

Economic Letter From Asia: Japan Juxtapositions

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11th March 2024

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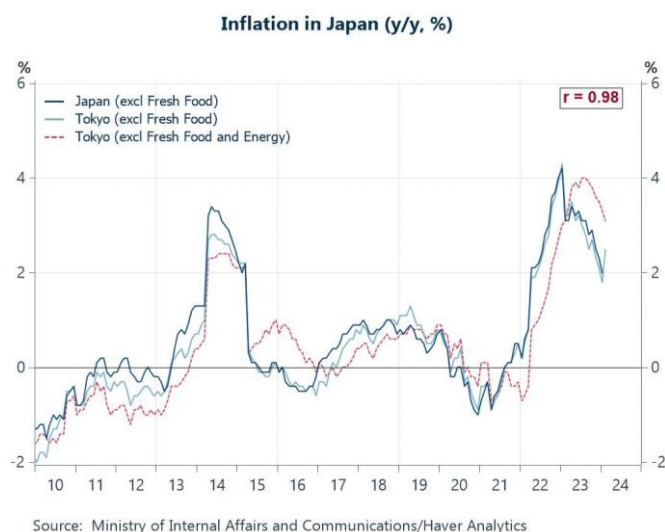
In this week's newsletter, we revisit some pivotal themes related to Japan. We begin by assessing the country's recent inflation trends, specifically highlighting the latest CPI figures from Tokyo and their potential impact on nationwide inflation and monetary policy. Next, we examine Japan's current macroeconomic landscape, acknowledging the slowdown in retail sales and industrial production, alongside a worsening outlook suggested by recent PMI readings. However, we also recognize the significant growth in corporate capital expenditure in Q4 and investigate the potential consequences of this unexpected positive development on Japan's Q4 GDP. We move on to analyze the ongoing rally in Japan's equity market, underscored by earnings growth and robust investment from foreign investors. Shifting gears, we delve into the recent performance of Japan's semiconductor industry, which has experienced a surge in production and exports, fueled by the global demand for AI chips. Finally, we explore Japan's long-term demographic challenges, focusing on workforce trends and the increase in foreign workers.

Tokyo inflation

Markets have continued to scan data prints and official comments for cues ahead of the Bank of Japan's (BoJ) upcoming monetary policy decision on March 19. Among the recent flurry of economic data was Tokyo's core CPI, which jumped to 2.5% y/y in February, as base effects from Japan's utility subsidy programme faded. The Japan government implemented support measures in early 2023 to help households tackle rising costs brought about by Russia's invasion of Ukraine and a weakening yen. Among the measures include subsidies of about 20% on consumer electricity bills. Stripping away energy-related price effects, however, underlying inflation in Tokyo continued to cool, having moderated to 3.1% from 3.3%. As such, it remains to be seen if Tokyo's latest inflation developments, if reflected in nationwide inflation

numbers, are supportive of imminent BoJ policy tightening. Of possible concern is non-fresh food and non-energy inflation, which has remained on a downward trajectory since late 2023.

