

Navigator

Now, next and how for business

Japan report



Japan

Positive outlook for trade, thanks to favourable global and domestic conditions

Japan is playing a key role in the global trade recovery. Demand for capital goods around the world as business step up investment benefits Japan's core strengths in machinery and manufacturing sectors, while a solid domestic economy will boost imports in the medium to long run. Service exports, while still trailing goods, are nevertheless growing thanks to strong performance in B2B services and a boom in tourism. Eyes are on the implementation of CPTPP for future growth momentum.

Short-Term Snapshot

The Japanese economy is at a key juncture. After years of deflation, offshoring and unsteady growth, Japan has recently enjoyed a good period of stronger expansion. Key to this have been better international economic conditions, and also robust domestic demand and investment, aided by fiscal and monetary stimulus. Exports have expanded at a solid pace, benefitting particularly the machinery and manufacturing sectors. Machinery and manufacturing have also been key drivers of domestic investment and imports, as construction gets underway for the 2020 Tokyo Olympic Games. Household spending improved markedly in late 2017, again boosting imports. Meanwhile, although services have performed a little less impressively than goods in the past year or so, relaxed visa conditions have boosted the tourism sector in particular, with visitors to Japan up 23% in the year to December 2017.

Japanese exports are benefitting from favourable global economic conditions; imports are expanding thanks to solid domestic growth.

Looking forward, with the Bank of Japan's business survey "Tankan" at multi-year heights thanks to strong corporate profits, we expect business investment to play an important role going forward, increasing supply potential for exports and relying partly on imported capital goods and raw materials. Finally, exports and imports should also benefit from the stability of the yen, which has remained largely flat throughout 2017. We expect the Japanese currency to continue moving within the 105-108 yen/dollar band within 2018, which should help support confidence in longer-term planning domestically and abroad – this is clearly positive for trade.

Action points for business

- ◆ Firms should ensure that opportunities to showcase technology and expertise ahead of the 2020 Olympic Games are maximised, helping further cement Japan's reputation in these spheres to a global audience.
 - ◆ Firms should also ensure the current favourable economic climate does not induce complacency, either on their part or government's. Continued technological innovation is crucial given Japan's declining workforce.
-

Trade Policy Developments

Japan has a seat at the table of all major trade initiatives being discussed in Asia. Eyes are on the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the ambitious trade agreement spanning Japan and ten other advanced and emerging economies bordering the Pacific. The improved protection for technology and intellectual property could see Japanese firms increasing investment and services trade within the region. Japan also recently concluded the EU-Japan Economic Partnership Agreement, which could enter into force as early as 2019. Policy measures included in both agreements, like the deregulation of services and the opening of long-protected domestic industries like agriculture, are likely to provide some upside in the medium to long run. Increased competition and FDI should positively affect domestic productivity enhancements, an item high on the Japanese government's agenda. Another possible upside is Tokyo Governor Koike's plan to turn Tokyo into an international financial centre, which may provide further positive momentum for services trade.

Action points for business

- ◆ As one of Asia's leading economies, Japan has a key role in maintaining the positive momentum behind trade policy that distinguishes the region from others. Continued support from firms is key in this respect.
 - ◆ Japanese firms should ensure intellectual property is safeguarded in trade negotiations. If so, further trade liberalisation offers major new opportunities, while protecting firms' investments.
-



Long-Term Outlook for Trade

Japan's economy continues to lead the world in several advanced sectors, particularly machinery and manufacturing. Japan is already deeply integrated into cross-border supply chains within the region, playing a crucial role in design, R&D, and final processing of goods produced within its geographical backyard. Implementation of trade agreements like the CPTPP would reinforce the integration of Asian supply chains and provide additional positive momentum for service exports while goods exports will continue to be a major engine of growth in the medium term.

