

Monthly Report of Prospects for Japan's Economy

April 2021

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

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

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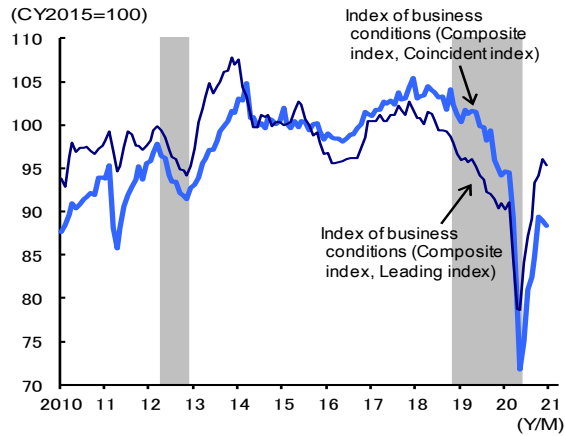
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The General Situation – Economic Recovery Has Come to a Halt

Figure 1-1 Economic Activity

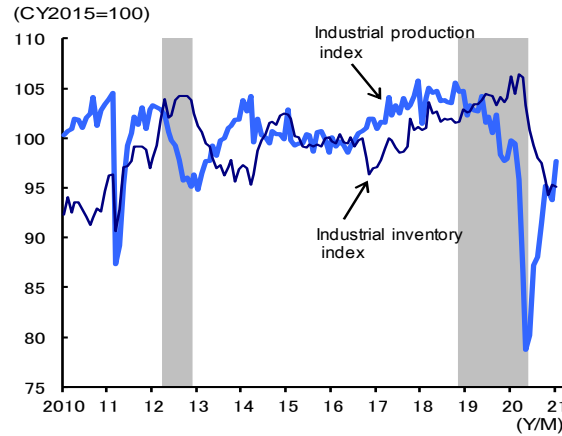
Both the CI leading index and the CI coincident index saw a temporary decline.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

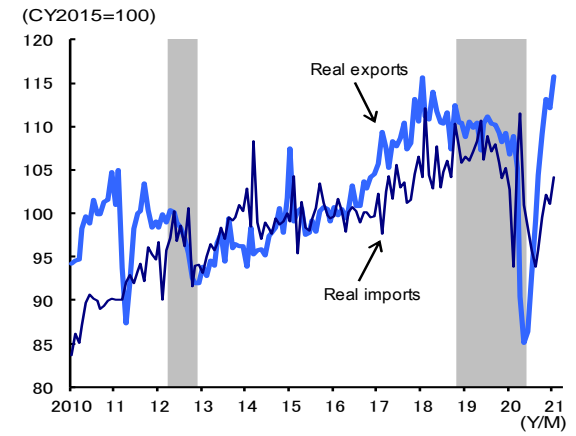
Industrial production has been increasing in a wide range of industries including general and industrial machinery and electronic parts and devices.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

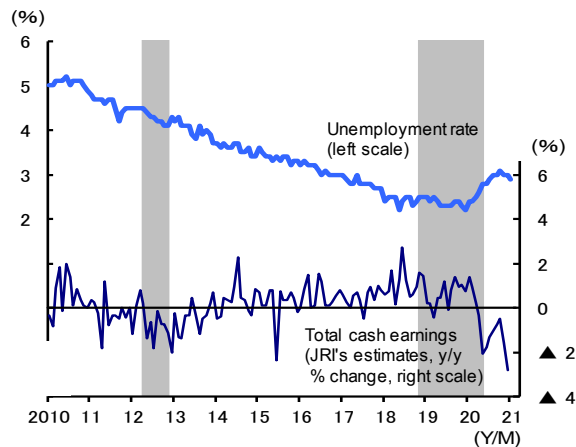
Exports increased, mainly to China and other Asian countries. Imports remained at a low level amid sluggish domestic demand.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate remained around 3%. Nominal wages declined, mainly for special salaries (bonuses).

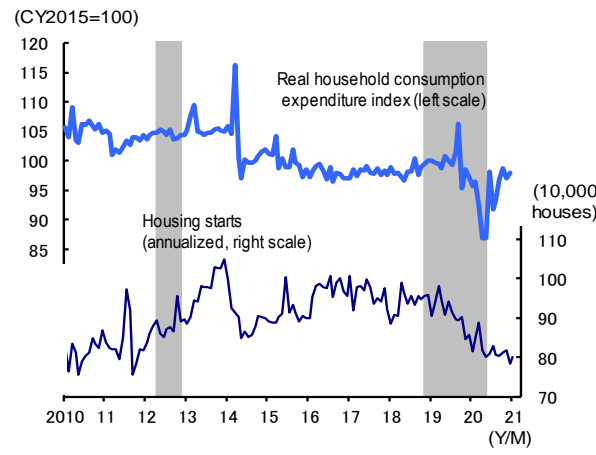


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

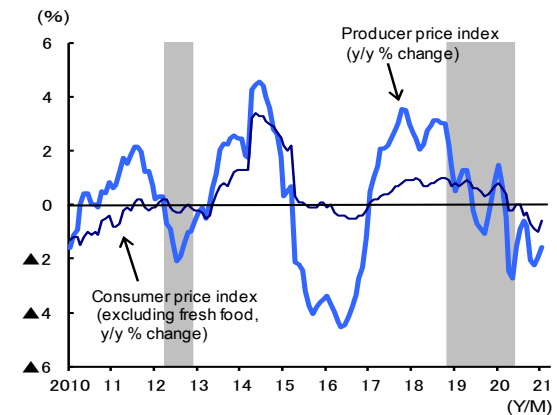
Real consumption saw some ups and downs due to the effect of COVID-19. Housing starts were sluggish.



