



Global Economic Outlook and Japan's Trade Policy

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Today's agenda

Global Economic Outlook

- 18:30 Global Economic Outlook
- 18:55 Global Economic Outlook Q&A

Turbulent times – how will Japan be trading in the future?

- 19:05 Survey Results
- 19:15 Overview of Japan's Trade Policy and Discussion

Networking in the banquet room “Victor's” from 19:30 onwards

Global Economic Outlook

Macroeconomic Trends in Japan

Snapshot

Although some indices appear feeble, the recent economy has remained overall robust, aided by the vibrant export thanks to solid external demand. The labor market is becoming further tighter, causing the service price hike to spread, but no evident sign of inflation has been observed in indices.

Economy

- IMF revised up considerably the 2017 growth outlook to +1.2% (as of January: +0.8%)
- March real consumption expenditure low (YOY ▲1.3%)
- March IIP declined to 99.6 (MOM ▲2.1%)
- Trend of price hikes led by logistics companies

Fiscal / Monetary Policies

- Governor Kuroda repeated at a press conference that discussions to revise policy targets are too early

Financial Market

- Stock prices reached its highest level since early this year, JPY depreciated against USD
- Bond yields information was temporarily unavailable (decrease in transactions)

Politics etc.

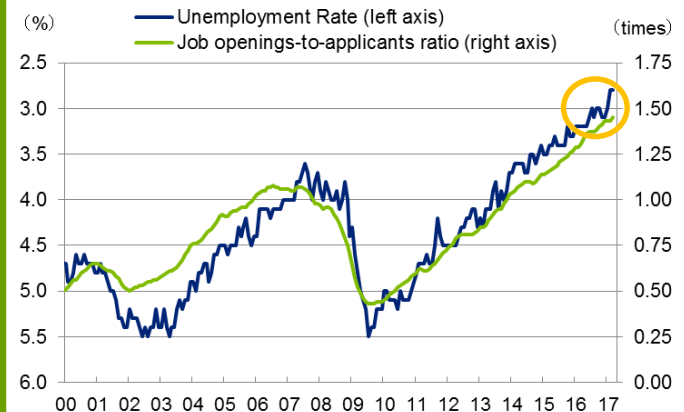
- Secretary Ross stated that the U.S. can no longer sustain the trade deficit with Japan
- Russia agreed to deploy a public-private research team to the Northern Territories

Baseline Scenario

The Trump rally begins to rewind gradually, and the downward pressure is imposed on the economy due to temporary JPY appreciation and declining stock prices, but the economy remains steady overall. In the latter half of the year, JPY depreciation and weak stock prices are likely to halt as the Trump administration will finally deliver its policy agenda and thereby gradually raising the production and capital investment. Meanwhile, inflation is expected to remain on an upward trend and hence a hike of long-term interest rates.

Key Point

Job Openings-to-Applicants Ratio



The March job openings-to-applicants ratio marked 1.45, the highest since November 1990.

Macroeconomic Trends in the U.S.

Snapshot

1Q GDP growth rate turned out to be very low, but this is widely seen as temporary. Now some indices such as auto sales seem weak, but overall indicators point to strong economy. With growing corporate earnings, stock prices have also been shifting in a high range. In the political scene, the Trump administration had finally seen a step forward of its agenda by the FY2017 budget approved and the Obamacare replacement bill passed at the House of Representatives though a dismissal of the FBI director could be another blow to the administration's credibility.

Economy

- 1Q GDP growth rate stagnated at +0.7%
- April automobile sales remained sluggish
- April University of Michigan Consumer Sentiment Index remained a high level at 97.0

Fiscal / Monetary Policies

- May FOMC postponed a rate hike as expected
- FRB views slowing in growth during 1Q slower as "temporary"

Financial Market

- Stock prices renewed record highs underpinned by strong corporate earnings

Politics etc.

- Obamacare replacement bill passed by a slim margin at the House, all eyes are on Senate voting
- FY2017 budget approved (government shutdown avoided)
- President Trump said he would be "honored" to meet North Korean leader Kim Jong-un "under right circumstances"

Baseline

Due to the turmoil over the policy implementation by the Trump administration, stock prices driven by policy expectations shift to a downward trend. FRB reinforces its cautious stance toward its interest rate hikes, which maintains a strong economy and avoids the tumble of the Trump rally. From autumn onwards, the tax reduction bill is passed and the risk-on trend in the market will be enhanced.

Key Point

ISM Report on Business Indices



The April ISM manufacturing index declined to 54.8 (MOM ▲2.4pt). Non-manufacturing index increased to 57.5 (MOM +2.3pt).

