

## Highlights

- Japanese markets continued to react positively to the BoJ's end-October expansion of QQE.
- Regular wage growth was at its highest since 2008, which should support near-term spending. But the latest data pointed to a softer start to activity in Q4.
- The coming week brings several sentiment surveys for October, along with September machine orders data.

### Interest and exchange rate forecasts

End period	07-Nov	Q414	Q115	Q215
BoJ ONR %	0-0.10	0-0.10	0-0.10	0-0.10
BoJ JGBs ¥trn	187	200	220	240
10Y JGB %	0.48	0.45	0.40	0.40
JPY/USD	115	115	117	119
JPY/EUR	143	142	144	146

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

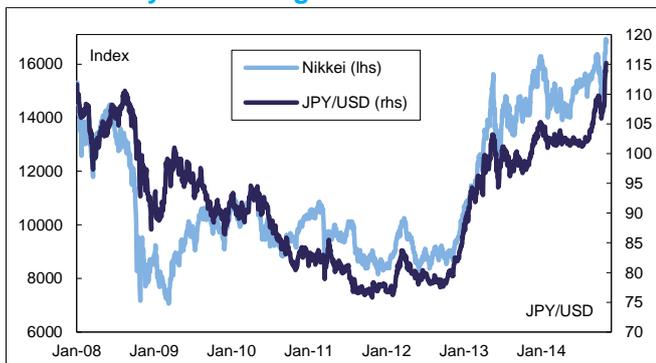
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#### BoJ's actions restore market confidence

The BoJ's policy announcement at the end of October, coupled with the reforms to the GPIF's investment strategy announced at the same time, have restored some much-needed market confidence in the 'first arrow' of Abenomics. The past week saw domestic equities rally to multi-year highs, with the Nikkei breaking through 17,000 for the first time since 2007 and the TOPIX rising close to 1,400, its highest level since mid-2008. Meanwhile, the yen depreciated to its lowest level in seven years, briefly dipping below ¥115.5/\$, to leave it down more than 5% since the announcement of QQE2 and roughly 25% lower than when Prime Minister Abe took office. Of course, the weaker yen should further boost exporters' earnings and help support a moderate pickup in exports, which to date has been a particularly disappointing feature of Japan's recovery. But it is the anticipated boost to confidence from the new initiatives that underpins the BoJ's view that the economy will grow at an above-potential rate through to the end of its forecast horizon.

#### Nikkei and yen exchange rate



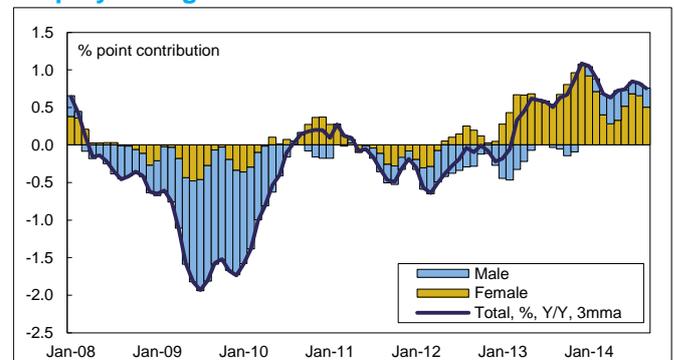
Source: Bloomberg

#### Labour market to support domestic demand

New policy initiatives aside, another factor supporting the BoJ's expectation of a steady recovery is the strength of the labour market. Since the end of 2012, the number of

people employed in Japan has risen by almost 1.1 million, with more than two-thirds of this reflecting growth in female employment. And the latest data showed that that strong performance continued into September. The female employment rate is now at 64.2%, its highest since records began in 1968 (albeit still almost one fifth lower than the male employment rate). And one of Abe's key targets under his 'third arrow' – to increase the employment rate of females aged between 25 to 44 by 5ppts to 73% by 2020 – is now three-quarters of the way to being met. And while the pickup over the past year or so has been largely accounted for by non-regular employment, regular female employment rose by almost 2%Y/Y in September. Meanwhile, overall regular full-time employment was up around 1½%Y/Y.

#### Employment growth



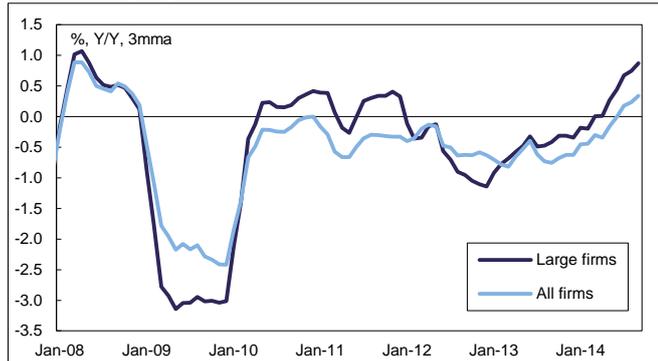
Source: MIC and Daiwa Capital Markets Europe Ltd.

