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Jan-Mar 2015 1st Preliminary GDP Estimate

Economic recovery confirmed in two major aspects of domestic demand

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Summary

- The real GDP growth rate for Jan-Mar 2015 (1st preliminary est) grew by +2.4% q/q annualized (+0.6% q/q). This is the second consecutive quarter of growth in GDP, and reconfirms that the economy is back on track and in a moderate growth phase. First quarter results were positive on three major points: (1) The pace of economic growth has accelerated in comparison to the previous quarter, (2) Performance exceeded market consensus (+1.6% q/q annualized and +0.4% q/q), and (3) Capital spending (capex), which had been in a downtrend until now, achieved a turnaround in the positive direction.

- The real GDP growth rate on an annualized basis in FY2014 declined by -1.0%, the first decline in growth in five years (since FY2009). This was due to the downward pressure brought on the economy by the increase in consumption tax in April of that year. As of January 2014 before the consumption tax was raised, outlooks from various sources including the government, the Bank of Japan, and private sector economists, was for positive growth, but the effects of the increase in consumption tax were much larger than expected, ultimately resulting in a major downturn in the economy.

- Performance by demand component in the Jan-Mar 2015 results shows personal consumption up +0.4% q/q, its third consecutive quarter of growth, continuing in a moderate growth trend. Real employee compensation was up by +0.6% q/q for the third consecutive quarter, due to improvements in household employment and income environments, and contributing also to growth in personal consumption. In previous forecasts many sources expected the pace of growth in personal consumption to slow down in comparison with the FY2014 Oct-Dec results (+0.4%), but the firm undertone continued thanks to gains in all personal consumption sectors, including goods and services.

- Japan's economy is expected to continue growing at a moderate pace in the future. We expect real GDP to continue this growth trend during the Apr-Jun 2015 period and beyond. We also see personal consumption continuing in a moderate growth trend, and capex to move unambiguously toward a comeback. As for personal consumption, the positive environment for households in the areas of employment and income is expected to lead to an improvement in the propensity to consume, and this will be the major impetus in the continuation of the growth trend.

Second consecutive quarter of growth achieved; performance exceeds market consensus

The real GDP growth rate for Jan-Mar 2015 (1st preliminary est) grew by +2.4% q/q annualized (+0.6% q/q). This is the second consecutive quarter of growth in GDP, and reconfirms that the economy is back on track and in a moderate growth phase. First quarter results were positive on three major points: (1) The pace of economic growth has accelerated in comparison to the previous quarter, (2) Performance exceeded market consensus (+1.6% q/q annualized and +0.4% q/q), and (3) Capital spending (capex), which had been in a downtrend until now, achieved a turnaround in the positive direction. Moreover, two important factors were behind the 1st quarter's performance, which exceeded market expectations: (1) Favorable growth in personal consumption, which was expected to slow down in previous forecasts, and (2) Inventory investment increased beyond expectations.

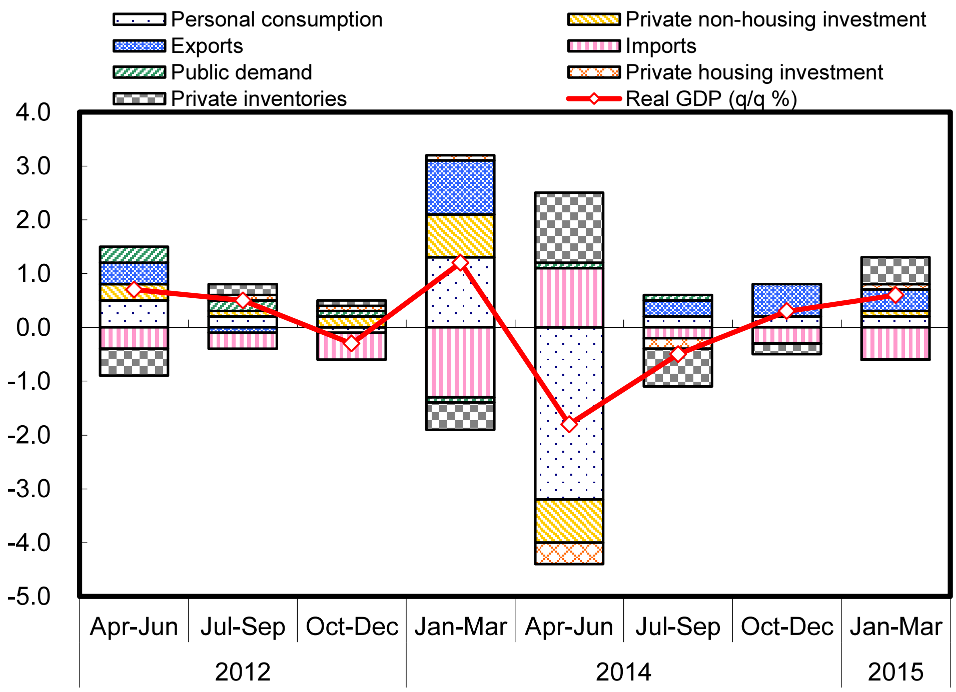
The real GDP growth rate on an annualized basis in FY2014 declined by -1.0%, the first decline in growth in five years (since FY2009). This was due to the downward pressure brought on the economy by the increase in consumption tax in April of that year. As of January 2014 before the consumption tax was raised, the government outlook for growth in FY2014 was +1.4% (*Fiscal 2014 Economic Outlook and Basic Stance Toward Fiscal Management, Cabinet Decision on January 24, 2014*), the Bank of Japan Policy Committee outlook was for +1.4% or middle of that range (*Midterm Evaluation, January 22, 2014*), and private sector economists came to a consensus of +0.84% (*January 2014 ESP Forecast Total Average Value*). All major sources issued outlooks for positive growth, but the effects of the increase in consumption tax were much larger than expected, ultimately resulting in a major downturn in the economy.

