

# Yen 4Sight

## Highlights

- Japanese manufacturers had a disappointing November, with the level of output falling to its lowest in 6½ years.
- The latest retail sales data were somewhat more encouraging, suggesting a slightly better performance after the sales tax hike than in 2014. Employment also rose to a new record high.
- December sentiment surveys, as well as November household spending and wage data, will be released in the coming week.

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### Interest and exchange rate forecasts

End period	03-Jan	Q120	Q220	Q320
BoJ ONR %	-0.10	-0.10	-0.10	-0.10
10Y JGB %	-0.03	-0.05	-0.10	-0.10
JPY/USD	108	108	106	105
JPY/EUR	121	120	118	117

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

## IP declines to lowest level in more than 6½ years

The festive period brought plenty of top-tier economic releases out of Japan, with perhaps the most noteworthy being November's industrial production figures. But these offered little seasonal cheer from the manufacturing sector, with production declining for the second successive month (0.9%M/M) to leave it down more than 8%Y/Y and at its lowest level for more than 6½ years. While there was a rebound in output in the autos sector in November – admittedly the 6½%M/M increase only partially offset October's sharp decline – this was an outlier. Indeed, twelve of the fifteen subsectors reported a fall in output, with particular weakness in production of construction machinery (-33%M/M) and semi-conductor manufacturing equipment (-18.1%M/M), which together accounted for around three-quarters of the monthly drop in total output.

## Manufacturing hit by various factors

The notable step down in production since the start of Q4 reflects a number of factors. Domestic demand – particularly for big-ticket items – was obviously impacted by October's consumption tax hike. Manufacturing plants – most notably of autos – were also significantly impaired by the super-typhoon. And the latest trade figures highlighted ongoing softness in external demand – the downtrend in vehicle exports continued in November, while there was renewed weakness in shipments of IT-related and capital goods.

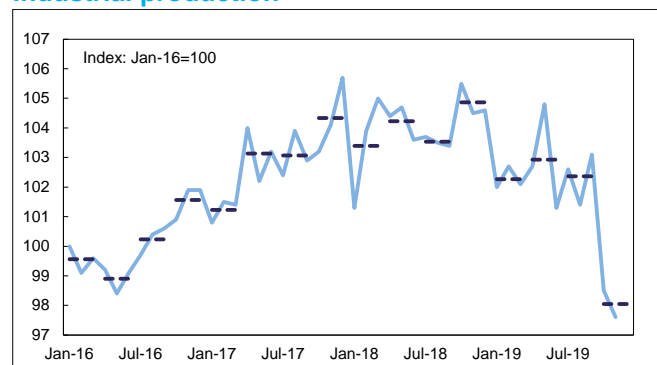
## Production outlook remains subdued

December's flash manufacturing PMI remained consistent with continued underlying contraction at the end of last year. And while the METI survey saw firms project a rebound in production in December (+2.8%M/M), such an outturn would still leave output down almost 3½%Q/Q in Q4, the steepest such drop since the 2011 quake, knocking roughly 0.7ppt off total output growth. Looking ahead, subdued global demand looks set to weigh on manufacturing output for some time. And in the absence of a vigorous rebound in domestic demand, the further increase in November in the inventory-shipment ratio – to the highest for more than a decade – raises risks of renewed weakness in production through the first half of 2020 too.

## Retail sales post modest recovery in November

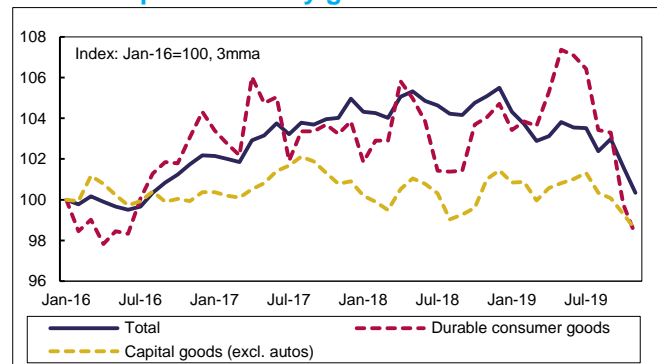
Given the 2ppt consumption tax increase, Japan's economy was always expected to have slipped into reverse in Q4, not least as payback for demand brought forward ahead of the hike. And while consumption-related indicators have provided mixed

