

“Analysis on Latest Japanese Economic Indicators (July 2014)”

<Key Points>

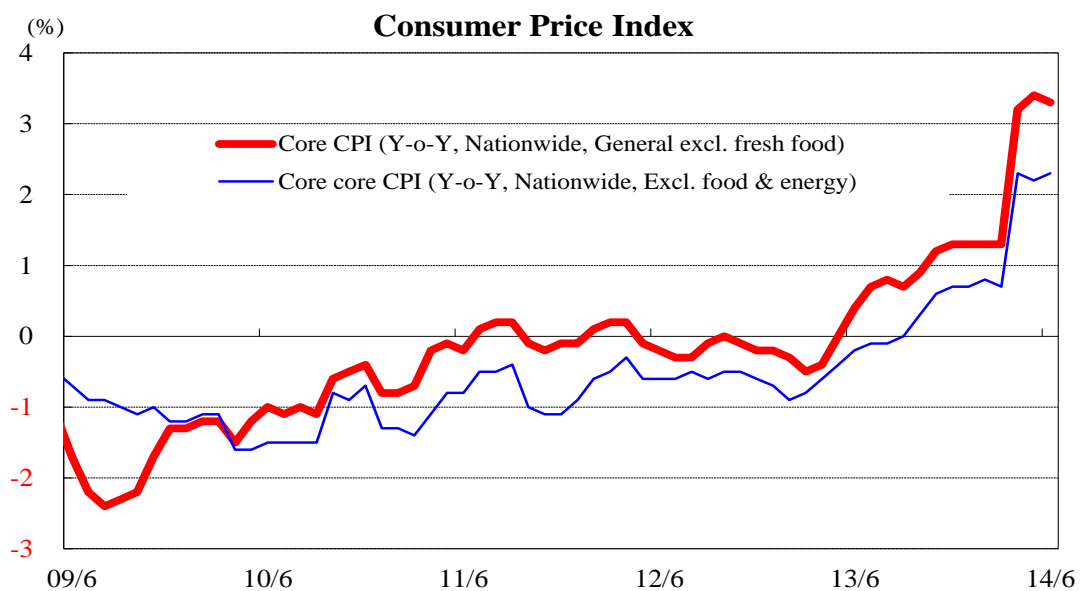
- Expect gradual consumer expenditure recovery as the impact of pullback of rush demand ahead of the consumption tax hike is fading out as well as the employment environment is recovering.
 - Trade deficit worsened as export declined for two consecutive months and import increased first time in two months.
 - Production output remains weak, affected still by pullback of rush demand ahead of the consumption tax hike.
- ⇒ **As anticipated, 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 export.**

1. Tax Hike Impact on Consumption & Price Fading Out and Employment Remains Stable

① Consumer Expenditure / Consumer Price Index

According to the June Current Survey of Commerce (Preliminary Report), commercial sales value declined 0.7% y-o-y for three consecutive months. However, on m-o-m basis it rose 2.5% for two consecutive months. This could be a sign of the weakening impact of pullback of rush demand ahead of the consumption tax. Breaking down the retail sales value by business type, you will find that Motor vehicles and Machinery equipment rose 10.0% and 14.7% m-o-m, respectively. Breaking down the large-scale retail stores by type of business, you will find sales of Department stores and Supermarkets rose 5.6% and 1.0%, respectively m-o-m, while that of Convenience stores fell 1.1% m-o-m. These figures show the recovery of consumer expenditure.

June core CPI (exclude fresh food) rose 3.3% y-o-y which was almost flat m-o-m. It rose 1.3% y-o-y excluding the impact of the consumption tax hike of 2.0% 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 nine consecutive months. Sub-indices of Household durable goods, Clothes and Medical care services fell m-o-m for two consecutive months as the price rise seems to have moderated due to a diminishing effect of yen depreciation on the price.



