Japan heads towards recession

Even before the economy was hit by Covid-19, Japan was contracting sharply. A recession now looks all but inevitable

-6.3%

4Q19 GDP

QoQ annualised

Worse than expected

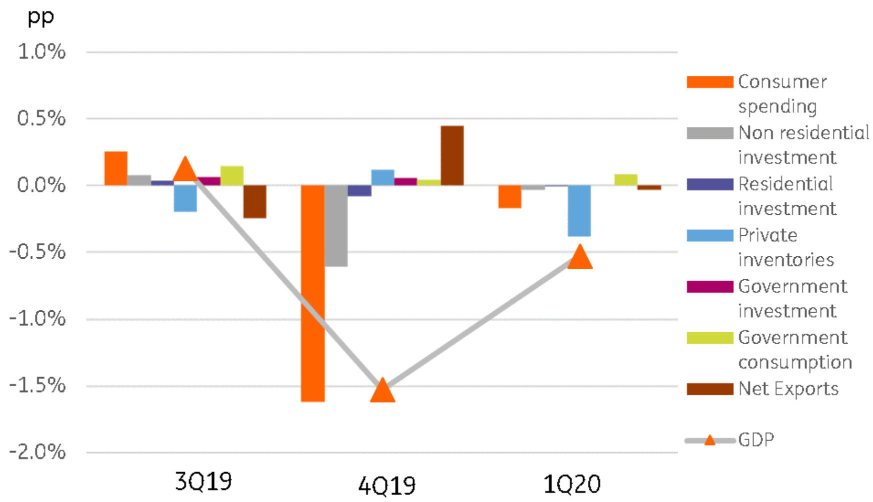
4Q19 contraction was man-made

The 1.6%QoQ contraction in GDP in 4Q19 (-6.3%QoQ annualised) was a surprise only in its magnitude. The decline was not much in doubt. Following on from Japan's 2 percentage point October consumption tax hike, there was a wholly expected decline in expenditure, which was only unusual in that the pre-hike front-loading of spending was very muted. So the October consumption tax hike was all about "bust" and not about "boom", though the full-year GDP result of 0.8% is probably not all that far off potential and on a historical basis, isn't really a problem.

The outlook for 1Q20 though is still terrible

At the beginning of the year, even this awful 4Q19 GDP figures could have been written off as a bygone, with 2020 shaping up to be buoyed by a less bellicose trade environment and a possible pick up in technology demand and production . The outlook was fair, rather than good, but that was before Covid-19 hit and now the story has changed substantially.

Contribution to GDP QoQ% 3Q and 4Q19 and 1Q20 forecast



Source: ING

Contributions to GDP

1Q20 will also contract

Looking at what caused the 4Q19 contraction, there are few encouraging signs for 1Q20. Consumer spending, which slumped following the tax hike in 4Q19, will now struggle to do anything except contract further in 1Q20 as the impact of Covid-19 weighs on consumer sentiment, weighing in particular on the consumer services sector.

Right now, there are few reasons to assume that this will not also be a factor weighing on consumer spending in 2Q20.

The net export sector was actually a positive contributor to GDP growth in 1Q19, despite weak exports, as imports fell even more sharply (2.6%QoQ), and any recovery in 1Q or 2Q20 will only work to drag down again on those GDP figures.

The other side of weak imports is often inventory reduction. But not here. Private inventory building was supportive for growth in 4Q19 to the tune of about 0.1pp. This increase was almost certainly unplanned and undesired and will need working down before inventories can begin to be rebuilt in a way that might help lift GDP. That might happen in 2Q20, but probably not in 1Q20.

In short, recession looks unavoidable

Without labouring the point too much further, other aspects of GDP, such as private investment offer no rays of hope for near term GDP either. The current fiscal stimulus programme, although substantial, basically only offsets the negative impact of last year's consumption tax hike, and without any further stimulus, will do nothing to change the overall growth picture. Some further government spending may help to curb any further contraction in GDP beyond 1Q20. But that will not stop what started off as a technical downturn, from evolving into a full-blown recession.

We now see full-year GDP growth for 2020 at -1.1%. The BoJ may try to talk up its resolve to tackle this abysmal outlook, but in our view, they were out of viable options years ago, and we don't anticipate any meaningful policy responses from them.

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