BoJ upbeat on outlook

The BoJ left its scenario for economic growth and prices virtually unchanged. It expects that inflation, excluding the VAT hike, could reach the 2% target in 2015. However, domestic and external risks to the scenario are considerable.

- Today, the Bank of Japan’s Policy Board updated its baseline scenario for economic activity and prices. The new forecast is virtually unchanged from the previous one made last April.

- The BoJ expects growth to ease from 2.8% in FY2013 to around 1.4% in FY 2014 and FY2015. (The Fiscal Year is from April to March). Inflation, excluding the direct effects of the consumption tax hikes, should gradually increase to 1.3% in FY2014 and 1.9% in 2015. This is consistent with the Bank’s 2% medium-term inflation target.

- Growth is currently largely driven by domestic demand. Households are bringing their purchases forward ahead of the 3-point VAT hike in April 2014 and the 2-point VAT hike in October 2015. The effect of these hikes on GDP is estimated at +0.3 percentage point in FY2013, -0.7 pp in FY 2014 and +0.2 pp in FY2015. But the Bank warns that there is a considerable uncertainty as it depends on income conditions and price developments.

- A second supportive factor is public investment. It is expected to remain very strong due to the fiscal stimulus announced in January 2013 and additional measures that will partly offset the VAT rate hike in April 2014.

- Overseas demand has been weaker than earlier assumed. However, the BoJ expect growth to strengthen gradually in the US and Europe, whereas the Chinese economy is likely to maintain stable growth at around the current pace. The Bank is more pessimistic about the emerging and commodity-exporting economies, which will lack momentum partly due to tighter financial conditions.

- However, the risks to the projections are considerable, and much larger than the ranges published by the Policy Board. For growth, these amount to only 0.5 percentage point above and below the mid-point in both FY 2014 and FY 2015. In fact, this range represents the differences in view on the most likely outcome by the Policy Board members rather than margins for uncertainty.

La Banque du Japon reste optimiste

La BoJ a laissé son scenario pour la croissance économique et les prix quasiment inchangé. Elle estime que l’inflation, hors les effets directs de la hausse de TVA, devrait atteindre la cible de 2% au cours de 2015. Cependant, les risques -- tant internes qu’externes -- qui pesent sur ce scenario, sont considérables.

BoJ Outlook for growth and prices

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Sources: BoJ, BNP Paribas
* excluding fresh food and effect consumption tax hike in 2014

- On the domestic side, a major uncertainty is how the rise in inflation expectations will be carried through to price and wage formation. Labour market tensions do not translate easily in wage rises. The Japanese Phillips Curve is very flat, which is partly related to the long period of deflation. Once prices start to rise, wage setting behaviour also could change. In addition, structural reforms could improve the functioning of the labour market.

- On the external side, a major downside risk concerns the fiscal problem in the US. On the other hand, the effect of new energy sources, such as the production of shale gas, could provide a boost to the economy. In Europe, the debt problems continue to weigh on growth.

- The Bank of Japan will continue its ultra-accommodative policy – the so-called quantitative and qualitative easing – as long as necessary to achieve the price stability target of 2%. For the moment, this has not led to speculative bubbles in asset markets. However, the Bank warns that attention should be paid to the fact that financial institutions’ holding of government bonds have remained at an elevated level. This could be a risk for financial stability once interest rates start rising again.

Raymond VAN DER PUTTEN
raymond.vanderputten@bnparibas.com
ECONOMIC RESEARCH DEPARTMENT

OECD COUNTRIES

Jean-Philippe Cotis
Chief Economist
+33.(0)1.55.77.47.31
jean-philippe.cotis@bnpparibas.com

Jean-Luc PROUTAT
Head
+33.(0)1.58.16.73.32
jean-luc.proutat@bnpparibas.com

Alexandra ESTIOT
Deputy Head – Globalisation, United States, Canada
+33.(0)1.58.16.81.69
alexandra.estiot@bnpparibas.com

Hélène BAUCHON
France, Belgium, Luxembourg
+33.(0)1.58.16.03.63
helene.baudchon@bnpparibas.com

Frédérique CERISIER
Public finance – European institutions
+33.(0)1.43.16.95.52
frederique.cerisier@bnpparibas.com

Clemente De LUCIA
Euro zone, Italy - Monetary issues - Economic modeling
+33.(0)1.42.98.27.62
clemente.delucia@bnpparibas.com

Thibault MERCIER
Spain, Portugal, Greece, Ireland
+33.(0)1.57.43.02.91
thibault.mercier@bnpparibas.com

Caroline NEWHOUSE
Germany, Austria-Supervision of publications
+33.(0)1.43.16.95.50
caroline.newhouse@bnpparibas.com

Catherine STEPHAN
United Kingdom, Switzerland, Nordic Countries – Labour market
+33.(0)1.55.77.71.89
catherine.stephan@bnpparibas.com

Raymond VAN DER PUTTEN
Japan, Australia, Netherlands - Environment - Pensions
+33.(0)1.42.98.53.99
raymond.vanderputten@bnpparibas.com

Tarik RHARRAB
Statistics
+33.(0)1.43.16.95.56	
tarik.rharrab@bnpparibas.com

BANKING ECONOMICS

Laurent QUIGNON
Head
+33.(0)1.42.98.56.54
laurent.quignon@bnpparibas.com

Delphine CAVALIER
+33.(0)1.43.16.95.41
delphine.cavalier@bnpparibas.com

Céline CHOULET
+33.(0)1.43.16.95.54
celine.choulet@bnpparibas.com

Laurent NAHMIAS
+33.(0)1.42.98.44.24
laurent.nahmias@bnpparibas.com

EMERGING ECONOMIES AND COUNTRY RISK

François FAURE
Head
+33.(0)1.42.98.79.82
francois.faure@bnpparibas.com

Christine PELTIER
Deputy Head - Methodology, China, Vietnam
+33.(0)1.42.98.56.27
christine.peltier@bnpparibas.com

Stéphane ALBY
Africa, French-speaking countries
+33.(0)1.42.98.02.04
stephane.alby@bnpparibas.com

Sylvain BELLEFONTAINE
Latin America - Methodology, Turkey
+33.(0)1.42.98.26.77
sylvain.bellefontaine@bnpparibas.com

Pascal DEVAUX
Middle East – Scoring
+33.(0)1.43.16.95.51
pascal.devaux@bnpparibas.com

Anna DORBEC
Russia and other CIS countries
+33.(0)1.42.98.48.45
anna.dorbec@bnpparibas.com

Hélène DROUOT
Asia
+33.(0)1.42.98.33.00
helene.drouot@bnpparibas.com

Jean-Luc GUEIZE
Africa, English and Portuguese speaking countries
+33.(0)1.42.98.43.86
jeanloic.guieze@bnpparibas.com

Johanna MELKA
Asia – Capital Flows
+33.(0)1.58.16.05.84
johanna.melka@bnpparibas.com

Sara CONFALONIERI
Latin America
+33.(0)1.42.98.74.26
sara.confalonieri@bnpparibas.com

Alexandre VINCENT
Central and Eastern Europe
+33.(0)1.43.16.95.44
alexandre.vincent@bnpparibas.com

Alexandra WENTZINGER
Africa
+33.(0)1.55.77.80.60
alexandra.wentzinger@bnpparibas.com

Michel BERNARDINI
Public Relations Officer
+33.(0)1.42.98.05.71
michel.bernardini@bnpparibas.com