8 March 2016 (No. of pages: 5)

Japanese report: 08 Mar 2016

Oct-Dec 2015 2nd Preliminary GDP Estimate

Real GDP growth rate revised upwards slightly from 1st preliminary; results within range of expectations

Economic Intelligence Team
Satoshi Osanai
Shunsuke Kobayashi

Summary

- The real GDP growth rate for Oct-Dec 2015 (2nd preliminary est) was revised upwards slightly to -1.1% q/q annualized (-0.3% q/q) in comparison to the 1st preliminary report (-1.4% q/q annualized and -0.4% q/q). Results also exceeded market consensus due to the upward revision of capex, which was expected to be revised downwards on the 1st preliminary report, and the upward revision of inventory investment, which was seen marking time on the 1st preliminary report. All in all, these results confirmed our previous opinion that Japan's economy was in a lull during the fourth quarter.

- Performance by demand component in comparison to the 1st preliminary results shows personal consumption and public investment recording downward revisions, while inventory and capex achieved slight upward revisions, helping to increase overall results. Capex was revised upwards to +1.5% q/q in comparison to +1.4% on the 1st preliminary report due to corporate statistics. Meanwhile, inventory investment was revised upwards slightly to -0.0% pt q/q in comparison to -0.1% pt on the 1st preliminary report, exceeding market expectations at -0.1% pt.

2015 Oct-Dec GDP (2nd Preliminary Estimate) **Chart 1**

		2014	2015				
		Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec First	Oct-Dec Second
Real GDP	Q/q %	0.5	1.1	-0.4	0.3	-0.4	-0.3
Annualized	Q/q %	2.2	4.6	-1.4	1.4	-1.4	-1.1
Personal consumption	Q/q %	0.7	0.2	-0.8	0.4	-0.8	-0.9
Private housing investment	Q/q %	-0.4	2.1	2.3	1.6	-1.2	-1.2
Private non-housing investment	Q/q %	-0.1	2.9	-1.1	0.7	1.4	1.5
Change in private inventories (contribution to real GDP growth)	Q/q % pts	-0.3	0.6	0.3	-0.2	-0.1	-0.0
Government consumption	Q/q %	0.3	0.2	0.5	0.2	0.5	0.6
Public investment	Q/q %	1.0	-3.0	3.2	-2.1	-2.7	-3.4
Exports of goods and services	Q/q %	3.2	2.1	-4.6	2.6	-0.9	-0.8
Imports of goods and services	Q/q %	1.1	1.9	-2.5	1.3	-1.4	-1.4
Domestic demand (contribution to real GDP growth)	Q/q % pts	0.2	1.1	-0.1	0.1	-0.5	-0.4
Foreign demand (contribution to real GDP growth)	Q/q % pts	0.3	-0.0	-0.3	0.2	0.1	0.1
Nominal GDP	Q/q %	0.9	2.0	-0.1	0.6	-0.3	-0.2
Annualized	Q/q %	3.6	8.3	-0.2	2.6	-1.2	-0.9
GDP deflator	Y/y %	2.3	3.3	1.5	1.8	1.5	1.5

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 slightly from 1st preliminary

The real GDP growth rate for Oct-Dec 2015 (2nd preliminary est) was revised upwards slightly to -1.1% q/q annualized (-0.3% q/q) in comparison to the 1st preliminary report (-1.4% q/q annualized and -0.4% q/q). Results also exceeded market consensus due to the upward revision of capex, which was expected to be revised downwards on the 1st preliminary report, and the upward revision of inventory investment, which was seen marking time on the 1st preliminary report. All in all, these results were unsurprising, as the upward revision from the 1st preliminary results was only slight, and results were generally in accordance with market consensus. Moreover, results confirmed our previous opinion that Japan's economy was in a lull during the fourth quarter. As for the future of Japan's economy, the focus is on the G7 summit to be held in Japan on May 26-27. Hopes are that the advanced nations will implement coordinated fiscal policies. There is also the question of whether or not China comes up with a full-fledged policy to bolster its economy.