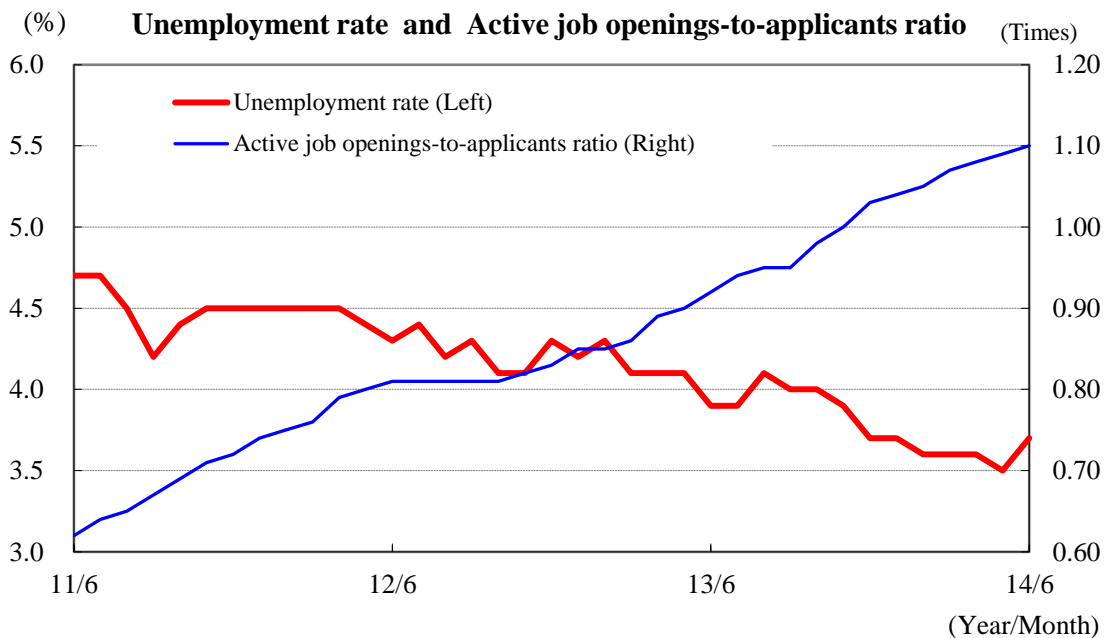
(Note) Data Period from June 2009 to June 2014
 (Source) SMAM, based on Bloomberg data

(Year / Month)

② Employment

June unemployment rate (seasonally adjusted, hereafter referred to) was 3.7% rose 0.2 points from the previous month. The working population was almost unchanged m-o-m at 63.59 million and the unemployed rose 0.11 million to 2.44 million. However, on the other hand, active job openings-to-applicants ratio rose 0.03 points m-o-m to 1.10 times, keeping more than 1.00 times for eight consecutive months. This is the highest level in twenty two years since June 1992. New job openings-to-applicants ratio, a leading indicator of labor market conditions, also rose 0.03 points m-o-m to 1.67 times.

The unemployed rose m-o-m. However, if you take a look at its breakdown you will realise that the number of employees who quitted their job voluntarily increased by 30,000, those who newly started to seek a job increased by 30,000, and those who quitted a job involuntarily (mandatory retirement or termination of employment contract) increased by only 10,000. These figures indicate that the number of people who newly started to seek a job and changing jobs for the improvement of labour conditions have increased. Moreover, we can expect amount of scheduled wages (basic salary etc.) to increase as active job openings-to-applicants ratio remains at a high level.



(Note) Data Period from June 2011 to June 2014
 (Source) SMAM, based on Bloomberg data

2. Export Declined Two Months in Row and Production Declined First Time in Two Months

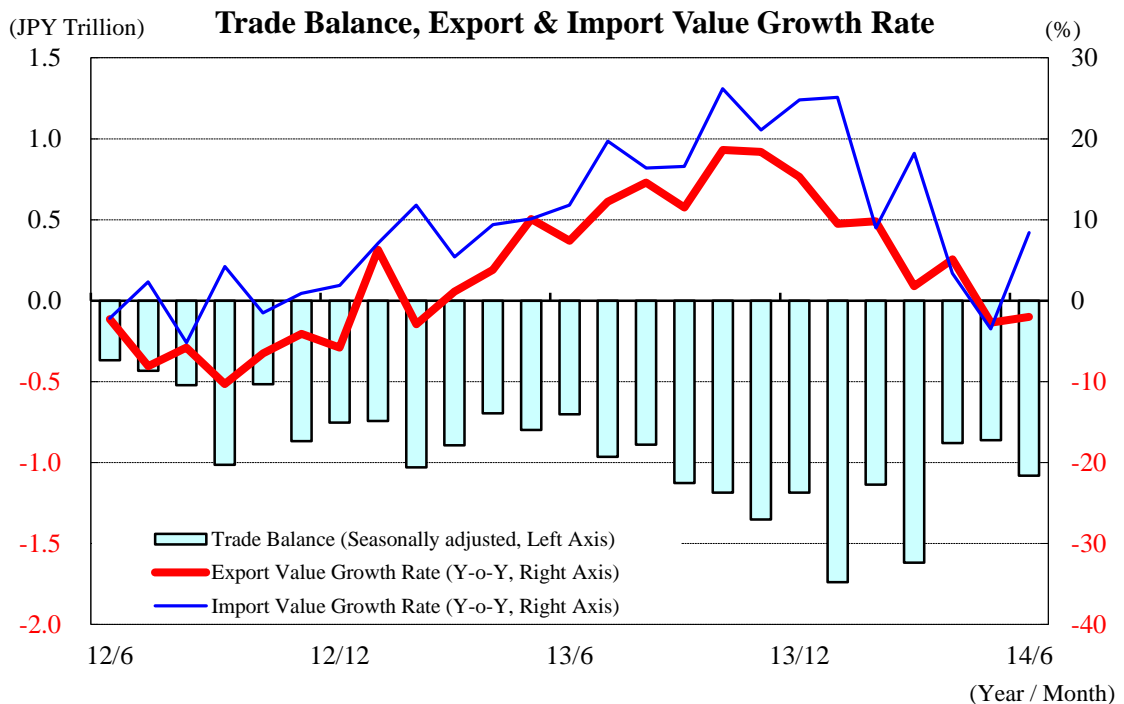
① Trade Balance

June trade balance was deficit of JPY1.808trillion (seasonally adjusted), which surpassed JPY1trillion first time in three months. Export declined y-o-y for two consecutive months and import increased first time in two months.

