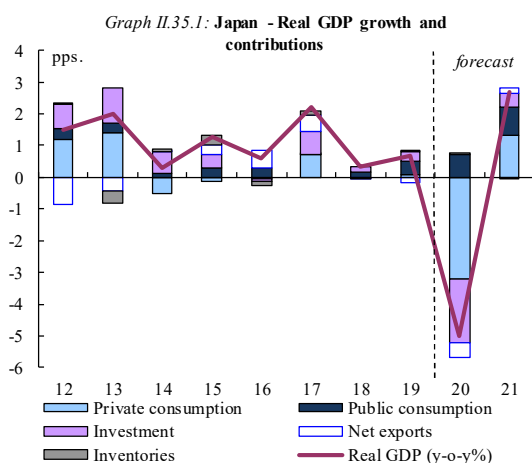


35. JAPAN

After a very weak end of 2019, economic activity is set to slump in the first half of 2020 amid the negative COVID-19 shock to external demand and lockdown-related demand suppression. The recovery from this shock is likely to be gradual, as policy space is limited and uncertainty about economic prospects has increased markedly.

Partial lockdown and tumbling external demand weighs on growth

After three quarters of robust growth, real GDP growth in Japan flattened in Q3-2019 and dropped rapidly in Q4-2019 to -1.8% q-o-q reflecting the negative impact of a hike in the consumption tax rate and the impact of typhoon Hagibis. For the year as a whole, economic activity increased by 0.7% driven by robust public consumption and investments linked to the organisation of the 2020 Tokyo Olympics and labour-replacing automation.



A recovery was expected to take hold in the beginning of 2020 but the COVID-19 outbreak led to a sharp fall in external demand, disruption of global value chains, plunging tourism revenues and weakened domestic demand. On the external side, tourism revenues plummeted as Japan has imposed wide-ranging border controls and exports slumped as the pandemics ravaged China and, later on, advanced economies. On the domestic side, retail sales were relatively robust in February in line with the limited scale of containment measures so far, although consumer confidence paints a bleaker picture for March.

In Q2-2020 domestic demand is expected to drop, curtailed by the introduction of a one-month state of emergency in seven prefectures responsible for half of Japan's economic activity, which in mid-

April was extended to the whole country. The declaration will enable prefectural governors to request people to stay in confinement and order closures of schools and public facilities. These measures are likely to result in a significant fall in private consumption. However, the scale of the closures seem to be more limited than in other advanced economies as public transportation, hotels and restaurants, distribution services and factories are not supposed to stop operating. At the same time, foreign trade is set to be hampered further by plunging foreign demand and temporary seizure of global supply chains.

Recovery is likely to be gradual ...

Economic activity is expected to rebound in the second half of 2020 and thereafter, as restrictive measures are gradually lifted. Private consumption is set to recover as pent-up demand for durables and semi-durables picks up and Tokyo Olympics are expected to take place in 2021. Public consumption and investments are likely to be prompted by sizeable stimulus measures. However, the extent of the rebound may be limited by changes in households' behaviour, as uncertainty around the health situation and future incomes is set to increase. Private investment growth is likely to remain sluggish, tough, reflecting lower global demand, increased uncertainty and disruptions in financing for some sectors.

On the external side, export growth is projected to pick up gradually in the second half of 2020 reflecting recovering demand in China and advanced economies. However, disruptions to global value chains and remaining travel restrictions are likely to hamper a strong rebound of foreign trade and tourism. At the same time, imports are likely to recover in line with rising domestic demand. Overall, net exports are expected to contribute negatively to growth in 2020 and recover afterwards, while real GDP is forecast to contract by 5% in 2020 before increasing by 2¾% in 2021.

... supported by renewed fiscal stimulus...

In the beginning of April the government adopted a new fiscal stimulus to cushion the impact of COVID-19 on the economy. The major part of the financing is intended to protect employment and businesses and key interventions include cash handouts to households and firms, deferral of tax payments and social security contributions, and concessional loans from public and private financial institutions. Although part of the announced government spending constitutes repackaging of previous stimuli, expansion of credit guarantees and deferment of tax and social security payments, the new fiscal spending in the supplementary budget amounts to around 4½% of GDP.

