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Jan-Mar 2015 2nd Preliminary GDP Estimate

Capex gradually makes comeback; results revised upwards

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Summary

- The real GDP growth rate for Jan-Mar 2015 (2nd preliminary est) was revised upwards to +3.9% q/q annualized (+1.0% q/q) in comparison to the 1st preliminary report (+2.4% q/q annualized and +0.6% q/q). This is the second consecutive quarter of growth in real GDP, and like the 1st preliminary report, reconfirms that the economy is back on track and in a moderate growth phase. Performance exceeded market consensus (+2.8% q/q annualized), while inventory investment was revised upwards beyond expectations, despite the original outlook expecting a downward revision. Meanwhile, capex performance was revised significantly upwards in comparison with the 1st preliminary, and as will be covered in more detail later in this report, figures for the Jul-Sep 2014 and Oct-Dec 2014 periods were also revised upwards.

- Performance by demand component in the revised Jan-Mar 2015 results features upward revisions for capex and inventory investment, which have pushed up overall results. Capex was up by +2.7% in response to corporate statistics, a major upward revision from the 1st preliminary result of +0.4%. Seasonal adjustment of the capex results also brought an upward revision of the figures for the Jul-Sep 2014 and Oct-Dec 2014 periods. On the 1st preliminary report capex grew for the first time in four quarters (since the Jan-Mar period of 2014), while on the 2nd preliminary report, figures for the Jul-Sep 2014 and Oct-Dec 2014 periods were also revised upwards from the originally expected negative figures.

2015 Jan-Mar GDP (2nd Preliminary Estimate) — **Chart 1**

		2014				2015	
		Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	
						First	Second
Real GDP	Q/q %	1.1	-1.7	-0.5	0.3	0.6	1.0
Annualized	Q/q %	4.4	-6.8	-2.0	1.2	2.4	3.9
Personal consumption	Q/q %	2.1	-5.1	0.4	0.4	0.4	0.4
Private housing investment	Q/q %	2.0	-10.8	-6.4	-0.6	1.8	1.7
Private non-housing investment	Q/q %	5.1	-4.8	0.1	0.3	0.4	2.7
Change in private inventories (contribution to real GDP growth)	Q/q % pts	-0.6	1.3	-0.7	-0.2	0.5	0.6
Government consumption	Q/q %	-0.3	0.3	0.2	0.3	0.1	0.1
Public investment	Q/q %	-0.9	0.7	1.6	0.1	-1.4	-1.5
Exports of goods and services	Q/q %	6.1	-0.0	1.6	3.2	2.4	2.4
Imports of goods and services	Q/q %	6.6	-5.2	1.1	1.4	2.9	2.9
Domestic demand (contribution to real GDP growth)	Q/q % pts	1.4	-2.8	-0.5	0.0	0.8	1.1
Foreign demand (contribution to real GDP growth)	Q/q % pts	-0.3	1.1	0.1	0.3	-0.2	-0.2
Nominal GDP	Q/q %	1.3	0.1	-0.7	0.8	1.9	2.3
Annualized	Q/q %	5.5	0.2	-2.7	3.1	7.7	9.4
GDP deflator	Y/y %	0.1	2.2	2.1	2.4	3.4	3.4

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.

