Japan’s Growth Strategy: What’s Next after Deflation

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Japan Economy encounters drastic changes every 20 years. If it turns from deflation into inflation, it could affect the behavior of corporate and investors.

The government has decided to cut corporate tax and submit various legislation in 2015. However, the implementation of growth strategy remains challenging without clear priorities.

We view Japan’s weak fiscal attributes as significant weakness in our credit metrics and they could threaten its financial stability via a spike of interest rates.
What’s Next? : Japan Economy Changes Every 20 Years

Japan Real GDP Growth%

High Economic Growth Started
↓
The 1st Oil Shock
↓
Zero-Growth Started (Burst of Bubble)
↓
High Growth Age

Great Moderation

Deflation & Lost 20 years

Source: Cabinet Office and S&P

Source: 8-point Arial (Body). This text box is pre-positioned and formatted to automatically wrap up when more lines are required. Copy and paste on pages as needed.
What’s Next? : Labor Force Shortage Could Lead to Higher CPI

- Investment to improve productivity is Key for Growth

Source: The Ministry of Health
Government Pension Investment Fund (GPIF) Will Rebalance its Portfolio

Potential Changes in Managed Assets of GPIF (Mid plan 2015-2020)

- GPIF Reform could have positive impact on Corporate Governance of private companies
- As a benchmark, it could lead to diversified portfolio of other pension funds
- However, market risk will surge

<table>
<thead>
<tr>
<th></th>
<th>Real Return</th>
<th>Nominal Return</th>
<th>Standard Deviation</th>
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<tbody>
<tr>
<td>New Portfolio</td>
<td>1.77%</td>
<td>4.57%</td>
<td>12.80%</td>
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<tr>
<td>Base case</td>
<td>-0.20%</td>
<td>2.60%</td>
<td>4.70%</td>
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<tr>
<td>All bonds</td>
<td></td>
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Source: GPIF HP
Japan Corporate Look For New Source of Revenue Growth

• Credit quality of Japanese corporate and financial institutions is improving

• They started to restructure their business lines and look for stable revenue sources (Hitachi, Toshiba, Panasonic etc.)

• We expect outbound M&As will further increase
## Major Growth Strategy

<table>
<thead>
<tr>
<th>Major Growth Strategy</th>
<th>Key Action</th>
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<tr>
<td><strong>Corporate Tax Reform</strong></td>
<td>Gradually cut to less than 30% from 35% in 2014 FY</td>
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<td>2.5% cut in 2015 FY</td>
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<td><strong>Labor Market Reform</strong></td>
<td>White Collar Exemption</td>
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<td>Submit the new law to the Diet in 2015</td>
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<td><strong>Medical Sector Reform</strong></td>
<td>Deregulation in special area</td>
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<td>Submit the new law to the Diet in 2015</td>
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<td><strong>Agriculture Reform</strong></td>
<td>Overhaul of Agriculture cooperative and related entities</td>
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<td>Submit the new law to the Diet in 2015</td>
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<tr>
<td><strong>Corporate Governance</strong></td>
<td>Amendment of Corporate Law to encourage independent directors</td>
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<td>The corporate law will be effective in FY 2015</td>
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<tr>
<td><strong>GPIF Reform</strong></td>
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</table>
Delay of Fiscal Consolidation is Key Risk Factor

- 10 year JGB rate hits record low but future volatility may increase
- Based on a certain assumption, 40% of commercial banks will not be able to attain 5.5% CETI 1 ratio if interest rates were to rise by 2.5% (excluding unrealized gains in equity)
Thank You

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