Monthly Economic Report

November 25, 2019
Mizuho Research Institute
Topic of the month: the rate of global economic growth will remain low in 2019 and 2020

- We have revised down our outlook on the rate of global economic growth (total of the forecast area) in 2019 to reflect the underlying weakness of the current economy. However, we have kept our outlook on the overall global economy unchanged for 2020. Even though the global economy should bottom out through 2020, the recovery is forecast to be weak.
  - For 2020, we have revised up our outlook for the developed market (DM) economies in view of changes in premises regarding US-China tensions and Brexit. On the other hand, we have revised down our outlook for certain emerging market (EM) economies. Given the persistence of strong uncertainties, we have kept our outlook on the overall global economy unchanged.

<table>
<thead>
<tr>
<th>[Outlook on the global economy]</th>
<th>(Y-o-y % change)</th>
<th>(Y-o-y % change)</th>
<th>(%Pt)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan, US, Eurozone</td>
<td>3.5  4.0  4.0  3.3  3.3</td>
<td>3.4  3.3</td>
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<tr>
<td>US</td>
<td>1.6  2.3  2.2  1.7  1.3</td>
<td>1.7  1.2</td>
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<tr>
<td>Eurozone</td>
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<tr>
<td>UK</td>
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<td>1.2  1.1</td>
<td>-  -</td>
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<tr>
<td>Japan</td>
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<td>-0.1  0.3</td>
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<tr>
<td>Asia</td>
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<td>China</td>
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<td>NIEs</td>
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<td>ASEAN5</td>
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<td>India</td>
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<td>Australia</td>
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<td>2.0  1.9</td>
<td>-  -</td>
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<td>Brazil</td>
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<td>0.8  1.9</td>
<td>-  -</td>
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<td>Mexico</td>
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<td>0.6  1.2</td>
<td>-0.5  -0.2</td>
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<tr>
<td>Russia</td>
<td>0.3  1.6  2.3  1.0  1.8</td>
<td>1.0  1.8</td>
<td>-  -</td>
</tr>
<tr>
<td>Japan (FY)</td>
<td>0.9  1.9  0.7  0.6  0.5</td>
<td>0.6  0.3</td>
<td>-  0.2</td>
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<tr>
<td>Crude oil prices (WTI, USD/bbl)</td>
<td>43 51 65 57 58</td>
<td>56 57</td>
<td>1 1</td>
</tr>
</tbody>
</table>

Note: The shaded areas indicate forecasts. The total of the forecast area is calculated upon the GDP share (PPP) by the International Monetary Fund (IMF). Sources: Made by MHRI based upon IMF and statistics of relevant countries and regions.
The second half of Round 4 of US additional tariffs upon China (set for imposition in December) will suspend

- The US and China are expected to reach an agreement on “Phase One” and call off the imposition of the second half of Round 4 of additional tariffs scheduled for December 15 (Round 4 List B).
  - Subsequent to ministerial talks in October, the US called off the tariff hikes scheduled for imposition on October 15 (Round 1 to 3 of the additional tariff hikes). The high degree of dependence on imports from China (87.1%) concerning items subject to Round 4 List B pose high hurdles to the imposition (Round 1: 6.3%, Round 2: 12.5%, Round 3: 20.4%, Round 4 List A: 24.4%).
  - China is expected to accept the measures such as expansion of imports of US agricultural products, strengthen protection of intellectual property rights and improve transparency of foreign exchange policy.
    - Structural matters such as industrial subsidies will be postponed.
    - As gaps remain between the US and China on the size of imports of US agricultural goods, there is still a possibility that the negotiations may break down.

[ US additional tariffs on Chinese goods and China’s additional tariffs of US goods ]
Global IT cycle is bottoming out

- There are signs of a slight improvement of the semiconductor market.
  - While the silicon cycle index still remains significantly below trend, it is in a recovery phase for the fourth consecutive month.
  - Demand appears to be picking up at last due to progress in inventory adjustments.

- Global semiconductor sales (real terms) have also bottomed out.
  - Concerns about a possible double dip stemming from the imposition of Round 4 (List B) of the US sanctions against China have receded considerably.

[Notes]
Prepared by synthesizing semiconductor-related shipment indexes of Japan, South Korea, Taiwan and the US. The latest point of time is August 2019.
Source: Made by MHRI based upon CEIC Data

[Notes]
The latest readings are as of September 2019.
Source: Made by MHRI based upon CEIC Data
1. Global economy and market trends: in contrast to expectations toward the bottoming out of the manufacturing sector, there are concerns regarding its spread to the nonmanufacturing sector

- A closer look at the real GDP growth rates of major countries in the Jul-Sep quarter reveals that the Japanese and Chinese economies slowed down for two quarters in a row, while the US and Eurozone economies continued to grow on par with the previous quarter.
  - Even though the global manufacturing PMI remained below 50, it improved for the second month in a row, indicating expectations that the manufacturing sector may bottom out. On the other hand, the services PMI and the composite PMI synthesized by the foregoing remained above 50 but continued to follow a downward trend, thus signaling a yellow light toward the decoupling scenario.

[ Quarterly GDP growth rates for major countries/regions ]

[ Global PMI ]

Source: Made by MHRI based upon statistics of relevant countries and regions

Note: The Purchasing Managers’ Index (PMI) is an index calculated by weighting indexes such as new orders, output, order backlogs, prices, employment, and quantity of purchases. The reading of 50 in the PMI is the "expansion-contraction" threshold.

