



# Japan in the World

Toward the next step: Japan has started tackling longer-term economic challenges

January 2016

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# We forecast y-y unchanged growth rate for global economy in 2016

Real GDP growth forecasts for major countries in 2014–16 (%)

Area	2014	2015	2016
Global	3.4	3.1	3.2
Developed	1.7	1.9	1.8
Emerging Markets	4.8	4.2	4.3
United States	2.4	2.5	2.2
Euro area	0.9	1.5	1.4
Japan	0.0	0.6	1.2
United Kingdom	2.9	2.4	2.5
Australia	2.7	2.3	2.4
China	7.3	6.8	5.8
India	7.1	7.3	7.8
South Korea	3.3	2.5	2.5
ASEAN5	4.3	4.1	4.2
Latin America	0.9	-0.2	0.4
EEMEA	1.6	-0.1	1.0

We think that 2016 will see the global economy's normalization process becoming full-fledged. We expect downsizing of the monetary easing measures implemented in many regions following the global financial crisis during 2008–09, with the US having taken the lead by hiking interest rates in December 2015. Nevertheless, we forecast stronger progress with economic recovery in regions that have seen persistent economic weakness, such as the eurozone. We project economic growth rates broadly unchanged y-y in both advanced and emerging economies.

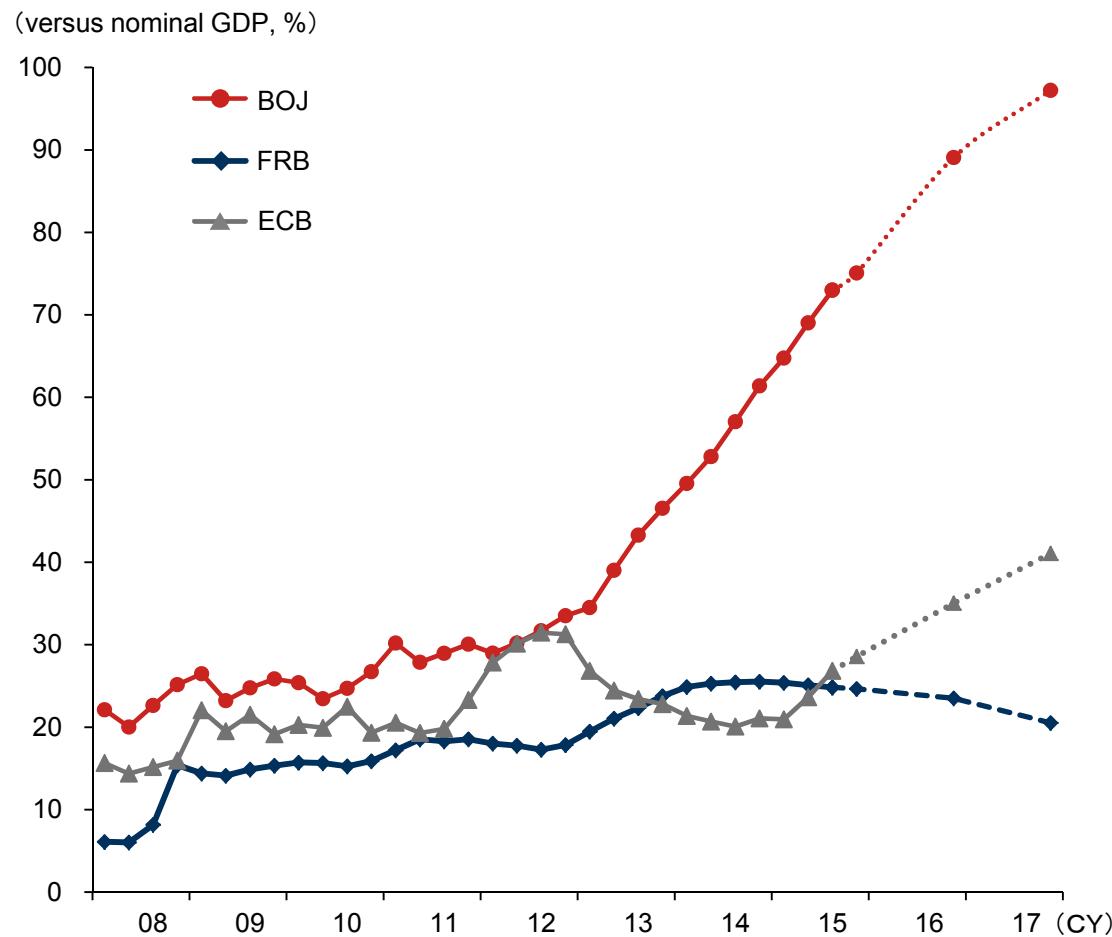
We forecast that the US economy's growth rate will slow from 2.5% in 2015 to 2.2%, but we think that it will continue to drive global economic growth. We forecast that a relatively high growth rate will continue in the eurozone. We project growth acceleration in Japan driven by domestic demand in the form of consumer spending and capital investment. We estimate 1.5% growth y-y in FY16.

Economic deterioration is halting in emerging economies, and we forecast broadly unchanged or slightly higher y-y growth rates during 2016 except in China. We think that China's growth rate will be depressed to slightly under 6% due to a slowdown in the manufacturing industry accompanying such factors as a decline in real estate investment.

Note : (1) EEMEA = European emerging economies, Middle East, and Africa. ASEAN5 = Indonesia, Thailand, Malaysia, the Philippines, Singapore. (2) Figures are weighted averages, based on each country's share of global GDP (purchasing power parity basis). (3) As of 21 December 2015.

# US is in monetary tightening phase, but strong monetary easing is continuing in Japan and Europe

## Total assets at central banks in Western nations and Japan



In the US, the Fed hiked interest rates in December 2015 for the first time in roughly 10 years, representing a major step forward toward the normalization of monetary policy. Assuming a gradual slowdown in the US economic growth rate during 2016, we think that rate hikes will continue at a pace of one hike per half year.

