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Japan's Economy: Monthly Outlook (Feb 2023)

Economic outlook revised; BOJ likely to continue easing for some time even under new leadership

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Summary

- In light of the announcement of the Oct-Dec 2022 GDP 1st preliminary results, we have revised our economic outlook. We now see growth in Japan's real GDP at +1.4% in FY2022, with FY2023 at +1.6%, and FY2024 at +1.0% (on a calendar year basis we expect +1.8% in 2023 and +1.1% in 2024). We expect growth to be on the high side centering on FY2023 despite the economic slowdown in the US and Europe, with underlying support from the normalization of economic activity and accommodative fiscal and monetary policies. However, caution is required as risks are piling up centering on overseas economies, such as the US, expected to enter a serious recession.

- The growth rate for Japan's Consumer Price Index on an aggregate basis excluding fresh food (core CPI) is expected to be +2.9% in FY2022, +1.8% in FY2023, and +1.4% in FY2024. The Bank of Japan is expected to maintain the current framework of monetary easing measures until the US economy bottoms out or the trend in wage increases in Japan becomes clearer after the spring wage negotiations. However, there is a possibility that under the new governor, the Bank will undertake "inspections" and revisions to the joint statement with the government, and begin a review of yield curve control, gradually moving to short-term interest rate operations. But even if that is the case, monetary easing itself will continue, including continued purchases of government bonds, maintenance of low interest rates, and forward guidance.

1. Economic Trends in Oct-Dec Period of 2022 and Outlook for Jan-Mar 2023

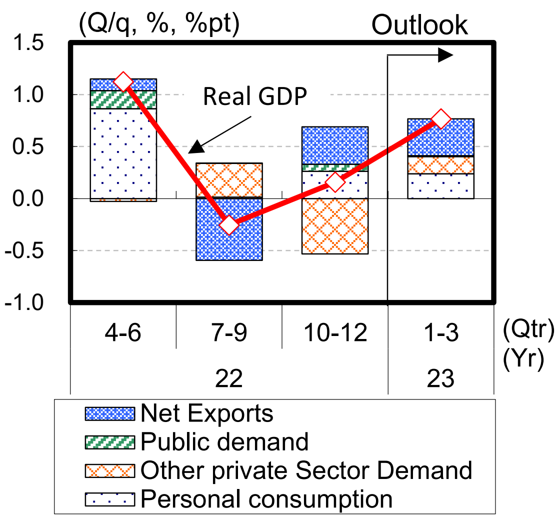
Oct-Dec period real GDP limited to small amount of positive growth due to decline in private sector inventories, but consumption and exports achieved gains

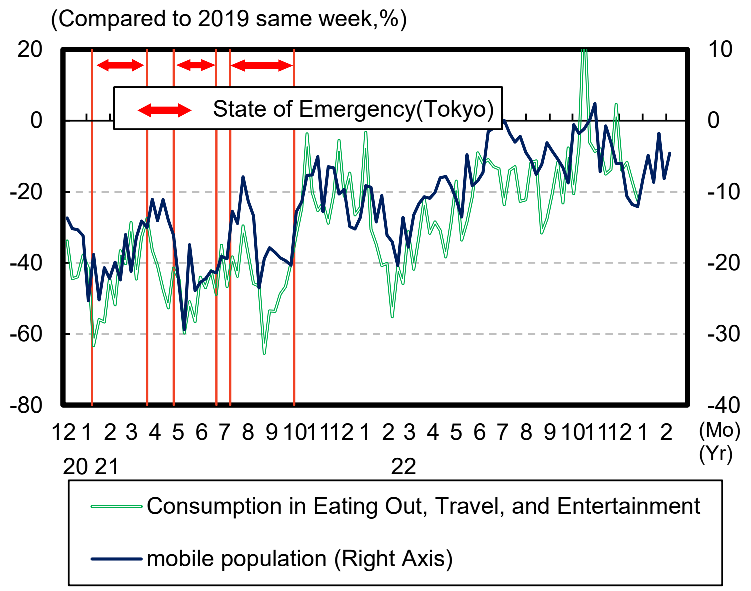
The real GDP growth rate for Oct-Dec 2022 registered modest growth at +0.6% q/q annualized (+0.2% q/q) (chart 1, left)[1]. Results fell below market expectations due largely to private sector inventories, whose negative influence on the GDP growth rate was more significant than expected (bringing down overall GDP by -0.5%pt q/q). The decline private sector inventories shows that economic activity was vigorous, and the decline can be said to have been an unexpected one. GDP statistics include an item called "final demand," which deducts private and public inventory changes from GDP. The growth rate of final demand was +2.3% q/q annualized. Thus, when looking at actual circumstances, economic recovery was stronger than suggested by the GDP growth rate.

Personal consumption was hindered by the spread of COVID-19 infections (the 8th wave) and rising prices. However, there were no government restrictions on activity (Chart 1, right), and economic measures such as Nationwide Travel Support and benefits, as well as the easing of motor vehicle supply constraints, contributed to growth in personal consumption of +0.5% q/q for the third consecutive quarter. While capital expenditure shifted into decline, partly in reaction to the large increase in the previous quarter, exports of services were boosted by a surge in consumption by inbound tourists to Japan, and exports of goods also maintained their growth momentum.

Looking at performance by demand component (Chart 1, left), in the area of private sector demand, personal consumption grew, while capex and housing investment declined. As was mentioned above, changes in inventories brought downward pressure on the GDP growth rate. As for public sector demand, government consumption grew, while public investment took a downward turn. As for overseas demand, exports grew and imports declined, and as a result the contribution of net exports (foreign demand) moved into positive territory.

