



[FY2020-22 Economic Outlook : Japan]

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Widening Recovery Gap in the Japanese Economy

**— Facilitation of Labor Movements and Business Reconstruction
are Urgent Issues —**

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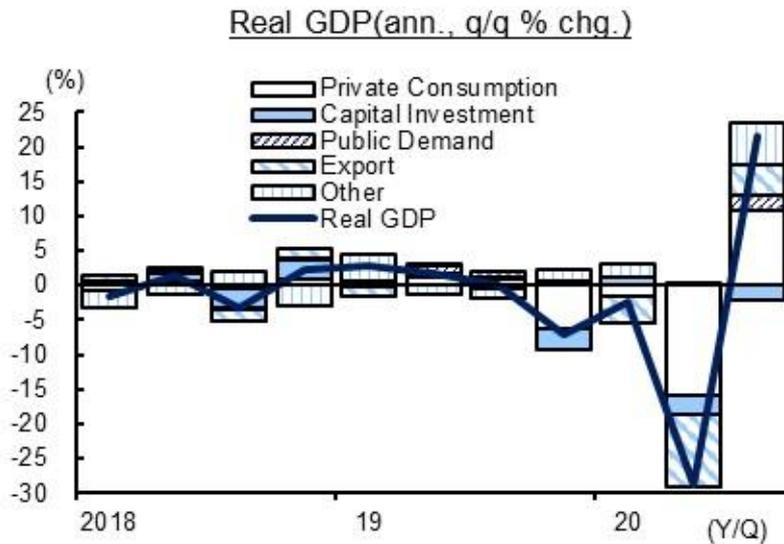
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- ◆ Although the Japanese economy is recovering from the historic downturn immediately following the outbreak of the new Coronavirus, the level of economic activity remains significantly below that at the beginning of the year.
- ◆ In terms of exports, China has not been seen as a strong driver of the global economy since the Lehman Brothers collapse. The pace of recovery in exports is expected to slow gradually as the new Coronavirus spreads, mainly in developed countries.
- ◆ On the other hand, in terms of domestic demand, although some companies are cautious about capital investment, the decline in capital investment did not occur as it did in the Lehman shock, supported by investment demand related to digitization and improvements implemented in management practices. The earnings environment is improving and capital investment is expected to pick up.
- ◆ While the new Coronavirus model has yet to see a resolution, self-restraint remains for the time being, and worsening employment and income conditions such as rising unemployment and declining bonuses will also weigh on personal consumption. Consumer spending is expected to remain below pre-coronavirus levels for a long time, as consumer stimulus measures such as the Go To campaign will not significantly boost macro-consumption.
- ◆ In light of the above, fiscal 2020 saw record negative growth of 5.2% due to the first quarter decline. Although positive growth is expected in fiscal 2021 (+ 3.4%) and fiscal 2022 (+ 1.7%), the pace of economic recovery is so slow that the recovery of GDP from its peak level prior to the outbreak of the Coronavirus pandemic is not expected until fiscal 2023.
- ◆ Under these economic forecasts, recovery from the economic downturn will not occur uniformly, and a "recovery gap" will remain due to differences in industry, company size and sales strategies. In the future, it will be essential to not only strengthen growth potential, but also take into account the "recovery gap." In formulating the 3rd supplementary budget for FY 2020, it is necessary to focus on the industries and fields that are significantly affected by the new Coronavirus and consider policies to support the "facilitation of labor mobility" and "business restructuring."

1. Current state of the economy

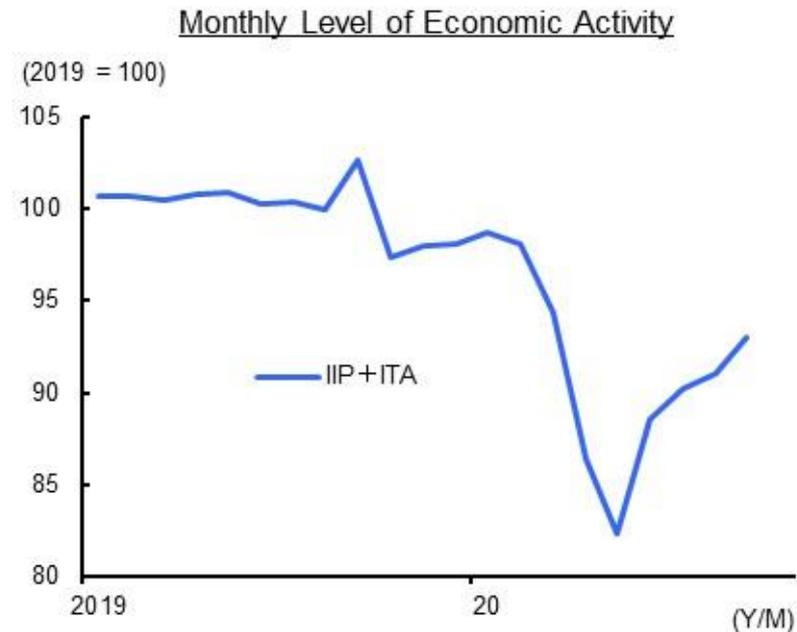
(1) Economic activity levels remained low

- Real GDP in the July-September quarter of 2020 recorded record positive growth that came as a reaction to the decline caused by the new Coronavirus.
- However, the overall pace of recovery has been slow. The current level of economic activity recovered only to 60% of the decline that occurred after the new Coronavirus outbreak.



Source: JRI, based on Cabinet Office

Note: Public demand = government consumption + public investment + public stock fluctuation.



Source: JRI, based on METI

1. Current state of the economy

(2) Sluggish domestic demand has become a heavy burden for economic recovery

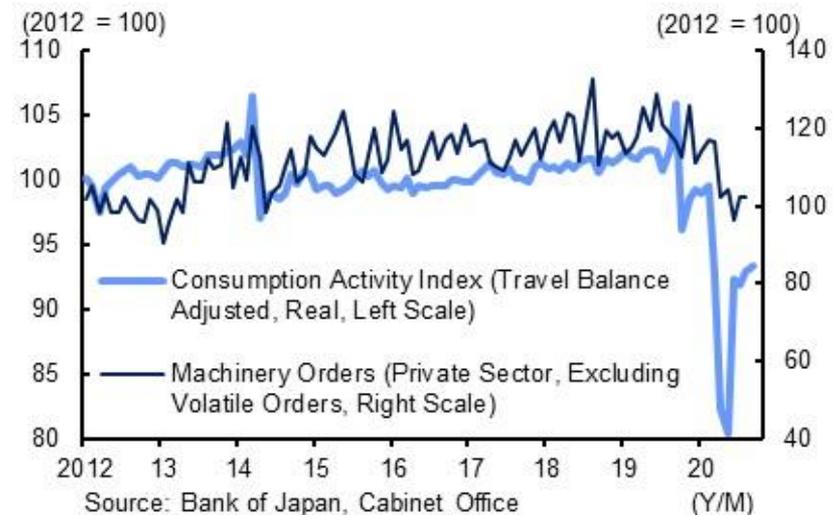
- In terms of demand, exports recovered to levels seen before the outbreak of the new Coronavirus. Production activity in the manufacturing sector is also recovering.
- On the other hand, companies are cautious about capital investment in domestic demand. Recovery in personal consumption has also peaked since the summer.
- The economic outlook for the future is as follows: "export" with a recovery ahead; "capital investment" with a stronger sense of stagnation; and "personal consumption".

