

Global Watch

《*Japanese Economy*》

July 2009

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1. Overview of the economy

By Akihiko Suzuki, Chief Economist

Conditions have improved but are still “not so good.”

For the first time in two-and-a-half years, the Bank of Japan’s Tankan survey of business confidence for June shows improvement in the diffusion index (DI) of business conditions, mainly among large enterprises in the manufacturing sector. However, the margin of improvement was less than the market had anticipated. In addition, small and medium-sized enterprises in the manufacturing and nonmanufacturing sectors showed no improvement. This and other considerations have led to assessments that the results of the June survey were worse than had been thought. However, the results this time are in part due to the nature of the survey itself, which asks respondents to choose from “good,” “not so good,” and “bad” responses. Many people seem to feel that “the economy has escaped from the worst phase of the downturn but conditions are still bad.” If respondents are asked to give their views on the direction of economic conditions by selecting “getting better” or “getting worse,” the number of respondents selecting “getting better” has increased slightly. However, if they are asked to give their views on the level of economic conditions by selecting “good” or “bad,” the number of respondents selecting “good” should still be small.

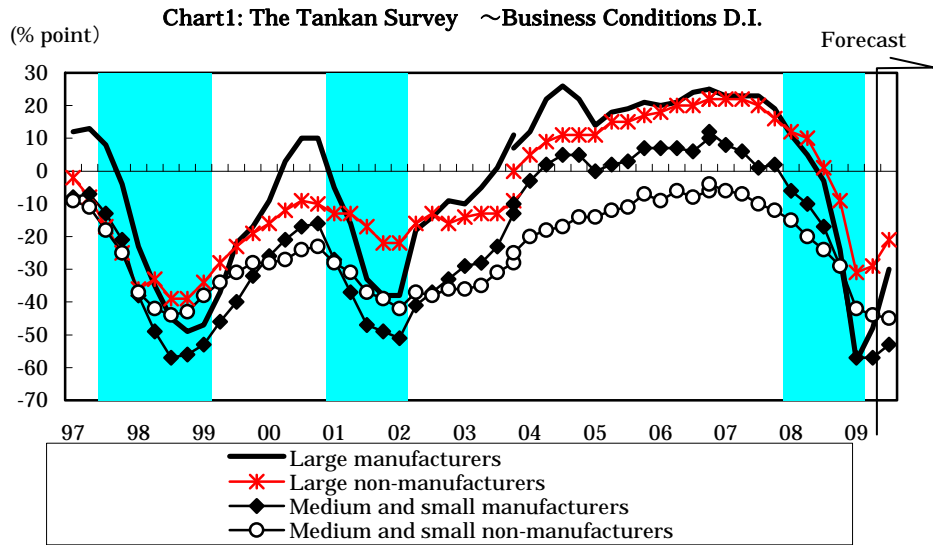
The reason why there were almost no corporate managers who selected “good” is that demand has not returned to the previous levels and profit conditions are quite tough. Under circumstances where companies are not just experiencing declines in sales and profit but also the number of companies reporting losses is increasing, the problems of excessive production capacity and excessive employment have spread suddenly. Even in the June Tankan, there were no signs of improvement in the DI that indicates management views of the level of productive and operating capacity or the DI that measures management views of the level of employment (which are calculated as “excessive” replies minus “insufficient” replies). In fact, among small and medium-sized enterprises and in the nonmanufacturing sector, the gap between “excessive” replies and “insufficient” replies has increased. Regarding capital investment plans for the current fiscal year, companies in the manufacturing sector, where the impact of the decline in exports has been the most severe, are planning to make major cutbacks in investment. However, although orders for machinery (private-sector demand, excluding shipping and electric power industries) for the April-June quarter are still on a declining trend, the momentum of decline is gradually diminishing. There is a possibility that the rapid decline in capital investment may pause in the latter half of the current fiscal year.

On the other hand, at the present time, companies are making deep adjustments in wages and employment levels. Through May, total cash wage payments per capita had declined

for 14 consecutive months, and the margin of decline has been increasing. Non-regular wage payments have shown steep declines because of cutbacks in overtime hours, and regular wage payments, which constitute workers' base pay, are showing gradually increasing margins of decline. Summer bonuses will be cut sharply, and, as a result, total cash wage payments in June and July are expected to drop substantially. Also, rising unemployment levels and decreases in the number of employed persons are adding further momentum to the downtrend. The cumulative total of the declines in employed persons since the peak in December 2007 comes to more than 1.7 million, and the number of employed persons (on a seasonally adjusted basis) in May posted a steep drop of about 440,000 from the previous month. This sudden deterioration in the employment and income environments will be a factor prolonging the stagnation in personal consumption.

