Yen 4Sight

Highlights

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- October's consumption figures suggest a notable plunge in spending following the sales tax hike. IP also declined sharply as natural disasters also took their toll.
- The latest labour market and capex figures were broadly positive, while Abe's fiscal stimulus will support growth in 2020.
- The coming week will bring revised Q3 GDP figures on Monday, as well as the BoJ's quarterly Tankan survey for Q4 on Friday.

Interest and exchange rate forecasts

End period	06-Dec	Q419	Q120	Q220
BoJ ONR %	-0.10	-0.10	-0.10	-0.10
10Y JGB %	-0.02	-0.05	-0.10	-0.15
JPY/USD	109	108	108	105
JPY/EUR	121	118	118	116

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

Japan's economic conditions still "worsening"

The first estimate of Japan's GDP in Q3 suggested that front-loading of spending ahead of October's consumption tax hike was more restrained than in 2014. But the first insights into economic activity in its immediate aftermath suggest that the initial drop in demand was just as large, if not bigger this time around. Of course, sales and production in October were also severely disrupted by the Super Typhoon Hagibis, so the economy obviously went into reverse at the start of Q4. And unsurprisingly, there was a sharp deterioration in the Cabinet Office's composite indicators of business conditions in October. Indeed, the headline index fell 5.6pts – the most since the 2011 quake – to its lowest level since early 2013. And despite signs of recovery in various November releases, the leading index fell further to its lowest level in almost a decade, raising concerns that economic weakness might persist through to the start of 2020. As such, the Government continued to judge that business conditions were "worsening", an assessment that might justify Abe's new fiscal stimulus (see below).

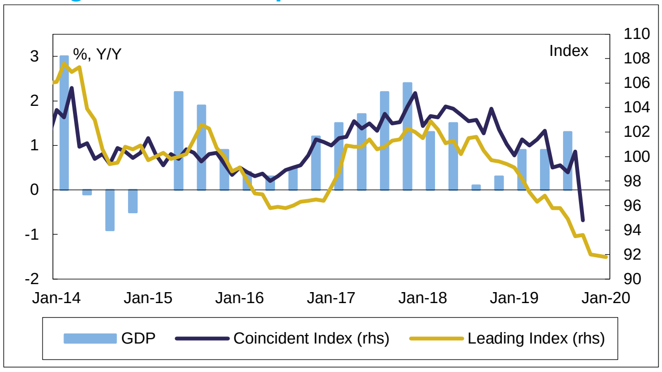
Consumption contracts sharply in October

In terms of the BoJ consumption activity index, the MIC household spending survey and METI retail sales data, spending plunged at the start of Q4. The BoJ consumption index – which out of these three provides the most reliable guide to the national accounts measure of consumption – declined 7.4%M/M in October. While this was a slightly softer pace of decline that seen in April 2014, the post-tax hike slump in spending on durable goods appears to have been much sharper this time around. Indeed, the relevant BoJ index fell by more than one third in October to leave the level at the start of Q4 more than 25% below the Q3 average. In contrast, the drop in spending on non-durable goods (-6.5%M/M) was just half that seen in 2014, while spending on services was little changed from September. There was widespread weakness in the headline household spending (-11.5%M/M) and retail sales (-14.4%M/M) figures too, with the monthly declines the steepest on the respective series. The most significant falls were seen at household appliance stores. And department stores saw notably lower sales of a wide range of goods, including furniture, cosmetics and luxury items, with the rates of decline all seemingly sharper than in 2014.

IP falls to lowest level since 2015

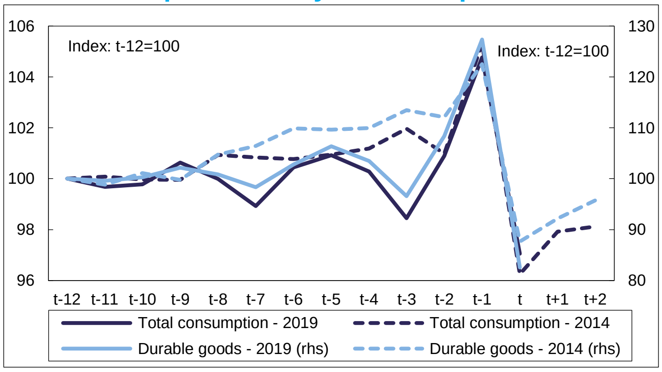
In addition to the volatility caused by the consumption tax hike and natural disasters, manufacturers are also facing up to soft global demand. In October, industrial production fell 4.2%M/M,

