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Apr-Jun 2015 2nd Preliminary GDP Estimate

GDP revised upwards from 1st preliminary report; results lack substance

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Summary

- The real GDP growth rate for Apr-Jun 2015 (2nd preliminary est) was revised upwards to -1.2% q/q annualized (-0.3% q/q) in comparison to the 1st preliminary report (-1.6% q/q annualized and -0.4% q/q). Results also exceeded market consensus at -1.6% q/q annualized (-0.4% q/q). The fact that results exceeded market consensus is attributed to the extent to which inventory investment was revised upwards, coming in well above original expectations. Our comprehensive assessment of this modest revision of the real GDP growth rate is that the 2nd preliminary estimate confirms our previous opinion that Japan's economy is in a temporary lull due to weak exports and consumption. With inventories accumulating to an extent which was previously unexpected and capex receiving a downward revision, the substance of this revision does not look good.

- Performance by demand component in the revised Apr-Jun 2015 results shows capex suffering a downward revision, but inventory investment getting a larger upward revision than was originally expected, thereby providing some upward pressure to overall results. The results of corporate statistics brought capex investment down by -0.9% q/q, a downward revision in comparison to the 1st preliminary GDP estimate (-0.1%). Meanwhile inventory investment grew by +0.3%pt q/q, an upward revision from the 1st preliminary's +0.1%pt, exceeding market consensus by +0.2%pt q/q. Looking at inventory investment by category we see that all four major categories were revised upwards, with inventory growth seen in three areas – finished goods, raw materials, and distribution inventory. It should be noted, however, that there are recent signs of inventory accumulating.

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

		2014			2015		
		Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun First	Apr-Jun Second
Real GDP	Q/q %	-2.0	-0.3	0.3	1.1	-0.4	-0.3
Annualized	Q/q %	-7.6	-1.1	1.3	4.5	-1.6	-1.2
Personal consumption	Q/q %	-5.0	0.3	0.3	0.4	-0.8	-0.7
Private housing investment	Q/q %	-10.9	-6.3	-0.6	1.7	1.9	1.9
Private non-housing investment	Q/q %	-4.2	-0.2	0.1	2.6	-0.1	-0.9
Change in private inventories (contribution to real GDP growth)	Q/q % pts	1.2	-0.5	-0.2	0.5	0.1	0.3
Government consumption	Q/q %	0.1	0.3	0.3	0.3	0.4	0.5
Public investment	Q/q %	0.4	1.6	0.2	-1.4	2.6	2.1
Exports of goods and services	Q/q %	0.6	1.8	2.8	1.6	-4.4	-4.4
Imports of goods and services	Q/q %	-3.9	0.9	0.8	1.8	-2.6	-2.6
Domestic demand (contribution to real GDP growth)	Q/q % pts	-2.8	-0.4	0.0	1.2	-0.1	-0.0
Foreign demand (contribution to real GDP growth)	Q/q % pts	0.9	0.1	0.3	-0.1	-0.3	-0.3
Nominal GDP	Q/q %	0.2	-0.6	0.8	2.1	0.0	0.1
Annualized	Q/q %	0.7	-2.4	3.2	8.9	0.1	0.2
GDP deflator	Y/y %	2.2	2.1	2.4	3.5	1.6	1.5

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 revised upwards from 1st preliminary report

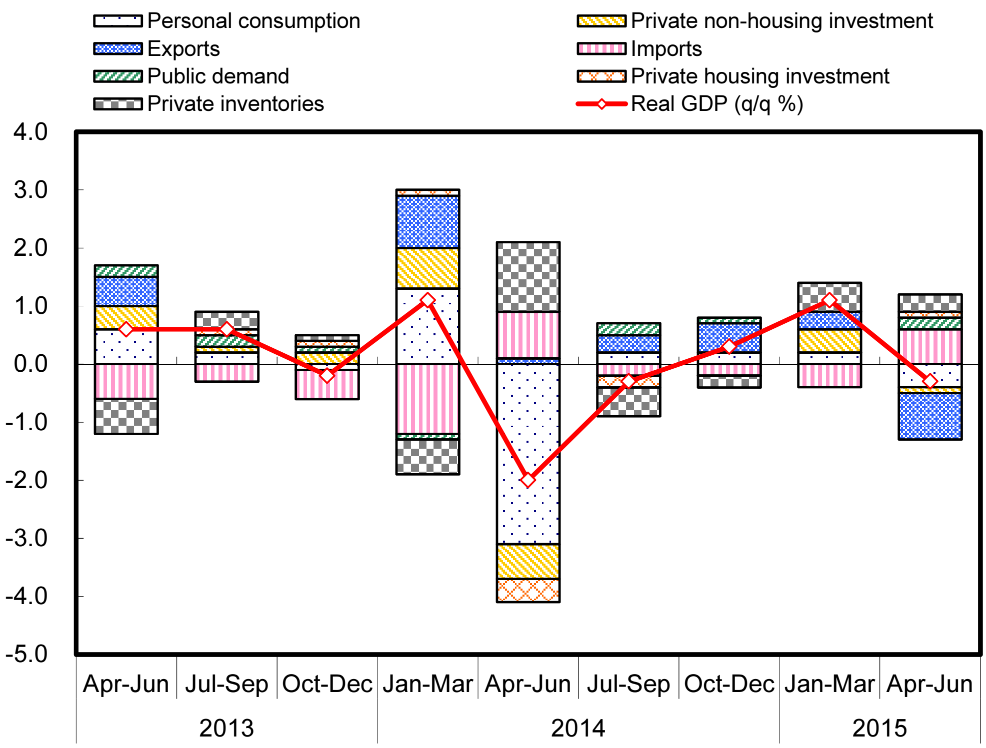
The real GDP growth rate for Apr-Jun 2015 (2nd preliminary est) was revised upwards to -1.2% q/q annualized (-0.3% q/q) in comparison to the 1st preliminary report (-1.6% q/q annualized and -0.4% q/q). Results also exceeded market consensus at -1.6% q/q annualized (-0.4% q/q). The fact that results exceeded market consensus is attributed to the extent to which inventory investment was revised upwards, coming in well above original expectations. Our comprehensive assessment of this modest revision of the real GDP growth rate is that the 2nd preliminary estimate confirms our previous opinion that Japan's economy is in a temporary lull due to weak exports and consumption. With inventories accumulating to an extent which was previously unexpected and capex receiving a downward revision, the substance of this revision does not look good.

