

Capital Expenditures Increasingly Likely to Avert Collapse

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1. The Real Economy

The Bank of Japan's September Tankan survey, released October 3, showed that companies are still committed to making capital expenditures, despite factoring in the UK Brexit vote and the subsequent yen rally (Table 1). Business sentiment among companies does not appear to have faltered.

The Business Conditions DI remained fairly flat among both large and small companies even as large manufacturers revised their exchange rate assumption for FY2017 to USD/JPY107.9 from USD/JPY111.4, anticipating a stronger yen. While companies are still cautious about conditions ahead, it appears that an event-driven deterioration has been averted, despite fears about the Brexit vote outcome. Further, companies of all sizes and across all industries cut their current profit forecasts to -8.1% YoY, or by 1.0% point from the June forecast. But while manufacturers expanded their projected margin of decline due to the stronger yen, non-manufacturers' forecasts improved slightly. Ministry of Finance corporate statistics show that companies' current profits fell by -10.0% YoY in Apr-Jun, but started to rise for the first time in four quarters, by +4.8% YoY, when adjusted for seasonal factors. Private consumption and other domestic demand components have been firm of late, and corporate profits, which are still strong but falling, have been bottoming, considering that the yen's rally since early 2016 has paused.

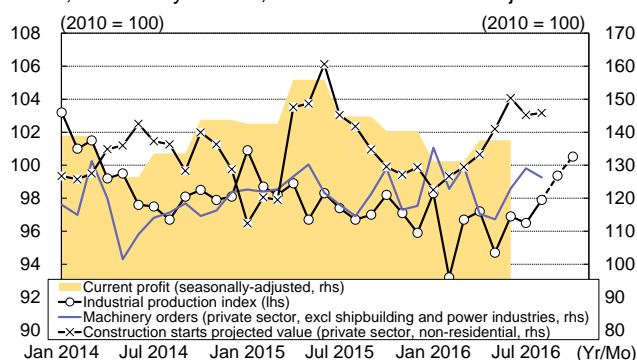
Large companies plan to increase capital spending by +6.3% YoY, but revise down their current profit forecasts. As such, large company survey results were slightly better than in June. This is a positive for capital expenditures ahead. Machinery orders (private demand, excluding the shipbuilding and power industries), a leading indicator of capital expenditures, and projected construction starts value (non-residential projects) have both been rising lately. Meanwhile, industrial production, which has been weak since early 2016, is starting to pick up (Figure 1). Capital expenditures have been weak since the start of the year but are expected to avert a collapse and continue to rise going forward.

Table 1: Bank of Japan Tankan Business Conditions DI and Current Profit and Capital Expenditures Forecasts

	Company size	Sector	Jun 2016 survey	Sept 2016 survey	Difference (revision rate)
Business Conditions DI (% pt)	All sizes	All	4	5	+1
		Manufacturers	0	1	+1
		Non-manufacturers	8	7	-1
	Large	All	12	12	+0
		Manufacturers	6	6	+0
		Non-manufacturers	19	18	-1
	SMEs	All	-1	0	+1
		Manufacturers	-5	-3	+2
		Non-manufacturers	0	1	+1
Recurring profit forecast (YoY, %)	All sizes	All	-7.2	-8.1	(-1.0)
		Manufacturers	-9.3	-11.8	(-2.8)
		Non-manufacturers	-5.8	-5.6	(+0.2)
	Capital expenditures forecast (YoY, %)	Large	All	6.2	6.3
Manufacturers			12.8	12.7	(-0.1)
Non-manufacturers			2.7	2.9	(+0.1)

Note: Capital expenditures forecast includes land, excludes software.
Source: BoJ, BTMU Economic Research Office

Figure 1: Corporate Current Profit, Industrial Production Index, Machinery Orders, Construction Starts Projected Value



Note: 1) September and October Industrial Production Index estimated using Manufacturers Forecast Index.
2) Construction starts floorspace is leading forward three-mnth moving average.
Source: MoF, METI, BTMU Economic Research Office