Personal consumption achieves a high while capex makes a comeback

Performance by demand component in the Jan-Mar 2015 results shows personal consumption up +0.4% q/q, its third consecutive quarter of growth, continuing in a moderate growth trend. Real employee compensation was up by +0.6% q/q for the third consecutive quarter, due to improvements in household employment and income environments, and contributing also to growth in personal consumption. In previous forecasts many sources expected the pace of growth in personal consumption to slow down in comparison with the Oct-Dec 2014 results (+0.4%), but the firm undertone continued thanks to gains in all personal consumption sectors, including goods and services. Looking at personal consumption by category, we see a comeback in durables though automobiles showed somewhat weak performance. This was balanced out by a moderate comeback for household electronics, which helped durables to register growth for the second consecutive quarter at +1.1% q/q. Semi-durables were up by +0.6% q/q, while non-durables were up by +0.4% q/q, both registering growth for the third consecutive quarter. This shows the comeback is continuing after the downtrend experienced subsequent to the increase in the consumption tax in 2014. Services also won growth for the second consecutive quarter at +0.4%. Looking at the level of performance we can conclude that the effects of the increase in consumption tax have pretty much run their course.

Housing investment grew for the first time in four quarters at +1.8%. Looking at the trend in new housing starts, a leading indicator for housing investment as a portion of GDP, pressures stemming from the reactionary decline after last year's consumption tax increase appear to be gradually easing up, and the employment and income environment affecting households is improving, while interest on housing loans is at a low. These factors have helped housing starts make a gradual comeback since the Oct-Dec period of 2014. Housing investment and housing starts are recorded on a progressive basis, hence there is a lag in their performance, and only now do we see that housing investment has hit bottom with a shift into a growth trend seen after the Jan-Mar 2015 period.

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



Source: Cabinet Office; compiled by DIR.

Capex grew by +0.4% q/q for the first time in four quarters, showing that it is now back into a growth trend after having been in a downtrend for some time. The sense of overcapacity is easing up amongst corporations and is being replaced by a sense of under-capacity. Improvements can be seen in corporate earnings due to the weak yen, especially in the area of major manufacturers, and this should provide underlying support for capex spending in the future.

Public investment was down by -1.4% q/q. Front-loading the FY2013 supplementary budget and the FY2014 budget helped to accelerate public investment all the way through the Oct-Dec 2014 period, but the positive effect is gradually running out, leading to the first decline in four quarters.

Exports grew for the third consecutive quarter at +2.4% q/q. Exports to the US and EU helped to push overall figures up, while imports also managed a comeback at +2.9% q/q thanks to a comeback in domestic demand. This constituted the third consecutive quarter of growth for imports. Growth in imports brought downward pressure on overseas demand (net exports) causing a slight decline at -0.2%pt q/q. This was the first time in four quarters that overseas demand declined.

The GDP deflator grew for the second consecutive quarter at +1.3% q/q. Growth was considerably more than the previous quarter (+0.4%). The domestic demand deflator was down by -0.3% q/q, its first decline in seven quarters. The collapse in the price of crude oil at the end of 2014 caused the import deflator to decline considerably, while pushing up overall figures. (the import deflator tends to move in the opposite direction of the GDP deflator). In y/y terms the GDP deflator was up by +3.4%, its fifth consecutive quarter of growth, with growth rate exceeding that of the previous period. Meanwhile, nominal GDP was up for the second consecutive quarter at +7.7% q/q annualized (+1.9% q/q).