Source: Made by MHRI based upon Markit
Overview of financial markets: rising uncertainties over US-China negotiations

Market concerns are rising over the future course of US-China trade talks following the enactment of the Hong Kong Human Rights and Democracy Act of 2019. Although the FOMC indicated a halt to further interest rate cuts, FRB Chair Jerome Powell commented that there are high hurdles to clear before interest rate hikes may be considered. US stock prices are hovering at record-high levels, reflecting strong employment data. The Nikkei Stock Average climbed to the JPY23,000-level. Long-term interest rates have stopped rising for now in Japan, the US and Germany.

Note: Currency exchange rates are based upon the nominal effective exchange rates as released by the authorities of each country.
Source: Made by MHRI based upon Bloomberg
2. (1) US economy: GDP in Jul-Sep 2019 grew moderately, fixed investment clearly stagnant

- Real GDP growth rate in the Jul-Sep quarter of 2019 rose moderately by +1.9% q-o-q p.a. (Apr-Jun quarter: +2.0% q-o-q p.a.).

- Personal consumption expenditures slowed down but still maintained strong growth (+4.6% q-o-q p.a. → +2.9% q-o-q p.a.). Residential investment recovered on interest rate falls.

- Nonresidential fixed investment deteriorated at a quicker pace (-1.0% q-o-q p.a. → -3.0% q-o-q p.a.). While investment in intellectual properties was strong, investment in construction and machinery slackened.
  - Shipment suspension by Boeing had only a minor impact (contribution of aircraft: -0.2%Pt q-o-q p.a.).
Investment in machinery and construction remains weak. There are no signs of corporate capital investment appetite bottoming out

- Investment in machinery and equipment remains weak. Both shipments and orders for core capital goods have peaked out.
  - Shipments of core capital goods in September fell (-0.7% m-o-m). New orders, a leading indicator of capital investment, were also sluggish (September: -0.6% m-o-m).

- Construction investment is continuing to follow a downtrend. Amid the lackluster rise of crude oil prices, the number of rigs in operation also declined.

- A survey by regional reserve banks shows that manufacturers’ appetite for nonresidential capital investment is continuing to follow a downtrend.

[ Shipments of core capital goods and new orders ]

[ Private- construction investment (non-residential) and number of rigs in operation ]
Personal consumption is gradually slowing down

- Personal consumption expenditures in the Jul-Sep quarter of 2019 posted strong growth of +2.9% q-o-q p.a., but only with the carry-over of growth equivalent to 1% pt. Trends on a monthly basis show a gradual slowdown of personal consumption.
  - Personal consumption expenditures in September grew by only +2.0% m-o-m p.a., lacking the strength in terms of the average of the Jul-Sep quarter.

- The breakdown shows a sharp slowdown of leisure-related consumption, including recreation and eating-out/accommodation services, which might reflect a decline of consumer expectations toward the future.

[ Real personal consumption expenditures ]

[ Consumption of leisure-related services ]
Despite solid consumer sentiment, future expectations regarding employment are declining

- The current economic conditions index of the October consumer confidence index (Conference Board) flattened out.
  - The index remained at a high level, given the current strength of employment.

- On the other hand, the expectations index (of the Conference Board Consumer Confidence Index) continued to underwhelm. The breakdown shows a significant decline in expectations on labor market conditions.
  - Despite the rise of optimism regarding US-China trade tensions in the financial markets, consumers’ concerns over the future are not easing.

![Consumer confidence index (Conference Board)](image1)

![Consumer confidence index (Expectations Index, 6 months ahead)](image2)

Source: Made by MHRI based upon the Conference Board

Note: The expectations index of the consumer confidence index is the average of the above three series. These are indexed by: improvement ÷ (improvement + deterioration)
Source: Made by MHRI based upon the Conference Board
(2) US monetary policy: the October FOMC made another interest rate cut but also stressed a pause in easing

- The FOMC in October decided to cut interest rate for the third time in 2019 in response to impacts of the slowing global economy and trade tensions and also as insurance against uncertainties.

- The FOMC deleted from its statement suggesting room for further easing, and shifted to a wait-and-see stance from the standpoint that “the three interest rate cuts greatly support the US economy.”

- On Oct 11, the Fed announced a program for supplying reserves. It will purchase Treasury bills at least into the second quarter of 2020 (initially USD60 billion per month) and continue temporary open market operations (TOMO) until January 2020.
  - At the post-FOMC press conference, Fed Chair Jerome Powell indicated that “the minimum level of range of reserves is between USD1.45 trillion to USD1.5 trillion (which will not cause an unexpected surge of short-term interest rates).”

[Summary of October FOMC meeting]

- The FOMC statement dropped the language that “it will act as appropriate to sustain the expansion,” and replaced it with the neutral expression that “it assesses the appropriate path of the target range for the federal funds rate.”

[Press conference]

- The policy adjustments we have made since last year are providing—and will continue to provide—meaningful support to the economy. We believe that the monetary policy is in a good place.

- We see the current stance of monetary policy as likely to remain appropriate as long as the state of the economy remains broadly consistent with our outlook.

- The tail risk of Brexit seems to have decreased, just as the situation in our trade negotiations with China seems to have taken a step closer to resolution since the previous FOMC meeting.

- The risk you mention of the weakness in the manufacturing—in export investment, business investment, parts of the economy getting into the consumer side of the economy, we really don’t see that.

