

JAPAN CHART BOOK

22nd Nov. 2011



Activity weak and business sentiment fragile

- GDP growth turned positive in Q3 but monthly data show the economy had stopped and gone into reverse by the end of the quarter. The first flush of data for October shows that conditions have remained difficult and business sentiment is fragile, although consumer confidence continues to recover.
- **Output and activity indicators** show consumer spending, business investment and net exports contributing to GDP growth in Q3. (See Chart of the Month.) On a monthly basis, activity in September was falling across all sectors except construction. (Page 2.)
- **Consumer indicators** show overall retail spending contracting but spending on motor vehicles continuing to rise. Spending on durables increased faster than spending on non-durables during Q3. (Page 3.)
- **Business indicators** show businesses expect the sharp fall in output in September to be reversed before the end of the year, but that sentiment is otherwise fragile. (Page 4.)
- **Labour market indicators** show unemployment falling and employment rising in September, but problems with revisions discourage us from putting too much faith in the latest numbers. (Page 5.)
- **Inflation indicators** show that prices were unchanged in September compared to a year earlier and that inflation is set to fall. (Page 6.)
- **Financial market indicators** show further turmoil in global equity markets resulting from the escalating sovereign debt crisis in the euro-zone. (Page 7.)

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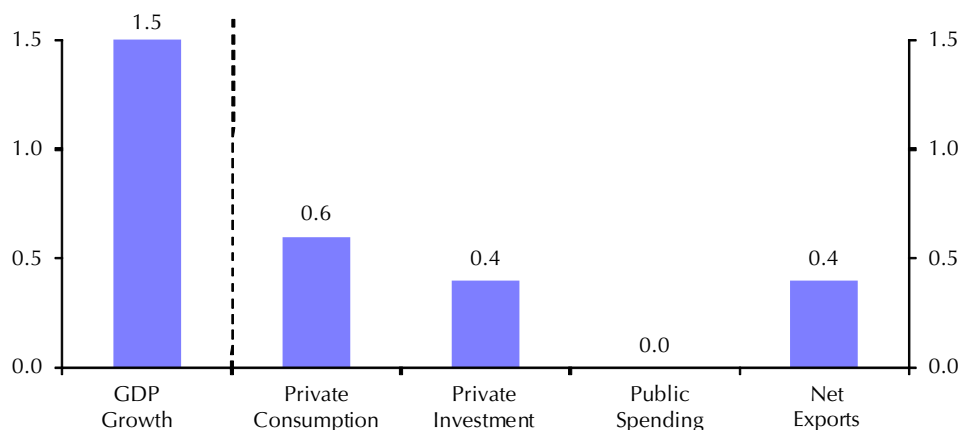
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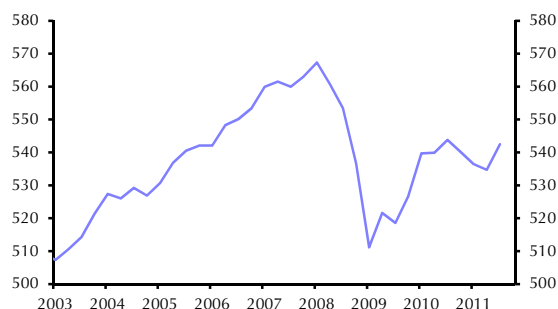
CHART OF THE MONTH: GDP GROWTH & CONTRIBUTIONS TO GROWTH (PERCENTAGE POINTS)



