Japan Securities Dealers Association
JSDA

September 2013
Japan Securities Dealers Association

Japanese Economy and Securities Market

I. Japanese Economy

(Macroeconomic trends)
A process to revive the Japanese economy is currently going on under the new government administration formed at the end of last year. They are making steady progress with their goals of (1) reversing the long-lasting trend of a shrinking Japanese economy suffering from prolonged deflation and (2) increasing employment and income by adopting a three-pronged strategy consisting of bold monetary policy, flexible fiscal policy and a growth strategy that promotes private investment.

Actually from late 2012 to 2013 onward, the drastic monetary and fiscal policy shifts along with the regime change that the new government administrationled by Mr. Shinzo Abe took power after December 2012 Lower House Election brought about a number of observable changes in the Japanese real economy as well as financial and capital markets. In tandem with the new government's economic policy mix "Abenomics", the unlimited quantitative and qualitative monetary easing and inflation target committed by the Bank of Japan further transformed the macroeconomic environment.

Some signs of a pickup in the economy are already emerging as corporate earnings have turned favorable.In the fourth quarter of 2012, although the decline in exports continued from the third quarter, the global economy was bottoming out, with the number of people employed in the U.S. non-agricultural sector increasing and the PMI of China's manufacturing industry rising above 50. In Japan, housing starts increased and public demand also rose.

Entering 2013, the economy remains on a recovery path. The decline in exports came to a halt despite the difficult conditions in the Euro Zone on the strength of the moderate economic recovery in the United States and China. Although the growth in housing starts leveled off in Japan, personal consumption gradually expanded. Furthermore, public demand is steadily increasing.

(Trends in employment conditions)
Entering 2013, the unemployment rate has shown a gradual improvement, with the most current figure of June being3.9%. The job-offers to seekers ratio also followed a moderate but positive upward curve,rising from 0.65 times to 0.80 timesin 2012 to reflect the improvement in demand-supply conditions. The ratio continued to move upward in 2013, andthe most current figure of June was 0.92 times. There is a strong possibility that the unemployment figure will continue to improve, supported by such factors as a rebound in employment in the manufacturing industry in line with a recovery in production.

Looking at a breakdown of the employment figure, there was a marked increase in employment in the medical care and welfare industry against the backdrop of the aging of Japan’s society and low birthrates. In contrast, employment in the manufacturing and in the wholesale and retail industries is decreasing. Moreover, despite the improvement in the overall unemployment rate, looking at population age groups, the average unemployment of 15- to 24-year olds is the higheston an annual basis, at 8.1%. Employment of Japan’s youth is clearly an issue.

(Price Trends)
In 2012, the Corporate Goods Price Index (CGPI) decreased 0.9 percentage point from a year earlier, to 100.6 (2010 as base value), declining for the first time in two years. Entering 2013, the CGPI remained practically flat from February onward, and the most current figure of June increased 0.1 percentage point, to 101.6 (preliminary report basis). Among the reasons for the drop in the CGPI was the decrease in crude oil prices in the first half. However, in the second half, oil and coal products became a factor driving up the CGPI and the progressive weakening of the yen has contributed to increasing import prices, particularly feedstock. As a result, it is expected that there will be a moderate increase in CGPI going forward.

The Consumer Price Index (CPI; excluding fresh produce) had been in a continuously declining trend since 2009 amid a relaxation in the demand-supply balance of the overall economy. In 2012, however, higher electricity rates and gasoline prices have put the brakes on the decline in consumer prices. On an annual basis, the CPI was down 0.1percentage point year on year, at 99.7 (2010 as base value), hovering at almost the same level as in the previous year. Entering 2013, the CPI swung upward, rising to 100.0 in the most current month of June.

<Table 1> Major Economic Indicators
Change from the previous period(Quarterly is seasonally adjusted)

(Major Economic Indicators)

	2012				2013		CY2011	CY2012
	1-3	4-6	7-9	10-12	1-3	4-6		
GDP	1.2	-0.2	-0.9	0.3	0.9	0.6	0.1	0.8
Domestic Demand	1.1	0.0	-0.2	0.3	0.5	0.4	0.3	2.8
(Contribution Ratio)	1.1	0.0	-0.2	0.3	0.5	0.5	0.3	0.5
Private Demand	0.6	-0.2	-0.6	0.1	0.6	0.2	0.5	2.4
(Contribution Ratio)	0.5	-0.2	-0.5	0.0	0.5	0.2	-0.1	0.4
Private Consumption	0.5	0.0	-0.2	0.3	0.5	0.5	0.3	0.5
Private Residential Investment	0.0	0.1	0.0	0.1	0.1	0.0	0.1	0.1
Private Non-Resi. Investment	-0.4	0.0	-0.4	-0.2	0.0	0.0	-0.5	0.0
Public Demand	2.7	-0.9	1.0	1.0	0.3	1.0	-0.2	4.2
(Contribution Ratio)	0.7	0.2	0.3	0.3	0.1	0.3	0.8	0.2
Government Consumption	0.3	0.0	0.1	0.1	0.0	0.2	0.3	0.1
Public Investment	0.3	0.2	0.2	0.2	0.1	0.1	0.5	0.1
Net Exports of Goods & Services(Contri. Ratio)	0.1	-0.2	-0.7	-0.1	0.4	0.2	-0.4	0.3
Exports of Goods & Services	0.4	0.0	-0.7	-0.4	0.6	0.4	-0.1	0.5
Imports of Goods & Services	-0.3	-0.2	0.0	0.3	-0.2	-0.3	-0.1	0.1

