MGSSI Japan Economic Quarterly April 2017

Global Economic & Political Studies Division
Mitsui Global Strategic Studies Institute

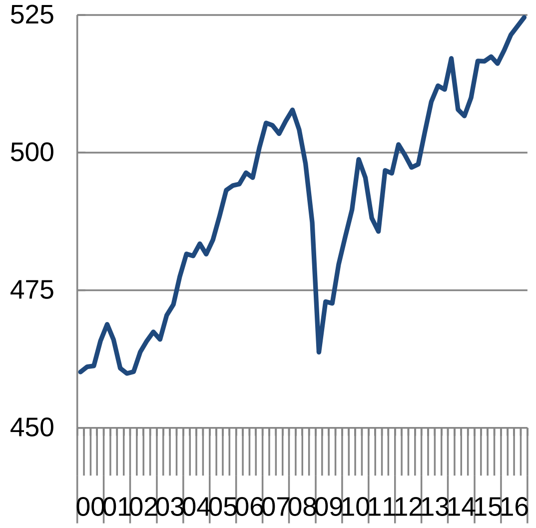
Moderate Recovery

Real GDP in the fourth quarter of 2016 rose by 0.3% (1.2% annualized) from the previous quarter, reaching all-time highs for four consecutive quarters. Exports of goods and services and private non-residential fixed investment served as a driving force to boost real GDP by 0.7 percentage points from the previous quarter in total.

Exports saw quarter-on-quarter growth of 2.6%. By region, the volume of exports to China and NIEs significantly rose by 7.8% and 5.6% from the previous quarter, respectively, while exports to the U.S. grew by 2.4%. By item, exports grew for most types of machinery and equipment. Exports of digital-related products such as semiconductors and their production equipment rose by 6.5% from the previous quarter, while exports of electrical devices excluding digital-related products significantly rose by 8.3%. Furthermore, exports of automobiles and their parts grew by 3.1% and 6.9% from the previous quarter, respectively. Exports of general machinery saw quarter-on-quarter growth of 4.2%. On the other hand, imports of goods and services rose by 1.3% from the previous quarter, contributing to pushing down real GDP by 0.2 percentage points.

Real Gross Domestic Product

at 2011 Price, Annualized, Trillion Yen



Source: CAO

Private non-residential fixed investment rose by 2.0% from the previous quarter. According to the Financial Statements Statistics of Corporations, nominal non-residential fixed investment (including software investment) saw quarter-on-quarter growth of 6.7% in the manufacturing sector and 3.4% in the non-manufacturing sector. Many major industries in the manufacturing sector grew, with the metal-related industry, including iron and steel, and the chemical industry having posted quarter-on-quarter growth of 15.5% and 9.5%, respectively. However, the transport machinery industry suffered sluggish growth after recovering to the 800 billion-yen level of investment in the second quarter of 2016, which was the highest level since

Real Gross Domestic Product (GDP)

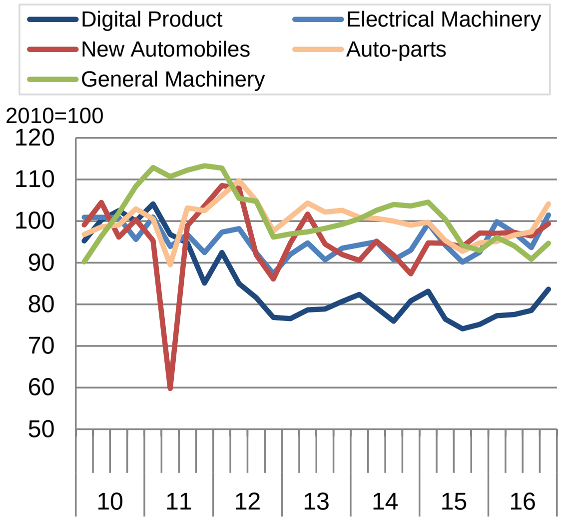
at 2011 Price, Calendar year

	2016 4-6 q/q%	2016 7-9 q/q%	2016 10-12 q/q%	2016 y/y%
Real Gross Domestic Product	0.5%	0.3%	0.3%	1.0%
Private Consumption	0.2%	0.3%	0.0%	0.4%
Private Housing Investments	3.3%	2.4%	0.1%	5.6%
Private Non-Resi. Fixed Investments	1.4%	-0.1%	2.0%	1.4%
Public Investments	1.0%	-0.9%	-2.5%	-3.0%
Government Consumption	-1.1%	0.2%	0.3%	1.5%
Exports of Goods & Services	-1.2%	2.1%	2.6%	1.2%
(less) Imports of Goods & Services	-1.0%	-0.3%	1.3%	-1.7%

Source: CAO

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

Exports Quantum Indexes by Major Products
(among Machinery & Transportation Equipment)



Note: Electrical Machinery exclude Digital-related Product. General Machinery exclude Digital-related Product and Auto-parts. The Index of Digital-related Product is calculated since 2007 due to limitation of original statistics.
Source: MOF, Re-classified and calculated by MGSSI.

before the world financial crisis. Moreover, the electric and communication machinery industry and the general machinery industry posted quarter-on-quarter growth, but this seems to be a recoil increase from the decline that had continued until the third quarter.

