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# *Outlook for Economic Activity and Prices*

*October 2020*



(English translation prepared by the Bank's staff based on the Japanese original)

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## Outlook for Economic Activity and Prices (October 2020)

### The Bank's View<sup>1</sup>

#### Summary

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- Japan's economy is likely to follow an improving trend with economic activity resuming and the impact of the novel coronavirus (COVID-19) waning gradually, but the pace is expected to be only moderate while vigilance against COVID-19 continues. Thereafter, as the impact subsides globally, the economy is projected to keep improving further with overseas economies returning to a steady growth path.
  - The year-on-year rate of change in the consumer price index (CPI, all items less fresh food) is likely to be negative for the time being, mainly affected by COVID-19, the past decline in crude oil prices, and the "Go To Travel" campaign. Thereafter, it is expected to turn positive and then increase gradually, since downward pressure on prices is projected to wane gradually along with economic improvement, and the effects of such factors as the decline in crude oil prices are likely to dissipate.
  - Compared with the previous projections in the July Outlook Report, the projected growth rate is lower for fiscal 2020, mainly due to a delay in recovery in services demand, but is somewhat higher for fiscal 2021 and more or less unchanged for fiscal 2022. The projected rates of increase in the CPI are more or less unchanged.
  - The outlook for economic activity and prices provided in this Outlook Report is extremely unclear, since it could change depending on the consequences of COVID-19 and the magnitude of their impact on domestic and overseas economies. The outlook is based on the assumption that COVID-19 will not spread again on such a large scale that the wide-ranging public health measures will need to be reinstated. It also is based on the premises that, while the impact of COVID-19 remains, firms' and households' medium- to long-term growth expectations will not decline substantially and the smooth functioning of financial intermediation will be ensured with financial system stability being maintained. However, the assumption and premises entail high uncertainties.
  - With regard to the risk balance, risks to both economic activity and prices are skewed to the downside, mainly due to the impact of COVID-19.
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<sup>1</sup> "The Bank's View" was decided by the Policy Board at the Monetary Policy Meeting held on October 28 and 29, 2020.

## **I. Current Situation of Economic Activity and Prices in Japan**

Japan's economy has picked up with economic activity resuming, although it has remained in a severe situation due to the impact of COVID-19 at home and abroad. Overseas economies also have picked up from a state of significant depression. In this situation, exports and industrial production have increased. On the other hand, business fixed investment has been on a declining trend, against the background of deterioration in corporate profits. With the continuing impact of COVID-19, the employment and income situation has been weak. Private consumption has picked up gradually on the whole, although consumption of services, such as eating and drinking as well as accommodations, has remained at a low level. Housing investment has declined moderately. Public investment has continued to increase moderately. Meanwhile, business sentiment deteriorated significantly but subsequently has improved somewhat. Financial conditions have been accommodative on the whole but those for corporate financing have remained less so, as seen in weakness in firms' financial positions. On the price front, the year-on-year rate of change in the CPI (all items less fresh food, and the same hereafter) has been slightly negative, mainly affected by COVID-19, the past decline in crude oil prices, and the "Go To Travel" campaign. Inflation expectations have weakened somewhat.

## **II. Baseline Scenario of the Outlook for Economic Activity and Prices in Japan**

### **A. Baseline Scenario of the Outlook for Economic Activity**

Japan's economy, with economic activity resuming and the impact of COVID-19 waning gradually, is likely to follow an improving trend, supported by accommodative financial conditions and the government's economic measures. However, the pace of improvement is expected to be only moderate while vigilance against COVID-19 continues. Thereafter, as the impact subsides globally, the economy is projected to keep improving further with overseas economies returning to a steady growth path.

This baseline scenario is based on the assumptions that, with progress in efforts to take preventive measures against COVID-19 and improve economic activities simultaneously, COVID-19 will not spread again on such a large scale that the wide-ranging public health measures will need to be reinstated, and that the impact of COVID-19 will almost subside toward the end of the projection period. The outlook also is based on the premises that, in Japan, while the impact of COVID-19 remains, firms' and households' medium- to long-term growth expectations will not decline substantially and the smooth functioning of financial intermediation will be ensured with financial system stability being maintained.

Looking at the outlook for economic activity based on the assumptions and premises in more detail, overseas economies are likely to continue improving, partly supported by aggressive macroeconomic policies, but the pace is expected to be only moderate while

vigilance against COVID-19 continues. Then, with the impact of COVID-19 almost subsiding, they are likely to continue improving toward the end of the projection period as the production activity of the manufacturing industry is projected to continue recovering globally and face-to-face services consumption in particular is expected to recover gradually.

Japan's exports of goods are expected to increase for the time being, mainly for automobile-related goods, and then increase for a wide range of goods, including capital goods, with the impact of COVID-19 waning globally. Inbound tourism consumption, which is categorized as services exports, is expected to remain subdued while entry restrictions continue, but is likely to recover thereafter along with a gradual easing in such restrictions.

Private consumption is likely to continue picking up, supported also by the government's economic measures, but while vigilance against COVID-19 continues, the pace is expected to be quite moderate, mainly for face-to-face services consumption. Thereafter, with households and firms adapting to a "new lifestyle" and the impact of COVID-19 waning, an uptrend in private consumption is likely to become evident gradually, supported also by improvement in employee income. Although the government's economic measures and accommodative financial conditions are expected to support employment, the employment and income situation is projected to be under downward pressure for the time being against the background of deterioration in corporate profits and worsening labor market conditions. The employment and income situation is likely to turn to an improving trend thereafter, with domestic and external demand recovering.

Business fixed investment is expected to remain on a declining trend for the time being, mainly in industries affected strongly by COVID-19. However, with accommodative financial conditions being maintained, it is expected that the capital stock adjustment will not be as significant as that seen at the time of the Global Financial Crisis (GFC) and that, with the impact of COVID-19 waning, business fixed investment will return to a moderate increasing trend along with improvement in corporate profits. Meanwhile, public investment is projected to steadily increase, reflecting the progress in construction related to restoration and reconstruction following natural disasters, as well as to building national resilience. Thereafter, it is expected to be at a relatively high level.

## **B. Baseline Scenario of the Outlook for Prices**

The year-on-year rate of change in the CPI is likely to be negative for the time being, mainly affected by COVID-19, the past decline in crude oil prices, and the "Go To Travel" campaign.<sup>2</sup> With economic activity remaining at a low level due to the impact of

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<sup>2</sup> The direct effects of the "Go To Travel" campaign on the CPI are estimated to be minus 0.2 percentage point for fiscal 2020 and 0.2 percentage point for fiscal 2021, based on assumptions such as in terms of the period (i.e., from August 2020 through January 2021).

COVID-19, it is expected that prices of goods and services that are sensitive to economic activity will be pushed down. The past decline in crude oil prices also is projected to push down the CPI through energy prices. Under these circumstances, medium- to long-term inflation expectations are likely to continue weakening somewhat.

Thereafter, downward pressure on prices is projected to wane gradually along with economic improvement. In addition, the effects of such factors as the decline in crude oil prices are likely to dissipate. Under these circumstances, the year-on-year rate of change in the CPI is expected to turn positive and then increase gradually. Medium- to long-term inflation expectations also are expected to rise again.

### **C. Financial Conditions**

The Bank has pursued "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control." It also has conducted various powerful monetary easing measures since March in response to COVID-19 with a view to supporting financing, mainly of firms, and maintaining stability in financial markets.<sup>3</sup> In addition, the government has conducted various measures to support financing, mainly of firms, through programs that provide loans guaranteed by the credit guarantee corporations and also quasi-capital funds. Private financial institutions have actively fulfilled the functioning of financial intermediation. In this situation, although firms' financial positions have been weak, the environment for external funding, such as bank borrowing and the issuance of CP and corporate bonds, has remained accommodative. Regarding financial markets, tension has eased, although they are still nervous. Owing to the Bank's and the government's measures, as well as efforts made by private financial institutions together with those measures, the Bank considers that financial conditions will remain accommodative and further downward pressure on the real economy from the financial side will be avoided.<sup>4</sup>

## **III. Risks to Economic Activity and Prices**

### **A. Risks to Economic Activity**

Regarding the baseline scenario of the outlook for economic activity, it is necessary to pay attention to the following three upside and downside risks in particular until the impact of COVID-19 subsides.

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<sup>3</sup> See "Enhancement of Monetary Easing in Light of the Impact of the Outbreak of the Novel Coronavirus (COVID-19)" released on March 16, 2020, "Enhancement of Monetary Easing" released on April 27, 2020, and "Introduction of a New Fund-Provisioning Measure to Support Financing Mainly of Small and Medium-Sized Firms" released on May 22, 2020.

<sup>4</sup> Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.

The first is the impact of COVID-19 on domestic and overseas economies. There are extremely high uncertainties over the consequences of COVID-19 and the magnitude of their impact on domestic and overseas economies. Until effective medicines and vaccines are developed, it is highly unclear how the COVID-19 pandemic will evolve and how long it will take for the impact to subside. In particular, if the wide-ranging public health measures are reinstated, economic activity is likely to be constrained significantly again. In addition, while vigilance against COVID-19 continues, households' and firms' behavior at home and abroad is uncertain, with people voluntarily making precautionary efforts.

The second risk is firms' and households' medium- to long-term growth expectations. If such expectations decline due to a shock caused by COVID-19 that pushes down the economy considerably, there is a risk that firms' and households' appetite for spending will not increase easily even after the impact of COVID-19 subsides. On the other hand, medium- to long-term growth expectations could increase if the issue of COVID-19 leads to, for example, active use of information and communication technology to prevent infection and an undertaking of investment to meet new demand, thereby having positive effects on economic activity such as further innovation.

The third risk is developments in the financial system. Although COVID-19 has affected the financial side as well, the Bank and the government have taken measures aggressively, with a view to supporting financing, mainly of firms, and maintaining stability in financial markets. In addition, financial institutions have considerable resilience in terms of both capital and liquidity. In this situation, the financial system has maintained stability on the whole and the smooth functioning of financial intermediation has been ensured.<sup>5</sup> However, if COVID-19 has a larger impact than expected, there is a risk that deterioration in the real economy will affect financial system stability, thereby exerting further downward pressure on the real economy. Although this risk is judged as not significant at this point, it is necessary to pay close attention to future developments.

## **B. Risks to Prices**

If the aforementioned risks to economic activity materialize, prices also are likely to be affected accordingly.

Risks that are specific to prices are as follows. The first is uncertainties over firms' price-setting behavior amid the impact of COVID-19 on both the demand and supply sides of economic activity. A decrease in demand due to constrained economic activity is likely to put downward pressure on prices of goods and services that are sensitive to economic activity. On the other hand, since one of the reasons for the current decrease is vigilance against COVID-19, price cuts that aim at stimulating demand have not been observed widely to date. In addition, economic activity has been constrained also from the supply

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<sup>5</sup> For details, see the Bank's *Financial System Report* (October 2020).

side, such as by limiting the number of customers to prevent infection. Under these circumstances, there are high uncertainties over how firms will set their prices and how this will affect general prices from a macro perspective.

The second is future developments in foreign exchange rates and international commodity prices, as well as the extent to which such developments will spread to import prices and domestic prices. These risks may lead prices to deviate either upward or downward from the baseline scenario, and thus continue to warrant attention.

#### **IV. Conduct of Monetary Policy**

In the context of the price stability target, the Bank assesses the aforementioned economic and price situation from two perspectives and then outlines its thinking on the future conduct of monetary policy.<sup>6</sup>

The first perspective involves an examination of the baseline scenario for the outlook. The year-on-year rate of change in the CPI is likely to increase gradually toward achieving the price stability target, although it will take time. For the time being, downward pressure is expected to be put on prices with economic activity remaining at a low level due to the impact of COVID-19, and medium- to long-term inflation expectations also are likely to weaken somewhat. Thereafter, prices are expected to increase gradually since downward pressure on them is projected to wane gradually along with economic improvement. In addition, medium- to long-term inflation expectations also are likely to rise again.

The second perspective involves an examination of the risks considered most relevant to the conduct of monetary policy. The outlook for economic activity and prices is extremely unclear, since it could change depending on the consequences of COVID-19 and the magnitude of their impact on domestic and overseas economies. The outlook is based on the assumption that COVID-19 will not spread again on such a large scale that the wide-ranging public health measures will need to be reinstated. It also is based on the premises that, while the impact of COVID-19 remains, firms' and households' medium- to long-term growth expectations will not decline substantially and the smooth functioning of financial intermediation will be ensured with financial system stability being maintained. However, the assumption and premises entail high uncertainties. With regard to the risk balance, risks to both economic activity and prices are skewed to the downside, mainly due to the impact of COVID-19. When examining financial imbalances from a longer-term perspective, prolonged downward pressure on financial institutions' profits could create a risk of a gradual pullback in financial intermediation, given the existing factors -- such as the prolonged low interest rate environment, the declining population, and excess savings

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<sup>6</sup> As for the examination from two perspectives in the context of the price stability target, see the Bank's statement released on January 22, 2013, entitled "The 'Price Stability Target' under the Framework for the Conduct of Monetary Policy."

in the corporate sector -- as well as the recent impact of COVID-19. On the other hand, under these circumstances, the vulnerability of the financial system could increase, mainly due to the search for yield behavior. Although these risks are judged as not significant at this point, mainly because financial institutions have sufficient capital bases, it is necessary to pay close attention to future developments.

As for the conduct of monetary policy, the Bank will continue with "QQE with Yield Curve Control," aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. It will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeds 2 percent and stays above the target in a stable manner.

The Bank will continue to support financing, mainly of firms, and maintain stability in financial markets through (1) the Special Program to Support Financing in Response to the Novel Coronavirus (COVID-19), (2) an ample provision of yen and foreign currency funds without setting upper limits mainly by purchasing Japanese government bonds (JGBs) and conducting the U.S. dollar funds-supplying operations, and (3) active purchases of exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs).

For the time being, the Bank will closely monitor the impact of COVID-19 and will not hesitate to take additional easing measures if necessary, and also it expects short- and long-term policy interest rates to remain at their present or lower levels.

### Forecasts of the Majority of the Policy Board Members

y/y % chg.

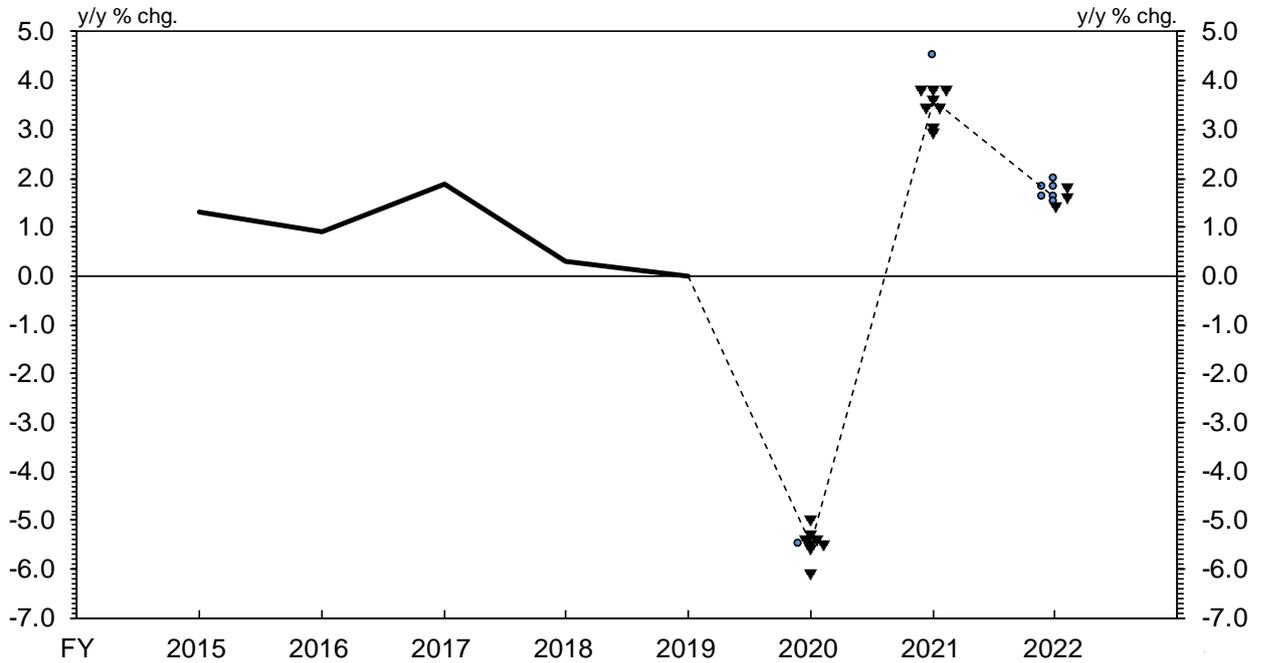
	Real GDP	CPI (all items less fresh food)	(Reference) Excluding the effects of the consumption tax hike and policies concerning the provision of free education
Fiscal 2020	-5.6 to -5.3 [-5.5]	-0.7 to -0.5 [-0.6]	-0.8 to -0.6 [-0.7]
Forecasts made in July 2020	-5.7 to -4.5 [-4.7]	-0.6 to -0.4 [-0.5]	-0.7 to -0.5 [-0.6]
Fiscal 2021	+3.0 to +3.8 [+3.6]	+0.2 to +0.6 [+0.4]	
Forecasts made in July 2020	+3.0 to +4.0 [+3.3]	+0.2 to +0.5 [+0.3]	
Fiscal 2022	+1.5 to +1.8 [+1.6]	+0.4 to +0.7 [+0.7]	
Forecasts made in July 2020	+1.3 to +1.6 [+1.5]	+0.5 to +0.8 [+0.7]	

Notes: 1. Figures in brackets indicate the medians of the Policy Board members' forecasts (point estimates).

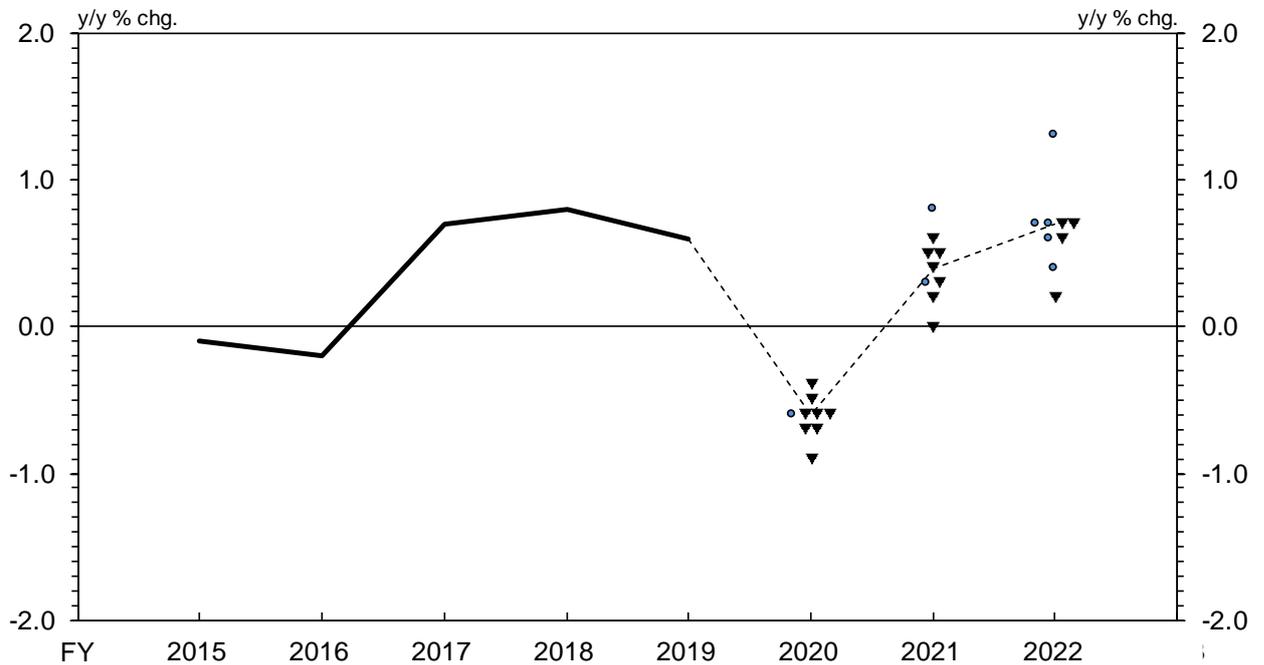
2. The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which he or she attaches the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.
3. Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.
4. The direct effects of the October 2019 consumption tax hike on the CPI for fiscal 2020 are estimated to be 0.5 percentage point. In addition, based on a specific assumption, the direct effects of policies concerning the provision of free education on the CPI for fiscal 2020 are estimated to be around minus 0.4 percentage point.

## Policy Board Members' Forecasts and Risk Assessments

### (1) Real GDP



### (2) CPI (All Items Less Fresh Food)



Notes: 1. The solid lines show actual figures, while the dotted lines show the medians of the Policy Board members' forecasts (point estimates).

2. The locations of ●, △, and ▼ in the charts indicate the figures for each Policy Board member's forecasts to which he or she attaches the highest probability. The risk balance assessed by each Policy Board member is shown by the following shapes: ● indicates that a member assesses "upside and downside risks as being generally balanced," △ indicates that a member assesses "risks are skewed to the upside," and ▼ indicates that a member assesses "risks are skewed to the downside."

3. The CPI figure for fiscal 2015 excludes the direct effects of the April 2014 consumption tax hike.

## The Background<sup>7</sup>

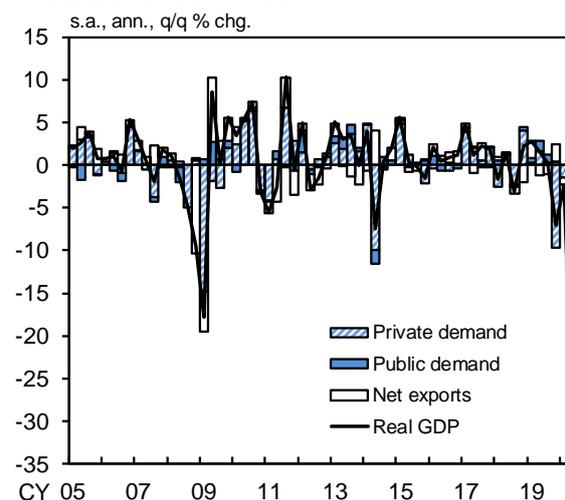
### I. Current Situation of Economic Activity and Its Outlook

#### A. Economic Developments

Japan's economy has picked up with economic activity resuming, although it has remained in a severe situation due to the impact of COVID-19 at home and abroad.

The real GDP growth rate for the April-June quarter of 2020 registered the largest-ever decline since 1980, from when comparable data are available, marking minus 7.9 percent on a quarter-on-quarter basis and minus 28.1 percent on an annualized basis (Chart 1). This is attributable to the fact that components such as exports -- including inbound tourism consumption, which is categorized as services exports -- and private consumption declined sharply due to the spread of COVID-19 at home and abroad and to the impact of the state of emergency that was in place in Japan in April and May. However, monthly indicators and high-frequency data since then suggest that exports and industrial production have turned to an increase, partly supported by improvement in overseas economies and the materialization of pent-up demand. Although private consumption has remained at a low level for face-to-face services, it has picked up gradually on the whole when including goods consumption, backed by various measures to support income and stimulate demand. The output gap -- which captures the

Chart 1: Real GDP



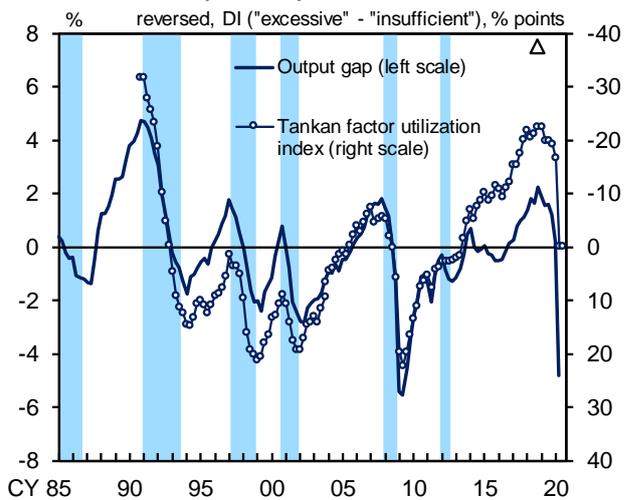
<sup>7</sup> "The Background" provides explanations of "The Bank's View" decided by the Policy Board at the Monetary Policy Meeting held on October 28 and 29, 2020.

utilization of labor and capital -- became significantly negative for the April-June quarter for the first time since immediately after the GFC (Chart 2). This is because working hours and capital utilization rates declined sharply against the background of the spread of COVID-19 and preventive measures strongly constraining firms' and households' economic activities. The output gap for the July-September quarter seems to have narrowed within negative territory, particularly for the manufacturing sector, mainly reflecting increases in exports and production.

As for the outlook, Japan's economy, with economic activity resuming and the impact of COVID-19 waning gradually, is likely to follow an improving trend, supported by accommodative financial conditions and the government's economic measures.<sup>8</sup> However, the pace of improvement is expected to be only moderate while vigilance against COVID-19 continues. Thereafter, as the impact subsides globally, the economy is projected to keep improving further with overseas economies returning to a steady growth path.

Specifically, goods exports are likely to continue increasing, mainly for automobile-related goods, and then do so for a wider range of goods, including capital goods, with the impact of

**Chart 2: Output Gap**



Source: Bank of Japan.

