In, On and For Emerging Markets

A CEIC Insights Report

Japan Economy in a Snapshot Q3 2020

Executive Summary

In, On and For Emerging Markets

Japan Economy in a Snapshot is a quarterly publication produced by the CEIC Macroeconomic Research Team. The report is designed to provide a comprehensive, albeit concise overview of the current economic and financial developments. The Japan Economy in a Snapshot report is produced using data from CEIC's Global Database.

Summary

Japan's economy witnessed its worst post-war slump in Q2 2020 due to the massive demand shock resulting from the lockdown measures required to address the virus outbreak. **Real GDP** declined at an annualised rate of 27.8%, corresponding to a 7.8% seasonally adjusted q/q contraction and plummeted at an unadjusted rate of 9.9% y/y.

This followed an annualised decline of 2.5% in the previous quarter when the coronavirus effects started, and by 7% in the fourth quarter of 2019 due to the rise in consumption tax and the effects of a typhoon. There were large falls in all the demand side or expenditure components in Q2.

Industrial production, a key economic indicator, fell by 17.7% y/y in June 2020 after plummeting by 26.3% and 15.1%in May and April 2020, respectively.

Consumer price inflation remains far below the BOJ's 2% target, averaging 0.1% y/y in Q2 2020.

The BOJ unveiled a slew of monetary measures in Q2 2020 and July 2020 to soften the economic and financial impact of the coronavirus. However, it left its -0.1% **policy interest rate** and 0% **bond yield target rate** unchanged.

Plummeting tax revenues and a massive rise in fiscal expenditure are expected to result in the government's **budget deficit** soaring to 10% of GDP in 2020 from 2.9% in 2019.

The marked downside impact of the coronavirus on Japan's **exports** in Q2 was reflected in its **trade deficit** in Q2 2020, which averaged JPY 679.6bn, compared with an average trade deficit of only JPY 67.1bn in Q1 2020.

Japan Economy: Statistics at a Glance

Name	03/2019	06/2019	09/2019	12/2019	03/2020	06/2020
Real GDP; % q/q annualized	2.80	1.70	0.20	-7.00	-2.50	-27.80
Fixed Investment; % q/q annualized	1.50	3.30	2.20	-12.40	1.90	-2.90
Industrial Production Index; % y/y change	-1.70	-2.18	-1.10	-6.85	-4.49	-19.81
Retail Trade; % y/y change	0.73	0.72	2.86	-3.82	0.45	-4.54
Consumer Price Index; % y/y change	0.30	0.79	0.33	0.49	0.53	0.07
Core CPI; % y/y change	0.43	0.56	0.56	0.72	0.66	0.33
Producer Price Index; % y/y change	0.93	0.59	-0.88	0.20	0.56	-2.23
Unemployment Rate; %	2.50	2.30	2.40	2.20	2.50	2.80
Exports; % y/y change	-3.86	-5.52	-4.97	-7.84	-5.49	-25.32
Imports; % y/y change	-1.91	-0.13	-4.91	-11.92	-7.23	-16.02
Trade Balance; USD mn	-5,245.86	-2,896.52	-4,985.78	-2,174.57	-1,847.23	-18,992.50
Government Bond Yield: 10 Years; % pa	-0.08	-0.16	-0.21	-0.01	0.03	0.04
Policy Rate; % pa	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
Government Debt; % of GDP	201.30	201.02	199.80	200.59	201.75	214.35
Current Account Balance; USD mn	55,190.59	41,308.95	53,270.32	34,533.89	52,226.97	14,973.20

Source: CEIC Data, Economic and Social Research Institute, Ministry of Economy, Trade and Industry, Statistical Bureau, Bank of Japan, Min of Finance

Economic Outlook

The smoothed CEIC Leading Indicator fell to 66.8 in June 2020, its lowest level on record, from 69.7 and 73.8 in May and April respectively. This indicates how rapidly economic conditions have deteriorated in Japan.

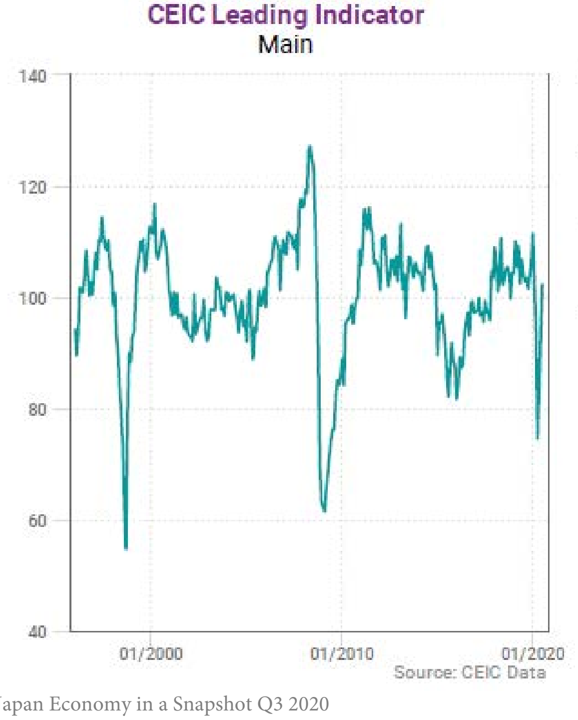
Even though the state of emergency was lifted in late May 2020, a sustained economic recovery is likely to prove elusive in FY2020 (to end March 2021). Overall, the economy will contract at its fastest pace in decades, which is likely to compel the government to announce another fiscal stimulus package.

