

Japan Economic Monthly

Japan's Economy Readies for Consumption Tax Hike Even While Still Recovering

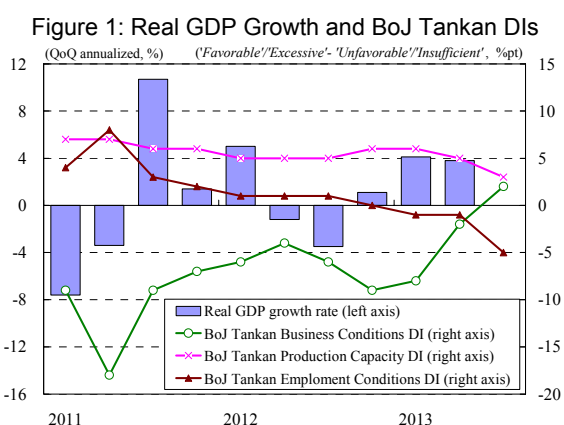
Economic Research Office
The Bank of Tokyo-Mitsubishi UFJ, Ltd.

1. The Real Economy

On October 1, the Japanese Government announced its final decision to hike the consumption tax from the current 5% to 8% starting in FY14 as well as the Cabinet's approval of an economic policy package. The tax hike will have an adverse impact on Japan's economy, at least over the short term. BTMU estimates that the tax hike will cut as much as 1%pt from real GDP growth in FY14 despite various measures to alleviate the burden, including cash subsidies for lower income households (up to JPY15,000 per person exempt from resident tax payment) and expanded tax breaks for housing loans. Demand, especially private consumption and residential investment, is expected to shrink due to a reactionary drop following a pre-hike surge as well as a decline in real purchasing power.

On the other hand, Japan's real economy has remained solid recently. Real GDP expanded by +4.1% QoQ annualized in Jan-Mar and +3.8% QoQ annualized in Apr-Jun (Figure 1). Further, the BoJ's September Tankan Survey—the final supporting factor for the consumption tax hike decision—showed that Japan's economy is expanding steadily. The survey's Business Conditions DI for companies of all sizes and across all industries improved for a third straight quarter to the highest level since the December 2007 survey. The sense of 'excessive' business equipment and labor has been easing as conditions start to support a virtuous economic cycle getting underway smoothly.

The economic policy package includes expenditures of JPY5 trillion, to be covered by a future supplementary budget, and JPY1 trillion in tax breaks to be covered by tax reform (Table 1). The measures will involve the balanced use of funds, like alleviation measures for households (which will be the first to feel the effects of the consumption tax hike), public investment that are expected to be fast-acting, as well as tax breaks for companies, which are supposed to be the main driver of economic growth. The Abe Administration has promoted its growth strategy—heralded from the start as an important issue—while at the same time averting an economic downturn to put the country's economy on a firm and sustainable recovery trajectory.



Note: Tankan DIs are for companies of all sizes and in all industries.
Source: Compiled by BTMU Economic Research Office from Cabinet Office, BoJ data.

Table 1: Size of Measures in Economic Policy Package

Additional appropriations	5 trn
Cash subsidies for lower income households	300 bn
Cash subsidies for the purchase of a personal residence	310 bn
Early termination of the special reconstruction corporate tax (under consideration)	900 bn
Accelerating reconstruction from the Tohoku Earthquake of the year 2011	1,300 bn
Cash subsidies for reconstruction of victim's residence	50 bn
Public Investment	2,000 bn
Tax measures	1 trn
Investment tax breaks, etc.	730 bn
Tax breaks to encourage higher wages	160 bn
Expanded tax breaks for housing loans	110 bn

Note: *Tax measures* is projected decline in national and local tax revenue (fiscal year) and includes revised FY13 tax system.

Source: Compiled by BTMU Economic Research Office from MoF materials, various reports.

2. Financial Markets

(1) Monetary Policy & Long-Term Yields

The BoJ's Monetary Policy meeting was held October 3-4, exactly six months since the introduction of quantitative and monetary easing. At the meeting, the BoJ unanimously agreed to maintain current policy ("The Bank of Japan will conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen"). The BoJ will also maintain the current pace of asset purchases, primarily long-term JGBs. As of end-September, Japan's monetary base had expanded by JPY47 trillion since end-2012, marking a steady 76.5% rate of progress against its goal of increasing the monetary base in 2013 by JPY62 trillion (Table 2). BoJ holdings of long-term JGBs, the bulk of the assets targeted for purchase, have grown by JPY37 trillion, or a 72.7% progress rate. Such smooth implementation of operations is important in the fact that the effects of monetary easing are clearly permeating the financial markets and the real economy. In fact, although the long-term JGB yield was volatile immediately after quantitative and qualitative easing was introduced, it has remained steady at a low level in the 0.6% range recently.

