



Outlook for Japanese Economy & Stock Market

Monthly comments & views by
Sumitomo Mitsui DS Asset Management (SMDAM)

-May 2019-

Executive summary

■ Japanese Economy

SMDAM down-revised GDP forecast for FY2018,19 and 20 each by 0.1% due mainly to slightly weaker than expected economic statistics for Jan-Mar 2019. Japanese economy is forecast to keep moderate growth going into FY2020. Total real wage payment as an economy is increasing driven by labor force expansion, which underpins mild and solid growth in private consumption. Foreign workers acceptance also increases in order for filling labor shortage. New exam for acquiring work permit started in Philippines.

- Visitors from China, Hong Kong, Korea and Taiwan account for about 75% of the total visitors from abroad. Robust inbound tourism is continuing in early 2019 and no waning has so far been apparent despite sharp slowdown in Chinese economy.
- Business sentiment declined lately as it did in 2015-16 period. As long as China can avoid severe downturn, slowdown in Japanese business sentiment is likely to be mild supported by resilient domestic businesses.

■ Japanese Stock Markets

Japanese stock market is likely to try upside of the current price range, though it would probably take some months before clear improvement in economy or corporate earnings can be confirmed. Momentum of Japanese economic growth and corporate earnings are getting to a level, which became a bottom in the previous downturn in 2012 and 2016. Japanese stock market has lagged global peers in the current rebounds and valuation looks relatively cheap.

- According to IBES, 12m forward consensus EPS forecast for TOPIX stopped deteriorating. Also, 12m forward EPS growth forecast rose to 8.5% lately. Earnings forecast revision index has reached to the level, which were bottom of the previous contraction periods in 2012 and 2016.
- Foreign investors turned to purchasing Japanese equities from April so far. They sold 5.4 trillion yens of Japanese equities in 2018, which was the largest annual net selling in the record since 1987. Their under-weighting of Japanese equity has widened.

Notes: Macro and market views are as of 16th Apr. 2019, and subject to updates thereafter without notice.



Outlook for Japanese Economy

SMDAM economic outlook for FY18-20

- SMDAM down-revised GDP forecast for FY2018,19 and 20 each by 0.1% due mainly to slightly weaker than expected economic statistics for Jan-Mar 2019.
- Japanese economy is forecast to keep moderate growth going into FY2020.

(YoY %)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Real GDP growth	1.3%	0.9%	1.9%	0.5%	0.4%	0.5%
Private Consumption Expenditure	0.7%	0.0%	1.1%	0.5%	0.4%	0.3%
Private Housing Investment	3.7%	6.3%	-0.7%	-5.1%	0.0%	-3.2%
Private Capital Investment	1.6%	-0.5%	4.6%	2.8%	1.2%	0.5%
Public Consumption Expenditure	1.9%	0.7%	0.4%	1.0%	1.2%	0.8%
Public Capital Investment	-1.6%	0.6%	0.5%	-4.3%	0.0%	0.8%
Net Exports (contrib. to GDP growth)	0.1%	0.8%	0.4%	-0.2%	-0.2%	0.1%
Exports	0.8%	3.6%	6.4%	1.2%	-1.1%	1.5%
Imports	0.4%	-0.9%	4.0%	2.4%	-0.2%	0.8%
Nominal GDP	2.8%	0.7%	2.0%	0.4%	1.2%	1.2%
GDP Deflator	1.5%	-0.2%	0.1%	-0.1%	0.8%	0.7%
Industrial Production	-0.6%	0.8%	2.9%	0.2%	0.1%	1.1%
CPI (excl. fresh food)	-0.1%	-0.2%	0.7%	0.8%	0.2%	0.2%

Notes: E=SMDAM forecasts. SMDAM views are as of 16th Apr. 2019 and subject to updates thereafter without notice

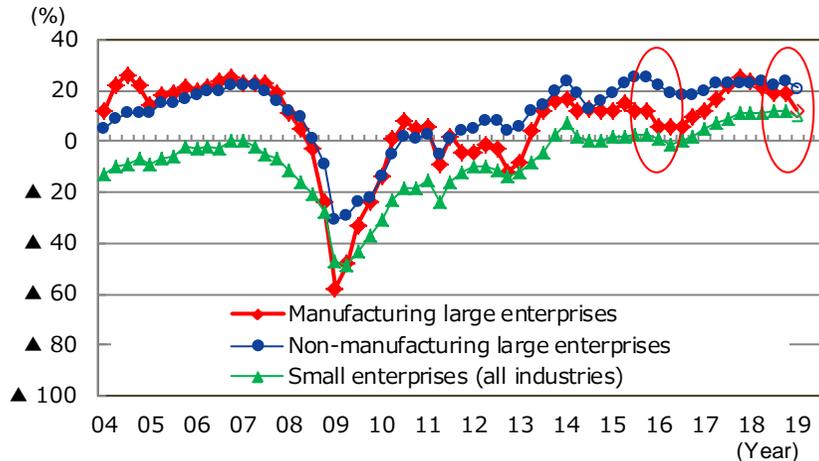
(%, YoY except Net Exports)

(Source) Cabinet Office, Bank of Japan, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, SMDAM forecasts

Domestic side of the Japanese economy shows resilience

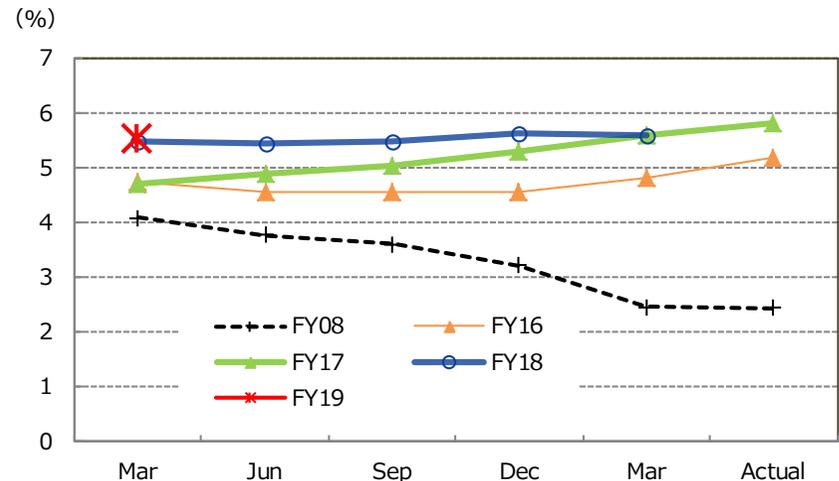
- Business sentiment declined lately as it did in 2015-16 period. As long as China can avoid severe downturn, slowdown in Japanese business sentiment is likely to be mild supported by resilient domestic businesses.
- In Oct-Dec 2018 financial results, rising input cost negatively affected Japanese companies, however, profit margin plan for FY 2019 was still at high level in the latest TANKAN Business Survey in March.

