

Monthly Report of Prospects for Japan's Economy

May 2021

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 April 2021 issue of the original Japanese version.

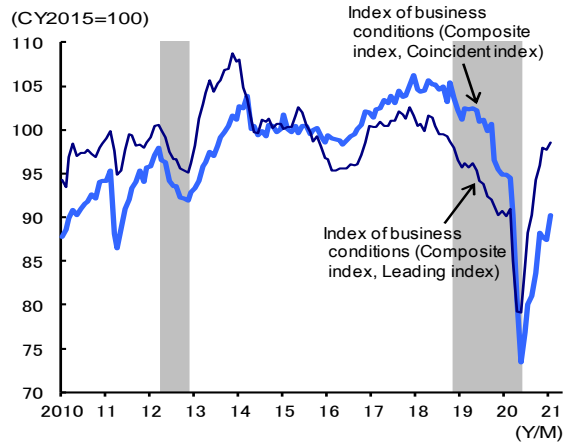
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The General Situation – Economic Recovery Has Come to a Halt

Figure 1-1 Economic Activity

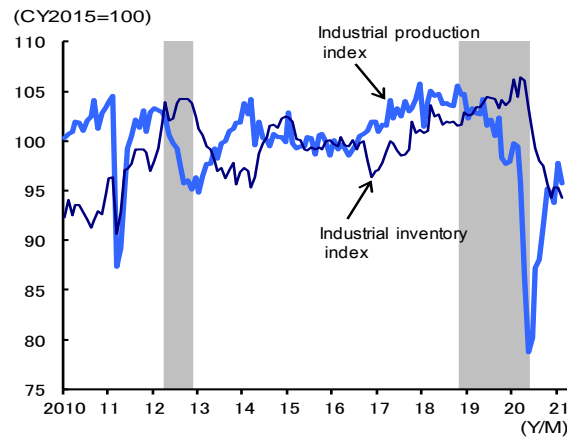
The pace of rise in both the CI leading index and the CI coincident index slowed.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

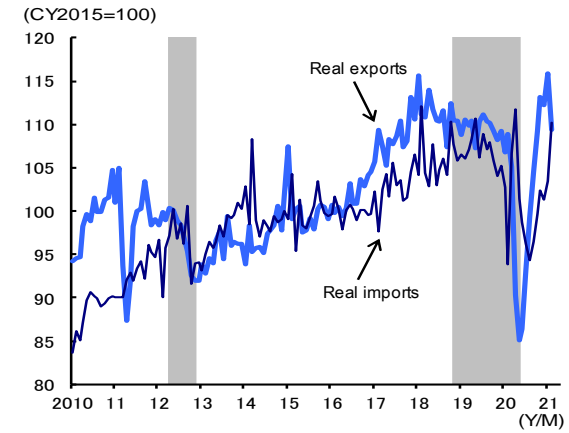
Industrial production has been increasing in a wide range of industries, albeit with fluctuations.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

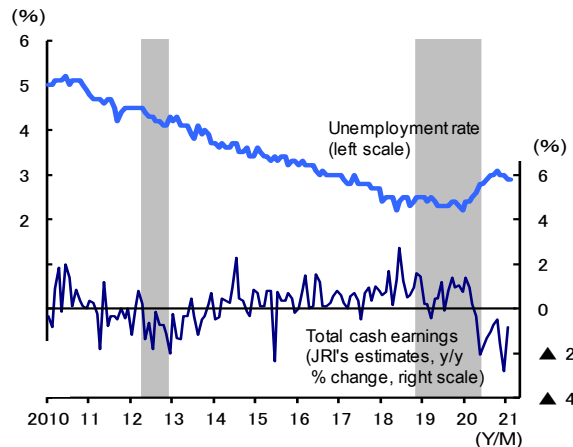
Exports temporarily decreased due to the effect of the Chinese New Year. Imports rebounded as production activity picked up.



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).

