Yen 4Sight

- Q3 GDP growth was revised up to 0.6%Q/Q, with domestic demand firmer than previously thought.
- While total labour earnings growth slowed in October, growth in contracted earnings remained at a 1½-year high.
- Consumer spending in October looks firmer than previously indicated and confidence is still rising in the household sector.
- The focus the coming week will be the BoJ's Q4 Tankan survey and October machinery orders data.

Chris Scicluna
+44 20 7597 8326
Chris.Scicluna@uk.daiwacm.com

Interest and exchange rate forecasts

End period	8-Dec	Q417	Q118	Q218
BoJ ONR %	-0.10	-0.10	-0.10	-0.10
10Y JGB %	0.05	0.05	0.05	0.05
JPY/USD	114	113	114	115
JPY/EUR	133	133	135	136

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

An encouraging week of data

Another busy week in Japan saw the release of several top-tier economic reports, which indicated that GDP growth had been stronger in Q3 than previously thought, and provided cause for optimism that growth remains above-trend in Q4. The new data suggest that consumption in October was firmer than indicated earlier; the Labour Survey suggested an improving underlying trend in earnings; and most sentiment surveys remained very upbeat. There were even signs of life in the PMI price indices. So, while debate about the appropriateness of BoJ policy continues, these data will likely have left Governor Kuroda and most of his Board colleagues feeling quite satisfied with the current policy framework and its calibration.

Q3 GDP growth revised up to 0.6%Q/Q

Perhaps most interest centred on the second release of the Q3 national accounts, which provided a positive surprise. Real GDP growth was revised up 0.3ppt to 0.6%Q/Q (2.5% annualised), above our and the market's expectation. Minor revisions to GDP in prior quarters were also a net positive, with growth in Q1 and Q2 raised by 0.1ppt to 0.4%Q/Q and 0.7%Q/Q respectively. So, annual GDP growth was revised up 0.4ppt to 2.1%Y/Y, a pace last achieved two years earlier.

A healthy upwards revision to private capex

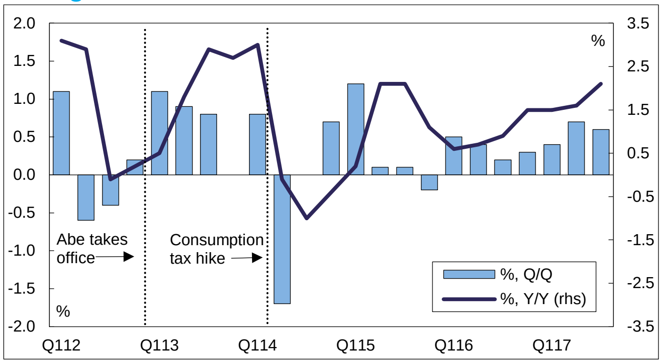
The upwards revision to GDP in Q3 was driven by domestic demand, now estimated to have risen 0.1%Q/Q rather than contracted 0.2%Q/Q. As expected, private non-residential investment was stronger than previously thought, with growth estimated at 1.1%Q/Q, up from 0.2%Q/Q previously, and the detail revealing that investment in non-transport machinery also grew 1.1%Q/Q following a similar increase in Q2. The other key driver of the upward revision was private inventories, now estimated to have added 0.4ppt to growth, twice as much as previously thought and the first positive contribution in five quarters. Private consumption is still estimated to have declined in Q3 by 0.5%Q/Q, albeit from growth in Q2 that was revised up 0.2ppt to 0.9%Q/Q. Other expenditure components saw minimal or no revisions (see table). With respect to prices, the annual GDP deflator was unrevised at just 0.1%Y/Y. So, nominal GDP growth in Q3 is now estimated at 0.8%Q/Q, with the annual rate revised up 0.5ppt to 2.2%Y/Y – the fastest since Q415. The domestic demand deflator – a better guide to the capacity of Japan's economy to generate inflation – rose an unrevised 0.5%Y/Y, while the PCE deflator rose an unrevised 0.2%Y/Y, broadly in line with recent developments in the BoJ's preferred measure of core CPI inflation.

