



Japan: Return to steady recovery trend

- We forecast the Japanese economy to return to underlying trend growth of real GDP at annualized 1.0-1.5% after a temporary soft patch in Q2 and Q3 2015.
- We see low likelihood of meaningfully negative second-round effects from the global slowdown to domestic non-manufacturers despite an inevitable impact on the Japanese manufacturers.

A soft patch, not a recession

Real GDP shrank 0.2%qoq (annualized -0.8%) in Q3, the second consecutive negative contraction, but we do not think this means the economy has entered a recession because of the large negative inventory contribution in Q3 growth and the low accuracy of Japanese preliminary GDP estimate. Our Nowcast index (DBNCI) has been revised upward and is now trending gradually higher. We think the Japanese economy was in a soft patch in Q2 and Q3 but these instances were mild and transitory and should be followed by real final sales (GDP minus inventories) growth at an underlying trend of an annualized 1.0-1.5%.

Resiliency of non-manufacturing sector

Because the scale of the ongoing global economic slowdown from early 2015 is limited compared to the collapse of the IT bubble in 2000-2001 or the global financial crisis of 2007-08, we forecast a low likelihood of meaningfully negative second-round effects from the global slowdown to domestic non-manufacturers, thus leading to a recession, despite an inevitable impact on the Japanese manufacturers.

Predicting an expansion in domestic demand (mainly private consumption)

Although we predict a return to an economic expansion with annualized growth of 1.0-1.5% from Q4 2015, this is likely to be driven not by exports but rather by domestic demand (in particular private consumption). Nominal aggregate wages (= total cash earnings per person x number of employees) are maintaining growth of an annualized 2.0-2.5% and inflation is predicted to converge at around 1%, so 1.0-1.5% growth in real aggregate wages is probably the underlying trend. Therefore, we think real private consumption could maintain annualized growth of 1.0-1.25%.

Figure 1: DBNCI turned to uptrend



Note: Horizontal line shows -0.25 threshold for recessions.
Source: Deutsche Bank Research

Figure 2: Rising nominal wages



Source: MHLW, Deutsche Bank Research

Figure 3: Macro-economic activity & inflation forecasts: Japan

Economic activity (% qoq, saar)	2015				2016				2015F % yoy	2016F % yoy	2017F % yoy
	Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F			
GDP	4.6	-0.7	-0.8	3.4	1.8	1.1	1.6	1.8	0.7	1.5	0.8
Private consumption	1.7	-2.3	2.1	1.4	1.4	1.4	1.4	2.4	-0.6	1.3	-0.2
Investment	6.4	-0.4	-2.7	2.0	1.8	0.7	1.2	1.6	0.0	0.8	1.0
Gov't consumption	1.1	2.6	1.2	1.2	1.2	1.2	1.2	1.2	1.4	1.3	1.2
Exports	8.0	-16.1	10.9	4.6	5.8	6.6	7.4	7.6	3.3	5.1	6.9
Imports	7.8	-10.8	7.1	-0.5	5.4	8.1	6.6	7.1	0.7	4.1	4.7
Contribution (pp):											
Private inventory	1.8	0.9	-1.9	0.5	0.2	0.0	0.0	-0.4	0.3	-0.1	-0.1
Net trade	0.2	-1.3	0.8	0.9	0.2	-0.1	0.3	0.3	0.5	0.3	0.5
Industrial production	6.3	-5.5	-5.2	3.0	2.6	3.0	3.4	4.1	-0.9	1.4	1.7
Unemployment rate, %	3.5	3.3	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.3
Prices & wages (% yoy)											
CPI	2.3	0.5	0.1	0.3	0.6	0.5	0.8	1.0	0.8	0.7	2.1
Core CPI	2.0	0.5	0.8	0.9	1.1	1.1	1.0	1.0	1.1	1.0	1.9
Producer prices	0.5	-2.2	-3.6	-2.8	-0.9	-0.9	0.4	1.3	-2.0	0.0	2.6
Compensation per empl.	0.6	0.2	0.8	1.3	1.9	1.9	1.9	1.7	0.7	1.9	1.8
Productivity	-1.9	1.3	1.0	1.2	1.1	1.1	1.7	1.0	0.4	1.2	0.5

Source: National authorities, Deutsche Bank Research