

Yen 4Sight

Highlights

- The final opinion polls suggest that Sunday's Lower House election will maintain the political status quo.
- This week's economic data confirmed softer consumer spending but strong net exports in Q3. The latter continues to underpin high levels of confidence in the manufacturing sector.
- Friday's CPI reports should be the economic focus this week. Monday's BoJ Senior Loan Officer survey is also of interest.

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Interest and exchange rate forecasts

End period	20-Oct	Q417	Q118	Q218
BoJ ONR %	-0.10	-0.10	-0.10	-0.10
10Y JGB %	0.08	0.05	0.05	0.05
JPY/USD	113	113	114	115
JPY/EUR	134	136	137	138

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

A status quo election?

Another relatively light week for domestic economic data allowed politics to remain at the forefront of attention in the lead up to Sunday's Lower House elections. That said, the election has shaped up to be less interesting than seemed possible a few weeks ago, with polls suggesting that PM Shinzo Abe's gamble on an early election will pay off more handsomely than UK PM Theresa May's bodge job earlier this year. Some of those polls suggest that not only will the LDP easily command a simple majority of the 465-seat Lower House, but together with its coalition partner Komeito, it might well retain its current two-thirds 'super majority', nudging the door wider for Abe to pursue his goal of reforming Japan's constitution (although it is far from clear that Abe would win public support for such change). That said, a Nikkei poll released at the end of the week predicted that the most likely outcome is that Abe's coalition will win 297 seats, leaving it 13 shy of a super majority.

Weather a wild card

Recent elections in Tokyo, the US and UK are a reminder of the scope for a surprise on polling day. And whether or not a super majority is achieved could well depend on turnout, and hence the impact of the weather. With Typhoon Lan due to cross Japan over the weekend bringing heavy rain to some regions, some may elect not to vote, particularly those who have seen the opinion polls and judge the outcome a foregone conclusion. Regardless of whether a super majority is achieved, however, Abe may well emerge in a strong position and well placed to win a third term as leader of the LDP in the compulsory leadership election that will take place next autumn. As such, he would remain on track to be PM past the Tokyo Olympics, and also become Japan's longest-serving post-war leader.

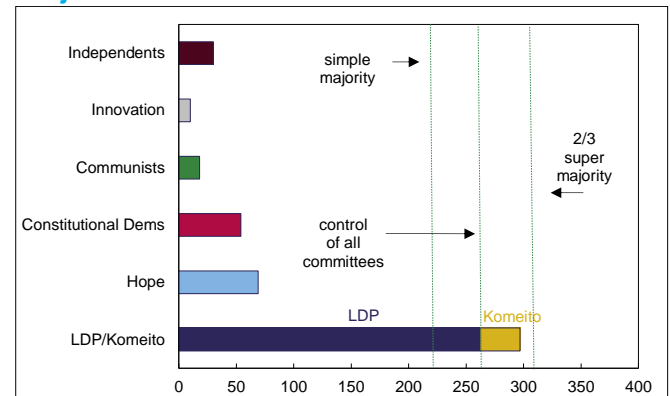
A muted market reaction on Monday morning?

As far as logistics are concerned, voting will begin on Sunday at 7am local time and close at 8pm. Once voting closes, the major networks will publish their respective exit polls. The formal count should be completed in the earlier hours of Monday, with a very good idea of the outcome quite likely to be known before FX markets reopen in Sydney at the start of the week. Presuming that the opinion polls have been broadly correct, the initial market reaction is likely to be muted.