Industrial Production and Export Volume



Source: JRI, based on METI and MOF

Private Consumption and Capital Investment

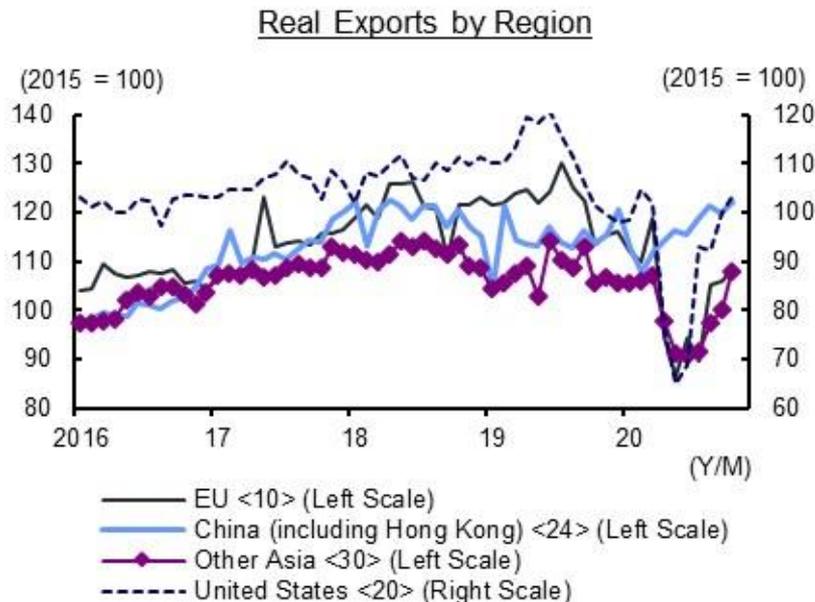


Source: Bank of Japan, Cabinet Office

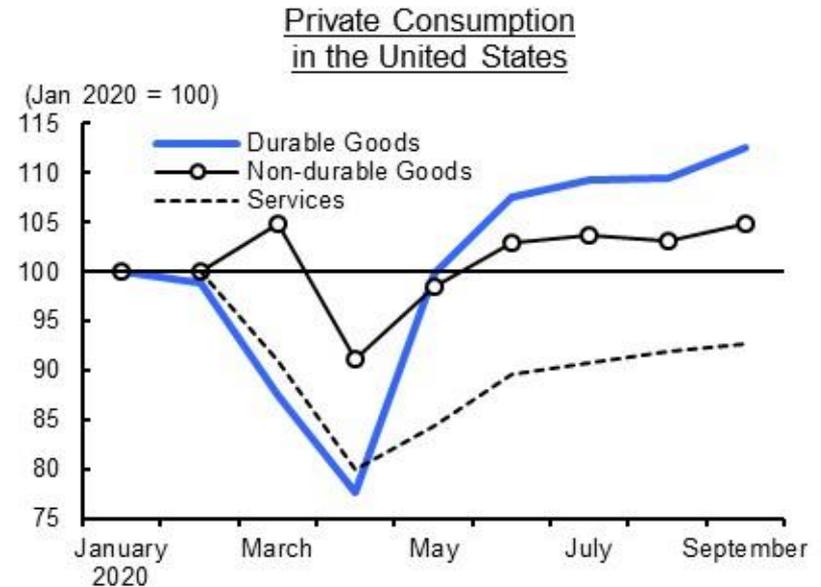
2. External demand

(1) Recovery in the Chinese economy and consumption of goods in developed countries

- It can be pointed out that the steady recovery of the Chinese economy is behind the recovery in exports. Exports to China started to pick up in March and have continued to increase since then. At present, levels are higher than before the new Coronavirus.
- In addition, rising consumption of goods, particularly in developed countries, contributed to the recovery of exports.



Source: JRI, based on the MOF and BOJ
 Note: <> is the nominal export share in 2019.



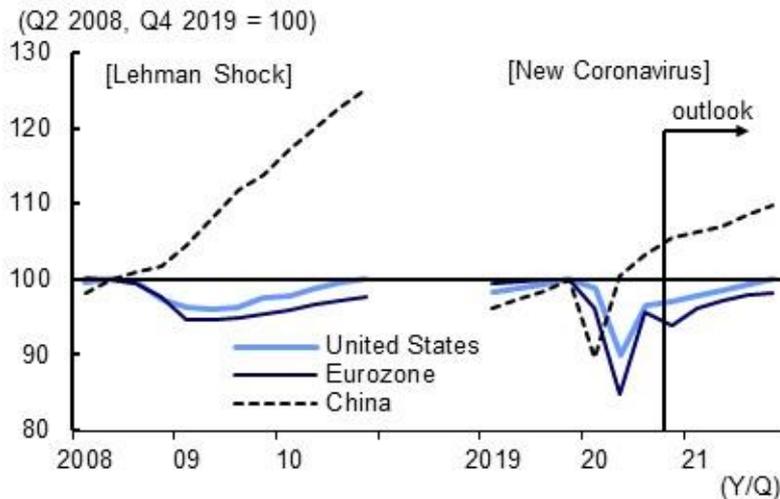
Source: JRI, based on U.S. Bureau of Economic Analysis

2. External demand

(2) Exports slow, and inbound demand remains at zero for the time being

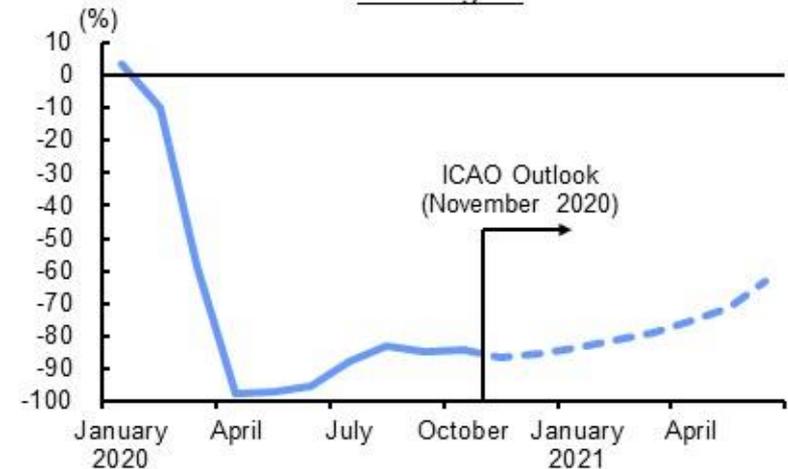
- But the pace of export growth is expected to slow gradually.
- In the wake of the Coronavirus Crisis, it is difficult to find a strong driving force for the global economy like China did after the Lehman Brothers collapse. The spread of the new Coronavirus, particularly in developed countries, is also a major factor in the recovery of exports.
- Inbound demand is expected to take some time to recover due to continued restrictions on the entry of tourists and sluggish global demand for tourism.

