Japanese Economy and Securities Market

I. Japanese Economy

(Macroeconomic trends)

Japan's economy is steadily mounting a recovery under Abenomics and other measures.

During the first and second quarters of 2013, the beneficial effects of recoveries in the economies of other countries and of the weakening yen steadily emerged, supporting a shift to high levels of exports. Corporate profits rose in conjunction with this trend, mainly in the manufacturing sector.

Exports and imports both began to decline in the third quarter, with net exports moving in the same direction. On the other hand, public demand was strong along with progress in the execution of emergency stimulus package-related projects and tax revenues increased.

In the fourth quarter, despite crude oil prices moving down a notch from previously high levels, exports and imports were at a low level. Consequently, the deficit in the current account balance expanded. Moreover, there were signs of a rush in demand in anticipation of the April 2014 hike in the consumption tax.

The economy generally remained in a recovery trend in the first quarter of 2014. Personal consumption was driven by a rush in demand ahead of the hike in consumption tax. However, there was concern that due to the timing of the hike in consumption tax, actual purchasing power would decline after April 2014.

The second quarter saw declines in all economic indicators in reaction to the last-minute demand in the first quarter. Private consumption especially exhibited a strong downward trend and GDP also significantly dropped. However, this movement is thought to be a transitory reaction to the last-minute demand and a steady recovery is expected.

(Trends in employment conditions)
Employment conditions could again be said to be on the rebound in 2013. There were signs of improvement in both the unemployment rate and the job-offers to seekers ratio.

The unemployment rate remained in the 4% range throughout the year, and ended the year at 4.0%, improving from 4.3% last year. Since entering 2014, the unemployment rate has stayed at 3.6%.

The job-offers to seekers ratio showed moderate improvement, breaking through the 1.00 times level in November 2013. On an annual basis, the ratio rose from 0.80 times at the end of 2012, to 0.93 times, a 0.13 point annual increase, suggesting a somewhat better job demand and supply balance. The ratio continued to move upward in 2014, exceeding 1.00 times and climbing to 1.10 times as of June 2014.

Looking at a breakdown of the employment figure, employment increased in such industries as manufacturing and retail and medical care and welfare. Moreover, despite the improvement in the overall unemployment rate, in terms of population age groups, the average unemployment of 15- to 24-year olds is the highest on an annual basis, at 6.8%. Employment of Japan’s youth clearly remains an issue.

While it is necessary to remain vigilant about the impact of the decline in demand in reaction to the rush demand ahead of the hike in the consumption tax and of movements in the economies of other countries, a scarcity of labor has emerged in various industries in Japan, pointing to the likelihood of continued improvement in employment conditions. On the other hand, because of the strongly rooted policy of curtailing personnel expenses among companies, it is expected that implementing wage increases will remain difficult.

(Price Trends)
In 2013, the Corporate Goods Price Index (CGPI) increased 1.3 percentage points from a year earlier, to 101.9 (2010 as base value), rising for the first time in two years. Entering 2014, the CGPI remained in an upward trend, and the most current figure of June increased another 0.3 percentage points from the previous month, to 106.6 (preliminary report basis). Among the reasons for the increase in the CGPI were the increase in import prices because of the depreciation of the yen and the rise in natural resource prices. Given these types of drivers, it is expected that even if the CGPI continues to rise in future, the pace of growth will decline.

The Consumer Price Index (CPI; excluding fresh produce) had been in a continuously declining trend since 2009 amid an improvement in the demand-supply balance of the overall economy. However, higher electricity rates and gasoline prices have put the brakes on the decline in consumer prices. On an annual basis, the CPI was up 0.4 percentage point year on year, at 101.1 (2010 as base value). This result could be attributed to the emergence of a rush in demand ahead of the April 2014 hike in the consumption tax in conjunction with a strengthening of the movement to pass on the increase in the price of supplies due to the depreciation of the yen to sales prices, pushing up the CPI. Entering 2014, the CPI continued to rise. Starting in April, despite the call for a smooth transition to higher prices reflecting the increase in the consumption tax, there were cases here and there where prices of goods rose in excess of the consumption tax hike due to rounding up and other processes. The current index as of June 2014 was 103.4 (preliminary report basis).

<Table 1> Major Economic Indicators

Change from the previous period(Quarterly is seasonally adjusted)

(Major Economic Indicators)

	2013				2014		CY2012	CY2013
	1-3	4-6	7-9	10-12	1-3	4-6		
GDP (Expenditure Approach)	1.2	0.8	0.4	-0.1	1.5	-1.8	-0.1	0.6
Private Consumption	0.6	0.5	0.1	0.2	1.3	-3.2	0.1	0.4
Consumption of Households	0.6	0.5	0.1	0.2	1.2	-3.2	0.1	0.4
Excluding Imputed Rent	0.6	0.4	0.1	0.2	1.2	-3.2	0.1	0.3
Private Residential Investment	0.0	0.1	0.1	0.1	0.1	-0.3	0.0	0.1
Private Non-Resi. Investment	-0.3	0.2	0.1	0.1	1.1	-0.7	-0.2	0.0
Change in Private Inventories	0.1	-0.4	0.2	-0.1	-0.5	1.4	0.0	-0.1
Government Consumption	0.2	0.1	0.0	0.0	0.0	0.0	0.1	0.1
Public Investment	0.2	0.3	0.3	0.1	-0.1	0.0	0.1	0.2
Change in Public Inventories	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Exports	0.4	0.1	-0.4	-0.6	-0.2	1.1	-0.2	-0.1
Exports	0.6	0.4	-0.1	0.0	1.1	-0.1	-0.2	0.2
Imports	-0.2	-0.4	-0.3	-0.6	-1.3	1.2	-0.1	-0.4

<Table 2> Employment Conditions

	2013				2014		CY2012	CY2013
	1-3	4-6	7-9	10-12	1-3	4-6		
Unemployment Rate (%)	4.2	4.0	4.0	3.9	3.6	3.6	4.3	4.0
Job-offers to Seekers Ratio (Ratio(Times))	0.86	0.90	0.95	1.01	1.05	1.09	0.80	0.93

(Note)1.Date is seasonally adjusted

2. Unemployment rate figures exclude figures for Iwate, Miyagi, and Fukushima prefectures, which were unavailable because of the earthquake and tsunami disaster.

(source)Ministry of internal Affairs and Communications, Ministry of Health, Labour and Welfare

<Table 3> Price Trends

(Corporate Goods Price and Consumer Price)

		2013				2014		CY2012	CY2013
		1-3	4-6	7-9	10-12	1-3	4-6		
Corporate Goods Price	Index	100.9	101.6	102.4	102.6	102.8	106.1	100.6	101.9
	YoY change	-0.3	0.6	2.2	2.5	2.0	4.5	-0.9	1.3
Consumer Price (excluding fresh food)	Index	99.3	99.9	100.3	100.7	100.6	103.3	99.7	100.1
	YoY change	-0.3	0.0	0.7	1.1	1.3	3.3	-0.1	0.4

(source)Ministry of Internal Affairs and Communications, Bank Of Japan

- **Financial Assets of Households**

At March 31, 2014, the end of fiscal 2013, household financial assets amounted to ¥1,630.4 trillion, expanding approximately ¥51 trillion or 3.3% from fiscal 2012. Although the investment climate remained severe during the year in review, against the backdrop of Abenomics, there was overall increase in household financial assets on a fiscal year-end basis for the fifth consecutive year.

