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Jul-Sep 2015 1st Preliminary GDP Estimate

Second consecutive quarter of negative growth due mainly to inventory adjustment

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Summary

- The real GDP growth rate for Jul-Sep 2015 (1st preliminary est) declined by -0.8% q/q annualized (-0.2% q/q). Meanwhile, market consensus was down by -0.2% q/q annualized (-0.1% q/q). This is the second consecutive quarter for real GDP to record negative growth. Personal consumption and exports achieved growth, but a decline in capex spending and major inventory adjustments brought downward pressure on overall results. If we were to apply the overseas standard whereby two consecutive quarters of negative growth means the economy is in a recession, these results would suggest that this may be what has occurred. However, the main reason for the negative growth was inventory adjustment and the extent of the decline was not great. Considering this fact, while at the same time judging the tone of Japan' s economy by averaging out the level of real GDP, we do not think that it has in reality buckled under.

- Performance by demand component in the Jul-Sep 2015 results shows personal consumption up by +0.5% q/q, the first time it has achieved growth in two quarters. However, it did not recover the same amount of ground it lost in the Apr-Jun decline (-0.6%). Hence recovery in personal consumption lacks real punch. Capex was down by -1.3% q/q, its second consecutive quarter of decline, apparently taking a breather from its recent growth trend. Private sector inventory was down for the first time in three quarters, with increase in stock down -0.5% pt in comparison with the previous period, contributing greatly to this period's decline in real GDP. Meanwhile, exports achieved growth for the first time in two quarters at +2.6% q/q.

- Our basic economic scenario sees Japan's economy gradually making a comeback from its temporary lull as the effects of the overseas economic slowdown ease up and personal consumption recovers backed by a good employment environment and improving incomes. Personal consumption is expected to continue its recovery due to these factors, and move toward a comeback despite occasional ups and downs. Meanwhile, exports are expected to continue a moderate recovery while experiencing both strong and weak points as the effects of the slowdown in overseas economies eases up. As for capex, a gradual recovery is seen despite ups and downs due to record-setting corporate earnings.

Japan's economy suffers second consecutive quarter of negative growth, falling below market consensus

The real GDP growth rate for Jul-Sep 2015 (1st preliminary est) declined by -0.8% q/q annualized (-0.2% q/q). Meanwhile, market consensus was down by -0.2% q/q annualized (-0.1% q/q). This is the second consecutive quarter for real GDP to record negative growth. Personal consumption and exports achieved growth, but a decline in capex spending and major inventory adjustments brought downward pressure on overall results. If we were to apply the overseas standard whereby two consecutive quarters of negative growth means the economy is in a recession, these results would suggest that this may be what has occurred. However, the main reason for the negative growth was inventory adjustment and the extent of the decline was not great. Considering this fact, while at the same time judging the tone of Japan' s economy by averaging out the level of real GDP, we do not think that it has in reality buckled under.

Looking at the details of the Jul-Sep period real GDP results, expectations will likely be raised in the market for an FY2015 supplementary budget. Currently, two factors are expected to carry a fair amount of weight in the mid-term in regards to elements included in the supplementary budget. These are TPP related issues and realization of the government program "Promoting Dynamic Engagement of All Citizens." The issue to watch for is whether or not policy is implemented to stimulate private sector demand which has been a bit on the dull side recently.

2015 Jul-Sep GDP (1st Preliminary Estimate) **Chart 1**

		2014		2015		
		Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep
Real GDP	Q/q %	-0.3	0.3	1.1	-0.2	-0.2
Annualized	Q/q %	-1.1	1.2	4.6	-0.7	-0.8
Personal consumption	Q/q %	0.2	0.4	0.4	-0.6	0.5
Private housing investment	Q/q %	-6.8	-0.7	2.0	2.4	1.9
Private non-housing investment	Q/q %	0.3	0.0	2.4	-1.2	-1.3
Change in private inventories (contribution to real GDP growth)	Q/q % pts	-0.5	-0.3	0.5	0.3	-0.5
Government consumption	Q/q %	0.3	0.3	0.3	0.6	0.3
Public investment	Q/q %	1.7	0.2	-1.3	2.1	-0.3
Exports of goods and services	Q/q %	1.6	2.9	1.9	-4.3	2.6
Imports of goods and services	Q/q %	1.1	0.9	1.9	-2.8	1.7
Domestic demand (contribution to real GDP growth)	Q/q % pts	-0.3	-0.0	1.2	0.0	-0.3
Foreign demand (contribution to real GDP growth)	Q/q % pts	0.1	0.3	-0.0	-0.2	0.1
Nominal GDP	Q/q %	-0.5	0.7	2.2	0.2	0.0
Annualized	Q/q %	-1.9	2.7	9.0	0.6	0.1
GDP deflator	Y/y %	2.1	2.3	3.5	1.5	2.0

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.

