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Apr-Jun 2015 1st Preliminary GDP Estimate

Japan's economy marks time due to worsening exports and personal consumption

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Summary

- The real GDP growth rate for Apr-Jun 2015 (1st preliminary est) declined by -1.6% q/q annualized (-0.4% q/q). Meanwhile, market consensus was down by -1.8% q/q annualized (-0.5% q/q).This is the first time in three quarters for real GDP to experience a decline. The decline was due to weak results for exports and personal consumption, and considering the extent to which the real GDP growth rate fell, it is likely that Japan's economy is now marking time, and has entered a temporary lull.

- Performance by demand component in the Apr-Jun 2015 results shows personal consumption down -0.8% q/q, its first decline in four quarters. Looking at personal consumption by category, we see that consumption was weak overall, with negative numbers in all goods and services. Capex was down a small amount by -0.1% q/q for the first time in three quarters, apparently taking a short break from the recent growth trend. Exports suffered a decline for the first time in six quarters at -4.4% q/q. A decline in exports to both the US and Asia are seen as having contributed to downward pressure on performance.

- Our basic economic scenario sees Japan's economy gradually making a comeback, avoiding any truly adverse situations. We expect real GDP to improve with personal consumption and exports moving into a growth trend, and capex to gradually make a comeback. We expect the economy to return to a positive growth trend in the Jul-Sep 2015 period. However, there is a certain amount of risk that real GDP could move into a downtrend for the time being. We suggest keeping an eye on the trend in inventory adjustment. As for exports, be on the lookout for the following: there remains some risk that US capital spending could continue its downtrend due to weak corporate earnings, while the slowdown in the Chinese economy could continue unabated for some time.

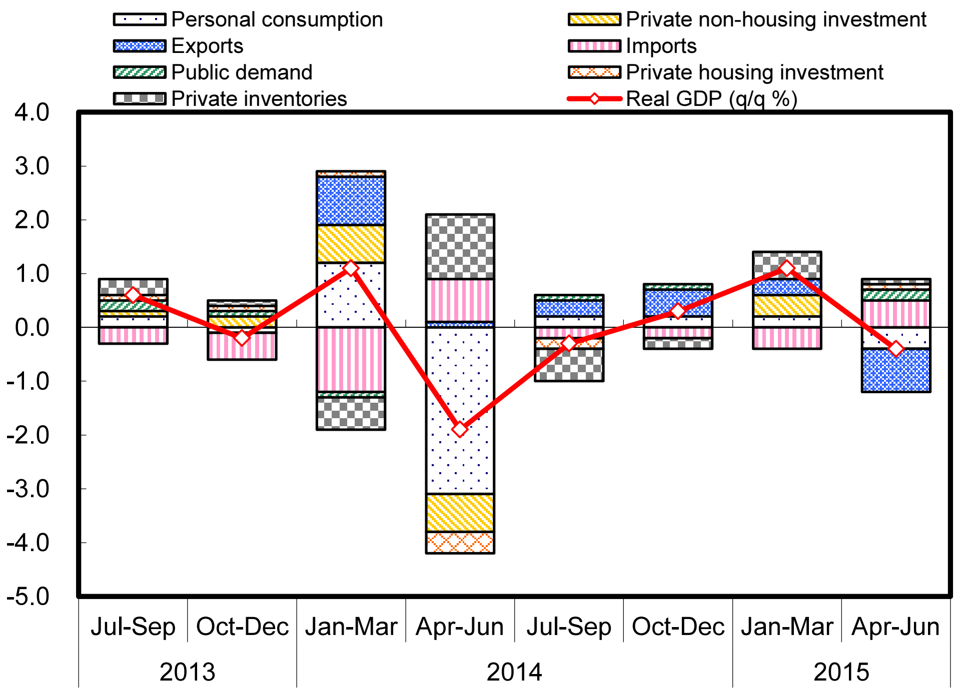
Japan's economy may have entered a temporary lull

The real GDP growth rate for Apr-Jun 2015 (1st preliminary est) declined by -1.6% q/q annualized (-0.4% q/q). Meanwhile, market consensus was down by -1.8% q/q annualized (-0.5% q/q).This is the first time in three quarters for real GDP to experience a decline. The decline was due to weak results for exports and personal consumption, and considering the extent to which the real GDP growth rate fell, it is likely that Japan's economy is now marking time, and has entered a temporary lull.

Exports and personal consumption are conspicuously weak

Performance by demand component in the Apr-Jun 2015 results shows personal consumption down -0.8% q/q, its first decline in four quarters. While the household employment and income environments continue to improve, there were several factors weighing heavily on personal consumption. These were (1) Real employee compensation fell for the first time in two quarters by -0.2% q/q, (2) Automobile sales were weak, centering on light vehicles, (3) Poor weather conditions brought downward pressure on economy, and (4) Households tended to watch their budgets due to the increase in prices for foodstuffs. Looking at personal consumption by category, we see that consumption was weak overall, with negative numbers in all goods and services. As for durables, household electronics marked time, while automobiles continued their decline, bringing negative results for the first time in three quarters at -2.2% q/q. Semi-durables were down considerably by -3.9% due to the effect of poor weather conditions on summer sale, while non-durables were also down for the first time in four quarters by -0.6%. Services suffered a small decline at -0.1%, but performance was actually somewhat on the high side in comparison with recent figures. Hence services are seen as maintaining a firm undertone.

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



Source: Cabinet Office; compiled by DIR.

Housing investment grew for the second consecutive quarter at +1.9%. Looking at the trend in new housing starts, a leading indicator for housing investment as a portion of GDP, the effects of 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, so it is only recently that housing investment hit bottom with a shift into the current growth trend.

