

## Next autumn's tax hike will go ahead as planned

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7 NOVEMBER 2018  
(ORIGINAL JAPANESE VERSION RELEASED ON 23 OCTOBER 2018)

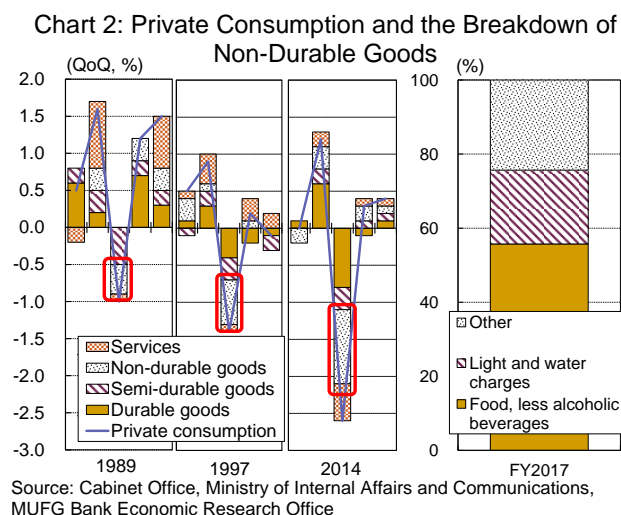
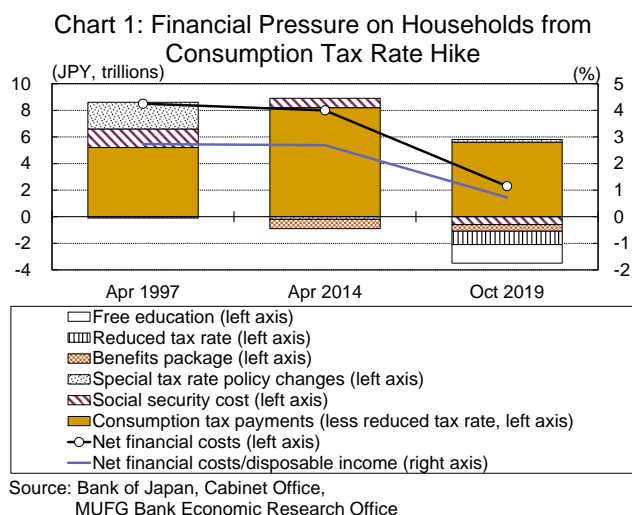
### 1. The Real Economy

At an extraordinary Cabinet meeting on 15<sup>th</sup> October, Prime Minister Abe announced that the October 2019 consumption tax rate hike will go ahead as scheduled in order to make progress with the shift towards an “all-generation” social security system and fiscal consolidation. The preparations for a smooth implementation of the tax hike – which include economic policies focused on reducing the negative impact on the economy – will be shifted up a gear over the coming months.

Increases in the consumption tax rate mainly affect the economy in two ways: increased pressure on household finances and a rise in consumption levels ahead of the hike, as well as a subsequent fall after. This time, it is highly likely that the negative effects will be limited compared with previous hikes, owing to the small scale of the increase in the tax rate and policy responses, such as a reduced tax rate and the provision of free education. Looking first at the burden on households, the net financial cost is expected to be around JPY 2 trillion, taking into account the corresponding amount subject to the rise in the consumption tax rate and the various policy responses. This equates to 1% of disposable income, and will be only about one quarter of the financial cost during previous tax rate hikes (Chart 1). Furthermore, it appears the impact of the sudden rise in consumption and the subsequent fall will also be limited. The focus regarding this rise and fall in consumption tends to be placed on the trend of durable goods, such as automobiles and home electrical appliances, but a breakdown of private consumption by goods at the time of previous tax rate hikes (including 2014) reveals a marked decline in non-durable goods (Chart 2). However, the introduction of the reduced tax rate for food (less alcoholic beverages) this time is expected to curb the decline in consumption as food (less alcoholic beverages), together with light and water charges, which generally cannot be purchased ahead of time, constitutes nearly 80% of non-durable goods. Once the robust corporate and household income is also taken into consideration, it is thought that a downturn in the economy sparked by the consumption tax rate hike can be avoided.

