26 June 2014

SMAM

SMAM Japan Market Memo (No. 002)

"Analysis on Latest Japanese Economic Indicators (June 2014) "

＜Key Points＞

- Both corporate earnings and labor environments seem to continue improving.
- Despite export decline, trade deficit seems to gradually improve as recovery of European and the US economic growth will accelerate.
- Production output has declined m-o-m mainly due to pullback of rush demand ahead of consumption tax hike.

⇒ **We expect economic growth in Apr.-Jun. quarter to be temporarily negative due to pullback of rush demand, however, it will turn positive in Jul.-Sep. quarter supported by moderate recovery of consumption and exports.**

1. CAPEX Trends Upward, Tax Hike Impact Passed on to Price

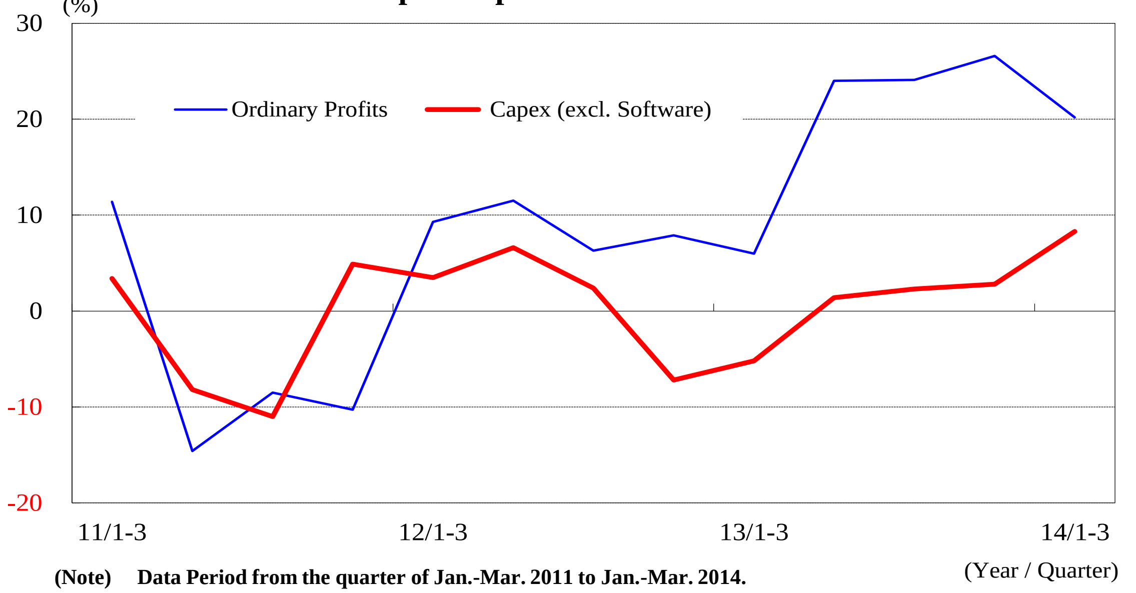
① CAPEX Increase and Second Preliminary GDP Estimates

According to the Financial Statements Statistics of Corporations by Industry (FSSCI), Jan.-Mar. quarter CAPEX (exclude finance & insurance, hereafter referred to) increased by 7.4% y-o-y to JPY12,230.7 billion for four consecutive quarters. If you break down by the industry sectors, you can find that Manufacturing sector rose 6.8% y-o-y for two consecutive quarters helped mainly by the increase in Transportation equipment and Food. Non-manufacturing sector rose 7.7% y-o-y for four consecutive quarters helped mainly by Transport & postal activities and Construction.

Ordinary profits increased by 20.2% y-o-y to JPY17,455.2billion and sales increased by 5.6% to JPY345,329.3billion. The positive trend of earnings growth is an incentive to the corporations for the forward-looking investment in plants & equipment.

