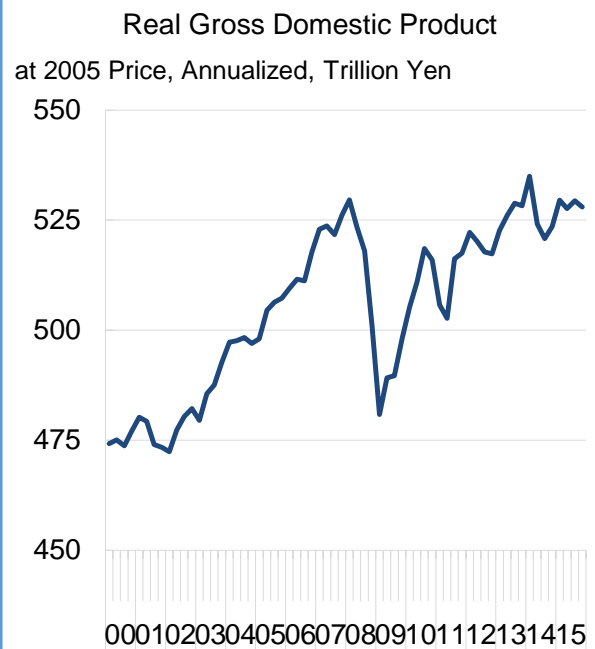


Negative Growth Again

Real GDP declined by 0.3% (1.1% annualized) in the fourth quarter of 2015 on a quarter-by-quarter basis. A major cause of this was a significant quarter-by-quarter decline of 0.9% in private consumption. Consumer spending on durable goods, such as TV sets and personal computers, and on semi-durable goods such as clothing, both marked a sharp quarter-by-quarter drop at 4.3% and 3.1%, respectively. Furthermore, consumer spending on non-durable goods including gasoline and heating oil fell by 0.8% from the previous quarter, and consumer spending on services saw a quarter-by-quarter decline of 0.1%. In November and December, both temperature and precipitation were above average for the period at many observation points, so the weather apparently had significant impact. However, new car sales increased for the first time in four quarters and finally stopped their downward slide, which is a favorable sign.

Private housing investments took a downward turn, marking a quarter-by-quarter decline of 1.2%. Housing starts also fell by 5.3% from the previous quarter, down for two consecutive quarters. In addition to a decline in starts of privately owned houses and condominiums for the third quarter, starts of houses for rent also declined for the fourth quarter. It is difficult to expect further growth but housing starts would be expected to increase gradually ahead of the consumption tax rate hike scheduled in April 2017.



Source: CAO

Public investments declined by 3.4% from the previous quarter, and fell to the same level as that in the first quarter of 2013, just after the inauguration of the second Abe administration. In the supplementary budget for fiscal 2015, which was passed in January, expenses related to investment increased by about ¥700 billion. Combined with the amount in the initial budget for fiscal 2015, the total amount of expenses related to investment amounted to about ¥6.5 trillion, declining by about ¥300 billion from the amount in the fiscal 2014 budget. In the fiscal 2016 budget, expenses

related to public works projects are expected to be almost equal to the fiscal 2015 budget's, so public investments will likely remain largely unchanged while maintaining a certain level.

Growth in private non-residential fixed investments accelerated, seeing a quarter-by-quarter increase of 1.5%. According to the

Real Gross Domestic Product (GDP)

	at 2005 Price, Calendar year			
	2015			2015
	4-6	7-9	10-12	
	q/q%	q/q%	q/q%	y/y%
Real Gross Domestic Product	-0.4%	0.3%	-0.3%	0.5%
Private Consumption	-0.8%	0.4%	-0.9%	-1.3%
Private Housing Investments	2.3%	1.6%	-1.2%	-2.6%
Private Non-Resi. Fixed Investments	-1.1%	0.7%	1.5%	1.3%
Public Investments	3.2%	-2.1%	-3.4%	-2.6%
Government Consumption	0.5%	0.2%	0.6%	1.1%
Exports of Goods & Services	-4.6%	2.6%	-0.8%	2.7%
(less) Imports of Goods & Services	-2.5%	1.3%	-1.4%	0.2%

Source: CAO

* All subsequent references to GDP demand items are in real terms unless otherwise indicated.

