

Yen 4Sight

Highlights

- The latest economic surveys contained mixed messages, but still remained consistent with ongoing expansion.
- The trade balance deteriorated in May but exports maintained an upwards trend.
- The coming week brings May data for retail sales (Thursday) and inflation, industrial production and unemployment (Friday).

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Interest and exchange rate forecasts

End period	23-Jun	Q317	Q417	Q118
BoJ ONR %	-0.10	-0.10	-0.10	-0.10
10Y JGB %	0.06	0.05	0.05	0.05
JPY/USD	111	112	114	116
JPY/EUR	124	120	123	125

Source: Bloomberg, BoJ and Daiwa Capital Markets Europe Ltd.

Manufacturing PMI weakens at end-Q2...

After five consecutive quarters of positive GDP growth through to the first quarter of 2017, successive policy meetings have seen the BoJ steadily revise up its assessment of economic conditions. And while the latest economic data were certainly not universally strong, most surveys and hard data suggest that Japan's expansion remains on track. Nevertheless, the flash June manufacturing PMI released at the end of the past week was certainly weaker than of late, flagging the possibility of a loss of momentum at the end of the second quarter. Having reached a three-year high in February and remained relatively elevated thereafter, the headline PMI slipped more than 1pt to 52, the lowest level since November. Moreover, the declines in the output and new orders PMIs were the steepest in more than a year, returning both indices to their lowest levels since late last year.

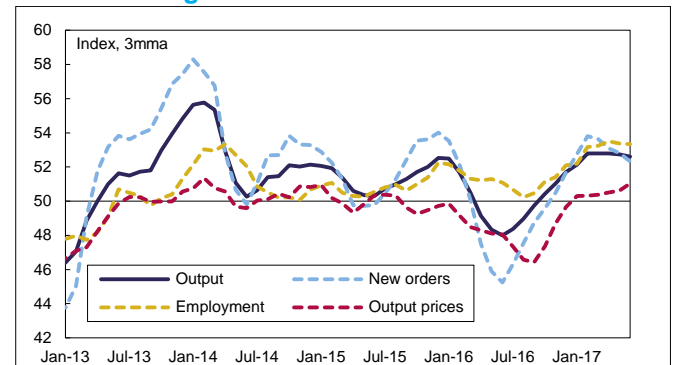
...but still consistent with expansion

Over Q2 as a whole, however, the manufacturing PMI averaged only marginally less than in Q1, and remained consistent with manufacturing output growth of more than 1½%Q/Q. Additionally, much of the survey remains encouraging. Growth in new orders appears still to be well within positive territory, while manufacturing employment growth should remain relatively firm. And the increase in the output price PMI to the highest level since late 2014 suggests that firms are better able to pass on any rising costs to consumers, consistent with our expectation that headline CPI will rise from about ½%Y/Y in June to about 1%Y/Y in the autumn. Overall, therefore, the flash manufacturing PMIs were still relatively reassuring.

Reuters survey suggests a stronger BoJ Tankan

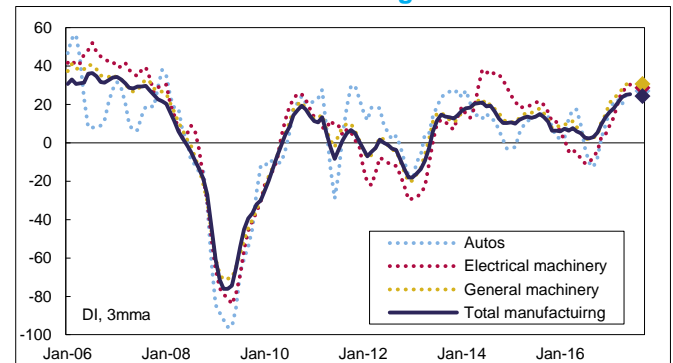
The June Reuters Tankan, which gave an indication of what to expect from the BoJ's key quarterly Tankan due on 3 July, was even more encouraging. Indeed, contrary to the end-quarter weakening suggested by the flash PMI, the headline index for manufacturers rebounded in June to match the decade high reached in April, with the survey predicting a further improvement in business conditions over the coming three months too. The survey suggested other sectors are upbeat too, as the headline index for non-manufacturers rose for the third consecutive month to a two-year high thanks to a rebound in construction and real estate firms and a further improvement in the retail and wholesale DI, also to a two-year high. Looking

Manufacturing PMIs



Source: Markit and Daiwa Capital Markets Europe Ltd.

