

## 【NEWS RELEASE】

December 10, 2018  
SMBC Nikko Securities Inc.

**Quarterly Economy Outlook for FY 2018-2019 (Update)**

December 10, 2018 (JST), “SMBC NIKKO Japan Economic Outlook for FY 2018-2019” has been released, responding to the Second preliminary of GDP (July-September 2018 period).

**Will economy accelerate in FY19 despite consumption tax hike?**

- ◆ Real GDP: +0.6% in FY18 and +1.2% in FY19
- ◆ Nominal GDP: +0.5% in FY18 and +2.2% in FY19

**Summary**• **GDP growth outlook**

We revise our economic outlook in light of the second preliminary estimates for Jul-Sep 2018 GDP. We forecast real GDP growth of +0.6% YoY in FY18 and +1.2% in FY19, a downward revision of 0.4ppt versus our previous outlook for FY18. This reflects the decline in capex in Jul-Sep. We think the decline in capex is a temporary factor that mainly reflects natural disaster impact and tough comps with Apr-Jun for some sectors, so we do not expect it will impact the economy in FY19.

• **Domestic economy is solid**

Domestic demand in the Japanese economy is strong. Private consumption is recovering on roughly 3% growth in employee income, which accounts for 85% of disposable income. Capex is also sustainable since the ratio of capital stock to GDP is at the lowest level in 20 years. Still, while core CPI has reached 1%, we expect it will slow in 2019 due to declining crude oil prices and cuts to telecom fees.

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 the latter half of 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 over an economic slowdown will 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. If the current account balance does not worsen, interest rates should not rise, 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

	《Actual》←→《Forecasts》																《A》←→《F》 (Unit:%)				Comparison with previous forecasts (as at 11 Nov 2018)	
	2017				2018				2019				2020	FY16	FY17	FY18	FY19	FY18	FY19			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q									
Real GDP growth (QoQ)	0.8	0.5	0.7	0.4	-0.3	0.7	-0.6	0.7	0.4	0.4	0.6	-0.3	0.3									
(annual rate)	3.3	2.1	2.7	1.5	-1.3	2.8	-2.5	2.9	1.7	1.5	2.3	-1.3	1.0	1.2	1.6	0.6	1.2	-0.4	0.0			
Domestic demand, contribution (QoQ)	0.7	0.8	0.1	0.5	-0.4	0.8	-0.5	0.5	0.5	0.4	0.8	-1.0	0.3	0.4	1.2	0.6	1.2	-0.4	0.0			
Private consumption (QoQ)	0.6	1.0	-0.8	0.4	-0.3	0.7	-0.2	0.3	0.2	0.1	1.0	-2.0	0.2	0.3	0.8	0.4	0.5	-0.3	0.0			
Capex (QoQ)	1.3	0.9	1.7	1.1	0.4	2.8	-2.8	2.0	0.8	1.0	1.0	0.5	0.5	1.2	3.1	2.2	3.0	-2.7	0.2			
Residential investment (QoQ)	0.4	1.9	-1.8	-3.3	-2.1	-1.9	0.7	1.0	4.0	2.0	-4.0	-3.0	-1.0	6.2	-0.3	-3.8	0.8	-0.2	0.0			
Public investment (QoQ)	0.5	3.3	-2.3	-0.6	-0.5	-0.5	-2.0	3.0	0.0	1.0	1.5	0.2	0.2	0.9	1.5	-2.6	3.6	-1.3	-0.1			
Foreign demand, contribution (QoQ)	0.1	-0.3	0.6	-0.1	0.1	-0.1	-0.1	0.2	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	1.8	0.8	0.8	0.8	0.8	0.8	3.6	6.3	2.3	3.4	0.7	0.6			
Imports (QoQ)	1.3	1.7	-1.0	3.1	0.2	1.0	-1.4	0.5	1.0	1.2	2.0	-3.0	1.0	-0.8	4.1	1.8	1.7	0.1	0.0			
Nominal GDP growth (QoQ)	0.3	0.7	1.0	0.5	-0.6	0.5	-0.7	1.5	-0.1	1.3	0.1	1.0	-0.3	1.0	1.7	0.5	2.2	-0.3	0.3			
Industrial production (QoQ)	3.9	5.6	4.4	4.1	2.5	2.0	-0.2	0.2	2.1	1.8	5.6	1.5	2.0	1.5	4.1	1.0	2.7	-0.3	0.5			
Trade balance (Y tn, SAAR)	4.6	3.3	7.9	6.9	4.0	2.8	0.5	1.8	6.3	6.6	5.6	9.9	10.0	4.9	5.5	2.8	8.0	0.5	1.1			
Unemployment rate (%)	2.9	2.9	2.8	2.7	2.5	2.4	2.4	2.4	2.4	2.3	2.3	2.2	2.2	3.0	2.7	2.4	2.3	0.1	0.1			
Core CPI (YoY)	0.2	0.4	0.6	0.9	0.9	0.8	0.9	0.8	0.6	0.3	0.2	1.1	1.3	-0.2	0.7	0.8	0.7	-0.2	-1.0			
(Ex effects of consumption tax hike)	0.2	0.4	0.6	0.9	0.9	0.8	0.9	0.8	0.6	0.3	0.2	0.1	0.3	-0.2	0.7	0.8	0.2	-0.2	-0.9			
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	3.1	3.0	2.8	2.5	2.3	2.1	2.0	2.5	3.3	2.7	0.1	0.4			
US unemployment rate (%)	4.6	4.3	4.3	4.1	4.1	3.9	3.8	3.7	3.6	3.6	3.6	3.6	3.6	4.9	4.3	3.9	3.6	0.0	-0.1			
US core CPI (YoY)	2.2	1.8	1.7	1.8	1.9	2.2	2.2	2.1	2.1	2.0	2.0	2.0	2.0	2.2	1.9	2.1	2.0	0.0	-0.3			
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			

