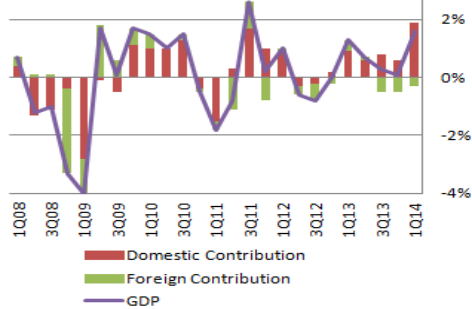




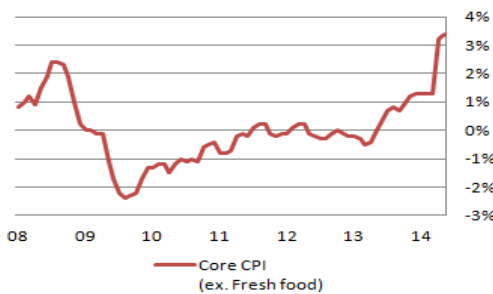
British Embassy
Tokyo

JAPAN: JUNE 2014 MONTHLY ECONOMIC REPORT

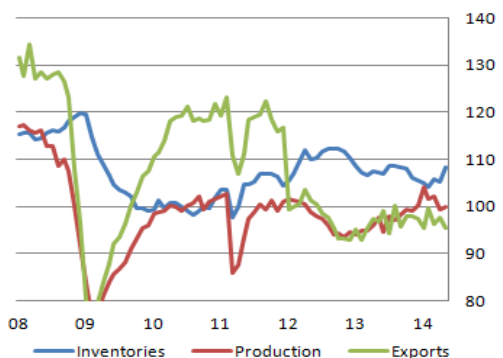
GDP



CPI (YoY%)



Production and exports



Key Points

- PM Abe announces new Growth Strategy
- BOJ becomes largest holder of Japanese Government Bonds
- EU approves continuation of EPA negotiations with Japan

Main Economic Indicators

	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14
GDP (QoQ%)	0.0	1.3	0.7	0.3	0.1	1.6
	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14
CPI (core, YoY%)	1.3	1.3	1.3	1.3	3.2	3.4
Unemployment rate (%)	3.7	3.7	3.6	3.6	3.6	3.5
Industrial production (YoY%)	7.1	10.6	7.0	7.4	3.8	0.8
Exports (YoY%)	15.3	9.5	9.8	1.8	5.1	-3.6
Imports (YoY%)	24.7	25.0	9.0	18.1	3.4	-2.7

(This report reflects data available up to 1 July 2014.)

GOVERNMENT POLICY

1. The Government released an updated Growth Strategy on 24 June. It includes new measures on labour market reform, corporation tax and increasing the Japanese workforce as well as further reforms in the agricultural and medical industries. While not a game-changer, it should reinforce Abe's reformist credentials.
2. The Diet session ended on 22 June. The Government had submitted thirty one bills related to last year's Growth Strategy to the Diet. All but two passed given the Government's majority in both houses. These included an Electricity Market Reform bill which should enable full liberalisation of retail electricity market by 2016. This is the first change in the electricity market in almost 60 years.
3. The Ministry of Health, Labour and Welfare (MHLW) released its regular 5 year review on the health of Japan's public pension system. The report illustrates eight different scenarios with various assumptions on economic growth and working population. Three of these assume relatively low economic growth and no meaningful improvement in labour participation rates. In these, the average pension payment is forecast to be lower the Government target of pensions providing more than 50% of a current worker's earnings. The other five scenarios' which do achieve this target all require that the pension funds increase by at least 4% annually. This could be used as a reason to encourage public pension funds to move to riskier assets.

ECONOMY

4. Consumption data in May was mixed. Retail sales fell 0.4% compared to a year ago. This was an improvement from a 4.3% decline in April. But household survey showed that household expenditure in the month dropped 8.0% (YoY), compared to a 4.6% fall in April. Nonetheless, the Government upgraded its assessment on private consumption slightly.
5. The Bank of Japan's (BOJ) Tankan survey reported lower business confidence for the first time in 18 months. This was not unexpected given April's VAT increase. Most firms expected any negative impact to be short-term and as such have upgraded their FY2014 capital investment plans.
6. Core CPI in May (excluding fresh food) rose 3.4%. This is the highest rate in more than 32 years. Excluding the impact from April VAT increase, it would probably have risen 1.4%. This is lower than the 1.5% in April. As the depreciation of the Yen starts to fall out of the CPI figures, BOJ Governor Kuroda has stated that the level of inflation could fall to around 1% (ex-VAT) before increasing later this year. The June preliminary core CPI figures for the Tokyo area, a leading indicator of nationwide CPI was unchanged at 2.8%.

