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FY2019 and FY2020 Economic Outlook

- The global economy will continue to slow down due to the escalation of US-China trade tensions -

August 13, 2019

Mizuho Research Institute

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Key points of our outlook

- Reflecting the mounting possibility that the US will launch its 4th round of punitive tariffs upon Chinese goods, we have revised down our outlook on the economy premised upon such launch. The global economy should continue to slow down in 2020. Even though the US will most likely avoid the "fiscal cliff" in 2020, a "no-deal Brexit" in addition to US-China trade tensions will serve as downward pressures.

- The impact of trade tensions will accelerate the adjustment of the Chinese economy and IT cycle, leading to the deceleration of global economic growth led mainly by the manufacturing sector. The growth of trade volume in 2019 will fall short of the growth rate of the global economy, thus falling back again into slow trade.

- On the other hand, fiscal and monetary policy measures will underpin the global economy. As exemplified by the US taking a shift toward interest rate cuts against a backdrop of rising uncertainties and low inflation, monetary policy is turning accommodative around the world. As a whole, fiscal policy is also expansionary.

- The risks factors are: the escalation of US-China trade tensions, the downshift of the Chinese economy and IT-related demand and their spillovers to the emerging market (EM) economies, the sharp fall of confidence due to a "no deal" Brexit, the rise of fiscal and financial sector uncertainties in southern Europe stemming from Europe's economic stagnation, the creation of a bubble due to prolonged monetary easing, the deterioration of the credit cycle accompanying the reversal of economic conditions, and Middle East risks and rise of crude oil prices.

- In FY2019 and FY2020, the Japanese economy will continue to record tepid growth due to the rise of adjustment pressures on capital investment and durable goods consumption. Given the cautious stance among corporate enterprises about raising sales prices, the rise of the core CPI (excluding the impact of the consumption tax hike) is forecast to moderate.

- The Bank of Japan (BOJ) will keep monetary policy unchanged until it determines the impact of the consumption tax hike. Even though the BOJ will most likely address a downshift of the economy merely by tweaking its forward guidance, it could resort to pushing interest rates further down into negative territory in the event of a sharp appreciation of the yen.

I. General Overview

The global economy will be subject to downward pressure due to the escalation of US-China trade tensions

(1) Overview of our outlook: the global economy will slow down through 2020

- Our main scenario is for an ongoing slowdown in the global economy, but there is also risk of a slowdown in the event of market turmoil and deterioration of sentiment due to the escalation of US-China trade tensions

[Outlook on the global economy]

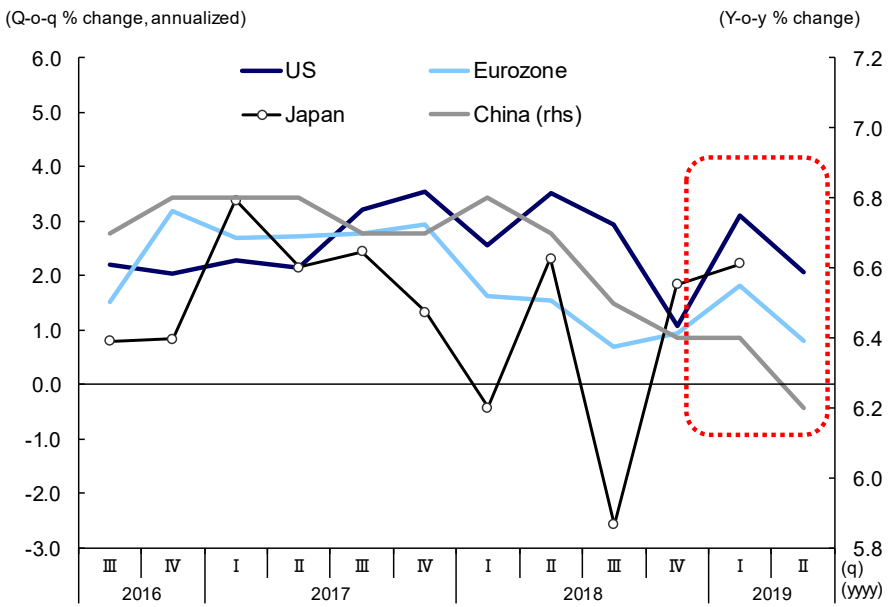
	2016	2017	2018	2019	2020	2019	2020	2019	2020
	Calendar year			(Y-o-y % change)		(Y-o-y % change) (Forecast in June 2019)		(% point) (Comparison with the forecast in June 2019)	
Total of forecast area	3.5	4.0	4.0	3.5	3.4	3.6	3.5	-0.1	-0.1
Japan, US, Eurozone	1.6	2.3	2.2	1.7	1.3	1.9	1.4	-0.2	-0.1
US	1.6	2.4	2.9	2.4	1.8	2.8	1.7	-0.4	0.1
Eurozone	1.9	2.4	1.9	1.2	1.1	1.2	1.4	-	-0.3
UK	1.8	1.8	1.4	1.3	0.9	1.4	1.4	-0.1	-0.5
Japan	0.6	1.9	0.8	1.0	0.0	0.8	0.4	0.2	-0.4
Asia	6.4	6.2	6.2	5.7	5.7	5.8	5.8	-0.1	-0.1
China	6.7	6.8	6.6	6.2	6.0	6.2	6.1	-	-0.1
NIEs	2.4	3.2	2.8	1.8	1.6	2.1	1.8	-0.3	-0.2
ASEAN5	5.0	5.3	5.2	4.9	4.8	5.0	4.8	-0.1	-
India	8.7	6.9	7.4	6.9	7.1	6.9	7.2	-	-0.1
Australia	2.8	2.5	2.7	2.1	2.0	2.1	2.0	-	-
Brazil	-3.3	1.1	1.1	0.8	1.9	1.2	1.9	-0.4	-
Mexico	2.9	2.1	2.0	0.6	1.2	1.2	1.4	-0.6	-0.2
Russia	0.3	1.6	2.3	1.0	1.8	1.3	1.7	-0.3	0.1
Japan (FY)	0.9	1.9	0.7	0.7	0.4	0.6	0.5	0.1	-0.1
Crude oil prices (WTI, USD/bbl)	43	51	65	56	57	58	58	-2	-1

Note: The shaded areas are forecasts. The total of the forecast area is calculated upon the GDP share (PPP) by the IMF
Sources Made by MHRI based upon releases by the International Monetary Fund (IMF) and statistics of relevant countries and regions

(2) Overview of the global economy: the global slowdown continues particularly in the manufacturing sector

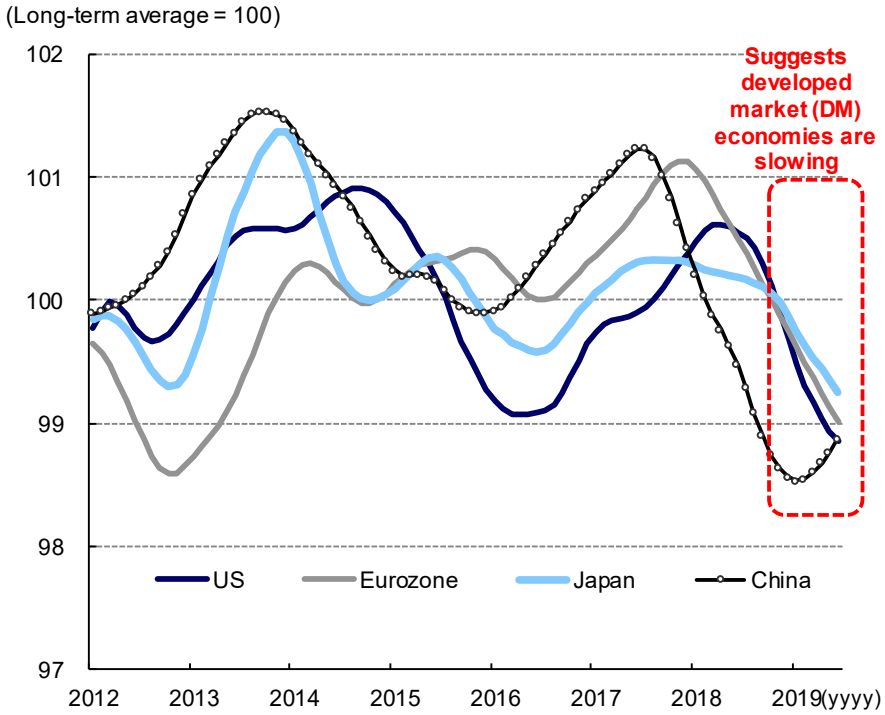
- Although there were some signs of bottoming out at the beginning of the year, on balance there has been no change in the trend for global economic slowdown since last year.
  - Quarterly growth rates recovered in the Jan-Mar quarter in Japan, the US and Europe, while China was flat, whereas there was a decline across the board in the Apr-Jun quarter.
  - Leading economic indicators also suggest an ongoing slowdown for major developed market (DM) economies. Although China shows signs of bottoming out, there is considerable uncertainty depending upon US-China relations.

[Quarterly GDP growth rates for Japan, US, Eurozone, China]



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

[OECD Leading Indicators]

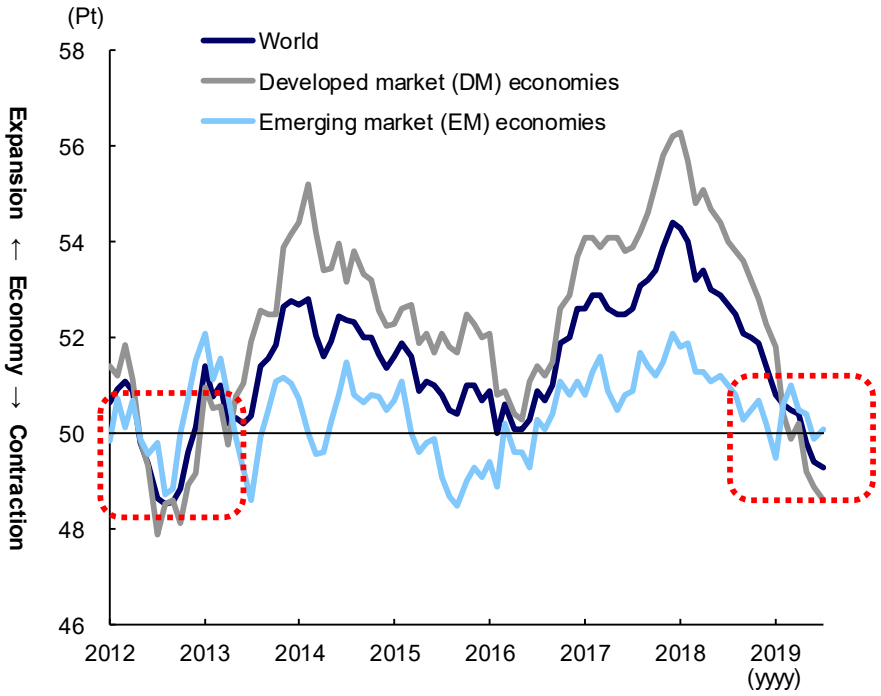


Source: Made by MHRI based upon OECD

In contrast to a clear slump in the manufacturing sector, the service sector remains firm

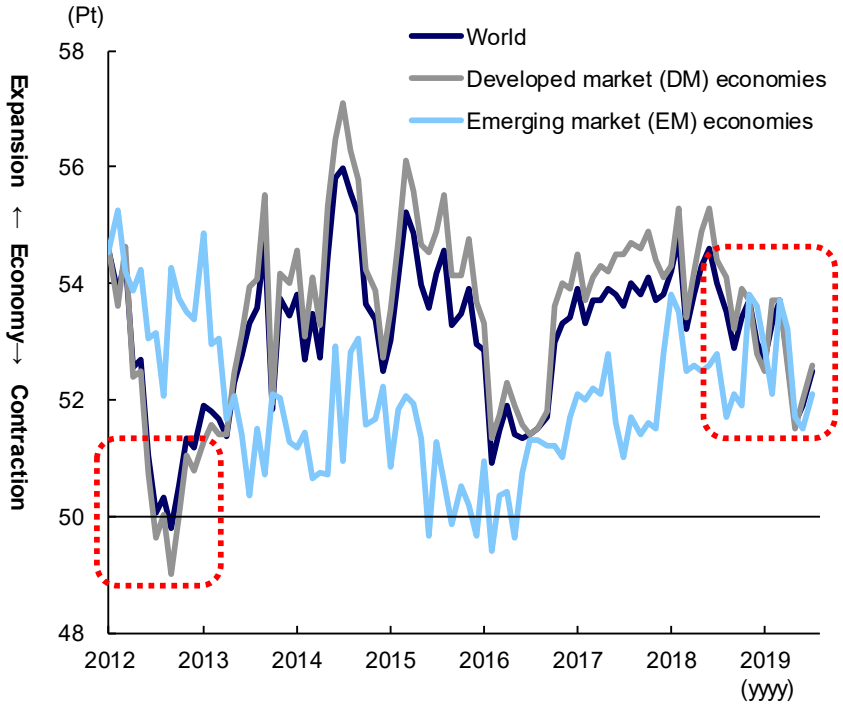
- The PMI, which indicates corporate sentiment, has clearly slumped for the manufacturing sector, yet the service sector remains firm albeit with a slowdown.
  - The global manufacturing PMI has fallen below the expansion-contraction threshold of 50 for the first time in six and a half years.
  - However, the global service PMI is above 50, and remains firm compared to past slumps in 2012 and 2016.

[Global manufacturing PMI]



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

[Global service PMI]

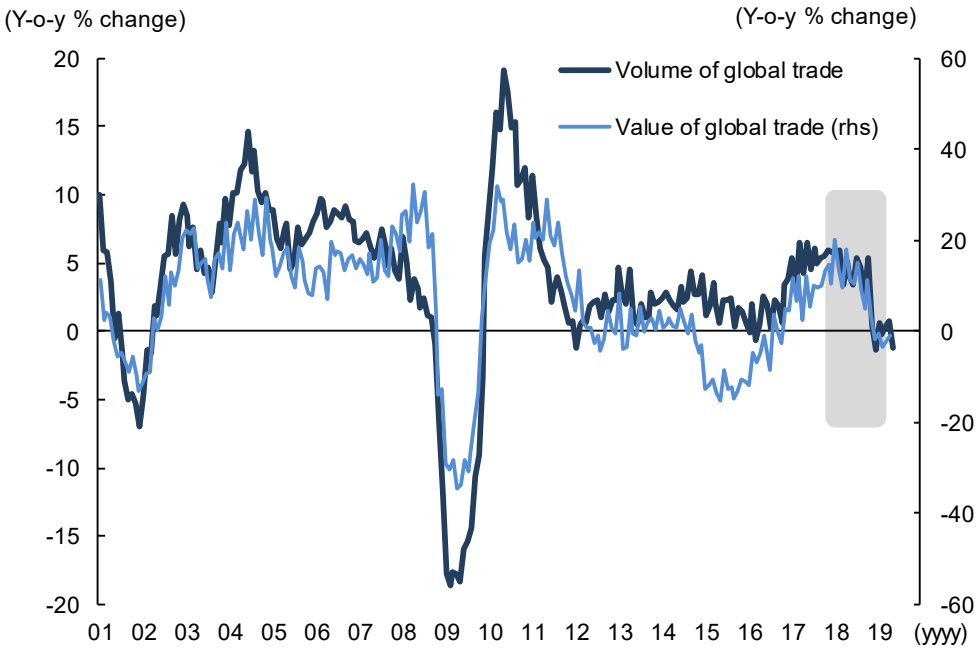


Source: Made by MHRI based upon OECD

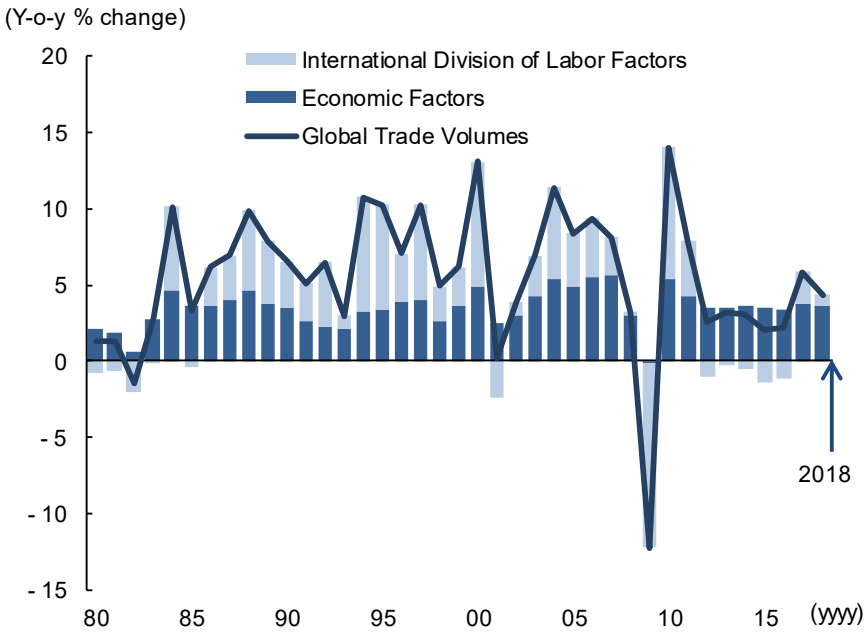
Global trade volumes are below the previous year, falling back again into slow trade

- The growth in global trade has stalled with global trade volumes below the previous year's level.
  - Expansion of global trade has paused because of the curtailment of the deepening international division of labor.
  - Currently, trade tensions mainly between the US and China are serving to suppress trade.

[Global trade]



[Factor analysis of global trade]



Source: Made by MHRI based upon CPB and IMF

Note: International Division of Labor factors indicate change in the trade/production ratio
Source: Made by MHRI based upon IMF

Monetary easing measures spread across the world

- The US cut interest rates for the first time in 10 years amid growing concerns about a global economic slowdown. The accommodative monetary policy trend should continue in the second half of the year.
- In a shift from 2018, when there was a period of global interest rate hikes, interest rate cuts are spreading around the world in 2019.

