High Frequency Economics®
Daily Data Analysis and Assessment of the Global Economy

Daily Notes on the **Global Economy**

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Japan Woes

It makes us angry to read the minutes of the BoJ's April Board meeting and see that the people entrusted with managing the economy are either completely oblivious to the consequences of a shrinking population or do not understand them. BoJ Board members seem to believe that monetary policy can fix what is wrong with Japan—certainly Governor Kuroda holds this view. QE is working, he said earlier this week, and the BoJ can sustain it as long as it takes to achieve the 2% inflation target, even though that remains a distant goal.

The BoJ Board upgraded its assessment of the economy at its April meeting, according to the minutes published on Wednesday: "With regard to economic activity, members shared the recognition that, with the virtuous cycle led by exports and production becoming firmer, labor market conditions had been tightening steadily and the output gap—which showed the level of economic activity—had started to take hold in positive territory. On this basis, they agreed to revise the Bank's economic assessment upward to one stating that Japan's economy 'has been turning toward a moderate expansion' from the previous one stating that the economy 'has continued its moderate recovery trend.'"

Oh, come on!

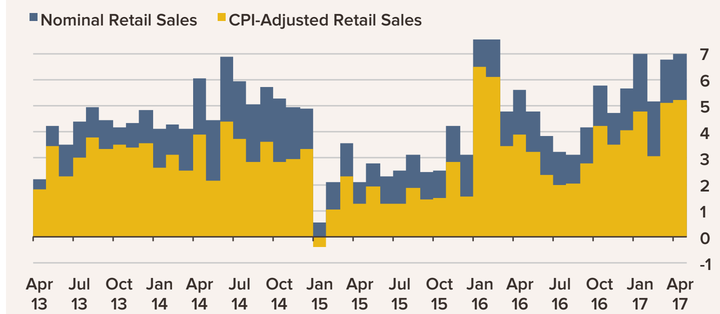
Unless QE and negative short-term interest rates can somehow create a new generation of people in Japan, sustained growth is impossible. Sure, workers' productivity can be boosted by technology, but why produce more stuff with fewer workers if there are fewer consumers to buy things? Members of the baby boomer generation, having started retiring 15 years ago, are now starting to die. People always consume less after they die!

Monetary policy cannot offset the decline in demand as the population shrinks. In this stage of the process, demand will unambiguously fall faster than supply in any and all monetary conditions. Thus, downward pressure on prices will persist no matter how long the BoJ can keep up its asset purchases, negative interest rates, yield curve twisting or whatever other cleverness it cooks up.

Of course, baby boomers are dissaving to finance their retirement. So far, BoJ asset purchases have prevented this cashout from causing major disruption in the bond and stock markets. However, the BoJ can only monetize the liabilities of the government to the economy for as long as it can find bonds to buy. It already owns 40% of the JGB market. While baby boomers are a big cohort, they are not the entire market for bonds: Some supply of assets at a positive yield has to be left for legitimate financial intermediaries to be able to service their long-term liabilities. After the plunge in interest rates in recent years, these intermediaries—with durations of liabilities set out to 40 years by actuaries, while assets are mainly 10-year bonds—have become insolvent. This is a problem for the second stage of this crisis, possibly involving the financial failure of the BoJ itself, but surely leading to institutional breakdown amongst the intermediaries.

One way out of this mess would be for Japan to become, once again, a nation powered by export growth. *Foreign demand could replace domestic demand and make everything right again.* Sadly, the direction of trade is moving against Japan. While it is still a mighty exporting nation, Japan is losing ground to mightier China and to other low-labor-cost economies around Asia. *We predict that the thrust of trade growth for Asia will be along China's Silk Road, whose routes stretch across all of Asia and East Africa, through the Middle East to Europe.* We discussed this in our webinar the other day. You are welcome to watch a replay by clicking here. ***Japan is not on China's Silk Road.*** Japan remains bound to the U.S. trade sphere by its dependence on the United States for its own defense. The U.S. sphere offers Japan sales into the replacement market for manufactured goods in a relatively small part of the world, and Japan's share of that market is shrinking.