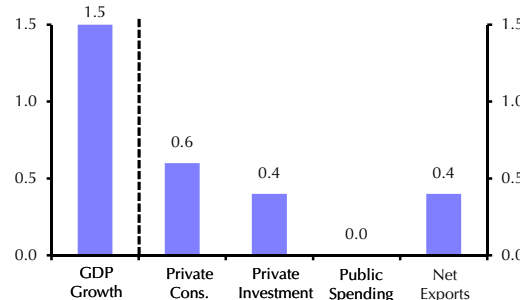
Output and Activity Indicators

- Real GDP increased for the first time in four quarters in Q3, rising by 1.5% q/q (6.0% at an annualised rate). This brought the level of GDP back to within 0.2% of its recent high in Q3 2010, although it remains significantly below its pre-financial crisis peak (1). Private consumption spending and investment both contributed positively to the quarter-on-quarter increase, as did net exports. Public spending was flat compared to the quarter before (2).
- The all industry activity index fell for a second consecutive month in September, dropping by 0.9% m/m. This was due to a fall in the tertiary, industrial and government sectors. Activity in the construction sector, however, continued to rise, climbing 2.2% m/m (3). This improvement was limited to civil engineering and non-housing construction, as housing starts fell sharply back to 64,000 in September from 82,000 in August (4).
- The level of domestic automotive output dropped by 10% m/m in September, but remained high (5). Auto exports and sales both rose, though, reducing inventories of finished goods. Meanwhile, the y/y change in bank lending turned positive in September for the first time in almost two years (6).

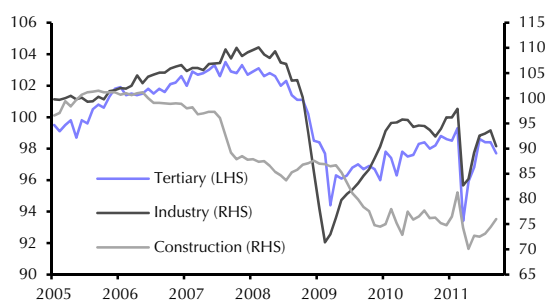
1. Real GDP Level (¥ Trillion)



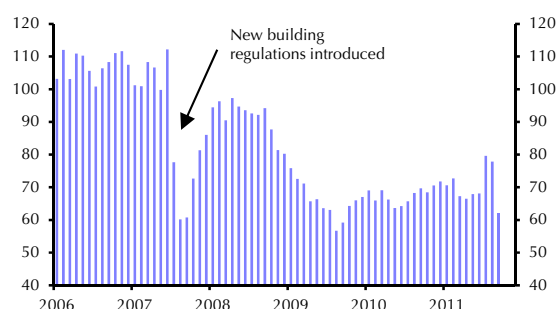
2. Contributions to Q3 GDP Growth (q/q, % points)



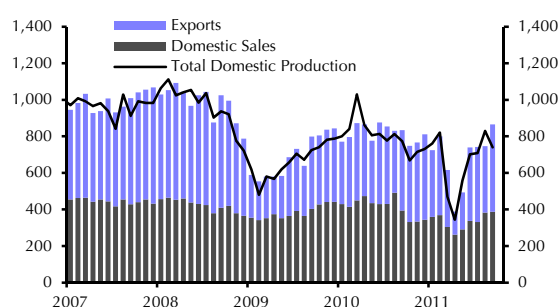
3. All Industry Activity Index (2005 = 100)



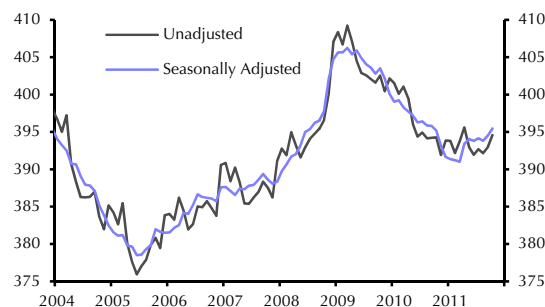
4. Housing Starts (000s)



