

Yen 4Sight

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Interest and exchange rate forecasts

End period	20 Jul	Q318	Q418	Q119
BoJ ONR %	-0.10	-0.10	-0.10	-0.10
10Y JGB %	0.04	0.05	0.07	0.07
JPY/USD	112	110	112	112
JPY/EUR	131	127	128	128

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

- The trade report for June confirmed that net exports are likely to have contributed positively to GDP growth in Q2.
- The June CPI was disappointing, with prices ex food and energy down for the third time in four months.
- The BoJ's survey of banks pointed to a further easing of credit conditions and expectations that this trend will continue.
- The data focus over the coming week will be Monday's final Labour Survey results for May and Friday's Tokyo CPI for July.

More signs of GDP lift in Q2; inflation still soft

With President Trump's trade policy agenda taking a back seat, financial markets were rather more settled in the past week, allowing more attention to be paid to the macroeconomic picture. In this respect, new economic data again painted Japan's GDP growth in Q2 in a positive light. However, while that will rightly be welcomed by policymakers, the latest news on the inflation front was far from encouraging for the BoJ.

Trade balance moves back into surplus in June

Following upbeat news on consumption and capex the [previous week](#), the latest news on goods trade was broadly positive too. Adjusted for seasonal factors, the MoF reported a trade surplus of ¥66.2bn – a touch below market expectations but still an improvement on May's deficit of about ¥300bn, the largest since 2015. Export values were little changed, down just 0.1%M/M in June. But after rising sharply in May, import values fell 5.3%M/M. Compared with a year earlier, exports rose 6.7%Y/Y while imports rose just 2.5%Y/Y. Notably, export growth remains broad-based with many key items still growing at or close to a double-digit annual pace. But growth in exports of transport equipment was softer at just 2.7%Y/Y.

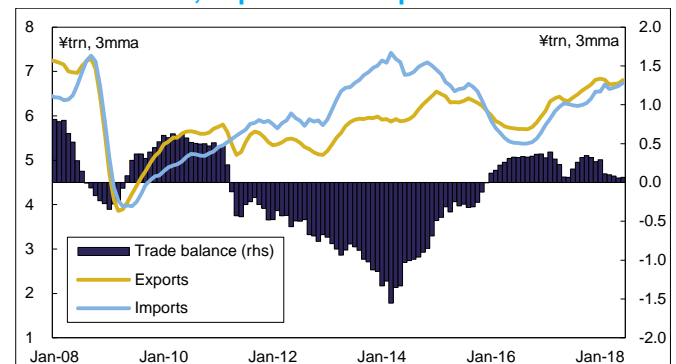
Net exports likely added to GDP growth in Q2

A better sense of the underlying trend was provided by the BoJ's estimates of export and import volumes. On this basis, export volumes fell 0.6%M/M in June, but still rose 0.5%Q/Q in Q2 – the same pace of growth as in Q1. Import volumes fell 7.2%M/M in June, reversing a similar lift in May, so dropped 1.6%Q/Q in Q2. As a result, there is a strong likelihood that net exports will have made a positive contribution (perhaps 0.2ppt) to GDP growth in Q2, unless there is a large offsetting contribution from services. But that negative scenario seems unlikely after another decent month for overseas visitors in June, with arrivals up 15.2%Y/Y in June to 2.7 million. In the twelve months to June, arrivals totalled almost 31 million, with visitors from China exceeding 8 million for the first time.

Construction output rising in Q2

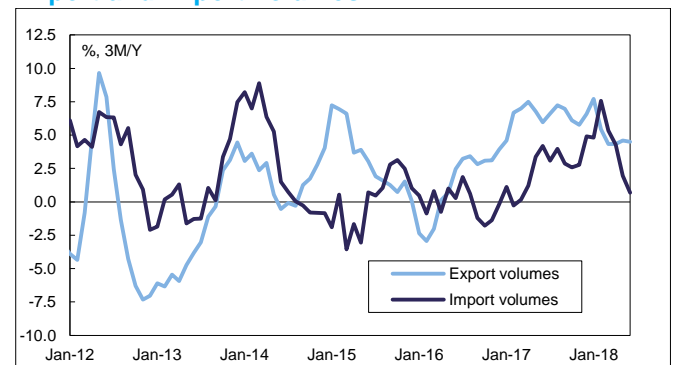
Some of the week's other releases also pointed to a firm Q2 for economic growth. For example, following growth of 1.0%M/M in April, the All Industry Activity Index rose 0.1%M/M in May, taking the average for the first two months of the quarter 1.1% above the Q1 average. Data already released showed manufacturing output on track to grow about 2.0%Q/Q in Q2, while services activity in April and May ran 0.8% above the Q1 mean.

