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# Japan's Economy: Monthly Outlook (April 2020)

## Industrial implications of an era with COVID-19

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**Summary**

- The global financial markets bottomed out during the latter part of March and regained some calm for the moment. A major factor here was the FRB's immediate countermeasures, which relieved credit uncertainty. However, credit uncertainty is still smoldering in Europe, which was notably slower in responding. Meanwhile, the situation remains unchanged for corporations with low credit ratings which are not eligible for bailout, and concerns regarding liquidity in the emerging nations. And there is high risk of a recurrence of rising yields on corporate and government bonds with low credit ratings. Ultimately this all depends on the length and depth of the impact of the corona disaster on the real economy.

- Looking at the real economy, there is some good news with local recovery in the Chinese economy and promise of the partial lifting of lockdown measures in the US and Europe. However, the recovery in China has yet to be accompanied by growth in demand, and gives one the feeling that there will be difficulties ahead for the continuation of recovery. Meanwhile, it is highly likely that mass unemployment in the US will slow the pace of recovery in demand. Even more essentially, risk remains great that the infection could begin to spread again after removing lockdown measures, or that there could be a second or even third wave of the pandemic triggered by the spread of the corona disaster in the southern hemisphere. It is therefore necessary to be prepared to face an era with COVID-19, accompanied by the economic impact of social isolation.

- As for the Japanese economy, the impact of social isolation measures is now becoming tangible centering on certain industries, including passenger transport, accommodations, department stores, eating out, entertainment, and others. At the same time we should not ignore the fact that there is some replacement demand and special demand being generated in industries such as supermarkets, e-commerce, medicines, telecommunications services, software, and electronic devices. As impact on the overall economy continues, it should also be pointed out that one of the characteristics of the COVID-19 era is that disparities in performance appear depending on the industry.

## Financial markets begin to calm down with relief of credit uncertainty

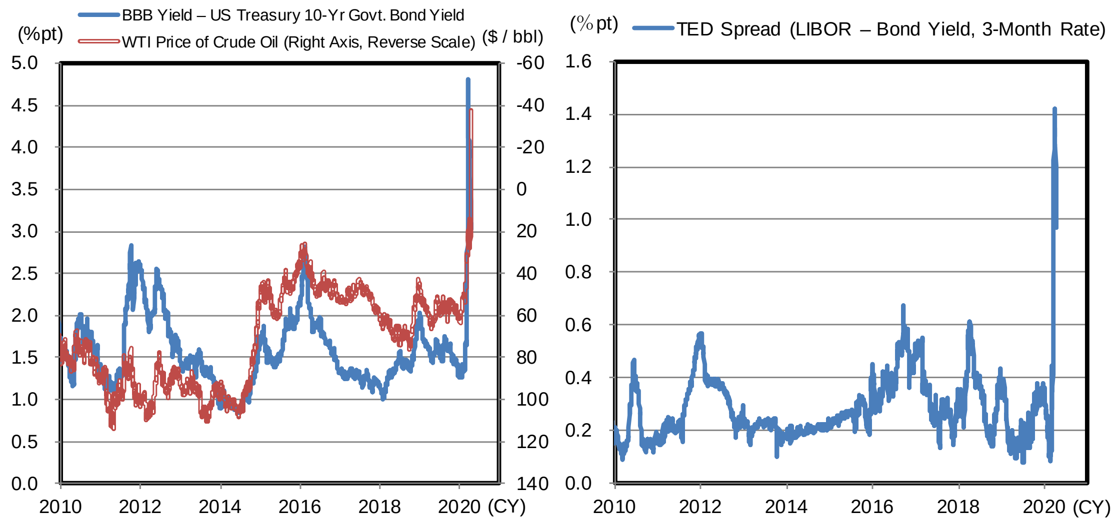
The global asset markets went into free-fall for a period of time due to the spread of the corona disaster, but then regained some calm after bottoming out.

Behind this situation unarguably lies the reality that the real economy is, at least to some extent, beginning to show some bright spots. The first epicenter of the infection's spread was China, where it has now been brought under control and economic activity can be seen to have partially recovered. In addition, the US and Europe, where the disease began to spread after some lag time and then grew exponentially, the pace of growth in COVID-19 infections is beginning to show signs of slowing down, with the possible release from lockdown measures coming into view in certain countries and cities. This observation is based on the fact that the worst case scenario woven into the behavior of the financial markets – in other words that there would be an uncontrollable spread of the disease throughout the world, and that it would be accompanied by a devastating economic impact – can be understood as having been corrected.

However, as will be discussed in more detail later in this report, neither of these factors suggest that we can assume that the global economy will be restored to levels seen before the corona disaster in the near future. A historical example here would be the Spanish flu epidemic of 1918. Much like that case, risk remains great that a second and third wave of the epidemic could occur, repeatedly causing declines in economic activity.

Nevertheless, the main reason that the financial markets are regaining some calm is that the efforts of central banks around the world, centering on the FRB, have provided some relief from credit uncertainty brought on by the corona disaster. It is self-evident that the deterioration of the economy associated with the corona disaster causes bond yields to rise, but then added to this problem is the weakening price of crude oil resulting from the failure of oil producing countries to agree on a production cut. This in turn has caused yields on high-yield bonds issued by members of the shale gas industry to rise (meaning a decline in value) (Chart 1, left side)[1].

