

JAPAN

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CONFIDENCE NEEDS TO BE RESTORED TO ACCELERATE THE RECOVERY

As in other countries the world round, Japan reported a record-breaking recession in 2020 and the lack of consumer confidence, stifling domestic demand, could slow the dynamics of its economic recovery. Japan's vaccination campaign has been relatively slow, notably compared to the United States, but the country was not hit as hard by the pandemic as other countries. Faced with expectations of sluggish demand, Japanese companies will continue to be reticent about making investment decisions. This outlook could undermine Japan's already weakened growth potential. Tighter financing conditions would be especially harmful, and the Bank of Japan will remain vigilant in the current environment of rising interest rates.

STARTING TO RETURN TO NORMAL

Compared to other countries, Japan was not hit as hard by the Covid-19 pandemic, and the decline in economic growth was relatively more moderate in 2020, notably compared to the European countries. Japanese GDP contracted 4.8% last year, compared to 5.3% for Germany and 8.2% for France.

The signal from the most recent economic data is mixed. As in the Eurozone, there is a divergence in the catching-up movement between the manufacturing sector and market services. After bottoming out in April 2020, the purchasing managers index (PMI) for the manufacturing sector has risen almost continuously, and is now in expansion territory (51.4 in February 2021). This favourable momentum must still be confirmed by hard data, since industrial output declined again in January on a year-on-year basis. The services PMI, in contrast, has been stagnant on the whole since June 2020, and has not risen above the 50 threshold since the pandemic began. The lack of confidence of Japanese consumers has hurt the services sector, which is dependent on private consumption. Granted, Japan's vaccination campaign has been relatively slow compared to countries like the United States, but the country was not hit as hard by the pandemic. Even so, the consumer confidence index is still below pre-crisis levels. This situation is straining corporate investment in Japan, which declined again in Q1 2021. Japanese companies are expecting economic growth to remain feeble in the years ahead¹, which is hampering their investment decisions. These dynamics are harmful for the country's growth potential, which is already weak.

RISING INTEREST RATES: THE BANK OF JAPAN IS VIGILANT

Early 2021 has been marked by an upturn in long-term rates, a trend that fits within the dynamics of rising inflation expectations in the United States. Japan, like other economies, is facing upward pressure on the cost of financing, and this trend is likely to continue. The Bank of Japan has largely managed to contain these pressures by maintaining a yield curve control policy. The central bank is taking action to avoid any tightening of financing conditions. Japan's 10-year sovereign yields have not risen nearly as rapidly as their UK counterparts. Japanese monetary policy will continue to be especially accommodating in a persistently deteriorated economic environment at a time of unfavourable pricing trends. Core inflation fell again on a year-on-year basis in February 2021. Consequently, monetary policy will continue to support fiscal policy, since reducing the public debt is currently not a priority (the debt ratio may have reached 266% of GDP in 2020).

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¹ According to an annual survey by the Ministry of Finance, the GDP growth rate expected by Japanese companies has trended downwards since the 1980s and is now at only about 1%.

GROWTH AND INFLATION (%)

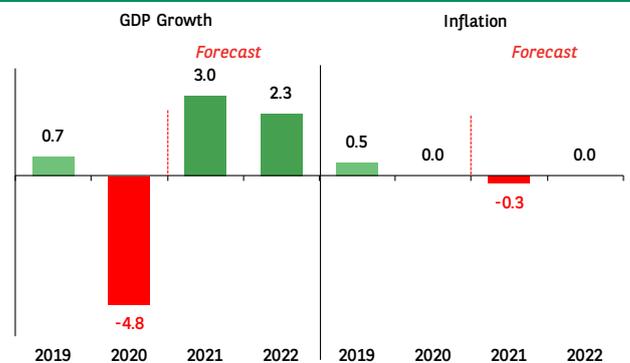


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

SOVEREIGN 10-YEAR INTEREST RATES (%)

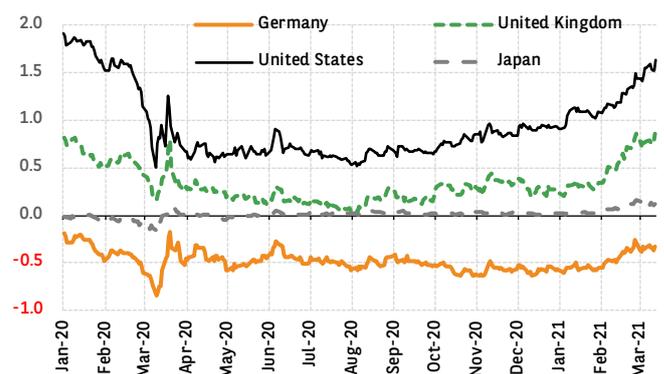


CHART 2

SOURCE: REFINITIV



BNP PARIBAS

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