GDP growth and composite economic indices*



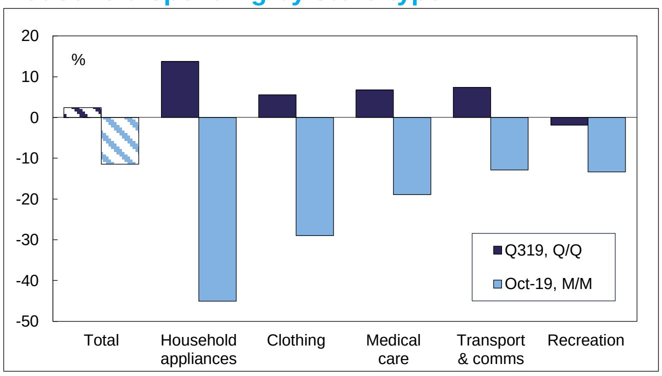
*Leading index has three-month lead.
Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

BoJ consumption activity: Pre- and post-tax hike*



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

Household spending by store-type



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

matching the steepest drop since the post-tax hike plunge in April 2014. This left output at its lowest level since 2015 and down 7.4%Y/Y. The detail of the report also suggested that the near-term outlook remains downbeat. With shipments down sharply and inventories up, the inventory-shipment ratio jumped to the highest in more than a decade suggesting that production will continue to see significant negative annual growth. METI (uncharacteristically) suggested that firms remain pessimistic about the near-term outlook, with the forecast profile suggesting that output could decline by around 4%Q/Q in Q4, the steepest quarterly contraction since the 2011 quake and tsunami.

Car sales and confidence improve in November

The recent data flow has not been all doom and gloom, however, with several November releases suggesting improvement. For example, while the latest vehicle sales figures unsurprisingly showed a further double-digit year-on-year pace of decline, the 14.6%Y/Y drop was significantly smaller than the 26.4%Y/Y fall in October. Admittedly, this still left new registrations on average so far in Q4 almost 25% below the Q3 average (a similar pace of decline to Q214). But consumers appear more upbeat about conditions ahead, with the headline sentiment index rising for the second successive month in November and by the most in more than six years. Households expressed greater willingness to buy durable goods, although the survey's relevant index was still notably lower than a year ago to suggest that consumption is unlikely to accelerate over coming quarters.

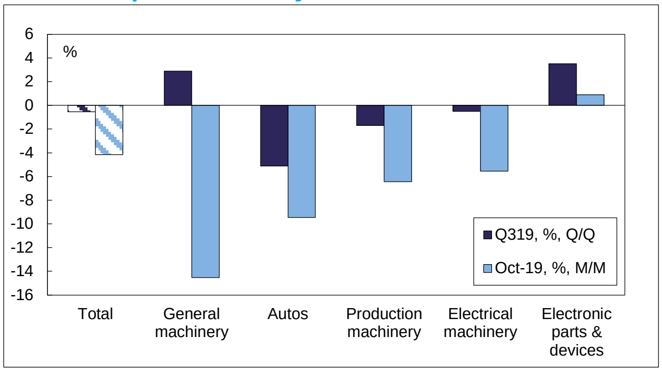
Labour market still positive

Labour market conditions also remain broadly positive, with October's report showing the largest monthly increase in employment (280k) since February. Admittedly, the monthly profile can be volatile. And alongside a recent drop in new job offers, the trend in employment has clearly slowed from last year. Nevertheless, the number of people employed in October was still up 620k from a year earlier to a record high. The unemployment rate (2.4%) remains close to July's 27-year low. And the job-to-applicant ratio remains consistent with a very tight labour market. Average earnings growth, however, remained relatively underwhelming in October at 0.5%Y/Y, albeit with regular wage growth up 0.3ppt to 0.6%Y/Y, the strongest since January. This, however, remains no better than the average of the past five years. And with the labour share of corporate income still trending well below the long-run average, firms appear to have further scope to boost employee compensation.