**Environment Surrounding US Financial Market** **Chart 1**




Source: Haver Analytics; compiled by DIR

[1] The rise in bond yields is a sore spot for the financial markets centering on the US market. Looking back at the past, we see that the result of continuing ultra-low interest rate policies after the global financial crisis of 2008 was that the leveraging of corporate debt continued to rise. For instance, looking at corporate debt in the US as a proportion of GDP, we see that the level exceeds what it was immediately before the global financial crisis of 2008, as well as just before the IT bubble burst. This is also the result of share buybacks financed by corporate bonds. This created an asset effect associated with the rise in stock prices resulting from this activity, and it is also something which undeniably helped to push up the real economy as well. This is why the rise in bond yields could cause bubble equilibrium to head toward reverse rotation.

Concern is also spreading in regard to capital loss and counterparty risk. There were signs of upheaval in the supply of capital between banks in mid-March (Chart 1, right hand side). This is typical of the beginnings of a credit crunch. As this problem becomes more serious, it could bring about a credit crunch along the lines of the global financial crisis of 2008.

## FRB Plays Trump Card

Reviewing the responses of central banks, we'll have to say that the initial response was off-target. It's not as if to say that the emergency interest rate cut on the part of the FRB on March 3 and 15 did not have at least some effect on the mid to long-term economic situation, but neither did it handle the problem just up ahead – the credit crunch. Next, a decision was made on additional asset purchases on March 15. This has been interpreted as having a certain amount of significance from the viewpoint of liquidity supply, but it has a limited effect from the viewpoint of easing credit.

But then the FRB changed its tune. Between March 17 and March 23, the FRB played its trump card, implementing the following measures: establishment of a lending facility for primary dealers, establishment of a lending facility for money market funds, unlimited purchase of US treasuries and mortgage-backed securities, reintroduction of a term asset-backed securities loan facility, and the announcement of a loan support program for small to medium-sized enterprises. The measures cover a broad range, but from the viewpoint of handling a credit crisis, the two most important items are (1) establishment of a qualified commercial paper purchase facility, and (2) establishment of a purchase facility for qualified corporate bonds. (Chart 2, colored portions.)

**Emergency Measures by Central Banks** **Chart 2**

| | FRB | ECB | BOE | BOJ |
|---|---|---|---|---|
| Interest Rate Cut | Rate cut of 0.5% (1.5–1.75% → 1.0–1.25%) (3/3) | --- | Rate cut of 0.5% (0.75% → 0.25%) (3/11) | --- |
| | Rate cut of 1.0% (1.0–1.25% → 0–0.25%) (3/15) | --- | --- | --- |
| Quantitative Easing | US Treasuries 500 bil dlrs, MBS 200 bil dlrs additional asset purchase (3/15) | 120 bil euros private sector asset purchase (till end 2020) (3/12) | Support for loans to small to medium-sized enterprises (3/11) | ETF (6 tril yen → 12 tril yen) and J-REIT (90 bil yen → 180 bil yen) asset purchase increase (3/16) |
| | Established qualified CP purchase facility (3/17) | 750 bil euros additional asset purchase (3/18) | --- | Established additional asset purchase framework for purchase of CP & corporate bonds 1 tril yen each |
| | Unlimited purchase of US Treasuries and MBS (3/23) | --- | --- | --- |
| | Established purchase facility for qualified corporate bonds (both primary & secondary) (3/23) → scale up + added fallen angels to eligible purchases (4/9) | --- | --- | Introduced special operation to support corporate financing. (3/16) |
| Liquidity Supply | Expanded supply of dollar liquidity through US dollar swap arrangement (3/13) | | | |
| | Lowered deposit reserve rate to 0% (3/15) | Relaxed conditions for TLTRO3 | Lowered counter-cyclical buffer from 1% to 0% (3/11) | --- |
| | Established lending facility oriented toward primary dealers of US treasuries (3/17) | Recommenced LTRO, relaxed conditions (3/12) | --- | --- |
| | Established lending facility for MMF (3/18) | --- | --- | --- |
| | Reintroduced term asset-backed securities loan facility (3/23) → scale up + expanded eligibility (4/9) | --- | --- | --- |
| | Established local govt. liquidity facility (4/9) | --- | --- | --- |
| | Announced SME loan support program (3/23) → established (4/9) | --- | --- | --- |
| | Established salary guarantee program loan facility (4/9) | --- | --- | --- |

Source: FRB, ECB, BOE, BOJ; compiled by DIR.

These measures take aim precisely at the problems discussed earlier – the credit crunch and liquidity depletion. It should also be mentioned here that these measures have no upper limit, but only a price. As for (1) and (2), the FRB has made it possible to carry out purchases on the secondary market at the same prices already issued or more. As for (2), the FRB has allowed purchase of bonds issued by corporations in need of new fundraising on the primary market. In other words, theoretically speaking an unlimited amount of capital input will take place, and the FRB will provide put options for the assets in question.

