

【NEWS RELEASE】

February 18, 2021
SMBC Nikko Securities Inc.

Quarterly Economic Outlook for FY2020-2022

February 18, 2021(JST), “SMBC NIKKO Japan Economic Outlook for FY2020-2022” has been released, responding to the second preliminary of GDP (October-December 2020 period)

CV19 to Subside, Excess Savings to Fuel Pent-up Consumption

- ◆ Real GDP: FY20 -4.6%, FY21 +3.7%, FY22 +1.7%
- ◆ Nominal GDP: FY20 -3.9%, FY21 +4.0%, FY22 +2.3%

Summary• **GDP growth outlook**

We revise our outlook to reflect the first preliminary Oct-Dec 2020 GDP data. We forecast real GDP growth of -4.6% YoY in FY20, +3.7% in FY21, and +1.7% in FY22, up 0.7ppt for FY20 and 0.1ppt for FY21 from our previous estimates (as of 8 Dec 2020). We reflect stronger-than-expected exports and capex, and the likelihood that this strength will continue as the pandemic is subdued in Japan and overseas.

- **Economic outlook**

Oct-Dec real GDP grew 12.7% QoQ annualized, so GDP has recovered 87.4% of the decline.

Private consumption slumped hardest amid the pandemic. Households reduced spending by around Y12tn, and the Y13tn in cash handouts went essentially unused, so savings have increased by Y25tn. This build-up of savings is the result of consumption being put off—demand has been pushed into the future. The more people put off consumption now, the bigger the future upside for consumption and the economy, so there is no need to worry that much about the economic outlook. This is likely why stocks have not corrected amid the pandemic.

It will be necessary to bring the pandemic under control for excess savings to be drawn down and for this potential consumption to be realized, and new Covid-19 case numbers are indeed declining sharply at present. This trend is similar to the pattern for influenza in typical years, and it is possible that the pandemic will subside without further spikes. In addition, the Japanese government commenced vaccinations from 17 February, and it is possible that all Japan residents aged 16 and over will have received two doses of vaccine by end-October if all goes smoothly. In addition, we see potential for herd immunity to be reached as early as Jun-Jul.

In addition to a recovery in private consumption as the pandemic is subdued, we see potential for a recovery in the durable goods cycle. Replacement demand accounts for the vast majority of demand in countries like Japan where penetration rates for durable goods are high. However, this replacement stalled in 2020 amid the pandemic, so replacement demand was put off. This means that demand may continue to run at high levels even with just a return to the pre-pandemic trend due to a top-up from unfulfilled replacement demand.

Based on the above, we forecast that the Japanese economy normalizes in 2021 on 1) containment of the pandemic, 2) the start of vaccinations and achievement of herd immunity by year-end, 3) drawdown of excess savings and release of pent-up consumption, and 4) a recovery in durable goods demand. We forecast that GDP returns to the pre-pandemic level in Jan-Mar 2022.

- **Risks**

The main upside risk is additional economic stimulus. Japan has three major elections looming in 2021, and the Suga administration is likely to roll out additional economic measures ahead of the elections given slumping approval ratings. We would see potential for upside to the economic outlook if the government rolls out a package on a similar scale to the last three (Y20-30tn = 5-6% of GDP) at the same time as the private-sector economy normalizes.

The main downside risk is increases in US long-term interest rates. Congress is currently deliberating over the Biden administration's \$1.9tn additional stimulus, and if approved, the 2021 budget deficit would be on track to reach 18% of GDP, even larger than 2020. Long-term interest rates could well rise if the US government runs an 18% deficit versus GDP at the same time as private consumption normalizes and savings decline.

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Quarterly forecasts for Japanese economy

