

Second consecutive quarter of negative growth was averted

Real GDP rose by 0.3% (1.0% annualized) in the third quarter of 2015 on a quarter-by-quarter basis. Negative growth for the second consecutive quarter, which had been anticipated at one point, was averted; however, private consumption and private non-residential fixed investments showed only a minor recovery, failing to reach the level recorded in the first quarter.

Private consumption* grew by 0.4% from the previous quarter, with increases in outlays for semi-durable goods such as clothing and outlays for services such as eateries, recreation and sports. Outlays for durable goods also increased marginally by 0.1% from the previous quarter. But private consumption were still 0.2% lower than the first quarter's level, and the average of the living expenditure level index in October and November showed a significant decline of 2.5% in comparison to the average of the third quarter, according to the Family Income and Expenditure Survey. Private consumption is likely to be sluggish in the fourth quarter.

Private non-residential fixed investments marked a 0.6% increase from the previous quarter. According to the Financial Statements Statistics of Corporations, higher growth drivers included electric and information & communications technology



machinery, general machinery, and transportation machinery from the manufacturing industry, and leasing, transportation, and electricity, gas, and water supplies from the non-manufacturing industry, although still 0.7% below the first quarter's level. In the third quarter, private machinery orders (excluding orders for ships and those from electric power companies) and building construction starts for private non-residential use, which can be considered as leading indicators, both decreased. Private non-

residential fixed investments may stagnate again in the fourth quarter.

Exports of goods and services showed a 2.7% increase from the previous quarter, mainly in shipbuilding and ship repairs, non-ferrous metals products, final chemical products, and travel, which are equivalent to domestic consumption by

Real Gross Domestic Product (GDP)

	at 2005 Price, Calendar year			
	2014	2015		
		1-3	4-6	7-9
	y/y%	q/q%	q/q%	q/q%
Real Gross Domestic Product	-0.0%	1.1%	-0.1%	0.3%
Private Consumption	-0.9%	0.3%	-0.5%	0.4%
Private Housing Investments	-5.3%	2.0%	2.5%	2.0%
Private Non-Resi. Fixed Investments	3.1%	2.7%	-1.3%	0.6%
Public Investments	0.4%	-2.0%	3.3%	-1.5%
Government Consumption	0.1%	0.2%	0.4%	0.3%
Exports of Goods & Services	8.3%	1.9%	-4.3%	2.7%
(less) Imports of Goods & Services	7.2%	1.7%	-2.6%	1.7%

Source: CAO

* All subsequent references to GDP demand items are in real terms unless otherwise indicated.

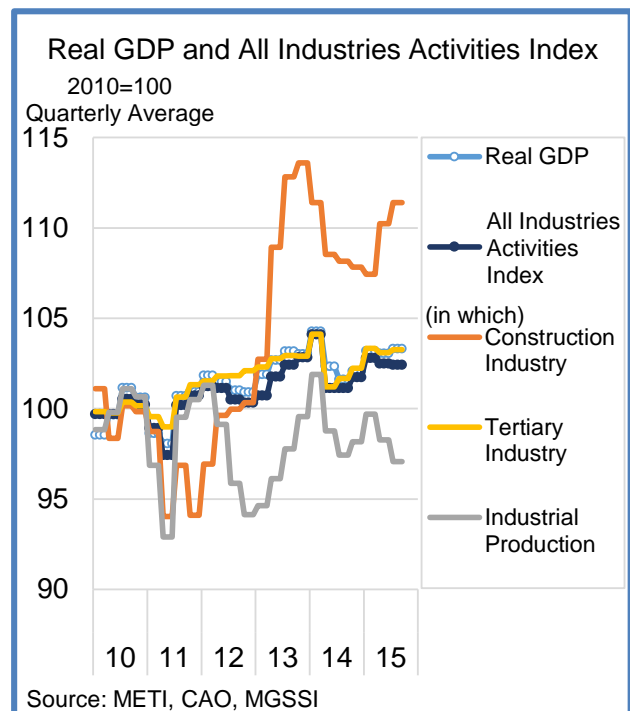
foreign visitors in Japan. Meanwhile, imports of goods and services showed a 1.7% increase from the previous quarter in crude oil, natural gas, electronic communication devices, and clothing and personal belongings. As a result, net exports contributed to a 0.1% quarterly growth in real GDP. Direct purchases in the domestic market by non-resident households, which indicates domestic consumption by foreign visitors in Japan, increased by 11.7% in the third quarter, marking a new record high for 11 quarters in a row. Despite its meager share of 0.6% in nominal GDP, there is no doubt that it has been a GDP growth booster to a certain extent.

