Monthly Report of Prospects for Japan's Economy

September 2020

Macro Economic Research Center

Economics Department

The Japan Research Institute, Limited

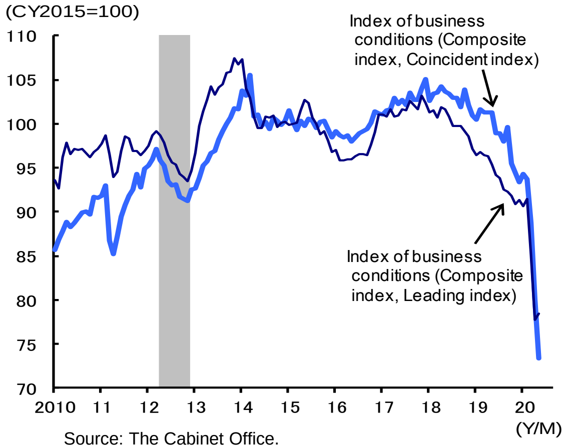
https://www.jri.co.jp/english/periodical/

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

The General Situation – The Economy Is Showing Signs of Bottoming out

Figure 1-1 Economic Activity

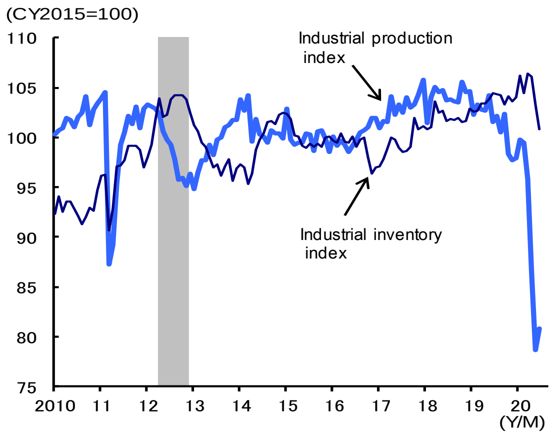
While the CI coincident index declined to its lowest level since July 2009, the CI leading index rose slightly.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

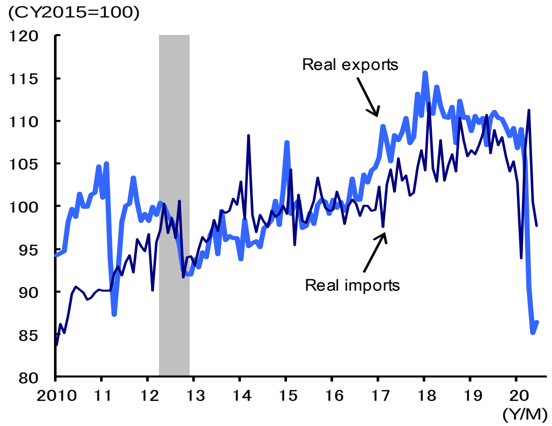
The industrial production index stopped declining mainly for automobiles and production machinery.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

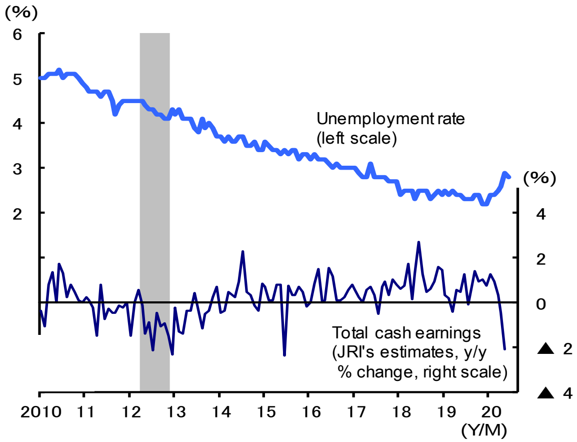
The decline in exports came to a halt primarily for transportation machinery. Imports saw decreases in crude oil and transportation machinery.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

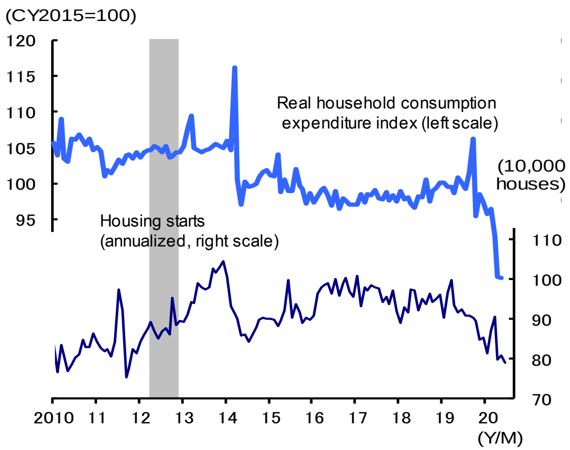
The unemployment rate rose to nearly 3%. Nominal wages declined mainly for non-scheduled salaries (overtime pay).



