

October 6, 2022

Economic Acumen

Commentary by CEBI Research Team

In Brief

- Japan's economy has demonstrated delayed pickup in growth momentum. However, the world's third-largest economy still faces an uncertain economic outlook on the growing concern over a synchronized global slowdown, rising inflation, supply chain constraints, Russia-Ukraine military crisis and 24-year low yen against the dollar.
- Lifted pandemic-related restrictions accelerate the pace of returning to normal work and consumption as well as increase cross-border business and tourism-related activities, thus releasing pent-up demand and investment. Surging aggregate demand put upward pressure on price level due to rising domestic wages and the yen depreciation with which inflation becomes a headwind to Japan's recovery.
- With unsuccessful yen intervention on increasingly divergent monetary settings between Japan and the U.S. alongside geopolitical tensions creating uncertainty for Japan's key industries, we are of the view that both consumption and export growth drivers have been undermined by the yen weakness and fluctuation of energy, commodity and food prices, thus posing risks to economic outlook of Japan's economy in coming quarters.

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Japan encountering bumpy recovery path

Japan's economy has demonstrated delayed pickup in growth momentum by returning to pre-pandemic size in the second quarter of 2022 amid continued normalization of manufacturing and business activities boosting consumption spending as well as exports. However, a series of economic challenges is clouding recovery momentum of Japan. The world's third-largest economy still faces an uncertain economic outlook on the growing concern over a synchronized global slowdown, rising inflation and supply chain constraints alongside Russia-Ukraine military crisis sparking volatility and sending the Yen to a 24-year low against the dollar as well as increasing worries for Japan's economic and financial stability. Looking forward, the road for Japan's economic recovery road is still bumpy on economic challenges both at home and abroad. Lifted pandemic-related restrictions accelerate the pace of returning to normal work and consumption as well as increase cross-border business and tourism-related activities, thus releasing pent-up demand and investment. Surging aggregate demand put upward pressure on price level due to rising domestic wages and the yen depreciation with which inflation becomes a headwind to Japan's recovery from the Covid-19 pandemic fallout. With unsuccessful yen intervention on increasingly divergent monetary settings between Japan and the U.S. alongside geopolitical tensions creating uncertainty for Japan's key industries, we are of the view that both consumption and export growth drivers have been undermined by the yen weakness and fluctuation of energy, commodity and food prices, thus posing risks to economic outlook of Japan's economy in coming quarters.

Complicated yen depreciation spiral further intensified by Government's intervention. Japanese yen has been on the downward spiral in 2022 as widening US-Japan yield spread and fragile recovery momentum trigger capital outflow towards the dollar, thus causing the yen against the dollar getting closer to 145 with YTD depreciation of more than 25%. The excess fluctuation of the yen prompted the Japanese Government to intervene in the foreign exchange market for the first time since 1998 in an attempt to support the yen. However, after one day rebound, the yen has returned to the

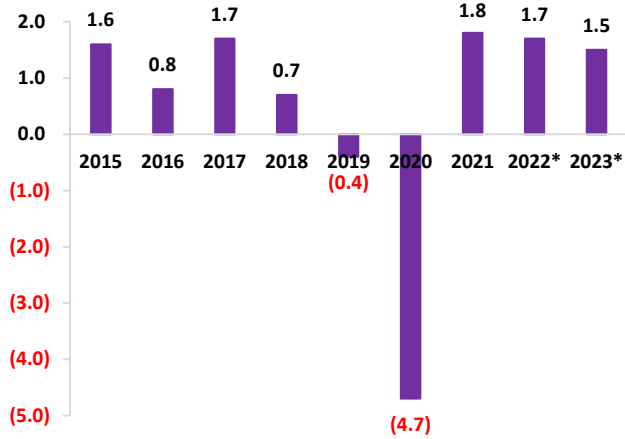
weak side, hitting its lowest level in two decades. In sum, the policy divergence between Japan's ultra-loose monetary policy and the U.S. tightening has contributed to the sharp slide in the yen with which short-lived intervention by the government only enhances volatility of the yen rather than reversing the depreciating trend. Looking forward, weakness of the yen is exacerbating pressure on the economy by amplifying the impact of soaring energy and commodity import prices. Cost pressures for companies rose at a fast pace, intensifying pressure on firms to pass on higher costs to consumers. We are of the view that further depreciation would reduce the purchasing power of firms and consumers, and hinder their ability to import key products. Further yen plunge would impose significant costs on the economy, thus worsening economic fundamentals and delaying economic recovery.

