Daiwa
Daiwa Institute of Research

8 December 2015 (No. of pages: 4)

Japanese report: 08 Dec 2015

Jul-Sep 2015 2nd Preliminary GDP Estimate

Real GDP growth rate revised considerably upwards from 1st preliminary

Economic Intelligence Team
Satoshi Osanai
Shunsuke Kobayashi

Summary

- The real GDP growth rate for Jul-Sep 2015 (2nd preliminary est) was revised considerably upwards to +1.0% q/q annualized (+0.3% q/q) in comparison to the 1st preliminary report (-0.8% q/q annualized and -0.2% q/q). Results also exceeded market consensus due to the upward revision of inventory investment. When averaged with the Apr-Jun period results, the Jul-Sep period 2nd preliminary estimate reconfirms our previous opinion that Japan’s economy is in a temporary lull.

- Performance by demand component in comparison to the 1st preliminary results shows personal consumption and public investment recording downward revisions, while inventory and capex won major upward revisions, helping to increase overall results. Capex declined by -1.3% q/q on the 1st preliminary report due to corporate statistics, but has recovered its growth trend on this report by +0.6%.

2015 Jul-Sep GDP (2nd Preliminary Estimate) **Chart 1**

		2014		2015			
		Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	
						First	Second
Real GDP	Q/q %	-0.7	0.5	1.1	-0.1	-0.2	0.3
Annualized	Q/q %	-2.8	1.8	4.4	-0.5	-0.8	1.0
Personal consumption	Q/q %	0.0	0.4	0.3	-0.5	0.5	0.4
Private housing investment	Q/q %	-6.9	-0.7	2.0	2.5	1.9	2.0
Private non-housing investment	Q/q %	-0.4	0.2	2.7	-1.3	-1.3	0.6
Change in private inventories (contribution to real GDP growth)	Q/q % pts	-0.6	-0.1	0.5	0.3	-0.5	-0.2
Government consumption	Q/q %	0.2	0.4	0.2	0.4	0.3	0.3
Public investment	Q/q %	1.6	-0.5	-2.0	3.3	-0.3	-1.5
Exports of goods and services	Q/q %	1.6	2.9	1.9	-4.3	2.6	2.7
Imports of goods and services	Q/q %	1.1	0.8	1.7	-2.6	1.7	1.7
Domestic demand (contribution to real GDP growth)	Q/q % pts	-0.7	0.1	1.1	0.1	-0.3	0.1
Foreign demand (contribution to real GDP growth)	Q/q % pts	0.1	0.3	-0.0	-0.2	0.1	0.1
Nominal GDP	Q/q %	-0.9	0.8	2.0	0.2	0.0	0.4
Annualized	Q/q %	-3.4	3.4	8.4	0.6	0.1	1.6
GDP deflator	Y/y %	2.0	2.3	3.3	1.5	2.0	1.8

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 considerably upwards from 1st preliminary

