

## 【NEWS RELEASE】

August 20, 2018  
SMBC Nikko Securities Inc.

**Quarterly Economy Outlook for FY 2018-2019 (Summer 2018)**

August 20, 2018 (JST), “SMBC NIKKO Japan Economic Outlook for FY 2018-2019 ” has been released.

**Solid Domestic Economy and Heightening Overseas Risks**

- ◆ Real GDP: +1.0% in FY18 and +1.0% in FY19
- ◆ Nominal GDP: +1.3% in FY18 and +2.5% in FY19

**Summary****• GDP growth outlook**

We revise our economic outlook in light of the first preliminary estimate for Apr-Jun 2018 GDP. We forecast real GDP growth of +1.0% in FY18 and +1.0% in FY19, downward revisions of 0.2ppt and 0.1ppt, respectively, from our previous outlook (as of 8 Jun). For FY18, we downgrade our export outlook in light of slowing exports, while for FY19, we make minor revisions to items like residential investment.

**• Domestic economy is solid**

Domestic demand in the Japanese economy is strong. Private consumption is a function of income, so while it does not give rise to economic cycles, sharp growth in employee incomes is stabilizing the economy. For capex, the ratio of capital stock to GDP is at the lowest level in 20 years, meaning the economy suffers from underinvestment. The upward leg of the capital stock cycle is still in the early stages and should be sustainable. On the other hand, the recovery in external demand is slowing from the torrid pace seen in 2017. There is still risk of fallout from trade disputes and the Turkey shock, so we advise caution.

For inflation, upward price momentum is gradually strengthening, centered on goods and services for which supply-demand is improving. Even so, we do not expect the BOJ's 2% inflation target to be reached until at least FY21. Wages are rising on the back of rising prices and productivity. We expect wage growth to gradually accelerate based on moderate inflation and productivity improvements driven by personnel shortages.

At its July monetary policy meeting, the BOJ introduced a new framework to enhance the sustainability of monetary easing. By allowing greater fluctuations in interest rates and ETF purchases, the BOJ has ultimately given itself room to continue QE for longer by reducing JGB and ETF purchases. That said, BOJ purchases of JGBs are already running at a lower pace than new JGB issuance, meaning it would have been able to continue JGB purchases even without the new framework (taken to its logical extreme, QE could be continued indefinitely). In this regard, the policy adjustment ultimately appears to be a rescue for financial institutions by allowing interest rates to rise.

In terms of future interest-rate hikes, the BOJ has newly introduced forward guidance. Its forward guidance at present is that "The Bank intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time". The market currently takes "an extended period of time" to mean one year and nine months, forecasting a rate hike in May 2020. This would be seven months after the consumption tax hike, which looks reasonable to us. If this forecast remains unchanged, there should be no increases in long-term interest rates driven by rate-hike expectations.

That said, the BOJ's decision to allow some fluctuation in interest rates means that domestic interest rates are likely to be even more strongly influenced by overseas interest rates. Moving forward, we think overseas interest rates are likely to be a more important factor than the JGB market and BOJ moves.

#### • **Heightening overseas risks**

Overseas risks now include the Turkey shock in addition to trade disputes. On the trade war front, we calculate combined macro (GDP growth) impact from four trade policy measures—1) US tariffs on steel and aluminum imports, 2) US tariffs against China, 3) Chinese retaliatory tariffs, and 4) US tariffs on automobile imports—at -0.35ppt for the US, -0.96ppt for China, and -0.09ppt for Japan. China, which has relatively smaller scope for levying tariffs against the US, stands to be more heavily impacted. That said, the impact on GDP growth is essentially a one-year phenomenon and will not persist in the long term. We therefore advise against excessive pessimism.

Meanwhile, the Turkey shock is fundamentally different from typical emerging market crises. Typical crises are caused by dollar shortages, usually when US rate hikes mean that investment money is sucked up from around the world into the US. This time though, US interest rates are not rising; in fact, they are falling. The US is not sucking up funds from around the world—investment money is fleeing from Turkey of its own accord, scared off by deteriorating external balances and inflation. Rising long-term interest rates signify that markets are calmly working to stem deterioration in external balances in place of the Turkish central bank. Real long-term interest rates have risen to 6.2% at present, closing on the real growth rate of 7.4%. We would expect the market adjustment to finish if slowdowns in economic indicators are confirmed.

