
Monthly Economic Report

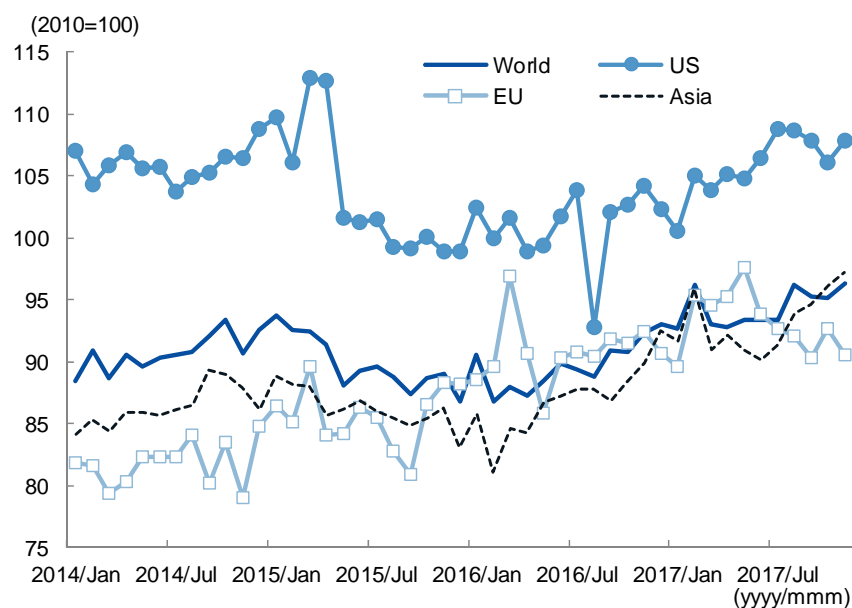
January 18, 2018

Mizuho Research Institute

1. The Japanese Economy: gradual economic recovery

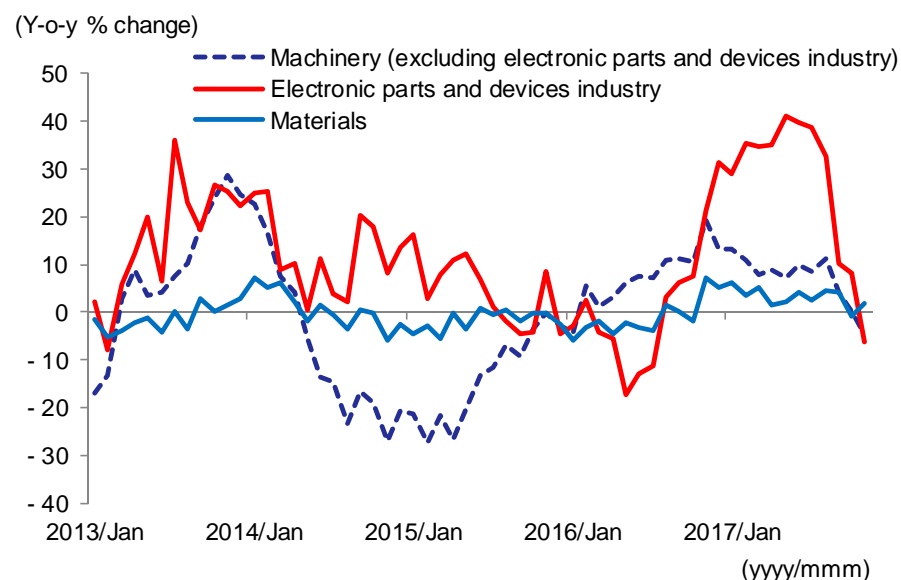
- ❑ The November export volume index (seasonally-adjusted by MHRI) rose +1.2% m-o-m, recording a positive reading for the first time in three months.
 - We also forecast ongoing recovery in exports as the global economy continues to follow a gradual recovery.
- ❑ In November, the industrial production index rose +0.6% m-o-m, rising for two months in a row. However, the inventory-shipment balance dipped into negative territory for the first time in 16 months.
 - The deterioration in the inventory-shipment balance was focused on the electronic parts and devices industry. Although the pace of increase in production will moderate given the inventory cycle's entry into an inventory accumulation phase, production should remain on a recovery trend since IT demand will remain firm for the foreseeable future.