Looking at a breakdown, the growth in the balance of household financial assets was driven by stocks and other equities, which rose ¥15.0 trillion, or 11.3% year on year, to ¥148.1 trillion, and investment trusts, which increased ¥7.2 trillion, or 10.2% from last year, to ¥78.4 trillion. In addition, cash and deposits expanded ¥17.4 trillion, or 2.1%, to ¥864.8 trillion, continuing on from last year in posting another record high on a year-end basis. Furthermore, foreign securities hit another historical high, at ¥11.3 trillion, suggesting that an investment environment is steadily being formed where households will look at a diverse selection of assets, including foreign securities, and are prepared to take some risk in choosing where to invest.

In terms of the composition of household financial assets, despite reaching a record high as previously mentioned, the proportion of cash and deposits contracted 0.7%, to 53.0%. Conversely, the proportions of stocks and other equities and of investment trusts increased 0.7%, to 9.1% and 0.3%, to 4.8%, respectively. With the Nippon Individual Savings Account (NISA) system, the new tax exemption scheme for small investments by individuals, getting under way in January 2014, it is expected that the shift “From Savings to Investment” in Japan will accelerate.

<Table 4>The Composition of Financial Assets of Households

	FY2011	FY2012	FY2013(E)	FY2013 (E) (Amount) (¥ trillion)
Financial Assets of Household	1,520.7	1,578.7	1,630.4	1,630.4
Currency and deposits	54.8%	53.7%	53.0%	864.8
Bonds	2.2%	1.9%	1.6%	26.7
Investment trusts	3.9%	4.5%	4.8%	78.4
Trust beneficiary rights	0.1%	0.1%	0.1%	2.4
Shares & Other Equities	7.2%	8.4%	9.1%	148.0
Insurance and pension reserves	27.8%	27.3%	27.1%	442.3
Overseas Portfolio Investment	0.6%	0.5%	0.7%	11.3
Others	3.5%	3.5%	3.4%	56.0

(source) Bank of Japan

Ⅱ. Securities Market

1. Equities

(1) Primary and Public Capital Increases
In 2013, reflecting the favorable market environment, 79 companies went public on the Tokyo Stock Exchange (TSE). This figure represented an increase of 10 companies from a year earlier and the fourth consecutive year of growth. By industry category, service companies took the top spot with 19 companies, followed by information and communications with 16 companies, and retail with 8 companies. In 2014, new listings totaled 36 companies at the end of July. These listings include several notable companies. CYBERDYNE Inc., a company well-known for its R&D, production, sales of and product-related services for robot suits used in the medical, nursing care and welfare and daily living support fields, used a special voting class share scheme when it listed—the first time this type of scheme had been used in Japan. Among foreign companies, Acucela Inc., of the United States, a biotechnology firm specializing in the ophthalmologic field, was the first new foreign company listing since 2007.

In 2013, the total amount of capital increases through public offerings (excluding primary offerings) on all stock exchanges in Japan expanded 2.3 times that in 2012, to ¥1,067.1 billion, exceeding one trillion yen for the first time since 2010 (¥3,077.9 billion). These capital increases were being made for such reasons as expanding capital investment in line with better corporate performance and to improve financial soundness. In 2014, public offerings have already reached ¥818.1 billion during the first six months of the year.

Initial public offerings in 2013 totaled ¥377.9 billion, jumping 9.6 times from 2012 and topping ¥300 billion for the first time since 2006 (¥594.8 billion). Entering 2014, initial public offerings have maintained almost the same pace, totaling ¥170.5 billion during the first six months.

The following issues were among the public offerings in the spotlight in 2013. Daiwa House Industry Co., Ltd., made the largest issue of the year on July 3. The proceeds from the issue are to be applied to partially fund the planned ¥400 billion in capital investments for real estate development (purchase of lease assets and construction capital, etc.) by the issuer and its group during the period from fiscal 2013 to fiscal 2015. Made as a general public offering in Japan and a global offering, the issue raised a total of ¥137.5 billion.

Another large public offering in 2013 was the Dentsu Inc. capital increase. Proceeds from the offering are tagged for use as partial repayment of a short-term loan incurred by the company in its acquisition of Aegis Group plc in March 2013. Made as a general public offering in Japan and a global offering, the issue raised a total of ¥121.8 billion.

Sharp Corporation launched a capital increase on September 18. The proceeds are to be used for planned capital investment during the period up to and including fiscal 2016. Made as a general public offering in Japan and a global offering, the issue raised a total of ¥119.1 billion.

Olympus Corporation’s public offering occurred on July 8. Proceeds are to be allocated capital investments to expand production capacity of a core plant in its medical business and to purchase fixed assets to improve productivity and ensure the continuation of its business. In addition, the funds were to be used to pay for expenses, etc. to promote the sales of new products of its medical business. The offering was made overseas and raised ¥112.6 billion.

One of the issues that stood out in 2014 was the January 7 offering by Mitsubishi Motors Corporation. The offering was part of a plan to retire all of the preferred shares issued as part of the company’s business revitalization program in 2004 and enable stable return of profits to shareholders and establish a business base that supports sustained growth. Of the ¥257.0 billion raised in the general domestic and overseas offering, up to ¥210.0 billion is earmarked for buyback of the preferred shares.

One of the initial public offerings that attracted attention in 2013 was Suntory Beverage & Food Limited. A core subsidiary of Suntory Holdings Limited operating in the soft drink market, Suntory Beverage & Food listed on the First Section of the TSE on July 3. The offering price for the issue was ¥3,100, giving the company a market capitalization of about ¥1 trillion when it listed. More than ¥200 billion of the capital raised from the public offering has being allocated to finance mergers and acquisitions (M&A) overseas, targeting the Southeast Asia market in particular.

So far in 2014, one of the highlights in the initial public offering market has been the listing of Japan Display Inc. on the First Section of the Tokyo Stock Exchange. Formed through a merger of the LCD businesses of Sony, Hitachi, and Toshiba, the company produces and sells small to medium-sized liquid crystal display. The offering price for the issue was ¥900, giving the company a market capitalization of about ¥550.0 billion when it listed. All of the capital raised from the public offering has being allocated to capital investment for the small to medium-sized liquid crystal display business.

<Table 5> Key Statistics for Stocks (TSE 1st, 2nd, Mothers, JASDAQ)

Year	No. of Listed Companies*	Newly Listed	Total Market Value* (¥trillion)	Trading Volume (billions of shares)	T.Volume. (daily avg) (millions of shares)	Trading Value (¥ trillion)	T.Value. (daily avg) (¥ billion)	TOPIX*
2011	2,279	50	255.8	536.7	2,190	347.1	1,416	728.61
2012	2,293	69	300.7	529.9	2,136	310.8	1,253	859.80
2013	3,406	79	477.5	887.9	3,624	682.7	2,786	1302.29

Note: *as of end of year

The companies newly listing on the TSE as a result of the merger (July 16, 3013) of the cash markets of the TSE and OSE (1,099 companies) were excluded from the Newly Listed figure for 2013.

(source) TSE Monthly Statistics Report

(2) Secondary Market

Stock prices continued on their upward trend in the first quarter of 2013. In January the market looked favorably on the U.S. government's temporary avoidance of the "fiscal cliff" problem and started to rise sharply. On January 4, the stock index broke through the supposed wall of ¥10,500, to hit ¥10,688. During the month, comments by a government spokesman and other materials concerning a strong yen caused the stock index to sink 300 points by the closing bell on one day, but the yen was back into a declining trend by the end of the month, support a recovery in the stock index to the ¥11,000 level, at ¥11,138. On March 8, the Nikkei 225 Stock Average reached ¥12,283. This mark represented a return to the pre-Lehman Brothers failure levels of 2008. Contributing to the surging market were the continued announcements of favorable economic indicators in the United States, the Dow Jones Industrial Average reaching record high levels on the strength of rising hopes of a recovery in the U.S. economy, and the progressive weakening of the yen based on heightened anticipation of further monetary easing prompted by the statements of candidates for the jobs of governor and deputy governor of the Bank of Japan at Diet hearings.

