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Apr-Jun 2014 1st Preliminary GDP Estimate

Major negative growth due to reactionary decline in consumption

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Summary

- The real GDP growth rate for Apr-Jun 2014 (1^{st} preliminary est) declined by -6.8% q/q annualized (-1.7% q/q), recording negative growth for the first time in two quarters. Performance was in line with market consensus (-7.0% q/q annualized and - 1.8% q/q). The primary reason for the major decline in real GDP was the reactionary decline in personal consumption following the raising of the consumption tax in April.

- The decline in personal consumption was expected, but the extent of the decline (-5.0% q/q) came as a surprise, bringing a somewhat negative tone to the results. On the other hand, contribution of inventory investment rose considerably in comparison to the previous period by +1.0%pt, bringing the overall GDP figures back in line with previous expectations. Regarding the huge increase in inventory investment, this is considered to be partly an attempt to recover inventory levels after the temporary decline experienced as a result of last minute demand prior to the April tax hike, though the decline in domestic demand cannot be ignored as another major cause, hence this is not necessarily a positive element.

- As for the outlook for the Japanese economy, the period of Jul-Sep 2014 is expected to see a comeback in GDP, with a continuation of economic expansion foreseen. A great deal of attention will be drawn to the announcement of Jul-Sep 2014 period GDP figures to be announced in mid-November. This is because of the great weight they are expected to carry in determining whether or not to increase the consumption tax yet again (next hike planned in October 2015). Chances are good that GDP figures will return to positive growth during the Jul-Sep period.

First negative growth in two quarters due to reactionary decline in consumption

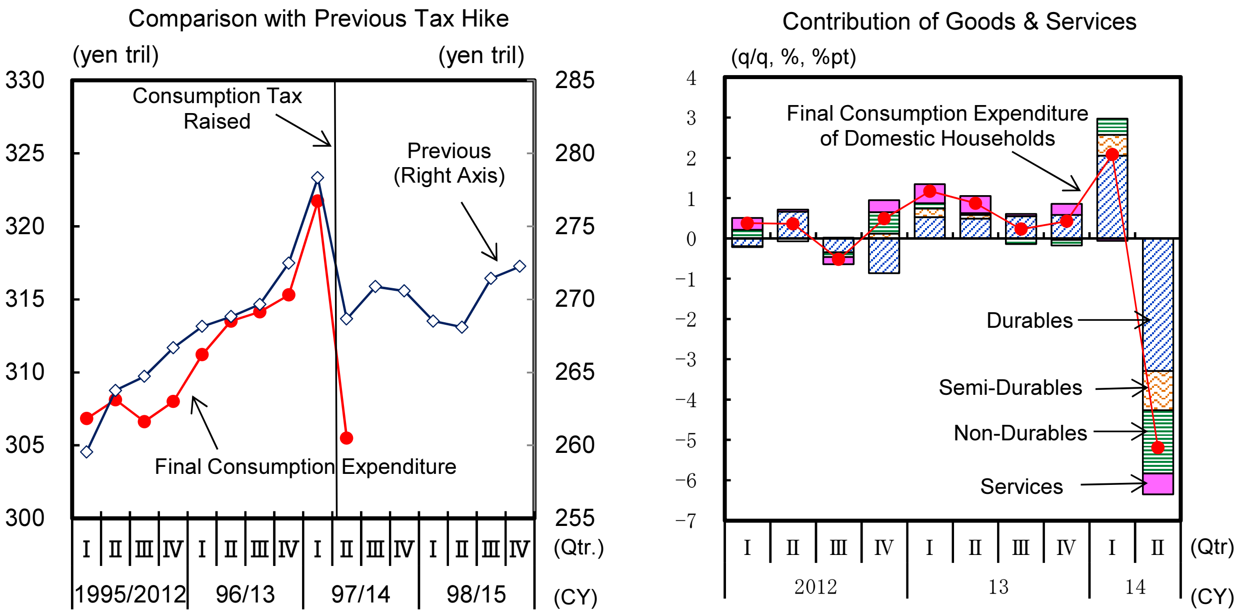
The real GDP growth rate for Apr-Jun 2014 (1st preliminary est) declined by -6.8% q/q annualized (-1.7% q/q), recording negative growth for the first time in two quarters. Performance was in line with market consensus (-7.0% q/q annualized and - 1.8% q/q). The primary reason for the major decline in real GDP was the reactionary decline in personal consumption following the raising of the consumption tax in April. The decline in personal consumption was expected, but the extent of the decline (-5.0% q/q) came as a surprise, bringing a somewhat negative tone to the results. On the other hand, contribution of inventory investment rose considerably in comparison to the previous period by +1.0%pt, bringing the overall GDP figures back in line with previous expectations. Regarding the huge increase in inventory investment, this is considered to be partly an attempt to recover inventory levels after the temporary decline experienced as a result of last minute demand prior to the April tax hike, though the decline in domestic demand cannot be ignored as another major cause, hence this is not necessarily a positive element.

