This time, however, after slowing to +0.7% QoQ annualized in Apr-Jun, the economy did not show any signs of picking up again in Jul-Sept. On the contrary, the Japanese economy's rate of deceleration has deepened and quarterly growth may have contracted. In fact, the Indices of All Industry Activity, which is conceptually close to real GDP, showed a drop of -0.6% MoM in July, then rose by only +0.1% YoY in August. The September result has not been announced yet, but if it is also flat, the Jul-Sept figure will drop by an annualized -1.6% QoQ.

Looking at domestic and external demand separately, exports to Europe and Asia continue to weaken. Overall exports cut real GDP growth by an annualized -2.3% QoQ in Oct-Dec 2011, but current conditions affecting Japanese exports—a worsening European debt crisis and the impact on Asia—are even worse. Further, on the domestic demand side, private consumption, which had been firm, is dulling. For example, the monthly Private Consumption Integrated Estimates stood at -0.9% MoM in June, then slipped to -1.0% MoM in July (Figure 2). Even considering the +1.5% MoM bounceback in August, the Jul-Sept figure could be the first on-quarter contraction in six quarters. (If the September figure is flat, the quarterly result would be -1.3% QoQ annualized.)

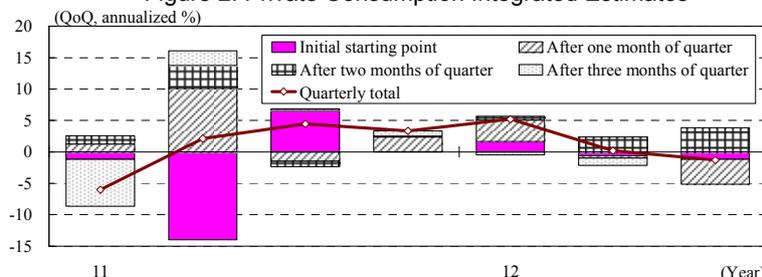
Overall, the recent shift in Japan's economy appears to be more deeply rooted than the change through the end of 2011. A prolonged stagnation in Japan's economy would suggest a steady worsening of conditions.

Figure 1: Real GDP and Indices of All Industry Activity



Notes: 1. *Initial starting point* is Quarterly rate of change when indicator level of final month of previous quarter continues.
 2. *After one month in quarter* is Quarterly rate of change when level of last two months does not change from first month (level MoM) minus *Initial starting point*.
 3. *After two months of quarter* is Quarterly rate of change when level of last month does not change from second month minus *Initial starting point* and *After one month of quarter*. *After three months of quarter* is calculated the same way. Q3 2012 is through Jul-Aug.
 Source: Compiled by BTMU Economic Research Office from Cabinet Office, METI data.

Figure 2: Private Consumption Integrated Estimates



Notes: 1. *Initial starting point* is Quarterly rate of change when indicator level of final month of previous quarter continues.
 2. *After one month in quarter* is Quarterly rate of change when level of last two months does not change from first month (level MoM) minus *Initial starting point*.
 3. *After two months of quarter* is Quarterly rate of change when level of last month does not change from second month minus *Initial starting point* and *After one month of quarter*. *After three months of quarter* is calculated the same way. Q3 2012 is through Jul-Aug.
 Source: Compiled by BTMU Economic Research Office from Cabinet Office data.

2. Financial Markets

(1) Monetary Policy & Long-Term Yields

The Bank of Japan voted to maintain current monetary policy at the October 4-5 monetary policy meeting. However, the BoJ downgraded its assessment of the economy from *the pick-up in Japan's activity has come to a pause* at the time of its September 18-19 meeting to *Japan's economic activity is leveling off more or less* in October. Exports have been weakening even more recently as overseas economies slow, and the economy's stagnation is expected to persist for some time. At the October 30 meeting, the BoJ is expected to cut its forecasts for real GDP and inflation in the semi-annual *Outlook Report*. At the same time, the BoJ is widely expected to implement additional monetary easing by increasing the size of the fund for asset purchases. Monetary policy has had some effect so far, with bond yields staying firm at approximately 0.1% for up to 3Yrs (Figure 3). Longer-term JGBs may be added to 1Yr-3Yr bonds for eligibility for purchase through the fund.

