1. Current state of the global economy: business confidence is picking up due to the resumption of economic activity

- Reflecting the resumption of economic activities around the world, the global economy is recovering, as indicated by the manufacturing PMI rising above 50 in the US, the Eurozone, and China.
- Even so, the leading economic indicators fall short of the long-term trend. While the level of economic activity is lower than pre-Covid levels, they should follow a moderate recovery process.

### Manufacturing PMI

<table>
<thead>
<tr>
<th>Country</th>
<th>PMI</th>
<th>Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>53.6</td>
<td>20/8</td>
</tr>
<tr>
<td>Eurozone</td>
<td>51.7</td>
<td>20/8</td>
</tr>
<tr>
<td>Japan</td>
<td>46.6</td>
<td>20/8</td>
</tr>
<tr>
<td>China</td>
<td>51.1</td>
<td>20/7</td>
</tr>
</tbody>
</table>

### OECD composite leading indicator

<table>
<thead>
<tr>
<th>Country</th>
<th>Index</th>
<th>Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>97.5</td>
<td>20/7</td>
</tr>
<tr>
<td>Eurozone</td>
<td>97.3</td>
<td>20/7</td>
</tr>
<tr>
<td>Japan</td>
<td>98.7</td>
<td>20/7</td>
</tr>
<tr>
<td>China</td>
<td>97.9</td>
<td>20/7</td>
</tr>
</tbody>
</table>

**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 MHRI based upon the National Bureau of Statistics of China, Markit Economics
Overview of financial markets: US stock market is firm, reflecting stronger-than-expected earnings. The dollar remains soft

- US stocks rose on the back of strong earnings mainly in the high-tech sector. For Japanese stocks the upside will be heavy due to the spread of Covid-19 infections, etc. in the Tokyo metropolitan area. Yields on 10-yr US treasury bonds rose slightly due to reluctance to increase government bond issues at the regular quarterly auction. The weakness of the dollar and strength of the euro is persisting in the forex market.

Major market trends

Note: Currency exchange rates are based upon the nominal effective exchange rates as released by the authorities of each country
Source: Made by MHRI based upon Bloomberg
2. (1) US economy: US real GDP growth marked its worst deterioration in history in the Apr-Jun quarter

- According to the advance estimate, US real GDP growth marked its worst deterioration in history in the Apr-Jun quarter (-32.9% q-o-q p.a.).
  - Given strict domestic and international travel restrictions, demand for services deteriorated severely (the degree of contribution by services to GDP growth was -22.1%).
  - For companies, capital investment is of secondary importance. Priority is placed upon securing cash on hand, and the situation is unlikely to change going forward.

- Even though the FOMC is focusing on providing support through monetary policy measures, the role of fiscal policy is more important. Coordination for additional economic measures are not progressing smoothly in Congress. In the case that passage of the measures is delayed, some of the income security effect will be lost unless retroactive measures are taken.
  - There are lingering risk of a short-term economic downturn due to the "income cliff".

Real GDP growth rate

<table>
<thead>
<tr>
<th>(Q-o-q % p.a.)</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1</td>
<td>3.8</td>
<td>2.7</td>
<td>2.1</td>
</tr>
<tr>
<td>Q2</td>
<td>1.3</td>
<td>2.9</td>
<td>1.5</td>
</tr>
<tr>
<td>Q3</td>
<td>2.6</td>
<td>2.4</td>
<td>-5.0</td>
</tr>
<tr>
<td>Q4</td>
<td>-5.0</td>
<td>-32.9</td>
<td>-40</td>
</tr>
</tbody>
</table>

(By demand item: %, % Pt)

<table>
<thead>
<tr>
<th>Degree of contribution</th>
<th>Key points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>-5.0</td>
</tr>
<tr>
<td>Personal consumption</td>
<td>-6.9</td>
</tr>
<tr>
<td>Housing investment</td>
<td>+19.0</td>
</tr>
<tr>
<td>Capital investment</td>
<td>-6.7</td>
</tr>
<tr>
<td>Inventory investment</td>
<td>-</td>
</tr>
<tr>
<td>Net exports</td>
<td>-</td>
</tr>
<tr>
<td>Government spending</td>
<td>+1.3</td>
</tr>
<tr>
<td>Domestic final demand</td>
<td>-4.6</td>
</tr>
<tr>
<td>GDP deflator</td>
<td>+1.7</td>
</tr>
</tbody>
</table>

Source: Made by MHRI based upon the U.S. Department of Commerce
With respect to additional fiscal support measures, we expect a compromise plan between the Democratic and Republican parties.

