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Oct-Dec 2014 1st Preliminary GDP Estimate

Japan's economy back on track, but results leave something to be desired

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Summary

- The real GDP growth rate for Oct-Dec 2014 (1st preliminary est) grew by +2.2% q/q annualized (+0.6% q/q). This is the first time growth in GDP has been recorded in three quarters, and confirms that the economy is finally back on track after a period in the doldrums. However, despite the positive growth rate, performance fell below market consensus (+3.7% q/q annualized and +0.9% q/q), leaving a somewhat negative impression. One of the main factors behind results falling below market predictions was the fact that growth in personal consumption was not nearly as high as had been originally expected.

- Performance by demand component shows personal consumption up +0.3% q/q, its second consecutive quarter of growth. Real employee compensation was up by +0.1% q/q for the second consecutive quarter, meaning that personal consumption will continue to make a gradual comeback with the help of improvements in the employment and income environment. However, the market forecast had been expecting an acceleration in growth rate, and this figure remains at about the same level as the Jul-Sep period, a result lacking in real strength.

- Results for the period showed considerable growth for real GDP, its first positive growth in three quarters. This indicates that Japan's economy is heading toward a comeback after a period of decline following the increase in consumption tax last year. We expect real GDP to continue this growth trend during the Jan-Mar 2015 period and beyond. We expect Japan's economy to continue expanding gradually. We also see personal consumption continuing in a growth trend due mainly to improvements in real employee compensation, conditions positively influencing households. Meanwhile, the price of crude oil which has experienced steep declines since the summer of 2014 will bring downward pressure on consumer price, providing added support to growth in personal consumption, which is in turn affected by rising real wages.

Real GDP wins growth for first time in three qtrs, but falls below consensus

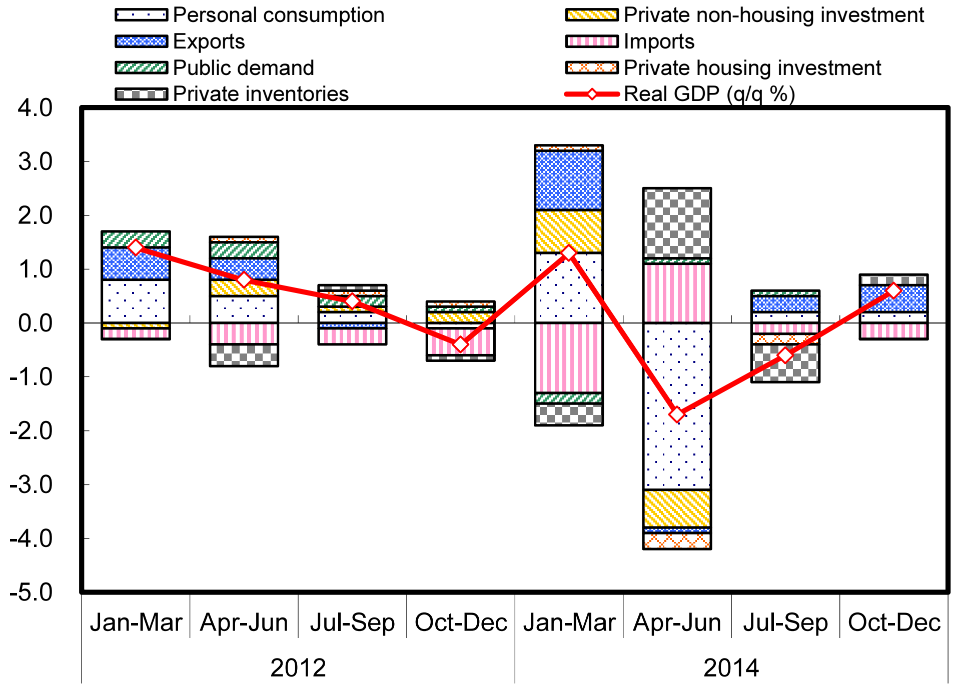
The real GDP growth rate for Oct-Dec 2014 (1st preliminary est) grew by +2.2% q/q annualized (+0.6% q/q). This is the first time growth in GDP has been recorded in three quarters, and confirms that the economy is finally back on track after a period in the doldrums. However, despite the positive growth rate, performance fell below market consensus (+3.7% q/q annualized and +0.9% q/q), leaving a somewhat negative impression. One of the main factors behind results falling below market predictions was the fact that growth in personal consumption was not nearly as high as had been originally expected.

Personal consumption lacks in strength; capex also leaves something to be desired

Performance by demand component shows personal consumption up +0.3% q/q, its second consecutive quarter of growth. Real employee compensation was up by +0.1% q/q for the second consecutive quarter, meaning that personal consumption will continue to make a gradual comeback with the help of improvements in the employment and income environment. However, the market forecast had been expecting an acceleration in growth rate, and this figure remains at about the same level as the Jul-Sep period, a result lacking in real strength. Looking at personal consumption by category, we see a comeback in durables such as automobiles, which had been sluggish ever since the increase in consumption tax. Durables were up by +0.7% q/q, the first instance of growth seen in three quarters. Meanwhile, services were also up by +0.5% q/q for the first time in three quarters, moving back into a growth phase. Non-durables were up slightly by +0.1% q/q, while semi-durables suffered a decline for the first time in two quarters by -0.4%.

