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# Japan's Economy: Monthly Outlook (Sept. 2018)

1. Latest in US-China Trade War: Thorough analysis on additional tariff by product
2. FY2019 budget expected to expand considerably: estimated impact on economy
3. Revised economic outlook: +1.2% in FY2018, and +0.8% in FY2019

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## Summary

- President Trump decided to levy additional tariffs on the equivalent of around 200 billion dollars in Chinese imports. Meanwhile, China has decided to implement retaliatory tariffs on the equivalent of around 60 billion dollars in American products. We examine additional tariff rates per item and the total amounts in tariffs associated with tariff policies which have already been publicly announced (US 50 bil dlrs + 200 bil dlrs, and China 50 bil dlrs + 60 bil dlrs).
- According to our analysis, US tariffs on Chinese products effect a total of 235.3 billion dollars in imported items. Tariffs totaled 30.5 billion dollars in 2018, and are expected to reach a total of 58.8 billion dollars in 2019. The average additional tariff rate imposed per product was 13.0% in 2018, and is expected to reach 25.0% by 2019. As for types of products affected, the greatest weight goes to various types of machinery and electronic devices. On the other hand, Chinese tariffs imposed on US products total 115.8 billion dollars in imported items. The total amount in tariffs is 17.5 billion dollars with the average tariff rate per item at 15.1%. As for types of products affected, the greatest weight goes to automobiles, soy beans, machinery of various kinds, electrical generators, and control devices as well as other electrical devices.
- The FY2019 budget request has been announced. The total is 102.8 trillion yen, or an increase of +5.1 trillion yen in comparison to the previous fiscal year, or +1.8 trillion yen in comparison to the budget request. The total amount in general expenditures excluding debt servicing costs (but including tax allocations to local governments) is 78.2 trillion yen, or +3.8 trillion yen in comparison to the previous fiscal year's budget, or +1.0 trillion yen in comparison to the budget request. We use the DIR macro model to estimate the effects on the Japanese economy with growth in the amount of the budget request as one of our basic assumptions. According to the results of our estimate, real GDP is expected to grow by 0.14% in association with the increase in government spending next fiscal year, while the deficit in the primary balance as a proportion of GDP is expected to grow by 0.15%pt.
- In light of the 2<sup>nd</sup> preliminary Apr-Jun 2018 GDP release we have revised our economic growth outlook. Our estimate of real GDP growth after the revision is +1.2% in comparison with the previous year for FY18, and +0.8% in comparison with the previous year for FY19. Our assessment of Japan's economy remains unchanged. The economy is now in a temporary lull, with the positive factors which came together in FY17 now in the process of falling away. We expect Japan's economy to continue slowing down for some time, and then move toward an extremely moderate growth pattern.

## 1. Latest in US-China Trade War: Thorough analysis on additional tariff by product

On September 17, President Trump decided to levy additional tariffs on the equivalent of around 200 billion dollars in Chinese imports. The tariff rate was set at 10% within the year 2018, with the intension of raising it to 25% in 2019. This most recent 25% tariff decision to be imposed on the equivalent of 50 billion dollars in imported products is to be added to existing ones, so that the number of items effected by tariffs and the total amount taxed has ballooned,

Meanwhile, China has decided to implement retaliatory tariffs on the equivalent of approximately 60 billion dollars in American products. (Both of these policy decisions are to go into effect as of September 24.) However, tariffs that were previously announced were cut from 10-25% to 5-10%. One possible reason for the change is that China may be rethinking its strategy in relation to the US. Retaliatory tariffs as a countermeasure may have a certain validity from the viewpoint of China's domestic politics since it maintains China's authority. However, when we compare amounts in imports and exports between the US and China, it becomes clear that China is the one that loses the most from this tit for tat in imposing tariffs. The other day, President Trump threatened that if China imposes retaliatory tariffs on US products, the US will place tariffs on virtually all Chinese products. China may be keeping countermeasures to the minimum, and setting tariff rates to a level that avoids provoking the US.

### *US-China trade war: Detailed list of tariff rates and tariff amounts by product*

The status of US-China trade friction is highly fluid. Meanwhile, trade negotiations between the US and Japan, the EU, and Canada, have yet to reach a conclusion. Therefore the situation is unpredictable. In this report we examine tariff rates per item and the total amounts in tariffs associated with tariff policies which have already been publicly announced (US 50 bil dlrs + 200 bil dlrs, and China 50 bil dlrs + 60 bil dlrs).

Chart 1 provides import value, additional tariff amount, and additional tariff rate per item, with reference to publicized lists of products<sup>1</sup> on which tariffs are imposed. The additional tariff rates according to this estimate, in cases where a more detailed product category was used in calculating total tariff amount, were calculated using the weighted average of import value per product.

First of all, US tariffs on Chinese goods total 235.3 billion dollars in imports of taxed items. The total amount in tariffs was 30.5 billion dollars in 2018, and is to be raised to 58.8 billion dollars in 2019. The average additional tariff rate on items subject to tariffs in 2018 was 13.0%, to be raised to 25.0% in 2019. Looking at the breakdown we can see that electronic devices and machinery of various kinds are subject to the largest total tariff amounts.

