

## Business sentiment is solid as non-manufacturing firms in particular focus on investment to address structural issues

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### 1. The Real Economy

On the 13<sup>th</sup> June, the Cabinet Office and Ministry of Finance published their Business Outlook Survey. According to the survey, large enterprises' BSI of business conditions across all industries – an indicator of the overall direction of economic growth – rose by 0.8% points and entered positive territory for the first time in two quarters (Chart 1). The breakdown by industry reveals manufacturing decreased 3.4% points and the responses that business conditions are “falling” exceeded those which said they are “rising” for the second consecutive quarter. On the other hand, non-manufacturing increased 2.9% points, maintaining its positive result for the tenth consecutive quarter. This quarter's survey was carried out using 15<sup>th</sup> May as a reference date and it appears that the worsening of US-China trade friction at the start of May was factored into enterprises' evaluations to a certain extent. On the whole, this survey confirms that business conditions remain firm; the manufacturing industry showed an improvement in its business conditions compared with the fall the previous quarter and the conditions in the non-manufacturing industry improved further.

There was a fall from last year in the number of corporations who selected “maintain and renew” as one of their top three most important options in terms of capital expenditure across all company sizes and industries (Chart 2). Meanwhile, there was an increase in the percentage of companies who selected “enhance quality of goods, services”, “labour saving, streamlining” and “respond to increased use of IT”. This seems to reflect a stronger response to structural issues by the majority of corporations, such as their improvements to value added and productivity, and increased competitiveness. This kind of investment is expected to underpin overall capital expenditure in the future as it is unlikely to be quickly postponed or discontinued, even in times when business sentiment worsens somewhat.

The US has taken a particularly hard-line stance with its foreign policy, not just with regards to China, but also Mexico and Iran, and its trade negotiations with Japan appear to be approaching an important juncture. As such, the uncertainty surrounding external demand continues to simmer, yet it seems unlikely that corporations' business sentiment will suddenly deteriorate at this point in time. Once corporations have assessed the business environment, they will make the solid, strategic moves necessary for future growth, such as increasing

accuracy, developing the internet of things and addressing the labour shortage. As a result, capital expenditure is forecast to remain firm.

Chart 1: Large Enterprises' BSI on Business Conditions

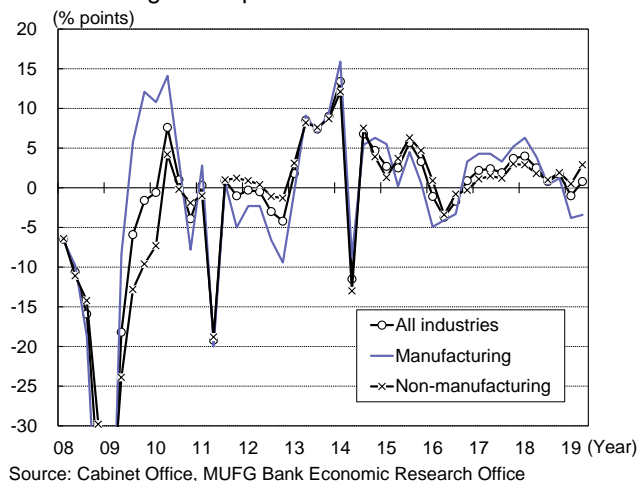
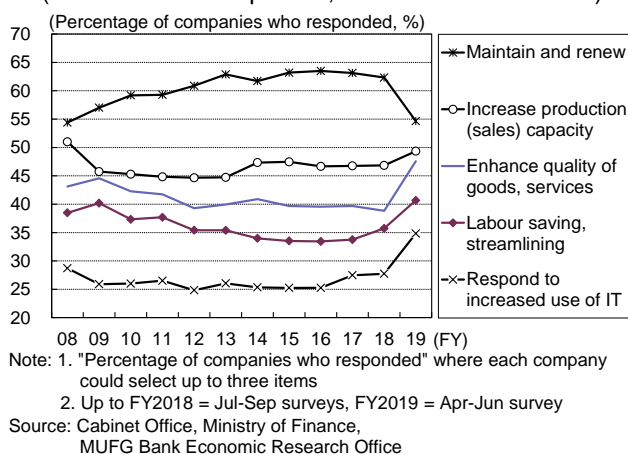


