

Japan Economic Monthly

Virtuous Economic Cycle, Origins Becoming Clearer as Expectations Mount

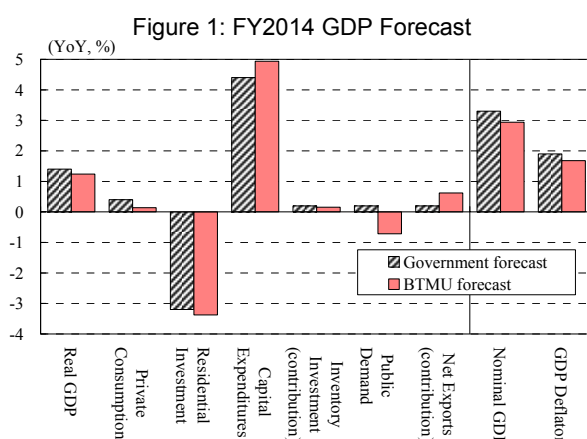
Economic Research Office

The Bank of Tokyo-Mitsubishi UFJ, Ltd.

1. The Real Economy

The Japanese Government approved a new economic outlook on December 21. According to the outlook, Japan's real GDP will expand by +1.4% YoY in FY2014 (Figure 1). This would be slower than the +2.6% growth (anticipated result) of FY2013, but given that the recent growth has averaged between +0.6% (FY2009—when Lehman Brothers collapsed—through FY2012) and +0.8% (over the 13 years since FY2000), the level is by no means low. By demand component, although private consumption is expected to weaken (to a projected +0.4% YoY) and residential investment to shrink (by -3.2% YoY) due to the adverse impacts from the consumption tax hike at the start of the fiscal year, capital expenditures (+4.4% YoY) and exports (+5.4% YoY) are expected to rise, while inventory investment and public demand are also projected to contribute +0.2% YoY each to real GDP growth. The Government outlook is roughly in line with BTMU forecast (+1.2% YoY real GDP growth). Further, nominal GDP growth is expected to exceed the real growth rate at +3.3% YoY, with a GDP deflator of +1.9% YoY (+0.5% YoY discounting effect of consumption tax hike). This would be the first increase in the GDP deflator since FY1997, 17 years ago.

The increased probability of a virtuous cycle being gradually realized is clearly tied to Government policy efforts. Such efforts include the economic policy package put together with the finalization of the consumption tax hike decision last fall. After releasing the outline of the package on October 1, the Government compiled economic measures for realization of virtuous cycles on December 5 and approved a JPY5.5 trillion supplementary FY2013 budget of the general account on December 12 (Table 1). Also, three-way talks between the government, corporate sector leaders and labor unions have been held since September. On December 20, they share the understanding that the economy must first pick up and lead to higher corporate profits, which must then be passed on in the form of higher wages, in order for a virtuous economic cycle to engage. The start of a virtuous economic cycle—including the results of monetary and fiscal policies already implemented—has begun to appear more clearly and in varied ways.



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

Table 1: FY2013 General Account Supplementary Budget

Central government expenditure on Economic measures for realization of virtuous cycles	JPY5.5 trn
Measures to strengthen competitiveness	JPY1.4 trn
Policies for women, young people, the elderly and the disabled	JPY300 bn
Acceleration of measures for reconstruction, disaster prevention and safety	JPY3.1 trn
Of this, covered by ending the special corporate tax surcharge for disaster reconstruction a year ahead of schedule	JPY800 bn
Measures for reducing impacts on low-income earners and child-rearing households and moderating the rush demand and recoil reduction	JPY649 bn
Cash benefit measures related to general housing acquisitions (Housing cash benefits)	JPY160 bn
Simple cash benefit measure (Provisional Welfare Benefits)	JPY342 bn
Temporary special cash benefit measures for child-rearing households	JPY147 bn
Increase of tax allocations to local governments	JPY1.2 trn
Additional financial contributions to international bodies	JPY363 bn

