



ECONOMICS: JAPAN PERSPECTIVES

BOJ LIKELY TO MAINTAIN STATUS QUO

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While it's all but certain that Japan's headline inflation rate will print close to zero in the coming months, it continues to look unlikely that the Bank of Japan (BOJ) will respond with more aggressive easing. This week's gross domestic product figures and BOJ policy statement reinforce that viewpoint.

First-quarter gross domestic product (GDP) data and the Bank of Japan's (BOJ) policy meeting this week provided a great opportunity to take stock of where the country's economy stands. The short answer is that the big picture hasn't changed much. Growth has stabilized after the turmoil caused by last year's consumption tax hike, and the BOJ looks inclined to sit on its hands for a while longer.

Stronger-Than-Expected Growth

On the growth front, GDP was a little stronger than expected—up 2.4% on a seasonally adjusted, annualized basis—with a little something for everyone. Those more negatively inclined could point to the sizeable contribution from inventory buildup. Those with a more positive bent could point to increases in consumption, housing and business investment as evidence that spending is stabilizing after last year's tax-hike hit. They could probably point, too, to the 3.4% year-over-year rise in the GDP deflator, the sharpest rise since the early 1980s, as evidence that deflation is lifting (*Display 1*).

We remain tilted toward the more positive camp. The readings that are coming from a range of business surveys—from the Purchasing Managers' Index to the Shoko

Chukin index (for small- and medium-size enterprises) to the Reuters Tankan survey—are consistent with an economy growing modestly above trend.

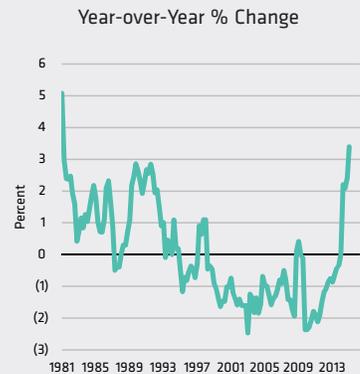
Much of that strength in the last few months has been concentrated in the nonmanufacturing sector (*Display 2*), so this isn't just a story about the weak yen helping out traditional manufacturing exporters. Our expectation is that we'll see growth of around 1.8% in 2016, slightly better than the current consensus in the market.

Upbeat BOJ Statement

Judging from the tone of its latest policy statement, the BOJ appears to be sitting in this more optimistic camp too. While acknowledging that inflation, as measured by the Consumer Price Index (CPI), is likely to be running at around 0% in the near term, the central bank's assessment of the growth outlook was upgraded, and it continues to think that longer-term inflation expectations are rising. The next CPI report, the first year-over-year reading that is not affected by the consumption tax hike, will be released on May 29.

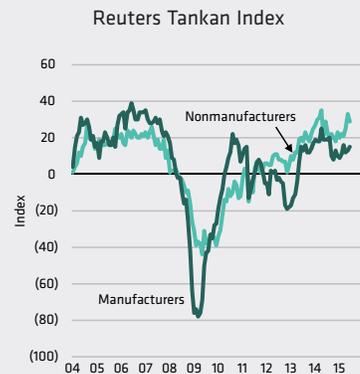
The combination of a relatively upbeat macro assessment and markets doing

Display 1
GDP Deflator Strongest Since Early 1980s



Through March 31, 2015
Source: Thomson Reuters Datastream

Display 2
Nonmanufacturing Has Led Recovery



As of May 22, 2015
Includes actual data through May 22, 2015 and expectations for late May and June 2015
Source: Thomson Reuters Datastream

broadly as policymakers would desire (low and stable yen and government bond yields, and strong equity and property markets) makes it difficult for us to see any material change in policy from the BOJ anytime soon. No need to do more, too early to taper.

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