BPI

Japan

Outlook

	Average 10-14	2015	2016	2017	2018	2019	2020	Forecasts 2021	Forecasts 2022
GDP growth (%)	1.6	1.6	0.7	1.7	0.6	0.3	-4.8	3.5	1.3
CPI inflation (%)*	0.4	0.8	-0.1	0.5	1.0	0.5	0.0	0.1	0.1
Fiscal balance (% of GDP)	-8.2	-3.8	-3.7	-3.1	-2.5	-3.3	-14.2(e)	-6.4	-3.2
Public debt (% of GDP)	225.3	231.3	236.4	234.5	236.6	238.0	266.2(e)	264.0	263.0
Reference rate (%)*	0.1	0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0
Exchange rate (JPY/USD)*	90.2	121.1	108.8	112.1	110.5	109.1	106.8	104.8	107.0
Current account balance (% of GDP)	1.7	3.1	4.0	4.2	3.6	3.6	2.9(e)	3.2	3.0
External debt (% of GDP)	52.7	66.1	73.3	72.8	80.1	83.0	91.4(e)	87.4	85.6

Notes: * Annual average. (e) estimation.
Source: BPI Research, based on data from national statistical agencies and IMF.

- **In Japan, the economic shock of COVID-19 came at a time of major weakness**, as the economy was already feeling the negative effects on activity of the VAT hike and the devastating typhoons of late 2019. **However, the impact of the pandemic has been less severe than on other advanced economies** due to: i) a rapid and forceful economic policy response, with a high number of direct spending measures, and ii) a lower incidence of the disease among the Japanese population, which favoured the deployment of looser restrictive measures on activity and mobility than in other countries. Looking ahead, the continuation of significant fiscal and monetary support measures together with the strong recovery in foreign demand and the steady progress of its two main trading partners (China and the United States, which represent 40% of total Japanese exports), will sustain the country's recovery.

- **Real shock of COVID-19.** As with most economies, Japan contracted greatly during Q2 2020 (–8.3% quarter-on-quarter). However, this contraction was not as severe as that of other large advanced economies due to less restrictive containment measures. Also, in the second half of 2020, there was a strong rebound in activity. In the early part of 2021, there could be a slowdown in activity though, given that, due to the increase in outbreaks, the country has reintroduced restrictions in some important regions. However, the new fiscal package approved at the end of 2020 (of more than 70 trillion yen, about 13% of GDP) will support the economy.

- **Economic policy response**
  - **Fiscal policy.** The fiscal response has been decisive. During 2020, three tax packages worth just over 300 trillion yen (more than 50% of GDP as a whole) were approved. These packages contained substantial direct spending measures, such as cheques to citizens and businesses. Also worth mentioning are the measures to support and protect employment, loans, guarantees, subsidies and grants to promote domestic tourism (with the Go To Travel campaign). It should also be noted that the packages go beyond alleviating the economic shock by including measures to favour structural changes, for example, in areas such as digitisation or green transformation.

Closing date of this edition: 10 February 2021

Outlook (continued)

- **Monetary policy.** The Bank of Japan has taken substantial actions since March 2020 to support the economy in the face of the impact of COVID-19. Specifically, it has increased government and corporate bond purchase programmes, has opened different loan schemes for companies and has kept the reference rate at –0.1%. The Bank also announced at the end of December 2020 that it would maintain the pace of purchases and the different schemes until September 2021. A period that could be extended if the country's economic recovery suffers from the outbreaks of early 2021.

- **Macrofinancial imbalances**
  - **Public debt.** The sharp worsening of the fiscal deficit as a result of the pandemic will continue to put pressure on an already substantial public debt (the highest in the world as a percentage of GDP). Some elements, however, significantly affect sovereign risk: its widespread denomination in yen and that it is mostly in domestic hands.
  - **Financial sector**. The low interest rate environment, present for several years now and which will continue with the COVID-19 shock, poses a risk to the profitability of the banking sector. Specifically, and according to the IMF, the taking of greater risks by banks (especially regional ones), insurers and pension funds represents a financial vulnerability. Likewise, the possible increase in NPLs due to the recourse to borrowing during the pandemic adds to this vulnerability.

Main risks

The risk balance is trending downward in the short-term, although there are certain elements that may bring positive surprises in the medium-term.

- **Macrofinancial risk.** Any worsening of the pandemic on the domestic economy could lead to further and greater restrictions on mobility and, consequently, a more notable slowdown in economic activity in the short-term. Likewise, widespread outbreaks or slower progress in the vaccination process in some of its main trading partners (such as the US) would also negatively affect the recovery of the country's foreign demand.
- **Positive risk in automation.** The COVID-19 shock has the potential to accelerate some technology trends, such as automation. This could benefit the Japanese economy in the medium-term, since it is the main producer of industrial robots and is at the forefront of robots in the service sector (an emerging area, but with high potential).

	Rating	Last changed	Outlook	Last changed
STANDARD & POOR'S	A+	16/09/15	Stable	09/06/20
MOODY'S	A1	01/12/14	Stable	24/08/11
FitchRatings	A	27/04/15	Stable	27/04/17

■ Indicates that the country has "investment grade".
□ Indicates that the country does not have "investment grade".