

# Japan

## The impact of fiscal stimulus is uncertain

In December 2019, the Japanese authorities decided to launch a major fiscal stimulus for the years ahead. A large part of the programme will target disaster prevention after the country was hit by a series of natural disasters recently. The stimulus will also limit the negative impact of last October's VAT hike, which probably strained private consumption in the year-end period. Buoyed in part by early purchases ahead of the VAT hike, household spending continued at a dynamic pace in Q2 and Q3 2019. The export sector, in contrast, was hard hit by the sluggish global environment. In 2020, public investment is expected to partially offset weak private consumption.

Given the lack of monetary policy leeway – a situation that is unlikely to change by 2021 – Japan has resorted to fiscal policy again. It has launched an ambitious fiscal stimulus plan equivalent to about 2% of GDP<sup>1</sup>, including infrastructure investments to rebuild and protect against natural disasters. Yet the economic impact of this stimulus is still uncertain.

### ■ Sluggish growth in 2020

Although domestic demand – and private demand in particular – was robust in the first 3 quarters of 2019, it is expected to slow sharply in Q4, which would erode momentum in 2020. Household spending are likely to be curtailed by October's VAT hike. Typhoon Hagibis in October would curb corporate investment. Manufacturing output and exports were both severely weakened last year and are unlikely to rebound strongly in 2020. The most recent economic data is still looking downbeat: since May, the Purchasing Managers Index (PMI) in the manufacturing sector has held below 50, the threshold that separates expansion from contraction (48.4 in December). Moreover, the Bank of Japan's Tankan index for the manufacturing sector still hasn't picked up (-4 points in Q4 2019). The non-manufacturing sector also dipped slightly. Two factors to follow closely are China's economic growth, given its heavy weighting in Japanese trade, and the outcome of negotiations to halt the US-China trade tensions.

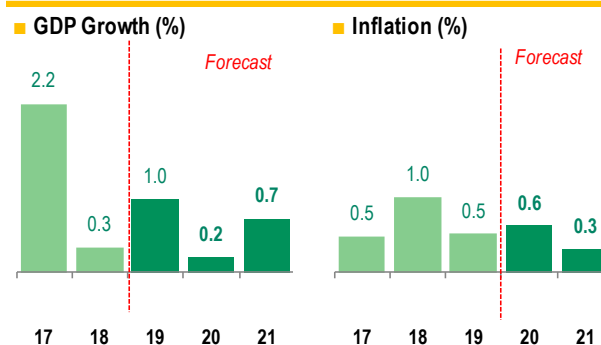
All in all, Japanese economic activity should slow to 0.2% in 2020 (down from 1% in 2019) before converging towards its potential in 2021. Without a significant acceleration in activity, inflationary pressures are likely to remain weak.

### ■ Major fiscal stimulus, but its impact is hard to evaluate

The fiscal stimulus package adopted by the Japanese authorities should limit the negative impact of the VAT increase. Yet, despite its size and apparently favourable structure (public investment will have a big impact on growth in the first year), it risks having only a mild impact on activity.

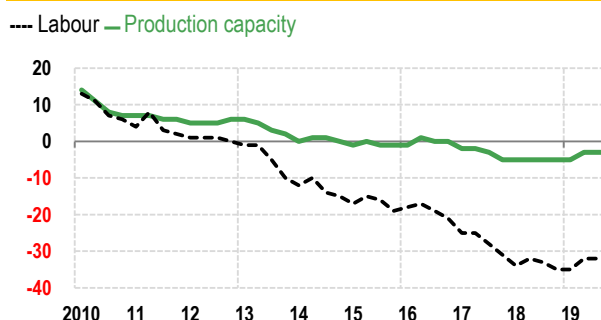
Indeed, it is hard to estimate the impact of a fiscal stimulus (in Japan, it is difficult to distinguish between trends and cyclical patterns), and the related fiscal multipliers are relatively less stable in Japan (the transmission channels for cyclical policies do not

### 1- Growth and inflation



Source: National accounts, BNP Paribas

### 2-Diffusion index (% points)



Source: Bank of Japan

Note: The diffusion index shows the number of companies signalling surplus capacity (or labour) minus those reporting a shortage of capacity (or labour).

seem to be very efficient)<sup>2</sup>. Moreover, certain investment projects may have to be postponed due to labour shortages (see chart 2).

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<sup>1</sup> Part of the budget programme that was presented did not directly concern public demand.

<sup>2</sup> A. Auerbach and Y. Gorodnichenko, *Fiscal multipliers in Japan*, NBER, February 2014