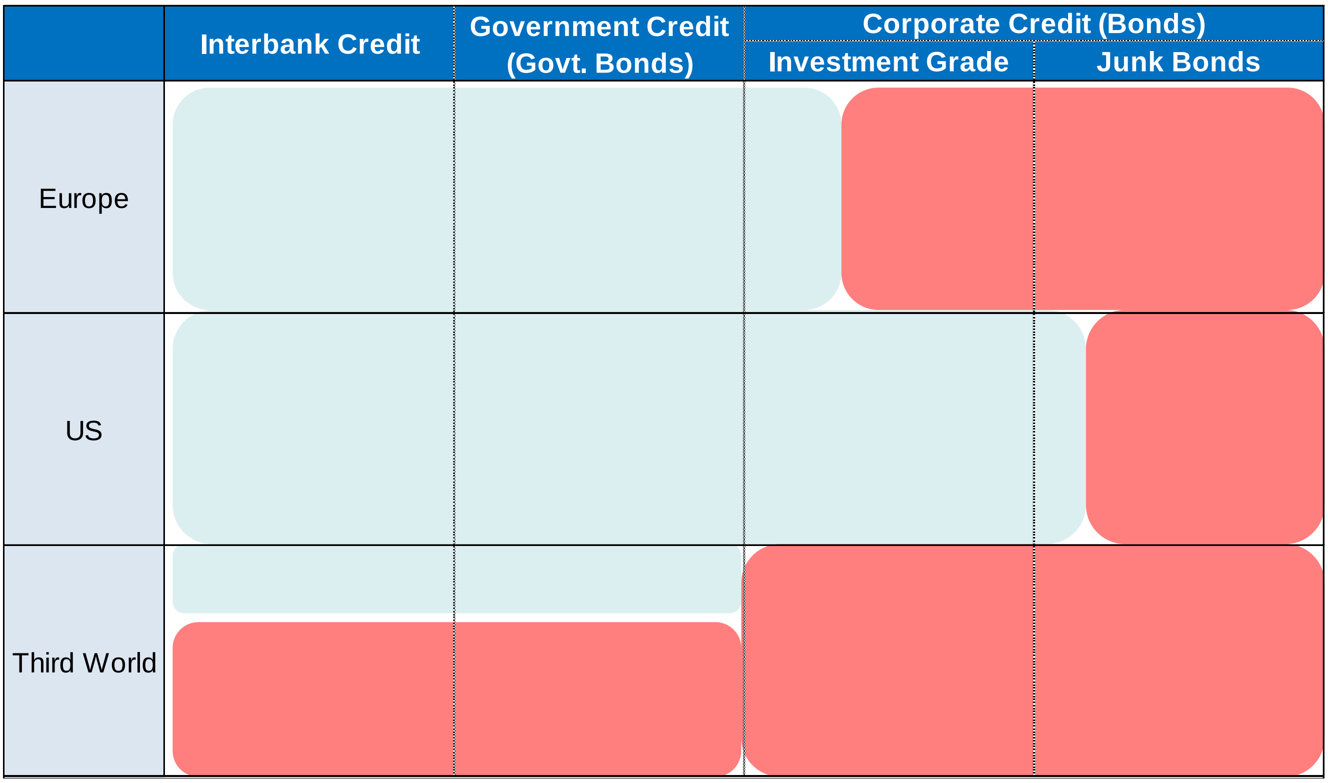
Emergency measures implemented by the FRB were strengthened on April 9, and the above safety net was extended to include fallen angels (as of March 23, bonds issued by corporations whose credit ratings have been lowered to a level where they are no longer considered eligible for investment). Additional measures then also included establishing a local government liquidity facility, a financing facility oriented towards main street companies (support for financing small to middle-sized enterprises), and a loan facility for the salary guarantee program (support for financing of small-scale businesses).

## Those who will benefit from relief measures, and those who will be forced to undergo hardships

The FRB's immediate countermeasures relieved credit uncertainty at least for the moment. Even so, a sense of uncertainty remains on the financial market. The situation remains unchanged for those who are not eligible for bailout under measures implemented by the world's central banks and this brings yet another concern.

First of all, assets which already lacked credit ratings that would make them eligible for investment before March 22 are not eligible for relief. While this is of course significant from the viewpoint of keeping future costs under control, such as the occurrence of moral hazard or the recurrence of a bubble economy. But on the other hand, it is also highly likely that the low-grade corporate bond turmoil will continue in the future.

**Eligibility for Relief Provided by Emergency Measures of Major Central Banks** **Chart 3**




Source: Statistics from various central banks; Compiled by DIR. Blue portions represent eligibility for relief. Red portions are ineligible.

Secondly, central banks other than the US – especially, the ECB – do not seem to have the same sense of urgency. Of course, the ECB has also decided to (1) expand liquidity supply, (2) ease TLTRO requirements, and (3) purchase assets centering on private sector bonds. Number (1) will likely ease the problem of interbank credit, while (3) should have the effect of easing the credit crunch. However, these measures alone may be insufficient. Unlike the FRB, the price (or amount) of (3) is not set, but neither is there a definite upper limit. Meanwhile, number (2) comes with strings attached. Injecting funds into financial institutions in the middle of a credit crunch does not necessarily mean that lending will increase. Caution is required here, as the delay in decision-making by the EU affiliated organization, which is merely for sovereign nations to create a closer relationship, and could simply end up causing fatal economic damage.

