



The Japan Report

EY Consulting Japan

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Economy

Japan powers out of the COVID-19 dip with 3% economic growth in Q4. Economic growth was well ahead of expectations. Nikkei index hit the 30,000 mark for the first time in 30 years, the highest since August 1990. Exports rose 2%, the unemployment rate drops to 2.9%. The March quarter is likely to be negatively impacted by the current state of emergency and COVID-19 restrictions resulting in a drop in consumer spending in January.

COVID-19

After a spike in January, new cases are declining rapidly. Despite number of cases dropping rapidly the government has erred on the side of caution and extended the state of emergency (SOE) by 2 weeks. Modest restrictions have proved successful in reducing cases. The number of new cases in Japan is low compared to most other countries. Vaccinations have started in February.

Geopolitical and trade

2021 will mark the year Japan will be at the center of the global economic diplomacy. Japan has been promoting regional cooperation. 2021 will be the year to see the fruits of these efforts by expanding the Comprehensive and the Progressive Trans-Pacific Partnership (CPTPP) agreement and enacting Regional Comprehensive Economic Partnership (RCEP). Japan is one of the main participating countries.

Politics

GREEN and DIGITAL are the two words that best describe the new initiatives upon which Prime Minister Suga will base his economic reforms. Japan will establish a digital agency to help the government deal with the digital transformation of society. It will formulate policies regarding digital issues, utilize digital in government, and develop infrastructure related to digitalization such as electronic signatures and electronic power of attorney. In its "Green Growth" strategy, Japan commits to be carbon neutral by 2050.

Olympics

Amidst much speculation and divided public opinion, the Japanese government says the Olympics will go ahead. However, several challenges are causing uncertainty; delays in the COVID vaccine rollout, the recent sexism row, and the TOC president Yoshiro Mori's replacement with Seiko Hashimoto. The end of March seems to be the de-facto decision deadline as to whether the games will have spectators or not.

1 COVID-19

New cases dropping rapidly,
state of emergency likely to
be lifted as planned on
7 March.

Source: Tokyo Metropolitan Government, The Prime Minister's Office, Ministry of Health, Labour and Welfare,
Ministry of Economy, Trade and Industry, Ministry of Foreign Affairs, Yomiuri 8 February 2021, Nikkei 14 February 2021.

1. Update on COVID-19 – state of emergency

- On 8 January, the government declared a state of emergency and asked people to refrain from going out and to close restaurants at 8PM for one month. Despite number of cases dropping rapidly the government has erred on the side of caution and extended the SOE by 2 weeks. The modest restrictions have been effective in reducing the number of COVID-19 cases - see graph "Number of new COVID-19 cases".