5. Automotive Industry Output (000s, Seas. Adj.)



6. Outstanding Bank Loans (¥ trillion)

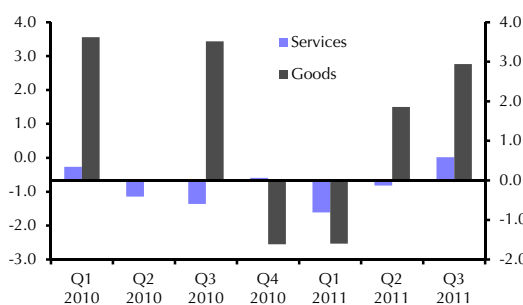


Sources – Thomson Datastream, Capital Economics

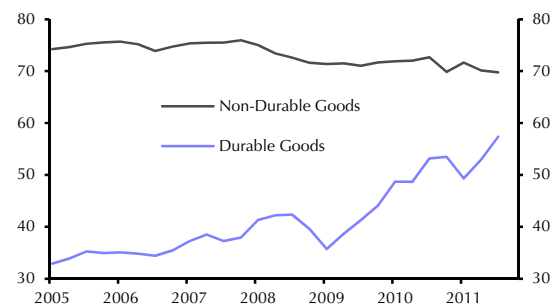
Consumer Indicators

- Final household expenditure on both goods and services increased for the first time in six quarters in Q3, according to the GDP release (1). Spending on services rose by 0.6% q/q in Q3, compared to a rise of 2.9% on goods. Durable goods in particular saw a large rise in spending (2).
- Monthly data, however, showed retail sales ended the quarter on a weak note, contracting by 1.5% m/m in September (3). Consumers reduced their purchases of all categories of expenditure compared to August, except for motor vehicles. In fact, spending on new cars continued to climb in October as well, rising by 7.4% m/m (4).
- Survey-based indicators of consumer activity and sentiment improved in October. The current conditions component of the Economy Watchers Survey edged up with the two-to-three month outlook component unchanged (5). The employment and willingness to buy durable goods components of the consumer confidence survey increased, while the income growth and overall livelihoods components both dropped leaving the headline index unchanged at 38.6 (6).

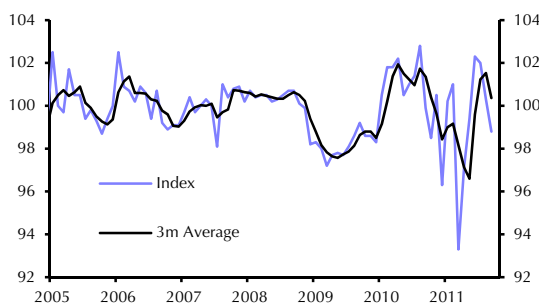
1. Final Household Expenditure, Goods & Services (% q/q)



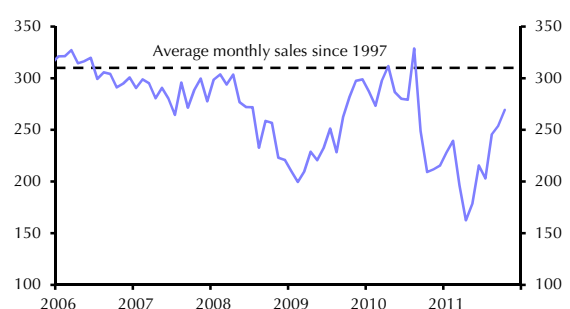
2. Final Consumption Expenditure (¥ Trillion)



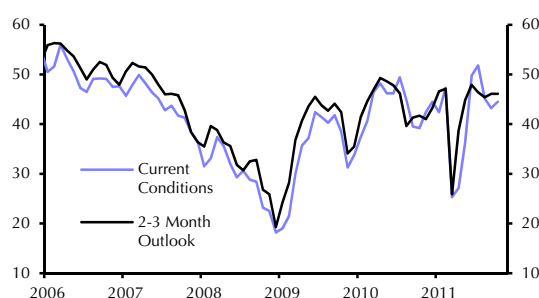
3. Retail Sales Values (2005 = 100)



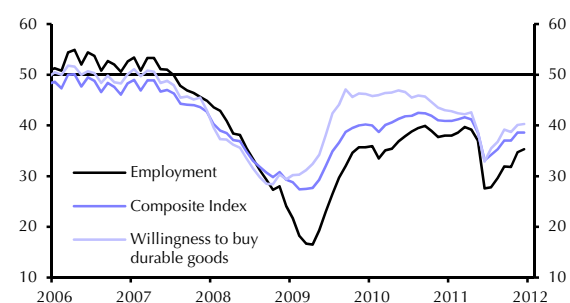
4. Auto Sales (000s, Seasonally Adjusted)



