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Jan-Mar 2014 2nd Preliminary GDP Estimate

Capex revised upwards, exceeding expectations

Economic Analysis Office
Masahiko Hashimoto

Summary

- The real GDP growth rate for Jan-Mar 2014 (2nd preliminary est) was revised upwards from the preliminary est, recording +6.7% q/q annualized as compared to the preliminary figures (+5.9% q/q annualized). The 2nd preliminary figures also exceeded market consensus (up 5.6% q/q annualized), due mainly to the upward revision of capex, which exceeded earlier expectations – all in all a positive report. At the same time, private sector inventories were revised downwards considerably. However, the sharp decline was due to last minute demand prior to the increase in consumption tax, hence these figures should not be taken negatively.

- As for the outlook for the Japanese economy, the period of Apr-Jun 2014 is likely to see declines in personal consumption and housing investment for the first time in 7 quarters. However the reactionary decline occurring after the last minute demand prior to the increase in consumption tax is seen as having hit bottom in April, and are expected to begin easing up. Therefore possibilities are good that personal consumption will enter a growth trend in q/q terms by the Jul-Sep quarter. Meanwhile, exports are expected to grow as overseas economies, led by the U.S., continue to expand, and as Japan improves its global competitiveness thanks to the weak yen. Increasing exports will lead to production growth and improved earnings, and this is expected to trigger more capex. Hence we believe the Japanese economy will be back on the growth track by the Jul-Sep 2014 period.

Jan-Mar 2014 2nd Preliminary GDP Estimate **Chart 1**

		2013				2014	
		Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	
						First	Second
Real GDP	Q/q %	1.3	0.7	0.3	0.1	1.5	1.6
Annualized	Q/q %	5.3	2.9	1.3	0.3	5.9	6.7
Personal consumption	Q/q %	1.0	0.7	0.2	0.4	2.1	2.2
Private housing investment	Q/q %	1.8	0.8	3.3	4.3	3.1	3.1
Private non-housing investment	Q/q %	-2.2	0.9	0.9	1.6	4.9	7.6
Change in private inventories (contribution to real GDP growth)	Q/q % pts	0.1	-0.4	0.1	-0.1	-0.2	-0.5
Government consumption	Q/q %	0.9	0.4	0.2	0.2	0.1	0.1
Public investment	Q/q %	4.6	6.4	6.8	1.1	-2.4	-2.7
Exports of goods and services	Q/q %	4.3	2.9	-0.7	0.5	6.0	6.0
Imports of goods and services	Q/q %	1.1	1.8	2.4	3.7	6.3	6.3
Domestic demand (contribution to real GDP growth)	Q/q % pts	0.9	0.6	0.8	0.6	1.7	1.9
Foreign demand (contribution to real GDP growth)	Q/q % pts	0.4	0.1	-0.5	-0.6	-0.3	-0.3
Nominal GDP	Q/q %	0.9	0.6	0.2	0.2	1.2	1.4
Annualized	Q/q %	3.7	2.6	0.9	0.8	5.1	5.7
GDP deflator	Y/y %	-1.0	-0.6	-0.4	-0.4	0.0	-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.

Real GDP growth rate revised upwards from 1st preliminary estimate

The real GDP growth rate for Jan-Mar 2014 (2nd preliminary est) was revised upwards from the preliminary est, recording +6.7% q/q annualized (+1.6% q/q) as compared to the preliminary figures (+5.9% q/q annualized, +1.5% q/q). The 2nd preliminary figures also exceeded market consensus (up 5.6% q/q annualized and up 1.4% q/q), due mainly to the upward revision of capex, which exceeded earlier expectations – all in all a positive report.