- We expect a compromise plan between the Democratic and Republican parties. Benefits to be paid retroactively for the gap period from August 1 to the day the measures are established and executed.
  - Additional unemployment benefits: extension of a reduced amount ($300/week until the end of December), cash benefits: implemented on the same scale as the first round.

- US President Donald Trump separately gave instructions for additional measures through an Executive Order.
  - Additional unemployment benefits ($400/week. Preparation of financial resources to cover 1.2 months), deferred collection of the payroll tax (employee contribution), etc.
  - In the event that the additional measures are not passed by Congress and an Executive Order is executed, US economic growth rate in 2020 will fall by 0.3% pt from our economic outlook as of August.

### Additional fiscal support measures

<table>
<thead>
<tr>
<th></th>
<th>MHRI Economic Outlook as of August (Compromise plan)</th>
<th>Democratic Party plan (HEROES bill)</th>
<th>Republican Party plan (HEALS bill)</th>
<th>* Executive Order</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional unemployment benefits</td>
<td>$300/week Until the end of December</td>
<td>$600/week Until the end of December</td>
<td>• $200/week Until the end of September • $360/week From October to the end of December</td>
<td>$400/week The federal contribution is a total of $44 billion = the federal government will run out of money in the middle of September</td>
</tr>
<tr>
<td>Cash benefits</td>
<td>Second round (The same scale as the first round implemented in Q2)</td>
<td>Second round (1.5 times the first round)</td>
<td>Second round (The same scale as the first round)</td>
<td>None</td>
</tr>
<tr>
<td>Deferred collection of the payroll tax (employee contribution)</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>September to the end of December</td>
</tr>
<tr>
<td>Impact on the 2020 growth rate (compared to the August outlook)</td>
<td>—</td>
<td>+0.4% Pt</td>
<td>0.0% Pt</td>
<td>-0.3% Pt</td>
</tr>
</tbody>
</table>

Note: The effect of the deferred collection of the payroll tax covers all employees (in the Executive Order, employees with an annual income of less than 100,000 dollars are covered), and is calculated assuming the same marginal consumption propensity as the additional unemployment benefits and cash benefits.

Source: Made by MHRI based upon US Congress materials and media reports
The FOMC is concerned about a slowdown in economic activity and a downturn of inflation due to the spread of Covid-19.

- Given the halt in improvements in mobility since mid-June, the Weekly Economic Index (WEI) of the Federal Reserve Bank of New York is deteriorating slightly.
- Inflation indicators are mixed. Despite the rise of inflation expectations among consumers reflecting the rise in price of consumer staples, the FOMC is concerned of a downward drift of inflation expectations in view of the prolonged fall and current sharp decline of the inflation rate.

Overview of press conference by Fed Chair Jerome Powell

- Overall economic activity remains well below its level before the pandemic, and the contraction in the second quarter will likely be the largest on record.
- The number of Covid-19 cases has increased sharply in many parts of the country since mid-June.
- The increase in virus cases and the renewed measures to control it are starting to weigh on economic activity.
- Regarding the inflation rate, for some goods, including food, supply constraints have led to notably higher prices. More broadly, however, weaker demand has held down consumer prices.
- The path forward for the economy is extraordinarily uncertain and will depend in large part on our success in keeping the virus in check. The sentence in the postmeeting statement about the course of the economy depending on the path of the virus is important and an extremely fundamental problem.
- The recent data are pointing to a slowing in the pace of the recovery. The data over the next couple of months will answer the question. We need to wait and see.
- We are committed to using our full range of tools to support the economy. We’re not even thinking about raising rates.
- We will continue to use the measures based on Section 13(3) of the Federal Reserve Act until we are confident that we are solidly on the road to recovery. The facilities obtaining funding support through the Department of the Treasury haven’t done as much lending as we thought, but it’s important that the facilities stay in place. That’s why we extended them.
- We have ways to further support the economy through our credit and liquidity facilities, which are effectively unlimited. We also can adjust our forward guidance. We can adjust our asset purchases.
- We haven’t done any work or thought about buying equities.
- Completion of the review is a very high priority. The new framework will inform everything we do going forward.

Source: Made by MHRI based upon the US Department of Commerce
Ongoing high unemployment, low inflation, low neutral interest rates. Odds are high that zero interest rate will persist until 2023

- According to the economic projections of FOMC participants in June, the federal funds rate will remain unchanged until the end of 2022.
- At the FOMC in September, the odds are high that a new policy framework will be introduced, consisting of an average inflation target (2% in the long term, short-term target range of 2 to 2.5%). We expect that the FOMC will take a stance tolerating an overshoot of the inflation rate and keep the federal funds rate unchanged over the projection period.
- In the event there is the need for additional monetary easing, there is a high possibility that the FOMC will strengthen its forward guidance and expand its asset purchases.

