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Connecting Markets East & West

Japan in the World

Challenging anti-globalism

January 2020

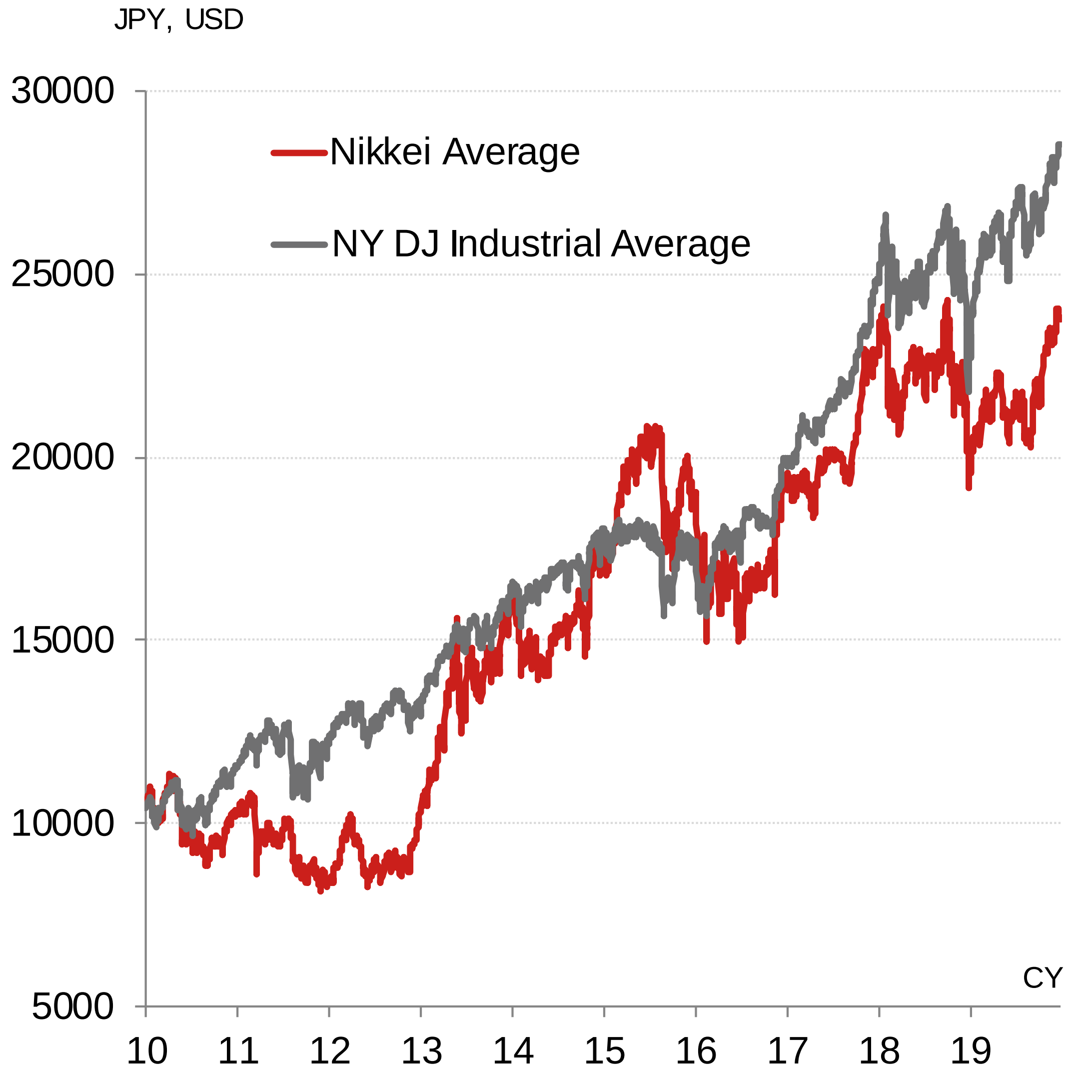
Japan in the World

Challenging Anti-Globalization

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

Global stock markets closed at high levels in 2019

Major stock indexes for the US and Japan



Looking back on 2019, stock prices remained weak until August due to concerns over intensifying trade friction between the United States and China and worsening global economic conditions.

Since September, the index has risen to new highs on hopes for progress in US-China trade talks and a recovery in the global economy. In addition, Japanese stocks, which had been lagging behind the global stock market, have outperformed overseas stock markets since September.

In December, favorable market events such as the first phase agreement of the US-China trade talks and the victory of the ruling party in the British general election led to high stock prices in 2019.

Source: Nomura, based on Bloomberg data

Fear of a prolonged decline in interest rates

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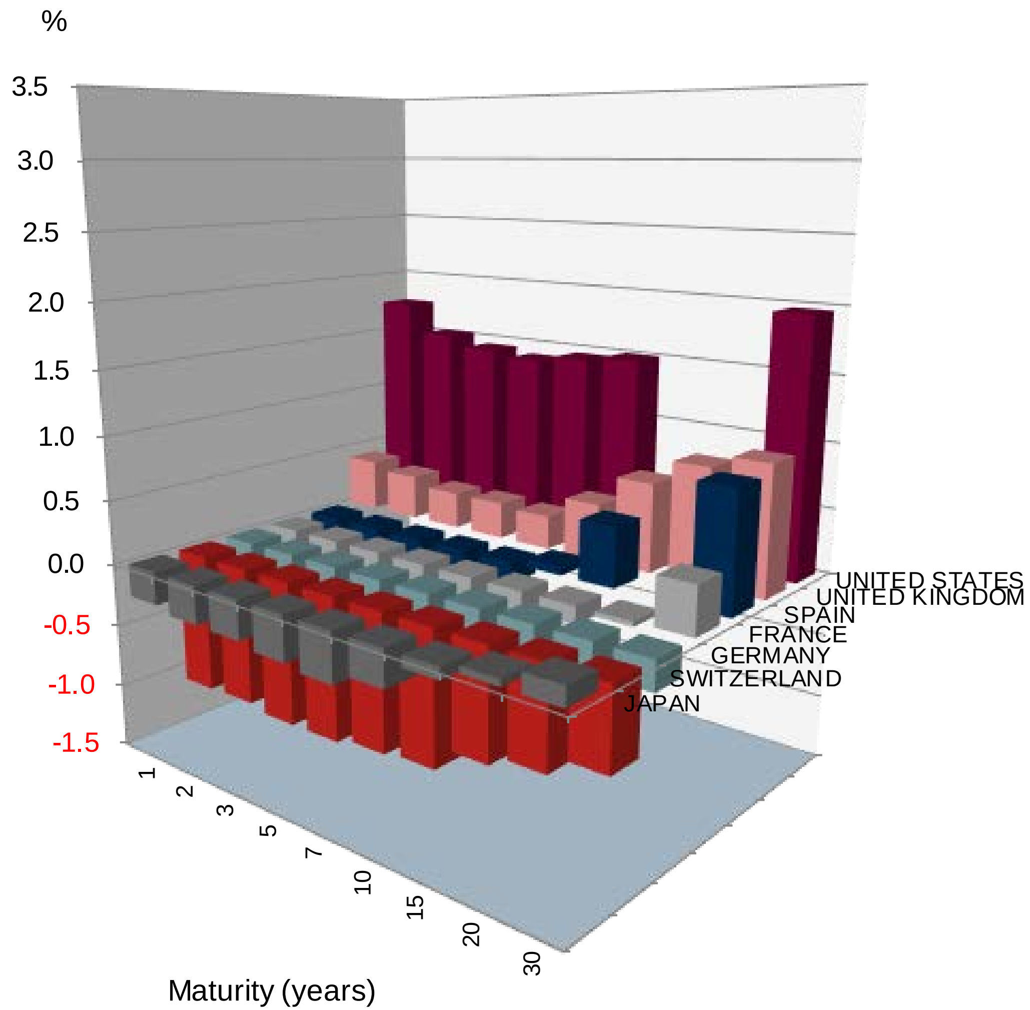
Government bond yields in major countries (as of August 29, 2019)



