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MACRO ECONOMY

Five questions about our monetary policy forecasts

Global Markets Research

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Summary

After making the revisions to our forecasts for Bank of Japan (BOJ) monetary policy that we set out in our Global Research report entitled *Japan Economic Weekly*, published on 10 March 2015, we had the opportunity to carry out useful discussions with both overseas and domestic investors. In this report, we set out our views on these forecasts in the form of answers to five questions from investors. In some cases, these views represent a slight change of viewpoint.

Question 1: Will the BOJ be able to start JGB tapering if the 2% inflation target has not been reached?

Answer: There is a risk that the impact of quantitative and qualitative easing (QQE) will be diminished if the BOJ's Japanese government bond (JGB) purchases fall substantially below the planned amount for some time. We therefore think the BOJ will probably approach the issue of JGB tapering (i.e., the reducing of its JGB purchases) with some degree of flexibility. When the BOJ announces the beginning of tapering, we think it should stress the impact that QQE has had to date and emphasize that it needs to adjust its JGB purchases because it has become possible to achieve more or less the same impact as before with a lower level of JGB purchases.

Question 2: Will it not be difficult for the BOJ to start JGB tapering in October 2016, six months ahead of the consumption tax hike?

Answer: This certainly will be difficult, but the risk of an insufficient supply of JGBs will increase after the consumption tax hike. From 2016 H1 onward, we think the frequency of occasions where the BOJ is unable to purchase the amount of JGBs it wants is highly likely to increase, which should make the announcement of JGB tapering come as less of a surprise to the markets. The BOJ might increase its purchases of equity exchange-traded funds (ETFs) further when it announces JGB tapering. However, we also see a possibility of tapering not starting until 2018 or later if the BOJ and the government coordinate their actions.

Question 3: Why do you see little possibility of additional monetary easing in April 2015?

Answer: The BOJ monetary policy board meeting on 16-17 March and the comments made by BOJ Governor Haruhiko Kuroda in a press conference following the meeting provided evidence that the BOJ sees little need for additional monetary easing in the near term. We expect attention to focus on the results of surveys of inflation expectations that the BOJ is scheduled to release on 2 April.

Question 4: When will the risk of a sharp rise in long-term JGB yields emerge?

Answer: We think the risk of long-term interest rates rising sharply will increase from around mid-FY17, after the start of tapering, when the BOJ's JGB purchases fall below the net level of the government long-term JGB issuance. However, we expect the 10-year long-term JGB yield to rise above 1% in 2017, and think the corresponding increase in JGB demand will reduce the risk of a sharp rise in interest rates.

Question 5: Is there no possibility of a reduction in the interest rate charged on excess reserve balances held at the BOJ (0.1%)?

Answer: We think the BOJ is unlikely to reduce the interest rate it charges on excess reserve balances, except as a temporary measure as it pursues JGB tapering.

Japanese version published on March 30, 2015

In our Global Research report entitled *Japan Economic Weekly*, published on 10 March 2015, we made slight changes to our previous forecasts for Japanese monetary policy. Our revised forecasts are as follows:

1) October 2015: additional monetary easing by the BOJ (increase in purchases of JGBs and equity ETFs)
2) April 2016: BOJ's 2% inflation target to be changed to a target for the longer term
3) After Upper House elections in summer 2016: BOJ to announce its intention to start reducing its JGB purchases (ie, JGB tapering) in October 2016
4) October 2016: BOJ to start JGB tapering
5) March 2018: BOJ to finish JGB tapering

After making these revisions to our monetary policy forecasts, we had the opportunity to carry out useful discussions with both overseas and domestic investors. Below, we set out our views in the form of answers to five questions from investors regarding our monetary policy forecasts. In some cases, these views represent a slight change in viewpoint.

Question 1: Will the BOJ be able to start JGB tapering if the 2% inflation target has not been reached?

Answer: Our current view on JGB tapering is based first and foremost on the assumption that there is highly likely to be a limit to the amount of JGBs that the BOJ will be able to purchase even if it wants to. The JGBs that the BOJ is able to purchase are the JGBs issued by the government (on a net basis, excluding redemptions) and the JGBs sold by investors on the market for the purpose of reducing their holdings. We calculate this total at around ¥223.4trn in FY15–17 (please see page 6 onward of our Global Research report entitled *Japan Economic Weekly*, published on 10 March 2015). However, if the BOJ were to maintain its long-term JGB purchases at their current annual level of ¥80trn (net basis) for three years, this would mean increasing its outstanding holdings of long-term JGBs by ¥240trn. We therefore calculate that the BOJ will have no alternative but to start tapering within three years.

