Monthly Report of Prospects for Japan's Economy

August 2020

Macro Economic Research Center
Economics Department

The Japan Research Institute, Limited

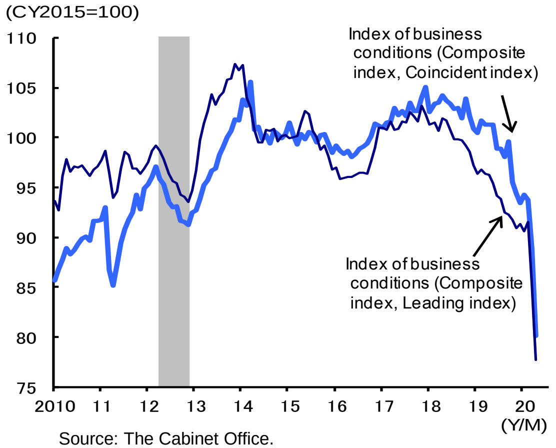
https://www.jri.co.jp/english/periodical/

This report is the revised English version of the July 2020 issue of the original Japanese version.

The General Situation – Economic Activity Saw a Significant Decline as the Effects of the Novel Coronavirus Continued

Figure 1-1 Economic Activity

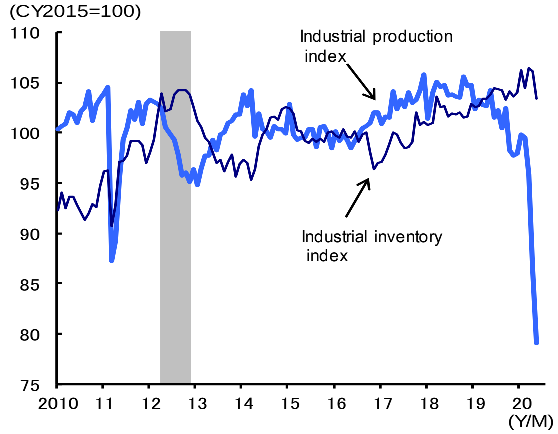
Indices of business conditions declined substantially both in terms of the CI coincident index and the CI leading index.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

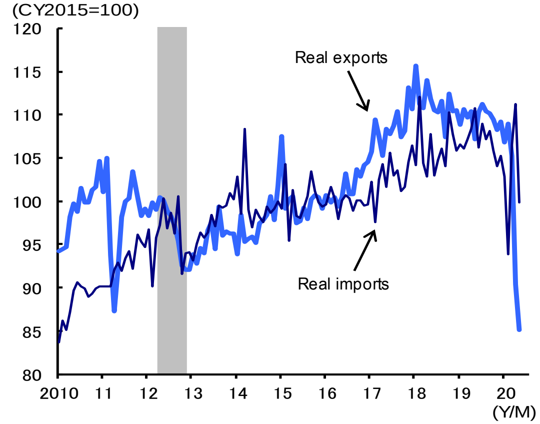
The industrial production index dropped mainly for automobiles, recording its lowest level since April 2009.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

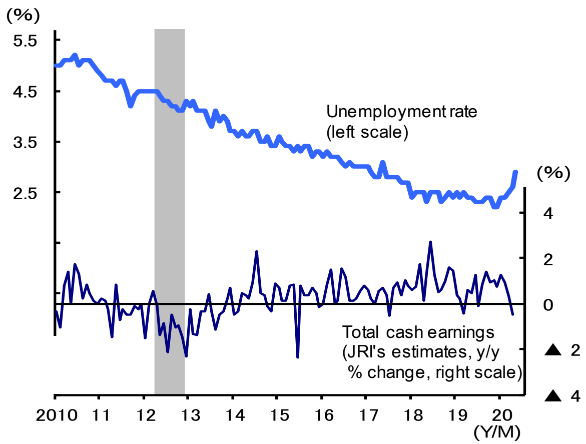
Exports declined mainly for transportation machinery. Imports saw a decline for crude oil and transportation machinery.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

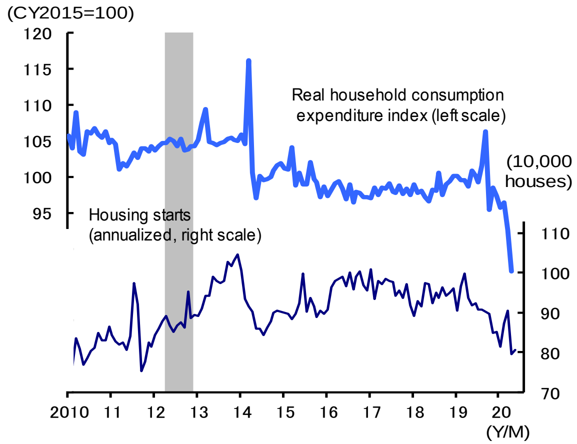
The unemployment rate rose to its highest level since June 2017. Nominal wages saw a year-on-year decline for the first time in nine months.



Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

Figure 1-5 The Household Sector

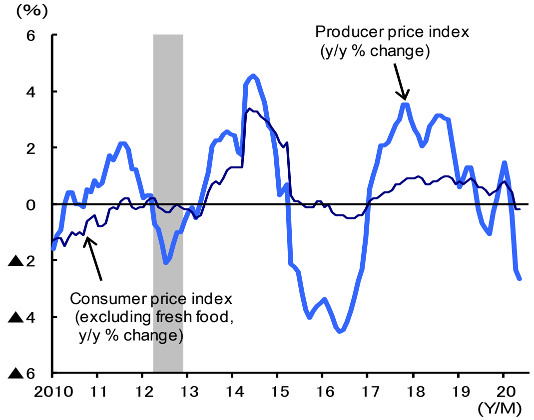
Real household consumption declined due to the effect of voluntary restraint on outings. Housing starts remained sluggish.



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office, The Ministry of Land, Infrastructure and Transport.

Figure 1-6 Prices

Against the backdrop of cheaper crude oil, both producer prices and consumer prices declined.



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications, The Bank of Japan.

∗ The shaded area indicates the recession phase.

Both Domestic and Overseas Demand Saw a Significant Decline

◆ The DI for Business Conditions Plummeted

In the Bank of Japan's June 2020 Tankan Survey, large manufacturers' DI for business conditions declined for six consecutive quarters, reaching its lowest level since June 2009. The DI deteriorated for all industries, mainly the auto industry, where sales are sluggish worldwide.

Moreover, the DI for large nonmanufacturers declined for the fourth consecutive quarter, recording its lowest level since December 2009. The DI deteriorated across a broad range of industries, including hotel and food services, due to the disappearance of demand related to inbound tourism and voluntary restraint on outings.

In terms of future outlook, the DI is anticipated to improve from its current level for large businesses in all industries in line with the resumption of economic activities. That being said, amid lingering uncertainty over the economic outlook, recovery in business sentiment will be limited.

◆ Exports Remained Sluggish

Real exports remained on a declining trend. By region, exports to China, where economic activity is returning to normal, are showing signs of recovery, while those to Europe and the United States, particularly automobile-related exports, are falling sharply.

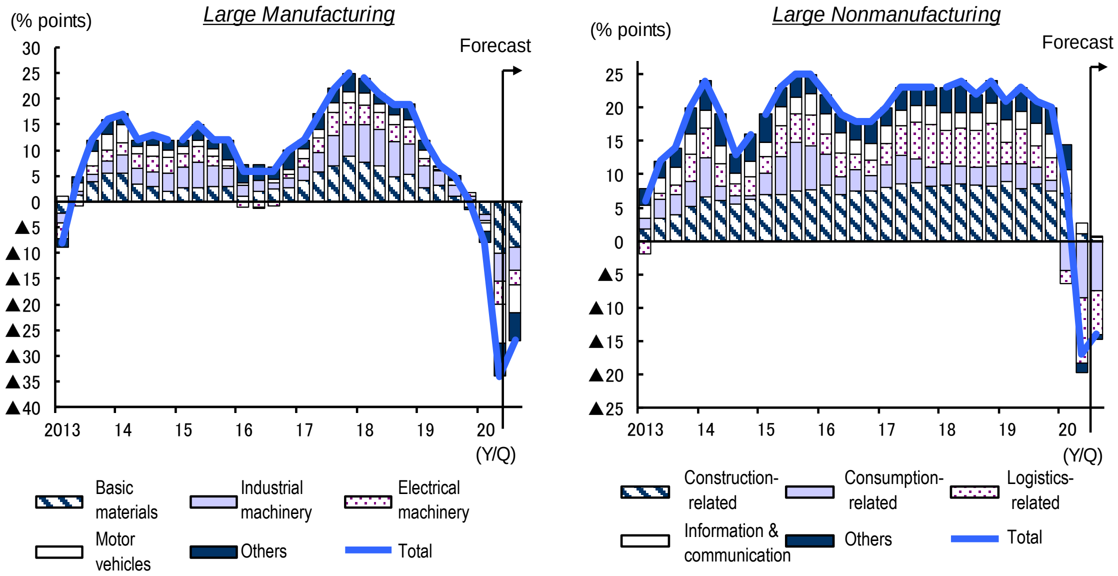
◆ Industrial Production Is Anticipated to Pick up

The industrial production index for May dropped 8.9% from the previous month, recording its lowest level since April 2009. Production of automobiles and production machinery, among others, declined substantially, reflecting stagnant external demand.