#### Basic wage growth at highest since 2008

As employment continues to rise this is putting further upward pressure on wages. In September, average wage growth rose for the seventh consecutive month, and by 0.8%Y/Y. Encouragingly, two-thirds of the year-on-year increase reflected a further improvement in basic salaries, which rose by ½%Y/Y, the fastest pace since 2008. And given that small firms have on average been scaling back their workforces, the improvement in basic salaries at enterprises with more than 30 employees was even larger, up by 1%Y/Y. Two out of the three largest sectors by share of the labour market reported a notable increase in basic wage growth – for example, the 1.4%Y/Y rise for manufacturer employees was the strongest in two years,

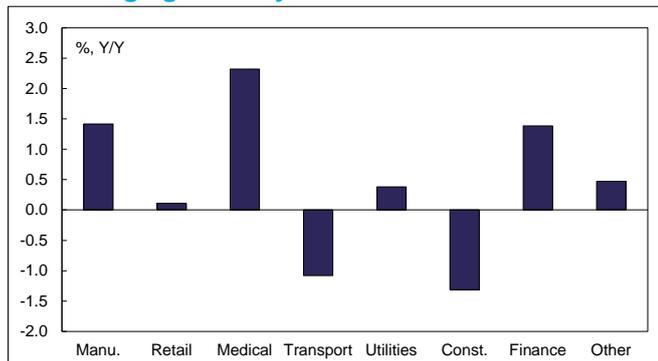
while the more-than 2% increase in the medical sector was the highest since 2006. Meanwhile, overtime earnings were up for the eighteenth consecutive month, 1.6%Y/Y, while bonus payments rose for the eighth time this year, 11½%Y/Y.

### Basic wage growth\*



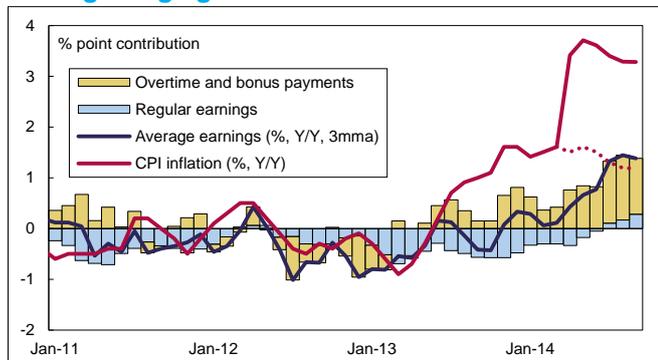
\*Large firms include those with 30 or more employees.  
Source: MIC and Daiwa Capital Markets Europe Ltd.

### Basic wage growth by sector\*



\*Sectors ordered by share of employment. Wage growth in firms with 30 or more employees. Source: MHLW, MIC and Daiwa Capital Markets Ltd.

### Average wage growth and CPI\*



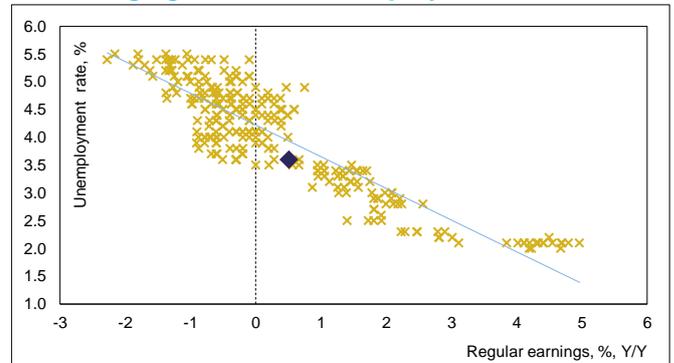
\*Dotted line represents headline CPI excluding the effect of the consumption tax hike. Source: MHLW, MIC, BoJ and Daiwa Capital Markets Europe Ltd.

