

# Japan Economic Monthly

## Rising Expectations for New Government's Economic Policies

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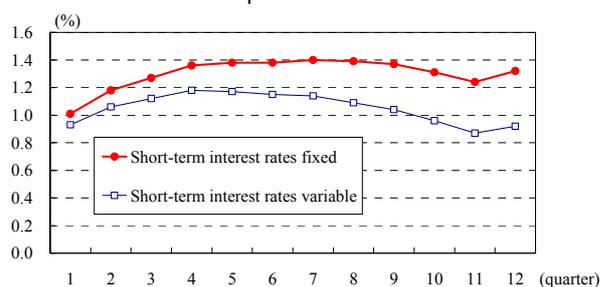
### 1. The Real Economy

One month has passed since the launch of the LDP-Komeito coalition government led by Prime Minister Shinzo Abe. Even before the Lower House election in December, the LDP had already clearly taken on a stronger stimulative and reflationary stance, in terms of both fiscal and monetary policy. After taking office, the new administration then proposed emergency economic measures on January 11, which were approved a week later on January 15 as part of the second-largest supplementary budget ever of JPY13.1 trillion (JPY10.3 trillion was related to emergency economic measures). The Bank of Japan assented to the administration's wishes and agreed to introduce an inflation target of 2% as well as further monetary easing at the January 21-22 Policy Board meeting. (See below for details.)

We believe these policies will have positive effects on the economy. The government spending is likely to be implemented quickly in order to lay the groundwork for the House of Councillors election in July and the consumption tax hike in April 2014. If the policies are executed smoothly, the economic growth rate could be boosted significantly through mid-FY13. Increased public spending usually raises market interest rates and results in private investment declining (a crowding out effect), but when monetary policy caps interest rates at the same time, the effects of fiscal policy are significant and long-lasting. The Cabinet Office has calculated that continued growth in public investment (equivalent to 1% of GDP) would impact real GDP by 1) less than +1.2% at most when short-term interest rates are variable and the effects start to diminish quickly; versus 2) +1.4% for a sustained period when short-term interest rates are fixed (de facto monetary easing)(Figure 1).

Japan still has a sizeable negative GDP gap namely a deflation gap (-2.7% of GDP as of Jul-Sept 2012, Figure 2). In order to close the gap quickly, steadily implementing a policy mix, including a micro growth strategy, is critical.

Figure 1: Continued Real Public Investment Growth and Impact on Real GDP

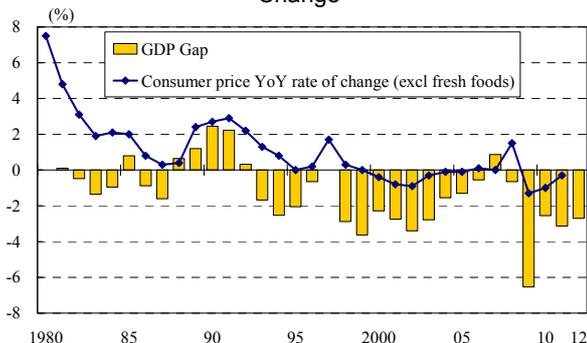


Note: 1. Continued growth equivalent to approximately 1% of GDP.

2. Calculations based on Cabinet Office's *Short-Term Japan Economic Macro Measurement Model (2011)*. Rate of deviation from real GDP used in absence of continued growth in real public investment.

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

Figure 2: The GDP Gap and Consumer Price Rate of Change



Note: *GDP Gap* is difference between real GDP and potential real GDP divided by potential real GDP. 2012 figure is Jul-Sept figure.