<sup>1</sup> Items on which tariffs are imposed, and tariff rates per item are based on the following sources.

US (34 bil dlrs) :

<https://ustr.gov/sites/default/files/enforcement/301Investigations/List%201.pdf>

US (16 bil dlrs)

<https://ustr.gov/sites/default/files/enforcement/301Investigations/List%202.pdf>

US (200 bil dlrs)

[https://ustr.gov/sites/default/files/enforcement/301Investigations/Tariff%20List\\_09.17.18.pdf](https://ustr.gov/sites/default/files/enforcement/301Investigations/Tariff%20List_09.17.18.pdf)

China (34 bil dlrs)

<http://images.mofcom.gov.cn/www/201806/20180616015345014.pdf>

China (16 bil dlrs)

<http://images.mofcom.gov.cn/www/201806/20180616015405568.pdf>

China (60 bil dlrs)

[http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201808/t20180803\\_2980950.html](http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201808/t20180803_2980950.html)

[http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201809/t20180918\\_3022592.html](http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201809/t20180918_3022592.html)



Looking at the effects of amounts in additional tariffs by product, we first look at previously implemented policy, in which a 25% tariff was imposed on approximately 50 billion dollars in imported goods. In this case most of the weight fell on machinery and devices, especially storage devices and media such as magnetic disks, as well as electronic parts such as semiconductors and integrated circuits.

As for the additional tariffs imposed on 200 billion dollars in imported goods (to go into effect as of September 24), weight fell especially on electronic devices and their parts such as storage devices and parts, as well as mobile phones. Items which were made exceptions after public comment included pharmaceutical products and plastic molding, which registered the largest amounts. Other items, including consumer electronics such as smart watches, textiles, and agricultural products, were removed from the list.

Meanwhile, Chinese tariffs imposed on goods imported from the US covered a total of 115.8 billion dollars in imported products, with tariffs totaling 17.5 billion dollars, and the average tariff rate per item at 15.1%. Then recently additional tariffs of 25% were implemented on 50 billion dollars in imported goods, with the largest amounts in tariffs placed on automobiles and soy beans. In addition, an announcement was made on September 18 that additional tariffs of 5-10% (or an average of around 7%) would be imposed on imported goods worth approximately 60 billion dollars. In this case, most of the weight fell on machinery and power generators, as well as electrical devices such as controllers.

### ***Economic effects; beyond model analysis***

As was explained previously, we have taken into consideration changing assumptions as this situation develops, and using the DIR macro model, have re-estimated the effects of tariffs on the Japanese, Chinese, and US economies<sup>2</sup>. Chart 2 (with details in Chart 3) presents our estimate of economic effects assuming the US freezes its additional tariff rate on 200 billion dollars in goods imported from China at 10%. Meanwhile, Chart 4 (details in Chart 5) estimates economic effects assuming the tariff rate is raised to 25%.

Looking at the results of our estimate of economic effects assuming the US freezes its additional tariff rate at 10% (in this case the government does not use the increase in revenues to increase public spending), we see that the negative effect on GDP would be as follows: China -0.17%, US -0.15%, and Japan -0.01%. (If the government does use the increase in revenues to increase public spending, the negative effects would be less, with China at -0.01%, and the US & Japan both at -0.00%.)

Meanwhile, if the US raises its additional tariff rate to 25%, negative effects are estimated to be as follows (with no increase in government spending as a result of growth in revenue): downward pressure on GDP would be as follows: China -0.22%, US -0.28%, and Japan -0.02%. (If the government does use the increase in revenues to increase public spending, the negative effects would be less, with China at -0.05%, US +0.00%, and Japan -0.00%.)

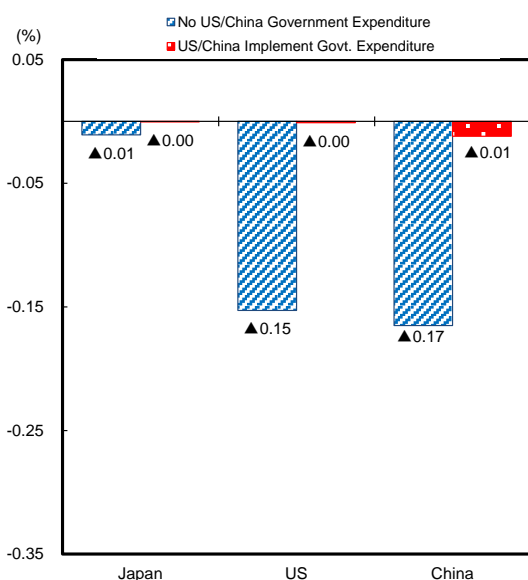
It should be kept in mind, however, that these are merely estimated values according to our computation model. The model has just one weakness. It cannot illustrate the ripple effects when a particular item or a particular industry is especially severely affected by tariffs.