Expect more of the same on economic policy

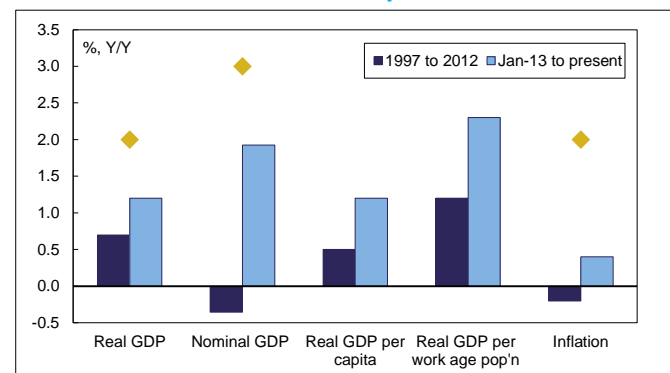
Certainly, unlike in 2012 when he returned to office on his

Projected seats in the Lower House*



*Predicted number of seats based on poll conducted on 17-19 October.
 Source: Nikkei newspaper poll & Daiwa Capital Markets Europe Ltd.

Abenomics: Macroeconomic performance indices



*CPI excluding consumption tax. Diamonds represent Abenomics targets.
 Source: Cabinet Office, MIC, OECD and Daiwa Capital Markets Europe Ltd.

Lower House election: Key numbers

- **Lower House seats up for grabs: 465**
 - Seats required for simple majority: 233
 - Seats required to control all committees: 261
 - Seats required for 2/3 supermajority: 310
- **Citizens vote twice**
 - Members elected in single-seat constituencies: 289
 - Members elected through regional proportional representation: 176
- **Seats in previous Lower House: 475, of which...**
 - LDP: 288 & Komeito: 35
 - (Former) Democratic Party: 88
 - Others: 64
- **Seats in Upper House: 242, of which...**
 - LDP: 125 & Komeito: 25
 - (Former) Democratic Party: 49
 - Others: 43

Source: Lower House and Daiwa Capital Markets Europe Ltd.



Abenomics platform, in the run-up to this election Abe made no new market-moving proposals one way or the other. So, on policy, his victory would largely imply more of the same. That means that the consumption tax would likely rise again in October 2019, by 2ppt to 10%, with some of the additional revenues earmarked for extra spending on education. We would also expect ongoing incremental structural reform, in line with Abe's initial 'third arrow' and subsequent Dynamic Engagement Plan, aimed at boosting potential growth and tackling demographic challenges. We should expect no sudden push to ensure fiscal sustainability, with Abe having quietly dropped his previous objective to balance the primary budget balance by FY20. And we might expect broad continuity at the BoJ too, regardless as to whether Kuroda gets a second term as Governor next year. Given the marked improvement in macroeconomic performance since end-2012, Japan could certainly do a lot worse.

Consumer spending may have declined in Q3

One of those achievements of Abe's time in office is the current run of six quarters of unbroken economic growth. But, after consumer spending rose in Q2 at the fastest pace in more than three years, data point to a softer third quarter for such expenditure. Indeed, the Cabinet Office's Synthetic Consumption index for August suggests that the hurdle to be cleared is high if Japan is to record a seventh consecutive quarter of growth in private consumer spending in Q3. This index – which is the one most closely aligned with the national accounts definition of consumption – rose 0.4%/M/M in August. But it did so following a revised 0.1%/M/M decline in July (previously reported as a 0.3%/M/M increase). So, average spending over the first two months of Q3 was 0.6% below the average in Q2. And without favourable revisions, consumption would need to rise by a particularly vigorous 1.6%/M/M in September just to bring the Q3 level up to that in Q2.

