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Connecting Markets East & West

Japan in the World

The global economy as the pandemic endgame approaches

January 2022

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Approaching the pandemic endgame

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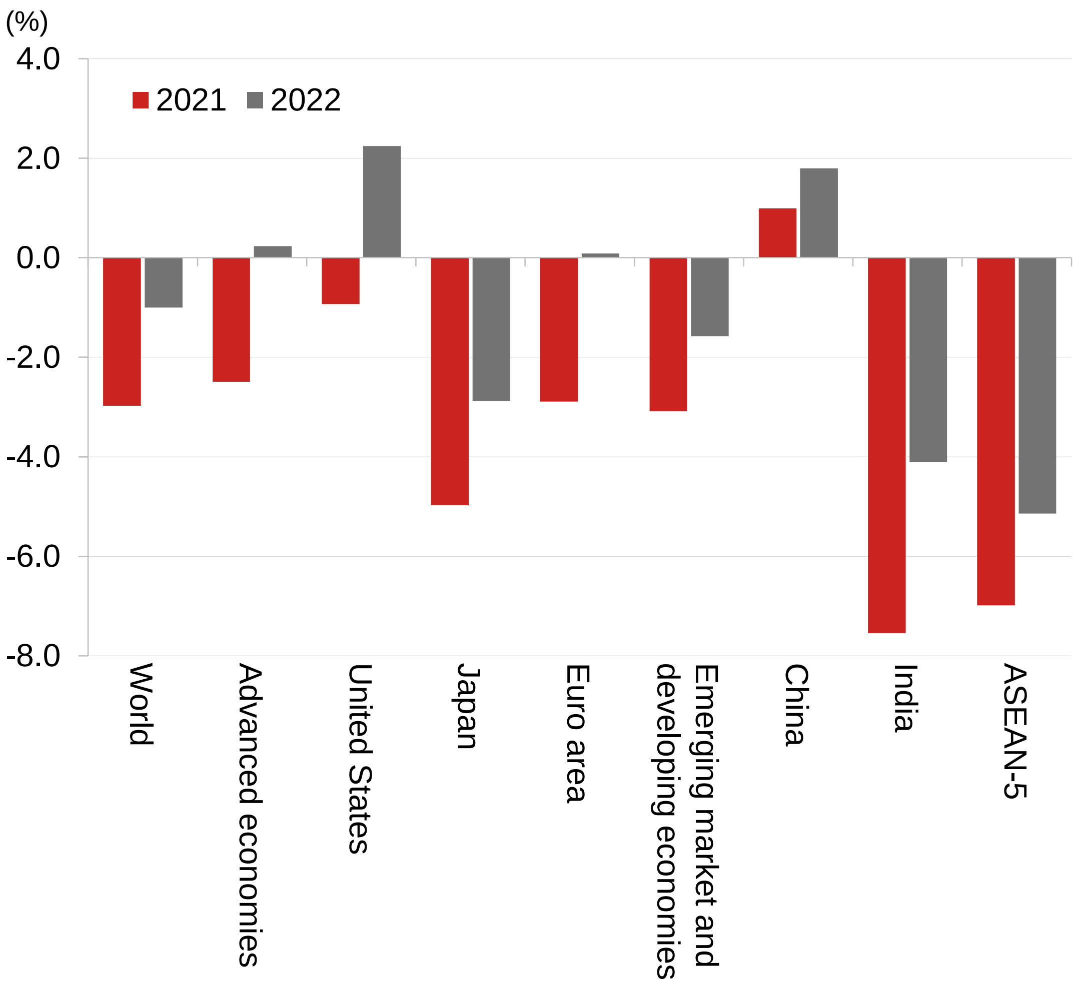
Deviation of real GDP level from past trend (2010-19)



Note: To estimate GDP deviation from the trend in 2021 and 2022, we measures the projected real GDP level based on IMF forecasts.

Source: Nomura, based on IMF data

Having faced repeated surges in infection, progress in vaccination has started to lead the global economy to the eventual endgame of COVID-19.

Despite differences in timing and degree of recovery among advanced and emerging economies, the world economy will more or less return to the pre-COVID growth trend in 2022.

Accelerated inflation due to supply constraints

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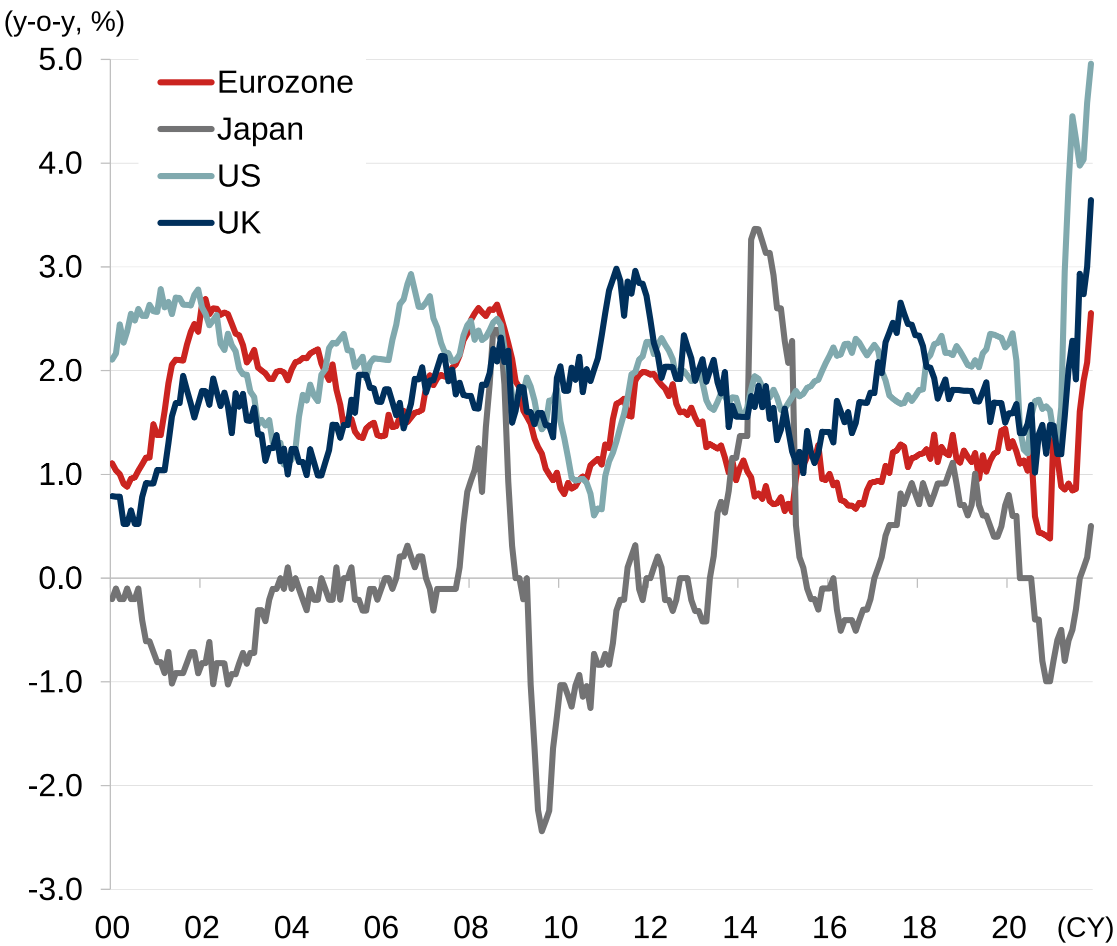
Core consumer price inflation rate in major developed economies



