

# Japan Economic Monthly

## Government Nears Decision on Consumption Tax as Recovery Takes Firmer Hold

Economic Research Office

The Bank of Tokyo-Mitsubishi UFJ, Ltd.

### 1. The Real Economy

Japan's second GDP preliminary report, released September 9, showed that real GDP grew an annualized +3.8% QoQ in Apr-Jun, a big upward revision to the +2.6% QoQ annualized expansion reported in the first preliminary report. The economy logged another quarter of fairly strong growth, following the +4.1% QoQ annualized pace of Jan-Mar. Especially striking points in the second preliminary report were upward revisions showing the first on-quarter increase of private non-residential investment in six quarters (+5.1% QoQ), as well as the first on-quarter double-digit public investment growth in two quarters (+12.7% QoQ). Details of the two components reveal that investment in computer software rose by +7.9% QoQ, buildings and structures by +7.3% QoQ, transportation equipment by +2.9% QoQ, and other machinery and equipment etc. by +6.3% QoQ, for a total of +6.4% QoQ growth (Figure 1). The re-acceleration in public investment appears to reflect the fuller implementation of the large-scale supplementary budget, while capital expenditures turning positive is an indication that the Abe Administration's policy effects are becoming more widespread.

Amidst this steady recovery, the Abe Administration is expected to make a final determination about an April 2014 consumption tax hike in early October. A comparison of H1 (Jan-Jun) real GDP growth in the year prior to a consumption tax hike shows that growth stood at +2.6% QoQ annualized before the last consumption tax hike in April 1997, and at +3.2% QoQ annualized in H1 2013. Private companies appear to be more sound and have improved their resilience to a consumption tax hike. The government will likely have to be proactive about addressing fiscal restructuring and social security reforms tied to the tax hike.

The impact of a consumption tax hike will likely be (i) a surge of pre-hike demand and a subsequent reactionary fall; and (ii) diminished household demand resulting from lower real purchasing power and incomes (①private consumption and ②housing investment). The actual impact on Japan's economy is projected to be +0.2%pt YoY in FY13 and -1.1%pt YoY in FY14 in terms of contribution to real GDP growth (Figure 2). In other words, although significant in FY14, the negative impact is expected to be offset by the effects of sustained monetary easing and the growth strategy, as well as a virtuous economic cycle getting underway (policy effects ⇒ higher corporate and household incomes ⇒ increased demand

and production).

Figure 1: Private Non-Residential Investment and Public Investment

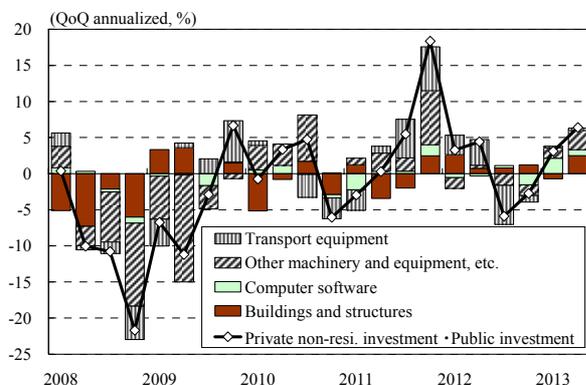
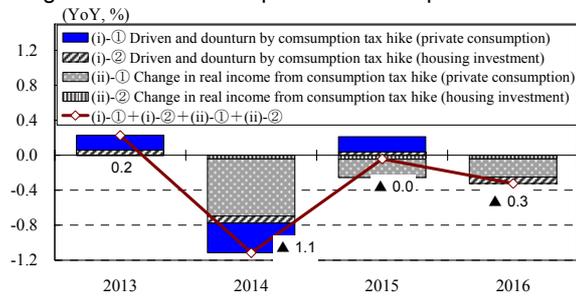


Figure 2: Estimated Impact of Consumption Tax Hike



Note: Impact in terms of contribution to real GDP growth of not only consumption tax hike (from 5% to 8% in Apr 2014, to 10% in Oct 2015), but also reduction in automobile acquisition tax (from 5% to 2% in Apr 2014 and to 0% in Oct 2015) and greater mortgage tax breaks [extending by four years to end-2017, raising maximum income tax exemption from JPY2 mn (JPY200,000/year × 10 years) to JPY4 mn (JPY400,000/year × 10 years)].