(2) Exchange Rates

The JPY weakened to near the USD/JPY104 level through the latter half of May, but then reversed course to the USD/JPY93 level in mid-June. Since then, the Japanese currency has fluctuated less, trading in USD/JPY95-USD/JPY100 band (Figure 2). Risk reversal is considered a reflection of the direction of risk awareness among market participants against sudden fluctuations. In light of risk reversal, the JPY strengthening since late May appears to show heightened caution about a big strengthening in the JPY amidst speculation that the FRB will begin tapering its asset purchases and growing concerns about slowing emerging economies. So-called risk-averse JPY buying appears to have fed the JPY strengthening. On

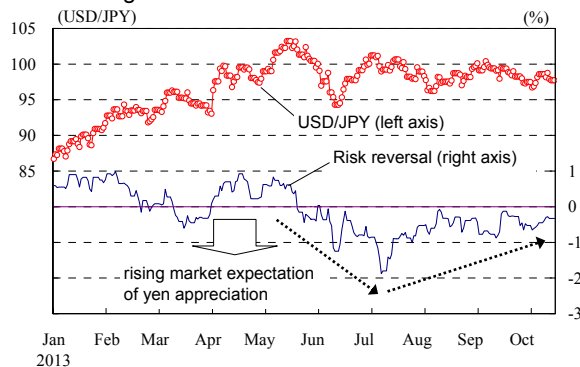
the other hand, risk reversal over the last few months has shifted, and fears of a strengthening JPY appear to be diminishing. The exchange rate has been fairly firm recently, but once a direction is formed, JPY will probably start to weaken.

Table 2: Monetary Base Increase Targets Under BoJ QQE

		(Trn JPY)			
		2013 target increase	Total through end-Sept	Achievement rate (%)	Target 2014 increase
Monetary base		62	47	76.5	70
Assets	Long-term JGBs	51	37	72.7	50
	CP, corporate bonds, etc.	0	-0	—	0
	ETFs, J-REITs	1	1	72.9	1
	Loan Support Fund	10	4	42.4	5
	Banknotes	1	-3	—	2
Liabilities	Current accounts	60	50	84.0	68

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

Figure 2: USD/JPY and Risk Reversal



Note: Risk reversal is call option implied volatility (25 delta, 1-month contract, annualized conversion value) minus put option implied volatility (same).
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 Nov. 12, 2013

