

Global Watch

March 2010

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This is an abstract of our monthly reports on the Japanese Economy. The information and the views contained herein are subject to change without notice.



Mitsubishi UFJ Research and Consulting

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§Japanese Economy

1. Overview of the economy

Risk of a double-dip recession has been averted for the time being but concerns remain about the weakening impact of government policy measures.

By Shinichiro Kobayashi, Senior Economist

The Japanese economy is continuing to show improvement, and the risk of a double-dip recession has receded for the time being. Nonetheless, the risk has not completely disappeared.

During the October-to-December quarter of 2009, real GDP expanded 0.9% over the previous quarter, or 3.8% an annualized rate, the third consecutive quarter of positive growth. As a consequence of the completion of inventory adjustments in Japan and overseas as well as improvement in the world economy, especially in China and other emerging economies, Japan's exports and industrial production are continuing to increase. Moreover, as a result of the positive effects of government policies, personal consumption is receiving a boost. In addition, private capital investment, which had been deteriorating, has finally shown signs of bottoming out, and the margin of decline in private residential investment from the previous quarter is shrinking, which suggests that a bottoming out may occur soon. The outlines of economic growth with a good balance between internal and external demand are taking shape, and the growth rate of nominal GDP for the October-to-December quarter was +0.1% (+0.4% at an annualized rate), the first positive growth in seven quarters. As a result of these and other developments, signs of improvement are spreading more widely through the economy.

It appears that the movement toward improvement has basically continued since the beginning of the calendar year. In January, the index of industrial production rose 2.5% over the previous month, the 11th consecutive monthly increase. This and other factors indicate that production activity in the manufacturing sector is continuing on an upward trend. Exports are also maintaining a robust uptrend, and, in January also, real exports were up 1.5% over the previous month, for the 10th consecutive monthly rise. However, since the boost to production coming from the rebound in reaction to prior declines in output and the restocking of inventories are close to running their course, there is a possibility that the momentum of production activity may weaken going forward. The forecast index for manufacturing in February calls for a decline of 0.8% (but for an increase in March of 1.6%), suggesting that the upward trend may pause. In addition, the index of activities in the tertiary

sector declined for two consecutive months, in November and December, revealing weakness outside the manufacturing sector.

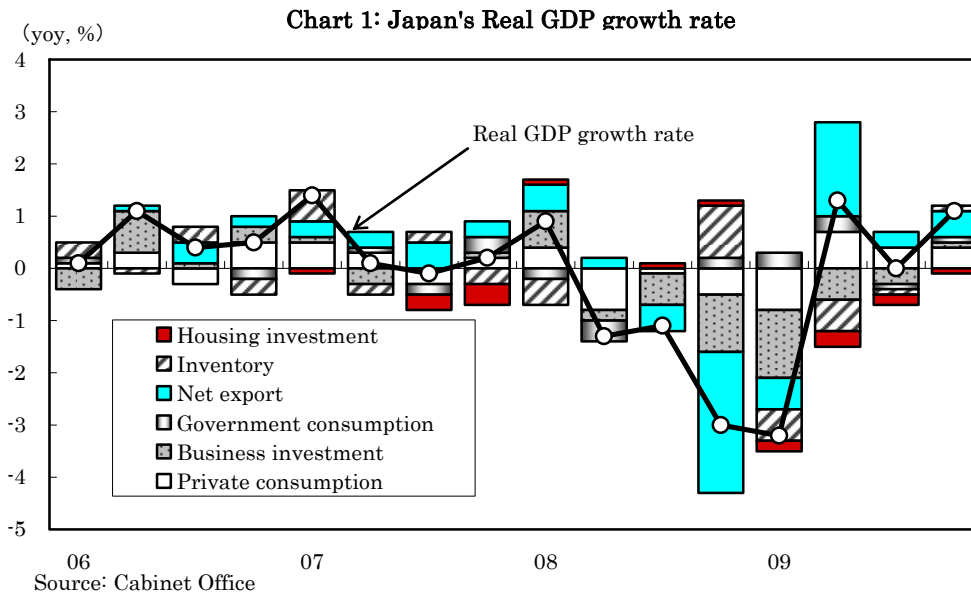
On the other hand, personal consumption is continuing to rise at a relatively robust pace as a result of the positive effects of government policies. This expansion is supported especially by sales of durable goods, with new car registrations up 39.2% in February over the same month of the previous year, and flat-panel TV unit sales up 76.0% year on year in January.

