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Jan-Mar 2016 1st Preliminary GDP Estimate

GDP grows for first time in two quarters. Economy remains in a lull.

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Summary

- The real GDP growth rate for Jan-Mar 2016 (1st preliminary est) grew by +1.7% q/q annualized (+0.4% q/q), and exceeded market consensus as well (+0.3% q/q annualized, +0.1% q/q). This is the first time in two quarters for real GDP to achieve growth. However, considering the fact that some of this growth is due to extra business days gained in the leap year, we would have to conclude that real GDP gained only slightly, or is actually marking time. All in all, results went according to the DIR outlook, with Japan's economy remaining in a lull.

- Performance by demand component in the Jan-Mar 2016 results shows personal consumption up for the first time in two quarters by +0.5% q/q. However, our assessment is that it is actually marking time if we remove the increase gained from extra business days due to the leap year. Our assessment is that personal consumption remains stagnant. Housing investment declined for the second consecutive quarter at -0.8%. Capex declined for the first time in three quarters at -1.4% q/q, apparently taking a breather from its overall growth trend. While the extent of contribution of private sector inventory growth was slight at -0.0%pt, the final contribution was down for the third consecutive quarter. Meanwhile, exports grew for the first time in two quarters at +0.6% q/q. As for exports of goods, trade with both the EU and the US grew, bringing a positive contribution.

- Although personal consumption is expected to continue its underlying strength due to improvements in the employment and income environment, the absence of a clearly driving force in the economy colors our basic economic scenario, which sees Japan's economy continuing to face risk of a possible downturn in the future. We urge caution regarding lingering risk factors which could have a negative impact 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. In addition, one should keep in mind the possible fluctuations in the economy which could occur due to the effects of the recent earthquake in Kumamoto.

GDP grows for first time in two quarters, exceeds market consensus

The real GDP growth rate for Jan-Mar 2016 (1st preliminary est) grew by +1.7% q/q annualized (+0.4% q/q), and exceeded market consensus as well (+0.3% q/q annualized, +0.1% q/q). This is the first time in two quarters for real GDP to achieve growth. However, considering the fact that some of this growth is due to extra business days gained in the leap year, we would have to conclude that real GDP gained only slightly, or is actually marking time. As for demand components, personal consumption, public investment, and exports moved into a growth trend, while housing investment, capex and imports suffered declines. All in all, results went according to the DIR outlook, with Japan's economy remaining in a lull.

2016 Jan-Mar GDP (1st Preliminary Estimate) **Chart 1**

		2015				2016
		Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar
Real GDP	Q/q %	1.3	-0.4	0.4	-0.4	0.4
Annualized	Q/q %	5.4	-1.7	1.6	-1.7	1.7
Personal consumption	Q/q %	0.2	-0.8	0.5	-0.8	0.5
Private housing investment	Q/q %	2.1	2.2	1.7	-1.0	-0.8
Private non-housing investment	Q/q %	3.8	-1.6	0.7	1.2	-1.4
Change in private inventories (contribution to real GDP growth)	Q/q % pts	0.6	0.3	-0.1	-0.1	-0.0
Government consumption	Q/q %	0.3	0.5	0.2	0.7	0.7
Public investment	Q/q %	-2.8	3.0	-2.2	-3.5	0.3
Exports of goods and services	Q/q %	2.2	-4.8	2.6	-0.8	0.6
Imports of goods and services	Q/q %	1.5	-2.6	1.7	-1.1	-0.5
Domestic demand (contribution to real GDP growth)	Q/q % pts	1.2	-0.1	0.3	-0.5	0.2
Foreign demand (contribution to real GDP growth)	Q/q % pts	0.1	-0.3	0.1	0.1	0.2
Nominal GDP	Q/q %	2.0	-0.1	0.7	-0.2	0.5
Annualized	Q/q %	8.2	-0.6	2.9	-0.7	2.0
GDP deflator	Y/y %	3.2	1.4	1.8	1.5	0.9

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.

Personal consumption flat when effects of leap year ignored

Performance by demand component in the Jan-Mar 2016 results shows personal consumption up for the first time in two quarters by +0.5% q/q. However, our assessment is that it is actually marking time if we remove the increase gained from extra business days due to the leap year. Our assessment is that personal consumption remains stagnant. Behind this situation lies real employee compensation, which maintained a firm undertone such that the employment and income environment contributed a plus, but households continued to be more budget minded, with average propensity to consume on the decline. The unseasonably warm January followed by the unusually cold weather in March brought a slowdown in sales of seasonal items, including cold weather clothing, heating equipment, and energy in January and spring clothing in March, thus bringing down overall performance. Looking at performance of specific items in personal consumption, we see that the upward push brought on by the leap year helped goods and services, with positive contributions from durables (+5.0% q/q), semi-durables (+0.7%), and services (+0.2%). The positive margin was especially wide for durable goods, but much of this is likely a rebound from the declines experienced during the previous quarter (-5.9%) and it remains unclear whether this reversal is the real thing. As for non-durables, performance was flat at -0.0%, pointing to four quarters of consecutive declines.

