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Special Report: The Corona Crisis and the Global Economy

Confronting the COVID-19 pandemic

Research Division

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1. Confronting the COVID-19 pandemic

The entire world has been shaken by the menace COVID-19. On April 7, the Abe administration declared a state of emergency in accordance with the revised law on special measures against new strains of influenza (special measures on Novel Coronavirus).

The spread of the Novel Coronavirus infection (COVID-19) may eventually produce a greater impact on Japan’s economy than the global financial crisis of 2008. Even if the spread of the infection can be brought under control in various countries by sometime between April and June as stated in our short-term estimate, Japan’s real GDP would still decline by around 24.4 tril yen, or 4.6% in comparison to what it would normally be during those months. According to a risk scenario which sees the epidemic continuing throughout this year (2020), Japan’s real GDP would suffer a decline of 41.1 tril yen, or 7.7%. In 2009, the year following the global financial crisis of 2008, Japan’s real GDP growth rate declined by 5.4%. There is risk that the current situation could impact Japan’s economy significantly more than the global financial crisis of 2008.

On March 26 the author of this report delivered the following policy recommendation at the Liberal Democratic Party Headquarters: First of all, the most important thing is for the government to quickly send a strong message declaring that they will protect the lives and livelihood of the citizens of Japan. Then the following policy should be implemented in three phases.

Phase 1: In addition to stopping the further spread of COVID-19 infection, concentration should be on the guarantee of the financial security of the people to the maximum degree possible. At this point in time, the best economic policy is to prevent the further spread of the disease. The most pressing issue is to prevent Japan’s medical infrastructure from collapsing, while at the same time building international cooperation for the development of a drug to treat the disease, as well as a vaccine.

As for the question of economic policy, emphasis should be placed on the financial security of the people. A strong message should be sent out that the government will protect employment and will prevent small to medium enterprises from going bankrupt. In practical terms, there will be a need for employment subsidies, as well as cash payments to people who are especially in need, small to medium sized businesses, and sole proprietors. Meanwhile, in order to prevent bankruptcies of small to medium sized businesses due to lack of funding, interest-free, unsecured financing should be made more widely available, while at the same time mobilizing policy regarding deferral and reduction of tax payments.

What is important at this early stage is to place emphasis on removing the fears and anxieties of the people, rather than fire off economic stimulus measures. There is a contradiction between calling on people to practice voluntary restraint in the form of cancelling events in order to prevent the further spread of the infection, and implementing policy to stimulate consumption.

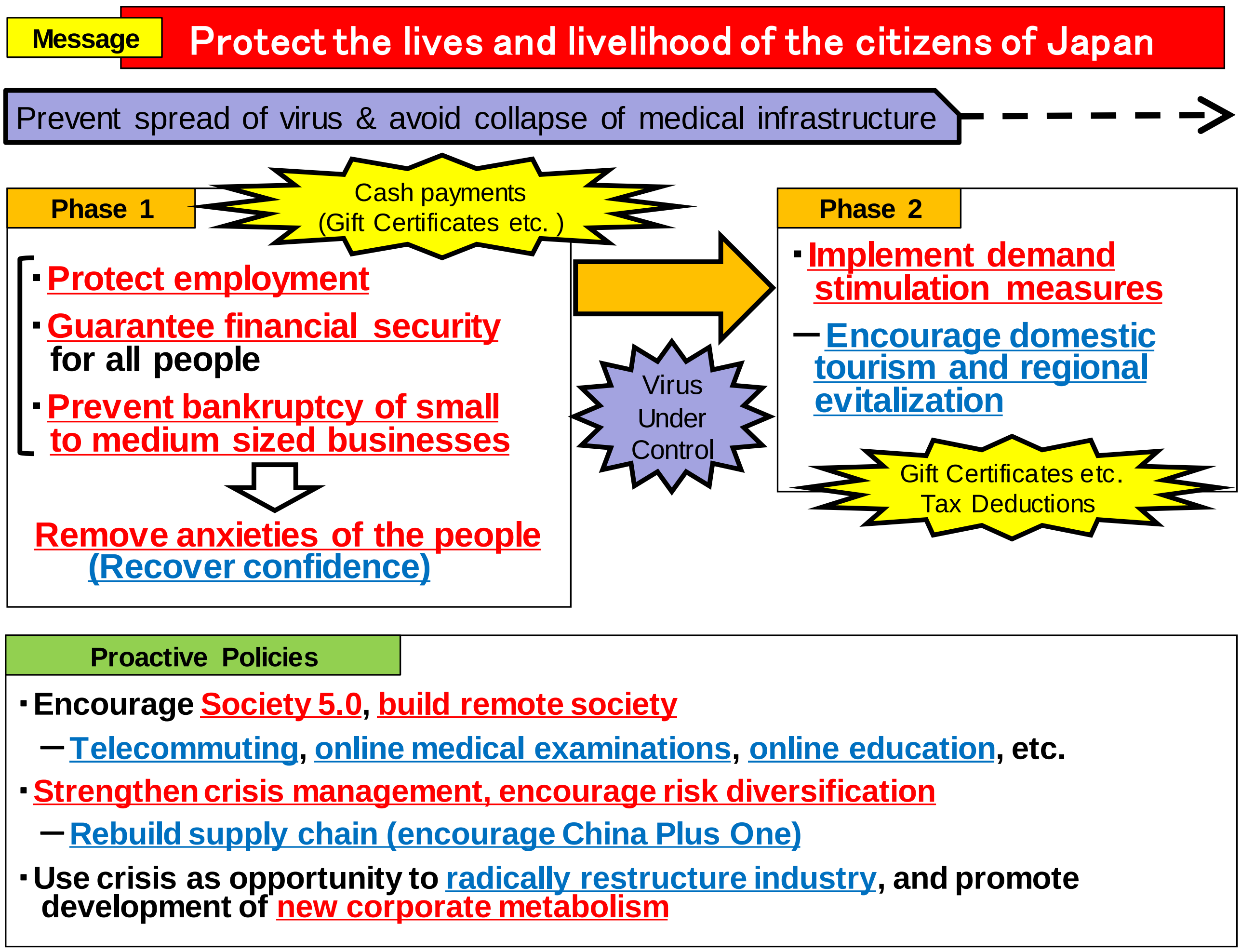
Stimulus of consumption should come in the second phase after the spread of the infection has been contained to some degree. During this second phase a host of programs should be implemented, such as the issuance of gift certificates and coupons, the promotion of industries such as tourism, transport, eating out, and events, and the opening of campaigns to encourage domestic tourism and regional revitalization.

Finally, the third phase will be to take this opportunity to develop proactive policies. Concretely speaking, this would mean to build a remote society and promote *Society 5.0* by encouraging telecommuting, online medical examinations, and online education. Meanwhile, the supply chain should be rebuilt using the *China Plus One* concept, and the crisis management infrastructure needs to be strengthened, and risk diversification carried out. We should use this crisis experience as an opportunity to radically restructure industry, and promote the gradual development of a new kind of corporate metabolism.

In addition to budget measures to handle these three phases of rebuilding the economy, in consideration of the unsettled nature of the situation, the author's recommendations placed emphasis on strengthening reserves to flexibly handle contingencies.

As we face this unprecedented crisis, which may exceed the global financial crisis of 2008 in its seriousness, the Abe administration and the LDP are being put to the test.

Snapshot View of Policy Recommendations **Chart 1-1**



2. Aspects of Global Recession

Depth of economy determined by timeline to return to normalcy

The magnitude of the global economic contraction depends heavily on the timeline to return to normalcy. Governments around the world are formulating large-scale economic measures, but there is a tradeoff between economic stimulus and the time needed to contain the COVID-19 epidemic. Full-fledged demand stimulus measures will have to wait until the spread of the infection is brought under control. In this sense, the timeline to return to normalcy is of vital importance to the future of the global economy. However, it goes without saying that it is impossible to get a clear picture of what will happen in the future. One view is that the epidemic can be brought under control without running into the long-term as was the case with SARS (just under 8-months from the time the first infection occurred and the official declaration of its end, or 4-months from the date of the WHO's global alert and its being brought under control), and also assumes that a recurrence can be avoided, but there is also the opinion that, as was the case with the Spanish flu in 1918, the epidemic could come in waves, and hit several times before finally ending.

In the midst of all this we have little to go on, but one of the few clues we have available is the experience of China. It is now common knowledge that the COVID-19 epidemic began in the city of Wuhan in the Hubei Province of China, and spread throughout China during the Lunar New Year's season when large numbers of people are on the move. With China as the starting point, the virus was then spread around the entire world. China initially failed at containment of the disease, and then the number of people contracting the virus peaked in mid-February. The number of infections decreased dramatically after that point. Although it cannot be claimed that the disease has been completely stamped out yet, the Chinese economy and society is gradually returning to normal. Of course, the Chinese government was able to forcibly impose a prevention policy with its top-down organization, and with few worries regarding the conflict between personal freedom and social stability due to its political situation. But at the same time, the measures which China implemented now seem less exceptional as a large number of cities and countries centering on the US and Europe go into strictly enforced lockdowns to prevent further spread of infection (which is often through touch or other close contact). Now there are signs that spread of the disease is close to peaking out in several countries in Europe, such as Italy and Spain where the epidemic was especially severe. This sequence of events acts as the basis of our assumptions in putting together the outlook provided in this report. We expect the worldwide spread of the COVID-19 epidemic to reach its peak sometime between April and June, after which economic activity will begin to move toward a state of normalcy. During this process of recovery, the economic measures of various countries will also begin to bear fruit.

Global recession to exceed period following financial crisis of 2008

We expect the global recession to exceed the level of seriousness experienced during the years following the global financial crisis of 2008. The advanced nations are expected to experience declines in growth rate of about the same level as was experienced in 2009, but the US, which in recent years was the sole winner as the global economy overall continued to stagnate, will be unable to avoid a hard landing, with the pillar of its economic growth – personal consumption – having suffered a dramatic decline. This will set the tone of the global recession.