The BOJ's current policy of QQE is open-ended, which means that in theory it plans to maintain its current asset purchase program as long as the 2% inflation target has not been reached. In other words, if inflation remains below 2%, as we expect it to, the BOJ will in theory continue to buy JGBs at its current pace. However, if the situation whereby the BOJ is unable to purchase the planned amount of JGBs were to occur relatively frequently, there is a risk that the markets might lose confidence in BOJ monetary policy. BOJ Policy Board member Mr Takahide Kiuchi made comments along the following lines in a press conference given on 5 March and reported on 6 March. What follows is an unofficial translation by Nomura of some of Mr Kiuchi's comments.

The point at which the BOJ is no longer able to purchase JGBs smoothly will be the point at which it becomes difficult for it to purchase JGBs from financial institutions. This situation has not yet been reached, but if at some point there is an increase in the number of financial institutions that do not want to sell JGBs, even if the BOJ is willing to purchase them at a high price, this is likely to be the turning point…. We cannot rule out the possibility that the central bank will suddenly become unable to purchase JGBs. If this possibility were to materialize, it would be likely to have an immediate negative impact on the financial markets because market participants would suddenly find themselves questioning the way forward for BOJ monetary policy. This would mean a sharp increase in uncertainty and could result in severe market disruption.

The calculations set out above are only rough estimates, but there is a risk that the impact of QQE will be diminished if the BOJ's JGB purchases remain substantially below the planned amount for some time. We thus think the BOJ is aware that it needs to approach the issue of JGB tapering with some degree of flexibility. The BOJ might have no alternative but to adjust its JGB purchases even if the 2% inflation target is not reached. Of course, its original aim was not to start JGB tapering until the 2% inflation target had been reached. We think the BOJ needs to be aware of the risk that tapering will give the markets the impression that it has given up on the 2% inflation target or that the effectiveness of QQE will diminish if it is not able to keep up the same level of JGB purchases. For this reason, when it announces its intention to start tapering, we think the BOJ should not emphasize that it has to reduce its JGB purchases because there are limits to the volume of JGBs it is able to purchase. Rather, we think it should stress that it needs to adjust its JGB purchases because of a change in supply/demand conditions on the JGB market, and that one of its initial objectives—to encourage an overall lowering of the yield curve—has already been achieved and it is making this adjustment because it is now possible to achieve more or less the same impact as before with a lower level of JGB purchases. If inability to purchase the planned amount of JGBs were to become the norm, we cannot rule out the possibility of 10-year interest rates turning negative. However, this would represent an excessive lowering of the yield curve, not the overall lowering of the yield curve that the BOJ was hoping for, and we think the BOJ would therefore have to adjust its JGB purchases as required in order to prevent this from happening.

We expect the BOJ to announce its intention to start tapering immediately after the Upper House elections in summer 2016. However, it is highly likely that the situation where it is unable to purchase the planned amount of JGBs will no longer be a rare occurrence by this time. In this scenario, we think many market participants would already be wondering whether or not the BOJ would adjust the pace of its JGB purchases, and the BOJ's announcement of the decision to start tapering would therefore not come as a major surprise for the markets.

Our forecast for the schedule for JGB tapering set out above is based on the assumption that the reduction of JGB holdings by Japan Post Bank and Japan Post Insurance, as envisaged by equity market players, will proceed at a relatively rapid pace. This reflects our view that these two institutions are likely to reduce their exposure to JGBs. In this sense, we need to note once again that the government's response will have an important impact on BOJ monetary policy.

The arguments set out above are based on our view that the 2% inflation target is highly unlikely to be achieved over the next 2–3 years. We think this view can be seen as the market consensus. Core CPI inflation fell to 0.0% y-y (excluding the impact of the consumption tax hike) in February. Japan’s inflation rate is highly sensitive to crude oil prices, USD/JPY, the output gap, and inflation expectations. However, based on Nomura's macroeconomic forecasts for Japan and overseas, our current forecasts for core CPI inflation (excluding the impact of the consumption tax hike) are only +0.3% in FY15 and +1.3% in FY16. The additional monetary easing that we expect the BOJ to implement in October 2015 might cause the yen to weaken to some extent, but even taking this inflationary effect into account we still think the inflation rate is unlikely to reach 2%. A sharp rise in crude oil prices could push the inflation rate up in the short term. If the crude oil price were to rise to around $100/bbl once again, and stay there, this would probably push the inflation rate up to around 2% temporarily. However, this would indeed only be temporary, and we do not think inflation would remain at the BOJ's target of 2% for long.