Real GDP of the United States, Eurozone, and China



Source: JRI, based on statistics from each country

Forecast of the Number of International Passengers



Source: JRI, based on ICAO

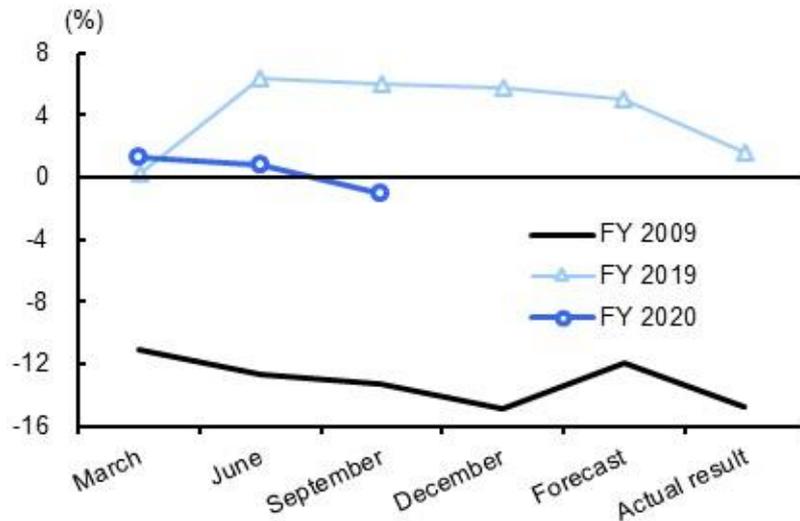
Note: Compared to the same month in 2019.

3. Capital investment

(1) Investment in digitization has been strong

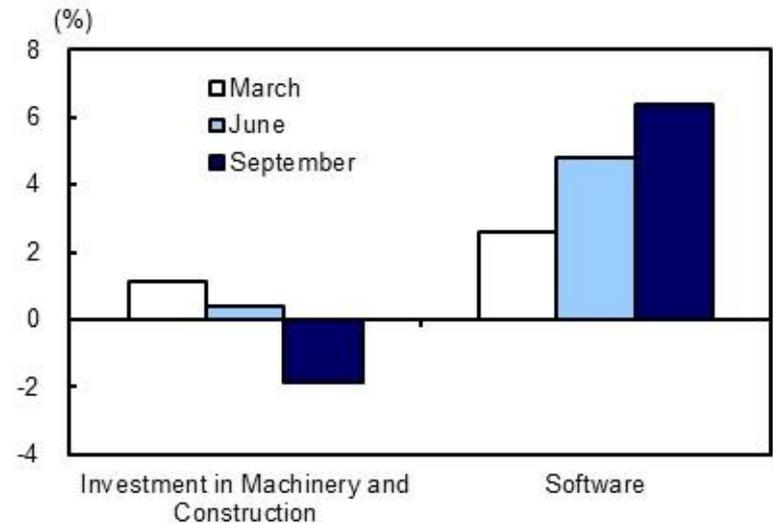
- Although companies have recently become cautious about investment, capital investment has not declined as much as during the Lehman shock.
- Strong demand for digital-related investment, reflecting the spread of remote work, underpinned capital investment.

Developments of Fixed Investment
(All Enterprises, year-on-year % change)



Source: Bank of Japan

Breakdown of FY 2020 Capital Investment Plan
(All Enterprises, year-on-year % change)

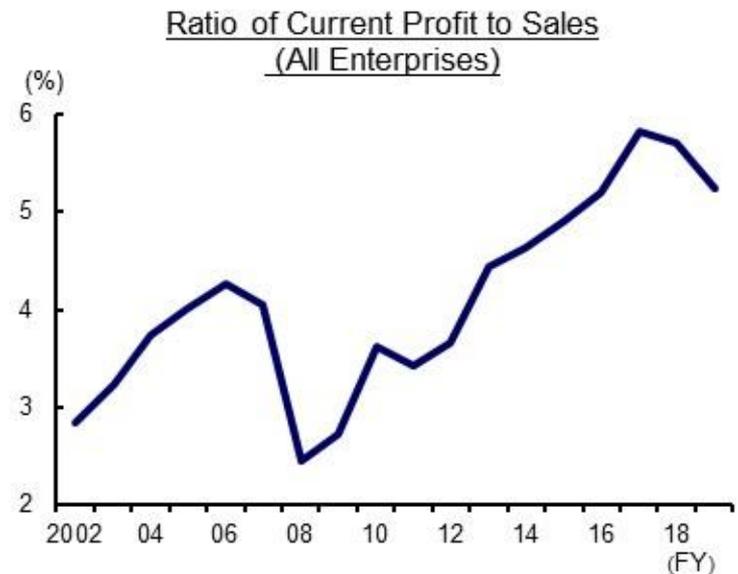
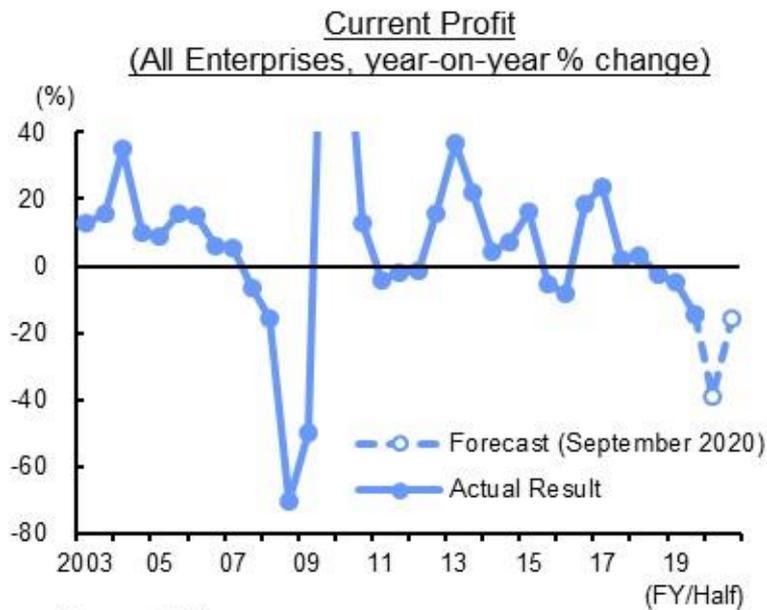


Source: JRI, based on BOJ

3. Capital investment

(2) Capital expenditures to rise in line with recovery in corporate profits

- Another reason why companies can maintain investment levels is that the decline in profits is smaller than during the Lehman shock.
- Since the collapse of Lehman Brothers, the company's management structure has improved, underpinning its earnings.
- Corporate earnings are improving and capital investment is expected to pick up.

