

Stress Scenario Considering Chinese, the US, and Japanese Economic Developments

Plausible Stress Scenarios to be considered

December 2015

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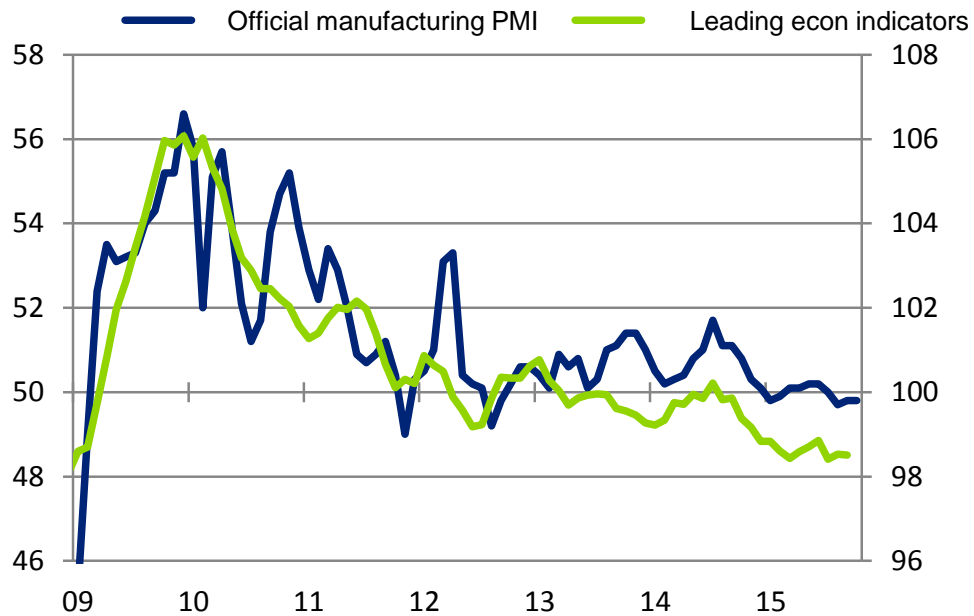
China: Ultra hard landing scenario



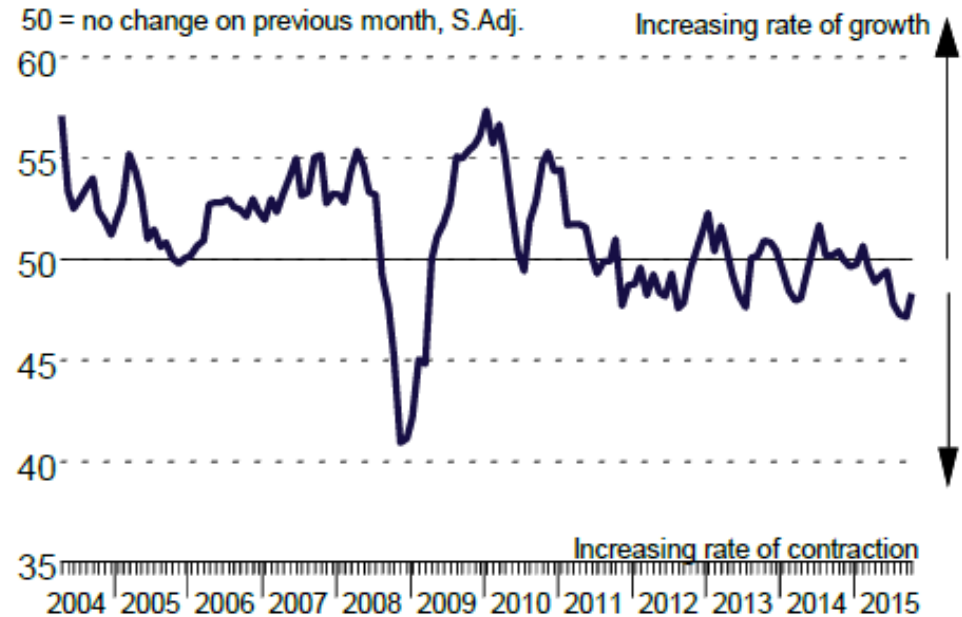
Chinese economy

Leading business indicators

■ Official manufacturing PMI, Leading economic indicators (CEMAC)



■ Caixin manufacturing PMI

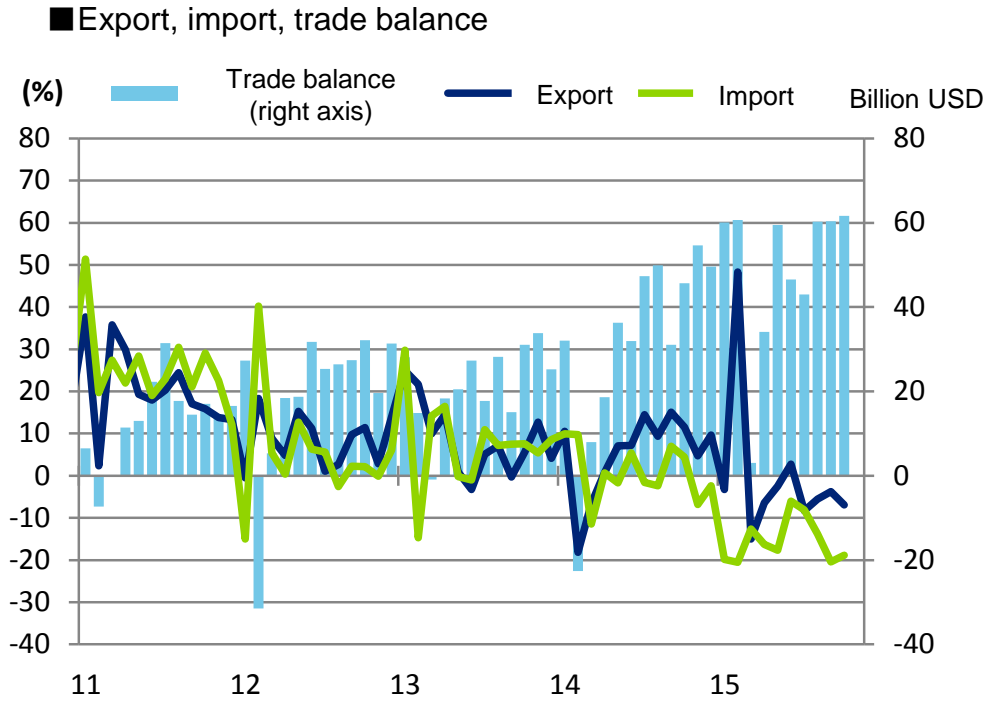
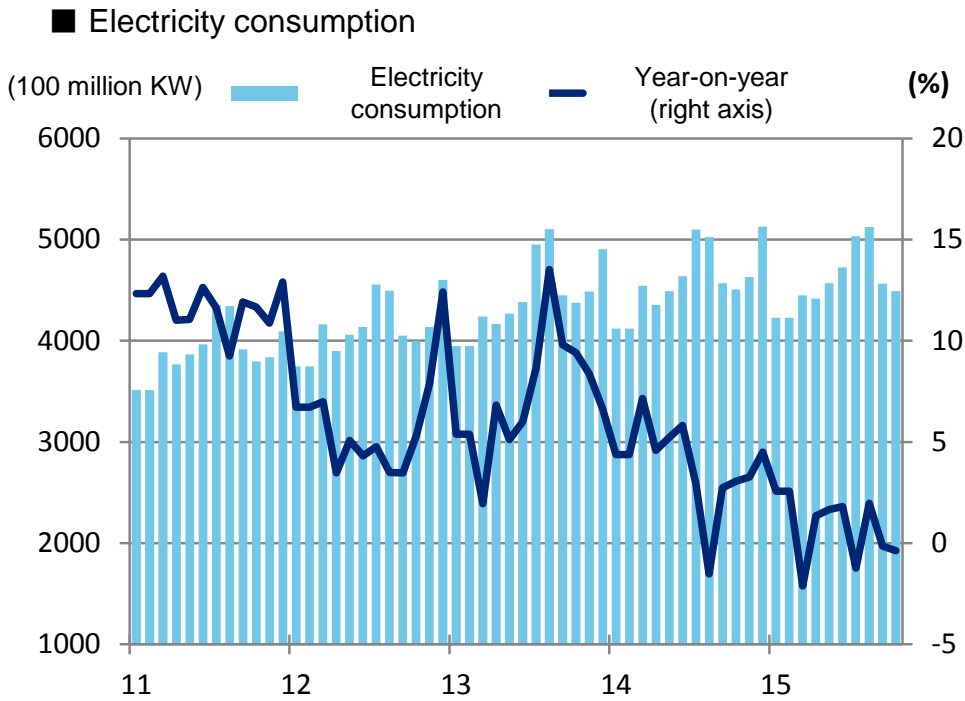


Sources: Markit, Caixin.