Notes: 1. The output gap is based on staff estimations.

2. The Tankan factor utilization index is calculated as the weighted average of the production capacity DI and the employment conditions DI for all enterprises. The capital and labor shares are used as weights. There is a discontinuity in the data in December 2003 due to a change in the survey framework.

3. Shaded areas indicate recession periods. The triangle shows the latest peak.

<sup>8</sup> It is assumed that economic activity will be supported by the various measures included in the first supplementary budget for fiscal 2020, which is based on the Emergency Economic Measures to Cope with the Novel Coronavirus (COVID-19) -- with a project size of around 117.1 trillion yen and fiscal spending of around 48.4 trillion yen -- decided by the Cabinet in April 2020, and those included in the second supplementary budget -- with a project size of around 117.1 trillion yen and fiscal spending of around 72.7 trillion yen -- approved by the Diet in June 2020.

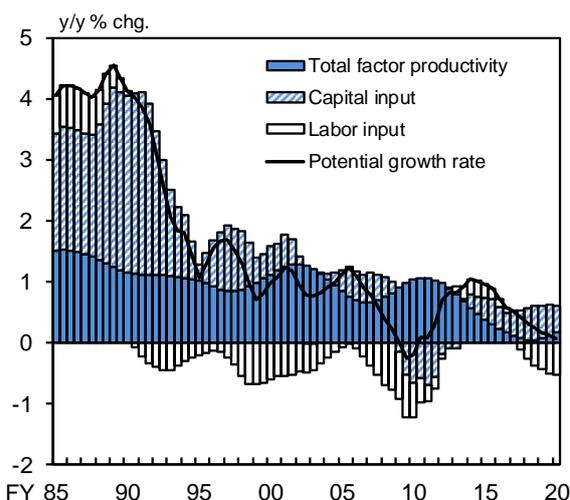
COVID-19 waning globally. Inbound tourism demand, which is categorized as services exports, is expected to remain subdued as long as entry and travel restrictions continue, but is likely to recover thereafter along with a gradual easing in such restrictions. Private consumption is projected to continue picking up, backed by the government's measures to support income and stimulate demand, but the pace is highly likely to be quite moderate, mainly for face-to-face services, due to vigilance against COVID-19 and the need to keep social distancing. Thereafter, with households and firms adapting to a "new lifestyle" and the impact of COVID-19 waning, an uptrend in private consumption is likely to become evident gradually, supported also by improvement in employee income. Although the government's economic measures and accommodative financial conditions are expected to support employment, the employment and income situation is highly likely to remain under downward pressure for the time being against the background of deterioration in corporate profits and worsening labor market conditions. The employment and income situation is likely to turn to an improving trend thereafter, while lagging behind a recovery in domestic and external demand. Business fixed investment is projected to remain on a declining trend for the time being against the background of deterioration in corporate profits and high uncertainties over the future. However, it is unlikely that the capital stock adjustment will be as significant as that seen at the time of the GFC, and business fixed investment is expected to increase again thereafter with the impact of COVID-19 waning. This is against the background of accommodative financial conditions being maintained owing to the Bank's and the government's measures to

support financing, mainly of firms, as well as efforts made by financial institutions together with those measures. Meanwhile, public investment is projected to steadily increase, reflecting progress such as in construction related to restoration and reconstruction following natural disasters, as well as to building national resilience. Thereafter, it is expected to be at a relatively high level.

Reflecting these developments in demand both at home and abroad, Japan's economic growth rate is expected to be significantly negative for fiscal 2020. However, the economy is likely to mark relatively high growth for fiscal 2021, when the impact of COVID-19 is expected to wane, and then continue to grow firmly for fiscal 2022, mainly on the back of improvement in overseas economies. Compared with the previous projections in the July Outlook Report, the projected growth rate is lower for fiscal 2020, mainly due to a delay in recovery in services demand, but is somewhat higher for fiscal 2021 and more or less unchanged for fiscal 2022.

The potential growth rate seems to have declined to around 0 percent recently (Chart 3). This is largely because total factor productivity (TFP) has declined, mainly due to preventive measures against COVID-19 and to labor hoarding, and working hours have been on a downtrend due to temporary store closures and shorter operating hours. For the time being, although the downtrend in working hours is likely to slow its pace, the potential growth rate is expected to remain at around the current low level since a decline in business fixed investment is likely to cause deceleration in the growth of capital stock. That

**Chart 3: Potential Growth Rate**



Source: Bank of Japan.  
 Note: Based on staff estimations. Figures for the first half of fiscal 2020 are those for 2020/Q2.

said, the rate is expected to rise moderately toward the end of the projection period. This is based on the projection that, (1) the TFP growth rate will increase moderately, reflecting adaptation to lifestyle changes that were caused by COVID-19, advances in digital transformation, and a resultant improvement in efficiency of resource allocation, and (2) the growth of capital stock will accelerate cyclically. However, there is a possibility that COVID-19 will bring about structural changes in people's working styles and firms' business processes, such as the widespread adoption of working from home and an acceleration in e-commerce, and these changes could lead to a trend that is different from the past one. Thus, the output gap and the potential growth rate, which are estimated based on a specific assumption regarding trends, should be interpreted with more latitude than usual. In addition, there are high uncertainties at this point over changes in households' behavior and structural changes in the corporate sector, both of which are assumed to bring about a future rise in the TFP growth rate.

Details of the outlook for each fiscal year are as follows. In the second half of fiscal 2020, with economic activity resuming and the impact of COVID-19 waning gradually, the economy is expected to continue picking up, mainly for exports and production, although downward pressure is expected to remain strong in the services industry in particular. Goods exports, mainly for automobile-related goods, are likely to continue increasing, partly supported by improvement in overseas economies and the materialization of pent-up demand. Meanwhile, inbound tourism demand, which is categorized as

services exports, is expected to remain significantly weak due to entry and travel restrictions to prevent COVID-19. Backed by the government's measures to support income and stimulate demand, private consumption is projected to continue picking up with an increase in the number of confirmed new cases of COVID-19 being constrained and restrictions on business activities, including holding of events, being eased gradually. However, the pace of increase in private consumption is likely to be quite moderate, mainly for face-to-face services, while people, seniors in particular, continue to be vigilant with regard to going out or contacting with others, and while social distancing remains a constraint on the supply side. Business fixed investment is projected to remain on a declining trend, with an increasing number of non-urgent projects being postponed against the background of deterioration in the profit environment and a decrease in demand. Meanwhile, public investment is expected to continue increasing steadily due to expansion such as in construction related to restoration and reconstruction following natural disasters, as well as to building national resilience. On the other hand, an increase in government consumption is likely to decelerate compared with fiscal 2019, mainly due to a drop in healthcare expenditure.

In fiscal 2021, as the impact of COVID-19 wanes at home and abroad and the growth rates of overseas economies rise, an improving trend in Japan's economy is expected to become evident, partly supported by accommodative financial conditions. Exports, including those of capital goods and IT-related goods, are expected to increase firmly amid improvement in overseas

economies. With the impact of COVID-19 continuing to wane, private consumption is likely to increase, albeit moderately, supported also by a pick-up in employee income and by Olympic Games-related demand. Business fixed investment is expected to turn to an uptrend, although construction investment, such as for commercial facilities and hotels, is likely to remain at a low level. This is because, with corporate profits improving, business fixed investment is projected to be pushed up by an undertaking of postponed investment projects and an increase in digital-related investment to set up systems for teleworking and contactless services. Meanwhile, government spending is likely to be at a high level, supported by expenditure on disaster-related reconstruction, river flood control projects, and infrastructure enhancements, as well as by that related to the Olympic Games.

In fiscal 2022, the economy is expected to continue growing firmly, with demand at home and abroad increasing in a well-balanced manner. Exports are likely to continue increasing clearly, reflecting improvement in overseas economies. In this situation, corporate profits are expected to follow their improving trend. Regarding business fixed investment, machinery investment is likely to see an acceleration in its growth pace, and digital-related investment as well as research and development (R&D) investment for growth areas also are likely to continue increasing. Private consumption is expected to continue increasing, with people, including seniors, adapting to lifestyle changes that were caused by COVID-19 and a virtuous cycle from income to spending operating. Meanwhile, although Olympic Games-related expenditure will have been

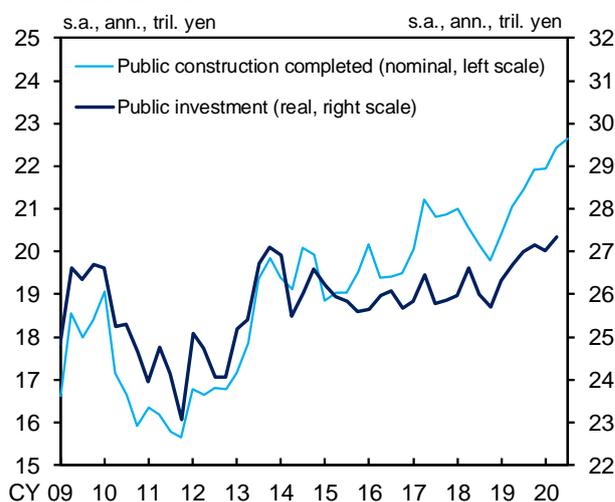
completed, government spending is likely to remain at a high level, due partly to demand for maintenance and replacement of decaying infrastructures.

## B. Developments in Major Expenditure Items and Their Background

### Government Spending

Public investment has continued to increase moderately (Chart 4). The amount of public construction completed, which is a coincident indicator, has continued to increase moderately since early 2019. The value of public works contracted, as well as orders received for public construction, both of which are leading indicators, have been on a moderate uptrend, albeit with fluctuations, reflecting such progress as in construction related to restoration and reconstruction following natural disasters, as well as to building national resilience.<sup>9</sup> As for the outlook, public investment is expected to continue increasing steadily for the time being due to the progress in the aforementioned infrastructure-related construction. Thereafter, albeit with a slower pace of increase, public investment is likely to be at a relatively high level, mainly supported by construction of Olympic Games-related temporary facilities and measures to address existing social capital stock that has been decaying.<sup>10</sup>

**Chart 4: Public Investment**



Sources: Cabinet Office; Ministry of Land, Infrastructure, Transport and Tourism.  
Note: The figure for 2020/Q3 is the July-August average.

<sup>9</sup> In view of the three-year emergency response plan for disaster prevention, disaster mitigation, and building national resilience decided by the Cabinet in December 2018 -- with a total project size of 7 trillion yen -- measures to maintain functions, such as of important infrastructure, are to be implemented intensively over three years, from fiscal 2018 through fiscal 2020.

<sup>10</sup> It is assumed that public investment will be pushed up by the Comprehensive Economic Measures to Create a Future with Security and Growth -- with a project size of around 26.0 trillion yen and fiscal spending of around 13.2 trillion yen -- which was decided by the Cabinet in December 2019, mainly led by construction related to restoration and reconstruction following natural disasters as well as to flood control.

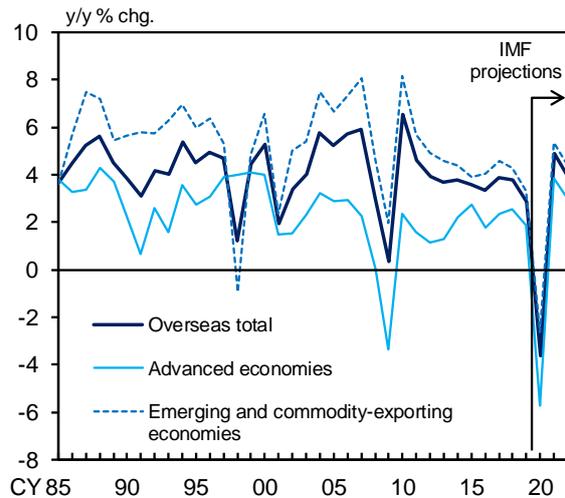
## Overseas Economies

Overseas economies have picked up from a state of significant depression (Chart 5).<sup>11</sup> The growth rates in many economies for the April-June quarter registered their largest-ever declines due to the strict and wide-ranging public health measures, such as lockdowns. However, the growth rates seem to have been relatively high for the July-September quarter, reflecting a resumption of economic activity, the materialization of pent-up demand, and a recovery in production from the decline brought about by COVID-19. In fact, the Global PMI shows that business sentiment has clearly improved to date, and global production and the world trade volume seem to have picked up (Chart 6). However, amid the number of confirmed new cases of COVID-19 increasing or remaining high in some countries and regions, economic activities have remained at low levels, mainly for services consumption, and significant variations in the pace of improvement have been observed across industries and countries.

Looking at developments by major region, the Chinese economy has recovered due to the emergence of the effects of aggressive macroeconomic policies and the materialization of pent-up demand. The U.S. and European economies have picked up from a state of significant depression. Emerging and commodity-exporting economies other than China have remained depressed, but a pick-up has been seen in part.

<sup>11</sup> With regard to the impact of COVID-19 on developments in overseas economies, see Box 1.

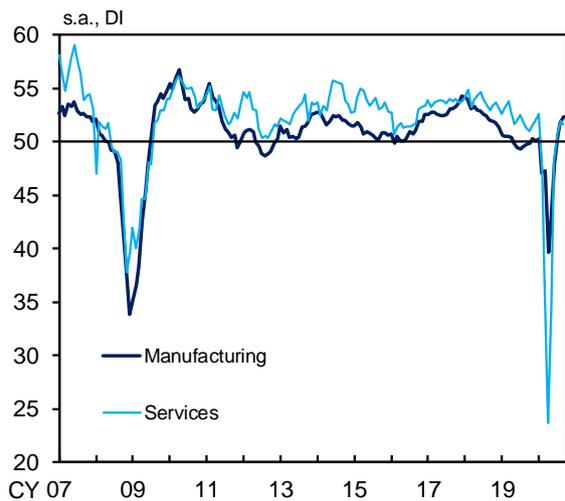
### Chart 5: Overseas Economies



Sources: IMF; Ministry of Finance.

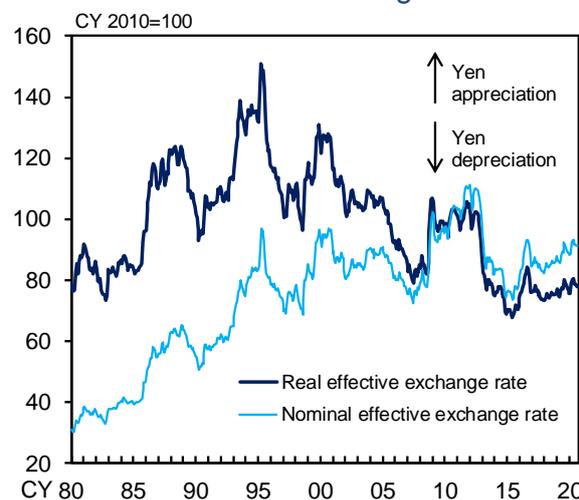
Note: Figures are the weighted averages of real GDP growth rates using countries' share in Japan's exports as weights. Annual GDP growth rates are from the "World Economic Outlook (WEO)" as of October 2020. Advanced economies consist of the United States, the euro area, and the United Kingdom. Emerging and commodity-exporting economies consist of the rest of the world economy.

### Chart 6: Global PMI



Source: IHS Markit (© and database right IHS Markit Ltd 2020. All rights reserved.). Note: Figures for manufacturing are the "J.P.Morgan Global Manufacturing PMI." Figures for services are the "J.P.Morgan Global Services Business Activity Index."

### Chart 7: Effective Exchange Rates



Source: BIS.

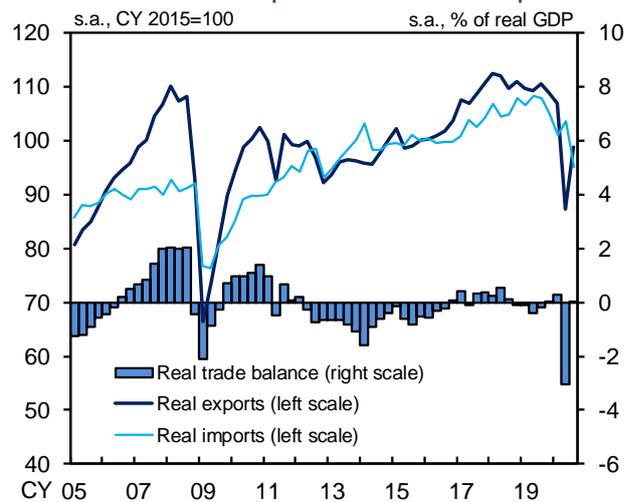
Note: Figures are based on the broad index of the "Effective Exchange Rate." Those prior to 1994 are calculated using the narrow index.

As for the outlook, with the impact of COVID-19 waning gradually, overseas economies are likely to improve, partly supported by aggressive macroeconomic policies taken by each country and region. That said, it is highly likely that the pace of improvement will be only moderate for the time being since people will remain cautious in their spending activities due to vigilance against COVID-19. Toward the second half of the projection period, the stimulus effects of macroeconomic policies are projected to dissipate, but overseas economies are likely to continue growing. This is because the pick-ups in services consumption and business fixed investment, both of which have been notably slow to recover, are expected to become evident gradually with the impact of COVID-19 subsiding.

## Exports and Imports

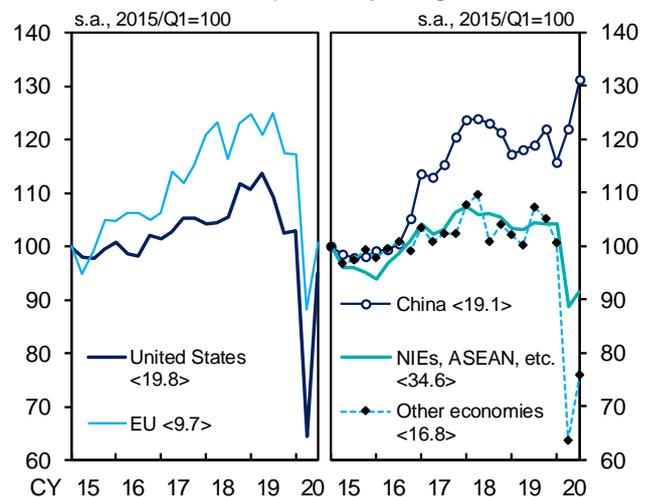
Exports have increased, reflecting developments in overseas economies (Chart 8). By region, exports to advanced economies have increased clearly due both to recovery in automobile sales and progress in inventory adjustments in those economies (Chart 9). Regarding exports to emerging economies, those to China have continued to increase firmly, whereas those to the NIEs and the ASEAN countries, as well as to other regions, have remained at low levels. By goods, exports of automobile-related goods have increased clearly, reflecting a recovery in automobile sales in the United States, Europe, and China (Chart 10). IT-related exports saw a relatively large decline in early spring, mainly for parts for on-board equipment for motor vehicles and those for smartphones. However, they have turned to an increase recently on the back of firm developments in parts for data centers and in

**Chart 8: Real Exports and Real Imports**



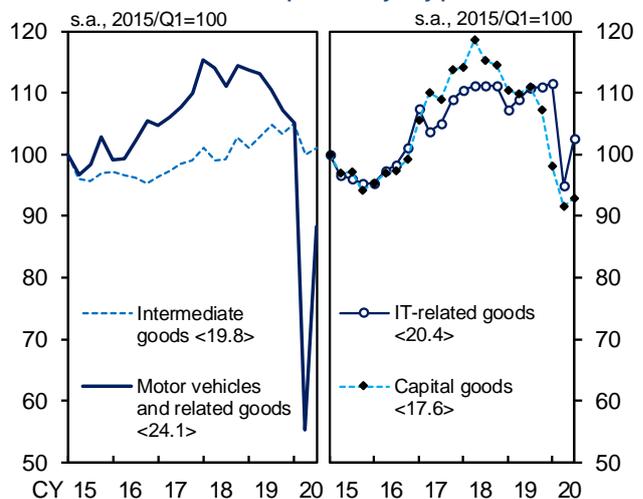
Sources: Bank of Japan; Ministry of Finance; Cabinet Office.  
 Note: Based on staff calculations.

**Chart 9: Real Exports by Region**



Sources: Bank of Japan; Ministry of Finance.  
 Notes: 1. Based on staff calculations. Figures in angular brackets show the share of each country or region in Japan's total exports in 2019.  
 2. "EU" does not include the United Kingdom for the entire period.

**Chart 10: Real Exports by Type of Goods**



Sources: Bank of Japan; Ministry of Finance.  
 Note: Based on staff calculations. Figures in angular brackets show the share of each type of goods in Japan's total exports in 2019.

those related to personal computers, as well as of a pick-up in parts for on-board equipment for motor vehicles. Exports of capital goods declined, mainly for metalworking machinery, as well as construction and mining machinery, reflecting a global postponement of business fixed investment. However, they have bottomed out recently due to a global pick-up in the production activity. Meanwhile, exports of intermediate goods declined, reflecting a decrease in exports of iron and steel to the NIEs and the ASEAN countries. They have increased marginally of late, mainly due to a rise in exports of chemicals to China.

With the impact of COVID-19 waning globally, exports are likely to continue increasing firmly for the time being, partly supported by the materialization of pent-up demand. By goods, exports are expected to increase for the time being, mainly for automobile-related goods, and the uptrend in exports is likely to become evident thereafter for a wider range of goods. Specifically, exports of automobile-related goods are expected to continue increasing clearly for the time being, reflecting a recovery in automobile sales that is partly supported by the materialization of pent-up demand in the United States, Europe, and China. Thereafter, the pace of increase is likely to decelerate gradually. Although IT-related exports may be affected by the U.S.-China trade friction in the short run, they are likely to continue increasing as a trend. This is because, while demand for parts for data centers, those related to personal computers, and those for on-board equipment for motor vehicles is expected to remain firm, demand for parts for 5G-related equipment is projected to increase. Capital goods exports are likely to bottom out, supported by firm

exports to China. They are expected to turn to an uptrend thereafter since business fixed investment that had been postponed is projected to recover globally with the impact of COVID-19 waning further.

Looking at the outlook for exports relative to the world trade volume, they are likely to increase. This is based on the projection that (1) the world trade volume will return to its uptrend and (2) Japan's share of exports in world trade also will pick up, reflecting a recovery in exports of automobile-related goods and capital goods (Charts 11 and 12).<sup>12</sup> The world trade volume decreased significantly for the April-June quarter but seems to have rebounded, having clearly picked up for the July-September quarter. Thereafter, the world trade volume is expected to increase moderately as the production activity of the manufacturing industry is projected to continue recovering with the impact of COVID-19 waning globally. On the other hand, Japan's share of exports in world trade has plunged, reflecting a decline in the trade volume of automobile-related goods and capital goods, both of which account for a large share of Japan's exports. However, it is likely to pick up gradually on the back of a global recovery in consumption for durable goods and in demand for business fixed investment.

Imports increased temporarily in early spring because economic activity resumed in China while demand for some products, such as personal computers and masks, rose due to COVID-19. That said, they have been weak

**Chart 11: World Trade Volume and Real GDP of the World Economy**



Sources: CPB Netherlands Bureau for Economic Policy Analysis; IMF, etc.  
 Notes: 1. Figures for the trade volume are those for real imports.  
 The figure for 2020/Q3 is the percentage change from the July-September 2019 average to the July-August 2020 average.  
 2. Real GDP of the world economy is based on staff calculations using GDP shares of world total GDP from the IMF as weights.

**Chart 12: Japan's Share of Exports in World Trade**



Source: CPB Netherlands Bureau for Economic Policy Analysis.  
 Note: Japan's share of exports in world trade is obtained by dividing Japan's real exports by world real imports (2010 prices). The figure for 2020/Q3 is the July-August average.

<sup>12</sup> The world trade volume is calculated by adding up real imports in each country.

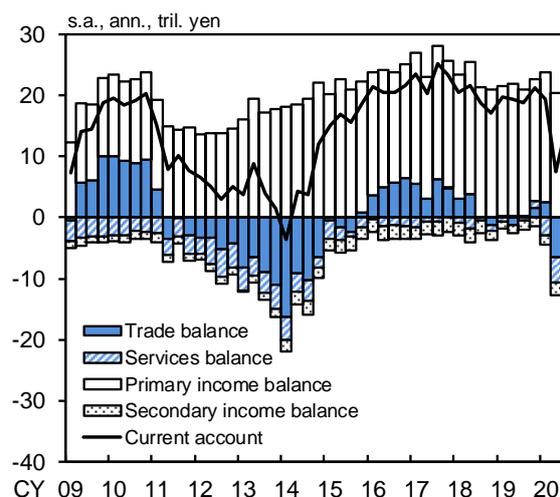
recently, reflecting the low level of domestic economic activity (Chart 8). Imports are expected to gradually return to an uptrend along with improvement in domestic economic activity.

## External Balance

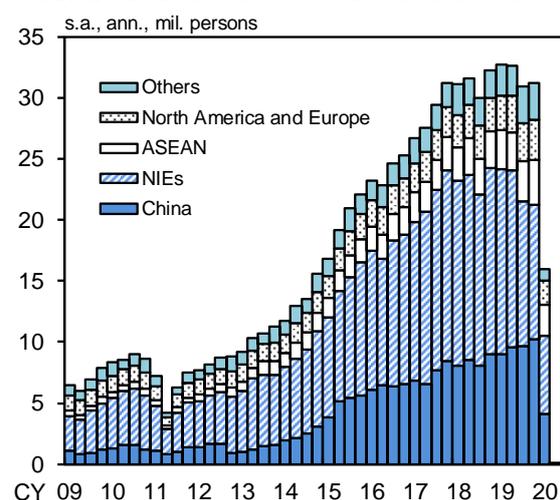
The nominal current account surplus declined around spring, mainly due to deterioration in the trade balance, but has been on an expanding trend recently (Chart 13). Looking at the breakdown of developments in the current account balance, although the nominal trade balance marked a relatively large deficit temporarily around spring due to a decline in exports, it has registered a surplus recently, mainly reflecting an increase in exports. On the other hand, the services balance has continued to register a deficit, reflecting deterioration in the travel balance, as described later. The primary income balance has been supported mainly by the interest income from past securities investment, but the surplus has been narrowing as a trend since the surplus on direct investment income has declined, reflecting the stagnation in overseas economic activity.