Jan.-Mar. 2014 second preliminary real GDP growth rate estimates was substantially revised up to +6.7% y-o-y from the first preliminary estimates of +5.9% after the announcement of FSSCI this time. The primary reason was the upward revision of CAPEX, however, consumer expenditure was also revised up moderately.

Corporate profits and CAPEX



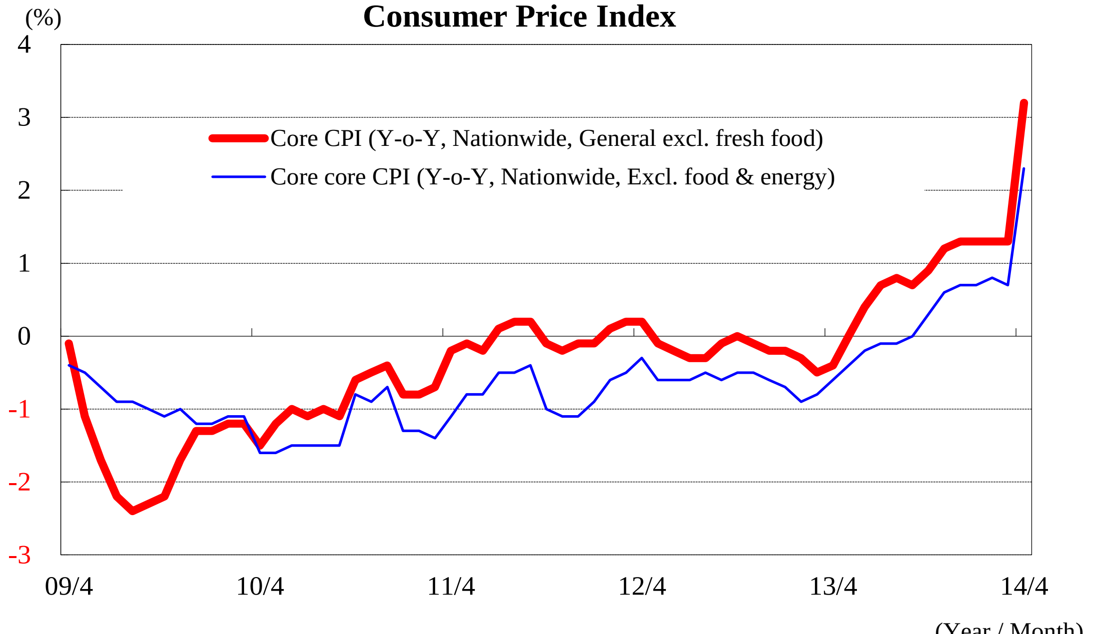
(Note) Data Period from the quarter of Jan.-Mar. 2011 to Jan.-Mar. 2014.
(Source) SMAM, based on Bloomberg data

② Employment / Consumer Price Index

April unemployment rate (seasonally adjusted, hereafter referred to) was 3.6% unchanged from the previous month. April active job openings-to-applicants ratio rose 0.01 points m-o-m to 1.08 times. New job openings-to-applicants ratio, a leading indicator of labor market conditions, fell slightly by 0.02 points m-o-m to 1.64 times, however, the labor environment seems to be on an improvement track as new applicants rose 10.0% y-o-y.

April core CPI (exclude fresh food) rose 3.2% y-o-y for eleven consecutive months. It rose 1.9 points from +1.3% y-o-y in March because of a certain effect from the consumption tax hike in April. It seems that the impact of the consumption tax hike was passed on to price as +1.7 points was estimated by the BOJ. Core core CPI (excl. food (ex. alcoholic beverages) & energy), a US standard core CPI which reflects the trend of price movement more accurately, rose 2.3% y-o-y for seven consecutive months.

The BOJ estimates that the rate of price increase excluding the impact of consumption tax hike will stay at around +1¼% per annum for some time and will rise again from the latter half of FY2014. With a high probability, it will finally reach around +2% or so in the midst of FY2015. So far, the BOJ's forecast seemed to be correct, however, we consider that the pace of price rise will possibly slowdown as the effect of JPY depreciation will fade away.



