

Caution recommended regarding the risk of an economic downturn due to the spread of Covid 19

KAZUFUMI KESHI
ECONOMIC RESEARCH OFFICE

MUFG Bank, Ltd.
A member of MUFG, a global financial group

6 MARCH 2020

(ORIGINAL JAPANESE VERSION RELEASED ON 28 FEBRUARY 2020)

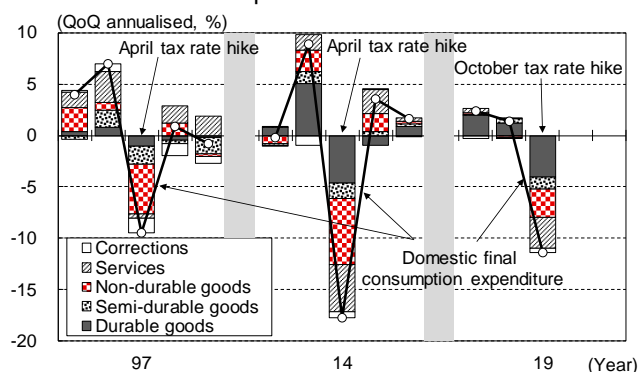
1. The Real Economy

The real GDP growth rate for the October-December 2019 quarter fell significantly to -6.3% QoQ annualised (first preliminary estimate). There was a particularly large drop of 11.0% QoQ annualised in private consumption. Given that the increase in the consumption tax rate was smaller than the previous hike and the introduction of multiple policies by the government, the decrease in consumption exceeded market expectations. Compared with the trend of goods and services at the time of the previous consumption tax rate hike, it appears the fall in “non-durable goods” and “services” was limited, whereas the surge in demand for “durable goods” and “semi-durable goods” was small and the subsequent dip was larger than predicted (Chart 1). In addition to the consumption tax rate hike, there were fewer opportunities for spending and damage to crops due to a large typhoon, as well as a decrease in sales of heating appliances and winter clothes owing to a warm winter. This result is said to have shed light on how Japan’s private consumption can be largely affected by external factors.

The trend of firm employment conditions and wages supporting private consumption and the deep-rooted need for investment to improve efficiency and other aims will continue. Against this backdrop, it is thought the impact of the consumption tax rate hike and other factors which led to the negative growth this quarter will slowly fade. That being said, the economy is currently exposed to new downward pressure from Covid 19 and this negative impact is likely to be unavoidable. For example, exports to China show a large decrease in January. One of the reasons for this was that the Lunar New Year occurred earlier this year compared with a typical year and so the period of decrease in exports from Japan was brought forward (Chart 2). Since many regions of China are late to resume their economic activities this year due to the spread of Covid 19, it is unlikely there will be the typical rebound the following month. In addition, there is predicted to be a significant decrease in inbound consumption as China prohibits group tours and it is possible there will also be a fall in foreign tourists to Japan from countries other than China due to worldwide travel bans and self-imposed restrictions. Taking this into consideration, although inbound consumption accounts for only 1% of real GDP, there is a chance it will have a certain effect on the economy. It is thought there will be a decline in economic activities due to the impact from disruption to China’s supply chains and the

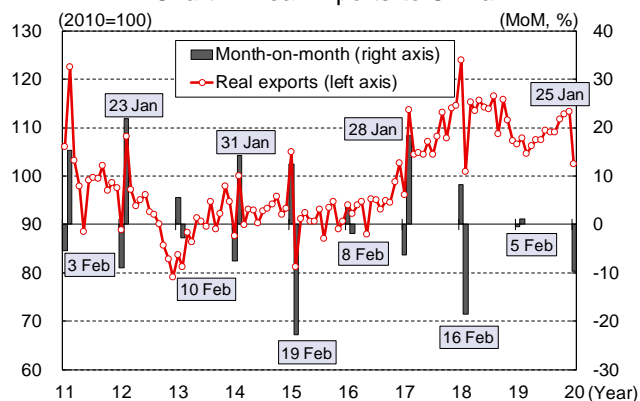
domestic policies imposed to address the spread of infection which are anticipated from now. Extreme caution is necessary regarding the effect of any decline.

