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Note: In the Investment Strategy section, most of Nomura Asset Management’s senior investment professionals offer their views of the investment strategy and market prospects – commentaries are as of June 2023, and reflect each professional’s personal views, and do not entirely match NAM’s house view.
Quarterly Financial Market Recap

As turmoil in the U.S. banking sector calmed down and attention returned instead to the resilient macro-economy, financial markets in the April-June 2023 quarter were characterized by a rise in U.S. long-term bond yields, a stronger dollar and stock market gains. The stock market rallied in a positive reaction to the passage of the Fiscal Responsibility Act, which eliminated immediate concerns about the American federal government debt ceiling. The dollar rose against both the euro and the yen as interest rate differentials widened amid rising yields on U.S. long-term Treasury bonds.

Equity Market of Major Countries

(Points)

Source: Nomura Asset Management based on Bloomberg data

10 Year Bond Yields in Major Countries

(%) (January 2, 2019 – June 30, 2023, daily)

Source: Nomura Asset Management based on Bloomberg data

Yen and Euro against the US dollar

(USD/EUR) (JPY/USD) (Points)

Source: Nomura Asset Management based on Bloomberg data

Trends in VIX and MOVE

(Points) (January 2, 2019 - June 30, 2023, daily)

Note: The VIX and the MOVE are indexes that show the risk of future volatilities of US stocks and US bonds, respectively.
Source: Nomura Asset Management based on Bloomberg data
Investment Environment Outlook

With the end of policy rate tightening in sight, we can expect to see the start of a downward trend in market interest rates

A turning point in monetary policy

Since the release of our Spring Investment Outlook commentary, we believe market risk sentiment has improved for two main reasons:

1. Concerns about systemic vulnerability triggered by the Silicon Valley Bank collapse have now eased somewhat.
2. The U.S. government's debt ceiling has been suspended until early 2025.

At the Federal Open Market Committee (FOMC) meeting in May, the phrase "some additional tightening may be appropriate" was removed from the statement, and in fact, the Fed chose not to implement a rate hike at the June FOMC meeting. While another policy rate hike remains a possibility, we are now able to see an eventual end to this interest rate tightening phase.

Bond yields are on a downward trend

U.S. and European long-term interest rates could begin a downward trend until the central banks start to cut short term policy rates in response to slowing economic and price momentum. However, we do not expect rapid rate cuts if the economy remains in the "mild recession" category. Also, we do not expect to see a significant decline in long-term interest rates.

If the economy shows a clear recovery in the second half of 2024 as rate cuts again start to stimulate growth as expected from the January-March quarter of 2024, we can expect long-term interest rates to stop declining and start rising again slightly due to expectations of a future economic recovery, with some yield curve steepening as short term rate cuts continue.

Over the longer term, we can see three main reasons why inflation could remain a little higher than before the pandemic. 1. Inflation expectations may not decline as much as before, as consumers have experienced price increases due to pandemic induced supply-demand imbalances. 2. Supply chain restructuring in light of economic security could lead to higher costs. 3. Labor supply and demand could remain tight due to demographic changes. At the same time, long-term interest rates are also expected to remain well above their pre-pandemic levels.

Yen-bond yields will be strongly affected by the Bank of Japan's monetary policy, but even if they rise temporarily as a result of the decision to extend the flexibility of long-term interest rates, as we expect, they are likely to stabilize in a manner that is linked to global interest rates, especially if the market offers no significant news that could fuel further market volatility.
**Weaker U.S. dollar expected**

The U.S. dollar appreciated through to the end of May, partly because of falling financial markets’ expectations for rate cuts in late 2023. However, thereafter, the U.S. dollar has depreciated against the euro and appreciated against the yen.

Looking ahead, we uphold our view that the U.S. dollar’s strength will be adjusted as monetary policy moves from tightening to maintaining the status quo, and with future interest rate cuts in sight. Even so, the exchange rate is not necessarily determined solely by differences in monetary policy and interest rates. We estimate that the exchange rate will fall back to around 130 yen to the U.S. dollar at the end of the year if the recent linkage with the U.S.-Japan interest rate gap is maintained.