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

Figure 1-5 The Household Sector

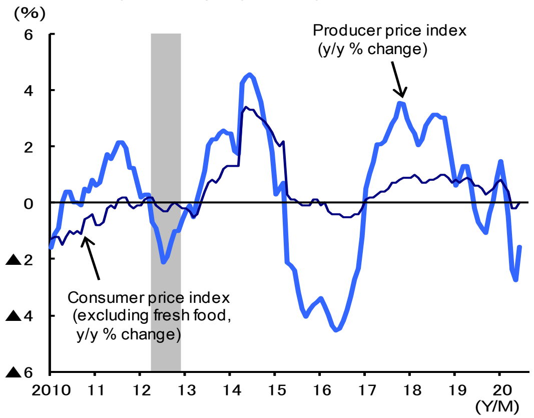
Real household consumption remained at a low level. Housing starts were sluggish.



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

Figure 1-6 Prices

The decline in producer prices for petroleum products diminished. Consumer prices remained virtually unchanged year-on-year.



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.

As Exports and Production Activity Bottomed out, Private Consumption Picked up

◆ The Decline in Exports Came to a Halt

Real exports in June rose slightly for the first time in three months. By region, exports to China, where economic activity is returning to normal, remained on a recovery trend, while those to Europe and the United States, which had been declining, showed signs of bottoming out, mainly for transportation machinery, in response to the resumption of economic activity.

◆ Industrial Production Stopped Declining

The industrial production index for June rose 1.9% from the previous month, recording a month-over-month increase for the first time in five months. By industry, production in the automobile industry saw a substantial increase as the disruption in the supply chain due to the spread of the novel coronavirus was resolved and exports stopped declining. The index also turned positive for the production machinery industry, among others.

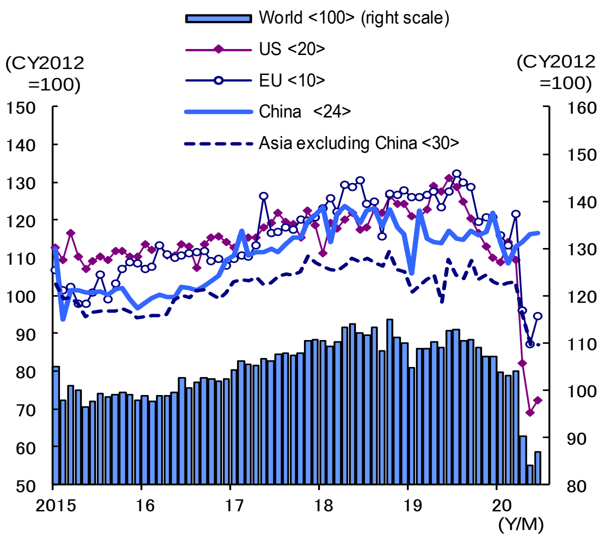
Looking at future production plans, industrial production is forecast to remain on a recovery path, up 11.3% month-over-month in July and up 3.4% month-over-month in August. However, given the moderate pace of recovery in exports, it is unclear whether production will rebound as vigorously as planned.

◆ Private Consumption Started to Pick up

The employment environment has deteriorated due to the impact of the novel coronavirus. The ratio of active job openings to applicants was 1.11 in June, declining for six consecutive months and recording its lowest level since October 2014. The unemployment rate also rose to nearly 3% in May and June.

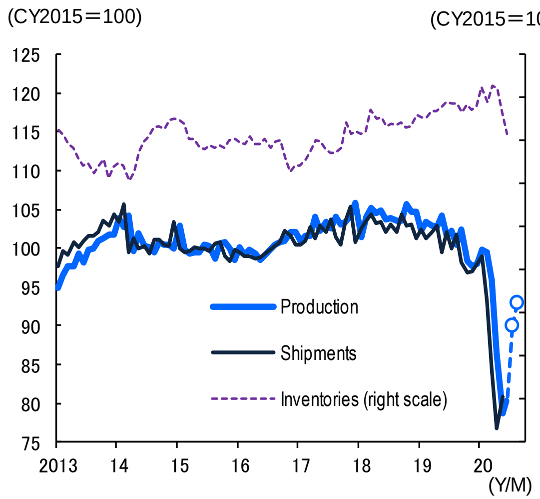
Meanwhile, there have been signs of recovery in household consumption activity on the back of the lifting of the state of emergency by the Japanese government. Retail sales in June fell 1.2% from a year earlier, showing a significantly improved year-on-year decline compared with the previous month (down 12.5% year-on-year). Due partly to the reaction to the self-restraint period (in other words, “revenge consumption”), sales of machinery and appliances retailers such as consumer electronics stores increased considerably.

Figure 2-1 Real Exports by Destination
<seasonally adjusted>



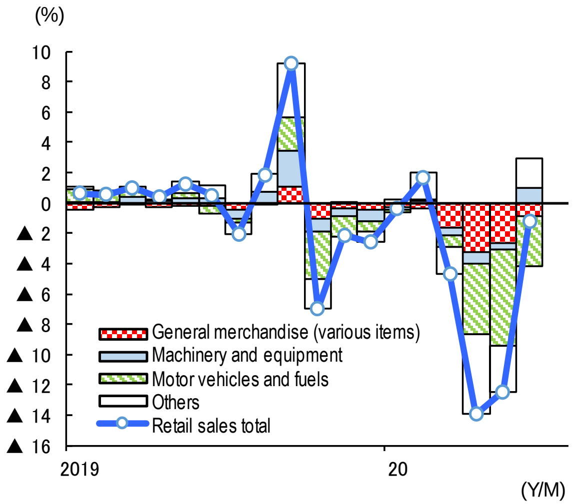
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angled brackets show the shares in total nominal exports in CY2019.