Canada: Retail Sales, Percent Change Year Ago



Next week will bring a barrage of economic reports from Japan—10 major releases altogether: Retail sales, industrial production, household spending, consumer and producer prices, employment, construction activity, housing starts and vehicle production... *phew!* ***We cannot imagine anything coming up in this next round of data that will change our thinking about the prospects for economic malaise and persistent deflation as Japan depopulates.*** *Sure, any given indicator can go up or down in any given month.* However, Japan faces long-term secular adversity, and nothing is set to change that: Trends will continue to point to the southeastern corner of every chart.

Some people will point to a 2.8% unemployment rate and argue that the labor market is so tight that wages have to rise. *We are sorry to say that the unemployment rate is an irrelevant measure of labor*

Yields On 10-Year Government Bonds @ 22:00 GMT

	Coupon	Maturity	Yield (%)	Prev (%)	Chge (bps)	Δ vs U.S.	Prev Δ vs U.S.
United States	2.375%	5/27	2.146	2.158	-1		
Japan	0.100%	6/27	0.051	0.054	-0	-210	-210
Germany	0.250%	2/27	0.250	0.264	-1	-190	-189
United Kingdom	4.250%	12/27	1.014	1.031	-2	-113	-113
France	1.000%	5/27	0.598	0.601	-0	-155	-156
Canada	1.000%	6/27	1.497	1.486	+1	-65	-67
Australia	4.750%	4/27	2.376	2.392	-2	+23	+23

Note: All yields converted to a comparable semi-annual basis. Data collected 22:00 GMT daily, from market sources believed to be reliable by High Frequency Economics. These data are market indications only, not quotes.

market tightness in an economy that is depopulating. There are roughly 66 million workers in Japan's economy today, compared to 67 million at the end of the last economic expansion in 2007 and 68 million at the turn of the century. If the economy is shedding labor—because demand for output is falling faster than supply as the population shrinks—no one is asking for a raise. *The Phillips curve model of the labor market only works when an economy is growing.*

Why would investors want to commit money to long-term positions in companies selling into an economy that is shrinking, depopulating and deflating? Most companies—other than exporters that have a way to sell into Asia's modernization trends—are not going to do very well, unless they are engaged in care for the aging. In contrast, the Silk Road initiative will open the way for China to export directly to 2-1/2 billion more customers than it can reach by today's sea routes. *Doesn't that seem like a better growth proposition than investing in rusty old Japan?*

We think the long-term prospects for the yen are adverse. We think the Nikkei is at risk of a secular decline. We worry about the market value of bonds, as we do not agree that the BoJ can support the market much further. However, we see institutional risks if it stops.

Euro Zone

The ECB published its latest ***Economic Bulletin*** in its entirety yesterday. The main articles were published on Wednesday. There were no surprises lurking in the rest of the document, which included a reprint of President Draghi's statement after last week's Governing Council meeting. *Yawn!*

The EC yesterday reported its flash estimate of an improvement in the **index of consumer confidence** for June, to minus 1.3 from minus 3.3 in May. So far, we have yet to see this year's surge in consumer confidence reflected in a surge of retail sales or other consumer spending. *Maybe this is because you cannot spend confidence, and wages and incomes are falling.* In any case, those who want to see positive trends in the Zonal economic data will like this report.

At the time of this writing, a rather agitated group of EU leaders is convening for a two-day Summit in Brussels. Concerns are being expressed widely that Britain's political uncertainty leaves its leaders with no clearly defined positions on matters related to Brexit. At a dinner meeting, Britain's Prime Minister May reportedly outlined to the Summit a proposal to allow EU nationals currently residing in Britain to remain after Brexit. Unclear and yet unspecified by the EU are its plans for the treatment of Britain's citizens in the EU. If this Summit is a test of how the whole conversation about Brexit will go, we can say it is not going very well. EU President Juncker expressed his now-unbridled dissatisfaction with Britain's posturing on key issues. "I still have dreams," he told reporters, "but I am at the same time a realist." Prime Minister May is caught between what hardline Brexiters will accept from these talks and what the Europeans will insist upon. After her presentation, Prime Minister May left the dinner meeting, and the other 27 leaders stayed for a brief update on Brexit talks by Chief Negotiator Michel Barnier. They also discussed, and hopefully endorsed, procedures for the relocation of the U.K.-based EU agencies. The European Banking Authority has brand new offices in London that are soon to become vacant, we are sure. The Summit will continue today.