Q3 GDP

	latest Q/Q	1st estimate Q/Q	latest Y/Y	1st estimate Y/Y
GDP	**0.6**	**0.3**	**2.1**	**1.7**
Final sales	0.2	0.1	18	17
Domestic demand	0.1	-0.2	14	10
-Private consumption	-0.5	-0.5	0.9	0.7
-Residential investment	-10	-0.9	16	15
-Non-residential invest.	11	0.2	3.8	3.0
-Government consump.	0.0	-0.1	0.2	0.4
-Public investment	-2.4	-2.5	0.3	0.8
Net exports (contr)	0.5	0.5	0.7	0.7
-Exports	15	15	6.4	6.4
-Imports	-16	-16	2.4	2.3
Private inventories (contr)	0.4	0.2	-0.1	-0.1

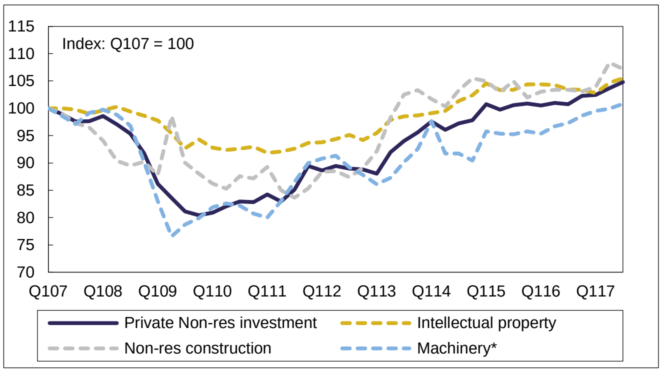
Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

GDP growth



Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

Fixed investment



** Machinery includes transport equipment, Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.*

Labour earnings maintain improved tone

Those hoping to see stronger economic growth feed through to higher wages might have been disappointed to see the preliminary Monthly Labour Survey for October. Growth in total labour cash earnings per person slowed 0.3ppt to 0.6%Y/Y. But the weakening owed to monthly volatility in special earnings (i.e. bonuses), with contracted earnings up 0.7%Y/Y, maintaining the 18-month high reached in September and tallying with recent upbeat consumer confidence surveys (see below). Allowing for inflation, real total cash earnings rose 0.2%Y/Y in October, the first positive reading this year. Hours worked rose 0.8%Y/Y – an improvement on the flat previous reading – while the number of regular employees rose a steady 2.7%Y/Y. Of course, these data are subject to possible significant revisions.

Consumer spending grew slightly in October

Adding to the positive tone, the BoJ's Consumption Activity Index indicated that consumer spending was much firmer in October than suggested by the weak household spending survey. The headline real index rose 0.3%M/M in October, nudging annual growth up to 1.1%Y/Y. And the travel-adjusted index – which conceptually aligns most closely with the national accounts measure of private consumption by removing the net spending of tourists – rose 0.2%M/M, reversing a decline of a similar amount in September, to be up 0.8%Y/Y. However, on this measure, expenditure in October was still 0.2% below the average monthly level seen in Q3. So, spending will need to pick up if growth in private consumption in Q4 is to return to positive territory. Thankfully, a return to more typical weather should have helped lift spending in November.

