

Monthly Report of Prospects for Japan's Economy

May 2020

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

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

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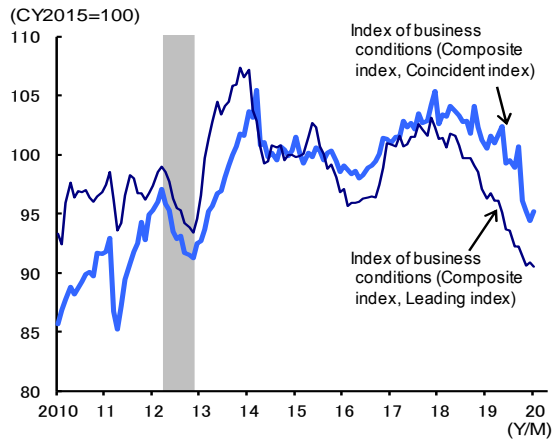
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The General Situation – Economic Activity Has Declined, and the Impact of the Novel Coronavirus Will Continue

Figure 1-1 Economic Activity

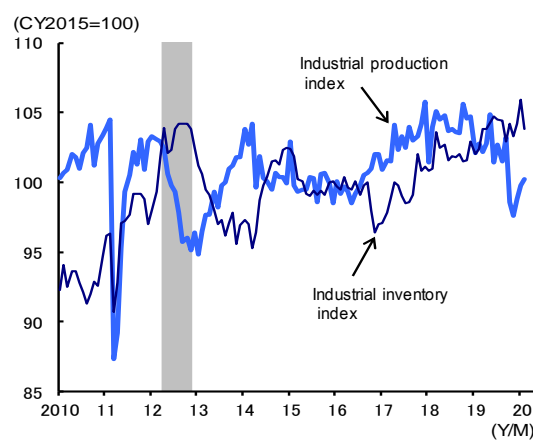
Indices of business conditions remained on a declining trend both in terms of the CI coincident index and the CI leading index.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

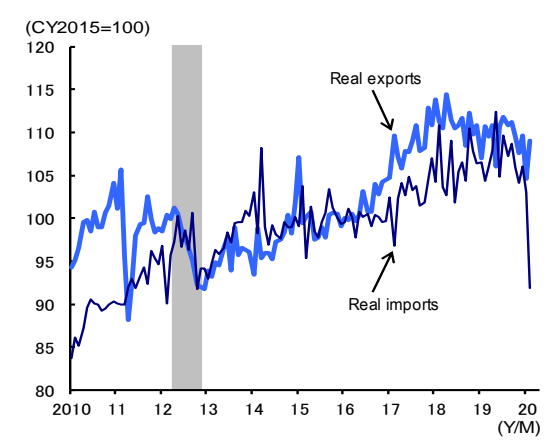
Industrial production index rose for the third consecutive month, as a result of a significant increase in the production of electronic components and devices (preliminary report).



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

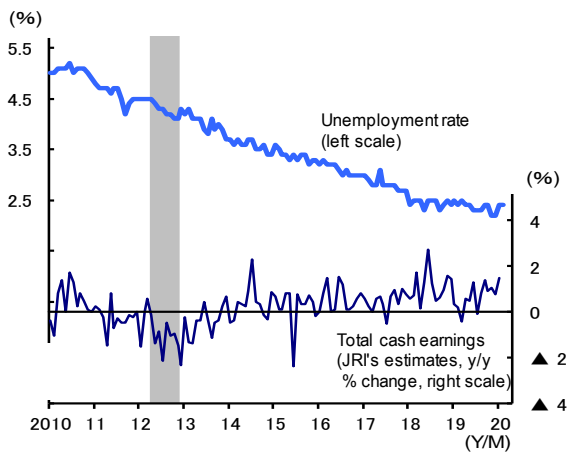
Exports remained sluggish with some fluctuations. Imports declined substantially, particularly of consumer goods from China.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate is hovering around its lowest level since 1993. Nominal wages have been on a rising trend despite some ups and downs.

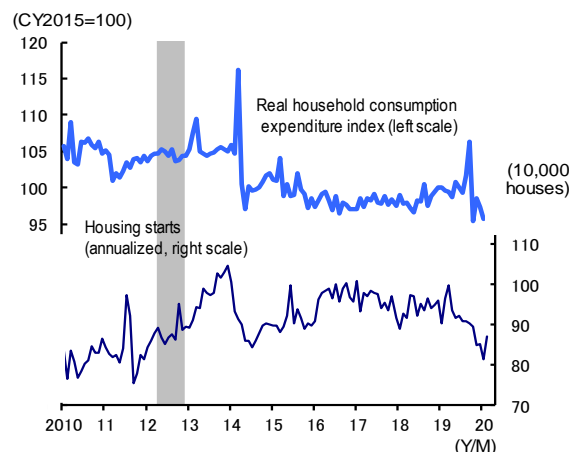


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

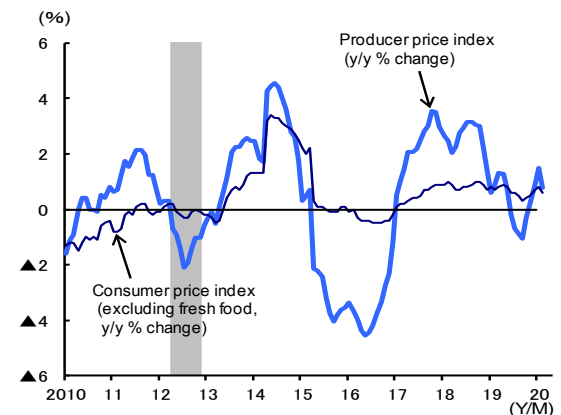
Real household consumption declined after the consumption tax rate hike. Housing starts have been sluggish.



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

Figure 1-6 Prices

Producer prices picked up, mainly for petroleum products. Consumer prices remained on a moderate rising trend.



