Daiwa Securities

Daiwa's View

Points of Jun BOJ Tankan toward Jul market

- BOJ would not conduct additional easing hastily unless yen strengthens further
- Jul market to be swayed by US fundamental factors

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Summary of Opinions at Jun MPM to confirm views on YCC

JGB purchase operation policy unlikely to change substantially amid uncertainty

BOJ would not focus on additional easing unless yen strengthens further

One week has passed since BOJ governor Haruhiko Kuroda said at his regularly held press conference on 20 June regarding the operational range for the long-term yield that there was no need to be overly strict in establishing a specific range and that the BOJ would respond flexibly. The 10-year JGB yield momentarily hit –0.195% on 21 June. However, the JGB market is returning to soberness, partly on expectations for fence-mending in US-China trade talks and Fed chair Jerome Powell's remark on pushing back excessive expectations for rate cuts. At an interview after his speech on 27 June, BOJ deputy governor Masazumi Wakatabe stated that "the 10-year JGB yield hitting the upper or lower end of the range (from +0.2% to –0.2%) would not lead to any immediate action. Our operational range is working well," similar to Gov. Kuroda's opinion. He also said that "it is necessary to take action in the future when we are convinced of the failure of achieving the inflation target." However, we have the impression that the current situation signals no imminent need for additional easing. Even if a preemptive rate cut in the US comes in sight, the BOJ is not expected to take substantial action by persisting with an easing stance unless we see yen appreciation, e.g., entrenchment of the USD/JPY below 100 (forward guidance to be revised by autumn).

US President brought storm as expected

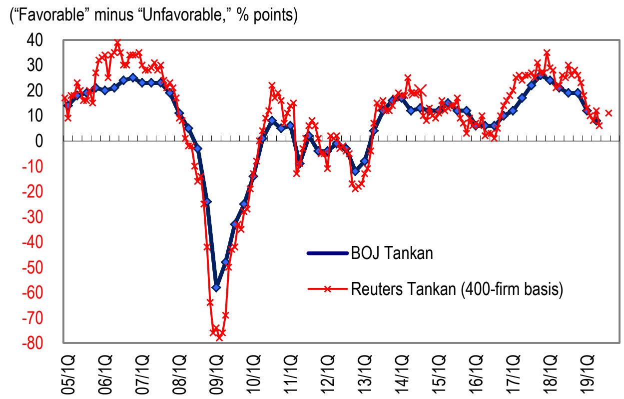
Jul market to be swayed by US fundamental factors

Today (28 Jun), the BOJ will announce the Summary of Opinions at the June Monetary Policy Meeting (MPM) in the morning and its JGB purchase operation guideline for July in late afternoon. The former provides an opportunity to confirm cautions about future downside risks, the opinion against market speculation on easing, and the view on the YCC. The latter will entail no major change ahead of an uncertain event—i.e., the US-Chinese leaders meeting at the G20 Summit. When US President Donald Trump arrived at Osaka on 27 June, a tropical cyclone in the waters off Shikoku was upgraded to Typhoon No. 3. He has brought a storm, as I expected. However, if the worst-case scenario is avoided, a risk-off market would temporarily go with the wind. In July, the market will be swayed by US fundamental factors, anticipating the timing of a preemptive rate cut in the US. This is because we need to confirm data for June because the Apr-May hard data for the US and Japan has not worsened yet.

Business conditions DIs for manufacturers to continue to worsen, but degree to be less than that in Mar survey

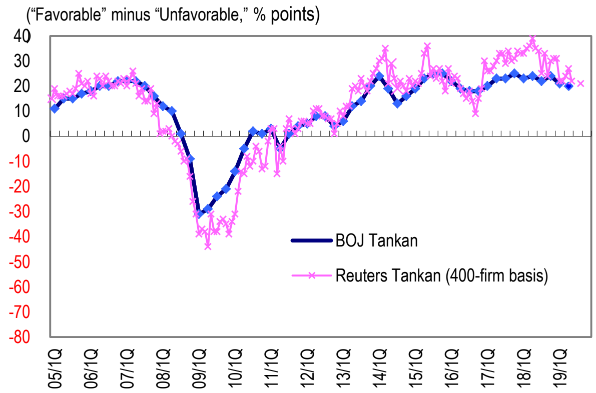
For Japan, July starts with the announcement of the BOJ's June Tankan on the 1st. The base date to respond to the survey is 11 June, and the response rate is expected to be at around 70%. In the Reuters Tankan, related statistics (see charts on next page), the business sentiment DI for manufacturers continued to worsen. However, in the March BOJ Tankan, the DI among large manufacturers substantially worsened to +12 (down 7 points from previous survey). Compared to this, deterioration in the June survey is likely to be limited (median of market forecasts: +9, down 3 points from previous survey). On the other hand, the DI among non-manufacturers is expected to maintain the +20 level on contributions from consumption related to the ten-day holiday. Here, we note three points to be watched.

Chart: Business Conditions DI at Large Manufacturers



Source: BOJ, Reuters; compiled by Daiwa Securities.
Note: Symbols away from lines indicate respective 1Q-forward forecasts.

Chart: Business Conditions DI at Large Non-manufacturers



Source: BOJ, Reuters; compiled by Daiwa Securities.
Note: Symbols away from lines indicate respective 1Q-forward forecasts.

