

Market Monitor – Japan

Yen Tumbles with Japan’s Divergent Monetary Policy



**Japan’s economy contracts in Q1 2022 amid surge in imports and slower consumption**

Japan’s GDP contracted by 0.5% quarter on quarter on an annualised basis in Q1 2022, as imports rose faster than exports amid a global surge of energy and commodity prices and supply chain disruptions due to Covid-19-related restrictions elsewhere. In Q1 2022, Japan’s total imports rose by 13.9% quarter on quarter, whereas exports only saw quarterly growth of 4.6%. At the same time, household consumption only registered 0.1% quarter-on-quarter growth in Q1 2022, about 10.3 percentage points lower than Q4 2021. This mainly reflects the impact of a quasi-state of emergency, which affected up to 36 prefectures at the peak of the sixth wave of Covid-19 infections.

Meanwhile, Japan is starting to see inflationary pressure, with the headline consumer price index (CPI) rising by 2.5% year on year in May and the negative base effect of reduced mobile phone charges fading. The yearly rise in CPI in May was same as that in April, still the highest increase since October 2014. The higher cost of living has put pressure on household consumption, with real household spending seeing a yearly decline for two consecutive months. The real household spending dropped by 1.7% year on year in April, after a 2.3% drop in March. Despite moderating economic growth, Japan’s labour market remained tight, with the job-to-applicant ratio rising to 1.24 in May from 1.23 in April. Meanwhile, the unemployment rate edged up by 0.1 percentage point from the previous month to 2.6% in May, still close to the low of 2.4% seen in early 2020.

**Growth outlook may continue to be clouded by high energy prices and the ongoing Russia-Ukraine conflict**

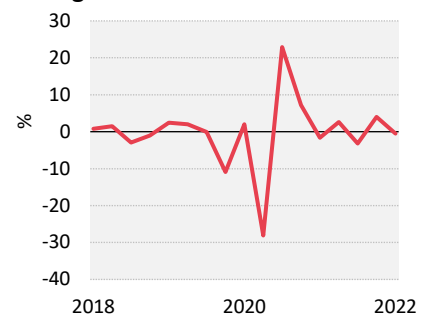
Going forward, Japan’s economy is expected to see a rebound in Q2 2022, as the quasi-state of emergency was lifted in late March and the government started to ease travel restrictions for business travellers and foreign students. Nonetheless, as restrictions on

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**BOJ keeps policy rates on hold and continues to pledge to defend 0.25% yield cap at June meeting.**

**Divergence in policy stance between BOJ and other major central banks results in continued weakness in Japanese yen.**

Japan GDP Annualised Quarterly Change



Source: Bloomberg, data as of 30/6/2022)

tourists were only eased on 10<sup>th</sup> June and only group tours are allowed in at present, any boost from international tourists is set to remain limited in the near term. Besides, a number of downside risks such as higher energy and food prices, continued supply chain constraints amid the pandemic, and heightened geopolitical tension from the Russia-Ukraine conflict may continue to cloud Japan's economic outlook in the second half of 2022. The boosts to exports from a weaker yen may be partly offset by a drop in household consumption amid a higher cost of living and import costs. A Bloomberg survey in June show a general market estimate that Japan's GDP will grow by 1.8% in 2022, 0.1 percentage point lower than in May's survey. It is expected that the economic growth will be further downgraded in July's survey.

### Japanese yen tumbles as Bank of Japan's policy stance diverges from its peers

The Bank of Japan (BOJ) kept the benchmark policy rates unchanged at its June meeting. It also pledged to purchase 10-year government bonds at 0.25% every business day through fixed-rate purchase operations, in order to maintain its implicit cap on the 10-year government bond yield. By contrast, the US Federal Reserve (Fed) raised its benchmark interest rates by 150 basis points during January to June 2022, while the Bank of England (BoE) raised its rate by 100 basis points. The divergence in policy stance between the BOJ and other major central banks has resulted in a substantial weakening of the yen's performance against the US dollar in Q2 2022. Despite a rare joint statement by the BOJ, the Ministry of Finance, and the Financial Services Agency on the yen's sharp decline, the yen continued to stay weak and depreciated against the US dollar by 10.3% to JPY 135.72 per US dollar between end-March and end-June.

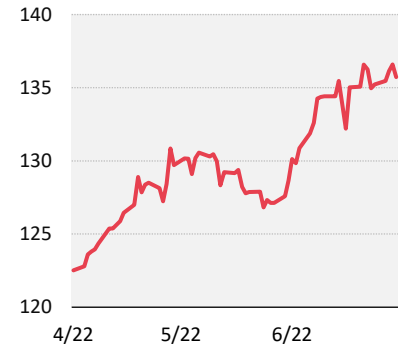
### Equity market corrects amid monetary tightening by major central banks

While some investors speculate that a weaker yen might give a boost to export-related companies as the BOJ maintained an accommodative policy stance, major central banks like the Fed and the BoE continued to tighten their policies amid high domestic inflationary pressure. Japan's equity market saw corrections alongside its global peers in Q2 2022. The Nikkei 225 Index recorded a 5.1% loss between end-March and end-June, while the TOPIX saw a 3.9% loss over the same horizon.

In the bond market, the 10-year Japanese government bond yield remained almost unchanged, mainly due to the BOJ's pledge to defend its 0.25% cap. As of 30<sup>th</sup> June, the 10-year government bond yield stood at 0.225%, only about 2 basis point higher than the level at the end of March.

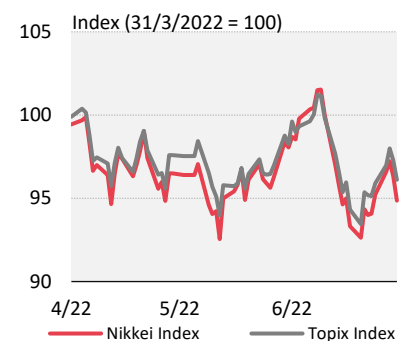
Looking ahead, as the central banks of major advanced economies continue to raise policy rates aggressively to curb domestic inflation, the yen may continue to weaken against the US dollar in the months ahead. However, expectations that the BOJ may intervene in the foreign exchange market will intensify if the yen depreciates too drastically. The rapidly changing global monetary policy outlook and uncertainties in the growth outlook may cause higher volatility in Japan's financial markets.

### USD/JPY



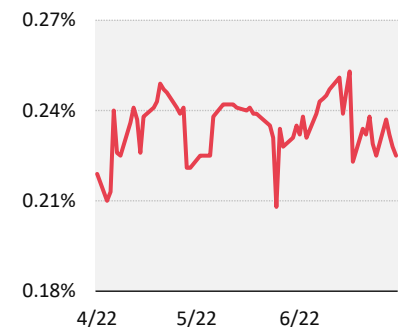
Source: Bloomberg, data as of 30/6/2022

### Japan Equity Indices



Source: Bloomberg, data as of 30/6/2022

### 10-year Japanese Government Bond Yield



Source: Bloomberg, data as of 30/6/2022

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