

2017 Economic Outlook

Will Trump change the world? Tailwinds for the Japanese economy

Mizuho Research Institute Ltd.

1. Chief Economist's perspective – Will Trump be a game-changer?

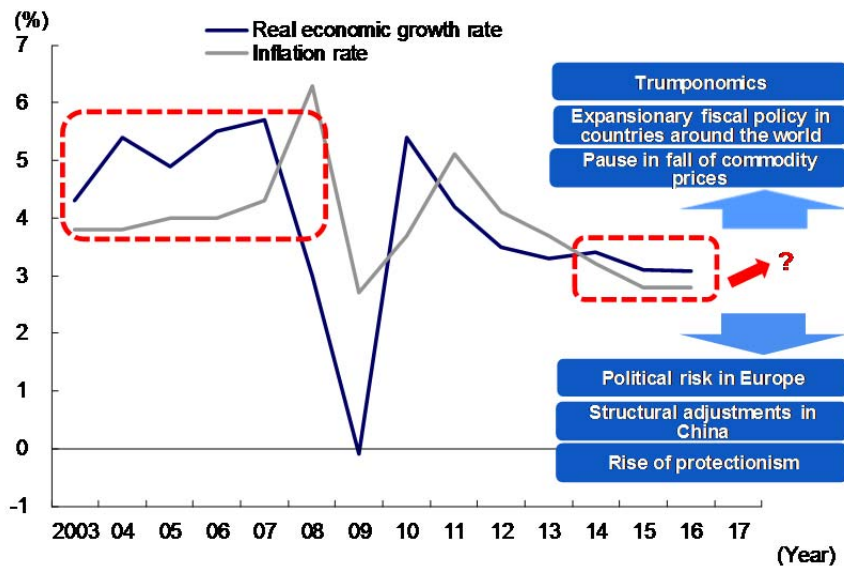
(1) A Trump-led “reformation”

The top item in MHRI's “Far Flung Forecasts 2016” at the end of 2015 was Donald Trump elected as the next US president. We now face a situation that exceeds our assumptions, with this completely unexpected scenario suddenly becoming a reality. In addition, when we look back on 2016, most events including Brexit were beyond our imagination. During my visit to the United States in December 2016, while many Japanese remained in a state of disbelief over the Trump shock, I felt many American people were beginning to look forward to President-elect Trump bringing about a “reformation” with his pro-business attitude. This feeling may be a repercussion to the actual economic situation up to now, which is characterized by the unprecedented “3Ls” (low economic growth, low inflation and low interest rates), described as “secular stagnation” by Lawrence Summers, former US Secretary of the Treasury. Since 2007, conventional economics have failed to write the necessary prescription for the economic crisis following the greatest balance sheet adjustment since the end of World War II. At the same time, we believe that American citizens share the view that eight years of Obama's presidency have sapped the nation's power, as reflected by the structural problems of the US economy and a decline in US global leadership, and this condition has fueled the momentum toward “reformation.” Ironically, the Obama administration, which appeared with the slogan of “Change”, will be replaced by Donald Trump, who has called for a “reformation” with the rallying cry of “Make America Strong Again.”

(2) From “Ron-Yasu” to “Don-Shin”

The slogan “Make America Strong Again,” mentioned earlier, is the same slogan used during the election campaign of former president Ronald Reagan in 1980, and today's situation can be seen as a return of Reaganomics. If we look back, the economic situation in the 1980s was exactly the opposite of the “3Ls” today and was plagued by the “3Hs” (high unemployment, high inflation and high interest rates). Just like today, a combination of high unemployment and high inflation, or stagflation, was a serious problem for which the economics at that time failed to write an effective prescription. Furthermore, the American public's dissatisfaction with the nation's diminished status under the previous Carter administration also heightened the awareness of

[Global economic growth and inflation rate]



Note: Inflation rate is CPI. Readings on 2016 are estimates by the Mizuho Research Institute Ltd.(MHRI).
 Source: Made by MHRI based on the International Monetary Fund (IMF).

