EVERCORE ISI

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Japan Research

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Japan Slowdown Bottoming Out. Coronavirus Impact on Japan 1Q GDP Could Be Significant.

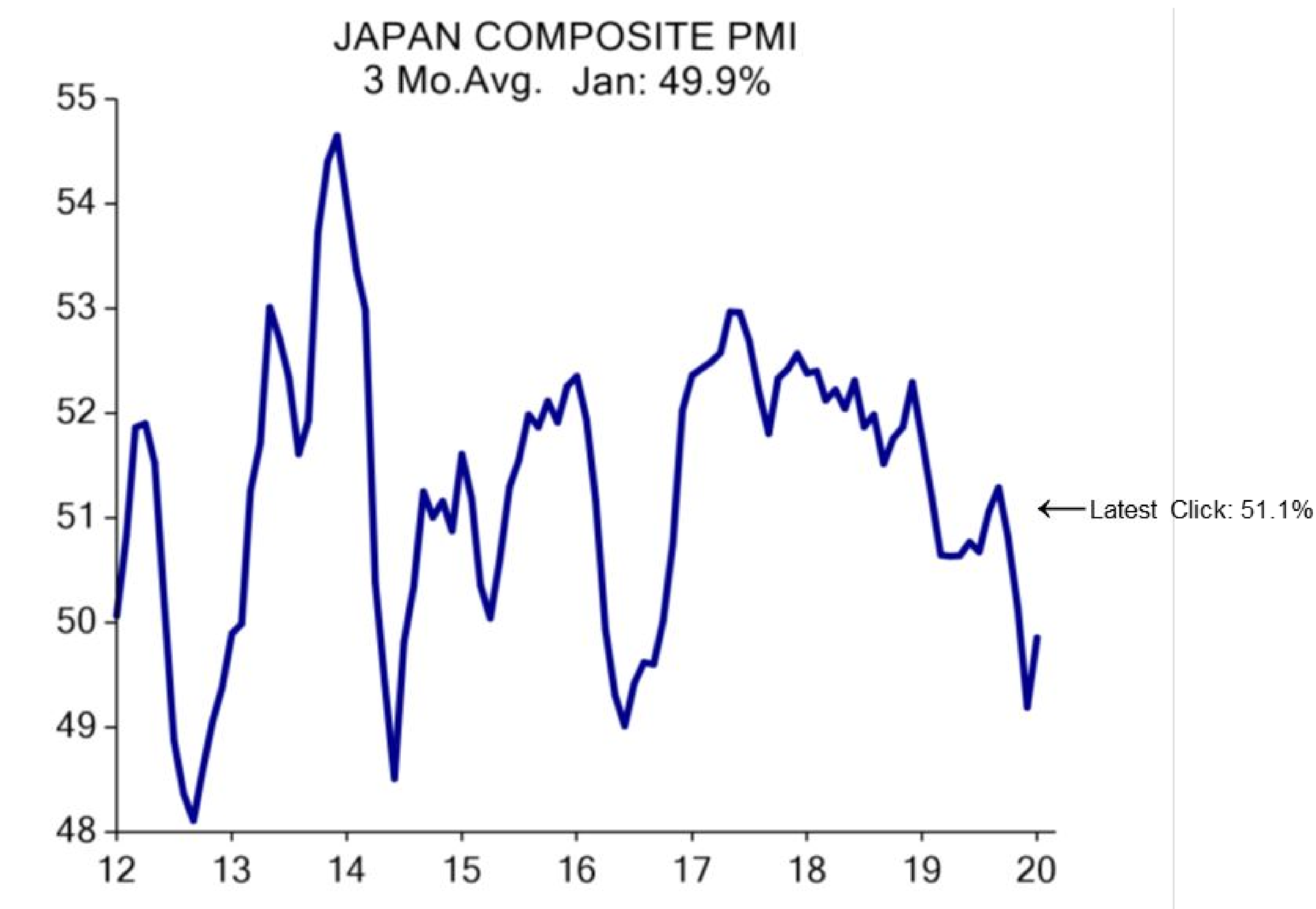
- Evidence continued to build last week that the slowdown in Japan is bottoming. Reported last week, the composite PMI rebounded +2.5 m/m in Jan, and exports increased +1.8% in Dec. These fit with a +4.9% m/m increase in machine tool orders for Dec, as well as the comment last week by Nidec, a bellwether for Japan mfg, that "*Business conditions have bottomed out*."
- Our best guess is that Japan's economy will continue to rebound and real GDP will increase +1.0% in 2020, a slight acceleration from a likely +0.8% increase in 2019, supported by improving global growth as well as fiscal stimulus and a weaker yen.
- However, a likely plunge in tourists from China due to travel bans is a near-term risk for the economy. During the 2003 SARS outbreak, tourists from China to Japan plunged -50% (simple rate) in just one quarter. Given that tourists from China play a much bigger role in Japan's economy, if tourists from China are to plunge -50%, it's likely to have a significant impact on 1Q growth (see pages 5-7).

