2 December 2016

Economic Report

Global Watch November 2016

1. Overview of the Japanese Economy: Remains Virtually Flat with Some Signs of Improvement

By Shinichiro Kobayashi, Principal Economist

The economy remains virtually flat, although some indications of improvement have emerged. Judging from the economic indicators that have been released over the past month, while the trend toward improvement has not been interrupted, there are no figures strong enough to suggest that the current assessment should be revised positively. As regards improvement in the economy, we are still at the "signs of improvement" stage.

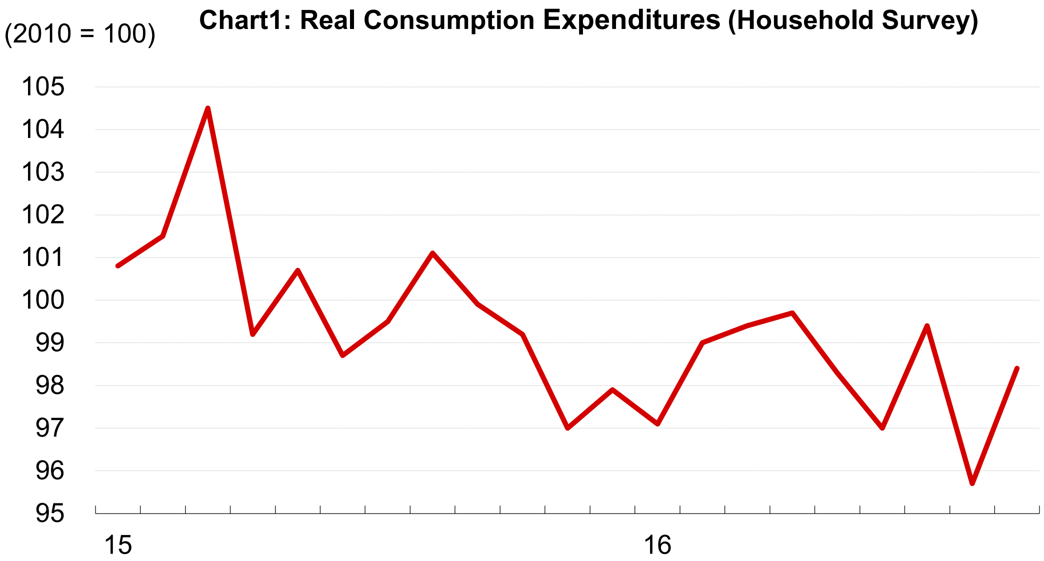
Following the unexpected victory of Donald Trump in the U.S. presidential election held on November 8, initially stock prices around the world plummeted, money flowed into bond investments, and the yen strengthened. The factor behind these trends was a shift toward risk avoidance. In his campaign speeches, Presidential candidate Trump emphasized "America First" and continued to make extreme statements, but many aspects of his pronouncements were seen as not implementable and their possible impact was unclear. This led to a trend toward avoiding risk as much as possible, and, temporarily, funds poured into safe assets. However, the day after the election, the markets in the United States were buoyed by Trump's statements regarding his promised major reduction in corporate taxes, deregulation, expansion in infrastructure investments, and these comments led to expectations of an improvement in performance of U.S. companies and expansion in the U.S. economy. This, in turn, led to sharp uptrends in stock prices, a return to U.S. dollars, and a drop in the value of the yen.

These developments, at least for the time being, brought a receding of concerns about risks that might have led to a chain of destabilizing turmoil in financial markets. In addition, markets seem to have realized it will take time to see how far Trump intends to go in implementing protectionist policies, revising U. S. foreign policy, and other issues. For this reason, the impact on the Japanese economy of the results of the U.S. presidential election was judged likely to be slight. However, the possibility remains that concerns may rise about President-elect Trump's previous strong statements and contribute to prolonged turmoil in financial markets that may have a detrimental impact on the world economy. If this should happen, it may have an adverse impact on Japan's exports. In addition, if trends toward yen appreciation and declines in stock prices arise, this could lead to a deterioration in corporate performance and in consumer and corporate psychology.

Turning to domestic economic trends, first, in the corporate sector, industrial production in September (preliminary figure) was virtually level with the previous month, which was far below the 2.2% rise predicted in the surveys of industrial production forecasts. However, industrial production in the July--September quarter rose 1.1% over the previous quarter, for the second consecutive quarter-to-quarter rise. In addition, the surveys of production forecasts call for month-to-month increases of 1.1% in October and 2.1% in November. Judging from these statistics, it appears the trend toward improvement in industrial production is continuing. Moreover, exports in real terms in September rose 1.0% over the prior month, led by increased exports to the NIEs and the ASEAN region. For the July-September quarter, exports rose 0.7%, for the second consecutive quarter-to-quarter increase, suggesting that the improvement in exports is continuing.