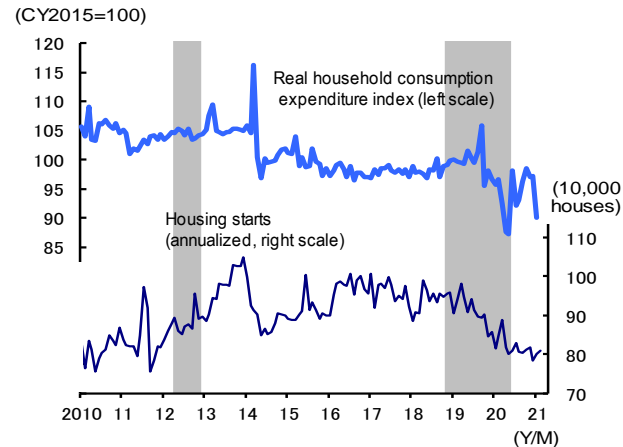


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

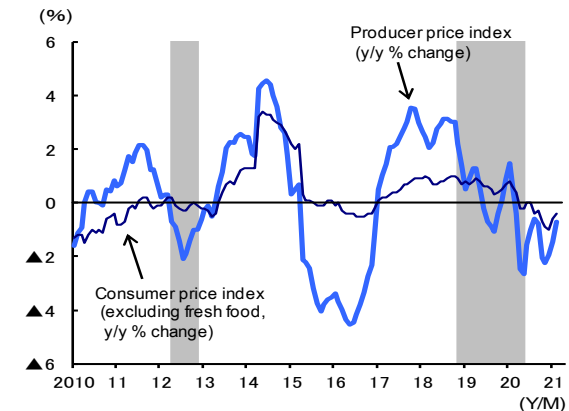
Real consumption saw some ups and downs due to the effect of COVID-19. Housing starts remained sluggish.



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

The decline in both producer prices and consumer prices diminished as international commodity prices picked up.



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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Business Sentiment Has Become Visibly Polarized

◆ The DI for Business Conditions for Accommodation and Food Services Sectors Has Deteriorated Again

In the Bank of Japan's March 2021 Tankan Survey, the DI for business conditions for large manufacturers was +5, up 15 percentage points from the previous month and recording the first positive DI in six quarters. Business sentiment was boosted, reflecting improvement in earnings as a result of the continued depreciation of the yen in addition to an increase in exports.

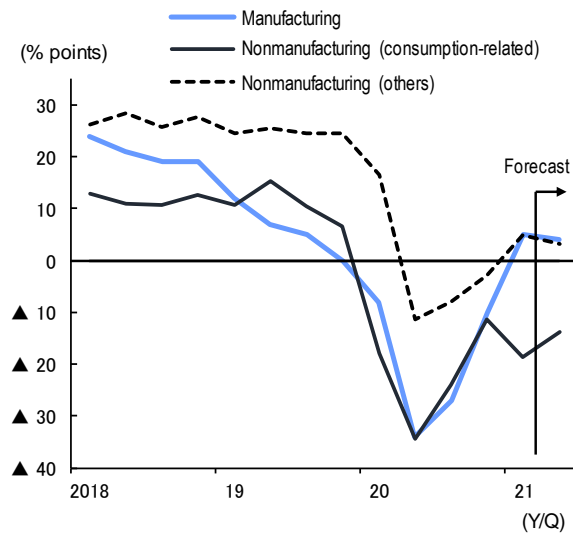
Meanwhile, the DI for large nonmanufacturers was -1, up only 4 percentage points from the previous month, with the DI remaining in negative territory. While the DI continued to improve for information services as demand remained strong for telework related services, the DI deteriorated again for personal consumption related industries such as personal services and accommodation and food services due to the reissuance of the state of emergency declaration.

◆ Exports and Production Are on a Rising Trend

Although the export volume in February 2021 decreased by 6.8% from the previous month for the first time in three months, this was due to the calendar factor of the Chinese New Year. Looking at the average volume in January and February 2021, exports rose above December 2020 levels, indicating that they are continuing to pick up. By region, exports to China and other Asian countries led the overall increase.

Production activities in the manufacturing industry have generally continued to recover on the back of increased exports. There is a possibility that production activities will temporarily become sluggish as the shortage of parts supplies caused by a fire at a semiconductor plant in March is expected to put downward pressure on automobile production. However, it is judged that there is little risk of a major downturn in production activity from a macroeconomic perspective, as it would likely be underpinned by increased production of manufacturing machinery and electronic parts, whose exports have been robust.

