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Masaru Hamasaki
Senior Strategist

# "The Japanese economy will turn to improve despite recent slowdown"

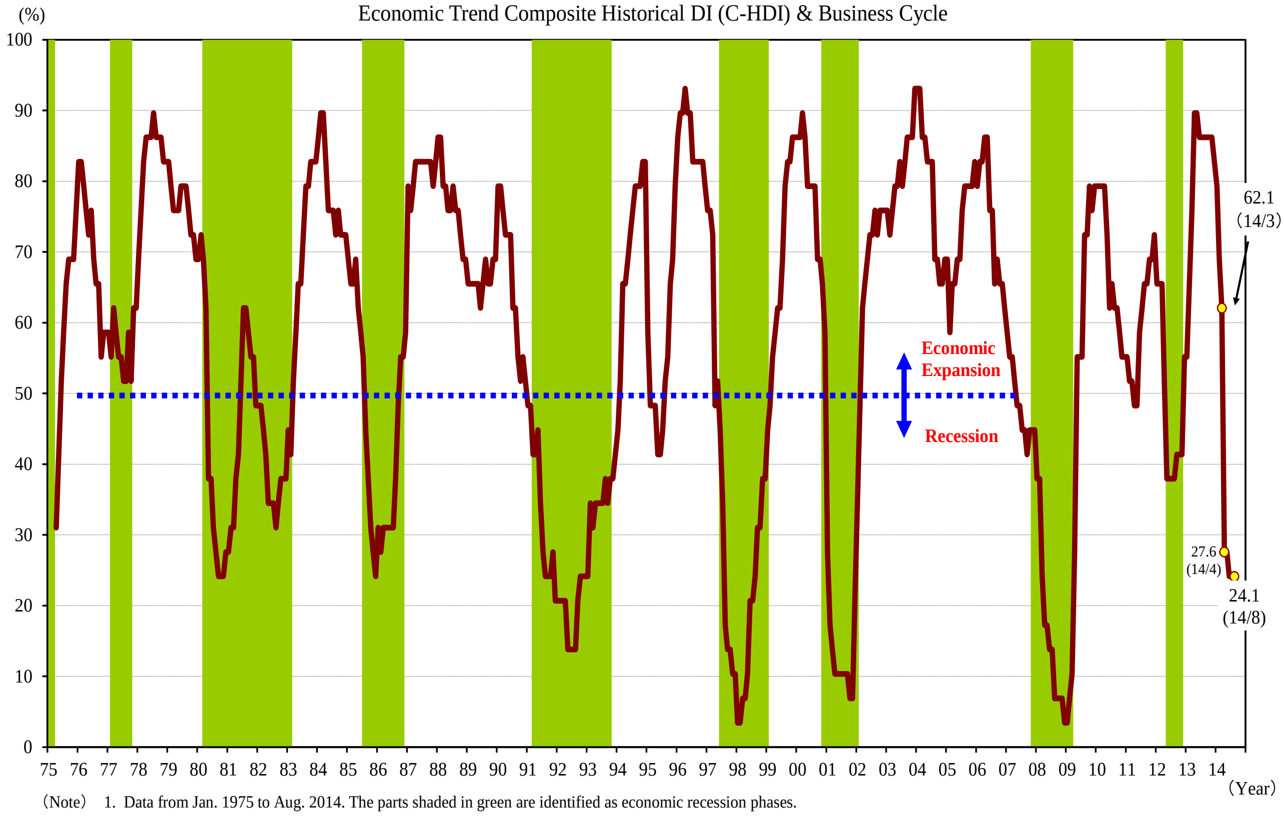
## How to capture the broad direction of the Japanese economy?

The Japanese economic recovery is not powerful, although somewhat recovered in Jul.–Sep. quarter from the negative growth after the implementation of the consumption tax hike in April. The recovery momentum seems too weak to be convinced.

As a useful index to judge direction of the future economic growth trend, there is an index called Diffusion Index (DI). The DI is calculated by classifying the movement of undelying key economic data into the folowing three categories; "Improved" (indicated as 100 or +1), "Unchanged" ( 50 or +/- 0) and "Worsened" ( 0 or -1), and calculating the average point. The well-known DIs are those of Tankan Survey (Short-Term Economic Survey of Enterprises in Japan) released by the Bank of Japan and the Purchasing Managers Index (PMI) released by the Institute for Supply Management (ISM) in the US.

The chart below illustrates a trend of the Historical DI (Composite Historical DI <C-HDI>) which is arranged to capture the broad direction of the Japanese economy by smoothing out the short term fluctuation with a mathematical method. C-HDI of 50% is the threshold level of the business cycle either entering into a economic expansion or recession, which almost corresponds with start and end of the actual Japanese economic recession phase in the past.

Economic Trend Composite Historical DI (C-HDI) & Business Cycle




(Note) 1. Data from Jan. 1975 to Aug. 2014. The parts shaded in green are identified as economic recession phases.
2. Calculated using 29 types of economic and market data closely related to the business cycle. Composed of data mostly used in DI released by the Cabinet Office.
(Source) SMAM, based on the Cabinet Office and the Ministry of Economy, Trade & Industry data.

Sumitomo Mitsui Asset Management
SMAM

## “Economic Recession” in progress, but most likely be short lived

The C-HDI surged beyond 50% right after Abe administration was established in December 2012 and kept a high level after that for a while, supported by the BOJ’s unprecedented monetary easing together with Abe’s flexible fiscal stimulus package. Even right before the consumption tax hike in March 2014, the C-HDI was keeping relatively high level of 62.1% indicating that the Japanese economy was still in the expansion phase though it began to lose its momentum. However, the index fell sharply to 27.6% in April and further down to 24.1% in August. As I had anticipated that the Japanese economy would recover in Jul.-Sep. quarter, it was disappointing that number of economic data indicating the economic recovery did not increase.If the C-HDI remains below 50% for half a year, the possibility of identifying April 2014 as the starting point of a recession will become higher. (The identification will be officially judged by the Economic and Social Research Institute, Cabinet Office)

However, I believe that even if the Japanese economy is identified as in a recession phase, it is, if any, would likely be short-lived because no other specific factors except the tax hike can be found for the reason for the recession. Despite of the lackluster DI’s we are seeing now, I would say that the Japanese economy will gradually recover toward the latter half of this fiscal year along with the diminishing impact of the tax hike effect, so long as any significant external shocks detrimental to the Japanese economy do not take place.



Sumitomo Mitsui Asset Management
SMAM