Yen 4Sight

Highlights

- Trade and store sales data, as well as business surveys, unsurprisingly suggest a weakening of economic activity in Q4.
- October's CPI data missed expectations with underlying price pressures softer after the consumption tax hike.
- The coming week will bring various top-tier economic releases, including October IP, retail sales and labour market data, as well as Tokyo CPI figures for November.

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Interest and exchange rate forecasts

End period	22 Nov	Q419	Q120	Q220
BoJ ONR %	-0.10	-0.10	-0.10	-0.10
10Y JGB %	-0.10	-0.15	-0.20	-0.20
JPY/USD	109	108	108	105
JPY/EUR	120	118	118	116

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

While politics dominates, economic data soften

Politics was front and centre over the past couple of weeks. While Shinzō Abe passed another milestone to become Japan's longest-serving Prime Minister, once again he was engulfed in scandal, this time related to the invitation list for the government's annual cherry blossom party. But against that colourful backdrop, the economic newsflow was more prosaic, suggesting – perhaps unsurprisingly – a loss of momentum in activity heading into the final quarter of the year, and a softening of underlying price pressures in the aftermath of October's consumption tax hike.

Inflation falls short of expectations in October

Certainly, October's inflation figures fell short of expectations, with the headline CPI rate (unadjusted for the tax increase and other special measures) merely moving sideways at just 0.2%Y/Y. When excluding fresh food prices, the BoJ's forecast core CPI measure was a touch firmer, up 0.1ppt to 0.4%Y/Y, nevertheless still the second-lowest rate since mid-2017. Admittedly, when also excluding energy, the BoJ's preferred core inflation measure edged slightly higher, up 0.2ppt to 0.7%Y/Y, the firmest since mid-2016.

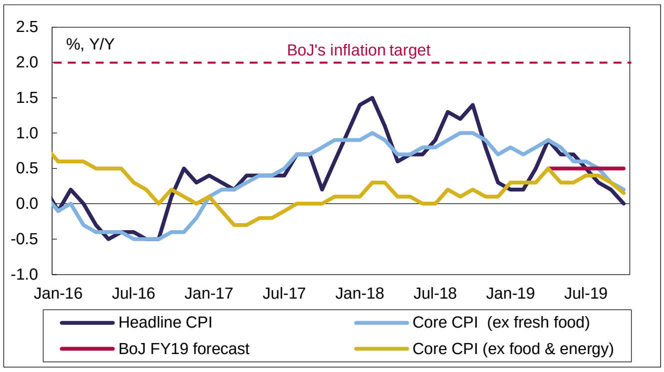
Underlying price pressures weaker still

However, the tax hike was estimated to have added 0.77ppt to headline CPI in October. Much of this was offset by the introduction of the Government's free education policy (-0.57ppt). But underlying inflation of items subject to the tax hike weakened. This in part reflected declining energy prices (-2.7%Y/Y), while there was also a steeper annual drop in the price of mobile phone handsets (-7.8%Y/Y) and continued falls in mobile phone charges (-5.0%Y/Y). And so, when excluding the impact of the tax hike and other special measures, 'underlying' headline CPI actually fell 0.2ppt in October to zero, the lowest for more than three years. On the same adjusted basis, the BoJ's forecast core inflation measure declined to just 0.2%Y/Y, the lowest since March 2017.

Department store sales slump in October

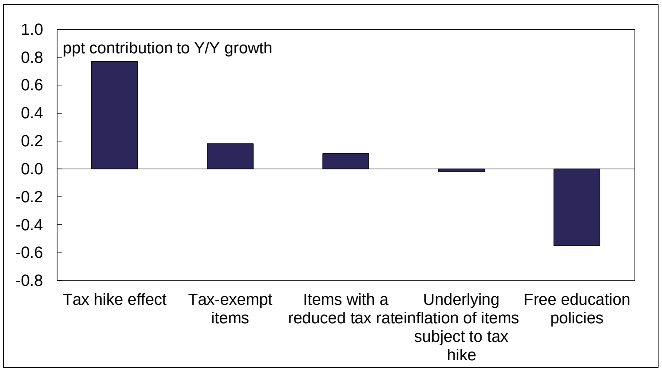
Of course, October's tax hike has taken its toll on the profile of demand too, as illustrated by the latest department store sales report. These data disappointed, with the 17.5%Y/Y drop the steepest since the aftermath of the previous consumption tax increase in 2014. Of course, this followed a near-23%Y/Y surge in September, as consumers brought forward purchases of a range of items, from cosmetics and luxury goods to alcohol.

