

THE GOVERNMENT OPENS THE FISCAL FLOODGATES

The victory of the Liberal Democratic Party in the October general election allows prime minister Kishida to implement his policies. In November, he presented an unprecedented fiscal package amounting to some JPY 55.7 trn or 10% of GDP. In 2022, GDP growth could rise to 2.6% after 1.7% in 2021, largely driven by private consumption.

In Q3 2021, the economy contracted by 0.9% on the previous quarter, as supply disruptions seriously hit exports and lockdown restrictions depressed private consumption. The lifting of the state of emergency in October allowed business conditions to improve, in particular in the services sector. In manufacturing, business conditions have remained very severe. Industrial production is hampered by delays in arrivals of components from overseas and the semiconductors shortage. Moreover, profit margins are being squeezed substantially, as manufacturers have difficulties in passing on price hikes for raw materials to their customers. Inflation has remained very tame, mainly due to a sharp cut in mobile phone fees in April 2021, which has deducted 1 percentage point from core inflation. In November, the Tokyo CPI was only 0.5% higher from a year earlier and core prices were even 0.3% lower.

AN UNPRECEDENTED FISCAL STIMULUS

The Liberal Democratic Party won the general election in October, although with a slim majority, allowing prime minister Fumio Kishida to put his policies in place. His priority is to narrow the gap between the rich and the poor, created by the deregulation and structural reforms since the early 2000s, the so-called Abenomics, and exacerbated by the coronavirus pandemic. One measure is to reduce taxes for companies that raise wages. The employers' organisation Keidanren has already rejected calls for across-the-board salary hikes. The second course of action will be to strengthen the incomes of workers in the health and care sector. In addition, the government is committed to achieving carbon neutrality by 2050, although it has not announced yet how to achieve it.

Fiscal prudence is not on the programme. In November, Mr Kishida presented a record breaking single fiscal package amounting to some JPY 55.7 tn or 10% of GDP, of which JPY 36 tn for FY2021. This year the programme will be for JPY 20 tn financed by government bonds (JGBs), thus increasing the the total JGB issuance to JPY 65 tn, unspent budget allocations and the expected increase in tax revenues. The package includes very sizeable handouts to families with children for example, which may help the ruling coalition at next summer's upper house election. The government might remain in campaign mode as local government elections are on the calendar for spring 2023.

The accommodative policy is supported by the Bank of Japan (BoJ), which is buying as many JGBs as necessary to keep the yield on the 10-year JGB at around zero percent. Through its special loan programme, the BoJ has also been supporting lending to businesses affected by the coronavirus. The programme was recently extended to end March 2022. Finally, the BoJ introduced the Climate Response Financing Operations through which it provides funds to banks against investment or loans in green projects.

GROWTH AND INFLATION

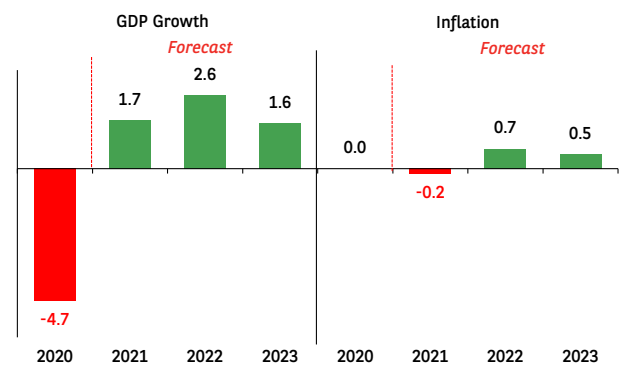


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

ROBUST GROWTH AHEAD

In the coming months, the effects of the Covid-19 will continue to shake the economy, although to a diminishing degree as the vaccination rate increases. In 2022, GDP could attain 2.6%, largely driven by private consumption. Despite the loss in purchasing power due to rising energy prices and poor wage growth, households are likely to draw down from the sizeable savings accumulated during the lockdown period.

The shortage of semiconductors and parts will continue to weigh on industrial production. The fall in profits related to the hike in prices for raw materials and energy is likely to depress business investment and wage growth in the early part of 2022. The summer bonuses are likely to fall further. In the course of the year, as the bottlenecks in manufacturing production will diminish progressively, exports and business investment could gain momentum. In 2023, as private consumption is slowing down, GDP growth is projected to fall to 1.6%, which is still well above Japan's potential growth rate. Core inflation might pick up in 2023, as the output gap closes.

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