

JAPAN GDP A CLEAR SIGNAL FOR BOJ, WHILE SAVINGS RATE SURGES

Jesper Koll — Senior Advisor

05/17/2018

Japan's [gross domestic product \(GDP\)](#) dropped at an annualized rate of .6% in the first quarter, January through March. After eight consecutive quarters with positive growth, some cyclical payback was inevitable. However, the report sends a loud and clear message for policy makers in general, the Bank of Japan (BOJ) in particular: there is no room for complacency. All components of private demand contracted simultaneously; only exports reported solid growth; and now Japan's absolute level of GDP generated dropped back down to where it was last spring. In short: Japan's [monetary policy](#) has more work to do. This week's report strengthens our conviction that the BOJ will fully decouple from the U.S. rates cycle—Japan's zero-rate anchor for both short and long rates will stay for at least another 15 to 18 months, in spite of rising U.S. policy rates and [bond yields](#).

Highlights from the New Facts Presented in the Report

Housing is the weakest spot, with the contraction now running for three consecutive quarters. The root cause is a classic "boom-bust cycle" that was triggered when the BOJ introduced its current zero-bond yield policy: from the first quarter of 2016 to the second quarter of 2017, residential investment surged by almost 10%, fueled by the new super-low mortgage rates (which resulted from the BOJ capping [10-year bond yields](#) at zero). Now that the rate elasticity has been exhausted, housing has dropped back 5.1% since its peak in the second quarter of 2017.

We look at housing as the all-important leading indicator for Japanese domestic demand in general, household sector risk appetite in particular. With the down cycle confirmed, when will the next up cycle start? We think it's about to start soon, because there is growing evidence that our thesis of "Japan's New Middle Class" is actually coming through: rising incomes, growing full-time job creation, and a pickup in household formation as marriage rates rise. These forces should combine to pull backup residential investment over the next couple of quarters.

The good news: the GDP report confirms a smart and steady acceleration in income growth: workers compensation rose .9% (quarter on quarter, not annualized, nominal) for the fourth consecutive quarter of growth. From a year ago, workers' compensation was up 3.2% in nominal terms, 2.0% in real terms. This is basically twice the year-over-year growth rate reported one year ago (1.4% nominal, 1.1% real, as reported for the first quarter of 2017). Workers' compensation is the best measure of the actual purchasing power of employees because, unlike the monthly wage and income data, it combines the number of people working and the average wage earned.

All said, the clear and steadfast rise in workers' compensation confirms that a virtuous cycle is now underway and that the purchasing power of the Japanese people is now rising. If, as we suspect, this cycle continues, the residential investment and housing cycle should begin to stabilize soon—now that the BOJ-induced "boom-bust cycle" has corrected.

Consumers are building a war chest—the savings rate is up again, up 1% of GDP in the past 12 months. Despite the accelerating positive growth in workers' incomes, consumption did not grow this quarter. In fact, from a year ago, workers compensation was up ¥8.5 trillion, but consumer spending was up only ¥2.8 trillion. So, workers' households savings rose ¥5.7 trillion in the past 12 months, which is equivalent to 1% of GDP. Make no mistake—it is this rise in employees' savings rate that is Japan's biggest "structural problem." It feeds both the structural external surplus and the

fiscal deficit; also, it indicates a fundamental lack of confidence in the future, as well as a fear of future tax hikes or cutbacks in public services. The fact that Mr. and Mrs. Watanabe are building precautionary balances suggests, so far, that they do not believe in the success of [Abenomics](#). To counter this fundamental mistrust is a Herculean task, but a good starting point would be more credible reform of social security and welfare programs, as well as more aggressive privatization and deregulation agendas, in our view.

All said, the message from the GDP report is straightforward—no room for complacency for policy makers; and with Japan's Parliament session coming to an end early next month, BOJ Governor Haruhiko Kuroda and his new policy board will be in charge to ensure this one negative quarter was just a pause for breath rather than the start of a genuine downturn. Most importantly, the BOJ will want to do everything it can to prevent a rise in the yen. Japan cannot afford to put the positive export growth dynamic at risk while domestic demand is trying to recover from the first-quarter fall.

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, Kara Marciscano, 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

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Bond yield : Refers to the interest received from a bond and is usually expressed annually as a percentage based on its current market value.

10-year government bond yield : Yields on the 10 year government debt security.

Abenomics : Series of policies enacted after the election of Japanese Prime Minister Shinzo Abe on December 16, 2012 aimed at stimulating Japan's economic growth.