## 2. Financial Markets

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

At its September 4-5 Monetary Policy meeting, the BoJ agreed to maintain current monetary easing policy. At the post-meeting press conference, Governor Kuroda expressed his belief that inflation is rising as envisioned as a production-income-expenditures virtuous cycle gets underway in the economy overall.

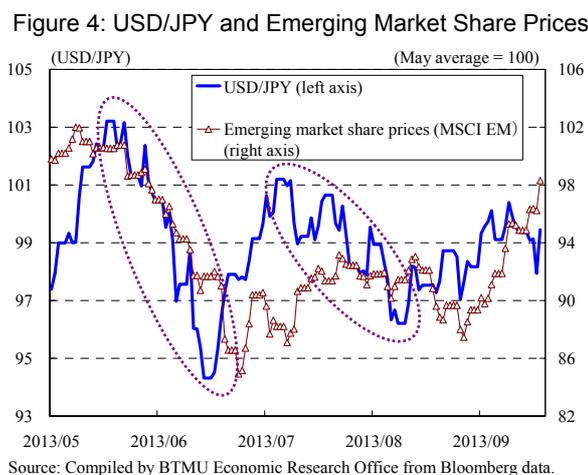
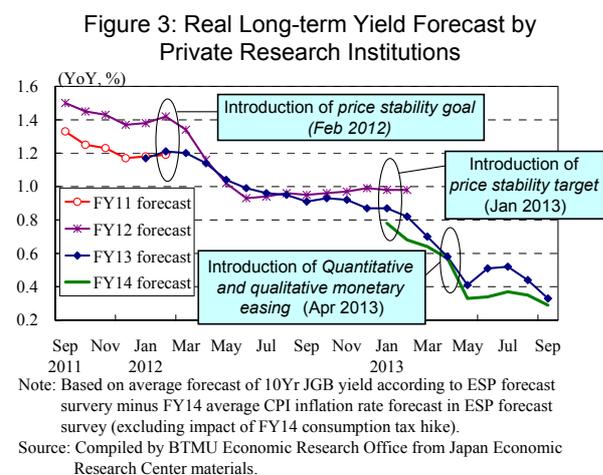
According to private research institution forecasts, Japanese real long-term interest rates (the 10Yr JGB yield minus CPI inflation rate excluding fresh foods) are expected to decline (especially in the distant future, Figure 3) with the introduction of price stability goal in the medium to long term in February 2012 and an price stability target in January 2013. The real yield has fallen further after the introduction of quantitative and qualitative monetary easing in April. Long-term rates are still expected to remain low and stable; only the expected inflation rate is higher. Such a decline in real interest rates is likely to stoke domestic and external demand via a weaker JPY and lower borrowing costs. The BoJ's current policies appear to be having a favorable impact on the real economy.

### (2) Exchange Rates

The JPY has been through two strengthening phases since May (Figure 4). The first phase, from late May to mid-June, was triggered by comments by FRB Chairman Bernanke and coincided with a sudden surge of speculation that the FRB would shrink its asset purchases. The second JPY strengthening phase was from early July through mid-August and was due to strong concerns about emerging country economies, including China. Both rises in USD/JPY largely correlated with falling and weak share prices in emerging countries, and JPY buying

due to risk aversion appears to have been a factor in the JPY's strengthening.

On the other hand, JPY weakening pressures—like the expansion in Japan's money supply due to the BoJ's continued large-scale monetary easing and a widening gap in real long-term interest rates (Japan < US)—clearly persist. Once views about an exit strategy for monetary policy in the US are set and the world economy (including emerging countries) stabilizes, JPY buying for the purpose of risk aversion will likely ebb and the JPY will probably start to weaken once again. In fact, share prices in emerging countries have been rising recently while the JPY has been weak.