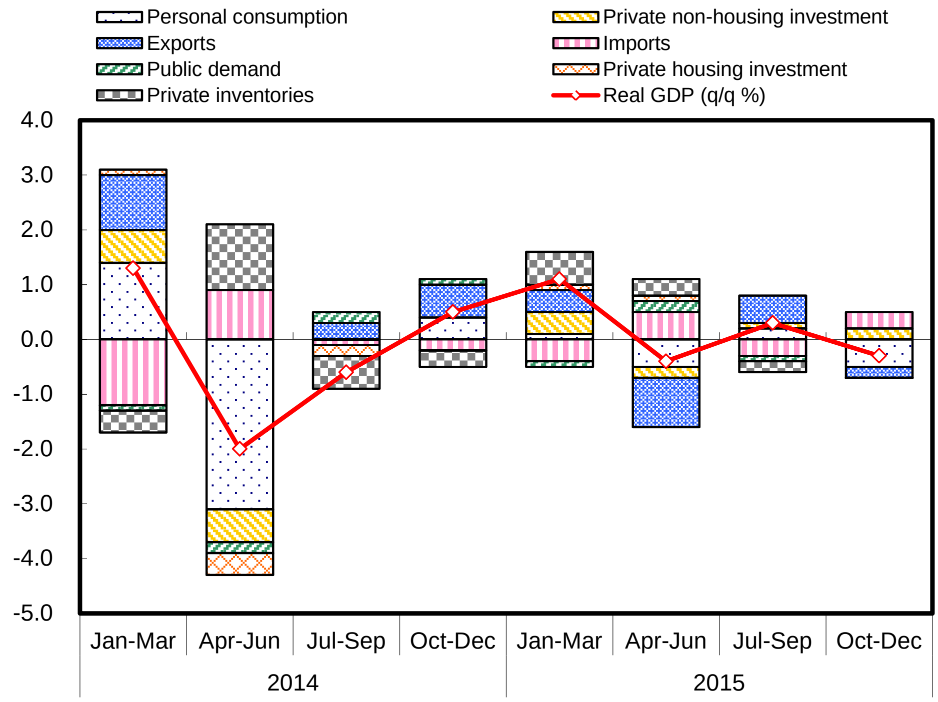
Small upward revision for capex and inventory investment in contrast to previous outlook

Performance by demand component in light of upward revisions from the 1st preliminary results shows personal consumption and public investment with downward revisions, but inventory investment and capex were revised upwards slightly, helping to increase overall results.

Capex was revised upwards to +1.5% q/q in comparison to +1.4% on the 1st preliminary report due to the results of corporate statistics. Inventory investment's contribution to overall results was revised slightly upwards from -0.1% pt q/q on the 1st preliminary report to -0.0% pt on the 2nd preliminary, while also exceeding market consensus at -0.1%. Looking at inventory investment by category, out of the four categories of investment work-in-process and raw materials were revised upwards, while finished goods inventory and distribution inventory were flat. The contribution of personal consumption was expected to remain flat in comparison to the 1st preliminary report, but then fell slightly in terms of rate of change. Public investment was revised downwards due mainly to the reflection of basic statistics from December. However, this was pretty much within the range of expectations.

As for other components, housing investment and imports were flat in comparison to the 1st preliminary report, while government consumption and exports were revised upwards. However, overall GDP results were not influenced much by this.

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



Source: Cabinet Office; compiled by DIR.

Trends by demand component: Major components show weak performance across the board with the exception of capex

Looking at trends in demand components on the Oct-Dec 2015 period results (2nd preliminary report), we see personal consumption suffering a decline for the first time in two quarters at -0.9% q/q (-0.8% on the 1st preliminary). This was due to the improvement in the employment and income environments, with real compensation of employees maintaining a firm undertone, and contributing to overall results. Meanwhile, households continue to tighten their budgets, dragging down overall results, with seasonal goods, including winter clothing, heating equipment, and energy, all performing poorly.

Housing investment declined for the first time in four quarters at -1.2% (also -1.2% on the 1st preliminary). New housing starts, a leading indicator for housing investment as a portion of GDP, have been weak since sometime around the middle of 2015. Housing investment and housing starts are recorded on a progressive basis, hence there is a lag in their performance, but it appears that this area has shifted into a declining trend.

Capex rose by +1.5% q/q (+1.4% on the 1st preliminary), its second consecutive quarter of growth, in a continuation of its comeback. This was made possible by historic highs in corporate earnings, which encouraged replacement investment.

Private sector inventory was down for the second consecutive quarter at -0.0% pt (-0.1% pt on the 1st preliminary) contributing to this period's decline in real GDP. It seems reasonable to deduce that this shows the pace of growth in inventories to be slowing down.

Public investment declined for the first time in two quarters at -3.4% q/q (-2.7% on the 1st preliminary). Without the effects of economic policy as there was in the past, public investment, one of the leading economic indicators, has also fallen into decline.

Meanwhile, exports were also down for the first time in two quarters at -0.8% q/q (-0.9% on the 1st preliminary). The increase in foreigners visiting Japan has led to an increase in exports of services. Meanwhile, with the slowdown in the economies of the emerging nations, especially China, goods, according to foreign trade statistics, continue to be weak, bringing down overall performance. Imports also declined for the first time in two quarters at -1.4% (also -1.4% on the 1st preliminary). Since the decline in imports was larger than that of exports, the contribution of overseas demand (net exports) was up by +0.1% pt (also up +0.1% pt on the 1st preliminary).