Turning to the household sector, the unemployment ratio in September declined to 3.0% again, and the ratio of job openings to job seekers for the same month reached 1.38 times. These and other data suggest the employment situation continues to be favorable. In September, total per capita cash compensation of workers (preliminary figures) rose 0.2% year on year, reflecting continued moderate growth, but regularly scheduled wages rose 0.4% year on year, the third consecutive monthly increase, indicating further improvement. However, consumer spending on average continues to be fluctuating within a narrow range. According to the September *Survey of Family Income and Expenditures* (covering households of two or more persons, seasonally adjusted) real consumption expenditure rose 2.8% over the previous month, but, since the temperature during the month was higher than in typical years, sales of fall clothing were lackluster and remained at a low level. On the other hand, in September, the consumer price index (comprehensive index, excluding fresh food) had declined 0.5% from the level of the same month of the previous year. Going forward, growth in wages is expected to remain moderate, but real incomes are recovering, because of the decline in consumer prices and the rise in the number of employed persons, and this will be a positive factor for consumer spending.

Looking ahead, the economy is expected to continue to show moderate improvement as exports increase gradually supported by recovery in the world economy, and the domestic economy receives a positive boost as the end of the fiscal year approaches along with the implementation of the supplementary budget for fiscal 2016. Nevertheless, it will be difficult for the tempo of improvement in the economy to increase suddenly. The positive effects of the comeback of production in automobiles and the increase in exports of materials for use in smartphones, which have supported industrial production, will run their course by the end of calendar 2016. As mentioned previously, if turmoil emerges in financial markets, there will be risk of an economic slowdown.（2016.11.30）



Source: Ministry of Internal Affairs and Communications, *Survey of Family Income and Expenditures*

2. Topic of the Month: Lower Profitability of Foreign Direct Investment vs. Inward Direct Investment

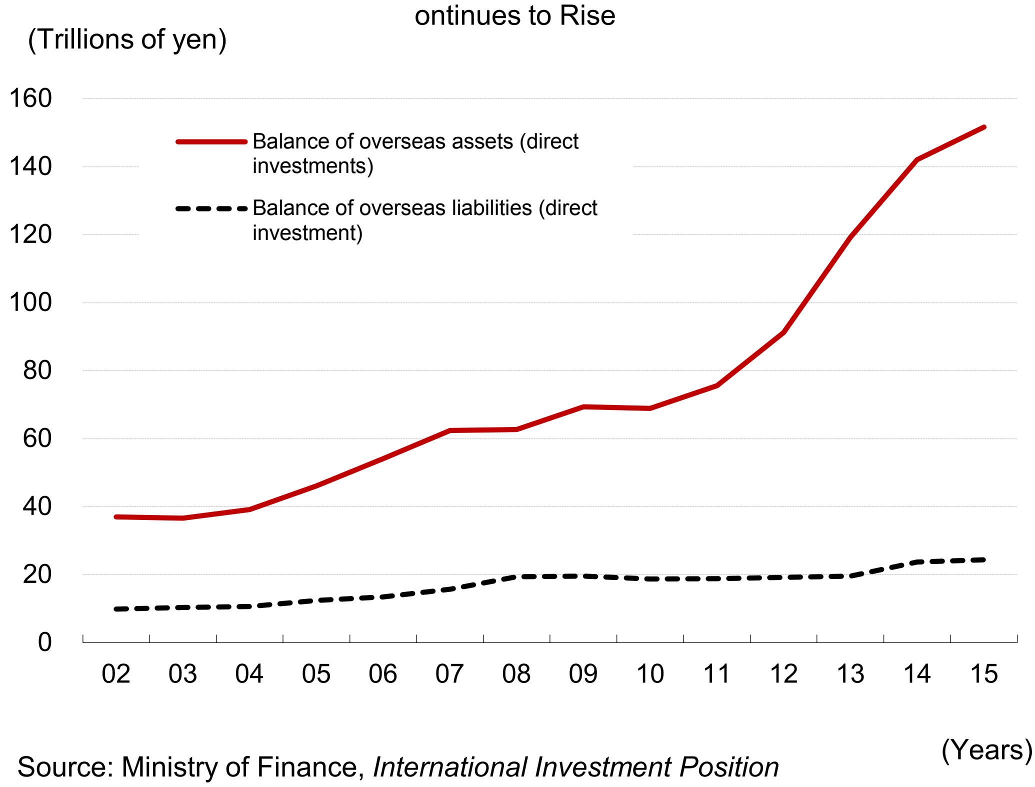
By Ruriko Toshida, Economist

Japanese companies are continuing to make aggressive robust investments overseas. Among those investments made from Japan to other countries, the direct investment balance, which measures investments and follow-on investments in corporations overseas, exceeded ¥150 trillion at the end of calendar 2015. On the other hand, although direct investments by foreign corporations into Japan are on a rising trend, the balance of such investment was only ¥24 trillion at the end of calendar 2015 (Chart 2).

