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Apr-Jun 2014 2nd Preliminary GDP Estimate

Capex revised downwards and inventory investment revised upwards

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Summary

- The real GDP growth rate for Apr-Jun 2014 (2nd preliminary est) was revised downward from the 1st preliminary estimate (-6.8% q/q annualized, -1.7% q/q) to -7.1% q/q annualized (-1.8% q/q). As in the 1st preliminary estimate, performance was in line with market consensus (-7.0% q/q annualized and -1.8% q/q). However, capex was revised downwards, while inventory investment was revised upwards, bringing a positive factor into the mix. 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. Ultimately, performance was not as good as the figures make it look at first glance.

- As for degree of contribution of domestic and overseas demand to the 2014 Apr-Jun period real GDP growth rate on a q/q basis, domestic demand contributed -2.9%pt (-2.8%pt on the 1st preliminary), while overseas demand contributed +1.1%pt (also +1.1%pt on the 1st preliminary). There is no major change from our conclusions on the 1st preliminary estimate, in which we referred to the major slump in the economy in the Apr-Jun period, due mainly to the reactionary decline in personal consumption which occurred after the increase in the consumption tax. The results did not prompt us to change our basic view of the economic environment.

2014 Apr-Jun GDP (2nd Preliminary Estimate) **Chart 1**

			2013			2014		
			Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	
							First	Second
Real GDP		Q/q %	0.8	0.4	-0.1	1.5	-1.7	-1.8
	Annualized	Q/q %	3.4	1.8	-0.5	6.0	-6.8	-7.1
	Personal consumption	Q/q %	0.7	0.2	0.4	2.0	-5.0	-5.1
	Private housing investment	Q/q %	2.1	4.7	2.4	2.0	-10.3	-10.4
	Private non-housing investment	Q/q %	1.8	0.5	1.0	7.8	-2.5	-5.1
	Change in private inventories (contribution to real GDP growth)	Q/q % pts	-0.4	0.2	-0.1	-0.5	1.0	1.4
	Government consumption	Q/q %	0.6	0.1	0.2	-0.2	0.4	0.1
	Public investment	Q/q %	5.8	7.1	1.4	-2.5	-0.5	-0.5
	Exports of goods and services	Q/q %	3.1	-0.7	0.3	6.5	-0.4	-0.5
	Imports of goods and services	Q/q %	2.3	1.8	3.7	6.4	-5.6	-5.6
Domestic demand (contribution to real GDP growth)		Q/q % pts	0.8	0.8	0.5	1.7	-2.8	-2.9
Foreign demand (contribution to real GDP growth)		Q/q % pts	0.1	-0.4	-0.6	-0.2	1.1	1.1
Nominal GDP		Q/q %	0.3	0.4	0.2	1.6	-0.1	-0.2
	Annualized	Q/q %	1.2	1.5	0.9	6.4	-0.4	-0.7
GDP deflator		Y/y %	-0.6	-0.4	-0.4	-0.1	2.0	2.0

Source: Cabinet Office; compiled by DIR.

Notes: 1) Due to rounding, contributions do not necessarily conform to calculations based on figures shown.
2) Q/q figures seasonally adjusted basis.