Chart 2: Companies' Capex Each Fiscal Year (Total of 3 most important, all sizes and industries)



## 2. Prices and Financial Markets

### (1) Monetary Policy

US and European central banks are becoming increasingly dovish. At its Federal Open Market Committee meeting in June, the Federal Reserve Board (FRB) suggested the possibility of a rate cut depending on its necessity as it adjusted its monetary policy, changing “the Committee will be patient as it determines what future adjustments ... may be appropriate” to “the Committee will closely monitor the implications of incoming information ... and will act as appropriate”. The European Central Bank also revised the time frame for its key interest rates from “at least through the end of 2019” to “at least through the first half of 2020” at a meeting in June. In addition, on the 18<sup>th</sup> June, President Draghi said “additional stimulus will be required” if it looks unlikely they will reach their inflation target, suggesting additional rate cuts or asset purchasing.

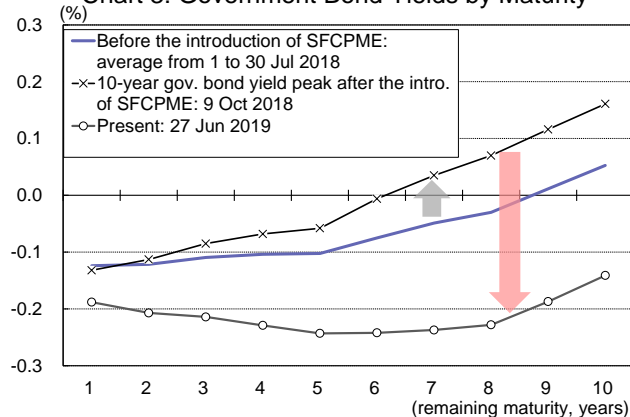
Meanwhile, while the direction of the Bank of Japan (BoJ)’s monetary policy is also garnering a lot of attention, it decided to maintain its current monetary policy at its Monetary Policy Meeting in June and made no changes to its assessment of the economy and prices. However, the BoJ added a sentence to a statement which suggests it is further strengthening its sense of caution towards overseas economies: “downside risks concerning overseas economies are likely to be significant, and it is also necessary to pay close attention to their impact on firms' and households' sentiment in Japan”. At a press conference, Governor Kuroda addressed such risks, saying the BoJ “will consider additional monetary easing without hesitation” if inflation loses its momentum to reach 2%, and that they would take measures which have small side effects and are balanced effectively overall. That being said, with the yield curve falling and flattening and an inverted yield appearing (Chart 3), and taking into consideration the side effects on the function of financial intermediaries, the BoJ is unlikely to venture further into negative territory by cutting interest rates, provided there is no trigger, such as sharp JPY appreciation. The BoJ is forecast to maintain its current monetary policy framework and

respond first with a policy which is comparatively less drastic, such as adjusting its forward guidance.

## (2) Exchange Rates

Risk aversion increased in May as the US imposed additional retaliatory tariffs against China and announced it would introduce tariffs against Mexico. As a result, the JPY appreciated to JPY 108 against the USD. Subsequently, the FRB shifted towards a more dovish stance and the JPY is currently trading at around JPY 107 per USD (Chart 4). Looking ahead, the JPY will become a safe haven against risks sparked by changes in US trade policy, and the decrease in US interest rates from changes to the FRB's monetary policy will continue to put upward pressure on the JPY. However, it will avoid sustained appreciation owing to the continued existence of a certain gap between Japanese and US interest rates, as well as USD buying due to the comparative strength of the US economy.

