

【NEWS RELEASE】

November 20, 2018
SMBC Nikko Securities Inc.

Quarterly Economy Outlook for FY 2018-2019

November 20, 2018 (JST), “SMBC NIKKO Japan Economic Outlook for FY 2018-2019” has been released.

Could Economy Accelerate in FY19 Despite Tax Hike?

- ◆ Real GDP: +1.0% in FY18 and +1.2% in FY19
- ◆ Nominal GDP: +0.8% in FY18 and +1.9% in FY19

Summary**• GDP growth outlook**

We revise our economic outlook in light of the first preliminary estimate for Jul-Sep 2018 GDP. We forecast real GDP growth of +1.0% YoY in FY18 and +1.2% in FY19, an upward revision of 0.2ppt versus our previous outlook for FY19 to factor in economic measures accompanying the consumption tax hike.

• Domestic economy is solid

Domestic demand in the Japanese economy is strong. Private consumption is recovering on the back of roughly 3% growth in employee income, which makes up 85% of disposable income. Capex is also sustainable since the ratio of capital stock to GDP is at the lowest level in 20 years. For inflation, the core CPI has reached +1% YoY, but we expect it to slow in 2019 due to the recent sharp decline in crude prices.

While some market participants expect the BOJ to hike interest rates around April 2019, we consider this unlikely since inflation would likely slow and there is risk that rate hikes prompt yen appreciation. Some experts argue that rates should be hiked in order to create room for future rate cuts, but we note that long-term interest rates have already increased by around 10bp following the BOJ's move to tolerate wider fluctuations in long-term rates at its July monetary policy meeting. We think this was precisely the "making room" that experts are calling for—the BOJ has built in a mechanism for interest rates to fall naturally without it raising or lowering rates itself. We do not expect any rate hikes until after the consumption tax hike.

• Risks

We see the following risk factors: 1) the consumption tax hike, 2) the global equity market selloff, and 3) the slowing Chinese economy.

With regard to the consumption tax hike, we put the burden on household budgets from the tax hike at ¥2.2tn. On the other hand, government policies to ease the burden are set to amount to ¥5.4tn (¥200bn from automobile tax reductions, ¥200bn from housing tax reductions, ¥1tn from allowing sales events, ¥1tn from reducing telecom charges, ¥3tn from public works). It is actually likely that the economy accelerates in FY19.

With regard to the global equity market sell-off, one driver of the sell-off is concerns over the US economy as a result of rising US long-term interest rates. Usually, concerns that the economy will lose speed emerge when long-term interest rates exceed the neutral interest rate, which represents the return for the real economy. Concerns over a slowdown have emerged suddenly on financial markets as the long-term interest rate overtook the upper bound for the neutral interest rate (3.2%) in early October.

The rise in long-term interest rates reflects concerns over deterioration in external balances (current account balance) due to overheating in the US domestic economy. That said, CBO forecasts call for the current account balance to worsen in 2019 and then trend flat. Interest rates should not rise if the current account balance does not worsen, so we would expect long-term interest rates to settle down moving forward.

With regard to the slowing Chinese economy, the slowdown owes to two factors—lower automobile sales and lower infrastructure investment. The Chinese government is rolling out stimulus measures, and it has got its targets right (automobiles, infrastructure investment), so we expect the Chinese economy to bounce back from around the start of 2019.

