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Economics Group

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Growth Streak Interrupted in Japan

The Japanese economy contracted at an annualized pace of 0.6 percent in the first quarter. The contraction reflects some retracement in inventories and business spending but does not herald a fundamental change.

Streak Ends

It had to end at some point. After eight consecutive quarters of expansion, the Japanese economy contracted at an annualized rate of 0.6 percent in the first quarter, thus ending the longest uninterrupted streak of GDP growth since 1989. Not only was Q1 growth negative, the growth rate in Q4 was revised lower to an annualized 0.6 percent from 1.6 percent in the prior estimate.

We do not mark this as a major turning point or the start of recession, but some of the factors that weighed on growth in the first quarter are emblematic of the challenges facing the Bank of Japan (BoJ) in its efforts to spur the economy enough to sustain its target of 2.0 percent inflation.

As a case in point, consider consumer spending, which stalled in the first quarter after having increased in three out of four quarters in 2017. Consumer confidence in Japan has been more or less unchanged over the past year or so, and retail sales have been inconclusive, up one month and down the next since December.

A case can be made that a tightening job market may eventually be supportive of the long-awaited improvement in wage growth, which could support future household spending growth. The unemployment rate at 2.5 percent is still low, even as participation in the labor force has climbed higher in recent months.

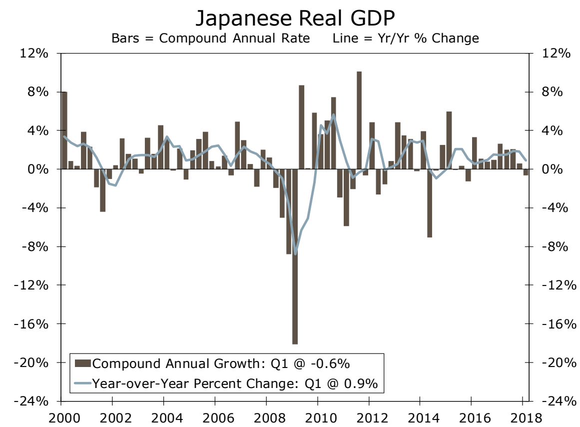
Business investment spending and inventories, both up in the three out of four quarters in 2017, gave up ground in the first quarter and together accounted for almost a full percentage point of downward pressure on the headline GDP number.

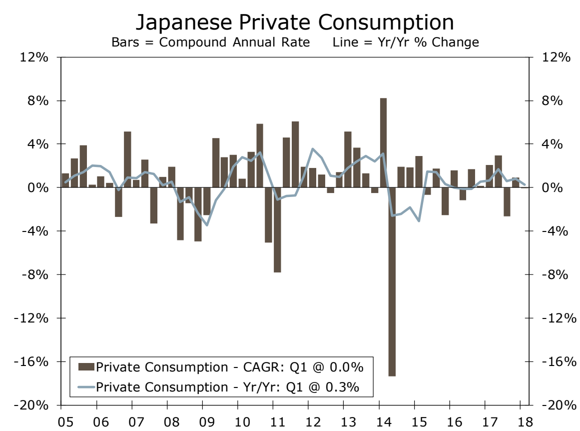
Imports grew in the first quarter but exports grew even faster, which resulted in a 0.2 percentage point boost from trade. Steady growth in the global economy and only modest pace of domestic spending growth ought to continue to be supportive of sustained help from net exports. Also, since its March high, the Japanese yen is down a little over 5 percent. That too bodes well for the outlook for trade.

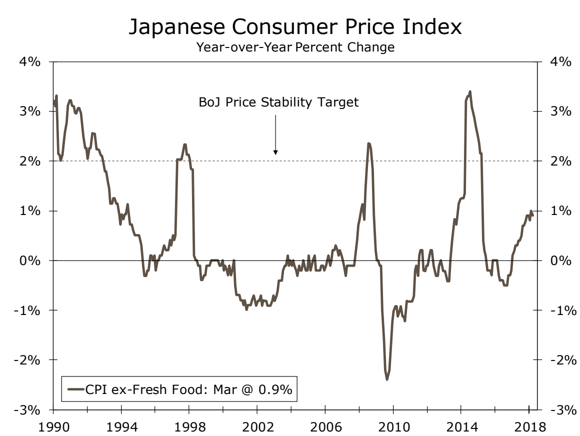
BoJ Still to Remain Accommodative

At its April meeting, the BoJ held interest rates steady and maintained its comprehensive program of monetary policy support, but it dropped any reference to a timeline for achieving its 2.0 percent inflation target, although Governor Kuroda affirmed multiple times that the removal of the date was not in any way an indication of monetary policy bias.

We do not see BoJ policy being materially impacted by today's GDP report, and we expect that the very modest growth which has characterized the past few years to return in the quarters ahead.







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