

Japan

The export sector is a source of concern

Japanese GDP growth was stronger than expected in early 2019. Despite the current troubles in the export sector, for the moment domestic demand - both public and private - is picking up the slack. In the short term, two sources of concern loom over Japan's macroeconomic scenario. First, Japan is highly exposed to the slowdown in both the Chinese economy and international trade. Second, the VAT increase in October will curb consumption during the year-end period and possibly in 2020 as well. Faced with these internal and external uncertainties, Japan will maintain accommodative monetary and fiscal policies, the effectiveness of which remains to be seen.

The most recent figures for Japanese economic growth were surprisingly strong as activity continued to expand at a relatively decent pace since year-end 2018. Yet two sources of concern still darken the horizon: the economy's exposure to Asia and the behaviour of Japanese consumers faced with October's VAT increase.

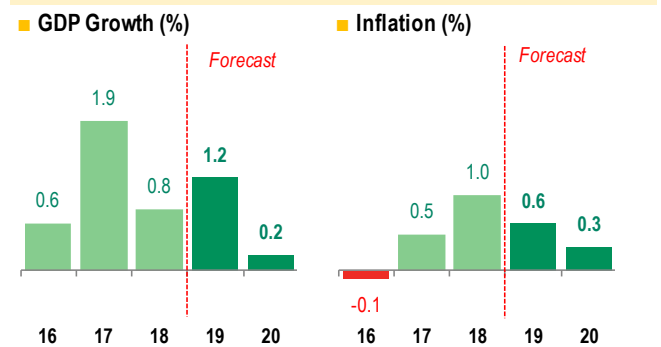
■ Sluggish exports

Since Q4 2018, Japanese GDP has grown at a relatively vigorous pace. Although quarterly growth declined, it remains relatively robust at 0.3% in Q2 2019, after 0.5% in Q1 2019 and 0.4% in Q4 2018. Like the other advanced countries, Japanese domestic demand picked up in H1 2019, but exports were hit by a sluggish environment. The economic slowdown in Europe and in the emerging markets, notably China, combined with the slowdown in world trade and the trade tensions are straining Japan's export and manufacturing sectors.

The latest cyclical indicators reveal a sharp and protracted deterioration in the manufacturing sector. For several months now, manufacturing PMI has held below 50, the threshold separating expansion from contraction (48.9 in September 2019). Meanwhile the services PMI is still resilient and holding at comfortable levels (52.8). This robust momentum could reflect the strength of private consumption in Q3 2019, buoyed by early purchasing ahead of October's VAT increase. The Bank of Japan's latest Tankan survey, an indicator of business confidence, delivered the same message. Manufacturing activity continued to deteriorate in 2019, while non-manufacturing companies showed resilience. Given the manufacturing sector's heavy weighting in the Japanese economy, however, its troubles could have a greater impact on the country's growth over the coming months. In Japan, manufacturing value added is equivalent to 20% of GDP, compared to an OECD average of 14%.

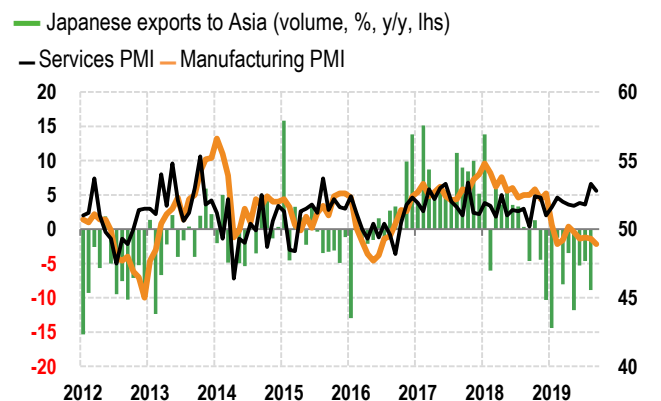
The difficulties in Japan's export sector began well before recent trade tensions. Highly concentrated in Asia, and in China in particular (nearly 20% of total exports), Japanese exporters have had to deal with a generally sluggish environment since 2011, when China's economy began to slow. Japanese exports to China were hard hit by a major backlash after the buoyant decade of the 2000s. In recent months, the difficulties in China, and in the Asian economies in general, have continued to erode the exports of Japanese companies. Japanese exports have declined continuously for several months.

1- Growth and inflation



Source: National accounts, BNP Paribas

2-Japanese exports and PMI



Source: Markit, Ministry of Finance

In 2020, Japanese GDP growth is expected to decrease further, to only 0.2%, compared to 1.2% in 2019. In addition to uncertainty over international trade, there is also concern about the 2-point VAT increase in October 2019 and the negative impact it is bound to have on household consumption. Public policy will remain accommodative, both in terms of monetary (which has only limited manoeuvring room) and fiscal policy (notably to offset the VAT increase).

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