

Market Monitor – Japan

Bumpy Road to Recovery



A resurgence in Covid-19 cases overshadows economic recovery

Japan’s economic recovery has been slowed by a resurgence of Covid-19 cases, with GDP contracting at an annualised rate of 3.9% quarter-on-quarter in Q1 2021. On a year-on-year basis, Japan’s GDP declined by 1.6% during Q1. Meanwhile, household consumption declined at an annualised rate of 6.0% quarter-on-quarter, mainly reflecting the impact of a state of emergency in 11 prefectures including Tokyo that remained effective for most of the first quarter.

The slow vaccine rollout led to a resurgence in cases in April. As of 25th April, the 7-day average of new cases surged to more than 4,700, up from around 2,000 at the end of March, resulting in another state of emergency in various major cities and prefectures starting from late April. Against this backdrop, the unemployment rate edged up to 3% in May, rising from 2.8% in April. Market participants generally expect Japan to see a more significant rebound in the second half of 2021, and growth of 2.5% for the whole year.

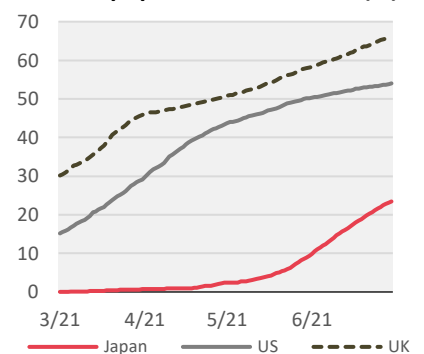
However, the expected recovery will still be subject to uncertainties concerning the epidemic situation at home, given Japan’s slower vaccination rate relative to other developed economies. As of 30th June, about 23.4% of Japan’s population had received at least one dose of vaccine, compared to 54% in US and about 66% in the UK. It may be difficult for Japan to achieve herd immunity before the Olympic Games begin in July. A team of experts from the National Institute of Infectious Diseases, Kyoto University, and Tohoku University warned that another state of emergency may be needed during the Tokyo Olympics to curb a Covid-19 resurgence.

Q1 2021 sees contraction due to the renewed state of emergency.

Slower vaccination progress relative to other advanced economies poses risks to economic rebound in H2 and the Olympics.

BOJ keeps policy rates unchanged and plans to launch new climate change scheme.

Share of population vaccinated (%)



Sources: Our World in Data, data as of 1/7/2021

Economic Research

July 2021

Equity market corrects as inflation pressure mounts in advanced economies

US inflation was higher than expected in April and May, prompting speculation that major central banks may start to taper off asset purchases earlier than expected, resulting in corrections in the major equity markets. In addition, resurgence in Covid-19 cases in Japan also adversely affected the local stock market. As of 30th June, the Nikkei Index recorded a 1.3% drop when compared to the level at the end of March 2021, while Topix registered a 0.5% decline over the same horizon.

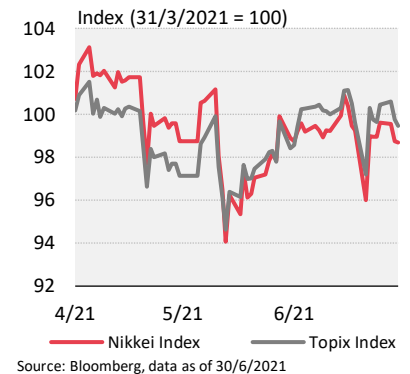
BOJ keeps policy rate unchanged and plans to launch new climate change scheme

The Bank of Japan (BOJ) kept the short-term interest rate at -0.1% at its June policy meeting, with a target of zero for the 10-year Japanese government bond (JGB) yield. The pandemic-relief programme will also be extended to March 2022. The BOJ has also announced the introduction of a new scheme to provide funds to financial institutions investing in or lending to initiatives that address climate change issues. It is expected that the new measures will be launched within 2021 and a preliminary outline will be released at the BOJ's July's meeting.

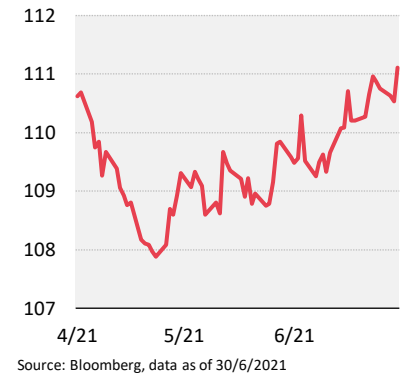
The US dollar has since strengthened after it was revealed that the US Federal Reserve intends to raise interest rates from 2023. As of 30th June, the yen stood at JPY 111.11 per US dollar, about 0.4% lower than the level at the end of March. Meanwhile, the 10-year government bond yield edged lower, mainly due to strong response at auction. As of 30th June, the 10-year government bond yield stood at 0.052%, about 4 basis points lower than the level at the end of March 2021.

Looking ahead, the trend of the yen and of Japanese bond yields will be governed by the recovery trajectory of the major advanced economies, as well as the domestic and international political and economic situations. The general election of members of the House of Representatives is scheduled to be held in October 2021 at the latest. An opinion poll by Japan Broadcasting Corporation (NHK) released on 14th June showed that the approval rate of Suga's cabinet dropped to 37%, compared to over 60% when he took office in September 2020. Potential changes to the cabinet and economic policies, coupled with evolving regional geopolitical tensions, may heighten market uncertainty and strengthen the yen going forward.

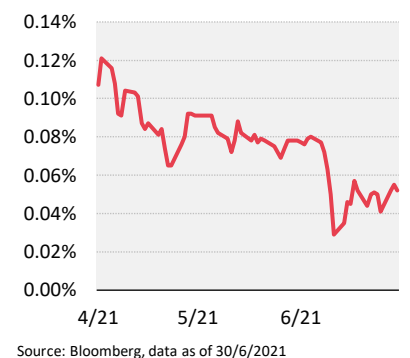
Japan Equity Indices



USD/JPY



10-year Japanese Government Bond Yield



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