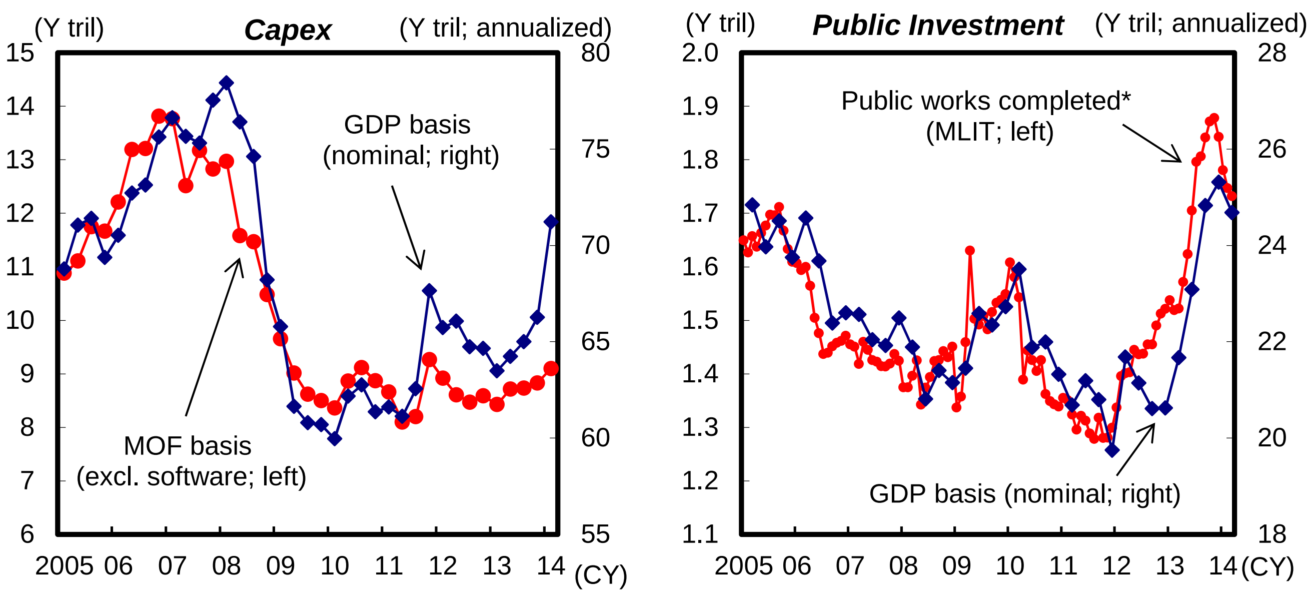
Capex revised sharply upwards

Looking at the upward revision since the 1st preliminary, capex was revised considerably upwards to +7.6% q/q (+4.9% on the 1st preliminary) as a result of the announcement of corporate statistics. Even at the stage of the 1st preliminary estimate, capex had exceeded previous performance, which was a major factor in GDP exceeding market expectations as of that point, and it has again been revised upwards even further in the current estimate. Meanwhile, personal consumption was also revised upwards somewhat in comparison to the 1st preliminary figures.

At the same time, private sector inventories were revised downwards considerably from the 1st preliminary estimate in reaction to corporate statistics (q/q real GDP contribution ratio -- 1st preliminary: -0.2% pt → 2nd preliminary: -0.5% pt). However, the sharp decline in inventories was due to last minute demand prior to the increase in consumption tax, hence these figures should not be taken negatively. Figures for public sector fixed capital formation were also revised downward (1st preliminary: -2.4% → 2nd preliminary: -2.7%) in response to the March 2014 synthetic construction indices (a basic statistic).

The GDP deflator was also revised downwards slightly to -0.1% y/y (0.0% on the 1st preliminary).

Change in Nominal capex, Nominal Public Investment, and Fundamental Statistics (Seasonally Adjusted) **Chart 2**



Source: Cabinet Office, Ministry of Finance (MOF), Ministry of Land, Infrastructure, Transport and Tourism (MLIT), compiled by DIR.
Note: Synthetic construction indices (available in Japanese), Seasonally adjusted by DIR.