Chart 1: Private Consumption before and after Consumption Tax Rate Hikes



Note: 1. Includes each quarter when the tax rate hike is carried out as well as the two former and subsequent quarters
 2. Annualisation calculations carried out by Economic Research Office
 Source: Cabinet Office, MUFG Bank Economic Research Office

Chart 2: Real Exports to China



Note: 1. Real and seasonal calculations carried out by ERO
 2. Dates on the chart are those from the Lunar New Year period
 3. "MoM" includes only January and February
 Source: Ministry of Finance, MUFG Bank Economic Research Office (ERO)

2. Prices and Financial Markets

2.1 Monetary Policy

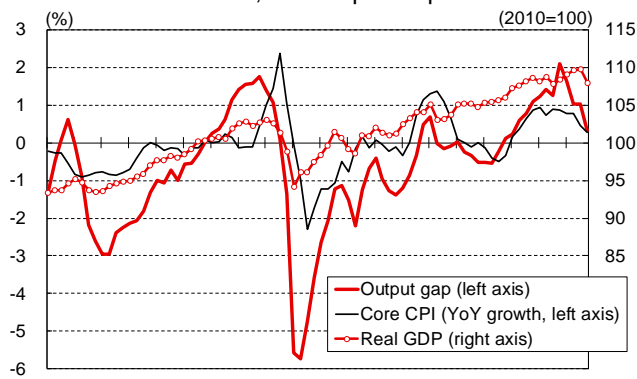
The output gap appears to have tightened by a considerable amount in the October-December 2019 quarter due to the significant negative growth of real GDP in the same quarter (Chart 3). The output gap is an important indicator for the Bank of Japan (BoJ) when it comes to examining the trend of prices. Governor Kuroda explained that typically the BoJ factors in a certain amount of tightening of the output gap in the future due to the impact of events such as a slowdown of overseas economies and consumption tax rate hikes, and that the indicator "is expected to remain at around the current level on average". Therefore, it is considered unlikely that the BoJ will immediately revise its outlook for prices by a large amount given this statement.

In the short term, there will be an unavoidable negative impact on the Japanese economy from the spread of Covid 19. Regarding this point, Deputy Governor Wakatabe said at the press conference following the meeting in Ehime prefecture on 6th February that the Bank is "paying maximum attention". He also stood by the BoJ's current policy when it comes to monetary policy and other risks related to US-China friction and overseas economies in the future: "the BoJ won't hesitate to take additional easing steps if risks become very large and increase the chance that the momentum toward achieving its 2% price target will be lost". If the impact of Covid 19 on the economy and financial markets remains temporary, the BoJ will maintain its current policy framework. However, it is thought the Bank will consider whether or not it is necessary to make changes to its policy depending on the scale and length of the impact of Covid 19 and action taken by other central banks in developed countries, such as the US FRB.

2.2 Financial Markets

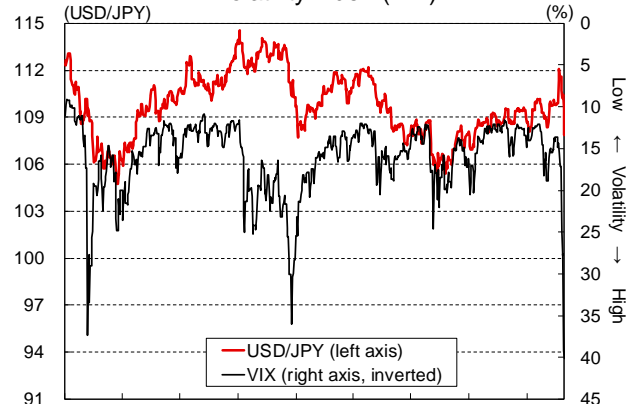
The JPY is currently trading at around JPY108 to JPY112 per USD (Chart 4). In general, the interpretation of the relationship between USD/JPY and the gap between US and Japanese interest rates that has gradually gained acceptance is when the gap between interest rates widens (shrinks), the JPY appreciates (depreciates). In the past when there was a rise in volatility brought about by things like “risk off” sentiment, it appears the JPY would appreciate even if there was no change in the gap between interest levels. Now, regardless of “risk off” sentiment, it appears markets are reluctant to buy JPY in light of news reports about the spread of Covid 19 in Japan. In the future, the JPY is expected to once again become a preferred currency for those avoiding risk as the spread of the infection is reported in other countries. As such, it is necessary to keep an eye on any temporary JPY appreciation due to a sharp rise in volatility.