That being said, whether it is temporary or not, the increase in the consumption tax rate is an event that will have a negative effect on consumption, and it is necessary to bear in mind that the economy will be susceptible to external shocks before and after the hike. Just as consumption was recovering from the April 1997 tax rate hike, the Asian financial crisis struck

in July that year and domestic demand lost its momentum, particularly private consumption. During this time, exports – which had been strong – started to decline, resulting in a two-stage slowdown of the economy before it entered a brief recession owing to the subsequent structural adjustments. While the government is taking note of trends overseas, there are hopes that it will provide a detailed response which will minimise the negative effects on the economy. This involves carrying out the tax system in a way which does not cause confusion related to the reduced tax rate.



## 2. Prices and Financial Markets

### (1) Monetary Policy

Up until now, the Bank of Japan (BoJ) has been slowly decreasing the pace of their Japanese government bond (JGB) purchases from an annual increase of about an 80 trillion yen in the amount outstanding. However, July’s “Strengthening the Framework for Continuous Monetary Easing” added that the BoJ would conduct purchases of JGBs “in a flexible manner”. Furthermore, in the “Outline of Outright Purchases of Japanese Government Securities” announced on 31<sup>st</sup> August, the number of monthly purchases of JGBs with a residual maturity of “more than 1 year and up to 5 years” and “more than 5 years and up to 10 years” had been lowered from 6 to 5. In addition, the BoJ tightened the range of the purchase size of JGBs per auction with a residual maturity of “more than 25 years” and lowered the upper limit on 28<sup>th</sup> September (lower limit: JPY 50 billion → JPY 10 billion; upper limit: JPY150 billion → JPY 100 billion). As a result, a year-on-year increase of approximately JPY 40 trillions’ worth of JGBs was purchased in September: around half of the BoJ’s target (Chart 3).

The BoJ released a Working Paper on 1<sup>st</sup> October which is attracting attention. The analysis states “government bond purchases conducted by the Bank of Japan have compressed the term premium, exerting an expansionary effect on economic activity and prices”. In addition, “the compression of the term premium has been mainly driven by stock effects” and that the contribution from flow effects is limited. This paper concludes that, when it comes to discussing this compression effect, the analysis “underscores the importance of the amount outstanding of the Bank’s government bond holdings”, rather than the amount of bonds

purchased each time. Of the outstanding balance of long-term JGBs, the percentage held by the BoJ was already 44.6% in June, exceeding the amount held by private domestic entities (Chart 4). In other words, this huge amount of outstanding JGBs will continue to result in a strong easing effect, regardless of the amount of bonds purchased. This analysis can be interpreted as an attempt by the BoJ to build a rationale for allowing a decrease in the amount of JGB purchases. Looking ahead, JGB purchases are expected to continue to decrease on the whole.

## (2) Exchange Rates

The USD rose to above JPY 114 per USD on 3<sup>rd</sup> October amid a sharp increase in US interest rates owing to the robust US economy. However, concerns about US-Chinese trade tension then rose and global stock markets were shaken, which led to a rise in risk aversion. The USD is now fluctuating around JPY 112 per USD. Even if the JPY temporarily appreciates due to a change in the situation overseas, JPY depreciation is forecast to remain at current levels in accordance with the difference in the directions of Japanese and US monetary policies.