Macroeconomic Trends in Europe

Snapshot

The Eurozone economy has stayed strong. In this environment, HICP has increased again but the ECB continued to deny the case of early change in the current loose monetary policy. In the political scene, the centrist candidate Emmanuel Macron won the French presidential election, which largely set back the concerns over the collapse of EU. However, the Greek support program remains uncertain, while the Brexit discussions between the U.K. and EU are expected to get fiercer.

Economy

- 1Q GDP growth rate increased to +1.8%
- Recent economy continues to be robust (April Eurozone PMI composite at 56.8)
- PMI composite declined in Germany and France, but improved in peripheral countries
- April HICP composite grew to +1.9% YOY (March: +1.5%)

Fiscal / Monetary Policies

- After the April ECB board meeting, President Draghi comments that there has been no assuring sign of inflation

Financial Market

- Long-term rates remained stable
- Stock markets rose upon the French presidential election

Politics etc.

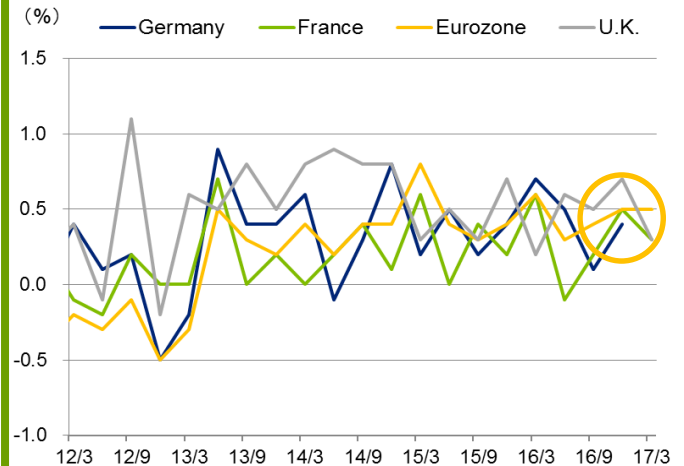
- (France) Macron was elected as the next president
- (EC) examines negotiating directives for Brexit
- (U.K.) Conservative is likely to win the next election
- (Germany) Conservative CDU/CSU defeated SPD in several state elections

Baseline

Uncertainty lingers over the continuation of the Greece support program, and concerns regarding the Brexit negotiations are expected to grow. However, the economic recovery will continue to take shape in Europe as the ECB maintains monetary easing measures, and further fiscal stimulus is expected.

Key Point

Eurozone GDP



The Eurozone January-March GDP remained stable at +0.5% QOQ (+1.8% SAAR).

Macroeconomic Trends in China

Snapshot

Current economic indices become a little weaker than those of 1Q, but the overall situation has remained strong and overheating in the housing market has again become apparent. In the political scene, speculation which could cause a rift in the relationship of Xi Jinping and Wang Qishan was reported, implying a power game prior to the National Congress. On the diplomatic side, the relationship with the U.S., which was once alarming, is beginning to improve remarkably.

Economy

- 1Q GDP showed strong growth at +6.9% YOY
- April official PMI decreased to 51.2 (MOM ▲0.6%pt), Caixin manufacturing PMI also fell to 50.3 (MOM ▲0.9%pt)
- April foreign currency reserve balance continued to rise from the previous month (USD 3.03 trillion)

Fiscal / Monetary Policies

- Tax reduction policy of RMB 380 billion throughout 2017 (to simplify VAT and reduce corporate income tax of SMEs)

Financial Market

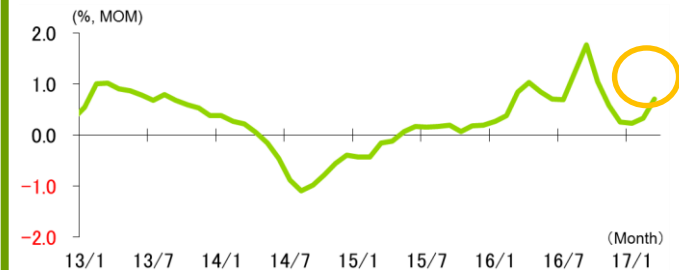
- Stock prices fell due to concerns over stricter regulation on the insurance industry

Politics etc.

- Media reported speculation that could deteriorate the ties between President Xi Jinping and Politburo Standing Committee member Wang Qishan, power struggles within the Communist Party leadership

Key Point

China New Home Sales Price



The March new home sales prices were +0.70% MOM (February: +0.33% MOM).

Baseline

With the National Congress approaching in autumn, the Chinese government continues to be beware of the downside risk, rather than upside. While the stance of neutral monetary policy is emphasized in order to contain capital outflows and real estate bubble, the monetary tightening ends up halfway. Underpinned by the strong growth-focused policies, the economy will continue to perform above its actual capacity up until the autumn. Later on, however, expanded imbalances will drag on growth rate.