Another factor that stands out in the comparison with the global economic crisis of 2008 is the weakness of the economies of the emerging nations. One thing is that the global economy in 2009 gained a certain amount of support from the 4 trillion yuan economic stimulus package that China implemented at that time. This time around it will not be able to repeat the same action. Secondly, most of the emerging nations are facing the fact that China is experiencing a sharp decline in demand with the same severity as in the US and Europe. Most of the emerging nations other than China have managed to avoid the severity of the spread of the disease in relative terms. However, there are major concerns regarding the capacity of medical infrastructures needed in case the disease does spread. For this reason the number of emerging nations implementing lockdowns and similar measures to prevent spread of the disease is growing. This has killed demand, and the number of countries that could provide underlying support for the global economy as occurred in 2009 is dwindling.

There is a third negative factor here as well. The Corona crisis is not only a crisis of demand, but of supply as well. People are avoiding going out, and reducing unnecessary spending. This causes a sharp decline in the consumption of leisure services, as well as eating and drinking out, and spending on durable goods. On the other hand, many people are not going to work, hence factories halt operations, and the supply chain ceases to function. This creates a supply crisis. Both supply and demand decline overall, but demand for the necessities of life, centering on foods, has not declined all that much. As a result, even though there is an increase in variation between various goods and services, an increase in prices, in other words stagflation, could still occur despite the economic slump. This is a headache for the advance nations, but the possibility increases that households in the emerging nations, which tend to have a high rate of expenditure going to necessities, will be hit hard by the situation.

For the emerging nations, the crisis situation means that in addition to these factors, there is the problem of capital outflow associated with risk-off behaviors, ballooning foreign debt burden brought on by exchange rate depreciation, and the deterioration of terms of trade for countries that depend on the export of natural resources when prices of natural resources collapse. Moreover, the possibility that the emerging nations could become the next battleground following the US and Europe in the spread of COVID-19 cannot be ignored. But even if they manage to avoid it, the major emerging nations will see their growth rates for the year 2020 drop significantly below what they were in 2009

We produced estimates for the US, the Eurozone, the UK, Japan, China, Russia, Brazil, and India (Chart 2-1). These countries together account for 73% of the world's nominal GDP. The sum total of their real growth rates in 2020 comes to -2.7%, bringing the growth rate of the global economy down by -1.9%pt. Fears are strong that the depth of the economy may significantly exceed what it was in 2009 after the global financial crisis (worldwide real growth rate was down that year by 0.1%). The governments of countries around the world are beginning to expect that there will be a worldwide hard landing. Priorities are on widening economic safety nets while at the same time focusing on bringing the spread of the infection under control. Once the spread of the infection has been stopped, there will be a need to implement bold measures to stimulate demand. It is our hope that, rather than triggering the tendency of countries to put their own interests first, the global Corona crisis will reawaken the awareness of the importance of international cooperation.

Outlook for Real GDP in Major Countries and Regions **Chart 2-1**

(%) (Y/y, %)

	2019				2020				2018	2019	2020	2021
	1-3	4-6	7-9	10-12	1-3	4-6	7-9	10-12				
Japan	2.2	2.3	0.1	-7.1	-4.3	-18.5	8.3	8.8	0.3	0.7	-4.5	2.4
US	3.1	2.0	2.1	2.1	-3.5	-21.9	9.7	8.7	2.9	2.3	-3.0	3.1
Eurozone	1.8	0.6	1.2	0.5	-6.5	-19.6	4.6	3.8	1.9	1.2	-4.6	1.7
UK	2.6	-0.4	2.0	0.1	-4.5	-19.4	3.8	5.2	1.3	1.4	-4.1	2.2
China	6.4	6.2	6.0	6.0	N.A.	N.A.	N.A.	N.A.	6.7	6.1	1.5	7.0
Brazil	0.6	1.1	1.2	1.7	N.A.	N.A.	N.A.	N.A.	1.3	1.1	-4.9	2.2
India	5.7	5.6	5.1	4.7	N.A.	N.A.	N.A.	N.A.	6.8	5.3	-4.0	4.0
Russia	0.4	1.1	1.5	2.1	N.A.	N.A.	N.A.	N.A.	2.5	1.3	-5.0	1.5

Source: Various statistics; compiled by DIR.

Note: The grey areas are estimates, while all others are actual results.

The quarterly growth rates for China, Brazil, India, and Russia are in y/y terms, while others are q/q.

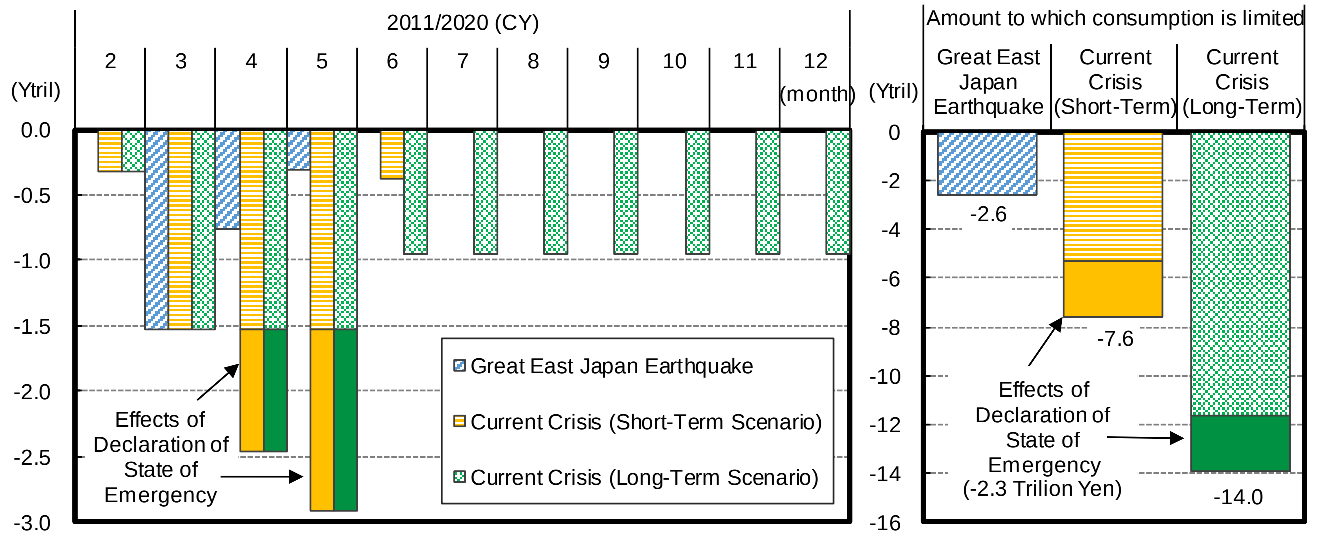
3. The Japanese Economy

Prime-minister Abe declares state of emergency in 7 prefectures

On April 7, 2020, Prime Minister Shinzo Abe declared a state of emergency in accordance with the revised law on special measures against new strains of influenza (special measures on Novel Coronavirus) in response to the spread of COVID-19 infections. Seven prefectures and metropolitan areas are affected, including Tokyo, Kanagawa, Saitama, Chiba, Osaka, Hyogo, and Fukuoka. The governors of each of these prefectures will determine the necessary steps, which can include requesting residents to refrain from unnecessary outings, closing down certain kinds of facilities, and requesting or ordering that events not be held. The period of the state of emergency is to last until May 6. However, depending on conditions, changes may be made in the affected regions, and the period may be extended if necessary.

The approach differs from the complete lockdown being implemented in certain cities in the US and Europe in that actions and behaviors of citizens and companies in the regions where the measure applies are not subject to penalties. It is assumed that the declaration of emergency will heighten people's awareness as regards the seriousness of the situation, and the sense of urgency in regard to the spread of the infection, and that this will encourage people to hold back on the consumption of services requiring going out. The amount to which consumption may be limited due to the situation is shown in Chart 3-1. According to the short-term scenario, which expects the epidemic to be brought under control by around June, the amount to which consumption will be limited totals around 7.6 trillion yen. The long-term scenario, which assumes that the epidemic lasts throughout the year 2020, the amount to which consumption would be limited totals around 14.0 trillion yen.

Effects of Restraints on Economic Activities and State of Emergency on Personal Consumption
Chart 3-1



Source: Cabinet Office; compiled by DIR.
Notes: 1) The amount to which consumption may be limited is expressed in month to month terms judging from changes in the overall consumption index, based on the estimated amount to which consumption was limited after the Great East Japan Earthquake.
2) Assuming the most recent level of consumption to be around 2.6 trillion yen as shown above, this amount is adjusted and divided into the categories transportation, leisure consumption, and other. The effect of the state of emergency in Tokyo, Kanagawa, Saitama, Chiba, Osaka, Hyogo, and Fukuoka is expected to be a 50% decrease in consumption in the areas of transportation, entertainment, leisure, and culture, while eating out and accommodations are expected to be down by 90%. This estimate excludes the amount by which personal consumption is held down as a result of practicing voluntary restraint.
3) According to the short-term scenario, the novel Coronavirus epidemic is expected to be brought under control by around June, while the long-term scenario expects it to continue throughout the year 2020.

Effects of COVID-19 epidemic on Japan’s economy

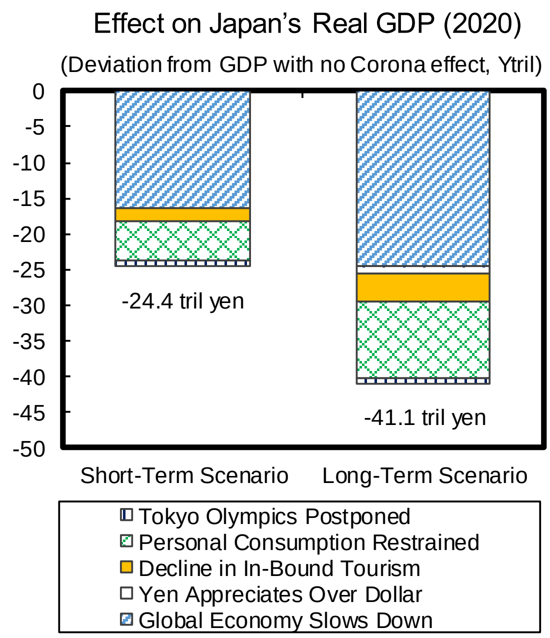
Revised results of the extent to which the COVID-19 epidemic may effect Japan’s economy are shown in Chart 3-2. The short-term scenario for the time it will take to return to normal sees GDP declining by around 24.4 trillion yen in comparison to what Japan’s real GDP would be if this problem had not occurred, while the long-term scenario expects it to be down by 41.1 trillion yen.

