17 March 2017

Economic Report

Global Watch February 2017

1. Overview of the Japanese Economy:Showing Moderate Improvement

By Shinichiro Kobayashi, Principal Economist

The Japanese economy is gradually showing improvement, led by the corporate sector.

Corporate activities are strengthening and are becoming the driving force for improvement in the economy. First, the rising trend in production is continuing. In December, the index of industrial production (final figure) increased 0.7% over the previous month. In the October–December quarter, production rose 2.0% over the previous quarter, which was the largest quarter-to-quarter increase since the January–March quarter of 2014 (+2.3%) at the time of the surge in demand prior to an increase in the consumption tax rate. Inventories in December rose 0.6% over the previous month, the fourth consecutive month-to-month rise, but the level of inventories remains low and pressures for inventory adjustments remain weak. The surveys of production forecasts for January and February call for increases in both months (+3.0% and +0.8%, respectively), but even after taking into account the fact that actual increases have recently been lower than the forecast levels, there is a strong possibility that industrial production in the January–March quarter will rise for the fourth consecutive month. (Trial calculations indicate that even if the production index remains flat from January onward, the index in the January–March quarter will show a rise of 1.0% over the previous quarter.) Data by industry show the rise in the transport machinery and electronics components/devices sectors will continue and boost overall production.

Exports are showing improvement. In January, exports in real terms were down 1.1% from the previous month, the second consecutive monthly decrease, but, on average, the improving trend is continuing, and the level of exports continues to be high. In the October–December quarter, exports were up 2.8% from the previous quarter, the third consecutive quarter-to-quarter rise. As with production, performances of automobiles and smartphone-related electronic components and devices were favorable.

On the other hand, improvement in the household sector is lagging. The unemployment ratio in December was a low 3.1%, as in the previous month, and the ratio of job openings to job seekers rose from 1.41 times in the previous month to 1.43 times, suggesting that employment conditions are continuing to be favorable. In addition, total per capita cash compensation of workers (final figure) in December rose a somewhat high 0.5% over the previous year, and scheduled wages were up 0.4% for the fifth consecutive monthly increase, indicating that movements toward improvement in wages have become visible. However, although the number of new car registrations in January rose a robust 8.9%, in part because of the introduction of new models, according to the

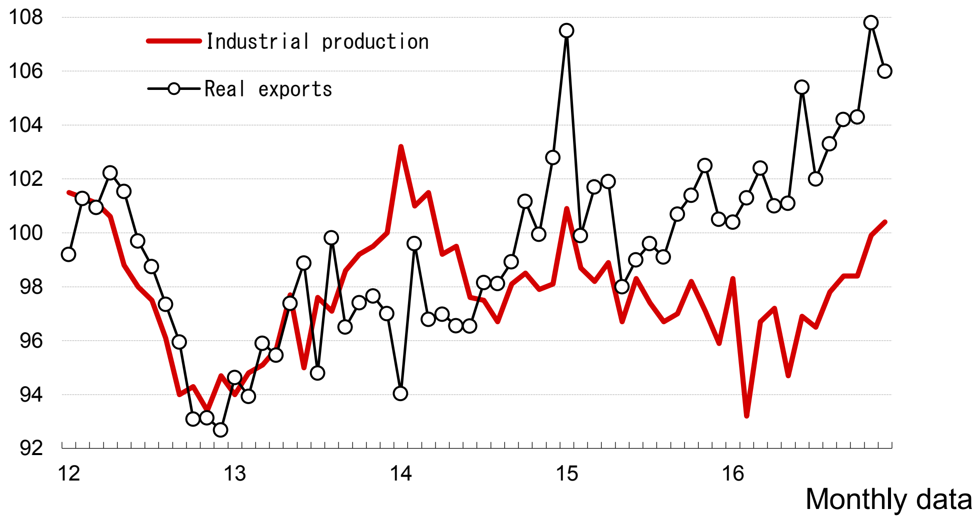
December *Survey of Family Income and Expenditures* (covering households of two or more persons, seasonally adjusted), real consumption decreased 0.6% from the previous month, the third consecutive monthly decrease, suggesting that there are some areas of weak movements, but, on average, consumer spending is continuing to fluctuate in a narrow range.
In the United States, attention in January was focused on President Trump's inaugural address, but it contained no new information regarding the economy or fiscal policy. Even on the White House website, which was renewed following the inauguration, although previous topics were mentioned, including such policies as the withdrawal from the TPP (Trans-Pacific Partnership), the renegotiation of NAFTA (North American Free Trade Agreement), progress toward job creation, and the reduction in taxes, no specific details on policies were announced. As a result, attention is now focused on the President's upcoming address to a joint session of both houses of Congress and the budget message. On the other hand, while the rise in the value of the U.S. dollar and increases in interest rates, which had been continuing after the presidential election, subsided after the beginning of 2017, the stock market, where expectations regarding policies are strong, began to set new record highs on a daily basis beginning in mid-February. Feelings of caution about high stock prices are rising, and, if what is new in the Trump administration's policies does not becomes evident, there is a risk that disappointment may set in temporarily.