Macroeconomic Trends in Other Emerging Economies

Snapshot

With the U.S. interest rates maintaining a low level, currencies of the emerging economies have remained steady and this has provided room for further monetary easing in some countries. With this and also strong external demands from advanced countries and China, emerging economies in general continue to be stable. Meanwhile, crude oil prices have been somewhat weak and thus some dampening effects on oil-producing countries' economy.

Economy

- Steady growth continued
- (Mexico) 1Q GDP increased to +2.7% YOY
- (S. Korea) 1Q GDP increased to +2.7% YOY
- (Indonesia) 1Q GDP showed strong growth at +5.01% YOY

Fiscal / Monetary Policies

- (Russia) consecutive rate cut (9.75% → 9.25%)
- (Brazil) 5-meeting consecutive rate cut (12.25% → 11.25%)

Financial Market

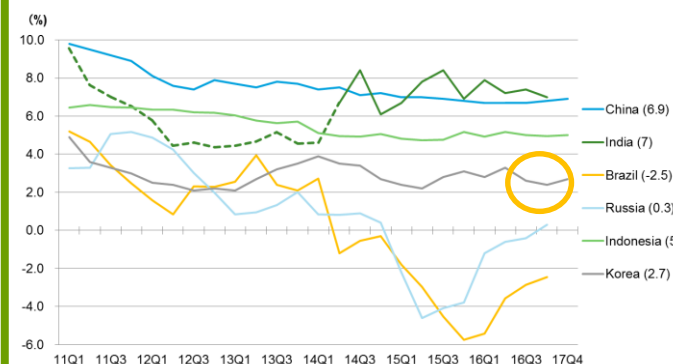
- Relatively stable in the foreign exchange markets

Politics etc.

- (S. Korea) Moon Jae-in of the Democratic Party, conciliatory towards North Korea, won the presidency
- (Turkey) At referendum, the majority voted to approve the constitutional reform to enhance presidential authorities
- (S. Africa) Possible non-confidence motion against President Zuma

Key Point

Emerging Economies GDP



The 1Q GDP growth rate in South Korea improved to +2.7% YOY.

Baseline

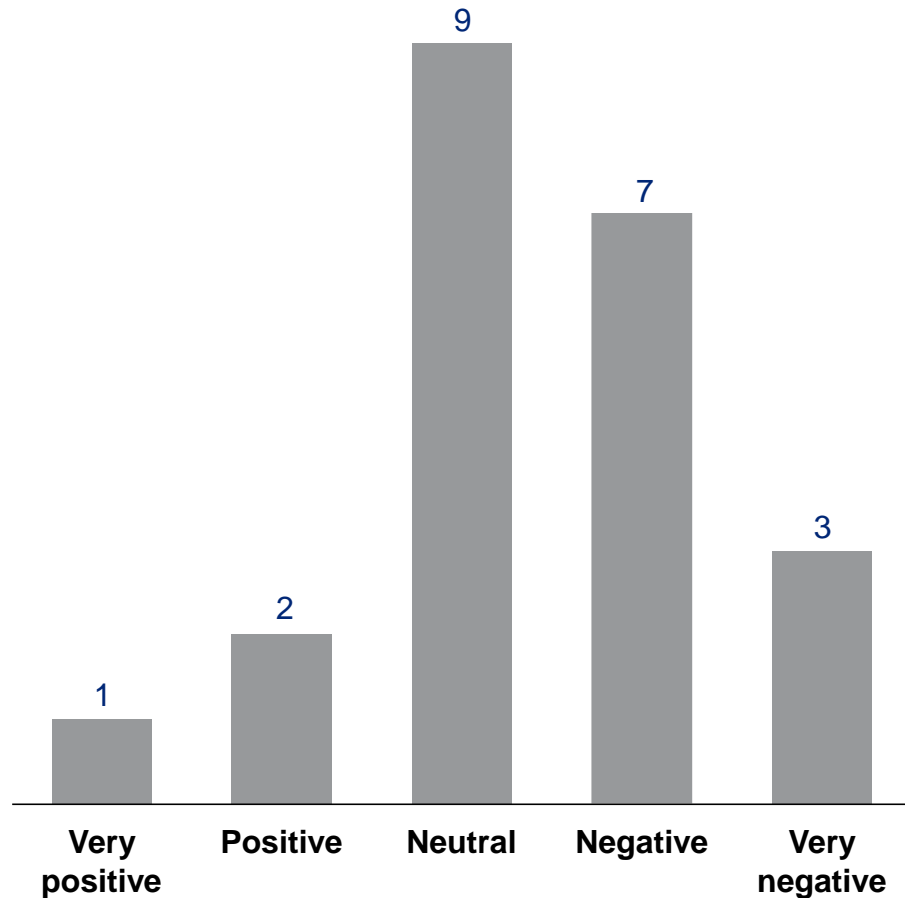
The advanced and Chinese economies are enjoying steady growth, whilst the upward pressure on the interest rates in the U.S. weakens, thus the economic condition and market environment in emerging markets remain stable for the time being. However, in the latter half of the year when the interest rates begin to rise in the U.S., growing pressures on capital outflows, currency depreciation, and falling stock prices will gradually induce further downward pressure on the economy.