[Export volume index by region]



Note: Seasonally-adjusted by Mizuho Research Institute Ltd. (MHRI)
 Source: Made by MHRI based upon Ministry of Finance, *Trade Statistics*

[Inventory-Shipment Balance]

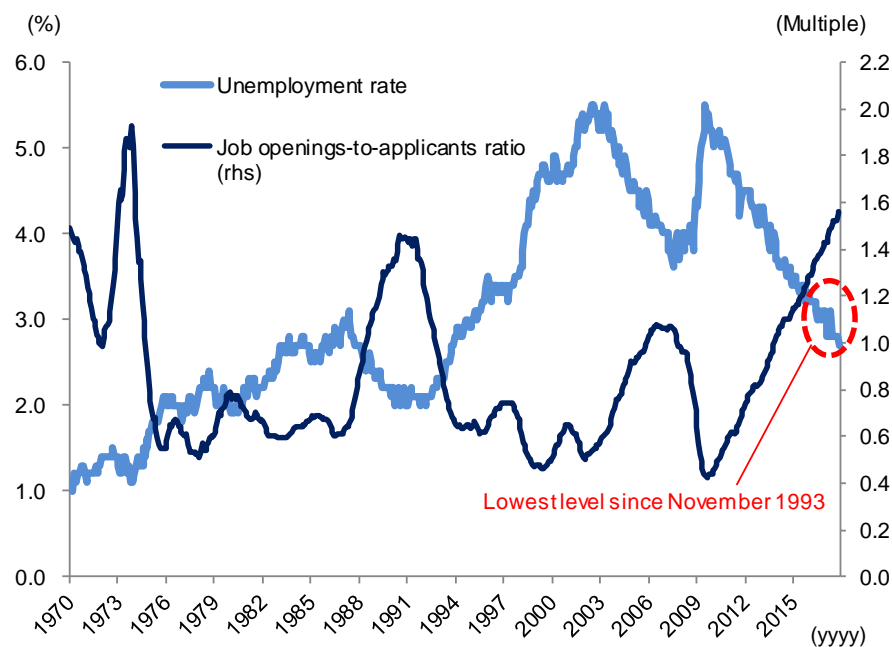


Source: Made by MHRI based upon Ministry of Economy, Trade and Industry, *Indices of Industrial Production*

Japan's employment conditions are improving. The unemployment rate fell to the lowest level since November 1993

- ❑ The labor market remains tight.
 - The November unemployment rate fell to 2.7%, the first decline in five months. This was the lowest level since November 1993.
 - The November job openings-to-applicants ratio rose to 1.56, rising for the second consecutive month.
- ❑ November real wages grew +0.1% y-o-y, the first positive figure in 11 months.
 - Despite the high growth in nominal wages (+0.9% y-o-y), the increase was modest due to downward pressure caused by the rise of inflation.

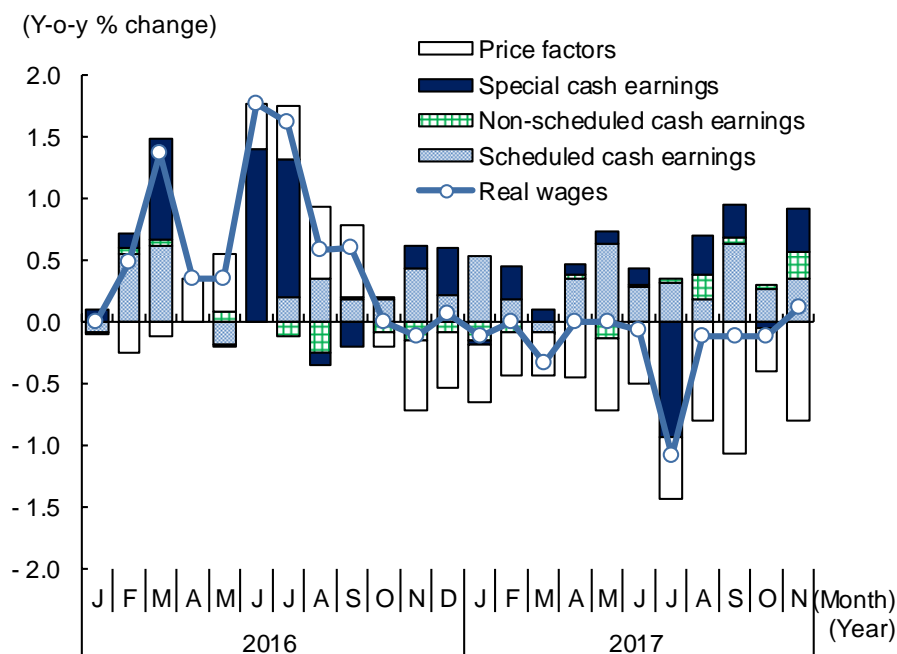
[Unemployment rate and job openings-to-applicants ratio]