Note: Definition of 'core' depends on particulars for each economy. Japan's core inflation includes impacts of consumption tax hikes and free education policy.

Source: Nomura, based on Haver Analytics data

At the same time, we are facing a sort of growing pain ahead of the endgame.

The production of various durable goods, the demand for which surged during the pandemic as stay at home and work from home became common, now suffers supply constraints for intermediate parts including semiconductor chips.

Mismatches in supply and demand caused by supply constraints are leading accelerated inflation, driven by elevated international commodities prices.

Emerging concerns of economic slowdown in China

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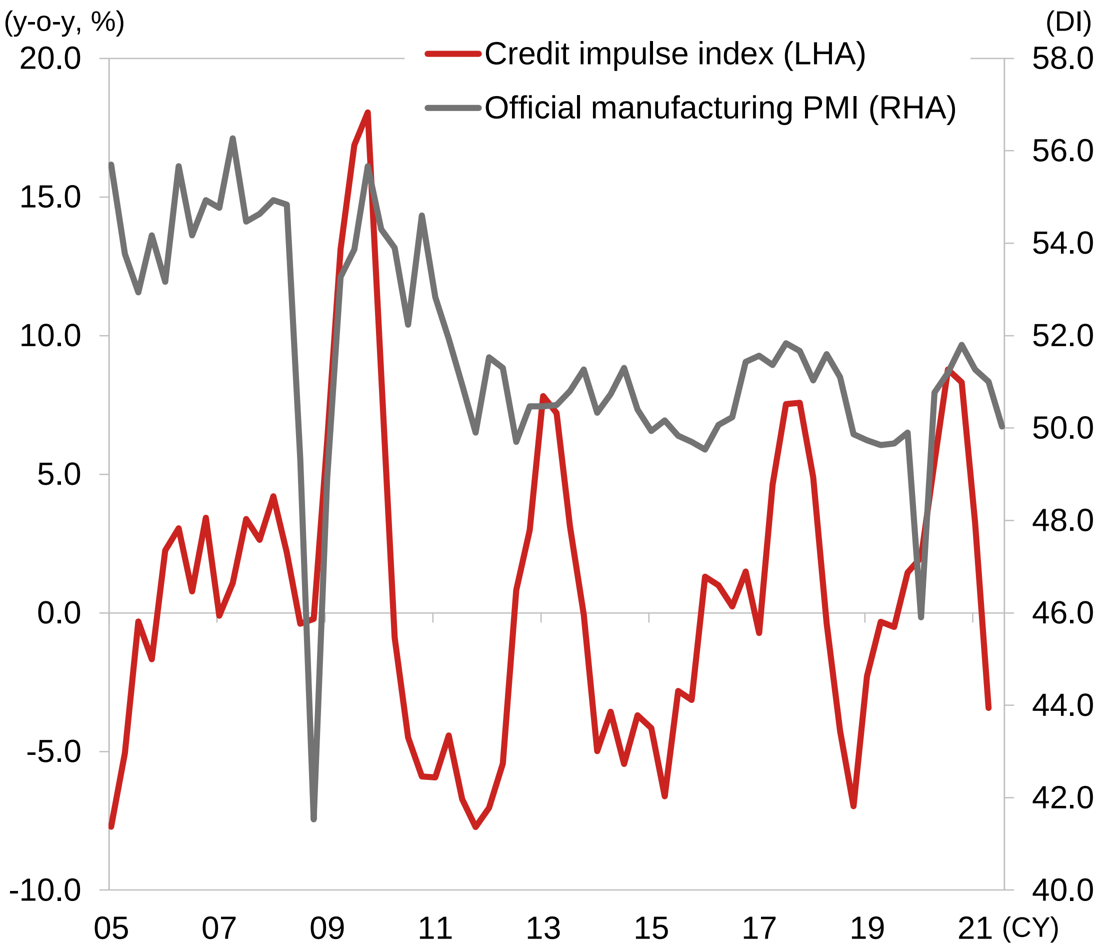
China's official manufacturing PMI and Credit Impulse Index



Source: Nomura, based on Haver Analytics data

Concern for the Chinese economy is casting a shadow over the global economy heading toward reopening.

Besides the deceleration of production activities due to supply constraints, 'Common Prosperity' policy enacted by the Xi Jinping administration is involving various tightening and controlling measures on economic activities.