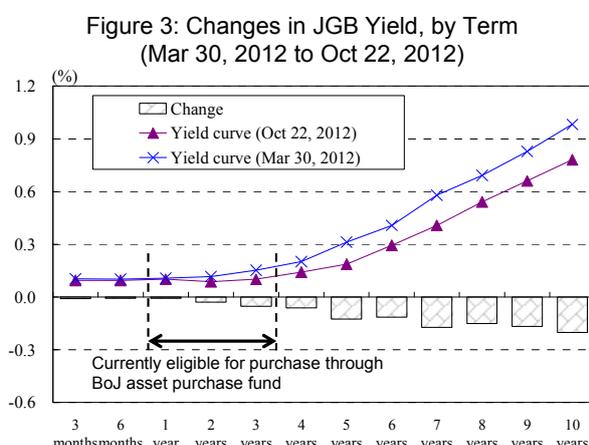
The 10Yr JGB yield hit the 0.8% level in early September, then slipped back down to the

mid-0.7% point as both the domestic and overseas economies slowed more and the BoJ introduced more monetary easing. Thereafter, the 10Yr JGB yield has risen in tandem with US Treasuries, but remains at a low level of around 0.7%.

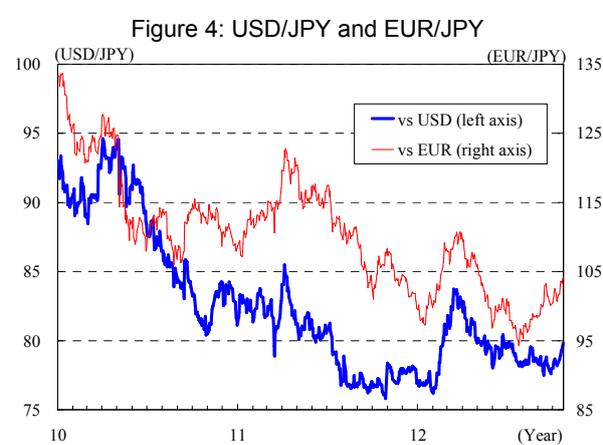
(2) Exchange Rates

The JPY hit the lower USD/JPY79 mark at one point in September after the BoJ implemented additional monetary easing, but thereafter has wavered on either side of the USD/JPY78 mark. From around mid-October, improving US economic indicators and speculation swirling about additional BoJ monetary easing have resulted in JPY selling. The JPY has fallen to around the USD/JPY80 mark recently.

The JPY continues to be prone to selling against the EUR. Since the head of the European Central Bank made pointed statements about protecting the EUR and details of a sovereign debt-buying program were released this summer, the yields of Greek and Spanish government debt have largely settled down. The strengthening of the EUR appears to be due to an easing of excessive risk aversion caused by the jitters in Europe. As such, after touching a post-Lehman Brothers collapse high of EUR/JPY94 in late July, the JPY has fallen to around the EUR/JPY104 mark (Figure 4).



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



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(Yasuhiro Ishimaru, Rei Tsuruta)

MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Oct. 31, 2012

| | Fiscal 2010 | Fiscal 2011 | 2011 | | | 2012 | | | | |
|---|-------------------|------------------|------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|------------------|
| | | | 4Q | 1Q | 2Q | MAY | JUN | JUL | AUG | SEP |
| Real GDP Growth Rate <% changes from previous period at SA annual rate> | 3.3 | -0.0 | 0.3 (-0.7) | 5.3 (2.9) | 0.7 (3.2) | *** | *** | *** | *** | *** |
| Index of All Industries Activity | 2.0 | 0.2 | 0.5 (0.0) | -0.1 (2.4) | -0.1 (2.6) | -0.2 (3.3) | 0.3 (0.6) | -0.6 (0.5) | 0.1 (-0.1) | |
| Industrial Production Index | 9.3 | -1.0 | 0.4 (-1.6) | 1.3 (4.8) | -2.0 (5.3) | -3.4 (6.0) | 0.4 (-1.5) | -1.0 (-0.8) | -1.6 (-4.6) | -4.1 (-8.1) |
| Shipments | 9.4 | -2.0 | 0.3 (-2.2) | 0.8 (4.1) | -0.2 (8.0) | -1.3 (11.7) | -0.9 (-1.1) | -3.1 (-1.8) | 0.2 (-3.3) | -4.4 (-8.5) |
| Inventory | 3.9 | 9.6 | -1.4 (3.8) | 5.9 (9.6) | 0.0 (6.3) | -0.7 (4.7) | -1.2 (6.3) | 2.9 (9.4) | -1.6 (5.9) | -0.9 (4.8) |
| Inventory/Shipments Ratio (2005=100) | 108.4 | 116.4 | 115.0 [111.0] | 113.1 [107.7] | 121.8 [121.1] | 118.6 [121.5] | 123.6 [115.2] | 128.2 [116.6] | 125.2 [115.2] | 130.5 [117.6] |
| Domestic Corporate Goods Price Index | 0.7 | 1.4 | -1.1 (1.1) | 0.2 (0.3) | -0.2 (-1.0) | -0.4 (-0.8) | -0.7 (-1.5) | -0.4 (-2.2) | 0.2 (-1.9) | 0.3 (-1.4) |
| Consumer Price Index(SA, total, excl.fresh foods) | -0.8 | 0.0 | -0.2 (-0.2) | -0.1 (0.1) | 0.3 (0.0) | -0.3 (-0.1) | -0.3 (-0.2) | 0.0 (-0.3) | 0.0 (-0.3) | 0.2 (-0.1) |
| Index of Capacity Utilization (2005=100) | 88.0 | 87.4 | 89.3 [88.4] | 92.1 [85.9] | 89.8 [79.8] | 89.8 [81.6] | 87.7 [85.7] | 88.1 [86.8] | 85.8 [88.8] | |
| Machinery Orders(Private Demand, Excl.Electric Power and Ship building) | 9.1 | 6.2 | -0.7 (6.7) | 0.9 (3.3) | -4.1 (-1.7) | -14.8 (1.0) | 5.6 (-9.9) | 4.6 (1.7) | -3.3 (-6.1) | |
| Manufacturing | 18.3 | 5.9 | -0.7 (4.1) | 0.1 (-0.5) | -5.8 (-7.6) | -8.0 (-6.3) | -2.9 (-16.2) | 12.0 (4.0) | -15.1 (-18.4) | |
| Non-manufacturing Excl.Electric Power & Ship building | 2.7 | 6.6 | -0.5 (8.6) | 0.5 (6.4) | 0.0 (3.1) | -6.4 (7.6) | 2.6 (-4.6) | -2.1 (-1.0) | 3.6 (3.9) | |
| Shipments of Capital Goods (Excl.Transport Equipment) | 21.4 | 5.4 | 1.2 (2.1) | -2.5 (7.0) | 0.7 (0.9) | 5.6 (5.1) | -3.5 (-4.5) | -1.8 (-4.5) | -3.0 (-7.1) | -2.2 (-5.1) |
| Construction Orders | -5.2 | 7.1 | | | | | | | | |
| Private | -2.6 | 3.7 | | | | | | | | |
| Public | -12.1 | 22.7 | | | | | | | | |
| Public Works Contracts | -8.8 | -0.5 | | | | | | | | |
| Housing Starts 10,000 units at Annual Rate, SA | 81.8 (5.6) | 84.1 (2.7) | 79.6 (-4.5) | 86.2 (3.7) | 87.8 (6.2) | 90.3 (9.3) | 83.7 (-0.2) | 87.0 (-9.6) | 88.8 (-5.5) | |
| Total floor | (9.0) | (2.5) | (-4.4) | (2.3) | (5.1) | (9.0) | (-0.4) | (-9.6) | (-7.7) | |
| Sales at Retailers | 0.8 | 0.8 | | | | | | | | |
| Real Consumption Expenditures of Households over 2 persons (SA) | -0.9 | -1.2 | 0.4 (-1.0) | 0.2 (1.1) | 1.7 (2.7) | 1.5 (4.0) | -1.3 (1.6) | -1.3 (1.7) | 2.2 (1.8) | -1.9 (-0.9) |
| Propensity to Consume (SA,%) | 73.4 | 73.3 | 74.2 [74.0] | 71.8 [72.4] | 74.1 [74.0] | 74.6 [73.4] | 72.0 [72.6] | 75.4 [71.9] | 73.2 [74.0] | 74.7 [74.1] |
| Overtime Hours Worked (All Industries, 5 employees or more) | 7.9 | 0.8 | 1.4 (1.9) | 1.0 (1.8) | 0.0 (4.0) | 1.9 (5.6) | -2.6 (1.2) | -2.2 (-0.8) | 0.3 (0.1) | |
| Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more) | 0.5 | -0.3 | | | | | | | | |
| Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y) | 23,384 | 52,083 | 25,350 28,038 | 127,239 33,848 | 138,382 28,033 | 142,285 24,914 | 141,824 30,531 | 130,161 28,860 | 133,260 29,735 | 24,538 |
| Ratio of Job Offers to Applicants (SA,Times) | 0.56 | 0.68 | 0.69 [0.57] | 0.75 [0.61] | 0.81 [0.62] | 0.81 [0.62] | 0.82 [0.63] | 0.83 [0.65] | 0.83 [0.66] | [0.67] |
| Unemployment Rate (SA,%) | 5.0 | 5.0 | 4.5 | 4.6 | 4.7 | 4.4 | 4.3 | 4.3 | 4.2 | 4.2 |
| Economy Watcher Survey (Judgment of the present condition D.I.%) | 44.2 | 44.9 | 46.0 [43.0] | 47.3 [40.1] | 47.3 [38.0] | 47.2 [36.0] | 43.8 [49.6] | 44.2 [52.6] | 43.6 [47.3] | 41.2 [45.3] |
| Bankruptcies (Number of cases) | 13,065 (-11.3) | 12,707 (-2.7) | 3,103 (-5.9) | 3,184 (-0.8) | 3,127 (-5.5) | 1,148 (7.1) | 975 (-16.3) | 1,026 (-5.0) | 967 (-5.7) | 931 (-6.9) |

