
JAPAN GDP—NOT BAD, BUT NO ROOM FOR COMPLACENCY

Jesper Koll – Senior Advisor
11/16/2018

The drop in Japan's third-quarter [GDP](#) does not mark the start of a [recession](#), but it does underscore that neither the Bank of Japan (BOJ) nor [fiscal policy](#) has room to change. If anything, the GDP report confirms BOJ Governor Kuroda's recent assertion that the balance of risk to the [macroeconomic](#) outlook has become more asymmetrical, tilted toward the downside. All said, the GDP report strengthens our conviction that Japan will decouple further from the U.S. policy mix: The BOJ stays steadfast at zero-rate-[yield curve](#) control, and "Team Abe" is poised to ease fiscal policy with a pro-growth budget expected to be presented before year-end.

The details of the GDP report show an annualized contraction of 1.2% in real GDP. The weakness was broad-based, with the largest negative contribution from public investment (-0.4 ppt) and negative contributions from consumption, net exports, inventories (all -0.3 ppt) and private capex (-0.1 ppt). While a string of natural disasters during the late summer explains some of the downside volatility, some fundamental trends need careful watching:

- **Household savings continues to surge, with the household savings rate up by 1% of GDP since the end of last year.**

While workers' salaries continues to rise-up for seven consecutive quarters, the longest positive growth trend in more than 20 years—consumer spending continues to lag the rise in incomes. Specifically, since the end of last year, workers' salaries rose ¥6.4 trillion but consumer spending rose only ¥1.3. This relentless build-up of consumer precautionary balances poses a key policy challenge to Team Abe. To fix it would require fundamental reform in the social security and healthcare system, which is politically unpopular (and economically meaningless without significant cuts in entitlements—which is exactly why the savings rate is rising as consumers prepare for the worst).

- **Business investment is back up to 16.7% of GDP, the highest level in more than 30 years.**

The [bullish](#) case for Japan is dependent on a structural upshift and upgrade in the productive capital stock. The case is strong, supported by rapid technological change, low financing cost, deregulation and Japan's favorable competitive position (e.g., onshoring). Survey data is unanimous in suggesting that a strong domestic [capex](#) cycle is under way. However, from a macroeconomic perspective, the already extraordinarily high share of private investment spending in GDP does suggest that the limits to growth may start to come into sight. At the very least, the end of the pre-Olympic construction boom should start to put some downward pressure on capex as a growth driver from mid-

2019. Stay bullish capital deepening and productivity-enhancing capex, but expect more concerted efforts from policy initiatives to counter the coming downdraft in private sector construction orders. Here, public orders for reconstruction of the summer's disaster areas provide a welcome buffer.

- **Housing investment is up for the first time in five quarters.**

Good news on the residential construction front. Here, the BOJ's adoption of negative interest rates had triggered a surge in activity as mortgage rates fell to record lows in the spring of 2016. This mini-boom turned into a mini-bust by mid-2017, with housing activity contracting for five consecutive quarters. Now we see the first up quarter, which we hope confirms our fundamental view that residential housing is in a multiyear structural uptrend, driven by rising demand for private homes and condominiums from the new middle class rising in Japan. Household formation continues to rise, with marriage rates increasing and birth rates, slowly but surely, also on an upturn. The next couple of quarters should see continued positive housing investment to help verify our structurally positive view.

Unless otherwise noted, all data from Japan's Cabinet Office as of November 14, 2018.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an “as is” basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the “MSCI Parties”) expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only. You cannot invest directly in an index.

DEFINITIONS

Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

Recession: two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemployment.

Fiscal Policy: Government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.

Macro: Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.

Yield curve: Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

Bullish: a position that benefits when asset prices rise.

Capex: Funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment. This type of outlay is made by companies to maintain or increase the scope of their operations.