8 December 2014 (No. of pages: 5)

Japanese report: 08 Dec 2014

Jul-Sep 2014 2nd Preliminary GDP Estimate

Downward revision betrays hopes, falls below market consensus

Economic Intelligence Team
Masahiko Hashimoto

Summary

- The real GDP growth rate for Jul-Sep 2014 (2nd preliminary est) was revised downward from the 1st preliminary estimate (-1.6% q/q annualized, -0.4% q/q) to -1.9% q/q annualized (-0.5% q/q). All of the major forecasting institutions with the exception of DIR had been expecting an upward revision with the market consensus at -0.5% q/q annualized (DIR revised downwards to -1.7% q/q annualized), bringing a downward revision with an especially negative tone.

- In terms of source of demand, the downward revision from the 1st preliminary estimate saw capex revised downwards in response to corporate statistics to -0.4% q/q (-0.2% q/q), helping to push the overall GDP figure downwards. Corporate statistics had reported capex as having a firm undertone and hence an upward revision of GDP was foreseen according to market consensus. Even so, the figure was revised downward, bringing an especially negative tone to this period's results. Private sector inventories had been almost unanimously expecting an upward revision in response to corporate statistics, but remained unchanged (contribution to GDP in q/q terms: -0.6%pt on 1st preliminary, -0.6%pt on 2nd preliminary).

2014 Jul-Sep GDP (2nd Preliminary Estimate) — **Chart 1**

		2013		2014			
		Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	
						First	Second
Real GDP	Q/q %	0.4	-0.4	1.4	-1.7	-0.4	-0.5
Annualized	Q/q %	1.6	-1.5	5.8	-6.7	-1.6	-1.9
Personal consumption	Q/q %	0.3	-0.1	2.2	-5.1	0.4	0.4
Private housing investment	Q/q %	4.3	2.2	2.3	-10.0	-6.7	-6.8
Private non-housing investment	Q/q %	0.5	1.0	6.2	-4.7	-0.2	-0.4
Change in private inventories (contribution to real GDP growth)	Q/q % pts	0.2	-0.1	-0.4	1.3	-0.6	-0.6
Government consumption	Q/q %	-0.1	0.1	-0.3	0.3	0.3	0.3
Public investment	Q/q %	5.1	1.6	-2.7	0.9	2.2	1.4
Exports of goods and services	Q/q %	-0.6	0.2	6.4	-0.5	1.3	1.3
Imports of goods and services	Q/q %	1.7	3.7	6.2	-5.4	0.8	0.7
Domestic demand (contribution to real GDP growth)	Q/q % pts	0.8	0.2	1.6	-2.8	-0.5	-0.5
Foreign demand (contribution to real GDP growth)	Q/q % pts	-0.4	-0.6	-0.2	1.0	0.1	0.1
Nominal GDP	Q/q %	0.2	0.2	1.3	0.1	-0.8	-0.9
Annualized	Q/q %	0.9	0.7	5.5	0.4	-3.0	-3.5
GDP deflator	Y/y %	-0.3	-0.3	0.1	2.1	2.1	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.

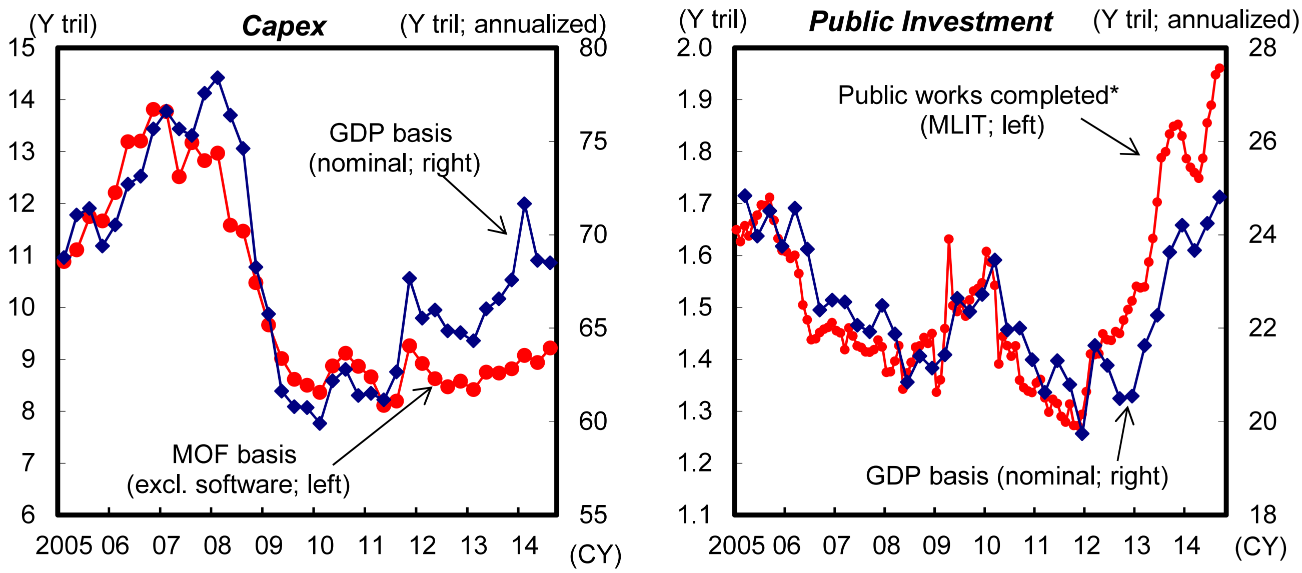
Real GDP growth rate revised downwards from 1st preliminary report