Note: Seasonally-adjusted

Source: Made by MHRI based upon Ministry of Internal Affairs and Communications, *Labour Force Survey* and Ministry of Health, Labour and Welfare *Employment Security Bureau Report on Employment Service*

[Real wages]

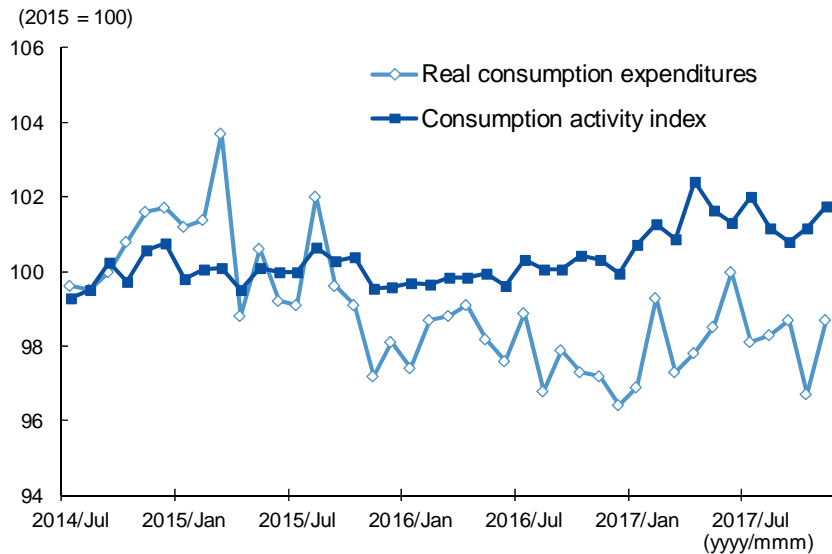


Source: Made by MHRI based upon Ministry of Health, Labour and Welfare, *Monthly Labour Statistics*

Personal consumption is recovering. Slight rise of core CPI

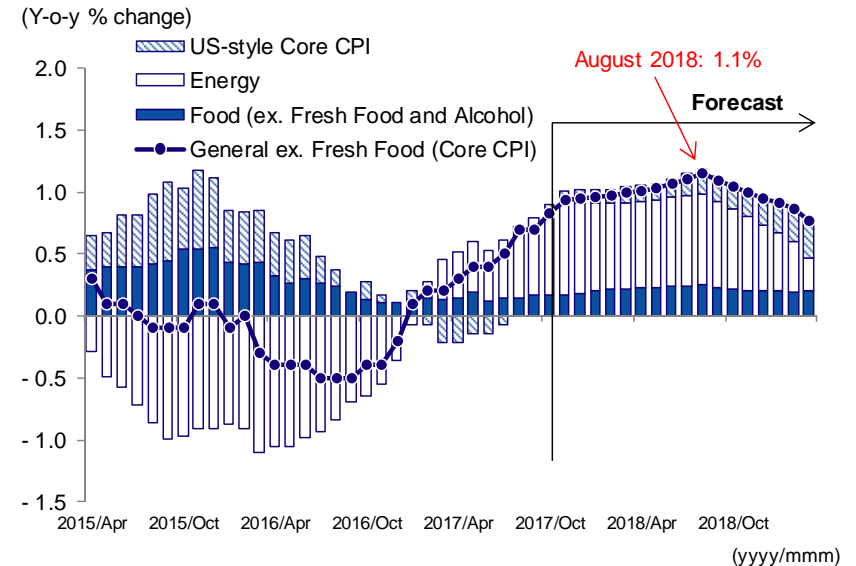
- ❑ The November consumption activity index rose +0.6% m-o-m (c.f., +0.4% m-o-m in October), rising for the second month in a row. Personal consumption is gradually picking up.
 - Durable goods were pushed up by the recovery in car sales, which had slumped due to the scandal surrounding unregistered motor vehicle inspections.
- ❑ November core CPI rose +0.9% y-o-y (c.f., +0.8% in October), up from the previous month. BOJ-style CPI was +0.3% y-o-y, up for the first time in three months.
 - Growth in energy prices paused mainly because of the sluggish growth in electricity and gas prices. Apart from energy, the CPI was lifted by hotel charges and charges for overseas package tours. Even so, given the slower rise of the CPI for the Tokyo metropolitan area in December, the upward impact is temporary. Sustained upward pressure on prices remains weak.