Turbulent times

How will Japan be trading in the future?

Survey Results: The US's withdrawal from the TPP

Given the recent U-turn on TPP from the US, how positive do you see the opportunity for Japan for trade?



In what way do you think Japan's trade will change?

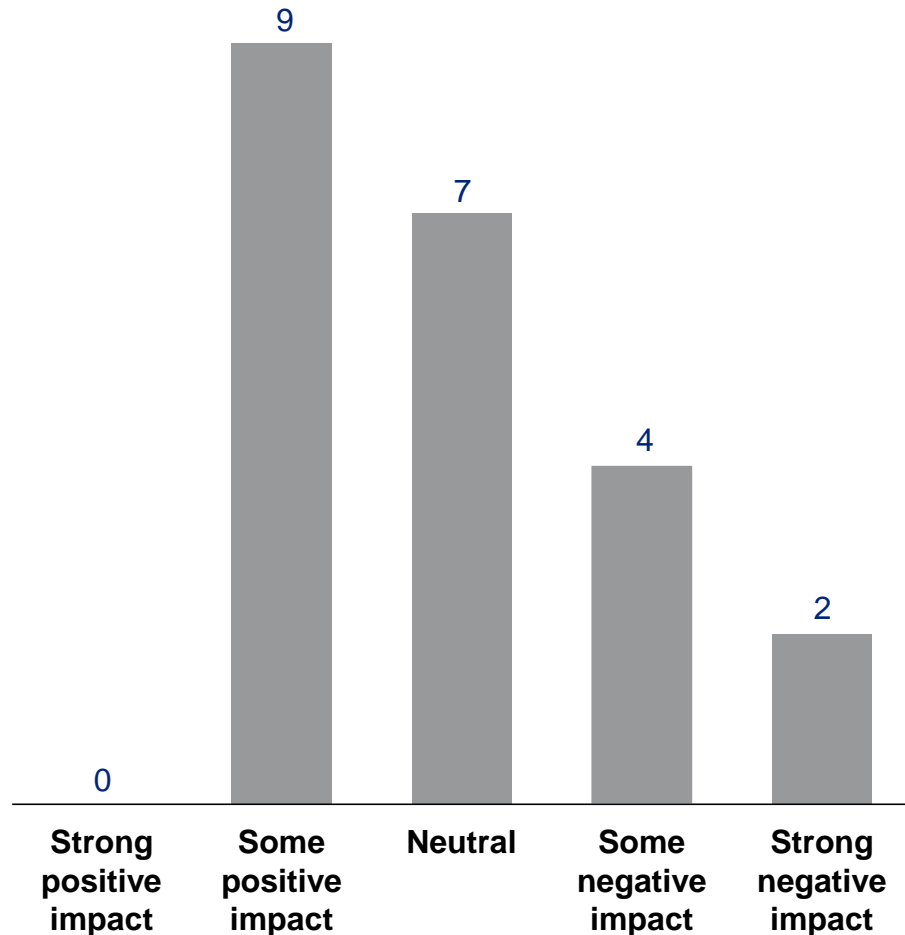
"Japan's focus could move to non US area such as Middle-East, Europe, Mexico and so on"

"Japan is still very well positioned for trading with Asian market which are more dynamic than the US"

"Japan will need to form individual trade alliances which will take longer to implement"

Survey Results: Bilateral trade agreement between Japan and the US

What is your view of a possible future bilateral FTA between Japan and the US?



Which sectors do you think has the biggest need for lower trade barriers and would that affect your company?