Chart 3: BoJ's JGB Holdings and Japanese and US Long-Term Interest Rates

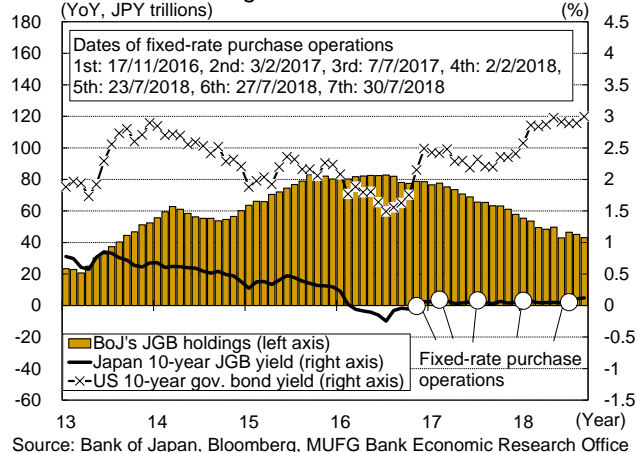
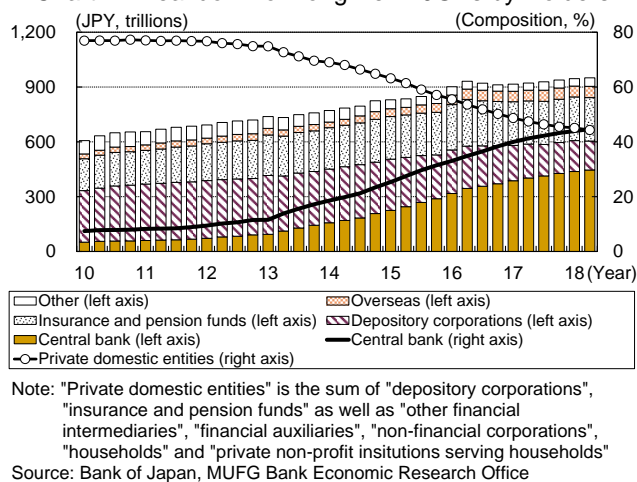


Chart 4: Breakdown of Long-Term JGBs by Holders



(Translated by Elizabeth Foster)

## MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

### 1. Main Economic Indicators

As of Oct. 23, 2018

	Fiscal	Fiscal	2017	2018		2018				
	2016	2017	4Q	1Q	2Q	MAY	JUN	JUL	AUG	SEP
Real GDP Growth Rate <% changes from previous period at SA annual rate>	1.2	1.6	0.9 (2.0)	-0.9 (1.0)	3.0 (1.3)	***	***	***	***	***
Index of All Industries Activity	0.6	1.8	0.7 (1.8)	-0.5 (1.3)	0.9 (1.1)	0.2 (1.7)	-0.9 (0.2)	-0.2 (0.9)	0.5 (0.9)	
Industrial Production Index	1.0	4.1	1.6 (4.6)	-1.3 (2.4)	1.3 (1.9)	-0.2 (4.2)	-1.8 (-0.9)	-0.2 (2.2)	0.2 (0.2)	
Production										
Shipments	0.8	3.3	0.8 (3.1)	-1.1 (1.5)	1.9 (2.2)	-1.6 (3.3)	0.3 (-0.2)	-2.0 (1.2)	1.7 (0.5)	
Inventory	-4.0	3.9	2.2 (1.9)	3.4 (3.9)	-1.9 (2.4)	0.6 (2.5)	-1.9 (2.4)	-0.2 (2.8)	-0.4 (3.0)	
Inventory/Shipments Ratio (2010=100)	112.9	112.4	112.1 [109.7]	114.9 [111.1]	114.7 [111.8]	113.9 [111.7]	116.5 [110.7]	117.0 [112.4]	114.6 [110.1]	110.7 [110.7]
Domestic Corporate Goods Price Index	-2.4	2.7	0.9 (3.3)	0.6 (2.5)	0.6 (2.4)	0.5 (2.6)	0.3 (2.8)	0.4 (3.0)	0.0 (3.0)	0.3 (3.0)
Consumer Price Index(SA, total, excl.fresh foods)	-0.2	0.7	0.4 (0.9)	-0.1 (0.9)	0.4 (0.7)	0.0 (0.7)	0.1 (0.8)	0.1 (0.8)	0.3 (0.9)	0.1 (1.0)
Index of Capacity Utilization (2010=100)	98.6	101.7	102.7 [100.1]	101.0 [100.1]	102.0 [101.8]	102.0 [100.3]	99.8 [101.7]	99.2 [100.6]	101.4 [102.5]	101.6 [101.6]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	0.5	-0.8	0.3 (0.0)	3.3 (0.2)	2.2 (8.0)	-3.7 (16.5)	-8.8 (0.3)	11.0 (13.9)	6.8 (12.6)	
Manufacturing	-4.6	9.2	3.5 (13.3)	2.5 (10.6)	5.5 (17.8)	1.3 (26.2)	-15.9 (6.6)	11.8 (21.2)	6.6 (13.9)	
Non-manufacturing Excl.Electric Power & Ship building	4.3	-7.8	-2.1 (-9.7)	3.4 (-6.9)	-0.4 (0.3)	0.2 (8.4)	-7.0 (-4.6)	10.9 (7.7)	6.0 (11.6)	
Shipments of Capital Goods (Excl.Transport Equipment)	1.4	6.2	3.1 (7.2)	-0.5 (7.0)	0.5 (4.2)	-4.6 (3.8)	-1.1 (0.0)	-0.7 (5.4)	4.7 (2.0)	
Construction Orders	4.0	0.7								
Private	5.1	0.6								
Public	8.4	-5.4								
Public Works Contracts	4.1	-4.3								
Housing Starts 10,000 units at Annual Rate, SA Total floor	97.4 (5.8) (4.1)	94.6 (-2.8) (-3.7)	94.8 (-2.4) (-3.2)	89.2 (-8.0) (-9.2)	96.8 (-1.8) (-3.6)	99.6 (1.3) (0.1)	91.5 (-7.1) (-8.9)	95.8 (-0.7) (-1.6)	95.7 (1.6) (0.5)	
Sales at Retailers	-0.2	1.9								
Real Consumption Expenditures of Households over 2 persons (SA)	-1.6	0.2	-0.6 (0.5)	1.1 (0.6)	-1.4 (-1.3)	-0.2 (-1.4)	2.9 (-1.2)	-1.1 (0.4)	3.5 (2.8)	
Propensity to Consume (SA, %)	72.1	71.7	71.3 [71.8]	71.4 [73.0]	69.4 [74.6]	72.3 [77.0]	66.1 [73.8]	69.9 [70.3]	70.7 [70.3]	70.3 [70.3]
Overtime Hours Worked (All Industries, 5 employees or more)	-0.7	0.4	0.3 (1.2)	-1.1 (-1.2)	1.6 (0.6)	1.3 (0.9)	-0.3 (0.9)	-3.1 (-1.8)	-0.1 (-1.9)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	0.4	0.7								
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	103	105	133	25	6	7	0	-11	-5	
Ratio of Job Offers to Applicants (SA, Times)	1.39	1.54	1.57 [1.41]	1.59 [1.44]	1.60 [1.49]	1.60 [1.49]	1.62 [1.50]	1.63 [1.51]	1.63 [1.52]	1.53 [1.53]
Unemployment Rate (SA, %)	3.0	2.7	2.7	2.5	2.4	2.2	2.4	2.5	2.4	
Economy Watcher Survey (Judgment of the present condition D.I.%)	46.4	50.5	53.3 [49.8]	49.1 [48.7]	48.1 [49.2]	47.1 [49.1]	48.1 [50.0]	46.6 [49.9]	48.7 [50.0]	48.6 [51.1]
Bankruptcies (Number of cases)	8,381 (-3.5)	8,367 (-0.2)	2,106 (1.0)	2,041 (-1.8)	2,107 (-3.7)	767 (-4.4)	690 (-2.3)	702 (-1.7)	694 (8.6)	621 (-8.5)