The one major risk to Japan's economy due to the US-China trade war is related to Chinese exports of electronic devices to the US. In order to produce these items, China has to import components and capital goods from Japan, and the danger is that import value in this area could suffer serious declines.

<sup>2</sup> For details see the DIR Report dated 26 June 2018, *Japan's Economy: Monthly Outlook (June 2018): 1. US-China tariff battle moves into extra innings: how will Japan's economy and corporate earnings fare?*, 2. *Underestimation rhetoric surrounding effects of consumption tax hike: arguments summarized*, 3. *Revised economic outlook: +1.0% in FY2018, +0.8% in FY2019*, by Shunsuke Kobayashi and Yota Hirono.

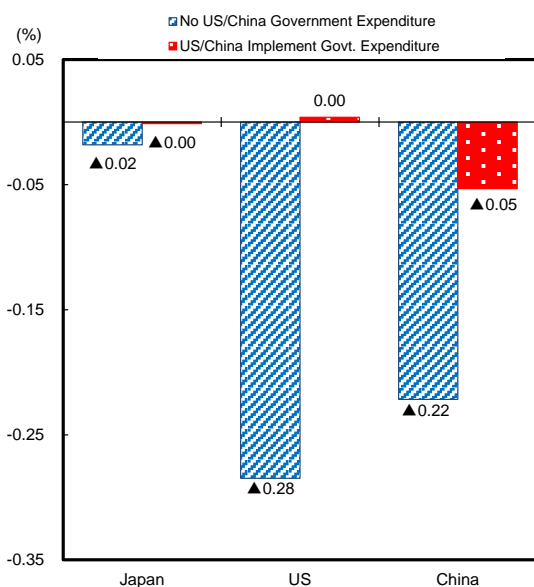
According to OECD estimates, as of the year 2011, Japan provided value-added input on a total of over 24 billion dollars' worth of items ultimately exported from China to the US. Of this, 15.2 billion dollars were accounted for by items associated with computers and electronic parts. Meanwhile, the total amount exported from China to the US has grown considerably since that time. Hence related industries in Japan could suffer from secondary effects from the US-China trade war which would be much larger than they would have in 2011. As for this industry in particular, the situation does not allow for much optimism.

**Estimated Effects of Tariffs (Summary)**  
Chart 2



Source: Estimates produced using the DIR macro model.  
Note: All figures are real. Rate of deviation from actual value.

**Estimated Effects of Tariffs (Summary)**  
Chart 4



Source: Estimates produced using the DIR macro model.

**Effects of Tariffs on Japan, US, and China Economies**  
(Detailed Version)  
Chart 3

Effects on Chinese Economy		Real GDP	Personal Consumption	Capex	Government Expenditure	Exports	Imports
No US/China Govt. Expenditure	Deviation Rate	▲0.17	▲0.34	▲0.06	0.00	▲0.30	▲0.32
	Contribution Rate		▲0.13	▲0.03	0.00	▲0.06	0.06
US/China Implement Govt. Expenditure	Deviation Rate	▲0.01	▲0.34	▲0.00	0.93	▲0.22	▲0.20
	Contribution Rate		▲0.13	▲0.00	0.13	▲0.04	0.03
Effects on US Economy		Real GDP	Personal Consumption	Capex	Government Expenditure	Exports	Imports
No US/China Govt. Expenditure	Deviation Rate	▲0.15	▲0.26	▲0.20	0.00	▲0.09	▲0.47
	Contribution Rate		▲0.18	▲0.03	0.00	▲0.01	0.08
US/China Implement Govt. Expenditure	Deviation Rate	▲0.00	▲0.26	▲0.00	1.08	▲0.07	▲0.05
	Contribution Rate		▲0.18	▲0.00	0.18	▲0.01	0.01
Effects on Japan's Economy		Real GDP	Personal Consumption	Housing Investment	Capex	Exports	Imports
No US/China Govt. Expenditure	Deviation Rate	▲0.01	▲0.00	▲0.00	▲0.08	▲0.12	▲0.11
	Contribution Rate		▲0.00	▲0.00	▲0.01	▲0.02	0.02
US/China Implement Govt. Expenditure	Deviation Rate	▲0.00	▲0.00	▲0.00	▲0.00	▲0.00	▲0.00
	Contribution Rate		▲0.00	▲0.00	▲0.00	▲0.00	0.00

Source: Estimates produced using the DIR macro model.

Notes: Estimated effects assuming US imposes tariff of 25% on 50 billion dollars' worth of Chinese imports, and 10% on 200 billion dollars' worth. Then China imposes tariff of 25% on 50 billion dollars' worth of imports from the US, and 7.4% on \$60 billion worth.

