

**NOMURA**

*Connecting Markets East & West*



# **Japan in the World**

**Hopes and Concerns for the Era of Asian Economies**

**January 2019**

# Japan in the World

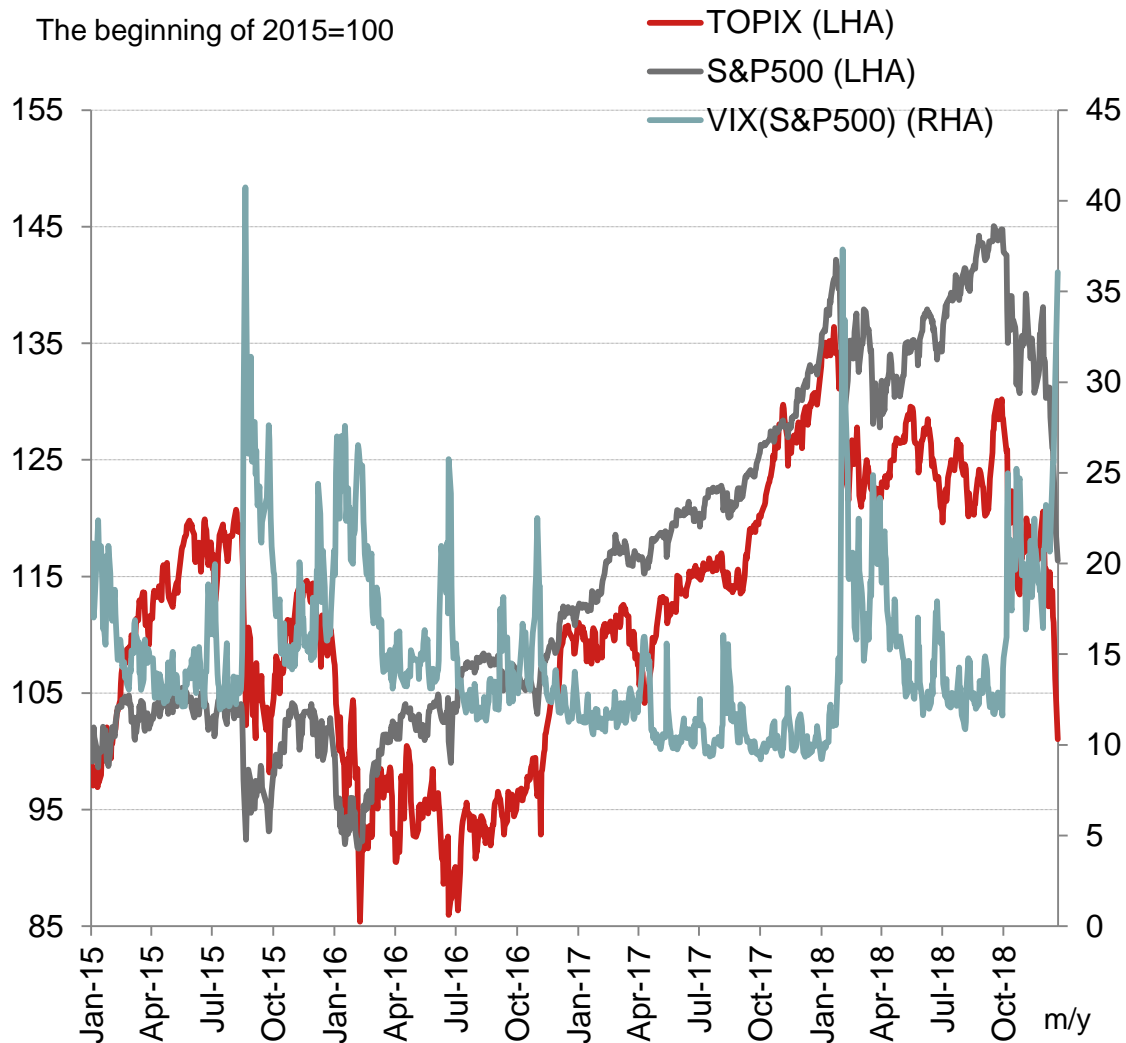
## Hopes and Concerns for the Era of Asian Economies

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

# Turbulent global equity markets amidst historical highs

## Stock price index and volatility



Global equity markets in 2018 experienced several significant adjustments along with sudden spikes in volatility, contrasting with relatively calm and bullish markets in 2017.