Reopening of economies looks set to ease supply constraints

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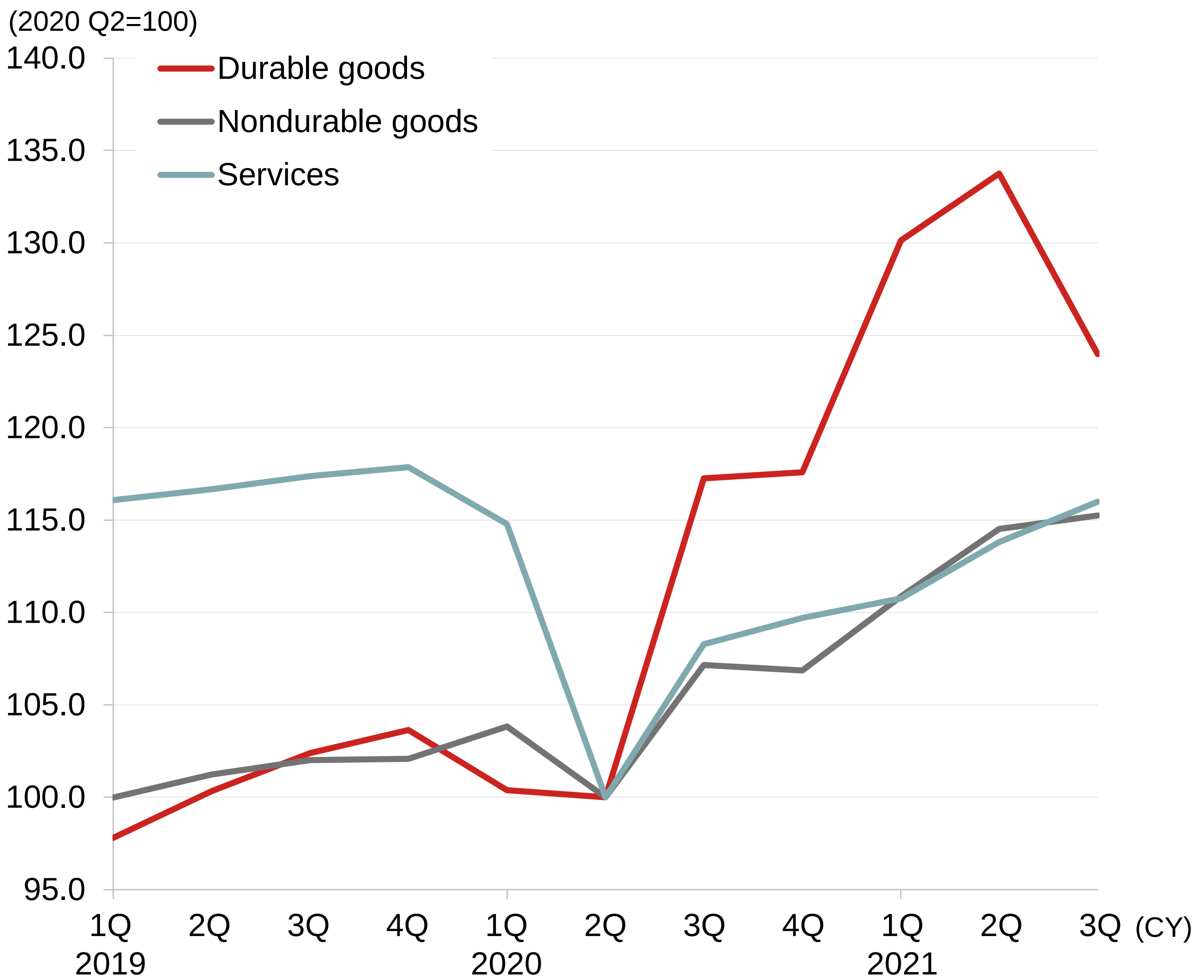
Decomposition of US real private consumption



Source: Nomura, based on US BEA data

Nomura does not consider it likely that accelerating inflation, serious downturn of the Chinese economy, or a state of stagflation combining the two will hinder the reopening of the global economy from the pandemic.

The reopening of economies from the pandemic will shift the axis of demand from durable goods to services.

Such a shift will ease the supply constraints along with expansion of overall demand.

Low probability of financial disequilibrium

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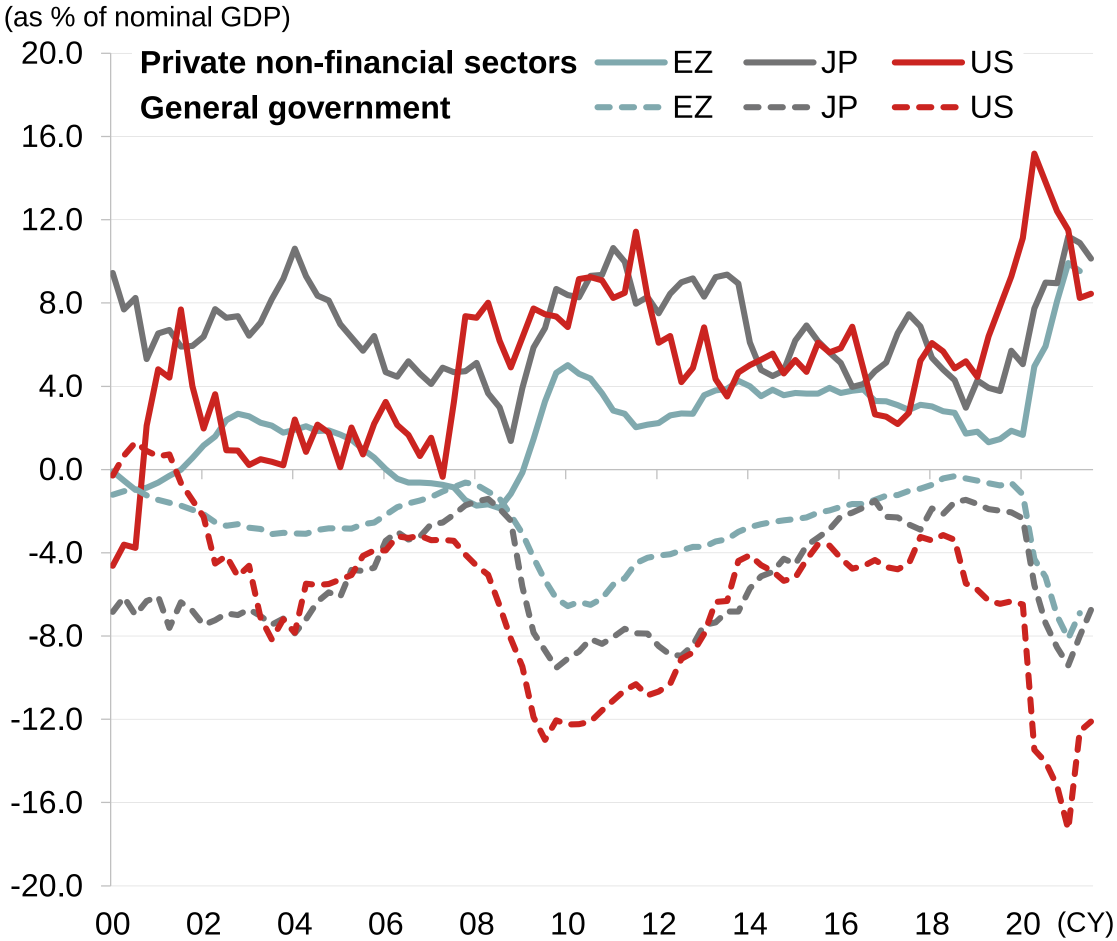
Net savings by sectors in G3 economies



Source: Nomura, based on US Fed, ECB, and BOJ data

In the financial markets in 2021, a concern emerged that a frontloaded tightening of monetary policy and the resulting rise in interest rates may hinder the reopening of economies.

However, we believe it unlikely that a significant surge in rates will occur, as the private sectors of major economies now have huge net financial surpluses. Subdued spending as well as policy driven fund transfer to household and enterprises in the form of financial aid has increased private sector net savings, which is sometimes called ‘forced savings’. This is the main source of financial surplus.