BOJ TANKAN Business Survey
Current condition DI



Note: Data is quarterly from Mar. 2004 to Mar. 2019 and the last plot is outlook for Jun. 2019.
(Source) Bank of Japan

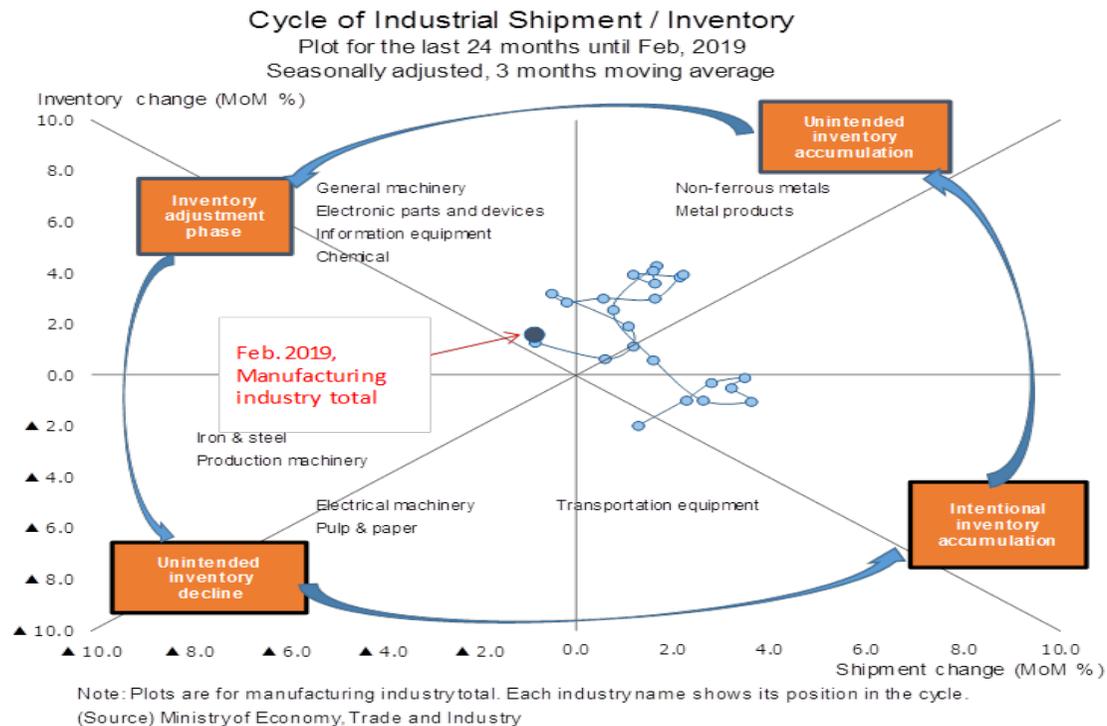
BOJ TANKAN Business Survey
Profit margin plan (YoY%), all enterprises



Note: Survey for each fiscal year (FY) in each month.
(Source) Bank of Japan

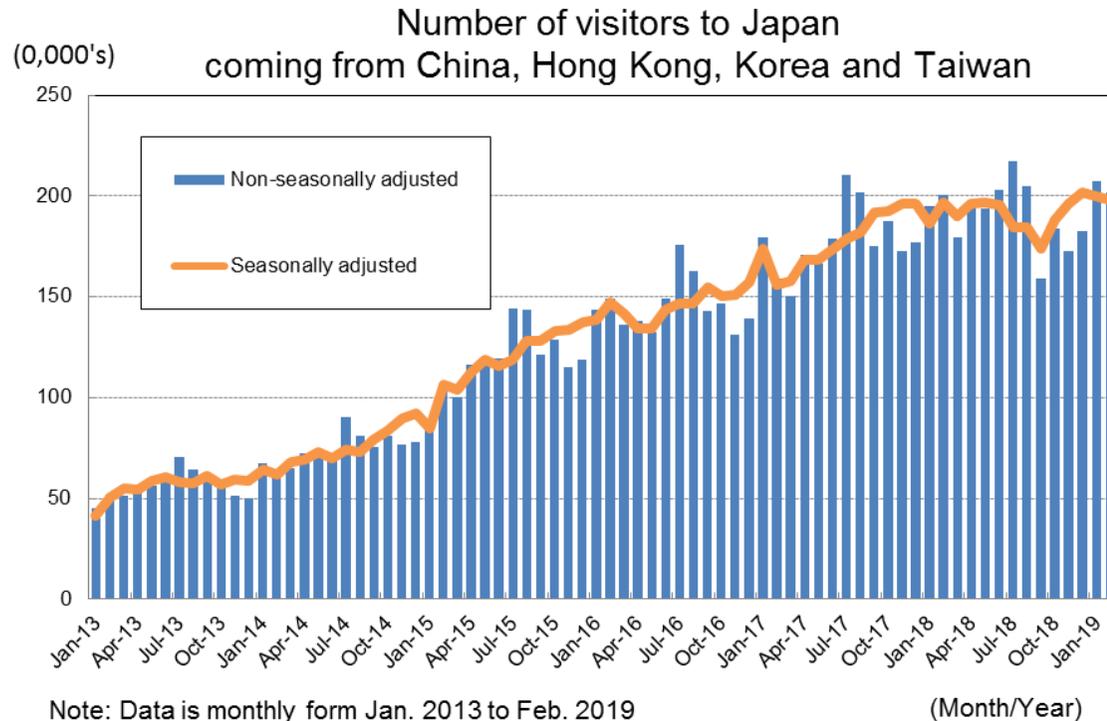
Inventory adjustment is probably necessary before production recovers

- The chart is supposed to show anti-clockwise move in a cycle of four phases of shipment vs. inventory.
- Sudden slowdown in Chinese economy caused unintended inventory accumulation. The level of inventory accumulation is still moderate, however, inventory adjustment is probably required before production and shipment start to recover.
- Transportation equipment such as cars has low inventory in Japan though overseas inventory is not included.