Meanwhile, as entry and travel restrictions remain in place to contain the spread of COVID-19, there have been almost no inbound visitors (Chart 14). As a result of these developments, travel receipts have declined significantly. Although travel payment also has decreased due to a smaller number of departures stemming from travel restrictions, the net travel balance has deteriorated since the impact of the decline in receipts is larger than that in payment.

### Chart 13: Current Account

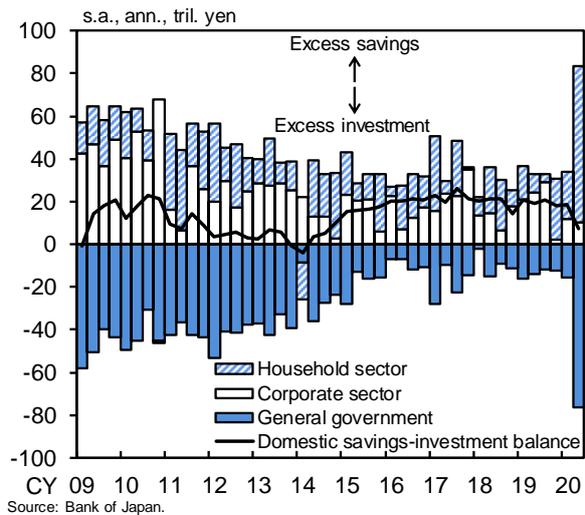


### Chart 14: Number of Inbound Visitors



The nominal current account surplus is expected to increase moderately from the bottom hit around this spring, on the back of improvements in the trade balance and the primary income balance that reflect a recovery in overseas economies. In terms of the savings-investment balance, overall excess savings in Japan's economy have declined, with the expansion in the fiscal deficit due to the conduct of economic measures exceeding that in excess savings in the private sector (Chart 15). However, thereafter, overall excess savings are projected to expand moderately, mainly due to improvement in the fiscal balance.

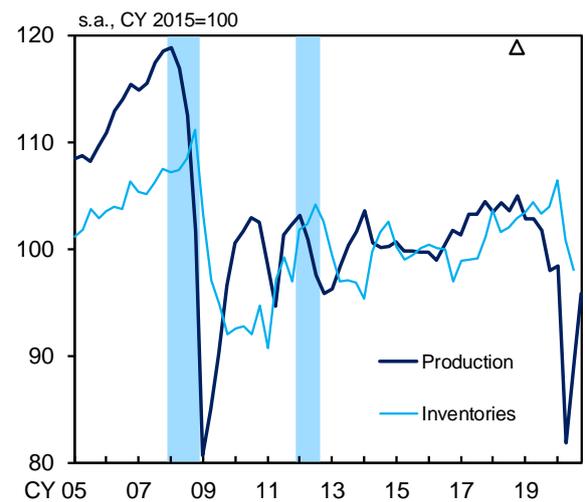
**Chart 15: Savings-Investment Balance**



## Industrial Production

Industrial production has increased (Chart 16). By major industry, transport equipment production decreased significantly around spring, mainly for goods related to automobiles and aircraft. However, it has turned to an increase thereafter on the back of a recovery in global automobile sales and the resultant progress in inventory adjustments. Such developments have spread to related industries such as materials. For example, production of iron and steel, as well as nonferrous metals, has headed toward a pick-up, although it has remained at a low level. Production of electronic parts and devices also has picked up from the bottom hit around spring, supported by an increase in demand for parts for data centers, those related to personal computers, and those for on-board equipment for motor vehicles. On the other hand, the production of machinery (i.e., "general-purpose, production, and business-oriented machinery" in the *Indices of Industrial Production*) has remained under strong downward pressure, mainly for metalworking

**Chart 16: Industrial Production**



Notes: 1. Shaded areas indicate recession periods. The triangle shows the latest peak.  
2. The production figures for 2020/Q3 and Q4 are calculated based on METI projections for September and October 2020.  
The inventories figure for 2020/Q3 is that for August.

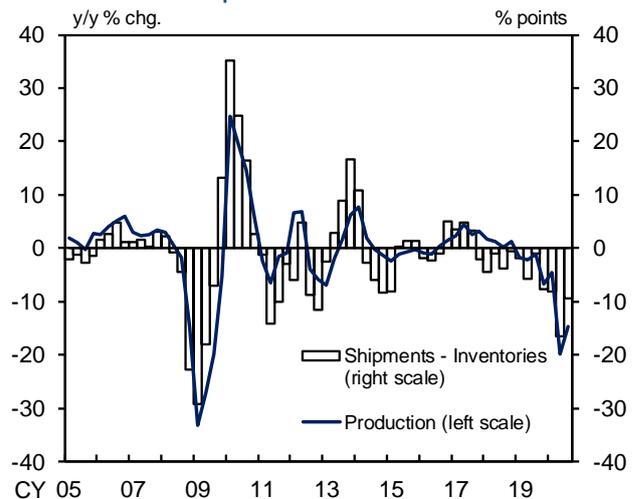
machinery, as well as construction and mining machinery, partly due to inventory adjustments. Meanwhile, the shipments-inventories balance (i.e., the year-on-year rate of change in shipments minus that in inventories) has turned to an improvement with progress in inventory adjustments that reflect the decrease in domestic and overseas demand due to COVID-19 (Chart 17). This progress has been happening at a relatively fast pace, mainly in transport equipment production.

With the impact of COVID-19 waning at home and abroad and partly supported by the materialization of pent-up demand, industrial production is likely to continue increasing firmly for the time being, mainly for transport equipment production.

### Corporate Profits

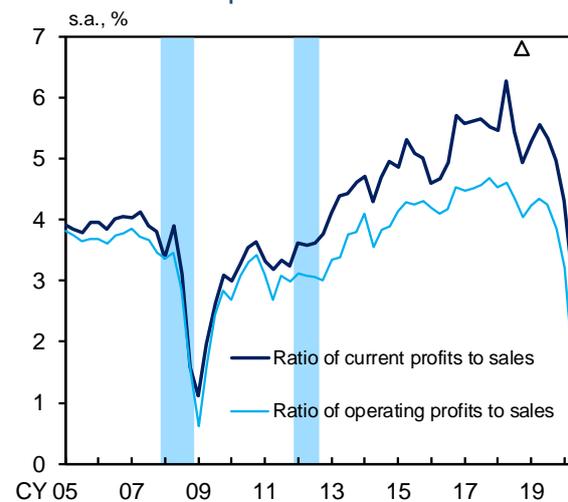
Corporate profits have deteriorated substantially, reflecting a rapid drop in domestic and overseas demand. According to the *Financial Statements Statistics of Corporations by Industry, Quarterly* (FSSC), the ratios of profits to sales for all industries and enterprises were already on a downtrend from the second half of last fiscal year, reflecting the effects of the slowdown in overseas economies and the consumption tax hike, and those for the April-June quarter have declined further due to the impact of COVID-19 (Chart 18). Looking at the ratios by firm size, the rates of decline in those for small and medium-sized firms in both the manufacturing and nonmanufacturing industries have been particularly large.

**Chart 17: Shipments-Inventories Balance**



Source: Ministry of Economy, Trade and Industry.  
 Note: The production figure and the shipments figure for 2020/Q3 are July-August averages. The inventories figure for 2020/Q3 is that for August.

**Chart 18: Corporate Profits**



Source: Ministry of Finance.  
 Notes: 1. Based on the "Financial Statements Statistics of Corporations by Industry, Quarterly." Excluding "finance and insurance."  
 2. Figures from 2009/Q2 exclude "pure holding companies."  
 3. Shaded areas indicate recession periods. The triangle shows the latest peak.

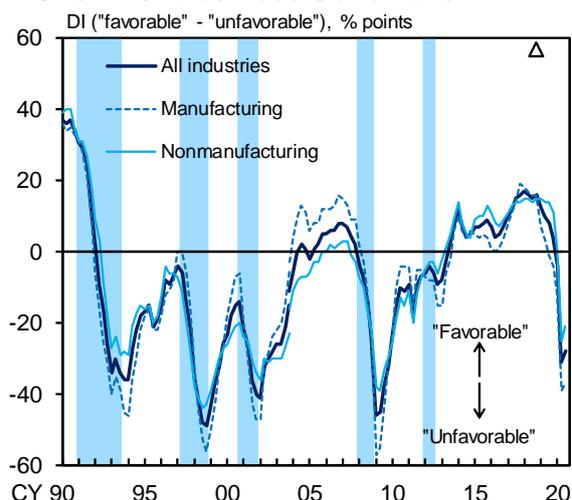
Business sentiment deteriorated significantly, but has improved somewhat. According to the diffusion index (DI) for business conditions for all industries and enterprises in the *Tankan* (Short-Term Economic Survey of Enterprises in Japan), the net "unfavorable" for that DI in the June survey hit a low level not seen since the GFC, but it improved marginally in the September survey (Chart 19). By industry, the DI for the manufacturing industry declined significantly, mainly for automobiles. However, it bottomed out and has headed toward a pick-up recently, supported by a domestic and overseas recovery in sales and production of automobiles. The DI for the nonmanufacturing industry declined rapidly, mainly for accommodations, eating and drinking, as well as services for individuals, due to the effects of temporary store closures and business restrictions. However, it has improved quite moderately of late, reflecting businesses reopening.

Corporate profits are likely to remain at low levels for the time being, mainly for face-to-face services, due to the impact of COVID-19. Thereafter, with the impact waning globally, they are expected to gradually return to their improving trend, reflecting a recovery in domestic and overseas demand.

## Business Fixed Investment

Business fixed investment has been on a declining trend (Chart 20). The aggregate supply of capital goods -- a coincident indicator of machinery investment -- has declined clearly due to deterioration in corporate profits and to increasing uncertainties over the future, both because of the impact of COVID-19. Private

**Chart 19: Business Conditions**



Source: Bank of Japan.  
 Notes: 1. Based on the *Tankan*. All enterprises. There is a discontinuity in the data in December 2003 due to a change in the survey framework.  
 2. Shaded areas indicate recession periods. The triangle shows the latest peak.

**Chart 20: Coincident Indicators of Business Fixed Investment**

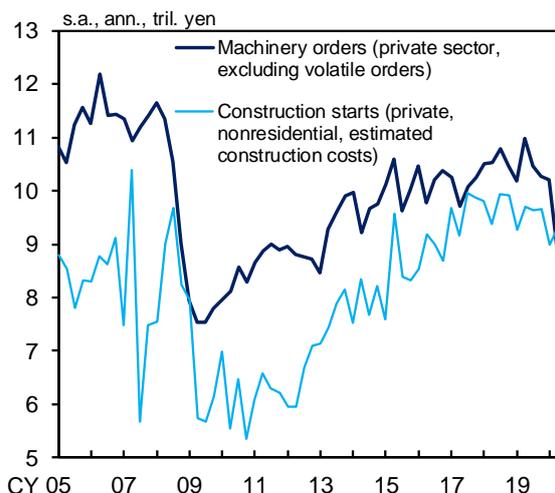


Sources: Cabinet Office; Ministry of Economy, Trade and Industry; Ministry of Land, Infrastructure, Transport and Tourism.  
 Notes: 1. Figures for 2020/Q3 are July-August averages.  
 2. Real private construction completed is based on staff calculations using price indices in the "Construction Cost Deflators."

construction completed (nonresidential) -- a coincident indicator of construction investment -- has been on a moderate declining trend, partly due to large-scale Olympic Games-related construction having almost completed.

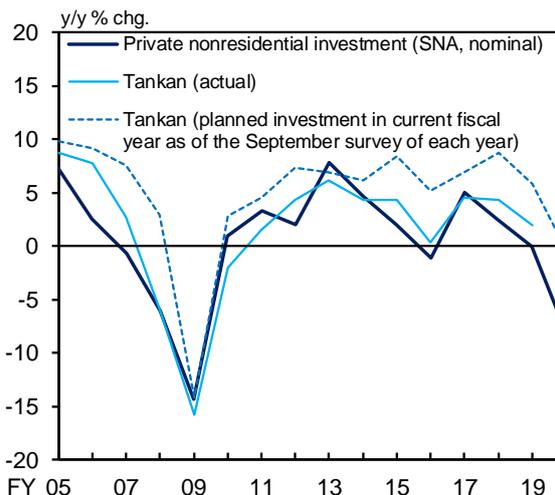
Machinery orders -- a leading indicator of machinery investment -- remained on a downtrend, but has shown signs of bottoming out recently on the back of increases in exports and production (Chart 21). On the other hand, a declining trend in construction starts (in terms of planned expenses for private and nonresidential construction) -- a leading indicator of construction investment -- has become evident recently. This is largely attributable to a decrease in construction of stores and accommodation facilities that has been seen mainly in the eating and drinking as well as accommodation industries, which have been affected by COVID-19. However, construction of warehouses, such as logistics facilities, has continued to increase on the back of expansion in e-commerce. Looking at the business fixed investment plan for this fiscal year in the *Tankan*, business fixed investment (on the basis close to GDP definition; business fixed investment -- including software and R&D investments, but excluding land purchasing expenses -- in all industries and enterprises including financial institutions) has decelerated clearly from the previous fiscal year and become negative on a year-on-year basis, albeit marginally, as of the September survey (Chart 22).<sup>13</sup>

**Chart 21: Leading Indicators of Business Fixed Investment**



Sources: Cabinet Office; Ministry of Land, Infrastructure, Transport and Tourism.  
Notes: 1. Volatile orders: orders for ships and orders from electric power companies.  
2. Figures for 2020/Q3 are July-August averages.

**Chart 22: Planned and Actual Business Fixed Investment**



Sources: Bank of Japan; Cabinet Office.  
Notes: 1. The *Tankan* figures include software and R&D investments and exclude land purchasing expenses (R&D investment is not included before the March 2017 survey). The figures are for all industries including financial institutions.  
2. The figure for private nonresidential investment for fiscal 2020 is that for 2020/Q2.

<sup>13</sup> Box 2 outlines recent developments in business fixed investment by type and industry.

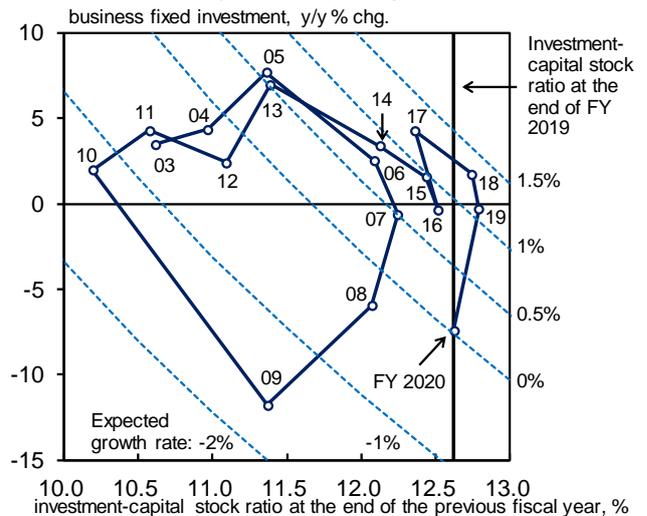
As for the outlook, business fixed investment is likely to continue its downtrend for the time being, mainly for construction investment by the face-to-face services industry, against the background of deterioration in corporate profits and high uncertainties over future developments related to COVID-19. That said, it is highly likely that the capital stock adjustment will not be as significant as that seen after the GFC (Chart 23). As the background to this, accommodative financial conditions are likely to be maintained on the back of the Bank's and the government's aggressive measures to support financing and of financial institutions' efforts together with those measures. Thereafter, with the impact of COVID-19 waning globally, business fixed investment is projected to return to a moderate uptrend, with some time lag from an improvement in corporate profits. Specifically, it is expected to be led mainly by (1) digital investment that is related to telework and remote services, (2) construction investment in logistics facilities reflecting expansion in e-commerce, and (3) software and R&D investments for growth areas.

### Employment and Income Situation

With the continuing impact of COVID-19, the employment and income situation has been weak.<sup>14</sup>

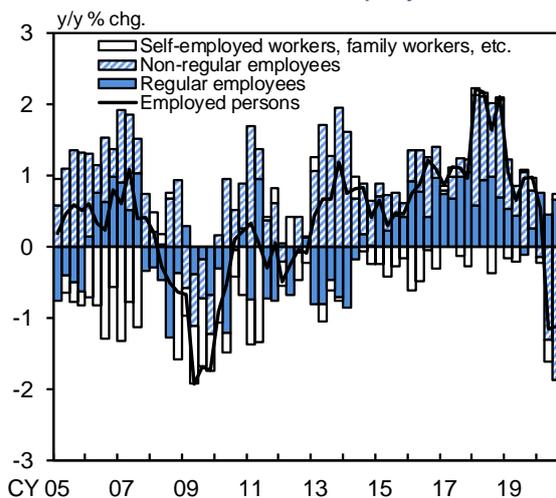
The year-on-year rate of change in the number of employed persons has continued to register a negative figure of slightly more than minus 1 percent, mainly due to a decrease in non-regular employees in the face-to-face services industry

**Chart 23: Capital Stock Cycles**



Source: Cabinet Office.  
 Note: Each broken line represents the combination of the rate of change in business fixed investment and the investment-capital stock ratio at a certain expected growth rate. The figure for fiscal 2020 is that for 2020/Q2.

**Chart 24: Number of Employed Persons**



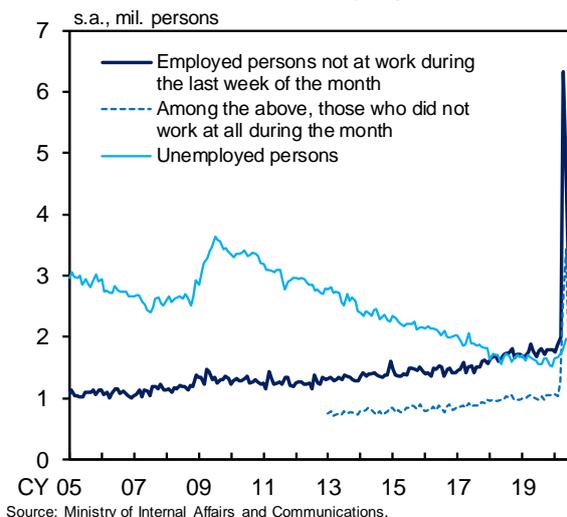
Source: Ministry of Internal Affairs and Communications.  
 Note: "Self-employed workers, family workers, etc." includes executives of companies or corporations. Figures prior to 2014 are based on the "detailed tabulation" in the "Labour Force Survey." Figures for 2020/Q3 are July-August averages.

<sup>14</sup> Box 3 outlines developments in adjustments in the labor market, mainly of the face-to-face services industry, in the current phase.

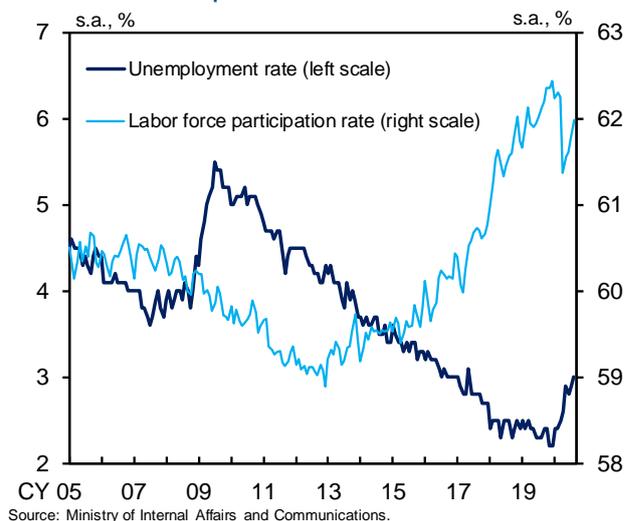
(Chart 24). However, the decline in the number of employed persons has been constrained compared with that in the level of economic activity. This is mainly because the employment adjustment subsidies, which were expanded in response to the current situation, have somewhat halted job cuts, and because bankruptcies of firms have been mitigated under the Bank's and the government's measures to support financing. The number of employed persons whose working hours were zero in the last week of each month (i.e., "employed persons not at work") spiked for the April-May period and has declined recently to around the pre-pandemic level. However, the number of hours and days worked per employee has remained at a low level (Chart 25). With regard to labor market conditions, the labor force participation rate declined around spring because some seniors, women, and student part-time workers were out of the labor market due to the impact of COVID-19 and school closures. However, since they have returned to the labor market, the labor force participation rate has increased recently (Chart 26). The unemployment rate rose toward early spring and has been more or less flat at around 3 percent. The active job openings-to-applicants ratio has continued to decline clearly, but the new job openings-to-applicants ratio, which is a leading indicator, has stopped declining (Chart 27).

As for the outlook, policy responses such as the employment adjustment subsidies and measures to support financing are likely to support employment, but with the continuing impact of COVID-19, albeit waning, it is expected that employment adjustment pressure will continue to be exerted to a certain level, mainly on

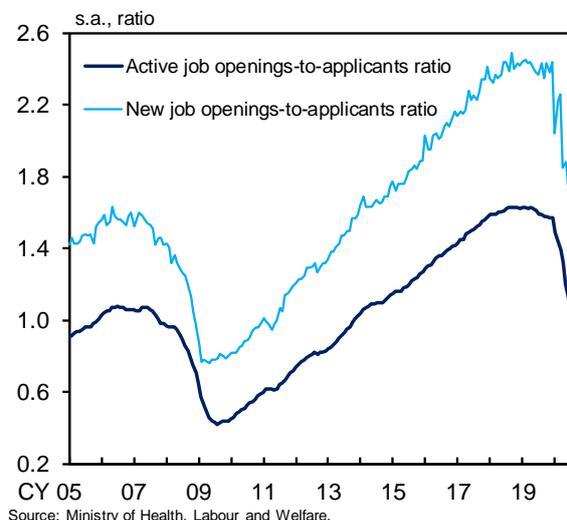
**Chart 25: Number of Employed Persons Not at Work and Unemployed Persons**



**Chart 26: Unemployment Rate and Labor Force Participation Rate**



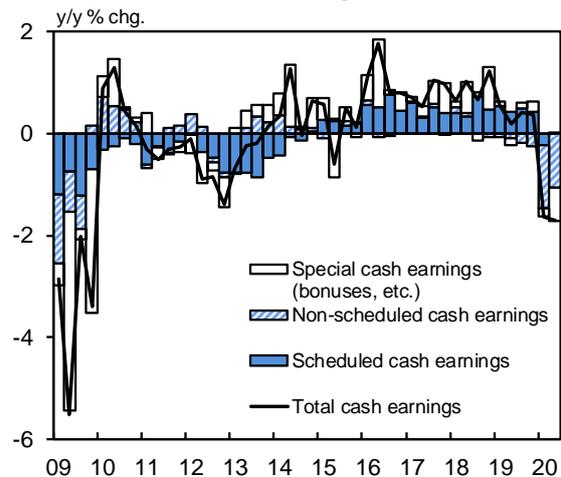
**Chart 27: Job Openings-to-Applicants Ratio**



non-regular employees in industries where the operation rates decline, such as eating and drinking, accommodations, as well as services for individuals. Toward the end of the projection period, with the impact of COVID-19 waning, the number of employed persons is likely to return to a moderate increasing trend as labor absorption is expected to progress to a certain degree, mainly in industries with labor shortage such as construction, as well as medical and elder care services.

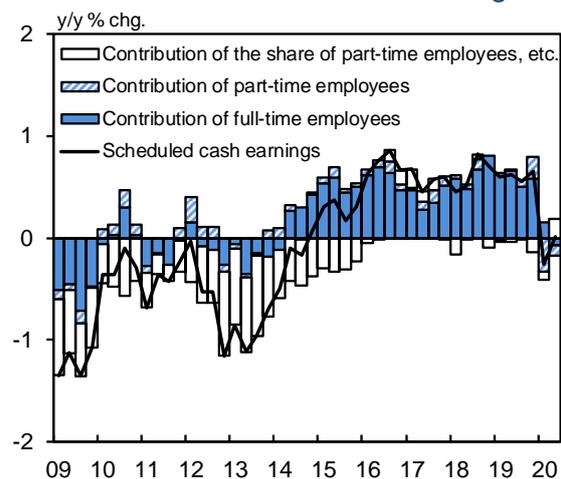
On the wage side, total cash earnings per employee have declined, mainly due to decreases in non-scheduled cash earnings and summer bonuses (Chart 28).<sup>15</sup> The year-on-year rate of change in scheduled cash earnings was negative due to an increase in the number of "employed persons not at work" and a decrease in working hours of mainly part-time employees (Chart 29).<sup>16</sup> However, it has been at around 0 percent recently along with a resumption of economic activity. With underlying downward pressure stemming from a decline in non-scheduled hours worked that has been brought about by working-style reforms, non-scheduled cash earnings have continued their downtrend, also affected by the decline in working hours due to the impact of COVID-19. Meanwhile, the year-on-year rate of change in special cash earnings has been clearly negative

**Chart 28: Nominal Wages**



Source: Ministry of Health, Labour and Welfare.  
 Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.  
 2. Figures from 2016/Q1 are based on continuing observations following the sample revisions.

