Coronavirus Hits Japanese Economy: An unprecedented composite crisis halting demand, supply and income

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The economic shock sparked by the COVID-19 coronavirus appears to be unprecedented in terms of its magnitude and the level of difficulty in addressing it. At the time of writing, early April 2020, the crisis is ongoing and the situation is changing from moment to moment. The whole picture is as of yet unknown. The following discusses the challenges that lie ahead of the Japanese economy based on the information that is available so far.

An abrupt change in circumstances and a colossal dive

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The coronavirus crisis has several unique characteristics. The first is the speed of the deterioration of economic conditions. As discussed below, the Japanese economy is facing the impact of multiple negative factors. This totally changed many people's perception of the economy.

For example, the economic view of the Japanese national government stated in the Monthly Economic Report that it had seen the Japanese economy "recovering at a moderate pace" while conceding some negative factors since July 2013. However, the report published in March 2020 reads: "[The Japanese economy is] in severe situation, extremely depressed by the Novel Coronavirus." The economy had been considered to be in the process of recovery, and it is now regarded as fairly poor.

The economic outlooks of private sector economists quickly turned negative. The monthly survey on the outlook of Japan's economy, the *ESP Forecast* published by the Japan Center for Economic Research (JCER) is a monthly questionnaire survey on the economic outlook of leading economists in the private sector. This survey includes a question asking the subjects whether or not they think that the economy has already passed its peak. The latest economic turning point was the bottom of recession in November 2012. Those economists who answer yes to this question think that the economy is now in the deceleration phase. The results show that until February 2020, between 8 (17%) and 13 (38%) of all respondents answered yes, while 29 respondents (88%) answered yes in March. This demonstrates that the spread of COVID-19 suddenly worsened both government officials' and private sector players' confidence in the economy.

The second characteristic is the very large size of the economic drop. Its overall picture is still unknown since the economic data is not yet fully available, but it will undoubtedly be the biggest dip since World War II. We surely face an appalling economic situation the likes of which we have never seen.

The scale of decline may be estimated from the trend in real gross domestic product (GDP) figures. On April 7, the Japanese government declared a state of emergency in Tokyo and six other prefectures and decided to implement its Emergency Economic Measures for Response to COVID-19. In the wake of this, JCER carried out an additional survey, *Special Survey: Updated Outlook Reflecting the Declaration of a State of Emergency and Economic Measures*. Its results announced on April 9 revealed that the average forecast real year-on-year GDP growth rate stood at -4.1% for the January-March period and at -11.1% for the April-June period. These projected figures already suggest a huge plunge, but the reality is more dreadful. The GDP growth rate had become a large negative figure for the October-December 2019 period as a result of a reactionary decline from a rush of consumption before the consumption tax rate increase from 8% to 10% in the preceding quarter, specifically in the July-September period. In other words, the big GDP slide in the October-December period reflected a reactionary decline. For two subsequent consecutive quarters, GDP growth has remained negative. This plunge is indeed beyond expectations. This crisis has yet more unique traits.

Compound damage to demand, supply and income

The third characteristic of the coronavirus crisis is that this is a composite crisis, consisting of a demand crisis, a supply crisis and an income crisis.

There are several types of external crises that can significantly impact the economic performance of a country. One is a demand crisis. The 2008 financial crisis characterized by the collapse of Lehman Brothers caused minor damage to the Japanese financial sector. However, it slowed the global economy and led to a massive decrease in exports. Japan suffered negative economic growth for two consecutive years in 2008 and 2009, due to the sudden decrease in export demand, and in this sense, it was a typical demand crisis.

The ongoing coronavirus crisis has aspects of a demand crisis. Specifically, overseas tourism to Japan, mainly from China, decreased at an early stage of the outbreak. The number of foreign visitors to Japan in the January-March quarter of 2020 dropped by as much as 51.1% year on year, and Chinese visitors by 52.9%. The figures in April and later will show a greater dip, although the statistics have yet to be announced. The decrease of tourists to Japan is expressed in the form of a decrease in tourism service exports in the context of the GDP. In addition, in and after March, the general public started to avoid going out to prevent infection. Consumer spending on eating out and recreational activities must have fallen significantly. The state of emergency which began on April 7 should have resulted in an even sharper decline in spending.

Another type of crisis is a supply crisis. Examples include the two oil crises in 1973 and 1979. The oil import price surged four times during the first crisis and doubled in the second. Oil is likened to the blood of the economy. High oil price hikes resulted in high prices for many products. That impaired profitability and slowed production activities. The oil crises were typical supply crises, given that they suddenly brought about factors increasing costs on the supply side.

The coronavirus crisis stands out as a supply crisis as well. In recent years, manufacturers around the world have been diversifying their procurement of materials and components. To finish one product, numerous intermediate goods move across national borders several times. This is what we know as a global supply chain, and China stands at their heart. However, production activities in this country were brought to a halt by the coronavirus outbreak. The entire supply chain ceases to function if any single link is broken. The Japanese manufacturing industry is not only suffering a decline of intermediate goods exports. It has also become unable to import necessary intermediate goods and is therefore unable to supply products even though there is demand.