“reformation.” Reaganomics brought about a new movement centered on monetarism aimed at overcoming the sense of stagnation that stemmed from the “3Hs” and realizing once again a “strong America.” Now after the passage of 36 years, we continue to face a situation where conventional economics cannot come up with the right prescription; in other words, monetary policies all around the world, including the policy of negative interest rates, have reached their limits. Amid such circumstances, the market is reacting favorably to the shift in government focus to pro-business industrial policies, such as fiscal policies and growth strategies, to push in the direction toward “reformation.” We can probably say that the Trump administration was created based on this reformation-oriented mindset.

For Japan, 2016 was quite a challenging year, with the yen appreciation at the beginning of the year compelling the retreat of Abenomics. Overseas, analysts described this situation as “the death of Abenomics,” and the Bank of Japan was forced to reexamine its policy in its “Comprehensive Assessment.” But the stock market’s “Trump bump” rally since November has proved nothing short of a *kamikaze* (a divine wind), bringing about a super positive situation for the Bank of Japan by making Japan’s easy monetary policy more effective in realizing the virtuous cycle of yen depreciation and stock market rise. The launch of full-fledged measures to pull Japan out of deflation begins from now. The driving factor behind the nation’s economic recovery, however, must shift from monetary policies to fiscal policies and growth strategies to stimulate business activities in the corporate sector.

In the 1980s, US President Ronald Reagan and Japan’s Prime Minister Yasuhiro Nakasone drew global attention with their frank relationship when they called each other “Ron and Yasu.” Prime Minister Abe, now recording the fourth longest term of office as prime minister after World War II, surpassing the tenure of Nakasone, may build a similar relationship with Donald Trump, calling each other “Don and Shin.” The Japanese people should reconfirm that Japan now enjoys an improved position relative to other countries in terms of government stability. After three years of the virtuous cycle from the end of 2012, Abenomics retreated in 2016 but will likely be reconstructed and rebooted from 2017. The Trump sensation may lead to a “Great Rotation” from bonds to stocks around the world.

(Hajime Takata, Chief Economist)

2. Messages from MHRI's overseas offices - Focal points in 2017

(1) From New York: Economic policy of the next US president Donald Trump is surprisingly realistic

President-elect Donald Trump unveiled plans for his first 100 days in office on November 21 after the election. Although he included his promise to withdraw from the Trans-Pacific Strategic Economic Partnership Agreement (TPP), he excluded such items as withdrawing from NAFTA, which was a major concern globally, and protectionism policies, such as the imposition of high tariffs on Mexican imports. In addition, while not included in the announcement, it is highly expected that he will implement tax reforms and infrastructure investment that can be effective in stimulating the economy in the short term. With most of the names appointed by Trump for his economic team are pro-business, such as Steven Mnuchin, a former investment banker of Goldman Sachs, as the next US Secretary of the Treasury, and prominent investor Wilbur Ross as the next US Secretary of Commerce, a sense of relief has spread throughout the US business community in belief that Trump's economic policies are quite realistic. However, Trump continues to criticize companies through speeches and SNS, and a US air-conditioning company actually named by Trump was forced to halt its factory relocation to Mexico. Even though his economic policies seem realistic, political pressure through the president's verbal interventions may become a risk factor for firms operating in the US in the future.

(Atsushi Niigata, Chief Representative, New York Office)

(2) From London: The UK overcast with the fog of "Brexit"

In June 2016, the UK made the historical decision to withdraw from the European Union (EU). Prime Minister Theresa May has also decided to submit the UK's withdrawal notification by March 2017 as stipulated in Article 50 of the Treaty on European Union. This article provides that, in principle, the European Union law will cease to be effective (i.e., the withdrawal will be completed) two years after the notification. But in November 2016, Her Majesty's High Court of Justice in England set forth its judgment that withdrawal notification requires the approval of Parliament. This will certainly make discussions on the negotiation policy with the EU even more difficult given that a majority in the House of Commons comprises the Remain camp, and some analysts even point out the possibility of delaying the "notification." We need to wait for the ruling of the Supreme Court of the United Kingdom in January 2017.

Although the public's attention will shift to the progress of the negotiations once they begin, significant progress cannot be expected in 2017 since many major EU countries will have important elections in that year. On the other hand, the UK economy could avoid an economic slowdown in 2016 thanks to the depreciation of the British Pound after the referendum. Nonetheless, in the future, the UK economy may be adversely affected by a more subdued attitude of firms unwilling to risk investment and hiring activities. It seems unavoidable that uncertainty over Brexit will exert a negative impact on the UK economy.