[Policy interest rates by country]

○: rate hike
●: rate cut

Policy interest rates
Monetary tightening stance
Monetary easing stance

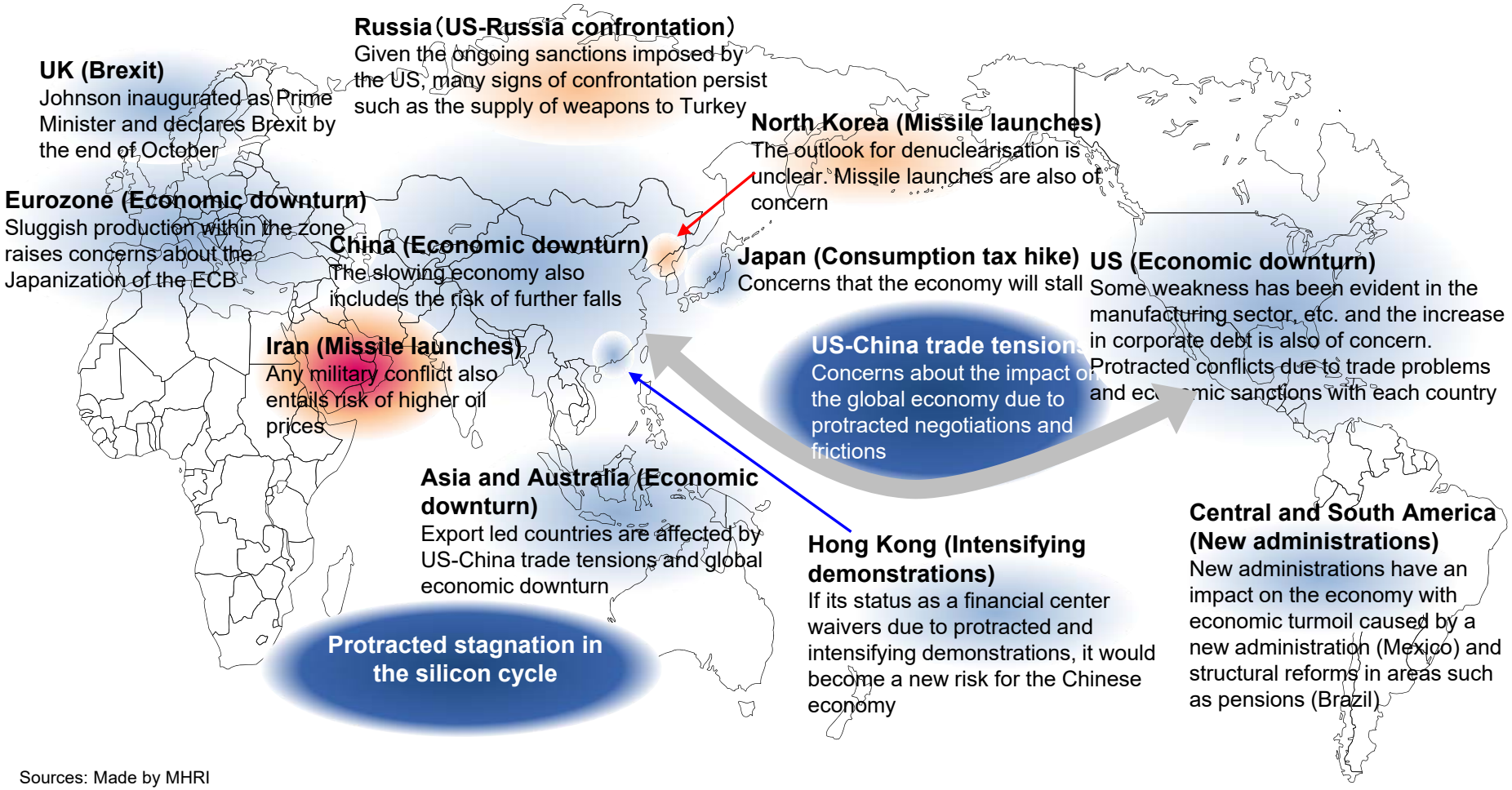
Country/ Region	2017	2018				2019							
	Q4	Q1	Q2	Q3	Q4	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Advanced countries													
US	○	○	○	○	○	–	–	–	–	–	–	●	–
Japan	–	–	–	–	–	–	–	–	–	–	–	–	–
Europe (ECB)	–	–	–	–	–	–	–	–	–	–	–	–	–
UK	○	–	–	○	–	–	–	–	–	–	–	–	–
Australia	–	–	–	–	–	–	–	–	–	–	●	●	–
India and ASEAN													
India	–	–	○	○	–	–	●	–	●	–	●	–	●
Thailand	–	–	–	–	○	–	–	–	–	–	–	–	●
The Philippines	–	–	○	○	○	–	–	–	–	●	–	–	●
Indonesia	–	–	○	○	○	–	–	–	–	–	–	●	–
Malaysia	–	○	–	–	–	–	–	–	–	●	–	–	–
China and NIEs													
China	–	–	–	–	–	–	–	–	–	–	–	–	–
South Korea	○	–	–	–	○	–	–	–	–	–	–	●	–
Taiwan	–	–	–	–	–	–	–	–	–	–	–	–	–
Other emerging countries													
Brazil	●	●	–	–	–	–	–	–	–	–	–	●	–
Mexico	○	○	○	–	○	–	–	–	–	–	–	–	–
Russia	●	●	–	○	○	–	–	–	–	–	●	●	–

Note: As of August 8, 2019
Sources: Made by MHRI based upon releases by each country's central bank and Refinitiv

(3) Worldwide risks

- There are economic and geopolitical risks around the world that may have an impact on the world.
  - In particular, the biggest risk is "US-China trade tensions". If exacerbated, there will be further downward pressure on the entire global economy.

[Global economic risk map]



Sources: Made by MHRI

President Trump announces intent to impose a 4th round of punitive tariffs on China from September 1

- On August 1, US President Trump announced his intent to impose a 4th round of punitive tariffs on China (on $300 billion worth of goods, 10% tariff) from September 1.
  - Agreement was reached to resume negotiations at the US-China summit held at the end of June when the US said it would forego a 4th round of punitive tariffs for the near term.
  - However, US-Chinese negotiations (end of July) ended as far a part as ever, with no sign of progress.
  - President Trump indicated strong dissatisfaction concerning the lack of progress made in China's commitment to purchase large volumes of US agricultural products.
- In response to the US announcement of punitive tariffs on China, China announced the suspension of US agricultural purchases it had commenced.
  - China continues to request (1) an end to punitive tariffs, (2) a lowering of the increased amount of imports from the US, and (3) improvements in the balance of the agreement document.
- President Trump also suggested delaying the next negotiations scheduled for September.

[US punitive tariffs on China and China's retaliatory measures against the US]

US punitive tariffs on China

	Value of target imports	Additional tariffs	Effective date	Target products
Imports	① $34 billion	25%	July 6, 2018	Industrial equipment, aircraft, etc.
	② $16 billion		August 23, 2018	
	③ $200 billion	10%	September 24, 2018	Food, clothing, etc.
		10%→25%	May 10, 2019	
	④ Approx. $300 billion	10%	September 1, 2019	Mobile telephones, etc.
Investments	Stricter reviews on inward investment to the US by CFIUS (Committee on Foreign Investment in the US)			
Exports/ Transactions	Export control regulations under ECRA (Export Control Reform Act) Government procurement regulations under NDAA (National Defense Authorization Act) Transaction regulations under IEEPA (International Emergency Economic Powers Act)			

China's retaliatory measures against the US

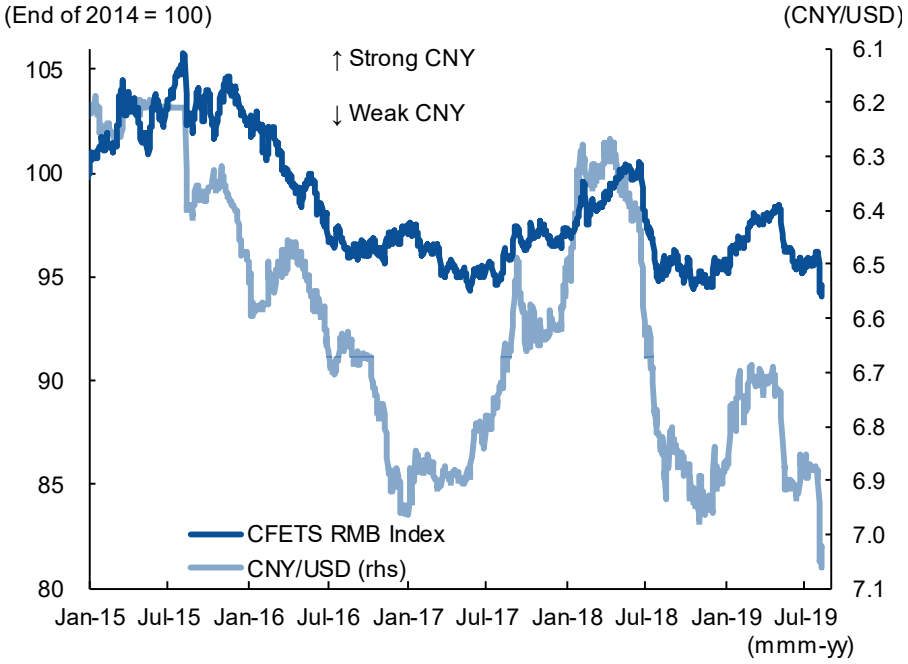
	Value of target imports	Additional tariffs	Effective date	Target products
Imports	① $34 billion	25%	July 6, 2018	Soya beans, chemicals, cars, etc.
	② $16 billion		August 23, 2018	
	③ $60 billion	5%, 10%	September 24, 2018	Lumber, LNG, etc.
		Max. 25%	June 1, 2019	
Qualitative countermeasures (Non-tariff measures)	• Stricter import inspections • Delays to custom procedures and approvals			

Sources: Made by MHRI based upon government documents from the US and China and media reports

US designates China a currency manipulator, serving to heighten concerns about the future course of US-China negotiations

- With the depreciation of the renminbi beyond 7 yuan to the dollar, the US designated China a currency manipulator (August 5). This is the first time since 1994 that China was designated a currency manipulator.
  - The Chinese government noted that while an excessive depreciation of the renminbi is not desirable, it could condone a moderate weakness, heightening concerns about future US-China negotiations.
- The procedures following the designation as a currency manipulator include the possibility of prohibition on federal government procurement, stronger monitoring by the IMF and progress towards a bilateral or regional trade agreement after the announcement of concerns and request for a planned response.

[China yuan renminbi (CNY) exchange rate]



Source: Made by MHRI based upon Bloomberg

[Procedures following recognition as a currency manipulation country]

ENHANCED BILATERAL ENGAGEMENT
A. Urge implementation of policies to address the causes of the undervaluation of its currency, its significant bilateral trade surplus with the United States, and its material current account surplus, including undervaluation and surpluses relating to exchange rate management
B. Express the concern of the United States with respect to the adverse trade and economic effects of that undervaluation and those surpluses
C. Advise that country of the ability of the President to take action under the section on Remedial Action
D. Develop a plan with specific actions to address that undervaluation and those surpluses

1 year after the commencement of enhanced bilateral engagement

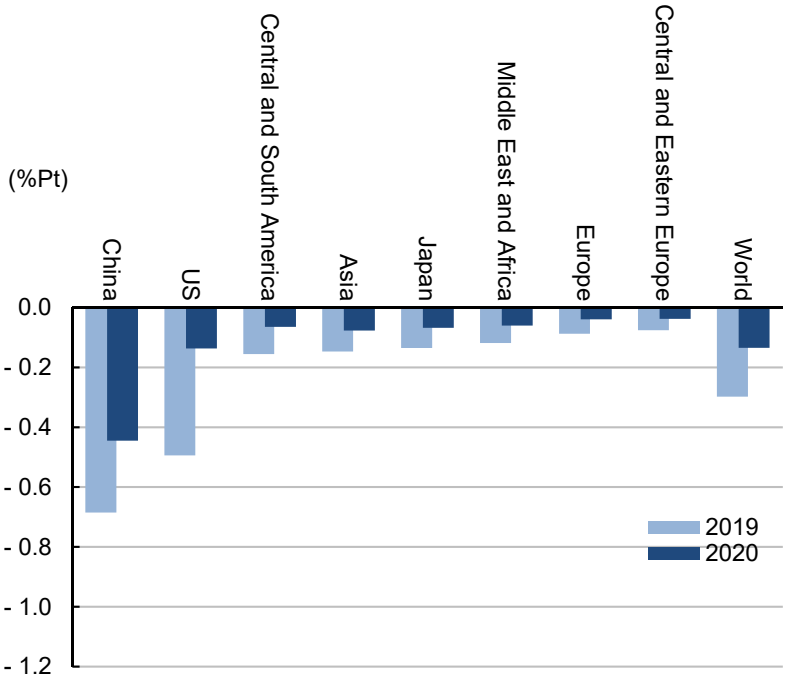
REMEDIAL ACTION
A. Prohibit the Overseas Private Investment Corporation (OPIC) from approving any new financing (including any insurance, reinsurance, or guarantee) with respect to a project located in that country on and after such date
B. Prohibit the Federal Government from procuring, or entering into any contract for the procurement of, goods or services from that country on and after such date
C. Instruct the United States Executive Director of the International Monetary Fund to call for additional rigorous surveillance of the macroeconomic and exchange rate policies of that country and, as appropriate, formal consultations on findings of currency manipulation
D. Instruct the United States Trade Representative to take into account, in consultation with the Secretary, in assessing whether to enter into a bilateral or regional trade agreement with that country or to initiate or participate in negotiations with respect to a bilateral or regional trade agreement with that country, the extent to which that country has failed to adopt appropriate policies

Source: Made by MHRI based upon GPO PUBLIC LAW 114-125-February 24, 2017
Trade Facilitation and Trade Enforcement Act of 2015

Potential downward pressure on the economy from prolonged US-China confrontation

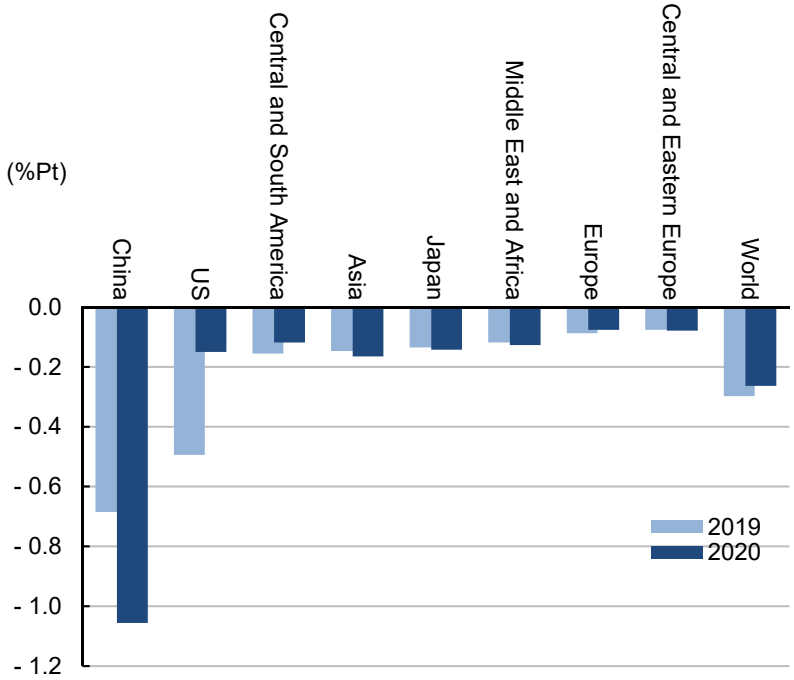
- The additional tariffs imposed respectively by the US and China have led to substantial reduction in trade between the two nations. If the impact spreads to fixed business investment and consumer spending, it is estimated that it would lower the rate of growth in real GDP for the global economy by as much as 0.3% points in 2019.
- If the US-China confrontation becomes protracted and a 4th round of additional tariffs are lifted to 25% in 2020, there is grave concern that the Chinese economy could be subject to greater downward pressure in 2020 than in 2019.

[Impact of US-China Trade Tensions (1)
If US imposes 4th round of punitive tariffs on China in September]



Note: The impact on the real GDP growth rate by country and region from additional tariffs imposed on trade between the US and China. Includes the impact on investment and consumer spending and the knock-on impact to third countries.
Source: Made by MHRI based upon the World Bank and IMF

[Impact of US-China Trade Tensions (2)
If 4th round of additional tariffs are lifted to 25% from 2020]

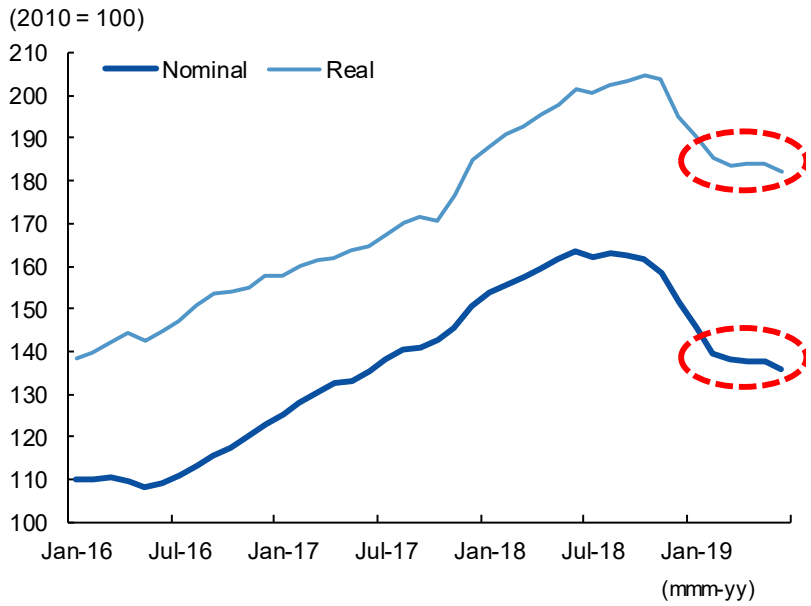


Note: The impact on the real GDP growth rate by country and region from additional tariffs imposed on trade between the US and China. Includes the impact on investment and consumer spending and the knock-on impact to third countries.
Source: Made by MHRI based upon the World Bank and IMF

IT: although global sales of semiconductors have bottomed out, real demand remains vulnerable

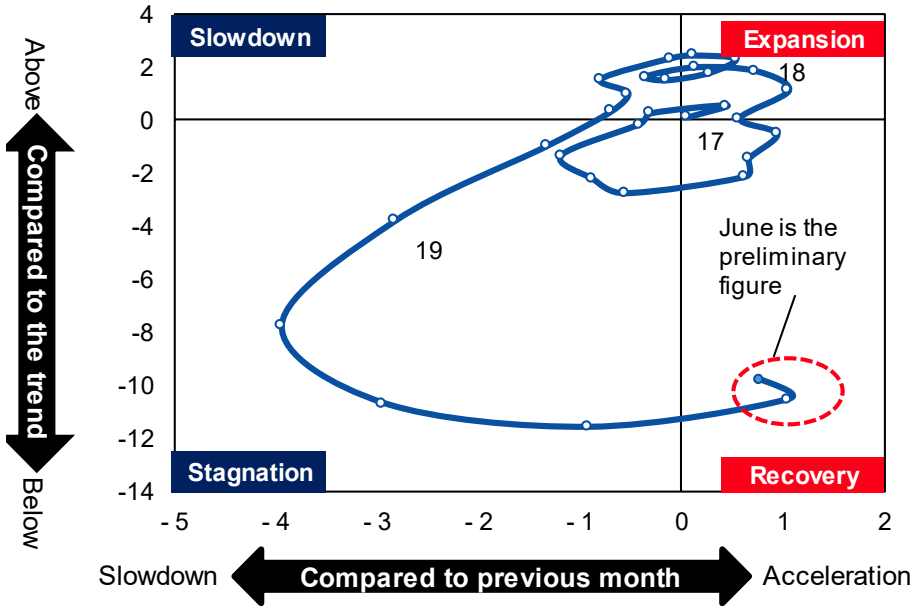
- Global sales of semiconductor have bottomed out. The Silicon Cycle Index entered a recovery period from May.
- However, this may be due partially to the rise of sales as some Chinese manufacturers have increased procurement to lift market share due to the exacerbation of US-China trade tensions. We believe real demand for semiconductors remains weak.
- We forecast renewed weakness due to increased uncertainty caused by procurement pressures on US and Chinese manufacturers, trade tensions between the US and China as well as between Japan and South Korea, and a 4th round of US tariff increases imposed on China.
  - While we anticipate a rush in demand in the Jul-Sep quarter to deal with trade tensions between Japan and South Korea, this is likely to be temporary.