(Note) Data Period from April 2009 to April 2014
(Source) SMAM, based on Bloomberg data

2. Both Export & Import Declined and Production Declined by Pullback of Rush Demand

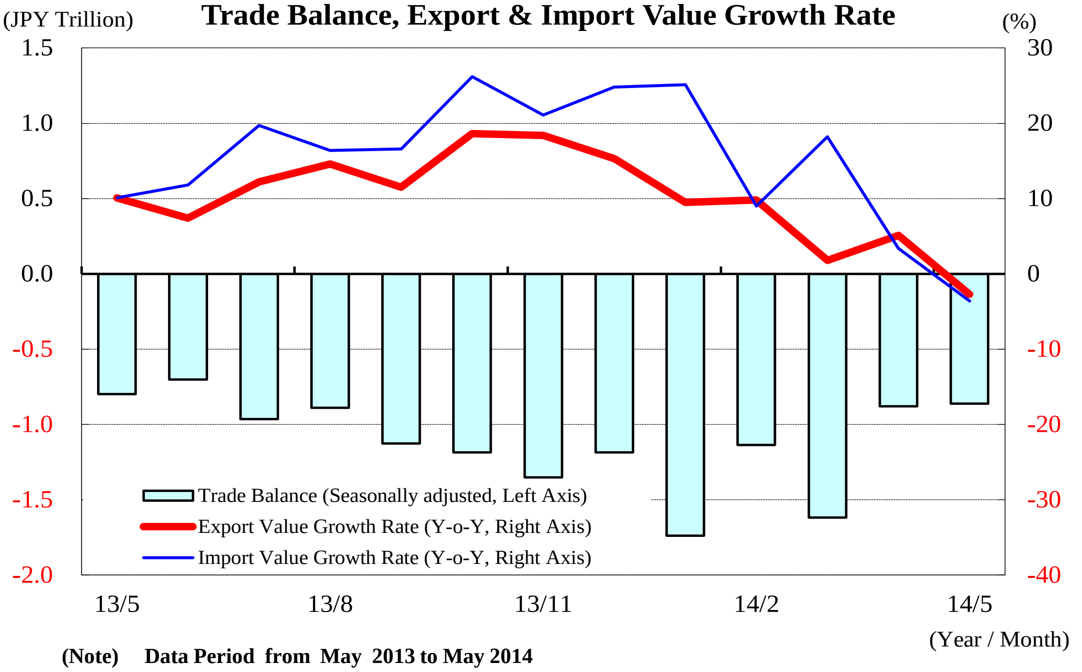
① Trade Statistics

May trade balance was – JPY866.2billion (seasonally adjusted) almost unchanged from the previous month.

The export value was –2.7% y-o-y declined after fifteen months interval. If you break down by the merchandises, you can find that Transport equipment was down by 7.3% y-o-y as motor vehicles and ships declined and as Fossil fuels declined sharply by 45.7%. Decline of these two merchandises pulled down the whole export value. The import value also declined 3.6% y-o-y after nineteen month interval. This was due to the pullback of the front-loaded demand of fossil fuels caused by the petroleum & coal tariff raise in April.

On the regional aspect, the export value towards EU increased by 14.5% y-o-y accelerated from +12.7% y-o-y in March, while it declined by 2.8% y-o-y towards the US after 17 months since Dec. 2012. For US, decline in export value of motor vehicles by 18.4% y-o-y affected substantially.

We believe that the trade deficit will gradually improve in tandem with the increase in exports supported by the moderate recovery of the European and the US economy, although the shift of manufacturing base in overseas by car makers negatively impacted as was reflected in the decline in export value.