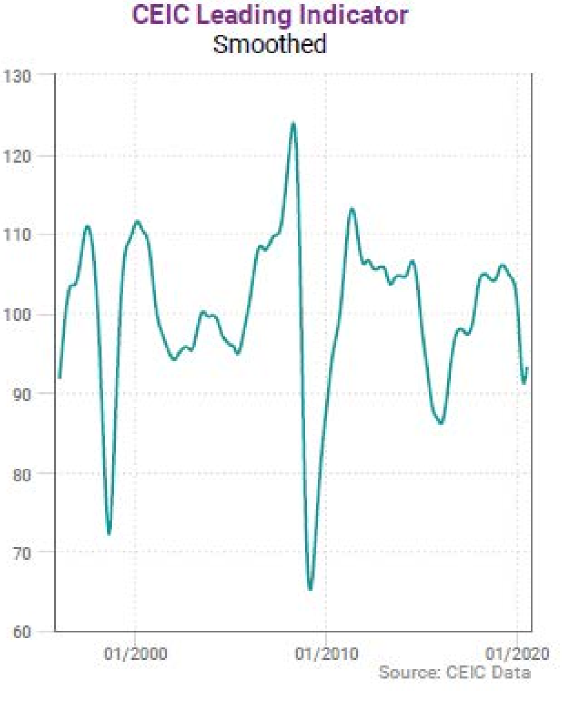
As of July 2020, the authorities have announced two stimulus packages totalling USD 2.2tn. According to the UK-based consultancy firm, Oxford Economics, real GDP is forecast to contract by 6% in 2020 before it grows by 2.8% in 2021.

According to Atsushi Takeda, chief economist at Itochu Research Institute, it will take two-to-three years for economic activity in Japan to return to normal, as the economies of Japan's trading partners continue to suffer the after-effects of the pandemic.

Business investment is expected to drop markedly in 2020 due to weak demand. According to Oxford Economics, declining profitability, falling production of capital goods and further falls in both domestic and foreign machinery tool orders seem to suggest that Japan is likely to witness a marked pull back from business investment in the coming quarters of 2020, weighing on GDP.

Consumer spending, which accounts for around 60% of Japanese GDP, is expected to recover very gradually after plummeting in Q2 2020 resulting from the state of emergency in Japan which was lifted on May 25, 2020. However, various factors, such as concerns regarding the coronavirus pandemic, rising unemployment, falling wages and plunging consumer confidence pose the risk of consumer spending sliding over the coming months.





Real Sector

Real Sector

Japan's economy witnessed its worst post-war slump in Q2 2020 due to the massive demand and supply shock resulting from the lockdown measures required to address the virus outbreak. Real GDP declined at an unprecedented annualised rate of 27.8% in Q2 2020 (the highest on record), corresponding to a 7.8% seasonally adjusted q/q contraction. This followed an annualised decline of 2.5% in the previous quarter as the coronavirus effects started, and by 7% in the fourth quarter of 2019 due to the rise in consumption tax and the effects of a typhoon.

Household consumption, which accounts for around 60% of Japan's GDP, and is a key driver of the economy, plummeted in Q2 by 8.2% q/q (28.9% annualised) as the coronavirus regulations compelled consumers to stay at home. Private residential and non-residential investment declined by 0.2% q/q and 1.5% q/q respectively (-0.8% and -5.8% annualised) and exports contracted by 18.5% (56% annualised), with imports down by 0.5% q/q (2.1%annualised).

Retail sales increased by 1.2% y/y in June 2020 after falling by 12.5% y/y in May 2020 and 13.9% y/y in April, as the state of emergency declaration stunted demand and dealt a blow to consumer confidence. A slump in discretionary spending has been pulling down retail sales of general merchandise, fabrics, clothing and accessories, motor vehicles and fuel.

Japan's household spending slumped by 16.2% y/y in May 2020, which is the fastest pace of decline on record, following an 11.1% decline in April 2020. The pandemic has led to a large reduction in consumer spending, particularly on hotels, transport and eating out due to declining real wages and firms furloughing and making staff redundant.

Real wages, a key measure of household spending, fell by 2.1% y/y in May 2020, following a 0.7% decline in April. This is the largest drop in real wages since 2015.

The consumer confidence index (CCI), which measures consumer expectations about the economy for the next six months, and price expectations every month for the year ahead, had been declining persistently from mid-2019 to 21.6 in April 2020, but rose in successive months to 29.5 in June 2020. However, this still indicates that consumers remain pessimistic amid the coronavirus crisis given the fact the CCI averaged 42.1 between 1983 and 2019.

Industrial production declined by 17.7% y/y in June 2020, after plummeting by 26.3% and 15.1% in May and April 2020, respectively. Industrial production contracted by 16.7% y/y in Q2 2020, which compares with a decline of 4/4%in Q1 2020 and reflect the severity of the pandemic's impact on Japan's export-reliant manufacturing sector.

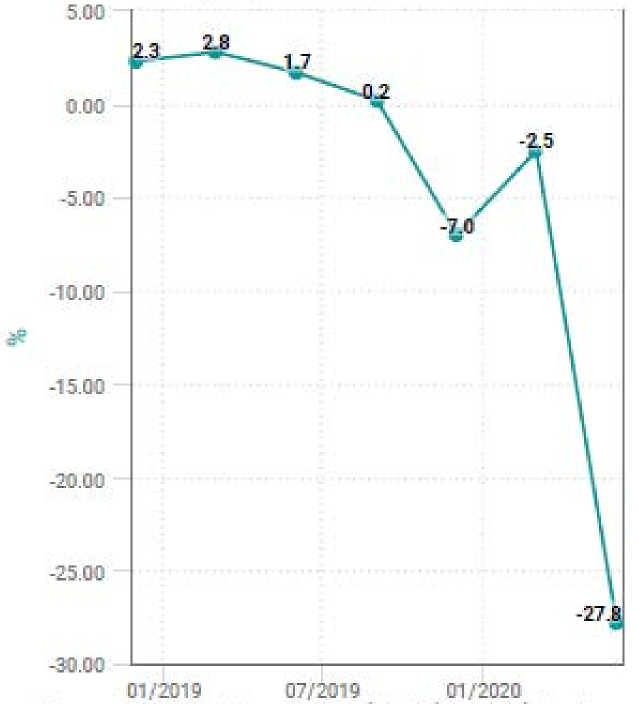
Core machinery orders (excluding ships and electricity) are a leading indicator of capital expenditure in the coming six to nine months and unexpectedly rose by 1.7% m/m in May 2020, after slumping by 12% in April (the fastest decline since 2018). The increase in headline orders was due to more demand from the services sector, which masked a plunge in external and manufacturing orders. A 15.5% drop in manufacturers' orders was offset by a 17.7% increase in orders by non-manufacturers in May 2020. External orders fell by 18.5% to the lowest level since 2010. Core machinery orders nevertheless fell by 16.3% y/y in May 2020, following a 17.7% decline in April.