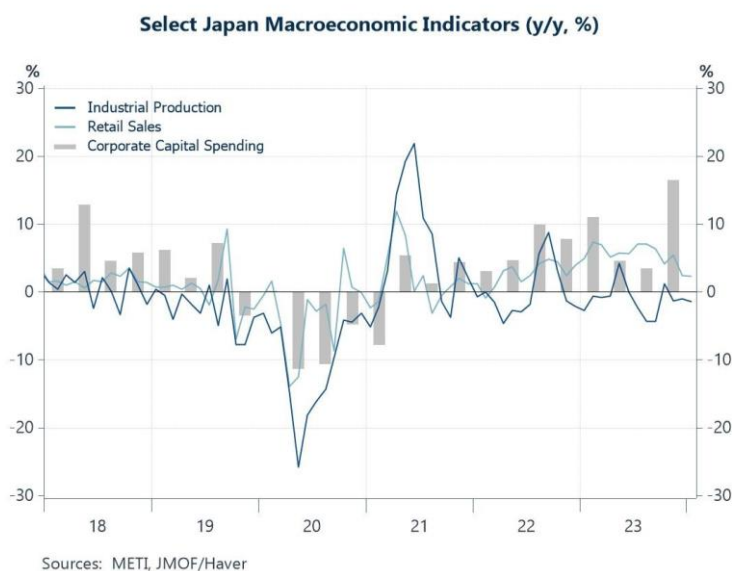
Chart 1: Inflation in Japan



Recent macroeconomic developments

The Japanese economy has not yet shown signs of a substantive pickup. Retail sales growth, although having exceeded the consensus, slowed further to 2.3% y/y in January, while contractions in industrial production steepened slightly to 1.5% (chart 2). Some forward-looking indicators indicate a modest worsening of conditions ahead as well. Namely, Japan's services PMI slipped to 52.9 in February, indicating a slowing expansion, while the manufacturing gauge fell to 47.2, signaling a worsening contraction. Regardless, there have been some positive developments, such as a surge in corporate capital expenditure specifically of 16.4% y/y in Q4. The surprise prompted some economists to expect quarterly GDP growth in Japan for the quarter instead of a contraction as indicated by preliminary readings. Sure enough, Japan avoided a technical recession in Q4, with growth greatly aided by private nonresidential investment, revised GDP data revealed.

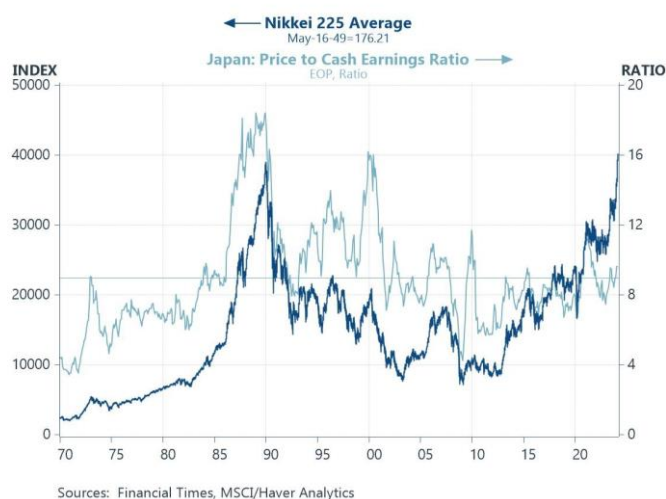
Chart 2: Select Japan macroeconomic indicators



Japan equity performance

Japan's equity market continue to be on a tear, regardless, with the Nikkei 225 index having crossed above 40,000 in early March to surpass 1980s-era highs. The strong equity performance was partly driven by semiconductor-related producers, who are benefitting from a global uptick in AI chip demand. Unlike Japan's 1980s equity price bubble, however, the recent rise in Japanese equity prices was accompanied by strong earnings growth (chart 3). Specifically, while the price-to-cash earnings ratio of Japanese equities has firmed, it has only recently crossed above historical averages and remains far from 1980s-era highs. Among broader sectors, transport equipment, oil & coal products, and machinery have outperformed so far this year. In contrast, textile products, land transport, and air transport sectors are comparative laggards.

