

Monthly Report of Prospects for Japan's Economy

December 2020

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

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

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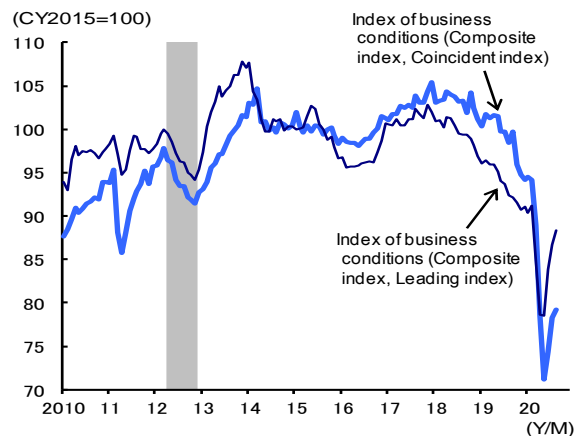
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The General Situation – Signs of Economic Recovery Have Been Seen

Figure 1-1 Economic Activity

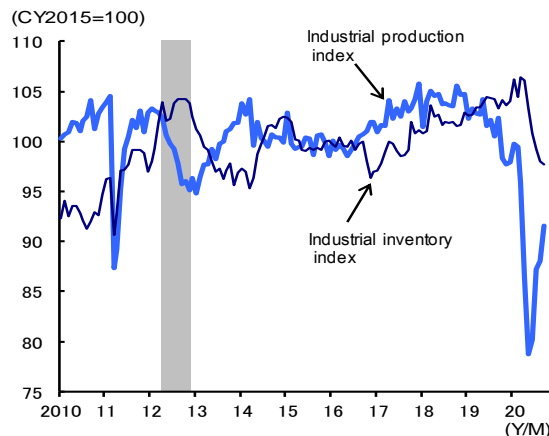
Indices of business conditions continued to rise both in terms of the CI coincident index and the CI leading index.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

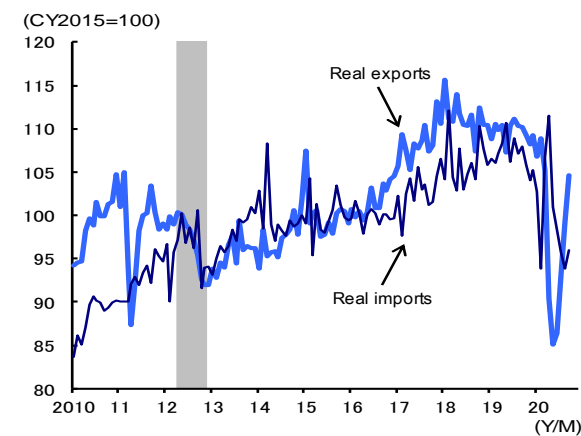
The industrial production index saw a rise in a wide range of industries, particularly automobiles.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

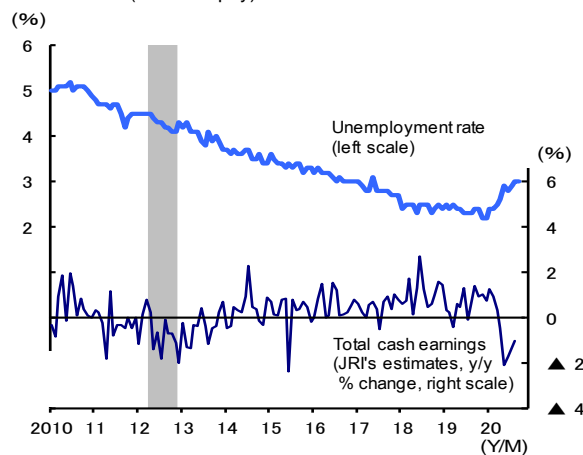
Exports increased, mainly those to the United States. Imports remained at a low level amid sluggish economic activities.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate was in the 3% range. Nominal wages declined mainly for non-scheduled salaries (overtime pay).

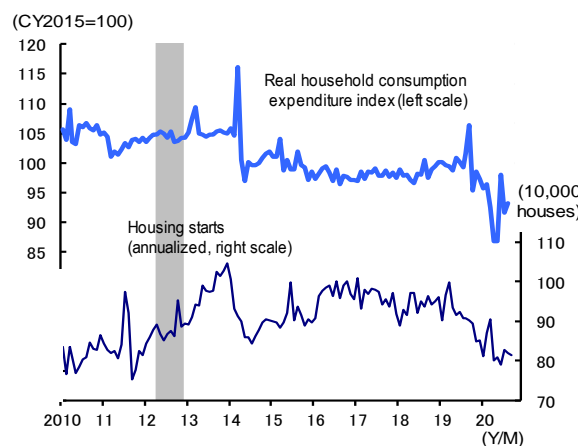


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

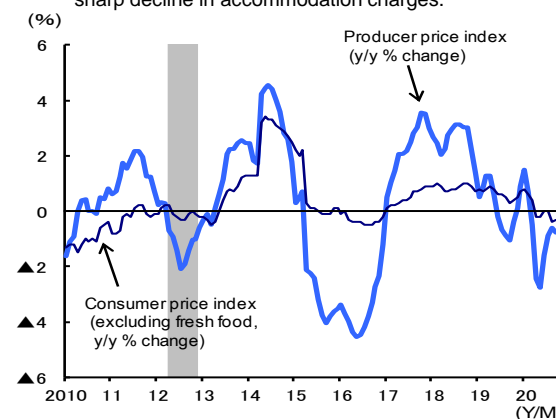
Stagnant service expenditure has been weighing on real household consumption. Housing starts were sluggish.