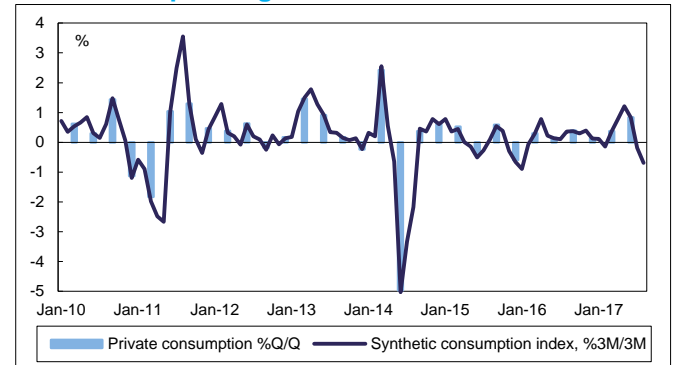
Payback for a strong Q2

While more favourable weather, improved levels of consumer confidence and retail sector indicators suggest that spending will likely have risen in September, an increase as large as 1.6%/M/M is a very tall order. It is certainly beyond that normally seen in non-exceptional circumstances (larger moves have typically only been seen around major events, such as the Great East Japan Earthquake or the 2014 consumption tax increase). Should private consumption prove to have declined in Q3, we continue to think that this outcome is best regarded as payback for the strong 0.8%/Q/Q growth recorded in Q2. And it would bring consumption growth over recent quarters back into line with the trend of growth in household incomes – indeed, real household disposable incomes grew just 1.3%/Y/Y in the three months to August.

Trade surplus down only slightly in September

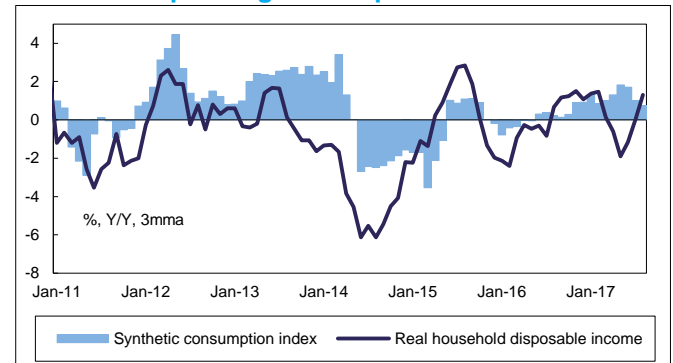
While it now seems certain that private consumption will be soft in Q3, this week's trade data provided greater certainty that net exports will contribute positively to growth. Japan recorded a (seasonally adjusted) trade surplus of ¥240bn in September, down marginally from August. The value of exports edged down 0.3%/M/M. But following strong growth in both July and August, receipts were still up more than 14%/Y/Y. Exports to China looked strongest, rising almost 30%/Y/Y, whilst exports

Consumer spending



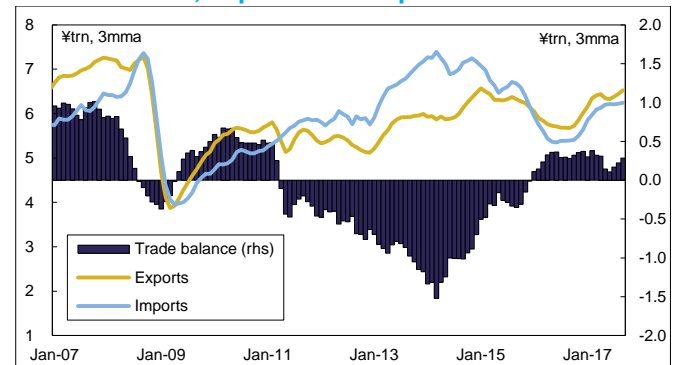
Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

Consumer spending and disposable income



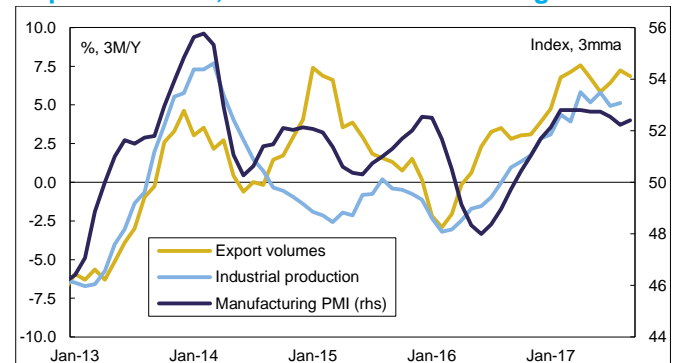
Source: MIC, Cabinet Office and Daiwa Capital Markets Europe Ltd.