SUMMARY

Japan Slowdown Bottoming Out

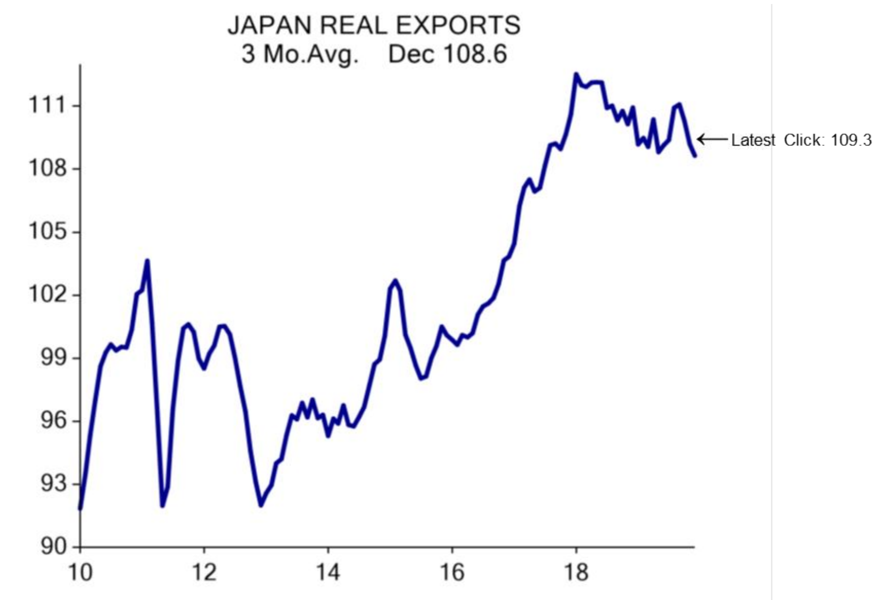
The 25 companies we met in Japan in Dec told us that they expected business conditions to improve in 2020, and that seems to be unfolding.

Eco data reported over the past few weeks show small increases. The most convincing piece of evidence was the composite PMI, which rebounded +2.5 m/m to 51.1%. Both the mfg and service PMIs increased.

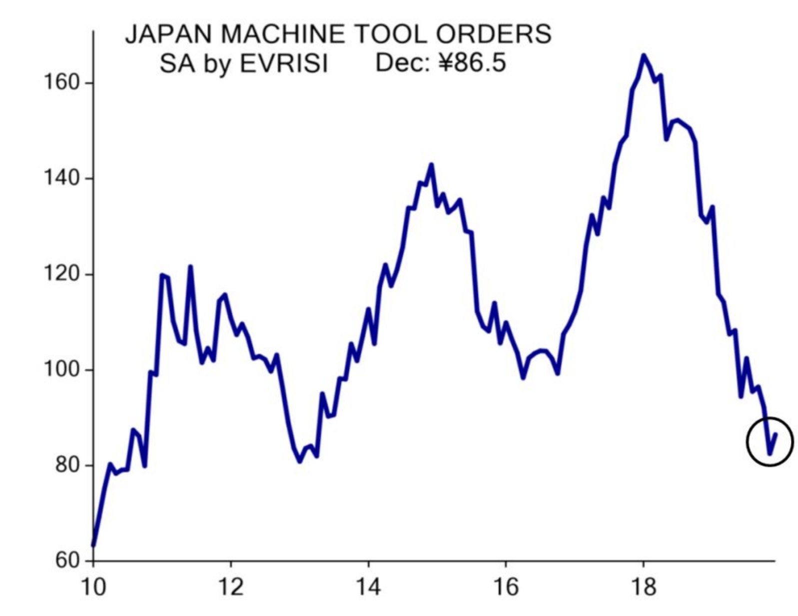


Japan Slowdown Bottoming Out Contd

Although real exports remained in a weakening trend, real exports increased +1.8% m/m in Dec.



This uptick in exports fits with an uptick in machine tool orders -- one of the best economic indicators for Japan. Orders increased +4.9% m/m in Dec from their low in Nov, although these were just a small uptick in a downtrend.



Japan Slowdown Bottoming Out Contd

The main drivers of these increases are:

- The *Global Easing Cycle*
- Global economy improving
- Financial conditions improving
- The VAT hike behind us.

In particular, judging by EVRISI's measure of Global Short Rates, we're approaching the point that the global easing cycle, which started in Dec 2018, should be lifting economic activity in Japan. Last week, the BoJ raised its 2020 real GDP forecast from +0.7% to +0.9%.

We forecast Japan's real GDP to increase +1.0% y/y in 2020, a slight acceleration from a likely +0.8% in 2019.

