

Why slowing GDP won't deter Japan's policy normalisation

The Japanese economy grew by 0.2% quarter-on-quarter seasonally adjusted in the third quarter of this year, slowing from 0.5%. But the BoJ is likely to pay attention to stronger-than-expected private consumption. From now until its December meeting, JPY movement will be a key factor in determining the timing of December or January rate hikes



Bank of Japan
headquarters in Tokyo

0.2% GDP
%QoQ, sa

As expected

The growth slowdown was mainly due to weather related one-off issue

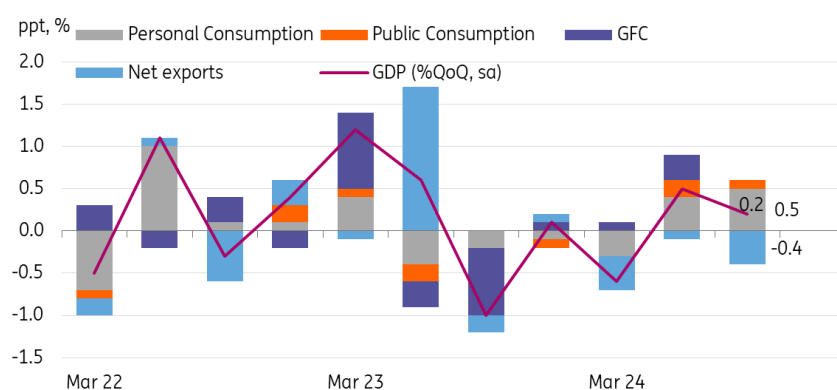
The Japanese economy grew by 0.2% QoQ sa in the third quarter of the year, decelerating from a revised 0.5% growth in the second quarter and in line with market consensus. In terms of the annualised growth rate, this grew 0.9% QoQ (seasonally adjusted annual rate), coming in a bit higher than the market consensus of 0.7%.

Weather-related problems, such as typhoons and a mega-earthquake alert, severely disrupted economic activity in August. The slowdown in GDP was therefore expected. We see the early signs of a recovery in the monthly activity data and therefore expect GDP to reaccelerate in the current quarter.

Private consumption growth was surprisingly strong, rising 0.9% QoQ sa (vs a revised 0.7% in the second quarter and 0.2% market consensus). This is all the more surprising given that bad weather may have dampened some activity and sentiment. The robust growth is likely due to solid wage growth and a temporary income tax cut. Business spending contracted -0.2% (in line with market consensus) after a 0.9% growth in the previous quarter. As core machinery orders appear to be bottoming out, we expect investment to recover in the current quarter.

Meanwhile, net exports made a negative contribution (-0.4ppt) to overall growth, as imports (2.1%) grew faster than exports (0.4%). We believe that exports were hit by the typhoons and should therefore improve. However, the recent depreciation of the JPY may push up imports further; net exports could remain a drag on current growth, but to a lesser extent.

Private consumption rose robustly in 3Q24



Source: CEIC

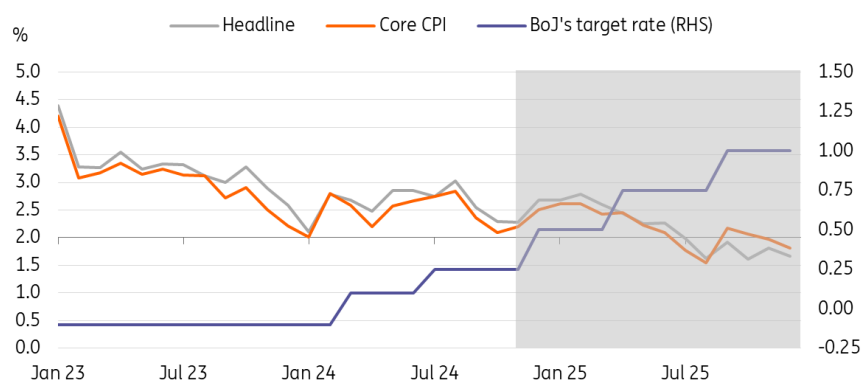
BoJ watch

We don't think the Bank of Japan will be too concerned about the temporary slowdown and will pay more attention to the fact that private consumption has grown for a second consecutive quarter. Inflation remains above 2%, while private consumption is firming up, suggesting that the virtuous cycle between wage growth and consumption is materialising.

In our view, the BoJ is likely to take a closer look at yen movements. The yen has depreciated by almost 4.5% against the dollar over the past month, raising the possibility of higher import costs

and a subsequent overshooting of inflation. As for the Bank of Japan raising interest rates, we believe it is only a matter of time and that this should materialise in either December or January. We see a slightly higher probability of a December hike than a January hike, as we expect the JPY depreciation to continue for a while and for upcoming inflation data to provide more evidence of growing inflationary pressures. If this is confirmed, the Bank of Japan is likely to hike 25bp in December.

We expect the BoJ's target rate to reach 1% by end of 2025



Source: CEIC, ING estimates

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