In contrast, we think that strong monetary easing will continue in Japan and Europe. In December 2015, the ECB decided to extend its asset purchasing program, and cut the deposit interest rate. We now expect it will maintain easing measures with the aim of allaying concerns over deflation.

Turning to Japan, we think that the BOJ will maintain its current quantitative and qualitative easing measures. We forecast that the BOJ will expand its value of equity ETF and other risk asset purchasing by end-2016, with the aim of driving up inflation expectations.

Note : (1) Quarterly data, as at end of term. (2) Figures from end-2015 are Nomura estimates/forecasts.

Source : ECB, Fed, BOJ, Nomura

# Leading global currencies have depreciated substantially against dollar, in both advanced and emerging economies

## Forex rate versus dollar for leading regions



The currencies of many leading economies depreciated substantially versus the dollar during 2015, triggered by monetary policy in the US starting to move in the opposite direction to other advanced economies.

Meanwhile, most emerging economy currencies also depreciated versus the dollar as US interest rate hikes came into view. Further declines versus the dollar for the currencies of resource-producing nations were prompted by current account deterioration stemming from lower export prices for primary goods.

The depreciation of non-US advanced economy currencies has halted, but emerging economy currencies have continued their decline trend. We now think that emerging economy currencies will gradually stabilize. Nevertheless, we recommend bearing in mind that frequent rate hikes by the US over a short period could create risk of greater-than-expected declines in emerging economy currencies versus the dollar.

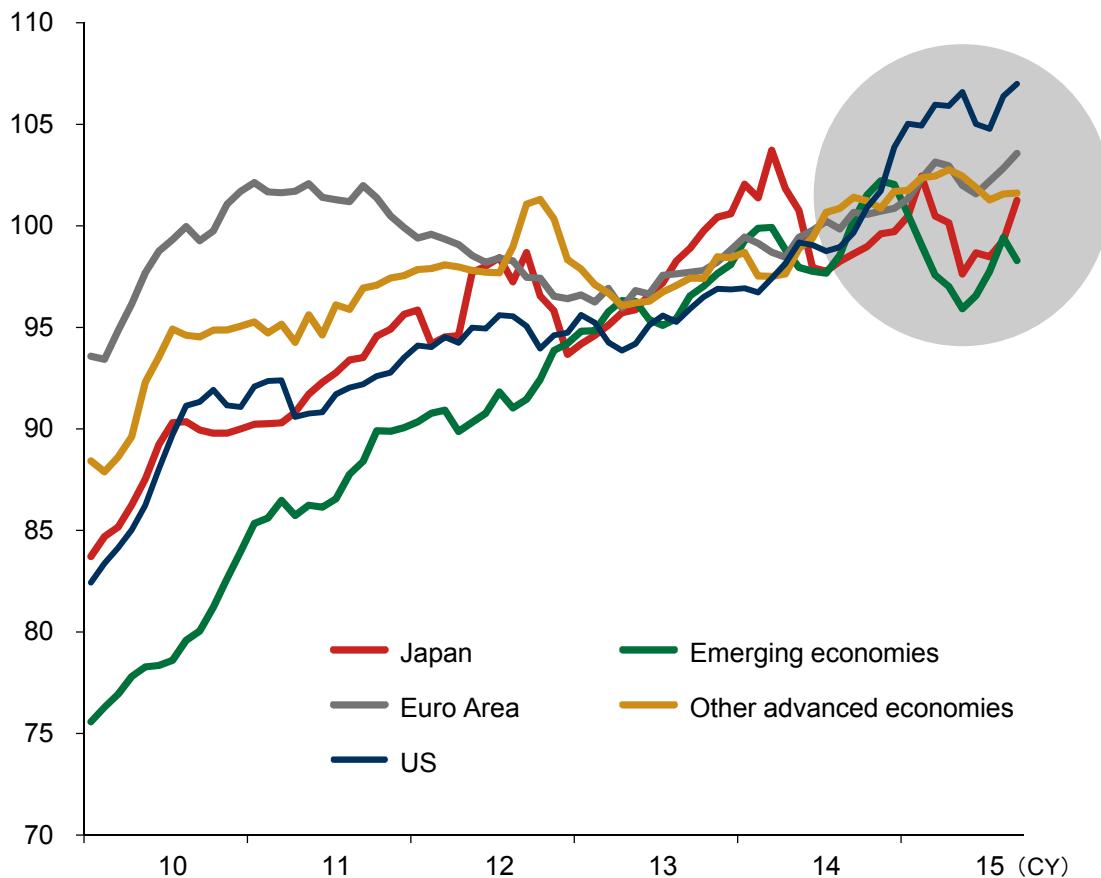
Note : (1) "Emerging economies/regions ex China" is GDP-weighted average forex rate versus dollar of 29 nations/regions. (2) "Advanced nations ex US" is GDP-weighted average forex rate versus dollar of 9 nations.

Source : Nomura

# Real imports fell temporarily around the world, but signs of recovery have recently strengthened

## Real imports in leading global regions

(Converted to index values based on 2014 average = 100)