In Japan, attention is focusing on the direction of 2017 spring wage negotiations which began in earnest in February 2017. Corporations are advocating wages on an annual basis, and, while bonuses may rise on the one hand, it appears that the margin of increase in base wages may fall below the margin last year. For this reason, going forward also, the rate of increase in wages, including the increase in bonuses, will only be moderate. Moreover, as a result of the impact of the bottoming out of energy prices and the decline in the value of the yen, upward pressure on prices is gradually strengthening. Already in January, the domestic corporate goods price index was up 0.5% over the previous year, thus moving into the positive range for the first time in 22 months. The consumer price index (comprehensive index, excluding fresh food) is also expected to move into the positive range in early spring, and this may restrain growth in real wages.

In the domestic economy, the boosting effects of the supplementary budget for fiscal 2016 may begin to strengthen as we approach the end of the fiscal year, and there is a strong possibility that moderate improvement in the economy will continue. However, if the slowing of growth in real wages results in weaker consumption, the pace of improvement in the economy may slow.(2017.2.27)

Chart 1: Indexes of Industrial Production and Real Exports

(Seasonally adjusted, 2010=100)



Sources: Ministry of Economy, Trade and Industry, *Indexes of Industrial Production*;
Bank of Japan, *Real Exports and Imports*

2. Topic of the Month:
Automobile Exports to the Unite States: Quantity Falling but Value Rising

By Ruriko Toshida, Economist

Since the inauguration of President Trump, he has expressed dissatisfaction regarding the U.S. trade deficit and criticized China and Japan by name for their large trade surpluses with the United States.

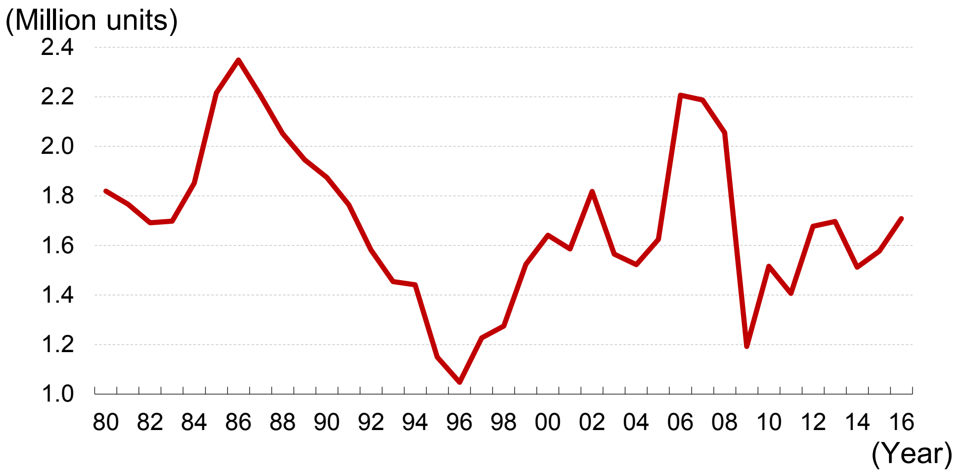
Within Japan, the automobile industry is the target of criticism, but, in the 1970s and 1980s also, trade in automobiles became a source of trade frictions. Looking at that era, in 1978 and 1979, just before Ronald Reagan became president, imports of cars into the United States expanded, sales of U.S. automakers weakened, and this led to an increase in unemployment and other social issues. On the other hand, along with the increase in exports, the annual volume of production in Japan in 1980 rose to more than 10 million, and Japan became the world's leading manufacturer of automobiles. In 1981, along with the rise in dissatisfaction because of the trade frictions, Reagan was inaugurated as president and immediately thereafter Japan introduced self-restraints on exports. Moreover beginning the next year, Japanese automobile companies began to manufacture in the United States. Subsequently, the framework for automobile exports was expanded gradually, and the number exported rose to 2.348 million in 1986, when it reached a peak, and declined in 1987 and thereafter. After that, under the background of a deterioration in profitability of exports due to the sharp appreciation of the yen, Japanese automakers shifted to full-scale production in the United States (Chart 2).

