

Increased feeling of a slowdown in exports due to trade friction between the US and China

YUUSUKE YOKOTA
KAZUFUMI KESHI
ECONOMIC RESEARCH OFFICE

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MUFG Bank, Ltd.
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1. The Real Economy

As the conflict between the US and China over trade continues, there is an increased feeling that exports are slowing. The Exports Quantum Index, published in December 2018's Trade Statistics, continued to decline from last year, falling to -5.8% YoY. The breakdown by country reveals exports to the US remained positive at 3.9% YoY, whereas those to China dropped to -13.8% YoY, dragging down the total (Chart 1). Despite views that the direct effect of additional tariffs on the volume of sales to China's domestic market by Japanese corporates' Chinese subsidiaries – which account for 70% of sales – would be limited, subsidiaries' business results indicate the amount of sales fell sharply from the latter half of 2018 and indirect impacts have started to appear, such as a wait-and-see approach to investment locally and a decrease in exports of finished goods by local businesses.

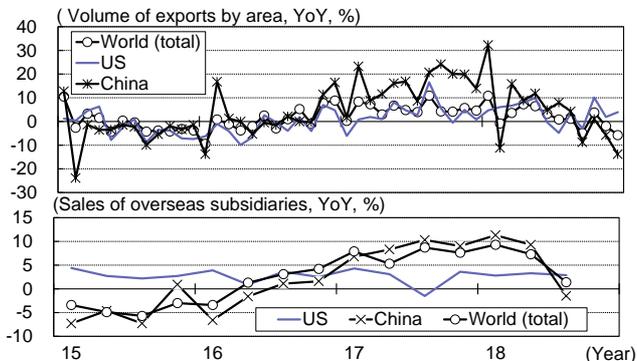
It goes without saying that this decrease in exports will put downward pressure on corporate earnings. Looking at the trend of exports and corporate sales, of course there is a strong correlation between exports and manufacturing sector sales, yet there is also a distinct relationship between exports and non-manufacturing sales (Chart 2). Currently, corporate earnings remain robust; there was an increase in earnings from the previous year for the last nine quarters up until the July-September quarter in 2018. However, if exports fall further, the effect of the increase in revenue may not be enough to balance out a rise in personnel costs brought about by the labour shortage as it has done up until now.

That being said, exports to China account for approximately 20% of total exports and are slowing, whereas exports to the US – which also constitute around 20% of all exports – are still robust, so it does not seem there will be a slump in external demand in global terms. In addition, the results of December's Business Outlook Survey show 70% of Japanese corporations' sales outlooks for the next fiscal year are “unchanged” or “rising”, confirming that businesses are not necessarily taking a pessimistic view amid solid domestic demand. The current decline in oil prices is also a positive factor for corporate earnings as it means a decrease in input prices.

Based on the above, it appears that the slowdown in exports will not lead to a deceleration of domestic economic growth via a deterioration of corporate earnings in the short term. However,

as Japan anticipates a consumption tax hike in October, there are fears that its economy will be unsettled if the US economy slows on top of a stall in the growth of China's economy. It is important to be sufficiently cautious about the future of US-Chinese trade talks and their impact as 1st March draws closer and the grace period before tariffs are increased draws to a close.

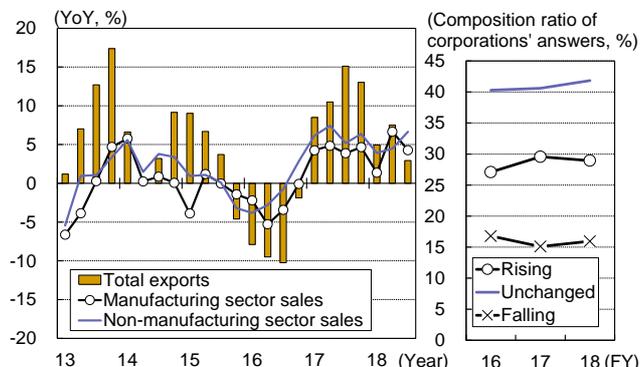
Chart 1: Quantity of Exports by Area and Sales of Overseas Subsidiaries



Note: "Sales of overseas subsidiaries" are YoY values at the time of conversion to USD

Source: Ministry of Finance, Ministry of Economy, Trade and Industry, MUFG Bank Economic Research Office

Chart 2: Non-Financial Corporations' Sales & Exports and Businesses' Sales Outlook for the Next Fiscal Year



Note: The "sales outlook" survey is carried out during mid-Nov. The survey for FY2018 was carried out 15 Nov. Survey of all business sizes and sectors
Source: Ministry of Finance, Cabinet Office, MUFG Bank Economic Research Office

2. Prices and Financial Markets

(1) Monetary Policy

The Bank of Japan (BoJ) decided to maintain its current monetary policy at its monetary policy meeting on 22nd-23rd January. While there was no change in the BoJ's core view of the economy in its Outlook for Economic Activity and Prices, there was a remark that downside risks concerning overseas economies are increasing, which can be interpreted as a sign that the awareness of risks has risen. In addition, the median forecast for CPI in fiscal 2019 was revised downwards significantly due mainly to the sharp drop in oil prices (Chart 3).