Real GDP Growth Rate Results & Outlook (Left); Mobile Population and Consumption in Eating Out, Travel, and Entertainment (Right) Chart 1





Source: Cabinet Office, Ministry of Internal Affairs and Communications, V-RESAS; compiled by DIR.
Notes: 1) Figures on the left side of the chart are seasonally adjusted.
2) The mobile population shown on the right is the weekly total for all municipalities of the population of persons whose estimated place of residence is outside the local municipality. Eating out, travel, and entertainment-related consumption is the sum of eating out, transportation, and education and entertainment services.

[1] See the DIR report by Keiji Kanda and Wakaba Kobayashi dated 14 February 2023, *Oct-Dec 2022 1st Preliminary GDP Estimate*.

The import deflator declined for the first time in eight quarters, and real GDI (Gross Domestic Income) adjusted for income outflow overseas (as well as inflow of income from overseas)[2] due to fluctuation in terms of trade, exceeded growth in real GDP at +1.6% q/q annualized in the Oct-Dec 2022 period. Meanwhile, real GNI (Gross National Income), which adds net receipts of interest and dividends from overseas to real GDI, recorded a high growth rate of +4.9%. The income environment for households and corporations improved more than seen in GDP, due to a lull in the effects of the weak yen and high resource prices, and an increase in interest and dividend receipts.

Real GDP in Jan-Mar 2023 expected to achieve positive growth for second consecutive quarter

Our outlook for the real GDP growth rate in the Jan-Mar period of 2023 sees growth of +3.1% q/q annualized. Personal consumption will continue to recover, due in part to the improved COVID-19 infection situation, further easing of motor vehicle supply constraints, and the government's measures to combat high energy prices. Capex is expected to increase, especially in the non-manufacturing sector. Further growth in inbound consumption is also expected.

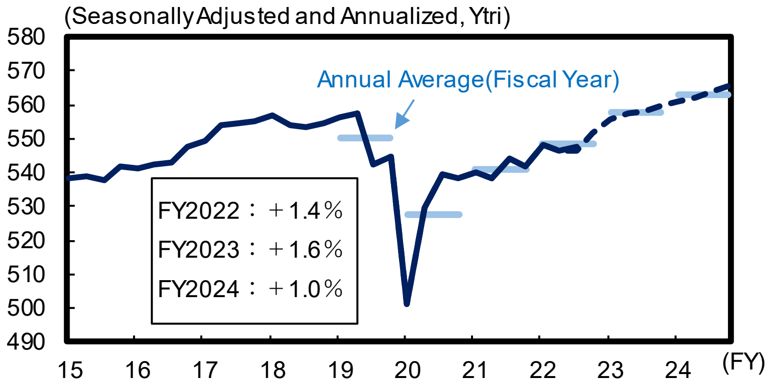
Faced with high inflation and monetary tightening, real GDP in the US and the Eurozone both showed positive growth in the Oct-Dec period. However, the impact of large interest rate hikes on economic activity will be delayed. Goods exports to Europe and the US will likely stagnate in the Jan-Mar 2023 period due to deteriorating demand. On the other hand, goods exports to China, where economic activity is rapidly normalizing with the elimination of the zero-Covid policy, are expected to pick up. However, export restrictions on semiconductor-related goods for reasons of economic security are becoming a reality. The trends of these restrictions and their impact on the Japanese economy require caution.

2. Outlook for Japan’s Economy in FY2023 & FY2024

Positive growth expected to continue due to economic normalization in both Japan and China, as well as accommodative fiscal and monetary policies

According to our main scenario, Japan’s real GDP is expected to achieve growth of +1.4% in FY2022, +1.6% in FY2023, and +1.0% in FY2024 (Chart 2, on a calendar year basis we expect +1.8% in 2023 and +1.1% in 2024). Our assumptions for the outlook for overseas economies is based on the latest predictions of our experts on the economies of each of the countries covered (as of February 20).

Outlook for Japan’s Real GDP and Assumptions Regarding Overseas Economies **Chart 2**



US, Eurozone & China Real GDP Growth Rate

US	2022 : +2.1% 2023 : +1.0% 2024 : +1.1%
Eurozone	2022 : +3.5% 2023 : +0.5% 2024 : +1.3%
China	2022 : +3.0% 2023 : +5.6% 2024 : +4.3%

Source: Produced by DIR based on data from Cabinet Office and various countries.
Note: The dashed line in the chart represents predicted values as estimated by DIR. Outlooks for the US, Eurozone and China are based on predictions by DIR’s in-house expert.

[2] Loss (gain if positive) due to changes in terms of trade from the base year of the deflator (currently 2015). It should be noted that the amount of loss or gain is revised when the base year is changed.

Although the outlook has been revised downwards by 0.4% in comparison to the December 8, 2022 report, *"Japan's Economic Outlook No. 215 Update"* (Japanese only, our previous outlook), in keeping with our previous outlook, we expect the real GDP growth rate in 2022 to continue on a recovery path centering on personal consumption and inbound consumption due to the normalization of economic activity and Japan's monetary policy. However, the resumption of Nationwide Travel Support in January 2023 will have a smaller effect on boosting travel demand because of the reduced discount rate. In addition, capex was revised downward in light of current trends.