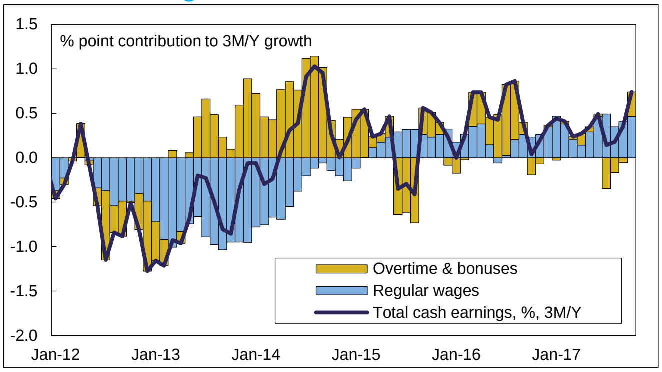
Consumer confidence up again

The Cabinet Office consumer confidence survey suggested that sentiment is no barrier to spending growth. Having set a three-year high the previous month, the headline confidence index rose further in November. All components improved, with the strong labour market reflected in a new three-year high for the employment index and the income growth index at its best since May 2007. Additionally, consumers' willingness to buy durable goods rose to a three-year high, suggesting that the sharp decline in spending on such items in October will prove temporary. The November Economy Watchers survey was similarly upbeat, with the headline current conditions index up to 55.1, the highest since January 2014, thanks to big gains in the household and employment indices. And having improved markedly the previous month, the business index remained robust too. While the overall expectations index fell slightly, this was still the second-best reading since December 2013, with the detail suggesting that households and businesses alike clearly anticipate ongoing economic expansion.

Reuters survey bodes well for BoJ Tankan

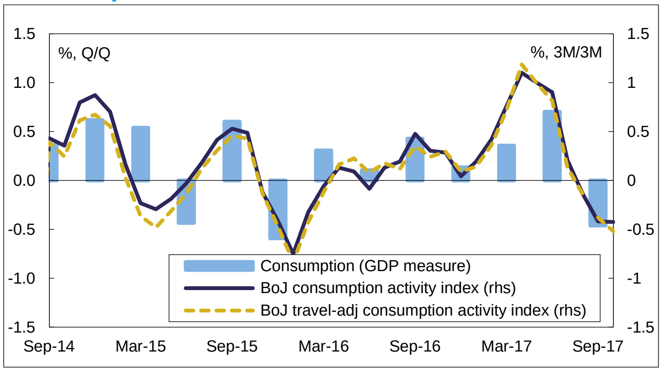
Similarly, giving a guide to what to expect from the BoJ's Q4 Tankan due at the end of the coming week, the final Reuters Tankan for 2017 also suggested that firms feel good heading into the New Year. The manufacturers' business conditions index was steady at a robust +27 in December, slightly above this year's mean and well above the long-run average. And the equivalent index for non-manufacturers rose 3pts to+34 in December, equalling this year's highpoint, with retail conditions encouragingly the best since January. Looking ahead,

Labour earnings



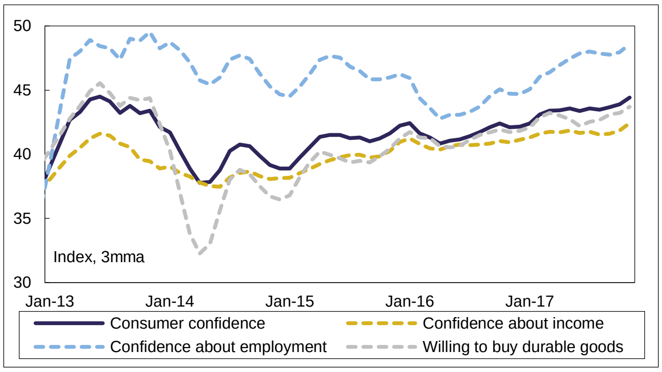
Source: MHLW and Daiwa Capital Markets Europe Ltd.

Consumption indices



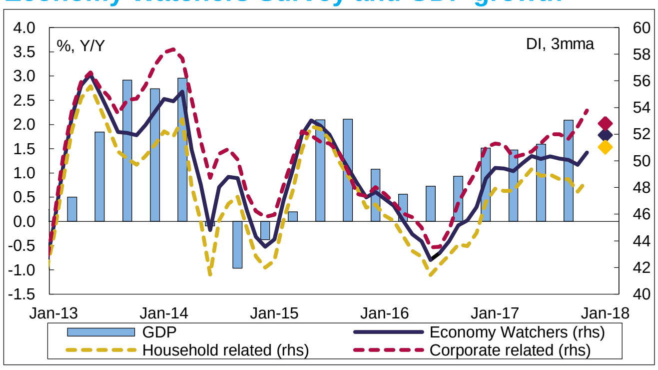
Source: BoJ, Cabinet Office and Daiwa Capital Markets Europe Ltd.

