Markit Economic Research

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Japan

Bank of Japan holds off from further stimulus despite economic woes

- **Bank of Japan holds policy despite worrying strength of yen and signs of first quarter economic weakness**
- **Manufacturing output down 1% in first quarter**
- **Growth outlook revised lower**

Official data confirmed the poor start to the year suffered by Japan's manufacturers. Data from the Ministry of Economics, Trade and Industry (METI) recorded a 1.0% drop in manufacturing output over the first quarter, corroborating Nikkei PMI data which have shown a deterioration in business conditions in the sector.

Although output rose 3.8% in March, the improvement failed to fully offset the 5.3% decline seen in February. The PMI data also suggest the March upturn in the volatile official data is merely noise in a downward trend. The 'flash' reading of the PMI for April slipped to 48.0, its lowest since January 2013.

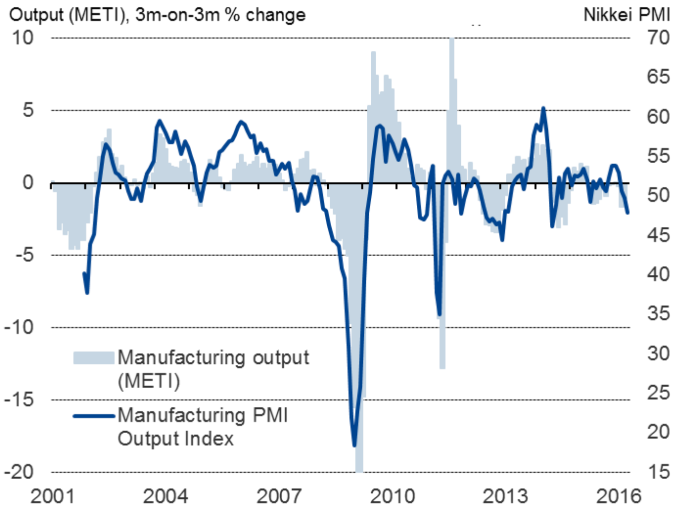
The official data also showed a 2.1% drop in goods shipments over the first quarter as a whole, which was the largest drop since the second quarter of 2014.

Inflation data meanwhile disappointed. Consumer prices fell 0.1% on a year ago in March, with core inflation (stripping out food but not oil) down 0.3% and registering the steepest decline for three years.

Much of Japan's woes can be traced to the exchange rate, which has appreciated sharply over the past six months despite stimulus measures from the Bank of Japan, which included the surprise move to negative interest rates in Japan. The appreciating yen has hit exports (the flash PMI showed the largest drop in export volumes since 2012) while simultaneously pulling down inflation by bringing down prices for imported goods.

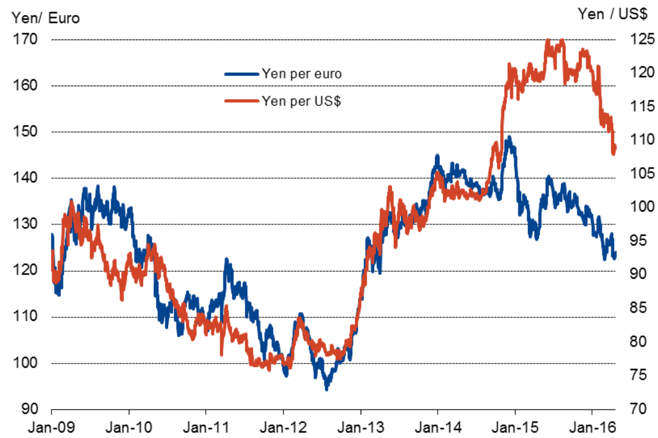
The decision by the Bank of Japan to hold policy at its April meeting therefore surprised the markets, leading to a further 2% surge in the yen. The central bank appears to be either hoping that business confidence is set to revive on the back of prior stimulus measures, or is perhaps keen to avoid micro-measures, preferring less frequent policy 'bazookas' such as January's introduction of negative interest rates. The latter seems more likely, as the bank is also revising down its current fiscal year growth forecast from 1.5% to 1.2%.

Manufacturing output*



*uses April manufacturing PMI Output Flash Index

Strengthening yen



Sources for charts: Nikkei, Markit, Thomson Reuters Datastream.

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