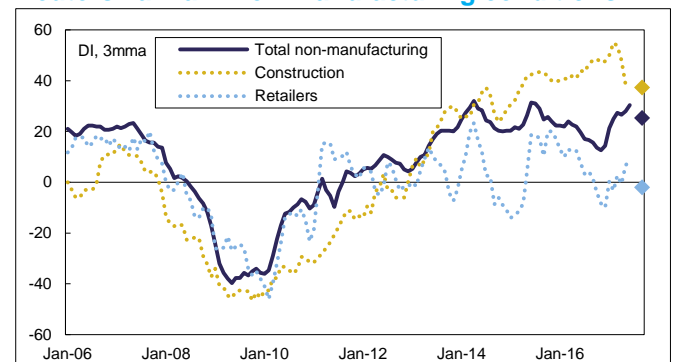
Reuters Tankan: Manufacturing conditions*



*Diamonds represent survey forecasts for September 2017.

Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Reuters Tankan: Non-manufacturing conditions*



*Diamonds represent survey forecasts for September 2017.

Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.



ahead, the survey signalled a slight cooling in the outlook for the services sector over the coming few months. But with all key indices well above their long-run averages, the Reuters Tankan suggested that economic growth will be well maintained in the main sectors in the second half of the year.

Strongest monthly growth in activity since 2000

Economic output in Japan undeniably started the second quarter on the front foot, with all-industry activity in April up 2.1%M/M, the highest single-month growth rate since 2000. It was always clear that manufacturing had a strong month, with output up 4.0%M/M, the best reading since 2011, while tertiary activity rose 1.2%M/M, the most in more than three years. And this week's figures highlighted a surge in the construction sector too, up a whopping 7.3%M/M, the most since the early 1990s, as Abe's supplementary budgets provided a boost, with public construction up 6%M/M and private civil engineering output up by more than one fifth. To a large extent, the vigour in April should be taken with a pinch of salt given that it partly reflected catch up from Q1, when all-industry activity fell marginally. Likewise, we expect payback in May, when IP and construction output seem likely to have reversed much of the gains in April. Nevertheless, looking through the volatility, the trend is up, with all-industry activity up 0.6%3M/3M in April and set to register solid growth over the second quarter as a whole.

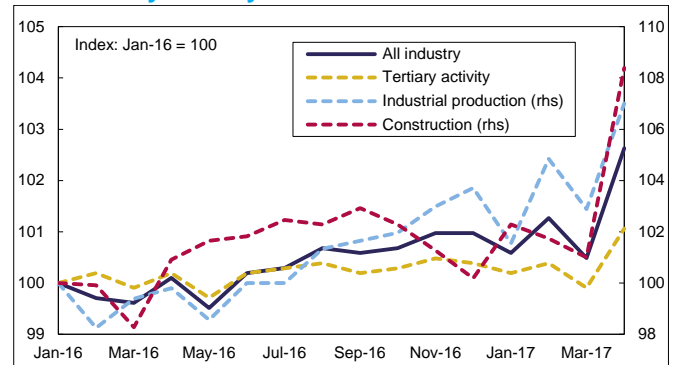
Trade balance slips back into the red...

