

Global Watch

August 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

The Japanese economy is recovering, but, recently, there have been signs of a slowdown.

By Shinichiro Kobayashi, Senior Economist

The economy has passed through the bottoming-out phase and has entered a period of recovery. On the other hand, signs of a weakening of momentum are beginning to emerge.

First, there are clear signs of a diminishing momentum in the industrial production index, which edged downward 1.5% from the previous month in June, the first decline in four months. In addition to declines in production in the transportation equipment as well as the electronic components and devices industries, declines in the industrial materials industries, such as steel and chemicals, have also been significant. As a result, the industrial production index for the April-June period was up 1.4% over the previous quarter, a marked decline in growth compared with 7.0% quarter-to-quarter growth in the January-March period. The forecast index for industrial production calls for a month-to-month decline of 0.2% in July, the second consecutive monthly decline; however, the outlook is for an increase of 2.0% in August. Therefore, there is a possibility that industrial production in the July-September quarter may be level with the previous quarter.

Real exports in June were 0.6% below the previous month, the first monthly decline in one year and four months. The momentum of exports to the rest of Asia, which had been strong, has paused. Thus far, there have been no signs of a negative impact on Japan's exports because of the increase in credit market uncertainties in Europe. However, reflecting concerns about future trends in overseas economies, the yen has appreciated into the 85yen to 86yen to US\$1 range, the strongest it has been in eight months, since November last year. This may have a negative impact on Japan's exports. By product, exports of chemicals, mainly to China, which had shown a strong upward trend at an early stage, are decelerating, and exports of semiconductors and other electronic components are losing the momentum they had previously.

Employment conditions have shown deterioration for four consecutive months, with the unemployment rate in June standing at 5.3%. While conditions have improved in comparison with the worst phase of the downturn, they remain tough. The increase in the unemployment rate has been particularly significant among younger people. Other indicators,

including the number of new housing starts and orders for machinery and equipment, remain relatively weak compared with their momentum after they began to recover. In addition, public investment, which has already peaked out, is expected to show larger margins of decline going forward because of major cuts in the government budget.

Because of the sharp deterioration in economic conditions following the collapse of Lehman Brothers, there is a possibility that, on a seasonally adjusted basis, data for the January-March quarter of this year may be prone to be higher and data for the April-June quarter lower than would be the case otherwise. However, even taking this into account, it is clear that the momentum of recovery is weakening.

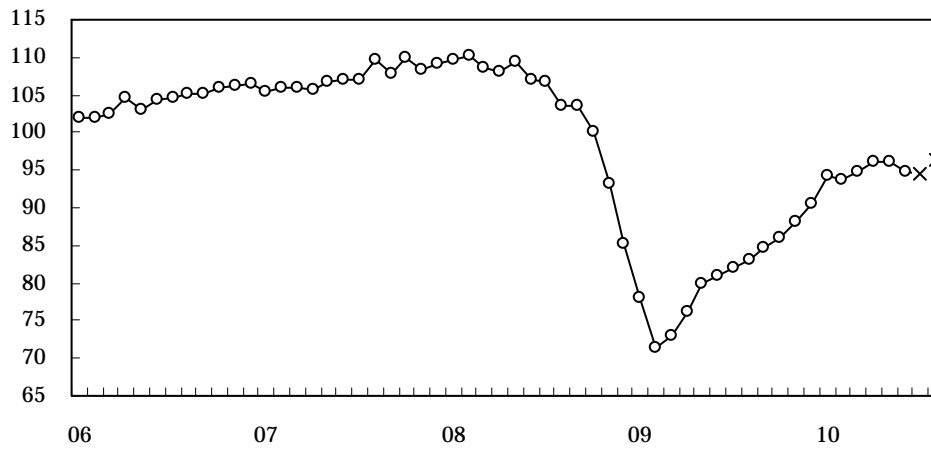
On the other hand, total cash compensation per worker in June was 1.5% above the level of the same month of the previous year. This was the fourth consecutive month for this indicator to rise above the previous year's levels. Other good news is that unscheduled compensation and special wage payments, principally summer bonuses, have begun to rise. In addition, the trend toward improvement in consumer spending on durable goods is continuing and is providing support for the economy. This uptrend is being sustained by the positive effects of government policies on sales of automobiles and flat panel display TVs as well as sales of air conditioners stimulated by the hot summer weather.