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

## 2. Financial Markets

### (1) Monetary Policy & Long-Term Yields

At the January 21-22 Monetary Policy Board meeting, the BoJ agreed to introduce the *Price Stability Target* and the *Open-Ended Asset Purchasing Method* and also issued a joint declaration to bolster collaboration with the government. The BoJ set the *price stability target at 2 percent in terms of the year-on-year rate of change in the consumer price index (CPI)*, and strengthened monetary policy to continue measures—including the virtual zero interest rate policy and asset purchases—in order to achieve the target. The asset purchase program was amended to make monthly purchases of a fixed amount for an undetermined period of time from early 2014, when purchases under the current system end. The monthly purchases will total JPY13 trillion for some time, and will include JPY2 trillion of long-term JGBs and JPY10 trillion of short-term JGBs. For financial assets other than JGBs and T-Bills, the Bank will aim to maintain the amount outstanding of those assets. Further, in the joint statement with the government, the BoJ announced its intent to achieve the price stability target as soon as possible, while the government bolsters economic growth and constructs a sustainable fiscal structure. The government and BoJ showed their determination to together end deflation quickly and achieve sustainable economic growth (Table 1).

The benchmark 10Yr JGB yield briefly hit the mid 0.8% level in early January as share prices rose and on concerns about increased issuance of JGBs, but thereafter fell on growing expectations of further BoJ monetary easing. The 10Yr yield is currently in the mid-0.7% range.

### (2) Exchange Rates

In the foreign exchange market, conditions have been supporting selling of the JPY. The JPY has been weakening against the USD more quickly recently, to approximately

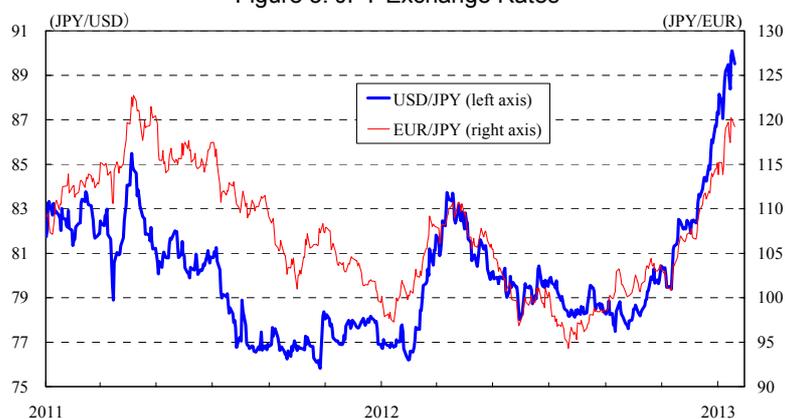
USD/JPY90, because of increased speculation of further BoJ monetary easing and the averted *fiscal cliff* in the US, as well as the release of FRB minutes detailing discussion regarding possible exit of quantitative easing. The JPY is also continuing to weaken against the EUR. Although the eurozone economy is still struggling, unease about the debt crisis has been alleviating, with long-term interest rates in Southern European countries stabilizing. After peaking at EUR/JPY94 in July 2012, the JPY has been weakening, and is now trading at the EUR/JPY120 range (Figure 3).

Table 1: BoJ Recent Monetary Easing Measures

Sept 19, 2012	Increased Asset Purchase Fund
	Increased from JPY70 trillion → JPY80 trillion Eliminated minimum bid yield for purchases of long-term JGBs and corporate bonds
Oct 30, 2012	Increased Asset Purchase Fund
	Increased from JPY80 trillion → JPY91 trillion
	Agreed to create funds supply framework to support increased lending To supply funds requested by financial institutions for long terms at low interest rates in order to boost lending BoJ, MoF, and Economic & Fiscal Policy heads released a joint statement on efforts to end deflation
Dec 20, 2012	Increased Asset Purchase Fund
	Increased from JPY91 trillion → JPY101 trillion
Jan 22, 2013	Introduced price stability target
	2% in terms of the year-on-year rate of change in the consumer price index (CPI).
	Introduced open-ended asset purchasing method
	To purchase JPY13 trillion of assets, including JPY2 trillion in long-term JGBs monthly, from early 2014 Government and BoJ release the joint statement of the government and BOJ on overcoming deflation and achieving sustainable economic growth

