

AT A GLANCE | Japan

June 2, 2023

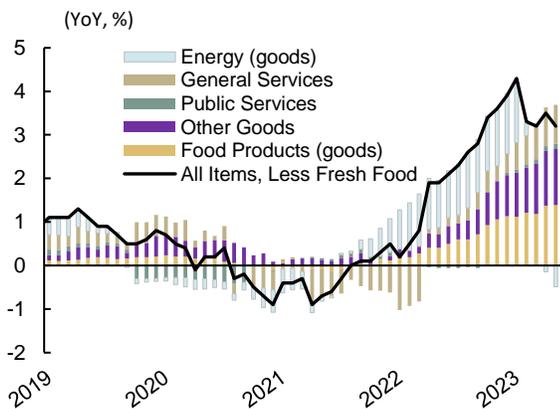
Will the Upbeat Inflation Path Continue?

Economist: Junya Takemoto

May Tokyo CPI Shows No Underlying Weakness

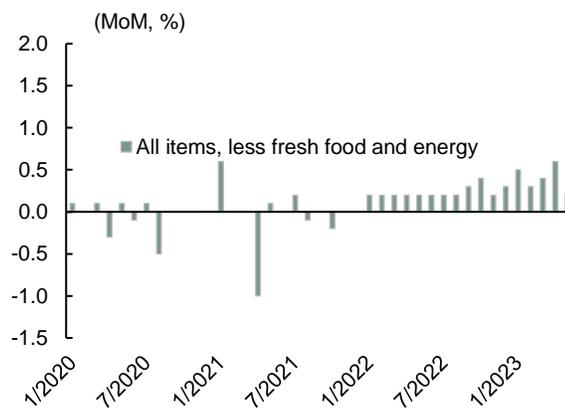
On May 26, the Tokyo Metropolitan Area Consumer Price Index (CPI) for May was released. The index is known to be closely linked to the national portion and is highly watched because it is released before the national portion. However, the core portion excluding fresh foods showed a year-over-year increase of 3.2%, down from 3.5% in the previous month (Figure 1). However, it is somewhat premature to assume that this is the beginning of a peak in domestic price increases. This is because the decline in core prices in the month was caused by a decline in electricity prices, but this is only linked to the prices of crude oil, liquefied natural gas and coal, which are fuels, and does not mean a retreat in the selling pricing stance of domestic companies. In fact, the core-core CPI, which excludes energy (including electricity), shows a year-over-year increase of 3.9%, up from 3.8% the previous month. Also of note is the month-over-month increase in seasonally adjusted indices, which have remained above +0.2% since inflation began in 2022 and show no signs of slowing down this month (Figure 2). This time around, we would like to consider whether this current level of price strength will continue.

Figure 1: Tokyo Metropolitan Area CPI (YoY)



Source: Ministry of Internal Affairs and Communications

Figure 2: CPI in Tokyo (month over month)