Financial Statements Statistics of Corporations, in the manufacturing industries, investment by the machinery industry that includes general machinery and electric & infocomm machinery grew for two consecutive quarters, while in the non-manufacturing industries, investment by the retail and wholesale industries also increased for two quarters in a row. Leading indicators, such as machinery orders (private demand excluding shipbuilding and electric power companies) and floor space of new private non-residential buildings, still lack direction but, thanks to abundant cash flow, private non-residential fixed investments are expected to continue to increase until March, when the accounting periods of many Japanese companies end.

Exports and imports of goods and services declined by 0.8% and 1.4% from the previous quarter, respectively. As a result, net exports contributed 0.1%pt to quarterly real GDP growth. Notably, the seasonally adjusted trade balance in November 2015 recorded a surplus of ¥22.3 billion, pulling out of the red for the first time in four years and nine months since February 2011. Furthermore, in January 2016, the surplus increased to ¥119.4 billion. This is mainly due to falling crude oil prices, and the at-arrival crude oil price declined from 128 dollars per barrel in April 2012 to 37 dollars per barrel in January 2016. If oil prices rebound to levels of over 40 dollars per barrel at the end of 2016, as forecasted by the US Energy Information Administration (EIA), the trade balance is estimated to improve by nearly ¥4 trillion.

Moderate Positive Growth Will Continue In 2016

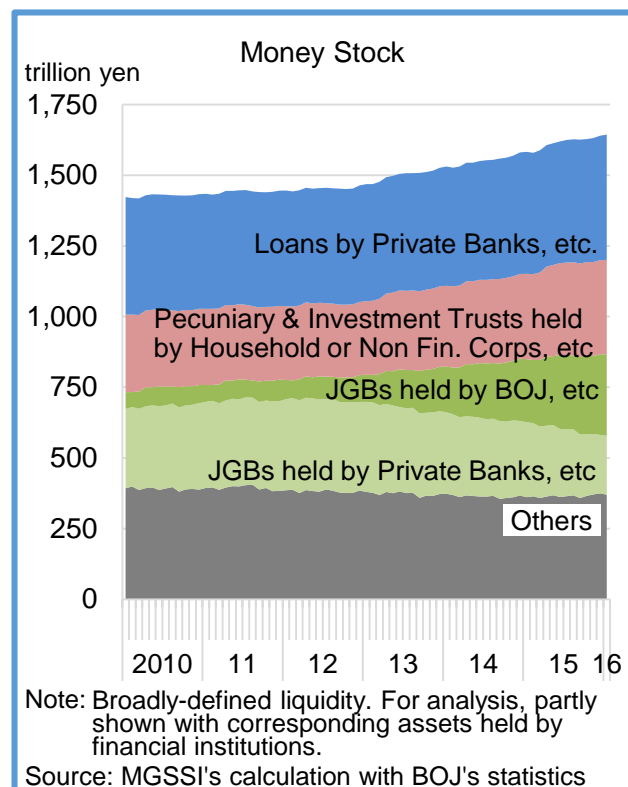
For now, many economists expect that the real GDP growth rate for the first quarter of 2016 will take an upward turn. According to the March results of the monthly ESP Forecast survey, which compiles outlook of economists in private institutions, the average of their forecasts was a 0.2% quarter-by-quarter increase (0.8% annualized). However, compared with the average of forecasts of a 0.4% quarter-by-quarter increase (1.5% annualized) in the December 2015 results of the same survey, the growth forecast slowed down. Meanwhile, in January, the living expenditure level index fell by 0.2% from the average for the fourth quarter of 2015. Furthermore, in February, the Nikkei Stock Average briefly fell to ¥14,866 from ¥19,034 at the end of 2015, and the yen

temporarily appreciated from ¥120 against the dollar at the end of 2015 to ¥111. It is impossible to deny the possibility that consumers and business managers will hold their purse strings tightly as they see the disturbance in the market.

However, the ordinary profits of corporations (excluding finance and insurance; with capital of ¥10 million or more) for the fourth quarter of 2015 remained at a high level of ¥17.4 trillion. In January, the number of employed people was 64.6 million, marking the highest level since February 2001, with the unemployment rate having declined to 3.2%. The expansion of corporate profits and employment, which are two major outcomes of the Abenomics, has not yet collapsed. The March ESP Forecast survey shows the real GDP growth rate in 2016 will be 0.5% on average from the previous year, so it is expected that the country will see positive GDP growth for two consecutive years following 0.5% year-on-year growth in 2015.