Figure 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 July and August 2020 based on the production forecast index.

Figure 2-3 Retail Sales by Item
<year-on-year % change>



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

The Decline in Goods Exports Has Come to a Halt, While Demand Related to Inbound Tourism Remains Virtually Nonexistent

◆ Goods Exports Have Picked up, Mainly for Transportation Machinery

Goods exports in June increased 3.3% from the previous month. By item, shipments of transportation machinery, which had continued to drop substantially, turned positive on the back of the recovery in global automobile sales, while there have been signs of bottoming out in exports of capital goods as well as electronic parts and devices.

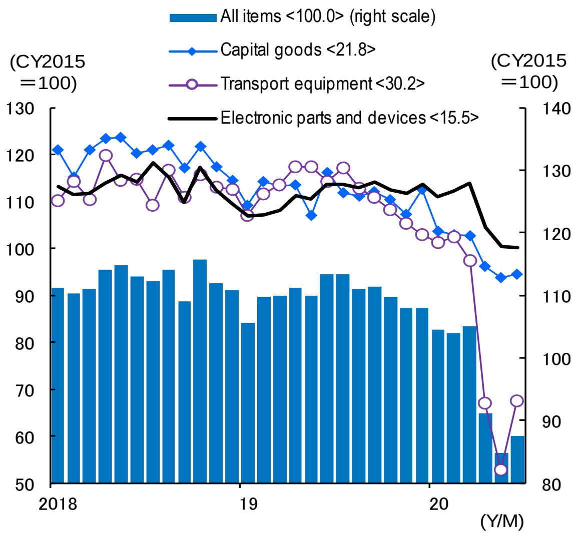
As for future prospects, exports are expected to remain on a recovery trajectory as the resumption of economic activity around the world exerts positive effects. However, as the global economic recovery is expected to remain slow due to the prolonged impact of the novel coronavirus, exports will unlikely return to the level seen before the coronavirus outbreak until 2022.

◆ Demand Related to Inbound Tourism Was Almost Zero

Amid restrictions on overseas travel around the world, the number of tourists that visited Japan in June fell 99.9% on a year-on-year basis.

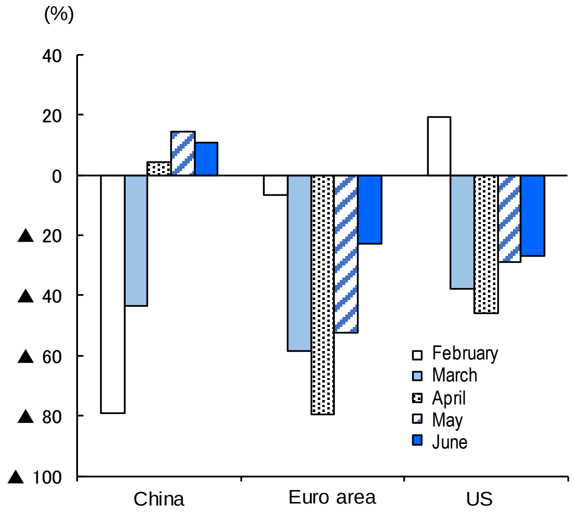
Although the Japanese government has started to ease immigration restrictions, demand related to inbound tourism is expected to remain virtually nonexistent, as the easing of restrictions will be limited to business trips for the time being. In addition, the pace of recovery is anticipated to be moderate, as people will likely continue to refrain from overseas travel due to concerns over infection risks even if the restrictions on tourists are relaxed. In fact, the International Civil Aviation Organization (ICAO) predicts that even based on a scenario in which the number of international passengers picks up after July, the number will only recover to one-fourth of the previous year's level in September and about 40% in December.

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



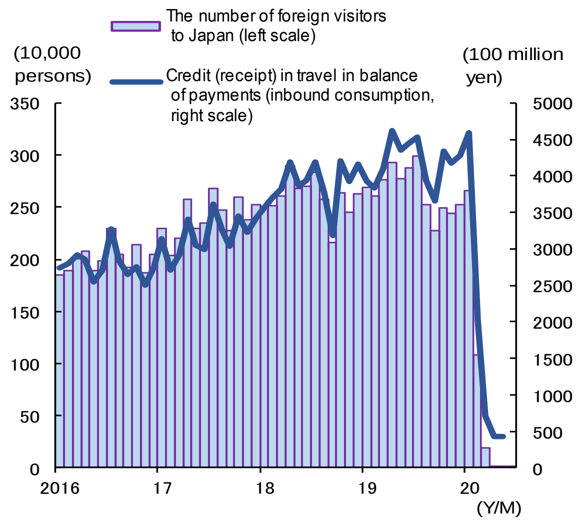
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angled brackets show the shares in total nominal exports in CY2019.