**Chart 29: Scheduled Cash Earnings**



Source: Ministry of Health, Labour and Welfare.  
 Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.  
 2. Figures from 2016/Q1 are based on continuing observations following the sample revisions.

<sup>15</sup> Wages in the *Monthly Labour Survey* are assessed on the basis of continuing observations, which are less affected by the sample revisions.

<sup>16</sup> The Labor Standards Act stipulates that employers shall pay to their employees allowances for absence from work that are equivalent to 60 percent or more of the employees' average wages. Thus, an increase in the number of "employed persons not at work" and days absent from work will put downward pressure on scheduled cash earnings.

due to a decline in summer bonuses that reflects deterioration in corporate profits.

With regard to the outlook for wages, for the time being, scheduled cash earnings of full-time employees are expected to be underpinned by the base pay increases, most of which were decided before the pandemic. However, downward pressure on such earnings is likely to increase gradually as deterioration in business performance and the negative figure of CPI on a year-on-year basis are expected to be reflected with some time lag. The rate of change in non-scheduled cash earnings is likely to register relatively large negative growth for the time being due to the effects of shortened working hours. However, thereafter, it is expected to increase in negative territory with economic activity resuming. The rate of change in special cash earnings (bonuses), which lags behind corporate profits for about half a year, is highly likely to decline further within negative territory in the second half of the fiscal year -- when a significant deterioration in business performance for the first half of the fiscal year will be reflected in winter bonuses -- but turn positive thereafter. Under these circumstances, the year-on-year rate of change in total cash earnings per employee is projected to register relatively large negative growth for the time being. However, thereafter, it is likely to gradually start bottoming out with the impact of COVID-19 waning and increase moderately in positive territory toward the end of the projection period.

In light of the aforementioned employment and wage conditions, employee income has declined (Chart 30). It is projected to continue declining

**Chart 30: Employee Income**



Sources: Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications.

- Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.  
 2. Employee income = total cash earnings ("Monthly Labour Survey") × number of employees ("Labour Force Survey")  
 3. Figures from 2016/Q1 are based on continuing observations following the sample revisions of the "Monthly Labour Survey."  
 4. Real employee income is based on staff calculations using the CPI (less imputed rent).

**Chart 31: Labor Share**



Sources: Cabinet Office; Ministry of Finance.

- Notes: 1. Labor share (SNA) = compensation of employees / nominal GDP × 100  
 2. The labor share (FSSC) is based on the "Financial Statements Statistics of Corporations by Industry, Quarterly (FSSC)" and excludes "finance and insurance." Figures from 2009/Q2 exclude "pure holding companies."  
 3. Labor share (FSSC) = personnel expenses / (operating profits + personnel expenses + depreciation expenses) × 100  
 4. Shaded areas indicate recession periods. The triangle shows the latest peak.

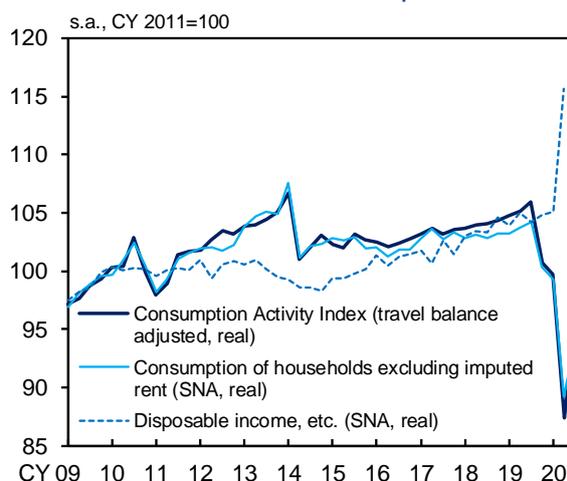
clearly for the time being, but thereafter is likely to return to a moderate increasing trend, while lagging somewhat behind economic improvement. The labor share has risen significantly, even compared with the past phases of economic downturn, since labor hoarding by firms and wage stickiness have been particularly strong amid the recent decline in economic activity (Chart 31). As for the outlook, however, the share is likely to turn to a moderate decreasing trend along with economic improvement.

### Household Spending

Private consumption has picked up gradually on the whole, although consumption of services, such as eating and drinking as well as accommodations, has remained at a low level.

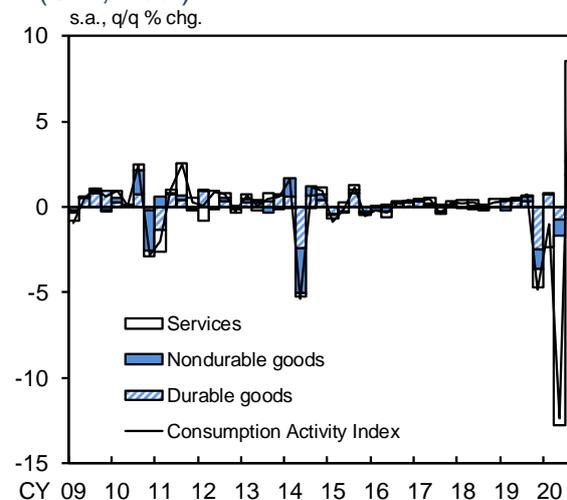
The Consumption Activity Index (CAI, travel balance adjusted) -- which is calculated by combining various sales and supply-side statistics from the viewpoint of gauging Japan's consumption activity in a comprehensive manner -- declined significantly for the April-June quarter due to the effects of the spread of COVID-19 and the declaration of a state of emergency.<sup>17</sup> The CAI for the July-August period has turned to a pick-up on the whole, mainly reflecting reopening of businesses and a provision of special cash payments, although the pick-up temporarily paused due to the effects of irregular weather and a resurgence of the number of confirmed new cases of COVID-19 (Charts 32 and 33). Based on various sources, such as high-frequency

**Chart 32: Private Consumption**



Sources: Bank of Japan; Cabinet Office, etc.  
 Notes: 1. The Consumption Activity Index is based on staff calculations (as of October 15). Figures for the Consumption Activity Index (travel balance adjusted) exclude inbound tourism consumption and include outbound tourism consumption. The figure for 2020/Q3 is the July-August average.  
 2. The figure for consumption of households excluding imputed rent for 2020/Q3 is based on staff calculations using the "Synthetic Consumption Index" (August).  
 3. "Disposable income, etc." consists of disposable income and "adjustment for the change in pension entitlements." Real values are obtained using the deflator of consumption of households.

**Chart 33: Consumption Activity Index (CAI, Real)**



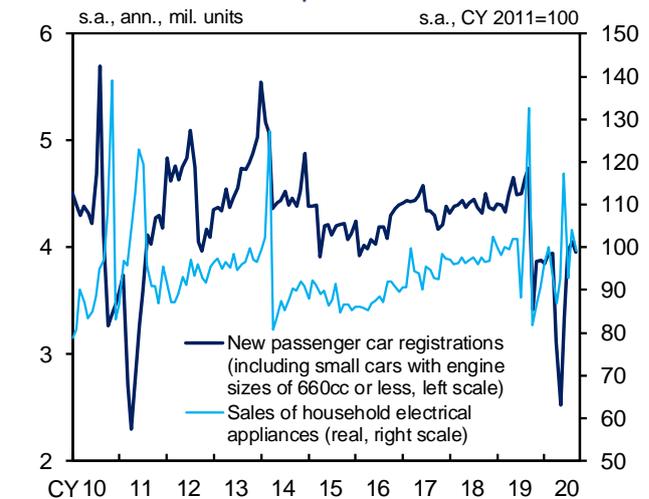
Sources: Bank of Japan, etc.  
 Notes: 1. Based on staff calculations (as of October 15). The Consumption Activity Index is adjusted for the travel balance. Figures for the components are not adjusted for the travel balance. Figures for 2020/Q3 are July-August averages.  
 2. Nondurable goods include goods classified as "semi-durable goods" in the SNA.

<sup>17</sup> Regarding the CAI, see the Bank's research paper "Revision of the Consumption Activity Index to Address the 2008 SNA and Improve Accuracy" published in April 2018.

indicators, statistics published by industry organizations, and anecdotal information from firms, a pick-up trend in consumption activities seems to be continuing after September, partly because an increase in the number of confirmed new cases of COVID-19 has been constrained again and various demand stimulus measures have had positive effects.<sup>18</sup>

Looking at private consumption by type, durable goods showed a relatively large decrease for the April-May period, but have picked up since June, partly supported by the provision of special cash payments and the materialization of pent-up demand (Chart 34). Specifically, automobile sales declined substantially for the April-May period, mainly reflecting a decline in the number of customers visiting dealerships. However, the sales have increased since June, reaching the pre-pandemic level on the back of a recovery in the number of such customers. With increasing demand for such items as personal computers, televisions, and air conditioners due to people spending more time at home, sales of household electrical appliances have been firm, also reflecting the effects of the provision of special cash payments, but the rate of increase currently is decelerating. Nondurable goods stopped declining and have headed toward a pick-up, albeit with fluctuations due to the effects of irregular weather and sales events. Food and daily necessities have remained firm on the back of the expansion in stay-at-home consumption, although the rates of increase have decelerated somewhat compared with a while ago. On the other hand, clothes declined significantly around

**Chart 34: Consumption of Durable Goods**



Sources: Japan Automobile Dealers Association; Japan Light Motor Vehicle and Motorcycle Association; Ministry of Economy, Trade and Industry; Ministry of Internal Affairs and Communications.

Note: Figures for real sales of household electrical appliances are based on staff calculations using the retail sales index of machinery and equipment in the "Current Survey of Commerce" and the price index of related items in the CPI.

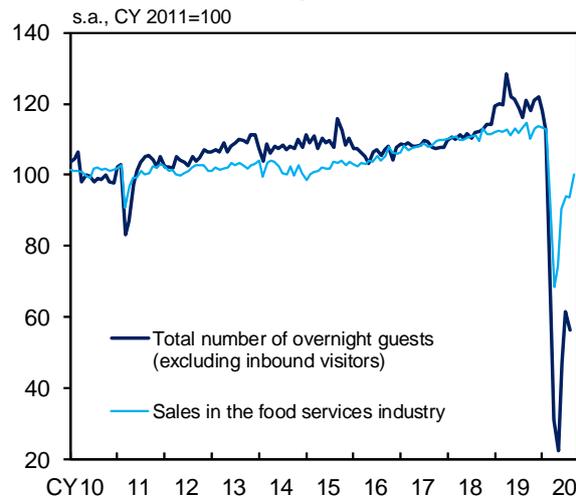
<sup>18</sup> Box 4 outlines developments in face-to-face services consumption to date, using high-frequency data as well.

spring and have remained relatively weak due to the effects of such factors as irregular weather. Services consumption has headed toward a pick-up from the bottom hit in the April-May period, when the state of emergency was in place. However, it has remained at a low level given the slow pace of improvement, as seen in a pause in the pick-up, due partly to the increase in the number of confirmed new cases of COVID-19 during the summer season (Chart 35). Dining-out declined substantially toward April but has increased gradually since May, when the state of emergency was lifted. However, it is still lower than the pre-pandemic level. Travel has remained weak to a considerable degree. Improvement in domestic travel paused temporarily due to the increase in the number of confirmed new cases of COVID-19 during the summer season. However, due partly to the effects of demand stimulus measures such as the "Go To" campaign, domestic travel has picked up gradually, although it has been at a low level. On the other hand, there has been almost no overseas travel due to continued travel restrictions.

Looking at confidence indicators related to private consumption, the Consumer Confidence Index and the DI of the *Economy Watchers Survey* have been on an improving trend after bottoming out in April, albeit with fluctuations that mainly reflect an increase and decrease in the number of confirmed new cases of COVID-19 (Chart 36).

In the outlook, private consumption is likely to continue picking up, partly supported by demand stimulus measures such as the "Go To" campaign. That said, while the impact of COVID-19 remains,

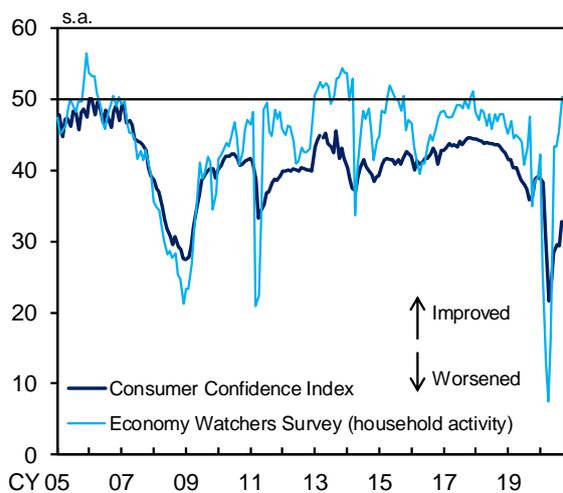
**Chart 35: Consumption of Services**



Sources: Japan Tourism Agency; Japan Foodservice Association, "Market Trend Survey of the Food Services Industry."

Note: Figures for the "total number of overnight guests (excluding inbound visitors)" in 2010 are calculated using those of accommodation facilities with more than nine employees.

**Chart 36: Confidence Indicators Related to Private Consumption**



Source: Cabinet Office.

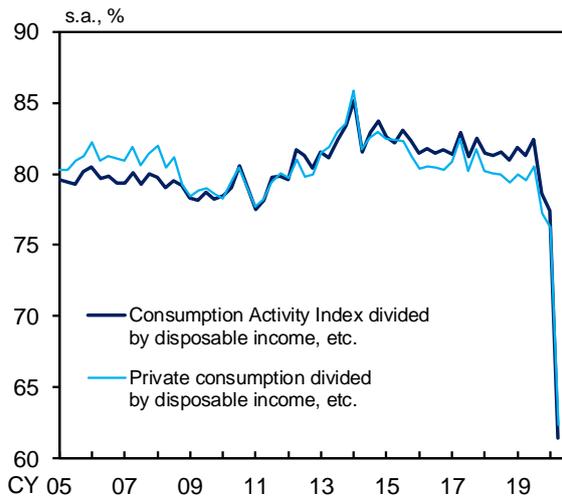
Note: Figures for the "Economy Watchers Survey" are those for the current economic conditions DI.

the pace of increase in private consumption is highly likely to be quite moderate because (1) a decline in the operation rates, mainly for dining-out and services for individuals, is inevitable and (2) there is strong vigilance against COVID-19, mainly by seniors. Thereafter, if households and firms adapt to lifestyle changes and if there is innovation in goods and services that meet new demand, the increasing trend in private consumption is likely to become evident gradually, partly supported by improvement in employee income.

The propensity to consume has declined significantly of late, reflecting (1) a sharp drop in private consumption and (2) an increase in disposable income due to various income support measures (Chart 37). As for the outlook, the propensity is likely to increase as the degree of COVID-19 constraining consumption activity is expected to decline. However, it is highly likely to remain at a somewhat low level compared with the past average, mainly due to uncertainties over future developments related to COVID-19.

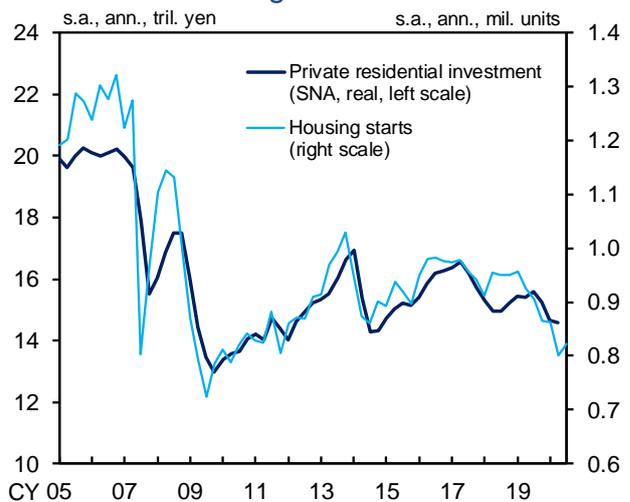
Housing investment has declined moderately (Chart 38). The number of housing starts -- a leading indicator of housing investment -- declined due to the effects of the consumption tax hike and COVID-19, but its rate of decline has decelerated recently. As for the outlook, housing investment is likely to continue decreasing moderately for the time being. However, it is expected to bottom out and then gradually turn to a pick-up, partly supported by accommodative financial conditions, and continue to be more or less flat from a somewhat long-term perspective.

**Chart 37: Average Propensity to Consume**



Sources: Bank of Japan; Cabinet Office, etc.  
 Notes: 1. The Consumption Activity Index is adjusted for the travel balance. Based on staff calculations (as of October 15).  
 2. Private consumption is consumption of households excluding imputed rent.  
 3. "Disposable income, etc." consists of disposable income and "adjustment for the change in pension entitlements."

**Chart 38: Housing Investment**



Sources: Cabinet Office; Ministry of Land, Infrastructure, Transport and Tourism.  
 Note: The figure for 2020/Q3 is the July-August average.

## II. Current Situation of Prices and Their Outlook

### Developments in Prices

The rate of change in the producer price index (PPI, adjusted for the effects of seasonal changes in electricity rates) has turned to an increase, reflecting developments in international commodity prices (Chart 39). The year-on-year rate of change in the services producer price index (SPPI, excluding international transportation) registered a negative figure of more than minus 1 percent for the April-June quarter, particularly for advertising services, hotels, as well as sales space and hotel rental. This is mainly against the background of increasing pressure stemming from cost cuts in response to deterioration in corporate profits and of the effects of a decrease in demand for travel, as well as eating and drinking, due to the impact of COVID-19. However, the rate of decline in the SPPI has decelerated to date.

The year-on-year rate of change in the CPI (all items less fresh food) has decelerated and become slightly negative, mainly due to the impact of COVID-19, the past decline in crude oil prices, and a decrease in hotel charges that reflects a discount through the "Go To Travel" campaign (Charts 39 and 40).<sup>19</sup> That in the CPI

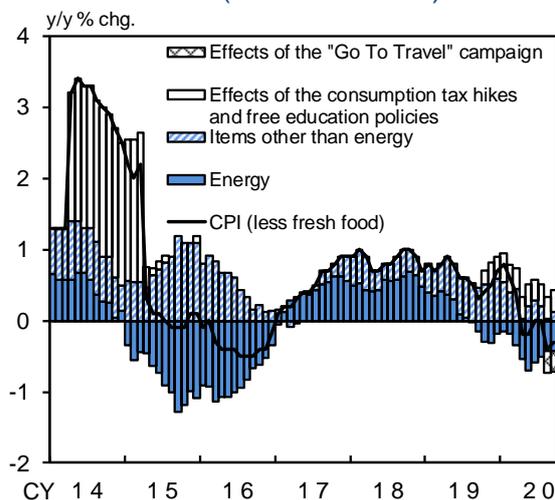
<sup>19</sup> The "Go To Travel" campaign offers up to a 35 percent discount for domestic travel, with a maximum of 14 thousand yen per person per night, on fees for registered accommodation facilities. Based on the campaign period that has been announced at this point and the effects on the actual CPI estimated by the Statistics Bureau of Japan, the Bank estimates in the October 2020 Outlook Report that this campaign will push down both the year-on-year rate of change in the CPI (all items less fresh food) and that in the CPI (all items less fresh food and energy) by around 0.3 to 0.4 percentage point during the six months from August 2020 through

### Chart 39: Inflation Indicators

	y/y % chg.			
	19/Q4	20/Q1	20/Q2	20/Q3
<b>Consumer Price Index (CPI)</b>				
Less fresh food	0.6	0.6	-0.1	-0.2
Adjusted figure	0.2	0.2	-0.4	-0.3
Less fresh food and energy	0.8	0.7	0.4	0.1
Adjusted figure	0.6	0.4	0.2	0.2
<b>Producer Price Index (q/q % chg.)</b>	-0.1	-0.4	-2.4	0.6
<b>Services Producer Price Index</b>	0.3	0.1	-1.1	-0.6
<b>GDP deflator</b>	1.2	0.9	1.3	
Domestic demand deflator	0.7	0.7	-0.1	

Sources: Ministry of Internal Affairs and Communications; Bank of Japan; Cabinet Office.  
Notes: 1. Adjusted figures exclude the effects of the consumption tax hike, policies concerning the provision of free education, and the "Go To Travel" campaign, which covers a portion of domestic travel expenses. The figures from 2020/Q2 onward are based on staff estimations, and exclude the effects of measures such as free higher education introduced in April 2020.  
2. Figures for the Producer Price Index are adjusted for the hike in electric power charges during the summer season.  
3. Figures for the Services Producer Price Index exclude international transportation.  
4. Figures for the Producer Price Index and the Services Producer Price Index exclude the effects of the consumption tax hike.

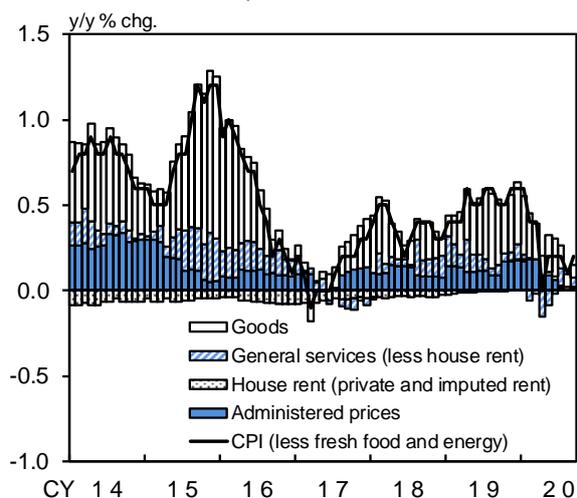
### Chart 40: CPI (less fresh food)



Source: Ministry of Internal Affairs and Communications.  
Notes: 1. Energy consists of petroleum products, electricity, and gas, manufactured & piped.  
2. Figures for the "effects of the consumption tax hikes and free education policies" from April 2020 onward are based on staff estimations, and include the effects of measures such as free higher education introduced in April 2020.

(all items less fresh food and energy) also decelerated after the turn of the year, and has been at around 0 percent recently, partly due to the effects of the "Go To Travel" campaign. The year-on-year rate of change in the CPI (all items less fresh food and energy, excluding the effects of temporary factors of the consumption tax hikes, policies concerning the provision of free education, and the "Go To Travel" campaign) also has been slightly positive recently (Chart 41). Looking at the breakdown of developments in this CPI, the year-on-year rate of increase in goods has decelerated, mainly due to a deceleration in the rate of increase in food products that are sensitive to economic activity and to a decline in clothes. The rate of change in general services has been slightly positive on the whole, albeit with fluctuations; hotel charges (excluding the effects of the "Go To Travel" campaign) and charges for package tours to overseas have declined, whereas the rate of change in dining-out has remained positive. Meanwhile, the rate of increase in administered prices has declined to around 0 percent, due mainly to reductions in or exemptions for water charges, sewerage charges, and school lunch charges implemented by some local governments, and to a reduction in airfare.

**Chart 41: CPI (less fresh food and energy)**



Source: Ministry of Internal Affairs and Communications.

Notes: 1. Administered prices (less energy) consist of "public services" and "water charges."

2. The CPI figures exclude the effects of the consumption tax hikes, policies concerning the provision of free education, and the "Go To Travel" campaign, which covers a portion of domestic travel expenses. The figures from April 2020 onward are based on staff estimations, and exclude the effects of measures such as free higher education introduced in April 2020.

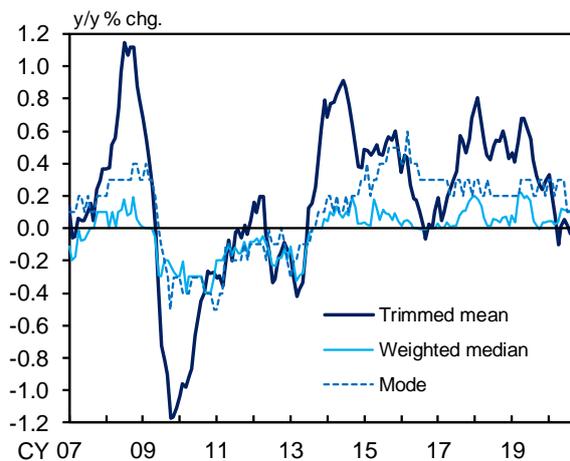
Regarding the indicators for capturing the underlying trend in the CPI, the rate of change in the trimmed mean decreased after the turn of the

January 2021. On the other hand, the CPI is assumed to be pushed up by 0.3 to 0.4 percentage point from August 2021 through January 2022, due to a dissipation of the effects of the campaign. Looking at the CPI by fiscal year, the effects of the campaign on the year-on-year rates of change in both the CPI (all items less fresh food) and the CPI (all items less fresh food and energy) are estimated to be minus 0.2 percentage point for fiscal 2020 and 0.2 percentage point for fiscal 2021. These contributions could change if, for example, the campaign is extended.

year, reflecting a decline in such items as those related to energy (electricity as well as manufactured and piped gas charges) and those related to travel (hotel charges and charges for package tours to overseas), both of which have large weights in the CPI, and it has been at around 0 percent recently (Chart 42).<sup>20</sup> The rate of change in the mode, which is less susceptible to developments in CPI items with large weights, has been in the range of 0.0-0.5 percent. Looking at annual price changes across all CPI items (less fresh food), the share of price-increasing items minus the share of price-decreasing items has maintained a net "increase" on the whole but has been on a moderate declining trend, given a gradual increase in the number of items for which the prices are unchanged or have turned to a decrease, mainly of food products that are sensitive to economic activity (Chart 43).