Japan's external trade worsening on high import price alongside uncertain export growth. International trade contributes significantly to the Japanese economy, with exports equivalent to more than 10% of GDP. Key exports include vehicles, machinery and manufactured goods. Lacking natural resources of its own, Japan has to import those resources for processing to produce manufactured goods for exports in order to earn the foreign reserves. Japan's main imports include mineral fuels, machinery and food. In sum, the Japanese economy has suffered a severe shock on external trade since the outbreak of the Covid-19 pandemic. Japan's trade deficit surged to JPY 2,817.3 billion in August 2022 from a JPY of 653.4 billion in the same month a year earlier. This was the largest trade shortfall on record, marking the 13th straight month of the deficit which was the longest stretch since 2015 and adding to concerns over a further worsening in the terms of trade for the export-oriented economy and the strength of the economic recovery. Looking ahead, the effect of a weak yen in shoring up Japan's exporting sector will be limited as manufacturers will continue to face rising input costs while Russia-Ukraine conflict creates difficulties for Japanese exporters to boost outbound shipments. The war and the resulting surge in consumer prices will dent economic growth and private consumption in Europe, decreasing orders in an important overseas market for Japanese companies. International trade and financial sanctions on Russia and production disruptions in Ukraine will also disrupt supply chains, which undermine productivity of Japanese carmakers and electronics manufacturers. We are of the view that gloomy international trade outlook remains intact, thus clouding growth momentum of Japanese economy.

Lifted travel restrictions boosting cross-border activities. Japan will open its doors to foreign tourists on 11 October 2022, after more than two years of closed borders due to the Covid pandemic. Tourists will be able to visit Japan without a visa and will no longer need to go through a travel agency. Although the opening is timed for the usually popular winter season, the pent-up demand for travel to Japan may not be unleashed immediately as most of Asian countries have scraped tough pandemic-related border restrictions, paving the way for mass tourism. Also, pre-pandemic tourism to Japan was heavily influenced by the Chinese outbound market and the return of mass

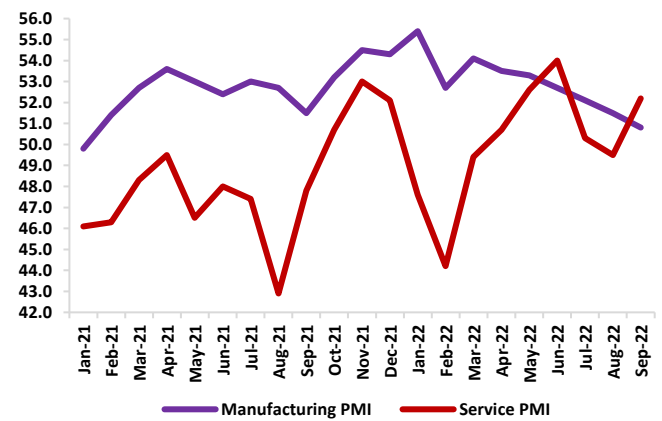
tourism in Japan is likely to be limited by China's zero-Covid policy as Chinese citizens face their own travel restrictions at home and won't be traveling to Japan in large numbers. Nevertheless, Japan's inbound tourism is expected to recover gradually with the aid of relaxed border restrictions and weak yen that help buoy the Japanese economy. The lifted border controls will brace for accelerating cross-border economic activities and travel-related consumption spending that support the recovery of the Japanese economy.

Fig. 1: Japan GDP growth (YoY%)