Manufacturing activity remained mired in deep contraction in Q2 2020, despite a rise in the sector's purchasing managers' index (PMI). This represented a 14th consecutive month of decline (a reading below 50), resulting from lower output, new orders and purchasing activity. The PMI continued to rise in July to 45.2 but remained in negative territory.

The services PMI came in at 45.4 in July 2020, rising slightly from 45.0 in June and much improved on the May and April readings of 26.5 and 21.5, respectively, although it marked a sixth consecutive month of contracting activity in the services sector. The slump in services sector activity eased significantly in June after a nationwide state of emergency was lifted, enabling business conditions to gradually return to normal, although demand conditions remained fragile.

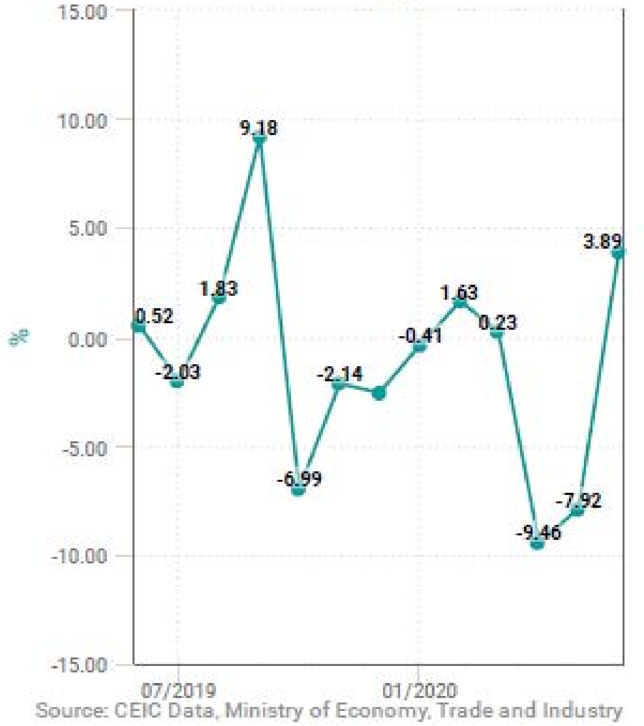
According to Ministry of Internal Affairs and Communications data, the seasonally adjusted unemployment rate rose to 2.8% in June 2020 from 2.9% in May and 2.6% in April. The number of unemployed people in Japan stood at 1.95mn in June 2020, which represented an increase of 330,000 from the previous year.

Real GDP Growth, q/q
Seasonally Adjusted at Annual Rates



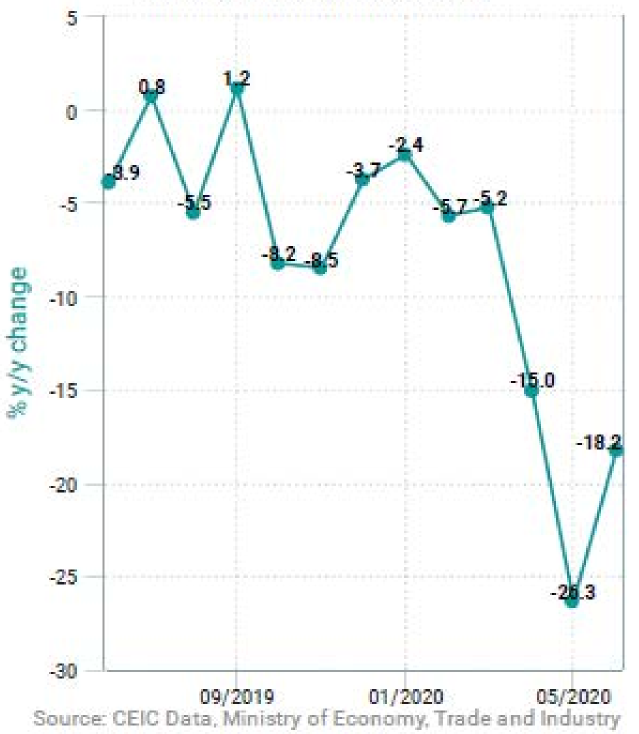
Source: CEIC Data, Economic and Social Research Institute

Retail Trade, y/y



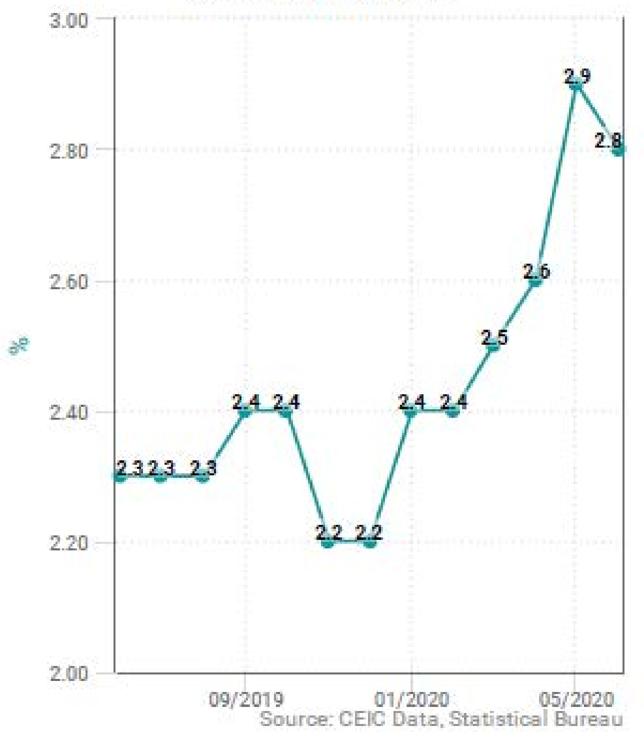
Source: CEIC Data, Ministry of Economy, Trade and Industry

Industrial Production Index
Mining and Manufacturing



Source: CEIC Data, Ministry of Economy, Trade and Industry

Unemployment Rate
Seasonally Adjusted



Source: CEIC Data, Statistical Bureau

Monetary & Financial Sector

Monetary and Financial Sector

Due to lower oil prices, weak wage growth and reduced private consumption resulting from the pandemic, inflation measured by the consumer price index (CPI) came in at a three-year low of 0.1% y/y in June 2020, unchanged from both May and April 2020, respectively.