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

Figure 3: JPY Exchange Rates



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

(Yasuhiro Ishimaru, Rei Tsuruta)

## MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

## 1. Main Economic Indicators

As of Feb. 5, 2013

	Fiscal 2010	Fiscal 2011	2012			2012				
			2Q	3Q	4Q	AUG	SEP	OCT	NOV	DEC
Real GDP Growth Rate <% changes from previous period at SA annual rate>	3.4	0.3	-0.1 (3.9)	-3.5 (0.5)		***	***	***	***	***
Index of All Industries Activity	2.0	0.2	-0.1 (2.6)	-0.5 (-0.2)		0.0 (-0.1)	-0.4 (-1.2)	0.2 (0.1)	-0.3 (0.1)	
Industrial Production Index Production	9.3	-1.0	-2.0 (5.3)	-4.2 (-4.6)	-1.9 (-5.9)	-1.6 (-4.6)	-4.1 (-8.1)	1.6 (-4.5)	-1.4 (-5.5)	2.5 (-7.8)
Shipments	9.4	-2.0	-0.2 (8.0)	-5.4 (-4.5)	-2.0 (-5.9)	0.2 (-3.3)	-4.3 (-8.4)	-0.1 (-4.9)	-0.8 (-5.6)	4.4 (-7.2)
Inventory	3.9	9.6	0.0 (6.3)	0.3 (4.8)	-2.4 (3.6)	-1.6 (5.9)	-0.9 (4.8)	-0.1 (3.8)	-1.2 (3.1)	-1.1 (3.6)
Inventory/Shipments Ratio (2005=100)	108.4	116.4	121.8 [121.1]	127.9 [116.5]	127.1 [115.0]	125.2 [115.2]	130.4 [117.6]	127.6 [116.6]	127.2 [115.6]	126.4 [112.7]
Domestic Corporate Goods Price Index	0.7	1.4	-0.2 (-1.0)	-0.8 (-1.9)	0.0 (-0.8)	0.2 (-1.9)	0.2 (-1.5)	-0.3 (-1.0)	0.0 (-0.9)	0.3 (-0.6)
Consumer Price Index(SA, total, excl.fresh foods)	-0.8	0.0	0.3 (0.0)	-0.3 (-0.2)	0.0 (-0.1)	0.0 (-0.3)	0.0 (-0.1)	0.0 (0.0)	-0.1 (-0.1)	0.0 (-0.2)
Index of Capacity Utilization (2005=100)	88.0	87.4	89.8 [79.8]	85.0 [87.5]	85.0 [89.3]	85.8 [88.8]	81.1 [87.0]	82.4 [89.9]	82.2 [88.1]	82.2 [89.9]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	9.1	6.2	-4.1 (-1.7)	-1.1 (-4.6)		-3.3 (-6.1)	-4.3 (-7.8)	2.6 (1.2)	3.9 (0.3)	
Manufacturing	18.3	5.9	-5.8 (-7.6)	-3.2 (-9.5)		-15.1 (-18.4)	2.8 (-12.7)	-3.6 (-13.3)	3.9 (-10.5)	
Non-manufacturing Excl.Electric Power & Ship building	2.7	6.6	0.0 (3.1)	0.1 (-1.3)		3.6 (3.9)	1.3 (-4.7)	2.8 (13.3)	6.2 (9.1)	
Shipments of Capital Goods (Excl.Transport Equipment)	21.4	5.4	0.7 (0.9)	-4.8 (-5.3)	-6.0 (-11.2)	-3.0 (-7.1)	-1.5 (-4.4)	-6.7 (-11.2)	0.0 (-12.9)	8.5 (-9.8)
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	81.9 (5.6)	84.1 (2.7)	87.6 (6.2)	87.6 (-1.1)	91.8 (15.0)	88.2 (-5.5)	87.5 (15.5)	96.8 (25.2)	90.6 (10.3)	88.0 (10.0)
Total floor	9.0	2.5	5.1	(-2.7)	12.2	(-7.7)	12.6	20.1	8.5	8.4
Sales at Retailers	0.8	0.8								
Real Consumption Expenditures of Households over 2 persons (SA)	-0.9	-1.2	1.7 (2.7)	-1.4 (0.9)		2.2 (1.8)	-1.9 (-0.9)	0.6 (-0.1)	-0.1 (0.2)	-0.7 (-0.7)
Propensity to Consume (SA,%)	73.4	73.3	74.1 [74.0]	74.4 [73.1]	74.2 [74.2]	73.2 [74.0]	74.7 [74.1]	74.0 [72.7]	75.0 [74.1]	75.7 [74.5]
Overtime Hours Worked (All Industries, 5 employees or more)	7.9	0.8	0.0 (4.0)	-3.3 (-0.9)	-0.5 (-2.8)	0.3 (0.1)	-0.8 (-2.0)	-1.0 (-3.1)	1.0 (-2.2)	0.8 (-3.1)
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	52	138	131	131	133	130	134	128	132
Ratio of Job Offers to Applicants (SA,Times)	0.56	0.68	0.81 [0.62]	0.82 [0.66]	0.81 [0.69]	0.83 [0.66]	0.81 [0.67]	0.80 [0.68]	0.80 [0.69]	0.82 [0.71]
Unemployment Rate (SA,%)	5.0	5.0	4.4	4.2	4.2	4.2	4.2	4.2	4.1	4.2
Economy Watcher Survey (Judgment of the present condition D.I,%)	44.2	44.9	47.3 [38.0]	43.0 [48.4]	41.6 [46.0]	43.6 [47.3]	41.2 [45.3]	39.0 [45.9]	40.0 [45.0]	45.8 [47.0]
Bankruptcies (Number of cases)	13,065 (-11.3)	12,707 (-2.7)	3,127 (-5.5)	2,924 (-5.9)	2,889 (-6.8)	967 (-5.7)	931 (-6.9)	1,035 (6.0)	964 (-11.9)	890 (-13.7)