Trade balance, exports and imports



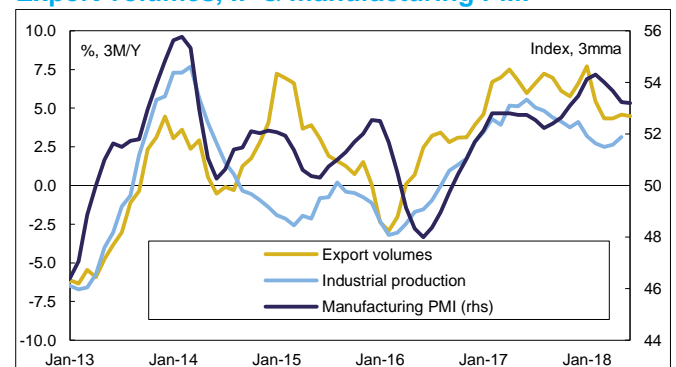
Source: MoF, Thomson Reuters and Daiwa Capital Markets Europe Ltd

Export and import volumes



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

Export volumes, IP & manufacturing PMI



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



New figures showed that construction output rose 0.7%M/M after a 2.4%M/M rebound in April, leaving the average level for Q2 so far 1.1% above the Q1 average, suggesting growth in the sector after a retreat in each of the three previous quarters.

Reuters Tankan survey little changed in July

Judging by the Reuters Tankan survey, business conditions remain broadly favourable at the start of Q3, with little change in sentiment from recent surveys. After improving in June, the manufacturing index fell just 1pt to +25 in July, with machinery firms still upbeat and only the textile and paper sector reporting a deterioration. At an elevated +29, the forecast index still envisaged a modest improvement in manufacturing conditions over coming months. In the non-manufacturing sector, the headline index also fell just 1pt to a still very robust +34 in July, with all sectors – including the laggard retail sector as well as buoyant construction firms – reporting positively. Moreover, the respective forecast indices suggested that these favourable conditions would continue in the near term at least.

BoJ survey points to easier credit conditions

The past week's other survey suggested, unsurprisingly, that credit conditions remain easy and supportive of GDP growth. The BoJ Senior Loan Officer Opinion survey reported that, on net, banks eased credit standards to firms of all sizes and to households to a similar extent as three months earlier. Regarding lending to corporates, banks cited competition from other banks and non-banks and proactive efforts to grow their business as the most important drivers of easing. Looking ahead, on net, banks forecast that credit standards will continue to ease for corporates and households, even if a small number of banks forecast that lending would take place at a wider spread over cost of funds, especially for low- and medium-rated borrowers. Turning to loan demand, very few banks reported any change over the past three months. A small number of banks expected household and corporate loan demand to pick up over the next three months, however.

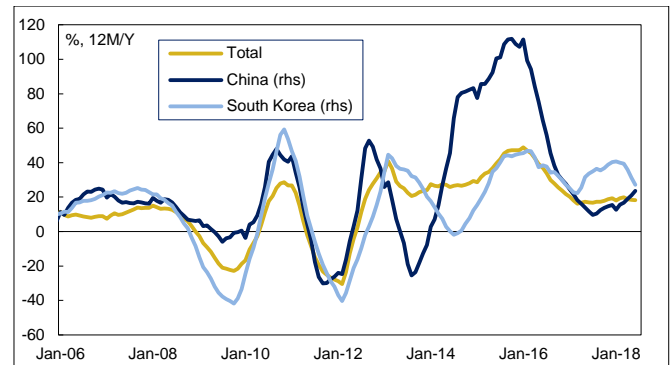
CPI disappointing in June

So, judging from the latest data, economic growth looks firm, and business and credit conditions favourable. But the other key report of the past week – national CPI – was disappointing. While the headline index inched up 0.1%M/M in June, the annual inflation rate remained steady at 0.7%Y/Y. Fresh food prices fell 2.3%M/M, fairly typical for this time of year. So, the core CPI forecast by the BoJ in its quarterly Outlook Report – which excludes fresh food prices – also rose 0.1%M/M in June, lifting annual inflation 0.1ppt to 0.8%Y/Y. However, energy prices, which rose 1.6%M/M, played a key role. The BoJ's new preferred measure of core prices, which excludes both fresh food and energy prices, fell 0.1%M/M – the third such decline in the last four months – causing annual inflation on this measure to fall an unexpected 0.1ppt to 0.2%Y/Y. The core measure that strips out prices of all food items and energy also fell 0.1%M/M and now records no change over the past year.

