

# Yen 4Sight

- A probable fall in IP in Q1 looks less severe in light of revisions. Net exports appear to have made no contribution to growth.
- As expected core inflation eased in March. Growth in labour incomes in February was not as strong as first reported.
- A BoJ survey points to a further easing of credit conditions, but the Bank expressed some concern about the pricing of risk.
- Friday will bring the BoJ policy review and Outlook Report, and several key economic reports too. We expect little change in the BoJ's policy stance or forecasts.

## Chris Scicluna

+44 20 7597 8326  
[Chris.Scicluna@uk.daiwacm.com](mailto:Chris.Scicluna@uk.daiwacm.com)

### Interest and exchange rate forecasts

End period	20 Apr	Q218	Q318	Q418
BoJ ONR %	-0.10	-0.10	-0.10	-0.10
10Y JGB %	0.06	0.07	0.07	0.07
JPY/USD	108	105	104	108
JPY/EUR	132	127	127	134

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

## A busy week of economic data

With the next BoJ policy review looming large there was plenty of news for investors to digest over the past week. It seems that IP might have fallen less in Q1 than had been feared, but trade data pointed to a flat quarter for net exports. There were more signs that optimism in the manufacturing sector is being eroded by various policy uncertainties and a firmer yen. And the recent uptrend in core inflation was confirmed to have stalled in March while growth in labour incomes in February was less than first estimated. Finally, the BoJ reported a further easing of credit conditions and expressed some concern about whether credit risk was being priced accurately by banks.

## Abe remained in the limelight too

Domestic politics inevitably remained a focus also. Weekend opinion polls pointed to a further decline in PM Abe's approval rating (e.g. down to a record low 26.7% in a Nippon TV poll) amid signs that his popularity is falling further behind that of his critic, and obvious challenger, Shigeru Ishiba. So, Abe would have hoped to have walked out of this week's meeting with President Trump with something to show. But Trump seemingly did little to help Abe's standing back home. On the trade front, the meeting did no more than commit the US and Japan to new talks focusing on "free, fair and reciprocal" trade, with Trump also refusing to exempt Japan from his tariffs on steel and aluminium (although as we noted last week, the impact of these tariffs on Japan's economy is likely to be minimal).

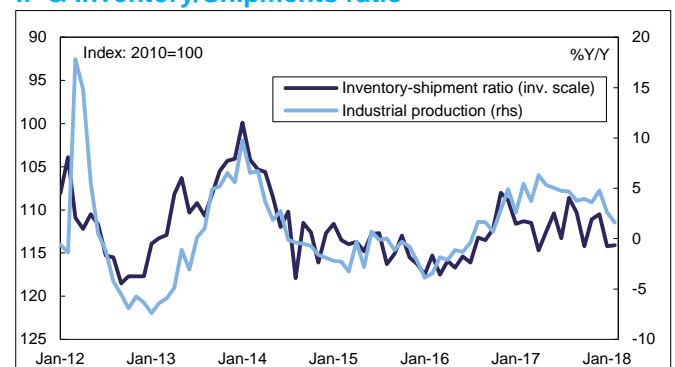
## IP revisions put Q1 in slightly firmer light

Turning to this week's data, the release of the final IP report for February contained some sizable revisions. IP is now estimated to have declined a less severe 3.1%M/M in January, rather than the 6.8%M/M slump estimated previously. So, while output is now estimated to have been flat in February, annual growth was revised up 0.2ppt to 1.6%Y/Y. And the new monthly profile means that the average level of industrial output across the first two months of Q1 was 'only' 1.7% below the average level seen through Q4 – hardly a great result, but still better than the 2.9% contraction that was estimated previously.

## Trade balance moves back into surplus in March

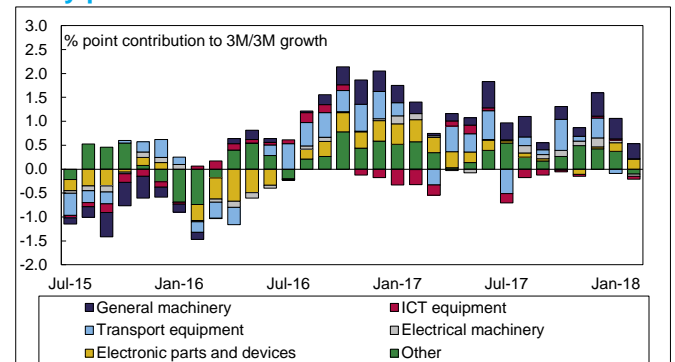
Japan recorded a (seasonally adjusted) trade surplus of ¥119.2bn in March, which was very close to market expectations. The value of exports fell 2.2%M/M – marking a third consecutive decline – and were up just 2.1%Y/Y. To some extent this likely reflects the stronger yen, with the BoJ's