One reason to be upbeat about the sustainability of the current economic expansion is its recent broad-based nature, with growth having received support from domestic demand – particular consumer spending – and exports alike. But while net exports made a positive contribution to GDP growth in each quarter from Q316, the May trade report missed expectations. The headline balance slipped into deficit for the first time since January at close to -¥200bn. And, on a seasonally adjusted basis, while still in surplus, the trade balance fell to a seventeen-month low of ¥134bn. To some extent, this deterioration reflected solid domestic demand. While both annual rates rose to the highest in more than two years, the value of imports (up almost 18%Y/Y) outpaced exports (almost 15%Y/Y). Nevertheless, within the detail there was solid growth in the value of exports of several key sub-sectors, notably general machinery (up more than 17%Y/Y, the strongest since end-2013), electrical machinery (up more than 13%Y/Y, the strongest since early 2015), and cars (up more than 10%Y/Y for the first time since the end of 2015).

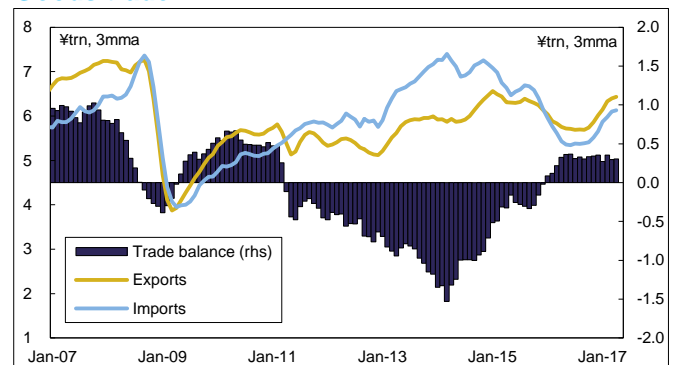
...but export volumes maintain uptrend

Adjusting for both prices and seasonal effects, on the BoJ figures, the volume of goods exports rose almost 2%M/M in May to a level 7.5% higher than a year earlier, while the volume of imports was down 1.3%M/M to stand little more than 1% above the level in May 2016. On the same basis, shipments of capital goods were particularly strong, rising more than 5%M/M, the most in more than two years, to illustrate the boost from the more favourable global investment environment. By destination, consistent with signs of a further strengthening of demand in the euro area, growth in shipments to the EU continued to outpace those to other major markets, rising almost 8%M/M, the most since 2014, and helping to offset a weaker month of

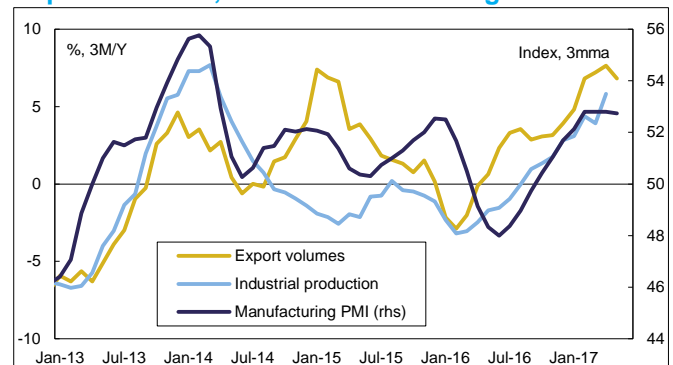
All-industry activity



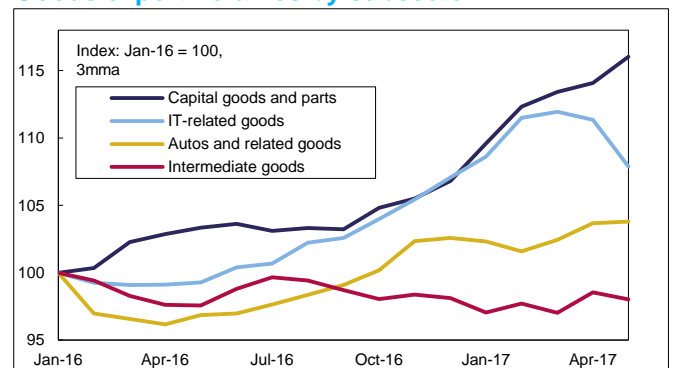
Goods trade*



Export volumes, IP and manufacturing PMI



Goods export volumes by subsector



exports to China. Nevertheless, given the weaker showing for exports and stronger performance of imports in April, so far on average in Q2 import volume growth has outpaced that of exports. And so, while surveys continue to suggest that the outlook for exports remains upbeat, it remains to be seen whether net trade will have made a positive contribution to Japanese GDP growth for the fourth consecutive quarter in Q2.

