

*Market Monitor – Japan***Road to Recovery Hinges on Vaccine Progress and Global Demand****State of emergency set to weigh on Japan's economy in Q1 2021**

Japan's economic recovery continued in the last quarter of 2020, though at a slower pace. In Q4 2020, Japan's GDP grew at an annualised rate of 11.7% quarter-on-quarter, down from the 22.8% growth in the previous quarter. Despite a slowdown in household consumption during the quarter, exports recorded faster growth, thanks mainly to the global rebound of manufacturing activity. For 2020 as a whole, Japan saw a 4.8% contraction year-on-year.

Japan's jobs market remained resilient at the start of 2021. The jobless rate dipped unexpectedly to 2.9% in January 2021, edging down slightly from the revised 3.0% in the previous month. At the same time, the job-to-applicant ratio surged to 1.10 from a revised 1.05 in December, mainly reflecting a larger increase in construction demand and a smaller drop in job offers in the IT and retail sectors. The relative resilience of the labour market can be partly attributed to the limited scope of the latest state of emergency that covered just 11 of the country's 47 prefectures. Besides this, Japan's aging population has also resulted in a chronic labour shortage.

For 2021, market expectation is that Japan will see contraction again in the first quarter, as the state of emergency imposed on 11 prefectures since January has had an adverse impact on business activity and household consumption. The year-on-year drop in household spending expanded to 6.1% in January, while the drop in December was 0.6%. That said, with most of the 11 prefectures ending the state of emergency on 7th March and Tokyo and its surrounding prefectures ending the state of emergency on 21st March, Japan's economy is expected to see a clear rebound starting from the second quarter. The ongoing recovery of Japan's trading partners such as the US will also boost demand for Japanese exports. General market expectation is that the Japanese economy will see a 2.8% growth in 2021.

- ❖ **Q4 2020 continued to see fast growth as exports recorded faster growth amid a rebound in global manufacturing.**
- ❖ **Jobs market saw slight improvement in January, chiefly due to the limited scope of the latest state of emergency as well as demographic factors.**
- ❖ **Slow vaccination progress poses uncertainties for Tokyo Olympics scheduled for July.**

Slow vaccination progress poses risk to Olympics

The Japanese economy's road to recovery is still subject to major uncertainties. Japan only started Covid-19 vaccination towards the end of February. As of 23rd March, only about 0.53% of its population have received at least one dose of vaccine, considerably lower than other developed economies like the US and UK. The slower vaccination was partly due to the slow approval process by the Japanese government and tight supply. At the current vaccination rate, it would be difficult for Japan to achieve herd immunity before the scheduled Tokyo Olympics in July. Moreover, global vaccination progress is also slow due to a tight supply of effective vaccines. On 20th March, the organising bodies of the Tokyo Olympics officially confirmed that no overseas spectators will be permitted to attend the Olympics in the summer. The Japanese government was reported to be considering holding the Tokyo Olympics without spectators, which could result in an estimated over JPY 2 trillion economic loss for Japan.

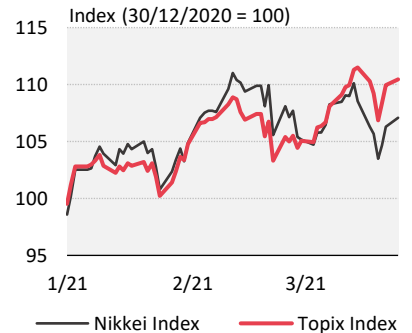
Optimism remains in equity market as policy stance is still accommodative

The Bank of Japan (BOJ) maintained the short-term interest rate at -0.1% at its March Policy meeting, with a zero target for the 10-year Japanese Government Bond (JGB) yield. The BOJ scrapped its JPY 6 trillion ETF buying target, but maintained the upper limit of about JPY 12 trillion a year, and will intervene if the new policy causes the market to fall. It also announced it will only purchase ETFs tracking the Tokyo Stock Price Index. As of 29th March, the Nikkei recorded a 7.1% gain when compared to the level at the end of 2020, while Topix registered a 10.5% gain over the same horizon.

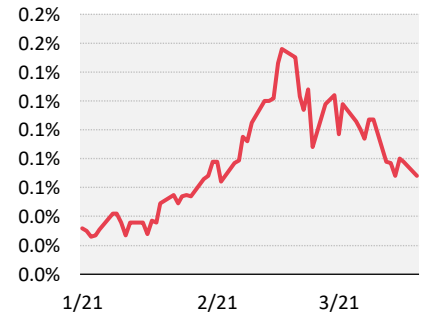
Japanese government bond yields edge higher against US Treasury yields

The higher US Treasury yields due to intensifying inflation expectations pushed the 10-year Japanese bond yield higher in the first quarter of 2021. On 26th February, the 10-year government bond yield closed at 0.156%, the highest since the end of January 2016 when the BOJ introduced a negative interest rate. At its March policy meeting, the BOJ announced that it would allow the 10-year government yield to fluctuate around zero at within 25 basis points rather than the 20 basis points announced previously. As of 29th March, the 10-year government bond yield still stood at 0.068%, about 5 basis points higher than the level at the end of 2020.

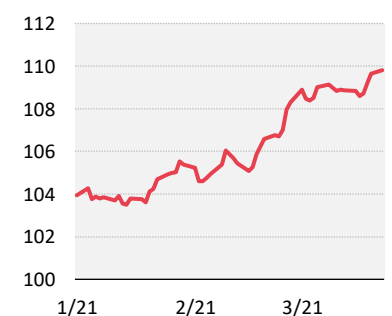
Meanwhile, as the US dollar strengthened with higher Treasury yields, the Japanese yen weakened against the US dollar. As of 29th March, the yen stood at JPY 109.81 per US dollar, about 6.0% lower than the level at the end of 2020. Looking ahead, the trend of the yen and Japanese bond yields will be influenced by the risk appetite of investors, which will hinge on the recovery trajectory of major advanced economies.

Japan Equity Indices


Source: Bloomberg, data as of 29/3/2021

10-year Japanese Government Bond Yield


Source: Bloomberg, data as of 29/3/2021

USD/JPY


Source: Bloomberg, data as of 29/3/2021

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