Figure 2-1 Business Conditions DI by Industry in BoJ's Tankan Survey <large enterprises>



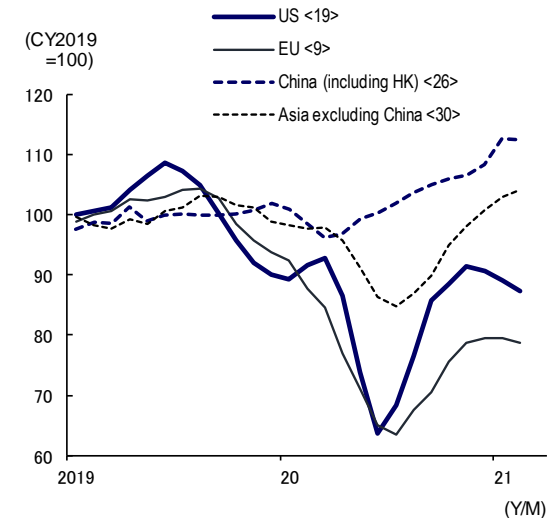
Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan.

Figure 2-2 Industrial Production and Export Volume <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry, The Ministry of Finance.
Note: The latest two figures in the industrial production index are forecasts based on the production forecast index.

Figure 2-3 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: 1. 3-month moving averages.
2. Figures in the angled brackets show the shares in total nominal exports in CY2020.

Exports of Goods Remained on a Recovery Trend

◆ Exports Were Led by Electronic Parts and Capital Goods

Goods exports remained on a rising trend on the whole, although the pace of recovery has slightly slowed since the beginning of this year. By item, while shipments of transportation machinery mainly to Europe and the United States were sluggish, those for electronic parts and devices remained firm as global demand for semiconductors picked up and shipments of capital goods increased primarily to China.

Looking ahead, shipments of transportation machinery are expected to remain weak for the foreseeable future given the shortage in semiconductor supply for automotive production. Demand for electronic parts and devices as well as capital goods will likely drive exports on the whole 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. Looking at the Bank of Japan's March 2021 Tankan Survey, it is predicted that production machinery and

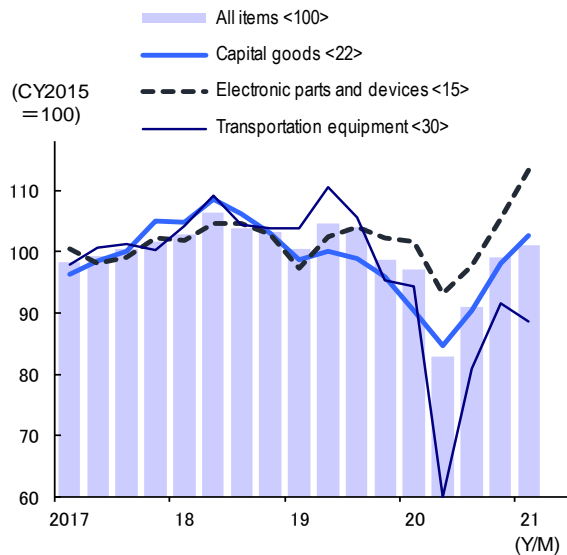
other processing industries will likely see a further improvement in supply and demand going forward for products overseas.

◆ Sluggish Demand Related to Inbound Tourism Will Likely Continue

Amid restrictions on overseas travel around the world, the number of tourists visiting Japan in February 2021 fell 99.3% on a year-on-year basis.

It is difficult for the Japanese government to ease entry restrictions for 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. The International Civil Aviation Organization (ICAO) predicts that the number of passengers around the world at the end of 2021 will recover to around 50% of the level prior to the outbreak of COVID-19. However, in Japan, where the rollout of COVID-19 vaccines has been delayed, the recovery in human traffic across national borders may be slower than in other developed countries.

