**MHRI Brief** **February 16, 2018**

# The Japanese economy: topic of the month

## Beware of uncertainty shocks

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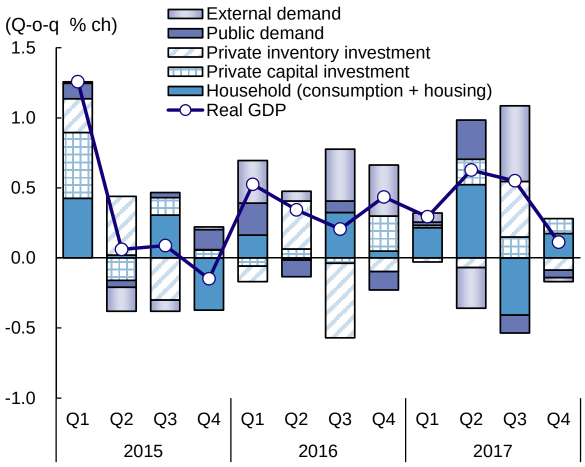
The *First Preliminary Quarterly Estimates of GDP* ("*1st QE*") released on February 14, 2018 revealed that Japan's real GDP grew +0.5% q-o-q p.a. in the Oct-Dec quarter of 2017, recording growth in positive territory for the eight consecutive quarter. While growth slowed sharply from the Jul-Sep quarter (+2.2p.a.), this stems from the surge of imports reflecting the recovery of domestic demand and a smaller contribution to overall growth by inventory investment. On the other hand, the upturn of personal consumption, acceleration of exports and ongoing rise of capital investment confirm our view that the economy is continuing to follow a firm recovery (**Chart 1**).

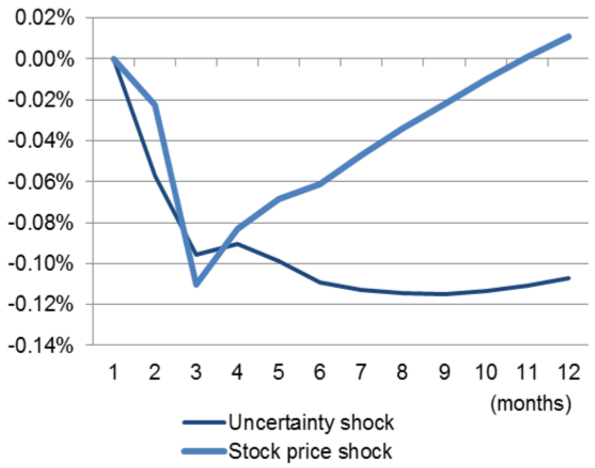
Looking forward, the Japanese economy should continue to expand, reflecting the recovery of overseas economies and solid domestic demand. However, there is the risk that the volatility in the financial market would persist for a while and send downward pressures upon the real economy. That is, in addition to the reverse wealth effect stemming from stock market falls, future uncertainties may rise along with market volatility and cause businesses and consumers to put off capital investment and purchases of big-ticket items.

**[ Chart 1: Trends in real GDP ]**




Source: Made by MHRI based upon Cabinet Office

**[ Chart 2: Impact of financial market fluctuation upon consumer spending ]**




Note: The figure shows impulse responses of the synthetic consumption index to a one standard deviation uncertainty and stock price shocks, identified in a 3-variable VAR model (consumption index, Nikkei volatility index and the Nikkei stock price).

Source: Made by MHRI

Even though there are views that the adjustment in the stock market is natural and that the reverse wealth effect would be negligible, the sharp fluctuation of the financial market itself may have an impact upon the real economy. A time series analysis of the impact on consumption reveals that uncertainty shocks tend to have a more lasting effect than stock price shocks, i.e., the wealth effect (**Chart 2**). While it seems unlikely at the moment that the market volatility will persist, we should pay close attention to whether financial market-led downside risks will materialize.