

Positive Growth in Two Consecutive Quarters

Real GDP in the second quarter of 2016 rose by 0.2% (0.7% annualized) from the previous quarter. It recorded positive growth for the second consecutive quarter and reached its second highest level following the amount for the first quarter of 2014, when there was a high last-minute demand before the consumption tax hike. Although lacking power, the economy is gradually recovering.

Private consumption* grew by 0.2% from the previous quarter, with apparent increases in spending on durable goods such as automobiles and TV sets. Lately, the ratio of private consumption to disposable income has continued to drop, but according to the Family Income and Expenditure Survey, it was 72.9% (for workers' households), stopping the series of consecutive declines at seven quarters. Although the recovery is weak, concerns over the bottom deepening of private consumption have eased.

Private housing investments rose 5.0% from the previous quarter. The number of housing starts in the quarter was 251,000, exceeding a pace of 1 million per year for the first time in 10 quarters (since the fourth quarter of 2013). Aided by inheritance tax saving measures and falling housing loan interest rates, rental housing starts reached a level of 107,000 for the first time since the fourth quarter of 2008. However, considering that as of 2013, there were 8.2 million vacant houses in Japan, and the ratio of vacant houses had reached 13.5%, it would be no surprise if private housing investments have reached their peak.



Public investments rose by 2.6% over the previous quarter. Contract amount for public works projects, which reflects the trends of order placement, was up by 10.1% over the previous quarter, reaching the level of the second quarter of 2014 for the first time since then. Public investments are likely to continue to grow. Moreover, the cabinet approved economic measures and a supplementary budget plan in August. Investment related spending in the national general account budget decreased from 6.5 trillion yen in fiscal 2015 (with a supplementary budget) to 6.3 trillion yen in initial fiscal 2016. However, this can be seen as

shifting to an increase when taking into consideration the fact that 1.4 trillion yen was secured for “creating infrastructure suited to the 21st century” under the supplementary budget.

Private non-residential fixed investments marked a 0.1% quarter-over-quarter decline. The Financial Statements Statistics of Corporations indicate that while private non-residential fixed

Real Gross Domestic Product (GDP)				
	at 2005 Price, Calendar year			
	2015	2016		
	y/y%	10-12	1-3	4-6
		q/q%	q/q%	q/q%
Real Gross Domestic Product	0.5%	-0.4%	0.5%	0.2%
Private Consumption	-1.2%	-0.8%	0.7%	0.2%
Private Housing Investments	-2.5%	-0.5%	-0.1%	5.0%
Private Non-Resi. Fixed Investments	1.5%	1.2%	-0.6%	-0.1%
Public Investments	-2.5%	-3.2%	0.2%	2.6%
Government Consumption	1.2%	0.8%	0.9%	0.1%
Exports of Goods & Services	2.8%	-0.9%	0.1%	-1.5%
(less) Imports of Goods & Services	0.3%	-1.1%	-0.5%	-0.0%

Source: CAO

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

investments increased in the manufacturing industry, driven by the transport machinery and chemical industries, there seems to have been a decrease in non-manufacturing industries, including a decline in the retail industry, which had previously continued at high levels, and a slump in the information and communication industry. Among leading indicators, private machinery orders (excluding orders for ships and those from electric power companies) fell for the first time in three quarters, while the floor space of new private non-residential buildings increased for the second straight quarter, and ordinary profit of corporations (excluding financial and insurance companies) recovered after decrease for four consecutive quarters. It is not likely that private non-residential fixed investments will continue to decrease further, but there is also a low probability that they will shift upward drastically.

Exports of goods and services fell 1.5% from the previous quarter. Goods exports that decreased included ships, steel products, and petroleum products, and while domestic consumption by foreign visitors is still high, it slipped for the first time in 14 quarters. Meanwhile, imports were almost unchanged from the previous quarter at 0.0%, but did show a slight decline. Imports of services increased while goods imports that decreased included personal-use articles, medicines, and semiconductor production equipment. As a result, net exports contributed to push real GDP growth of 0.3 percentage points from the previous quarter.