**Effects of Tariffs on Japan, US, and China Economies**  
(Detailed Version)  
Chart 5

Effects on Chinese Economy		Real GDP	Personal Consumption	Capex	Government Expenditure	Exports	Imports
No US/China Govt. Expenditure	Deviation Rate	▲0.22	▲0.34	▲0.08	0.00	▲0.57	▲0.36
	Contribution Rate		▲0.13	▲0.03	0.00	▲0.12	0.06
US/China Implement Govt. Expenditure	Deviation Rate	▲0.05	▲0.34	▲0.02	0.93	▲0.41	▲0.24
	Contribution Rate		▲0.13	▲0.01	0.13	▲0.09	0.04
Effects on US Economy		Real GDP	Personal Consumption	Capex	Government Expenditure	Exports	Imports
No US/China Govt. Expenditure	Deviation Rate	▲0.28	▲0.50	▲0.38	0.00	▲0.10	▲0.87
	Contribution Rate		▲0.35	▲0.06	0.00	▲0.01	0.14
US/China Implement Govt. Expenditure	Deviation Rate	0.00	▲0.50	0.01	2.07	▲0.08	▲0.08
	Contribution Rate		▲0.35	0.00	0.35	▲0.01	0.01
Effects on Japan's Economy		Real GDP	Personal Consumption	Housing Investment	Capex	Exports	Imports
No US/China Govt. Expenditure	Deviation Rate	▲0.02	▲0.01	▲0.00	▲0.13	▲0.19	▲0.18
	Contribution Rate		▲0.00	▲0.00	▲0.02	▲0.03	0.03
US/China Implement Govt. Expenditure	Deviation Rate	▲0.00	▲0.00	▲0.00	▲0.01	▲0.01	▲0.01
	Contribution Rate		▲0.00	▲0.00	▲0.00	▲0.00	0.00

Source: Estimates produced using the DIR macro model.

Note: Estimated effects assuming US imposes tariff of 25% on 250 billion dollars' worth of Chinese imports, and China imposes tariff of 25% on 50 billion dollars' worth of imports from the US, and 7.4% on \$60 billion worth.

## 2. FY2019 budget expected to expand considerably: estimated impact on economy

The FY2019 budget request criteria obtained cabinet approval on July 10. Based on these parameters, the various ministries submitted their requests (the deadline is August 31), and the final budget request was drawn up by the Ministry of Finance and announced on September 7. In this chapter we provide an outline of the budget, and using the DIR macro model, estimate the effects on the Japanese economy.

As is shown in Chart 6, the total budget request is 102.8 trillion yen. This is an increase of +5.1 trillion yen in comparison to the previous fiscal year (FY2018), or +1.8 trillion yen in comparison to the budget request. The total amount in general expenditures excluding debt servicing costs (but including tax allocations to local governments) is 78.2 trillion yen, or +3.8 trillion yen in comparison to the previous fiscal year's budget, or +1.0 trillion yen in comparison to the budget request. In either case, expenditures are expected to grow significantly.

FY2019 Budget (Budget Request)				Chart 6	
	FY2019 Budget Request	FY2018 Budget Request	FY2018 Budget Amount	Increase or Decrease from Budget Request	Increase or Decrease from Budget Amount
					(Y 100mil)
Imperial Household Expenses	88	64	99	24	-11
The National Diet	1,495	1,456	1,426	39	69
The Court	3,274	3,261	3,212	13	62
Board of Audit	182	180	175	2	7
Cabinet Office	29,425	29,042	28,634	383	791
National Police Agency	3,459	3,307	3,151	152	308
Ministry of Internal Affairs and Communications	164,645	162,835	160,969	1,810	3,675
Ministry of Justice	8,019	7,864	7,626	155	393
Foreign Ministry	8,102	7,675	6,967	427	1,135
Ministry of Finance	19,590	21,961	22,229	-2,371	-2,639
Ministry of Education, Culture, Sports, Science and Technology	59,351	58,380	53,088	971	6,263
Ministry of Health, Labour, and Welfare	318,956	314,298	311,262	4,658	7,694
Ministry of Agriculture, Forestry, and Fisheries	25,231	24,499	21,304	732	3,928
Ministry of Economy, Trade and Industry	11,743	11,326	9,365	417	2,377
Ministry of Land, Infrastructure, Transport and Tourism	70,677	68,385	59,420	2,292	11,258
Ministry of the Environment	4,560	4,288	3,271	272	1,290
Ministry of Defense	52,986	52,551	51,911	435	1,075
<b>Total</b>	<b>781,784</b>	<b>771,372</b>	<b>744,108</b>	<b>10,412</b>	<b>37,675</b>
Public Works Related Expenditures	74,005	72,698	62,754	1,307	11,251
Ministry of Land, Infrastructure, Transport and Tourism	61,736	60,238	51,828	1,498	9,908
Ministry of Agriculture, Forestry, and Fisheries	8,308	8,222	6,860	86	1,448
Reconstruction Ministry	3,961	4,238	4,066	-277	-105
Non-public works related (other than the above)	707,779	698,674	681,354	9,105	26,425
<b>Debt Servicing Costs (Govt. Bonds)</b>	<b>245,874</b>	<b>238,214</b>	<b>233,020</b>	<b>7,660</b>	<b>12,854</b>
<b>Total</b>	<b>1,027,658</b>	<b>1,009,586</b>	<b>977,128</b>	<b>18,072</b>	<b>50,530</b>

Source: Ministry of Finance, various news sources; compiled by DIR.