[Consumer spending indices]



Source: Made by MHRI based upon Ministry of Internal Affairs and Communications, *Family Income & Expenditure Survey* and the Bank of Japan *Consumption Activity Index*

[CPI (trends and forecast)]

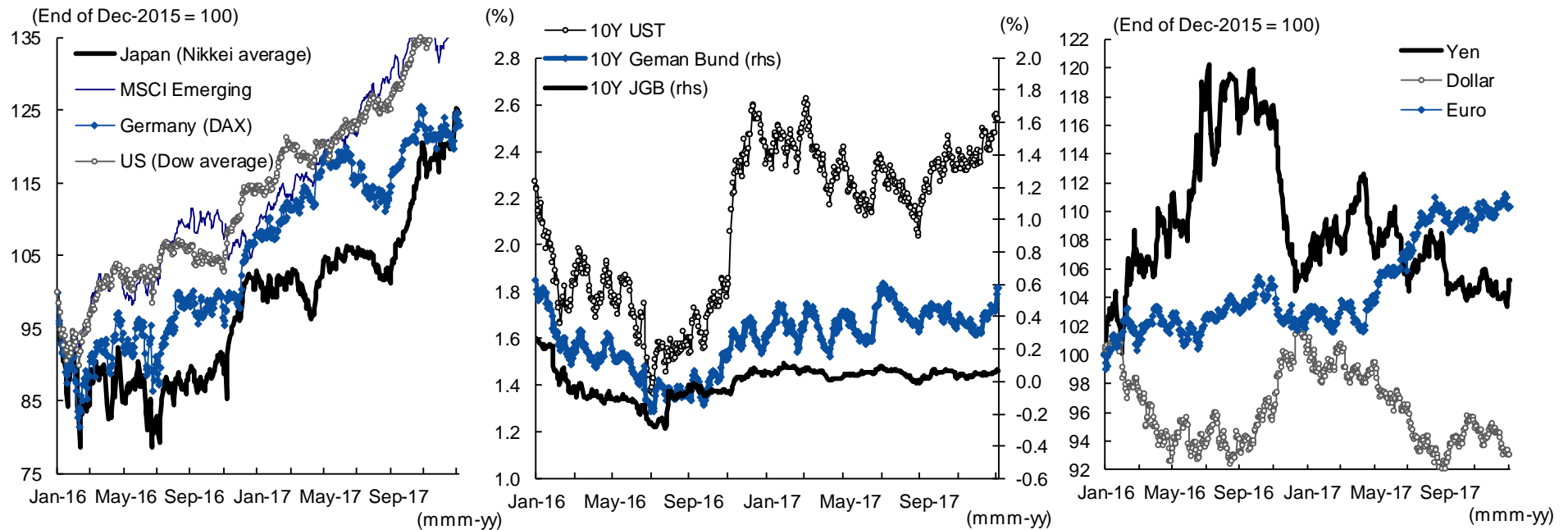


Note: Excludes the impact of consumption tax hike.
Source: Made by MHRI based upon Ministry of Internal Affairs and Communications, *Consumer Price Index*

2. State of the Financial Markets: stock prices continue to rise due to expectations for a global economic recovery

- Stock prices are continuing to rise due to expectations for a global economic recovery. US and European long-term yields have risen due to speculation on a shift in monetary policy.
 - US stocks continue to rise on the back of strong economic indices such as the ISM manufacturing index. The Dow average has risen above 25,000 points. The Nikkei average is nearing 24,000 points on the back of the rise of US stocks.
 - 10Y UST yields are trading at mid 2.5% levels reflecting the reduction in the size of the BOJ's outright purchases of JGBs and reports of a reduction in Chinese purchases of US treasury bonds. 10Y German bund yields have risen to high 0.5% levels. The yen and the euro are both strong.

