

CAN JAPAN ASSUME ITS SINGULARITY MUCH LONGER?

Since early 2022, inflation has been rising, albeit moderately, for the first time since 2014, while growth contracted in Q1. The yen has depreciated sharply due to the Bank of Japan's very accommodating monetary policy, which is out of step with the other major central banks, who have already begun to tighten their monetary policy. In June 2022, BoJ Governor Haruhiko Kuroda still thought it was "necessary" to maintain a yield curve control policy to boost core inflation to a "stable and sustainable" level. Yet currency depreciation aggravates imported inflation and further erodes household purchasing power. A few weeks before the legislative elections of 25 July, the government is likely to reinforce measures to support household purchasing power.

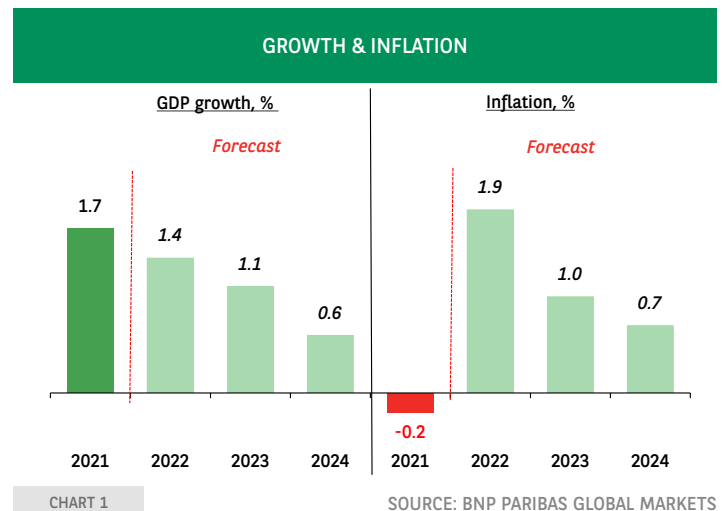
The Bank of Japan (BoJ) justified the continuation of its policy of yield curve controls, insisting on the "temporary" nature of current inflation. The entire annual increase in the consumer price index (CPI), which rose 2.5% y/y in April 2022, can be attributed to higher prices for energy and food products, that are essentially imported and thus highly exposed to the surge in international commodity prices, which has been amplified by the war in Ukraine. Excluding energy and perishable food items (the BoJ's core inflation target), the CPI rose only 0.8% y/y in April 2022. This low figure is another reason why BoJ Governor Haruhiko Kuroda argues for maintaining its policy of yield curve controls, which he claims is "necessary" to boost core inflation to a "stable and sustainable" level¹.

The absence of widespread price inflation reflects the sluggish nature of domestic demand, which is why Japan's cumulative performance has lagged behind that of the other advanced countries since the 2021 recovery. In Q1 2022, real GDP was still 2.5% below the 2019 level, whereas it has already exceeded pre-Covid levels by 3.7% in the United States and 0.5% in the Eurozone. Japanese GDP contracted in Q1 2022 (-0.1% q/q). Notably, there was a decline in the consumption of durable goods (-0.8% q/q) and semi-durable goods (-1.8% q/q), which was hampered by the supply chain problems of businesses, who were also hurt by shortages of components and global supply chain disruptions, especially in China. Consumption of services also contracted (-0.1% q/q) due to health restrictions introduced last winter to curb the expansion of the Omicron variant.

The divergence in monetary policies between the BoJ and the Fed resulted in a sharp depreciation of the yen, which has fallen 22% against the US dollar since the beginning of the year. The deterioration of Japan's current account surplus is also adding downward pressures on the currency. Higher energy prices have increased the cost of imports, while the shutdown of borders due to health restrictions has reduced external revenues. In Q1 2022, foreign trade made a negative contribution of 0.4 points to Japanese GDP as import growth (+3.3% q/q) largely exceeded the rise in exports (+1.1% q/q).

SUPPORT FOR HOUSEHOLDS

The yen's depreciation accentuates imported inflation, which is deeply felt by households. In Q1 2022, household purchasing power declined 2.5% q/q². To limit this decline, the government has implemented a series of support measures since the end of April 2022 totalling JPY 6.2 trillion (USD 48.2 bn), including a check of JPY 50,000 (USD 391) per child for low-income households. Since the majority of these measures are debt financed, they will further erode government finances.



The OECD is now forecasting a public deficit of 6.9% of GDP in 2022, up from 5.7% in 2021. The Japanese authorities have also renounced their target of generating a primary fiscal surplus by 2025. Yet fiscal revenues will get a boost from the expected rebound in private consumption, following the removal of health restrictions and the reopening of Japan's borders to tourists. In place since March 2020, the partial lifting of this restriction will allow 20,000 tourists to enter the country daily according to the government, although this is a far cry from the 2019 average of 88,000 tourists (METI).

Looking beyond economic measures, the government also intends to transform its growth model to foster the emergence of a "new capitalism", one that is more sustainable and equitable in the long term. It aims to better divide up value added between profits and wages. The three "arrows" established by the previous Prime Minister, Shinzo Abe, could give way to redistribution policies that favour households coupled with stricter corporate measures. A more precise road map is expected to be presented following the election of the House of Councillors, Japan's upper house of parliament, in July 2022, an election that the ruling Liberal Democratic party is once again favoured to win.

Guillaume Derrien

(with collaboration from Elias Krief, trainee)

guillaume.a.derrien@bnpparibas.com

¹ "The Bank's Thinking on Monetary Policy: Toward Achieving the Price Stability Target in a Sustainable and Stable Manner", BoJ speech (6 June 2022)

² Households Family Income Survey, Statistics Japan, April 2022.

