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Oct-Dec 2015 1st Preliminary GDP Estimate

GDP experiences negative growth for first time in two quarters hinting at risk of economic downturn in future

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Summary

- The real GDP growth rate for Oct-Dec 2015 (1st preliminary est) declined by -1.4% q/q annualized (-0.4% q/q), falling just below market consensus as well (-1.3% q/q annualized (-0.3% q/q), though this fell within expectations. This is the first time in two quarters for GDP to record negative growth. Capex continued its comeback, but personal consumption, housing investment, inventory investment, and exports suffered declines, bringing downward pressure on overall results. All in all, these results indicate that Japan’s economy remained in a lull during the fourth quarter as our previous outlook suggested.

- Performance by demand component in the Oct-Dec 2015 results shows personal consumption down by -0.8% q/q, the first time it has declined in two quarters. Though real employee compensation maintained a strong undertone such that the employment and income environment contributed a plus, households continued to be more budget minded, while the unseasonably warm winter took a bite out of sales of cold weather products, including clothing, heating equipment, and energy, thus bringing down overall performance. Capex rose by +1.4% q/q, its second consecutive quarter of growth, in a continuation of its comeback. Private sector inventory was down for the second consecutive quarter at -0.1% pt, contributing to this period’s decline in real GDP. Meanwhile, exports declined for the first time in two quarters at -0.9% q/q.

- Due to the absence of a clearly driving force, our basic economic scenario sees Japan’s economy facing risk of a possible downturn in the future. We urge caution regarding the rapid increase in risk factors in recent weeks which could have a negative effect on Japan’s economy, especially the downturn in the Chinese economy, turmoil in the global financial markets in response the US exit strategy, and a strong yen / weak stock market situation brought on by risk-off behavior of investors. We also note that GDP statistics do not make adjustments for the leap year, hence the Jan-Mar 2016 period figures could be on the strong side due to the extra day in comparison to February of the previous year.

GDP experiences negative growth for first time in two quarters, but results were within the range of expectation

The real GDP growth rate for Oct-Dec 2015 (1st preliminary est) declined by -1.4% q/q annualized (-0.4% q/q), falling just below market consensus as well (-1.3% q/q annualized (-0.3% q/q), though this fell within expectations. This is the first time in two quarters for GDP to record negative growth. Capex continued its comeback, but personal consumption, housing investment, inventory investment, and exports suffered declines, bringing downward pressure on overall results. All in all, these results indicate that Japan's economy remained in a lull during the fourth quarter as our previous outlook suggested.

2015 Oct-Dec GDP (1st Preliminary Estimate) **Chart 1**

		2014	2015				
		Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	
						First	Second
Real GDP	Q/q %	0.6	1.0	-0.3	0.3	-0.4	-0.4
Annualized	Q/q %	2.5	4.2	-1.4	1.3	-1.4	-1.4
Personal consumption	Q/q %	0.6	0.2	-0.8	0.4	-0.8	-0.8
Private housing investment	Q/q %	-0.4	2.1	2.3	1.6	-1.2	-1.2
Private non-housing investment	Q/q %	-0.0	2.8	-1.2	0.7	1.4	1.4
Change in private inventories (contribution to real GDP growth)	Q/q % pts	-0.2	0.5	0.3	-0.2	-0.1	-0.1
Government consumption	Q/q %	0.3	0.2	0.5	0.2	0.5	0.5
Public investment	Q/q %	0.7	-2.9	3.3	-2.0	-2.7	-2.7
Exports of goods and services	Q/q %	3.2	2.1	-4.6	2.6	-0.9	-0.9
Imports of goods and services	Q/q %	1.1	1.9	-2.6	1.3	-1.4	-1.4
Domestic demand (contribution to real GDP growth)	Q/q % pts	0.3	1.0	-0.0	0.1	-0.5	-0.5
Foreign demand (contribution to real GDP growth)	Q/q % pts	0.3	-0.0	-0.3	0.2	0.1	0.1
Nominal GDP	Q/q %	1.0	1.9	-0.0	0.6	-0.3	-0.3
Annualized	Q/q %	3.9	7.9	-0.1	2.5	-1.2	-1.2
GDP deflator	Y/y %	2.3	3.3	1.5	1.8	1.5	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.

All major components suffered declines with the exception of capex

Performance by demand component in the Oct-Dec 2015 results shows personal consumption down by -0.8% q/q, the first time it has declined in two quarters. Though real employee compensation maintained a strong undertone such that the employment and income environment contributed a plus, households continued to be more budget minded, while the unseasonably warm winter took a bite out of sales of cold weather products, including clothing, heating equipment, and energy, thus bringing down overall performance. Looking at performance of specific items in personal consumption, we see that there was influence from a variety of sources, including reactionary decline after the growth experienced during the Apr-June period and declines which occurred due to the unusually warm winter, including declines in all four categories of goods and services. Durables (-3.1%) and semi-durables (-3.7%) recorded especially noticeable declines. These areas suffered from negative factors including continued sluggishness of automobile sales and poor performance for sales of heating equipment due to the warm winter weather. Sales of semi-durables also suffered for the same reason, with a decline in sales of winter clothing. These factors all contributed to the overall decline in GDP. Meanwhile, non-durables suffered a decline for the first time in two quarters, due also to the unseasonable weather. Energy consumption, such as heating oil, also suffered a decline. Services suffered a decline for the first time in five quarters at -0.1%, though a small one. This area still retained underlying strength in the balance.