A risk of greenflation

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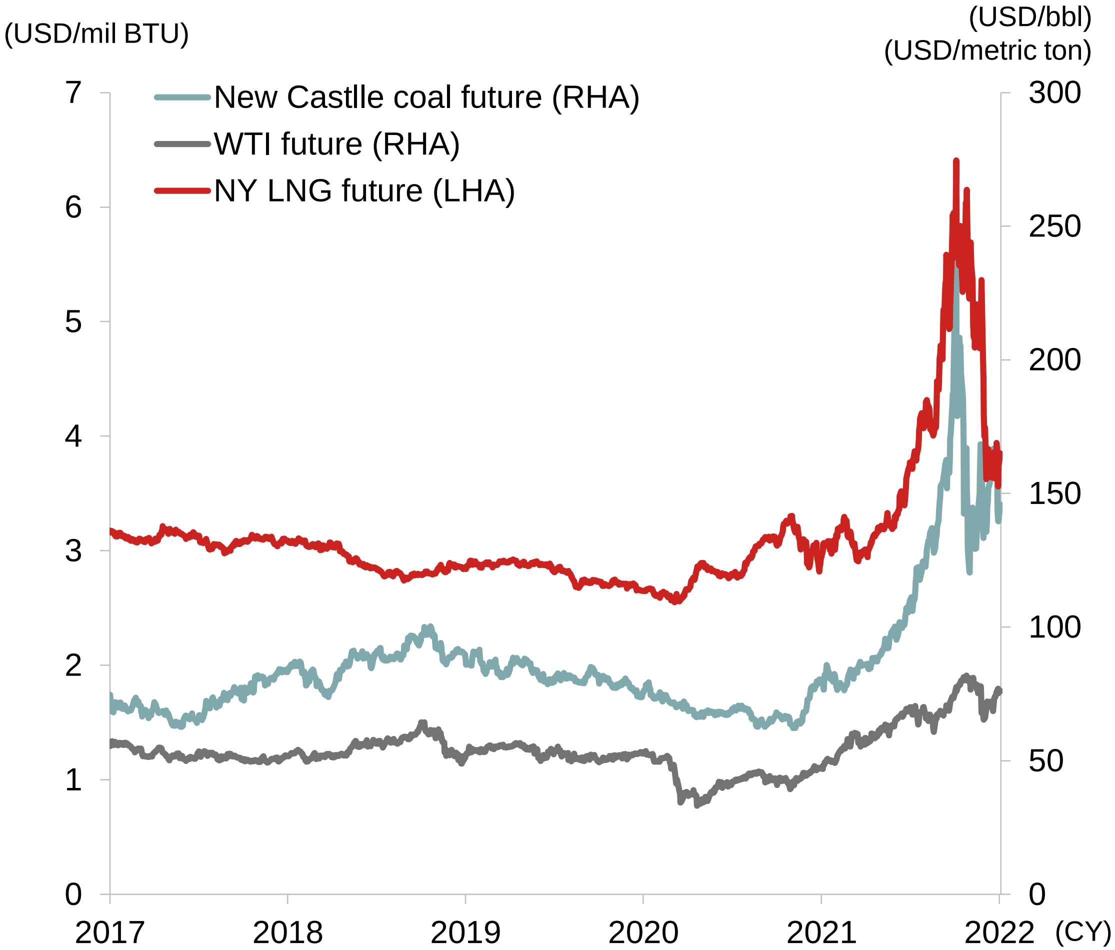
Major fossil fuel commodity index



Source: Nomura, based on Bloomberg data

In the longer run, however, we cannot totally rule out the possibility of stagflation.

A move toward carbon neutrality in the middle of the 21st century ironically raised concerns of a lack and halt of investment in mining and production facilities for fossil fuels like oil, LNG, and coal.

Markets have started to worry that a resulting persistent supply shortage may steadily elevate commodity prices and result in accelerated inflation.

Risk of asymmetric reopening of economies

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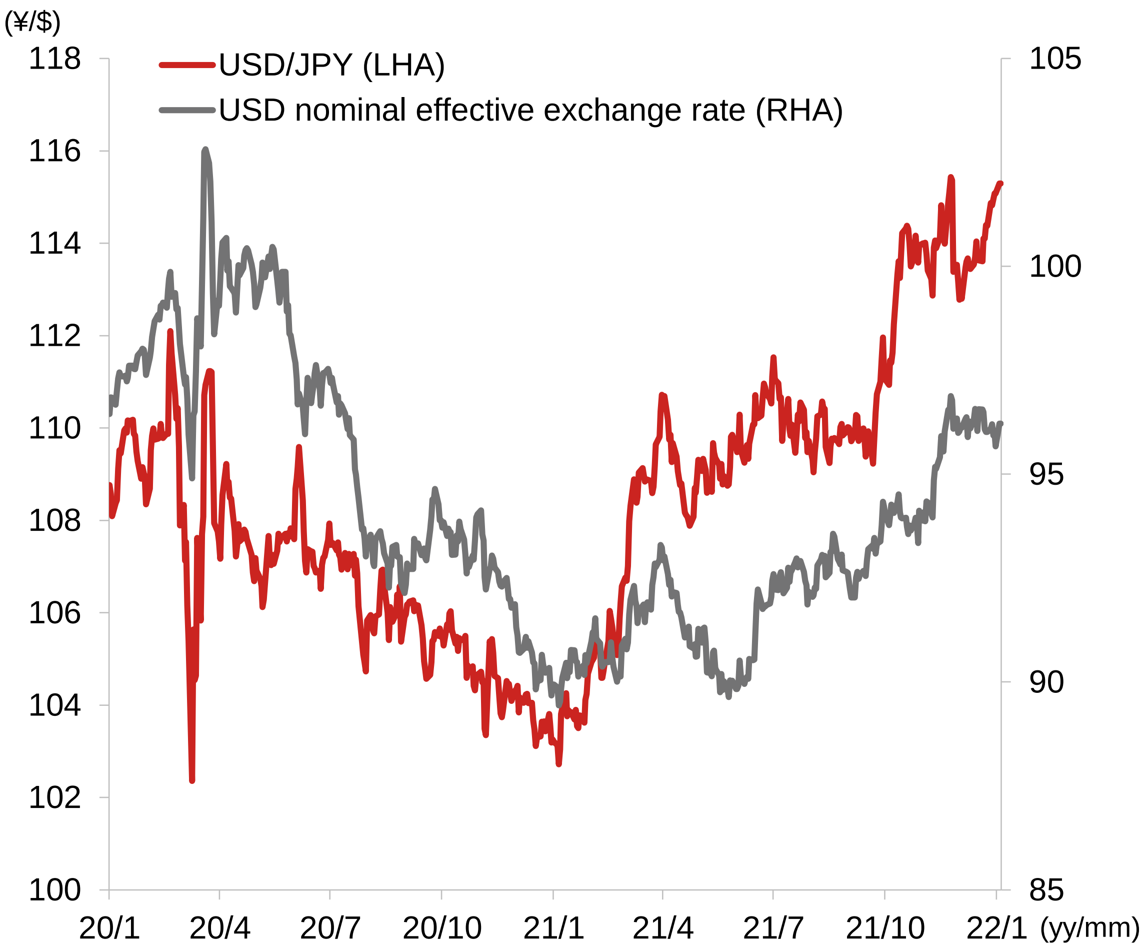
USD/JPY rate and USD nominal effective exchange rate



Source: Nomura, based on Bloomberg data

Monetary policy normalization leading up to the pandemic endgame may put financial stress to global economy as a whole.