Orders for machinery and equipment in the October-to-December quarter rose 0.5% over the previous quarter, and, although the increase was relatively small, this was the first rise in seven quarters. Even in the survey of the outlook for the January-to-March quarter, an increase of 2.0% over the previous quarter is expected, and capital investment will probably continue to increase gradually following the beginning of the year. The number of new housing starts is beginning to bottom out. Through January, new housing starts had risen for five consecutive months and recovered to the 863,000 level at an annual rate. The rising trend in owner-built housing is continuing, and new starts of rental and built-for-sale housing, which had been stagnant, have now bottomed out.

The employment environment has also moved out of the worst phase of the recession and is showing moderate improvement. The unemployment rate in January stood at 4.9%, which was 0.3 percentage point below the previous month. On the other hand, the income environment continues to be harsh. In January, among total salary payments, nonscheduled cash compensation began to rise and special payments, including bonuses, increased sharply, resulting in an overall rise in payments for the first time in one year and eight months. However, the month-to-month change in scheduled salary payments, excluding special payments, continued to be negative. The trend in wages is downward, and there is a possibility that data for February may show a resumption of the decline.

For the time being, the improving trend in the economy is likely to continue, and it appears that the risk of a double-dip recession is receding. Consumer spending, in particular, is expected to hold strong, sustained by the positive effects of government policies. However, during the latter half of the fiscal year, the impact of government policies may have run its course, and there is a strong possibility of sudden downturn in consumer spending. The larger the margin of decline, the greater the concern about a second dip in the economy as we approach the end of fiscal 2010.

(2010.3.10)



2. Topic of the month

Reasons for the increase in the Money Stock (M3)

By Shinichiro Kobayashi, Senior Economist

Even though loans from banks to corporations have declined, the money stock (or M3, defined as currency + deposits + quasi currency + CDs) has held relatively steady.

Lending to corporations from banks rose sharply following the turmoil in financial markets that began at the end of 2008 as corporations sought to secure substantial amounts of liquidity. However, thereafter, along with the restoration of stability to financial markets, restraints among corporations on new capital expenditures, and other developments, demand for loans paused. Since December 2009, lending to corporations has declined for two consecutive months (Chart 2). On the other hand, growth in M3 is weakening to some degree, but, even so, this figure also posted a relatively high rate of growth of 2.1% in January 2010. In general, when prices are rising, the money stock tends to grow as the demand for money rises, but, under the current deflationary conditions, it seems unlikely that the demand for money would rise.

To examine these developments more closely, we recompiled data published in the Bank of Japan's Monetary Survey to analyze the factors accounting for the changes in M3.

According to our analysis, on the one hand, the factor contributing to a decline in M3 is the balance of bank assets held overseas, but credit creation in Japan is increasing and is pushing M3 upward. (Changes in M3 can be recompiled to show domestic credit creation, external assets, and other factors.)

Examining the breakdown of domestic credit creation in more detail, lending to the private sector (households and nonfinancial corporations) is decreasing, but lending to central government and to local governments and other public entities (in the form of bank loans, purchases of bonds, etc.) is increasing steadily. As prices fall, and lending to the private sector stagnates, it appears that one factor boosting M3 is the movement in fiscal policy toward issuing more government bonds to finance economic policies.

(2010.3.10)