2. Financial Markets

(1) MONETARY POLICY & LONG-TERM YIELDS

The Bank of Japan will hold its next Monetary Policy Board meeting October 31-November 1, when it will also release its Outlook Report for economic activity and prices. BoJ Governor Haruhiko Kuroda spoke before the Diet's Lower House Committee on Financial Affairs on October 21 and noted that it is difficult to think that an appropriate yield curve is changed immediately. This seems to show that the BoJ is not likely to expand monetary easing at the upcoming meeting, and Board members are expected to lower their inflation forecast and extend the target date for achieving the price stability target of 2%, to beyond the current FY2017, in the Outlook Report. The BoJ and private sector economists differ considerably—by about 1%pt—in their inflation forecasts for both FY2017 and FY2018 (Figure 2). The BoJ had been predicting that the price stability target would be met soon, even as falling oil prices have weighed heavily, so this probably means the BoJ felt it had to stick to its bullishness. However, in its comprehensive assessment of monetary policy, released at the September meeting, the BoJ admitted to the possibility that inflation could be slowed even further because of events abroad. We think the BoJ could now lower its inflation outlook to a more realistic level by taking a longer view strategy.

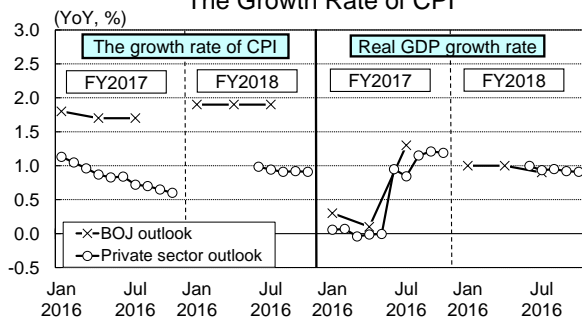
The yield on the 10Yr JGB turned positive after the last BoJ meeting, hitting 0.005% at one point. Thereafter, the yield fell to -0.09% in late September, seeking a lower level of the BoJ's target of around zero percent. The BoJ then released a statement on long-term JGB buying operations on September 30, announcing plans to cut purchases of long-dated JGBs. The yield on the 10Yr JGB subsequently rose to -0.05% due to widening views that the bottom margin of the BoJ's target level of 'around zero percent' was now -0.1%.

(2) Exchange rate

The US Fed's deferral on a rate hike at the September FOMC meeting touched off dollar selling, and USD/JPY hit 100. Thereafter, the yen weakened and dollar rose in line with the real yield spread (the 10Yr yield minus the breakeven inflation rate), and USD/JPY now stands

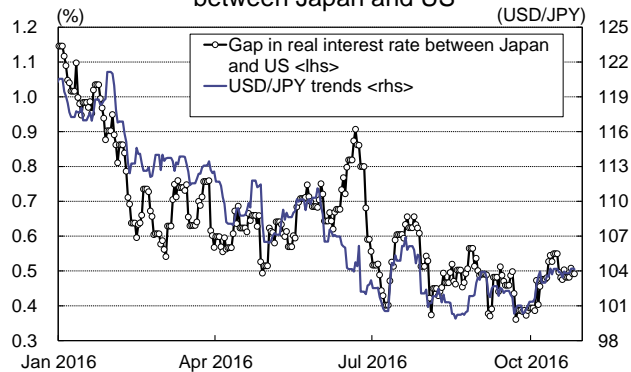
at around 104 (Figure 3). Japan is likely to maintain monetary policy guidelines, while key events loom in the US—the presidential election and a possible FRB rate hike before year’s end. The events in the US are likely to touch off more USD/JPY moves.