Headline and core inflation*



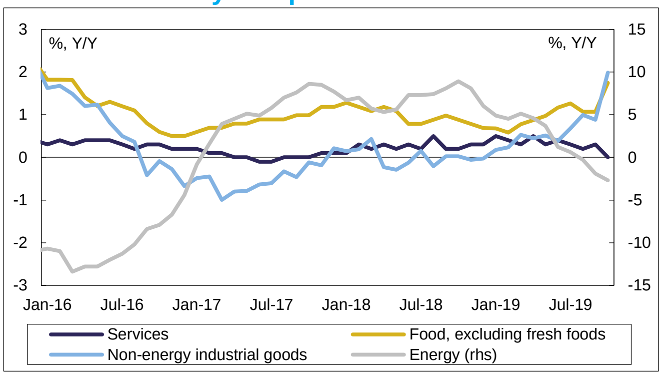
**Excluding the effects of the consumption tax hike and free education policies.*
Source: MIC, BoJ, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Contribution to headline CPI in October 2019



Source: MIC and Daiwa Capital Markets Europe Ltd.

CPI: Selected key components



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

But department store sales account for just a fraction of total consumption. And overall, the preliminary national accounts reported underwhelming consumer spending growth in Q3. Indeed, despite increased expenditure on durable and semi-durable goods (up 3.2%Q/Q and 1.7%Q/Q respectively), total consumption growth of 0.3%Q/Q in Q3 was just half the pace seen in Q2 and far weaker than the 2.1%Q/Q surge in the quarter preceding the 2014 sales tax increase. As such, despite the drop in department store sales in October, the fall in total spending after the tax hike is still expected to be significantly smaller than in 2014.

GDP growth in Q3 was already the softest in a year

Overall, GDP growth certainly fell short of expectations last quarter, slowing to just 0.1%Q/Q (0.2%Q/Q ann.), the softest pace for a year. While private non-residential investment maintained its steady uptrend, inventories provided a notable drag (-0.3ppt) as firms chose to run down stocks. Net trade also weighed on GDP for the fourth quarter out of the past five. But given the weakness of imports, net trade should at least provide some support to growth in Q4.

Korean spat weighing on services exports

Of course, exports remain weak against the backdrop of soft global demand, Typhoon Hagibis-related disruption, and geopolitical tensions. The latter was evident in the drop in exports in Q3, particularly the decline in the services component – the near-4%Q/Q drop was the most since Q212 – as lower spending by overseas visitors reflected the steep decline in visitors from South Korea (-50%Y/Y). The impact of the dispute across the Sea of Japan was again evident at the start of Q4, with the number of Korean visitors (197k) down a whopping 65.5%Y/Y in October. So, despite a modest increase in tourists from elsewhere in Asia and a Rugby World Cup boost to visitors from the UK and other participating nations, the total number of overseas visitors was down compared with a year earlier in October, by 5½%Y/Y to 2.5mn.

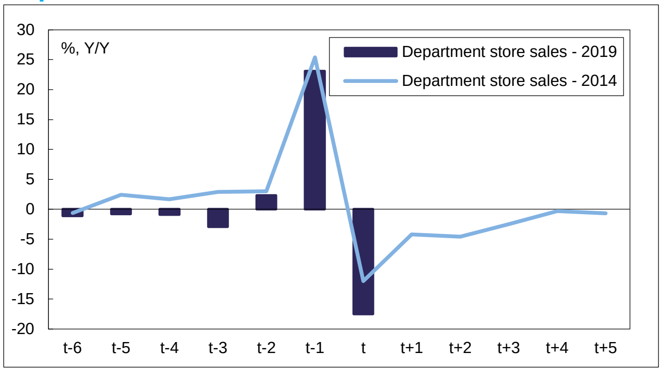
Trade dispute hitting goods shipments too

With Japan having in July imposed additional export controls on certain items, the impact of the Japan-Korea dispute on goods exports was also evident in the past week's October trade report. Shipments to South Korea of chemicals were down 28%Y/Y, while exports of semiconductor machinery were down a whopping 49%Y/Y. And while they account for a relatively small share, exports of Japanese cars to South Korea fell more than 70%Y/Y. In total, exports to South Korea – which account for roughly 7% of the total – declined 23%Y/Y in October, the largest drop for more than a decade.

