

NRI Group Urgent Proposals Regarding Measures for Covid-19 No. 15

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Anticipating Protracted Effects, We Need Measures Not Only for Preserving Jobs but Also for Enabling Corporate Survival — Impact of Covid-19 on Japan’s Economy and Employment (2) —

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■ Summary

- A prolonged spread of Covid-19 will likely lead to increased economic costs (economic contraction, employment, and corporate survival costs) and irreversible social changes.
- Japan's economic growth and average unemployment rates for this year in three scenarios, based on the latest IMF global economic outlook, are in the respective ranges of -7.8% to -3.9% and 3.0% to 5.6%, according to simple NRI estimates. A protracted spread of Covid-19 is expected to have a significant impact on employment; to keep this impact to the minimum, it will be necessary not only to bolster the efforts discussed in our previous proposal but also to hammer out measures to keep businesses afloat for the purpose of maintaining our society.
- If restrictions on activity remain in place for about a year due to a protracted spread of Covid-19, this may increase the likelihood that businesses will be unable to pay for major costs through their own efforts, and society as a whole will need to examine how to cover this cost, which is about 25 trillion yen.
- As predictions point to another Covid-19 outbreak and frequent occurrences of natural disasters and other emergency situations going forward, in order to continue a certain level of daily life as members of society even in emergency situations, greater information technology adoption and greater digitization of economic and social activities will be critical. We need to promote information technology investment in different fields beyond the existing standpoint of efficiency for addressing a labor shortage.

■ Significant Changes to be brought on by Protracted Spread of Covid-19 Infection

In our March 24 proposal titled "Government Should Promptly Make a 'Pledge to Preserve Jobs' (Impact of Covid-19 on Japan's Economy and Employment)

(<https://www.nri.com/jp/keyword/proposal/20200324>), made based on information available as of March 2020, we analyzed the impact of Covid-19 on Japan's economy and employment, and called for employment measures as well as the development of an emergency safety net, including compensation for lost income and revenue at economic agents. At the time the proposal was published, the outbreak appeared to be headed into containment; however, Japan subsequently declared a nationwide state of emergency and the situation remains unpredictable as of the time this proposal was written (late April). In any case, the spread of Covid-19 is expected to last longer than predicted at the time of our previous proposal.

Accordingly, in this proposal we will discuss what changes a protracted spread of Covid-19 is expected to bring about to Japan's economy and society, from the following two perspectives:

- 1) Increased economic costs (economic contraction, employment, and corporate survival costs)
- 2) Irreversible social changes

As we emphasized in our previous proposal, what we need to do is first understand anticipated changes and then boldly take proper action in advance.

■ **How severely will Japan's economy and economic environment deteriorate?**

Our proposal team laid out the following three scenarios (Cases 1, 2, and 3) depending on how long it may take for the spread of infection to wind down.

Case 1: Restrictions on activity in place for a relatively short period of time (ease in 1-2 months)

Case 2: Restrictions on activity in place for about half a year (economic activity to fully resume in the fall of 2020)

Case 3: Restrictions on activity in place for about one year (economic activity to fully resume in the spring of 2021)

The International Monetary Fund (IMF) publishes a World Economic Outlook in April and October every year, and its latest report from April includes growth projections in light of the global spread of Covid-19. Our proposal takes the growth projections in the IMF's baseline scenario as our Case 2 above, and we made simple growth estimates for Case 1 (the spread is contained early) and Case 3 (the spread lasts for a long time). Moreover, based on these estimates, we made an outlook on the impact on Japan's employment going forward. In the IMF's baseline scenario, global economic growth is projected at -3% in 2020, with Japan's growth projected at -5.2%.

- 1) Case 1: Restrictions on activity in place for a relatively short period of time

In Case 1, the declaration of the state of emergency and other factors will yield benefits, leading to an early lifting of restrictions on activity; therefore Japan's economic contraction is assumed to be kept at three-quarters of that in Case 2. Meanwhile, in 2021, because the economic decline for this year will be milder, the rebound will be that much milder as well. Accordingly, Japan's economic growth is projected at -3.9% in 2020 and 2.3% in 2021.

With respect to effects on employment, because the spread will be contained in a relatively short period of time, employment adjustment subsidies and other safety-net measures are expected to bear fruit effectively. In that case, both fulltime employment and non-fulltime employment will show a similar level of employment sensitivity to the economy as they did during the 2008 financial crisis (employment elasticity: 0.17), and thus the average unemployment rate for 2020 may rise to around 3.0% (the 2019 average was 2.4%).

2) Case 2: Restrictions on activity in place for about half a year

In Case 2, restrictions are assumed to be in place for three to six months, roughly the same time period as the baseline scenario in the IMF's latest outlook. According to the IMF, Japan's economic growth is projected at -5.2% in 2020 and 3.0% in 2021.

With respect to effects on employment, given that it will take longer for the spread of infection to wind down than in Case 1, non-fulltime employment is expected to be hit particularly hard. Accordingly, supposing roughly the same level of employment sensitivity as in Case 1 (employment elasticity: 0.17) for fulltime but a harsher condition for non-fulltime (employment elasticity: 0.34), the average unemployment rate for 2020 may rise to around 3.6% (the average in 2019 was 2.4%).