In the second quarter of 2013, the bull market that had continued since November 2012 finally reached a turning point in May. The stock index started the second quarter at ¥12,135 on April 1, and rode the new wave of depreciation in the yen caused by Bank of Japan Governor Haruhiko Kuroda's introduction of large-scale quantitative and qualitative monetary easing—hitting ¥13,926 on April 25. Even entering May, the market continued to rise during the first half of the month on the back of expectations of an improvement in the U.S. economy and other factors, reaching ¥15,900 on May 23. However, on the same day, news that the China PMI was struggling caused the Nikkei 225 Stock Average to shed ¥1,143, to ¥14,483. At the start of the next week, the stock index continued its slide, shaving off ¥469 on May 27 and ¥737 on May 30, and dropping to ¥13,774 at the end of the month. At the beginning of June, foreign investors started to unwind the positions they had built by aggressively buying Japanese stocks and selling yen and buying U.S. dollars, causing falling Japanese stock prices and the appreciation of the yen to move in tandem. On June 13, the Nikkei 225 Stock Average was down ¥843, to ¥12,445. However, the stock index rebounded in the second half of June because of a weakening yen.

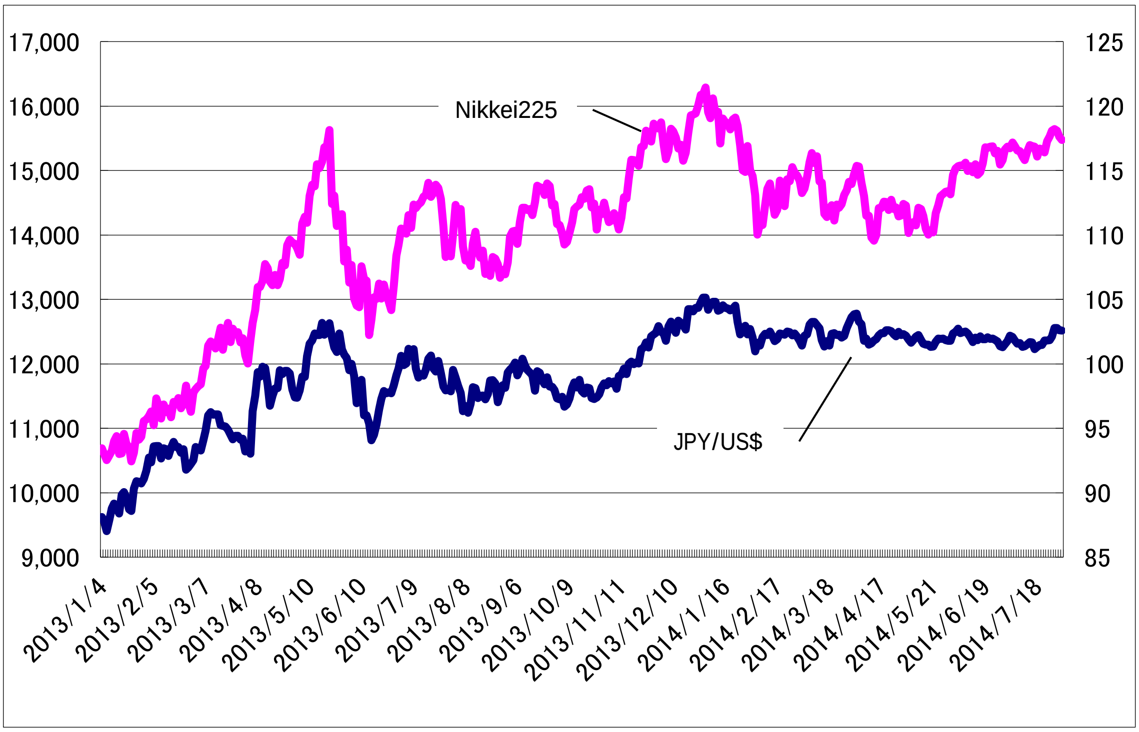
In the third quarter, the stock index moved in a boxed zone bounded by ¥13,000 and ¥15,000. On July 1, the index rebounded from the end of the previous month, starting at ¥13,852 and rising to the ¥14,000 level on July 2 against the backdrop of the weak yen and other factors. Following the positive start, the market continued its upswing on the strength of a rising U.S. market, reaching ¥14,808 on July 18. During the latter part of the month, the market gave back some of its gains based on profit taking, etc., falling through the ¥14,000 mark by the end of the month. Amid thin trading in August, the market again challenged the ¥14,000 mark, but temporarily fell to ¥13,338 on August 28 because of the growing tension in political conditions in Syria. Entering September, the stock index recovered to the ¥14,000 level, reacting to a calming down of concerns over the situation in Syria, Tokyo being awarded the 2020 Summer Olympic and Paralympic Games, and a rising U.S. market. After hitting ¥14,799 on September 26, concerns about fiscal problems in the United States spread through the market at the end of the month, driving the stock index down to ¥14,455.

In the fourth quarter of 2013, the market overall followed an upward path until the end of the year. The up-and-down trend of the previous quarter continued from October to mid-November, at which time improvement in U.S. employment figures and the cautious stance of the incoming Chair of the Federal Reserve Board (FRB), Janet L. Yellen, on effecting a quick end to the quantitative easing program pushed the stock average up to ¥15,000 on November 15. Following that recovery, the upward trend continued to the end of the year, driven by progressive weakening of the yen, by the U.S. decisions on tapering of the QE program and maintaining low interest rates, and by the record highs being set by the Dow Jones Industrial Average. On December 30, the Nikkei stock average ended the year at ¥16,291, a six-year high not reached since November 2007.

In the first quarter of 2014, following a dip in the market, the stock index moved in a narrow range around ¥14,500. In January, the market fell on profit taking after the sharp rise at the end of the previous year, starting the year at ¥15,908, ¥383 down from the end of 2013. The market continued to struggle under pressure from falling stock prices in the United States and other factors, with the stock index falling below ¥15,000 at the end of the month because of concerns over the economies of emerging countries that began to emerge during the latter part of the month. The stock index moved in the ¥14,000 range in February, but recovered in the latter part of the month buoyed by the February 18 announcement of a revision in the Bank of Japan’s money market operations, a weak yen, and a strong U.S. stock market. In March there was some buying on dips in the market caused by the depreciation of the yen and other factors, with the stock index rebounded to the ¥15,000 level at one point, but further gains were difficult amid growing tensions in political conditions in the Ukraine and other factors.

In the second quarter, after moving almost in the mid-¥14,000 level for a while, the market began to rise in the second half of the quarter. In April, the stock index recovered to the ¥15,000 level on April 3 against the backdrop of a bull market in the United States and a weak yen, but dropped down below the ¥14,000 mark for the first time in 2014 on April 11 when political conditions in the Ukraine worsened. After the sell off phase, investors began to buy stock again, but market momentum was weak with the stock index moving mostly in the lower ¥14,000 range. Even entering May, there was little incentive to buy as it became clear that the earnings growth of Japanese corporations would be lower than a year earlier. As a result, the market followed the previous month's trend until May 22, when the market rose for six consecutive days on the strength of the U.S market. In June, with the Dow Jones Industrial Average again hitting new highs, the Japanese market firmed up supported by an improvement in economic indicators in China, the introduction of a minus interest rate policy by the European Central Bank (ECB), and Japan's Prime Minister Abe's statement in a press conference about lowering the effective tax rate for Japanese corporations. On June 3, the stock average hit ¥15,034, rising above the ¥15,000 level for the first time in two months. It later moved mostly in the ¥15,000 range, ending the quarter at ¥15,162 on June 30.

