

# Japan's economic recovery is being driven by a tourism boom

Today's data release confirms that the trend of weak manufacturing against strong services continues. Service activity has risen for four consecutive months while sluggish demand for chips is dragging on exports. We believe that a continued recovery would support the Bank of Japan revising its yield curve control (YCC) policy in the coming months



While a contraction can be expected for third-quarter GDP, the current quarter should bounce back thanks to resilience in auto manufacturing and an influx of foreign tourists supporting service activity

0.7%

Tertiary Industry Index

% MoM sa

Better than expected

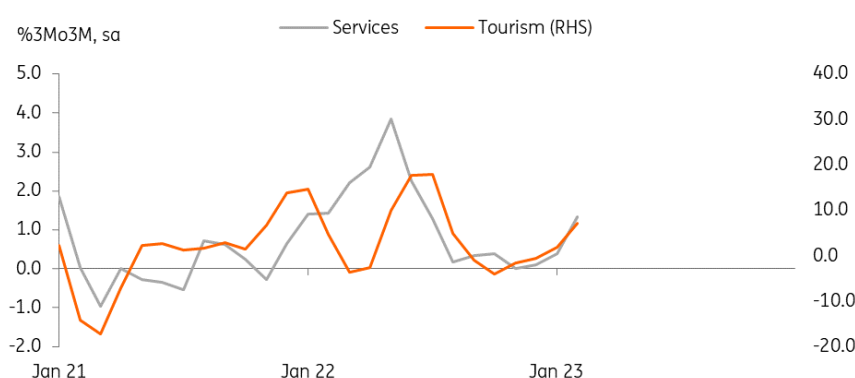
The Tertiary Industry Index, which measures the change in the total value of services purchased by businesses, and is a strong indicator of economic health, was stable in March at 0.7%.

## Service activity improved in February on the back of tourism boom

Services rose 2.0% month-on-month, seasonally adjusted in February, signalling a solid recovery in service activities. By industry, tourism activity surged the most – by 10% in February (vs 5.7% in January), and retail trade also gained solidly for the third consecutive month.

According to visitor arrival statistics, the number of foreign tourists has increased sharply since last December when the border crossing restrictions were lifted. However, Chinese visitors – who normally make up the biggest group of foreign tourists to Japan – have not yet returned in great numbers. We expect further improvements in services in the coming months, as we believe Chinese tourists will begin to increase more rapidly, and there will also be more domestic tourists travelling during Japan's upcoming Golden Week season in May.

## Tourism and services have room for further improvement



**4.3%** Exports  
%YoY  
Higher than expected

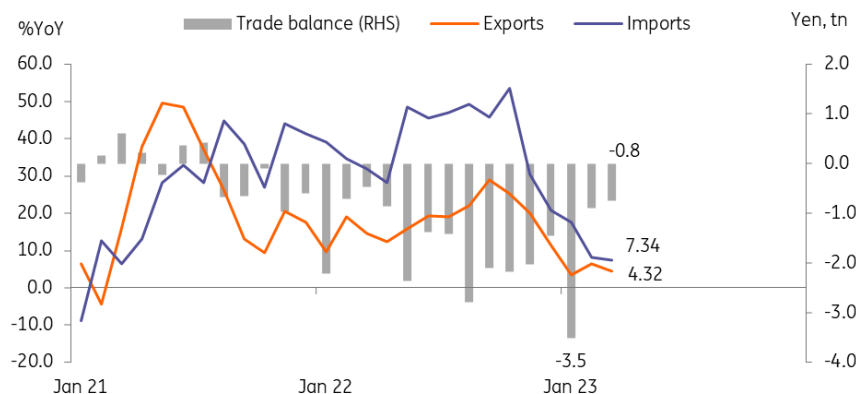
## Exports rose 4.3% in March (vs 6.5% in February and a 2.4% market consensus)

The trade deficit narrowed modestly in March for a second month as import growth slowed to 7.3% year-on-year (vs 8.3% in February) mainly due to the firming Japanese yen (JPY) and falling commodity prices. By destination, exports to China fell by 7.7% while exports to the US and EU rose by 9.4% and 5.1% respectively. By export item, motor vehicles gained 38.3% while electrical machinery deepened its contraction (-4.5%) in March.

We expect interregional trade to remain sluggish as poor semiconductor performance will dominate the positive impact of China's reopening for a while. But, solid exports to developing markets are likely to continue, especially in the auto sector, at least for this quarter. That being said, given the US's IRA act is expected to negatively affect Japanese automakers along with

softening demand in the US, we believe that exports will likely turn negative in the coming months.

## Trade deficit narrowed in March



Source: CEIC

## The Bank of Japan watch

The BoJ will hold its monetary policy meeting next week for the first time under Governor Kazuo Ueda, and it is expected to stand pat. We believe that a solid service sector will not only lead to growth recovery but also stimulate service prices. Tourism and hospitality prices, in particular, are expected to continue rising for the time being, keeping the CPI above the long-term average.

This year's strong wage growth will also likely compensate real incomes to keep up with high inflation. Thus, we believe that the BoJ will likely take a gradual step towards normalisation in the coming months.

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