

Japan Exits Recession: But where to?

Japan's quarter on quarter GDP growth recorded a 0.90% increase versus consensus estimates of 1.0% and a prior quarter's alarming 3.8% decline. There are several ways to read this.

One is that growth was positive on a quarterly basis and we should all be thankful for it, let's all go and buy equities. The other is that the number was below forecast and that the recovery is weaker than expected, this despite fiscal and monetary policy specifically designed to revive a critically ill economy, what a disaster, let's all sell equities.

There is another angle. Japan's economy was boosted by fiscal and monetary policy in the last quarter. The monetary policy can go on, the fiscal policy will be difficult given the parlous state of the public balance sheet. With unemployment continuing to rise, retail sales showing no signs of strength and Japan's natural export markets still weak, it is hard to imagine the recovery scenario. Inventory restocking can only take an economy so far.

Moreover, the GDP deflator came in well below forecast at a mere 0.50% year on year for the quarter versus a forecast 1.8% and a prior quarter's 0.9%. For a country plagued by deflation this is potentially disastrous. (And implies an even weaker number for nominal GDP.)

Perhaps its time for consumption taxes, currently at 5%, to be stepped up by 2% per annum over the next 2 years.