Source: National Bureau of Statistics of China, China Economic Monitoring and Analysis Center (CEMAC), Caixin, Markit, Deloitte Touche Tohmatsu LLC

Chinese economy

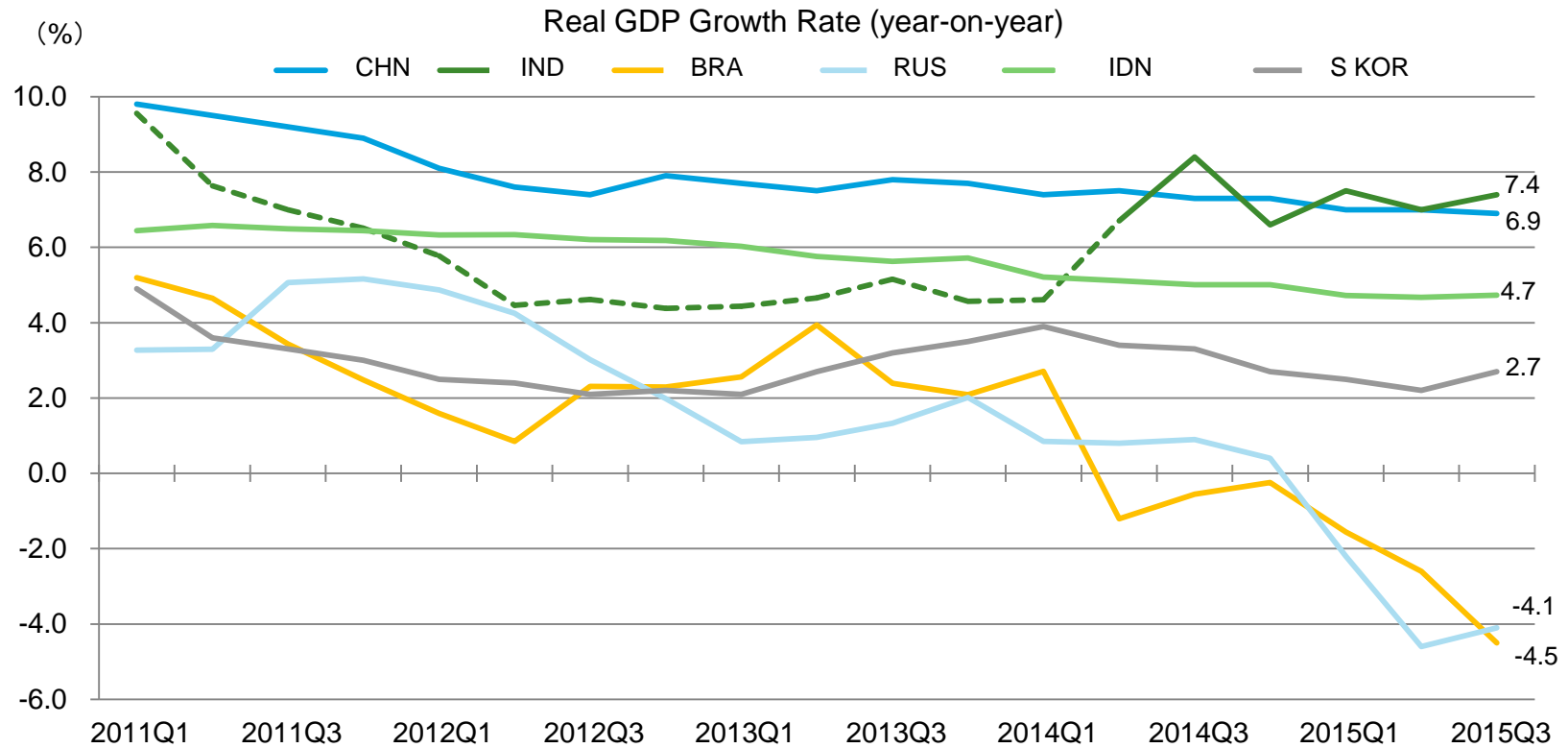
Electricity consumption and trade



Source: National Energy Administration, General Administration of Customs of People's Republic of China, Deloitte Touche Tohmatsu LLC

Emerging economies

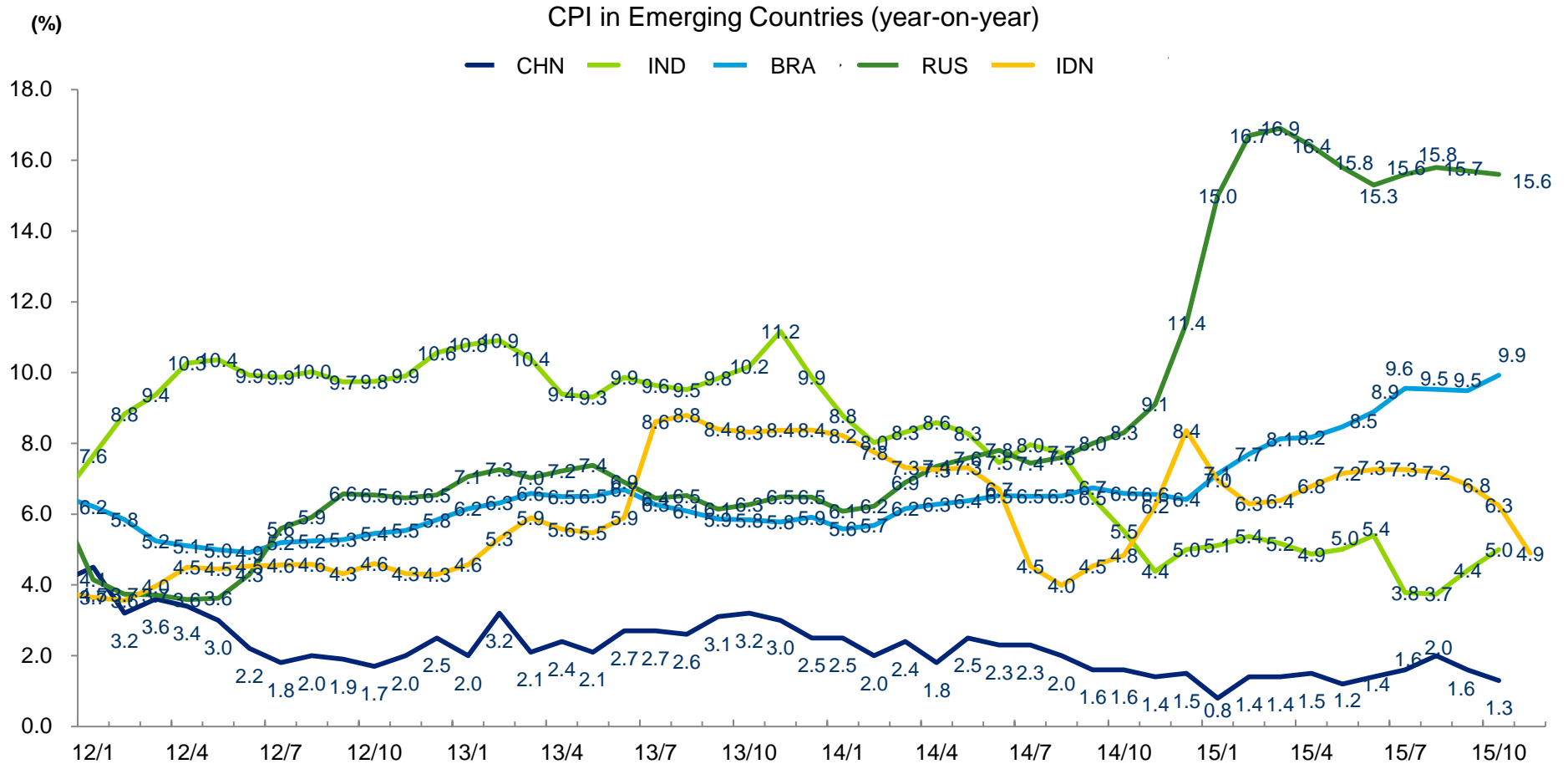
GDP growth rates



Source: OECD, statistics of respective countries, etc. Deloitte Touche Tohmatsu LLC

