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Apr-Jun 2016 2nd Preliminary GDP Estimate

GDP revised upwards to +0.7% q/q annualized, with major demand components following suit

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Summary

- The real GDP growth rate for Apr-Jun 2016 (2nd preliminary est) was revised upwards to +0.7% q/q annualized (+0.2% q/q) in comparison to the 1st preliminary report (+0.2% q/q annualized and +0.0% q/q), while at the same time exceeding market consensus (+0.2% q/q annualized and +0.0% q/q). Considering the fact that some growth during the Jan-Mar period was due to extra business days gained in the leap year, we would have to conclude that current results are maintaining a firm undertone since by now the positive effects of the leap year have worn off.

- Performance by demand component in comparison to the 1st preliminary results shows upward revisions for all major components, including personal consumption, capex, inventory investment, and public investment helping to push up overall results. Personal consumption was revised upwards a small amount, reflecting fundamental statistics for the month of June. As for capex, results of corporate statistics brought an upward revision of this area as well, at -0.1% q/q (-0.4% on the 1st preliminary). Inventory investment was also revised upwards to +0.1%pt q/q in comparison to the 1st preliminary report (-0.0%pt).

2016 Apr-Jun GDP (2nd Preliminary Estimate) **Chart 1**

		2015			2016		
		Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	
						First	Second
Real GDP	Q/q %	-0.5	0.5	-0.4	0.5	0.0	0.2
Annualized	Q/q %	-1.9	2.1	-1.7	2.1	0.2	0.7
Personal consumption	Q/q %	-0.6	0.4	-0.8	0.7	0.2	0.2
Private housing investment	Q/q %	1.7	1.1	-0.5	-0.1	5.0	5.0
Private non-housing investment	Q/q %	-1.0	0.8	1.2	-0.6	-0.4	-0.1
Change in private inventories (contribution to real GDP growth)	Q/q % pts	0.3	-0.0	-0.2	-0.1	-0.0	0.1
Government consumption	Q/q %	0.4	0.2	0.8	0.9	0.2	0.1
Public investment	Q/q %	0.9	-1.8	-3.2	0.2	2.3	2.6
Exports of goods and services	Q/q %	-4.2	2.6	-0.9	0.1	-1.5	-1.5
Imports of goods and services	Q/q %	-1.8	1.2	-1.1	-0.5	-0.1	-0.0
Domestic demand (contribution to real GDP growth)	Q/q % pts	-0.1	0.3	-0.5	0.4	0.3	0.4
Foreign demand (contribution to real GDP growth)	Q/q % pts	-0.4	0.2	0.1	0.1	-0.3	-0.3
Nominal GDP	Q/q %	-0.1	0.6	-0.3	0.8	0.2	0.3
Annualized	Q/q %	-0.2	2.5	-1.1	3.3	0.9	1.3
GDP deflator	Y/y %	1.4	1.8	1.5	0.9	0.8	0.7

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.

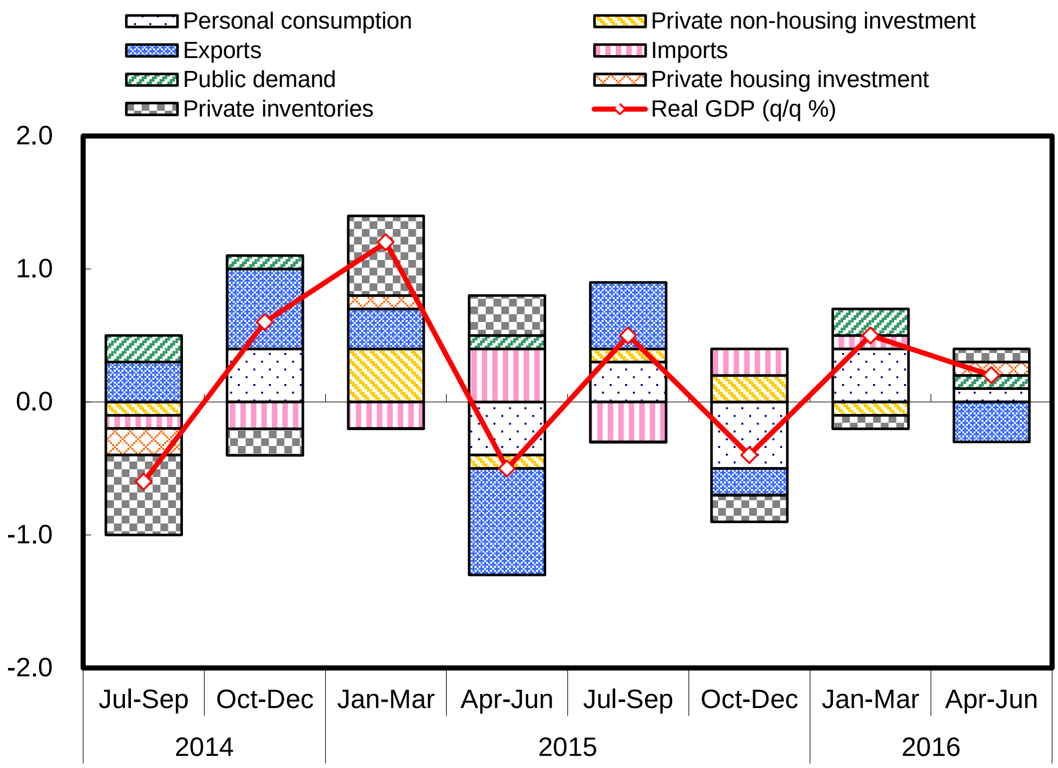
Real GDP growth rate revised upwards from 1st preliminary