The economic and federal funds rate projection of FOMC participants (June)

<table>
<thead>
<tr>
<th>(%)</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>Long term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth rate</td>
<td>5.0%</td>
<td>4.5%</td>
<td>4.0%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>9.3%</td>
<td>6.5%</td>
<td>5.5%</td>
<td>4.1%</td>
</tr>
<tr>
<td>Core inflation rate</td>
<td>1.0%</td>
<td>1.5%</td>
<td>1.7%</td>
<td>2.0%</td>
</tr>
</tbody>
</table>

Changes in the balance sheet of the FRB form March 2020 onwards

![Changes in the balance sheet of the FRB form March 2020 onwards](Image)

Note: The economic projections are median figures. Oct-Dec quarter each year
Source: Made by MHRI based upon the FRB

Note: Shows the relative change from February 28
Source: Made by MHRI based upon the FRB
(3) US bond market: 10yr UST yields expected to move around 0.6% to 0.9%

- The 10yr UST yield temporarily fell to the lower half of the 0.5%-range, reflecting concerns regarding a second wave of Covid-19 infections and the slow progress of deliberations on additional economic measures. Subsequently, the 10yr UST yield rose to a level around 0.7% against the background of upward pressure on interest rates accompanying the increase of US treasury bond issues.
  - Given the fall of nominal interest rates and rise of the expected inflation rate, US real interest rates fell to the lowest level since the European debt crisis.
  - According to market participants' projections on the US federal funds rate, the zero interest rates policy is expected to continue for another three years or so.

- While there are concerns regarding the escalation of US-China tensions and the suspension of the reopening of the economy in areas subject to the resurgence of Covid-19 infections, we expect the 10yr UST yield to trend around 0.6% to 0.9% since the fiscal stimulus measures may serve as upward pressures on interest rates.

**Trends of real interest rates**

**Trends of US OIS interest rates**

Note: The expected inflation rate is the break-even inflation rate (10yr)
Source: Made by MHRI based upon Bloomberg
(4) US stock market: despite a stock market rise, keep a close eye upon the risk of a market adjustment

- Optimistic views on the future are growing due to expectations toward additional measures to address the Covid-19 pandemic. The Dow Jones Average has risen above 27,000 points.
  - The S&P 500 Index renewed record highs. The moves to review value stocks in the capital goods and materials sectors also contributed to pushing up stock prices.

- Corporate earnings results turned out to be better than initially expected, due in part to the fact that analysts had lowered their forecasts on corporate earnings in view of the impact of the Covid-19 pandemic. The forward EPS is continuing to follow a recovery.

- Regarding valuation, the forward P/E ratio remains pinned at a high level of 22x, supported by the low-interest rate environment.
  - However, it is necessary to keep a close eye upon the risk of a market adjustment due to a strong sense of overvaluation even in consideration of the low level of interest rates, as well as the fast pace of the market surge.

Earnings trends for stocks in the S&P 500 Index

<table>
<thead>
<tr>
<th>Sector</th>
<th>Upside</th>
<th>No surprises</th>
<th>Downside</th>
<th>Reported No. of stocks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Energy</td>
<td>69%</td>
<td>4%</td>
<td>27%</td>
<td>26 / 26</td>
</tr>
<tr>
<td>Materials</td>
<td>89%</td>
<td>4%</td>
<td>7%</td>
<td>28 / 28</td>
</tr>
<tr>
<td>Industrials</td>
<td>89%</td>
<td>0%</td>
<td>11%</td>
<td>71 / 73</td>
</tr>
<tr>
<td>Consumer Discretionary</td>
<td>73%</td>
<td>0%</td>
<td>27%</td>
<td>52 / 61</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>88%</td>
<td>0%</td>
<td>12%</td>
<td>26 / 33</td>
</tr>
<tr>
<td>Health Care</td>
<td>90%</td>
<td>0%</td>
<td>10%</td>
<td>60 / 62</td>
</tr>
<tr>
<td>Financials</td>
<td>78%</td>
<td>3%</td>
<td>18%</td>
<td>65 / 65</td>
</tr>
<tr>
<td>Information Technology</td>
<td>94%</td>
<td>3%</td>
<td>3%</td>
<td>62 / 71</td>
</tr>
<tr>
<td>Communication Services</td>
<td>85%</td>
<td>4%</td>
<td>12%</td>
<td>26 / 26</td>
</tr>
<tr>
<td>Utilities</td>
<td>82%</td>
<td>14%</td>
<td>4%</td>
<td>28 / 28</td>
</tr>
<tr>
<td>Real estate</td>
<td>45%</td>
<td>6%</td>
<td>48%</td>
<td>31 / 31</td>
</tr>
<tr>
<td>S&amp;P500</td>
<td>82%</td>
<td>3%</td>
<td>15%</td>
<td>475</td>
</tr>
</tbody>
</table>