## Stock index in emerging markets and USD

December 31, 1987 = 100

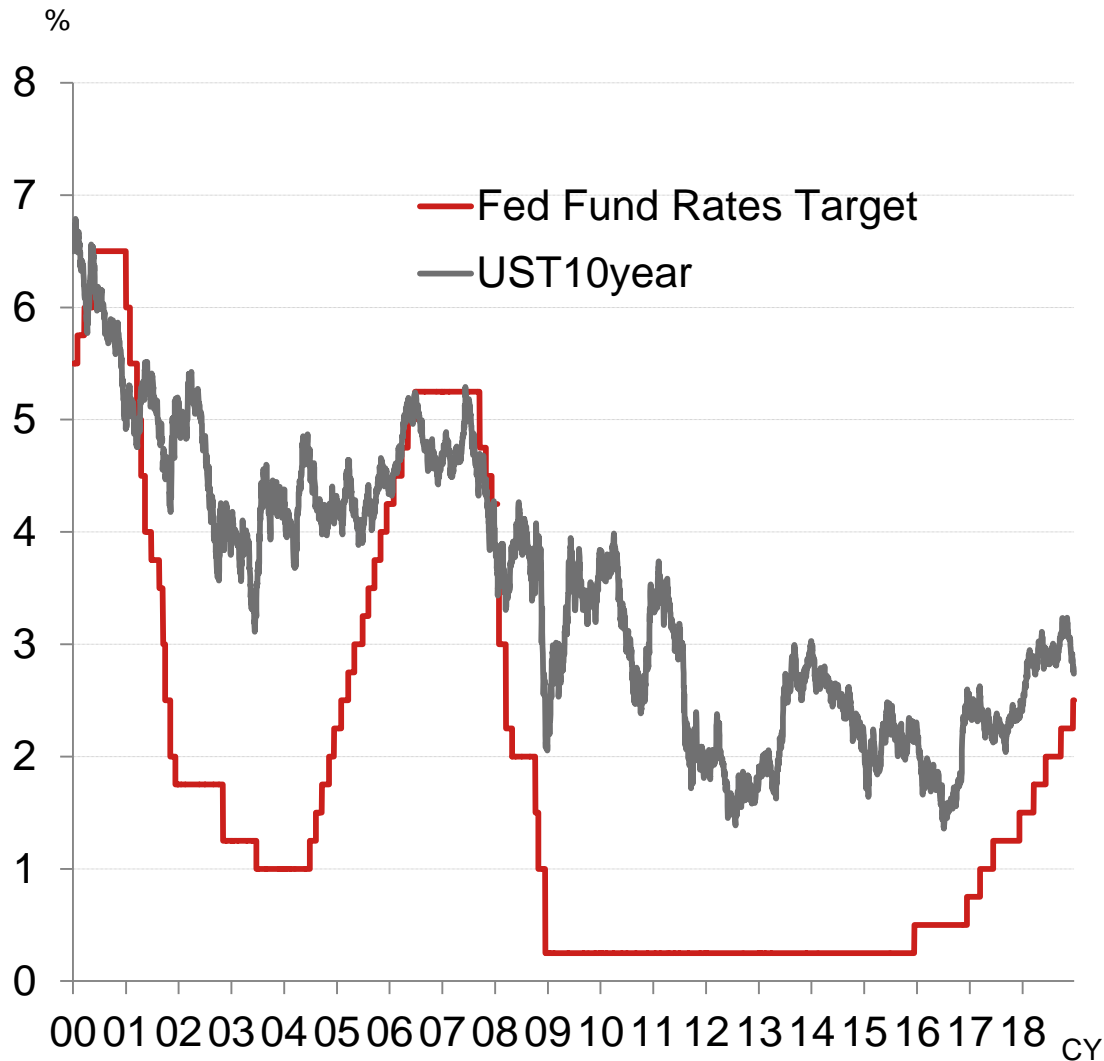


The change in emerging markets in 2018 was more profound than that seen in financial markets in developed economies.

Adjustments in equity markets as well as high yield bond markets continued throughout the year, and capital outflow brought about depreciation of emerging currencies.

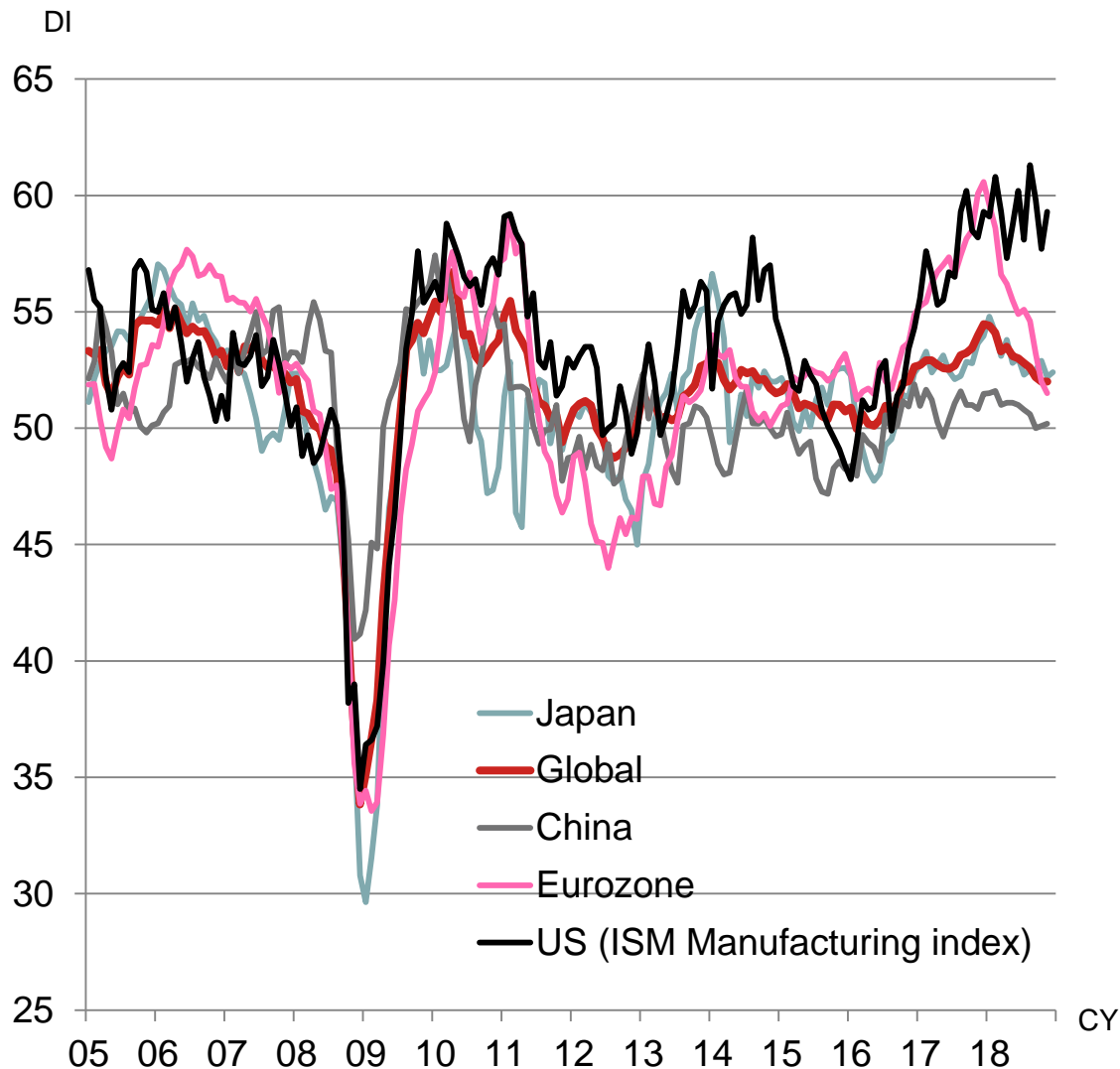
Appreciation of the US dollar against emerging currencies destabilized markets further, raising concerns about a default of the foreign currency denominated debt of emerging economies.

## US policy rate and 10y Treasury yield



One of the major reasons behind the significant instability of global financial markets in 2018 was a change in US rates market conditions; long term yields shifted upwards materially as the US Federal Reserve continued to raise rates.

