Japan Falls Into Recession

GDP Declines 1.6%, Setting Stage for Delay in Sales-Tax Increase

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TOKYO—Japan’s economy shrank for a second quarter in a row, after a sales-tax increase took the steam out of Prime Minister Shinzo Abe’s bid to turn Japan into a global model of revival.

Mr. Abe, who has sought to revive the world’s third-largest economy after two mostly sluggish decades, is set to announce this week that he will delay plans to raise the nation’s sales tax next year and call elections in December.

The prime minister hopes that delaying the tax increase, along with the Bank of Japan’s move on Oct. 31 to pump tens of billions of dollars of cash into the economy, will keep so-called Abenomics humming, said advisers.

But the growth figures released on Monday demonstrated the size of his challenge. Real gross domestic product fell 1.6% on an annualized basis in the July-September period, following a 7.3% contraction in the previous quarter. That means Japan met one definition of a recession: two consecutive quarters of contraction.

None of the 18 economists surveyed by The Wall Street Journal had forecast a contraction; the median forecast was for a 2.25% expansion.

The weak data will make opposition parties “raise their voice, saying ‘Abenomics was a failure,’” said Yuichi Kodama, chief economist at Meiji Yasuda Life Insurance Co.
“People in the market may harbor doubts about policy continuity and confidence in the government.”

Indeed, after the release of the data, Yukio Edano, secretary-general of the main opposition Democratic Party of Japan, said, “The economic policy of the past two years may have been effective in pushing up share prices, but it was not in turning around the real economy. We can say with confidence that Abenomics has reached its limit.”

The Nikkei Stock Average, which surged after the Bank of Japan’s move to a seven-year high, ended morning trading down 2.6% on the news.

The two negative quarters followed an increase in the nation’s sales tax to 8% on April 1 from 5%. That hit consumer spending and chilled the whole economy. One example: Private housing investment fell an annualized 24% in the July-September quarter, according to Monday’s data.

Mr. Abe’s advisers said last week that if the growth figure was weak, Mr. Abe would postpone by 18 months a plan to raise the sales tax further to 10% in October 2015, and they said he would call elections in December. Local media said on Monday that the prime minister would announce both moves on Tuesday and set Dec. 14 as the election date for parliament’s lower house, which chooses the prime minister.

Mr. Abe’s ruling Liberal Democratic Party enjoys an overwhelming majority in the lower house and is unlikely to lose it because opposition parties are weak.

But the LDP on Sunday suffered its second big loss in a regional gubernatorial election in recent months, when a staunch opponent of a U.S.-Japan plan to build a new American military base on the southern island of Okinawa was elected governor of the prefecture, complicating the allies’ regional-security strategy to counter a rising China.

A top government official said in an interview last week that the LDP believed it could get by with only modest losses in the lower-house election and lay claim to a popular mandate to carry on Mr. Abe’s policies.

But Monday’s figures could give opposition parties a stronger case, and Mr. Abe’s ministers hastened to play them down.

“Abenomics is not a failure,” said Economy Minister Akira Amari. “What we have to do now is to give consumers confidence that their life will improve going forward.”

Mr. Abe took power after a landslide victory in December 2012 and quickly introduced a “reflationist” program designed to get Japan out of its long cycle of falling prices, falling wages and weak demand. His handpicked Bank of Japan governor, Haruhiko Kuroda, fired his first monetary “bazooka” in April 2013, sending stocks soaring and driving down the yen. That, in turn, lifted corporate profit, and Japan seemed well on the road to recovery by early this year—until the sales-tax increase intervened.

The U.S., Europe and Japan have all faced choices in recent years between tackling large budget deficits and stimulating economies hit by lackluster demand. By choosing to delay the tax increase, Mr. Abe would place himself squarely in the stimulus camp.

Former U.S. Treasury Secretary Lawrence Summers praised the delay in an interview Friday. “The most important determination to fix Japan’s longer-term debt situation is its growth rate,” he said. “It will not be able to service its debt unless growth accelerates, and that should be its first priority.”
“Rather than letting the Japanese economy stall by raising the sales tax again, it would be a better idea to wait for about a year until domestic demand recovers,” said Akira Emi, president of Ride On Express Co., the operator of Japan’s biggest sushi delivery chain.

Others say Japan needs to move quickly to reduce its government debt, now the highest in the world at more than twice the size of the economy.

“If you delay the tax increase a year and a half, you risk raising the tax when the Bank of Japan is starting to end its easing. So you have tapering and fiscal tightening at the same time,” said J.P. Morgan Securities’s top Japan economist, Masaaki Kanno. “That is very dangerous.”

Mr. Abe might choose to do even more to stimulate the economy by introducing a new spending package early next year, economists said. And the weak figures could force the Bank of Japan to add to its easing.

Should the annualized growth rate in the October-December period come to only 1% or so, “it is possible that they would ease one more time” by March 2015, said Takeshi Minami, chief economist at Norinchukin Research Institute.

Yet many economists remain upbeat about the months ahead, saying the worst might have ended in the July-September quarter when companies were reducing inventories.

“We think that the economy is gradually improving,” said Tomo Kinoshita, an economist at Nomura Securities. “There’s no reason to be pessimistic about the economy going forward.”

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