- When insurance cuts were performed in the 1990s, the reason why we raised interest rates is because—generally is because we see inflation as moving up—or, in danger of moving up significantly, and we really don’t see that now. So, we are not thinking about raising rates right now.

- The real rate is probably modestly below zero, […] my own sense is that that’s somewhat accommodative policy.

Source: Made by MHRI based upon FRB
(3) US bond market: US long-term interest rates temporarily rose to the 1.9% level and are likely to remain in the upper-half of the 1% level

- In a positive reflection of the progress in US-China trade talks and the robust US economy, yields on 10yr US treasury bonds (UST) temporarily rose to the 1.9% level.
  - The yield inversion between 3mo and 10yr UST, which some believe presages a recession, has abated.
  - Term premiums recovered to the highest level since July 2019.
  - Given suggestions of an end to interest rate cuts at the October FOMC, speculation on another interest rate cut by the end of the year have faded. Market participants now expect 0 interest rate cuts by the end of 2019 and about 1.2 interest rate cuts in 2020.
- Since concerns regarding inflation are not strong, US long-term interest rates are expected to move in the upper-half of the 1% level.

### [US long-term interest rate decomposition]

- 10yr UST yields
- Expected short-term interest rates
- Term premiums

### [Market participants’ forecast on the US policy rate]

- 2019/11/22
- Actual
- FRB outlook
  (Sep 2019, median)

Note: As of Nov 22 for the month of November
Source: Made by MHRI based upon Bloomberg

Note: Calculated based upon FF rate futures
Source: Made by MHRI based upon Bloomberg
(4) US stock market: despite record highs, the market swung in reaction to developments in US-China trade talks

- After renewing record highs, the US market swung in reaction to developments in US-China trade talks. The strong corporate earnings and expectations that the US economy will bottom out are serving to underpin the market.

- In addition to IT-sector stocks such as semiconductors, stocks in the health care sector served as the driver. Even though the forward P/E ratio in the upper-half range of 17x is relatively high, there is no selling material in the short term, and forward P/E ratio is rising. Thus, US stocks are forecast to move in a high range before the year-end shopping season.

- Stock prices are expected to rise moderately over the next year in line with the strong US economy, although valuation adjustments are expected following the fading of excessive optimism about business performance.

[ Sector-based rate of change of the S&P 500 index and the degree of contribution (Oct-Nov) ]

Note: Calculated based on the rate of rise/fall against end-September as of November 22
Source: Made by MHRI based upon Bloomberg

[ S&P 500 Index forward P/E ratio and forward EPS ]

Note: The forward EPS and forward P/E ratio are for 12 months ahead.
Source: Made by MHRI based upon Refinitiv
3. The European economy: even though eurozone growth in the Jul-Sep quarter maintained the same level as the preceding quarter, the weakness should persist

- Eurozone real GDP growth stood at +0.2% q-o-q in the Jul-Sep quarter of 2019, maintaining growth comparable to the preceding quarter.
  - Germany’s real GDP rose +0.1% q-o-q, rising into positive territory for the first time in two quarters.
    - In addition to household consumption expenditures, government consumption expenditures, and construction investment, the growth of exports in September was a positive contribution.
  - France, Italy and Spain posted the same rate of growth as in the preceding quarter. In these countries, domestic demand served to support the economy to make up for the weakness of external demand.
- The Purchasing Managers’ index (synthetic PMI), having a high correlation with GDP, remains at a level barely above the expansion/contraction threshold of 50.

[ Eurozone real GDP growth rate (by demand component) ]

[ Eurozone PMI ]

Note: PMI at 50 is the expansion/contraction threshold.
Source: Made by MHRI based upon Markit, Bloomberg
Given the ongoing slowdown of exports to areas outside the eurozone, a recovery of production is unlikely anytime soon.

- In September 2019, exports to areas outside the eurozone stood at +2.1% y-o-y, remaining at the rate of growth two months ago.
  - Exports to the UK grew, contributing +0.5%pt y-o-y.
  - Intra-eurozone exports fell (-1.6% y-o-y), indicating the ongoing fall of intra-eurozone demand.

- In September 2019, eurozone industrial production fell (-1.9% y-o-y), revealing the weakness of the underlying trend.
  - In particular, production of motor vehicles remains weak at -8.1% y-o-y.

[Exports of goods to areas outside the eurozone (by region)]

[Eurozone industrial production]

Source: Made by MHRI based upon Eurostat
Despite the ongoing strength of the labor market, the improvement is showing signs of peaking out

- In September 2019, the eurozone unemployment rate stood at 7.5%, leveling off from the preceding month (7.5%).
  - In the Apr-Jun quarter of 2019, compensation per employee in the eurozone rose +2.1% y-o-y, remaining on firm footing.
- Meanwhile, manufacturing sector employment expectations are continuing to deteriorate.
  - The employment expectations DI for the next-three-months in the manufacturing sector continued to decline, dragged down mainly by Germany.

[ Eurozone unemployment rate and compensation per employee ]

[ Eurozone employment expectations DI by sector ]

Note: “Zero” is the "expansion-contraction" threshold. The figures are based on queries on employment expectations over the next three months.
Source: Made by MHRI based upon the European Commission
Eurozone core inflation remains close to 1%

In October 2019, the eurozone inflation rate (flash estimate) stood at +0.7% y-o-y, declining from the preceding month (+0.8% y-o-y) due to the fall of energy prices.