Question 2: Will it not be difficult for the BOJ to start JGB tapering in October 2016, six months ahead of the consumption tax hike?

Answer: Our forecast that JGB tapering will begin in October 2016 is based on (1) the increased likelihood that the BOJ will be unable to purchase JGBs from the market if it begins JGB tapering after the economy has settled down following the consumption tax hike, and (2) the inevitable adverse impact on the Japanese economy of financial market turmoil if tapering were to take place at about the same time as the expected hike in the consumption tax in April 2017, when the economy will already be facing the adverse impact of the tax increase.

If the BOJ were to announce tapering abruptly, without any warning, we think that would surprise the markets and pose risks of an adverse impact on the real economy through rises in long-term interest rates, falling stock prices, and yen appreciation. That being so, we think the BOJ is likely to announce the timing with its release of the April 2016 *Outlook Report*, when we expect it to change its 2% stable inflation target to a longer-term target. We project that core CPI inflation will rise to 0.9% y-y in 2016 Q1 against a backdrop of sustained economic recovery from 2014 Q3 as downward pressure on inflation from fluctuations in crude oil prices finally fades, but that would still be far off the BOJ's 2% target. We think the BOJ, while recognizing that even with robust QQE, it will be difficult to attain its stable inflation target during "the projection period centered on FY15," could send a message in April 2016 to the markets along the following lines:

(1) QQE has been a driving force in helping the Japanese economy leave deflation behind, and labor-management talks in spring 2016 have led more proactive moves to raise wages than in spring 2015. This points to the Japanese economy being on a steady path toward 2% inflation.

(2) However, the response to changes in the output gap and in inflationary expectations has been slightly slower than anticipated, and it is no longer realistic to expect attainment of 2% inflation in the projection period centered on FY15.

(3) The BOJ will stick to its 2% inflation target, of course.

(4) QQE, an open-ended policy, will continue and the BOJ will keep making purchases of the various assets at the same pace as until now.

We expect that the BOJ's aim in shifting to a longer-term target will be to limit the negative impact on financial markets (in particular, the JGB, forex, and stock markets). Because the change to a longer-term target would signify a downgraded commitment to the 2% target, we think the BOJ could seek to do all it can to limit market turmoil by emphasizing that QQE is open-ended and that a longer-term 2% inflation target is fully attainable.

As noted earlier, given the increased possibility of BOJ bidding shortfalls occurring more often from 2016 H1 onward, we think the bank is likely from April 2016 to nurture broad expectations in the market that tapering is near. We would expect this to limit market surprise accompanying the announcement of tapering. When JGB tapering does begin, however, we expect the markets to take that as evidence of a further watering down in the BOJ's commitment to the 2% inflation target. That might prompt the BOJ to step up its purchases of equity ETFs and other risk assets to indicate the strength of its commitment to the inflation target. With regard to equity ETF tapering, we had said in our *Japan Economic Weekly* published on 10 March that we thought this would take place once the markets have to some extent become calm about JGB tapering; however, we also see a possibility of tapering starting around the time the economy settles down following the April 2017 increase in the consumption tax rate.

We think the BOJ could let the government know through unofficial channels of its intention to implement JGB tapering ahead of time. We would expect constraints on the supply of long-term JGBs to be eased at that juncture if the government (1) boosts JGB sales to Japan Post Bank and Japan Post Insurance, and (2) promises to put in place the legislative and regulatory framework to allow excess reserves in current account balances with the BOJ to be used as collateral for various financial transactions conducted by financial institutions. We also see a possibility that the government could announce such policies in advance, thereby helping avert early tapering by the BOJ. If these conditions were to fall into place, we think the timing of the start of tapering could be put off until after the conclusion of Governor Kuroda's first term of office (in March

2018). We accordingly think a close watch is needed on such developments from the perspective of assessing the monetary policy outlook.