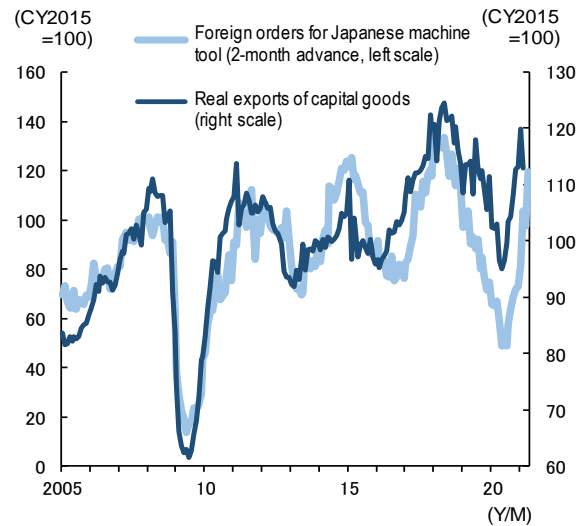
Figure 3-1 Real Exports by Item
<seasonally adjusted>



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

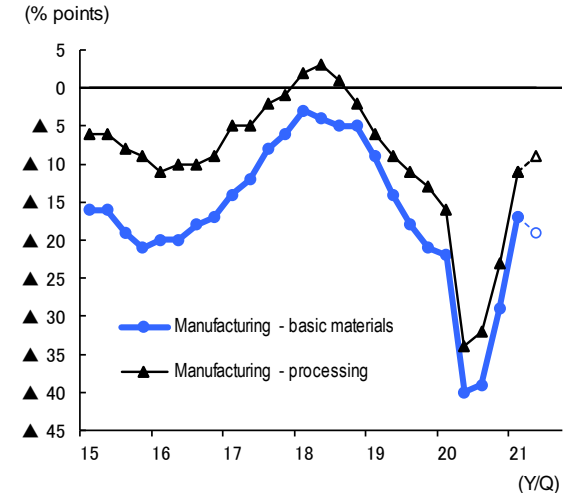
Note: 1. Figures in Q1 2021 are for January-February in 2021.
2. Figures in the angled brackets show the shares in total nominal exports in CY2020.

Figure 3-2 Machine Tool Orders and Exports of Capital Goods
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of Japan Machine Tool Builders' Association, The Ministry of Finance.

Figure 3-3 DI for Overseas Supply and Demand Conditions for Products
<all sizes of enterprises>



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

Note: The latest figures are forecasts based on March 2021 Tankan Survey.

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Corporate Earnings Have Been Polarized, While Business Fixed Investment Is Expected to Rebound

◆ Corporate Earnings Have Been Polarized

In the October-December 2020 period, sales on an industry-wide basis increased 2.5% from the previous quarter and current profits increased 15.5% from the previous quarter, up for the second consecutive quarter. However, it appears that corporate earnings for the January-March 2021 period have been polarized. While the manufacturing sector is expected to post increased sales on the back of brisk goods exports, the personal services industry will likely record further losses due to the effects of the reissuance of the state of emergency declaration.

In the April-June 2021 period, while corporate earnings are anticipated to pick up from a macroeconomic perspective upon the lifting of the state of emergency declaration, the severe situation will likely continue in the personal services industry, where ongoing restrictions are in place such as shortened operating hours and limits imposed on the number of persons in venues amid an increase in the number of

regions experiencing a resurgence of COVID-19 infections.

◆ 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 during the start of the COVID-19 outbreak was reflected by a time lag as the amount of investment was tracked on a progress basis.

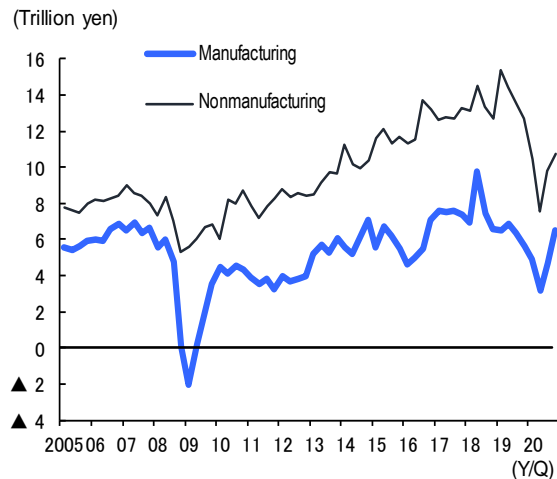
Recently, manufacturers, whose business performance has been recovering, have begun to resume investment activities. In fact, machinery orders and construction starts, which are leading indicators of capital investment, have picked up since the fall of 2020. According to the Bank of Japan's Tankan Survey, capital expenditure plans (large enterprises, industry-wide basis) for fiscal 2021 are 3.0% higher than those of the previous year, which indicates that they are solid as initial plans.