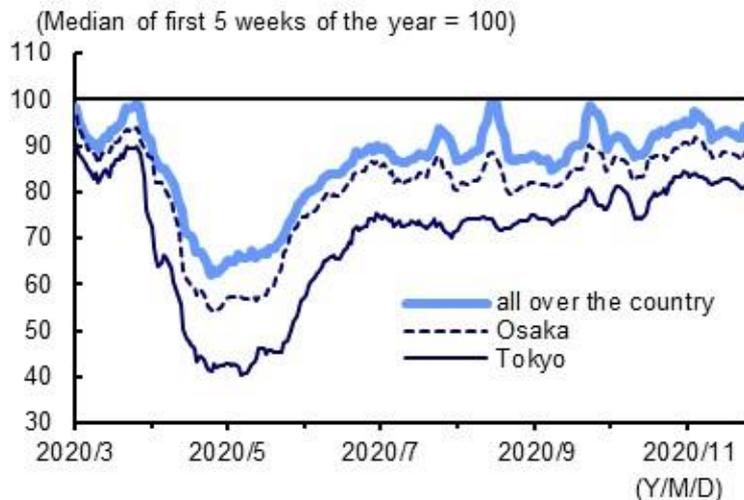


4. Private consumption

(1) The Mood of self-restraint will persist for the time being

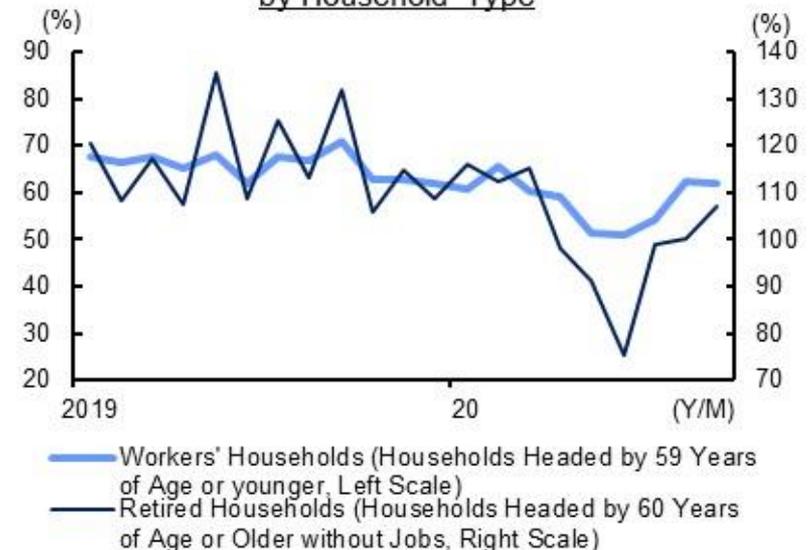
- Mainly in major metropolitan areas, where the number of people infected with the new Coronavirus is high, people continue to refrain from going out.
- It is clear that elderly people, who are at high risk of serious illness, are refraining from consumer activities.
- Vaccines are being developed, but it will take time to supply them to the public, so the mood with regard to self-restraint is expected to continue to depend on the number of infected people in 2021.

Mobility Trends for "Retail and Recreation"
(7-day Backward Moving Average)



Source: Google

Consumption Propensity
by Household Type

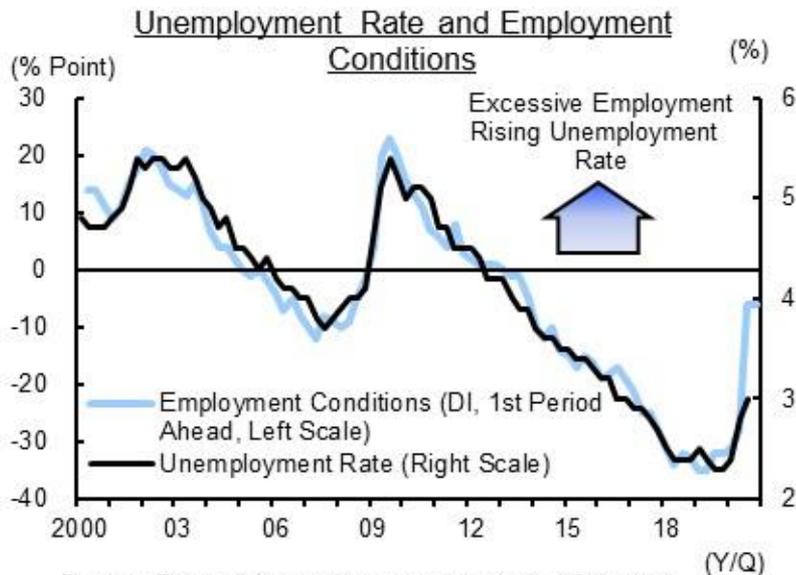


Source: JRI, based on MIC

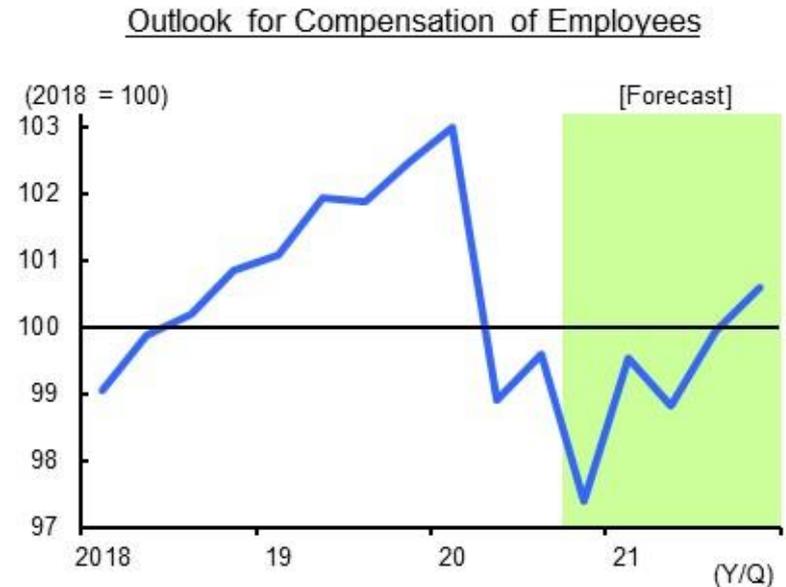
4. Private consumption

(2) Rising unemployment rate and falling wages down personal consumption

- Deterioration in employment and income conditions will become a major factor in the recovery of consumption.
- The unemployment rate is likely to rise to nearly 4% from the beginning of 2021. In terms of wages, downward pressure on wages, particularly bonuses, has continued.
- As a result, employers' pay will not be able to recover from the decline that occurred in the wake of the outbreak of the new Coronavirus.



