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Indicators Review (25 Jul-21 Aug)

Economic Research Dept
Tsutomu Saito
Shotaro Kugo
Chisaki Masukawa

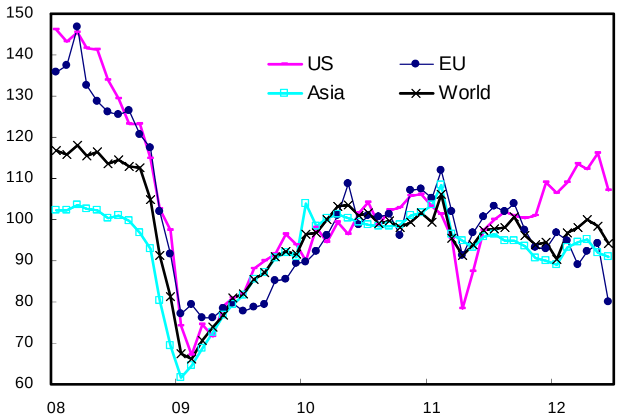
Summary

- The latest indicators of corporate activity suggest the recovery is increasingly likely to stall over the short term. Industrial production gained 0.4% m/m, rising for the first time in three months but still lacking momentum. Export value decreased for the first time in four months, falling 2.3% y/y. Visibility remains clouded as exports to China softened amid growing concerns about the economic slowdown there. Machinery orders (private demand, excl. orders for shipbuilding and from electric utilities) advanced 5.6% m/m, climbing for the first time in two months. However, it appears orders have remained weak in view of the decline a month earlier, with the Jul-Sep outlook calling for negative growth. On balance, indicators of corporate activity may slow down temporarily but we expect them to be largely solid going forward thanks to reconstruction demand following the Great East Japan Earthquake.

- Household indicators raised concerns about a modest lull in employment, incomes, and consumption. Real household consumption expenditures (excl. spending on housing/automobiles) fell 2.1% m/m, retreating for the second straight month. The unemployment rate improved 0.1 percentage point m/m, while the ratio of job offers to applicants rose 0.01 point m/m. Cash earnings slipped 0.4% y/y, falling for the second straight month. Contracted cash earnings dropped for the first time in five months with a 0.1-point y/y decline. We see employment, incomes, and consumption faring solidly as relatively healthy manufacturing activities should provide support.

- Upcoming statistical announcements include the financial statement statistics of corporations by industry (slated for 3 Sep). As yen appreciation raises concerns about a hollowing-out of the industrial base, the statistics are likely to serve as an important yardstick to gauge corporate capex. Our focus also rests on the second preliminary Apr-Jun GDP estimates that reflect a revision to the first estimates after the announcement of the financial statement statistics.

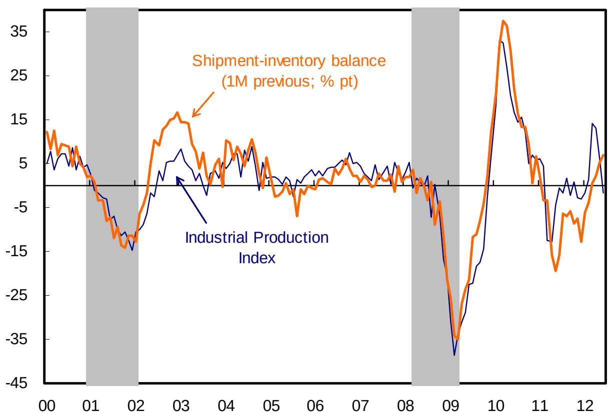
Exports by Trading Partner (CY2010 = 100; SA basis)



Source: Cabinet Office; compiled by DIR.

June Trade Statistics showed export value dropped 2.3% y/y, faring slightly better than the market consensus forecast but falling for the first time in four months. Exports to the eurozone sputtered due to the financial crisis and those to China also lost momentum amid a further slowdown in the economy there. Import value decreased 2.2% y/y, falling for the first time in 30 months. Japan's trade balance recorded the first surplus in four months, with a gap of Y60.3 billion. However, on a seasonally adjusted basis, Japan was still in a deficit with a Y300.8 billion gap. Exports for transportation equipment remained on an uptrend for the fifth consecutive month, rising 13.2%, but exports for chemicals and general machinery dropped noticeably. By destination, export value climbed 15.1% for the US, rising for the eighth consecutive month, but retreated 21.3% for the eurozone, falling for the ninth straight month. Going forward, we expect exports to pick up, barring further deepening of the European debt crisis. Imports should remain high, although the uptrend may not continue.