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



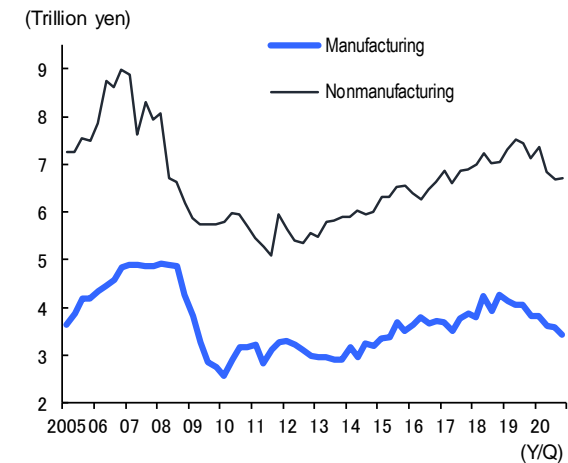
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All industries except for financial services and insurance.

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 Wage Increase Rate for This Year's Spring Labor Offensive Is Expected to Fall Below 2%

◆ The Impact of the Extension of the State of Emergency Declaration Has Been Limited

The number of workers in February 2021 decreased by 30,000 from the previous month, while the number of unemployed persons remained virtually flat month-over-month. Although the state of emergency declaration was extended, there has been no prominent deterioration in employment conditions thus far. Even food services operators, which suffered from a fall in sales as a result of being required to shorten their hours of operation, appear to have maintained employment levels by means of business suspensions and other measures.

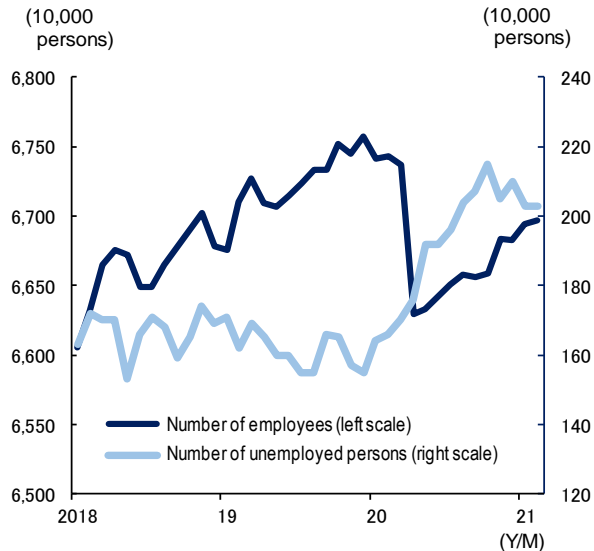
Despite the foregoing, the number of new COVID-19 cases surged again in many regions after the lifting of the state of emergency declaration. It is inevitable that the employment environment will be negatively affected to a certain extent by various restrictions on activities such as tougher measures to control the spread of COVID-19 (so-called "Manbo"), which will continue to weigh on corporate activities. According to the Bank of Japan's March 2021 Tankan Survey, the perception of a

bloated workforce among enterprises has remained at its highest level since the December 2013 Tankan Survey, and employment adjustment will be unavoidable in the future, mainly in the food services and accommodation industries which have been significantly affected by the pandemic.

◆ Total Cash Earnings Saw a Decline

COVID-19 has also had ripple effects on wages. Total cash earnings (on the basis of common business establishments) in January 2021 plunged 1.0% year-on-year, recording a year-on-year decline for the tenth 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, which will remain at a high level, among other factors, are expected to exert downward pressure on scheduled salaries. As a result, the wage increase rate for this year's spring labor offensive is expected to fall below 2% for the first time since 2013, and the expectation of a marked improvement in wages is unlikely.

Figure 5-1 Number of Employees and Number of Unemployed Persons



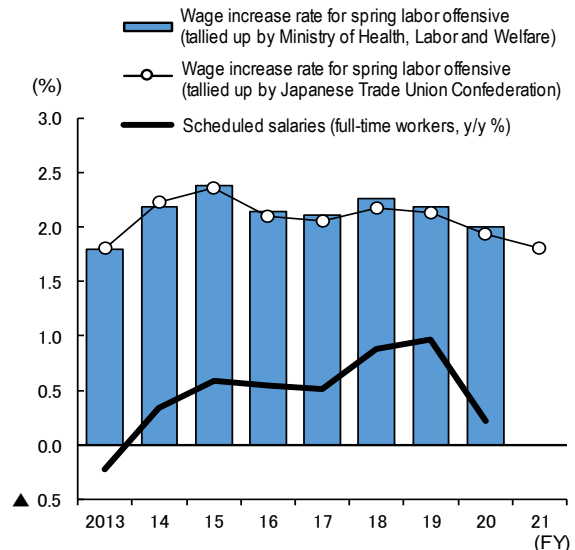
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.