<Chart 1> Nikkei 225 Stock Average and Yen Exchange Rate



<Table 6> Market Share & Trading Balance by Types of Investors
-Tokyo, Nagoya -

Year	Member Account	Individuals	Foreigners	Investment Trusts	Business Cos.	Life & Non-life	Citi BK & Regional BK	Trust BK	Other Financial Institutions
Market Share									
2011	19.5%	16.0%	54.5%	1.8%	0.9%	0.4%	0.1%	4.9%	0.1%
2012	17.9%	18.0%	54.1%	1.8%	0.9%	0.4%	0.1%	4.6%	0.2%
2013	12.5%	28.0%	50.8%	1.5%	1.0%	0.2%	0.1%	3.1%	0.1%
Net Selling (-)/Buying (+) (¥billion)									
2011	- 3,150	5	1,972	- 138	617	-575	-81	789	30
2012	254	-1,911	2,826	45	380	-697	-118	-1,019	-62
2013	- 585	-8,750	15,119	426	629	-1,075	-282	-3,966	-468

Note: Figures up to and including the second week of July 2013 are the totals of the three markets of Tokyo, Osaka, and Nagoya.
(Source) TSE Monthly Statistics Report

2. Bond Market

(1) Primary Market

In 2013, public and corporate bond issuance in Japan increased ¥8.3 trillion, or 4.1%, from 2012, to ¥210.8 trillion, growing for the second consecutive year. Looking at a breakdown, public debt securities and corporate bonds increase year on year, but non-resident issues declined. Accounting for the largest share of the market, JGB issuance totaled ¥181.0 trillion, expanding ¥8.7 trillion from last year and posting growth for the third consecutive year. Among general bond issuance other than JGBs, municipal bonds amounted to ¥7.8 trillion compared with ¥6.8 trillion in 2012; Government-guaranteed bonds were ¥4.9 trillion compared with ¥4.7 trillion last year; Fiscal Investment and Loan Program (FILP) agency bonds totaled ¥4.8 trillion compared with ¥5.4 trillion the year before; and straight corporate bonds were ¥8.7 trillion compared with ¥8.2 trillion last year.

Looking at an overview of the 2013 primary market, JGBs and straight corporate bonds demonstrated greater than 5% year on year growth. A breakdown of JGBs shows growth in issuance across all categories, whether short-term bills, medium-term notes, long-term bonds or superlong-term bonds. From the point of view of developing the market, the government shifted from issuance 8 times a year to monthly issuance for 30-year JGBs. In addition, although they account for only a small percentage of total issuance, the government added a principal guarantee to the consumer price index (CPI)-linked JGBs that have not been issued since August 2008, re-launching them in October 2013 for the first time in five years. Moreover, for CPI-linked issues maturing in January 2016 or later, the government will lift the sale restrictions in January 2015, making these issues available to individuals and other non-institutional investors.

Issuance of straight corporate bonds is increasing along with growing demand for capital by corporations as the economy recovers coupled with the low interest rate climate. Issuance of straight corporate bonds targeting individual investors also continues to be firm. Some of the standout issues have been the March issue of a 4-year straight bond (¥300.0 billion) and the June issue of a 5-year straight bond (¥400.0 billion) by SOFTBANK CORP. and a 5-year straight bond issue (¥150.0 billion) by Sony Corporation.

Among other bond issues, total issuance of convertible-type bonds with subscription rights (CBs) was ¥75.5 billion spread among seven issues. This represented a substantial increase from the total issuance of ¥8.5 billion for two issues in 2012.

In the first six months of 2014, public and corporate bond issuance in Japan amounted to ¥102.9 trillion, a little less than half of the annual total issuance in the previous year. However, non-resident yen-denominated samurai issues made in the first six months reached ¥1.6 billion, approaching the total for the whole year in 2012 (¥1.6 billion). In other categories, JGB issuance totaled ¥88.2 trillion; municipal bonds amounted to ¥3.1 trillion; Government-guaranteed bonds were ¥2.5 trillion; Fiscal Investment and Loan

Program (FILP) agency bonds totaled ¥2.1 trillion; and straight corporate bonds were ¥4.2 trillion.

<Table 7> Public and Corporate Bonds

(¥ trillion)

Year	Trading Volume(face value)			Issuing Amount			
	JGB	Others	Total	Public Debt Securities (JGB)（Note 1）	Corporate Bonds （Note ２）	Non-Resident Issues(Yen-denominated)	Total （Note ３）
2011	7,860	104	7,964	179.5(164.0)	8.5	1.8	193.3
2012	8,737	105	8,843	189.1(172.2)	8.4	1.7	202.4
2013	8,951	89	9,040	197.7(181.0)	8.7	1.6	210.8

(Source) Japan Securities Dealers Association

Notes: 1. JGBs do not include bonds placed in the public sector or financial bills (including financial bills that are accounted or under treasury bills). Public bonds other than JGBs comprise municipal, government-guaranteed, and FILP agency bonds (including regional public corporation bonds).

2. Corporate bonds comprise straight corporate bonds (including investment company bonds), convertible-type bonds with subscription rights (CBs), and asset-backed corporate bonds.

3. The total figures are not equal to the sum of individual categories because they include bank bonds, private placement corporate bonds and private placement government bonds.

(2) Secondary Market

In the first quarter of 2013, the long-term interest rate moved in the 0.8% range during early January, then slid mainly downward for the rest of the quarter. Looking at the movement in more detail, in early January the rate stayed around 0.8% because the U.S. long-term interest rate rose on the strength of the U.S. government’s temporary avoidance of the “fiscal cliff” problem. Following that phase, the rate headed downward after the Cabinet determined the Japan’s supplementary budget and other parts of its emergency economic measures, allaying the market’s concerns about excessive JBG issuance, and bond auctions went on without difficulty. Entering February, the decline in the long-term interest rate progressed. With the announcement of the names of the candidates for the governor and deputy governors jobs at the Bank of Japan, expectations of additional quantitative easing heightened further, causing the rate to drop to 0.6555% on February 28, setting a new low for the first time since June 2003. On March 27, the rate declined to 0.515% after setting record lows for five consecutive business days, registering lows on consecutive days for the first time in nine years and nine months since June 2003. Based on the view that the Bank of Japan would boost monetary easing, bond buying ramped up in the market, mainly of long- and medium-term bonds. Furthermore, with the end of the fiscal year in sight, domestic institutional investors, such as pension funds and life and non-life insurers, were increasing their bond portfolios.