Housing investment declined for the first time in four quarters at -1.2%. Looking at the trend in new housing starts, a leading indicator for housing investment as a portion of GDP, it appears that performance has been weak since sometime around the middle of the year. Housing investment and housing starts are recorded on a progressive basis, hence there is a lag in their performance, but it appears that this area too has shifted into a declining trend. Behind this development is a reaction to the quick pace of recovery for housing investment earlier in 2015 and an increase in construction costs and sales prices, which led to the tendency of consumers to hold off on buying.

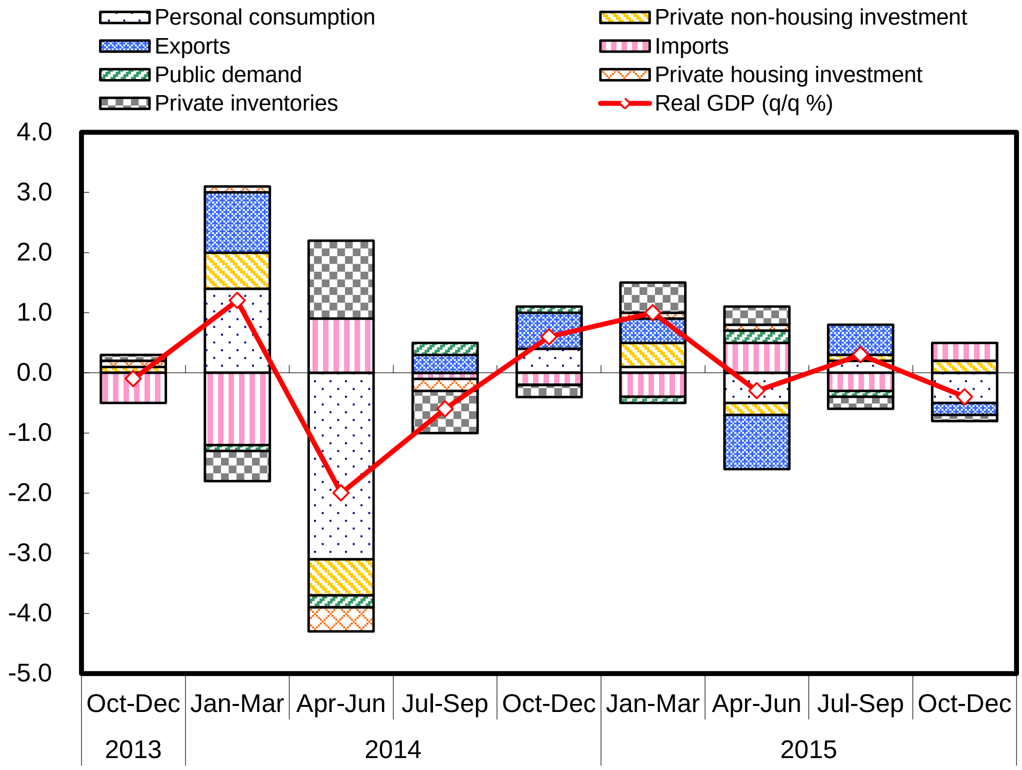
Capex rose by +1.4% q/q, its second consecutive quarter of growth, in a continuation of its comeback. This was made possible by historic highs in corporate earnings, which encouraged replacement investment. Meanwhile, according to surveys including the BOJ Tankan, corporations are showing a forward-looking stance toward capex, especially in the non-manufacturing industries. Looking at the trend in total supply of capital goods and shipment of capital goods, coincident indicators for capex, we see that non-ferrous metals and general-purpose, production, & business oriented machinery suffered declines, which contributed negatively to overall results, but transport equipment is showing signs of bottoming out, and electrical machinery achieved growth, helping to bring overall performance up somewhat.

Private sector inventory was down for the second consecutive quarter at -0.1% pt contributing to this period's decline in real GDP. Raw materials inventories are provisional at the stage of 1st preliminary GDP estimates, and this component brought a major negative contribution this time around. Other items in the inventory category were marking time, including finished goods inventory, goods in process inventory, and distribution inventory.

Public investment declined for the first time in two quarters at -2.7% q/q. Without the effects of economic policy as there was in the past, public investment, one of the leading economic indicators, was weak.