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 Wage Increase Rate for Spring Labor Offensive



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

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

◆ The Pace of Recovery in Personal Spending Has Slowed

Consumption based on credit card settlements in February 2021 declined for the 12th consecutive month, down 9.8% compared to the same month in 2018, at which time there was no impact from the consumption tax hike. However, the decline slightly diminished from the previous month, and the tendency toward self-restraint among households has not grown much even amid the extension of the state of emergency declaration. The number of people visiting retail and entertainment facilities further recovered between February and March, indicating a pick-up in consumption activities.

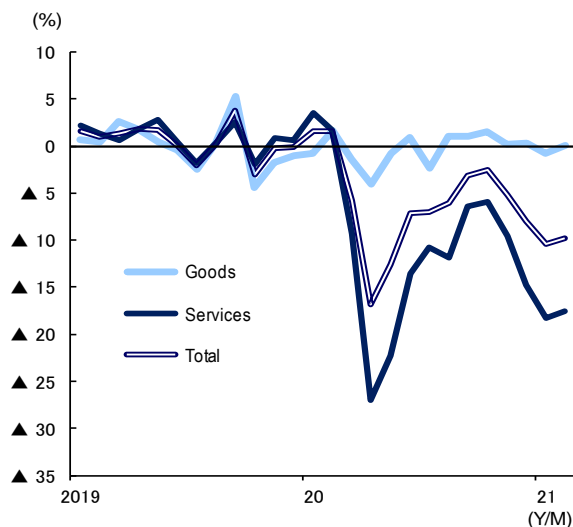
As for future prospects, private consumption for the April-June 2021 period will likely rebound to the level seen last autumn as a result of the lifting of the state of emergency declaration. Nevertheless, as it is difficult to predict when the spread of COVID-19 will settle down, a wide range of restrictions on activities will remain in an effort to curb the number of new COVID-19 cases, and the deterioration in the

employment environment, such as the rise in the unemployment rate, is expected to exert downward pressure on consumption recovery. Therefore, private spending is highly likely to remain below the level that existed prior to the outbreak of COVID-19. It is predicted that the recovery in personal consumption will not become clear until this autumn and thereafter when COVID-19 vaccines become widely available mainly among the elderly.

◆ Housing Investment is Expected to Remain Lackluster

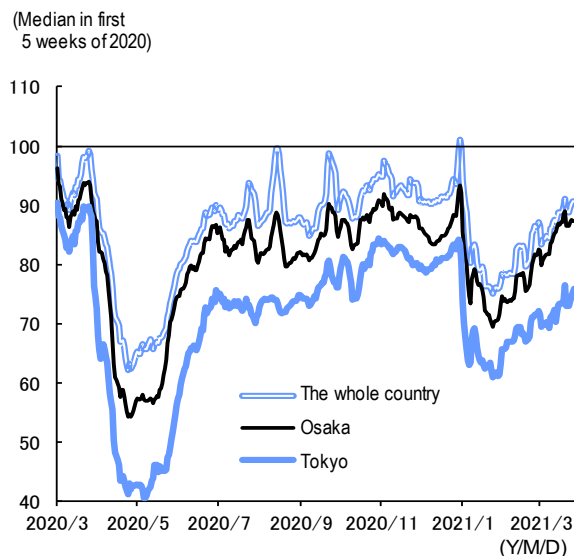
The number of housing starts (seasonally adjusted annual rate) in February 2021 stood at 808,000, remaining at the low level of around 800,000 since the spring of 2020. As for future prospects, against the backdrop of a more cautious lending approach by financial institutions toward apartment construction 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>