[Global semiconductor sales]



Note: Real semiconductor sales are calculated by MHRI
Source: Made by MHRI based upon CIEC Data

[SCI Business Cycle Clock]

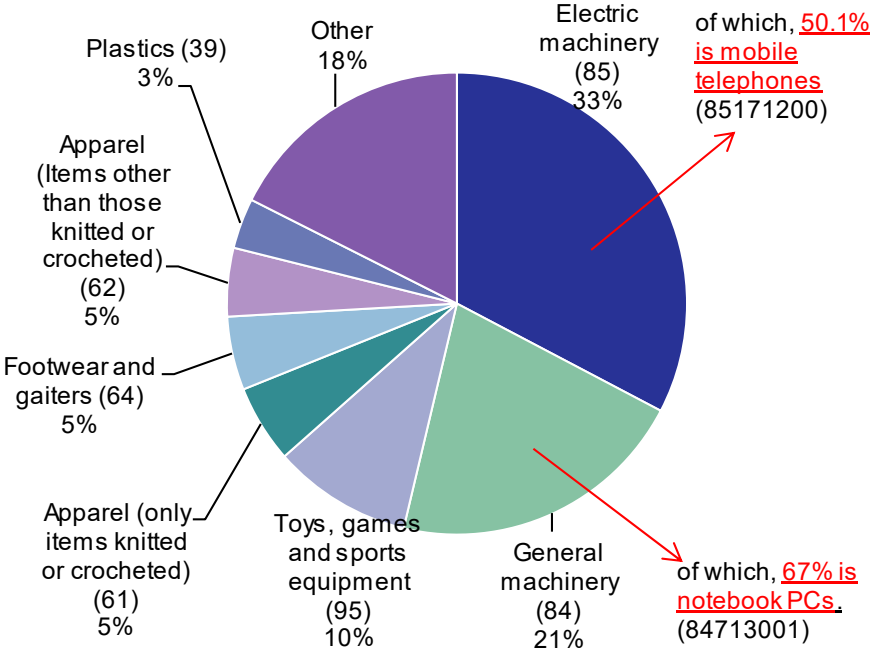


Note: The Silicon Cycle Index (SCI) is calculated by MHRI.
Source: Made by MHRI based upon CEIC Data

IT: a 4th round of tariff hikes affects the IT supply chain and weighs on semiconductor demand

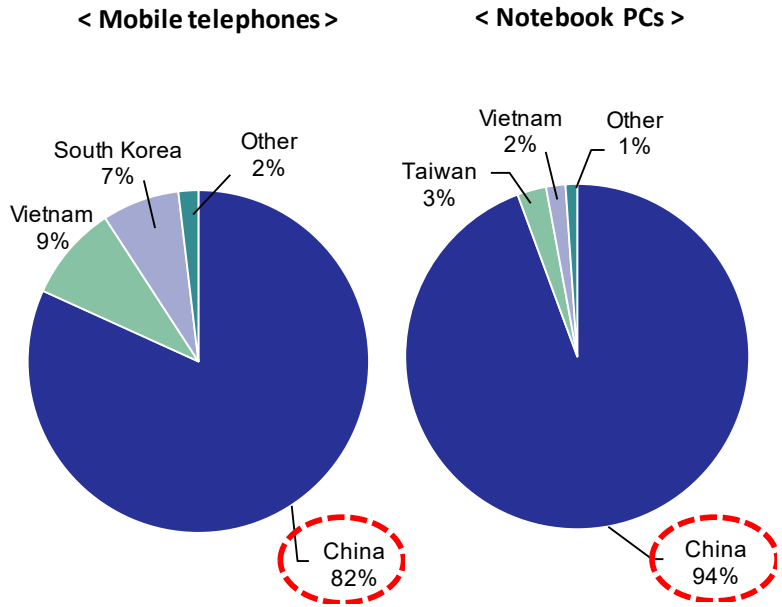
- Items with large import value subject to increased tariffs in a 4th round of punitive tariffs on China include telephones and computer equipment.
- The negative impact could spread beyond US consumers to the Asian region such as Japan through the supply chain.
  - The US imports many of its telephones and computer equipment from China. Many components used in these products are imported from countries such as Japan, South Korea and Taiwan. There are concerns that increased tariffs will negatively affect the IT supply chain in a wide area of Asia.
- The odds are high that a slump in demand for telephones and computer equipment will cause a fall in demand for semiconductors installed in such products.

[Amount of imported goods from China affected by 4th round of additional tariffs imposed by the US]



Note: The figures in parenthesis are the HS Codes. 2018 values.
Source: Made by MHRI based upon USA Trade Online, etc.

[Share of telephone handsets and PCs in the US by company of origin]

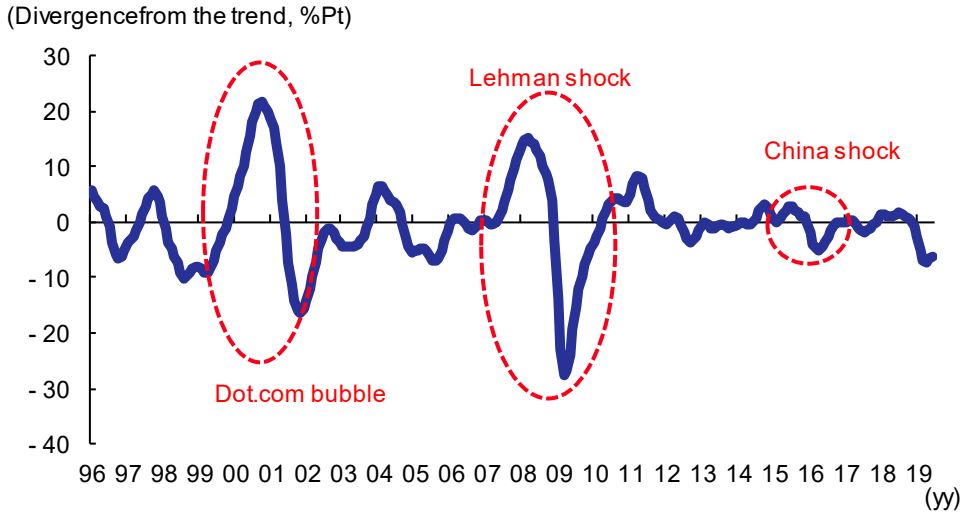


Note: The HS Code for mobile telephones is 85171200 and for laptop PCs 84713001
Source: Made by MHRI based upon USA Trade Online, etc.

IT: procurement pressures of global manufacturers will also negatively affect the semiconductor market

- The Silicon Cycle Index is below the trend. Although not to the extent of the dot.com bubble and the Lehman shock, the rate of divergence is higher than at the time of the China shock, and the negative impact on the global economy is gradually increasing.
- A 4th round of US punitive tariffs on China puts negative pressure on the production of global manufacturers and raises concerns that semiconductor demand will fall further.
- A time frame analysis using four variables (the Semiconductor Sector Index (SOX), US PMI, China PMI, global semiconductor sales), indicates a trend for US and China PMI to lead the trend in global semiconductor sales.
- Since the US and China PMI are currently weakening, reflecting the downturn in the manufacturing sector, global semiconductor sales will likely be subject to downward pressure going forward.

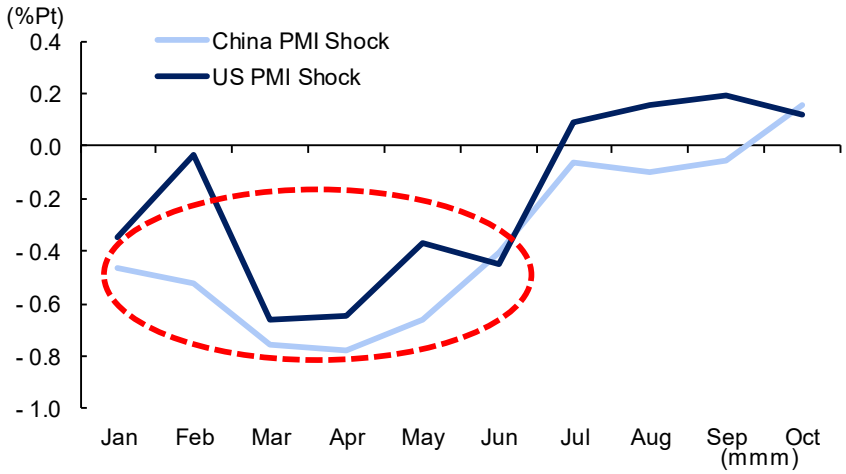
[Rate of divergence from the Silicon Cycle Index trend]



Note: The Silicon Cycle Index (SCI) is calculated by MHRI. The trend is calculated up until December 2018 using the HP filter. The recent figures are an extension of the trend line from 2018.

Source: Made by MHRI based upon CEIC Data

[Impulse response to US and China PMI shocks for global semiconductor sales]



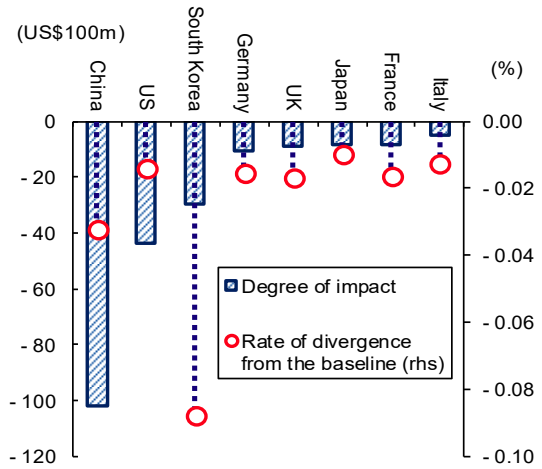
Note: Indicating the change in real global semiconductor sales (y-o-y growth rate) if affected by one standard deviation of negative shock. The degree of lag is taken to be 5 months according to AIC information criterion.

Source: Made by MHRI

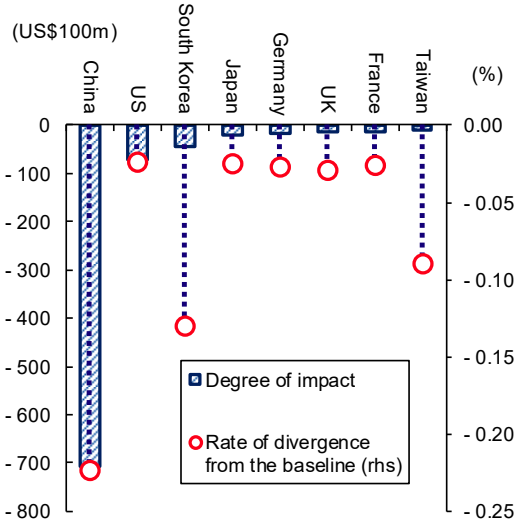
IT risks: sanctions on Chinese IT companies has limited impact on production if imposed only by the US

- The restrictions on exporting US products to Chinese IT companies (Huawei, etc.) could also escalate depending on President Trump.
- We calculated the downward impact on each country's production in the event the US (1) imposes sanctions on Chinese electronic and optical equipment and electrical equipment industries.
  - We used the production reduction model to estimate the ripple effect from the bottleneck of interim inputs using the World Input Output Tables (WIOT).
  - Secondary ripple effects (lower investment, etc.) from reduced production and heightened uncertainty are not factored into this calculation.
- Under Hypothesis 1, we estimate a slight reduction in Chinese production of about $10 billion. The negative impact would be limited since sanctions are imposed only by the US.
- Under Hypothesis 2, where Japan also imposes similar sanctions, the impact would be slightly greater with Chinese production to decline by about $70 billion.
- Under Hypothesis 3, where South Korea and Taiwan also impose sanctions, we estimate Chinese production to decline by about $280 billion. The impact would be large if South Korea and Taiwan take similar action.

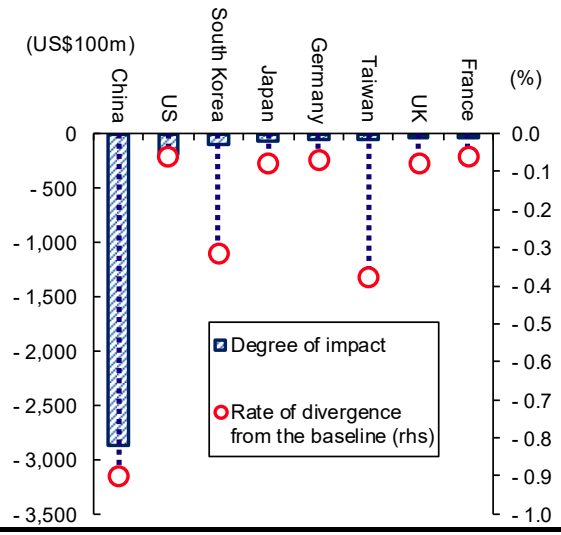
[Hypothesis 1: The US imposes sanctions on Chinese electronic and electrical sectors]



[Hypothesis 2: The US and Japan impose sanctions]



[Hypothesis 3: The US, Japan, South Korea and Taiwan impose sanctions]



Source: Made by MHRI based upon WIOT

II. The Japanese Economy

The growth of the economy will remain tepid for some time, given the rise of adjustment pressures on capital investment and durable goods consumption

The Japanese economy: the growth of the economy will remain tepid for some time, given the weakness of investment and consumption

- Japan's real GDP grew +0.4% q-o-q p.a. in the Apr-Jun quarter of 2019, recording growth in positive territory for the third consecutive quarter. Even though exports served as downward pressures, domestic demand such as consumption, investment and public demand continued to follow firm footing, helping to push up the rate of growth. However, this should be taken with a grain of salt since the growth of consumption may be attributed in part to temporary factors such as the long Golden Week holidays this year.

- Forecast on the rate of Japan's GDP growth: FY2019 (+0.7% q-o-q p.a.), FY2020 (+0.4% q-o-q p.a.). A recovery in exports is unlikely, considering negative pressures stemming from the rise of uncertainties due to a 4th round of punitive tariff hikes by the US. Production activity should also remain stagnant for some time.

- The rise of uncertainties surrounding trade tensions and consumption tax hike are weighing down upon corporate capital investment sentiment. Corporate expectations on economic growth remain tepid, providing reasons to believe that capital investment will slow down.

- Despite temporary fluctuations before and after the consumption tax hike, personal consumption will likely be tepid when averaged out. The impact of restrictions upon overtime hours stemming from Japan's work-style reforms and the stagnation of production activity will curb the growth of income. Durable consumer goods will shift into adjustment phase, serving as downward pressures upon consumption.

- Corporate enterprises are taking a cautious stance toward raising sales prices. Given institutional factors such as free preschool education, we expect that the rise of the core CPI (excluding the impact of the consumption tax hike) will moderate for some time.

Japan: forecast growth rates of +0.7% in FY2019 and +0.4% in FY2020

- The Japanese economy is forecast to remain tepid in FY2019 and FY2020.
  - We forecast growth of +0.7% in FY2019. Export growth will be weak due to the global economic slowdown. Despite temporary fluctuations before and after the consumption tax hike, personal consumption will likely be tepid when averaged out.
  - We forecast growth of +0.4% in FY2020. Adjustment pressures on capital expenditure will gradually intensify and growth will gradually subside.

