

【NEWS RELEASE】

February 17, 2023
SMBC Nikko Securities Inc.

Quarterly Economic Outlook for FY2022-2023

February 17, 2023(JST), “SMBC NIKKO Japan Economic Outlook for FY2022-2023” has been released, responding to the first preliminary of GDP (October-December 2022 period)

Recovery as Consumption Normalizes, Terms of Trade Improve

- ◆ Real GDP: FY22 +1.4%, FY23 +2.0%
- ◆ Nominal GDP: FY22 +1.4%, FY23 +2.6%

Summary• **GDP growth outlook**

We revise our outlook to reflect the first preliminary Oct-Dec 2022 GDP data. We forecast real GDP growth of 1.4% YoY in FY22 and 2.0% in FY23. Compared to our previous outlook (8 Dec), we cut our FY22 and FY23 forecasts by 0.2ppt each to reflect our reduced capex and public investment assumptions in light of Oct-Dec GDP.

• **Economic outlook**

We forecast a solid recovery in the Japanese economy towards 2024 for five reasons.

Normalized consumption: Households are no longer fazed by the number of CV19 infections and recognize the limited danger of the virus, including the low fatality rate, so are loosening their purse-strings at last. The fatality rate of CV19 is currently around 0.04%, less than half that of influenza, so the real risk is low. We expect consumption to continue recovering as CV19 becomes less virulent.

Strong purchasing power: Households have held off on spending and increased savings during the pandemic, so purchasing power has reached around Y360tn, or around Y70tn higher than consumption, i.e. there is no need for households to reduce consumption. Households have sufficient purchasing power, so we do not expect income constraints to curb consumption.

Containing inflation: 75% of inflation in Japan comes from energy and food prices. International commodity prices are key, and crude oil and grain prices have already peaked out due to the Fed's QT policy. We expect domestic inflation to slow sharply toward 2024 as commodity prices fall.

Wage growth: The previous year's inflation rate is referenced in the spring labor negotiations. We estimate inflation of around 3% in FY22, which should boost base salary hikes. We forecast wage hikes (scheduled salary escalator + base salary hikes) of around 3.3%; we expect real wages to rise as inflation slows.

Better terms of trade: We expect the terms of trade to improve as QT (quantitative tightening) by the Fed pushes down resource prices. Terms of trade could improve by up to around Y22tn. This should stem the outflow of income overseas and boost domestic incomes.

All told, we expect a solid recovery in the Japanese economy toward 2024 boosted by both domestic factors (weaker CV19 virulence, high purchasing power, subsiding inflation, rising wages) and overseas factors (improved terms of trade).

• **The BOJ's monetary policy**

Change in monetary policy: Kazuo Ueda has been nominated as the next BOJ governor; he has said that the 2% inflation target is still a long way off, the BOJ's current policy looks appropriate, and it needs to continue monetary easing. This suggests that monetary policy is unlikely to change any time soon.

YCC adjustment: Ueda said that the BOJ makes theoretical judgments on policy, but adjusting YCC will in theory requires breaking out of the liquidity trap. The current situation requires a recalculation of the equilibrium real interest rate via a comprehensive assessment, so a change in policy looks unlikely until after that.

Once achievement of the 2% inflation target comes into view, we see four options for future changes in monetary policy: 1) scrapping YCC; 2) hiking interest rates (hike IOER, L/T rate targets); 3) widening the range of long-term rate swings; and 4) proposing a dot plot. While a rate hike as early as FY25 is possible, until then we expect the BOJ to gradually normalize interest rates while keeping real interest rates in negative territory (ie, keeping easing policy accommodative) by expanding the tolerated range for long-term rates or proposing a dot plot.