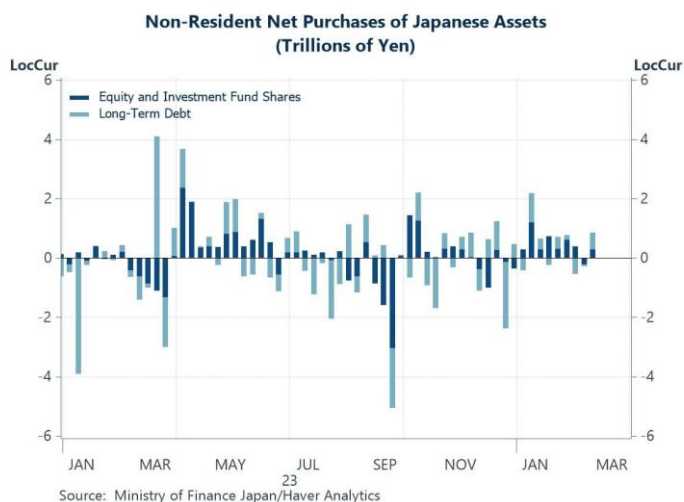
Chart 3: Japan equity performance



Foreign investor flows

Foreign investors have been largely supportive of Japanese equities, with net inflows of about 3.9 trillion yen (\$26.4 billion) seen so far this year, as seen in chart 4. Mild net outflows were logged, however, for the week ending February 23, following seven consecutive weeks of inflows. In contrast, the investment pattern of foreign long-term debt investors has been comparatively varied, likely due to shifting perceptions of prospective BoJ policy. The attractiveness of Japanese equities was likely boosted by currency effects, as a weakening yen made them more of a bargain in the investors' respective base currencies. That being said, a depreciating yen can negatively impact foreign investors who currently hold equities in Japan without hedging their currency exposure.

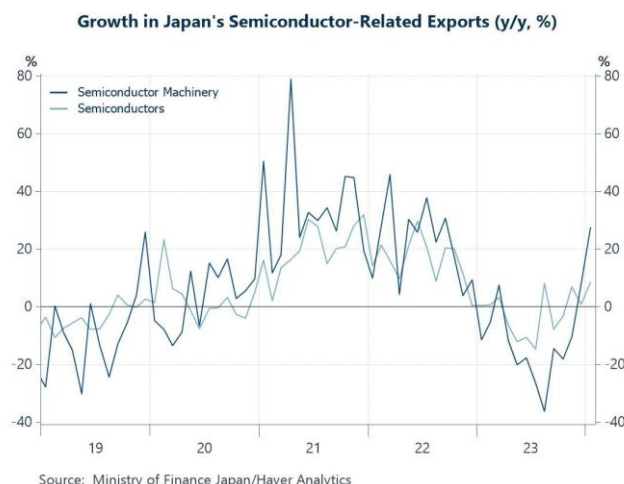
Chart 4: Non-resident purchases of Japanese assets



Japan's semiconductor sector

Japan's semiconductor sector has started to see a turnaround of late, amidst a surge in global chip demand. Japan semiconductor exports growth firmed to 8.4% y/y in January (chart 5), while integrated circuit production logged their fourth consecutive month of double-digit growth. Still, Japan's share of global semiconductor exports remains low, having accounted for about only 3.5% of the world's shipments in 2022 (HS codes 8541 and 8542). That does not mean, however, that Japan's contribution to the global semiconductor industry is insignificant. Instead, Japan's comparative advantage lies in its relative dominance in semiconductor equipment, exports of which contributed 23.6% to global shipments in 2022. The economy has benefitted from a rebound in this space too, with its semiconductor machinery exports surging 27.5% y/y in January, while semiconductor equipment production jumped 30.2%.

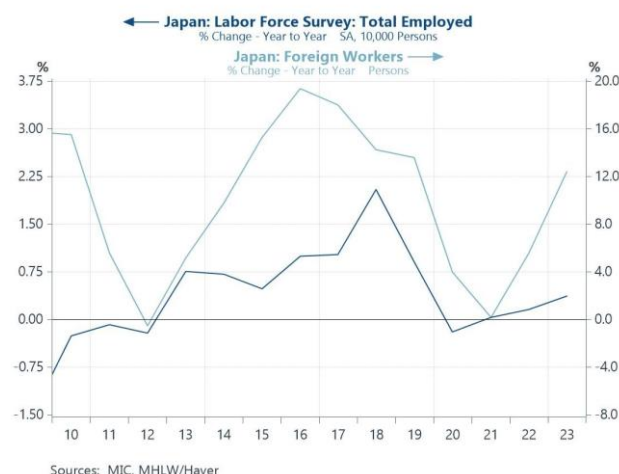
Chart 5: Growth in Japan's semiconductor-related exports



