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The Japanese economy: topic of the month

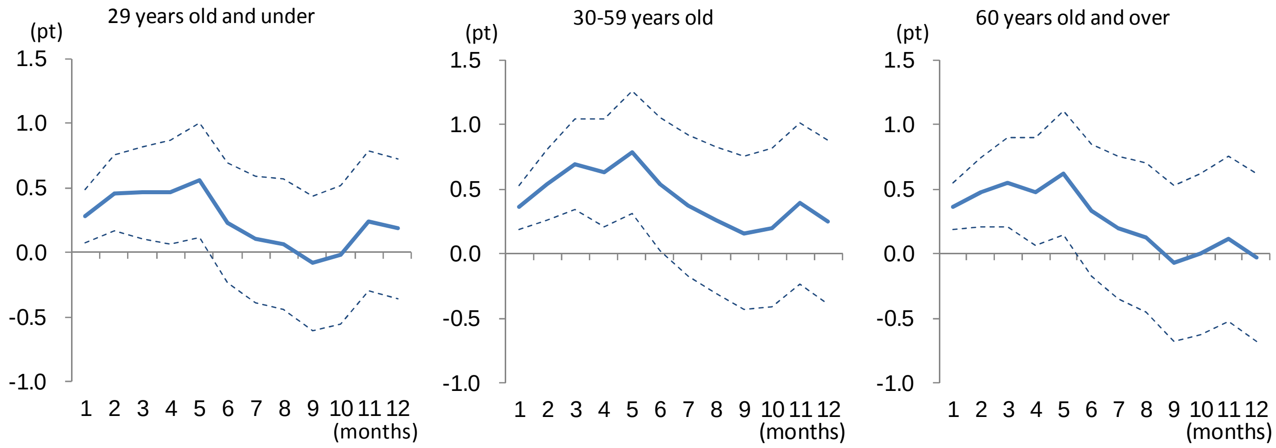
The impact of the stock market rise upon consumer confidence

Yusuke Ichikawa, Senior Economist, Economic Research Department

Japan's real GDP grew +1.4% q-o-q p.a. in the Jul-Sep quarter of 2017, recording its seventh consecutive quarter of positive growth. Even though the results shed light upon the weakness of domestic demand (contribution to real GDP growth: -0.6% pt p.a.) ---- in stark contrast to the strength of net exports (contribution: +2.0% pt p.a.) ---- this should be interpreted mainly as a backlash to the strong growth in the previous quarter. Looking ahead, personal consumption, which dipped into negative territory for the first time in seven quarters, should return on recovery track due to such factors as the expected increase of winter bonus payments, and the "wealth effect" stemming from the stock market rise.

Theoretically, the wealth effect refers to the situation in which the increase of financial assets ease the household's budget constraints over the lifetime, thereby leading to the rise of consumer spending. A typical example would be the increase in the sales of luxury items such as jewelry at department stores, which obviously would only apply to households that own stock. What matters more for the current state of the economy is the positive effect even for less wealthy households, through the improvement of consumer confidence. **Chart 1**

[Chart 1: The impact of the stock market rise upon consumer confidence]



Note: The figure shows the responses of the confidence index to a one standard deviation shock on the stock price, based on a bivariate VAR model (Number of lags =12, sample period 2005/5 to 2017/10). The stock price (end of previous month) is deflated using the seasonally-adjusted CPI. The shock is identified by assuming that a confidence shock has no contemporaneous impact on the stock price. The dashed lines indicate the 90% confidence interval.

Source: Made by MHRI based upon the Cabinet Office, *Consumer Confidence Survey* shows the estimated effects of higher stock prices on the consumer confidence index. We see that there is a positive impact on confidence among households in their 20s who do not hold much financial assets, just as in the case of asset-rich older households. The improvement of the consumer confidence index in October to the highest level in four years is due most likely to media reports that the Nikkei stock average recorded its longest winning streak running for 16 straight days. Because of its volatility, the stock market would not be able to drive a sustained recovery of consumer spending. Yet, it should still be able to serve as underpinnings, at least over the short term.