Trade balance, exports and imports



Source: MoF, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Export volumes, IP and the manufacturing PMI



Source: BoJ, METI, Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

across Asia rose almost 19%Y/Y. And growth in exports to the US and the EU was very similar at a little more than 11%Y/Y – the former seeing some payback from a strong August and possibly also influenced by disruptions caused by hurricanes. Exports of machinery rose more than 17%Y/Y and exports of electrical machinery rose almost 15%Y/Y suggesting continued firm demand associated with the upswing in global investment.

Net trade likely boosted GDP growth in Q3

After removing the impact of price changes, the BoJ estimated that the volume of exports fell 5.4%M/M in September. Nevertheless, coming after strong gains in July and August – which lifted real exports to their highest level since March 2008 – the volume of exports rose a very respectable 1.9%Q/Q after declining 0.5%Q/Q in Q2. According to the BoJ, the volume of imports also had a soft month, falling 3.6%M/M in September to leave them down 1.5%Q/Q in Q3, to some extent representing payback following growth of 2.9%Q/Q in Q2. As a result, net trade seems likely to have reversed at least some of the 0.3ppt negative contribution made to GDP growth in Q2.

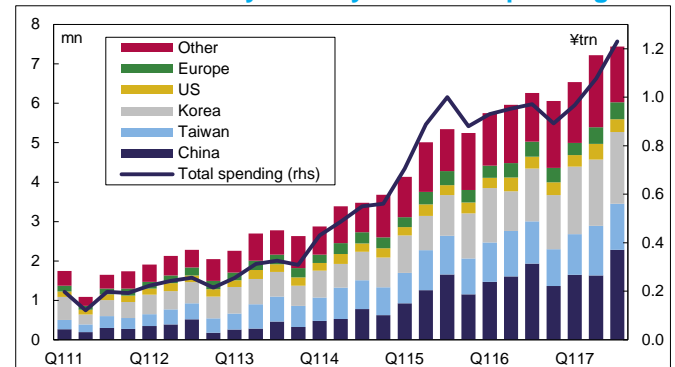
Another strong month for tourism

While net exports of goods likely boosted growth in Q3, so too probably did exports of services. Evidently, there remains strong momentum in tourism, another success of Abenomics. Total arrivals rose almost 19%Y/Y in September to surpass Abe's original 20mn full-year target, initially set for the end of the decade, more than three months early. Growth was led by arrivals from Mainland China, up almost 30%Y/Y. And the number of visitors would likely have been stronger were it not for the movement of national holidays in some countries to October this year from September in 2016. For this reason growth in arrivals from Korea eased to 'just' 29%Y/Y, but the total from that country in 2017 so far (more than 5.2mn) has already surpassed that for the whole of 2016. Encouragingly, average spending per visitor rose 6.6%Y/Y in Q3, and so total spending by visitors rose almost 27%Y/Y to more than ¥1.2trn. Such spending has almost quadrupled in the last four years. And with events such as the 2019 Rugby World Cup and 2020 Olympics sure to expose Japan to a wider range of potential visitors (over the past six months 86% have come from other Asian countries), while there remain concerns about capacity constraints, we expect the upwards trend to be maintained.

