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SA166 Short-Term Forecast (2016/4-6—2018/1-3)

Fiscal 2016–17 Growth Projections Revised Downward Again

- First Quarter Growth Belies Inherent Risks

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Overview

The Japanese economy returned to positive growth in January–March 2016, expanding by 0.4% in real terms, or an annual rate of 1.7%. While housing investment declined for the second straight quarter and capital spending took a downturn for the first time in three quarters, consumption recovered to 0.5% growth following a 0.8% decline during the previous three months. Contributing to the strong growth was sustained and substantial government spending, leading to the first signs of an upturn in public investment in three quarters. External demand also helped to push up the growth rate, with exports rebounding following declines in the preceding two quarters and imports falling for the second straight quarter.

That said, growth in January–March merely made up for the contraction (at an annual rate of 1.7%) during the previous quarter, and it was bolstered by the fact this is a leap year; the extra day in February pushed up personal consumption by around 0.5 points and GDP by 0.3 points. The decline in imports and capital spending points to a high likelihood of a lull in corporate activity, moreover, so the strong first-quarter showing must be taken with a grain of salt. Now that the consumption tax hike scheduled for April 2017 would be pushed back until October 2019, our forecast for fiscal 2016 and 2017 is now 0.5% and 0.9%, respectively.

The following provides details on trends in overseas markets affecting external demand and on domestic factors influencing growth.

Trends in Overseas Markets

Real GDP in the United States registered quarterly growth of 0.8% in January–March 2016, decelerating conspicuously from the previous quarter, when the economy grew by 1.4%. Capital spending in energy-related industries fell owing to declining crude oil prices, and exports struggled in the face of a strong dollar. Personal consumption, though, is projected to hold steady given an improving employment picture. And the financial condition is toward relaxation, given the decline in long-term rates, as there has recently been a correction to the stronger dollar and cheaper oil. The manufacturing sector is showing signs of rebounding; the ISM manufacturing index had been hovering below the threshold of 50—indicating a decline in industrial production—for four months since October 2015, but it edged above the breakeven point in March and April (50.8 in April) thanks to new orders. The US economy should recover to 2%–2.5% growth from the second quarter on.

There was 0.5% quarterly GDP growth in real terms in the eurozone during January–March, a slight improvement from 0.3% in October–December. The expansion is being powered almost solely by personal consumption, though, along with the additional fiscal outlays to address the influx of migrants and refugees. The terrorist attacks in Paris (last November) and Brussels (March) have thus far not had a significant impact on economic performance. By individual countries, quarterly growth accelerated in Germany (from 0.3% to 0.7%) and France (from 0.4% to 0.6%), while the expansion in Spain remained strong at 0.8% for the second straight quarter.

Italy, meanwhile, accelerated slightly from 0.2% to 0.3%, a level that is lower than the eurozone average. Real GDP is 8 points lower than before the Lehman crisis, moreover, and over 15% of loans held by Italian banks are considered to be nonperforming. Weaknesses in the financial sector can exert downward pressure on the real economy, so the situation bears close watching.

China's real GDP in January–March grew by 6.7%, a slight deceleration from 6.8% in the preceding quarter. Nominal GDP, of which concept is closer to corporate sales,recovered, accelerating from 6.0% in October–December to 7.2% in the same period. The PMI index of business sentiment appears to corroborate these figures, having bottomed out in March. Factors behind these trends include (1) hefty fiscal outlays by Beijing for infrastructure improvement and (2) stepped-up real-estate investments sparked by rising housing prices, particularly in the major cities, in the ongoing easy-money environment.

There has been a progressive worsening of China's two "excesses" in capacity and debt, however, casting a shadow on the country's long-term outlook. Beijing has announced a scaling down of the excess capacity at SOEs, but with markets beginning to recover, industrial production has also picked up; steel production in March 2016, for example, registered an all-time high of 70.65 million tons. Debts are continuing to mount, though, with private-sector liabilities reaching 160% of GDP—higher even than during Japan's bubble years—raising concerns about mounting nonperforming assets. In this context, we project 6.4% real growth in 2016 and 6.1% in 2017.