Performance by demand component: major decline in personal consumption due to reactionary decline, capex marks time

Performance by demand component shows personal consumption down by 5.0% q/q, its first decline in seven quarters. The reactionary decline in personal consumption in the Jan-Mar period following the last minute demand prior to the April tax hike brought major downward pressure on personal consumption. Durables, which experienced especially brisk last minute demand during the Jan-Mar period, suffered a major pounding in the second quarter with a -18.9% q/q plunge which in turn contributed much to the general downturn. Meanwhile semi-durables and non-durables, which did not see much last-minute demand in the last quarter, recorded declines of -12.3% and -7.0% respectively. Nominal employee compensation actually rose by +0.6% q/q, its first sign of growth in two quarters, but real employee compensation fell considerably at -1.8% q/q due to rising prices associated with the increase in consumption tax. This represents an obvious decline in household purchasing power, which has in turn brought downward pressure on personal consumption.

Housing investment fell for the first time in nine quarters at - 10.3% q/q. Housing also suffered from the reactionary decline following the raising of the consumption tax. New housing starts peaked in December 2013 and have since continued to decline. Housing investment on a GDP basis, recorded on a progressive basis, also took a downward turn due to lagging housing starts.

Effects of Last-Minute Demand & Reactionary Decline on Real Personal Consumption **Chart 1**



Source: Cabinet Office, compiled by DIR.

Capex declined for the first time in five quarters at -2.5% q/q. The halting of Windows XP support by Microsoft during the Jan-Mar period produced last minute demand which produced considerable growth, but then the inevitable reactionary decline came after. Capex activity was limited due to the influence of the higher consumption tax. In comparison to the extent of growth in the previous period, the downturn during the Apr-June period is considered to be small. Hence when everything is averaged out, performance during this period can be considered a continuation of the overall comeback trend.

Public investment was down by -0.5% in comparison to the previous period. The effects of past supplementary budgets are now wearing thin and this represents the second consecutive quarter in which public investment has been in decline. Front-loading the FY2013 and FY2014 budgets has reduced the extent to which public investment otherwise would have declined on a q/q basis, hence in the final view it is continuing at a high level.

Exports were down -0.4% q/q, their first decline in three quarters. Exports to the US and EU continue their gradual growth, but Asian exports declined, thereby pulling down results for exports overall. However, imports have also been influenced by the reactionary decline in personal consumption following the raising of the consumption tax, as well as the increase in the petroleum and coal tax which led to a sharp increase in fuel imports during the Jan-Mar period followed by a reactionary decline this period, which saw figures down steeply by -5.6% q/q. All in all, this helped to push up contribution from external demand (net exports) by +1.1%pt, the first positive growth for exports in four quarters.

The GDP deflator grew for the third consecutive quarter by +1.7% q/q. The rate of growth increased considerably due to the consumption tax hike, which in turn caused the personal consumption deflator to achieve major gains. In annual terms the GDP deflator's y/y growth was +2.0%, the first time it has won growth since the Jul-Sep period of 2009. Nominal GDP was down by -0.4% annualized (-0.1% q/q), its first decline in seven quarters.

Apr-Jun 2014 1st Preliminary GDP Estimate — **Chart 2**

		2013			2014	
		Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun
Real GDP	Q/q %	0.9	0.4	-0.0	1.5	-1.7
Annualized	Q/q %	3.4	1.4	-0.2	6.1	-6.8
Personal consumption	Q/q %	0.7	0.2	0.4	2.0	-5.0
Private housing investment	Q/q %	2.1	4.7	2.4	2.0	-10.3
Private non-housing investment	Q/q %	1.4	0.6	1.4	7.7	-2.5
Change in private inventories (contribution to real GDP growth)	Q/q % pts	-0.3	0.0	-0.1	-0.5	1.0
Government consumption	Q/q %	0.4	0.2	0.2	-0.1	0.4
Public investment	Q/q %	5.8	7.1	1.4	-2.5	-0.5
Exports of goods and services	Q/q %	3.0	-0.7	0.3	6.5	-0.4
Imports of goods and services	Q/q %	2.3	1.8	3.7	6.4	-5.6
Domestic demand (contribution to real GDP growth)	Q/q % pts	0.8	0.8	0.5	1.7	-2.8
Foreign demand (contribution to real GDP growth)	Q/q % pts	0.1	-0.4	-0.6	-0.2	1.1
Nominal GDP	Q/q %	0.3	0.3	0.3	1.6	-0.1
Annualized	Q/q %	1.3	1.2	1.1	6.4	-0.4
GDP deflator	Y/y %	-0.6	-0.4	-0.4	-0.1	2.0

Source: Cabinet Office, compiled by DIR.