Figure 2: Outlook for Real GDP Growth Rate and The Growth Rate of CPI



Notes: 1) *BoJ outlook* is median outlook of Policy meeting members; *Private sector outlook* is average outlook of private research institutions (approximately 40) responding to ESP Forecast Survey.
 2) *The growth rate of CPI* is overall excluding fresh foods and direct impact of consumption tax hike.
 Source: BoJ, Japan Center for Economic Research, BTMU Economic Research Office

Figure 3: USD/JPY trends and gap in real interest rate between Japan and US



Note: "Real interest rate" is calculated based on the formula, 10-year JGB yield minus break-even inflation rate.
 Source: Bloomberg, BTMU Economic Research Office

MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Oct. 26, 2016

	Fiscal	Fiscal	2015	2016		2016				
	2014	2015	4Q	1Q	2Q	MAY	JUN	JUL	AUG	SEP
Real GDP Growth Rate <% changes from previous period at SA annual rate>	-0.9	0.8	-1.7 (0.7)	2.1 (0.2)	0.7 (0.8)	***	***	***	***	***
Index of All Industries Activity	-1.1	0.9	-0.2 (0.6)	0.0 (0.4)	0.4 (0.1)	-1.3 (0.3)	1.0 (0.1)	0.2 (-0.8)	0.2 (1.7)	
Industrial Production Index	-0.5	-1.0	0.1 (-0.8)	-1.0 (-1.6)	0.2 (-1.8)	-2.6 (-0.4)	2.3 (-1.5)	-0.4 (-4.2)	1.3 (4.5)	
Production										
Shipments	-1.2	-1.2	0.4 (-0.8)	-2.0 (-2.4)	0.2 (-2.0)	-2.6 (-1.0)	1.7 (-1.7)	0.7 (-4.0)	-1.1 (1.6)	
Inventory	6.1	1.8	-0.5 (0.0)	2.4 (1.8)	-1.3 (0.0)	0.4 (0.8)	0.0 (0.0)	-2.4 (-1.8)	0.3 (-1.6)	
Inventory/Shipments Ratio (2010=100)	112.0	115.0	114.9 [113.8]	116.3 [113.0]	116.5 [113.8]	117.8 [114.8]	116.0 [112.8]	117.3 [112.7]	113.6 [116.3]	115.1
Domestic Corporate Goods Price Index	2.7	-3.2	-1.4 (-3.7)	-1.5 (-3.5)	-0.6 (-4.4)	0.1 (-4.4)	-0.1 (-4.3)	0.0 (-4.0)	-0.3 (-3.6)	0.0 (-3.2)
Consumer Price Index(SA, total, excl.fresh foods)	2.8	0.0	0.0 (0.0)	-0.7 (-0.1)	0.4 (-0.4)	-0.1 (-0.4)	0.1 (-0.4)	-0.2 (-0.5)	0.0 (-0.5)	
Index of Capacity Utilization (2010=100)	100.6	98.0	97.9 [100.7]	97.3 [101.4]	95.4 [98.0]	94.2 [96.8]	95.6 [98.0]	96.2 [97.7]	98.7 [97.4]	97.7
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	0.8	4.1	2.6 (2.1)	6.7 (3.4)	-9.2 (-6.5)	-1.4 (-11.7)	8.3 (-0.9)	4.9 (5.2)	-2.2 (11.6)	
Manufacturing	7.0	6.2	-3.0 (-3.1)	13.7 (4.3)	-13.4 (-12.9)	-6.4 (-21.5)	17.7 (-3.8)	0.3 (-1.4)	-4.0 (2.0)	
Non-manufacturing Excl.Electric Power & Ship building	-3.3	2.5	5.6 (6.3)	3.5 (2.6)	-5.0 (-1.0)	-0.3 (-2.5)	2.1 (1.8)	8.6 (11.3)	-1.9 (19.6)	
Shipments of Capital Goods (Excl.Transport Equipment)	4.4	-2.3	-1.7 (-4.2)	-2.4 (-5.5)	3.4 (-2.7)	-1.4 (-1.1)	1.0 (-2.9)	0.6 (-4.9)	0.2 (2.5)	
Construction Orders	8.2	-0.9								
Private	4.8	7.9								
Public	22.9	-15.6								
Public Works Contracts	-0.3	-3.8								
Housing Starts 10,000 units at Annual Rate, SA	88.0 (-10.8)	92.1 (4.6)	86.8 (-0.7)	94.7 (5.5)	100.5 (4.9)	101.7 (9.8)	100.4 (-2.5)	100.5 (8.9)	95.6 (2.5)	
Total floor										
Sales at Retailers	-1.2	0.8								
Real Consumption Expenditures of Households over 2 persons (SA)	-5.1	-1.2	-2.2 (-3.3)	0.5 (-2.6)	-0.2 (-1.2)	-1.4 (-1.1)	-1.3 (-2.3)	2.5 (-0.5)	-3.7 (-4.6)	
Propensity to Consume (SA, %)	74.2	73.6	73.1 [74.4]	72.8 [74.3]	72.9 [74.2]	75.2 [74.8]	69.4 [74.3]	69.3 [71.9]	70.4 [74.1]	74.3
Overtime Hours Worked (All Industries, 5 employees or more)	2.0	-1.3	-0.2 (-0.9)	-1.2 (-2.1)	0.0 (-1.2)	-0.9 (-1.8)	1.4 (-1.0)	-0.9 (-1.9)	-0.8 (-2.0)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	0.5	0.2								
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	77	98	104	98	93	91	95	97	106	
Ratio of Job Offers to Applicants (SA, Times)	1.11	1.23	1.26 [1.12]	1.29 [1.15]	1.36 [1.18]	1.36 [1.18]	1.37 [1.19]	1.37 [1.21]	1.37 [1.22]	1.23
Unemployment Rate (SA, %)	3.5	3.3	3.3	3.2	3.2	3.2	3.1	3.0	3.1	
Economy Watcher Survey (Judgment of the present condition D.I.%)	46.6	48.8	47.7 [43.6]	45.6 [49.3]	42.6 [52.6]	43.0 [53.3]	41.2 [51.0]	45.1 [51.6]	45.6 [49.3]	44.8 [47.5]
Bankruptcies (Number of cases)	9,543 (-9.4)	8,684 (-9.0)	2,152 (-3.1)	2,144 (-5.6)	2,129 (-7.2)	671 (-7.3)	763 (-7.4)	712 (-9.5)	726 (14.9)	649 (-3.6)