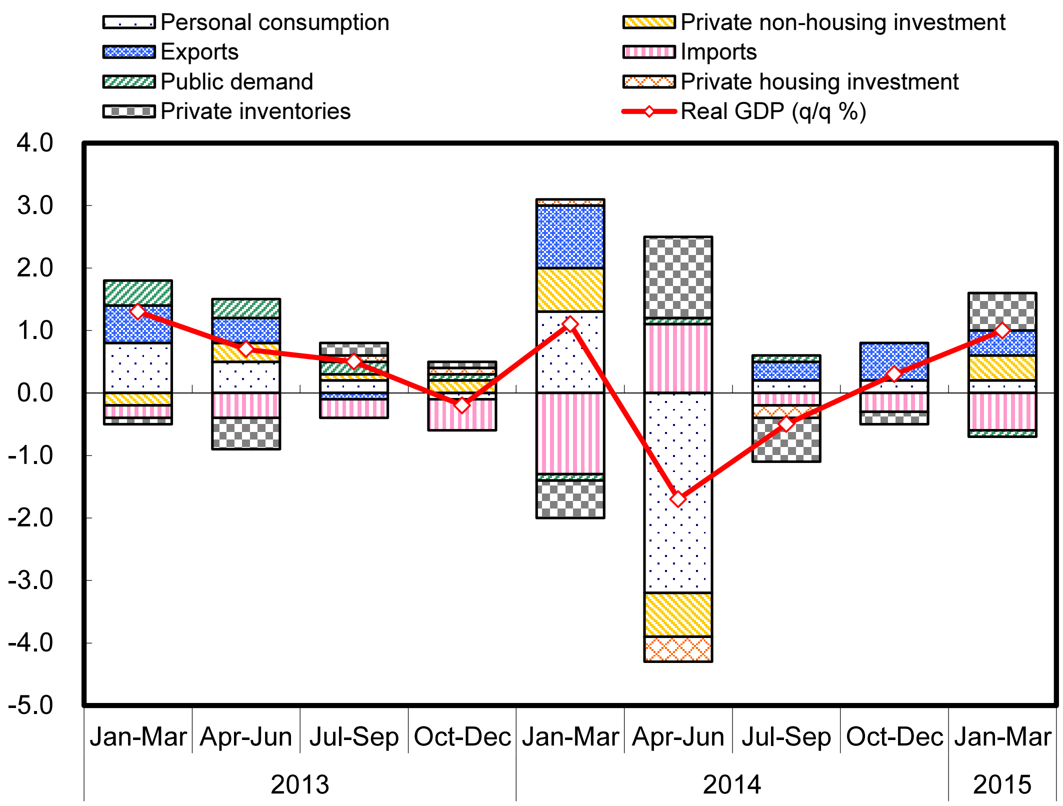
Real GDP growth rate revised upwards from 1st preliminary report

The real GDP growth rate for Jan-Mar 2015 (2nd preliminary est) was revised upwards to +3.9% q/q annualized (+1.0% q/q) in comparison to the 1st preliminary report (+2.4% q/q annualized and +0.6% q/q). This is the second consecutive quarter of growth in real GDP, and like the 1st preliminary report, reconfirms that the economy is back on track and in a moderate growth phase. Performance exceeded market consensus (+2.8% q/q annualized), while inventory investment was revised upwards beyond expectations, despite the original outlook expecting a downward revision. Meanwhile, capex performance was revised significantly upwards in comparison with the 1st preliminary, and as will be covered in more detail later in this report, figures for the Jul-Sep 2014 and Oct-Dec 2014 periods were also revised upwards.

Upward revision of capex and inventory investment increase overall result

Performance by demand component in the revised Jan-Mar 2015 results features upward revisions for capex and inventory investment, which have pushed up overall results. Capex was up by +2.7% in response to corporate statistics, a major upward revision from the 1st preliminary result of +0.4%. Seasonal adjustment of the capex results also brought an upward revision of the figures for the Jul-Sep 2014 and Oct-Dec 2014 periods. On the 1st preliminary report capex grew for the first time in four quarters (since the Jan-Mar period of 2014), while on the 2nd preliminary report, figures for the Jul-Sep 2014 and Oct-Dec 2014 periods were also revised upwards, now making this the third consecutive quarter of capex growth. Until now, the recovery in capex had been seen as lagging, but with these new results, capex can be assessed as being in a gradual comeback. Based on corporate statistics, results of both the manufacturing and non-manufacturing sectors contributed to growth.

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



Source: Cabinet Office; compiled by DIR.

As for inventory investment, positive contribution increased by +0.6%pt q/q in comparison to the 1st preliminary result of +0.5%pt, a completely unexpected upward revision, which helped to push up the overall GDP growth rate. It should be noted, however, that inventory investment may receive downward pressure in the future due to expected inventory adjustment. But when we consider the fact that both personal consumption and capex are more influenced by final demand, growth in this area suggests that there is no need to be overly pessimistic.

Meanwhile, housing investment and public investment were revised downwards just slightly, but their influence on overall GDP was limited. Personal consumption, government consumption, exports and imports were flat in comparison to the 1st preliminary report.

Economic recovery confirmed by two important aspects of domestic demand

Trends by source of demand according to the results of the 2nd preliminary GDP report for the Jan-Mar period show personal consumption up +0.4% q/q (the same as on the 1st preliminary report), its third consecutive quarter of growth, continuing in a moderate growth trend. Real employee compensation in macro terms was up by +0.6% q/q for the third consecutive quarter (here also the same as on the 1st preliminary report), due to improvements in household employment and income environments, and contributing also to growth in personal consumption. The firm undertone continued thanks to gains in all personal consumption sectors, including goods and services.