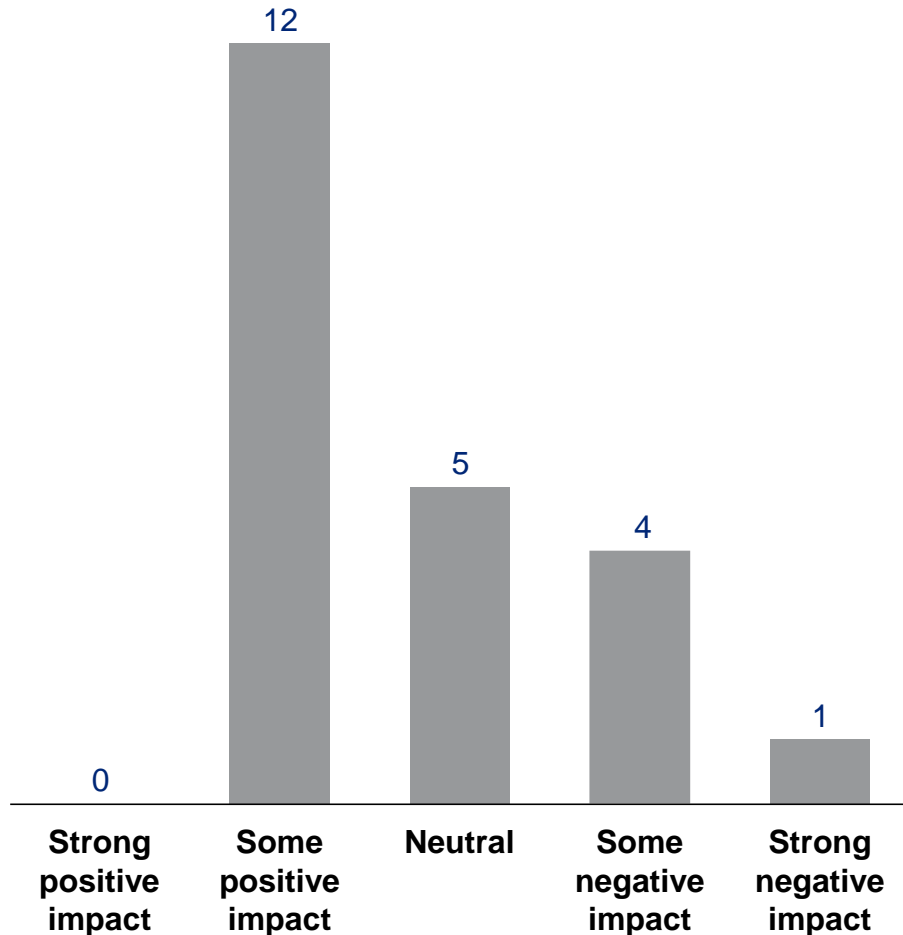
“In an FTA with US, the automobile industry, definitely”

“None... trade barriers are already low, the question is does Japan allow further global corporatism into the domestic economy or not?”

“Fishing and farming products, building materials, technology”

Survey Results: Entering TPP without the US

In what way do you think Japan would benefit from participating in TPP without the US?



How would your company specifically be impacted from a TPP without the US?

“TPP will be negative by increasing health costs for on patent drugs, will reduce Japan's sovereign flexibility for Corporate vs State lawsuits, and attach Japan's somewhat effective single payer health care. I don't see any positive benefits from it at all”

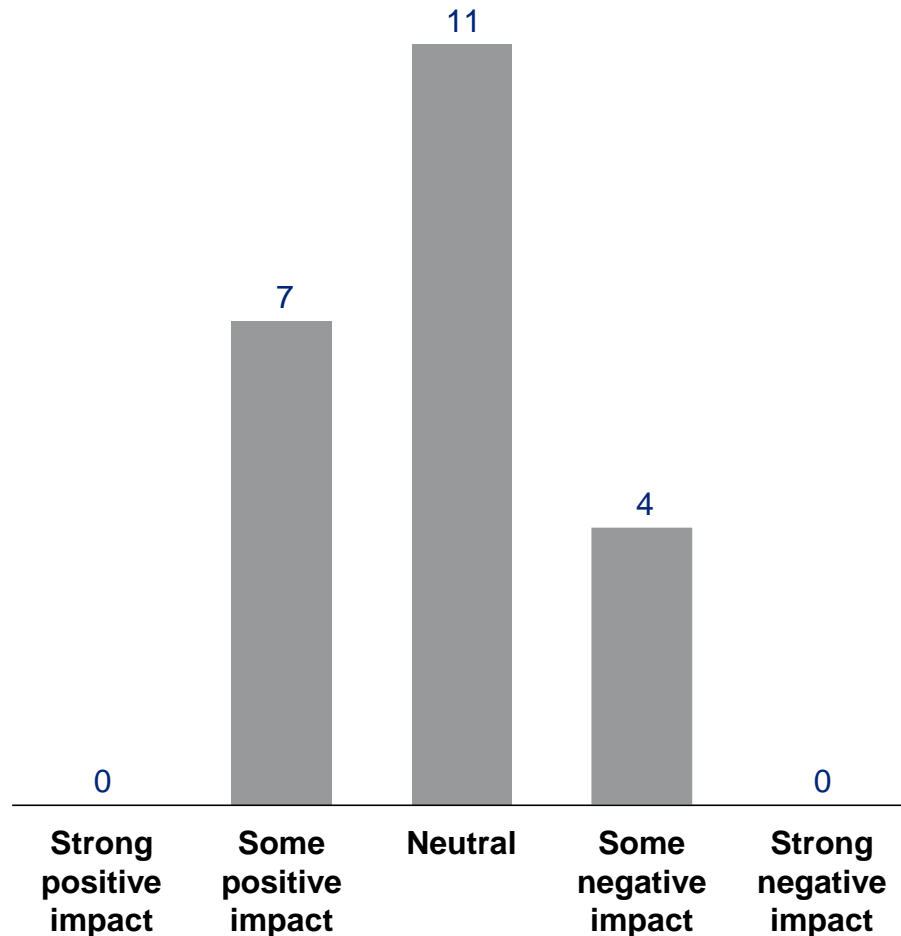
“Not significant”