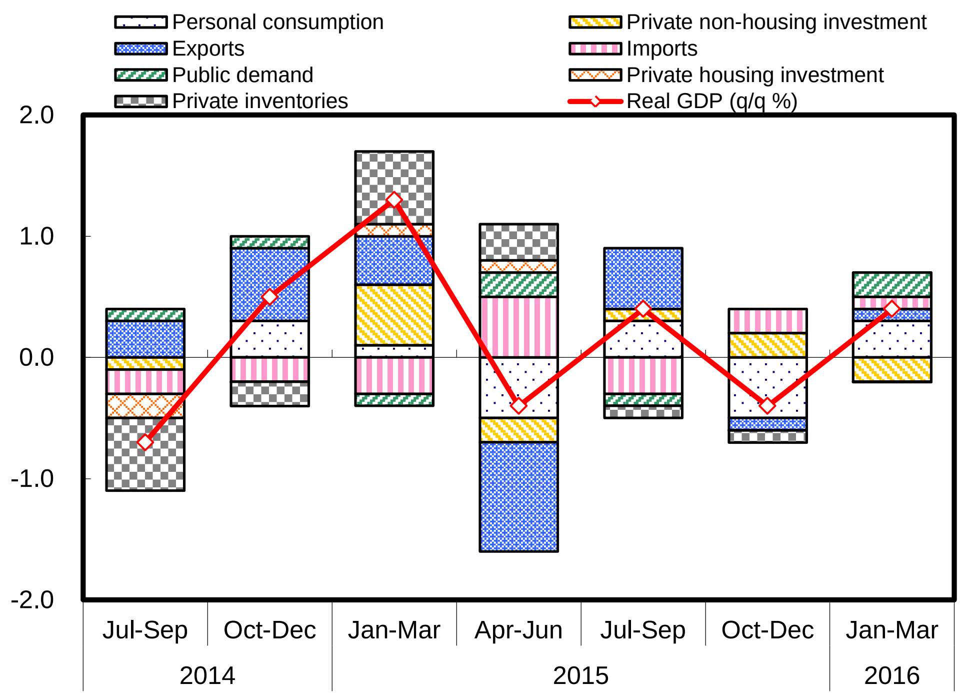
Housing investment declined for the second consecutive quarter at -0.8%. New housing starts, a leading indicator for housing investment as a portion of GDP, have been weak since the middle of 2015, and housing investment, as well as housing starts, which are recorded on a progressive basis, continued their declining trend. However, the extent of the decline is less than the previous period, and considering the fact that housing starts have just recently achieved some growth, it is possible that housing investment is close to bottoming out.

Capex declined for the first time in three quarters at -1.4% q/q, apparently taking a breather from its overall growth trend. While replacement and renovation investment, associated with positive corporate earnings, brought upward pressure on results, the strong yen and a sluggish domestic economy have brought an increasing sense of uncertainty to the future of corporate earnings. This brings about the possibility that investing in capital expenditure is being put off for the future especially by the manufacturing industry. In addition to this development, operating ratio continues to be weak due to stagnant export volume and domestic demand. Hence from an overall macro point of view, it is difficult in structural terms for corporations to invest in capacity increase, and this has brought a negative contribution. Looking at the actual production capacity index, there are currently no signs of movement toward increasing production capacity in the manufacturing industry overall. The trend toward decreasing capacity is continuing due to attempts in the chemical industry and information & communication electronics equipment to adjust to the law regarding Sophisticated Methods of Energy Supply Structures, as well as the decline in international competitiveness.

While the extent of contribution of private sector inventory growth was slight at -0.0%pt, the final contribution was down for the third consecutive quarter. This was due to the fact that in addition to work in progress inventory and material & supplies inventories, which are provisional on the 1st preliminary GDP estimate, finished goods inventory also brought a negative contribution. Wholesale and retail trade inventory contributed on the positive side, at +0.2%pt.

Public investment grew unexpectedly for the first time in three quarters at +0.3% q/q. Without the effects of economic policy as there was in the past, public investment and several other leading economic indicators have been weak for some time, and the declining trend was expected to continue, but public works projects have been progressing at a faster pace than expected, bringing a positive contribution to GDP. Considering the fact that other leading indicators are beginning to make a comeback, it is possible that public investment is in the process of bottoming out.

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



Source: Cabinet Office; compiled by DIR.