Emerging economies

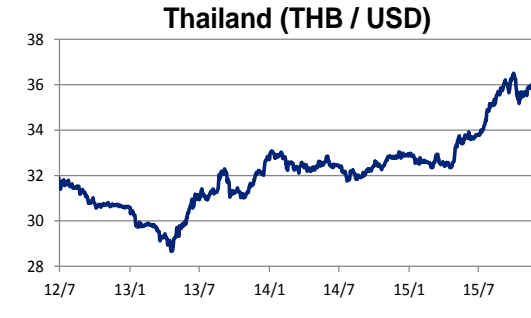
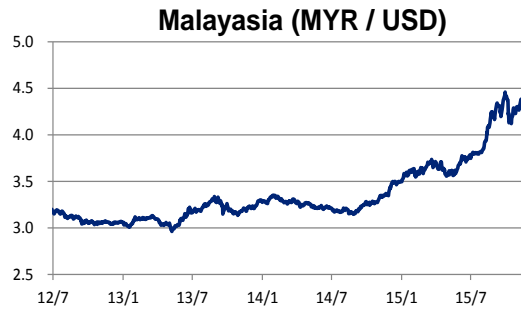
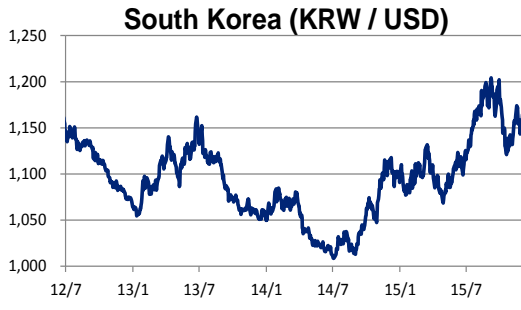
Inflation rates



Source: OECD, statistics of respective countries, etc. Deloitte Touche Tohmatsu LLC

Emerging economies

Exchange rates



Note: as of November 30, 2015

Source: Bloomberg, Deloitte Touche Tohmatsu LLC

Plausible scenarios

Baseline scenario

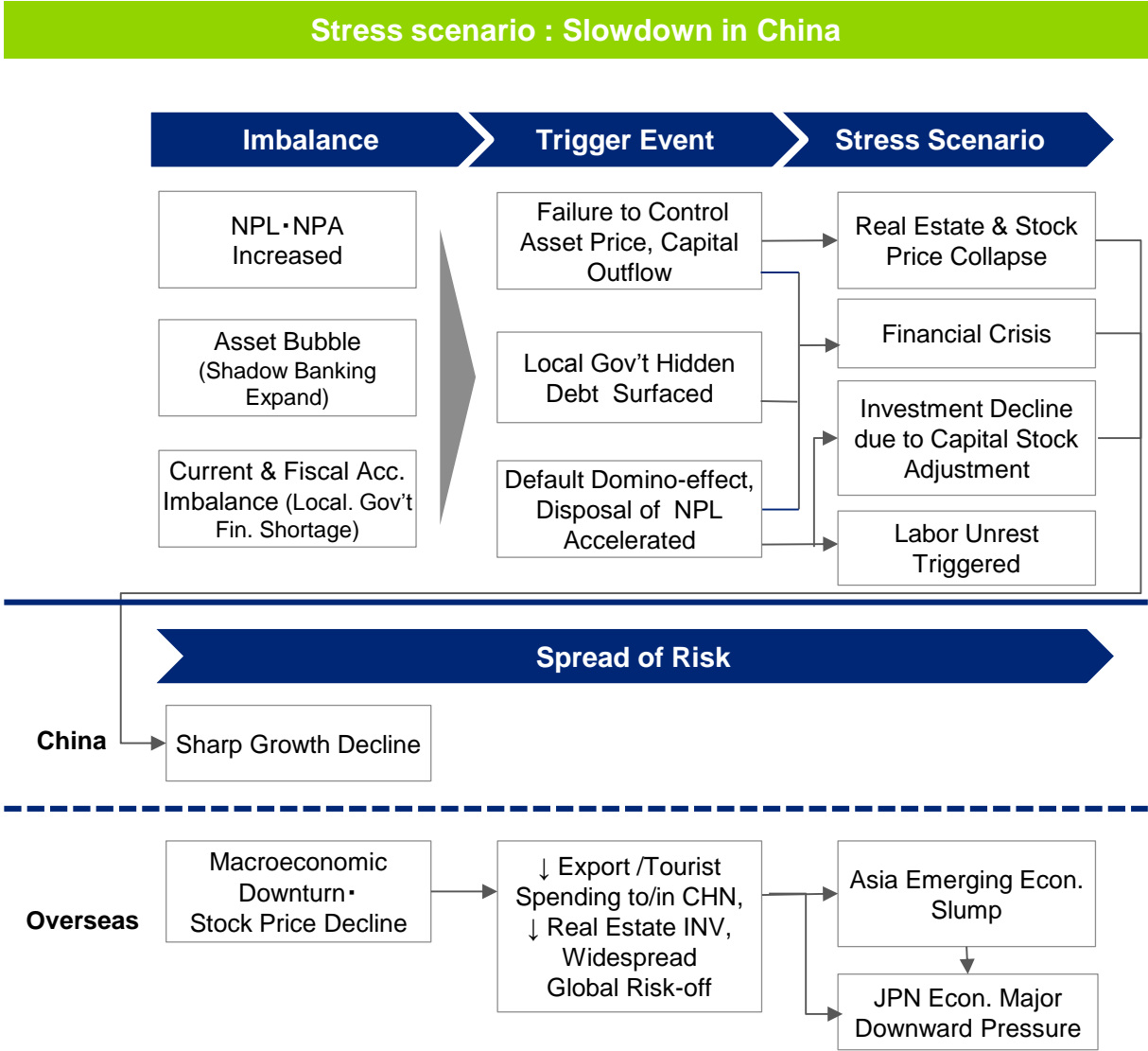
China

- On the Chinese economy, capital stock adjustment will continue with modest speed while the effects of economic stimulus measures and monetary easing will be limited. Thus, the economic growth will continue to decelerate within 2015.
- Monetary easing and various market intervention measures could temporarily alleviate the panic declines of asset prices that occur from time to time, and avoid the domino effect of firm defaults, but the imbalances to be solved will remain in place.
- Since the liberalization of the market also will be delayed, the efficiency of the economy or potential growth will decline at a relatively fast pace, while the imbalances continue to widen.

Other emerging economies


- Being exposed by currency depreciation pressures, many countries tighten their monetary and fiscal policies, which will exert downward pressure on their economies.
- Furthermore, as the Chinese economy continues to slow down, many emerging economies face downward pressures due to declining exports to China, and falling crude oil and overall commodity prices.
- Energy price fall will somewhat relax the economic conditions for net energy importers such as India, Turkey, Thailand, the Philippines, while net exporters such as Russia, Brazil, South Africa, Indonesia, and Malaysia face strong downward pressures.

Plausible Stress scenario



Likelihood of the stress scenario


Likelihood level of this scenario (Outlook within one year)



Level 2

- Recent key economic indicators signal a further slowdown of the economy. Consumer spending will be curbed, should labor adjustments start.
- Policy measures such as increasing public investment, PBOC's monetary easing, mortgage market deregulation, and RMB devaluation are expected to underpin the economy, stock market as well as the real estate market.
- The government has not yet seemingly resolved to embark on massive capital stock and labor adjustments which will hurt the economy severely. This will help stop an increase of the likelihood of significant slowdown in the near future but by contrast, this will increase the likelihood of pushing down its potential growth rate and trigger a massive adjustments with somewhat disorderly manner in the medium term.