### Labour market tightness to push wages higher

Notwithstanding the marked improvement in household income over recent quarters, the inflationary impact of

April's 3ppt consumption tax hike means that declining real wage growth will remain the norm for at least the next five months. But a number of indicators suggest that Japan's labour market is at its tightest since the early 1990s. For example, the job-to-applicant ratio has now been above parity for ten consecutive months, while firms of all sizes continue to report insufficient staffing levels. And with the unemployment rate, at 3.6% in Q3, broadly consistent with our measure of structural unemployment, we, like the BoJ, expect any further tightening of labour market conditions to generate additional upward pressure on wages, particularly following the next annual negotiation round in the New Year.

### Basic wage growth and unemployment rate\*



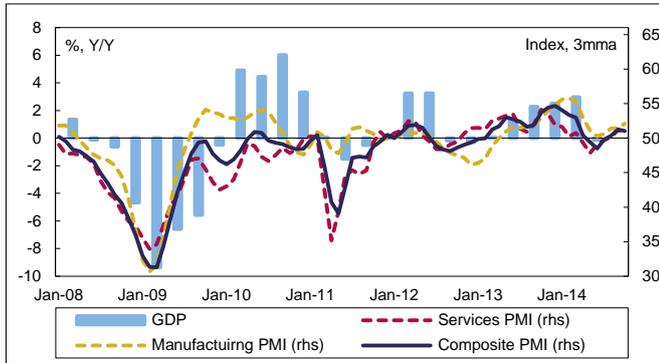
\*Diamond shows October 2014 unemployment rate and basic wage growth. Light blue line represents the average trade-off between wages and unemployment since 1991.

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

### PMIs indicate mixed start to Q4

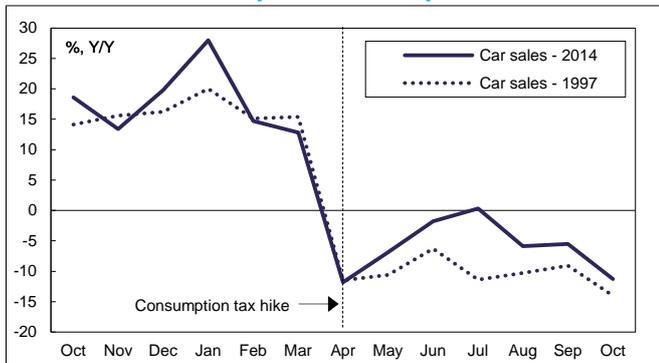
A final decision on whether to go ahead with the second stage of the consumption tax hike is expected to be made in early December principally on the basis of an assessment of the strength of the economy to withstand the measure. While activity and spending figures were more promising at the end of Q3, recent surveys have provided mixed messages about the near-term recovery profile. The latest PMIs were no exception. Despite pointing to continued moderate growth, the manufacturing output PMI fell more than 2pts on the month in October. The services and composite indices were even more downbeat. The headline services PMI dropped almost 4pts in October to a six-month low of 48.7, more than 2pts lower than the average level in Q3 and only 2pts above the post-tax hike low. And the weakness was widespread with the new orders component down almost 2pts on the month to a five-month low of 51.2, while firms reportedly expanded their workforces at a slower pace. So, overall the composite PMI fell below the key-50 expansion level for the first time since May. And while it is far from a perfect indicator of GDP growth, the fact that October's PMI was 1.8pts below the 51.3 average seen in Q3 is cause for concern.

**GDP growth and PMIs**



Source: Cabinet Office, Markit and Daiwa Capital Markets Ltd.

**Car sales: Pre- and post-consumption tax hike**



Source: Bloomberg and Daiwa Capital Markets Ltd.

**Vehicle sales down, but better than 1997**

The softer PMIs at the start of Q4 were broadly consistent with the past week's vehicle sales figures, which reported a notable deterioration in the year-on-year pace of decline in October, by more than 6ppts to 9.1%Y/Y, the steepest drop since the post-tax hike plunge in April. Nevertheless, the recent profile in spending continues to outperform the post-tax hike recovery in 1997. And as the impact of April's consumption tax hike on domestic demand continues to fade over coming months, and the economy hopefully reaps the benefit of the monetary-policy-induced boost to confidence, the BoJ's expectation of above-potential GDP growth might just come to fruition.

**The coming week in Japan and the US**

The coming week looks set to be a busy one for Japanese economic releases, with the data calendar kicking off on Tuesday with the latest consumer confidence survey, preliminary machinery tool orders figures and the 20-day trade report for October. The economy watchers survey, on Wednesday, will also be worth watching for insights into how economic conditions fared at the start of Q4, as will the monthly Reuters Tankan survey for November on Thursday. But the likely data highlight on Thursday will be the release of September machine orders, which will provide a guide to the near-term profile for investment. Also of interest on Thursday will be the latest PPI figures, which will provide the first insight into nationwide inflation in October.