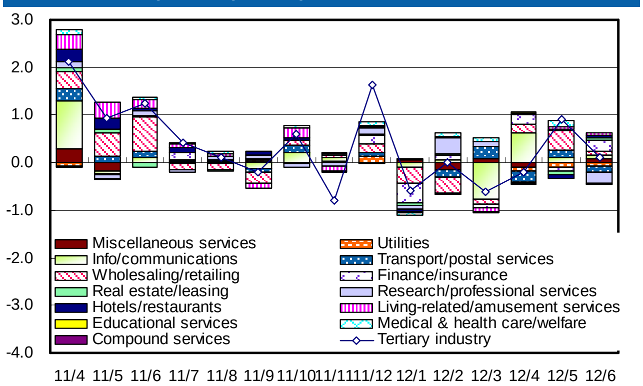
Production and Shipment-inventory Balance (y/y %)



Source: Ministry of Economy, Trade, and Industry; compiled by DIR.
Note: Shaded areas denote economic downturns.

The seasonally adjusted industrial production index grew 0.4% m/m in June, rising for the first time in three months but lagging the market consensus estimate. The index retreated 4.0% m/m for transportation equipment, falling for the second straight month, mainly because of the absence of a boost to production on the back of a revival of the government subsidy for green car purchases. Overall, the index should stay flat without a significant downturn going forward, assuming post-quake restoration demand provides support. The Survey of Production Forecast in Manufacturing shows a relatively bullish outlook by companies, calling for m/m production gains of a sharp 4.5% in July, the first growth forecast in four months. We caution, however, that benefits from the green car subsidy are playing out and the European economy is slowing, suggesting more likelihood of downside to production.

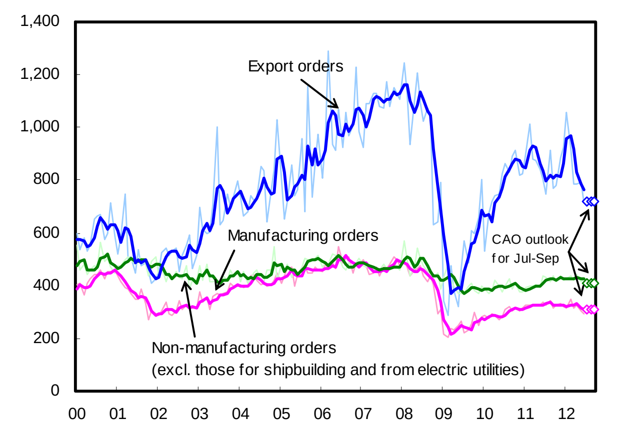
Indices of Tertiary Industry Activity (m/m %; % pt)



Source: Ministry of Economy, Trade, and Industry; compiled by DIR.

June tertiary industry activity (seasonally adjusted) rose 0.1% m/m, advancing for the second consecutive month. Finance/insurance showed a noticeable 2.2% gain as a rise in dividend payments drove up bank settlements, and stock trading turnover climbed. Retailing and hotels/restaurants also gained ground, more evidence of solid consumer spending based on supply-side data. Meanwhile, utilities pulled back 1.8% m/m as electricity sales continued to fall. Going forward, we see the service industry performing solidly overall amid restoration demand in construction and ongoing growth in information/communication.

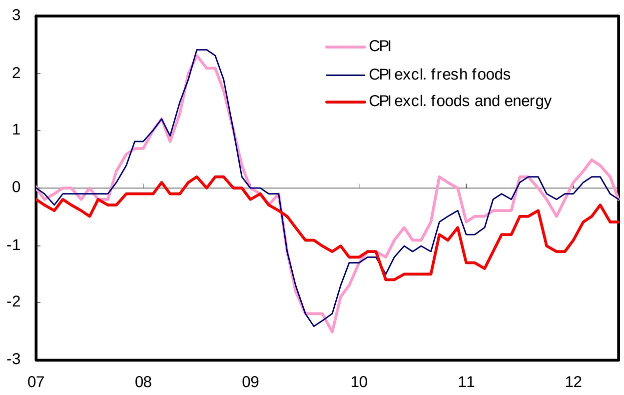
Machinery Orders by Demand Source (Y bil)



Source: Cabinet Office (CAO); compiled by DIR.
Note: Bold lines show three-month moving averages.