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

Figure 1-6 Prices

Producer prices declined, mainly for petroleum and coal products. Consumer prices were sluggish, reflecting a sharp decline in accommodation charges.



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

While Overseas Demand Continued to Pick up, the Recovery of Household Demand Has Been Limited

◆ External Demand Continued to Pick up

Real exports in September rose 4.2% from the previous month, up for the fourth consecutive month and recovering around 80% of the decline since April. By region, while shipments to the United States increased significantly by 11.8% month-over-month mainly for transportation machinery and electronic parts and devices, shipments to EU also continued to pick up.

◆ The Industrial Production Index Rebounded Moderately

In response to the increase in exports, corporate production activities remained on a recovery trend. The industrial production index for September rose 3.9% from the previous month, up for the fourth consecutive month. Automobile production continued to increase against the backdrop of the recovery of demand both in Japan and overseas, while production of production machinery, and electrical and information and communication machinery also rose. Looking at future production

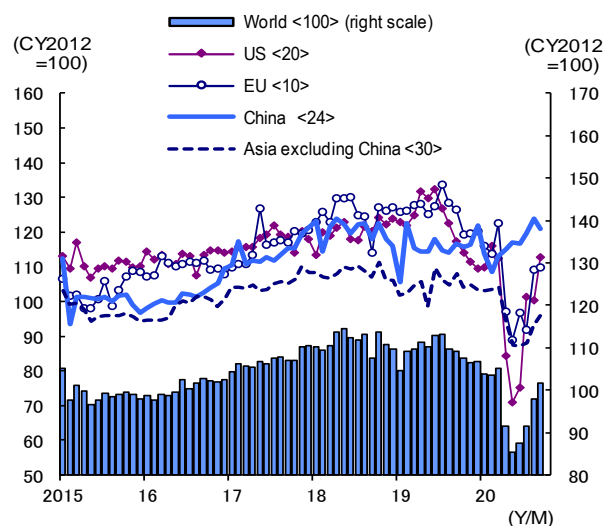
plans, industrial production is forecast to remain on a recovery path, up 4.5% month-over-month in October and up 1.2% month-over-month in November.

◆ Employment Environment Deteriorated, and Recovery of Consumption Stalled

Employment conditions continued to deteriorate. The ratio of active job openings to applicants was 1.03 in September, down for nine straight months and remained at the lowest level since December 2013. The unemployment rate was 3.0% in August and September, up 0.6% points from the beginning of this year.

Recovery of personal consumption also remained at a standstill. The month-over-month increase in the real consumption activity index was only 1.1% in August, remaining at a level approximately 10% below that prior to the outbreak of the novel coronavirus. The high number of new coronavirus cases as well as the tendency toward self-restraint have been weighing on the recovery of service consumption.

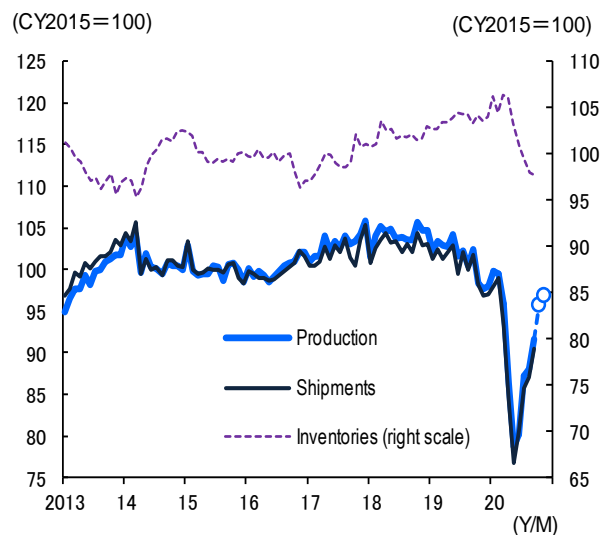
Figure 2-1 Real Exports by Destination
<seasonally adjusted>



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.

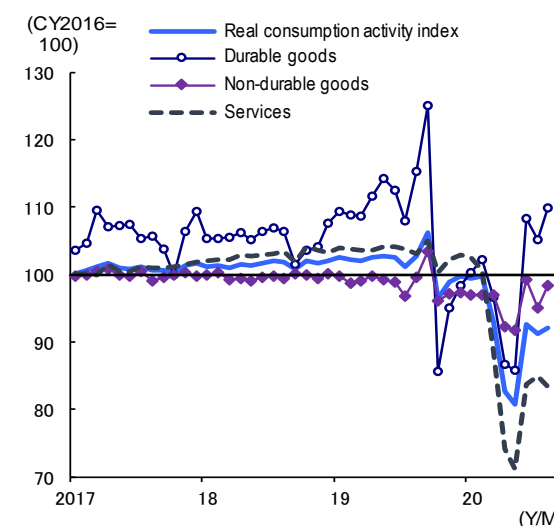
Figure 2-2 Industrial Production Index
<seasonally adjusted>



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 October and November 2020 based on the production forecast index.