## Manufacturing PMI in major economies



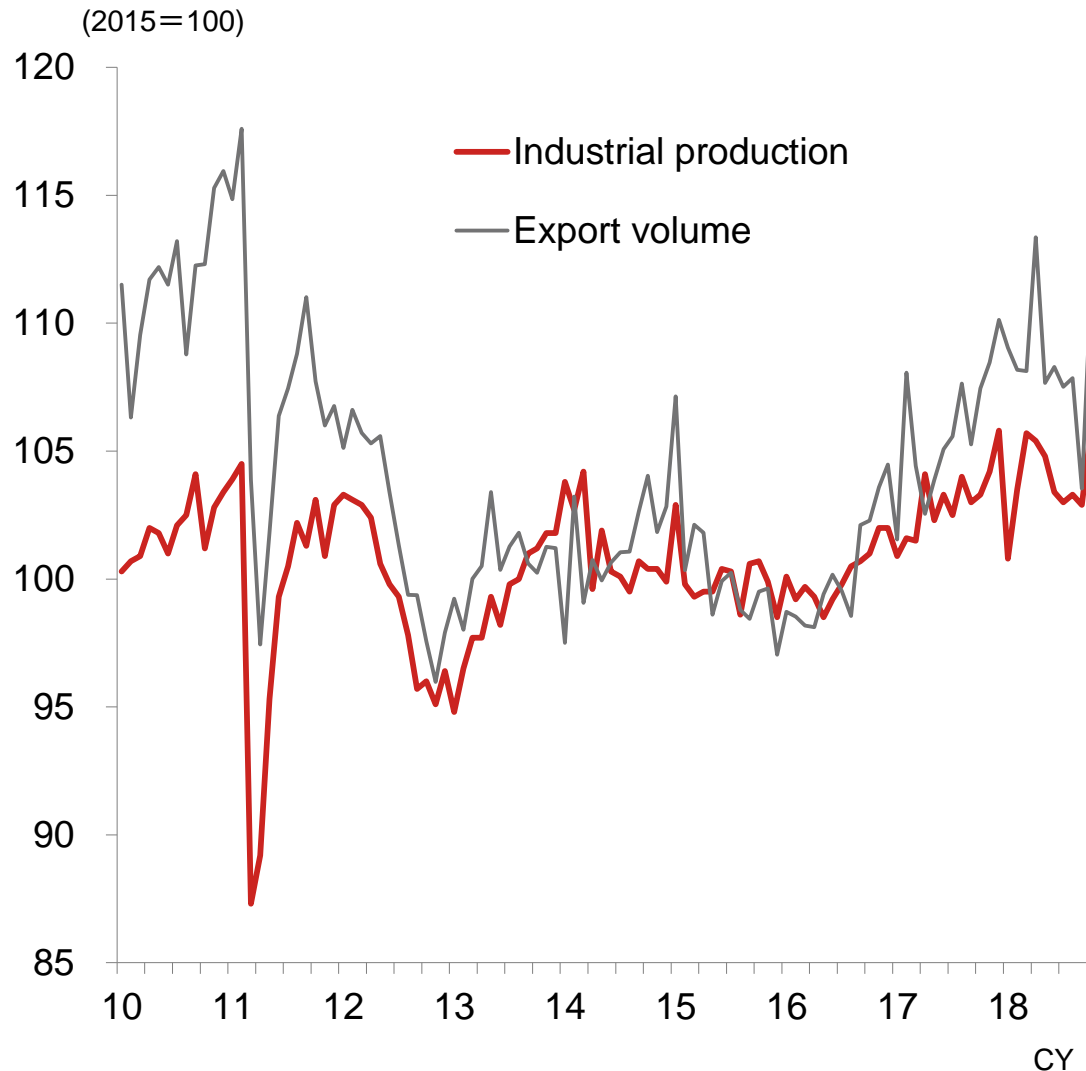
Higher US rates destabilized markets due to concerns that global economic fundamentals may not endure higher rates.

The global economy is already in a cyclical slowdown phase and it is becoming clear that economic activities in major economies other than the US are losing momentum.

Even the US economy is likely to start decelerating as it becomes difficult for the Trump administration to maintain various fiscal measures such as tax cuts and infrastructure spending under the divided Congress formed through the mid-term elections in November 2018.

