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

**Economic outlook revised: while recovery continues, concerns regarding explosive spread of infections increases**

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## Summary

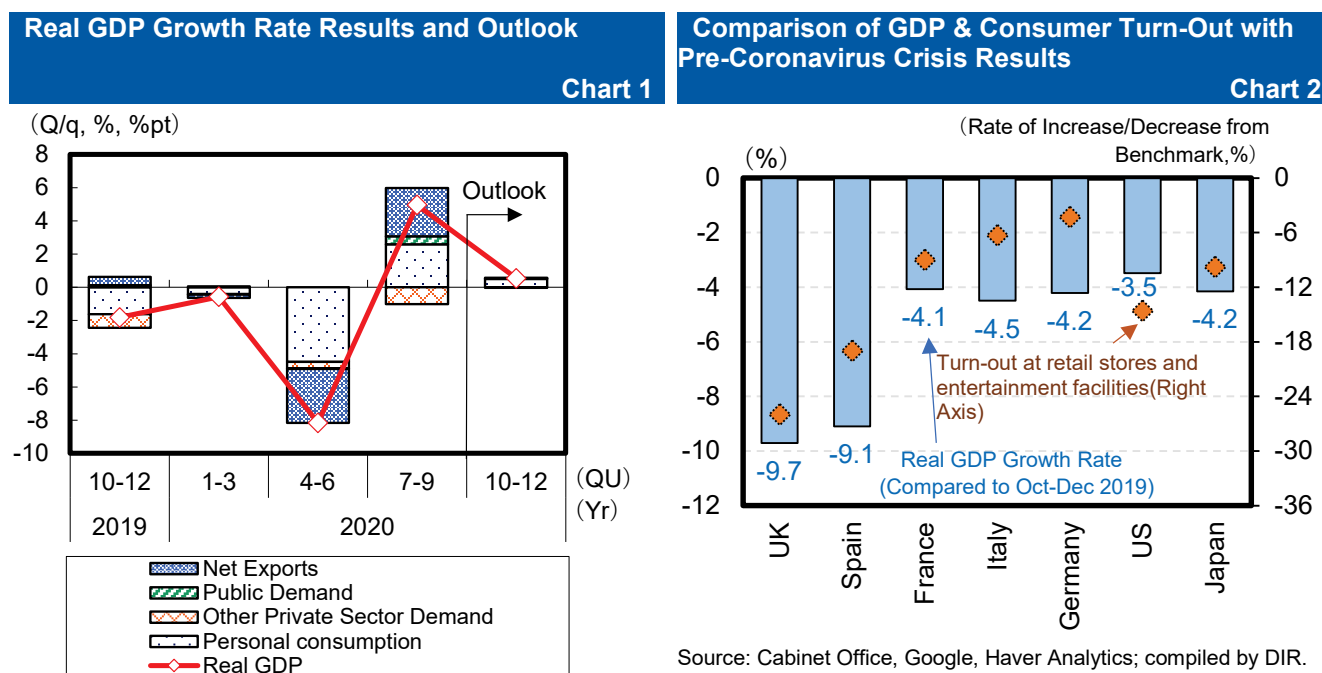
- In response to the Jul-Sep GDP 1<sup>st</sup> preliminary results, we have revised our economic outlook. We now see Japan's real GDP at -5.5% in FY2020, with FY2021 at +3.2%. Jul-Sep period real GDP won significantly positive growth, but the pace of recovery is expected to remain moderate in the Oct-Dec period and beyond. Our main scenario sees the unemployment rate shifting into a decline after peaking around the end of CY2020, with 3.0% expected in CY2021.
- Explosive spread of COVID-19 infections has been recorded recently, and possibilities that a declaration of a state of emergency and lockdown orders as occurred during the months of April and May this year will be unavoidable are increasing rapidly both in Japan and abroad. Our risk scenario is based on the assumption that explosive spread of COVID-19 infections will occur twice in Japan, the US and Europe in the first and second halves of CY2021. In this case, the CY2021 real GDP growth rate will decline from +2.0% as seen in the main scenario to -0.8%, with the unemployment rate increasing to 4.9%. This outlook for the employment rate assumes that there will be an extension of measures to expand employment adjustment subsidies and other support measures. If measures to support corporations are not implemented, a major increase in the unemployment rate of more than 6% could occur.

# 1. Moderate Recovery Trend to Continue as Spread of COVID-19 Increases

## Jul-Sep period real GDP wins considerable growth, but makes up for just over half of previous period's decline

The real GDP growth rate for Jul-Sep 2020 (1<sup>st</sup> preliminary est) grew by +21.4% q/q annualized (+5.0% q/q) (Chart 1)<sup>1</sup>. Positive growth was achieved for the first time in four quarters. The highest growth rate in around fifty years (also in comparison with the old standard) was achieved due in part to the rebound from the Apr-Jun period (-28.8% q/q annualized), when economic activities were severely inhibited both in Japan and abroad associated with the spread of COVID-19. However, despite improvements, Jul-Sep period growth reached only 24 tril yen in comparison to the previous period on an annualized basis, making up for just over half of the Apr-Jun period decline (43 tril yen). Results were heavily influenced by the spread of COVID-19 even as the reopening of economic activities advanced.

The Jul-Sep period real GDP growth rates in the Eurozone and the US registered positive growth considerably exceeding Japan at +60.5% q/q annualized (+12.6% q/q) and +33.1% q/q annualized (+7.4% q/q) respectively. However, since these countries all went into lockdown in March, their real GDP fell both faster and more sharply than did Japan's. If we look at a comparison of real GDP before the coronavirus crisis (the Oct-Dec period of 2019), we see that Japan recorded around -4%, around the same level as was experienced in the US, Germany, France, and Italy (Chart 2). In other words, economic recovery after the coronavirus crisis has been at approximately the same level in both Japan and the US and Europe. That said, the pace of recovery has not exactly been the same in all countries. Economic recovery and recovery in turn-out has been notably lagging in the UK, Spain and other countries where the effects of measures to prevent the spread of infection during the Apr-Jun period were especially great.