Firms not convinced that 2% is achievable

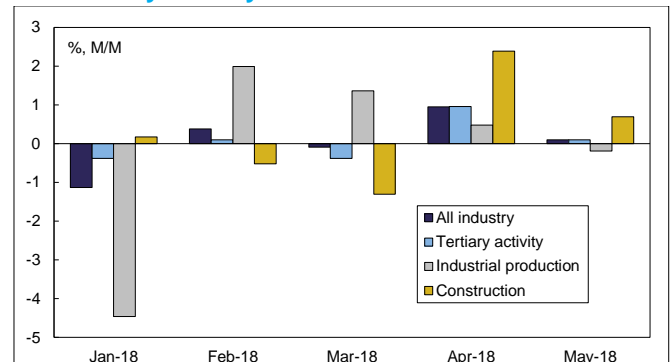
The source of the weakening in June was other food (i.e. excluding fresh items), for which inflation declined 0.4ppt to 0.7%Y/Y. Prices for non-energy industrial goods fell 0.1%Y/Y, an improvement on the 0.3%Y/Y decline reported last month.

Visitor arrivals



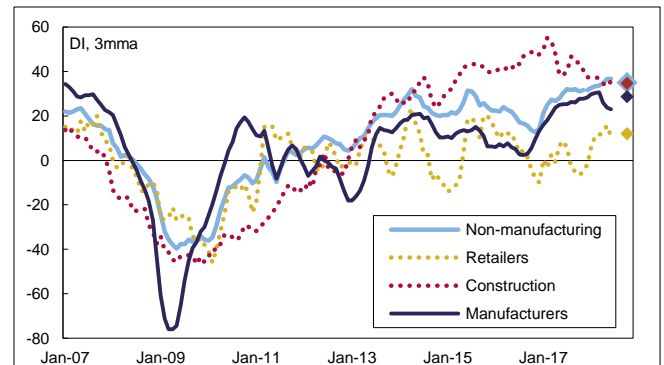
Source: JNTO, Bloomberg, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

All industry activity



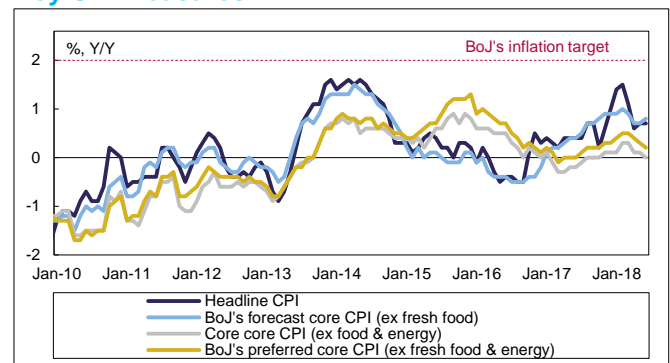
Source: METI, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Reuters Tankan



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Key CPI measures



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

Service sector prices rose 0.3%Y/Y, up 0.1ppt from May – and at the top of its recent range – but still nowhere near the pace required if the BoJ is to achieve sustained annual CPI inflation of 2%. Indeed, there was further evidence that the BoJ has its work cut out to convince firms that it is on track to achieve its inflation target. A Reuters poll released in the past week, conducted by Nikkei Research, reported that 44% of business respondents thought it would take more than three years to achieve the 2% target and 27% viewed the target as impossible to achieve. Moreover, 61% of respondents thought the most appropriate target for inflation was between 0-1% while 52% thought that the 2% target should be lowered or scrapped.

