

# Monthly Economic Report

March 29, 2021

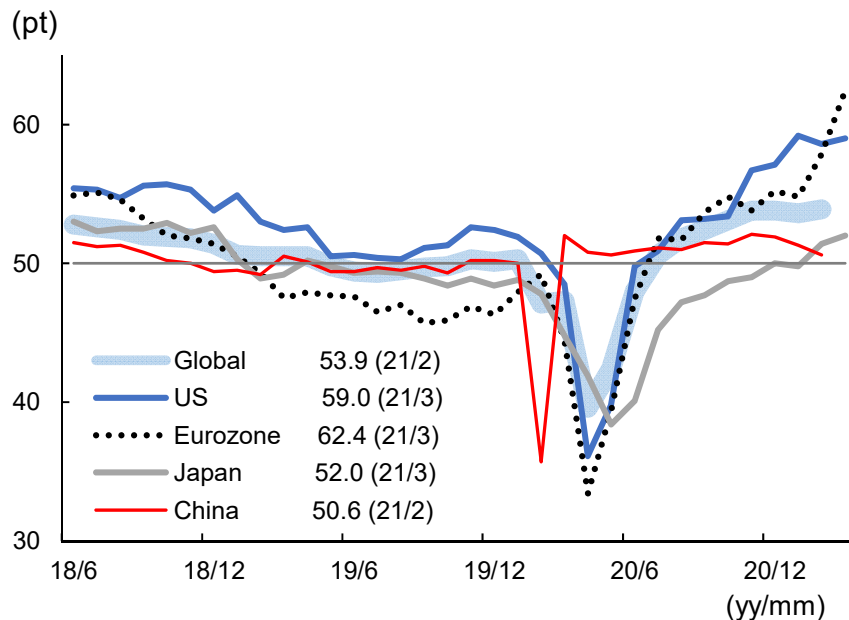
Mizuho Research & Technologies, Ltd.

**MIZUHO**  


# 1. Current state of the global economy: the US economy is continuing to serve as the driver

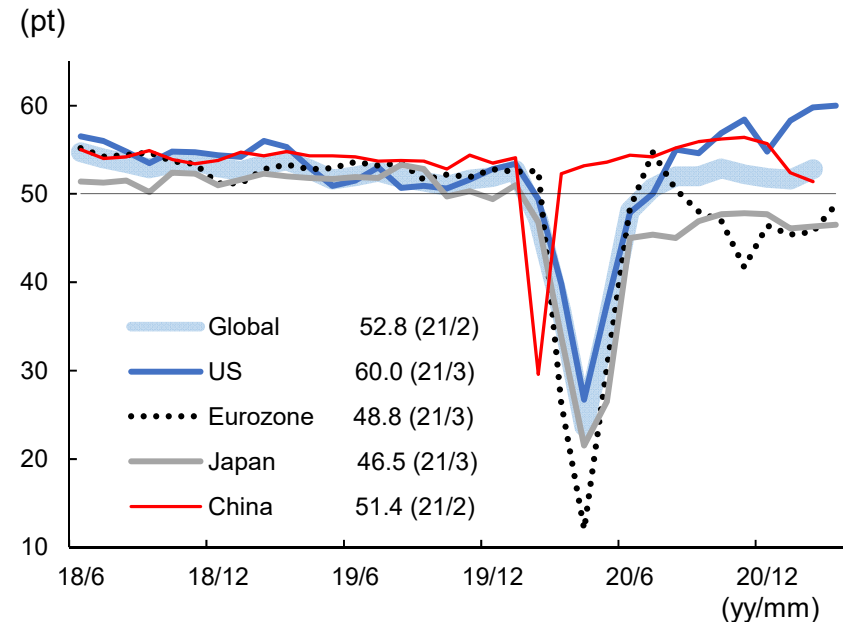
- The global economy is recovering, mainly in the manufacturing sector. In particular, the US economy is continuing to show solid growth.
  - In the US, business conditions in the manufacturing sector was generally favorable despite the dip in production due to the cold snap in February.
- In the US, the nonmanufacturing PMI also rose as consumer spending was lifted by economic stimulus measures.
  - On the other hand, the nonmanufacturing sectors of Japan and Europe lacked strength due to mobility restrictions. There is a growing possibility that the March improvements seen in the Eurozone were transitory in nature.
- Given that the fall of China's PMI appears to be temporary due to the impact of the Chinese New Year, the Chinese economy is continuing to follow a recovery trend.

## Manufacturing PMI



Note: The Purchasing Managers' Index (PMI) is an index calculated by weighting indexes such as new orders, output, order backlogs, prices, employment, and quantity of purchases. The reading of 50 in the PMI is the "expansion-contraction" threshold.  
 Source: Made by MHRT based upon the National Bureau of Statistics of China, Markit Economics.

## Nonmanufacturing PMI

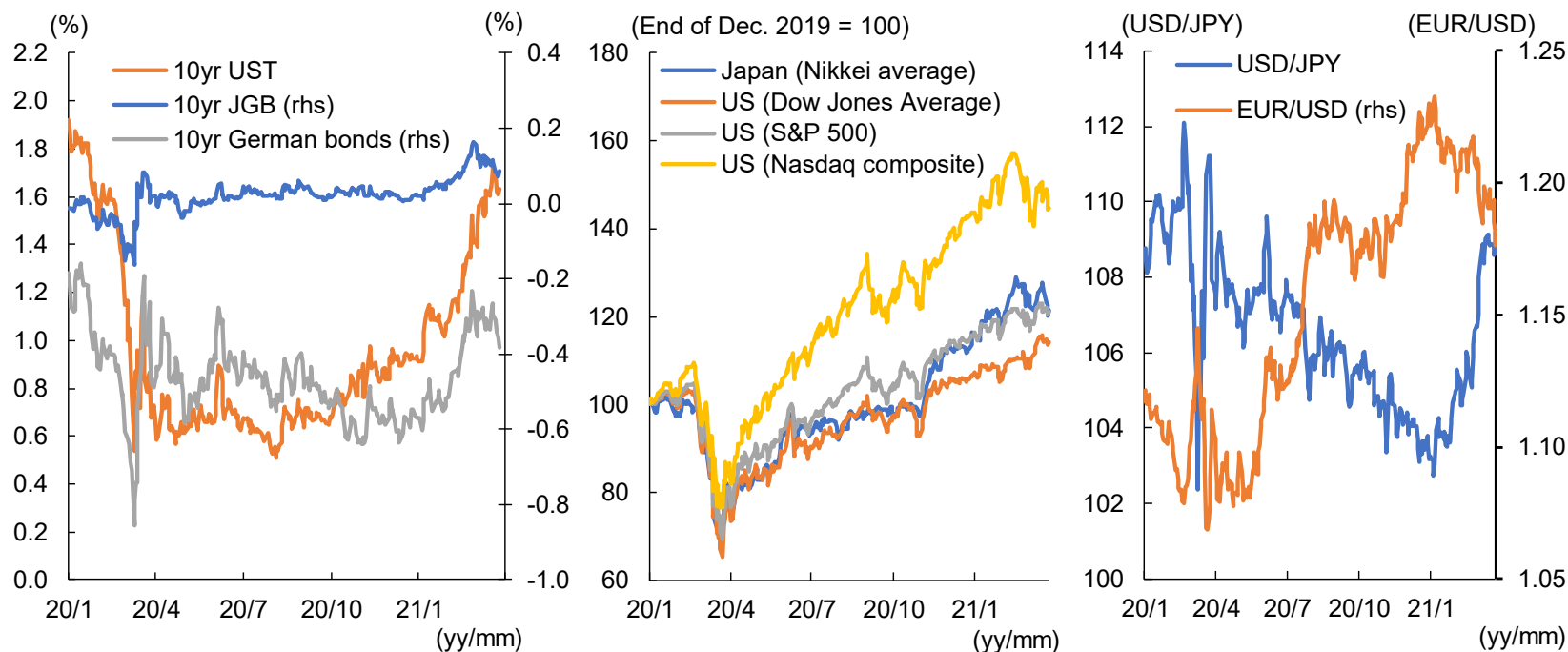


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# Overview of financial markets: market focus on long-term US interest rates

- Long-term US interest rates are rising sharply amid growing expectations of an economic recovery, underpinned by factors such as additional large-scale economic stimulus and the swift vaccine rollout in the US.
  - The 10yr UST yield momentarily reached 1.75% on expectations of economic recovery, and remains elevated at the 1.6% range. The yield on 10yr JGB declined after BOJ Governor Haruhiko Kuroda indicated a clear stance that the BOJ would maintain the yield curve at a low level after its policy assessment.
  - Stocks were caught in a tug-of-war between mounting expectations toward economic recovery and concerns over the rise of US interest rates. In contrast to the strong performance of the Dow Jones Average, the upside of the tech-focused Nasdaq remained heavy. As for the Nikkei average, prices were dragged down lower due in part to the BOJ's removal of Nikkei-average-linked ETFs from its ETF purchases.
  - In terms of exchange rates, the USD/JPY rate fell to its lowest level since June 2020, reaching the JPY109-range due to the widening interest rate differential between Japan and the US.

## Major market trends

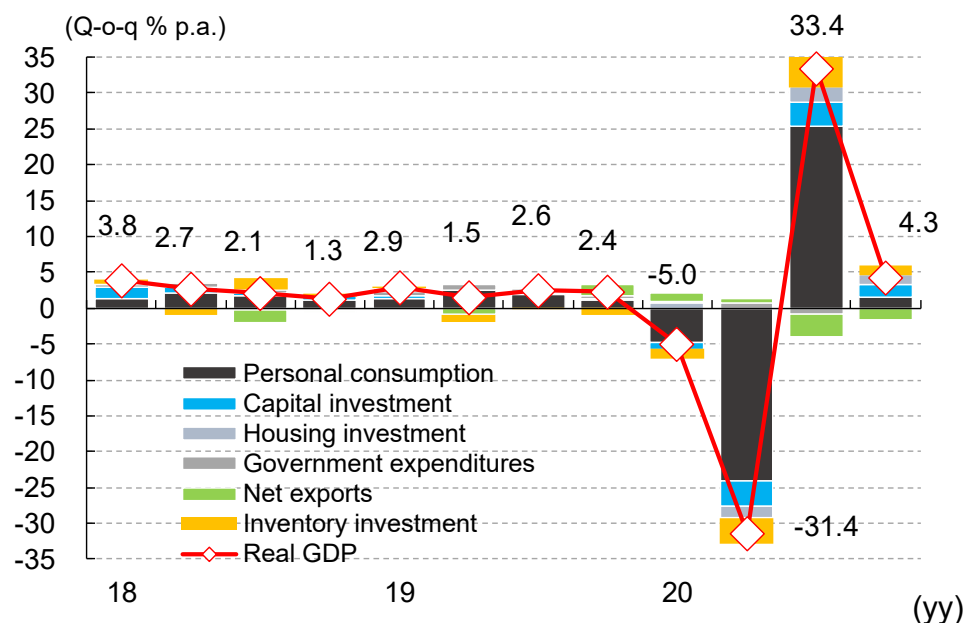


Note: All indexes show actual results up to March 25.  
Source: Made by MHRT based upon Bloomberg.

## 2. (1) US economy: Oct-Dec quarter real GDP (“third” estimate) more or less unchanged from “second” estimate

- In the Oct-Dec quarter 2020, US GDP rose 4.3% (“third” estimate), revealing a slight upward revision from the “second” estimate of 4.1%. While the revisions of demand components are mixed, the narrative remains unchanged that “despite a sharp slowdown in consumption, robust investment is supporting the economy”.
  - Personal consumption was revised down slightly from the second estimate, marking a sharp slowdown compared to the Jul-Sep quarter. Following the fading impact of last spring’s economic stimulus measures, the resurgence in Covid-19 caseloads and the accompanying tightening of restrictions on sales activities served as downward pressures on personal consumption.
  - Capital investment was also revised downward from the second estimate. Even so, capital investment continued to grow at a double-digit pace, indicating the strength of demand to adapt to lifestyle changes due to the Covid-19 pandemic.
  - Housing investment was revised upward from the second estimate. The growing trend toward home ownership continued to serve as tailwinds.