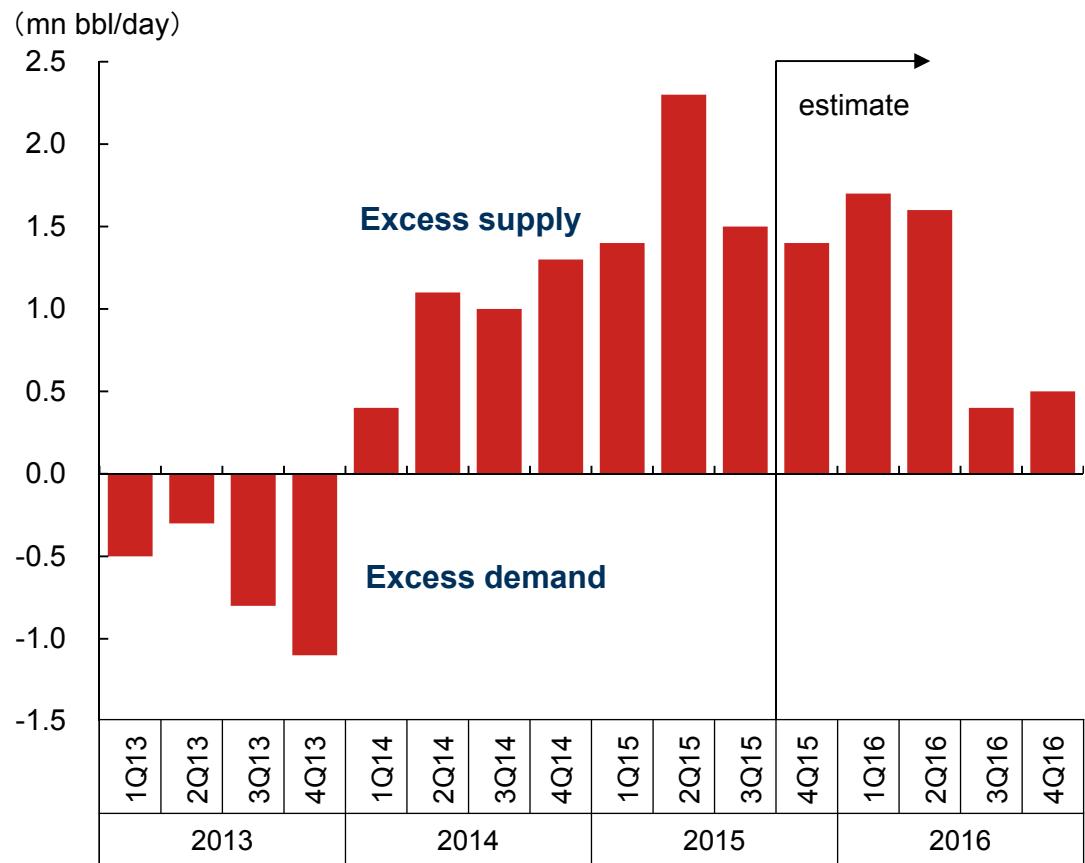
Currency depreciation generally has positive economic effects, but the depreciation of many currencies versus the dollar had an unexpectedly negative impact on the global economy. Global trade is overwhelmingly conducted on a dollar basis, with some observers estimating that dollar-basis transactions make up around 80% of the total. The economies that saw currency depreciation versus the dollar experienced a decline in their dollar-basis purchasing power, and their real imports fell temporarily. In the US, furthermore, the manufacturing industry was negatively affected by the dollar's appreciation.

Given also China's reduction of primary goods imports, real imports declined in global terms during Apr–Jun 2015.

Conditions normalized as the global economy adapted to currency depreciation versus the dollar, however, and over the past few months real imports have started to expand again in nearly all regions, and global trade has returned to a growth track.

# Crude oil price: we see short-term decline scope, but expect increase over longer term

## Global supply surplus in crude oil



The global economy benefited from low-priced crude oil during 2015. Low-priced crude oil boosted consumers' real purchasing power in the Western advanced economies, thereby contributing to the strong expansion in consumer spending principally on durable consumer goods. We think that these positive effects will continue at least through 2016 H1.

The price of North Sea Brent crude fell to the \$35–39/bbl level in late December 2015. This level is lower than production costs for many offshore oil fields and shale oil fields, and new investment in drilling for oil and other activities has consequently tended to decline globally. We think that the crude oil price will gradually rise over the medium term, owing to the resulting decline in crude oil supply.

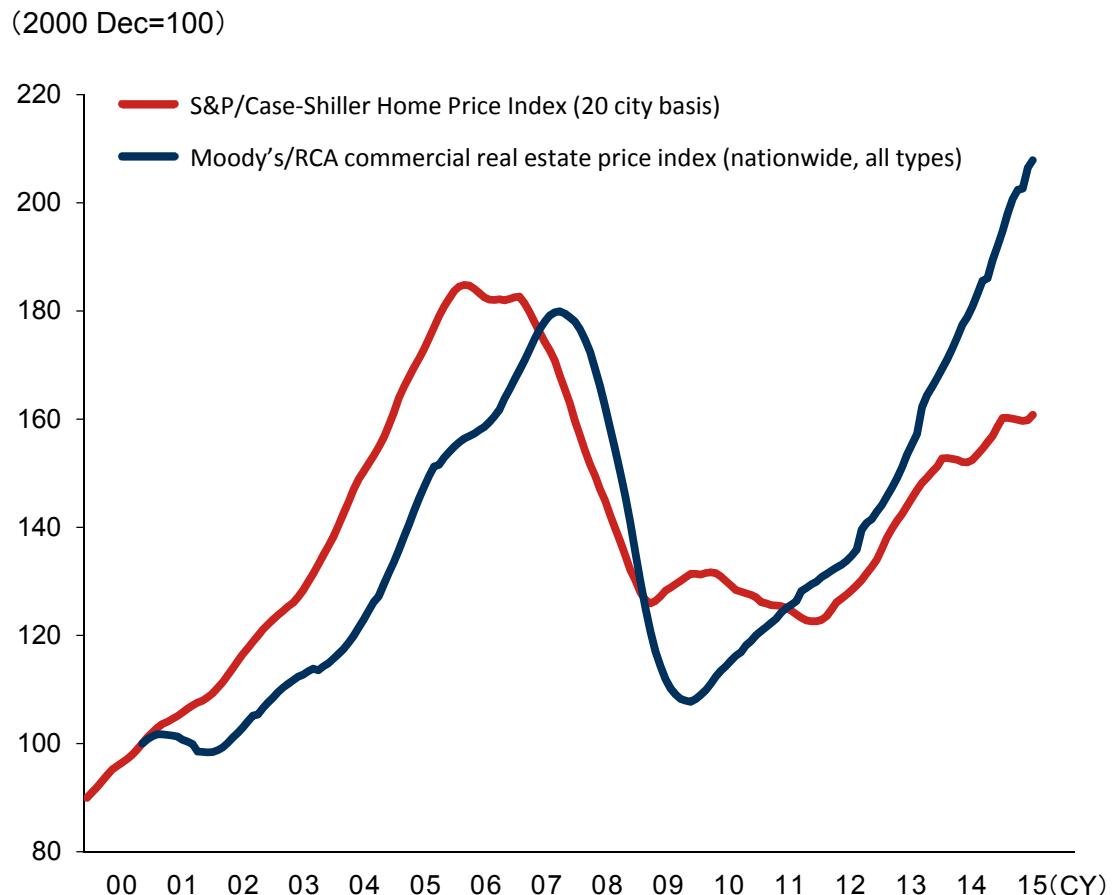
We do not think that the crude oil price will clearly tend to rise before 2016 H2, however, given the prospects for higher crude oil production in Iran during 2016 H1. A higher crude oil price should be beneficial for crude oil producing economies such as Russia and the Middle East. America lifted its ban on crude oil exports at end-2015, furthermore, but we do not expect a major impact on global supply-demand conditions for crude oil, with only minor effects on the crude oil price.