...and more accommodative monetary policy

The space for further interest rate cuts appears limited in Japan as interest rates are in negative territory and the central bank has refrained from cutting them further. Still, the Bank of Japan introduced a set of measures to provide liquidity and support credit flows. It increased the size and

frequency of Japanese sovereign bond purchases and the annual pace of purchases of Exchange Traded Funds (ETFs) and Real Estate Investment Trusts (REITs). It also introduced a special funds-supplying operation to provide loans to financial institutions to facilitate financing of corporates and temporary increased targeted purchases of commercial paper and corporate bonds. At the same time, it has enhanced the provision of USD liquidity through swap arrangements with the Fed. Overall, financing conditions for corporates have been kept loose, but the risks for some sectors have increased significantly with the virus outbreak and the turmoil on international financial markets.

Risks are elevated

Risks to the forecast are skewed to the downside. On the domestic side, the scale and duration of lockdown measures might be higher than currently assumed, leading to a much sharper and longer contraction in domestic demand. On the external side, postponed rebound in external demand and more pronounced disintegration of value chains remains an important downward risk.

Table II.35.1:

Main features of country forecast - JAPAN

	2018			Annual percentage change						
	bn JPY	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	547125.5	100.0		0.9	0.5	2.2	0.3	0.7	-5.0	2.7
Private Consumption	304427.8	55.6		0.8	-0.3	1.3	0.0	0.2	-5.7	2.3
Public Consumption	108335.3	19.8		1.6	1.4	0.2	0.9	1.9	3.5	4.2
Gross fixed capital formation	131971.2	24.1		-0.4	-0.3	3.0	0.6	1.3	-8.4	1.6
of which: equipment	44170.7	8.1		1.1	-1.9	5.3	2.8	-	-	-
Exports (goods and services)	101354.6	18.5		4.4	1.7	6.8	3.4	-1.8	-15.0	3.2
Imports (goods and services)	100077.9	18.3		3.3	-1.6	3.4	3.4	-0.8	-11.8	2.0
GNI (GDP deflator)	567134.5	103.7		1.0	0.1	2.4	0.4	0.6	-4.3	2.2
Contribution to GDP growth:										
Domestic demand				0.7	0.1	1.5	0.3	0.8	-4.4	2.6
Inventories				0.1	-0.1	0.1	0.0	0.1	0.0	0.0
Net exports				0.2	0.6	0.6	0.0	-0.2	-0.6	0.2
Employment				0.0	1.0	1.0	1.7	0.5	-5.0	-1.0
Unemployment rate (a)				4.5	3.1	2.8	2.4	2.3	4.3	4.5
Compensation of employees / head				-0.6	1.2	0.5	1.5	0.9	-2.1	2.3
Unit labour costs whole economy				-1.5	1.6	-0.7	2.9	0.8	-2.0	-1.4
Real unit labour cost				-0.7	1.3	-0.5	3.0	0.2	-2.0	-1.4
Saving rate of households (b)				10.5	9.7	9.0	10.5	10.6	13.3	11.4
GDP deflator				-0.7	0.3	-0.2	-0.1	0.6	-0.1	0.1
Consumer-price index				0.0	-0.1	0.5	1.0	0.5	0.0	0.2
Terms of trade goods				-2.5	7.4	-4.9	-4.8	1.1	0.0	0.0
Trade balance (goods) (c)				1.1	1.0	0.9	0.2	0.3	-0.1	0.0
Current-account balance (c)				2.7	4.0	4.1	3.5	3.5	3.6	3.2
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				2.6	3.9	4.1	3.5	3.4	3.5	3.2
General government balance (c)				-6.3	-3.5	-2.9	-2.3	-2.3	-4.9	-5.3
Cyclically-adjusted budget balance (d)				-	-	-	-	-	-	-
Structural budget balance (d)				-	-	-	-	-	-	-
General government gross debt (c)				190.5	236.5	234.6	236.8	236.2	253.7	252.2

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.