Kimura Dreamvisor Newsletter Summary 21st December 2006

A wall of evidence against BOJ further tightening

Most economist forecast BOJ to rise rates in January but…

Yen weakened further triggering foreign investors Japanese large exporters buying which in turn helped Nikkei 227 to log in 17,000. US FRB Inflation warnings short-circuited monetary easing expectations meanwhile BOJ committee just postponed rate increase. BOJ governor Fukui made clear that he would carefully consider economic factors before tightening consequently the deeply rooted belief that rates would be increased in January took a beating.

Nikkei poll states that out of 10 economists 6 forecast a rate increase in January 1 is forecasting February and 3 believe it will be postponed to June. Those forecasting a quick tightening believe that due to the strong earnings and investments background it is merely impossible to maintain balance between borrowers (corporates) and lenders (households) at ultra low 0,25 %. Therefore it is highly desirable to raise interest rates to give some manoeuvre for future easing (should economy slows down). In addition they believe this decision should be made ahead of lower house elections (now closing by).

Those who favour delayed tightening (including myself) believe that with close to zero inflation rate (which remain the base to get rid of deflation) individual’s consumption remain abnormally low. Tightening rates on the sole background of positive corporate performance or capital investment is not appropriate neither desirable. In addition this would casts a shadow on US economy current cycle. Last year’s inflation rate increase was due to oil prices jump, but effects were temporary. US housing boom backlash effects will soon deepen, in addition US ISM index broke 50 recently and remain at a three years crossroad.

This said I do not believe that economic recovery would be endangered by rates tightening. However rising rates too soon when business cycle is close to peak out could raise questions on BOJ business analysis abilities. In the past when BOJ tightened just before IT bubble burst they set up a precedent and lost market trust. Should such a fiasco repeat itself medias will be quick to blame BOJ. Even if this is unrelated Fukui participation in ex-Murakami fund will pop up again, current situation does not allow any false start for BOJ.

Rather than domestic economy the most worrying factor are US indicators. US Christmas sales took a slow start. Another ISM announced below 50 and doubtlessly corporate performances would worsen. I really find difficult to rush in rising rates, unless domestic indicators would suddenly jump-start.

Prices, corporate difference scale and geographic unbalance are the next hurdles.

Corporate earnings continue registering new highs but fund suppliers (savers) are taking no advantage out of it, this is precisely nowadays Japan situation. The responsibility is equally shared between savers (unwilling to move their capital to risky assets) as much as financial authorities.

Former Bank Of Japan executive committee member Taketo Hata recently said ‘BOJ is facing three hurdles in raising interest rates’. First nominal GDP and real GDP reversal pattern, second large and mid companies cyclical gap, third large cities and regional economy discrepancies. For current fiscal year July September quarter nominal growth GDP rate should have been higher than real GDP growth rate, nominal was 1,8 %, real was 2,7 %. GDP deflator is still problematic and one cannot claim yet total victory over deflation.

In addition although BOJ recognizes a general improvement in the economic climate, situation remain highly contrasted between manufacturing sector companies with a high export ratio (or non manufacturing sector with high foreign business ratio) and companies totally dependent on domestic sector. Large differences between regions do not help either. In the vicinities of large cities like Tokyo or Nagoya with high concentration of high export industries manpower shortage is becoming severe. However in Tohoku, Kyushu or Hokkaido area mid size cities job offers just disappear and salaries stay low. Depopulation and aging are worsening, there is a shift in consumption toward ‘roadside’ large-scale shopping centres, developing countries manufactured products are making strong inroads. In fact an increasing number of people just cannot adapt to the rapidly changing environment, situation has deteriorated for such people.

Japanese government is not prepared to loosen fiscal reconstruction purse strings. Authorities are increasingly transferring the cost of public services to Japanese people. I think although government is right to prioritise growth, opportunities access equal chances and differences corrections are also important. If parliament representatives would visit their constituencies no doubt they vote against BOJ tightening rates.

In the end without fully complete objective data BOJ just cannot rush into rising rates. Brushing aside economists viewpoint I believe ultra low rates can continue for now. Current Yen weakness will be extended, which is good for exporters. Leaving money idle in bank accounts remain unrewarding which in turns is good for Stock Market and foreign investments.