The export value (pre-seasonally adjusted base, hereafter referred to) was -2.0% y-o-y in June improved from -2.7% in May, declined two months in row. If you see breakdown by the merchandises, you can find that Semiconductors etc. and Organic chemical declined sharply by 8.7% and 12.8% y-o-y, respectively. On the regional orientation aspect, the export value towards EU increased while it declined towards the US and Asia.

The import value turned into increase of 8.4% y-o-y from the decline of 3.5% in May. Wide variety of goods such as Fossil fuels, Machinery and Electrical appliance increased y-o-y as the effect of the pullback of the front-loaded demand created by the consumption tax and the green tax hikes faded out.

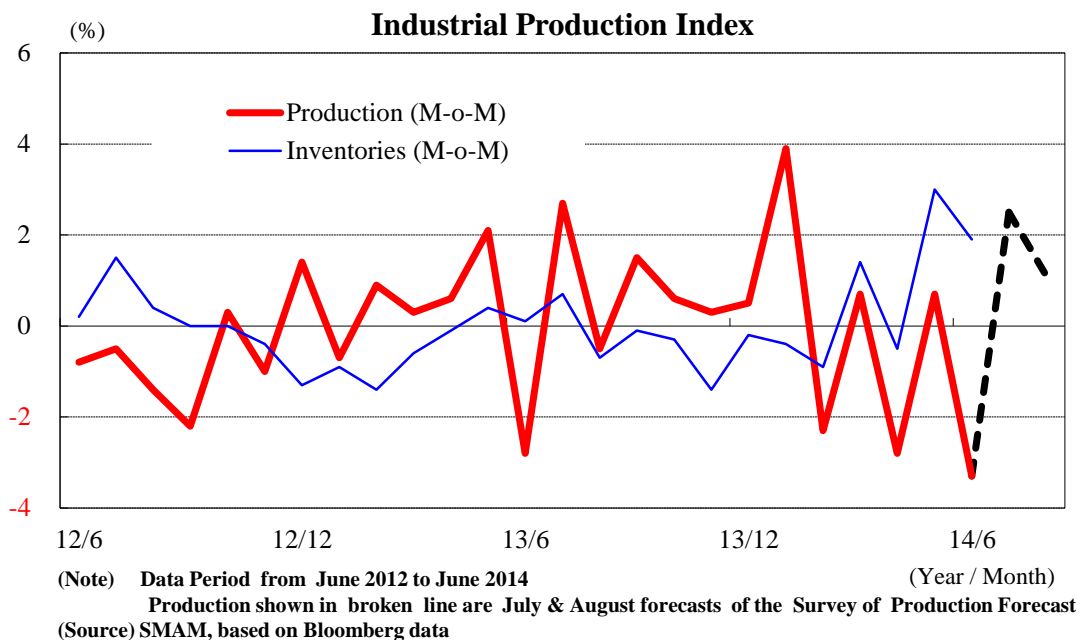
We think that the trade deficit would not improve for a while despite the expected increase in export thanks to the steady growth of global economy, as import will also increase due to the weakening impact of pullback of rush demand ahead of the consumption tax hike and the recovery of domestic demand.



② Industrial Production

June industrial production index was -3.3% m-o-m, declined from +0.7% m-o-m in May. All industrial sectors except Others declined. The major sectors which declined sharply were Transportation equipment, General-purpose, production & business oriented machinery and Information & communication electronics equipment. The impact of pullback of rush demand ahead of the consumption tax this time seems to be relatively bigger as the industrial production index rose 2.8% m-o-m in May and declined only 0.6% in June after the previous consumption tax hike in 1997. Inventory ratio rose 1.9% m-o-m for two consecutive months.

According to the Survey of Production Forecast (based on the production plan of the corporations), which indicates the future production trend, July and August figures are expected to increase by 2.5% and 1.1% m-o-m, respectively, indicating future recovery of the industrial production. We have to keep an eye on this index as the actual figure would fall short of the estimated figure as the pace of recovery in export and domestic consumer expenditure is a bit slow.



3. Future Outlook

We can observe that the impact of pullback of rush demand ahead of the consumption tax hike this time on the consumer expenditure related indicators seems similar to the previous case in 1997, while bigger in terms of the production related indicators. We think that the main reason of the slower recovery in production is due to the slow recovery of export. We, therefore, anticipate that production will gradually recover as the economy of Europe and the US is on steady recovering trend. We also believe that private consumption will show a gradual recovery thanks to the favourable employment environment, such that active job openings-to-applicants ratio is showing highest figure in twenty two years.

While we forecast the overall 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 the moderate recovery in consumer expenditure and export.

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