(Yasuhiro Ishimaru, Rei Tsuruta)

## MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

## 1. Main Economic Indicators

As of Oct. 4, 2013

	Fiscal 2011	Fiscal 2012	2012			2013			2013		
			4Q	1Q	2Q	MAY	JUN	JUL	AUG	SEP	
Real GDP Growth Rate <% changes from previous period at SA annual rate>	0.3	1.2	1.1 (0.4)	4.1 (0.3)	3.8 (1.2)	***	***	***	***	***	
Index of All Industries Activity	0.3	0.1	-0.1 (-0.3)	0.0 (-1.2)	1.0 (0.6)	1.1 (1.2)	-0.7 (0.1)	0.5 (1.7)			
Industrial Production Index Production	-0.7	-2.9	-1.9 (-5.9)	0.6 (-7.9)	1.5 (-3.1)	1.9 (-1.1)	-3.1 (-4.6)	3.4 (1.8)	-0.7 (-0.2)		
Shipments	-1.5	-1.8	-1.3 (-6.4)	4.1 (-6.3)	-1.9 (-3.5)	1.0 (-2.1)	-3.2 (-5.1)	2.0 (1.4)	0.4 (-0.8)		
Inventory	12.1	-2.7	-1.6 (5.2)	-3.4 (-2.7)	0.4 (-2.9)	-0.4 (-2.7)	0.0 (-2.9)	1.6 (-2.8)	-0.1 (-3.2)		
Inventory/Shipments Ratio (2010=100)	109.0	114.4	117.7 [107.2]	112.1 [107.6]	107.6 [111.5]	104.8 [110.5]	111.0 [111.7]	110.5 [115.3]	112.3 [115.5]	[118.5]	
Domestic Corporate Goods Price Index	1.4	-1.1	0.0 (-0.9)	0.8 (-0.3)	0.6 (0.6)	0.0 (0.5)	0.1 (1.2)	0.6 (2.3)	0.3 (2.4)		
Consumer Price Index(SA, total, excl.fresh foods)	0.0	-0.2	-0.1 (-0.1)	-0.3 (-0.3)	0.7 (0.0)	0.1 (0.0)	0.3 (0.4)	0.2 (0.7)	0.2 (0.8)		
Index of Capacity Utilization (2010=100)	97.9	95.4	93.1 [100.3]	94.4 [102.6]	96.6 [99.6]	98.1 [99.8]	95.8 [97.7]	99.3 [97.8]		[91.9]	
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	6.2	-3.0	-0.8 (-0.8)	0.0 (-4.6)	6.8 (6.4)	10.5 (16.5)	-2.7 (4.9)	0.0 (6.5)			
Manufacturing	5.9	-10.1	-5.3 (-11.1)	-1.7 (-12.1)	5.6 (-4.2)	3.8 (-6.2)	2.4 (2.4)	4.8 (-2.0)			
Non-manufacturing Excl.Electric Power & Ship building	6.6	2.8	5.6 (7.4)	-3.1 (2.8)	12.5 (14.1)	25.4 (34.3)	-17.5 (6.6)	0.0 (13.0)			
Shipments of Capital Goods (Excl.Transport Equipment)	6.7	-6.0	-4.3 (-11.5)	4.7 (-9.1)	-0.2 (-5.4)	1.7 (-6.4)	-3.5 (-6.4)	3.9 (1.2)	-1.5 (-1.0)		
Construction Orders	7.1	2.4									
Private	3.7	2.6									
Public	22.7	5.3									
Public Works Contracts	-0.5	10.3									
Housing Starts 10,000 units at Annual Rate, SA	84.1 (2.7)	89.3 (6.2)	90.9 (15.0)	89.9 (5.1)	98.3 (11.8)	102.7 (14.5)	97.6 (15.3)	97.9 (12.4)	96.0 (8.8)		
Total floor	(2.5)	(4.8)	(12.2)	(5.7)	(11.6)	(13.0)	(15.2)	(11.2)	(9.8)		
Sales at Retailers	0.8	0.3									
Real Consumption Expenditures of Households over 2 persons (SA)	-1.2	1.6	-0.6 (-0.2)	3.8 (2.8)	-1.9 (-0.2)	0.1 (-1.6)	-2.0 (-0.4)	0.9 (0.1)	-0.5 (-1.6)		
Propensity to Consume (SA,%)	73.3	74.8	74.4 [73.8]	76.3 [72.3]	73.9 [74.2]	74.0 [74.2]	72.3 [73.2]	73.7 [74.7]	73.9 [72.9]	[74.3]	
Overtime Hours Worked (All Industries, 5 employees or more)	0.8	-0.3	-0.3 (-2.5)	1.5 (-1.6)	2.7 (1.0)	0.5 (0.0)	-0.1 (2.0)	0.0 (3.9)	-0.8 (3.0)		
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	-0.3	-0.7									
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	52	107	133	24	33	32	37	40	37		
Ratio of Job Offers to Applicants (SA,Times)	0.68	0.82	0.82 [0.71]	0.85 [0.75]	0.90 [0.80]	0.90 [0.80]	0.92 [0.81]	0.94 [0.81]	0.95 [0.81]	[0.81]	
Unemployment Rate (SA,%)	4.5	5.0	4.2	4.2	4.0	4.1	3.9	3.8	4.1		
Economy Watcher Survey (Judgment of the present condition D.I,%)	44.9	46.3	41.6 [46.0]	53.3 [47.3]	55.1 [47.3]	55.7 [47.2]	53.0 [43.8]	52.3 [44.2]	51.2 [43.6]	[41.2]	
Bankruptcies (Number of cases)	12,707 (-2.7)	11,719 (-7.7)	2,889 (-6.8)	2,779 (-12.7)	2,841 (-9.1)	1,045 (-8.9)	897 (-8.0)	1,025 (0.0)	819 (-15.3)		