Figure 2-3 Real Consumption Activity Index
<seasonally adjusted>



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

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Exports of Goods Remained on a Recovery Path, While Demand Related to Inbound Tourism Continued to Be Virtually Nonexistent

◆ Goods Exports Have Picked up, Mainly for Transportation Machinery

Goods exports in September increased month-over-month for the fourth consecutive month. By item, shipments of transportation machinery continued to recover sharply on the back of a recovery in global automobile sales, while those of electronic parts and devices remained on a rising trend.

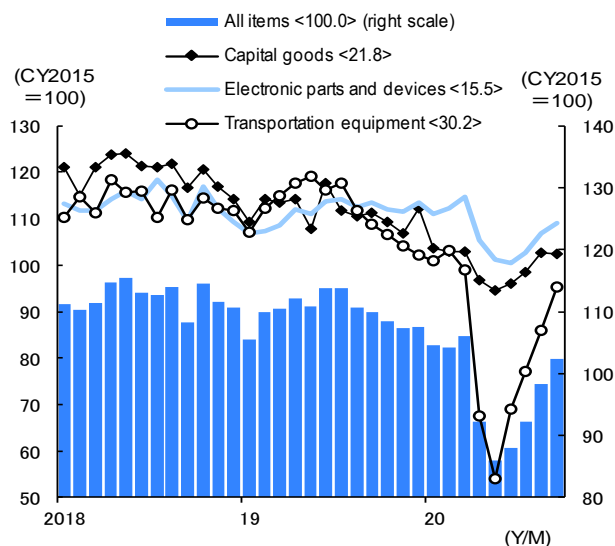
As for future prospects, exports are expected to remain on a recovery trajectory as goods exports have moved out of the worst period in line with the resumption of economic activity around the world. In fact, looking at the Bank of Japan's September 2020 Tankan Survey, companies assume that overseas supply and demand conditions for products will further improve mainly in transportation machinery and other industries. Having said that, as it is hard to predict when the global outbreak of the novel coronavirus will be contained, with the number of new cases started to increase rapidly in Europe and the United States once again, the pace of recovery of exports on the whole is likely to slow down considerably going forward.

◆ Demand Related to Inbound Tourism Was Almost Zero

Amid restrictions on overseas travel around the world, the number of tourists that visited Japan in September fell 99.4% on a year-on-year basis.

While the Japanese government has been easing immigration restrictions by permitting the entry of business travelers and international students from around the world since October, it will not allow tourists to enter the country for the time being. Therefore, demand related to inbound tourism is expected to remain virtually nonexistent even after this autumn. 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) revised downward its forecast of the number of international passengers as the number of new coronavirus cases started to increase in Europe and the United States once again, predicting that the number of international passengers will only recover to around 30% of the level prior to the outbreak of the novel coronavirus even in March 2021.

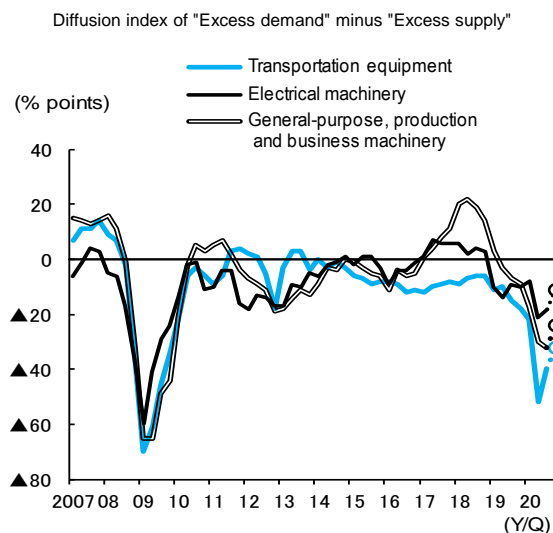
Figure 3-1 Real Exports by Item
<seasonally adjusted>



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.

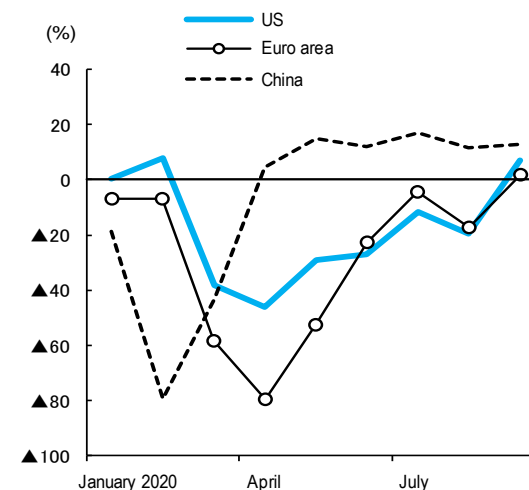
Figure 3-2 Overseas Supply and Demand Conditions for Products
<large enterprises>



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

Note: The latest figures are forecasts.