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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Both Domestic and Overseas Demand Saw a Significant Decline

◆ The DI for Business Conditions Plummeted

In the Bank of Japan's March 2020 Tankan Survey, the large manufacturers' DI for business conditions was down 8 percentage points from the previous survey, showing a decline for five consecutive quarters. The DI deteriorated for both the materials and processing industries due to worsening international commodity market conditions and sluggish overseas demand.

Moreover, the DI for large nonmanufacturers declined for the third consecutive quarter, to plus 8 percentage points from the previous survey, which was its lowest level since March 2013. The DI saw a substantial decline in hotel and food services and personal services due to a rapid decrease in consumption related to inbound tourism and voluntary restraints on outings.

In terms of future outlook, the DI is anticipated to sharply deteriorate, dropping to minus 18 percentage points from the current DI (minus 4 percentage points) across businesses of all sizes and all industries.

◆ Industrial Production Saw an Increase

The Industrial Production Index for February rose, albeit slightly, for the third consecutive month, up 0.4% from the previous month on a preliminary report basis. The production of electronic components and devices increased, reflecting a rebound in global semiconductor demand.

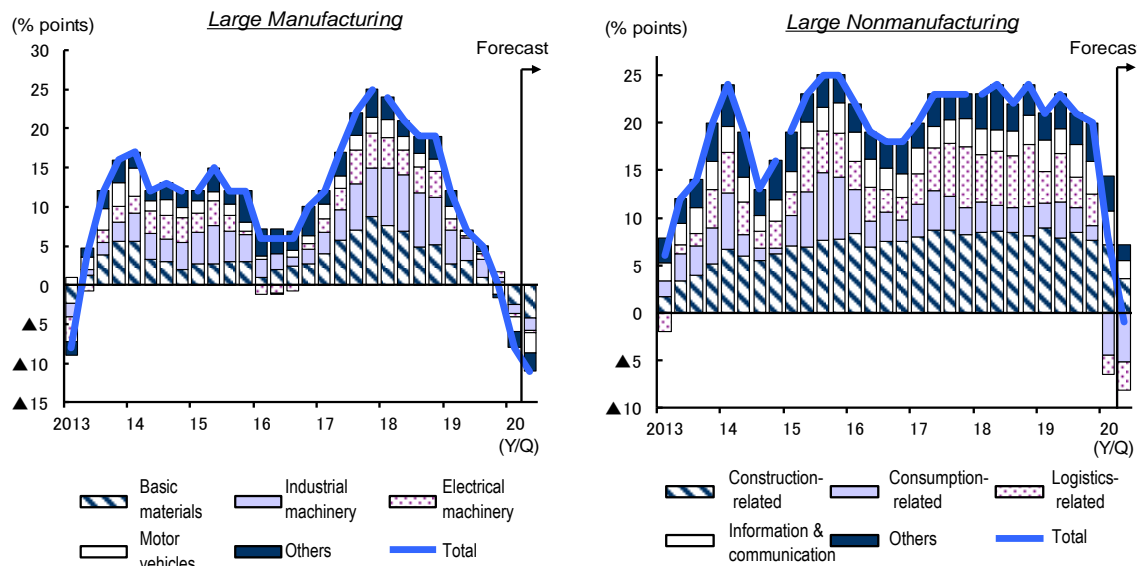
Looking at future production plans, industrial production is forecast to decrease in March by 5.3% month over month, but to increase in April by 7.5% month over month. Since the effects of the spread of the novel coronavirus are not fully reflected on the results of this survey, it is inevitable that there will be a significant decline from the levels in the plan.

◆ Imports from China Have Declined

Real exports remained sluggish amid a global economic slowdown. Meanwhile, Japan's real imports fell sharply. Imports from China declined substantially against a backdrop of a decline in domestic production in China following the outbreak of the novel coronavirus.

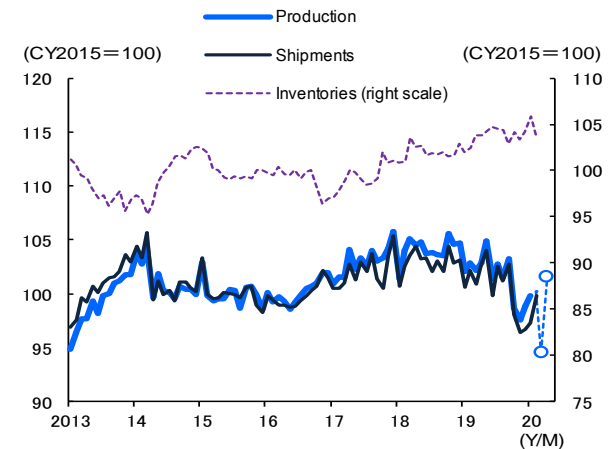
Figure 2-1 Contributions to the Business Conditions Diffusion Index by Industry

<diffusion index of "favorable" minus "unfavorable," and percentage point contribution to total DI points>



Source: The Japan Research Institute, Ltd. based on data of The Bank of Japan, "The Tankan March 2020 Survey".

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 March and April 2020 based on the production forecast index.

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The Global Outbreak of the Novel Coronavirus Will Cause Sharp Negative Growth for FY2020

◆ Significant Negative Growth Will Be Inevitable Due to the Impact of the Novel Coronavirus

JRI economic outlook for Japan has been drastically revised down due to the global outbreak of the novel coronavirus. Japan has not seen an explosive increase in the number of confirmed cases, and the decline in economic activity appears to be less than in other major countries where strict curfews have been imposed. However, negative growth is inevitable in both the January to March period and the April to June period.