3) Case 3: Restrictions on activity in place for about one year

In Case 3, the lockdown will likely last intermittently until mid-2021. In addition to the baseline scenario above, the IMF's latest outlook presents three alternative risk scenarios, including a case where the pandemic lasts longer, and thus Case 3 is closer to the IMF's third risk scenario (a protracted infection plus a second wave). However, Case 3 considered by NRI assumes a shorter time period for containing the spread of infection than in the IMF's risk scenario (instead of all of 2021, until mid-2021). In this case, Japan's economic growth is forecast at -7.8% in 2020 and 1.9% in 2021.

With respect to effects on employment, given that it takes longer to contain the spread of infection, it is thought to be likely that businesses will begin dismissing fulltime workers as well. Assuming that employment sensitivity increases to the level seen during the recession from spring 1997 to early 1999, and employment elasticity rises to 0.30 for fulltime and 0.60 for non-fulltime, the unemployment rate for this year could climb to around 5.6% (the 2019 average was 2.4%).

Based on the three cases above, Japan's economic growth for 2020 is projected at the range of -

7.8% to -3.9% and the 2020 average for Japan's unemployment rate is expected to come between 3.0% and 5.6%.

It should be noted that the unemployment rate above is the average for 2020; in the second half of the year, as the employment environment is expected to deteriorate rapidly, there is a risk that a worse-than-expected level may be recorded.

As estimated above, a protracted spread of Covid-19 will have a serious impact on employment. To minimize this impact, efforts such as full use of employment adjustment subsidies and a government "pledge to preserve jobs" should be made to further reduce employment elasticity and decrease the newly unemployed, as called for by our previous proposal. While the ongoing spread of Covid-19 has already prompted the government to ease the eligibility criteria for employment adjustment subsidies, the system is still criticized for complex procedures that discourage people from using and applying for subsidies. From the standpoint of preserving jobs as well, the system needs to be run in a way that better meets the urgent needs of businesses.

Moreover, if a prolonged crisis makes it difficult for companies themselves to stay afloat, preserving jobs will be that much challenging for business operators. As discussed in the next section, it would seem that measures to keep companies afloat for the purpose of maintaining society will become necessary as well.

■ Need for Support for Keeping Companies Afloat as a Cost of Maintaining Society

As discussed in the previous section, a protracted spread of Covid-19 will have a serious impact on the economy. In particular, if corporate activity itself is restricted or suspended, such as temporary closures due to people staying at home, companies will lose a source of revenue even while continuing to incur personnel costs and other expenses, and this will threaten their survival itself. Industries such as hotel and restaurant operators are already starting to see bankruptcies. If companies become unable to keep going during the stay-at-home period, this will hamper economic rebuilding after the spread of Covid-19 winds down. That is to say, keeping companies afloat during the stay-at-home period translates to maintaining society itself.

The question is: what cost must society bear to enable companies to stay afloat in the event of a prolonged stay-at-home period—in other words, what is the cost that society as a whole needs to cover in some way or another? Let us calculate this amount.

The most easily understood way to ensure corporate survival is "supplementing sales" (a total of 1,535 trillion yen in the 2018 Financial Statements Statistics of Corporations by Industry, which was used for this proposal); but in reality, product procurement and profit are also included. Some industries such as information and communications are less affected by restrictions on activity in terms of sales.

We will suppose that the bare minimum cost for enabling companies going is gross profit (revenue less cost of goods) or major costs (the sum of personnel expenses, interest payments, movable assets and real estate rent income; equals gross profit less the sum of taxes and public charges and operating profit), and

will consider how much of these costs should be covered. Only the industries thought to be hit hard by restrictions on activity will be covered (construction, manufacturing, transportation, wholesale and retail, hotel and restaurant, and lifestyle-related services). Aggregate gross profit of these industries is 268 trillion yen and major costs, 156 trillion yen. These industries also hold 149 trillion yen in cash and cash equivalents.

Using these assumptions, Cases 2 and 3 above will be considered here (Case 1 is assumed to have a limited impact on companies themselves).

It should be noted that our estimates are for the cost of society as a whole, and how to pay for such cost needs to be discussed separately. For instance, possible ideas include using government credit guarantee to pay with long-term, low-burden borrowings and government supplementation of business-preserving cost itself, but specific measures will not be considered under this proposal. Moreover, while a slump in economic activity is anticipated for a certain period of time following a lifting of restrictions, measures for stimulating demand and the like will not be considered by this proposal.

1) Case 2: Restrictions on activity in place for about half a year

For each of the industries expected to be hit hard, the scale of the impact (the proportion of gross profit and major costs requiring supplementation) is projected as follows, taking into consideration projected declines in demand:

Construction, manufacturing, transportation: 20%, wholesale/retail: 10%, hotel/restaurant and lifestyle-related services: 70%

The total impact for the aforementioned industries is projected to be 30 trillion yen in gross profit and 18 trillion yen in major costs. Even if businesses make their own efforts and use a portion of their cash and cash equivalents (excluding one month's worth of revenue for liquidity-securing purposes), 11 trillion yen and 4 trillion yen portions will still need to be supplemented in some way.