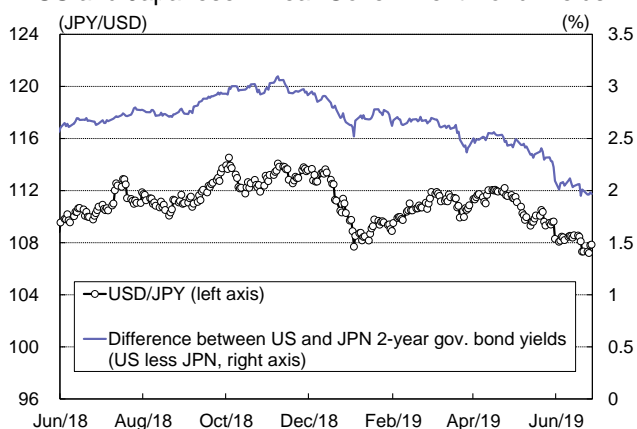
Chart 3: Government Bond Yields by Maturity



Note: SFCPME= Strengthening the Framework for Continuous Powerful Monetary Easing

Source: Bloomberg, MUFG Bank Economic Research Office

Chart 4: USD/JPY Exchange Rate and the Difference in US and Japanese 2-Year Government Bond Yields



Source: Bloomberg, MUFG Bank Economic Research Office

(Translated by Elizabeth Foster)

## MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

### 1. Main Economic Indicators

As of Jun. 27, 2019

	Fiscal	Fiscal	2018		2019	2019				
	2017	2018	3Q	4Q	1Q	JAN	FEB	MAR	APR	MAY
Real GDP Growth Rate <% changes from previous period at SA annual rate>	1.9	0.7	-2.6 (0.1)	1.8 (0.3)	2.2 (0.9)	***	***	***	***	***
Index of All Industries Activity	1.8	0.9	-0.4 (0.4)	0.9 (1.4)	-0.4 (0.3)	0.0 (1.0)	-0.2 (0.3)	-0.3 (-0.3)	0.9 (1.0)	
Industrial Production Index	2.9	0.3	-0.7 (0.1)	1.4 (1.3)	-2.5 (-1.7)	-2.5 (0.7)	0.7 (-1.1)	-0.6 (-4.3)	0.6 (-1.1)	
Production										
Shipments	2.2	0.2	-1.2 (-0.3)	1.0 (1.1)	-2.1 (-1.6)	-2.4 (-0.1)	1.6 (-0.3)	-1.3 (-4.0)	1.8 (-1.4)	
Inventory	5.1	0.2	0.4 (3.5)	0.9 (1.7)	0.9 (0.2)	-0.9 (1.2)	0.4 (1.4)	1.4 (0.2)	0.0 (1.2)	
Inventory/Shipments Ratio (2015=100)	101.9	105.0	105.0 [99.6]	105.6 [102.6]	105.9 [104.3]	105.0 [104.7]	105.5 [103.4]	107.2 [104.9]	104.6 [102.8]	104.9 [104.9]
Domestic Corporate Goods Price Index	2.7	2.2	0.9 (3.1)	0.1 (2.3)	-0.8 (0.9)	-0.6 (0.6)	0.3 (0.9)	0.3 (1.3)	0.4 (1.3)	-0.1 (0.7)
Consumer Price Index(SA, total, excl.fresh foods)	0.7	0.8	0.2 (0.9)	0.4 (0.9)	-0.2 (0.8)	0.2 (0.8)	0.1 (0.7)	0.0 (0.8)	0.1 (0.9)	-0.1 (0.8)
Index of Capacity Utilization (2015=100)	102.7	102.5	101.9 [102.5]	104.7 [103.8]	100.5 [102.2]	100.0 [100.2]	101.0 [102.8]	100.6 [103.7]	102.2 [104.3]	104.0 [104.0]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	-0.8	2.8	1.5 (4.8)	-3.2 (2.0)	-3.2 (-2.5)	-5.4 (-2.9)	1.8 (-5.5)	3.8 (-0.7)	5.2 (2.5)	
Manufacturing	9.2	3.8	-1.0 (8.5)	-4.1 (-0.6)	-7.7 (-8.0)	-1.9 (-7.5)	3.5 (-9.1)	-11.4 (-7.6)	16.3 (-8.2)	
Non-manufacturing Excl.Electric Power & Ship building	-7.8	2.1	3.4 (2.0)	-1.9 (4.5)	-0.3 (1.8)	-8.0 (1.0)	-0.8 (-2.0)	13.4 (4.1)	1.2 (12.6)	
Shipments of Capital Goods (Excl.Transport Equipment)	7.0	-0.3	-1.4 (1.6)	1.6 (1.3)	-7.4 (-6.9)	-7.9 (-8.2)	3.8 (-3.6)	-1.5 (-8.5)	0.7 (-9.3)	
Construction Orders	0.7	6.5								
Private	0.6	14.5								
Public	-5.4	-15.0								
Public Works Contracts	-4.3	1.1								
Housing Starts 10,000 units at Annual Rate, SA	94.6	95.3	95.0	95.5	94.2	87.2	96.7	98.9	93.1	
Total floor	(-2.8)	(0.7)	(-0.2)	(0.6)	(5.1)	(1.1)	(4.2)	(10.0)	(-5.7)	
Sales at Retailers	1.9	1.6								
Real Consumption Expenditures of Households over 2 persons (SA)	0.3	0.0	1.5 (1.0)	0.2 (1.1)	-0.2 (2.0)	0.7 (2.1)	-2.0 (1.9)	0.1 (2.1)	-1.4 (1.3)	
Propensity to Consume (SA, %)	71.7	69.2	70.6 [70.6]	68.6 [71.6]	69.8 [71.0]	70.4 [73.3]	69.8 [69.3]	69.4 [70.6]	66.9 [69.9]	70.6 [70.6]
Overtime Hours Worked (All Industries, 5 employees or more)	0.5	-1.6	-2.6 (-2.5)	-0.1 (-2.3)	-0.7 (-2.1)	0.7 (-1.9)	2.5 (-0.9)	-2.6 (-3.5)	1.3 (-1.8)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	0.7	0.9	(0.9)	(1.5)	(-0.8)	(-0.6)	(-0.7)	(-1.3)	(-0.3)	
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	99	1	-34	-40	96	100	96	93	88	
Ratio of Job Offers to Applicants (SA, Times)	1.54	1.62	1.62 [1.52]	1.62 [1.56]	1.63 [1.59]	1.63 [1.59]	1.63 [1.59]	1.63 [1.59]	1.63 [1.60]	1.61 [1.61]
Unemployment Rate (SA, %)	2.7	2.4	2.4	2.4	2.4	2.5	2.3	2.5	2.4	
Economy Watcher Survey (Judgment of the present condition D.I.%)	50.5	47.8	48.0 [50.4]	48.3 [52.3]	46.0 [49.5]	45.6 [49.9]	47.5 [49.0]	44.8 [49.6]	45.3 [49.5]	44.1 [47.9]
Bankruptcies (Number of cases)	8,367 (-0.2)	8,111 (-3.1)	2,017 (-0.7)	2,070 (-1.7)	1,917 (-6.1)	666 (4.9)	589 (-4.5)	662 (-16.1)	645 (-0.8)	695 (-9.4)