Consumer confidence



Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

Economy Watchers Survey and GDP growth*



** Lines represent current conditions indices, diamonds represent latest observation for expectations index Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.*

respondents seem to expect more of the same, with the month-ahead indices for manufacturers and non-manufacturers edging up to well above the long-run average.

PMIs hint at firmer price pressures?

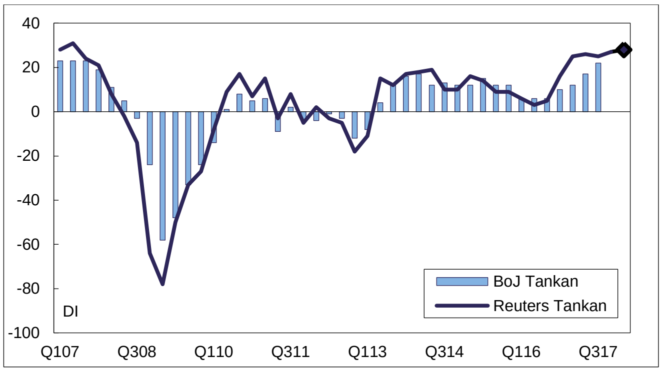
At face value, the outlier among the latest surveys was the services PMI, for which the headline index fell more than 2pts in November to 51.2, well below the 2017 average. But this is a volatile series, and the survey detail was better than the headline implied. For example, having in October reached its highest since May 2013, the new orders PMI edged down just 0.1pt, and the business expectations index rose to a six-month high. And perhaps most encouraging for the BoJ, the input prices PMI rose 2.2pts to 55.5 – no less than a nine-year high – and the output prices PMI rose 0.9pt to 51.7, the highest since July 2015. Added to information from the manufacturing PMIs, this took the composite PMI output prices index to a three-year high of 51.6, suggesting possible stirring in underlying inflation pressure, albeit by no means as much as the BoJ might like.

The week ahead in Japan and the US

The highlight of the coming week's Japanese economic diary will be Friday's BoJ Tankan survey for Q4. There is little reason to think that this report will be other than upbeat, maintaining the positive tone of the Q3 survey. As ever, firms' forecast for capex will be of particular interest. Ahead of the Tankan, some pointers will be provided by Monday's less-widely followed MoF/Cabinet Office Business Outlook Survey for Q4. Turning to the rest of the diary, Tuesday's October Tertiary Industry Index and November PPI report might attract some attention. However, more interest will centre on Wednesday's October machine orders report, especially after the very disappointing 8.1%M/M decline in core orders reported in September. On Thursday, the flash December manufacturing PMI will be released, together with the final IP report for October. During the week we will also be keeping an eye open for the Cabinet Office Synthetic Consumption Index for October. In the bond market, the MoF will auction 5-year JGBs on Tuesday and 20-year JGBs on Thursday.

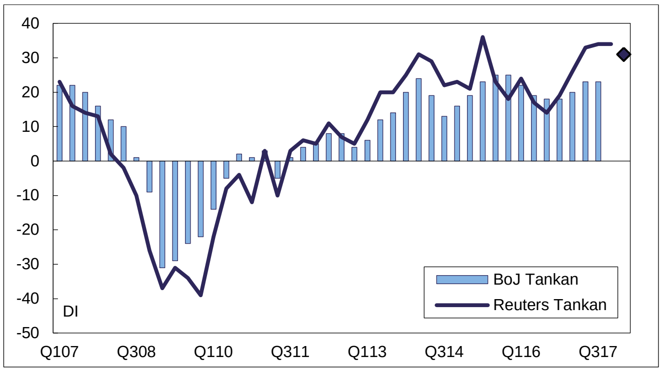
In the US, the coming week will be busy, highlighted by the conclusion of the latest FOMC meeting on Wednesday and the November retail and CPI reports due Wednesday and Thursday respectively. There is little doubt that the FOMC will announce a further 25bps hike in the target range for the fed funds rate (FFR), to 1.25-1.50%. So, most interest will be on the accompanying Fed projections, including the FFR dot-plots, and outgoing Fed Chair Yellen's final press conference. Turning to the CPI data, a further 0.2%M/M lift in the core index would likely return annual headline inflation to 2.2%Y/Y. In addition, while lower auto sales will weigh on overall retail spending, high levels of consumer confidence and solid income growth suggests that a decent increase should still be seen. The coming week also sees a number of other economic reports, including the BLS JOLTS report on Monday; the PPI on Tuesday; the flash Markit manufacturing and services PMIs on Thursday; and the November IP report and New York Fed manufacturing survey on Friday. In the bond market, the Treasury will auction 3Y and 10Y notes on Monday and 30Y bonds on Tuesday.

