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Apr-Jun 2017 2nd Preliminary GDP Estimate

GDP growth registers +2.5% q/q annualized (+0.6% q/q) despite downward revision of private sector corporate capex

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Summary

- The real GDP growth rate for Apr-Jun 2017 (2nd preliminary est) was revised downwards to +2.5% q/q annualized (+0.6% q/q) in comparison to the 1st preliminary report (+4.0% q/q annualized and +1.0% q/q), while at the same time falling below market consensus (+2.9% q/q annualized and +0.7% q/q). The downward revision was due mainly to a major downward revision in private sector corporate capex. Despite this fact, results remain unchanged from the 1st preliminary in that all major domestic demand components contributed positively to GDP growth, including private sector corporate capex, personal consumption, housing investment, government consumption, and public investment. Hence an overly pessimistic reaction is unnecessary.

- Overall, these results confirm our main scenario, which sees Japan's economy moving toward a moderate recovery and expansion. We again point out that Japan's economy has shifted from growth driven by overseas demand to growth driven by domestic demand.

2017 Apr-Jun GDP (2nd Preliminary Estimate) **Chart 1**

		2016				2017	
		Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	
						First	Second
Real GDP	Q/q %	0.5	0.2	0.4	0.3	1.0	0.6
Annualized	Q/q %	2.0	0.9	1.6	1.2	4.0	2.5
Personal consumption	Q/q %	0.1	0.4	0.1	0.4	0.9	0.8
Private housing investment	Q/q %	3.2	2.8	0.2	1.0	1.5	1.3
Private non-housing investment	Q/q %	1.4	-0.3	2.0	0.5	2.4	0.5
Change in private inventories (contribution to real GDP growth)	Q/q % pts	0.4	-0.5	-0.2	-0.1	0.0	-0.0
Government consumption	Q/q %	-1.3	0.2	0.0	-0.1	0.3	0.4
Public investment	Q/q %	-0.6	-0.9	-2.4	0.4	5.1	6.0
Exports of goods and services	Q/q %	-0.9	2.1	3.1	1.9	-0.5	-0.5
Imports of goods and services	Q/q %	-1.2	-0.2	1.4	1.3	1.4	1.4
Domestic demand (contribution to real GDP growth)	Q/q % pts	0.4	-0.2	0.1	0.2	1.3	0.9
Foreign demand (contribution to real GDP growth)	Q/q % pts	0.1	0.4	0.3	0.1	-0.3	-0.3
Nominal GDP	Q/q %	0.2	-0.0	0.5	-0.1	1.1	0.7
Annualized	Q/q %	0.7	-0.1	2.1	-0.4	4.6	3.0
GDP deflator	Y/y %	0.4	-0.1	-0.1	-0.8	-0.4	-0.4

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.

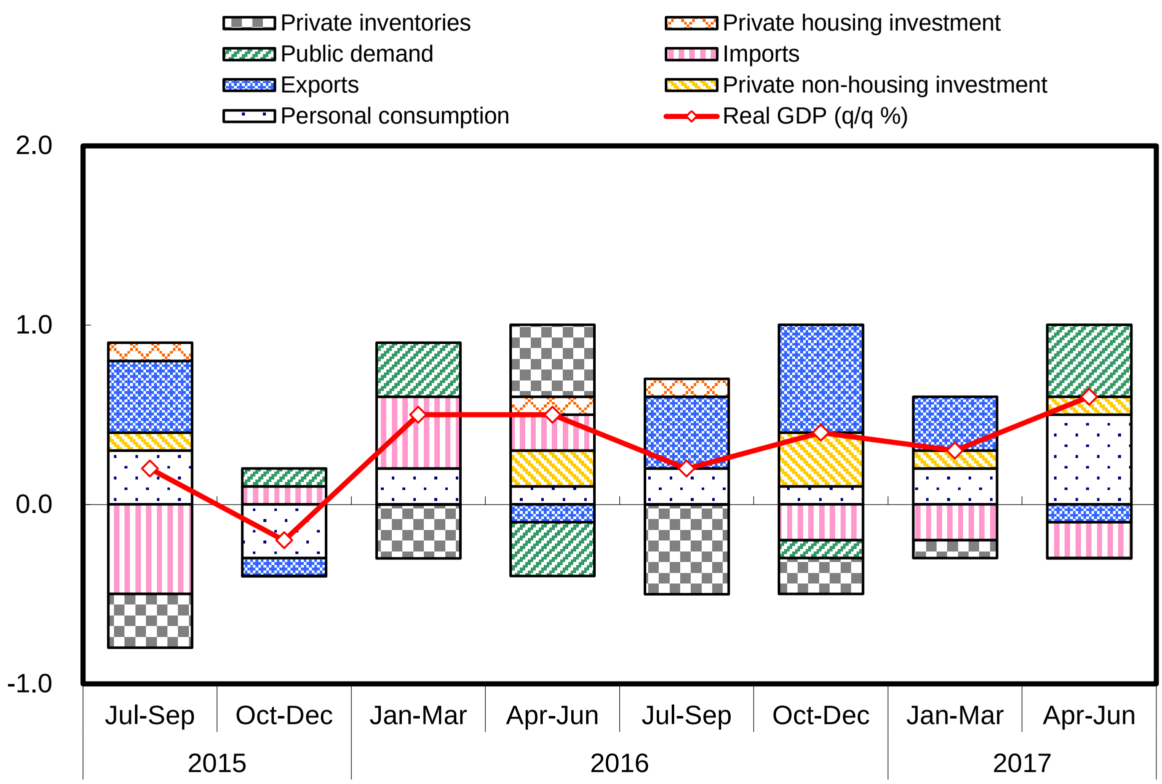
Real GDP growth rate revised downwards from 1st preliminary, falls below market consensus