(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. 27, 2019

	Fiscal	Fiscal	2018		2019	2019				
	2017	2018	3Q	4Q	1Q	JAN	FEB	MAR	APR	MAY
Customs Clearance (Exports in Yen Terms)	10.8	1.9	(2.9)	(1.3)	(-3.9)	(-8.4)	(-1.2)	(-2.4)	(-2.4)	(-7.8)
Value	5.5	2.5	(4.0)	(2.8)	(1.2)	(0.7)	(-0.6)	(3.4)	(2.0)	(1.2)
Volumes	5.0	-0.6	(-1.1)	(-1.4)	(-5.0)	(-9.0)	(-0.6)	(-5.6)	(-4.3)	(-8.9)
Imports (In Yen terms)	13.7	7.2	(12.4)	(11.2)	(-2.0)	(-0.8)	(-6.5)	(1.2)	(6.5)	(-1.5)
Value	8.9	5.7	(10.2)	(6.9)	(-0.2)	(-1.4)	(-0.0)	(0.8)	(2.3)	(-0.3)
Volumes	4.4	1.4	(2.0)	(4.0)	(-1.8)	(0.5)	(-6.5)	(0.4)	(4.1)	(-1.2)
Current Account (100 mil. yen)	221,749	194,144	56,944	26,018	61,251	6,004	26,768	28,479	17,074	
Goods (100 mil. yen)	45,396	7,068	545	-6,423	2,245	-9,648	4,892	7,001	-982	
Services (100 mil. yen)	-4,567	-6,378	-1,658	-3,066	4,306	-1,512	2,366	3,451	-3,127	
Financial Account (100 mil. yen)	206,805	214,974	44,864	27,016	90,833	27,087	25,527	38,219	-12,667	
Gold & Foreign Exchange Reserves (\$1mil.)	1,268,287	1,291,813	1,259,673	1,270,975	1,291,813	1,279,297	1,281,846	1,291,813	1,293,499	1,307,975
Exchange Rate (¥/\$)	110.80	110.88	111.44	112.87	110.17	108.95	110.36	111.21	111.66	109.83