(Outlook within three years)



Level 3

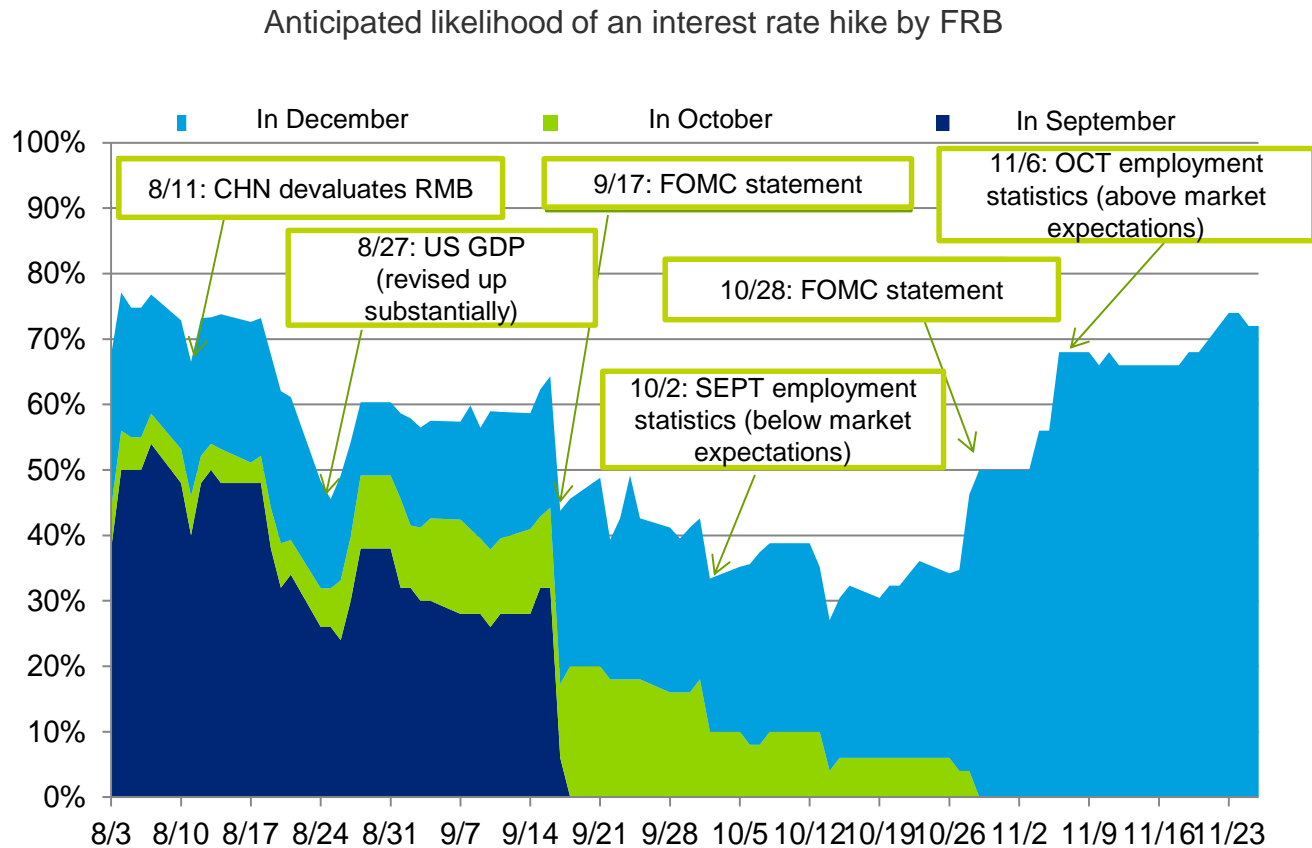
- Although a soft landing continues thanks to fiscal / monetary policy measures, though structural reforms will be postponed.
- Imbalances (increasing NPLs and excessive capital stock and labor in some sectors, hidden fiscal deficits) that are temporarily hidden by policy measures could gradually begin to surface.
- Thus, the likelihood of ultra hard landing within three years have further increased.

US: Economic slowdown scenario



US economy

A rate hike implied in the futures market

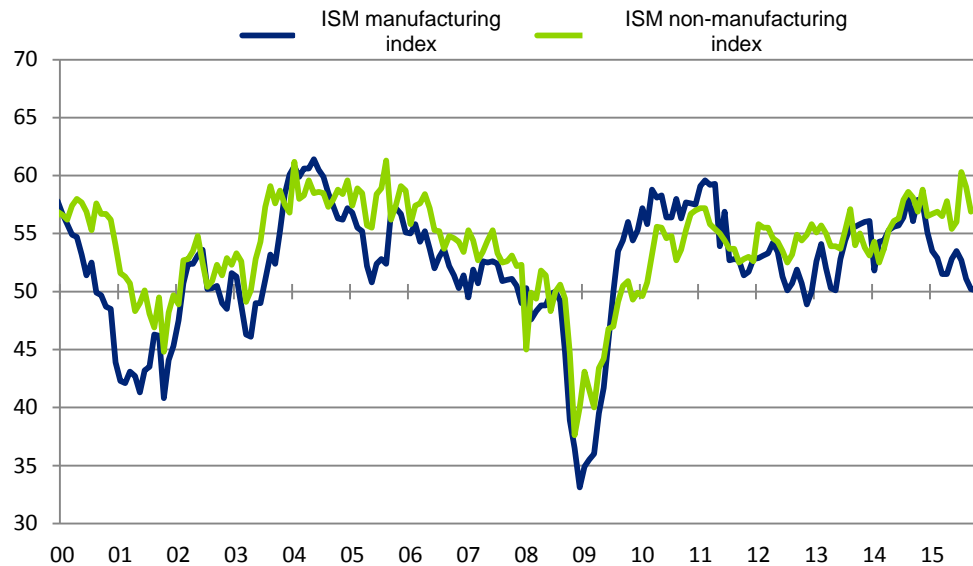


Source: Bloomberg, Deloitte Touche Tohmatsu LLC

US economy

Leading business indicators and house price indicator

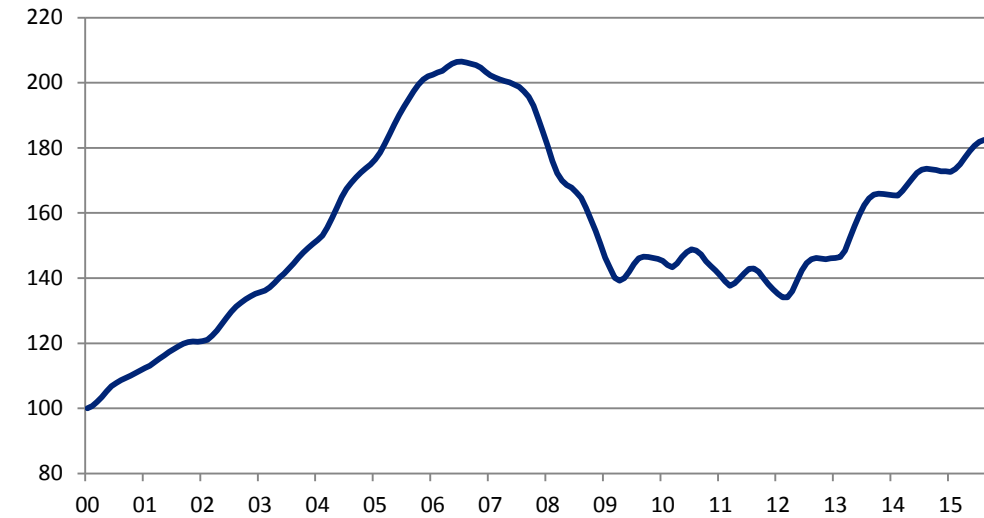
■ ISM manufacturing, non-manufacturing index



Source: ISM, Deloitte Touche Tohmatsu LLC

■ S&P/Case-Shiller Home Price Indices (Composite-20)

(2000/1=100)