### Industrial production\*



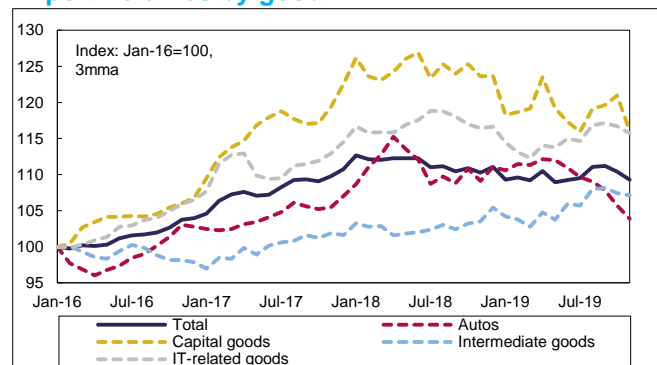
\*Dashed dark blue lines are quarterly average. Source: METI and Daiwa Capital Markets Europe Ltd.

### Industrial production by good



Source: METI and Daiwa Capital Markets Europe Ltd.

### Export volumes by good



Source: BoJ and Daiwa Capital Markets Europe Ltd.

messages about the initial retrenchment in spending, they all point to contraction last quarter. Encouragingly, however, the [Cabinet Office's synthetic consumption](#) index – the best gauge of the national accounts measure of household expenditure – signalled a more modest decline in October than after the 2014 and 1997 tax hikes. And the first insights into expenditure in November suggest that the post-tax hike pullback is already starting to fade. In particular, retail sales increased 4½%M/M, to leave the year-on-year decline moderating 4.9ppts to -2.1%Y/Y.

### Post-tax hike performance better than in 2014?

Admittedly, this rise in sales followed a much steeper decline in October, with the drop of 14.2%M/M the largest since the series began in 1992. But while this left sales in the first two months of Q4 down a sizeable 6.8% compared with the Q3 average, this was nevertheless slightly improved on the equivalent periods after the previous sales tax hikes. The coming week's household spending and BoJ consumption activity indices – both adjusted for price effects – should provide a more accurate guide to real consumption in November. And like the retail sales release these might well echo the initial assessments of the government and BoJ that the negative economic impact appears more moderate this time around.

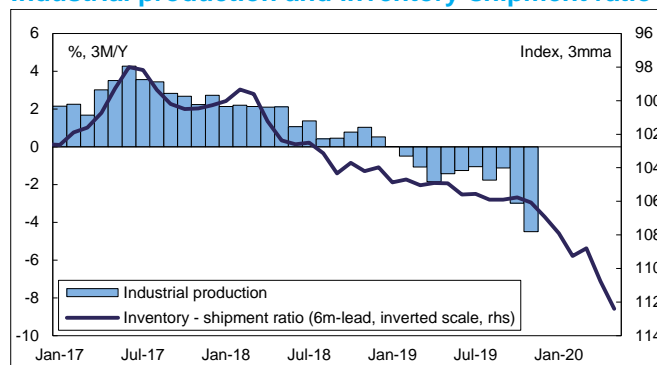
### Unemployment at lowest since early 1990s

The latest labour market figures were encouraging too. For example, the number of people employed rose for the fifth month out of the past six in November (110k) to a record 67.7mn, an increase of more than 500k over the past year and 5mn since Abe took office in 2012. There was a further solid increase in the number of people employed in the finance sector, as well as the first annual increase in the retail sector for seven months. In contrast, but perhaps unsurprisingly, manufacturers continued to scale back their workforces. Overall, however, the total number of people in unemployment fell to the lowest since the early 1990s, leaving the jobless rate down 0.2ppt on the month to 2.2%, implying a still very tight labour market. This notwithstanding, the job-to-applicant ratio moved sideways for the third consecutive month (1.57x), while there was a further fall in the number of new job vacancies to the lowest level for three years. So, against the weaker economic backdrop, further significant increases in employment might seem unlikely, while upwards pressures on wage growth might remain absent.