Capital spending maintains upward trend

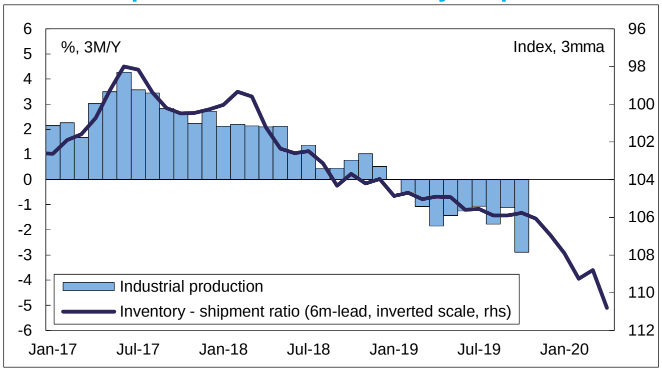
Elevated profits have supported a steady uptrend in capital spending over the past few years. And the past week's MoF survey of corporations' financial statements suggested that this trend was maintained in Q3. Total capex rose for the third quarter out of the past four and by a solid 1.2%Q/Q, with similar growth in the non-manufacturing and manufacturing sectors alike. That left fixed investment up more than 7%Y/Y, the strongest annual rate for five quarters and at its second-highest level since 2008. While a further fall in profits in Q3 (the fourth quarterly drop out of the past five) might suggest a more cautious approach to future capex, profits in both manufacturing and non-manufacturing sectors remain elevated. Given production capacity constraints, there remain incentives in some sectors to do so too.

Industrial production by subsector



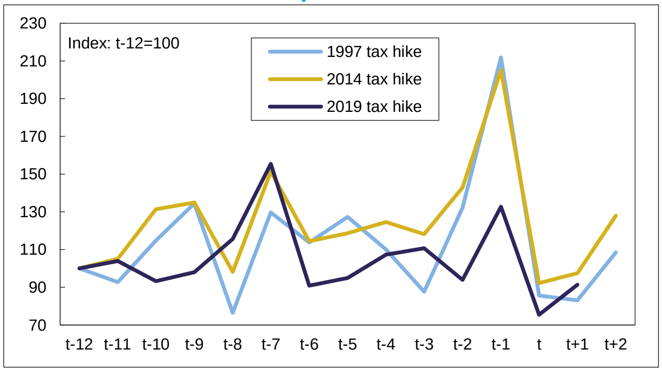
Source: METI, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Industrial production and inventory-shipment ratio



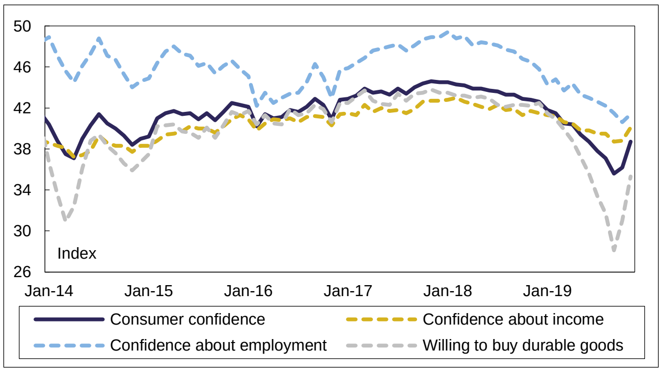
Source: METI and Daiwa Capital Markets Europe Ltd.

Vehicle sales: Pre- and post-tax hike*



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

Consumer confidence



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Abe stimulus somewhat less than meets the eye

Of course, as in 1997 and 2014, there are valid concerns that the consumption tax hike might prove to have been a policy error, reversing some of the achievements of Abenomics. With this in mind, and damage caused by the super-typhoon also to be addressed, after weeks of speculation Abe finally unveiled his fiscal stimulus proposals. As is often the case, the headline figure – an eye-catching ¥26trn (about 5% of GDP) – was misleading, with about half representing extra spending by the private sector, which the Government claims will be crowded in by its initiatives. In addition, almost ¥4trn of the total is set to come from government agency loans. As such, extra public expenditure will amount to ¥9.4trn. At about 1.7% of GDP, that is not to be sniffed at. And at face value, the various measures appear worthwhile. A little more than half of the new funds will be allocated to boosting resilience to natural disasters. Roughly half of the remainder will focus on supporting SMEs and the agricultural sector as the Japan-US trade agreement is phased in from the start of next year, as well as attracting FDI. And the remainder aims to support innovation in high-tech sectors and catalyse investment once the boost to activity from the Tokyo Olympics has faded.