Source: Made by MHRI based upon Refinitiv

S&P 500 Index forward P/E ratio and forward EPS

Note: The forward EPS and forward P/E ratio are on a 12 months ahead forecast basis.
Source: Made by MHRI based upon Refinitiv
3. (1) The Eurozone economy: Apr-Jun quarter GDP was the worst in history and the recovery going forward is expected to be sluggish

• In the Apr-Jun quarter, Eurozone real GDP growth stood at -12.1% y-o-y (preliminary figure), recording the largest decline in history.
  ■ All the major countries of the Eurozone recorded double-digit falls (Germany: -10.1% y-o-y, France: -13.8% y-o-y, Italy: -12.4% y-o-y, Spain: -18.5% y-o-y).
  ◆ Since Spain was subject to a longer period of stay-at-home orders than other major countries, its growth rate turned out to be the lowest among the major countries.

• The Eurozone Purchasing Managers’ Index (composite PMI), having a high correlation with GDP, stood at 54.9 in July, surpassing the expansion/contraction threshold of 50 for the first time in five months.
  ■ As the rebound stemming from the lifting of lockdowns is slowing down, the economic recovery going forward is expected to be sluggish.

Eurozone: real GDP

Eurozone: PMI

Note: Y-o-y growth rate of real GDP and contribution ratio by demand item
Source: Made by MHRI based upon Eurostat

Note: PMI at 50 is the expansion/contraction threshold
Source: Made by MHRI based upon IHS Markit
(2) Eurozone monetary policy: the ECB is continuing to take a wait-and-see stance; the amount of Italian government bond purchases is the largest

- The ECB is still at the stage of assessing the impact of its policy measures.
  - Even though Executive Member Philip R. Lane (Chief Economist) of the ECB posted a blog on August 4th, mentioning the possibility of a rebound of GDP in the Jul-Sep quarter, he also commented that there are major uncertainties regarding the future. At the same time, he emphasized the effectiveness of the market stabilization function of the PEPP.

- Regarding the ECB’s asset purchase program, purchases of Italian government bonds continue to be the largest.
  - Purchases of Italian government bonds turned out to be the largest in the ECB’s asset purchases, under the PEPP (Pandemic Emergency Purchase Programme) and PSPP (Public Sector Purchase Programme) combined from March to July. Even though yields on Italian government bonds are trending at a low level, in view of the fact that non-resident investors have shifted to significant net-selling, bond yields could have been rising in the absence of the PEPP.

Amount of ECB PEPP asset purchases (breakdown by country, March to July)

Amount of Italian government bond purchases by type of investor

Note: Cumulative total of purchases made from March to July
Source: Made by MHRI based upon ECB

Source: Made by MHRI based upon the Bank of Italy
The German 10yr government bond yield trended around -0.5%, given the limited impact of the second wave of Covid-19 infections due to the agreement on a European recovery fund (7/21) and the fact that the improvement of the Eurozone PMI was well-received. Subsequently, it rose to the upper-half of the -0.4% range along with the rise of US interest rates.

- Spreads between southern European government bonds and the German 10yr government bond yield are stabilizing, reflecting the provision of larger support by the recovery fund to southern European countries such as Greece and Italy.

- Given the concerns regarding the resurgence of Covid-19 infections amid the resumption of economic activity, the German 10yr government bond yield is expected to trend around -0.5% to -0.3%.

---

**German long-term interest rate and Eurozone short-term interest rate**

![Graph: German 10yr interest rate vs. EONIA and 1-year 1-month OIS](Image)

**Spread versus German government bond (10yr)**

![Graph: Spread between various Eurozone countries (bp)](Image)
The main indicators in July indicate the continuation of a gradual recovery. As the negative impacts from flooding and the resurgence of Covid-19 infections are small, the economy is trending as expected.