### Real GDP growth rate



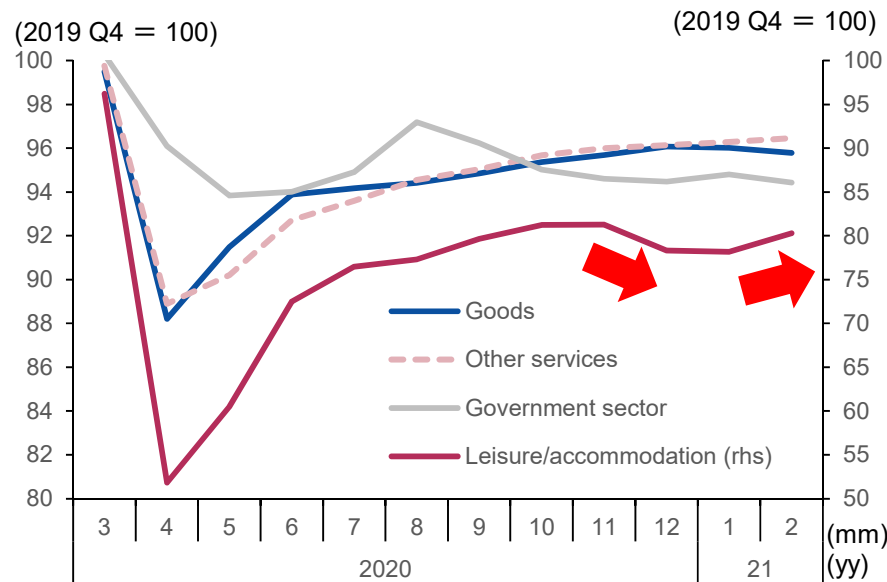
	Second estimate	Third estimate	Change
<b>Y-o-y p.a., %</b>			
Real GDP	4.1	4.3	+ 0.2
Personal consumption	2.4	2.3	-0.0
Housing investment	35.8	36.6	+ 0.9
Capital investment	14.0	13.1	-0.9
Exports	21.8	22.3	+ 0.5
Imports	29.6	29.9	+ 0.2
Government expenditures	-1.1	-0.8	+ 0.3
Final gross domestic demand	4.4	4.4	-0.1
<b>Contribution, %Pt</b>			
Personal consumption	1.6	1.6	-0.0
Housing investment	1.4	1.4	+ 0.0
Capital investment	1.8	1.7	-0.1
Inventory investment	1.1	1.4	+ 0.3
Net exports	-1.6	-1.5	+ 0.0
Exports	2.0	2.0	+ 0.0
Imports	-3.6	-3.6	-0.0
Government expenditures	-0.2	-0.1	+ 0.1

Source: Made by MHRT based upon the US Department of Commerce.

# Leisure and accommodations serve as the drivers of employment recovery due to the easing of restrictions, leading to a slight decline of the unemployment rate

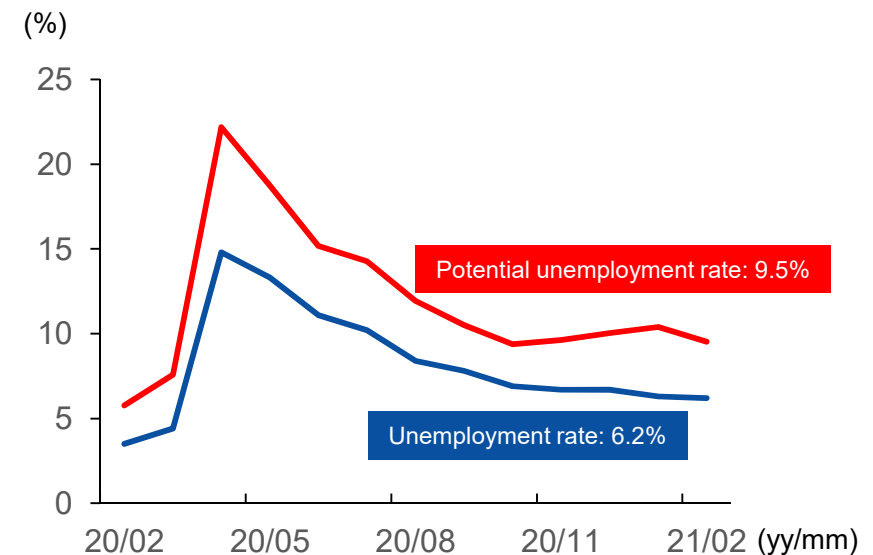
- In February, nonfarm payrolls rose a dramatic +379 thousand m-o-m. The readings for January were also revised upward by 166 thousand (pre-revision: +49 thousand m-o-m).
  - Employment was driven by leisure and accommodations (+355 thousand m-o-m), reflecting the pause in rise of Covid-19 caseloads and easing of social distancing restrictions.
  - Hourly wages rose a strong +5.2% y-o-y. The unemployment of low-income workers continued to push up the composite effect.
- The unemployment rate dipped slightly to 6.2% (January: 6.3%). Permanent layoffs remained pinned at a high 3.5 million.
  - In addition to discouraged workers, in the event "other non-labor force population" stemming most likely to the Covid-19 pandemic and "workers with zero working hours" (categorized under normal conditions as unemployed) are counted as unemployed, the potential unemployment rate remained elevated at 9.5%.

## Number of employees by sector



Source: Made by MHRT based upon the US Department of Labor.

## Unemployment rate



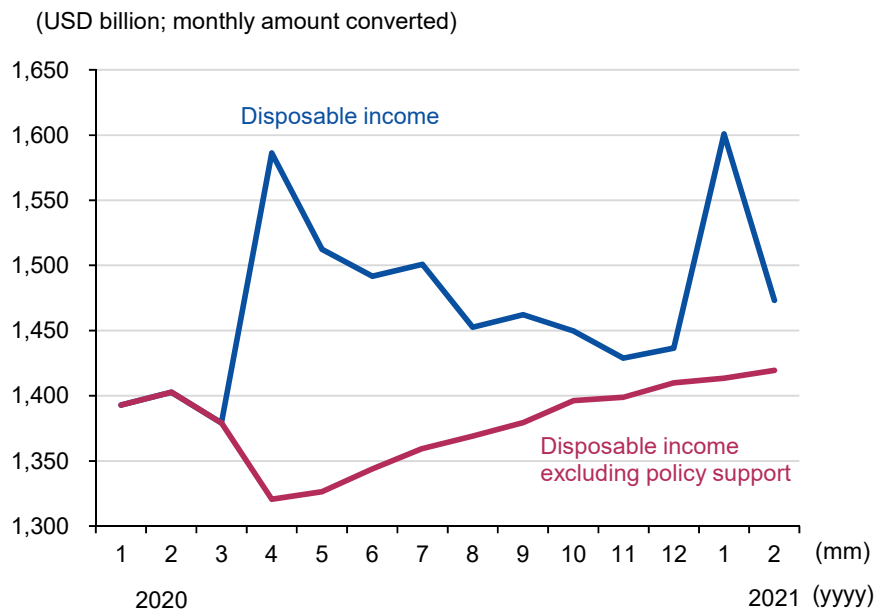
Note: The "potential" unemployment rate refers to 1) people who are out of the labor force due to Covid-19, including discouraged workers, and 2) employed persons with zero working hours, who are deemed unemployed, due to Covid-19. "Due to Covid-19" refers to factors such as "sickness" and "childcare". The potential unemployment rate is not adjusted for seasonal factors.

Source: Made by MHRT based upon the US Department of Labor.

# Income and consumption continue to follow a recovery trend. An upswing is likely in March due to economic stimulus measures and recovery of mobility

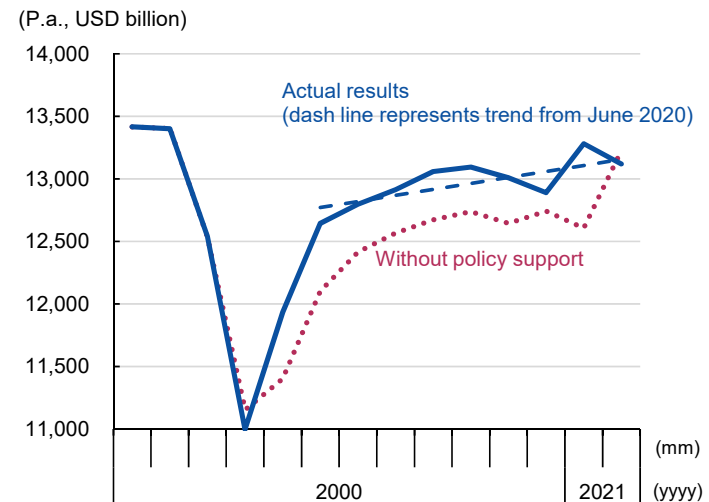
- Personal income fell in February (-7.1% m-o-m), and real personal consumption declined (-1.0% m-o-m). This stems from a backlash to the rise of income and consumption in January due to the cash benefits (government stimulus package passed at the end of 2020).
  - The personal savings rate declined from 19.8% in January to 13.6% in February.
  - Excluding the impact of policy support, personal income improved in February (+0.4% m-o-m), indicating the underlying strength of income.
  - The recovery trend in consumption remains intact. In February, the recovery of mobility appears to be contributing to the rise of consumption.
- The odds are high that income and consumption will rise dramatically in March due to cash benefits (government stimulus package passed on March 11) and recovery of mobility.
  - On the other hand, the recovery of mobility carries the risk of a resurgence in Covid-19 caseloads. Therefore, we should monitor closely whether the rollouts of vaccinations keeps the rise of caseloads in check.

## Disposable income



Source: Made by MHRT based upon the US Department of Commerce.

## Real personal consumption



Note: Personal consumption without policy support is a dynamic estimate using the consumption function. The consumption function follows the VEC model that assumes the convergence between previous year's fluctuation in consumption and income and the long-term relationship of consumption, income, net assets and disposable income ratio, and mobility change. The estimate period is from January 2015 to September 2020.

Source: Made by MHRT based upon US Department of Commerce.

## (2) US monetary policy: FOMC's projections in March remain largely unchanged despite more participants supporting interest rate hike

- The FOMC left financial policy and guidance unchanged at its meeting in March. In terms of interest rate adjustments, even though the IOER and reverse repo rate were left unchanged, the latter was expanded from USD30 to USD80 billion per counterparty and provided stronger support for the floor interest rate (0%).
- Economic projections were revised upward mainly for 2021, reflecting the progress of vaccinations and approval of additional economic stimulus. However, projections for 2022 and 2023 were revised up only slightly and the median policy rate was unchanged (dot plots shifted upward).
- FRB Chair Jerome Powell stressed his stance of changing policy rates based on “actual progress” towards its targets rather than “improvement of projections” as in the past.
  - (Concerning maximum employment) “The Summary of Economic projections doesn’t include a lot of other things that FOMC does look at”
  - (Concerning “inflation running moderately above 2% for some time” as one condition for interest rate hikes) “I don’t want to be too specific about what that means, because I think it’s hard to do that.”