Capex was down a small amount by -0.1% q/q for the first time in three quarters, apparently taking a short break from the recent growth trend. However, 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, hence the positive environment for capex continues. In addition, considering the fact that capex is experiencing moderate growth on the whole and that there is a firm undertone in corporate plans for capex spending according to the BOJ Tankan, these results should not be taken in an overly negative light.

Public investment grew for the first time in two quarters by +2.6% q/q. Results for the period were favorable, but the effects of having front-loaded the FY2013 supplementary budget and the FY2014 budget are gradually running out, leaving public investment, one of the leading economic indicators, weak. This means that additional economic measures will be needed in the future.

Exports suffered a decline for the first time in six quarters at -4.4% q/q. A decline in exports to both the US and Asia are seen as having contributed to downward pressure on performance. Exports to the US are seen as having been effected by the drop in exports of capital goods affected by weak capital spending in addition to what was likely a rebound effect from the previous period’s strong performance. As for exports to Asia, results reflect the overall decrease in transactions with the entire region, which has been influenced by China’s economic slowdown. Imports have also slowed down due to the decline in domestic demand (-2.6% q/q) for the first time in four quarters. The major contributor to downward pressure on exports which has expanded during this period is overseas demand (net exports), falling for the second consecutive quarter by -0.3%.

2015 Apr-Jun GDP (1st Preliminary Estimate) **Chart 2**

		2014			2015	
		Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun
Real GDP	Q/q %	-1.9	-0.3	0.3	1.1	-0.4
Annualized	Q/q %	-7.5	-1.3	1.4	4.5	-1.6
Personal consumption	Q/q %	-5.0	0.3	0.3	0.3	-0.8
Private housing investment	Q/q %	-10.9	-6.3	-0.6	1.7	1.9
Private non-housing investment	Q/q %	-4.6	-0.0	0.2	2.8	-0.1
Change in private inventories (contribution to real GDP growth)	Q/q % pts	1.2	-0.6	-0.2	0.5	0.1
Government consumption	Q/q %	0.1	0.3	0.3	0.3	0.4
Public investment	Q/q %	0.2	1.7	0.3	-1.2	2.6
Exports of goods and services	Q/q %	0.6	1.8	2.8	1.6	-4.4
Imports of goods and services	Q/q %	-3.9	0.9	0.9	1.8	-2.6
Domestic demand (contribution to real GDP growth)	Q/q % pts	-2.8	-0.4	0.0	1.2	-0.1
Foreign demand (contribution to real GDP growth)	Q/q % pts	0.9	0.1	0.3	-0.1	-0.3
Nominal GDP	Q/q %	0.2	-0.7	0.8	2.2	0.0
Annualized	Q/q %	0.8	-2.6	3.2	9.0	0.1
GDP deflator	Y/y %	2.2	2.1	2.4	3.5	1.6

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.

The GDP deflator grew for the third consecutive quarter at +0.4% q/q. Growth was less than the previous quarter (+1.1%), but shows a steady undertone. The domestic demand deflator was up for the second consecutive quarter at +0.2%. The price of crude oil took a break from its rapid decline, causing the import deflator’s rate of decline to slow somewhat. (The import deflator tends to move in the opposite direction of the GDP deflator). In y/y terms the GDP deflator was up by +1.6%, its sixth consecutive quarter of growth. The growth rate shrank in comparison to that of the previous period. Meanwhile, nominal GDP was up for the third consecutive quarter at +0.1% q/q annualized (+0.0% q/q).

Japan's economy expected to gradually make a comeback, avoiding adverse situations

Our basic economic scenario sees Japan's economy gradually making a comeback, avoiding any truly adverse situations. We expect real GDP to improve with personal consumption and exports moving into a growth trend, and capex to gradually make a comeback. We expect the economy to return to a positive growth trend in the Jul-Sep 2015 period. However, there is a certain amount of risk that real GDP could move into a downtrend for the time being. We suggest keeping an eye on the trend in inventory adjustment. As for exports, be on the lookout for the following: there remains some risk that US capital spending could continue its downtrend due to weak corporate earnings, while the slowdown in the Chinese economy could continue unabated for some time.

As for personal consumption, the positive environment for households in the areas of employment and income is expected to gradually lead to a recovery of the growth trend. Nominal wages and income are gaining support from positive factors including the following: (1) According to a survey carried out by the Japanese Trade Union Confederation, this year's pay scale increase is +0.69% y/y, (2) The FY2015 pension revision rate is +0.9% y/y (it was -0.7% in FY2014), and (3) Summer bonuses are expected to increase for the third consecutive year due to improvements in corporate business performance. This is expected to begin showing up in increases in household disposable income 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. 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. However, considering the weak performance of personal consumption this period, chances are that households will be budgeting more carefully in response to the rush to raise prices of foodstuffs. Weakening consumer confidence is something which must be watched over carefully on into the future.

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 exports, growth is seen gradually increasing centering on the advanced countries, and a shift to a growth trend is expected. However, both the US economy, and China's economy are becoming increasingly uncertain. There is some risk here that the recovery in exports could begin dragging its feet. The US economy experienced a major slowdown during the Jan-Mar 2015 period due to special factors, but is expected to make a comeback in the Apr-Jun 2015 period and to continue favorably in the future. 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, and 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. However, risk remains that US capital spending could remain in a downtrend due to weakening corporate earnings, and the possibility that the slowdown in the Chinese economy could continue unabated are factors which must be continually watched over with care in the future.

As for capex, a moderately paced comeback is expected despite fluctuations. 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. However, considerable downtrends being experienced in personal consumption and exports could, if they continue, could bring cuts in industrial production and capacity utilization. If this occurs, it would throw a shadow over hoped for recovery in capex spending. We suggest vigilance in this area.