- Investment grew +6.1% y-o-y in July (June: +5.3% y-o-y), revealing an ongoing recovery driven by real estate development and infrastructure investment.
- Exports (USD-denominated) grew +7.2% y-o-y in July (June: +0.5% y-o-y), indicating the expansion of export growth driven mainly by a special procurement boom (such as PCs and textiles for masks).
- Even though retail sales growth stood at -1.1% y-o-y in July (June: -1.8% y-o-y) and remained in negative territory, note that it is improving, supported by strong motor vehicle sales.

**Main monthly indicators**

- **Retail sales**
- **Investment in fixed assets**
- **Exports (denominated in USD)**

**Fixed asset investment (by industry)**

- **Other**
- **Real estate development investment**
- **Infrastructure investment**
- **Manufacturing**
- **Investment in fixed assets**

Note: All are nominal figures. Retail sales and investment in January and February are the cumulative totals for January to February.

Source: Made by MHRI based upon the National Bureau of Statistics of China and CEIC data
5. (1) The Japanese economy: GDP growth falls deep into negative territory of -27.8% q-o-q p.a. in the Apr-Jun quarter

- According to the First Preliminary Quarterly Estimates of GDP (1st QE) for the Apr-Jun quarter of 2020, Japan's real GDP fell -7.8% q-o-q (-27.8% p.a.), revealing a sharp fall into negative territory.
- Personal consumption, particularly of services, fell sharply, reflecting the declaration of a state of emergency. Exports (primarily US- and Europe-bound exports) also fell sharply due to the global spread of lock-downs. Capital investment also fell into negative territory due to the deterioration of profits and rise of uncertainties.

- Jul-Sep quarter growth should achieve double-digit growth on a quarter-on-quarter (p.a.) basis, due in part to a counter reaction to the sharp fall in the previous quarter. Even so, it will fall short of a full recovery from the previous quarter's sharp fall.
  - Consumption should grow strongly, given the "carry-over" from the recovery (mainly in consumption of goods) in June. Motor vehicle exports are also predicted to increase, reflecting the recovery of demand accompanying the lifting of lockdowns overseas. Given full-scale adjustments, the breadth of decline of capital investment should fall deeper into negative territory.
  - From the Oct-Dec quarter onward, concerns regarding the resurgence of Covid-19 infections are expected to dampen household and corporate activities, thus serving as a drag upon the pace of recovery.

1st QE in the Apr-Jun quarter of 2020

(Q-o-q % change)

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td>Domestic demand</td>
<td>0.7</td>
<td>0.6</td>
</tr>
<tr>
<td>Private demand</td>
<td>0.6</td>
<td>0.5</td>
</tr>
<tr>
<td>Household (private consumption + housing)</td>
<td>1.2</td>
<td>1.1</td>
</tr>
<tr>
<td>Public demand</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Public investment</td>
<td>1.0</td>
<td>0.5</td>
</tr>
<tr>
<td>Government consumption</td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td>External demand</td>
<td>1.8</td>
<td>0.5</td>
</tr>
<tr>
<td>Exports</td>
<td>0.2</td>
<td>0.5</td>
</tr>
<tr>
<td>Imports</td>
<td>1.8</td>
<td>0.4</td>
</tr>
<tr>
<td>Nominal GDP</td>
<td>0.5</td>
<td>0.4</td>
</tr>
<tr>
<td>GDP deflator (y-o-y change)</td>
<td>0.6</td>
<td>0.9</td>
</tr>
</tbody>
</table>

Note: The figures in the table on the right are real y-o-y figures unless stated otherwise, and the figures in the brackets are the contribution ratio to the GDP growth rate.

Source: Made by MHRI based upon Cabinet Office, Preliminary Quarterly Estimates of GDP.
In July, exports (mainly US-bound motor vehicle exports) recovered. In the Jul-Sep quarter, the contribution by external demand turned positive.

- The export volume index rose +4.5% m-o-m in July, rising for two months in a row (June: +4.3% m-o-m). Exports, particularly motor vehicle exports, bottomed out.
  - Looking at the results by country, US-bound exports rose sharply, mainly due to motor vehicles. Regarding exports to China, exports of semiconductor manufacturing equipment and motor vehicles and motor vehicle parts continued to recover. Exports of motor vehicles to the EU are sluggish but are forecast to recover from next month in a lag following the recovery in sales.

- The import volume index dipped slightly into negative territory in July (-2.8% m-o-m). Given a pause in special demand arising from pandemic prevention and remote working, imports of masks and notebook computers also came to a pause (note, however, that the level of demand is still high, indicating the firmness of demand).

- Jul-Sep quarter exports are off on good start due to the recovery of motor vehicles. The odds are high that external demand turn positive and push up GDP in the Jul-Sep quarter.
  - Based upon assumptions that exports will flatten out in August to September, the contribution by external demand would be +2.1% Pt in Jul-Sep quarter according to a straightforward calculation.

