

13 August 2008

# Economic news

## JAPAN'S GDP

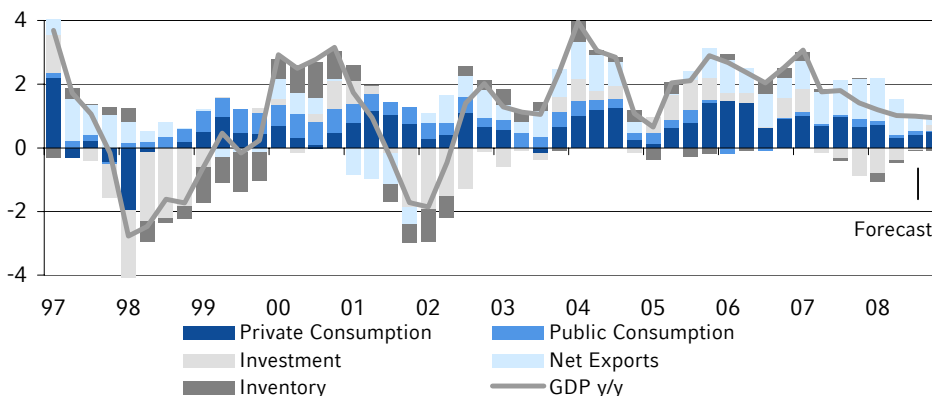
### GDP contracted in the second quarter

The pick-up in economic activity seen in the first quarter was followed by a corresponding reversal in the second, with Japan's GDP down 0.6% q/q, below our expectation of -0.4% q/q. We look for continued weak growth in the second half of the year. Monetary policy remains highly expansionary given that the real interest rate is currently negative, and the BoJ will most probably leave the policy rate unchanged through well into next year.

- **Private consumption**, which accounts for roughly 50% of Japan's overall economic activity, declined by 0.5% q/q in the second quarter following GDP growth of 0.7% in the first quarter also due to the calendar effect. A sharp rise in daily goods' prices, combined with weaker labour market data, significantly undermined consumer confidence and dampened consumer willingness to spend.
- Although **investment in machinery and equipment** was down 0.2% q/q overall, partly attributable to flagging external demand, the decline was not as sharp as feared. Unlike the downturn in 2001, according to recent surveys companies continue to expect investment spending to grow, albeit less strongly than last year. **Construction spending** saw a surprisingly sharp drop of 3.4% q/q. Following the slump in the construction sector in late summer of last year, there are no signs of a sustained recovery for the time being, as households are shying away from larger investments given the economic slowdown and discouraging labour market environment.

### Japan: GDP and components of growth

in % y/y and percentage points



Alexander Klein  
+49 211 826-8457  
alexander.klein@westlb.de

Source EcoWin, WestLB Research

- Alongside domestic demand, **exports** – usually an important mainstay of Japanese growth – also dropped by 2.3% q/q. A contraction of comparable magnitude was last seen in 2001. Japan has seen a recent further decline in demand from the USA, which had been looming since last spring. Exports to Asia and Europe are also shrinking. Overall, with growth slowing worldwide, the outlook for Japanese exports has also deteriorated further; however, we do not currently expect to see a downturn of the kind seen in 2001.
- Although the GDP contraction is indeed a cause for concern, bringing as it does the Japanese economy to the **brink of a recession**, we do not believe the downturn will be as pronounced as it was in 2001. On the contrary, we expect “no more than” a definitive period of weakness in 2008, bringing to an end the growth cycle that started in 2002. Although the employment situation has steadily worsened since the summer of last year, it is still far from reaching the level seen in 2001. The corporate situation also looks better today. Although operating profits were down y/y, there is no sign of a major slump as in 2001. In addition, Japanese companies’ profitability and financial situation are far better today due to the good earnings of the past few years.
- Against this background, we assume that economic activity will increase during the rest of the year, albeit weakly. This assumption is also borne out by the leading indicators, which have been bullish recently. Overall, however, **economic growth remains below potential growth** (1.5-2%), particularly given the downward revision of first-quarter growth from 1.0% to 0.8% q/q.
- In the current environment the **Bank of Japan** will most probably leave policy rates unchanged until well into next year. Given that the real interest rate is negative at the moment, monetary policy remains highly expansionary, and for this reason we do not expect to see a rate cut.

**WestLB AG**  
Herzogstrasse 15  
D-40217 Düsseldorf

**WestLB AG**  
**London Branch**  
Woolgate Exchange  
25 Basinghall Street  
London EC2V 5HA  
United Kingdom

T: +49 (0)211 826 71841  
F: +49 (0)211 826 6154

T: +44 (0)20 7020 2000  
F: +44 (0)20 7020 4209

**Regulator:** WestLB AG is authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht and by the Financial Services Authority. It is regulated by the Financial Services Authority for the conduct of UK business.

#### **Disclaimer**

This publication has been prepared by the independent economics department within the research department of WestLB AG ("WestLB"). This report is for information purposes only.

Publications in the United Kingdom are distributed by WestLB AG London Branch, and are available only to Eligible Counterparties and Professional Clients not Retail Clients, as defined by the rules of the Financial Services Authority. Individuals who do not have professional experience in matters relating to investments should not rely on it.

The information contained herein has been obtained from public sources believed by WestLB to be reliable, but which may not have been independently justified. No guarantees, representations or warranties are made as to its accuracy, completeness or suitability for any purpose.

This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument or any other action and will not form the basis or a part of any contract.

Neither WestLB nor any of its affiliates, its respective directors, officers or employers accepts any liability whatsoever (in negligence or otherwise) for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection therewith. Any opinion, estimate or projection expressed in this publication reflects the current judgement of the author(s) on the date of this report. They do not necessarily reflect the opinions of WestLB and are subject to change without notice. WestLB has no obligation to update, modify or amend this report or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results.

WestLB, its affiliates, principals or employees may have a long or short position or may transact in the financial instrument(s) referred to herein or may trade in such financial instruments with other customers on a principal basis. WestLB may act as a market maker in the financial instruments or companies discussed herein and may also perform or seek to perform investment banking services for those companies. WestLB AG may act upon or use the information or conclusion contained in this report before it is distributed to other persons.

This report is subject to the copyright of WestLB. No part of this publication may be copied or redistributed to persons or firms other than the authorised recipient without the prior written consent of WestLB.

By accepting this report, a recipient hereof agrees to be bound by the foregoing limitations.

WestLB AG Düsseldorf is a member of the London Stock Exchange. WestLB AG London Branch is a member of the International Capital Market Association.

Copyright: 2008 WestLB AG. All rights reserved.