The real GDP growth rate for Apr-Jun 2017 (2nd preliminary est) was revised downwards to +2.5% q/q annualized (+0.6% q/q) in comparison to the 1st preliminary report (+4.0% q/q annualized and +1.0% q/q), while at the same time falling below market consensus (+2.9% q/q annualized and +0.7% q/q). The downward revision was due mainly to a major downward revision in private sector corporate capex. Despite this fact, results remain unchanged from the 1st preliminary in that all major domestic demand components contributed positively to GDP growth, including private sector corporate capex, personal consumption, housing investment, government consumption, and public investment. Hence an overly pessimistic reaction is unnecessary. Overall, these results confirm our main scenario, which sees Japan’s economy moving toward a moderate recovery and expansion. We again point out that Japan’s economy has shifted from growth driven by overseas demand to growth driven by domestic demand.

Downward revision of private sector capex brings downward pressure on overall results

Major revisions in comparison to the 1st preliminary report in terms of performance by demand component are as follows: capex was revised downwards considerably along with private sector final consumption expenditure, private sector housing investment, and private sector inventory. On the other hand, public investment and government consumption were revised upwards.

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



Source: Cabinet Office; compiled by DIR.

Private-sector capital investment was revised downwards in response to the results of corporate statistics to +0.5% q/q (+2.4% on the 1st preliminary). Looking at the trend in gross fixed capital formation by type, we see that housing and other buildings & structures registered a high growth rate, while housing investment and public fixed capital formation concurred in their favorability. On the other hand, transport machinery, which had been favorable until now, fell into negative growth. Other machinery and equipment continues to record moderate growth along with products associated with intellectual property.

Private final consumption expenditure was revised downwards just slightly reflecting June fundamental statistics to +0.8% q/q (+0.9% on the 1st preliminary). This was due to the fact that durable goods and semi-durables were all revised downwards by a small amount.

Inventory investment was revised downwards slightly to -0.0%pt q/q (+0.0%pt on the 1st preliminary). Looking at contribution to GDP by category we see that work in progress inventory was revised downwards slightly. The most recent value of public fixed capital formation was reflected in the result of +6.0%, showing an accelerated growth rate in comparison to +5.1% on the 1st preliminary. There were no revisions for either exports or imports. As for other components, private sector housing was revised downwards slightly, while government final consumption was revised upwards just a bit, but influence on overall GDP statistics was limited.

Japanese economy shifts from growth driven by overseas demand to growth driven by domestic demand

Performance by demand component in the Apr-June 2017 2nd preliminary results shows private sector final consumption expenditure achieving growth for the sixth consecutive quarter at +0.8% q/q (+0.9% on the 1st preliminary). The employment environment continued to improve due to economic growth and the labor shortage, as well as improvement in consumer confidence, which has contributed to a comeback for personal consumption. Looking at trends in goods and services, durable goods grew for the sixth consecutive quarter by +2.0% due to the disappearance of the negative effects of pre-consumption over demand and Eco-car related tax breaks, which helped to increase consumption since 2009 along with the Ecopoint program effecting household electronics, as well as last-minute demand prior to the increase in consumption tax. In addition, services grew for the 12th consecutive quarter by +0.6% in a continuation of favorable performance. Non-durables grew for the first time in five quarters by +1.7%, but semi-durables suffered a reactionary decline in response to the previous period's high growth, falling by -2.3%.

Housing investment achieved growth for the sixth consecutive quarter at +1.3% q/q (+1.5% on the 1st preliminary). Housing investment has maintained growth as a result of lower interest rates on housing loans, and growth in rental property construction as an inheritance tax strategy, as well as the commencement of work on the construction of housing for athletes in the 2020 Tokyo Olympics and Paralympics in January this year, which appears to have contributed to pushing up overall results.