Question 3: Why do you see little possibility of additional monetary easing in April 2015?

Answer: The BOJ monetary policy board meeting on 16–17 March and Mr Kuroda's comments after the meeting provided evidence of the BOJ's basic stance that (1) there is little need for additional monetary easing in the near term, given relatively high expectations for inflation and economic recovery at present, and (2) the BOJ will not hesitate to ease policy if needed to achieve its 2% stable inflation target. Regarding (1), Mr Kuroda said at the press conference that price trends have shown a steady improvement and that even if the CPI were to turn negative, reflecting the sharp drop in crude oil prices, this would not have an immediate effect on price trends, prompting us to think that the BOJ is now even less likely to implement additional easing in 2015 H1. In terms of inflationary expectations, the February *Consumer Confidence Survey* showed 87.3% of respondents expecting prices to be higher in one year's time, versus 87.4% in January. We will be watching for the results of the BOJ's *Tankan: Inflation Outlook of Enterprises* survey, due to be released on 2 April, and its *Opinion Survey on the General Public's Views and Behavior*. If these surveys show sharp downward revisions in the outlook on prices of companies and consumers, that could give rise to the possibility of further easing in April. At this point, however, we see little chance of such large downward outlook revisions.

Question 4: When will the risk of a sharp rise in long-term JGB yields emerge?

Answer: Japanese long-term interest rates are basically affected by supply/demand factors centered around the BOJ's asset purchase program, interest rates in the US and elsewhere, and changes in the underlying inflation rate. As long-term interest rates fell substantially after the BOJ launched QQE, we do not think it would be surprising if long-term interest rates were to rise when an end to QQE comes into view. We thus think the risk of a sharp rise in long-term interest rates might emerge when the BOJ announces that it is changing its 2% inflation target to a target for the longer term (which we expect to happen in April 2016, as we explained earlier), when the BOJ announces tapering (which we expect to happen after the Upper House elections in summer 2016), or when the markets start to factor in the impact of these events. If, while the BOJ's purchases of large volumes of JGBs are depressing liquidity in the long-term JGB market, the volatility (liquidity) of long-term interest rates were to increase in response to these announcements or speculation about these announcements, investors' preference for holding JGBs might decrease. However, we think long-term interest rates are unlikely to rise substantially when this happens, because the BOJ will still be buying more JGBs than the government's total net issuance—in other words, the BOJ will still be a net purchaser of JGBs from investors on the open market. As we mentioned earlier, we expect the BOJ to treat market stabilization as a top priority when it makes monetary policy announcements, and we think it might do this by temporarily stepping up the value of its JGB purchases if long-term interest rates rise excessively sharply.

In our view, the risk of a sharp rise in long-term interest rates is likely to emerge when the BOJ's JGB purchases fall below the net level of the government's long-term JGB issuance (¥28trn per year) as it pursues gradual JGB tapering. We think this might happen around the middle of FY17. From this point on, we would expect the overall stance of investors other than the BOJ to switch from one of decreasing their net holdings of JGBs to one of increasing these holdings. That is to say, from this point on, we would expect the smooth absorption of the JGBs issued by the government to be a major issue for the markets. We think the level of long-term interest rates will depend to a large extent on whether or not JGB demand from financial institutions and life insurers returns to previous levels at this point. We expect the 10-year JGB yield to rise to 1.05% at end-2016 as a result of interest rate hikes in the US and the beginning of JGB tapering by the BOJ. However, we think this is likely to lead to a corresponding increase in JGB demand from regional financial institutions and life insurers that place emphasis on coupon income from their JGB holdings, which we think should reduce the risk of long-term interest rates rising higher than 1.05%. Nevertheless, depending on factors such as the level of volatility at the time, we think there will still be a risk of a temporary sharp rise in long-term interest rates.

Question 5: Is there no possibility of a reduction in the interest rate charged on excess reserve balances held at the BOJ (0.1%)?
Answer: We think the BOJ is unlikely to reduce the interest rate it charges on excess reserve balances, except as a temporary measure as it pursues JGB tapering. The BOJ's current QQE policy is centered on large-volume asset purchases by the BOJ and the resulting expansion of the monetary base. Financial institutions' excess reserve balances in their BOJ accounts have increased substantially as their sales of JGBs to the BOJ have grown. Financial institutions currently hold the funds generated through the sale of JGBs to the BOJ in accounts that pay an interest rate of 0.1%. For these financial institutions, this interest rate of 0.1% serves as a strong incentive for them to sell JGBs to the BOJ.