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 dropped for electricity and gasoline.



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

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Economic Recovery Slowed Slightly as Private Consumption Levelled Off

◆ The October-December 2020 Period Saw Significant Positive Growth

Japan's real GDP (second preliminary report) for the October-December 2020 period increased 11.7% on an annualized quarter-on-quarter basis, recording significant positive growth for the second consecutive quarter. In terms of domestic demand, personal consumption increased 9.0% on an annualized quarter-on-quarter basis as COVID-19 infections settled down temporarily during the fall. Looking at external demand, exports saw a significant surge of 52.4% on an annualized quarter-on-quarter basis against the backdrop of the recovery in global automobile sales.

◆ Exports and Production Remained on an Upward Trend

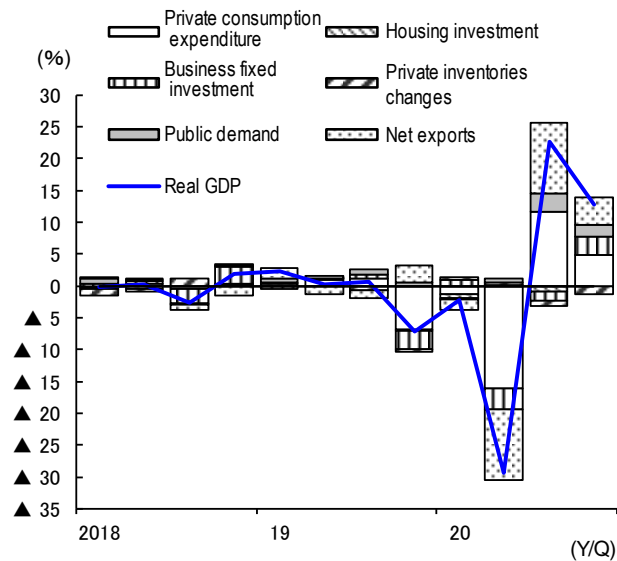
Real exports in January 2021 increased 3.1% from the previous month, up for the first time in two months as an increase in exports to China boosted overall exports. While the pace of recovery slowed slightly on the whole, exports remained on a recovery trend.

As exports picked up, production activities continued to recover. The Industrial Production Index in January increased for the first time in three months, up 4.3% from the previous month. By industry, production increased in a wide range of industries including general and industrial machinery and electronic components and devices. As for future production plans, while production is anticipated to decrease in March, overall production for the January-March period will likely increase for the third consecutive quarter on the back of the rapid recovery in production activities.

◆ There Was a Lull in Recovery of Personal Consumption

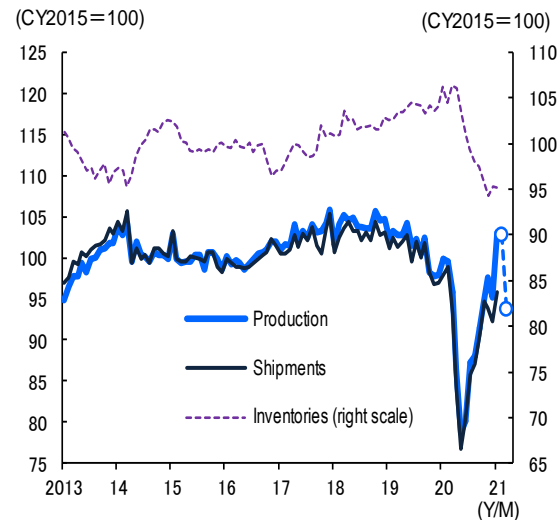
Meanwhile, the recovery of personal consumption leveled off through the winter, reflecting the tendency toward self-restraint regarding outings due to the resurgence of COVID infections. The Bank of Japan's Real Consumption Activity Index (travel balance adjusted) for December 2020 declined for the first time in five months, down 0.6% from the previous month.

Figure 2-1 Real GDP Change Rate by Demand Item <the first preliminary estimates, on an annualized q/q change basis, seasonally adjusted>



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

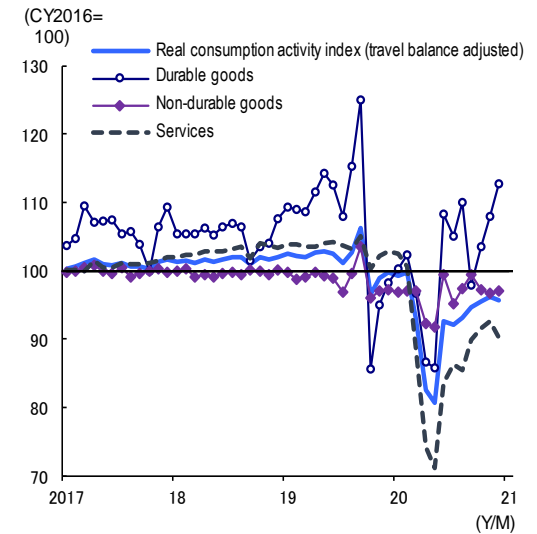
Figure 2-2 Industrial Production Index <seasonally adjusted>



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 February and March 2021 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 Continued to Rebound

◆ Exports of Goods Continued to Recover

Goods exports in January 2021 increased month-over-month for the first time in two months. By item, while shipments of transportation machinery were sluggish, reflecting stagnant new vehicle sales in Europe and the United States, shipments of electronic parts and devices remained firm as global demand for semiconductors picked up. Shipments of capital goods also increased. Looking at exports of capital goods by region, an increase in exports to Europe and the United States has leveled off, while those to China, which is showing a marked recovery in economic activity, led the growth.