### Inflation pressures still subdued

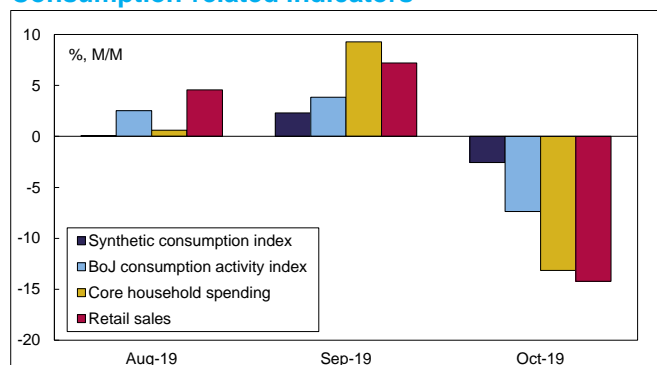
There was, however, a slight pickup in inflation at the end of 2019, at least in terms of the Tokyo data. The headline Tokyo CPI rate rose 0.1ppt to 0.9%Y/Y, a five-month high. With fresh fish prices down significantly, the BoJ's forecast measure of core CPI (excluding fresh food) rose a larger 0.2ppt to 0.8%Y/Y. Clothing inflation provided the largest positive impulse, up 2.5ppts to 4.8%Y/Y, the strongest since August 1998. Golf equipment also added 0.1ppt to annual inflation. But energy remained a drag (-1.2%Y/Y), although this was the softest decline for three months. And mobile phone charges continued to fall compared with a year earlier. Indeed, overall, underlying price pressures remained subdued. So, while we would expect nationwide inflation also to have risen in December, this might mark the peak for the time being. Certainly, with energy prices set to remain a drag, limited upwards pressures on inflation of other goods and services, and downside risks from further big cuts to mobile phone tariff, inflation seems unlikely to take a

### Industrial production and inventory-shipment ratio



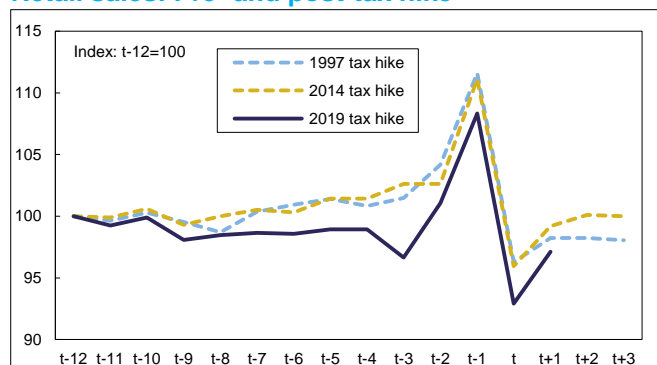
Source: MoF, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Consumption-related indicators



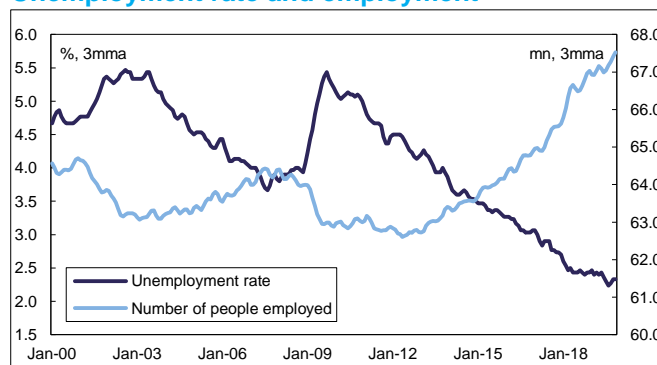
Source: Cabinet Office, BoJ, MIC, METI, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Retail sales: Pre- and post-tax hike\*