(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 Oct. 31, 2012

| | Fiscal | Fiscal | 2011 | 2012 | | | 2012 | | | | |
|--|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|--|
| | 2010 | 2011 | 4Q | 1Q | 2Q | MAY | JUN | JUL | AUG | SEP | |
| Customs Clearance(Exports in Yen Terms) | 14.9 | -3.7 | (-5.5) | (-1.6) | (4.8) | (10.0) | (-2.3) | (-8.1) | (-5.8) | (-10.3) | |
| Value | 0.1 | 0.6 | (-0.5) | (1.4) | (1.2) | (0.6) | (0.1) | (2.4) | (-1.6) | (0.9) | |
| Volumes | 14.7 | -4.3 | (-5.0) | (-3.1) | (3.5) | (9.3) | (-2.3) | (-10.2) | (-4.2) | (-11.1) | |
| Imports(In Yen terms) | 16.0 | 11.6 | (12.4) | (9.9) | (5.1) | (9.4) | (-2.2) | (2.2) | (-5.4) | (4.1) | |
| Value | 3.4 | 9.1 | (10.9) | (6.5) | (1.8) | (0.9) | (-1.5) | (-4.5) | (-3.3) | (-0.1) | |
| Volumes | 12.4 | 2.2 | (1.3) | (3.1) | (3.2) | (8.5) | (-0.7) | (7.0) | (-2.1) | (4.2) | |
| Current Balance(100 mil. yen) | 166,595 | 76,180 | 9,257 | 20,544 | 11,377 | 3,421 | 4,221 | 6,254 | 4,547 | | |
| Trade Balance(100 mil. yen) | 64,955 | -34,698 | -9,446 | -12,956 | -11,298 | -8,049 | 1,122 | -3,736 | -6,445 | | |
| Services(100 mil. yen) | -12,730 | -18,265 | -6,658 | -1,421 | -8,303 | -1,377 | -2,083 | -3,462 | -2,225 | | |
| Capital and Financial Accounts(100 mil. yen) | -97,221 | 68,806 | 83,422 | -28,153 | -30,182 | -9,037 | -19,683 | -7,329 | -11,472 | | |
| Gold & Foreign Exchange Reserves(\$1mil.) | 1,116,025 | 1,288,703 | 1,295,841 | 1,288,703 | 1,270,547 | 1,277,716 | 1,270,547 | 1,272,777 | 1,273,242 | 1,277,000 | |
| Exchange Rate(V\$) | 85.69 | 79.05 | 77.39 | 79.28 | 80.17 | 79.70 | 79.32 | 79.02 | 78.66 | 78.17 | |

