

**Ma Tieying**

Economist



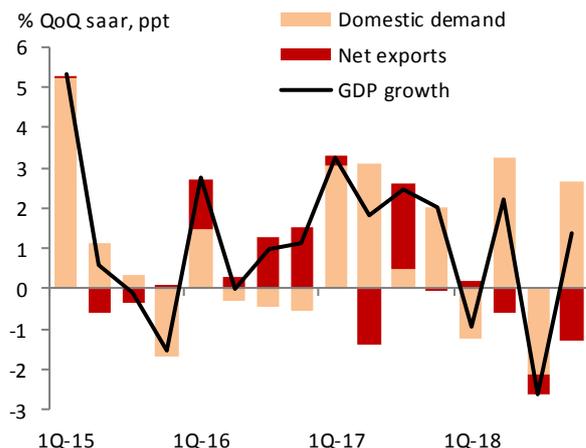
Please direct distribution queries to

Violet Lee +65 68785281 [violetleeyh@db.com](mailto:violetleeyh@db.com)

- *The Japanese economy has emerged from the natural disasters last autumn but the return to positive growth has been disappointing*
- *We have trimmed our 2019 GDP growth forecast to 0.7% from 1.0%*
- *First, the consumption tax hike in October is widely expected to hurt domestic demand but the impact will be lesser than the previous increase in 2014*
- *Second, the export slowdown has not been fully priced in, not helped by signs that manufacturing sector activities have stalled*
- *Third, the outlook has also been complicated by recent reports on the government's statistical errors, particularly those pertaining to labour and wages*
- *Against a more challenging outlook this year, the Bank of Japan is likely to maintain its short- and long-term interest rate targets at -0.1% and 0% respectively, and at the soonest, consider a rate hike in 2H 2020*

**The Japanese economy has emerged from the natural disasters last autumn but the recovery was nothing to shout about.** Preliminary real GDP growth turned positive to 1.4% (QoQ saar) in 4Q18 but this was not enough to offset the -2.6% decline in 3Q18. The recovery was led by domestic demand where an increase in public spending helped lead the recovery of consumption and investment from the disasters. On the other hand, external demand remained as a notable drag on headline growth (**Chart 1**). Full-year GDP growth has decelerated to 0.7% in 2018 from 1.9% in 2017 and below our 1% forecast. We have trimmed our 2019 GDP growth forecast to 0.7% from 1% previously.

**Chart 1: GDP growth rebounded on domestic demand, but exports remained a drag**

**The consumption tax hike is largely expected**

Until lately, the 2019 growth outlook debate has centered on the **consumption tax hike** scheduled in October. The tax increase will **dampen domestic demand less this time around**. First, the tax hike will be smaller at 2ppt compared to the 3ppt rise in 2014. Second, some daily necessity items, such as food and newspapers, will be excluded in order to lessen the impact on low-income households.

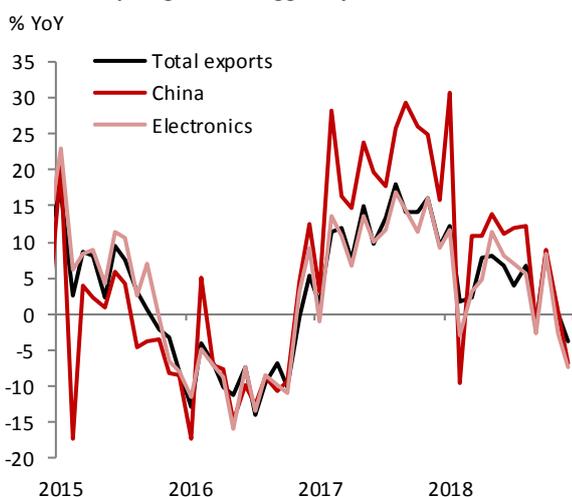
Government policies are more supportive this time. The cabinet has approved a record JPY101.5tn budget for FY19, a 3.8% increase compared to last year, and the biggest rise seen since 2011. The budget specifically allocated JPY2tn spending to counter the impact of consumption tax hike, for example, shopping vouchers to help the low-income households and higher infrastructure spending.