If the BOJ were to lower the interest rate it charges on excess reserve balances—for example, reducing the interest rate to a negative level—this would reduce the incentive for financial institutions to sell JGBs to the BOJ. We think it unlikely that the BOJ would deliberately reduce the incentive for financial institutions to sell their JGBs, because restrictions on the volume of JGBs the BOJ is able to purchase would lead to major problems. Of course, a negative interest rate on excess reserves would increase the incentive for financial institutions to lend, but we think this would be unlikely to lead to a clear increase in demand for funds. Thus, in our view, the disadvantages of a switch to a negative interest rate on excess reserves held at the BOJ would substantially outweigh the advantages.

However, as we mentioned in our answer to question 4, when the BOJ's JGB purchases fall below the net level of the government's long-term JGB issuance (¥28trn per year) as it pursues JGB tapering (which we expect to take place from mid-FY17 onward), the BOJ might lower the interest rate it charges on excess reserves as a temporary measure aimed at preventing a sharp rise in JGB yields. At this point, we think the BOJ might do a 180 degree turn from a stance of wanting financial institutions to sell JGBs, to one of wanting financial institutions to become net purchasers of JGBs. We thus see a possibility of a reduction in the interest rate the BOJ charges on excess reserves as a temporary measure aimed at preventing a sharp rise in JGB yields.

(Tomo Kinoshita)

The week ahead

1 Apr (Wed): March *Tankan* survey (business conditions DI (large manufacturing companies, actual result); previous figure: +12, Nomura forecast: +14)

We have drawn up estimates for the March 2015 BOJ *Tankan* survey, scheduled for release on 1 April. We think the current business conditions diffusion index (DI) for large manufacturers, a component of the *Tankan* watched closely by the market, will come in at +14, up 2pts versus the December 2014 survey. While industrial production could well rise q-q for a second straight quarter in 2015 Q1, surveys such as the Reuters *Tankan*, which exhibits a strong correlation with the BOJ *Tankan* (conducted over 3–16 March, 255 out of 400 companies replied), show only a modest improvement in business sentiment within the manufacturing sector. The Reuters *Tankan* also gave voice to some respondents complaining about the negative impact of yen depreciation. This notwithstanding, we think manufacturing activity will continue to grow, and also expect the future conditions DI for large manufacturers to improve modestly to +16, 2pts higher than the current conditions DI.

Elsewhere, we think the current business conditions DI for large nonmanufacturers will come in at +18, up 1pt versus the December 2014 survey. The Reuters *Tankan* also revealed consistently flat business sentiment within nonmanufacturing amid a modest recovery in consumer spending, with retailers in particular still complaining about the fallback in demand following the consumption tax hike. We think consumer spending growth will only pick up from 2015 H2, and thus expect the future conditions DI for large manufacturers to come in at +18, the same as the current conditions DI.

We think the March 2015 *Tankan* survey will contain a fixed investment projection for FY15 of -5.9% y-y (all enterprises, all industries). Initial fixed investment projections are often downbeat in March, but tend to be revised up over time. Even so, we expect the latest reading to be weaker than the equivalent projection of -4.2% y-y for FY14 in the March 2014 survey. This reflects the weak fixed investment projection for FY15 in the *Business Outlook Survey*, which the Ministry of Finance (MOF) and Cabinet Office have already released.

However, these figures refer to the traditional definition of fixed investment that excludes software and includes land. According to the *Business Outlook Survey*, fixed investment projections that include software but exclude land, thereby matching the definition of fixed investment in GDP data, are at -3.9% y-y for FY15, higher than the equivalent reading of -5.1% y-y for FY14 in the same survey one year ago. Companies are not as downbeat about capex on a basis that includes software but excludes land than on the reverse basis.

The market consensus (Bloomberg survey median) forecast for the current business conditions DI for large manufacturers is +14, in line with our forecast.