5. Economy Watchers Survey – Household Activity



6. Consumer Confidence – Selected Detail

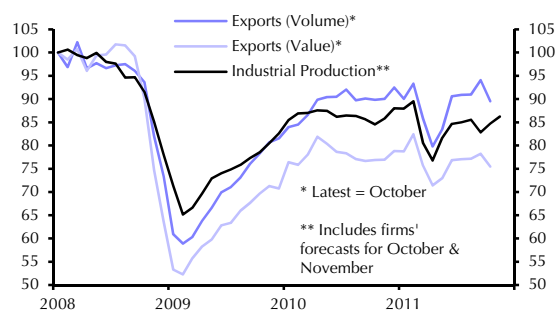


Sources – Thomson Datastream, Capital Economics

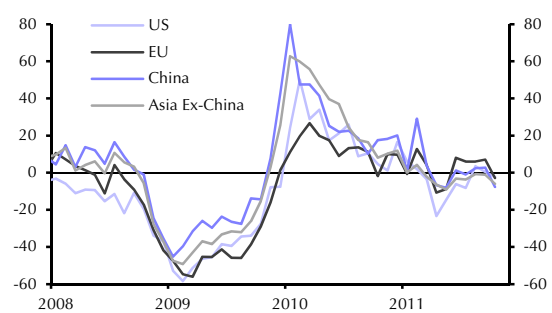
Business Indicators

- Industrial production dropped sharply in September, falling by 3.3% m/m – the first fall since the 15.5% m/m decline in March. However, manufacturers expect a quick turnaround with output predicted to rise by 2.3% and 1.8% m/m in October and November respectively (1). Merchandise export value fell 3.5% m/m in October, in part due to the damage caused by the floods in Thailand. Exports to other destinations also weakened (2).
- The manufacturing and services PMIs both rose in October, suggesting September’s drop in output may indeed prove to be short-lived. The manufacturing PMI increased to 50.6 from 49.3 in September, while the services PMI rose above 50 (to 52.3) for the first time since January (3). The corporate activity component of the EWS provided a less rosy picture of activity in October, with both current and outlook components falling (4).
- SME businesses conditions weakened slightly in October but have been largely unchanged since July (5). The components of the survey showed firms remain uncertain about the outlook (6).

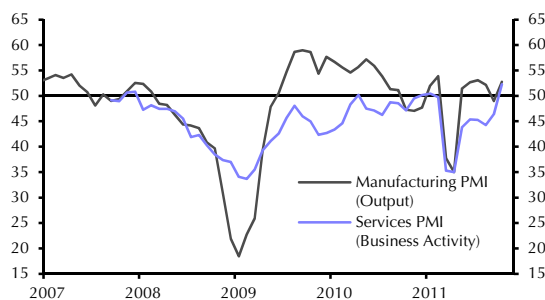
1. Industrial Production & Goods Exports (Jan. 2008 = 100)



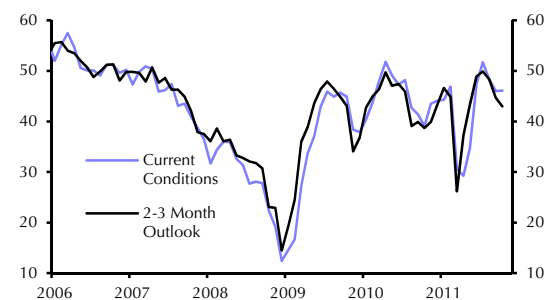
2. Export Values by Destination (% y/y)



3. Manufacturing & Services PMI



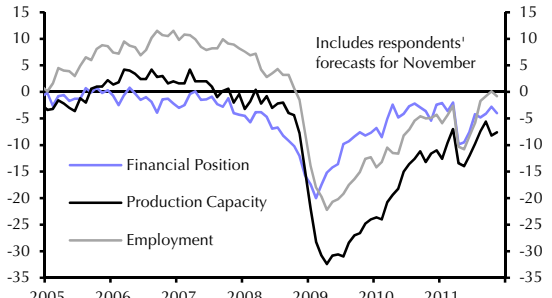
4. Economy Watchers Survey – Corporate Activity