**Stock market expected to rise in 2024**

In the months leading up to June, stock indexes across the major developed countries and regions have been on an upward trend following the Fed’s decision to hold U.S. interest rates steady, the postponement of the U.S. federal government’s debt ceiling problem, and solid corporate earnings, particularly among high-tech stocks.

We expect stock price volatility to increase as recession expectations intensify; however, expectations for a rate cut as economic and price momentum slow will support stock prices from a valuation perspective. Then, as we enter 2024, we expect the economy to bottom out due to the effect of interest rate cuts, which we believe will lead to an upward trend in stock prices in major developed economies.

Therefore, we need to pay attention to downside risks to stock prices that could arise in the near term, but afterwards we can expect risk sentiment to improve on expectations of a rate cut.

In Japan, stock prices have risen somewhat rapidly. However, if the yen appreciates in the future, as we expect, this could hurt the earnings prospects of exporters. On the other hand, a stronger yen would be effective in controlling import and basic material costs, while the relatively easy monetary environment will be maintained and the economy is expected to remain strong. Accordingly, for the time being we believe Japan could maintain a slight advantage over the global equity market.
Japan Equity Market Outlook

Ending deflation and sustaining corporate reform efforts will be the key variables

Japan’s stock market returns have outpaced all other countries in the first half of 2023

As of the end of June, the Japanese stock market was up 21.0% for the year in local currency terms, outperforming the U.S. S&P500’s 15.9% and the China A Share market’s 3.7%. By industry, precision electronic components suppliers, mainly semiconductor-related stocks, led the market rally amid strong earnings growth expectations backed by investments in emergent cutting edge technologies such as generative AI. Trading company stocks, which have benefited from positive comments from prominent foreign investors, also recorded strong returns. Meanwhile, financial stocks, which had rallied late last year amid rising overseas interest rates and expectations that the Bank of Japan (BOJ) would revise its accommodative monetary policy, posted the weakest year to date performance. The incoming BOJ governor has instead left the existing easy monetary policy settings unchanged, while turmoil among U.S. regional banks in March has continued to unsettle the overall banking sector.

Corporate earnings trends

Corporate earnings momentum in Japan appeared to hit the bottom toward the end of last year after seeing a modest downturn due to the appreciation of the yen, following the yen’s sharp depreciation through the second half of last year, as well as the expected deterioration in business sentiment against a backdrop of monetary tightening in most major economies. In fact, the actual business results of the Russell/Nomura Large Cap Index (all industry ex financials) for FY2022 exceeded previous forecasts.

For fiscal year 2022 revenue, operating profits, and recurring profits grew by 17.2%, 6.9%, and 7.7%, while for fiscal year 2023 (ending March 2024), these figures were 0.3%, 11.1%, and 4.2%, respectively. As a result, the market’s overall ROE is likely to remain stable around 9% over an approximately three-year period.
Impact of wage rises on corporate earnings and the macro-economy

Although Japan’s inflation is still moderate compared to inflation rates in many other countries, the BOJ’s long-targeted 2% inflation is still a reality. However, these price pressures have mainly been caused by temporary external factors such as supply chain disruption due to the impact of the pandemic, rising resource prices, and sharp depreciation of the yen. For this reason, investors’ attention will focus on domestic wage trends as to whether inflation can remain consistently above the BOJ target going forward. This year’s spring wage negotiation ended with a broad 3.7% rise in wage remuneration, a rate of increase not seen in recent years. Moreover, given that Japan’s working age population and therefore its labor force will decline in the coming years, it is increasingly likely that labor shortages will underpin wage growth. On the other hand, higher wages mean higher employment costs for companies, and if those increased costs are not accompanied by higher productivity or effectively passed through to prices of goods and services, then it could have a negative impact on corporate earnings.

