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Jan-Mar 2016 2nd Preliminary GDP Estimate

Real GDP growth rate revised upwards slightly from 1st preliminary; results in accordance with market consensus

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Summary

- The real GDP growth rate for Jan-Mar 2016 (2nd preliminary est) was revised upwards slightly to +1.9% q/q annualized (+0.5% q/q) in comparison to the 1st preliminary report (+1.7% q/q annualized and +0.4% q/q). Results were in accordance with market consensus (+1.9% q/q annualized and +0.5% q/q). Results brought only a small upward revision, but were in accordance with market consensus and hence no surprise.

- Performance by demand component in comparison to the 1st preliminary results shows inventory investment and public investment revised downwards, while personal consumption was revised upwards, helping to bring up overall results. As a result of corporate statistics, capex was revised upwards to -0.7% q/q (-1.4% on the 1st preliminary). Inventory investment was revised downwards slightly to -0.1%pt q/q in comparison to the 1st preliminary report (-0.0%pt) in accordance with market consensus (-0.1%pt).

2016 Jan-Mar GDP (2nd Preliminary Estimate) **Chart 1**

		2015				2016	
		Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	
						First	Second
Real GDP	Q/q %	1.3	-0.4	0.4	-0.4	0.4	0.5
Annualized	Q/q %	5.2	-1.7	1.7	-1.8	1.7	1.9
Personal consumption	Q/q %	0.2	-0.8	0.5	-0.8	0.5	0.6
Private housing investment	Q/q %	2.1	2.2	1.7	-1.0	-0.8	-0.7
Private non-housing investment	Q/q %	3.2	-1.2	0.8	1.3	-1.4	-0.7
Change in private inventories (contribution to real GDP growth)	Q/q % pts	0.6	0.3	-0.1	-0.2	-0.0	-0.1
Government consumption	Q/q %	0.3	0.4	0.2	0.7	0.7	0.7
Public investment	Q/q %	-2.3	2.8	-2.4	-3.6	0.3	-0.7
Exports of goods and services	Q/q %	2.2	-4.8	2.6	-0.8	0.6	0.6
Imports of goods and services	Q/q %	1.5	-2.5	1.7	-1.1	-0.5	-0.4
Domestic demand (contribution to real GDP growth)	Q/q % pts	1.2	-0.1	0.3	-0.5	0.2	0.3
Foreign demand (contribution to real GDP growth)	Q/q % pts	0.1	-0.4	0.1	0.1	0.2	0.2
Nominal GDP	Q/q %	2.0	-0.2	0.8	-0.2	0.5	0.6
Annualized	Q/q %	8.1	-0.7	3.0	-0.7	2.0	2.4
GDP deflator	Y/y %	3.2	1.4	1.8	1.5	0.9	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.

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Economic Research

Real GDP growth rate revised upwards slightly from 1st preliminary

The real GDP growth rate for Jan-Mar 2016 (2nd preliminary est) was revised upwards slightly to +1.9% q/q annualized (+0.5% q/q) in comparison to the 1st preliminary report (+1.7% q/q annualized and +0.4% q/q). Results were in accordance with market consensus (+1.9% q/q annualized and +0.5% q/q). Results brought only a small upward revision, but were in accordance with market consensus and hence no surprise. All in all, results went according to the DIR outlook, with Japan's economy remaining in a lull.

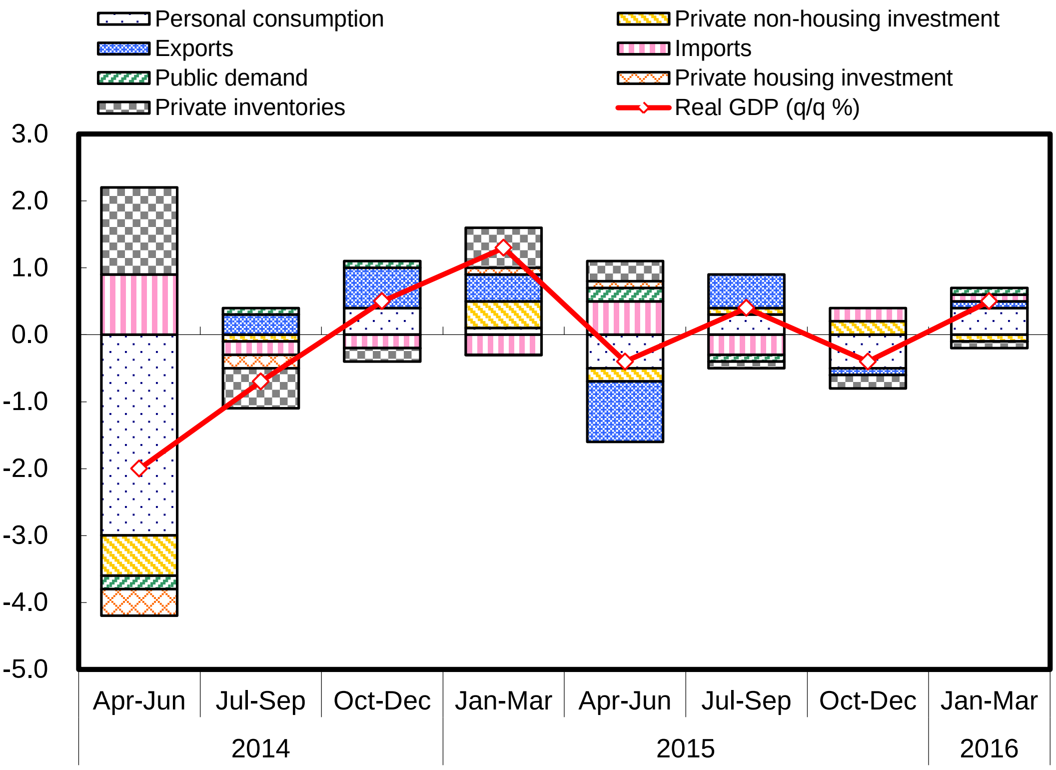
Upward revision of personal consumption and capex bring overall results up