In August 2019, a very unusual situation arose where as much as USD 17 trillion in outstanding bonds recorded negative yields.

The start of rate cuts by the US Federal Reserve sparked speculation of a race to cut rates by various central banks, resulting in a worldwide decline in interest rates.

One factor behind the race in rate cuts and continuous decline in rates was a fear of 'Japanization', in other words major economies sinking into deflationary economic conditions.

Since September 2019, the unusual rush of declining rates halted due to a recovery of optimism in markets reflected in equity prices and a diminishing expectation of rate cuts in US monetary policy.

Source: Nomura, based on Bloomberg data

Signs of cyclical recovery in the global economy

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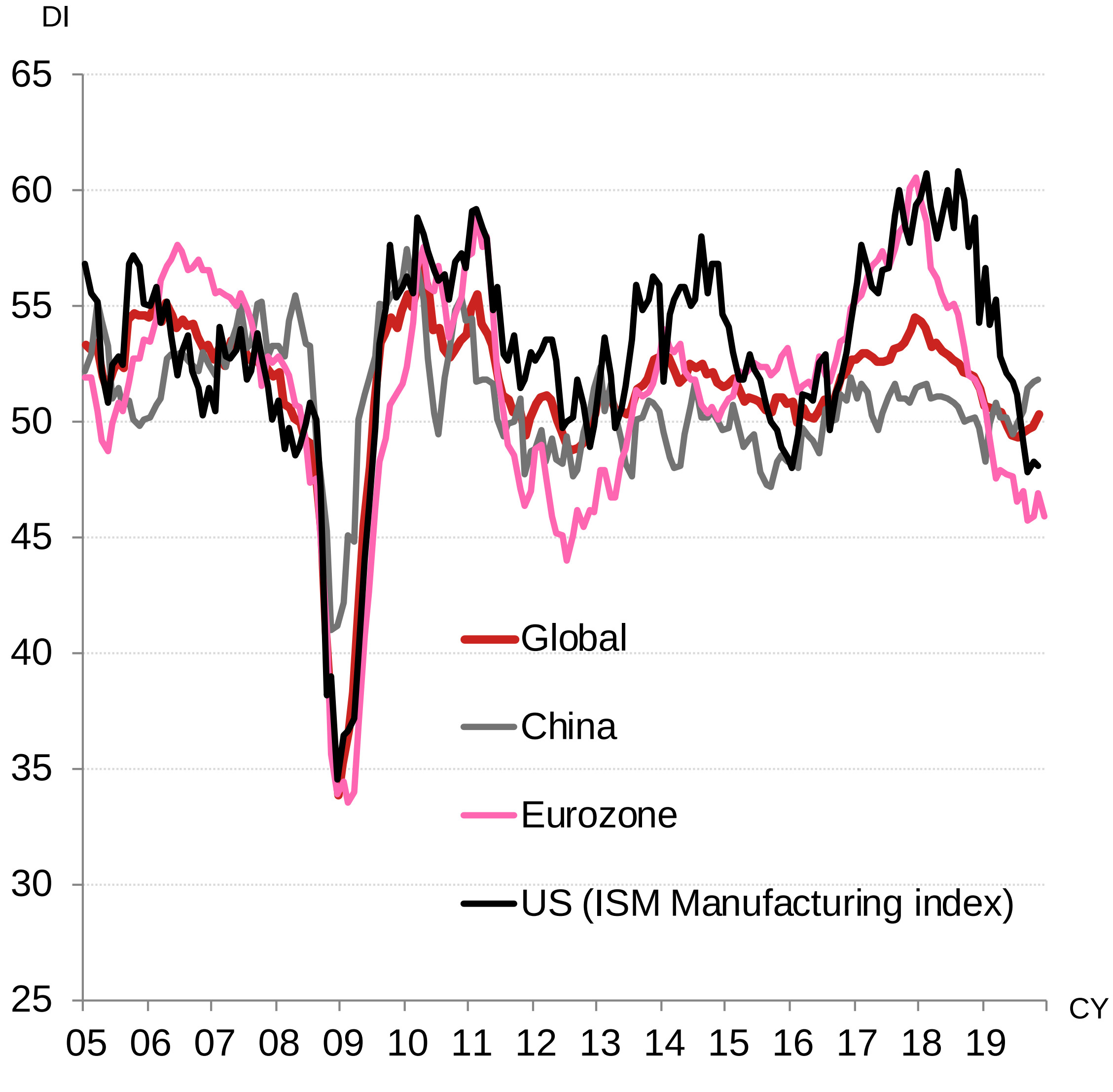
Manufacturing PMI levels for major economies



The global decline in interest rates has come to a halt as stock prices at home and abroad have reached a new high, partly because there are signs that the global economy is entering a cyclical recovery.