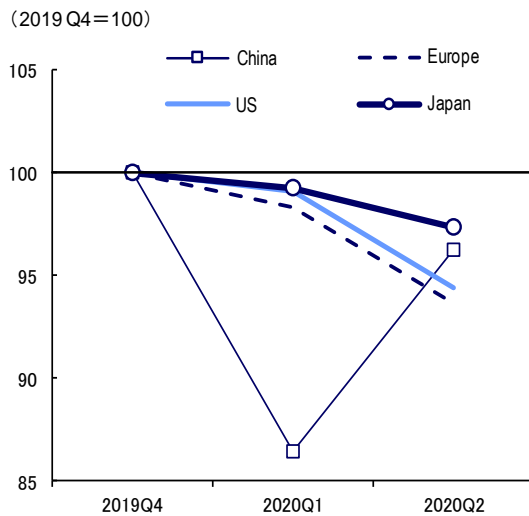
In order for the economy to recover, it is mandatory that the spread of the novel coronavirus settle down. Personal consumption is expected to pick up to some extent if the spread of the outbreak in Japan is contained and the voluntary restraints on outings are eased. However, because it will take time for the economy to return to its previous level, particularly in terms of demand related to inbound tourism and trade activities, a strong, V-shaped economic recovery is expected to be difficult to achieve. Even if we assume that the outbreak was to settle down around May, Japan

is likely to face significant negative growth for fiscal 2020, at a rate below minus 1%.

◆ Policy Measures Are Required to Prevent a Downward Spiral in the Economy

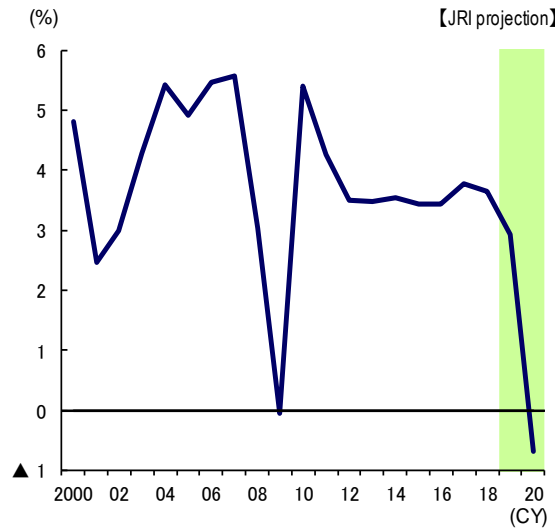
Against this backdrop, the government has drawn up a series of emergency measures related to the novel coronavirus. Furthermore, the government plans to formulate economic measures by the end of April on a scale comparable to the measures taken after the collapse of Lehman Brothers. However, in order for the consumption stimulus measures discussed in the economic package to be effective, it is essential to stop the spread of the outbreak. In addition to preventing the spread of the pandemic and improving the medical system, it is necessary to fully expand measures that are effective in preventing a spiraling economic downturn, such as financial support for companies and income compensation for those on temporary leave.

Figure 3-1 Decline in Real GDP by Country or Area <JRI projection>



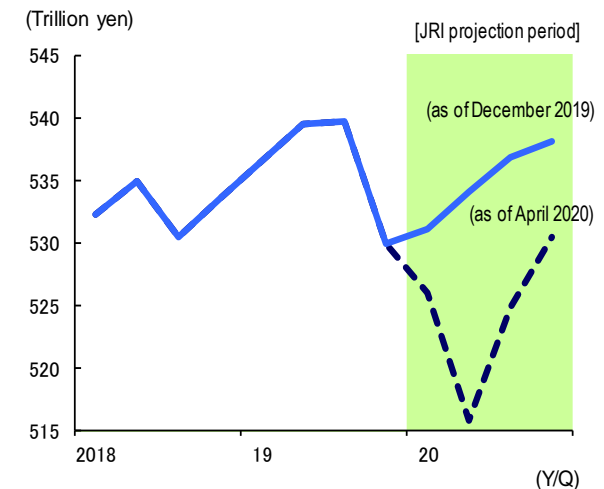
Source: The Japan Research Institute, Ltd. based on data of statistics of each country or area.

Figure 3-2 Growth Rate of the World Economy <JRI projection>



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

Figure 3-3 Japan's Real GDP <JRI projection, seasonally adjusted>



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

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Declines in the Exports of Both Goods and Services Are Inevitable

◆ Exports of Goods Continued to Stagnate

Exports of goods remained sluggish. The decline in exports to the United States came to a halt as the impact of the transfer of auto production subsided, but the decline in exports to China of intermediate goods and capital goods fell sharply against the backdrop of a decline in production activities due to the outbreak of the coronavirus.

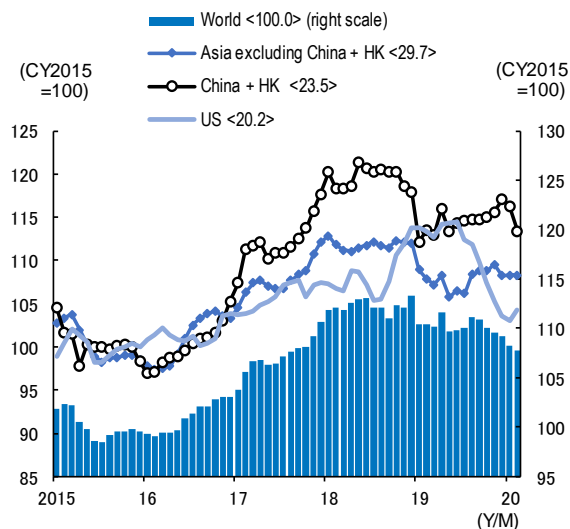
In the future outlook, exports are likely to fall sharply as a result of sluggish economic activities around the world due to the impact of the coronavirus outbreak. Looking at the BOJ Tankan Survey's future outlook of business conditions DI, the DI for overseas supply and demand conditions for products is expected to deteriorate only slightly, so it is likely that the impact of the novel coronavirus was not fully incorporated due to the survey period.

