Key Insights

➔ Abenomics: The 30th of June, the Cabinet approved the “Annual Fiscal and Economic Policy Blueprint”. The focus of this year Economic and Revitalization Plan is to promote the productivity and, as a consequence of that, the growth of the country. The subtitle is quite relevant “No fiscal rehabilitation without economic revival”, meaning no fiscal consolidation until the economy is not on a sustainable path.

➔ Economic Outlook: The Final Q1 2015 GDP has been upward revised thanks to a stronger Capex increase than previously reported. On the base of the new data set, we revised up our GDP growth expectations for the forecasting horizon: in CY 2015 at 1.1% from 0.7%, in CY 2016 at 1.8% from 1.7% and in CY 2017 at 0.8% from 0.7%. Even though we do not rule out negative Core Inflation in the short period, we expect that the Core Inflation will remain mildly positive, trending towards 1.0% by the end of the current calendar year.

➔ Monetary Policy: Our main case is that the Bank of Japan will not intervene further in 2015, having a look at the inflation dynamics on a more medium-longer term than on a short-term perspective. The risk to our main case, of further intervention is now at 30% of probability and the timing associated to that risk is towards the end of the year, when the BoJ will reassess a proper economic outlook for 2016.

Macro Pulse


- Q1 2015 GDP growth has been upgraded on better numbers for Capex.
- Preliminary Industrial Production figures are drawing a more cautious picture for Q2 in terms of Capex. Waiting for the Final release and the Machinery Orders.
- The latest BoJ’s outlook reinforced our case of no further intervention by the BoJ this year.
- Next year Fiscal Blueprint: no cap for the Fiscal Expenditure and new Primary Fiscal Deficit target in 2018/2019 at 1.0%. Commitment to contain the Social Security expenditure.
- The Winter Diet has been extended by 95 days till the 27 of September. Abe is really determined to pass the defence and security package in that period.
- Abe’s approval rating declined in June.
- The 2015 Economic and Revitalization Plan promotes the growth through productivity gains.
- Talks about the TPP have accelerated. So far, the military partnership between the US and Japan has upgraded. JA-Zenchu’s new president elected by August.
Japan: Economy Update

Economic Conditions

Growth & Economic Trend
On the 8th of June, the Japanese Cabinet Office revised up the Final figure for Japan’s Q1 2015 GDP at 3.9% QoQ ann. rate from 2.4% (Pioneer expectations for the Preliminary figure was 1.8%).

The Q1 2015 figure was quite good and someway better than our expectations. Although the Inventory rebuilding played a no trivial role contributing by 2.0% out of 3.9% of GDP growth, Non-Residential Investments (Capex) contributed by 1.5% and Households Consumptions by 0.9%, painting a resilient internal demand. At the base of the upward revision, there was the Capex increase higher than previously reported, released together with a revised better performance for the most recent quarters as well. The path of Investments as per the latest figures is more coherent with the increase of the Corporate Profitability and with the Financial Statements Statistics of Corporations by Industry, released by the Ministry of Finance.

Figure 1. Japan Investments

Source: Japan Ministry of Finance, Datastream, Pioneer Investments, as of Q1 2015

On the base of the new data set, we revised up our GDP growth expectations for the forecasting horizon: in CY 2015 at 1.1% from 0.7%, in CY 2016 at 1.8% from 1.7% and in CY 2017 at 0.8% from 0.7%.

On the Consumption side, we remain constructive on the outlook because of the turning up of the real wages and because of tight labor market.

Moving to the evidence that we have for the second quarter, on the Consumption side, we remain constructive on the outlook because of the turning up of the real wages and because of tight labor market. The Total Cash Earnings released for May, increased for the sixth time at 0.6% YoY from the 0.7% YoY of April. The spring wages talks are almost at the end and the base wage increase is going to be higher than in last year negotiations, between 0.5% and 1.0% as in the expectations. Last year the increase has been around 0.4% for all unions. However, we do not expect that the Consumption Expenditure will drive the recovery this year.

On the Investment side, the higher frequency figures as the Industrial Production induce a more cautious assessment of a recovery phase based on the Capex revival. The Preliminary figure of IP for May has reported at -2.2% MoM and -4.0% YoY with a wide range of industries dropping. Based on these figures, the Industrial
Output in Q2 is declining in comparison with Q1; however, it’s worth to mention the fact the these figures are quite volatile and are often significantly revised.

**Figure 2. Japan Industrial Production and Capacity Utilization**

Notwithstanding we keep expecting a positive Net Trade contribution to the GDP in 2015, the latest Trade Balance figures shown a return to the negative territory of the Trade Balance. With regard of the Exports dynamics in Q2, in April and May they registered a negative performance after the bounce back of March. That explains the negative performance of the Trade Balance and goes together with the poor performance just reported by the Industrial Output.