June machinery orders (private demand excl. orders for shipbuilding and from electric utilities; seasonally adjusted) rose 5.6% m/m. This was the first advance in two months but still below the market consensus forecast. There are signs of trends temporarily weakening, and it now seems likely that recovery will be more sluggish than expected. Orders from manufacturers fell 2.9% while rising 2.6% from non-manufacturers (excl. for shipbuilding, from electric utilities), somewhat weak. Among manufacturers, the drop in orders from materials makers was striking. Overseas orders dropped 9.8% m/m, the first decline in three months. Private demand (excl. for shipbuilding, from electric utilities) for Jul-Sep is expected to fall 1.2% q/q. While the sense of excessive capex is receding at many firms, their appetite for further investment is dulled by economic slowdown overseas. If exports to the US and to emerging economies can gradually pick up, investments by exporters may contribute to a recovery in capex going forward.

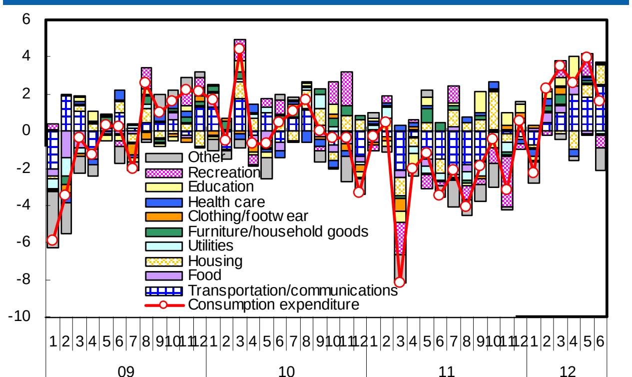
CPI by Definition (y/y %)



Source: Ministry of Internal Affairs and Communications; compiled by DIR.

June nationwide CPI excluding fresh foods (core CPI) slipped 0.2% y/y, falling short of the consensus forecast. Even on a seasonally-adjusted basis, the figure fell 0.3% m/m, with nationwide core-core CPI (excl. energy and foods/beverages but not alcohol) down 0.2%, both down for a second straight month. Seasonally-adjusted core CPI also fell 0.2% m/m on a three-month moving average basis, again a second month of decline, confirming a mild downtrend in prices. Falling crude oil prices are narrowing gains in energy prices, while the contribution of non-durables to y/y core CPI growth reversed to a 0.1-point drag. This explains why core CPI has fallen y/y for the last two months. We believe contributions from energy price gains will continue to narrow due to a follow-on effect from falling international crude prices. Meanwhile, we need to watch for effects of a drought in the US on grain prices.

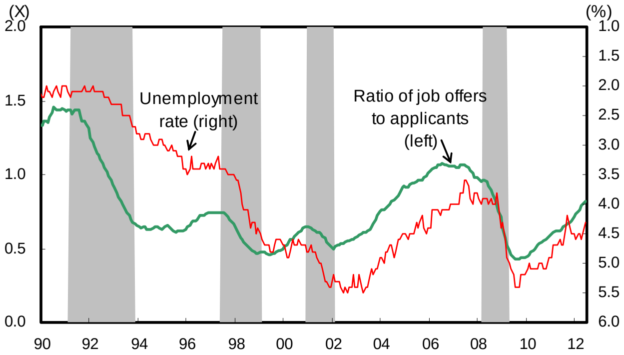
Real Household Consumption (all households; y/y %; % pt)



Source: Ministry of Internal Affairs and Communications; compiled by DIR.

June real household consumption expenditures rose 1.6% y/y, increasing for a fifth month in a row. Excluding spending on housing and automobiles, which is volatile, the seasonally-adjusted figure marked a second month of decline, falling 2.1% m/m. Car purchases, buoyed by eco-car subsidies, remain on the rise. However, their contribution to overall consumption figures could not make up for persistently low spending on TVs combined with low energy bills during the unseasonably cool summer. Moreover, improvement in consumer sentiment seems to have topped out, so that June consumption stalled a bit. Still, according to industry association data, luxury spending on goods such as travel and jewelry continued to rise. With gradual improvement in consumer sentiment supporting a recovery trend in corporate earnings, and reconstruction demand increasing production, wages are also on a recovery path. We are therefore seeing gradual ongoing improvement in consumption centered on big-ticket products.

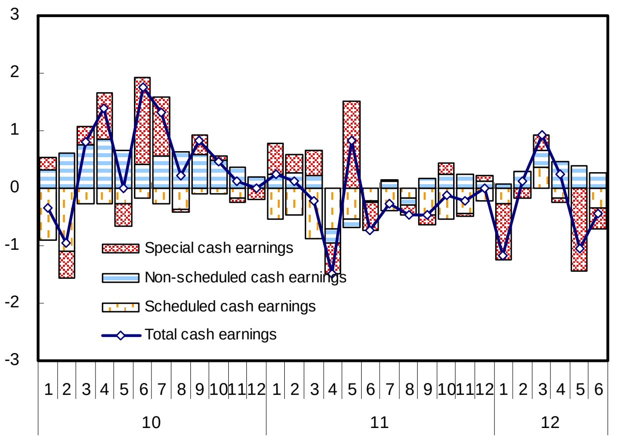
Unemployment Rate and Ratio of Job Offers to Applicants



Source: Ministry of Internal Affairs and Communications; Ministry of Health, Labour, and Welfare; compiled by DIR.
Note: Shaded areas denote economic downturns.