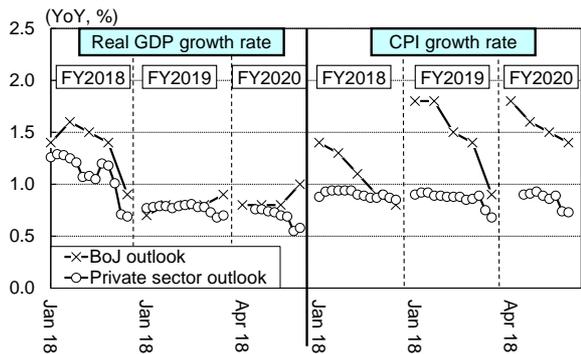
"Strengthening the Framework for Continuous Powerful Monetary Easing" published in July last year was considered the BoJ's first step towards normalisation of its monetary policy, but as the sense of caution about overseas economies grows and CPI is still some distance from the BoJ's price target, it seems the move toward normalisation has been shelved for the time being. On the other hand, while there are some expectations of additional easing, it appears that it would be difficult to carry out drastic easing in current conditions based on the impact on banks' function as financial intermediaries owing to the continued low-interest-rate environment, such as a decline in earnings during this fiscal year's interim results across over 60% of regional banks. In fact, at a press conference, Governor Kuroda described markets' risk aversion from around the end of last year to the start of this year as "somewhat sensitive". He also emphasised the difference between the current fall in oil prices and the previous phase, which had led to the introduction of negative interest rates, thereby distancing the BoJ's stance from expectations of further easing. Taking this into account, it seems the BoJ will maintain its current monetary policy for the time being.

(2) Exchange Rates

The JPY continues to strengthen against the USD owing to an increase in concerns of a slowdown in overseas economies and a softening of global financial markets at the end of last year. Amid light trading at the start of the year, the JPY broke the 1 USD = JPY 105 mark on 3rd January. The JPY then returned to its previous level as markets calmed and the USD clawed back some of its losses. Currently, the JPY is around USD 1 = JPY 109.

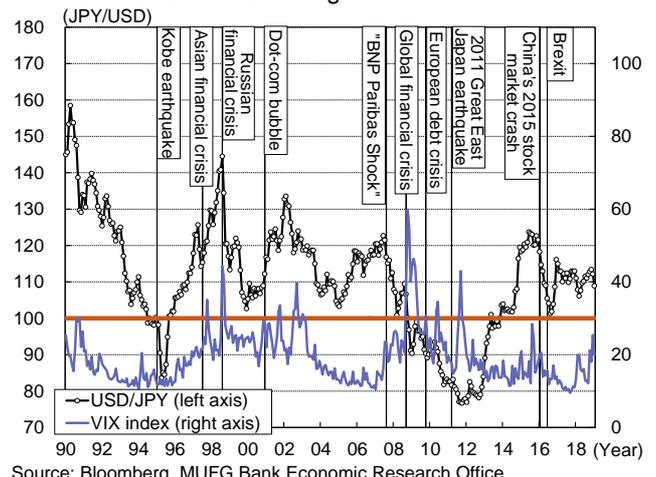
Looking at the USD/JPY exchange rate based just on its relationship with the difference in US and Japanese real interest rates, the JPY will trade at around JPY 110 per USD for the time being – keeping in mind, of course, that it will fluctuate to some extent – and is unlikely to appreciate further. Looking back, times where the JPY has appreciated past JPY 100 per USD, which is referred to as a psychological milestone, are limited to the 1995 Kobe earthquake and the period from just after the global financial crisis to just before Abenomics was introduced: a series of global financial shocks and large-scale natural disasters (Chart 4). Although the JPY does appreciate during a shock to markets, it is rectified after a short period, particularly in recent years. As such, it is expected to avoid prolonged or established periods of sharp appreciation in future due to the continued existence of the difference between Japanese and US interest rates.