[Major Market Trends]



Note: BOE Nominal effective exchange rate
 Source: Made by MHRI based upon Bloomberg materials

3. Japanese Monetary Policy: opinion at the December MPM was that current policy should continue with persistence

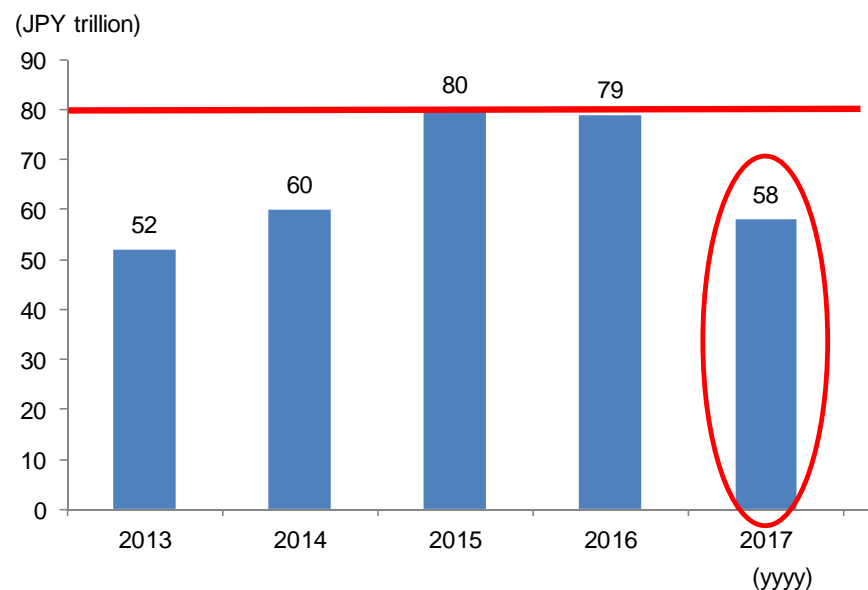
- ❑ The majority opinion at the December BOJ Monetary Policy Meeting (MPM) (December 20 and 21) was that current monetary easing should continue with persistence. Opinions also noted the “need to consider whether adjustments in the level of interest rates will be necessary from the perspective of strengthening the sustainability of the framework”, but no opinions were voiced for a need to change policy.
- ❑ The BOJ is likely to maintain its current monetary policy stance while closely monitoring developments regarding wage hikes at the *shunto* spring labor-management wage negotiations. We need to continue monitoring the discussion within the BOJ about the side effects of the low interest rate policy as well as any announcements.
 - The increase in the size of JGB outright purchases was about JPY58 trillion in 2017. We forecast further reduction in the size of JGB outright purchases by the BOJ in 2018.

[Summary of Opinions at the December BOJ Monetary Policy Meeting]

- With regard to the conduct of monetary policy for the time being, it is appropriate for the Bank to maintain the current policy stance and pursue powerful monetary easing with persistence under the current policy framework toward achieving the price stability target of 2 percent.
- Since there is a long way to go for inflation to accelerate, it is judged as necessary to persistently conduct monetary policy so that highly accommodative financial conditions are maintained.
- Amid the situation of the inflation rate increasing toward 2 percent and the economy's medium- to long-term growth potential rising going forward, the effects of monetary easing measures will be enhanced. In conducting monetary policy, it will be necessary to take into account such changes in the environment as well as the side effects of the measures.
- When it is expected that economic activity and prices will continue to improve going forward, the situation may occur where the Bank will need to consider whether adjustments in the level of interest rates will be necessary under the framework of "QQE with Yield Curve Control," including from the perspective of strengthening the sustainability of the framework.