However, the government subsidies for purchases of eco-friendly cars are slated to end at the end of September, as originally scheduled, and concerns about a weakening of consumer spending in the latter half of this fiscal year have not been dispelled. In view of the ending of positive effects of government policies, automobile manufacturers are scheduling production cutbacks beginning in October, meaning that there is a strong possibility of a temporary, sudden decline in industrial production. If the weakening in exports, which have driven the economy thus far, continues, the economy appears likely to reach a crucial turning point in the latter half of this fiscal year.

(2010.8.6)

Chart1: Industrial production

(Year 2005 = 100, seasonally adjusted)



Note: Cross marks indicate forecast figures based on the Survey of Production Forecast in Manufacturing.

Source: Ministry of Economy, Trade and Industry

2. Topic of the month

Domestic automobile production has begun to decline.

By Rei Tsuruta, Economist

Japan's automobile manufacturers are experiencing an improvement in operating performance, supported by recovery in car sales in Japan and overseas. Honda's operating income for the April-June quarter was 234.4 billion yen, the highest for the first quarter of the fiscal year in the company's history, while Toyota reported 211.6 billion yen and Nissan 167.9 billion yen in operating income for the quarter.

Nevertheless, by geographic area, there have been differences in the degree of recovery in production (Chart 2). As a result of strong demand, principally in China, production in Asia has increased rapidly. On the other hand, production in North America and Europe has not recovered to the previous peak levels, while production in Japan is about 80% of the peak. In addition, an examination of shipments of automobiles by destination shows that, since the beginning of 2010, both shipments to the domestic market and exports have peaked and begun to decline (Chart 3). In the case of domestic auto shipments, this has been influenced by the weakening of the effectiveness of subsidies for purchases of new cars in generating additional

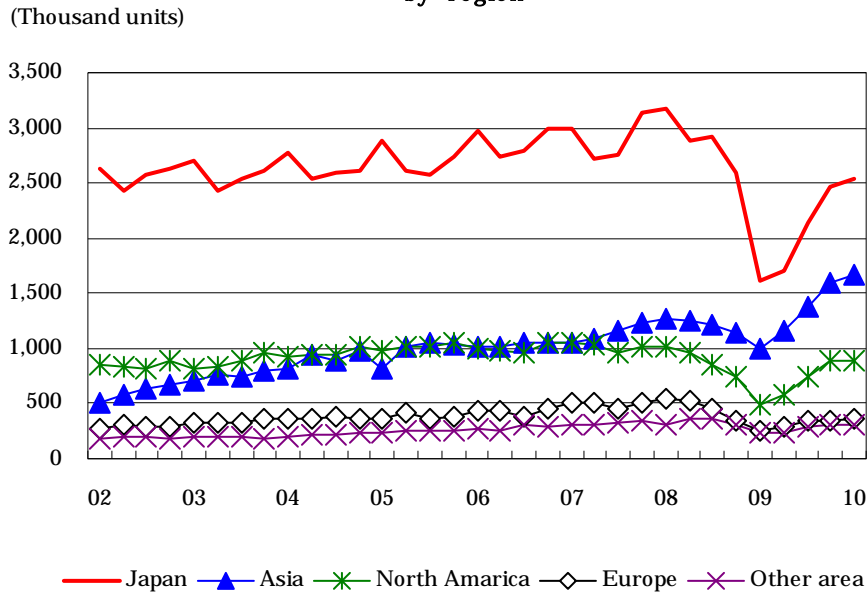
demand. On the other hand, the reason for the lackluster performance of exports is that automobile sales in the principal export markets of Europe and the Americas have been relatively dull. Since automobile manufacturers can basically respond to strong demand in Asia through local production, this demand is not contributing to an increase in exports from Japan. Therefore, the linkage between profitability of auto manufacturers, which are now global companies, and production in Japan has been weakened.

