

**Key Points**

* **Draft FY2015 budget to be presented on 14 January**
* **3.5tr yen stimulus package to support the economy without issuing new bonds**

* **Q3 GDP contracts more than initially estimated, confirming a technical recession**
* **Household saving rate falls for the first time**
* **Largest annual population decline in 2014**
* **Panasonic repatriates some overseas operations**

**[This report reflects data available up to 4 January 2015.**]

**DEC 2014: JAPAN ECONOMIC MONTHLY REPORT**

9 January 2015

**This publication was archived on 4 July 2016**

This article is no longer current. Please refer to [Overseas Business Risk – Japan](https://www.gov.uk/government/publications/overseas-business-risk-japan)

1. After winning the elections in December 2014, PM Abe formed his third Cabinet. Apart from the Defence Minister all other Cabinet ministers were reappointed to their previous posts. The election delayed the annual budget planning process and the tax reform plan for FY2015. The Cabinet is expected to approve the FY2015 budget draft on 14 January after which parliamentary approval will be sought. Major features in the budget are likely to include:

* Total expenditure (including. debt servicing costs) to be about 98tr yen (£516bn);
* Tax revenue forecast at 54tr yen (£290bn), the highest in 18 years, even though the planned VAT rise will not go ahead this October;
* New government bond issuance to be reduced to 37tr yen (£200bn) from 41tr yen in 2014. This means that less than 40% of spending will be funded by borrowing - the lowest in 7 years
* Social security expenditure expected to rise to 31tr yen (£167bn), a new record.
* Public investment and defence expenditure to increase for the third consecutive year; and
* Corporation tax rate to be cut by a total of 3.29% in two years, 2.51% in 2015.

1. The Government also approved a 3.5tr yen (£19bn) stimulus package to support the economy on 27 December. This mainly focuses on revitalising local economies and supporting SMEs and households. It is expected to boost Japan’s GDP by 0.7%. The package has been financed without additional borrowing by utilising under-spent budgets elsewhere.
2. The Bank of Japan (BOJ) left its monetary policy unchanged. The current rate of Japanese Government Bond (JGB) purchases will remain around 80tr Yen (£434bn) per year. As a result of its on-going policy, BOJ’s assets reached 300tr yen (£1.6tr, 60% of GDP).
3. To maintain Tokyo’s position as an international financial hub, Japan’s government will discuss with China to issue RMB-dominated bonds in Japan. The Government is to hold a preliminary discussion with financial institutions and related ministries in January.
4. The Japan Financial Services Authority released a consultation on Japan’s first ever Corporate Governance Code. Improving corporate governance in Japan is a major part of the Government’s Growth Strategy. It hopes that the code will help Japanese firms focus on their financial performance, strengthen their decision making

processes and help restructure the economy. Japanese firms currently hold the equivalent of nearly 50% of GDP as cash and encouraging firms to deploy this capital more effectively could mean a major boost for the economy.

**ECONOMY**

1. Data continued to confirm weak economic activity. Q3 GDP contracted more than initially estimated (revised down from -1.6% to -1.9% annualised), confirming a technical recession (**Chart A**). Industrial production in November fell unexpectedly (-4.2%). Households reduced their spending (-2.5%) for eight months in a row, reflecting 4 months of weak consumer sentiment. Real wages fell for the 17th consecutive month (-4.3%). The number of housing construction starts fell 14% YOY, the ninth consecutive monthly drop. Largely as a result of falling energy prices core CPI inflation (excluding fresh food) weakened to 0.7% in November from 0.9% the previous month (after discounting for April’s VAT increase).
2. Some positive signs emerged as well. Winter bonuses at major firms increased more than 5%. Petrol prices hit their lowest level in a year, possibly underpinning household spending. The interest rates on new fixed rate mortgages reached their lowest levels on record, potentially encouraging house buying. Planned corporate investment stayed firm. Rice and beef exports in 2014 are reportedly the largest in terms of volume, helping meet the Government export target of 1trn yen in 2020. The number of bankruptcies in 2014 is also expected to be less than 10,000, the lowest in 24 years. Unemployment remained low at 3.5% in November. For the first time, over 20 million employees or 30% of the workforce are now in ‘non-regular’ contracts.
3. Japan's household savings rate fell to -1.3% in FY2013 (**Chart B**). This is the first negative figure since 1955 (when comparable data became available). The result suggests non-income earners such as pensioners used their savings for consumption, a by-product of Japan’s declining and aging population.
4. 2014 saw the largest ever gap in Japan’s ‘Natural population decline’ (the difference between births and deaths) at 268,000. There were 1 million registered births and 1.26 million deaths. This continued decline will have long term strategic effects on Japan’s economy.