Meanwhile, exports were also down for the first time in two quarters at -0.9% q/q. The increase in foreigners visiting Japan has led to an increase in exports of services, bringing a positive contribution to GDP. Meanwhile, with the slowdown in the economies of the emerging nations, especially China, goods, according to foreign trade statistics, continue to be weak, bringing down overall performance. Imports also declined for the first time in two quarters at -1.4%. Since the decline in imports was larger than that of exports, the contribution of overseas demand (net exports) was up by +0.1% pt.

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



Source: Cabinet Office; compiled by DIR.

The GDP deflator grew for the fifth consecutive quarter at +0.1% q/q. Growth was slightly less than the previous quarter (+0.3%), but shows an overall steady undertone. The domestic demand deflator was flat at +0.0%, while the export deflator was down by a larger degree than the previous period's GDP results, but overall results were still on the plus side. (A decline in the export deflator normally would have a negative effect on overall GDP results.) In y/y terms the GDP deflator was up by +1.5%, its eighth consecutive quarter of growth, but the growth rate shrank in comparison to that of the previous period. Meanwhile, nominal GDP was down for the first time in two quarters at -1.2% q/q annualized (-0.3% q/q).

With no clearly driving force, Japan's economy faces risk of possible downturn

Due to the absence of a clearly driving force, our basic economic scenario sees Japan's economy facing risk of a possible downturn in the future. We urge caution regarding the rapid increase in risk factors in recent weeks which could have a negative effect on Japan's economy, especially the downturn in the Chinese economy, turmoil in the global financial markets in response the US exit strategy, and a strong yen / weak stock market situation brought on by risk-off behavior of investors. We also note that GDP statistics do not make adjustments for the leap year, hence the Jan-Mar 2016 period figures could be on the strong side due to the extra day in comparison to February of the previous year.

Personal consumption is expected to continue its underlying strength due to a recovery in personal consumption backed by improvements in the employment and income environment. As for the question of income, real wages according to the monthly labour survey continue to be weak since summer of 2015 due to a changeover in sampling, but it appears that the decline will stop in the near future. Real employee compensation (real wages x employment) in the macro sense is maintaining a strong undertone due to the growth trend in employment. Meanwhile, the positive employment environment and the raising of the minimum wage are expected to bring a gradual increase in part-timer pay. The effect of a slower growth rate in the consumer price index promises to continue pushing up real wages, and this should be a factor in providing underlying support for personal consumption. Meanwhile, factors to keep in mind are the pension revision rate which was raised in Fiscal 2015 for the first time in sixteen years, and which the government has decided to leave unchanged in Fiscal 2016, as well as the spring labor offensive in 2016, which may very possibly bring a smaller wage revision rate than in 2015 (final tally results +2.20%).

Looking at the trend in new housing starts, a leading indicator for housing investment, it appears that performance continues to be weak. Housing starts are weighted down by an increase in construction costs and sales prices, as well as the scandal regarding the falsification of condominium construction data which surfaced late n 2015. However, improvements in the employment and income environment, along with the historic lows in interest on housing loans, and then beyond the year 2016, the expected further increase in consumption tax in April 2017, are expected to work together in encouraging a gradual increase in the number of households considering purchase of a new home. Housing starts should soon return to a growth trend. Housing investment is expected to recover to a growth trend in the future, though there is expected to be a time lag between the expected increase in housing starts and the subsequent recovery in housing investment.

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

Meanwhile, exports are expected to make a gradual comeback while experiencing both strong and weak points with the US and European economies showing a firm undertone and exports of services recording favorable performance. However, overseas economies show a growing risk of a downturn, with the worldwide industrial sector in the doldrums due to the rapid decline in the price of resources and excess production capacity. Overseas shipments of electronic parts and devices for smartphones are expected to suffer a temporary decline. Considering this fact, the expected shift back into a growth trend for exports of goods will likely have to wait until sometime after spring. 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 are expected to gradually recover to a growth trend. As for the Asian economy, electronic parts and devices for smartphones as mentioned above, as well as iron & steel and materials are expected to be a drag on performance due to China’s excess production capacity. Asian exports are expected to continue on the weak side. As for China, whose economic slowdown continues, monetary easing and promotion of automobile sales are helping to lift the real economy, and the effects are beginning to show up in personal consumption and the service sector. There is a good possibility that declines in consumption can be avoided in the area of consumer goods.

As for capex, the gradual recovery is seen continuing due to record-setting corporate earnings, which are encouraging replacement investment. According to surveys measuring capex investment plans such as the BOJ Tankan, there is a forward-looking stance in regard to capex spending, especially in the non-manufacturing industries. Replacement investment, labor saving, and energy saving appear to be promising. However, statistics seem to see current business sentiment in the manufacturing industries as being stronger than it actually is, and caution is urged regarding risk of a downtrend in the future. 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 means that corporations delaying capex spending may increase in the future, especially amongst manufacturers.