Chart 2: Money stock (M3) and bank lending

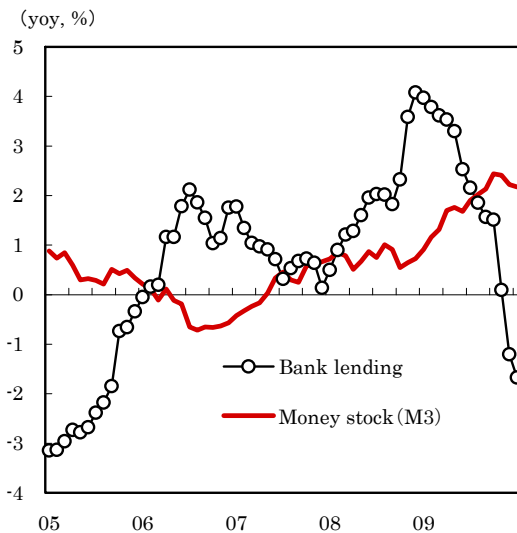
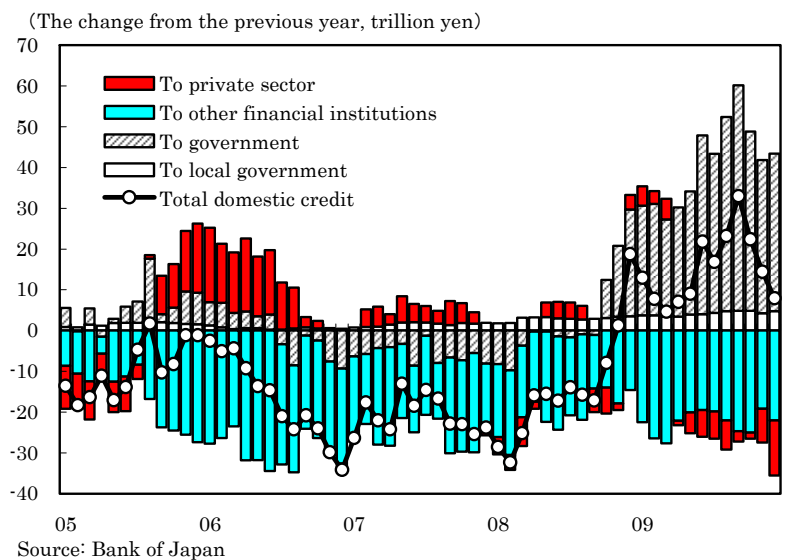


Chart 3: Domestic credit factor regarding change in M3



§Asian Economy

Continued expansion in domestic demand and recovery in exports is expected to bring growth above 7% in Asia.

By Mariko Noda, Economist

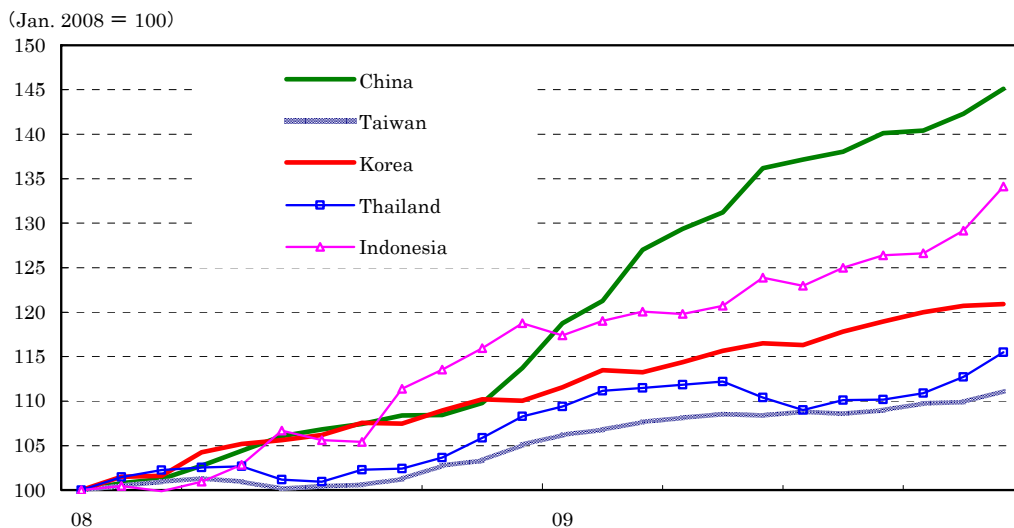
Most of the major Asian economies hit the bottom in the January-to-March quarter of 2009 due to expansionary fiscal and monetary policies and various measures to stimulate domestic demand on top of the benefits of strong recovery in the Chinese economy (Charts 4 and 5). In fact, all nine major economies in Asia reported positive growth over the same periods of the previous year in the October-to-December quarter.