Private housing investments increased by 2.0% from the previous quarter. Housing starts, while remaining at a high level of annually 915,000 units, showed a 3.9% quarter-by-quarter decline. Rental house constructions continued to increase as a countermeasure for an inheritance tax and ultimately surpassed annually 400,000 units, but condominium constructions marked a deeper decrease. Further jump in housing investments is hardly expected, but they should be underpinned by housing starts that would gradually pick up in anticipation of the consumption tax hike in April 2017.

Public investments fell by 1.5% from the previous quarter. Public works contracted, which indicate the trend in orders, remained at a high level but took a downturn and fell by 9.6% in the third quarter. Construction companies' works in progress as estimated by the Ministry of Land, Infrastructure, Transport, and Tourism also stopped showing an increase. The government formulated a supplementary budget in December 2015, but a large portion of which is not earmarked for public investments. Thus, public investments should level off down the road while remaining at a high level.

Three years passed since the launch of the second Abe Administration

On December 26, 2015, it has been three years since the inauguration of the second Abe administration. During the last three years between the third quarter of 2012 (before the inauguration) and the third quarter of 2015, real GDP marked a 2.3% growth, while the all industries activities index, which indicates the economic trend measured by the suppliers' side, rose by 1.9% during the same period.



According to this index, the Japanese economy after the inauguration of the second Abe administration is roughly divided into three periods. In the first period, a surge in the activity level was seen in the construction sector. Fiscal stimulus under the second arrow of Abenomics of "Flexible Fiscal Policy" and strong reconstruction demand after the Great East Japan Earthquake in March 2011 boosted the construction industry activity index by 2.4% on a quarter-by-quarter basis in the first quarter of 2013, and by 6.0% and 3.6% further in the second and the third quarters of the same year, respectively.

The second period lasted until the consumption tax hike in April 2014, during which the industrial production index, which is composed primarily of the manufacturing industry, and tertiary industries activity index, which indicates the service industry's activities in a broad sense, started picking up. The industrial domestic shipments index recorded quarter-by-quarter increases of 2.9% and 3.5% in the fourth quarter of 2013 and the first quarter of 2014, respectively. Non-essential personal services of the tertiary industries activity index rose by 1.6% from the previous quarter in the first quarter of 2014.

The third period began after the consumption tax hike. During this period, recovery from the downturn was much anticipated, but it took place only weakly. At first the tertiary industries activity index and then the industrial shipments index, particularly for exports, started to recover, but both lost momentum in a year.

Industrial domestic shipments also stayed stagnant until the end of 2014. In 2015, the construction industry activity index took an upturn mainly in private demand. However, accounting for only around 6% of the all industries activities index, the construction sector failed to boost overall industries activities with its growth rate of no more than 40% of that recorded immediately after the launch of the second Abe administration.