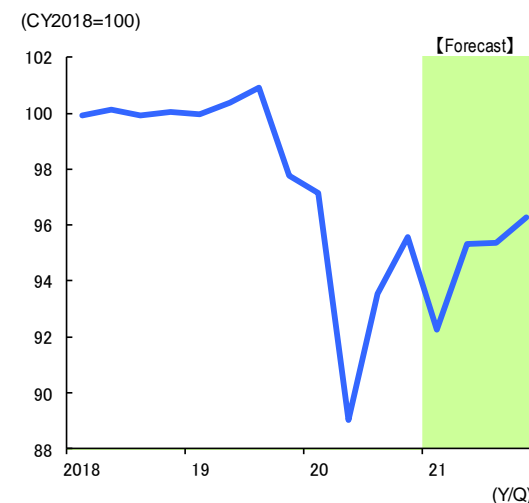
Source: The Japan Research Institute, Ltd. based on data of JCB Consumption NOW.

Figure 6-2 Number of People Who Visited Retail and Entertainment Facilities



Source: The Japan Research Institute, Ltd. based on data of Google "Covid-19 community mobility report."
Note: 7-day moving averages.

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



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

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Topic: Senior Consumer Spending Is Key to a Full-Fledged Recovery

◆ Senior Consumer Spending Has Been Sluggish Due to Voluntary Restraint on Outings and Low Usage of Online Shopping

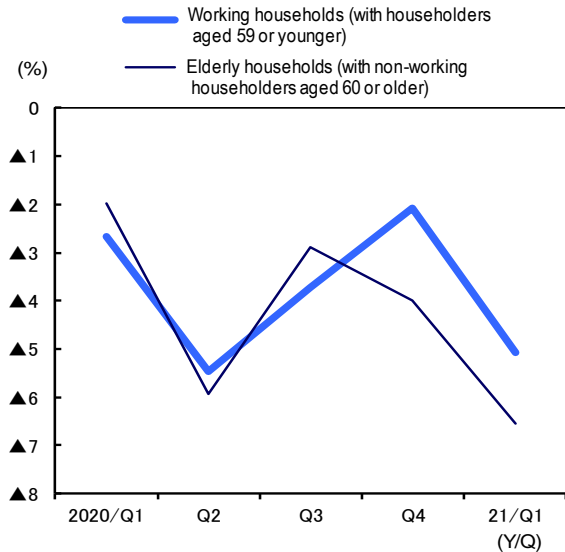
In Japan, consumption by elderly households (households with non-working householders aged 60 or older) has been sluggish, dropping more than that of working households (households with householders aged 59 or younger). Since consumption by elderly households accounts for about half of total consumption, it has a significant impact on the economy.

Senior consumer spending has declined since many elderly people are refraining from going out due to concerns about coronavirus infection and the risk of severe illness. People in their 60s and 70s tend to go out less frequently compared to those who are young or middle-aged. Sluggish consumption among the elderly is also attributable to the fact that many elderly people are not accustomed to using the Internet, and online shopping among the elderly has therefore been low.

◆ There Is Room for Consumption Increase Amounting to Four Trillion Yen

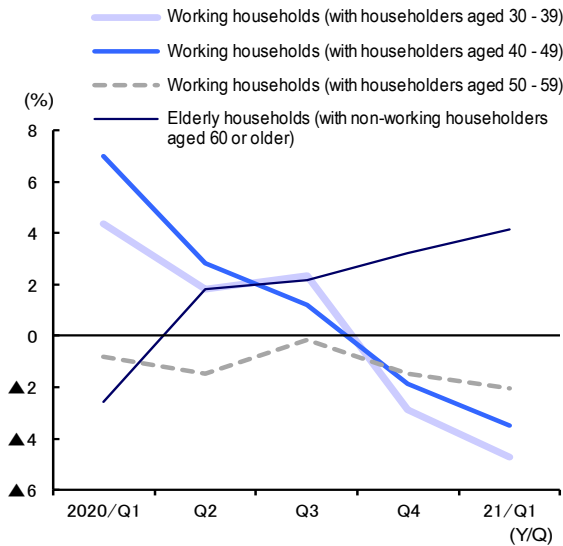
On the other hand, elderly household income has been stable even amid the COVID-19 pandemic. This is due to upward revision of pension benefits for fiscal 2020, reflecting the economic situation prior to the outbreak of COVID-19. The amount of pension benefits for fiscal 2021 is expected to decrease only by 0.1% from the previous year. This is in contrary to working households whose incomes have declined due to deterioration of corporate earnings. As a result of a decrease in consumption despite steady income, the propensity to consume among elderly households declined significantly. If the opportunity for consumption returns and the propensity to consume recovers to the level prior to the outbreak of COVID-19, consumption by elderly households will increase by about 4 trillion yen. This amounts to about one-fourth of the decrease in personal consumption seen in 2020 (17 trillion yen).