◆ Demand Related to Inbound Tourism Declined Sharply

The number of tourists that visited Japan in February 2020 sharply dropped by 56.0% from the previous month. Since the Chinese government banned group trips abroad due to the outbreak of the coronavirus, the number of Chinese tourists visiting Japan plummeted by 90.8%. Tourists from other regions also decreased. According to an estimate based on the number of tourists visiting Japan and per capita consumption, consumption related to inbound tourism in February decreased by 226.1 billion yen.

In March, the Japanese government tightened immigration regulations, such as by increasing the number of countries subject to visa suspensions, and other governments requested that their citizens refrain from traveling abroad, which has resulted in a movement to refrain from overseas travel. Consequently, consumption related to inbound tourism is expected to decline further in the future.

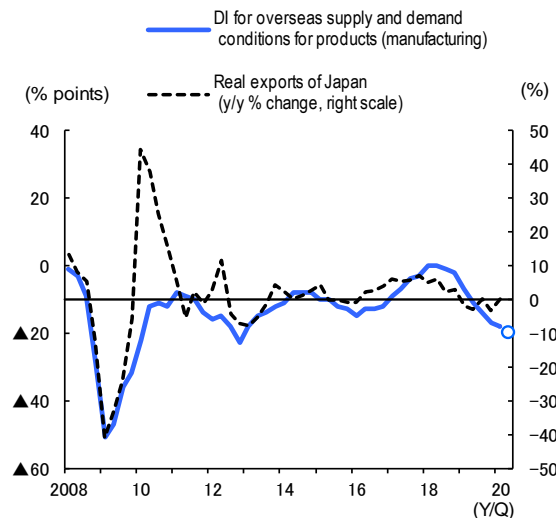
Figure 4-1 Real Exports by Destination
<seasonally adjusted,
3-month moving averages>



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.

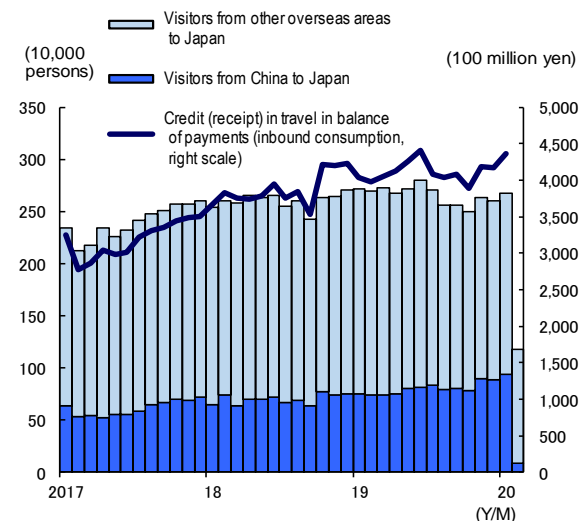
Figure 4-2 DI for Overseas Supply and Demand Conditions for Products



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

Note 1. The latest figure in the DI is a forecast.
2. The figure of real exports in Q1 2020 is for January - February 2020.

Figure 4-3 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).

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As Corporate Profits Deteriorate, Business Sentiment Has Become More Cautious Towards Capital Investment

◆ Corporate Profits Have Deteriorated

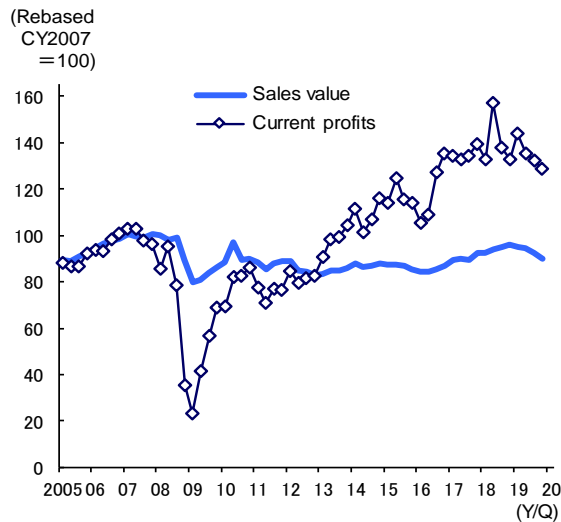
Corporate profits will inevitably deteriorate significantly due to the loss of demand related to inbound tourism and the voluntary restraints on outings among Japanese people stemming from the spread of the coronavirus outbreak. In particular, the hotel and food service businesses, which are heavily dependent on demand related to inbound tourism and are susceptible to a decline in domestic demand, are likely to see a sharp decline in sales, with many companies getting into the red. In addition, as overseas economies are shrinking rapidly due to the global outbreak of coronavirus, business performance is expected to deteriorate in the manufacturing sector, particularly among export-oriented companies including automobile, machinery and electrical equipment manufacturers.

The possibility of rapid deterioration in corporate financing is causing concern. When Lehman Brothers collapsed, funding conditions for SMEs deteriorated substantially within three to four months. There is a risk that corporate bankruptcies could increase sharply if the severe decline in sales continues until around summer.

◆ Business Fixed Investment Has Declined

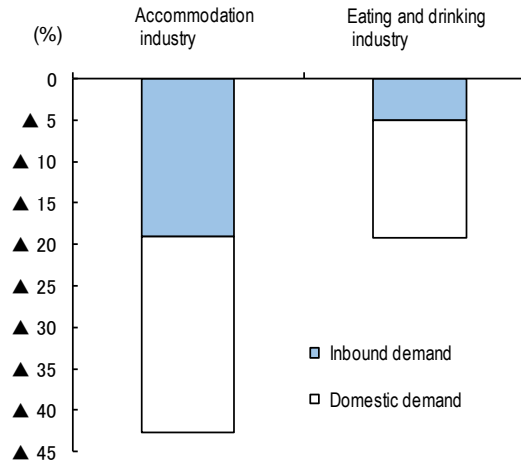
Capital investment is also expected to decline due to the effects of the novel coronavirus. According to the Bank of Japan's Tankan Survey conducted in March, the capital investment plan for fiscal 2020 was kicked off as usual, but it may not have fully taken into account the deteriorating business environment caused by the coronavirus outbreak, given that the survey was conducted on March 11. As a result, the June survey is expected to indicate a weaker pace than usual.