Quarterly forecasts for Japanese economy

| | 《Actual》←→《Forecasts》 | | | | | | | | | | | | 《A》←→《F》 (Unit:%) | | | Comparison with previous forecasts (as at 8 Dec 2022) | | |
|-------------------------------------|-----------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------------------|-------|-------|---|------|------|
| | 2021 | | | | 2022 | | | | 2023 | | | | 2024 | FY21 | FY22 | FY23 | FY22 | FY23 |
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | | | | | |
| Real GDP growth (QoQ) | -0.1 | 0.3 | -0.3 | 1.1 | -0.4 | 1.1 | -0.3 | 0.2 | 0.8 | 0.6 | 0.5 | 0.5 | 0.4 | 2.6 | 1.4 | 2.0 | -0.2 | -0.2 |
| (annual rate) | -0.5 | 1.3 | -1.4 | 4.4 | -1.7 | 4.6 | -1.0 | 0.6 | 3.2 | 2.4 | 2.2 | 2.1 | 1.7 | 2.1 | 1.1 | 1.9 | -0.1 | -0.3 |
| (Calendar year base) | | | | | | | | | | | | | | | | | | |
| Domestic demand, contribution (QoQ) | -0.2 | 0.5 | -0.5 | 1.0 | 0.1 | 1.0 | 0.4 | -0.2 | 0.7 | 0.6 | 0.6 | 0.5 | 0.4 | 1.8 | 1.9 | 1.9 | -0.2 | -0.4 |
| Private consumption (QoQ) | -1.6 | 0.2 | -1.1 | 3.0 | -0.9 | 1.6 | 0.0 | 0.5 | 0.5 | 0.6 | 0.6 | 0.4 | 0.4 | 1.5 | 2.5 | 2.0 | 0.0 | 0.1 |
| Capex (QoQ) | 1.5 | 1.5 | -1.6 | -1.3 | -1.7 | -1.9 | -0.4 | -0.1 | 0.0 | 0.5 | 0.7 | 0.7 | 0.7 | -1.1 | -4.5 | 1.4 | 0.1 | 0.0 |
| Residential investment (QoQ) | 1.5 | 1.4 | -1.7 | 0.6 | -0.3 | 2.1 | 1.5 | -0.5 | 1.0 | 1.0 | 1.0 | 1.0 | 0.5 | 2.1 | 3.0 | 3.3 | -1.0 | -1.9 |
| Public investment (QoQ) | 0.1 | -2.0 | -3.4 | -3.2 | -3.2 | 0.5 | 0.7 | -0.5 | 0.8 | 0.8 | 1.3 | 1.3 | 1.0 | -6.4 | -3.5 | 3.2 | -0.9 | -0.8 |
| Foreign demand, contribution (QoQ) | 0.1 | -0.2 | 0.2 | 0.0 | -0.5 | 0.1 | -0.6 | 0.3 | 0.1 | 0.0 | -0.1 | 0.0 | 0.0 | 0.7 | -0.5 | -0.1 | -0.1 | 0.3 |
| Exports (QoQ) | 2.5 | 3.1 | -0.4 | 0.4 | 1.2 | 1.5 | 2.5 | 1.4 | 0.5 | 0.3 | -0.1 | 0.5 | 0.5 | 12.3 | 5.3 | 2.3 | 1.0 | 1.7 |
| Imports (QoQ) | 2.1 | 4.4 | -1.5 | 0.3 | 3.8 | 0.9 | 5.5 | -0.4 | -0.5 | 0.2 | 0.3 | 0.4 | 0.4 | 7.0 | 7.5 | 1.5 | 1.3 | 0.4 |
| Nominal GDP growth (QoQ) | 0.0 | 0.4 | -0.5 | 0.7 | 0.2 | 1.0 | -0.8 | 1.3 | -0.3 | 1.0 | 0.9 | 0.8 | 0.9 | 2.4 | 1.4 | 2.6 | 0.1 | -0.8 |
| Industrial production (YoY) | -1.8 | 18.4 | 6.6 | 1.1 | -0.6 | -3.6 | 4.0 | 0.6 | 0.9 | 3.7 | -0.6 | 3.5 | 4.1 | 5.9 | 0.5 | 2.6 | -2.4 | -2.3 |
| Trade balance (Y tn, SAAR) | 3.0 | -0.4 | -3.5 | -6.1 | -11.4 | -21.4 | -25.7 | -23.5 | -21.0 | -18.7 | -15.9 | -12.4 | -8.9 | -5.4 | -22.9 | -14.0 | -2.6 | -4.5 |
| Unemployment rate (%) | 2.9 | 2.9 | 2.8 | 2.7 | 2.7 | 2.6 | 2.6 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.4 | 2.8 | 2.5 | 2.5 | 0.0 | -0.1 |
| Core CPI (YoY) | -0.5 | -0.6 | 0.0 | 0.4 | 0.6 | 2.1 | 2.7 | 3.8 | 3.3 | 2.0 | 1.2 | 1.0 | 1.2 | 0.1 | 3.0 | 1.4 | 0.5 | 0.1 |
| 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 | 0.0 | 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 |
| US real GDP growth (QoQ annualized) | 6.3 | 7.0 | 2.7 | 7.0 | -1.6 | -0.6 | 3.2 | 2.9 | -1.0 | -0.5 | 0.0 | 1.0 | 1.5 | 5.9 | 2.1 | 0.6 | 0.2 | 0.4 |
| US unemployment rate (%) | 6.2 | 5.9 | 5.1 | 4.2 | 3.8 | 3.6 | 3.5 | 3.6 | 3.8 | 4.0 | 4.2 | 4.3 | 4.2 | 5.4 | 3.6 | 4.1 | 0.0 | 0.0 |
| US core CPI (YoY) | 1.4 | 3.7 | 4.1 | 5.0 | 6.3 | 6.0 | 6.3 | 6.0 | 4.7 | 4.5 | 4.4 | 4.3 | 3.8 | 3.6 | 6.2 | 4.5 | 0.3 | 0.1 |
| Fed rate (Eop) | 0.125 | 0.125 | 0.125 | 0.125 | 0.375 | 1.625 | 3.125 | 4.375 | 4.875 | 5.125 | 5.125 | 5.125 | 5.125 | 0.125 | 4.375 | 5.125 | 0.0 | 0.00 |