| | 2020 | | | | 2021 | | | | 2022 | | | | 2023 | (Unit:%) | | | | Comparison with previous forecasts (as at 8 Dec 2020) | |
|--------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|----------|-------|-------|-------|-------------------------------------------------------|------|
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | FY19 | FY20 | FY21 | FY22 | FY20 | FY21 |
| Real GDP growth (QoQ) | -0.6 | -8.3 | 5.3 | 3.0 | -0.6 | 0.7 | 0.5 | 0.3 | 0.5 | 0.5 | 0.3 | 0.3 | 0.3 | -0.3 | -4.6 | 3.7 | 1.7 | 0.7 | 0.1 |
| (annual rate) | -2.2 | -29.3 | 22.7 | 12.7 | -2.3 | 2.7 | 2.0 | 1.3 | 2.1 | 2.0 | 1.3 | 1.2 | 1.1 | -0.3 | -4.6 | 3.7 | 1.7 | 0.2 | 0.1 |
| Domestic demand, contribution (QoQ) | -0.2 | -5.2 | 2.6 | 2.0 | -0.4 | 0.7 | 0.5 | 0.5 | 0.6 | 0.6 | 0.4 | 0.4 | 0.4 | -0.1 | -3.8 | 3.8 | 1.7 | -0.5 | -1.5 |
| Private consumption (QoQ) | -0.6 | -8.4 | 5.1 | 2.2 | -1.0 | 0.8 | 0.8 | 1.0 | 1.0 | 1.0 | 0.5 | 0.5 | 0.5 | -1.0 | -5.9 | 3.7 | 3.2 | 0.5 | 2.1 |
| Capex (QoQ) | -3.7 | 0.5 | -5.7 | 0.1 | 0.0 | 1.0 | 1.5 | 1.0 | 1.0 | 0.8 | 0.0 | -1.0 | -1.5 | 2.5 | -7.4 | 1.4 | 1.5 | 2.3 | 2.7 |
| Residential investment (QoQ) | 1.4 | -5.9 | -2.4 | 4.5 | 0.5 | 1.0 | 0.7 | 1.0 | 0.8 | 0.8 | 0.5 | 0.5 | 0.5 | -0.6 | -6.3 | 4.3 | 2.9 | 0.7 | -0.1 |
| Public investment (QoQ) | 0.1 | 2.2 | 0.9 | 1.3 | 0.8 | 0.6 | 0.2 | -0.2 | -1.2 | -0.7 | -0.7 | -0.7 | -0.7 | 1.5 | 4.6 | 1.9 | -2.7 | 0.4 | 0.1 |
| Foreign demand, contribution (QoQ) | -0.4 | -3.1 | 2.6 | 1.0 | -0.2 | 0.0 | 0.0 | -0.2 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.2 | -0.9 | -0.1 | 0.0 | 2.4 | -2.3 |
| Exports (QoQ) | -5.3 | -17.2 | 7.4 | 11.1 | 2.0 | 2.0 | 2.0 | 1.0 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | -2.6 | -10.9 | 13.1 | 2.6 | 0.0 | -5.0 |
| Imports (QoQ) | -3.1 | 1.3 | -8.2 | 4.1 | 3.0 | 2.0 | 2.0 | 2.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | -1.3 | -5.9 | 7.0 | 4.8 | 0.5 | -1.3 |
| Nominal GDP growth (QoQ) | -0.5 | -8.0 | 5.5 | 2.5 | -0.4 | 0.8 | 0.7 | 0.5 | 0.7 | 0.7 | 0.5 | 0.4 | 0.4 | 0.5 | -3.9 | 4.0 | 2.3 | 1.5 | -0.1 |
| Industrial production (YoY) | -4.3 | -20.5 | -12.6 | -3.5 | -2.9 | 17.4 | 8.5 | 3.0 | 4.6 | 4.0 | 3.5 | 3.0 | 2.0 | -3.6 | -10.0 | 8.0 | 3.1 | 1.8 | 8.0 |
| Trade balance (Y tn, SAAR) | -0.4 | -6.7 | 3.9 | 5.6 | 5.3 | 5.3 | 5.3 | 4.3 | 3.7 | 5.2 | 4.6 | 4.0 | 3.3 | -1.1 | 2.0 | 4.7 | 4.3 | -0.1 | 0.0 |
| Unemployment rate (%) | 2.4 | 2.8 | 3.0 | 3.0 | 3.0 | 2.9 | 2.8 | 2.7 | 2.7 | 2.6 | 2.6 | 2.5 | 2.5 | 2.4 | 2.9 | 2.8 | 2.5 | 0.0 | 0.0 |
| Core CPI (YoY) | 0.6 | 0.1 | -0.2 | -0.9 | -0.8 | -0.6 | -0.2 | 0.1 | 0.3 | 0.5 | 0.6 | 0.8 | 0.9 | 0.6 | -0.4 | -0.1 | 0.7 | 0.0 | 0.0 |
| (Ex effects of consumption tax hike) | -0.4 | -0.9 | -1.2 | -0.9 | -0.8 | -0.6 | -0.2 | 0.1 | 0.3 | 0.5 | 0.6 | 0.8 | 0.9 | 0.4 | -0.9 | -0.1 | 0.7 | 0.0 | 0.0 |
| 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 | -0.1 | -0.1 | -0.1 | -0.1 | 0.0 | 0.0 |
| 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 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| US real GDP growth (QoQ annualized) | -5.0 | -31.4 | 33.4 | 4.0 | 3.2 | 5.3 | 5.5 | 4.3 | 3.1 | 2.8 | 2.5 | 2.5 | 2.5 | 2.2 | -3.5 | 4.7 | 3.6 | 0.0 | 0.7 |
| US unemployment rate (%) | 3.8 | 13.0 | 8.8 | 6.7 | 6.3 | 6.3 | 6.1 | 5.7 | 5.4 | 5.3 | 5.2 | 5.1 | 5.0 | 3.7 | 8.1 | 6.1 | 5.3 | -0.7 | 0.2 |
| US core CPI (YoY) | 2.2 | 1.3 | 1.7 | 1.6 | 1.4 | 1.5 | 1.6 | 1.6 | 1.7 | 1.7 | 1.8 | 1.8 | 1.8 | 2.2 | 1.7 | 1.5 | 1.8 | 0.1 | -0.2 |
| Fed rate (Eop) | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 | 0.375 | 0.375 | 0.625 | 0.125 | 0.125 | 0.125 | 0.375 | 0.00 | 0.00 |

