

JAPAN

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A VERY GRADUAL NORMALISATION PROCESS

As in other economies across the globe, Japan will report a record-breaking recession in 2020. The path to a full economic recovery will be probably longer because growth would remain very subdued. According to our forecast, Japanese GDP will not return to pre-crisis levels before the end of 2022. Domestic demand remains sluggish due to corporate investment, although household consumption seems to be picking up again. For the moment, Japanese exports are benefiting from China's robust economic rebound. Fiscal policy, the front line of defence, will continue to receive support from the Bank of Japan's monetary policy. There are also talks of a new fiscal package.

BEGINNING TO RETURN TO NORMAL

Faced with the first wave of the pandemic, Japan declared a state of emergency from early April to the end of May 2020, albeit without a legally enforced lockdown. Even so, economic activity plummeted, real GDP contracting by an unprecedented 8.2% in Q2 2020 (q/q, non-annualised). In Q3, GDP rebounded more strongly than expected (up 5% q/q). Consumption regained vigour as consumer confidence picked up, while exports were supported by Japan's main trading partners (led by China) return to growth. In contrast, corporate investment still seems to be weak and will probably remain depressed given the low production capacity utilisation rates and persistently high uncertainty.

The most recent cyclical indicators are sending mixed signals. The Bank of Japan's Tankan index improved very slightly in Q3 2020 but is still holding at a low level, while the composite purchasing managers index (PMI) stagnated in November below the 50 threshold, separating expansion from contraction. After the strong Q3 rebound, GDP growth is expected to slow significantly in Q4, up only 0.6% q/q. The rise in new Covid-19 cases in both Japan and its main trading partners will strain both foreign and domestic demand, especially household consumption. Activity is still expected to be fairly lacklustre in H1 2021 due to uncertainty over the health situation and the labour market. By H2 2021, hopes for the distribution of a vaccine should boost global demand and reduce uncertainty. The yen is expected to appreciate mildly over the course of 2021 (JPY/USD of 98 in Q4 2021 vs. 101 in Q1 2021) and should not have a significant impact on Japanese exports. According to our scenario, Japanese GDP will not return to Q4 2019 levels until our forecast horizon (year-end 2022). Under this environment, inflation will remain low or even negative, and fiscal support will remain strong.

FISCAL POLICY: THE FRONT LINE OF DEFENCE

In the midst of a slow and incomplete recovery, disinflationary pressures will persist. Headline inflation entered negative territory in October 2020 (-0.4% y/y, after 0% in September) and should remain there throughout 2021. Wages will not be very attractive as companies initially seek to restore margins.

Fiscal policy will continue to be the main vector of public support in 2021. A bigger fiscal package is currently being discussed, including subsidies for service sector companies hard hit by social distancing measures and lockdown restrictions, as well as financing for the digital transition. Under this environment, the Bank of Japan's main action will be to maintain its 10-year rate at about 0%. BoJ might also extend its corporate financing support, but we do not expect to see any major changes in monetary policy in 2021, despite low inflation.

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GROWTH AND INFLATION (%)

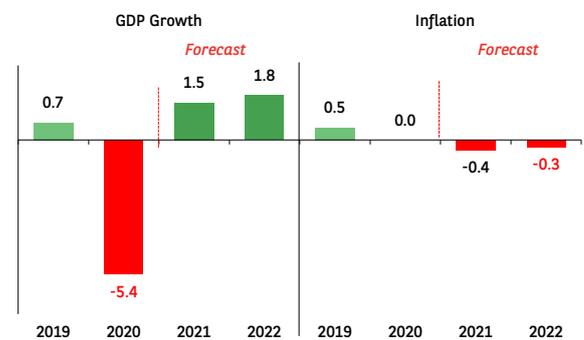


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

EXPORTS (VOLUME, YEAR-ON-YEAR)

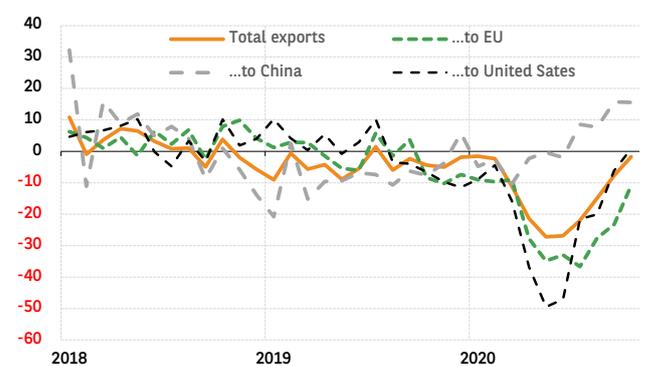


CHART 2

SOURCE: MINISTRY OF FINANCE



BNP PARIBAS

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