Exports down in October, but net trade positive

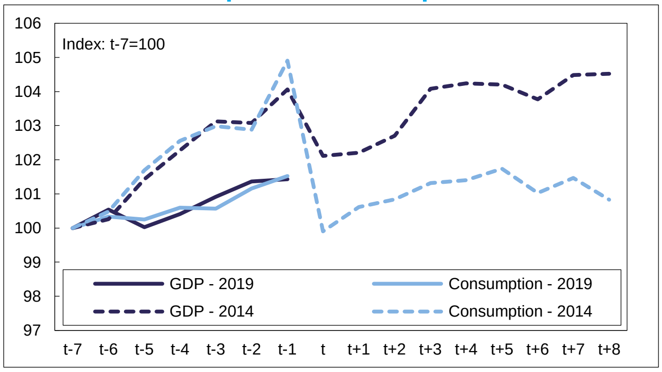
While South Korea at the end of the past week decided to reverse its decision to exit a military intelligence pact with Japan, a step that might help to improve diplomatic relations between the two countries, weakness in Japanese exports last month was unsurprisingly widespread, with a steeper pace of decline in shipments to China (-10.3%Y/Y), the US (-11.4%Y/Y) and the EU (-8.4%Y/Y). With a further notable drop in US demand for Japanese autos, overall exports of transport equipment were down 7½%Y/Y. Meanwhile, total shipments of manufactured goods and general machinery were down around 13%Y/Y. So, overall the value of exports fell 9.2%Y/Y, the

Department store sales*



*t represents the month the consumption tax was increased.
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.*

GDP and consumption: Pre- and post-tax hike*



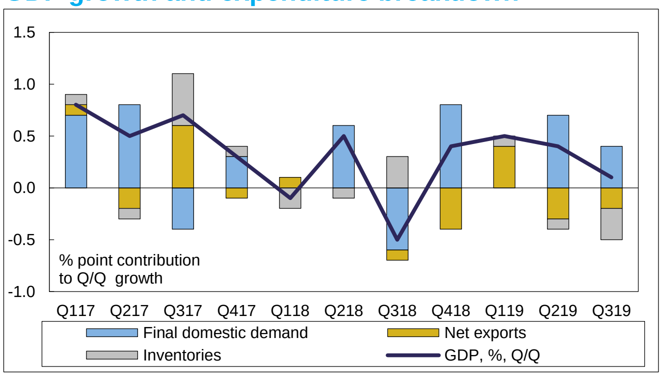
*t represents the quarter the consumption tax was increased.
Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.*

GDP growth and expenditure breakdown in Q319

	%, Q/Q	contr	%, Y/Y	contr
GDP	**0.1**		**1.3**	
Final domestic demand	-	0.4	-	2.2
- Private consumption	0.3	0.2	12	0.7
- Residential investment	14	0.0	4.1	0.1
- Non-residential investment	0.9	0.1	4.2	0.7
- Government consumption	0.5	0.1	2.5	0.5
- Public investment	0.8	0.0	4.0	0.2
Net exports	-	-0.2	-	-0.6
- Exports	-0.7	-0.1	-12	-0.2
- Imports	0.2	0.0	2.0	-0.3
Private inventories	-	-0.3	-	-0.3

Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

GDP growth and expenditure breakdown



Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

eleventh consecutive monthly year-on-year drop and the steepest for three years. But when adjusting for price and seasonal effects, the BoJ's export volumes measure indicated a more modest year-on-year decline (just 2½%Y/Y). And while export volumes were down 1½%M/M, a steeper pace of decline in import volumes (2½%M/M and 4½%Y/Y) suggests net trade made a positive contribution to GDP growth at the start of Q4.