	Fiscal 2011	Fiscal 2012	2013			2013				
			1Q	2Q	3Q	JUN	JUL	AUG	SEP	OCT
Real GDP Growth Rate <% changes from previous period at SA annual rate>	0.3	1.2	4.1 (0.3)	3.8 (1.2)		***	***	***	***	***
Index of All Industries Activity	0.3	0.1	0.0 (-1.2)	1.0 (0.5)		-0.8 (0.0)	0.4 (1.5)	0.3 (0.9)		
Industrial Production Index Production	-0.7	-2.9	0.6 (-7.9)	1.5 (-3.1)	1.8 (2.3)	-3.1 (-4.6)	3.4 (1.8)	-0.9 (-0.4)	1.5 (5.4)	
Shipments	-1.5	-1.8	4.1 (-6.3)	-1.9 (-3.5)	0.6 (1.6)	-3.2 (-5.1)	2.0 (1.4)	-0.1 (-1.3)	1.6 (4.7)	
Inventory	12.1	-2.7	-3.4 (-2.7)	0.4 (-2.9)	1.2 (-3.5)	0.0 (-2.9)	1.6 (-2.8)	-0.2 (-3.3)	-0.2 (-3.5)	
Inventory/Shipments Ratio (2010=100)	109.0	114.4	112.1 [107.6]	107.6 [111.5]	111.1 [116.4]	111.0 [111.7]	110.5 [115.3]	112.5 [115.5]	110.2 [118.5]	[117.7]
Domestic Corporate Goods Price Index	1.4	-1.1	0.8 (-0.3)	0.7 (0.7)	0.8 (2.2)	0.0 (1.2)	0.6 (2.2)	0.2 (2.3)	0.3 (2.3)	
Consumer Price Index(SA, total, excl.fresh foods)	0.0	-0.2	-0.3 (-0.3)	0.7 (0.0)	0.4 (0.7)	0.3 (0.4)	0.2 (0.7)	0.2 (0.8)	-0.1 (0.7)	
Index of Capacity Utilization (2010=100)	97.9	95.4	94.4 [102.6]	96.6 [99.6]	95.6 [95.1]	95.8 [97.7]	99.3 [97.8]	97.2 [95.7]	97.2 [91.9]	[93.0]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	6.2	-3.0	0.0 (-4.6)	6.8 (6.4)		-2.7 (4.9)	0.0 (6.5)	5.4 (10.3)		
Manufacturing	5.9	-10.1	-1.7 (-12.1)	5.6 (-4.2)		2.4 (2.4)	4.8 (-2.0)	0.8 (8.7)		
Non-manufacturing Excl.Electric Power & Ship building	6.6	2.8	-3.1 (2.8)	12.5 (14.1)		-17.5 (6.6)	0.0 (13.0)	6.2 (11.6)		
Shipments of Capital Goods (Excl.Transport Equipment)	6.7	-6.0	4.7 (-9.1)	-0.2 (-5.4)	0.3 (0.2)	-3.5 (-6.4)	3.9 (1.2)	-1.5 (-1.0)	-1.7 (0.3)	
Construction Orders	7.1	2.4	(1.2)	(17.0)	(48.7)	(21.9)	(13.7)	(21.4)	(89.8)	
Private	3.7	2.6	(1.2)	(13.5)	(60.6)	(12.4)	(1.6)	(23.0)	(127.1)	
Public	22.7	5.3	(0.2)	(18.7)	(29.9)	(13.6)	(4.0)	(23.9)	(51.3)	
Public Works Contracts	-0.5	10.3	(-6.0)	(25.2)	(22.5)	(21.7)	(29.4)	(7.9)	(29.4)	
Housing Starts 10,000 units at Annual Rate, SA	84.1 (2.7)	89.3 (6.2)	89.9 (5.1)	98.3 (11.8)	100.4 (13.5)	97.6 (15.3)	97.9 (12.4)	96.0 (8.8)	104.4 (19.4)	
Total floor	(2.5)	(4.8)	(5.7)	(11.6)	(13.0)	(15.2)	(11.2)	(9.8)	(18.1)	
Sales at Retailers	0.8	0.3	(-1.2)	(0.7)	(1.2)	(1.6)	(-0.3)	(1.1)	(3.1)	
Real Consumption Expenditures of Households over 2 persons (SA)	-1.2	1.6	3.8 (2.8)	-1.9 (-0.2)		-2.0 (-0.4)	0.9 (0.1)	-0.5 (-1.6)	1.6 (3.7)	
Propensity to Consume (SA,%)	73.3	74.8	76.3 [72.3]	73.9 [74.2]	[74.2]	72.3 [73.2]	73.7 [74.7]	73.9 [72.9]	76.0 [74.3]	[73.9]
Overtime Hours Worked (All Industries, 5 employees or more)	0.8	-0.3	1.5 (-1.6)	2.7 (1.0)	0.1 (4.0)	-0.1 (2.0)	0.0 (3.9)	0.2 (4.0)	-0.5 (3.9)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	-0.3	-0.7	(-0.6)	(0.3)	(-0.3)	(0.6)	(-0.1)	(-0.9)	(0.1)	
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	52	107	24 127	33 138	42 131	37	40	42	45	
Ratio of Job Offers to Applicants (SA,Times)	0.68	0.82	0.85 [0.75]	0.90 [0.80]	0.95 [0.81]	0.92 [0.81]	0.94 [0.81]	0.95 [0.81]	0.95 [0.81]	[0.81]
Unemployment Rate (SA,%)	4.5	5.0	4.2	4.0	4.0	3.9	3.8	4.1	4.0	
Economy Watcher Survey (Judgment of the present condition D.I,%)	44.9	46.3	53.3 [47.3]	55.1 [47.3]	52.1 [43.0]	53.0 [43.8]	52.3 [44.2]	51.2 [43.6]	52.8 [41.2]	51.8 [39.0]
Bankruptcies (Number of cases)	12,707 (-2.7)	11,719 (-7.7)	2,779 (-12.7)	2,841 (-9.1)	2,664 (-8.8)	897 (-8.0)	1,025 (0.0)	819 (-15.3)	820 (-11.9)	959 (-7.3)