Source: Cabinet Office; compiled by DIR.

Source: Cabinet Office, Google, Haver Analytics; compiled by DIR. Note: Figures for turn-out at retail stores and entertainment facilities represent daily rates of average increase or decrease, with the Sunday median between January 3 and February 6, 2020 set as the benchmark.

The outlook for the real GDP growth rate in the Oct-Dec period is +2.2% q/q annualized, a major slowdown in comparison to the previous period. We estimate Eurozone GDP results for the same period at -13.2%, with the ripple effect from this downturn expected to influence the Japanese economy in the form of worsening exports to Europe. The recovery in domestic consumption of services was

<sup>1</sup> For details see the DIR report dated 2020 November 16, *Jul-Sep 2020 1<sup>st</sup> Preliminary GDP Estimate*, by Keiji Kanda and Akane Yamaguchi.

strengthening from the last half of September due to the effects of the Go To Campaigns, but now possibilities are that the practice of self-restraint in going out and other activities will continue through the month of December when household consumption tends to be at its greatest. Depending on how the situation turns out with the spread of infection both in Japan and abroad, possibilities are that Japan's economy may suffer negative growth during the Oct-Dec period for the first time in two quarters.

### ***Three possible scenarios associated with the spread of COVID-19***

DIR estimates associated with the spread of COVID-19 are based on the assumptions shown in Chart 3. First of all, in terms of the status of the spread of infections, we used a classification into four stages with reference to the definitions of Subcommittee on Novel Coronavirus Disease Control established by the government. The stages are as follows: I : Zero, sporadic, II : Gradual increase, III: Rapid increase, and IV: Explosion. As was the case in our previous outlook, according to our main scenario, the situation moves from Stage I to Stage III, and depending on the status of infection in each region, appropriate measures are implemented, such as request for suspension of business and refraining from going out, but the situation in Japan overall does not reach the Explosion stage. Measures to control COVID-19 infections have been in effect throughout the forecast period, hence the economic activities of households and corporations have continued to be subject to a certain level of restrictions. However, repeated trial and error toward the coexistence of efforts to prevent further spread of the infection and social and economic activity will gradually strengthen immunity of the society overall, and we expect that the level of economic activity will gradually rise.

**Three Scenarios Associated with the Spread of COVID-19**

**Chart 3**

	<b>Main Scenario</b>	<b>Risk Scenario</b>	<b>Risk + Financial Crisis Scenario</b>
Status of Spread of Infection (Classification into four stages with reference to the definitions of subcommittee on Novel Coronavirus Disease Control)	Stages I-III (Zero-Sporadic – Rapid Increase)	Stage IV (Explosion) occurs twice in 2021, once in the first half and then in the second half of the year.	
Measures to prevent spread of the COVID-19 infection	Requests on a regional basis to cease operations and practice self-restraint in going out as appropriate	Stage IV: Month-long state of emergency declared for all prefectures (lockdown occurs during same period in the US and Europe)	
Outlook for real GDP growth rate in 2021 (2020:-5.3%)	+2.0%	-0.8%	-7.7%

Source: Produced by DIR.

On the other hand, in our risk scenario, we assumed that an explosion of infections occurs in Japan in both the first and second halves of 2021 (Stage IV for Japan as outlined above). In this case there would be an unavoidable repeat of tough restrictions on economic activity in all of these countries as well as limitations on economic activity and voluntary restraint. In Japan a reissuance of the state of emergency lasting for one month in all prefectures is expected to occur. The question of how serious economic deterioration would be is taken up in Chapter 2 of this report. In this case, the 2021 real GDP growth rate will decline from +2.0% as seen in the main scenario to -0.8%.

According to the risk scenario, if there is a sharp increase in bankruptcies of corporations unable to endure the measures to prevent the spread of the COVID-19 infection, the possibility that the situation could develop into a financial crisis will increase. This brings us to a third possibility according to our risk scenario, which assumes that a major financial crisis will occur. A more detailed explanation of this scenario is offered in the DIR report dated 2 June 2020, *Japan's Economic Outlook No. 205 (Summary)*. If we assume that a global financial crisis of a similar scale as the Great Depression of 1929 will occur, real GDP could be expected to decline by an additional 7%. In this case, the real GDP growth rate in 2021 is expected to be at -7.7%.

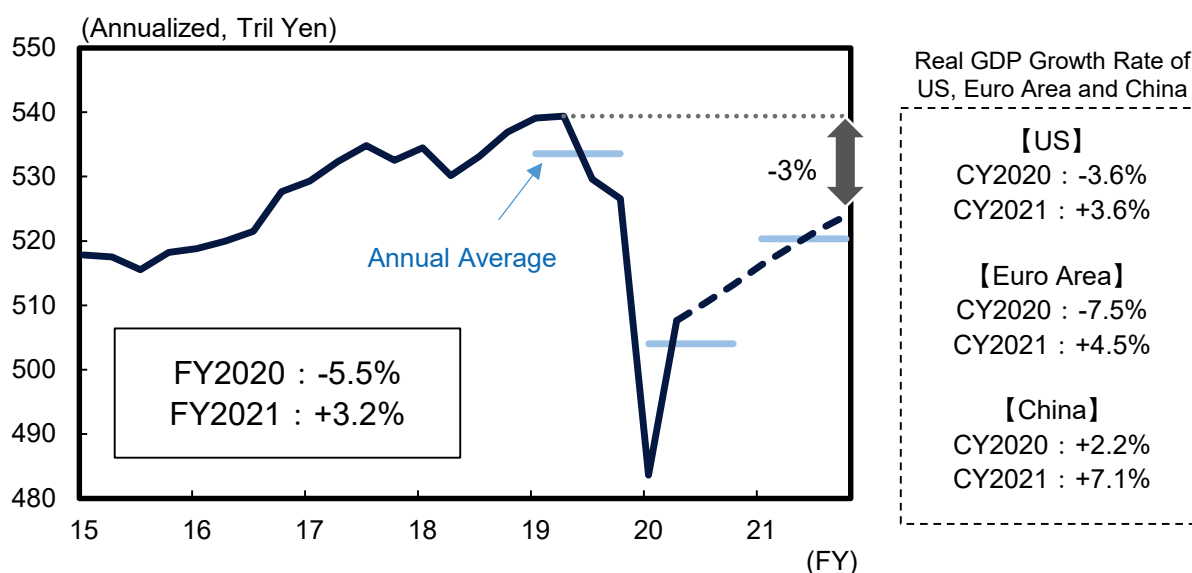
### Real GDP Outlook According to our Main Scenario: -5.5% in FY2020, and +3.2% in FY2021