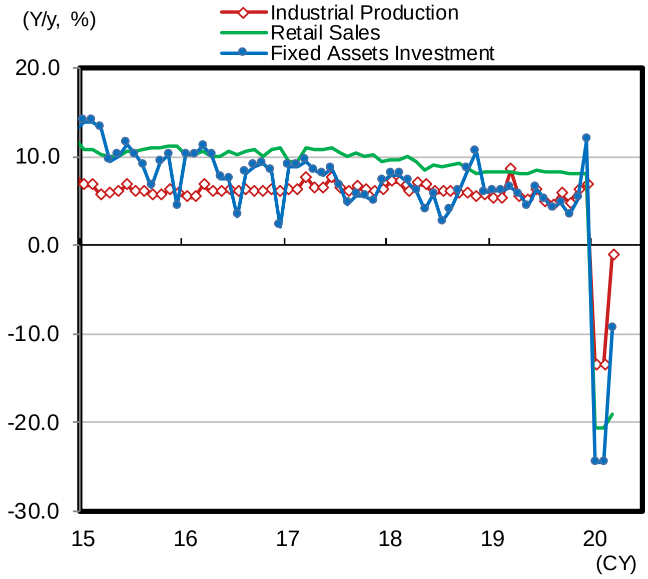
Third, the emerging nations are not yet out of danger, and they have limited means of dealing with the credit crisis. Countries which have made dollar swap agreements with the FRB have been relieved of concerns regarding dollar depletion, but by itself the dollar swap agreement does not resolve the problem of corporate credit. Almost none of the emerging nations are covered by a dollar swap arrangement.

The fourth issue we would like to mention here, and which involves all of the above items, is that the deteriorating economy due to the corona disaster, and which is also behind the growth in yields on corporate and government bonds with low credit ratings, has not been resolved merely by having implemented these measures. Ultimately, whether or not credit uncertainty recurs in the future depends on the length and depth of the impact of the corona disaster on the real economy.

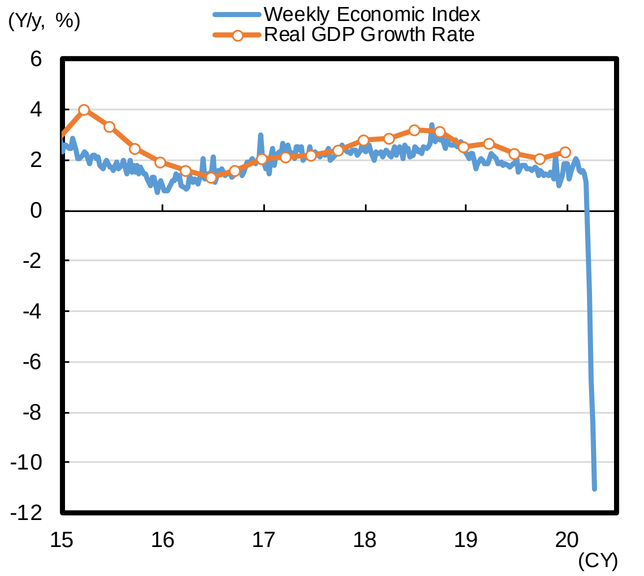
## The real economy – caught between fleeting expectations and the difficult road ahead

Taking a look now at the real economy, as we touched upon briefly earlier in this report, the good news is that economic activity is gradually recovering in China, and they are headed toward returning to normal. Meanwhile, there is promise of the partial lifting of lockdown measures in the US and Europe. However, when we look at China's economic indicators, we see that supply side statistics, an important part of the industrial production index, shows a slight recovery, while demand side statistics in retail sales amount and fixed asset investment is still very weak. This gives one the feeling that it will be tough going in the future as China continues to move toward recovery.

**Economic Conditions in China (Left) and the US (Right)** **Chart 4**




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




Source: Federal Reserve Bank of New York, BLS, Haver Analytics; compiled by DIR.

Meanwhile, as global final demand continues to decline centering on the US and Europe, concern remains for China regarding overseas demand. And in regard to the US and Europe which are most important here, even if lockdown measures can be successfully removed at this point (in other words while avoiding a recurrence of the epidemic), there is still the astronomical unemployment, which will highly likely make recovery in demand, expected to come after this is all over with, move at a sluggish pace.

The global economy, on its road back to the level where it was before the COVID-19 pandemic hit, has no choice but to wait for the Chinese government's economic measures which as of this moment the National People's Congress has yet to make a decision on, and in the US, the Trump Administration's additional fiscal policy centering on infrastructure investment and other economic stimulus measures.