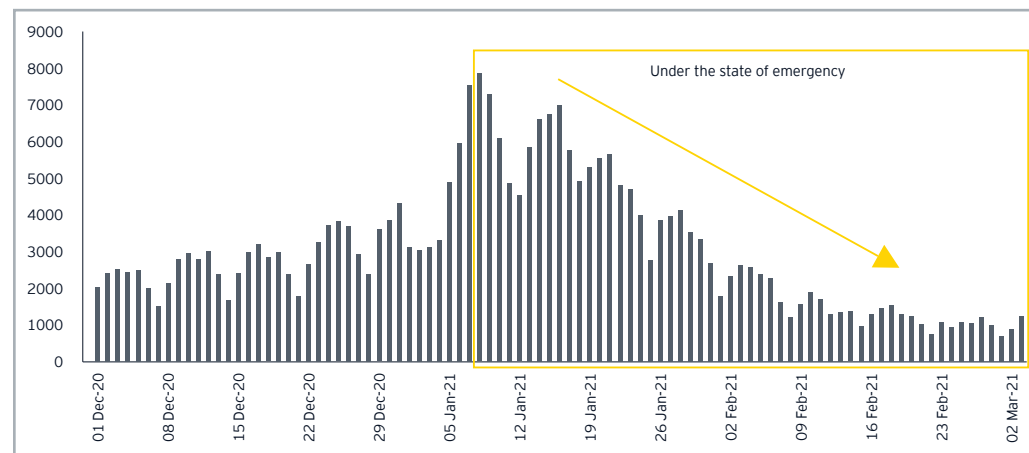
2. Schedule of Vaccination for COVID-19

- The Japanese government has secured a total of 314 million doses of the vaccine. At present, the procedures for importing vaccines from overseas are underway. At the same time, the transportation and management systems in Japan are being established.
- On 14 February, one of the vaccines for COVID-19 was approved for the first time in Japan. Vaccinations to healthcare workers have begun on 17 February. However, there is no specific schedule for the vaccination, and the implementation schedule is likely to vary depending on local governments.

3. Partial resumption of the "Go To" campaign

- The government has suspended the "Go To" campaign due to the declaration of a state of emergency and announced that it would extend the campaign's suspension of the "Go To" campaign following the decision to extend the declaration of a state of emergency in early February. The government considers resuming the "Go To" campaign in prefectures with low infection rates.
- *("Go To" is an initiative from the Japanese government to promote travel and tourism in Japan)

Number of new COVID-19 cases



2 Politics, economic policy and Olympic update

In his new year's speech, Prime Minister Suga positioned "green" and "digital" as his dual focus.

Source: Cabinet Secretariat, Prime Minister's Office of Japan, Ministry of Foreign Affairs, Ministry of Economy, Trade and Industry, NHK 18 February 2021.

GREEN - Carbon neutral by 2050

On 25 December 2020, the Ministry of Economy, Trade and Industry (METI) formulated the "Green Growth Strategy Accompanying Carbon Neutrality in 2050". This strategy is an industrial policy to link the challenge of the Suga administration's "carbon neutrality by 2050" to a "positive cycle between the economic growth and the environmental protection". The main focus is to set high goals and formulate action plans for each of 14 key areas.

Reduce sales of new gasoline and diesel vehicles to zero by 2030

The Ministry of Economy, Trade and Industry (METI) has indicated in its "Green Growth Strategy with Carbon Neutrality in 2050" that it intends to reduce sales of new gasoline and diesel vehicles to zero by 2030.

DIGITAL - Digitalization of society and government

On 9 February 2021, the Japanese government decided to submit six bills related to digital reform to the Diet, including a bill to establish the Digital Agency. The bills aim to expand the use of "My-Number" and unify and standardize local governments' core systems.

The tax system will support the private sector with digital investments across entire business activities, from internal software to production, distribution, and sales.

The purpose of the Digital Agency is to help the government deal with the digital transformation of the society. Its function is to formulate policies regarding digital issues, utilize digital in government, and develop infrastructure related to digitalization such as electronic signatures and electronic power of attorney. It is expected to be the main body to handle issues that have

so far involved several ministries, including the Ministry of Internal Affairs and Communications, the Ministry of Economy, Trade and Industry, and the Ministry of Justice.

Foreign affairs and security

Japan will be at the center of the global economic diplomacy in 2021. While the US under Trump has focused on bilateral economic diplomacy, Japan focused on regional cooperation. 2021 will be the year to see the fruits of Japan's economic diplomacy by expanding the Comprehensive and the Progressive Trans-Pacific Partnership (CPTPP) agreement and enacting Regional Comprehensive Economic Partnership (RCEP). Japan is one of the main participating countries in terms of GDP among member-countries.

On 1 January 2021, Japan - UK Economic Partnership Agreement (EPA) has been enacted. On 31 January 2021, the UK announced its participation in the Japan-led CPTPP. On February 10 2021, the Liberal Democratic Party of Japan (LDP) has approved a draft of RCEP for approval process of the Diet, an agreement consisting of 15 countries including China and ASEAN. The draft approval was signed in November 2020 and is to be discussed in an ordinary Diet session in 2021.