Growth of Japan's real exports, in the light of the above, has been downwardly revised to 1.4% in fiscal 2016 and 1.9% in fiscal 2017.

[Table: The Outlook for Foreign Economies]

(%)

	World		United States		Euro Area		China		NIEs		ASEAN	
	SA165R	SA166	SA165R	SA166	SA165R	SA166	SA165R	SA166	SA165R	SA166	SA165R	SA166
2014	3.9		2.4		0.9		7.3		3.4		4.4	
2015	3.4		2.4		1.6		6.9		2.1		4.6	
2016	3.3	3.1	2.1	1.8	1.6	1.6	6.4	6.4	2.6	2.0	4.6	4.6
2017	3.6	3.4	2.5	2.5	1.8	1.6	6.1	6.1	3.0	2.6	4.7	4.7

Note: World economic growth rate is an average weighted by exports from Japan. Estimates are calendar year base.

Domestic Demand

As for public finances, the government has enacted a ¥778 billion supplementary budget (with ¥300 billion to ¥400 billion being earmarked for public works projects) to help Kumamoto and other areas in Kyushu rebuild from the devastating earthquakes in April. We are not incorporating the consumption tax being raised to 10% in April 2017 to our projection anymore, as the Prime Minister Abe called for the postponement till October 2019.

Personal consumption grew by 0.5% in January–March, but the showing would have been much weaker had it not been a leap year. Spending projections will likely hinge on employment trends; while wages are not rising as quickly as anticipated, growth in the number of employed persons have exceeded expectations. The higher aggregate nominal wages have helped to prop up consumption. Now that the consumption tax hike is to be postponed till October 2019, the fluctuation of demand resulting from the tax increase will disappear for the projection period, which leads to our revised forecast of 0.3% for 2016 and 1.2% for 2017.

We downwardly revised our capital investment outlook all the way down to 0.5% growth in fiscal 2016 and to 1.7% growth the following year. The bump in the yen's value is likely to shrink both corporate profits and business sentiment. The Kumamoto earthquakes, too, will adversely affect investment plans, at least in the short term, due to production and shipping disruptions. There is no reason to become overly pessimistic, however, as corporate profit levels remain high. Companies had not overreacted to the windfall from a weaker yen and cheaper oil with fresh investments, so, in a similar vein, they are unlikely to abruptly rescind their spending plans now that the windfalls have dissipated.

Consumer Prices

We revised our fiscal 2016 projections for the core CPI down to 0.2% owing to widening output gap. For the time being, companies are maintaining a forward-looking pricing strategy, even after the core CPI plummeted to −0.3% in March. Prices of a large majority of items in the core inflation index are continuing to rise, and there is no major change in the distribution of the rates of increase. Given the prospects of higher crude oil prices, we have maintained our fiscal 2017 projections at 0.7%.

Risk Factors

The immediate external risks include (1) a hard landing of the Chinese economy caused by an aggravation of structural issues, namely, the two “excesses” described above; (2) political uncertainties arising from a Donald Trump election victory and Britain leaving the EU; and (3) chaos in emerging markets due to an interest rate hike in the United States. While projecting the impact of political risks is not easy, a Trump presidency or Brexit could send shockwaves through the financial market and force the dollar and stock markets to crash.

Risks on the domestic front requiring vigilant attention include (4) a steep appreciation of the yen and a plunge in share prices, which would negatively affect both corporate and personal spending, and (5) a lower credit rating for Japanese government bonds triggered by postponement in the consumption tax hike (leading to lower ratings for private companies and higher long-term interest rates).