“Better than not entering it”

“No impact to my industry. Considering Japan as whole, it should be positive”

Survey Results: Consequences of Brexit

How do you see the developments of Brexit negotiations and its impact on your business in Japan?



Do you think Japan has a unique opportunity to strengthen ties with the UK?

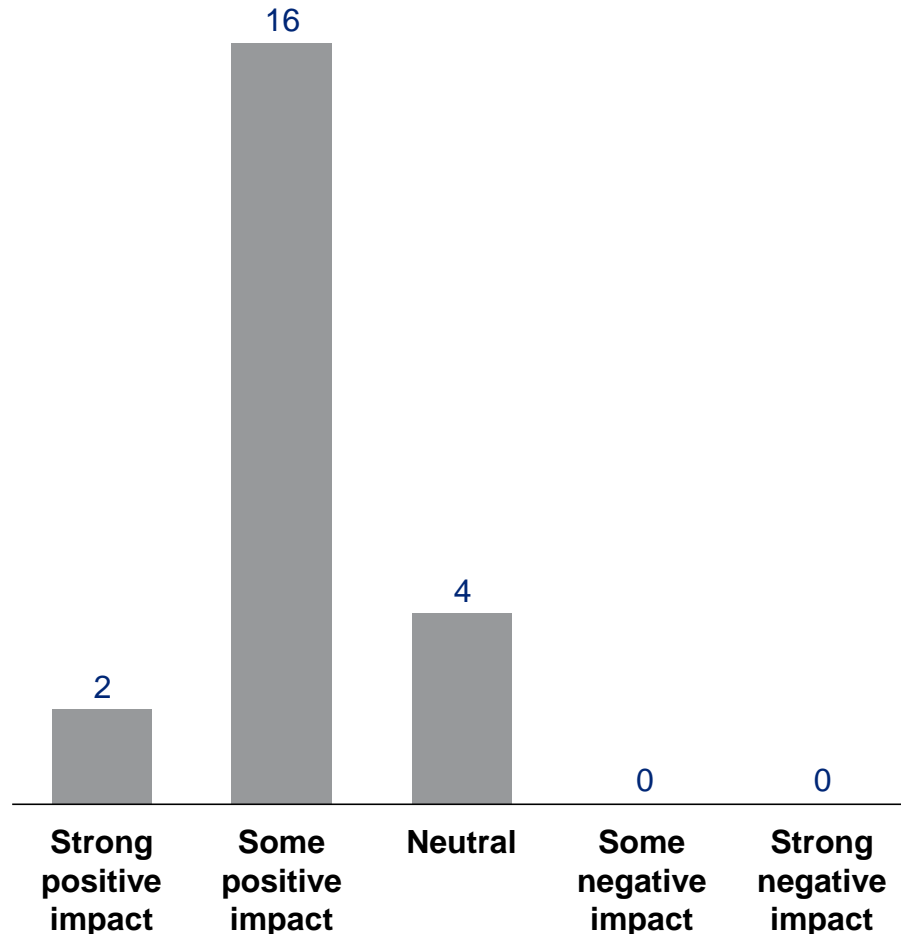
“Japan could have more leverage in negotiations with UK standalone than with EU”

“Japanese production in England may be negatively effected, where it comes to export to the European mainland”

“As a result of close monitoring of the discussion, unexpected business chances could come up”

Survey Results: Trade agreement between Japan and the EU

How do you think a future free trade agreement between Japan and the EU will influence Japan's trade?