The long-term interest rate began to show some instability in the second quarter of 2013. On April 4, the Bank of Japan announced its qualitative and quantitative easing policy, spreading the view throughout the market of a supply and demand gap opening up for JGBs. The rate declined below the 0.43% recorded in June 2003, to hit 0.425% at one point. On April 5, it dropped further to 0.315%. However, the market then became cautious about the sudden drop in rates and reversed direction, with the selling trend driving up the rate to 0.6%. On April 10, the rate increased to 0.615%, up 0.085% on the day. Large sell orders for medium-term bonds were placed by what was thought to be regional banks, a trend that spilled over into long-term bonds. This action was seen to be investors rushing to sell off medium-term bonds, the yields on which were expected to fall significantly after Bank of Japan Governor Haruhiko Kuroda refused to lower interest rates on the excessive reserves in the Bank of Japan current account. It has also been pointed out that prices tend to drop easily when large sell orders are pitted against only a few buy orders. Entering May, the weak yen and high stock prices combination continued for the first half of the month, resulting in the long-term interest rate increasing sharply from the 0.5% level to the 0.9% level over a period of four consecutive business days ending on May 15. On May 22, disappointment about the details of the Bank of Japan’s Monetary Policy Meeting and the impact of the rising U.S. long-term interest rate started to push the rate up. The rate rose to 1.0% for the first time in about a year during trading on May 23. Once into June, the turbulence in the rate settled down. During June, the rate posted a high of 0.9% and a low of 0.795%, moving almost entirely within a 0.8% range. It was pointed out that the market settled down because the market positively evaluated the dialogue between it and the Bank of Japan and recognized the bank’s flexible long-term JGB purchasing operations policy.

In the third quarter, the long-term interest rate settled into a downward trend. In July, the rate moved in the 0.8% range before declining to the 0.7% level by the end of the month based on a hiatus in the rise in U.S. long-term interest rates, further appreciation of the yen, and other factors. Entering August, the decline in the stock market and growing tensions in the political situation in Syria caused the rate to follow a downward path, deteriorating to 0.72% at the end of the month. In September, the yen exchange rate fell to around ¥100 to the U.S. dollar at the beginning of the month, causing the long-term interest rate to rise to the upper 0.7% range, but from the middle of September the rate declined again because of such factors as the postponement of the tapering off the U.S. QE program and the decision by the Japanese government to raise the consumption tax the following Spring. The long-term interest rate slipped to 0.67% on September 19, falling below the 0.7% mark for the first time since early May.

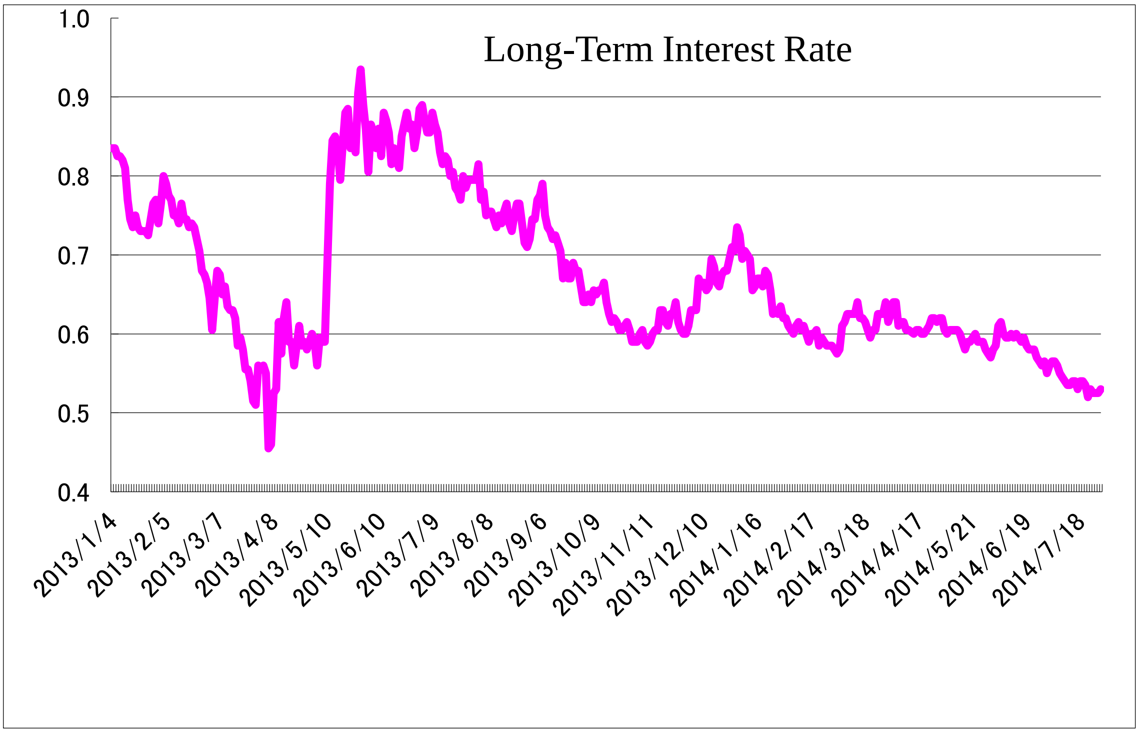
In the fourth quarter, the long-term interest rate continued its decline under October before rebounding. The deterioration continued throughout October because of concerns over U.S. fiscal problems and the market view that the tapering of the U.S. QE program would be postponed, culminating in the long-term interest rate hitting its lowest level in six months, at 0.585%, on October 30. Entering November, the rate sunk to 0.585% on November 8, but then recovered slightly to the 0.6% to 0.65% range on the strength of a rise in U.S. long-term interest rates, the swing in the exchange rate toward depreciation, and a rising stock market. In December, the rate moved a step up because of the U.S.

decision on tapering of the QE program and maintaining low interest rates and the accompanying rise in U.S. interest rates and acceleration in the depreciation of the yen and the increase in stock prices. On December 26, Japan's long-term interest rate rose above 0.7% and moved up further to end the year at 0.735% on December 30.

In the first quarter of 2014, after moving into a downward trend, the long-term interest rate rose a little in March and then stayed in the same range. In the early part of January, the long-term interest rate approached 0.7%, but then resettled into the downward trend ending the month at 0.62%. Reasons for the relapse included the increase in number of employees in the United States falling to half that of the previous month, the weak stock market and low long-term interest rate trends in United States, and the emergence of anxiety over the economies of emerging countries. The decline in the rate continued in February, driven by the strong yen, falling stock prices, and other factors, with the long-term interest rate dropping below 0.6% for the first time in three months on February 14. The rate then moved in the 0.5% range. In March, the rate climbed back to the 0.6% level at the beginning of the month as concerns about political tensions in the Ukraine receded. Following that, based on such concerns as the conditions in the Ukraine, the feeling that FRB Chair Janet L. Yellen would be raising interest rates sooner than expected based on a press conference, and other factors, the long-term interest rate stayed in that range, ending the month at 0.64% on March 31.

The long-term interest rate made a slow decent during the second quarter of 2014. In April, the rate moved in a tight range between 0.60% and 0.65% under pressure from the political situation in the Ukraine that continued on from the previous month and the decline in long-term interest rates in the United States and Europe. Under these conditions, on April 14, there was no market for newly issued 10-year JGBs for a day. It was the first time in 13 years (not since December 26, 2000) that newly issued JGBs had not attracted a single successful private sector bid for a whole day. In May, the decline in the rate proceeded as it became clear that the earnings growth of corporations would be smaller than a year earlier and U.S. rates fell below the key level of 2.5% as well as other factors. On May 15, Japan's long-term interest rate fell below 0.6% and slid to 0.57% on May 30. Entering June, the rate made a run toward the 0.6% mark at the beginning of the month but ended up staying in the upper 0.5% range. During the first part of the month, decisions were made by the ECB to lower its key refinancing rate by 0.1%, to 0.15% and to reduce the interest rate on its deposit facility to minus 0.1%. Against the backdrop of the acceleration in the decline of European bond interest rates and other factors, the long-term interest rate in Japan fell to 0.565% on June 30.