Quarterly forecasts for Japanese economy

	2017				2018				2019				2020	《(A)》→《(F)》 (Unit:%)				Comparison with previous forecasts (as at 10 Sept 2018)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	FY16	FY17	FY18	FY19	FY18	FY19
Real GDP growth (QoQ)	0.6	0.5	0.7	0.2	-0.3	0.8	-0.3	0.6	0.4	0.3	0.5	-0.3	0.3						
(annual rate)	2.3	1.9	2.9	0.8	-1.1	3.0	-1.2	2.2	1.7	1.3	2.2	-1.3	1.0	1.2	1.6	1.0	1.2	0.0	0.2
Domestic demand, contribution (QoQ)	0.5	0.8	0.1	0.3	-0.3	0.9	-0.2	0.5	0.5	0.4	0.7	-1.0	0.3	0.4	1.2	1.0	1.2	0.0	0.2
Private consumption (QoQ)	0.5	0.8	-0.6	0.3	-0.2	0.7	-0.1	0.3	0.2	0.1	1.0	-2.0	0.2	0.3	0.8	0.7	0.5	-0.2	0.3
Capex (QoQ)	0.6	0.2	1.5	0.7	0.7	3.1	-0.2	1.0	0.8	0.8	0.8	0.5	0.5	1.2	3.1	4.9	2.8	1.4	0.8
Residential investment (QoQ)	1.1	1.6	-1.8	-3.2	-2.1	-1.9	0.6	1.0	4.0	2.0	-4.0	-3.0	-1.0	6.2	-0.3	-3.6	0.8	0.6	-2.8
Public investment (QoQ)	-0.4	5.0	-2.2	-0.8	-0.5	-0.3	-1.9	3.0	0.0	1.0	1.5	0.2	0.2	0.9	1.5	-1.3	3.7	-0.9	0.5
Foreign demand, contribution (QoQ)	0.1	-0.3	0.6	-0.1	0.1	-0.1	-0.1	0.0	0.0	-0.1	-0.2	0.7	0.0	0.8	0.4	0.0	0.0	0.0	0.0
Exports (QoQ)	1.7	-0.2	2.7	2.1	0.5	0.3	-1.8	0.6	0.8	0.8	0.8	0.8	0.8	3.6	6.3	1.6	2.8	-1.7	-0.6
Imports (QoQ)	1.4	1.7	-1.0	3.1	0.1	1.0	-1.4	0.5	1.0	1.2	2.0	-3.0	1.0	-0.8	4.1	1.7	1.7	-1.4	-0.1
Nominal GDP growth (QoQ)	0.1	0.7	1.1	0.2	-0.5	0.6	-0.3	1.1	-0.3	1.3	-0.1	1.0	-0.4	1.0	1.7	0.8	1.9	-0.4	-0.5
Industrial production (QoQ)	3.9	5.6	4.4	4.1	2.5	2.0	-0.2	0.7	2.6	2.3	5.1	0.5	1.0	1.5	4.1	1.3	2.2	-0.8	-0.3
Trade balance (Y tn, SAAR)	4.6	3.2	7.7	6.9	4.0	2.7	0.4	0.7	5.2	5.5	4.5	8.8	8.8	4.8	5.5	2.3	6.9	-2.4	-1.0
Unemployment rate (%)	2.9	2.9	2.8	2.7	2.5	2.4	2.4	2.3	2.3	2.2	2.2	2.1	2.1	3.0	2.7	2.3	2.2	0.0	0.0
Core CPI (YoY)	0.2	0.4	0.6	0.9	0.9	0.8	0.9	1.1	1.1	1.1	1.1	1.2	2.3	-0.2	0.7	1.0	1.7	0.1	0.0
(Ex effects of consumption tax hike)	0.2	0.4	0.6	0.9	0.9	0.8	0.9	1.1	1.1	1.1	1.1	1.2	1.3	-0.2	0.7	1.0	1.2	0.0	0.0
IOER (Eop)	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0
YCC 10y JGB yields target (Eop)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
US real GDP growth (QoQ annualized)	1.8	3.0	2.8	2.3	2.2	4.2	3.5	2.8	2.4	2.3	2.3	2.1	2.1	2.0	2.5	3.2	2.3	-0.1	0.1
US unemployment rate (%)	4.6	4.3	4.3	4.1	4.1	3.9	3.8	3.8	3.8	3.7	3.7	3.6	3.6	4.9	4.3	3.9	3.7	0.0	0.0
US core CPI (YoY)	2.2	1.8	1.7	1.8	1.9	2.2	2.2	2.1	2.3	2.3	2.2	2.2	2.2	2.2	1.9	2.1	2.3	-0.1	0.0
Fed rate (Eop)	0.875	1.125	1.125	1.375	1.625	1.875	2.125	2.375	2.375	2.625	2.875	3.125	3.125	0.625	1.375	2.375	3.125	0.00	0.00