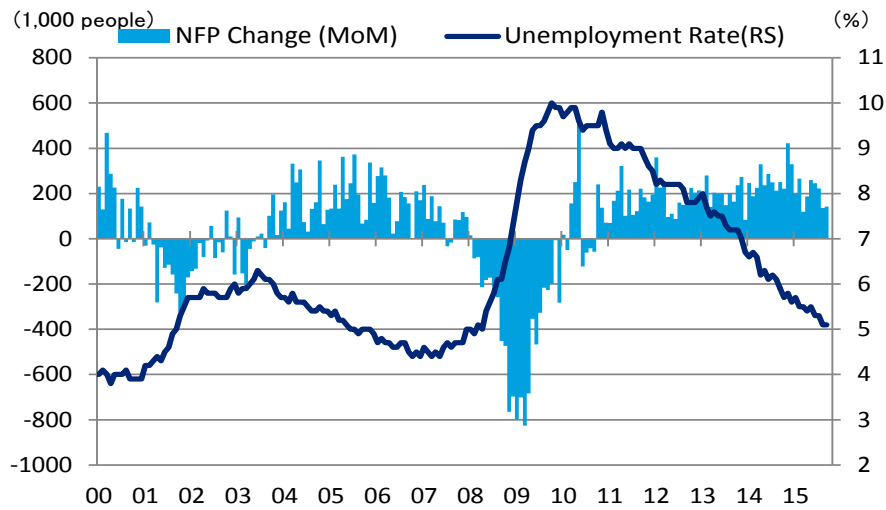


Source: S&P, Deloitte Touche Tohmatsu LLC

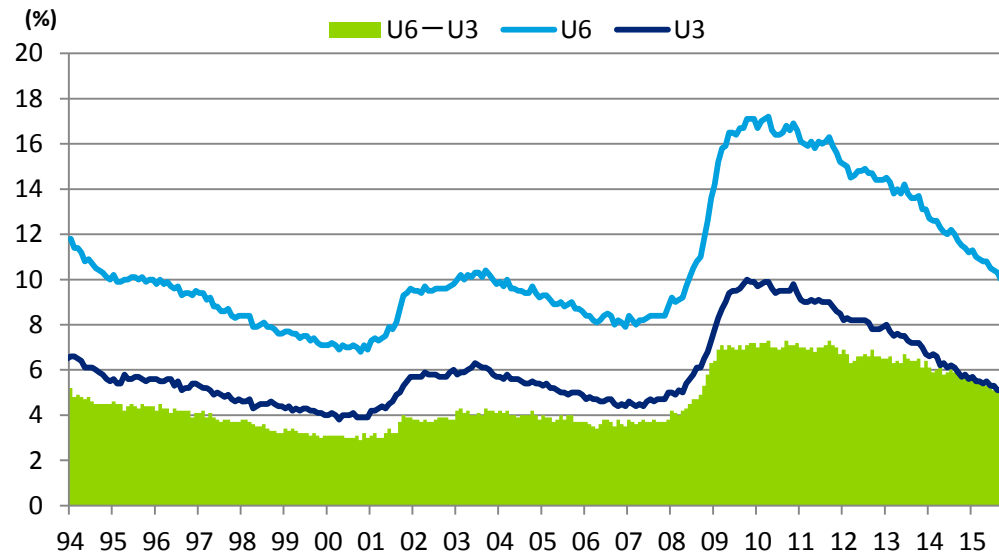
US economy

Labor market indicators

■ Non-farming employment (MoM), unemployment



■ Gap between U3 and U6 unemployment rate

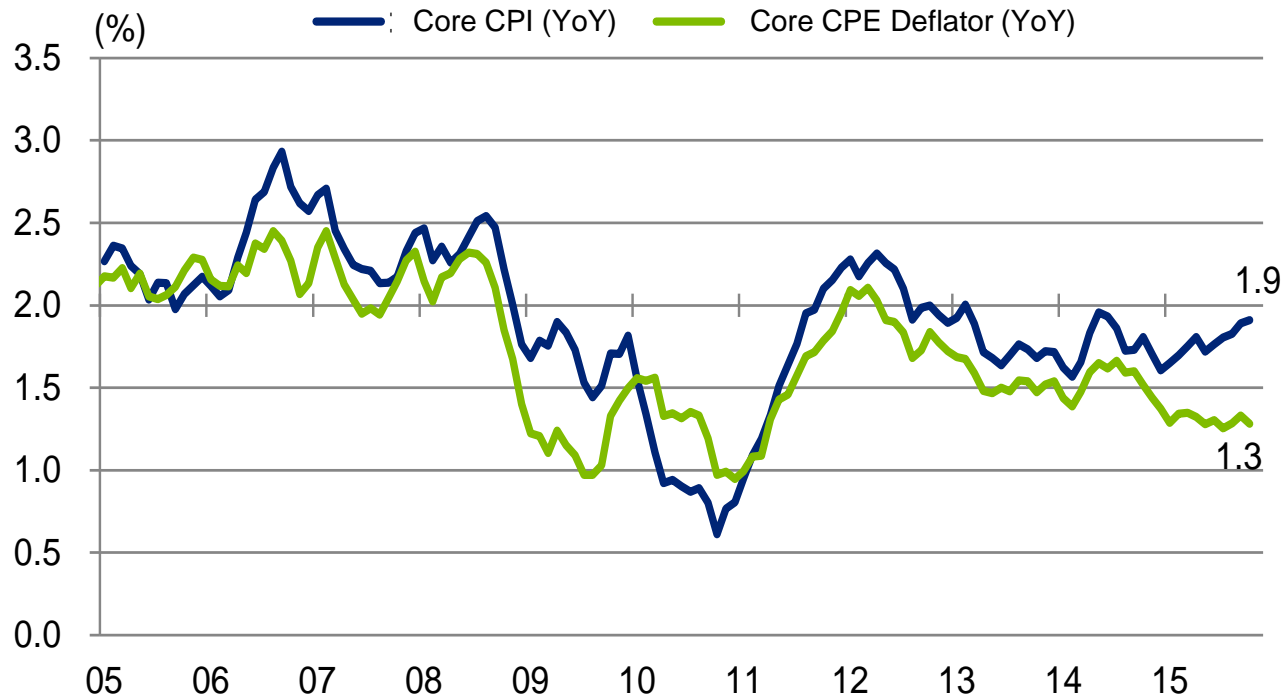


Source: BLS, Deloitte Touche Tohmatsu LLC

US economy

CPI

Consumer Price Index (excludes food and energy), core PCE Deflator



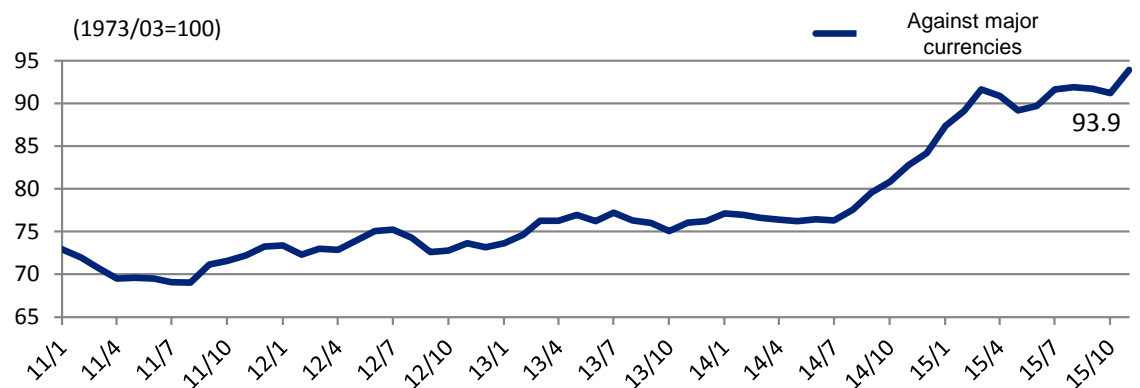
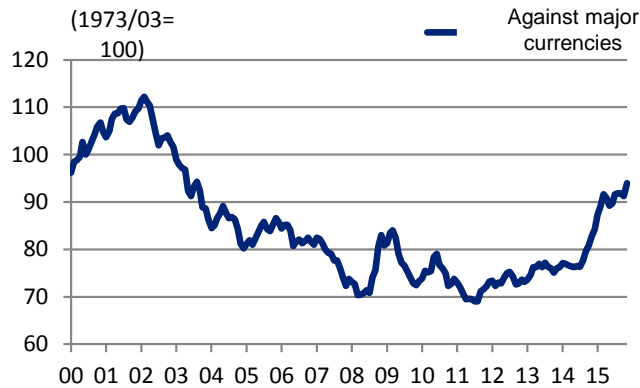
Source: BLS, BEA, Deloitte Touche Tohmatsu LLC