(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. 4, 2013

	Fiscal	Fiscal	2012	2013		2013				
	2011	2012	4Q	1Q	2Q	MAY	JUN	JUL	AUG	SEP
Customs Clearance(Exports in Yen Terms)	-3.7	-2.1	(-5.5)	(1.2)	(7.1)	(10.1)	(7.4)	(12.2)	(14.6)	
Value	1.7	4.0	(4.3)	(9.4)	(10.5)	(11.5)	(13.1)	(10.2)	(12.5)	
Volumes	-5.3	-5.8	(-9.4)	(-7.5)	(-3.1)	(-1.2)	(-5.0)	(1.8)	(1.9)	
Imports(In Yen terms)	11.6	3.5	(0.4)	(8.1)	(10.4)	(10.1)	(11.8)	(19.7)	(16.0)	
Value	9.2	2.5	(1.0)	(10.1)	(12.2)	(12.5)	(17.6)	(16.9)	(18.2)	
Volumes	2.2	1.0	(-0.5)	(-1.7)	(-1.5)	(-2.2)	(-5.0)	(2.4)	(-1.9)	
Current Balance(100 mil. yen)	76,180	43,536	105	15,844	16,270	5,407	3,363	5,773		
Trade Balance(100 mil. yen)	-34,698	-68,921	-18,744	-23,735	-18,647	-9,067	-1,392	-9,433		
Services(100 mil. yen)	-18,265	-25,417	-7,083	-1,939	-5,269	441	-1,305	-1,965		
Capital and Financial Accounts(100 mil. yen)	29,618	-49,201	3,165	1,720	20,290	6,390	15,024	-8,618		
Gold & Foreign Exchange Reserves(\$1mil.)	1,288,703	1,254,356	1,268,125	1,254,356	1,238,713	1,250,243	1,238,713	1,254,033	1,254,204	
Exchange Rate(¥/\$)	79.05	83.08	81.16	92.38	98.74	101.08	97.43	99.71	97.87	