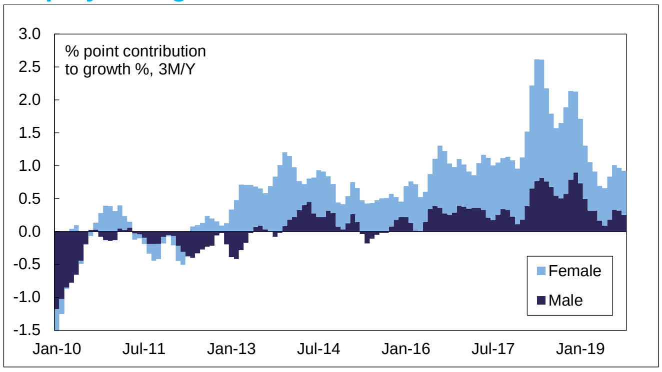
But fiscal policy takes pressure off the BoJ

Described as a "15-month budget", the extra funds will be disbursed over at least five quarters. The amount to be allocated from the supplementary budget for the current fiscal year (¥4.6trn) is not particularly large by recent standards. And the experience of past years suggests that it is impossible to know quite how much of the extra public spending will actually materialise and score in terms of GDP, particularly with the FY19 budget already having included a little more than ¥2tn to try to neutralise the impact on demand of October's consumption tax hike. So, the actual boost to public spending and economic growth from the package is hard to gauge accurately. Overall, however, we would consider it a helpful source of support for demand and ensure that economic growth returns to positive territory from Q120 on. Indeed, public spending will probably make the single largest contribution to GDP growth in the coming year. And with inflation having recently headed in the wrong direction, fiscal policy will thus help take a little pressure off the BoJ, which remains highly reluctant to ease monetary policy further.

Looking ahead…

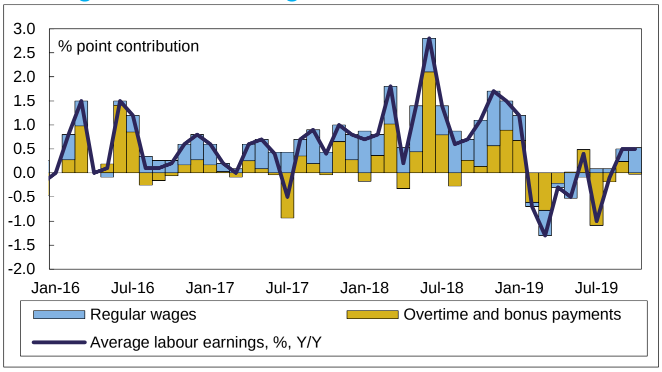
The coming week in Japan will bring a number of releases of note, kicking off on Monday with revised Q3 GDP. The MoF's survey of corporations suggested a possible modest upwards revision to GDP growth, due in part to a stronger contribution from private inventories. But we caution that this release will be subject to even greater uncertainty given methodological tweaks. Focus in the second half of the week will turn to business conditions in Q4, with the MoF's latest business sentiment survey – due on Wednesday – set to provide firms' first projections for conditions in H120. This will be followed on Thursday by the monthly Reuters Tankan indicators for December, as well as machine orders figures for October. But of most interest will be Friday's comprehensive quarterly BoJ Tankan, which will report a deterioration in conditions in the manufacturing and non-manufacturing sectors in the final quarter, but also expectations of modest recovery in the New Year. In the markets, the MoF will sell 5Y JGBs on Tuesday.

Employment growth



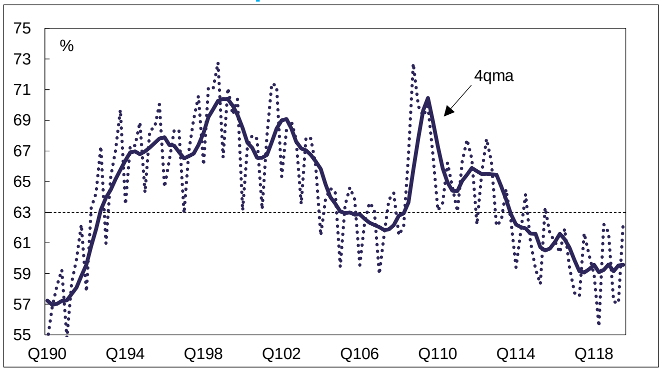
Source: MIC, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Average labour earnings



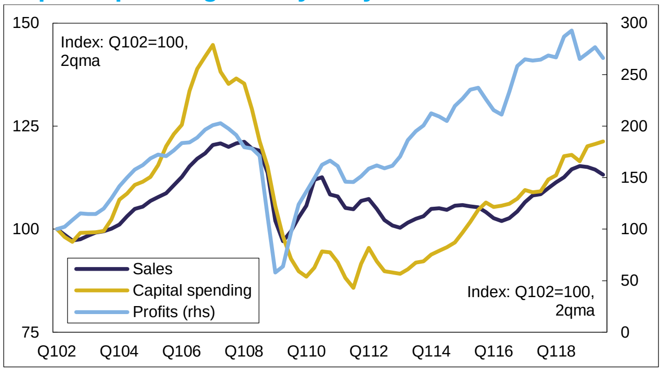
Source: MHLW, Bloomberg and Daiwa Capital Markets Europe Ltd.

