

Japan: Mostly good

Japan's economy is in decent shape, judging by GDP and the labour market performance, and its persistently low inflation is doing no harm at all. Which leads us to question the Bank of Japan's continued extremely dovish policy stance



Except for an unrealistic inflation target, policy measures are working

If the Bank of Japan (BoJ) did not have such an unrealistic inflation target (2.0%), and therefore didn't have to spend so much time, and let's face it, so much money, trying to achieve the unachievable, we would look at Japan's economy right now and conclude that the BoJ and the government were doing a decent job.

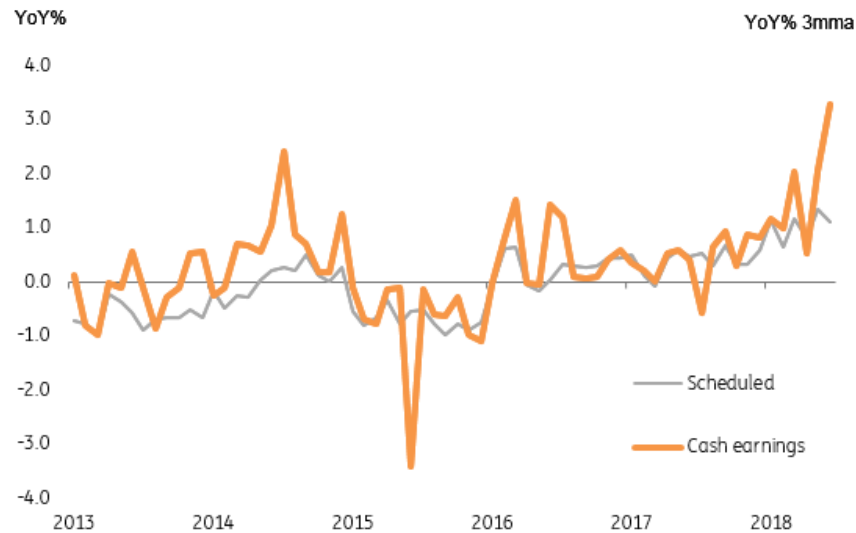
The labour market is tight, and spending and wages are growing well

An unemployment rate of only 2.5% is a very good figure, with rising labour force participation the main reason behind last month's slight uptick. Match this with further gains in cash earnings, now running at 3.0% year on year, a rate that is good by any G-7 standard, and the outlook for consumer spending looks robust, and, importantly, sustainable. This is no debt- fuelled spending

binge.

And it isn't just consumer spending that is motoring. Business investment has also picked up strongly. The 2Q18 figure for business investment of 12.8% YoY, or 14.0% YoY excluding software, is a noticeable pick up from the low single digit growth recorded in 1Q18, and almost double what analysts had expected.

Japanese cash wages - up, up and away



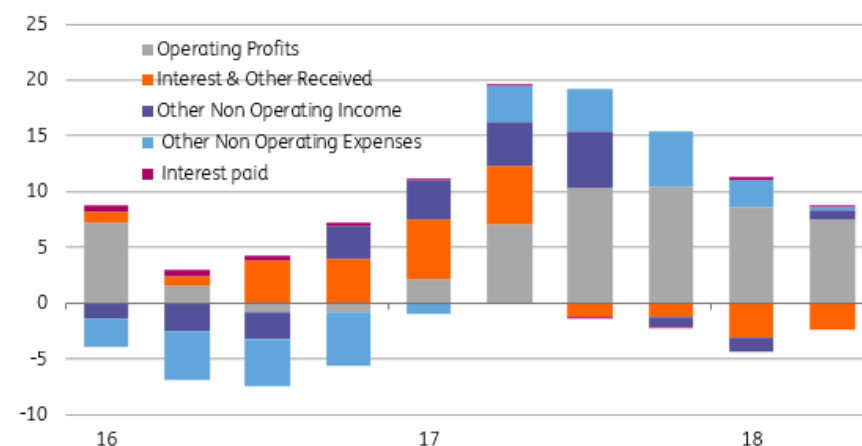
Source: Bloomberg

2Q19 GDP could well be revised higher from an initial 1.9% annualised rate

Put this all together and you have all the makings of a decent upgrade to the initial 2Q18 GDP figure of 1.9%. We are pencilling in 2.4%, but a figure closer to 3.0% can't be ruled out.

Helping all this along is the backdrop for corporate profits. These have slowed since their end-2017 peak rate, but that was always to be expected. And the rate of growth now, though more moderate, looks steady, and remains supportive.

Profit growth slowing, but remains positive



Source: Bloomberg

Abe likely to win LDP top job again

The decent macro backdrop plays into the hands of Prime Minister Shinzo Abe, who is standing for re-election as LDP leader. He is viewed as likely to get it, as his likely opponent, Ishiba reportedly lacks a sufficiently strong party backing to oust him.

Inflation is still low, but then it should be

Headline inflation is a touch higher at 0.9% YoY, but this is almost entirely food, and energy. Strip these out and inflation remains insignificantly above zero at 0.3%. This is only a “problem” because the inflation target has been set at 2.0%. Were it, more reasonably, set closer to zero, then monetary policy would not have to waste resources purchasing assets and distorting market prices in pursuit of the unachievable.

BoJ policy remains contorted

BoJ policy continues to say one thing, whilst delivering another. The recent “dovish’ forward guidance on BoJ policy lacks any credibility given the slowdown in asset purchases of the last year. And the one-off increase of purchases during normal market operations was no more than a check on rising yields which are now consistently trading above 0.1%. This should not be viewed in any way as a change in policy direction. The net purchase of assets in the coming quarters will likely be smaller, not larger than in recent quarters.

Indeed, as the BoJ slowly extricates itself from its official asset purchase commitments, benchmark yields could rise still further.

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