Figure 5-1 Sales Value and Current Profits of Corporations <seasonally adjusted>



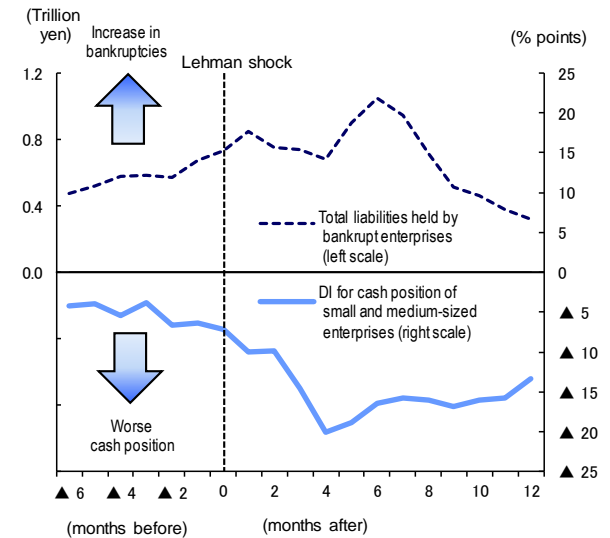
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All industries except for financial services and insurance.

Figure 5-2 Estimated Rate of Decline in Sales Value by Industry <y/y % change in March 2020>



Source: Estimate of The Japan Research Institute, Ltd.

Figure 5-3 DI for Cash Position of Small and Medium-Sized Enterprises



Source: The Japan Research Institute, Ltd. based on the data of Japan Finance Corporation, Tokyo Shoko Research.
Note: The figures of total liabilities are 3-month moving averages.

A Prolonged Outbreak of the Novel Coronavirus Will Result in Serious Employment Adjustments

◆ The Income Situation Has Continued to Improve

While the pace of growth in the number of workers peaked out in 2018, the rising trend has continued with the number of workers increasing by around 600,000 year-on-year. Meanwhile, on the wages front, nominal wages have remained on a rising trend. The total sum of cash earnings in January 2020 rose 1.5% from the previous year, reflecting an increase in scheduled salaries.

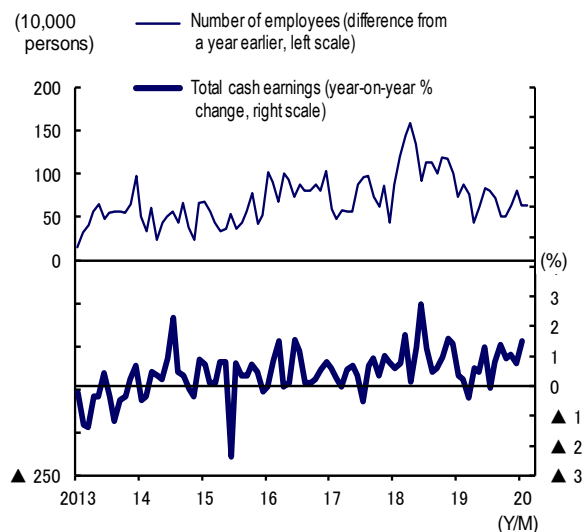
Looking ahead, however, a decline in income is inevitable due to the outbreak of the novel coronavirus. Amid a rising trend of shorter business hours and closures of commercial facilities, incomes for part-time workers will likely see a significant temporary plunge. Regular employees will also see their overtime pay decline due to a decrease in overtime hours. Furthermore, deterioration in corporate earnings has adversely affected this year's spring wage negotiations, and growth in scheduled

salaries is likely to slow down.

◆ There Are Concerns over Serious Employment Adjustments

Furthermore, if the impact of the novel coronavirus continues for a long time, large-scale employment adjustments may occur. Estimates of the impact of a decline in real GDP on employment through the employment adjustments function show that even if demand declines at the same level, downward pressure on employment will almost double if the period of decline increases from three to six months. The unemployment rate is expected to rise only slightly on the assumption that the coronavirus outbreak settles down by the end of May. However, if the impact is prolonged, the unemployment rate will likely rise sharply as was the case with the collapse of Lehman Brothers.

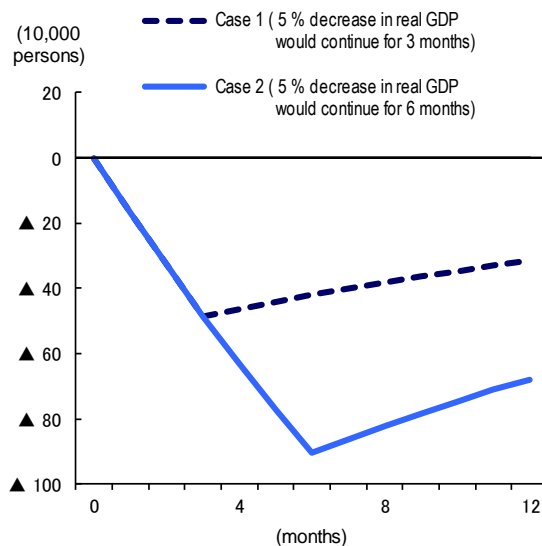
Figure 6-1 Number of Employees and Total Cash Earnings



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

Note: The effects of the sample changes in January 2018 and January 2019 were adjusted in the figures of total cash earnings.

