

Daiwa's View

Things to watch for in Oct, starting from BOJ Tankan

- Recovery of services consumption, catch-up production vs. weak capex

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Will people enjoy autumn consumption activities—“autumn is for outdoor amusement or eating”?

How will autumn services consumption be boosted?

Check points in Oct—Sep data likely to confirm upturn in economic vector

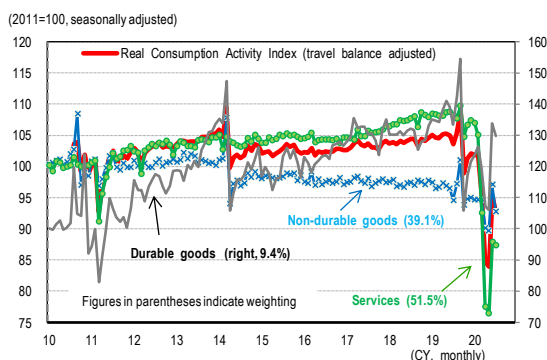
Transport machinery-driven catch-up production continuing

Things to watch for in Oct, starting from BOJ Tankan

In Japan, it has become cooler since late September. With an end to the unusual summer, autumn has finally arrived. Speaking of autumn, we have several sayings like “autumn is for outdoor amusement,” “autumn is for eating,” “autumn is for art,” or “autumn is for sports.” This October has no national holidays because of the Tokyo 2020 Olympics factor. However, as trips to or from Tokyo become eligible for the “Go To Travel” campaign from 1 October, we would like to check whether people will enjoy autumn consumption activities. While the recovery of services consumption is especially slow, a check point is how such services will be boosted by the effects of demand stimulus measures. In the BOJ’s July Real Consumption Activity Index (travel balance adjusted), services consumption, which accounts for just over 50% of consumption, was slightly above 80% of the pre-pandemic January level (Chart 1). The August data (to be released 7 Oct) is expected to show sluggish services consumption as people were in a cautious mode. However, the *Current Survey of Commerce* for August (released 30 Sep) showed solid consumption of goods (pent-up demand), such as consumer electronics and clothing/accessories. Over the four-day weekend in September, there was an easing of restrictions on the number of people who can gather at events, the Go To Travel campaign appeared to be successful in prompting a recovery of travel, and a recovery of spending on services looks hopeful. Consequently, the various September data to be announced in October is likely to confirm an upturn in the vector of the economy.

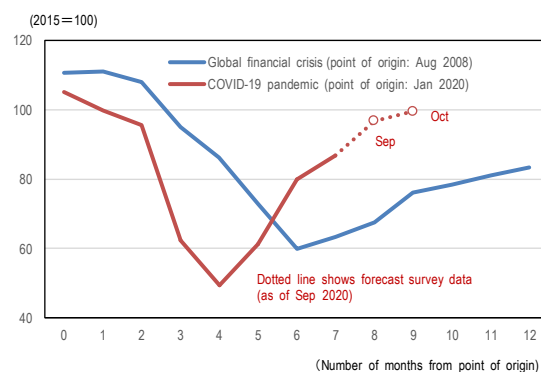
August industrial production (released 30 Sep) was up 1.7% m/m, increasing for three months in a row (up 8.7% in Jul). The momentum has weakened compared to the biggest rise under the current standard in the previous month, but data confirmed continued catch-up production. The driver was automobiles (passenger cars, auto bodies, auto parts). Looking at the production forecast index for transport machinery (Chart 2), momentum is expected to gain in September and then to slow down in October, but the level turned out higher than our estimate.

Chart 1: Consumption Activity Index in Japan



Source: BOJ; compiled by Daiwa Securities.

Chart 2: Production Trends of Transport Machinery in Japan



Source: Ministry of Economy, Trade and Industry; compiled by Daiwa Securities.

Time needed before entire industrial production recovers to pre-pandemic level

Weak capex a concern

Growth rate projections to be lowered in Oct Outlook Report

BOJ Sep Tankan firstly announced indicator in 2H

Data will imply that corporate sentiment bottomed out in Jun and is now recovering

Recovery degree differs by size/sector

Degree of downward revision to capex and corporate financing DIs also important items to be checked

