

Global Watch

January 2012

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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

Economic Research Department

§Japanese Economy

1. Overview of the economy

The Movement toward Improvement in the Economy Is Continuing, but the Pace of Recovery Is Slowing.

By Shinichiro Kobayashi, Senior Economist

The trend toward economic recovery is continuing, but the pace of improvement is becoming more moderate. The movement toward the restoration of supply capacity accompanying reconstruction after the earthquake has paused, growth in demand in Japan and overseas is weakening, and individual economic indicators show a mixed picture of strengths and weaknesses.

In November, real exports decreased 2.7% from the previous month, thus posting their second consecutive monthly decline. Examining trends in exports in volume terms by region shows that trends in shipments to the United States, the rest of Asia, and the EU are weak. Exports to the rest of Asia are showing particular weakness, with recent shipments now below the level following the earthquake when exports fell sharply.

Industrial production in November decreased 2.7% from the previous month, and, since the summer months, has been virtually level within a narrow range. By industry, automobile production has fallen significantly, and declines have been reported in the information and telecommunications equipment industries, including mobile phones, digital cameras, and flat panel display (FPD) TVs. Production in the steel industry, where inventory adjustments are continuing, has also dropped by a large margin. However, the declines in production in the automobile, mobile phone, and digital camera industries have been due to shortages of parts caused by the flooding in Thailand, and are expected to be temporary. To make a comeback from the effects of the flooding, companies, mainly in the automobile, telecommunications equipment, and certain other industries, are preparing robust production plans going forward, and surveys of production forecasts call for large gains of 4.8% in December, followed by 3.4% in January. If production activities proceed as planned, industrial production in December will set a new post-earthquake record level.

Data for November, which show inventories down 0.8% month to month, indicate that the brakes have been put on the rise in inventories, but the level of inventories still remains relatively high. The rise in inventories in basic materials industries, such as steel and chemicals, and electronic parts and devices has peaked, but the pace of decline remains

moderate. There is a possibility that production may continue to be restrained.

Trends in private capital investment continue to be weak. The GDP statistics for the July-September quarter show that real capital investment declined for the fourth consecutive quarter. Since then, no signs of recovery have emerged, and machinery orders (from the private sector, excluding those from the shipping and electric power industries) in October were down 6.9% from the previous month, the second consecutive monthly drop. Although demand for reconstruction following the earthquake is believed to be emerging, corporate attitudes toward capital investment are continuing to be cautious, in part because of the impact of the high value of the yen against other major currencies.

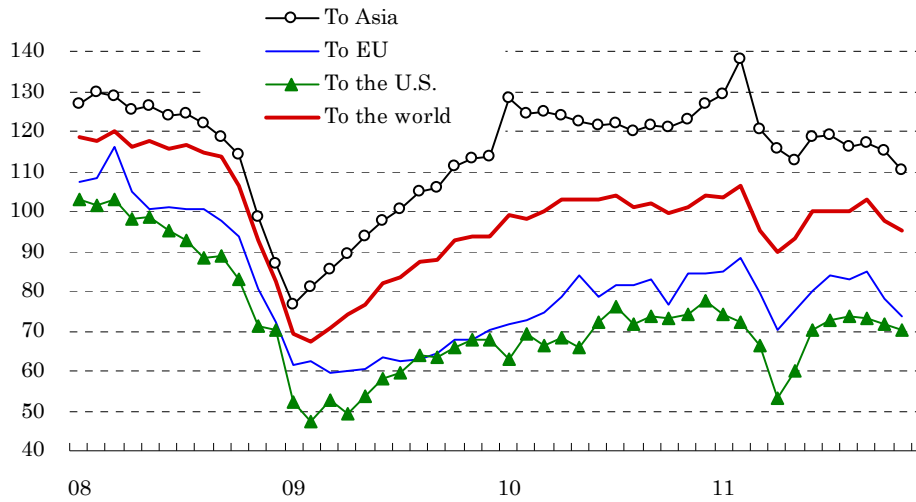
Personal consumption in real terms in November was down 1.3% from the previous month according to the household expenditure survey (covering households of two or more persons), the third consecutive monthly decline. However, there are continuing signs that personal consumption has not lost its firmness, including continued robust automobile sales. Nevertheless, the pace of recovery in labor conditions is moderate, with the unemployment rate at 4.5% in November, the same as in the previous month. Conditions in the income environment also remain dull as evidenced by a 1.0% decline in total per capita cash earnings of employed persons, the first decline in two months. As a result, uncertainty remains regarding future trends in consumer spending.

Looking ahead, post-earthquake demand for recovery-related expenditures, mainly public investment, is expected to give a boost to the economy. The value of public works investment contracted in November rose for the fourth consecutive month, and the margin of increase is expanding. Moreover, as production and sales of automobiles remain favorable, the economy is expected to avoid a loss of momentum. However, the risk that companies may make full-scale production adjustments because of the decline in exports has still not been eliminated.

(2012.1.13)

Chart1: Export volume index

(Year 2005= 100, seasonally adjusted)



Source: Cabinet Office

2. Topic of the month

Tough Conditions Are Continuing in the J-REIT Market.