Notes: 1) The previous fiscal year's budget amount can be known through a comparison of the budget request with the amount demanded, so the entire thing has to be recomposed. The budget request amount, which includes tax allocations to local governments, is automatically calculated, as well as the amount of tax revenue.

2) Coefficients are rounded off, hence sums do not match with those which have used fractions.

3) Public works related expenditures are a total of expenses submitted by the Ministry of Land, Infrastructure, Transport and Tourism, the Ministry of Agriculture, Forestry, and Fisheries, and the Reconstruction Ministry. According to the FY2016 balance sheet, expenses reported by the Ministry of Land, Infrastructure, Transport and Tourism, and the Ministry of Agriculture, Forestry, and Fisheries accounted for 98% of all public works related expenditures.

Looking at increase or decrease from budget request by ministry, we can clearly see that the Ministry of Health, Labour, and Welfare shows by far the greatest increase in comparison to the previous fiscal year's budget and budget request. The ministry's request for FY2019 is approximately 31.9 trillion yen including expenses for programs such as workstyle reform and child rearing related programs. This represents an increase of +769.4 billion yen in comparison to the FY2018 budget, or an increase of +465.8 billion yen in comparison to the original budget request of that year. The next greatest increase in budget is from the Ministry of Land, Infrastructure, Transport and Tourism. Expenses centered on

flood control measures. The ministry's request for FY2019 is approximately 7.1 trillion yen, or +1 trillion 125.8 billion yen in comparison to the FY2018 budget, or an increase of +229.2 billion yen in comparison to the original budget request of that year.

It should be noted that the budget request does not include economic measures to prepare for an increase in consumption tax. These kinds of needs are to be included in the year-end budget compilation.

Meanwhile, the total amount and contents of the FY2018 supplementary budget, which is expected to take shape during the extraordinary session of the Diet in fall, is an unknown factor as of this moment in time. However, opinions are that adjustments are likely to be huge due to multiple natural disasters which occurred this year, including heavy rains and earthquakes, as well as the need to draw up a reconstruction budget.

### ***Real GDP seen up by 0.14%, with deficit in primary balance up by 0.15%pt***

As was described above, total government expenditure remains an open question until concrete figures arrive associated with economic measures to prepare for the next increase in consumption tax, and more detail on the supplementary budget. For this reason our analysis in this report must be satisfied with only the currently available numbers, such as the increase in the budget request. With these figures, we estimated the influence on the Japanese economy of the FY2019 budget using the DIR macro model.

The increase in budget amount which we use as our assumption is 1.0 trillion yen, but due to the estimation model, we then calculate the ripple effects for government final consumption expenditure (+910.5 billion yen) and fixed capital formation (+130.7 billion yen) separately, and add all of the factors up for final analysis.

We provide estimates for two different cases: (1) increase in government expenditure occurs in FY2019 only, and from 2020 and beyond we assume the same level as FY2018, and (2) government expenditure increases in FY2019, and from FY2020 and beyond, continues at that same level.

Results of the estimate are shown in Chart 7. In Case (1), real GDP is boosted by +0.14% in the first year of budget increase, +0.07% in the second year, and +0.00% in the third year. On the other hand, the primary balance deficit as a proportion of nominal GDP expands by 0.15%pt in the first year, but then in the second year and beyond decreases somewhat as a result of the boost in real GDP. However, the decrease in the primary balance deficit is not expected to be enough to compensate for the amount of growth in debt which will occur as a result of the expansion in government spending.

In Case (2), real GDP is boosted by +0.14% in the first year of budget increase, +0.21% in the second year, and +0.21% in the third year. At the same time, the primary balance deficit naturally continues to expand. In this case, the primary balance deficit as a proportion of nominal GDP expands by 0.15%pt in the first year, and continues to accumulate, with expansion of government spending seen at 0.12%pt in the second year, and 0.11%pt in the third year.

**Case (1) Increase in government expenditure occurs in FY2019 only.**

(Rate of Deviation from Standard Scenario, %, %pt)

	Real GDP	Private Sector Final Consumption Expenditure	Private Sector Housing Investment	Private Sector Capex	Govt. Final Consumption Expenditure	Public Fixed Capital Formation	Exports	Imports
1st Year	0.14	0.00	0.00	0.10	0.86	0.47	0.00	0.46
2nd Year	0.07	0.03	0.00	0.16	-0.02	0.00	0.01	0.26
3rd Year	0.00	0.04	0.08	0.07	-0.04	0.00	0.01	0.02
	Nominal GDP	GDP Deflator	Unemployment Rate	Dir/Yen Rate	CPI	Current Account Balance	Fiscal Balance (National / Regional)	Primary Balance (National / Regional)
1st Year	0.13	-0.01	0.00	0.00	-0.01	-0.07	-0.15	-0.15
2nd Year	0.10	0.03	-0.02	0.00	0.03	-0.04	0.03	0.03
3rd Year	0.04	0.05	-0.01	0.01	0.05	0.00	0.00	0.01