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



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

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Business Fixed Investment Has Declined as Corporate Earnings Deteriorate

◆ Corporate Earnings Recorded their Biggest Ever Drop

In the April-June period, sales on an industry-wide basis fell 10.7% from the previous quarter, recording their biggest ever drop since statistics were first recorded. Sales in both manufacturing and nonmanufacturing industries declined substantially due to a sharp drop in domestic and overseas demand caused by the global outbreak of the novel coronavirus. Meanwhile, current profits on an industry-wide basis were down 29.7% from the previous quarter, falling for the fifth consecutive quarter. Industries including food services, accommodation, living-related and entertainment services, and transportation services, all of which had been hit hard by consumers' voluntary restraint on outings, have fallen into the red.

Corporate earnings for the July-September period and after are expected to remain at a level below before the outbreak of the novel coronavirus, despite the recovery trend on the back of the easing of restrictions on business activities both in Japan and overseas. By industry, the pace of recovery will be more moderate in the nonmanufacturing industry where the impact of measures to avoid the spread of the

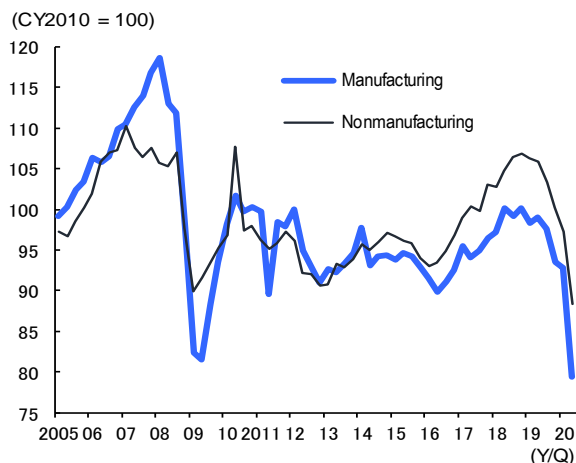
virus, such as loss of demand related to inbound tourism and avoidance of the "Three Cs (closed spaces, crowded places and close contacts)," is unavoidable.

◆ Business Fixed Investment Fell Again

The corporate sector has become more cautious about investment due to the deterioration of earnings. In the April-June period, capital investment on an industry-wide basis fell 6.7% from the previous quarter, recording its first decline in two quarters. However, as capital investment was partly underpinned by investment aimed at preventing the spread of coronavirus infection, such as investment related to teleworking, the decline has been smaller than when the Lehman Brothers collapse occurred.

As for future prospects, business fixed investment is expected to recover moderately, though lagging the recovery in corporate earnings, although the prolonged impact of the coronavirus pandemic will likely continue to weigh on the recovery. In fact, machinery orders, a leading indicator of capital investment, have recently bottomed out, and orders for construction work have picked up.

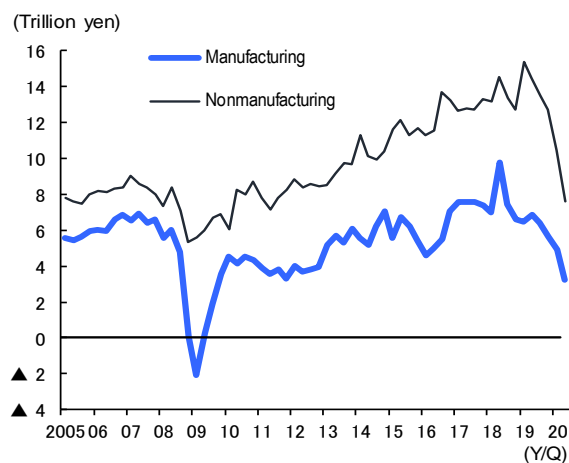
Figure 4-1 Sales Value of Japanese Corporations by Type
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note: All industries except for financial services and insurance.

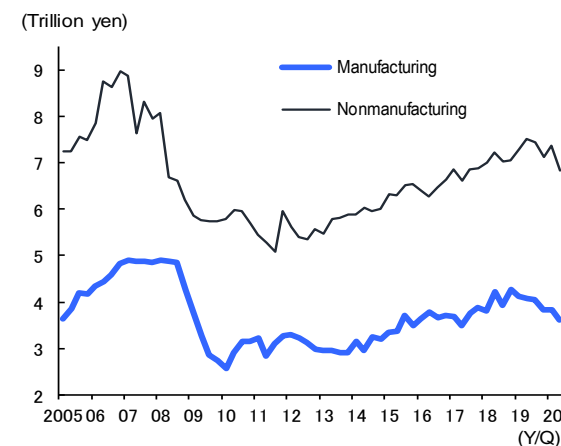
Figure 4-2 Current Profits of Japanese Corporations by Type
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note: All industries except for financial services and insurance.

Figure 4-3 Business Fixed Investment of Japanese Corporations by Type
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note: 1. All industries except for financial services and insurance.

2. Excluding software investment.

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The Unemployment Rate Is Expected to Rise to Nearly 4% in the Future

◆ The Sense of an Excessive Workforce Among Enterprises Has Remained at a High Level

The ratio of active job openings to applicants was 1.03 in September, down for the nine consecutive months since the beginning of the year and reaching its lowest level since December 2013. Looking at the breakdown, the opening to applicant breakdown showed that the number of active job openings dropped 20% in the same period, while the number of job seekers increased for five months in a row since May. Non-regular workers who lost their jobs in the wake of the outbreak of the novel coronavirus recently resumed their job-hunting activities, contributing to the decline in the ratio of active job openings to applicants.