Looking ahead, demand for electronic parts and devices as well as capital goods will likely remain firm against the backdrop of the expansion of telework, an increase in demand for 5G-related products, and growth in capital investment in line with the sophistication of industries in China. Exports are expected to remain on a recovery trend on the whole, although exports of transportation machinery to Europe and the

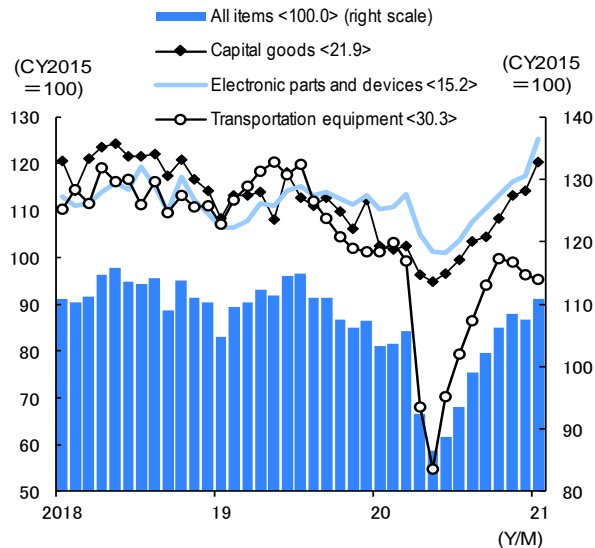
United States are expected to remain stagnant for the time being due to the resurgence of COVID-19 infections in these regions.

◆ Demand Related to Inbound Tourism Was Almost Zero

Amid restrictions on overseas travel around the world, the number of tourists visiting Japan in January 2021 fell 98.3% on a year-on-year basis.

It is difficult for the Japanese government to ease entry restrictions on tourists until COVID-19 infections settle down both in Japan and overseas. Given this situation, demand related to inbound tourism is expected to remain virtually nonexistent for the foreseeable future. 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 by June 2021 the number of passengers around the world will have only recovered to around 30% of the level prior to the outbreak of COVID-19.

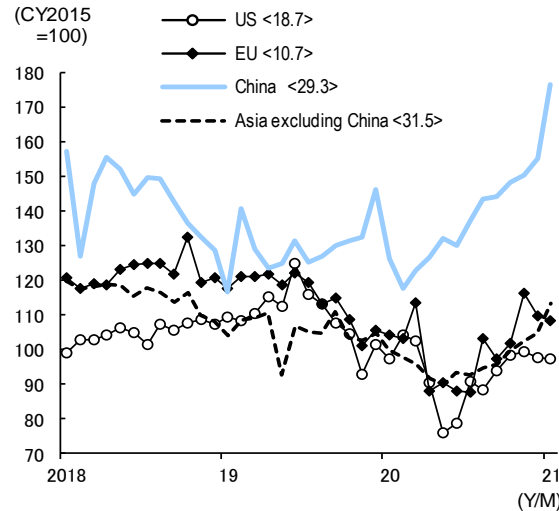
Figure 3-1 Real Exports by Item
<seasonally adjusted>



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 CY2020.

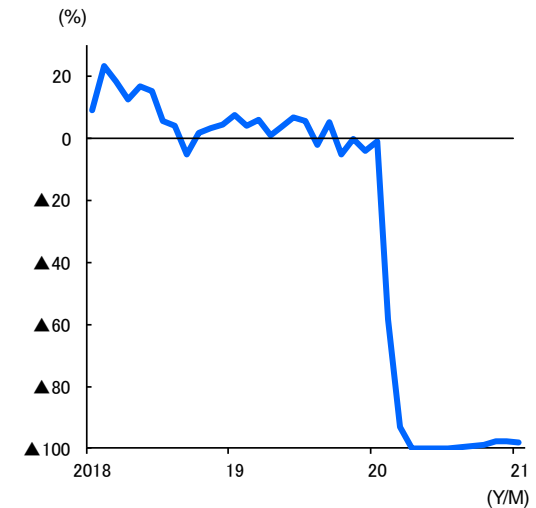
Figure 3-2 Real Exports of Capital Goods by Country or Area
<seasonally adjusted>



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 of capital goods in CY2020.

Figure 3-3 Number of Tourists Visiting Japan
<year-on-year % change>



Source: The Japan Research Institute, Ltd. based on data of Japan National Tourism Organization.