Chart 3: Outlook for Real GDP and CPI Growth Rates



Notes: "BoJ outlook" is the median of policy meeting members' forecasts; "Private sector outlook" is the average of private research institutions' outlooks (approximately 40) in response to the ESP Forecast Survey. The direct impact of the consumption tax hike is excluded.
Source: Bank of Japan, Japan Center for Economic Research, MUFG Bank Economic Research Office

Chart 4: USD/JPY Exchange Rate and the VIX Index



Source: Bloomberg, MUFG Bank Economic Research Office

(Translated by Elizabeth Foster)

MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Jan. 30, 2019

	Fiscal	Fiscal	2018			2018				
	2016	2017	1Q	2Q	3Q	AUG	SEP	OCT	NOV	DEC
Real GDP Growth Rate <% changes from previous period at SA annual rate>	0.9	1.9	-1.3 (1.2)	2.8 (1.4)	-2.5 (0.0)	***	***	***	***	***
Index of All Industries Activity	0.6	1.8	-0.5 (1.3)	0.9 (1.1)	-0.8 (0.1)	0.4 (0.8)	-1.1 (-1.3)	2.1 (2.5)	-0.3 (1.2)	
Industrial Production Index	0.8	2.9	-1.1 (1.8)	1.2 (1.2)	-1.3 (-0.1)	0.3 (0.2)	-0.4 (-2.5)	2.9 (4.2)	-1.0 (1.5)	
Production										
Shipments	0.6	2.2	-1.3 (0.8)	2.1 (1.6)	-1.9 (-0.5)	1.8 (0.6)	-2.0 (-2.9)	3.5 (5.7)	-1.2 (0.9)	
Inventory	-1.4	5.2	3.0 (5.2)	-2.6 (2.4)	1.2 (3.5)	-0.2 (2.8)	1.2 (3.5)	-1.3 (-0.7)	0.1 (0.6)	
Inventory/Shipments Ratio (2015=100)	100.7	102.2	106.6 [100.2]	104.1 [100.3]	104.6 [99.6]	102.7 [98.1]	105.2 [100.6]	104.7 [105.0]	102.4 [101.5]	101.3 [101.3]
Domestic Corporate Goods Price Index	-2.4	2.7	0.6 (2.5)	0.6 (2.4)	0.9 (3.0)	0.0 (3.0)	0.3 (3.0)	0.4 (3.0)	-0.3 (2.3)	-0.6 (1.5)
Consumer Price Index(SA, total, excl.fresh foods)	-0.2	0.7	-0.1 (0.9)	0.4 (0.7)	0.2 (0.9)	0.2 (0.9)	0.1 (1.0)	0.1 (1.0)	0.0 (0.9)	-0.1 (0.7)
Index of Capacity Utilization (2015=100)	99.2	102.7	101.9 [100.7]	103.2 [102.8]	101.4 [102.5]	102.7 [103.1]	101.2 [102.8]	105.2 [102.8]	106.3 [103.4]	105.1 [105.1]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	0.5	-0.8	3.3 (0.2)	2.2 (8.0)	0.9 (4.8)	6.8 (12.6)	-18.3 (-7.0)	7.6 (4.5)	0.0 (0.8)	
Manufacturing	-4.6	9.2	2.5 (10.6)	5.5 (17.8)	-2.0 (8.5)	6.6 (13.9)	-17.3 (-5.5)	12.3 (3.9)	-6.4 (-0.0)	
Non-manufacturing Excl.Electric Power & Ship building	4.3	-7.8	3.4 (-6.9)	-0.4 (0.3)	3.5 (2.0)	6.0 (11.6)	-17.1 (-8.0)	4.5 (5.1)	2.5 (1.4)	
Shipments of Capital Goods (Excl.Transport Equipment)	0.3	7.0	-0.7 (8.0)	0.7 (4.0)	-1.5 (1.6)	3.6 (1.8)	-2.0 (-1.3)	5.4 (7.2)	-3.9 (1.8)	
Construction Orders	4.0	0.7								
Private	5.1	0.6								
Public	8.4	-5.4								
Public Works Contracts	4.1	-4.3								
Housing Starts 10,000 units at Annual Rate, SA Total floor	97.4 (5.8) (4.1)	94.6 (-2.8) (-3.7)	89.2 (-8.0) (-9.2)	96.8 (-1.8) (-3.6)	95.3 (-0.2) (-0.9)	95.7 (1.6) (0.5)	94.3 (-1.5) (-1.6)	95.0 (0.3) (2.2)	95.7 (-0.6) (0.8)	
Sales at Retailers	-0.2	1.9								
Real Consumption Expenditures of Households over 2 persons (SA)	-1.6	0.2	1.1 (0.6)	-1.4 (-1.3)	1.4 (1.0)	3.5 (2.8)	-4.5 (-0.5)	1.8 (1.0)	1.1 (0.3)	
Propensity to Consume (SA, %)	72.1	71.7	71.4 [73.0]	69.4 [74.6]	70.2 [70.3]	70.7 [70.3]	69.9 [70.3]	70.0 [71.2]	70.6 [71.7]	70.9 [70.9]
Overtime Hours Worked (All Industries, 5 employees or more)	-0.7	0.5	-1.0 (-1.2)	1.3 (0.3)	-2.7 (-2.5)	-0.2 (-1.9)	-0.6 (-3.6)	2.2 (0.0)	-0.6 (-2.6)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	0.5	0.7								
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	102	99	3	-17	-36	-29	-39	-41	-43	
Ratio of Job Offers to Applicants (SA, Times)	1.39	1.54	1.59 [1.44]	1.60 [1.49]	1.63 [1.52]	1.63 [1.52]	1.64 [1.53]	1.62 [1.55]	1.63 [1.56]	1.59 [1.59]
Unemployment Rate (SA, %)	3.0	2.7	2.5	2.4	2.4	2.4	2.3	2.4	2.5	
Economy Watcher Survey (Judgment of the present condition D.I.%)	46.4	50.5	49.1 [48.7]	48.1 [49.2]	48.0 [50.3]	48.7 [50.0]	48.6 [51.1]	49.5 [52.0]	51.0 [54.1]	48.0 [53.9]
Bankruptcies (Number of cases)	8,381 (-3.5)	8,367 (-0.2)	2,041 (-1.8)	2,107 (-3.7)	2,017 (-0.7)	694 (8.6)	621 (-8.5)	730 (-0.4)	718 (6.1)	622 (-10.6)