While inventory investment was revised upwards more than expected, capex suffered a downward revision

Performance by demand component in the revised Apr-Jun 2015 results shows capex suffering a downward revision, but inventory investment getting a larger upward revision than was originally expected, thereby providing some upward pressure to overall results. The results of corporate statistics brought capex investment down by -0.9% q/q, a downward revision in comparison to the 1st preliminary GDP estimate (-0.1%). Meanwhile inventory investment grew by +0.3%pt q/q, an upward revision from the 1st preliminary's +0.1%pt, exceeding market consensus by +0.2%pt q/q. Looking at inventory investment by category we see that all four major categories were revised upwards, with inventory growth seen in three areas – finished goods, raw materials, and distribution inventory. It should be noted, however, that there are recent signs of inventory accumulating.

Meanwhile, public investment was revised downwards from the 1st preliminary report, but no so much as to have a great influence on the final GDP figure. Housing investment, imports and exports were flat in comparison to the 1st preliminary report, while personal consumption and government consumption were revised upwards.

Contribution to Real GDP (% pt; seasonally adjusted basis) **Chart 2**



Source: Cabinet Office; compiled by DIR.

Trends by demand component: Weak exports and consumption bring downward pressure on overall results

Next we take a look at trends in demand components based on the results of the Apr-Jun 2015 (2nd preliminary est). Personal consumption was down by -0.7% q/q (-0.8% on the 1st preliminary report), its first decline in four quarters, taking a short breather from the recovery trend seen up to now. While the employment environment is improving for households, there have been several factors weighing down on personal consumption: (1) Real compensation of employees from a macro viewpoint declined for the first time in two quarters by -0.2% q/q (-0.2% on the 1st preliminary report), (2) Automobile sales centering on light vehicles have slowed down, (3) Unseasonable weather has brought downward pressure on the economy, and (4) Prices of foodstuffs have been on the rise, making households more budget-minded.

Housing investment grew for the second consecutive quarter at +1.9% (also +1.9% on the 1st preliminary report). 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 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 is recorded on a progressive basis, hence there is a lag in performance in comparison to housing starts, but housing investment has now hit bottom and has shifted into a growth trend.

Capex declined for the first time in three quarters by -0.9% q/q (-0.1% on the 1st preliminary report) apparently taking a short break from the recent growth trend. However, the sense of overcapacity is easing up amongst corporations and improvements can be seen in corporate earnings, 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 +2.1% q/q (+2.6% on the 1st preliminary report). Results for the period were favorable, but the effects of having front-loaded government budgets in the past are gradually running out, leaving the leading economic indicator of public investment weak. This means that additional economic measures will be needed in the future in order to avoid a gradual decline.

Exports suffered a decline for the first time in six quarters at -4.4% q/q (also -4.4% on the 1st preliminary report). A decline in exports to both the US and Asia are seen as having contributed to downward pressure on performance. Imports have also slowed down due to the decline in domestic demand (-2.6% q/q, unchanged from the 1st preliminary report) 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%pt (also -0.3%pt on the 1st preliminary report).

Japan's economy expected to gradually make a comeback, but a sense of uncertainty regarding the future has been increasing recently

Our basic economic scenario sees Japan's economy gradually making a comeback. We expect real GDP to improve with personal consumption and exports, which contributed to downward pressure on this report, making a turnaround and capex gradually make a comeback. We expect the economy to return to a positive growth trend in the Jul-Sep 2015 period, even if only by a small amount. However, there is a certain amount of risk that real GDP could be sluggish for the time being. We suggest keeping an eye on the trend in inventory adjustment. Final demand during the Apr-Jun 2015 period was weak, and inventories have accumulated. For this reason we believe that there will be growing pressure to carry out inventory adjustment during the Jul-Sep 2015 period. In addition, considering the trends in the monthly indices, the pace of the comeback for personal consumption and exports could be slow.

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 continue to budget 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 has been making a comeback since the Apr-Jun 2015 period and should 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 a steady undertone. 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, 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.