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Corporate Earnings Will Be Polarized While Business Fixed Investment Is Expected to Rebound

◆ Accommodation and Food Services Sectors Will Continue to Suffer Losses

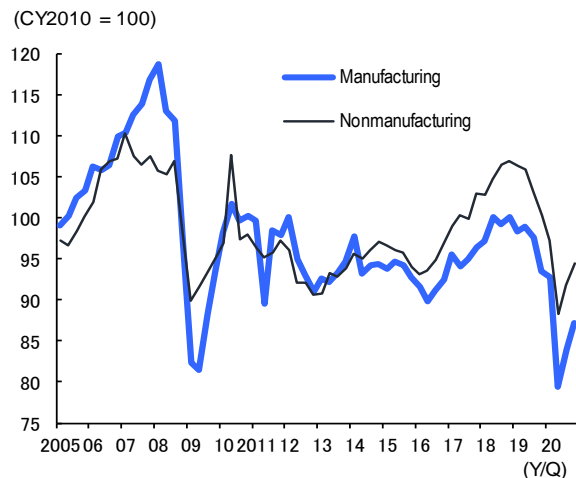
In the October-December 2020 period, sales on an industry-wide basis increased 2.5% from the previous quarter, up for the second consecutive quarter. The manufacturing sector saw increased sales in a wide range of industries, mainly for transportation machinery and production machinery on the back of the recovery in goods exports. Sales also increased in the nonmanufacturing sector against the backdrop of an increase in outings by people as the tendency toward self-restraint faded as well as an expansion of the government's "Go To" campaigns. In addition, current profits on an industry-wide basis increased 15.5% from the previous quarter, up for the second consecutive quarter. However, the transportation industry, accommodation and food services industries, and lifestyle-related services industry, which are severely affected by the COVID-19 pandemic, have not made it out of the red yet.

Corporate earnings for the January-March 2021 period will likely be further polarized as losses continue to increase in the personal services industry due to the effects of the reissuance of the state of emergency declaration, while the manufacturing industry will continue to rebound on the back of brisk goods exports.

◆ Companies Have Resumed Capital Investment

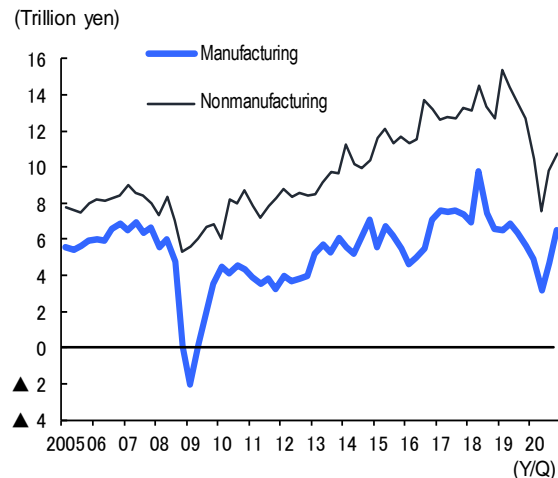
Capital expenditure for the October-December 2020 period decreased 1.4% on an industry-wide basis, down for the third consecutive quarter. This is partly because a decline in orders received in the spring of 2020 has been reflected with a time lag as the amount of investment is tracked on a progress basis. Recently, manufacturers, whose business performance has been recovering, have begun to resume investment. In fact, machinery orders and construction starts, which are leading indicators of capital investment, have picked up since the fall of 2020. Corporate investment sentiment is steadily improving and business fixed investment is expected to recover sooner or later.

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



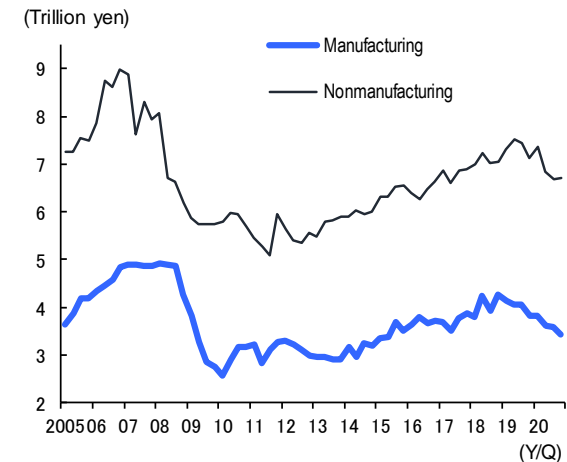
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All industries except for financial services and insurance.

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.

The Unemployment Rate Could Rise to the Mid-3% Level

◆ Impact of the Reissuance of State of Emergency Declaration Has Been Limited

The number of workers in January 2021 decreased by 500,000, which was less than the 710,000 recorded in the previous month. Despite the reissuance of the state of emergency declaration, the type of industries subject to the restrictions on business operations was limited, and there has not been a prominent deterioration in employment conditions so far. Even in the food service industry, in which businesses were required to shorten their hours of operation, some companies and business operators that have been significantly affected by the reissuance of the declaration seem to have maintained employment by means of business suspension and other measures.