- The core inflation rate, which excludes volatile items such as energy and food, stood at +1.1% y-o-y, more or less unchanged from the previous month (+1.0% y-o-y).
- As selling price expectations remain lackluster in the services and manufacturing sectors, the core inflation rate is expected to remain close to 1% for some time.

Note: "Zero" is the "expansion-contraction" threshold. The figures are based on queries on selling price expectations over the next three months.

Source: Made by MHRI based upon Eurostat

Source: Made by MHRI based upon the European Commission
Monetary policy: no surprise from the October ECB Governing Council meeting. The ECB kept its monetary policy framework unchanged

- There was no surprise from the ECB Governing Council meeting on October 24. The ECB retained its monetary policy framework.
  - The ECB is poised to assess the effect of the comprehensive easing package put into operation in September. There are high hurdles for further easing steps, given the absence of a sharp deterioration of economic indicators and in view of strong criticisms toward additional easing from within and from outside the ECB. We expect the ECB to retain the current monetary policy for some time.

- ECB President Mario Draghi attended the Governing Council meeting for the last time. The German government recommended Isabel Schnabel as a candidate to succeed Sabine Lautenschläger who is resigning as a member of the ECB Executive Board. Her appointment will be officially decided at the European Union (EU) summit meeting on December 12-13.

[ Key points from ECB Governing Council meeting (Oct 24) ]

<table>
<thead>
<tr>
<th>Business conditions</th>
<th>The incoming data since September confirm the ECB’s previous assessment of a protracted weakness in euro area growth dynamics.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic outlook</td>
<td>The risks surrounding the euro area growth outlook remain on the downside. In particular, these risks pertain to the prolonged presence of uncertainties, related to geopolitical factors, rising protectionism and vulnerabilities in emerging markets.</td>
</tr>
<tr>
<td>Prices</td>
<td>Measures of underlying inflation remained generally muted and indicators of inflation expectations stand at low levels. The weaker growth momentum is delaying the pass-through of higher wage to inflation.</td>
</tr>
<tr>
<td>Forward guidance on policy interest rates</td>
<td>The Governing Council expects the key ECB interest rates to remain at their present or lower levels until it has seen (1) the inflation outlook converge to a level sufficiently close, but below, 2% within its projection horizon, (2) the probability of reaching this outlook are done &quot;robustly&quot;, and (3) such convergence has been consistently reflected in underlying inflation dynamics.</td>
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<tr>
<td>Asset purchase program</td>
<td>The ECB restarted net purchases under the asset purchase program (APP) at a monthly pace of €20 billion as from 1 November. The ECB expects them to run for as long as necessary to reinforce the accommodative impact of the ECB policy rates, and to end shortly before the ECB starts raising the key ECB interest rates. There remains &quot;enough time&quot; before the purchases reach their ceiling.</td>
</tr>
<tr>
<td>Side effects of negative interest rates</td>
<td>The overall assessment of negative rates is generally positive. For Europe alone, it’s very positive.</td>
</tr>
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[ Profile and policy stance of Isabel Schnabel ]

<table>
<thead>
<tr>
<th>Name</th>
<th>Isabel Schnabel</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of birth</td>
<td>August 9, 1971 (48)</td>
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<tr>
<td>Present post</td>
<td>A professor at the University of Bonn (monetary economics) and a member of the German Council of Economic Experts (the &quot;Five Sages of Economy&quot;).</td>
</tr>
<tr>
<td>Specialization</td>
<td>Financial markets, economic history</td>
</tr>
<tr>
<td>Policy stance</td>
<td>Hawkish. &quot;Although monetary policy is already very expansive, the ECB is preparing a further loosening ... It is doubtful that it will succeed in bringing the inflation rate in the euro zone close to 2 percent. At the same time, the risks to financial stability rise further.&quot; (Press report by Reuters, September 27)</td>
</tr>
<tr>
<td>Other</td>
<td>Although Schnabel has no previous experience as a monetary policy official, she is a proven expert in banking and monetary policy issues, she has long years of experience as an economist. There is speculation that Schnabel could take up her new role at the ECB, along with ECB chief economist Philip Lane (Press report by Reuters, October 23).</td>
</tr>
</tbody>
</table>

Source: Made by MHRI based upon ECB

Source: Made by MHRI based upon Reuters and other press reports
German long-term interest rates rise on an extension of the Brexit deadline

- German long-term interest rates rose temporarily to the -0.2% level. The German 20yr government bond yield rose into positive territory for the first time in approximately four months.
  - An extension of the Brexit deadline and ECB officials’ comments on the need for fiscal policy steps helped lift interest rates.
  - In France, the October PMI surpassed expectations, pushing long-term interest rates into positive territory. S&P raised its rating for Greece to “BB-”, keeping Greek long-term interest rates on a downward path.

- Given the expected persistence of soft fundamentals, the German 10yr government bond yield is expected to hover around -0.3%.
4. The Chinese economy and EM financial markets: the Chinese economy is continuing to slow down

- The Chinese economy is continuing to slow down, with the growth of major economic indicators declining across the board.
  - Growth of industrial production slowed to +4.7% y-o-y partly in reaction to the surge in September. Investment fell to +4.2% y-o-y. Despite the recovery of investment in the manufacturing sector, investment related to real estate development slowed down.
  - Retail sales remain weak, reflecting the deterioration of employee income. In real terms, growth of retail sales slowed to +4.9% y-o-y.