What is more, one other characteristic of the coronavirus crisis is that it is an income crisis. This is its most significant characteristic. As mentioned earlier, the number of tourists to Japan fell and so did consumers' recreational activities. Furthermore, business trips, events and parties have been cancelled. Sales and corporate income plummeted in the related industries. Individuals have suffered sudden, massive losses of income as a result of decreasing opportunities to work part-time, non-renewals of fixed-term employment contracts and the like.

And finally, the fourth characteristic of the crisis is that it has arisen from the response to the COVID-19 outbreak. This part of the crisis is closely linked to the policy response discussed below.

Constraints on policy response

How should economic policies address this tough national challenge brought about by the coronavirus crisis? In normal times, fiscal and financial measures aimed at stimulating demand would be required to address a demand crisis. In this event, the supply-demand gap is often used as a key indicator. This represents the difference between actual demand in the economy and the potential supply capacity. A positive value means a short supply situation where demand exceeds supply. A negative value means that demand is below supply and that there is excess supply. Estimated by the Cabinet Office, Japan's supply-demand gap had been slightly positive since 2017 until it suddenly fell from +0.5% for the July-September 2019 period to -1.5% for the October-September period of the same year. In consideration of the expected future slide of the GDP, the supply-demand gap will be far below zero. A member of the Council on Economic and Fiscal Policy from the private sector remarked in materials submitted to the Council on March

31 that the supply-demand gap in the January-March quarter may widen to around 20 trillion yen and it is feared to be even wider in April and later months. This forecast will undoubtedly, rather than perhaps or possibly, turn out to be true.

To address a supply crisis, it is necessary to implement a so-called growth strategy that boosts the basic potential of the economy for growth, given that it is difficult to recover supply capacity quickly.

However, in the coronavirus crisis, it is not possible to stimulate demand or to step up a growth strategy. Basically, the level of supply and demand is lowered to stop the spread of COVID-19. It is a matter of human life or death which is of course given a very high priority. The COVID-19 countermeasures cannot be eased to stop the economy from falling. While the threat of COVID-19 lingers, it is impossible to increase public investment, to reduce taxes to stimulate consumption or to reduce interest rates (although there is little room to do so) to encourage corporate investment. The stimulation of economic activity could increase the spread of COVID-19. This crisis leads us to a rather shocking conclusion that we cannot do anything except sit still and let the economy fall into a severe recession at an unprecedented pace. We are unable to do anything to stop it.

The thing that still remains possible to do is tackling the income crisis. If the government took no action to address the unexpected income decline that hit households and business operators, businesses would collapse and the number of jobless workers would increase. This situation would not end quickly, but become enduring. Making bridge loans more accessible to business operators and covering the loss of income of individuals are effective strategies. However, these measures are mere financial actions redistributing income. They do not help raise the GDP.

Assessing the governmental emergency economic measures

In response to this policy demand, the Japanese government decided to implement Emergency Economic Measures on April 7. There has been a lot of debate already about these measures. It would be possible to discuss the value of the measures endlessly, but I appreciate their basic direction. Since the measures have already been determined and I believe that their basic direction is appropriate, I hope that they proceed smoothly and speedily. Honestly, I do not feel like quibbling over governmental measures at this time of emergency. The following presents my principal personal viewpoints in assessing the measures.

The first is an evaluation of the scale of the measures. They have a total size of nearly 117 trillion yen, after revisions on April 20. This is equivalent to around 20% of Japan's GDP. They are far larger than those during the 2008 financial crisis, which amounted to 56.8 trillion yen and were implemented in April 2009, and they are far beyond many people's expectations. From the point of view of a specialist, this striking figure of the scale is actually a mixture of measures backed by actual governmental spending (which is commonly dubbed *mamizu*, meaning pure water, in Japanese) and other measures with various characteristics, such as cash benefits, grace periods for tax and insurance premium payments and bridge loans. The total figure itself has little significance. But in reality, this figure representing the scale of measures is highly publicized by the media as a symbolic figure of the package. I suppose that the government emphasized the scale in a bid to gain public confidence by demonstrating its stance of making a considerably sized effort. In this respect, I think that the 117 trillion yen size of the measures is creditworthy.

The second viewpoint is the details of the measures. In this respect, they can be rated as appropriate for addressing the income crisis. They specifically include cash grants for medium- and small-sized enterprises and self-employed individuals, the creation of a program for loans from private financial institutions with virtually no interest and no collateral required, and addition of 10,000 yen child allowance. At the beginning, the government announced a cash payment of 300,000 yen per household suffering an income decrease but later changed its policy into a cash grant of 100,000 yen to every registered resident in Japan. I hope that it will be smoothly and swiftly paid out.

