



Daily Note: 29 August 2008

## Minor stimulus package: Japan in recession

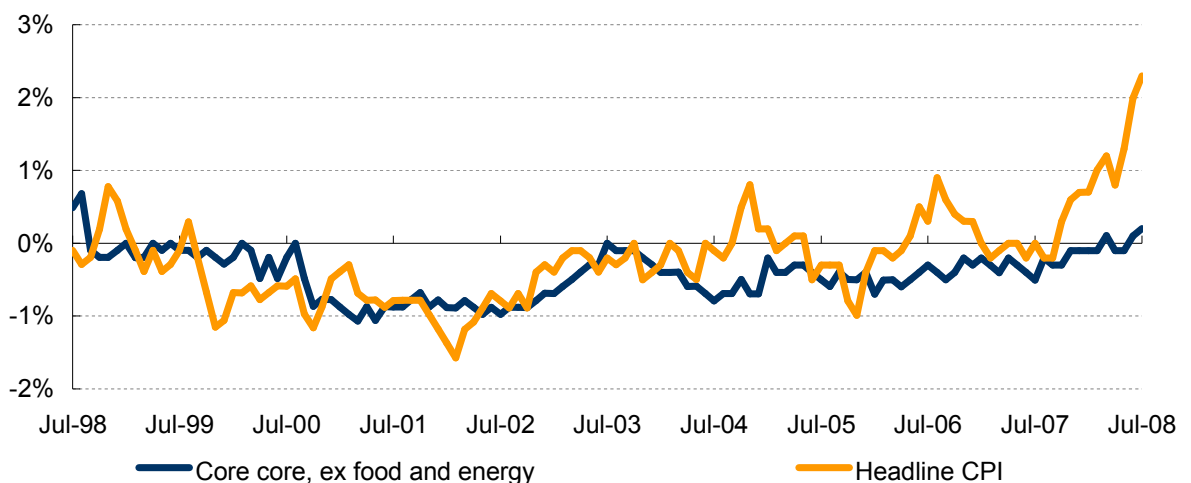
**WE SUGGEST: Recession in Japan but equities look OK**

**SUMMARY: The Japanese government announced a modest economic stimulus package this morning. But more significant is the rise in inflation to a decade high of 2.3% in July. Externally driven inflation is hurting consumer and business confidence and is a key factor in the recession now under way.**

The Japanese government has announced a modest stimulus package this morning, the full details of which are not yet available. But the essential facts appear to be a 2 trillion yen increase in government spending (0.3% of GDP) plus 9 trillion yen for small businesses, some in the form of loan guarantees. The total package is said to be worth 11.7 trillion yen (2.3% of GDP). Initial reaction is that the package will do little to boost growth.

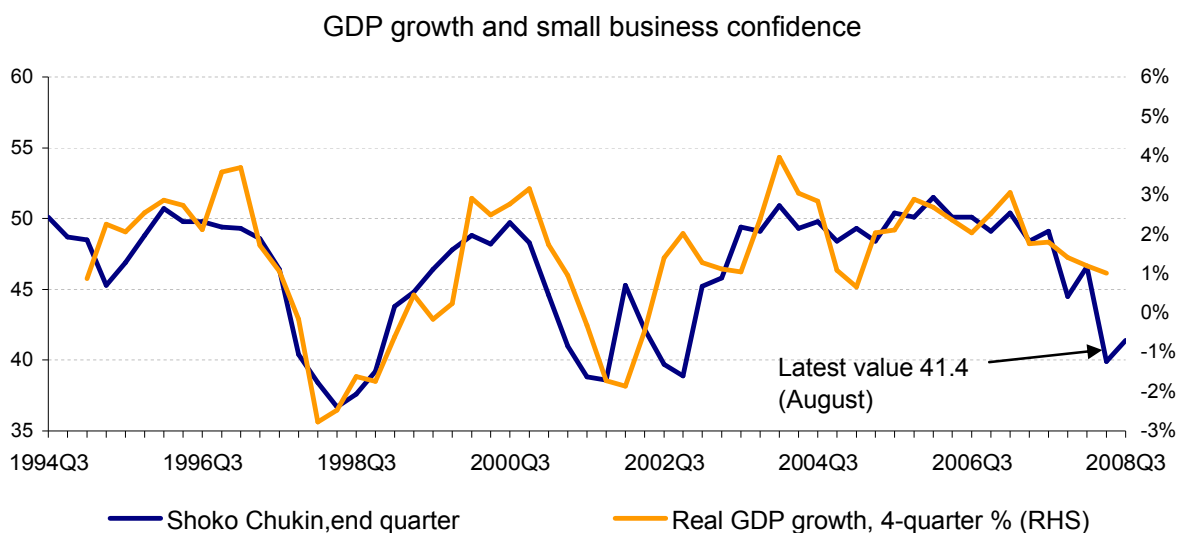
Also this morning we have had numerous data releases. Overall they are a mixed bag but do not change our recession view. A major factor in the weak economy is the squeeze on corporate profits but especially consumer real incomes from externally generated inflation. Today's inflation data underscored this as the national CPI rose to a 12-monthly rate of 2.3% in July (from 2.0% in June) – a new decade high. There was also a rise in the CPI excluding food and energy to 0.2% in July from 0.1% last month. Inflation is likely to rise further in coming months with wholesale prices up 7.1% in the 12 months to July.

**Japanese CPI, total & "core-core", 12-month % change**



There was further bad news for the consumer from the labour market data. Although the unemployment rate ticked lower to 4.0% in July from 4.1%, the job-to-applicant ratio fell to 0.89, the lowest since October 2004 and the eighth month in a row in which it has been below unity. This ratio is a good indicator of labour market prospects and its continued fall is consistent with rising unemployment in coming months. A faltering labour market combined with the squeeze from higher inflation adds up to a poor outlook for consumer spending.

But there was some good news with a rise in the *Shoko Chukin* small business confidence measure to 41.4 in August from 39.9 last month and contrary to market expectations of a further fall. But the rise was the first since March and confidence remains at a low level ad consistent with further weakness in GDP growth. (See chart.)



Elsewhere industrial production for July rose by 0.9%, better than market expectations of a 0.3% fall. But this rise comes after the 2.2% drop last month. Housing starts also picked up in July but the 19.9% annual growth rate in starts is distorted by the collapse in starts a year ago triggered by a change in building regulations. The underlying trend in starts remains weak. Following the 0.6% drop in GDP in Q2 a further contraction looks very likely in Q3, resulting in technical recession. Recession should be short-lived and shallow. But the best hope for a return to sustained positive growth is through a fall back in inflation that relieves pressure on the household and corporate sectors – rather than negligible fiscal stimulus packages.

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