Three Positives For Japan in 2020

Japan’s economy continued to show signs of weakness last week, eg, IP declined -6.6% y/y and retail sales -2.1%. The VAT hike, typhoons, and a global slowdown are all pushing down economic activity.

Looking ahead to 2020, there are three positives:

• **Fiscal stimulus**: Stimulus is being applied to an economy with the unemployment rate at just 2.2%.

• **Global growth improving**: The 30 companies we surveyed in Japan and Taiwan in Dec expect business conditions to improve in 2020.

• **Financial conditions improving**: The yen has weakened, the yield curve has steepened, and the Nikkei has rebounded.

Today marks the 30th anniversary of Japan’s Bubble peak in the Nikkei. Most economic measures are still well below the Bubble peaks. But arguably, the last decade made some progress.
SUMMARY

THREE POSITIVES FOR 2020:

#1 Fiscal Stimulus

The latest fiscal stimulus package is equivalent to 1.4% of nominal GDP, and the boost to growth is likely to spread out over a number of years. What’s remarkable is that this stimulus is being applied to an economy at full employment. That’s probably never happened before. And monetary stimulus is also being applied.

JAPAN UNEMPLOYMENT RATE
Nov: 2.2%
THREE POSITIVES FOR 2020:

#1 Fiscal Stimulus  Contd

The unemployment rate in Nov declined to just 2.2%.

Employment reached a record-high (see more later), and the labor force participation rate for workers between the ages of 25 and 54 years is 88%, a record by a wide margin.

There’s no doubt that the latest fiscal stimulus package is aimed to offset an expected slowdown in economic activity starting in fall of 2020 after the Olympics. However, it should be noted that fiscal stimulus of this magnitude at full employment is unprecedented, and that policymakers are proactive in sustaining this expansion.

Again, it should be noted that this fiscal stimulus is being applied while BoJ continues to expand its balance sheet and the policy rate is -10bp. So, at full employment, Japan’s economy is being lifted by both fiscal and monetary stimulus.
THREE POSITIVES FOR 2020:

#2 Bottoming View Growing

In early Dec, we met with 25 companies in Tokyo, Osaka, Kobe, and Kyoto and 5 companies in Taiwan. The most important takeaway was that most contacts expected business conditions in 2020 to improve: 77% of the Japanese companies we surveyed expected sales to increase over the next year. That’s up clearly from 61% this summer.

Evercore ISI Survey of Japanese Companies:

Sales expectations over the next year

2019:4Q 77% Increase
THREE POSITIVES FOR 2020:

#2 Bottoming View Growing

Corroborating this finding, Nikkei News published its own survey of Japanese CEOs last week, showing that 35% of them expect the global economy to expand, up from 28% in 3Q.

NIKKEI SURVEY OF JAPANESE CEOs

Do you expect the global economy to expand?

35% Yes

Chart courtesy Nikkei News
THREE POSITIVES FOR 2020:

#2 Bottoming View Growing  Contd

Also fitting with this view, EVRISI’s surveys of company sales in the US, China, and Europe have hooked up over the past two months, and the Global Economic Diffusion Index has rebounded.
THREE POSITIVES FOR 2020:
#2 Bottoming View Growing  Contd

These improvements are important in that they help reinforce the view that global growth is improving. It may be helpful to remember that in 2016-2018 as global growth prospects improved, the Nikkei surged +60% from 15000 to 24000 in just 19 months.

Reflecting the fiscal stimulus and bottoming views we picked up in Japan, we lifted our 2020 real GDP forecast from +0.5% to +1.0%.

THREE POSITIVES FOR 2020:
#3 Financial Conditions Improving

Almost two years ago, we developed a Financial Conditions Index for Japan to better monitor the impact of financial markets on Japan’s economy. The index is based on six components from currency, equity, money, and bond markets.
THREE POSITIVES FOR 2020:

#3 Financial Conditions Improving  Contd

Over the past three months, virtually all aspects of Japan's financial markets have improved: The yen has weakened, the yield curve has steepened some, and the Nikkei has rallied. As a result, the Financial Conditions Index has improved significantly from negative to positive.

At 0.23, the Financial Conditions Index suggests roughly +1.5% real GDP growth.
Still Plenty of Weak Signs

The data reported last week show weakness persisting. The most important negative was that IP declined -0.9% m/m in Nov and -6.6% y/y. The slowdown in China, trade concerns, the typhoon, and the VAT hike were all at work.

[Graph: Japan Industrial Production, Nov: 97.7]
Still Plenty of Weak Signs

After the VAT-hike-related plunge in Oct, retail sales rebounded +4.6% m/m in Nov, but they’re still -2.1% y/y.

![Retail Sales Chart]

Both these suggest that real GDP in 4Q is likely to decline sharply, raising recession concerns. However, as suggested above, we forecast real GDP to increase +1.0% y/y in 4Q of 2020, up from a likely +0.7% y/y in 4Q of this year.
IMPORTANT POSITIVE

With IP down a sharp -6.6% y/y, it’s hard to believe that Japan’s labor markets remain strong. But they are. As noted above, the unemployment rate declined to just 2.2% in Nov. And employment increased +110k m/m and +0.8% y/y to 67.7m. That’s a strong result for an economy whose working-age population is declining.

Also worth noting, the labor force participation rate for 15-64 years old remained around a record high of 80%. Again, with the economy at full employment, stimulus is being applied.
30th Anniversary of Nikkei’s Peak

Most investors are unconvinced that Japan’s out of the woods. Population is shrinking, the debt problem is a perpetual overhang, policy options are limited, and inflation seems like it’s never going to pick up. But judging by these indicators, progress is being made.

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<td>Tokyo Office Vacancy Rate</td>
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