- Looking forward, the Chinese economy should gradually slow down, while avoiding a sharp decline due to the government’s economic support measures.

Note: 1. The figures for industrial production, retail sales, and investment in fixed assets in January and February are changes of the cumulative total of January and February over the same period a year ago.
2. For fixed asset investment, the cumulative year-to-date figure is converted into a single month.
3. Industrial production is in real terms. Total retail sales of consumer goods and investment in fixed assets, and exports are in nominal terms.
4. Exports are on a RMB basis.

Source: Made by MHRI based upon the National Bureau of Statistics of China, the General Administration of Customs of China, CEIC data.
The yuan recovered to the level of 6 yuan to the dollar for the first time since August. The PBoC implemented successive policy interest rate cuts

- The yuan remained on an uptrend against the US dollar, reflecting favorable developments in US-China trade talks.
  - On November 5, the yuan rose sharply, recovering to the level of 6 yuan to the dollar for the first time in approximately three months, boosted by media reports that the US is considering withdrawing some of its tariffs on imports from China.
  - In view of preparations in the run-up to the US-China summit meeting, we expect that the yuan will be swayed by the future course of US-China trade talks.

- Amid rising concerns regarding economic slowdown, as shown by the fall of the Manufacturing PMI, the People’s Bank of China (PBoC) lowered the one-year MLF interest rate to 3.25% on November 5.
  - The PBoC cut the seven-day reverse repo rate to 2.5% on November 18, and lowered the Loan Prime Rate (LPR) to 4.15% on November 20. However, the reductions of both rates were limited to 5bp, with the PBoC maintaining a cautious stance on monetary easing.

<table>
<thead>
<tr>
<th>[ USD/RMB rate ]</th>
<th>[ LPR and MLF interest rates ]</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image1" alt="Graph of USD/RMB rate and CFETS RMB index" /></td>
<td><img src="image2" alt="Graph of LPR and MLF interest rates" /></td>
</tr>
</tbody>
</table>

- **Source:** Made by MHRI based upon Bloomberg

Note: LPR is the average of the prime rates of 18 major banks. MLF is the medium-term lending facility of the People’s Bank of China.

Source: Made by MHRI based upon the People's Bank of China, CEIC Data
EM financial markets: the stock markets are recovering

- EM stocks are showing signs of recovery due to the US interest rate cut and expectations toward the progress of US-China trade relations.
  - Although EM stocks are approaching the year-to-date highs in the second half of April, they are still weak compared to with the levels in the first half of 2018.
  - Argentine stocks recovered even after the presidential election on October 27 that resulted in the inauguration of a leftist government, but showed volatility in November.
- Even though EM currencies have calmed down since September, they have generally lost momentum and are continuing to trade at rock-bottom levels.
- EM stocks and currencies remain susceptible to developments in US-China relations. The EM markets continue to face a heavy upside due to lingering uncertainties in the global economy.

Note: The bars in positive territory show the rate of rise of EM currencies against the USD, and the bars in negative territory show the rate of fall of EM currencies against the USD. Source: Made by MHRI based upon Refinitiv
5. (1) The Japanese economy: real GDP growth was weak in the Jul-Sep quarter GDP (*1st QE*) despite fourth consecutive quarter of growth in positive territory

- Japan’s real GDP (*1st QE*) grew +0.1% q-o-q (+0.2% p.a.) in the Jul-Sep quarter of 2019. Although this marked the fourth consecutive quarter of growth in positive territory, the pace of growth stayed weak. In addition to downward pressures stemming from external demand, private demand also lacked strength, leaving the economy to be supported by public demand.
  - Considering that there was a front-loading of demand prior to the consumption tax hike, personal consumption growth was weaker than the actual readings. Although capital investment continued to follow firm footing, it fell short of serving as the engine of growth, leading to our view that the Japanese economy is pausing on the landing.
  - The rate of Japan’s real GDP growth is forecast to dip into negative territory in the Oct-Dec quarter of 2019 in a backlash to the rush of demand prior to the consumption tax hike in October, and chart weak growth from the Jan-Mar quarter of 2020. Even though exports should bottom out, the growth of private capital investment is expected to slow down and a slower rise in income is also expected to weigh on the growth of personal consumption.

[First Preliminary Quarterly Estimates of GDP (*1st QE*) of the Jul-Sep quarter of 2019]