Today's only economic data will be Markit's flash PMIs for June. As regular readers know, we recognize that markets react to these figures, although we put no stock in their signal for the economy. We do not try to predict where they are headed because we do not have enough historical data to build statistically trustworthy correlations. Next week, the ECB will be hosting its annual Forum on Central Banking in Sintra, Portugal. The main events are on Tuesday and Wednesday; BoC Governor Poloz, BoJ Governor Kuroda, BoE Governor Carney and ECB President Draghi will appear together on a panel at 14:30 CEST on Wednesday. In addition to the regular seven-day repo operation on Monday and Tuesday next week, the ECB will offer three-month repos on Tuesday, announcing the results on Wednesday. The first economic report next week will come on Wednesday, covering money supply and credit growth for May. Thursday, the EC will release its suite of confidence indexes for June, including an update to the flash consumer confidence estimate published yesterday. Friday, we will see the flash CPI estimate for June from EuroStat.

A Quick Look At Upcoming Events

	Friday	Monday
Japan	Nothing	Services PPI (5) LEI (4r)
Australia	Nothing	Nothing
Euro Zone	Markit PMIs (6p)	Call For Repo Tenders
Germany	Markit PMIs (6p)	**IFO Survey (6)**
France	GDP (Q1r) Markit PMIs (6p)	Job Seekers (5)
United Kingdom	Nothing	BBA Mortgages (5)
Canada	**CPI (5)**	Nothing
United States	Markit PMIs (6p) **New Home Sales (5)**	Dallas Fed Survey (6) **Durable Goods (5)**
China	Nothing	Nothing

Underscore=Already released *Italics*=Estimated release date
CCI/BCI=Consumer/Business Confidence HPI=House Price Index

Further Down The Road...

July 4	Australia—RBA Board Meeting
July 7 - 8	G-20 Summit in Hamburg
July 12	Canada—BoC Governing Council Decision
July 20	Euro Zone—ECB Governing Council Decision
July 20	Japan—BoJ Board Decision
July 26	United States—FOMC Decision
August 3	United Kingdom—MPC Decision
August 24 - 26	Jackson Hole Economic Symposium
October 13 - 15	IMF Annual Meetings in Washington

Germany

There were no economic reports yesterday.

Today, Markit's flash PMIs for June will be the only economic data. Sometime next week, we will see May reports on retail sales and import prices from FSO. Monday, the IFO survey results for June are due. Thursday, the largest states will release flash CPI estimates for June, followed immediately by an estimate of the national index from FSO. Also Thursday, GfK will publish its consumer confidence index for July. Friday, the June employment report is due.

Japan

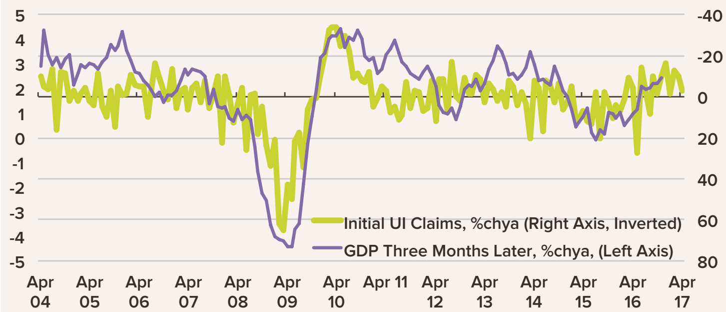
No economic reports were published yesterday.

The calendar for today is empty. Monday, the BoJ will publish the services PPI for May, and the Cabinet Office will release a revised estimate of the LEI for April. No major economic releases are due Tuesday or Wednesday. BoJ Governor Kuroda will appear on the policy panel at the ECB Forum on Central Banking on Wednesday. Thursday, the retail sales report for May is due. Friday is the monthly data dump: We will see flash estimates of the Tokyo-area CPI for June, along with May reports on employment, household spending, industrial production, vehicle production, housing starts and construction orders.