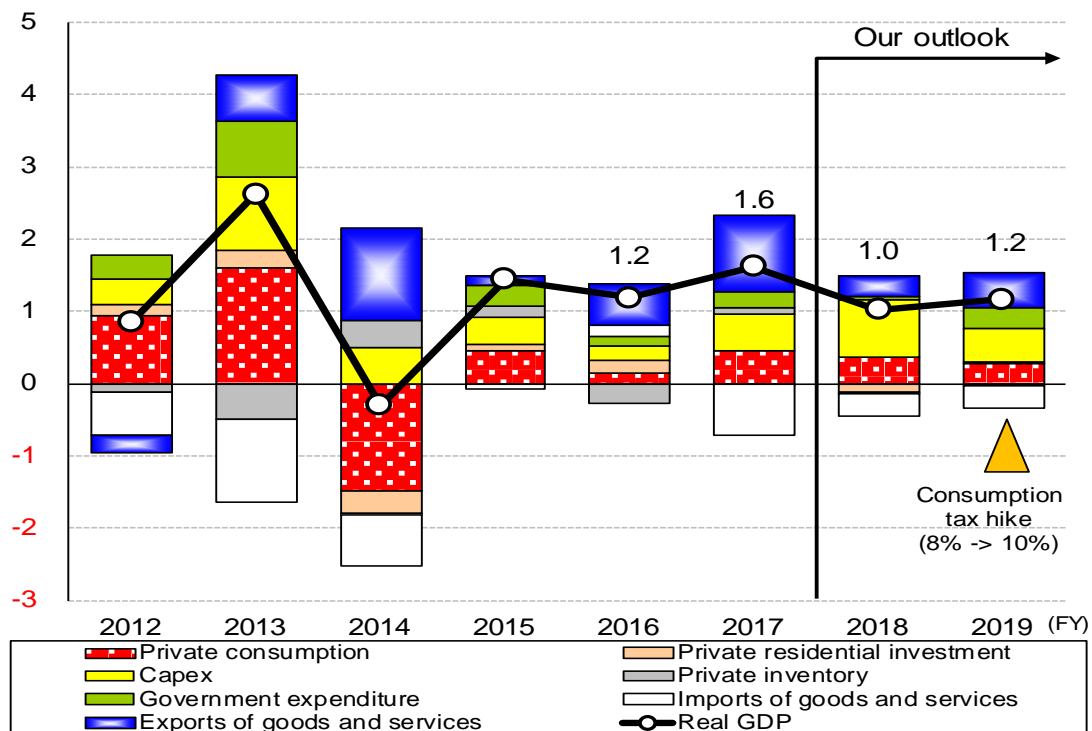
Assumptions: Forex rate (annual mean): Y112.9/USD in FY18, Y117.4/USD in FY19; Crude oil price (WTI annual mean): \$66.4/bbl in FY18 and \$65.0/bbl in FY19.

Notes: 1) US GDP on a calendar basis, US unemployment rate is the average for the period, and FF rate at end of year. 2) Actual figures from Cabinet Office, MIC, METI, BOJ. Forecasts by SMBC NIKKO.

Sources: Cabinet office (CAO); Ministry of Economy, Trade and Industry (METI); Ministry of Internal Affairs and Communications (MIC); Bank of Japan (BOJ); SMBC NIKKO estimates

Outlook for Real GDP growth

(YoY % chg, contribution, ppt)



Source: CAO, SMBC NIKKO forecast

APPENDIX

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NR: Not Rated

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