The growth rate for FY2023 outlook was revised upwards by 0.2%pt. This was based on the fact that the outlook for real GDP growth in 2023 was revised upwards for the US, Europe, and China, and the expectation that the number of Chinese tourists visiting Japan will reach full-fledged recovery beginning in the spring of 2023 (this latter phenomenon will be discussed in more detail later in this report). With the lowering of the classification of COVID-19 under the Infectious Diseases Control Law from the current equivalent to category II to category V on May 8, the normalization of economic activities is expected to proceed mainly in the first half of FY2023. The elimination of restrictions on behavior of persons in close contact, etc., will greatly reduce the economic and social burden. Growth will remain moderate in FY2024, the outlook for the next fiscal year having been announced for the first time in this report. If we ignore the carryover from the previous term, growth is expected to be low at +0.7% y/y.

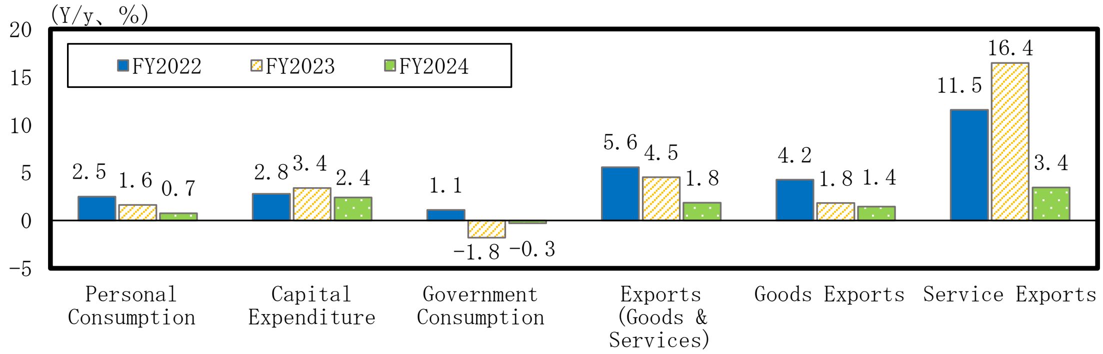
Major demand components are expected to perform as illustrated in Chart 3. Personal consumption is expected to shed the positive effects of Nationwide Travel Support between now and spring of 2023, but the stable COVID-19 infection situation is expected to provide underlying support for eating out and entertainment. In addition, the easing of supply constraints on motor vehicles promises to release pent-up demand.

Capex has been taking a breather due to the downturn in semiconductor related demand in PCs and smartphones, but with the acceleration of domestic economic normalization expected in the future, capex centering on the non-manufacturing industry should pick up. However, it is necessary to remain cautious regarding the possibility that the tendency to avoid investment in manufacturing may occur due to uncertainty regarding the US and European economies.

Government consumption is expected to decline through the Oct-Dec 2023 period as the boost from infectious disease control measures, such as testing programs and vaccinations, will gradually wear off. Thereafter, we expect consumption to return to the trend before the spread of infection, which was increasing mainly in medical and long-term care benefit spending amid the aging of the population.

Regarding exports, although the resumption of the Chinese economy will boost exports of goods, the growth rate is expected to remain in the 1% y/y range through FY2024, partly due to the slowdown in the US and European economies. On the other hand, in the area of service exports, inbound consumption is expected to recover significantly.

Outlook for Major Demand Components **Chart 3**



Source: Cabinet Office; compiled by DIR.

Major factors supporting or providing a boost for Japan's economy

Looking at real GDP in 2022 relative to 2019 for the top 15 OECD member countries in terms of economic size, Japan is almost on a par with Spain, which has had the slowest recovery among the countries covered. Among the major advanced economies, Japan still has plenty of room for recovery in demand through normalization of economic activity.

The Japanese economy is expected to see a full-fledged recovery in domestic service consumption and inbound consumption as economic activity normalizes, especially in 2023. The resolution of the semiconductor shortage is expected to lead to the emergence of pent-up demand for motor vehicles (recovery production) (Chart 4). In addition, the main factors supporting and boosting the economy include the withdrawal of household savings which increased significantly after the spread of COVID-19, and the government's economic measures to mitigate the effects of high prices, as well as a lull in imported inflation.

Acceleration of wage hikes in the 2023 spring wage negotiations is also expected. As mentioned in *Japan's Economy: Monthly Outlook (Jan 2023)* (the previous month's report (Japanese only)), the wage hike rate including annual wage increase may reach the 3% level in the 2023 spring wage negotiations, compared to around 2% in 2022. However, since the trend of wage increases is not yet clear, we do not assume a significant wage increase in our main scenario.

Major Factors Supporting or Providing a Boost for Japan's Economy **Chart 4**

Factor	Comments
Recovery of domestic consumption of services	Lowering of classification of COVID-19 under the Infectious Diseases Control Law from current equivalent to category Ⅱ to category Ⅴ on May 8.
Recovery of inbound consumption (foreign tourists visiting Japan)	The number of Chinese tourists visiting Japan, which had suffered a downturn in recent years, will reach full-fledged recovery beginning in the spring of 2023. The outlook for inbound consumption in 2023 sees growth of around 3 tril yen.
Recovery production in motor vehicles due to resolving of semiconductor shortage	If pent-up demand for motor vehicles appears, demand will increase by around 1.6 tril yen from households alone.
Moderation of effects of high prices due to withdrawal of household savings which grew significantly after the spread of COVID-19 and government economic measures	Excess savings by households beyond the pace before the spread of COVID-19 was about 47 tril yen. This is equivalent to 16% of personal consumption in 2022.
A lull in imported inflation	Resource prices may continue stable with the slowdown in the global economy, but resource prices still threaten to rise again if the Ukraine situation becomes increasingly tense.
Acceleration of wage hikes in 2023 spring wage negotiations	Possibilities are that the rate of wage increase including annual wage increase could be raised to the 3% level in 2023. The rate of wage increase was around 2% in 2022.