Looking at future production plans, industrial production is forecast to increase, up 5.7% month-over-month in June and up 9.2% month-over-month in July. While it is unclear whether production will rebound rapidly as planned amid the prolonged effects of the novel coronavirus, industrial production is anticipated to pick up against the backdrop of the resumption of economic activities.

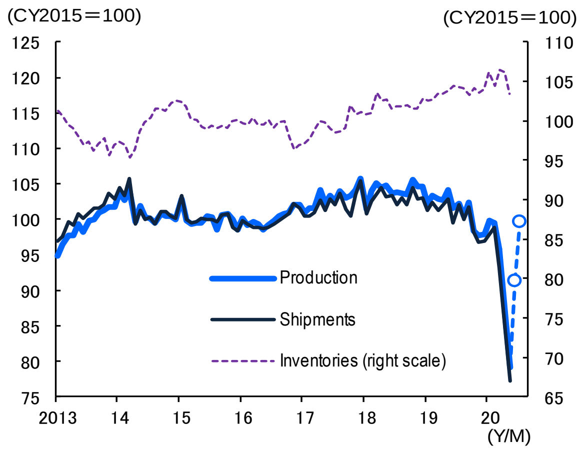
Figure 2-1 Contributions to the Business Conditions Diffusion Index by Industry

<diffusion index of "favorable" minus "unfavorable," and percentage point contribution to total DI points>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, "The Tankan June 2020 Survey".

Figure 2-2 Industrial Production Index <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.

Note: The latest two figures in the industrial production index are forecasts for June and July 2020 based on the production forecast index.

The Decline in Exports of Goods Will Likely Halt, While Demand Related to Inbound Tourism Remains Virtually Nonexistent

◆ Exports of Transportation Machinery Declined Further

Exports of goods in May fell 6.8% from the previous month. By item, shipments of transportation machinery saw a further decline due to sluggish automobile sales in the United States and Europe, which account for a large share of Japan's exports. Exports of capital goods to China recovered following the resumption of economic activities, while those to other Asian countries and the United States continued to decline.

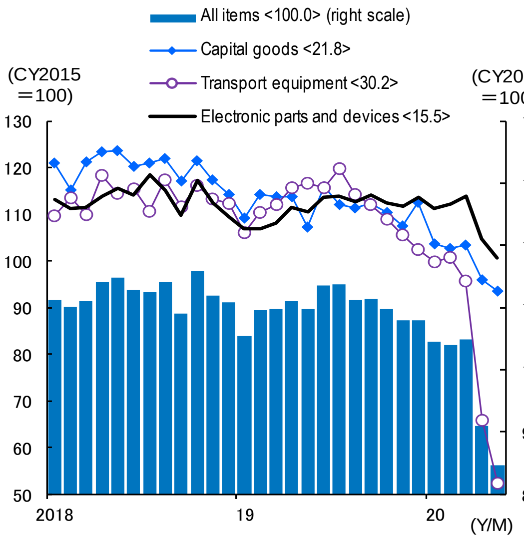
As for future prospects, exports are expected to turn positive after the summer, as some countries are easing restrictions on economic activities. Automobile sales, which had been declining sharply, have bottomed out in the United States and Europe, and the decline in exports from Japan is likely to stop sooner or later. However, as the global economic recovery is expected to remain slow due to the prolonged impact of the novel coronavirus, exports are not expected to return to the level before the coronavirus outbreak until 2022.

◆ Demand Related to Inbound Tourism Was Almost Zero

The number of tourists that visited Japan in May fell 99.9% on a year-on-year basis.

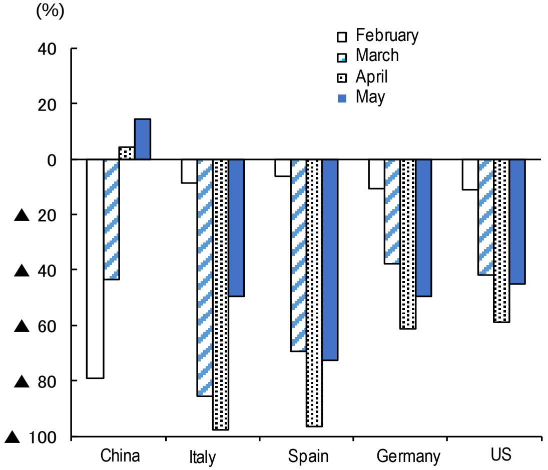
Although the Japanese government has started to ease immigration restrictions, demand related to inbound tourism is expected to remain virtually nonexistent, as the easing of restrictions will be limited to business trips for the time being. Given the situation where people continue to refrain from traveling aboard, the World Tourism Organization estimates that the number of people traveling abroad at the end of this year will be about 60% of last year's level, even if countries around the world begin relaxing their travel restrictions. The recovery of demand related to inbound tourism in Japan following the easing of restrictions is also expected to be moderate.