Note : (1) Actual values are as calculated by International Energy Agency (IEA). (2) Estimates are based on IEA projections for non-OPEC crude oil production and demand; assumes OPEC ex Iran crude oil production is unchanged from IEA estimate for Jul–Sep 2015 average. (3) Iran estimates assume expansion of daily production by 500,000bbl in Jan–Mar 2016, and a further 200,000bbl in Apr–Jun.

Source : IEA, estimates by Nomura

# US economy continues to drive global economy

## US: real estate prices for residential and commercial districts



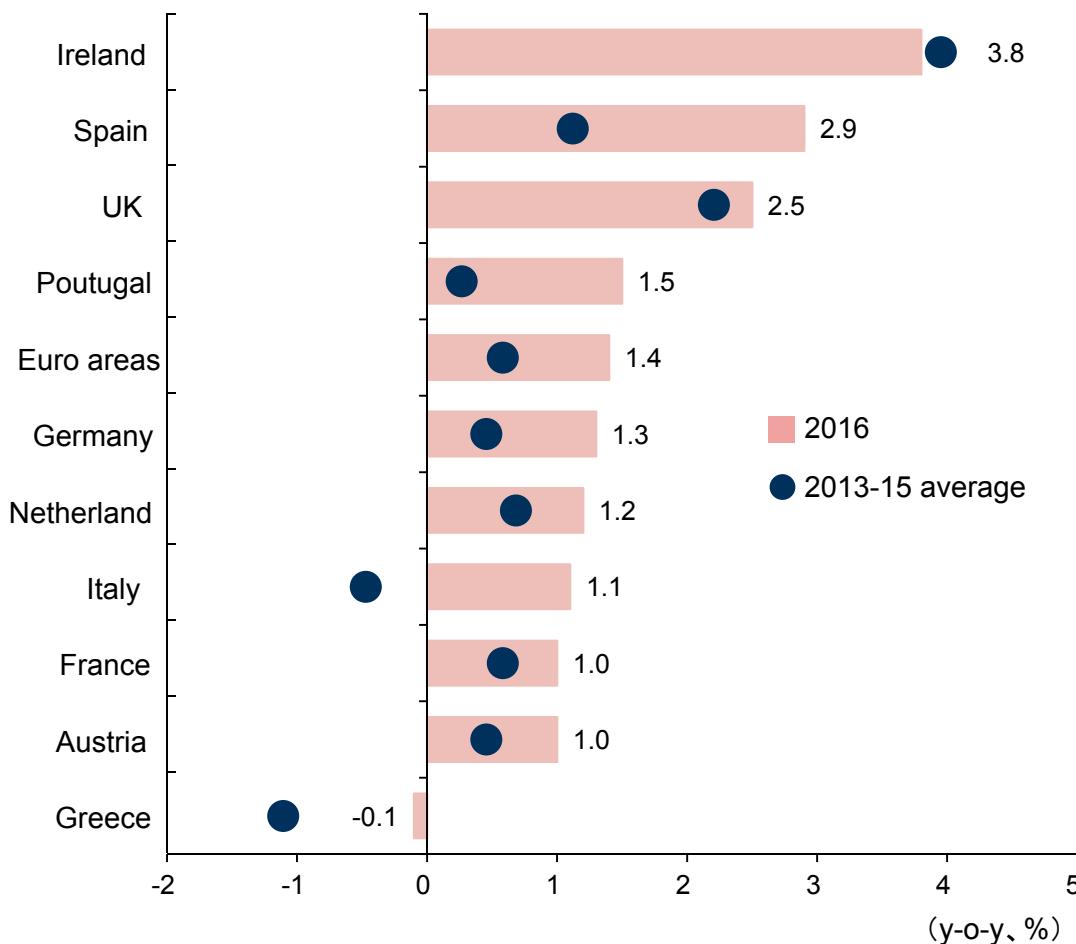
We estimate that the US latent growth rate has fallen more than we had previously expected, to around 1.5%, due to slower growth in US labor productivity and the labor force. The growth rate has also been restricted by US monetary policy starting to move toward normalization after having previously helped to boost the economy. We still think that the US will drive the global economy during 2016, however, as we estimate that consumer spending will maintain relatively strong growth of 2.7%, while capex growth reaches 4.4%.

Meanwhile, we think that the real estate market will hold up well for both residential and commercial districts. The growth rate in residential real estate prices has been slowing, but an upward trend has been maintained. We project that real estate price growth will contribute to expansion in consumer spending via the wealth effect.