By Miki Ohata, Economist

Japan's real estate investment trust (J-REIT) market came into being in September 2001. Since then, the number of J-REITs listed and their total market value increased, and the market for J-REITs was expanding smoothly. However, in mid-2007, prices peaked and then fell sharply as the impact of the subprime loan crisis in the United States surfaced (Chart 2). Then in 2011, which marked the 10th year since J-REITs came into existence, prices took another major plunge, and the margin of decline for the year was the second largest after the drop in 2008.

In recent years, progress has been made in reorganizing the J-REIT market and making systemic improvements with the aims of bringing about recovery in the shrinking J-REIT market. In addition, in October 2010, owing to the rising risk of a downturn in the domestic economy, the Bank of Japan (BOJ) decided to implement a comprehensive monetary easing policy. As part of this policy, "an Asset Purchase Program" was established to purchase

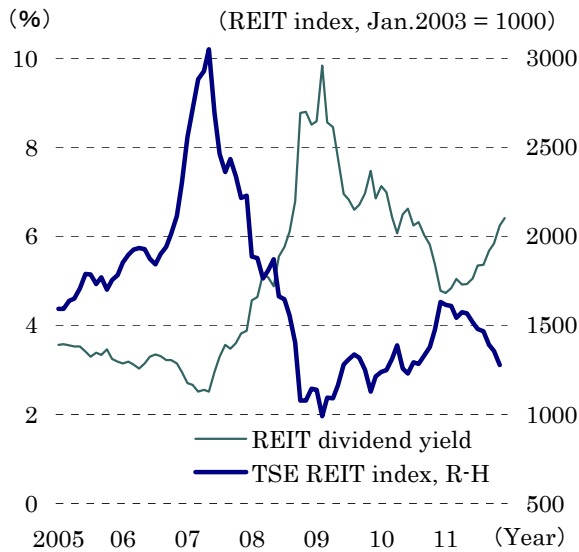
various financial instruments, including J-REITs. The amount of these purchases was initially set at 50 billion yen, but, on two occasions, it was expanded in size, thus increasing it to about 110 billion yen, and the period for purchases was extended to the end of 2012. Accumulated purchases through the end of November 2011 amounted to 62.2 billion yen, leaving the balance more than 47 billion yen below the specified limit.

At the time it was decided to have the BOJ make these purchases, they were believed likely to have the positive impact of promoting investments in J-REITs by generating anticipations that their prices would stabilize. In fact, since October 2010, examination of the Tokyo Stock Exchange (TSE) REIT index shows that it has risen substantially in comparison with the Nikkei Stock Average (Chart 3). However, after BOJ purchases began, they have had almost no effect in providing support for J-REIT prices, and, even now, the TSE REIT index is continuing to decline. Thus far, foreign investors have had a major influence on Japan's real estate market, including J-REITs. One of the factors that can be cited for causing the sharp rise in the TSE REIT index around 2007 was active purchases by foreign investors who had taken note of the high return on J-REITs. When the BOJ decided to purchase these instruments, foreign investors increased their J-REIT investments, but currently they are net sellers.

As these comments suggest, as land values and other real estate prices continue to stagnate, BOJ purchases in the J-REIT market have had only a marginal positive impact in providing support for the market. At present, as distribution yields on J-REITs remain at a high level, their market prices seem to be relatively low. However, investors are adopting a highly risk averse stance because of factors that include concerns about trends in overseas economies. Therefore, it seems to be unlikely to expect that foreign investors will invest aggressively in J-REITs. The road to renewed vitality in the J-REIT market seems likely to be a difficult one.

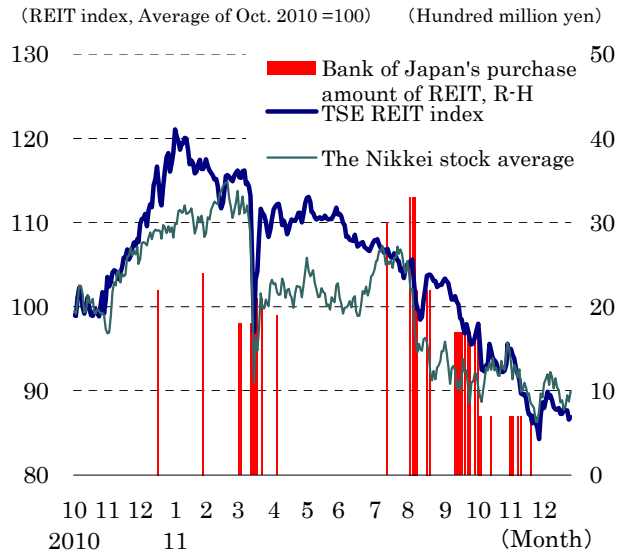
(2012.1.13)

Chart2: REIT index and dividend yield



Note: Monthly data. REIT index includes dividend.
Source: Bloomberg

Chart3: REIT index and BOJ's purchase amount



Note: Daily data.
Source: Bloomberg

§Chinese Economy

Inflation and Consumption

By Mariko Noda, Economist

Boosting consumption is said to be the key to promote a shift towards a sustainable growth model, and one of the most pressing issues for the Chinese government. The reasons for the emphasis placed on restraining inflation in China include not only avoiding social instability but also preventing a loss of real purchasing power among households due to rising prices that might reduce the effectiveness of policies to expand consumption.