Source: Bank of Japan, Ministry of Internal Affairs and Communications

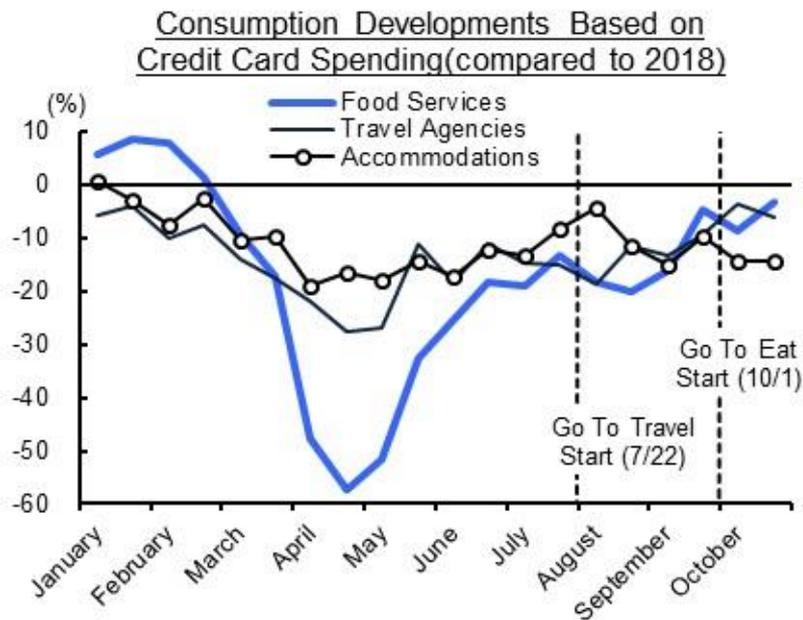


Source: JRI, based on the Cabinet Office

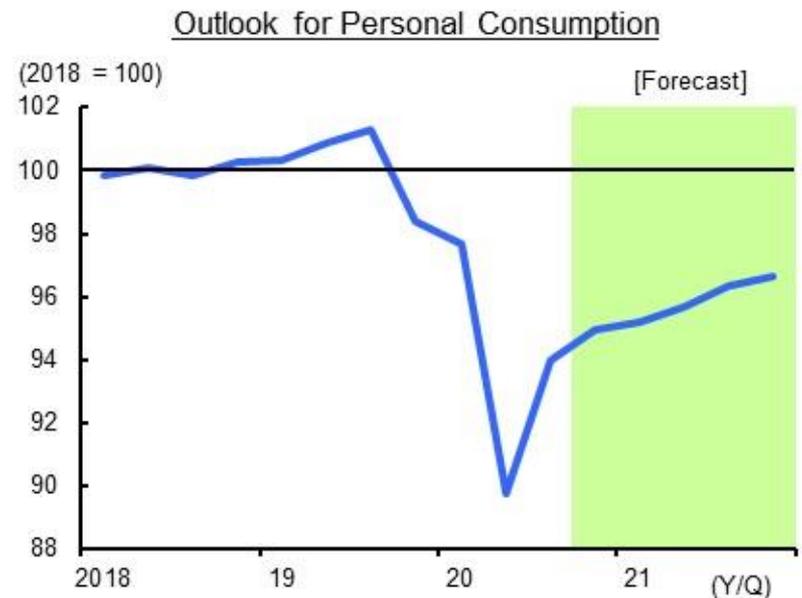
4. Private consumption

(3) Consumer spending is expected to remain sluggish for a long time

- The Go To campaign has so far had a limited impact on consumer spending. Given the persistent mood of self-restraint, simply extending or expanding existing policies may not boost macroeconomic personal consumption.
- As a result, consumer spending is expected to remain below pre-coronavirus levels for a long time.



Source: JCB Consumption NOW

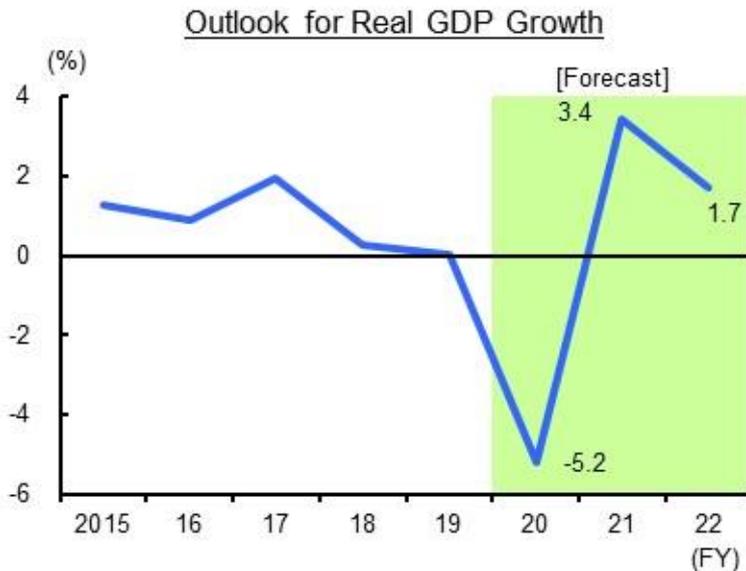


Source: JRI, based on Cabinet Office

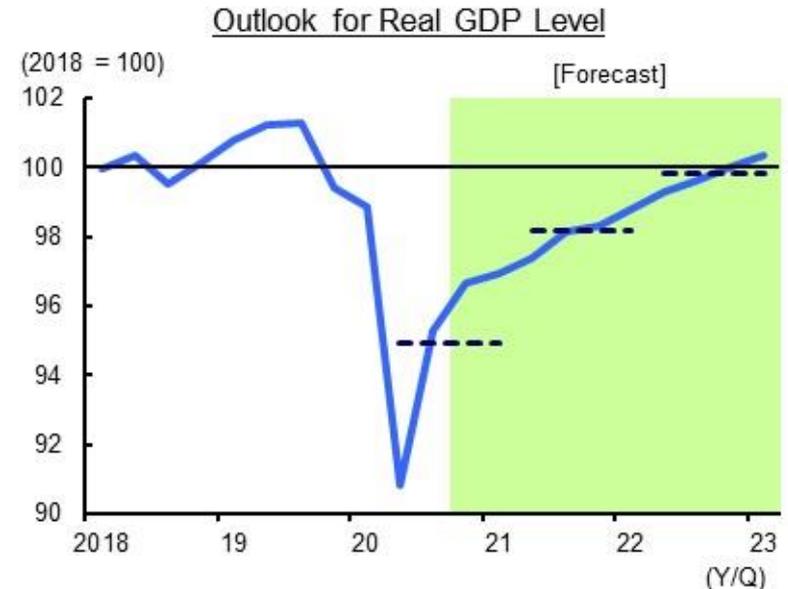
5. Outlook

(1) The pace of economic recovery remains moderate

- In fiscal 2020, the economy posted a record minus growth of 5.2%.
- Although the economy is expected to show positive growth in fiscal 2021 and 2022, the pace of recovery is so slow that the recovery of GDP from the peak level before the outbreak of the new corona is expected to be delayed until fiscal 2023.



Source: JRI, based on Cabinet Office



Source: JRI, based on Cabinet Office
 Note: The broken line shows the fiscal year average.