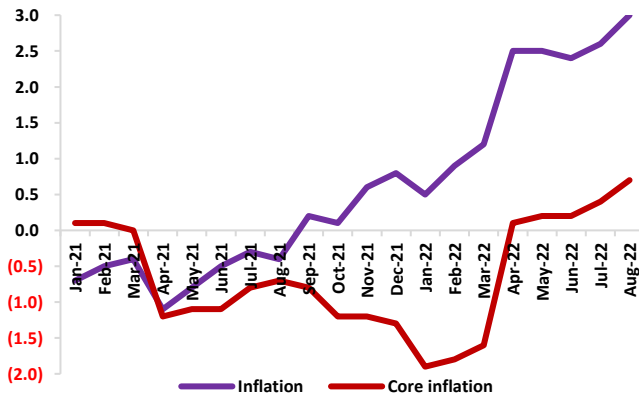
Source: Bloomberg *CEBI forecast

Fig. 2: Japan Manufacturing and Service PMI



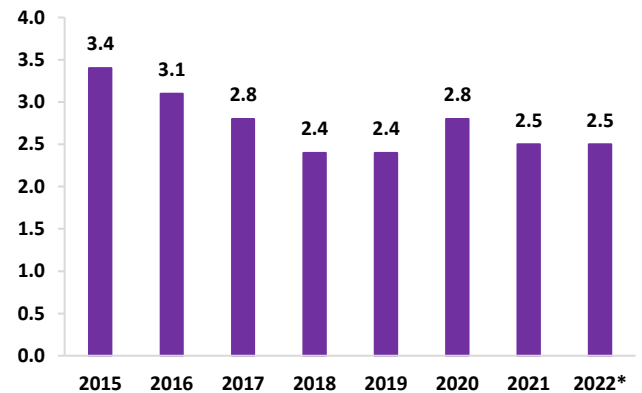
Source: Bloomberg

Fig. 3: Japan inflation and core inflation (%)



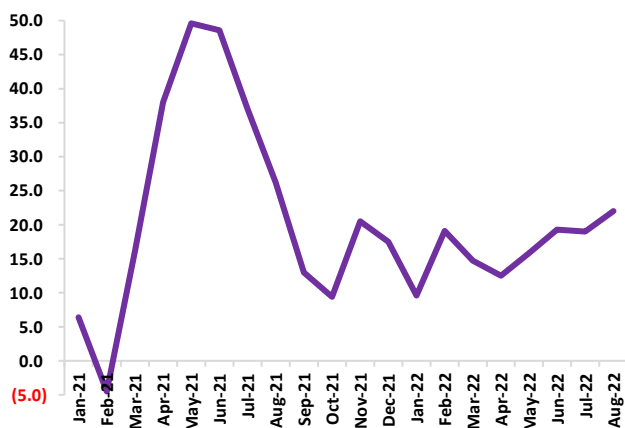
Source: Bloomberg

Fig. 4: Japan Unemployment rate (%)



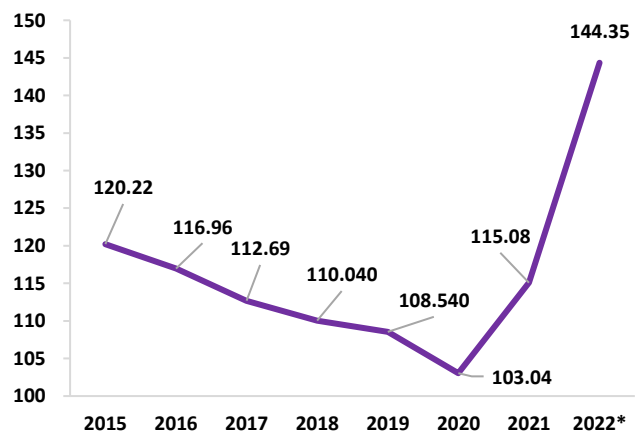
Source: Bloomberg *August

Fig. 5: Japan's exports (%)



Source: Bloomberg

Fig. 6: USD/¥en



Source: Bloomberg *5th October

China economic indicators

	2020	1Q2021	2Q2021	3Q2021	4Q2021	2021	1Q2022	2Q2022
Real GDP (YoY%)	2.2	18.3	7.9	4.9	4.0	8.1	4.8	0.4
PMI Manufacturing (%)	51.9	51.3	51.0	50.0	49.9	50.3	49.9	49.1
PMI Non-Manufacturing (%)	55.7	53.4	54.5	51.3	52.5	52.7	50.4	48.1
Exports (RMB YoY %)	4.0	38.7	19.9	14.4	17.8	21.2	13.4	13.3
Imports (RMB YoY %)	(0.2)	19.3	32.4	15.7	18.7	21.5	7.6	1.9
Trade Balance (RMB/bn)	3634.2	709.3	866.8	1180.9	1608.4	4372.1	1029.7	1478.2
Exports (USD YoY %)	3.6	48.8	30.6	24.2	22.9	29.9	15.8	13.0
Imports (USD YoY %)	(0.6)	29.4	44.2	25.4	23.7	30.0	9.8	1.7
Trade Balance (USD/bn)	524.0	108.6	134.0	183.0	250.2	676.9	162.9	227.8
CPI (YoY %)	2.5	0.0	1.1	0.8	1.8	0.9	1.1	2.2
PPI (YoY %)	(1.8)	2.1	8.2	9.7	12.2	8.1	8.7	6.8
FAI (YTD/ YOY %)	2.9	25.6	12.6	7.3	4.9	4.9	9.3	4.2
Real Estate Investment (YTD YoY %)	7.0	25.6	15.0	8.8	4.4	4.4	0.7	(9.0)
Industrial Production (YoY %)	2.8	24.6	9.0	4.9	3.9	9.6	6.5	0.6
Retail Sales (YoY%)	(3.9)	33.9	13.9	5.0	3.5	12.5	3.3	(4.6)
New Lending (RMB/bn)	19632.9	7667.9	5084.5	3961.4	3231.2	19945.1	8338.9	5340.1
M2 (YoY %)	10.1	9.4	8.6	8.3	9.0	9.0	9.7	11.4
Aggregate Financing (RMB bn)	34791.8	10288.9	7510.9	6967.1	6584.1	31351.0	12031.0	8946.9