Source: Data from Various Sources; compiled by DIR.

Likelihood of full-fledged recovery in consumption of services will increase when COVID-19 is moved to category Ⅴ

Although the spread of COVID-19 is likely to continue intermittently after 2023, Europe and the US have already largely regained their pre-corona lives. The possibility of a "living with corona" situation similar to that in Europe and the US is increasing in Japan, due to such factors as the shift of the classification of COVID-19 under the Infectious Diseases Control Law to category V on May 8.

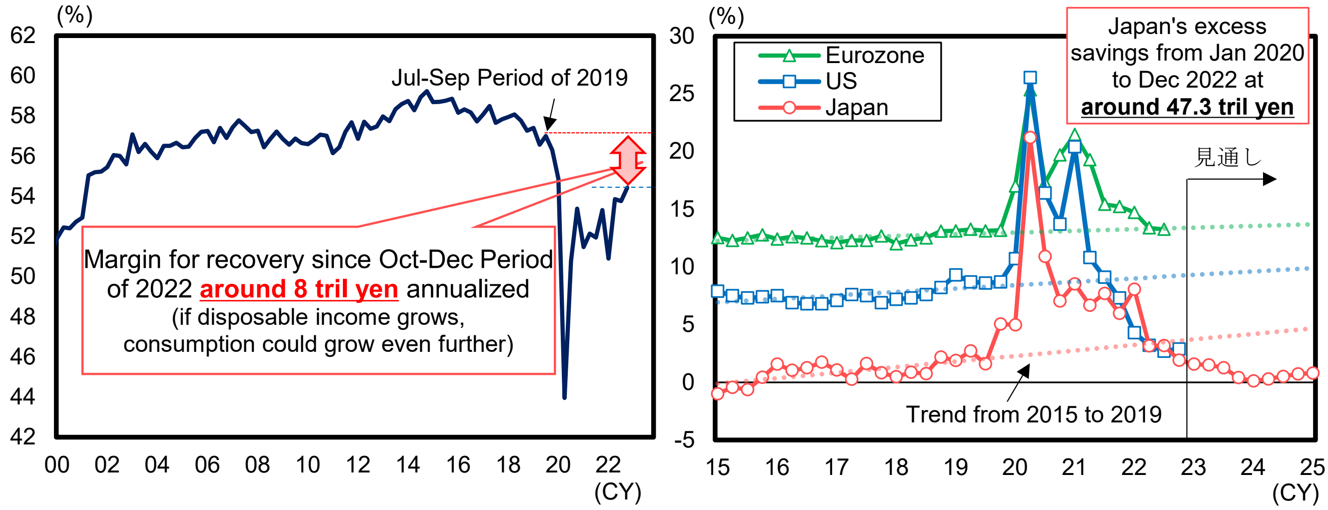
Domestic consumption of services in GDP statistics, excluding inbound consumption, is estimated to have been 54% of disposable income in the Oct-Dec period of 2022 (Chart 5, left). This is a significant increase from 44% in the Apr-Jun 2020 period when the first emergency declaration was issued, bfut it is still lower than the 57% in the Jul-Sep 2019 period, before the spread of COVID-19 and before the consumption tax hike. Recovery to this level would boost services consumption by about 8 tril yen, and with an increase in disposable income, consumption would be even larger.

As the recovery in consumption of services proceeds, it is possible that consumption of goods could stall, hence it is necessary to discount the amount of growth seen for consumption overall somewhat. Even so, we expect economic measures to stimulate demand, such as Nationwide Travel Support through spring of 2023, to provide support for recovery. If Nationwide Travel Support is extended till the end of March, the economic effect during its period of implementation is estimated to be around 1.6 tril yen, exceeding the effects of the Go To Travel Campaign’s 1.2 tril yen.

High prices have put downward pressure on personal consumption through a decline in household purchasing power, but this has been mitigated by the approximately 47 tril yen in excess savings[3] that have accumulated at a faster pace since the pandemic and by government economic stimulus measures. The household savings rate rose sharply after the spread of COVID-19 in Europe and the US, but in the US, the rate has recently declined substantially, and US households have been able to maintain their consumption levels despite record-high inflation by drawing down their excess savings (Chart 5, right). Going forward, the withdrawal of excess savings is expected to continue in Japan as well, and will be a major factor supporting increases in services consumption, spending on motor vehicles, and other spending even as prices remain high.

[3] We consider the deviation from the trend in household savings seen in 2015-19 (excluding the Oct-Dec 2019 period, which was strongly affected by the consumption tax hike and natural disasters) to be "excess savings," and base our estimate on this amount. This is equivalent to 16% of personal consumption in 2022, which is significantly higher than our forecast for consumer price inflation in 2023 (+1.9% y/y). Excess savings has been reduced from our previous outlook due to the downward revision of disposable income following the annual revision of GDP statistics.

Consumption of Services Relative to Disposable Income (Excluding Inbound, Left), and Savings Rates in Japan, US, and Europe (Right) **Chart 5**



Source: Cabinet Office, Japan Tourism Agency, BEA, European Commission, Haver Analytics; compiled by DIR.