It is particularly noteworthy that China's manufacturing activity, which should have been hit hard by the US tariff increase, has been on the rise since summer of 2019.

Source: Nomura, based on IHS Markit, Ltd., Jibun Bank, and US Institute of Supply Management.

Inventory adjustment in electronic equipment is ending

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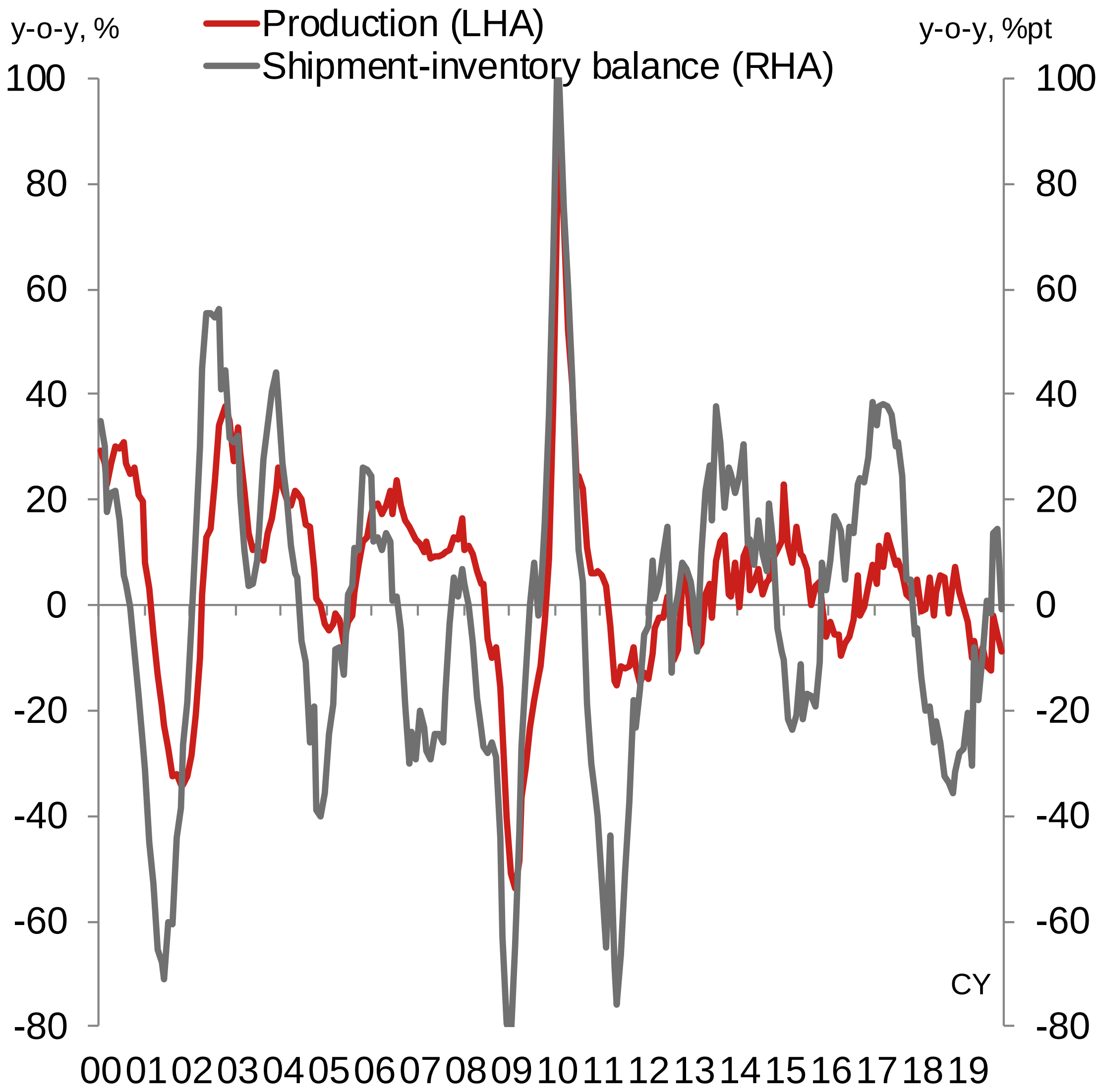
Inventory and production cycle in Japanese electronic component and device manufacturers



Expectations for a recovery in the global economy, including the economy of China, which is bearing the brunt of trade friction, can be attributed to the completion of inventory adjustments for information technology-related equipment and parts, which was the main cause of global economic slowdown since 2018, and the emergence of expectations for a recovery in production.

In other words, the true origin of the global economic slowdown so far has been IT-related production and inventory adjustments, not the trade friction between the United States and China.

