Yen 4Sight

Highlights

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- Business surveys have been mixed, but some tentatively suggest stabilisation in conditions at the start of 2020. The external environment is somewhat more encouraging too.
- The post-tax hike pullback in consumption appears slightly smaller than in 2014. And consumers appear somewhat more upbeat too.
- The BoJ's meeting on Tuesday seems unlikely to see a change in policy, but will bring updated economic forecasts.

Interest and exchange rate forecasts

End period	17-Jan	Q120	Q220	Q320
BoJ ONR %	-0.10	-0.10	-0.10	-0.10
10Y JGB %	0.00	-0.05	-0.10	-0.10
JPY/USD	110	108	106	105
JPY/EUR	122	120	118	117

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

Japan's regions flag hit to consumption

As the BoJ's Policy Board prepared to meet in the coming week and update its economic forecasts, the full magnitude and duration of the impact of the October's tax hike on economic activity was still not clear. To some extent, the Board might take comfort from the past week's BoJ Regional Economic Report, which suggested that the economy has weathered the tax hike as well as might have been hoped. This unsurprisingly flagged that most regional representatives observed a hit to the recent consumption profile due to October's tax hike, while many remained downbeat about housing investment. And all suggested that production was weak, weakening or declining. This notwithstanding, they remained generally encouraged about business investment with the majority citing increasing or high levels of capital spending, while prospects for the labour market remained buoyant. And even before the government's fiscal stimulus package feeds through, eight of the nine regions saw public investment increasing or at a high level.

But BoJ likely to revise up its growth forecasts

While three of the nine regional representatives revised down their assessments of economic conditions over the past three months, all assessed that the economy had been recovering or expanding, albeit moderately for most. As such, when the BoJ's meeting concludes on Tuesday, the Policy Board might feel little need to amend significantly its assessment of the outlook, maintaining the view that the economy is likely to continue on an expanding trend. Indeed, recent upward revisions to the estimates of GDP growth in 2019 – by a cumulative ½ppt in the first three quarters – will see the BoJ revise up its full-year growth projection for FY19. The government's fiscal stimulus package should provide a boost to its FY20 growth forecast too. And changes to its inflation forecasts seem likely to be minimal.

Policy Board to be in no mood to ease policy

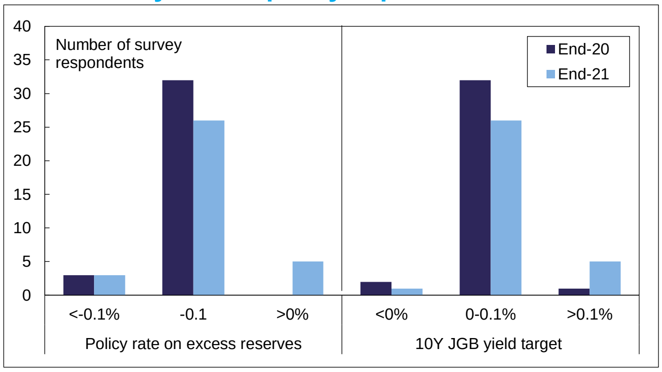
In addition to the firmer GDP forecast, the BoJ will also be encouraged by the recent downward shift in the yen as well as the steepening of the yield curve back close to the profile seen when the YYC framework was first introduced. So, while Kuroda in the past week reiterated that the BoJ stands ready to ease policy "if risks heighten to an extent that the momentum towards the price target is undermined", this time around the BoJ will be in no mood for policy action. Indeed, Kuroda has also made it clear that he would prefer the curve to steepen further. And given concerns about negative side-effects, the hurdle for additional easing is now high. So, for the foreseeable

BoJ Outlook Report: Growth and inflation forecasts

	Real GDP		Core CPI		*Core CPI excl. policies*	
	Outlook Report Oct-19		**Outlook Report Oct-19**		**Outlook Report Oct-19**	
FY19	**0.6 (0.6-0.7)**	↑	**0.7 (0.6-0.8)**	→	***0.5 (0.4-0.6)***	→
FY20	**0.7 (0.6-0.9)**	↑	**1.1 (0.8-1.2)**	→	***1.0 (0.7-1.1)***	→
FY21	**1.0 (0.9-1.2)**	→	**1.5 (1.2-1.7)**	→	***1.5 (1.2-1.7)***	→