<Table 2> Employment Conditions

	2012				2013		CY2011	CY2012
	1-3	4-6	7-9	10-12	1-3	4-6		
Unemployment Rate (%)	4.5	4.4	4.3	4.2	4.2	4.0	4.6	4.4
Job-offers to Seekers Ratio(Ratio(Times))	0.75	0.80	0.81	0.82	0.85	0.90	0.65	0.80

(Note)1.Data 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>Corporate Goods Price and Consumer Price

		2012				2013		CY2011	CY2012
		1-3	4-6	7-9	10-12	1-3	4-6		
Corporate Goods Price	Index	101.2	100.9	100.1	100.1	100.9	101.5	101.5	100.6
	YoY change (%)	0.3	-1.0	-1.9	-1.0	-0.3	0.6	1.5	-1.0
Consumer Price (excluding fresh food)	Index	99.6	99.9	99.6	99.6	99.3	99.6	99.8	99.7
	YoY change (%)	0.1	-0.1	-0.3	-0.1	-0.3	0.0	-0.2	-0.1

(Source)Ministry of Internal Affairs and Communications, Bank of Japan

(Financial Assets of Households)

At March 31, 2013, the end of fiscal 2012, household financial assets amounted to ¥1,570.5 trillion, expanding approximately ¥53 trillion or 3.6% from the end of fiscal 2011. Although the investment climate remained severe during Fiscal 2012, against the backdrop of the heightened expectations created by so-called “Abenomics,” there was overall increase in household financial assets on a fiscal year-end basis for the fourth consecutive year.

Looking at a breakdown, the growth in the balance of household financial assets was driven by stocks and other equities, whichrose ¥18.0 trillion, or 17.0% year on year, to ¥124.3 trillion, and investment trusts, whichincreased ¥11.9 trillion, or 20.0% from last year, to ¥71.2 trillion.On the other hand, cash and deposits expanded ¥15.1 trillion, or 1.8%, to ¥848.2 trillion, continuing on from last year in posting another record high on a year-end basis. Furthermore, the breakdown of cash and deposits showed a large increase in liquid deposits during the second and third quarters. This can be attributed to the continuation in the Fiscal 2012 of the trends toward a heightened preference for liquid depositsin the wake of the major earthquake disaster in 2011 and the flow of money into ordinary accounts and other liquid deposits due to low interest rates on time deposits and other factors. In addition, after reaching a historical fiscal-year end high last year, investment in foreign securitiesmaintained that high level in fiscal 2012. This result suggests 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 0.9%, to54.0%.

Conversely, the proportions of stocks and other equities and investment trusts increased 0.9%, to 7.9% and 0.6%, to 4.5%, respectively.

<Table 4>The Composition of Financial Assets of Households

	FY2010	FY2011	FY2012	FY2012 (Amount) (¥ trillion)
Financial Assets of Household	1,500.0	1,516.6	1,570.5	1,570.5
Cash and deposits	54.3%	54.9%	54.0%	848.2
Bonds	2.5%	2.3%	2.1%	32.1
Investment trusts	4.2%	3.9%	4.5%	71.2
Trust beneficiary rights	0.2%	0.1%	0.1%	2.1
Stocks& Other Equities	7.0%	7.0%	7.9%	124.3
Insurance and pension reserves	27.9%	27.9%	27.6%	432.9
Overseas Portfolio Investment	0.5%	0.6%	0.5%	8.2
Others	3.4%	3.3%	3.3%	51.2

(source) Bank of Japan

II. Securities Market

1. Equities

(1)New listing and Capital Increase by Public Offering

In 2012, 69 companies were newly listed on the Tokyo Stock Exchange (TSE). Among the publicofferings and secondary distributionin the spotlight in 2012 were the capital increase by All Nippon Airways Co., Ltd., announced on July 3, and the re-listing of Japan Airlines Co., Ltd., in September 2012. One of the recent public offerings that stood out 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. More than ¥200 billion of the capital raised from the public offering is being allocated to financemergers and acquisitions (M&A) overseas, targeting the Southeast Asia market in particular.