Reuters Tankan weakened in November

More generally, sentiment surveys paint a rather mixed picture of economic conditions in the immediate aftermath of the consumption tax hike. The Reuters Tankan for November was downbeat, with the headline DI down to a 6½-year low (-9). And following a surprisingly upbeat assessment the prior month, the headline non-manufacturing diffusion index (DI) fell to a three-year low (+12). The retailing DI reported a particularly steep decline, down a whopping 45pts on the month – the most since the series began in 1998 – to -15. Admittedly, when smoothing out monthly volatility, the non-manufacturing index on a three-month moving average basis moved sideways (+19) for the third consecutive month. But that level is still well below those seen at the start of the year and a sizeable 18pts lower than the peak in mid-2018. And if the forward-looking DI is to be believed, the downward trend will resume into the New Year.

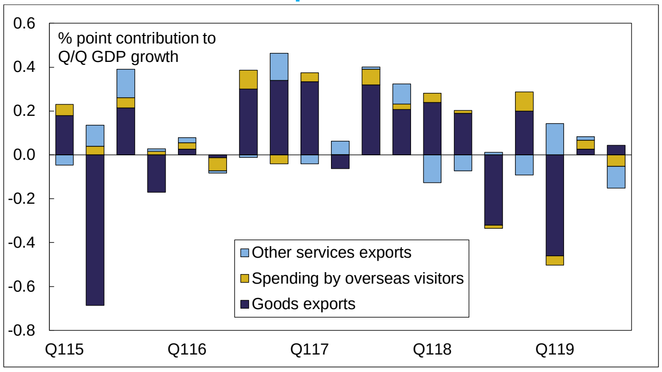
But PMIs a little more encouraging

The flash PMIs for November, however, were more encouraging. Having dropped below the key-50 level for the first time in more than three years in October, the flash services PMI rose 0.7pt in November to 50.4. The new orders component fully reversed October's 1.1pt decline to leave the index in expansion territory (51.9), while the business expectations PMI jumped to a 22-month high. There was also a modest increase in the headline manufacturing PMI for the first month in four (up 0.2pt to 48.6), with a larger improvement in the survey's output component (up 0.9pt to 48.8). Overall, therefore, following the 2.4pts drop in October, the headline composite PMI increased 0.8pt in November. But this still left it just below the key 50-level for the second successive month at 49.9, and well below the Q3 average, with the new orders component signalling no growth ahead. The survey was also disappointing in terms of the inflation-related indices, with the output price PMI declining 2.1pts in November to leave the index at just 50.6.

BoJ stepping back from its ETF purchases?

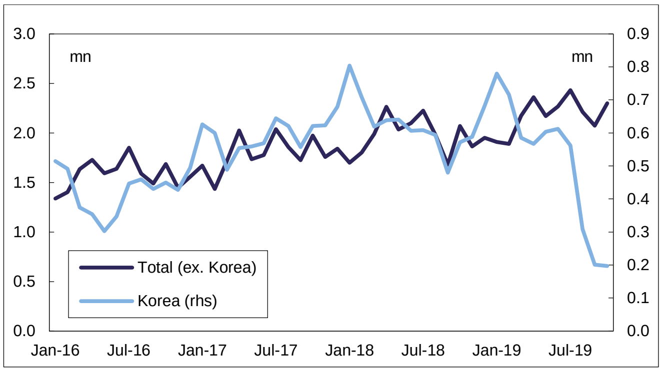
Overall, there seems every reason to expect activity to remain subdued at best. We expect a contraction in GDP of at least 0.5%Q/Q in Q4 followed by modest recovery thereafter. This period of sub-potential growth will ensure price pressures remain subdued too. The Government will add some fiscal stimulus in the New Year (although probably not as much as the ¥10trn cited by certain LDP officials). And against this backdrop the BoJ might ordinarily have been expected to ease policy too. But while Kuroda has insisted that the BoJ's policy guidance is tilted towards a more accommodative stance, given ongoing concerns about the cost-benefit analysis of further easing, expectations of additional BoJ stimulus have been pared back. Indeed, just as the Bank has long sought to reduce its JGB purchases, it has recently limited its ETF purchases too. Excluding ETFs purchased under the Human and Physical Capex support programme, the BoJ has come to the market just once since 9 October, and is on track to increase its ETF holdings by ¥5trn in 2019, ¥1trn short of the stated target.

