

20 January 2017

## Economic Report

## Global Watch December 2016

### 1. Overview of the Japanese Economy:

#### Continuing to Fluctuate within a Narrow Range with Signs of Improvement in Some Areas

By Shinichiro Kobayashi, Principal Economist

The Japanese economy is continuing to fluctuate within a narrow range, but some signs of improvement are emerging.

The index of industrial production (final figure) in October was level with the previous month, but is judged to be showing continuing signs of improvement. Factors leading to this judgment are (1) on average the improving trend appears to be sustained, (2) shipments expanded a firm 2.0% over the previous month and demand is not weak, (3) inventories decreased 2.1% from the previous month and have now declined to the lowest level since April 2014, suggesting pressures for inventory adjustments are receding, and (4) the surveys of production forecasts call for a major increase of 4.5% in November (and for a decline of 0.6% in December). Therefore, there is a possibility of an increase in production for the October-December quarter, which will be the third consecutive quarterly rise. Increases in production in the automobile and electronic components and devices industries are boosting the overall level of production.

Exports in real terms posted a firm increase of 3.4% over the previous month in November. This was the fourth consecutive monthly rise, and exports have improved to the level prevailing just before the collapse of Lehman Brothers. As with industrial production, automobiles, smartphone-related electronic components and devices were especially favorable.

Moreover, a movement toward improvement in corporate performance has emerged. The July-September quarter data for incorporated enterprises shows a continued rise of 7.9% over the previous quarter in ordinary profit. Although a major increase in interest received, etc., by corporate holding companies was a special factor behind this rise, sales rose over the previous quarter for the first time in seven quarters, and profit of manufacturing companies continued to increase over the previous quarter. These factors suggest that sales and profit are on an improving trend, and the deterioration in corporate performance is believed to have passed through its worst phase. However, private capital investment (in nominal terms) remained virtually level, rising 0.4% for the quarter.

Amid these developments, taking account of the results of the coincident index (CI) of economic trends in October, the Cabinet Office revised its judgment about the economy upward, from “marking time” to “improving.” This was first upward revision in judgment about economic conditions in 22 months.

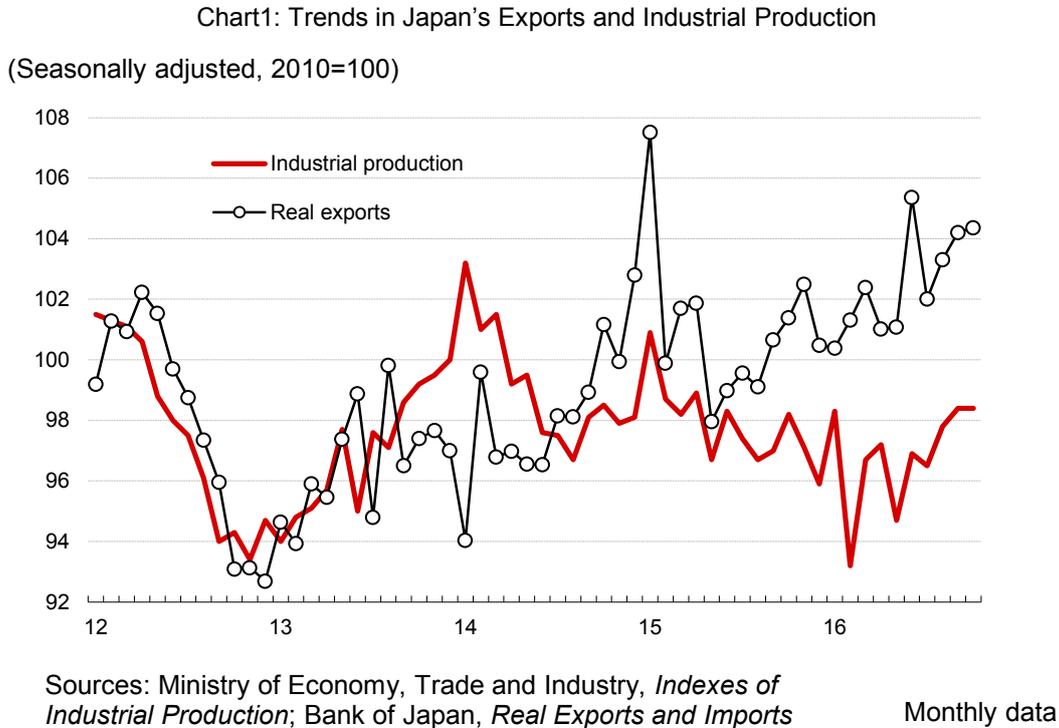
In the household sector, the unemployment ratio in October was a low 3.0%. In addition, the ratio of job openings to job seekers rose to 1.40, and these and other indicators suggest that favorable employment conditions are continuing. Total per capita cash compensation of workers (preliminary figure) in October was up a marginal 0.1% over the same month of the previous year, but scheduled wages showed signs of improvement and were up 0.3% year on year, the third consecutive monthly year-on-year increase.

