

GIAM Macro & Market Research – Market Commentary

Japan's Q4 GDP growth rebounded only moderately after Q3 drop

- **According to the first print, Japan's GDP growth rebounded to 1.4% qoq annualized after the drop by 2.6% qoq ann. in Q3, caused by natural disasters.**
- **Private consumption and business investment were the main positive drivers, while net exports and the inventory component dragged on growth.**
- **Looking ahead, we expect exports to remain lackluster given softening global growth. By contrast, private consumption is likely to accelerate ahead of the planned sales tax hike in October 2019, but to drop thereafter. Support will also come from fiscal policy.**
- **We recently revised our growth forecast already down to 0.9% for 2019. Risks are still tilted to the downside. Slowing growth makes it even more difficult for the BoJ to change its monetary policy stance ahead of the sales tax hike.**

Dear Colleagues,

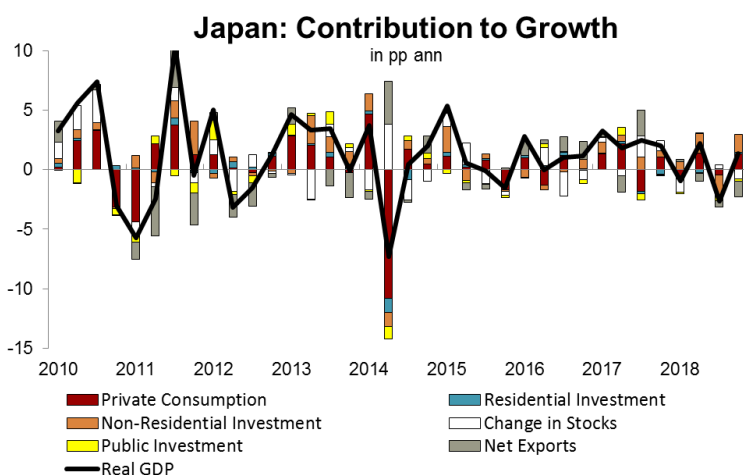
After Japan had been repeatedly hit by natural disasters in Q3, Q4 GDP growth saw the expected rebound. According to the first print, Japan's GDP increased by 1.4% qoq annualized (ann.) after the drop by 2.6% qoq ann. in Q3. However, the figures also show that the rebound was not strong enough to make up for the previous quarter's drop. The reasons are twofold. On the one hand, the Q3 drop was exacerbated by fast growth before. More importantly, however, exports increased only softly (especially in December) while imports accelerated much more pronounced. As a result, the contribution of net export to Q4 GDP growth amounted to -1.3 pp ann. Looking ahead, headwinds from the international environment have intensified amid slowing growth rates around the globe. The slowdown in China will especially limit capital goods exports. On top, Japan is also exposed to less high-tech demand. Accordingly, we expect export growth to remain rather lackluster, going forward.

By contrast, domestic demand components contributed +3.4 pp to Q4 annualized growth. Private consumption increased by 2.4% qoq ann, more than offsetting the previous drop. Especially consumer durables and services could benefit, the components most hit before by the natural disasters. Moreover, total compensation of employees also turned around again, rising by 2.6% qoq ann, or 2.5% yoy. Correcting fresh food prices, lower energy inflation and receding telecommunication prices led headline CPI inflation to recede to 0.3% yoy in December, which additionally helped real purchasing power. Looking ahead, the main upcoming event regarding private consumption will be the planned sales tax hike in October 2019 from 8% to 10%. This is likely to spur especially purchases of durable consumption goods beforehand, but will create a cliff thereafter. Given the negative experience with the first part of the sales tax hike in April 2014, the government is mulling

action to smooth this pattern. The two supplementary fiscal packages plus the initial budget could lead to a fiscal impulse of 0.5 pp of GDP in 2019.

The second main pillar of domestic growth in Q4 was private business investment, rising by 9.8% qoq ann, after an almost equal drop in Q3. Nevertheless, as exports are a typical driver for investments in Japan (investments typically lag exports by about two quarters), the outlook has also clouded somewhat. Japan's Nikkei PMI receded markedly in January to 50.3 index points. Moreover, the monthly Reuters Tankan receded substantially, driven by manufacturers, while the service sector was much less affected. However, we see also positive factors concerning labor-saving investments, given Japanese demographics and the strong labor market. Building/infrastructure investments could also still benefit from the Tokyo Olympics in summer 2020.

All in, we revised our 2019 growth forecast down to 0.9%, from 1.3% before. We see risks still tilted to the downside. Against this backdrop of lower growth, we consider it even more difficult for the BoJ to change its monetary policy stance ahead of the sales tax hike. However, Japan's bank lobby called today for the BoJ to review its ultra-easy monetary policy, showing that the discussion about its negative side effects is still ongoing. At the same time, BoJ Governor Kuroda – speaking to a lower house budget committee – said it was his responsibility to meet the 2% inflation target. At its meeting at the end of January, the BoJ cut again its inflation forecasts but stuck to its policy stance, warning of risks to the economy from trade protectionism and faltering global demand.



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