Demographic and labour market challenges

Touching on longer-term issues, Japan continues to face steep demographic challenges as its fertility rate declines and its dependency ratio firms. Japan's demographic challenge is not unique; other advanced Asian economies, such as Singapore, are also struggling with rapidly ageing populations. Unlike Singapore, however, Japan has not yet relied heavily on foreign labour to supplement its workforce. As of 2023, foreign workers make up only about 3% of Japan's employed persons, although the growth in the number has been accelerating in recent years (chart 6). Regardless, the Japan government has already taken additional steps to include more foreign workers to address its labour shortages. For one, the government plans to more than double the cap on skilled foreign workers for specific industries to 800,000 for the five years, starting fiscal 2024.

Chart 6: Japan's employed force



About the author



Haver Analytics is pleased to bring [Tian Yong Woon's](#) commentaries on the state of the global economy to its clients.

Tian Yong joined Haver Analytics as an Economist in 2023. Previously, Tian Yong worked as an Economist with Deutsche Bank, covering Emerging Asian economies while also writing on thematic issues within the broader Asia region. Prior to his work with Deutsche Bank, he worked as an Economic Analyst with the International Monetary Fund, where he contributed to Article IV consultations with Singapore and Malaysia, and to the regular surveillance of financial stability issues in the Asia Pacific region. Tian Yong holds a Master of Science in Quantitative Finance from the Singapore Management University, and a Bachelor of Science in Banking and Finance from the University of London.

Data featured in this commentary:

Chart 1: Inflation in Japan

Series 1: JYCIJE@JAPAN [Japan: CPI: All Items, Less Fresh Food (NSA, Y/Y %Chg)]

Series 2: TKYCITE@JAPANR [Japan: CPI: Ku-Area of Tokyo: All Items, Less Fresh Food (NSA, Y/Y %Chg)]

Series 3: JYCITEX@JAPAN [Japan: CPI: Ku-Area of Tokyo: All Items, Less Fresh Food & Energy(NSA, Y/Y %Chg)]

Chart 2: Select Japan macroeconomic indicators

Series 1: yryr%(JPNIP@JAPAN) [Japan: IP: Mining and Manufacturing (NSA, 2020=100)]

Series 2: yryr%(JPSIR@JAPAN) [Japan: Retail Sales Value: Total (NSA, 2020=100)]

Series 3: yryr%(FSAFASN@JAPAN) [Japan: Non Fin Corps: All Indus: Tot Fixed Assets: Gro Incr, New Capex (Bil.Yen)]

Chart 3: Japan equity performance

Series 1: S158NKA@INTDAILY [Japan: Stock Price Index: Nikkei 225 Average (May-16-49=176.21)]

Series 2: JPPC@MSCIE [Japan: Price to Cash Earnings Ratio (EOP, Ratio)]

Chart 4: Non-resident purchases of Japanese assets

Series 1: F158ISN@INTWKLY [Japan: Foreigners' Net Purch/Sales of Dom Eq & Inv Fund Shares(100 Mil.Yen)]

Series 2: F158IBN@INTWKLY [Japan: Foreigners' Net Purch/Sales of Domestic LT Debt Sec (100 Mil.Yen)]

Chart 5: Growth in Japan's semiconductor-related exports

Series 1: yryr%(VEC701SC@JAPAN) [Japan: Value of Exports by Commodity: Semicon Machinery Etc (Mil.Yen)]

Series 2: yryr%(VEC703SV@JAPAN) [Japan: Value of Exports by Commodity: Semiconductors Etc (Mil.Yen)]

Chart 6: Japan's employed force

Series 1: yryr%(FLED2@JAPAN) [Japan: Labor Force Survey: Total Employed (SA, 10,000 Persons)]

Series 2: yryr%(JPAELEX@JAPAN) [Japan: Foreign Workers (Persons)]