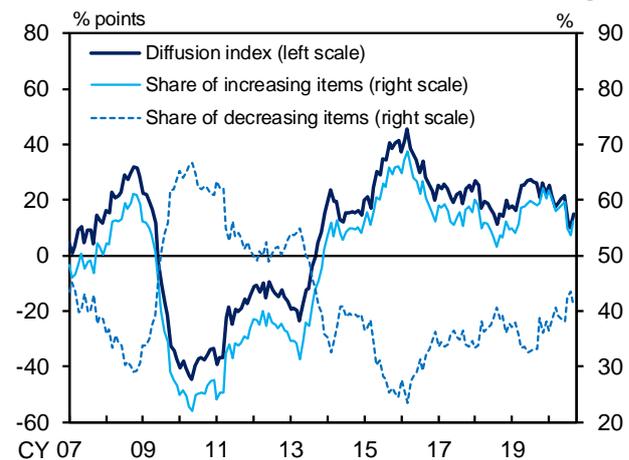
The year-on-year rate of change in the GDP deflator has been in the range of 1.0-1.5 percent recently, mainly due to a decrease in the import deflator stemming from the decline in crude oil prices (Chart 39). The year-on-year rate of change in the domestic demand deflator has declined to around 0 percent, reflecting developments such as in the PPI.

**Chart 42: Various Measures of Core Inflation**



Sources: Bank of Japan; Ministry of Internal Affairs and Communications.  
 Note: Based on staff calculations using the CPI excluding the effects of the consumption tax hikes, policies concerning the provision of free education, and the "Go To Travel" campaign, which covers a portion of domestic travel expenses. The CPI figures from April 2020 onward are based on staff estimations and exclude the effects of measures such as free higher education introduced in April 2020.

**Chart 43: Diffusion Index of Price Changes**



Sources: Bank of Japan; Ministry of Internal Affairs and Communications.  
 Note: The diffusion index is defined as the share of increasing items minus the share of decreasing items. The share of increasing/decreasing items is the share of items whose price indices increased/decreased from a year earlier. Based on staff calculations using the CPI (less fresh food) excluding the effects of the consumption tax hikes, policies concerning the provision of free education, and the "Go To Travel" campaign, which covers a portion of domestic travel expenses. The CPI figures from April 2020 onward are based on staff estimations and exclude the effects of measures such as free higher education introduced in April 2020.

<sup>20</sup> The trimmed mean is calculated by excluding items that belong to a certain percentage of the upper and lower tails of the price change distribution (10 percent of each tail) in order to eliminate the effects of large relative price changes. The mode is the inflation rate with the highest density in the price change distribution. The weighted median is the average of the inflation rates of the items at around the 50 percentile point of the cumulative distribution in terms of weight. All three indicators are calculated by using data for each CPI item that excludes the effects of the consumption tax hikes, policies concerning the provision of free education, and the "Go To Travel" campaign.

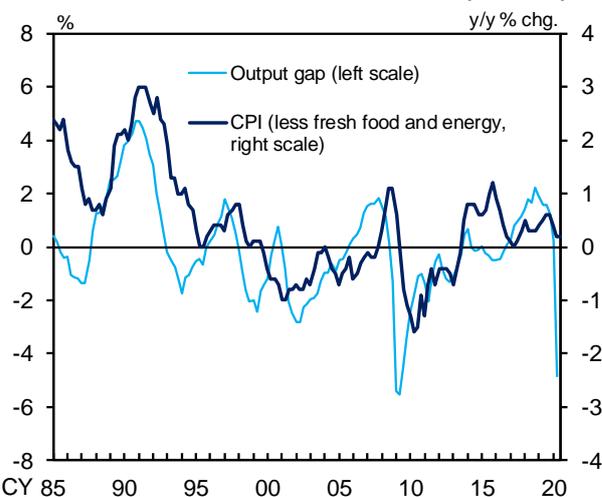
## Environment surrounding Prices

In the outlook for prices, the main factors that determine inflation rates are assessed as follows. First, the output gap is likely to bottom out from the substantial decline marked in the April-June quarter and head toward a pick-up, mainly for the manufacturing industry. However, for the time being, it is expected to register a relatively large negative figure, with the impact of COVID-19 exerting downward pressure on working hours and the capital utilization rate in the nonmanufacturing industry (Charts 2 and 44). Thereafter, with the impact of COVID-19 waning and the economy following a growth path above its potential from a macroeconomic perspective, an improving trend in the output gap is projected to become evident gradually, leading the gap to turn positive.

Second, medium- to long-term inflation expectations have weakened somewhat (Charts 45 and 46). With regard to the outlook, such expectations are likely to continue to do so for the time being, since actual inflation that includes the effects of the decline in energy prices is expected to be negative, as described later. Thereafter, however, as the economy improves, such expectations are projected to rise again on the back of an increase in actual prices and the Bank pursuing monetary easing through its strong commitment to achieving the price stability target.

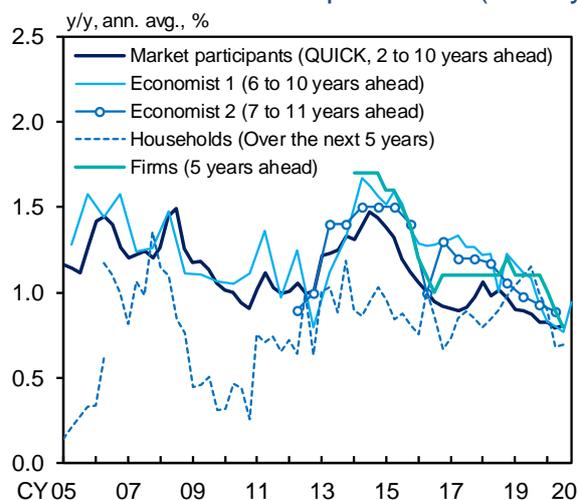
The third factor is developments in import prices. The CPI is likely to be pushed down by the past significant decline in crude oil prices through declines in electricity as well as manufactured and piped gas charges toward the second half of the

### Chart 44: Inflation Rate and Output Gap



Sources: Ministry of Internal Affairs and Communications; Bank of Japan.  
 Notes: 1. The CPI figures exclude the effects of the consumption tax hikes, policies concerning the provision of free education, and the "Go To Travel" campaign, which covers a portion of domestic travel expenses. The figures from 2020/Q2 onward are based on staff estimations, and exclude the effects of measures such as free higher education introduced in April 2020.  
 2. The output gap is based on staff estimations.

### Chart 45: Inflation Expectations (Survey)



Sources: Bank of Japan; QUICK, "QUICK Monthly Market Survey (Bonds)"; JCER, "ESP Forecast"; Consensus Economics Inc., "Consensus Forecasts."  
 Notes: 1. Figures for the economist 1 are from the "Consensus Forecasts." Figures for the economist 2 are from the "ESP Forecast."  
 2. Figures for households are from the "Opinion Survey on the General Public's Views and Behavior," estimated using the modified Carlson-Parkin method.  
 3. Figures for firms are "Outlook for General Prices (*Tankan*, all industries and enterprises, average)."

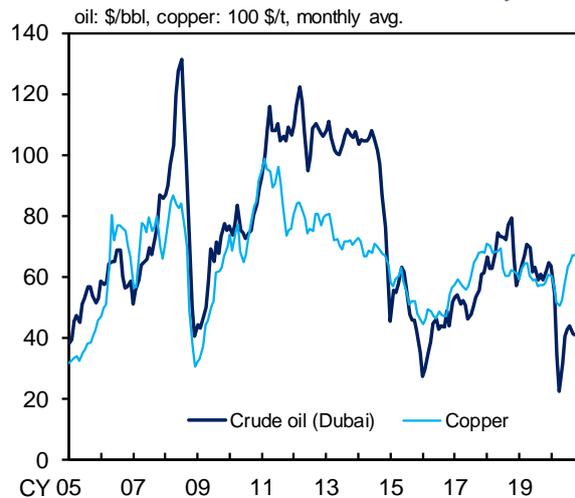
fiscal year (Chart 47). That said, the effects of downward pressure on the CPI are expected to wane thereafter.

**Chart 46: Inflation Expectations (BEI)**



Source: Bloomberg.  
 Note: BEI (break-even inflation) rates are yield spreads between fixed-rate coupon-bearing JGBs and inflation-indexed JGBs. Inflation-indexed JGBs issued since October 2013 are designated as "new," while the rest are designated as "old." Figures for "old (longest)" are calculated using yield data for issue No. 16 of inflation-indexed JGBs, which matured in June 2018.

**Chart 47: International Commodity Prices**



Sources: Nikkei Inc.; Bloomberg.

## Outlook for Prices

Based on the recent developments in the indicators, as described earlier, downward pressure on prices of items that are sensitive to economic activity has increased gradually along with deterioration in economic activity due to the impact of COVID-19. That said, price cuts that aim at stimulating demand have not been observed widely to date. As the background to this, in the current phase of economic downturn, it seems that firms, mainly in the face-to-face services industry, which is confronted with a substantial decrease in demand, cannot in the near term readily make price cuts that would lead to a further deterioration in their profits. This is because it is highly likely that the price elasticity of demand in the industry has become low in the short run since the primary cause of the decrease in demand is consumers' vigilance against COVID-19, and because the supply capacity of those firms has been restrained in order to avoid creating crowds. In addition, it can be pointed out that, from a macroeconomic perspective, households' disposable income has been supported by large-scale income support measures despite deterioration in employment conditions. Thus, regarding the outlook, despite a recent significant drop in the output gap, a decline in the CPI is likely to be relatively small for the time being, and thereafter the CPI is expected to turn to a moderate increase with the impact of COVID-19 waning (Chart 44).

Based on this underlying scenario, the year-on-year rate of increase in the CPI (all items less fresh food and energy, excluding the effects of the consumption tax hikes, policies concerning the provision of free education, and the "Go To

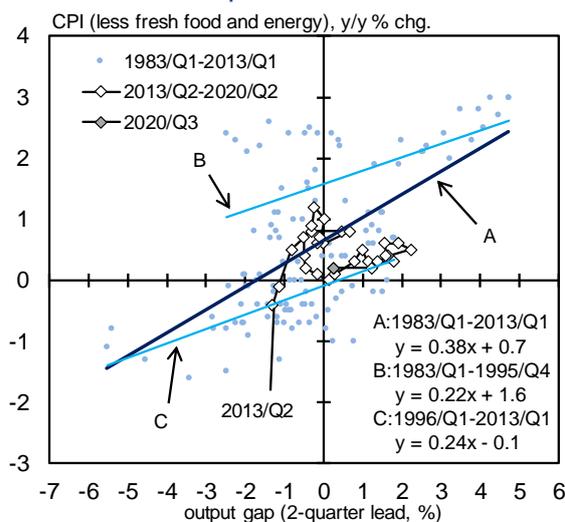
"Go To Travel" campaign) is likely to decline somewhat for the time being, being at around 0 percent. In detail, (1) travel-related services -- such as hotel charges, charges for package tours to overseas, and airfare -- for which demand has deteriorated significantly due to the direct impact of COVID-19, are likely to remain on a declining trend. In addition, (2) downward pressure on prices of the CPI items that are sensitive to economic activity, such as food products, durable goods, clothes, and dining-out, is expected to increase gradually, albeit with some time lag from deterioration in the output gap. Moreover, (3) mobile phone-related prices (i.e., prices of and charges for mobile phones) is highly likely to continue showing some weakness given the recent competitiveness in the industry and price-setting stance of major carriers.

As for the outlook from a somewhat long-term perspective, the year-on-year rate of increase in the CPI (all items less fresh food and energy, excluding the effects of the consumption tax hikes, policies concerning the provision of free education, and the "Go To Travel" campaign) is expected to accelerate on the whole. This is based on the projection that, with the impact of COVID-19 waning, travel-related services will bottom out and then turn to a pick-up, also due to the hosting of the Olympic Games, and upward pressure on prices of goods and services that are sensitive to economic activity will increase, reflecting improvement in the output gap. Thereafter, the year-on-year rate of change in the CPI (all items less fresh food and energy) is likely to increase moderately toward the end of the projection period with (1) the output gap continuing to improve and (2) medium- to long-term inflation expectations rising through

both the adaptive and the forward-looking expectation formation mechanisms (Chart 48).

Under these circumstances, the year-on-year rate of decline in the CPI (all items less fresh food) is likely to accelerate to a relatively large degree in the second half of fiscal 2020. This is because (1) the effects of the consumption tax hikes are projected to dissipate, (2) the rate of decline in energy prices is expected to accelerate, such as for electricity as well as manufactured and piped gas charges, reflecting the past significant decline in crude oil prices, and (3) a discount on hotel charges due to the "Go To Travel" campaign is likely to continue putting downward pressure on the overall CPI. Thereafter, the year-on-year rate of change in the CPI (all items less fresh food) is likely to turn positive in the middle of the projection period and then accelerate, since (1) with the underlying upward pressure on prices rising gradually along with improvement in the output gap, (2) the effects of the decline in energy prices are expected to wane, and (3) hotel charges are projected to push up the overall CPI due to a dissipation of the effects of the "Go To Travel" campaign.

**Chart 48: Phillips Curve**



Sources: Ministry of Internal Affairs and Communications; Bank of Japan.  
 Notes: 1. The CPI figures exclude the effects of the consumption tax hikes, policies concerning the provision of free education, and the "Go To Travel" campaign, which covers a portion of domestic travel expenses. The figures from 2020/Q2 onward are based on staff estimations, and exclude the effects of measures such as free higher education introduced in April 2020.  
 2. The output gap is based on staff estimations.

### III. Financial Developments in Japan

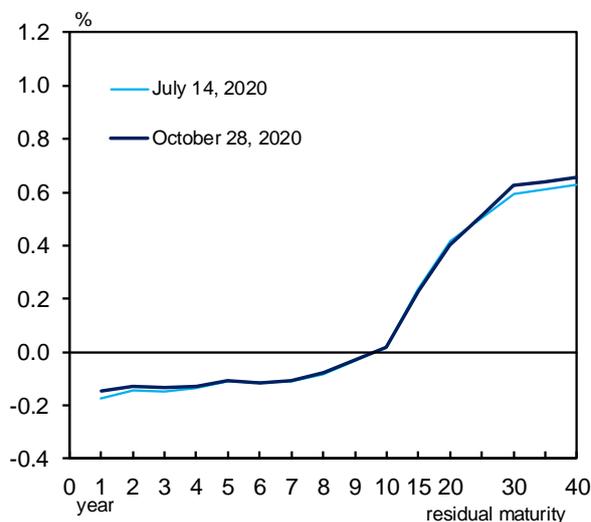
#### Financial Conditions

Financial conditions have been accommodative on the whole but those for corporate financing have remained less so, as seen in weakness in firms' financial positions.<sup>21</sup>

Under "QQE with Yield Curve Control," the yield curve for JGBs has been in line with the current guideline for market operations, in which the short-term policy interest rate is set at minus 0.1 percent and the target level of 10-year JGB yields is around zero percent (Chart 49). That is, the yields for relatively short maturities have been in slightly negative territory and the 10-year JGB yields have been at around 0 percent. As the background to this, the Bank has purchased a necessary amount of both JGBs and treasury discount bills (T-Bills) without setting upper limits with a view to maintaining stability in the bond market and stabilizing the entire yield curve at a low level, taking into account the impact on the market of the increase in the amount of issuance of JGBs and T-Bills in response to the government's emergency economic measures. Meanwhile, the 20-year JGB yields have been at around 0.5 percent.

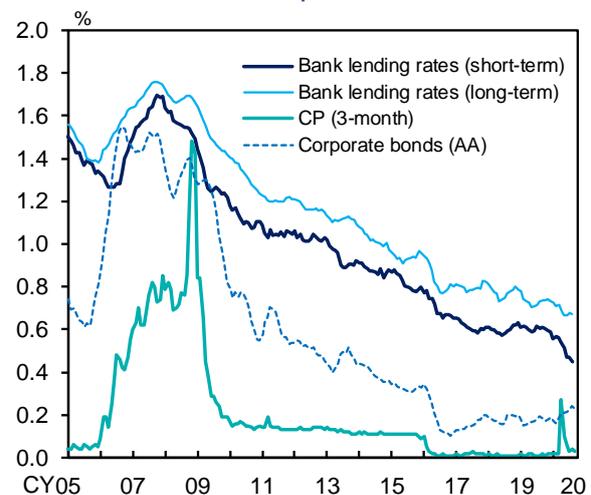
Firms' funding costs have been hovering at low levels (Chart 50). Issuance rates for CP showed a significant rise in April, but they declined after the Bank announced that it would increase purchases of CP and have been at low levels. The DI for

**Chart 49: Yield Curves**



Source: Bloomberg.

**Chart 50: Bank Lending Rates and Issuance Yields for CP and Corporate Bonds**



Sources: Bank of Japan; Japan Securities Depository Center; Capital Eye; I-N Information Systems; Bloomberg.

- Notes: 1. Figures for issuance yields for CP up to September 2009 are the averages for CP (3-month, rated a-1 or higher). Those from October 2009 are the averages for CP (3-month, rated a-1).  
 2. Figures for issuance yields for corporate bonds are the averages for domestically issued bonds launched on a particular date. Bonds issued by banks and securities companies, etc., are excluded.  
 3. Figures for bank lending rates and issuance yields for corporate bonds show 6-month backward moving averages.

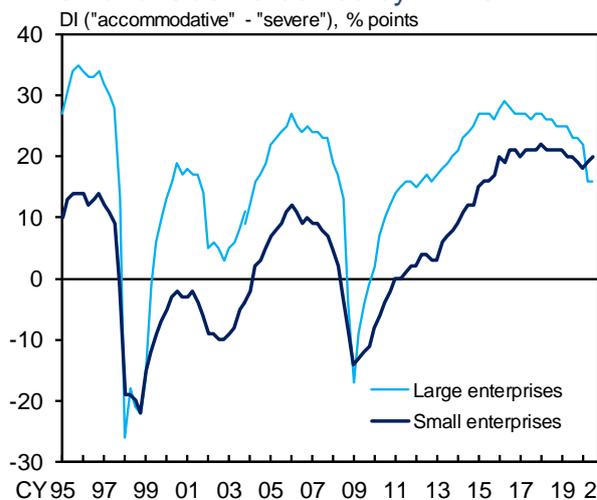
<sup>21</sup> As for the Bank's responses to COVID-19 and financial conditions, see Box 5.

issuance conditions for CP in the *Tankan*, which declined temporarily, has seen a slight improvement recently, reflecting stabilized issuance rates. Issuance rates for corporate bonds rose somewhat in April, but they declined thereafter and have been at extremely low levels. Meanwhile, lending rates (the average interest rates on new loans and discounts) have been at around historical low levels.

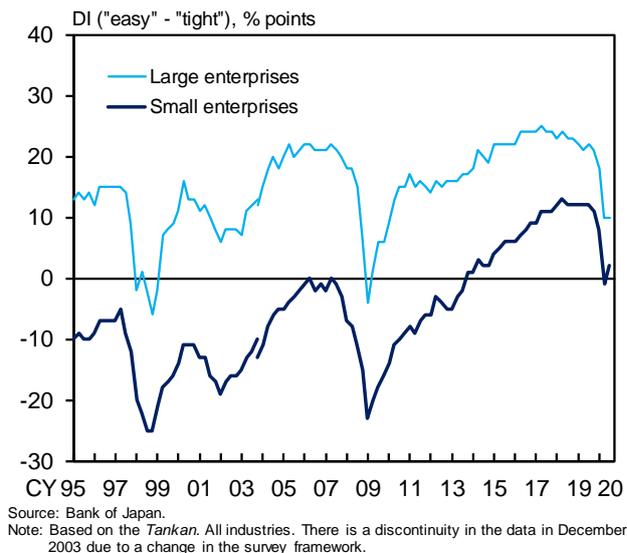
With regard to the availability of funds for firms, the DI in the *Tankan* for financial institutions' lending attitudes as perceived by firms suggests that such attitudes have remained accommodative on the whole (Chart 51). Although the DI for large firms has declined somewhat compared to a while ago, the proportion of firms answering that financial institutions' lending attitudes are "severe" has remained small for both large and small firms. As the background to these developments, there have been various measures taken by the Bank and the government to support financing, mainly of firms, as well as efforts made by financial institutions together with those measures. With regard to corporate financing, the DI for firms' financial positions in the *Tankan* deteriorated regardless of firm size, mainly reflecting a decline in sales due to the impact of COVID-19. Thereafter, the DI has been flat for large firms and marginally increased for small firms (Chart 52). Although firms' financial positions have stopped deteriorating, they have remained weak.

Firms' demand for funds has remained at a high level, mainly reflecting a decline in sales and a rise in precautionary demand, although an

**Chart 51: Lending Attitude of Financial Institutions as Perceived by Firms**



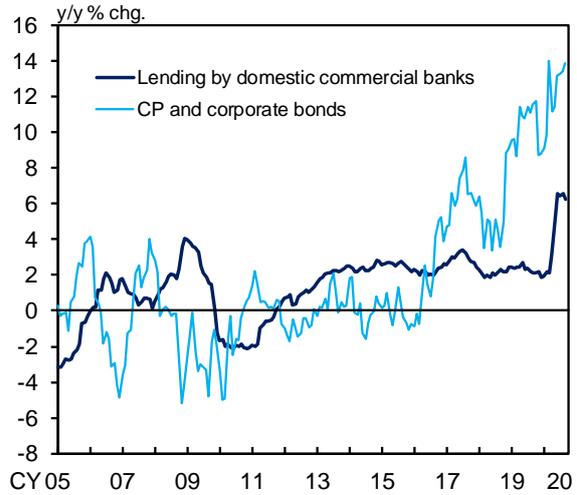
**Chart 52: Financial Position**



increase in demand by large firms in particular has paused recently. Under these circumstances, the year-on-year rate of increase in the amount outstanding of bank lending has been in the range of 6.0-6.5 percent, registering the highest increase in about 30 years (Chart 53). Funding through direct financing has been conducted actively, as seen in the year-on-year rate of increase in the aggregate amount outstanding of CP and corporate bonds being at a relatively high level that exceeds 10 percent.

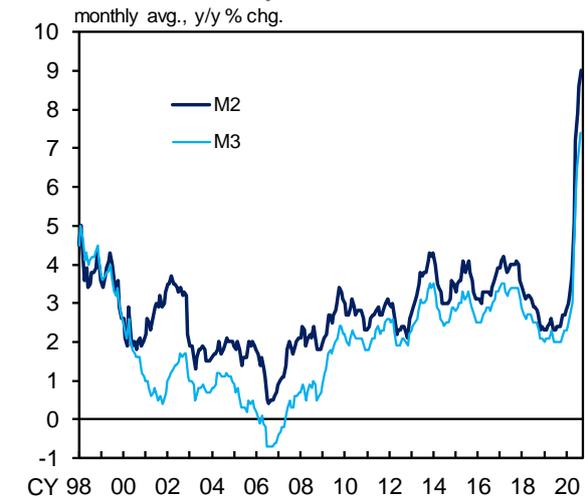
The year-on-year rate of increase in the monetary base has been in the range of 14.0-14.5 percent, and its amount outstanding as of end-September was 606 trillion yen, of which the ratio to nominal GDP was 120 percent.<sup>22</sup> The year-on-year rate of increase in the money stock (M2) has been at around 9 percent, pushed up mainly by an increase in bank lending and fiscal factors (Chart 54).

**Chart 53: Amount Outstanding of Bank Lending, CP, and Corporate Bonds**



Sources: Bank of Japan; Japan Securities Depository Center; Japan Securities Dealers Association; I-N Information Systems.  
 Note: Figures for lending by domestic commercial banks are monthly averages. Figures for CP and corporate bonds are those at the end of period.

**Chart 54: Money Stock**



Source: Bank of Japan.

<sup>22</sup> It is assumed that the figure for nominal GDP is unchanged from the April-June quarter of 2020.

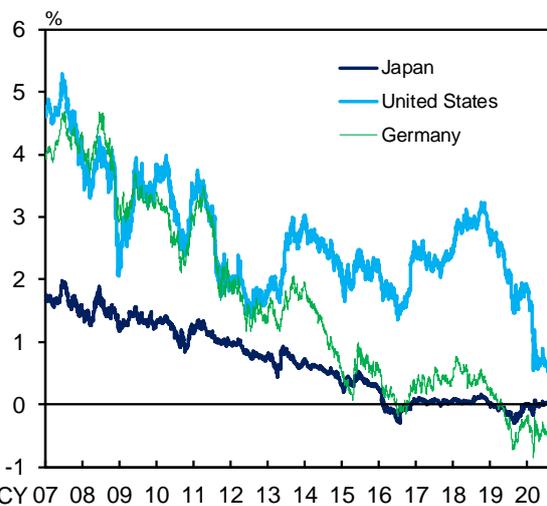
## Developments in Financial Markets

With regard to developments in global financial markets, tension has eased in reflection of aggressive fiscal and monetary policies taken in each country and region. That said, the markets have remained nervous; amid a situation of highly unclear developments in domestic and overseas economies, the volatility of stock prices has stayed relatively high and stock prices have declined in Europe, where the effects of a resurgence of COVID-19 are of concern.

Yields on 10-year government bonds in the United States have been at low levels due to the Federal Reserve's purchases of government bonds and anticipation that the low interest rate policy will continue for a prolonged period. However, the yields have risen slightly recently, mainly on the back of economic indicators being above market forecasts and expectations for additional economic measures (Chart 55). Yields on 10-year government bonds in Germany increased temporarily along with those in the United States. However, with the European Central Bank (ECB) purchasing government bonds, the yields have declined slightly, partly due to concern over the effects of a resurgence of COVID-19 in Europe.