Three Years since the Introduction of QQE

It has been nearly three years since the Bank of Japan (BOJ) introduced qualitative and quantitative monetary easing (QQE) in April 2013. The BOJ expanded the QQE in October 2014, which caused the Nikkei Stock Average to briefly rise to ¥20,953 in



June 2015, and the yen to fall to ¥126 against the dollar.

In its monetary easing policy, monetary base, which is the central bank's target, increased from ¥146 trillion in March 2013 to ¥359 trillion in January 2016. The BOJ purchased a total of ¥200 trillion in long-term government bonds from financial institutions and others, and the current account deposits at the BOJ held by financial institutions increased by ¥184 trillion.

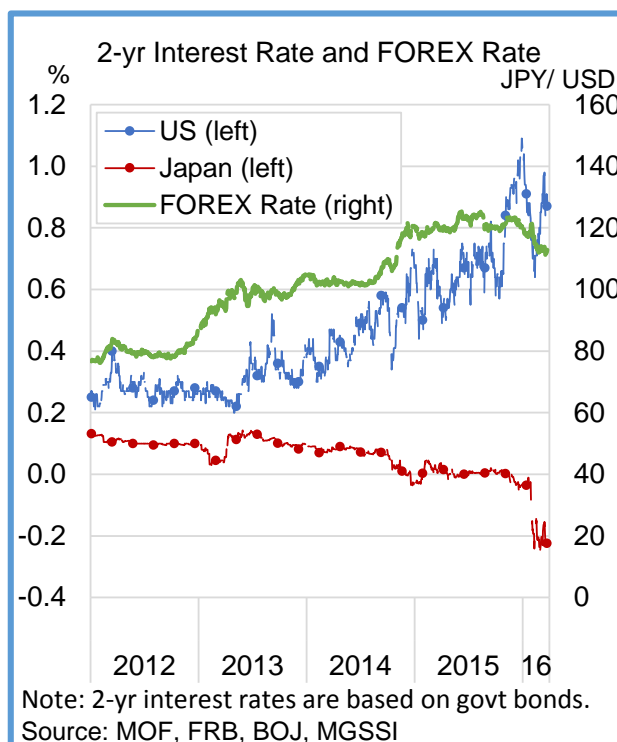
Money stock, which is more closely linked to economic activities, increased from ¥1,477 trillion to ¥1,644 trillion during the above-mentioned period in terms of the broadest definition in official statistics. There are three reasons behind this increase. The first reason is the government's fiscal deficit. Namely, government bonds held by private banks and others significantly decreased due to the QQE, while those held by the BOJ dramatically increased, resulting in an increase of ¥68 trillion combined. Second, pecuniary trusts and investment trusts held by households, companies, and others increased by ¥68 trillion in total. According to definition, equities held by these entities are not included in money stock, while the amount of such equities is believed to have increased by approximately ¥50 trillion during the same period. Third, lending by private banks and others to the private sector increased by ¥29 trillion. Loans to individuals, including housing mortgages, grew by ¥11 trillion, while lending to the real estate industry and to the manufacturing industry increased by ¥6 trillion and ¥2 trillion, respectively.

The pace of increase in money stock accelerated from an annual rate of about 1% to about 3.5%. The BOJ expects that the monetary easing will reduce real interest rates generally and that this will have the effect of stimulating consumption and investment or bringing about rebalance of asset portfolios. The policy does not rely on a simple quantity theory of money that presumes that an increase in monetary base or money stock will immediately lead to price increase or nominal GDP growth. However, the rule of thumb in Japan suggests that, excluding the period around the Lehman collapse, if money stock increases by 1%, nominal GDP will grow by nearly 0.3%. While this falls short of the government's goal of 3% growth in nominal GDP, it can be said that the QQE had the effect of helping increasing money stock, and then raising prices in general, which contribute to overcoming the deflation.

Introduction of Negative Interest Rates

The BOJ maintains the view that price trend are steadily improving. However, in the second half of 2015, the decline in crude oil prices accelerated, so the growth of the consumer price index excluding fresh foods slowed down. In particular, the CPI experienced a month-on-month decline from July to October 2015. Furthermore, the financial markets became more unstable in 2016. Therefore, the BOJ complemented the QQE in December 2015 by purchasing more index-linked exchange-traded funds (ETF) and other measures, and introduced negative interest rates as part of the QQE in January 2016.