5. Outlook

(2) Outlook for Japan's economic growth and prices

	(seasonally adjusted, annualised % changes from the previous quarter)											(% changes from the previous fiscal year)		
	2020		2021				2022				2023	FY 2020	FY 2021	FY 2022
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Projection)	(Projection)	(Projection)
Real GDP	21.4	5.9	1.1	1.9	3.0	0.8	2.0	2.0	1.5	1.4	1.4	▲ 5.2	3.4	1.7
Private Consumption	20.1	4.2	1.0	2.2	2.9	1.2	2.0	2.0	1.6	1.6	1.4	▲ 6.0	3.3	1.8
Residential Investment	▲ 28.1	2.8	14.4	10.9	5.4	4.8	3.1	0.2	▲ 0.5	▲ 2.6	0.2	▲ 9.1	5.4	1.1
Capital Investment	-12.8	15.1	4.4	3.1	2.4	2.6	3.6	3.6	2.8	2.6	2.4	-6.0	3.5	3.0
Private Inventories (Degree of Contribution)	(-0.8)	(0.3)	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	(0.0)	(0.0)
Government Consumption	9.3	3.7	-3.5	1.1	3.8	-2.6	0.4	0.8	0.8	0.8	0.8	2.0	1.0	0.5
Public Investment	1.5	3.5	2.8	-3.4	-1.2	0.6	0.8	0.6	-1.8	-1.4	0.8	2.5	0.0	-0.2
Public Inventories (Degree of Contribution)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.0)	(0.0)	(0.0)
Export	31.3	29.5	11.8	2.3	5.1	3.2	3.9	3.9	3.6	3.4	3.0	-13.0	9.3	3.7
Import	-33.8	28.1	10.6	2.9	4.1	2.2	3.1	3.1	2.8	2.8	2.6	-5.8	4.4	2.9
Domestic Private Demand (Degree of Contribution)	(6.2)	(5.0)	(1.7)	(2.0)	(2.1)	(1.2)	(1.7)	(1.7)	(1.3)	(1.2)	(1.1)	(-4.4)	(2.5)	(1.5)
Public Demand (Degree of Contribution)	(2.1)	(1.0)	(-0.6)	(0.1)	(0.7)	(-0.5)	(0.1)	(0.2)	(0.1)	(0.1)	(0.2)	(0.5)	(0.2)	(0.1)
Net Exports (Degree of Contribution)	(12.2)	(0.4)	(0.3)	(-0.1)	(0.2)	(0.2)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(-1.2)	(0.8)	(0.1)

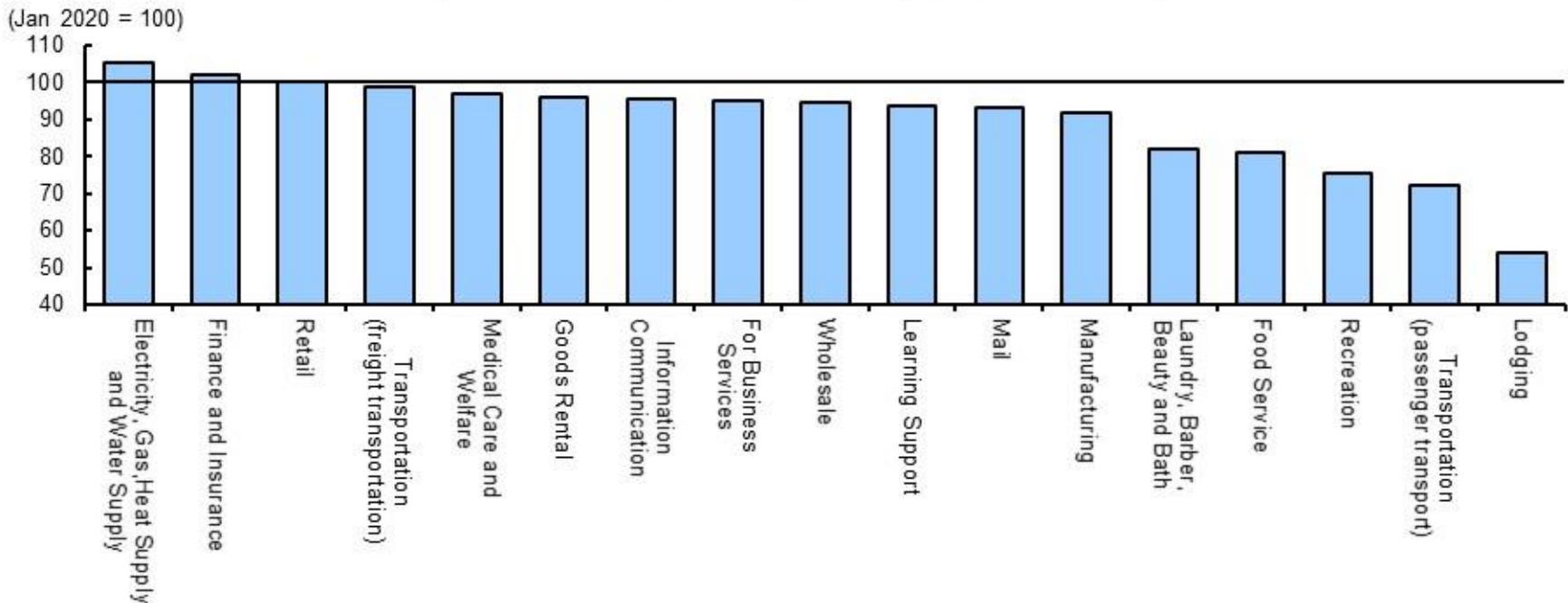
	(% changes from the same quarter of the previous year)											(% changes from the previous fiscal year)		
	2020	2021	2022	2023	FY 2020	FY 2021	FY 2022							
Nominal GDP	-4.8	-2.5	-1.6	7.3	2.6	1.7	1.9	2.0	2.0	2.1	2.2	-4.4	3.3	2.1
GDP Deflator	1.1	0.4	0.5	-0.1	-0.4	0.1	-0.1	0.1	0.4	0.4	0.5	0.8	-0.1	0.4
Consumer Price Index (Excluding Fresh Food)	-0.2	-1.2	-0.9	0.0	0.1	0.6	0.5	0.6	0.6	0.7	0.7	-0.6	0.3	0.6
(Excluding Fresh Food, Consumption Tax and Education Free of Charge)	-0.5	-1.2	-0.8	0.0	0.1	0.6	0.5	0.6	0.6	0.7	0.7	-0.7	0.3	0.6
Unemployment Rate (%)	3.0	3.4	3.8	3.8	3.6	3.4	3.3	3.2	3.1	3.0	2.9	3.2	3.5	3.1
Exchange Rates (JY/US\$)	106	104	105	105	106	106	106	106	106	107	107	106	105	106
Import Price of Crude Oil (US\$/barrel)	41	45	46	47	50	51	54	57	59	58	59	41	51	58

6. Recovery gap

(1) Industry

- Given the slow pace of economic recovery at the macro level, there is a strong possibility that there will be a recovery gap in the future.
- By industry, lifestyle-related services, entertainment and transportation (passenger transport), which saw a sharp drop in economic activity due to the new Corona, are expected to take some time to recover

Economic Activity Levels by Industry (September 2020)



