

Atradius Country Report

Japan – June 2014



Overview

General information

Capital:	Tokyo
Government type:	Parliamentary government with a constitutional monarchy
Currency:	Yen (JPY)
Population:	127.6 million

Most important sectors (% of GDP, 2012)

Services:	71.3 %
Industry:	27.5 %
Agriculture:	1.2 %

Main import sources (2012, % of total)

China:	21.3 %
USA:	8.6 %
Australia:	6.4 %
Saudi Arabia:	6.2 %
United Arab Emirates:	5.0 %
South Korea:	4.6 %

Main export markets (2012, % of total)

China:	18.1 %
USA:	17.6 %
South Korea:	7.7 %
Taiwan:	6.2 %
Thailand:	5.5 %

Key indicators

	2011	2012	2013	2014*	2015*
Real GDP (y-on-y, % change)	-0.4	1.4	1.5	1.4	1.3
Consumer prices (y-on-y, % change)	-0.3	0.0	0.4	3.0	2.0
Private consumption (y-on-y, % change)	0.3	2.1	1.9	0.9	-0.1
Retail sales (y-on-y, % change)	-0.7	1.8	0.6	-0.1	1.0
Industrial production (y-on-y, % change)	-2.6	0.2	-0.6	5.5	4.2
Unemployment rate (%)	4.6	4.3	4.0	3.7	4.1
Real fixed investment (y-on-y, % change)	1.5	3.2	2.7	4.5	1.7
Export of goods and non-factor services (y-on-y, % change)	-0.4	-0.1	1.6	5.8	7.8
Fiscal balance (% of GDP)	-8.7	-10.4	-9.4	-7.4	-6.5
Government debt (% of GDP)	203.3	210.4	212.7	208.5	206.8

* forecast

Source: IHS Global Insight

Main economic developments

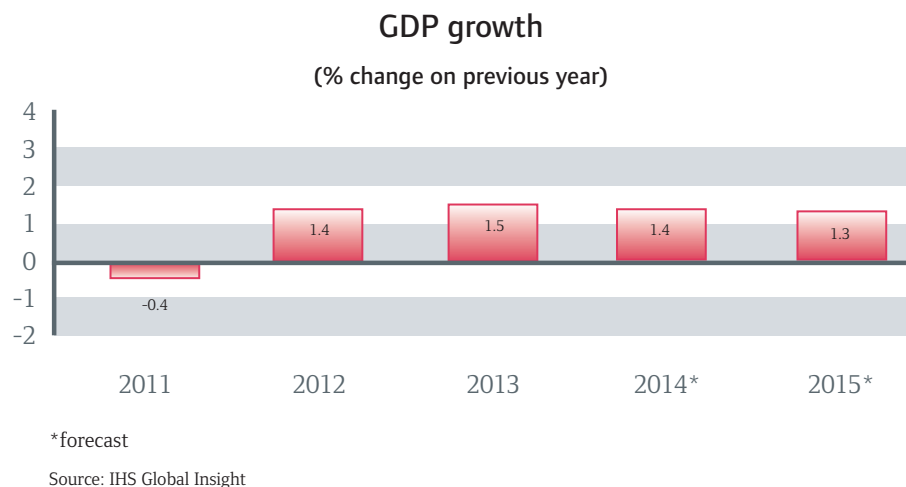
A turnaround of economic policies since early 2013

In the 20 years leading up to 2013, Japan suffered from very low inflation, with bouts of deflation and low economic growth. Prime Minister Shinzo Abe, who came into office in December 2012, immediately launched drastic measures to turn around Japan's contracting and deflationary economy. Abe devised the so called 'three arrow' approach, now dubbed 'Abenomics', consisting of drastic monetary easing, fiscal policy measures and structural reforms. In July 2013, he secured a comfortable majority in the upper house, placing the ruling LDP party firmly in political control with a legislative mandate.

Economic growth of 1.4% expected in 2014

Together with a loose monetary policy, a large fiscal stimulus package launched in February 2013 helped to increase economic growth by 1.5 % in 2013. In the first quarter of 2014 the Japanese economy grew 1.5 % year-on-year and 5.9 % on the previous quarter, driven by domestic demand. Capital spending by businesses increased 4.9 %, while private consumption rose 2.1 %, as households brought forward purchases ahead of a consumer tax hike in April 2014.