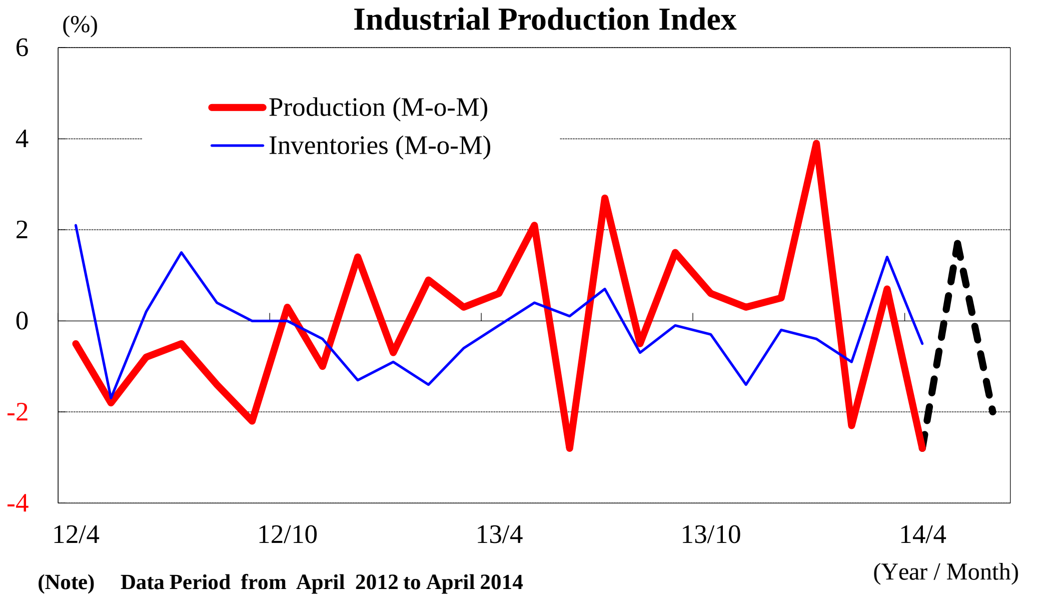


(Note) Data Period from May 2013 to May 2014
(Source) SMAM, based on Bloomberg data

② Industrial Production

April industrial production index was – 2.8% m-o-m. The key industrial sectors which declined were Foods & tobacco, Transport equipment and Electronic parts & devices which seem to have been impacted by the pullback of rash demand ahead of the consumption tax hike. On the other hand, the production increased in three industry sectors which were Fabricated metals, General-purpose, production & business oriented machinery and Non-ferrous metals. Items such as Steel bridges included in Fabricated metals industry increased their production, supported probably by public works related business which was not that much affected by the tax hike.

According to the Survey of Production Forecast (based on the production plan of the corporations), which indicates the future production trend, May figure will increase by 1.7% m-o-m and June figure will decline by 2.0% m-o-m. Japanese corporations seem to have a cautious view on June as they were not sure of demand trend after the tax hike, however, once the consumer expenditure starts to recover, we expect that the production will increase, which will eventually narrow the rate of decline.



(Note) Data Period from April 2012 to April 2014
Production shown in broken line are May & June forecasts of the Survey of Production Forecast
(Source) SMAM, based on Bloomberg data

3. Future Outlook

Although, we can observe various signs of pullback of rush demand ahead of the consumption tax hike, the impact this time would likely be moderate compared with the previous case as there are positive signs in consumer expenditure related indicators such as department store sales. We believe that consumer expenditure remains strong even though the tax hike was passed on to the price. We expect that the domestic demand will remain strong as CAPEX would continue to increase supported by the strong recovery of corporate earnings. The export is expected to recover as the economy of Europe and the US is moderately but steadily recovering and the Chinese government started to gradually strengthen the economic stimulation.

We expect that the economic growth will decelerate in Apr.-Jun. quarter due to pullback of rush demand but, from Jul.-Sep. quarter onward, it will gradually recover supported by moderate growth of both consumer expenditure and exports, which will eventually put Japan back on its growth path.

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