However, according to the October *Survey of Family Income and Expenditures* (covering households of two or more persons, seasonally adjusted), real consumption shifted downward, falling 1.0% from the previous month. These and other factors suggest that, on average, household incomes are fluctuating within a narrow range. Nevertheless, household incomes are continuing to show improvement, supported by the rise in the number of employed persons. Thus, although the environment for consumer spending is not unfavorable, the prices, mainly of fresh food, increased, reflecting the impact of unseasonable weather during the summer, and this tended to depress real consumption. Note, however, there are some positive movements, including the fact that the number of new automobile registrations in November (for passenger automobiles, excluding light automobiles) was up a robust 16.2% year on year, in part because of the positive impact of the introduction of new models.

Even after the U.S. presidential election on November 8, the expectations of expansion in the U.S. economy have continued, and, in financial markets, the “Trump” market has continued, with U.S. stocks rising, the U.S. dollar strengthening, and interest rates rising. On the other hand, accompanying the rise in the value of the dollar, the currencies of emerging countries have depreciated, and some countries have resorted to raising their interest rates to defend their currencies, thus bringing the risk of a slowdown in the world economy. In addition, the concern continues that extreme statements by the newly elected President Trump may again create turmoil in financial markets and suddenly wipe away positive expectations about the world economy. At present, the U.S. economy is expanding steadily under the Trump administration, but we cannot have excessive expectations about the U.S. economy being the driving force for the world economy.

Going forward, although there is a possibility that consumer spending in Japan may continue to be weak, it seems likely that, along with the recovery in the world economy, Japan’s exports may rise moderately and the positive effects of the implementation of the supplementary budget for fiscal 2016 will gradually strengthen as we approach the fiscal year-end. This is expected to bring moderate improvement in the economy. However, there is a possibility that the current increase in production due to the comeback in automobile production and the rise in exports of smartphone related materials may run its course by the end of this year, and this will make a sudden rise in the pace of increase in exports difficult. Moreover, the risk remains that the emergence of turmoil in financial markets may lead to greater concern about deterioration in the world economy and an economic

downturn. (2016.12.20)



## 2. Topic of the Month: Reasons for the Increase in Cash Held at Home by Households

By Ruriko Toshida, Economist

As of November 30, 2016, the amount of Bank of Japan notes in circulation had reached ¥97.4 trillion (a year-on-year increase of 4.6%). Since this figure tends to increase at the end of the year, the outlook is for notes in circulation to rise to more than ¥100 trillion at 2016 year-end. Households have more than 80% of these notes, and the increase will be largely due to households holding more cash notes. The total cash held by households has been increasing more than ¥4 trillion for three consecutive quarters (Chart 2).

Examination of recent trends among households shows that the number of employed persons is rising and that worker compensation, which is total household income, is increasing, but recently, the propensity to consume is declining. In other words, households are restraining their consumption and are tending to increase their savings. Usually, worker wage incomes are transferred directly to their deposit accounts, and it is thought that the unused portion accumulates, thereby raising the ratio of deposits to total cash and deposits. However, in actuality, the

ratio of cash is rising (Chart 3). It is thought likely that consumers are deliberately keeping more cash at home than is necessary for their daily lives, and there is the possibility that cash stashed away at home is rising. What is the reason for this rise in the tendency among households to hold cash?