**Case (2) Government expenditure continues to increase**

(Rate of Deviation from Standard Scenario, %, %pt)

	Real GDP	Private Sector Final Consumption Expenditure	Private Sector Housing Investment	Private Sector Capex	Govt. Final Consumption Expenditure	Public Fixed Capital Formation	Exports	Imports
1st Year	0.14	0.00	0.00	0.10	0.86	0.47	0.00	0.46
2nd Year	0.21	0.03	0.00	0.26	0.83	0.47	0.01	0.71
3rd Year	0.21	0.07	0.08	0.33	0.78	0.47	0.01	0.73
	Nominal GDP	GDP Deflator	Unemployment Rate	Dir/Yen Rate	CPI	Current Account Balance	Fiscal Balance (National / Regional)	Primary Balance (National / Regional)
1st Year	0.13	-0.01	0.00	0.00	-0.01	-0.07	-0.15	-0.15
2nd Year	0.23	0.02	-0.02	0.00	0.02	-0.11	-0.12	-0.12
3rd Year	0.28	0.07	-0.03	0.00	0.06	-0.12	-0.11	-0.11

Source: Compiled by DIR using Midterm Macro Model.

Notes: 1) Amount of increase in government spending is assumed to be the same as the amount of increase in the FY2019 budget request (compared with FY2018 budget request, excluding debt servicing costs.

2) Current account balance, fiscal balance, and primary balance expressed as proportions of nominal GDP.



### 3. Revised economic outlook: +1.2% in FY2018, and +0.8% in FY2019

In light of the 2nd preliminary Apr-Jun 2018 GDP release we have revised our economic growth outlook. We now forecast real GDP growth of +1.2% in comparison with the previous year for FY18, and +0.8% in comparison with the previous year for FY19. The economy is now in a temporary lull, with the positive factors which came together in FY17 now in the process of falling away. We expect Japan's economy to continue slowing down for some time, and then move toward an extremely moderate growth pattern.

The real GDP growth rate for Apr-Jun 2018 (2nd preliminary est) was revised upwards considerably to +3.0% q/q annualized (+0.7% q/q) in comparison to the 1st preliminary report (+1.9% q/q annualized and +0.5% q/q). The major factor behind these results was the major upward revision of private sector capital expenditure, though this did not come as a surprise. Meanwhile, market consensus was at +2.7% q/q annualized (+0.7% q/q).

Looking at performance by demand component, private sector capital expenditure revised upwards considerably (+1.3% q/q to +3.1%) pulling up overall performance along with it. In addition, contribution to overall results was also revised upwards from +0.2%pt to +0.5%pt. As for other demand components, modest upward revisions were also recorded for public fixed capital formation (public investment) (-0.1% to +0.0%) and private sector housing investment (-2.7% to -2.4%), but this had little effect on overall performance.

The GDP deflator remained unchanged in comparison to the 1st preliminary at -0.0% q/q. The worsening of terms of trade associated with growth in import prices centering on the price of crude oil appears to have taken a short rest, but price pass-through has been weak centering on final goods. Nominal GDP was up by +2.8% q/q annualized (+0.7% q/q).

The growth rate for the Jan-Jun period of 2018 was +0.3% in comparison to the Jul-Dec period of 2017 (+0.5% annualized). Japan's economy is currently in a temporary lull, with the positive factors of 2017 having fallen away. Exports accelerated in 2017 due to the following factors: (1) the inventory cycle moving into the recovery phase centering on the US, (2) China's economy speeding up in anticipation of the meeting of the National Congress of the Communist Party in October last year, and (3) the recovery in Europe's economy associated with the shift from austerity to an expansionary fiscal policy. However, the effects of these factors have now disappeared. As for domestic demand, this will also be affected by the disappearance of major positive factors - that of inventory recovery and accumulation, and the replacement cycle for durables centering on automobiles from the end of last year.

That said, there are few fears of anything more drastic, such as the growth rate continuing to fall below the potential growth rate, or the economy crossing the line into recession territory. Employee compensation remains in an upward trend. Meanwhile, the shortage of labor, the recovery in operating rate (capacity utilization), and low interest rates should provide support for the maintenance of vigorous capital expenditure demand. As for overseas demand, ups and downs centering on China and Europe are expected to continue, while the benefits of tax cuts are expected to become more evident in the US. While careful attention must be paid to the negative effects of intensifying trade friction and the increasing price of crude oil, as well as the effects of the consumption tax hike planned for October 2019, all in all, Japan's economy is expected to continue moderate growth at around the level of the potential growth.