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

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*
2010	2,280	26	310.4	520.0	2,122	359.1	1,466	898.80
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

Note: *as of end of year
(Source) TSE Monthly Statistics Report

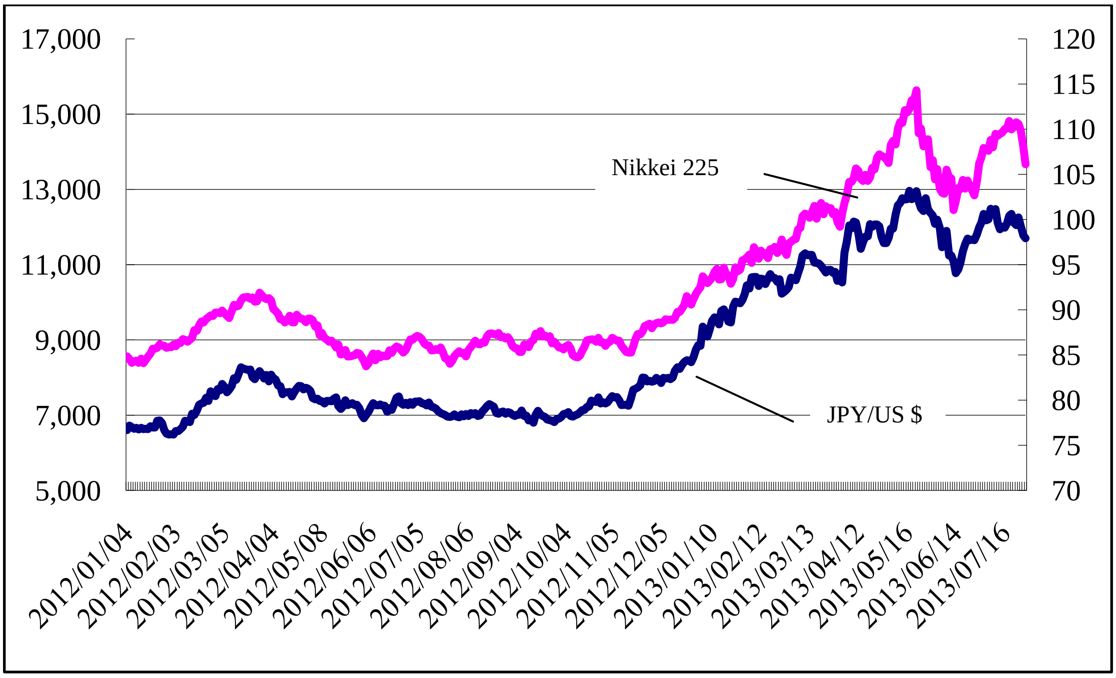
(2) Secondary Market

In the fourth quarter of 2012, economic trends reversed direction after November 14, with the yen depreciating and stock prices rising in the wake ofLiberal Democratic Party (LDP) President Shinzo Abe's announcement that his partywould ask the Bank of Japan for unlimited monetary easing and setting an inflation target for the economy. From October to November 13, the stock index had moved mostly in a range from 8,500 to 9,000. Then on November 14, during question time in the Diet, the then prime minister, Mr. Yoshihiko Noda, announced his intention to dissolve the Lower House of the Diet.The yen exchange rate, which had been stuck around 79 yen to the dollar, collapsed to 81 yen and the stock market surged, rising to 9,024 on November 16. In the following days, the expectations of a change in government andthe weakening yen fuelled a bull market. By the end of November, the stock index had recovered to the 9,400 level, rising to 9,446 and hitting a record high for the first time since April 27, a period of about seven months. Entering December, stock prices rose substantially on the strength of expectations of huge quantitative easing and large-scale fiscal measures after the Liberal Democratic Partyoverwhelmingly won the lower house elections. The weakening of the yen also continued, pushing up the Nikkei 225 Stock Average to a record high for the year on a closing price basis of 10,395 on December 28.

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 Nikkei 225 Stock Average broke through the supposed wall of 10,500, to hit 10,688. On March 8, the stock indexreached 12,283. This mark represented a return to the pre-Lehman Brothers failure levels of 2008. Contributing to the surging marketwere the continued announcements of favorable economic indicators in the United States, the Dow 30 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 governors 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,after the Bank of Japan Governor Haruhiko Kuroda's introduction of large-scale quantitative and qualitative monetary easing, hit 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 Purchasing Managers Index (PMI) was struggling caused the Nikkei 225 Stock Average to shed 1,143 points, to 14,483. At the start of the next week, the stock index continued its slide, shaving off 469 points on May 27 and 737 points 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, theNikkei 225 Stock Average was down 843 points, to 12,445. However, the stock index rebounded in the second half of June and fluctuated around 13,000 - 15,000 yen level during July and August.

<Chart 1> Nikkei 225 Stock Average and JPY/USD Exchange Rate



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

Year	Member Accounts	Individuals	Foreigners	Investment Trusts	Business Cos.	Life & Non-life	Citi BKs& Regional BKs	Trust BKs	Other Financial Institutions
Market Share									
2010	24.2%	17.6%	47.2%	2.0%	1.0%	0.4%	0.1%	5.0%	0.1%
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%
Net Selling (-)/Buying (+) (¥billion)									
2010	-1,299	-2,277	3,210	17	-273	-631	-245	962	-34
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

(Source) TSE Monthly Statistics Report

2. Bond Market

(1) Primary Market

In 2012, public and corporate bond issuance in Japan increased ¥9.1 trillion, or 4.7%, from 2011, to ¥202.4 trillion. Accounting for the largest share of the market, JGB issuance totaled ¥189.1 trillion, expanding ¥9.6 trillion from last year. Among general bond issuance other than JGBs, municipal bonds amounted to ¥6.8 trillion compared with ¥6.7 trillion in 2011; Government-guaranteed bonds were ¥4.7 trillion compared with ¥3.2 trillion last year; Fiscal Investment and Loan Program (FILP) agency bonds totaled ¥5.4 trillion compared with ¥5.6 trillion the year before; and straight corporate bonds were ¥8.2 trillion compared with ¥8.3 trillion last year.