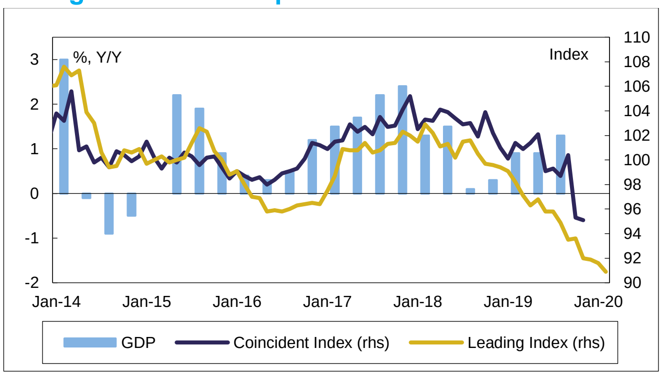
Policy Board members' median forecast in October's Outlook Report. Figures in parentheses represent full range of forecasts. Arrows are Daiwa expectations for direction of adjustment. Source: BoJ

JCER survey of BoJ policy expectations*



**January survey. Source: JCER and Daiwa Capital Markets Europe Ltd.*

GDP growth and composite business indices*



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

future, we should expect no change to the BoJ's main policy parameters and its purchases of longer-dated JGBs are likely to continue to be reduced. The JCER's January survey suggested that this expectation is widespread: more than 90% of respondents anticipate no change to either the -0.1% policy rate or 0% 10YJGB target this year, and almost three quarters anticipate the status quo to be maintained in 2021 too.

Business surveys provide mixed signals

Not least given ongoing manufacturing weakness, the BoJ will continue to flag that risks to the outlook remain skewed to the downside. And notwithstanding the likely upward revision to the BoJ's growth projection, there is no doubt that the economy went into reverse in the final quarter of 2019. Certainly, the Cabinet Office's composite index of business conditions – which often offers a relatively good guide to GDP growth – has weakened considerably, falling in November to its lowest level since early 2013. And the persistent downtrend in the leading index raises concerns that economic weakness extended through to the start of 2020. But the past week's Reuters Tankan – the first sentiment survey of the New Year – suggested that conditions did not deteriorate further in January. And while the headline manufacturing (-6) and non-manufacturing (+14) DIs remained close to multi-year lows, the forward-looking indices signalled that the worst might now have passed.

Machine orders boosted by special factors

The latest machine orders data were also, at face value, more encouraging. Core orders – which provide a guide to private sector capex three months ahead – rose in November for the first month in five and by a striking 18%M/M, leaving them up more than 5%Y/Y. Admittedly, the improvement principally reflected a surge in orders from non-manufacturers – the 27.8%M/M increase was the third highest on record – thanks to two one-off large-scale orders in transportation and the postal sector. And core orders were still on track for a drop of ½%Q/Q in Q4. But that points to stabilisation of private sector non-residential capex in Q120. And while government orders were also weaker in November, they were broadly flat compared with a year earlier and should receive a boost over coming quarters on the back of the fiscal stimulus announced in December.

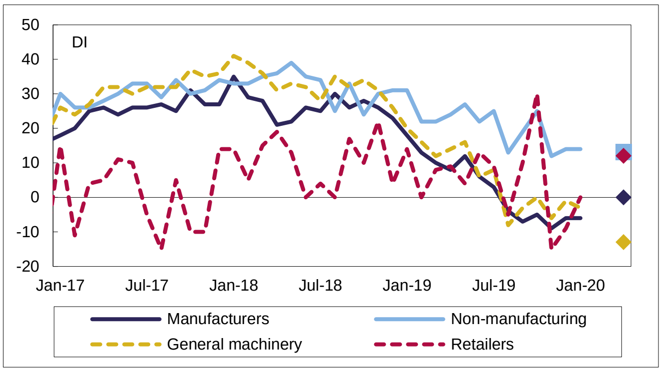
Overseas orders down, but signs of improvement

While overseas orders disappointed in November – down 11½%M/M to leave them down almost 40%Y/Y – there are some signs of improvement in the external environment. In the first twenty day of December, the year-on-year decline in Japanese exports moderated by 5½ppts to -4.6%Y/Y. And Chinese goods imports from Japan surged in December, by 16.4%Y/Y, the most since mid-2018. This, however, was likely flattered by the timing of the Lunar New Year. And over Q4 as a whole, Japanese goods export volumes likely declined. But with imports even weaker, net goods trade will provide support to Q4 GDP. (December's full-month trade data are due 23 January).