2018 Apr-Jun GDP (2<sup>nd</sup> Preliminary Estimate)

Chart 8

		2017				2018			
		Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun		Jan-Jun	
						First	Second	First	Second
Real GDP	Q/q % / HF/hf %	0.5	0.6	0.2	-0.2	0.5	0.7	0.1	0.3
	Annualized Q/q % / HF/hf %	2.0	2.3	0.9	-0.9	1.9	3.0	0.2	0.5
Personal consumption	Q/q % / HF/hf %	0.8	-0.7	0.3	-0.2	0.7	0.7	0.3	0.3
Private housing investment	Q/q % / HF/hf %	1.3	-1.4	-3.0	-2.5	-2.7	-2.4	-5.1	-5.1
Private non-housing investment	Q/q % / HF/hf %	0.2	1.3	0.9	0.7	1.3	3.1	1.5	2.6
Change in private inventories (contribution to real GDP growth)	Q/q %pts / HF/hf %pts	-0.1	0.4	0.2	-0.2	0.0	0.0	-0.1	-0.1
Government consumption	Q/q % / HF/hf %	0.4	0.1	0.1	0.0	0.2	0.2	0.1	0.1
Public investment	Q/q % / HF/hf %	5.3	-2.8	-0.6	-0.4	-0.1	0.0	-0.8	-0.7
Exports of goods and services	Q/q % / HF/hf %	0.2	2.1	2.1	0.6	0.2	0.2	1.8	1.8
Imports of goods and services	Q/q % / HF/hf %	1.9	-1.5	3.3	0.2	1.0	0.9	2.3	2.3
Domestic demand (contribution to real GDP growth)	Q/q %pts / HF/hf %pts	0.8	0.0	0.4	-0.3	0.6	0.9	0.2	0.3
Foreign demand (contribution to real GDP growth)	Q/q %pts / HF/hf %pts	-0.3	0.6	-0.1	0.1	-0.1	-0.1	-0.1	-0.1
Nominal GDP	Q/q % / HF/hf %	0.8	0.8	0.3	-0.4	0.4	0.7	-0.0	0.1
	Annualized Q/q % / HF/hf %	3.1	3.2	1.2	-1.5	1.7	2.8	-0.1	0.2
GDP deflator	Q/q % / HF/hf %	0.3	0.2	0.1	-0.2	-0.0	-0.0	-0.1	-0.1
	Y/y %	-0.3	0.1	0.1	0.5	0.1	0.1	0.3	0.3

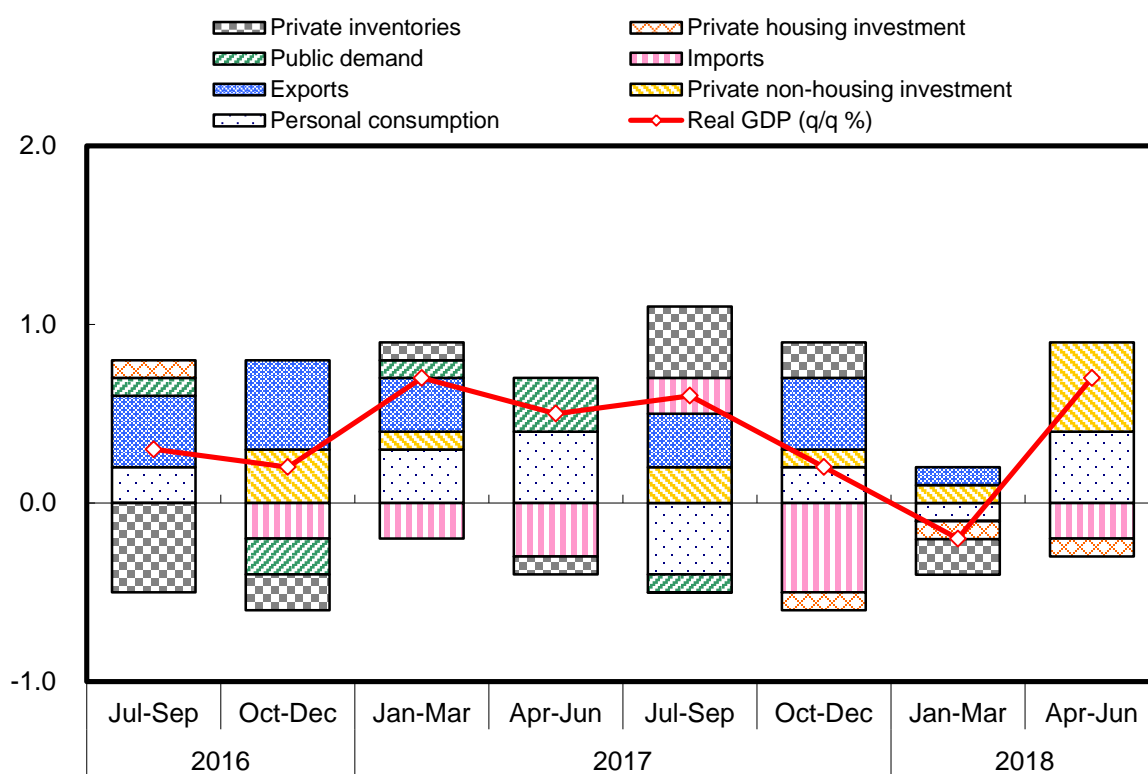
Source: Cabinet Office; compiled by DIR.