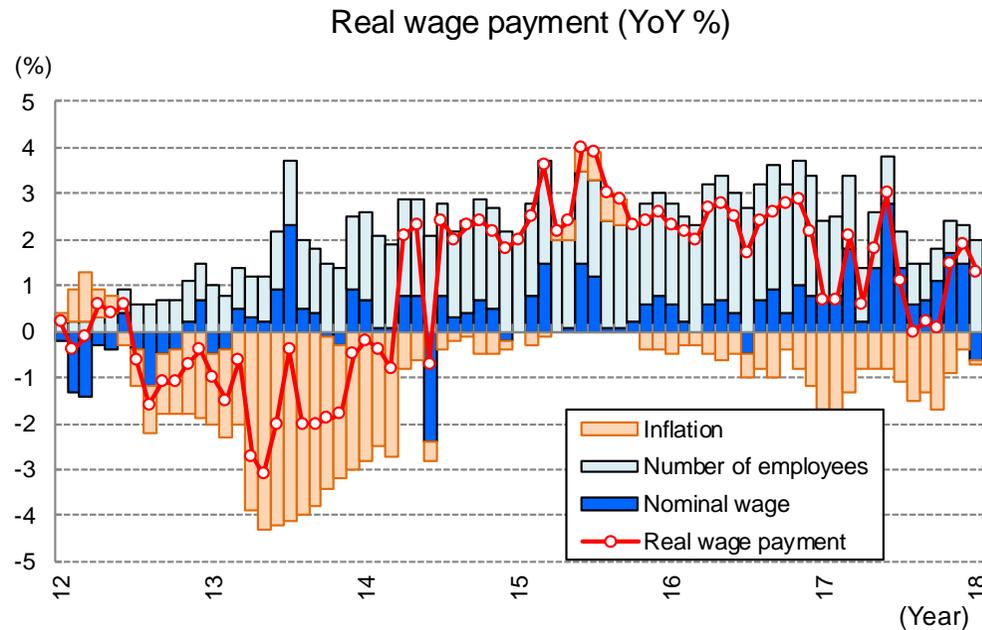
Robust inbound tourism continues to support Japanese economy

- Visitors from China, Hong Kong, Korea and Taiwan account for about 75% of the total visitors from abroad.
- Robust inbound tourism is continuing in early 2019 and no waning has so far been apparent despite sharp slowdown in Chinese economy.



Expanding labor force continues to lift total real wage

- Labor force in Japan continues to expand despite gradually declining population. Female participation is still increasing, retirement age is getting older and businesses are hiring people aggressively.
- Nominal wage per person is increasing just marginally after adjusting inflation, however, tight labor market provides a feeling of job security.
- Total real wage payment as an economy is increasing driven by labor force expansion, which underpins mild and solid growth in private consumption.



Note: Data is from Jan. 2012 to Jan. 2019.
(Source) Ministry of Health, Labour and Welfare

Labor reforming legislations started from April 2019

- Labor reform has a big potential for energizing Japanese economy even with an aging population. According to OECD statistics, Japanese labor productivity in terms of “GDP per hour worked” is very low. Japan is the lowest among G7 countries and its productivity is 65% of the US and 87% of the OECD total. Looking from the other side, Japan has a huge potential if labor efficiency can be improved.
- Multiple labor reforming legislations began in April this year such as stricter overtime ceiling and enabling high skilled professionals to be rewarded on achievements rather than hours worked. Foreign workers acceptance also increases in order for filling labor shortage. New exam for acquiring work permit started in Philippines.

Labor productivity global ranking (GDP per hour worked)

Ranking	Country	2017 (US dollar, 2010 constant prices)
1	Ireland	85.9
2	Norway	80.7
3	Luxembourg	79.5
6	United States	64.1
7	Netherlands	63.0
9	Germany	60.5
10	France	59.8
11	Switzerland	59.2
15	United Kingdom	53.5
16	Australia	52.4
17	Canada	49.8
18	Italy	47.9
19	Spain	47.5
20	Japan	41.9
23	Turkey	38.1
24	New Zealand	37.1
29	Korea	34.3
31	Greece	32.8
36	Mexico	18.8
	G7	56.5
	OECD - Total	48.2

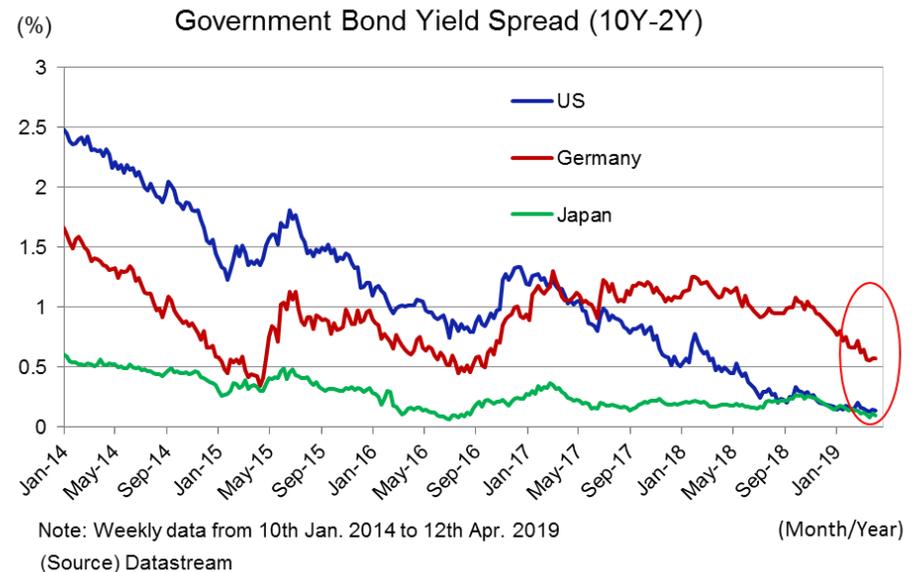
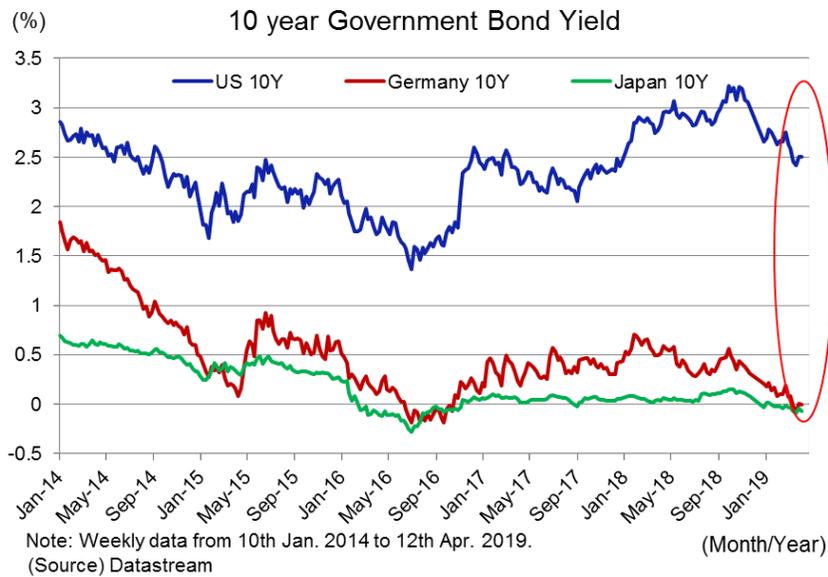
(Source) OECD