Looking at the numbers by industry, even if the restaurant industry uses a portion of cash and cash equivalents (2.7 trillion yen), 1.4 trillion yen in major costs will need to be covered in some manner; however, the manufacturing, lifestyle-related services and other industries will be able to cover their major costs with a portion of their cash and cash equivalents (manufacturing: 59 trillion yen and lifestyle-related services 3.5 trillion yen).

Needless to say, these estimates are industrywide numbers and each company will experience a different degree of impact depending on its unique financial position. Still, if restrictions on activity are lifted after about half a year, so long as a focus is placed on supporting certain industries such as restaurant operators, other industries may be able to handle the impact to a certain degree through individual companies' own efforts, such as tapping of their cash and cash equivalents; this means all we need is bolstered support for financing and other types of indirect support.

2) Case 3: Restrictions on activity in place for about one year

For each of the industries expected to be hit hard, the scale of the impact (the proportion of gross

profit and major cost requiring supplementation) is projected as follows, taking into consideration projected declines in demand. In Case 3, demand is assumed to decline more steeply and the impact more severe than in Case 2.

Construction, manufacturing, transportation: 40%, wholesale/retail: 20%, hotel/restaurant and lifestyle-related services: 100%

The total impact for the aforementioned industries is projected to be 107 trillion yen in gross profit and 65 trillion yen in major costs. As in Case 2, even if businesses make their own efforts and use a portion of their cash and cash equivalents, 61 trillion yen and 25 trillion yen portions will still need to be supplemented in some way.

Looking at the numbers by industry, the retail and restaurant industries will be unable to cover major costs by use of a portion of their cash and cash equivalents (retail: 16 trillion yen, restaurant: 2.7 trillion yen), and 24.8 trillion yen and 2.2 trillion yen, respectively, will have to be supplemented in some manner. Moreover, to cover major costs, even the manufacturing industry will have to use most of its cash and cash equivalents (59 trillion yen) after setting aside a portion for liquidity-securing purposes.

As described above, if the restrictions on activity remain in place for a prolonged period of time such as about one year, the risk increases that businesses will be unable to pay for their major costs through their own efforts, which means that there will be a need to consider how society as a whole should cover this cost.

It will be necessary to provide not only financing and other types of indirect support but also provide longer and lower-cost financing. This will require such measures as creation of a fund in the scale of tens of trillions of yen, mainly contributed by the government.

As discussed above, in the event of a protracted Covid-19 crisis, up to tens of trillions of yen will be required to keep businesses afloat as a cost of maintaining society. The assumption here is that repayment of loans is suspended during the period of restrictions on activity, and after such restrictions are lifted businesses will need to make repayments in addition to repay the cost of keeping them afloat; because of this, repayment conditions need to be modified and/or repayments suspended altogether, and government support will be needed in this respect as well.

■ Digital investments in Social Capital for Ensuring “Safety of All Citizens” and “Maintaining Functions of Society”

Since the outbreak of Covid-19, people have been actively discussing digitization of economic and social activities, including teleworking, telemedicine and online learning.

As predictions point to another Covid-19 outbreak and frequent occurrences of natural disasters and other emergency situations going forward, many people must now recognize that in order to continue a certain level of daily life as members of society even in an emergency situation, greater information technology

adoption and greater digitization of economic and social activities are critical. A particular focus should be placed on information technology and digitization investments in social capital that directly helps maintain functions of society.

After the government asked essential businesses and services such as grocery stores, pharmacies and banks to continue operating even under the state of emergency, it became clear that people who work in industries related to functions of society face high risks in supporting preservation of Japan's social functions.

IT investments must be promoted in different fields, not only from the existing perspective of enhancing efficiency to address the labor shortage, but also from the standpoint of maintaining functions of society in an emergency situation like the current one and securing safety of workers who help maintain such functions. For instance, deployment of self-checkout machines and cleaning robots at retailers, introduction of unmanned stores and online stores, use of IT for monitoring and well-being management at nursing and childcare facilities, and moving administrative procedures online will all lead to lower risks for both workers and users.

The government must bolster its support for IT investments in social capital that directly helps maintain functions of our society, and even amid the ongoing emergency, it must swiftly launch efforts to build a country that ensures safety of all citizens while also maintaining functions of society to the extent possible.

■ **Conclusion: Anticipating Irreversible Changes, Make Best Efforts to Maintain Society**

A prolonged spread of Covid-19 has brought on, and will continue bringing on, irreversible changes. The world as we know it will never be the same. At the risk of repeating ourselves, we emphasize that what we need to do is first understand anticipated changes and then boldly take proper action in advance. We need to make our utmost effort to maintain our society, especially if we want to build an even better society in a post-Covid-19 world.

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<https://www.nri.com/en/keyword/proposal>

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