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).

Business Fixed Investment Has Declined as Corporate Earnings Deteriorate

◆ Current Profits for the April-June Period Halved from the Previous Year

Corporate activities in a wide range of industries have shrunk sharply. While the decline in the manufacturing sector has been limited compared to the time of the Lehman Brothers collapse, the decline in the retail services sector, including accommodations, food services, and entertainment industries, has been unprecedented due to Japanese people's self-restraint on outings. In the April-June period, current profits on an industry-wide basis were roughly halved from the previous year due to sluggish production activity.

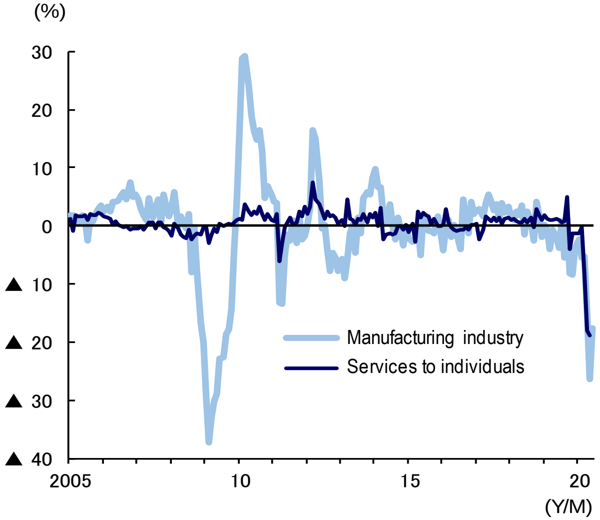
◆ Capital Investment Saw a Decline

Against the backdrop of rapid deterioration in the earnings environment, the corporate sector has become more cautious about investment. In fact, orders for machinery and construction works have decreased significantly.

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 reasons. First, looking at incentives behind capital investment by the corporate sector in recent years, investment has been mainly aimed at replacing aging facilities, developing new products and achieving product sophistication. The ratio of investment for capacity expansion has declined significantly, making the investment structure less susceptible to demand fluctuations.

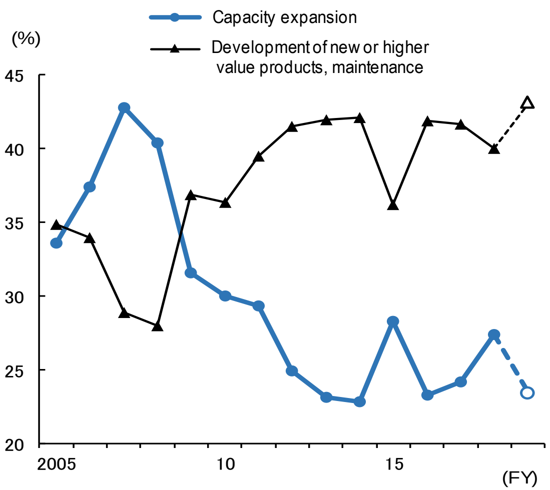
Furthermore, business fixed investment will likely be sustained by demand for IT-related investment. Looking at the latest investment plans, it appears that companies are increasing software investment. Specifically, demand for investment related to the development of the telework environment and factory automation has been on the rise from the perspective of controlling the risk of coronavirus infection and accelerating digitization.

Figure 4-1 Activity Index by Industry <year-on-year, % change>



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

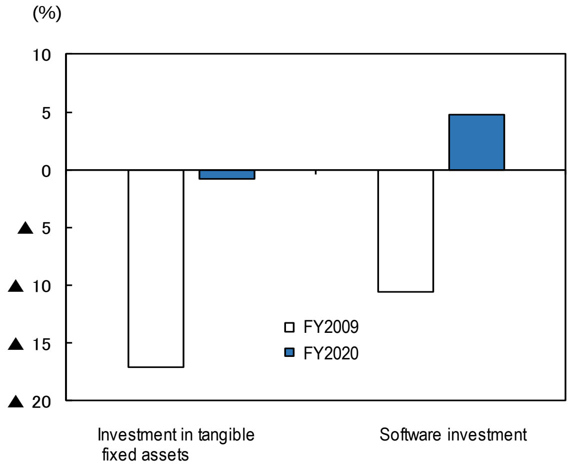
Figure 4-2 Ratio of Incentives behind Business Fixed Investment <large manufacturers>



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

Note: The figures for FY2019 are plans.

Figure 4-3 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.

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

◆ More Companies Will Likely Start Cutting Back on Employment in the Future

The employment environment continued to deteriorate. The ratio of active job openings to applicants was 1.11 in June, declining for six consecutive months and recording its lowest level since October 2014. The number of active job openings has decreased more than 20% compared to February when the outbreak of the novel coronavirus became serious, indicating a decline in the corporate appetite for hiring.