Confidence strong at the start of Q4

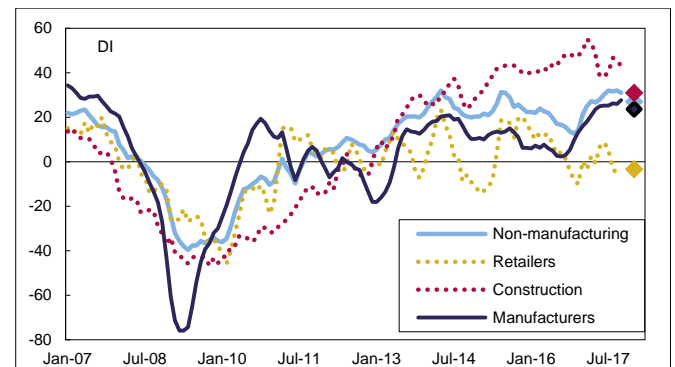
Despite signs of a softer showing from consumption in Q3, we do still expect to see GDP post another gain in Q3. And sentiment surveys strongly suggest that the economic expansion continues in Q4. Indeed, if there was any doubt about the positive mood in Japan's manufacturing sector, this was surely dispelled by the monthly Reuters Tankan survey results for October. The business conditions index for manufacturers rose 6pts to +31 – a level last seen in June 2007. While the gains were quite broad-based, it was not surprising to see particular strength in the export-intensive sectors (for example, business conditions in the electrical machinery sector were assessed as being in the best shape since 2006). And firms seem to expect positive conditions to be sustained, with the month-ahead forecast index rising 3pts to +24 – about double the average reading recorded over the past 5 years. Turning to the non-manufacturing

Tourism arrivals by country and total spending



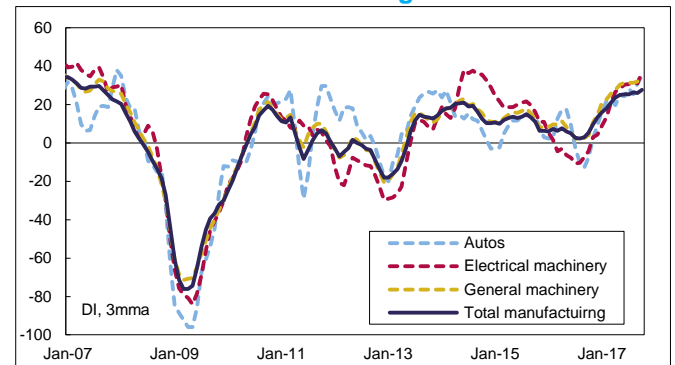
Source: JNTO, JTA and Daiwa Capital Markets Europe Ltd.

Reuters Tankan



Note Diamonds represent survey forecasts for January 2018. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Reuters Tankan: Manufacturing subsectors



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

sector, the business conditions index fell 4pts to +30 in October. However, this hit a 26-month high in September and the October reading is still well above the average recorded over the past five years. And in aggregate non-manufacturers were upbeat about the outlook with the forecast conditions index remaining at +28 – well above the long-run average. So, all up, the Reuters Tankan supports other indicators that suggest that Japan is likely to continue benefiting from and contributing to an expanding global economy.

The week ahead in Japan and the US

In Japan, the focus in the early part of the coming week is obviously likely to be on the outcome of Sunday's Lower House election. But assuming that the polls are correct, attention will likely quickly turn back to the economy. The key focus this week will be Friday's national and Tokyo CPI outcomes for September and October respectively. As regards the national CPI, last year's September readings provide a low hurdle to a slight pick-up in annual headline and core inflation from the 0.7%Y/Y rate reported in August (the core CPI was unchanged in September 2016). The other economic reports of note this week are the BoJ's Senior Loan Officer Survey (Monday) and the flash October manufacturing PMI (Tuesday). In the bond market the MoF will hold an enhanced-liquidity auction for 20-, 30- and 40-year JGBs on Tuesday and a regular auction for 2-year JGBs on Thursday.

In the US, the focus in the coming week will likely be on Friday's first estimate of Q3 GDP, with growth expected to have slowed to about 2.5%Q/Q annualised from 3.2%Q/Q ann. in Q2. However, ahead of Friday, estimates might well be refined depending on the outcome of Wednesday's September durables goods orders report and Thursday's advance September goods trade and inventory reports. Other reports of note this week include the flash PMIs for October (Tuesday) and the final University of Michigan consumer survey results for October (Friday). Adding to a busy diary, more than a third of the companies in the S&P500 will report their Q3 earnings. And while there is no Fed-speak due to the black-out period ahead of the 1 November FOMC meeting, investors will be attuned to any news on who President Trump might announce as his nominee to be the next Fed Chair when Janet Yellen's current term expires. In the markets, the Treasury will sell 2Y notes on Tuesday, 5Y notes and 2Y FRNs on Wednesday, and 7Y notes on Thursday.

