

Japan

Recession signalled despite fastest nominal GDP growth for five years

- **Real GDP falls 0.2% in third quarter...**
- **...but nominal GDP shows largest annual rise for five years and PMI points to further strong growth at start of fourth quarter**

Headline data showing Japan to have fallen back into recession in the third quarter give a misleading view of the health of the economy.

A 0.2% drop in gross domestic product in the third quarter followed a similar decline in the second quarter, according to official data. Two consecutive quarterly contractions in GDP is the commonly used definition of recession. However, there are good reasons to read the latest downbeat headline number with caution.

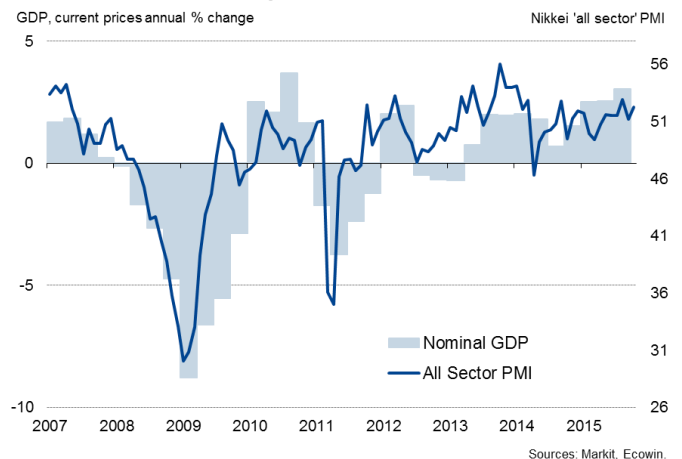
First, if inventories are excluded, GDP rose 0.3% in the three months to September. This upturn was driven by a 0.5% rise in consumption, the largest such increase seen since the first quarter of 2014, when consumers were front-loading purchases ahead of the April 2014 sales tax rise. Exports, buoyed by the weakened yen, also made a positive contribution, which is encouraging given Japan's energy import requirements. More worrying was a 3.0% slump in investment spending, though these data tend to be especially prone to revision.

Second, if inflation is excluded, GDP rose at a 3.1% annual rate, its highest for five years. As the government is targeting stronger growth and inflation, this series is an important gauge of policy success and suggests the Bank of Japan may be not overly worried by the slide into recession according to the headline GDP numbers.

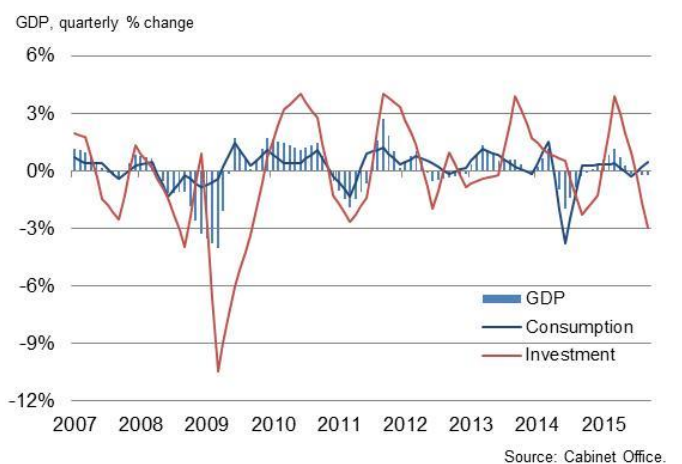
Nominal GDP is closely correlated with the Nikkei PMI, the October data for which suggested that further strong growth was recorded at the start of the fourth quarter. The composite ('all sector') PMI rose from 51.2 in September (and a third quarter average of 51.9) to 52.3 in October. The October survey also signalled an upturn in exports.

Since 2007, a weighted composite of the output indices from the manufacturing and services surveys has exhibited a correlation of 74% against the annual rate of change in nominal GDP, rising to 79% with the PMI acting with a lead of three months.

Japanese economic growth and the Nikkei PMI



GDP, consumption and investment



Exports



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