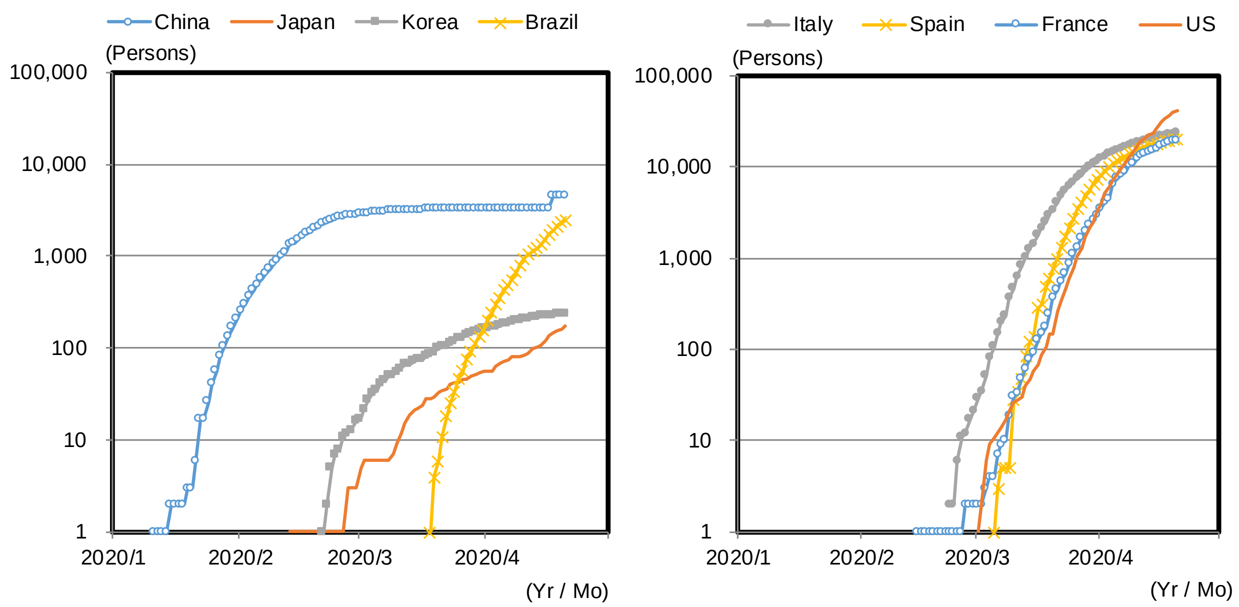
## Can second and third waves as occurred during the Spanish flu epidemic of 1918 be avoided?

The above arguments are all dependent on the successful removal of the lockdown measures (while at the same time avoiding a recurrence of the epidemic). As of this point, we must voice skepticism about this basic assumption. It is undeniable that an overly-hasty removal of lockdown measures could lead to a further spread of the epidemic.

Meanwhile, another concern is that Brazil and other countries in the southern hemisphere are just beginning to detect the spread of COVID-19. Ultimately, it will be difficult to bring the infection under control until one of the following occurs: (1) COVID-19 is eradicated throughout the world, or it loses its virulence through some kind of mutation, (2) a drug to treat the disease is developed, or (3) collective immunity is attained. However, it is clear that the spread of the infection in the southern hemisphere makes it difficult to achieve (1). And (3) would require a huge amount of time and he sacrifice of many lives. As for (2), there is some promising news as regards development of a drug. But in any case, the situation remains uncertain.

In light of the above, there's nothing we can do but wait out the time it takes to achieve (2) or (3), while maintaining social isolation measures so as to avoid the collapse of the medical infrastructure, and doing our best to endure the reduction of economic activity. It is therefore becoming ever more necessary to face the reality of an era with COVID-19.

**Time Series Transition of Number of Fatalities by Country (Logarithmic Scale)** **Chart 5**



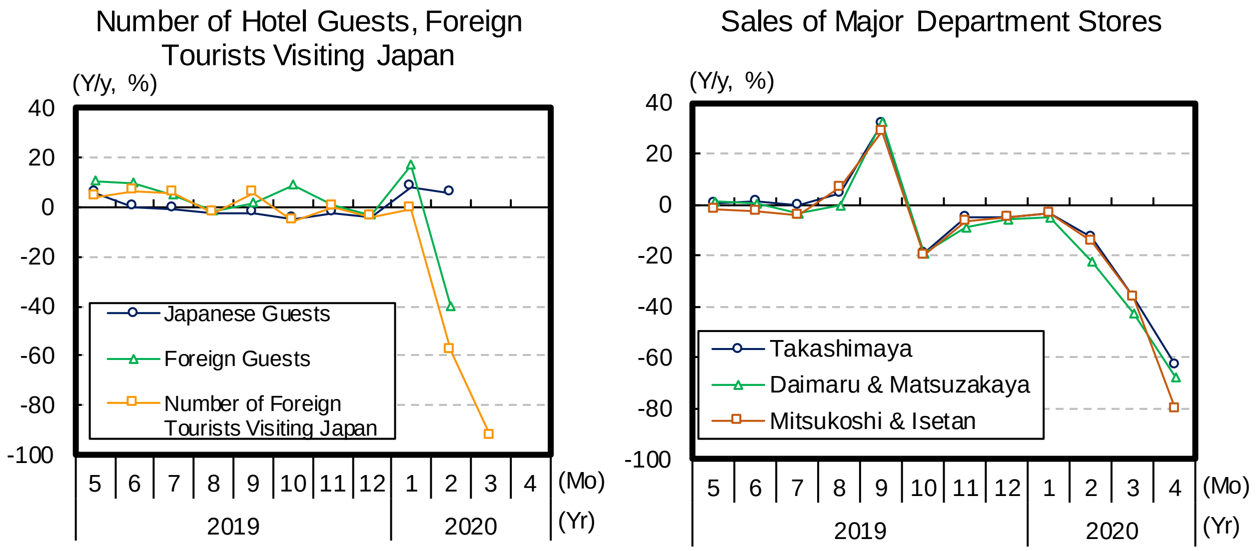

Source: ECDC; compiled by DIR.