Would a Japan – EU free trade agreement lead your company to realign its positions in Europe and if so in what way?

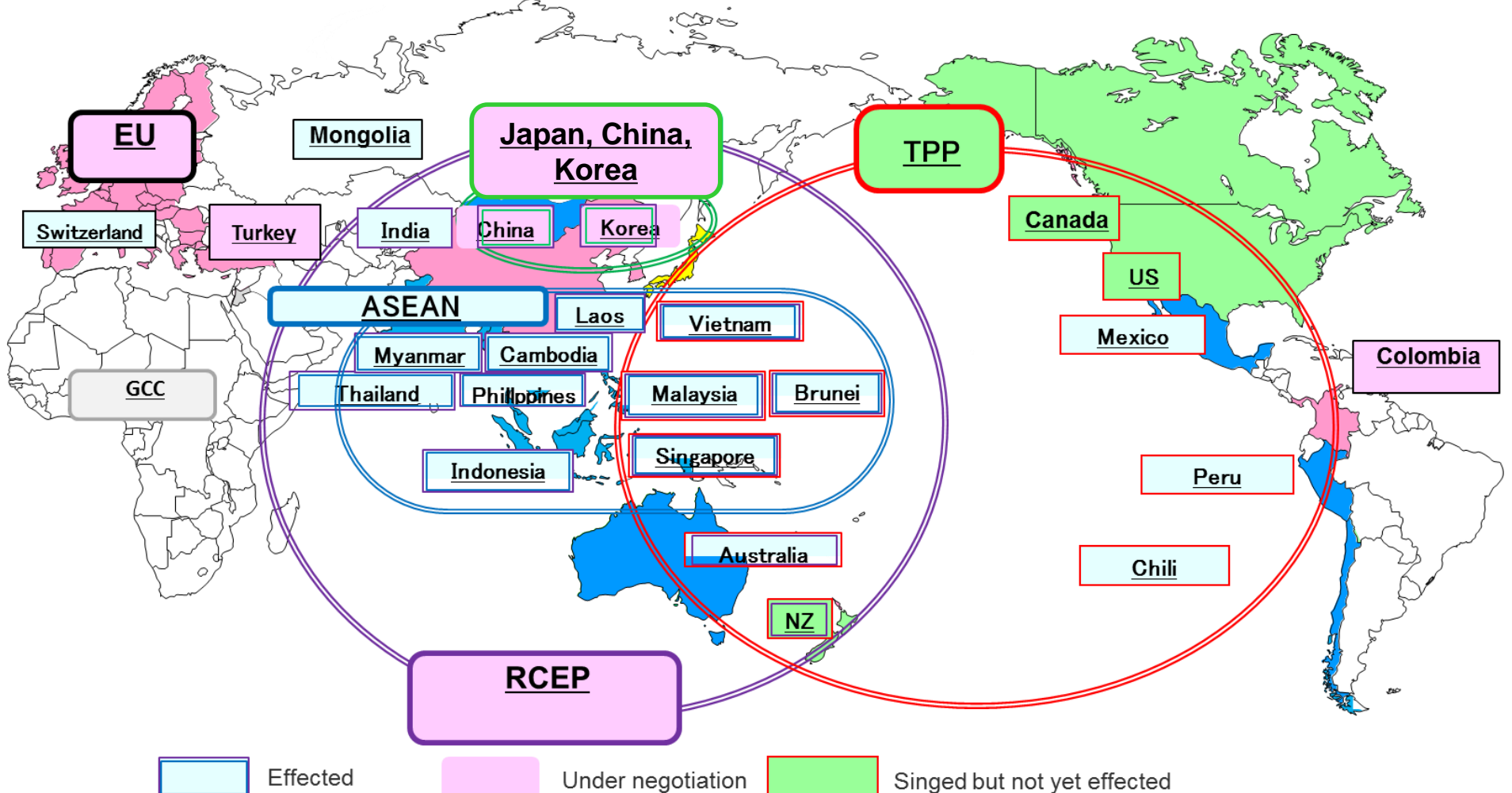
“Yes, would give better access to this market than today”

“Some exports should have benefits, but with Brexit confusion, the benefit amount looks limited”

“We are a US-owned financial services company - not much effect”

Japan's Economic Partnership Agreements—The Current Status

Previously, the Japanese government has planned to increase its EPA/FTA coverage ratio from the current around 40% to 70% by 2018



Source: The author made this map based on Watanabe, T. "International Environment and Japan's Trade Policy," January, 2017
<https://www2.deloitte.com/jp/ja/pages/strategy/articles/cg/member-of-the-board-networking-vol4.html>