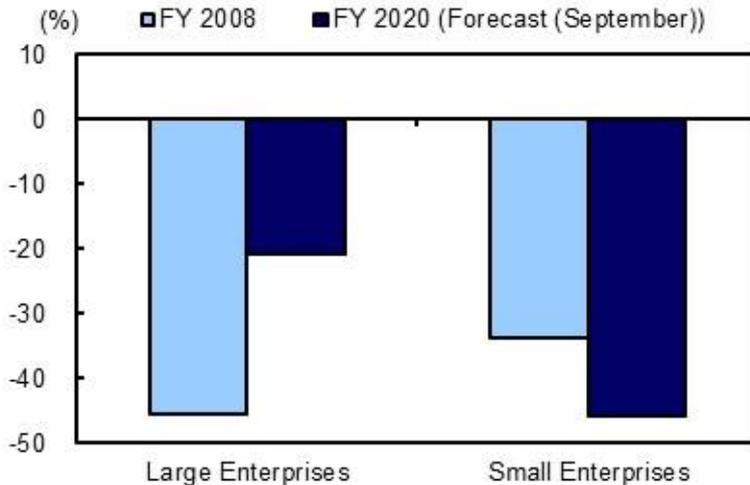
Source: JRI, based on METI

6. Recovery gap

(2) Corporate size 1

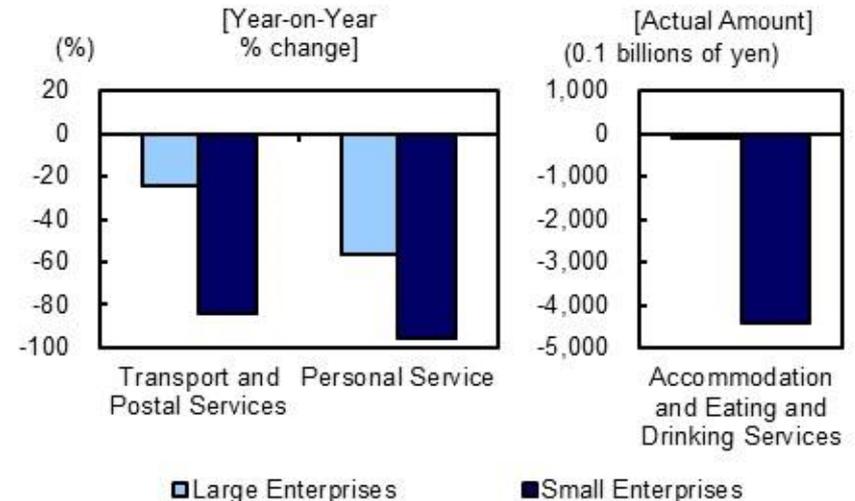
- In the wake of the Coronavirus Crisis, small and medium-sized firms' profits, in contrast to those of large firms, plunged more than during the Lehman shock.
- Small and midsize companies are also suffering from deteriorating earnings, particularly in the transportation, accommodation and restaurant industries, which are heavily affected by the new Coronavirus.

Current Profit by Enterprise size
(year-on-year % change)



Source: Bank of Japan

FY 2020 Current Profit (Forecast (September))

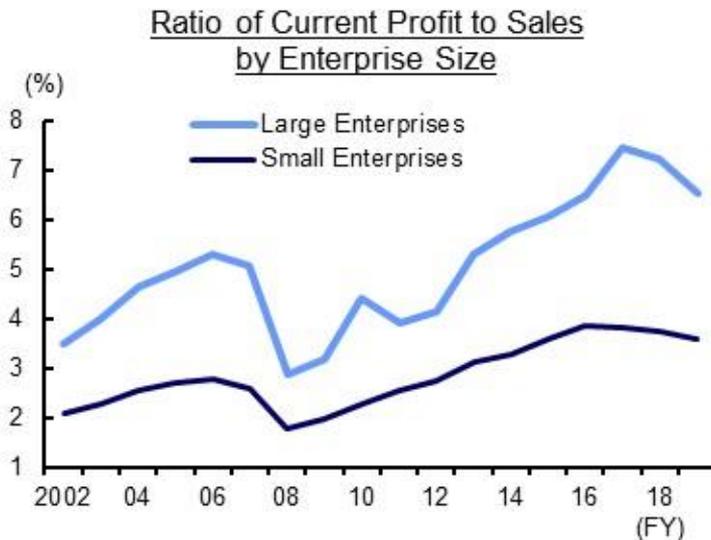


Source: Bank of Japan

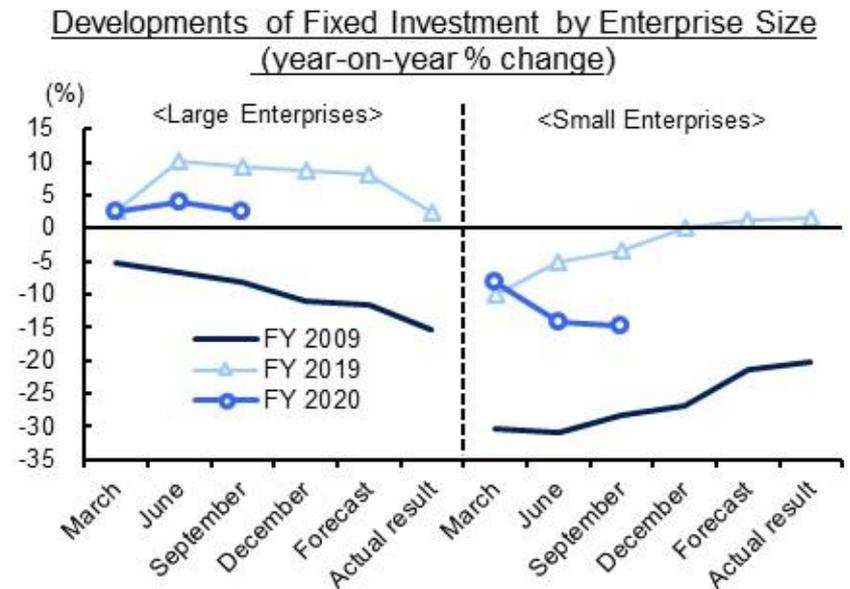
6. Recovery gap

(3) Corporate size 2

- Because small and midsize companies have lower profitability than large companies, falling sales will lead to lower profits.
- Small- and medium-sized companies have become more cautious about investing in plants and equipment due to deteriorating profits.