Figure 3-1 Real Exports by Item <seasonally adjusted>



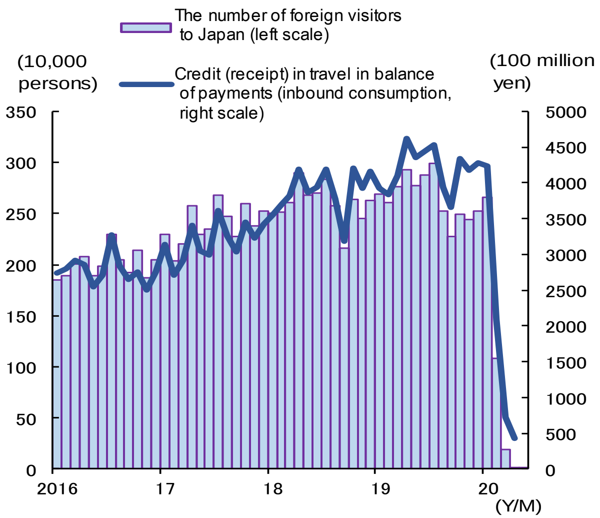
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angled brackets show the shares in total nominal exports in CY2019.

Figure 3-2 New Car Sales by Country <year-on-year % change>



Source: The Japan Research Institute, Ltd. based on data of European Automobile Manufacturers' Association and so on.

Figure 3-3 Receipt in Travel in Balance of Payments <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, Japan National Tourism Organization (JNTO).

The Unemployment Rate Is Expected to Rise to Nearly 4% Toward Year-End

◆ The Number of Employees on Furlough Remains High

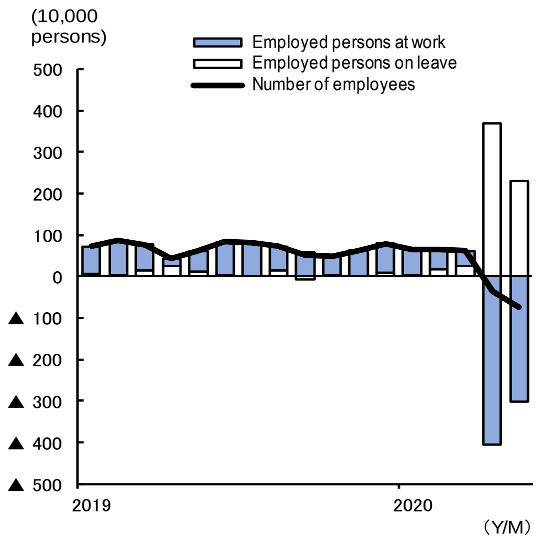
The number of employees in May fell by 730,000 year-on-year, down for the second consecutive month, but the decrease was only about 1% of the total number of employees. However, this is due to the fact that companies maintained their employment numbers by suspending workers through implementing temporary leave or leaves of absence rather than through dismissal. The number of "employees on furlough"—those who still have jobs but are not actually working—increased by 2.29 million in May on a year-on-year basis, recording its second highest level following April despite a slight decrease from the previous month as the government lifted its state of emergency declaration.

By industry, the number of employees on furlough remains high in the hotel and food services industries, which have been deeply impacted by the decline in demand related to inbound tourism and measures required for preventing the spread of infection. In addition to the service sector, the manufacturing sector is experiencing a large number of furloughed workers due to the impact of a slowdown in exports.

◆ The Employment Condition DI for the Manufacturing Industry Indicated "Excessive Employment"

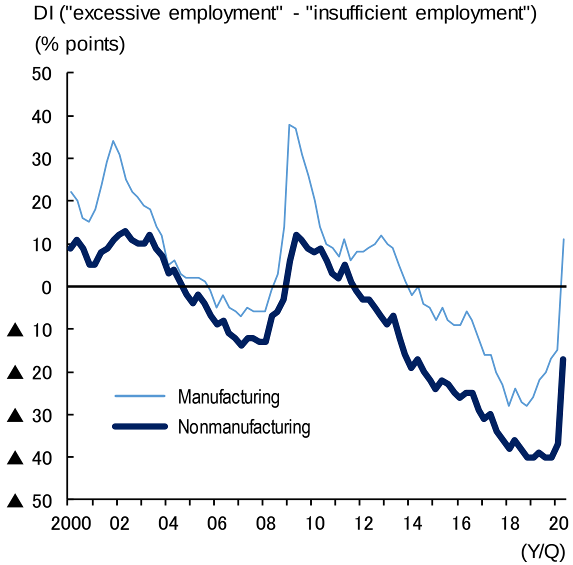
Although companies managed to avoid sharp increases in the number of jobless through job retention efforts, the sense of job shortages that was previously apparent has rapidly diminished as domestic and overseas demand plummeted. Looking at the employment condition DI ("excessive employment" – "insufficient employment") in the BOJ Tankan Survey for June, the DI for nonmanufacturers showed its largest rise in the past, while that for manufacturers indicated "excessive employment" for the first time since December 2013. Demand is expected to remain sluggish for a long time due to the impact of the novel coronavirus pandemic, with an increasing number of companies likely cutting back on employment in the future. As a result, the unemployment rate is forecast to rise to nearly 4% by the end of the year.