Source: Made by MHRI based upon Bank of Japan

[Trends in increase of the annual amount of BOJ outright purchases of JGBs]

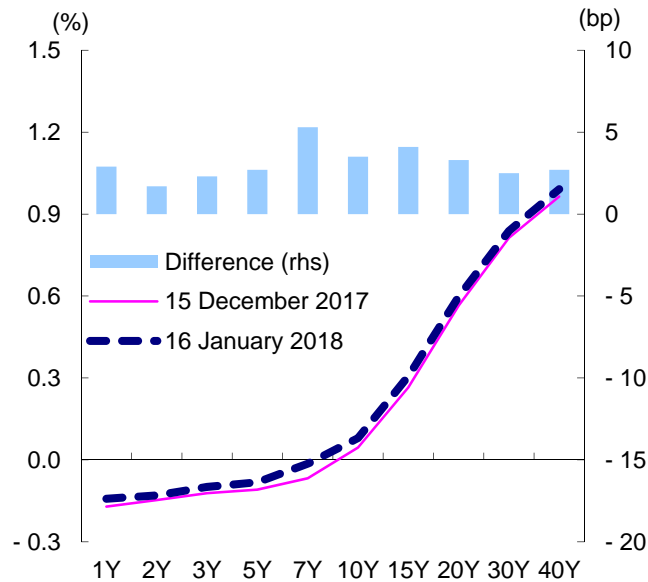


Source: Made by MHRI based upon Bank of Japan

4. Japanese Long-term Yields: upward shift in yield curve due to reduction in BOJ's operations in super long-term zone

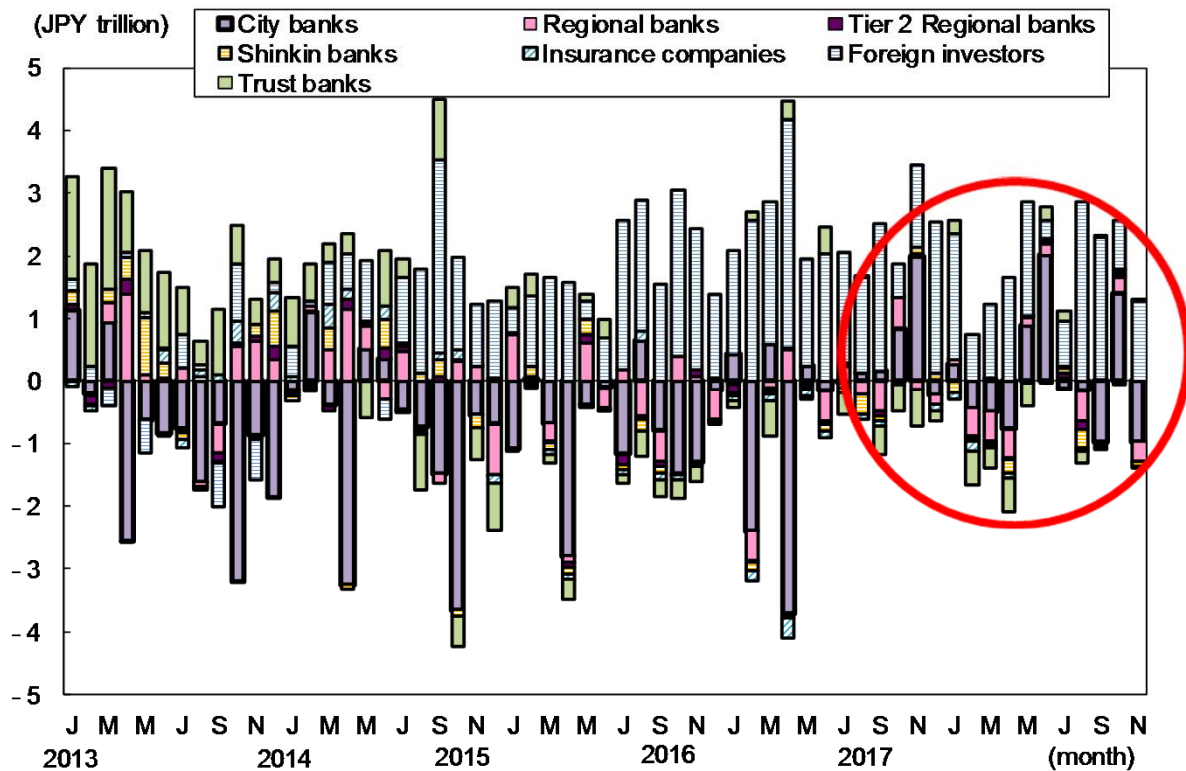
- ❑ 10Y JGB yields are trading at around 0.05% to 0.10%. Given the BOJ's reduction of its outright purchases of super long-term JGBs (Jan 9), the rise of concerns regarding a policy shift led to an upward shift of the yield curve.
- ❑ 10Y JGB yields are forecast to continue moving at around 0.05%. Net selling of medium to long-term JGBs by financial institutions has paused, and we forecast moves to build up bond holdings during periods of rising yields. 10Y JGB yields could approach 0.1% if foreign yields continue to follow an upward trend. However, we expect the BOJ to conduct fixed-rate operations at the same level thus far.

