

【NEWS RELEASE】

February 20, 2020
SMBC Nikko Securities Inc.

Quarterly Economy Outlook for FY 2019-2021

February 20, 2020 (JST), “SMBC NIKKO Japan Economic Outlook for FY 2019-2021” has been released, responding to the first preliminary of GDP (October-December 2019 period).

Some Coronavirus Caution, but Recovery Nevertheless

- ◆ Real GDP: FY19 +0.5%, FY20 +0.7%, FY21 +1.1%
- ◆ Nominal GDP: FY19 +0.9%, FY20 +0.8%, FY21 +1.6%

Summary• **GDP growth outlook**

We revise our outlook to reflect the first preliminary Oct-Dec 2019 GDP data. We also add FY21 to our forecast horizon. We forecast real GDP growth of +0.5% YoY in FY19, +0.7% in FY20, and +1.1% in FY21, downward revisions of 0.4ppt vs our previous FY19 and FY20 estimates (9 Dec) to factor in weaker demand given the major typhoon in Oct-Dec last year.

• **Current state of the economy**

On an annualized basis, Oct-Dec 2019 real GDP growth was down 6.3% QoQ, an unexpectedly steep drop despite the small demand rush ahead of the hike in consumption tax in October 2019.

The same goes for industrial output, which slumped 15.2% in Oct-Dec. However, there was a large typhoon in October and production plans suggest recovery to pre-slump levels in two months' time as damages are quickly repaired. We expect both private consumption and capex to recover in a similar fashion. All told, we believe the impact from the tax hike this time around was a small one.

- **Outlook for the economy**

The coronavirus requires some caution, but we think Japan's economy is in general recovery nevertheless.

Coronavirus impact: China's recent ban on overseas group tours should only dent Japan's GDP by roughly 0.05%, while lower demand in China itself is unlikely to hurt Japan's exports by much. Rather than domestic demand in China, Japan's exports to China are more correlated with China's exports to the world. Hubei Province (capital Wuhan) is inland and only accounts for 1.4% of China's exports, so is unlikely to impact Japan's exports by much. Even if Chinese exports did slump, coronavirus infections are already in decline, so the drag would likely be short-lived. We would expect pent-up demand to strengthen exports through the latter half of the year.

Domestic sentiment after the consumption tax increase: Consumption tax increases have never caused a recession in Japan. That is because the rise and fall in demand before and after the hike usually involves imported daily goods, apparel, home appliances, and brand goods, which have no relation to domestic production. Private consumption could stagnate if higher prices due to the tax hike reduce purchasing power, but prices only rose about 0.6% this time and rising nominal incomes should prevent real incomes from falling. Thus, private consumption is unlikely to collapse because of the recent tax hike.

Domestic economy after the Olympics: We expect the economy to continue recovering after the Olympics as recession is highly unlikely in Goldilocks conditions, where the reduced investment cycle effectively renders the business cycle non-existent. We also expect government spending on infrastructure (resilience against natural disasters etc), a tighter labor market, and steady capex growth. An adjustment phase after the Olympics is unlikely in our view.

- **Risks**

Monetary policy by the BOJ is a risk factor. The BOJ has reduced purchases of JGBs to Y16tn (annualized) and if that pace continues, the BOJ might end up not purchasing any JGBs by about October this year. The BOJ has continued this "stealth taper" vs its annual purchase target of Y80tn, but a clear explanation would be needed if it were to reduce purchases to zero. If it did in fact terminate QE, observers might start expecting a rate hike and test the upper bound of the long-term interest rate target (roughly 0.2%) indicated by Governor Kuroda in 2018.

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Quarterly forecasts for Japanese economy