Private housing investment remains basically unchanged, posting quarter-on-quarter growth of 0.1%. The number of new housing starts has already declined for two consecutive quarters, and in the fourth quarter, rental housing starts declined by 6.2% from the previous quarter. An increase in housing loan interest rates appeared to be a factor constraining growth.

Private consumption remained almost unchanged. Spending on food and drink services seemed to have increased. But spending on vegetables and clothes appeared to have declined, probably affected by the rising price of fresh food due to bad weather. However, spending on durable goods increased for five consecutive quarters, so it seems that people are not necessarily holding their family's purse strings tight.

Public investment fell by 2.5% from the previous quarter. In the supplementary budget that was passed in October 2016, the central government increased investment-related spending by 2 trillion yen, while contract amount for public works projects, which reflects the trends of order placement, was down in the fourth quarter for two consecutive quarters. In addition, the government's investment-related spending in the fiscal 2017 budget was 9.1 trillion yen, which is at a high level but smaller than 10.5 trillion yen in fiscal 2016 (with a supplementary budget).

Recovery in the World Economy to Boost Japan's Exports

In the first quarter of 2016, the world's real GDP growth seemed to temporarily decelerate to annualized 2.1% (based on market rates) from the previous quarter, while in the second and third quarters of 2016, it appeared to rise to an annualized rate of around 2.7% and 3.0%, respectively, with the growth attributed to China in the second quarter and to the U.S. in the third quarter. In the fourth quarter, the figure slightly declined for the first time in three quarters, while remaining at the level of 3% annualized compared with the previous quarter. Following the victory of Donald Trump in the U.S. presidential election, there were high expectations that large-scale tax breaks and investment in infrastructure will contribute to growth. However, the world economy is highly likely to have begun recovering before the election result was announced. In addition, according to statistics by the Netherlands Bureau for Economic Policy Analysis (CPB) the world's total trade volume in the fourth quarter of 2016 grew by 1.1% from the previous quarter, the highest growth since the third quarter of 2014. The word of "slow trade" have been more common recent years, but it is possible that trade bottomed out following the trend of the world economy.

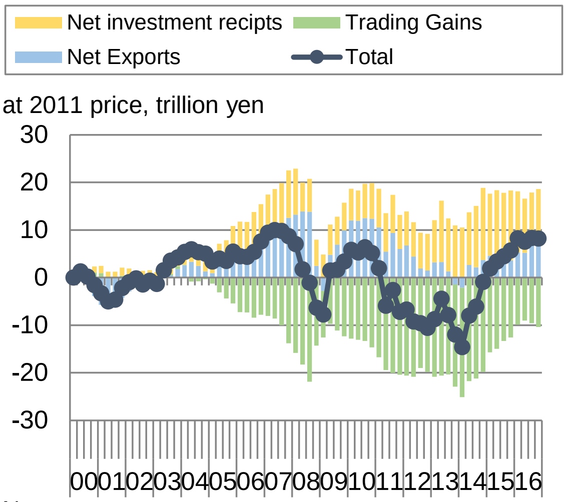
Needless to say, the recovery in the world's economy will give a boost to Japan's exports. However, the outlook is not necessarily optimistic depending on the item. For example, one of the reasons for the growth in exports of digital-related products apparently lies in the introduction of new model of a smartphone series, which was initially launched 10 years ago. When it comes to exports of automobiles, it is highly likely that new light vehicle sales will remain at high levels but peak out in the U.S., to which about 40% of Japanese exports of automobiles are shipped. Furthermore, in China, to which about 20% of Japanese exports of automotive parts are shipped, a review on tax break measures for small-sized cars is likely to have an impact.

For the April-December period of 2016, ordinary profits of Japanese corporations amounted to 65 trillion yen, increasing by 2.3% year on year. The increase in profits will probably encourage non-residential fixed investment. According to a questionnaire survey conducted on more than 10,000 companies across the nation, around 10% of companies in the manufacturing sector said they had "excessive capacity" as of December 2016, the lowest level since 2008. Furthermore, in the non-manufacturing sector, the ratio of companies that said they had "insufficient capacity" has been surpassing that of companies which said they had "excessive capacity" since September 2013. However, according to another questionnaire survey, listed companies believe that the real growth rate of the Japanese economy or industry to which their main businesses belongs is at a record-low level of around 1%. Production activities in the manufacturing sector still remain at around 90% of the 2007 level, and the tertiary sector, which is comprised of service industries, remained at the same level as that of 2007. It is still difficult to expect growth in non-residential fixed investment as was the case with the past expansion period.