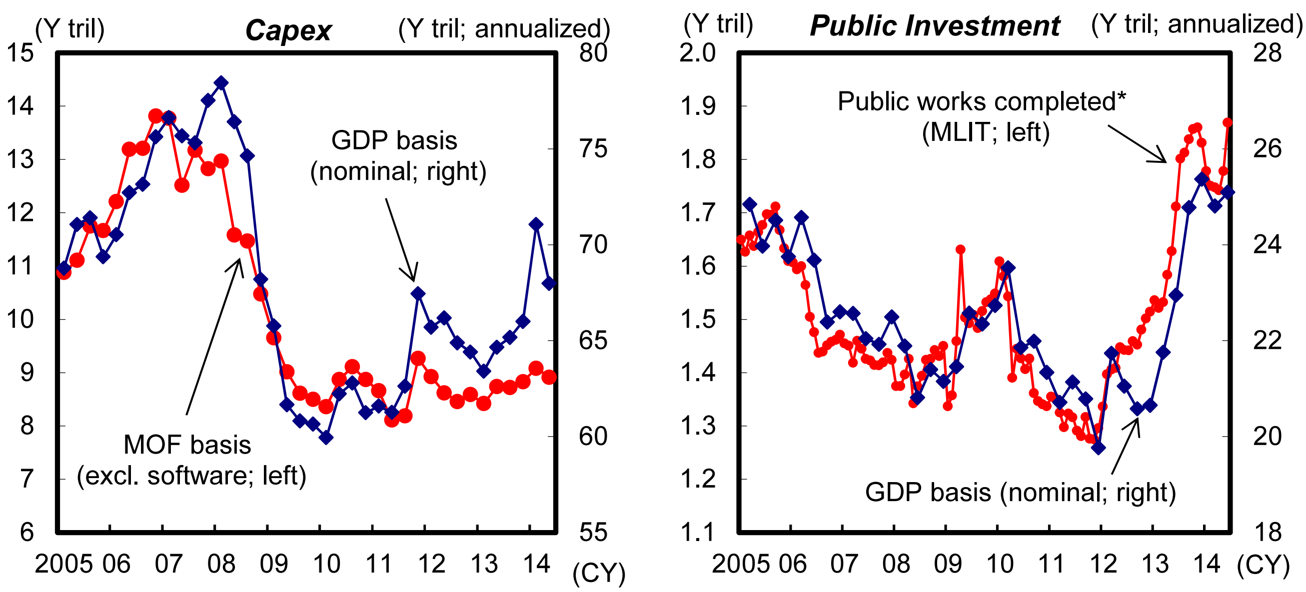
Real GDP growth rate revised downward slightly from 1st preliminary estimate

The real GDP growth rate for Apr-Jun 2014 (2nd preliminary est) was revised downward from the 1st preliminary estimate (-6.8% q/q annualized, -1.7% q/q) to -7.1% q/q annualized (-1.8% q/q). As in the 1st preliminary estimate, performance was in line with market consensus (-7.0% q/q annualized and -1.8% q/q). However, capex was revised downwards, while inventory investment was revised upwards, bringing a positive factor into the mix. 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. Ultimately, performance was not as good as the figures make it look at first glance.

Capex revised downwards and inventory investment revised upwards

Performance by demand component as revised from the 1st preliminary estimate shows a considerable downward revision in capex to -5.1% in reaction to corporate statistics (it was -2.5% on the 1st preliminary estimate). Meanwhile, personal consumption was also revised downwards a tad to -5.1% in comparison to the 1st preliminary estimate (-5.0% q/q). Meanwhile, private sector inventories were revised upwards considerably from the 1st preliminary estimate in reaction to corporate statistics (extent of contribution to real GDP in q/q terms was +1.4%pt on the 2nd preliminary estimate as compared to +1.0%pt on the 1st preliminary estimate). As for public investment, revised figures are normally announced on the 2nd preliminary estimate to reflect the third full month of figures from the monthly construction statistics, but this time around there was practically no change.

Capex and Public Investment: GDP basis vs. Basic Statistics **Chart 2**



Source: Cabinet Office, Ministry of Finance (MOF), *Financial Statement Statistics of Corporations by Industry*, Ministry of Land, Infrastructure, Transport and Tourism (MLIT), "Synthetic construction indexes" (available in Japanese); compiled by DIR.
Note: Seasonally adjusted by DIR.

Decline in personal consumption continues to push GDP figures downward

As for degree of contribution of domestic and overseas demand to the 2014 Apr-Jun period real GDP growth rate on a q/q basis, domestic demand contributed -2.9%pt (-2.8%pt on the 1st preliminary), while overseas demand contributed +1.1%pt (also +1.1%pt on the 1st preliminary). There is no major change from our conclusions on the 1st preliminary estimate, in which we referred to the major slump in the economy in the Apr-Jun period, due mainly to the reactionary decline in personal consumption which occurred after the increase in the consumption tax. The results did not prompt us to change our basic view of the economic environment.