Housing investment declined for the third consecutive quarter at -1.2%, continuing the downtrend it has experienced ever since the reactionary decline after the increase in consumption tax last year. New housing starts, a leading indicator for housing investment as a portion of GDP, bottomed out during the Jul-Sep period. Pressures stemming from the reactionary decline after last year's consumption tax increase appear to be gradually easing up.

Contribution to Real GDP (% pt; seasonally adjusted basis) **Chart 1**



Source: Cabinet Office; compiled by DIR.

Capex grew by +0.1% q/q for the first time in three quarters, showing that it has indeed bottomed out and is now back into a growth trend. Improvements can be seen in operating rates as production begins to recover, and with the progressively weaker yen, corporate earnings continue to improve, especially in the area of major manufacturers. This should provide support for capex spending. However, the coincident index for capex, shipments of capital goods, shows growth in capex is still extremely limited, with results leaving a bit to be desired.

Public investment was up for the third quarter in a row at +0.6% q/q. Front-loading the FY2013 and FY2014 budgets helped to accelerate public investment during the Jul-Sep period, but the positive effect is gradually running out, and growth now shows signs of slowing.

Exports grew for the second consecutive quarter at +2.7% q/q. Exports to the US and Asia helped to push overall figures up, while imports also managed a comeback at +1.3% q/q, winning a second consecutive quarter of growth. Overseas demand (net exports) grew only slightly at +0.2%pt q/q.

The GDP deflator grew considerably in comparison to the previous period at +0.5% q/q, the first time it has recorded growth in two quarters. The domestic demand deflator also grew for the sixth consecutive quarter at +0.3% q/q, and the export deflator grew considerably by +2.9% q/q, due to the weak yen. In y/y terms the GDP deflator was up by +2.3%, its fourth consecutive quarter of growth. Meanwhile, nominal GDP was up for the first time in two quarters at +4.5% q/q annualized (+1.1% q/q).

2014 Oct-Dec GDP (1st Preliminary Estimate) **Chart 2**

			2013	2014			
			Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec
Real GDP		Q/q %	-0.4	1.3	-1.7	-0.6	0.6
	Annualized	Q/q %	-1.4	5.5	-6.7	-2.3	2.2
	Personal consumption	Q/q %	-0.1	2.2	-5.1	0.3	0.3
	Private housing investment	Q/q %	2.6	2.4	-10.3	-7.0	-1.2
	Private non-housing investment	Q/q %	1.2	5.9	-5.0	-0.1	0.1
	Change in private inventories (contribution to real GDP growth)	Q/q % pts	-0.1	-0.4	1.3	-0.7	0.2
	Government consumption	Q/q %	0.1	-0.4	0.3	0.2	0.1
	Public investment	Q/q %	0.7	-2.2	1.0	2.1	0.6
	Exports of goods and services	Q/q %	-0.2	6.5	-0.3	1.5	2.7
	Imports of goods and services	Q/q %	3.0	6.8	-5.3	1.0	1.3
Domestic demand (contribution to real GDP growth)		Q/q % pts	0.2	1.7	-2.7	-0.6	0.3
Foreign demand (contribution to real GDP growth)		Q/q % pts	-0.5	-0.3	1.1	0.1	0.2
Nominal GDP		Q/q %	-0.1	1.5	0.2	-0.9	1.1
	Annualized	Q/q %	-0.6	6.1	0.7	-3.4	4.5
GDP deflator		Y/y %	-0.3	0.1	2.2	2.0	2.3

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.

Japan’s economy expected to continue expanding

Results for the period showed considerable growth for real GDP, its first positive growth in three quarters. This indicates that Japan’s economy is heading toward a comeback after a period of decline following the increase in consumption tax last year. We expect real GDP to continue this growth trend during the Jan-Mar 2015 period and beyond. We expect Japan’s economy to continue expanding gradually.

We also see personal consumption continuing in a growth trend due mainly to improvements in real employee compensation, conditions positively influencing households. Meanwhile, the price of crude oil which has experienced steep declines since the summer of 2014 will bring downward pressure on consumer price, providing added support to growth in personal consumption, which is in turn affected by rising real wages. Meanwhile, housing investment, which suffered from the effects of the reactionary decline last year, is expected to move steadily toward recovery now that housing starts, a leading indicator, are clearly making a comeback.

As for capex, the growth trend is expected to continue. In addition to continued improvement in machinery orders, another leading indicator, the BOJ Tankan indicates that capex activities are reflecting a steady undertone. Production, which had been continually worsening since the beginning of 2014, is now making a comeback and operating rates are in a growth trend. Both non-manufacturing, which has reflected a growing sense of deficiency in capex for some time now, and the manufacturing sector will continue to be relieved of any since of surplus in capex, and this should encourage more capex related demand in the future. Meanwhile, as yen continues to be weak, some manufacturers appear to be increasing the percentage of their domestic production, while improvements in corporate earnings due to the major decline in the price of crude oil should also become a factor encouraging an increase in capex spending.

As for exports, moderate growth is seen continuing as overseas economies gradually recover. The major factor pulling exports along is the US whose economy continues to improve. Meanwhile, the expanding US economy is expected to help not only Japan’s exports to the US, but exports of Japanese intermediate goods to Asia which is the location of final demand for many goods. One worrisome factor is Europe and China whose economies are still suffering a slowdown. However, Europe’s economy is expected to move gradually toward a comeback due to the effects of additional monetary easing on the part of the ECB, and so Japan’s exports are seen strengthening their growth trend.