Source: Nomura, based on METI data

Negative impact of the consumption tax hike was limited

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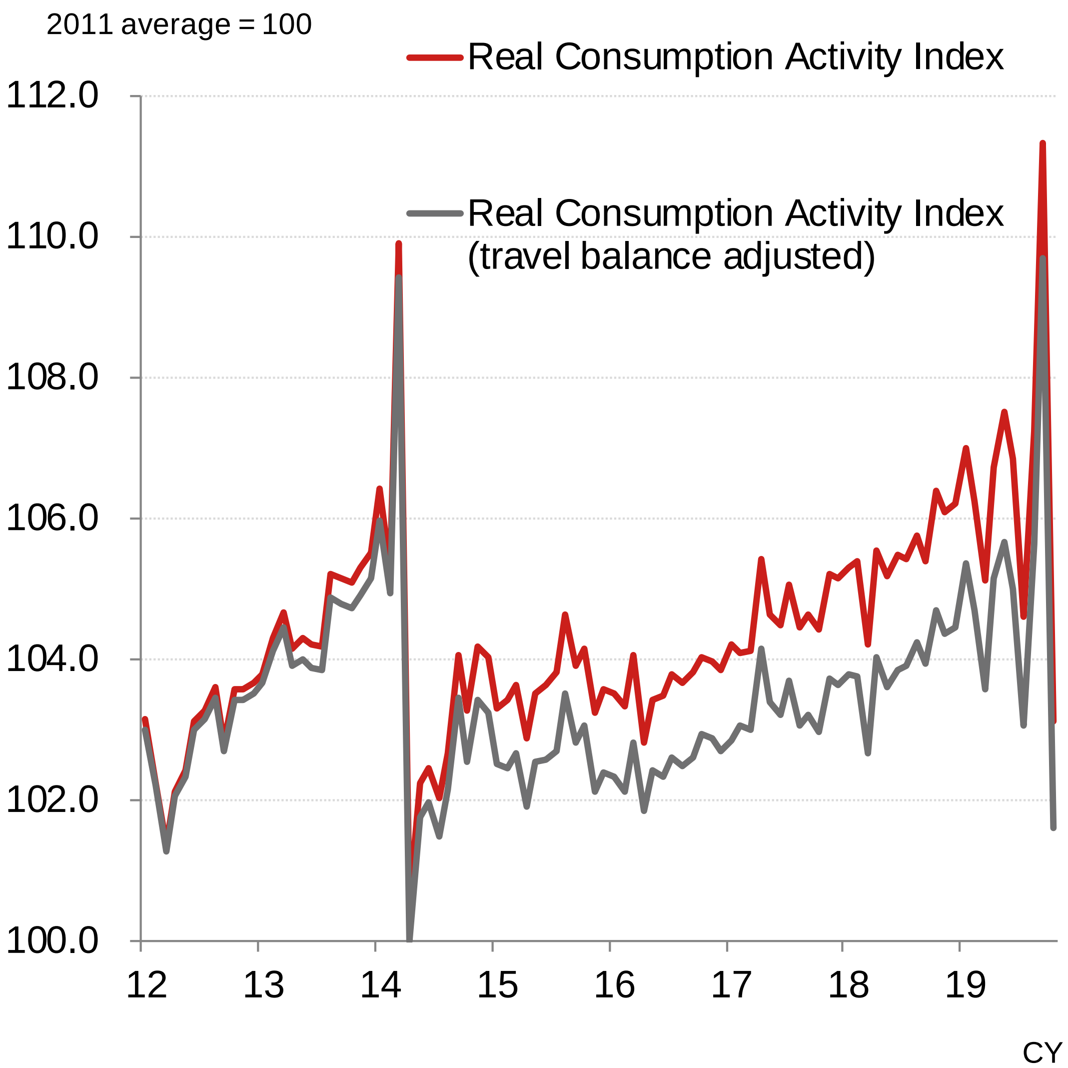
Consumption activity index



Source: Nomura, based on BOJ data

The consumption tax rate was raised again in October 2019, causing fears that it might trigger a slowdown in domestic demand, especially consumption, on the top of export-led slowdown in the overall economy.

Looking at consumption-related indicators after the tax increase shows a sharp decline, exceeding the level of the previous tax increase in April 2014. However, discounting the impact of Typhoon Hagibis, which hit Japan in October, it can be said that the overall decrease in demand following the tax increase was small.

In addition to the fact that the increase in the tax rate was 1% smaller, that a reduced tax rate has been introduced, and that de facto income refunds have been introduced through the free pre-school education policy, it can be surmised that cashless point returns and other temporary measures to mitigate the impact on the economy have had some effect.

Summary of 2020 global economic forecast

Summary of Nomura's global economic forecast

	Real GDP y-y, %			CPI y-y, %		
	2019	2020	2021	2019	2020	2021
World	3.1	3.1	3.3	2.6	2.8	2.5
Developed economies	1.6	1.3	1.5	1.5	1.8	1.7
Japan	1.0	0.2	0.5	0.5	0.6	0.5
US	2.3	1.8	1.9	1.8	2.4	2.2
Eurozone	1.2	0.9	1.3	1.2	1.3	1.5
Emerging economies	4.2	4.5	4.7	3.5	3.6	3.1
China	6.1	5.7	5.5	3.0	3.3	2.1

Note: As of 19 December 2019
Source: Nomura global research

In the United States, the Trump administration's fiscal expansion measures have lost their effectiveness, while in China, efforts to curb excessive debt are likely to curtail growth. The impact of these will linger in Japan until the first half of 2020, but the economy is expected to accelerate moderately from the second half of 2020 to 2021.

Nomura predicts that although the global economic growth rate in 2020 will remain roughly the same as in 2019, the cyclical recovery in IT-related equipment production will lead to a recovery in economic growth rates, mainly in emerging countries.

The world fears 'Japanization'

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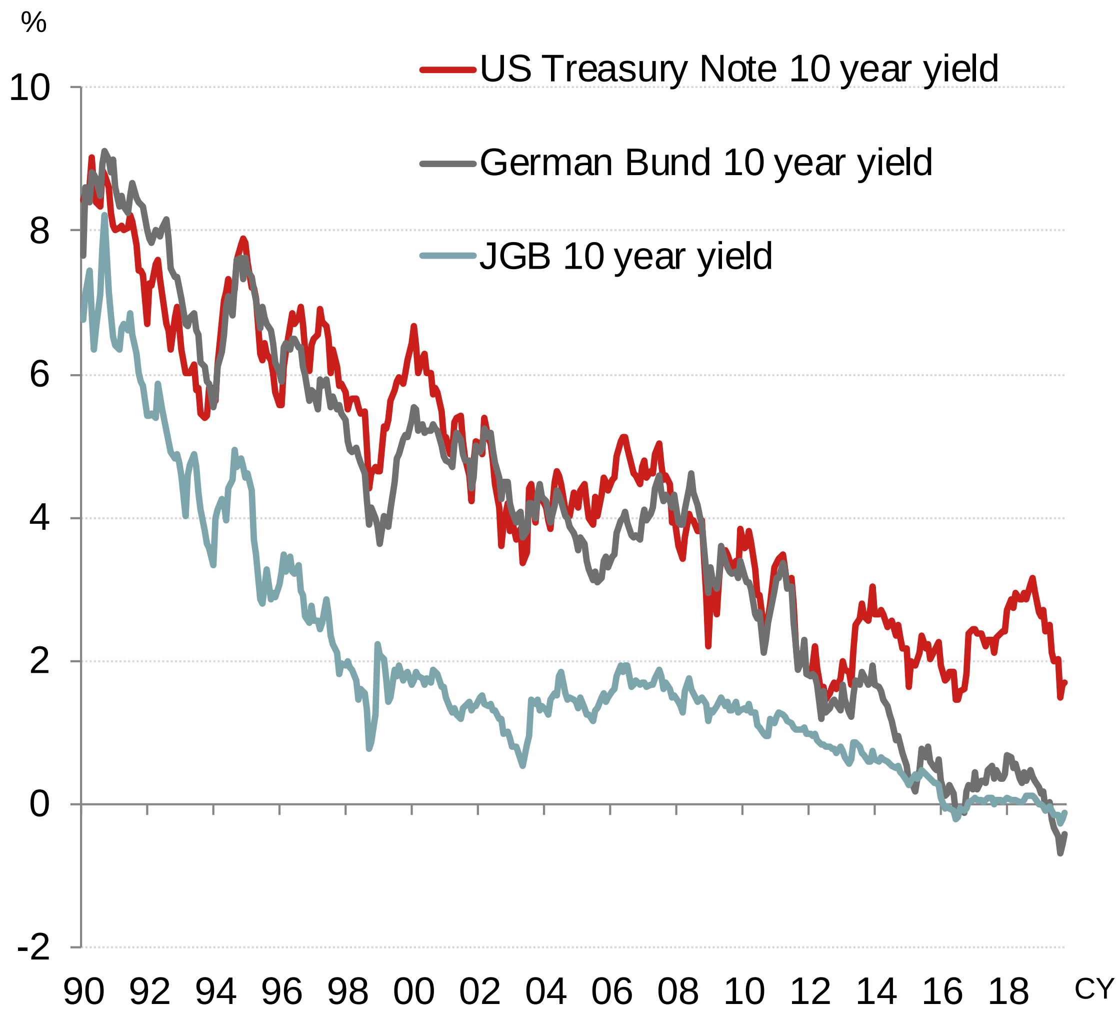
10 year G3 government bond yields