## Japan's Economy and Industrial Implications of an Era with COVID-19

Looking now at the Japanese economy, the effects social isolation measures are especially notable in particular industries (Chart 6 and 7). As of March, the number of foreign tourists visiting Japan had fallen by 90% in comparison to the same period of the previous year, while in April, the number of reservations on passenger airlines as of the 1st of the month had declined by around 90% y/y on international routes and by around 60% on domestic routes. Meanwhile, transport volume on the Shinkansen (the Bullet Train) was down by around 80% during the first half of April, further expanding the extent to its decline in comparison to March when transport volume was down by around 60%. Major department stores suffered declines in sales of 60-80% during the first half of April. Further deterioration is expected for the latter part of April in light of the declaration of the state of emergency.

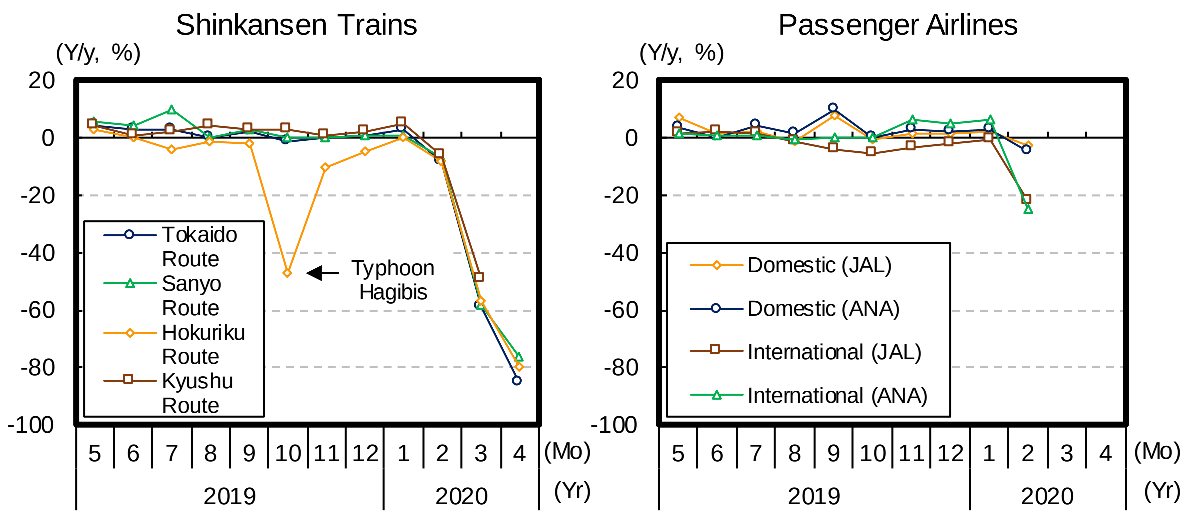
According to JCB Consumption NOW, based on data on credit card transactions, consumption amount in eating out and entertainment also recorded a major downturn in March

**Number of Hotel Guests, Number of Foreign Tourists Visiting Japan, and Sales of Major Department Stores** **Chart 6**




Source: Japan Tourism Agency, Japan National Tourism Organization (JNTO), corporate data; compiled by DIR.
Note: Number of hotel guests based on number of days of stay.

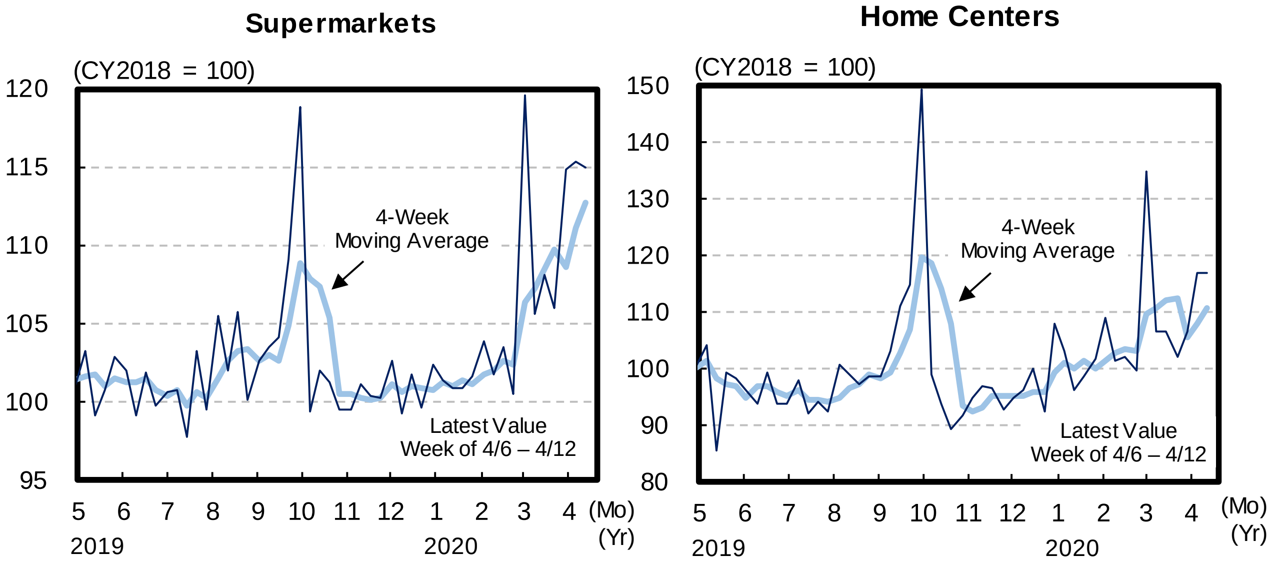
**Number of Passengers on Shinkansen Trains and Airlines** **Chart 7**