## IP & Inventory/Shipments ratio



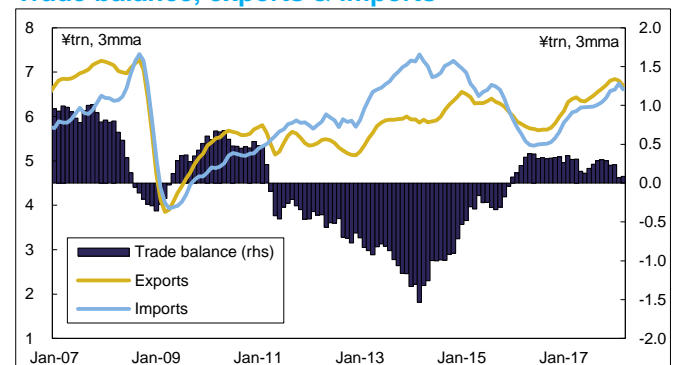
Source: METI and Daiwa Capital Markets Europe Ltd

## IP by product



Source: METI and Daiwa Capital Markets Europe Ltd

## Trade balance, exports & imports



Source: MoF and Daiwa Capital Markets Europe Ltd.



effective yen exchange rate index appreciating by around 2% over each of the past two months. Meanwhile, import values continued their recent bumpy ride, falling 6.9%M/M to be down 0.6%Y/Y. Of course, much of the recent volatility is related to the timing of regional holidays, especially those in China.

### Net exports look roughly flat in Q1

A better sense of the underlying real trend is provided by the BoJ's estimates of export and import volumes. According to these data, real exports fell 1.9%M/M in March, but annual growth still firmed to 2.7%Y/Y. For Q1 as a whole, real exports rose 0.5%Q/Q, down from 1.7%Q/Q in Q4. Real imports slumped 6.9%M/M in March, so their annual growth fell to just 0.8%Y/Y. For Q1 as a whole, real imports also rose 0.5%Q/Q. In other words, at face value, the BoJ's estimates suggest that net exports will be a non-contributor to GDP growth in Q1.

### Manufacturer sentiment continues to ease

Unfortunately, the Reuters Tankan survey for April suggested that developments in US trade policy and other geopolitical news, together with a firmer yen, are undermining optimism in the globally-exposed manufacturing sector. The overall index of current conditions in the manufacturing sector eased a further 7pts to a 14-month low of +21 in April, albeit remaining far above average. The good news from the survey is that conditions in the non-manufacturing sector – which is more sheltered from the issues worrying exporters – remain very positive. Indeed, the overall current conditions index edged up a further 1pt to +36 in April, which remains the highest reading since June 2015.

### Total labour earnings revised lower in February

As is often the case, the final results of the Monthly Labour Survey for February contained some notable revisions. Growth in total labour cash earnings (per person) was revised down 0.2ppt to 1.0%Y/Y. Of particular note, growth in contracted earnings was revised down 0.3ppt to 0.6%Y/Y, albeit remaining modestly above the average growth recorded last year. These revisions meant that real total cash earnings fell 0.8%Y/Y in February. Scheduled earnings of part-time workers rose 2.0%Y/Y on a per hour basis. Scheduled monthly wages for full-time workers rose 0.8%Y/Y in February, which is just 0.3ppt above the average recorded over the past two years.