Even the short-term scenario expects the difficult situation for the Japanese economy to continue for some time for both overseas and domestic demand. Japan’s real GDP growth rate in 2020 is expected to be at -4.5%. The US and Europe are also expected to fall into negative growth at the -3% or -4% level, while China, which is maintaining positive growth, is expected to fall significantly below last year’s figure of +6.1%. Neither Japan nor the world will be able to avoid a recession.

In 2009, immediately after the global financial crisis of 2008, Japan’s real GDP was at -5.4% in comparison to the previous year. If the risk scenario becomes a reality, year-to-year declines in the GDP growth rate will continue for five consecutive quarters, starting with the Oct-Dec period of 2019. The GDP growth rate for the entire year of 2020 would then be expected to come in at -7.6% (Chart 3-3). This is the largest decline the Japanese economy has experienced since calendar year statistics first became available in 1956. The economic impact of this crisis may ultimately exceed that of the global financial crisis of 2008.

Expected Effects of COVID-19 Epidemic and Effect on Japan’s Real GDP **Chart 3-2**

		Short-Term Scenario	Long-Term Scenario
Duration of Epidemic		Japan, US, Europe: June China: April	Throughout 2020 (except for China)
Effect of Spread of COVID-19 on Real GDP Growth (2020)			
	US	-5.0%pt	-8.1%pt
	Eurozone	-5.6%pt	-8.3%pt
	China	-4.5%pt	-7.2%pt
Number of Foreigners Visiting Japan (Compared to 2019)		-11million people (about -30%)	-25million people (about -80%)
Exchange Rate		No Change	Yen appreciates Y5/dlr



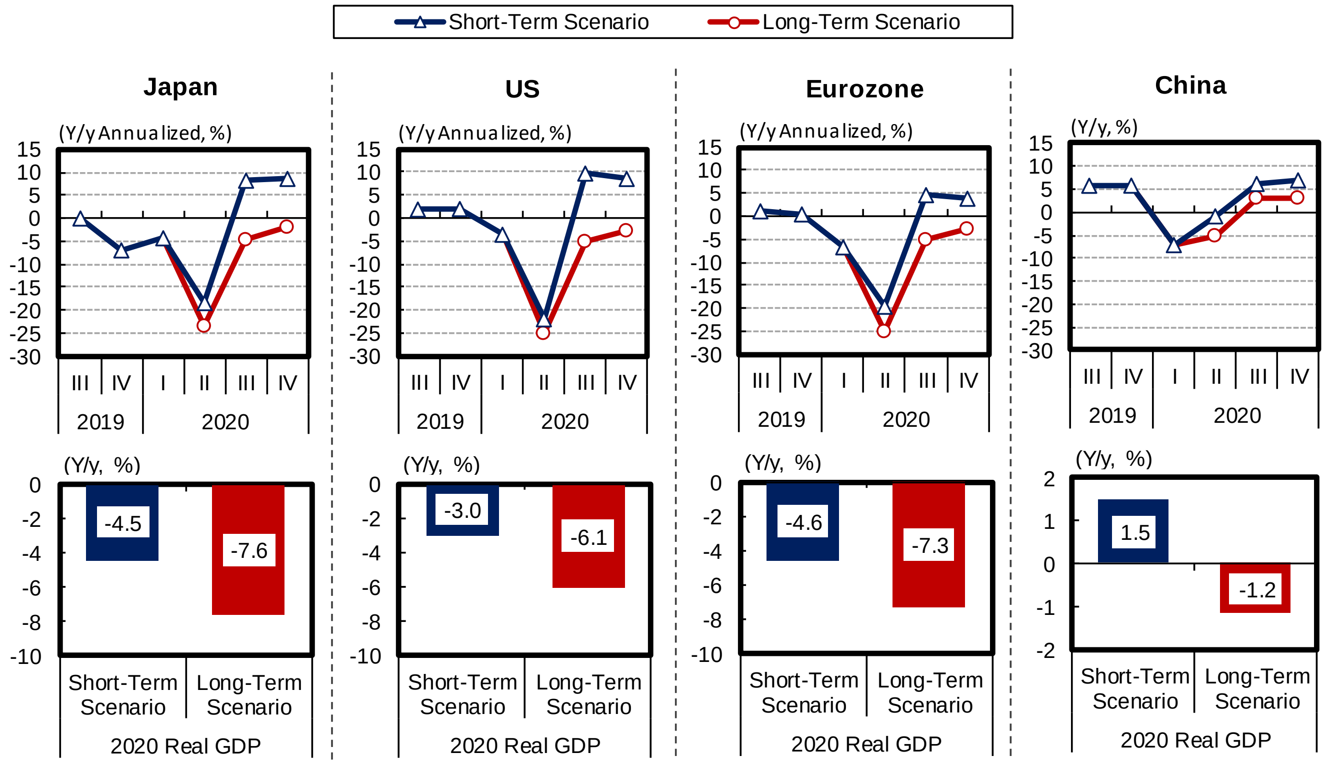
Source: Various statistics, Bing et al. (2019), Tokyo Organizing Committee of the Olympic and Paralympic Games, City of Tokyo Statistics; compiled by DIR.

Notes: 1) Effects of Chinese economic slowdown on Japan and global economies based on statistical results in “Global Impact of a Slowdown in China” (Bing, Roth, and Santabarbara, 2019), and Banco de España.

2) Effects of economic slowdown in US and Europe, strong yen-weak dollar, and suppression of personal consumption based on DIR macro model.

3) Effects of postponement of Tokyo Olympic and Paralympic Games (Tokyo Olympics) projected to be around 0.8 tril yen according to The Tokyo Organising Committee of the Olympic and Paralympic Games Budget V4, and city of Tokyo estimate. Games expense around 0.3 tril yen of total amount. Consumption expenditure by participants and spectators estimated at around 0.2 tril yen. Increase in household consumption expenditure associated with the games estimated at around 0.3 tril yen.

Real GDP Growth Outlook for Japan, US, Europe, and China **Chart 3-3**



Source: Various national statistics; compiled by DIR.
Notes: 1) Short-term scenarios for bringing the epidemic under control in the US and Europe are from DIR representatives based in those countries.
2) The novel coronavirus epidemic is expected to last until around June in Japan, the US, and Europe according to the short-term scenario for bringing the disease under control, and around April in China. Meanwhile, the long-term scenario sees the epidemic lasting throughout the year 2020 in countries and regions other than China.

Biggest ever emergency economic stimulus package places emphasis on protecting livelihoods of citizens

On April 7, emergency economic measures in response to the spread of the Novel Coronavirus received cabinet approval. The program totals around 108.2 trillion yen with fiscal expenditures of approximately 39.5 trillion yen. The scale of the emergency economic measures includes amounts from the comprehensive economic measures formulated at the end of 2019 and phase 1 and phase 2 of the emergency measures drawn up between February and March 2020. Excluding these measures, the program totals around 86.4 trillion yen with fiscal expenditures of around 29.2 trillion yen. The newly added portion alone exceeds the economic crisis measures of April 2009, which at the time represented the biggest stimulus package ever to have been put together by the Japanese government.

As is indicated by the estimates presented in this chapter, there are fears that the impact of the Corona crisis on Japan's economy will ultimately exceed that of the global financial crisis of 2008. With the dramatic decrease in foreign visitors to Japan recently, and the tendency to refrain from going out on the part of Japanese citizens, business conditions have rapidly deteriorated, especially in the services industries such as tourism and leisure, eating out, and retailing. The language in the emergency measure states that under these conditions, Japan's economy will likely worsen after the month of April, and that in order to prepare for devastating effects from infectious disease of this magnitude, emergency economic measures carrying the necessary strength to match these effects has been provided.

The emergency economic measures are organized into two phases based on the spread of the infection. First, in the emergency support phase, put in place until the infection can be brought under control, emphasis will be placed on providing support for the livelihood of households, the continuation of corporate business operations, and maintaining employment, in addition to preventing further spread of the disease. Once the infection is brought under control, measures will move into the V-shaped recovery phase, which involves stimulus of demand and promotion of social reforms. (This includes stimulus of investment which looks ahead to the future in digitalization and remote systems.)

During the emergency support phase, a total of over six trillion yen in cash benefits will be provided to households and small to medium-sized enterprises and small-scale business proprietors who are experiencing difficult economic conditions. Specifically, low income households who have experienced a decline in income will be paid benefits of 300,000 yen per household (extraordinary benefits for the support of livelihoods). Meanwhile, the current allowance for dependent children will be increased by 10,000 yen per child (available only in June to households already receiving benefits according to this program). For small to medium-sized enterprises, a maximum of two million yen will be provided for operations experiencing a more than 50% drop in business income in comparison to the same period of the previous year. This program has been expanded to include providing benefits of maximum one million yen to sole proprietorships, including individuals doing freelance work.

The special measures for employment adjustment subsidies will be expanded during the emergency response period (April 1 – June 30). Requirements will also be relaxed and subsidy rates raised, while the maximum number of days payments can be provided will also be increased. Companies experiencing difficulty in paying taxes and insurance due to the effects of the COVID-19 epidemic will be allowed to delay payments for one year. The scale of this program is 26 trillion yen. Meanwhile, for small to medium-sized enterprises experiencing difficult business conditions, property tax and city planning tax will be reduced for a limited period of one year.

Besides these programs, the government will distribute cloth masks to all households as part of its policy to prevent further spread of infection, and to improve medical services and develop a drug to treat the disease. According to this program, respirators will also be acquired and the anti-influenza drug, Avigan, which has proven to be hopeful as a drug to treat COVID-19, will be stockpiled. An amount of Avigan to treat two million people will be acquired before the end of FY2020.

In the V-shaped recovery phase, which entails the implementation of a demand stimulus program, a consumption stimulus campaign with the public and private sectors working together will be implemented for a limited time. This campaign will focus especially on businesses which were most severely affected by the crisis: tourism and transport, food & beverages (eating and drinking out), events and entertainment. During the period covered by the campaign, purchase of gift certificates and tickets for travel, events, and eating out at restaurants will be supported. Another aspect of this program will be points or coupons provided for consumers when they make reservations at restaurants, bars and cafes.

