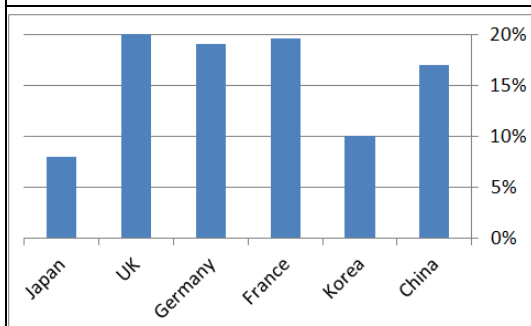




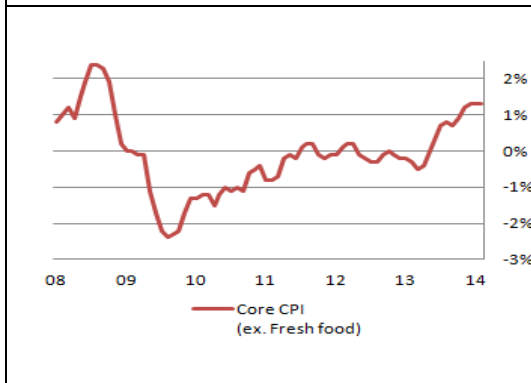
British Embassy
Tokyo

JAPAN: MARCH 2014 MONTHLY ECONOMIC REPORT

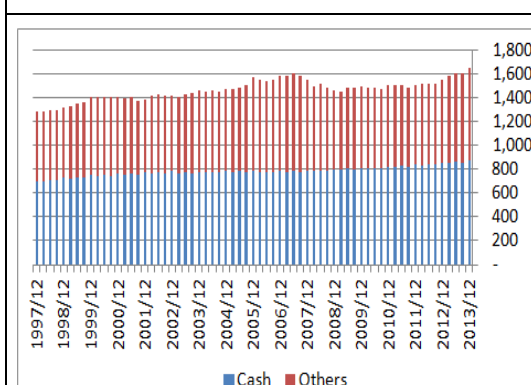
VAT comparison



Core CPI (YoY%)



Household financial assets (trillion yen)



Key Points

- Government raises consumption tax from 5% to 8% on 1 April
- BOJ Governor Kuroda remains confident on reaching its inflation target
- Household financial assets reach their highest ever level of 1645 trillion yen (340% of GDP)
- Major firms such as Toyota agree to raise wages

Main Economic Indicators

	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13
GDP (QoQ%)	-0.8	0.0	1.1	1.0	0.2	0.2
	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14
CPI (core, YoY%)	0.7	0.9	1.2	1.3	1.3	1.3
Unemployment rate (%)	4	4	4	3.7	3.7	3.6
Industrial production (YoY%)	5.1	5.4	4.8	7.1	10.6	-
Exports (YoY%)	11.5	18.6	18.4	15.3	9.5	9.8
Imports (YoY%)	16.5	26.1	21.1	24.7	25.0	9.0

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

GOVERNMENT POLICY

1. The Bank of Japan (BOJ) decided to keep its current monetary policy unchanged. Governor Kuroda stated that he remains confident the BOJ will reach its 2% inflation target without further action at a press conference after the decision was announced.
2. Japan's consumption tax (VAT) increased on 1 April from 5% to 8%. This is the first consumption tax increase in 17 years. Japanese retailers are now allowed for a period of 3 years to display prices including or excluding tax, with many choosing the latter to appear more appealing to price-sensitive consumers. Other retailers are using this change to introduce higher price rises (8%+). The impact on overall consumption will be a key question for policy-makers in coming months.
3. The Government announced the first regions designated as "National Strategic Special Zones": greater Tokyo, the Kansai region (including Osaka and Kyoto) and Okinawa. Niigata, Yabu and Fukuoka were named as special zones for innovative business. Details remain sketchy, but planned deregulation in these zones looks likely to be low-level (eg relaxing rules on foreign doctors) rather than the major moves such as labour market deregulation or tax benefits which would be needed to attract foreign investment.
4. A Corporate Tax Study Group, created by the Tax Commission (a government advisory body) has started looking at the feasibility of cutting Japan's corporation tax rate. Suggestions by the Study Group are to be submitted to the Commission by June when the Government plans to announce a new Growth Strategy. The Government reiterated recently it would like to see the tax lower in FY2015.
5. The Government announced that it considered Bitcoin a commodity rather than a currency. Mt. Gox, an online Bitcoin exchange based in Tokyo, filed for bankruptcy in February. Chief Cabinet Secretary Suga, the Government's chief spokesman stated 'it will consider further responses if needed'.
6. The Ministry of Health, Labour and Welfare (MHLW) started its regular 5 year evaluation process of the pension system. The MHLW review could lead to a range of reforms, including to its fund management arrangements and the system itself. Reforms being considered include extending contributions to 65 (from 60) and increasing the qualifying age for pensions above 65.
7. The FY2014 budget passed on 20 March. The budget of 95.88 trillion yen (£560bn) is Japan's largest ever.