<Chart 2>　Long-Term Interest Rates in Japan



3. Investment Trust

At the end of 2013, the net assets of publicly offered investment trusts amounted to ¥81,532.2 billion, up a substantial ¥17.459.4 billion from ¥64,063.7 billion last year. Total net assets of stock investment trusts were ¥65,027.4 billion compared with ¥52,913.9 billion, an increase of ¥12,113.4 billion. Total net assets of bond investment trusts, including MMFs, increased ¥5,345.9 billion year on year from ¥11,149.8 billion, to ¥16,495.7 billion.

At March 31, 2013, the balance of investment trusts held by Japanese households was ¥71,229.3 billion. This balance rose dramatically over the course of 2013, increasing to ¥71, 880.4 billion at June 30, ¥74,710.8 billion at September 30, and ¥78,945.1 at December 31, 2013.

Looking at capital flow, there was a net capital inflow throughout the year. Capital inflow was ¥2,415.0 billion in the first quarter (January to March), ¥2,831.1 billion in the second quarter (April to June), ¥1,865.4 billion in the third quarter (July to September), and ¥1,217.6 billion in the fourth quarter (September to December).

Looking at investment trusts in detail, the number of publicly offered investment trust funds increased by 538 funds year on year, to 4,922 funds, demonstrating substantial growth. Stock investment trusts comprised most of the total number of funds, at 4,756 funds, as the number of bond investment funds declined slightly.

Growth in the number of funds continued in 2014, with the number of stock investment funds increasing to 5,011 funds in June. One of the reasons behind the continued growth in the number of funds was an increase in the development of non-distribution investment trusts and other new products in conjunction with the start of the NISA system, Japan's new tax exemption scheme for small investments by individuals. These products have been developed because if distributed income from investment trusts purchased through a NISA is reinvested, those amounts will be included as part of the ¥1 million annual tax exemption under the new system.

<Table 8> Changes in Assets of Investment Trusts

(¥ trillion)

Year	Total	Stock Investment Trusts			Bond Investment Trusts (除く MMFs)			MMFs		
		Sales	Repurchases	Assets	Sales	Repurchases	Assets	Sales	Repurchases	Assets
2011	57.3	23.5	19.7	46.7	35.3	35.8	8.5	0.6	0.8	2.0
2012	64.0	23.8	22.3	52.9	33.2	32.4	9.3	0.4	0.6	1.8
2013	81.5	40.0	34.8	65.0	66.5	61.2	14.5	0.6	0.5	1.9

(Source) The Investment Trusts Association, Japan

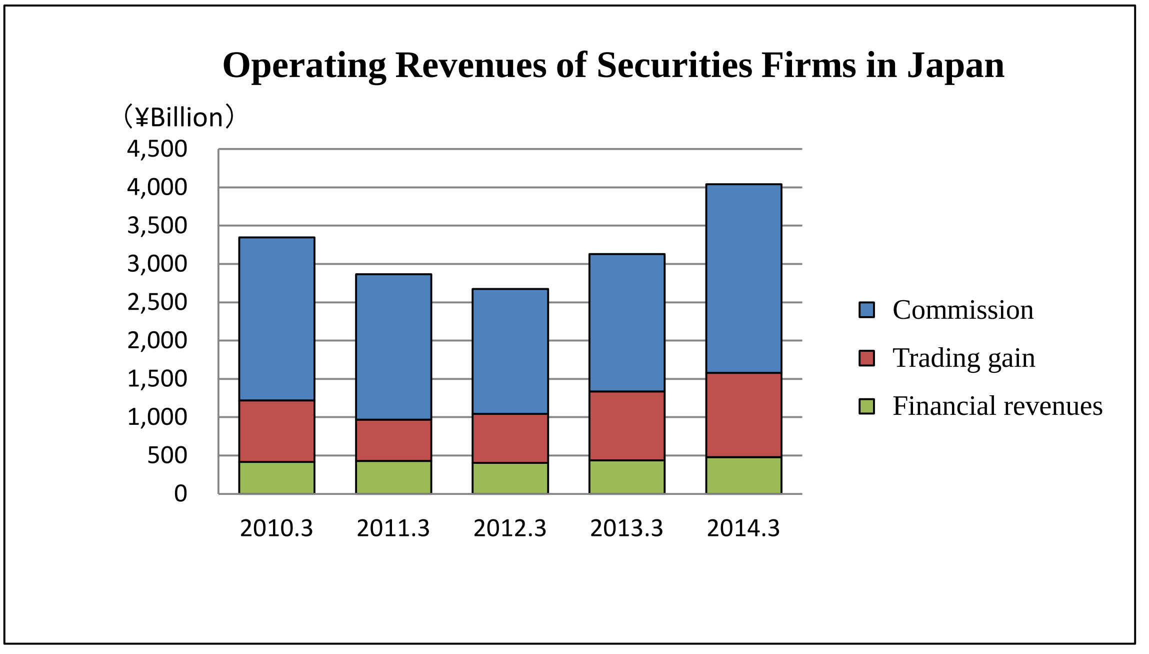
III. Overview of Securities Industry Performance

Against the backdrop of strong expectations for the government's and Bank of Japan's monetary and fiscal policies, a robust stock market and other positive factors supported favorable annual performances by securities firms in Japan in the fiscal year ended March 31, 2014. The proportion of securities firms posting profits (companies reporting profits on a net income basis) was 81%, up from 74% in the previous fiscal year. It was the first time in ten years (since the fiscal year ended March 2004) that more than 80% of firms were profitable.

Overall, the industry recorded operating revenues of ¥4,086.5 billion, increasing 28.9%, or ¥915.4 billion, from the previous year.

Looking at a breakdown of operating revenues (see Chart 3), all categories improved: commissions increased 32.2%, or ¥667.1 billion, to ¥2,460.9 billion; trading gain grew 22.6%, or ¥202.6 billion, to ¥1,098.7 billion; and financial revenues rose 9.1%, or ¥40.1 billion, to ¥479.8 billion.

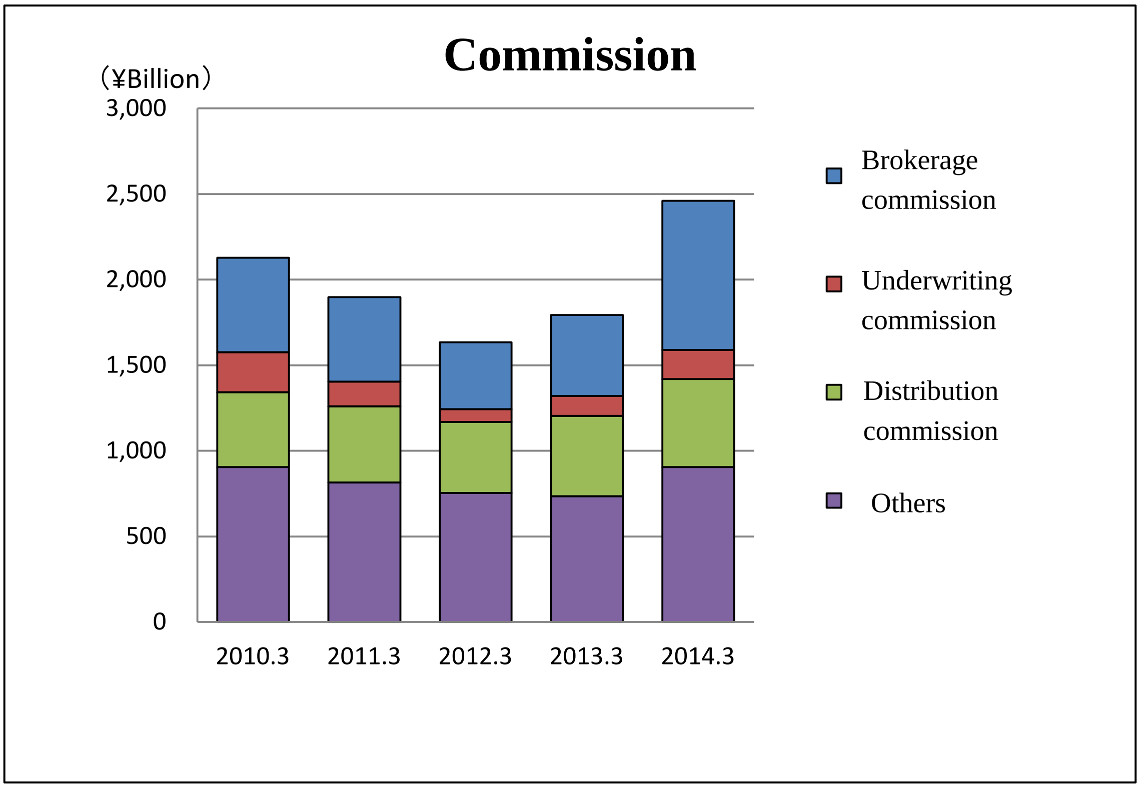
<Chart 3> Operating Revenues of Securities Firms in Japan