**TRADE**

1. The 8th round of EU-Japan FTA negotiations were held in Tokyo. These focused on reviewing the 2nd list of non-tariff measures from the EU. Reactions from Japanese side were positive. Both sides agreed to speed up negotiations and future rounds are scheduled at two months intervals. The TPP Chief negotiators’ meeting in Washington failed to resolve outstanding critical issues. The FTA with Australia was approved by the Japan’s Diet and will come into force from 15 January 2015.

**ENERGY**

1. For the first time since 1966, no nuclear reactors were in operation in Japan during 2014. Two reactors at Sendai Nuclear Power Plant are expected to restart between February and May 2015. Two reactors at Takahama Nuclear Power Plant also passed initial safety inspections in December raising hopes of further nuclear re-starts.
2. The forthcoming energy market liberalisation is seeing new commercial alliances being formed: Kansai Electric and Tokyo Gas are negotiating a partnership on purchasing fuel and building a power plant in Tokyo; Hitachi is to launch a joint venture with Swiss firm ABB to market power transmission equipment.

**PRIVATE SECTOR**

1. The weaker Yen has had a positive impact on Japan’s corporate net worth as publically listed companies are estimated to have increased their value by 20tr yen (£108bn) compared to December 2012 (pre-Abe). Panasonic is repatriating production of some of its product lines due to the weaker yen and rising overseas wages. Other manufacturers are expected to follow.
2. Cross-border business initiatives between UK/Japan include: Aioi Nissay Dowa insurance is to acquire a UK firm, Box Innovation Group with £105m; and UK catalogue shopping company Farfetch is to launch an affiliate in Japan. Hitachi aims to make 60% local procurement in its UK businesses.

**MARKETS**

1. The Nikkei 225 index rose to 18,000 for the first time in 7 years while the Yen fell at 121.86 Yen/$, its lowest level since July 2007. Following the Japanese Government’s decision to postpone October 2015’s VAT rise, Moody’s downgraded Japan’s credit rating from ‘Aa3’ to ‘A1’. However this had no discernable impact. Meanwhile, 10 year Japanese Government Bond reached their lowest ever yields at 0.3%.
2. The issuance of Samurai bonds (Yen dominated bonds issued by foreign entities in Japan) exceeded 2.5tr yen (£13.4bn), the highest in 18 years, in 2014. Lower interest rates and the weaker yen have encouraged such issuance.

**COMMENT**

1. Following the re-election of the Abe led Administration the economic mood in government and business circles is upbeat. The new stimulus package has been welcomed locally as another short term measure to restart economic growth though there are concerns about how effective it will be. The government is likely to present the repatriation of production back to Japan as a good news story to drive domestic growth and create new jobs.

1. Japan’s position in the global market means that its domestic economy and production base should benefit from emerging trends in 2015. Sustainably lower oil prices should increase household real disposable income and coupled with lower global commodity prices, cheaper input costs for SMEs could stimulate local production (although lower energy prices could make BOJ’s efforts to reach its inflation target harder). The weaker Yen and potential corporate reform measures may make Japan a more attractive inward investment destination. As negotiations for both the TTP and EU-Japan FTA enter the end game in 2015, the potential benefits of FTAs may also result in Japan beginning some structural reforms that stimulate trade and investment.

However, the rate of private expenditure for business and domestic purposes is slow. Domestic experts believe that the expected 2015 budget will allow Japan to keep its 2015 fiscal consolidation pledge, even with the postponed VAT increase. However, its FY2020 pledge (i.e. primary balance to be in surplus) remains a big challenge.

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| **Chart 1: CPI (%Y/Y)** | **Chart 2: Labour Market** |
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| **Chart 3: Real wage (%Y/Y)** | **Chart 4: Real GDP (% Q/Q)** |
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| **Chart 5: Stock Market** | **Chart 6: Yen** |
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