The week ahead in Japan and the US

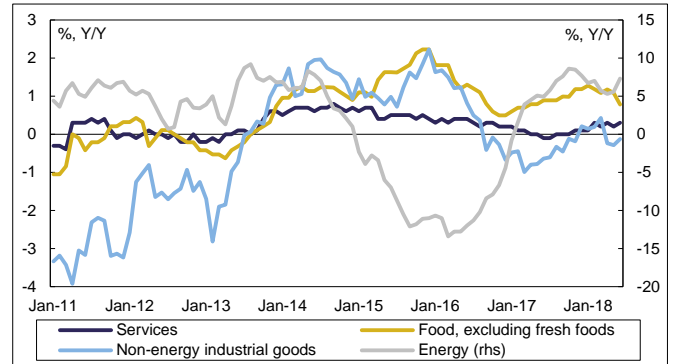
The coming week’s economic diary kicks off on Monday with the final Monthly Labour Survey results for May – of particular interest given the encouraging growth in earnings that was evident in the preliminary report. The flash manufacturing PMI for June will follow on Tuesday followed by the services PPI for June on Thursday. The only remaining economic report this week – and perhaps of greatest importance given the approaching BoJ meeting – is Friday’s advance Tokyo CPI for July. In the bond market, the MoF will auction 40Y JGBs on Tuesday and 2Y JGBs on Thursday.

In the US, Monday brings the June existing home sales report, with the July flash PMIs the following day and June new home sales data on Wednesday. On Thursday, some final clues on GDP in Q2 will be provided by the advance durable goods orders, trade and inventory reports for June. The advance national accounts for Q2 follow on Friday, with growth expected to be about double the 2.0%Q/Q ann. pace of Q1. The final University of Michigan consumer survey for July will also come on Friday. The Q2 corporate reporting season will move into top gear with 10 DJI and more than a third of all S&P500 companies scheduled to state their earnings. In the bond market, the Treasury will auction 2Y notes on Tuesday, 2Y FRNs and 5Y notes on Wednesday and 7Y notes on Thursday.

BoJ meeting & Q2 GDP report also on the horizon

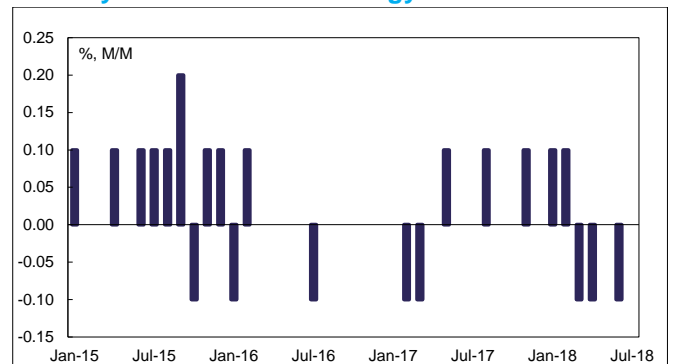
The next *Yen 4Sight* will be published on 10 August. Ahead of that, the first key event of note in Japan is the BoJ’s policy meeting and publication of its revised Outlook Report on 31 July. We expect the Bank again to confirm the key policy settings that have now been in place for two years i.e. the -0.1% interest rate on banks’ excess reserves and the 0% yield target for 10-year JGBs. As regards the BoJ’s outlook for growth and inflation, there may yet be only minimal changes depending on the data flow that is still to come. If so, the Bank will also have to continue to acknowledge downside risks to growth and inflation. That said, we can’t rule out more significant revisions to its forecasts as a result of its full review of price developments. Once the BoJ is out of the way, the Monthly Labour survey on 7 August and machinery orders report on 9 August will be of interest. Finally, on 10 August the preliminary national accounts for Q2 will reveal the net impact of the various cross-currents impacting the economy. Our colleagues in Tokyo currently estimate growth of 0.6%Q/Q (2.6%Q/Q ann.), although that figure will be refined in light of a number of indicators that are still be released. Like net exports, residential and business capex and private consumption are likely to have contributed positively to GDP growth.

