Daiwa
Daiwa Institute of Research

14 November 2016 (No. of pages: 4)

Japanese report: 14 Nov 2016

Jul-Sep 2016 1st Preliminary GDP Estimate

GDP achieves major growth for 3rd consecutive quarter led by overseas demand, but deflator declines

Economic Intelligence Team
Shunsuke Kobayashi

Summary

- The real GDP growth rate for Jul-Sep 2016 (1st preliminary est) grew by +2.2% q/q annualized (+0.5% q/q), while considerably exceeding market consensus (+0.8% q/q annualized, +0.2% q/q). Looking at results by source of demand, we see that positive contributions came from growth in personal consumption, capex, housing investment, and exports, while declines were experienced in public investment and imports. (The decline in imports is a plus for overall GDP growth rate.) All in all, performance was favorable. However, caution is still required since the major source of growth was in overseas demand and the GDP deflator fell, causing the growth rate in nominal GDP to be smaller than real GDP.

- Performance by demand component in the Jul-Sep 2016 results shows personal consumption up just a bit for the third consecutive quarter by +0.1% q/q, centering on durable goods. Housing investment grew for the second consecutive quarter at +2.3%. Capex continues to mark time at +0.0% q/q. Private sector inventory declined for the first time in two quarters at -0.1%pt making a negative contribution. Exports grew for the first time in two quarters at +2.0% q/q. As a result, overseas demand had a positive contribution of +0.5%pt to GDP.

- 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 election of Donald Trump to the US presidency. We therefore urge caution regarding possible downside risk.

GDP achieves major growth for 3rd consecutive quarter led by overseas demand, but deflator declines

The real GDP growth rate for Jul-Sep 2016 (1st preliminary est) grew by +2.2% q/q annualized (+0.5% q/q), while considerably exceeding market consensus (+0.8% q/q annualized, +0.2% q/q). Looking at results by source of demand, we see that positive contributions came from growth in personal consumption, capex, housing investment, and exports, while declines were experienced in public investment and imports. (The decline in imports is a plus for overall GDP growth rate.) All in all, performance was favorable. However, caution is still required since the major source of growth was in overseas demand and the GDP deflator fell, causing the growth rate in nominal GDP to be smaller than real GDP.

2016 Jul-Sep GDP (1st Preliminary Estimate) **Chart 1**

		2015		2016		
		Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep
Real GDP	Q/q %	0.4	-0.4	0.5	0.2	0.5
Annualized	Q/q %	1.6	-1.6	2.1	0.7	2.2
Personal consumption	Q/q %	0.5	-0.8	0.7	0.1	0.1
Private housing investment	Q/q %	1.2	-0.4	-0.3	5.0	2.3
Private non-housing investment	Q/q %	0.8	1.2	-0.7	-0.1	0.0
Change in private inventories (contribution to real GDP growth)	Q/q % pts	-0.0	-0.1	-0.1	0.1	-0.1
Government consumption	Q/q %	0.3	0.6	0.9	-0.3	0.4
Public investment	Q/q %	-1.2	-3.4	0.0	2.3	-0.7
Exports of goods and services	Q/q %	2.6	-1.0	0.1	-1.5	2.0
Imports of goods and services	Q/q %	2.4	-1.2	-0.6	-0.6	-0.6
Domestic demand (contribution to real GDP growth)	Q/q % pts	0.4	-0.5	0.4	0.3	0.1
Foreign demand (contribution to real GDP growth)	Q/q % pts	-0.0	0.1	0.1	-0.2	0.5
Nominal GDP	Q/q %	0.8	-0.3	0.8	0.1	0.2
Annualized	Q/q %	3.2	-1.2	3.0	0.6	0.8
GDP deflator	Y/y %	1.7	1.5	0.9	0.7	-0.1

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.

Overseas demand the driving force; consumption continues to bottom out

Performance by demand component in the Jul-Sep 2016 results shows private sector final consumption expenditure up just a bit for the third consecutive quarter by +0.1% q/q. Results were favorable despite the negative effects of typhoons which hit Japan in greater number than normal this year, and the unusually hot weather nationwide which continued into early autumn, taking a bite out of growth in purchase of seasonal items. Looking at personal consumption by sector we see gains for both goods and services. Durable goods grew by +1.5% q/q, with semi-durables at +0.1%, and services at +0.1%. Durables did especially well, winning considerable growth. The negative effect 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, is gradually falling away. On the other hand, nondurable goods (-0.5%) were unmoved. This is probably due to the fact that in addition to the factors mentioned above, real employee compensation is maintaining a firm undertone and the employment and income environment contributed a plus, but 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 second consecutive quarter at +2.3%. New housing starts, a leading indicator for housing investment as a portion of GDP, are continuing to grow as a result of lower interest rates, growth in rental property construction as an inheritance tax strategy, and 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.

Capital expenditure on the part of private sector corporations continues to mark time at +0.0% q/q. 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.