The real GDP growth rate for Jul-Sep 2014 (2nd preliminary est) was revised downward from the 1st preliminary estimate (-1.6% q/q annualized, -0.4% q/q) to -1.9% q/q annualized (-0.5% q/q). All of the major forecasting institutions with the exception of DIR had been expecting an upward revision with the market consensus at -0.5% q/q annualized (DIR revised downwards to -1.7% q/q annualized), bringing a downward revision with an especially negative tone.

Downward revision of capex exceeds expectations

In terms of source of demand, the downward revision from the 1st preliminary estimate saw capex revised downwards in response to corporate statistics to -0.4% q/q (-0.2% q/q), helping to push the overall GDP figure downwards. Corporate statistics had reported capex as having a firm undertone and hence an upward revision of GDP was foreseen according to market consensus. Even so, the figure was revised downward, bringing an especially negative tone to this period's results. Meanwhile, public investment was also revised downwards in response to monthly construction statistics for September (1st preliminary +2.2% q/q, 2nd preliminary +1.4% q/q), thereby increasing the extent to which the GDP fell into negative numbers. Private sector inventories had been almost unanimously expecting an upward revision in response to corporate statistics, but remained unchanged (contribution to GDP in q/q terms: -0.6%pt on 1st preliminary, -0.6%pt on 2nd preliminary).

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 for Jul-Sep 2014*, Ministry of Land, Infrastructure, Transport and Tourism (MLIT), "Synthetic construction indexes" (available in Japanese); compiled by DIR.

Note: Seasonally adjusted by DIR.

Negative growth unchanged from 2nd quarter due mostly to inventory revision

The Jul-Sep 2014 real GDP growth rate on a quarterly basis saw contribution from domestic demand unchanged from the previous quarter at -0.5%pt, while contribution from overseas demand also remained the same at +0.1%pt q/q. No major change was seen in the Jul-Sep 2014 GDP figure in comparison to the 1st preliminary report, with recovery in domestic demand (mostly personal consumption) lagging and inventory adjustment bringing downward pressure. The adjustment brings this figure more in line with our sense of current economic conditions here at DIR.

Looking at trends in source of demand, personal consumption grew for the first time in two quarters by +0.4% q/q. However, considering the major growth rate during the Apr-Jun period, the increase was only slight. The result was lukewarm for rebound growth from a reactionary decline. In terms of goods and services, durables, which had already suffered a steep reactionary decline during the Apr-Jun period, suffered another decline (for the second consecutive quarter) at -4.4% q/q. Meanwhile, services also suffered a decline for the second consecutive quarter by -0.2% q/q. Semi-durables, which were not affected so much by reactionary decline during the second quarter, were up by +3.4% q/q along with non-durables boasting +2.4% q/q. The recovery was sluggish due to the decline in real income.