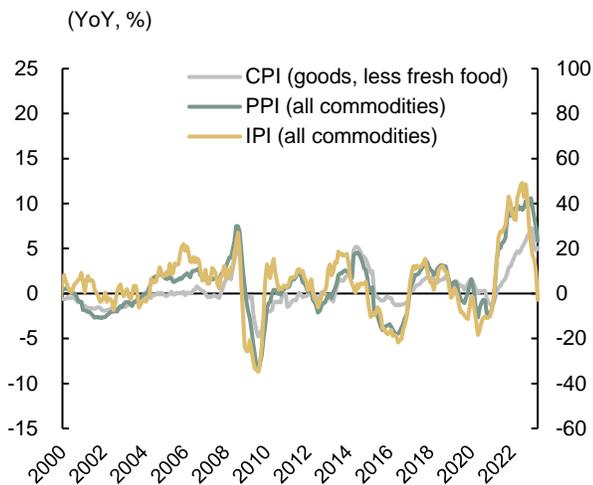


Source: Ministry of Internal Affairs and Communications

Cost-Push Pressure to Decline

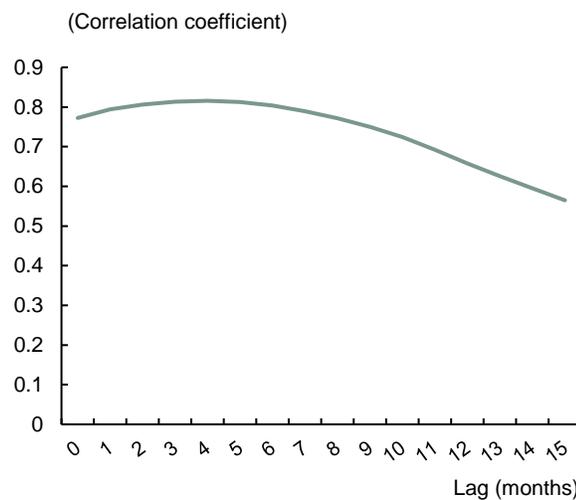
The recent inflation was triggered by the global supply shortage that occurred after the pandemic and the consequent rise in prices, which acted as a strong cost-push pressure point on domestic consumer prices through import prices. This cost-push pressure is clearly starting to peak at the foot of the line. Year-over-year changes in domestic corporate and import prices show that the rate of increase has recently peaked out rapidly, with import prices in May falling by 2.9% from a year earlier (Figure 3). Where import prices and domestic corporate prices have been on a downward path in the past, consumer prices for goods have also been on a downward path, with a lag of about four months (Figure 4). Given that import prices and domestic corporate prices have peaked since the end of last year, it is likely that consumer goods prices will peak in April-June.

Figure 3: Domestic Corporate and Import Prices



Sources: Ministry of Internal Affairs and Communications, Bank of Japan

Figure 4: Time Lag Correlation Between Domestic Corporate Prices and Consumer Prices



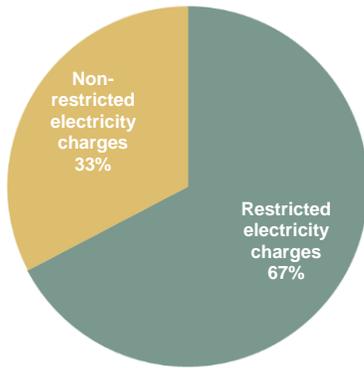
Source: SMBC

Impact of Rising Electricity Bills

On May 19, Minister of Economy, Trade and Industry Yasutoshi Nishimura approved an application by seven major power companies to raise electricity rates for households starting in June. The price increase is expected to range from 14% to 42% (depending on the utility), according to reports. This will push up consumer prices, but there are a few things to keep in mind about the impact. First, as pointed out in this report in the past, the rate hikes are for “regulated rates”, not for all electricity bills (Figure 5). Another factor is that while 7 of the 10 major electric power companies applied for price increases this time, the sales volume share of those that did not apply for price increases in the Kansai, Chubu and Kyushu regions accounted for 41% of the total (Figure 6). In light of these factors, the impact on the CPI is likely to be limited to a certain extent, with the effect of boosting the core CPI by around 0.4%.

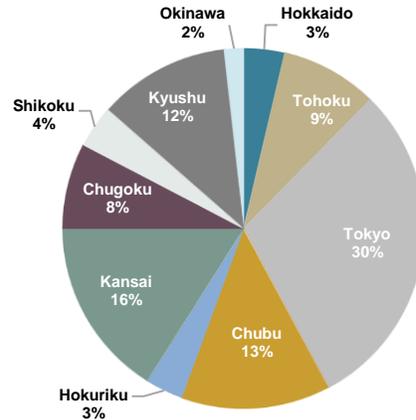
There’s one more thing to consider about electric bills. Electricity costs reflect changes in fuel prices with a lag. The international market price of this fuel is significantly lower than during 2022 (Figure 7), and this effect will have an impact with a lag of more than six months. For this reason, it is expected that the “free rate”, which has been increasing continuously, will start to be reduced from here. Due to this effect, although there will be some ups and downs in electricity bills during 2023 due to policy effects and other factors, it will not have much of an impact if it is equalized (Figure 8).