Based on estimates by Oxford Economics, our analysis suggests that a wage increase of around 3% would result in a positive impact on corporate earnings through increased sales. Similarly, we estimate that wage increases would boost GDP growth in the entire economy. The economic environment that the BOJ is aiming for can only be realized if a virtuous circle is created in which rising wages stimulate domestic consumption through increased disposable income, and drive robust demand. This in turn should lead to steadily rising prices and improved corporate earnings, which feeds back into further wage increases. Thus, in light of this potential positive feedback loop, the pace of wage increases next year will be a vital focus for investors.
Tokyo Stock Exchange applies pressure on companies with PBR of less than 1.0

In March 2023, the Tokyo Stock Exchange required companies whose shares were trading at a PBR of less than 1 (i.e. trading below book value) to disclose business plans that take into account how their management perceived this situation, how they estimate their cost of capital, and how they might achieve a return on invested capital that exceeds it. Given that around half of TSE-listed companies trade at a PBR of 1 or less means that the ROE of nearly 900 companies is below the rate of return demanded by investors. One way to improve ROE is to return excess cash to shareholders in the form of dividend increases and share buybacks. This would achieve the objective by increasing the company’s financial leverage. The TSE’s emphasis this time, however, is not on improving ROE through such temporary financial strategies, but on rethinking longer term management policies, such as sales growth and operating margins, that can generate sustainable growth in a company’s core business. The TSE also explains that PBR is only one indicator that recognizes these challenges and is used to inspire companies to action and to help them develop a response. At the time of the financial results announcement in May of this year, more than 50 companies referred to PBR as a metric in their medium-term plans. Although this is a welcome start, we hope, through applying a variety of indicators in addition to PBR, that the dialogue between Japanese companies and investors, on whether companies are generating the business profits that investors seek and how to improve their growth and profitability if they are not, will lead to a better understanding and assessment of the overall valuation of the Japanese stock market.

PBR of Listed Companies in Major Equity Markets
(As of April 14, 2023)

ROE of Listed Companies in Major Equity Markets
(1980 – 2022, annually)

(Note)U.S.: MSCI U.S. stocks, Eurozone: MSCI Europe stocks, Japan: TOPIX500 (excluding financial and trading companies)
Source: Nomura Asset Management based on Quick and Factset data.
Global Equity Market Outlook

After growth stocks led the rebound in developed equity markets, can a broadening base for bargain hunting become the focus of sustained gains? Emerging equity markets are advancing too, supported by valuations.

Developed equity markets: Growth stocks leading the rebound

Developed equity markets rebounded strongly in 2023 after the turn of the year. Amid signs that U.S. inflation might be close to its peak with the Fed beginning to see an end point for monetary tightening, interest rate concerns that had previously weighed on the stock valuations of growth stocks began to recede. This view was hastened by the credit market uncertainty that followed in the wake of the collapse of SVB and other regional banks in the U.S. The market therefore shunned the financial sector and focused on stable growth stocks whose earnings were seen as relatively resilient, even in the event of an economic slowdown. As a result, developed stock markets have advanced since March 2023, with growth stocks significantly outperforming value stocks in terms of share price performance.

New artificial intelligence (AI) applications have become a stock bargain hunting theme

One of the factors supporting the rise of growth stocks has been investors' expectations for increased use of AI. This trend emerged from the release of the latest version of OpenAI’s conversational ChatGPT in 2022. This system makes the power of a large-scale language model available on smartphones and other devices, making it easy for many users to try out and experiment with such systems.

Reflecting expectations of growing AI use, the public cloud data storage providers are increasing their computing power. Nvidia, a leading provider of semiconductors for data centers, reported sales forecasts for the May-July quarter that exceeded market analysts’ consensus expectations by more than 50%, and its stock price rallied by more than 20% after the announcement. In light of these developments, the stock market began to look for related stocks, particularly semiconductor and software stocks, that could benefit from the increased use of AI. This contributed to the rebound in growth stocks from the beginning of the year.

The global AI market is forecast to be worth $390 billion by 2025, but we expect it to become an investment theme that can drive the market forward over the long term as more specific AI-based services emerge and begin to contribute to corporate earnings.

*The descriptions of individual stocks do not imply any recommendation to buy or sell specific stocks or any increase or decrease in prices or other factors.*
More recently, the stock price gains supported by those themes have started to look somewhat overheated. Semiconductor stocks seemed to benefit most from the AI theme, but when we analyse the expected price-to-earnings ratio (PER) of the Philadelphia Semiconductor Index, which is a major index of semiconductor stocks, it has rebounded back towards record levels even in the short period since the regional banking turmoil in March. Moreover, the contribution from the higher performing stocks in the U.S. market over this year to date has been rather extreme in terms of concentration. The 10 strongest stocks have accounted for 75% of the rise in the Index. A broader investor base will therefore be key to placing the stock market rally on a more sustainable footing.