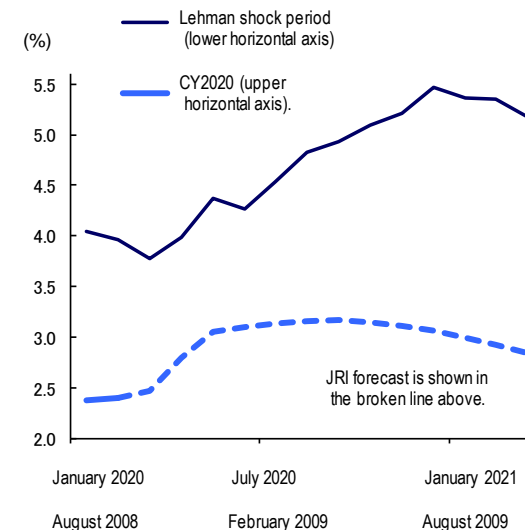
Figure 6-2 Simulation of the Number of Employees



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

Note: Simulation by JRI.

Figure 6-3 Forecast of the Unemployment Rate <seasonally adjusted>



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

Note: Forecast by JRI.

Private Consumption Will Decline Due to the Effects of the Novel Coronavirus

◆ The Spread of the Novel Coronavirus Will Weigh on Consumption

In February, retail sales rose 0.6% from the previous month, up for the fourth month in a row, almost returning to level prior to the consumption tax rate hike. However, the increase in sales in February was actually a temporary upturn in the wake of the coronavirus outbreak. By type of store, sales at drugstores rose sharply, reflecting a growing trend of stockpiling sanitary goods and daily necessities against the backdrop of voluntary restraints on outings. On the other hand, demand for takeout and home delivery services has increased, leading to a rise in fast food and other food services.

In March, a wide range of businesses began to close their doors and operate shorter hours amid the spread of the novel coronavirus. In addition, an increasing number of people, mainly in the Tokyo metropolitan area, has been refraining from

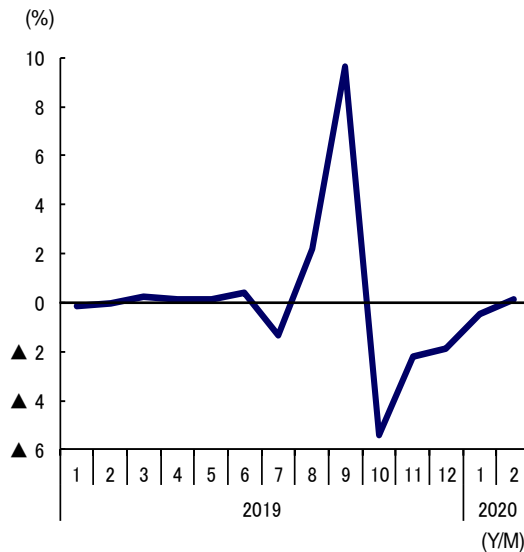
going out. As a result, personal consumption is expected to fall sharply.

◆ Housing Investment Has Been Sluggish

Housing starts in February increased 7.2% from the previous month, up for the first time in two months. Since the surge in demand prior to the consumption tax rate hike was limited and the reactionary decline afterwards has run its course, the fall in housing starts for owner-occupied and subdivision housing came to a halt. Meanwhile, housing starts for rental housing remained sluggish, reflecting stricter screening for apartment loans by financial institutions.

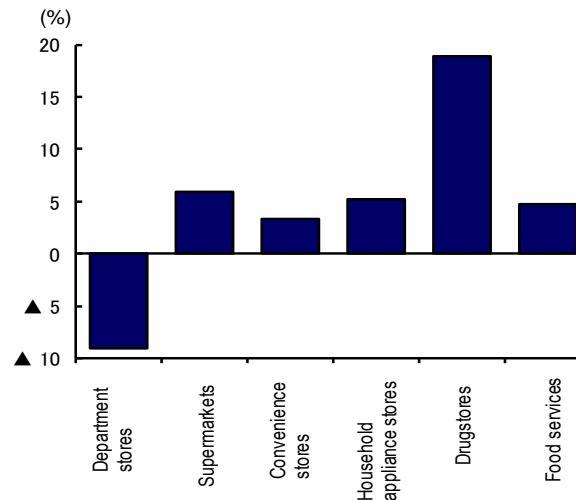
In future prospects, housing investment is expected to decline due to delays in construction and voluntary suspension of events at housing exhibition halls due to the effects of the novel coronavirus.

Figure 7-1 Retail Sales Value
<year-on-year % change>



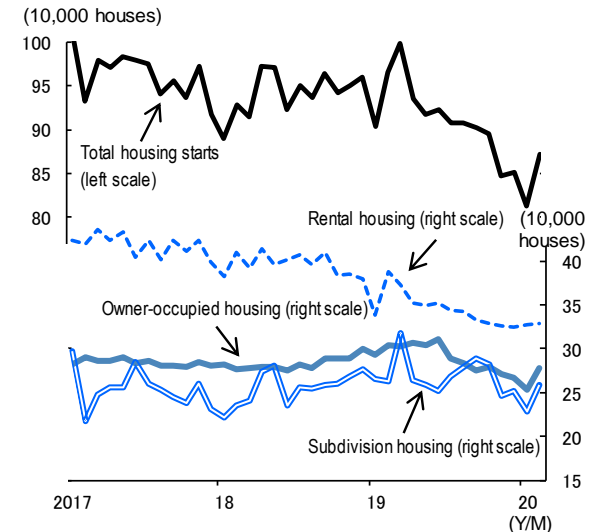
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.