Summary Table of the 166th Quarterly Forecast

四半期／年度／暦年 Quarter / Fiscal Year / Calendar Year	単位 Unit	2015				2016				2017				年度(FY) 2014 (実績) Actual	年度(FY) 2015 (実績) Actual	年度(FY) 2016 (予測) Forecast	年度(FY) 2017 (予測) Forecast	暦年(CY) 2014 (実績) Actual	暦年(CY) 2015 (実績) Actual	暦年(CY) 2016 (予測) Forecast	暦年(CY) 2017 (予測) Forecast
		4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3								
実質国内総支出（2005暦年連鎖価格） Real GDE (Chained 2005 Yen)	前期比% **	-0.4	0.4	-0.4	0.4	-0.2	0.4	0.3	0.1	0.2	0.3	0.1	0.2	-0.9	0.8	0.5	0.9	-0.0	0.6	0.3	0.9
	前年同期比% ****	0.7	1.8	0.7	-0.0	0.2	0.2	0.9	0.7	1.1	0.9	0.8	0.8								
国内需要 Domestic Demand	寄与度%ポイント ++	-0.1	0.3	-0.5	0.2	-0.1	0.4	0.3	0.1	0.2	0.2	0.1	0.2	-1.6	0.7	0.4	0.9	0.0	0.1	0.2	0.9
民間最終消費支出 Private Consumption	前期比% **	-0.8	0.5	-0.8	0.5	-0.3	0.4	0.4	0.3	0.3	0.3	0.2	0.2	-2.9	-0.3	0.3	1.2	-0.9	-1.2	-0.0	1.2
民間住宅投資 Private Residential Investment	前期比% **	2.2	1.7	-1.0	-0.8	0.8	2.2	-0.4	-1.9	-0.3	-0.7	-1.3	-1.8	-11.7	2.4	1.1	-3.0	-5.3	-2.5	1.4	-1.8
民間企業設備投資 Private Non-Residential Investment	前期比% **	-1.6	0.7	1.2	-1.4	-0.2	0.8	0.5	0.4	0.4	0.4	0.3	0.3	0.1	1.6	0.5	1.7	3.1	1.5	-0.2	1.7
公的固定資本形成 Public Investment	前期比% **	3.0	-2.2	-3.5	0.3	1.0	1.2	0.4	-0.5	-1.0	-1.1	-1.2	-1.5	-2.6	-2.2	-0.1	-2.7	0.4	-2.5	-1.2	-1.0
外需 Net Exports of Goods & Services	寄与度%ポイント ++	-0.3	0.1	0.1	0.2	-0.0	-0.0	-0.0	-0.0	0.0	0.0	0.0	0.0	0.6	0.1	0.1	0.0	-0.0	0.4	0.1	-0.0
財貨・サービスの輸出 Exports of Goods & Services	前期比% **	-4.8	2.6	-0.8	0.6	0.2	0.3	0.4	0.4	0.5	0.6	0.6	0.5	7.9	0.4	1.4	1.9	8.3	2.8	0.4	1.7
財貨・サービスの輸入 Imports of Goods & Services	前期比% **	-2.6	1.7	-1.1	-0.5	0.5	0.6	0.5	0.5	0.5	0.5	0.5	0.5	3.4	-0.1	0.9	2.0	7.2	0.3	-0.3	2.1
名目国内総支出 GDE at Current Prices	前期比% **	-0.1	0.7	-0.2	0.5	-0.2	0.4	0.2	0.2	0.3	0.2	0.1	0.2	1.5	2.2	0.7	1.0	1.6	2.5	0.8	0.9
	前年同期比% ****	2.2	3.6	2.2	0.8	0.8	0.5	0.9	0.6	1.2	1.0	0.9	0.8								

（注） 1. **季節調整済み前期比
2. ***季節調整済み前期比年率換算、****前年同期比
3. ++ 前期比寄与度

[Note] 1. ** Seasonally adjusted changes from the previous quarter
2. *** Seasonally adjusted changes from the previous quarter in annual rate, **** Year-on-year percentage change
3. ++ Contributions to changes from the previous quarter