Looking at the broader corporate performance picture, corporate earnings forecasts for 2023 had been revised downward since last summer due to concerns over the impact of monetary tightening and an economic slowdown. Recently, these forecasts have bottomed out with help from a round of semiconductor inventory adjustments, a pause in high fuel costs, and a recovery in digital advertising, which had been slowing. However, in view of the consumption of surplus household sector savings, a trend that has supported the solid economic performance thus far, and evidence that monetary tightening is starting to take effect, we believe that corporate earnings in the second half of this year need to be watched closely for further signs of deterioration (risk of heading to 1. as shown in this chart). If inflationary pressures subside toward the end of the year and the economy begins to bottom out, the focus of the market is expected to be on earnings growth in the second half of this year and into next year (2. in the chart below), as this will be the driving force behind the rise in stock prices from the second half of this year through to 2024.
The MSCI Emerging Markets Equity Index (in U.S. dollars) has remained in slightly positive territory since the beginning of the year, but there is still a significant gap in returns across emerging country markets. While the Mexican stock market and some others rallied in tandem with the strong U.S. economy, others have underperformed such as South Africa, which has suffered from power shortages and the recent decline in resource prices, and the Turkish stock market, where hopes of political change were crushed when President Erdogan was re-elected.

In the second half of 2023, we expect emerging markets to show strong potential. It will depend on the sustainability of economic strength and the continuity of inflation in the U.S. and elsewhere, but for monetary tightening in the U.S., we generally believe that we are approaching the end of the tightening phase. As for the Chinese equity market, which represents a large position among emerging markets, the best phase of the rebound from the zero-Covid policy may be passing, but monetary easing and fiscal stimulus are expected to support the economy. Also, emerging market stocks are currently trading at historically cheap valuations, making them less sensitive to additional negative news.

On the other hand, downside risks include a devaluation of Chinese stocks due to the escalating tensions between the US and Chinese governments, global inflationary pressures, the prospect of a global economic recession, and political risks in emerging countries.

In this context, portfolio managers are focusing on the following markets: 1. Countries where the policy interest rate is expected to peak as inflation peaks in the short term, and 2. Countries that are highly attractive in demographic terms in the medium term. In group 1. we are focusing on Brazilian stocks based on historical valuations, as well as other undervalued stocks, and for group 2. we are focusing on Indian and Indonesian stocks. These countries are likely to continue benefiting from the demographic dividend stage whereby young people drive economic growth as they enter the workforce.

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**Year-to-date stock market returns (in U.S. dollars, total return)**

(December 31, 2022 to May 31, 2023)

- Emerging: ±20%
- Developed: ±10%
- Emerging Developed: ±30%
- Greece: ±20%
- Czech Republic: ±30%
- Mexico: ±20%
- Taiwan: ±30%
- Hungary: ±20%
- China: ±30%
- Malaysia: ±20%
- South Africa: ±30%
- Columbia: ±20%
- Turkey: ±30%

Note: Emerging Markets: MSCI EM(Emerging Market) Index, Developed Markets: MSCI World Index, Countries: MSCI Country Index
Source: Nomura Asset Management based on FactSet data
J-REIT Market Outlook

Economic conditions for the J-REIT market are stabilizing, including interest rates and real estate prices.

Interest rates in Japan and overseas have settled down for a while

Volatility also increased in the J-REIT market in 2022, indirectly affected by rising interest rates overseas. On the other hand, the 10-year Treasury yield has seen a pause in its upward trend this year, although it remains volatile. As for the domestic market, it is suggested that monetary policy, which attracted attention following the change of the Bank of Japan governor, will basically remain accommodative. Under these circumstances, domestic and foreign interest rate trends have temporarily calmed down. The TSE REIT index had been in a correction phase since the Bank of Japan increased the range of fluctuation in long-term interest rates in December. The market has bottomed out from April this year.