Goods and services exports



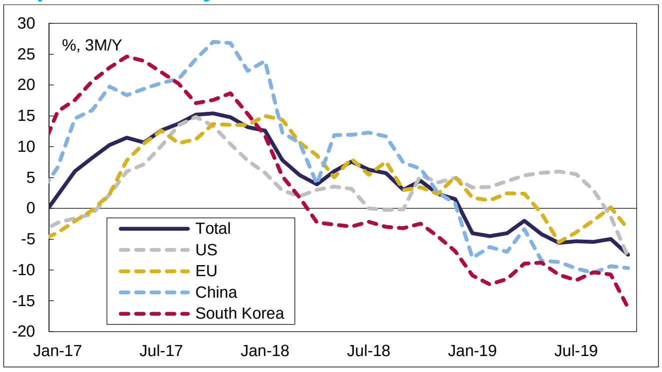
Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

Overseas visitors



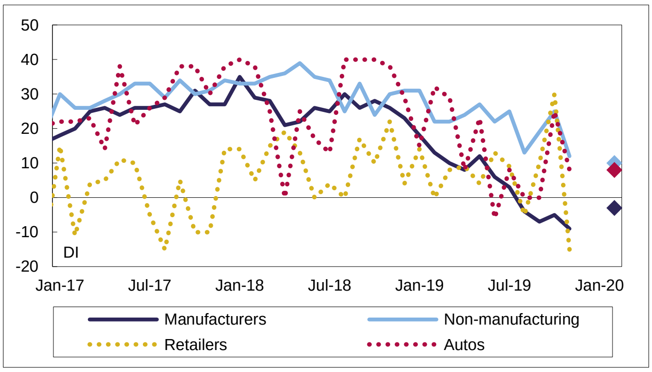
Source: JTNO and Daiwa Capital Markets Europe Ltd.

Export values by destination



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

Reuters Tankan: Business conditions*



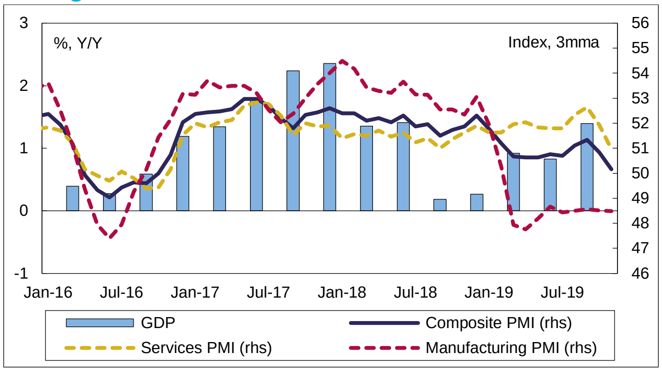
**Diamonds represent survey forecast for February 2020. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

Looking ahead…

Looking ahead, the coming week will bring a number of releases of note, including October's retail sales figures on Thursday. Like the past week's department store sales, these are expected to show a notable pull-back in spending at the start of Q4, to leave sales down more than 4%Y/Y. Friday will also bring IP figures for October, which are similarly forecast to show that output declined that month. Against the backdrop of weakening demand, the latest labour market figures might also report a further slowdown in employment growth at the start of Q4. And consumer confidence is likely to remain downbeat too, with November's survey results due on Friday. The end of the week will also bring the latest Tokyo CPI figures for November, which seem bound to further illustrate the subdued inflationary environment.