[Outlook on the Japanese economy]

		2018 FY	2019	2020	2018 Apr-Jun	Jul-Sep	Oct-Dec	2019 Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	2020 Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	2021 Jan-Mar
GDP (real)	Q-o-q % ch	0.7	0.7	0.4	0.4	-0.5	0.4	0.7	0.4	0.0	-0.9	0.1	0.4	0.3	0.2	0.2
	Q-o-q % ch p.a.	—	—	—	1.6	-1.9	1.6	2.8	1.8	0.2	-3.4	0.3	1.6	1.1	0.9	0.6
Domestic demand	Q-o-q % ch	0.8	0.7	0.2	0.4	-0.3	0.8	0.3	0.7	0.1	-1.3	-0.0	0.4	0.3	0.2	0.1
Private sector demand	Q-o-q % ch	1.1	0.5	-0.1	0.6	-0.3	1.0	0.3	0.7	0.2	-1.9	0.1	0.4	0.3	0.1	0.3
Personal consumption	Q-o-q % ch	0.5	0.4	-0.0	0.4	-0.1	0.4	0.1	0.6	0.8	-2.2	0.2	0.4	0.2	0.2	0.2
Housing investment	Q-o-q % ch	-4.4	-3.8	-6.8	-1.9	0.8	1.3	0.6	0.2	-3.3	-4.3	-2.5	-1.2	-0.6	-0.5	-0.4
Capital investment	Q-o-q % ch	3.5	1.9	0.8	2.5	-2.6	2.7	0.4	1.5	-0.4	-0.7	0.1	0.6	0.7	-0.3	0.5
Inventory investment	Q-o-q contribution, % pt	(0.1)	(-0.1)	(0.0)	(-0.1)	(0.2)	(0.1)	(0.1)	(-0.1)	(-0.2)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Public sector demand	Q-o-q % ch	-0.1	1.6	0.9	-0.2	-0.2	0.3	0.2	0.9	0.0	0.7	-0.2	0.2	0.3	0.6	-0.2
Government consumption	Q-o-q % ch	0.9	1.4	0.7	0.1	0.2	0.7	-0.1	0.9	-0.2	0.4	0.0	0.4	0.0	0.2	0.1
Public investment	Q-o-q % ch	-4.0	2.7	1.4	-1.2	-1.8	-1.3	1.4	1.0	0.9	2.0	-1.1	-0.6	1.4	1.9	-1.4
External demand	Q-o-q contribution, % pt	(-0.1)	(-0.1)	(0.2)	(0.0)	(-0.2)	(-0.4)	(0.4)	(-0.3)	(-0.1)	(0.4)	(0.1)	(0.0)	(-0.0)	(-0.0)	(0.0)
Exports	Q-o-q % ch	1.5	0.2	1.8	0.8	-2.1	1.2	-2.0	-0.1	1.3	1.0	0.6	0.3	0.2	0.2	0.3
Imports	Q-o-q % ch	2.1	0.6	0.5	0.8	-1.2	3.6	-4.3	1.6	1.8	-1.2	0.2	0.2	0.3	0.2	0.2
GDP (nominal)	Q-o-q % ch	0.5	1.4	0.7	0.2	-0.4	0.4	1.0	0.4	0.4	-0.8	0.7	0.1	0.2	0.1	0.9
GDP deflator	Y-o-y % ch	-0.1	0.7	0.4	-0.1	-0.4	-0.3	0.1	0.4	0.7	0.8	1.1	0.8	0.3	0.1	0.2
Domestic demand deflator	Y-o-y % ch	0.5	0.4	0.7	0.5	0.6	0.5	0.3	0.5	0.3	0.4	0.6	0.7	0.7	0.5	0.6

Notes: Figures in the shaded areas are forecasts.
Source: Made by MHRI based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP.*

Japan: the CPI excluding fresh food (y-o-y change) should gradually slow down

[Outlook on the Japanese economy (major economic indicators)]

		2018 FY	2019	2020	2018 Apr-Jun	Jul-Sep	Oct-Dec	2019 Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	2020 Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	2021 Jan-Mar
Industrial production	Q-o-q % ch	0.3	-1.3	0.6	0.8	-0.7	1.4	-2.5	0.5	0.7	-1.2	-0.0	0.6	0.8	-0.5	0.2
Ordinary profits	Y-o-y % ch	6.2	-6.2	1.1	17.9	2.2	-7.0	10.3	-10.9	4.3	-2.9	-12.2	1.2	3.1	-0.7	0.5
Nominal compensation of employees	Y-o-y % ch	2.7	2.0	1.5	3.8	2.6	3.1	1.3	2.0	1.5	1.1	1.3	0.9	1.2	1.3	1.3
Unemployment rate	%	2.4	2.4	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.5	2.5	2.5	2.6
New housing starts	P.a., 10,000 units	95.3	87.6	83.8	96.6	95.0	95.5	94.2	91.8	88.0	85.6	84.7	84.3	83.8	83.5	83.3
Current account balance	P.a., JPY tril	19.2	21.8	20.9	21.8	18.7	17.2	18.8	19.4	20.4	23.8	23.9	21.7	20.3	20.7	20.9
Domestic corporate goods prices	Y-o-y % ch	2.2	0.9	2.0	2.6	3.1	2.3	0.9	0.6	-0.7	1.6	2.1	1.9	2.9	1.2	1.7
Domestic corporate goods prices (ex consumption tax)	Y-o-y % ch	-	0.0	1.0	-	-	-	-	-	-	-0.3	0.3	0.0	1.0	-	-
Consumer prices, ex fresh food	Y-o-y % ch	0.8	0.8	0.9	0.8	0.9	0.8	0.8	0.7	0.4	0.8	1.0	0.9	1.1	0.7	0.9
Consumer prices, ex fresh food (ex consumption tax)	Y-o-y % ch	-	0.3	0.4	-	-	-	-	-	-	-0.1	-0.0	-0.1	0.1	-	-
Consumer prices, ex fresh food (ex consumption tax, free preschool education)	Y-o-y % ch	-	0.6	0.7	-	-	-	-	-	-	0.4	0.5	0.4	0.7	-	-
Consumer prices, ex fresh food and energy	Y-o-y % ch	0.3	0.7	0.6	0.3	0.4	0.3	0.4	0.6	0.5	0.9	0.9	0.8	0.8	0.4	0.3
Consumer prices, ex fresh food and energy (ex consumption tax)	Y-o-y % ch	-	0.2	0.2	-	-	-	-	-	-	0.0	-0.0	-0.1	-0.1	-	-
Uncollateralized overnight call rate	%	-0.06	-0.05	-0.05	-0.07	-0.06	-0.06	-0.06	-0.08	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05
Yield on newly-issued 10-yr JGBs	%	0.04	-0.14	-0.09	0.04	0.10	0.07	-0.04	-0.10	-0.15	-0.15	-0.15	-0.15	-0.10	-0.10	0.00
Nikkei average	JPY	22,000	20,900	21,300	22,341	22,654	21,897	21,000	21,414	21,000	20,500	20,500	21,000	21,000	21,500	21,500
Exchange rate	USD/JPY	111	107	106	109	111	113	110	110	107	105	105	106	106	106	107
Crude oil price (WTI nearest term contract)	USD/bbl	63	56	59	68	69	59	55	60	55	54	53	57	59	59	60

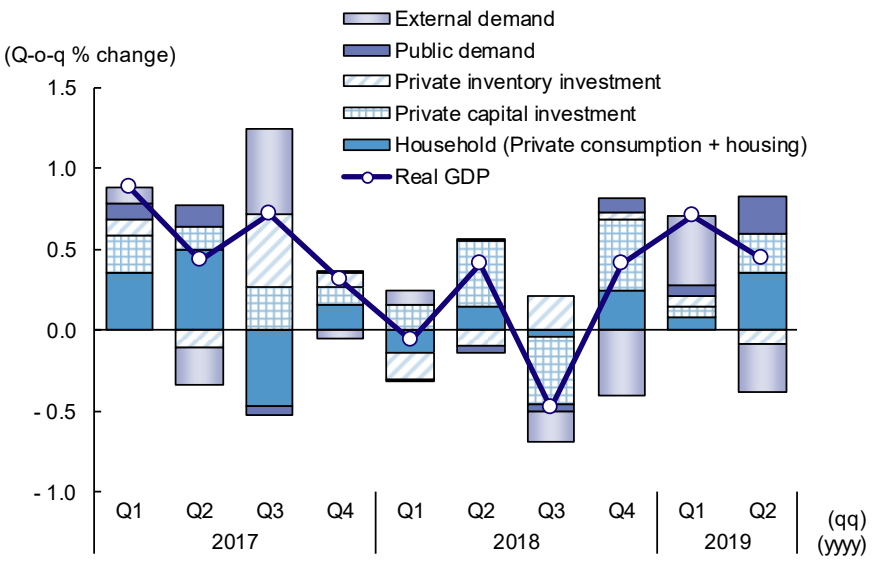
Notes: 1. Figures in the shaded areas are forecasts.The readings above may differ from public releases because the rates of change are calculated on the basis of real-terms data
2. Ordinary profits are based upon the *Financial Statements Statistics of Corporations by Industry* (all industries basis) (ex finance & insurance)
3. Of the finance-related indices, the uncollateralized overnight call rate refers to the rate at the end of term, the yield on newly-issued 10-yr JGBs refers to the average of the end-of-month rates during the relevant term, and all others are averages during the relevant terms

Sources: Made by MHRI based upon relevant statistics

Current conditions: even though external demand dragged down growth in the Apr-Jun quarter, domestic demand was firm, serving to push up growth

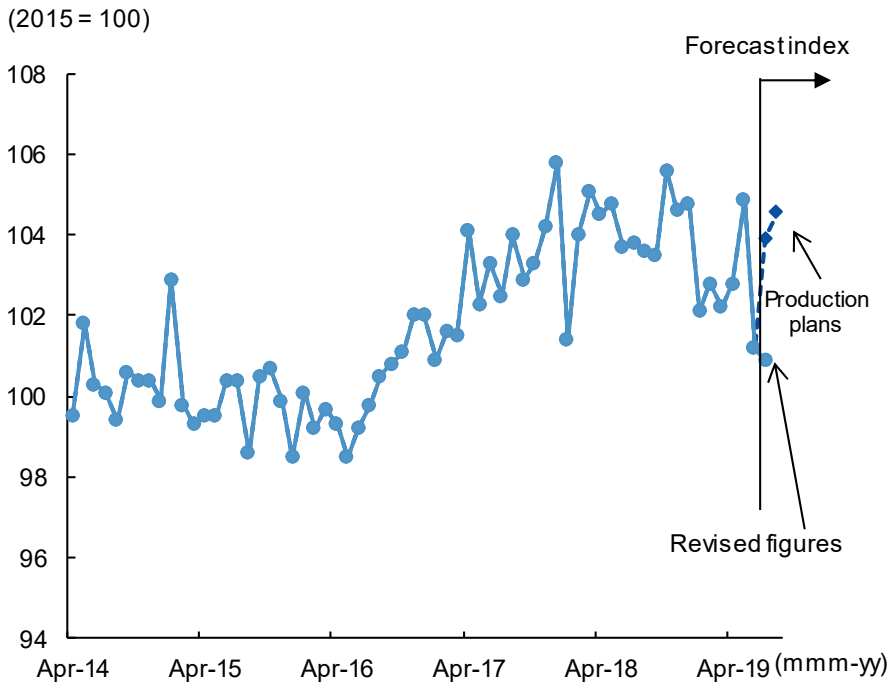
- Real GDP for the Apr-Jun quarter was +0.4% q-o-q (+1.8% annualized). Domestic demand such as personal consumption, capital investment and public demand was firm and pushed up the growth rate despite the downward pressure from external demand.
  - However, this should be taken with a grain of salt when looking at the trend since the growth in personal consumption may be attributed in part to temporary factors such as the long Golden Week holiday this year as well as model changes for cars.
- Industrial production was slightly higher at +0.5% q-o-q in the Apr-Jun quarter, and not enough to make up for the slump recorded in the Jan-Mar quarter (-2.5% q-o-q).

[Real GDP (quarterly)]



Source: Made by MHRI based upon Cabinet Office, *National Accounts*

[Industrial production index]

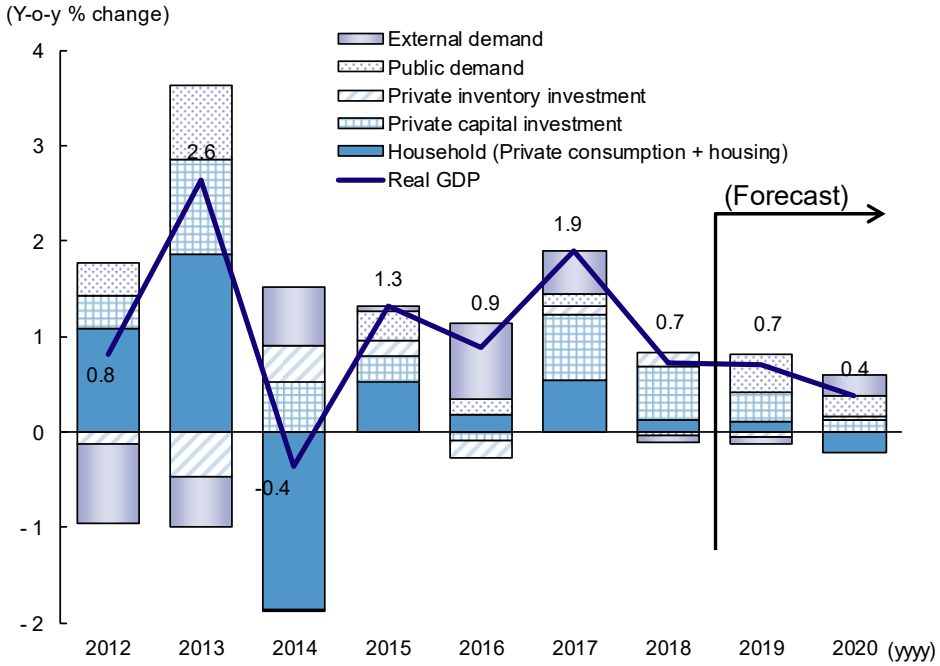


Source: Made by MHRI based upon Ministry of Economy, Trade and Industry, *Indices of Industrial Production*

Outlook: an adjustment phase for capital investment and durable goods consumption. Economic growth remains weak

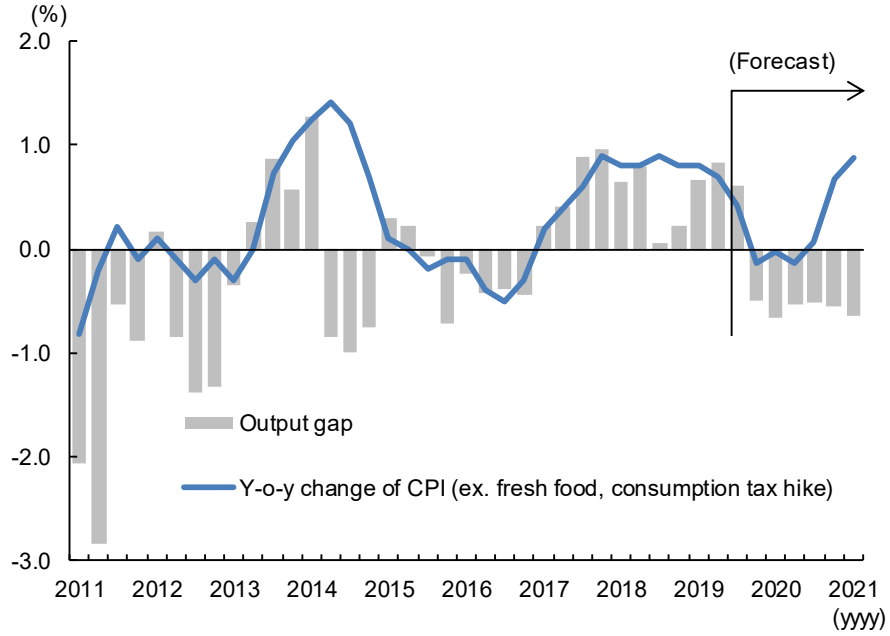
- Our outlook on GDP growth in FY2019 is +0.7%. Exports are expected to remain on a weak trend due to the slowdown in US and Chinese manufacturing sectors. Consumption of durable goods will enter an adjustment phase, weighing on overall consumption.
- Our outlook on GDP growth in FY2020 is +0.3%. The pace of growth will slow down, given tepid corporate expectations for economic growth and rising pressures to curb capital expenditure.
- The output gap will turn negative and inflation growth will also slow down.
  - Note that higher energy prices from the second half of 2020 will push up inflation.

[Real GDP (fiscal year outlook)]



Source: Made by MHRI based upon Cabinet Office, *National Accounts*

[Forecast output gap and CPI]

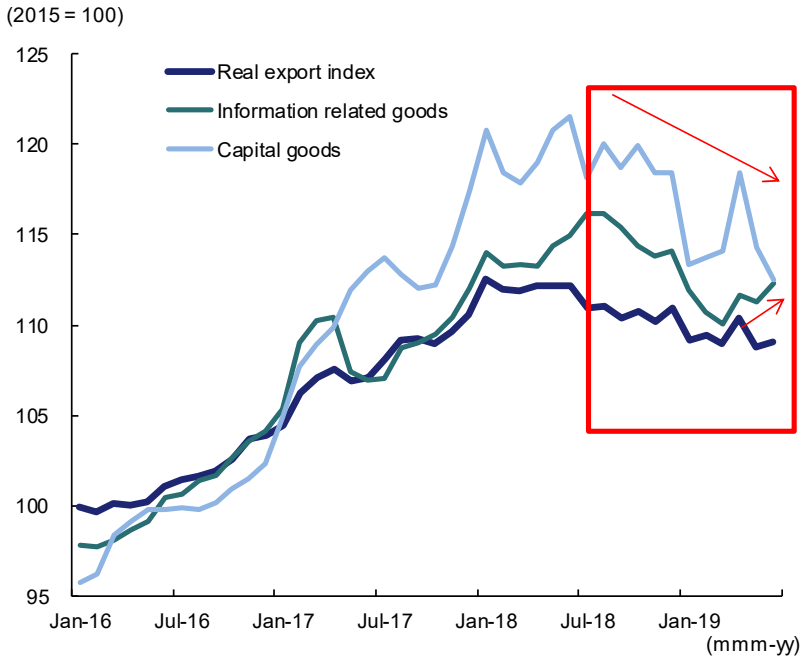


Source: Made by MHRI based upon Cabinet Office, *National Accounts and* Ministry of Internal Affairs and Communications *Consumer Price Index*

External demand: a recovery in exports is unlikely reflecting heightened uncertainties stemming from a 4th round of tariff hikes

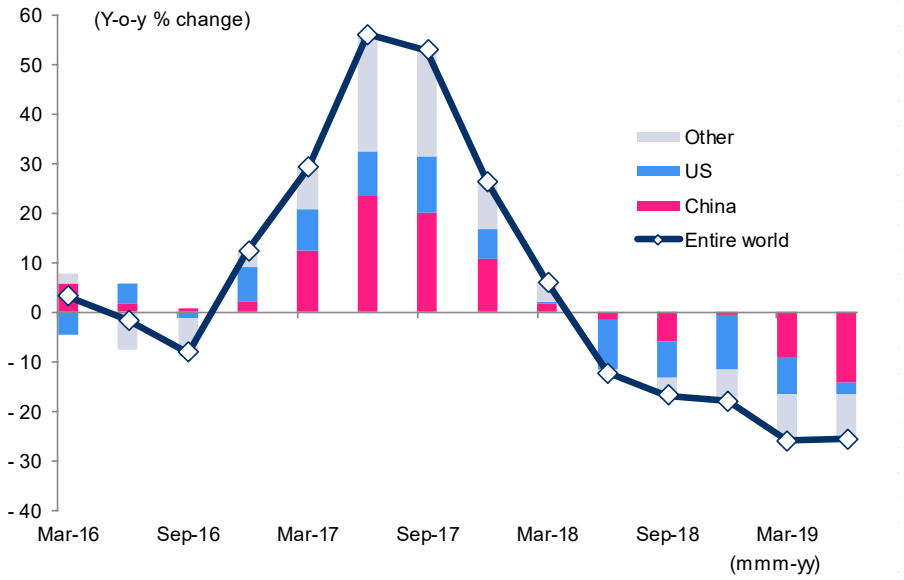
- Even though exports are showing signs of bottoming out, they are being weighed down by heightened uncertainty created by factors such as a 4th round of tariff hikes imposed by the US. The possibility of a recovery going forward are slim.
  - There are signs that exports of information-related goods are bottoming out. However, we forecast renewed weakness in the strongly correlated semiconductor market due to tariff hikes.
  - Capital goods exports are weak. This is in part due to the slowdown in exports of semiconductor manufacturing equipment and industrial robots. There is lack of strength for a rebound.
    - ✓ The slowdown in industrial robot exports is mainly due to exports bound for the US and China. The slowdown in investment growth in both countries' manufacturing sector is having an impact.