Tourism continues to support growth

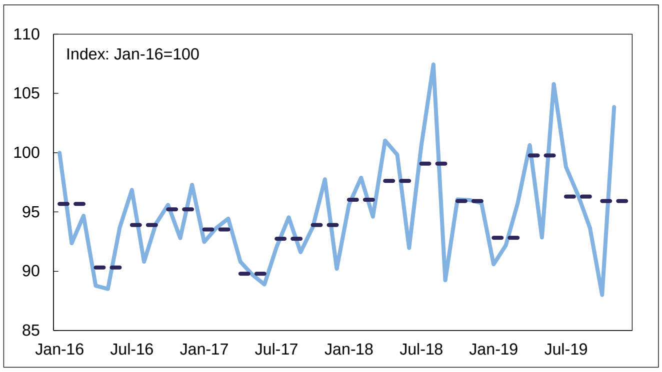
The latest overseas arrivals figures suggest that tourist spending also provided support to economic growth at the end of 2019. In particular, spending increased 3.2%Y/Y in Q4, with a notable decline in spending by South Korean visitors (-67%Y/Y) offset by stronger expenditure by tourists from China as well as

Reuters Tankan: Business conditions*



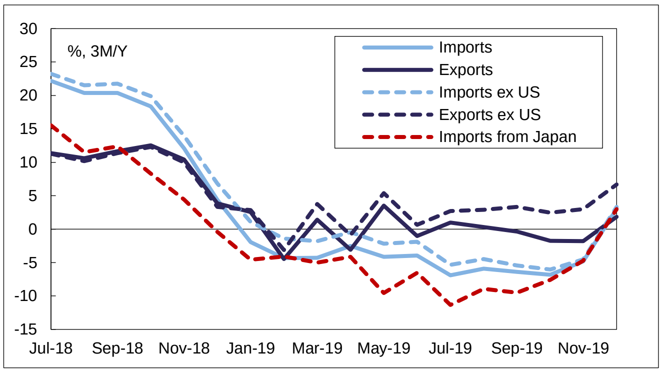
Diamonds/square represent survey forecast for April 2020. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Private sector core machine orders*



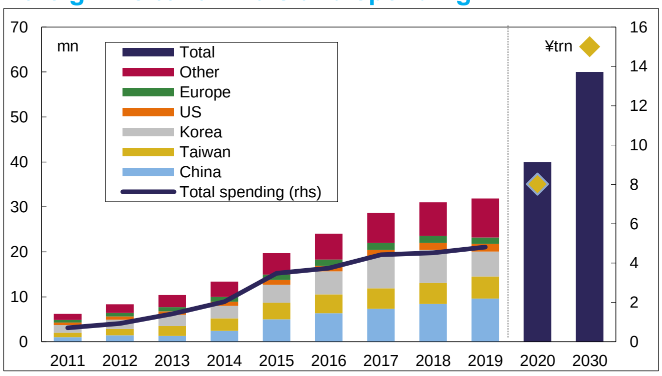
Dark blue dashed lines are quarterly averages. Source: Cabinet Office, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

China: Goods trade



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Foreign visitor arrivals and spending*



2020 and 2030 are government targets. Source: JTNO, JTA and Daiwa Capital Markets Europe Ltd.

those nations participating in the Rugby World Cup. So, overall, just as the number of visitors in 2019 reached a new high (31.9mn), so did their spending, which rose 6½%Y/Y to ¥4.8trn. But December's figures also flagged weakening in arrivals at the end of the year as the spat with South Korea continued to take its toll – visitors from that country were down by more than 60%Y/Y in December at just 250k. As such, the total number of visitors that month, 2.53mn, was down 4%Y/Y, the third consecutive year-on-year decline. While the Olympics should provide a welcome boost later this year, the government will fall well short of its 2020 target of 40mn visitors spending ¥8bn.