(Source) Ministry of Health, Labour and Welfare

Yield curve flattening continues

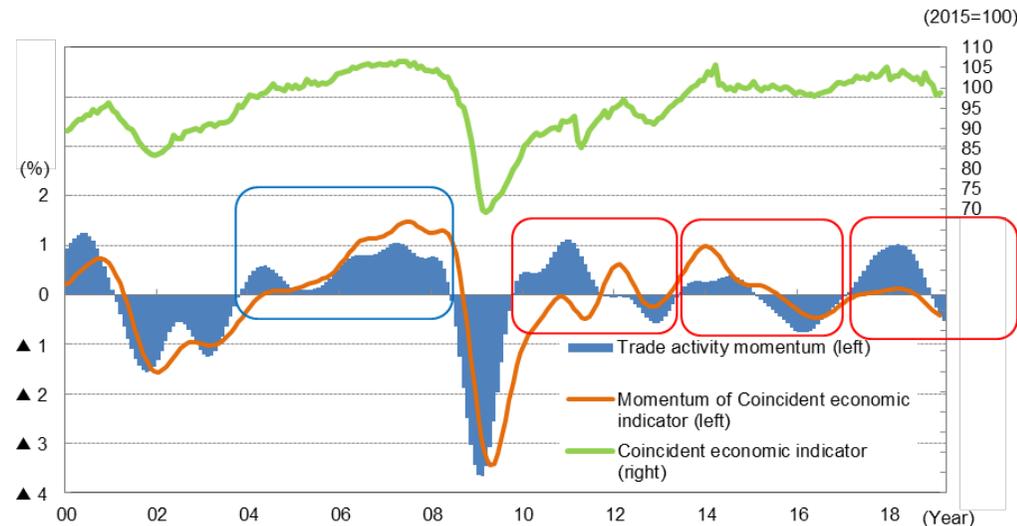
- Yield curve flattening continued in advanced economies, especially sharp flattening continued in Europe.
- Pressure is building on Bank of Japan for expanding monetary easing after such moves made in US and Europe.



Japanese economy is probably in a soft patch

- After the end of Global Financial Crisis, Japan has experienced 2 and a half mini cycles as indicated in red squares. According to this analysis, currently, Japanese economy is probably in a soft patch as in 2015-16 or a mini recession in 2012-13.
- Before the Global Financial Crisis, positive momentum lasted for a long time as blue square indicates, which is not comparable to this time's mini cycle. Possibility of a deep recession seems still remote and we do not need to be too pessimistic.