	Sept 21	Oct 21	Nov 21	Dec 21	Jan 22	Feb 22	Mar 22	Apr 22	May 22	Jun 22	July 22	Aug 22	Sept 22
Real GDP (YoY%)	4.9	-	-	4.0	-	-	4.8	-	-	0.4	-	-	-
PMI - Manufacturing %	49.6	49.2	50.1	50.3	50.1	50.2	49.5	47.4	49.6	50.2	49.0	49.4	50.1
PMI - Non-manufacturing%	53.2	52.4	52.3	52.7	51.1	51.6	48.4	41.9	47.8	54.7	53.8	52.6	50.6
Exports (RMB YoY %)	19.7	20.1	16.3	17.3	20.8	3.9	12.7	1.6	14.8	21.8	23.9	11.8	-
Imports (RMB YoY %)	9.7	14.3	25.6	16.0	17.9	9.4	(1.1)	(1.9)	2.2	4.8	7.4	4.6	-
Trade Balance (RMB/bn)	441.6	547.8	460.6	600.1	537.3	178.8	287.6	317.7	494.8	646.5	682.7	535.9	-
Export (USD YoY %)	28.0	26.9	21.7	20.9	24.0	6.1	14.4	3.6	16.4	17.7	18.0	7.1	-
Import (USD YoY %)	17.2	20.4	31.4	19.5	20.9	11.5	0.5	0.1	4.0	1.0	2.3	0.3	-
Trade Balance (USD/bn)	68.1	84.8	71.7	93.7	82.7	28.1	45.3	50.0	77.5	97.4	101.3	79.4	-
CPI (YoY %)	0.7	1.5	2.3	1.5	0.9	0.9	1.5	2.1	2.1	2.5	2.7	2.5	-
PPI (YoY %)	10.7	13.5	12.9	10.3	9.1	8.8	8.3	8.0	6.4	6.1	4.2	2.3	-
FAI (YTD/ YOY %)	7.3	6.1	5.2	4.9	-	12.2	9.3	6.8	6.2	6.1	5.7	5.8	-
Real Estate Investment (YTD/ YoY %)	8.8	7.2	6.0	4.4	-	3.7	0.7	(2.7)	(4.0)	(5.4)	(6.4)	(7.4)	-
Industrial Production (YoY %)	3.1	3.5	3.8	4.3	-	7.5	5.0	(2.9)	0.7	3.9	3.8	4.2	-
Retail Sales (YoY%)	4.4	4.9	3.9	1.7	-	6.7	(3.5)	(11.1)	(6.7)	3.1	2.7	5.4	-
New Lending (RMB/bn)	1663.0	826.2	1273.2	1131.8	3980.0	1233.6	3125.4	645.4	1888.4	2806.3	679.0	1254.2	-
M2 (YoY %)	8.3	8.7	8.5	9.0	9.8	9.2	9.7	10.5	11.1	11.4	12.0	12.2	-
Aggregate Financing (RMB bn)	2902.6	1617.6	2598.3	2368.3	6162.3	1221.2	4647.5	943.0	2833.8	5170.7	762.0	2432.2	-
Urban Unemployment Rate (%)	4.9	4.9	5.0	5.1	5.3	5.5	5.8	6.1	5.9	5.5	5.4	5.3	-
Urban Unemployment Rate in 31 major cities (%)	5.3	5.0	5.1	5.1	5.1	-	6.0	6.7	6.9	5.8	5.6	5.4	-