(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. 23, 2018

	Fiscal	Fiscal	2017			2018			2018		
	2016	2017	4Q	1Q	2Q	MAY	JUN	JUL	AUG	SEP	
Customs Clearance (Exports in Yen Terms)	-3.5	10.8	(13.0)	(4.9)	(7.5)	(8.1)	(6.7)	(3.9)	(6.6)	(-1.2)	
Value	-6.0	5.5	(7.9)	(0.8)	(1.8)	(1.5)	(3.4)	(3.0)	(5.4)	(3.7)	
Volumes	2.7	5.0	(4.8)	(4.1)	(5.6)	(6.4)	(3.2)	(0.9)	(1.1)	(-4.8)	
Imports (In Yen terms)	-10.2	13.7	(17.0)	(7.5)	(7.5)	(14.1)	(2.6)	(14.7)	(15.3)	(7.0)	
Value	-10.0	8.8	(10.9)	(3.6)	(6.1)	(7.0)	(7.5)	(10.2)	(10.5)	(10.0)	
Volumes	-0.2	4.4	(5.5)	(3.7)	(1.4)	(6.6)	(-4.5)	(4.0)	(4.4)	(-2.7)	
Current Account (100 mil. yen)	210,188	218,127	43,257	58,821	49,775	18,873	11,989	20,097	18,384		
Goods (100 mil. yen)	57,851	45,936	11,527	7,246	10,661	-3,165	8,227	-10	-2,193		
Services (100 mil. yen)	-13,813	-5,378	-1,975	2,127	-6,118	63	-1,729	-1,744	-61		
Financial Account (100 mil. yen)	247,407	196,174	30,753	75,622	53,095	32,690	6,698	-8,319	19,128		
Gold & Foreign Exchange Reserves (\$1mil.)	1,230,330	1,268,287	1,264,283	1,268,287	1,258,748	1,254,477	1,258,748	1,256,276	1,259,305	1,259,673	
Exchange Rate (¥/\$)	108.37	110.80	112.95	108.20	109.05	109.69	110.03	111.37	111.06	111.89	