Of note, claims against Turkey at European banks amount to only 2.1% of total lending even at Spanish banks, which have the largest exposures, and exposures for Italy, Germany, and France are less than 0.5%. We therefore see little risk that the Turkey shock will spill over to Europe and the rest of the world.

## Quarterly forecasts for Japanese economy

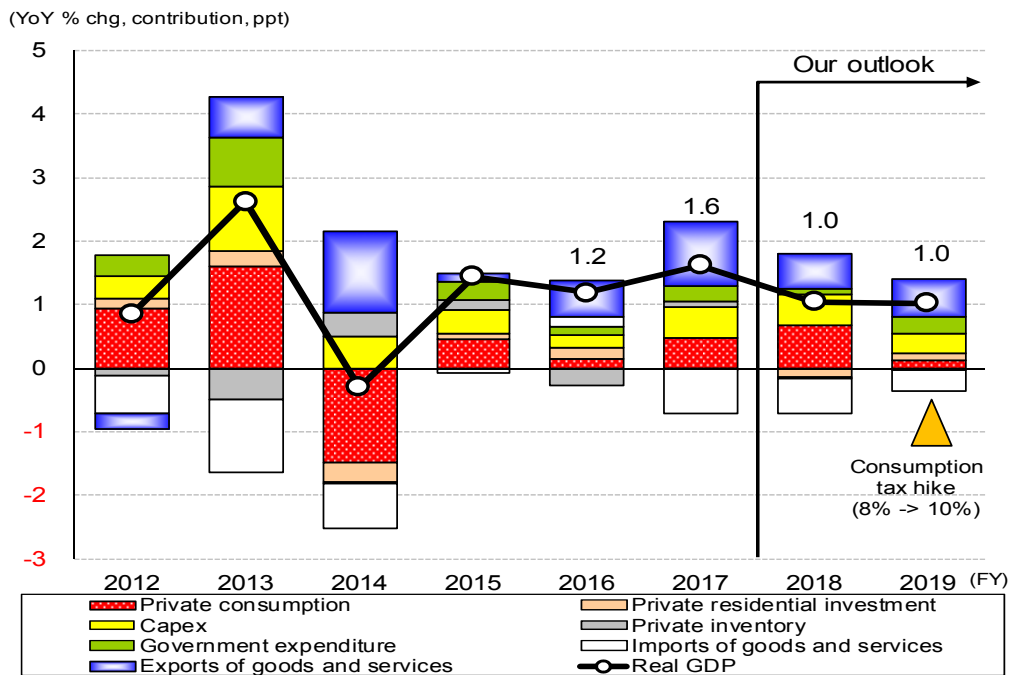
	《Actual》→《Forecasts》												《A》→《F》 (Unit:%)				Comparison with previous forecasts (as at 8 June 2018)			
	2017				2018				2019				2020	FY16	FY17	FY18			FY19	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q					FY18	FY19	
Real GDP growth (QoQ)	0.7	0.5	0.6	0.2	-0.2	0.5	0.2	0.4	0.3	0.3	0.5	-0.4	0.3							
(annual rate)	2.7	2.1	2.3	0.8	-0.9	1.9	0.9	1.8	1.2	1.1	1.9	-1.5	1.3	1.2	1.6	1.0	1.0	-0.2	-0.1	
Domestic demand, contribution (QoQ)	0.6	0.8	0.0	0.3	-0.3	0.6	0.2	0.4	0.4	0.3	0.7	-1.2	0.3	0.4	1.2	1.0	1.0	-0.2	-0.1	
Private consumption (QoQ)	0.5	0.8	-0.7	0.3	-0.2	0.7	0.4	0.3	0.2	0.1	0.8	-2.5	0.2	0.3	0.8	1.2	0.3	0.0	0.0	
Capex (QoQ)	0.6	0.5	1.2	0.8	0.5	1.3	0.5	0.5	0.5	0.5	0.5	0.4	0.4	1.2	3.1	3.1	1.9	0.5	-0.1	
Residential investment (QoQ)	0.8	1.3	-1.3	-3.0	-2.3	-2.7	0.5	2.0	2.0	3.5	1.0	-5.0	-3.0	6.2	-0.3	-4.3	3.6	-1.7	-0.6	
Public investment (QoQ)	-0.2	5.4	-2.9	-0.6	-0.4	-0.1	0.2	0.5	0.4	-0.2	0.2	3.0	3.0	0.9	1.4	-0.6	3.2	-1.3	0.7	
Foreign demand, contribution (QoQ)	0.1	-0.3	0.6	-0.1	0.1	-0.1	0.0	0.0	-0.1	-0.1	-0.2	0.9	0.0	0.8	0.4	0.0	0.0	0.0	0.0	