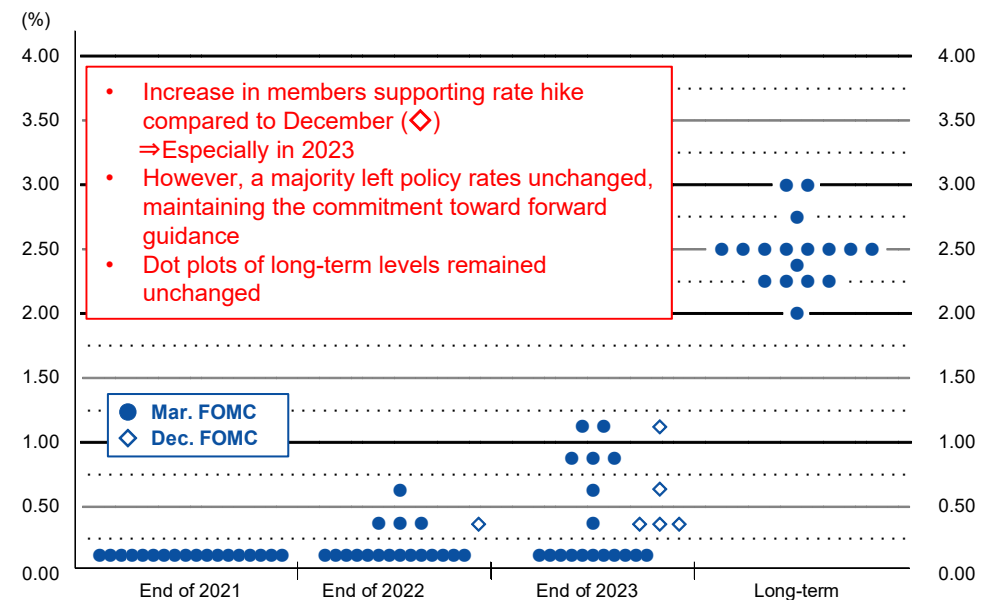
### Economic projections (note these are y-o-y comparisons and levels as of the Oct-Dec quarter of each year)

- Projections for 2021 revised up sharply, but only slightly for 2022 and 2023
- Revisions to inflation were small reflecting the narrow breadth of revisions to the unemployment rate
- The unemployment rate will only reach pre-pandemic lows at the end of 2023

Oct-Dec quarter of each year		2021	2022	2023	Long-term
Real GDP growth rate	Mar	6.5	3.3	2.2	1.8
	(y-o-y, % change) Dec	4.2	3.2	2.4	1.8
Unemployment rate	Mar	4.5	3.9	3.5	4.0
	(%) Dec	5.0	4.2	3.7	4.1
Inflation rate	Mar	2.4	2.0	2.1	2.0
	(y-o-y, % change) Dec	1.8	1.9	2.0	2.0
Core inflation rate	Mar	2.2	2.0	2.1	2.1% inflation not high enough to begin interest rate hikes
	(y-o-y, % change) Dec	1.8	1.9	2.0	

Source: Made by MHRT based upon FRB.

### Policy rate projections

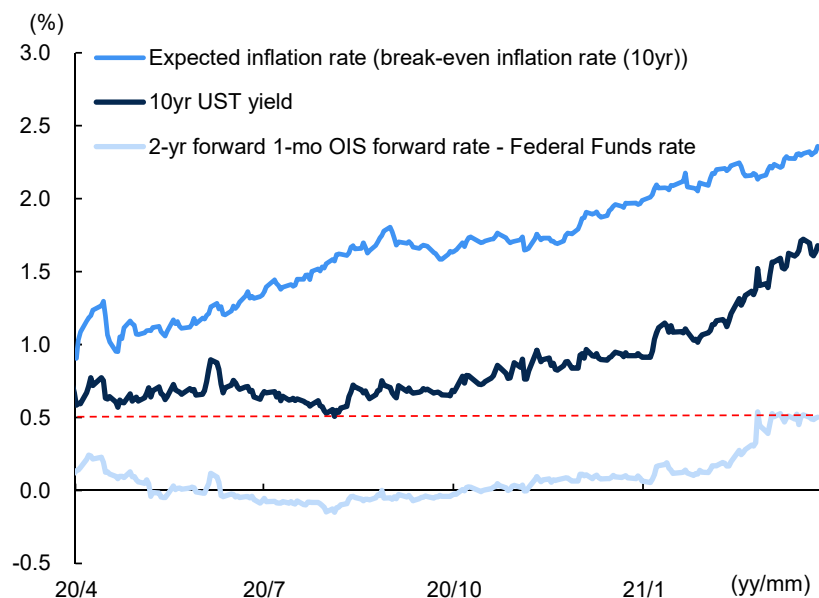


Source: Made by MHRT based upon FRB.

### (3) US bond market: 10yr UST yields are forecast to move around 1.4% to 1.8%.

- The 10yr UST yield momentarily rose to 1.75%, reflecting expectations toward economic recovery on the back of vaccine rollouts and passage of additional economic stimulus measures.
  - The expected inflation rate rose at one point to its highest level since May 2013.
  - The market is factoring in a rate hike of 50bp in two years time (2023), and also expecting a tapering ahead of the rate hike.
- At the FOMC (March 16 and 17), the FRB indicated that it will maintain current policy rates until the end of 2023.
  - Even though FOMC participants' economic projections were revised upward, FRB Chair Jerome Powell maintained a cautious stance toward scaling down monetary easing. However, the 10yr UST yield is expected to move around 1.4% to 1.8% due to lingering market expectations toward the acceleration of inflation and normalization of monetary policy.

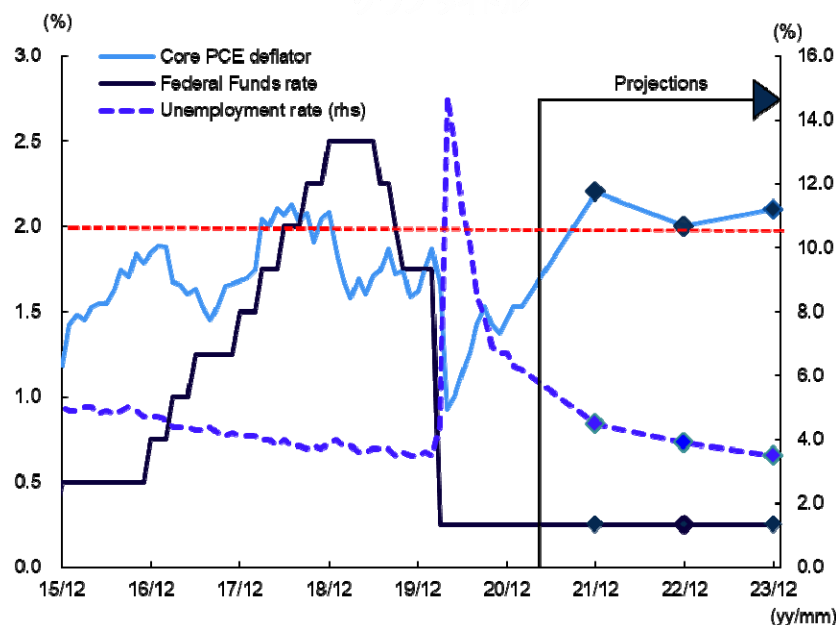
#### Long-term interest rates, expected inflation rate and pricing-in of interest rate hike



Note: The OIS is a type of interest rate swap that references the overnight call rate (in the US, the Federal Funds rate used as the target by the FRB) as the variable interest rate. It may be deemed as a proxy variable for financial policy because it reflects the future forecasts of monetary policy. In addition, FRB intends to begin tapering before hiking interest rates. A rising OIS forward rate can be interpreted as rising expectations toward the start of tapering.

Source: Made by MHRT based upon Bloomberg.

#### Trends in policy rates, core PCE deflator and unemployment rate



Note: Forecast figures represent the median of forecast figures for each year by FOMC participants (as of the fourth quarter) announced by the FRB on March 17.

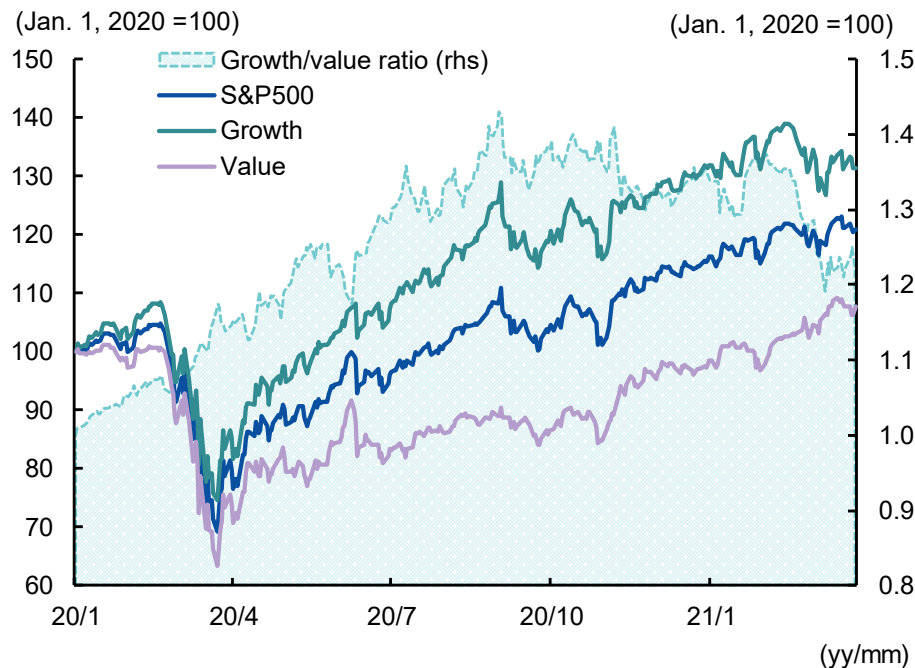
Source: Made by MHRT based upon Bloomberg.



## (4) US stock market: although expectations toward economic recovery are driving up stock prices, caution is necessary with respect to valuation adjustments

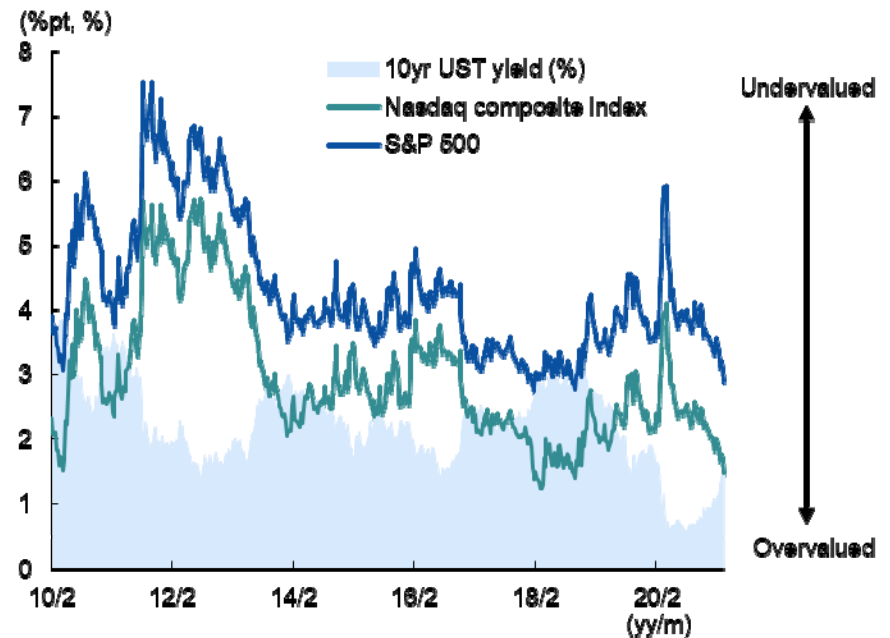
- Value stocks rose on expectations toward economic recovery due to economic stimulus measures. The Dow Jones average breached USD 33,000.
  - Meanwhile, hi-tech and other growth stocks softened, given the rise of perceptions that stocks are overvalued because of the rise of long-term interest rates.
- In terms of valuation, although the S&P 500's forward P/E ratio declined slightly due to the rise of interest rates, there are lingering perceptions that stocks are overvalued compared to bonds.
  - The forward EPS has recovered to the level prior to the pre-Covid-19 pandemic (end of 2019).
- Even though stock prices should remain firm for the time being on expectations for improved corporate earnings, caution is needed regarding valuation adjustments accompanying the rise of interest rates.

### S&P 500 and growth/value indices



Source: Made by MHRT based upon Refinitiv.