In 2012, issuance of callable subordinated debt, or so-called practical five-year bonds, were at a low level. Compared with redemptions totaling ¥1.4 trillion in 2012, issuance of this type of subordinate debt amounted to about ¥690 billion. Of that amount, issuance to institutional investors was only about ¥80.0 billion. Issuance of callable subordinated debt by financial institutions has been impacted bythe Basel regulatory framework. Consequently, issuance to institutional investors has been in a downward trend since 2009. One of the main reasons behind this trend is seen as greater caution among regional banks, major institutional investors, in anticipation of stricter regulations on using other financial institutions, etc., as counterparties when raising capital, or so-called double gearing. In contrast, issuance of subordinated debt targeting individual investors has been robust. For example, during the year the Bank of Tokyo-Mitsubishi UFJ, Ltd. floated a ¥130.0 billion issue of 10-year subordinated debt (practical five year bonds) targeting individual investors.

<Table 7> Public and Corporate Bonds

(¥ trillion)

Year	Trading Volume(face value)			Issuing Amount			
	JGB	Others	Total	Public Debt Securities (JGB)(Note1)	Corporate Bonds (Note2)	Non-Resident Issues(Yen-denominated)	Total (Note 3)
2010	7,452	100	7,553	182.9(165.8)	9.8	1.7	198.4
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

(Source) Japan Securities Dealers Association

Notes: 1. JGBs do not include financial bills (including those among treasury discount 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-backedcorporate bonds.

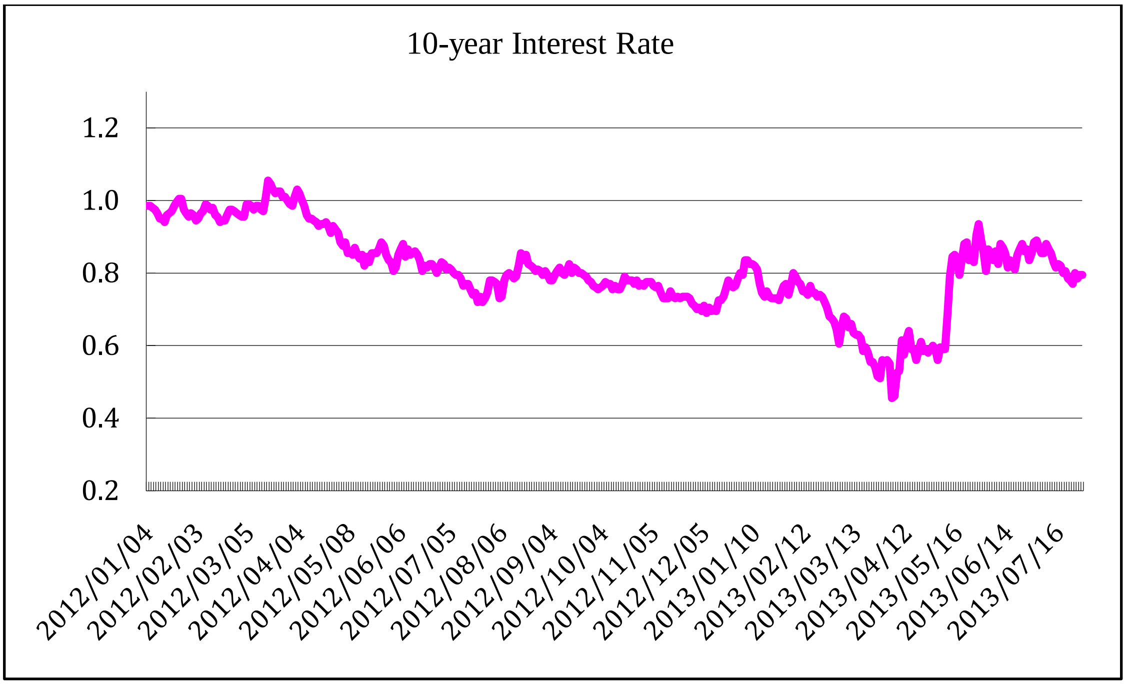
3. The total figures are not equal to the sum of individual categories because they include bank bonds, private placement corporate bonds and private placement government bonds.