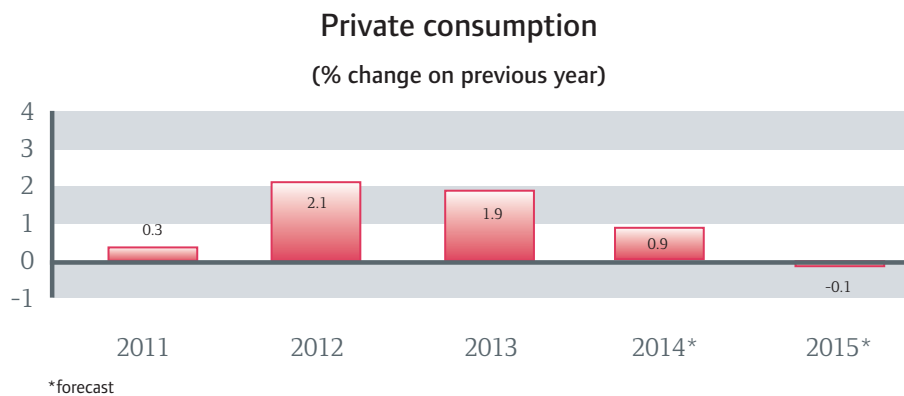
The economy is expected to contract in the second quarter of 2014, as consumers rein in their spending after the tax increase. However, the forecast is for the economy to grow 1.4 % this year and 1.3 % in 2015.



How will the recent tax increase affect household spending?

On 1 April 2014 the value added tax was increased for the first time in 17 years, to consolidate the high public deficit. The tax has been increased from 5 % to 8 %, with a significant impact on consumer spending. Durable goods purchases increased sharply in the months leading up to the tax rate hike, while a similarly sharp decrease is expected for the second quarter. There are concerns that the tax increase could drag on private consumption in 2014 and 2015 with a negative effect on economic growth, since household consumption accounts for around 60 % of the Japanese economy.

However, a gradual return of normal purchasing is expected in the second half of 2014, with private consumption expected to grow 0.9 % this year after 1.9 % in 2013. A further tax increase, from 8 % to 10 %, is planned for October 2015, on the assumption that household consumption will not decrease sharply: currently, private consumption is expected to level off in 2015 or to shrink only modestly (see chart overleaf).



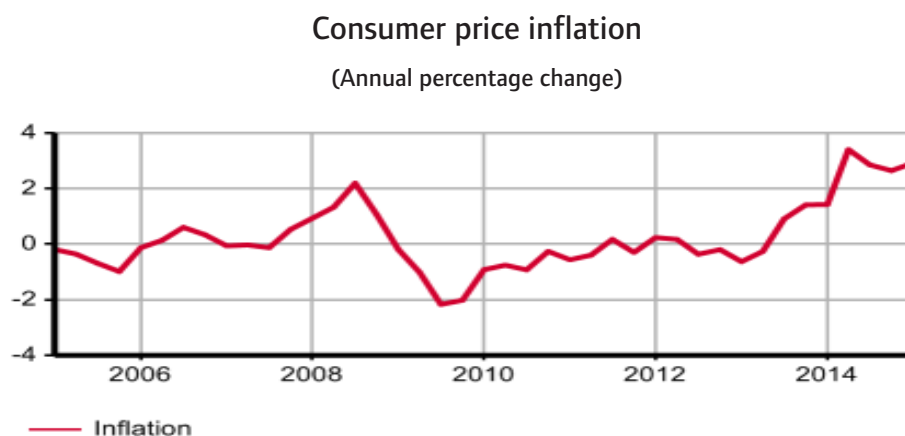
Source: IHS Global Insight

Monetary policy: quantitative easing to continue

In March 2013 the governor of Japan's Central Bank announced that the bank will abandon interest rates as a target, focusing instead on the monetary base. Since then it has expanded the monetary base by the purchase of long-term bonds (quantitative easing). This programme aims to devalue the Japanese Yen in order to promote exports, discourage imports and generate inflation.

The Central Bank is committed to bringing inflation up to 2 % to combat Japan's structural deflation, which has depressed domestic consumption as businesses and consumers alike have tended to delay purchases in the hope of getting a better deal in the future. The hope is that, by expanding the amount of cash in circulation, businesses and consumers will have more cash to spend. Coupled with low interest rates, prices should increase and property and shares should become more attractive propositions.