Figure 7-2 Retail Sales Value
by Type of Stores
<February 2020,
year-on-year % change>



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

Figure 7-3 Housing Starts by Type
<annualized, seasonally adjusted>



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

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Topic: There Will Be Effects of the Postponement of the Tokyo Olympics and Paralympics

◆ Negative Effects Due to the Postponement Will Likely Be Limited

The Tokyo Olympics and Paralympics have been postponed due to the global outbreak of the novel coronavirus. As the Tokyo metropolitan government estimated that the economic effect (direct effect) of the Tokyo Olympics and Paralympics would be 5.2 trillion yen, there are concerns over the negative effects of the postponement.

However, most of the increase in demand has already occurred. For example, looking at construction costs for large-scale facilities with a significant increase in demand, permanent facilities such as the New National Stadium have already been completed. Construction demand, which will be delayed due to the postponement, is expected to be limited to some areas such as construction costs for temporary facilities. Most of the other expenses related to the operations of the Games, such as those for marketing and information systems, have already been spent.

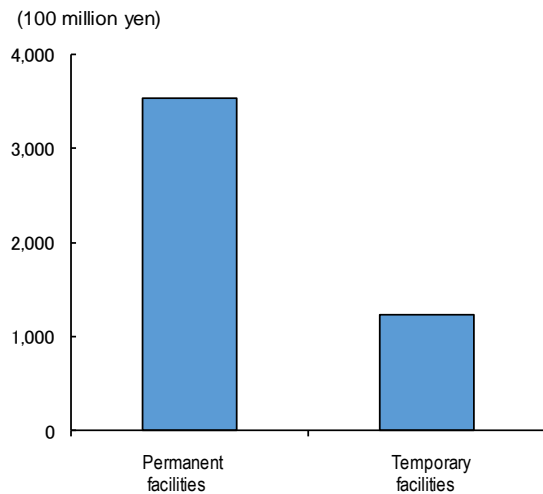
As a result, delayed demand stemming from the postponement is expected to be

limited to around 610 billion yen, including ticket purchases by spectators, consumption related to inbound tourism and expenses for running the Games. Most of this demand is expected to be realized during the July to September 2021 period when the postponed Games will be held.

◆ There Will Be Enormous Effects if the Games are Scaled Down or Canceled

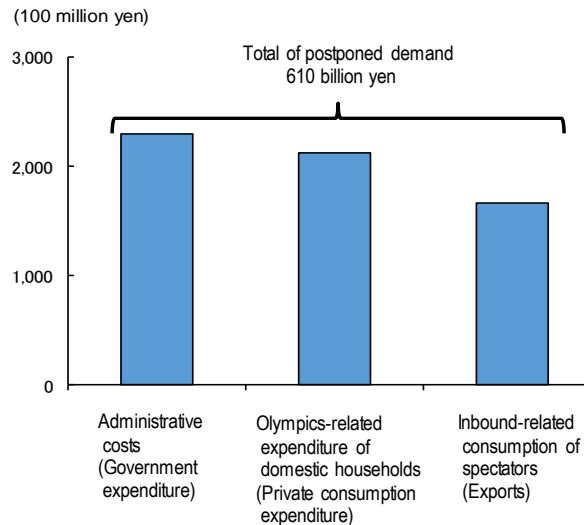
However, if the coronavirus pandemic has not been contained by the time when the postponed Games are to be held next year, the Games may be scaled down or canceled. In this case, the unrealized demand related to the Games would decrease or be lost. Furthermore, if the Games are canceled, the 11.3 trillion yen in legacy effects which are expected after the Games will be mostly lost, except for the use of new permanent facilities and the athletes' village, which have already been constructed.

Figure 8-1 Costs of Athletic Facilities for the Tokyo Olympics and Paralympics



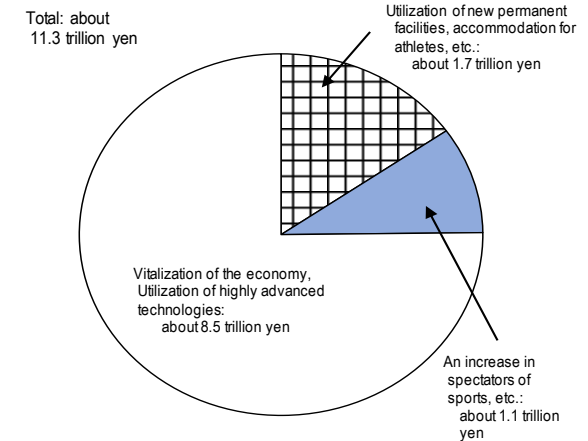
Source: The Japan Research Institute, Ltd. based on data of The Tokyo Organizing Committee of the Olympic and Paralympic Games, various media.

Figure 8-2 Postponed Demand <JRI estimates>



Source: The Japan Research Institute, Ltd. based on data of The Tokyo Organizing Committee of the Olympic and Paralympic Games, Oxford Economics.
Note: The items in parentheses show demand in GDP.

Figure 8-3 Economic Effects after the Tokyo Olympics and Paralympics <JRI estimates>



Source: The Japan Research Institute, Ltd. based on data of Bureau of Olympic and Paralympic Games Tokyo 2020 Preparation.

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Prospects for Japan's Economy - Projected Real GDP Change; -0.1% in FY2019 and -1.4% in FY2020

◆ Japan Will Enter a Recessionary Phase Due to the Growing Influence of the Novel Coronavirus

(1) Negative Growth Is Anticipated for the First Half of 2020

Japan's economy will shrink significantly due to the global outbreak of coronavirus. It is inevitable that both the January to March period and the April to June period will see negative growth. Exports are expected to decline substantially due to a sharp drop in demand related to inbound tourism and a downturn in the global economy. Personal expenditures are also anticipated to continue diminishing, with voluntary restraints on outings weighing on consumption. Furthermore, the corporate sector is expected to become more cautious about capital spending.