At this level, the headline inflation rate is well below the Bank of Japan's (BOJ's, central bank's) 2% target, despite almost seven years of massive monetary policy stimulus. The headline inflation rate averaged 0.1% in Q2 2020, down from 0.5% in Q1 2020.

The core CPI measure (excluding fresh food) was unchanged in June 2020 (showing zero inflation) after declining by 0.2% y/y in both May and April 2020. It highlights the continued fragility of domestic demand in Japan and the enormous challenge the BOJ has to achieve the inflation target.

The BOJ's response to the COVID-19 slump in the economy has essentially involved providing corporate credit to support the government's fiscal efforts, while keeping its interest rates unchanged.

At its April 27, 2020, monetary policy meeting, the BOJ announced a raft of new policies and stated that it would purchase an unlimited amount of JGBs, which until then were restricted to a total volume of JPY 80tn (USD 745.2bn) per year. However, the BOJ did not alter its yield-control framework within which it targets short-term interest rates of -0.1% and 10-year bond yields of around 0%. The BOJ also announced an expanded corporate bond purchase programme that will slightly lower yields on short-term commercial paper.

The BOJ furthermore increased the existing limit on purchases of corporate bonds and commercial paper to ease corporate funding strains which means that, according to Reuters, the BOJ will enhance three-fold the maximum amount of corporate bonds and commercial paper it purchases to JPY 20tn (USD186 bn) from around JPY 7tn.

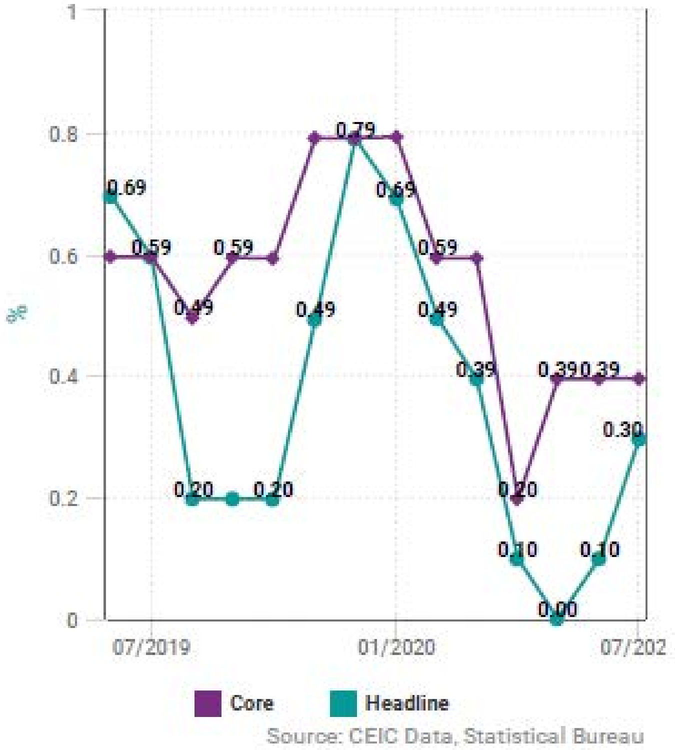
Following its policy initiatives in April 2020, the BOJ, presented an upgrade to its SME lending programme in an emergency meeting in early May, according to Oxford Economics, which essentially ties its previous pandemic funds supply operations to the government's emergency support measures. This adds to the range of measures undertaken by the BOJ in April 2020, while at the same time it kept its -0.1% policy rate and 0% bond yield target unchanged.

At its monetary policy meeting in June 2020, the BOJ kept its policy broadly unchanged, although, according to Focus Economics, it revised upwards the amount of business loans it could potentially back under a pre-existing scheme designed to provide support to the Japanese economy. Furthermore, in its loan support programme, which helps banks extend loans to firms at low interest rates, the BOJ revised the total potential value of the programme to JPY 110tn (around USD 1.0tn), from JPY 75tn (around USD 700bn) in June 2020 after the government expanded its loan support programme in the previous month. The BOJ also stated that it would continue with not setting an upper ceiling on the amount of JGBs it would purchase to cap the 10-year JGB yield at around 0.0%.

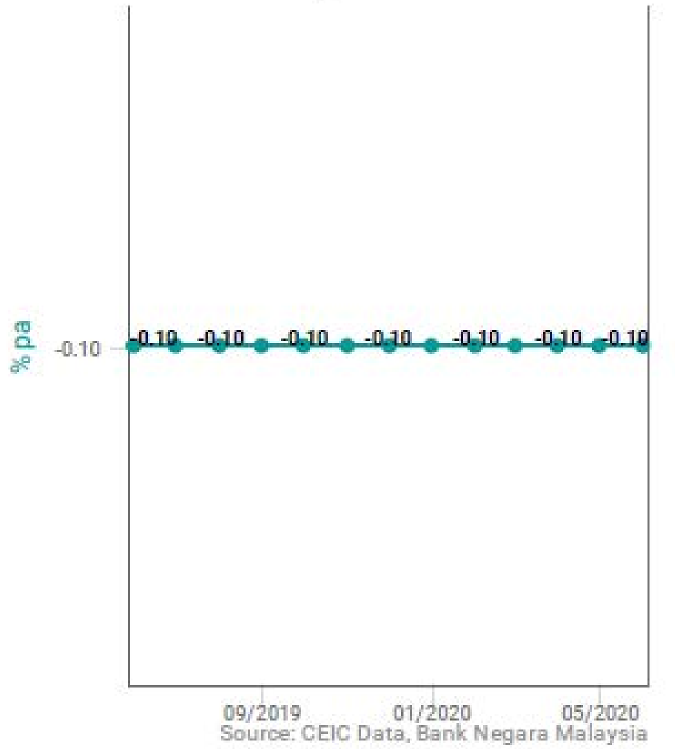
The BOJ kept monetary policy unchanged at its July 2020 meeting, despite the weak economic outlook, which suggests that it believes it has done all that it can for now and is focused on the stability of the JPY against the USD. The overnight interest rates were kept on hold at minus 0.1%, while 10-year bond yields remained capped at around 0.0% and purchases of equity exchange traded funds (ETF's) were kept steady at a pace of JPY 12tn (USD 112bn) per year. The BOJ also decided to maintain its corporate support measures totalling JPY 110tn (USD1tn) in July 2020. These measures include interest-free loan programmes for companies, and corporate bond and commercial paper purchases introduced at its June monetary policy meeting.