The motivation for policy support should be strong this year. Abe’s Liberal Democratic Party intends to tout the success of Abenomics in delivering Japan’s longest post-war recovery ahead of the upper house elections in July. The imperial transition in April and the G20 Osaka summit in June will also put Japan in the international spotlight this year.

**Downside risks from the export slowdown...**

The downside growth risks from external sources are new that have not been fully priced in. The global economic slowdown and faltering electronics demand have started to weigh on Japan’s exports (Chart 2). Export conditions are likely to get worse before better in the coming months. Key leading indicators such as Taiwan’s electronics export orders and China’s manufacturing PMI have continued to point south.

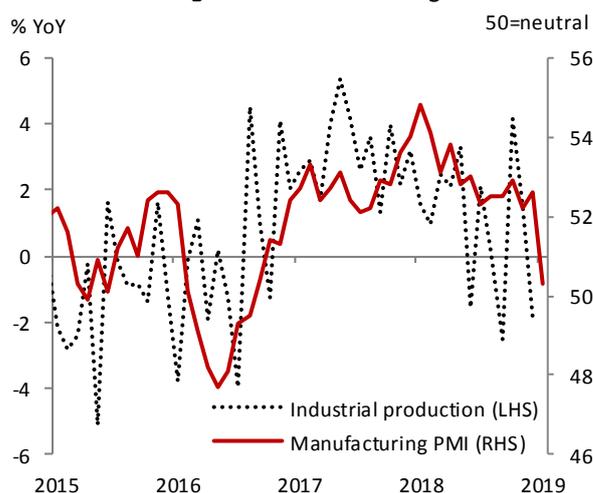
**Chart 2: Export growth dragged by China and electronics**



There are additional headwinds from the US-China trade disputes and the potential automobile tariffs considered by the Trump administration. These could offset the tailwinds from Japan’s further trade liberalisation such as the implementation of Comprehensive and Progressive Agreement for Trans-Pacific Partnership and Japan-EU Economic Partnership Agreement in 2019.

The macro impact of export slowdown should not be underestimated. Exports of goods and services account for a small 17% of Japan’s GDP. Thanks to the large swings in export cycle, the contribution of net exports to GDP growth has been more significant at an average of 38% in the last three years. There are tentative signs that the country’s manufacturing sector growth has stalled in 1Q19 due to the weakness in exports. Manufacturing PMI has fallen to 50.3 in January, sharply down from 52-54 in the past 12 months, and the lowest seen since August 2016 (Chart 3).

**Chart 3: PMI falling to the lowest since August 2016**



**... and official statistical errors**

**Recent reports on the government’s statistical errors have complicated the picture.** The labour ministry was found to have surveyed only a third of the country’s large companies during 2004-2017 before correcting its methodology in 2018. According to a report from the internal affairs ministry, about 40% of the government’s 56 key economic data releases contained errors and needed revisions.

Given that large companies typically pay more than small ones, the correction in the labour survey methodology last year resulted in an artificial jump in total wage growth to 1.7% from 0.4% in 2017. The labour ministry admitted that the year-on-year wage increase in January-November 2018 was overstated by as much as 0.7ppt. Likewise, it could be inferred that wage growth during the 2004-17 period was underestimated by a similar extent. As such, the whole trajectory of wage growth needs to be reviewed to get a clearer picture about the state of economic recovery and the effects of Abenomics.

### Implications for monetary policy

**A weaker-than-expected 2019 growth outlook will likely hinder the Bank of Japan from normalising monetary policy.** The data revisions/reviews would also prompt the BOJ to adopt a cautious stance e.g. wage data are watched closely by board members to assess the medium-term inflation outlook. The BOJ, has at the January meeting, not only slashed its FY18 GDP growth forecast sharply to 0.9% from 1.4%, but more importantly, its FY19 inflation forecast to 0.9% from 1.4%. The 10-year Japanese government bond yield has, since end-December, fallen back to the mid-point of the official target band (-0.2% to 0.2%, **Chart 4**).