As for other issues which have become topical lately, the possibility that the consumption tax might be reduced is one that has been shelved. Reducing the consumption tax has been of great interest to citizens, and it is true that this could have a big impact. It might be promising as a means of stimulating demand. However, even if there is a time limit placed on such a measure, if the period is continually extended, the budget deficit could grow exponentially, and the realization of a social security system which serves all ages will become even more distant. The demand stimulus policy after the epidemic has been brought under control should be one that is well-designed for mid to long-term purposes, and should have a consistent content.

Additional economic measures may be required depending on future conditions, including spread of the infection and the economy

The emergency economic measures include policies whose purpose is to provide support for the livelihoods of households, continuance of corporate business operations, and the maintenance of employment. It is hoped that these measures will keep bankruptcies and unemployment under control, and give a strong push to jumpstart economic recovery after the epidemic has been brought under control. However, both the Japanese and the global economies are now facing an unprecedented situation, and it is unknown at this time whether these measures are of an appropriate scale. Countries around the world are implementing large-scale measures to prevent further spread of the epidemic, as well as fiscal and monetary policies, but the risk is great, as the epidemic could continue to spread in the long-term and lead to a global financial crisis. This means that flexible policy is required that can change along with the quickly changing economic situation. Implementing additional economic policy is one valid approach.

Chart 3-3 shows the short-term scenario, in which it is assumed that the emergency economic measures are successful in controlling unemployment and bankruptcies, and systemic risk does not become manifest. In this case real GDP is expected to continue negative growth through the Apr-Jun period, and then shift into positive growth during the Jul-Sep period. In this case two consecutive quarters of nearly 10% y/y annualized growth is expected. In order to manifest a V-shaped recovery of this sort, it is first necessary for both the public and private sectors to cooperate in working toward preventing further spread of the epidemic with the help of the recent declaration of a state of emergency.

4. The US Economy

US economy loses speed after lockdown declared in mid-March

In the US, which has now become the global center of the COVID-19 pandemic, the number of infections has continued to grow dramatically, and at the same time the country's economy has rapidly deteriorated. Before the number of domestic COVID-19 infections began to grow so quickly, the problem of supply constraints had appeared due to the spread of the disease in China, but the US economy continued to expand due to its underlying strength, centering on domestic demand, especially in personal consumption. However, after the beginning of March things changed all at once. The decisive event which brought on economic deterioration was the declaration of a state of emergency on March 13, followed by the announcement of CDC guidelines on March 15, which called for the cancellation of all events of 50 participants or more or their postponement for a period of 8 weeks. Then on March 16 President Trump announced that gatherings of ten people or more, including eating out, should be refrained from. This required that business operations in industries including accommodations, food services, and entertainment would be unavoidably reduced. In addition, many state and city governments also announced restrictions requiring people to remain isolated at home, almost forcing consumers to hold down unnecessary, non-urgent expenditures.

According to the number of guests visiting restaurants on a daily basis as announced by OpenTable, the major restaurant reservation website in the US[1], this number decline steeply in mid-March, and by the latter half of the month the nationwide total was at -100% in comparison to the previous year. In other words, restaurants had no customers at all as of that point. This figure of course covers only restaurants registered on the website, so should be taken with a certain grain of salt, but it gives us an idea of just how miserable the economic environment that restaurants find themselves in is at this time. Meanwhile, hotel occupancy rates as of the fourth week of March according to a private sector research organization, were at their lowest level ever, having fallen to the 20% level. These figures make it clear that the accommodations industry has experienced a catastrophic blow.

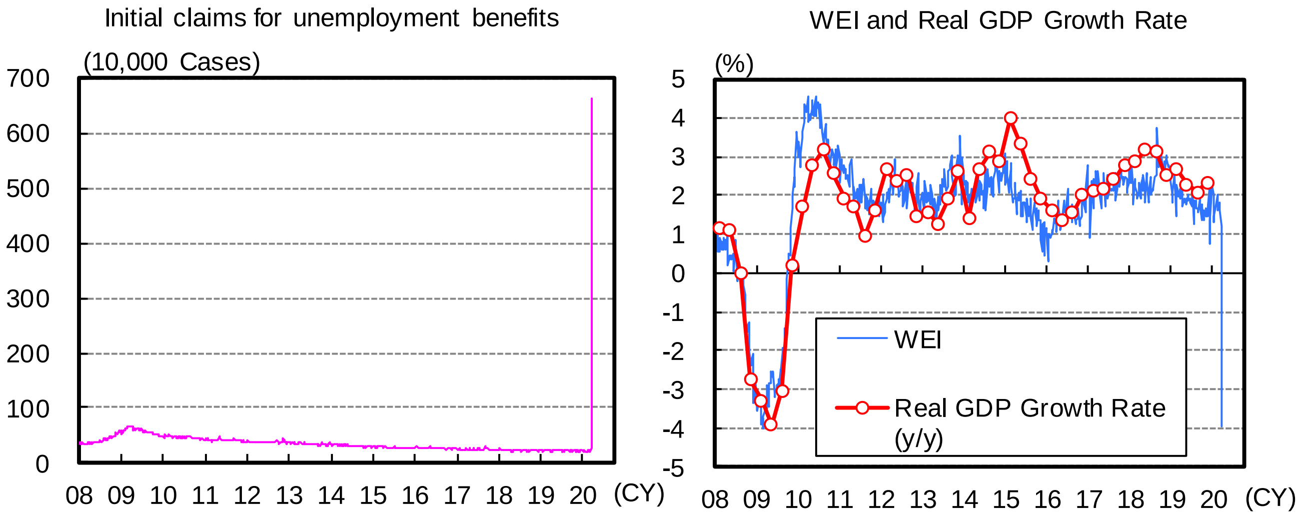
The rapid decline of business conditions for this portion of the services industry has immediately spread to the labor market. Initial claims for unemployment benefits announced weekly totaled 3,307,000 during the third week of March (March 15 – 21), ten times more than in the previous week. During the week that followed, the number doubled, swelling to a total of 6,648,000, a level heretofore unheard of.

The Weekly Economic Index (WEI), a leading indicator put together by the Federal Reserve Bank of New York based on seven different indices, including initial claims for unemployment benefits, fell sharply at the end of March[2]. The monthly economic statistics for March to be announced soon are expected to show a major downturn. Meanwhile, it has been made clear from other economic indices already announced that the US economy was performing favorably through the month of February. The economy rapidly deteriorated beginning in late March, making it highly possible that real GDP for the Jan-Mar period of 2020 may fall into a decline in comparison to the previous quarter for the first time in six years (i.e. since 2014).

[1] https://www.opentable.com/state-of-industry

[2] Details of the WEI can be viewed on the FRB New York website.
https://libertystreeteconomics.newyorkfed.org/2020/03/monitoring-real-activity-in-real-time-the-weekly-economic-index.html

Initial Claims for Unemployment Benefits, WEI, and Real GDP Growth Rate **Chart 4-1**



Source: DOL, Federal Reserve Bank of New York, BLS, Haver Analytics; compiled by DIR.
Note: The latest figures for the number of new applications for unemployment benefits are from the week of March 22 – 28. The latest figures from the WEI are from the week of March 15 – 21.

Apr-Jun period expects historic low in negative growth with extended shelter-in-place orders

As is indicated in the above, the US economy has rapidly deteriorated since the latter half of March, and an even bigger downturn is expected for the Apr-Jun period. The major factor here was President Trump's calling on Americans to avoid large gatherings including restaurants and bars on March 16, which at the time was to last for 15-days. This request was then extended until the end of April due to the continued spread of the infection in the domestic United States. As of this point it had become definite that the devastating conditions for the services industries would continue until at least the end of April. Over 10% of total personal consumption in the US is accounted for by entertainment services, food services, and accommodations, which are most severely affected by restrictions on going out. These industries account for around 7% of overall GDP. The impact of demand in these industries disappearing for one month is huge.

In addition, by continuing restrictions on going out, the unemployment numbers which were already growing rapidly could grow much higher in April and beyond. The major factor behind the stagnation of economic activity until now has been the restrictions on going out, which hold down consumption of services. However, with no stop to growth in the number of unemployed, plus the lengthy period until people can return to work, the downturn in personal consumption is expected to move beyond services which are directly affected by the restrictions on going out, and begin affecting a broader range of industries. Personal consumption, which provides the framework for the American economy, has continued in an expansion phase for some time, influencing growth in employment, which in turn brought more growth in consumption. This self-sustaining growth mechanism is beginning to move in reverse due to shelter-in-place and stay-at-home orders.

Meanwhile, the dramatic growth in the number of unemployed will likely have significantly negative influence not only on personal consumption, but on housing investment as well, which had maintained favorable performance supported by low interest rates. The rapid reduction of demand is not limited to the US domestic situation alone, but is a worldwide phenomenon due to the spread of the infection. As this situation persists, capital expenditure by corporations will be also held down. In consideration of these conditions, we expect real GDP for the Apr-Jun period to decline to the -20% q/q annualized level. This is the biggest decline in GDP ever experienced since the statistic in its current form began.

Economic stimulus package totaling 2 trillion dollars to support economic comeback

But the rapid deterioration of the economy won't last forever. Stay-at-home orders have been issued in specific localities on the state and city government levels, and so cancellation of said orders is also expected to take place individually. It is assumed that once President Trump's request for Americans to refrain from going out is cancelled, economic activities in the entire US will return to normal, and the economy will gradually recover.

The series of economic measures which took shape in rapid succession on the part of the Trump administration and Congress are expected to be a major factor in supporting a comeback for the economy once stat-at-home orders have been cancelled. The Coronavirus Aid, Relief and Economic Security Act (CARES Act) was passed on March 27, and at over 2 trillion dollars, is the largest economic stimulus package ever implemented in the US. It is expected to provide broad-ranging support for the US economy[3].

Regarding the CARES Act, looking at the concrete content of the measure, the first thing we notice is that the most important feature is cash benefits paid to households. A maximum of 1,200 dollars will be paid to individuals with total income of up to 75,000 dollars (500 dollars for persons aged 16 or below), with the month of April targeted for payment of benefits. The budget for this measure is 290 billion dollars, the equivalent of 1.8% of household disposable income in 2019. When 260 billion dollars in unemployment benefits enhancement is added to this, income support paid to households increases to 3.3% of disposable income.