TPP12 is by far the biggest impacts on Japanese economy

Each FTA/EPA's share of global numbers as of 2015 (%)

	Population	Nominal GDP	Global Trade	Japanese Export	Japanese FDI
TPP	11%	38%	26%	33%	47%
RCEP	49 %	31%	29%	43%	31%
CJK - FTA	22%	23%	19%	25%	11%
JPN - EU EPA	9%	28%	35%	11%	23%

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Coming EPA/FTA negotiations – TPP11

EPA/FTA Overview and the Japanese government's strategy

- **TPP11**

- ✓ The TPP is featured to be a **comprehensive and “high quality”** trade agreement
- ✓ The TPP covers **trade and trade-related issues**, beginning with trade in goods and continuing through customs and trade facilitation; sanitary and phytosanitary measures; technical barriers to trade; trade remedies; investment; services; electronic commerce; government procurement; intellectual property; labour; environment; dispute settlement, exceptions, and institutional provisions
- ✓ The TPP **eliminates or reduces tariff and non-tariff barriers** across substantially all trade in goods and services
- ✓ Now that the US new administration officially announced its withdrawal from the TPP, however, **the TPP12** may not be realized in the near future.
- ✓ **Instead, the TPP11 (excluding the US) is now being discussed** and according to the recent media reports, Japanese government intends to agree with other members without major changes of the current one by the end of this year

Our view on the Japanese government's possible strategy:

- ✓ **Waiting until the US comes back to the framework**, which could be a counterbalance against the Chinese trade initiatives
- ✓ Using an excuse for not accepting more favorable terms for the **US in the bilateral FTA negotiation**

Coming EPA/FTA negotiations – Japan-EU FTA

EPA/FTA Overview and the Japanese government's strategy

- **Japan-EU FTA**

- ✓ According to media reports, “**Brussels hopes to seal its biggest trade deal by reaching a political agreement with Japan in early July**, which would close large parts of the negotiations and only leave a few areas to be resolved later this year”
- ✓ Key points of remaining disagreement **are the EU's 10% tariff on the automotive sector**, which Japan would like to see removed, as well as the Japanese reluctance to open up its food market for agricultural goods from the EU, especially for dairy products

Our view on the Japanese government's possible strategy:

- ✓ **Keeping the trend of globalization and free trade**, which tends to be dismissed by the US new government and also by some populism movements in the EU
- ✓ **Enhancing its exports to the EU**, which has tended to lag behind its exports to other regions
- ✓ **Mitigating some possible damages on Japanese firms in the UK**, which could be caused by **Brexit**

Coming EPA/FTA negotiations – RCEP

EPA/FTA Overview and the Japanese government's strategy

- **RCEP (Regional Comprehensive Economic Partnership)**
 - ✓ **Launched in November 2012**, the agreement aims to deepen economic integration between ASEAN and Australia, China, India, South Korea, Japan, and New Zealand. Having missed two deadlines, the pressure is on for these 16 countries to substantially conclude negotiations this year.
 - ✓ **RCEP was designed to be a comprehensive and mutually beneficial economic partnership agreement**, which would involve broader and deeper engagement between ASEAN and its dialogue partners by significantly improving their existing FTAs
 - ✓ According to the media reports, “**still, the Japan meeting (in February) may only take officials about 30 percent of the way to a deal** ...Some countries want to offer different degrees of market access to member nations, but that is not an approach with universal support,” “it depends whether they prioritize speed over quality”

Our view on the Japanese government's possible strategy:

- ✓ Putting pressure on the US to come back to the TPP
- ✓ Enhancing its exports to Asian countries
- ✓ Containing the influence of China over the regional trade policy

Remaining Trade issues for Japan

FTA with the US and NAFTA

- The new US government has now a **strong intention to start bilateral FTA with Japan** mainly focusing on opening up the agricultural market, while Japan is rejecting the idea partly due to the political concerns of re-fueling the debate of agricultural issues
- **Renegotiation of NAFTA could also impact Japanese firms located mainly in Mexico**

Our view on the Japanese government's possible strategy:

- ✓ Japan might recognize that starting the FTA talks with the US might be difficult to avoid but will try to align their conditions with the ones of TPP

Brexit

- **Hard or ultra-hard Brexit is becoming a more likely case**
- Many foreign financial institutions located in London have already started their preparation to move some operations to continental Europe given that they will likely lose their **passporting** status given by the EU

Our view on the Japanese government's possible strategy:

- ✓ **Continue to put pressure on the UK government** to seek a more softer approach, menacing possible shift of business bases of Japanese firms outside the UK
- ✓ **Enhancing the trade relationship with the EU** to mitigate some possible damaging effects on Japanese firms in the UK

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