In 2016, auto exports to the United States amounted to 1,708 million units, which represented about 70% of the level in 1986. Also, since then, Japanese automobile companies have increased local production in the United States, and the trade environment has changed substantially since the 1980s. For this reason, President Trump's belief that the same kind of trade frictions as in the Reagan era are occurring could be viewed as inappropriate.

However, from the U.S. perspective, one can take a different view regarding automobile imports. Chart 3 shows Japan's exports to the United States in dollar terms. Compared with 1986, when the unit volume of car exports reached a peak, the value of imports into the United States has increased 2.5 times. From the U.S. perspective, the value of imports has expanded significantly. In actuality, of the total value of the U.S. trade deficit with Japan, which amounted to $68.9 billion, automobiles accounted for $39.4 billion, and, if auto parts are included, the amount rises to $52.6 billion, which is a very high percentage of the U.S. deficit with Japan. (U.S. Department of Commerce, *Trade Statistics,* customs-clearance basis)

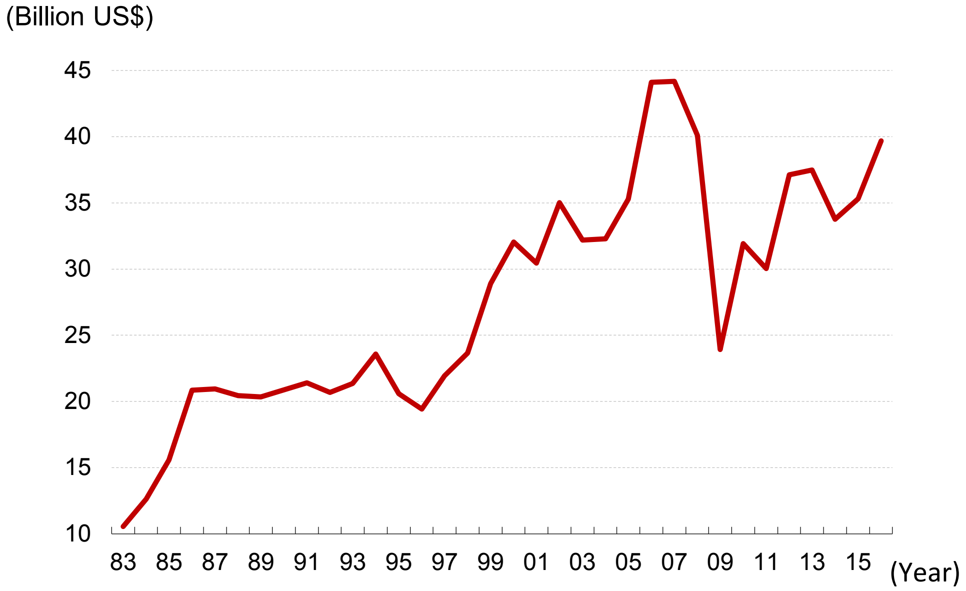
The reason for the ballooning of the value of automobile imports into the United States on the one hand and the decline in the unit volume of exports has been an improvement in automobile features and an accompanying rise in the unit price of autos ($8,900/car in 1986 versus $23,200 in 2016). This rise in value added per car is still continuing, and, as exports from Japan of hybrid vehicles (HVs) and sports utility vehicles (SUVs) increase, the value of exports from Japan in dollar terms grows larger and larger. Even if Japan insists that "this is a different situation than what happened in the 1980s," as long as automobiles account for the largest portion of the U.S. trade deficit, Japanese automobile companies will continue to be the target of President Trump's verbal attacks. (2017.2.27)

Chart 2: Automobile Exports from Japan to the U.S. in Unit Terms



Source: Japanese Automobile Manufacturers Association, Inc., *Production and Export Summary*

Chart 3: Automobile Exports from Japan to the U.S. in Value Terms (U.S. Dollars)



Source: Ministry of Finance, *Trade Statistics of Japan*