\*t represents month consumption tax rate was increased. Source: METI, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Unemployment rate and employment



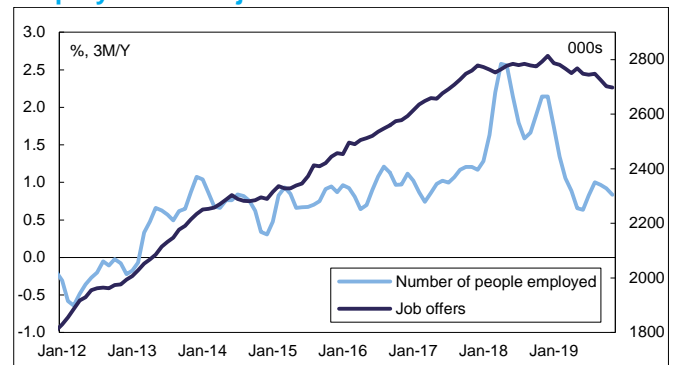
Source: MIC, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

step up in 2020. Excluding the impact of the consumption tax hike and education fee policies, the BoJ's forecast core inflation rate will likely struggle to break through  $\frac{1}{2}\%$ Y/Y.

### Looking ahead...

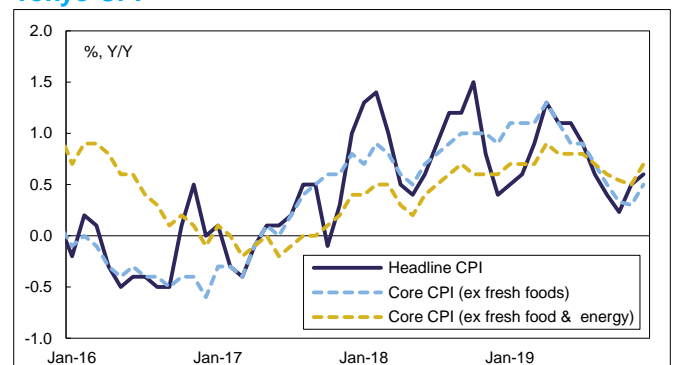
The coming week will bring an update on economic conditions at the end of 2019. Final manufacturing and services PMIs for December (due Monday and Wednesday) are likely to signal ongoing weakness at the end of the year, particularly for manufacturing output. In contrast, the latest consumer confidence survey (Wednesday) is expected to show a further modest improvement in household sentiment heading into 2020. This will follow the December vehicle sales release (Monday), which is likely to show further recovery in demand following the sharp decline in the immediate aftermath of the consumption tax hike. In this respect, the household spending and BoJ consumption activity indices for November (due Friday) will also be of interest. The latest labour earnings figures (Wednesday) will also be watched. In the markets, a 10Y JGB auction will be conducted on Tuesday, followed by a 30Y auction on Thursday.

### Employment and job offers



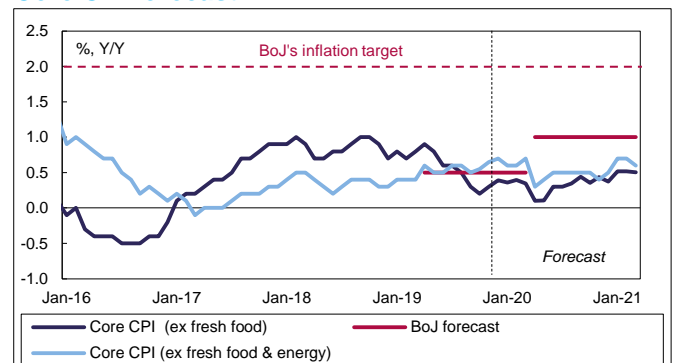
Source: MIC, MHLW, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Tokyo CPI