Withthe global coronavirus crisis showing no signs of abating, the Nikkei stock market index (or Nikkei 225) fell sharply to 18,917 at the end of Q1 2020, from 23,657 at the end of Q4 2019. Thereafter, the index rose to 22,288 at the end of Q2 2020 and further to 22,946 by July 15, 2020.

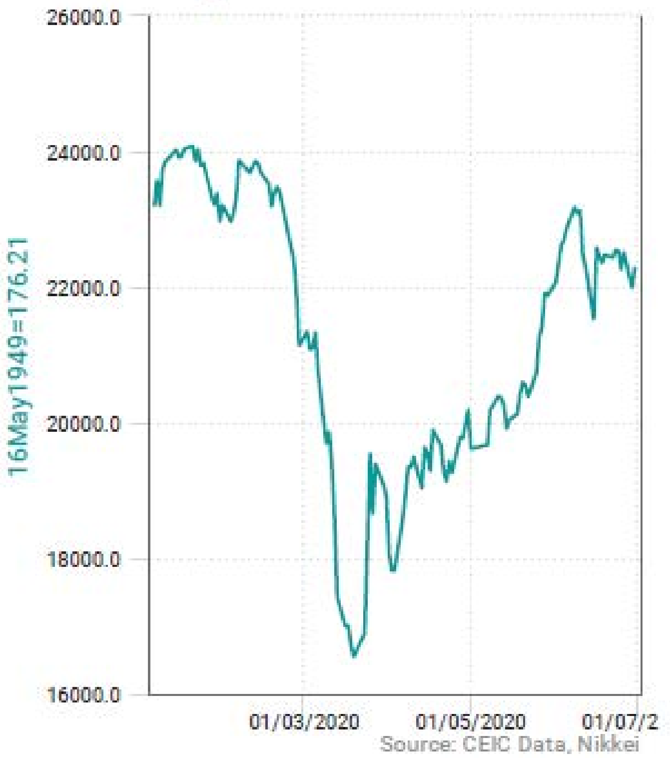
Headline & Core Inflation



Policy Rate



Tokyo Index Nikkei 225



10 Year Government Bond Yield

Fiscal Sector

Fiscal Sector

As a result of the coronavirus pandemic, Japan has rolled out massive fiscal stimulus plans that as of July 7, 2020, amounted to more than 40% of GDP, according to the New York Times.

In view of the worsening economic scenario due to the spread of the coronavirus, the government unveiled on April 7, 2020, a JPY 108.2tn (USD 992bn) fiscal stimulus package worth around 20% of GDP. Later in April, the government increased the size of this emergency fiscal stimulus package to JPY 117.1tn (USD 1.1tn) after approving a revised supplementary budget worth approximately JPY 25.7tn for fiscal year 2020.

The government then announced a second fiscal package worth an estimated 13% of GDP of new spending in late May 2020. According to Oxford Economics, this package included measures to enhance medical spending, provided firms with direct subsidies and offered support for payment of rent and financial assistance to students.

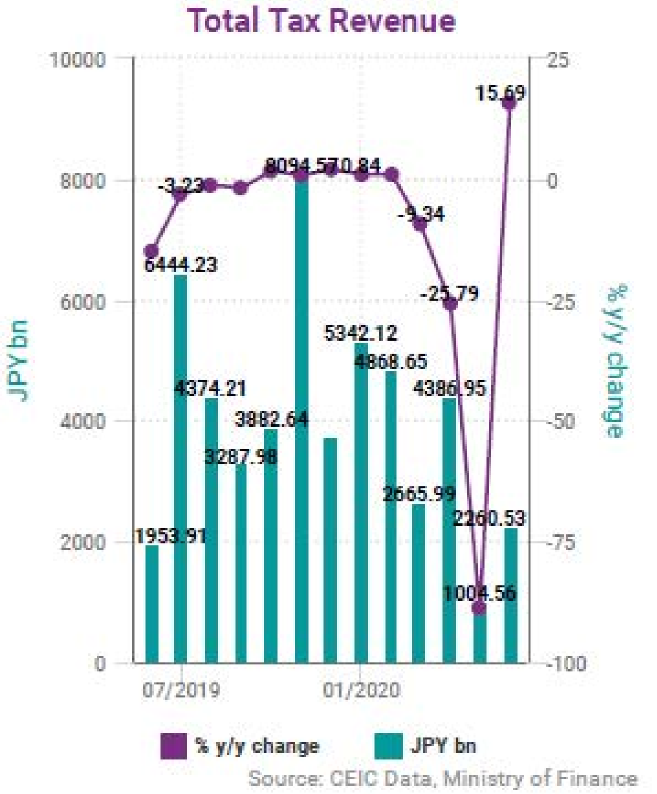
The government in December 2019 estimated that FY2020 (to end-March 2021) tax revenues would reach JPY 63.51tn but given the onset of the pandemic attaining this now seems highly implausible. The pandemic has already adversely affected Japan's tax revenues in FY2019 (to end-March, 2020), due to the hit to corporate sales and profits. According to the Finance Ministry, Japan's fiscal revenue fell by 3.2% y/y to JPY 58.44tn (USD 540bn) in FY2019 with sluggish corporate tax revenues mainly responsible for the sharp fall.