(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 Oct. 26, 2016

	Fiscal	Fiscal	2015	2016		2016				
	2014	2015	4Q	1Q	2Q	MAY	JUN	JUL	AUG	SEP
Customs Clearance (Exports in Yen Terms)	5.4	-0.7	(-4.6)	(-7.9)	(-9.5)	(-11.3)	(-7.4)	(-14.0)	(-9.6)	(-6.9)
Value	3.9	2.1	(-0.6)	(-4.7)	(-8.3)	(-9.1)	(-10.1)	(-11.9)	(-10.3)	(-11.1)
Volumes	1.3	-2.7	(-4.1)	(-3.2)	(-1.3)	(-2.4)	(3.1)	(-2.4)	(0.8)	(4.7)
Imports (In Yen terms)	-1.0	-10.3	(-13.9)	(-15.7)	(-18.8)	(-13.7)	(-18.7)	(-24.6)	(-17.2)	(-16.3)
Value	1.2	-8.5	(-11.8)	(-14.9)	(-17.6)	(-16.7)	(-19.1)	(-21.5)	(-20.3)	(-14.9)
Volumes	-2.1	-1.8	(-2.5)	(-0.8)	(-1.3)	(3.6)	(0.4)	(-4.0)	(3.8)	(-1.6)
Current Account (100 mil. yen)	87,245	180,028	34,479	59,636	45,955	17,827	9,815	19,382	20,008	
Goods (100 mil. yen)	-65,890	5,419	954	8,534	14,959	458	7,615	6,139	2,432	
Services (100 mil. yen)	-27,252	-11,451	-5,212	2,414	-4,951	823	-1,632	-2,223	-525	
Financial Account (100 mil. yen)	137,595	238,095	49,065	90,136	71,315	40,821	14,005	36,737	29,220	
Gold & Foreign Exchange Reserves (\$1mil.)	1,245,316	1,262,099	1,233,214	1,262,099	1,265,402	1,253,967	1,265,402	1,264,750	1,256,053	1,260,145
Exchange Rate (¥/\$)	109.92	120.13	121.48	115.45	108.17	109.15	105.49	103.90	101.27	102.04