(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 Nov. 12, 2013

	Fiscal	Fiscal	2013			2013				
	2011	2012	1Q	2Q	3Q	JUN	JUL	AUG	SEP	OCT
Customs Clearance(Exports in Yen Terms)	-3.7	-2.1	(1.2)	(7.1)	(12.7)	(7.4)	(12.2)	(14.6)	(11.5)	
Value	1.7	4.0	(9.4)	(10.5)	(12.1)	(13.1)	(10.2)	(12.5)	(13.6)	
Volumes	-5.3	-5.8	(-7.5)	(-3.1)	(0.6)	(-5.0)	(1.8)	(1.9)	(-1.8)	
Imports(In Yen terms)	11.6	3.5	(8.1)	(10.4)	(17.4)	(11.8)	(19.7)	(16.1)	(16.5)	
Value	9.2	2.5	(10.1)	(12.2)	(18.1)	(17.6)	(16.9)	(18.3)	(19.1)	
Volumes	2.2	1.0	(-1.7)	(-1.5)	(-0.5)	(-5.0)	(2.4)	(-1.9)	(-2.1)	
Current Balance(100 mil. yen)	76,180	43,536	15,844	17,287	13,261	3,777	5,773	1,615	5,873	
Trade Balance(100 mil. yen)	-34,698	-68,921	-23,735	-19,624	-27,040	-1,418	-9,433	-8,859	-8,748	
Services(100 mil. yen)	-18,265	-25,417	-1,939	-3,334	-4,513	-861	-1,965	-1,533	-1,015	
Capital and Financial Accounts(100 mil. yen)	29,618	-49,201	1,720	23,052	-8,290	15,460	-8,618	-1,805	2,133	
Gold & Foreign Exchange Reserves(\$1mil.)	1,288,703	1,254,356	1,254,356	1,238,713	1,273,446	1,238,713	1,254,033	1,254,204	1,273,446	1,276,751
Exchange Rate(US\$)	79.05	83.08	92.38	98.74	98.94	97.43	99.71	97.87	99.24	97.85

3. Financial Market Indicators

	Fiscal	Fiscal	2013			2013					
	2011	2012	1Q	2Q	3Q	JUN	JUL	AUG	SEP	OCT	
Uncollateralized Overnight Call Rates	0.077	0.083	0.083 [0.083]	0.073 [0.078]	0.073 [0.085]	0.074 [0.076]	0.073 [0.084]	0.073 [0.087]	0.072 [0.085]	0.070 [0.085]	
Euro Yen TIBOR (3 Months)	0.331	0.312	0.270 [0.331]	0.228 [0.333]	0.228 [0.327]	0.228 [0.335]	0.228 [0.327]	0.228 [0.327]	0.228 [0.327]	0.221 [0.326]	
Newly Issued Japanese Government Bonds Yields (10 Years)	1.050	0.760	0.655 [0.968]	0.772 [0.848]	0.732 [0.780]	0.855 [0.830]	0.795 [0.780]	0.720 [0.795]	0.680 [0.765]	0.590 [0.775]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.269	1.184	1.184 (-0.042)	1.153 (-0.031)		1.153 (-0.026)	1.145 (-0.008)	1.139 (-0.006)			
The Nikkei Stock Average (TSE 225 Issues)	10,084	12,398	12,398 [10,084]	13,677 [9,007]	14,456 [8,870]	13,677 [9,007]	13,668 [8,695]	13,389 [8,840]	14,456 [8,870]	14,328 [8,928]	
M2(Average)	(2.9)	(2.5)	(2.9)	(3.5)	(3.8)	(3.8)	(3.7)	(3.8)	(3.9)	(4.1)	
Broadly-defined Liquidity(Average)	(0.2)	(0.5)	(1.3)	(2.6)	(3.6)	(3.1)	(3.3)	(3.6)	(3.8)	(4.1)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin		(-0.1)	(0.9)	(1.4)	(1.8)	(2.0)	(1.9)	(2.0)	(2.0)	(2.0)
	Banks		(-0.1)	(1.1)	(1.8)	(2.1)	(2.3)	(2.2)	(2.3)	(2.2)	(2.3)
	City Banks etc.		(-1.8)	(-0.2)	(1.0)	(1.6)	(1.9)	(1.6)	(1.8)	(1.9)	(1.7)
	Regional Banks		(1.9)	(2.9)	(3.1)	(3.2)	(3.2)	(3.3)	(3.4)	(3.3)	(3.1)
	Regional Banks II		(1.1)	(0.8)	(0.4)	(0.6)	(0.7)	(0.6)	(0.6)	(0.6)	(0.9)
Deposits and CDs (Average)	Shinkin		(-0.5)	(-0.7)	(-0.5)	(-0.2)	(0.1)	(-0.1)	(-0.0)	(0.1)	(0.1)
	Total(3 Business Condition)		(2.7)	(2.2)	(2.9)	(3.8)	(3.8)	(4.1)	(3.9)	(3.8)	(3.9)
	City Banks		(1.9)	(1.8)	(2.8)	(4.1)	(3.7)	(4.5)	(4.0)	(3.7)	(3.5)
	Regional Banks		(3.7)	(2.8)	(3.4)	(4.0)	(4.5)	(4.2)	(4.4)	(4.4)	(4.6)
	Regional Banks II		(2.8)	(1.8)	(1.2)	(1.5)	(2.1)	(1.7)	(1.7)	(1.9)	(2.6)

(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.

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[] 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>

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