Economic conditions through summer have been improving as a result of a number of factors. These include the bottoming out of production along with the progress toward inventory adjustments, the increase in demand from China owing to the impact of local economic policies, and the increase in sales of automobiles and electric appliances in Japan as a result of domestic economic stimulus policies. The positive effects of economic policies in Japan will continue through the fall as public works spending rises, but these effects will gradually diminish. As problems of excessive production capacity and employment persist, not much increase in the private capital investment and personal consumption components of domestic final demand can be expected. Also, since full-scale recovery in the world economy, centered around the United States, will be difficult, expansion in exports will be marginal. During the April-June quarter, an increase in industrial production over the previous quarter of close to 10% is expected, and the rising trend is likely to continue during the July-September quarter, but the pace of increase will gradually weaken, and the recovery trend will weaken from the fall onward.

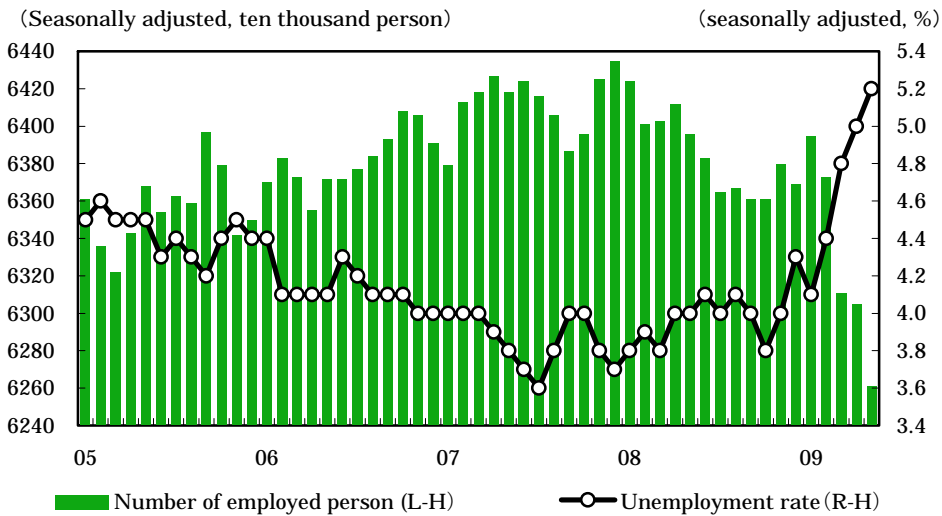
(2009.7.6)



Note: Shaded areas indicate the recession periods according to the Cabinet Office. Current bottom is our own estimate. Due to revision, data are not comparable before and after March 2004 and March 2007 survey.

Source: Bank of Japan

Chart2: Unemployment rate and number of employed person



Source: Ministry of Internal Affairs and Communications

2. Topic of the month

By Rei Tsuruta, Economist

How much has the excessive consumption behavior of U.S. households actually changed?

Households in the United States are increasing their savings at the same time they are paying down their debt. The amount of savings in the January-March quarter of 2009 (as measured by the portion of income that is not allocated to consumption, which includes debt repayments) was 2.4 times the recent low point reached in the January-March quarter of 2008. On the other hand, the balance of household debt, after reaching a peak in the July-September quarter of 2008, declined for two consecutive quarters (Chart 3). This shows that, as a result of the bursting of the housing bubble and the eruption of the financial crisis, U.S. consumers are being forced to repay the excessive amounts of debt they have incurred. To secure the cash flow necessary to increase savings, or, in other words, to repay debt, it is necessary to restrain the amount of their income they use for consumption. This seems to be a major factor behind the weakness in consumer spending.