Figure 4-1 Number of Employees by Type <difference from a year earlier>



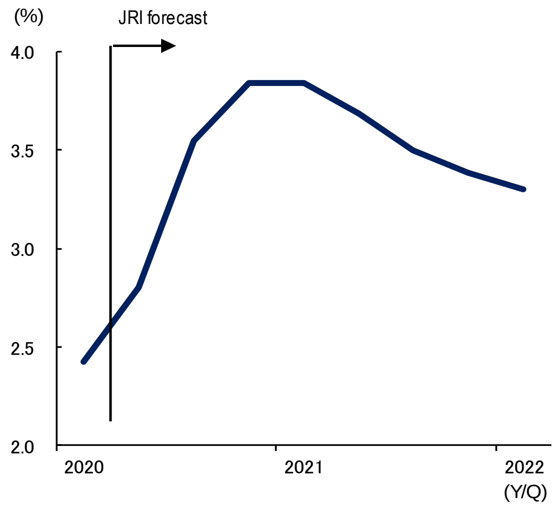
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Figure 4-2 Tankan DI of Employment Conditions <all sizes>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.

Figure 4-3 Forecast of the Unemployment Rate <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
Note: Forecast by JRI.

Private Consumption Will Likely Rebound During the July-September Period

◆ Consumption Stopped Declining After the State of Emergency Declaration Was Lifted

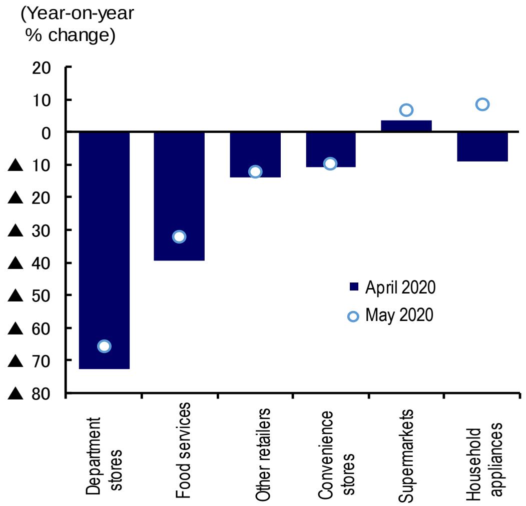
Retail sales in May fell 12.3% from a year earlier, continuing a sharp decline. By business type, while electronics retail stores saw year-on-year growth thanks to the decision to provide fixed amount benefits to all households in the fiscal 2020 supplementary budget, department stores and restaurants continued to experience sharp declines due to the effects of voluntary restraint on outings and shorter business hours.

Meanwhile, the consumer confidence index rose for the second consecutive month to 28.4 in June. Consumer confidence is picking up as the number of new coronavirus infection cases declines, and personal consumption is expected to turn positive in the future. However, the number of people at retail and entertainment facilities was less than 90% of what it was before the outbreak of the coronavirus pandemic. As the tendency toward self-restraint will not completely disappear, personal consumption in the July-September quarter is expected to recover about 60% of its decline in the April-June quarter.

◆ Housing Investment Is Expected to Continue Declining

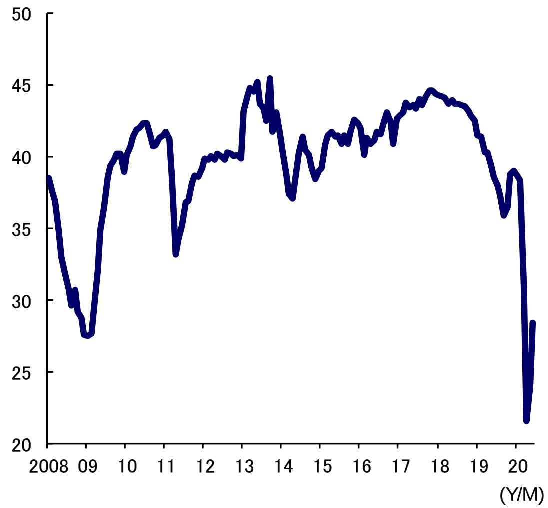
The environment surrounding the housing market has remained harsh due to voluntary restraint on outings, the closure of housing exhibition halls and the worsening employment income environment. In fact, the housing DI in the Economy Watchers Survey for May rose for the first time in five months, but remained below the level seen immediately after the collapse of Lehman Brothers. Taking into account the correlation between the index and the number of housing starts, the number of housing starts is expected to drop to around 600,000 on an annualized basis in the second half of the year, mainly for owner-occupied houses and built-for-sale houses.