The quantitative easing programme will continue in 2014. Since mid-2013 inflation and inflation expectations have risen steadily towards the 2 % target (see chart below). After a 0.3 % increase in 2013 consumer prices are expected to rise 3 % in 2014, also as a result of the recent tax hike, and to increase 2 % in 2015.



Source: IHS Global Insight

Business investment and industrial production are forecast to grow 4.5 % and 5.5 % respectively in 2014, and business sentiment among manufacturers is soaring. In the second quarter of 2013, the Bank of Japan's quarterly business sentiment indicator for manufacturers turned positive for the first time in almost two years and has increased in every quarter since then.

Small current account deficits expected in 2014 and 2015

The Bank of Japan's loose monetary policy has led to depreciation of the Yen, boosting exports. In 2014 and 2015 exports are expected to increase 5.8 % and 7.8 % respectively.

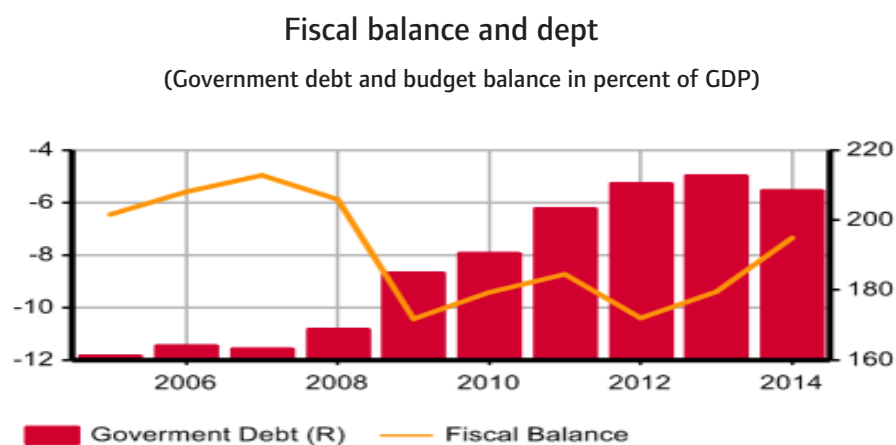
However, since 2011, the country has been posting trade deficits as the cost of imports have surged. Purchases of fossil fuels and gas have increased, to make up for the loss of nuclear power following the March 2011 earthquake and tsunami, while the Yen devaluation makes US\$ denominated imports more expensive.

In the first quarter of 2014 exports rose 6 % on the previous quarter. However, imports increased 6.3 %, boosted by increased buying of foreign goods before the tax hike.

In view of the higher trade deficit, it is expected that the current account will turn negative in 2014 and 2015, to 0.4 % of GDP.

There are still obstacles to a comprehensive rebound

Following a long period of loose fiscal policy, the Japanese government is struggling with extremely high public debt: over 200 % of GDP (see chart below).



Source: IHS Global Insight

Japan relies mostly on domestic creditors to support its government debt (about 90 % is held by Japanese investors), which makes the funding base less susceptible to capital flight. But maintaining this level of debt is costly and further growth of the government debt will at some point render it unsustainable.

The administration will have to carefully assess Japan's debt position as it currently has the world's highest debt-to-GDP ratio and its public debt is second only to the US. If the current account were to turn structurally negative in the mid-term, such a 'twin deficit' (i.e. deficits in the current account and fiscal balances) would force the Japanese government to finance the growing government debt from external sources, and this would probably lead to higher interest rates.

The government has to find a solution to Japan's demographic challenges: the population is shrinking and the working age population is also declining. Without appropriate measures, the Japanese will inevitably face a shrinking tax base and rising expenditure on retirement benefits.