Figure 5: Percentage of Contract Units for Regulated and Free Rates at Major Power Companies (January 2023)



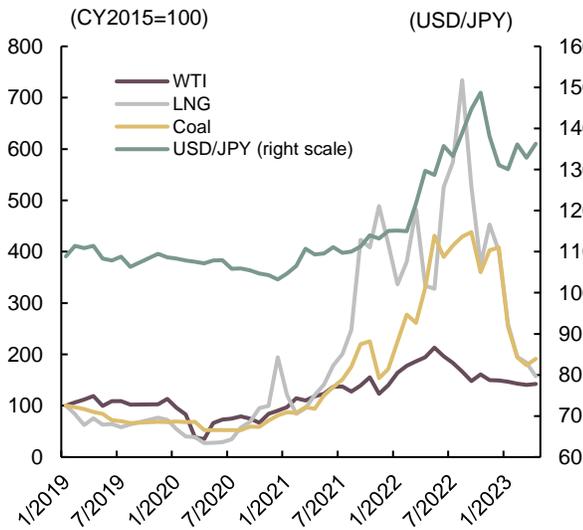
Source: Electricity and Gas Market Surveillance Commission

Figure 6: Share of Electricity Sales by Major Power Companies



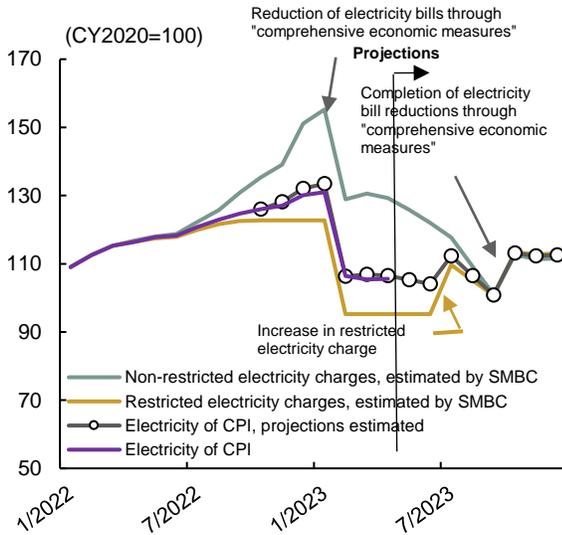
Source: Electricity and Gas Market Surveillance Commission

Figure 7: Resource Prices



Sources: Bloomberg, SMBC

Figure 8: Forecast of CPI Electricity Bills



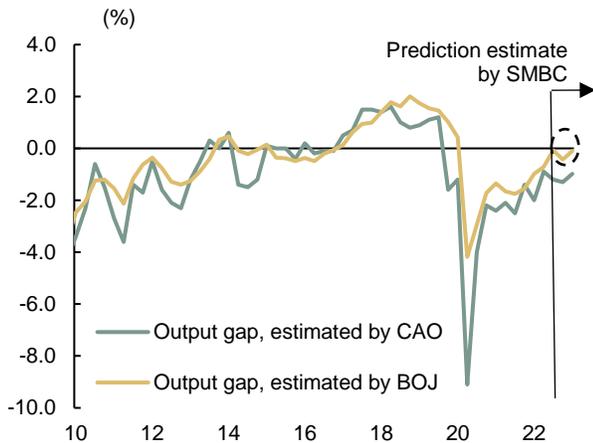
Source: Ministry of Internal Affairs and Communications

But Price Increases May Continue to Be Sticky

As we have seen, the fact that cost-push pressure will diminish in the future and that electricity costs will have no appreciable impact on the CPI supports the Bank of Japan's (BOJ) cautious price outlook. In fact, we believe it is not very likely that inflation will decline steadily from here to below 2% in 2023. That's