Chart 4 shows trends in real GDP according to our main scenario, along with our outlook for the overseas economy, which provides the major assumption for our estimates. Estimates for overseas economies were provided by DIR economists specializing in the economies of various countries. Our outlook for real GDP growth rates of various countries in 2020 is as follows: US -3.6%, the Eurozone -7.5%, and China +2.2%.

Our outlook for 2021 sees the US at +3.6%, the Eurozone at +4.5%, and China at +7.1%. Economic recovery in the Eurozone is expected to be moderate with the influence of measures to prevent the spread of COVID-19 infections, and will not improve enough to make up for the downturn of 2020. On the other hand, the US is expected to recover to the level before the coronavirus crisis (the Oct-Dec period of 2019) by around the Oct-Dec period of 2021 in a recovery led by consumption of goods and housing investment. China is expected to achieve high growth, but its real GDP growth rate when averaged with 2020 is expected to remain at +4.6%, falling below the approximately +6% level it maintained for a while before the coronavirus crisis. Even so, China is expected to uphold relatively high performance in the “with corona era” among the major countries.

Outlook for Japan's Real GDP and Assumptions Based on Overseas Economies

Chart 4



Source: Cabinet Office, Statistics from Each Country; compiled by DIR.

Note: The dotted line in the chart is based on DIR estimates. Outlooks for the US, Europe and China based on predictions by DIR economists specializing in those economies.

Under these circumstances, Japan's real GDP growth rate is expected to be -5.5% in FY2020 and +3.2% in FY2021 (on a calendar year basis, -5.3% in 2020 and +2.0% in 2021). Compared to the previous forecast, the outlook for FY2020 has been revised upwards by about 0.6%pt, mainly because imports have decreased more than expected. The outlook for domestic demand including personal consumption has not improved. The Japanese economy, like Europe, is not strong enough to make up for the decline in the previous year with positive growth in 2021 (and in the fiscal year). The pace of economic recovery will likely be slow. Although the economy is expected to gain support from fiscal and monetary policies, the risk of the spread of infections in Japan and overseas will not be eliminated, and certain measures against infectious diseases will be continued, hence it will be difficult to expect aggressive business development by companies and a full-scale recovery of personal consumption.

Regarding additional economic measures, our main scenario envisions expansion measures for employment adjustment subsidies, extension of the Go To Campaigns, and additional public investment for the purpose of disaster prevention and mitigation.

Real GDP for the Jan-Mar period of 2022 is about 3% lower than the highest level it recorded before the coronavirus crisis during the Jul-Sep period of 2019 (Chart 4). In the future, the coronavirus crisis may encourage ingenuity and technological innovation in the private sector, and the economic growth rate may accelerate due to the creation of new products, services and business models adapted to the remote society (non-contact society). However, with COVID-19 yet to be brought under control, we cannot anticipate these growth-accelerating factors, in which case it will be around 2023-24 before real GDP returns to the level of the Jul-Sep period of 2019.

***With COVID-19 infections on the increase, the key to improvement in personal consumption is the recovery of services requiring face-to-face contact and movement from place to place***

Taking a closer look at personal consumption amongst the other demand components, we can expect a continuation of the moderate growth trend as Japan searches for a balance between prevention of the spread of infection and social & economic activity. Personal consumption is expected to be at -6.0% in FY2020 and +3.4% in FY2021 (or -6.0% in 2020 and +2.3% in 2021 on a calendar year basis).

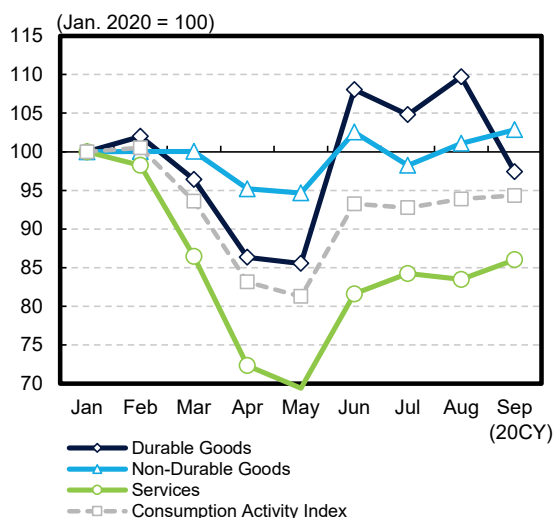
Looking at consumption trends by goods and services using the Bank of Japan's "Consumption Activity Index" (Chart 5), consumption of durable goods was significantly higher than before the coronavirus crisis between June and August, but in September it fell below the level recorded before the coronavirus crisis. Looking at POS data, it appears that October was also sluggish. Consumption of durable goods may have entered an adjustment phase as demand carried forward during the state of emergency (pent-up demand) has subsided and the effects of the special fixed benefit have subsided. Consumption is expected to continue in a weak phase for the time being.