With the global economy showing signs of a cyclical recovery, the decline in global interest rates, which was particularly noticeable in August 2019, is coming to an end. However, it remains to be seen whether the decline in interest rates, which had continued against the backdrop of concerns that major developed regions will follow Japan in the path of low growth and low inflation, has completely ceased.

There is a possibility that the source of the fear of 'Japanization' and the current trend towards protectionism and other elements of anti-globalization have the same roots.

Anti-globalization, characterized by protectionism and populism, is seen as a political backlash against the negative effects of economic globalization, but it seems to have many aspects in common with the 'Japanization' of the economy.

Source: Nomura, based on Bloomberg data

Relative inflation of goods and services in Japan and U.S.

One of the reasons why anti-globalization, symbolized by protectionism and populism, is gaining momentum in many regions could be resentment against the hollowing out of industries, especially in the manufacturing sector, and the shrinking of employment opportunities caused by the progress of economic globalization.

At the same time, these developments have much in common with the ‘Japanization’ of the economy, in that they have brought about a sharp decline in the inflation rate of goods due to the influx of cheap industrial products from emerging countries.

Source: Nomura, based on MIC and US Department of Labor data

The origins of anti-globalization (2)

– Diminishing investment opportunities in developed countries

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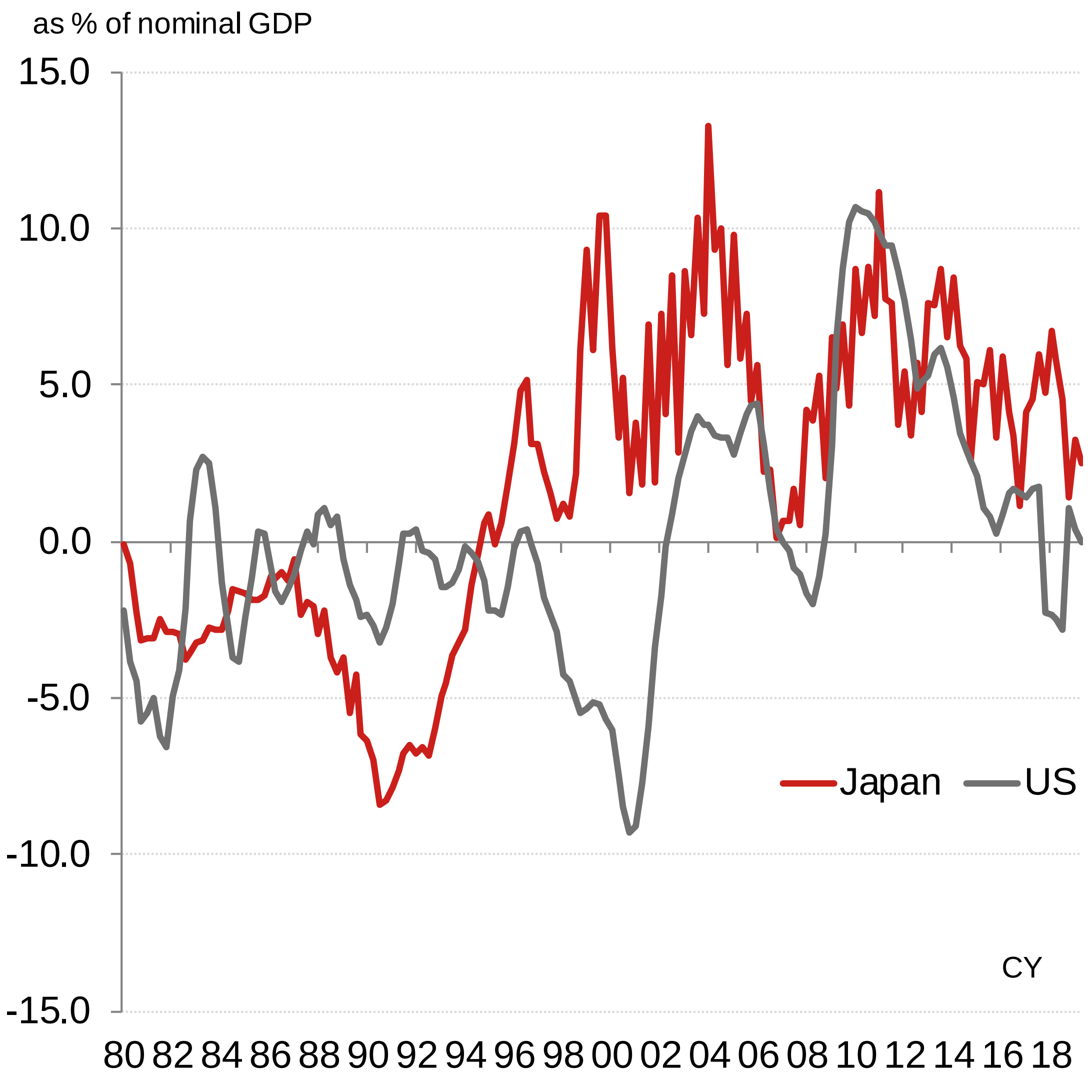
Saving-investment balance of non-financial corporations



Economic globalization may have transferred corporate investment opportunities from developed regions to emerging countries.

