Master of ceremony

Prime Minister Abe's summit with President Trump has certainly played well at home. Seventy-two percent of those polled were satisfied with the outcome of the talks, while Abe's Cabinet support rating ticked up to 61.7% versus 59.6 a month earlier. **If Abe's diplomatic skills have served him well, his economic management is more questionable**. The government's inflation, growth and budget targets are all hopelessly distant, reflecting the weak domestic demand response to current policy settings (see Chart 8). This was again evident in the latest GDP print, where domestic demand contributed nothing to the 1.0% quarter-on-quarter (q/q) annualised increase in activity, following a negative contribution in Q3. That Japan grew at all in the second half of the year was largely a reflection of overseas demand. Exports rose 11.0% q/q annualised in the quarter, following a 8.5% q/q annualised increase in Q3. Given this background, one may excuse Abe's pursuit of overseas suitors at the expense of his crumbling domestic policy programme.

Despite the overall subdued domestic environment, private sector investment did tick up in the final quarter of 2016, with plant and equipment investment up 0.9% q/q. The capex reading is consistent with the recent improvement in PMIs and industrial activity data (see Chart 9). However, it conflicted with the December Tankan survey which had pointed to downbeat capex plans. The mixed messages reflect the continued pessimism on domestic capex opportunities, which are largely defensive in nature – i.e. labour and energy saving investment, versus a renewed optimism on global demand. Looking at Japan's trade statistics for the October-December period, it is clear that not only has the pick-up in overseas demand been geographically diverse, spanning the US, Europe and Asia, but it has also extended across sectors, with US demand for autos and Asian demand for electrical machinery particularly supportive. **Stronger-than-expected overseas demand should fuel investment trends given the recent correction in inventories, but uncertainties about political risk are likely to hold back Japanese corporates from a more emphatic capex response**. Of course, we will again be watching for an improvement in corporate growth expectations when the Cabinet Office publishes its Annual Survey of Corporate Behaviour in the coming weeks to signal a more persistent recovery.

An improvement in overseas demand dynamics has also lifted optimism for corporate investment elsewhere in developed Asia. The Asian tech cycle has been an important driver as consumer durable spending in the US got back on track in 2016. However, with the developed market consumer set for a real income squeeze, is the tech cycle set to turn? A closer look at the aggregate regional data suggests that US corporate capex demand trumps even the US tech consumer as a driver for Asian electronics exports. **By country, though, the impact is more ambiguous, with Korea and Taiwan more leveraged to consumer demand, while Singapore and other ASEAN exporters more closely tied to the corporate cycle**. While we are seeing encouraging signs that equipment and facilities investment is accelerating in the US, it would be unwise to count these chickens too early given US capex trends have proven less reliable in recent years.

Chart 8: Domestic no longer leading

Source: Cabinet Office, Haver (as of Q4 2016)

Chart 9: Global cycle dominates

Source: Markit, Haver (as of December 2016)