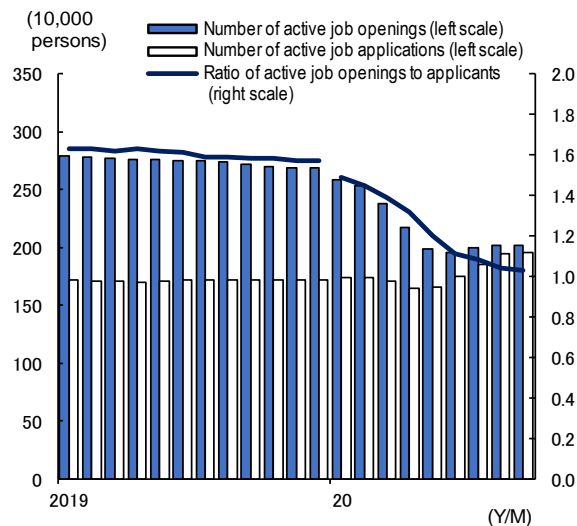
Meanwhile, the number of workers in September decreased 1.3% on a year-on-year basis, but the corporate sector's move to cut back on employment has been rather restrained. As a result, the sense of an excessive workforce among

enterprises has remained at a high level. The employment conditions DI (all enterprises, all industries) in the BOJ September 2020 Tankan Survey was -6 percentage points, remaining at its highest level since September 2013 as in the previous survey. Judging from the correlation with the DI, the unemployment rate will likely rise to nearly 4% between the end of the year and the beginning of next year.

◆ Total Cash Earnings Saw a Decline

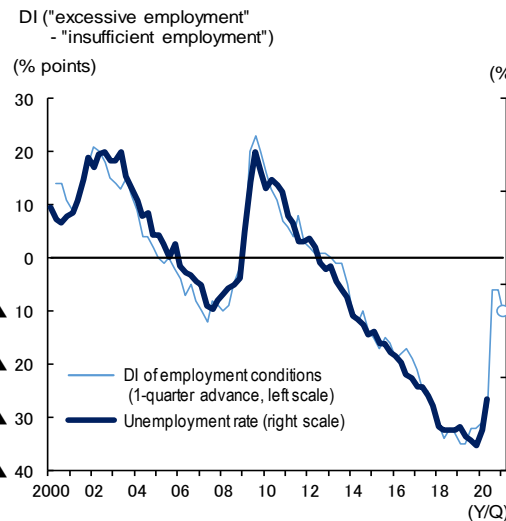
The novel coronavirus has also had ripple effects on wages. Total cash earnings in August plunged 1.0% year-on-year, recording a year-on-year decline for the fifth consecutive month. Against the backdrop of a decline in overtime due to sluggish economic activity, non-scheduled salaries (overtime pay) declined significantly. As for future prospects, it is anticipated that special salaries, mainly winter bonuses, will decrease, and that downward pressure on scheduled salaries will increase going forward. As a result, the fall in wages is expected to accelerate once again.

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.

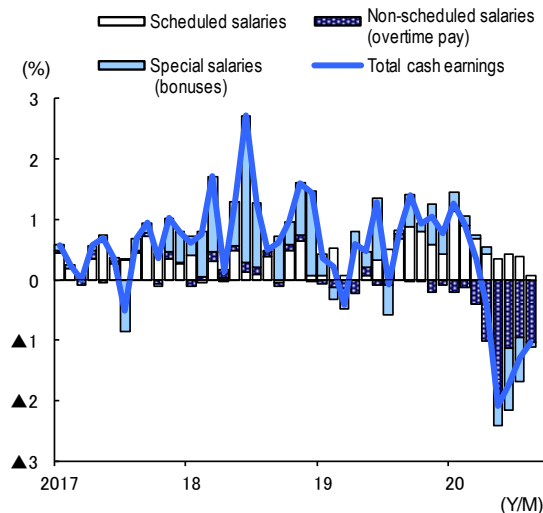
Figure 5-2 Tankan DI of Employment Conditions and Unemployment Rate



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.

Figure 5-3 Contributions to Change Rate of Nominal Wages
<year-on-year % change>



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

Private Consumption Will Likely Remain Sluggish for a Long Period of Time

◆ Recovery of Consumption Has Remained at a Standstill

Private consumption remained virtually flat since the beginning of the summer. Retail sales in September declined 0.1% from the previous month, down for the first time in two months. Service consumption through credit card settlements has remained at a level about 10% below that of the same period of the previous year.