## 3. Financial Market Indicators

	Fiscal	Fiscal	2017			2018			2018		
	2016	2017	4Q	1Q	2Q	MAY	JUN	JUL	AUG	SEP	
Uncollateralized Overnight Call Rates	-0.045	-0.050	-0.042	-0.048	-0.065	-0.061	-0.071	-0.070	-0.059	-0.059	
			[-0.043]	[-0.042]	[-0.054]	[-0.053]	[-0.056]	[-0.054]	[-0.049]	-0.058	
Euro Yen TIBOR (3 Months)	0.057	0.065	0.063	0.078	0.084	0.078	0.078	0.091	0.091	0.050	
			[0.056]	[0.056]	[0.056]	[0.056]	[0.056]	[0.075]	[0.058]	[0.056]	
Newly Issued Japanese Government Bonds Yields (10 Years)	0.065	0.045	0.045	0.045	0.030	0.030	0.030	0.060	0.110	0.125	
			[0.040]	[0.065]	[0.075]	[0.040]	[0.075]	[0.075]	0.010	[0.060]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	0.847	0.817	0.828	0.817	0.789	0.794	0.789	0.788	0.786		
			(-0.003)	(-0.011)	(-0.028)	(0.001)	(-0.005)	(-0.001)	(-0.002)		
The Nikkei Stock Average (TSE 225 Issues)	18,909	21,454	22,765	21,454	22,305	22,202	22,305	22,554	22,865	24,120	
			[19,114]	[18,909]	[20,033]	[19,651]	[20,033]	[19,925]	[19,646]	[20,356]	
M2(Average)	(3.6)	(3.7)	(3.9)	(3.2)	(3.1)	(3.2)	(3.1)	(2.9)	(2.9)	(2.8)	
Broadly-defined Liquidity(Average)	(1.9)	(3.1)	(3.3)	(2.6)	(2.5)	(2.5)	(2.4)	(2.3)	(2.2)	(2.3)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin	(2.4)	(2.8)	(2.6)	(2.1)	(2.0)	(1.9)	(2.1)	(2.0)	(2.2)	(2.3)
	Banks	(2.4)	(2.8)	(2.6)	(2.1)	(2.0)	(1.9)	(2.1)	(2.0)	(2.2)	(2.3)
	City Banks etc.	(1.2)	(2.0)	(1.7)	(0.7)	(0.5)	(0.3)	(0.6)	(0.3)	(0.7)	(1.1)
	Regional Banks	(3.5)	(3.6)	(3.6)	(3.5)	(4.1)	(4.4)	(4.5)	(4.5)	(4.5)	(4.5)
	Regional Banks II	(3.1)	(3.0)	(3.0)	(2.8)	(0.6)	(-0.5)	(-0.4)	(-0.5)	(-0.5)	(-0.6)
	Shinkin	(2.3)	(2.7)	(2.6)	(2.5)	(2.3)	(2.3)	(2.2)	(2.2)	(2.2)	
Deposits and CDs (Average)	Total(3 Business Condition)	(3.8)	(4.2)	(4.3)	(3.5)	(3.8)	(3.8)	(3.8)	(3.7)	(3.6)	
	City Banks	(5.5)	(5.9)	(6.1)	(4.9)	(5.2)	(5.1)	(5.3)	(5.4)	(5.2)	(5.2)
	Regional Banks	(2.3)	(2.5)	(2.5)	(2.2)	(2.8)	(3.2)	(3.0)	(3.0)	(3.0)	(2.9)
	Regional Banks II	(2.1)	(2.1)	(2.0)	(1.6)	(-0.2)	(-1.1)	(-1.1)	(-1.2)	(-1.3)	(-1.4)

(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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