(Yasuo Yamamoto, Chief Representative, London Office)

(3) From Singapore: Many Asian countries are raising concerns regarding the birth of the Trump administration

The coming Trump administration will kick off early in the new year, but the countries of the ASEAN appear to have a different perception on what the new administration will bring. Given the remote chance for the successful conclusion of the TPP, some participant countries such as Vietnam and Malaysia are disappointed, while non-participant countries, including Thailand, welcome the new move that will help them avoid exposing their market share to further competition in international markets such as North America. On the other hand, many Asian countries are taking a cautious view on Donald Trump's emphasis on securing domestic jobs and his focus on protectionism. If he keeps his pledge to impose high tariffs on Chinese products, exports to China will likely be adversely affected, and if he restrains the immigration of foreign workers, it will particularly affect countries like the Philippines, which is heavily dependent on the remittances of its nationals working overseas. On the other hand, if Trump, who comes from the business community, adopts a utilitarian approach to US foreign policy, some countries may see an improvement in their relationship with the US. Specifically, Thailand, currently under the rule of a military dictatorship that persecutes the nation's Islamic minority, should benefit from Trump's foreign policy. In any case, the biggest question for the countries of the ASEAN is whether they can continue applying their conventional strategies to maintain their bargaining position with the major powers of the world based on an evenhanded foreign policy toward President-elect Donald Trump.

(Hiroshi Inagaki, Senior Economist)

(4) From Beijing: Trump's election victory has increased uncertainty over future relations between the US and China

The result of the US presidential election has also caused ripples in China. Trump's repeated eccentric comments, such as "China is a currency manipulator" and "I will impose tariffs up to 45% on imports from China," during the election campaign have increased concerns that destabilization of the Chinese yuan and deterioration of US-bound exports may adversely affect China's economy. On the other hand, if the US becomes more focused on domestic affairs and weakens its involvement in the Asia Pacific region, some critics believe it may lessen the obstacles to China's external economic policy of "Belt and Road" and facilitate the expansion of China's influence in the region. Regarding Japan-China relations, while a weaker alliance between Japan and the US may be favorable for China, it runs the risk of "military expansion" in Japan, and views are mixed with both expectations and concerns. As indicated by Trump's unprecedented teleconference with the president of Taiwan, it is difficult to predict the contents of Trump's economic and foreign policies. But opinions vary from "realization of Trump's extreme policies will be difficult given complicated interests" to "Trump emphasizes a sense of business, so he will demonstrate leadership in the arena of foreign policy based on utilitarianism." How will China deal with Trump's heavy-handed diplomacy – this will be the focus of attention in 2017.

(Yusuke Miura, Senior Economist)

3. Outlook on the global economy in 2017 - The economy will recover, watch out for the policies of the new US president

- ◆ The global economic growth rate in 2017 (average of economic growth rate of countries and regions covered by MHRI) is expected to rise to +3.7% y-o-y (2016: +3.3% y-o-y), the first increase in the past three years, driven by recovery in the US economy and Brazil and Russia growing their way out of economic contraction. Concerning the US, robust personal consumption on the back of the improved job situation is forecast to boost the economy, and in the latter half of the year, fiscal measures implemented by the new Trump administration are expected to contribute to further improvement in the economy.
- ◆ As its main scenario of its outlook, MHRI forecasts the recovery of the global economy. However, downside risks must be watched closely in view of the political problems in Europe and structural adjustments in China. In addition, while the US policy mix of fiscal expansion and interest rate hikes will generate pressure to strengthen the US dollar, an excessive appreciation of the US dollar may serve as a negative factor for the US economy and emerging economies, and trigger a rise of protectionism in the US.