Exports (QoQ)	1.9	0.2	2.1	2.1	0.6	0.2	0.5	0.5	0.8	0.8	0.8	0.8	0.8	3.6	6.3	3.2	3.4	-1.9	-0.2	
Imports (QoQ)	1.4	1.9	-1.5	3.3	0.2	1.0	0.5	0.5	1.2	1.2	2.0	-4.0	1.0	-0.8	4.1	3.1	1.8	-0.6	-0.4	
Nominal GDP growth (QoQ)	0.2	0.8	0.8	0.3	-0.4	0.4	0.2	1.4	-0.1	1.2	0.1	1.0	-0.1	1.0	1.7	1.3	2.5	-0.1	0.1	
Industrial production (QoQ)	3.9	5.6	4.4	4.1	2.5	1.5	1.9	1.3	3.8	4.0	4.1	1.0	1.0	1.5	4.1	2.1	2.5	0.0	0.0	
Trade balance (Y tn, SAAR)	4.6	3.7	7.5	6.9	4.1	3.2	4.6	5.2	5.5	5.9	4.8	10.3	10.3	4.8	5.5	4.6	7.8	-1.5	-1.3	
Unemployment rate (%)	2.9	2.9	2.8	2.7	2.5	2.4	2.4	2.3	2.3	2.2	2.2	2.1	2.1	3.0	2.7	2.3	2.2	-0.1	0.0	
Core CPI (YoY)	0.2	0.4	0.6	0.9	0.9	0.8	0.8	1.1	1.1	1.1	1.1	2.2	2.3	-0.2	0.7	0.9	1.7	0.0	0.0	
(Ex effects of consumption tax hike)	0.2	0.4	0.6	0.9	0.9	0.8	0.8	1.1	1.1	1.1	1.1	1.2	1.3	-0.2	0.7	0.9	1.2	0.0	0.0	
IOER (Eop)	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0	
YCC 10y JGB yields target (Eop)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.1	0.1	0.0	0.0	
US real GDP growth (QoQ annualized)	1.8	3.0	2.8	2.3	2.2	4.1	3.0	2.8	2.4	2.3	2.0	2.1	2.1	2.0	2.5	3.0	2.2	0.5	-0.1	
US unemployment rate (%)	4.6	4.3	4.3	4.1	4.1	3.9	3.9	3.8	3.8	3.7	3.7	3.6	3.6	4.9	4.3	3.9	3.7	-0.1	0.0	
US core CPI (YoY)	2.2	1.8	1.7	1.8	1.9	2.2	2.2	2.3	2.3	2.3	2.2	2.2	2.2	2.2	1.9	2.2	2.3	0.2	0.1	
Fed rate (Eop)	0.875	1.125	1.125	1.375	1.625	1.875	2.125	2.375	2.375	2.625	2.875	3.125	3.125	0.625	1.375	2.375	2.375	0.25	0.25	