7. Japan's trade deficit was 909bn yen (£5.3bn). This is the 23 consecutive monthly deficit. Strong demand for imported fuel continues to be a major source of the deficit as Japan's nuclear reactors remain closed.
8. The Current Account balance was the lowest monthly surplus [187.4 bn yen (£1.09bn)] in April since 1985. The trade deficit and a decline in income contributed to the weaker surplus. However, the travel balance was a surplus for the first time in 44 years due to more foreign tourists in Japan. Japan's tourism industry accounts for 3.5% of GDP. The Government hopes to increase this to 20 million by 2020. There were 5.2 million visitors during Jan-May 2014. This is a faster pace than last year when Japan recorded 10 million visitors.
9. Japan's economy grew more than initially estimated in Q1 2014. Revised figures show it grew at an annualised rate of 6.7% (originally estimated: 5.9%). Higher private sector capital investment led the revision upwards coming in at 7.6% qoq (originally 4.9%), more than offsetting downward revisions in private inventories, and public investment.
10. The number of births recorded fell to a new low of 1.02 million in 2013, However, this represents a slight increase in the birth rate slightly from 1.41 in 2012 to 1.43.

TRADE POLICY

11. The EU successfully concluded its one year review of the EU-Japan EPA on 25 June. All Member States accept that Japan had made sufficient progress in the first year but that some key issues remained to be resolved. The next round of EU-Japan talks will be held in Tokyo during July.
12. The US-Japan TPP negotiations held in Washington in early June made limited progress. Some commentators expect progress to be achieved after US mid-term election in November. The Obama administration views the APEC Ministerial in November as the next key deadline to conclude a broad agreement. US and Japan held a working-level meeting in Tokyo on 30 June to 2 July ahead of the Chief Negotiators meetings in Ottawa from 3 July. ASEAN+6 nations also held a 5 round of negotiations on the Regional Comprehensive Economic Partnership (RCEP) FTA in Singapore on 21-26 June.

ENERGY AND ENVIRONMENTAL ISSUES

13. The second of three Electricity Market Reform bills passed in the Diet. This aims to liberalise the retail electricity market in 2016. Currently, households and small retailers, which account for 37% of the retail market, are only allowed to buy electricity from their regional utility, which has a monopoly position in their area. Full liberalisation of the retail market, which is estimated to be worth 7.5 trillion JPY (£43 bn), will allow consumers to buy electricity from the firm of their choice.

PRIVATE SECTOR

14. Against a backdrop of higher corporate profitability, several major firms announced plans to increase investment in Japan. According to a Nikkei survey, Toyota plans to invest 500bn yen (£2.9bn) domestically in FY2014, its highest level since 2008. Toshiba will invest 320bn yen (£1.9bn) on enhancing its semiconductor production facilities. Aeon will also increase domestic investment by 30.8% to 530bn yen (£3.1bn) to open large-scale shopping centres. Total amount of R&D expenditure by 7 car makers is to be the largest in FY2014 (2.4 trillion yen, £14bn). Daiichi Life is to buy US Protective Life for over 500 bn yen (£2.9bn) to broaden its overseas business beyond Asia.
15. Patent applications in high tech fields are dominated by Japanese, according to the Japanese Patent Office. In the field of big data analysis, firms such as Hitachi, Fujitsu and NTT all rank among the top five. In autonomous vehicles, Toyota ranks first.

MARKETS

16. Foreign equity ownership accounted for 30% of Japanese equities for the first time in FY2013. This suggests overseas money has underpinned domestic equity markets over past year. PM Abe urged Government Public Investment Fund (GPIF) to consider shifting funds from JGB holdings to riskier asset classes such as equity. In addition, total assets in NISA (Nippon Individual Saving Accounts) reached 1 trillion yen (£5.8bn) in the first three months following their launch. Again helping to underpin markets.
17. The BOJ 's JGB holdings increased 57.2% YoY to 201 trillion yen (£1.2 trillion) as at the end of March 2014. The BOJ now accounts for 20.1% of all outstanding JGBs, exceeding the level of holdings held by the insurance industry. Meanwhile, China reduced its JGB holding by 6.2 trillion yen (£36bn) to 14.3 trillion yen (£82bn) for the past year (2012-2013).