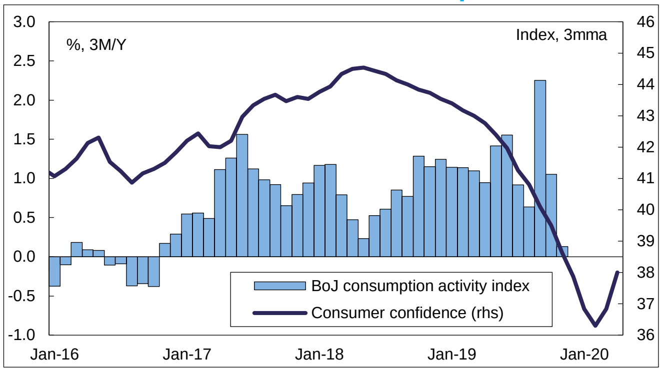
Consumers happier but spending subdued

Like in 2014, the key determinant of Japan's post-tax hike recovery will be domestic consumption. But while consumers became increasingly downbeat during 2019 as the hike drew closer, the latest confidence survey suggested relief heading into 2020. In particular, the headline sentiment index rose for the third consecutive month in December to 39.1, a seven-month high. The improvement principally reflected a pickup in households' willingness to buy durable goods, with the relevant index 8½pts higher than September's more-than-decade low. Of course, this remains well below the level a year earlier and consistent with still restrained consumption growth. And the BoJ's November consumption activity figures point to only modest recovery following the initial post-hike retrenchment – the headline index was on average in October and November 4½% lower than the Q3 average. But this still suggests a smaller post-tax hike pullback than in 2014. The Cabinet Office's synthetic consumption release in the coming week will, however, offer a more accurate guide.

Fiscal consolidation behind target

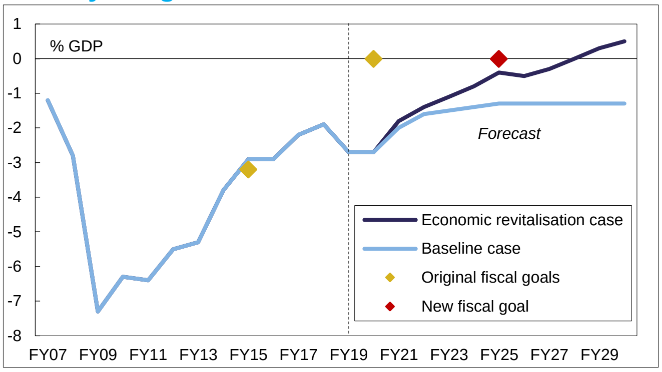
The longer-term impact of the consumption tax hike on growth should be minimal. But while the measure was envisaged as a vital step to restoring fiscal sustainability, given the decisions to spend much of the extra revenue and add extra stimulus this year, the Cabinet Office's latest medium-term fiscal projections suggest that the impact on the health of the public finances was also minimal. Indeed, these forecasts suggest that only with a growth miracle (annual GDP growth rates rising to an unimaginable 2.0%Y/Y from 2022 on) might a balanced primary budget (which Abe had previously targeted for the current year) be achieved by 2027. Under the more conservative (albeit still likely overoptimistic) assumption of GDP growth of 1.5%Y/Y in 2022 drifting back just below 1.0%Y/Y from 2026 on, the primary deficit is expected to drop only gradually from 2.7% of GDP this year and level off at about 1.3% of GDP over the second half of the decade. So, without new reforms to public spending, government debt as a share of GDP is likely to flat-line over coming years, before rising steadily from the start of the next decade due to bad demographics.

Consumer confidence* and consumption



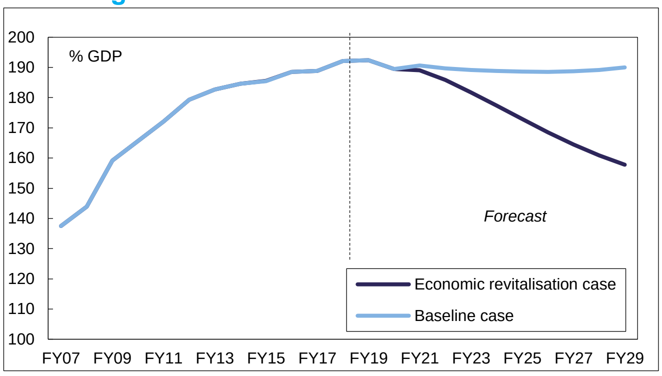
*Consumer confidence has four-month lead. Source: Cabinet Office, BoJ, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Primary budget balance*



*High growth scenario assumes annual average real GDP growth of 2.0% over the medium term. Low growth assumes annual average GDP growth of 1.3%. Source: Cabinet Office medium-term fiscal projections January 2020

General government debt*



*High growth scenario assumes annual average real GDP growth of 2.0% over the medium term. Low growth assumes annual average GDP growth of 1.3%. Source: Cabinet Office medium-term fiscal projections January 2020

Looking ahead…

The main focus at the start of the coming week will be the conclusion of the BoJ's latest Policy Board meeting on Tuesday. But there is no expectation for a change to its key policy parameters. Of more interest will be its updated economic forecasts, for further insights into its assessment of the impact of the consumption tax hike. The second half of the week will bring a few releases of note, including December's goods trade report and November's all-industry activity indices (Thursday), and January's flash PMIs (Friday). The latest CPI release (Friday) will likely confirm still very subdued underlying price pressures, with headline inflation expected to rise 0.2ppt to 0.9%Y/Y on the back of higher energy price inflation.