Considering the steep rise in the number of unemployed in recent weeks, it will not be possible to reimburse the total of employment and income losses due to stay-at-home and shelter-in-place orders. Moreover, there is a possibility that a portion of benefits paid will go to savings rather than personal consumption, hence the effect of pumping up the economy will likely be less than actual benefits paid. However, with the number of unemployed growing at an unprecedented pace, it will be extremely meaningful if these measures can at least prevent the bottom falling out of income.

The CARES Act provides support not only for households, but extensive support for corporations as well. For instance, in addition to loans with credit guarantees for small to medium sized enterprises with up to 500 employees, partial exemption from repayment of loans is offered on the condition that the company retains its employees. For large corporations, the federal government will provide direct financing for the airline industry, which has sustained heavy losses due to the effects of the spread of the infection. The necessary capital will be supplied to a facility established by the FRB, and funding will be provided with government guarantee.

The major cause behind the extremely rapid growth in unemployment in the US is seen as being layoffs in the services industries necessitated by shrinking operations. Many of these layoffs are only temporary, so once the restrictions on going out are cancelled, operations can resume and employees on temporary leave can quickly return to their original place of work. However, there will also likely be corporations that have difficulty in restarting operations after a month and a half of reductions and closings. Some may even be threatened with bankruptcy. It is quite likely that recovering employment after temporary layoffs will be difficult without some kind of policy in place. The corporate support package included

[3] The first phase of the Novel Coronavirus countermeasures came in the form of the passage of the Emergency Supplementary Budget Law on March 6 making 8.3 billion dollars available for developing a vaccine and financial support for public health agencies. Meanwhile, phase 2 implemented on March 18 was the passage of the Families First Coronavirus Response Act, under which testing for the Novel Coronavirus is provided for free, and the income of employees who are unable to work because of the effects of the virus is guaranteed. There is also a program for providing food for low income households included.

in the CARES Act is expected to hold down the number of bankruptcies to a certain extent, thereby encouraging a quick reduction in the number unemployed and encouraging a comeback for the economy.

Under current conditions, the Daiwa Institute of Research expects shelter-in-place and stay-at-home orders to be cancelled sometime during the Apr-Jun period, and although major negative growth is seen, the economy is expected to bottom out during the period and then begin to head toward a comeback. Meanwhile, a trend toward recovery should become clear during the Jul-Sep period. Due to the dramatic downturn during the Apr-Jun period, our outlook for the real GDP growth rate in 2020 is -3.0% in comparison with the previous year, falling below the -2.5% figure recorded in 2009 immediately after the global financial crisis of 2008. However, looking at developments on a quarterly basis, we expect the Jul-Sep period to shift into positive growth on a q/q basis.

However, our assumption here is that the epidemic will be brought quickly under control, and if that takes longer than expected, the timing of the US economy's bottoming out and the shift back to a growth phase will then be pushed back to a later point. If the suppression of economic activity moves into the long-term due to stay-at-home and shelter-in-place orders, the damage will spread centering on the labor market, and in this case the support provided by the economic measures could prove to be insufficient. As a result, once the stay-at-home orders are finally removed, the pace of the economic comeback could also be lukewarm. The US now has the largest number of cases of COVID-19 infections in the world. The White House has stated that the number of dead could reach a maximum of 240,000. Stopping the spread of infection is the most urgent issue now in the US, and the best possible prescription for moving toward economic recovery.

Major Contents of CARES Act and Amounts **Chart 4-2**

Description	Amount
Issue One-Time Checks (A maximum of 1,200 dlrs per person, 500 dlrs under age 17)	290 bil dlrs
Expand & Extend Unemployment Benefits (additional 600 dlrs per week)	260 bil dlrs
Reduce Individual Taxes	20 bil dlrs
Provide Small Business Loans & Grants ・Loans to small business guaranteed by SBA ・Exemption from repayment if loans used to pay salaries on condition that employees are maintained for a certain period	377 bil dlrs
Support Loans & Loan Guarantees for Large Businesses & Governments ・Capital supplied to corporations and regional governments through facility established by FRB (454 bil dlrs) ・Financing for passenger and cargo airlines (29 bil dlrs)	510 bil dlrs
Cut Business Taxes ・Deduction limit on interest paid relaxed ・5-year carry-back on losses reported for years 2018-2020 possible ・Tax write-off possible on portion of employee social security tax borne by employer	280 bil dlrs
Support State & Local Governments	150 bil dlrs
Increase Health-Related Spending	180 bil dlrs
Support the Safety Net (food stamps etc.)	42 bil dlrs
Increase Disaster Assistance	45 bil dlrs
Increase Education Spending	32 bil dlrs
Support Transportation Providers & Industries	72 bil dlrs
Other spending	25 bil dlrs
TOTAL	2.3 tril dlrs

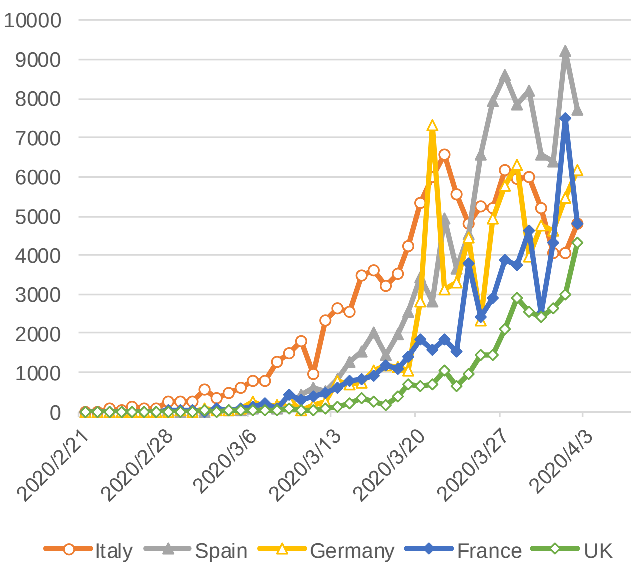
Source: Joint Committee on Taxation, Committee for a responsible Federal Budget; compiled by DIR.

5. The European Economy

Novel coronavirus infections have spread rapidly since mid-March

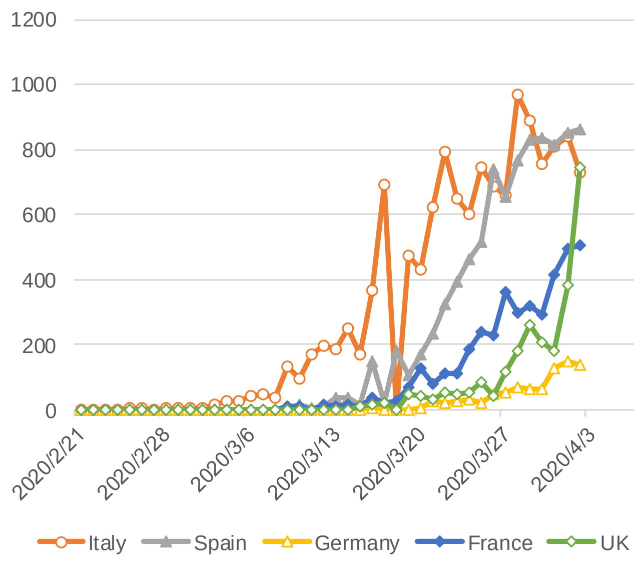
The Novel Coronavirus epidemic began to spread rapidly in Europe around mid-March. The number of people infected with the disease had surpassed 100,000 as of March 20, and had exceeded 500,000 by April 2. The number of deaths grew rapidly as well, reaching over 33,000 as of April 2. As for statistics by country, Italy was the most serious, with rapid spread of the disease becoming apparent as of the end of February, with the number of cases exceeding 110,000 as of April 2, and the number of deaths more than 13,000. The infection also began to spread to other countries in Europe, with the number of infections as of April 2 reaching 102,000 in Spain, 73,000 in Germany, and 56,000 in France. The number of infections was relatively low in the UK at 29,000. However, this number was reached only half a month after the disease began to spread in Italy, while Germany and France were a week later. It is highly possible that the spread will accelerate from this point.

Number of New Infections in Major European Countries — Chart 5-1



Source: WHO; compiled by DIR

Number of Newly Recorded Deaths in Major European Countries — Chart 5-2



Source: WHO; compiled by DIR

One after another, European countries adopt lockdown measures

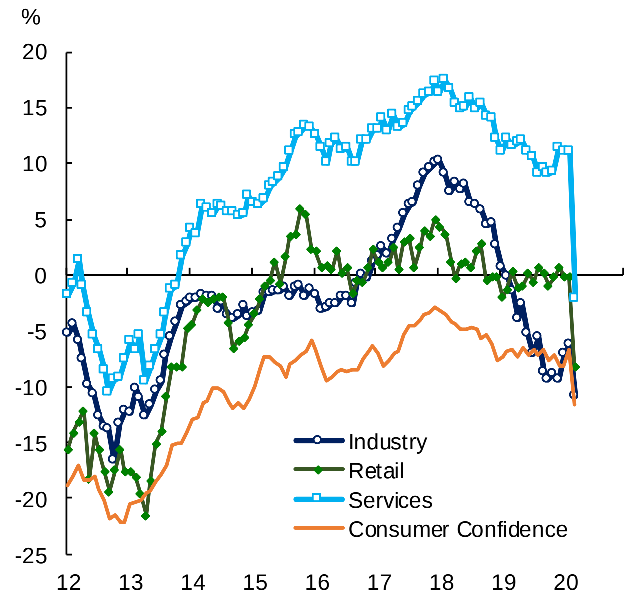
A drug to treat COVID-19 has yet to be found, and the medical infrastructures of the European countries are overwhelmed as the disease rapidly spreads. Italy and Spain have a shortage of medical equipment and hospital beds, and on top of that, medical staff are also contracting the disease, which is a serious problem. In order to control the pace of the epidemic's spread, the European countries are implementing restrictions on the movement of people and situations in which they might touch, in hopes of reducing the number of infections. Major events have been cancelled and schools have been closed. Meanwhile, retail stores with the exception of supermarkets, gas stations, and banks, have been closed, as well as restaurants and bars. Individuals are urged to remain at home and not go out except to shop for food, visit a medical institution for a checkup, go to work, or to care for children. The first country to implement a lockdown was Italy. At first this measure was limited to the area in the north where the epidemic was first centered, but then restrictions on movement were implemented on March 10 affecting the entire nation, and on the next day, the 11th, retail stores, restaurants and bars were forbidden from opening. The same measures regarding going out and closing restaurants and bars were adopted by Spain on the 14th, France on the 15th, and Germany on the 16th. Meanwhile, the UK, which has been less aggressive in strictly limiting movement, finally did so on the 23rd in response to the sharp increase in fatalities, implementing strict measures restricting going out with the exception of shopping for food, going to work, or visiting a medical facility for a medical checkup and diagnosis.