Source: Bank of Japan



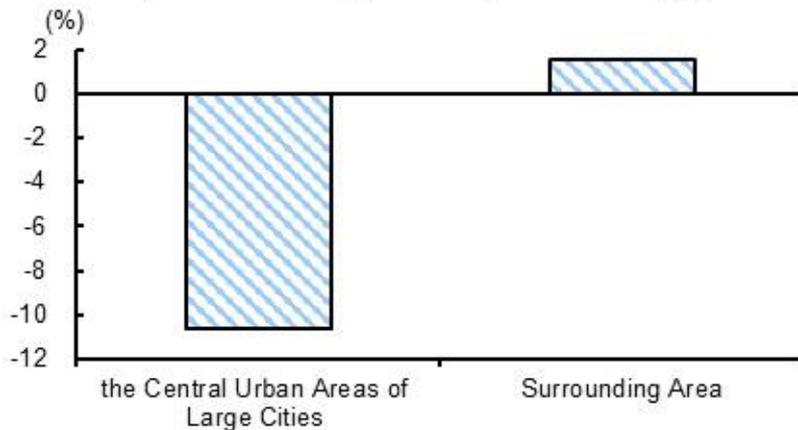
Source: Bank of Japan

6. Recovery gap

(4) Sales strategy

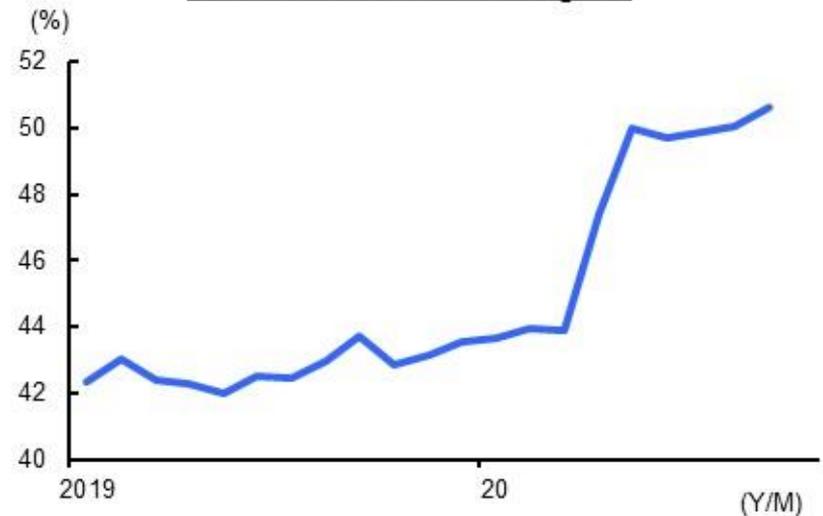
- Sales at stores in central Tokyo fell sharply as more people stayed in residential areas to promote telework and avoid crowds.
- Even after the declaration of a state of emergency was lifted, the shift from brick-and-mortar stores to online shopping continued.
- Even if the new coronavirus pandemic is resolved, this lifestyle and consumption behavior is likely to take root to a certain extent.

Sales of Shopping Centers by Location
(October 2020, year-on-year % change)



Source: Japan Shopping Center Association
 Note: The central urban areas of large cities have more than 150,000 people in a cluster of central urban areas. The surrounding areas consist of other areas.

Share of Households Using EC

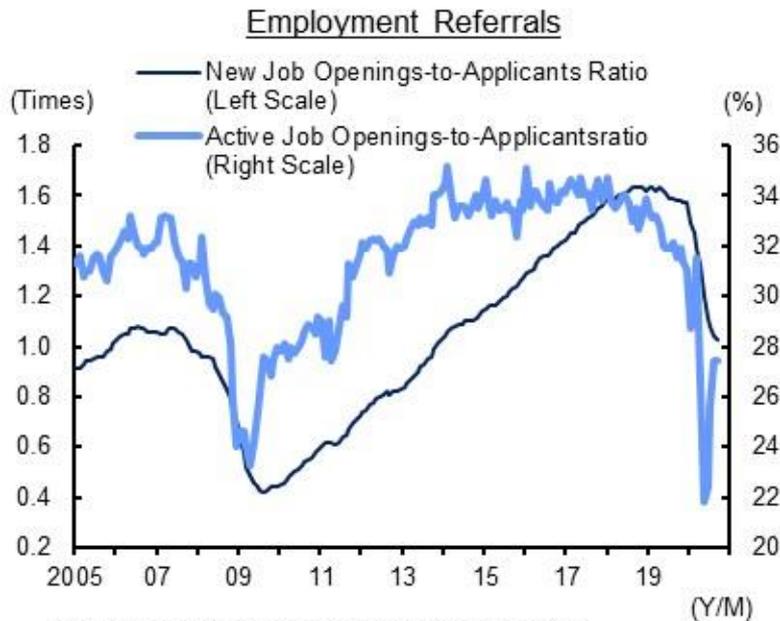


Source: JRI, based on MIC
 Note: a household is comprised of two or more people.

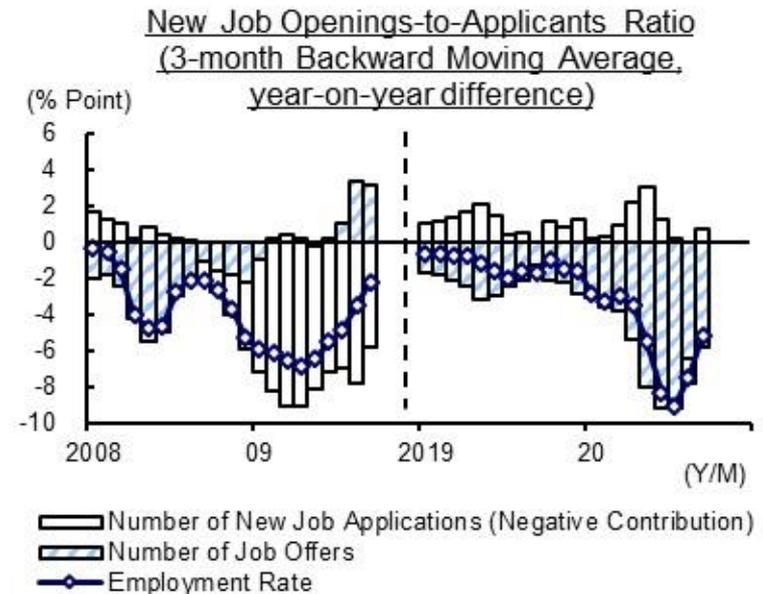
6. Recovery gap

(5) Households

- In the labor market, it has become difficult to find a new job after job losses due to mismatches in employment.
- In the Coronavirus Crisis, the number of job seekers has been limited due to concerns about the risk of infection, but the number of job seekers has decreased significantly, and there is a possibility that it has become more difficult to find new jobs than it was during the Lehman shock.



Source: Ministry of Health, Labour and Welfare



Source: JRI, based on MHLW

Policy responses focused on industries that are highly affected by the new coronavirus

- The weakness of the current economic recovery reflects a decline in the growth potential of the Japanese economy. In the wake of the Coronavirus Crisis, the government should reexamine the validity of its growth strategy and improve its effectiveness.
- Given the widening economic recovery gap in Japan, it is important to promote investment in growth areas such as digitalization and environment-related fields, not only to increase growth potential, but also to narrow the recovery gap.
- In the formulation of the FY 2020 3rd supplementary budget, it is necessary to consider policy support focusing on industries and fields that are highly affected by the new Coronavirus, rather than expanding the scale of existing measures.
- As for employment measures, it is important not only to implement policies to maintain employment, such as extending special measures for employment adjustment subsidies, but also to support "facilitation of labor mobility" such as employment support.
- In order to facilitate labor mobility, it is necessary to establish a system to match job openings and human resources between different industries and occupations. In the private sector, there have been cases in which job sites for the tourism industry and companies that introduce human resources for agriculture have collaborated to recruit human resources from the tourism industry, where the number of workers on leave is increasing, to agricultural producers, where it is difficult for technical intern trainees to come to Japan and labor shortages are becoming serious. Government support for these independent efforts by private companies is the key to solving these problems.
- While there is a strong sense of self-restraint, consumer stimulus measures such as flat-rate benefits and Go To campaigns are unlikely to boost personal consumption. For the recovery of consumption, it is urgent that consumers concerned about the risk of infection will "be safe to consume" by creating a system to visualize and check the measures taken by companies and stores against infection.
- For industries that are heavily affected by the new Coronavirus, it is essential to shift from financial support for the continuation of existing businesses to policies that support "business restructuring," such as changes in business types, corporate restructuring, and a review of sales strategies.
- The promotion of investment in digitization by SMEs should be actively supported not only to create demand but also to contribute to strengthening the growth potential of the Japanese economy by improving productivity.

This is a English version of “【日本経済見通し】回復格差が広がる日本経済 ～労働移動の円滑化と事業の再構築が急務～” in JRI Research Focus (The original version is available at <https://www.jri.co.jp/MediaLibrary/file/report/researchreport/pdf/12246.pdf>)

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