In the JGB market, Tuesday brings a 30Y auction, followed on Thursday by a 5Y auction.

In the US, it should be a quieter week for economic news than of late with markets closed on Tuesday for the Veterans Day holiday. Nevertheless, the data calendar gets underway on Monday with the release of the Fed's labour market conditions index for October. Wednesday, meanwhile, brings wholesale trade figures for September, followed on Thursday by JOLTs data for October, the latest weekly jobless claims and Federal monthly budget statement. Friday arguably brings the most noteworthy of the week's data with the release of retail sales figures for October and the preliminary ready of the University of Michigan's consumer sentiment survey for November.

In the UST market, Monday brings a 3Y auction, Wednesday sees a 10Y auction and Thursday brings a 30Y auction.

## Economic calendar

### Key data releases – November

03	04	05	06	07
NATIONAL HOLIDAY – CULTURE DAY	VEHICLE SALES Y/Y% SEP -2.8 OCT -9.1 MANUFACTURING PMI SEP 51.7 OCT F 52.4	6M TB AUCTION 10Y JGB AUCTION AVERAGE EARNINGS Y/Y% AUG 0.9 SEP 0.8 MONETARY BASE Y/Y% SEP 35.3 OCT 36.9 SERVICES PMI SEP 52.5 OCT 48.7 COMPOSITE PMI SEP 52.8 OCT 49.5	3M TB AUCTION COINCIDENT INDEX AUG 108.3 SEP P 109.7 LEADING INDEX AUG 104.4 SEP P 105.6  BOJ POLICY BOARD MINUTES (6-7 OCT MEETING)	AUCTION FOR ENHANCED LIQUIDITY
10	11	12	13	14
	30Y JGB AUCTION (APPROX ¥0.6TRN) BANK LENDING Y/Y% SEP 2.4 OCT 2.3 ECONOMY WATCHERS SURVEY – CURRENT CONDITIONS DI SEP 47.4 OCT 47.2 CONSUMER CONFIDENCE SEP 39.9 OCT 40.5 MACHINE TOOL ORDERS Y/Y% SEP 34.7 OCT P N/A TRADE – 1 <sup>ST</sup> 20 DAYS OF MONTH Y/Y% SEP 7.5 OCT N/A	TERTIARY ACTIVITY INDEX MM% AUG -0.1 SEP 0.8 M3 MONEY SUPPLY Y/Y% SEP 2.5 OCT 2.5	3M TB AUCTION (APPROX ¥5.7TRN) 5Y JGB AUCTION (APPROX ¥2.7TRN) INDUSTRIAL PRODUCTION M/M% AUG -3.3 SEP F 0.6 CAPACITY UTILISATION M/M% AUG -1.7 SEP N/A MACHINE ORDERS Y/Y% AUG -3.3 SEP -0.1 REUTERS TANKAN* - MANUFACTURING DI OCT 8 NOV N/A NON-MANUFACTURING DI OCT 20 NOV N/A PPI Y/Y% SEP 3.5 OCT 3.3	
17	18	19	20	21
GDP (Q3 P) DEPARTMENT STORE SALES* (OCT)	1Y TB AUCTION 20Y JGB AUCTION  BOJ POLICY BOARD MEETING (18-19 OCTOBER 2014)	ALL INDUSTRY ACTIVITY (SEP) COINCIDENT INDEX (SEP F) LEADING INDEX (SEP F)  BOJ POLICY ANNOUNCEMENT	3M TB AUCTION AUCTION FOR ENHANCED LIQUIDITY  GOODS TRADE REPORT (OCT) MANUFACTURING PMI (NOV P) MACHINE TOOL ORDERS (OCT F)	
24	25	26	27	28
NATIONAL HOLIDAY – LABOR THANKSGIVING DAY OBSERVED	SERVICES PPI (OCT)	40Y JGB AUCTION	3M TB AUCTION TRADE – 1 <sup>ST</sup> 10 DAYS OF MONTH (NOV)	2Y JGB AUCTION NATIONAL CPI (OCT) TOKYO CPI (NOV) UNEMPLOYMENT RATE (OCT) JOB-TO-APPLICANT RATIO (OCT) HOUSEHOLD SPENDING (OCT) RETAIL SALES (OCT) INDUSTRIAL PRODUCTION (OCT P) HOUSING STARTS (OCT) CONSTRUCTION ORDERS (OCT)

Source: BoJ, MoF, Bloomberg & Daiwa Capital Markets Europe Ltd.

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