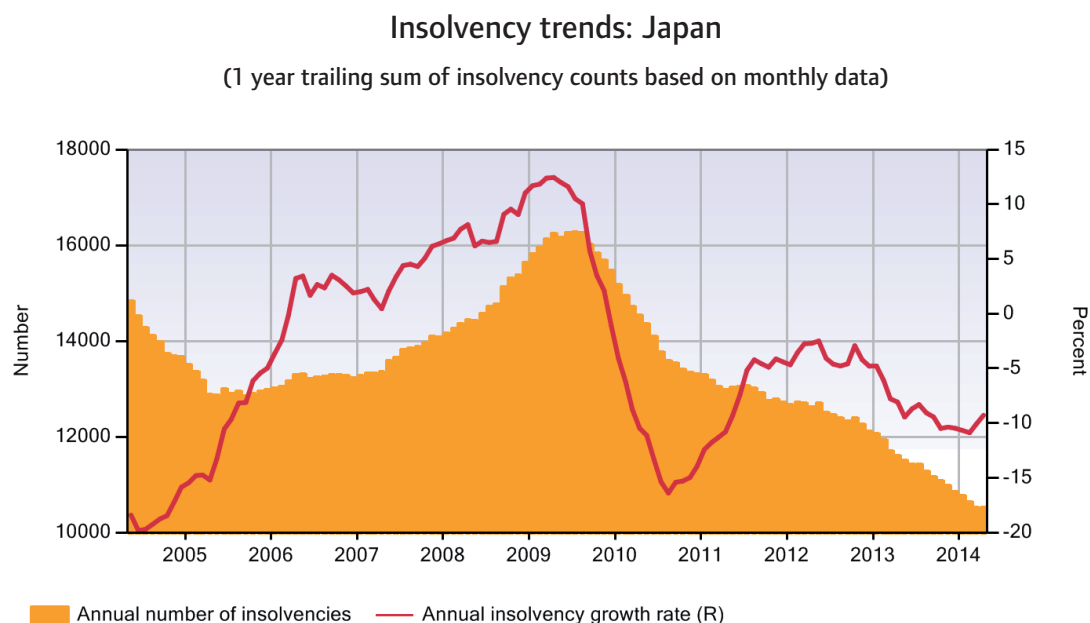
Outlook: a recovery on shaky ground

2014 will prove an exceptional challenge for Japanese policy makers, and concerns remain about whether the current recovery is sustainable. Japan's economic future depends on firm implementation of structural reforms.

But, despite Prime Minister Abe's stated aim of initiating structural reforms to boost the country's long-term economic performance, nothing substantial has happened so far. In order to achieve a sustainable rebound there is an urgent need to make the labour market more flexible, to end protection for farmers, doctors and pharmaceutical companies, and to introduce more business deregulation. However, all this is vehemently opposed by powerful interest groups.

That said, it is planned to implement economic zones with relaxed corporate litigation and to cut corporate taxes. Another opportunity to obtain economic growth is the opening of the electricity market and a restarting of Japan's nuclear reactors: something the government strongly supports.

The insolvency environment

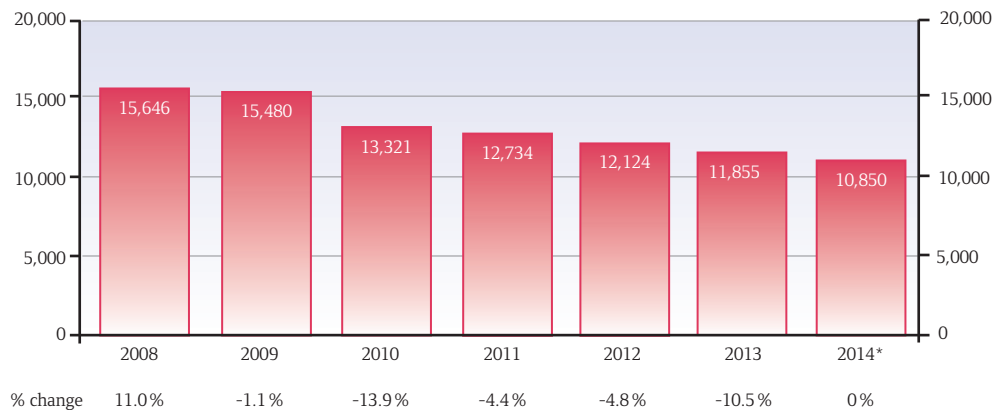


Source: IHS Global Insight, Teikoku Databank

Since 2009, annual corporate insolvencies in Japan have decreased. After falling by 4% in 2011 and 2012 and as much as 10.5% in 2013, we expect insolvencies to level off in 2014 (see chart overleaf).

Japanese business insolvencies

(year-on-year change)



*forecast

Japanese industries performance forecast

June 2014

Agriculture	Automotive/ Transport	Chemicals/ Pharma	Construction	Construction Materials	
					Excellent
Consumer Durables	Electronics/ICT	Financial Services	Food	Machines/ Engineering	Good
					Fair
Metals	Paper	Services	Steel	Textiles	Poor
					Bleak

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