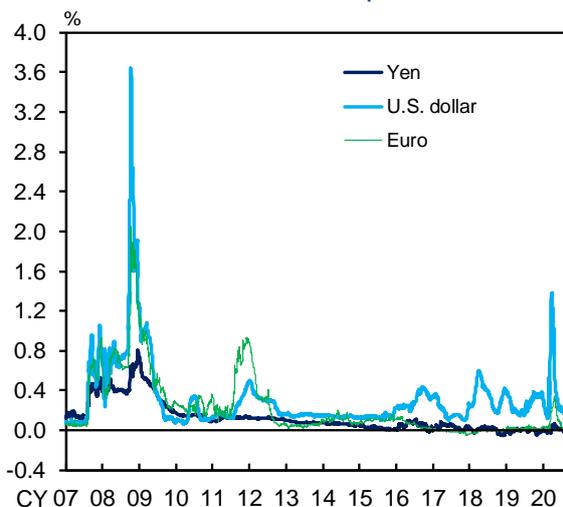
With regard to the LIBOR-OIS spreads for major currencies, those for the U.S. dollar, the euro, and the yen have been more or less flat at low levels (Chart 56). Premiums for U.S. dollar funding through the dollar/yen foreign exchange swap market have risen somewhat since end-September, partly reflecting transactions conducted in view of the year-end. That said, they

**Chart 55: 10-Year Government Bond Yields in Selected Advanced Economies**



Source: Bloomberg.

**Chart 56: LIBOR-OIS Spreads**



Source: Bloomberg.

Note: LIBOR-OIS spreads are LIBOR (3-month) minus yields on overnight index swaps (3-month).

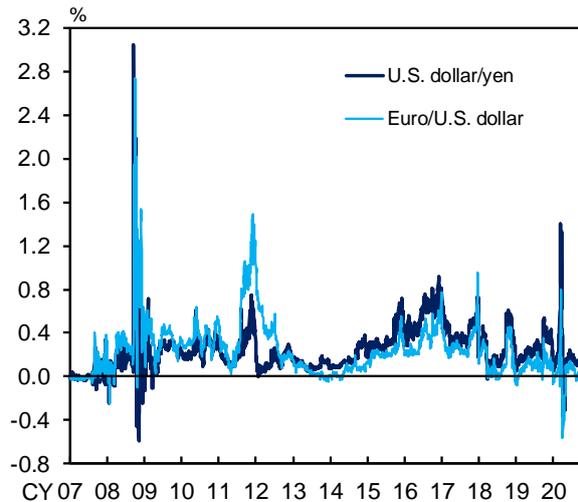
have been at low levels on the whole as the U.S. dollar funds-supplying operations conducted by the central bank of each country and region, including the Bank of Japan, have been functioning as a backstop (Chart 57).

Regarding the stock market, stock prices in Europe have declined because of concern over the effects of a resurgence of COVID-19 (Chart 58). Those in the United States have fluctuated to a relatively large degree. They rose through the beginning of September, mainly reflecting increasing expectations for a recovery in business performance. Subsequently, however, selling for position adjustments, mainly of high-tech stocks, was observed temporarily, and more recently, the stock prices have declined with market participants being aware of a resurgence of COVID-19. Meanwhile, stock prices in Japan have continued to be on an uptrend on the whole.

In the J-REIT market, prices have been more or less flat (Chart 59). Developments in REITs have been mixed across asset types; hotel REITs have picked up, due partly to expectations for a recovery in demand for accommodations, while residential REITs have declined.

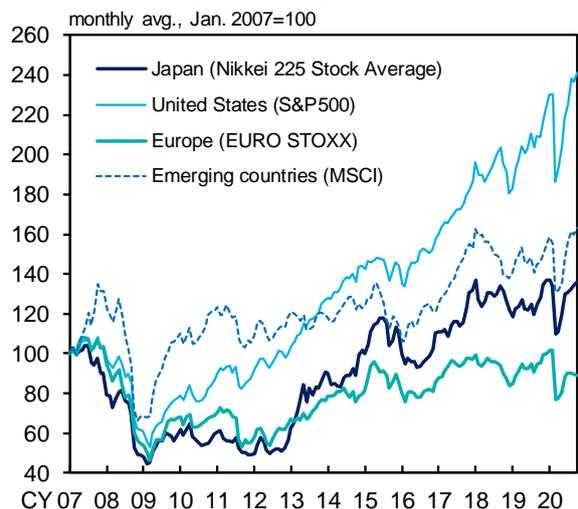
In foreign exchange markets, the yen has appreciated somewhat against the U.S. dollar, which has weakened against many other currencies due mainly to anticipation that the Federal Reserve's low interest rate policy will continue for a prolonged period (Chart 60). The yen depreciated against the euro to a relatively large degree, reflecting a deal on the European

**Chart 57: Dollar Funding Premiums through Foreign Exchange Swaps**



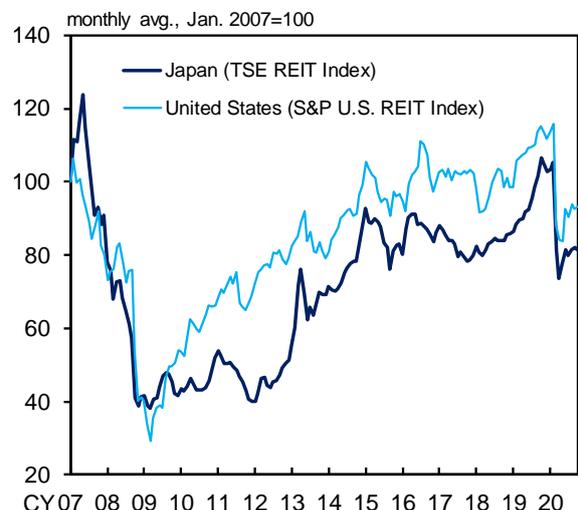
Source: Bloomberg.  
Note: U.S. dollar funding rate from yen or euro minus 3-month dollar LIBOR.

**Chart 58: Selected Stock Prices**



Source: Bloomberg.  
Note: Figures for emerging countries are based on the MSCI Emerging Markets Index calculated in the local currencies.

**Chart 59: Selected REIT Indices**



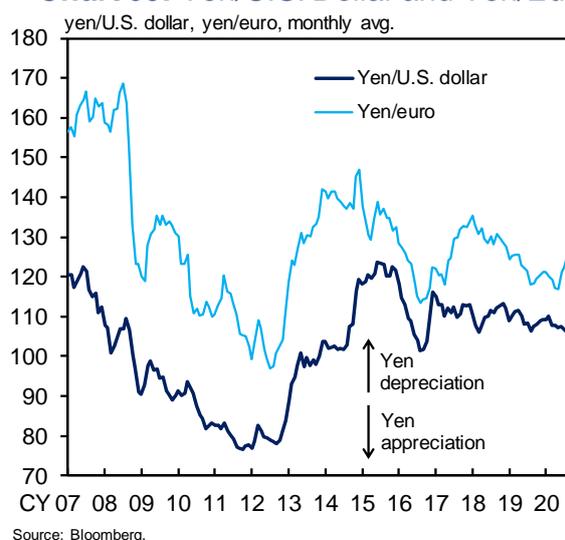
Source: Bloomberg.

Union (EU) recovery fund reached in late July, but subsequently has appreciated, due partly to concern over the effects of a resurgence of COVID-19.

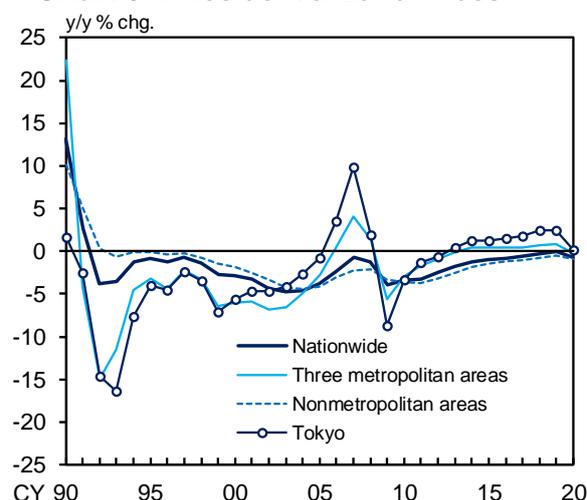
## Land Prices

Land prices have declined marginally on the whole. According to the *Land Price Research by Prefectural Governments* for 2020 (as of July 1), the year-on-year rate of change in residential land prices gradually increased to close to 0 percent in negative territory but has declined further within that territory (Chart 61). That in commercial land prices turned negative for the first time in five years after showing a steady expansion in positive territory (Chart 62). With regard to the three major metropolitan areas (Tokyo, Osaka, and Nagoya), the year-on-year rate of change in residential land prices has turned negative for the first time in seven years. That in commercial land prices for Tokyo and Osaka has continued to rise in positive territory, albeit at a reduced pace, whereas that for Nagoya has turned negative for the first time in eight years. In nonmetropolitan areas, the year-on-year rate of change in residential land prices has declined further within negative territory. That in commercial land prices, which turned positive last year for the first time in 28 years, has become negative again.

**Chart 60: Yen/U.S. Dollar and Yen/Euro**

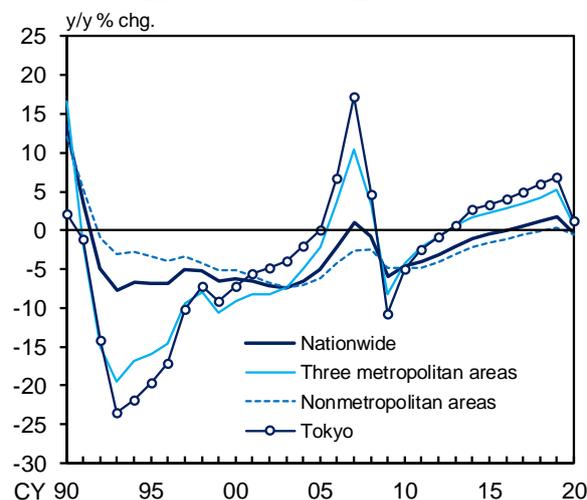


**Chart 61: Residential Land Prices**



Notes: 1. Based on the "Land Price Research by Prefectural Governments." Figures are as of July 1.  
2. Three metropolitan areas: the Tokyo area (Tokyo, Kanagawa, Saitama, Chiba, and Ibaraki prefectures), the Osaka area (Osaka, Hyogo, Kyoto, and Nara prefectures), and the Nagoya area (Aichi and Mie prefectures).  
Nonmetropolitan areas: other than the three metropolitan areas.

**Chart 62: Commercial Land Prices**



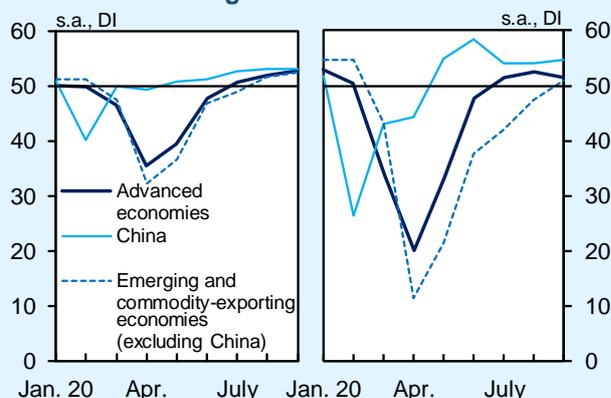
Notes: 1. Based on the "Land Price Research by Prefectural Governments." Figures are as of July 1.  
2. Three metropolitan areas: the Tokyo area (Tokyo, Kanagawa, Saitama, Chiba, and Ibaraki prefectures), the Osaka area (Osaka, Hyogo, Kyoto, and Nara prefectures), and the Nagoya area (Aichi and Mie prefectures).  
Nonmetropolitan areas: other than the three metropolitan areas.

## (Box 1) Variation in the Pace of a Pick-Up in Overseas Economies

Although overseas economies have picked up from a state of significant depression, the pace varies across sectors as well as countries and regions. Looking at the PMI by sector, business sentiment in the goods sector (i.e., manufacturing) has improved in many countries and production activity of that sector also has picked up clearly. On the other hand, in the services sector (i.e., nonmanufacturing), the PMI dropped sharply in early spring and the pace of improvement has been only moderate (Charts B1-1 and B1-2). By country and region, there is large variation in the degree of improvement, particularly in the services sector. This box provides an overview of the slow and varying pace of the pick-up in overseas economies.

In China, with the number of confirmed cases of COVID-19 being at a low level since early spring, economic activity resumed earlier than in any other country. Under these circumstances, the GDP growth rate for the April-June quarter turned positive on a year-on-year basis, partly due to the emergence of the effects of aggressive macroeconomic policies and the materialization of pent-up demand (Chart B1-3). By industry, the information and communication, construction, and real estate industries have recovered steadily due mainly to the establishment of 5G communication networks and an expansion in infrastructure investment. In addition, mainly on the back of the spillover effects of the expansion in such investment and of an increase in global demand for IT-related goods, the GDP growth rate of the manufacturing industry and industrial production

**Chart B1-1: PMI for Major Economies**  
1. Manufacturing PMI 2. Services PMI

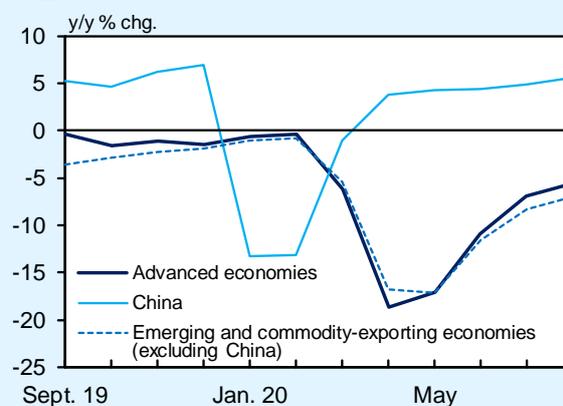


Sources: IHS Markit (© and database right IHS Markit Ltd 2020. All rights reserved.); IMF; Haver.

Notes: 1. Figures for China are the "Caixin China PMI." Figures for the services PMI are the "Services Business Activity Index."

2. Figures for advanced economies are the weighted averages of the PMIs for the United States, the euro area, the United Kingdom, and Japan using their global GDP shares from the IMF as weights. As for figures for emerging and commodity-exporting economies excluding China, those for manufacturing are the weighted averages of the PMIs for 19 countries and regions and those for services are the weighted averages of the PMIs for 3 countries, both using their global GDP shares from the IMF as weights.

**Chart B1-2: Industrial Production in Major Economies**



Sources: CPB Netherlands Bureau for Economic Policy Analysis; Haver.

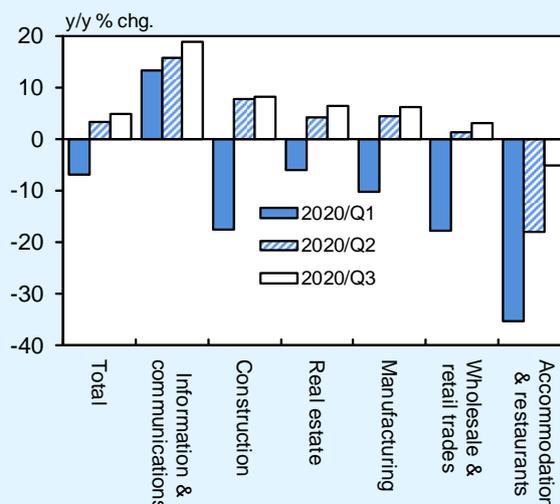
Note: Figures for emerging and commodity-exporting economies excluding China are the weighted averages of industrial production using countries' share in global value added taken from the CPB Netherlands Bureau for Economic Policy Analysis as weights.

also have been positive on a year-on-year basis (Chart B1-2). Meanwhile, a recovery in the services industry, such as accommodations and restaurants, was delayed, due mainly to voluntary efforts to prevent infections, but some improvements have been observed recently.

In the United States and Europe, private consumption fell significantly in early spring, but a pick-up has been seen since then, mainly in goods consumption (Charts B1-4 and B1-5). This is mainly attributable to fiscal measures to compensate households for lost incomes, the materialization of pent-up demand, and, in some countries, a rise in subsidies for the purchase of low-emission vehicles. Under these circumstances, production activity of the manufacturing industry also has picked up clearly (Chart B1-2). On the other hand, with the number of confirmed new cases of COVID-19 increasing in the United States and Europe, the pace of improvement in consumer sentiment has been slow, and thus the pace of the pick-up in services consumption, mainly for face-to-face services, has been only moderate.<sup>23</sup>

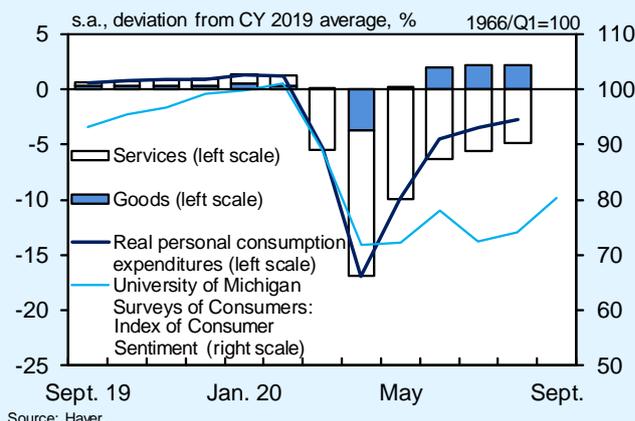
Lastly, turning to emerging economies other than China, although there are variations across countries and regions, the number of people going out has continued to be constrained even after the summer season in such places as India, where the number of confirmed new cases of COVID-19 has increased or remained high (Chart

**Chart B1-3: China's Real GDP**



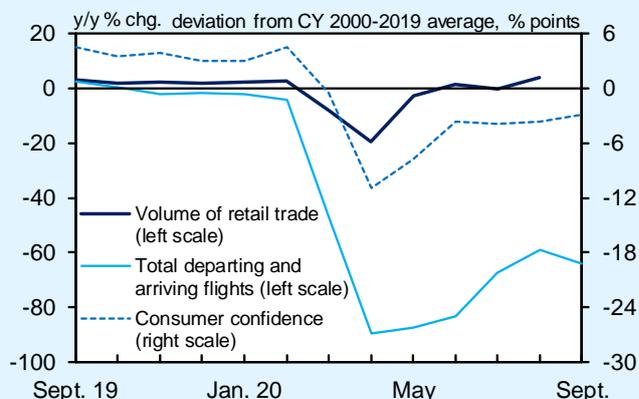
Source: CEIC.  
Note: Figures for "information & communications" are those for "information transmission, software, and information technology services."

**Chart B1-4: Private Consumption Indicators for the United States**



Source: Haver.

**Chart B1-5: Private Consumption Indicators for the Euro Area**



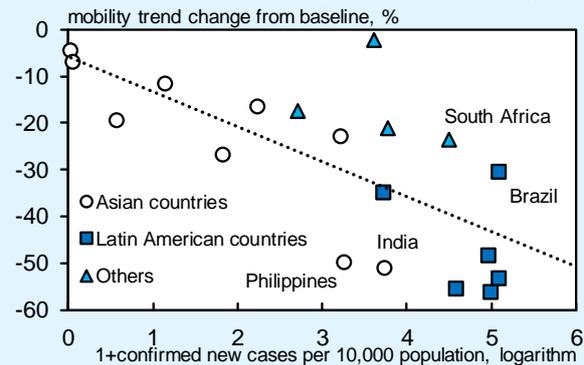
Sources: Haver; EUROCONTROL.  
Note: Figures for total departing and arriving flights are the simple averages for the main airports in Germany, France, Italy, and Spain.

<sup>23</sup> With regard to the impact of the spread of COVID-19, see also "The Impact of COVID-19 on US Consumer Spending: Quantitative Analysis Using High-Frequency State-Level Data," *Bank of Japan Review Series*, no. 2020-E-7, October 2020.

B1-6). In these countries and regions, consumer sentiment also has been at a low level, and the pace of improvement in consumption, mainly of services, seems to have been only moderate in contrast to the sharp decline in the April-June quarter. However, in many of these countries and regions, business sentiment and production activity of the manufacturing industry have been heading toward improvement, even though each of their overall economies has remained in a severe situation (Charts B1-1 and B1-2).

Thus, although overseas economies have improved on the whole, the pace varies across countries and regions, mainly reflecting the effects of developments in COVID-19 on the service sector. As for the outlook, although they are likely to continue improving for the time being, partly supported by aggressive macroeconomic policies, the pace is expected to be only moderate and varying while vigilance against COVID-19 continues. In addition, given that public health measures have been tightened again, mainly in Europe, their economies could be pushed down temporarily. The consequences of COVID-19 and the magnitude of their impact on overseas economies remain highly uncertain, and thus downside risks warrant close attention.

**Chart B1-6: COVID-19 Cases and Mobility Trends in Developing Countries/Regions**



Sources: CEIC; United Nations; Google LLC "Google COVID-19 Community Mobility Reports." <https://www.google.com/covid19/mobility/>. Accessed: October 6, 2020.

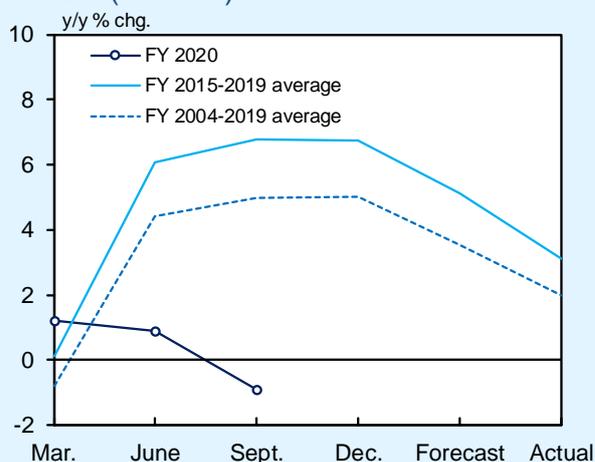
- Notes:
1. Confirmed new COVID-19 cases are July-September totals. Taiwan and Hong Kong figures are from the Taiwan Ministry of Health and Welfare and the Hong Kong Centre for Health Protection, Department of Health, respectively. Other figures are from the WHO.
  2. Figures for mobility trends are July-September averages of the percent change in visits to places categorized as "retail and recreation" in the report released by Google. The baseline is the median value, for the corresponding day of the week, during the 5-week period from January 3 to February 6, 2020.
  3. The dotted line represents the fitted regression line for the 19 country observations shown in the chart.

## (Box 2) Impact of COVID-19 on Business Fixed Investment

While COVID-19 has adversely affected business fixed investment through such channels as deterioration in corporate profits and increasing uncertainties over the future, such impact varies across types and industries. This box examines developments in business fixed investment in the current phase in some detail, looking at its leading indicators and firms' fixed investment plans in the *Tankan*.

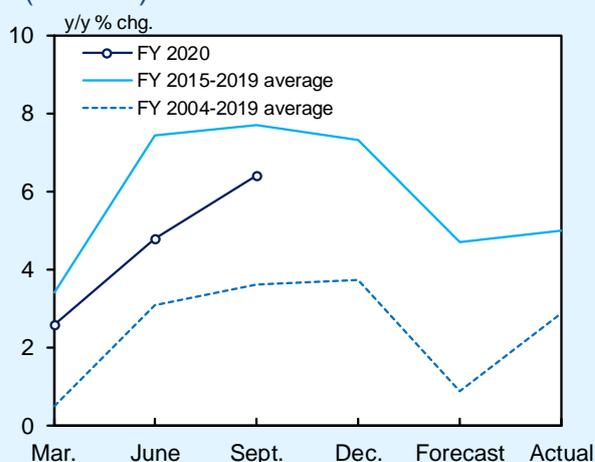
A breakdown by type of investment shows that, although business fixed investment has been on a declining trend on the whole, software investment has been firm. Looking at the business fixed investment plans for fiscal 2020 in the September *Tankan*, the overall investment plan has been revised markedly downward from that in the June *Tankan*, and its year-on-year rate of change has turned negative (Chart B2-1). Such a clear downward revision is unusual for a September survey, and it seems that firms have been postponing or scaling down their planned fixed investment with the continuing impact of COVID-19. In contrast to that overall fixed investment plan, the software investment plan has been notably firm, as seen in the fact that, in the September *Tankan*, the plan has been revised upward and its year-on-year rate of increase has remained at a relatively high level (Chart B2-2). Looking at software investment by industry, such investment is expected to substantially decline in the accommodations as well as eating and drinking services industry, whereas it is projected to increase clearly mainly in the communications,

**Chart B2-1: Business Fixed Investment Plans (*Tankan*)**



Source: Bank of Japan.  
 Note: Figures are for all industries and enterprises. Including software and R&D investments and excluding land purchasing expenses (R&D investment is not included before the March 2017 survey).