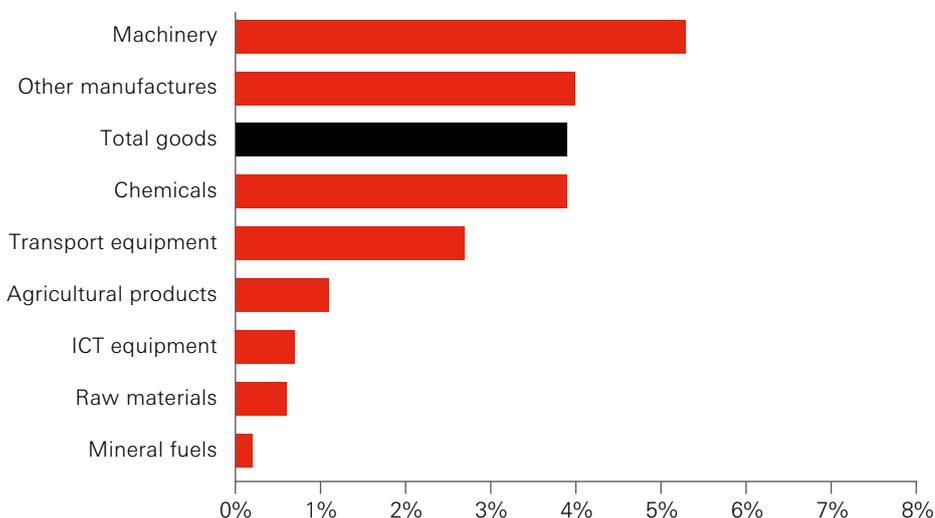
The fortunes of Japan's service exports depend on the success of enhancing productivity in those areas where the country lags its key competitors. We expect B2B and other services to lead Japanese service exports at a growth rate of just above 5% annually until 2030, but this still falls short of the almost 10% annual increase we expect for China, underlining the intensifying competition between the two countries. The contrast is even starker on the goods side, where we expect Japanese exports of ICT equipment to expand by less than 1% annually until 2030, compared to an annual increase of 8.1% of Chinese exports within this crucial sector.

Machinery and manufactured goods will remain sectoral strengths

Japan has a world-class goods export sector, with a variety of advanced industries that are leaders in their respective fields. Core strengths of the Japanese economy are machinery and manufactured exports, which are likely to remain key drivers of export growth over the medium term. Particularly industrial machinery, electrical machinery, and robotics will contribute positively to Japanese export growth, and we expect an increasing share of these exports to target Asian markets as they move up the value chain. Chemicals will also contribute majorly to Japanese export growth until 2030, as Japanese companies continue to maintain leadership in several niche areas. For example, Japanese companies account for most of the global production of lithium-ion battery components.

Transport equipment is another important area, as the Japanese government is actively marketing Japanese high-speed rail to Asian and emerging markets, as they invest in infrastructure upgrades. Japan continues to be a major exporter of passenger cars, a sector which will benefit massively from rising populations and increased income per head in Asian markets. Lower value-added goods sectors such as ICT equipment will underperform relative to other exports though, reflecting competitive pressure from other Asian economies.

Exports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Action points for business

- ◆ Tapping into rising household incomes across Asia will be the next wave of opportunity for Japanese firms. Ensuring Japanese brands retain their reputation for world-leading technology will be crucial in this respect.
- ◆ Supply chains will continue to unbundle and specialise across Asia. Firms can make savings by outsourcing, and at the same time also pursue revenues by exporting key capital goods and supporting services.
- ◆ Firms should ensure that the government provides the right support to open up opportunities in infrastructure-heavy regional initiatives, such as Belt & Road.

China is forecast to become the largest export market for Japan by 2030.

Top 5 Hotlist destinations of goods exports

Rank	2016	2030
1	USA	China
2	China	USA
3	Korea	Korea
4	HK	HK
5	Singapore	Vietnam

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

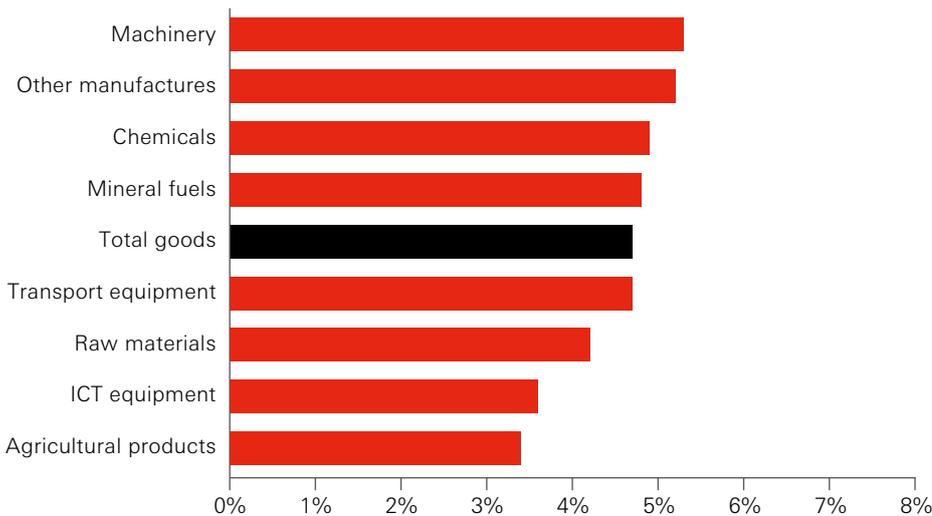
While we expect the United States to remain a major export market for Japan, Asian economies are likely to become more important destinations for Japanese exports over the medium run going forward. Thanks to faster long-term GDP growth we expect China to displace the US as Japan’s largest export market by 2030, while Korea and Hong Kong will remain in third and fourth place, respectively. Strong growth in demand from Vietnam (particularly for capital goods to support industrial upgrading) should see it become the fifth largest export market, displacing Singapore.