[Real exports (Total, information related goods, capital goods)]



Source: Made by MHRI based upon Bank of Japan, *Real Exports and Real Imports*

[Factor contribution by country from industrial robots (exports)]

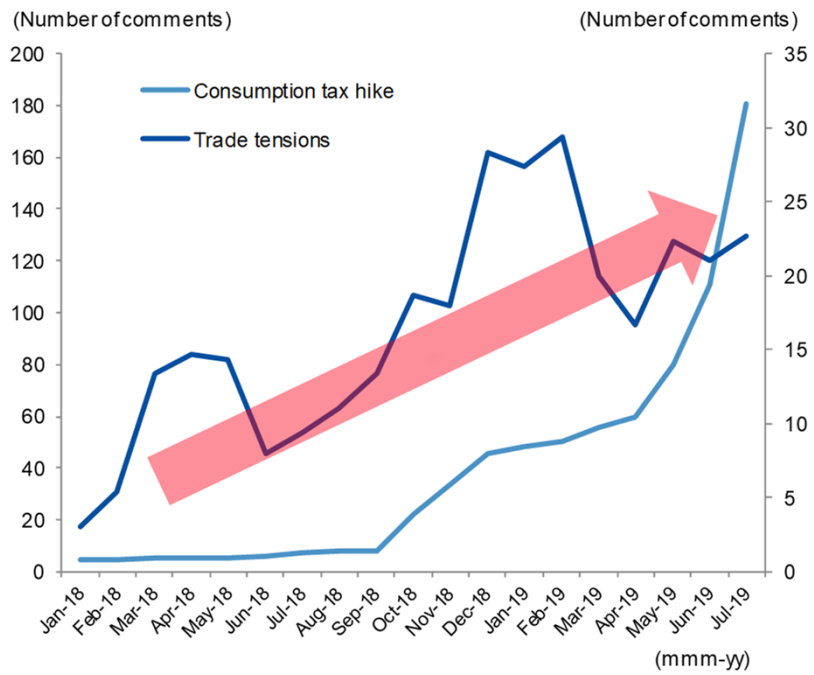


Source: Made by MHRI based upon Ministry of Finance, *Trade Statistics*

Corporate sector: trade tensions and uncertainty surrounding the consumption tax hike are weighing on revenue forecasts

- There has been an increase in comments about the economic outlook, citing concerns about trade tensions for overseas factors and the consumption tax hike for domestic factors.
- The revision rates of forecasts on current profits for FY2019 in the BOJ *Tankan* (June survey) for both the manufacturing and non-manufacturing sectors turned out to be smaller than in past surveys in June.
  - Forecasts on current profits are possibly being weighed down by trade tensions and a slowdown in overseas economies as well as concerns about the prospect of a sluggish domestic economy following the consumption tax hike.

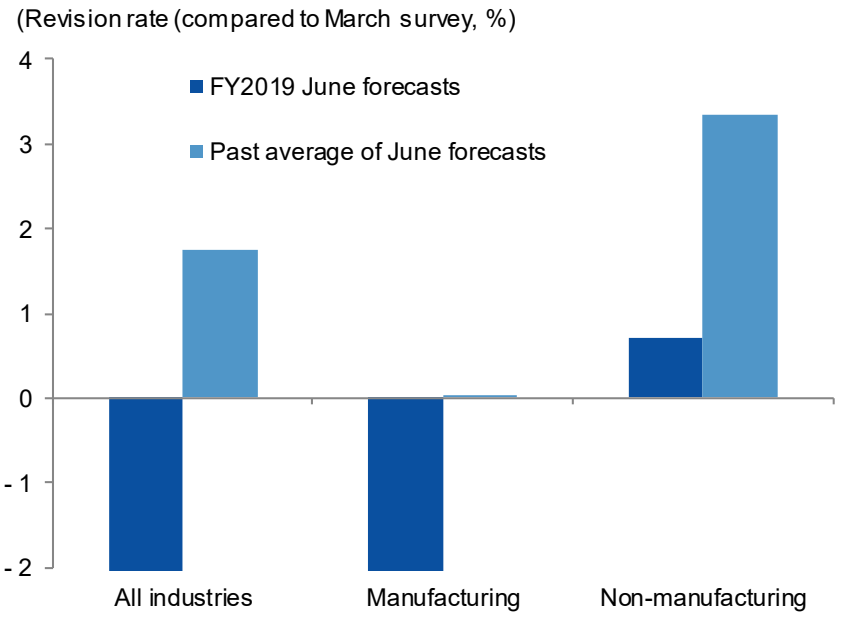
[Number of comments judging the economic outlook as negative (related to the consumption tax hike and trade tensions)]



Note: Extracting the comments that judge the economic outlook as slightly worse or worse, displaying the number of comments as the backward 3-month moving average

Source: Made by MHRI based upon Cabinet Office *Economy Watchers Survey*

[Revision rate for current profit forecasts (large enterprises)]

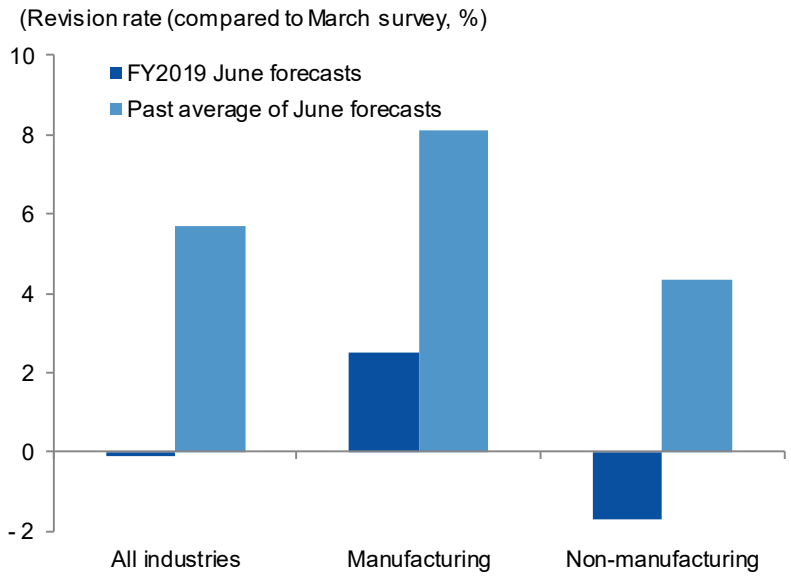


Source: Made by MHRI based upon Bank of Japan, *Short-term Economic Survey of Enterprises in Japan* (*Tankan*).

Corporate sector: uncertainty weighing on investment sentiment
investment growth will slow down due to the rise of adjustment pressures

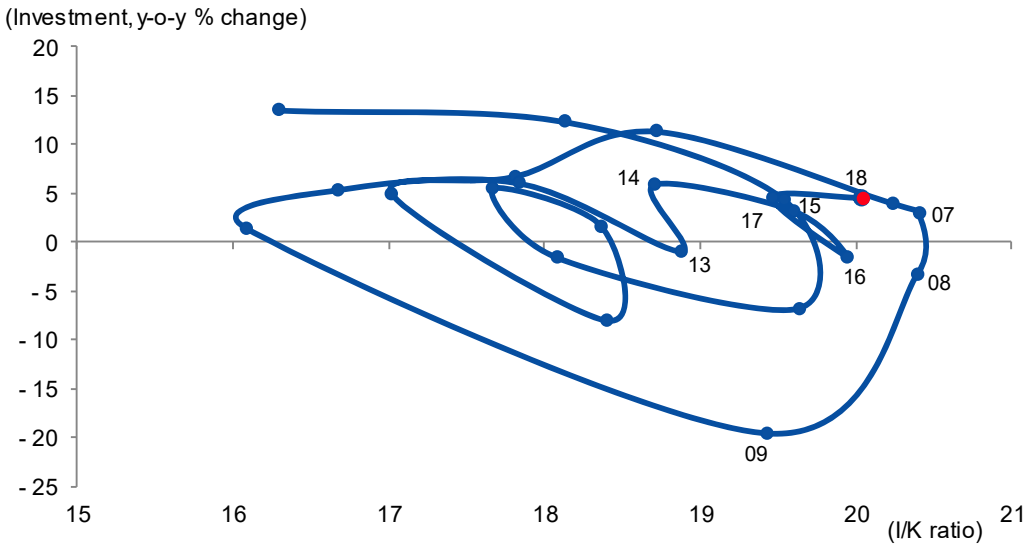
- The BOJ *Tankan* (June survey) revealed a smaller-than-usual revision rate of fixed investment forecasts, indicating a cautious outlook among firms.
  - The revision rate for fixed investment forecasts was -0.1%, the first downward revision in a June survey since FY2009, which followed the Lehman shock.
  - This is attributed to heightened uncertainty both in and outside Japan. Supply constraints caused by the shortage of labor in the non-manufacturing sector is possibly weighing on construction investment forecasts.
- The capital stock cycle suggest heightened adjustment pressures. Fixed investment will likely slow down through 2019 to 2020.
  - However, a major adjustment will likely be avoided, as labor-savings investment and demand for construction investment such as urban redevelopment projects serve to underpin fixed investment.

[Revision rate for fixed investment (large enterprises)]



Source: Made by MHRI based upon Bank of Japan, *Short-term Economic Survey of Enterprises in Japan* (*Tankan*).

[Capital stock cycle (machinery and fixed investment (private sector)]



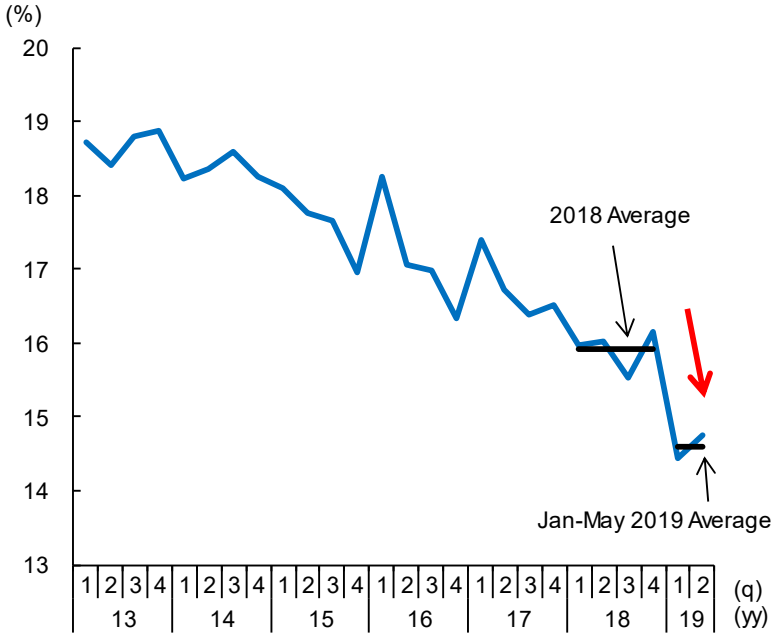
Note: For 2018, the Cabinet Office *Quarterly Estimates of GDP* is used to estimate and extrapolate the growth rate for private sector building and construction in 2018

Source: Made by MHRI based upon Cabinet Office

Employment: despite a decline in long working hours, employment has not grown due to stalled production

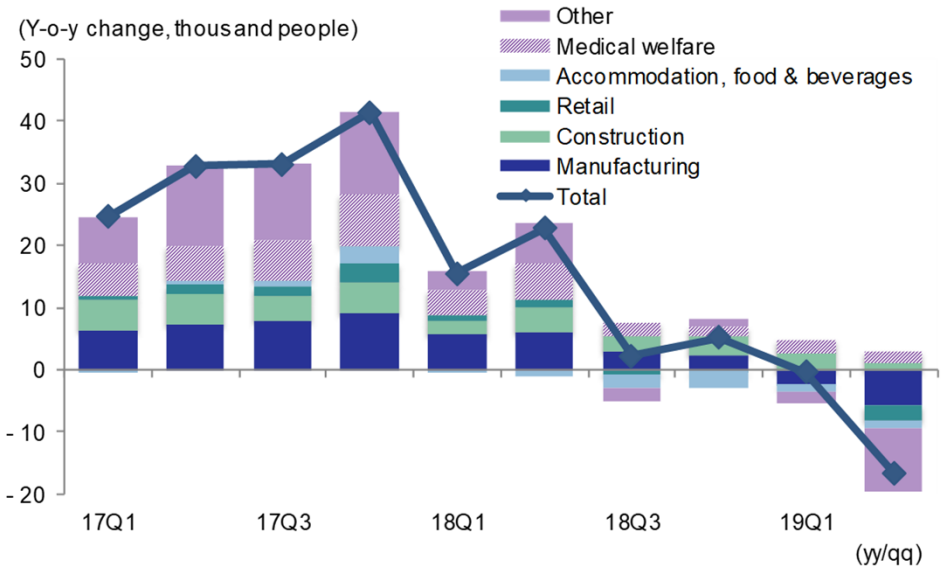
- Long working hours have been reduced due to regulations on overtime. However, the pace of increase in employment has moderated due to stalled production.
  - The proportion of regular employees working more than 60 hours overtime per month has dropped sharply from 2019.
  - Production activity is currently stalling due to sluggish external demand. The rise in number of new job openings has come to a pause.
    - ✓ In the near term, we forecast a lack of strength in production activity, and that employment growth will slow down due to demand-side factors.

[The proportion of regular employees working more than 60 hours overtime per month]



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

[The number of new job openings]

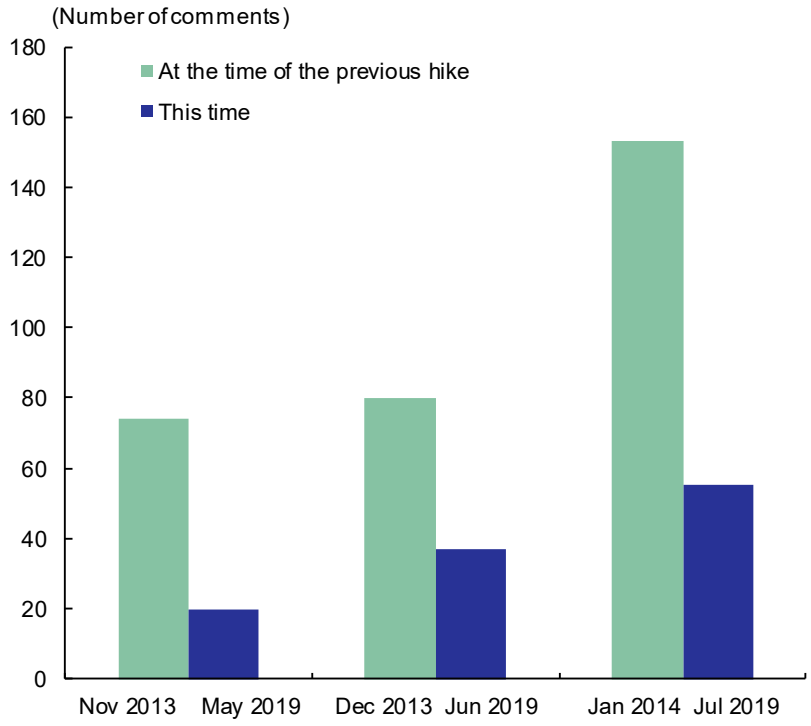


Note: Excluding part-time jobs
Source: Made by MHRI based upon Association of Job Information of Japan, Ministry of Health, Labour and Welfare, *Status of General Job Placements*

Consumer spending: limited pre-consumption hike rush in demand for durable goods in the Apr-Jun quarter

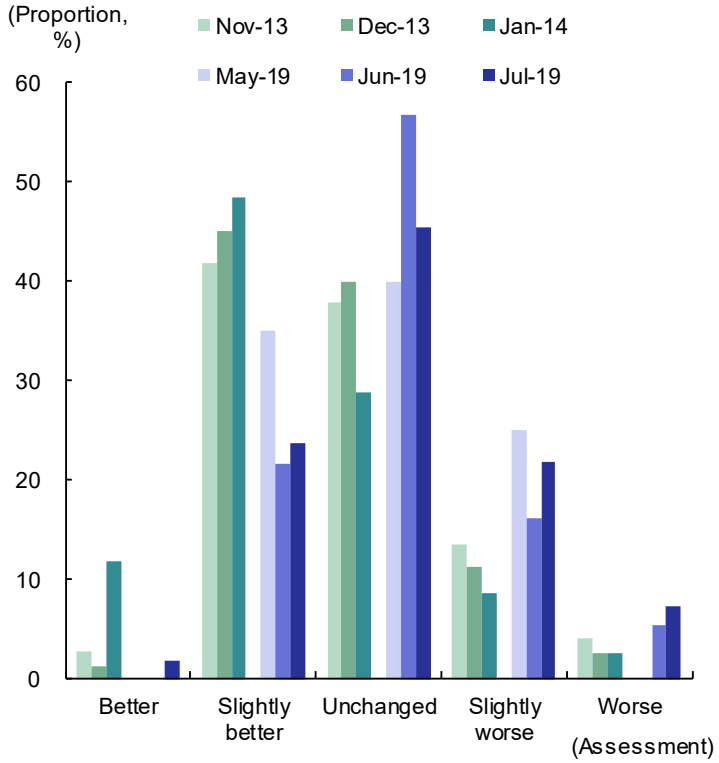
- The rush in demand for durable goods ahead of the consumption tax hike was limited as of the Apr-Jun quarter.
  - The number of comments citing "rush in demand" decreased compared to the previous consumption tax hike. The breakdown shows a high proportion of "unchanged", and a lower proportion of "better" and "slightly better".
- While we anticipate a certain level of rush in demand and a reactionary decline in the Jul-Sep quarter and Oct-Dec quarter, the impact is likely to be small compared to the previous consumption tax hike in 2014.

