

Japan Economic Monthly

Quantitative and Qualitative Monetary Easing Delivering Results, Year Two Underway

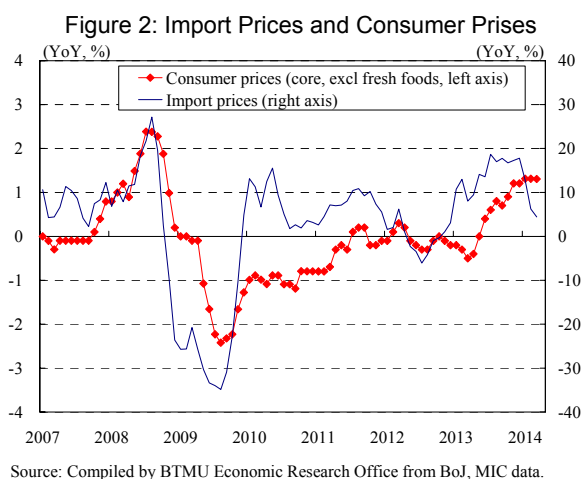
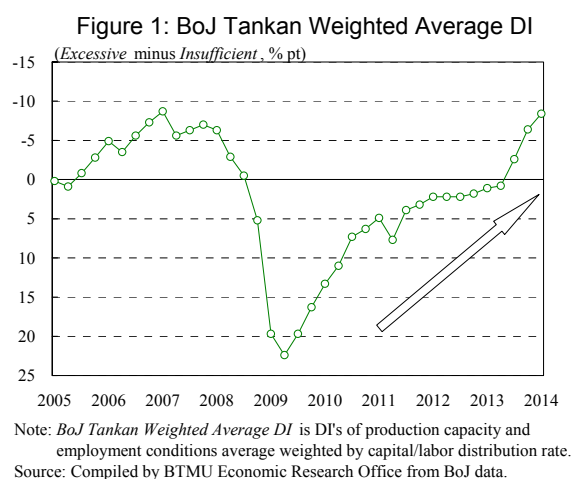
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1. The Real Economy

One year has passed since the BoJ introduced *quantitative and qualitative monetary easing*, and Japan's economy appears to be nearing an end to deflation. In fact, with domestic demand firming due to bolstered monetary easing and large-scale economic measures, the macro supply-demand balance appears to be tightening. Figure 1 shows the BoJ's Tankan average of production capacity DI and employment conditions DI weighted by capital and labor distribution rates. This indicator is highly correlated to the macro supply-demand balance. The weighted average DI number of *excessive* responses has continued to shrink since bottoming in the June 2009 survey, with more *insufficient* responses reported since September 2013. The level of *insufficient* responses recovered to the level during the economic expansion prior to the collapse of Lehman Brothers in the March 2014 survey.

The year on year rate of increase in core CPI stood at -0.5% YoY in March 2013, prior to the introduction of *quantitative and qualitative monetary easing*, but rose to +1.3% YoY in March 2014 (Figure 2), because of the ripple effect from a temporary surge in import prices due to the JPY's weakening. Looking more closely, rising prices appears to be spreading, as durable consumer goods, which had long weighed on prices, recently began making a positive contribution.

The macro supply-demand balance could start to loosen due to the effect of the recent consumption tax hike, but is expected to start tightening again this summer due to relatively high wage hikes resulting from the spring wage negotiations as well as a lift from "Economic Measures for Realization of Virtuous Cycles". The YoY rate of increase in the consumer price index (excluding the effect of the recent consumption tax hike) is not likely to remain at the recent +1.3% YoY level as the upward pressure from the weaker JPY dissipates, but is expected to once again gradually rise from H2.