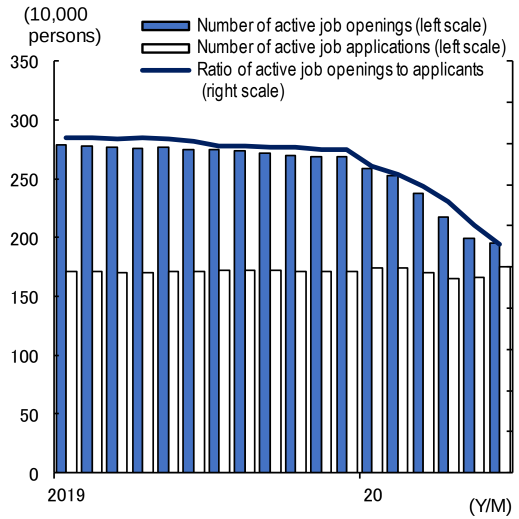
Meanwhile, looking at the number of workers in June, those on furlough declined considerably, leading to a smaller drop in the number of workers. This suggests that many employees on temporary leave or leaves of absence went back to their workplaces upon the resumption of economic activity following the lifting of the state of emergency.

Despite the foregoing, amid the prolonged decline in demand due to the impact of the novel coronavirus, more companies are expected to move toward cutting back on employment in the future. In fact, the sense of job shortages in the corporate sector has rapidly diminished. Looking at the employment condition DI (“excessive employment” – “insufficient employment”) in the BOJ Tankan Survey for June, the sense of “excessive job shortages” among enterprises decreased to its lowest level since the survey conducted in September 2013. Judging from the correlation with this index, the unemployment rate will likely rise to nearly 4% at least, its highest level since 2013, by the end of the year.

◆ The Total Cash Earnings Saw a Decline

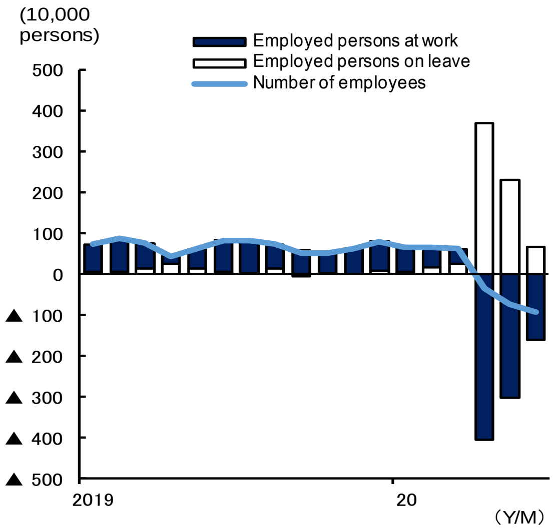
The novel coronavirus has also had ripple effects on wages. Total cash earnings in May plunged 2.1% year-on-year. Against the backdrop of a decline in overtime due to sluggish economic activity, non-scheduled salaries (overtime pay) declined significantly. As the corporate earnings environment has also deteriorated considerably, downward pressure on special salaries and scheduled salaries is anticipated to increase going forward.

Figure 5-1 Ratio of Active Job Openings to Applicants <seasonally adjusted>



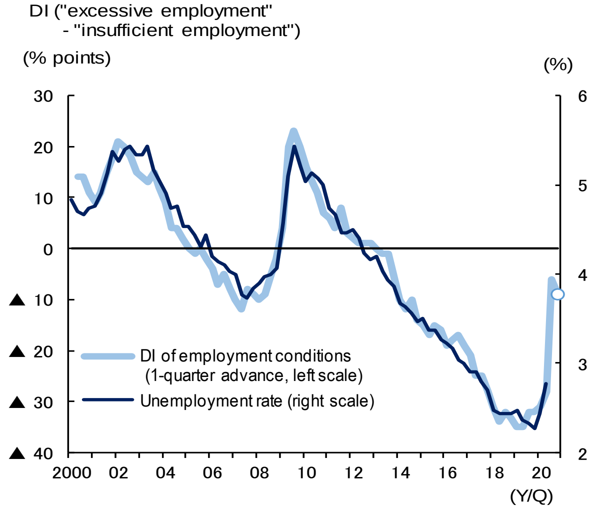
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Health, Labor and Welfare.

Figure 5-2 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 5-3 Tankan DI of Employment Conditions and Unemployment Rate



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

Note: The latest figure of the DI is a forecast.

Rebound in Private Consumption Will Be Limited

◆ Consumption Has Picked up

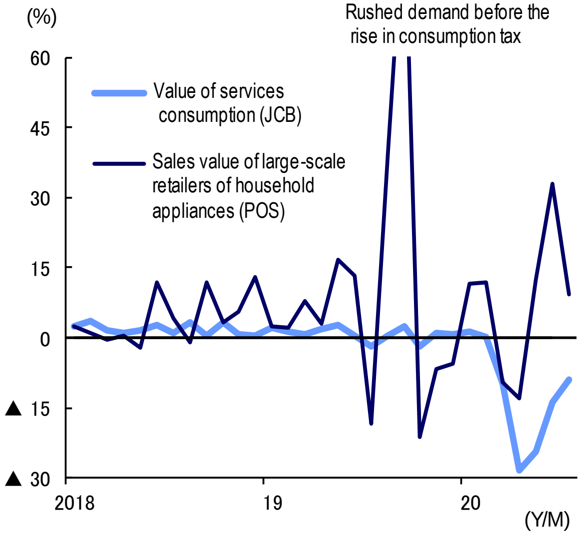
Consumer spending is picking up on the back of the easing of restrictions on outings following the lifting of the state of emergency. In particular, the recovery in home appliance sales has been remarkable. While pent-up demand subsequent to the self-restraint period has run its course, consumption remained on a rising trend even in July. Meanwhile, the year-on-year decline in services consumption diminished to around minus 10% year-on-year.