# Decelerating Japanese exports and production activity of manufacturers

## Industrial production and export volume in Japan

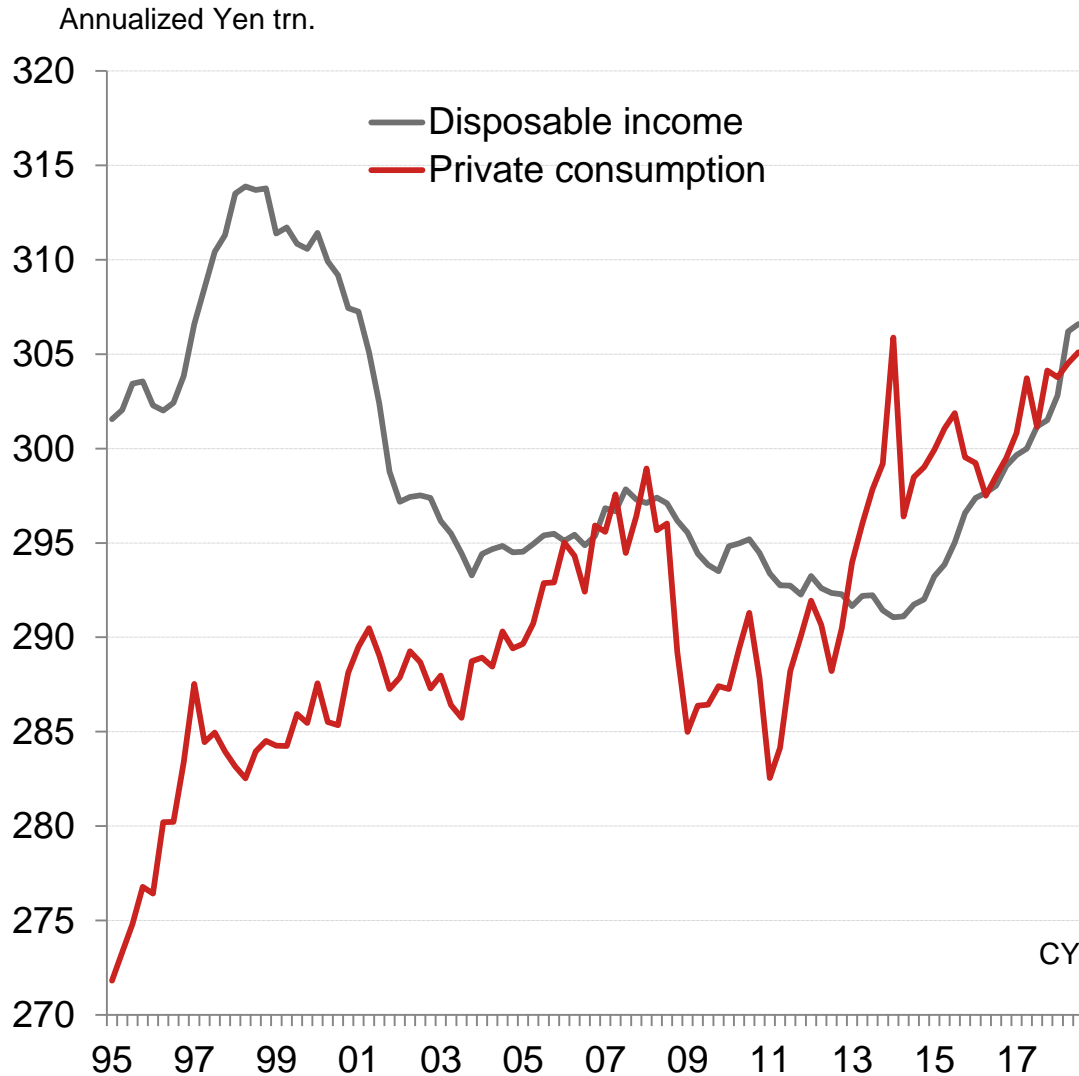


Deceleration in the global economy is already casting a shadow on the Japanese economy.

Since the beginning of 2018, Japan's exports have been slowing down and dampening production activity of domestic manufacturers, which expanded rapidly in 2016 and 2017.

# Private consumption stagnant despite favorable income conditions

## Disposable income and household consumption



Japanese economic growth has, along with the aging population trend, created many jobs, thereby improving Japanese household income conditions.

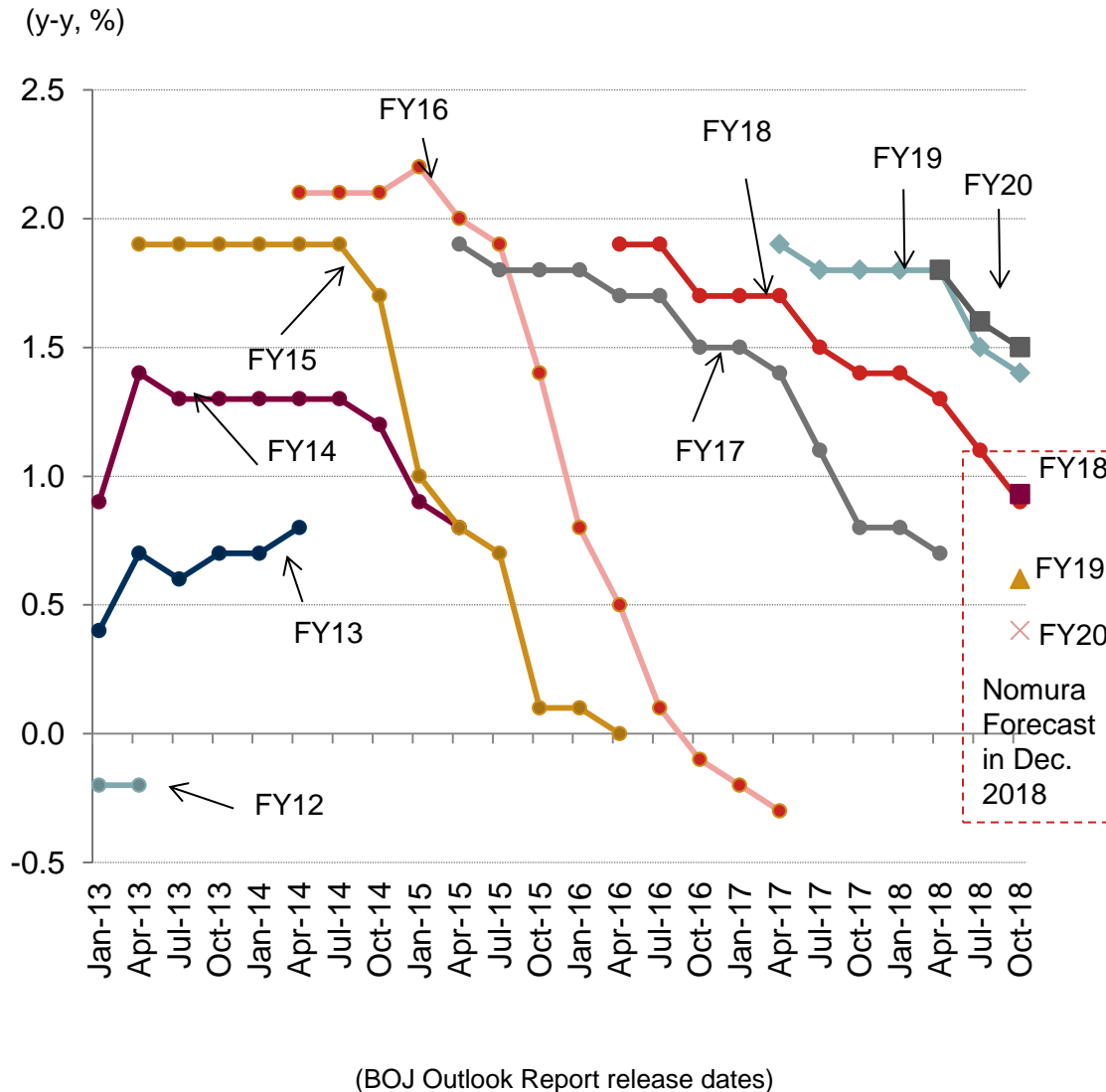
However, wages for relatively well-paid full-time employees under the life long employment system have failed to accelerate, preventing steady expansion in consumption spending by Japanese households due to the lack of expectations for medium- to long-term income growth.