Our view remains unchanged for the BOJ to maintain this year's short- and long-term interest rate targets at -0.1% and 0% respectively. The BOJ is only expected to raise rates in the second half of 2020 at the soonest.

Related reports:

[DBS 2019-20 outlook: Fading momentum](#)

[DBS Annual Chartbook: 2019 in 64 charts](#)

**Chart 4: JGB yield curve flattened again since Dec 2018**



## Group Research

### Economics & Strategy Team

**Taimur Baig, Ph.D.**

Chief Economist - G3 &amp; Asia

+65 6878-9548 [taimurbaig@db.com](mailto:taimurbaig@db.com)**Nathan Chow**

Strategist - China &amp; Hong Kong

+852 3668-5693 [nathanchow@db.com](mailto:nathanchow@db.com)**Masyita Crystallin, Ph.D.**

Economist – Indonesia &amp; Philippines

+ 62 21 2988-4003 [masyita@db.com](mailto:masyita@db.com)**Joanne Goh**

Regional equity strategist

+65 6878-5233 [joannegohsc@db.com](mailto:joannegohsc@db.com)**Neel Gopalakrishnan**

Credit strategist

+65 6878-2072 [neelg@db.com](mailto:neelg@db.com)**Eugene Leow**

Rates Strategist - G3 &amp; Asia

+65 6878-2842 [eugeneleow@db.com](mailto:eugeneleow@db.com)**Chris Leung**

Economist - China &amp; Hong Kong

+852 3668-5694 [chrisleung@db.com](mailto:chrisleung@db.com)**Ma Tieying, CFA**

Economist - Japan, South Korea &amp; Taiwan

+65 6878-2408 [matieying@db.com](mailto:matieying@db.com)**Radhika Rao**

Economist - Eurozone &amp; India

+65 6878-5282 [radhikarao@db.com](mailto:radhikarao@db.com)**Irvin Seah**

Economist - Singapore, Malaysia, &amp; Vietnam

+65 6878-6727 [irvinseah@db.com](mailto:irvinseah@db.com)**Duncan Tan**

Strategist - ASEAN

+65 6878-2140 [duncantan@db.com](mailto:duncantan@db.com)**Samuel Tse**

Economist - China &amp; Hong Kong

+852 3668-5695 [samueltse@db.com](mailto:samueltse@db.com)**Philip Wee**

FX Strategist - G3 &amp; Asia

+65 6878-4033 [philipwee@db.com](mailto:philipwee@db.com)

**Sources:** Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

**Disclaimer:**

The information herein is published by DBS Bank Ltd and PT Bank DBS Indonesia (collectively, the "DBS Group"). It is based on information obtained from sources believed to be reliable, but the Group does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. Opinions expressed are subject to change without notice. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation & the particular needs of any specific addressee. The information herein is published for the information of addressees only & is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. The Group, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Group or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Group & its associates, their directors, officers and/or employees may have positions or other interests in, & may effect transactions in securities mentioned herein & may also perform or seek to perform broking, investment banking & other banking or financial services for these companies. The information herein is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation. Sources for all charts & tables are CEIC & Bloomberg unless otherwise specified.

DBS Bank Ltd., 12 Marina Blvd, Marina Bay Financial Center Tower 3, Singapore 018982. Tel: 65-6878-8888. Company Registration No. 196800306E.  
PT Bank DBS Indonesia, DBS Bank Tower, 33<sup>rd</sup> floor, Ciputra World 1, Jalan Prof. Dr. Satrio Kav 3-5, Jakarta, 12940, Indonesia. Tel: 62-21-2988-4000.  
Company Registration No. 09.03.1.64.96422.