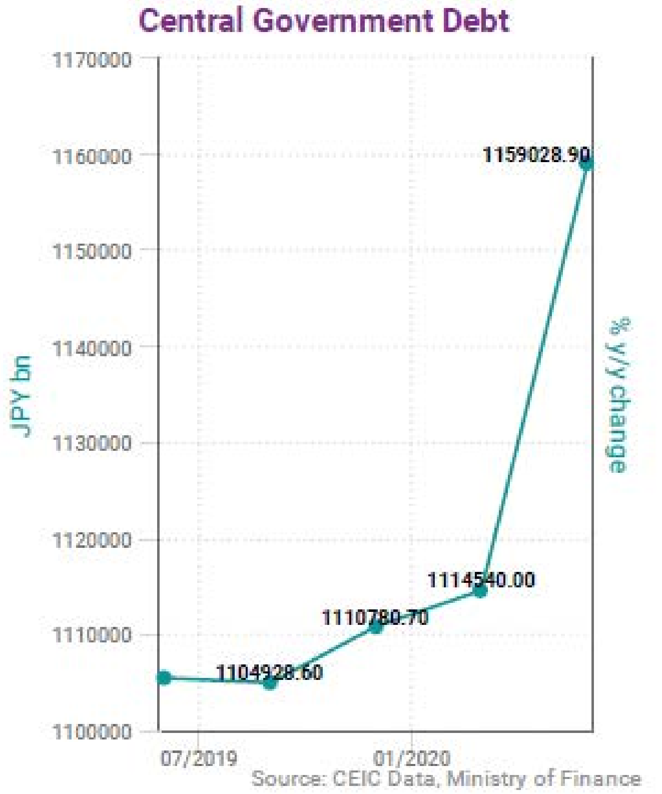
Corporate tax revenue plunged by 12.3% y/y in FY2019 to JPY 10.8tn, while consumption tax revenue grew by 3.8%y/y to JPY 18.35tn, aided by the October 2019 sales tax hike to 10% from 8%. However, due to the pandemic, consumption tax revenue was lower than the government estimate of JPY 19.1tn in FY 2019.

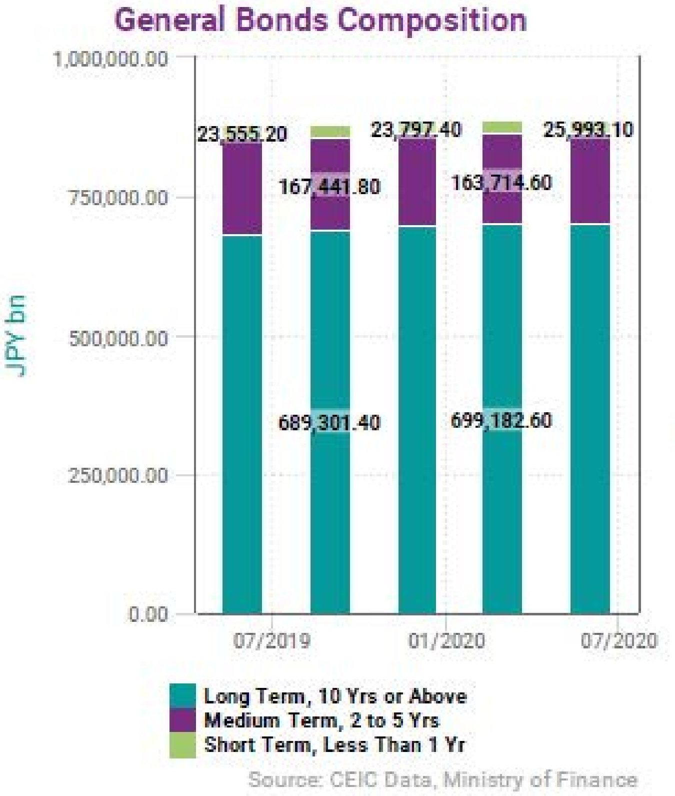
Given plummeting tax revenues and massive fiscal expenditure to offset the downside impact of the virus on the Japanese economy, the government's budget deficit is expected to soar to 10% of GDP in 2020 from 2.9% in 2019. This, in turn, will result in gross public debt rising to 252% of GDP, from 230% of GDP at the end of 2019, according to the US think-tank Atlantis Council. Japan has run budget deficits consistently over the past three decades, resulting in one of the highest public debt-to-GDP ratios in the world.

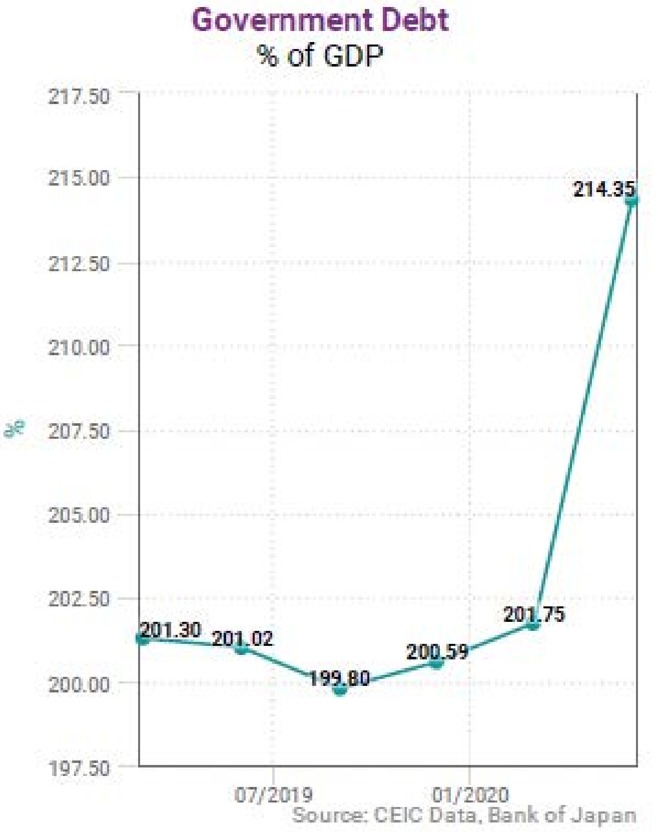
Increases in net lending by households and corporate sectors consistent with weak demand conditions and the high level of precautionary savings have enabled Japan to accommodate larger budget deficits. However, over time, due to the ageing population, running budget deficits and accumulating debts will be unsustainable.