Tokyo Olympics and Paralympics

Olympics. Amidst much speculation and divided public opinion, the Japanese government says the Olympics will go ahead. However, several challenges are causing uncertainty; delays in the COVID vaccine rollout, the recent sexism row, and the TOC president Yoshiro Mori's replacement with Seiko Hashimoto. The end of March seems to be the de-facto decision deadline as to whether the games will have spectators or not.

3 Sector insights – Energy

The government has set a goal to achieve carbon-neutrality by 2050. Utilizing hydrogen and ammonia is key.

Source: “Green Growth Strategy towards 2050 Carbon Neutrality” Formulated,” Ministry of Economy Trade and Industry, 25 December 2020, Nikkei, 22 December 2020, Jiji Press, 25 December 2020, The third meeting of a Council to Promote the use of Ammonia, Ministry of Economy Trade and Industry, 8 February 2020

Government Policy

- ▶ Following Prime Minister Yoshihide Suga’s declaration of the net-zero target in October, the Japanese government announced its “Green Growth Strategy” on 25 December. Green Growth is the plan to be carbon-neutral by 2050.
- ▶ The Green Growth Strategy will set ambitious goals in 14 fields and has roadmaps to attain them. The share of renewable energy will be raised to 50-60%, while nuclear power and thermal power generation combined with carbon dioxide capture will account for 30-40% by 2050. Power generations using hydrogen and ammonia will account for a 10% share even though they are still in a demonstration phase.

Offshore wind power

The government commits to generating 10 gigawatts (GW) of offshore wind power by 2030 and to 30-45 GW by 2040. 10 GW output is equivalent to that of 10 nuclear power reactors. The government will review power grids in the country and prepare them for renewable energy. The plan will include constructing power grids that connect remote wind power sites and areas of demand. At present, wind power in Japan accounts for only a small portion of its power production.

Fuel ammonia

Ammonia will be a transitional fuel in the run-up to a hydrogen society. Ammonia used as fuel does not produce carbon dioxide. During the transitional phase, ammonia will be mixed with coal at coal-fired thermal plants to reduce total CO2 emission. Burning ammonia produces air-polluting nitrogen oxides, but technologies to curb their emission below environmental standards have already been established. The government has set an annual target for ammonia at 3 million tons by 2030 and 30 million tons by 2050.

Hydrogen

The government plans to raise annual use of hydrogen in Japan to 10 million tons by 2030. It will help introduce hydrogen to power generation as well as fuel cell vehicles, aiming to lower the cost and spread it.

Vehicles

By mid-2030s, all new passenger cars sold will be electric vehicles. Compact cars are no exception. Electric vehicles (EV) include fuel cell vehicles (FCV) and hybrid cars. The government is expected to announce goals for commercial vehicles, such as buses and trucks, by this summer and it will work to build up the infrastructure for charging facilities to speed up the transition to electric vehicles.

Nuclear and power generation

Despite the Fukushima Daiichi nuclear accident in 2011, the government sees nuclear power generation with improved safety as one of options to achieve a net-zero emission target by 2050. It plans to develop small modular reactors (SMR) and next-generation reactors, including high-temperature gas reactors.

Tax incentives

Companies committing to “Green Investment” will be eligible for tax incentives. These tax incentives will cover investments in emission-reducing or energy-saving equipment. Facilities will include production lines for new type lithium-ion batteries as well as power semiconductors.

The government will create indices to measure each company’s contribution. Based on these contributions, companies can choose a 50% special depreciation or a 5-10% corporation tax deduction.