Performance by demand component in light of upward revisions from the 1st preliminary results shows personal consumption and capex gaining upward revisions, while inventory investment and public investment were revised downwards.

Results of corporate statistics brought an upward revision for capex, putting it at -0.7% q/q (-1.4% on the 1st preliminary). Personal consumption was also revised upwards reflecting fundamental statistics for the month of March. However, if we ignore the effects of the leap year, personal consumption is still lacking in strength. Inventory investment was revised downwards slightly to -0.1%pt q/q in comparison to the 1st preliminary report (-0.0%pt) in accordance with market consensus (-0.1%pt). Looking at contribution by inventory classification, work in progress inventory was revised downwards, while material & supplies inventories, finished goods inventory, and distribution inventory marked time. Public investment received an especially large downward revision, but this was merely a reflection of fundamental statistics for the month of March. In the final assessment, results were in accordance with market consensus.

As for other components, government consumption and exports were flat in comparison to the 1st preliminary report, while housing investment and imports were revised upwards. Ultimately these revisions had almost no effect on GDP results.

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



Source: Cabinet Office; compiled by DIR.

Trends by demand component: Personal consumption and exports continue sluggish performance

Looking at trends in demand components on the Jan-Mar 2016 period results (2nd preliminary report), we see personal consumption achieving growth for the first time in two quarters at +0.6% q/q (+0.5% on the 1st preliminary). However, if we ignore the effects of the leap year, personal consumption is still stagnant, merely marking time. This was due to the improvement in the employment and income environments, with real compensation of employees maintaining a firm undertone, but households continue to tighten their budgets, dragging down overall results, with seasonal goods, including winter clothing, heating equipment, and energy, all performing poorly.

Housing investment declined for the second consecutive quarter at -0.7% (-0.8% on the 1st preliminary). New housing starts, a leading indicator for housing investment as a portion of GDP, have been weak since sometime around the middle of 2015. Housing investment and housing starts are recorded on a progressive basis, hence there is a lag in their performance, but it appears that housing investment is continuing its decline in tandem with the trend in housing starts. However, the extent of the decline has narrowed somewhat, and considering the fact that just recently housing starts have shifted into a growth trend, housing investment is likely moving closer to bottoming out.

Capex fell by -0.7% q/q (-1.4% on the 1st preliminary), its first decline in three quarters. Capex appears to be taking a breather from its general growth trend. This suggests that the high level of corporate earnings is providing underlying support for replacement and renovation investment. On the other hand, a sense of uncertainty regarding the future of corporate earnings is growing due to the strong yen and the sluggish domestic economy, a development which may lead corporations, especially those in manufacturing, to delay carrying out capital investment.

Private sector inventory was down for the third consecutive quarter at -0.1%pt (-0.0%pt on the 1st preliminary) bringing a negative contribution to this period's GDP. This is likely a reflection of the slowdown in the pace of growth in inventories, as well as possibly the beginnings of an inventory adjustment in some sectors.

Public investment declined for the third consecutive quarter at -0.7% q/q (+0.3% on the 1st preliminary). The progressive front-loading of public works contracts and orders helped to push up GDP preliminary figures on the 1st preliminary report, and public investment achieved unexpected growth. However, progress of actual public works projects according to fundamental statistics in March was not as fast paced as contracts and orders, and this is thought to be what was behind the downward revision on the 2nd preliminary.

Meanwhile, exports grew for the first time in two quarters at +0.6% q/q (+0.6% on the 1st preliminary). As for exports of goods, exports to the EU and the US appear to have contributed to growth. Imports declined for the second consecutive quarter at -0.4% (-0.5% on the 1st preliminary) reflecting the stagnant domestic economy. As a result, the contribution of overseas demand (net exports) was up by +0.2%pt (+0.2%pt on the 1st preliminary), making a positive contribution to GDP.

Japan's economy continues to face risk of possible downturn

There are no major changes to our main economic scenario for Japan since our last GDP report. 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. Prime Minister Abe announced at a press conference held on June 1st that the increase in consumption tax originally planned for April 2017 would be postponed. The main influence this decision has on the outlook for the real GDP growth rate (based on the fiscal year) is as follows: (1) FY2016 GDP will be revised downwards due to the absence of last minute demand which occurs prior to an increase in consumption tax, (2) Reactionary decline which usually occurs after the last minute demand phenomenon will be avoided, along with the effects of decline in real income which would have occurred if a tax hike had taken place, which also means that FY2017 GDP will be revised upwards, and (3) Overall GDP for FY2016-FY2017 will be revised upwards.

Personal consumption is likely to continue its 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.