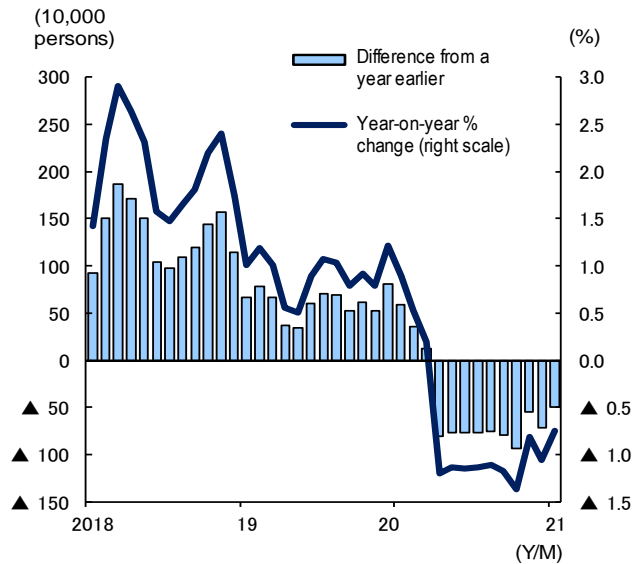
The level of economic activity is expected to pick up to a certain degree if the state of emergency declaration is lifted. However, the employment environment will likely continue to be affected by various restrictions on activities, which will weigh on

economic recovery, given that it is difficult to completely eliminate COVID-19 infections. Among enterprises, the perception of a bloated workforce has remained at a high level, and employment adjustment to a certain extent is unavoidable, mainly in the food services and accommodation industries, where excess labor is an issue. The unemployment rate, which is currently hovering around 3%, will likely rise to the mid-3% level in the future.

◆ Total Cash Earnings Saw a Decline

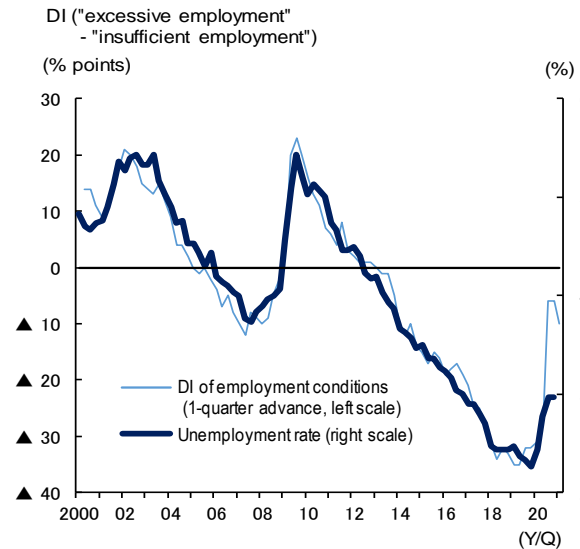
COVID-19 has also had ripple effects on wages. Total cash earnings in December 2020 plunged 2.8% year-on-year, recording a year-on-year decline for the ninth consecutive month. Regarding future prospects, while non-scheduled salaries (overtime pay) will likely return to positive territory upon the recovery of economic activity, the perception of a bloated workforce, among other factors, which will remain at a high level, is expected to exert downward pressure on scheduled salaries. As a result, it is difficult to expect a marked improvement in wages.

Figure 5-1 Change in Number of Employees



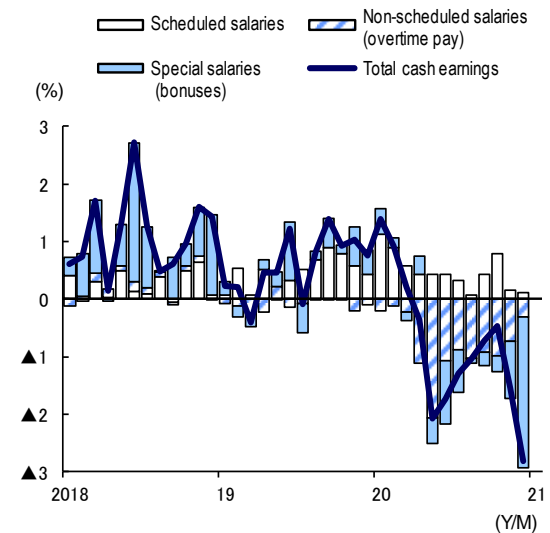
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.

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.

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.

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

◆ Consumption Has Been Sluggish as the Government Once Again Declares a State of Emergency

The decline in consumption based on credit card settlements in January 2021 accelerated further, down 10.4% compared to the same month in 2018, at which time there was no impact from the consumption tax hike. While goods consumption was relatively firm, consumption of services declined substantially due to the impact of the reissuance of the state of emergency declaration. Nevertheless, as the number of regions subject to the declaration and the number of industries required to reduce working hours are limited this time, the decline in consumption related to travel, accommodation and entertainment, which have been severely affected by the declaration, has been smaller than that in the declaration period last spring.

Private consumption for the January-March 2021 period is expected to drop 10% or more on an annualized quarter-on-quarter basis. However, if the state of emergency declaration is lifted, the level of consumption for the April-June period will likely pick

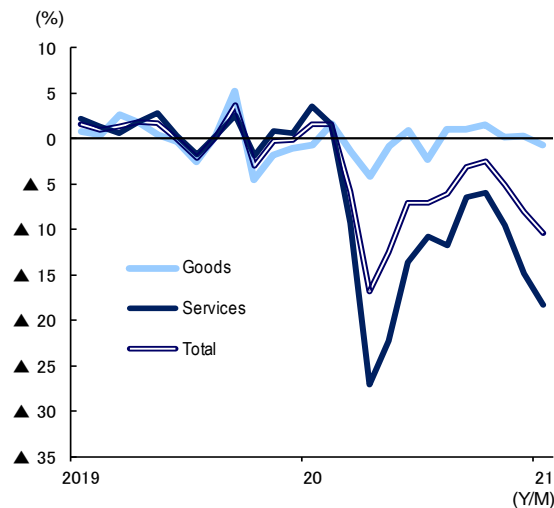
up. The deterioration in employment and income conditions, such as the rise in the unemployment rate, is nevertheless anticipated to exert downward pressure on consumption recovery, and it will likely take time before COVID-19 vaccines become widely available. Therefore, private spending is highly likely to remain below the level prior to the outbreak of COVID-19.