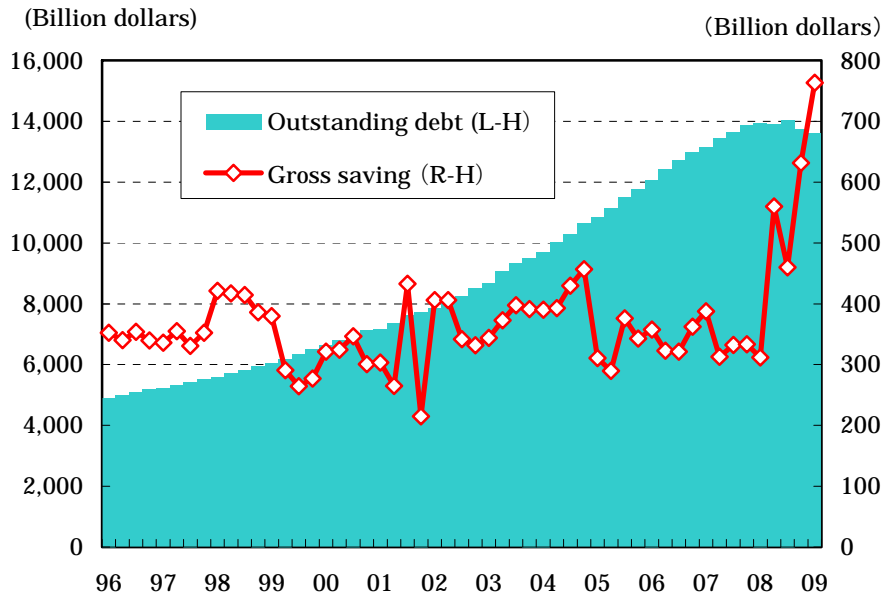
As a result of the shrinkage in their debt balances and increase in savings, the debt-repayment capabilities of U.S. households have shown substantial recovery. Calculations of the number of years for households as a group to pay down their debt (the balance of debt divided by gross savings, showing how many years of cash flow that the household sector has in outstanding debt) indicate that, in the January-March quarter of 2008, the number of years had risen to 45. Since then, however, this figure has dropped sharply to 18 years in the January-March quarter of 2009 (Chart 4). If we consider the average term for households to repay the mortgages on their homes, it appears that about 15 years would strike a good balance between borrowings and savings; however, in fact, the number of years for debt repayment has now fallen to close to that level. If households can maintain the current level of savings, we believe it would be correct to think that excessive consumption, which has characterized U.S. household behavior, has undergone significant correction.

The difficulty of maintaining the current level of savings will depend on trends in income. If income rises, it will be possible for households to maintain the level of their savings, even if they increase their spending by the same amount as the increase in their income. However, if their income declines, households will have to cut their consumption further to maintain the level of their savings. Recently, as employment conditions have worsened along with the deterioration in overall economic conditions, compensation of employed persons, which forms the basis for household income, and financial income have been weak. We believe this means there may be a risk of further declines in consumer spending. It may take more time for

personal consumption in the United States to stabilize as consumers become used to adjusting their consumption to the levels of their income and outstanding debt.

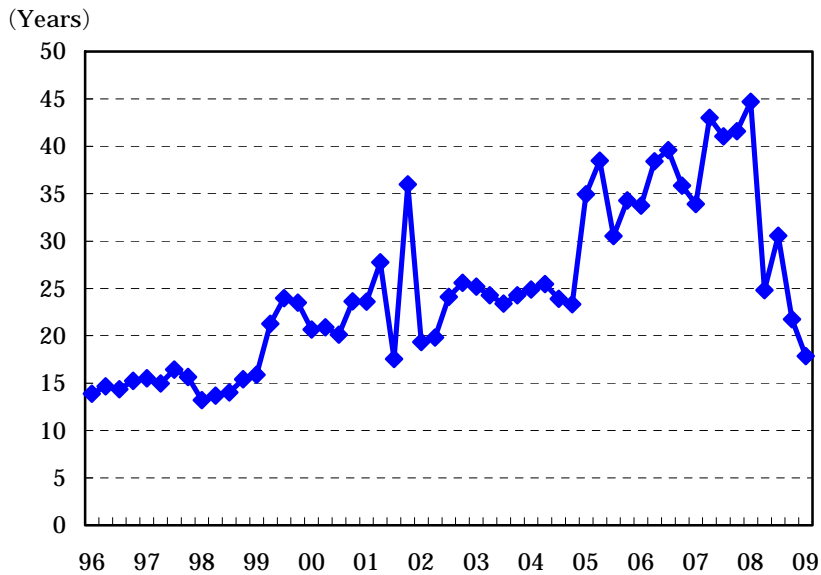
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Chart3: U.S. Households' outstanding debt and gross saving



Source; U.S. Department of Commerce, Federal Reserve

Chart4: U.S. Households' years required for debt redemption



Note: Years required for debt redemption = debts / total savings
Source: U.S. Department of Commerce, Federal Reserve