# Forecast for April 2018 *Outlook Report*

BOJ Watch Commentary REPE820

## Should broadly stick with its scenario

- The BOJ should stick with its view of achieving 2% inflation by around FY2019; we expect its FY2020 outlook for inflation to be slightly above 2%
- There may be room for it to revise its growth outlook downwards near term and upwards farther out, albeit only slightly

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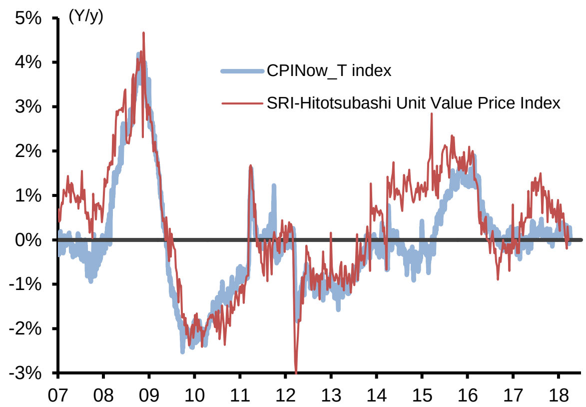
**Should broadly stick with its scenario**

The BOJ will release its *Outlook for Economic Activity and Prices* at the Monetary Policy Meeting on Friday, April 27. The market environment has changed somewhat over the three months since it last released the *Outlook Report*, including a stronger yen and weaker share prices, but economic data have broadly followed the improving trend expected by the BOJ. There does not appear to have been enough of a change to lead it to modify its view that it is maintaining momentum toward achieving the price stability target, and we expect it to broadly stick with its outlook scenarios. We do not expect it to go beyond slightly modifying its projected numbers for FY2017-19 to reflect the data that is already out. Although two deputy governors of the bank were just replaced, even if there is some change in the distribution of board members' outlooks and risk assessments,[1] we do not think it will be enough to significantly change the median numbers.

**March *TANKAN* suggests companies are taking a cautious stance**

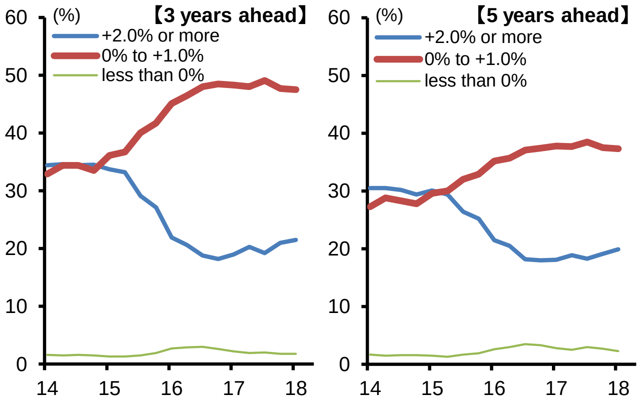
In the March *TANKAN* survey, the headline business conditions DI for large manufacturers worsened relative to the previous survey (from +26 to +24) for the first time in two years, those for both manufacturing and nonmanufacturing SMEs were relatively solid, and that for all industries and all enterprises improved slightly (from +16 to +17). The yen is stronger than the exchange rates assumed by companies (large manufacturers planned for a USD/JPY of 109.66 in FY2018), however, and depending on what happens next, including with US trade policy, there is a non-trivial risk that the lowering USD/JPY will have a

**Chart 1: Price Index Calculated by POS Data**




*Source: NowcaSTats, SRI-Hitotsubashi Consumer Decomposition Indices.*
*Note: Monthly average. Figures of SRI-Hitotsubashi UVPI are Total excluding cigarette.*

**Chart 2: Enterprises' Outlook for General Prices**




*Source: BOJ; compiled by Daiwa Securities.*

[1] In the press conference announcing his appointment on March 20, Deputy Governor Masayoshi Amamiya said that he does not deny it is conceptually or theoretically possible to adjust the yield curve (upward), but emphasized that it is really premature at this point to be talking about doing so. New Deputy Governor Masazumi Wakatabe said that he thinks it essential to apply additional easing without hesitation if necessary, he said later in front of the Diet that the current policy direction is correct and producing results. Although there are differences in the vectors they spoke of, the current stance of the two new Deputy Governors is in line with the majority opinion of the previous set of board members. It suggests that both will indicate an outlook for the economy and prices that is close to the board's median outlook.

negative impact on the business plans. Many companies (all industries and all enterprises) have a slightly cautious bias, expecting overseas supply-demand to continue improving (from -4 to -1), but the domestic supply-demand balance to stop improving for the first time in six quarters (from -12 to -12).

