The Novel Coronavirus Pandemic and the Japanese Economy

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1. The State of Japan's Economy during the Novel Coronavirus Pandemic

The main characteristic of the Japanese economy during the Novel Coronavirus pandemic since the January-March 2021 period is that the direction of the economy is upward, but the level is low. Economists usually judge whether the economy is good or bad by whether the economy is going up or down. The general public, on the other hand, is implicitly aware of not only the direction of the economy but also of the level of the economy and thus considers the current economy to be bad. This situation presents an economic recovery that is not perceived as such by the public.

Let's take a look at the state of the Japanese economy during the pandemic from three aspects: expenditures, production, and income. First, in terms of spending, the April-June 2020 period, when the effects of the coronavirus were most strongly felt, real GDP declined at an annualized rate of 28.1% from the previous quarter, due to a decline in consumption as people refrained from going out, and a sharp drop in exports as supply chains were disrupted. In comparison, GDP for the January-March 2021 period, even though it was subject to the same state of emergency, declined only 4.2% on an annual basis. This was due to the fact that exports had turned around and started to increase.

In terms of production, the major characteristic was that the decline was not only in the manufacturing sector but also in the non-manufacturing sector. Efforts to prevent the spread of the coronavirus resulted in a drop in consumption in the food and beverage industry and travel industry. The manufacturing industry has experienced a drop in production due to a sharp decline in exports many times before, but this is almost the first time that the non-manufacturing industry has experienced such a drop. For this reason, the shock to businesses in the non-manufacturing sector must have been great.

Next, let's look at income trends. GDP statistics also provide information on household income, and the movement of household income since April-June 2020 has been surprising. The table shows that, first of all, employment compensation (wages) declined by 11 trillion yen (annualized rate, hereinafter the same) from the previous period. This is not surprising since the economy had fallen sharply due to the declaration of the state of emergency. However, the 100,000 yen benefit increased "other current transfers" by 40 trillion yen, so disposable income increased by 31 trillion yen. On the other hand, consumption expenditure decreased by 26 trillion yen due to people refraining from going out. Since disposable income increased significantly and consumption decreased significantly, savings increased by 57 trillion yen. As a result, the household savings rate reached a never-before-seen high of 21.9%. In essence, the previous 100,000 yen benefit was a further handout of money to a household sector with an overall surplus of money.

Since then, even after the effects of the 100,000 yen benefit wore off, household savings continued to increase and the savings rate has remained high. The latest data for April-June 2021 shows a savings rate of 7.8%. Since Japan's savings rate before the pandemic was at most 1-2%, this means that Japanese households continue to have a considerable surplus of money.

Table 1: Household disposable income and Household saving ratio
(Reference series, Nominal, Seasonally-adjusted)

unit: trillion yen

	Compensation of employees, receivable	Other current transfers, net	Disposable income	Consumption of households	Saving	Saving ratio (%)
2020 Jan.-Mar.	289.9	-1.3	309.2	291.5	17.6	5.7
Apr.-Jun.	278.9	38.6	340.1	265.7	74.5	21.9
Jul.-Sep.	280.7	11.7	315.2	279.4	35.9	11.4
Oct.-Dec.	281.7	0.8	303.4	284.4	19.1	6.3
2021 Jan.-Mar.	289.0	-1.1	308.5	281.8	26.8	8.7
Apr.-Jun.	284.2	1.0	306.0	282.2	24.0	7.8
2020 Apr.-Jun. QoQ change	-11.0	39.9	30.9	-25.8	56.9	16.2

Source: National Accounts, Cabinet Office.

Next, let's take a look at the outlook for the future. In this case, the monthly "ESP Forecast Survey" conducted by the Japan Center for Economic Research is useful. In this survey, about 40 leading economists are asked to give their outlook on the future of the economy, including future growth rates, and the average of the results is published. This gives us an idea of the average expert's forecast.

According to the October 2021 survey, the growth rate for the October-December 2021 period is expected to be 2-4% per year (real annual rate). This means that as far as the growth rate is concerned, a steady recovery is expected. This is probably because economic activity is expected to return to normal due to the vaccination rollout. If the economy continues at this pace, in the October-December 2021 period, GDP will recover to the level of the October-December 2019 period before the coronavirus pandemic.

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Next, let us consider how economic policies implemented so far during the pandemic should be evaluated.

When managing economic policy during the pandemic, it is not enough to simply add demand through public investment and other means just because the economy is in a downturn. This is because increased economic activity increases the risk of infection.

Therefore, from a policy standpoint, it becomes important to ensure that temporary shocks do not leave lasting scars. This means making sure that temporary employment adjustments do not lead to long-term unemployment, and that temporary business crises do not lead to long-term business closures and bankruptcies. It appears that the government has been relatively successful in addressing these issues by providing employment adjustment subsidies and bridge financing to companies.