Figure 5-1 Retail Sales Value by Type of Stores <year-on-year % change>



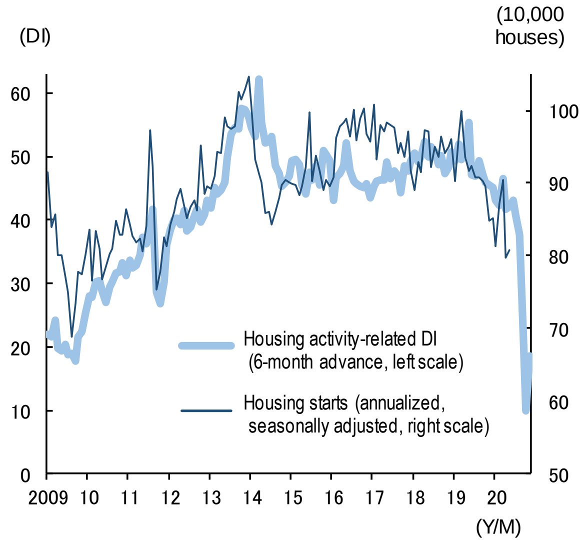
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry, Japan Foodservice Association, Japan Department Stores Association.

Figure 5-2 Consumer Confidence Index <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.

Figure 5-3 Economy Watchers Survey and Housing Starts



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Land, Infrastructure and Transport and The Cabinet Office.

Topic: The Decrease in Business Fixed Investment Is Smaller Than That After the Collapse of Lehman Brothers

◆ The Business Fixed Investment Plan Faced an Unusual Downward Revision

The FY2020 business fixed investment plan (all enterprises, all industries) in the BOJ Tankan Survey was revised downward in June, which was unusual for the June survey, as the plan is normally revised upward due to the carry-over of investment projects from the previous fiscal year. The corporate sector has become more cautious about capital spending due to a sharp drop in domestic and overseas demand following the spread of coronavirus.

◆ There Are Three Factors That Underpin Capital Investment

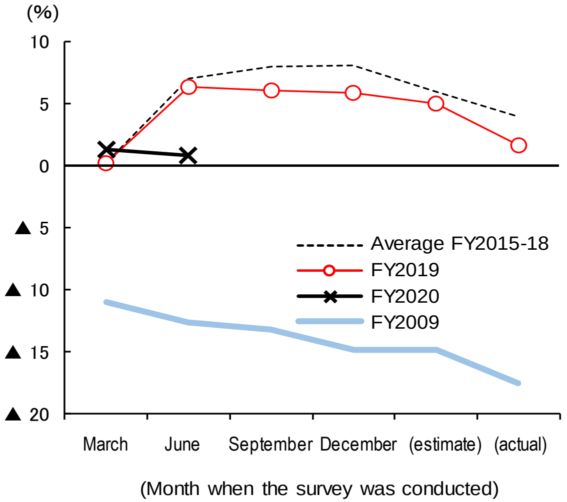
Despite the foregoing, the sharp decline in capital investment that occurred after the collapse of Lehman Brothers is expected to be avoided for the following three reasons.

First, there is financial support. As a result of the improved earnings structure of companies, it will be easier to secure internal funds to continue investment even when demand declines. In addition, looking at the availability of external funds, banks' lending attitudes have been more accommodating compared to after the collapse of Lehman Brothers.

Second, changes in capital investment incentives have occurred. At the time of the Lehman Brothers collapse, the proportion of investment in capacity-building to meet overseas demand was high. Therefore, business fixed investment diminished rapidly as demand plummeted. On the other hand, current capital investment is mainly aimed at replacing of aging facilities and developing new markets. The ratio of investment for capacity expansion has declined significantly, making the investment structure less susceptible to demand fluctuations.