However, the pace of recovery in personal consumption is expected to remain moderate. As the number of new coronavirus cases started to increase once again, people continued to refrain from going out to a certain extent. As a result, the number of people at retail and entertainment facilities is still only about 90% of that before the outbreak of the novel coronavirus. The consumer confidence index rose only slightly in July, indicating that the improvement in consumer sentiment is limited. Against this backdrop, personal consumption in the July-September period is expected to recover to only about 50% of the decline seen in the April-June period.

◆ Housing Investment Is Expected to Continue Declining

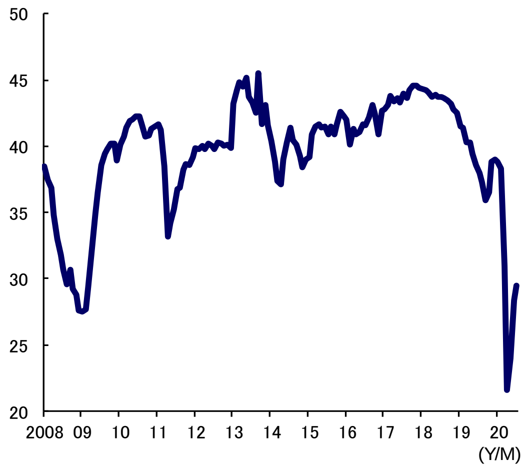
The environment surrounding the housing market has remained harsh due to voluntary restraint on outings and the worsening employment and income environment. In fact, the housing DI in the Economy Watchers Survey for June rose for the second consecutive month, but remained at a low level. Taking into account the correlation between the index and the number of housing starts, the number of housing starts is expected to drop to around 600,000-700,000 on an annualized basis in the second half of the year, mainly for owner-occupied houses and built-for-sale houses.

Figure 6-1 Private Consumption Activities
<year-on-year % change>



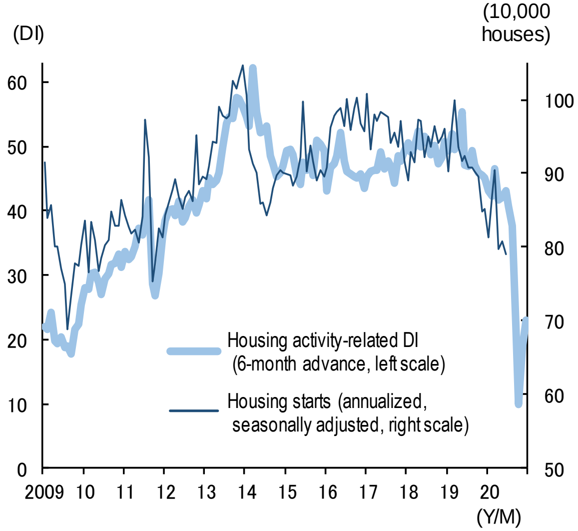
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry, JCB Consumption NOW.

Figure 6-2 Consumer Confidence Index
<seasonally adjusted>



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

Figure 6-3 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 Number of Bankruptcies in Fiscal 2020 Will Increase by 30-40%

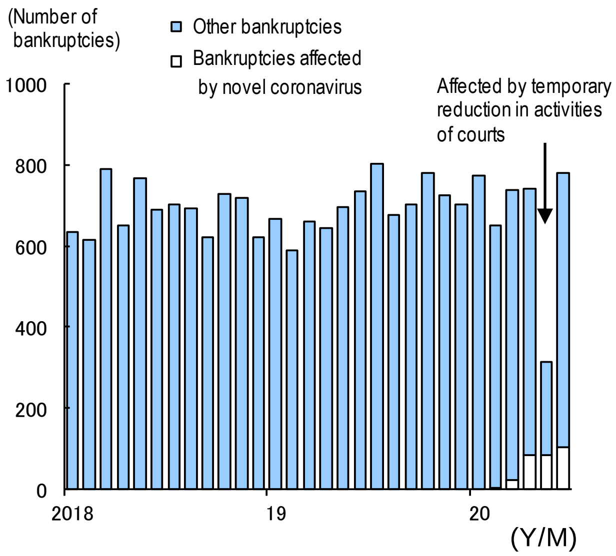
◆ Funding Support Measures Curb Bankruptcies at This Stage

Although the economy deteriorated rapidly due to the impact of the novel coronavirus, the number of bankruptcies has been limited to 700-800 a month, about the same as the same period in the previous year. The main reason for this was the government's large-scale funding support for companies affected by the pandemic. The government has been strengthening funding assistance, including real interest-free, unsecured loans provided by private financial institutions through subsidies for the credit guarantee system, in addition to offering a "special loan for novel coronavirus infection" and a "capital-type subordinated loan to combat the novel coronavirus" for SMEs which are provided by government financial institutions. Recently, the outstanding amount of loans by Japan Finance Corporation (JFC) increased sharply, and the amount of loans provided by private financial institutions has also been rising at an accelerated pace, indicating that companies have been propped up financially by the government's funding support measures.