The J-REIT market has outperformed overseas REIT markets

Interest rates are already high in the U.S., although the pace of interest rate increases has slowed, and the profitability of real estate investment through leverage has declined. A series of bankruptcies among regional U.S. banks could also have a knock on effect on commercial real estate lending. Against this backdrop, the U.S. REIT market continues to stagnate due to concerns over the risk of a future decline in real estate prices. On the other hand, Japan’s relatively low inflation rate and long-term interest rates have had a limited impact on the real estate market due to stable lending attitudes of financial institutions, and the J-REIT market has remained firm relative to comparable overseas markets.
Japanese real estate prices have not declined

Rising interest rates have caused property prices to fall to account for higher expected yields on real estate investments; therefore, property prices have already begun to suffer in some overseas markets. In Japan, on the other hand, due to the limited rise in interest rates, this has not led to an increase in expected yields, and the appraisal values of properties owned by J-REITs have held steady. Given that the attractive real estate investment environment is likely to continue in Japan against the backdrop of relatively low interest rates, real estate prices are expected to remain stable.

No significant differences in sector returns this year

Sector returns in 2022 were indirectly affected by rising interest rates in the U.S., EU, and other economies, with a significant negative return in the logistics sector, where dividend yields are low and investment attractiveness was more vulnerable to higher rates. The hotel sector, on the other hand, enjoyed significant gains on expectations of a recovery in inbound demand in addition to domestic demand.

Although sector returns did not vary significantly in 2023 as they did in 2022, the rental housing sector, with its defensive characteristics and high tenant diversification, has been on the rise due to a resurgence in population inflows to urban centers. The hotel sector, where a recovery in demand is expected to continue, has also been on the rise since last year.
Office market shows signs of recovery in demand

The office market has been wavering after the vacancy rate rose to the mid-6% range. In a situation where many office buildings lie vacant and in competition with each other, rents are still falling because of the need to relax rental conditions to attract tenants. On the other hand, there have been signs of an overall recovery in office demand since the beginning of this year, with the vacancy rate falling to the low 6% range periodically due to new contracts. Although we expect to see upward pressure on the vacancy rate, with many new office buildings expected to be supplied in the future and the notable decline in office demand by foreign-owned companies, investor attention will focus on the extent to which these gradually improving demand dynamics will be able to fill vacancies.

Vacancy rate at logistics facilities rises, but limited impact on existing properties

While strong demand for advanced logistics facilities continues against the backdrop of restructuring needs for e-commerce and logistics tenants, the pace of new supply of logistics facilities is also accelerating. Vacancy rates are therefore on an upward trend. As vacancies are concentrated in newly supplied logistics facilities with high asking rents, they are not in direct competition with existing properties held by logistics REITs and there has been no notable change in the operating conditions. While logistics REITs continue to enjoy solid rent growth and cash flow growth, we expect vacancies in the overall market to be digested gradually in the future due to strong demand.

*This material contains the personal views of the author and does not necessarily represent the house view.*
Bond and Currency Market Outlook

Watch to see if bond yields move out of range as Fed ends rate hikes

Bond yields have stayed range bound

Bond yields in the major economies have traded in a range since the second half of last year. The 10-year Treasury note yield temporarily fell to the 3.2% level for a time when expectations were high that the Federal Reserve might shift to an early interest rate cut following the release of weak business sentiment indicators and bank failures in the United States. But with the U.S. labor market reaffirming its strength in spite of the regional bank failures, yields started to rise again as expectations grew that the Fed would keep raising policy rates. Similarly for Germany, the 10-year government bond yield has hovered between 1.7% and 2.8%, taking into account economic and inflationary trends and the subsequent monetary policy response from the European Central Bank (ECB).

Fed to leave rates on hold after one more rate hike

At the Federal Open Market Committee meeting in June, the Fed decided to leave its key interest rate unchanged. Since March 2022, the Bank has raised interest rates at 10 consecutive meetings, but it decided to leave rates unchanged on this occasion to assess the spillover effects of the interest rate hikes to date on the economy and inflation. Despite this hiatus, we think there is a good chance that the Fed will tighten at least one more time. Given the lack of downward pressure on the real economy from bank failures, we believe the Fed is highly likely to raise rates again in an effort to bring down inflation.