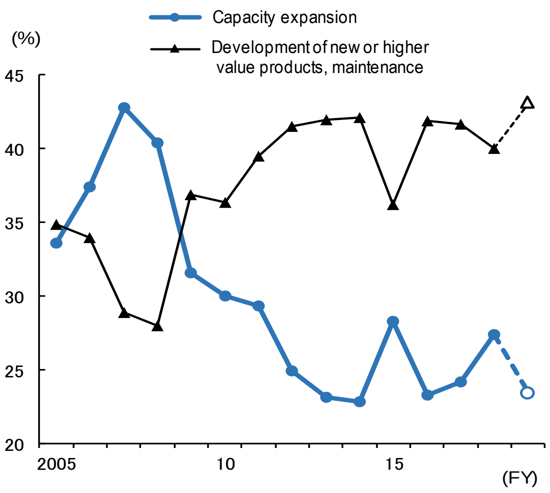
Third, IT investment has been robust. Looking at the business fixed investment plan for this fiscal year by investment type, investment in property, plants and equipment decreased while investment in software increased. IT demand seems to be increasing in order to control the risk of coronavirus infection through remote working and factory automation.

Figure 6-1 Change over Time in Planned Business Fixed Investment for Each Fiscal Year <year-on-year, %>



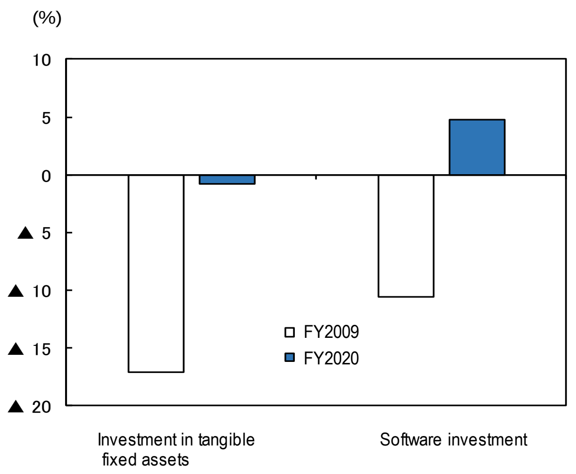
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, "The Tankan Surveys."
Note: All sizes and all industries. Excluding land purchasing expenses, including software

Figure 6-2 Ratio of Incentives to Business Fixed Investment <large manufacturers>



Source: The Japan Research Institute, Ltd. based on data of The Development Bank of Japan Inc.
Note: The figures for FY2019 are plans.

Figure 6-3 Planned Business Fixed Investment by Type <June Survey, year-on-year % change>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, "The Tankan Surveys."
Note: All sizes and all industries.

Prospects for Japan's Economy - Projected Real GDP Change; -4.6% for FY2020 and 3.3% for FY2021

◆ Economic Activities Will Not Return to Their Pre-coronavirus Growth Level Until 2022

(1) A V-shaped Economic Recovery Is Expected to Be Difficult to Achieve

On the assumption that the outbreak of the novel coronavirus will gradually resolve itself in the future, the Japanese economy will likely return to positive growth of approximately 10% on an annualized basis in the July-September period as personal consumption picks up in line with the easing of peoples' voluntary restraint on outings.

Despite the foregoing, a strong V-shaped economic recovery is expected to be difficult to achieve even if a second wave of coronavirus infections can be avoided. As for exports, it will take time for trade activities to rebound, as the resumption of economic activity remains slow in various countries. In addition, demand related to inbound tourism will remain virtually nonexistent for the time being due to ongoing border restrictions in an effort to avoid a second coronavirus wave.

Meanwhile, in terms of domestic demand, household consumption activities will likely take some time to normalize as a result of measures to prevent the spread of coronavirus infection such as restrictions on the number of customers and seating capacity, on top of the lingering tendency toward self-restraint. Personal consumption is expected to remain below pre-coronavirus levels for a long time, with a rise in unemployment and a worsening income situation, including a decline in overtime payment and bonuses.

(2) Japan Will See a Negative Growth Rate of Minus 4.6% for FY2020

Due to the foregoing, Japan will likely see negative growth for FY2020 at a rate of minus 4.6%. While the growth rate for FY2021 is expected to turn positive at +3.3%, the pace of recovery will be slow, and it is forecast that economic activity will not recover to the level before the coronavirus outbreak until after 2022.

◆ Prices Are on a Declining Trend

(3) The core CPI growth in May diminished from the previous month for a second consecutive month. This was attributable mainly to a significant fall in energy prices against the backdrop of a decline in crude oil prices as well as a continuous decrease in accommodation fees and overseas package tours that reflected a drop in travel demand due to the influence of the novel coronavirus.

As for future prospects, in addition to a further drop in energy prices, downward pressure on prices from the viewpoint of supply and demand is expected to intensify. Consequently, the decline in core CPI is expected to continue further.