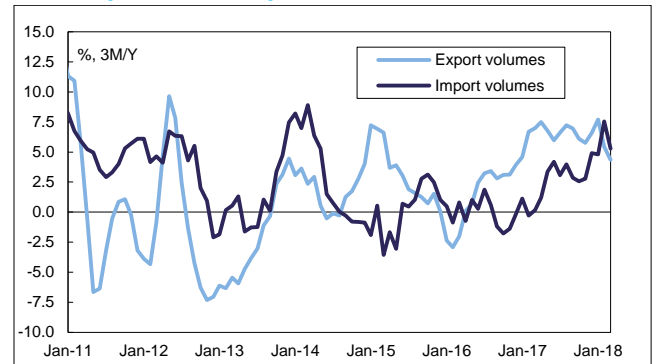
### No surprises in the March CPI

In keeping with what had been signalled by the advance Tokyo CPI, the national CPI fell 0.4%M/M in March, lowering the annual inflation rate by 0.4ppts to 1.1%Y/Y. The BoJ's forecast measure of core inflation, which excludes prices of fresh food, fell 0.1%M/M, lowering the annual rate of core inflation on this measure by 0.1ppt to 0.9%Y/Y. The BoJ's preferred measure of core inflation, which excludes both fresh food and energy, also fell 0.1%M/M. Even so, annual inflation on this measure was steady at 0.5%Y/Y. While annual inflation for non-energy industrial goods edged up 0.2ppt to 0.4%Y/Y, a level last seen in August 2016, inflation in the service sector eased 0.1ppt to 0.2%Y/Y and so remains nowhere near the level required if the BoJ is to achieve sustained CPI inflation of 2%Y/Y.

### BoJ survey reports easier credit conditions

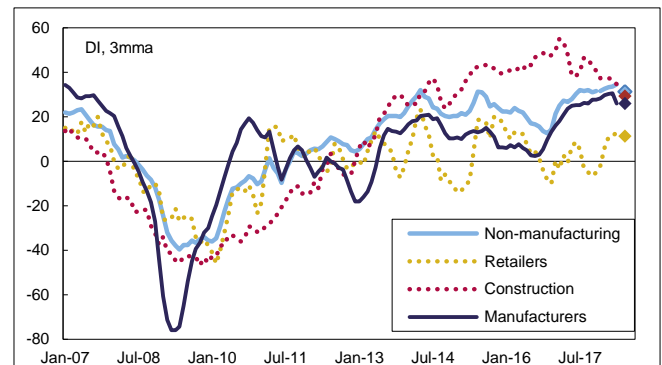
The BoJ latest quarterly Senior Loan Officer survey indicated

### Real exports and imports



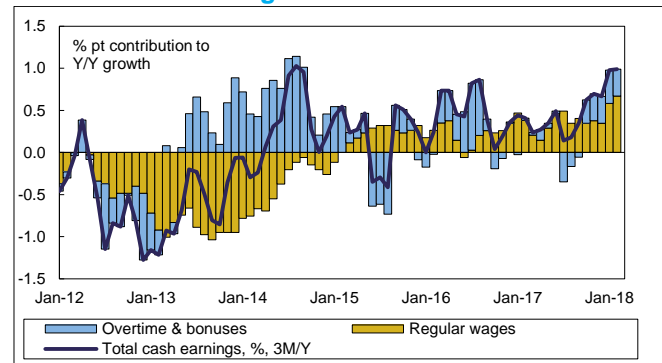
Source: BoJ and Daiwa Capital Markets Europe Ltd.

### Reuters Tankan\*



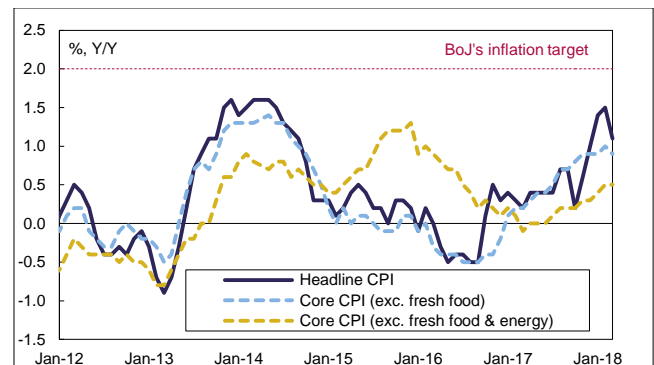
\*Diamonds represent the forecast index. Source: Reuters & Daiwa Capital Markets Europe Ltd

### Labour cash earnings



Source: MHLWI & Daiwa Capital Markets Europe Ltd

### CPI: Headline and core measures\*



\*Adjusted for the consumption tax, Source: MIC & Daiwa Capital Markets Europe Ltd

that, on net, a small proportion of banks had experienced an increase in loan demand. Banks again reported easing their credit standards in about the same fractions as reported three months earlier, citing competition from other banks and proactive efforts to grow their business. On balance, a small fraction of banks reported having upped their lending interest rates relative to their cost of funding, with more expecting to widen their spreads over the next three months.