### Yield spread of S&P 500 and Nasdaq composite

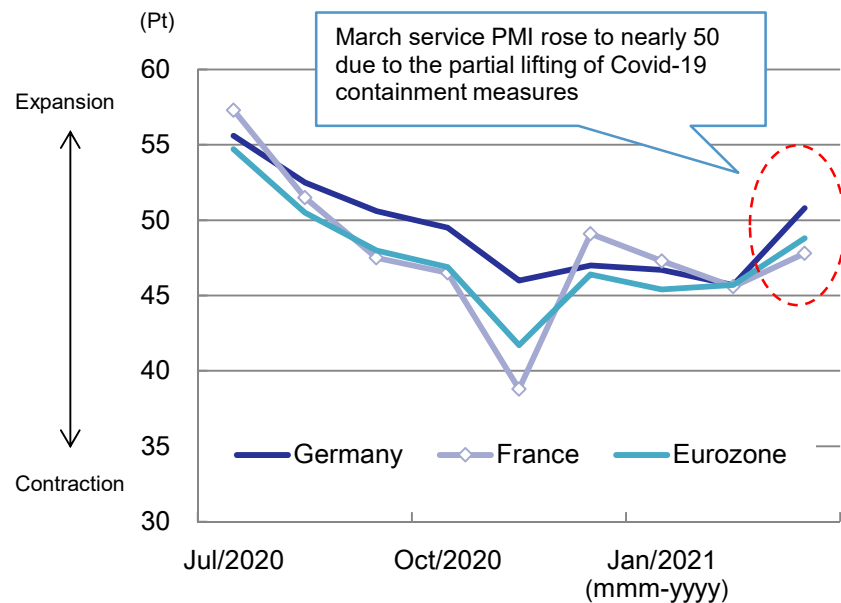


Note: 1. Yield spread = Stock yield (reciprocal of forward PER) – 10yr UST yield  
 2. Forward PER based on 12-month forecasts  
 Source: Made by MHRT based upon Refinitiv.

### 3. (1) The Eurozone economy: even though the March PMI indicates economic expansion, the odds are high that the economy will stagnate in the Apr-Jun quarter

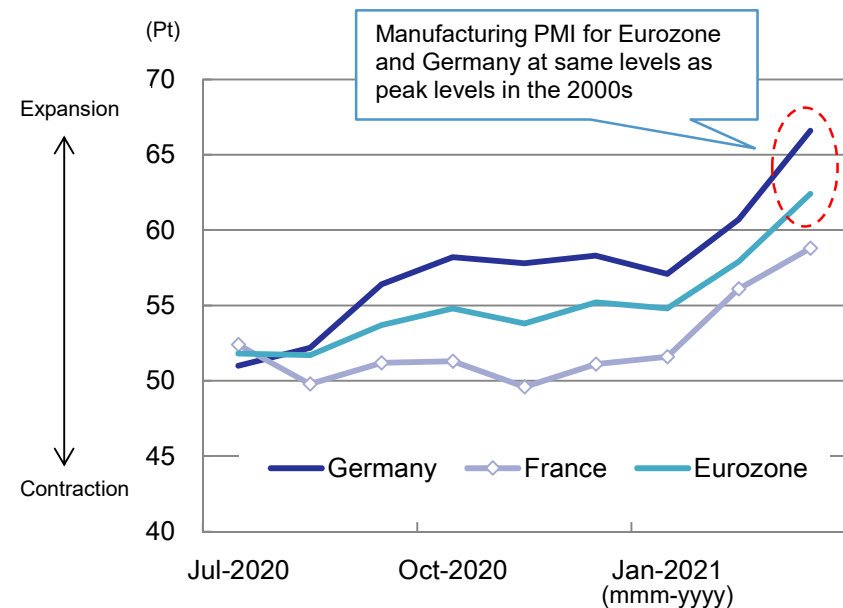
- In March, the Eurozone composite PMI (52.5 in preliminary flash estimate) rose to its highest level since July 2020. The main factor was the improvement of the service PMI accompanying the partial lifting of COVID-19 containment measures.
  - The manufacturing sector continued to follow a steady recovery, with the manufacturing PMI rising to its highest level (62.4) in the 2000s.
- The improvement of business sentiment will most likely turn out to be transitory.
  - In the Apr-Jun quarter, the odds are high that the composite PMI will flatten out at around 50 due to the maintenance and/or reinforcement of COVID-19 containment measures.

**Eurozone: service PMI**



Note: The reading of 50 is the "expansion-contraction" threshold.  
Source: Made by MHRT based upon IHS Markit.

**Eurozone: manufacturing PMI**



Note: The reading of 50 is the "expansion-contraction" threshold.  
Source: Made by MHRT based upon IHS Markit.

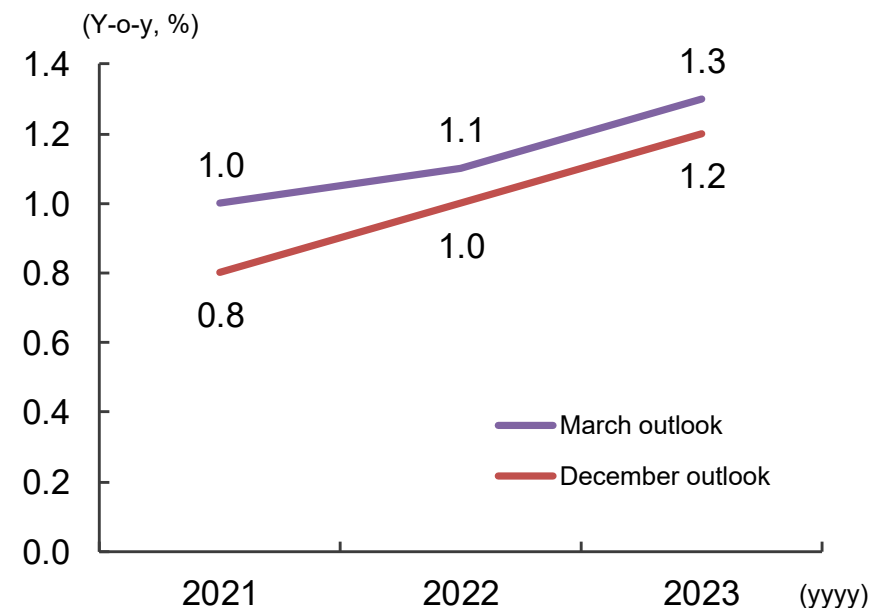
## (2) Eurozone monetary policy: the ECB decided to accelerate asset purchases reflecting the rise of market interest rates among other factors

- At the Governing Council meeting on March 11<sup>th</sup>, the ECB decided to accelerate the pace of asset purchases under the Pandemic Emergency Purchase Programme (PEPP). Among the background factors are concerns regarding the rise of market interest rates.
  - In the ECB staff macroeconomic projections, the outlook for GDP was kept more or less unchanged. The acceleration of the pace of asset purchases going forward is expected to offset the downturn accompanying the current resurgence of Covid-19 caseloads. Although the outlook for core inflation was revised up slightly, it remains well below the Governing Council's inflation target.
  - Policy rates were left unchanged.

### Key points of the ECB Governing Council meeting (March 11)

Economic situation	Real GDP is likely to <b>contract again in the first quarter</b> of the year, driven by the pandemic and the associated containment measures. Looking ahead, the ongoing vaccination campaigns, together with the gradual relaxation of containment measures, underpin the expectation of a rebound and the <b>outlook for economic activity is broadly unchanged in the course of 2021</b> . (annual real GDP growth foreseen at 4.0% in 2021 (revised up by +0.1%pts)). Overall, the risks surrounding the growth outlook over the medium term have become more balanced, although downside risks remain in the near term.
Outlook for prices	Underlying price pressures remain subdued in the context of weak demand, etc., and longer-term inflation expectations remained at low levels. Inflation has picked up over recent months mainly on account of some transitory factors.
Long-term interest rates	<b>Market interest rates have increased since the start of the year, which poses a risk to wider financing conditions</b> . Banks use risk-free interest rates and sovereign bond yields as key references for determining credit conditions. If sizeable and persistent, increases in these market interest rates could translate into a premature tightening of financing conditions for all sectors of the economy.
Pandemic Emergency Purchase Programme (PEPP)	<b>Purchases under the PEPP over the next quarter will be conducted at a significantly higher pace</b> . The Governing Council should review the purchase pace on a quarterly basis to take into account the inflation outlook, etc.
Method of assessing favorable financing conditions	<b>Financing conditions are to be assessed on a holistic and multifaceted basis</b> . "Holistic" means the whole chain of transmission from the upstream (risk-free interest rate, sovereign yields, etc.) to the downstream (credit terms, etc.). It's also important to be "multifaceted" because there are some downstream components that are not influenced by upstream movement. ECB doesn't operate mechanically.

### Core inflation rate projections by ECB staff



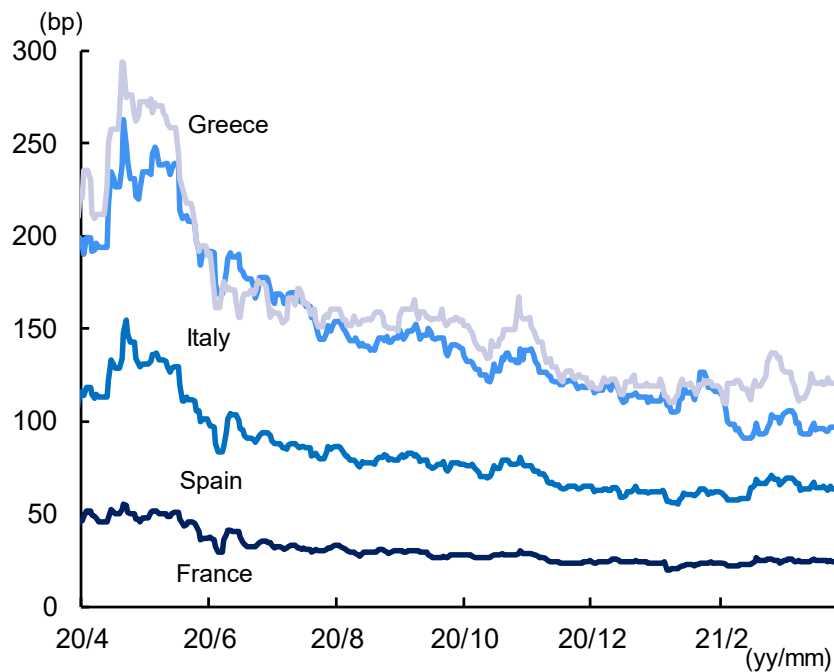
Source: Made by MHRT based upon ECB.

Source: Made by MHRT based upon ECB.

### (3) Eurozone bond market: German 10yr government bond expected to move around -0.5% to -0.2%

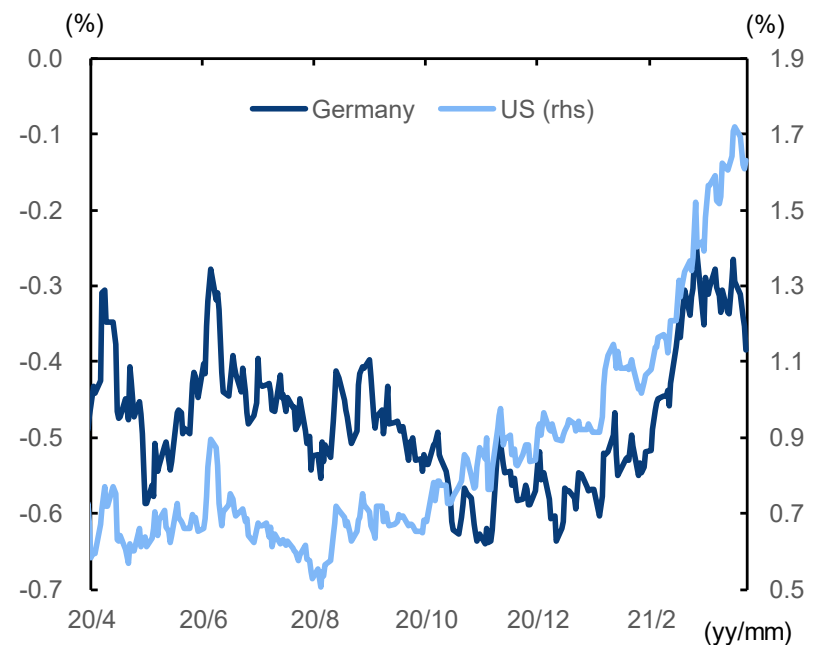
- Although interest rates rose in Eurozone countries reflecting the rise of interest rates in the US, the spread versus German government bonds remained low due to the continuation of monetary easing measures.
  - The ECB is taking a grave view of the current surge of interest rates. The ECB Governing Council decided at its meeting on March 11, to increase the pace of asset purchases in the next quarter under the Pandemic Emergency Purchase Programme (PEPP).
- The upside of the rise of interest rates in Europe will most likely be limited due to further monetary easing by the ECB as well as the reinforcement of mobility restrictions stemming from the spread of Covid-19 variants and concerns over delays in vaccine rollouts because of concerns regarding side effects.
  - The yield on German 10yr government bonds is expected to move around -0.5% to -0.2%.