(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 Feb. 5, 2013

	Fiscal	Fiscal	2012			2012				
	2010	2011	2Q	3Q	4Q	AUG	SEP	OCT	NOV	DEC
Customs Clearance(Exports in Yen Terms)	14.9	-3.7	(4.8)	(-8.2)	(-5.5)	(-5.8)	(-10.3)	(-6.5)	(-4.1)	(-5.8)
Value	0.1	0.6	(1.2)	(0.6)	(4.2)	(-1.6)	(0.9)	(1.7)	(3.6)	(7.3)
Volumes	14.7	-4.3	(3.5)	(-8.7)	(-9.3)	(-4.2)	(-11.1)	(-8.1)	(-7.5)	(-12.2)
Imports(In Yen terms)	16.0	11.6	(5.1)	(0.2)	(0.4)	(-5.3)	(4.2)	(-1.5)	(0.9)	(1.9)
Value	3.4	9.1	(1.8)	(-2.6)	(1.1)	(-3.3)	(-0.1)	(-0.4)	(1.8)	(1.8)
Volumes	12.4	2.2	(3.2)	(2.9)	(-0.6)	(-2.1)	(4.2)	(-1.0)	(-0.9)	(0.0)
Current Balance(100 mil. yen)	166,595	76,180	11,377	16,210		4,448	5,137	3,769	-2,224	
Trade Balance(100 mil. yen)	64,955	-34,698	-11,298	-15,144		-6,636	-4,747	-4,503	-8,475	
Services(100 mil. yen)	-12,730	-18,265	-8,303	-8,092		-2,167	-2,633	-3,568	-1,901	
Capital and Financial Accounts(100 mil. yen)	-155,633	29,618	-30,182	-23,904		-10,278	-6,860	-5,920	-3,274	
Gold & Foreign Exchange Reserves(\$1mil.)	1,116,025	1,288,703	1,270,547	1,277,000	1,268,125	1,273,242	1,277,000	1,274,160	1,270,848	1,268,125
Exchange Rate(US\$)	85.69	79.05	80.17	78.62	81.16	78.66	78.17	78.97	80.87	83.64