COMMENT

18. Abenomics depends on the successful implementation of the Growth Strategy. Markets do not seem as disappointed as they were last June. However, this could mean that the Government has successfully managed market expectations or that these have been lowered. Japan's rate of growth potential is estimated to be 0.5%-1.0%. The Government is targeting 2% sustainable growth. Thus, it needs real, substantive reforms to achieve this.

Chart 1: CPI

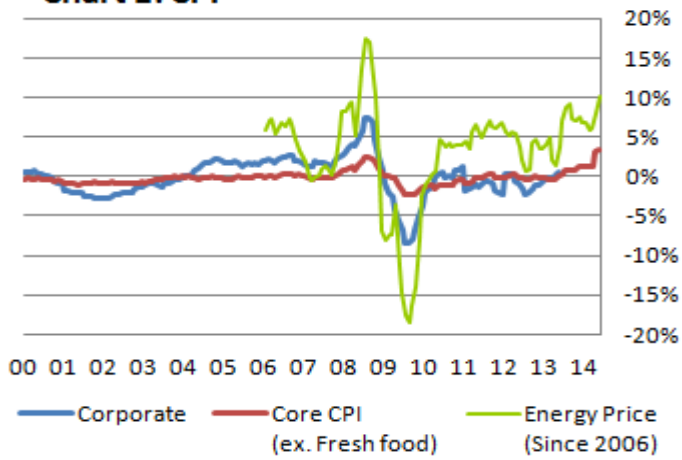


Chart 2: Labour Market

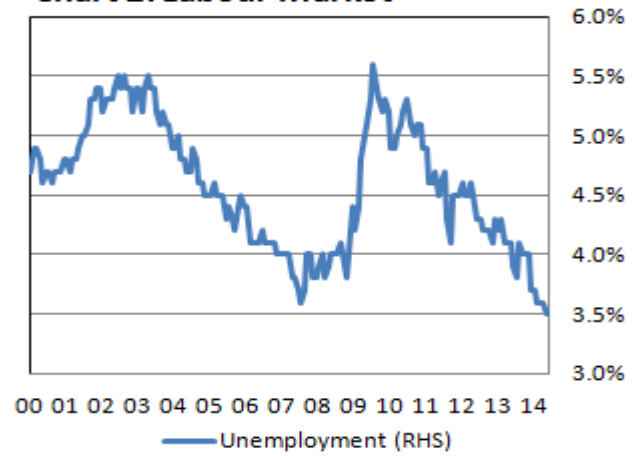


Chart 3: Wages



Chart 4: GDP

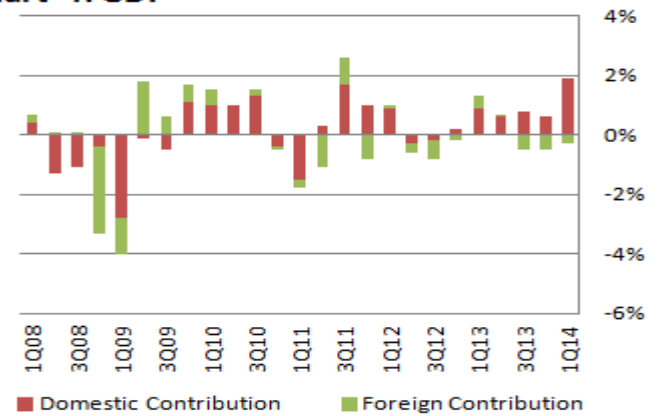


Chart 5: Stock Market

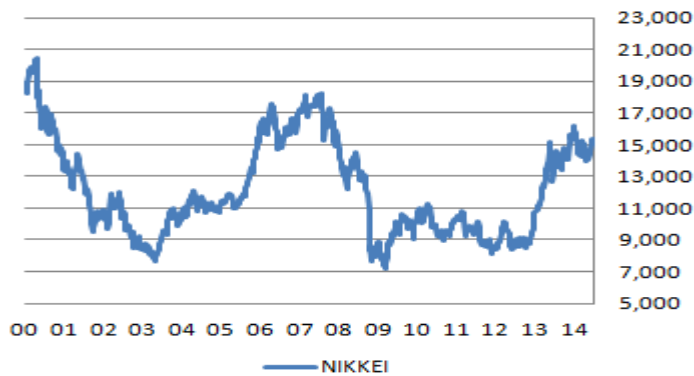


Chart 6: Yen