Point is whether business conditions DI for non-manufacturers, one indicator for robustness of Japan's economy, will be at high level

First, the BOJ is pointing out that the business conditions DI for non-manufacturers is at a high level as one indicator regarding the robustness of Japan's economy. Accordingly, it is important whether the June Tankan can confirm the fact that solid domestic demand is supporting the non-manufacturing sector, while the manufacturing sector is sluggish reflecting weak external demand. However, the Forecast DIs are likely to worsen in both the manufacturing and non-manufacturing sectors because the survey was conducted amid increased uncertainty about US-China trade talks.

Our eyes on how gov't will assess weakness in sentiment

It is highly possible that the DIs for small firms will worsen more than those for large firms. I wonder how Koichi Hagiuda, executive acting secretary-general of the Liberal Democratic Party of Japan, who pointed out the June Tankan as a factor to determine the implementation of the consumption tax hike, will assess the readings. This is because he stated in a Reuters' interview that he adhered to "the figures that reflect actual conditions especially at SMEs." In its Basic Plan, the government clearly stated that it would hike the consumption tax. We thus do not assume a last-minute cancellation, but our eyes are on how the government will assess the June Tankan. This is because the government's intention for fiscal spending (formulation of supplementary budget) in preparation for a recession may become a topic after the election.

FY19 capex plan likely to show clear difference by sector

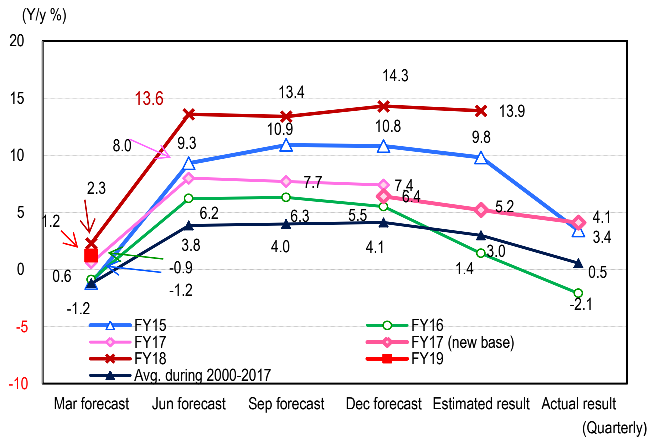
The second point is FY19 capex plans especially at large firms (see chart). Usually, the response rate of the capex plan is low in the March survey (at 70-80%, because survey held before shareholders' meeting, non-respondents' data regarded as flat q/q). As a recession for Japan's economy was a strong concern during Jan-Mar 2019, we will keep our eyes on the degree of upward revisions—whether non-respondents in the March survey will boost the June figures. We expect the capex plan among large firms in all industries to be revised upward from +1.2% as of March (median of market forecasts: +8.9%). However, we should see a clear difference by sector. Manufacturers' capex data may be revised downward, reflecting weakness in machinery orders and the aggregate supply of capital goods. While the manufacturing sector is likely to show a cautious stance due to the impact of IT adjustments, the non-manufacturing sector should continue to show strong labor-saving investment due to the labor shortage. As the outlook of the manufacturing sector is clouded, downside risks remain.

BOJ's GDP gap, estimated by Tankan DIs, should be watched

BOJ would keep assessment that "momentum maintained" as long as GDP gap remains positive

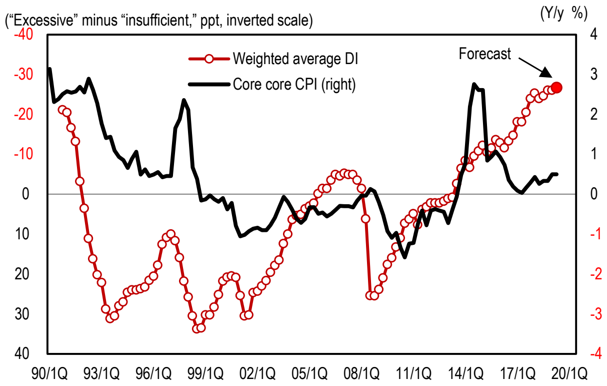
The third is the trend of the GDP gap. As of the March survey, the BOJ's GDP gap, estimated by Tankan DIs, remained flat (Chart). However, the gap is expected to improve going forward as the labor shortage is likely to intensify. The improvement in the GDP gap (deepening of weighted average DI in negative territory in chart) is expected to pause, but the GDP gap should remain positive (weighted average DI in negative territory = insufficiency). When the BOJ considers additional easing, an important point is whether momentum toward achievement of the 2% price stability target is maintained. The BOJ would not change its assessment that "momentum is maintained" as long as the GDP gap remains positive. The central bank would deem it unnecessary to rush to additional easing.

Chart: Capex Plan at Large Firms in All Industries in BOJ Tankan



Source: BOJ; compiled by Daiwa Securities.

Chart: Price Trends and GDP Gap Estimated by BOJ



Source: BOJ, Ministry of Internal Affairs and Communications; compiled by Daiwa Securities.
Note: Weighted average DI = Employment conditions DI x Labor share + Production capacity DI x Capital share.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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[Fitch]

The Name of the Credit Rating Agencies group, etc

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The name and registration number of the Registered Credit Rating Agency in the group: Fitch Ratings Japan Limited (FSA commissioner (Rating) No.7)

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May 2018

IMPORTANT

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

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.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

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The Financial Futures Association of Japan
Japan Investment Advisers Association
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