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Japan – Rebound quickened in Q3

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- Q3 GDP showed first gain in corporate investment since the crisis
- Not all is good news, as the deflator recorded another hefty drop during the quarter
- Our full-year 2009 GDP forecast is unchanged at -5.8%

Corporate spending up, fiscal spending down

The rebound continued in Q3, with GDP growth improving to 1.2% q/q (-4.5% y/y) from 0.7% q/q (-7% y/y) in Q2. The q/q pace was the highest since Q1-2007. The main good news was a rebound in corporate investment growth to 1.6% q/q after six quarters of decline, which confirms that business sentiment has bottomed. Private consumption also gained another 0.7% q/q, following a 1.0% q/q increase in Q2. Exports rose by 6.4% q/q, the same as in Q2, but net exports' contribution to headline growth decreased as import growth rebounded to 3.4% q/q after two quarters of contraction. Construction remained the laggard, with residential investment falling by 7.7% q/q. Growth in total public demand also slowed to a trickle, rising by just 0.1% q/q after a 1.2% q/q jump in Q2, as public investment spending lost steam after being front-loaded in Q2.

More policy support is needed

While the stabilisation in corporate investment is cause for some optimism, headline growth was merely in line with our expectations (we had expected +1.5% q/q, -4.5%y/y), and we maintain our full-year GDP forecast of -5.8% y/y. On a grimmer note, we note that growth may well slow on a q/q basis in the coming quarters as fiscal support left over from the previous administration wanes, while legislative hurdles slow new support from the current administration. Meanwhile, the improved headline growth figure does not lessen the threat of deflation, as the GDP deflator dropped by another 1.2% q/q (+0.2% y/y), following readings of -1.1% q/q (+0.5% y/y) in Q2. With the latest GDP rebound, the economy still suffers from a deflationary output gap of around 5%. Even as recent news reports have suggested that the government is considering another supplementary budget, we do not expect any fresh or forceful new initiatives before the new fiscal year starts next April. All of this suggests that the Bank of Japan (BoJ) will keep the policy rate at the current near-zero level and reiterate its easy stance at its meeting this week.

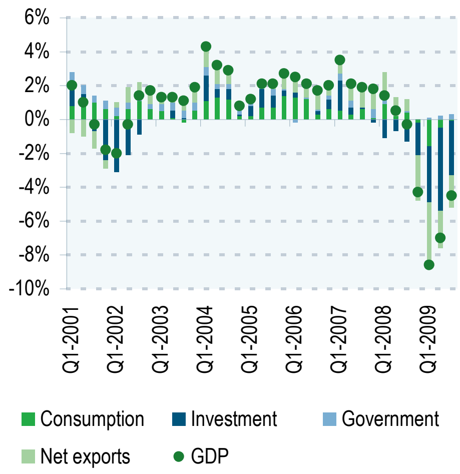
Table 1: SCB Japan forecasts

	Q2-09	Q3-09	Q4-09F	Q1-10F	Q2-10F	2009F	2010F
Real GDP growth (y/y %)	-7.00	-4.50	-3.40	2.50	0.00	-5.80	0.60
Inflation (y/y %)	-1.00	-2.20	-2.70	-2.50	-2.50	-1.60	-2.50
Policy rate (%, end of period)	0.10	0.10	0.10	0.10	0.10	0.10	0.10

Source: SCB Global Research

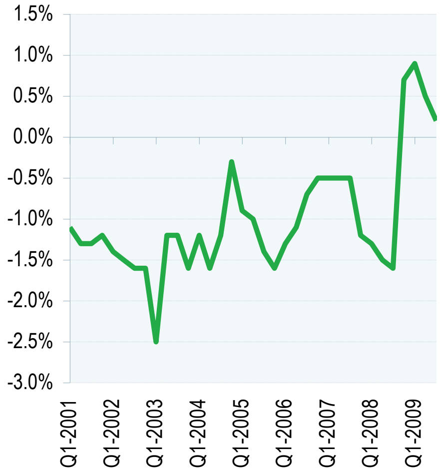
Important disclosures can be found in the Disclosures Appendix

Chart 1: GDP growth contributors
(y/y %)



Sources: Bloomberg, SBC Global Research

Chart 2: GDP deflator
(y/y %)



Sources: Bloomberg, SCB Global Research

Table 2: Japan real GDP breakdown

	Q3-2009 q/q %	Q3-2009 SAAR %	Q3-2009 y/y %	Contribution to GDP	Q2-2009 q/q %
GDP	**1.2%**	**4.8%**	**-4.5%**	--	**0.7%**
Domestic demand	**0.8%**	**3.3%**	**-2.6%**	**0.8%**	**-0.8%**
Private demand	1.0%	4.2%	-4.2%	0.8%	-1.4%
Private consumption	0.7%	2.8%	-0.1%	0.4%	1.0%
Residential investment	-7.7%	-27.5%	-20.4%	-0.2%	-10.2%
Capital investment	1.6%	6.6%	-16.6%	0.2%	-4.2%
Private inventories	--	--	--	0.4%	--
Public demand	0.1%	0.3%	3.2%	0.0%	1.2%
Fixed capital formation	-0.3%	-1.3%	-12.8%	-0.1%	-2.7%
Net exports	--	--	--	0.4%	--
Exports of goods/services	6.4%	28.0%	-23.0%	0.9%	6.4%
Imports of goods/services	3.4%	14.1%	-13.4%	-0.5%	-4.2%
GDP deflator (y/y %)	**0.2%**				**0.5%**

Sources: Cabinet Office, Bloomberg, SCB Global Research

Disclosures Appendix

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