Given the asymmetry in degree of economic reopening among developed and emerging economies, rise in rates, and currency appreciation, higher USD in particular, caused by monetary policy normalization in developed economies, may lead to capital outflow and tightening of financial conditions in emerging economies, resulting in the destabilization of financial markets and financial systems.

Japan enters the reopening phase

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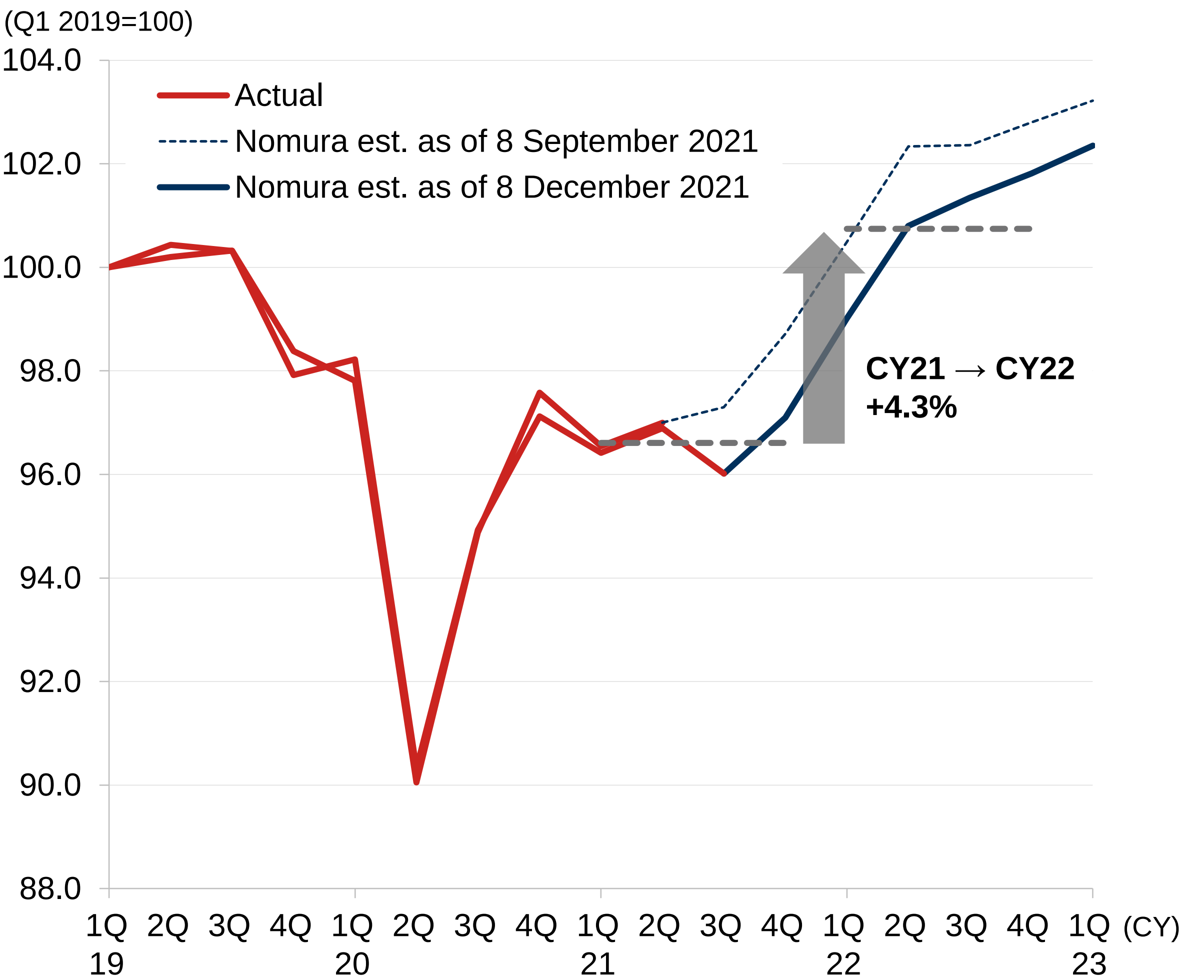
Nomura's estimate for Japan's real GDP



Source: Nomura, based on Cabinet Office data

We expect more or less full normalization of economic activity for Japan to be achieved in 2022, overcoming supply constraints and the 5th wave of infection in the summer of 2021.

Nomura expects real GDP growth for 2022 to exceed 4% year on year, well above the potential growth of Japan, driven both by corporate related demands of real exports and capital expenditures which will overcome supply constraints and household demand relieved from public health measures.