Reuters vs BoJ Tankan: Manufacturers



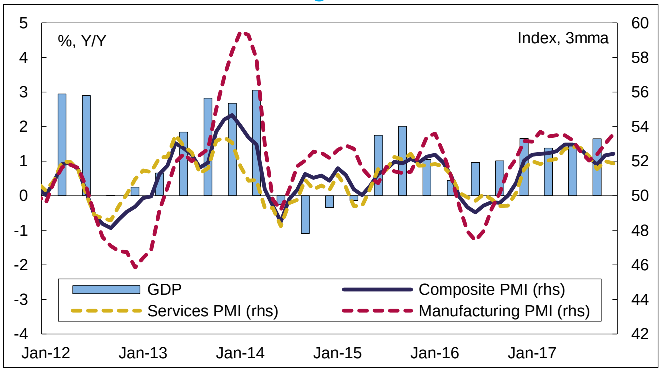
Diamond represents forecast index from December Reuters Tankan, Source: Thomson Reuters, BoJ and Daiwa Capital Markets Europe Ltd.

Reuters vs BoJ Tankan: Non-manufacturers



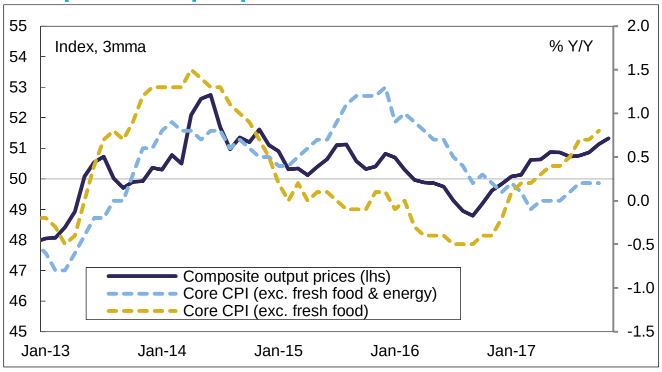
Diamond represents forecast index from December Reuters Tankan, Source: Thomson Reuters, BoJ and Daiwa Capital Markets Europe Ltd.

Headline PMIs and GDP growth



Source: Markit, Cabinet Office, Daiwa Capital Markets Europe Ltd.