### Exports volume index by country (seasonally-adjusted)

![Graph showing exports volume index by country](image1)

Note: Seasonal adjustments by MHRI
Source: Made by MHRI based upon Ministry of Finance, Trade Statistics

### Motor vehicle exports volume index by country (seasonally-adjusted)

![Graph showing motor vehicle exports volume index by country](image2)

Note: Seasonal adjustments by MHRI
Source: Made by MHRI based upon Ministry of Finance, Trade Statistics
Consumer spending: despite a strong rebound in spending on motor vehicles, the recovery of services consumption came to a pause in July

- New car sales increased +19.0% m-o-m in July (June: +30.5% m-o-m). The level stood at 3.9 million units p.a., marking a recovery to the pre-Covid level (3.86 million units p.a. in January).
  - Sales were pushed up primarily by light motor vehicles (+23.1% m-o-m) (it appears that the elimination of the backlog of orders along with the resumption of production served as a factor).
  - In August and September, even though sales promotions are expected to push up sales of standard and compact motor vehicles, sales of light motor vehicles should face a reactionary slump, resulting in an overall slowdown of growth.

- The recovery in the consumption of services stalled in July because of heavy rains in July and spread of self-restraint among consumers due to the resurgence of Covid-19 infections.
  - Despite the ongoing recovery in leisure and accommodations, spending on eating out and travel are largely flat, and transportation is deteriorating.

- Consumption in the Jul-Sep quarter is projected to be flat (note that growth on a quarter-on-quarter basis turns out high because of the carry-over from the increase in June).

Motor vehicle sales (seasonally-adjusted)

Consumption indicators by industry for the second half of July

Note: Seasonal adjustments by MHRI
Source: Made by MHRI based upon Japan Automobile Dealers Association, Japan Light Motor Vehicle and Motorcycle Association

Note: Reference data
Source: Made by MHRI based upon JCB and Nowcast, JCB Consumption NOW
An unexpected fall of unemployment in June. However, it should rise again from July

- The unemployment rate stood at 2.8% in June, marking a decline from the previous month (2.9%). The number of employed persons not at work, which surged to 5.97 million as of April, decreased to 2.36 million.
  - The number of employed persons not at work decreased in sectors such as accommodations, and eating and drinking services (May: 0.79 million →June: 0.28 million), wholesale and retail (May: 0.49 million→June: 0.29 million), education and learning support (May: 0.38 million→June: 0.13 million), living-related services and entertainment (May: 0.34 million→June: 0.14 million), manufacturing (May: 0.37 million→June: 0.25 million).
  - However, in comparison with the same month last year, the number of employed persons not at work still rose 0.93 million (May: +2.74 million). In view of the high possibility that they will become unemployed from July, the unemployment rate is projected to rise again.

- Given the ongoing business slump in sectors such as accommodations, eating and drinking, and entertainment, workers who have returned to the workplace are expected to suffer larger falls in their wages.

Trends of employed persons not at work

!(Image: Trends of employed persons not at work)

Note: Original data, actual count
Source: Made by MHRI based upon Ministry of Internal Affairs and Communications, Labour Force Survey

Flow of the labor market in June

!(Image: Flow of the labor market in June)

Note: Original data basis. Estimates by MHRI. The flow is on a net basis.
Source: Made by MHRI based upon Ministry of Internal Affairs and Communications, Labour Force Survey
(2) BOJ monetary policy: continue to implement the "three main pillars" to focus on the response to Covid-19

- The Bank of Japan (BOJ) is closely monitoring the behavior of households and companies accompanying the resumption of economic activities, and the impact of the deterioration of demand and supply upon prices.

  - At the July monetary policy meeting, the BOJ expressed its opinion that "the impact of Covid-19 on people’s mindset and developments in firms' medium- to long-term growth expectations warrant close monitoring." Deputy Governor Masayoshi Amamiya indicated that in case of supply-side constraints, upward pressure could be exerted on prices (7/29).

- For the time being, the BOJ will focus its efforts on the response to Covid-19 using the "three main pillars." It is unlikely that in-depth studies of negative interest rates, etc. will be discussed.

  - At the June monetary policy meeting, the BOJ expressed the opinion that "if firms continue to prioritize securing internal reserves, their investment stance will become cautious and the effects of monetary policy on their demand for funds could be limited."