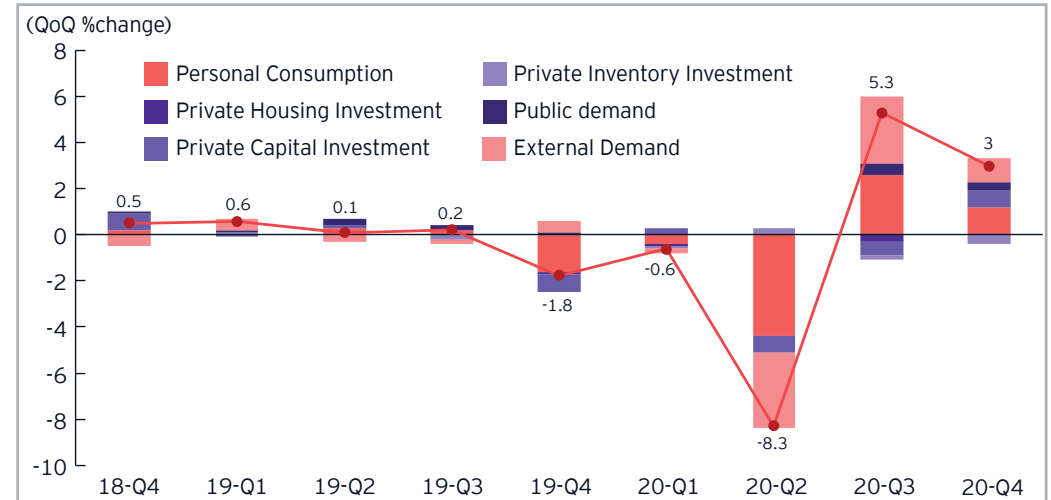
4 Macroeconomic trends

Japan's economy grew 3% in October-December for the second quarter

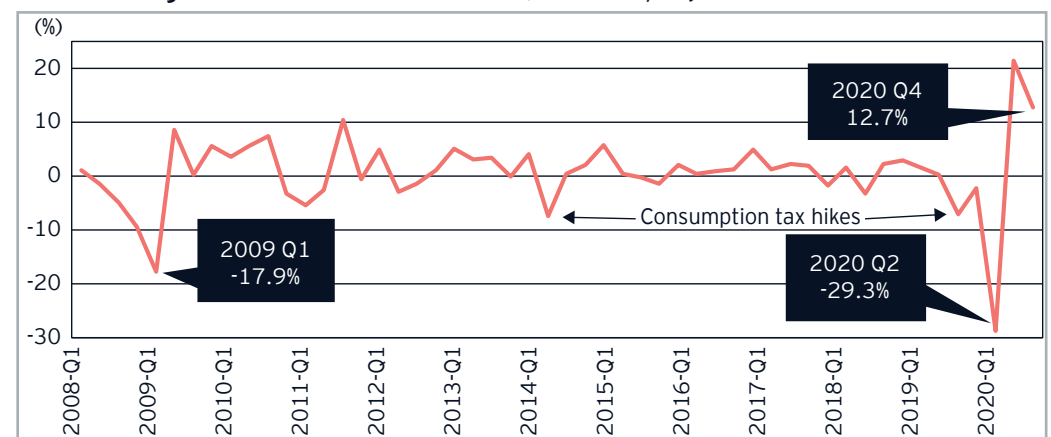
Japan's GDP grew 3.0% in the fourth quarter (October to December) from the previous quarter in real terms. The annualized growth rate of 12.7% is lower than the 22.7% growth rate in the third quarter (July to September). A government-subsidized "Go To" campaign that boosted travel and eating out led to an increase in spending. Exports rose owing to the increase in electronic parts and vehicles for China.

- The GDP growth for the year 2020 was -4.8% because of the impact of the COVID-19 spread. It is the first contraction since 2009 when the economic growth was -5.7% due to the global financial crisis in the previous year.

Contribution to real GDP (% , %pt seasonally adjusted basis)



Real GDP growth rate (QoQ Annualized, seasonally adjusted basis)



Source: Cabinet Office, 15 February 2021, NHK, 15 February 2020, Nikkei 15 February

The economic situation

Business conditions and industrial production

The Coincident Index (CI) and Industrial Production (IPI) drop for two months in a row. The CI in January is likely to be revised upward. IPI is expected to increase in January.