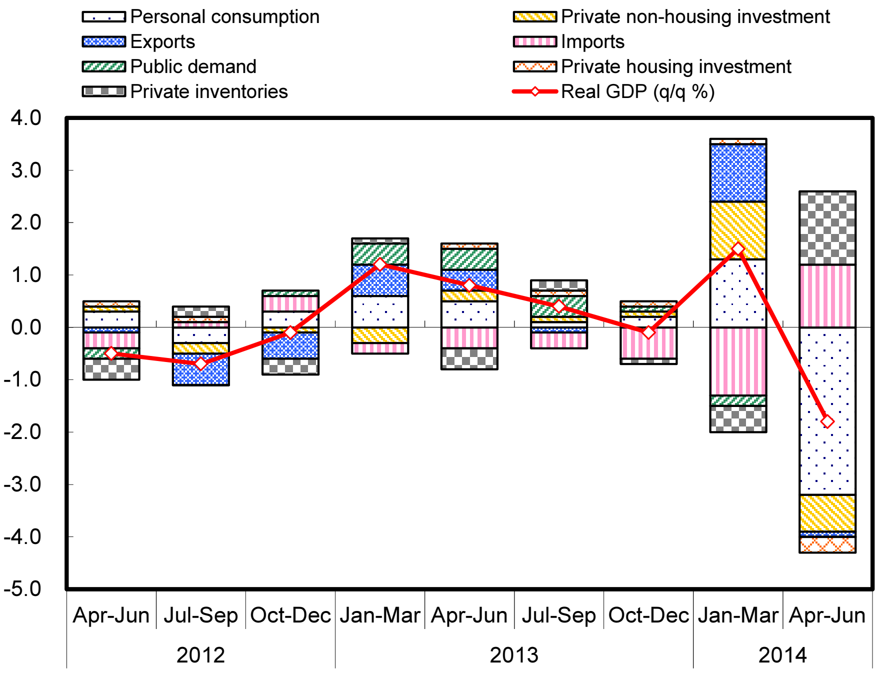
Performance by demand component shows personal consumption down considerably by 5.1% q/q, helping to push GDP downwards. Durables, which experienced especially brisk last minute demand during the Jan-Mar period, suffered a major decline of -19.3% q/q. Meanwhile, semi-durables and non-durables, which did not see much last-minute demand in the last quarter, also recorded considerable declines of -12.6% and -6.9% respectively. In addition to the reactionary decline, the decline in real income, resulting from the increase in prices of goods, was also a factor in reducing personal consumption.

Capex was revised downwards this time around, falling considerably in comparison to the previous period at -5.1% for the Apr-Jun quarter. However, considering the fact that capex rose so dramatically during the Jan-Mar period, the decline is not an especially serious one. With the halting of Windows XP support by Microsoft during the Jan-Mar period along with last minute demand, this can actually be interpreted as meaning that capex is actually exhibiting a gradual growth trend.

Public investment was down by -0.5% in comparison to the previous period. The effects of past economic policy measures are now wearing thin and this represents the second consecutive quarter in which public investment has been in decline. Front-loading the FY2013 supplementary budget and the FY2014 budget 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.

Overseas demand became a plus factor for the first time in four quarters. However, the main reason was the shrinking of domestic demand as a result of a major decline in imports. Exports were down by -0.5% q/q, their first decline in three quarters, and are continuing at a sluggish pace.

Contribution to Real GDP (% pt; seasonally adjusted basis)
Chart 3



Source: Cabinet Office; compiled by DIR.

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 personal consumption hit bottom in April and then began making a comeback in May and June. Up to now, personal consumption had been slowing down, but with help from the monthly carryover effect, there is a good chance that Jul-Sep period personal consumption will return to positive growth. Moreover, public investment related orders have been growing rapidly since early in FY2014. 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, which suffered from a slowdown during the Apr-Jun period, 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. 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, the yen has weakened further of late, and is expected to remain at the same level 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. The world economy is gradually expanding, and Japan’s exports are expected to move toward a comeback