Improvement in employment conditions in Europe and North America is sluggish, and, recently, uncertainty about future directions has increased. In part because of the change in consumer preferences from large automobiles to more-compact vehicles, no robust improvement in exports to the European and North American markets is expected for the time being. In addition, the subsidy payments in Japan for purchases of new cars are scheduled to terminate at the end of September. After the level of domestic automobile sales, which had been boosted by the positive effects of government subsidies, moves down significantly, stagnation in sales may continue for some time. Therefore, there is a strong possibility that a downtrend may continue in domestic automobile production going forward.

The automobile industry is linked to a broad range of industrial areas, and its impact on other domestic industries in both the manufacturing and non-manufacturing sectors is substantial. Whether other industries, such as general machinery and electronic components, can make up for the effects of a slump in the automobile industry through strong exports to newly emerging countries will have a major impact in determining whether the overall upward trend in domestic production can continue. In the medium-to-long term also, whether Japan's automobile manufacturers can continue to develop products, such as electric cars and fuel cell powered automobiles, that have sufficient value added to be manufactured in Japan and then exported overseas will be a major key to preventing the hollowing out of domestic industries and the loss of domestic jobs.

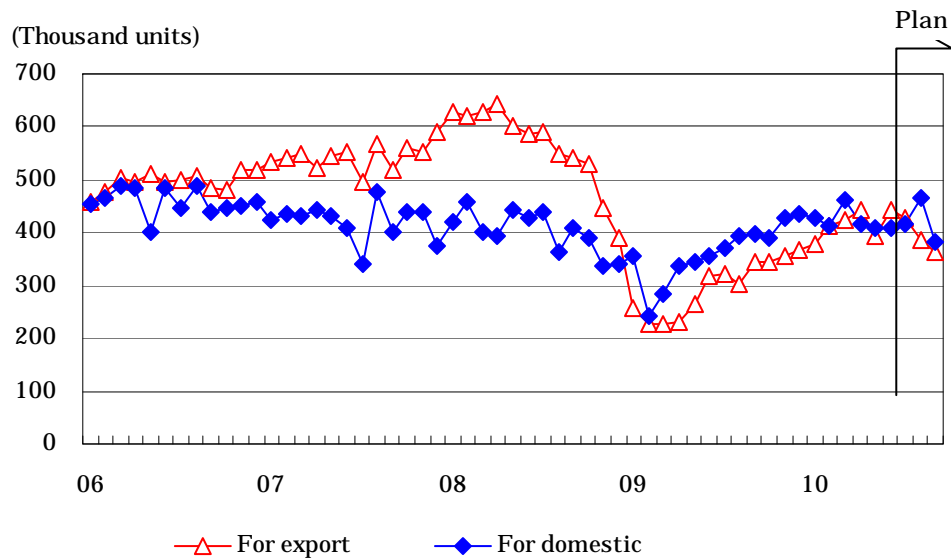
(2010.8.6)

Chart2: Number of auto production of Japan's manufacturers by region



Source: Japan Automobile Manufacturers Association

Chart3: Actual and planned production of automobile



Note: Production plan is as of the beginning of July, seasonally adjusted.

Source: Japan Automobile Manufacturers Association

§Chinese Economy

Reasons for a decline in the growth rate of industrial production

By Mariko Noda, Economist

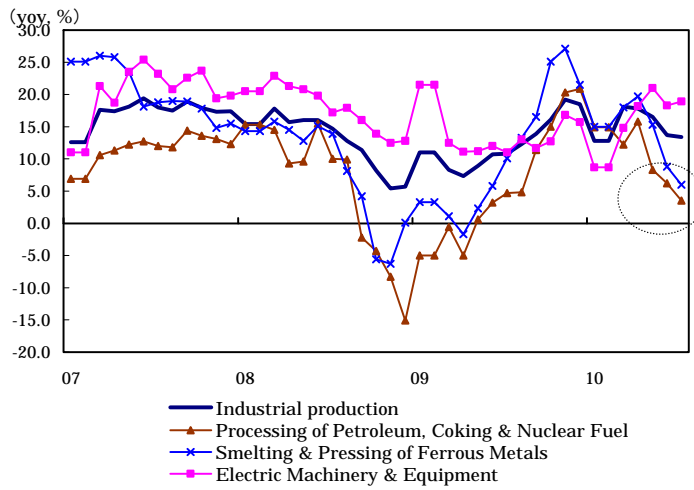
Partly because of the effects of the government's policy to restrain the economy from overheating, economic indicators for July generally showed weaker performance compared with the previous month. Industrial production (on a value-added basis) for the January-to-July period rose by 17.0% on a year-on-year basis, which was slightly slower than the 17.6% reported for the January-to-June period.