However, we cannot overlook the fact that there have been policy mistakes. Here, I would like to point out three major mistakes. At the end of 2020, the government decided on a large-scale economic stimulus package with a fiscal expenditure of 40.0 trillion yen and a project scale of 73.6 trillion yen. There was a debate on the need to close the GDP gap (estimated by the Cabinet Office for the July-September 2009 period), which was said to be 34 trillion yen at the time, and this may have influenced the scale of the measures. However, the real/annualized GDP gap does not correspond to nominal fiscal spending, and the idea of closing the entire GDP gap with fiscal measures was quite unreasonable.

The second mistake is the uniform 100,000 yen benefit. From the abovementioned picture of household finances, it appears that as a result of the widespread provision of benefits to people other than those who needed it, much of the money ended up in savings.

The third mistake is the "GoTo Travel" campaign. In summer 2020, the government launched (and later suspended) the GoTo Travel campaign to stimulate demand for travel and eating out. This was a policy completely contrary to economic principles, as it encouraged, through subsidies, face-to-face services that created external diseconomies in terms of the spread of infection.

This is a clear policy mistake that we do not want to see repeated.

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The pandemic has had a multifaceted impact on Japan's economy and society. These effects can be divided into short-term changes that will disappear once the pandemic is over and long-term structural changes that will remain even after the pandemic has ended. It is the structural changes that will be important from now on.

The structural changes under the pandemic can be divided into two categories. One is a change that makes it even more difficult to resolve issues that we have been attempting in the past, and the other is a change in which the pandemic is a catalyst for progress in addressing issues that have been difficult to address in the past.

First, some of the former issues that are becoming increasingly difficult to solve are as follows.

The first is fiscal consolidation. During the pandemic, demands for increased spending were multifaceted. These included the improvement of medical systems, promotion of vaccination, employment measures, and relief for affected businesses. As a result, the scale of spending ballooned, but the government had no choice but to rely on deficit financing. Fiscal reconstruction, which had been difficult even before the pandemic, has become even more distant.

Second, breaking out of deflation has also become increasingly difficult. The price inflation target of 2% seems to have slipped further away.

The third is the so-called "low-temperature economy." The term "cold economy" refers to an economy in which households do not consume aggressively even if their income increases and companies do not invest aggressively even if their earnings increase. The pandemic has made it even more difficult for households and companies to have a positive outlook for the future, and this trend of a low-temperature economy may be getting stronger.

On the other hand, it is also possible that the pandemic will lead to structural changes that will enable people to do things that they had wanted to do but could not do before, and that will lead to the resolution of existing problems. Such a change is sometimes referred to as a "big push" in the sense that it will act as a strong motivator. Here are two examples of big pushes that many people are expecting.

One is the reform of work styles. The pandemic may bring about a fundamental change in the way of working, from "membership-type" to "job-type" employment. Membership-based employment has several problems: (1) it prevents job mobility, (2) it prevents women from participating in the economy and society, and (3) it widens the gap between regular and nonregular workers. However, even knowing this, it has been difficult to make progress in shifting to a job-based system. However, the fact that remote work has become commonplace during the pandemic could be a big push to break through the hesitation on all sides and promote the shift to a job-based system. This is because the non-face-to-face work style brought about by remote work is highly compatible with job-based employment in that it clarifies job duties and makes it easier to evaluate work performance rather than working hours. It seems that the time has come for the government, companies, and working people to seriously consider a shift to job-based employment.

Another change triggered by the pandemic that has been attracting a lot of attention recently is the fact that population movement in Tokyo has turned into an outflow. I am skeptical, however, that this will lead to a correction in the concentration of the population in the Tokyo metropolitan area, even though the pandemic undoubtedly changed people's awareness of their lifestyles and work patterns, the flow of people, and their choice of places to live.

First, if we look at population movements in the Tokyo metropolitan area (Tokyo plus Saitama, Chiba, and Kanagawa prefectures) rather than solely in Tokyo, we see that the inflow of population has basically continued to exceed the outflow even after the pandemic. This indicates that most of the population movement has been from Tokyo to the surrounding prefectures, and that there has been almost no outflow of population from the Tokyo metropolitan area to the regional areas.

In Japan, large scale inter-regional population movement occurs between March and April, the last month and the first month of the fiscal year, respectively. Looking at the population movement for March and April 2021, Tokyo had an excess influx of about 30,000 people for both months combined. The cumulative influx into Tokyo from May 2020 to February 2021 (25,000) was cancelled out in March alone. The biggest reason for the influx of people into the Tokyo metropolitan area is the population shift associated with employment and schooling, which occurs every March and April. What occurred after the pandemic was the movement of working people from Tokyo to the suburbs. While this did occur, this population movement was on a much smaller scale than the population shifts associated with employment and schooling.

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