Composite output prices PMI and core CPI inflation



Source: Markit, MIC, Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

Economic Calendar

Key data releases – December

04	05	06	07	08
MONETARY BASE Y/Y% OCT 14.5 NOV 13.2 CONSUMER CONFIDENCE OCT 44.5 NOV 44.9	10Y JGB AUCTION SERVICES PMI OCT 53.4 NOV 51.2 COMPOSITE PMI OCT 53.4 NOV 52.2	6M TB AUCTION	3M TB AUCTION 30Y JGB AUCTION REUTERS TANKAN - MANUFACTURING DI NOV 27 DEC 27 NON-MANUFACTURING DI NOV 31 DEC 34 LEADING INDEX SEP 106.4 OCT P 106.1 COINCIDENT INDEX SEP 116.2 OCT P 116.5 BOJ CONSUMPTION ACTIVITY INDEX (DEC)	GDP Q/Q% Q2 0.7 Q3 F 0.6 GDP DEFLATOR Y/Y% Q2 -0.4 Q3 F 0.1 BANK LENDING Y/Y% OCT 2.8 NOV 2.7 AVERAGE WAGES Y/Y% SEP 0.9 OCT 0.6 ECONOMY WATCHERS SURVEY - CURRENT CONDITIONS DI SEP 52.2 NOV 55.1 - FUTURE CONDITIONS DI SEP 54.9 NOV 53.8
11	**12**	**13**	**14**	**15**
MOF'S BUSINESS SENTIMENT SURVEY Q/Q% Q3 5.1 Q4 5.8 M3 MONEY SUPPLY OCT 3.5 NOV 3.5 MACHINE TOOL ORDERS Y/Y% OCT 49.8 NOV P N/A	5Y JGB AUCTION (APPROX ¥2.2TRN) GOODS PPI Y/Y% OCT 3.4 NOV 3.3 TERTIARY ACTIVITY M/M% SEP -0.2 OCT 0.2	CORE MACHINE ORDERS Y/Y% SEP -3.5 OCT -3.9	3M TB AUCTION (APPROX ¥4.4TRN) 20Y JGB AUCTION (APPROX ¥1.0TRN) MANUFACTURING PMI NOV 53.6 DEC P N/A INDUSTRIAL PRODUCTION Y/Y% SEP 2.6 OCT F 5.9 CAPACITY UTILIZATION M/M% SEP -1.5 OCT N/A	DEPARTMENT STORE SALES* Y/Y% OCT -1.8 NOV N/A REUTERS TANKAN LARGE MANUFACTURING DI Q3 22 Q4 24 LARGE NON-MANUFACTURING DI Q3 23 Q4 24
18	**19**	**20**	**21**	**22**
1Y TB AUCTION GOODS TRADE BALANCE (NOV) EXPORTS (NOV) IMPORTS (NOV)	AUCTION FOR ENHANCED LIQUIDITY MACHINE TOOL ORDERS (NOV F)	3M TB AUCTION ALL INDUSTRY ACTIVITY (OCT) BOJ FLOW OF FUNDS (Q3) BOJ POLICY BOARD MEETING 20-21 DECEMBER)	BOJ POLICY BOARD MEETING (20-21 DECEMBER)	AUCTION FOR ENHANCED LIQUIDITY
25	**26**	**27**	**28**	**29**
LEADING INDEX (OCT F) COINCIDENT INDEX (OCT F)	2Y JGB AUCTION JOB-TO-APPLICANT RATIO (NOV) HOUSEHOLD SPENDING (NOV) NATIONAL CPI (NOV) TOKYO CPI (DEC) SERVICES PPI (NOV) BOJ POLICY BOARD MINUTES (30-31 OCTOBER MEETING)	HOUSING STARTS (NOV) CONSTRUCTION ORDERS (NOV)	RETAIL TRADE (NOV) INDUSTRIAL PRODUCTION (NOV P) BOJ SUMMARY OF OPINIONS (20-21 DECEMBER MEETING)	

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

Economic Research

Key contacts

London		
Head of Research	*Grant Lewis*	+44 20 7597 8334
Head of Economic Research	*Chris Scicluna*	+44 20 7597 8326
Emerging Markets Economist	*Saori Sugeno*	+44 20 7597 8336
Economist	*Emily Nicol*	+44 20 7597 8331
Associate Economist	*Mantas Vanagas*	+44 20 7597 8318
Research Assistant	*Valerie Harrison*	+44 20 7597 8332
New York		
Chief Economist	*Mike Moran*	+1 212 612 6392
Junior Economist	*Lawrence Werther*	+1 212 612 6393
Hong Kong		
Economist	*Kevin Lai*	+852 2848 4926
Research Associate	*Christie Chien*	+852 2848 4482
Economic Assistant	*Olivia Xia*	+862 2773 8736
London Translation		
Head of Translation, Economic and Credit	*Mariko Humphris*	+44 20 7597 8327

DAIR <GO>

All of the research published by the London and New York research teams is available on our Bloomberg page at DAIR <GO>. If you are unable to access the research on this page, please contact Valerie Harrison on +44 207 597 8332.

Access our research blog at:
http://www.uk.daiwacm.com/research-zone/research-blog

Follow us
@DaiwaEurope