On the other hand, consumption of services remained weak until September, but has been increasing moderately since then, partly due to the effects of the Go To Campaigns. Chart 6 shows changes in consumption related to eating out, travel, and entertainment, and turn-out at retail stores and entertainment facilities. The former is the amount of consumption of eating out, transportation, and culture & recreation (accommodation expenses, package tour expenses, entertainment facility expenses, etc.) according to the Ministry of Internal Affairs and Communications Family Income and Expenditure Survey, and the latter is turn-out at retail stores and entertainment facilities as was shown in Chart 2 above. Both exhibit very similar trends, and it can be seen that the increase or decrease in turn-out is directly linked to consumption trends related to eating out, travel, and entertainment. Turn-out at retail stores and entertainment facilities, which was about -10% to -15% compared to the period before the coronavirus crisis during the Jul-Sep period, has recently shrunk by around -5% to -10%.

In October, the "Go To Travel Campaign" was applied to travel to and from Tokyo, and the "Go To Eat Campaign" was also launched. At the end of the same month, the "Go To Event Campaign" was launched. Looking at the current data, the effectiveness of the campaign appears clearly in the accommodation and eating out industry. The left side of Chart 7 shows changes in the number of hotel guests, but the number of hotel guests according to V-RESAS announced by the Cabinet Office was about -40% y/y in the first half of September. Since the latter half of September, it has been higher than the previous year. V-RESAS data is limited to so-called tourism purposes via travel agencies, reservation sites, and foreign language reservation sites, and is growing higher than the total number of guests, including educational and business purposes, which continue to be sluggish. Although the growth rate may have been higher than overall performance, it is certain that the number of guests has recovered significantly. In addition, as shown on the right side of Chart 7, the number of views to restaurant information sites, which generally coincides with sales in the food service industry, is in a recovery phase, so it is thought that spending on eating out is also increasing.

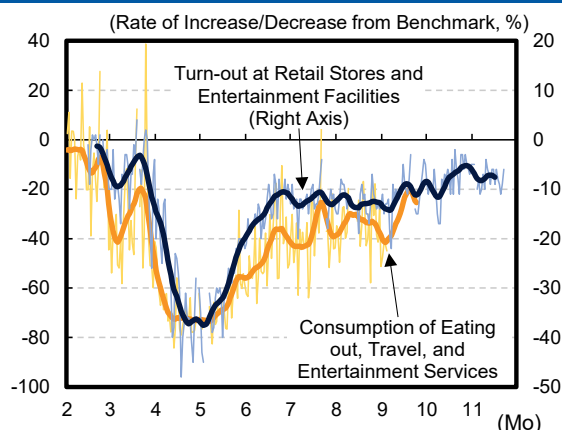


**Consumer Activity Index by Individual Goods and Services**  
Chart 5



Source: Bank of Japan; compiled by DIR.  
Note: Real values, seasonally adjusted. The Consumption Activity Index is adjusted for the travel balance. Individual goods and services are not adjusted for the travel balance. Non-durables include those listed in the National Accounts.

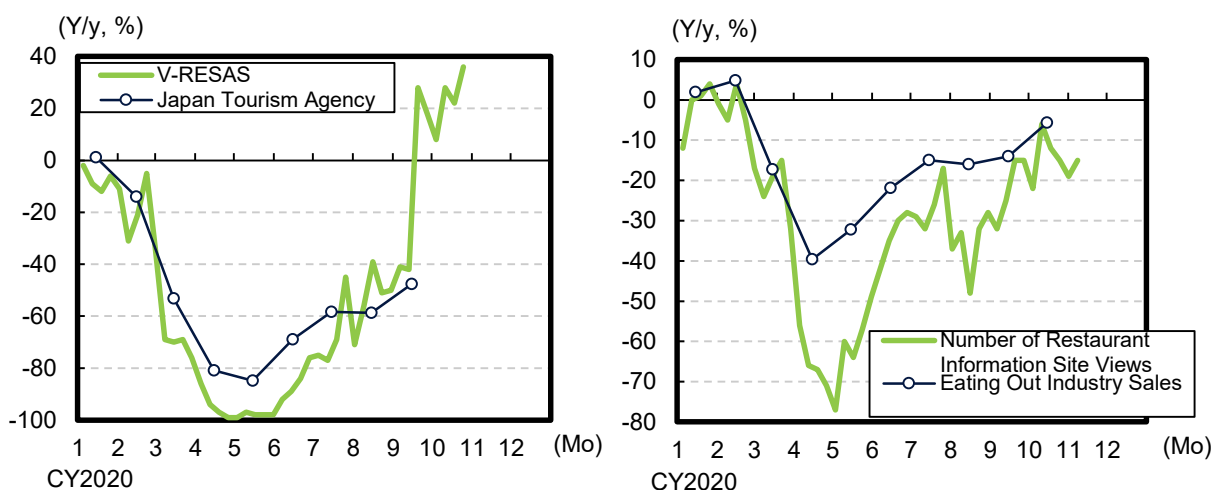
**Eating Out, Travel, Entertainment Related Consumption, and Turn-Out**  
Chart 6



Source: Ministry of Internal Affairs and Communications, Google; compiled by DIR.

Note: The benchmark used in the left side of the chart is the daily median between January 3 and February 6, 2020. The thick lines represent the 7-day central moving average. Eating out, travel, and entertainment related consumption is the total value of eating out, transportation, and culture & entertainment services. Data from holidays falling on weekdays and the Obon Festival are excluded.