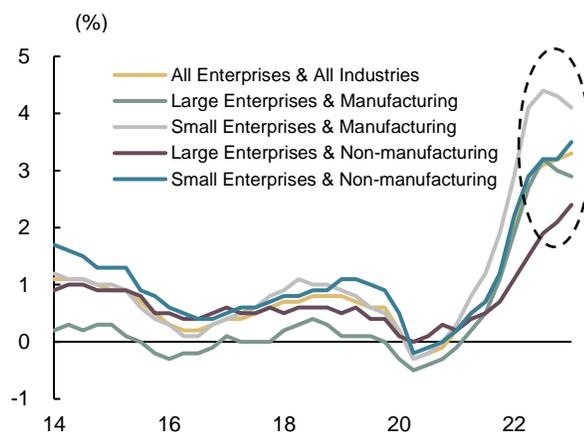
because there are improvements in inflation expectations and the supply-demand gap that form a fundamental part of inflation. As BOJ Governor Kazuo Ueda also said in a speech on May 19, there is a consensus among economic experts that as inflation expectations have fallen, the Phillips curve has shifted downward, resulting in lower inflation rates realized under the same supply-demand gap. This inflation expectation has risen so much recently that it is possible that the Phillips curve has shifted upward, in which case a tightening of the supply-demand gap in the future could lead to more price pressures than ever (Figure 9). In fact, the Tankan sales price outlook has risen markedly even for non-manufacturing industries, which have not seen hikes, suggesting that the pricing stance is tilting forward as the economic recovery continues amid a deepening labor shortage (Figure 10). It will be necessary to examine the data a little more closely to see whether the Phillips curve has actually shifted upward, but if this is confirmed, the time has finally come for the BOJ to declare that it has reached its long-cherished goal.

Figure 9: Supply-Demand Gap



Sources: Cabinet Office, Bank of Japan, SMBC

Figure 10: Sales Price Outlook (after one year)



Sources: Bank of Japan, SMBC

Economic Outlook: 2022-2024 Forecast

Figure 1: Forecasts for Economic Growth, Inflation, and Unemployment Rates

		2022			2023				2024				2021	2022	2023	2024
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
US	Real GDP	-0.6	3.2	2.6	1.3	1.5	-0.8	0.6	0.9	1.4	1.8	2.2	5.9	2.1	1.4	1.0
	Inflation	5.0	4.9	4.8	4.8	4.6	4.2	3.9	3.2	2.8	2.5	2.2	3.3	5.0	4.4	2.7
	Unemployment	3.6	3.6	3.6	3.5	3.4	3.7	4.3	4.6	4.7	4.7	4.6	5.4	3.7	3.7	4.7
Euro Area	Real GDP	0.9	0.4	0.0	0.1	0.3	0.2	0.1	0.1	0.4	0.3	0.3	5.3	3.5	0.9	0.9
	Inflation	8.0	9.3	10.0	8.4	6.7	5.2	3.7	3.3	2.7	2.3	2.2	2.6	8.4	6.0	2.6
	Unemployment	6.7	6.7	6.7	6.9	7.1	7.1	7.2	7.4	7.4	7.3	7.2	7.7	6.7	7.1	7.3
Japan	Real GDP	4.7	-1.0	-0.1	1.6	1.7	1.0	0.9	0.9	0.8	0.8	0.7	2.2	1.0	1.0	0.9
	Inflation	2.1	2.7	3.8	3.5	3.3	2.8	2.3	2.9	2.7	2.6	2.2	-0.2	2.3	3.0	2.6
	Unemployment	2.6	2.5	2.5	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.8	2.6	2.4	2.3
China	Real GDP	0.4	3.9	2.9	4.5	8.4	5.7	6.3	5.4	5.2	5.1	5.0	8.4	3.0	6.3	5.2
	Inflation	2.2	2.8	1.8	1.3	1.6	1.4	1.5	1.6	1.9	2.0	2.0	0.8	1.7	1.5	1.9
	Unemployment	5.8	5.4	5.6	5.5	5.4	5.1	4.9	4.9	4.9	5.0	5.0	5.1	5.1	5.2	5.0

Real GDP growth is in QoQ annualized for U.S. and Japan, QoQ for euro area and YoY for China and India. Inflation rate is in YoY%. Inflation rate is YoY, % of core index (ex. fresh food) for Japan, YoY % of PCE deflator for U.S., and total YoY% for the rest.