Notes: 1) Figures on the left side of the chart are seasonally adjusted. Inbound consumption included in services consumption is estimated by multiplying direct domestic purchases by non-resident households according to the SNA with the ratio of services consumption calculated from the Japan Tourism Agency's "Survey of Foreigners' Consumption Trends in Japan". The survey does not provide data on expenditures by expense category for the January-March 2010 period and earlier, and for the April-June 2020-July-September 2022 period. Hence the former uses the average proportion of service consumption in the Apr-Jun 2010 period, and the latter uses the average proportion of service consumption in the Jan-Mar 2020 period and the Oct-Dec 2022 period. Disposable income in the Oct-Dec period of 2022 is estimated by DIR.

2) Figures on the right side of the chart are seasonally adjusted. The 2015-2019 trend line for Japan excludes the Oct-Dec period of 2019 which experienced significant effects from the increase in consumption tax and natural disasters.

Full-fledged recovery of inbound tourism to boost economy centering on 2023

According to the Japan National Tourism Organization, the number of foreign visitors to Japan has surged since October 2022, immediately after the drastic relaxation of border control measures. In September 2022, it was only -91% of the same month in 2019, but in January 2023, the negative growth rate narrowed to -44%. However, the number of Chinese, who accounted for about 30% of the total in 2019, remains sluggish at -96%.

Taking into account trends in the number of visitors to the US and the UK[4], which have relaxed or eliminated border control measures ahead of Japan, the recovery in the number of foreign visitors to Japan is expected to continue for the foreseeable future. On the other hand, the timing of the recovery of Chinese visitors to Japan will depend on the Chinese government's decision. The Chinese government lifted the ban on group travel overseas on February 6, 2023, but the target countries do not include Japan and are limited to 20 countries, including Thailand and Russia.

However, since the COVID-19 situation in both Japan and China has been improving recently, our main scenario assumes that the ban on group travel to Japan will be lifted around spring 2023. As a result, the number of foreign visitors to Japan is expected to increase from 3.83 million in 2022 to about 25 million in 2023 (up by about 5 million from our previous outlook). Furthermore, the number of visitors in 2024 is expected to recover to around 32 million, the same level as in 2019 (around 28 million in FY2023 and around 33 million in FY2024).

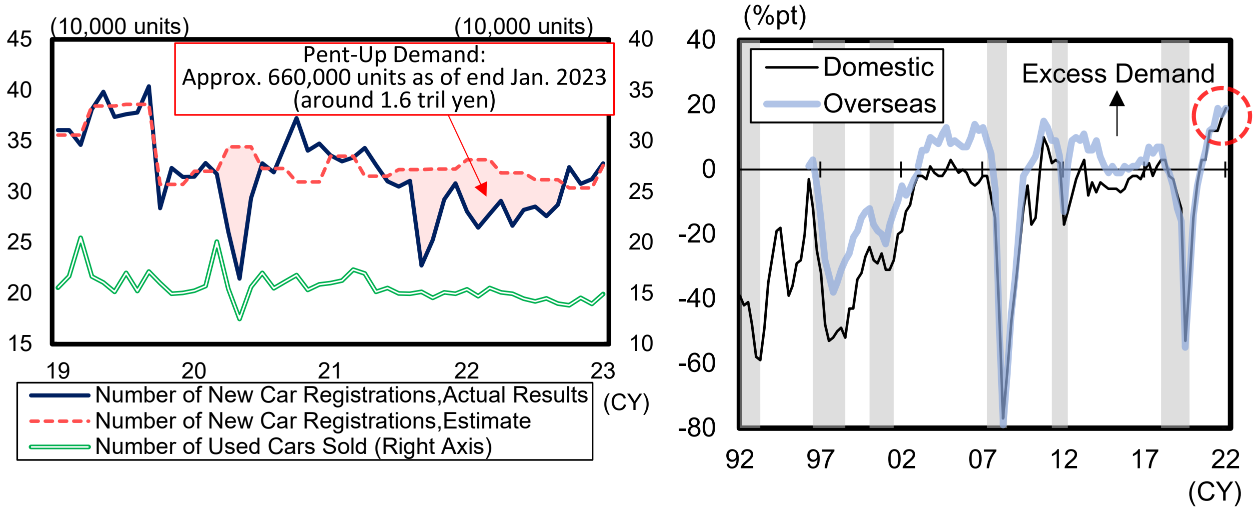
In terms of real inbound consumption, growth of around 3 tril yen is expected in 2023. Although there is a possibility that the number of inbound visitors to Japan may remain sluggish due to appreciation of the yen and the global economic downturn, as indicated in the previous month's report, even if these risks materialize, the recovery of inbound spending will remain a major supporting factor for the Japanese economy, especially in 2023.

[4] For details see the DIR report dated 20 October 2022, *Japan's Economy: Monthly Outlook (Oct 2022)* (Japanese only).

Pent-up household demand for motor vehicles was about 1.6 tril yen as of end January 2023

The shortage of semiconductors for motor vehicles has eased since the second half of 2022, and domestic new passenger vehicle sales in January 2023 were the highest since May 2021 (seasonally adjusted figures by DIR). Estimating demand for motor vehicles in the absence of supply constraints (red dashed line in Chart 6, left), new vehicle sales in the fall of 2022 and beyond appear to be generally in line with demand. However, pent-up demand, which has arisen because supply has not been able to keep up with demand, is expected to remain high, amounting to approximately 660,000 units at the end of January 2023 and estimated to amount to about 1.6 tril yen in value.