In October, the government's measures to stimulate consumption were implemented in earnest including the addition of travel to and from Tokyo to the targets of the "Go To Travel" campaign and the commencement of the "Go To Eat" campaign. However, amid strong concerns over coronavirus infections, the effect of boosting consumption has been limited. In fact, the number of people who visited retail and entertainment facilities has remained at a level approximately 10% below that prior to the outbreak of the novel coronavirus. In addition to this lingering tendency toward self-restraint, the deterioration in employment and income conditions such as the rise in the unemployment rate and decline in winter bonuses

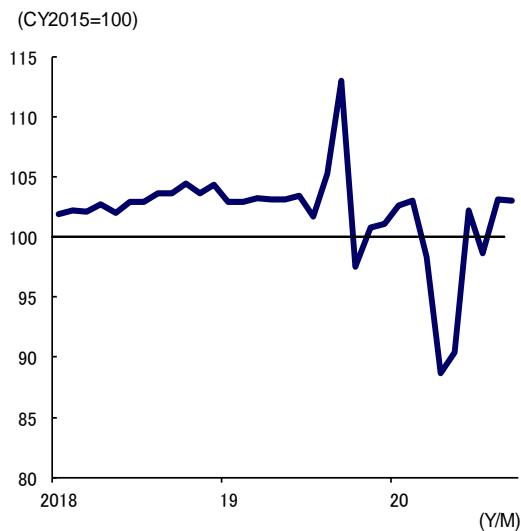
is anticipated to exert downward pressure on the recovery of consumption. Therefore, private spending is highly likely to remain at a level below that prior to the outbreak of the novel coronavirus even through FY2021.

◆ Housing Investment is Expected to Remain Lackluster for the Foreseeable Future

The number of housing starts in September decreased 0.5% from the previous month, down for two consecutive months. By type of housing, the number of housing starts for subdivision housing increased, while the decline in that for rental housing pushed down the overall housing starts.

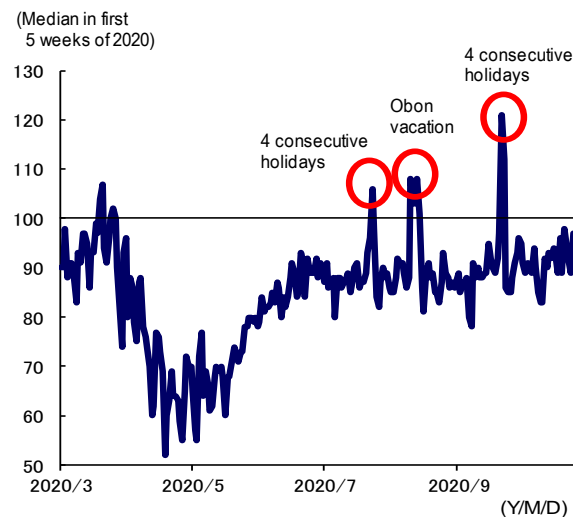
For future prospects, against the backdrop of a more cautious lending approach by financial institutions toward apartment construction projects in addition to weak consumer confidence due to the worsening employment and income environment, housing investment will likely remain lackluster on the whole.

Figure 6-1 Retail Sales Value
<seasonally adjusted>



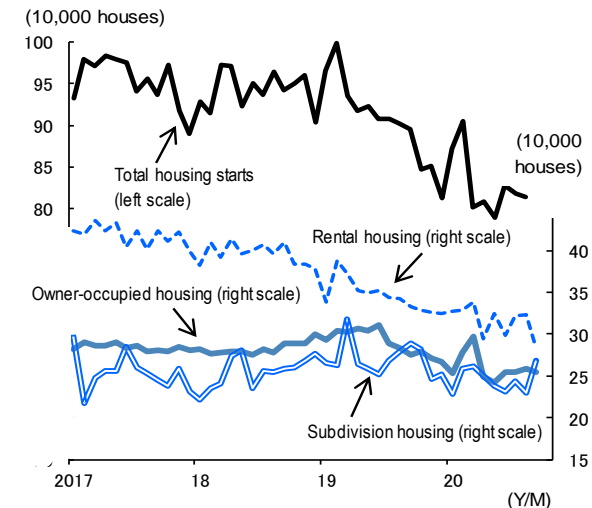
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.

Figure 6-2 Number of People Who Visited
Retail and Entertainment Facilities
<on a nationwide basis>



Source: The Japan Research Institute, Ltd. based on data of Google "Covid-19 community mobility report".

Figure 6-3 Housing Starts by Type
<annualized, seasonally adjusted>



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

Topic: China Dependency Risk in Procurement Became Apparent in the Wake of Novel Coronavirus Outbreak

◆ Risk of Dependence on China Has Emerged

In February, when restrictions on activities in China peaked due to the spread of the novel coronavirus, Japan's imports from China decreased by a record 47% from the previous year.

In recent years, Japan has become increasingly dependent on China for procurement due to the development of global supply chains and the rise of China. Therefore, the decline in imports from China was a big blow to the Japanese economy. In particular, the decreased imports of IT products and daily necessities, for which dependence on China is high, have had a broad impact on corporate activities and people's lives.