With the Consumption Tax hike impact fading off, Japan had a sort of back to reality on the inflation side. The figures in April and May are flirting with the zero level of Consumer Price increase yet.

Even though we do not rule out negative Core Inflation in the short period, we expect that the trend of the Core Inflation remains mildly positive targeting towards 1.0% by the end of the current calendar year.

Source: Japan Cabinet Office, Datastream, Pioneer Investments, as of June 30, 2015.

We expect that the trend of the Core Inflation remains mildly positive targeting towards 1.0% by the end of the current calendar year.
In comparison with the macroeconomic outlook released by the BoJ in April, we are on the same line in terms of growth expectations on the forecasting horizon; with regard to the inflation, we keep remaining significantly below the target.

**Economic Policies**

**Monetary Policy**
The BOJ in June reduced the frequency of its monetary policy meetings to 8 a year. The move was intended to “improve communication”. It indicated that it will continue its QQE policy (quantitative and qualitative easing) “until stable 2% inflation achieved”; it highlighted that “Japan’s economy has continued to recover moderately” and that “risks are balanced for the growth outlook”; CPI was described as “seen at zero for the time being” but noted that “inflation expectations are rising from a longer term view”. It vowed to “watch risks” and to “adjust policy as appropriate” going forward.

The 2% inflation target became a medium-term target, with the BOJ no longer vowing to reach it within two years.

Our main case is that the BoJ will not intervene further in 2015, having a look at the inflation dynamics on a more medium-longer term than on a short-term perspective.

**Fiscal Policy**
The 30th of June, the Cabinet approved the Fiscal Blueprint for the following year. A new fiscal target has been added between the -3.3% of Primary Fiscal Deficit for the current Fiscal Year and the 0% Primary Fiscal Target in 2020/2021, a 1% of Primary Fiscal deficit has been fixed for 2018/2019.
Japan: Economy Update

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Abe got rid of the cap to the Fiscal Expenditure proposed by the Ministry of Finance, arguing that focusing on spending cuts is a path to a Greece-style debt crisis. However, the Government committed to contain the Social Security expenditure, increasing the use of generic drugs, changing the insurance premiums for outpatient medical care and nursing care or the pension payments for high-income people.

Stability Conditions

Politics
The winter Diet, that was supposed to end the 24th of June, has been extended by 95 days till the 27th of September; it’s the first time that the Diet has extended that much. In that period of time, Abe wants to pass the defense and security legislative package (known as re-interpretation of the Article 9 of the Constitution): Abe is informally committed with the US to pass that bill. However, the “obsession” of the Prime Minister towards this goal is likely at the base of the recent drop of his approval rating by more than 2%. The strategy is to pass the bill on the 16th of July, in the Lower House and present it to the Upper one. If the bill will turn down there, after 60 days, it can be newly legislated by the Lower House alone with a super majority (2/3 of the House). That way to force the things has not much appreciated within the LDP as well. Meanwhile, there is a different proposal on the same topic made by the Japan Innovation Party within the Constitution borders; however, this latest proposal is not that much welcomed by Abe and his entourage.

The development of this parliamentary phase is quite tricky, considering that, next autumn, there will be the elections of the LDP leader. As of now, Abe’s leadership doesn’t look like in danger.

Another important Bill under deliberation in the current Diet is the Agriculture one, aiming to reduce the power in production, procurement and disbursement of the Japan’s Central Union of Agricultural Co-operatives (JA-Zenchu) in favor of a greater autonomy of local co-operatives. In accepting the Bill proposal last February, the JA-Zenchu former President stepped down. The election of the new President is now on the way (results in August). The probability of passing the Bill in the current Diet is almost certain, considering the Commitment that Abe has to sign the deal on the TPP and the fact that the JA-Zenchu has been opposing to it in order to protect the local farmers. The new President elected will take care of the reform implementation.

The 30th of June the Cabinet approved the “Annual Fiscal and Economic Policy Blueprint”. The focus of this year Revitalization Plan is to promote the productivity and as a consequence of that the growth of the country. The subtitle is quite relevant “No fiscal rehabilitation without economic revival”. (See the Fiscal Policy section for more details).

2015 Triggers and Risks
Triggers

- A global trade stronger than expected together with a weak yen can support further the Japanese exports going forward.
- A more incisive implementation of the economic measures by the Cabinet could boost the competitiveness of the Japanese system the productivity and the potential GDP growth rate in coming years.