Annualized Growth Rate of around 1% Is Expected to Continue

The connection between the Japanese and world economy can be interpreted by net exports of goods and services (exports minus imports) and net income from external assets such as financial investments and overseas subsidiaries of companies (receipt minus payment). Net exports can be broken down into real net exports and trading gains. The former represents increase or decrease in the volume of trade and the latter represents the difference between export prices

Contributions by the World Economy
on the Japanese Economy



Note: The accumulated amount since the first quarter of 2000. The real GDP is incread from 460 trillion yen to 525 trillion yen for the same period.
Source: CAO, MGSSI

and import prices. Looking back, the sum of the above three factors (real net exports plus trading gains plus net income from external assets) helped boost the Japanese economy in the medium and long term. However, it worked to considerably push down the Japanese economy until the first quarter of 2014 after the economy peaked in the second quarter of 2007 just before the world financial crisis. After that, it rebounded and has recovered to past peak levels in recent years.

Generally speaking, the depreciation of the yen helps increase real net exports and net income from external assets, while it works against trading gains because of rising import prices. In addition, a rise in resource prices also negatively affects trading gains. However, if the growth of resource producing countries accelerates, it will help increase real net exports. For example, trading gains had deteriorated until the fourth quarter of 2008 against the background of rising energy prices, while real net exports increased over the same period. Subsequently, real net exports dramatically declined following the world financial crisis, while on the other hand, trading gains improved.

Meanwhile, over three and a half years from the fourth quarter of 2010 to the first quarter of 2014, net income from external assets remained at high levels due to an increase in net external assets, while real net exports and trading gains deteriorated at the same time. Real imports increased due to the effects of the last-minute rush in demand prior to the consumption tax hike from 5% to 8% in April 2014, while real exports were hindered by the March 2011 Great East Japan Earthquake and the appreciation of the yen, which temporarily rose to 75 to the dollar in October 2011. In the first place, the world's real GDP growth remained at an annualized rate of 2.6% (based on market exchange rates) over the three years until 2013, and this may be another reason for the sluggish growth in real exports. The deterioration in trading gains was largely because import price of crude oil, which had temporarily declined after the world financial crisis, exceeded the 100 dollars/barrel level for four years in a row from 2011.

Currently, import price of crude oil is at the 50 dollars/barrel level, while the yen-dollar exchange rate is at the 110 level. The world economy is recovering moderately. There is no doubt that the environment surrounding the Japanese economy has been improving compared to three years ago, although its best period might have passed. According to an ESP Forecast survey, the average of forecasts by private economists suggests that real GDP will continue quarter-on-quarter growth of around 0.25% (1% annualized) until the first quarter of 2019. In the coming quarters, it is possible that public investment and private residential investment will decline. In addition, if crude oil prices increase further, inflation will accelerate, which is feared to put downward pressure on private consumption. Even so, moderate growth is expected to continue, centering on the recovery in exports and private non-residential fixed investment.

(Yusuke Suzuki, Senior Economist)

Selected Economic Indicators

	Fiscal Year		2016			
	2014	2015	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec
GDP at current prices (SAAR, Trillion Yen)	517.8	532.1	535.0	536.9	537.6	539.7
Real GDP at 2011 prices (SA, q/q%)	-0.4%	1.3%	0.5%	0.5%	0.3%	0.3%
Industrial Production Index (SA, 2010=100)	98.4	97.4	96.1	96.3	97.6	99.6
Exports (SA, Trillion Yen)	74.7	74.1	17.6	17.1	17.0	18.1
Imports (SA, Trillion Yen)	83.8	75.2	16.7	16.1	16.1	16.9
Balance on Current Account (SA, Trillion Yen)	8.7	18.0	5.1	4.9	5.0	5.2
Corporate Bankrupcies	9,543	8,684	2,144	2,129	2,087	2,086
Unemployment Rate (SA, %)	3.5%	3.3%	3.2%	3.2%	3.0%	3.1%
Wage Index (SA, 2010=100)	99.0	99.2	99.7	99.1	99.9	99.5
Consumer Prices (y/y%)	2.9%	0.2%	0.1%	-0.4%	-0.5%	0.2%
Nikkei Stock Average	16,273	18,841	16,849	16,408	16,479	17,933
Japanese Government Bond Yields (%)	0.48	0.39	0.05	-0.12	-0.13	0.00
Foreign Exchange Rate (Yen/ Dollar)	109.9	120.1	118.1	108.2	102.4	109.3

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