## 3. Financial Market Indicators

	Fiscal	Fiscal	2012			2012					
	2010	2011	2Q	3Q	4Q	AUG	SEP	OCT	NOV	DEC	
Uncollateralized Overnight Call Rates	0.091	0.077	0.078 [0.067]	0.085 [0.078]	0.084 [0.079]	0.086 [0.081]	0.085 [0.080]	0.085 [0.081]	0.086 [0.077]	0.082 [0.078]	
Euro Yen TIBOR (3 Months)	0.356	0.331	0.333 [0.332]	0.327 [0.330]	0.318 [0.329]	0.327 [0.329]	0.327 [0.329]	0.326 [0.329]	0.318 [0.329]	0.308 [0.329]	
Newly Issued Japanese Government Bonds Yields (10 Years)	1.127	1.050	0.848 [1.160]	0.780 [1.043]	0.757 [1.030]	0.795 [1.030]	0.765 [1.020]	0.775 [1.045]	0.700 [1.065]	0.795 [0.980]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.357	1.269	1.255 (-0.014)	1.245 (-0.010)	1.226 (-0.019)	1.257 (0.005)	1.245 (-0.012)	1.242 (-0.003)	1.239 (-0.003)	1.226 (-0.013)	
The Nikkei Stock Average (TSE 225 Issues)	9,755	10,084	9,007 [9,816]	8,870 [8,700]	10,395 [8,455]	8,840 [8,955]	8,870 [8,700]	8,928 [8,988]	9,446 [8,435]	10,395 [8,455]	
M2(Average)	(2.7)	(2.9)	(2.4)	(2.4)	(2.3)	(2.4)	(2.4)	(2.3)	(2.1)	(2.6)	
Broadly-defined Liquidity(Average)	(0.6)	(0.2)	(0.2)	(0.3)	(0.7)	(0.3)	(0.5)	(0.5)	(0.5)	(1.1)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin	(-1.9)	(-0.1)	(0.3)	(0.8)	(1.0)	(0.8)	(0.9)	(0.8)	(1.0)	(1.2)
	Banks	(-2.0)	(-0.1)	(0.5)	(1.1)	(1.2)	(1.1)	(1.2)	(1.1)	(1.2)	(1.4)
	City Banks etc.	(-4.2)	(-1.8)	(-1.1)	(-0.4)	(-0.1)	(-0.4)	(-0.4)	(-0.4)	(-0.2)	(0.3)
	Regional Banks	(0.6)	(1.9)	(2.4)	(2.9)	(3.2)	(2.9)	(3.2)	(3.1)	(3.2)	(3.1)
	Regional Banks II	(-0.4)	(1.1)	(1.3)	(1.4)	(0.4)	(1.5)	(1.2)	(0.3)	(0.5)	(0.5)
Deposits and CDs (Average)	Shinkin	(-1.3)	(-0.5)	(-0.7)	(-0.8)	(-0.6)	(-0.8)	(-0.7)	(-0.8)	(-0.7)	(-0.4)
	Total(3 Business Condition)	(2.6)	(2.7)	(1.8)	(2.2)	(2.0)	(2.3)	(2.3)	(2.1)	(1.7)	(2.3)
	City Banks	(2.6)	(1.9)	(0.7)	(2.1)	(1.7)	(2.1)	(2.5)	(1.9)	(1.1)	(2.1)
	Regional Banks	(3.1)	(3.7)	(3.0)	(2.3)	(2.6)	(2.4)	(2.1)	(2.5)	(2.5)	(3.0)
	Regional Banks II	(0.6)	(2.8)	(2.8)	(2.2)	(1.1)	(2.4)	(1.9)	(1.1)	(1.0)	(1.2)

(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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