Significant job losses have been avoided in Japan

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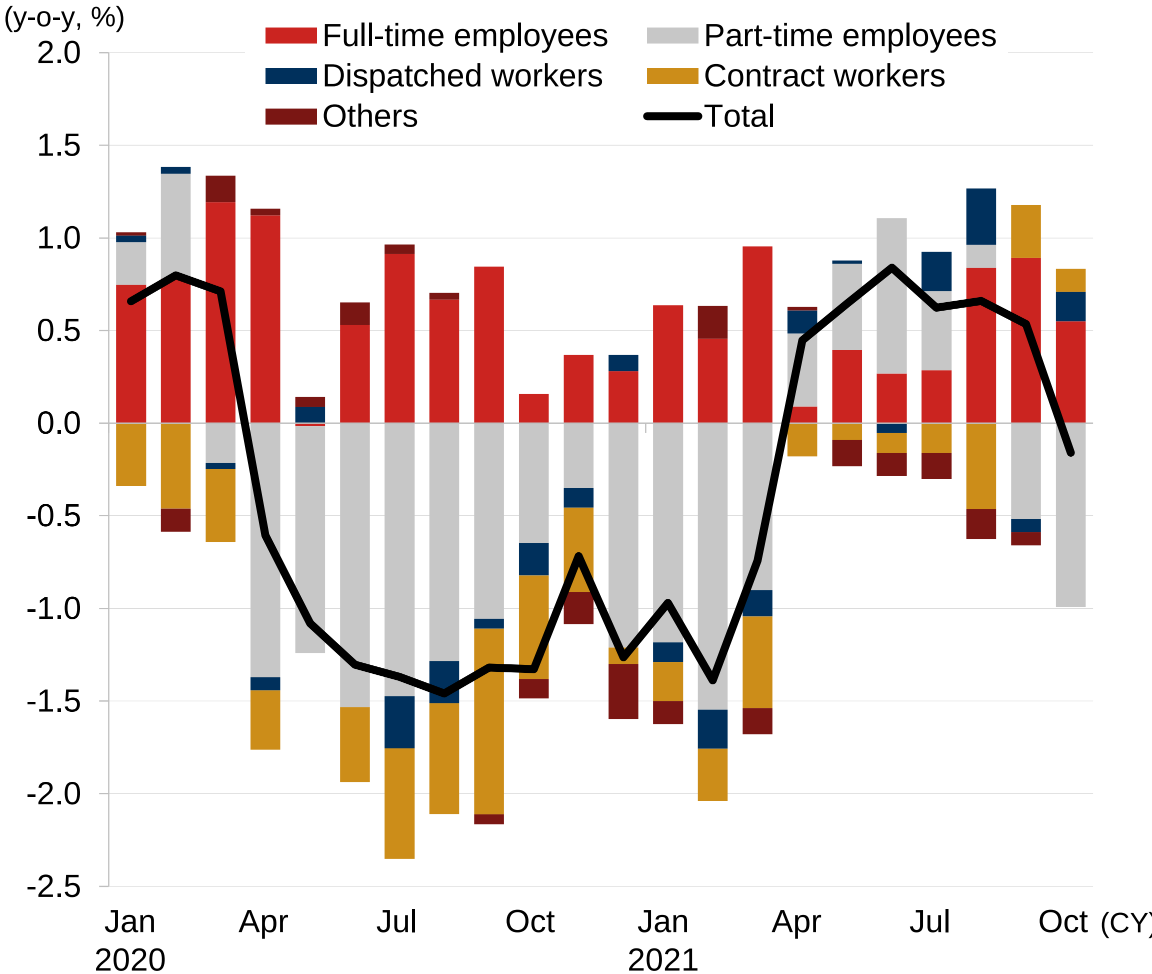
A breakdown of the number of employees by contract type



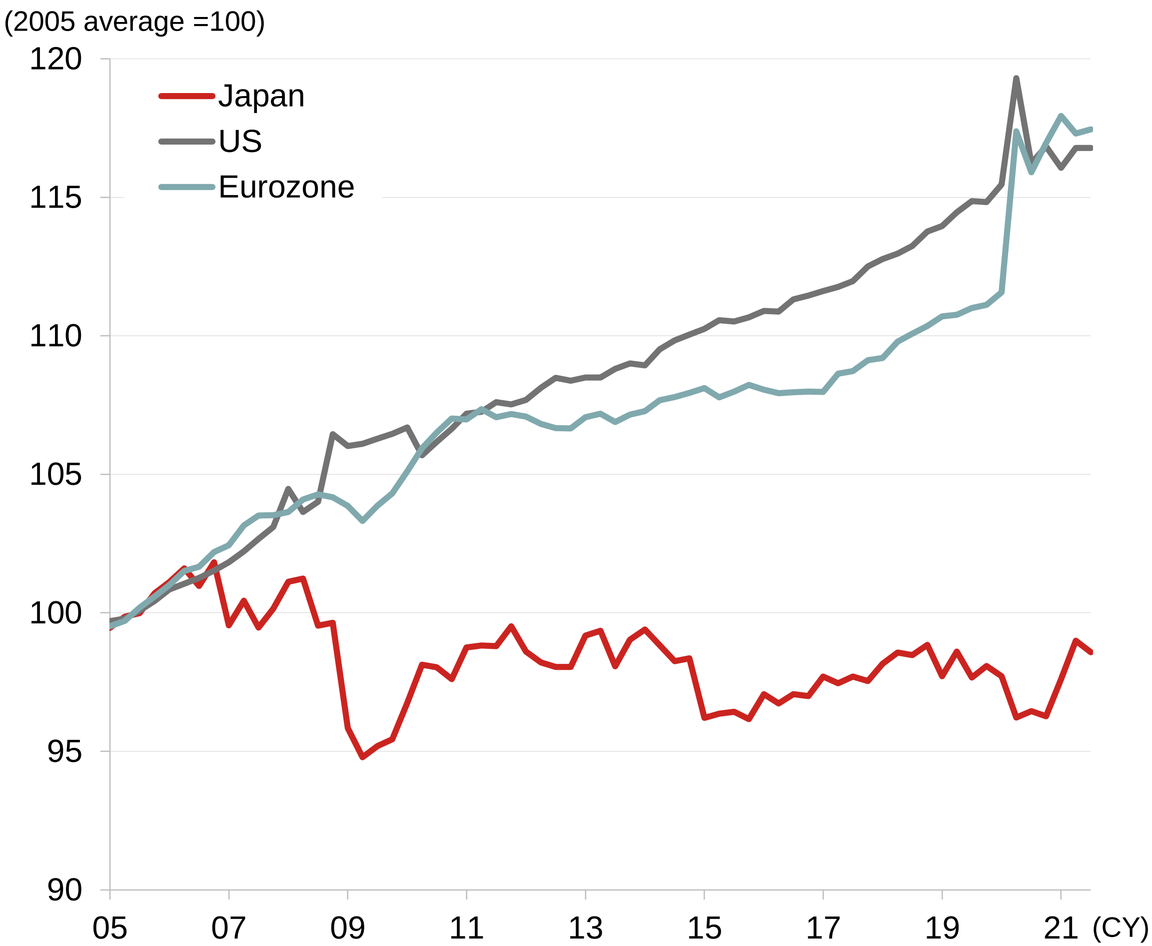
Source: Nomura, based on MIC data

One reason for the smooth reopening of Japan's economy after the pandemic is the relatively small scale of job losses during the pandemic. Employment and income conditions for Japanese households avoided the serious deterioration and jump in unemployment seen in the US and European countries. The risk of employment and household income acting to hinder economic recovery may thus be lower.

Avoidance of large scale job losses, on the other hand, may mean that little progress has been made in reforming Japan's unique employment customs and system characterized by terribly low employee mobility. Following reopening after the pandemic, these characteristics of Japan's labor market could pose a serious challenge to economic growth.

Subdued wage growth remains unchanged

Per capita real wage growth in G3 economies



Source: Nomura, based on Haver Analytics data

The preservation of Japan's unique employment customs and system may also lead to stagnation of wage growth compared to overseas economies.

