

17<sup>th</sup> Aug. 2009

# JAPAN DATA RESPONSE



## Japan GDP (Q2 Prelim.)

### *Robust V-shaped recovery remains unlikely*

- **The 0.9% q/q (3.7% annualised) increase in Japanese GDP in Q2 is clearly welcome but, with the level of output still some 7.5% below the previous peak (in Q1 2008), the recovery has yet to impress.**
- A return to growth last quarter was widely anticipated - regular readers will know that we have been talking about this for many months - and there were no major surprises in the breakdown either.
- The pivotal factor was the partial recovery in exports combined with a further decline in imports. (See Table.) As a result, **the contribution to quarterly growth from external trade swung from -0.9 percentage points (pp) in Q1 to +1.6pp in Q2.**
- Both government (0.3pp) and consumer spending (0.5pp) also made positive contributions, reflecting the massive fiscal stimulus (the largest in the G7) which includes cash handouts to households and incentives to purchase durable goods. The boost to real household incomes from falling prices will also have helped.
- The main negatives were an acceleration in the pace of destocking (which subtracted 0.5pp) and the continued weakness of private investment (non-residential investment subtracted another 0.6pp and residential investment, i.e. housebuilding, a further 0.3pp). The inventory cycle at least should turn positive in the third quarter and beyond. But **the massive amounts of spare capacity that have opened up in the economy during the recession mean that investment is likely to remain weak for at least another year.** Demand for new housing – the biggest of big ticket items – will also remain relatively slow to recover.
- Indeed, even though our forecasts for Japan have long been among the least pessimistic, it is hard to get excited about today's numbers. **Japan is on track for the strongest recovery of any G7 economy, but it was also the first into recession and has experienced the largest falls in output.**
- There is little doubt that Japan has emerged from recession in the sense that the economy is growing again. The survey evidence is already pointing to a further increase in GDP in Q3. But it will take many quarters of above-trend growth simply to recoup the activity lost over the last year or so. In the meantime, the **prospects for private domestic demand are still poor – this part of the economy actually continued to shrink in Q2 (by 1.3% q/q), underlining the dependence of the recovery on the rebound in external trade and government spending.** There is also a growing risk that the recovery stalls as deflationary pressures continue to build. (See our *Asian Economics Update*, "Will deflation stall Japan's recovery?", 31<sup>st</sup> July.)
- The upshot is that, while it is good to see vindication of our long-held views on Japan's performance in the second quarter, **a robust V-shaped recovery remains unlikely.**

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### JAPAN GDP (Q/Q UNLESS STATED)

	GDP		Consumer spending	Non-Res. Investment	Residential Investment	Gov't.	Exports	Imports	Domestic Demand Deflator y/y
	q/q	y/y							
2008 Q3	-1.0	-0.3	0.1	-4.9	3.5	0.1	-0.8	0.2	1.5
2008 Q4	-3.5	-4.3	-0.7	-7.1	2.6	1.5	-13.6	2.5	0.3
2009 Q1	-3.1	-8.7	-1.2	-8.5	-5.7	0.6	-22.5	-14.9	-1.0
<b>2009 Q2</b>	<b>0.9</b>	<b>-6.4</b>	<b>0.8</b>	<b>-4.3</b>	<b>-9.5</b>	<b>1.2</b>	<b>6.3</b>	<b>-5.1</b>	<b>-1.7</b>

Source: Cabinet Office