(Notes)

Unless otherwise indicated, tabulated figures and those in parentheses show % changes from previous quarter/month as applicable.

The figures in () indicate % changes from previous year.

[] show the comparable figure of the previous year.

2. Balance of Payments

As of Jan. 30, 2019

	Fiscal	Fiscal	2018			2018				
	2016	2017	1Q	2Q	3Q	AUG	SEP	OCT	NOV	DEC
Customs Clearance (Exports in Yen Terms)	-3.5	10.8	(4.9)	(7.5)	(2.9)	(6.8)	(-1.3)	(8.2)	(0.1)	(-3.9)
Value	-6.0	5.5	(0.8)	(1.8)	(4.0)	(5.4)	(3.7)	(4.3)	(2.1)	(2.1)
Volumes	2.7	5.0	(4.1)	(5.6)	(-1.1)	(1.1)	(-4.9)	(3.8)	(-1.9)	(-5.8)
Imports (In Yen terms)	-10.2	13.7	(7.5)	(7.5)	(12.4)	(15.5)	(7.1)	(20.0)	(12.5)	(1.9)
Value	-10.0	8.8	(3.6)	(6.1)	(10.3)	(10.5)	(10.1)	(8.8)	(7.9)	(4.1)
Volumes	-0.2	4.4	(3.7)	(1.4)	(1.9)	(4.5)	(-2.7)	(10.3)	(4.3)	(-2.2)
Current Account (100 mil. yen)	210,188	218,127	58,821	49,775	57,137	18,270	18,486	13,099	7,572	
Goods (100 mil. yen)	57,851	45,936	7,246	10,661	617	-2,529	3,193	-3,217	-5,591	
Services (100 mil. yen)	-13,813	-5,378	2,127	-6,118	-1,645	158	-242	-2,330	121	
Financial Account (100 mil. yen)	247,407	196,174	75,622	53,095	44,004	20,421	31,940	15,479	11,205	
Gold & Foreign Exchange Reserves (\$1mil.)	1,230,330	1,268,287	1,268,287	1,258,748	1,259,673	1,259,305	1,259,673	1,252,873	1,258,264	1,270,975
Exchange Rate (¥/\$)	108.37	110.80	108.20	109.05	111.44	111.06	111.89	112.78	113.37	112.45