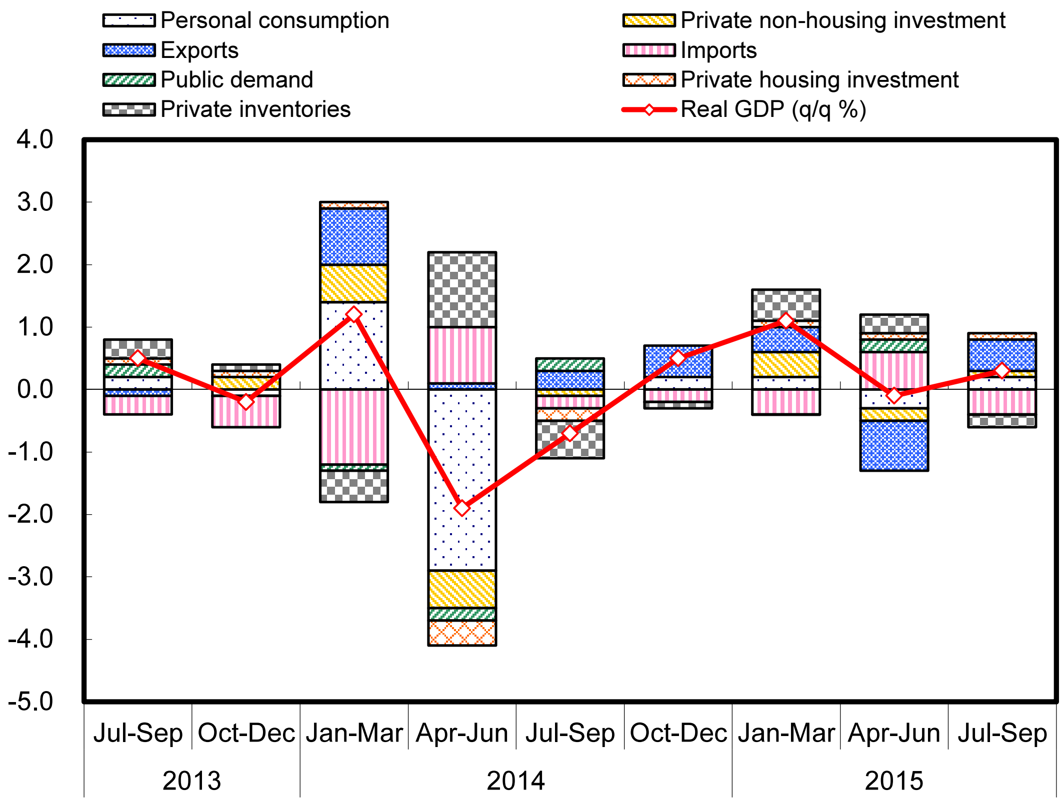
The real GDP growth rate for Jul-Sep 2015 (2nd preliminary est) has been revised considerably upwards to +1.0% q/q annualized (+0.3% q/q) from the 1st preliminary results (-0.8% q/q annualized and -0.2% q/q). results also exceeded market consensus at +0.1% q/q annualized and +0.0% q/q. When averaged with the Apr-Jun period results, the Jul-Sep period 2nd preliminary estimate reconfirms our previous opinion that Japan's economy is in a temporary lull. An especially positive factor in these results is the major upward revision in capex.

Major upward revision for capex and inventory investment raises overall results

Performance by demand component in light of upward revisions from the 1st preliminary results shows personal consumption and public investment with downward revisions, but inventory investment and capex were revised considerably upwards, helping to increase overall results. Capex declined by -1.3% q/q on the 1st preliminary report due to corporate statistics, but has recovered its growth trend on this report by +0.6%. Inventory investment's contribution to overall results was revised considerably upwards from -0.5% q/q on the 1st preliminary report to -0.2% on the 2nd preliminary, while also exceeding market consensus at -0.5%. Looking at inventory investment by category, out of the four categories of investment raw materials and transit inventory were revised upwards, while finished goods inventory and work-in-process were flat. Transit inventory received an especially major upward revision, thought to be due mainly to the computerization of statistics on finished goods on hand in commercial statistics.

As for other components, government consumption and imports were flat in comparison to the 1st preliminary results, while housing investment and exports were revised upwards. However, overall GDP results were not influenced much by this.

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



Source: Cabinet Office; compiled by DIR.

Trends by demand component: inventory adjustment becomes apparent

Looking at trends in demand components after upward revisions on the Jul-Sep 2015 period results (2nd preliminary report), we see personal consumption achieving growth for the first time in two quarters at +0.4% q/q (+0.5% on the 1st preliminary). However, this was not enough to recover lost ground from the Apr-Jun period decline of -0.6%, showing the pace of recovery in personal consumption to lack strength. On average, personal consumption is evaluated as still marking time. Behind this situation lies the rush of price hikes in foodstuffs, which, despite the improvement in the employment and income environments leading to growth in real compensation of employees (and which does contribute to overall increase in GDP), has tended to increase the tendency of households to tighten their budgets, causing a drag on growth in personal consumption.

Housing investment grew for the third consecutive quarter at +2.0% q/q (+1.9% on the 1st preliminary). Housing starts, a leading indicator for housing investment, are continuing a gradual comeback due to improvement in the household employment and income environments, as well as low interest on housing loans. Housing investment is recorded on a progressive basis, hence there is a time lag which causes these figures to come in later than housing starts. Hence it appears that the growth trend is continuing.

Capex grew for the first time in two quarters at +0.6% q/q (+1.9% on the 1st preliminary), continuing to show a moderate growth trend despite some fluctuations during the period. Growth is considered to be due to the high level of corporate cash flow associated with record earnings for corporations.

Private sector inventory was down for the first time in three quarters at -0.2% q/q. inventory adjustment is considered to have become more evident after a period of accumulation.