(2) Secondary Market

The long-term interest rate (yield on newly issued 10-year JGBs) stayed in the 0.7% range throughout the fourth quarter of 2012. Entering October, the long-term interest rate struggled against a downward trend caused by growing uncertainty about the direction of the economy prompted by successive announcements of downward revisions in corporate performance forecasts in the United States and Japan and the quantitative easing strategy of the Bank of Japan falling well within market expectations. The U.S. presidential and house of representativeelectionson November 6 gave President Barack Obama a second term of office. After his re-election, apessimistic view prevailed that a U.S. economic recession could not be avoided because of the lingering “fiscal cliff” issue. U.S. stock price fell swiftly while bond yields soared. As a result of these developments, Japan’s long-term interest rate fell through the 0.75% mark for the first time since August 6 and approached what would have been a year-low of 0.720% on November 13. However, on November 14, then Prime Minister Yoshihiko Noda’sannouncement to dissolve the Lower House, the market became cautious about the impact of Reflation policies and postponement of fiscal restructuring resulting if the Liberal Democratic Partyled byShinzo Abe would form the next government. This concern drove the interest rate up to 0.760% on November 15. On December 6 when all the morning newspapers carried prediction of LDP’s victory,heightened expectations for stronger monetary easing pushed the rate down to 0.685%. In thelower house elections held on December 16, the landslide victory of the LDP convinced the market that the ruling party would push strongly forward with its fiscal policy expansion and quantitative easing strategies, termed “Abenomics.” On December 18, Prime Minister Abe told then Bank of Japan Governor MasaakiShirakawa that he would request an inflation target of 2%. On the foreign currency market, the yen exchange rate sunk as low as ¥84 to the U.S. dollar at one point. In response to these movements, the long-term interest rate jumped up a level, rising to 0.780% on December 19 and again on December 21.

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 JGB 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 0.655% 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.

<Chart 2> Long-Term Interest Rates in Japan



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 on tightened supply and demand condition 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 domestic 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 had been expected to fall significantly,reflectingBank of Japan Governor Haruhiko Kuroda'sannouncement not 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.

3. Investment Trust

At the end of 2012, the net assets of publicly offered investment trusts amounted to ¥64,063.7 billion, increasing from ¥57,327.4 billion last year. Sales of stock investment trusts amounted to ¥23,824.1 billion.

Heading into 2013, there was a capital inflow of ¥2,972.2 billion into publicly offered investment trusts in the first quarter. Sales of publicly offered open-type stock investment trusts rose sharply along with the progressive weakening of the yen and rising stock prices under "Abenomics." Sales in the fourth quarter of 2012 had been a significant ¥6,392.6 billion, but this figure surged to ¥10,598.5 billion in the first quarter of 2013. Net assets of publicly offered investment trusts at the end of March 2013 totaled ¥72 trillion, expanding to a scale that had not been seen for four years and 8 months—since July 2008, before the failure of Lehman Brothers. Even in comparison with the end of December 2012, sales ballooned about ¥8 trillion. The popular products shifted from foreign bond products, to U.S. and emerging country stock investment trusts.

In the second quarter, the flow of individual investor money into the market accelerated during April and May. Overall, there was a capital inflow of ¥1,356.9 billion into publicly offered investment trusts in April. This figure rose further in May to ¥1,779.7 billion, representing a 30% increase from April. In addition, it was the fourth consecutive month of sales over ¥1 trillion. However, fund performance deteriorated because of the drop in stock prices and weakening of foreign bond prices during the period up to the end of May. Net assets of investment trusts at the end of May, therefore, were ¥78.039.4 billion, showing almost flat growth at 0.5%. It seems that investors started buying Japanese stock investment trusts on the dip in the market directly after the large drop in the Nikkei 225 Stock Average on May 23, but during the prolonged correction in the market, they shifted to a wait-and-see mode.

<Table 8> Changes in Assets of Investment Trusts (¥ trillion)

Year	Total	Stock Investment Trusts			Bond Investment Trusts			MMFs		
		Sales	Cancella-tions	Assets	Sales	Cancella-tions	Assets	Sales	Cancella-tions	Assets
2010	63.7	23.9	17.5	52.4	37.0	36.8	9.0	0.6	0.9	2.2
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

