Comment:
Will Abenomics Restore Japan’s Growth?

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September 2013

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

Any authors named on this report are research analysts unless otherwise indicated.
Economy gains momentum due to Abenomics

Channels through which effective demand rises under Abenomics

- Aggressive monetary policy
- Flexible fiscal policy
- Growth strategy (including tax reform)
- Financial markets
- Expectation effects
- Shrinkage of deflation gap
- Break away from deflation

Abenomics represents three arrows under Abenomics:
① Higher stock prices
② Financial markets
③ Rise in corporate profit
④ Higher wages
⑤ Increase in private consumption
⑥ Wealth effects
⑦ Increase in corporate capex
⑧ Higher import prices
⑨ Increase in public investment
⑩ Higher wages
⑪ Increase in exports
⑫ Growth strategy (including tax reform)
⑬ Break away from deflation

Creation of effective demand = Higher

Source: Nomura Global Economics
Inflation expectation is rising

Source: Nomura, based on MIAC data

Note: Unlike in the original Carlson-Parkin method, we calculated delta thresholds for price rises and falls based on the assumption that rational expectations up to one year out from a given point will on average agree with derived inflation expectations. In this case, delta values vary at each point in time. Expected inflation rate shows expectations for change in consumer prices one year out.

Source: Nomura, based on Cabinet Office, and MIAC data
Japan to exit from deflationary environment

Forecasts of the majority of Policy Board Members

Source: Nomura, based on BOJ and Cabinet Office data
We expect the BOJ to ease monetary policy further in mid-2014

1. The BOJ should be inclined to see the effects of growth strategy on growth and inflation, which is likely to be implemented rigorously starting from Q4 2013.

2. The actual inflation path in FY13 is unlikely to achieve the ideal inflation path, which leads to 2% inflation.

We expect the next easing measures to include purchasing JPY10-15trn more JGBs per year and JPY1-1.5trn more risk assets, mainly equity ETFs
Structural unemployment rate now stands at 3.5%

Relationship between unemployment rate and vacancy rate (UV curve)

Unemployment rate (%)

Labor demand shortage

Rising structural unemployment rate

Falling structural unemployment rate

Labor supply shortage

Note: Unemployment rate = number of unemployed people / (number of employed people + number of unemployed people). Vacancy rate = (number of job openings - number of people in employment) / (number of job openings - number of people finding work + number of people in employment). Sample period is 1965 Q1–2013 Q2.

Source: Nomura, based on MIAC, Ministry of Health, Labour and Welfare (MHLW) data

Structural unemployment remains high

Note: Cyclical unemployment rate = unemployment rate - structural unemployment rate. We calculated the structural unemployment rate by first estimating $\beta$ such that $\ln(\text{unemployment rate}) = \alpha + \beta \times \ln(\text{vacancy rate})$. We then derived the unemployment rate for the 45° line that represents a balanced labor market using the formula $\ln(\text{balanced unemployment rate}) = \{\ln(\text{unemployment rate}) - \beta \times \ln(\text{vacancy rate})\} (1 - \beta)$. We obtained the number of unemployed people that corresponds to the balanced unemployment rate, and derived the structural unemployment rate by dividing this number by the labor force.

Source: Nomura, based on MIAC and MHLW
Wage may rise by 2% if labor market continues to tighten

Phillips curve

Nominal wages (% y-y)

Wages rise on further decline in unemployment

Note: Uses Cabinet Office's employee compensation figures for nominal wages.
Source: Nomura, based on Cabinet Office, MIAC, and MHLW
Policy priorities for Abe administration

- **Make a decision to raise consumption tax**
  
  Decision will be made sometime in late September to early October.

- **Implement growth strategy**
  
  The government aims to enact some bills in the extraordinary Diet session this fall.

- **Engage in TPP negotiations**

- **Decide measures to reduce budget deficit in the social security areas**
# Estimates for direct boost to growth from key parts of the growth strategies

<table>
<thead>
<tr>
<th>Policy</th>
<th>Boost to real GDP (annual average for 2013–20)</th>
<th>Calculation method notes</th>
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<tbody>
<tr>
<td>Doubling of foreign direct investment in Japan by 2020</td>
<td>0.08ppt</td>
<td>Assumes 70% of investment amount boosts GDP in addition to lowering of tariff and non-tariff barriers in member nations, assumes liberalization measures are enacted in the fields of services and investment</td>
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<tr>
<td>Promotion of TPP</td>
<td>0.07ppt</td>
<td>Assumes power-related investment increases by same amount each year</td>
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<tr>
<td>Promotion of electricity industry reform</td>
<td>0.04ppt</td>
<td>Assumes cumulative infrastructure export value increases in equal annual increments from ¥1trn to ¥12trn in next 10 years. All project increases assumed to be new projects.</td>
</tr>
<tr>
<td>Promotion of PF/PPP</td>
<td>0.03ppt</td>
<td>Assumes PF/PPP value increases in equal annual increments from ¥1trn to ¥12trn in next 10 years. All project increases assumed to be new projects.</td>
</tr>
<tr>
<td>Promotion of infrastructure system exports</td>
<td>0.03ppt</td>
<td>Assumes market grows by same amount each year</td>
</tr>
<tr>
<td>Increasing number of overseas visitors to Japan to 30mn by 2030</td>
<td>0.03ppt</td>
<td>Assumes market grows by same amount each year</td>
</tr>
<tr>
<td>Expanding size of agricultural senary market from current ¥1trn to ¥10trn by 2020</td>
<td>0.024ppt</td>
<td>Assumes market grows by same amount each year</td>
</tr>
<tr>
<td>Easing of plot ratio regulations in national strategic special zones</td>
<td>0.01ppt</td>
<td>Assumes demand increases by same amount each year up to 2030</td>
</tr>
<tr>
<td>Promotion of internationalization of medical technology and services</td>
<td>0.005ppt</td>
<td>Assumes demand increases by same amount each year up to 2030</td>
</tr>
<tr>
<td>Total</td>
<td>0.32ppt</td>
<td>Source: Nomura</td>
</tr>
</tbody>
</table>
Do not underestimate elderly person’s purchasing power

Macro spending (nominal) at elderly households

Contribution of elderly generation’s consumption to real GDP growth

Note: Calculated by apportioning consumer spending at households of those aged 65 years and older in the Family Income and Expenditure Survey and the ratio of such households to household final consumption (excluding imputed rents) in GDP statistics. Nominal basis.

Source: Nomura, based on Cabinet Office and MIAC data