The coincident index of business conditions in December fell by 1.2 points from the previous month to 87.8. The figure is against the 2015 base of 100. The index has now fallen for two consecutive months. The production and shipment of automobiles and capital investment decreased compared to the previous month.

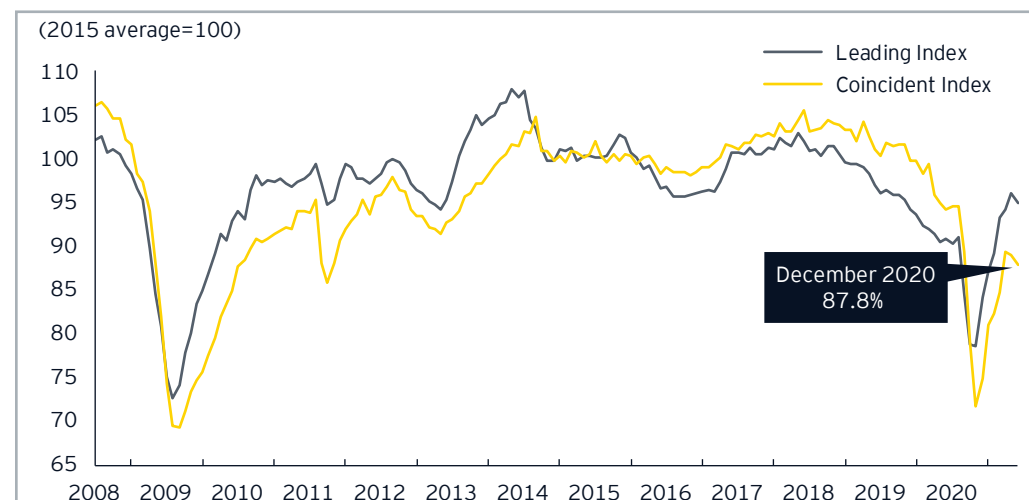
Government officials say there appears to be a pause in growth of industrial production which has been contributing to the economic recovery.

The decrease in retail sales and reduced exports to Europe and the US due to the COVID-19 outbreak also influenced the trend.

The industrial production index in December fell 1.0% from the previous month to 93.8. The production of motor vehicles, general-purpose and business-oriented machinery, electrical machinery, and Information communication electronics equipment mainly contributed to the decrease. In 2020, the index fell from February to May, and then picked up from June for five months.

However, having been impacted by the spread of COVID-19 infection, the figure decreased for two consecutive months in November and December. The production level is still low comparing to the pre-pandemic levels. It is expected to increase in January.

CI* Coincident Index of business conditions



* The Composite Indexes (CI) mainly aim to measure the tempo and the volume of economic fluctuations. They compose the quantitative changes in indicators such as factory output, employment and retail sales data that are sensitive to business cycle movements.

* Leading Index tends to precede the coincident CI by a few months. It is used to forecast changes in the direction of the economy in the upcoming months.

Source: Cabinet Office, 5 February 2021, Nikkei, 6 February 2021, Dai-ichi Research Institute, 5 February 2021

Industrial Production Index (seasonally adjusted)



Source: Ministry of Economy, Trade and Industry, 15 February 2021, Nikkei, 15 February 2021