◆ Housing Investment is Expected to Remain Lackluster

The number of housing starts in January 2021 increased 2.2% from the previous month, up for the first time in two months. While the number of housing starts for rental housing decreased, the number of housing starts for owner-occupied housing and subdivision housing saw an increase.

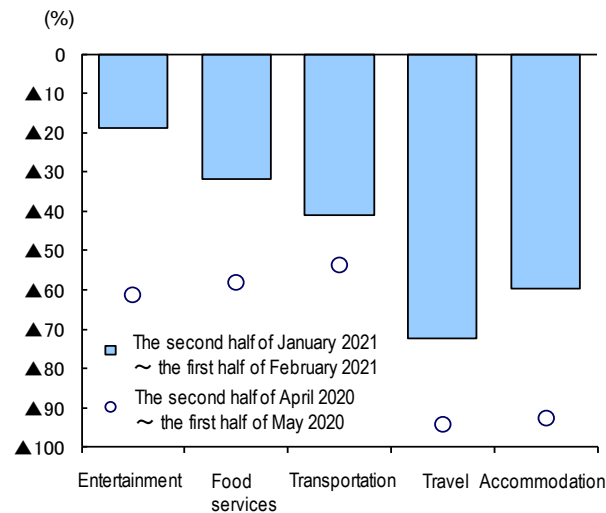
As for future prospects, against the backdrop of a more cautious lending approach by financial institutions toward apartment construction projects, in addition to weak consumer confidence due to the worsening employment and income environment, housing investment will likely remain lackluster on the whole.

Figure 6-1 Consumption Based on Credit Card Settlements <compared to the same month in 2018>



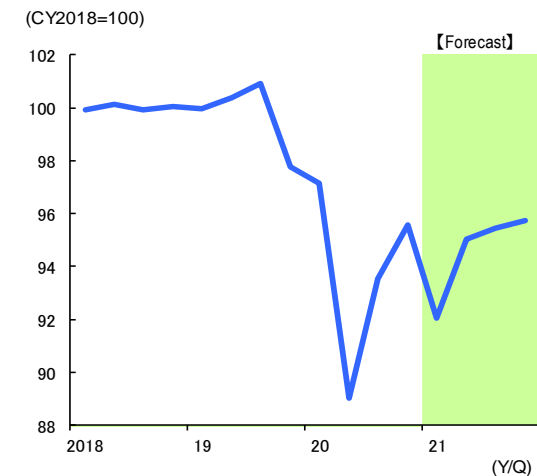
Source: The Japan Research Institute, Ltd. based on data of JCB Consumption NOW.

Figure 6-2 Service Consumption during State of Emergency Declaration Period <compared to the same period in 2018>



Source: The Japan Research Institute, Ltd. based on data of JCB Consumption NOW.

Figure 6-3 Forecast of Private Consumption Expenditure <seasonally adjusted>



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

Topic: COVID-19 and Demographic Factors Have Been Driving Wages Down

◆ COVID-19 Has Been Exerting Downward Pressure on Wages

Due to the deterioration in corporate earnings caused by the COVID-19 pandemic, wages have declined significantly since the spring of 2020, mainly for non-scheduled salaries (overtime pay) and special salaries (bonuses). In fiscal 2021, while these decreases are expected to come to a halt, downward pressure on scheduled wages is expected to increase due to the reduction of pay-scale increases (across-the-board increase in base salaries). However, unlike in fiscal 2013, when pay-scale increases were almost zero across all industries, some companies are expected to raise base salaries in fiscal 2021 due to the polarization in corporate earnings.

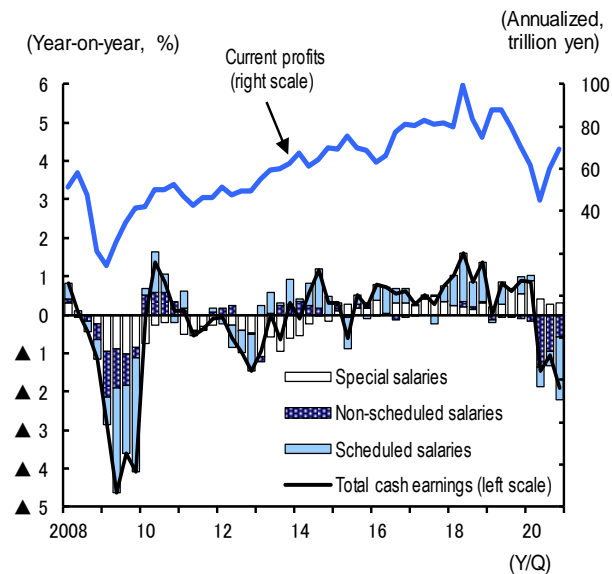
◆ Regular Pay Increases Are Also Declining Due to Demographic Factors

On the other hand, regular pay increases have been declining due to demographic factors. In Japan, the rate of wage growth gradually decreases as employees age,

and wages tend to decrease from the late 50s. As the members of the large baby boomer junior generation (those born between 1971 and 1974) reach their late 40s, the number of employees in their 30s and early 40s in 2020 decreased compared to 2013, but the number of those their late 40s and 50s increased. As a result, the rate of regular pay increases in fiscal 2021 is expected to decline by 0.2 percentage points compared to fiscal 2013. Since fiscal 2014, sluggish regular pay increases have been underpinned by pay-scale hikes. In fiscal 2021, however, stagnant wage growth will become apparent as pay-scale increases diminish.