US economy

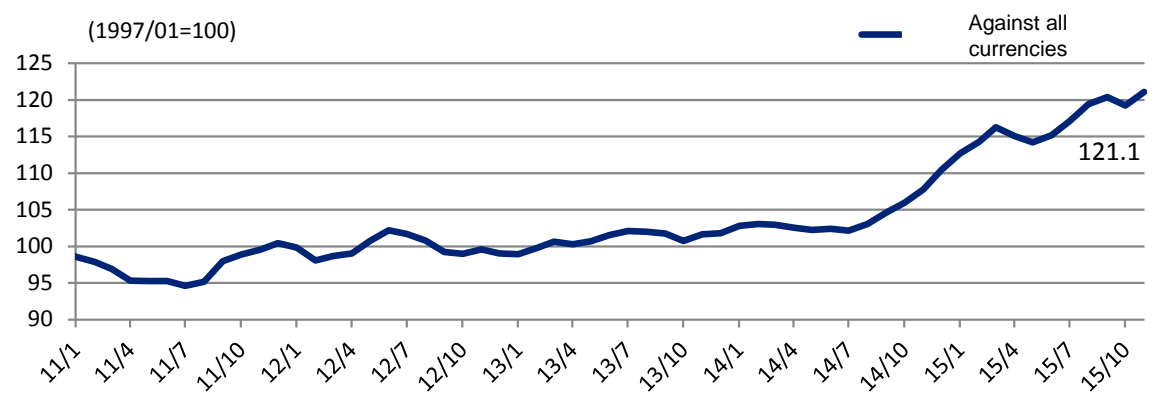
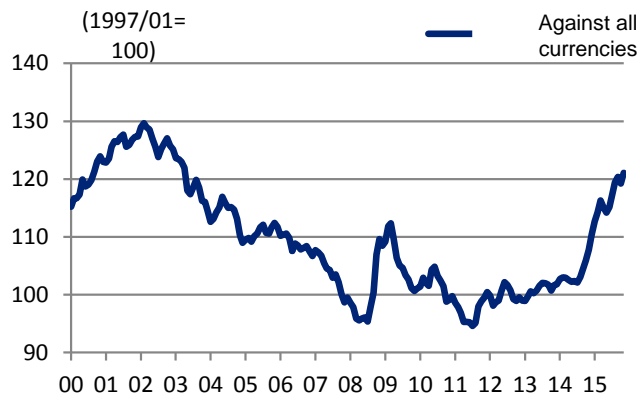
USD index

The major currencies index (Nominal USD index, monthly average)

<Against major currencies>



<Against all currencies>



Source: FRB, Deloitte Touche Tohmatsu LLC

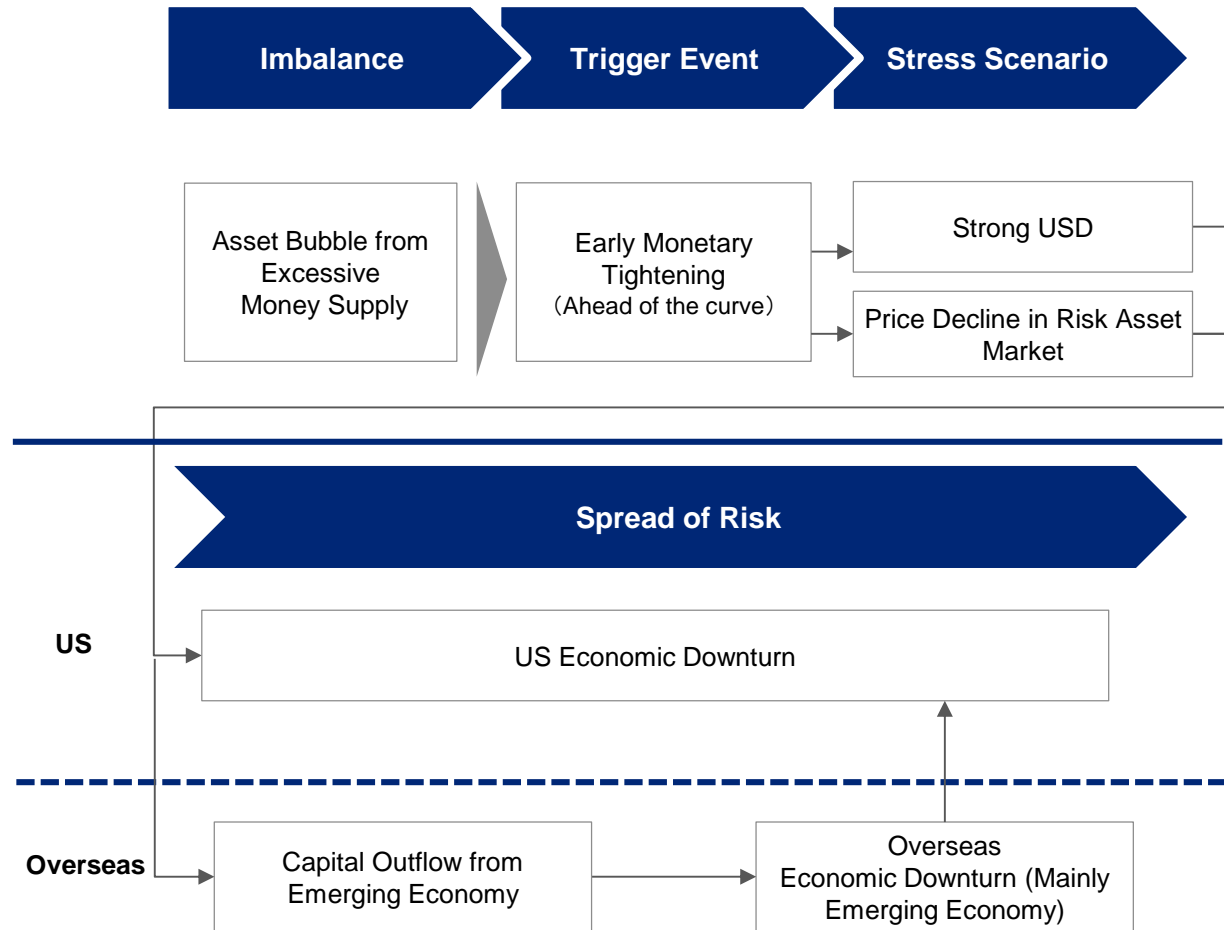
Plausible scenario

Baseline scenario

- The course of economic growth will slowdown gradually due to adverse effects of strong dollar, which has been materialized due to an increasing gap of business condition between the US and other economies.
- Unemployment rate is at a declining trend while the impact of strong dollar keeps low inflationary pressure.
- Despite price stability, Fed is likely to increase its policy rate in December based on the labor market tightness. This decision is likely to invite further the US dollar appreciation and put another downward pressure on the US economy.

Plausible Stress scenario

Stress scenario: US economic downturn scenario



Likelihood of the stress scenario

Likelihood level of this scenario (Outlook within one year)



Level 1

- FOMC continues to send strong signals of a policy rate hike within this year, at the same time also indicates policy to cautiously raise the rate after the initial hike, to avoid hasty rate hike and extreme lagging of the timing.
- Recently, no signs of accelerating inflation trends on the backdrop of cheap crude oil price and strong USD. The growth rate has slowed down from Q2 partly due to stock adjustment and possibly the impacts of strong dollar.
- Anticipation of rate hike in December is increasing as results of an increasingly hawkish stance of FOMC and the recent strong number of labor markets.

(Outlook within three years)



Level 2

- As indicated in the Chinese economy's stress scenario, the possible negative impacts of Chinese economy's slow down could be quite significant and hence the downward pressures on the US economy.
- Now that the policy rate hike in December is very likely, it might be difficult for the Fed to change the direction of its monetary policy in a short period of time and hence more chances of missing the timing of monetary loosening.