The administration of Prime Minister Fumio Kishida is trying to address this issue by giving more tax incentives for wage increases and conducting a direct revision of publicly-stipulated salaries for some types of jobs. However, we expect that solving the issue of low wages and stagnated wage growth will be difficult without comprehensive structural reforms of the labor market..

Disadvantages of a cheaper Japan

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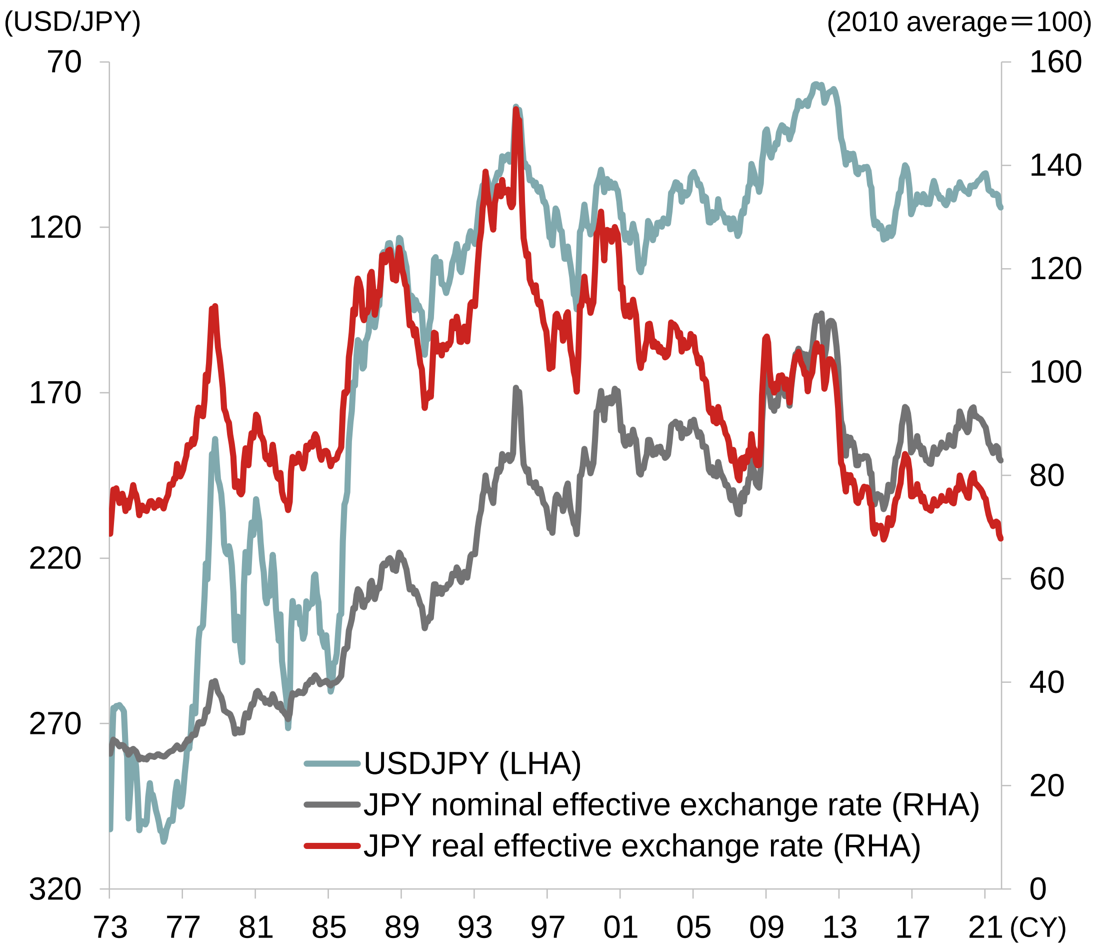
USD/JPY and JPY effective exchange rates



Source: Nomura, based on BOJ data

With the end of the pandemic, the addressing of issues if low wages and low wage growth is becoming ever more urgent.

As inflation accelerates in the world economy and the Japanese yen starts to depreciate following the normalization of monetary policy and rise of rates in overseas markets, the discrepancies of price levels between Japan and overseas grows more apparent.

This means a growing risk that we Japanese residents may one day face price discrepancies and suddenly realize a significant loss in the yen's purchasing power. This may also be a reason why the discussion on 'cheap Japan' and 'cheaper yen' is becoming more and more popular.

To reboot Japan’s potential growth rate

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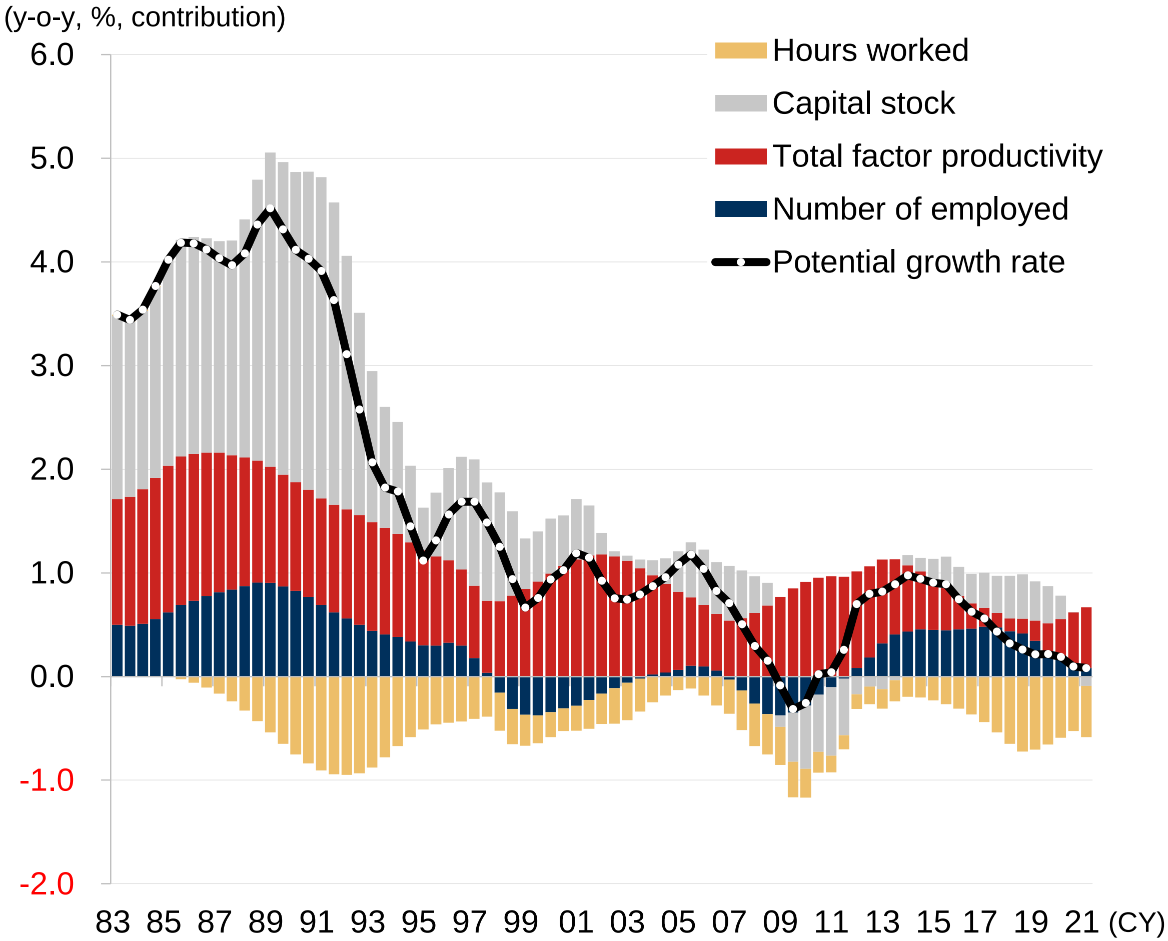
Decomposition of Japan’s potential growth rate (BOJ estimate)