Concerns have been raised over weak performance by some high-yield bond investment trusts, but this reflects substantial investment in the bonds of energy related companies with low credit ratings at the investment trusts in question. We do not think that this development will have negative effects on the financial system or the economy.

# Eurozone economies still face risk but we expect stabilization in relative terms

Real GDP growth in Eurozone nations and UK



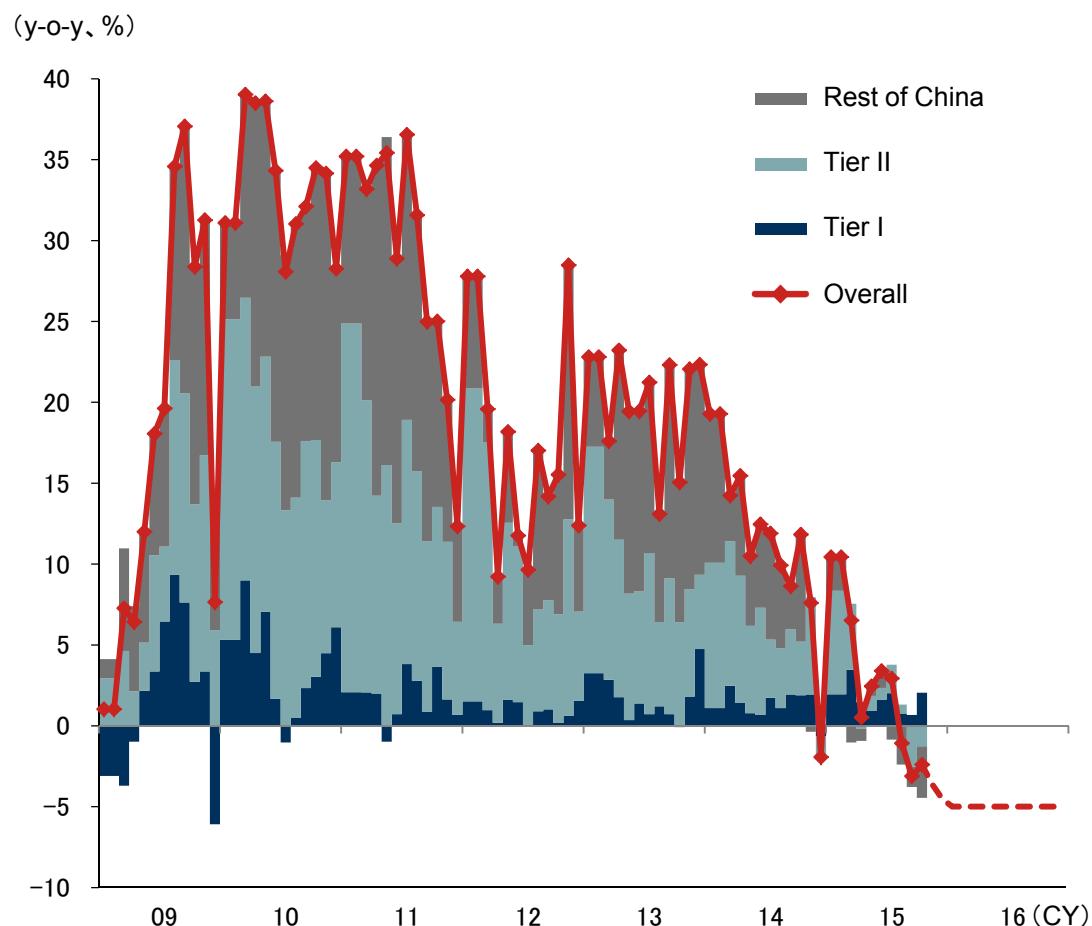
The eurozone economy has been making progress in bottoming out. The euro depreciation caused by the ECB's monetary easing has been positive for exports. The phase of negative economic effects from fiscal austerity has also ended, with the depressing of economic growth by fiscal measures fading away. In 2016, we forecast that growth rates in many countries will exceed the average over the past three years.

Nevertheless, we do not think that restructuring measures in Europe have made enough progress. Debt problems have also persisted to an extent, mainly in southern Europe. Growth rate divergence has consequently continued in Europe, and we expect disinflation pressure will continue. We think these factors could encourage the ECB to implement further monetary easing.

Over the medium term, we focus on the emergence of doubts over the existing framework for European integration. Thorny problems have also emerged, such as the refugee crisis. We identify a need to pay attention to political developments.

# Decline in real estate investment in second-tier and lower-ranked Chinese cities

## China: real estate investment growth



The Chinese economy has been transitioning to a “new normal” state. Given the difficulty of economic support via large-scale fiscal spending over the long term, China is currently in a transition phase from an investment-led economy to a consumption-led economy.

We think that the real estate market will determine how China’s economy fares during 2016. Real estate investment is equivalent to just under 20% of GDP. Investment in first-tier cities has returned to a growth trend owing to the rapid implementation of various forms of deregulation, and monetary easing. Nevertheless, smaller cities still face the problem of excessive investment. We think that real estate investment will fall 5ppt y-y during 2016, and that this will depress the real GDP growth rate to just under 6%.