### BoJ expresses some concern about credit pricing

The latter should please the BoJ, which in the latest semi-annual Financial System Review – also released this week – expressed some concern that financial institutions tend to be complacent in their perception of credit risk amid prolonged benign macroeconomic conditions. Indeed, the BoJ stated that financial institutions that have actively extended loans to ‘middle-risk’ firms need to set appropriate interest rates reflecting the risks involved, and improve the effectiveness of credit risk management, including examining whether their loan-loss provisions are appropriate. Needless to say, such re-pricing would act to tighten financial conditions, all else equal making it even less likely that the BoJ would be able to normalise its monetary policy stance in the foreseeable future.

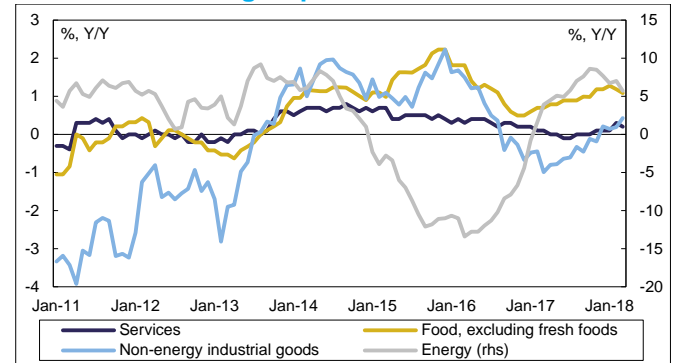
### BoJ likely to leave policy settings unchanged

On that note, the focus over the coming week will be Friday’s BoJ Board meeting, which is the first to be attended by the Bank’s two newly appointed Deputy Governors – Masayoshi Amamiya and Masazumi Wakatabe. Despite the change in personnel it seems very likely that the Board will make no changes to its key policy settings i.e. the -0.1% interest rate on banks’ marginal excess reserves and its pledge to keep 10Y JGB yields at 0%. We expect that Goushi Kataoka will continue to argue for further policy easing. The BoJ will also certainly repeat its intention to maintain its JGB purchases ‘at more or less the current pace’, but it remains to be seen whether this continues to be described as an annual increase in its holdings of about ¥80trn (so far this year the Bank’s purchases are running at less than half that pace). And despite increased criticism of the policy – some of which is reportedly shared internally at the BoJ – the Bank will also very likely re-commit to increase its ETF holdings at an annual rate of ¥6trn.

### Outlook Report forecasts also likely little changed

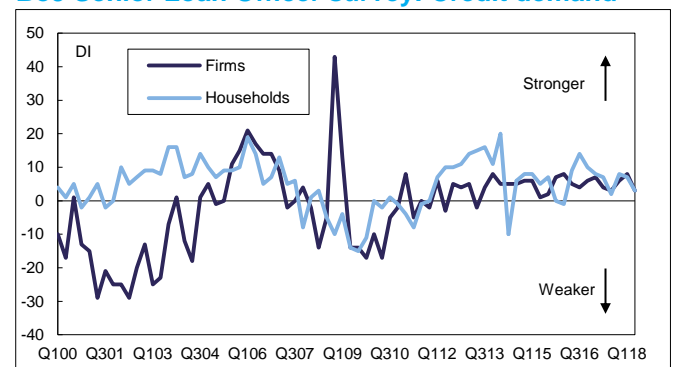
Kuroda’s press conference will still be scrutinised for signals of possible evolution of policy. The BoJ’s Outlook Report will be watched too, although this seems unlikely to offer catalysts for change, even if the risk distribution may have widened in light of recent events. With Q1 GDP growth shaping up to be soft – possibly even negative – our colleagues in Tokyo think that the median forecast of Policy Board members for GDP in FY17 could edge down 0.1ppt to 1.8%Y/Y. But with the tone of most key indicators – including, crucially, the BoJ’s Tankan – remaining upbeat, they expect that the forecast for FY18 will be left at 1.4%Y/Y while that for FY19 might be nudged higher to 0.8%Y/Y. As regards inflation, the firmer yen means the forecast for core CPI in FY17 might be lowered by 0.1ppt to 0.7%Y/Y. But our colleagues think the median forecasts for FY18 and FY19 will be unchanged at 1.4%Y/Y and 1.8%Y/Y respectively. And the first published forecast for FY20 might even reveal a median expectation slightly above 2%Y/Y.