The June unemployment rate (seasonally adjusted) improved 0.1 points m/m to 4.3%. The number of employed rose by 270,000, while those unemployed and looking for work fell by 80,000. At the same time, the population outside the labor force dropped by 180,000. We believe the good news goes beyond the numbers, with the number of employed up for both men and women and the number of unemployed down. The June job offer to applicant ratio improved 0.01 points to 0.82X, with the number of job offers up and the number of job seekers flat. The ratio of new job offers to new applicants, a leading indicator, deteriorated 0.03 points to 1.32X, with the number of new job offers decreasing and new job applications flat. The Japanese economy has continued to recover, backed by solid domestic demand. Demand for labor has remained on an uptrend owing to post-quake reconstruction demand and an increasing need for medical/nursing services to cope with an aging society. The economy could hit a lull from the summer as the effects of government policies peter out. However, with Japan's economy likely to remain solid overall, we expect employment conditions to continue improving at a modest pace.

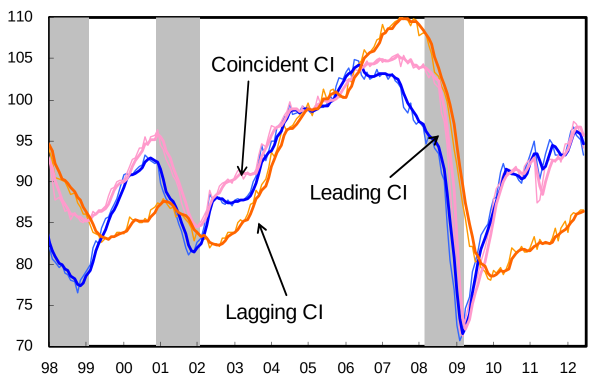
Breakdown of Labor Cash Earnings (y/y %; % pt)



Source: Ministry of Health, Labour, and Welfare; compiled by DIR.

According to the Monthly Labor Survey, total labor cash earnings edged down 0.4% y/y in June, declining for a second consecutive month. Scheduled cash earnings (regular pay), which tend to lag production activity and change only gradually, fell for the first time in two months, by 0.6%. Non-scheduled cash earnings (overtime pay), which are closely correlated with production, advanced 5.1%, rising for a tenth consecutive month. Contractual cash earnings, the sum of regular and overtime pay, dropped for the first time in five months, by 0.1% (basically flat). Improvement in personal income conditions has hit a lull since May due to a decline in summer bonus payments. However, with non-scheduled cash earnings continuing to increase and production expected to remain solid, personal income conditions should stay on a modest recovery trend.

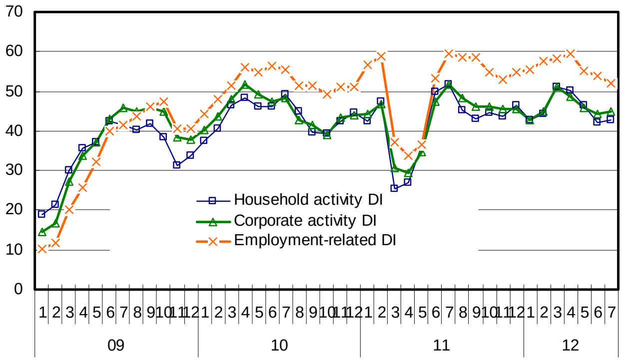
Coincident/leading/lagging CIs (CY05 = 100)



Source: Cabinet Office; compiled by DIR.
Notes: 1) Bold lines show three-month moving averages.
2) Shaded areas denote economic downturns.

In assessing June Indexes of Business Conditions (revised), the Cabinet Office downgraded its opinion to "weakening." The coincident CI fell 1.7 points m/m, dropping for a third consecutive month. The decline in production-related indices such as shipments of producer goods and durable consumer goods, as well as falling commercial sales, weighed considerably on the overall index. The three-month moving average fell 1.07 points, down for the first time in seven months. The leading CI also dropped 2.0 points, down for the third month in a row. Meanwhile, the three-month moving average was also down for a second consecutive month, by 1.13 points, reflecting deterioration in various areas including mounting industrial inventories and falling housing starts. The Japanese economy, which has been on a recovery track with the support of solid domestic demand, could hit a slow patch as production plateaus and the effects of government policies (subsidies for purchases of eco-friendly cars and homes) wane.