Amid new normal, severe solvency issues likely to persist

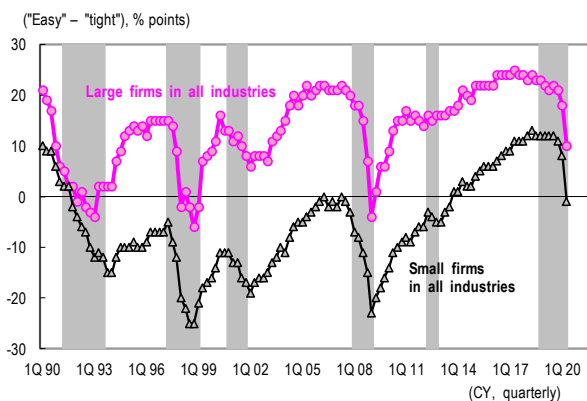
Detailed analyses anticipated in Oct Financial System Report

However, the mode of estimates for entire industrial production in September is +2.8% m/m (ranging from +1.3% to +4.3%). Based on this figure, Jul-Sep production is expected to increase 8.8% q/q. This equates to recouping less than half of the 16.9% plunge in Apr-Jun. Although catch-up production is likely to continue, it will take time before recovering to the pre-pandemic level. Meanwhile, weak capex-related data is a concern. Shipments of capital goods were weak in August, falling 8.7% m/m (down 1.0% in Jul). As shown by the 4.2% decline in Jul-Aug vs. Apr-Jun, the figure is continuing to drop. In Jul-Sep GDP, capex is likely to remain weak similar to the Apr-Jun quarter. In compiling the October *Outlook for Economic Activity and Prices* report (*Outlook Report* to be released 29 Oct), BOJ board members are expected to discuss downward revisions to their FY20 growth rate projections.

In Japan, the first announced indicator in 2H is always the BOJ's September Tankan (normally about 70% of responses received by response deadline of 10 Sep). The business conditions DI (released 1 Oct) is expected to imply that corporate sentiment bottomed out in June and is now recovering. However, the degree of recovery differs by size and by sector. Compared to manufacturers, the pace of non-manufacturers is slow and the DI is expected to tread water. Sales and profit forecasts do not indicate any sudden earnings recovery for those sectors hit hardest by the pandemic (accommodations, eating & drinking services, transport & postal). There is also a broadening trend to put off unessential business investment, which makes it important to confirm the degree to which capex plans have been revised downward (raised 3.2% by large enterprises in all industries in Jun survey). We also intend to confirm capex-related comments in the interview surveys of the BOJ's Regional Economic Report (*Sakura Report*) to be released on 8 October. Meanwhile, in confirming the effects of the government's and BOJ's financing measures, it is important to check the corporate financing trends of the financial position DI (Chart 3) and the DI for lending attitudes of financial institutions (Chart 4).

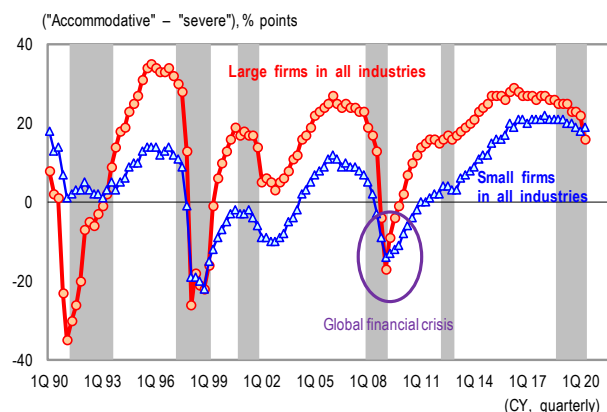
The new Suga Cabinet is trying to achieve both containment of COVID-19 and economic rejuvenation, continuing with Abenomics. Even if we have a third wave of COVID-19 infections, the economy could avoid the Apr-May bottom because of the learning effect on medical treatment and people getting used to the new lifestyle, in addition to the experiences of the first wave (Mar-May) and the second wave (Jul-Aug). For now, government and industry must work together and endeavor to apply their fundamental strengths amid the coronavirus new normal. Lagging employment data will start to worsen from here. Severe solvency issues would persist for those industries hard hit by the pandemic and corporations without good prospects for earnings recoveries. In the near term, a "negative feedback loop between the real economy and the financial sector" warrants caution. In the *Financial System Report* to be announced in the latter half of October, detailed analyses are anticipated.

Chart 3: DI for Financial Position in BOJ Tankan



Source: BOJ; compiled by Daiwa Securities.
Note: Shaded periods indicate recession.

Chart 4: DI for Lending Attitude of Financial Institutions in BOJ Tankan



Source: BOJ; compiled by Daiwa Securities.
Note: Shaded periods indicate recession.

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[Standard & Poor's]

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- 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.

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