[JGB: Yield curve]



Source: Made by MHRI based upon Bloomberg materials

[Net purchases of medium and long-term bonds]

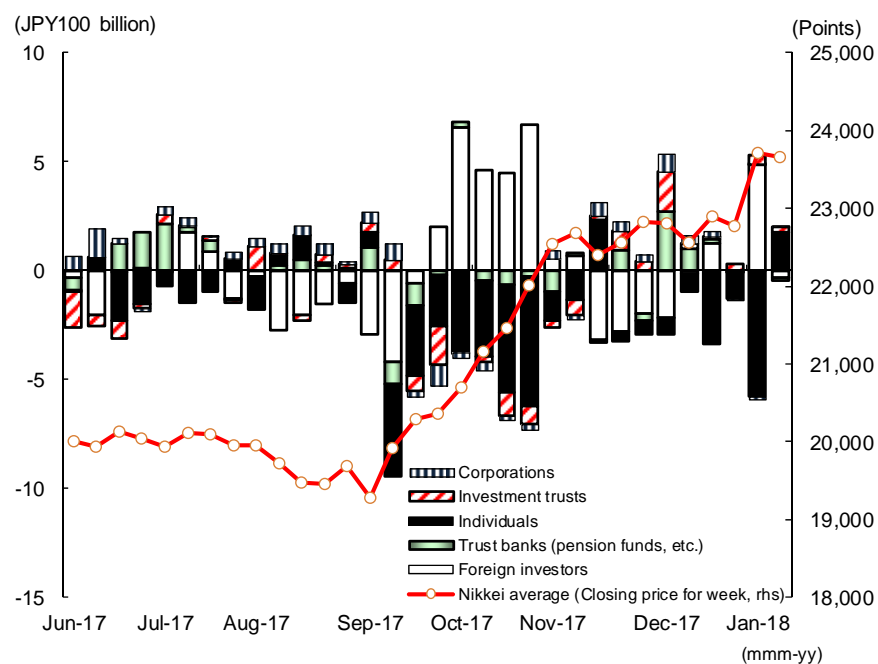


Note: Purchase amount minus sales amount. Medium and long-term bonds
Source: Made by MHRI based upon Japan Securities Dealers Association

5. Japanese Stock Market: forecast to firm due to expectations for FY2018 earnings

- Japanese stocks have risen substantially on the back of expectations for a global economic recovery. The Nikkei average has broken through 23,000 points, to its highest level in 26 years.
 - Given the forecast improvement in corporate earnings for FY2018, overseas funds are flowing into Japanese stocks, which do not seem over-valued from a valuation perspective.
- Stock prices have scope to rise if expectations for FY2018 corporate earnings rise further on the back of corporate results from late January. We forecast very solid expectations for Japanese stocks.
 - However, the upside could be limited by the strong yen triggered by speculation on a shift in BOJ monetary policy.

[Trading trends by investor type and the Nikkei average]



Source: Made by MHRI based upon Tokyo Stock Exchange and Bloomberg

[Nikkei Average calculated from the FY2018 forecast PER and EPS]