5. SME Business Conditions



6. SME Selected Indicators



Sources – Thomson Datastream, Capital Economics, Markit

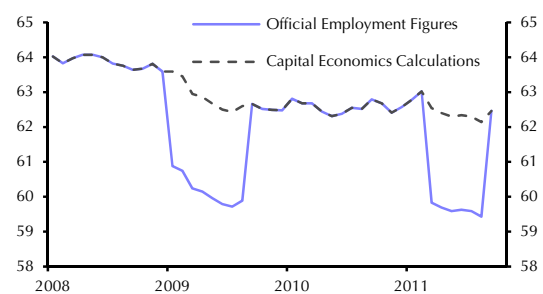
Labour Market Indicators

- The Statistics Bureau reintroduced the three disaster-affected prefectures into the official Labour Market statistics in September, after an absence since March. The unemployment rate dropped from 4.3% to 4.1% in September and the number in employment jumped by 320,000 (1). However, there were several problems with the new and revised figures leading us to believe the current data for September is not wholly reliable and is likely to be subject to significant revisions (2).
- Figures on earnings do not appear to have suffered the same problems, and show that real and nominal cash earnings continued to fall in September (by 1.0% and 0.2% respectively) (3). Regular and overtime earnings were flat compared to a year earlier (4) despite a small increase in overtime hours.
- The current and outlook employment components of the Economy Watchers Survey both fell further in October suggesting conditions remain weak and will deteriorate further (5). The PMI survey, on the other hand, points to virtually no change in manufacturing employment, but a continued small fall in non-manufacturing payrolls. (6).

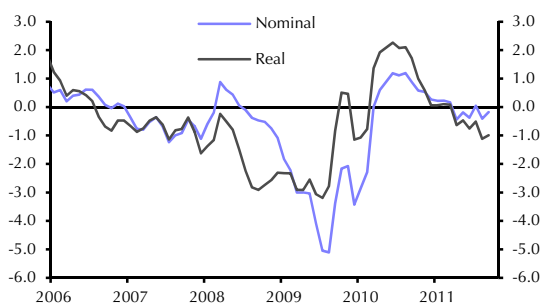
1. Employed & Unemployed Persons (Millions, Seas. Adj.)



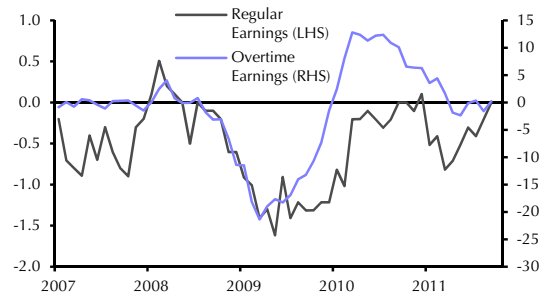
2. Employed Persons (Millions)



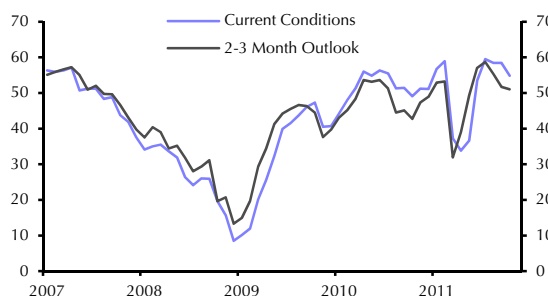
3. Labour Cash Earnings (% y/y)