With no clearly driving force, Japan's economy faces risk of possible downturn

There is no major change in our main scenario as expressed in the 1st preliminary report. The future of Japan's economy will be assisted by a number of positive factors, including improved employment and income environments, which should encourage a recovery in personal consumption. However, due to the absence of a clearly driving force, Japan's economy faces risk of a possible downturn in the future. Especially notable are the downturn in the Chinese economy, turmoil in the global financial markets in response the US exit strategy, and a strong yen / weak stock market situation brought on by risk-off behavior of investors. These factors require caution. The focus for the time being is expected to be on the G7 summit to be held in Japan on May 26-27. Hopes are that the advanced nations will implement coordinated fiscal policies. There is also the question of whether or not China comes up with a full-fledged policy to bolster its economy. We also note that GDP statistics do not make adjustments for leap year, hence the Jan-Mar 2016 period figures could be on the strong side due to the extra day in comparison to February of the previous year.

Personal consumption is expected to mark time. As for the question of income, real wages according to the monthly labour survey continue to be weak since summer of 2015 due to a changeover in sampling, but it appears that it has recently been moving toward a comeback. Real employee compensation (real wages x employment) in the macro sense is maintaining a strong undertone due to the growth trend in employment. Meanwhile, the positive employment environment and the raising of the minimum wage are expected to bring a gradual increase in part-timer pay. The effect of a slower growth rate in the consumer price index promises to continue pushing up real wages, and this should be a factor in providing underlying support for personal consumption. Meanwhile, factors to keep in mind are the pension revision rate which was raised in Fiscal 2015 for the first time in sixteen years, and which the government has decided to leave unchanged in Fiscal 2016, as well as the spring labor offensive in 2016, which may very possibly bring a smaller wage revision rate than in 2015 (final tally results +2.20%).

Looking at the trend in new housing starts, a leading indicator for housing investment, it appears that performance continues to be weak. Housing starts are weighted down by an increase in construction costs and sales prices, as well as the scandal regarding the falsification of condominium construction data which surfaced late n 2015. However, improvements in the employment and income environment, along with the historic lows in interest on housing loans, and then beyond the year 2016, the expected further increase in consumption tax in April 2017, are expected to work together in encouraging a gradual increase in the number of households considering purchase of a new home. Housing starts should soon return to a growth trend. Housing investment is expected to recover to a growth trend in the future, though there is expected to be a time lag between the expected increase in housing starts and the subsequent recovery in housing investment.

As for capex, the gradual recovery is seen continuing due to record-setting corporate earnings, which are encouraging replacement investment. According to surveys measuring capex investment plans such as the BOJ Tankan, there is a forward-looking stance in regard to capex spending, especially in the non-manufacturing industries. Replacement investment, labor saving, and energy saving appear to be promising. However, statistics seem to see current business sentiment in the manufacturing industries as being stronger than it actually is, and caution is urged regarding risk of a downtrend in the future. 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 means that corporations delaying capex spending may increase in the future, especially amongst manufacturers.

Public investment is gradually shedding the effects of economic policy which provided support in the past, and is expected to continue its gradual decline. Contracts and orders received, which provide the leading indicators for this area, are showing signs of weakening. The general tone in this area is expected to continue in that vein. However, if the FY2015 supplementary budget and the FY2016 budget are implemented in advance, public investment is expected to gradually end its declining trend starting in the latter part of FY2016 and beyond.

Meanwhile, exports are expected to make a gradual comeback while experiencing both strong and weak points with the US and European economies showing a firm undertone and exports of services recording favorable performance. However, overseas economies show a growing risk of a downturn, with the worldwide industrial sector in the doldrums due to the rapid decline in the price of resources and excess production capacity. Overseas shipments of electronic parts and devices for smartphones are expected to suffer a temporary decline. Considering this fact, the expected shift back into a growth trend for exports of goods will likely have to wait until sometime after spring. 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. Exports to the EU are expected to gradually recover to a growth trend. As for the Asian economy, electronic parts and devices for smartphones as mentioned above, as well as iron & steel and materials are expected to be a drag on performance due to China's excess production capacity. Asian exports are expected to continue on the weak side. As for China, whose economic slowdown continues, monetary easing and promotion of automobile sales are helping to lift the real economy, and the effects are beginning to show up in personal consumption and the service sector. There is a good possibility that declines in consumption can be avoided in the area of consumer goods.