JAPAN

ON THE HUNT FOR GROWTH

Along with the United Kingdom, Japan has had the least vigorous recovery out of all of the G7 countries during the last two years. The country even recorded a 0.3% q/q contraction in real GDP in Q3 2022, pulled down by slowing residential investments and net exports. Even though consumption expenditures grew during Q3 (+0.2% q/q), it is still well below its 2019 levels. The end of Covid-19 restrictions, which were completely lifted in October, will provide additional growth during the last quarter of the year, but the overall increase for 2022 will be rather sluggish (+0.9%). We are expecting a further slowdown in business activity in 2023 (+0.3%), which implies a return to pre-pandemic levels during 2024 at the earliest.

The current economic scenario, which is already not very favourable, is still vulnerable to a range of external factors, and, in particular, to pandemic-related developments in China. Although the Chinese authorities have started to ease some restrictions, they remain binding. Covid-19 outbreaks have skyrocketed in some regions, disrupting the country's industrial production line operations once again. Japanese companies, particularly those in the motor-vehicle sector, are heavily reliant on these production lines in China. The war in Ukraine and its repercussions on the global energy market, which are still not yet fully clear, could once again hinder business activity, as Japan imports most of its energy resources.

However, the labour market continued to recover, with the size of the country's workforce and the employment rate now returning very close to 2019 levels. However, inflation accelerated this autumn (3.5% y/y in October at a national level and 3.6% y/y for Tokyo in November) and therefore further eroded consumer purchasing power, which fell by 2.2% q/q during Q3 2022 (Family Income & Expenditure Survey). As a result, this has forced some households to reduce their spending on non-essential goods. According to the Japanese Cabinet Office's survey, during November, purchasing intentions on durables among Japanese households hit their lowest levels since the survey began in 1982.

Wage growth in Japan is therefore still at historically low levels, but the rise in inflation and the ongoing major recruitment problems are an unprecedented combination that could drive salaries up. As a result, salary negotiations next spring will be a major event: Rengo, the country's largest Trade Union Confederation, is demanding wage increases of around 5%, which would be the highest rise for 28 years.

In order to absorb the energy shock, a second supplementary budget for the 2022 tax year (1st April-31st March) was introduced in early November, which committed to an additional Y29.1 trillion in public spending. This rise significantly reinforces the first supplementary budget introduced last May, which stood at Y2.7 trillion. This increased spending will be mainly financed (80%) by debt, which will mostly be absorbed by the Bank of Japan (BoJ). Since the start of Quantitative and Qualitative Monetary Easing in April 2013, which coincided with the launch of the Abenomics programme, the BoJ has bought more than Y400 trillion (USD 2940 billion) worth of Japanese sovereign bonds, and its share in total public debt has quadrupled, going from 10% in early 2013 to 43% in September 2022.

THE FALLING YEN INFLATES PROFITS

According to the Japanese Ministry of Finance report, Japanese corporate profits fell sharply during Q3 (-5.3% q/q), but this drop must be analysed with the benefit of hindsight. Corporate profits hit an al-time high during the previous quarter and remain elevated this autumn, at Y23.3 trillion or 17.0% of GDP.

GROWTH & INFLATION

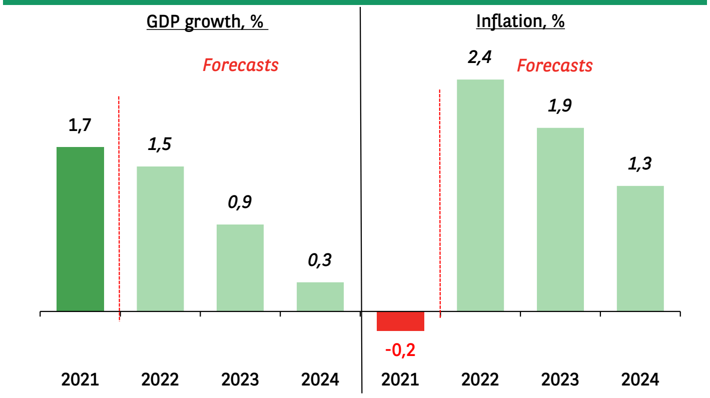

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

In addition, the downturn during the third quarter stemmed particularly from the services sector (-13.1% q/q), which was hit harder by the weak recovery in domestic consumption than export-oriented industrial companies. In fact, export-oriented industrial companies managed to post record Q3 profits, up 6.9% q/q, thanks to the drop in the yen, which has helped to inflate profits repatriated from subsidiaries based abroad. These subsidiaries are accounting for an increasingly large proportion of Japanese industrial companies[1].

However, the exchange rates effect is expected to significantly wear off during 2023. With inflation slowing in the United States, and expectations that the US Federal Reserve will raise its key rates less than expected, the yen has already regained ground vis-à-vis the dollar. Even though Japanese Government bond interest rates are still fixed at the limit set by the BoJ (0.25% on 10-year bonds), pressure on the Japanese central bank to change its yield curve control policy, which has been in place since September 2016, has somewhat eased. Nevertheless, the expected appointment of a new Governor of the BOJ in April 2023, replacing Haruhiko Kuroda, will be a pivotal moment. However, it is unlikely that this new Governor will radically shift the direction of monetary policy, which should remain very accommodating.

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1See the BNP Paribas Charts of the week: An increasingly large proportion of Japanese subsidiaries based abroad, 1 November 2022