(Masaki Kuwahara)

Fig. 1: Economic data and events in the week ahead

Tuesday 31 March		Units	Period	Last	Nomura	Consensus
10.30	Total cash earnings	% y-y	Feb	1.3	N/A	0.7
14.00	Housing starts	% y-y	Feb	-13.0	N/A	-7.0
Wednesday 1 April						
8.50	Business conditions in Tankan	Index	Mar	12	14	14
Thursday 2 April						
8.50	Tankan (figures by industry)					
Friday 3 April						
	No indicators					
Monday 6 April						
14.00	Economic coincident index	Index	Feb	113.3	N/A	N/A

Note: Consensus forecasts are Bloomberg survey median forecasts. As of 30 Mar 2015.

Source: Nomura, based on Bloomberg data and various other materials

From recent reports

Japan manufacturing PMI: March 2015 - Above 50, but down for second straight month, issued on 24 March 2015

All-Japan CPI: February 2015 - All-Japan core inflation continues to fall, issued on 27 March 2015

Japan employment & household spending: February 2015 - February consumer spending data mixed, issued on 27 March 2015

Japan industrial production: February 2015 - February output below consensus, issued on 30 March 2015

Economic forecasts for Japan

Fig. 2: Key points of our economic outlook

- GDP growth was +1.5% annualized in 2014 Q4, after contraction in 2014 Q2 and Q3. We expect the economy to gain momentum from here on.
- We expect core CPI inflation to average +0.3% y-y in FY15 (excluding the impact of the consumption tax hike), staying below the BOJ's 2% target even on a monthly basis.
- The BOJ unexpectedly opted for major monetary easing on 31 October 2014 and we expect it to conduct additional easing in October 2015.
- The main risks are yen appreciation, a worsening European debt problem, and the US and China slowing.

Source: Nomura

Fig. 3: Summary of our forecasts for the Japanese economy (1)

CY:	14Q1	14Q2	14Q3	14Q4	15Q1	15Q2	15Q3	15Q4	16Q1	16Q2	16Q3	16Q4	2014	2015	2016
Real GDP (seas adj, annualized, % q-q)	5.1	-6.4	-2.6	1.5	3.0	2.8	2.1	1.7	1.5	1.5	1.9	1.5			
													(% y-y)		
Real GDP (seas adj, % q-q)	1.3	-1.6	-0.7	0.4	0.7	0.7	0.5	0.4	0.4	0.4	0.5	0.4	0.0	1.2	1.7
Private consumption	2.2	-5.0	0.3	0.5	0.3	0.4	0.5	0.5	0.4	0.3	0.4	0.4	-1.2	0.1	1.6
Private-sector capex	5.9	-5.0	-0.2	-0.1	1.4	1.4	1.3	1.1	1.1	1.0	1.0	0.8	4.1	1.7	4.5
Residential fixed investment	2.4	-10.3	-7.0	-1.2	1.3	0.3	0.0	-0.4	-0.5	1.3	2.1	0.8	-5.2	-5.7	1.7
Government expenditure	-0.3	0.4	0.2	0.3	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	1.3	1.3
Public investment	-2.2	1.1	2.1	0.8	1.5	0.0	-1.2	-1.5	-1.7	-0.8	-0.9	-1.9	3.7	2.4	-4.8
Exports of goods & services	6.5	-0.3	1.5	2.8	1.8	1.8	0.9	0.7	1.0	1.0	1.1	1.2	8.2	6.7	4.1
Imports of goods & services	6.9	-5.3	1.0	1.3	1.0	0.9	0.9	1.0	1.3	1.5	1.5	1.3	7.2	2.5	5.0
Contributions to GDP (seas adj, ppt q-q)													(ppt y-y)		
Domestic final sales	2.1	-4.1	0.0	0.4	0.6	0.5	0.5	0.5	0.4	0.4	0.5	0.4	-0.1	0.6	1.7
Inventories	-0.5	1.4	-0.8	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.1	-0.2	0.0
Net trade	-0.3	1.1	0.1	0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.8	0.0
Unemployment rate (%)	3.6	3.6	3.6	3.5	3.5	3.5	3.4	3.4	3.4	3.3	3.3	3.3	3.6	3.4	3.3
Consumer prices (% y-y)	1.5	3.6	3.3	2.6	2.3	0.1	0.1	0.5	0.9	1.2	1.3	1.3	2.7	0.8	1.2
Core CPI	1.3	3.3	3.2	2.7	2.2	0.1	0.1	0.4	0.9	1.2	1.2	1.3	2.6	0.7	1.2
(ex impact of consumption tax hike)	1.3	1.4	1.1	0.7	0.2	0.0	0.1	0.4	0.9	1.2	1.2	1.3	1.1	0.2	1.2
Fiscal balance (% of GDP)													-8.3	-7.1	-7.4
Current account balance (% of GDP)													0.5	3.6	3.7
Unsecured overnight call rate (%)	0.04	0.06	0.03	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07
5-year JGB yield (%)	0.20	0.17	0.17	0.03	0.10	0.10	0.20	0.20	0.20	0.30	0.35	0.40	0.03	0.20	0.40
10-year JGB yield (%)	0.64	0.57	0.53	0.33	0.40	0.50	0.60	0.60	0.65	0.80	1.00	1.05	0.33	0.60	1.05
USD/JPY	103.2	101.3	109.7	119.8	120.0	123.0	124.0	125.0	126.0	128.0	129.0	130.0	119.8	125.0	130.0