United Kingdom

CBI's index of industrial orders improved to 16 in June from nine

Canada: Initial Unemployment Insurance Claims Vs GDP



in May. This is a diffusion index, and positive levels are supposed to signal industrial expansion. This is the highest level of this index since August 1988. A rise in export orders explains some of the strength. Inventories of finished goods have been falling briskly since the start of this year, according to the same survey. *With consumer demand falling, we had better hope that exports keep up the pace or else stockpiles will rise quickly, and that could trigger production cutbacks later this year.* Yesterday, though, this was good news for British companies.

No economic releases are due today. There will surely be more fallout in the press from Prime Minister May's dinner engagement in Brussels last night. Monday, BBA will publish its report on mortgage lending for May. Tuesday, we will see CBI's retail survey results for June. Wednesday, BoE Governor Carney will appear on a policy panel with four other central bank governors at the ECB's Forum on Central Banking. Thursday, the BoE will publish May data on money supply and credit growth, including its own figures on mortgage lending. Friday, NatStats will publish another round of GDP estimates for Q1, including our first look at the current account balance. *With oil prices down and Brexit uncertainties looming, a bad number for the current account could send sterling tumbling. Watch out!* Also Friday, GfK will publish its consumer confidence index for June. Before the week is through, we should see Nationwide's house price index for June.

France

INSEE reported yesterday that its **index of manufacturing confidence** fell to 108 in June from 109 in May. Manufacturers say production is down and inventories are up. The index of **overall business confidence improved**, however, to 106 from 105. Another **index of retailing sector confidence** improved. *We expected business approval of the Macron presidency to be reflected in an uptick in this index.* Then again, the steady improvement of this index over the last five years has not been reflected in economic performance. *So why should we hope to be able to correlate this index with political developments or anything else?* Markets ignored this report because, like us, they cannot make any sense out of it.

Today, INSEE will publish revised estimates of GDP for the first quarter. The preliminary report said GDP increased 0.4% in the first quarter after a 0.5% gain in Q4, and the year-over-year rate of growth dipped to 1.0% from 1.2% in Q4. *No particular revision can be predicted.* Also today, we will see flash estimates of Markit's PMIs for June. *Yawn.* Monday, INSEE will release May data on job seekers. Wednesday, we will see INSEE's consumer confidence index for June. Friday, look for flash CPI estimates for June, along with May data on household spending and producer prices.

Australia

We did not see any economic reports yesterday, and none are due today... or next Monday, Tuesday, Wednesday or Thursday. Friday, the RBA will will report domestic credit growth aggregates for May.

Canada

StatCan yesterday reported that seasonally adjusted **retail sales** were up 0.8% in April. The March figures were revised down to show only a 0.5% increase on the month instead of 0.7%, as initially reported. These results leave sales 7.0% higher than a year ago in April after a 6.8% pace in March. *These are huge increases!* Even adjusting for CPI increases, sales volumes were still up 5.2% year-over-year in April after 5.1% in March. *We may now ponder how growth of retail sales at this pace will be maintained.* Next week's report should show real wages are still falling. Employment growth was only 1.5% as of April, and we expect an uptick to just 1.8% for May. *If the funding for this surge in spending is not coming from income, then people are dis-saving, and that almost surely means credit growth is supporting the retail boom. So the expansion may not be sustainable.* Piling more debt onto already high household debt ratios—the highest in the G-7—leaves that sector vulnerable to dislocations should borrowing costs ever go up. *This is the stuff the BoC worries about. We simply point out that the retail expansion is not on solid ground.*

Also reported yesterday, there were 142,480 **initial claims for unemployment insurance** in April, 3.2% fewer than a year ago. That is a less zippy decline than we have seen recently: The drop over the five most recent months averaged 10.1%. However, down is down, and a dip signals an improving economy, as we have come to learn. *This is a good report, if not quite as strong as the manufacturing survey and other data. A single report of a lesser decline in jobless claims does not challenge the hypothesis that the broad direction of the economy is improving.*

Today, StatCan will release CPI estimates for May. No economic releases are scheduled for Monday, Tuesday or Wednesday next week, but on Wednesday, BoC Governor Poloz will appear on the policy panel at the ECB Forum on Central Banking. Thursday, StatCan will release April data on average earnings. Friday will bring monthly GDP estimates for April as well as May data on industrial product and raw materials prices. Also Friday, the BoC will publish its quarterly Business Outlook Survey and Senior Loan Officer Survey.

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