The yields on the benchmark 10-year Japanese government bond (JGB) have been suppressed by negative interest rates and the Bank of Japan (BOJ, the central bank) purchasing bonds for several years, capping borrowing costs using a yield curve control strategy, causing yields to fall from nearly 2% in 2006 to 0.02% by June 30, 2020. However, as of July 5, 2020, longer-term borrowing costs had jumped to their highest level in a year due to the fact investors had become concerned about a summer deluge of bonds issued by the government to finance its fiscal stimulus. The yield on the 30-year JGB went up to more than 0.5%, its highest since May 2019, and the spread between 20- and 30-year bond yields widened to more than 0.15%. Despite the higher yield on government bonds with a longer maturity, the 10-year government bond yield has remained suppressed due to the BOJ's yield curve control strategy.


Total Tax Revenue
10000
8000
6000
4000
2000
0
25
0
-25
-50
-75
-100
JPY bn
% y/y change
15.69
-3.23
8094.57
0.84
-9.34
6444.23
-25.79
5342.12
4868.65
4374.21
4386.95
3882.64
3287.98
2665.99
2260.53
1953.91
1004.56
07/2019
01/2020
% y/y change
JPY bn
Source: CEIC Data, Ministry of Finance


Central Government Debt
1170000
1160000
1150000
1140000
1130000
1120000
1110000
1100000
JPY bn
% y/y change
1159028.90
1114540.00
1110780.70
1104928.60
07/2019
01/2020
Source: CEIC Data, Ministry of Finance


General Bonds Composition
1,000,000.00
750,000.00
500,000.00
250,000.00
0.00
JPY bn
23,555.20
23,797.40
25,993.10
167,441.80
163,714.60
689,301.40
699,182.60
07/2019
01/2020
07/2020
Long Term, 10 Yrs or Above
Medium Term, 2 to 5 Yrs
Short Term, Less Than 1 Yr
Source: CEIC Data, Ministry of Finance


Government Debt
% of GDP
217.50
215.00
212.50
210.00
207.50
205.00
202.50
200.00
197.50
%
214.35
201.75
201.30
201.02
200.59
199.80
07/2019
01/2020
Source: CEIC Data, Bank of Japan

External Sector

External Sector

The dismal data on exports provides the strongest evidence of Japan's marked economic downturn in Q2 2020 compared with the previous quarter due to the coronavirus pandemic. Merchandise exports, valued in USD, fell by 26.5% y/y in June 2020, following declines of 23.5% and 19.8% in May and April, respectively. This was the 19th consecutive month of a y/y decline in Japanese exports and they fell at their fastest pace since the global financial crisis.

Disconcertingly, June was the fourth consecutive month in which Japan's exports tumbled at a double-digit pace - reflective of the heavy toll that the pandemic is taking on Japan's export-led economy.

In June 2020, exports to China and Taiwan, which are Japan's first and fourth largest export destinations, grew by a paltry 0.3% y/y and 0.8% y/y respectively, while exports to the US, Japan's second largest trading partner after China, plunged by 46% y/y, contributing to a significant decline in exports to the US in Q2 2020 compared with Q1 2020. Exports to South Korea and Hong Kong, the third and fifth largest destinations fell by 14.7% y/y and 14.1% y/y respectively.

As for imports, valued in USD, they fell by 17.7% y/y in June 2020 after dropping by 18.4% y/y and 4.6% y/y in May and April respectively, reflecting the ongoing weakness in domestic demand.

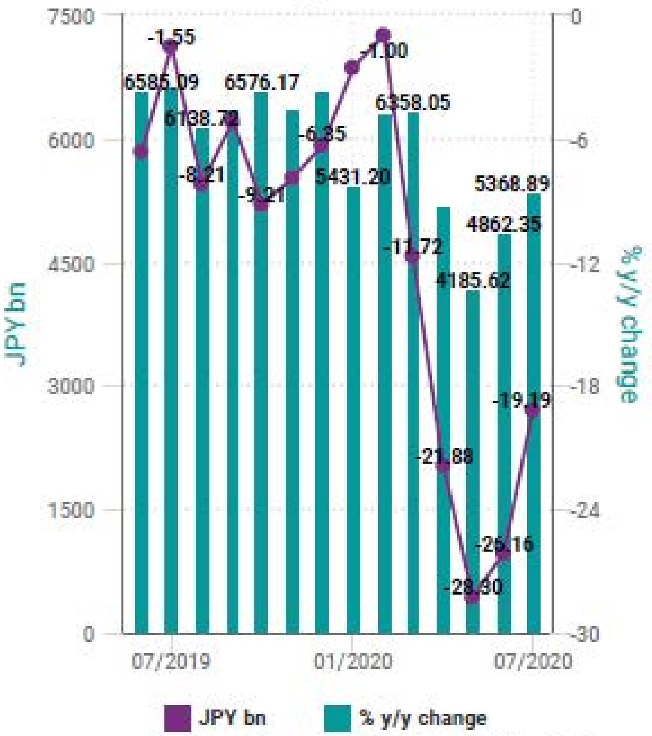
Consequently, Japan's trade deficit was USD 3.9bn in June 2020, narrowing from USD 5.5bn and USD 8.8bn in May and April 2020, respectively but still worse off than in June 2019 when Japan had a trade surplus of USD 0.3bn.

The JPY per USD exchange rate ended Q2 2020 at 107.42, appreciating from 108.4 and 109.2 at the end of Q1 2020 and Q2 2020 respectively. The JPY has been drawing strength from Japan's relatively successful COVID-19 containment strategy, while the USD has been weakening against major currencies, including the JPY, due to various US-related economic, financial, social and political reasons and a shift in investor sentiment favouring the euro and JPY.

In a sign of rising protectionism, in May 2020 Japan adjusted its foreign direct investment (FDI) rules, according to Business Today. According to the revisions, foreign investors will have to notify the Ministry of Finance before they acquire a 1% stake in more than 50% of all Tokyo-listed companies, including the large 'blue-chips' such as Sony and Toyota. Making prior government approval mandatory is likely to restrict foreign investments into Japan but according to the Finance Ministry these measures were taken in view of Japan's national security and will not obstruct any attempts to improve corporate governance or enhance returns to shareholders.