The economic situation

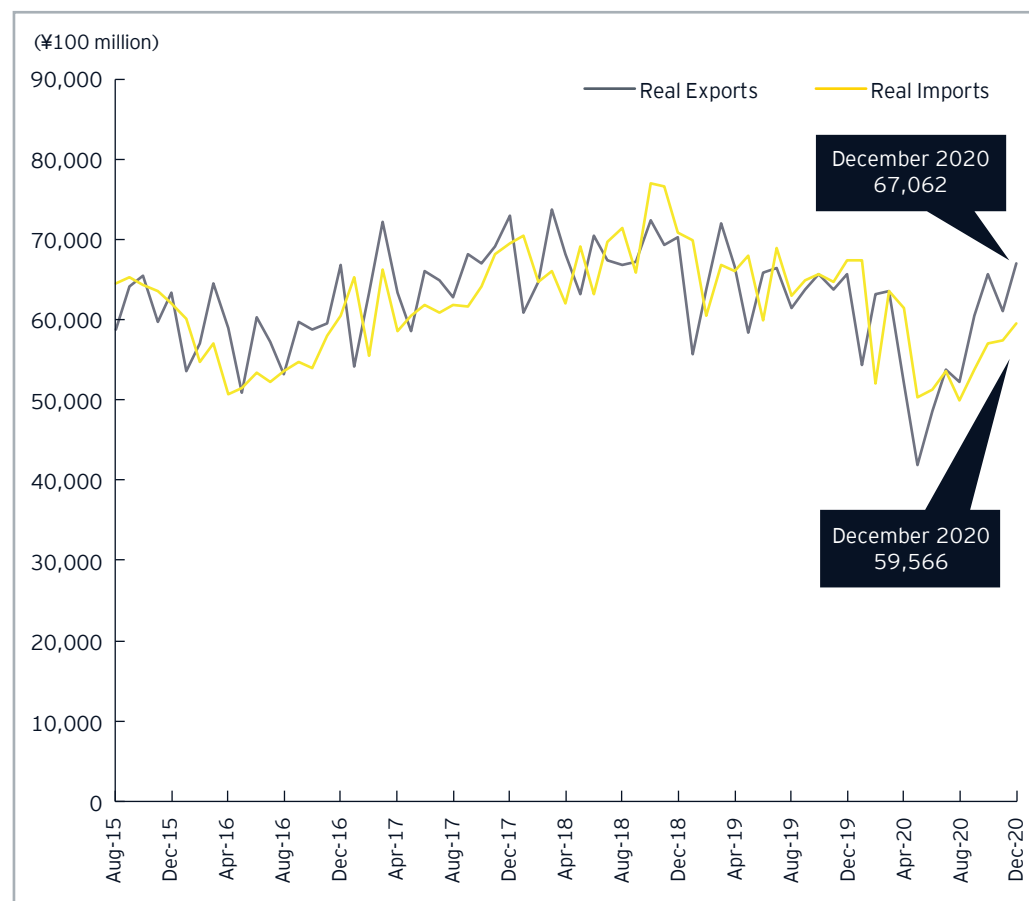
Foreign trade

Japan's exports rose 2.0% in December compared to the previous year, mainly driven by exports to China. Imports dropped due to a decline in energy imports. Exports are expected to remain on a recovery trend.

- ▶ Japan's exports increased 2.0% in December from a year earlier to ¥6.71t (US\$ 63.8b), the first YoY rise in 25 months since November 2018. Shipments to China rose 10.2% YoY due to the strong demand for plastic and non-ferrous metals, such as silver. Exports to Asia rose 6.1% YoY boosted by an increase in semiconductor machinery.
- ▶ On the other hand, exports to US fell by 0.7% in two consecutive months of decline, influenced by the resurgence of the COVID-19 infections. Aircraft parts were one of the most affected. Exports to the EU decreased by 1.6% driven by a drop in demand for motor vehicles.
- ▶ Imports in December fell 11.6% YoY to ¥5.95t (US\$ 56.7b) due to a decline in energy imports such as petroleum and coal. Imports remain at a low level compared to a year earlier.
- ▶ The December trade surplus in goods was ¥749b (US\$ 7.14b); a surplus for the sixth month straight.
- ▶ Export and imports are expected to remain on a recovery trend. But its pace is predicted to be moderate line with the likely slow recovery of the global economy.