Following the introduction of negative interest rates, yields on one-year Japanese government bonds fell to minus 0.141% on February 1, and 10-year JGB yields also fell to minus 0.02% on February 9. While the measure had the effect of widely lowering interest rates in Japan, effect on the yen exchange rate or stock prices has been limited so far. Generally, if Japanese interest rates decline, the yen exchange rate also falls. However, US interest rates marked its peak at the end of 2015, and interest rate difference between Japanese and US 2-year government bonds temporarily narrowed from 1.11%pt to 0.84%pt at the end of January 2016. Even after the introduction of negative interest rates in Japan, the difference has not greatly widened. In addition, it is now widely believed that



US interest rates will be hiked after June 2016, which means boost on the depreciation of the yen by higher US interest rate has apparently become less effective now.

In Japan, the appreciation of the yen tends to cause speculation that yen-denominated earnings from overseas businesses could decrease, often causing a fall in stock prices. Furthermore, there is another speculation that the introduction of negative interest rates could put pressure on the profits of financial institutions. However, according to an estimate by the BOJ, out of ¥253 trillion in current account deposits outstanding in January, deposits to which an interest rate of minus 0.1% is applied will be ¥23 trillion. Moreover, the estimate shows that deposits to which an interest rate of 0.1% is applied as in past years will be ¥206 trillion, while those to which a zero-interest rate is applied will be ¥24 trillion. Interest rates paid by financial institutions to the BOJ will amount to approximately ¥23.2 billion per year. The impact of negative interest rates on the profits of financial institutions is limited, given that the total net profit of 82 banks listed on the First Section of the Tokyo Stock Exchange was ¥3.5 trillion for the April-December period of 2015. In addition, because costs of Japanese companies are reduced due to falling crude oil prices, their profits will increase. Given this effect, the above-mentioned speculation among some observers over the earnings of Japanese companies may be too extreme.

It is undeniable that, following the introduction of the QQE along with negative interest rates, confusion of understandings over its effects arose. In February, BOJ Governor Haruhiko Kuroda indicated that individuals would not face negative interest rates on their deposits, and in March, he said that the central bank did not consider further rate cuts for the time being. However, Kuroda reiterated a negative view towards negative interest rates just before the bank actually introduced them in January. Speculation that the BOJ will embark on large rate cuts in the future, which could influence the profits of financial institutions and cause interest rates on the deposits of individuals to become negative, will not disappear.

At present, interest rates on loans such as housing mortgages have been declining more than those on the deposits of individuals, so the introduction of negative interest rates appears to be rather beneficial to households. However, if interest rates on individuals' deposits become negative, a negative view not only of the BOJ's monetary policy but also of the government's overall economic policy could spread mainly among elderly people, who account for about 30% of the electorate in Japan.

(Yusuke Suzuki, Senior Economist)

Selected Economic Indicators	Fiscal Year		2015			
	2013	2014	Jan-Mar	Apr-Jun	Jul-Sep	Sep-Dec
GDP at current prices (SAAR, Trillion Yen)	482.4	489.6	498.1	497.9	501.0	499.8
Real GDP at 2005 prices (SA, q/q%)	2.0%	-1.0%	1.1%	-0.4%	0.3%	-0.3%
Industrial Production Index (SA, 2010=100)	98.9	98.5	99.7	98.3	97.1	97.6
Exports (SA, Trillion Yen)	70.9	74.7	19.5	18.9	18.8	18.4
Imports (SA, Trillion Yen)	84.6	83.8	20.5	19.6	19.8	18.6
Balance on Current Account (SA, Trillion Yen)	1.5	7.9	3.7	3.9	4.1	4.9
Corporate Bankruptcies	10,536	9,543	2,272	2,296	2,092	2,152
Unemployment Rate (SA, %)	3.9%	3.5%	3.5%	3.4%	3.4%	3.3%
Wage Index (SA, 2010=100)	98.5	99.0	98.9	98.7	99.5	99.1
Consumer Prices (y/y%)	0.9%	2.9%	2.3%	0.5%	0.2%	0.3%
Nikkei Stock Average	14,424	16,273	18,175	20,049	19,412	19,053
Japanese Government Bond Yields (%)	0.70	0.48	0.34	0.40	0.40	0.31
Foreign Exchange Rate (Yen/ Dollar)	100.2	109.9	119.1	121.3	122.2	121.5

Note: SAAR means Seasonally Adjusted Annual Rate. SA means Seasonally Adjusted.
q/q% means %change from a quarter earlier. y/y% means %change from a year earlier.
Source: CAO, METI, MOF, Tokyo Shoko Research, MIC, MHLW, Nihon Keizai Shimbun, CEIC, BOJ