Assumptions: Forex rate (annual mean): Y111.7/USD in FY18, Y114.6/USD in FY19; Crude oil price (WTI annual mean): \$70/bbl in FY18 and \$65.8/bbl in FY19.

Note: 1) US GDP on a calendar basis, US unemployment rate is the average for the period, and FF rate at end of year. 2) Actual figures from Cabinet Office, MIC, METI, BOJ. Forecasts by SMBC NIKKO.

Source: Cabinet office; Ministry of Economy, Trade and Industry (METI); Ministry of Internal Affairs and Communications (MIC); Bank of Japan (BOJ); SMBC NIKKO forecast

## Outlook for Real GDP growth



Source: CAO, SMBC NIKKO forecast

## **APPENDIX**

### **ANALYST'S CERTIFICATION**

Each analyst shown on the first page of this research report prepared and issued by SMBC Nikko Securities Inc. ("SMBC NIKKO") is primarily responsible for the preparation and content of this research report. Each analyst certifies that the opinions contained herein accurately reflect the analyst's individual views for the subject securities and issuers. Each analyst also certifies that no part of the analyst's compensation was in the past, at present, or in the future, directly or indirectly related to the specific recommendations or views expressed in this research report.

### **IMPORTANT DISCLOSURES**

Target prices assigned by research analysts reflect the estimated share price level the analyst forecasts the stock to reach within the next six to 12 months.

Each coverage stock is assigned an investment rating relative to the analyst or analyst team's coverage sector universe which encompasses said stock. Investment ratings are defined as below; the effective rating period is six to 12 months.

1-Outperform:An individual stock's investment return, as forecast by the research analyst, is expected to exceed the median investment return of all stocks within the coverage universe.

2-Neutral:An individual stock's investment return, as forecast by the research analyst, is expected to be in line with the median investment return of all stocks within the coverage universe.

3-Underperform:An individual stock's investment return, as forecast by the research analyst, is expected to be below the median investment return of all stocks within the coverage universe.

NR:Not Rated

RS:Rating Suspended

Also please note the following:

During the period from October 30th 2012 until November 16th 2016, each coverage stock classified as a Small-Mid Caps & Growth Stocks was assigned an investment rating based on expected performance versus the market average (defined as TOPIX). Investment ratings are defined as below; the effective rating period is six to 12 months.

A-Outperform:An individual stock's investment return, as forecast by the research analyst, is expected to exceed the market average.

B-Neutral:An individual stock's investment return, as forecast by the research analyst, is expected to be in line with the market average.

C-Underperform:An individual stock's investment return, as forecast by the research analyst, is expected to be below the market average.

NR:Not Rated

RS:Rating Suspended

Sector ratings are defined as below; the effective rating period is six to 12 months. The market as it pertains to Japan is TOPIX.

Overweight:The investment return of the sector coverage universe, as forecast by the research analyst, is expected to exceed the market average.

Equal weight:The investment return of the sector coverage universe, as forecast by the research analyst, is expected to be in line with the market average.

Underweight:The investment return of the sector coverage universe, as forecast by the research analyst, is expected to be below the market average.

## Distribution of Investment Ratings

The following table shows (1) the distribution of investment ratings for all SMBC NIKKO coverage universe stocks and (2) the proportions of stocks of each rating to which SMBC NIKKO or an affiliate or other related party has provided investment banking (IB) services within the past 12 months (updated as of 17 August, 2018)

	1-Outperform	2-Neutral	3-Underperform	Others
(1) Companies under coverage	38%	55%	7%	0%
(2) Proportion of stocks of each rating in (1) with IB relationships	43%	36%	22%	50%

Note: For the purposes of mandatory regulatory disclosures, 1-Outperform corresponds to a “buy” rating, 2-Neutral corresponds to a “hold” rating, and 3-Underperform corresponds to a “sell” rating. However, SMBC NIKKO investment ratings are assigned relative to an analyst or analyst team’s sector coverage as defined above and are thus different from “buy”, “hold,” and “sell” ratings as defined by FINRA.

Analyst compensation, including the compensation of the analyst(s) directly involved in the preparation of this report, is based upon (among other factors) the overall profitability of SMBC NIKKO, which includes the overall profitability of investment banking services.

Please refer to the following URL for all relevant and current price charts and the history of changes in investment rating(s) and/or target price(s):

<https://researchdirect.smbcnikko.co.jp/disclosure/disclosure.php>

Clients may request all relevant and current disclosures by contacting a SMBC NIKKO or branch representative, or by sending a request to the following postal address:

Equity Research Division, SMBC Nikko Securities Inc., 1-5-1 Marunouchi, Chiyoda-ku, Tokyo, 100-6519

Individual stock/sector recommendations and share price forecasts contained in SMBC NIKKO’s technical analysis reports are based on a variety of technical analysis techniques that take historical share price performance, position analysis, and other technical factors into consideration, but are not based on a fundamental analysis of those stocks/sectors in question. Accordingly, stock/sector recommendations and share price forecasts based on the technical analysis of individual stocks/sectors that are also within the SMBC NIKKO fundamental equity research coverage universe do not necessarily correspond to, nor are intended to match, respectively, the fundamental investment/sector ratings and target prices determined by SMBC NIKKO’s fundamental equity research analysts responsible for covering those same stocks/sectors.