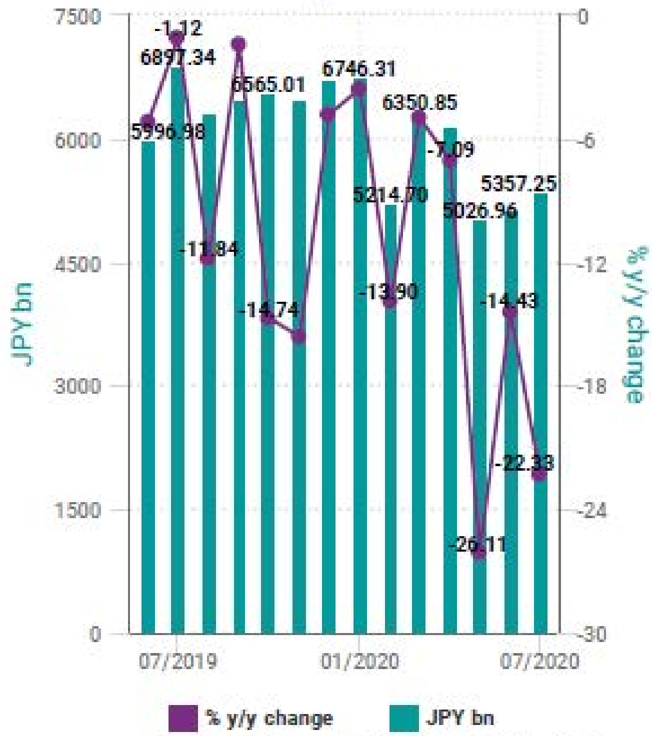
According to a notification issued by the Finance Ministry, as many as 518 companies have been named as pivotal to Japan's national security. As a result, foreign investment in these companies will require government clearance. Such companies include apartment rental agencies, online brokerage firms, travel agencies and an online gift-giving service.

Exports



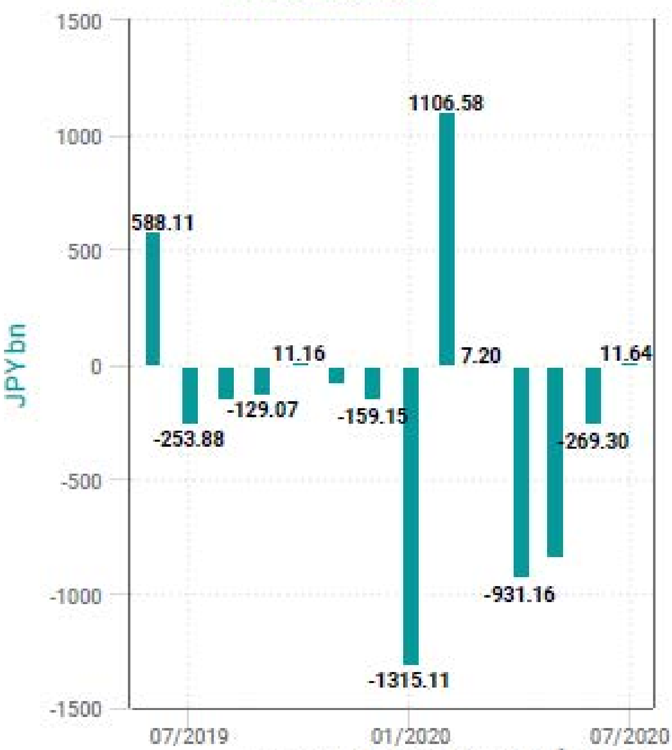
Source: CEIC Data, Ministry of Finance

Imports



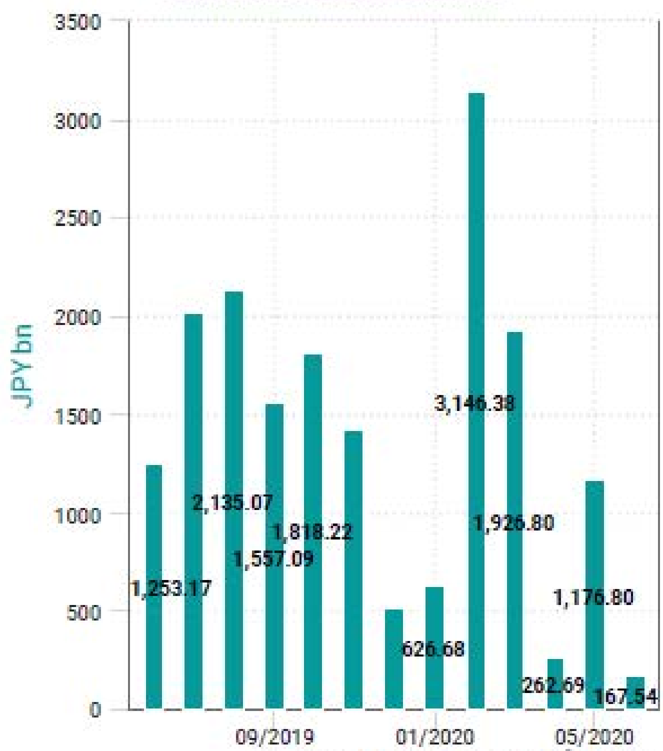
Source: CEIC Data, Ministry of Finance

Trade Balance



Source: CEIC Data, Ministry of Finance

Current Account Balance



Source: CEIC Data, Ministry of Finance

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About CEIC Data

CEIC is an ISI Emerging Markets Group Company specialized in high quality macroeconomic databases. CEIC's databases have earned a world-class reputation among financial institutions, government agencies, universities, and corporations due to accuracy and comprehensiveness. Today, we are the service of choice for economic research on emerging and developed markets by economists around the globe.

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CEIC Insights is a unit of CEIC Data that produces proprietary research and analysis. The service features data templates with dynamic visuals for Emerging and Developed markets, providing instant insight from macro overviews to individual sector analysis.

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