Meanwhile, exports grew for the first time in two quarters at +0.6% q/q. As for exports of goods, trade with both the EU and the US grew, bringing a positive contribution. Meanwhile, imports declined for the second consecutive quarter at -0.5%. As a result, overseas demand (net exports) contributed +0.2%pt to GDP.

Though modest, the GDP deflator grew for the sixth consecutive quarter at +0.1% q/q. The domestic demand deflator was down by -0.5%, while the import deflator increased its margin of decline. Hence results were positive overall. (A decline in the import deflator normally would have a positive effect on overall GDP results.) In y/y terms the GDP deflator was up by +0.9%, its ninth consecutive quarter of growth, but the growth rate shrank in comparison to that of the previous period (+1.5%). Meanwhile, nominal GDP was up for the first time in two quarters at +2.0% q/q annualized (+0.5% q/q).

Japan's economy continues to face risk of possible downturn

Although personal consumption is expected to continue its underlying strength due to improvements in the employment and income environment, the absence of a clearly driving force in the economy colors our basic economic scenario, which sees Japan's economy continuing to face risk of a possible downturn in the future. We urge caution regarding lingering risk factors which could have a negative impact 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. In addition, one should keep in mind the possible fluctuations in the economy which could occur due to the effects of the recent earthquake in Kumamoto.

Personal consumption is likely to suffer a temporary downturn due to the reactionary decline following the initially positive effects of the leap year, and the effects of the Kumamoto earthquake. However, with the exception of these special factors, there is an overall positive note due to improvements in the employment and income environment. Hence we see personal consumption remaining flat. As for the question of income, real wages according to the monthly labour survey are beginning to make a comeback, and with the number of employers increasing, real employee compensation (real wages x employment) in the macro sense is exhibiting major growth. Meanwhile, the positive employment environment and the shortage of manpower in certain areas of the non-manufacturing industry will likely lead to the gradual increase in part-timer pay. In addition, 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. Factors to keep in mind are worsening consumer confidence due to falling stock prices and increasing uncertainty in regard to how personal income will be effected in the future as a result of fears of worsening corporate earnings associated with the strong yen. This could likely be a drag on personal consumption. Other developments 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, and the spring labor offensive in 2016, which may very possibly bring a smaller wage revision rate than in 2015 (final tally results +2.20%). In addition, regarding durable goods, it is quite possible that sales volume of smartphones may suffer a major decline as a result of changes in carrier rates and sales prices.

As for housing investment, signs of an increase are seen in new housing starts, a leading indicator for housing investment, and a gradual comeback is expected. Housing starts were recently held back by an increase in construction costs and sales prices. However, improvements in the employment and income environment, along with the historic lows in interest on housing loans are expected to work together in encouraging a gradual increase in the number of households considering purchase of a new home. Housing starts should also gradually increase. 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.

As for capex, the gradual recovery is seen continuing, despite some ups and downs, due to the high level of corporate earnings, which provide underlying support for replacement and renovation investment. Favorable corporate earnings and the manpower shortage are expected to encourage replacement investment, labor saving, and energy saving, especially in the non-manufacturing industries. Meanwhile, restoration and reconstruction of production facilities lost or damaged in the recent Kumamoto earthquake are expected to contribute to growth in capital expenditure. However, as was stated earlier in our outlook, the manufacturing industries are still at risk of a downturn in the future, and caution is urged. Factors include the slowdown in the world economy, weakness in the corporate sectors of overseas economies leading to stagnation for exports, and the slow pace of recovery in personal consumption. Additional downward pressure on earnings is brought on by the strong yen, meaning that corporations delaying capex spending may increase in the future, especially amongst manufacturers.

Public investment is expected to continue to be weighed down by the shedding the effects of economic policy which provided support in the past, but progress is being made on the FY2015 supplementary budget and the FY2016 budget, so gradually the situation should bottom out. After that, the new focus on reconstruction associated with the Kumamoto earthquake should bring a gradual return to a growth trend. It should be noted that contracts and orders received, which provide the leading indicators for this area, are showing signs of a comeback.

Meanwhile, exports are expected to remain flat for a while longer, and then make a gradual comeback as overseas economies improve. The US economy is showing a firm undertone and should provide underlying support for exports. However, industrial sectors the world over are suffering from stagnant raw materials prices and excess production capacity. Overseas shipments of electronic parts and devices for smartphones are expected to continue to be sluggish. Considering this fact, the expected shift back into a growth trend for exports of goods will likely not come until after summer. In addition, the export of services, which had been favorable up to now, will be effected by the following factors: (1) The Chinese government has increased customs duty on goods purchased in foreign countries, causing fears that the “explosive buying” trend by Chinese tourists will likely take a rest, and (2) The number of tourists visiting Japan may decrease due to the recent Kumamoto earthquake. Looking at the current situation by region, we see that 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 further declines in consumption can be avoided in the area of consumer goods.