Public investment suffered a decline for the first time in two quarters at -1.5% q/q (-0.3% on the 1st preliminary). Without the effects of economic policy as there was in the past, public investment, one of the leading economic indicators, was weak. It appears that public investment, which lags behind the leading indicators, has now shifted into the negative region.

Exports achieved growth for the first time in two quarters at +2.7% q/q (+2.6% on the 1st preliminary). With the slowdown in the economies of the emerging nations, especially China, goods, according to foreign trade statistics, continue to be weak. The overseas corporate sector was especially weak and prices of natural resources are low, bringing sluggish performance in capital goods and materials. However, exports on an SNA basis (national accounts of Japan) are not nearly as bad as they look in the trade statistics, and the increase in foreigners visiting Japan has led to an increase in exports of services, bringing a positive contribution to GDP. Imports also grew for the first time in two quarters at +1.7% (unchanged from the 1st preliminary). Since growth in exports was larger than that of imports, the contribution of overseas demand (net exports) was close to zero, but exports did contribute +0.1%, (unchanged from the 1st preliminary).

Japan's economy expected to gradually make a comeback

There is no change in our basic economic scenario. We see Japan's economy gradually making a comeback from its temporary lull as the effects of the overseas economic slowdown ease up and personal consumption recovers backed by a good employment environment and improving incomes.

Personal consumption is expected to continue its recovery due to the above factors, and move toward a comeback despite occasional ups and downs. Nominal wages according to the monthly labour survey continue to be weak due to a changeover in sampling. However, considering the trend in this year's pay scale increase after the annual spring labor offensive, as well as trends in bonuses according to survey findings (data from summer), the real situation with wages appears to be maintaining a stronger undertone than it appears when looking at the statistics. In addition, wages of part-time workers are also continuing to grow due to the positive employment environment and the increase in minimum wage. Meanwhile, disposable income of pensioners is growing somewhat, due to the increase in the pension revision rate. A number of factors are expected to provide support for personal consumption, including the upward pressure real wages are getting from the decline in the growth rate of the consumer price index and the continued increase in the number of employees.

Housing investment is expected to maintain a firm undertone with improvements in the employment and income environment and low interest on housing loans. In addition, households considering purchase of a new house should gradually increase as we move into the year 2016 in anticipation of a second consumption tax hike. However, considering the sluggishness in housing starts, a leading indicator, the tempo of growth is expected to be gradual. A note of caution is required in regard to the recent scandal regarding the falsification of condominium construction data and where this might lead. If the problem persists for the long-term, suspicions regarding the safety of newly built condominiums could become acute, and consumers could delay purchasing. Looking back to the year 2005 when it was found that seismic strength of buildings had been falsified, a situation which led to the revision of the Building Standards Law in 2007, steep declines in housing investment due to this kind of problem remain fresh in memory.

Public investment is gradually shedding the effects of economic policy which provided support in the past, and is expected to continue to decline. Contracts and orders received, which provide the leading indicators for this area, are already showing signs of peaking out. The general tone in this area is expected to continue in that vein.

Meanwhile, exports are expected to continue a moderate recovery while experiencing both strong and weak points as the effects of the slowdown in overseas economies eases up. A firm undertone continues in US economic expansion centering on the household sector, bringing expectations for a recovery in Japanese exports centering on durables. As for the EU, the economy is expected to move gradually toward a comeback due to the effects of the collapse of crude oil prices and additional monetary easing on the part of the ECB. Exports to the EU, which had been weak during summer, are expected to gradually recover to a growth trend. As for the Asian economy, China’s real economy has hit bottom due to the lowering of the reserve deposit rate and interest cuts, and effects are gradually being seen in personal consumption. There is a good possibility that declines in consumption can be avoided with positive effects in purchasing of consumer goods.

As for capex, a gradual recovery is seen despite ups and downs due to record-setting corporate earnings. According to surveys measuring capex investment plans such as the BOJ Tankan, there is a forward-looking stance in regard to capex spending. Replacement investment, labor saving, and energy saving appear to be promising. However, statistics seem to see current business sentiment as being stronger than it actually is, and caution is urged regarding risk of a downtrend in the future. The possibility that corporations delaying capex spending, especially in manufacturing, may increase in the future due to the slowdown in emerging nation economies centering on China, weakness in the corporate sectors of overseas economies leading to stagnation for exports, and the slow pace of recovery in personal consumption. In addition, machinery orders, one of the leading indicators, have been weak. Hence we suggest vigilance in this area.