Figure 8 Projections for GDP Growth and Main Indicators of Japan (as of July 6, 2020)

(seasonally adjusted, annualised % changes from the previous quarter) / (% changes from the previous fiscal year)

	CY2019		CY2020			CY2021				CY2022	FY2019	FY2020	FY2021
	10～12	1～3	4～6	7～9	10～12	1～3	4～6	7～9	10～12	1～3			
	(Actual)	(Actual)	(Projection)			(Projection)				(Projection)	(Actual)	(Projection)	(Projection)
Real GDP	▲ 7.2	▲ 2.2	▲ 21.2	9.7	4.2	5.0	2.5	3.0	0.0	1.2	0.0	▲ 4.6	3.3
Private Consumption Expenditure	▲ 11.1	▲ 3.0	▲ 26.4	19.8	4.4	5.2	1.3	1.8	0.4	1.0	▲ 0.6	▲ 5.2	3.4
Housing Investment	▲ 8.9	▲ 15.7	▲ 15.5	▲ 24.8	▲ 13.4	29.2	15.1	7.4	6.9	4.2	0.5	▲ 13.0	7.5
Business Fixed Investment	▲ 17.7	8.0	▲ 19.3	▲ 6.4	9.5	5.8	4.3	3.8	2.6	2.6	▲ 0.2	▲ 5.8	4.1
Private Inventories (percentage points contribution)	(0.0)	(▲ 0.4)	(▲ 0.1)	(0.5)	(0.2)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.1)	(▲ 0.1)	(0.0)
Government Consumption Expenditure	0.8	0.2	3.8	1.4	0.4	0.4	0.6	3.5	▲ 2.3	0.6	2.4	1.6	0.8
Public Investment	1.9	▲ 2.2	1.5	2.8	5.9	▲ 1.0	▲ 2.5	▲ 0.4	0.6	0.8	3.3	1.7	0.0
Net Exports (percentage points contribution)	(2.1)	(▲ 0.8)	(▲ 2.3)	(0.9)	(0.7)	(0.9)	(1.0)	(0.6)	(▲ 0.3)	(0.0)	(▲ 0.2)	(▲ 0.9)	(0.6)
Exports of Goods and Services	1.7	▲ 21.9	▲ 61.3	44.2	32.7	19.8	13.6	6.5	▲ 0.2	2.0	▲ 2.7	▲ 15.2	14.2
Imports of Goods and Services	▲ 9.3	▲ 18.3	▲ 47.9	38.6	28.1	14.3	7.8	3.2	1.4	1.8	▲ 1.7	▲ 10.2	10.6
(Ref.) Domestic Private Demand (percentage points contribution)	(▲ 9.8)	(▲ 1.4)	(▲ 18.1)	(9.1)	(3.7)	(4.4)	(1.7)	(1.8)	(0.8)	(1.1)	(▲ 0.4)	(▲ 4.2)	(2.7)
(Ref.) Public Demand (percentage points contribution)	(0.3)	(▲ 0.0)	(0.9)	(0.5)	(0.4)	(0.0)	(▲ 0.0)	(0.7)	(▲ 0.5)	(0.2)	(0.6)	(0.4)	(0.2)

(% changes from the same quarter of the previous year) / (% changes from the previous fiscal year)

	CY2019 10～12	1～3	4～6	7～9	10～12	1～3	4～6	7～9	10～12	1～3	FY2019	FY2020	FY2021
Nominal GDP	0.5	▲ 0.9	▲ 6.0	▲ 5.1	▲ 2.9	▲ 1.3	4.3	3.3	2.3	1.7	0.8	▲ 3.8	2.9
GDP deflator	1.2	0.9	2.0	0.9	0.3	0.1	▲ 1.0	▲ 0.4	▲ 0.3	▲ 0.1	0.8	0.8	▲ 0.4
Consumer Price Index (excluding fresh food)	0.6	0.6	▲ 0.2	▲ 0.0	▲ 0.7	▲ 0.6	0.1	0.1	0.8	0.8	0.6	▲ 0.4	0.4
(excluding fresh food, consumption tax, education free of charge)	0.3	0.2	▲ 0.5	▲ 0.3	▲ 0.6	▲ 0.5	0.1	0.1	0.8	0.8	0.4	▲ 0.5	0.4
Unemployment Rate (%)	2.3	2.4	2.8	3.5	3.8	3.8	3.7	3.5	3.4	3.3	2.3	3.5	3.5
Exchange Rates (JY/US$)	109	109	108	109	109	109	109	110	110	110	109	109	110
Import Price of Crude Oil (US$/barrel)	66	68	35	41	43	45	50	55	60	62	68	41	57

Source: The Cabinet Office; The Ministry of Internal Affairs and Communications; The Ministry of Economy, Trade and Industry; The Ministry of Finance.
The projection figures are based on those of The Japan Research Institute, Ltd.

Note : "▲" indicates minus.