### CPI: Selected subgroups\*



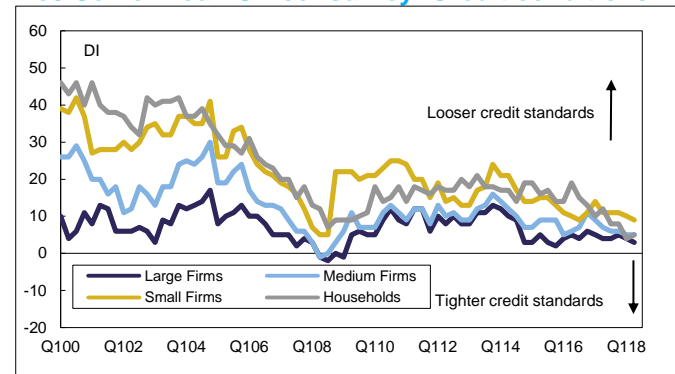
\*Adjusted for the consumption tax, Source: MIC & Daiwa Capital Markets Europe Ltd

### BoJ Senior Loan Officer survey: Credit demand



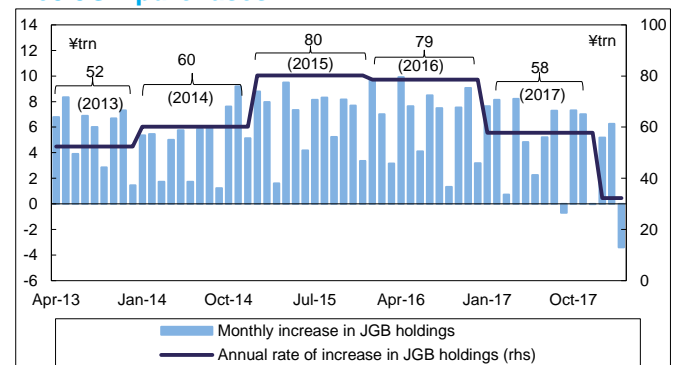
Source: BoJ & Daiwa Capital Markets Europe Ltd

### BoJ Senior Loan Officer survey: Credit conditions



Source: BoJ & Daiwa Capital Markets Europe Ltd.

### BoJ JGB purchases



Source: BoJ, Thomson Reuters & Daiwa Capital Markets Europe Ltd.

## The week ahead in Japan and the US

The coming week's Japanese economic diary kicks off with the release of the flash manufacturing PMI for April (Monday) and the All-Industry Index for February (Wednesday). However, the key day this week is Friday, which features the outcome of the BoJ's latest Board meeting and the publication of the revised Outlook Report – previewed already above – and the release of a large number of economic indicators. The latter includes the March IP, labour market, retail sales, housing starts and construction orders reports, together with the advance Tokyo CPI for April. The March IP report will be of particular interest as it will determine the size of the contraction in output in Q1, and provide a good idea about the size of a prospective rebound in activity in Q2. The Tokyo CPI will cast some light on whether the stalling of core inflation observed in March is the start of a softer trend. In the bond market, the MoF will auction 2-year JGBs on Tuesday.

Turning to the US, the advance PMI reports for April will be released on Monday, together with existing home sales data for March. The S&P/CoreLogic home price index for February and new home sales data for March follow on Tuesday, alongside the Conference Board's consumer survey for April. On Thursday most interest will centre on the advance durable goods orders report for March, with the advance trade and inventory reports for March also released that day. Following those reports, analysts will be able to refine their estimates of Q1 GDP growth, the advance estimate of which is the highlight of Friday's diary. At present Bloomberg's survey indicates that the market expects growth to have slowed to 2.0%Q/Q ann. from 2.9% in Q4. Also of significant interest on Friday will be the Employment Cost Index for Q1, while the final University of Michigan survey results for April round out the economic diary. In the bond market, the Treasury will auction 2-year notes on Tuesday, 2-year FRNs and 5-year notes on Wednesday, and 7-year notes on Thursday. It is also worth noting that over a third of the companies that make up the S&P500 will report their Q1 earnings over the coming week.