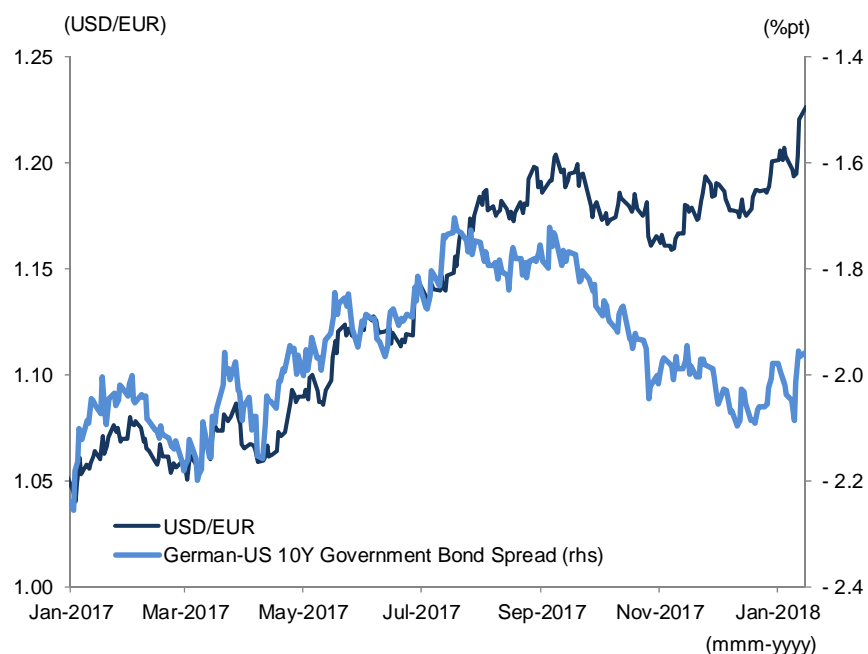
Nikkei average (points)	FY2018 forecast EPS (y-o-y)				
	Market forecast (5% increase)	15% increase	10% increase	±0%	5% decrease
PER 13x	20,200	22,100	21,100	19,200	18,300
PER 14x	21,800	23,800	22,800	20,700	19,700
PER 15x	23,300	25,500	24,400	22,200	21,100
PER 16x	24,900	27,200	26,000	23,700	22,500
PER 17x	26,400	28,900	27,700	25,100	23,900

Note: Using the TOPIX forecast EPS, taking the NT ratio to be 12.5 times
Source: Made by MHRI based upon IBES

6. Foreign Exchange: upward pressure on euro due to concerns about suspension of ECB asset purchases and rate hikes

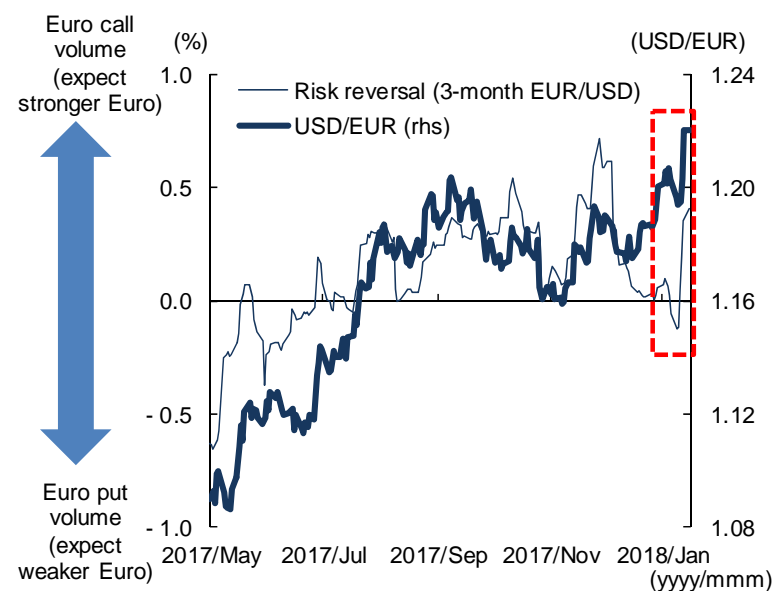
- Expectations toward a stronger euro against the US dollar are rising on the back of speculation on the suspension of ECB asset purchases and interest rate hikes and in risk reversal investment strategy.
 - Trends in German-US interest rate spreads and USD/EUR have been diverging since last summer, when there were heightened expectations for a reduction in ECB asset purchases.
- Since the market has already priced in expectations toward a ECB policy shift to a certain degree, a further appreciation of the euro is limited. Meanwhile, the rise of US interest rates has also been sluggish reflecting the stagnation of US inflation. We forecast the upside for the dollar against the euro to remain limited.

[USD/EUR and German-US long-term yield spread]



Source: Made by MHRI based upon Bloomberg materials

[USD/EUR and risk reversal]



Note: Risk reversal is a transaction used to go in the opposite direction to risk by buying currency calls (puts) and selling puts (calls) at the same time. Periods of increased call buying suggest high expectations for a strong euro.

Source: Made by MHRI based upon Bloomberg materials

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