Economy Watchers Survey (DI; %pt)



Source: Cabinet Office; compiled by DIR.

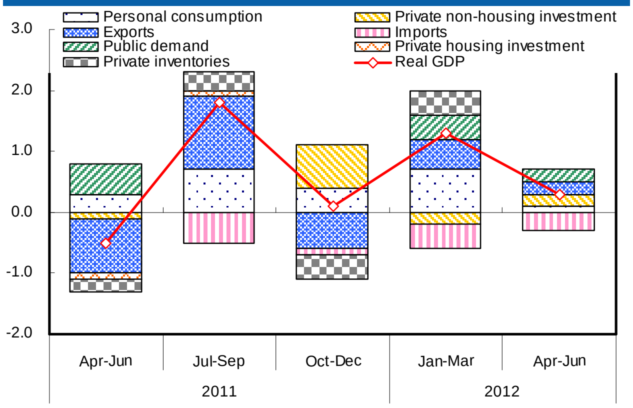
DI for current economic conditions (% pt)	2012 Feb	Mar	Apr	May	Jun	Jul	
Total	45.9	51.8	50.9	47.2	43.8	44.2	(0.4)
Household activity	44.4	51.1	50.3	46.4	42.1	42.8	(0.7)
Retail	44.9	49.9	48.6	44.8	40.4	40.2	(-0.2)
Food and beverage	38.4	49.1	49.7	44.0	37.0	42.1	(5.1)
Services	44.5	53.7	53.9	49.4	45.2	46.7	(1.5)
Housing	46.0	53.0	50.3	50.0	49.1	49.7	(0.6)
Corporate activity	44.8	51.0	48.7	45.9	44.4	44.8	(0.4)
Manufacturing	45.1	52.2	49.3	45.9	43.9	43.1	(-0.8)
Non-manufacturing	44.6	50.9	48.6	46.1	45.1	46.6	(1.5)
Employment-related	57.7	58.1	59.6	55.2	53.9	52.1	(-1.8)

Source: Cabinet Office; compiled by DIR.

Note: Figures in the parentheses show changes from the previous month.

Based on the Economy Watchers Survey in July, the Cabinet Office said "the economy had been so far picking up moderately, but now shows some weak movements." The current conditions DI rose for the first time in four months, edging up 0.4 points m/m. By category, the household activity DI rose 0.7 points, also up for the first time in four months. While vehicle sales growth hit a plateau, sales of air conditioners and other durables for the home were robust with the onset of a heat wave and heightened energy conservation awareness. The corporate activity DI also advanced for the first time in four months, by 0.4 points. Recovery was conspicuous for non-manufacturers as post-quake reconstruction demand boosted the construction industry, among others. Meanwhile, the economic sentiment of manufacturers was weighed down by falling orders, the result of yen appreciation and economic slowdowns overseas. The employment DI fell for the third month in a row, dropping 1.8 points. We attribute this to slowing growth in the overall number of job vacancies, as well as a lack of vacancies for permanent employment. The forecast DI dropped for the third consecutive month, shedding 0.8 points. Respondents cited future uncertainties stemming from an end to the government subsidy for purchases of eco-friendly cars, risk of electricity shortages, and a reactionary decline following last minute demand prior to the consumption tax hike. Overall, we think respondents retained their cautious tone, believing that the economy is in a lull and faced with numerous uncertainties.

Real GDP (q/q %)



Source: Cabinet Office; compiled by DIR.

Apr-Jun real GDP climbed 1.4% q/q annualized, posting a fourth consecutive quarterly gain (based on first preliminary report). While the pace of growth slowed vs. Jan-Mar, continued recovery in domestic demand contributed to solid expansion. Personal spending rose for a fifth consecutive quarter, by 0.1%, owing mainly on household durables and services such as restaurants and travel. Housing investment rose for the first time in two quarters, by 0.8%. Capex also grew for the first time in two quarters, by 1.5%, rebounding from the previous quarter and boosted by reconstruction-related demand and smartphone-related investments. Public investment expanded for the second quarter in a row, by 1.7%, with reconstruction demand gradually becoming apparent. Meanwhile, exports rose for a second consecutive quarter, by 1.2%, owing to solid demand from the US and ASEAN nations. Imports rose for the twelfth quarter in a row, by 1.6%. We expect the Japanese economy to track a mild recovery trajectory, backed by post-quake reconstruction demand and steady consumer spending. That said, contributions from foreign demand (export – import) will likely be slow to recover as resource imports linger at high levels, thereby keeping the economic recovery dependant on domestic demand.