[Number of comments citing "rush in demand"]



Note: The aggregate number of comments in which the phrase "rush in demand" appears (Current economic conditions)
Source: Made by MHRI based upon Cabinet Office *Economy Watchers Survey*

[Breakdown of comments citing "rush in demand"]

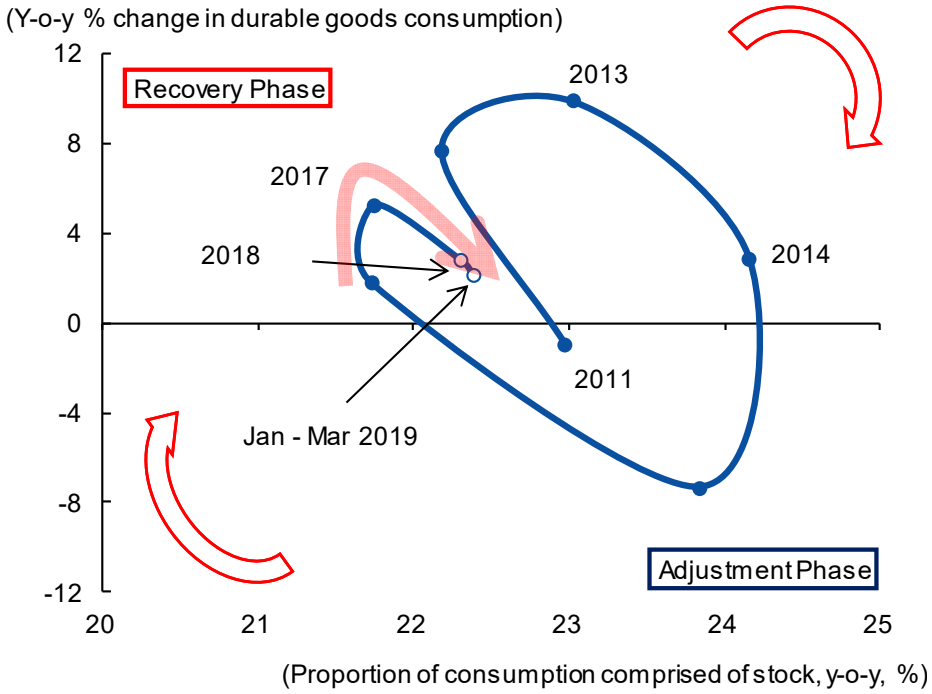


Note: For each, the aggregate number of comments in which the phrase "rush in demand" appears (Current economic conditions)
Source: Made by MHRI based upon Cabinet Office *Economy Watchers Survey*

Consumer spending: although the reactionary fall after the consumption tax hike will not be large, the rise of adjustment pressures on durable goods will serve as downward pressure

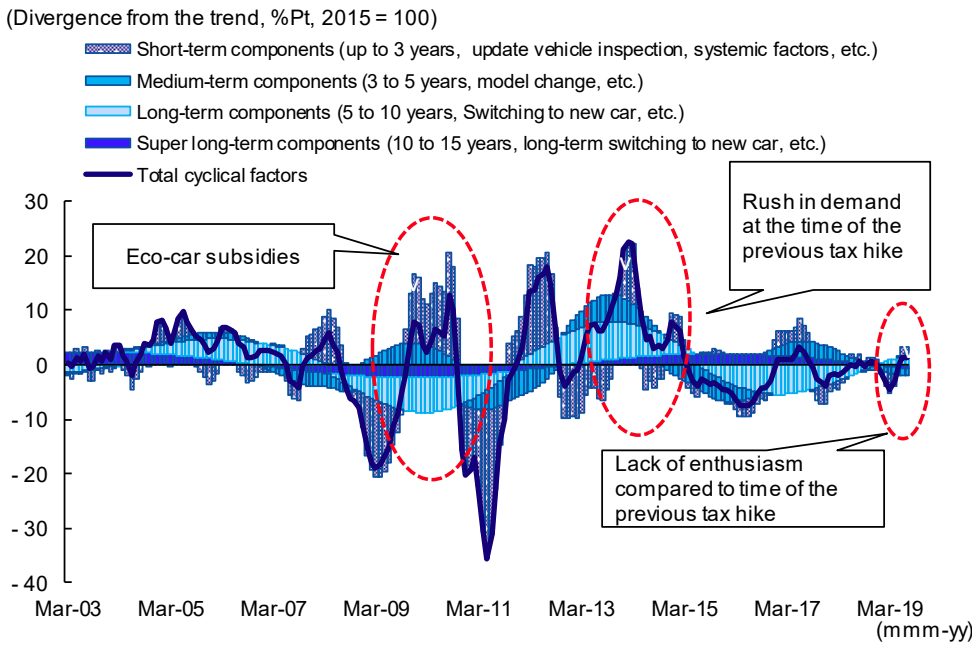
- The durable goods stock cycle indicates an entry into an adjustment period. We anticipate consumption on durable goods will remain weak for the near term.
  - Sales of cars before the 2014 consumption tax hike were attributed to the replacement demand of model changes and extension of the years of use in addition to the rush in demand. No such trend is currently evident.

[Durable goods stock cycle]



Note: From 2018, stock has been calculated based on the extrapolation of the trend for the rate of depreciation and the actual figures for consumption of durable goods.
Source: Made by MHRI based upon Cabinet Office *National Accounts*

[Decomposition of the components of the car sales cycle]

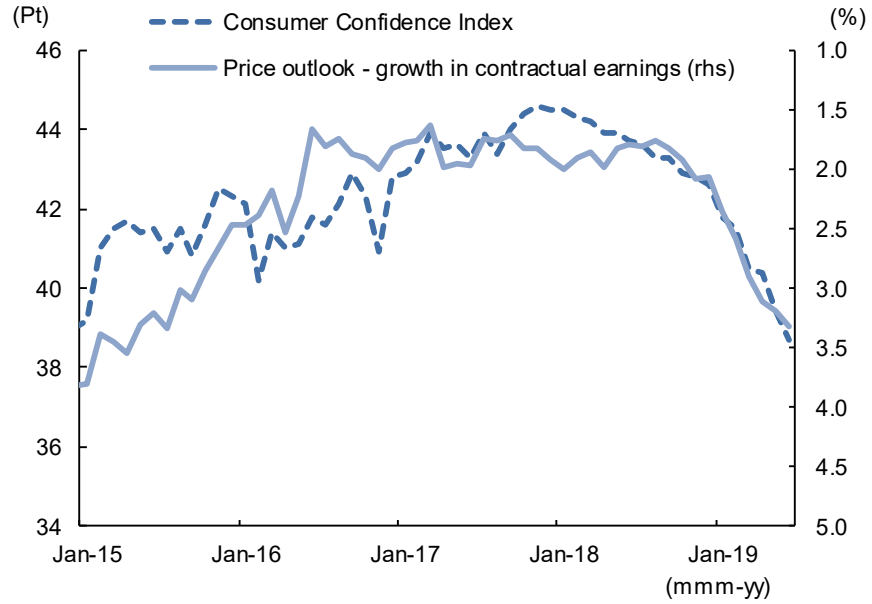


Note: 1. Aggregate of ordinary, small and light vehicles.
2. Seasonally-adjusted by MHRI
Source: Made by MHRI based upon Japan Automobile Dealers Association and Japan Mini Vehicle Association

Consumer spending: decline in sentiment due to concerns regarding the rise of prices. The negative pressures would be alleviated if consumers feel the impact of reduced tax rates

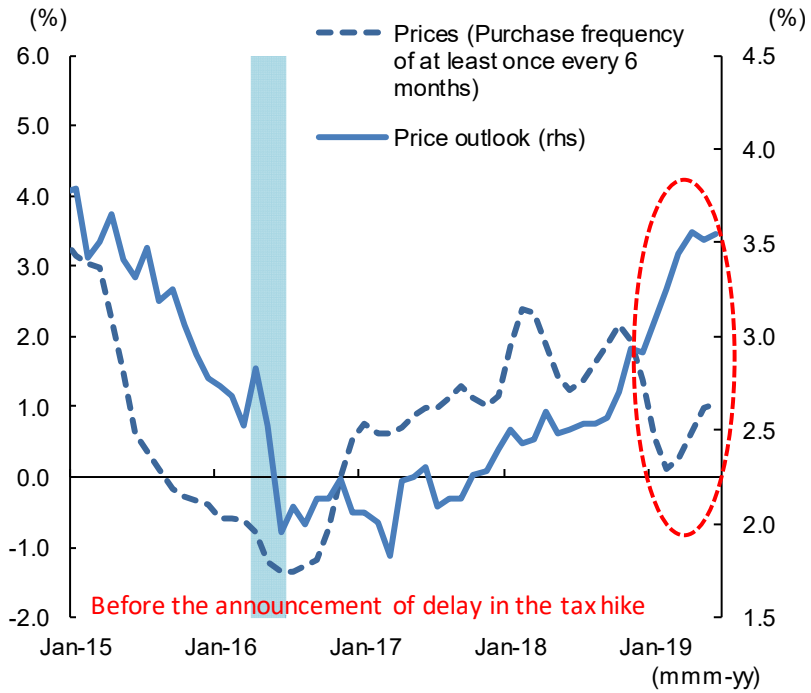
- The recent decline in consumer sentiment is attributed to concerns regarding the rise of prices due to the consumption tax hike. Downward pressures would be eased if consumers feel the impact of reduced tax rates.
  - The trend in consumer sentiment tends to align with household forecasts for prices after deducting the recent rise of wages.
  - The household price outlook is similar to the levels before the 2014 consumption tax hike. They have possibly taken a conservative view regarding the impact of reduced tax rates. Uncertainty on the system for reduced tax rates have exacerbated concerns regarding the rise of prices.
    - ✓ The downward pressure on sentiment could be alleviated once reduced tax rates are applied and households feel the impact.

[Consumer Confidence Index and the difference between the price outlook and the growth in amount of compensation set to be paid]



Note: "Contractual earnings" (wages based upon predetermined contracts such employment rules, etc.) are calculated on the basis of the past 12 month's wages
Source: Made by MHRI based upon Cabinet Office *Consumer Confidence Survey*, Ministry of Health, Labour and Welfare, Monthly Labour Survey

[Price outlook and (actual) prices]

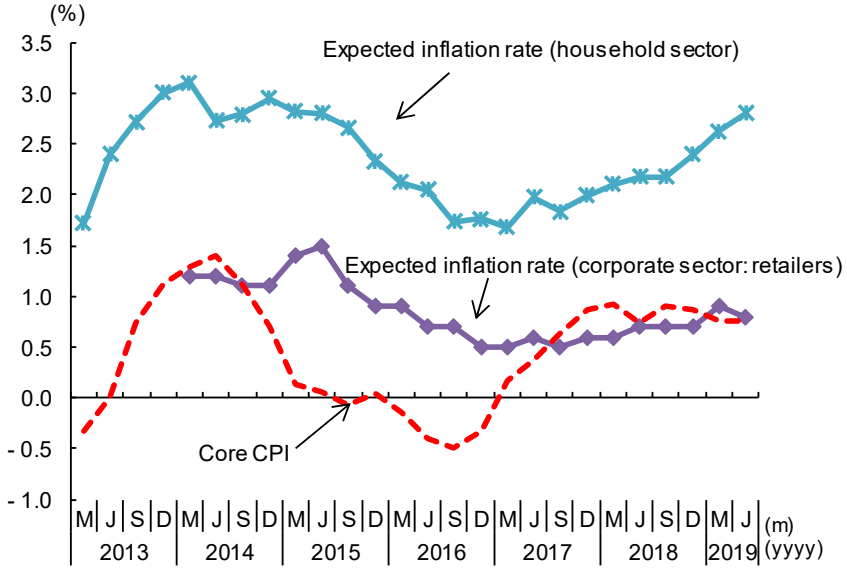


Note: The growth in prices is the 3-month backward moving average
Source: Made by MHRI based upon Cabinet Office *Consumer Confidence Survey*, Ministry of Internal Affairs and Communication, *Consumer Price Index*

Prices: as companies are cautious in raising prices, the rise of prices (excluding the consumption tax hike) will be sluggish

- Although household inflation expectations are rising, the inflation expectations of businesses remain low.
  - Companies remain cautious about raising prices given the weakness of household consumer sentiment.
  - There are also institutional factors such as the shift to free preschool education, and we forecast that rise of prices excluding the consumption tax hike will be sluggish for the near term.
    - ✓ However, the rise in energy prices from the second half of FY2020 will contribute positively.

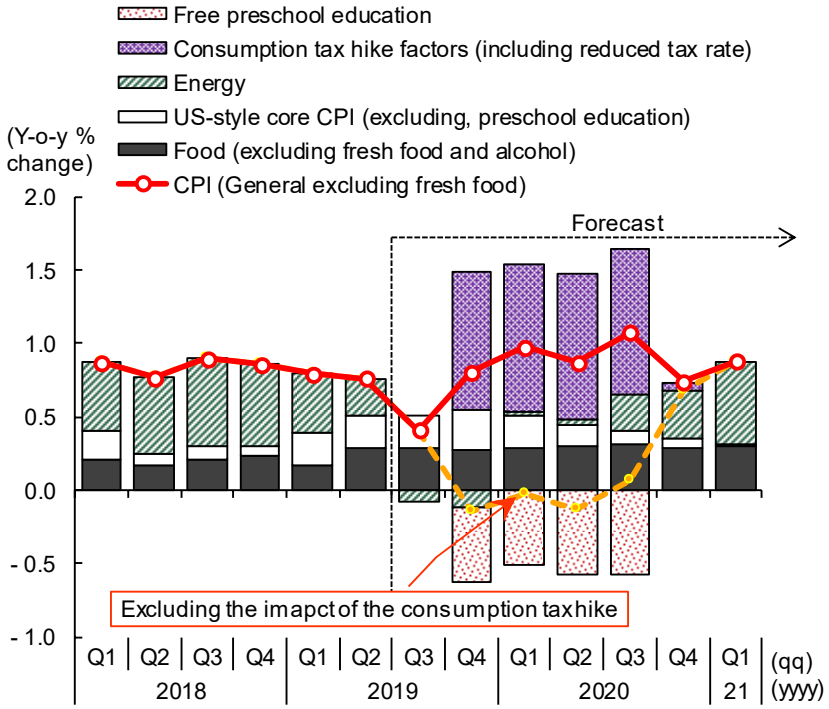
[Household and corporate sector expected inflation rates]



Note: Household expected inflation rates (weighted average) for 1 year hence were calculated for each option of response using the following percentages for each band. Expected declines "-5% or more" was taken to be -5%, "-5% to -2%" was taken to be -3.5%, and "below -2%" was taken to be -1%. Expected increases "below 2%" was taken to be +1%, "2% to 5%" was taken to be +3.5% and "5% or more" was taken to be +5%. Business expected inflation rates used the weighted average for the rate of change for 1 year ahead from the inflation outlook of enterprises of the BOJ Tankan

Source: Made by MHRI based upon Bank of Japan *Tankan*, Cabinet Office *Consumer Confidence Survey*, Ministry of Internal Affairs and Communications, *Consumer Price Index*

[Outlook for core CPI (quarterly, by factor contribution)]



Source: Made by MHRI based upon Ministry of Internal Affairs and Communications, *Consumer Price Index*

Japanese Monetary Policy: policy is likely to remain on hold until the impact of the consumption tax hike is ascertained

- Despite the rise of the Bank of Japan's (BOJ) concerns about a downturn in the global economy, we forecast that the central bank will keep policy on hold until it can ascertain the impact of the consumption tax hike. Any policy response when there is an economic downturn is likely to be limited to an adjustment to forward guidance (extension of the time frame) and an increase in the size of ETF purchases, while supporting the government's economic policy with low interest rates.
- However, any heightened risk about a loss of momentum in higher prices due to a sharp rise in the yen could lead to a policy response including the prospect of negative interest rates. We expect action will be taken in conjunction with suppressing deterioration in the balance sheets of financial institutions (revision of the structure of tiered levels for current account deposits, etc.)

[*Outlook for Economic Activity and Prices* (July 2019)]

(Y-o-y % change)

	Real GDP	CPI (All items except fresh food)	
			Excluding impact of consumption tax hike and free preschool education
FY2019	+0.6 to +0.9 (+0.7)	+0.8 to +1.1 (+1.0)	+0.6 to +0.9 (+0.8)
Forecast made in April 2019	+0.7 to +0.9 (+0.8)	+0.9 to +1.2 (+1.1)	+0.7 to +1.0 (+0.9)
FY2020	+0.8 to +1.0 (+0.9)	+1.1 to +1.4 (+1.3)	+1.0 to +1.3 (+1.2)
Forecast made in April 2019	+0.8 to +1.1 (+0.9)	+1.2 to +1.5 (+1.4)	+1.1 to +1.4 (+1.3)
FY2020	+0.9 to +1.2 (+1.1)	+1.3 to +1.7 (+1.6)	
Forecast made in April 2019	+0.7 to +1.0 (+1.0)	+1.4 to +1.7 (+1.6)	

Note: Forecasts of the Majority of Policy Board Members. Figures in brackets indicate the median of the Policy Board members' forecasts (point estimates)
Source: Made by MHRI based upon Bank of Japan materials

[Options for additional easing]

Policy measures		Assessment
Cut short-term policy interest rates	・increase from the negative interest rate level from -0.1%. An option if there is sudden appreciation of the yen	・Expected suppression of a strong yen due to lower yields ・Concerns about side effects on the balance sheets of financial institutions due to the decline in interest rates on loans. If implemented, the measure could be introduced as a set with measures to mitigate the side effects (such as a revision of current accounts to a three tier structure)
Lower the target for long-term yields	・Allow yields to fall by lowering the target for 10-year JGB yields from the current level of about 0%	・Possible further flattening of the yield curve. Considered unlikely since it would be inconsistent with the analytical results under the Comprehensive Assessment (2016) that excessive declines in long-term yields can have a negative impact on economic activity through aspects such as sentiment ・Expected suppression of a strong yen due to lower yields
Accelerate the pace of increase in the monetary base	・Increase the monetary base by increasing the size of outright purchases of JGBs, etc.	
Increase the size of asset purchases	・Increase the purchases of assets such as JGBs and ETF. Since the amount of ETF purchases is allowed to be above or below 6 trillion yen, a certain level of increase is possible even now.	・Purchases of ETF are expected to provide support when there is a sharp drop in stock prices. However, there are concerns about side effects such as distortion to the market function and heightened risk of a BOJ loss.