Solid domestic growth in Japan will be a boon for import growth.

Solid demand and constrained domestic supply will drive imports higher

We expect Japanese import growth to be concentrated in those product categories that feed into Japanese supply chains, such as manufactured goods, machinery, or chemicals. Japanese companies have over the past decades expanded strongly into Asia, so many Japanese corporations maintain supply chains within the region. Japan will also continue importing raw materials, such as mineral fuels, and food products, given the lack of domestic resources and agricultural capacity. The recent streak of positive growth in Japan has added further positive momentum for imports. We expect this positive momentum to continue which will turn Japan into a more important destination of trade in the near to medium term. Particularly imports from Asia have grown rapidly over the past two decades and recent policy developments suggest room for further growth.

Imports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Top 5 Hotlist origins of goods imports

Rank	2016	2030
1	China	China
2	USA	USA
3	Saudi Arabia	Vietnam
4	Korea	Saudi Arabia
5	Germany	Korea

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

Japan’s largest import supplier is China, followed by the United States. We do not expect this to change in the years up to 2030. Like exports, however, we expect Japan’s import base overall to shift towards Asia. Vietnam will become an important import partner for Japan, rising to third place and overtaking Saudi Arabia and Korea. The composition of Japan’s imports will continue to reflect the country’s demand for key commodities, such as fuels and agricultural products, and the integration of its industry into international supply chains. Japan’s domestic manufacturing is deeply integrated with production centres in its Asian and international trading partners. As Asian economies climb up the value chain, a larger part of Japanese imports will be supplied from within the region. Integration into these supply chain networks should be a top priority for businesses seeking to strategically benefit from this shift.

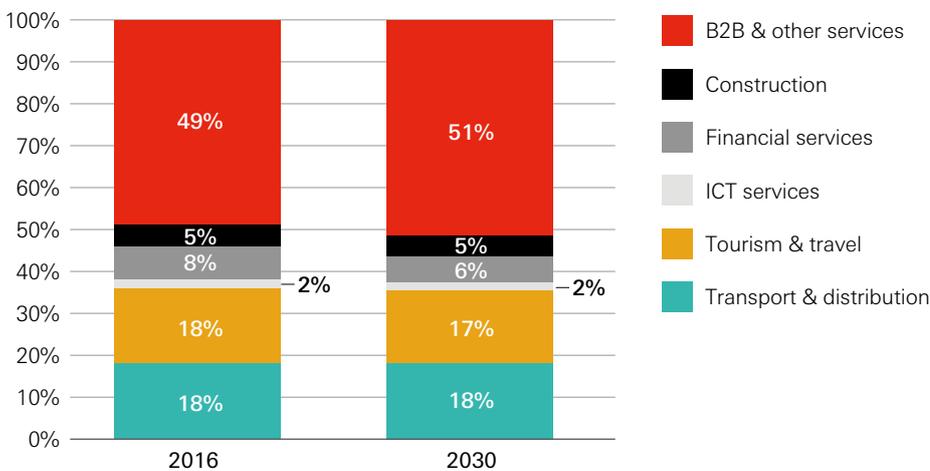
Tourism driving service exports in the short run, B2B and transportation taking over after the Olympics

Our projections indicate that the value of Japanese service exports will increase by almost 5% annually between 2017 and 2030, about 1% ahead of goods export growth over the same period. Japanese services exports are dominated by B2B and other services, which includes legal and consulting services, or charges for the use of intellectual property (licensing fees and brand names). We expect B2B and other services to grow just above average, which will lead their share to increase to 51% of overall Japanese service exports by 2030. B2B and other services are particularly important within service exports to the US, where they outstrip all other types of service exports. We see potential for this sector to continue growing in the long term, as R&D and technology are primary areas of future growth.

In the near term, tourism will be a major source of revenues, as we expect visitor numbers to rise in the run-up to the 2020 Tokyo Olympic Games. Especially Asian countries are contributing to this growth, led by China. While we expect growth in tourism to flatten off over time, efforts to deregulate gambling services may provide further upside for tourism beyond 2020. We also believe that other sources of growth will assert themselves in the decade to 2030. Aside from B2B and other services, we see transport and distribution-related services growing above average, reflecting the strength of Japanese industry in this area and current efforts to promote the export of Japanese high-speed rail technology to Asian and emerging markets. Transport and distribution-related services play a particularly strong role in service exports to Asia’s mid and high-income economies, including China, Hong Kong, Korea, and Singapore, but also the US.