3. Financial Market Indicators

	Fiscal	Fiscal	2018			2018					
	2016	2017	1Q	2Q	3Q	AUG	SEP	OCT	NOV	DEC	
Uncollateralized Overnight Call Rates	-0.045	-0.050	-0.048 [-0.042]	-0.065 [-0.054]	-0.063 [-0.054]	-0.059 [-0.049]	-0.059 [-0.058]	-0.060 [-0.037]	-0.070 [-0.048]	-0.068 -0.042	
Euro Yen TIBOR (3 Months)	0.057	0.065	0.078 [0.056]	0.084 [0.056]	0.077 [0.062]	0.091 [0.056]	0.050 [0.056]	0.050 [0.063]	0.050 [0.063]	0.050 [0.063]	
Newly Issued Japanese Government Bonds Yields (10 Years)	0.065	0.045	0.045 [0.065]	0.030 [0.075]	0.125 [0.060]	0.110 [0.010]	0.125 [0.060]	0.130 [0.065]	0.085 0.035	-0.010 [0.045]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	0.847	0.817	0.817 (-0.011)	0.789 (-0.028)	0.775 (-0.014)	0.786 (-0.002)	0.775 (-0.011)	0.777 (0.002)	0.772 (-0.005)		
The Nikkei Stock Average (TSE 225 Issues)	18,909	21,454	21,454 [18,909]	22,305 [20,033]	24,120 [20,356]	22,865 [19,646]	24,120 [20,356]	21,920 [22,012]	22,351 [22,725]	20,015 [22,765]	
M2(Average)	(3.6)	(3.7)	(3.2)	(3.1)	(2.9)	(2.9)	(2.8)	(2.7)	(2.3)	(2.4)	
Broadly-defined Liquidity(Average)	(1.9)	(3.1)	(2.6)	(2.5)	(2.2)	(2.2)	(2.2)	(2.1)	(1.9)	(1.9)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin	(2.4)	(2.8)	(2.1)	(2.0)	(2.2)	(2.2)	(2.3)	(2.2)	(2.1)	(2.4)
	Banks	(2.4)	(2.8)	(2.1)	(2.0)	(2.2)	(2.2)	(2.3)	(2.2)	(2.2)	(2.5)
	City Banks etc.	(1.2)	(2.0)	(0.7)	(0.5)	(0.7)	(0.7)	(1.1)	(1.1)	(0.9)	(1.6)
	Regional Banks	(3.5)	(3.6)	(3.5)	(4.1)	(4.5)	(4.5)	(4.5)	(4.3)	(4.4)	(4.3)
	Regional Banks II	(3.1)	(3.0)	(2.8)	(0.6)	(-0.5)	(-0.5)	(-0.6)	(-0.8)	(-0.8)	(-0.9)
Deposits and CDs (Average)	Shinkin	(2.3)	(2.7)	(2.5)	(2.3)	(2.2)	(2.2)	(2.2)	(2.1)	(2.0)	(2.0)
	Total(3 Business Condition)	(3.8)	(4.2)	(3.5)	(3.8)	(3.7)	(3.7)	(3.6)	(3.4)	(3.0)	(3.1)
	City Banks	(5.5)	(5.9)	(4.9)	(5.2)	(5.3)	(5.2)	(5.2)	(4.8)	(4.3)	(4.5)
	Regional Banks	(2.3)	(2.5)	(2.2)	(2.8)	(3.0)	(3.0)	(2.9)	(2.8)	(2.5)	(2.4)
	Regional Banks II	(2.1)	(2.1)	(1.6)	(-0.2)	(-1.3)	(-1.3)	(-1.4)	(-1.7)	(-1.8)	(-1.8)

(Notes)

Newly Issued Japanese Government Bonds Yields and Interest rates are averages. The Nikkei Stock Average is as of month-end. Unless otherwise indicated, tabulated figures and those in parentheses show % changes from previous quarter/month as applicable. The figures in () indicate % changes from previous year. [] show the comparable figure of the previous year.

(Sources)

Cabinet Office, National Accounts, Machinery Orders; METI, Indices of Tertiary Industry Activity, Industrial Production, Current Survey of Commerce; MOF, Trade Statistics, Balance of Payments; MPMHAPT, Consumer Price Index, Family Income and Expenditure Survey, Labour Force Survey; MHLW, Monthly Labour Survey; Ministry of Land, Infrastructure, and Transport, Economic Construction Statistics; BOJ, Corporate Price Index, Financial and Economic Statistics Monthly, etc.

For further details, please contact the Economic Research Office, MUFG Bank

Managing Director, Yasuhiro Ishimaru Tel: +81-(0)3-3240-3204

Written by Yuusuke Yokota <yuusuke_yokota@mufg.jp>

Kazufumi Keshi <kazufumi_keshi@mufg.jp>

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