Looking at commission in more detail, supported by the vigorous stock market, brokerage commission increased 83.8%, or ¥396.9 billion, to ¥870.8 billion. Underwriting commission grew 47.5%, or ¥55.0 billion, to ¥170.7 billion based on growth in equity finance issues. In other categories, distribution commission rose 9.4%, or ¥44.1 billion, to ¥513.8 billion.

Net operating income after subtracting the financial expenses shown in Chart 5 from operating income amounted to ¥3,797.7 billion, a 31.1% or ¥899.8 billion increase from a year earlier.

<Chart 4> Commission

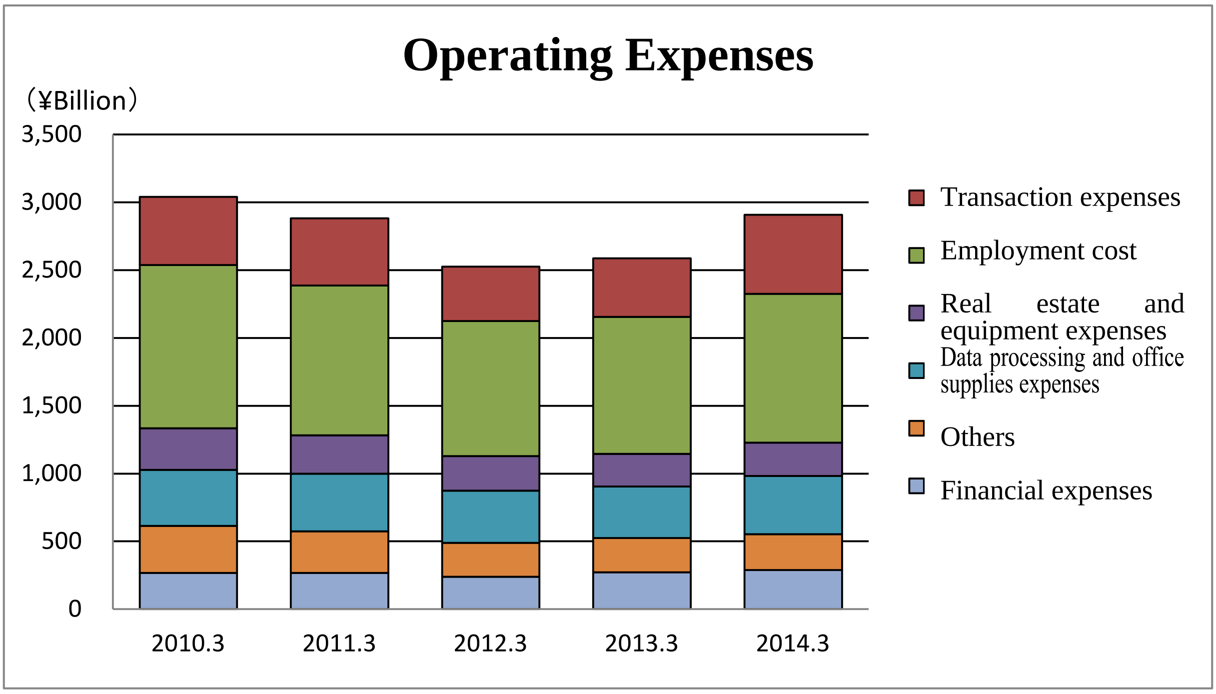


Compared with the large increase in operating revenues, operating expenses of securities firms in the fiscal year ended March 2014 increased to smaller extent, growing 12.4%, or ¥322.0 billion, to ¥2,912.4 billion (see Chart 5).

Looking at separate categories, selling and general administrative costs rose 13.2%, or ¥306.5 billion, climbing to ¥2,623.7 billion while financial expenses edged up 5.6%, or ¥15.4 million, to ¥288.7 billion.

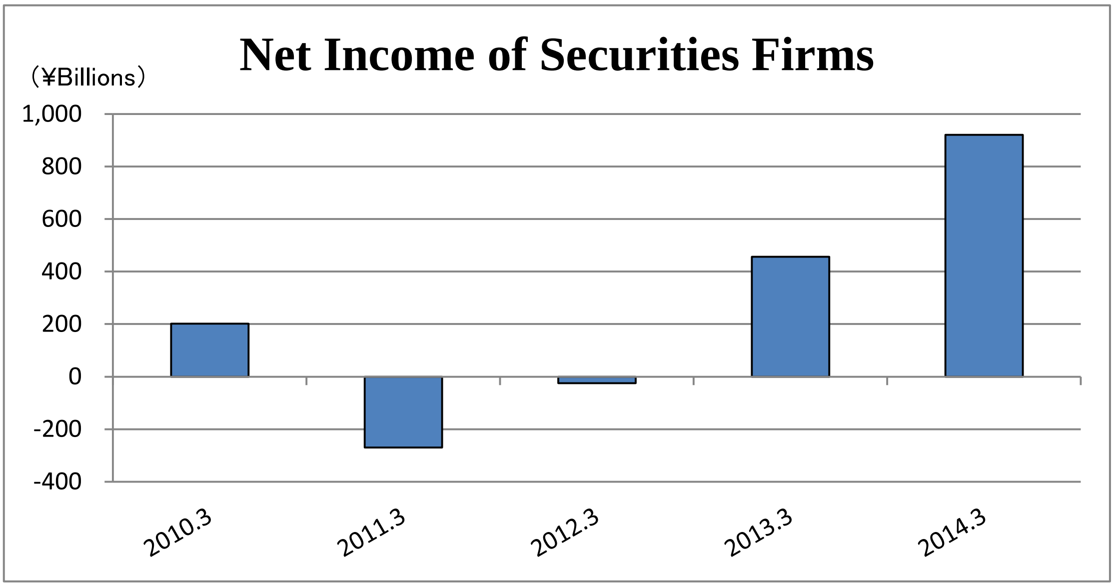
Breaking down selling and general administrative costs, driven by the higher trading volumes of the robust market, transaction expenses increased 34.9%, or ¥151.5 billion, to ¥585.6 billion. However, other cost components were held to a lower pace of growth. Employment cost increased 8.7%, or ¥87.4 billion, to ¥1,096.3 billion, real estate and equipment expenses edged up 1.3%, or ¥3.1 billion, to ¥246.0 billion, and data processing and office supplies expenses rose 13.2%, or ¥50.0 billion, to ¥429.0 billion.

