

【NEWS RELEASE】

May 21, 2020
SMBC Nikko Securities Inc.

Quarterly Economic Outlook for FY2020-2021

May 21, 2020 (JST), “SMBC NIKKO Japan Economic Outlook for FY2020-2021” has been released, responding to the first preliminary of GDP (January-March 2020 period).

Post-lockdown Japan and Risk of 2nd Wave

- ◆ Real GDP: FY20 -4.4%, FY21 +3.3%
- ◆ Nominal GDP: FY20 -4.7%, FY21 +3.8%

Summary**• GDP growth outlook**

We revise our outlook to reflect the first preliminary Jan-Mar 2020 GDP data. We forecast real GDP growth of -4.4% YoY in FY20 and +3.3% in FY21, down 4.6ppt for FY20 and up 1.9ppt for FY21 from our previous estimates (as of 10 March), reflecting restrictions on economic activity prompted by Covid-19.

• Economic overview

Japan is in a recession after real GDP growth for Jan-Mar 2020 was -3.4% QoQ annualized, the 2nd straight quarter of negative growth after -7.3% in Oct-Dec 2019 owing to the consumption tax hike and super-typhoon. The Jan-Mar contraction largely reflected the plunge in exports after Europe and North America locked down to contain the coronavirus. Private consumption in Japan did fall, but this was minor compared to exports. Japan declared a state of emergency in Apr and asked people to stay at home as much as possible, so we expect this will show up as a full-on drop in consumption from now. Still, the number of new Covid-19 cases has dropped sharply since Apr, suggesting the virus is tapering off. We expect the SOE will be lifted by end-May.

- **Economic outlook**

Once the SOE is lifted we expect Japan's economy to ease back to normal and get on a recovery track.

Private consumption: We estimate non-essential consumption is worth about Y5.2tn in a single month. It declined by just Y1tn in Jan-Mar, but if it falls to zero in Apr-June we would expect the decline in private consumption to halt there. However, if job losses and lower bonuses lead to lower incomes, it could dampen any rebound in consumption. In this connection, we note that while employee income is likely to fall by Y9.9tn in FY20, the government plans cash payouts of Y100,000 per resident, for a total amount of Y12.9tn. The decline in income and government cash payouts should net out to a Y3tn rise in aggregate personal income. We therefore think a collapse in incomes is unlikely.

Capex: Companies have put off a lot of capital investment, first in Oct-Dec 2019 owing to the super-typhoon and in Jan-Mar owing to Covid-19, so pent-up demand has built up significantly. Once the state of emergency is lifted this pent-up demand should emerge, fueling a rebound in capex. The risk is a credit crunch, which could result in a sharp decline in investment like that seen during the Lehman crisis. We note SMEs have ample retained earnings, while the government is providing guarantees on SME loans as well as no-interest, long-term loans. We currently see little risk of a credit crunch.

Exports: The plunge in exports reflects a global economic contraction, but the downturn has been particularly bad in Europe and North America owing to lockdowns there to contain Covid-19. That said, the number of new cases in Europe seems to be tapering off, and even declining modestly in the US. Some cities have already begun lifting restrictions on economic activity, so we expect Apr-June could prove to be a bottom for Western economies as well. Therefore we expect Japanese exports to rebound from a bottom in Apr-June.

- **Risk of post-lockdown 2nd wave**

Lifting curbs on activity could spur both economic recovery as well as a reemergence of the virus.

However, we think the risk of a 2nd wave of the virus is low in Japan, given that 1) the effective reproduction number was below 1 before the SOE was announced, indicating virus infectivity had already weakened, 2) the strain of the virus in Japan and the rest of Asia seems to be less virulent than stronger strains in Europe and North America, and 3) new clusters tend to emerge at hospitals/care homes and nightlife establishments, which suggests targeted countermeasures can be taken. We think it should be possible to resume activity in most areas of the economy other than those at risk of generating new clusters.

We expect Japan to lift its SOE by end-May and achieve a recovery ahead of developed-world peers.

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Quarterly forecasts for Japanese economy