Labour share of corporate income



Source: MoF and Daiwa Capital Markets Europe Ltd.

Capital spending survey: Key indicators



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

Daiwa Capital Markets

Economic calendar

Key data releases – November/December

02	03	04	05	06
MOF CAPITAL SPENDING SURVEY Y/Y% Q2 1.9 Q3 7.1 MANUFACTURING PMI OCT 48.4 NOV F 48.9 VEHICLE SALES Y/Y% OCT -26.4 NOV -14.6 BOJ BOND MARKET SURVEY (NOV)	10Y JGB AUCTION MONETARY BASE Y/Y% OCT 3.1 NOV 3.3	SERVICES PMI OCT 49.7 NOV F 50.3 COMPOSITE PMI OCT 49.1 NOV F 49.8	30Y JGB AUCTION	3M TB AUCTION AVERAGE WAGES Y/Y% SEP 0.5 OCT 0.5 HOUSEHOLD SPENDING Y/Y% SEP 9.5 OCT -5.1 BOJ CONSUMPTION ACTIVITY INDEX M/M% SEP 3.8 OCT -7.4 COINCIDENT INDEX SEP 101.1 OCT P 94.8 LEADING INDEX SEP 91.9 OCT P 91.8
09	**10**	**11**	**12**	**13**
6M TB AUCTION (APPROX ¥2.3TRN) GDP Q/Q% Q2 0.4 Q3 F 0.2 BANK LENDING Y/Y% OCT 2.0 NOV N/A ECONOMY WATCHERS SURVEY – CURRENT CONDITIONS DI OCT 36.7 NOV 39.7 FUTURE CONDITIONS DI OCT 43.7 NOV 44.6	5Y JGB AUCTION (APPROX ¥1.9TRN) M3 MONEY SUPPLY Y/Y% OCT 2.1 NOV 2.1	MOF'S BSI – BUSINESS CONDITIONS Q/Q Q3 1.1 Q4 N/A GOODS PPI Y/Y% OCT -0.4 NOV 0.0	MACHINE ORDERS M/M% SEP -2.9 OCT 0.7 REUTERS TANKAN – MANUFACTURERS DI NOV -9 DEC N/A NON-MANUFACTURERS DI NOV 12 DEC N/A	3M TB AUCTION (APPROX ¥4.32TRN) BOJ TANKAN - LARGE MANUFACTURERS DI Q3 5 Q4 3 - LARGE NON-MANUFACTURERS DI Q3 21 Q4 16 INDUSTRIAL PRODUCTION M/M% SEP 1.7 OCT F -4.2 CAPACITY UTLISATION M/M% SEP 1.0 OCT N/A
16	**17**	**18**	**19**	**20**
BOJ TANKAN – INFLATION OUTLOOK OF ENTERPRISES (Q4)	20Y JGB AUCTION	1Y TB AUCTION GOODS TRADE BALANCE (NOV) OVERSEAS VISITORS (NOV) DEPARTMENT STORE SALES* (NOV) BOJ POLICY BOARD MEETING (18-19 DEC 2019)	BOJ POLICY BOARD ANNOUNCEMENT	3M TB AUCTION AUCTION FOR ENHANCED LIQUIDITY NATIONAL CPI (NOV) FLOW OF FUNDS (Q3)
23	**24**	**25**	**26**	**27**
	2Y JGB AUCTION	SERVICES PPI (NOV)	HOUSING STARTS (NOV) CONSTRUCTION ORDERS (NOV)	INDUSTRIAL PRODUCTION (NOV) RETAIL SALES (NOV) UNEMPLOYMENT RATE (NOV) JOB-TO-APPLICANT RATIO (NOV) TOKYO CPI (DEC) BOJ SUMMARY OF OPINIONS (18-19 DECEMBER 2019)

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

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