## 3. Financial Market Indicators

	Fiscal	Fiscal	2012	2013		2013					
	2011	2012	4Q	1Q	2Q	MAY	JUN	JUL	AUG	SEP	
Uncollateralized Overnight Call Rates	0.077	0.083	0.084 [0.079]	0.083 [0.078]	0.073 [0.078]	0.073 [0.084]	0.074 [0.076]	0.073 [0.084]	0.073 [0.086]	0.073 [0.085]	
Euro Yen TIBOR (3 Months)	0.331	0.312	0.318 [0.329]	0.270 [0.331]	0.228 [0.333]	0.228 [0.332]	0.228 [0.335]	0.228 [0.327]	0.228 [0.327]	0.228 [0.327]	
Newly Issued Japanese Government Bonds Yields (10 Years)	1.050	0.760	0.757 [1.030]	0.655 [0.968]	0.772 [0.848]	0.860 [0.830]	0.855 [0.830]	0.795 [0.780]	0.720 [0.795]	0.680 [0.765]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.269	1.184	1.226 (-0.019)	1.184 (-0.042)	1.153 (-0.031)	1.179 (-0.004)	1.153 (-0.026)	1.145 (-0.008)	1.139 (-0.006)		
The Nikkei Stock Average (TSE 225 Issues)	10,084	12,398	10,395 [8,455]	12,398 [10,084]	13,677 [9,007]	13,775 [8,543]	13,677 [9,007]	13,668 [8,695]	13,389 [8,840]	14,456 [8,870]	
M2(Average)	(2.9)	(2.5)	(2.3)	(2.9)	(3.5)	(3.5)	(3.8)	(3.7)	(3.7)		
Broadly-defined Liquidity(Average)	(0.2)	(0.5)	(0.5)	(1.3)	(2.6)	(2.7)	(3.1)	(3.2)	(3.5)		
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin		(-0.1)	(0.9)	(1.0)	(1.4)	(1.8)	(1.8)	(1.9)	(2.0)	(2.0)
	Banks		(-0.1)	(1.1)	(1.2)	(1.8)	(2.1)	(2.1)	(2.2)	(2.3)	(2.3)
	City Banks etc.		(-1.8)	(-0.2)	(-0.1)	(1.0)	(1.6)	(1.6)	(1.6)	(1.8)	(1.9)
	Regional Banks		(1.9)	(2.9)	(3.1)	(3.1)	(3.2)	(3.2)	(3.3)	(3.4)	(3.3)
	Regional Banks II		(1.1)	(0.8)	(0.4)	(0.4)	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)
	Shinkin		(-0.5)	(-0.7)	(-0.7)	(-0.5)	(-0.2)	(-0.2)	(-0.1)	(-0.0)	(0.2)
Deposits and CDs (Average)	Total(3 Business Condition)		(2.7)	(2.2)	(2.0)	(2.9)	(3.8)	(3.7)	(4.1)	(3.9)	(3.8)
	City Banks		(1.9)	(1.8)	(1.7)	(2.8)	(4.1)	(4.0)	(4.5)	(4.0)	(3.7)
	Regional Banks		(3.7)	(2.8)	(2.6)	(3.4)	(4.0)	(4.0)	(4.2)	(4.4)	(4.4)
	Regional Banks II		(2.8)	(1.8)	(1.1)	(1.2)	(1.5)	(1.7)	(1.7)	(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.

For further details, please contact the Economic Research Office, Bank of Tokyo-Mitsubishi UFJ  
(Chief Manager Date) Tel: 03-3240-3204

Written by Yasuhiro Ishimaru <yasuhiro\_ishimaru@mufg.jp>

Rei Tsuruta <rei\_tsuruta@mufg.jp>

This report is intended for information purposes only and shall not be construed as solicitation to take any action such as purchasing/selling/investing financial market products. In taking any action, each reader is requested to act on the basis of his or her own judgment. This report is based on information believed to be reliable, but we do not guarantee its accuracy. The contents of the report may be revised without advance notice. Also, this report is a literary work protected by the copyright act. No part of this report may be reproduced in any form without express statement of its source. This report is also available for viewing online.