2. Financial Markets

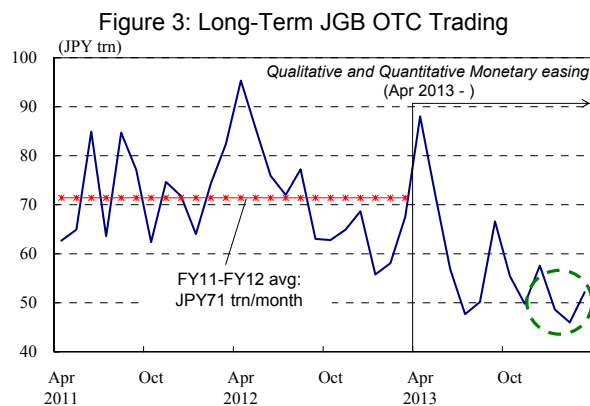
(1) Monetary Policy & Long-Term Yields

At the April 7-8 Monetary policy meeting one year after the introduction of *quantitative and qualitative monetary easing*, the BoJ agreed to maintain current monetary easing policy. Governor Haruhiko Kuroda, at the post-meeting press conference, commented that the monetary easing policy has been exerting the desired effects and the Japanese economy is on the path to achieving the BoJ's price stability target. The 10Yr JGB yield remains a low 0.6%, likely the result of the BoJ's large-scale purchases, as economic fundamentals improve. On the other hand, the side effect of lowered liquidity in the JGB market has become clear. In fact, trading volume of over-the-counter long term JGBs (not including transaction with repurchase agreement) have shrunk from JPY71 trillion/month prior to the introduction of *quantitative and qualitative monetary easing* to JPY50 trillion/month recently (Figure 3). The new issued 10Yr JGB even went untraded on April 14. The BoJ will have to consider the timing for tapering monetary easing operations at some point, but the drop in market liquidity may raise the risk of a sudden yield surge when that happens. As noted in a joint statement released January 22 2013, the Government will have to steadily work toward fortifying the country's finances in order to avoid an unforeseen surge in yield.

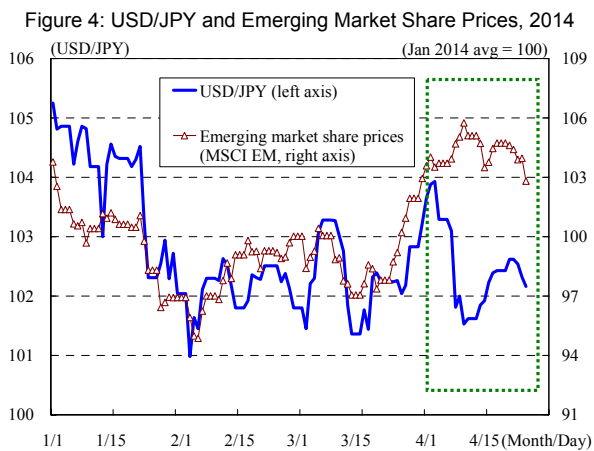
(2) Exchange Rates

Although the USD strengthened to the USD/JPY104 level in early April, the JPY has risen since then (Figure 4). Further BoJ monetary easing, which had been anticipated by some market participants, was deferred, while the US Treasury yield fell, propelling JPY buying. On the other hand, stock prices in emerging markets have been improving overall despite concerns about China's economy and developments in Ukraine, and have been at year-to-date highs. As such, investors' overall risk-off behavior does not appear to have invited a stronger

JPY, and USD/JPY is expected to continue to be more vulnerable to the differing degrees of monetary easing in the US and Japan.



Note: Excluding transaction with repurchase agreement.
 Source: Compiled by BTMU Economic Research Office from Japan Securities Dealers Association data.



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

(Mitsuyoshi Miyagi, Rei Tsuruta)

MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Jun. 9, 2014

	Fiscal 2012	Fiscal 2013	2013		2014	2013	2014			
			3Q	4Q	1Q	DEC	JAN	FEB	MAR	APR
Real GDP Growth Rate <% changes from previous period at SA annual rate>	0.7	2.3	1.3 (2.3)	0.3 (2.5)	6.7 (3.0)	***	***	***	***	***
Index of All Industries Activity	0.1	1.9	0.5 (1.8)	0.3 (1.9)	1.6 (3.1)	0.0 (2.2)	1.7 (3.5)	-1.1 (2.2)	1.5 (3.6)	
Industrial Production Index Production	-2.9	3.2	1.8 (2.3)	1.8 (5.8)	2.9 (8.2)	0.5 (7.2)	3.9 (10.6)	-2.3 (7.0)	0.7 (7.4)	-2.5 (4.1)
Shipments	-1.8	2.9	1.2 (1.5)	2.6 (6.5)	4.6 (7.4)	0.2 (6.4)	5.1 (9.3)	-1.0 (6.5)	-0.2 (6.5)	-5.0 (2.4)
Inventory	-3.0	-1.4	-0.1 (-3.5)	-1.9 (-4.3)	0.2 (-1.4)	-0.2 (-4.3)	-0.4 (-3.9)	-0.9 (-3.4)	1.4 (-1.4)	-0.5 (-1.9)
Inventory/Shipments Ratio (2010=100)	114.4	106.2	109.4 [116.4]	104.6 [117.7]	102.6 [113.4]	104.1 [117.7]	99.3 [113.9]	103.2 [113.3]	105.4 [112.9]	103.5 [108.2]
Domestic Corporate Goods Price Index	-1.1	1.9	0.8 (2.2)	0.2 (2.5)	0.2 (1.9)	0.3 (2.5)	0.1 (2.4)	-0.1 (1.8)	0.0 (1.7)	2.8 (4.1)
Consumer Price Index(SA, total, excl.fresh foods)	-0.2	0.8	0.4 (0.7)	0.3 (1.1)	-0.1 (1.3)	-0.1 (1.3)	0.2 (1.3)	0.1 (1.3)	-0.1 (1.3)	2.1 (3.2)
Index of Capacity Utilization (2010=100)	95.4	100.0	97.8 [95.1]	100.2 [93.1]	106.0 [95.1]	101.4 [94.0]	107.7 [94.7]	104.9 [95.2]	105.3 [95.4]	[96.0]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	-3.0	11.5	4.8 (9.6)	1.9 (13.3)	4.2 (16.4)	-12.1 (6.7)	8.1 (23.6)	-4.6 (10.8)	19.1 (16.1)	
Manufacturing	-10.1	10.2	8.1 (8.2)	2.0 (14.8)	3.9 (22.1)	-7.8 (5.5)	4.9 (24.0)	-4.6 (8.0)	23.7 (29.5)	
Non-manufacturing Excl.Electric Power & Ship building	2.8	12.1	-0.2 (10.4)	4.9 (12.4)	-1.0 (11.8)	-11.5 (7.6)	6.1 (23.1)	-5.1 (12.6)	8.5 (6.6)	
Shipments of Capital Goods (Excl.Transport Equipment)	-6.0	5.6	1.1 (-0.2)	4.8 (10.8)	10.8 (16.8)	-0.1 (7.6)	14.3 (22.2)	-4.8 (14.8)	2.2 (14.9)	-6.1 (10.0)
Construction Orders	2.4	20.1								
Private	2.6	14.2								
Public	5.3	31.2								
Public Works Contracts	10.3	17.7								
Housing Starts 10,000 units at Annual Rate, SA	89.3 (6.2)	98.7 (10.6)	100.4 (13.5)	102.6 (12.9)	93.9 (3.4)	105.5 (18.0)	98.7 (12.3)	91.9 (1.0)	89.5 (-2.9)	90.6 (-3.3)
Total floor	(4.8)	(9.9)	(13.0)	(13.8)	(0.5)	(17.1)	(10.5)	(-2.4)	(-6.2)	(-6.9)
Sales at Retailers	0.3	2.9								
Real Consumption Expenditures of Households over 2 persons (SA)	1.6	0.9	-0.3 (0.7)	-0.2 (0.6)	4.6 (2.3)	-0.4 (0.7)	1.6 (1.1)	-1.5 (-2.5)	10.8 (7.2)	-13.3 (-4.6)
Propensity to Consume (SA,%)	74.8	75.5	74.8 [74.1]	74.6 [74.5]	78.8 [76.2]	75.0 [75.1]	75.9 [76.1]	75.9 [77.3]	85.1 [77.1]	74.2 [73.6]
Overtime Hours Worked (All Industries, 5 employees or more)	-0.3	4.4	0.7 (4.0)	1.6 (6.0)	2.1 (7.1)	-0.2 (5.6)	0.8 (7.0)	0.4 (5.8)	2.3 (8.4)	-0.4 (6.4)
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	-0.7	0.1								
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	107	45	43 131	49 133	54 24	48	55	54	55	57
Ratio of Job Offers to Applicants (SA,Times)	0.82	0.97	0.95 [0.81]	1.01 [0.82]	1.05 [0.85]	1.03 [0.83]	1.04 [0.84]	1.05 [0.85]	1.07 [0.87]	1.08 [0.88]
Unemployment Rate (SA,%)	4.3	5.0	4.0	3.9	3.6	3.7	3.7	3.6	3.6	3.6
Economy Watcher Survey (Judgment of the present condition D.I.%)	46.3	54.0	52.1 [43.0]	53.7 [41.6]	55.2 [53.3]	55.7 [45.8]	54.7 [49.5]	53.0 [53.2]	57.9 [57.3]	41.6 [56.5]
Bankruptcies (Number of cases)	11,719 (-7.7)	10,536 (-10.0)	2,664 (-8.8)	2,571 (-11.0)	2,460 (-11.4)	750 (-15.7)	864 (-7.4)	782 (-14.6)	814 (-12.3)	914 (1.6)

