

## ECONOMIC POLICY CONTINUITY

It will take a long time for Japan to erase the economic shock of the Covid-19 pandemic. Even though lockdown measures were less restrictive than in other countries, Japanese GDP is poised for a record contraction in 2020. The expected rebound could be mild. Household confidence and business activity indicators have stagnated, sending mixed signals about the strength of domestic demand. The Covid crisis is bound to accentuate the weaknesses of the Japanese economy: sluggish growth, low inflation and record-high public debt. Prime Minister Shinzo Abe's resignation is unlikely to lead to any major policy changes as Japan continues to pursue expansionist economic policies.

The Japanese economy experienced a historic contraction of GDP in Q2 2020 (-7.9% q/q), the third consecutive quarterly decline (-0.6% in Q1 2020 and -1.8% in Q4 2019). The lag created by the Covid-19 crisis will not have been closed by the end of our forecast horizon.

## ANOTHER TOUGH YEAR ON THE ECONOMIC FRONT

Even though lockdown measures were less restrictive than in other regions of the world, especially compared to Europe, Japan was not spared the economic shock of the Covid-19 pandemic. Real GDP temporarily plummeted to mid-2011 levels, prior to the launch of Abenomics. Prime Minister Shinzo Abe's recent resignation is not expected to significantly change the economic policy trajectory (see below). Hard hit by private consumption and corporate investment, Q2 2020 GDP contracted by 7.9% q/q. Moreover, the expected catching-up effect in Q3 2020 and beyond risks being relatively mild.

Indeed, the latest cyclical indicators suggest that the economic recovery is losing momentum. According to the Bank of Japan's Tankan indicator, business activity deteriorated sharply in the manufacturing and non-manufacturing sectors in Q2 2020 (Q3 statistics were not available yet when this article was written). More recently, after rebounding strongly, the composite Purchasing Managers Index (PMI) levelled off in August at 45.2, far below the 50 threshold separating expansion from contraction. In the manufacturing sector, which accounts for more than 20% of GDP, activity continues to improve (47.2 in August after 45.2 in July). Business in the services sector has stalled, in contrast, and continues to be undermined by lacklustre household spending. Retail sales are still trending downwards (-1.9 % year-on-year in August, after -2.9% in July). The latest figures on household confidence did not alleviate concerns about private consumption: after picking up briefly, confidence seems to have stagnated below its level at the beginning of the year. Moreover, Japanese exports, which tend to be dominated by high value-added products, could be further strained by sluggish external demand, notably in the machinery and transport equipment segment. Lastly, the Haishen typhoon that swept the country in early September could place another squeeze on demand, notably in terms of corporate investment.

## POLICIES CONTINUITY AFTER SHINZO ABE'S RESIGNATION

Yoshihide Suga was named Prime Minister to replace Shinzo Abe, but this is unlikely to lead to any major economic policy changes. According to preliminary information at our disposal, Mr. Suga is expected to provide continuity with "Abenomics" and the three "arrows" of Mr. Abe's programme: a very accommodating monetary policy, abundant public spending, and structural reforms.

### GROWTH AND INFLATION (%)

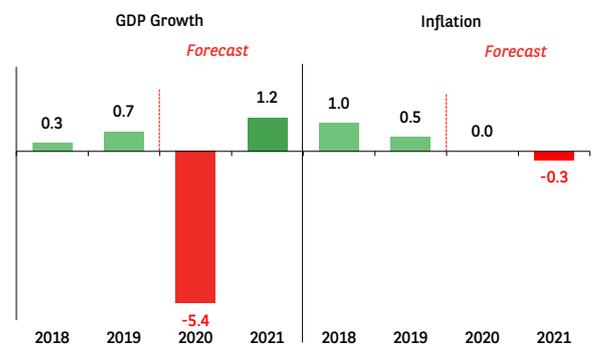


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

### REAL GDP (BILLION YEN, ANNUALIZED)



CHART 2

SOURCE: CABINET OFFICE

The new Prime Minister underscored how fiscal support was more important than ever to turnaround the Japanese economy during these times of crisis. Getting a grip on public debt - which will exceed 250% of GDP in 2020<sup>1</sup> - does not seem to be a priority.

**Louis Boisset**

[louis.boisset@bnpparibas.com](mailto:louis.boisset@bnpparibas.com)

<sup>1</sup> Fiscal Monitor: Chapter 1 – Policies to support people during the Covid-19 pandemic, IMF, April 2020