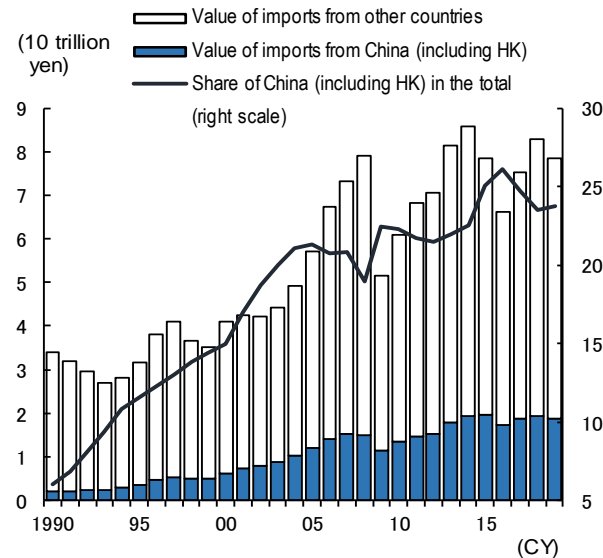
Given the further worsening of the U.S.-China conflict among other factors, excessive dependence on China poses a high risk in the future, and the outbreak of the novel coronavirus has prompted a reconsideration of Japan's dependence on China.

◆ Strengthening Competitiveness is Key to Reducing Dependence on China

Amid this situation, some observers predict that Japanese manufacturers will shift their production bases from China back to Japan. However, this effect of reducing dependence on China is not expected. In fact, Japan's procurement of goods from China is mainly via Chinese companies, and the amount of exports to Japan from Japanese companies' subsidiaries in China is limited.

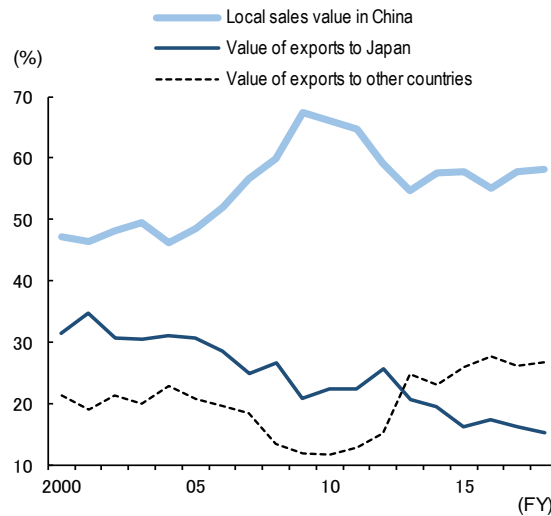
To reduce Japan's dependence on China for procurement, it is essential to strengthen the competitiveness of Japanese manufacturers. Due to the rapid rise in labor costs in China in recent years, wage costs in Japan have become less expensive than in China. By strengthening competitiveness through factory automation and expansion of the scale of business, it is possible even for products made in Japan to compete with Chinese products.

Figure 7-1 Japan's Goods Imports from China



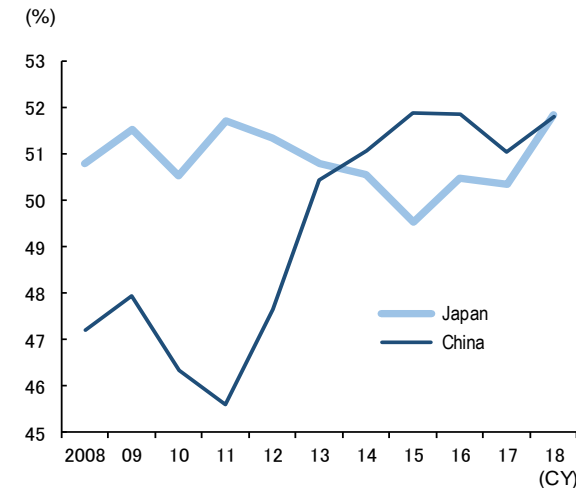
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance.

Figure 7-2 Breakdown of Sales Value of Japanese Companies' Subsidiaries in China



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

Figure 7-3 Labor's Share in Japan and China



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office of Japan, National Bureau of Statistics of China.

Note: Labor's share = compensation of employees / GDP

Prospects for Japan's Economy - Projected Real GDP Change; -5.2% for FY2020 and 3.4% for FY2021

◆ Japan Will See a Negative Growth Rate of Minus 5.2% for FY2020 and Will Not Return to Its Pre-coronavirus Growth Level Until After 2022

(1) The real GDP for the July-September 2020 period increased 21.4% on an annualized quarter-on-quarter change basis (up 5.0% from the preceding quarter), recording the largest rise under the current standards. By demand item, exports surged 31.3% on an annualized quarter-on-quarter change basis due to the resumption of economic activity in each country, while personal consumption also saw a record increase on the back of the lifting of the state of emergency. Having said that, the GDP level in the July-September period only recovered approximately half of the decline in GDP seen in the April-June period, suggesting that Japan's economy is still in a very difficult situation.

(2) Monthly economic statistics indicate that the pace of economic recovery has slowed substantially since the beginning of the summer against the backdrop of an increase in the number of new coronavirus cases, among other factors. As it is hard to predict when the spread of the novel coronavirus will settle down, a decline in the growth rate for the October-December period and thereafter is unavoidable.

(3) Looking at the environment surrounding exports, the absence of a strong global economic engine such as China after the collapse of the Lehman Brothers is evident. The pace of recovery in exports is likely to slow gradually, as the number of coronavirus infections has started to increase once again mainly in developed countries, which will also weigh on the recovery.