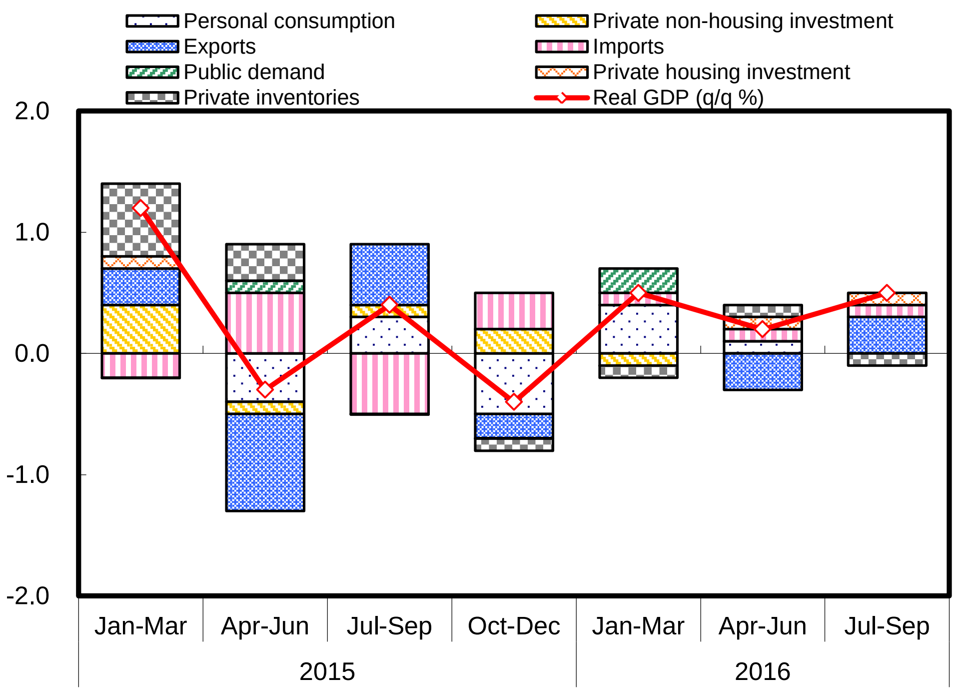
Private sector inventory declined for the first time in two quarters at -0.1%pt. Distribution inventory made a negative contribution. Meanwhile, work in progress inventory and material & supplies inventories, which are provisional on the 1st preliminary GDP estimate, also made negative contributions.

Public investment declined for the first time in three quarters at -0.7% q/q. While the government having front-loaded the FY2015 supplementary budget brought a plus, the positive effect of past economic policies on public investment has begun to peter out. Government consumption was up by +0.4%. When averaged out this constitutes a continuation of the growth trend.

Exports grew for the first time in two quarters at +2.0% q/q. As for exports of goods, Asia has maintained the favorability of the previous quarter, while exports to the US and the EU show signs of a comeback. As for Asia, export volume of ICs expanded in anticipation of the marketing of new smart phone models. Meanwhile, export volume of automobiles to the US maintained a firm undertone despite some fluctuations. In a reflection of stagnant domestic demand, imports declined for the fourth consecutive quarter at -0.6%. As a result, overseas demand had a positive contribution of +0.5%pt to GDP for the first time in two quarters.

The GDP deflator declined for the second consecutive quarter at -0.3% q/q. The domestic demand deflator was down by -0.2%, while the export deflator declined by -2.4%. In y/y terms the GDP deflator was down by -0.1%, its first decline in eleven quarters. Meanwhile, nominal GDP was up for the third consecutive quarter at +0.8% q/q annualized (+0.2% q/q).

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



Source: Cabinet Office; compiled by DIR.

Moderate recovery expected for Japan’s economy, but risk of possible downturn remains

We expect Japan’s economy to continue in a moderate expansion phase. However, caution is required as domestic demand continues to lack strength. Overseas demand is expected to continue its gradual expansion. However, if the world economy becomes more uncertain in the future, this could cause domestic demand to stagnate, and to become a negative factor bringing downward pressure on Japan’s overall economy. A further risk is the expectation that the US Fed will increase interest rates within the year. Doing so could cause a slowdown in the US economy, or capital outflow from the emerging nations associated with interest hikes. Meanwhile, the future of the world economy becomes increasingly uncertain with the election of Donald Trump to the US presidency. Risk-off behaviors in the global capital markets could cause stock price lows and rapid depreciation of the dollar. We therefore urge caution.

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. This should provide a boost to personal consumption. On the other hand, corporate earnings appear to be about to peak out due to the strong yen and other factors, and uncertainty is increasing in regard to the future of the income environment. Households may become more budget-minded in the future due to recent increases in the price of fresh foods, hence caution is required.

Meanwhile, housing investment is expected to gradually slow down. Interest on housing loans remains low, and therefore should provide continued underlying support. 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 decrease in the future, especially for condominiums, and housing investment is also expected to begin declining after that point.

Capex is expected to continue marking time. The supply of labor continues to be tight, and this should provide underlying support for replacement and renovation investment in the non-manufacturing industries. On the other hand, the stagnant world economy and the strong yen/weak dollar situation, is expected to continue eating away at the strength of domestic demand, and this brings the increasing sense that corporate earnings are about to peak out. Corporations are therefore likely to become more cautious as regards capex spending in the future.

Public investment is expected to move toward a comeback as we approach year-end. The government’s second supplementary budget, which includes economic policy measures, has taken shape, and this should gradually provide more upward pressure for public investment as we move closer to the end of the year.

As for exports, with overseas economies continuing moderate growth, we can expect exports to maintain a firm undertone, centering on consumer goods. Looking at exports of goods by region, consumer goods are expected to maintain a strong undertone in the US, EU, and Asia backed by improvements in employment environment, the effects of monetary easing, and favorable personal consumption in all regions. On the other hand, growth in corporate earnings in the US is at a low level, and overcapacity in Asia, especially in the steel industry, requires adjustment. There is a good possibility that exports of capital goods and materials will continue to be slow.