Japan

Recession on the cards despite new fiscal stimulus package

The shock of the Covid-19 pandemic comes hard on the heels of a difficult second half of 2019 for the Japanese economy. Like many others, the country is exposed to the economic fallout from this crisis. Its significant economic dependence on China, for imports, exports and tourist flows, further weakens the Japanese economy. The latest economic indicators suggest that the shock will be important. Japan will thus go into recession this year. Lacking adequate room for manoeuvre on the monetary front, fiscal policy will need to provide support. To this end, the Abe government would be preparing a major stimulus package.

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The shock of the Covid-19 pandemic comes at a time when economic conditions in Japan were already fragile.

Considerable exposure to the pandemic shock

The Japanese economy is exposed to the Covid-19 pandemic shock *via* a number of channels[1]: 1) a fall in tourist numbers, with February bringing the sharpest drop in the number of people visiting Japan since the Fukushima disaster; 2) shortages in supply, particularly of metals, as a result of the collapse in Chinese exports; 3) weakening exports to China – these experienced their 15th consecutive monthly fall in February; 4) a lack of consumer confidence, which had already taken a knock from the increase in VAT in October 2019; and 5) slowdown in the global economy.

As in many countries, the latest economic indicators for Japan now incorporate the pandemic shock to a large extent. In particular, the Purchasing Managers Index (PMI) for March was 35.8, its lowest level since the Fukushima disaster in March/April 2011. The services sector PMI is at a record low of 32.7. The indicator of machine tool orders has also performed very poorly since the beginning of the year.

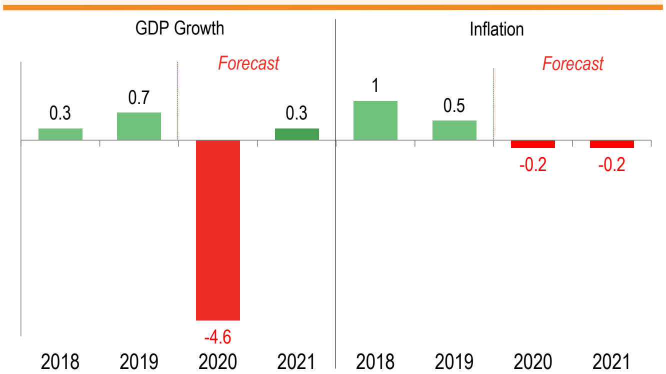
All in all, Japan is therefore likely to go into recession in the early part of this year. Any recovery is unlikely to be particularly robust, given the continued fragilities in the global and national economies. The absence of any clear-cut recovery in tourism and the postponement of the Olympic Games will also hit the Japanese economy.

Support from economic policy, particularly on the fiscal front

The Bank of Japan (BoJ) is fast running out of options in terms of monetary policy. At its last monetary policy meeting it held its policy rate at -0.1%. The authorities are paying very close attention to the effect of negative interest rates on the financial system. The BoJ decided, however, to double the volume of purchases of ETFs (exchange traded funds) and J-REITs (Japan real estate investment funds), to more than USD110 billion.

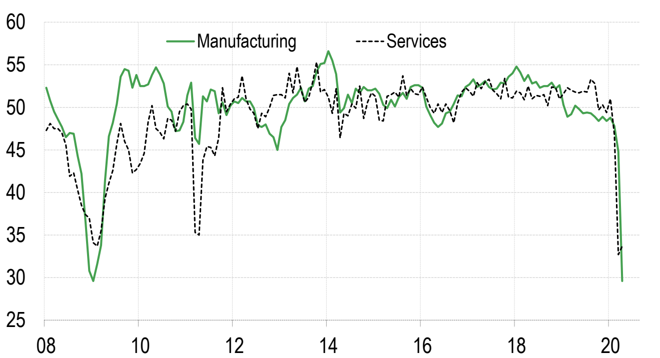
On the fiscal front, there have been a series of programmes since the beginning of the year. These were initially fairly limited in terms of volume, but the March programme was more substantial and

1- Growth and inflation
(Y/Y, %)



Source: BNP Paribas Global Markets

2- PMI index in Japan



Source : Markit

included direct fiscal support (to companies affected and households dealing with the effects of school closures) and assistance in the financing of companies, particularly SMEs. An even bigger programme is now being worked up by the Abe government and is likely to be announced in April. Most notably this is likely to include the distribution of direct aid to consumers, as was previously done in response to the economic crisis of 2009.

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[1] *Covid-19 update 23/03/2020 – Japan,* DG Trésor, 23 March 2020