Source: Made by MHRI

III. Asian Economies

The growth rate will be flat through 2020

Asian economies: the growth rate will be flat through 2020

- China's economic growth fell from the previous quarter for the first time in two quarters in the Apr-Jun quarter of 2019, the lowest level of growth since statistics have been compiled.

- Amid concerns regarding an economic slowdown due to US-China trade tensions, the Chinese authorities have implemented counter-cyclical adjustments to stabilize the economy, leading to our view that the growth rate will gradually decline.

- In the Asian economies (excluding China), the growth rates of many countries in the Apr-Jun quarter turned out to be lower than the previous quarter. Exports either fell or moderated due to the slowdown in China and the US-China trade tensions. In particular, there was a noteable decline in economic growth due to the fall of exports of export-dependent countries such as Singapore, Hong Kong and South Korea.

- In terms of the outlook for Asian economies (excluding China), we forecast that economic growth rates, mainly in exports, will continue to fall in countries that rely heavily on exports to both China and the US due to an anticipated slowdown of the US economy as well as the continuation of the gradual slowdown of the Chinese economy. In addition, in regard to US-China trade tensions, the negative impact on component exports for the supply chain from each country due to the 1st to 3rd round of US punitive tariffs on China will have run its course. However, a 4th round of punitive tariffs will lead to further downward pressures.

- On the other hand, since domestic demand-driven economies such as India and Indonesia are projected to be firm, the growth rate of the Asian economies as a whole is forecast to be flat in 2019 and 2020.

Asia: China, NIEs, ASEAN growth projected to slow through 2020, while India's growth is expected to recover

- China: the rate of growth should gradually decline due to support from counter-cyclical adjustments to address concerns of a slowdown stemming from US-China trade tensions.
- NIEs: the rates of economic growth should slow down, particularly in exports, due to their heavy reliance on exports and the impact of the global economic slowdown and US-China trade tensions.
- ASEAN5: even though the negative impact of the global economic slowdown and US-China trade tensions may not be avoided, the pace of slowdown will be more gradual than the NIEs, in view of prospects of a slight acceleration of the Indonesian economy which is domestic demand-driven.
- India: the growth rate is expected to recover through 2020, given India's heavy reliance on domestic demand as in the case of Indonesia.

[Outlook on the Asian economies]

(%)

	2016	2017	2018	2019	2020
Asia	6.4	6.2	6.2	5.7	5.7
China	6.7	6.8	6.6	6.2	6.0
NIEs	2.4	3.2	2.8	1.8	1.6
South Korea	2.9	3.1	2.7	2.0	1.6
Taiwan	1.5	3.1	2.6	2.2	1.8
Hong Kong	2.2	3.8	3.0	1.3	1.2
Singapore	3.0	3.7	3.1	0.8	1.7
ASEAN5	5.0	5.3	5.2	4.9	4.8
Indonesia	5.0	5.1	5.2	5.1	5.2
Thailand	3.4	4.0	4.1	3.2	3.0
Malaysia	4.4	5.7	4.7	4.6	3.9
The Philippines	6.9	6.7	6.2	5.5	5.6
Vietnam	6.2	6.8	7.1	6.8	6.4
India	8.7	6.9	7.4	6.9	7.1

Note: Real GDP growth rate (y-o-y). Shading denotes forecasts. Average figures are calculated using the GDP share from the IMF (purchasing power parity base)
Source: Made by MHRI based upon statistics of the relevant countries and regions and CEIC Data

Asia: the economy slowed down in the Apr-Jun quarter, with lackluster exports in general

- A look at the GDP growth rates of countries which have already released their results for the Apr-Jun quarter reveals that the growth rates of many of these countries fell below their levels of the Jan-Mar quarter.
  - Although South Korea's growth rate accelerated, this stems mainly from government spending from economic stimulus measures. Private-sector consumption remains sluggish in negative territory.
- Exports were lackluster across the board due to China's economic slowdown and US-China trade tensions.
  - Exports in all the countries either fell or slowed down.
  - The decline in exports was particularly noteworthy in Singapore, Hong Kong and South Korea.

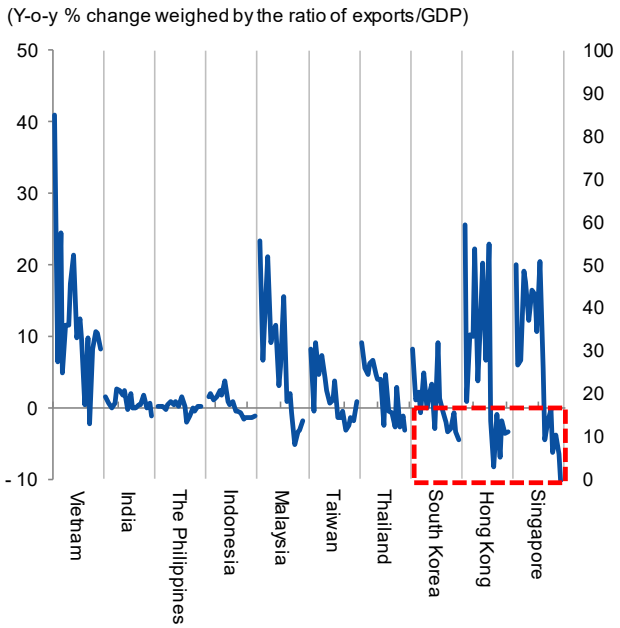
[Rate of growth in real GDP]

(Q-o-q % change, annualized)

	2018				2019	
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun
South Korea	3.9	2.3	1.8	3.8	- 1.5	4.4
Taiwan	2.8	1.6	1.7	1.2	2.3	4.7
Hong Kong	7.8	- 1.2	0.4	- 1.9	5.4	- 1.2
Singapore	4.9	0.7	0.8	- 0.8	3.8	- 3.4
Thailand	7.9	4.7	- 1.4	3.8	4.1	N.A.
Malaysia	5.3	2.5	6.0	5.2	4.4	N.A.
The Philippines	5.5	6.3	5.5	8.3	2.6	5.6
						(Units: Y-o-y % change)
China	6.8	6.7	6.5	6.4	6.4	6.2
Indonesia	5.1	5.3	5.2	5.2	5.1	5.0
Vietnam	7.5	6.7	6.8	7.3	6.8	6.7
India	8.1	8.0	7.0	6.6	5.8	N.A.

Source: Made by MHRI based upon each country's and region's statistics, and CEIC Data

[Exports by Asian country (Jan 2018 – Jun 2019)]

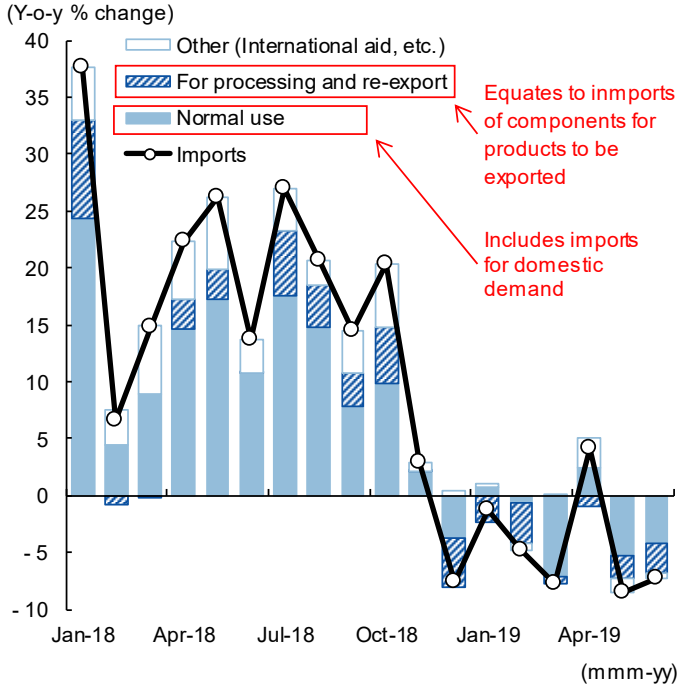


Note: To indicate the impact on GDP, calculated using exports (y-o-y) x (exports/ (GDP in 2018/12))
Source: Made by MHRI based upon General Administration of Customs of the People's Republic of China and IMF

Impact of US-China trade tensions: China-bound exports from Asian countries fell, given the additional impact of the slowdown of China's domestic demand

- China's imports declined not only for imports of components used in processing goods for exports but also for products to meet domestic demand.
  - From the perspective of the other countries of Asia, there has been a decline not only in exports of components for China's supply chain due to US-China trade tensions, but a decline in exports for Chinese domestic demand due to the slowdown of the Chinese economy.
  - There has been a notable decline in China-bound exports from Vietnam, Taiwan and South Korea, and exports for the supply chain for electrical products appears to be declining for all three countries. Meanwhile, China-bound exports from Indonesia have fallen particularly in relation to natural resources, suggesting the impact of the slowdown of China's domestic demand.

[China's imports]



Source: Made by MHRI based upon General Administration of Customs of the People's Republic of China

[China-bound exports from each Asian country (y-o-y % change weighted by exports/GDP, January to May 2019)]

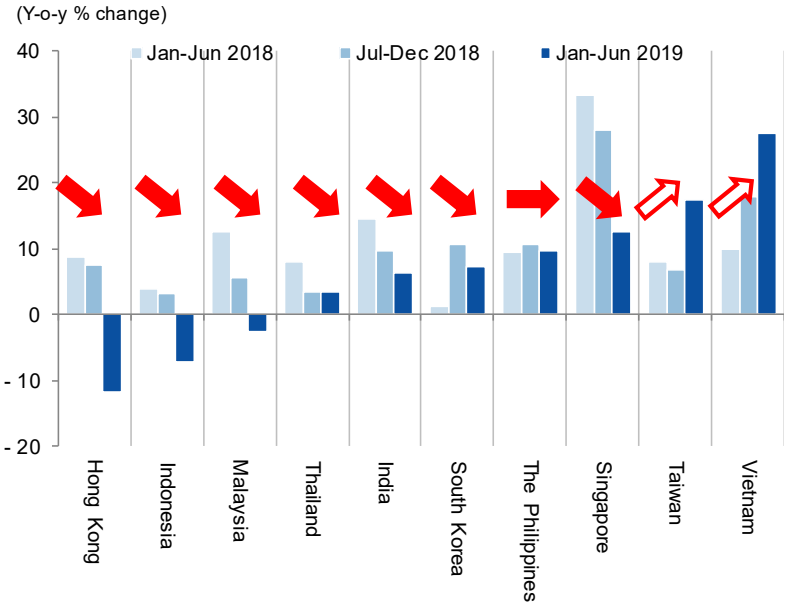
	Total China-bound exports	Degree of contribution							
		Minerals	Chemicals	Plastic	Wooden products	Pulp & Paper	Metals	Machinery	Electrical appliances
Vietnam	- 1.8	0.2	0.3	0.1	0.0	0.0	0.0	- 0.0	- 1.1
Taiwan	- 1.8	- 0.0	- 0.2	- 0.2	- 0.0	0.0	- 0.2	0.2	- 1.1
South Korea	- 1.5	- 0.1	0.0	- 0.1	- 0.0	0.0	- 0.0	0.0	- 1.3
Indonesia	- 0.3	- 0.2	0.0	- 0.0	- 0.0	- 0.0	- 0.1	0.0	- 0.0
Singapore	- 0.2	- 0.2	- 0.3	- 0.0	- 0.0	0.1	0.0	- 0.7	0.2
The Philippines	- 0.2	0.1	- 0.0	0.0	0.0	0.0	- 0.0	0.1	- 0.3
India	- 0.0	- 0.0	0.0	0.0	0.0	0.0	- 0.1	0.0	0.0
Thailand	0.1	0.0	- 0.0	- 0.1	- 0.1	0.0	- 0.0	0.4	- 0.1
Malaysia	1.5	0.2	- 0.1	0.1	- 0.0	0.0	0.5	- 0.0	0.8

Note: China-bound exports by the countries of Asia on the basis of China's imports from each of the countries according to China's statistics. To indicate the impact on GDP, calculated using exports (y-o-y) x (exports/ (GDP in 2018 x 5/12))
Source: Made by MHRI based upon General Administration of Customs of the People's Republic of China and IMF

Impact of US-China trade tensions: substitution of China's US-bound exports by exports by other Asian countries is currently uncertain

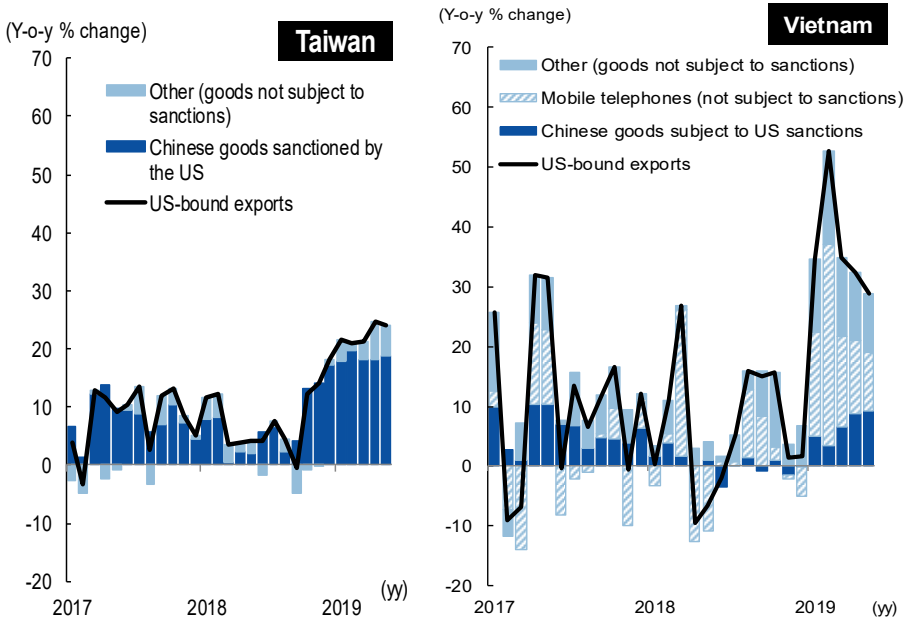
- One option to avoid the US tariffs imposed on China would be to replace US-bound exports from China with exports from other Asian countries. However, in view of the overall decline or sluggishness of US-bound exports from other Asian countries, the prospect of substitution is currently uncertain.
  - As exceptions, US-bound exports from Vietnam and Taiwan are accelerating. For Vietnam, given the sharp increase of mobile phone exports for which China has not been subject to punitive tariffs, the impact of substitution appears to be limited. Given the increase of Taiwan's exports of products on which the US has imposed tariffs on Chinese manufactured goods, this may serve as an alternative.
  - Progress in substitution of China's US-bound exports with exports from other Asian countries will be a time-consuming process as it requires supply chain revisions.

[US-bound exports from each Asian country]



Note: US-bound exports by the countries of Asia on the basis of US imports from each of the countries according to US statistics.
Source: Made by MHRI based upon the US Department of Commerce

[US-bound exports from Taiwan and Vietnam]

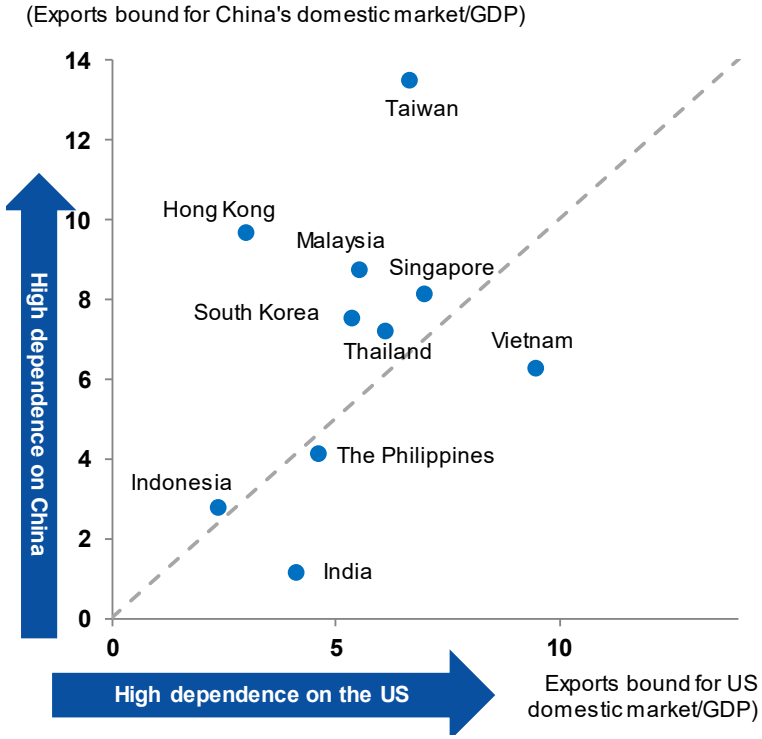


Note: US-bound exports from Taiwan and Vietnam on the basis of US imports from both countries according to US statistics.
Source: Made by MHRI based upon the US Department of Commerce

Asia: forecast of a further economic slowdown of the Asian economies, dragged down mainly by exports

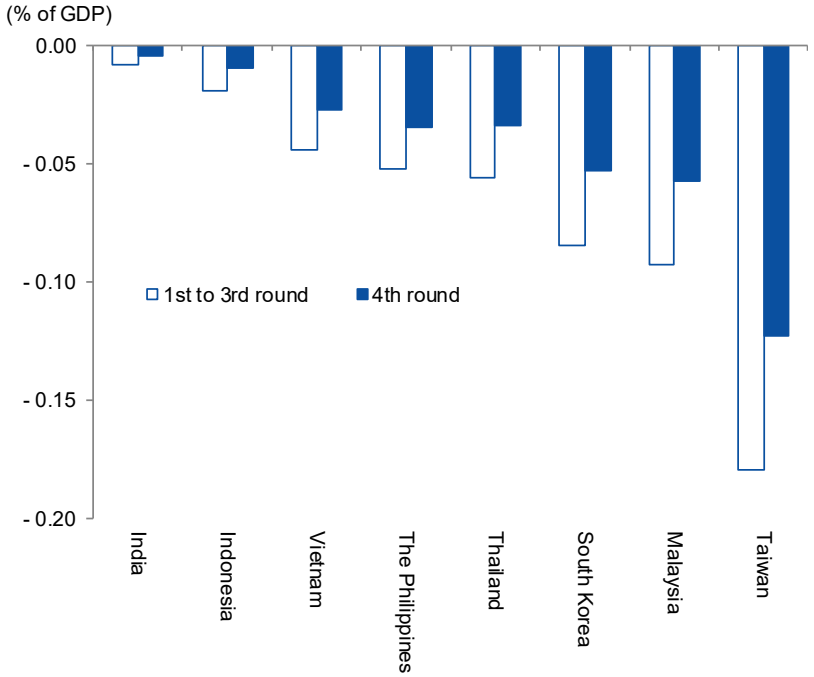
- Looking forward, given the anticipated slowdown of the US economy in addition to the continuation of a moderate slowdown of the Chinese economy, Asia's export growth is forecast to decline, particularly for economies which are heavily dependent upon exports.
  - Regarding the impact of US-China trade tensions, downward pressures on exports of components for the supply chain from each country due to the 1st to 3rd rounds of US punitive tariffs on China will run its course on a year-on-year basis after one year from implementation of punitive tariffs.
  - While there will be downward pressure from a 4th round, we do not anticipate this will have as great an impact as the 1st to 3rd rounds.