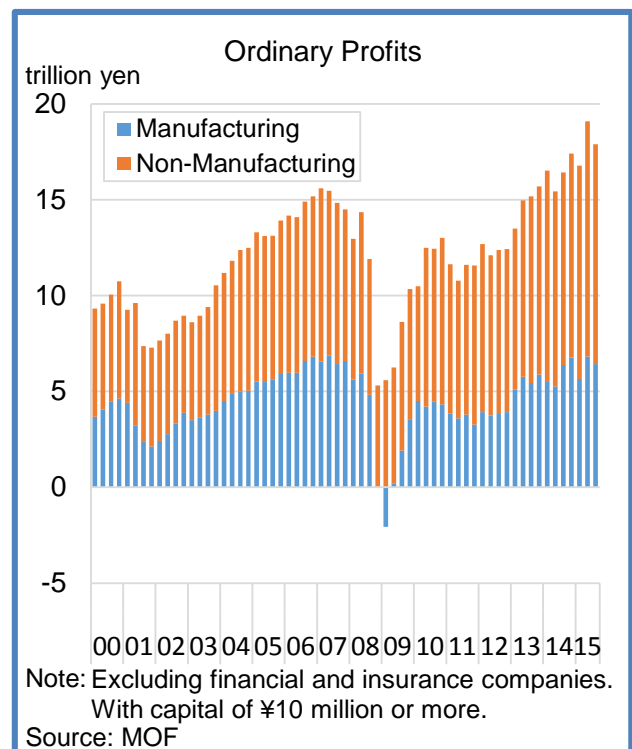
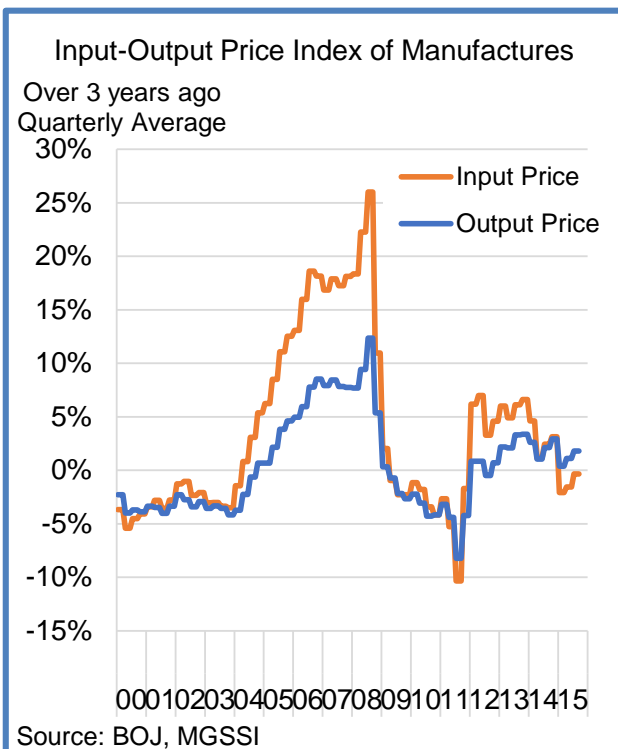
Corporate profits are growing

The biggest achievement of Abenomics is the growth in corporate profits. According to the aggregated statistics of non-consolidated (standalone) income statements of corporations (excluding financial and insurance companies; with capital of ¥10 million or more), ordinary profits increased from ¥12.4 trillion in the third quarter of 2012 to ¥19.1 trillion in the second quarter of 2015, marking a record high. In the third quarter of 2015, it fell to ¥17.9 trillion, which was still the second highest level in history.

Net sales increased by ¥12.0 trillion in three years. Major expenses included decreases of ¥608.9 billion in labor costs and ¥198.2 billion in depreciation and amortization, and an increase of ¥568.8 billion in net financial income; a total of ¥1.4 trillion profit booster was not comparable to an increase in ordinary profits. Net financial income grew in the second quarter when

receipts of dividends increased, yet it accounted for only around 20% of an increase in ordinary profits. Growth in ordinary profits is attributed mainly to a fairly limited increase of ¥8.6 trillion in other expenses such as material costs, which was not as large as an increase in net sales.