4. Nominal Regular & Overtime Cash Earnings (% y/y)



5. Economy Watchers Survey – Employment



6. PMI Employment Indices

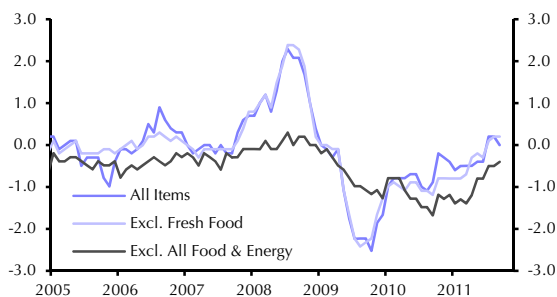


Source – Thomson Datastream, Markit

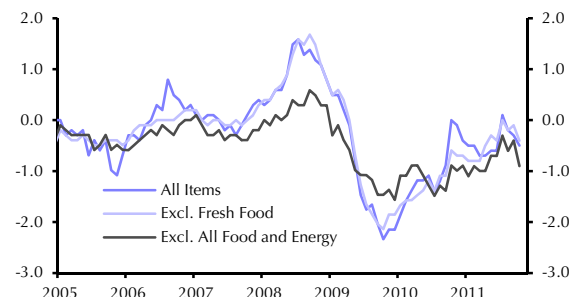
Inflation Indicators

- All items CPI inflation fell to 0.0% y/y in September from 0.2% in August. The core measure, which excludes fresh food was unchanged from the month before at 0.2%, while the “core core” measure increased slightly but remained negative at 0.4% (1). All three Tokyo measures of inflation dropped in October as the increase in tobacco taxes last October dropped out of the annual comparison (2). National CPI in October should fall for the same reason.
- Consumers’ inflation expectations for the year ahead were unchanged at 2.0% in October, and have remained unaffected by the downward revision in the headline rate that took place in August following the change in the CPI weights (3). The lagged effect of previous rises in oil prices continues to have an upward influence on the energy component of the CPI, but this looks like it will begin to reverse at the start of 2012 (4).
- The lagged effect of higher commodity prices continued to boost corporate goods prices in August, although the rate of increase was unchanged at 2.6% y/y (5). The manufacturing PMI recorded a sharp fall in input prices in October, possibly the result of a stronger yen reducing the price of imports (6).

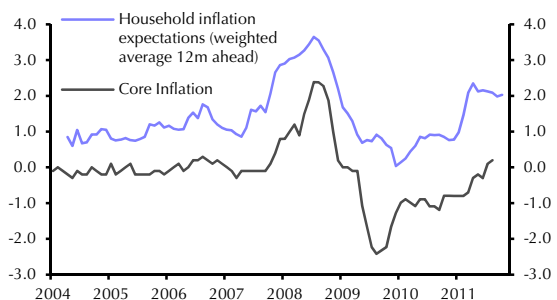
1. National Consumer Prices (% y/y)



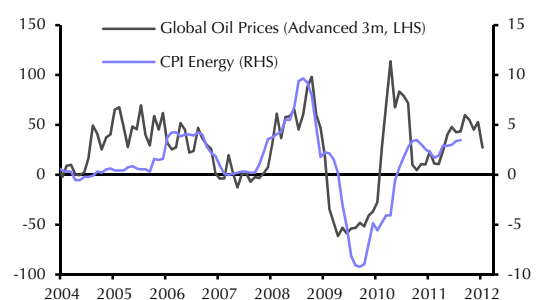
2. Tokyo Consumer Prices (% y/y)



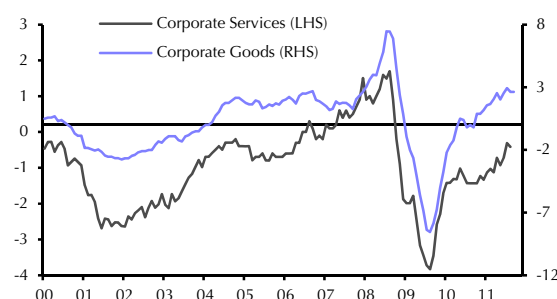
3. Inflation Expectations & Actual Core Inflation (%)



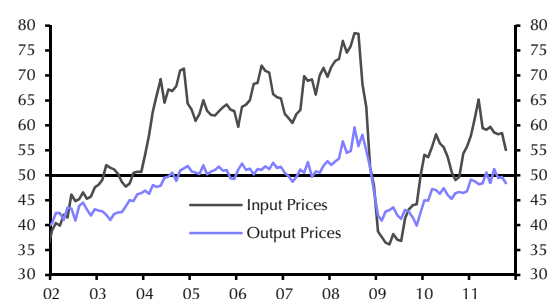
4. Crude Oil Prices & CPI Energy (% y/y)