Figure 2: Forecast for Rates

Interest rate		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
US	Policy rate	4.25 ~ 4.50	4.75 ~ 5.00	5.00 ~ 5.25	5.00 ~ 5.25	5.00 ~ 5.25	4.75 ~ 5.00	4.50 ~ 4.75	4.25 ~ 4.50	4.00 ~ 4.25	4.25 ~ 4.50	5.00 ~ 5.25	4.00 ~ 4.25
	2yr	3.43	4.03	4.00	3.80	3.80	3.60	3.40	3.20	3.00	3.43	3.80	3.00
	10yr	3.87	3.47	3.70	3.60	3.60	3.60	3.60	3.50	3.50	3.87	3.60	3.50
Germany	Policy rate	2.50	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	2.50	4.25	3.75
	Deposit rate	2.00	3.00	3.50	3.75	3.75	3.75	3.75	3.50	3.25	2.00	3.75	3.25
	2yr	2.50	2.68	3.10	3.20	3.00	2.80	2.60	2.40	2.30	2.50	3.00	2.30
Japan	Policy rate	-0.10	-0.10	-0.10	-0.10	-0.10	0.10	0.10	0.10	0.10	-0.10	-0.10	0.10
	2yr	0.04	-0.06	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.04	0.20	0.30
	10yr	0.42	0.35	0.75	0.75	0.75	0.90	0.90	0.90	0.90	0.42	0.75	0.90
China	Policy rate	2.75	2.75	2.75	2.75	2.75	2.85	2.85	2.85	2.85	2.75	2.75	2.85
	2yr	2.39	2.41	2.45	2.50	2.65	2.70	2.75	2.80	2.85	2.39	2.65	2.85
	10yr	2.83	2.85	2.87	2.90	2.95	3.00	3.05	3.10	3.15	2.83	2.95	3.15

Figure 3: Forecast for FX and Oil Price

		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
USD/JPY	Range	130.58 ~ 151.95	127.23 ~ 137.91	128.00 ~ 145.00	123.00 ~ 137.00	123.00 ~ 137.00	121.00 ~ 135.00	119.00 ~ 133.00	116.00 ~ 130.00	116.00 ~ 130.00	113.47 ~ 151.95	123.00 ~ 145.00	116.00 ~ 135.00
	End of quarter	131.12	132.86	133.00	133.00	130.00	128.00	126.00	123.00	123.00	131.12	130.00	123.00
EUR/USD	Range	0.9633 ~ 1.0735	1.0806 ~ 1.1033	1.0400 ~ 1.1400	1.0300 ~ 1.1300	1.0200 ~ 1.1200	1.0100 ~ 1.1100	1.0000 ~ 1.1000	1.0100 ~ 1.1100	1.0100 ~ 1.1100	0.9536 ~ 1.1495	1.0200 ~ 1.1400	1.0000 ~ 1.1100
	End of quarter	1.0705	1.0839	1.0800	1.0700	1.0600	1.0500	1.0500	1.0600	1.0600	1.0705	1.0600	1.0600
EUR/JPY	Range	138.81 ~ 148.40	124.40 ~ 149.00	137.00 ~ 153.00	136.00 ~ 150.00	132.00 ~ 146.00	128.00 ~ 142.00	126.00 ~ 140.00	124.00 ~ 138.00	124.00 ~ 138.00	124.40 ~ 150.00	132.00 ~ 153.00	124.00 ~ 142.00
	End of quarter	140.41	144.01	143.64	142.31	137.80	134.40	132.30	130.38	130.38	140.41	137.80	130.38
Crude Oil Prices (WTI)		82.64	75.99	82.50	87.00	91.00	91.00	82.00	83.00	85.50	98.74	84.12	85.38

※ Crude oil prices are averages for each period. Source: SMBC.