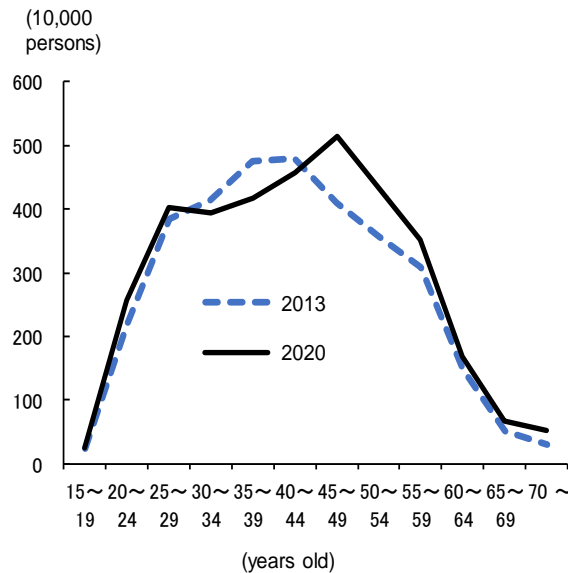
As a result, wage growth in fiscal 2021 (based on the survey of major private companies conducted by the Ministry of Health, Labor and Welfare) is expected to be 1.8%, declining to below the 2% level for the first time since 2013.

Figure 7-1 Current Profits and Contributions to Change Rate of Nominal Wages <year-on-year % change>



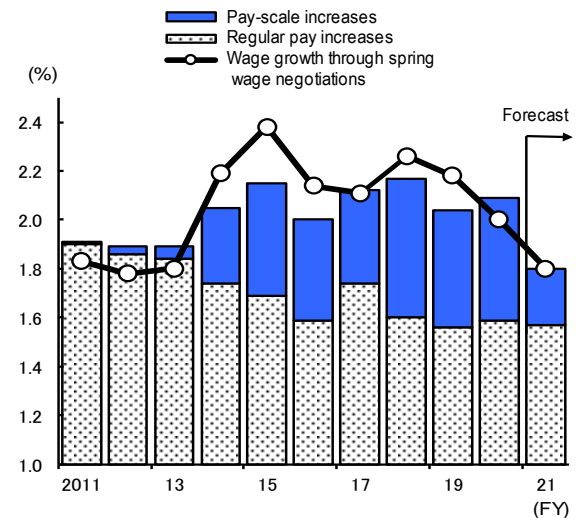
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Ministry of Health, Labor and Welfare.

Figure 7-2 Age Group Distribution of Regular Employees



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

Figure 7-3 Forecast of Wage Growth through Spring Wage Negotiations



Source: The Japan Research Institute, Ltd. based on data of Central Labor Relations Commission, Japanese Trade Union Confederation, The Ministry of Health, Labor and Welfare.

Prospects for Japan's Economy - Projected Real GDP Change; -5.0% for FY2020 and 4.0% for FY2021

◆ There Are Clear Indications That the Japanese Economy Will Pick up Again toward the Second Half of FY2021

(1) According to the Second Preliminary Quarterly Estimates of GDP (2nd QE), Japan's real GDP for the October-December 2020 period was +11.7% on an annualized quarter-on-quarter change basis (up 2.8% from the preceding quarter), remaining virtually flat from the First Preliminary Quarterly Estimates of GDP (1st QE) (+12.7% on an annualized quarter-on-quarter change basis; up 3.0% from the preceding quarter). There has been no change in the perception that economic activity had continued to recover rapidly until the end of last year, just before the resurgence of COVID-19 infections.

(2) As for future prospects, the January-March 2021 period is expected to see negative growth for the first time in three quarters as the government declared a state of emergency once again. Looking at monthly economic indicators since the beginning of this year, however, goods consumption has remained solid, reflecting smaller infection risks compared with those for services consumption. In addition, an increase in overseas demand, mainly from China, has underpinned the Japanese economy. For this reason, while the extension of the state of emergency declaration for the four prefectures including Tokyo places downward pressure on private consumption, the growth rate forecast for the January-March 2021 period has been revised slightly upward this time. If the state of emergency declaration is lifted by the end of March, the April-June 2021 period will likely see higher positive growth as a result of a rapid recovery in economic activity.

(3) The growth rate is anticipated to slow significantly toward the summer. It will likely take time before COVID-19 vaccines become widely available, and various restrictions on activities will remain in order to reduce the number of new COVID-19 cases to a controllable level. Moreover, the deterioration in employment conditions, such as a rise in the unemployment rate, is expected to weigh on economic recovery.

(4) It is assumed that the economic recovery trend will become clearer once again after the fall of 2021 as COVID-19 vaccines become available, mainly for the elderly. Although Japan's measures related to COVID-19 vaccination have been delayed compared with other countries, the Japanese government plans to expedite as much as possible efforts to vaccinate elderly people with a higher risk of severe illness from

COVID-19. Looking at private spending after the outbreak of COVID-19 by household type, it is clear that the stance toward consumption activities has become especially more cautious among elderly households. Based on that, it is expected that consumption activities will be boosted if COVID-19 vaccines become widely available among the elderly.