[Outlook on the global economy]

Calendar year	(Y-o-y % change)			
	2014 (Actual)	2015 (Actual)	2016 (Forecast)	2017 (Forecast)
Total of forecast area	3.6	3.4	3.3	3.7
Japan, US, Eurozone	1.7	2.2	1.5	1.7
US	2.4	2.6	1.6	2.2
Eurozone	1.2	2.0	1.6	1.3
Japan	0.3	1.2	1.0	1.1
Asia	6.4	6.1	6.0	6.0
China	7.3	6.9	6.7	6.5
NIEs	3.5	2.0	2.0	2.2
ASEAN5	4.6	4.8	4.8	4.7
India	7.0	7.2	7.0	7.6
Australia	2.7	2.4	2.4	2.5
Brazil	0.1	-3.8	-3.4	1.0
Russia	0.7	-3.7	-0.7	1.0
Japan (FY)	-0.4	1.3	1.2	1.2
Crude oil price (WTI, USD/bbl)	93	49	43	55

Note: The total of the forecast areas is calculated based on the 2014 GDP share (PPP) by the IMF.

Source: Made by MHRI based on the International Monetary Fund (IMF).

4. Outlook on the 2017 Japanese economy - economic stimulus measures and “Trump-led yen depreciation” will serve as tailwinds

- ◆ The Japanese economy is expected to recover moderately in 2017 fueled by public works projects following the economic stimulus package and by the virtue of the “Trump-led yen depreciation.”
- ◆ By major category, exports are predicted to improve gradually thanks to the recovery of overseas economies and enhancement of the IT cycle. Concerning domestic demand, public demand is expected to be steadily supported by economic stimulus measures. Capital investment is also projected to grow moderately on the back of strong demand for facility renewal and high interest in intangible investments, such as R&D. Private consumption will likely be on a gradual recovery track driven by the better employment situation.
- ◆ Due to the impact of “Trumponomics,” we expect the yen to continue weakening during the forecast period of FY2017. After FY2018, improvement in the growth potential of the US economy led by such measures as large-scale tax cuts, preferential treatment for infrastructure investment, and deregulation will have positive impacts on Japan’s economy.
- ◆ Core inflation rate is projected to rise gradually, primarily due to a moderate improvement in the GDP gap, an increase in crude oil prices, and the positive impact of the “Trump-led yen depreciation.” MHRI forecasts the the core inflation rate will rise to the 1%-level in the latter half of 2017.

[Outlook on the Japanese economy]

		2015	2016	2017	2016		2017				2018
		FY			Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar
GDP (real)	Q-o-q % ch	1.3	1.2	1.2	0.3	0.2	0.2	0.3	0.3	0.4	0.3
	Q-o-q % ch p.a.	--	--	--	1.3	0.9	0.9	1.1	1.3	1.4	1.3
Domestic demand	Q-o-q % ch	1.1	0.9	1.1	-0.0	0.4	0.3	0.2	0.3	0.3	0.3
Private demand	Q-o-q % ch	1.1	0.8	0.9	-0.1	0.2	0.2	0.2	0.3	0.3	0.3
Personal consumption	Q-o-q % ch	0.5	0.7	1.0	0.3	0.1	0.2	0.3	0.3	0.3	0.3
Housing investment	Q-o-q % ch	2.7	6.4	-5.2	2.6	0.5	-1.2	-3.9	-2.3	-0.1	2.1
Capital investment	Q-o-q % ch	0.6	1.7	1.8	-0.4	0.8	0.5	0.4	0.4	0.7	0.3
Inventory investment	Q-o-q contribution, % pt	0.3	-0.2	-0.0	-0.3	-0.0	-0.0	0.0	0.1	-0.0	-0.1
Public demand	Q-o-q % ch	1.2	1.1	1.8	0.3	1.0	0.5	0.4	0.3	0.3	0.3
Government consumption	Q-o-q % ch	2.0	0.9	1.3	0.3	0.4	0.4	0.3	0.3	0.3	0.3
Public investment	Q-o-q % ch	-2.0	1.9	3.7	0.1	3.1	0.8	0.8	0.7	0.5	0.3
External demand	Q-o-q contribution, % pt	0.2	0.3	0.1	0.3	-0.2	-0.0	0.0	0.0	0.1	0.0
Exports	Q-o-q % ch	0.8	1.5	3.1	1.6	1.5	0.6	0.5	0.6	0.7	0.5
Imports	Q-o-q % ch	-0.2	-0.3	2.8	-0.4	2.7	1.0	0.2	0.4	0.4	0.4
GDP (nominal)	Q-o-q % ch	2.8	1.2	1.4	0.1	0.5	0.0	0.5	0.8	0.4	-0.4
GDP deflator	Y-o-y % ch	1.4	-0.0	0.3	-0.2	-0.1	-0.3	-0.0	0.7	0.5	0.0
Domestic demand deflator	Y-o-y % ch	0.0	-0.3	0.9	-0.8	-0.1	0.4	0.7	1.1	1.0	0.9

Note: Figures in the shaded areas are forecasts.