	2019				2020				2021				2022	FY19 FY20 FY21			Comparison with previous forecasts (as at 10 Mar 2020)		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	(A)	(F)	(F)	FY20	FY21	
Real GDP growth (QoQ)	0.6	0.5	0.0	-1.9	-0.9	-3.6	0.7	-0.1	0.8	1.0	1.0	1.0	1.0						
(annual rate)	2.6	2.1	0.0	-7.3	-3.4	-13.6	2.9	-0.4	3.4	4.1	3.9	4.0	4.0						
Domestic demand, contribution (QoQ)	0.1	0.8	0.2	-2.4	-0.7	-2.7	0.7	0.1	0.6	0.7	0.8	0.8	0.8						
Private consumption (QoQ)	0.1	0.5	0.4	-2.9	-0.7	-3.9	1.0	-0.5	0.8	1.0	1.0	1.0	1.0						
Capex (QoQ)	1.5	-0.3	1.2	-2.5	-4.5	-3.1	0.0	0.8	1.0	0.8	0.8	0.8	0.8						
Residential investment (QoQ)	-0.5	0.9	0.2	-4.8	-0.5	-2.0	0.8	1.5	0.7	0.5	0.8	1.0	1.0						
Public investment (QoQ)	2.3	1.7	1.0	0.5	-0.4	-1.0	0.0	1.0	0.9	0.6	0.2	0.1	-0.2						
Foreign demand, contribution (QoQ)	0.5	-0.3	-0.2	0.5	-0.2	-0.9	0.0	-0.2	0.2	0.3	0.2	0.2	0.2						
Exports (QoQ)	-1.8	0.2	-0.6	0.4	-6.0	-8.5	-1.0	0.0	2.5	2.6	2.0	2.0	2.0						
Imports (QoQ)	-4.5	1.8	0.7	-2.4	-4.9	-3.2	-1.0	1.0	1.2	0.9	0.8	0.8	0.8						
Nominal GDP growth (QoQ)	1.1	0.6	0.4	-1.5	-0.8	-4.4	0.9	0.2	0.7	1.2	1.1	1.1	1.1						
Industrial production (QoQ)	-2.1	0.0	-1.1	-3.7	0.4	-4.0	-2.0	1.0	1.0	0.5	0.0	1.0	1.0						
Trade balance (Y tn, SAAR)	-2.0	-2.7	-1.3	2.7	2.7	-3.7	3.5	1.8	1.1	0.8	0.0	-0.7	-0.5						
Unemployment rate (%)	2.5	2.4	2.3	2.3	2.4	2.5	2.7	3.3	3.3	3.1	2.9	2.8	2.7						
Core CPI (YoY)	0.8	0.8	0.5	0.6	0.6	0.0	-0.1	-0.7	-0.8	-0.4	-0.2	0.1	0.3						
(Ex effects of consumption tax hike)	0.8	0.8	0.5	-0.4	-0.4	-1.0	-1.1	-0.7	-0.8	-0.4	-0.2	0.1	0.3						
IOER (Eop)	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1						
YCC 10y JGB yields target (Eop)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0						
US real GDP growth (QoQ annualized)	3.1	2.0	2.1	2.1	-4.8	-30.0	15.0	8.0	5.0	4.2	3.6	3.0	2.0						
US unemployment rate (%)	3.9	3.6	3.6	3.5	3.8	16.0	13.0	10.0	9.0	8.0	7.0	6.0	5.0						
US core CPI (YoY)	2.1	2.1	2.3	2.3	2.2	0.4	0.4	0.3	0.8	1.9	2.0	2.0	2.1						
Fed rate (Eop)	2.375	2.375	1.875	1.625	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125						

Assumptions: Forex rate (annual mean): Y107.9/\$ in FY20 and Y108.0/\$ in FY21

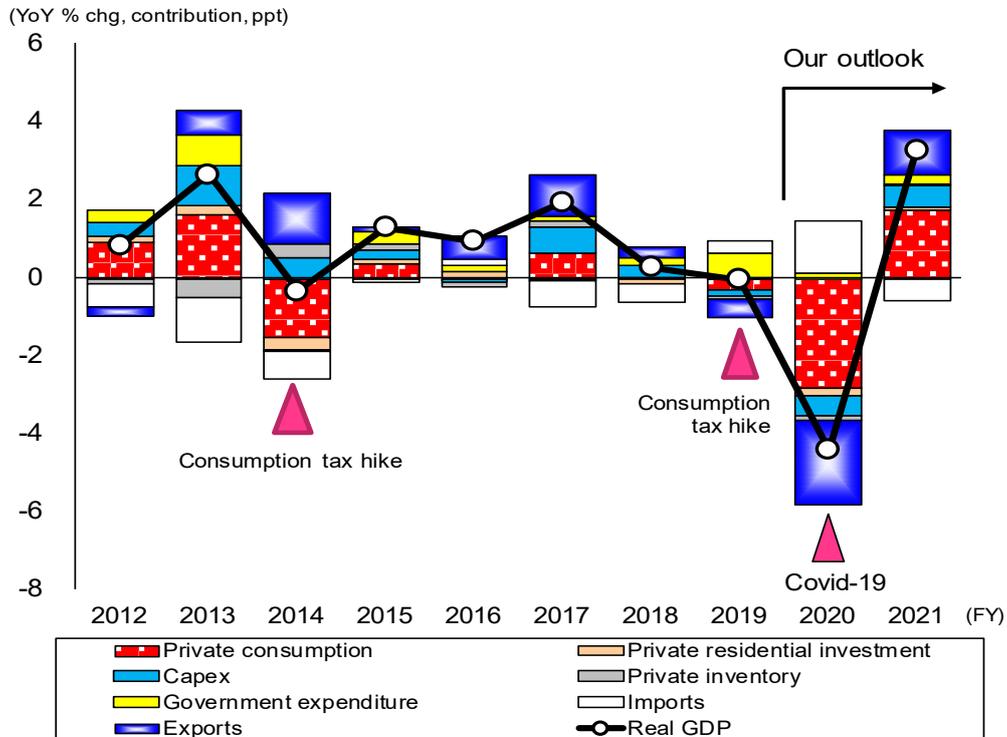
Crude oil price (WTI annual mean): \$31.2/bbl in FY20 and \$51.2/bbl in FY21.

Notes: 1) US GDP on a calendar basis, US unemployment rate is the average for the period, FF rate is at end of year.

2) Actual figures from Cabinet Office (CAO), Ministry of Internal Affairs and Communications (MIC), Ministry of Economy, Trade and Industry (METI), and Bank of Japan (BOJ). Forecasts by SMBC NIKKO.

Sources: CAO, MIC, METI, BOJ, SMBC NIKKO estimates

Outlook for real GDP growth



Sources: CAO, SMBC NIKKO estimates

APPENDIX

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