\*Excluding effect of consumption tax hike and government's education policy.  
 Source: MIC, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

### Core CPI forecast\*



\*Excluding effect of consumption tax hike and government's education policy.  
 Source: MIC, BoJ, Thomson Reuters and Daiwa Securities

# Economic calendar

## Key data releases – December/January

23	24	25	26	27
ALL INDUSTRY ACTIVITY M/M% SEP 1.9 OCT -4.3	2Y JGB AUCTION	SERVICES PPI Y/Y% OCT 2.1 NOV 2.1	HOUSING STARTS Y/Y% OCT -7.4 NOV -12.7 CONSTRUCTION ORDERS Y/Y% OCT 6.4 NOV -1.2	INDUSTRIAL PRODUCTION M/M% OCT -4.5 NOV -0.9 RETAIL SALES M/M% OCT -14.2 NOV 4.5 UNEMPLOYMENT RATE % OCT 2.4 NOV 2.2 JOB-TO-APPLICANT RATIO OCT 1.57 NOV 1.57 TOKYO CPI Y/Y% NOV 0.8 DEC 0.9 EX FRESH FOOD OCT 0.6 OCT 0.8 EX FRESH FOOD/ENERGY OCT 0.7 OCT 0.9  BOJ SUMMARY OF OPINIONS (18-19 DECEMBER 2019)
30	31	01	02	03
		NATIONAL HOLIDAY - NEW YEAR'S DAY	NATIONAL HOLIDAY	NATIONAL HOLIDAY
06	07	08	09	10
MANUFACTURING PMI NOV 48.9 DEC F 48.8 VEHICLE SALES Y/Y% NOV -14.6 DEC N/A	3M TB AUCTION (APPROX ¥4.34TRN) 10Y JGB AUCTION (APPROX ¥2.1TRN)	SERVICES PMI NOV 50.3 DEC F 50.6 COMPOSITE PMI NOV 49.8 DEC F 49.8 AVERAGE WAGES Y/Y% OCT 0.0 NOV -0.2 CONSUMER CONFIDENCE NOV 38.7 DEC 39.5	6M TB AUCTION (APPROX ¥2.3TRN) 30Y JGB AUCTION (APPROX ¥0.7TRN)	3M TB AUCTION (APPROX ¥4.34TRN)  HOUSEHOLD SPENDING Y/Y% OCT -5.1 NOV -2.0 BOJ CONSUMPTION ACTIVITY INDEX M/M% OCT -7.4 NOV N/A COINCIDENT INDEX OCT 95.3 NOV P 95.2 LEADING INDEX OCT 91.6 NOV P 90.9
13	14	15	16	17
NATIONAL HOLIDAY – COMING OF AGE DAY	BANK LENDING (DEC) CURRENT ACCOUNT (NOV) ECONOMY WATCHERS SURVEY (DEC)	5Y JGB AUCTION REUTERS TANKAN (JAN)	1Y TB AUCTION  MACHINE ORDERS (NOV) GOODS PPI (DEC)	3M TB AUCTION 20Y JGB AUCTION  TERTIARY ACTIVITY (NOV)
20	21	22	23	24
INDUSTRIAL PRODUCTION (NOV F)  BOJ POLICY BOARD MEETING (20 JANUARY 2020)	DEPARTMENT STORE SALES* (DEC)  BOJ POLICY ANNOUNCEMENT AND OUTLOOK REPORT	AUCTION FOR ENHANCED LIQUIDITY	GOODS TRADE BALANCE (DEC) ALL INDUSTRY ACTIVITY INDEX (NOV)	3M TB AUCTION AUCTION FOR ENHANCED LIQUIDITY  NATIONAL CPI (DEC) MANUFACTURING PMI (JAN P) SERVICES PMI (JAN P) COMPOSITE PMI (JAN P)

\*Approximate date of release. Source: BoJ, MoF, Bloomberg, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

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