Main opinions (July monetary policy meeting)

- The enhancement of monetary easing since March has had positive effects in terms of maintaining stability in financial markets and ensuring smooth corporate financing. The top priority for monetary policy for the time being is to contribute to sustaining businesses and employment by continuing to support corporate financing.

- Effectively interest-free loans will have significant positive effects since they serve as support for firms that have difficulties in raising funds. On the other hand, even after the impact of COVID-19 subsides, such loans might put downward pressure on spreads on the ordinary loans that will be made.

- Downward pressure on prices is likely to intensify in the short run, but medium- to long-term inflation expectations have been generally maintained to this point. It is appropriate to consider the policy responses for achieving the price stability target of 2 percent when the impact of COVID-19 almost subsides.

Covid-19 response operations (balance)

Source: Made by MHRI based upon the Bank of Japan
(3) Japanese bond market: 10yr JGB yield forecast to trend around 0%

- The 10yr JGB yield moved around 0%. In the medium- and long-term zones, yields are expected to remain around 0% for the time being, supported in terms of the supply-demand balance by the BOJ's purchases.
  - Despite a bear steepening at one time, the yield curve is flattening, triggered by the strong 30yr bond auction results in July. Even so, it has started to steepened again along with the rise of US interest rates.
  - Fitch revised down its outlook on JGBs from "stable" to "negative" (7/30).
  - The downgrade did not have much of a discernible impact upon the yen bond market.

**Fitch's downward revision of outlook on JGBs**

<table>
<thead>
<tr>
<th>Content of revision</th>
<th>Reason for revision</th>
<th>Factors that could lead to rating upgrade</th>
<th>Factors that could lead to rating downgrade</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revised the outlook on Japan's long-term sovereign rating from &quot;stable&quot; to &quot;negative.&quot; *Affirmed the JGB rating of &quot;A&quot;.</td>
<td>Reflecting the view that the higher debt ratio and downside risks to the macroeconomic outlook will nevertheless exacerbate the challenge of placing the debt ratio on a downward path over the medium term.</td>
<td>Growing confidence in the government’s ability to implement fiscal consolidation sufficient to place the GGGD/GDP ratio on a downward path over the medium term once the coronavirus crisis subsides.</td>
<td>Expectations of a persistent rise in the GGGD/GDP ratio over the medium term, for example, due to a more pronounced and longer period of fiscal loosening and economic contraction, or a failure to consolidate meaningfully after the coronavirus shock.</td>
</tr>
</tbody>
</table>

Source: Made by MHRI based upon Bloomberg

Source: Made by MHRI based upon the Fitch Ratings
(4) Japanese stock market: the market should be range-bound due to cautious views on corporate earnings

- The Nikkei Stock Average is moving at a high level, reaching a record-high since February 21, reflecting factors such as the rise of overseas stocks and expectations toward the progress in development of a Covid-19 vaccine.

- Given that the forward EPS is still hovering at a low level, the forward P/E ratio at 17 indicates a strong sense of overvaluation.
  - According to analysts’ forecasts, the pace of downward revision is slowing down, providing signs of a bottoming of the forward EPS.

- Looking forward, concerns regarding a second wave of Covid-19 infections and a cautious view of corporate earnings should cap the upside, keeping the pace of rise slow.
  - Furthermore, in view of ETF purchases by the BOJ in a stock market downturn, the market fall will be limited, leading to our view that the stock market will be range-bound.

TOPIX forward EPS and the Revision Index

ETF purchases by the BOJ

Note: Revision index = (number of stocks with earnings estimates revised upward – number of stocks with earnings estimates revised downward) / number of stocks estimated. All m-o-m changes for the current and following year.
Source: Made by MHRI based upon Refinitiv

Note: For the morning session, the percentage change in price from the closing price of the previous day. For the afternoon session, the percentage change in price from the closing price of the morning session.
Source: Made by MHRI based upon Bloomberg and the Bank of Japan
6. Forex market: given a heavy upside of the US dollar, the USD/JPY exchange rate should move within a narrow range. The EUR/USD exchange rate is forecast to remain high.

- The USD has been weakening since late July. Investors are sensitive to risks originating from the US, such as the slowdown of US economic recovery due to the resurgence of Covid-19 infections and the rising tensions between the US and China.
  - The fall of US interest rates due to expectations toward additional monetary easing at the August FOMC, and the dollar sell-off against the euro triggered by the agreement of the EU recovery fund are also spurring the weakening of the US dollar.
  - As for the USD/JPY exchange rate, even though the Japanese yen gained ground to the US dollar to as high as JPY104.19/USD at one point in time, the exchange rate has been moving within a narrow range around JPY106, reflecting the strength of US employment data in July.