This presentation is for discussion purposes only and is not intended to be an offer to sell or the solicitation of an offer to buy any securities, or any commitment to underwrite, subscribe for or place any securities, is not an offer or commitment to provide any financing or extension of credit or service, and does not contain any tax or legal advice. This presentation has been prepared by SMBC Group (which may include, collectively or individually, any of the following entities in the Americas Division: Sumitomo Mitsui Banking Corporation (“SMBC”), SMBC Nikko Securities America, Inc. (“SMBC Nikko”), SMBC Nikko Securities Canada, Ltd. (“Nikko Canada”), SMBC Capital Markets, Inc. (“SMBC-CM”), SMBC Leasing and Finance, Inc., JRI America, Inc., and SMBC Rail Services LLC) and is being furnished by SMBC Group solely for use by the client or potential client to whom such materials are directly addressed and delivered. This presentation is confidential, and is the property of SMBC Group subject to copyright. Any reproduction of this presentation, in whole or in part, is prohibited, and you may not release these materials to any person, except to your advisors and professionals to assist you in evaluating these materials, provided that they are obligated, by law or agreement, to keep the presentation confidential. These materials do not constitute research, a recommendation or an offer or solicitation to any person to enter into any transaction or adopt any hedging, trading or investment strategy. Prior to participating in any such transaction, you should consult your own independent, competent, legal, tax, accounting and other professional advisors.

In preparing this presentation, SMBC Group has relied upon information available from third parties, including public sources, and we have assumed, without independent verification, the accuracy and completeness of such information. Specific prices, indices or measures, including ranges, listed in this document were prepared at the time the document was prepared, and are subject to change without notice. SMBC Group makes no representations to and does not warrant this presentation’s accuracy or completeness. SMBC Group expressly disclaims any liability for any use of the information set forth herein, including, without limitation, any use of the information set forth herein in the preparation of financial statements or accounting material.

These materials may contain forward looking statements, which may include projections, forecasts, income estimates, yield or return, future performance targets or similar analysis. These forward-looking statements are based upon certain assumptions. All forward-looking statements are based upon currently available information and SMBC Group is not obligated to provide an update. Actual events may differ from those assumptions. Opinions, projections, price/yield information and estimates are subject to change without notice. There can be no assurance that estimated returns or projections will be realized, that forward-looking statements will materialize or that actual results will not be materially lower than those presented. Past performance is not necessarily indicative of future results. Any transactions or strategies addressed may not be suitable for all parties. The value, price or income from transactions or strategies may fall as well as rise. SMBC Group or an affiliate may have a position in any of the underlying instruments, assets, indices or rates mentioned in this document. You should make your own independent judgment or seek independent financial and tax advice with respect to any matter contained herein.

SMBC is subject to Japanese firewall regulations and therefore absent client consent, non-public client information may not be shared with SMBC Nikko Securities Inc.

SMBC Nikko is a U.S. registered broker-dealer of SMBC Group. Nikko Canada is a U.S. and Canadian registered broker-dealer of SMBC Group. SMBC-CM is provisionally registered as a U.S. swap dealer with the CFTC. Capital markets and other investment banking activities for SMBC Group are performed by a combination of SMBC Nikko, Nikko Canada, SMBC Nikko Securities Inc. and SMBC-CM. Lending and other commercial banking activities are performed by SMBC and its banking affiliates. Derivative activities may be performed by SMBC-CM or SMBC. SMBC Group deal team members may also be employees of any of the foregoing entities. SMBC Group does not provide tax advice. Accordingly, any discussion of U.S. tax matters contained herein (including any attachments) is not intended or written to be used, and cannot be used, in connection with the promotion, marketing or recommendation by anyone unaffiliated with SMBC Group or for the purpose of avoiding U.S. tax-related penalties. © 2023 SMBC Group. All rights reserved.