World Economic/Financial Indicators

Global Indices			
Index	Closing Price	P/E	One Week chg(%)
U.S.			
DJIA	30,273.87	16.69	1.99
S&P 500	3,783.28	18.54	1.73
NASDAQ	11,148.64	35.76	0.88
EUR			
FTSE 100	7,052.62	13.67	0.67
DAX	12,517.18	12.21	2.74
CAC40S	5,985.46	12.62	3.82
STOXX EUR 600	398.91	13.89	2.44
Asia			
HSI	18,087.97	6.83	1.27
HSCEI	6,224.61	6.01	1.21
CSI300	3,804.89	13.92	(1.33)
SSE Composite	3,024.39	13.25	(2.07)
SZSE Composite	1,912.00	34.31	(2.63)
NIKKEI 225	27,120.53	27.36	3.62
KOSPI	2,215.22	9.38	(0.39)
TWSE	13,801.43	9.96	2.49
S&P/ASX 200	6,815.68	13.99	5.47
MSCI Index			
MSCI WORLD	2,500.07	16.15	2.51
MSCI DEVELOPED	580.85	15.17	2.66
MSCI EMERGING	909.52	10.18	3.84
MSCI US	3,604.39	19.04	1.82
MSCI UK	2,032.19	13.65	0.72
MSCI France	171.02	14.32	3.86
MSCI Germany	124.33	11.69	2.53
MSCI China	59.84	10.45	3.58
MSCI Hong Kong	12,060.30	17.89	4.42
MSCI Japan	1,166.70	14.86	3.22

* As of 2022/10/05 closing for all markets

Money market		
	Yield (%)	One Week chg(%)
US Fed Fund Rate	3.25	0.00
US Prime Rate	6.25	0.00
US Discount Window	3.25	0.00
ECB Rate (Refinancing)	1.25	0.00
BOJ Policy Rate	(0.10)	0.00
US Treasury (1 Mth)	2.7123	0.2391
US Treasury (1 Yr)	4.1047	0.1761
US Treasury (5 Yr)	3.9662	0.0184
US Treasury (10 Yr)	3.7528	0.0217
US Treasury (30 Yr)	3.7538	0.0548
1-Month LIBOR	3.1857	0.0651
3 Month LIBOR	3.7407	0.0989
Japan 1-Yr Gov. Bond	(0.137)	(0.024)
Japan 10-Yr Gov. Bond	0.252	0.005
German 1-Yr Gov. Bond	1.686	(0.071)
German 10-Yr Gov. Bond	2.034	(0.086)
China LPR (1-year)	3.65	0.00
China 1-Yr Gov. Bond	1.845	0.043
China 5-Yr Gov. Bond	2.574	0.112
China 10-Yr Gov. Bond	2.750	0.070
O/N SHIBOR	2.081	0.616
1-mth SHIBOR	1.711	0.086
HK Base rate	3.50	0.00
O/N HIBOR	1.3067	(0.0760)
1-mth HIBOR	2.5196	(0.0902)
O/N CNH HIBOR	1.0609	(0.1846)
1-mth CNH HIBOR	2.8827	(0.0909)
Corporate Bonds (Moody's)		
Aaa	4.77	(0.15)
Baa	5.89	(0.16)

Global Commodities			
	Unit	Price	One Week chg(%)
Energy			
NYMEX WTI	USD/bbl	87.76	6.83
ICE Brent Oil	USD/bbl	93.37	4.53
NYMEX Natural	USD/MMBtu	6.93	0.90
Basic Metals			
LME Aluminum	USD/MT	2,345.25	11.53
CMX Copper	USD/lb.	350.05	4.23
LME Steel Rebar	USD/MT	685.00	1.93
LME Lead Cash	USD/MT	2,075.25	13.37
Precious Metals			
CMX Gold	USD/T. oz	1,712.78	5.15
Gold Futures	USD/T. oz	1,720.80	3.04
CMX Silver	USD/T. oz	20.47	12.07
NYMEX Platinum	USD/T. oz	923.29	8.90
Agricultural			
CBOT Corn	USD/bu	684.00	2.01
CBOT Wheat	USD/bu	902.00	(0.14)
NYB-ICE Sugar	USD/lb.	17.95	1.36
CBOT Soybeans	USD/bu.	1,369.75	(2.77)

Currency market		
	Spot Rate	One Week chg(%)
US Dollar Index	111.21	(1.24)
Euro/USD	0.9924	3.66
GBP/USD	1.1376	6.62
AUD/USD	0.6471	0.87
USD/CAD	1.3574	(1.39)
USD/JPY	144.35	(0.22)
USD/CHF	0.9828	(0.69)
USD/CNY Midpoint	7.0998	1.54
USD/CNY	7.1160	(0.17)
USD/CNY NDF-12-mth	6.9670	(2.32)
USD/CNH	7.0562	(2.52)
USD/HKD	7.8498	0.00
CNY/HKD	1.1030	1.18
CNH/HKD	1.1123	2.57
USD/KRW	1,410.60	(0.83)
USD/TWD	31.57	(0.98)
USD/SGD	1.4240	(1.53)
USD/INR	81.52	(0.07)

All data sources: Bloomberg

Disclosures

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