CPI selected sectors



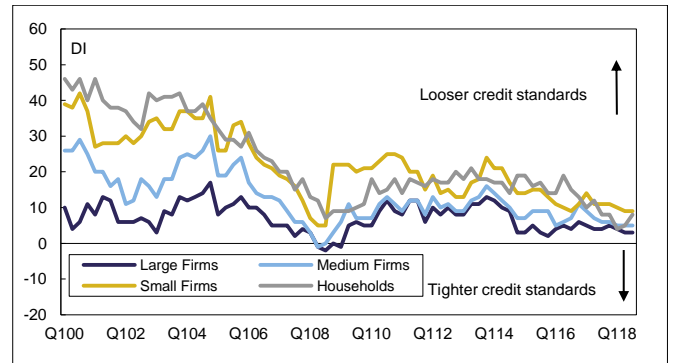
Source: MIC, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Monthly CPI ex food and energy



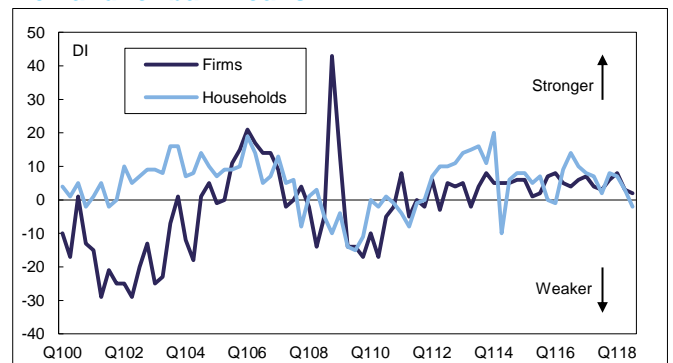
Source: MIC, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Bank credit standards



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

Demand for bank loans



Source: BoJ and Daiwa Capital Markets Europe Ltd

Economic calendar

Key data releases – July/August

16	17	18	19	20
PUBLIC HOLIDAY - MARINE DAY		AUCTION FOR ENHANCED LIQUIDITY OVERSEAS VISITORS Y/Y% MAY 16.6 JUN 15.3	12M TB AUCTION SENIOR LOAN OFFICER OPINION SURVEY (JUL) GOODS TRADE BALANCE ¥BN MAY -297 JUN 66 EXPORTS Y/Y% MAY 8.1 JUN 6.7 IMPORTS Y/Y% MAY 14.0 JUN 2.5	3M TB AUCTION AUCTION FOR ENHANCED LIQUIDITY NATIONAL CPI Y/Y% MAY JUN 0.7 0.7 EX FRESH FOOD 0.7 0.8 EX FRESH FOOD/ENERGY 0.3 0.2 ALL INDUSTRY ACTIVITY M/M% APR 1.0 MAY 0.1
23	24	25	26	27
	40Y JGB AUCTION (APPROX ¥0.4TRN) MANUFACTURING PMI JUN 53.0 JUL N/A		2Y JGB AUCTION (APPROX ¥2.1TRN) SERVICES PPI Y/Y% MAY 1.0 JUN 1.0	3M TB AUCTION (APPROX ¥4.25TRN) TOKYO CPI Y/Y% JUN JUL 0.6 0.7 EX FRESH FOOD 0.7 0.7 EX FRESH FOOD/ENERGY 0.4 0.4
30	31	1	2	3
RETAIL TRADE (JUN) BOJ POLICY BOARD MEETING (30-31 JULY)	BOJ POLICY BOARD ANNOUNCEMENT AND OUTLOOK REPORT JOB-TO-APPLICANT RATIO (JUN) UNEMPLOYMENT RATE (JUN) INDUSTRIAL PRODUCTION (JUN) CONSTRUCTION ORDERS (JUN) HOUSING STARTS (JUN) VEHICLE PRODUCTION (MAY) CONSUMER CONFIDENCE (JUL)	MANUFACTURING PMI (JUL F) VEHICLE SALES (JUL)	10Y JGB AUCTION MONETARY BASE (JUL)	3M TB AUCTION BOJ POLICY BOARD MINUTES (14-15 JUNE MEETING) SERVICES PMI (JUL) COMPOSITE PMI (JUL)
6	7	8	9	10
	10Y JGBI AUCTION HOUSEHOLD SPENDING (JUN) AVERAGE WAGES (JUN) COINCIDENT INDEX (JUN) LEADING INDEX (JUN) BOJ CONSUMPTION ACTIVITY INDEX (JUN)	BANK LENDING (JUL) ECONOMY WATCHERS SURVEY (JUL) BOJ SUMMARY OF OPINIONS (30-31 JULY MEETING)	6M TB AUCTION 30Y JGB AUCTION M3 MONEY SUPPLY (JUL) CORE MACHINE ORDERS (JUN)	3M TB AUCTION GDP (Q2 P) GDP DEFLATOR (Q2 P) PPI (JUL) TERTIARY ACTIVITY INDEX (JUN)

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

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