Figure 7-1 Real Consumption Expenditure by Household Type <compared to the same quarter in 2018>



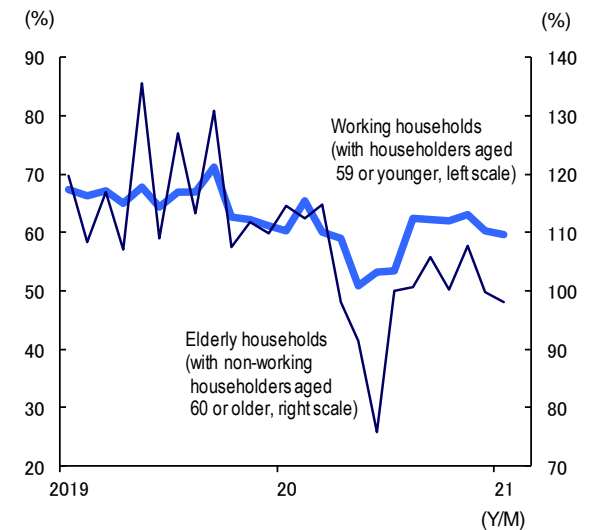
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
 Note: 1. Households with 2 or more household members.
 2. The figure in Q1 2021 is for January 2021.

Figure 7-2 Household Income by Age Group of Householders <year-on-year % change>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
 Note: 1. Households with 2 or more household members.
 2. The figure in Q1 2021 is for January 2021 (year-on-year % change of the 3-month moving average).

Figure 7-3 Average Propensity to Consume by Household Type <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
 Note: Households with 2 or more household members.

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

◆ Japan's Economic Recovery Is Expected to Become Clear After This Autumn

(1) The April-June 2021 Period Will Likely See Positive Growth

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. However, the April-June 2021 period will likely see positive growth at an annual rate of nearly 10% as economic activities pick up following the lifting of the state of emergency declaration, recovering from the decline in the previous quarter. Tougher measures to control the spread of COVID-19 (so-called "Manbo") have been applied to Osaka Prefecture and two other prefectures, where a resurgence in coronavirus infections has been prominent, since April 5. However, since the tougher COVID-19 measures, such as the requirement for restaurants and bars to shorten their hours of operation, with possible fines for non-compliance, will only be implemented in limited areas, the negative effects on the macroeconomy are expected to be limited compared to those under the state of emergency declaration.

Despite the foregoing, as it is difficult to predict when the spread of COVID-19 will settle down, people will continue to refrain from consumption activities considered to have a high risk of infection such as dining out. Consequently, economic activity is anticipated to remain below the level prior to the outbreak of COVID-19. Japan's economic recovery will not likely become clear until this autumn when COVID-19 vaccines become widely available mainly among the elderly.

(2) Japan's Growth Rate for FY2021 Is Expected to Be +4.0%

As a result, Japan will likely see negative growth for FY2020 at a rate of minus 5.0%, while the growth rate is expected to turn positive at +4.0% in FY2021 on the back of accelerated growth anticipated for the second half of the year. Japan's GDP is forecast to return to its peak level seen prior to the outbreak of COVID-19 around the end of 2022.

◆ Prices Have Been Declining

(3) In February 2021, core CPI declined 0.4% year-on-year, showing a smaller year-on-year decline compared to the previous month. This is attributable mainly to the fact the decline in energy prices diminished as a result of the recovery in crude oil prices.

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 April 5, 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	3.0	3.2	3.4	3.3	3.2	3.1	3.0	3.0	2.9	2.9	3.3	3.0
Exchange Rates (JY/US\$)	106	104	106	110	111	112	113	112	112	113	114	106	112	113
Import Price of Crude Oil (US\$/barrel)	41	44	56	63	62	63	61	61	62	61	62	43	62	62

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.