3. Financial Market Indicators

	Fiscal	Fiscal	2015	2016		2016					
	2014	2015	4Q	1Q	2Q	MAY	JUN	JUL	AUG	SEP	
Uncollateralized Overnight Call Rates	0.068	0.063	0.076 [0.064]	0.035 [0.073]	-0.050 [0.067]	-0.059 [0.069]	-0.055 [0.072]	-0.043 [0.074]	-0.043 [0.076]	-0.052 [0.073]	
Euro Yen TIBOR (3 Months)	0.194	0.157	0.169 [0.184]	0.122 [0.171]	0.060 [0.169]	0.060 [0.169]	0.059 [0.169]	0.058 [0.169]	0.058 [0.169]	0.056 [0.169]	
Newly Issued Japanese Government Bonds Yields (10 Years)	0.400	-0.050	0.270 [0.330]	-0.050 [0.400]	-0.230 [0.455]	-0.120 [0.390]	-0.230 [0.455]	-0.195 [0.410]	-0.070 [0.380]	-0.085 [0.350]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	1.006	0.924	0.956 (-0.013)	0.924 (-0.032)	0.886 (-0.038)	0.904 (-0.010)	0.886 (-0.018)	0.885 (-0.001)	0.880 (-0.005)		
The Nikkei Stock Average (TSE 225 Issues)	19,207	16,759	19,034 [17,451]	16,759 [19,207]	15,576 [20,236]	17,235 [20,563]	15,576 [20,236]	16,569 [20,585]	16,887 [18,890]	16,450 [17,388]	
M2(Average)	(3.3)	(3.6)	(3.4)	(3.2)	(3.4)	(3.4)	(3.5)	(3.4)	(3.3)	(3.6)	
Broadly-defined Liquidity(Average)	(3.3)	(3.9)	(3.8)	(3.4)	(2.2)	(2.2)	(1.9)	(1.7)	(1.6)	(1.8)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin	(2.3)	(2.4)	(2.3)	(2.2)	(2.1)	(2.2)	(2.0)	(2.1)	(2.0)	(2.2)
	Banks	(2.5)	(2.5)	(2.3)	(2.2)	(2.1)	(2.2)	(2.0)	(2.1)	(2.0)	(2.2)
	City Banks etc.	(1.4)	(1.2)	(1.0)	(0.9)	(0.8)	(0.9)	(0.6)	(0.7)	(0.5)	(0.8)
	Regional Banks	(3.8)	(3.7)	(3.7)	(3.4)	(3.4)	(3.4)	(3.4)	(3.5)	(3.4)	(3.5)
	Regional Banks II	(2.9)	(3.2)	(3.2)	(3.2)	(3.2)	(3.2)	(3.1)	(2.9)	(2.8)	(2.9)
Deposits and CDs (Average)	Shinkin	(1.4)	(2.2)	(2.3)	(2.3)	(2.2)	(2.2)	(2.3)	(2.3)	(2.2)	(2.3)
	Total(3 Business Condition)	(3.3)	(3.7)	(3.2)	(3.0)	(3.3)	(3.3)	(3.3)	(3.5)	(3.3)	(3.6)
	City Banks	(3.4)	(4.5)	(3.6)	(3.6)	(4.7)	(4.7)	(4.6)	(4.9)	(4.4)	(5.1)
	Regional Banks	(3.3)	(3.0)	(3.0)	(2.4)	(1.9)	(1.7)	(2.1)	(2.1)	(2.2)	(2.1)
	Regional Banks II	(3.1)	(2.5)	(2.3)	(2.1)	(1.9)	(1.8)	(1.8)	(1.9)	(2.1)	

(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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