(Source) The Investment Trusts Association, Japan

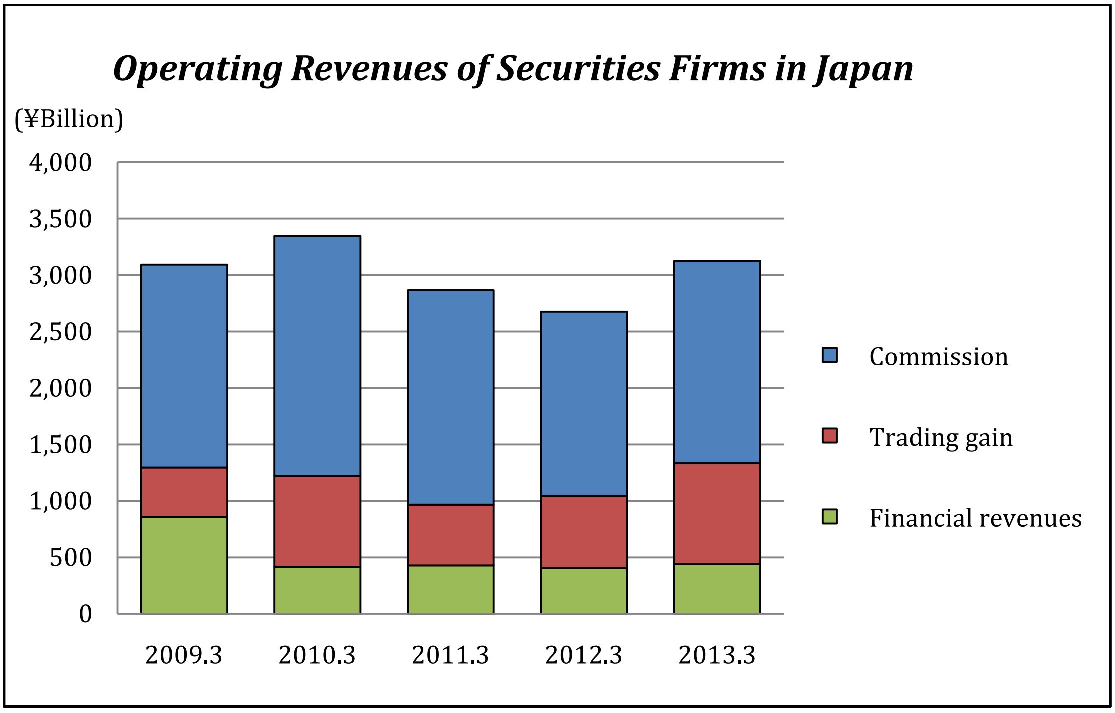
III. Overview of Securities Industry Performance

Benefiting from the robust stock market, annual performancesby securities firms in Japan were favorable in the fiscal year ended March 31, 2013. The proportion of securities firms posting profits (companies reporting profits on a net incomebasis) was 74%, up from 40% in the previous fiscal year. It was the first time in seven years (since the fiscal year ended March 2006) that more than 70% of firms were profitable.

The stock market has been robust since fall 2012 based on high expectations for the monetary and fiscal policies of the Shinzo Abe government and the Bank of Japan. Boosted by the higher activity, many securities companies expanded their operating revenues. Overall, the industry recorded operating revenues of ¥3,171.5 billion, increasing 17.0%, or ¥460.5 billion, from the previous year.

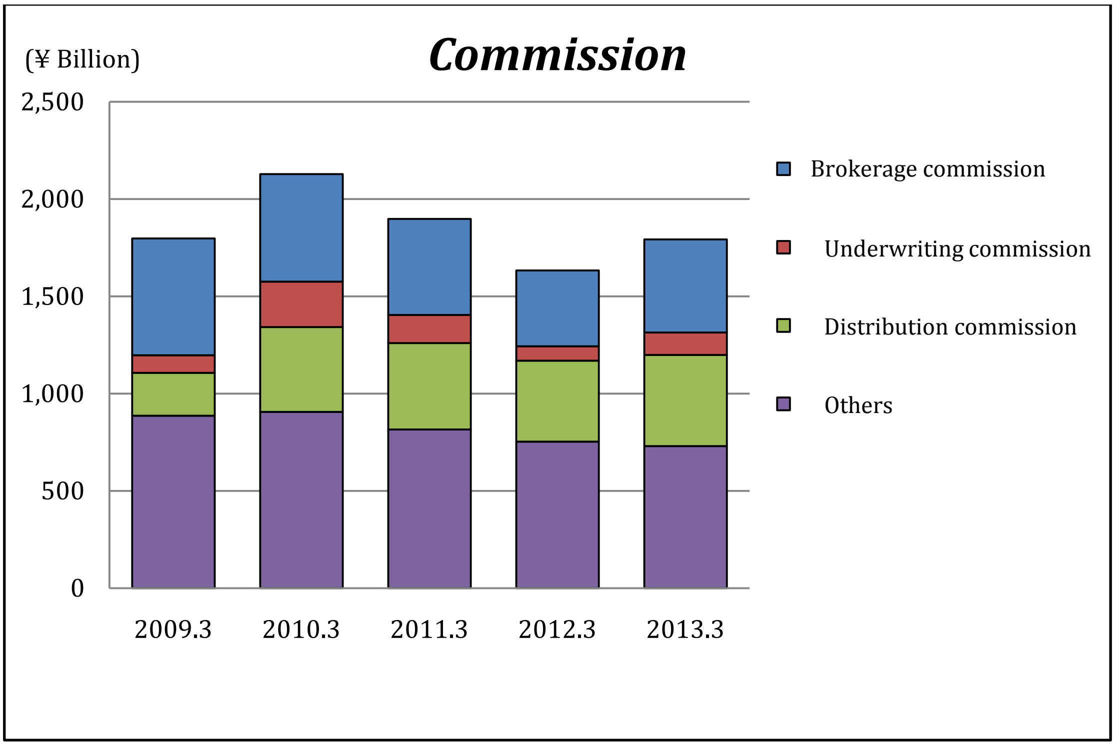
Looking at a breakdown of operating revenues (see Chart 3), while all categories improved, trading gain was particularly substantial, rising 40.8%, or ¥259.7 billion, to ¥895.9 billion. Among the other categories, financial revenues rose 8.3%, or ¥33.7 billion, to ¥440.3 billion, while commissions increased 9.7%, or ¥157.8 billion, to ¥1,792.7 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 22.4%, or ¥87.5 billion, to ¥478.4 billion. Underwriting commission grew 53.9%, or ¥40.5 billion, to ¥115.8 billion. This increase was supported by a greater number of large-scale equity finance issuescompared with last year, including initial public offerings (IPOs)such as the re-listing of Japan Airlines and the Japan Tobacco Inc. (JT)'s IPO.In other categories, distribution commission rose 13.0%, or ¥53.8 billion,to ¥469.7 billion.