As a result, Japanese household consumption has been lagging behind income growth.

Note: Disposable income data in Q2 2018 and thereafter are estimated from employee compensation data.  
Source: Nomura, based on Cabinet Office data



## BOJ's core inflation forecasts in its Outlook Reports



Underlying weakness in household consumption demand is making it difficult for Japanese companies to pass rising material costs and labor costs onto prices.

In addition, slowdown in the pace of improvement in the output gap is likely to decelerate inflation rates in fiscal years 2019 and 2020.

As the Bank of Japan maintains a 2% inflation goal and is committed to maintaining lower short- and long-term interest rates “for an extended period of time,” it has less room for adjusting and changing its monetary policy under such price conditions.

## Summary of Nomura's global economic forecast

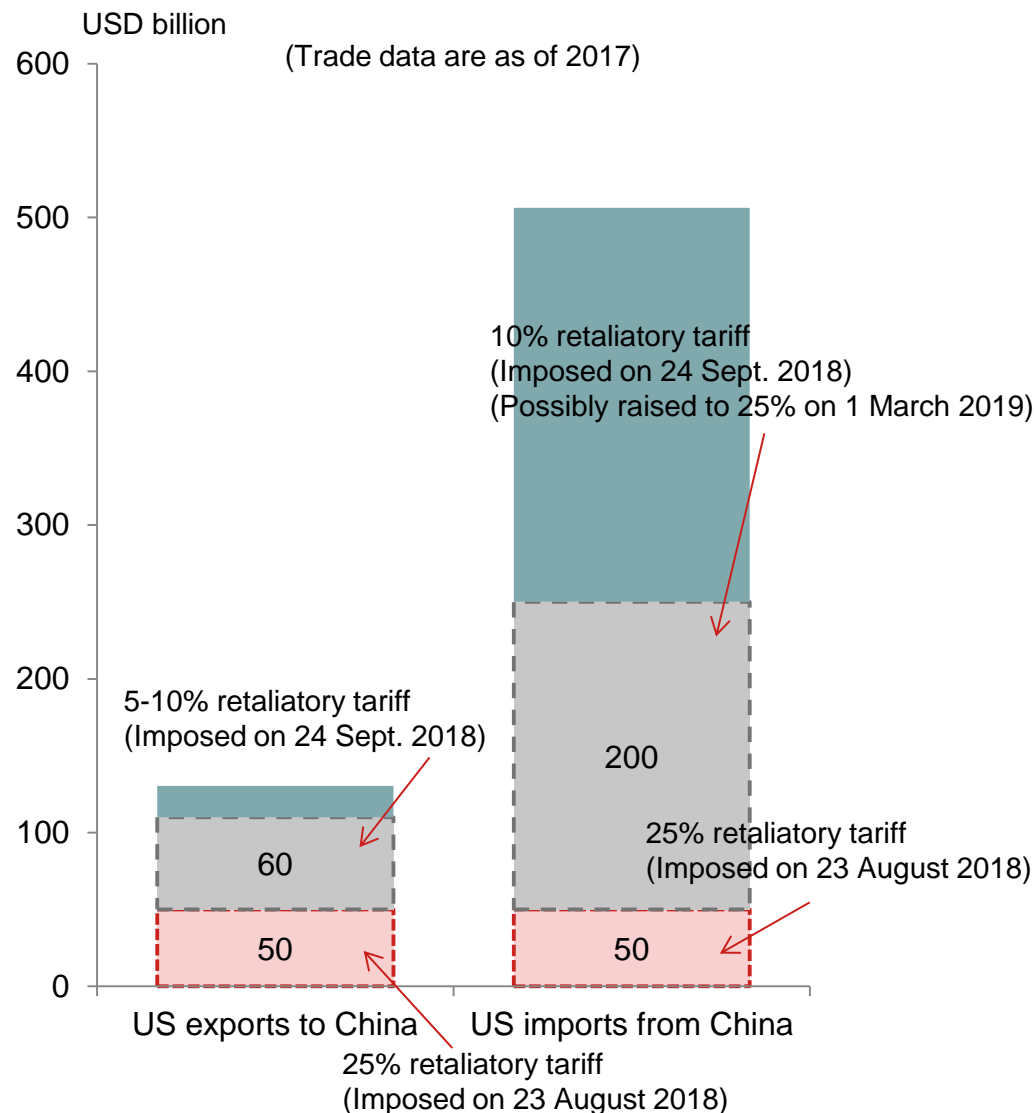
	Real GDP			CPI		
	y-y, %			y-y, %		
	2018	2019	2020	2018	2019	2020
<b>World</b>	<b>3.9</b>	<b>3.6</b>	<b>3.5</b>	<b>3.0</b>	<b>2.7</b>	<b>2.8</b>
<b>Developed countries</b>	<b>2.2</b>	<b>1.9</b>	<b>1.5</b>	<b>2.0</b>	<b>1.5</b>	<b>2.0</b>
<b>Japan</b>	<b>0.7</b>	<b>0.8</b>	<b>0.3</b>	<b>1.0</b>	<b>1.0</b>	<b>1.2</b>
<b>US</b>	<b>2.9</b>	<b>2.4</b>	<b>1.7</b>	<b>2.4</b>	<b>1.6</b>	<b>2.5</b>
<b>Eurozone</b>	<b>1.9</b>	<b>1.5</b>	<b>1.4</b>	<b>1.8</b>	<b>1.5</b>	<b>1.5</b>
<b>Emerging countries</b>	<b>5.2</b>	<b>4.9</b>	<b>5.0</b>	<b>3.8</b>	<b>3.6</b>	<b>3.4</b>
<b>China</b>	<b>6.6</b>	<b>6.0</b>	<b>6.0</b>	<b>2.2</b>	<b>1.9</b>	<b>2.0</b>

Nomura expects that global economic growth will slow down, including growth in the US economy, which has hitherto been robust.

On the other hand, peaking US rates have the potential to stabilize asset markets such as equities, which would likely generate a wealth effect to a certain extent and support overall growth in global demand.

As such, we believe that the global economy can avoid a typical recession-like economic downturn.

