Little hope for an export recovery

We do not carry high hopes for exports to recover due to Japan-specific factors (continued outward foreign direct investment, low price elasticity for luxury goods exports, an exclusion of Japanese manufacturers from the global supply chain since the Great East Japan Earthquake) as well as a global factor, namely the shift to a closed economy regime (disappearance of growth frontiers: decline in benefits of international trade).

CPI inflation to converge at around 1%

The level of CPI excluding energy clearly turned around in H1 2013 after 15 years of declines up to 2012, and has maintained an upward trend of around 1% annualized since then. Deflation has clearly ended, mainly as the result of QE that started at a cautious pace under former-BoJ Governor Shirakawa in 2012. There is an argument that inflation will slow from now on due to a stable JPY exchange rate and a weak rise in wages; however, the fact that the Japanese economy is moving from the flat section on the Phillips curve to the steeper section indicates that an economic expansion will have larger impact on inflation than before. This regime shift should fully offset possible drags on inflation from a stable JPY exchange rate and slow wage growth.

Not predicting additional monetary easing

Based on the facts that the BoJ at present is promising an almost open-ended easing with no set limit on the timeline and that the scale of the monetary base increase is an annual JPY80trn (16% of GDP), an overwhelming scale compared to other countries, we forecast monetary policy is likely to maintain the current easing stance (no more rounds of easing). Were the BoJ to enact additional monetary easing reluctantly, we believe this would only occur in the case of a sharp slowdown in the global economy, JPY appreciation, and a slump in share prices.

Japanese economy almost reaches its new steady state

We have reiterated several times that the new steady state of the Japanese economy since the introduction of QQE in April 2013 is 2% nominal GDP growth, 1% CPI inflation, 1% 10-year JGB yield, and 5% M2 growth. The Japanese economy has been in the transition process and seems to be very close to this new steady state.

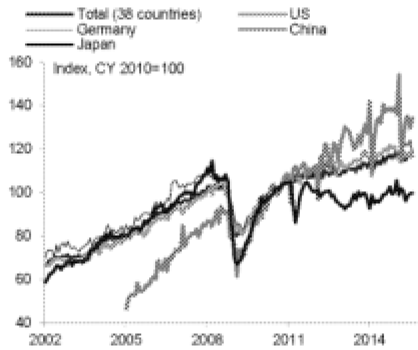
Figure 7: Other indicators & financial forecasts

	2014	2015F	2016F	2017F
M2 growth, %	3.4	3.8	4.8	5.1
Fiscal balance, % of GDP	-5.9	-5.4	-4.5	-3.4
Public debt, % of GDP	213.6	211.6	210.5	208.4
Trade balance, USD bn	-99.8	-9.3	-22.6	-23.5
Trade balance, % of GDP	-2.2	-0.2	-0.5	-0.5
Current account, USD bn	24.9	137.0	152.4	168.8
Current account, % of GDP	0.5	3.3	3.6	3.9
Financial forecasts	**Current**	**Q1-2016**	**Q2-2016**	**Q4-2016**
Official	0.10	0.10	0.10	0.10
3M rate	0.17	0.15	0.15	0.15
10Y yield	0.32	0.40	0.45	0.55
JPY per USD	123	127	128	128
JPY per EUR	134	128	124	115

Source: National statistics, Deutsche Bank Research, as of December 07

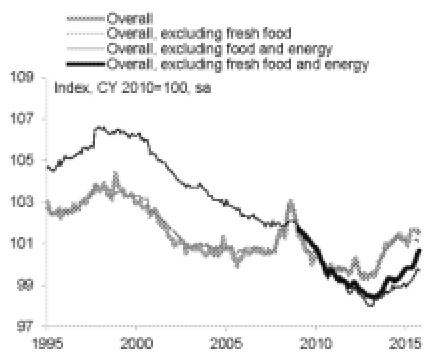
Mikihiro Matsuoka, [redacted]

Figure 4 : Export volume of major countries



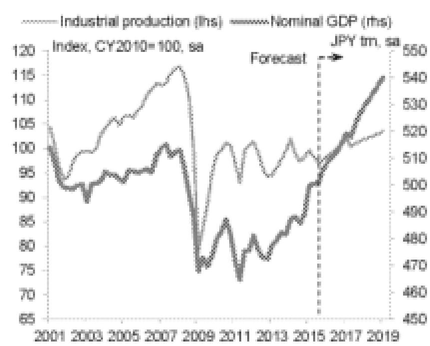
Note: Total includes EU 28 countries, US, Japan, Canada, Brazil, Mexico, China, Hong Kong, Korea, Taiwan and Singapore. China is included from January 2005.
Source: Haver Analytics LP, Deutsche Bank Research

Figure 5 : Consumer price index



Note: Excluding the consumption tax hike effect
Sources: MIC, Deutsche Bank Research

Figure 6 : Nominal GDP and industrial production



Note: DB forecast from Q4 2015.
Source: Cabinet Office, METI, Nikkei NEEDS, Deutsche Bank Research