Source: "Recent Economic Developments," Cabinet Office, 27 January 2020, NHK, 21 January 2020, 21 January 2020, "Economic Indicators," Dai-ichi Research Institute, 28 January 2021, Ministry of Finance

Export/Import



Source: Ministry of Finance

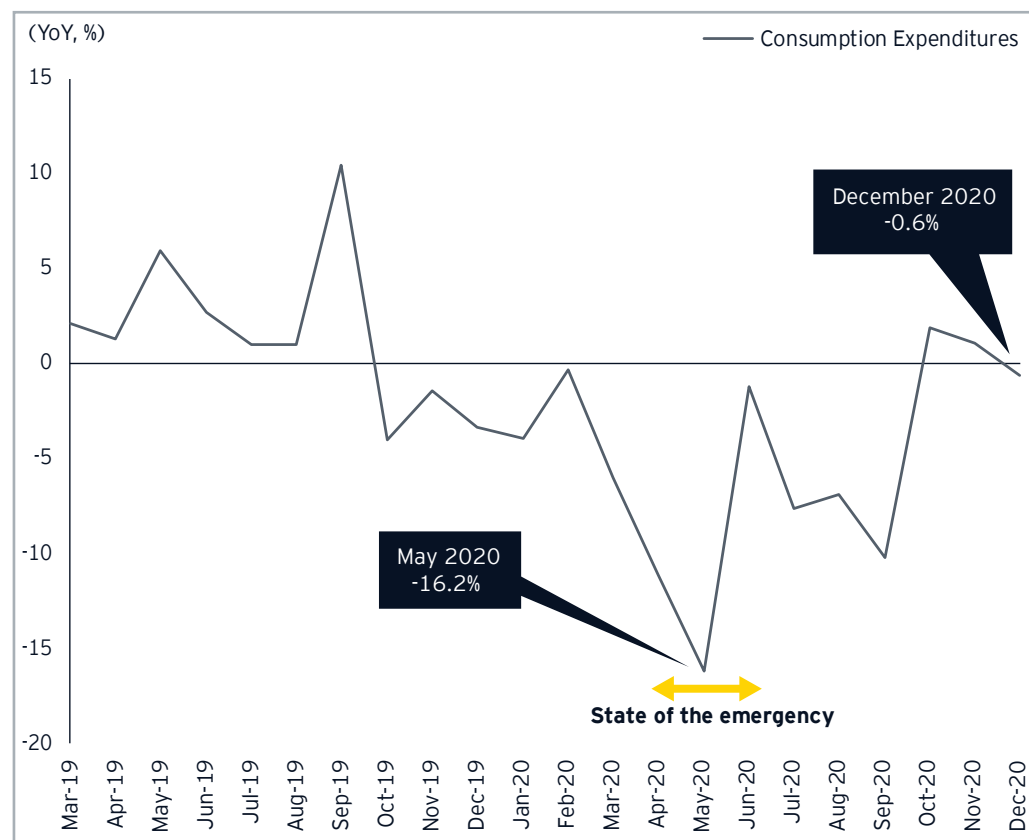
The economic situation

Consumption

Household spending fell in December by 0.6% in real terms YoY due to COVID-19 and bonus cuts. This trend is expected to continue as restrictions continue and people are requested to stay at home

- ▶ The average household consumption expenditure fell 0.6% YoY in December, for the first time in three months in Japan. Spending on eating out and traveling plummeted, influenced by a resurgence of COVID-19 infections. Sharp cuts in bonuses hit workers' household spending.
- ▶ Compared to the previous month, the figure rose 0.9% for the first time in two months.
- ▶ The average household monthly spending for 2020 was down 5.3% from the previous year, the sharpest drop since the comparable data became available in 2001. Spending on culture and recreation, such as domestic and overseas package tours and accommodation fees, fell by 18.1%. Spending on furniture and household goods rose 6.1%, driven by a rapid spending increase in sterilization products. Overall all household spending is expected to fall despite strong stay-at-home demand.