Assumptions: Forex rate (annual mean): Y106.5/\$ in FY20, Y106.0/\$ in FY21 and Y108.0/\$ in FY22

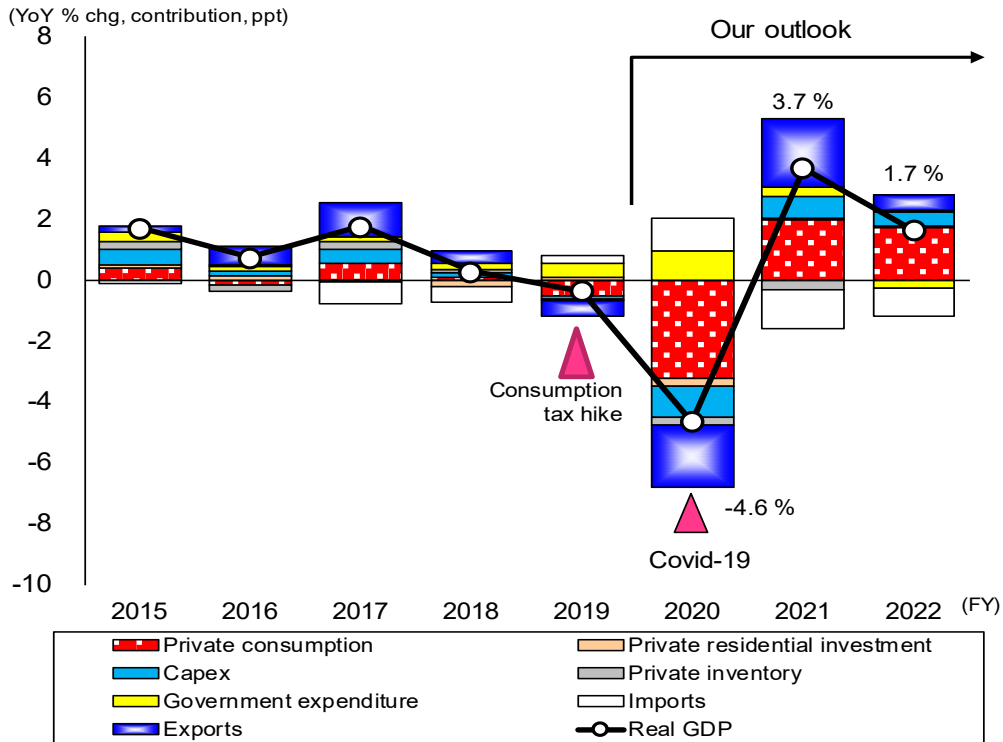
Crude oil price (WTI annual mean): \$43.9/bbl in FY20, \$55.3/bbl in FY21 and \$57.3/bbl in FY22.

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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