3. Financial Market Indicators

| | Fiscal | Fiscal | 2011 | 2012 | | | 2012 | | | | |
|---|-----------------------------|--------|-------------------|-------------------|-------------------|------------------|-------------------|-------------------|------------------|------------------|--------|
| | 2010 | 2011 | 4Q | 1Q | 2Q | MAY | JUN | JUL | AUG | SEP | |
| Uncollateralized Overnight Call Rates | 0.091 | 0.077 | 0.079 [0.090] | 0.083 [0.088] | 0.078 [0.067] | 0.084 [0.069] | 0.076 [0.069] | 0.084 [0.073] | 0.086 [0.081] | 0.085 [0.080] | |
| Euro Yen TIBOR (3 Months) | 0.356 | 0.331 | 0.329 [0.336] | 0.331 [0.336] | 0.333 [0.332] | 0.332 [0.332] | 0.335 [0.332] | 0.327 [0.332] | 0.327 [0.329] | 0.327 [0.329] | |
| Newly Issued Japanese Government Bonds Yields (10 Years) | 1.127 | 1.050 | 1.030 [1.072] | 0.968 [1.242] | 0.848 [1.160] | 0.830 [1.150] | 0.830 [1.130] | 0.780 [1.080] | 0.795 [1.030] | 0.765 [1.020] | |
| Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period) | 1.357 | 1.269 | 1.292 (-0.023) | 1.269 (-0.023) | 1.255 (-0.014) | 1.268 (0.000) | 1.255 (-0.013) | 1.252 (-0.003) | 1.257 (0.005) | | |
| The Nikkei Stock Average (TSE 225 Issues) | 9,755 | 10,084 | 8,455 [10,229] | 10,084 [9,755] | 9,007 [9,816] | 8,543 [9,694] | 9,007 [9,816] | 8,695 [9,833] | 8,840 [8,955] | 8,870 [8,700] | |
| M2(Average) | (2.7) | (2.9) | (3.0) | (3.0) | (2.4) | (2.2) | (2.3) | (2.3) | (2.4) | (2.4) | |
| Broadly-defined Liquidity(Average) | (0.6) | (0.1) | (0.1) | (0.3) | (0.2) | (0.2) | (0.0) | (0.0) | (0.3) | (0.7) | |
| Principal Figures of Financial Institutions | | | | | | | | | | | |
| Loans and Discount (Average) | Banks & Shinkin | (-1.9) | (-0.1) | (0.2) | (0.6) | (0.3) | (0.2) | (0.6) | (0.7) | (0.8) | (1.0) |
| | Banks | (-2.0) | (-0.1) | (0.2) | (0.8) | (0.5) | (0.4) | (0.8) | (0.9) | (1.1) | (1.2) |
| | City Banks etc. | (-4.2) | (-1.8) | (-1.3) | (-0.4) | (-1.1) | (-1.3) | (-0.7) | (-0.5) | (-0.4) | (-0.3) |
| | Regional Banks | (0.6) | (1.9) | (2.0) | (2.3) | (2.4) | (2.3) | (2.6) | (2.6) | (2.8) | (3.2) |
| | Regional Banks II | (-0.4) | (1.1) | (1.2) | (1.2) | (1.3) | (1.2) | (1.4) | (1.3) | (1.5) | (1.2) |
| Deposits and CDs (Average) | Shinkin | (-1.3) | (-0.5) | (-0.4) | (-0.5) | (-0.7) | (-0.7) | (-0.7) | (-0.9) | (-0.8) | (-0.5) |
| | Total(3 Business Condition) | (2.6) | (2.7) | (3.0) | (2.9) | (1.8) | (1.5) | (1.9) | (2.0) | (2.3) | (2.3) |
| | City Banks | (2.6) | (1.9) | (2.1) | (2.2) | (0.7) | (0.1) | (1.4) | (1.7) | (2.1) | (2.5) |
| | Regional Banks | (3.1) | (3.7) | (4.0) | (3.7) | (3.0) | (3.0) | (2.4) | (2.3) | (2.4) | (2.1) |
| | Regional Banks II | (0.6) | (2.8) | (3.1) | (3.2) | (2.8) | (2.5) | (2.3) | (2.4) | (1.9) | |

(Notes)

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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