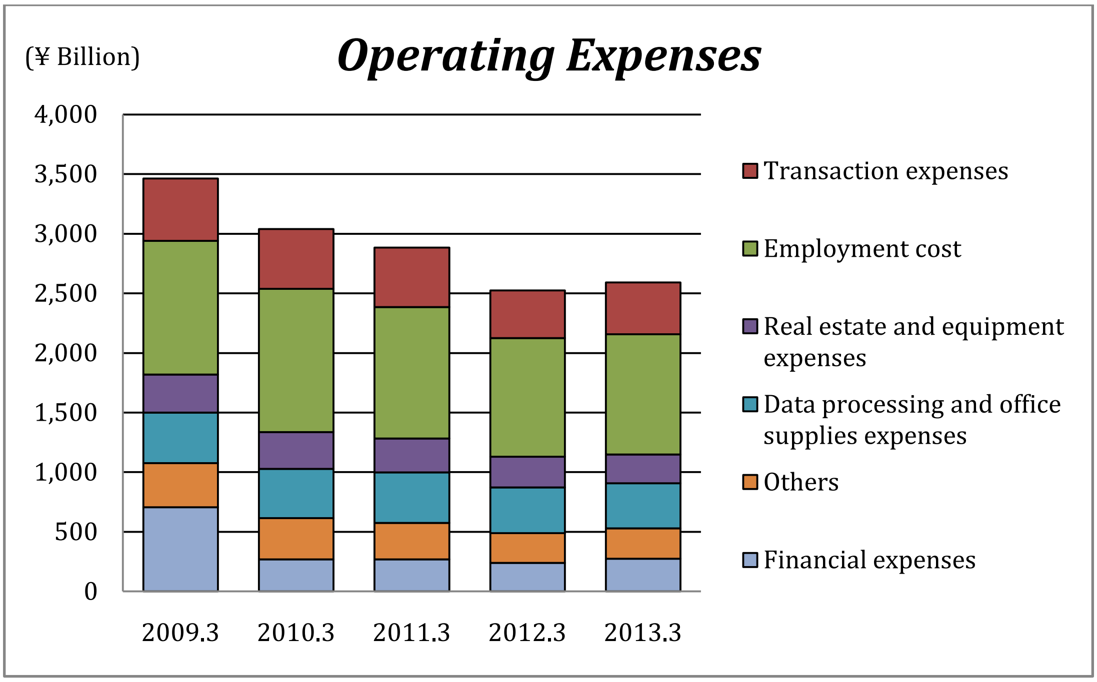
<Chart 4> Commission



Compared with the large increase in operating revenues, operating expenses of securities firms in the fiscal year ended March 2013 edged up 2.6%, or ¥65.6 billion, to ¥2,591.7 billion, showing no major changes (see Chart 5).The restraint in operating expenses growth can be attributed to continued efforts to rationalize operations and strengthen cost control. While financial expenses rose at a slightly higher pace of 14.2%, or ¥34.0 billion, to ¥274.0 billion, selling and general administrative costs were held to an increase of 1.4%, or ¥31.6 billion, rising to ¥2,317.7 billion.