Momentum of Japanese economic indicator and trade activities

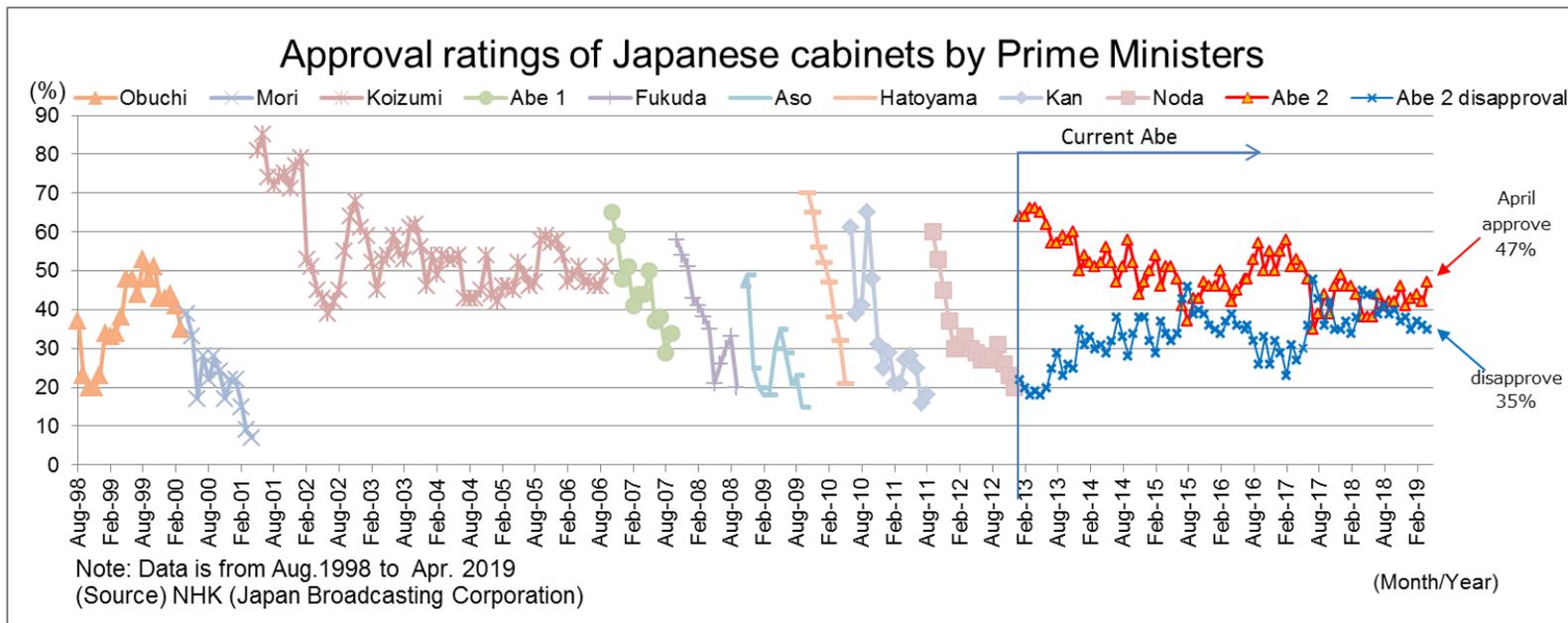


Note: Data is monthly from Jan 2000 to Feb 2019 for coincident economic indicator and to Feb 2019 for trade activity momentum. Trade activity momentum is composed by SMDAM using various trade related statistics. Momentum of coincident economic indicator was created by SMDAM using coincident economic indicator published by cabinet office.

(Source) Cabinet Office and other various trade related statistics, compiled by SMDAM

Approval rating for PM Abe's cabinet rose to 47% in April

- PM Abe's approval rating improved in April. Name of the new imperial era "REIWA", for which selection PM Abe played an important role, became quite popular among Japanese people and contributed to this improvement.
- This time's improvement is a comfort for PM Abe, who is facing upper-house election in July. Governing parties have more seats to be contested than oppositions have, and even how to minimize the number of losing seats is an uphill task.



Trade negotiation reopens between US and Japan

- Trade negotiation reopens between US and Japan, in which the negotiator for US mentions such as “foreign exchange article to prevent cheap currency policy”, “Agriculture & Farm products from US” and “tariff on Cars”. US President Trump is coming to Japan on 26th May.
- Other influential events will be “US-China trade and high-tech negotiation” and “Brexit”. For the latter, new time limit was set at the end of October. However, UK prime minister is trying to get the majority consensus at the parliament by June.
- Upper-house election in Japan in July is also an important event to watch.

Upcoming key events

Month	Region/Country	Events	Notes
2019 May	Japan	1 Prince Naruhito becomes the new emperor. Japanese calendar is set for renewal, from "HEISEI" to "REIWA". Japan is in 10 days long holidays from 26th April to 6th May.	Positive economic effect is expected from celebratory atmosphere and calendar renewal.
	US-Japan	26 US president Trump is going to visit Japan to be the first foreign leader to meet the new emperor.	Diplomatic agenda to be discussed.
	US	18 Limit for deciding US action on car tariffs	
	June	18-19 FOMC meeting	
June	Japan	14-15 Bank of Japan Monetary Policy Committee Meeting	
	Global	28-29 G20 top meeting in Osaka, which PM Abe chairs	US president Trump is said to be absent from G20.
July	Japan	Upper house election	
September	Japan	18-19 Bank of Japan Monetary Policy Committee Meeting	
October	Japan	1 Consumption Tax is scheduled to rise from 8% to 10% Rakuten begins mobile carrier business as the 4th company in Japan	
	UK-EU	31 New time limit for Brexit	PM May aims at reaching agreement in UK parliament by 1st June.
December	Japan	19-20 Bank of Japan Monetary Policy Committee Meeting	
2020 Jul-Aug	Japan	Tokyo Olympic Games	

(Source) Various publications, assembled by SMDAM



Outlook for Japanese Stock Market

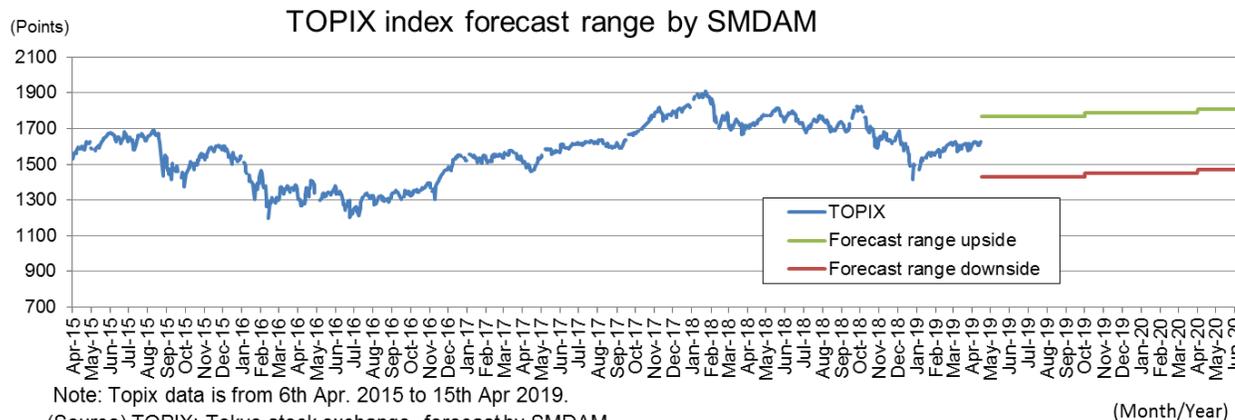
Japanese stock market is likely to try upside in the short term

■ SMDAM short-term view

➤ Japanese stock market is likely to try upside of the current price range, though it would probably take some months before clear improvement in economy or corporate earnings can be confirmed. Momentum of Japanese economic growth and corporate earnings are getting to a level, which became a bottom in the previous downturn in 2012 and 2016. Japanese stock market has lagged global peers in the current rebounds and valuation looks relatively cheap. Chinese economy is gradually showing signs of recovery by large stimulus measures.

■ Longer-term outlook (6-months and beyond)

➤ SMDAM's main scenario for the global economy expects that US economy keeps growing in 2019 despite slight slowdown, stimulus measures works for China and global economy shows clear recovery in the 2H 2019. US-China struggle in technology field goes on, however, trade dispute will moderate. Japanese stock market is expected to gather strength in the 2H of 2019. Major risks will be such as hard US-Japan trade negotiation, tumultuous Brexit and larger than negative impact of consumption tax hike in October.



Note: Topix data is from 6th Apr. 2015 to 15th Apr 2019.