On the other hand, I cast doubt on the inclusion of support measures for tourism business operators, restaurants and other businesses to effect a V-shaped economic recovery after the end of the COVID-19 pandemic. Demand for recreational activities and eating out at restaurants did actually shrink, but it is not because of a decline in consumer confidence, but because of the measures to combat COVID-19. Consumers are rather eager to go out if the situation permits. This so-called pent-up demand must be mounting. Even without policy support, consumer spending will surely rally swiftly after the end of the COVID-19 pandemic.

The third viewpoint is on fiscal actions, such as budgetary expenditures and taxation. Fiscal spending increased around 48.4 trillion yen, after revisions on April 20. This figure includes the amount for measures that have already been determined and a newly added 38.1 trillion yen. The national general account will cover 25.7 trillion yen of that, funded by government bonds. In addition, delayed tax payments mean that tax revenue will fall. More government bonds will be issued. Japan's financial standing, which was already the worst among all developed countries before the coronavirus pandemic, will be even worse. In this respect, it is my speculation that many economists thought that fiscal actions should only be allowed in an emergency like the 2008 financial crisis, and that policy management with a focus on fiscal health would be desired in normal times. Given that the current crisis is more severe than the 2008 financial crisis, it is natural to expect fiscal actions to be taken and there is no helping the resulting expansion of the fiscal deficit.

In the event of this crisis, there was discussion, not only among opposition parties but also within the ruling Liberal Democratic Party, that the consumption tax rate should be lowered or temporarily suspended to help increase household income. While it was not introduced in the recent Emergency Economic Measures, I believe that the proposed measure is reasonable and appropriate. Many economists' remarks against the introduction of the reduced tax rate apply as they are to the lowering of the consumption tax rate. In other words, people with higher income spend more and therefore pay more consumption tax. Lowering the consumption tax rate would be more beneficial to those with higher income. The government replaced its initial plan of offering 300,000 yen to households with decreased income with a new plan offering 100,000 yen to every registered resident in Japan, without an income limit. At a glance, the new plan appears to be unfair since it gives money to people with high income. However, it is much fairer in terms of a redistribution of income than the reduction or abolition of the consumption tax. Of course, the best solution is to give financial support to those with difficulties with pinpoint precision, but this method of offering money uniformly is acceptable as a second-best action given that it is difficult and time consuming to identify the people who would be eligible.

Contemplating economy and society after the coronavirus crisis

The above section discussed the challenges facing the Japanese economy. The arguments are inevitably based on a short-term perspective. However, the coronavirus crisis will come to an end someday and peace will return, although it is unknown when. We will need to discuss the issues to be addressed in the coming peace. They seem to include the following.

First, Japan will be forced back to the beginning of its efforts to address the medium- and long-term challenges in its fiscal and economic policy. In its economy, the government had oriented itself towards a departure from the control of deflation that had occurred under the Abenomics policy since the end of 2012. The Bank of Japan started an unconventional monetary easing policy under its governor Kuroda Haruhiko in April 2013. It stepped into unexplored areas, such as negative interest rates and yield curve control. However, the coronavirus crisis resets the progress in this fight against deflation to nothing. According to the aforementioned Special Survey of the *ESP Forecast*, the year-on-year percent change in consumer price index (CPI) of all items less fresh food, excluding the impact of the consumption tax hike, was positive until the October-December 2019 quarter, and fell below zero in the January-March 2020 quarter. For the quarters of April-June and July-September 2020, it is forecast to be -0.8%. Prices have returned to their downward trend. The strategy for halting the deflation will need to be reconsidered.

Fiscal reconstruction efforts will restart under harsher conditions. At the moment, the Japanese government has two goals. One is to achieve a primary balance (PB) surplus of the central and local governments in FY2025, and the other is a stable decrease of the government debt to GDP ratio. Even an estimate based on a fairly optimistic economic outlook suggests that the first goal will be difficult to meet in FY2025. According to the estimate of the Cabinet Office, there will be a PB deficit of 0.5% of the GDP in FY2025, even if growth is attained. The coronavirus crisis will result in a larger budgetary expenditure, a smaller tax revenue and much slower current economic growth. All the prior efforts must be done again.

Second, Japan will need to tackle the structural problems that have been brought to the fore by the coronavirus crisis. The large number of events after the crisis will be a mixture of temporary, or short-term, ones and structural, or long-term, ones.

In the future, we will identify from among the different phenomena we are currently facing those which highlight structural problems and seek solutions to them. Connected to this, there are many questions, such as what actions should be taken to respond to a similar virus if one were to hit Japan in the future, how should we increase the prevalence of remote work, how should information technologies be implemented in medicine and in education and how should we change the supply chains that are highly dependent on China. I am thinking of intensively exploring these issues. In the near future, governments, businesses and households will each be urged to redesign their courses of action on the basis of experience gained in the coronavirus crisis.

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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).