Assumptions:

Forex rate (annual mean): Y135/\$ in FY22 and Y130/\$ in FY23; Crude oil price (WTI annual mean): \$84/bbl in FY22 and \$67/bbl in FY23.

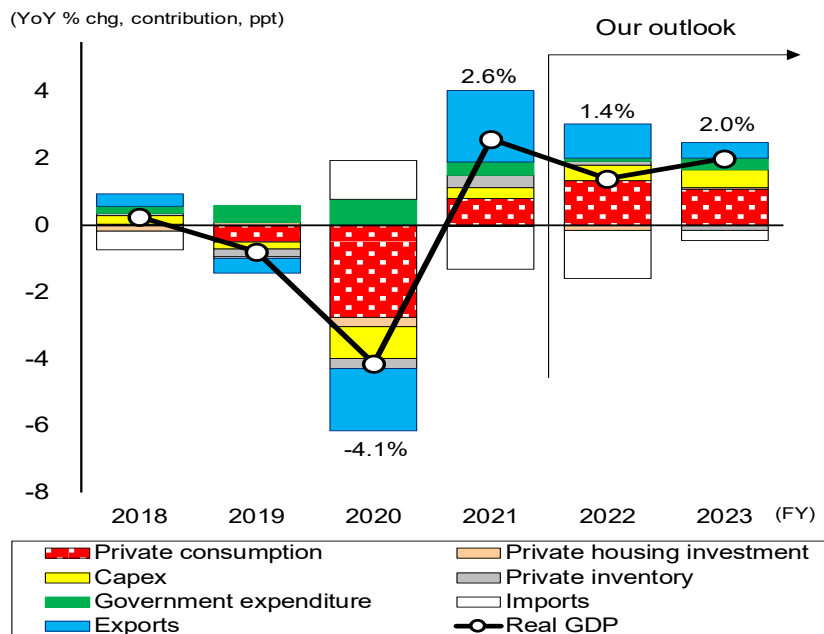
Notes: 1) US GDP on a calendar basis, US unemployment rate is the average for the period, FF rate is at end of year

2) Actual figures from Cabinet Office (CAO), Ministry of Internal Affairs and Communications (MIC),

Ministry of Economy, Trade and Industry (METI), and Bank of Japan (BOJ). Estimates are SMBC NIKKO estimates.

Sources: CAO, MIC, METI, BOJ, SMBC NIKKO estimates

Outlook for real GDP growth



Sources: CAO, SMBC NIKKO estimates

APPENDIX

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