2015 Jan-Mar GDP (1st Preliminary Estimate) **Chart 2**

		2014				2015
		Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar
Real GDP	Q/q %	1.2	-1.8	-0.5	0.3	0.6
Annualized	Q/q %	4.9	-6.9	-2.1	1.1	2.4
Personal consumption	Q/q %	2.1	-5.1	0.3	0.4	0.4
Private housing investment	Q/q %	2.0	-10.8	-6.4	-0.6	1.8
Private non-housing investment	Q/q %	5.9	-5.2	-0.1	-0.0	0.4
Change in private inventories (contribution to real GDP growth)	Q/q % pts	-0.5	1.3	-0.7	-0.2	0.5
Government consumption	Q/q %	-0.3	0.4	0.2	0.3	0.1
Public investment	Q/q %	-0.9	0.7	1.6	0.1	-1.4
Exports of goods and services	Q/q %	6.1	-0.0	1.6	3.2	2.4
Imports of goods and services	Q/q %	6.6	-5.2	1.1	1.4	2.9
Domestic demand (contribution to real GDP growth)	Q/q % pts	1.5	-2.8	-0.6	0.0	0.8
Foreign demand (contribution to real GDP growth)	Q/q % pts	-0.3	1.1	0.1	0.3	-0.2
Nominal GDP	Q/q %	1.5	-0.0	-0.6	0.7	1.9
Annualized	Q/q %	6.1	-0.1	-2.6	2.8	7.7
GDP deflator	Y/y %	0.1	2.2	2.1	2.4	3.4

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

Japan’s economy is expected to continue growing at a moderate pace in the future. We expect real GDP to continue this growth trend during the Apr-Jun 2015 period and beyond. We also see personal consumption continuing in a moderate growth trend, and capex to move unambiguously toward a comeback.

As for personal consumption, the positive environment for households in the areas of employment and income is expected to lead to an improvement in the propensity to consume, and this will be the major impetus in the continuation of the growth trend. According to the Keidanren survey (preliminary results), wages are expected to grow around +0.7% y/y due to this year’s pay scale increase, pushing revised pension amounts for FY2015 up +0.9% as compared to -0.7% in FY2014. With improvements in corporate earnings, summer bonuses are expected to grow for the third year in a row, bringing another plus factor into the mix. This is expected to begin showing up in increases in household disposable income by around May and promises to become a factor in increasing personal consumption a little further up the road. Meanwhile, the price of crude oil, which has experienced steep declines since the summer of 2014 is expected to continue at a low in the immediate future. There tends to be a time lag in the effects of this phenomenon, meaning that the consumer price will see downward pressure and real household wages will get a boost. Personal consumption should also increase as a side effect. Meanwhile, housing investment is expected to be free of the effects of the reactionary decline after the increase in consumption tax last year, and backed by improvements in the employment and income environment, is expected to move toward a moderate recovery now that housing starts, a leading indicator, are clearly making a comeback.

As for capex, a moderately paced comeback is expected. Machinery orders, another leading indicator, are expected to continue in a growth trend, while the BOJ Tankan indicates that capex activities are reflecting a steady undertone. 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 sense of surplus in capex, and this should encourage more capex related demand in the future. Meanwhile, as the 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.

Moreover, considering the increase in exports and the results of the indices of industrial production, moderate growth in production and capacity utilization is seen despite some weakness seen in this area.

As for exports, moderate growth is seen continuing as overseas economies gradually recover. As for the US economy, the real GDP growth rate experienced a major slowdown during the Jan-Mar 2015 period, though certain negative factors, such as the effects of bad weather on the winter period and the collapse in the price of natural resources, as well as the one-sided strength of the dollar, are easing up somewhat, while the expected increase in interest rates is now to be delayed, the economy is now expected to pull off a sure recovery after the Apr-Jun period. The recovery in the US economy is expected to help not only Japan’s exports to the US, but exports of Japanese intermediate goods to Asia since the US is the location of final demand for many goods. 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 continuing favorably. As for China, whose economy has experienced slower growth recently, positive factors are now developing including the People’s Bank of China showing stronger interest in monetary easing, bringing expectations that moderate growth can be maintained on into the future and that the economy’s back will not be broken due to recent developments.

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