**Number of Hotel Guests (Left), and Trends in Eating Out Industry (Right)**  
Chart 7



Source: Japan Tourism Agency, Japan Food Service Association, V-RESAS; compiled by DIR.  
Note: V-RESAS data is updated weekly, while all the others are on a monthly basis. The number of hotel guests is taken from Japan Tourism Agency statistics, which are based on length of stay (number of days), while V-RESAS is based on the start date of the hotel stay.

As mentioned earlier, our main scenario assumes that the Go To Campaigns will be extended, and we expect this to continue boosting the recovery of personal consumption, but the situation with COVID-19 infections has been deteriorating rapidly of late. In response to this, Prime Minister Suga requested each prefectural governor to consider limiting the number of users of the Go To Eat Campaign to four or less per restaurant visit in areas where the infection is spreading. In areas where the infection situation has worsened and Subcommittee on Novel Coronavirus Disease Control has determined falls under Stage III, a review of the campaign may be considered. In fact, in Hokkaido, Osaka, Aichi, etc., the policy indicated that the number of users should be four or less in principle. The future of personal consumption will be greatly influenced by how sustainable the demand for services involving face-to-face contact and movement from place to place can be stimulated while at the same time suppressing the spread of infection.

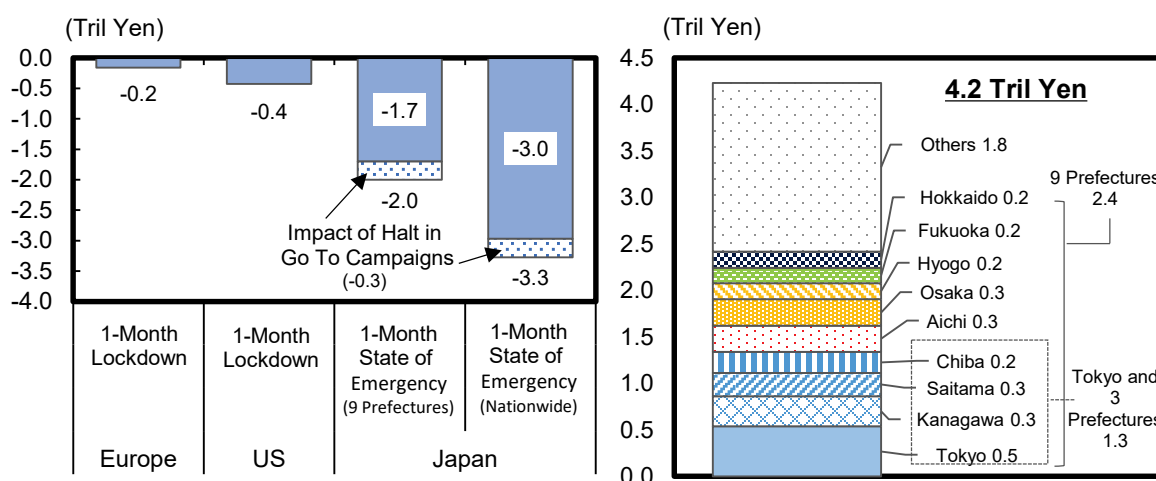
## 2. Risk Scenario: 2021 Real GDP Growth Rate Expected to Worsen to -0.8% due to Explosive Spread of COVID-19 Infections

According to our main scenario, Japan’s economy is expected to achieve a moderate recovery, but possibilities that explosive spread of COVID-19 infections are increasing rapidly both in Japan and abroad. However, the extent of the risk differs depending on the country. This situation has already become manifest in some European countries.

In our risk scenario, shown in Chart 3 above, which takes into consideration the current infection situation, we assumed that an explosion of infections occurs in Japan, the US, and Europe in both the first and second halves of 2021 (Stage IV according to the Japanese categories). Governments will again be forced to implement strict restrictions on economic activities and requests for self-restraint, and it is expected that a state of emergency will be issued to all prefectures in Japan for a month. As a result, the real GDP growth rate, which is expected to be +2.0% in 2021 in the main scenario, is expected to deteriorate to -0.8%.

Chart 8 summarizes the expected impact on real GDP if strict measures to prevent the spread of infection are implemented in Japan, the US, and Europe. Based on trends in Japan's real exports and personal consumption after the pandemic’s 1st wave, we produced an estimate using the DIR macro model, and found that lockdowns and emergency declarations of the sort implemented in April and May in Japan, the US and Europe, if implemented for a month, would push Japan's real GDP down by about 3.9 tril yen. The risk scenario assumes that economic activity will not automatically recover when lockdowns states of emergency are lifted, but that economic activity levels will gradually recover over a two-month period. Therefore, the adverse effects of measures to prevent the spread of infection on the real economy are estimated to be larger than those shown on the left in Chart 8.

**Impact on Real GDP by Risk (Left), and Amount Consumption Suppressed by Month-Long State of Emergency (Right)** Chart 8



Source: Cabinet Office, Ministry of Finance, Bank of Japan; compiled by DIR.

Notes: 1) The left side of the chart shows our estimate of the amounts by which exports and personal consumption would be suppressed in the case of each of the scenarios using the DIR macro model. The impact of a halt in the Go To Campaigns is estimated for both the direct effect and the ripple effect.

2) The right side of the chart shows estimates for the amount of consumption in March and April (estimates of amounts and average values based on the Consumer Activity Index and the Synthetic Consumption Index), and the weight of consumption by prefecture (total expenditure in FY2017 on transportation, entertainment, leisure & culture, and eating out & accommodations).

In the US, the number of new infections per day has recently reached a record high, but the Trump administration has been reluctant to implement lockdowns as has been done in Europe. Meanwhile, Joseph Biden (Democrat), who has now been recognized as the winner of the presidential election, is focusing on infectious disease control. If the spread of the infection becomes more serious, economic

activity may be severely restricted after the inauguration of the president. If a lockdown of the sort seen in April and May were to take place across the United States for a month, the negative impact on the Japanese economy would be greater than on the European economy. Japan's real exports to the United States are expected to be curtailed by about 0.6 tril yen, and real GDP is expected to be curtailed by about 0.4 tril yen (Chart 8, left).