(Source) TOPIX: Tokyo stock exchange, forecast by SMDAM

(Month/Year)

Note: SMDAM's projection is as of 16th Apr. 2019 and subject to updates without notice.

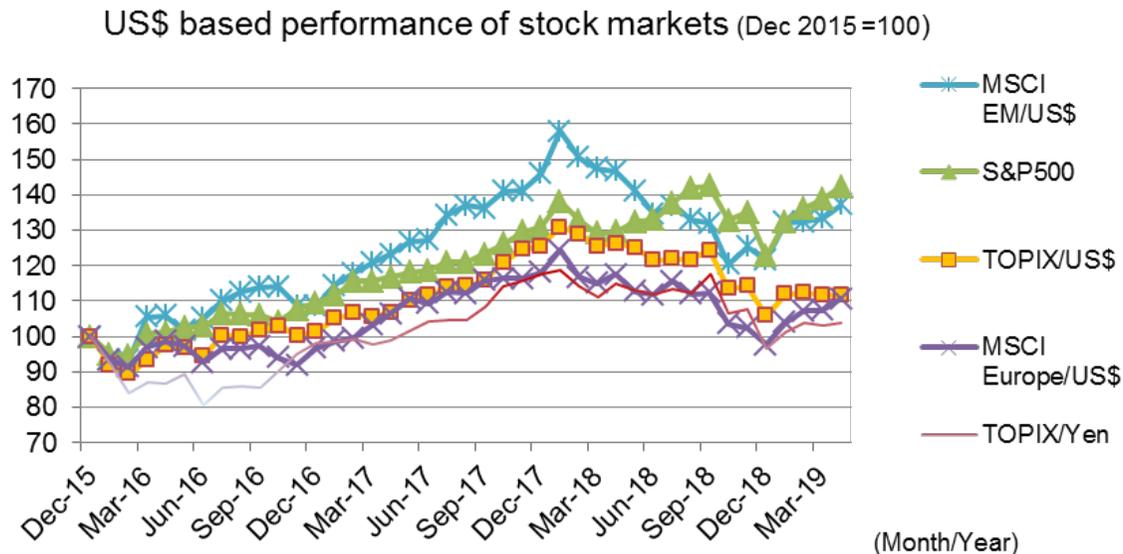
Base scenario & Upside / Downside risks for our forecasts

- Our **Base Scenario** is assuming the following views:
 - Severe tensions between US and China go on, however, US is going to avoid making a fatal blow for the global economy.
 - US economy keeps growing despite possible mild slowdown. Recession in 2019 is avoided.
 - Japan's private consumption grows mildly supported by wage growth.
 - Japanese yen does not get extremely stronger beyond 100 yen against US\$.
 - Tension in the East Asia or Middle East does not get out of control.
 - Central banks avoid killing economic growth and adjust the pace of monetary normalization.
- **Upside Risks** include:
 - China makes significant concession in the trade negotiation with US.
 - Stronger-than-expected global growth.
 - Denuclearization in Korean peninsula makes a visible progress.
 - Japanese economy gets stronger than expected boosted by large fiscal spending.
- **Downside Risks** include:
 - US economy significantly slows down and puts global economy into a recession.
 - Chinese economy falls into a significant slowdown spreading negative shock globally.
 - Trade negotiation between US and China completely breaks up igniting a decades of power struggle.
 - Seriously escalating geo-political tensions in Middle East & East Asia.
 - Global monetary tightening intensifies to choke global economy.
 - Political turmoil flares up in US over the impeachment of the President Trump.
 - Populism gains in Europe further destabilizing EU.

Note: SMDAM's projection is as of 16th Apr. 2019 and subject to updates without notice.

Japanese stocks are lagging behind peers in this time's rebounds

- Performance gap is widening between Japanese stock market and its peers.
- This time's recovery was ignited by easy monetary policy reinstated by FRB and ECB. BOJ is lagging in this easing contest.
- Also another factor in this backgrounds is continuing down-revision of earnings forecasts for Japanese companies. If earnings forecast bottoms out, Japanese stocks may have large upside potential to catch up peers.



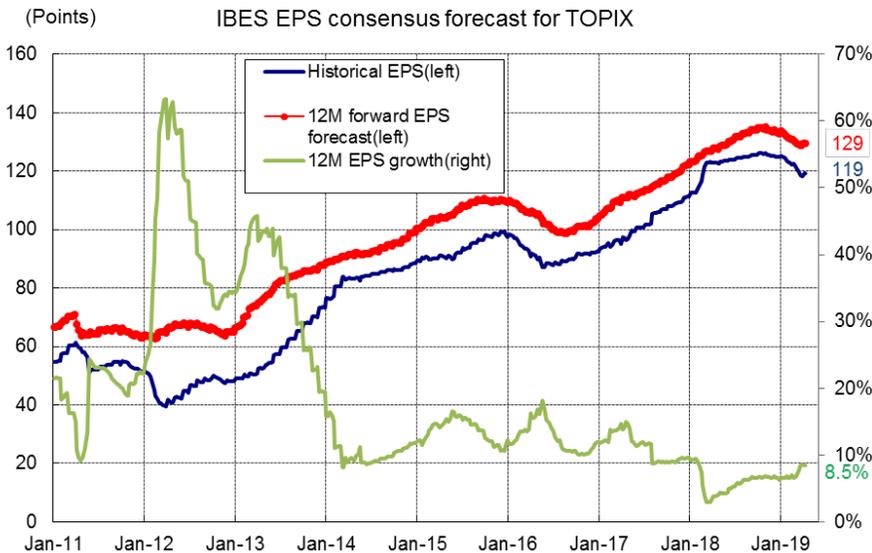
Notes: Data is up to 12th Apr. 2019.

(Source) Datastream, MSCI and Tokyo Stock Exchange, compiled by SMAM.