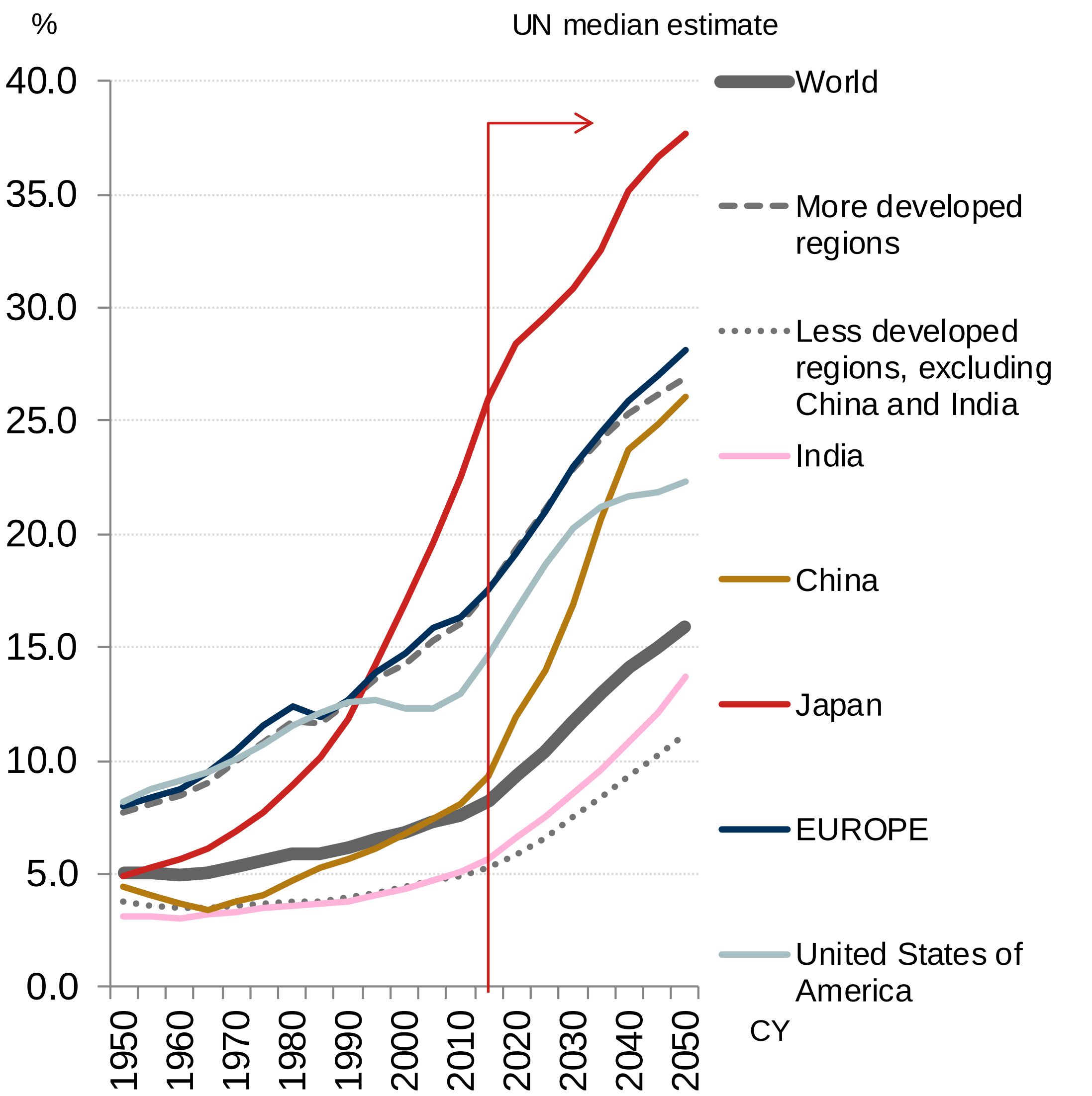
At present, the corporate sector, led by Japan and the United States, has been earning a financial surplus as capital investment has been below cash flow for a long time. This can be seen as a result of a decrease in investment opportunities due to globalization.

Excess money in the corporate sector may have structurally lowered interest rates in advanced economies in tandem with low inflation and falling inflation rates.

Source: Nomura, based on BOJ, FRB, US Department of Commerce and the Japanese Cabinet Office.

The tidal wave of aging populations

International comparison of the percentage of populations aged 65 or older



Further tracing the origins of anti-globalization and the 'Japanization' of the economy leads to demographic changes.

Population decline and aging are not unique to Japan, and even in many developed regions where population growth is sustained by immigration and a relatively high birth rate, aging is inevitable.

It is also worrisome that China, the world's most populous country, has been rapidly aging since the 2010s.

The aging of society may be restraining corporate investment through concerns about reduced business opportunities and shrinking market sizes. At the same time, there is a possibility that households are increasing their savings rates in order to prepare for longer life spans, thereby increasing the surplus of money.