### ***A month-long state of emergency would restrict consumption by 4.2 tril yen nationwide, and by 2.4 tril yen in the nine most populous prefectures***

As was mentioned previously, possibilities that an explosion in the number of COVID-19 infections could occur in Japan are increasing as well. The Japan Medical Association has recognized that Japan is now experiencing a third wave of the infection's spread.

Let us now summarize what the effects would be if another state of emergency were to be declared. First we look at the indices which can best provide us with a grasp of trends in personal consumption on a GDP basis. This would be the Synthetic Consumption Index published by the Cabinet Office and the Consumer Activity Index issued by the Bank of Japan. Using the data from these indices we can determine the extent to which personal consumption on a GDP basis has been suppressed after the coronavirus crisis. These are all real amounts showing the extent of decline since January: around 0.9 – 1.2 tril yen in March, around 2.7 – 3.3 tril yen in April, and around 3.1 – 3.7 tril yen in May<sup>2</sup>. Considering the differences in timeframe when states of emergency were declared by prefecture and the amounts in consumption<sup>3</sup>, we estimated the amount by which personal consumption would be suppressed if a state of emergency were declared for all prefectures at 4.2 tril yen per month (Chart 8, right side)<sup>4</sup>.

Considering the fact that monthly consumption of households in 2019 (real final consumption expenditure of households excluding imputed rent<sup>5</sup>) was 19.7 tril yen, this means that households reduced their consumption level by about 20% on average. It can be said that most of the unnecessary and non-urgent consumption was suppressed. According to the DIR macro model, if personal consumption is suppressed by 4.2 trillion yen, Japan's real GDP will be pushed down by about 3.0 tril yen (Chart 8 left).

In reality, the status of infection varies greatly from region to region, so when a state of emergency is issued, it is likely that only metropolitan areas where infection is becoming more serious will be taken into consideration. Even if the declaration is limited to the nine most populous prefectures, the amount of consumption restraint is expected to reach about 2.4 tril yen per month, and real GDP is expected to be pushed down by about 1.7 tril yen (Chart 8, left). In either case, if a state of emergency is issued, the Go To Campaigns during that period is expected to be suspended, and real GDP is expected to be further reduced by about 0.3 tril yen (Chart 8, left).

<sup>2</sup> Upper and lower limits of the estimated values correspond to the Synthetic Consumption Index and the Consumer Activity Index.

<sup>3</sup> Before the state of emergency was issued, consumption is considered to have been suppressed by the same amount as in March. Then, by apportioning the weight of consumption by prefecture, adjustments were made for the difference in timeframe when the state of emergency was issued for each region. The weight of consumption by prefecture is based on the amount of consumption expenditure in the fields of transportation, entertainment, culture & recreation, and eating out & accommodations in FY2017 according to the Cabinet Office's Prefectural Accounts. This is because most of the consumption suppressed during the state of emergency falls into these categories.

<sup>4</sup> The amount by which consumption was suppressed in March and April, which provides the reference value for this estimate, is an average value calculated using the Synthetic Consumption Index and the Consumer Activity Index.

<sup>5</sup> In the national accounts, even owner occupied homes that do not actually incur rent are assessed on the assumption that they produce a rental amount the same as rental homes. This is done in order to make it possible to compare the economic scale of countries with different home ownership ratios. The rent in the attribution calculation is recorded in the personal consumption amount.



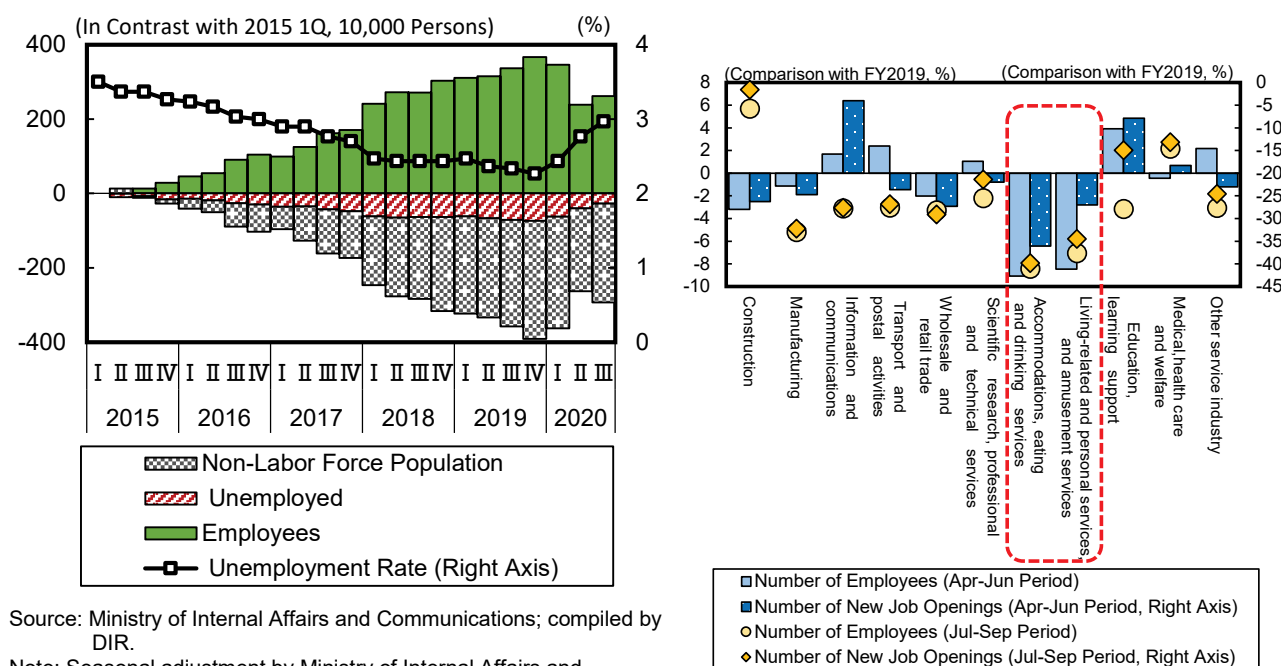
### 3. Uncertainty Increases Regarding Future of Employment Environment