## Outline of US-China tariff war

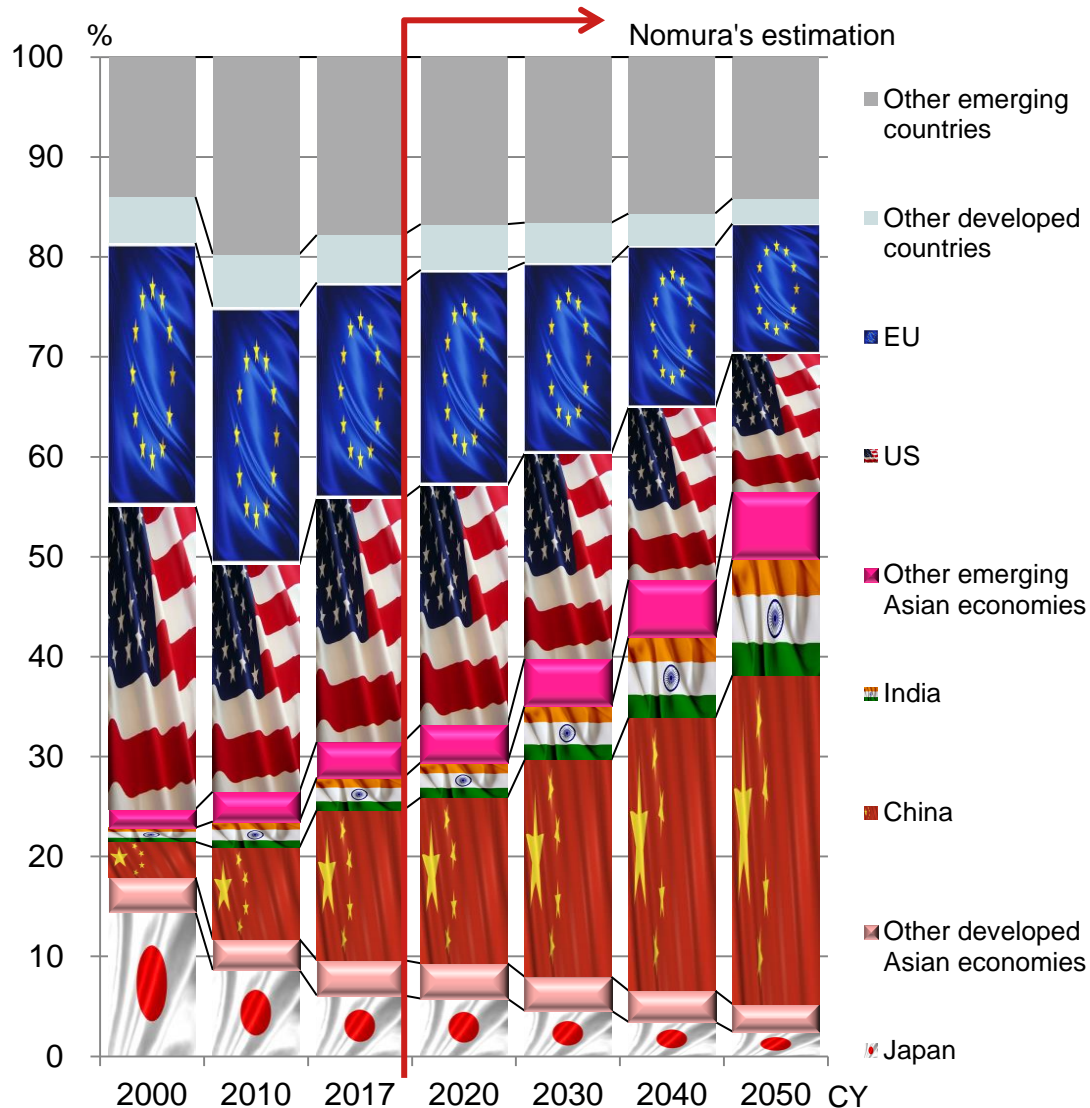


We should be concerned that the destabilization of financial markets in 2018 may reflect the negative impact arising from the Trump administration's protectionist trade policy.

The US has already imposed retaliatory tariffs on more than half of its imports from China and is threatening further retaliatory measures.

The background for such measures is the US's geopolitical strategy of containing China's ambition of becoming a military, economic, and technological superpower.