However, even after these measures restricting movement and closing down certain businesses were put into place, the number of infections in Europe continued to grow rapidly. The incubation period for COVID-19 is considered to be around two weeks, and hence it will take time to confirm whether the lockdown strategy has worked. There are also cases where restrictions on movement are not closely followed. Stricter controls on unnecessary outings were therefore put into place in the European countries. The Italian government decided on implementing an even stricter lockdown measure on March 21. Retail stores and restaurants and bars were originally to close until March 25, but the measure was extended until April 3. Factories and offices not considered to be essential were also closed until April 3. After that point, lockdown measures were again extended until April 13. Spain announced the strengthening of lockdown measures on March 26. Meanwhile, extensions of lockdowns were also implemented in France (from March 31 to April 15—decision made on March 27) and Germany (from April 6 to April19 – decision made on April 1).

Economy deteriorates rapidly due to lockdown

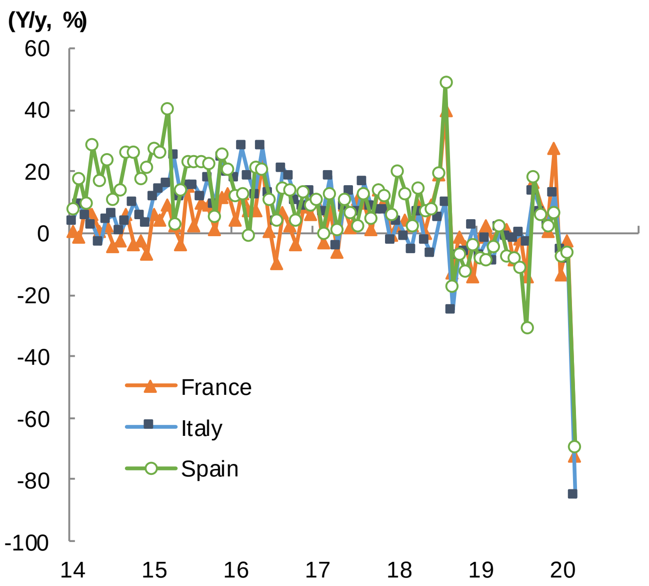
Though each country views things differently, the governments of many countries of Europe have made decisions on lockdown policies. As the infection continues to spread, consumption has stopped in most European countries, with the exception of minimum necessities. The industries most significantly affected are the services industries, such as eating and drinking out, hotels, travel, and leisure. The Economic Sentiment Indicator (ESI), published by the European Commission, deteriorated all at once, falling from the 103.4 points announced in February to 94.5 points in March. This degree of change in only a month exceeds that of the global financial crisis of 2008. All components making up the index worsened, including business confidence in industry, construction, retailing, and services, and consumer confidence. The worsening of business confidence in the services industries played a significant role in pushing the ESI figure downwards.

Eurozone Business & Consumer Confidence
Chart 5-3



Source: European Commission; compiled by DIR.

New Car Registrations Fell Sharply in March
Chart 5-4



Source: European Automobile Manufacturers' Association (ACEA); compiled by DIR.

On the other hand, compared to the services industry, the deterioration of business confidence in industry was limited. However, with the exception of foods and medical equipment, industry faces a major decline in demand. New car registrations in March announced on April 1 fell by -85.4% in comparison to the same period of the previous year in Italy, by -72.2% in France, and -69.3% in Spain. This is a huge decline never seen before in the past. Automobile manufacturers based in Europe made the decision to halt factory operations one after the other at the end of March. One of the reasons was of course to prevent the spread of the infection amongst employees, but the rapid decline in demand for automobiles was also a factor. Lockdown measures in the European countries were initially intended to keep production of necessities going. This included foods, medicines, and some other items. But as demand declines sharply, it becomes necessary to halt supply and make adjustments to supply & demand. This necessity is steadily increasing. This increases the possibility that future economic indices will worsen further.

Economic support measures of European countries emphasize support for corporate financing and household income subsidies

In order to reduce the worsening economic effects that come along with lockdown measures, the governments of European countries have announced a variety of economic measures. These are tailored to the particular conditions in each country, but there tends to be two major factors in common. One is that corporations facing a steep decline in sales are in need of funding. Hence low interest financing to provide emergency funding is being strengthened, as well as tax and insurance premium payment deferrals. Another issue is the decrease in income being faced by households. Many governments are helping with measures to supply a portion of the necessary income to households which have lost income because of the temporary halt of operations. In addition, deferral of mortgage payments is also included in these programs. One of the major concerns associated with the rapid deterioration of the economy is the sharp rise in the number of unemployed. European countries are looking to the German *Kurzarbeit* (short-time work) program as a model in working out support programs to maintain employment. According to the short-time work program, if a corporation which is experiencing a decline in operating rate has its employees on temporary lay-off or shorter work hours, the government will pay a portion of the reduction in income. In Germany the payment is 60%, and in some other countries it is 100%. The benefit for corporations is that they do not have to let trained employees go. This same program has been praised for having allowed Germany to avoid a major increase in unemployment when its economy sharply declined during the global financial crisis of 2008.

The Eurozone Finance Ministers Meeting (Eurogroup) was held on March 24 using a video-conferencing format. It became evident at this meeting that fiscal stimulus programs implemented by the various countries as of that point had reached a scale of 2% of the Eurozone's total GDP, twice what it had been only a week previously. Meanwhile, it was reported that loan guarantees and tax deferral measures to support funding had grown to over 13% of GDP. The EU requires member states to maintain fiscal health, and to keep budget deficits within 3% of GDP, but at the emergency EU summit meeting of March 17, it was agreed to temporarily suspend this rule, so that economic support measures could be prioritized. Special note should be made here that Germany, which had long held up the ideal of achieving a fiscal surplus while strictly imposing the fiscal health rule on other member states, made the decision to issue more government bonds for the first time in seven years. Issuance of government bonds totaling 156 billion euros for the purpose of securing financial resources for the supplementary budget and to compensate for the reduction in tax revenue was approved by the Bundestag.

Monetary policy also in crisis mode

Both the ECB and the BOE, which are in charge of monetary policy, have strengthened their crisis response modes. The BOE decided on an emergency interest rate cut of 50 basis points timed to go with the UK government's announcement of its proposed budget for 2020 on March 11. Then on the 19th the bank moved on making a further emergency interest rate cut of 15 more basis points. By this time the policy interest rate stood at 0.10%, the lowest it has ever been. Meanwhile, the bank recommenced asset purchases, integrating its asset purchase allowance so that it would include both government bonds and corporate bonds, which were always kept separate in the past, thereby increasing the amount by 200 billion pounds to a total of 645 billion pounds.

The ECB shelved the idea of lowering the policy interest rate at the meeting of the board of directors on March 12, but decided on an arrangement by which banks with a growing number of private sector financing deals could carry out financing at a rate that is lower than the policy interest rate. At the same time, the bank expanded its quantitative easing policy, and decided on additional asset purchases totaling 120 billion euros by the end of 2020. However, the COVID-19 epidemic spread rapidly centering on southern Europe, followed by fears of a sharp downturn in the economy due to the lockdown, and then the rapid expansion of Italian and German government bond spreads under these conditions. Because of this situation, the ECB adopted the Pandemic Emergency Purchase Programme (PEPP) on March 18, making a decision to commence asset purchases totaling 750 billion euros. It was also decided that the ECB's usual rules (upper limit of 33% on purchases per issuer and per issue, and purchase ratio of government bonds of member states based on member state's capital contribution to ECB capital (capital key)) would not apply to asset purchases under PEPP, making a more flexible asset purchasing program possible than usual.

In addition to the above measures, an agreement was made by the six major central banks (ECB, BOE, FRB, BOJ, SNB, and Bank of Canada) on March 16 regarding measures to strengthen liquidity supply through US dollar swaps.

EU-style policy coordination yet to gain currency on international level

While the central banks of Japan, the US, and Europe quickly agreed to cooperate on maintaining liquidity, international cooperation on fiscal policy has not yet reached the level seen within the EU where European integration has been promoted. At this point in time, measures to counter economic deterioration due to the COVID-19 pandemic are being carried out separately by each individual nation. The EU budget is only around 1% of GDP, so in actual fact the leading role is played by the governments of the various European nations. Italy, where the COVID-19 epidemic has been the most serious, recorded a public debt balance of 130% in 2018, and the concern is that this may grow another 10-20%pt due to the emergency measures. For a situation like Italy's, a quick decision on a backup mechanism at the level of the EU would be most desirable.

EU-style economic measures are now being discussed, and there has been a decision to temporarily suspend the fiscal health rule. At the same time, many ideas are being considered. There is a proposal for a total of nine countries, including Italy, Spain, France, and Belgium, to issue Corona bonds in the form of EU common bonds, and to use the funds raised to support the medical infrastructure and develop a vaccine for COVID-19, as well as to support economic measures. In response to this idea, the Netherlands and Germany, who have been dragging their feet in regard to the issuance of EU common bonds, are instead advocating the use of the European Stability Mechanism (ESM) to rescue member states who fell on hard times due to the European debt crisis. The ESM has the capacity to carry out a total of 410 billion euros in financing, but in order to receive ESM support, certain conditions must be fulfilled – mainly, submitting to a financial reconstruction plan determined by the European Commission, as well as monitoring to make sure said plan is being followed. Hence Italy is insisting that these conditions be eased for the purposes of COVID-19 measures. Other proposals include the issuance of European Investment Bank (EIB) bonds and use of funds raised to provide financial backing for employment maintenance measures (short-time work) in member countries. There is also a proposal to review allocation of the 2021 – 2027 EU multi-year budget in light of COVID-19 crisis measures. Discussions will continue at the next Eurozone Finance Ministers Meeting to be held on April 7. But first, it is thought that it would be best to prioritize measures for suppressing further spread of the infection, and which are more likely to be feasible in the short-term, such as making use of the ESM program.