◆ The Number of Bankruptcies Will Increase in the Future

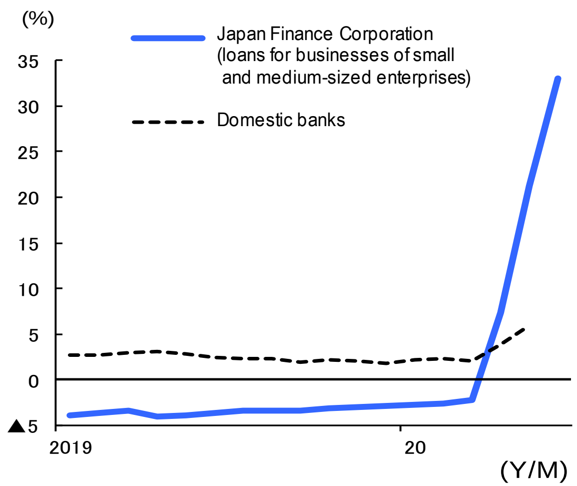
However, the government's funding support measures are largely designed to deal with temporary declines in sales, and if the impact of the novel coronavirus is prolonged, the number of bankruptcies will inevitably increase. Based on the correlation with the ratio of ordinary profits to sales, the number of bankruptcies in fiscal 2020 is expected to increase ultimately by 30-40% from the previous year, the highest level in about 10 years. By industry, the number of bankruptcies is expected to increase sharply due to worsening cash flow in the accommodation and food services industries, where sales have fallen sharply and the ratio of cash and deposits to fixed costs is low

Figure 7-1 Number of Bankruptcies



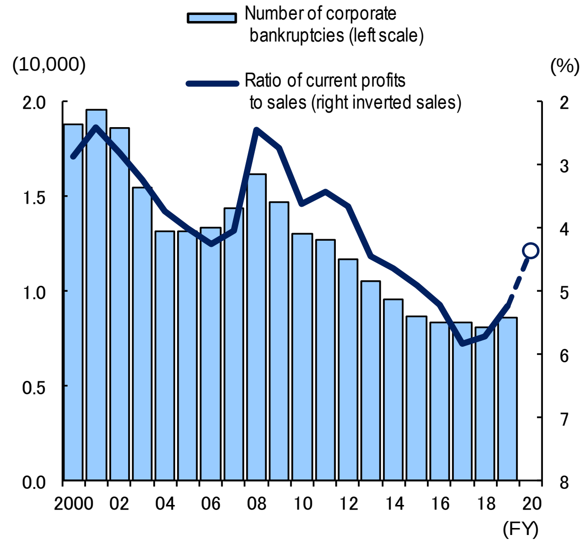
Source: The Japan Research Institute, Ltd. based on data of Tokyo Shoko Research, Ltd.

Figure 7-2 Outstanding Amount of Loans by Lender
< year-on-year % change>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, Japan Finance Corporation.
Note: Domestic banks excluding The Bank of Japan and government financial institutions.

Figure 7-3 Corporate Bankruptcies and Ratio of Current Profits to Sales



Source: The Japan Research Institute, Ltd. based on data of Tokyo Shoko Research, Ltd., The Bank of Japan.
Note: The figure of the ratio for FY2020 is a forecast based on Tankan June 2020 survey.

Prospects for Japan's Economy - Projected Real GDP Change; -5.4% for FY2020 and 3.4% for FY2021

◆ Japan Will See a Negative Growth Rate of Minus 5.4% for FY2020 and Will Not Return to Its Pre-coronavirus Growth Level Until After 2022

(1) Japan’s real GDP for the April–June 2020 period declined 27.8% on an annualized quarter-on-quarter basis (down 7.8% from the preceding quarter), surpassing the decline which occurred immediately after the collapse of Lehman Brothers. Although the decline was smaller than that in the United States and European countries for the same period, it is clear that the Japanese economy has fallen sharply due to the impact of COVID-19. By demand item, personal consumption recorded the biggest statistical drop following the declaration of a state of emergency by the government. Japan's exports have also fallen sharply, indicating that severe restrictions imposed by other countries have depressed the Japanese economy through trade transactions.

(2) Looking ahead, the level of economic activity since summer has been recovering due to the lifting of the state of emergency, and the growth rate in the July–September period is likely to be positive, with an annualized growth rate of over 10% expected. However, the pace of the economic recovery is expected to remain moderate as the number of new coronavirus cases started to increase once again, recovering around 40% of the decline in GDP in the first half of the year.

(3) By demand item, trade activities related to exports will likely take time 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 wave of coronavirus.