Notes: 1) Due to rounding, contributions do not necessarily conform to calculations based on figures shown.

2) Q/q figures seasonally adjusted basis.

## Contribution to Real GDP (% , % pt; seasonally adjusted basis)

Chart 9



Source: Cabinet Office; compiled by DIR.

## Japan's Economic Outlook No.198 Update

	FY17	FY18 (Estimate)	FY19 (Estimate)	CY17	CY18 (Estimate)	CY19 (Estimate)
<b>Main economic indicators</b>						
Nominal GDP (y/y %)	1.7	1.4	1.8	1.5	1.3	1.9
Real GDP (chained [2011]; y/y %)	1.6	1.2	0.8	1.7	1.1	1.2
Domestic demand (contribution, % pt)	1.2	1.2	0.6	1.2	0.9	1.0
Foreign demand (contribution, % pt)	0.4	0.1	0.2	0.6	0.2	0.1
GDP deflator (y/y %)	0.1	0.2	1.0	-0.2	0.2	0.7
Index of All-industry Activity (y/y %)*	1.8	1.2	1.0	1.6	1.2	1.3
Index of Industrial Production (y/y %)	4.1	2.0	1.7	4.4	1.9	2.2
Index of Tertiary Industry Activity (y/y %)	1.0	1.2	0.8	0.7	1.1	1.1
Corporate Goods Price Index (y/y %)	2.7	2.6	3.3	2.3	2.6	2.8
Consumer Price Index (excl. fresh food; y/y %)	0.7	0.9	1.3	0.5	0.8	1.1
Unemployment rate (%)	2.7	2.4	2.5	2.8	2.5	2.4
Government bond yield (10 year; %)	0.05	0.08	0.10	0.05	0.07	0.10
Money stock; M2 (end-period; y/y %)	3.7	2.9	1.8	4.0	3.0	2.1
Balance of payments						
Trade balance (Y tril)	4.6	3.8	4.7	5.0	3.6	3.9
Current balance (\$100 mil)	1,968	1,911	1,968	1,957	1,870	1,886
Current balance (Y tril)	21.8	21.5	22.3	22.0	20.6	20.9
(% of nominal GDP)	3.9	3.9	3.9	4.0	3.7	3.7
<b>Real GDP components</b> (Chained [2011]; y/y %; figures in parentheses: contribution, % pt)						
Private final consumption	0.8 (0.5)	0.8 (0.5)	0.1 (0.1)	1.0 (0.6)	0.5 (0.3)	0.8 (0.5)
Private housing investment	-0.4 (-0.0)	-4.9 (-0.1)	2.0 (0.1)	2.7 (0.1)	-6.4 (-0.2)	3.0 (0.1)
Private fixed investment	3.1 (0.5)	4.7 (0.7)	1.0 (0.2)	2.9 (0.4)	4.4 (0.7)	1.9 (0.3)
Government final consumption	0.7 (0.1)	0.6 (0.1)	0.8 (0.2)	0.4 (0.1)	0.5 (0.1)	0.8 (0.2)
Public fixed investment	1.4 (0.1)	-1.9 (-0.1)	1.0 (0.0)	1.2 (0.1)	-1.2 (-0.1)	-0.4 (-0.0)
Exports of goods and services	6.3 (1.0)	3.4 (0.6)	2.8 (0.5)	6.7 (1.1)	4.0 (0.7)	2.9 (0.5)
Imports of goods and services	4.1 (-0.6)	2.9 (-0.5)	1.4 (-0.2)	3.4 (-0.5)	3.3 (-0.5)	2.4 (-0.4)
<b>Major assumptions:</b>						
<b>1. World economy</b>						
Economic growth of major trading partners	4.2	3.9	3.7	4.1	4.0	3.8
Crude oil price (WTI futures; \$/bbl)	53.6	68.0	67.7	50.9	66.8	67.7
<b>2. US economy</b>						
US real GDP (chained [2009]; y/y %)	2.4	2.9	2.2	2.2	2.8	2.5
US Consumer Price Index (y/y %)	2.1	2.4	2.3	2.1	2.5	2.1
<b>3. Japanese economy</b>						
Nominal public fixed investment (y/y %)	3.2	-0.4	1.8	2.8	0.4	0.4
Exchange rate (Y/\$)	110.8	110.6	111.0	112.2	109.9	111.0
(Y/€)	130.3	128.8	128.5	127.2	129.7	128.5

Source: Compiled by DIR.

Note: Due to rounding, actual figures may differ from those released by the government.

\* Excl. agriculture, forestry, and fisheries.

Estimate: DIR estimate.