(5) As a result, Japan will likely see negative growth for FY2020 at a rate of minus 5.0% due partly to the effects of the reissuance of the state of emergency declaration. However, the growth rate is expected to turn positive at +4.0% in FY2021 and +2.3% in FY2022. Consequently, it is forecast that Japan's GDP will return to the level prior to the outbreak of COVID-19 (October-December 2019 period) after the beginning of 2022, and recover to the peak level recorded before the consumption tax rate hikes (July-September 2019 period) by the end of 2022.

◆ Prices Have Been Declining

(6) In January 2021, core CPI declined 0.6% year-on-year, showing a smaller year-on-year decline compared with the previous month. While energy prices kept on falling, the decline in accommodation charges diminished as a result of the temporary suspension of the government's "Go To Travel" campaign.

As for the future outlook, while energy prices are expected to increase year-on-year, there will be strong downward pressure on prices from the viewpoint of supply and demand. Consequently, core CPI will likely remain in negative territory for the time being.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of March 9, 2021)

	(seasonally adjusted, annualized % changes from the previous quarter)											(% changes from the previous fiscal year)		
	CY2020		CY2021				CY2022				CY2023	FY2020	FY2021	FY2022
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3			
	(Actual)		(Projection)				(Projection)				(Projection)	(Projection)	(Projection)	(Projection)
Real GDP	22.8	11.7	▲ 7.2	8.2	1.0	2.9	3.6	2.8	1.5	1.1	1.1	▲ 5.0	4.0	2.3
Private Consumption Expenditure	22.0	9.0	▲ 13.2	14.0	0.2	3.9	4.2	3.1	1.5	1.2	1.2	▲ 6.5	3.7	2.6
Housing Investment	▲ 20.9	0.2	2.6	3.9	▲ 2.1	3.0	3.5	3.0	0.4	0.2	0.0	▲ 7.3	0.2	1.7
Business Fixed Investment	▲ 9.2	18.2	3.6	2.7	1.0	4.4	4.4	4.2	3.2	2.4	2.1	▲ 6.2	3.9	3.5
Private Inventories (percentage points contribution)	(▲ 0.7)	(▲ 2.2)	(1.0)	(0.2)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.2)	(▲ 0.1)	(0.0)
Government Consumption Expenditure	12.1	7.6	▲ 4.2	2.6	3.2	▲ 1.0	1.6	0.9	0.4	0.4	0.4	3.3	2.0	0.8
Public Investment	3.8	6.1	▲ 3.9	▲ 1.4	0.0	0.9	1.0	0.5	▲ 1.0	▲ 1.2	0.0	4.2	▲ 0.0	0.0
Net Exports (percentage points contribution)	(11.3)	(4.4)	(▲ 0.3)	(▲ 0.2)	(0.1)	(0.2)	(0.2)	(0.1)	(0.1)	(0.0)	(0.0)	(▲ 0.8)	(1.1)	(0.1)
Exports of Goods and Services	33.2	52.4	9.8	3.4	4.3	4.9	4.9	4.6	4.3	3.5	3.5	▲ 10.7	11.6	4.4
Imports of Goods and Services	▲ 29.0	17.0	12.8	4.9	3.8	3.8	4.1	4.1	3.6	3.4	3.4	▲ 6.0	4.8	3.8
(Ref.) Domestic Private Demand (percentage points contribution)	(7.7)	(5.1)	(▲ 5.4)	(8.1)	(0.2)	(2.9)	(3.1)	(2.4)	(1.3)	(1.0)	(1.0)	(▲ 5.0)	(2.5)	(2.0)
(Ref.) Public Demand (percentage points contribution)	(2.8)	(1.9)	(▲ 1.1)	(0.5)	(0.7)	(▲ 0.2)	(0.4)	(0.2)	(0.0)	(0.0)	(0.1)	(0.9)	(0.4)	(0.2)

	(% changes from the same quarter of the previous year)											(% changes from the previous fiscal year)		
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	FY2020	FY2021	FY2022
Nominal GDP	▲ 4.7	▲ 1.1	▲ 2.9	7.8	2.4	0.8	4.1	2.7	3.0	2.4	1.8	▲ 4.4	3.7	2.5
GDP deflator	1.2	0.3	▲ 0.3	▲ 0.6	▲ 0.8	▲ 0.2	0.2	0.1	0.2	0.2	0.2	0.6	▲ 0.3	0.2
Consumer Price Index (excluding fresh food)	▲ 0.2	▲ 0.9	▲ 0.5	▲ 0.4	0.3	1.1	0.5	0.9	0.4	0.4	0.4	▲ 0.4	0.4	0.5
(excluding fresh food, consumption tax, education free of charge)	▲ 0.5	▲ 0.9	▲ 0.4	▲ 0.4	0.3	1.1	0.5	0.9	0.4	0.4	0.4	▲ 0.5	0.4	0.5
Unemployment Rate (%)	3.0	3.0	3.1	3.4	3.5	3.4	3.3	3.2	3.1	3.0	2.9	3.0	3.4	3.0
Exchange Rates (JY/US\$)	106	104	105	106	107	108	107	107	108	108	108	106	107	108
Import Price of Crude Oil (US\$/barrel)	41	44	57	59	57	60	59	60	62	60	59	43	59	60

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.