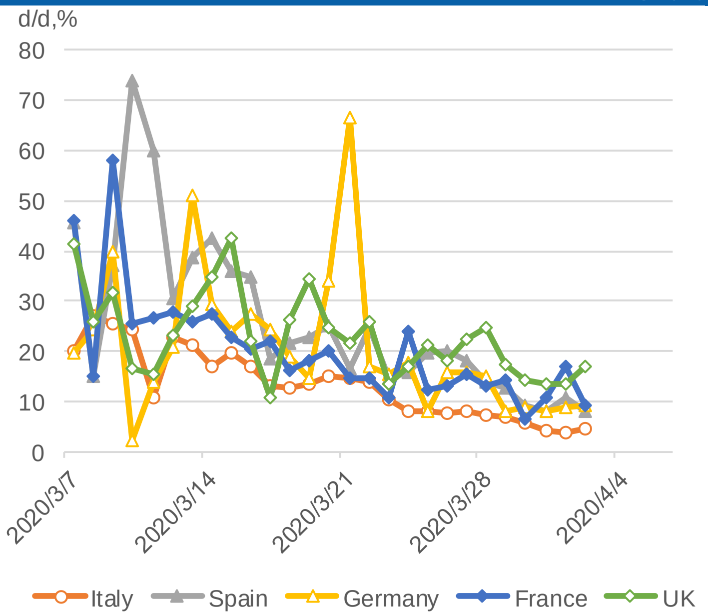
In terms of momentum, growth rates of Eurozone and UK to fall below that of the global financial crisis of 2008

In January and February of 2020, the main concerns for the European economy were the negative effects of the spread of the infection in China on external demand and the supply chain. But beginning in March, worries shifted to major declines in domestic demand. Economic activity in the Eurozone fell into a state of significant stagnation in the middle of March, with the UK following in late March. It is highly possible that this state of affairs will continue until the COVID-19 epidemic reaches its peak.

It goes without saying that the future prospects for the economy depend on how long the COVID-19 pandemic lasts, and exactly when and how various cities and countries can be released from lockdown. The pace of growth in the number of persons infected with the disease in Italy, which was the first country in Europe where COVID-19 began to spread and was also the first country to impose restrictions on the movement of people and contact with people, is now seeing the numbers gradually decrease. Growth rate in comparison to the previous day slowed to the single digit level on March 24, and then declined by 4.5% on April 2. However, the number of new infections per day is still more than 4,000. The situation is highly unpredictable, but attentions are focused on Italy in hopes that infections will continue to decline. The growth rate in number of people infected in comparison to the previous day also slowed to the single digit level in Spain, France, and Germany at the end of March, but there are still days when the numbers revert to the double-digits.

The Jan-Mar period GDP growth rate is expected to shift into negative numbers in both the Eurozone and the UK, while the Apr-Jun period is expected to experience a nearly 20% drop in q/q annualized terms. In terms of momentum, the economic growth rate is expected to fall significantly below that experienced during the global financial crisis of 2008. Lockdown measures in European countries are expected to be cancelled gradually during the latter part of the Apr-Jun period, but recovery in consumption is expected to be moderate. Growth rate in the Eurozone for the entire year in 2020 is expected to be -4.6%, with -4.1% seen in the UK.

Change in Number of Infections in Major European Countries
Chart 5-5



Source: WHO; compiled by DIR.

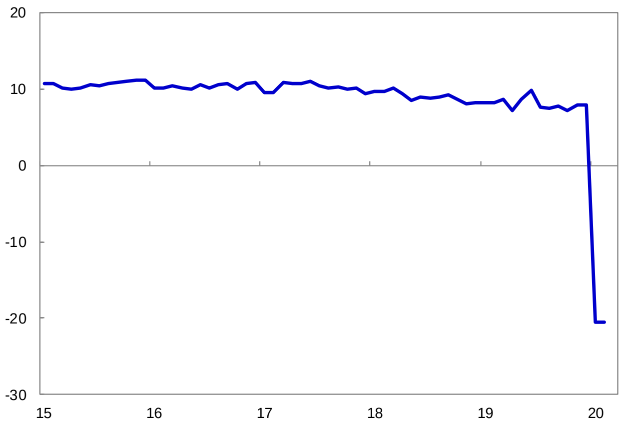
6. The Chinese Economy

Economic effects of Jan-Feb 2020 Corona Crisis catastrophic

The Chinese government implemented extremely strict measures to control further spread of the COVID-19 epidemic as of the end of January 2020, including restricting movements of people and avoidance of contact with others. According to the National Bureau of Statistics of China, retail sales in January and February made a complete turnaround from the 8.0% in growth experienced in the previous year in a precipitous decline of 20.5% in comparison to the same period of the previous year (all rates of change in remainder of this chapter in y/y terms). Discretionary consumption was hit especially hard with a major decline, while restaurant, automobiles, furniture, household electronics, and clothing registering more than 30% in declines.

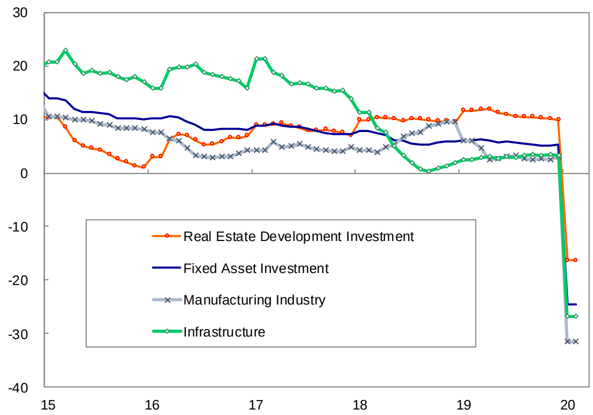
The resumption of factory operations and construction work were delayed, with industrial production down by 13.5% in January and February (as compared to the +5.7% growth experienced in 2019). Investment in fixed assets also declined steeply by 24.5% (compared to last year's +5.4%). Meanwhile, according to customs statistics (US dollar denominated), exports were down by 17.2% in January and February, with imports down by 4.0%. The balance of trade was in the red by 7.1 billion dollars. The double-digit decline in exports is thought to have been influenced significantly by supply constraints.

Change in Retail Sales (y/y, %)
Chart 6-1



Source: National Bureau of Statistics of China; compiled by DIR
Note: January and February expressed as an average in order to avoid influence of Lunar New Year.

Change in Fixed Asset Investment (y/y cumulative from Jan., %)
Chart 6-2



Source: National Bureau of Statistics of China; compiled by DIR
Note: January and February expressed as an average in order to avoid influence of Lunar New Year.

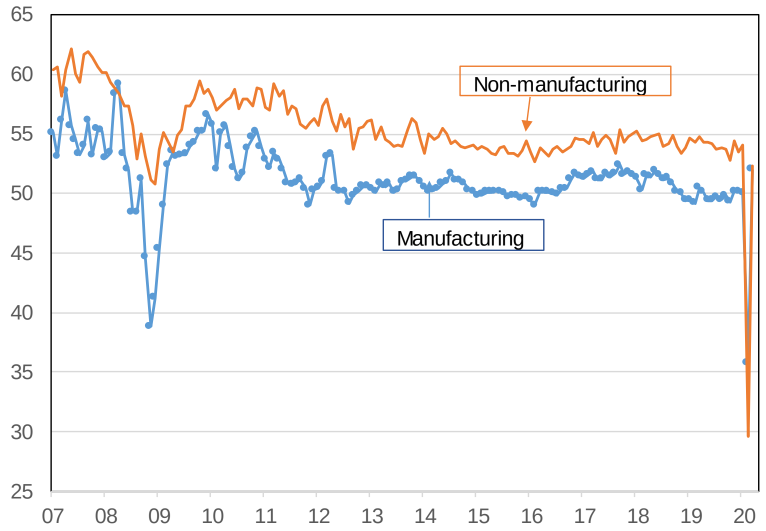
Positive factors arrive at beginning of March – economy past worst period, but negative growth could continue throughout Apr-Jun period

China's thorough measures to control the spread of COVID-19 were successful, with the number of new infections per day (24 hours) falling steeply. Since March 16 infections per day have been 0 or 1, even in Wuhan where the epidemic began. The spread of the infection has been pretty much brought under control in domestic China. The Chinese government implemented strong measures on January 23, closing the Wuhan airports and train stations, and halting all public transportation. Later the measure was expanded to include the entire province of Hubei. On March 25 restrictions on road traffic were lifted in Hubei Province with the exception of the city of Wuhan, then on the 29th, airports were reopened to domestic passengers in Hubei Province (with the exception of Wuhan). On April 8, the Wuhan lockdown will finally be lifted.

The Chinese economy began moving toward normalizing as of the beginning of March. According to the Ministry of Commerce, the business resumption rate for wholesale and retail as of March 22 was at 97% for large agricultural wholesale markets, 96% for major supermarkets, 94% for free markets, and 90% for department stores. Results of the nationwide 4S (stores that provide sales, maintenance, parts, and information services) survey of 8,569 outlets carried out by the China Automobile Distribution Association show that the business resumption rate had reached 94.7% as of March 24. Meanwhile, the Ministry of Industry and Information Technology reported that 98.6% of industrial enterprises with sales of more than 20 million yuan had resumed operations as of March 28, while 89.9% of employees (70% of these small to medium-sized enterprises) had returned to work. Even in Hubei Province, over 95% of industrial enterprises have resumed operations, with around 70% of employees having returned to work.

Under these conditions, the March Purchasing Manager's Index (PMI), published by the National Bureau of Statistics of China on March 31, was over 50, the junction between expansion and contraction, with manufacturing at 52.0 and non-manufacturing at 52.3. This is a dramatic improvement in comparison to February when the index was at a historic low, with manufacturing at 35.7 and non-manufacturing at 29.6.

Changes in Purchasing Manager's Index (PMI) for Manufacturing and Non-manufacturing Chart 6-3



Source: National Bureau of Statistics of China; compiled by DIR.

The fact that the Chinese economy has gotten past its worst period is a positive factor. However, statistics indicating the resumption ratio of factories, stores and outlets of various kinds only tells us whether or not things have gotten started again. It does not tell us anything about the extent to which production and sales have recovered. For instance, the 4S index for automobiles mentioned above reports that the number of customers visiting stores has recovered to only 61.7% of what it was before the corona crisis. Meanwhile, the PMI index shows the change in business confidence in comparison to the previous month, but as even the National Bureau of Statistics of China admits, "improvement in the PMI does not mean that production and sales of corporations have returned to the levels where they were before the Novel Coronavirus epidemic."