Domestic Pent-Up Demand for Passenger Vehicles (Left), and Supply & Demand Conditions DI for Motor Vehicles According to BOJ Tankan (Right) — Chart 6



Source: Bank of Japan, Cabinet Office, Ministry of Internal Affairs and Communications, Japan Automobile Dealers Association, Japan Mini Vehicles Association; compiled by DIR.

Notes: 1) Figures on the left side of the chart are seasonally adjusted. See Chart 2-13 in *"Japan's Economic Outlook No. 214 Update"* (dated 8 September 2022 (Japanese Only)) for method of estimation.

2) The figures on the right are not continuous before the December 2003 survey and after the March 2004 survey due to a revision of the survey method. For the December 2003 survey, figures on both old and new bases are shown. The shaded areas represent recessionary periods.

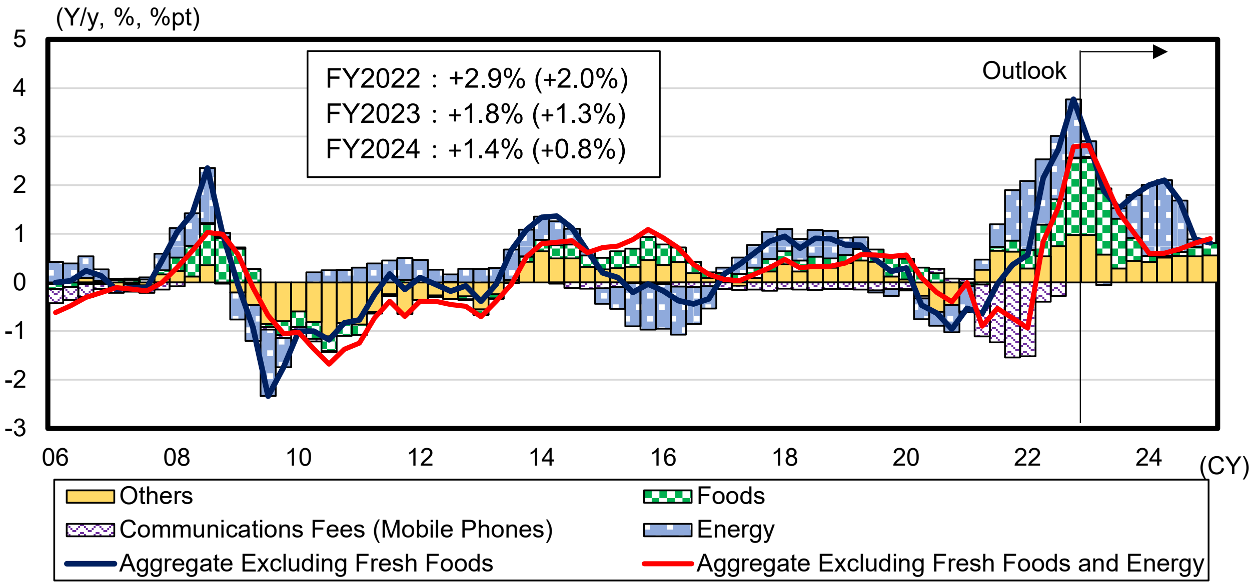
Looking at supply & demand conditions DI according to the BOJ Tankan, we can see that the supply and demand situation for motor vehicles is extremely tight. Supply & demand conditions DI for motor vehicles according to the December 2022 survey (the larger the positive figure the tighter the supply-demand situation) was +19%pt for both domestic and overseas – near historic highs in both cases since the 1990s when they were retroactive (Chart 6, Right). This suggests that pent-up demand for motor vehicles may be building up not only domestically but also overseas. If the shortage of semiconductors is resolved, and if recovery production of motor vehicles to meet pent-up demand (≒backlog of orders) goes into full swing, it will boost not only consumption of durable goods, but also exports and capex (corporate purchases of motor vehicles).

Core CPI growth rate to decline through Jul-Sep period of 2023, partly due to effects of measures to prevent high energy costs

The CPI on an aggregate basis excluding fresh food (core CPI) is expected to increase by 2.9% y/y in FY2022, 1.8% in FY2023, and 1.4% in FY2024, assuming the latest resource prices and exchange rates (Chart 7).

The growth of import prices has already peaked out as the appreciation of resources and the depreciation of the yen have run their course, but companies have not made sufficient progress in passing prices on to consumers, and we expect price hikes, particularly for food, to continue in FY2023, albeit not to the same extent as in FY2022.

Outlook for CPI (Excluding Fresh Foods for All Years – Figures in Parenthesis Exclude Both Fresh Foods and Energy) **Chart 7**



Source: Ministry of Internal Affairs and Communications; compiled by DIR.
Note: Price outlook assuming resource prices and exchange rates at the time the chart was produced. Assumes that national travel assistance will be implemented from October 2022 through the end of March 2023, excluding the year-end and New Year holidays, and that high energy price measures will be implemented through the end of September 2023 (energy bills for February-October will be reduced).

The government selling price of imported wheat is scheduled to be revised in April 2023, and if prices are raised, it will affect the prices of products such as bread and noodles. Further increases in electricity prices should also be noted. Seven of the 10 major electric power companies have applied to raise their regulated rates starting in April (June for TEPCO and Hokkaido Electric Power Co.) In addition, five major electric power companies, including TEPCO, have announced that they will raise electricity rates for households starting in April in line with higher wheeling charges.