<table>
<thead>
<tr>
<th></th>
<th>2018 Jun-Sep</th>
<th>Oct-Dec</th>
<th>2019 Jul-Aug</th>
<th>Apr-Jun</th>
<th>Jul-Sep</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>-0.5</td>
<td>0.4</td>
<td>0.0</td>
<td>0.4</td>
<td>0.1</td>
</tr>
<tr>
<td>(q-o-q change, p.a.)</td>
<td>-2.0</td>
<td>1.5</td>
<td>2.0</td>
<td>1.8</td>
<td>0.2</td>
</tr>
<tr>
<td>(y-o-y change)</td>
<td>0.1</td>
<td>0.3</td>
<td>0.9</td>
<td>0.9</td>
<td>1.3</td>
</tr>
<tr>
<td>Domestic demand</td>
<td>-0.4</td>
<td>0.8</td>
<td>0.1</td>
<td>0.7</td>
<td>0.2</td>
</tr>
<tr>
<td></td>
<td>(-0.4)</td>
<td>(0.8)</td>
<td>(0.1)</td>
<td>(0.8)</td>
<td>(0.2)</td>
</tr>
<tr>
<td>Private demand</td>
<td>-0.4</td>
<td>1.0</td>
<td>0.0</td>
<td>0.5</td>
<td>0.1</td>
</tr>
<tr>
<td></td>
<td>(-0.3)</td>
<td>(0.7)</td>
<td>(0.0)</td>
<td>(0.0)</td>
<td>(0.1)</td>
</tr>
<tr>
<td>Housing investment</td>
<td>0.4</td>
<td>1.1</td>
<td>1.1</td>
<td>0.5</td>
<td>1.4</td>
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<tr>
<td>Capital investment</td>
<td>-3.2</td>
<td>3.2</td>
<td>-0.4</td>
<td>0.7</td>
<td>0.9</td>
</tr>
<tr>
<td>Inventory investment</td>
<td>(0.3)</td>
<td>(-0.0)</td>
<td>(0.1)</td>
<td>(-0.1)</td>
<td>(-0.3)</td>
</tr>
<tr>
<td>Public demand</td>
<td>-0.4</td>
<td>0.4</td>
<td>0.3</td>
<td>1.4</td>
<td>0.6</td>
</tr>
<tr>
<td></td>
<td>(-0.1)</td>
<td>(0.1)</td>
<td>(0.1)</td>
<td>(0.3)</td>
<td>(0.1)</td>
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<td>Government consumption</td>
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<td>0.7</td>
<td>-0.0</td>
<td>1.2</td>
<td>0.5</td>
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<tr>
<td>Public investment</td>
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<td>-1.0</td>
<td>1.6</td>
<td>2.1</td>
<td>0.8</td>
</tr>
<tr>
<td>External demand</td>
<td>-0.1</td>
<td>(-0.4)</td>
<td>(0.4)</td>
<td>(-0.3)</td>
<td>(-0.2)</td>
</tr>
<tr>
<td>Exports</td>
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<td>1.1</td>
<td>-2.0</td>
<td>0.5</td>
<td>-0.7</td>
</tr>
<tr>
<td>Imports</td>
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<td>3.8</td>
<td>-4.1</td>
<td>2.1</td>
<td>0.2</td>
</tr>
<tr>
<td>Nominal GDP</td>
<td>-0.4</td>
<td>0.4</td>
<td>0.9</td>
<td>0.4</td>
<td>0.3</td>
</tr>
<tr>
<td>GDP deflator (y-o-y change)</td>
<td>-0.4</td>
<td>-0.3</td>
<td>0.1</td>
<td>0.4</td>
<td>0.6</td>
</tr>
</tbody>
</table>

Notes: The readings in the right hand table are q-o-q changes in real terms unless otherwise stated. The figures in parentheses indicate the contributions to GDP growth.

Source: Made by MHRI based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*
Exports for the Oct-Dec quarter started out weak; materials-based products fell while IT-related goods remained firm

- The export volume index (adjusted for seasonal factors by MHRI) fell in October (-0.9% m-o-m), dipping into negative territory for the first time in two months. The index also turned out to be negative (-1.4%) in terms of a comparison with the Jul-Sep quarter.
  - By region, exports to the US, EU and China all declined from the preceding month.
  - The downswing of the export volumes of materials-based products, such as iron & steel, plastics and pharmaceuticals, served as a drag upon the overall index.

- Among major export items, IC exports are picking up and semiconductor manufacturing equipment is bottoming out, indicating the improvement of exports of IT-related goods.
  - Even though exports of motor vehicles are continuing to fall, the margin of the fall is narrowing, leading to our forecast that motor vehicle exports will bottom out.

Note: Adjusted for seasonal factors by MHRI. The bold line shows the three-month moving average.
Source: Made by MHRI based upon Ministry of Finance, Trade Statistics of Japan
Corporate sentiment remains weak. Capital investment is expected to slow down

- The index for current economic conditions of the *Economy Watchers Survey* for October 2019 worsened by -10.0%pt m-o-m (September: 46.7 → October: 36.7), due largely to a drop in a backlash to the consumption tax hike and in the wake of the typhoon damage.
  - In light of the impact of typhoons, the reactionary fall of the index stemming from the consumption tax hike is considered to be limited in comparison with the previous consumption tax hike in 2014.

- In September 2019, private-sector machinery orders (excluding orders for ships and orders by electric power companies) fell (-2.9% m-o-m) for the third straight month, dragged down by the manufacturing sector (-5.2% m-o-m).
  - Despite support by investment to address the shortage of labor, capital investment is forecast to slow down reflecting factors such as the deterioration of corporate earnings and uncertainties regarding the future course of the domestic and overseas economies.

![Economy Watchers Survey Index (current economic conditions)](chart1)

![Machinery orders (3mma)](chart2)

*Source: Made by MHRI based upon Cabinet Office, Economy Watchers Survey*
*Source: Made by MHRI based upon Cabinet Office, Machinery Orders*
September retail sales data confirm that there was a certain level of last-minute demand prior to the consumption tax hike. When averaged out, however, it fell short of the previous consumption tax hike.

- Retail sales (nominal) in September 2019 rose +9.1% y-o-y and +7.1% m-o-m, both larger increases than the consensus forecasts.
  - The breakdown shows that retail sales rose in all sectors. In addition to home electronics and motor vehicles, a certain level of last-minute demand was confirmed for items such as daily necessities, medicine & toiletries.
  - In terms of last-minute demand in the month immediately prior to the consumption tax hike, September sales was comparable to the level of demand at the time of the previous consumption tax hike (+7.1% m-o-m in September 2019, +8.3% m-o-m in March 2014).
- When averaged out, however, the size of last-minute demand was smaller than at the previous consumption tax hike (+3.2% q-o-q in the Jul-Sep quarter of 2019, +4.4% q-o-q in the Jan-Mar quarter of 2014).