(4) Meanwhile, in terms of domestic demand, recovery of personal consumption is expected to be hampered by deteriorating employment and income conditions, on top of the lingering tendency toward self-restraint on outings. The unemployment rate is likely to rise to close to 4% through the first half of next 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 the novel coronavirus for a long period of time, as downward pressure on wages, especially bonuses, is expected to intensify against the backdrop of worsening corporate earnings.

(5) Due to the foregoing, Japan will likely see negative growth for FY2020 at a rate of minus 5.2%. 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 the novel coronavirus until after 2022.

◆ Prices Have Been Declining

(6) In September, core CPI (excluding the impact of the increase in the consumption tax rate and the provision of free education) remained negative, down 0.6% compared with the same month of the previous year. The fall in accommodation charges, as a result of Japan's Go To Travel campaign, among other factors contributed to the decline in core CPI.

As for the future outlook, downward pressure on prices from the viewpoint of supply and demand will likely intensify. Furthermore, the trend of falling energy prices will likely continue for the foreseeable future, reflecting the year -on-year decline in crude oil prices. Consequently, core CPI is expected to diminish further, recording a year-on-year decline of about 1% between the end of this year and early next year.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of November 16, 2020)

	(seasonally adjusted, annualised % changes from the previous quarter)									(% changes from the previous fiscal year)		
	CY2020			10~12	CY2021				CY2022	FY2019	FY2020	FY2021
	1~3	4~6	7~9		1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	(Projection)
	(Actual)	(Actual)	(Actual)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Actual)	(Projection)	(Projection)
Real GDP	▲ 2.3	▲ 28.8	21.4	6.0	1.0	1.9	3.1	0.7	1.5	0.0	▲ 5.2	3.4
Private Consumption Expenditure	▲ 2.8	▲ 28.7	20.1	4.5	1.2	2.0	2.9	1.2	1.4	▲ 0.5	▲ 5.9	3.3
Housing Investment	▲ 15.0	▲ 2.0	▲ 28.1	2.8	14.4	10.9	5.4	4.8	3.1	0.6	▲ 9.1	5.4
Business Fixed Investment	7.0	▲ 16.9	▲ 12.8	15.1	7.0	3.8	2.9	2.2	2.2	▲ 0.3	▲ 5.8	4.1
Private Inventories (percentage points contribution)	(▲ 0.3)	(1.5)	(▲ 0.8)	(0.3)	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.1)	(0.1)	(0.0)
Government Consumption Expenditure	0.1	▲ 1.4	9.3	3.7	▲ 3.5	1.1	3.8	▲ 2.6	0.4	2.3	2.0	1.0
Public Investment	▲ 1.3	5.1	1.5	3.5	2.8	▲ 3.4	▲ 1.2	0.6	0.8	3.3	2.5	0.0
Net Exports (percentage points contribution)	(▲ 0.9)	(▲ 11.8)	(12.2)	(0.4)	(▲ 0.3)	(▲ 0.1)	(0.2)	(0.1)	(0.2)	(▲ 0.2)	(▲ 1.3)	(0.7)
Exports of Goods and Services	▲ 19.7	▲ 53.4	31.3	29.5	11.8	2.3	5.1	3.2	3.8	▲ 2.6	▲ 13.0	9.3
Imports of Goods and Services	▲ 15.5	9.0	▲ 33.8	28.1	14.4	2.9	4.1	2.4	2.8	▲ 1.5	▲ 5.6	5.0
(Ref.) Domestic Private Demand (percentage points contribution)	(▲ 1.3)	(▲ 19.4)	(6.2)	(5.1)	(2.2)	(2.0)	(2.2)	(1.1)	(1.2)	(▲ 0.4)	(▲ 4.4)	(2.5)
(Ref.) Public Demand (percentage points contribution)	(▲ 0.0)	(▲ 0.1)	(2.1)	(1.0)	(▲ 0.6)	(0.1)	(0.7)	(▲ 0.5)	(0.1)	(0.6)	(0.5)	(0.2)

	(% changes from the same quarter of the previous year)									(% changes from the previous fiscal year)		
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	FY2019	FY2020	FY2021
Nominal GDP	▲ 0.9	▲ 8.9	▲ 4.8	▲ 2.4	▲ 1.5	7.3	2.7	1.7	1.8	0.8	▲ 4.4	3.3
GDP deflator	0.9	1.4	1.1	0.3	0.5	▲ 0.1	▲ 0.4	0.1	▲ 0.1	0.8	0.8	▲ 0.1
Consumer Price Index (excluding fresh food)	0.6	▲ 0.1	▲ 0.2	▲ 1.4	▲ 1.0	▲ 0.1	0.0	0.7	0.6	0.6	▲ 0.7	0.3
(excluding fresh food, consumption tax, education free of charge)	0.2	▲ 0.4	▲ 0.5	▲ 1.3	▲ 0.9	▲ 0.1	0.0	0.7	0.6	0.4	▲ 0.8	0.3
Unemployment Rate (%)	2.4	2.8	3.0	3.4	3.8	3.8	3.6	3.4	3.3	2.3	3.2	3.5
Exchange Rates (JY/US\$)	109	108	106	104	105	105	106	107	107	109	106	106
Import Price of Crude Oil (US\$/barrel)	68	31	41	43	44	46	49	51	54	68	41	50

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.