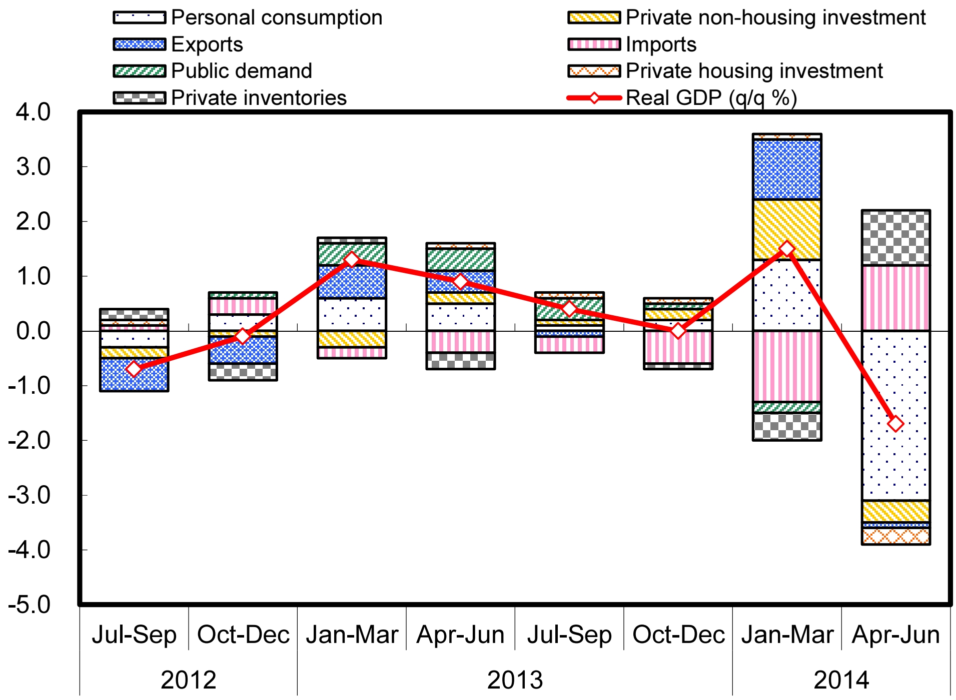
Notes: Due to rounding, contributions do not necessarily conform to calculations based on figures shown.

Jul-Sep 2014 GDP to turn in positive direction

As for the outlook for the Japanese economy, the period of Jul-Sep 2014 is expected to see a comeback in GDP, with a continuation of economic expansion foreseen. A great deal of attention will be drawn to the announcement of Jul-Sep 2014 period GDP figures to be announced in mid-November. This is because of the great weight they are expected to carry in determining whether or not to increase the consumption tax yet again (next hike planned in October 2015). Chances are good that GDP figures will return to positive growth during the Jul-Sep period.

The reactionary decline in personal consumption following the raising of the consumption tax in April brought major downward pressure on Apr-Jun GDP. However, if we look at performance on a monthly basis, we see that the economy hit bottom in April and then began making a comeback in May and June. Growth in personal consumption was high during the Jul-Sep period, and there was additional help from the monthly carryover effect. Moreover, public investment related orders have been growing rapidly since early in FY2014 as a result of the government's having front-loaded the budget. Public investment is expected to exhibit unequivocal growth during the Jul-Sep period, and is seen providing support for growth in real GDP. Meanwhile, capex is already beginning to recover, and is seen returning to a growth trend during the Jul-Sep period and beyond. Although recent production activity has been stagnant due to the effects of the reactionary decline after the tax hike went into effect, industry is showing signs of feeling a shortage in equipment and facilities especially in the non-manufacturing industries. Rising operating rates are expected to spark an increase in capex. The positive attitude of corporations toward capex has been reflected in various business surveys including the BOJ Tankan, and chances are good that capex will continue developing underlying strength. As for exports, weakening of the yen has continued of late, but has slowed some and is expected to level off for some time. However, shifting our view toward the external environment, we see that the US economy is exhibiting underlying strength and should continue moving toward recovery. Meanwhile the EU is slowly but surely moving toward economic expansion. China's economy continues its slowdown, but economic stimulus policies are taking effect, and a comeback can be seen on the horizon. The world economy is gradually expanding, and Japan's exports are expected to gradually strengthen their growth trend.

Change in Real GDP **Chart 3**



Source: Cabinet Office, compiled by DIR.