5. Domestic Corporate Goods & Services Prices (% y/y)



6. Manufacturing PMI Input & Output Prices

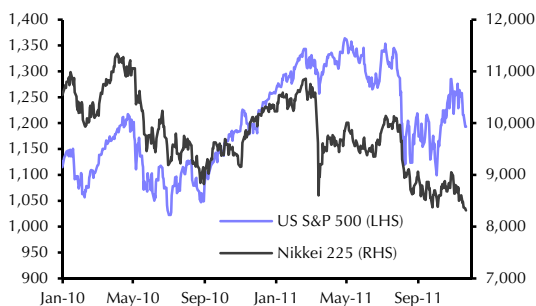


Sources – Thomson Datastream, Markit

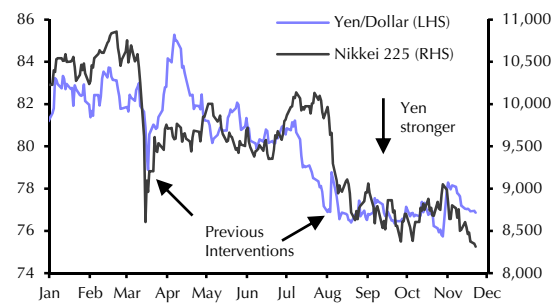
Financial Market Indicators

- The escalation of the sovereign debt crisis in the euro-zone caused the fall of three governments in the region (those of Greece, Italy and Spain), and pushed up the cost of borrowing for France and Austria. Turmoil carried over in to global equity markets on concerns that further problems could tip Europe into recession (1). Demand for safe haven assets saw the yen pushed to a new high, prompting the Japanese government to intervene in foreign exchange markets (2). The yen weakened to 78 against the dollar, but has since started to appreciate again.
- The previously close relationship between US 10-year treasury yields and both the yen and 10-year JGBs that broke down over the summer has not yet returned (3, 4). Investors may be losing patience with Japan over its ever expanding level of government debt.
- This view is supported by the relatively high cost of insuring against the risk of a Japanese sovereign default, even though this came down as the prospects for euro-zone deteriorated (5). The 12-month overnight interest rate swap fell further below the official policy ceiling as the Bank of Japan has increased liquidity by boosting current account deposits and extended the ceiling of its asset purchase program by ¥5 trillion to ¥20 trillion (6).

1. Nikkei 225 & US S&P 500



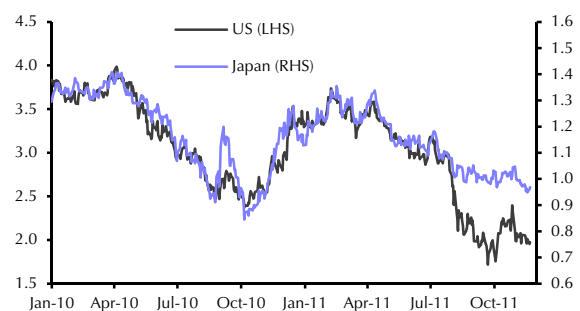
2. Yen & Nikkei



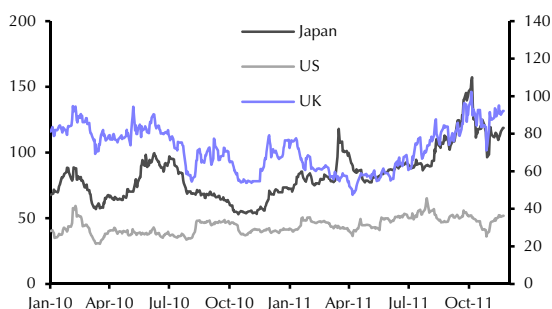
3. US Yields & Yen



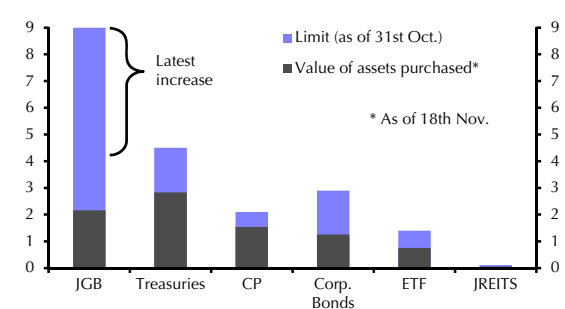
4. 10-Year Government Bond Yields (%)



5. Sovereign Credit Default Swap Premia (bp)



6. Asset Purchase Program (¥ Billion)



Sources – Thomson Datastream, Bloomberg