- Looking forward, we expect the USD/JPY exchange rate to remain range-bound around JPY106 to 107. The EUR/USD exchange rate should remain firm.
  - Despite a pause in the depreciation uncertainties originating from the US, such as the presidential election, US-China tensions, and concerns regarding the resurgence of Covid-19 infections, will continue to serve as a drag upon the US dollar.
  - However, USD sell positions in USD/JPY and USD/EUR are at their largest ever level. The closing of these positions may serve temporarily as dollar-strengthening pressures.

The USD nominal effective exchange rate and analysis of the contribution ratio of the USD

![Graph showing USD nominal effective exchange rate]

Note: The graph on the left shows the actual performance on a BIS basis (Broad) until August 17. The graph on the right is benchmarked at 2020/1/1 = 100
Source: Made by MHRI based upon Bloomberg

JPY/EUR speculators’ net positions and the USD Index

![Graph showing JPY/EUR speculators’ net positions and the USD Index]

Note: Chicago IMM currency futures non-commercial net positions. The latest figures are as of 8/18.
Source: Made by MHRI based upon Bloomberg
7. Crude oil market trends: weighed down by surplus stock of crude oil, the upside of the market will remain heavy for the time being

- US crude oil production is continuing to slump.
  - Crude oil prices (WTI) have recovered to the USD40/barrel-level, given the easing of the crude oil glut. There are signs that the sharp fall of US crude oil extraction is bottoming out.
  - However, the upside is heavy for the crude oil price, and should take more time for US crude oil production to return to the level at the beginning of the year.

- Crude oil should trend around the lower half of the USD40/barrel-level for the time being, amid the lack of upward pressures due to uncertainties regarding the situation following Covid-19.
  - Despite the upturn of crude oil prices, market players are cautious regarding the future course of the market because of the absence of signs that the Covid-19 pandemic will be contained anytime soon. Crude oil, which had a structural tendency toward a supply glut even before the Covid-19 pandemic, will continue to lack the strength to rebound, in comparison to US stocks.

### US crude oil extraction and crude oil production

**US crude oil extraction**

**US crude oil production (rhs)**

![Graph showing US crude oil extraction and production](source: Made by MHRI based upon EIA, Baker Hughes)

### Crude oil price and US stocks

**Crude oil**

**US stocks**

![Graph showing crude oil price and US stocks](source: Made by MHRI based upon EIA, Refinitiv)
8. Outlook on the financial markets

- **Sub-scenario 1** (upside scenario)

- **Sub-scenario 2** (downside scenario)
  - Despite a temporary global economic recovery due to the restart of economic activities around the world, a second wave of Covid-19 arises in the Oct-Dec quarter of 2020. Measures to prevent the spread of Covid-19 infections leads to a global economic slowdown. Both long-term interest rates and stock prices fall. The dollar weakens against the yen.

<table>
<thead>
<tr>
<th></th>
<th>O Main scenario</th>
<th>OSub-scenario 1</th>
<th>OSub-scenario 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal funds rate</td>
<td>0.00 ~0.25</td>
<td>0.00 ~0.25</td>
<td>0.00 ~0.25</td>
</tr>
<tr>
<td>10-yr UST bond yield</td>
<td>0.68 0.60</td>
<td>0.70 0.75</td>
<td>0.80 0.85</td>
</tr>
<tr>
<td>Dow Jones Average</td>
<td>24,542 26400</td>
<td>25,500 26,600</td>
<td>26,700 27,400</td>
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<tr>
<td>Euroyen TIBOR</td>
<td>-0.03 -0.07</td>
<td>-0.07 -0.07</td>
<td>-0.07 -0.06</td>
</tr>
<tr>
<td>10-yr JGB yield</td>
<td>0.00 0.00</td>
<td>0.00 0.00</td>
<td>0.00 0.00</td>
</tr>
<tr>
<td>Nikkei Stock Average</td>
<td>20,746 22,500</td>
<td>22,500 22,600</td>
<td>22,600 23,100</td>
</tr>
<tr>
<td>ECB deposit facility rate</td>
<td>-0.50 -0.50</td>
<td>-0.50 -0.50</td>
<td>-0.50 -0.50</td>
</tr>
<tr>
<td>10-yr government bond yield</td>
<td>-0.44 -0.50</td>
<td>-0.40 -0.35</td>
<td>-0.35 -0.30</td>
</tr>
<tr>
<td>EUR/USD rate</td>
<td>1.10 1.16</td>
<td>1.15 1.15</td>
<td>1.15 1.15</td>
</tr>
</tbody>
</table>
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