Source: Nomura, based on BOJ data

In order to escape the trap of ‘cheap Japan’, we need to raise per capita value added to receive proper compensation.

By raising per capita value added of all employees and raising productivity, we can also improve growth potential of the overall Japanese economy.

A policy-based effort to promote recurrent education and reskilling is important. Private enterprises and their employees should also recognize its importance and intensify efforts for job training.

Green and digital will drive structural reform in Japan

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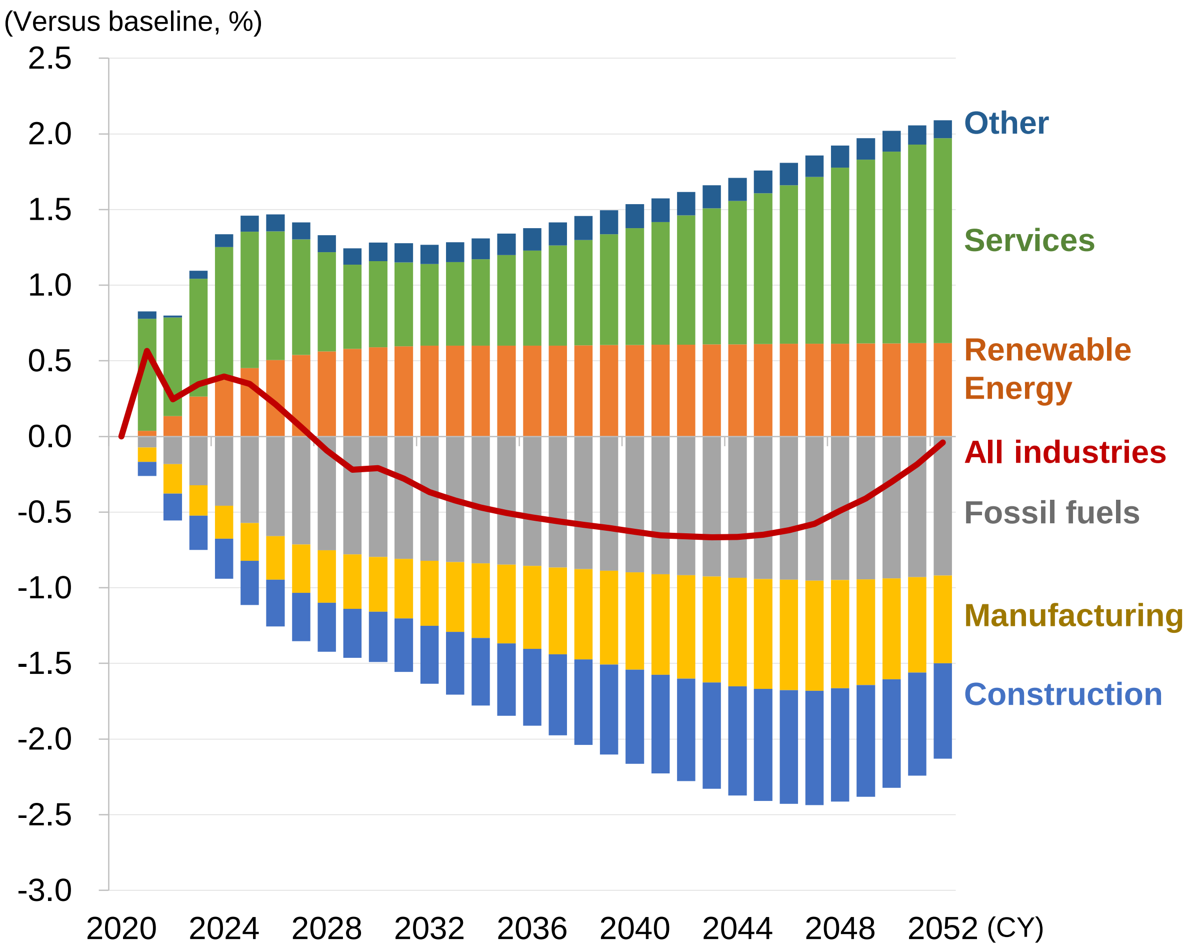
Impact of carbon neutrality on global employment (IMF estimate)



Note: IMF estimates. Envisages 80% decline in greenhouse gas emissions by 2050 driven by national and regional policies aimed at mitigating climate change. Shows outcome of (1) phased increases in carbon taxation, (2) green stimulus including infrastructure investment and renewables subsidies, and (3) compensatory transfers to households. Also assumes avoidance of economic losses due to climate change.

Source: Nomura, based on IMF data

We saw many seeds of structural changes during the pandemic; new work styles that we were forced to adopt accelerated the speed of digitalization. The birth of the Biden administration in the US also accelerated the trend towards carbon neutrality.

The shift to carbon neutrality is sure to be a large scale structural shift that produces clear winners and losers in various industries. The keys for revitalizing Japan’s economy will be efforts by enterprises to be the winners in these rapid structural changes and policy efforts by the government to create as many winners as possible in the domestic economy.

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 analyzing 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 analyzed 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 (majoring in Russian culture and society) 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 behavior from the perspectives of 'Law and Economics'. This experience proved useful in analyzing banking behavior, 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 has also authored several textbooks on economics and finance for beginners that are popular among university students and young graduates starting careers in financial institutions

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. Since August 2018, he has been serving a dual assignment as head of the Economic Research Department

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