Spread versus German government bonds (10yr)



Source: Made by MHRT based upon Bloomberg.

10yr UST and 10yr German government bond yield spreads

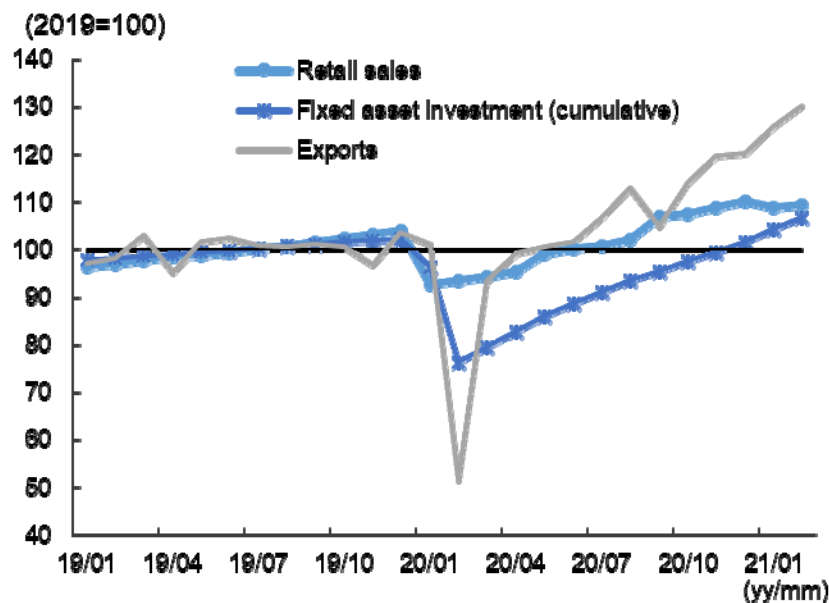


Source: Made by MHRT based upon Bloomberg.

## 4. The Chinese economy: despite a surge of exports and stagnation of consumption, the odds are high that this will only be transitory due to the Chinese New Year

- China's major economic indicators for January and February 2021 revealed the acceleration of exports and investment in contrast to the stagnation of consumption.
  - Exports increased sharply. This was due in part to workers remaining in urban areas during the Chinese New Year due to mobility restrictions, thereby leading to the early restart of production after the Chinese New Year.
  - Investment also followed an upward path. Investment in real estate development and hi-tech manufacturing (communications, electronics and medical) was strong.
  - Food and beverage services and consumption in rural areas stagnated under mobility restrictions during the Chinese New Year for the purpose of curbing the spread of Covid-19 infections.
- The surge of exports and stagnation of retail sales will turn out to be transitory. We expect the continuation of a gradual recovery, driven mainly by manufacturing investment and consumption.

### China's major economic indicators (seasonally- adjusted)



Note: Retail and fixed asset investment are estimates based on seasonally adjusted m-o-m change announced by the National Bureau of Statistics of China. Exports are adjusted for seasonal factors by MHRT.

Source: Made by MHRT based upon National Bureau of Statistics of China and CEIC data.

### Total retail sales of consumer goods

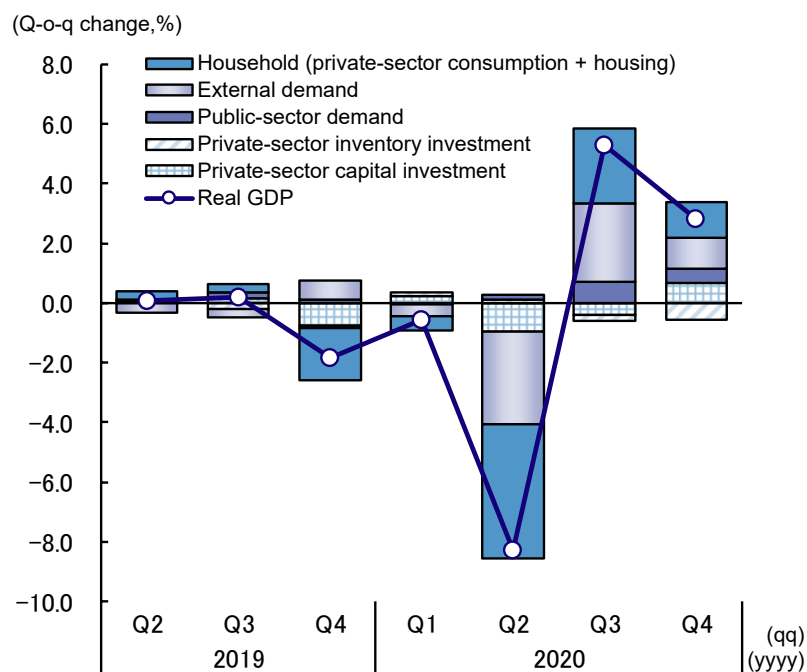
	Jan-Feb 2020, Jan-Feb 2021 Average (Y-o-y %)	Oct-Dec 2019, Oct-Dec 2020 Average (Y-o-y %)	Breadth of change (Y-o-y % pt)
Overall retail sales	+3.2	+5.0	(-1.8)
Consumption of goods	+3.8	+6.4	(-2.6)
Food and beverage services	-2.0	+4.7	-6.7
Urban areas	+3.4	+6.0	(-2.6)
Rural areas	+1.3	+7.2	-5.9

Source: Made by MHRT based upon National Bureau of Statistics of China and CEIC data.

## 5. (1) The Japanese economy: our view on economic conditions is unchanged despite downward revisions to GDP for Oct-Dec quarter 2020

- The *Second Preliminary Quarterly Estimates of GDP* ("2nd QE") revealed that Japan's real GDP growth in the Oct-Dec quarter 2020 rose +2.8% q-o-q, in a downward revision from +3.0% q-o-q in the *First Preliminary Quarterly Estimates of GDP* ("1st QE").
  - Our view remains unchanged that the economy is charting significant positive growth, driven mainly by consumption and exports.
  - The contents of growth is not bad, considering that the major factor of the downward revision was the downturn in inventory investment. The downward revision of capital investment was also small.
  - Following the reissuance of the declaration of a state of emergency, it looks inevitable that growth in the Jan-Mar quarter 2021 will fall into negative territory for the first time in three quarters. In addition to the sharp fall of personal consumption primarily in services requiring face-to-face interactions, the growth of exports and capital investment is also expected to slow down.

### 2020 Oct-Dec quarter GDP (2<sup>nd</sup> QE)



	2020				2021
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar
Real GDP	-0.6	-8.3	5.3	2.8	-2.2
(Q-o-q % change, %)	-2.2	-29.3	22.8	11.7	-8.3
(Y-o-y % change)	-2.0	-10.3	-5.8	-1.4	-2.8
Domestic demand	-0.2	-5.2	2.5	1.7	-2.3
(-0.2)	(-5.2)	(2.6)	(1.8)	(-2.3)	
Private-sector demand	-0.2	-7.2	2.6	1.7	-2.5
(-0.1)	(-5.4)	(1.9)	(1.3)	(-1.8)	
Personal consumption	-0.6	-8.4	5.1	2.2	-3.8
Housing investment	-3.7	0.5	-5.7	0.0	-2.5
Capital investment	1.4	-5.9	-2.4	4.3	0.5
Inventory investment	(0.1)	(0.1)	(-0.2)	(-0.6)	(0.3)
Public-sector demand	-0.2	0.6	2.5	1.7	-1.7
(-0.0)	(0.2)	(0.7)	(0.5)	(-0.5)	
Government consumption	-0.3	0.2	2.9	1.8	-1.9
Public investment	0.1	2.2	0.9	1.5	-0.9
External demand	(-0.4)	(-3.1)	(2.6)	(1.1)	(0.1)
Exports	-5.3	-17.2	7.4	11.1	2.4
Imports	-3.1	1.3	-8.2	4.0	1.7
Nominal GDP	-0.5	-7.9	5.5	2.3	-2.8

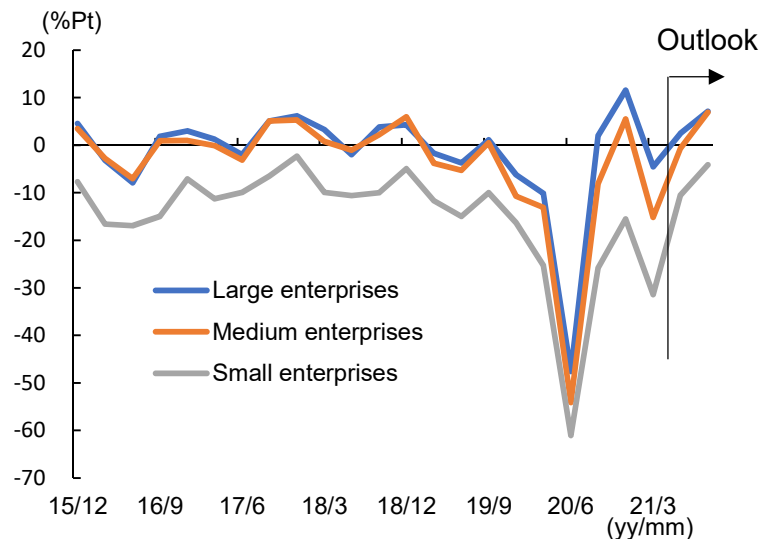
Note: Figures in the right-hand chart indicate changes from the previous quarter (in real terms) unless otherwise noted. The figures in parentheses represent the contribution to growth. Figures for the Jan-Mar quarter 2021 are forecasts.

Source: Made by MHRT based upon Cabinet Office, *Quarterly Estimates of GDP*

# In the Jan-Mar quarter, business sentiment worsened mainly in the services sector. A slow recovery of small enterprises is expected going forward.

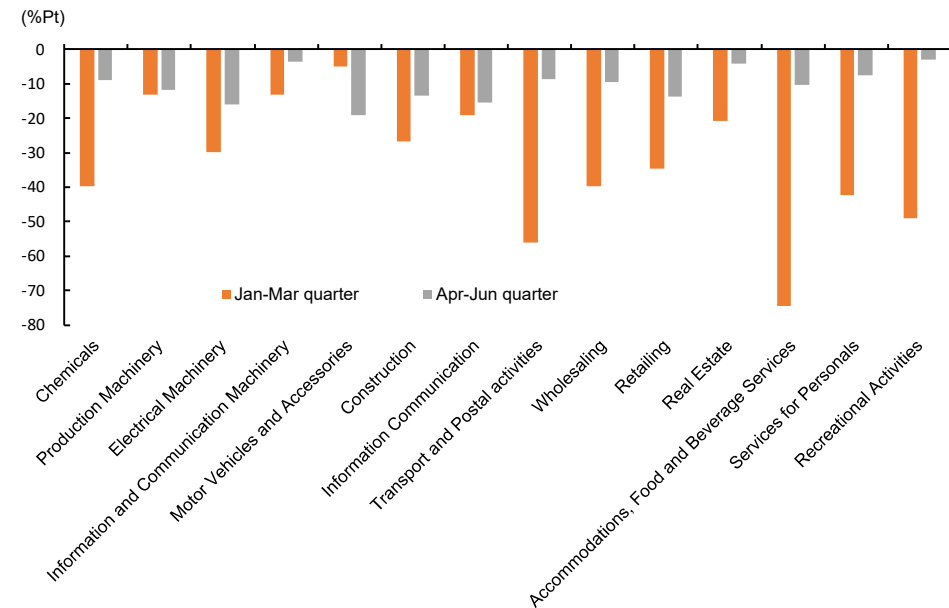
- The BSI on business conditions for the Jan-Mar quarter 2021 deteriorated mainly among small enterprises, reflecting Japan's issuance of a declaration of state of emergency.
  - Looking at small enterprises by sector, the breadth of deterioration was narrow in the manufacturing sector such as motor vehicles, information and communication machinery and production machinery, and the information communication sector.
  - In contrast, the breadth of deterioration was considerably wide in services requiring face-to-face interactions such as accommodations, food and beverage services and transport and postal activities due to the issuance of a declaration of a state of emergency. Business sentiment is polarizing between the manufacturing sector which is following a significant recovery worldwide and the services sector which is dragged down by the prolonged impact of the Covid-19 pandemic.
- The recovery of business sentiment regarding the future is expected to be slow among small enterprises.
  - The BSI among small enterprises was negative up to the Jul-Sep quarter 2020. As the impact of the Covid-19 pandemic draws out, we expect a further widening of the gap in pace of improvement in business sentiment by company size.

