

【NEWS RELEASE】

March 10, 2020
SMBC Nikko Securities Inc.

Quarterly Economy Outlook for FY 2019-2021 (Update)

March 10, 2020 (JST), “SMBC NIKKO Japan Economic Outlook for FY 2019-2021” has been released, responding to the second preliminary of GDP (October-December 2019 period).

Coronavirus to Inflict Short-term Economic Squeeze

- ◆ Real GDP: -0.2% in FY19, +0.2% in FY20, +1.4% in FY21
- ◆ Nominal GDP: +0.3% in FY19, +0.3% in FY20, +1.9% in FY21


Summary**• GDP growth outlook**

We revise our economic outlook to reflect Japan’s Oct-Dec GDP (second preliminary). We now forecast real GDP growth rates of -0.2% YoY in FY19, +0.2% in FY20, and +1.4% in FY21. Compared to our previous forecast (20 Feb), we cut our outlook for FY19 and FY20 by 0.7ppt and 0.5ppt, respectively, but raise it 0.3ppt for FY21. Our FY19-20 outlook factors in anemic demand from a major typhoon and weakening demand brought on by the coronavirus. We anticipate a recovery from these negatives in FY21.

• Economic overview

Real GDP in Oct-Dec 2019 fell 7.1% YoY. Consumer spending, which was boosted only slightly on frontloaded demand prior to the consumption tax hike, fell sharply and capex also declined even as impact from the tax hike should have been neutral. Industrial production also plummeted around the same time. A major typhoon that slammed Japan in October was behind the weak data.

Industrial production was expected to recover quickly after impact from the typhoon subsided, but the coronavirus outbreak from the start of the year has sapped production’s momentum. Japan’s economy is reeling from a severe correction triggered by the typhoon and the coronavirus.

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- **Economic outlook**

We formulate two scenarios in terms of impact from the coronavirus: A) virus spreads in Japan for three months (Feb-Apr) and B) virus spreads for six months (Feb-Jul) and the Tokyo Olympics/Paralympics are cancelled.

Case A) is our base case and should it unfold we see the virus dragging GDP down by 0.9%. On a quarterly basis growth plummets in Oct-Dec 2019 (typhoon) and Jan-Mar 2020 (coronavirus outbreak) and Japan's economy enters a recession. With economic fundamentals solid, however, we would assume that Japan's economy rebounds quickly as long as the number of coronavirus cases is contained.

Case B) assumes a 1.4% hit to GDP. The freeze on consumption brought on by the spread of the virus delivers an even bigger economic hit than the cancellation of the Olympics. We assume three straight quarters of negative growth starting from Oct-Dec 2019, though we do envision a quick recovery thereafter.

- **Risks**

The biggest risk is likely a credit crunch if the financing environment for SMEs becomes increasingly hostile. Economic deterioration could lead to more bankruptcies among SMEs. In turn, tighter lending stances by banks could trigger an economic crisis brought on by the lack of credit. The most effective measure to combat a credit crunch is for the government to guarantee bank loans. Government-backed guarantees of bank loans would reduce loan risk to zero and thus allow banks to ease their lending stances.

One other risk is yen appreciation. As things stand, the yen is gaining ground owing to economic jitters in the US and expectations for another rate cut. The BoJ must expand its quantitative easing program to prevent the yen from strengthening further. Rates in Japan are effectively at zero, so the yen has become an "interest-free" currency. An increase in the money supply brings down the value of interest-free currency, and we believe the BoJ will need to expand JGB purchases to around at least Y50tn to stave off yen appreciation. If the BoJ also revises forward guidance and allows rates to stand at their current level or even lower it would be equivalent to a rate cut and thus be even more effective.

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Quarterly forecasts for Japanese economy