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

2. Financial Markets

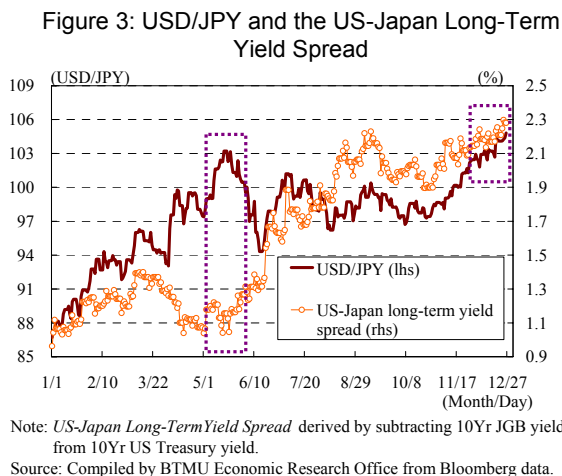
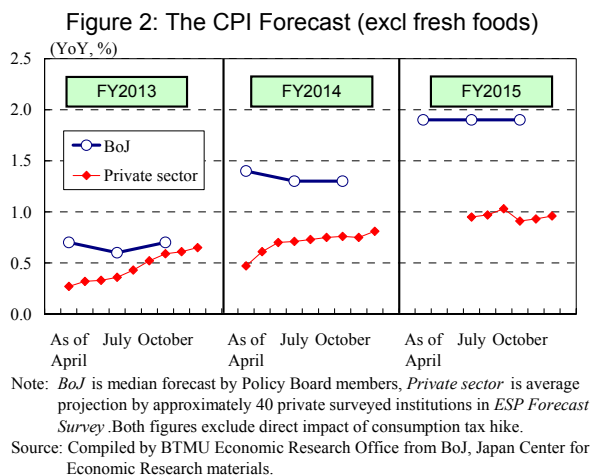
(1) Monetary Policy & Long-Term Yields

The BoJ agreed to maintain monetary easing policy at the monthly Monetary Policy meeting December 19-20. As he did following a December 2 speech, Governor Haruhiko Kuroda stressed after the meeting that current policy would be maintained in an ‘open-ended’ manner until the price stability target is achieved and the rate stabilizes. Although BoJ and private sector inflation forecasts (excluding fresh foods and without the direct impact of the consumption tax hike) largely converge for FY2013, there is a wide difference between the forecasts for FY2015, by when the inflation rate is to be achieved (Figure 2). By stressing that monetary easing will be open-ended, Governor Kuroda hopes that an extended policy timeline will help the effects of easing permeate further and also raise inflation expectations. Such expectations are critical for the inflation target to be achieved. Further, although the 10Yr JGB yield has been rising slightly recently in line with US yields, the Japanese yield still remains within the 0.6%-0.7% range as supply and demand remain tight because of large-scale purchases of JGBs by the BoJ.

(2) Exchange Rates

The USD finally broke out of the upper JPY90 range in which it had long been traded, and USD/JPY has been at the USD/JPY104 level recently (Figure 3). Although the current level is roughly the same as in late May, the macroeconomic supporting factors appear to be stronger now. The JPY’s weakening trend reversed course in late May as the currency strengthened again, triggered by FRB Chairman Ben Bernanke’s comments about tapering asset purchases. The yield spread between 10Yr JGBs and 10Yr US Treasuries was less than 100 basis points at the time, and the expectation-driven JPY weakening trend reversed easily. On the other hand, the spread between the 10Yr notes has been more than 200 basis points of late and is

considered to be a solid supporting factor for a weak JPY. The FRB decided on December 18 to begin tapering asset purchases from January, but a sudden reversal is unlikely to occur again.



(Yasuhiro Ishimaru, Rei Tsuruta)

MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Jan. 15, 2014

	Fiscal 2011	Fiscal 2012	2013			2013				
			1Q	2Q	3Q	AUG	SEP	OCT	NOV	DEC
Real GDP Growth Rate <% changes from previous period at SA annual rate>	0.3	0.7	4.5 (0.1)	3.6 (1.2)	1.1 (2.4)	***	***	***	***	***
Index of All Industries Activity	0.3	0.1	0.0 (-1.2)	1.0 (0.5)	0.6 (1.6)	0.3 (0.9)	0.5 (2.3)	-0.2 (1.9)		
Industrial Production Index Production	-0.7	-2.9	0.6 (-7.9)	1.5 (-3.1)	1.7 (2.3)	-0.9 (-0.4)	1.3 (5.1)	1.0 (5.4)	0.1 (5.0)	
Shipments	-1.5	-1.8	4.1 (-6.3)	-1.9 (-3.5)	0.6 (1.6)	-0.1 (-1.3)	1.5 (4.6)	2.3 (6.3)	-0.1 (6.5)	
Inventory	12.1	-2.7	-3.4 (-2.7)	0.4 (-2.9)	1.2 (-3.5)	-0.2 (-3.3)	-0.2 (-3.5)	-0.3 (-3.8)	-1.9 (-5.2)	
Inventory/Shipments Ratio (2010=100)	109.0	114.4	112.1 [107.6]	107.6 [111.5]	111.0 [116.4]	112.5 [115.5]	110.1 [118.5]	106.0 [117.7]	104.5 [117.7]	[117.7]
Domestic Corporate Goods Price Index	1.4	-1.1	0.8 (-0.3)	0.7 (0.7)	0.8 (2.2)	0.2 (2.3)	0.2 (2.2)	-0.1 (2.5)	0.1 (2.7)	
Consumer Price Index(SA, total, excl.fresh foods)	0.0	-0.2	-0.3 (-0.3)	0.7 (0.0)	0.4 (0.7)	0.2 (0.8)	-0.1 (0.7)	0.2 (0.9)	0.2 (1.2)	
Index of Capacity Utilization (2010=100)	97.9	95.4	94.4 [102.6]	96.6 [99.6]	98.3 [95.1]	97.2 [95.7]	98.4 [91.9]	99.6 [93.0]		[94.0]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	6.2	-3.0	0.0 (-4.6)	6.8 (6.4)	4.3 (9.6)	5.4 (10.3)	-2.1 (11.4)	0.6 (17.8)		
Manufacturing	5.9	-10.1	-1.7 (-12.1)	5.6 (-4.2)	9.8 (8.2)	0.8 (8.7)	4.1 (17.3)	-0.2 (21.9)		
Non-manufacturing Excl.Electric Power & Ship building	6.6	2.8	-3.1 (2.8)	12.5 (14.1)	-4.1 (10.4)	6.2 (11.6)	-7.0 (8.0)	11.5 (15.1)		
Shipments of Capital Goods (Excl.Transport Equipment)	6.7	-6.0	4.7 (-9.1)	-0.2 (-5.4)	0.4 (0.3)	-1.5 (-1.0)	-1.5 (0.7)	9.3 (14.8)	-2.6 (11.0)	
Construction Orders	7.1	2.4	(1.2)	(17.0)	(48.7)	(21.4)	(89.8)	(61.1)	(2.2)	
Private	3.7	2.6	(1.2)	(13.5)	(60.6)	(23.0)	(127.1)	(67.0)	(-14.7)	
Public	22.7	5.3	(0.2)	(18.7)	(29.9)	(23.9)	(51.3)	(56.1)	(30.3)	
Public Works Contracts	-0.5	10.3	(-6.0)	(25.2)	(22.5)	(7.9)	(29.4)	(3.5)	(4.9)	
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)	96.0 (8.8)	104.4 (19.4)	103.7 (7.1)	103.3 (14.1)	
Total floor	(2.5)	(4.8)	(5.7)	(11.6)	(13.0)	(9.8)	(18.1)	(9.4)	(15.2)	
Sales at Retailers	0.8	0.3	(-1.2)	(0.7)	(1.2)	(1.1)	(3.0)	(2.4)	(4.0)	
Real Consumption Expenditures of Households over 2 persons (SA)	-1.2	1.6	3.8 (2.8)	-1.9 (-0.2)	-0.6 (0.7)	-0.5 (-1.6)	1.6 (3.7)	0.0 (0.9)	-0.3 (0.2)	
Propensity to Consume (SA,%)	73.3	74.8	76.3 [72.3]	73.9 [74.2]	74.9 [74.2]	73.9 [72.9]	76.0 [74.3]	75.0 [73.9]	74.7 [74.7]	[75.0]
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)	0.2 (4.0)	-0.5 (3.9)	1.2 (5.8)	0.4 (5.7)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	-0.3	-0.7	(-0.6)	(0.3)	(-0.3)	(-0.9)	(-0.2)	(-0.1)	(0.5)	
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	52	107	24 127	33 138	43 131	42	46	46	48	
Ratio of Job Offers to Applicants (SA,Times)	0.68	0.82	0.85 [0.75]	0.90 [0.80]	0.95 [0.81]	0.95 [0.81]	0.95 [0.81]	0.98 [0.81]	1.00 [0.82]	[0.83]
Unemployment Rate (SA,%)	4.5	5.0	4.2	4.0	4.0	4.1	4.0	4.0	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]	51.2 [43.6]	52.8 [41.2]	51.8 [39.0]	53.5 [40.0]	55.7 [45.8]
Bankruptcies (Number of cases)	12,707 (-2.7)	11,719 (-7.7)	2,779 (-12.7)	2,841 (-9.1)	2,664 (-8.8)	819 (-15.3)	820 (-11.9)	959 (-7.3)	862 (-10.5)	750 (-15.7)