Chart 3: Real GDP, the Output Gap and Core CPI



Note: Calculations for the “output gap” for Oct-Dec 2019 quarter, such as real GDP, were carried out by Economic Research Office
 Source: Bank of Japan, Cabinet Office, Ministry of Internal Affairs and Communications, MUFG Bank Economic Research Office

Chart 4: USD/JPY Exchange Rate and Volatility Index (VIX)



Source: Bloomberg, MUFG Bank Economic Research Office

(Translated by Elizabeth Foster)

MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

1. Main Economic Indicators

As of Feb. 28, 2020

	Fiscal	Fiscal	2019			2019					2020
	2017	2018	2Q	3Q	4Q	SEP	OCT	NOV	DEC	JAN	
Real GDP Growth Rate <% changes from previous period at SA annual rate>	1.9	0.3	1.9 (0.9)	0.5 (1.7)	-6.3 (-0.4)	***	***	***	***	***	
Index of All Industries Activity	1.8	0.8	0.5 (0.2)	0.5 (1.3)	-3.1 (-2.7)	1.9 (3.4)	-4.8 (-3.9)	0.9 (-2.8)	0.0 (-1.4)		
Industrial Production Index	2.9	0.3	0.6 (-2.3)	-0.5 (-0.8)	-4.1 (-6.3)	1.7 (1.3)	-4.5 (-7.7)	-1.0 (-8.2)	1.2 (-3.1)	0.8 (-2.5)	
Production											
Shipments	2.2	0.2	1.0 (-2.7)	-0.1 (-0.1)	-4.9 (-6.1)	1.5 (2.2)	-4.5 (-7.3)	-1.7 (-7.7)	0.3 (-3.4)	0.2 (-3.7)	
Inventory	5.1	0.2	0.9 (3.0)	-1.7 (0.9)	1.3 (1.3)	-1.4 (0.9)	1.3 (2.6)	-0.9 (1.6)	0.9 (1.3)	1.5 (3.8)	
Inventory/Shipments Ratio (2015=100)	101.9	105.0	106.9 [104.0]	108.8 [105.0]	115.4 [105.6]	108.4 [105.2]	113.4 [105.1]	115.9 [104.5]	116.8 [107.2]	115.0 [105.0]	
Domestic Corporate Goods Price Index	2.7	2.2	0.4 (0.6)	-0.6 (-0.9)	1.2 (0.2)	0.0 (-1.1)	1.1 (-0.4)	0.2 (0.1)	0.1 (0.9)	0.2 (1.7)	
Consumer Price Index(SA, total, excl.fresh foods)	0.7	0.8	0.4 (0.8)	-0.1 (0.5)	0.5 (0.6)	0.0 (0.3)	0.1 (0.4)	0.1 (0.5)	0.1 (0.7)	0.1 (0.8)	
Index of Capacity Utilization (2015=100)	102.7	102.5	102.4 [103.3]	100.6 [101.9]	95.5 [104.7]	100.3 [101.7]	95.8 [104.8]	95.5 [105.0]	95.1 [104.2]		
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	-0.8	2.8	7.5 (4.1)	-3.5 (-2.7)	-2.1 (-1.5)	-2.9 (5.1)	-6.0 (-6.1)	18.0 (5.3)	-12.5 (-3.5)		
Manufacturing	9.2	3.8	2.5 (-8.5)	-0.9 (-10.2)	-3.6 (-10.2)	-5.2 (-4.4)	-1.5 (-15.0)	0.6 (-12.8)	4.3 (-2.7)		
Non-manufacturing Excl.Electric Power & Ship building	-7.8	2.1	13.1 (15.9)	-7.3 (3.6)	2.4 (6.2)	2.6 (11.8)	-5.4 (2.9)	27.8 (22.5)	-21.3 (-4.5)		
Shipments of Capital Goods (Excl.Transport Equipment)	7.0	-0.3	2.5 (-6.6)	2.9 (-0.3)	-6.2 (-8.1)	8.9 (8.1)	-11.9 (-12.0)	-6.1 (-14.5)	12.7 (1.9)	-5.1 (1.5)	
Construction Orders	0.7	6.5									
Private	0.6	14.5									
Public	-5.4	-15.0									
Public Works Contracts	-4.3	1.1									
Housing Starts 10,000 units at Annual Rate, SA	94.6	95.3	92.5	90.6	86.5	90.3	89.5	84.8	85.2	81.3	
Total floor	(-2.8)	(0.7)	(-4.7)	(-5.4)	(-9.3)	(-4.9)	(-7.4)	(-12.7)	(-7.9)	(-10.1)	
Sales at Retailers	1.9	1.6									
Real Consumption Expenditures of Households over 2 persons (SA)	0.3	0.0	0.6 (3.3)	2.5 (4.1)	-6.5 (-2.9)	5.5 (10.5)	-11.5 (-4.0)	2.6 (-1.4)	-1.7 (-3.3)		
Propensity to Consume (SA, %)	71.7	69.2	67.5 [68.8]	72.5 [70.6]	64.6 [68.6]	75.8 [70.4]	65.2 [70.4]	66.9 [70.1]	61.8 [65.5]	[70.4]	
Overtime Hours Worked (All Industries, 5 employees or more)	0.4	-1.7	1.0 (-2.4)	-1.2 (-1.0)	-1.5 (-2.4)	1.6 (0.0)	0.2 (-1.8)	-2.2 (-2.7)	-2.3 (-2.7)		
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	0.7	0.9									
Employment Index(Regular Employees Only;All Industries, 5 employees or more) (Change over the M/Q/Y)	99	1	86	100	107	107	109	110	102		
Ratio of Job Offers to Applicants (SA, Times)	1.54	1.62	1.62 [1.60]	1.59 [1.63]	1.57 [1.63]	1.58 [1.63]	1.58 [1.63]	1.57 [1.63]	1.57 [1.62]	1.49 [1.63]	
Unemployment Rate (SA, %)	2.7	2.4	2.4	2.3	2.3	2.4	2.4	2.2	2.2	2.4	
Economy Watcher Survey (Judgment of the present condition D.I.%)	50.5	47.8	44.5 [48.8]	43.8 [48.2]	38.5 [48.0]	46.6 [48.2]	36.9 [48.7]	38.8 [48.8]	39.7 [46.6]	41.9 [45.9]	
Bankruptcies (Number of cases)	8,367 (-0.2)	8,110 (-3.1)	2,074 (-1.6)	2,182 (8.2)	2,211 (6.8)	702 (13.0)	780 (6.8)	727 (1.3)	704 (13.2)	773 (16.1)	