## Estimated composition of world GDP

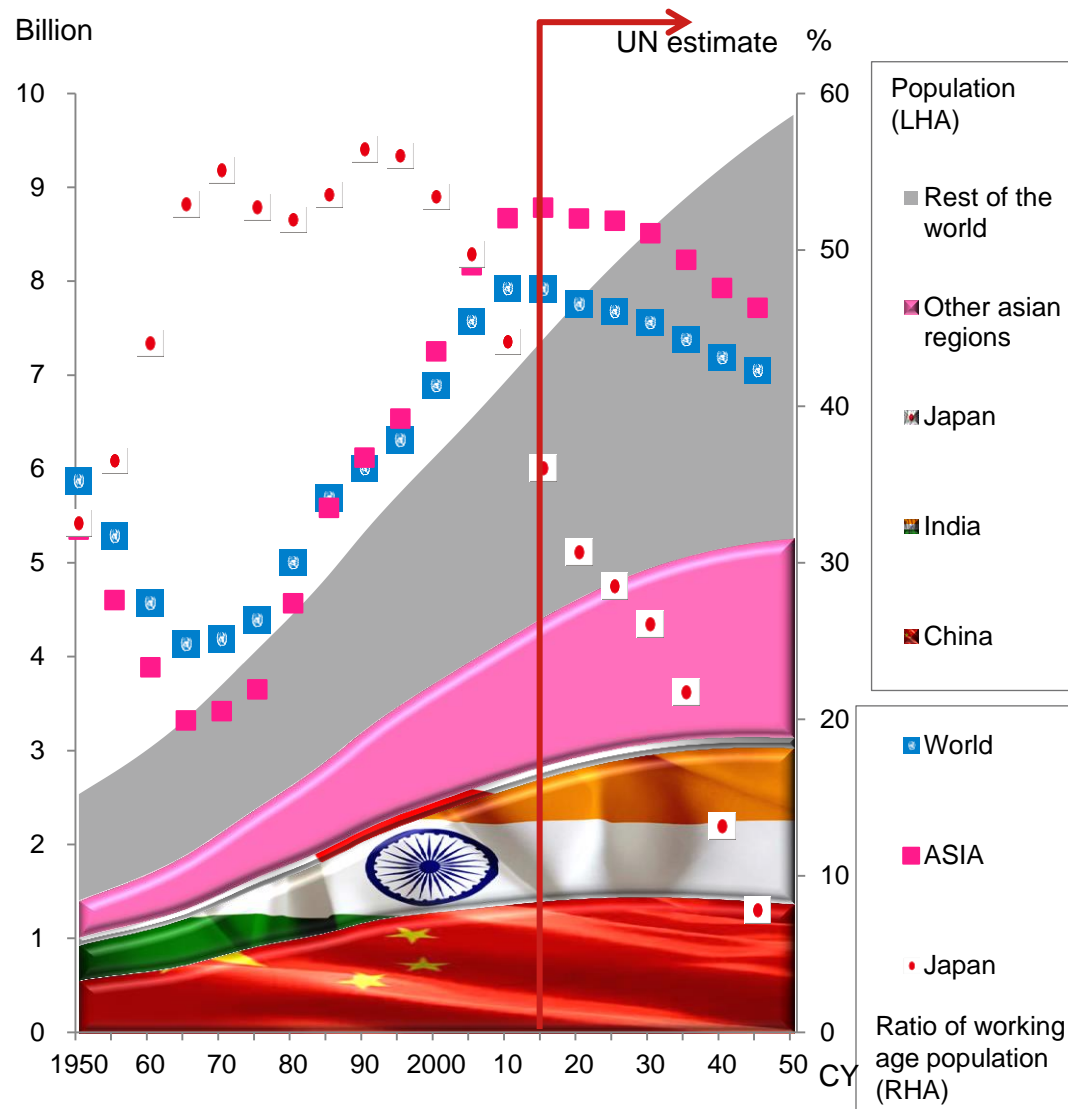


The hostile stance that the US has taken towards China is emblematic of its position against the rapid expansion of economic power amongst Asian countries as whole, not just China.

By 2050, Asian countries could account for more than half of the world GDP, assuming that each region maintains the growth rate it achieved in the five years through 2017.

Note: Nomura's estimation is based on GDP outlook of IMF from 2017 to 2023 and from 2024 and beyond, on an assumption where growth rate of each region will be the same as most recent 5 years average.  
Source: Nomura based on IMF data

## Forecasts for world population and working age population



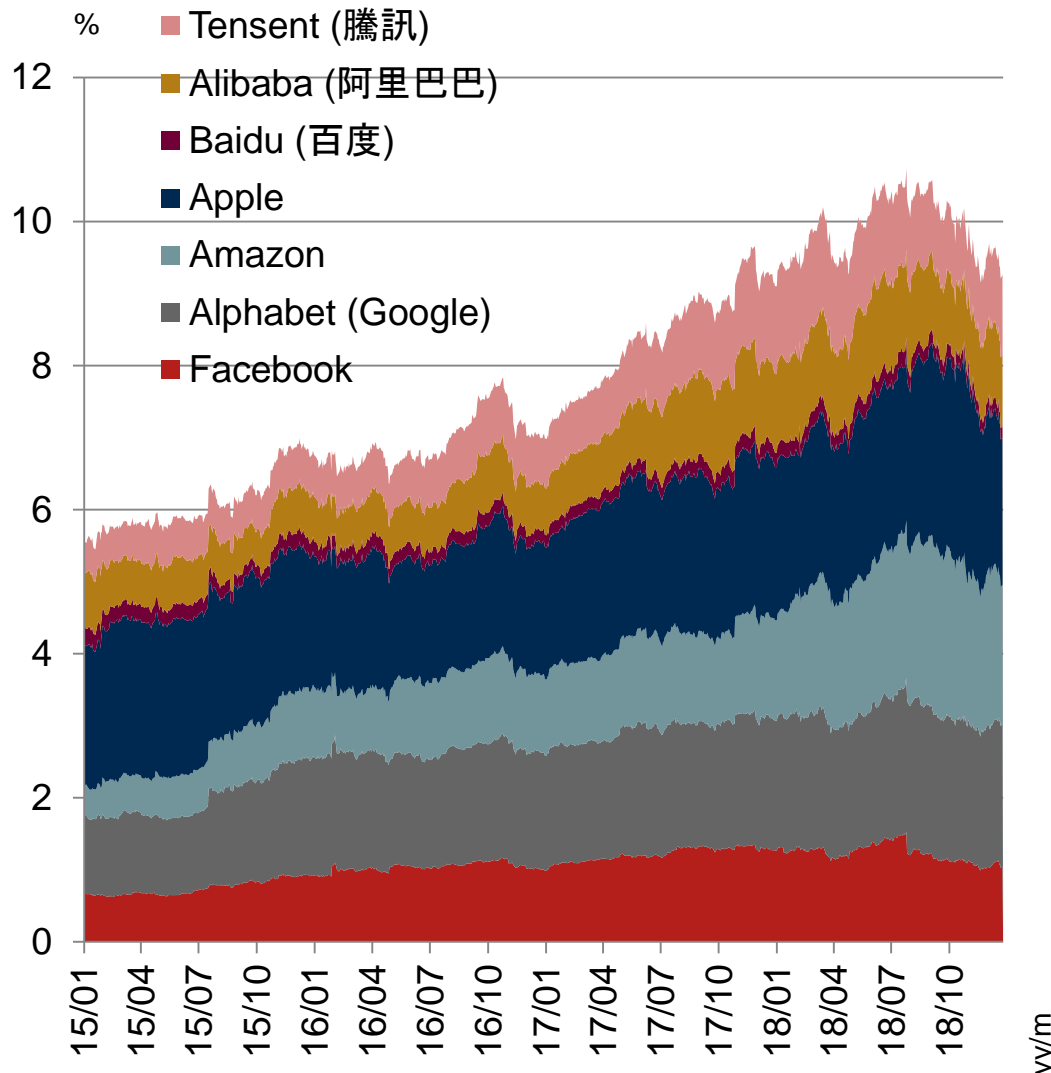
In Asia, the overall population will continue to grow and the high share of the working age population will be sustained, even in China, which will likely face rapid decline and an aging population due to its previous one-child policy.

These demographics will continue to support the relatively strong growth of Asian economies.

