Preface: Back onto the Growth Track?

HONDA, Yuzo

As of December 30, 2021, the Delta variant is still raging around the globe. In addition, the new Omicron variant is increasingly spreading across the EU, the UK and the US, creating a great uncertainty in the future. The total number of deaths caused by COVID-19 exceeds 5.4 million globally. With more than 822 thousand deaths, the US is by far the most affected nation.

Despite the resurgence of the virus, the US economy is already recovering from the COVID-19 recession, thanks to the appropriate expansionary fiscal and monetary policies conducted by the US government and the Federal Reserve Board of Governors (FRB). Industrial production has surpassed its pre-pandemic level in February 2020. Both consumption and investment are recovering slowly but steadily.

Although the unemployment rate rose sharply to 14.7% in April 2020, hitting a record high since World War II, it rapidly declined to 4.2% in November 2021.

However, the issue with prices is becoming increasingly prominent. The 12-month percentage change in Consumer Price Index (CPI) stood at 6.8% in November 2021, much higher than the targeted 2%. There are at least three possible explanations for this increase. One is that consumption plunged sharply, leading to the lower prices at the beginning of the pandemic in 2020, making the inflation rate in 2021 appear higher when compared with the corresponding month of the previous year. Another explanation is that the disruption in the global supply chain due to the pandemic, together with the price hike in energy industries, has contributed to pushing up the overall price level. The third and most important factor, however, is that the FRB has been pumping a massive amount of base money into the economy to cope with the devastating consequences of the COVID-19 pandemic since March 2020.

In addition, in November 2021, President Biden signed into law the federal investment plan in infrastructure, the largest one in the past 14 years, and is also trying to pass another social safety net and climate change bill through the Congress. Although the infrastructure bill is in balanced budget and neutral to the economy in the long run, it is designed to be expansionary in the short run to support the fight against the recession.

Some economists argue that the scale of the expansionary fiscal and monetary stimuli by the government and the FRB are too large considering the current stage of recovery. At first, the government and the FRB interpreted the high inflation rate as transient, but have now admitted the increasing threat of persistent galloping inflation in the future, and have decided to shorten the tapering period and to eventually end it by the end of March 2022.

The US economy seems to be on the right track, but COVID-19 still remains the greatest risk. The number of new daily infections is on the sharp rise again, and is now more than 300 thousand.

All these developments in US affect the Japanese economy in real time through stock prices, exchange rates, interest rates, and other variables.

The Japanese economy was already in downturn around the middle of 2019, partially due to the trade war between the US and China, and partially due to the domestic consumption tax hike from 8% to 10% in October 2019. On top of these head winds, the COVID-19 dealt a blow to the Japanese economy in March 2020. Production plummeted sharply, but rebounded quite quickly to its pre-pandemic level by the middle of 2021. However, the fifth wave of the pandemic started to wash over the Japanese economy around the beginning of July, and peaked at the end of August, roughly coinciding with the summer Olympics and Paralympics held in Tokyo. Production dropped again in September 2021 as the virus raged throughout the country.

As a result of the pandemic, the unemployment rate rose from 2.2% at the end of 2019 to over 3% by the end of 2021 and remained high until November 2021, hovering around 2.8%.

Prices have kept declining since the beginning of 2020, largely due to lack of spending in the service sector, including transportation, hotel accommodations, retails, and other service industries. In 2021, however, there were two exogenous shocks to the Japanese economy, which counteracted the deflationary pressure. One was the sharp rise in energy prices, the other was the rise in import prices. As a result, the 12-month percentage change in headline CPI stood at 0.6% as of November 2021.

Overall, the economic recovery in Japan is weaker and slower than that in the US. The fifth wave has now subsided, and the number of new infections is limited for the moment. However, it is yet to be seen how damaging the impact of the Omicron variant will be. The Japanese economy is facing a bumpy recovery process.

Part I of this year's Economic Outlook discusses the economic status quo in the major countries along the Pacific Rim, which surround Japan. Part II outlines the performance of the Japanese economy in general, as well as that of the Kansai area in particular. The fact that the coronavirus is threatening our lives and the global economy alike is a recurring theme throughout this volume. For your convenience, we have added a chronology of events related to the COVID-19 pandemic in Part III this year too. Although this Economic Outlook is an abridged English-language version of the original Economic Outlook 2021 published by APIR in Japanese, some of the authors have updated their manuscripts in order to provide readers with the latest information.