Housing investment grew for the first time in four quarters at +1.7% (+1.8% on the 1st preliminary). Looking at the trend in new housing starts, a leading indicator for housing investment as a portion of GDP, pressures stemming from the reactionary decline after last year's consumption tax increase appear to be gradually easing up, and the employment and income environment affecting households is improving, while interest on housing loans is at a low. This represents a comeback since the Oct-Dec period of 2014. Housing investment and housing starts are recorded on a progressive basis, hence there is a lag in their performance, and only now do we see that housing investment has hit bottom with a shift into a growth trend seen after the Jan-Mar 2015 period.

Capex grew by +2.7% q/q (+0.4% on the 1st preliminary) exhibiting growth for the third consecutive quarter, exhibiting a moderate comeback in average terms. The sense of overcapacity is easing up amongst corporations and is being replaced by a sense of under-capacity. Improvements can be seen in corporate earnings due to the weak yen and a recovering domestic economy, and this should provide underlying support for capex spending in the future.

Public investment was down by -1.5% q/q (-1.4% on the 1st preliminary). Front-loading the FY2013 supplementary budget and the FY2014 budget helped to accelerate public investment all the way through the Oct-Dec 2014 period, but the positive effect now run its course, leading to the first decline in four quarters.

Exports grew for the third consecutive quarter at +2.4% q/q (the same as on the 1st preliminary report). Exports to the US and EU helped to push overall figures up, while imports also managed a comeback at +2.9% q/q (the same as on the 1st preliminary report) thanks to a comeback in domestic demand. Growth in imports brought downward pressure on overseas demand (net exports) causing a slight decline at -0.2%pt q/q (unchanged from the 1st preliminary). Though small, this was the first time in four quarters that overseas demand declined.

Japan's economy expected to continue expanding

Japan's economy is expected to continue growing at a moderate pace in the future. We expect real GDP to continue this growth trend. We also see personal consumption continuing in a moderate growth trend, and capex to move unambiguously toward a comeback.

As for personal consumption, the positive environment for households in the areas of employment and income is expected to lead to an improvement in the propensity to consume, and this will be the major impetus in the continuation of the growth trend. According to the Keidanren survey (preliminary results), wages are expected to grow around +0.7% y/y due to this year's pay scale increase, pushing revised pension amounts for FY2015 up +0.9% as compared to -0.7 in FY2014. With improvements in corporate earnings, summer bonuses are expected to grow for the third year in a row, bringing another plus factor into the mix. This is expected to begin showing up in increases in household disposable income by around May and promises to become a factor in increasing personal consumption a little further up the road. Meanwhile, the price of crude oil, which has experienced steep declines since the summer of 2014 is expected to continue at a low in the immediate future. There tends to be a time lag in the effects of this phenomenon, meaning that the consumer price will see downward pressure and real household wages will get a boost. Personal consumption should also increase as a side effect. Meanwhile, housing investment is expected to be free of the effects of the reactionary decline after the increase in consumption tax last year, and backed by improvements in the employment and income environment, is expected to move toward a moderate recovery now that housing starts, a leading indicator, are clearly making a comeback.

As for capex, a moderately paced comeback is expected. Machinery orders, another leading indicator, are expected to continue in a growth trend, while the BOJ Tankan indicates that capex activities are reflecting a steady undertone. Both non-manufacturing, which has reflected a growing sense of deficiency in capex for some time now, and the manufacturing sector will continue to be relieved of any sense of surplus in capex, and this should encourage more capex related demand in the future. Meanwhile, as the yen continues to be weak, some manufacturers appear to be increasing the percentage of their domestic production, while improvements in corporate earnings due to the major decline in the price of crude oil should also become a factor encouraging an increase in capex spending. Moreover, considering the increase in personal consumption and exports, moderate growth in production and capacity utilization is seen despite some weakness seen in this area.

As for exports, moderate growth is seen continuing as overseas economies gradually recover. As for the US economy, the real GDP growth rate experienced a slowdown during the Jan-Mar 2015 period, though certain negative factors, such as the effects of bad weather on the winter period and the collapse in the price of natural resources, as well as the west coast port strike, are easing up somewhat, while the expected increase in interest rates will be moderate, the economy is now expected to pull off a sure recovery after the Apr-Jun period. The recovery in the US economy is expected to help not only Japan's exports to the US, but exports of Japanese intermediate goods to Asia since the US is the location of final demand for many goods. Europe's economy is expected to move gradually toward a comeback due to the effects of quantitative easing (QE) on the part of the ECB, and so Japan's exports are seen continuing favorably. As for China, whose economy has experienced slower growth recently, positive factors are now developing including the People's Bank of China showing stronger interest in monetary easing, and bringing expectations that moderate growth can be maintained on into the future and that the economy's back will not be broken due to recent developments.