For another example, in the manufacturing industry, its output price increased by 1.8%, while its input price decreased by 0.3% in the last three years. Apparently, export goods drove output price higher, while falling resource prices contributed to lower input price. There are some differences depending on the sector, needless to say, but even in the construction sector and the real estate sector, which were a driver of growth in ordinary profits of the non-manufacturing industry, an increase in other expenses was smaller than an increase in net sales. In the case of Japan that had been stuck in prolonged deflation, the output price growth rate was smaller than the input price growth rate most of the time. However, output prices of export goods upturned when the yen weakened with the help of Abenomics; net sales of the construction sector and the real estate sector increased when bullish outlook grew on land prices and real estate prices in some areas. The government hasn't yet officially declared the end of deflation, but without a doubt an underlying uptrend of prices contributed to the growth in corporate profits.



Establishing a positive cycle of the economy remains as a challenge

Most of the private sector economists forecast unchanged to 0.2% growth (0.2% to 0.8% annualized) in real GDP for the fourth quarter of 2015 from the previous quarter. In this case the real GDP growth rate for 2015 will be around 0.7% from the previous year, and the median forecast for 2016 is around 1.0%. If that actually happens, it is not bad at all, given the potential growth rate at around 0.5% or lower (estimated by the Bank of Japan).

The unemployment rate dropped to 3.4% in the third quarter of 2015 from 4.2% three years ago. The number of employed workers increased from 62.7 million to 63.8 million. Employment growth is the second biggest achievement of Abenomics, next to growth in corporate profits. With an underlying price uptrend and falling resource prices such as crude oil prices taken into account, corporate profits are highly likely to stay at a high level, while the labor market is less likely to worsen given the decreasing working age (15 – 64 years old) population in the aging society of Japan. Currently, there are few reasons to expect the Japanese economy will autonomously fall into recession. But the actual 2015 real GDP growth is likely to fall below the forecasts made at the beginning of the year two years in a row. A positive economic cycle, which connects growth in corporate profits and employment with increases in income, consumption,

and investments, still remains as a challenge for the Japanese economy, in order to achieve the growth as initially expected in 2016.

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Selected Economic Indicators						
	Fiscal Year		2014	2015		
	2013	2014	Jul-Sep	Jan-Mar	Apr-Jun	Jul-Sep
GDP at current prices (SAAR, Trillion Yen)	482.4	489.6	488.0	498.0	498.7	500.7
Real GDP at 2005 prices (SA, q/q%)	2.0%	-1.0%	0.5%	1.1%	-0.1%	0.3%
Industrial Production Index (SA, 2010=100)	98.9	98.5	98.2	99.7	98.3	97.1
Exports (SA, Trillion Yen)	70.9	74.7	19.4	19.4	18.9	18.9
Imports (SA, Trillion Yen)	84.6	83.8	21.7	20.4	19.6	19.9
Balance on Current Account (SA, Trillion Yen)	1.5	7.9	2.7	3.9	4.2	3.7
Corporate Bankruptcies	10,536	9,543	2,222	2,272	2,296	2,092
Unemployment Rate (SA, %)	3.9%	3.6%	3.5%	3.5%	3.3%	3.4%
Wage Index (SA, 2010=100)	98.5	99.0	98.6	98.8	98.9	99.7
Consumer Prices (y/y%)	0.9%	2.9%	2.5%	2.3%	0.5%	0.2%
Nikkei Stock Average	14,424	16,273	16,705	18,175	20,049	19,412
Japanese Government Bond Yields (%)	0.70	0.48	0.45	0.34	0.40	0.40
Foreign Exchange Rate (Yen/ Dollar)	100.2	109.9	114.6	119.1	121.3	122.2

Note: SAAR means Seasonally Adjusted Annual Rate. SA means Seasonally Adjusted.
q/q% means %change from a quarter earlier. y/y% means %change from a year earlier.
Source: CAO, METI, MOF, Tokyo Shoko Research, MIC, MHLW, Nihon Keizai Shimbun, CEIC, BOJ