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# Jul-Sep 2017 1st Preliminary GDP Estimate

## GDP wins seventh consecutive quarter of growth. Exports lead growth, while consumption and public investment take a negative turn

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**Summary**

- The real GDP growth rate for Jul-Sep 2017 (1st preliminary est) grew for the seventh consecutive quarter by +1.4% q/q annualized (+0.3% q/q), pretty much in line with market consensus (+1.5% q/q annualized, +0.4% q/q). Continuing bad weather was influential, with categories such as personal consumption and public investment, which contributed to the acceleration of growth during the previous quarter, taking a negative turn. However, an increase in exports led growth in overall results. Terms of trade improved due to import prices settling down, and the GDP deflator grew for the first time in three quarters (+0.3% q/q) as a result of moderate progress in domestic price pass-through. Nominal GDP grew for the second consecutive quarter by +2.5% q/q annualized (+0.6% q/q).

- 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.

## GDP grows by +1.4% q/q annualized, its seventh consecutive quarter of growth

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**2017 Jul-Sep GDP (1st Preliminary Estimate)** **Chart 1**

| | | 2016 | | 2017 | | |
|---|---|---|---|---|---|---|
| | | Jul-Sep | Oct-Dec | Jan-Mar | Apr-Jun | Jul-Sep |
| Real GDP | Q/q % | 0.2 | 0.4 | 0.3 | 0.6 | 0.3 |
| Annualized | Q/q % | 0.9 | 1.6 | 1.0 | 2.6 | 1.4 |
| Personal consumption | Q/q % | 0.4 | 0.1 | 0.4 | 0.7 | -0.5 |
| Private housing investment | Q/q % | 2.9 | 0.3 | 0.9 | 1.1 | -0.9 |
| Private non-housing investment | Q/q % | -0.1 | 1.9 | 0.5 | 0.5 | 0.2 |
| Change in private inventories (contribution to real GDP growth) | Q/q % pts | -0.5 | -0.2 | -0.2 | 0.0 | 0.2 |
| Government consumption | Q/q % | 0.3 | 0.0 | -0.0 | 0.6 | -0.1 |
| Public investment | Q/q % | -0.4 | -2.7 | 0.1 | 5.8 | -2.5 |
| Exports of goods and services | Q/q % | 2.1 | 3.0 | 1.9 | -0.2 | 1.5 |
| Imports of goods and services | Q/q % | 0.1 | 1.2 | 1.4 | 1.4 | -1.6 |
| Domestic demand (contribution to real GDP growth) | Q/q % pts | -0.1 | 0.1 | 0.1 | 0.9 | -0.2 |
| Foreign demand (contribution to real GDP growth) | Q/q % pts | 0.4 | 0.3 | 0.1 | -0.2 | 0.5 |
| Nominal GDP | Q/q % | 0.0 | 0.5 | -0.0 | 0.6 | 0.6 |
| Annualized | Q/q % | 0.1 | 1.9 | -0.1 | 2.5 | 2.5 |
| GDP deflator | Y/y % | -0.1 | -0.0 | -0.8 | -0.4 | 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.

## Exports lead growth, while consumption and public investment take a negative turn

Performance by demand component in the Jul-Sep 2017 results shows private sector final consumption expenditure suffering a decline for the first time in seven quarters by -0.5% q/q. In addition to continued improvements in the employment environment due to the labor shortage, consumer confidence remains at a positive level. However, bad weather appears to have brought down personal consumption, with record level rain especially in eastern Japan in August, and a series of typhoons hitting various areas of the country in September. Another aspect of the decline is a reaction to the favorable results of the Apr-Jun period when personal consumption grew by +0.7%.

Looking at performance by sector we see services down by -0.7% due to bad weather, while semi-durables and non-durables maintained underlying strength in relative terms at +1.0% and +0.1% respectively. Meanwhile, durables, which have continued to chalk up growth since 2016, suffered a notable decline for the first time in seven quarters at -1.2%. We have seen the gradual dissipation 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. Meanwhile, the effects of replacement demand for durables which has continued over the past six quarters may be moving closer to the point of peaking out.

Housing investment declined for the first time in seven quarters at -0.9% q/q. Low interest housing loans continue to provide underlying support. However, the positive effects of strategies in dealing with inheritance tax are beginning to disappear, and rising prices may be putting a damper on demand.