Capital expenditure on the part of private sector corporations is maintaining a moderate growth trend at +0.5% q/q (+2.4% on the 1st preliminary). Favorable corporate earnings and recovery in the world economy have provided support for maintaining the growth trend in capex. Past growth in operating rates associated with export expansion, and growing seriousness of the shortage in manpower are thought to be an undercurrent helping to maintain favorable capex spending.

Private sector inventory continues to mark time with a contribution to GDP growth of -0.0%pt q/q (+0.0%pt on the 1st preliminary). Contribution of raw materials inventory grew by +0.3%pt, while work in progress inventory marked time at -0.0%pt, and finished goods inventory declined by -0.2%pt, and distribution inventory's contribution declined by -0.1%pt.

Public investment won a major acceleration of growth at +6.0% q/q (+5.1% on the 1st preliminary). Implementation of the government's FY2016 second supplementary budget appears to be progressing.

As for government consumption, the growth trend appears to be continuing, with growth of +0.4% (+0.3% on the 1st preliminary).

Exports declined for the first time in four quarters at -0.5% q/q (-0.5% on the 1st preliminary). Looking at trade statistics for the Apr-Jun period, we see that exports to the EU grew, while those to the US were up and down. Exports to Asia declined, with ICs, which have been favorable up to this point, appearing to take a breather. This contributed negatively to overall results. On the other hand, domestic demand has been making a comeback, bringing the third consecutive quarter of growth of imports, which were up by +1.4% (+1.4% on the 1st preliminary). As a result, overseas demand brought a negative contribution to GDP for the first time in seven quarters with a decline of -0.3%pt q/q.

Domestic demand to continue expanding, while overseas demand shows risk of further deterioration

We expect Japan's economy to continue in a moderate expansion phase. Domestic demand is expected to continue its expansion centering on personal consumption, while overseas demand is expected to maintain steady growth backed by the recovery in the world economy, providing support for Japan's economic growth. However, downside risk remains for overseas demand requiring caution, due to fears that China's economy may slow down after the National Congress of the Communist Party in fall, and increased geopolitical risk. Meanwhile, we also urge caution regarding the slowdown of the US economy accompanying the Fed's tight money policy, and the problem of capital outflows from the emerging nations. Domestic demand components are expected to lead growth in the future. Until now the driving force behind Japan's economic growth was overseas demand, but there is a very good chance that this role is now shifting to domestic demand.

Personal consumption is expected to continue in a moderate expansion phase. The supply of labor is becoming increasingly tight, and this should provide underlying support for personal consumption through growth in employee compensation. However, caution is advised here as corporations may try to compensate for the cost of wage increases by flattening the wage curve and placing restrictions on overtime. This could create a slowdown in the pace of growth in employee compensation, as well as the expansion of consumption.

Housing investment is expected to experience a lull in its growth trend, and then move into a gradual descent from its current plateau. 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 in urban areas, and housing investment is also expected to begin declining after that point. Caution is required regarding a possible reactionary decline following the initially positive effect of inheritance tax strategies on growth in the construction of rental housing.

Capex is expected to see moderate growth. Operating rates in the manufacturing sector are on the rise due to the expansion of exports thanks to the recovery in the world economy. However, if uncertainty grows regarding the future of the world economy, corporations are likely to lose their willingness to invest in capex, hence caution is required. On the other hand, research & development, which is in growth phase, is expected to continue pushing up overall capex figures in the future. Meanwhile, investment in labor-saving and rationalization due to the continuing labor shortage is expected to continue its growth trend centering on the non-manufacturing industries.

As for public investment, we expect a gradual comeback to accompany implementation of the government's FY2016 supplementary budget.

As for exports, with overseas economies continuing moderate growth, we can expect exports to maintain a firm undertone. Exports to the US appear to be about to peak out, while exports to the EU and Asia are maintaining a firm undertone. As for exports to Asia, there is danger that the current weakening will continue, centering on components used to manufacture products whose final destination is the US. On the other hand, exports of electronic parts and other products oriented toward domestic demand in China are expected to maintain favorability, and this is expected to compensate for the slowdown in other parts of Asia.

However, caution is required regarding overseas demand due to possible downside risk. As for the US, the Fed is continuing to implement its tight money policy. Meanwhile, there are signs of demand for Japan's major export to the US, passenger vehicles, peaking out, and the tight money policy may bring further downward pressure on the economy. The Fed's tight money policy may also cause an acceleration of capital flows from emerging nations. On the other hand, though there is little chance of China's economy slowing down much before the National Congress of the Communist Party to be held this fall, after that point there is risk that the economy could come under downward pressure due to a reactionary decline in demand, which had been kept artificially high until now by the implementation of economic measures. Other issues include geopolitical risk such as rising tensions in North Korea. All of these risks require caution. Our main scenario sees the world economy continuing its moderate growth. However, if uncertainty grows regarding the future of the world economy, Japan's exports are likely to decline, bringing the risk of downward pressure on Japan's economy.