As foreign direct investments by Japanese companies have risen more rapidly than inward direct investments, the surplus in the primary income balance of Japan's international balance of payments has increased and the positive current account balance has expanded.

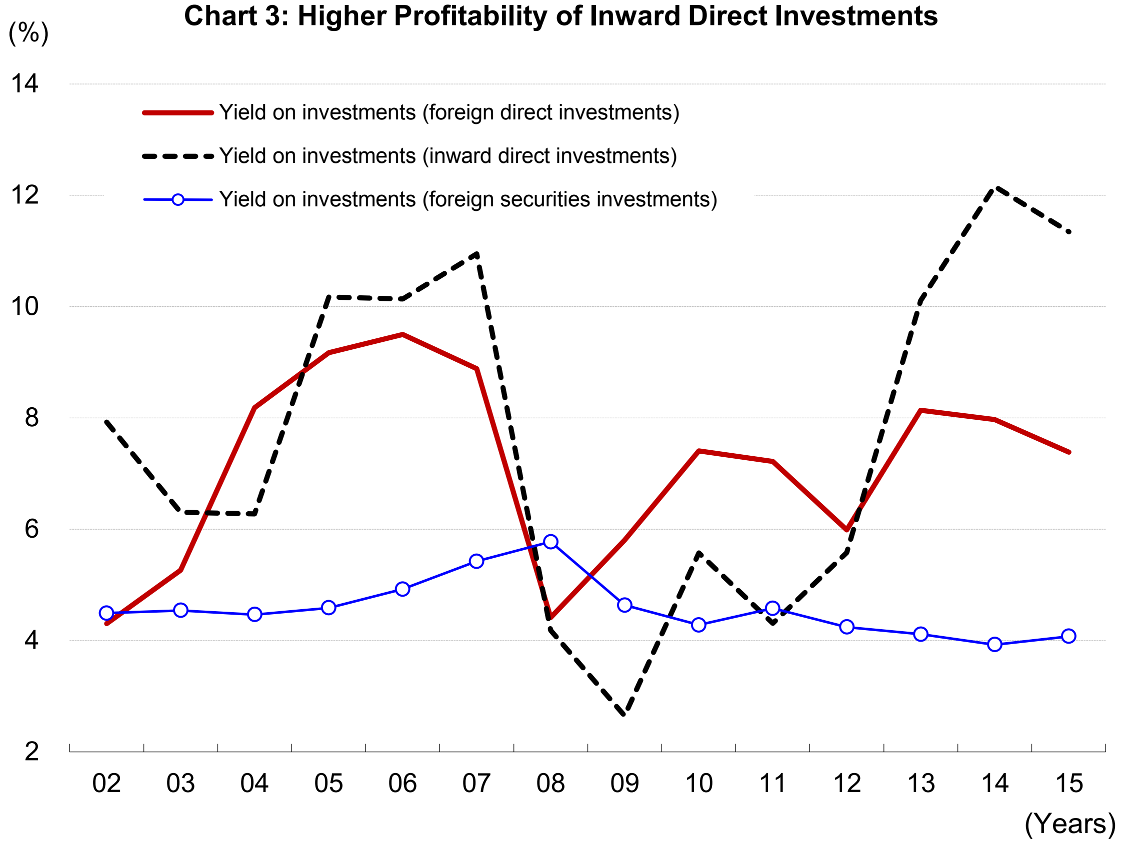
However, we wonder whether such enormous investments are securing sufficient return for the investing companies. Chart 3 shows a comparison of the return on direct investments and investments in securities. In 2015, the return on foreign direct investments was 7.4%, which was higher than the 4.1% earned on foreign securities investments. However, direct investment coming from overseas (inward direct investments) earned an even higher return of 11.3%. Although the amount of inward direct investment in Japan is relatively small, it appears that such investments are more effective in generating income than foreign direct investments (direct investments from Japan to other countries). There is a possibility that Japanese companies are directing so much attention to investing overseas that they are overlooking highly profitable opportunities in Japan. The outlook is for Japanese companies to continue to increase their foreign direct investments and securities investments because of concerns about low interest rates in Japan and the decline in demand in the domestic market. However, another review of opportunities close to home might lead to the discovery of profitable investments in Japan.　(2016.11.30)

Chart 2: The Balance of Foreign Direct Investments ontinues to Rise



Source: Ministry of Finance, *International Investment Position*

Chart 3: Higher Profitability of Inward Direct Investments



Note: Yield on investments = Investment income ÷ (Average balance of investments at the end of previous period and balance at the end of the current period) x 100
Source :Ministry of Finance, *International Investment Position* and *Balance of Payments*