(2) Japan will likely see significant negative growth for fiscal 2020

The timing of an economic recovery will depend on the future developments in the coronavirus pandemic. We currently assume that the government's measures against the spread of the outbreak will be proven to be effective and that the outbreak will settle down by the end of May. If the outbreak can be contained in Japan, the economy is expected to return to a recovery path with a rebound in personal consumption, which has been sluggish due to voluntary restraints on outings.

However, even based on the assumption that the coronavirus pandemic settles down sooner, it will take time for demand related to inbound tourism and trade activities to return to their original levels. Because personal consumption is also expected to recover at a moderate pace overall due to the worsening employment and income situation, a strong, V-shaped economic recovery is expected to be difficult to achieve. As a result, Japan will likely see significant negative growth for fiscal 2020, at a rate of minus 1.4%.

◆ The Pace of Year-on-year Rise in the Core CPI Will Likely Slow for the Time Being

(3) The core CPI growth in February diminished from the previous month. This was attributable mainly to a significant fall in energy prices due to a decline in crude oil prices as well as lower accommodation fees reflecting a decrease in demand in line with a drop in the number of tourists visiting Japan and the negative effects of voluntary restraints on outings.

As for future prospects, in addition to weaker upward pressure from the supply-demand side against the backdrop of recession as a result of the spread of the novel coronavirus, energy prices are expected to continue to fall. Consequently, the pace of year-on-year increase in the core CPI will likely slow to around +0% (excluding the impact of the consumption tax rate hike and the provision of free child education and nursery care).

Figure 10 Projections for GDP Growth and Main Indicators of Japan (as of April 3, 2020)

	(seasonally adjusted, annualised % changes from the previous quarter)											(% changes from the previous fiscal year)		
	CY2019		CY2020				CY2021				CY2022	FY2019	FY2020	FY2021
	7~9	10~12	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Projection)	(Projection)	(Projection)
	(Actual)	(Actual)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)
Real GDP	0.1	▲ 7.1	▲ 2.9	▲ 7.5	7.1	4.4	2.6	1.3	2.3	▲ 0.2	1.0	▲ 0.1	▲ 1.4	2.2
Private Consumption Expenditure	1.8	▲ 10.6	▲ 5.0	▲ 6.3	10.5	3.8	2.3	1.2	1.7	0.3	0.9	▲ 0.7	▲ 1.4	2.2
Housing Investment	5.0	▲ 9.7	▲ 4.9	▲ 6.9	▲ 3.4	0.2	1.4	1.8	1.1	0.6	0.4	1.1	▲ 4.2	0.8
Business Fixed Investment	0.9	▲ 17.3	0.8	▲ 8.1	4.2	4.8	3.9	3.2	2.9	2.4	2.4	▲ 0.7	▲ 2.5	3.3
Private Inventories (percentage points contribution)	(▲ 1.0)	(0.0)	(▲ 0.2)	(0.2)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(▲ 0.1)	(▲ 0.1)	(0.0)
Government Consumption Expenditure	3.0	0.9	0.2	2.1	0.6	0.6	0.6	0.5	3.4	▲ 2.4	0.5	2.5	1.1	0.7
Public Investment	4.5	2.8	▲ 0.3	2.3	2.1	5.9	▲ 1.0	▲ 2.5	▲ 0.4	0.6	0.8	3.6	2.2	0.0
Net Exports (percentage points contribution)	(▲ 1.0)	(1.9)	(▲ 0.0)	(▲ 3.2)	(0.7)	(1.2)	(0.7)	(0.2)	(0.3)	(▲ 0.2)	(0.0)	(▲ 0.2)	(▲ 0.4)	(0.4)
Exports of Goods and Services	▲ 2.8	▲ 0.3	▲ 10.3	▲ 15.5	9.0	11.2	7.1	3.3	4.2	▲ 0.2	2.0	▲ 2.0	▲ 3.0	4.9
Imports of Goods and Services	2.8	▲ 10.2	▲ 10.5	3.4	5.2	4.3	3.1	2.4	2.8	1.2	2.0	▲ 1.2	▲ 0.7	2.8
(Ref.) Domestic Private Demand (percentage points contribution)	(0.4)	(▲ 9.5)	(▲ 2.9)	(▲ 4.8)	(6.2)	(2.9)	(1.9)	(1.2)	(1.4)	(0.6)	(0.9)	(▲ 0.6)	(▲ 1.3)	(1.8)
(Ref.) Public Demand (percentage points contribution)	(0.8)	(0.3)	(0.0)	(0.6)	(0.2)	(0.4)	(0.1)	(▲ 0.0)	(0.7)	(▲ 0.5)	(0.1)	(0.7)	(0.3)	(0.1)

	(% changes from the same quarter of the previous year)											(% changes from the previous fiscal year)		
Nominal GDP	2.3	0.5	▲ 1.1	▲ 1.9	▲ 1.7	0.6	1.8	2.4	2.4	1.5	1.4	0.7	▲ 0.3	1.9
GDP deflator	0.6	1.2	1.0	2.5	1.1	0.5	0.3	▲ 1.3	▲ 0.3	0.0	0.3	0.8	1.1	▲ 0.3
Consumer Price Index (excluding fresh food)	0.5	0.6	0.6	0.1	0.2	▲ 0.4	▲ 0.2	0.4	0.4	0.8	0.7	0.6	▲ 0.1	0.6
(excluding fresh food, consumption tax, education free of charge)	0.5	0.3	0.2	▲ 0.2	▲ 0.1	▲ 0.3	▲ 0.1	0.4	0.4	0.8	0.7	0.4	▲ 0.2	0.6
Unemployment Rate (%)	2.3	2.3	2.4	3.0	3.2	3.1	2.9	2.7	2.6	2.5	2.4	2.3	3.0	2.6
Exchange Rates (JY/US\$)	107	109	109	107	108	108	107	108	108	108	108	109	108	108
Import Price of Crude Oil (US\$/barrel)	66	66	66	40	52	58	61	62	63	63	63	68	53	63

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.