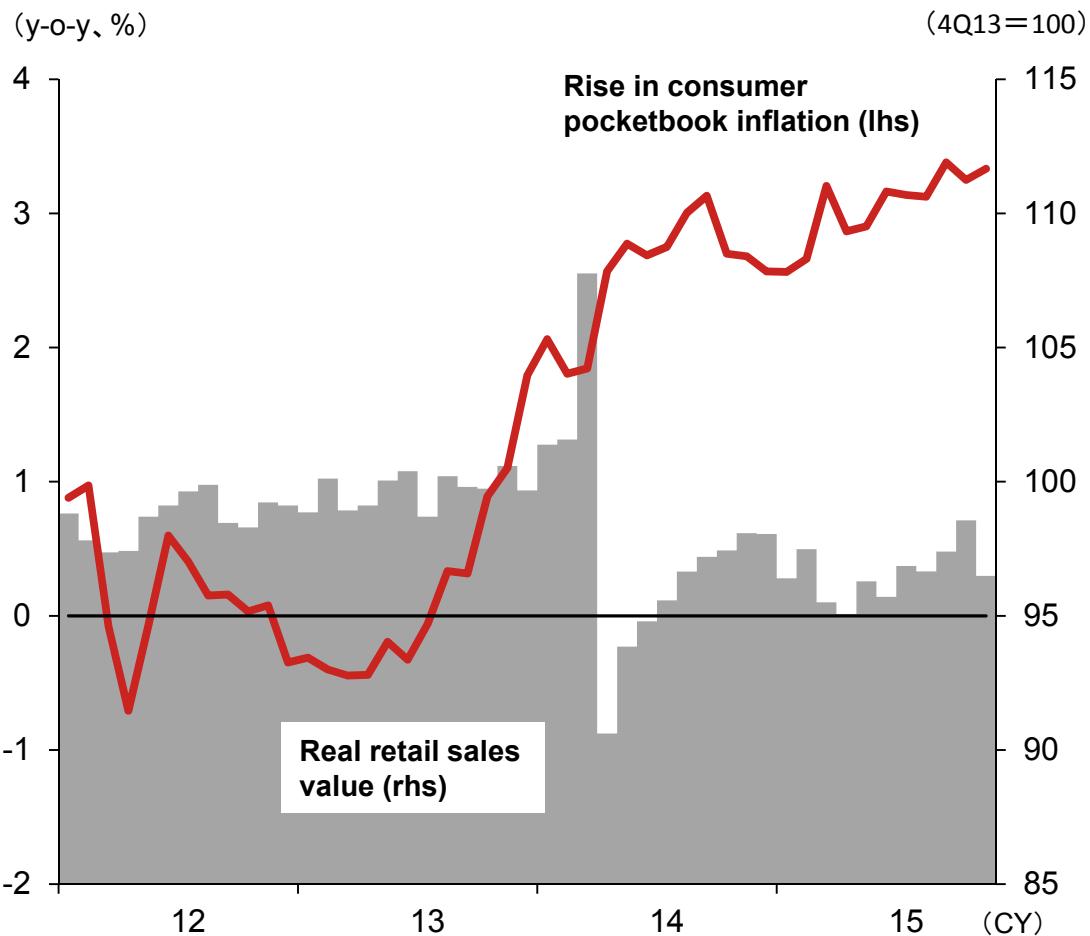
The Xi Jinping administration has decided on a policy of aiming for at least 6.5% average growth during the 13th five-year plan (2016–20). However, we think real growth of 6.5% will be difficult to achieve in 2016 without large-scale measures in terms of both monetary and fiscal policy. As in 2015, we think attention will focus on policy developments in China during 2016.

Note : Estimates from November 2015 are by Nomura.

Source : CEIC Data, Nomura

# Restrained consumer spending in Japan due to perceptions of higher inflation

## Japan: real retail sales value and consumer “pocketbook inflation”



Japanese consumer spending growth was weak during 2015, confounding the projections of many specialists. We attribute the only limited improvement in consumer spending to inflation as perceived by consumers rising relatively substantially. We estimate that consumer “pocketbook inflation” has recently been above 3% y-y, when considering the rate for foods that consumers purchase relatively frequently, combined with the effective price hikes implemented by companies introducing new products. This contrasts with the most recent core inflation rate (ex fresh food) for consumer goods of close to 0% y-y. We think this factor led to deterioration in consumer sentiment.

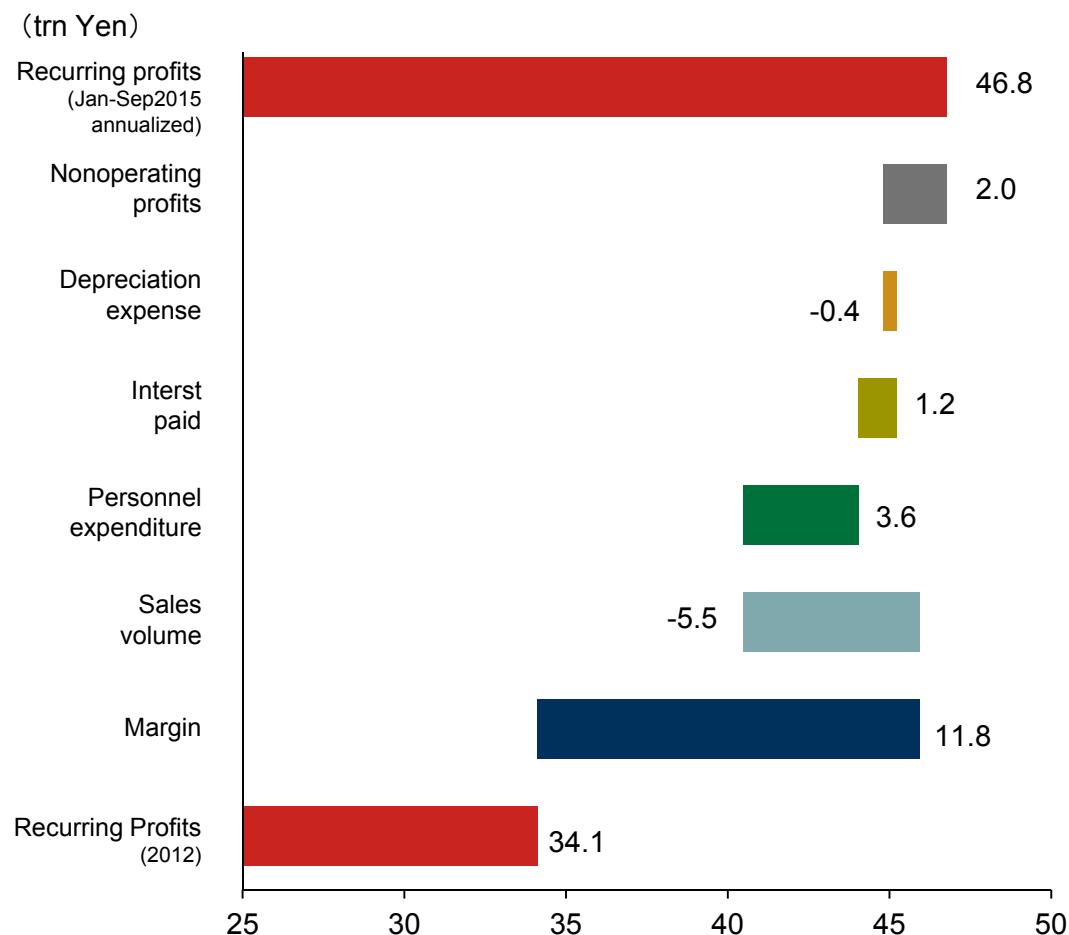
We now only expect limited hiking of food prices, however, and forecast a near-term decline in perceived inflation. We also project steady improvement in income conditions during 2016, stemming from such factors as higher increases in base pay than during 2015. We thus forecast gradual expansion in real-term consumer spending.