## BSI on business conditions



Source: Made by MHRT based upon Cabinet Office and Ministry of Finance, *Business Outlook Survey*.

## BSI on business conditions by sector (small enterprises)



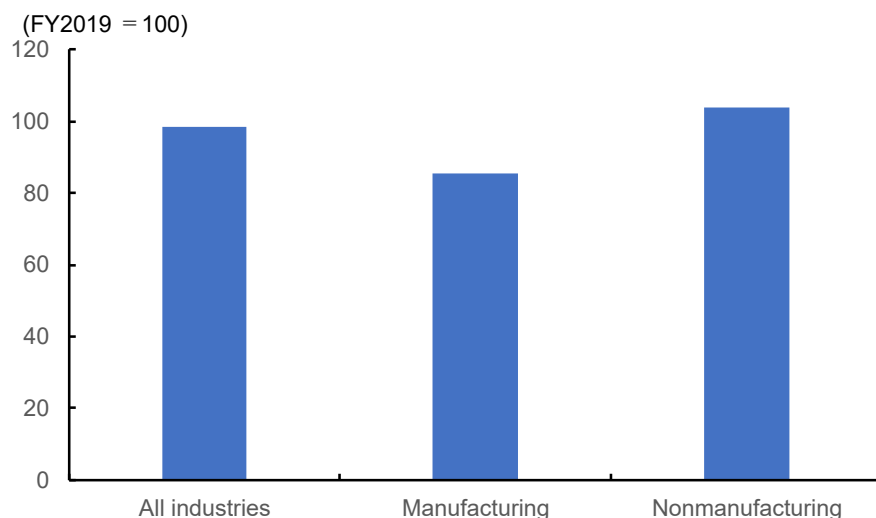
Source: Made by MHRT based upon Cabinet Office and Ministry of Finance, *Business Outlook Survey*.



## FY2021 earnings projections are positive, but fall short of pre-pandemic levels

- Even though FY2021 earnings projections are substantially higher than the previous year, they still fall short of pre-pandemic levels.
  - FY2021 ordinary profit projections stood at +8.8% y-o-y (manufacturing sector: +16.7% y-o-y and nonmanufacturing sector: +6.4% y-o-y). Even so, the total for all industries is only around 98% of pre-pandemic levels (FY2019).
- The recovery appears to vary by sector.
  - Looking at the levels in terms of sector compared to FY2019, information communication and electrical machinery, etc., turned positive, reflecting the shift to online services. However, the recovery in transport and postal activities, accommodations, food and beverage services, and recreational activities was particularly weak.
  - Given the difficulty to predict when the pandemic will be contained, the recovery of services requiring face-to-face interactions will continue to be slow in FY2021.

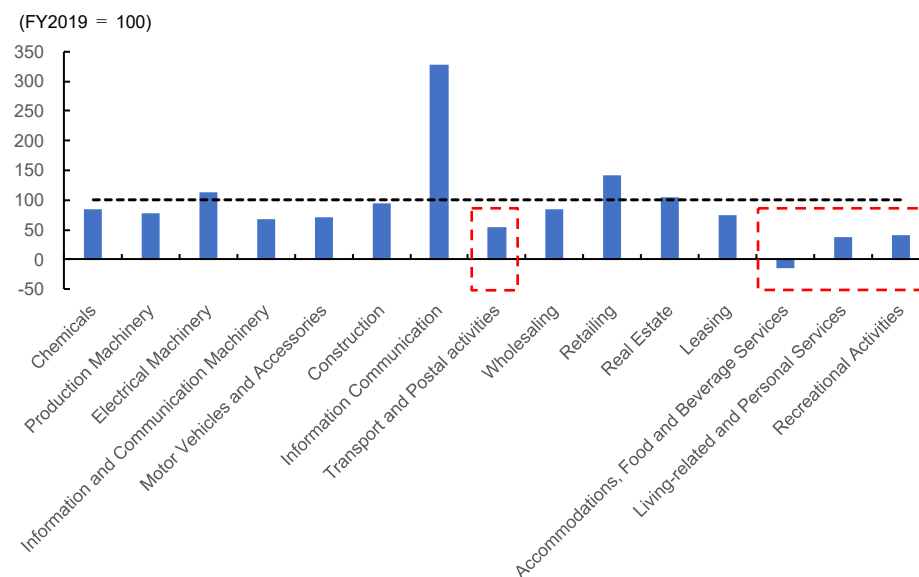
### Ordinary profit projection for FY2021 (FY2019=100)



Note: Indexed using the FY2019 earnings projection (value) released for the Jan-Mar quarter of 2019 as 100.

Source: Made by MHRT based upon Cabinet Office and Ministry of Finance, *Business Outlook Survey*.

### Ordinary profit projection for FY2021 by sector (FY2019=100)



Note: Indexed using the FY2019 earnings projection (value) released for the Jan-Mar quarter of 2019 as 100.

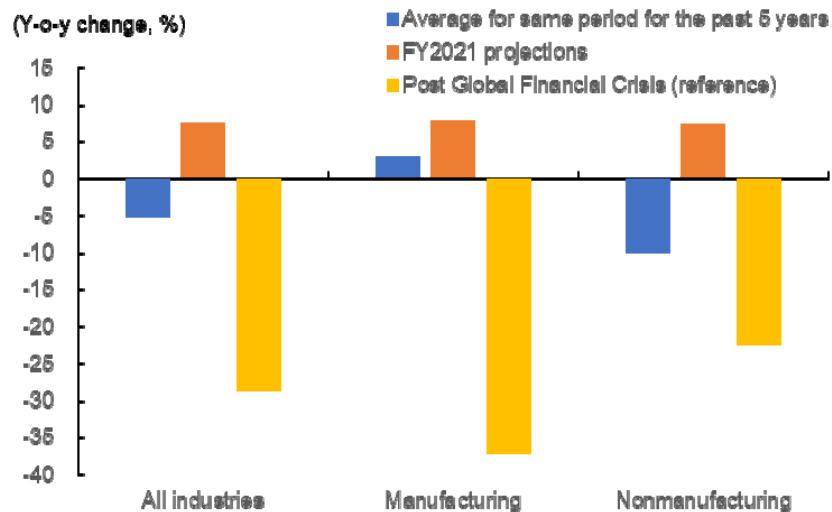
Source: Made by MHRT based upon Cabinet Office and Ministry of Finance, *Business Outlook Survey*.



# FY2021 capital investment projections are bullish, driven by software investment

- FY2021 capital investment projections rose sharply. The odds are high that capital investment will head toward recovery from the slump in FY2020.
  - FY2021 capital investment projections (including software, excluding land) rose +7.6% y-o-y (manufacturing sector: +7.9% y-o-y and nonmanufacturing sector: +7.4% y-o-y), indicating a bullish stance. Capital investment is picking up from the slump in FY2020 (-9.2% y-o-y).
- The rise of software investment triggered by Covid-19 served as a positive factor.
  - FY2021 software investment projections rose a dramatic +14.9% y-o-y (manufacturing sector: +18.3% y-o-y and nonmanufacturing sector: +14.1% y-o-y). This served to lift overall capital investment projections.

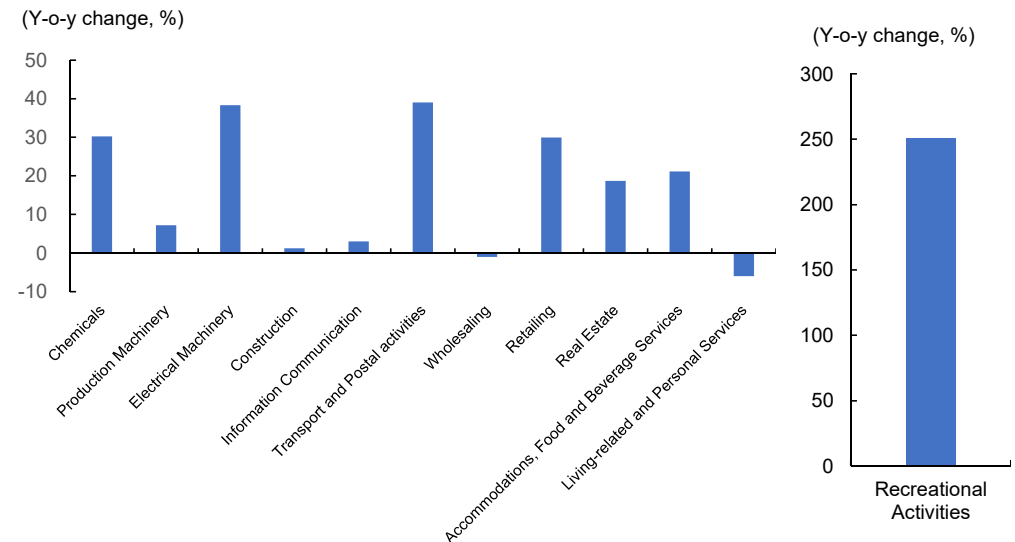
## Capital investment projection for FY2021



Note: Capital investment including software but excluding land  
 "Post Global Financial Crisis" refers to the FY2009 projections released in the Jan-Mar quarter of 2009

Source: Made by MHRT based upon Cabinet Office and Ministry of Finance, *Business Outlook Survey*.

## Software investment projection for FY2021

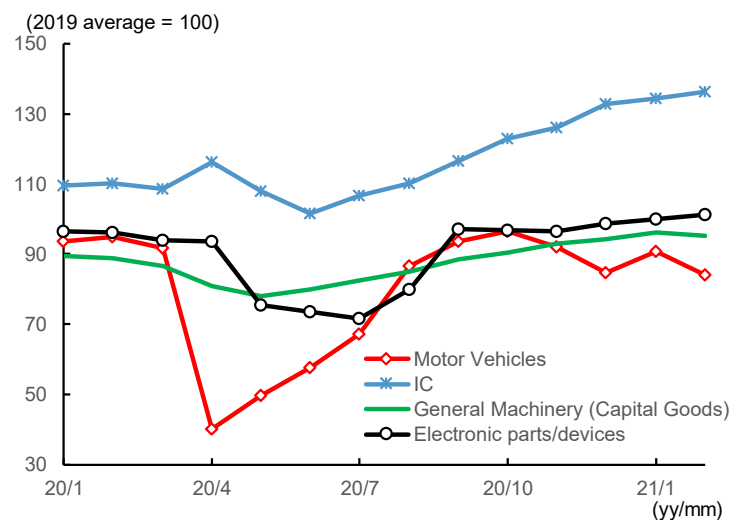


Source: Made by MHRT based upon Cabinet Office and Ministry of Finance, *Business Outlook Survey*.