ECONOMY

8. The unemployment rate fell to 3.6% in February, its lowest level since July 2007. The Corporate Service Prices Index (CSPI) reported its first year-over-year (YoY) increase

(0.5%) in 21 years, suggesting that wages are starting to place upward pressure on prices. Monthly machinery orders in January were much stronger (13.4%) than market expectations (7.1%), indicating improving business sentiment. In addition, households' financial assets reached 1645 trillion yen (340% of GDP) as of December 2013. This is their highest ever level and is largely due to equity holdings increasing by 38.5% over the year.

9. However, the Cabinet Office slightly downgraded its assessment on consumer sentiment. This reflects concerns over the impact of the consumption tax rise over the next 6 months despite strong demand in Q1.
10. February's trade deficit was 800bn yen (£4.7bn). This is the twentieth consecutive monthly deficit. Imports have increased 9.0% in value, over the year reflecting both healthy domestic demand and robust energy consumption. Volume exports were up 5.4%, the fastest in three months, suggesting a sign of their recovery.
11. Core CPI inflation (excluding fresh food) remained at 1.3%- its fastest rate since October 2008. However, the Corporate Goods Price Index (CGPI) in February fell to 1.8% from 2.5% as the impact of the depreciation of the Yen weakened, suggesting less pressure on firms to raise their prices.

TRADE POLICY

12. Australia and Japan have been trying to reach an agreement on their bilateral FTA. The main issue left to resolve is around access to Japan's agricultural markets. The 5th round of EU-Japan EPA negotiations is taking place in Tokyo between 31 March - 4 April. Both sides hoped to be able to exchange first market access offers.
13. Nippon Export and Investment Insurance (NEXI) is to triple its upper limit of coverage to 30bn yen (£175ml) in April. This change aims to reduce the risk for Japanese firms not being able to collect payments for exports. In particular, it is hoped this will promote more trade with emerging markets such as the Middle East and Asia.

ENERGY AND ENVIRONMENTAL ISSUES

14. The Nuclear Regulation Authority has announced that it would prioritise safety assessments for Kyushu Electric Power's Sendai power plant, one of ten sites under review (a total of 17 reactors). The two reactors at the site could restart as early as this summer, if they could pass the remaining safety checks.

PRIVATE SECTOR

15. Major firms such as Toyota and three of Japan's biggest banks have agreed to increases in the basic salaries of their employees from April 2014. Manufacturers are also expected to

hire 13.4% more college graduates in April 2015, the first such double-digit increase in three years.

16. According to the Japan Automobile Manufacturers Association (JAMA), car sales are expected to fall by 15% to 4.75 million units in FY2014. This reflects the fact that demand for durable goods such as cars and other white goods has been strong as consumers sought to avoid the VAT increase.

MARKETS

17. The BOJ increased its share of Japanese Government Bond (JGB) holdings from 17.4% (September 2013) to 18.6% (end 2013), as it continues to implement its QQE monetary policy. The BOJ held 183 trillion yen (£1.08 trillion) worth of JGBs, which is a 68 trillion yen (£400bn) increase over the same time a year ago. The BOJ's share remains the second highest after the insurance sector at 19.6%.

COMMENT

18. The immediate risk for Japan's economy is the April VAT rise and its impact on the economy. The consensus view is that there will be a sharp contraction in Q2 GDP, followed by a positive turnaround in Q3.

19. The Q3 GDP figure will be a key data point in deciding whether Japan raises VAT again in October 2015. The Government has announced that in addition to its previously announced 5.5 trillion Yen (£32bn) stimulus package, it will frontload other government capital spending so that more than 60% takes place by September. This should be enough for the Government to go ahead with the further VAT rise, with one of Abe's policy advisors saying 2-3% growth in Q3 would be sufficient.