Economic calendar

Key data releases – January/February

13	14	15	16	17
NATIONAL HOLIDAY – COMING OF AGE DAY	BANK LENDING Y/Y% NOV 2.1 DEC 1.8 CURRENT ACCOUNT ¥TRN OCT 1.7 NOV 1.8 ECONOMY WATCHERS SURVEY – CURRENT CONDITIONS DI NOV 39.4 DEC 39.8 FUTURE CONDITIONS DI NOV 45.7 DEC 45.4	5Y JGB AUCTION M3 MONEY SUPPLY Y/Y% NOV 2.2 DEC 2.3 BOJ REGIONAL ECONOMIC REPORT	1Y TB AUCTION REUTERS TANKAN – MANUFACTURING DI DEC 14 JAN 14 NON-MANUFACTURING DI DEC -6 JAN -6 MACHINE ORDERS M/M% OCT -6.0 NOV 18.0 GOODS PPI Y/Y% NOV 0.1 DEC 0.9	3M TB AUCTION 20Y JGB AUCTION TERTIARY ACTIVITY M/M% OCT -5.2 NOV 1.3
20	**21**	**22**	**23**	**24**
INDUSTRIAL PRODUCTION M/M% OCT -4.5 NOV F -0.9 BOJ POLICY BOARD MEETING (20-21 JANUARY 2020)	BOJ POLICY ANNOUNCEMENT AND OUTLOOK REPORT	AUCTION FOR ENHANCED LIQUIDITY (APPROX ¥0.6TRN) DEPARTMENT STORE SALES Y/Y% NOV -6.0 DEC N/A	GOODS TRADE BALANCE ¥BN NOV -60.8 DEC -236.0 EXPORTS Y/Y% NOV -7.9 DEC -4.2 IMPORTS Y/Y% NOV -15.7 DEC -2.6 ALL INDUSTRY ACTIVITY INDEX M/M% OCT -4.3 NOV 0.4 BOJ SENIOR LOAN OFFICER SURVEY	3M TB AUCTION (APPROX ¥4.34TRN) AUCTION FOR ENHANCED LIQUIDITY (APPROX ¥0.4TRN) NATIONAL CPI NOV 0.5 DEC 0.7 MANUFACTURING PMI DEC 48.4 JAN P N/A SERVICES PMI DEC 49.4 JAN P N/A COMPOSITE PMI DEC 48.6 JAN P N/A BOJ POLICY BOARD MINUTES (18-19 DEC 2019 MEETING)
27	**28**	**29**	**30**	**31**
	40Y JGB AUCTION SERVICES PPI (DEC)	CONSUMER CONFIDENCE (JAN) SUMMARY OF OPINIONS AT THE BOJ POLICY BOARD MEETING (20-21 JANUARY 2020)	2Y JGB AUCTION	3M TB AUCTION TOKYO CPI (JAN) RETAIL SALES (DEC) INDUSTRIAL PRODUCTION (DEC P) UNEMPLOYMENT RATE (DEC) JOB-TO-APPLICANT RATIO (DEC) HOUSING STARTS (DEC) VEHICLE PRODUCTION (NOV) CONSTRUCTION ORDERS (DEC)
03	**04**	**05**	**06**	**07**
MANUFACTURING PMI (JAN F) VEHICLE SALES (JAN)	10Y JGB AUCTION MONETARY BASE (JAN)	SERVICES PMI (JAN F) COMPOSITE PMI (JAN F)	6M TB AUCTION 30Y JGB AUCTION	3M TB AUCTION HOUSEHOLD SPENDING (DEC) AVERAGE WAGES (DEC) BOJ CONSUMPTION ACTIVITY INDEX (DEC) COINCIDENT INDEX (DEC P) LEADING INDEX (DEC P)

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

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