Consumption expenditure (real, two-or-more-person households)



Source: Ministry of Internal Affairs and Communications,

"Economic Indicators," Dai-ichi Life Research Institute, 5 February 2021, Statistics Bureau of Japan, Ministry of Internal Affairs and Communications, 5 February 2021

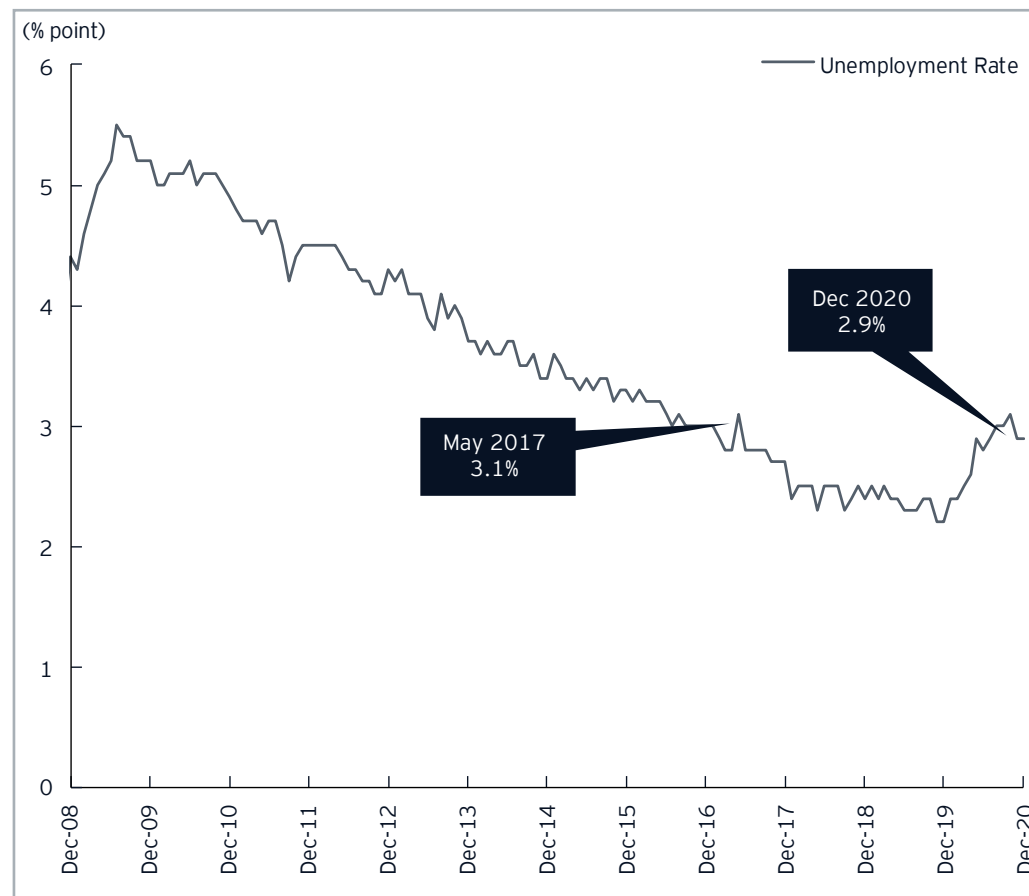
The economic situation

Employment

Employment was steadily improving in recent years until it was hit hard by COVID-19. The upward trend in unemployment has reversed in this quarter.

- ▶ The unemployment rate in December was 2.9%, a decrease from 3.1% in October.
- ▶ In December, the number of employed persons was 66.66 million, a decrease of 710 thousand from the previous year. It was the ninth consecutive month of decline.
- ▶ The decrease after March 2020 is mainly due to a reduction of non-regular workers. There will be no significant change in regular workers. The decline in employment under the COVID-19 epidemic is due to a decrease in non-regular workers in services sectors, especially in retail, accommodation, and restaurants.
- ▶ The government expects that weakness will remain in the short-term due to the impact of the COVID-19 epidemic.

Unemployment rate (seasonally adjusted)



Source: The Ministry of Internal Affairs and Communications, Statistic Bureau of Japan, The Ministry of Health, Labor and Welfare,

"Recent Economic Developments," Cabinet Office, 29 January 2021

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