Note : (1) Consumer pocketbook inflation = food price inflation + (SRI-Hitotsubashi Unit Value Price Index growth rate – SRI-Hitotsubashi Consumer-purchase Price Index growth rate). (2) SRI-Hitotsubashi Unit Value Price Index includes new goods. (3) SRI-Hitotsubashi Consumer-purchase Price Index only covers existing goods (excludes new goods). (4) Both indices exclude cigarettes. (5) Food price inflation is based on core CPI component. (6) Excludes effects from consumption tax hike.

Source : METI, MIC, SRI-Hitotsubashi Consumer Purchase Indices, Nomura

# Nonmanufacturing sector profits have improved substantially since Abenomics started

## Japan: breakdown of recurring profit growth at nonmanufacturers since Abenomics started



Nonmanufacturing sector profit margins have improved substantially since Abenomics started, thereby driving the setting of new record highs for recurring profits. Within the Financial Statements Statistics of Corporations by Industry, the nonmanufacturing sector's recurring profits in Japan expanded from ¥34.1trn in 2012 (before Abenomics started) to ¥46.8trn annualized during Jan–Sep 2015.

Within nonmanufacturing, profits improved markedly in sectors where personnel shortages have become a major problem, such as construction, real estate, and services in a narrow sense. We see this as indicating that supply restrictions have strengthened the price-setting power of nonmanufacturing companies.

We now think that labor shortages will become more severe, but if companies use their higher profits to steadily expand capex we think it will lead to improvement of the Japanese economy's growth prospects via strengthening of supply capacity.

# We project gradual expansion in Japanese exports, thereby boosting corporate earnings

## Japan: real exports



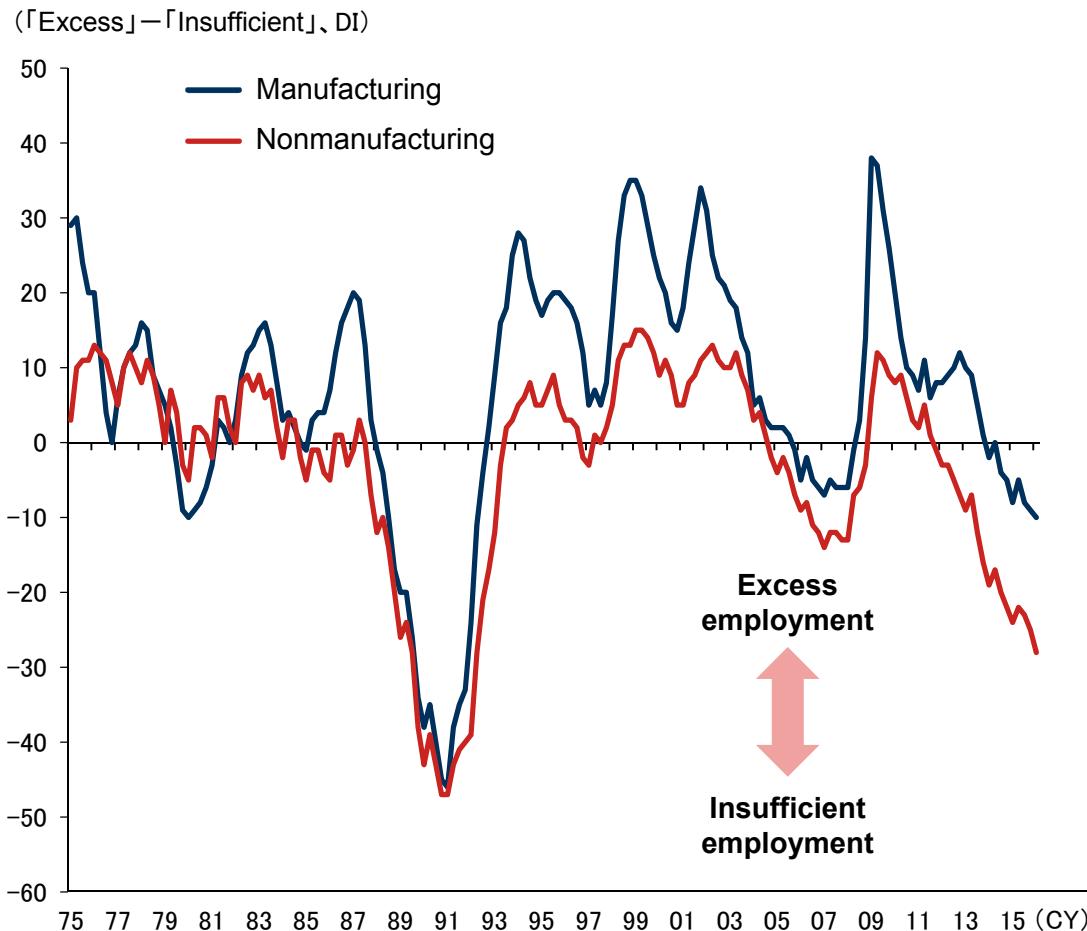
Turning to manufacturing companies, the Financial Statements Statistics of Corporations by Industry also show recurring profits approaching record high levels. We now think that export growth will help to underpin business conditions. Japan's real exports expanded for a time from fall 2014, before declining in Apr–Jun 2015 and then returning to a growth track from Jul–Sep.