(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 Jun. 9, 2014

	Fiscal	Fiscal	2013		2014	2013	2014			
	2012	2013	3Q	4Q	1Q	DEC	JAN	FEB	MAR	APR
Customs Clearance (Exports in Yen Terms)	-2.1	10.8	(12.7)	(17.4)	(6.6)	(15.3)	(9.5)	(9.8)	(1.8)	(5.1)
Value	4.0	10.2	(12.1)	(12.5)	(6.0)	(12.4)	(9.7)	(4.2)	(4.4)	(3.0)
Volumes	-5.8	0.6	(0.6)	(4.3)	(0.7)	(2.5)	(-0.2)	(5.4)	(-2.5)	(2.0)
Imports (In Yen terms)	3.4	17.4	(17.5)	(24.1)	(17.6)	(24.8)	(25.1)	(9.0)	(18.2)	(3.4)
Value	2.5	14.6	(18.2)	(18.4)	(10.3)	(19.1)	(15.9)	(9.6)	(5.9)	(4.7)
Volumes	1.0	2.3	(-0.5)	(4.8)	(6.5)	(4.7)	(8.0)	(-0.5)	(11.6)	(-1.3)
Current Account (100 mil. yen)	42,233	7,899	13,523	-14,311	-8,600	-6,799	-15,890	6,127	1,164	1,874
Goods (100 mil. yen)	-52,474	-108,642	-22,463	-31,002	-40,123	-10,733	-23,454	-5,334	-11,336	-7,804
Services (100 mil. yen)	-41,864	-35,779	-9,106	-11,319	-7,451	-3,746	-4,674	-1,934	-843	-6,597
Financial Account (100 mil. yen)	20,255	-28,589	30,689	-28,031	-18,353	-19,224	-14,720	-7,319	3,686	-16,342
Gold & Foreign Exchange Reserves (\$1mil.)	1,254,356	1,279,346	1,273,446	1,266,815	1,279,346	1,266,815	1,277,058	1,288,206	1,279,346	1,282,822
Exchange Rate (¥/\$)	83.08	100.23	98.94	100.45	102.78	103.46	103.94	102.13	102.27	102.56

3. Financial Market Indicators

	Fiscal	Fiscal	2013		2014	2013	2014				
	2012	2013	3Q	4Q	1Q	DEC	JAN	FEB	MAR	APR	
Uncollateralized Overnight Call Rates	0.083	0.073	0.073	0.072	0.074	0.074	0.073	0.077	0.072	0.065	
			[0.085]	[0.084]	[0.083]	[0.082]	[0.083]	[0.087]	[0.078]	[0.072]	
Euro Yen TIBOR (3 Months)	0.312	0.223	0.228	0.220	0.215	0.220	0.220	0.212	0.212	0.212	
			[0.327]	[0.318]	[0.270]	[0.308]	[0.292]	[0.269]	[0.250]	[0.228]	
Newly Issued Japanese Government Bonds Yields (10 Years)	0.560	0.640	0.680	0.735	0.640	0.735	0.620	0.580	0.640	0.620	
			[0.765]	[0.795]	[0.560]	[0.795]	[0.740]	[0.665]	[0.560]	[0.600]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.184	1.077	1.125	1.102	1.077	1.102	1.096	1.093	1.077	1.078	
			(-0.028)	(-0.023)	(-0.025)	(-0.012)	(-0.006)	(-0.003)	(-0.016)	(0.001)	
The Nikkei Stock Average (TSE 225 Issues)	12,398	14,828	14,456	16,291	14,828	16,291	14,915	14,841	14,828	14,304	
			[8,870]	[10,395]	[12,398]	[10,395]	[11,139]	[11,559]	[12,398]	[13,861]	
M2(Average)	(2.5)	(3.9)	(3.8)	(4.2)	(4.0)	(4.2)	(4.3)	(4.0)	(3.6)	(3.4)	
Broadly-defined Liquidity(Average)	(0.5)	(3.7)	(3.5)	(4.4)	(4.1)	(4.5)	(4.5)	(4.1)	(3.7)	(3.1)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin	Banks	(0.9)	(2.0)	(2.0)	(2.2)	(2.2)	(2.3)	(2.2)	(2.1)	(2.1)
		Banks	(1.1)	(2.3)	(2.3)	(2.4)	(2.4)	(2.6)	(2.5)	(2.4)	(2.2)
		City Banks etc.	(-0.2)	(1.7)	(1.9)	(1.8)	(1.6)	(2.0)	(1.8)	(1.6)	(1.3)
		Regional Banks	(2.9)	(3.3)	(3.2)	(3.3)	(3.4)	(3.4)	(3.5)	(3.4)	(3.4)
		Regional Banks II	(0.8)	(1.4)	(0.7)	(2.0)	(2.4)	(2.1)	(2.3)	(2.4)	(2.4)
		Shinkin	(-0.7)	(0.3)	(0.1)	(0.5)	(0.9)	(0.6)	(0.8)	(0.9)	(0.9)
Deposits and CDs (Average)	Total(3 Business Condition)	(2.2)	(3.8)	(3.8)	(3.9)	(3.6)	(3.8)	(4.1)	(3.5)	(3.1)	(3.0)
		City Banks	(1.8)	(3.7)	(3.7)	(3.7)	(3.2)	(3.5)	(3.8)	(3.2)	(2.5)
		Regional Banks	(2.8)	(4.3)	(4.5)	(4.5)	(4.2)	(4.4)	(4.7)	(4.1)	(3.8)
		Regional Banks II	(1.8)	(2.5)	(2.1)	(3.2)	(3.1)	(3.3)	(3.3)	(2.9)	(3.0)

(Notes)

Newly Issued Japanese Government Bonds Yields and 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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