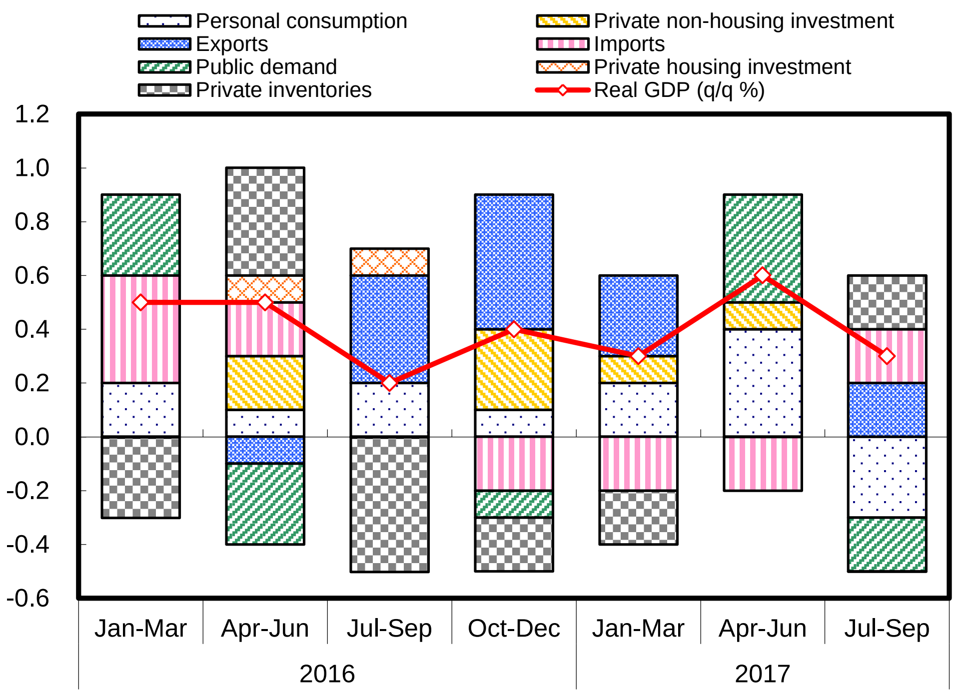
Capital expenditure grew for the fourth consecutive quarter though by just a small amount at +0.2% q/q. Capital expenditure continues to maintain an undercurrent of growth due to increased factory operating rates associated with recent growth in exports, and the growing seriousness of the shortage of manpower.

Private sector inventory increased its contribution to GDP growth at +0.2%pt. This was the first time in five quarters for inventory to bring a positive contribution. Work in progress inventory and material & supplies inventory, which are provisional on the 1st preliminary GDP estimate, each contributed +0.0%pt, while finished goods and distribution inventory contributed +0.1%pt. In terms of the inventory cycle, Japan's economy is currently in the recovery and accumulation phase, and these results are consistent with the cycle.

Public investment suffered a decline for the first time in three quarters at -2.5% q/q. The FY2016 supplementary budget was implemented during the Apr-Jun period for the most part (public investment was up by +5.8% during that quarter), with a reactionary decline manifesting during the Jul-Sep period. In addition, government consumption fell for the first time in two quarters by -0.1%.

Exports grew for the first time in two quarters at +1.5% q/q. According to trade statistics for the Jul-Sep period, exports to the EU fell due to a downturn for automobiles, while semiconductor manufacturing equipment drove up overall results, with exports to the US and Asia also registering growth. On the other hand, imports were down by -1.6% due to a decline in domestic demand. As a result, contribution of overseas demand to GDP growth exhibited a major increase for the first time in two quarters at +0.5%pt.

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




Source: Cabinet Office; compiled by DIR.

## Japan’s economy to continue moderate expansion, but risk remains in the area of overseas demand

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.

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. Meanwhile, in the short-term the negative effects of bad weather in October on personal consumption are expected to have continued. Moreover, new model car sales, which had been maintaining favorability until now have been weakening recently, indicating that replacement demand is beginning to peak out as was mentioned earlier in this report. One automobile manufacturer halted production and shipments at its domestic factories for a period of about two weeks due to its being unprepared to carry out completion inspections, and this could become a factor in the decline in new car sales.

Housing investment is expected to take a breather from its recent growth trend, and then move into a gradual descent from its current plateau. Low interest housing loans continue to provide underlying support. However, the positive effects of strategies in dealing with inheritance tax are beginning to disappear, and a reaction to recent performance may appear in the near future, hence caution is urged.

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, there is not necessarily enough propensity to invest in capex to encourage a capacity increase. Possibilities are great that the leader in capex spending will be maintenance & repair of aging and existing facilities. Meanwhile, investment in labor-saving and rationalization due to the continuing labor shortage is expected to continue its growth. In addition, investment in research & development oriented toward increasing profitability has also been on the rise, and is expected to become a factor in pushing up capex with support provided by improvements in free corporate cash flow.

As for public investment, we expect to see a gradual decline though retaining relatively high levels, due to the increasing disappearance of the positive effects 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. However, caution is required regarding 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, China’s economy risks the possibility of slowing down now that the meeting of the National Congress of the Communist Party is over. A reactionary decline in demand could now occur the economic measures which had kept it artificially high until now. 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.