Note: Estimate after 2015 onward is based on median forecast in the UN population outlook revision in 2017.  
Source: Nomura based on the United Nations data

# Is the globalization of the flow of information taking a step back?

## Market capitalization share of giant ICT companies



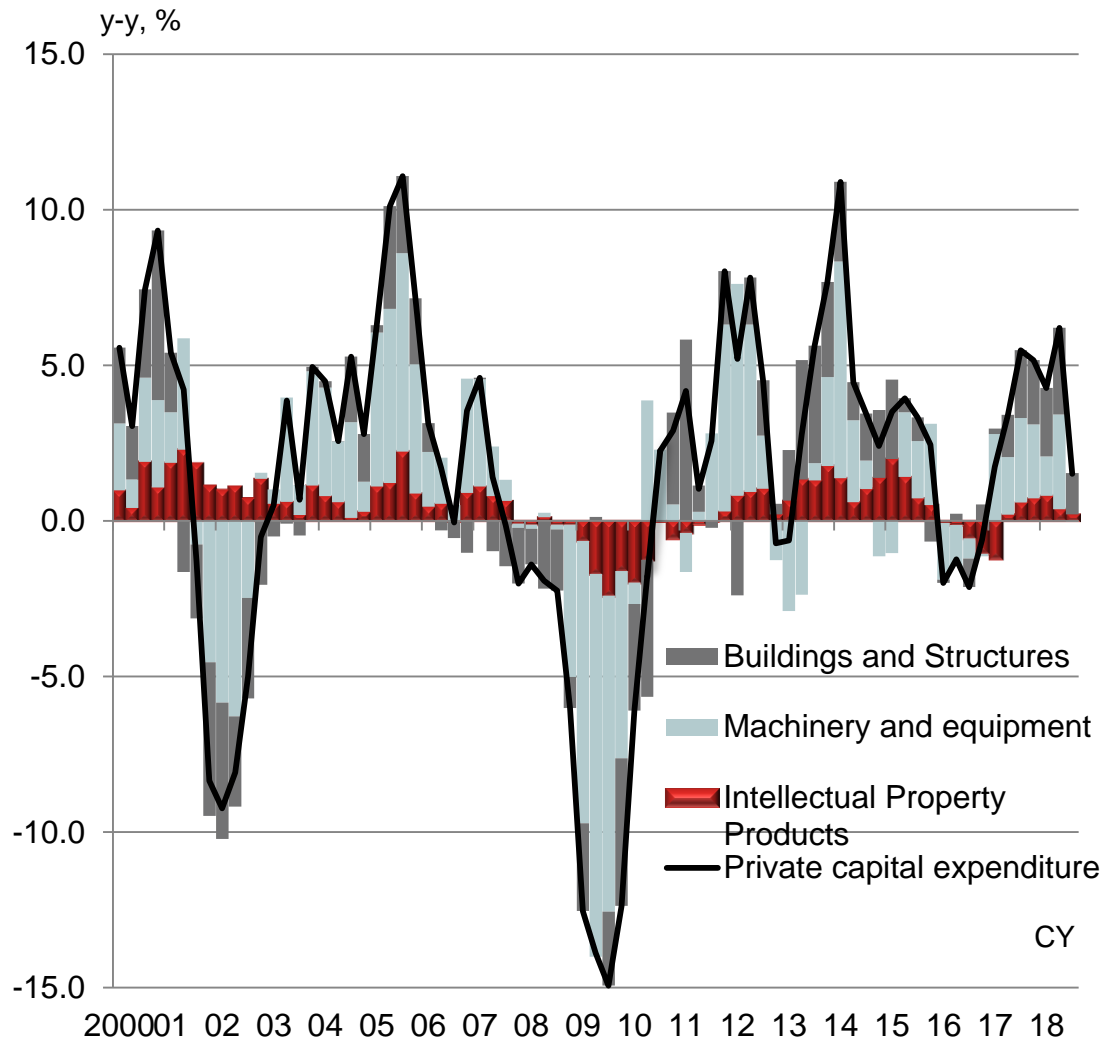
The problem is that the US is beginning to challenge the rise in Asian economies through various means such as trade protectionism.

There are particularly strong concerns that such US initiatives will constrain and cut off the flow of information as well as the goods trade and capital flows. Currently, one of the major forces driving the global economy is rapid expansion in the profits of giant ICT companies, which utilize information as a core business resource.

Deglobalization of information flows stemming from escalated US protectionism could pose a material risk to global economic growth.

Note: Market capitalization share refers to each companies' share against MSCI World market capitalization.  
Source: Nomura based on Bloomberg data

## Composition of private capex in Japan



Nomura believes that the globalization of the flow of information flow is irreversible and that even the US-China conflict cannot reverse the trend.

Accordingly, we are very likely to see an accelerated trend in which those that control the flow of information come out as winners in the global economy and markets.

Japanese companies should go beyond their previous efforts to allocate more resources to this area.



**Takashi Miwa**  
**Chief Japan Economist**

Takashi Miwa is the Chief Japan Economist of Nomura Securities Co. Ltd. He provides in-depth analysis and forecasts of the Japanese economy, based on interregional analysis of the macro economy and financial market analysis across various asset classes. He has a particular strength in analysing the macro economy from legal and administrative perspectives. Since joining Nomura Research Institute in 1990, he has engaged in macroeconomic analysis and financial market forecasting for various regions. In 1994-96, he moved to the Fixed Income Department of Nomura Securities and analysed the macro economy from more market-oriented perspectives while engaging in forecasting monetary policy and interest rates. He also made feasibility studies and conducted investment strategy planning with a view to the start of European Monetary Union in 1999.

He received his master's degree in Law from the University of Tokyo in 2001 and his bachelor's degree in Liberal Arts and Science from the University of Tokyo in 1990. While in the graduate school of law, he studied contract law, corporate law and bankruptcy law, and made an analysis of financial contracts and corporate behaviour from the perspectives of 'Law and Economics'. This experience proved useful in analysing banking behaviour, administrative responses and price reactions of fixed income and other securities during Japan's financial turmoil through 2003 and the global financial crisis after the collapse of Lehman Brothers in 2008.

From 2001, he provided economic analysis and investment ideas for major regional financial institutions including regional banks in Japan and gained an extremely good reputation among the top management of those clients. He moved to Nomura Securities in 2004. After belonging to the Economic Research, Investment Research, and Investment Research and Investor Services departments, he took his current position in May 2016.

He has authored several textbooks on economics and finance for beginners that are popular among university students and young graduates starting careers in financial institutions.



## Appendix A-1

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