On the other hand, the government's measures to prevent high energy prices, which are included in its comprehensive economic measures, are expected to suppress the rise in core CPI for the time being. The effect of the measures is estimated to push down core CPI growth by about 1.2%pt y/y per month from February to October 2023, and while core CPI growth will increase in the short term from November, it will decline through FY2024, when upward pressure from energy prices diminishes.

The CPI growth rate excluding fresh food and energy is expected to continue its downward trend from early 2023, rising moderately from the second half of 2024 to about +1% y/y in the Jan-Mar 2025 period. The underlying tone of prices is expected to continue to rise moderately throughout the forecast period due to the tightening of the macro supply-demand balance and higher wage growth.

BOJ likely to continue easing for some time even under new leadership

On February 14, 2023, the government presented to the Diet a personnel proposal to replace Bank of Japan (BOJ) Governor Haruhiko Kuroda with Kazuo Ueda, a professor emeritus at the University of Tokyo and former Member of the BOJ Policy Board. Ryozo Himino, former Commissioner of the Financial Services Agency, and Shinichi Uchida, a BOJ Executive Director will be appointed as Deputy Governors. With the side effects of the Bank's massive easing measures being pointed out, monetary policy is entering a new phase.

Our main scenario assumes that the BOJ will maintain its current framework of monetary easing measures until the bottoming out of the US economy and the trend of wage increases in the spring wage negotiations become somewhat clearer. The CPI growth rate, which has recently reached the +4% y/y level, still has a large "cost-push inflation" aspect. However, there have been recent changes in the consumption behavior of households and price revision behavior of firms[5]. The cyclical upward mechanism of wages and prices has begun to function, a phenomenon not seen in the past quarter century. Against this backdrop, we see little likelihood that the BOJ will move to tighten monetary policy too quickly, which could erode the possibility of sustained price hikes.

However, it is possible that measures aimed at improving market functioning, such as further expansion of the allowable range of fluctuation in long-term interest rates, will be implemented by the end of the year. Correcting imbalances in financial markets is a pressing issue for the BOJ. It is also conceivable that under the new Governor, the BOJ will conduct "inspections" of the effectiveness and adverse effects of its monetary easing measures, revise its joint statement with the government, and initiate a review of the YCC (gradual shift to short-term interest rate operations). Even in that case, until the achievement of the 2% price stability target is in sight, the Bank will probably continue its monetary easing measures, including JGB purchases, maintenance of low interest rates, and forward guidance.

3. Risk Factors from a Global Perspective

US entering serious recessionary phase remains a cautionary point

As was discussed earlier in this report, our outlook for the overseas economy in 2023 has improved since our previous outlook, centering on the US, Europe, and China. However, downside risks affecting overseas economies continue to require caution.

Chart 8 lists seven major risk factors for the global economy. Of these, the probability is relatively high that the US economy will enter a serious recession, and if this risk materializes, the impact will be significant. Although inflation is slowing, partly due to the Federal Reserve's monetary tightening, the employment data for January 2023 shows a level of favorability exceeding that of market expectations, and the growth rate of the consumer price index (CPI) for the same month also exceeded market expectations. If short-term interest rates are raised more than expected or the duration of interest rate hikes is prolonged due to overly strong employment conditions, the possibility of the US economy falling into negative growth with a significant increase in the unemployment rate will increase.

Major Risk Factors for the Global Economy **Chart 8**

(1) US enters serious recession (negative growth with major increase in unemployment rate)
(2) Heightened tensions in Ukraine (economy worsens centering on Europe, and resource prices increase)
(3) Significant adjustment in China’s real estate market
(4) BOJ eliminates yield curve control (YCC)
(5) Debt risk surfaces in some of the emerging nations
(6) A Taiwan contingency occurs
(7) A new mutant strain of COVID-19 spreads with major risk of becoming serious

Source: Produced by DIR.

The risk of further tensions in Ukraine requires constant vigilance. Another possibility is a significant adjustment in the real estate market in China. One domestic risk factor is a major revision of monetary policy. For example, the Bank of Japan, under its new leadership, will conduct "inspections" of the effectiveness and side effects of its monetary easing measures, and the elimination of yield curve control

[5] For details, see Chapter 4 of DIR report dated 20 February 2023, *“Japan’s Economic Outlook No. 216 Update”* (Japanese only).

(YCC) could lead to an increase in long-term interest rates (our main scenario assumes that long-term and short-term interest rates will remain generally unchanged during the forecast period).

In addition, rising interest rates in the US and other advanced economies are rapidly increasing the burden of interest payments in emerging economies, and there is a danger that debt risk could materialize in some emerging nations. If a Taiwan contingency occurs, Japan, which has strong economic ties with both China and Taiwan, will suffer a tremendous blow. Although the risk of severe cases of COVID-19 has been greatly reduced through the spread of vaccines and the outbreak of the Omicron strain, if a new mutant strain that greatly increases the risk of severe cases becomes prevalent, the progress of economic normalization in countries around the world will be forced to take a drastic step backward.

Many of the risk factors listed in Chart 8 can be considered tail risks. Chart 9 shows the estimated impact on real GDP (i.e., the downward pressure on growth) if (1) US risk, (2) European risk, and (3) Chinese risk were to manifest themselves. Here, we assumed a scenario in which the unemployment rate rises to about 10% in the US, a credit crunch occurs in the Eurozone with a 15% deleveraging of financial institutions, and the real estate market shrinks substantially in China.