Decline in capex and major inventory adjustment push down overall results

Performance by demand component in the Jul-Sep 2015 results shows personal consumption up by +0.5% q/q, the first time it has achieved growth in two quarters. However, it did not recover the same amount of ground it lost in the Apr-Jun decline (-0.6%). Hence recovery in personal consumption lacks real punch. When all is averaged out, personal consumption appears to be continuing to mark time. While improvements in the employment and income environment and the increase in real compensation of employees brought a positive contribution to GDP, the increasing tendency of households to economize due to price hikes of foodstuffs appears to have weighed down overall results. Looking at performance of specific items in personal consumption, we see that there was a rebound from the downtrend of the Apr-Jun period which was a plus to all four major items in goods and services. Durables (+1.4%) and semi-durables (+2.6%) achieved growth for the first time in two quarters. Automobile sales moved toward a comeback from the April tax increase on light vehicles, while sales of fall clothing items were good as temperatures began to drop. Both of these developments were a plus to overall performance. Meanwhile, non-durables grew for the first time in two quarters though just a small amount at +0.2%. Services grew for the fourth consecutive quarter at +0.4% adding another plus, and continue to be favorable.

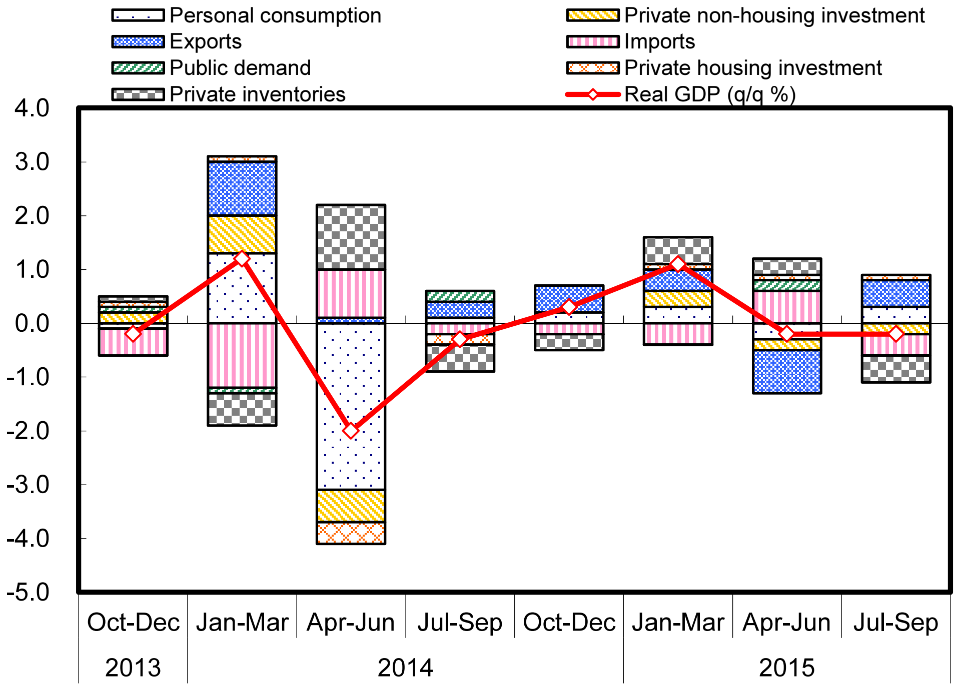
Housing investment grew for the third consecutive quarter at +1.9%. Looking at the trend in new housing starts, a leading indicator for housing investment as a portion of GDP, the employment and income environment affecting households is improving, while interest on housing loans is at a low, helping housing starts to continue a gradual comeback. Housing investment and housing starts are recorded on a progressive basis, hence there is a lag in their performance, but with that in mind, the growth trend is expected to continue.

Capex was down by -1.3% q/q, its second consecutive quarter of decline, apparently taking a breather from its recent growth trend. Meanwhile, according to surveys including the BOJ Tankan and a survey run by the Development Bank of Japan, corporations are showing a forward-looking stance toward capex, though GDP results contrasted with these findings. Looking at the trend in total supply of capital goods and shipment of capital goods, coincident indicators for capex, we see that electrical power and transport related areas rebounded after the declines of the last period, making positive contributions to overall results, but manufacturing equipment and facilities, as well as the business related areas brought a negative contribution.

Private sector inventory was down for the first time in three quarters, with increase in stock down -0.5% pt in comparison with the previous period, contributing greatly to this period's decline in real GDP. Regarding the Apr-Jun period GDP statistics, DIR indicated that inventory adjustment would be a factor of concern in the future, and it appears that this became manifest during the Jul-Sep period, with inventories continuing to mount due to weak final demand. All items in this area brought a negative contribution to GDP, with distribution inventory especially negative.

Public investment suffered a decline for the first time in two quarters at -0.3% q/q. Without the effects of economic policy as there was in the past, public investment, one of the leading economic indicators, was weak. It appears that public investment, which lags behind the leading indicators, has now shifted into the negative region.