(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 Jan. 15, 2014

	Fiscal	Fiscal	2013			2013				
	2011	2012	1Q	2Q	3Q	AUG	SEP	OCT	NOV	DEC
Customs Clearance(Exports in Yen Terms)	-3.7	-2.1	(1.2)	(7.1)	(12.7)	(14.6)	(11.5)	(18.6)	(18.4)	
Value	1.7	4.0	(9.4)	(10.5)	(12.1)	(12.5)	(13.6)	(13.6)	(11.5)	
Volumes	-5.3	-5.8	(-7.5)	(-3.1)	(0.6)	(1.9)	(-1.8)	(4.4)	(6.2)	
Imports(In Yen terms)	11.6	3.5	(8.1)	(10.4)	(17.5)	(16.1)	(16.6)	(26.2)	(21.1)	
Value	9.2	2.5	(10.1)	(12.2)	(18.1)	(18.3)	(19.1)	(18.7)	(15.4)	
Volumes	2.2	1.0	(-1.7)	(-1.5)	(-0.5)	(-1.9)	(-2.1)	(6.4)	(5.0)	
Current Balance(100 mil. yen)	76,180	43,536	15,844	17,287	13,523	1,571	5,948	-1,279	-5,928	
Trade Balance(100 mil. yen)	-34,698	-68,921	-23,735	-19,624	-27,452	-9,050	-8,870	-10,919	-12,543	
Services(100 mil. yen)	-18,265	-25,417	-1,939	-3,334	-4,116	-1,468	-922	-3,137	-1,100	
Capital and Financial Accounts(100 mil. yen)	29,618	-49,201	1,720	23,052	-7,458	700	1,631	4,073	6,443	
Gold & Foreign Exchange Reserves(\$1mil.)	1,288,703	1,254,356	1,254,356	1,238,713	1,273,446	1,254,204	1,273,446	1,276,751	1,273,352	1,266,815
Exchange Rate(¥/\$)	79.05	83.08	92.38	98.74	98.94	97.87	99.24	97.85	100.03	103.46

3. Financial Market Indicators

	Fiscal	Fiscal	2013			2013					
	2011	2012	1Q	2Q	3Q	AUG	SEP	OCT	NOV	DEC	
Uncollateralized Overnight Call Rates	0.077	0.083	0.083 [0.083]	0.073 [0.078]	0.073 [0.085]	0.073 [0.086]	0.072 [0.085]	0.070 [0.085]	0.073 [0.086]	0.074 [0.082]	
Euro Yen TIBOR (3 Months)	0.331	0.312	0.270 [0.331]	0.228 [0.333]	0.228 [0.327]	0.228 [0.327]	0.228 [0.327]	0.221 [0.326]	0.220 [0.318]	0.220 [0.308]	
Newly Issued Japanese Government Bonds Yields (10 Years)	1.050	0.760	0.655 [0.968]	0.772 [0.848]	0.732 [0.780]	0.720 [0.795]	0.680 [0.765]	0.590 [0.775]	0.600 [0.700]	0.735 [0.795]	
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)	1.125 (-0.028)	1.139 (-0.006)	1.125 (-0.014)	1.124 (-0.001)	1.114 (-0.010)		
The Nikkei Stock Average (TSE 225 Issues)	10,084	12,398	12,398 [10,084]	13,677 [9,007]	14,456 [8,870]	13,389 [8,840]	14,456 [8,870]	14,328 [8,928]	15,662 [9,446]	16,291 [10,395]	
M2(Average)	(2.9)	(2.5)	(2.9)	(3.5)	(3.8)	(3.8)	(3.9)	(4.1)	(4.4)	(4.2)	
Broadly-defined Liquidity(Average)	(0.2)	(0.5)	(1.3)	(2.6)	(3.5)	(3.6)	(3.8)	(4.2)	(4.5)	(4.4)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin		(-0.1)	(0.9)	(1.4)	(1.8)	(2.0)	(2.0)	(2.0)	(2.2)	(2.3)
	Banks		(-0.1)	(1.1)	(1.8)	(2.1)	(2.3)	(2.2)	(2.3)	(2.4)	(2.6)
	City Banks etc.		(-1.8)	(-0.2)	(1.0)	(1.6)	(1.9)	(1.9)	(1.7)	(1.8)	(2.0)
	Regional Banks		(1.9)	(2.9)	(3.1)	(3.2)	(3.2)	(3.1)	(3.1)	(3.3)	(3.4)
	Regional Banks II		(1.1)	(0.8)	(0.4)	(0.6)	(0.7)	(0.6)	(0.9)	(1.9)	(2.1)
Deposits and CDs (Average)	Shinkin		(-0.5)	(-0.7)	(-0.5)	(-0.2)	(0.1)	(0.1)	(0.4)	(0.5)	(0.7)
	Total(3 Business Condition)		(2.7)	(2.2)	(2.9)	(3.8)	(3.8)	(3.8)	(3.9)	(4.0)	(3.8)
	City Banks		(1.9)	(1.8)	(2.8)	(4.1)	(3.7)	(3.7)	(3.7)	(3.7)	(3.5)
	Regional Banks		(3.7)	(2.8)	(3.4)	(4.0)	(4.5)	(4.4)	(4.6)	(4.4)	(4.4)
	Regional Banks II		(2.8)	(1.8)	(1.2)	(1.5)	(2.1)	(1.9)	(2.6)	(3.1)	(3.3)

(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.