Questions and comments welcomed.

Sunil Sood (2nd Secretary) & Akira Maekawa (Economist)

Chart 1: CPI

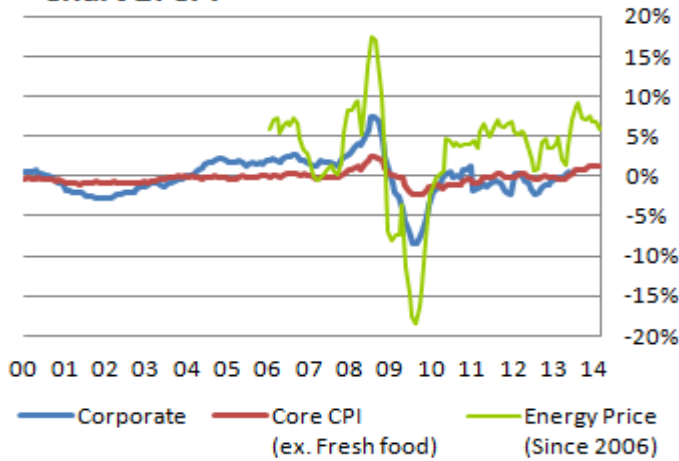


Chart 2: Labour Market

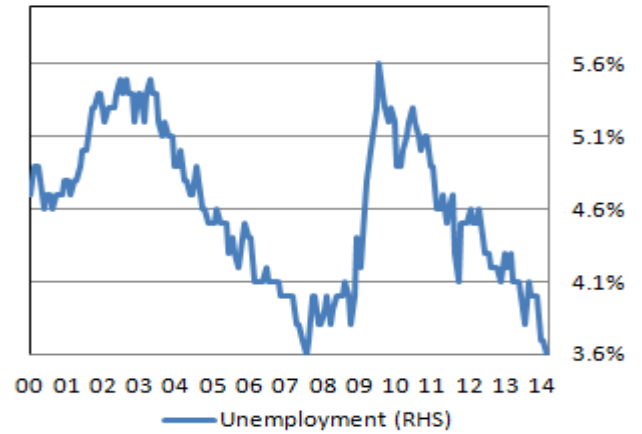


Chart 3: Wages

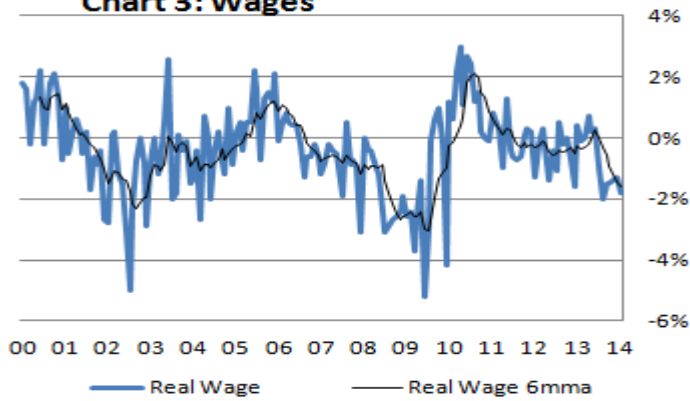


Chart 4: GDP

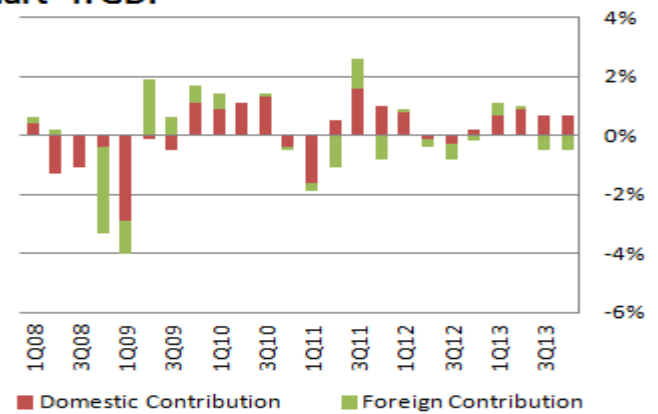


Chart 5: Stock Market



Chart 6: Yen