## 3. Financial Market Indicators

	Fiscal	Fiscal	2018		2019	2019					
	2017	2018	3Q	4Q	1Q	JAN	FEB	MAR	APR	MAY	
Uncollateralized Overnight Call Rates	-0.050	-0.062	-0.063	-0.066	-0.054	-0.064	-0.055	-0.044	-0.068	-0.050	
			[-0.054]	[-0.042]	[-0.048]	[-0.040]	[-0.042]	[-0.062]	[-0.063]	-0.061	
Euro Yen TIBOR (3 Months)	0.065	0.062	0.077	0.050	0.037	0.030	0.030	0.050	0.050	0.049	
			[0.062]	[0.063]	[0.078]	[0.068]	[0.068]	[0.097]	[0.097]	[0.078]	
Newly Issued Japanese Government Bonds Yields (10 Years)	0.045	-0.095	0.125	-0.101	-0.095	0.000	-0.015	-0.095	-0.045	-0.095	
			[0.060]	[0.045]	[0.045]	[0.080]	[0.045]	[0.045]	0.050	[0.030]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	0.817	0.751	0.775	0.759	0.751	0.759	0.758	0.751	0.751		
			(-0.014)	(-0.016)	(-0.008)	(0.000)	(-0.001)	(-0.007)	(0.000)		
The Nikkei Stock Average (TSE 225 Issues)	21,454	21,206	24,120	20,015	21,206	20,773	21,385	21,206	22,259	20,601	
			[20,356]	[22,765]	[21,454]	[23,098]	[22,068]	[21,454]	[22,468]	[22,202]	
M2(Average)	(3.7)	(2.7)	(2.9)	(2.5)	(2.3)	(2.3)	(2.3)	(2.4)	(2.5)	(2.7)	
Broadly-defined Liquidity(Average)	(3.1)	(1.9)	(1.9)	(1.6)	(1.7)	(1.4)	(1.7)	(2.0)	(2.0)	(1.9)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin	(2.8)	(2.2)	(2.2)	(2.2)	(2.3)	(2.4)	(2.3)	(2.3)	(2.4)	(2.6)
	Banks	(2.8)	(2.2)	(2.2)	(2.3)	(2.4)	(2.4)	(2.4)	(2.5)	(2.5)	(2.8)
	City Banks etc.	(2.0)	(1.0)	(0.7)	(1.2)	(1.6)	(1.6)	(1.5)	(1.8)	(2.1)	(2.8)
	Regional Banks	(3.6)	(4.3)	(4.5)	(4.3)	(4.1)	(4.2)	(4.1)	(4.0)	(5.9)	(4.9)
	Regional Banks II	(3.0)	(-0.4)	(-0.5)	(-0.8)	(-0.8)	(-0.8)	(-0.8)	(-0.8)	(-8.6)	(-5.6)
	Shinkin	(2.7)	(2.1)	(2.2)	(2.0)	(1.7)	(1.9)	(1.7)	(1.6)	(1.5)	(1.5)
Deposits and CDs (Average)	Total(3 Business Condition)	(4.2)	(3.4)	(3.7)	(3.2)	(3.1)	(3.1)	(3.1)	(3.1)	(2.6)	(2.6)
	City Banks	(5.9)	(4.9)	(5.3)	(4.6)	(4.7)	(4.7)	(4.7)	(4.6)	(3.6)	(3.7)
	Regional Banks	(2.5)	(2.7)	(3.0)	(2.6)	(2.3)	(2.2)	(2.3)	(2.4)	(3.9)	(3.1)
	Regional Banks II	(2.1)	(-1.3)	(-1.3)	(-1.8)	(-2.0)	(-1.9)	(-2.0)	(-1.9)	(-8.1)	(-5.2)

(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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