

Soft flash PMIs add to rising concerns over Japan's recovery

The October flash composite PMI fell below neutral for the first time since December 2022 in Japan, which is all the more concerning given that the cooling of service activity caused most of the decline



49.9

Flash Jibun Bank PMI Composite

(vs 52.1 in September)

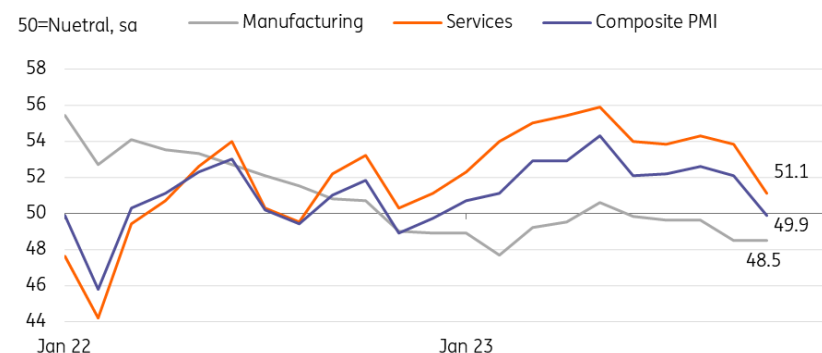
Manufacturing PMI unchanged at 48.5 for a second month

The manufacturing index has remained in contraction territory for the past five months, showing the ongoing weakness in manufacturing activity. Output fell to 47.6 (vs 48.7 in September), probably related to production halts of auto factories due to parts shortages. Yet, new orders rose and so recovery in manufacturing is expected in the coming months.

Service PMI down to 51.1 in October (vs 53.8 in September)

Service activity has been the main driver of the outperformance of Japan's economy among other developed markets. The index stayed above 50 for 14 months in a row, but we see some cooling down of service PMI after recording the historical high of 55.9 in May. Employment expanded and input prices softened slightly, and we still believe that the service sector-led recovery should continue and the services job market will likely tighten.

PMI weakened, driven by service



Source: CEIC

BoJ Watch

With growing concerns over global commodity prices, the government is planning to extend its energy subsidy programs again to the end of April next year. Fuel and utility subsidy programs were originally scheduled to end in September, but the government has now extended them until year-end. Despite efforts to curb inflation, we see upside risks increasing rapidly.

As JGB 10Y yields floated higher, moving along with the UST yield, the Bank of Japan's yield curve control has been challenged. Local media leaked the news that the BoJ is considering another tweak to the YCC policy. Meanwhile, the central bank announced today that it will conduct an unscheduled bond operation on Wednesday and offer one trillion of 5Y loans to commercial banks aimed to supply more liquidity and eventually bring yields down.

The weak JPY is clearly another concern for the BoJ. Currently, the USDJPY remains below 150, but the market is cautious about potential intervention by authorities. In terms of levels, 150 is the market-specified level, triggering FX interventions – but at this point, we think the volatility of the currency should be a more important factor for intervening in the market than the level itself.

The BoJ is badly trapped in the YCC policy. The BoJ appeared to provide more liquidity for fear of a sharp rise in interest rates, but at the same time, the global higher-for-longer trend and rise in inflation have put more pressure on the sustainability of the YCC policy. We think scrapping the YCC policy is too radical for the BoJ, but they could have other options for the change:

1. Shifting the formal 10Y upper limit from 0.5% to 0.75% while keeping the flexible cap at 1%;
2. Bringing the anchor year forward from the current 10Y to 5Y;
3. Adjusting its forward guidance of the statement.

Author

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.