#### Number of employed growing despite upward trend in unemployment rate

Shifting our attention to the employment situation, we see that the unemployment rate was at 2.8% during the Apr-Jun period of 2020, and then registered 3.0% during the Jul-Sep period in its third consecutive quarter of growth (Chart 9, left). Looking in more detail we see that while the number of unemployed grew by +130,000 persons in comparison to the previous period, the number of employed fell sharply during the Apr-Jun period (-1,080,000 persons), and then shifted back into a growth trend at +240,000. During past economic crises, the number of employed has tended to decline over a period of several quarters, while the number of unemployed has increased during the same period<sup>6</sup>, but the current situation differs greatly from past patterns.

To put these developments into context, labor demand recovered early as the economy shifted into a recovery trend after hitting bottom around May. Even companies whose business environment deteriorated significantly due to the effects of economic measures did not carry out much employment adjustment. The government has endeavored to support corporations in the maintenance of employment, significantly expanding the employment adjustment subsidy (hereinafter referred to as employment allowance), as well as other support measures, after the spread of COVID-19. As a result, the amount of benefits paid including the employment allowance<sup>7</sup> has increased sharply since May, reaching a cumulative total of 2.2 tril yen as of November 13. This greatly exceeds the total amount of payments (1.0 tril yen) including employment allowance in FY2008-10 associated with the global financial crisis. It seems that such generous employment maintenance support measures suppressed large-scale employment adjustments and stopped the decrease in employment and the increase in unemployment.

**Employment Situation (Left); Number of Employees & New Job Openings by Industry (Right) Chart 9**



Source: Ministry of Internal Affairs and Communications; compiled by DIR.

Note: Seasonal adjustment by Ministry of Internal Affairs and Communications.

Source: Ministry of Health, Labour and Welfare, Ministry of Internal Affairs and Communications; compiled by DIR.

Note: Seasonal adjustment by DIR. Figures for number of employees and number new job openings from Apr-Jun period and Jul-Sep period of 2020.

<sup>6</sup> The past economic crises in this comparison are the Asian currency crisis, the domestic financial crisis at the end of the 1990s, the bursting of the IT bubble in the early 2000s, and the global financial crisis of the late 2000s.

<sup>7</sup> This includes the amount of emergency employment stability subsidies, leave support and benefits. In addition, the total amount of employment payments for FY2008-10, which will be described later, includes those of the SME employment stability subsidy.

However, the recent recovery in demand for labor varies widely from industry to industry. Looking at the rate of change in the number of employees by industry compared to FY2019, the number of employees decreased significantly in the Apr-Jun period of 2020 in services involving face-to-face contact, such as the accommodations, eating and drinking services industry, and the living-related and personal services, and amusement services industry (Chart 9, right). During the Jul-Sep period, the number of employees in all industries began to increase, but the recovery was limited, with the average for the accommodations, eating and drinking services industry at -6.4% compared to FY2019. In addition, it can also be pointed out that considering the fact that the number of new job openings is significantly lower than that of other industries, the recovery in demand for labor notably lags in industries that are susceptible to the spread of infection, and require time to improve business conditions.

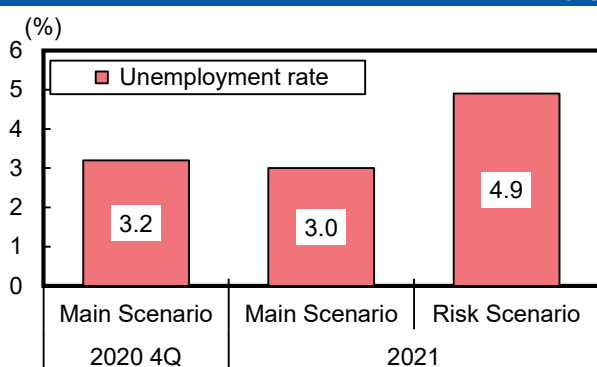
### ***Main scenario sees improvements in employment environment in 2021, but sense of uncertainty remains strong***

In the future, as long as the spread of COVID-19 does not become serious, the economy will continue in a moderate recovery, and demand for labor is also expected to recover. The unemployment rate according to our main scenario is expected to peak around the end of 2020 and then begin to decline, and is seen at 3.0% in 2021 (Chart 10). On the other hand, if the risk scenario becomes manifest, the unemployment rate in 2021 will rise to 4.9%. This outlook for the employment rate assumes that there will be an extension of measures to expand employment adjustment subsidies. If measures to support corporations are not implemented, a major increase in the unemployment rate of more than 6% could occur.

Even if the risk scenario does not materialize, if the economy hits a second bottom, or the recovery lags behind expectations, employment adjustments will progress against the backdrop of a growing sense of overemployment, and the unemployment rate could increase sharply. The levels of employment reserves (= actual number of employees - optimal number of employees)<sup>8</sup> and labor's relative share (= nominal employee compensation ÷ nominal GDP) are lower than in early spring, but still exceed their peak levels around the time of the global financial crisis of 2008 (Chart 11). The risk of employment adjustment remains a major concern.

