Japanese Economy Shrinks in Q2

Wednesday 13 August, 2014

Japanese GDP contracted by 1.7% in Q2 2014, an annualised decline of 6.8%. This is the largest economic contraction in Japan since the 2011 earthquake.

The contraction is primarily a result of an increase in Japan's sales tax, from 5% to 8%, in April of this year. This rise served to bring consumption forward from Q2 into Q1 2014; indeed the first quarter of this year saw a 1.6% rise in GDP, mirroring the Q2 decline. In short, Japan's economy is now back to where it was at the beginning of the year, though another rise in the sales tax to 10% is pencilled in for 2015.

The contraction will raise questions over the capacity for Abenomics to revive Japan's economic fortunes. However short term movements in GDP are only part of the overall picture: the IMF is still predicting growth for Japan this year, of 1.6% over 2014. This is only marginally behind the 1.7% growth forecast for the US economy this year.

Indeed, the market was expecting this fall in GDP, and the Nikkei is actually up on the day.

Japan does undoubtedly face challenges, in particular an ageing population and a shrinking workforce. The working age population is falling by around 1 million every year, and unemployment stands at just 3.7%. One of the paradoxes of Japan is this has not translated into higher wages for workers, which Abe wants to encourage to stimulate consumption.

This is why Abe's 'third arrow' for reform included measures to reform the labour market to make it more flexible and encourage more participants, particularly women, giving rise to the idea of 'womanomics'.

The Japanese market has returned 23% for UK investors since Abe came to power in December 2012. This includes an 18% devaluation of the Yen against Sterling, in local currency terms the stock market has actually risen 51%

Our long term valuation analysis suggests Japan is the world's cheapest developed market. While we don't think it is in absolute bargain territory, this does suggest investors buying Japan today are doing so at a reasonable valuation relative to other markets.

Investors wishing to gain exposure to Japan might wish to consider GLG Japan Core Alpha, or Schroder Tokyo, both of which sit on our Wealth 150+ list of favourite active funds at low charges.

Passive fund investors might consider BlackRock Japan Equity Tracker which is available from as little as 0.12% as a fund management charge.

Laith Khalaf, Senior Analyst, Hargreaves Lansdown:

'The drop in GDP was fully anticipated, in fact consensus was for a slightly worse contraction, and so the Japanese market has shrugged the data off. Japan's economic fortunes still hinge on the success of Abenomics, and in particular the third arrow of structural reforms which aim to change Japan's labour market.

The stock market doesn't currently look particularly expensive compared to its own history and compared to other developed markets, which suggests investors buying Japan today are doing so at a reasonable valuation.'

If you would like any further details please feel free to get in touch.

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