Capex achieves considerable growth with help of last minute demand

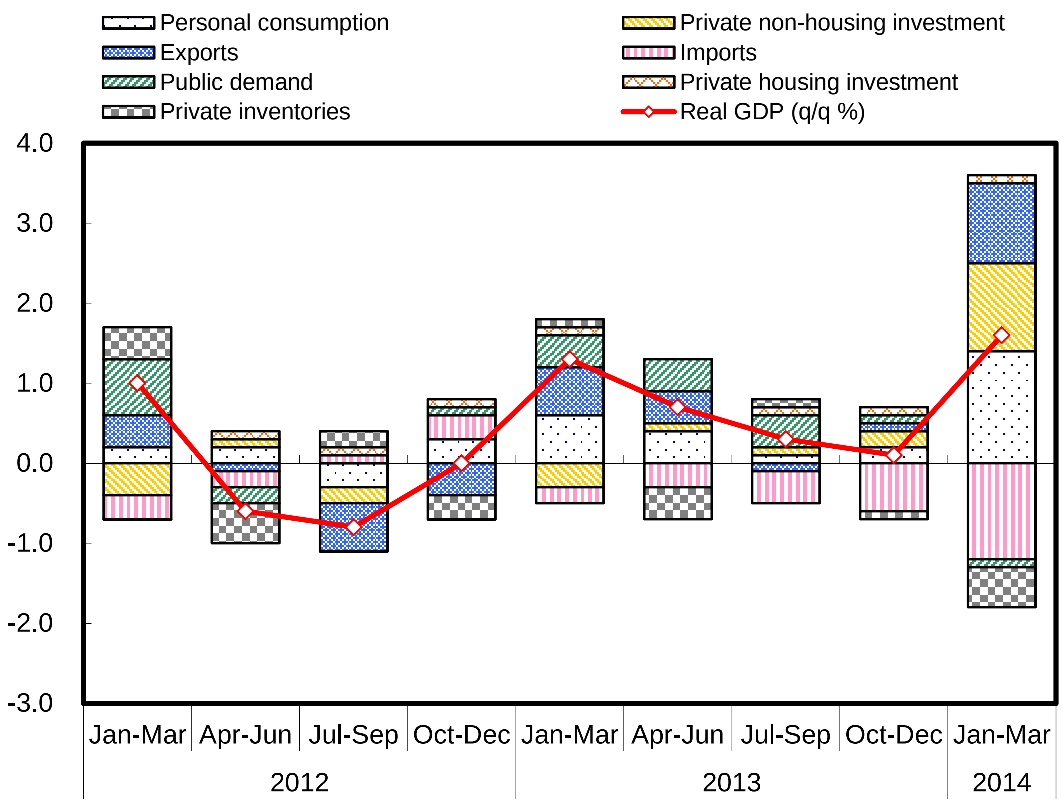
Looking at the extent of contribution of domestic and foreign demand to real GDP growth rate during the Jan-Mar 2014 period (q/q basis), we see contribution from domestic demand at +1.9% pt (+1.7% on the 1st preliminary) and foreign demand at -0.3% pt (-0.3% pt on the 1st preliminary report).

The primary cause in the growth of domestic demand was last minute demand prior to the increase in consumption tax, which led to a major jump in personal consumption (+2.2% q/q) – results which were pretty much expected. Within this context, the major upward revision of capex in the current estimate due to high growth in this area is an especially positive factor. It is hard to believe that positive capex performance is due only to the emergence of large scale growth in last minute demand alone. It makes much more sense to see growth in capex as connected to recent improvement in corporate earnings and the resolution of the recent sense that capex was in excess.

Contribution of foreign demand to GDP has seen minus figures for the past three quarters. This is due to the fact that the expansion of domestic demand led to growth in imports exceeding that of exports. While revision of the international balance of payments indicates an upward trend, but even without that, exports are definitely showing signs of coming out of a slump.

On the other hand, public investment, which had been in a continuous growth trend in recent months, suffered its first decline in five quarters. Ever since 2013, public investment continued to grow in due to the effects of implementation of the FY 2012 supplementary budget, but it appears that the effects of that budget period are gradually wearing thin. We recommend keeping an eye on future trends in this area.

Change in Real GDP **Chart 3**



Source: Cabinet Office; compiled by DIR.

Japanese economy back on growth track by Jul-Sep 2014 period

As for the outlook for the Japanese economy, the period of Apr-Jun 2014 is likely to see declines in personal consumption and housing investment for the first time in 7 quarters. However the reactionary decline occurring after the last minute demand prior to the increase in consumption tax is seen as having hit bottom in April, and are expected to begin easing up, supported by increases in base wages by major corporations feeling pressured to raise wages due to the stringent supply and demand situation for labor. Therefore possibilities are good that personal consumption will enter a growth trend in q/q terms by the Jul-Sep quarter.

Meanwhile, exports are expected to grow as overseas economies, led by the U.S., continue to expand, and as Japan improves its global competitiveness thanks to the weak yen. Increasing exports will lead to production growth and improved earnings, and this is expected to trigger more capex. Hence we believe the Japanese economy will be back on the growth track by the Jul-Sep 2014 period.