According to the ESP Forecast survey, which compiles real GDP growth rate forecasts of economists in the private sector, real GDP is expected to see quarter-over-quarter growth of more than 0.2% (0.8% annualized) in following quarters, and the economy will grow by 0.5% in 2016 from 2015 and by 0.9% in 2017 from 2016. The Japanese economy is expected to sustain gradual growth.

BOJ Conducts “Comprehensive Assessment”

At its monetary policy meeting in September, the Bank of Japan conducted a comprehensive assessment of monetary easing, and decided to newly introduce quantitative and qualitative easing with control of short-term and long-term interest rates. The “quantitative and qualitative monetary easing” that BOJ started in April 2013 had economic activity and prices improved by a decline in real interest rates. However, the BOJ concluded that the price stability target of a year-on-year consumer price index (CPI)

inflation rate of 2% could not be met due to a fall in crude oil prices, the consumption tax hike, and the fact that in Japan, past results exert significant influence on future predictions of CPI inflation rates. The BOJ said that it is necessary to adopt measures that will raise expectations for future inflation in a more forceful manner.

The BOJ seems to have created an impression that it will commit itself to even longer-term monetary easing by introducing a policy of control of short-term and long-term interest rates that prevents excessive drops in long-term interest rates while emphasizing that the policy will be continued until actual CPI inflation rate results exceed targets. However, BOJ continues to a negative interest rate of minus 0.1% applied to Policy-Rate Balances and its past policy of purchasing exchange-traded funds (ETFs). Targeted 10-year Japanese government bond rates and long-term government bond purchase amounts will remain more or less unchanged from current levels. Although it is said that the BOJ has shifted the emphasis of monetary policy from quantity to rates, doubt remains as to whether this decision will be able to raise expectations of future inflation.

Demographics and the Japanese Economy

Due to the view that the Japanese economy has been in a prolonged recession since the Nikkei Stock Average hit a record high in December 1989, or since the height of the bubble economy in February 1991, we have been hearing the words “lost decade,” “lost two decades,” and “lost 25 years” for quite some time.

However, it has also been pointed out that compared to countries like the United States and Germany, the performance of Japan’s economy has not always looked so bad. A typical example is rate of increase in real labor productivity per working hour. An estimate using OECD data shows that Japan’s rate of increase over the 25 years from 1990 to 2015 was 1.5% annually, which stands comparison with the United Kingdom and the U.S. (both 1.6%), and Germany (1.5%). Despite this, the reason that Japan’s real GDP growth rate over the same period does not look so good is because overall labor hours did not increase.

Hearing this, one may think that Japan’s overall labor hours decreased because of demographics. In 2009, the population of Japan shifted to a decrease. Before that, in 1996, the population of people over 15 and under 65, who are generally considered to be the

“working generation,” also turned to a decrease. However, because the number of employed women and elderly increased, the annual percentage of employed persons barely increased by 0.1% annually in the years from 1990 to 2015. On the contrary, the impact of the 0.7% decrease in annual average number of working hours per capita was significant. The monthly number of labor hours worked by those working at private sector companies fell from 189 hours in 1990 to 155 hours in 2015. Behind this trend was an increase in the proportion of people working under a full two-day weekend system from 39.2% to 61.1% that occurred over the same period.

Prime Minister Shinzo Abe put reform of ways of working as his greatest challenge, and has stated that he will correct long working hours. However, although this seems to go against the times, one way to compensate for the decrease in the working age population would be to lengthen the number of per capita working hours. Based on future population estimates by the National Institute of Population and Social Security Research with an assumption that employment rate (the proportion of employed persons in the working age population) and others remain unchanged, the estimated number of working hours of male employees needed to sustain the level of total working hours that was recorded in 2015 would be 200 hours per month in 2030, which is roughly equivalent to 1980s levels.