As for foreign economic relations, with the Novel Coronavirus having reached pandemic proportions, and countries all over the world implementing measures to control its further spread, overseas demand has diminished. The cumulative number of persons infected with the COVID-19 outside China exceeded that of China itself for the first time on March 16. This was a newsworthy moment, but only two weeks later this event was left behind as if it had happened in the distant past, since by that time the number of people infected outside China were multiplying rapidly. New infections in China are now mainly returnees from overseas. The Ministry of Foreign Affairs, National Immigration Administration, decided to temporarily halt the entry of travelers into China, including persons carrying Chinese passports and foreigners with residence permits starting on March 28. On March 29, the Civil Aviation Administration of China announced to both foreign and domestic airlines that international flights would be limited to one per week. Diplomatic, business, and the observing of protocol will be made an exception, but for the time being, the coming and going of persons between China and the rest of the world will be extremely limited.

COVID-19 is now rampant centering in the US and Europe, and these countries have also implemented tough restrictions on the movement of people and coming into contact with others. It is highly likely that these countries will be susceptible to economic damage of the same extent or more than China experienced during the months of January and February. Beginning in March, the freezing of economic activity in these countries has caused worldwide demand to decline, and the concern is that the negative effects will be huge for China, which has come to be known as the world's factory.

We see China's real GDP growth rate for the Jan-Mar 2020 period at around -7.0%. As for the Apr-Jun period, the degree of negative growth is expected to be reduced considerably, but coming back up to the positive range will likely be difficult. There are still concerns regarding the decline of global demand associated with measures to prevent the further spread of the infection, the deterioration of China's domestic employment (as of the end of February the national unemployment rate in urban areas was at 6.2%, rising considerably above the 5.2% recorded at the end of 2019), and the slow recovery of consumption due to the decline in income. The key to the recovery of China's economy is bringing the further spread of the infection under control, and the implementation of economic recovery measures. Even if we can expect a full-fledged recovery by the end of the year, the 2020 real GDP growth rate will still be only at around 1.5% compared to the 6.1% of 2019. The outlook for GDP in 2021 is around 7.0%, but this is will be due to the rebound from the unprecedented low growth in 2020.

Liquidity supply to avoid financial crisis and deal with large number of corporate bankruptcies

Bringing the COVID-19 epidemic quickly under control and realizing a stable economy cannot be achieved at one and the same time. China of course made bringing the COVID-19 epidemic quickly under control its highest priority, and in doing so stalled its economy. Past economic policy emphasized the supply of liquidity in order to avoid a financial crisis and the bankruptcy of large numbers of corporations. The Chinese government provides an exemption with time limit on corporate contributions to pensions, unemployment and industrial accident insurance (burden reduction of 500 billion yuan per year, or approximately 7.5 trillion yen). Meanwhile, the Chinese government requested local governments to provide reduced interest rates, a grace period on repayment of loans, and increased lending for corporations facing financial difficulties. The People's Bank of China is providing 300 billion yuan in special loan renewal, while implementing renewal of loans and discounts totaling 500 billion yuan to small to medium sized banks for the support of production and supply of materials used for the purpose of keeping the spread of the infection under control, as well as for agriculture, and small & micro businesses. In addition, China policy bans (the China Development Bank, Export-Import Bank, and the Agricultural Bank of China) have set up a special loan line of 350 billion yuan, and are carrying out lending at preferential lending rates for small & micro businesses, private sector corporations, foreign trade, and corporations making up the global supply chain.

The People's Bank of China lowered the deposit reserve ratio from 0.5%pt to 1.0%pt for banks which are in compliance with the examination criteria for inclusive financing, and implemented an additional cut of 1.0%pt for publically traded commercial banks who meet the criteria on March 16. This made it possible to use a total of 550 billion yuan in savings for the purpose of loans. This capital will go mainly to small & micro businesses and private sector corporations which have been especially affected by the economic slowdown.

On March 31 it was decided at the Executive Council of the State Council of the People's Republic of China presided over by Prime Minister Li Keqiang, that the relending and rediscount framework for small to medium-sized banks would be increased by 1 trillion yuan, thereby further lowering the deposit reserve rate for small to medium sized banks. The decision is expected to be implemented soon. (The People's Bank of China announced on April 3 that it would lower the deposit reserve rate of agricultural banks and city commercial banks by 0.5%pt on April 15 and May 15 respectively, or a total of 1.0%pt. This makes a total of 400 billion yuan available for loans.) The scale of programs announced up to now, bringing together the total of tax and expense reductions for corporations, and liquidity supply measures for corporations, the major portion alone totals 5 trillion yuan (approximately 75 trillion yen, or around 5% of GDP).

Eagerly awaited announcement of growth rate target at National People's Congress

The next priority after bringing the spread of the infection under control is stimulating the economy. The third meeting of the 13th National People's Congress, which was to taken place on March 5, was postponed due to the spread of COVID-19. A new date has yet to be announced. However, being that the number of people infected by the virus has significantly declined, the meeting may be held sometime in April. The government's annual announcement of the target growth rate will likely attract more attention than usual.

With the economy having lost speed due to the thorough measures to stop COVID-19 from spreading, the government will likely not stick to the usual growth target, but go with something a bit more realistic instead. Ma Jun, member of the Monetary Policy Committee of the People's Bank of China, proposed that the government not set a growth target for 2020. His reasoning was that (1) there is a high rate of uncertainty in 2020, and (2) if the target is set overly high, the government will end up having to rely on a pork-barrel policy.

On the same token, the year 2020 marks the culmination of the government's pledge to the people in which it promised to double real GDP growth in comparison to the year 2010. In order to do so, real growth must reach 5.6% in 2020. This would have been possible if not for the Corona Crisis. Now it is highly likely that the real GDP growth rate will register major negative growth for the Jan-Mar period. It would be quite a stretch at this point to attempt to achieve a growth target of the level mentioned here. If the government were to set a growth target for 2020 of around 5.5%, infrastructure investment, which has experienced a decline in rate of return, would have to experience major growth (also requiring a surge in debt), and this would bring fears of a major increase of risk of bad debt in the future.

Economic recovery measures and fears of increased financial risk in mid to long-term

How will the Chinese government approach economic recovery measures in the future? First of all, there is plenty of room for monetary easing. And the importance of lowering the deposit reserve rate, which increases the lending capacity of financial institutions, will likely increase. As of this point in time, the deposit reserve rate of the major banks is at a fairly high level of 12.5%, hence there is plenty of room for lowering that rate.

In relation to fiscal policy, the Chinese government has kept the budget deficit within 3% of GDP in view of maintaining fiscal health. However, they will probably have to accept going above this level in order to deal with the crisis of 2020. The net issuance amount of local government bonds, which is a source of capital for infrastructure investment, is expected to be increased. Issuance of 2.15 trillion yuan was planned in 2019, an increase of 800 billion yuan in comparison with the previous year's budget. The entire amount had been issued by the end of September of that year, and in 2020, the amount will likely increase to 3.5 – 4.0 trillion yuan.

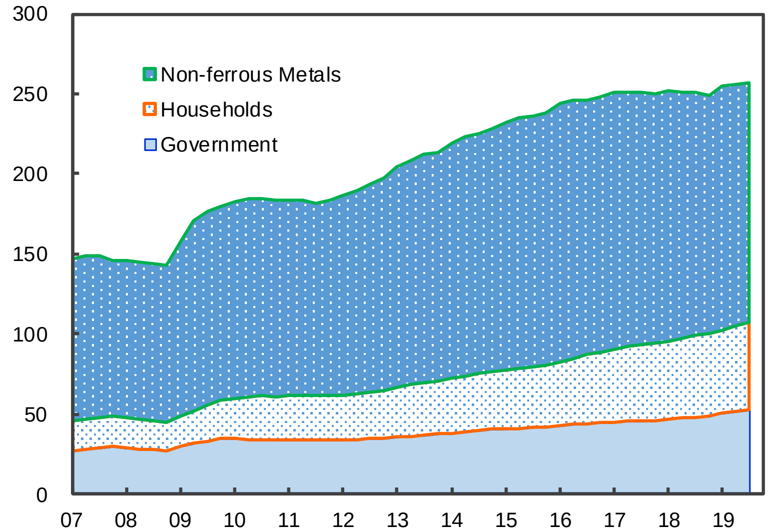
As for infrastructure investment, “new infrastructure investment” may become a focus. This is investment in 5G networks for mobile devices, data centers, intelligent transportation systems, smart grids, and smart cities. Demand for investment in this area alone is seen at around 1 trillion yuan within the year.

There are two other policies originally announced at the end of January in 2019 which have yet to be fully implemented. The first is a subsidy policy for purchasing cars and home appliances. According to National Development and Reform Commission estimates, if a policy to stimulate consumption of energy-saving household appliances and smart appliances is rolled out nationwide, it will have the effect of stimulating consumption by 700 billion yuan over a period of three years. If a policy to stimulate consumption of automobiles in general and household electronic devices is fully implemented in the future, the demand stimulation effect should be promising for some time.

The second policy is the enhancement of public services. This policy covers 27 items to be implemented by 2022, including the balanced development of public education, improvement of medical hygiene services in poor districts so that they reach the level of services rendered by provincial governments, and the strengthening of maternal and child health. This would involve provincial governments carrying out the accelerated construction of public facilities including schools and medical facilities. This policy has not yet been fully implemented due to the lack of funds of provincial governments. However, it is possible that this policy may now be strongly promoted by the party and the central government as a part of the economic recovery measures.

At the same time, overdependence on infrastructure investment is also a concern. Transportation infrastructure, where recovery of the cost of investment is possible by collecting fees over the long-term, is no problem, but profitability of public services is not very promising. Accelerating infrastructure investment despite its declining profitability at this time could invite a deepening level of seriousness for the problem of excessive debt mentioned earlier, and could very well cast another shadow over the Chinese economy in the mid to long-term. Therefore caution is recommended regarding future developments.

China’s Balance of Debt by Sector as a Proportion of GDP (Unit: %) Chart 6-4



Source: Bank for International Settlements (BIS); compiled by DIR.