(Notes)

Unless otherwise indicated, tabulated figures and those in parentheses show % changes from previous quarter/month as applicable.

The figures in () indicate % changes from previous year.

[] show the comparable figure of the previous year.

2. Balance of Payments

As of Feb. 28, 2020

	Fiscal	Fiscal	2019			2019				2020
	2017	2018	2Q	3Q	4Q	SEP	OCT	NOV	DEC	JAN
Customs Clearance (Exports in Yen Terms)	10.8	1.9	(-5.6)	(-5.0)	(-7.8)	(-5.2)	(-9.2)	(-7.9)	(-6.3)	(-2.6)
Value	5.5	2.5	(0.7)	(-2.8)	(-4.2)	(-2.9)	(-5.0)	(-3.1)	(-4.6)	(-1.0)
Volumes	5.0	-0.6	(-6.2)	(-2.2)	(-3.8)	(-2.3)	(-4.4)	(-5.0)	(-1.9)	(-1.6)
Imports (In Yen terms)	13.7	7.2	(-0.1)	(-4.9)	(-11.9)	(-1.5)	(-14.7)	(-15.6)	(-4.9)	(-3.5)
Value	8.9	5.7	(-0.0)	(-7.1)	(-7.8)	(-7.7)	(-9.2)	(-8.2)	(-6.0)	(-1.9)
Volumes	4.4	1.4	(-0.1)	(2.3)	(-4.5)	(6.8)	(-6.1)	(-8.1)	(1.2)	(-1.7)
Current Account (100 mil. yen)	221,749	192,434	45,676	57,603	37,776	15,802	18,168	14,368	5,240	
Goods (100 mil. yen)	45,396	6,963	-16	-312	3,723	28	2,540	-25	1,207	
Services (100 mil. yen)	-4,567	-7,123	-1,046	-1,637	879	64	-995	1,630	245	
Financial Account (100 mil. yen)	206,805	212,310	65,220	67,091	27,019	40,652	8,799	5,728	12,492	
Gold & Foreign Exchange Reserves (\$1mil.)	1,268,287	1,291,813	1,322,279	1,322,581	1,323,750	1,322,581	1,324,468	1,317,322	1,323,750	1,342,267
Exchange Rate (¥/\$)	110.80	110.88	109.85	107.30	108.72	107.41	108.12	108.86	109.18	109.34