Note: (1) Interest rate and exchange rate forecasts are end of period. (2) Numbers in bold are actual values; others are Nomura forecasts. (3) Unemployment rate is % of labor force. (4) Fiscal balance is for fiscal year (April through following March). (5) As of 9 Mar 2015.

Source: Nomura, based on Cabinet Office, Ministry of Internal Affairs and Communications (MIC), MOF, and BOJ data

Fig. 4: Summary of our forecasts for the Japanese economy (2)

(% y-y, except where noted)d)

		As of 9 Mar 2015					
		FY14E	FY15E	FY16E	CY14	CY15E	CY16E
Gross domestic product	Real GDP growth	-0.9	2.0	1.8	0.0	1.2	1.7
	Contribution of domestic demand (ppt)	-1.7	1.5	2.0	0.0	0.4	1.8
	Private-sector demand (ppt)	-1.9	1.3	1.9	-0.3	0.1	1.7
	Public-sector demand (ppt)	0.3	0.2	0.0	0.3	0.3	0.0
	Contribution of external demand (ppt)	0.7	0.5	-0.2	0.0	0.8	0.0
	Private-sector consumption	-3.0	1.6	1.9	-1.2	0.1	1.6
	Private-sector housing investment	-12.0	-1.3	2.7	-5.2	-5.7	1.7
	Private-sector capital expenditure	-0.1	4.3	4.7	4.1	1.7	4.5
	Private-sector inventories (contribution)	0.3	-0.2	0.0	0.1	-0.1	0.0
	Government consumption	0.6	1.3	1.4	0.3	1.3	1.3
	Public fixed capital formation	3.5	-0.5	-5.2	3.7	2.4	-4.8
	Goods/services exports	7.4	6.3	4.2	8.2	6.7	4.1
	Goods/services imports	3.0	4.2	5.9	7.2	2.5	5.0
	Nominal GDP growth	1.6	4.2	2.3	1.6	4.0	2.4
	GDP deflator	2.5	2.2	0.5	1.7	2.8	0.6
Production/prices	Industrial production	-0.4	3.8	2.3	2.0	2.7	2.4
	Corporate goods price index	3.2	-2.0	0.5	3.2	-1.1	-0.2
	Consumer price index	2.9	0.4	1.3	2.7	0.8	1.2
	Excluding fresh foods	2.9	0.4	1.3	2.6	0.7	1.2
	Excludes impact of consumption tax hike	0.9	0.3	1.3	1.1	0.2	1.2
	Unemployment rate (%)	3.6	3.4	3.3	3.6	3.4	3.3
External balances	Trade balance (¥trn)	-7.2	2.4	-0.4	-10.4	1.4	0.6
	Trade/services balance (¥trn)	-10.0	-0.3	-3.1	-13.5	-1.2	-2.1
	Current account balance (¥trn)	7.5	20.0	18.0	2.6	18.6	18.8

Note: Where value = -0.0, this is shown as 0.0.

Source: Nomura, based on Cabinet Office, MIC, Ministry of Economy, Trade and Industry (METI), MOF, and BOJ data

Fig. 5: Assumptions on which our economic forecasts are based

	FY14	FY15	FY16
USD/JPY (FY-end)	120.0	126.0	130.0
Consumption tax rate (at FY-end, %)	8.0	8.0	8.0
Crude oil price (North Sea Brent, FY-end, $/bbl)	55.7	64.4	69.0

Source: Nomura

Appendix A-1

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