Source: Made by MHRI based on the Cabinet Office, *National Accounts*.

5. Outlook on the financial markets in 2017 - We expect a moderate appreciation of the US dollar, rise of US interest rates, and stock market rise

- ◆ The financial market in 2017 is forecast to see a strengthening of the US dollar, an interest rate hike in the US, and increasing stock prices, based on the assumption that expectations toward Trumponomics will be maintained to some degree throughout the year. However, since the Trump rally after the US presidential election has already factored in positive scenarios to a certain extent, the rise in stock prices is not likely to be constant.
- ◆ We expect the FRB in the US to raise interest rates twice in 2017. The Bank of Japan (BOJ) will leave its policy unchanged in the immediate future to examine the effects of its new policy framework.
- ◆ The US stock market will likely be lackluster before and after the interest rate hike, but will perform firmly on the back of improved corporate earnings. Japanese stocks are expected to strengthen the rising trend fueled by the gradual depreciation of the yen and improvement in the domestic economy. The exchange rate between the US dollar and the Japanese yen will head toward a stronger US dollar within a range tolerable to the US economy.
- ◆ Although the US long-term interest rate will try to move higher, the rise of interest rates will be restrained by lingering global uncertainties, such as the political situation in Europe. While the long-term interest rate in Japan will face upward pressure, the interest rate is expected to hover around 0% with no large fluctuations, due to yield curve control by the BOJ.

[Outlook on the financial markets]

	2015 FY	2016 FY	2017 FY	2016 Jul-Sep Oct-Dec		2017 Jan-Mar Apr-Jun Jul-Sep Oct-Dec				2018 Jan-Mar
Japan										
Uncollateralized overnight call rate (End of period, %)	-0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Euroyen TIBOR (3-mo, %)	0.16	0.06	0.06	0.06	0.06	0.06	0.06	0.06	0.06	0.06
Interest rate swaps (5-yr, %)	0.17	-0.03	0.05	-0.10	0.02	0.05	0.05	0.05	0.05	0.05
Newly-issued JGBs (10-yr, %)	0.29	-0.05	0.00	-0.13	-0.01	0.00	0.00	0.00	0.00	0.00
Nikkei average (JPY)	18,841	17,400	19,800	16,497	17,700	18,800	19,100	19,600	19,900	20,400
US										
Federal funds rate (End-of-period, %)	0.25~ 0.50	0.50 ~0.75	1.25 ~1.50	0.25 ~0.50	0.50 ~0.75	0.50 ~0.75	0.75 ~1.00	0.75 ~1.00	1.00 ~1.25	1.25 ~1.50
Newly-issued government bonds (10-yr, %)	2.12	1.95	2.50	1.56	2.10	2.40	2.40	2.50	2.50	2.60
Dow Jones average (USD)	17,298	18,500	19,600	18,368	18,600	19,100	19,200	19,500	19,700	20,000
NASDAQ Composite Index (pt)	5,030	5,350	0	5,300	5,400	5,500	1,644	1,988	1,936	2,081
Eurozone										
ECB key policy interest rate (End-of-period, %)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
German government bonds (10-yr, %)	0.53	0.10	0.35	-0.07	0.15	0.25	0.25	0.35	0.35	0.35
Foreign exchange rate										
JPY/USD (JPY/USD)	120	108	115	102	109	114	114	115	116	117
USD/EUR (USD/EUR)	1.10	1.09	1.03	1.12	1.08	1.04	1.04	1.03	1.02	1.02

Note: The shaded areas are forecasts. The forecasts are averages of the relevant periods. However, the uncollateralized overnight call rate, federal funds rate, and ECB policy interest rates are end-of-period rates.

Source: Made by MHRI based on Bloomberg.

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