3. Financial Market Indicators

	Fiscal	Fiscal	2019			2019				2020	
	2017	2018	2Q	3Q	4Q	SEP	OCT	NOV	DEC	JAN	
Uncollateralized Overnight Call Rates	-0.050	-0.062	-0.060 [-0.065]	-0.059 [-0.063]	-0.034 [-0.066]	-0.059 [-0.059]	-0.022 [-0.060]	-0.043 [-0.070]	-0.038 [-0.068]	-0.032 -0.064	
Euro Yen TIBOR (3 Months)	0.065	0.062	0.049 [0.084]	0.022 [0.077]	0.016 [0.050]	0.009 [0.050]	0.009 [0.050]	0.018 [0.050]	0.021 [0.050]	0.021 [0.030]	
Newly Issued Japanese Government Bonds Yields (10 Years)	0.045	-0.095	-0.165 [0.030]	-0.215 [0.125]	-0.025 [-0.010]	-0.215 [0.125]	-0.150 [0.130]	-0.080 [0.085]	-0.025 -0.010	-0.065 [0.000]	
Average Contracted Interest Rates on Loans and Discounts(City Banks) (% changes from previous period)	0.817	0.751	0.749 (-0.002)	0.738 (-0.011)	0.729 (-0.009)	0.738 (-0.008)	0.741 (0.003)	0.737 (-0.004)	0.729 (-0.008)		
The Nikkei Stock Average (TSE 225 Issues)	21,454	21,206	21,276 [22,305]	21,756 [24,120]	23,657 [20,015]	21,756 [24,120]	22,927 [21,920]	23,294 [22,351]	23,657 [20,015]	23,205 [20,773]	
M2(Average)	(3.7)	(2.7)	(2.5)	(2.4)	(2.6)	(2.4)	(2.4)	(2.7)	(2.7)	(2.8)	
Broadly-defined Liquidity(Average)	(3.1)	(1.9)	(1.8)	(1.7)	(2.3)	(1.7)	(1.9)	(2.4)	(2.6)	(2.7)	
Principal Figures of Financial Institutions											
Loans and Discount (Average)	Banks & Shinkin		(2.8)	(2.2)	(2.4)	(2.1)	(2.0)	(2.0)	(2.1)	(1.8)	(1.9)
	Banks		(2.8)	(2.2)	(2.6)	(2.3)	(2.1)	(2.2)	(2.2)	(1.9)	(2.0)
	City Banks etc.		(2.0)	(1.0)	(2.4)	(2.2)	(1.9)	(2.1)	(2.0)	(2.2)	(1.6)
	Regional Banks		(3.6)	(4.3)	(5.1)	(4.3)	(4.3)	(4.3)	(4.3)	(4.2)	(4.3)
	Regional Banks II		(3.0)	(-0.4)	(-6.6)	(-5.7)	(-5.7)	(-5.7)	(-5.7)	(-5.7)	(-5.5)
Shinkin		(2.7)	(2.1)	(1.4)	(1.1)	(1.0)	(1.0)	(1.0)	(1.0)	(0.9)	
Deposits and CDs (Average)	Total(3 Business Condition)		(4.2)	(3.4)	(2.5)	(2.3)	(2.8)	(2.5)	(2.6)	(3.0)	(2.8)
	City Banks		(5.9)	(4.9)	(3.5)	(3.1)	(3.8)	(3.4)	(3.6)	(4.2)	(3.6)
	Regional Banks		(2.5)	(2.7)	(3.4)	(3.1)	(3.4)	(3.1)	(3.2)	(3.4)	(3.6)
	Regional Banks II		(2.1)	(-1.3)	(-6.2)	(-5.4)	(-5.4)	(-5.5)	(-5.5)	(-5.3)	(-5.2)

(Notes)

Newly Issued Japanese Government Bonds Yields and Interest rates are averages. The Nikkei Stock Average is as of month-end. Unless otherwise indicated, tabulated figures and those in parentheses show % changes from previous quarter/month as applicable. The figures in () indicate % changes from previous year. [] show the comparable figure of the previous year.

(Sources)

Cabinet Office, National Accounts, Machinery Orders; METI, Indices of Tertiary Industry Activity, Industrial Production, Current Survey of Commerce; MOF, Trade Statistics, Balance of Payments; MPMHAPT, Consumer Price Index, Family Income and Expenditure Survey, Labour Force Survey; MHLW, Monthly Labour Survey; Ministry of Land, Infrastructure, and Transport, Economic Construction Statistics; BOJ, Corporate Price Index, Financial and Economic Statistics Monthly, etc.

For further details, please contact the Economic Research Office, MUFG Bank

Managing Director, Rei Tsuruta Tel: +81-(0)3-3240-3204

Written by Kazufumi Keshi <kazufumi_keshi@mufg.jp>

This report is intended for information purposes only and shall not be construed as solicitation to take any action such as purchasing/selling/investing financial market products. In taking any action, each reader is requested to act on the basis of his or her own judgment. This report is based on information believed to be reliable, but we do not guarantee its accuracy. The contents of the report may be revised without advance notice. Also, this report is a literary work protected by the copyright act. No part of this report may be reproduced in any form without express statement of its source. This report is also available for viewing online.