Note: Change in nominal retail sales when setting 100 for sales four quarters before the consumption tax hike. Adjusted for seasonal factors.
Reactionary fall in consumption after the consumption tax hike seen as limited compared with the previous consumption tax hike

According to POS data, the breadth of the fall in consumption in October is currently limited in comparison with the previous consumption tax hike in April 2014.

- As of the third week after the consumption tax hike (the week of October 28), the drop in sales (-4.0% y-o-y) turned out to be smaller than the drop at the time of the previous consumption tax hike (-6.7% y-o-y).
- However, it should be noted that the pace of improvement from the drop following the consumption tax hike is rather tepid.

In October, seasonally-adjusted passenger car sales fell -30.1% m-o-m. This surpasses the drop of -14.8% m-o-m at the time of the previous consumption tax hike in April 2014.

- The two weekends of bad weather (Typhoon No. 19 and heavy rains) served to push down sales. The impact of the consumption tax hike will be assessed along with the November index.

[SRI-Hitotsubashi Consumer-purchase Expenditure Index (excluding tobacco)]

Note: The sales index based on POS data from 4,000 stores across Japan, including supermarkets, convenience stores, drug stores and large-scale retail stores. Contributions by each item are contributions, including tobacco, to the purchase index. The 0 period (the consumption tax hike) comprises one day before and six days after the consumption tax hike for both the latest tax hike and the 2014 tax hike, thereby precluding any impact due to the difference in the number of days before and after the tax hike.

Source: Made by MHRI based upon Institute of Economic Research, Hitotsubashi University

[Passenger car sales before and after the consumption tax hikes]

Note: Seasonally adjusted and based on registered units. As the consumption tax is levied at the time of deliveries, the peak of last-minute demand before the consumption tax hike comes with front-loaded deliveries.

Source: Made by MHRI based upon Japan Automobile Dealers Association, Japan Light Motor Vehicle and Motorcycle Association
The softening of labor market conditions is the cause for concern

- Employment-related statistics suggests that the pace of improvement of labor market conditions is slowing down.
  - The unemployment rate deteriorated to 2.4% in September (August: 2.2%). Both the number of employed persons and employees fell by approximately -50 thousand m-o-m and -260 thousand m-o-m respectively. When averaged out, it is clear that the growth of the number of employees is slowing down.
  - The ratio of job offers to job applications is on the decline as well. The number of new job offers fell sharply by -3.6% m-o-m. The incentive to hire among corporations is ebbing, particularly in the manufacturing sector.

- Given stagnant wage growth, coupled with downward pressures on special cash earnings, employee compensation, which is the source of consumption expenditures, is slowing down.

![Graph showing Number of employed persons/employees and Nominal employee compensation (quarterly)](image)

**Source:** Made by MHRI based upon Ministry of Internal Affairs and Communications, Labour Force Survey

**Note:** Nominal wages are actual wages estimated by MHRI.

**Source:** Made by MHRI based upon Ministry of Health, Labour and Welfare, Monthly Labour Survey; Ministry of Internal Affairs and Communications, Labour Force Survey.
Price hikes following the consumption tax hike are weaker than after the previous consumption tax hike, possibly due to sluggish consumption reflecting the decline of disposable income

- The nation-wide core CPI in October showed a larger rise of +0.4% y-o-y. Excluding institutional factors (contributions of +0.8% pt from the consumption tax hike and -0.6% pt from free education), the rise of the core CPI (+0.2% y-o-y) slowed down from the previous month. Price hikes after the consumption tax hike are limited.

- Compared with the previous consumption tax hike, the reduced tax rate for certain items, larger drops in gasoline prices, and the intensification of price competition along with the introduction of reward points for consumers making cashless payments served to contain “price hikes.” Even though these developments per se served to underpin consumption expenditures, the real cause of the muted price hikes most likely stems from the weak rise of consumer spending reflecting the consumption tax hike and the softening of labor market conditions.

- Winter bonus payments per person in the private sector are forecast to fall (-2.1% y-o-y) for the first time in four years, compared to the rise of +1.0% y-o-y in 2018. The odds are high that this, together with a slowdown in employment, will serve to drag down consumption in the Oct-Dec quarter of 2019. Looking forward, prices are also forecast to flatten out.

[Comparison of CPI (y-o-y) before and after the consumption tax hike (excluding institutional factors)]

Note: Values for April 2014 and October 2019 exclude institutional factors.
Source: Made by MHRI based upon Ministry of Internal Affairs and Communications, Consumer Price Index

[Bonus payments per person in the private sector]

Note: 1. Scheduled cash earnings are calculated by dividing the amount of bonus payments per person by the number of months of payment. The number of months of payments represents the number of months of scheduled cash earnings.
2. Actual amounts are based on the main series.
The Bank of Japan (BOJ) maintained its current monetary policy at the Monetary Policy Meeting (MPM) in October. The BOJ changed its forward guidance, linking it to the momentum toward achieving the price stability target, thereby effectively retaining its readiness for further easing.