Regarding the outlook, we see expected gradual improvement in external conditions as an important factor. We also expect a boost to exports from the dollar-yen rate, since we forecast yen depreciation to \$1/¥130 by end-2016 mainly as a result of monetary policy in Japan and the US working in opposite directions. In overall terms, we think that real exports will maintain a gradual improvement trend.

Based on our analysts' forecasts, recurring profit growth at the companies in the Russell/Nomura Large Cap Index (ex financials; includes both manufacturing and nonmanufacturing companies) will reach 13.5% y-y in FY15, and then maintain relatively strong growth of 8.0% in FY16.

# We think measures to cope with labor shortages will become more important

## Japan: employment conditions DI by sector (all companies) in BOJ Tankan survey



Note : Most recent data are forward conditions DIs from December 2015 survey.  
Source : BOJ, Nomura

Japan's inflation rate reached its lowest level since July 1995 of 3.1% in October 2015. Looking also at the employment conditions DI in the BOJ's Tankan survey, an eye-catchingly large number of companies face labor shortages, with this becoming a particularly severe problem for nonmanufacturing companies.

While we expect gradual expansion in the Japanese economy, we see its greatest challenge as how to fundamentally resolve the supply restrictions stemming from labor shortages. Many companies face a labor shortage, but given the limited prospects for labor force growth we see a need for improvement of productivity, and for targeting of a virtuous circle whereby income is used for consumption and investment.

We spotlight the likes of artificial intelligence and the Internet of Things (IoT) as new technology with the potential to drive up productivity. We would expect a negative social reaction from the use of such technology in countries with a high unemployment rate, but given Japan's labor shortage problem we think such new technology would be welcomed. We see good prospects for productivity improving owing to the aggressive adoption of new technology.

# We see strengthening of growth prospects as key for Japan's economic outlook

## Measures we expect

Steady implementation of new three arrows aimed at realizing society in which all citizens are dynamically engaged

Further regulatory reform

Proactive efforts to establish economic alliances such as TPP, Japan-China-Korea FTA, Asian Regional Comprehensive Economic Partnership (RCEP), and Japan-Europe EPA

Various reforms aimed at achieving highly flexible labor market

Greater acceptance of foreign workers

Lowering of corporation tax rate to level of that in most Asian countries (25%)

Improvement of laws and regulations aimed at driving up productivity

- Regarding IoT, improvement of laws and regulations in areas including proprietary rights and privacy
- Formulation of next-generation standards for communications and internet, improvement of high-speed communications environment

Convincing efforts aimed at fiscal reconstruction

We think that Abenomics has played an important role in enabling the Japanese economy to escape from deflation, via monetary easing of a different dimension, aggressive fiscal spending, and the government's growth strategy. The Abe administration's new "three arrows" now target nominal GDP of ¥600trn, a birthrate of 1.8, and no one being forced to leave their job in order to provide nursing care, with the aim of realizing a society in which all citizens are dynamically engaged. We see these new targets as building on the near-term success of Abenomics thus far, and being designed to tackle the longer-term challenges faced by Japan's economy.

We think that strengthening of Japan's longer-term growth prospects will also require various reforms aimed at achieving a highly flexible labor market, and more acceptance of foreign workers. Furthermore, we see good prospects for creation of the right conditions to enable the active adoption of new technology such as the IoT and artificial intelligence. We think that steady progress in such government policies would deepen the confidence of corporate managers in the future, and improve the prospects for a virtuous circle being created via higher capex and wage increases.

We expect that the key factor influencing Japan's economic prospects will be how the government and the corporate sector tackle the obstacles in the way of strengthening the country's growth outlook.

# Biography

## NOMURA GLOBAL ECONOMICS



### Tomo Kinoshita

Chief Economist, Japan

Tomo Kinoshita is the Chief Economist of Nomura Securities Co., based in Tokyo. He provides in-depth analysis on Japan's economy from various perspectives including monetary and fiscal policies, industrial structure and politics. Mr. Kinoshita's viewpoints are truly Pan-Asian, acquired through his 15 years of experience in economic research in Asia. Prior to his current assignment, he covered Asian economies for 15 years including China, India, Hong Kong, Taiwan, Korea and ASEAN, having been stationed in Singapore for five years and Hong Kong for nearly six years.

Known for his accurate economic forecast, he correctly forecast the positive impact of Abenomics on Japan's economy at its early stages. His growth forecast on China was one of the most accurate when he was based in Hong Kong. His views are frequently aired by various TV programs and newspapers, including Financial Times, Wall Street Journal, Nikkei, TV Tokyo and NHK.

Mr. Kinoshita also has extensive research management experience. In 2000, he became the Head of Asian Economic Research at the Nomura Research Institute based in Tokyo before he moved to Singapore to manage the Economic Research Division at Nomura Research Institute Singapore. In 2005, he became Chief Economist for Asia and Head of Asia Economic Research at Nomura Singapore. He moved to Nomura's Hong Kong office in 2007 to hold the same position until early 2009, following which he managed the team as the Deputy Head of Economics, Asia ex-Japan.

Mr. Kinoshita received his Masters degree in Economics from Northwestern University and a Bachelor of Economics degree from Kyoto University. He also engaged in political analysis when he was at the Washington, D.C., office of Nomura Research Institute America during 1990-1993 and 1996-1997. In 1995, he worked for the World Bank as a Consultant to the Financial Sector Development Department.

# Appendix A-1

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