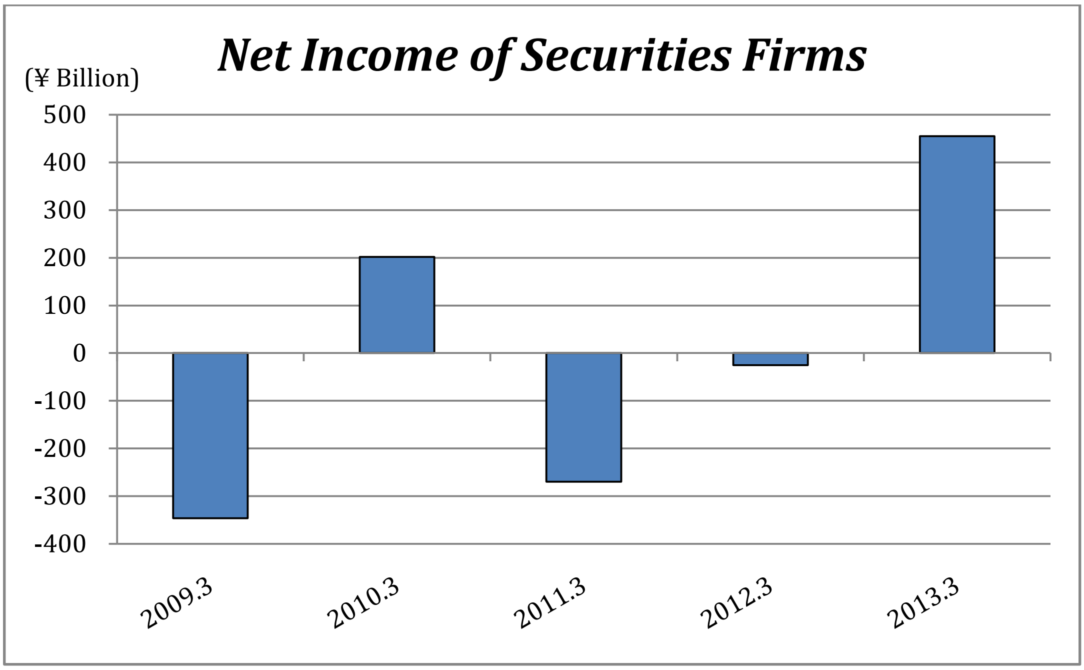
Breaking down selling and general administrative costs, transaction expenses increased 8.4%, or ¥33.8 billion, to ¥433.9 billion and employment cost climbed 1.3%, or ¥13.1 billion, to ¥1,009.3 billion. On the other hand, real estate and equipment expenses contracted 5.2%, or ¥13.3billion, to ¥242.8 billion and data processing and office supplies expenses decreased 1.6%, or ¥6.2 billion, to ¥379.1 billion.

<Chart 5> Operating Expenses



As a result, the securities industry in Japan registering a net income of ¥455.8 billion in the fiscal year ended March 2013, recovering profitability for the first time in three years.

<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 June 2013, the 2013 Amendment Act of the Financial Instruments and Exchange Act, etc. was passedthe Diet. The new round of revisions included the following measures aimed at dealing with financial crises originating from market disruption and recovering confidence in Japan’s financial and capital markets and financial services industry.

(1) Establishment of Orderly Resolution Regime for Financial Institutions

During the international financial crisis triggered by the failure of Lehman Brothers, it became clear that the failure, etc. of systemically important financial institutions could lead to a chain reaction that halted market transactions and paralyzed market functions. Based on that recognition, a new framework for the effective resolution of failures by financial institutions was discussed internationally in such forums as the G20 summits. Based on those discussions, the act also establishes for Japan procedures and other measures regarding orderly resolution that maintains transaction continuity while dealing with the crisis.

(2) Measures Relating to Recent Insider Trading Cases, etc.

Cases of insider trading during capital increases through public offerings came to light one after the other in 2012, resulting in authorities implementing measures regarding information disclosure and trading recommendations that had previously been outside the direct scope of insider trading regulations. Therefore, the revised act prohibitsdisclosure of information or making trading recommendations for the purpose of gain before the public announcement of an issue and introduces criminal and monetary penalties. Furthermore, because the fines assessed on asset managers making illegal transactions using their clients’ accounts were extremely low, the revised act increases the monetary penalties for asset managers in such cases.

(3) Revision of Asset Management Regulations

Based on the incident of the falsification of investment performance reports and other fraudulent behavior by AIJ Investment Advisors Co., Ltd., discovered in January 2012, the revised act expands the reporting items and the frequency of investment reports. The revised act also increases the penalties for false reporting, fraudulent solicitation, and falsification of discretionary investment contracts by Discretionary Investment Management Business Operators, etc.

2. Rulemaking to Prevent Insider Trading

In April 2013, the Japan Securities Dealers Association (JSDA) made revisions and introduced new rules to prevent insider trading by its member firms and ensure thorough management of confidential corporate information and to address issues related to leakage of pertinent information, etc., before the public announcement of a public offering or distribution by a listed company.

3. Merger of Stock Exchanges

In January 2013, the Tokyo Stock Exchange (TSE) Group and Osaka Securities Exchange (OSE) merged their operations. In July, the cash stock market of the OSE was combined into the TSE stock market. Conversely, in March 2014, the TSE's derivatives market is scheduled to be folded into the OSE market.

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

Under the slogan "From Savings to Investment," in January 2003, Japan introduced a preferential tax rate of 10% on dividends and capital gains from listed stocks and some other equities. Since then, the deadline for the end of this preferential tax treatment has been extended many times, but is finally set for the end of 2013, after which the tax rate will rise to 20%.

In preparation for this change, Japan will introduce the Japanese version of Individual Savings Account (NISA) system, a tax exemption system for small investments, in January 2014. The system is modeled after the ISA system in the United Kingdom, with dividends and capital gains from listed stocks, stock investment trusts, and some other securities purchased through a NISA beingexempt from tax.

5. "My Number" Act

In May 2013, Japan passed an act governing the identification numbers used in the social security and taxation systems. Commencing in the latter half of 2015, each resident of Japan will beassigned a unique identification number. Plans call for these numbers to start being used for social security and taxation in 2016.