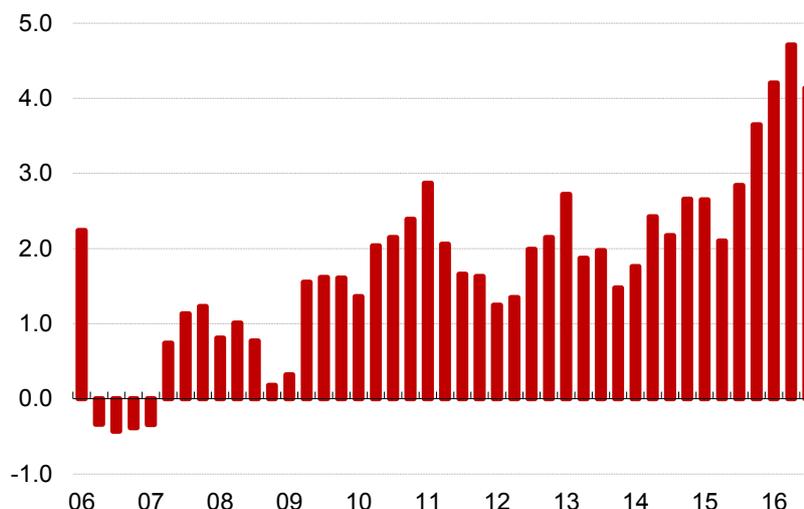
Historically speaking, around 2010 to 2011, the increase in the ratio of cash holdings coincided with a period of deterioration in the global economy following the collapse of Lehman Brothers and the Great East Japan Earthquake. At that time, the rise in social uncertainty is thought likely to have encouraged households to hold cash.

However, recently, there have been no events that would lead to a rise in social uncertainty. On the other hand, there are a number of systemic and policy changes taking place in the background in the financial field. These include the introduction of the “my number” social security system. It has been pointed out that, since some individuals may not want to disclose the actual amount of their savings to the government, they may have a stronger need than before to reduce their deposits. In addition, as a result of the decline in interest rates, the motivation to save money in deposits has diminished. Moreover, since the beginning of 2016, a negative interest rate policy has been introduced, and concerns have risen about deposit interest rates turning negative temporarily. As a result, there is a possibility that households are taking steps to avoid a decline in their deposits.

In actuality, although positive deposit interest rates are being maintained, the level of interest rates is extremely low. In addition, since under certain conditions, when depositors withdraw their deposits, they may incur fees, and, because deposits are less attractive than in the past, there is a possibility that the increase in cash held at home may continue to increase. (2016.12.20)

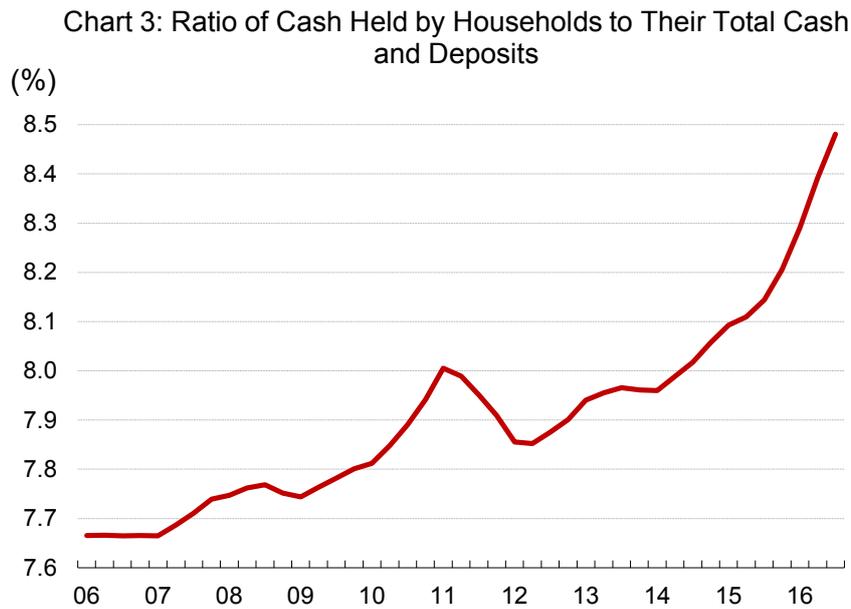
Chart 2: Cash Held by Households

(Year-on-year change, ¥ trillion)



Source: Bank of Japan, *Flow of Funds Statistics*

(Quarterly data)



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(Quarterly data)

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