**Outlook for Unemployment Rate**

**Chart 10**

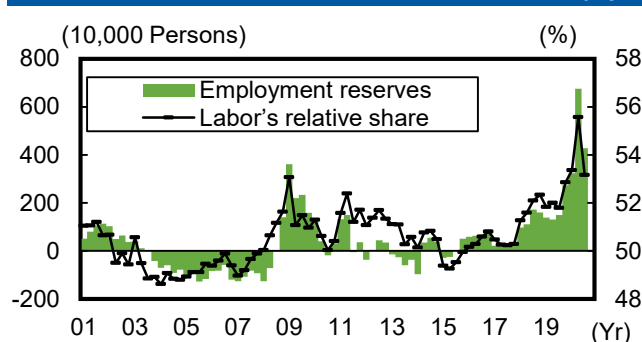


Source: Produced by DIR.

Note: Our risk scenario assumes that month-long states of emergency will be declared in Japan (lockdowns in the US and Europe) in the 1<sup>st</sup> and 2<sup>nd</sup> halves of 2021.

**Employment Reserves & Labor's Relative Share**

**Chart 11**



Source: Ministry of Economy, Trade and Industry, Ministry of Health, Labour and Welfare, Ministry of Internal Affairs and Communications, and the Cabinet Office; compiled by DIR.

Note: The estimate period for employment reserves is 1990 1Q – 2020 2Q. The estimation method is shown in Note 8. Labor's relative share is nominal employee compensation ÷ nominal GDP.

<sup>8</sup> The method of estimating the number of employment reserves was based on the Cabinet Office report "The Japanese Economy 2011-2012" (December 2011). Specifically, (1) after estimating the labor productivity (man-hour base) function using the trend-adjusted employment rate index and time trends as explanatory variables, (2) the level of employment reserves was estimated based on labor productivity, the average working hours per employee, and the actual number of employees, with the potential utilization rate set at the highest time of the trend-adjusted employment rate index (1Q 2008).

## Japan's Economic Outlook No. 207 (November 20, 2020)

## Chart 12

		2019				2020				2021				2022	FY2019	FY2020	FY2021
		Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar			
Real GDP	Q/q %; annualized	2.9	1.6	0.2	-7.1	-2.3	-28.8	21.4	2.2	2.2	2.4	2.1	2.1	1.8			
	Y/y	0.8	0.9	1.7	-0.7	-1.8	-10.2	-5.8	-3.6	-2.6	6.7	2.2	2.2	2.1	0.0	-5.5	3.2
Private spending	Q/q %; annualized	0.3	2.2	1.8	-11.0	-2.8	-28.7	20.1	3.6	3.0	2.4	2.0	1.6	1.2	-0.5	-6.0	3.4
Private housing investment	Q/q %; annualized	5.8	-0.7	5.2	-8.9	-15.0	-2.0	-28.1	6.1	3.2	0.8	0.8	0.8	1.2	0.6	-9.3	-0.1
Capex	Q/q %; annualized	-1.9	3.3	1.0	-17.7	7.0	-16.9	-12.8	0.0	2.8	4.1	3.2	3.2	3.2	-0.3	-7.7	2.0
Government final consumption	Q/q %; annualized	0.4	4.0	3.8	1.2	0.1	-1.4	9.3	0.3	0.7	0.7	0.6	0.6	0.5	2.3	1.9	1.1
Public investment	Q/q %; annualized	10.5	6.1	3.4	2.7	-1.3	5.1	1.5	1.5	0.4	1.6	0.9	1.0	0.5	3.3	2.2	1.0
Exports	Q/q %; annualized	-6.8	0.6	-2.5	1.7	-19.7	-53.4	31.3	19.3	6.1	7.8	6.6	6.1	5.7	-2.6	-14.2	9.4
Imports	Q/q %; annualized	-16.9	7.5	2.8	-9.3	-15.5	9.0	-33.8	18.8	7.0	6.1	4.5	2.8	2.8	-1.5	-6.9	3.7
Nominal GDP	Q/q %; annualized	5.0	2.0	1.5	-5.7	-1.7	-27.7	22.7	1.3	1.7	2.7	2.5	2.2	1.9	0.8	-4.8	3.2
GDP deflator	Y/y	0.1	0.4	0.6	1.2	0.9	1.4	1.1	0.6	0.3	-0.1	-0.2	0.0	0.2	0.8	0.8	0.0
Industrial production	Q/q	-2.1	0.0	-1.1	-3.7	0.4	-16.9	8.8	5.3	0.6	0.6	0.6	0.5	0.3	-3.7	-10.6	6.5
Core CPI	Y/y	0.8	0.8	0.5	0.6	0.6	-0.1	-0.2	-1.1	-1.4	-0.7	-0.5	0.1	0.1	0.6	-0.7	-0.3
Unemployment rate	%	2.5	2.4	2.3	2.3	2.4	2.8	3.0	3.2	3.2	3.1	3.0	2.9	2.8	2.4	3.0	3.0
Trade balance (goods, services)	Y tril; annualized	0.3	-1.2	0.3	1.6	2.5	-6.6	5.5	3.1	3.7	4.0	4.6	4.8	5.4	0.7	1.4	4.7
Current account balance	Y tril; annualized	20.2	19.9	19.3	21.7	19.8	7.9	16.0	17.5	17.1	17.1	17.4	18.3	18.8	20.1	14.6	17.9
Major assumptions																	
Crude oil price (WTI futures)	\$/bbl	54.9	59.9	56.4	56.9	45.8	28.0	40.9	40.5	41.0	41.0	41.0	41.0	41.0	54.7	37.6	41.0
Exchange rate	Yen/\$	110.2	109.8	107.3	108.7	108.9	107.6	106.1	104.4	104.0	104.0	104.0	104.0	104.0	108.7	105.5	104.0

Source: Compiled by DIR.

Note: GDP through Jul-Sep 2020: actual; thereafter: DIR estimates.