Coronavirus Impact on Japan

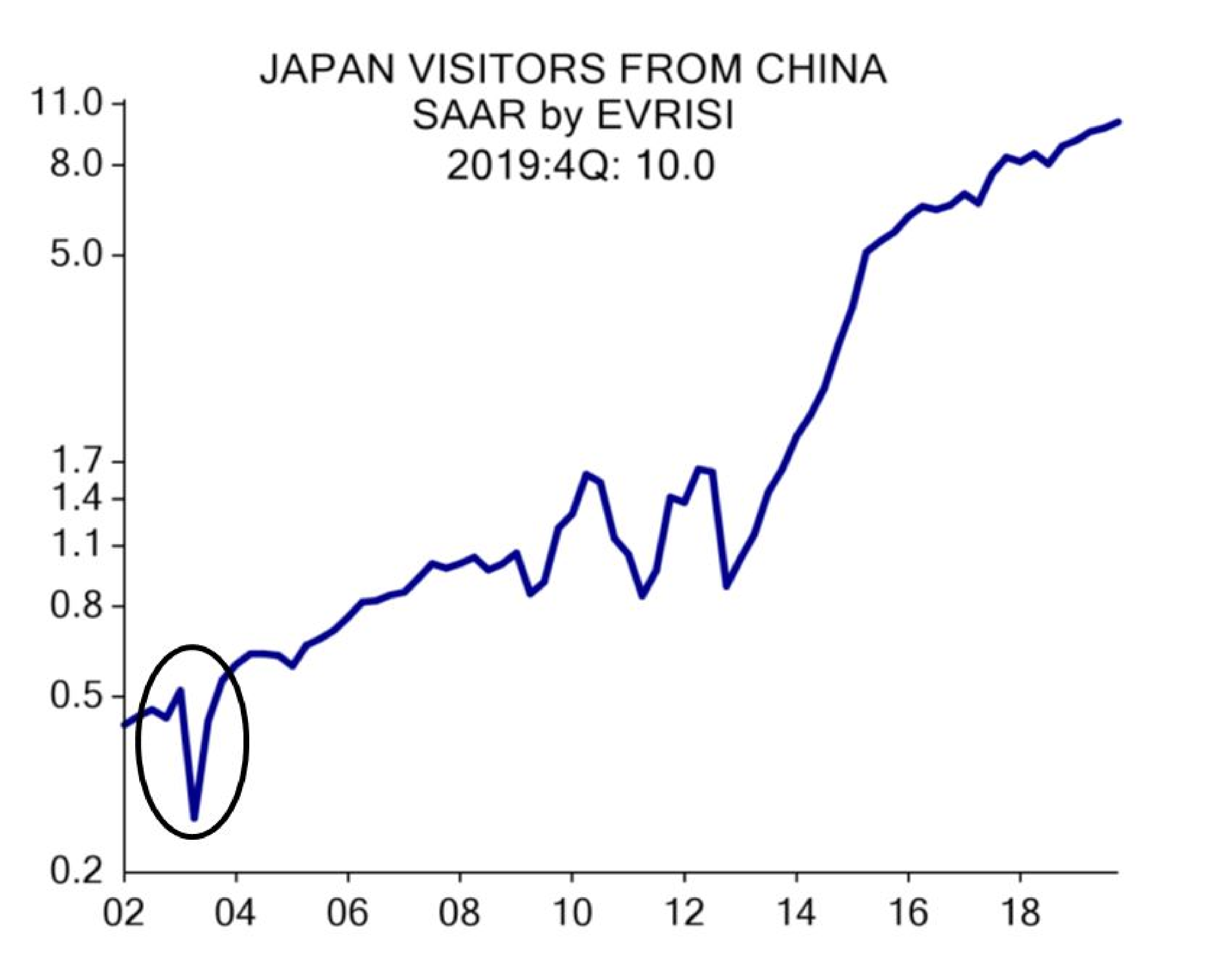
We have frequently noted that tourism in Japan has been a significant lift to the economy over the past seven years. The number of tourists to Japan has more than tripled in the past seven years from roughly 9m annual rate to over 30m in Dec. This surge in tourism has been largely driven by a 12-fold surge in tourists from China to over 10m, ie, a third of tourists in Japan are from China.

Yesterday, China's govt announced it would "*suspend all tour groups the sale of flight and hotel packages for its citizens headed overseas, starting on Monday*." The travel ban, coinciding with the Lunar New Year during which Japan typically sees a huge influx of Chinese tourists, is likely to be a hit to retail sales as well as hotel occupancy and other travel-related spending.

There were substantially fewer tourists from China in 2003 (0.5m then versus 10m today). But during the SARs breakout, the number of Chinese tourists plunged almost -50% from 0.52m to 0.27m in just one quarter (see next page).

Coronavirus Impact on Japan Contd

If a similar plunge were to happen, the number of Chinese tourists is likely to plunge to 5.0m from 10.0m in 4Q of 2019.



In 1Q of 2003, Japan's real GDP increased just +0.3% q/q a.r., a clear slowdown from +1.2% in 2H of 2002.

Coronavirus Impact on Japan Contd

According to the Japanese govt's latest survey, an average tourist from China spends roughly ¥210000 ($1900) in Japan, far exceeding tourists from other countries. So if Chinese tourists were to halve in 1Q, the total spending by Chinese tourists is likely to plunge roughly -¥1t (-$10b) from ¥2.10t ($19b) to ¥1.05t ($9.5b). That represents 0.2% of Japan's $5t nominal GDP. But if all of this negative hit in one quarter, it would be a -0.8% drag on 1Q real GDP. In any event, it's likely to show a significant negative impact on the service sector. Stay tuned.

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