- In the Outlook for Economic Activity and Prices (the “Outlook Report”), the BOJ lowered the forecasts for GDP growth and consumer prices; but expressed the view that the situation would not involve any concerns growing further that the momentum for rising prices might be lost.

We expect the BOJ to maintain the current monetary policy while closely monitoring the impact of the consumption tax hike. Given concerns regarding side effects, the hurdles to pushing interest rates further into negative territory remain high. The government’s policy response is expected to address the possibility of any economic downturn stemming from the consumption tax hike.

[Outlook for Economic Activity and Prices (October 2019) ]

<table>
<thead>
<tr>
<th>[Change in the forward guidance on the policy rates]</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Bank intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time, at least through around spring 2020, taking into account uncertainties regarding economic activity and prices including developments in overseas economies and the effects of the scheduled consumption tax hike.</td>
</tr>
<tr>
<td>As for the policy rates, the Bank expects short- and long-term interest rates to remain at their present or lower levels as long as it is necessary to pay close attention to the possibility that the momentum toward achieving the price stability target will be lost.</td>
</tr>
</tbody>
</table>

Note: Figures in brackets indicate the medians of the Policy Board Members' forecasts.

Source: Made by MHRI based upon the Bank of Japan
The 10yr JGB yield temporarily rose close to -0.02%. This was a response to increased selling pressure on US and European government bonds as investors increased their risk appetite amid expectations on progress in US-China trade talks and improving key US economic indicators (employment data and the ISM Nonmanufacturing Index), and due to the reduction of purchases of super-long JGBs in the BOJ’s market operations.

In market operations (November 5), the BOJ purchased JPY100 billion worth of bonds with remaining maturities of 10 to 25 years, down JPY20 billion from the previous market operation. Amid the BOJ’s indication of a further monetary easing stance by revising its forward guidance, attention is focusing on the steepening of the super-long-term zone through the reduction of purchase operations. Yields are expected to remain stable, especially for super-long-term bonds.
(4) Japanese stock market: stocks rose reflecting improved supply-demand and expectations-driven fund inflows

- The Nikkei Stock Average topped JPY23,000. Backed by an improvement in supply and demand, net purchases of spot-trading stocks by foreign investors (Week 1 of October to Week 2 of November) reached JPY1,598.4 billion, the highest level since April.

- Despite the year-on-year decline in corporate earnings, this is generally in line with the market consensus. Stock prices rose as market participants factored in the bottoming out of earnings by semiconductor makers and other companies.

- At valuation, while the forward EPS continued to fall, expectations-driven inflows of funds lifted the forward P/E ratio to the 13x level.

- The Nikkei Stock Average is expected to face resistance of JPY24,000 for the time being, but is expected to top out if the recovery of corporate business performance is confirmed.

[ Net buying of foreign investors by investment sector ]

[ TOPIX forward P/E ratio and forward EPS ]

Source: Made by MHRI based upon the Japan Exchange Group

Source: Made by MHRI based upon Refinitiv
6. Forex market: range-bound forex rates intact despite swings due to speculation about US-China trade tensions

- The USD/JPY exchange rate is continuing to move around the JPY108/USD level, reflecting expectations toward the progress of US-China trade talks, strong data from the October Current Employment Statistics (CES), and an improvement, albeit small, in the ISM Manufacturing index for October.

- While the USD/JPY exchange rate is subject to fluctuations on speculation over the US imposition of Round 4 List B of the punitive tariffs upon China, the movement lacks a clear direction. We expect USD/JPY exchange rates to remain range-bound in the higher JPY100 level.

- As for EUR/USD exchange rates, the euro is expected to continue to depreciate due to the weakness of the eurozone economy.
7. The crude oil market is factoring in expectations toward the continuation of coordinated output cuts

- WTI crude oil futures rose to the upper half of the USD50 level on the back of expectations toward the progress of US-China trade talks.
  - While the attacks on Saudi Arabian oil facilities in September served as a factor for the fall of crude oil output, the sense of excessive output is easing.
  - As the sense of excess crude oil supply is easing, the rise of expectations toward the continuation of output cuts also served to support crude oil prices.

- Given the high probability that the OPEC Plus will extend the coordinate output cut until June 2020, WTI crude oil futures are expected to stay firm in the upper-half range of the USD50 level.

[ Crude oil prices (WTI crude oil futures) ]
8. Outlook on the financial markets

<table>
<thead>
<tr>
<th></th>
<th>FF rate (qtr-end value, %)</th>
<th>10yr UST bond yield (%)</th>
<th>Dow Jones Average (USD)</th>
<th>Euroyen TIBOR (three months, %)</th>
<th>10yr JGB yield (%)</th>
<th>Nikkei 225 Average (JPY)</th>
<th>ECB repo rate (qtr-end value, %)</th>
<th>10yr government bond yield (German bonds, %)</th>
<th>USD/JPY rate (USD/JPY)</th>
<th>EUR/USD rate (EUR/USD)</th>
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<td>1.12</td>
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</table>

- **Sub-scenario 1** (upside scenario)
  - Long-term interest rates and stock prices rise on the rise of expectations toward interest rates driven by the acceleration of US economic recovery. The dollar continues to strengthen against the yen.

- **Sub-scenario 2** (downside scenario)
  - Global economic slowdown, including Europe and the US, due to tariff hikes accompanying US protectionist policy. Both long-term interest rates and stock prices fall. The dollar continues to weaken against the yen.
Mizuho Research Institute Ltd.

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