Source: JR Central, JR West Japan, JR Kyushu, JAL, ANA; compiled by DIR.
Notes: 1) April figures for the Tokaido Shinkansen line runs through the 15th, while for Sanyo and Hokuriku lines it goes through the 7th.
2) Figures for JAL and ANA include group companies they are associated with.

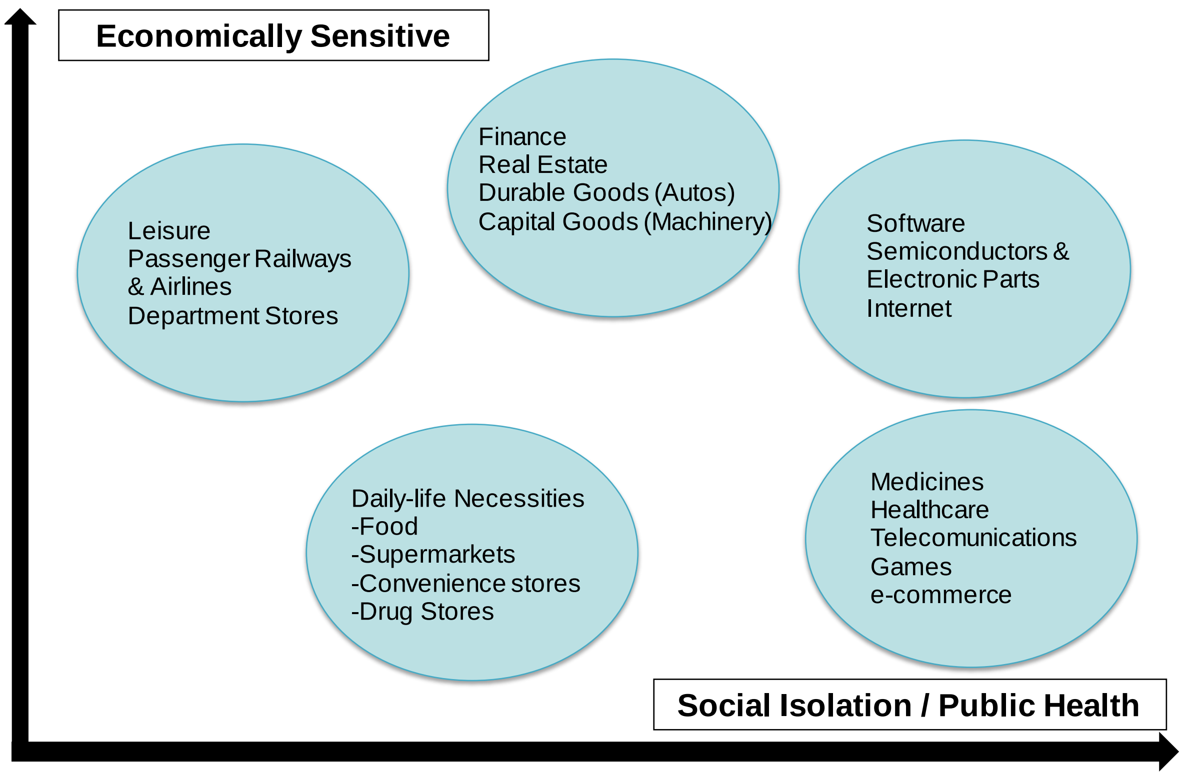
On the other hand, it should not be overlooked that some industries are actually profiting from the situation. For instance supermarket and home center sales have grown from a mere “nest-dweller consumption” level to a much higher one which it is maintaining (Chart 8). According to JCB Consumption NOW, in addition to the above mentioned categories, liquor stores, e-commerce, medicines, and convenience stores are also experiencing growth in consumption amount. Meanwhile, though not much data is available at this point in time, items associated with the promotion of working remotely, such as telecommunication services, software, and electronic devices, are also experiencing major growth in demand. The Corona Disaster is also generating replacement demand and special demand.

**Supermarket and Home Center Sales** **Chart 8**




Source: Ministry of Economy, Trade and Industry; compiled by DIR.
Note: METI weekly data from POS retail sales index. Excludes consumption tax. Seasonal adjustment by DIR.

**Industrial Implications of an Era with COVID-19** **Chart 9**




Source: Produced by DIR.