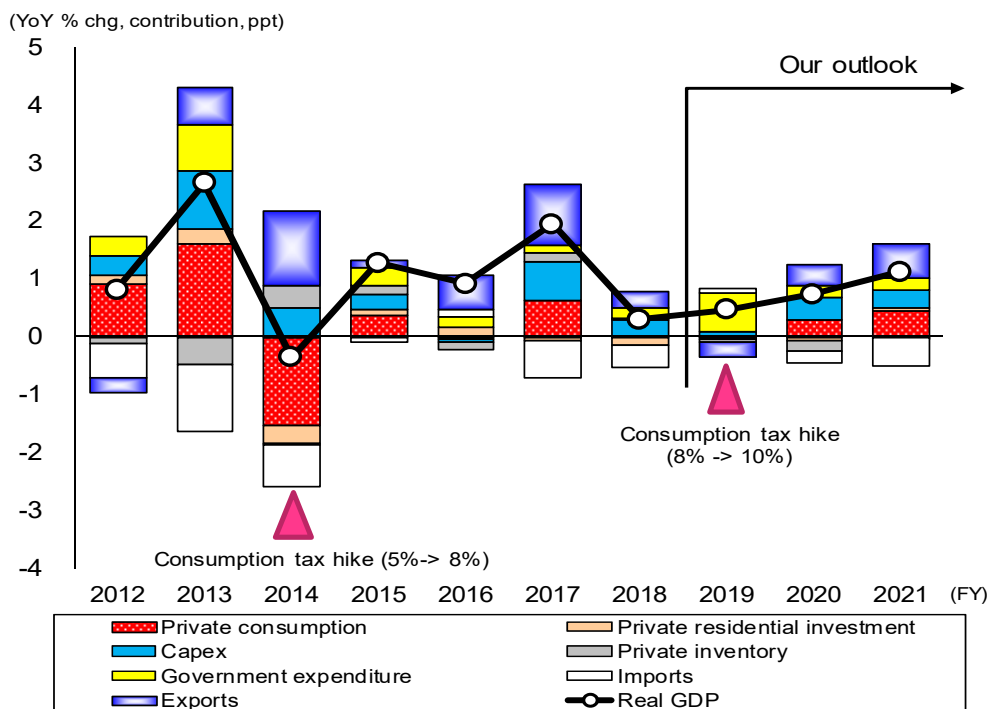
	(Actual) → (Forecasts)												(A) → (F) (Unit:%)				Comparison with previous forecasts (as at 9 Dec 2019)					
	2019				2020				2021				2022									
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			FY18	FY19	FY20	FY21
Real GDP growth (QoQ)	0.6	0.5	0.1	-1.6	0.5	0.5	0.6	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.5	0.7	1.1	-0.4	-0.4
(annual rate)	2.6	1.9	0.5	-6.3	2.1	2.2	2.3	0.7	1.1	1.1	1.1	1.1	1.0	1.0	1.0	1.0	0.3	0.5	0.7	1.1	-0.4	-0.4
Domestic demand, contribution (QoQ)	0.2	0.8	0.4	-2.1	0.6	0.5	0.5	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.2	-0.2	0.0	-0.7	-1.3
Private consumption (QoQ)	0.0	0.6	0.5	-2.9	1.2	0.5	0.6	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	-0.1	0.5	0.8	-0.8	-0.2
Capex (QoQ)	1.5	-0.2	1.2	-2.7	-1.5	-0.5	0.0	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	-4.9	0.9	-2.3	1.9	-0.6	-0.3
Residential investment (QoQ)	-0.5	0.8	0.5	-3.7	2.0	1.5	0.9	0.8	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	1.7	0.4	2.4	1.9	-1.7	0.9
Public investment (QoQ)	2.1	1.8	1.2	1.1	2.4	0.0	1.2	-1.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	0.6	3.5	0.1	1.0	0.2	-6.4
Foreign demand, contribution (QoQ)	0.5	-0.3	-0.3	0.5	-0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	-0.2	0.2	0.0	-0.2	0.2
Exports (QoQ)	-1.9	0.4	-0.7	-0.1	-0.5	1.0	1.5	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	1.6	-1.5	2.1	3.4	0.0	0.2
Imports (QoQ)	-4.3	2.0	0.7	-2.6	0.0	1.0	1.0	1.0	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	2.2	-0.5	1.3	2.8	-1.3	-0.2
Nominal GDP growth (QoQ)	1.2	0.5	0.5	-1.2	-0.6	0.8	0.8	0.5	0.2	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.1	0.9	0.8	1.6	-0.3	-0.5
Industrial production (QoQ)	-2.5	0.7	-0.5	-4.0	3.0	1.0	0.5	0.5	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	0.2	-2.5	1.9	0.6	-1.6	0.2
Trade balance (Y tn, SAAR)	-1.7	-2.6	-1.3	2.9	0.4	0.4	1.9	2.2	3.3	3.2	3.2	3.6	4.1	4.1	4.1	4.1	-1.5	-0.1	1.9	3.5	1.8	2.7
Unemployment rate (%)	2.4	2.4	2.3	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.4	2.3	2.2	2.2	-0.1	-0.1
Core CPI (YoY)	0.8	0.8	0.5	0.6	0.6	0.4	0.5	0.5	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.8	0.6	0.5	0.7	0.1	0.0
(Ex effects of consumption tax hike)	0.8	0.8	0.5	-0.4	-0.4	-0.6	-0.5	0.5	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.8	0.1	0.0	0.7	0.1	-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	-0.1	-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	0.0	0.0	0.0
US real GDP growth (QoQ annualized)	3.1	2.0	2.1	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.7	2.1	2.0	2.0	0.0	-0.1
US unemployment rate (%)	3.9	3.6	3.6	3.5	3.5	3.5	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.9	3.5	3.4	3.4	-0.1	0.0
US core CPI (YoY)	2.1	2.1	2.3	2.3	2.2	2.3	2.3	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.3	2.2	0.0	0.0
Fed rate (Eop)	2.375	2.375	1.875	1.625	1.625	1.625	1.625	1.625	1.875	1.875	2.125	2.125	2.125	2.125	2.125	2.125	2.375	1.625	1.875	2.125	0.00	0.00

Assumptions: Forex rate (annual mean): Y109.0/\$ in FY19, Y113.3/\$ in FY20 and Y115.0/\$ in FY21; Crude oil price (WTI annual mean): \$56.40/bbl in FY19, \$56.40/bbl in FY20 and \$58.40/bbl in FY21.

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 (CAO), MIC, METI, BOJ. Forecasts by SMBC NIKKO.

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

Outlook for real GDP growth



Sources: CAO, SMBC NIKKO forecasts

APPENDIX

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