Overseas visitor numbers hit new record

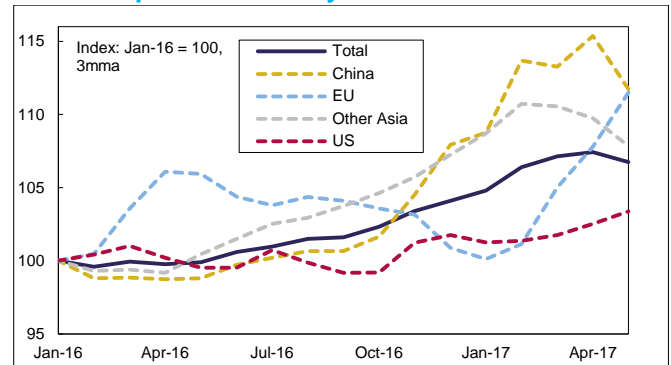
However, one source of GDP growth in the second quarter is likely to be services exports, with spending by overseas visitors having probably taken a further step up. Certainly, the number of overseas visitors continues to rise rapidly, up more than 20%Y/Y in May to 2.3m, thanks not least to an increase of 85%Y/Y in the number of visitors coming from Korea, who again outnumbered those arriving from China. That took the total number of visitors so far this year to more than 11mn, up more than 17% from the equivalent level in the first five months of last year, and more than one third higher than the total number of visitors over the whole year in 2012. So, Abe's target, upwardly revised last year to 40mn visitors by 2020, remains well on track.

The week ahead in Japan and the US

After a quiet start to the coming week, the back end will bring several top-tier Japanese economic data for May, kicking off with retail sales figures. Having grown in each month so far in 2017 and leapt 1.4%M/M – the most in six months – in April, some payback seems likely. Friday, meanwhile, brings several releases of note, including the latest inflation figures, which are expected to post slight increases on each of the main measures. In particular, headline CPI is forecast to have edged up 0.1ppt to a six-month high of 0.5%Y/Y with the 'core core' measure, which excludes fresh food and energy, expected to have risen by the same month to 0.1%Y/Y. Other May data due on Friday include May's preliminary IP figures, which are expected to show a drop of more than 3%M/M following the 4.0%M/M rise in April. And May's labour market and housing starts numbers are also due at the end of the coming week.

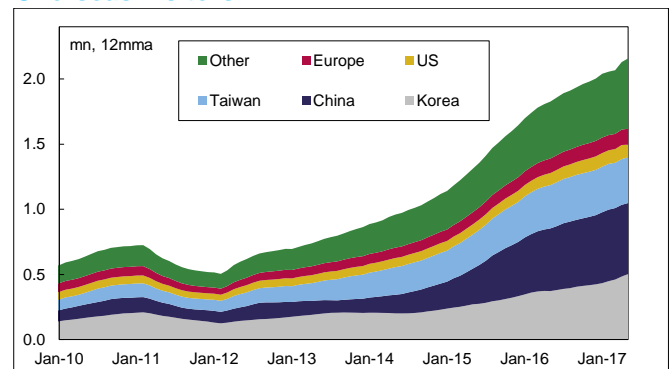
With respect to the BoJ, meanwhile, the summary of opinions of the June policy meeting will be published on Monday while Kuroda will be participating in the ECB's

Goods export volumes by destination



Source: BoJ and Daiwa Capital Markets Europe Ltd.