In 2010, the industrialized countries will begin to recover, and this is expected to boost Asian exports. However, since the pace of recovery in the industrialized countries is expected to be moderate, Asian countries are likely to maintain their stimulus measures for the time being. As a result, strong domestic demand and recovery in exports will accelerate the growth rate of the nine major Asian countries as a group from 3.8% in 2009 to 7.1% in 2010.

Risks are the possible acceleration of inflation along with economic recovery and the resulting policy tightening, which may dampen momentum in domestic demand, and the possible delay in recovery in the industrialized countries due to renewed instability in financial markets, which may diminish the recovery momentum of Asian exports.

(2010.3.10)

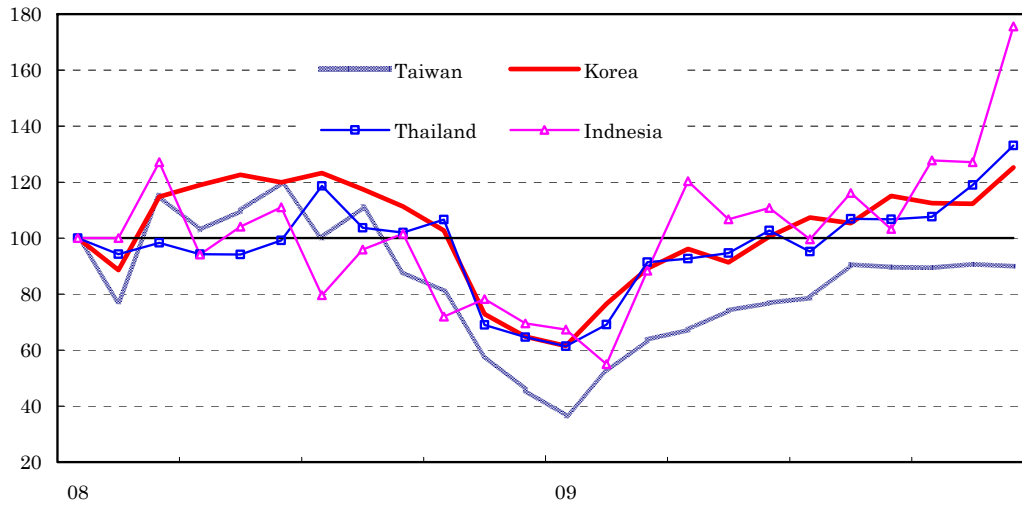
Chart 4: Change in money supply (M2) in major Asian countries



Source: CEIC

Chart 5: Export to China by major Asian countries

(Jan. 2008 = 100)



Source: CEIC Note: Data for Indonesia are non-oil and gas export base.

Chart 6: Actual and forecast data of real GDP growth rate for major Asian countries.

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 Forecast
Nine major Asian countries	4.8	7.1	6.8	7.9	7.6	8.5	9.2	5.9	3.8	7.1
China	8.3	9.1	10.0	10.1	10.4	11.6	13.0	9.6	8.7	9.8
NIEs	1.3	5.5	3.2	6.0	5.0	5.8	5.8	1.7	▲ 1.0	4.8
Taiwan	▲ 1.7	5.3	3.7	6.2	4.7	5.4	6.0	0.7	▲ 1.9	5.0
Korea	4.0	7.2	2.8	4.6	4.0	5.2	5.1	2.2	0.2	4.5
Hong Kong	0.5	1.8	3.0	8.5	7.1	7.0	6.4	2.1	▲ 2.7	4.4
Singapore	▲ 2.4	4.2	3.8	9.2	7.6	8.7	8.2	1.4	▲ 2.0	6.1
ASEAN	2.3	4.9	5.6	6.0	5.2	5.5	6.1	4.4	0.8	4.7
Thailand	2.2	5.3	7.1	6.3	4.6	5.1	4.9	2.5	▲ 2.3	4.0
Indonesia	3.6	4.5	4.8	5.0	5.7	5.5	6.3	6.0	4.5	5.4
Malaysia	0.5	5.4	5.8	6.8	5.3	5.8	6.2	4.6	▲ 1.7	4.6
Philippines	1.8	4.4	4.9	6.4	5.0	5.3	7.1	3.8	0.9	4.2

Note: Aggregated figures are weighted average based on the US dollar basis nominal GDP weight of each countries as of 2001.
Source: IMF, CEIC. Forecast figures for 2010 is by MURC.