The real GDP growth rate for Apr-Jun 2016 (2nd preliminary est) was revised upwards to +0.7% q/q annualized (+0.2% q/q) in comparison to the 1st preliminary report (+0.2% q/q annualized and +0.0% q/q), while at the same time exceeding market consensus (+0.2% q/q annualized and +0.0% q/q). Considering the fact that some growth during the Jan-Mar period was due to extra business days gained in the leap year, we would have to conclude that current results are maintaining a firm undertone since by now the positive effects of the leap year have worn off. All in all, these results confirmed our previous opinion that Japan's economy is pulling out of a lull and moving toward a moderate recovery.

All major domestic demand components follow suit in gaining upward revisions

Performance by demand component in light of upward revisions from the 1st preliminary results shows all major components, including personal consumption, capex, inventory investment, and public investment gaining upward revisions, helping to push the overall figure upwards. Personal consumption was revised upwards slightly, reflecting fundamental statistics for the month of June. Looking at the various components, we see that durables were revised upwards considerably, helping to push overall results upwards even as other components received small downward revisions, including semi-durables, nondurables and services. As for capex, results of corporate statistics brought an upward revision of this area as well, at -0.1% q/q (-0.4% on the 1st preliminary). Looking at capex investment by category we see that growth in transport equipment was major. Inventory investment was also revised upwards to +0.1%pt q/q in comparison to the 1st preliminary report (-0.0%pt). As for contribution by inventory classification, all categories were revised upwards, including finished goods inventory, work in progress inventory, materials & supplies inventories, and distribution inventory. Public investment also received a small upward revision at +2.6% q/q in comparison with the 1st preliminary (+2.3%). For the most part this reflected fundamental statistics for the month of June.

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 Apr-Jun 2016 period results (2nd preliminary report), we see personal consumption achieving growth for the second consecutive quarter at +0.2% (+0.2% on the 1st preliminary). These were favorable results when we consider the reactionary decline following the leap year effect during the Jan-Mar period. As for performance by component in personal consumption, durables were up by +2.2% q/q while services were up by 0.1% bringing a plus for overall performance. Growth was especially large for durables. It appears that the negative effects of pre-consumption over demand experienced since 2009 due to Eco-car related tax breaks, the Ecopoint program effecting household electronics, and last-minute demand prior to the increase in the consumption tax, are gradually falling away. On the other hand, semi-durable goods (-1.6% q/q) and nondurable goods (-0.4%) were unmoved. This is probably due to the fact that while real employee compensation is maintaining a firm undertone and the employment and income environment contributed a plus, growth in real disposable income for households has been limited, with downward pressure on income produced by insurance rate hikes and the increase in tax rate for the highest tax bracket.

Housing investment grew for the first time in three quarters at +5.0% (also +5.0% on the 1st preliminary). New housing starts, a leading indicator for housing investment as a portion of GDP, are continuing to grow as a result of last-minute demand which developed on the assumption that the consumption tax would again be increased in April of 2017. This in turn gave a lift to housing investment, which is recorded on a progressive basis.

Capex declined for the second consecutive quarter at -0.1% q/q (-0.4% on the 1st preliminary). Though corporate earnings remain at a high level, the source of growth is not volume, but rather the decline in the cost of input and growth in the calculated price of exports. It has not led to an increase in operating rates. Moreover, the slowdown in the overseas economy and the progressively strong yen create a major headwind for capex.

While the extent of contribution of private sector inventory growth was slight at +0.1%pt (-0.0%pt on the 1st preliminary), the final contribution was up for the first time in four quarters. Finished goods inventory and distribution inventory made negative contributions, but work in progress inventory and materials & supplies inventories brought positive contributions.

