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Oct-Dec 2016 1st Preliminary GDP Estimate

GDP records fourth consecutive quarter of mostly export driven growth. Deflator even more positive than in past, driven by upstream inflation

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Summary

- The real GDP growth rate for Oct-Dec 2016 (1st preliminary est) grew by +1.0% q/q annualized (+0.2% q/q), coming in pretty much according to market consensus (+1.0% q/q annualized, +0.3% q/q). Looking at results by source of demand, we see that positive contributions came from growth in capex, housing investment, government consumption, exports, and imports (note: growth in imports is a negative contribution to growth rate). Meanwhile, declines were experienced in personal consumption, public investment, and fluctuations in private sector inventory. All in all, performance was favorable, with the deflator increasing the extent to which it has expanded. However, caution is still required since the major source of growth was in overseas demand with domestic demand contributing -0.0%pt, and rising import prices caused terms of trade to deteriorate, hence caution is required.

- Performance by demand component in the Oct-Dec 2016 results shows private sector final consumption expenditure down just slightly for the first time in four quarters by -0.0% q/q. Housing investment grew for the fourth consecutive quarter at +0.2% due to last-minute demand which developed on the assumption that the consumption tax would again be increased in April of 2017, but it appears to be nearing the end of its growth phase. Capital expenditure on the part of private sector corporations is maintaining a firm undertone despite ups and downs at +0.9% q/q due to the high level of corporate earnings. Private sector inventory declined just slightly for the second consecutive quarter at -0.1%pt, making a negative contribution to GDP. Exports won major growth at +2.6% q/q, while imports also grew by +1.3%. As a result, the contribution of overseas demand to GDP hit +0.2%pts.

- 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 US going through changes in its trade policy. We therefore urge caution regarding possible downside risk.

GDP records fourth consecutive quarter of mostly export driven growth. Deflator even more positive than in past, driven by upstream inflation

The real GDP growth rate for Oct-Dec 2016 (1st preliminary est) grew by +1.0% q/q annualized (+0.2% q/q), coming in pretty much according to market consensus (+1.0% q/q annualized, +0.3% q/q). Looking at results by source of demand, we see that positive contributions came from growth in capex, housing investment, government consumption, exports, and imports (note: growth in imports is a negative contribution to growth rate). Meanwhile, declines were experienced in personal consumption, public investment, and fluctuations in private sector inventory. All in all, performance was favorable, with the deflator increasing the extent to which it has expanded. However, caution is still required since the major source of growth was in overseas demand with domestic demand contributing -0.0%pt, and rising import prices caused terms of trade to deteriorate, hence caution is required.

2016 Oct-Dec GDP (1st Preliminary Estimate) **Chart 1**

			2015	2016			
			Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec
Real GDP		Q/q %	-0.3	0.6	0.4	0.3	0.2
	Annualized	Q/q %	-1.2	2.3	1.8	1.4	1.0
	Personal consumption	Q/q %	-0.6	0.4	0.2	0.3	-0.0
	Private housing investment	Q/q %	-1.0	1.4	3.3	2.4	0.2
	Private non-housing investment	Q/q %	0.5	-0.3	1.3	-0.3	0.9
	Change in private inventories (contribution to real GDP growth)	Q/q % pts	-0.1	-0.2	0.2	-0.3	-0.1
	Government consumption	Q/q %	0.7	1.4	-1.1	0.3	0.4
	Public investment	Q/q %	-1.5	-1.1	1.1	-0.7	-1.8
	Exports of goods and services	Q/q %	-0.8	0.9	-1.2	2.1	2.6
	Imports of goods and services	Q/q %	-0.8	-1.1	-1.0	-0.2	1.3
Domestic demand (contribution to real GDP growth)		Q/q % pts	-0.3	0.2	0.5	-0.1	-0.0
Foreign demand (contribution to real GDP growth)		Q/q % pts	0.0	0.3	-0.0	0.4	0.2
Nominal GDP		Q/q %	-0.3	0.8	0.3	0.2	0.3
	Annualized	Q/q %	-1.0	3.1	1.2	0.7	1.2
GDP deflator		Y/y %	1.5	0.9	0.4	-0.1	-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; domestic demand declines for second consecutive quarter

Performance by demand component in the Oct-Dec 2016 results shows private sector final consumption expenditure down just slightly for the first time in four quarters by -0.0% q/q. Though record low temperatures provided a positive factor for durables, an increase in fresh food prices was a negative factor for nondurables. Looking at personal consumption by sector we see declines for semidurables (-2.1% q/q) and nondurables (-0.4%). This is thought to be due to the rise in living expenses associated with higher prices for fresh foods, which has caused the lack of energy in personal consumption. On the other hand, 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 being increasingly resolved. Durables have been maintaining a steady undertone because of this at +1.4% q/q. As for services (+0.1%), while restraint was seen in nonessential services such as entertainment, expenditure on non-elective services maintained favorable performance.

Housing investment grew for the fourth consecutive quarter at +0.2%. New housing starts, a leading indicator for housing investment as a portion of GDP, are maintaining their growth trend 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. However, housing starts most recently have shown growing signs of peaking out, and housing investment appears to be losing momentum as well.

Capital expenditure on the part of private sector corporations is maintaining a firm undertone despite ups and downs at +0.9% q/q. Corporate earnings remain at a high level, and this has pushed up capital expenditure, especially in labor-saving and rationalization due to the continuing labor shortage. In addition, there has been growth in demand for construction as non-manufacturers focus on distribution facilities and warehouses, bringing a positive contribution to capex spending.