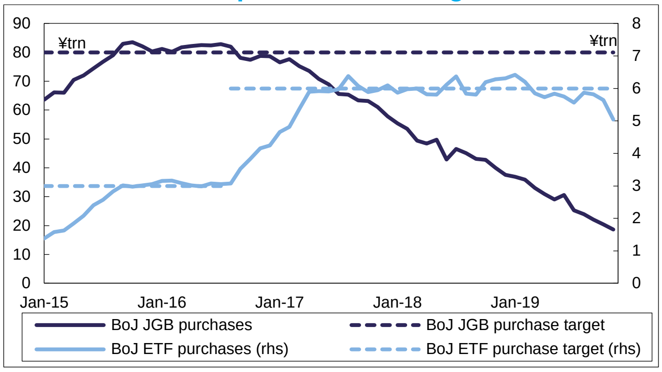
In the markets, the MoF will conduct a 40Y JGB auction on Tuesday and a 2Y JGB auction on Thursday.

GDP growth and PMIs



Source: Cabinet Office, Markit, Thomson Reuters and Daiwa capital Markets Europe Ltd.

BoJ JGB and ETF purchases vs target



**Monthly figures are based on 12mms. November 2019 figures based on first twenty days of the month. Source: BoJ and Daiwa capital Markets Europe Ltd.*

Daiwa Capital Markets

Economic calendar

Key data releases – November/December

18	19	20	21	22
ENHANCING LIQUIDITY AUCTION	1Y TB AUCTION	20Y JGB AUCTION GOODS TRADE BALANCE ¥BN SEP -64 OCT -35 EXPORTS Y/Y% SEP -5.2 OCT -9.2 IMPORTS Y/Y% SEP -1.5 OCT -14.8 OVERSEAS VISITORS MN SEP 2.27 OCT 2.50	ALL INDUSTRY ACTIVITY M/M% AUG 0.0 SEP 1.5	3M TB AUCTION ENHANCING LIQUIDITY AUCTION NATIONAL CPI Y/Y% SEP OCT 0.2 0.2 *EX FRESH FOOD* *0.3 0.4* *EX FRESH FOOD/ENERGY* *0.5 0.7* MANUFACTURING PMI OCT 48.4 NOV P 48.6 SERVICES PMI OCT 49.7 NOV P 50.4 COMPOSITE PMI OCT 49.1 NOV P 49.9 DEPARTMENT STORE SALES Y/Y% SEP 23.1 OCT -17.5 AVERAGE WAGES Y/Y% AUG -0.1 SEP F 0.5
25	**26**	**27**	**28**	**29**
	40Y JGB AUCTION (APPROX ¥0.4TRN) SERVICES PPI Y/Y% SEP 0.5 OCT 1.7		2Y JGB AUCTION (APPROX ¥2.0TRN) RETAIL SALES Y/Y% SEP 9.2 OCT -4.3	3M TB AUCTION (APPROX ¥4.28TRN) INDUSTRIAL PRODUCTION M/M% SEP 1.7 OCT P -2.0 UNEMPLOYMENT RATE % SEP 2.4 OCT 2.4 JOB-TO-APPLICANT RATIO SEP 1.57 OCT 1.56 TOKYO CPI Y/Y% OCT NOV 0.4 0.4 *EX FRESH FOOD* *0.5 0.5* *EX FRESH FOOD/ENERGY* *0.6 0.7* CONSUMER CONFIDENCE OCT 36.2 NOV N/A
02	**03**	**04**	**05**	**06**
MOF CAPITAL SPENDING SURVEY (Q3) MANUFACTURING PMI (NOV F) VEHICLE SALES (NOV)	10Y JGB AUCTION MONETARY BASE (NOV)	SERVICES PMI (NOV F) COMPOSITE PMI (NOV F)	30Y JGB AUCTION	3M TB AUCTION AVERAGE WAGES (OCT) HOUSEHOLD SPENDING (OCT) BOJ CONSUMPTION ACTIVITY INDEX (OCT)
09	**10**	**11**	**12**	**13**
6M TB AUCTION GDP (Q3 F) BANK LENDING (NOV) ECONOMY WATCHERS SURVEY (NOV) M3 MONEY SUPPLY (NOV)	5Y JGB AUCTION	MOF'S BSI (Q4) GOODS PPI (NOV)	ENHANCING LIQUIDITY AUCTION MACHINE ORDERS (OCT) REUTERS TANKAN (DEC)	3M TB AUCTION BOJ TANKAN (Q4) INDUSTRIAL PRODUCTION (OCT F) CAPACITY UTLISATION (OCT)

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

Daiwa Capital Markets

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