



# Lombard Street Research

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## Exports – and inflation – to keep Japan weak

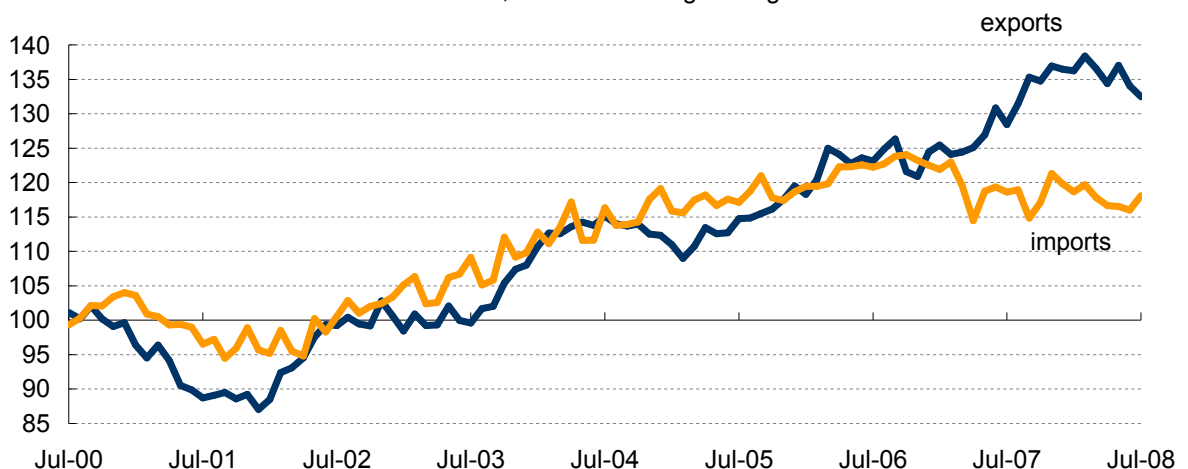
**WE SUGGEST: Recession in Japan but equities look OK**

**SUMMARY: Japanese export volumes rose in July but not by enough to offset the plunge in June. The underlying trend in exports is now clearly downwards – a trend that is likely to intensify in coming months. Even the Bank of Japan now acknowledges that exports are a source of weakness, alongside higher inflation.**

This morning's trade data from Japan showed a monthly bounce in export volumes of 4.7% after the 6.6% slump recorded in June. (Data are volumes, seasonally adjusted by LSR.) On this measure exports are down by 1.2% in the latest three months compared with the previous three months. The underlying trend in exports is clearly one of decline. This is likely to continue in coming months as the global economy slows. Meanwhile import volumes were up 1% in July but are down almost 1% in the latest three months. Falling imports are a reflection of the continued poor state of Japanese domestic demand.

The regional breakdown of export values shows exports to the US down 11.5% in the last 12 months, the eleventh consecutive month of annual declines. Exports to the EU fell in June but are up 4.1% in the 12 months to July. As the US economy remains weak and the EU economy slows, the trend of falling Japanese exports to these regions will continue. But exports to elsewhere in Asia – destination of around half of total Japanese exports – are up 12.7% in the last year, and 16.8% to China. As Asian economies slow later this year as their central banks tighten policy, these exports will also start falling.

Japanese trade, price/seasonally adjusted  
2000 = 100, 2-month moving averages



Earlier this week the BoJ left interest rates on hold at 0.5% as expected. But in its latest *Monthly Economic Report* the BoJ downgraded its assessment for the economy again. For the first time in the current slowdown weaker exports are identified as one of the causes of “sluggish” growth. Until now “high energy and materials prices” have been cited as the chief culprit. (CPI for July is due on 29<sup>th</sup> August and is expected to show inflation around a ten-year high of 2%). After the 0.6% fall in GDP in Q2, the outlook is for another fall in Q3, heralding a recession. However, a lack of severe imbalances and limited exposure to the credit crunch should mean that any recession is relatively short-lived and shallow.

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