Risks

- A weak attitude in terms of growth strategies without any effort in terms of fiscal consolidation will push the country towards the default.
- Higher-than-expected interest rates could offset the efforts put in place by the BoJ and the Cabinet to revive the economy, pushing the country’s debt to default.
- Historical reasons and the alliance with the US can prevent Japan to enjoy a more constructive dialogue with China that is increasing his role and influence in the Asia region.
Macroeconomic Forecast

Japan: Economy Update

July 2015

Important Information

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Macroeconomic Forecasts Q1 Q2 Q3 Q4E Q1E Q2E Q3E Q4E Q1E Q2E Q3E Q4E

GDP Components

GDP 1.8 1.6 0.1 1.1 1.7 0.8 4.4 6.8 2.9 1.2 3.9 3.8 1.5 1.7 1.4 2.8 2.1 2.0
Personal Consumption Expenditures 2.4 2.1 1.3 0.0 1.2 0.0 8.7 19.0 1.4 1.5 1.5 0.9 1.7 2.0 0.7 0.9 1.2 1.2
Government Consumption Expenditures 1.7 2.9 1.0 0.2 0.2 0.5 1.5 1.7 1.8 0.6 0.9 - - 0.4 - 0.4 0.4 0.8 0.8
Residential Investments 3.2 8.7 4.5 2.7 6.3 3.0 8.3 36.6 23.3 2.5 7.0 4.3 3.8 9.8 7.5 5.9 4.5 3.2
Non-Residential Investments 3.8 0.6 3.7 3.7 5.7 2.7 21.9 17.9 0.3 1.0 11.0 6.0 4.2 6.4 6.6 5.1 5.9 4.0

Total Internal Demand (%YoY)

Total Consumption + Fixed Investments + Inventories 2.6 1.9 0.1 0.6 1.5 0.7 3.3 0.3 1.6 1.8 2.2 1.0 1.7 1.7 1.2 1.4 1.7 1.8 1.8

Final Internal Demand (%YoY)

Total Consumption + Fixed Investments 2.4 2.3 0.2 0.5 1.7 0.6 4.0 1.3 1.7 1.7 3.0 1.4 1.6 1.9 1.7 1.7 1.8 1.8 1.7

Exports 0.0 1.3 8.4 5.0 6.4 3.0 26.8 0.1 6.5 13.5 9.9 9.4 5.9 7.7 12.9 4.3 4.2 5.9
Imports 5.4 3.1 7.5 3.6 6.3 2.2 29.3 19.3 4.3 5.8 12.2 2.3 4.0 5.2 13.5 5.0 4.5 3.6

GDP Contributions

Gross Domestic Product 0.7 0.2 0.3 0.3 0.1 0.2

Exports 0.0 1.3 8.4 5.0 6.4 3.0 26.8 0.1 6.5 13.5 9.9 9.4 5.9 7.7 12.9 4.3 4.2 5.9
Imports 5.4 3.1 7.5 3.6 6.3 2.2 29.3 19.3 4.3 5.8 12.2 2.3 4.0 5.2 13.5 5.0 4.5 3.6

GDP Contributions

Net trade 0.7 0.2 0.3 0.3 0.1 0.2

Inventories changes 0.2 0.4 0.2 0.4 0.1 0.1

Economic Trend

Industrial Production 0.3 -0.5 2.2 1.6 5.4 2.3 7.7 2.8 -0.4 1.4 2.1 0.6 3.6 4.2 5.1 6.1 5.3 5.0
Corporate Profits 8.7 20.2 11.0 8.9 16.1 6.8 20.2 4.5 7.6 11.6 0.4 11.1 15.7 8.6 24.2 13.8 14.6 11.7
Employees’ Compensation 0.9 0.6 1.2 0.8 1.1 0.8 - 0.5 2.1 1.1 1.0 0.4 1.5 1.1 1.1 0.9 1.1 1.1 1.2
Corporate Goods/Prices Index -0.9 1.3 3.2 1.1 1.9 2.0 2.0 4.3 4.0 2.4 0.4 - 1.9 - 2.0 0.7 1.7 1.7 2.0 2.3
Consumer Prices Index -0.1 0.4 2.6 0.8 1.0 1.7 1.3 3.4 3.2 2.7 2.1 0.1 0.3 0.6 1.2 1.1 0.8 0.9
Unemployment Rate 4.3 4.0 3.6 3.4 3.1 3.3 3.6 3.6 3.6 3.5 3.5 3.5 3.4 3.3 3.3 3.3

M2+CD 2.5 3.8 3.4 3.2 2.9 3.2 3.9 3.2 3.0 3.5 3.5 3.1 3.4 2.8 2.6 2.7 2.9 3.1

Update as of June 30, 2015; for time series with higher frequency (monthly or daily) than quarterly, we consider the quarterly average; in grey AAR elaborations; in italic exogenous variables; GDP components on quarterly frequency are %Q/Q annualized rates; all other figures, if not otherwise specified, are %Y/Y.