**Chart B2-2: Software Investment Plans (*Tankan*)**

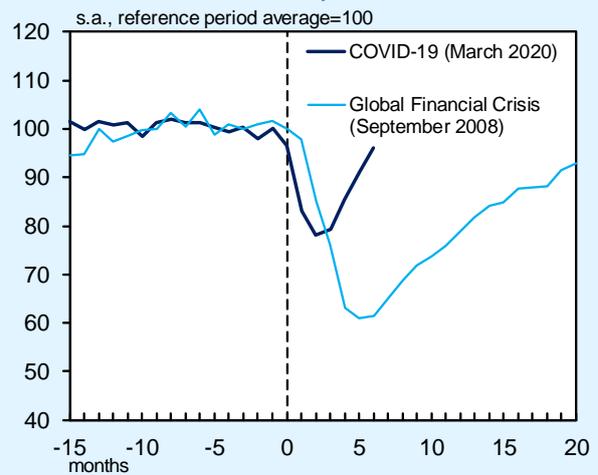


Source: Bank of Japan.  
 Note: Figures show the amount of newly recorded software investment under intangible fixed assets. Figures are for all industries and enterprises.

information services, and retail industries. One of the factors behind such firmness is the continuing trend of enhancing business efficiency and undertaking labor-saving investment since before the outbreak of COVID-19. In addition, it seems that, amid expansion in demand for non-face-to-face services (e.g., e-commerce, telework, and digital content distribution services) due to the prolonged impact of COVID-19, firms have recently been taking an active stance toward making fixed investment for these growth areas.

Turning to a breakdown by industry, business fixed investment has been decreasing in both the manufacturing and nonmanufacturing industries recently, but it is highly likely that investment in the manufacturing industry will pick up relatively early. Regarding the manufacturing industry, there is a quite high correlation between machinery investment and real exports. Looking at developments in such exports, they saw a substantial decline immediately after the GFC -- against the background of a rapid decline in the world trade volume, and also partly due to the yen's appreciation and inventory adjustments in IT-related goods -- and their subsequent pick-up was slow (Charts B2-3 and 11). On the other hand, primarily because the global impact of COVID-19 has been mainly on the services sector, Japan's exports in the current phase have not seen as much of a decline in a wide range of goods as at the time of the GFC, and the degree of decline itself has been limited. In addition, exports of automobile-related goods, for which demand declined rapidly in early spring, have registered a prompt and clear recovery owing to the

**Chart B2-3: Real Exports**

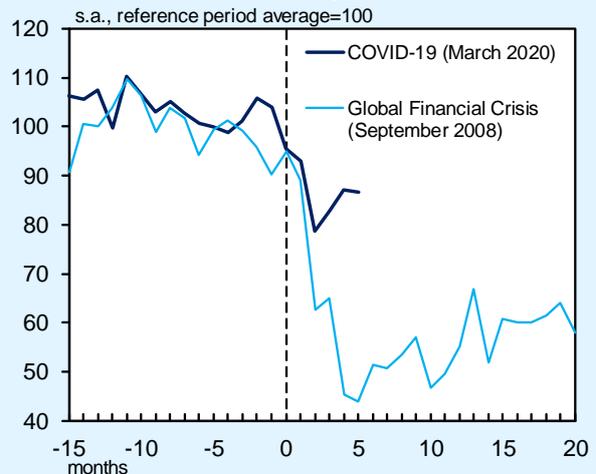


Sources: Bank of Japan; Ministry of Finance.  
 Notes: 1. Month 0 is indicated in the legend for each event.  
 2. The average for the period from October through December 2019 and that for the period from April through June 2008 are used for reference and set to 100 for "COVID-19 (March 2020)" and "Global Financial Crisis (September 2008)," respectively.

subsequent inventory adjustments progressing relatively swiftly (Chart 10). With respect to the outlook, since exports are expected to continue increasing, mainly for automobile-related goods, it is highly likely that machinery investment by the manufacturing industry will not decline as significantly as at the time of the GFC, and will eventually turn to a pick-up. In fact, looking at machinery orders -- a leading indicator of machinery investment -- those by the manufacturing industry have bottomed out and headed toward a pick-up, on the back of an increase in orders by the "general-purpose, production, and business-oriented machinery" and "automobiles, parts, and accessories" industries (Chart B2-4).

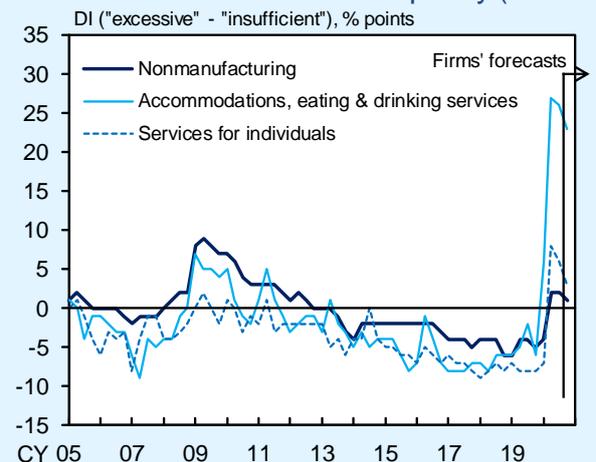
On the other hand, breaking down the nonmanufacturing industry, the environment surrounding business fixed investment has rapidly deteriorated in the face-to-face services industry, which has been strongly affected by COVID-19. The production capacity DI in the *Tankan* shows that, since the outbreak of COVID-19, firms' perception of excess capacity has rapidly intensified in the accommodations as well as eating and drinking services and services for individuals industries (Chart B2-5). In addition, looking at construction starts in terms of planned expenses -- a leading indicator of construction investment -- those for warehouses have continued to increase on the back of expansion in e-commerce, whereas those for stores and accommodation facilities have shown a clear downtrend, as construction projects have been successively postponed or canceled since the

**Chart B2-4: Machinery Orders (Private Sector, Manufacturing)**



Source: Cabinet Office.  
Notes: 1. Month 0 is indicated in the legend for each event.  
2. The average for the period from October through December 2019 and that for the period from April through June 2008 are used for reference and set to 100 for "COVID-19 (March 2020)" and "Global Financial Crisis (September 2008)," respectively.

**Chart B2-5: Production Capacity (*Tankan*)**

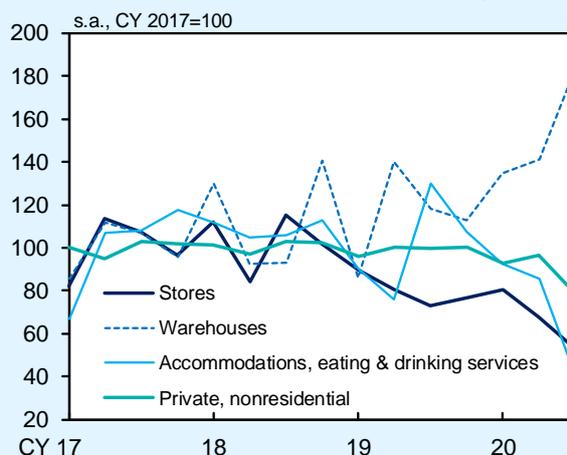


Source: Bank of Japan.  
Note: Figures are for all enterprises.

outbreak of COVID-19 (Chart B2-6). Under these circumstances, the business fixed investment plan for fiscal 2020 of the face-to-face services industry shows that fixed investment is expected to substantially decline, mainly for the accommodations as well as eating and drinking services industry, which had significantly increased investment over the past few years, reflecting a rise in inbound tourism demand (Chart B2-7). Business fixed investment by the overall nonmanufacturing industry is expected to decline somewhat, due mainly to the negative contribution of the face-to-face services industry. This is because, although the face-to-face services industry is labor intensive and thus its share in business fixed investment of the overall nonmanufacturing industry is not necessarily high, the degree of the decline in its fixed investment plan is significant.

Taking into account these developments, business fixed investment is likely to continue its downtrend on the whole for the time being, mainly for sectors that are directly affected by COVID-19, such as the face-to-face services industry. That said, it is projected that, with financial conditions remaining accommodative compared with at the time of the GFC, the capital stock adjustment will not be so significant, mainly because digital investment that is related to telework and remote services has been firm and exports, which have high correlation with machinery investment by the manufacturing industry, have been increasing.<sup>24</sup> Given that there remain extremely high uncertainties over the consequences of

**Chart B2-6: Construction Starts (in Terms of Estimated Construction Costs)**



Source: Ministry of Land, Infrastructure, Transport and Tourism.  
 Note: Figures for "stores" and "warehouses" are taken from data compiled by type of use, and those for "accommodations, eating & drinking services" are taken from data compiled by type of industry. Figures for 2020/Q3 are July-August averages.

**Chart B2-7: Business Fixed Investment (Tankan)**



Source: Bank of Japan.  
 Notes: 1. Figures up through fiscal 2019 are actual results. Figures for fiscal 2020 are forecasts from the September 2020 survey. Figures include software and R&D investments and exclude land purchasing expenses (R&D investment is not included before the March 2017 survey).  
 2. Figures in angular brackets show the share of each industry in total business fixed investment in the nonmanufacturing sector for fiscal 2019.

<sup>24</sup> With regard to the relationship between financial conditions and business fixed investment under the COVID-19 pandemic, see Box 2 in the July 2020 Outlook Report.

COVID-19, it is necessary to continue to pay close attention to a downside risk that the overall economy will remain at a low level for a prolonged period and that, accordingly, more industries will constrain business fixed investment to a larger degree.

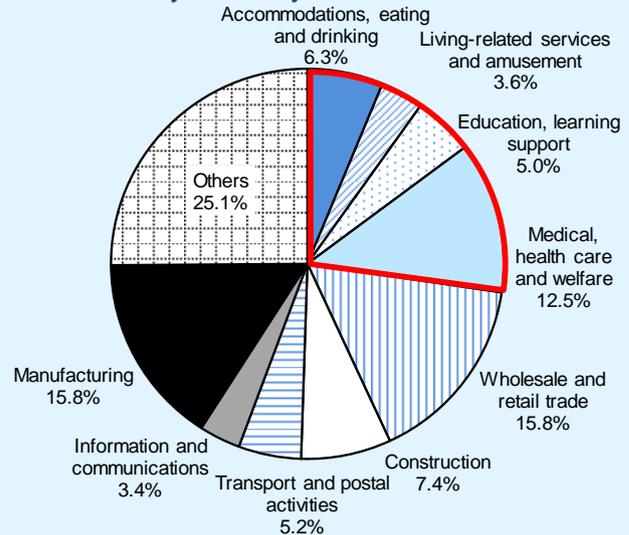
### (Box 3) Employment Adjustments in the Face-to-Face Services Industry

With regard to a decline in face-to-face services consumption due to COVID-19, this box discusses how this is expected to affect the overall labor market through employment adjustments in the industry of these services. Specifically, it examines current developments and the outlook for this issue.

The face-to-face services industry is a labor-intensive industry, accounting for a relatively large share in the labor market. The share of this industry in terms of the total number of employed persons has recently reached nearly 30 percent, partly reflecting the expanding inbound tourism demand in recent years and the increasing demand for medical and elder care services due to the aging population (Chart B3-1). In addition, the face-to-face services industry -- particularly the accommodations as well as eating and drinking services industry, which has been strongly affected by COVID-19 -- has the characteristic of a decrease in demand tending to directly lead to employment adjustments because it holds a large number of micro, small, and medium-sized firms with relatively weak financial bases and has a high proportion of non-regular employees compared with other industries (Chart B3-2).

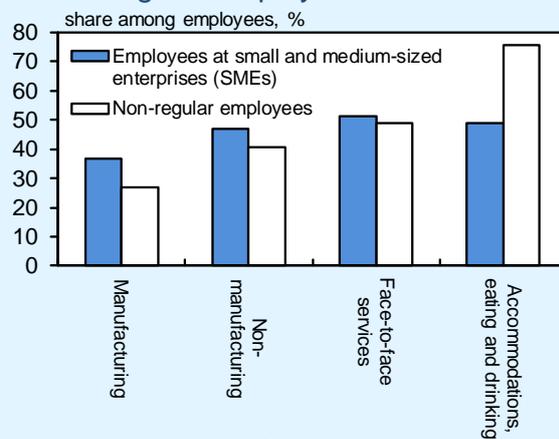
In fact, looking at the breakdown of the recent decline in the number of employed persons in the face-to-face services industry, the decline is remarkable in the number of non-regular

**Chart B3-1: Composition of Employed Persons by Industry**



Source: Ministry of Internal Affairs and Communications.  
 Note: Figures show the percentage share of each industry in the total number of employed persons (averages for 2019).

**Chart B3-2: Employees at SMEs and Non-Regular Employees**



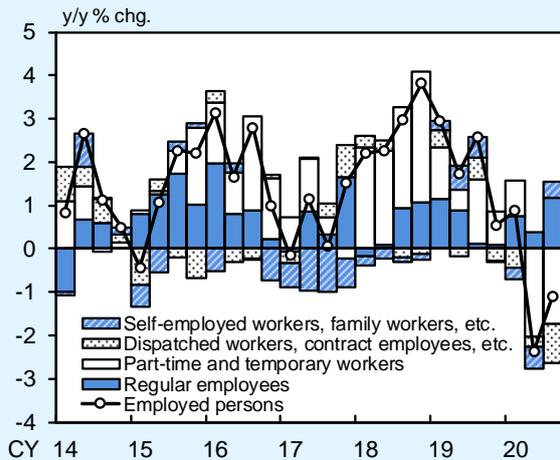
Source: Ministry of Internal Affairs and Communications.  
 Notes: 1. "Face-to-face services" consists of "accommodations, eating and drinking," "living-related services and amusement," "education, learning support," and "medical, health care and welfare."  
 2. Figures for employees at small and medium-sized enterprises (SMEs) represent the share of those working at firms with fewer than 100 employees among all employees. Figures for non-regular employees represent the share of non-regular employees among all employees excluding executives of companies or corporations. Figures show the averages for 2019.

employees, such as part-time and temporary workers, dispatched workers, and contract employees (Chart B3-3). Such employment adjustments in the face-to-face services industry, mainly of non-regular employees, explain a fairly large part of the decline in the number of employed persons of the overall economy in the current phase (Chart B3-4). This is in contrast to the fact that, at the time of the GFC, employment adjustments took place mainly in the manufacturing industry and the number of employed persons in the face-to-face services industry actually increased.

In comparison with the situation at the time of the GFC, it is also notable in the current phase that, even though the extent of deterioration in overall economic activity has generally been the same, the degree of employment adjustments has remained relatively small to this point (Charts 2 and B3-4). This is largely attributable to the fact that large-scale layoffs and bankruptcies have been avoided due to the swift implementations of the substantial policy responses, such as the expansion of employment adjustment subsidies, the provision of subsidies for sustaining businesses and rent assistance subsidies, and support for financing. However, such labor hoarding also indicates that there remains potential pressure for employment adjustments, mainly in the face-to-face services industry.

In this regard, taking a look at the number of working hours per employee, the figure for all industries has been recovering to the pre-pandemic level, but those for the accommodations as well as eating and drinking

**Chart B3-3: Number of Employed Persons in Face-to-Face Services**

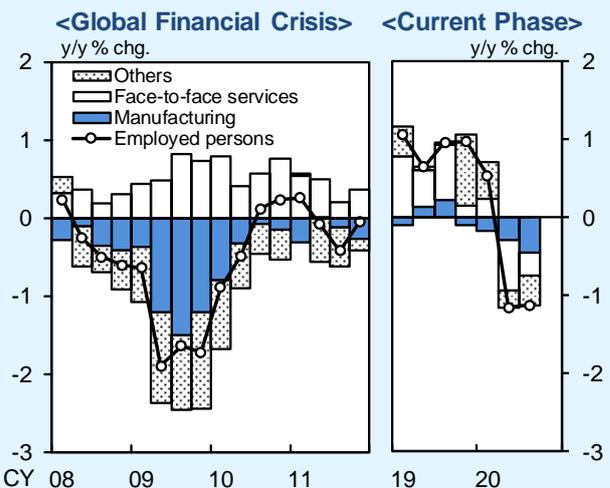


Source: Ministry of Internal Affairs and Communications.

Notes: 1. "Face-to-face services" consists of "accommodations, eating and drinking," "living-related services and amusement," "education, learning support," and "medical, health care and welfare."

2. "Self-employed workers, family workers, etc." includes executives of companies or corporations. Figures for 2020/Q3 are July-August averages.

**Chart B3-4: Number of Employed Persons by Industry**



Source: Ministry of Internal Affairs and Communications.

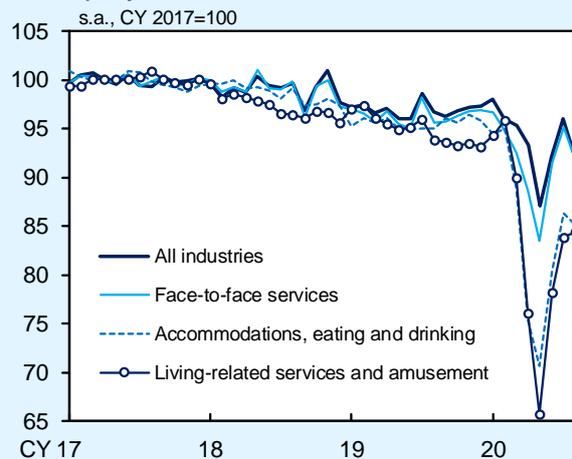
Notes: 1. "Face-to-face services" consists of "accommodations, eating and drinking," "living-related services and amusement," "education, learning support," and "medical, health care and welfare."

2. Figures for 2020/Q3 are July-August averages.

services industry and the living-related and amusement services industry have remained at low levels (Chart B3-5). As the background to this, firms facing a decrease in demand seem to have been constraining the numbers of working days per employee and working hours per day while continuing with labor hoarding. Given this, looking at the average hourly wage for temporary and part-time jobs at time of recruitment -- which is sensitive to labor market conditions -- while there is no significant change in the wages for clerical jobs, a decline in the pace of wage increase has been evident for food-related jobs as well as sales and services jobs since early spring, when the impact of COVID-19 materialized (Chart B3-6). In addition, in the food services industry, amid concern that weak sales due to COVID-19 may prolong, there has been an increasing number of store closures with the aim of reducing fixed costs such as personnel expenses and rent payments (Chart B3-7). Besides the store closures, given the possibility that an increasing number of firms will choose to discontinue their businesses, it is necessary to be aware of the risk that there will be a greater-than-expected expansion in employment adjustments in the face-to-face services industry, mainly for the accommodations as well as eating and drinking services industry, which has been strongly affected by COVID-19.

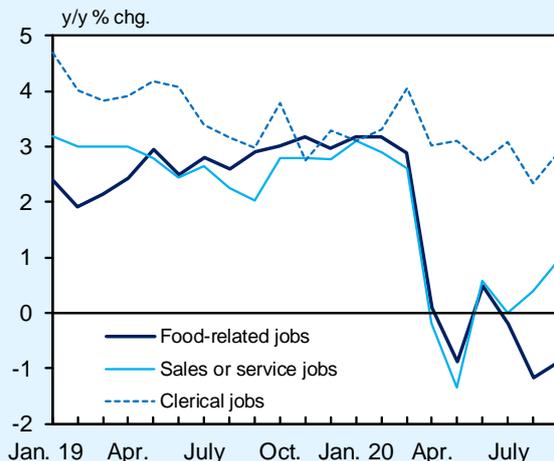
In considering the outlook for labor market conditions in the overall economy, another important point is the extent to which such employment adjustments in the face-to-face services industry will be absorbed by an increase in employment in other industries. In this regard, the DI in the *Tankan* for employment conditions by industry shows that, while firms' perception of

**Chart B3-5: Total Hours Worked per Employee**



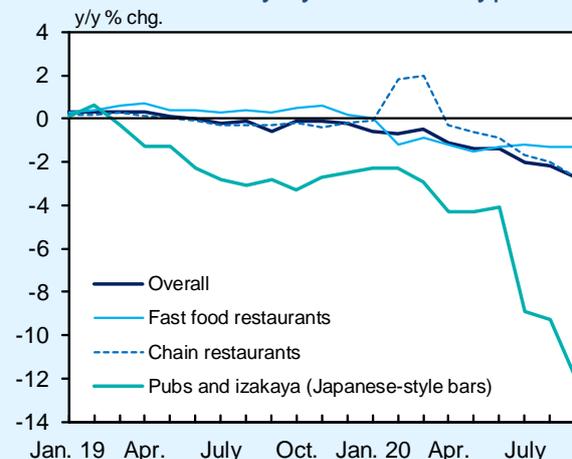
Source: Ministry of Health, Labour and Welfare.  
 Note: "Face-to-face services" consists of "accommodations, eating and drinking," "living-related services and amusement," "education, learning support," and "medical, health care and welfare."

**Chart B3-6: Average Hourly Wage for Part-Time Jobs at Time of Recruitment**



Source: Recruit Jobs Co., Ltd., "Report on Average Hourly Wages for Part-Time Jobs at Time of Recruitment" (available only in Japanese).  
 Note: Figures are for the three largest metropolitan areas (the Tokyo metropolitan, Tokai, and Kansai areas).

**Chart B3-7: Number of Stores in the Food Services Industry by Business Type**

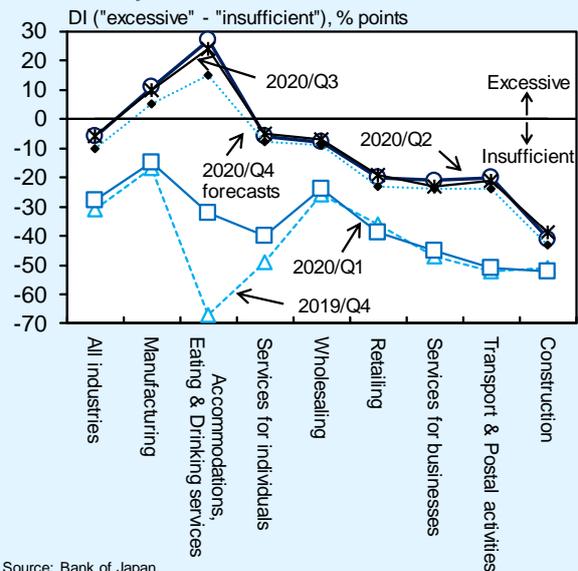


Source: Japan Foodservice Association, "Market Trend Survey of the Food Services Industry."

excess employment has been intensifying to a large extent in the accommodations as well as eating and drinking services industry, there continues to be a perception of insufficient employment, albeit easing, in other nonmanufacturing industries, such as the retail and construction industries (Chart B3-8). Despite being affected by COVID-19, firms are highly likely to continue securing employment, taking into account developments after the impact of COVID-19 subsidies, including the medium- to long-term trend of labor shortage under the circumstance of a declining population. Looking at the situation for job changing by industry, it has been observed in the past that employed persons in the accommodations as well as eating and drinking services industry tended to make a relatively smooth move to another industry (Chart B3-9). This is mainly because a large number of them are non-regular employees whose mobility is relatively high and reservation wage (the minimum wage level at which a worker will accept employment) tends to be low.

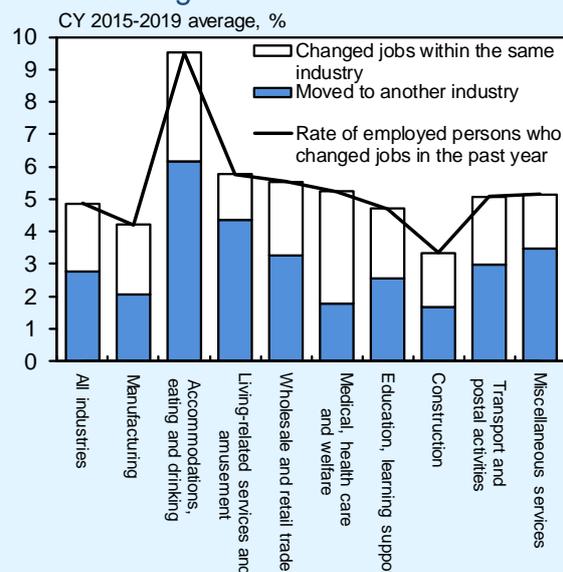
Taking into account these points, in the current phase, it is projected that a decline in employment, mainly in the accommodations as well as eating and drinking services industry, will be absorbed to some extent by an increase in employment in other industries, partly underpinned by the policy responses made for the time being. With regard to labor market conditions in the overall economy, although they are likely to remain deteriorated for a while, they are expected to turn to an improvement thereafter as the impact of COVID-19 wanes. However, attention should be paid to the risks that the employment stance taken by a wide range of firms will become

**Chart B3-8: Employment Conditions by Industry**



Source: Bank of Japan.  
Note: Figures are based on the *Tankan* and are for all enterprises.

**Chart B3-9: Rate of Employed Persons Who Changed Jobs**



Source: Ministry of Internal Affairs and Communications.

cautious and that labor transfers between industries will not proceed as smoothly as expected, given, for example, that (1) uncertainties over future developments due to COVID-19 have been high in not only the face-to-face services industry but also other industries and (2) the workforce skills required by firms may significantly change from the conventional ones, partly due to advances in digital transformation.

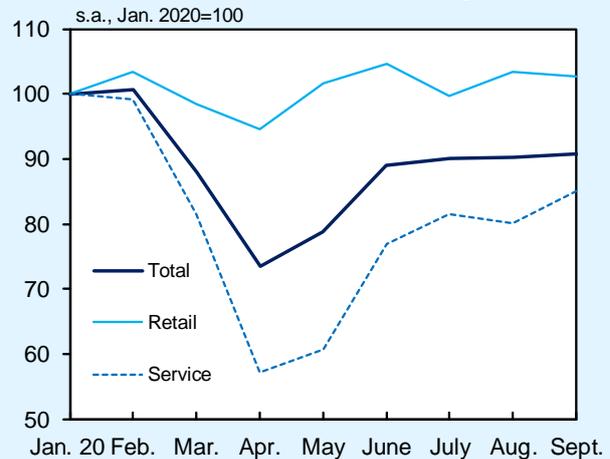
## (Box 4) Developments in Face-to-Face Services Consumption

This box outlines developments to date in face-to-face services consumption during the COVID-19 pandemic by making use of data such as high-frequency data, and examines the outlook for such consumption.