Overseas visitors



Source: JNTO and Daiwa Capital Markets Europe Ltd.

Sintra Forum on Central Banking in the first half of the week. In the bond market, the MoF will sell 2Y JGBs on Tuesday.

In the US, the coming week brings several top-tier economic releases including preliminary May durable goods orders and new home sales (Monday), the June Conference Board's consumer confidence indices and April Case-Shiller home price figures (Tuesday), the May advanced goods trade report (Wednesday), third estimate of Q1 GDP (Thursday), and May personal income and spending figures, including the associated deflators (Friday). In addition, the Treasury will sell 2Y bonds on Monday, 5Y bonds on Tuesday, and 2Y FRNs and 7Y bonds on Wednesday.

Economic calendar

Key data releases – June/July

19	20	21	22	23
GOODS TRADE BALANCE ¥BN APR 158 MAY 134	AUCTION FOR ENHANCED LIQUIDITY REUTERS TANKAN - MANUFACTURERS DI MAY 24 JUN 26 - NON-MANUFACTURERS DI MAY 30 JUN 33 ALL INDUSTRY ACTIVITY M/M% MAR -0.7 APR 2.6	OVERSEAS VISITORS MN APR 2.6 MAY 2.3	3M TB AUCTION AUCTION FOR ENHANCED LIQUIDITY	MANUFACTURING PMI MAY 53.1 JUN P 52.0
26	27	28	29	30
SERVICES PPI APR 0.7 MAY 0.7	2Y JGB AUCTION (APPROX ¥2.2TRN) FLOW OF FUNDS (Q1)		3M TB AUCTION (APPROX ¥4.4TRN) RETAIL SALES Y/Y% APR 3.2 MAY 2.8	NATIONAL CPI Y/Y% APR MAY 0.4 0.5 <i>EX FRESH FOOD</i> 0.3 0.4 <i>EX FRESH FOOD/ENERGY</i> 0.0 0.1 TOKYO CPI Y/Y% MAY JUN 0.2 0.3 <i>EX FRESH FOOD</i> 0.1 0.2 <i>EX FRESH FOOD/ENERGY</i> 0.0 0.1 UNEMPLOYMENT RATE % APR 2.8 MAY 2.8 JOB-TO-APPLICANT RATIO APR 1.48 MAY 1.48 INDUSTRIAL PRODUCTION M/M% APR 4.0 MAY -3.0 HOUSING STARTS Y/Y% APR 1.9 MAY -0.7 CONSTRUCTION ORDERS Y/Y% APR -0.2 MAY N/A
03	04	05	06	07
BOJ TANKAN SURVEY (Q2) MANUFACTURING PMI (JUN F) VEHICLE SALES (JUN) CONSUMER CONFIDENCE (JUN)	10Y JGB AUCTION BOJ TANKAN – INFLATION OUTLOOK OF ENTERPRISES (Q2) MONETARY BASE (JUN)	6M TB AUCTION SERVICES PMI (JUN) COMPOSITE PMI (JUN) BOJ'S OUTPUT GAP AND POTENTIAL GROWTH (Q1)	3M TB AUCTION 30Y JGB AUCTION	AVERAGE WAGES (MAY) BOJ CONSUMPTION ACTIVITY INDEX (MAY) COINCIDENT INDEX (MAY P) LEADING INDEX (MAY P)
10	11	12	13	14
MACHINE ORDERS (MAY) CURRENT ACCOUNT (MAY) BANK LENDING (JUN) ECONOMY WATCHERS SURVEY (JUN)	5Y JGB AUCTION M3 MONEY SUPPLY (JUN)	GOODS PPI (JUN) TERTIARY ACTIVITY INDEX (MAY)	3M TB AUCTION 20Y JGB AUCTION	INDUSTRIAL PRODUCTION (MAY F) CAPACITY UTILISATION (MAY)

*Approximate date of release. Source: BoJ, MoF, Bloomberg & Daiwa Capital Markets Europe Ltd.

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