Tourism is forecast to make up a major part of Japanese service exports in the run-up to the 2020 Tokyo Olympics.

Sectoral shares in total services exports



Source: Oxford Economics

Top 5 Hotlist destinations of services exports

Rank	2016	2030
1	USA	USA
2	China	China
3	Singapore	Singapore
4	Korea	Korea
5	Hong Kong	Hong Kong

Note: Ranking among the 23 trade partners covered in the forecast

Source: Oxford Economics

The main destination for Japanese service exports are the United States, followed by China, Singapore, Korea and Hong Kong. We expect this ranking to remain unchanged, although the relative importance of each export destination will change. As global trade in goods shifts toward Asia, so will trade in services. We expect Asian countries to claim the top three spots with the fastest growth for Japanese service exports in the final decade before 2030, led by India (10%), China (9%), and Indonesia (9%). Recent policy developments, such as CPTPP, are also likely to improve the environment for trade in services within the region. In line with this shift, we also see service exports to Malaysia and Vietnam (two of the signatories of CPTPP) picking up to reach 7% annually in 2021-30.

About the HSBC Navigator

The HSBC Navigator presents a blend of survey evidence, policy analysis, and economic modelling to generate unique and timely insights into the changing landscape for global trade.

The business survey is a quantitative indicator of the short-term outlook for global trade. The survey, which is the largest of its kind, is conducted on behalf of HSBC by Kantar TNS. It is compiled from responses by decision-makers at over 6,000 businesses – from small and mid-market to large corporations – across a broad range of industry sectors in 26 markets. Interviewees were polled on a range of questions including expectations around future growth in trade, trade finance needs, attitudes toward trade policy developments and strategic business plans.

The survey represents a timely source of information on the fast-evolving trade environment. And it can provide a useful contextual setting for interpreting developments in official data. In this way, economists at Oxford Economics are able to blend insights from the survey with their own analysis and modelling of developments in trade.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods and services, in part based on HSBC's own analysis and forecasts of the world economy. A top-down approach is employed, with Oxford Economics' suite of models used to ensure consistency between HSBC's forecasts for economic growth and exchange rates in key countries and the more granular projections for bilateral trade flows presented here.

Oxford Economics employs a global modelling framework, with headline bilateral trade forecasts constructed as a function of demand in the destination market and the exporter's competitiveness (as measured by unit labour costs in nominal USD terms). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2017-20 and 2021-30.

These headline bilateral trade forecasts for goods and services are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends and taking into account the historic relationship between output and exports in each sector, by market:

- ◆ For trade in goods, sectors are classified according to the UN's Standard International Trade Classifications (SITC) system at the two-digit level and grouped into 30 sector headings.
- ◆ For trade in services, we identify five broad sectors: B2B and other services, tourism & travel, transport & distribution, financial services, ICT services and construction.

Drawing on the Kantar TNS survey results and Oxford Economics' long-term forecasts, Oxford Economics produces in consultation with HSBC a global report and specific reports on the following 23 markets: Argentina, Australia, Bangladesh, Canada, China, Egypt, France, Germany, Hong Kong, India, Indonesia, Ireland, Japan, Malaysia, Mexico, Poland, Saudi Arabia, Singapore, Turkey, UAE, UK, USA and Vietnam. The analysis of trade in goods also includes trade with Brazil and Korea for a total sample of 25 key trading markets; for trade in services the analysis also includes Korea for a total sample of 24 key trading markets.

For media enquires please contact:
Natasha Plowman
HSBC Global Communications
Natasha.Plowman@hsbc.com

Or go to www.business.hsbc.com/trade-navigator

All images copyright © HSBC Holdings plc. All reasonable efforts have been made to obtain copyright permissions where required. Any omissions and errors of attribution are unintentional and will, if notified in writing to the publisher, be corrected in future printings.

Photo Credits

Page 1: Shigemi Okano, Shutterstock.com

Page 3: Nicole Yau, HSBC Hong Kong, #HSBCphotographer

Note: Whilst every effort has been made in the preparation of this report to ensure accuracy of the statistical and other content, the publishers and data suppliers cannot accept liability in respect of errors or omissions or for any losses or consequential losses arising from such errors or omissions. The information provided in this report is not intended as investment advice and investors should seek professional advice before making any investment decisions.

Issued by HSBC Bank plc
8 Canada Square
London E14 5HQ
United Kingdom

www.hsbc.com