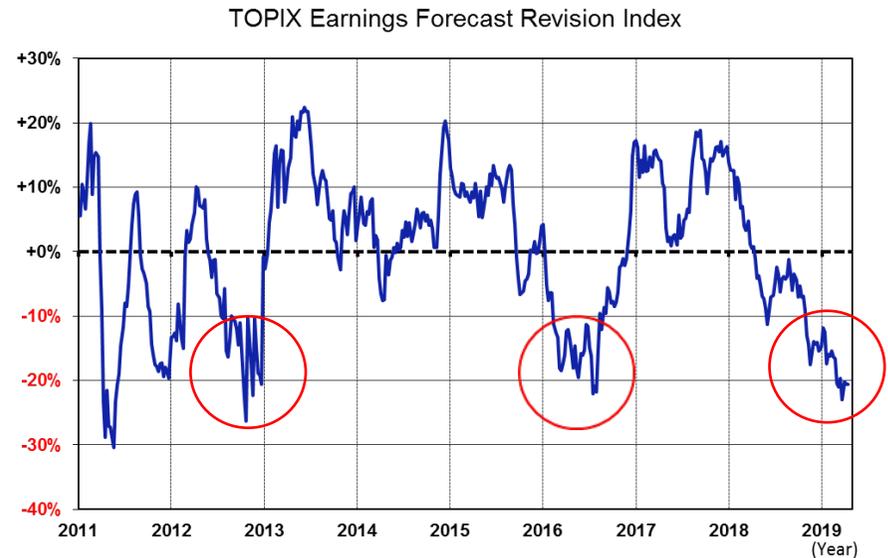
Earnings forecast may be bottoming out

- According to IBES, 12m forward consensus EPS forecast for TOPIX stopped deteriorating. Also, 12m forward EPS growth forecast rose to 8.5% lately.
- Earnings forecast revision index has reached to the level, which were bottom of the previous contraction periods in 2012 and 2016.



Note: Weekly data from 7th Jan. 2011 to 12th Apr. 2019. (Month/Year)

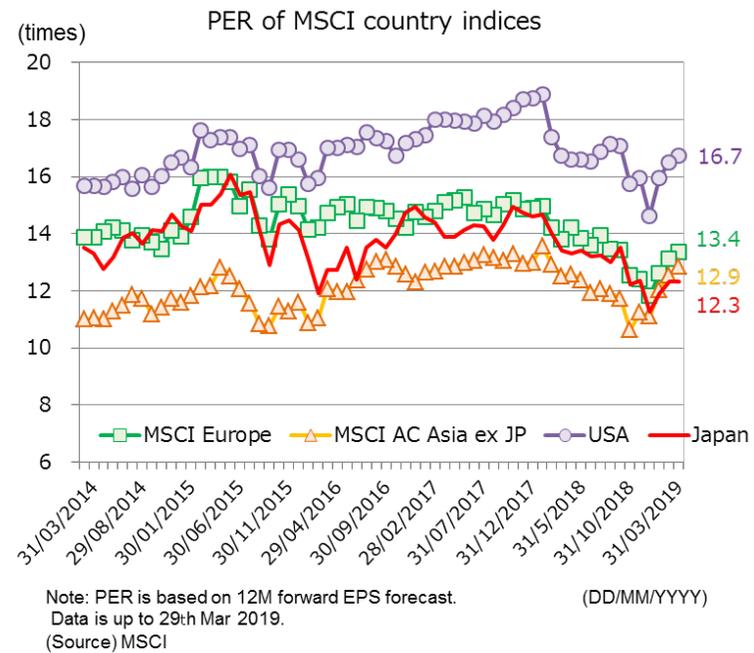
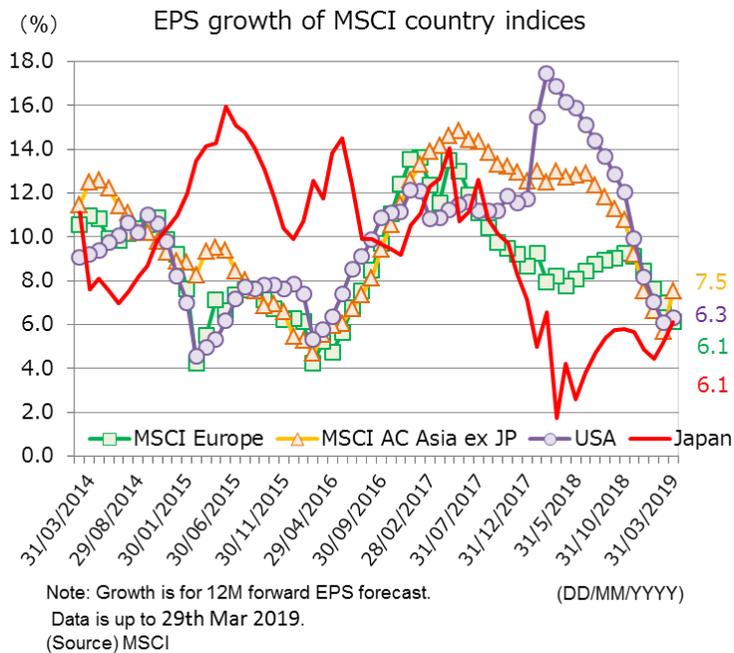
(Source) Datastream, IBES



Notes: Revision index= % of Analyst upgrades out of total Topix firms - % of downgrades.
Data is weekly from 7th Jan. 2011 to 12th Apr. 2019.
(Source): IBES, SMDAM