For example, if US risk emerges, real GDP growth in the US will decline by 4.6%pt, meaning that our main scenario of +1.0% y/y in the 2023 growth outlook will fall to -3.6% y/y. The impact on Japan's real GDP growth rate would also be extremely large at -2.8%pt, and this alone would plunge Japan into negative growth.

Although Japan is in an environment where the economic recovery is more likely to continue than in major advanced nations such as Europe and the US, a significant deterioration in overseas economies centering on the US should continue to be watched with caution.

Effects on Real GDP Growth Rate by Country & Region if Tail Risk Appears in US, Europe, or China
Chart 9

(%pt)

	Global Economy	Japan	US	China	Eurozone	Emerging Nations (Excluding China)
US Risk ⇒Unemployment rate grows to around 10%	▲ 3.7	▲ 2.8	▲ 4.6	▲ 2.2	▲ 3.3	▲ 4.2
European Risk ⇒European financial institutions' leverage shrinks by 15% Around 1.5 times the extent seen during the government debt crisis of the early 2010's	▲ 1.8	▲ 1.3	▲ 0.6	▲ 1.1	▲ 4.2	▲ 2.0
Chinese Risk ⇒Real estate market shrinks significantly (twice the extent seen during the global financial crisis of 2008)	▲ 1.4	▲ 1.0	▲ 0.4	▲ 2.6	▲ 0.4	▲ 1.7

Source: IMF, Haver Analytics; compiled by DIR.
Note: Estimates performed using the DIR macro model. See DIR report, *"Japan's Economic Outlook No. 215 Update"* (dated 8 December 2022 (Japanese only)) for method of estimation.

Japan’s Economic Outlook No. 216 (February 20, 2023) Chart 10

		2022			2023				2024				2025	FY2022 (CY)	FY2023 (CY)	FY2024 (CY)
		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	Y tril; annualized	548.0	546.7	547.5	551.7	555.4	557.4	558.2	559.5	560.9	562.3	563.8	565.3	548.6	557.5	563.1
	Q/q %	1.1	-0.3	0.2	0.8	0.7	0.3	0.2	0.2	0.2	0.3	0.3	0.3			
	Q/q %; annualized	4.6	-1.0	0.6	3.1	2.7	1.4	0.6	1.0	1.0	1.0	1.0	1.0			
	Y/y %	1.7	1.5	0.6	1.9	1.2	2.0	2.0	1.4	1.1	0.9	1.0	1.0	1.4	1.6	1.0
														(1.1)	(1.8)	(1.1)
Private Consumption	Q/q %	1.6	0.0	0.5	0.4	0.6	0.4	0.3	0.2	0.2	0.2	0.2	0.2	2.5	1.6	0.7
Private Residential Investment	Q/q %	-1.9	-0.4	-0.1	0.2	0.6	0.3	0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-4.4	0.8	-0.6
Private Non-Resi. Investment	Q/q %	2.1	1.5	-0.5	0.6	1.3	1.2	0.9	0.6	0.5	0.5	0.5	0.5	2.8	3.4	2.4
Government Consumption	Q/q %	0.8	0.1	0.3	-0.1	-0.6	-1.3	-0.9	0.2	0.2	0.2	0.2	0.2	1.2	-1.9	-0.3
Public investment	Q/q %	0.5	0.7	-0.5	0.6	0.8	0.5	0.4	0.3	0.5	0.5	0.5	0.5	-3.4	1.8	1.9
Exports	Q/q %	1.5	2.5	1.4	1.4	1.2	0.8	0.5	0.4	0.4	0.5	0.5	0.5	5.6	4.5	1.8
Imports	Q/q %	0.9	5.5	-0.4	-0.4	0.5	0.5	0.3	0.2	0.3	0.3	0.3	0.3	7.5	1.9	1.1
Nominal GDP	Q/q %; annualized	4.2	-3.1	5.2	6.6	4.2	1.8	3.1	2.3	1.4	1.3	1.3	1.6	1.9	3.6	1.8
GDP deflator	Y/y	-0.3	-0.4	1.1	1.2	1.9	2.4	1.9	1.4	1.1	1.1	0.6	0.4	0.4	1.9	0.8
Industrial production	Q/q	-2.7	5.9	-3.0	0.7	3.4	1.4	0.4	0.1	0.0	0.1	0.2	0.2	0.4	5.1	0.9
Core CPI	Y/y	2.1	2.7	3.8	2.9	1.9	1.5	1.8	2.0	2.1	1.7	0.9	0.8	2.9	1.8	1.4
Unemployment rate	%	2.6	2.6	2.5	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.3	2.3	2.5	2.3	2.3
Trade balance (goods, services)	Y tril; annualized	-15.1	-23.4	-20.2	-14.3	-13.0	-12.6	-12.7	-12.4	-12.4	-12.2	-12.0	-11.8	-18.1	-12.6	-12.0
Current account balance	Y tril; annualized	12.9	2.7	10.0	13.7	16.8	17.4	17.7	18.2	18.6	19.1	19.6	20.2	9.9	17.6	19.4
Major assumptions																
Crude oil price (WTI futures)	$/bbl	108.5	91.4	82.6	78.2	78.5	78.5	78.5	78.5	78.5	78.5	78.5	78.5	90.2	78.5	78.5
Exchange rate	Yen/$	129.6	138.4	141.4	132.4	133.9	133.9	133.9	133.9	133.9	133.9	133.9	133.9	135.4	133.9	133.9

Source: Compiled by DIR.

Note: GDP through 2022: actual; thereafter: DIR estimates.