# The stagnation of exports in February is transitory and should turn upward from March onward

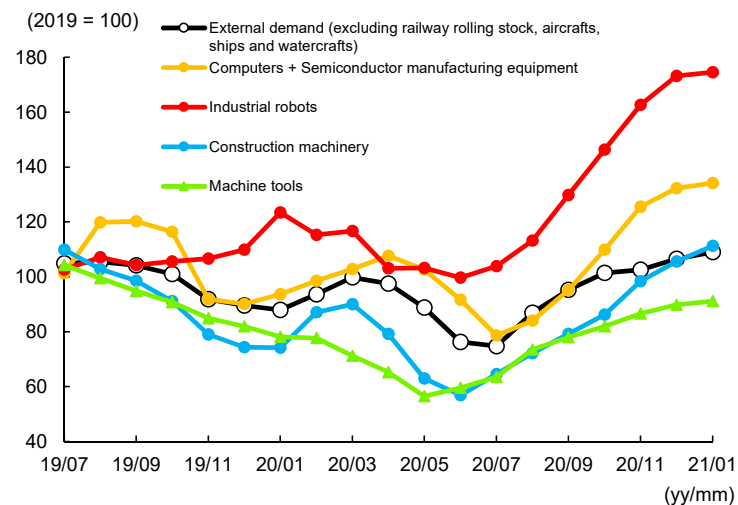
- Even though exports were stagnant in February due to the impact of the earthquake, the slump was due largely to a temporary factor. Exports should continue to follow a recovery path mainly with respect to IT-related goods and capital goods.
  - In February, the export volume index was more or less flat at -0.2% m-o-m (seasonally-adjusted, adjusted for the lag of the Chinese New Year).
  - In contrast to the strength of exports of IT-related goods such as ICs and PC components, motor vehicle exports to the US declined, reflecting the impacts of the earthquake and semiconductor shortage.
- In January, machinery orders from overseas rose +6.4% m-o-m, recording positive growth for the fourth month in a row
  - Our view remains unchanged that exports of capital goods are strong, reflecting China's investment in semiconductors and infrastructure and US investment to address the Covid-19 pandemic.
- Despite the lingering impact of the shortage of semiconductors, exports of motor vehicles should pick up from March onward as the impact of the earthquake subsides.
  - Exports as a whole should continue to follow an upward path, as IT-related goods and capital goods remain on an uptrend.

## Export trends by major items



Note: Nominal amounts used for general machinery; seasonally adjusted by MHRT excluding the impact of the Chinese New Year.  
Source: Made by MHRT

## Machinery orders from overseas (order value by types of machinery)

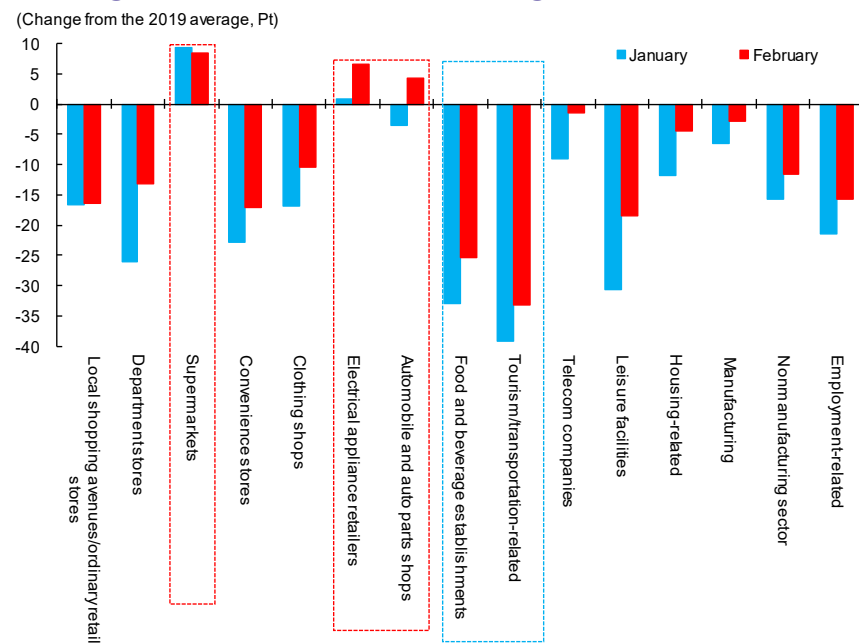


Note: 3-month moving average. Adjusted for seasonal factors by MHRT.  
Source: Made by MHRT based upon Cabinet Office, *Machinery Orders*.

# Even though business sentiment bottomed out in February, the level is low. Looking forward, the recovery will most likely remain tepid.

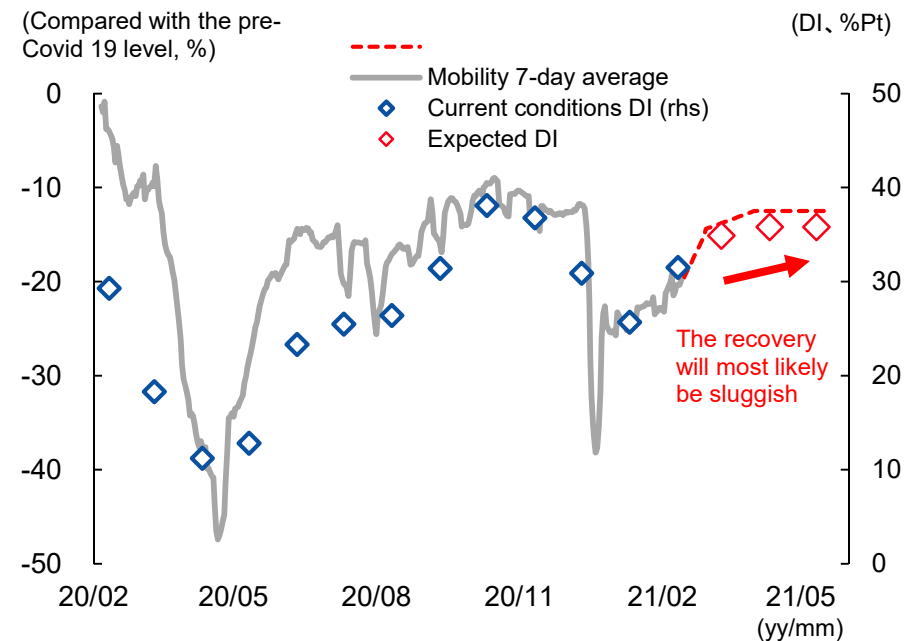
- Although business sentiment bottomed out following the rise of mobility, it remains lower than pre-pandemic levels.
  - The *Economic Watchers Survey* (February) revealed a major improvement of the DI for current conditions (direction) (January: 31.2 → February: 41.3) for the first time in four months. Department stores and food and beverage establishments lifted the DI, reflecting the strong consumption of big-ticket items and increase in turnout of people.
- The DI for future economic conditions improved (January: 39.9 → February: 51.3), buoyed by Japan lifting its declaration of state of emergency and expectations toward the vaccine rollout (number of comments: January: 226 → February: 379)
  - Even so, given that certain restrictions on the service sector are expected to remain in place under the quasi-state of emergency even after the declaration of a state of emergency is lifted, the recovery of business sentiment going forward will most likely be tepid.

## Economic Watchers Survey: DI for current conditions (level) (by sector; original data and change from the 2019 average)



Source: Made by MHRT based upon Cabinet Office, *Economy Watchers Survey*.

## Economic Watchers Survey: DI for current conditions (level) and mobility



Source: Made by MHRT based upon Cabinet Office, *Economy Watchers Survey* and Google LCC, *Google Mobility*.

## (2) BOJ monetary policy: results of the “assessment” at the March BOJ MPM

- At the Monetary Policy Meeting (MPM) on March 18 and 19, the Bank of Japan (BOJ) judged that it is important to continue with monetary easing in a sustainable manner and make nimble and effective responses without hesitation to counter changes in developments in economic activity and prices, as well as in financial conditions, and decided on policy responses in line with the table in the bottom left.
- Basically, this involves (1) securing further room to cut policy interest rates while considering the impact on the functioning of financial intermediation, (2) making clear that the range of 10-year JGB yield fluctuations would be between around plus and minus 0.25 percent from the target level, and (3) seek greater flexibility to purchase ETFs and J-REITs, which is more or less unchanged from previous media reports.
- Under the Interest Scheme to Promote Lending, interest rates will be linked to the short-term policy interest rate (absolute value), enabling the BOJ to cut interest rates nimbly while considering the impact on the functioning of financial intermediation.
- For the time being, the BOJ will maintain its monetary policy stance, placing priority on stabilizing the entire yield curve at a low level.

### YCC and Purchases of ETFs and /J-REITs

Conduct of YCC
• BOJ will establish the Interest Scheme to Promote Lending (see right for details)
• BOJ will make clear that the range of 10-year Japanese government bond (JGB) yield fluctuations would be between around plus and minus 0.25 percent from the target level
• BOJ will introduce "fixed-rate purchase operations for consecutive days," through which it will conduct the fixed-rate purchase operations consecutively for a certain period of time.
• BOJ will, for the time being, conduct yield curve control with a priority on stabilizing the entire yield curve at a low level
Purchases of ETFs and J-REITs
• BOJ will purchase ETFs and J-REITs as necessary and maintain the upper limits of about 12 trillion yen and about 180 billion yen, respectively, even after Covid-19 subsidies.
• BOJ will only purchase ETFs tracking the Tokyo Stock Price Index (TOPIX).

Source: Made by MHRT based upon the Bank of Japan.

### The Interest Scheme to Promote Lending

- Mitigates the impact on financial institutions' profits at the time of rate cuts depending on the amount of their lending.  
 - Depending on the situation, the interest rates and the eligible fund-provisioning measures for each category will be changed at the MPMs.

	Applied interest rate	Eligible fund-provisioning measure
Category I	0.20%	Special Funds-Supplying Operations to Facilitate Financing in Response to COVID-19 (eligible loans provided directly from financial institutions)
	Higher interest rate than Category II	
Category II	0.10%	Special Funds-Supplying Operations to Facilitate Financing in Response to the Novel Coronavirus (COVID-19) (other except for eligible loans provided directly from financial institutions)
	Absolute value of short-term policy interest rate	
Category III	0%	(Funds-Supplying Operation to Support Financial Institutions in Disaster Areas)
	Lower interest rate than Category II	

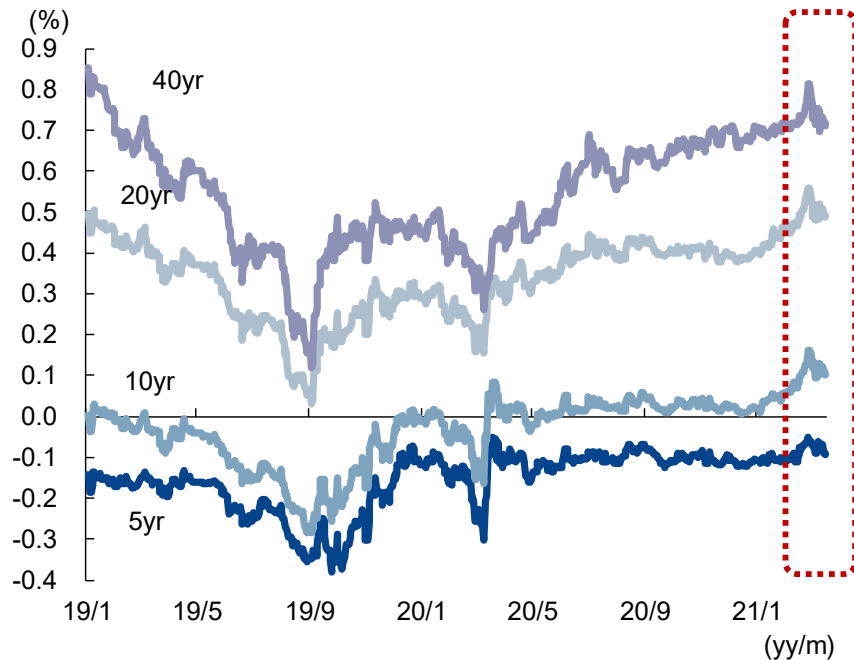
Note: Eligible loans provided directly from financial institutions is the amount of loans provided directly from financial institutions to small enterprises, etc., as part of BOJ's Special Program to Support Financing in Response to the Novel Coronavirus (COVID-19), less the amount of financial institutions' loans provided with Japan Federation of Credit Guarantee Corporations' guarantee, as part of the government's budgetary measures.

