

# Japan

## Risks on the rise

Although Japan's economic openness is relatively limited, the high concentration of Japanese exports to China, and the other Asian countries in general, creates a major external risk for the dynamics of Japanese growth. This situation is squeezing the manufacturing sector, but for the moment, its difficulties do not seem to have carried over to the other sectors of the economy. The VAT increase planned for October should encourage households to make some early purchases, while the high level of uncertainty is hampering corporate investment. In this environment, the Bank of Japan is expected to maintain a very accommodating monetary policy, although this is unlikely to trigger a sustainable upturn in price inflation.

Hit by a typhoon in the third quarter, Japan's economic growth profile was highly volatile in 2018. The planned VAT increase in October 2019 should dampen private consumption in the year-end period as well as in 2020, while Japan's high exposure to Asia, and China in particular, makes the country highly vulnerable to an extended economic slowdown in the region.

### All eyes riveted on Asia

In 2018, the Japanese economy slowed down sharply, with annual growth of only 0.8%, compared to 1.9% in 2017.

In Q1 2019, growth was relatively robust at 0.6% q/q. Foreign trade made a net positive contribution to growth, thanks essentially to a contraction in imports at a time of sluggish domestic demand. Exports also declined, especially to destinations on the Asian continent. For the rest of the year, plans to increase the VAT rate from 8% to 10%, which the authorities have scheduled for October after postponing it on two occasions already, should encourage households to make early purchases. Private consumption is likely to rise significantly in Q3 before slowing again in Q4. The negative effect will continue in 2020. Investment risks being undermined by the persistently high level of uncertainty, especially in the manufacturing sector, which is more exposed to the current slowdown in world trade and in the Chinese economy (China accounts for about 20% of Japanese exports). The Bank of Japan's most recent Tankan survey, a reliable indicator of business confidence, shows that the situation in Japan's manufacturing sector has eroded sharply again. The purchasing managers index (PMI) for the manufacturing sector paints a similar picture: at 49.3 in June, below the 50 threshold that separates expansion from contraction. The other sectors seem to have been spared for the moment.

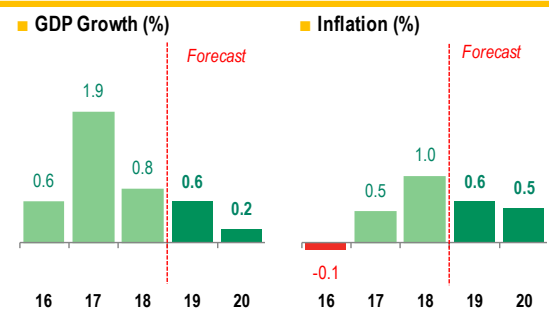
All in all, Japanese growth is expected to drop sharply to an average annual rate of 0.2% in 2020.

### An ever more accommodating monetary policy

The Bank of Japan's monetary policy is already largely expansionist, but these sluggish macroeconomic projections could convince it to add another degree of accommodation at its monetary policy meeting in late July. It could begin by extending its forward guidance.

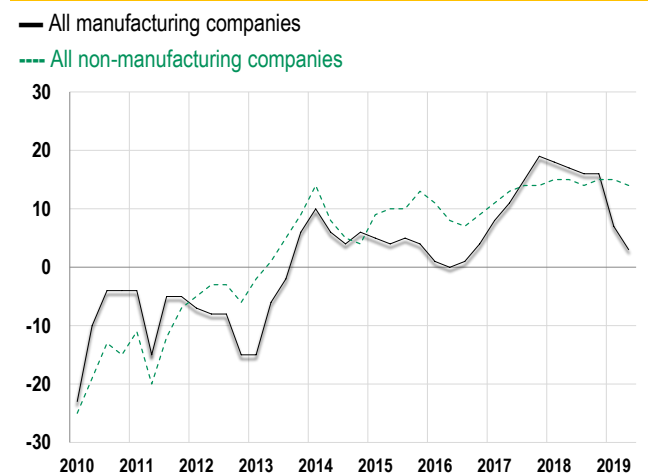
Even though its balance sheet accounts for 100% of the country's GDP, and interest rates are already negative for a broad range of maturities, the Bank of Japan's monetary policy has not had the intended impact on price momentum. Year-on-year inflation has

### 1- Growth and inflation



Source: National accounts, BNP Paribas

### 2- Bank of Japan's Tankan indicator



Source: Bank of Japan

averaged only 0.5% since the beginning of the year and has held below 1% since early 2016.

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