(4) Meanwhile, in terms of domestic demand, the recovery of personal consumption is expected to be hampered by deteriorating employment and income conditions, on top of the lingering tendency toward self-restraint. The unemployment rate is likely to rise to close to 4% at least by the end of the year, as companies are increasingly feeling employment surpluses due to the effects of declining demand. It is projected that personal consumption will remain below the level before the outbreak of COVID-19 for a long period of time, as downward pressure on wages, especially winter bonuses, is expected to intensify in light of deteriorating corporate earnings.

(5) Due to the foregoing, Japan will likely see negative growth for FY2020 at a rate of minus 5.4%. While the growth rate for FY2021 is expected to turn positive at +3.4%, the pace of recovery will be slow, and it is forecast that economic activity will not recover to the level before the outbreak of COVID-19 until after 2022.

◆ The Decline in Prices Has Diminished

(6) The year-over-year decline in the core CPI change rate diminished in June. Prices of durable household goods rose sharply due to pent-up demand subsequent to the voluntary restraint period. In addition, downward pressure from falling energy prices also decreased.

As for the future outlook, the fall in crude oil prices this spring will have delayed ripple effects on energy prices, and downward pressure on prices from the viewpoint of supply and demand will likely intensify. Consequently, the decline in core CPI is expected to expand once again toward year-end.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of August 17, 2020)

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

	CY2020				CY2021				CY2022			
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	FY2019	FY2020	FY2021
	(Actual)	(Actual)	(Projection)		(Projection)				(Projection)	(Actual)	(Projection)	(Projection)
Real GDP	▲ 2.5	▲ 27.8	14.9	8.8	3.6	1.1	2.5	▲ 0.2	0.9	0.0	▲ 5.4	3.4
Private Consumption Expenditure	▲ 3.1	▲ 28.9	17.4	7.6	3.4	1.0	1.9	0.4	1.0	▲ 0.6	▲ 6.0	3.3
Housing Investment	▲ 15.8	▲ 0.8	▲ 26.8	▲ 15.5	28.2	16.1	7.4	6.9	4.2	0.5	▲ 10.2	7.1
Business Fixed Investment	7.0	▲ 5.8	▲ 10.2	13.0	3.7	2.3	2.3	1.8	1.8	▲ 0.3	▲ 2.7	2.9
Private Inventories (percentage points contribution)	(▲ 0.3)	(▲ 0.2)	(0.2)	(0.3)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.1)	(▲ 0.1)	(0.0)
Government Consumption Expenditure	0.1	▲ 1.0	3.9	2.5	0.0	0.2	3.5	▲ 2.3	0.4	2.3	1.2	1.0
Public Investment	▲ 1.8	4.7	2.8	4.9	▲ 1.0	▲ 2.1	▲ 0.4	0.6	0.8	3.3	2.5	0.0
Net Exports (percentage points contribution)	(▲ 0.9)	(▲ 10.8)	(6.2)	(2.1)	(0.8)	(▲ 0.1)	(0.2)	(▲ 0.4)	(▲ 0.1)	(▲ 0.2)	(▲ 1.6)	(0.7)
Exports of Goods and Services	▲ 19.9	▲ 56.0	26.2	23.7	17.2	9.5	6.1	▲ 0.2	2.0	▲ 2.6	▲ 15.2	10.9
Imports of Goods and Services	▲ 15.6	▲ 2.1	▲ 16.2	8.9	12.1	9.8	4.7	2.4	2.8	▲ 1.5	▲ 6.1	6.0
(Ref.) Domestic Private Demand (percentage points contribution)	(▲ 1.5)	(▲ 19.1)	(6.9)	(6.1)	(3.1)	(1.3)	(1.6)	(0.7)	(1.0)	(▲ 0.4)	(▲ 4.1)	(2.5)
(Ref.) Public Demand (percentage points contribution)	(▲ 0.0)	(▲ 0.0)	(1.0)	(0.8)	(▲ 0.1)	(▲ 0.1)	(0.7)	(▲ 0.5)	(0.1)	(0.6)	(0.4)	(0.2)

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

Nominal GDP	▲ 1.0	▲ 8.5	▲ 6.3	▲ 3.2	▲ 1.8	6.3	3.7	1.7	1.2	0.8	▲ 4.9	3.2
GDP deflator	0.9	1.5	0.7	0.0	▲ 0.2	▲ 0.8	▲ 0.3	0.0	0.1	0.8	0.5	▲ 0.2
Consumer Price Index (excluding fresh food)	0.6	▲ 0.1	0.1	▲ 0.8	▲ 0.7	0.1	0.0	0.7	0.6	0.6	▲ 0.4	0.3
(excluding fresh food, consumption tax, education free of charge)	0.2	▲ 0.4	▲ 0.2	▲ 0.7	▲ 0.6	0.1	0.0	0.7	0.6	0.4	▲ 0.5	0.3
Unemployment Rate (%)	2.4	2.8	3.4	3.8	3.9	3.7	3.5	3.4	3.3	2.3	3.5	3.5
Exchange Rates (JY/US$)	109	108	106	106	107	108	108	108	108	109	107	108
Import Price of Crude Oil (US$/barrel)	68	31	46	49	50	51	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.