In fact, when higher inflation occurred because of increases in food prices, particularly meat costs in 2008 and 2011, the Engel's coefficient, which measures the percentage of food purchases in household expenditures, rose, and the possibility was suggested that households would cut back on non-essential consumption. However, in both cases, the rise in the Engel's coefficient was smaller than anticipated (Charts 4 and 5).

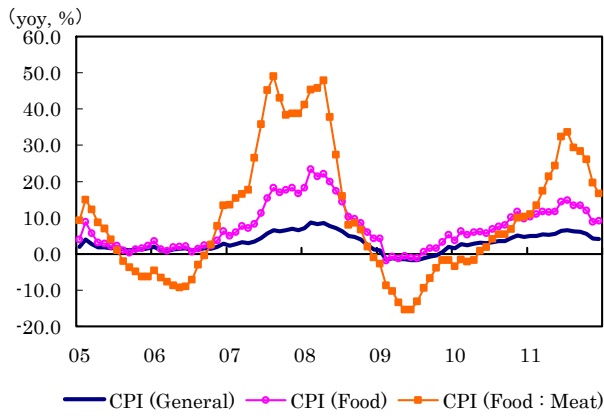
One of the reasons for this appears to be that Chinese consumers, in general, are quite sensitive to prices. Chart 6 plots the year-on-year change in the volume of pork consumption, which is an indispensable item in the Chinese diet, and meat prices. It suggests that, when

prices rise, consumers consume less pork. The consumption of pork in 2011 is, thus, estimated to decline by approximately 10% from the previous year.

With the price sensitivity of the Chinese people, it is easy to understand why payments subsidizing measures were effective in stimulating certain consumption. However, these kinds of policies are effective only in boosting consumption in the short term. In the medium-to-long term, price stability and expansion in incomes appears to be more important. We also think that the “vessel” for containing household goods—namely comfortable housing available broadly to households—is another base for expansion in consumer spending.

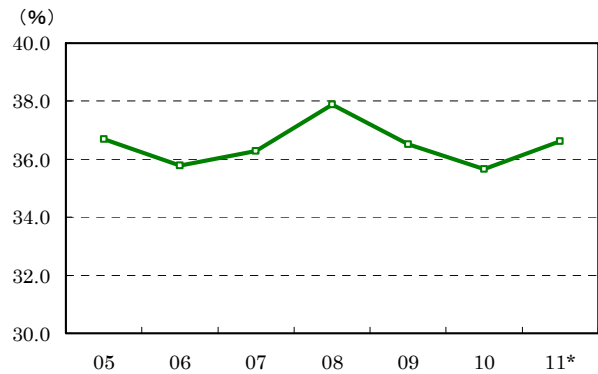
(2012.01.16)

Chart4: Change in consumer price index



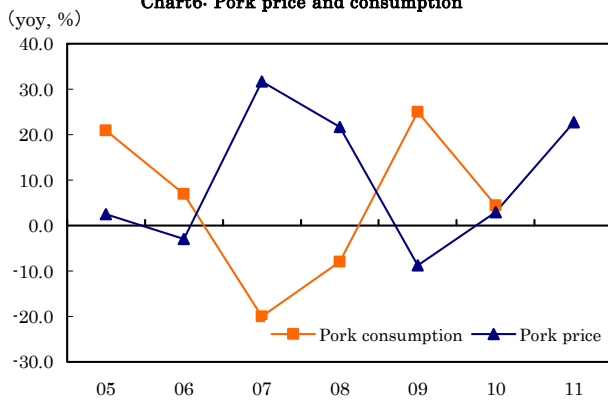
Source: CEIC

Chart5: Change in Engel's coefficient (Urban area)



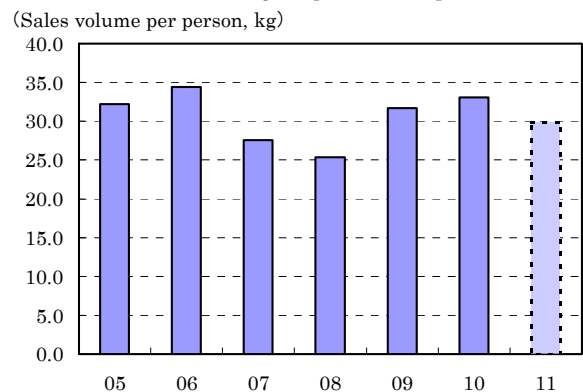
Note: Engel's coefficient (%) = Food price / All spending of households.
 Data for 2011 is actual data between Jan. and Sep.
 Source: CEIC

Chart6: Pork price and consumption



Source: CEIC

Chart7: Change in pork consumption



Source: CEIC Note: Data for 2011 is our own estimate.