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



Source: Cabinet Office; compiled by DIR.

Meanwhile, exports achieved growth for the first time in two quarters at +2.6% q/q. With the slowdown in the economies of the emerging nations, especially China, goods, according to foreign trade statistics, continue to be weak. The overseas corporate sector is especially weak and prices of natural resources are low, bringing sluggish performance in capital goods and materials. However, exports on an SNA basis (national accounts of Japan) are not nearly as bad as they look in the trade statistics, and the increase in foreigners visiting Japan has led to an increase in exports of services, bringing a positive contribution to GDP. Imports also grew for the first time in two quarters at +1.7%. Since growth in exports was larger than that of imports, the contribution of overseas demand (net exports) was close to zero, but exports did contribute +0.1%.

The GDP deflator grew for the fourth consecutive quarter at +0.2% q/q. Growth was slightly less than the previous quarter (+0.3%), but shows a low but steady undertone. The domestic demand deflator was up for the second consecutive quarter at +0.2%, while the export deflator was down, causing a drag on overall results. In y/y terms the GDP deflator was up by +2.0%, its seventh consecutive quarter of growth. The growth rate also grew in comparison to that of the previous period. Meanwhile, nominal GDP was up a small amount for the fourth consecutive quarter at +0.1% q/q annualized (+0.0% q/q).

Japan’s economy expected to gradually make a comeback

Our basic economic scenario sees Japan’s economy gradually making a comeback from its temporary lull as the effects of the overseas economic slowdown ease up and personal consumption recovers backed by a good employment environment and improving incomes.

Personal consumption is expected to continue its recovery due to the above factors, and move toward a comeback despite occasional ups and downs. Nominal wages according to the monthly labour survey continue to be weak due to a changeover in sampling. However, considering the trend in this year’s pay scale increase after the annual spring labor offensive, as well as trends in bonuses according to survey findings, the real situation with wages appears to be maintaining a stronger undertone than it appears when looking at the statistics. In addition, wages of part-time workers are also continuing to grow due to the positive employment environment and the increase in minimum wage. Meanwhile, disposable income of pensioners is growing somewhat, due to the increase in the pension revision rate. A number of factors are expected to provide support for personal consumption, including the upward pressure real wages are getting from the decline in the growth rate of the consumer price index and the continued increase in the number of employees.

Housing investment is expected to maintain a firm undertone with improvements in the employment and income environment and low interest on housing loans. In addition, households considering purchase of a new house should gradually increase as we move into the year 2016 in anticipation of a second consumption tax hike. However, considering the sluggishness in housing starts, a leading indicator, the tempo of growth is expected to be gradual. A note of caution is required in regard to the recent scandal regarding the falsification of condominium construction data and where this might lead. If the problem persists for the long-term, suspicions regarding the safety of newly built condominiums could become acute, and consumers could delay purchasing. Looking back to the year 2005 when it was found that seismic strength of buildings had been falsified, a situation which led to the revision of the Building Standards Law in 2007, steep declines in housing investment due to this kind of problem remain fresh in memory.

Public investment is gradually shedding the effects of economic policy which provided support in the past, and is expected to continue to decline. Contracts and orders received, which provide the leading indicators for this area, are already showing signs of peaking out. The general tone in this area is expected to continue in that vein.

Meanwhile, exports are expected to continue a moderate recovery while experiencing both strong and weak points as the effects of the slowdown in overseas economies eases up. A firm undertone continues in US economic expansion centering on the household sector, bringing expectations for a recovery in Japanese exports centering on durables. As for the EU, the economy is expected to move gradually toward a comeback due to the effects of the collapse of crude oil prices and additional monetary easing on the part of the ECB. The ECB is expected to implement additional monetary measures in December. Exports to the EU, which had been weak during summer, are expected to gradually recover to a growth trend. As for the Asian economy, China's real economy has hit bottom due to the lowering of the reserve deposit rate and interest cuts, and effects are gradually being seen in personal consumption. There is a good possibility that declines in consumption can be avoided with positive effects in purchasing of consumer goods.

As for capex, a gradual recovery is seen despite ups and downs due to record-setting corporate earnings. According to surveys measuring capex investment plans such as the BOJ Tankan, there is a forward-looking stance in regard to capex spending. Replacement investment, labor saving, and energy saving appear to be promising. However, statistics seem to see current business sentiment as being stronger than it actually is, and caution is urged regarding risk of a downtrend in the future. The possibility that corporations delaying capex spending, especially in manufacturing, may increase in the future due to the slowdown in emerging nation economies centering on China, weakness in the corporate sectors of overseas economies leading to stagnation for exports, and the slow pace of recovery in personal consumption. In addition, machinery orders, one of the leading indicators, have been weak. Hence we suggest vigilance in this area.