Meanwhile, this is the final year of China's 11th Five-Year Plan: 2006 to 2010. Among various objectives, the one that appeared to be particularly difficult to achieve was the energy-saving goal to reduce energy usage per unit of GDP by 20% over the five years of the plan. At the end of 2009, energy used per unit of GDP had decreased by 15.61%, but, on the contrary, during the first half of this year, it has become clear that energy usage has increased, slightly, by 0.09%. As if reflecting this development, production in energy-intensive industries, such as smelting and pressing of ferrous metals, has decelerated significantly in comparison with the industrial sector as a whole. At the beginning of August, the government issued orders to about 2000 companies in 18 industries, mainly energy-intensive sectors, to scrap aging facilities by the end of September. Looking ahead, there is a possibility that these moves may bring a further significant slowing of production activities.

However, what concerns us is that sentiment regarding business conditions is deteriorating or recovery in sentiment is lagging more in private-sector companies, rather than in state-owned enterprises, and in small and medium-sized enterprises (SMEs), rather than in large companies. It seems likely that the attaining of energy-conservation objectives is weighing relatively more heavily on private-sector companies and SMEs.

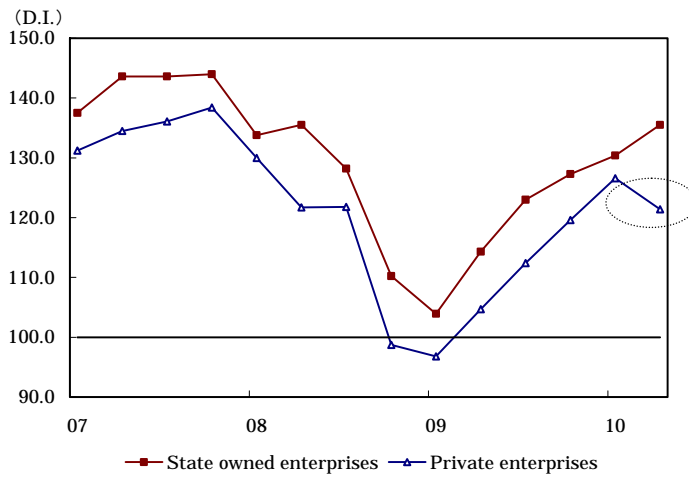
(2010.8.13)

Chart4: Change in Industrial production (value-added base)



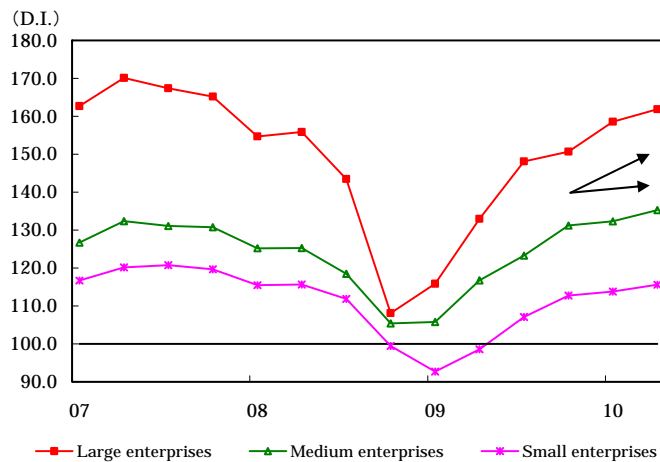
Source: CEIC

Chart5: Business conditions index by ownership



Source: CEIC

Chart6: Business conditions index by company size



Source: CEIC