



The Japanese Economy is Facing an Unprecedented Crisis

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Due to the COVID-19 pandemic, the Japanese economy is facing an unprecedented crisis. It is obvious that the economy has declined significantly, although adequate data is not available. To see how sharply the economy has declined, let's look at forecasts of real GDP trends. The ESP Forecast Survey (on May 14, 2020) by the Japan Center for Economic Research (JCER) shows that the average of the annualized real GDP growth rate forecasts of leading economists is -4.6% year-on-year for the January-March quarter of 2020 and -21.3% for the April-June quarter. With a negative real GDP growth rate having been recorded in the October-December quarter of 2019, real GDP growth has been in negative territory for three consecutive quarters.



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A major economic characteristic of the corona shock is that it is the combination of a demand shock, a supply shock and an income shock. Looking at the demand shock, the number of inbound tourists, primarily tourists from China, fell at an early stage. In March 2020, the number of inbound tourists dropped a whopping 93% year-on-year. I am sure that the same decrease will continue from April. The fall in the number of inbound tourists is shown as a decrease in tourist service exports in the GDP. From March, it has been requested that people avoid going out to prevent infection, and consumer spending, including spending on eating out and leisure, should be falling. On April 7, a state of emergency was declared. Consumption should be declining more sharply. The corona shock has caused a large supply shock. In recent years, manufacturers worldwide have been procuring components and parts from diverse sources. Many of the intermediate products of a final product cross borders many times. Global supply chains have been formed, with China at the center. However, production activities in China stopped due to the coronavirus crisis. A supply chain stops if any part of it is disrupted. Exports of intermediate goods from Japanese manufacturers have dropped. Meanwhile, they have not been able to import the intermediate goods that they need. They cannot supply goods although there is demand. The corona shock also involves an income shock. The abovementioned decreases in the number of inbound tourists and consumers' leisure activities as well as falls in business trips, events and parties have led to sharp decreases in sales and income in related industries. Many individuals have experienced a sudden decline in income.

What kind of economic policy should be implemented to handle the difficult challenge of the corona shock? To prevent a decline in the economy, fiscal and monetary pump-priming measures are usually taken. However, it is impossible to stimulate demand or strengthen growth strategies to deal with the corona shock. Demand and supply declined due to the measures to stop the spread of the infection. The infection affects life and death, and measures to stop it have the highest priority. Infectious disease control cannot be loosened to prevent the decline of the economy. As a result, we cannot prevent the abovementioned sharp decline in the economy. We cannot take any action.

Therefore, all we can do is deal with the income shock. If no action is taken to deal with the sudden fall in household income and corporate income, companies will go bankrupt and unemployment will rise. The effect of the temporary shock will persist. Enabling businesses to get bridge financing and compensating individuals for their losses are effective strategies. However, these are financial measures and transfers of income and will not increase GDP.

On April 7, the government responded to those policy requirements, deciding on a 117 trillion yen economic package that is approximately 20% GDP. The scale of the package far exceeds the scale of the April 2009 Lehman shock economic package, which totaled 56.8 trillion yen.

The core of the package is measures to deal with the income shock. Specifically, these include a payment of benefits to small and medium enterprises and sole proprietors, the creation of a financing scheme where effectively zero-interest loans and unsecured loans will be given by private financial institutions, a cash benefit of 100,000 yen paid to each resident and an additional 10,000 yen child allowance.

The measures will result in an increase of 25.7 trillion yen in expenditures in the government's general account, and the financial resource being used is government bonds. In addition, tax revenues will decrease chiefly due to the postponement of tax payments, which will likely increase issued government bonds further. The Japanese government's financial position, which is the worst among advanced nations, will worsen. My understanding is that many economists think that fiscal stimulus measures should be taken only in an emergency, like the Lehman shock and that in normal times, policy management in consideration of financial soundness is desirable. Because the corona shock is worse than the Lehman shock, the high expectations for fiscal stimulus are natural, and as a result, an expansion of the fiscal deficit is unavoidable.

The corona shock will end sooner or later, although we do not know when, and normal times will come. We should discuss now the challenges that need to be addressed in the normal times following the corona shock. I think the key points in the discussion are as follows.

The medium- to long-term fiscal and monetary policy challenges will have to be addressed from square one. Looking at monetary policy, the Abenomics policies have emphasized overcoming deflation since the end of 2012. Since April 2013, the Bank of Japan, under Governor Kuroda Haruhiko, has promoted monetary easing of a "different dimension" and proceeded into uncharted territories, including negative interest rates and yield curve control (YCC). The battle

with deflation will be reset. The abovementioned ESP Forecast Survey shows that the year-on-year increase (excluding the effect of the consumption tax hike) in the consumer price index (overall, excluding fresh foods) is in negative territory again from the January-March quarter of 2020 and is expected to remain in negative territory until the July-September quarter. The strategy for overcoming deflation will have to be reviewed.

The fiscal restructuring will also go back to square one, and the situation will be worse. The government now has two fiscal restructuring targets: bringing the primary balance of the national and local governments into the black by fiscal 2025 and constantly lowering the debt balance to GDP ratio. It has been said that achieving the primary balance target by fiscal 2025 would be difficult even if the primary balance were calculated based on a very optimistic economic outlook. Because of the current shock, expenditures will increase, tax revenues will decrease, and the growth rate will slow significantly. The government will have to address those problems again, from the beginning.

Also it is important is to address the structural problems revealed by the current crisis from a long-term perspective. There are many issues: How to deal with another similar virus if Japan were to be affected again, how to promote remote working, how to implement IT technology in clinical and educational settings, how to review supply chains that depend heavily on China and how to review strategies to revitalize regional economies that have depended heavily on inbound tourists. In the near future, the government, business and private households will be required to separately redesign their futures based on the corona shock.

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Born in 1947. Graduated from the University of Tokyo and joined the Economic Planning Agency (currently the Cabinet Office), Japanese Government. Served as Director of the first Domestic Research Division of the Research Bureau, Councillor for the General Planning Bureau, President of the Economic Research Institute of the Agency, Director General of the Price Policy Bureau, Research Bureau at the Agency and Director General of the National and Regional Planning Bureau at the Ministry of Land, Infrastructure, Transport and Tourism. Has served as Professor at Hosei University since 2003. His publications include *Nihon keizairon kogi* (Discourse on the Japanese Economy), *Heisei no Keizai* (Japanese economy in Heisei era; won the Yomiuri-Yoshino Sakuzo Prize) and *Jinko fuka-shakai* (Population onus society).