Source: Nomura, based on United Nations data

Stagnating technological innovation

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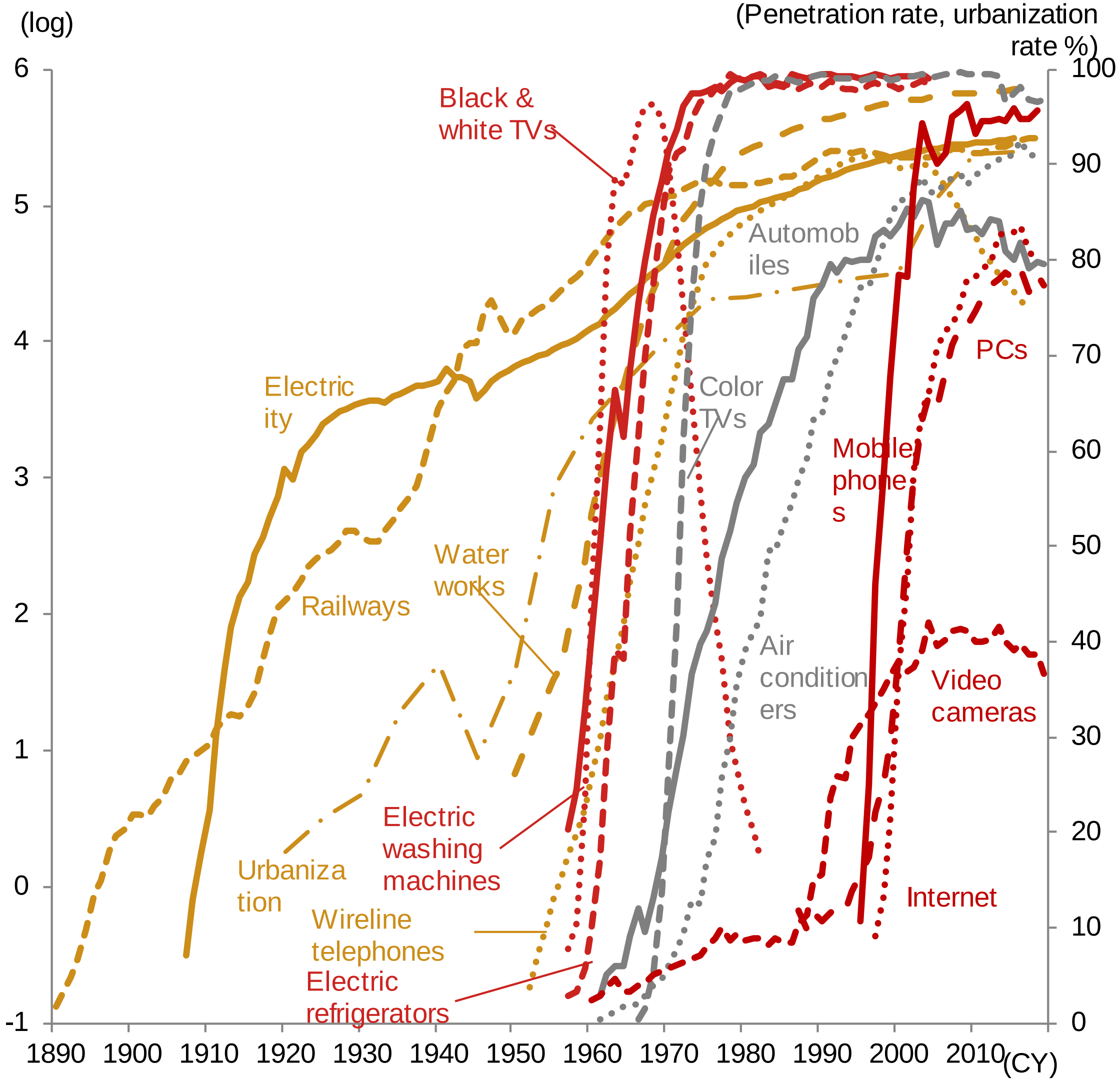
Rising household living standards



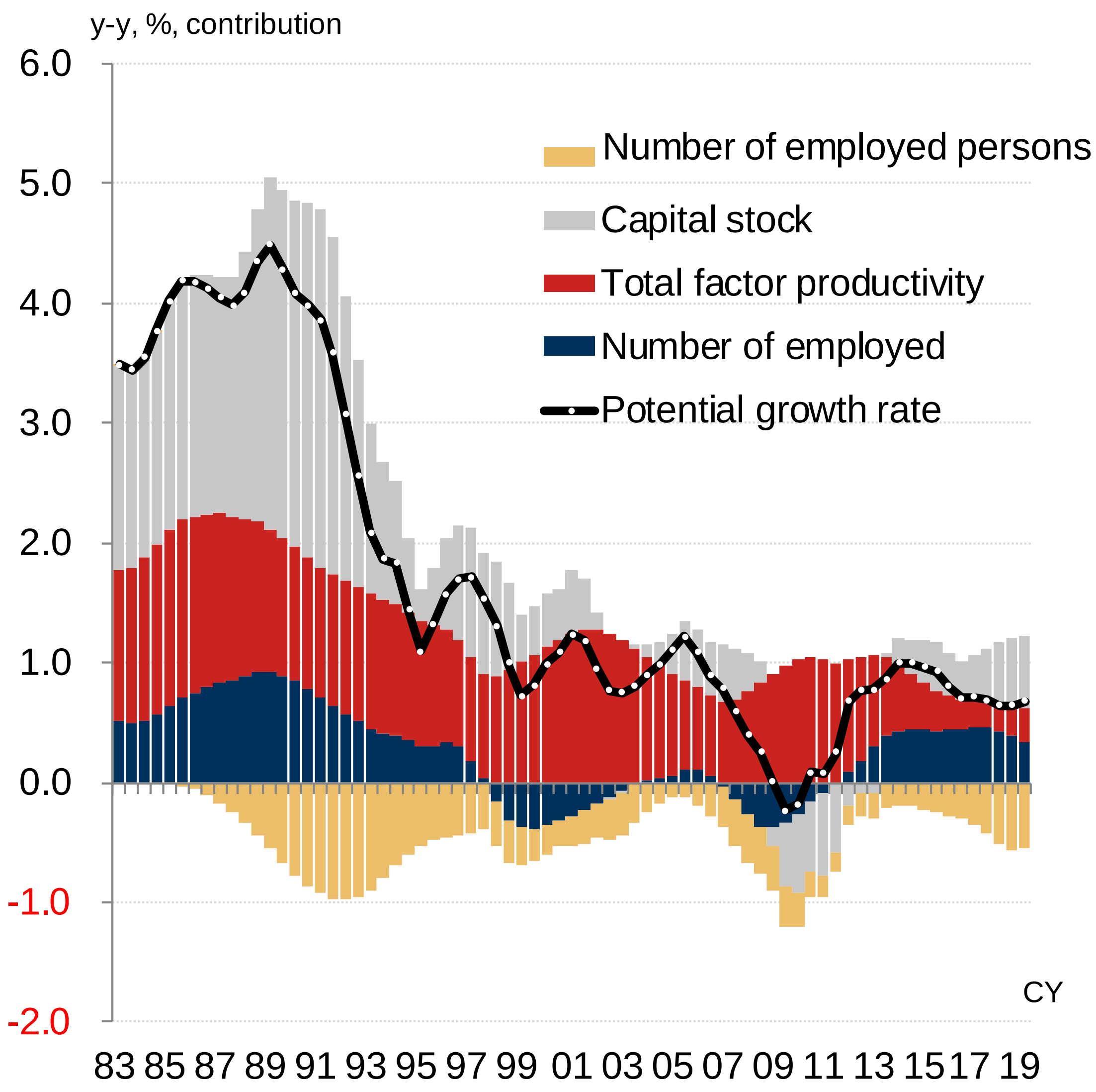
Note: "Electricity" is the number of contracts for electric lighting; "railways" is the number of passengers per kilometer; and "wireline telephones" is the number of Nippon Telegraph and Telephone's domestic subscribers. These three time series are logs (lhs) of the (standardized) absolute number. "Urbanization" is the percentage of urban dwellers (rhs). The other time series are penetration rates (rhs).