**There will likely be no change in its view that the 2% inflation target will be reached around FY2019**

It appears that companies have adopted this cautious stance because even though personnel, logistics, raw materials, and other costs are rising, price pass-through to reflect such higher costs has been insufficient. In fact, the rate of increase in the nationwide core CPI, helped by energy prices, has been steadily rising, but price increases for food and daily necessities appear to have weakened very recently (Chart 1). With concerns ahead about (1) impacts from yen appreciation, (2) results from the FY2018 spring wage negotiations, although exceeding those of FY2017, not having enough of an impact to propel price increases, and (3) consumers continuing to not have much tolerance for price hikes,[2] we think it will stick with its view that risks to prices are skewed to the downside. That said, the number of companies forecasting inflation (general prices) to accelerate above 2% in either three or five years has once again increased, albeit only slightly (Chart 2). Given also that the output gap, which tends to lead the inflation rate, has continued to get larger, we think it likely that the BOJ will stick with its view that inflation will reach 2% by FY2019. We expect the price outlook within the forecast period to be reduced slightly for FY2017 actual but left generally unchanged for FY2018-19, and we expect the forecast for FY2020, a new addition to the forecast period, to be slightly above 2% (Chart 3).

**There may be room for it to revise very slightly its growth outlook downwards near term and upwards farther out**

It looks likely that it will lower its estimate of actual FY2017 real growth[3] (Chart 3). Because consumption has been weak since January owing to a major cold wave and large amounts of snowfall, the real growth rate could drop into negative territory for the first time in nine quarters in Jan-Mar 2018. Nevertheless, the growth trend in exports and production driven by global economic growth appears to be continuing, and we expect the BOJ to stick with its FY2018 outlook. Meanwhile, we think there may be room for a small upward revision to its FY2019 growth outlook. The BOJ's estimate of the potential growth rate announced on April 4 (Wednesday) rose to +0.88% as of end-2017. Given the likelihood of continued growth in the capital stock over the near term, it is conceivable that the BOJ will slightly revise its outlook to reflect this higher potential growth rate. For the newly added forecast period of FY2020, we think the BOJ is likely to project slightly lower growth than in FY2019 to reflect the decline in real incomes that will result from the consumption tax hike.

**Chart 3: Policy Board Members Outlook (median) and Our Forecast**

(y/y % chg.)

| | Real GDP | | Core CPI | |
|---|---|---|---|---|
| | Jan. 2018 | **Apr.2018*** | Jan. 2018 | **Apr.2018*** |
| FY 2017 | +1.9 % | **+1.8 %** | +0.8 % | **+0.7 %** |
| FY 2018 | +1.4 % | **+1.4 %** | +1.4 % | **+1.4 %** |
| FY 2019 | +0.7 % | **+0.8 %** | +1.8 % | **+1.8 %** |
| FY 2020 | — | **+0.7 %** | — | **+2.1 %** |

**Figures as of Apr. 2018 are the author's estimates of policy board member outlooks.*
*Source: BOJ; compiled by Daiwa Securities.*
*Note: Core CPI forecasts for FY2019-2020 are the figures excluding the effect of consumption tax hike.*

[2] In response to the question, in the March 2018 Opinion Survey on the General Public's Mindset and Behavior, of what major factors they will consider when choosing goods and services over the next year (up to three answers can be chosen) 54.3% of respondents chose low price, the highest that percentage has been since the survey began five years ago.

[3] In the Japan Center for Economic Research's ESP Forecast Survey taken in April, the aggregate average real growth forecast was 1.81% (vs. 1.88% in the January survey) for FY2017, 1.25% (1.26%) for FY2018, and 0.79% (0.77%) for FY2019. The aggregate average core CPI forecast (excluding consumption tax hike impacts) was +0.70% (vs. +0.66%) for FY2017, +0.94% (+0.88%) for FY2018, and +0.89% (+0.90%) for FY2019.

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**[Standard & Poor's]**

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**[Moody's]**

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**[Fitch]**

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Apr 2017

**IMPORTANT**



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If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

• In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
• For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
• There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
• There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
• Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

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