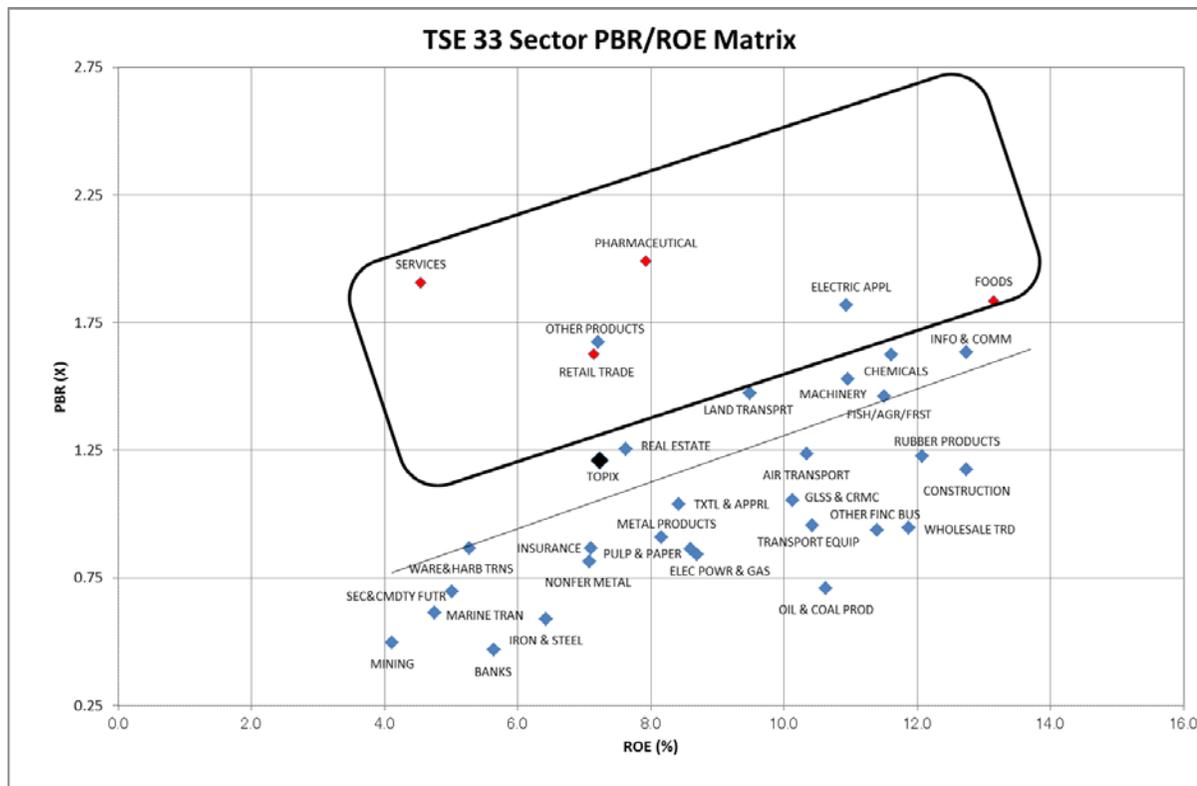
Forecast EPS growth is converging for global equity markets

- On the left hand chart, 12m forward EPS forecast growth rate is converging globally. It has been falling for US, Europe and Asia, meanwhile Japan showed recovery lately.
- In terms of PE Ratio, Japan looks relatively cheap on the right hand chart. Japan fell below Asia.



Stock valuation levels are widely dispersed among industry sectors

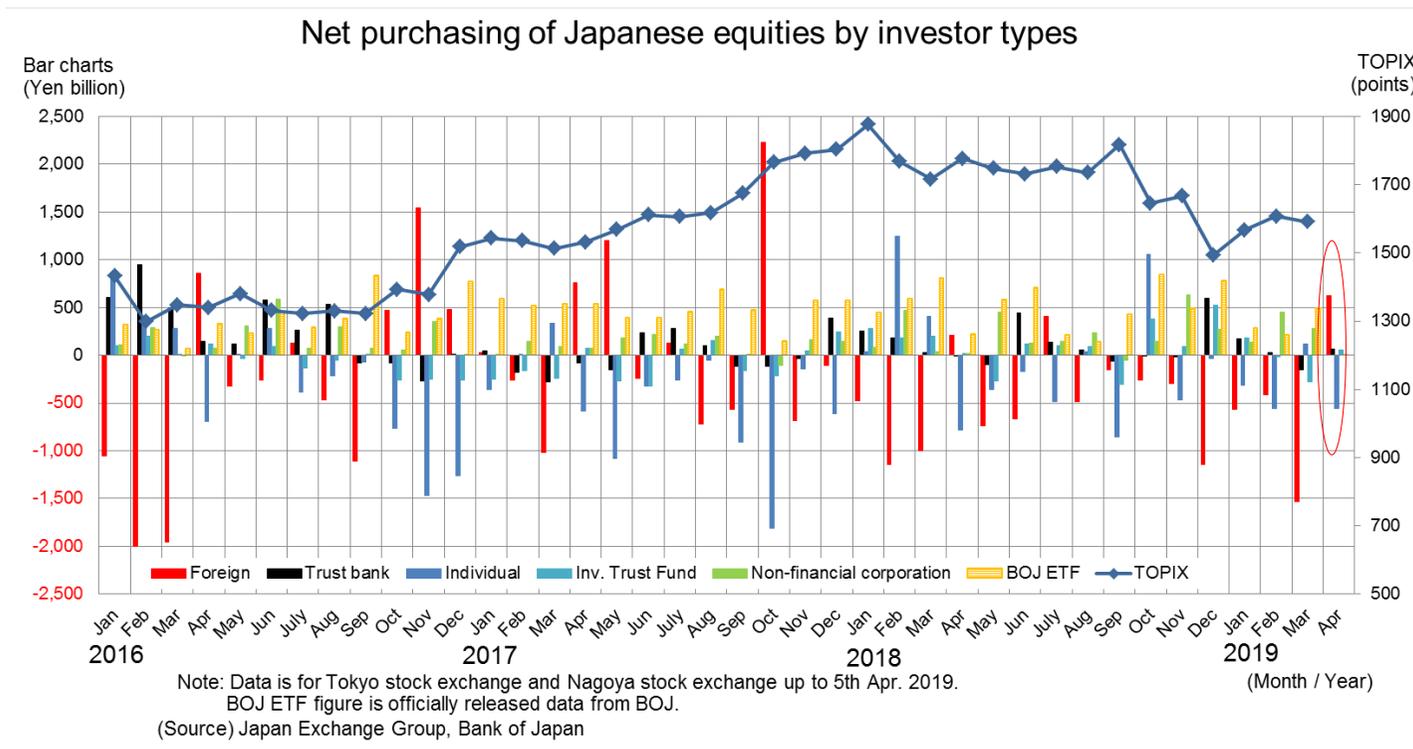
- PBR (Price to Book Ratio) for so called “defensive” sectors such as “Food” “Pharmaceuticals” “Retail trade” and “Services” are at very high levels compared to other sectors.
- This is supposed to be the result of popular Minimum Variance Portfolio Investing, which favors these low variance sectors.



Note: Data is as of 16th Apr. 2019
(Source): Bloomberg

Foreign investors turned to purchasing Japanese equities

- Foreign investors turned to purchasing Japanese equities from April so far.
- Foreign investors sold 5.4 trillion yens of Japanese equities in 2018, which was the largest annual net selling in the record since 1987. Their under-weighting of Japanese equity has widened.
- Once the outlook for Japanese equities improves, foreign purchasing could drive the Japanese equity market upwards again.



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