### General Disclaimer

This research report has been produced by SMBC NIKKO for informational purposes only. It does not constitute solicitation of the sale or purchase of securities or other investments. The information contained herein is derived from sources that SMBC NIKKO believes to be reliable, but SMBC NIKKO does not guarantee the accuracy or completeness of said information. In some cases, such information may be incomplete or summarized. Prices, numbers, and similar data contained herein include past results, estimates, and forecasts, all of which may differ from actual data. These prices, numbers, and similar data may also change without prior notification. This research report does not guarantee future performance, and the information contained herein should, for whatever purpose, be used solely at the discretion and responsibility of the client. Neither SMBC NIKKO nor its affiliates accept any liability or responsibility for any results in connection with the use of such information. This research report does not take into account specific financial situations, needs, or investment objectives of any client, and it is not intended to provide tax, legal, or investment advice. Clients are responsible for making final investment decisions and should do so at their own discretion after careful examination of all documentation delivered prior to execution, explanatory documents pertaining to listed securities, etc., prospectuses, and other relevant documents. Non-research departments of SMBC NIKKO and its affiliates may provide commentary to clients and their proprietary trading departments that are inconsistent with or incompatible with investments or opinions recommended in this research report. SMBC NIKKO and its affiliates may make investment decisions on the basis of such commentary. In addition, SMBC NIKKO and its affiliates, as well as employees of either, may trade in the securities mentioned in this research report, their derivatives, or other securities issued by the same issuing companies in this research report. This research report is distributed by SMBC NIKKO and/or its affiliates. The information contained herein is for client use only. SMBC NIKKO holds the copyright on this research report. Any unauthorized use or transmission of any part of this research report for any reason, whether by digital, mechanical, or any other means, is prohibited. If you have any questions, please contact your sales representative. Additional information is available upon request

Certain company names, product and/or service names that appear in this research report are trademarks or registered trademarks of SMBC NIKKO or other companies mentioned in the report.

Important notes concerning Article 37 of the Financial Instruments and Exchange Act (Advertising Regulations, etc.)

**Commissions** (below figures do not apply to certain customers, such as non-residents in Japan and professional investors under FIEA, for whom commissions are set on an individual basis)

When a trade is executed based on information contained in this research report, a predetermined brokerage commission may be charged. For example, when an order is placed at a branch to buy or sell a stock or other security on a securities exchange in Japan (with the exception of odd-lot remainders), a commission of up to a maximum of 1.242% of the contract settlement amount (Note: The minimum commission is 5,400 yen) is charged to the client for each product trade executed. Clients will only be charged for the purchase price of a bond, stock or other security in trades executed as part of a primary offering, secondary distribution, or with a counterparty (Note: In the case of bonds, the trade may require that the client pay accrued interest if separate from the purchase price). For trades involving products denominated in foreign currencies, an exchange of products denominated in yen and another currency, or an exchange of products denominated in different currencies, the applicable exchange rate will be determined by SMBC NIKKO. For fees mentioned above that are subject to consumption tax, the rates and amounts include the consumption tax portion.

### **Risks**

Each product entails the risk of a partial loss of the amount of invested capital (the risk of a partial loss of principal) or a loss equal to or greater than the amount of invested capital (the risk of a loss equal to or exceeding principal) due to a variety of factors, which may include price variance and fluctuations in stock markets, interest rates, exchange rates, real estate markets, and commodity markets, and deterioration in the creditworthiness (including the financial and management condition) of issuers of securities. When executing margin or derivative transactions (“derivatives”), there is a risk the amount of derivatives transaction exposure could exceed the client’s margin collateral or margin deposit (“margin collateral amount”), and there is also a risk of loss exceeding the client’s margin collateral should prices of securities or values of indexes underlying such transactions fluctuate (the risk of a loss equal to or exceeding principal). When executing over-the-counter derivative transactions, there may be a spread between the ask and bid prices on financial instruments quoted by SMBC NIKKO. For asset-backed securities, interest, dividends, repayment of principal and other elements may be affected by changes in conditions in certain assets. Such changes may result in losses relating to early sale or redemption of such assets.

Aforementioned commissions and risks differ by financial instrument and clients should carefully examine all relevant documentation, including documentation delivered prior to execution, prospectuses, and other material provided. Clients may contact any SMBC NIKKO branch for questions regarding such documentation.

### **Company Name**

SMBC Nikko Securities Inc. is a financial instruments dealer governed by the Financial Instruments and Exchange Act, registered with the Kanto Local Finance Bureau, Registration No. 2251.