Japan: Abenomics failure /Stagflation scenario



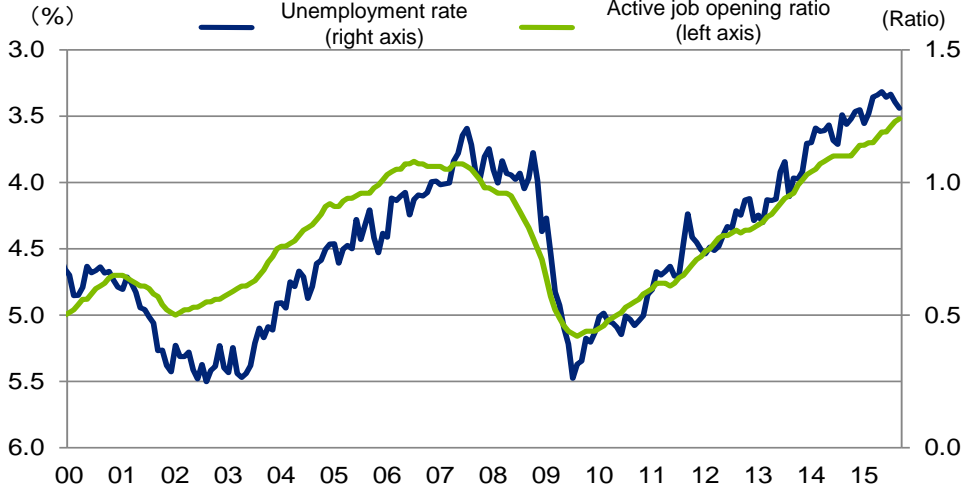
Japanese economy

Inflation and employment indicators

■ CPI (YoY, excludes fresh food composite)



■ Unemployment rate, Active job opening ratio

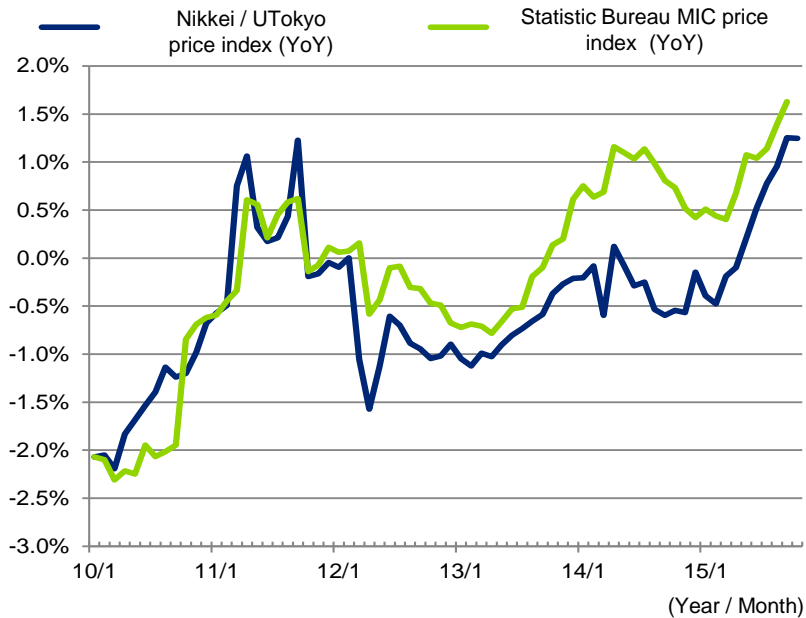


Source: Statistic Bureau MIC, Deloitte Touche Tohmatsu LLC

Japanese economy

Inflation

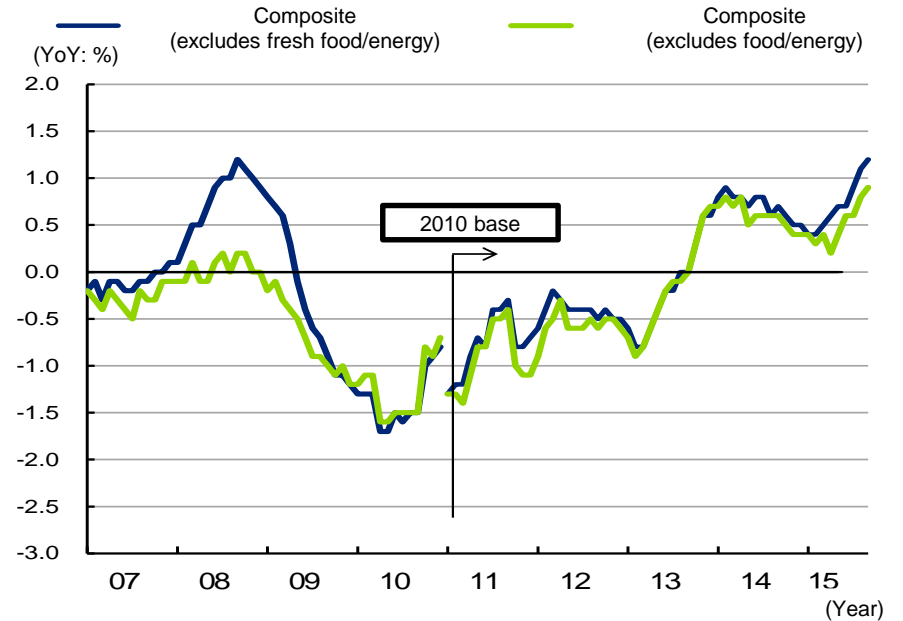
■ Nikkei / UTokyo price index, Statistic Bureau MIC price index



Note: as of November 7th, 2015

Source: UTkyo Daily Price Project, Statistic Bureau MIC, Deloitte Touche Tohmatsu LLC

■ BoJ 'New price index'



Source: Bank of Japan, Deloitte Touche Tohmatsu LLC

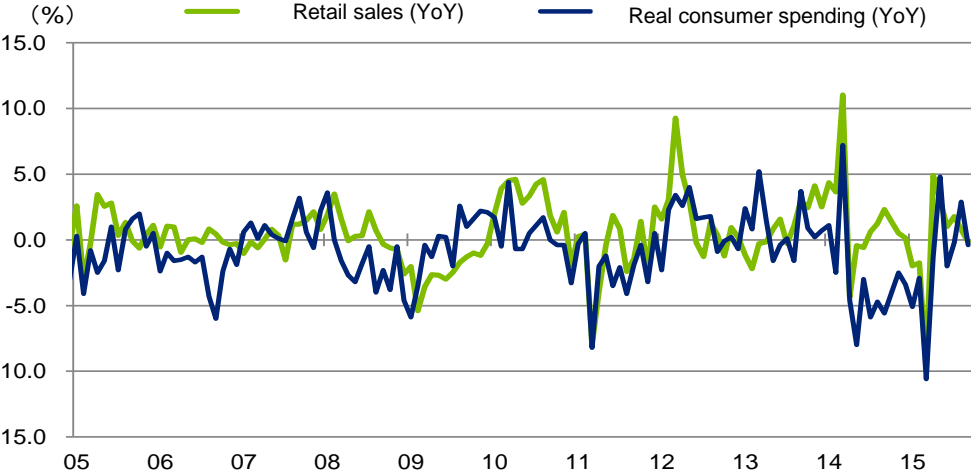
Japanese economy

Wages trends, private consumption

■ Real wage index (YoY)



■ Retail sales (dynamic statistics of commerce), real consumer spending (household survey)