**Japan's Economic Outlook（2020/4/8）**

| | FY19 (Estimate) | FY20 (Estimate) | FY21 (Estimate) | CY19 | CY20 (Estimate) | CY21 (Estimate) |
|---|---|---|---|---|---|---|
| **Main economic indicators** | | | | | | |
| Nominal GDP (y/y %) | 0.7 | -2.9 | 2.8 | 1.2 | -3.2 | 2.5 |
| Real GDP (chained [2011]; y/y %) | -0.1 | -4.0 | 2.7 | 0.7 | -4.5 | 2.4 |
| Domestic demand (contribution, % pt) | 0.1 | -2.1 | 1.7 | 0.8 | -2.7 | 1.6 |
| Foreign demand (contribution, % pt) | -0.2 | -1.9 | 1.0 | -0.2 | -1.8 | 0.8 |
| GDP deflator (y/y %) | 0.8 | 1.1 | 0.1 | 0.6 | 1.3 | 0.1 |
| Index of All-industry Activity (y/y %)* | -1.1 | -4.7 | 2.8 | -0.3 | -5.4 | 2.5 |
| Index of Industrial Production (y/y %) | -3.4 | -6.7 | 3.3 | -2.8 | -7.4 | 2.3 |
| Index of Tertiary Industry Activity (y/y %) | -1.1 | -6.3 | 2.9 | 0.5 | -7.7 | 2.8 |
| Corporate Goods Price Index (y/y %) | -0.3 | -5.4 | 0.5 | 0.2 | -4.5 | -0.8 |
| Consumer Price Index (excl. fresh food; y/y %) | 0.6 | -1.6 | -0.5 | 0.7 | -0.9 | -1.0 |
| Unemployment rate (%) | 2.3 | 3.4 | 2.7 | 2.4 | 3.3 | 2.8 |
| Government bond yield (10 year; %) | -0.12 | 0.00 | 0.00 | -0.11 | -0.02 | 0.00 |
| Balance of payments | | | | | | |
| Trade balance (Y tril) | 1.2 | 1.7 | 6.5 | 0.6 | 1.2 | 6.0 |
| Current balance ($100 mil) | 1,900 | 1,934 | 2,515 | 1,840 | 1,870 | 2,463 |
| Current balance (Y tril) | 20.8 | 20.9 | 27.2 | 20.1 | 20.2 | 26.5 |
| (% of nominal GDP) | 3.8 | 3.9 | 4.9 | 3.6 | 3.8 | 4.8 |
| **Real GDP components** **(Chained [2011]; y/y %; figures in parentheses: contribution, % pt)** | | | | | | |
| Private final consumption | -0.8 (-0.5) | -2.6 (-1.4) | 2.2 ( 1.2) | 0.2 ( 0.1) | -3.9 (-2.1) | 2.5 ( 1.4) |
| Private housing investment | 1.1 ( 0.0) | -2.6 (-0.1) | -0.0 (-0.0) | 2.0 ( 0.1) | -3.1 (-0.1) | -0.2 (-0.0) |
| Private fixed investment | -0.8 (-0.1) | -6.1 (-1.0) | 1.7 ( 0.3) | 0.7 ( 0.1) | -6.3 (-1.0) | 0.6 ( 0.1) |
| Government final consumption | 2.6 ( 0.5) | 1.9 ( 0.4) | 0.9 ( 0.2) | 1.9 ( 0.4) | 2.2 ( 0.4) | 1.2 ( 0.2) |
| Public fixed investment | 3.6 ( 0.2) | 1.2 ( 0.1) | -0.3 (-0.0) | 2.9 ( 0.1) | 2.0 ( 0.1) | 0.1 ( 0.0) |
| Exports of goods and services | -2.2 (-0.4) | -20.1 (-3.4) | 15.9 ( 2.3) | -1.8 (-0.3) | -18.9 (-3.3) | 11.8 ( 1.7) |
| Imports of goods and services | -0.9 ( 0.2) | -8.8 ( 1.6) | 7.3 (-1.2) | -0.8 ( 0.1) | -9.0 ( 1.5) | 6.3 (-0.9) |
| **Major assumptions:** | | | | | | |
| **1. World economy** | | | | | | |
| Economic growth of major trading partners | 2.4 | -1.8 | 4.8 | 3.0 | -1.8 | 4.0 |
| Crude oil price (WTI futures; $/bbl) | 54.7 | 25.0 | 25.0 | 57.0 | 30.2 | 25.0 |
| **2. US economy** | | | | | | |
| US real GDP (chained [2012]; y/y %) | 1.8 | -3.3 | 3.8 | 2.3 | -3.0 | 3.1 |
| US Consumer Price Index (y/y %) | 1.9 | 1.1 | 2.3 | 1.8 | 1.3 | 2.1 |
| **3. Japanese economy** | | | | | | |
| Nominal public fixed investment (y/y %) | 5.2 | 1.7 | 0.2 | 4.5 | 2.9 | 0.5 |
| Exchange rate (Y/$) | 108.7 | 107.5 | 107.5 | 109.0 | 107.9 | 107.5 |
| (Y/€) | 120.9 | 119.0 | 119.0 | 122.2 | 119.3 | 119.0 |

Source: Compiled by DIR.
Notes: 1) Index of All-Industry Activity Index: excl. agriculture, forestry, and fisheries.
2) Due to rounding, figures may differ from those released by the government.