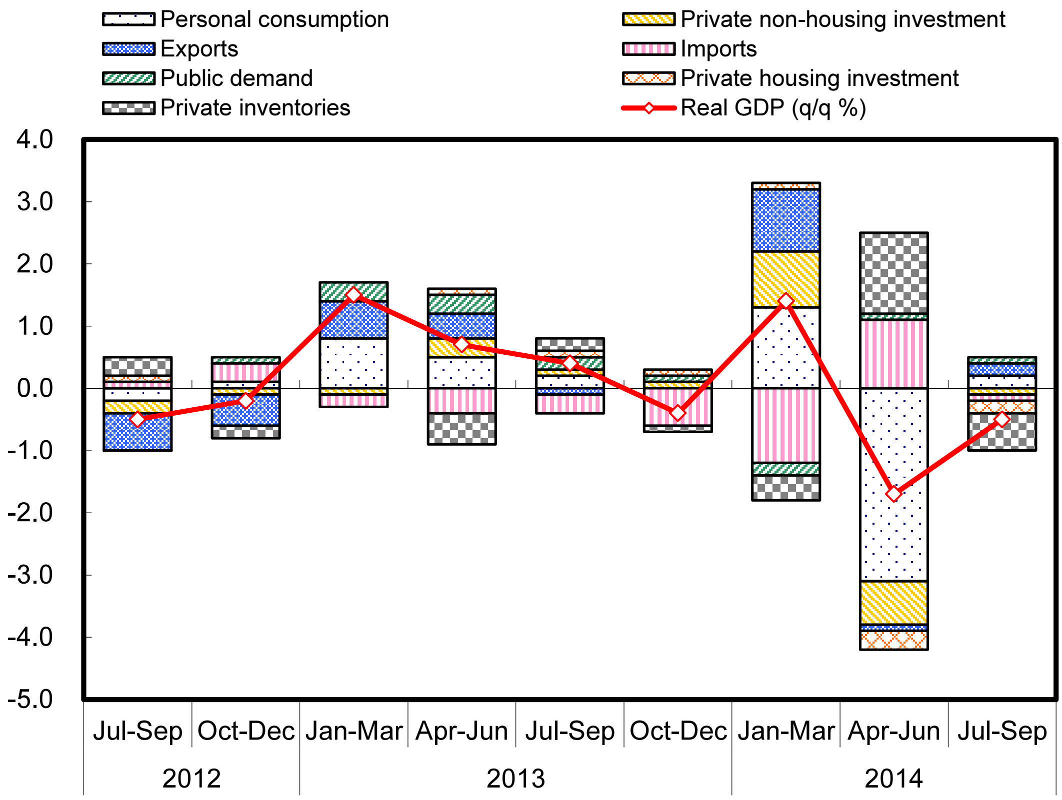
Housing investment was down for the second consecutive quarter at -6.8% q/q. Though small, personal consumption did show signs of getting back on track compared to where it was during the Apr-Jun quarter when it suffered a deep reactionary decline. However, housing investment continued to suffer from last quarter's reactionary decline. New housing starts halted their decline once into the Jul-Sep period. However, since GDP is recorded on an accrual basis, housing starts on the GDP report itself continue to decline.

Capex fell by -0.4% q/q, recording a decline for the second consecutive quarter. Considering the major growth during the Jan-Mar 2014 period (+6.2% q/q), it is not that low, but growth rate has been slow up to now.

Public investment was up +1.4% in comparison with the previous period. Although it was revised downwards from the 1st preliminary report, it continued a high level of growth, reacting to the frontloading of the FY2013 supplementary budget and the main budget of FY2014. Public investment has definitely provided underlying support for the economy.

Exports made a positive contribution to GDP for the second consecutive quarter. Exports continued moderate growth reflecting the gradual recovery of overseas economies centering on the US. Meanwhile, imports also grew, meaning that contribution to GDP, external demand (net exports) contributed almost nothing to the GDP figure.