Source: Nomura, based on Cabinet Office, MIC, MHLW, MLITT, Japan Statistical Association, and Federation of Electric Power Companies of Japan data

In particular, the aging of the population structure in developed regions may lead to saturation of demand, particularly for durable consumer goods.

On the other hand, there is a possibility that the improvement of life satisfaction through the penetration of durable consumer goods, especially among the elderly, is slowing down the speed of technological innovation, which is required to develop new products and new functions for products.

Decomposition of the potential growth of the Japanese economy



Source: Nomura, based on BOJ data

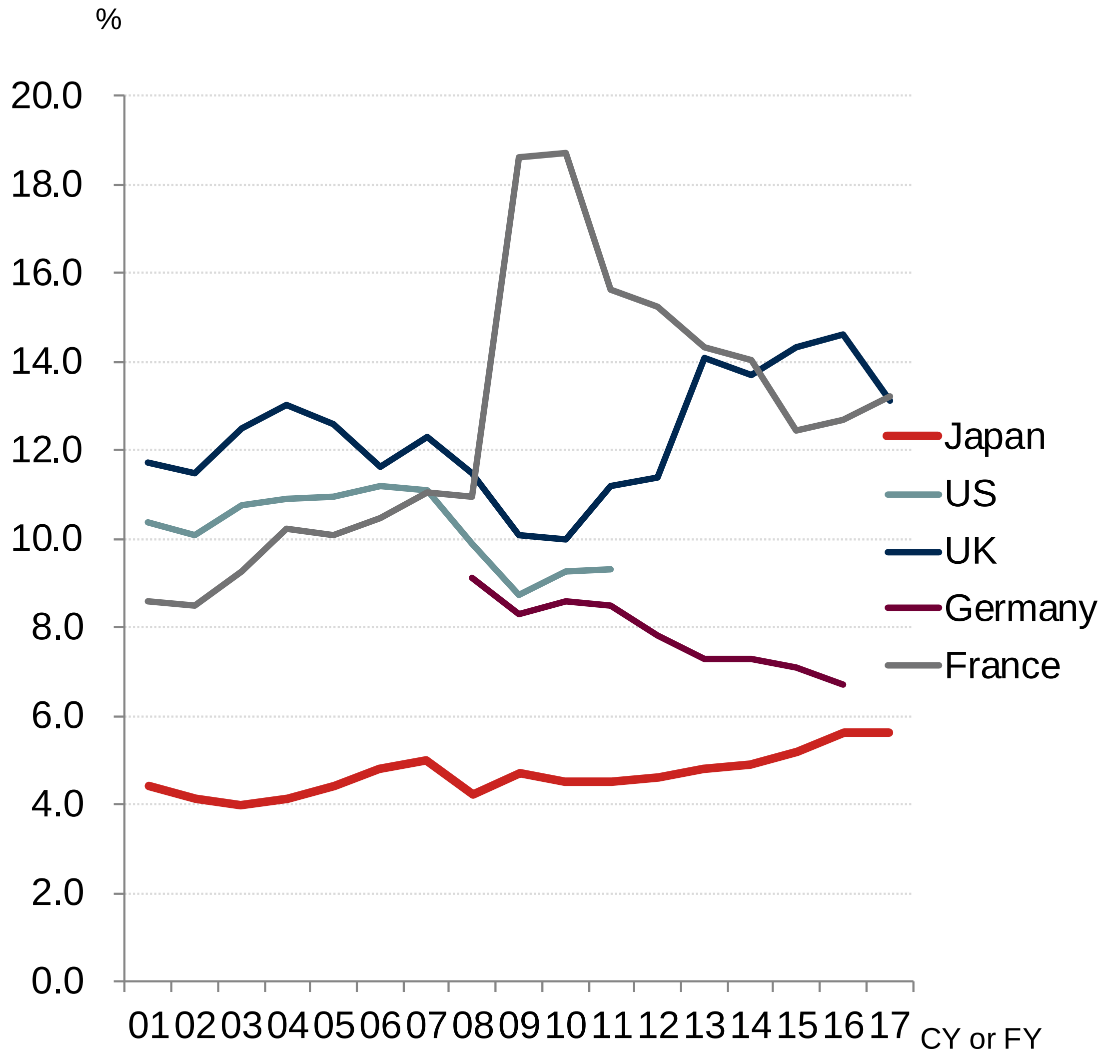
What challenges will emerge if the various problems that lie behind the trend of anti-globalization are reexamined from the viewpoint of the Japanese economy?

Looking back on the performance of the Japanese economy since the second administration of Prime Minister Shinzo Abe was inaugurated at the end of 2012, it is clear that growth has been underpinned by an increase in the number of employed people and an increase in the outstanding balance of corporate capital stock, while a decline in working hours and a slowdown in the growth rate of productivity have hindered economic growth.

Although it may appear commonplace, the key to accelerating Japan's economic growth lies in productivity improvement measures that create significant added value in short working hours and acceleration of technological innovation that dramatically improves productivity.

A key to overcoming anti-globalization

Start-up ratio of major countries



Note: Start-up ratio = newly established companies/total number of companies. Definition varies among countries.
Source: Nomura, based on official statistics of corresponding countries

Ironically, the Japanese economy which is serving as an unwelcome teacher of 'Japanization' has the qualification to become a leader in quickly solving the problems behind 'Japanization' and overcoming the wave of anti-globalization that is rampant across the world.

The key to enabling Japan to draw on its qualification and play a leading role in overcoming anti-globalization is to take measures to improve productivity and accelerate technological innovation that will dramatically improve productivity. In order to do this, it is necessary to once again revive the vigorous entrepreneurial activity that restored Japan from burnt-down ruins after the end of World War II.

Adequate supply of risk money is essential to revitalize Japanese business start-ups and entrepreneurship, which lags behind other major industrialized countries. We believe Nomura has an important role to play in this regard.

Biography

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.

Source: Nomura

Appendix A-1

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