On the other hand, reforming ways of working aims to increase choices of ways to work, including shorter hours and every-other-day work schedules, and

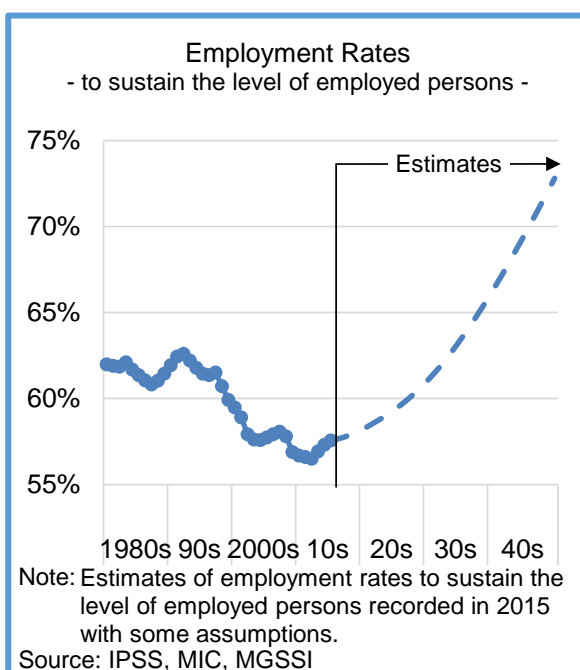
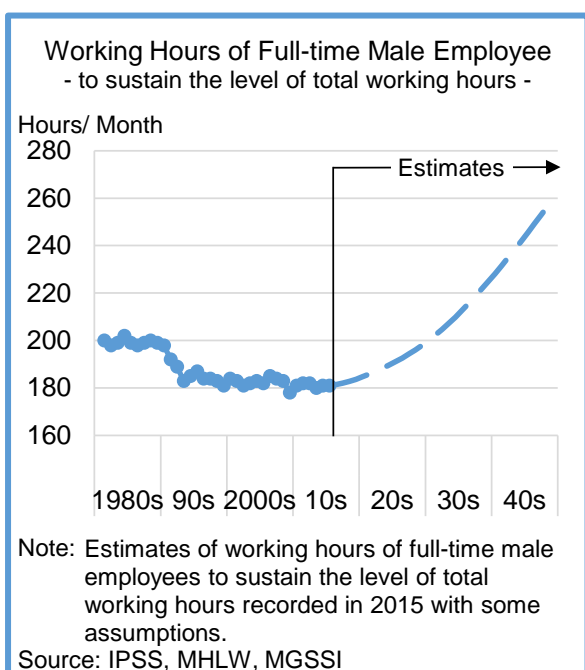
increase the employment rate. An estimate of the employment rate needed to sustain the level of employed persons that was recorded in 2015 in 2034 is 62.8%, exceeding the 62.6% recorded in 1992.

However, if the proportion of women and elderly among employed persons rises, per capita labor hours could become shorter. For example, in 2015, men worked 170 hours per month and women worked 135 hours, while workers under 65 worked 157 hours per month compared to 117 hours for workers aged 65 and above. In this sense, the assumptions in both estimates above are optimistic. However, while it takes almost 20 years from a child's birth until he or she becomes an employed person, it should take a relatively shorter period of time to realize the effect of measures to raise the employment rate by extending working hours in order to sustain overall labor hours.

Excessive Pessimism Is Unneeded

Another method to compensate for the decrease of Japanese people is to enlist the help of foreigners. In 2015, foreigners working in Japan accounted for 1.4% of employed persons at 910,000. However, in the five years since 2010, the number of foreign workers increased by 260,000, while the number of employed persons increased by 780,000. Thus, in reality, one in three people that accounted for the increase was a foreign worker.