Source: Made by MHRT based upon

### (3) Japanese bond market: 10yr JGB yield is projected to trend around 0.1%

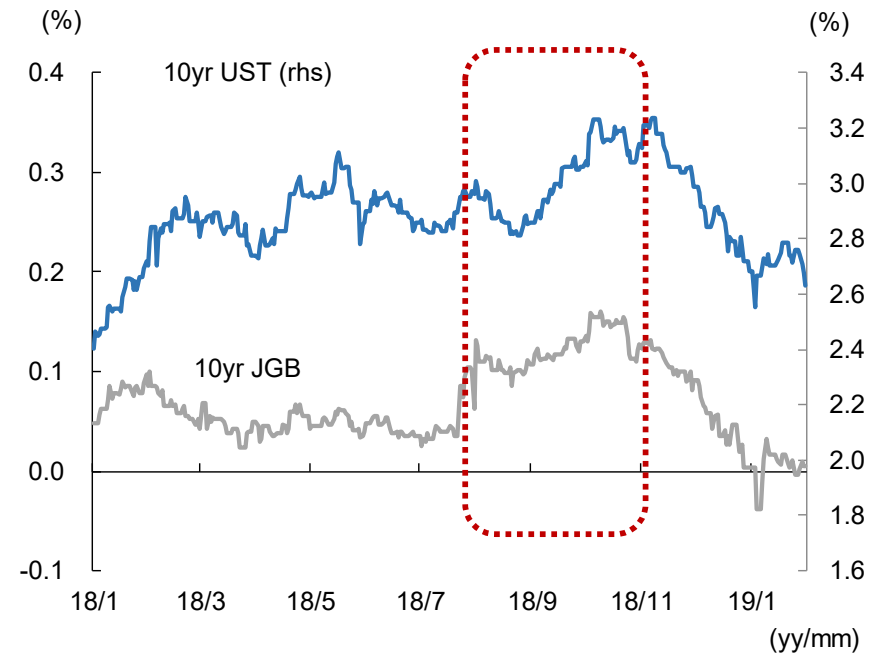
- Even though the yield on 10yr JGBs rose to the 0.16%-level on February 26, the yield momentarily took a downturn subsequent to comments by BOJ Governor Haruhiko Kuroda that “I think it neither necessary nor appropriate” regarding the acceptable range of 10-year JGB yield fluctuations.
- However, the MPM decided at its meeting in March to clarify that the acceptable range of 10-year JGB yield fluctuations is around plus and minus 0.25 percent from the target level.
  - Nevertheless, given that the expansion of the acceptable range currently remains small, and that the basic monetary policy easing stance is expected to be prolonged, the 10yr JGB yield is projected to trend around 0.1%.

#### Trends in JGB yields



Source: Made by MHRT based upon Bloomberg.

#### Trends of 10yr UST and JGB yields in 2018 when the acceptable range of fluctuations was widened

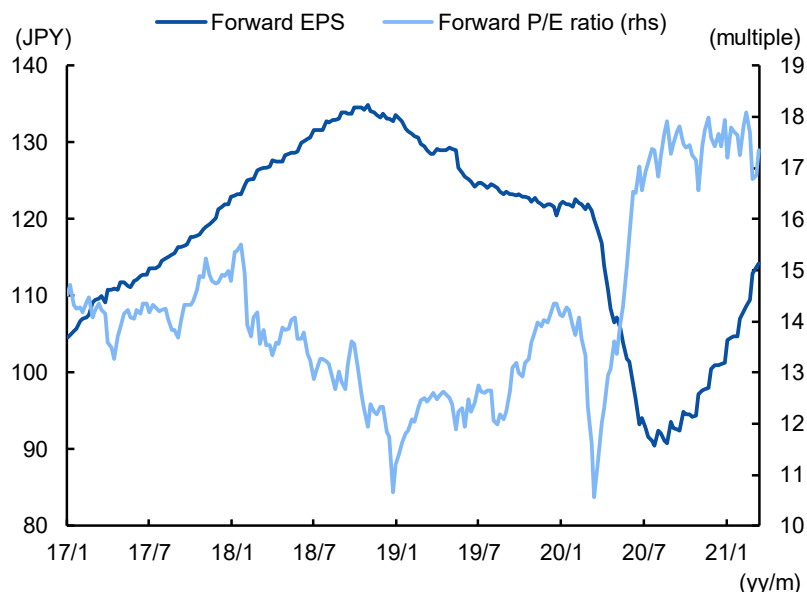


Source: Made by MHRT based upon Bloomberg.

## (4) Japanese stock market: even though the stock market should follow firm footing due to expectations for improved earnings, keep a close eye upon the rise of US interest rates

- Even though the Nikkei Average fell below 29,000 reflecting the rise of long-term interest rates in the US, it is currently trending around the mid-29,000 range.
  - Although the Nikkei Average recovered at one point to the 30,000-range (March 18), it took a downturn due to the rise of US interest rates and the BOJ's decision to exclude Nikkei-average-linked ETFs from its ETF purchases.
  - On the other hand, as shown by the TOPIX rising above 2,000 pt (March 18), stocks sensitive to economic conditions continued to rise on expectations toward global economic recovery.
- The pace of recovery of the forward EPS is picking up. The revision index continues to be revised up and expectations toward the improvement of earnings are driving up stock prices
  - In terms of valuation, the forward P/E ratio fell from the previous month to around the 17x range. Looking forward, the odds are high that the ratio will continue to follow a gradual downtrend along with the recovery of corporate earnings.
- Reflecting the recovery of the global economy, we expect Japanese stocks to remain firm, mainly with respect to stocks sensitive to economic conditions. However, it will be necessary to keep a close eye upon the possibility of market adjustments due to the rise of US interest rates.

### TOPIX forward EPS and forward P/E ratio



Note: Forward EPS and forward P/E ratios are based upon 12-month forward forecast.  
Source: Made by MHRT based upon Refinitiv.

### Revision Index

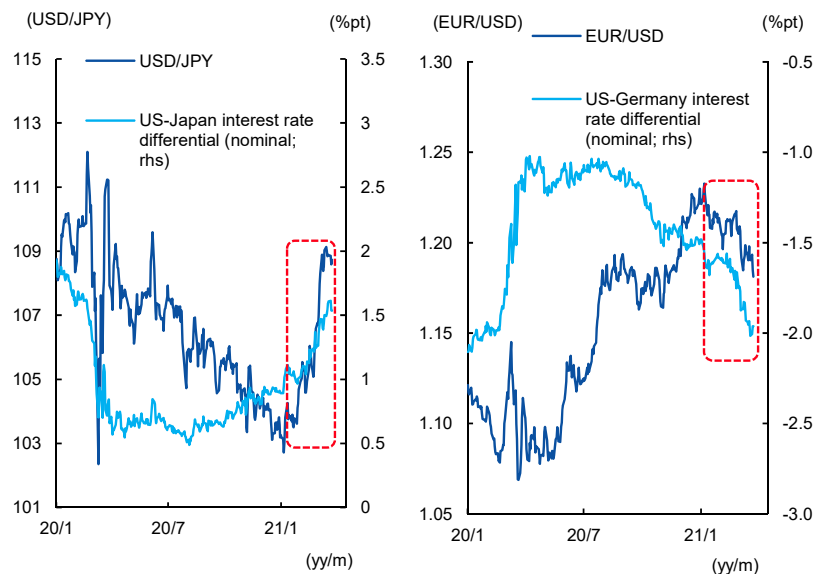


Note: Revision Index = (Stocks with upward revisions – Stocks with downward revisions) / Number of stocks forecast  
Source: Made by MHRT based upon Refinitiv.

## 6. Forex market: concerns regarding the rise of US long-term interest rates are lingering. The US dollar is projected to remain firm against the yen

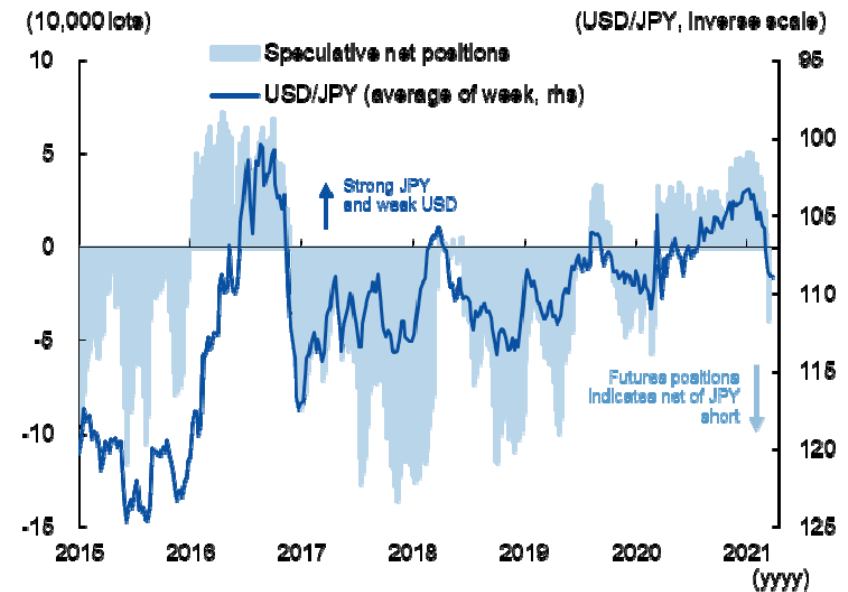
- The US-Japan and US-Germany interest rate differentials widened further since the end of January, reflecting the acceleration of the rise of US interest rates. The US dollar is strengthening against both the yen and the euro.
  - The USD/JPY exchange rate rose to the JPY 109-level for the first time since June last year, and has been following firm footing. At one point, the EUR/USD exchange rate fell to the mid-USD 1.17-level.
  - Amid the dollar-bullish tone of the market, the closing of dollar-selling positions which increased during the weakness of the dollar at the end of last year is one of the factors driving the US dollar.
- Despite a pause in the rise of US long-term interest rates, there are lingering concerns regarding the rise of interest rates in the US. The strength of the US dollar against the yen is expected to continue for the time being.
  - Even though the FOMC (March 16 and 17) maintained a cautious stance toward early tapering, participants did not show a proactive stance toward curbing the rise of long-term interest rates.
  - Even so, investors shifted to yen-short positions as adjustments of yen positions to the dollar ran their course. Further yen-weakening pressures due to position adjustments will be limited.

### USD/JPY and EUR/USD rates and interest rate differential with US long-term rates



Source: Made by MHRT based upon Bloomberg.

### USD/JPY and speculators' net position



Source: Made by MHRT based upon Bloomberg.



## 7. Outlook on the financial markets

		○ Main scenario					○ Sub-scenario 1				○ Sub-scenario 2			
		2020/ Oct-Dec	2021/ Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	2021/ Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	2021/ Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec
US	Federal funds rate (End-of-quarter, %)	0.00 - 0.25	0.00 - 0.25	0.00 - 0.25	0.00 - 0.25	0.00 - 0.25	0.00 - 0.25	0.00 - 0.25	0.00 - 0.25	0.00 - 0.25	0.00 - 0.25	0.00 - 0.25	0.00 - 0.25	0.00 - 0.25
	10yr UST bond yield (%)	0.86	1.30	1.50	1.60	1.60	1.30	1.80	1.90	1.90	1.30	0.80	0.85	0.85
	Dow Jones Average (USD)	29,093	31,500	32,300	32,600	32,700	31,500	33,200	34,000	34,400	31,500	26,900	27,300	27,400
Japan	Euroyen TIBOR (3-month, %)	-0.06	-0.07	-0.07	-0.07	-0.07	-0.07	-0.07	-0.07	-0.07	-0.07	-0.07	-0.07	-0.07
	10yr JGB yield (%)	0.02	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
	Nikkei Stock Average (JPY)	25,203	28,900	29,500	29,700	29,800	28,900	30,200	31,100	31,300	28,900	23,500	23,600	23,600
Europe	ECB deposit facility rate (End-of-quarter, %)	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
	10yr government bond yield (German government bonds, %)	-0.57	-0.40	-0.35	-0.30	-0.30	-0.40	-0.25	-0.20	-0.20	-0.40	-0.70	-0.65	-0.65
Forex	USD/JPY rate (USD/JPY)	104	106	108	109	109	106	109	110	110	106	105	105	105
	EUR/USD rate (EUR/USD)	1.19	1.21	1.18	1.17	1.17	1.21	1.17	1.17	1.16	1.21	1.20	1.20	1.20

- Sub-scenario 1 (upside scenario)
  - The vaccine rollout is completed at an early stage and restrictions on economic activities are lifted along with the achievement of herd immunity as early as mid-2021. Long-term interest rates and stock prices rise. The dollar strengthens against the yen.
- Sub-scenario 2 (downside scenario)
  - Vaccine rollouts do not progress due to concerns regarding efficacy and side effects, and restrictions to ensure social distance are prolonged. The pace of global economic recovery remains extremely sluggish, long-term interest rates decline, and stock prices fall. The dollar weakens against the yen.



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