Public investment grew for the second consecutive quarter at +2.6% q/q (+2.3% on the 1st preliminary). This is thought to be due to the government having front-loaded the FY2015 supplementary budget. Government consumption also continued its growth trend at +0.1%.

Meanwhile, exports declined for the first time in two quarters at -1.5% q/q (-1.5% on the 1st preliminary as well). As for exports of goods, trade with both the US and Asia is showing signs of a comeback, while exports to the EU, which had been maintaining a firm undertone up to now, declined. This was especially marked in exports of ships, which had grown considerably during the previous quarter, and are now showing a moment of weakness. In a reflection of stagnant domestic demand, imports declined somewhat for the third consecutive quarter at -0.0% (-0.1% on the 1st preliminary). As a result, overseas demand (net exports) had a negative contribution of -0.3%pt to GDP (-0.3%pt on the 1st preliminary as well).

Though modest, the GDP deflator grew for the seventh consecutive quarter at +0.2% q/q (also +0.2% on the 1st preliminary). The domestic demand deflator was down by -0.3% (-0.2% on the 1st preliminary), while the import deflator continued to decline. (A decline in the import deflator has the effect of pushing up the GDP deflator.) Overall, positive performance was maintained. In y/y terms the

GDP deflator was up by +0.7% (+0.8% on the 1st preliminary), its tenth consecutive quarter of growth, but the growth rate shrank in comparison to that of the previous period (+0.9%). Meanwhile, nominal GDP was up for the second consecutive quarter at +1.3% q/q annualized and +0.3% q/q (+0.9% q/q annualized and +0.2% q/q on the 1st preliminary).

Japan's economy will most likely continue to face risk of possible downturn

There are no major changes to our main economic scenario for Japan since our last GDP report. We expect Japan's economy to continue in a moderate expansion phase. However, domestic demand continues to lack strength, and with the absence of a clearly driving force in the economy, Japan may continue to face risk of a possible downturn in the future. As for overseas demand, the future of the world economy becomes increasingly uncertain with the UK decision to withdraw from the EU, and we therefore urge caution regarding possible downside risk.

Personal consumption is expected to continue in a moderate expansion phase. The supply of labor continues to be tight, and this should provide underlying support for personal consumption through growth in employee compensation. Meanwhile, the growth rate in the consumer price index has turned in the negative direction, and this promises to continue pushing up real wages. Consumer confidence promises to improve due to the postponement of the consumption tax increase which had been slated for April 2017, and this should help to improve personal consumption as well. Meanwhile, the income environment is becoming more uncertain due to fears that corporate business performance may worsen due to the strong yen, and this may be a drag on personal consumption.

Meanwhile, housing investment is expected to gradually slow down. The Bank of Japan's decision to adopt a negative interest rate in January should provide underlying support for housing investment with interest on housing loans on the decline. However, housing starts, which had rapidly expanded with the expectation that there would be a rush to purchase homes before the additional increase in consumption tax originally planned for April 2017, are expected to gradually decrease in the future, and housing investment is also expected to begin declining after that point.

Capex is expected to mark time in the future. The supply of labor continues to be tight, and this should provide underlying support for replacement and renovation investment in the non-manufacturing industries which are not so easily influenced by overseas demand. On the other hand, the worsening of the external environment, including the stagnant world economy and the strong yen/weak dollar situation, is expected to continue being a drag on the business performance of export-driven companies mainly in the area of manufacturing. If the assumption of favorable business performance, which provided support for capex up to this point, should collapse in the near future, the number of corporations putting off capex could increase in the future.

Public investment is expected to continue favorably. As the effects of past economic policies begin to wear thin, demand associated with the main FY 2016 budget and the supplementary budget should gradually come to the fore, and this is expected to provide underlying support for public investment in the future.

As for exports, gradual expansion is seen in the future. Looking at exports of goods by region, consumer goods are expected to continue to perform favorably in the US backed by improvements in the employment environment in that country. On the other hand, exports to the EU are expected to require a cautious approach for the time being. The UK made the decision to withdraw from the EU after a referendum held in June, and as a result, the future of the EU economy has become increasingly uncertain. This is because it is assumed that this event could have the effect of dampening growth in demand in the region. Meanwhile, as for exports to Asia, one positive factor is that China's economy appears to be close to bottoming out after having slowed down increasingly. However, just recently there have been signs of an additional slowdown, and caution is required as regards the possible acceleration of capital outflow due to US monetary restraint expected between now and the end of the year.