The government has not changed its policy of accepting foreign workers in professional and technical fields while being circumspect with so-called

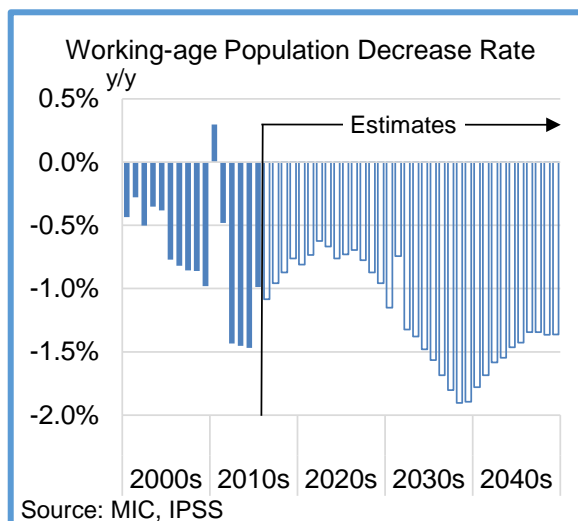


simple laborers.

However, permanent residents and people of Japanese descent account for about 40% of foreigners that work in Japan, while foreigners with working status that recognizes them as professionals or technical experts, students from overseas who receive permission and work part time, and technical trainees each accounted for about 20%. The fact that the government has worked to review items such as adding automobile maintenance, building cleaning, and nursing care to the job types eligible for technical training will attract attention.

Hopes are also resting on the utilization of robots. The number of robots for industrial use operating worldwide rose from over 750,000 in the year 2000 to upwards of 1,480,000 in 2014. However, in Japan, these numbers decreased from over 390,000 in 2000 to around 300,000 in 2014.

In addition to the transfer of production bases of Japanese industries overseas, the fact that robots are mostly introduced by big companies (especially automobile manufacturers) and do not become widely used by other than these, are said to be behind this development. In the case of SMEs, it seems a view that it is hard to build production systems using robots due to heavy initial cost burden, time required to teach tasks, and unsuitableness of robots for small-volume production in great varieties, is the reason they hesitate before introducing robots. What is anticipated going forward are the sharing of experiences of introducing robots and the implementation of simple general-purpose robots, as well as learning robots that are



Source: MIC, IPSS

equipped with sensors and artificial intelligence. After the Second World War, Japan had high population growth rates in the late 1940s and the early 1970s. The early 2010s was the exact period in which the baby boom generation born in the late 1940s retired from working. Looking ahead to the future, as the second-generation baby boomers born in the early 1970s head toward retirement in the 2030s, the rate of decrease of the working age population will actually be relatively low. While it goes without saying that various efforts will be necessary, it will certainly not be impossible for the Japanese economy to deal with the country's demographic changes, at least until around 2030.

(Yusuke Suzuki, Senior Economist)

Selected Economic Indicators	Fiscal Year		2015		2016	
	2014	2015	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun
GDP at current prices (SAAR, Trillion Yen)	489.6	500.5	501.1	499.7	503.8	505.4
Real GDP at 2005 prices (SA, q/q%)	-0.9%	0.8%	0.5%	-0.4%	0.5%	0.2%
Industrial Production Index (SA, 2010=100)	98.4	97.4	97.0	97.1	96.1	96.3
Exports (SA, Trillion Yen)	74.7	74.1	18.9	18.4	17.6	17.1
Imports (SA, Trillion Yen)	83.8	75.2	19.8	18.4	17.0	16.1
Balance on Current Account (SA, Trillion Yen)	8.7	18.0	4.0	4.8	5.0	4.7
Corporate Bankruptcies	9,543	8,684	2,092	2,152	2,144	2,129
Unemployment Rate (SA, %)	3.5%	3.3%	3.4%	3.3%	3.2%	3.2%
Wage Index (SA, 2010=100)	99.0	99.2	99.5	99.1	99.7	99.1
Consumer Prices (y/y%)	3.0%	0.2%	0.1%	0.2%	0.0%	-0.4%
Nikkei Stock Average	16,273	18,841	19,412	19,053	16,849	16,408
Japanese Government Bond Yields (%)	0.48	0.39	0.40	0.31	0.05	-0.12
Foreign Exchange Rate (Yen/ Dollar)	109.9	120.1	122.2	121.5	118.1	108.2

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