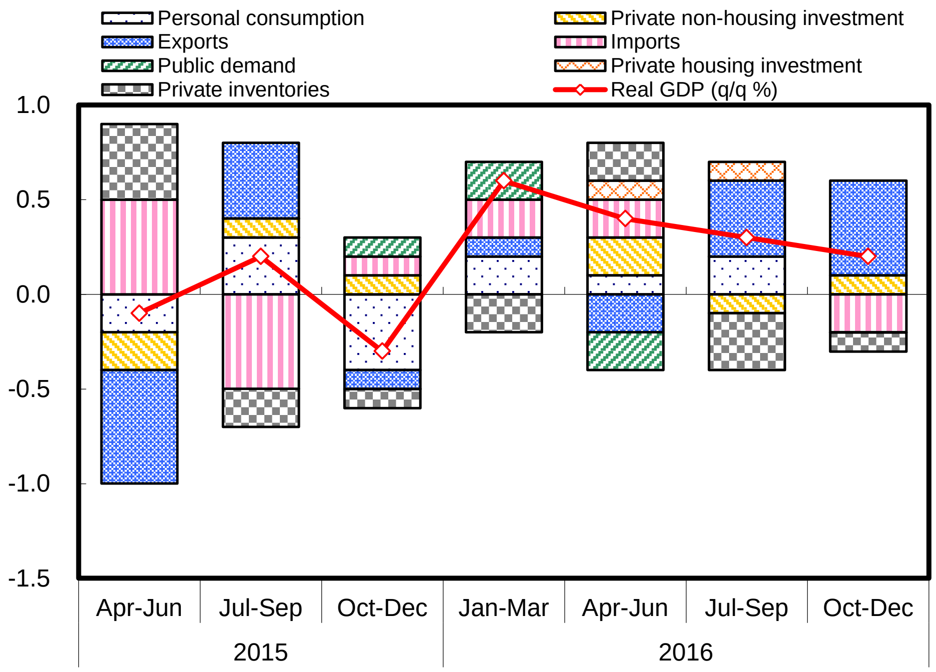
Private sector inventory declined just slightly for the second consecutive quarter at -0.1%pt, making a negative contribution to GDP. While work in progress inventory, which is provisional on the 1st preliminary GDP estimate, made a positive contribution, material & supplies inventories made a negative contribution to GDP. Meanwhile, finished goods inventory and distribution inventory also contributed negatively.

Public investment declined for the second consecutive quarter at -1.8% q/q. Implementation of the 1st supplementary budget of FY2016 provided underlying support, but the positive effects of past stimulus packages are now falling away, and this is seen as having brought a negative contribution to GDP. Government consumption was up by +0.4%. When averaged out this constitutes a continuation of the growth trend.

Exports grew for the second consecutive quarter at +2.6% q/q. Looking at Japan's trade statistics for the Oct-Dec period, exports were favorable, especially to Asia, but the US and EU as well. Exports of automobiles to the US maintained a steady undertone, while exports of transport equipment to Asia, including passenger vehicles, buses and trucks were also favorable, in addition to exports of ICs. Meanwhile, imports achieved growth for the first time in five quarters at +1.3% q/q. As a result, contribution of overseas demand to GDP increased by +0.2%pt q/q, bringing a positive contribution to GDP for the second consecutive quarter.

The GDP deflator grew for the first time in three quarters at +0.1% q/q. The domestic demand deflator was up by +0.2% q/q, thereby increasing the extent of its growth, while the import deflator also grew by +3.4%. The export deflator was also up by +2.2%, thereby suppressing growth of the overall deflator. Meanwhile, nominal GDP was up for the fourth consecutive quarter at +1.2% q/q annualized (+0.3% 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 even as overseas demand continues its gradual expansion. 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, causing a slowdown in the US economy or capital outflow from the emerging nations. Meanwhile, the future of the world economy becomes increasingly uncertain with US President Donald Trump moving the country more toward protectionism, declaring a withdrawal of the US from the TPP agreement, and calling for renegotiation of NAFTA with a possible future withdrawal. These are all risk factors which could bring negative pressure on Japan’s economic growth, which is driven by overseas demand.

Personal consumption is expected to continue in a moderate expansion phase. The supply of labor remains tight, and this should provide underlying support for personal consumption through growth in employee compensation. However, the one worrisome point is that the CPI has been on the rise since last October due to rising prices of fresh foods. Meanwhile, the government is encouraging corporations to increase base salary rates during the annual spring labor offensive this year. However, many corporations, which are becoming worried about future business performance, are taking the stance that they will raise annual salaries but not monthly wages. Keeping in mind the influence of prices, if real wages begin to stagnate, households will likely tighten the purse strings.

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 see gradual growth. The supply of labor continues to be tight, and this should provide underlying support for investment in labor-saving and rationalization due to the continuing labor shortage in the non-manufacturing industries. Meanwhile, research & development expenses, which were to be recorded after the Jul-Sep period 2nd preliminary report, should also be a factor pushing up capex spending. However, it is important to be aware that although corporate earnings remain at a high level, this is due merely to the decline in input cost and not growth in volume. A more substantial increase in capex spending would be dependent on an increase in operating rate, and this can come only from the expansion of overseas demand.

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

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. However, with US President Donald Trump moving the country more toward protectionism, declaring a withdrawal of the US from the TPP agreement, and calling for renegotiation of NAFTA with a possible future withdrawal, caution is required. If the US becomes extremely protectionist in its trade policy, it could cause world trade to stagnate. We expect this to remain as a mid to long-term risk factor. If trade friction with the US comes to the surface, Japan’s export industries, especially the automobile industry, would likely take a serious hit.