	(Actual) ← (Forecasts)												(A) ← (F) (Unit:%)				Comparison with previous forecasts (as at 20 Feb 2019)				
	2019				2020				2021				2022	FY18	FY19	FY20	FY21	FY19	FY20	FY21	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q								
Real GDP growth (QoQ)	0.5	0.6	0.0	-1.8	-1.5	0.7	1.5	0.7	0.5	0.2	0.1	0.1	0.1								
(annual rate)	2.2	2.3	0.1	-7.1	-5.8	2.7	6.1	2.9	1.8	0.7	0.5	0.4	0.4	0.3	-0.2	0.2	1.4		-0.7	-0.5	0.3
Domestic demand, contribution (QoQ)	0.1	0.8	0.3	-2.3	-1.4	0.3	1.0	0.5	0.4	0.2	0.2	0.2	0.2	0.1	0.2	-1.0	0.0		0.0	-0.8	0.0
Private consumption (QoQ)	0.0	0.6	0.5	-2.8	-1.9	0.5	1.5	0.5	0.4	0.1	0.1	0.1	0.2	0.1	-0.8	-0.8	1.2		-0.7	-1.3	0.4
Capex (QoQ)	1.5	-0.2	1.2	-2.5	-1.5	-0.5	0.0	0.5	0.5	0.5	0.5	0.5	0.5	-4.9	1.0	-2.2	1.9		0.1	0.1	0.0
Residential investment (QoQ)	-0.4	0.8	0.2	-4.6	-1.0	0.0	0.9	0.8	0.4	0.4	0.4	0.4	0.4	1.7	-0.9	-1.9	1.9		-1.3	-4.3	0.0
Public investment (QoQ)	2.1	1.7	1.1	0.7	0.0	0.0	1.2	-1.5	2.5	2.5	2.5	2.5	2.5	0.6	3.3	0.3	1.0		-0.2	0.2	0.0
Foreign demand, contribution (QoQ)	0.5	-0.3	-0.3	0.5	-0.1	0.3	0.5	0.3	0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.2	1.0	0.0		0.0	0.8	0.0
Exports (QoQ)	-1.9	0.4	-0.7	-0.1	-2.8	1.0	2.5	1.5	1.4	0.8	0.8	0.8	0.8	1.6	-2.0	1.7	4.5		-0.5	-0.4	1.1
Imports (QoQ)	-4.3	2.0	0.7	-2.7	-2.5	-1.0	-0.5	0.0	1.0	1.0	1.2	1.2	1.5	2.2	-1.1	-4.1	3.6		-0.6	-5.4	0.8
Nominal GDP growth (QoQ)	1.1	0.6	0.4	-1.5	-2.5	1.0	1.7	1.0	0.4	0.3	0.3	0.3	0.2	0.1	0.3	0.3	1.9		-0.6	-0.5	0.3
Industrial production (QoQ)	-2.5	0.7	-0.5	-4.0	0.7	0.5	0.5	1.0	1.0	0.5	0.0	0.0	0.5	0.2	-3.0	-0.1	1.0		-0.5	-2.0	0.4
Trade balance (Y tn, SAAR)	-1.5	-2.6	-1.4	2.9	0.6	2.6	6.5	8.6	10.1	9.7	9.2	9.0	8.6	-1.5	-0.1	6.9	9.1		0.0	5.0	5.6
Unemployment rate (%)	2.5	2.4	2.3	2.3	2.4	2.4	2.4	2.4	2.4	2.4	2.3	2.3	2.3	2.4	2.3	2.4	2.3		0.0	0.2	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	0.8	0.6	0.5	0.7		0.0	0.0	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	0.8	0.1	0.0	0.7		0.0	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	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
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	2.7	2.1	2.0	2.0		0.0	0.0	0.0
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	3.9	3.5	3.4	3.4		0.0	0.0	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	2.3	2.2		0.0	0.0	0.0
Fed rate (Eop)	2.375	2.375	1.875	1.625	1.125	0.875	0.875	0.875	1.125	1.125	1.375	1.375	1.375	2.375	1.125	1.125	1.375		-0.50	-0.80	-0.70

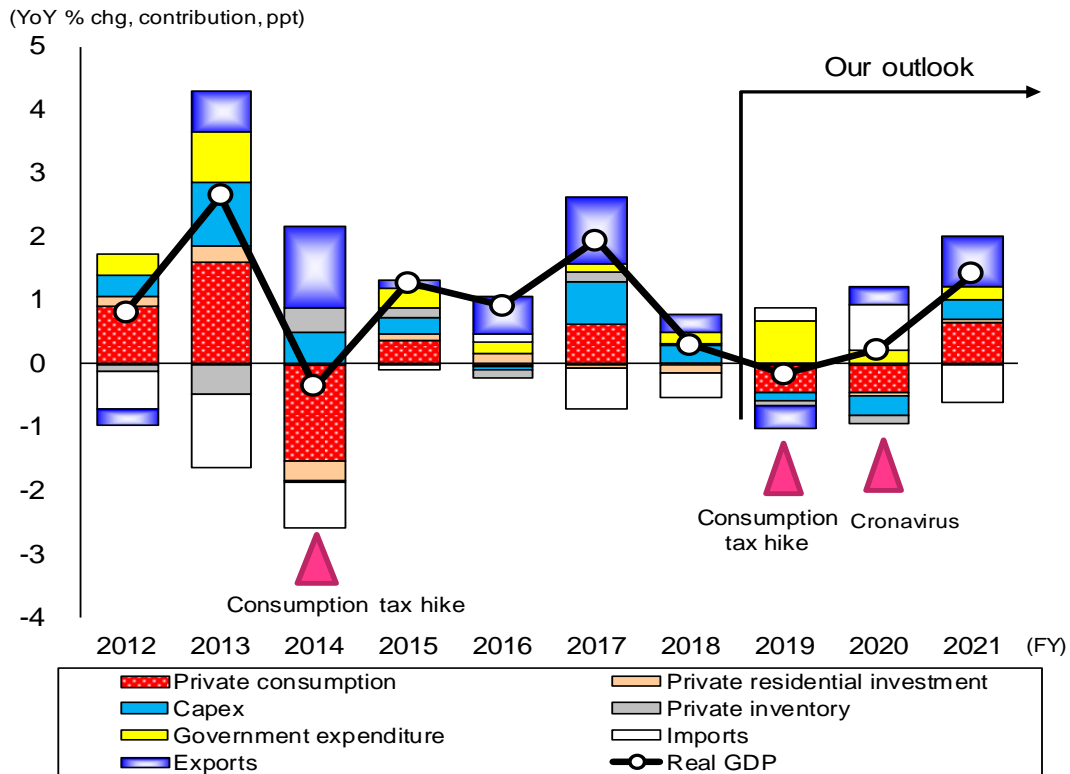
Assumptions: Forex rate (annual mean): Y108.8/\$ in FY19, Y110.0/\$ in FY20 and Y114.0/\$ in FY21;

Crude oil price (WTI annual mean): \$55.7/bbl in FY19, \$48.8/bbl in FY20 and \$50.80/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 CAO, 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 forecasts

Outlook for real GDP growth



Sources: CAO, SMBC NIKKO forecasts

APPENDIX

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