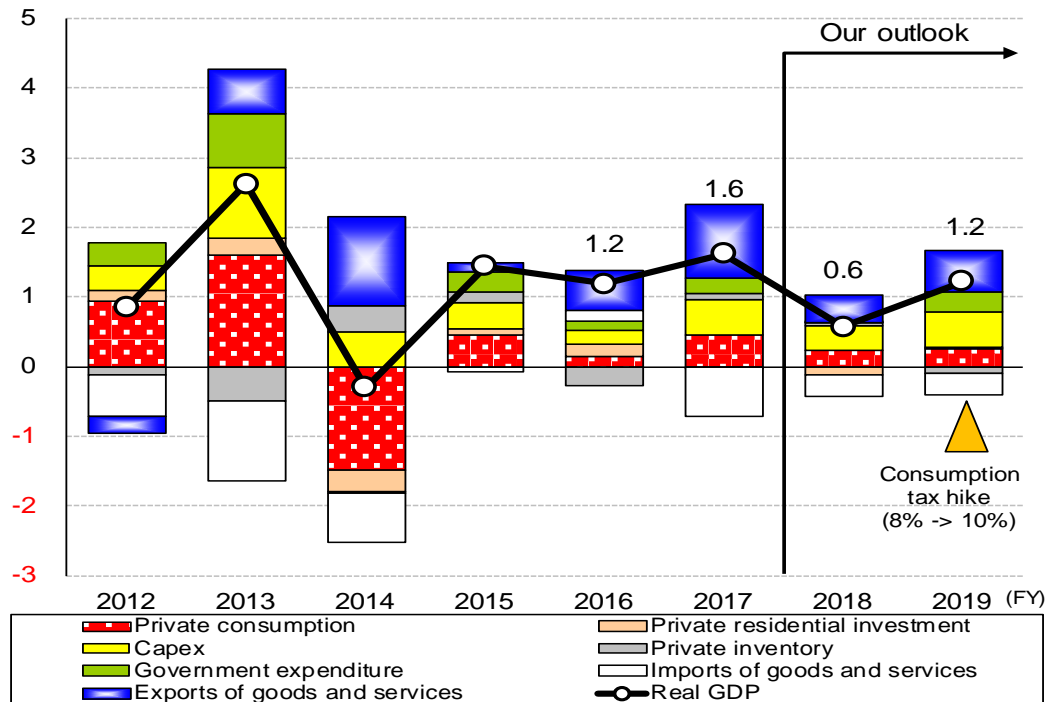
Assumptions: Forex rate (annual mean): Y111.9/USD in FY18, Y117.5/USD in FY19; Crude oil price (WTI annual mean): \$68.4/bbl in FY18 and \$60.2/bbl in FY19.

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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