# Economic calendar

## Key data releases – April/May

16	17	18	19	20
	5Y JGB AUCTION  INDUSTRIAL PRODUCTION M/M% JAN -4.5 FEB F 2.0 CAPACITY UTILIZATION M/M% JAN -5.1 FEB 1.3	1Y TB AUCTION  TRADE BALANCE ¥BN FEB -212 MAR 119 EXPORTS Y/Y% FEB 1.8 MAR 2.1 IMPORTS Y/Y% FEB 16.6 MAR -0.6	3M TB AUCTION 20Y JGB AUCTION  BOJ FINANCIAL SYSTEM REPORT (APR)	NATIONAL CPI Y/Y% FEB 1.5 MAR 1.1 EX FRESH FOOD 1.0 0.9 EX FRESH FOOD/ENERGY 0.5 0.5 TERTIARY ACTIVITY INDEX M/M% JAN -0.4 FEB 0.0 REUTERS TANKAN- LARGE MANUFACTURERS DI MAR 28 APR 21 LARGE NON-MANUFACTURERS DI MAR 35 APR 36 BOJ SENIOR LOAN OFFICER SURVEY (APR)
23	24	25	26	27
MANUFACTURING PMI FEB 53.1 APR P N/A	2Y JGB AUCTION (APPROX ¥2.1TRN)  SERVICES PPI Y/Y% FEB 0.6 MAR 0.5 MACHINE TOOL ORDERS Y/Y% FEB 39.5 MAR F 28.1	ALL INDUSTRY ACTIVITY M/M% JAN -1.8 FEB 0.5	3M TB AUCTION (APPROX ¥4.4TRN)  BOJ POLICY BOARD MEETING (26 - 27 APRIL)	UNEMPLOYMENT RATE % FEB 2.5 MAR 2.5 JOB-TO-APPLICANT RATIO FEB 1.58 MAR 1.59 HOUSEHOLD SPENDING Y/Y% JAN -0.1 FEB -0.4 TOKYO CPI Y/Y% MAR 1.0 APR 0.8 EX FRESH FOOD 0.8 0.8 EX FRESH FOOD/ENERGY 0.5 0.5 INDUSTRIAL PRODUCTION M/M% FEB 2.0 MAR P 0.5 HOUSING STARTS Y/Y% FEB -2.6 MAR -4.8 CONSTRUCTION ORDERS Y/Y% FEB 19.2 MAR N/A RETAIL SALES M/M% FEB 0.5 MAR 0.0 VEHICLE PRODUCTION Y/Y% FEB -0.1 MAR N/A  BOJ POLICY ANNOUNCEMENT
30	01	02	03	04
	MANUFACTURING PMI (APR F) VEHICLE SALES (APR)	3M TB AUCTION AUCTION FOR ENHANCED LIQUIDITY  MONETARY BASE (APR) SERVICES PMI (APR) COMPOSITE PMI (APR) CONSUMER CONFIDENCE (APR)		
07	08	09	10	11
BOJ MINUTES (2-9 MARCH MEETING)	10Y JGB AUCTION  HOUSEHOLD SPENDING (MAR) AVERAGE WAGES (MAR)	6M TB AUCTION  BOJ CONSUMPTION ACTIVITY INDEX (APR)	10Y JGBI AUCTION  TRADE BALANCE (MAR) ECONOMY WATCHERS SURVEY (APR) BOJ SUMMARY OF OPINIONS (26-27 APRIL MEETING)	3M TB AUCTION  MONEY SUPPLY M3 (APR)

Source: BoJ, MoF, Bloomberg, Thomson Reuters & Daiwa Capital Markets Europe Ltd

# Economic Research

## Key contacts

### London

Head of Research	<i>Grant Lewis</i>	+44 20 7597 8334
Head of Economic Research	<i>Chris Scicluna</i>	+44 20 7597 8326
Emerging Markets Economist	<i>Saori Sugeno</i>	+44 20 7597 8336
Economist	<i>Emily Nicol</i>	+44 20 7597 8331
Associate Economist	<i>Mantas Vanagas</i>	+44 20 7597 8318
Research Assistant	<i>Jodene Adjei</i>	+44 20 7597 8332

### New York

Chief Economist	<i>Mike Moran</i>	+1 212 612 6392
Junior Economist	<i>Lawrence Werther</i>	+1 212 612 6393

### Hong Kong

Economist	<i>Kevin Lai</i>	+852 2848 4926
Research Associate	<i>Christie Chien</i>	+852 2848 4482
Economic Assistant	<i>Olivia Xia</i>	+862 2773 8736

### London Translation

Head of Translation, Economic and Credit	<i>Mariko Humphris</i>	+44 20 7597 8327
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