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

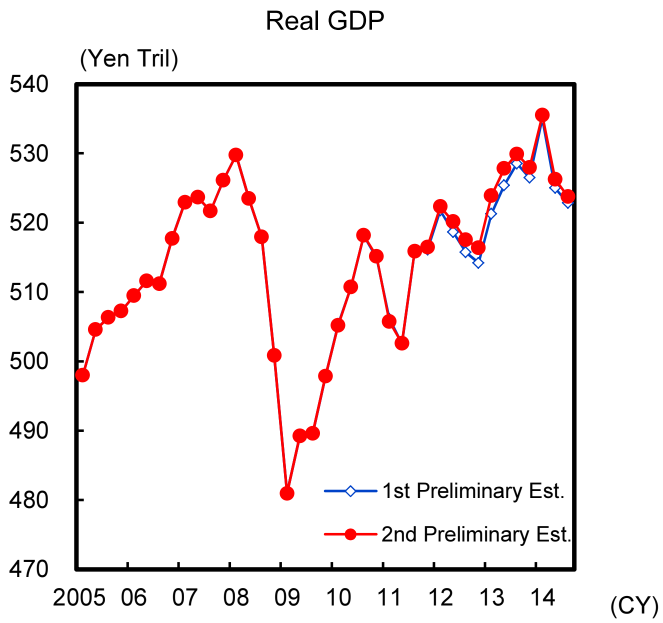


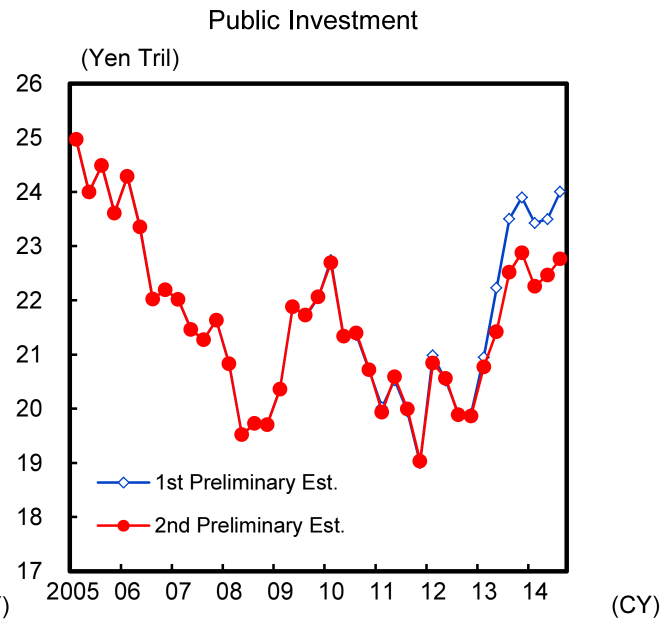
Source: Cabinet Office; compiled by DIR.

Public investment to be revised downward on final FY2013 Report

In this revised report, results from past fiscal years were revised in addition to the usual revisions to the 1st preliminary report. This involved reflecting the final FY2012 and FY2013 results in the current report. Looking at growth rate on a fiscal year basis, growth rate in real GDP during FY2012 was revised upwards from +0.7% y/y to +1.0% y/y, while FY2013 results were revised downwards from the original +2.2% y/y to +2.1% y/y. Overall GDP in FY2012 was pushed up further by the upward revision of personal consumption (+1.5% y/y before revision to +1.8% y/y after revision). The main factor in revising FY2013 figures downwards was the downward revision in public investment as was done on the previous fiscal year's final report (FY2012). Before revision the figure was +15.0% y/y, and after revision +10.3% y/y. However, while public investment was revised downward, capex was revised upward (+2.6% y/y before revision to +4.0% y/y after revision). After this revision, the FY2014 GDP figures shrink slightly with the carryover of real GDP growth rate at +1.0% (+1.2% before revision).

Revised GDP Figures According to FY2013 Final Report Chart 4





Source: Cabinet Office; compiled by DIR.

GDP for the Oct-Dec 2014 period to move toward positive growth

The results in this report confirm that Japan's economy is stagnant, but we predict that a gradual expansion phase will occur during the Oct-Dec 2014 period and beyond.

Although recovery in personal consumption has been lagging since the reactionary decline earlier this year, conditions influencing households, including employment and income, reflect a steady undertone. Hence we expect personal consumption to get back on track in the near future. As for the Oct-Dec period, chances are good that growth will be achieved for the first time in two quarters due to upward pressure from monthly carryover (carryover as seen in the aggregate index for consumption will give a push of +0.4%). Meanwhile, housing investment, which has continued to suffer from the effects of the reactionary decline, is expected to move steadily toward recovery now that housing starts, a leading indicator, appear to be making a comeback.

As for capex, a recovery is expected which will bring activity back to a growth trend. In addition to continued improvement in machinery orders, another leading indicator, the BOJ Tankan indicates that capex activities are reflecting a steady undertone. Operating rates remain at a low level in the manufacturing industries and hence there is still some hesitance regarding increases in capacity, but underlying strength is expected to continue centering on replacement investment.

As for exports, moderate growth is seen as overseas economies gradually recover. There has been an increasing sense recently that overseas economies are slowing down in both the EU economy and in the emerging economies of Asia centering on China. But in the EU, the ECB has implemented additional monetary easing measures which provide a firm undertone, and so the EU economy is expected to gradually improve. Meanwhile, the emerging economies of Asia with their high level of dependence on the US economy are expected to gradually move more strongly toward a growth trend, led by the US economy, which retains a firm undertone.