Economic calendar

Key data releases – October/November

16	17	18	19	20
INDUSTRIAL PRODUCTION Y/Y% JUL 4.7 AUG F 5.3 CAPACITY UTILISATION M/M% JUL -1.8 AUG 3.3	20Y JGB AUCTION REUTERS TANKAN - MANUFACTURING DI SEP 25 OCT 31 NON-MANUFACTURING DI SEP 34 OCT 30 SYNTHETIC CONSUMPTION M/M% JUL -1.1 AUG 0.4	1Y TB AUCTION	3M TB AUCTION 5Y JGB AUCTION GOODS TRADE BALANCE ¥BN AUG 308.3 SEP 240.3 EXPORTS Y/Y% AUG 18.1 SEP 14.1 IMPORTS Y/Y% AUG 15.2 SEP 12.0 ALL INDUSTRY ACTIVITY M/M% JUL -0.1 AUG 0.1 MACHINE TOOL ORDERS Y/Y% AUG 36.2 SEP F 45.0	
23	24	25	26	27
DEPARTMENT STORE SALES Y/Y% AUG 2.0 SEP N/A LENDING INDEX JUL 105.2 AUG F N/A COINCIDENT INDEX JUL 115.7 AUG F N/A SENIOR LOAN OFFICER OPINION SURVEY (OCT)	AUCTION FOR ENHANCED LIQUIDITY (APPROX ¥0.4TRN) MANUFACTURING PMI SEP 52.9 OCT N/A		3M TB AUCTION (APPROX ¥4.4TRN) 2Y JGB AUCTION (APPROX ¥2.2TRN) SERVICES PPI Y/Y% AUG 0.8 SEP 0.8	NATIONAL CPI Y/Y% AUG SEP 0.7 0.7 EX FRESH FOOD 0.7 0.7 EX FRESH FOOD/ENERGY 0.2 0.2 TOKYO CPI Y/Y% AUG SEP 0.5 0.1 EX FRESH FOOD 0.5 0.5 EX FRESH FOOD/ENERGY N/A 0.1
30	31	01	02	03
UNEMPLOYMENT RATE (SEP) JOB-TO-APPLICANT RATIO (SEP) HOUSEHOLD SPENDING (SEP) INDUSTRIAL PRODUCTION (SEP) BOJ POLICY BOARD MEETING (30-31 OCTOBER)	VEHICLE PRODUCTION (SEP) SMALL BUSINESS CONFIDENCE (OCT) HOUSING STARTS (SEP) CONSTRUCTION ORDERS (SEP) BOJ POLICY ANNOUNCEMENT AND OUTLOOK REPORT	3M TB AUCTION 10Y JGB AUCTION MANUFACTURING PMI (OCT F) VEHICLE SALES (OCT) MONETARY BASE (OCT)	CONSUMER CONFIDENCE (OCT)	NATIONAL HOLIDAY - CULTURE DAY
06	07	08	09	10
SERVICES PMI (OCT) COMPOSITE PMI (OCT) BOJ POLICY BOARD MINUTES (20-21 SEPTEMBER MEETING)	AUCTION FOR ENHANCED LIQUIDITY AVERAGE WAGES (SEP)	6M TB AUCTION LEADING INDEX (SEP) COINCIDENT INDEX (SEP) MACHINE TOOL ORDERS (SEP) CURRENT ACCOUNT (SEP) GOODS TRADE BALANCE (SEP) BOJ CONSUMPTION ACTIVITY INDEX (OCT)	3M TB AUCTION 30Y JGB AUCTION BOJ SUMMARY OF OPINIONS (30-31 OCTOBER MEETING)	

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



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