### **Member Associations**

SMBC Nikko Securities Inc. is a member of the Japan Securities Dealers Association, the Japan Investment Advisers Association, The Financial Futures Association of Japan and the Type II Financial Instruments Firms Association.

### **Regional Specific Disclosures**

Reports sent to clients outside Japan are intended only for institutional investors. The definition of ‘institutional investor’ varies from country to country. Neither this research report nor the information contained in it is intended to be an offer, an inducement or an attempt to induce any person to enter into any agreement to acquire, dispose of, subscribe for or underwrite securities.

**US** This research was prepared by non-U.S. analysts employed by SMBC Nikko Securities Inc., a broker-dealer located in Japan which is an affiliate of SMBC Nikko Securities America, Inc. (“SI”), a U.S. broker-dealer and member firm of FINRA. The research analysts involved in the preparation of this research report, whether in whole or in part, are not based in the US (non-U.S. analysts) and are not registered/qualified as research analysts with FINRA. The non-U.S. analysts who prepared this research report may not be associated persons of the member firm and therefore may not be subject to FINRA Rules 2241 and 2242 restrictions on communications with a subject company, public appearances and trading securities held in a research analyst account. This report is intended for distribution in the United States solely to institutional investors. Each such investor by acceptance of this report agrees that it will not distribute or provide this report to any other person. Any U.S. person receiving this report who desires to effect transactions in the securities discussed in this report should contact SI.

**Canada** Under no circumstances should this material be construed as an offer or sale of securities. This material is a general discussion of the merits and risks of a security or securities only, and is not in any way meant to be tailored to the needs and circumstances of any recipient. This material is not a recommendation to purchase a specific security, service, or product and should not be construed as such.

**Hong Kong** This research report is distributed by SMBC Nikko Securities (Hong Kong) Limited and is intended to be distributed to professional investors (as defined in the Securities and Futures Ordinance and its subsidiary legislation) only.

**China** The distribution of this research report has not been licensed or approved by the Chinese Securities and Regulatory Commission and this research report is not meant to be distributed in China directly or indirectly to investors in China, except that, subject to the applicable laws and regulations, this research report will be sent to certain investors in China on an invitation basis. Chinese investors making investments outside China may be subject to foreign exchange control approvals and filing requirements under the relevant Chinese foreign exchange regulations, as well as offshore investment approval requirements.

**Taiwan** The distribution of this research report from the jurisdiction outside of Taiwan has not been licensed or approved by the regulators of Taiwan.

**Singapore** This research report is distributed by SMBC Nikko Securities (Singapore) Pte Ltd. ("NKSG"), to, and is intended only for institutional investors, accredited investors and/or expert investors (as defined in the Financial Advisers Act, Cap.110). Neither this research report nor the information contained in it is intended to be an offer to make with any person, or to induce or attempt to induce any person to enter into or to offer to enter into any agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities in Singapore. By accepting this report, you confirm that you are an "institutional investor", "accredited investor" and/or "expert investor" and agree to be bound by the foregoing limitations. Recipients of this document in Singapore should contact NKSG in respect of any matters arising from, or in connections with, this document.

**Europe, Middle East and Africa** This material and any attached presentations from third parties is distributed within the EMEA region by SMBC Nikko Capital Markets Limited ("CM"). It contains the current opinions of the writer but not necessarily of CM. CM may or may not own the securities referenced and, if such securities are owned, no representation is being made that such securities will continue to be held. SMBC Nikko Capital Markets Limited, One New Change, London EC4M 9AF, tel +44 (0)20 3527 7000. Registered in England No.02418137. Authorised and regulated by the Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS. Please refer to the following URL for SMBC NIKKO's "Conflict of Interest Management Policies Concerning Research Analysts and the Production of Investment Research":

<https://researchdirect.smbcnikko.co.jp/pdf/coidisclosure.pdf>

United Arab Emirates: This information does not constitute or form part of any offer to issue or sell, or any solicitation of any offer to subscribe for or purchase, any securities or investment products in the UAE (including the Dubai International Financial Centre) and accordingly should not be construed as such. Furthermore, this information is being made available on the basis that the recipient acknowledges and understands that the entities and securities to which it may relate have not been approved, licensed by or registered with the UAE Central Bank, Emirates Securities and Commodities Authority or the Dubai Financial Services Authority or any other relevant licensing authority or governmental agency in the UAE. The content of this report has not been approved by or filed with the UAE Central Bank or Dubai Financial Services Authority.