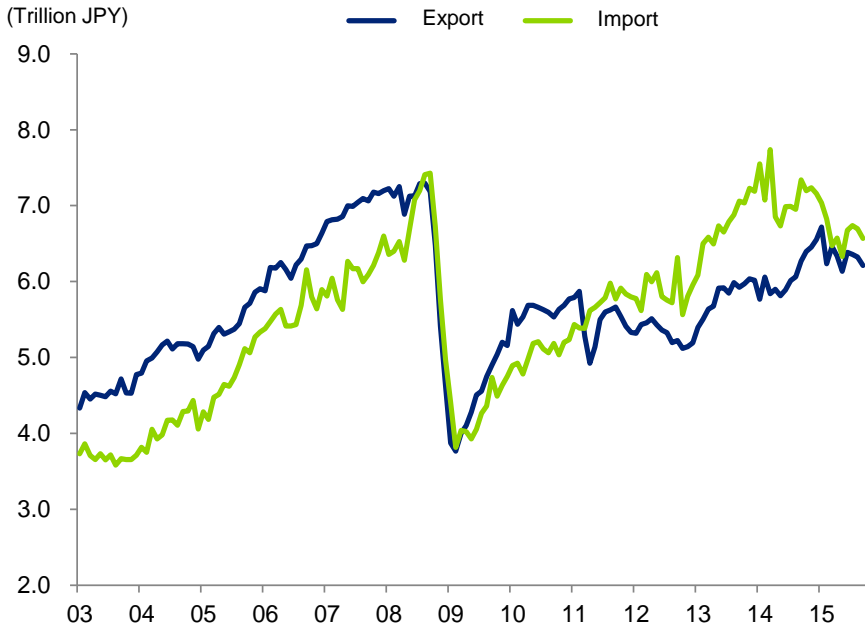
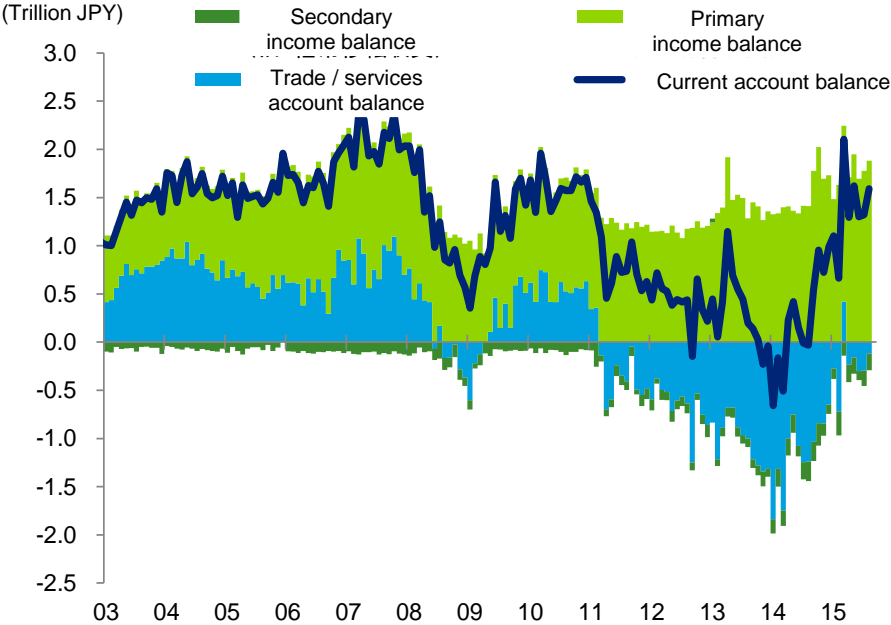


Source: Statistic Bureau MIC, METI, Deloitte Touche Tohmatsu LLC

Japanese economy

Changes in current account and trade balance

■ Current account and trade balance (seasonally-adjusted value)



Source: MOF, Deloitte Touche Tohmatsu LLC

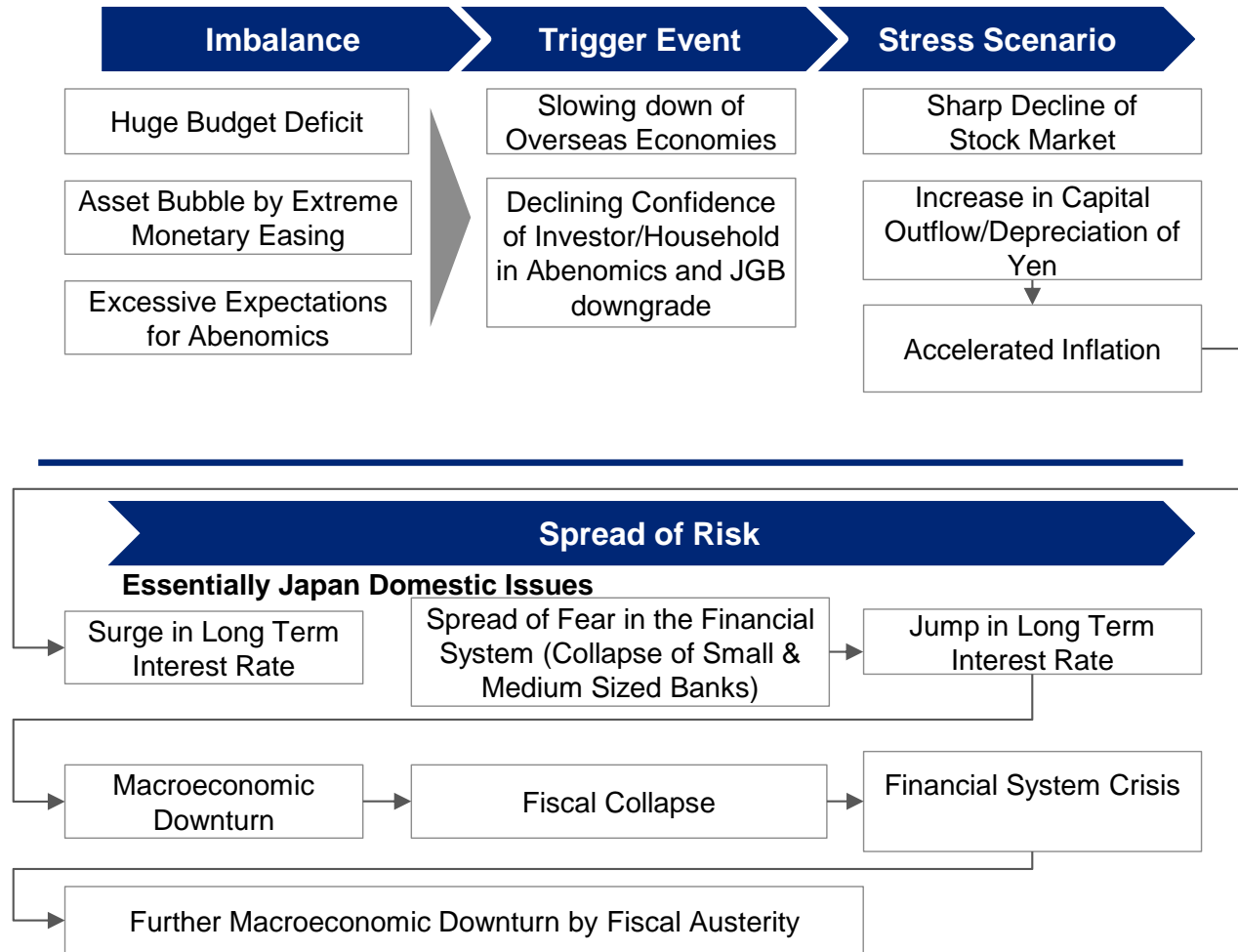
Plausible scenario

Baseline scenario

- The economy will continue to grow a little faster than its potential rate owing to modest recovery in consumption and capital expenditure despite sluggish exports
- However, increasing uncertainties over structural and fiscal reforms under Abenomics will also overshadow the domestic economy, which will see a gradual but constant decline in its potential growth rate.
- Possible policy rate hike in the US in December would delay the BOJ's decision to ease further its QQE to next year.

Plausible Stress scenario

Stress scenario : Abenomics failure / Stagflation scenario



Likelihood of the stress scenario

Likelihood level of this scenario (Outlook within one year)



Level 2

- While some important items of structural reform such as TPP and a reduction in corporate tax are more likely to be materialized, new three arrows of Abenomics have not yet regain a confidence of market in the structural reform of Japanese economy and fiscal consolidation.
- Although Chinese and emerging economies continue to show signs of slowing down, the US and European economies remain resilient. Also, the economy shall enjoy the benefits of cheap crude oil price for the time being.
- The bond market saw rising volatilities due to liquidity decline triggered by the BOJ's QQE and global regulations though the long term interest rate remains at a low level.

(Outlook within three years)



Level 3

- The success of Abenomics to pick up the potential growth rate is still highly uncertain while the size of various imbalances will constantly expand to be closer to their thresholds, which are even falling due to unstoppable aging and declining population and declining potential growth rates of emerging economies.
- A fundamental measure to reduce spending is not likely to put forward until 2018, time for the half-way appraisal of the mid-term fiscal consolidation plan. Therefore, questions have been raised for the sustainability of public finances, should the likelihood of failing to achieve the 2020 primary surplus target to increase.
- Core price indicators currently show the strong trend of consumer price index, which might induce the discussion of QQE exit in 2017, when the second consumption tax hike could dampen the economy.



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