<Chart 5> Operating Expenses



As a result, the net income of the securities industry in Japan in the fiscal year ended March 2014 amounted to ¥921.1 billion, up 101.6%, or ¥464.2 billion year on year. This performance represented a more than doubling of net income over the previous fiscal year (see Chart 6). It was the first time since the fiscal year ended March 2006 (net income was ¥1,036.3 billion) that the securities industry had recorded more than ¥900.0 billion in profits.

<Chart 6>　Net Income of Securities Firms



IV. Regulatory and Legal Framework Revisions, Industry Topics

1. Amendment of Japan's Financial Instruments and Exchange Act
In May 2014, the 2013 Amendment Act of the Financial Instruments and Exchange Act, etc. was passed and promulgated. The new round of revisions included the following measures aimed at enhancing the appeal of Japan's financial and capital markets including measures that seek to direct household financial assets into growth investing.

• Promoting investment-type crowdfunding
Japan relaxed the regulations on the handling by financial intermediaries of investment-type small amount (total funding under ¥100 million, ceiling of ¥500,000 on individual investments) crowdfunding. The new rules avoid imposing overlapping regulations on this type of crowdfunding as well as reducing the minimum capital requirements for registering a business. In addition, the new rules seek to eliminate any fraudulent or inappropriate activity in soliciting crowdfunding investment over the Internet by requiring the businesses operating the crowdfunding websites to provide appropriate information over the Internet and to check the business details of venture businesses trying to raise funds on their websites.

• Reducing the cost burden on newly listed companies
Regulations have been revised to give newly listed companies (excluding particularly large-scale companies and companies that have a significant impact on the society or economy) the option of electing to not be audited by a certified public accountant regarding their Internal Control System Report for the first three years after listing.

• Introduction of regulations concerning financial benchmarks
Regulations were introduced that designate some providers of special financial benchmarks as “Special Financial Benchmark Providers.” These benchmark providers are obligated under the regulations to produce and comply with a “Code of Conduct” that incorporates the International Organization of Securities Commissions (IOSCO) Principles for Financial Benchmarks. The regulations also established a framework for the inspection and monitoring of Special Financial Benchmark Providers, including information collection and on-site inspections.

2. Amendment of Japan’s Companies Act
In June 2014, the Amendment Act of the Companies Act was passed by the Diet. The new round of revisions included the following measures aimed at enhancement of corporate governance, etc. in light of recent socioeconomic trends related to joint stock companies.

• Disclosure of the reason for not choosing an outside board member
While a consensus was not reached on mandatory appointment of an outside board member, the Diet did introduce a rule of "comply, or explain" based on the U.K. rule. If a large company does not have any outside board members, the directors of the company must give a reasonable explanation as to why the appointment of an outside director is not necessary at the regularly scheduled general meeting of shareholders.

• Introduction of a corporate auditors and directors board as a new governance structure
From the perspective of encouraging greater utilization of the function of outside board member, companies can now also select a corporate auditor and directors board (half of the members must be outside directors) as their governance structure by amendment of their articles of incorporation in addition to the previous choices of either an corporate auditor board or a designated committees (previously called “three committees”) system.

• Introduction of a new regulation for third-party allocations of new shares resulting in a change in the controlling shareholders
To restrain third-party allocations of new shares that result in a change in the controlling shareholders that can lead to significant damage to the interests of existing shareholders, companies are basically required to place the matter before the annual meeting when 10% of shareholders make an objection to the third-party allocation.

3. Self-Regulation System
The following is a summary of the significant new and revised self-regulatory rules introduced by the Japan Securities Dealers Association (JSDA).

In October 2013, the JSDA revised relevant rules regarding solicitation of investments from elderly customers (enforced on December 16, 2013). The JSDA made the revisions from the perspective of the necessity of taking a careful approach to solicitation of elderly customers based on the suitability principle in order to encourage the proper solicitation of elderly customers by member firms.

In November 2013, the JSDA introduced “Rules Concerning Binary Options Transactions” and made revisions to other related self-regulatory rules. These actions were taken to provide the necessary compliance framework regarding the content, investment solicitation, and customer management, etc., of securities-related binary option trading of member firms. The new rule and revisions were enforced as of December 1, 2013.

In March 2014, based on the report by the Study Group to Vitalize the Corporate Bond Market (released July 30, 2012), the JSDA made partial revisions to its relevant regulations to revise the reference statistical prices for OTC bonds and to establish regulations for the reporting of corporate bond trading information and the creation of a public announcement system. The revisions are to be implemented beginning in Fall 2015 and by the start of 2016 at the latest.

4. Revisions to Financial and Securities Taxation System, etc.

The Nippon Individual Savings Account (NISA) system, the new tax exemption scheme for small investments by individuals, got under way in January 2014. Created based on the United Kingdom’s Individual Savings Account (ISA) system, the system allows individuals 20 years of age or older domiciled in Japan to invest up to ¥1 million annually for up to five years in listed stocks, stock investment trusts, and other eligible securities with capital gains, dividends, and coupons earned on those funds being tax free. Originally, an individual was only allowed to open a NISA with one financial institution, but effective January 2015, the system will become more convenient by allowing individuals to change the financial institution at which they hold an NISA by going through a transfer procedure. According to a survey by the Japan Financial Services Agency (JFSA), at June 30, 2014, there were approximately 7.3 million registered accounts through which a total of ¥1.5 trillion in assets had been purchased.

Moreover, to establish an environment that facilitates investment by individuals in a variety of financial products, the government is progressing with the unification of the taxation system for financial income. Specifically, from January 2016, investors will be able to separately file their earnings on public and corporate bonds, etc., in the same way as can be done currently with listed stocks, etc., expanding the currently limited range of financial products for which losses and gains can be offset to include public and corporate bonds.

5. “Principles for Responsible Institutional Investors” << Japan’s Stewardship Code>>, etc.

In February 2014, JFSA’s Council of Experts Concerning the Japan Version of the Stewardship Code formulated and made public the “Principles for Responsible Institutional Investors” << Japan’s Stewardship Code>>. (http://www.fsa.go.jp/en/refer/councils/stewardship/20140407.html) The Code defines principles considered to be helpful for institutional investors who behave as responsible institutional investors in fulfilling their stewardship responsibilities with due regard both to their clients and beneficiaries and to investee companies. In this Code, “stewardship responsibilities” refers to the responsibilities of institutional investors to enhance the medium- to long-term investment return for their clients and beneficiaries by improving and fostering the investee companies' corporate value and sustainable growth through constructive engagement, or purposeful dialogue, based on in-depth knowledge of the companies and their business environment. Currently, JFSA and JPX also are discussing the formulation of a corporate governance code.

6. Launch of JPX Nikkei Index 400

The JPX Nikkei Index 400 was launched in January 2014. The new stock index is composed of companies with high appeal for investors that meet requirements of global investment standards, such as efficient use of capital and investor-focused management perspectives.

7. Merger of Derivatives Markets

The Japan Exchange Group, Inc. (JPX) was formed in January 2013 as a result of the merger of the operations of the Tokyo Stock Exchange (TSE) Group and Osaka Securities Exchange (OSE). Along with the merger, the cash stock market of the OSE was combined into the TSE stock market in July 2013. Following up on that combination, the TSE's derivatives market was folded into the OSE market in March 2014. In conjunction with that move, the OSE changed its name to the Osaka Exchange. The OSE's next generation derivatives trading system, which will be released in 2016, will include a commodities futures trading function from the viewpoint of enhancing competitiveness.