Consumption of face-to-face services -- such as dining out, travel, and entertainment -- has been most strongly affected by COVID-19. Although such consumption seems to have moved out of the worst stage, which was from April through May this year, the pace of its pick-up has been slow and it has remained at a low level to date. In fact, looking at a high-frequency consumption indicator based on credit card transaction data, services consumption, compared with goods consumption, not only registered a sharp decline for the April-May period but has also seen a marked delay in a subsequent pick-up (Chart B4-1). In addition, mobility changes based on location tracking data -- which have high correlation with selective expenditures for services -- have been susceptible to developments in the number of confirmed cases of COVID-19; such changes have picked up gradually as a trend since the state of emergency was lifted, but the pick-up leveled off around summer in reflection of a resurgence in the number of confirmed new cases (Chart B4-2).

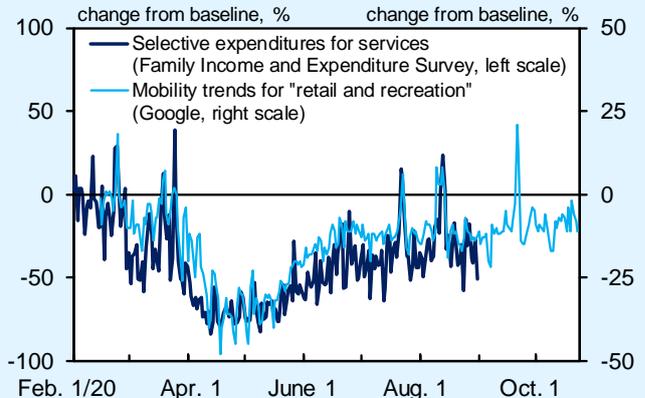
Looking at the breakdown of business activity in the face-to-face services industry, a pick-up in restaurants as well as eating and drinking

**Chart B4-1: Consumption Developments Based on Credit Card Spending**



Source: NOWCAST, Inc./ JCB, Co., Ltd., "JCB Consumption NOW."  
Note: Figures are from the reference series in "JCB Consumption NOW," which take changes in the number of consumers into account. Seasonally adjusted based on staff calculations.

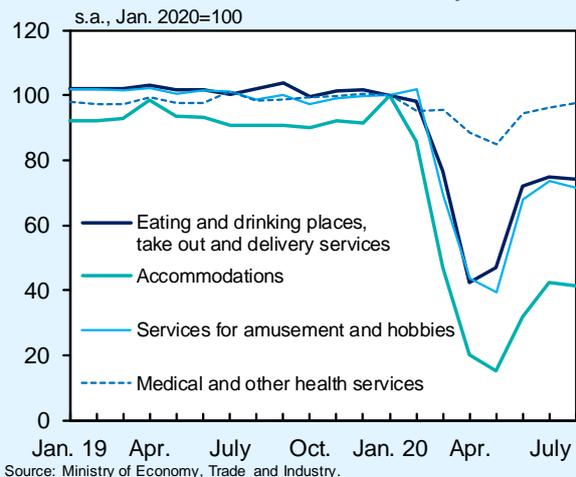
**Chart B4-2: Mobility Trends and Selective Expenditures for Services**



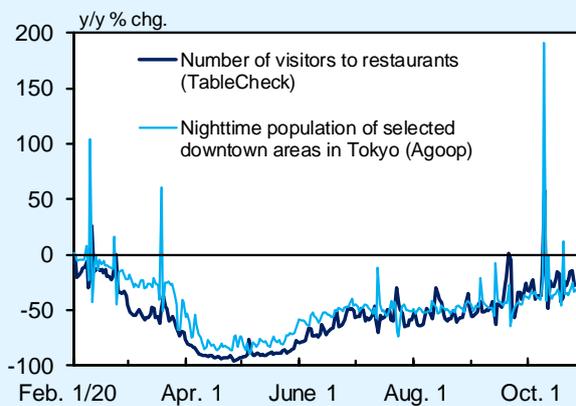
Sources: Ministry of Internal Affairs and Communications;  
Google LLC "Google COVID-19 Community Mobility Reports."  
<https://www.google.com/covid19/mobility/>. Accessed: October 29, 2020.  
Notes: 1. The baseline is the median on the corresponding day of the week during the 5-week period from January 3 to February 6, 2020.  
2. Figures for selective expenditures for services are the sum of expenditure on public transportation, recreational services (accommodation services, etc.), and meals outside the home. The latest figure is for August 31.  
3. Figures for mobility trends for "retail and recreation" are mobility trends for places such as restaurants, shopping centers, and theme parks. The latest figure is for October 23.

services has been weak, mainly for chain restaurants and *izakaya* (Japanese-style bars), both of which basically provide services on the premises (Chart B4-3). The nighttime population of selected downtown areas in Tokyo and the number of visitors to restaurants have been at low levels (Chart B4-4). However, with the number of confirmed new cases of COVID-19 being at a constrained level, positive developments have started to be seen to date, partly because pent-up demand has materialized, due mainly to the effects of the "Go To Eat" campaign.<sup>25</sup> Turning to the accommodation services industry, although its business activity has been underpinned by the "Go To Travel" campaign, its pick-up temporarily paused during the summer season, pushed down mainly by the shortened school summer holiday and by the broadened sense of self-restraint from visiting hometowns. Since the turn of September, when an increase in the number of confirmed cases remained constrained, the year-on-year rate of decrease in the number of people at airports has decelerated and it is highly likely that domestic travel has picked up gradually again (Chart B4-5). Business activity of the amusement services industry has remained lower than the pre-pandemic level -- mainly for theaters, performance and theatrical companies, amusement parks, and theme parks -- since social distancing has been a constraint on, for example, the scale of events and the number of customers. Meanwhile, business activity of the medical services industry has picked up from the bottom hit in the April-May period, but it has remained below the pre-pandemic level. This is

**Chart B4-3: Developments in Activity in the Face-to-Face Services Industry**

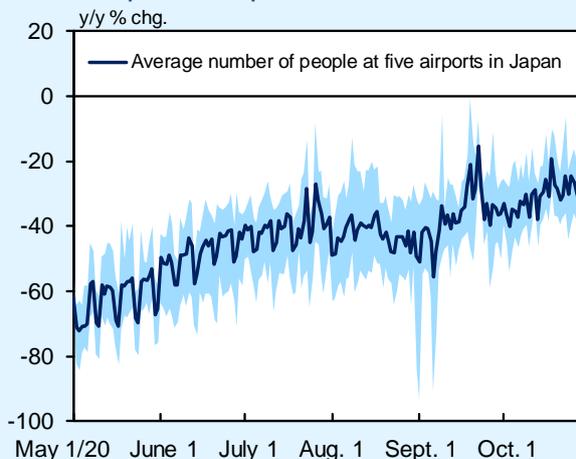


**Chart B4-4: Number of Visitors to Restaurants**



Notes: 1. Figures for the number of visitors to restaurants show the number of visitors per restaurant, and are for about 4,800 restaurants that have installed the reservation and customer management system for restaurants provided by TableCheck Inc. The latest figure is for October 26.  
2. Figures for the nighttime population of selected downtown areas in Tokyo show the aggregate population between 20h-24h within a 500 m radius centered on Ginza, Shinjuku, and Roppongi stations. The figures for 2019 are estimated using data for the aggregate population within the 900 m x 900 m square areas centered around the same stations. The latest figure is for October 28.

**Chart B4-5: Developments in the Number of People at Airports**



Notes: 1. The five airports are New Chitose Airport, Haneda Airport (the average of Terminals 1 and 2), Osaka International Airport, Fukuoka Airport, and Naha Airport. The latest figure is for October 28.  
2. Figures are adjusted for differences between weekdays and weekends/holidays.  
3. The shaded area shows the range between the highest and lowest year-on-year rates of change in the average number of people at the five airports in Japan.

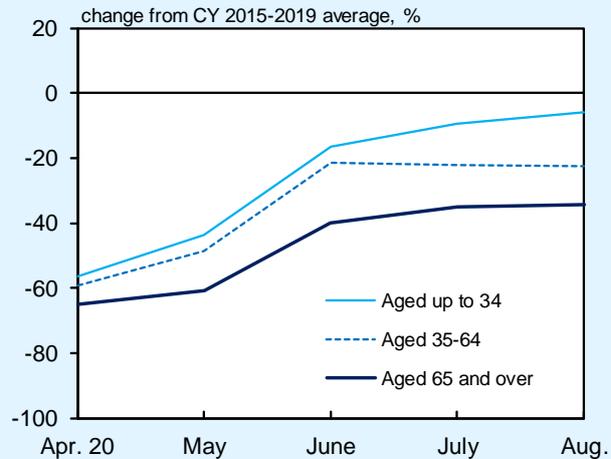
<sup>25</sup> The year-on-year rate of change in the number of visitors to restaurants surged temporarily in early October. This is due to a reactionary increase from a drop in the number last year because of the effects of the typhoon.

because there have been persistent moves -- mainly among seniors and child-rearing households, both of which have been highly vigilant against COVID-19 -- to refrain from going to the hospital for such purposes as treatments that can be postponed to some extent.

The weak pick-up in face-to-face services consumption seems largely attributable to the cautiousness of senior households (for which the head is aged 65 years and older) -- of which consumption accounts for nearly 40 percent of overall private consumption. Compared with other age groups, seniors -- who are considered to have a relatively high risk of severe illness due to COVID-19 -- are more inclined to constrain spending activity that involves going out or contacting with others when the number of confirmed new cases increases. This could be a major factor behind the pause in the pick-up in face-to-face services consumption through the summer season. In fact, looking at consumption developments by age of the household head, by using the data from the *Family Income and Expenditure Survey*, they show the following: although it is necessary to take into account, for example, the size of fluctuations due to sample bias, consumption of services, such as dining out and travel, by seniors saw a larger decline and its subsequent pick-up has been slower in pace compared with other age groups (Chart B4-6). Regarding the outlook, with the impact of COVID-19 remaining, this cautious stance of seniors is projected to constrain the pace of the pick-up in private consumption.

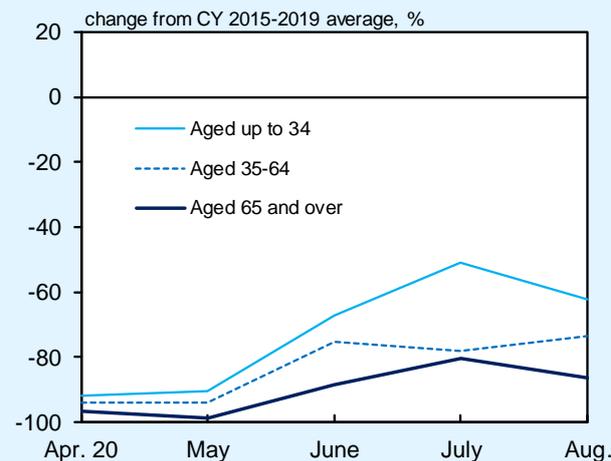
**Chart B4-6: Developments in Consumption by Age**

**1. Eating Out**



Source: Ministry of Internal Affairs and Communications.  
 Note: Figures are for two-or-more-person households and compiled by the age of the household head.

**2. Travel**



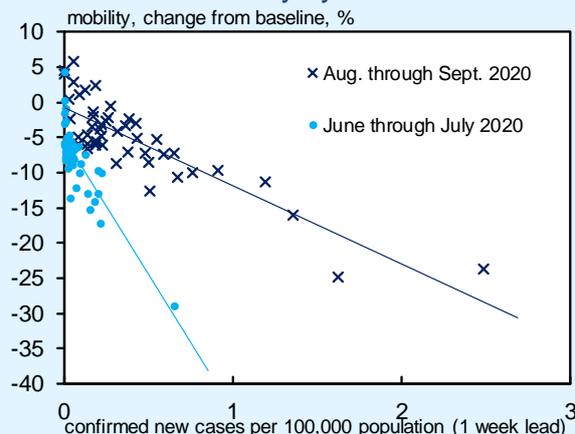
Source: Ministry of Internal Affairs and Communications.  
 Notes: 1. Figures are for two-or-more-person households and compiled by the age of the household head.  
 2. Figures are the sum of expenditures on accommodation services and package tours.

On the other hand, the relationship between consumer vigilance against COVID-19 and consumption activity involving going out or contacting with others may have gradually been changing over time. Looking at the relationship between the number of confirmed new cases per population and mobility changes at the prefecture level, it seems that, for a more recent sample period, the rate of decline in mobility in response to an increase in the number of confirmed cases has become somewhat moderate (Chart B4-7).<sup>26</sup>

This can be investigated more precisely by using a quantitative method (panel local projection) that employs daily prefectural-level panel data for the June-September period. The estimation results indicate that the extent to which an increase in the number of confirmed cases reduces mobility is statistically significantly smaller for a more recent sample period (Chart B4-8). In the meantime, medical institutions have made progress in addressing COVID-19, mainly in metropolitan areas, and an increase in the number of confirmed severe cases has been constrained. Given these factors, there is a possibility that consumer behavior has been changing over time, in that they simultaneously respond to COVID-19 -- such as being vigilant against it and taking preventive measures -- and engage in consumption activities that involve going out and contacting with others.

In conclusion, face-to-face services consumption has remained susceptible to developments in COVID-19, such as changes in the number of

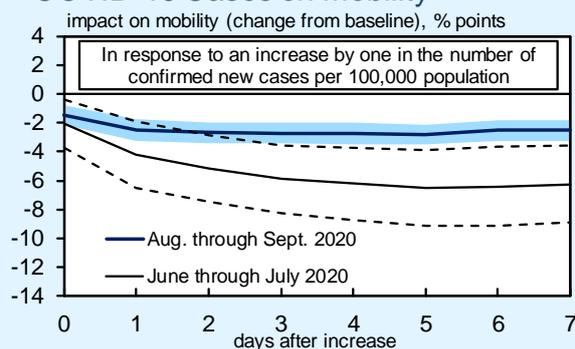
**Chart B4-7: Confirmed New COVID-19 Cases and Mobility by Prefecture**



Sources: Local governments in Japan; Ministry of Internal Affairs and Communications; Google LLC "Google COVID-19 Community Mobility Reports." <https://www.google.com/covid19/mobility/>. Accessed: October 29, 2020.

- Notes: 1. The percent change in mobility shows that in visits to places such as restaurants, shopping centers, and theme parks. The baseline is the median on the corresponding day of the week during the 5-week period from January 3 to February 6, 2020.  
2. Figures are prefecture-level averages for each period indicated in the legend.

**Chart B4-8: Impact of an Increase in COVID-19 Cases on Mobility**



Sources: Local governments in Japan; Ministry of Internal Affairs and Communications; Japan Meteorological Agency; Google LLC "Google COVID-19 Community Mobility Reports." <https://www.google.com/covid19/mobility/>. Accessed: October 29, 2020.

- Notes: 1. The percent change in mobility shows that in visits to places such as restaurants, shopping centers, and theme parks. The baseline is the median on the corresponding day of the week during the 5-week period from January 3 to February 6, 2020.  
2. Figures are estimated using panel local projection employing daily prefecture-level data on mobility and confirmed new COVID-19 cases (7-day backward moving average). Explanatory variables include lagged dependent variables, temperature, precipitation, day-of-the-week dummies, and dummies for holidays and the *bon* festival period. The shaded area and the broken lines indicate the 90 percentile bands.

<sup>26</sup> The data for the number of confirmed new cases are one-week prior to data for mobility, considering that it takes some time for the change in the number of confirmed new cases to affect mobility.

confirmed new cases. As for the outlook, it is highly likely that the pace of a pick-up in such consumption will be only moderate, with spending behavior, mainly by seniors, continuing to be cautious. However, given that consumer behavior under the COVID-19 pandemic seems to have been changing recently, the pick-up trend in face-to-face services consumption is projected to continue for the time being, supported also by the effects of demand stimulus measures including the "Go To" campaign (covering such areas as travel, dining out, and events).

## (Box 5) Bank of Japan's Responses to COVID-19 and Financial Conditions

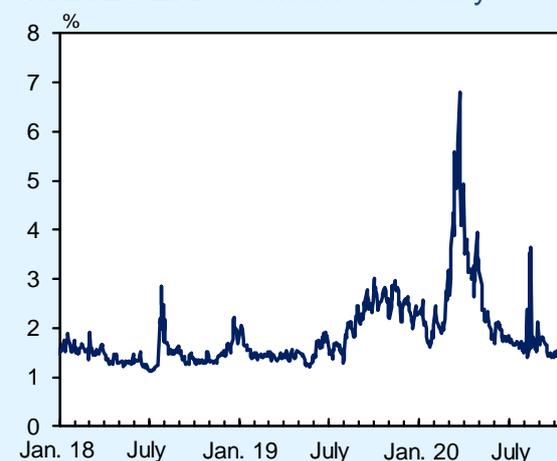
COVID-19 has affected the financial side. With a view to supporting financing, mainly of firms, and maintaining stability in financial markets, the Bank has actively made responses by conducting the following three measures: (1) the Special Program to Support Financing in Response to the Novel Coronavirus (COVID-19); (2) an ample provision of yen and foreign currency funds without setting upper limits, mainly by purchasing JGBs and conducting the U.S. dollar funds-supplying operations; and (3) active purchases of ETFs and J-REITs (Chart B5-1).

These measures have had positive effects. Global financial markets became rapidly unstable from late February, reflecting the spread of COVID-19, but tension has eased. As for the funding environment for foreign currencies, premiums for U.S. dollar funding through the foreign exchange swap market between the dollar and other major currencies rose significantly due to vigilance against COVID-19. However, the premiums narrowed quickly and have been stable because major central banks, including the Bank of Japan, have cooperated to strengthen the U.S. dollar funds-supplying operations and to provide ample dollar funds, based on the lessons learned at the time of the GFC (Chart 57). In addition, although the volatility of the JGB market heightened, it has declined, partly due to the Bank's active JGB purchases (Chart B5-2). Meanwhile, the yield curve for JGBs has been stable at a low level, even at a time when market participants factored in an increase in JGB issuance (Charts 49 and 55). Triggered by the

### Chart B5-1: The Bank's Measures in Response to COVID-19

Supporting Corporate Financing
Special Program to Support Financing in Response to COVID-19: total size of about 130 tril. yen + $\alpha$
Purchases of CP and corporate bonds: amount outstanding of about 20 tril. yen at maximum (previous amount outstanding of about 5 tril. yen)
Special Funds-Supplying Operations to Facilitate Financing in Response to COVID-19: about 110 tril. yen
Stabilizing Financial Markets
Ample and Flexible Provision of Yen and Foreign Currency Funds
Further active purchases of JGBs and T-Bills: unlimited
Enhancement of the U.S. Dollar Funds-Supplying Operations: unlimited
Active Purchases of ETFs and J-REITs
ETFs: annual pace of about 6 tril. yen → annual pace with the upper limit of about 12 tril. yen (for the time being)
J-REITs: annual pace of about 90 bil. yen → annual pace with the upper limit of about 180 bil. yen (for the time being)

### Chart B5-2: Bond Market Volatility



Source: Bloomberg.

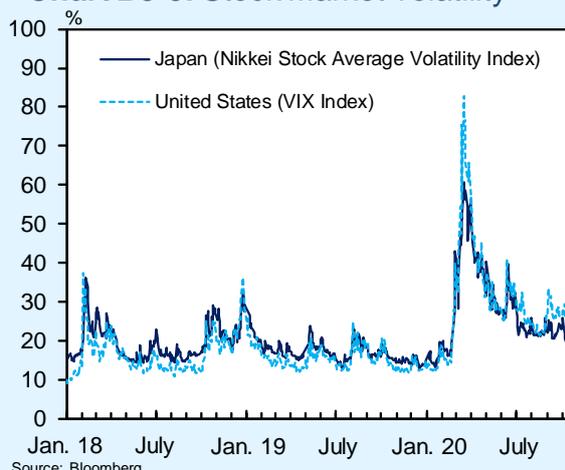
Note: Figures are based on the S&P/JPX JGB VIX Index.

spread of COVID-19, the volatility indices for the stock market rose to a level not seen since the GFC, but they have declined, partly because the government and central bank of each country and region have taken aggressive measures (Chart B5-3). That said, global financial markets have remained nervous, as seen in the volatility of the stock market staying relatively high compared with the pre-pandemic level.

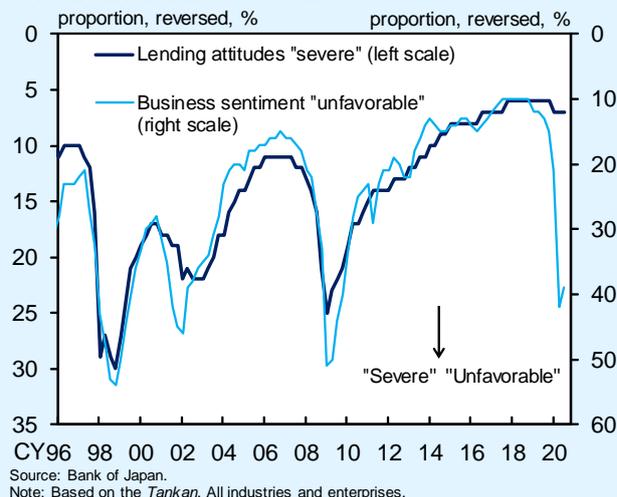
Despite weakness in financial positions, mainly of firms, the environment for external funding has remained accommodative since private financial institutions have actively fulfilled the functioning of financial intermediation on the back of various measures taken by the Bank and the government (Chart 52). The Bank has mainly provided liquidity support by conducting the aforementioned measures. Meanwhile, the government has provided solvency support by enhancing programs that make use of guaranteed loans and by establishing programs to supply capital and quasi-capital funds.

On this basis, financial institutions' lending attitudes have remained accommodative. Specifically, the DI in the *Tankan* for financial institutions' lending attitudes as perceived by firms shows that the proportion of firms answering that such attitudes are "severe" has remained small compared with when business sentiment deteriorated in the past (Charts 51 and B5-4). The amount outstanding of lending has increased on the whole and loans to small and medium-sized firms also have increased for many industries (Charts 53 and B5-5). Meanwhile, the Special Funds-Supplying Operations to Facilitate

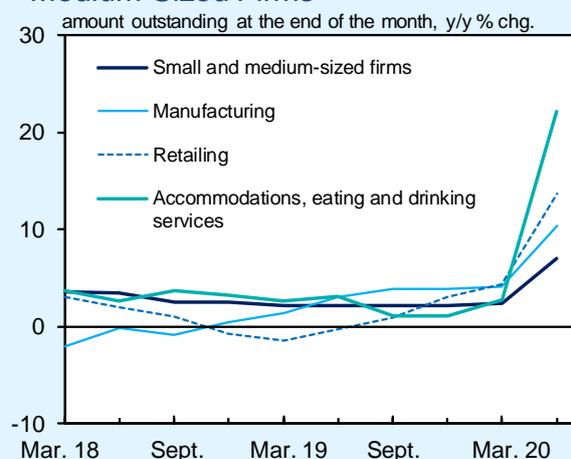
**Chart B5-3: Stock Market Volatility**



**Chart B5-4: Business Sentiment and Firms' Perceptions of Lending Attitudes of Financial Institutions**

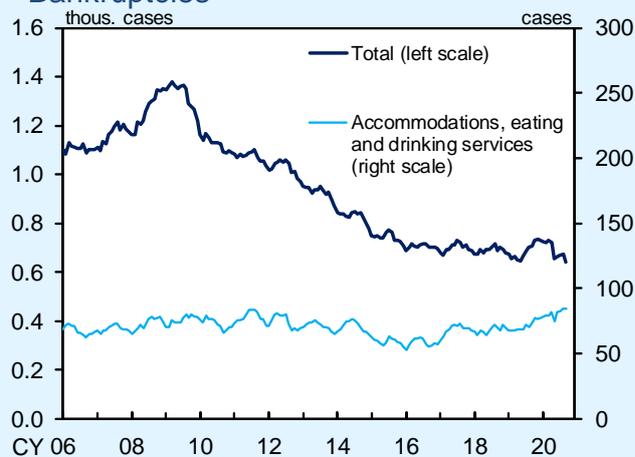


**Chart B5-5: Loans to Small and Medium-Sized Firms**



Financing in Response to the Novel Coronavirus (COVID-19), in which the Bank provides funds on favorable terms to financial institutions that particularly make loans in response to COVID-19, have increased significantly in size. For example, when the special operation was first conducted in March, there were 18 eligible counterparties and the amount outstanding of loans to them was 3.4 trillion yen, increasing to about 250 counterparties and 45 trillion yen, respectively, as of end-September. Issuance rates for CP and corporate bonds rose temporarily but have been stable after the Bank increased the upper limit on the total purchases of CP and corporate bonds to 20 trillion yen (Chart 50). The rate of increase in the amount outstanding of CP and corporate bonds has continued to be at a high level (Chart 53). These developments suggest that the economy has been supported from the financial side. Against this backdrop, the number of bankruptcies of firms has been stable on the whole, without a sudden increase seen even in the eating and drinking as well as accommodations industry, which has been largely affected by COVID-19 (Chart B5-6).

**Chart B5-6: Number of Corporate Bankruptcies**



Source: Tokyo Shoko Research Ltd., "Tosan Geppō" (Monthly Review of Corporate Bankruptcies).  
 Note: Figures show 6-month backward moving averages.

That said, there are extremely high uncertainties over the consequences of COVID-19 and their impact on the economy. It is expected at this point that financial system stability will be maintained and the economy will continue to be supported from the financial side, partly owing to the policy responses by the Bank and the government. However, future developments warrant close attention.