[Each Asian country's dependence on exports to the US and China]



Source: Made by MHRI based upon OECD TiVA

[Impact of US-China trade tensions on exports of components to the supply chain]

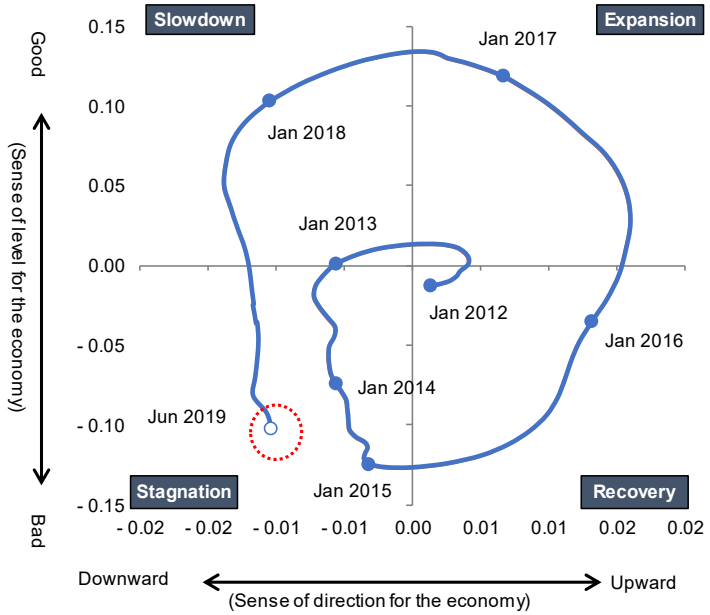


Source: Made by MHRI based upon OECD ICIO, IMF World Economic Outlook Database

China: the business cycle clock remained in the "stagnation phase" up until June

- China's economy shifted into the "stagnation phase" in the second half of 2018. Despite expectations toward the impact of economic stimulus through the end of 2019, the imposition of a 4th round of US punitive tariffs on China would aggravate the decline in exports and cause the Chinese economy to stay in the stagnation phase.
- Although June retail sales recorded their highest levels in almost a year (+9.8% y-o-y), this was attributed to sales campaigns on old model cars before the introduction of stricter environmental standards on cars from July. Considering the ongoing high level of unemployment and slowdown of real income growth, a recovery in personal consumption is unlikely.

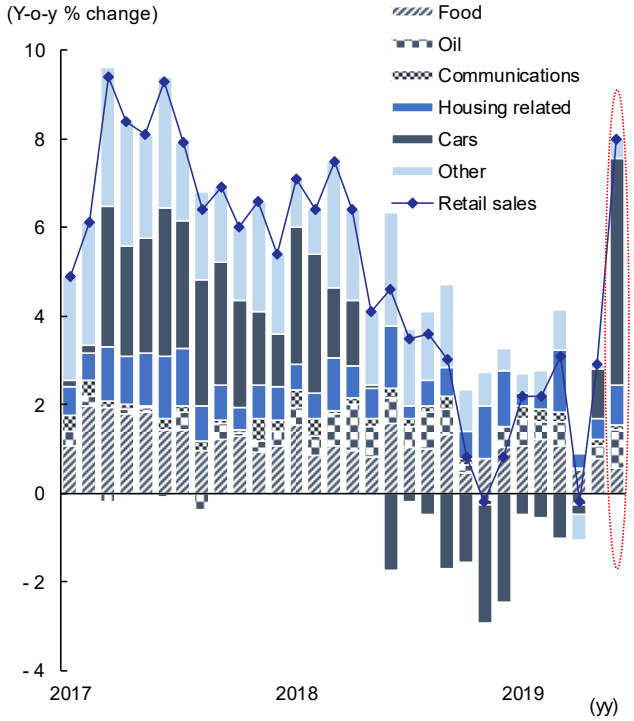
[Business cycle clock of China's diffusion index]



Note: 1. The diffusion index comprises six indices of production, retail sales of consumer goods, investment in fixed assets, exports, ratio of job offers to applicants and corporate earnings, respectively standardised, and adjusted to remove the trend and outliers, weighted equally. The Y-axis plots the upward and downward divergence from the trend, while the X-axis plots the variation in the time series for the cycle components.
2. Since the ratio of job offers to applicants is quarterly data, it is converted to a monthly basis using spline interpolation

Source: Made by MHRI based upon National Bureau of Statistics of China and the General Administration of Customs, China

[Retail sales above a certain level (real)]



Note: Converted to real figures using retail price indices for each retail sales item

Source: Made by MHRI based upon National Bureau of Statistics China

China: given a 4th round of US punitive tariffs on China, the stagnation of China's exports will continue to serve as a drag upon the economy in 2020

- If the downward pressure from a 4th round of US punitive tariffs on China is similar in magnitude to the previous punitive tariffs and affects all US-bound exports, China's exports will remain sluggish in 2020.
  - US-bound exports that were subject to the 1st to 3rd rounds of US punitive tariffs on China recorded a drop of approximately 30% y-o-y in 2019. If the target of a 4th round of punitive tariffs (US-bound exports worth $300 billion) falls by 30%, it would serve as downward pressure equivalent to approximately 0.6% of China's GDP.
    - ✓ Considering the rush in demand, the full-fledged slump from a 4th round of US punitive tariffs on China's US-bound exports will take place from 2020. On the other hand, since the y-o-y decline attributed to the 1st to 3rd rounds of US punitive tariffs should run its course in 2020, the downward impact on overall exports from punitive tariffs should be on a par with 2019.

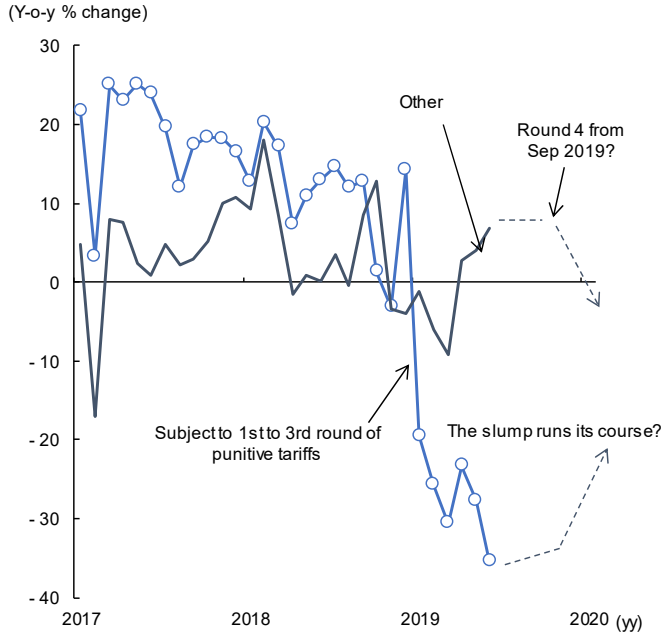
[Chinese goods subject to US punitive tariffs]

(US$100m)

Category	HS Code	US punitive tariffs on China			
		1st to 3rd round	4th round	Total	Proportion (%)
Animals and animal protein products	01～05	22	7	29	0.5
Vegetable products	06～15	11	7	18	0.3
Food and beverages	16～24	33	3	36	0.7
Minerals	25～27	9	4	13	0.2
Chemicals	28～38	90	79	170	3.1
Plastic and rubber	39～40	134	90	223	4.0
Leather and wood products	41～49	171	34	205	3.7
Textiles and apparel	50～63	44	361	405	7.3
Footwear, down, ceramic products and precious metals	64～71	78	222	300	5.4
Base metals and metal products	72～83	232	61	293	5.3
Machinery and electronic goods	84～85	1,174	1,600	2,775	50.2
Transportation equipment	86～89	180	8	189	3.4
Other	90～97	351	523	873	15.8
Total		2,529	3,000	5,529	100.0

Note: Created from actual dollar value of US-bound exports in 2017
Source: Made by MHRI based upon US Department of Commerce and Taiwan Institute of Economic Research

[China's US-bound exports subject to US punitive tariffs]

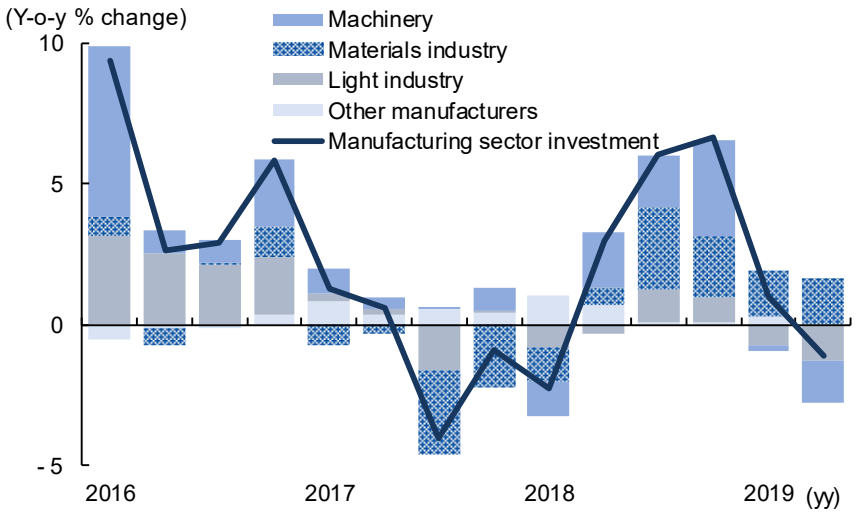


Note: Aggregating items subject to punitive tariffs at 8 HTS levels. The broken line indicates the path anticipated from June 2019.
Source: Made by MHRI based upon US Department of Commerce

China: manufacturing sector investment will likely remain weak amid growing uncertainties regarding the future

- Manufacturing sector investment growth dipped into negative territory in the Apr-Jun quarter. It appears that the deterioration of corporate revenues and future uncertainties served as drags on investment.
  - By industry breakdown, the y-o-y negative contribution increased for sectors other than the materials industries such as iron and non-ferrous metals for which the rise of demand for infrastructure is expected.
- Looking forward, manufacturing sector investment should remain weak due to ongoing concerns regarding US-China trade tensions and economic slowdown.
  - Growth in revenues of industrial enterprises and area of industrial land, which tend to lead investment in manufacturing by about a year, is slowing.

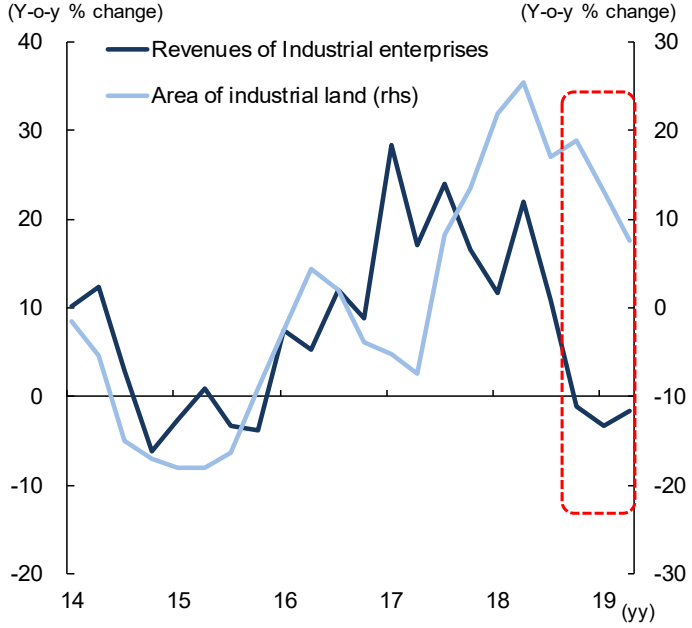
[Rate of growth (real) of manufacturing sector investment]



Note: "Machinery" includes metal products, general purpose machinery, special purpose machinery, cars, shipping and aerospace, electrical machinery and equipment, communication equipment, computers and other electronic equipment. "Materials industry" includes petroleum and coal, raw chemical materials, medicines, chemical fibers, rubber, non-metal minerals, ferrous metals, non-ferrous metals. "Light industry" includes food, beverages, tobacco, textiles, leather, apparel, processing of timber, furniture, paper and pulp, printing and reproduction of recording materials, articles for culture, education, art, sport and entertainment activities.

Source: Made by MHRI based upon National Bureau of Statistics China and CEIC Data

[Revenues of industrial enterprises and area of industrial land]



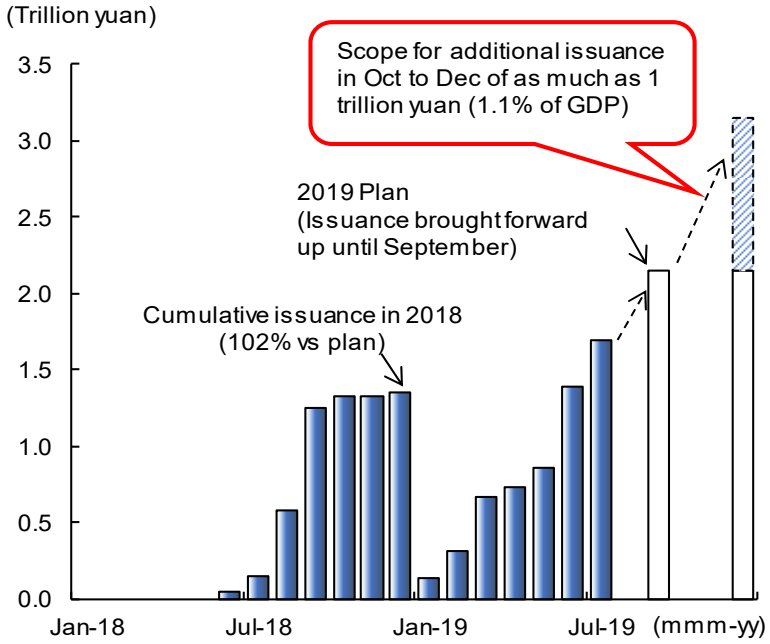
Note: Area of industrial land is the area of industrial land in 100 cities. Y-o-y change is the 4-quarter backward moving average

Source: Made by MHRI based upon National Bureau of Statistics China, CEIC Data and wind

China: economic slowdown in 2020 should be moderate, given support by the expansion of infrastructure investment

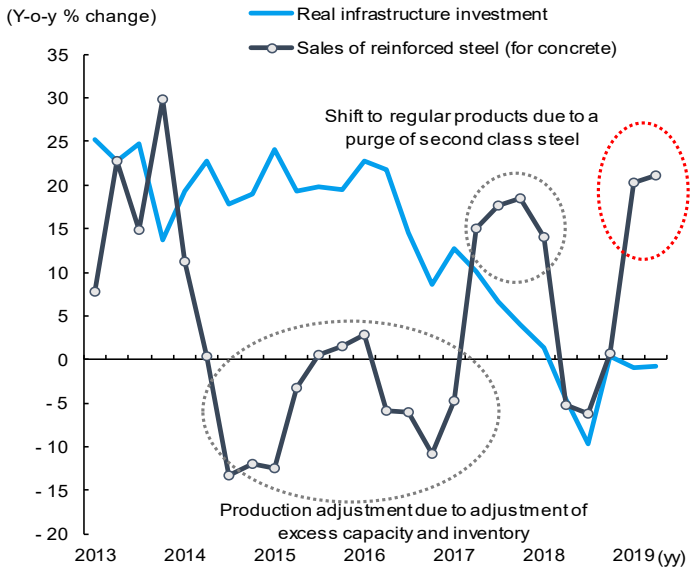
- Infrastructure investment will increase in 2019 and 2020, which should ease the negative impact stemming from the escalation of trade tensions.
  - Apart from the progress in issuance of special-purpose local government bonds to finance infrastructure investment, borrowing restrictions were eased (in June) to support funding by local governments. Currently, sales of steel for concrete most likely for infrastructure investment is rising sharply.
  - Issuance of special-purpose local government bonds has been brought forward with annual issuance plans targeted to be completed by September. There are currently rumors of there being scope for additional issuance of as much as 1 trillion yuan (renminbi) from October. Issuance of an additional 1 trillion renminbi in special-purpose local government bonds would offset the downward pressure on the rate of economic growth anticipated from additional US punitive tariffs. However, as the government is opposed to pork barreling, additional issuance would most likely be kept at the necessary minimum while monitoring the impact of trade tensions.

[Issuance of special-purpose local government bonds (annual cumulative total)]



Source: Made by MHRI based upon China's Ministry of Finance, etc.

[Sales of steel (reinforced steel) and infrastructure investment]



Note: Sales of steel bars of differing shapes are to medium and large companies
Source: Made by MHRI based upon National Bureau of Statistics China and China Iron and Steel Association

Reference: Key political events for major countries

	2019		2020		2021	
US			Nov	Presidential election	Sep	20 years since the September 11 terrorist attacks
Europe	Oct	ECB President Draghi's term of office ends			Sep	Germany: Federal election
	Oct	Brexit deadline			Autumn	Chancellor Merkel scheduled to step down
Japan	Oct	Consumption tax hike	Jul-Sep	Tokyo Olympic and Paralympic Games	Mar	10 years since the Great East Japan Earthquake
					Sep	Term of office expires for the next president of the LDP
					Oct	Term of offce for Lower House members ends
Asia	Oct	China: Fourth Plenary Session of the CPC Central Committee	Jan	Taiwan: Presidential and legislative elections	By year end	Vietnam: National Congress of the Communist Party
			Apr	South Korea: Legislative election		
			@Sep	Singapore: Legislative election		
			Sep	Hong Kong: Legislative Council election		
			By year end	China: Fifth Plenary Session of the CPC Central Committee		

Sources: Made by MHRI from various reports