Turning to other central banks, the Bank of Canada stopped raising rates in March, but in June it implemented another rate hike for the first time in three meetings. The Reserve Bank of Australia also raised interest rates again after a temporary hold. What both countries have in common is a tight labor market, signs of a pickup in the housing market, and a slowing but still high inflation rate.

Given the similar economic environment in the United States, we believe the Fed will raise rates again in the future to ensure that inflation is brought down to its target level. After that, however, we expect the Fed to hold interest rates steady for a while until the negative economic impact of previous monetary tightening becomes apparent. Beyond this time-frame, the Fed could start to explore a shift to monetary easing towards the end of the year.
Signs of a slowdown in the U.S. economy

Although the U.S. labor market has been robust, this strength is slowly starting to fade. Non-farm payrolls continued to grow, reaching over 300,000 in May. However, the number of new unemployment claims gradually increased, and the Employment Status Survey showed a downward trend in the number of job openings, indicating a slowdown in the labor market. If the Fed raises interest rates again in the future, we think the labor market, and therefore the economy as a whole, will slow further. This could lead to a recession in the U.S. economy later this year, with a slowdown in the labor market that will gradually demonstrate the cumulative effect of the large rate increases since last year.

Bond yields set to fall as we look ahead to the end of Fed rate hikes

The bond market is likely to remain directionless for some time, as investors pay attention to the monetary policies of the major central banks and the underlying economic and inflation trends. However, we expect U.S. bond yields to face gradual downward pressure in the second half of the year. During previous Fed policy rate tightening phases, there has been a tendency for U.S. 10-year Treasury yields to begin a downward trend in the months before the terminal interest rate hike. We believe that at most just a few more rate hikes are likely to bring the Fed’s monetary tightening to an end for this phase of the cycle, and that bond yields are likely to face downward pressure with the prospect of a turnaround to the policy rate cut ahead.

Inflation, which is showing signs of slowing but remains high, is still a concern in terms of the outlook for major central bank policies and bond markets. Our main scenario is that wage growth will slow down as the labor market cools, and inflation will gradually settle down. But we must also be alert to a possible alternative scenario in which prices and wages spiral upward while the labor market remains strong. We also believe that in an environment of continued high inflation, we must keep an eye on the risk that high inflation could continue even during an economic slowdown as consumers’ expectations of inflation remain high and slow to adjust.
U.S. dollar is expected to remain on a downward trend

In the currency market, the U.S. dollar moved in a trading range that followed a similar pattern to the yield on U.S. government bonds. Looking ahead, we expect some downward pressure on the U.S. dollar as market participants become aware of an eventual end to the Fed's monetary tightening that had driven the U.S. dollar to multi decade-highs during the first half of last year. Inflation in the United States, although still high, is showing signs of moderating, and there is growing awareness that the rate hike phase of the cycle could be over soon. Similarly, inflation is now peaking in the Eurozone too. However, in some eurozone countries labor-management negotiations are starting to reflect higher prices in higher wages, and the ECB is wary of the "secondary effect" of higher wages causing inflation to accelerate again. The ECB sees the possibility of continuing to raise interest rates even after the Fed ends its rate hikes, with divergence in monetary policy leading to a weaker U.S. dollar and a stronger euro.

As for the yen, we believe the currency is likely to rebound if bond yields in the United States and other countries start to decline. If the high level of interest rate differentials between Japan and other countries continues, then the yen could weaken further. However, in this situation, the Bank of Japan is expected to revise its yield curve control policy due to concerns about accelerating inflation in Japan against the backdrop of a weak yen, and we believe the likely policy response means that the yen’s continued weakness is unlikely.

Watch out for break outs from range bound market activity

A scenario in which the U.S. dollar continues to appreciate would be where the Fed is forced to raise interest rates substantially again as a result of stubborn inflation in the United States. In addition, when a sharp credit crunch is feared, such as in the case of financial system instability following the collapse of U.S. banks in March, it is conceivable that flight-to-quality demand for the U.S. dollar, as the reserve currency, will increase.

It is possible that the bond and currency markets, which have moved in a range since the second half of last year, will start to move with a trend in the second half of the year. We would need to prepare for changes in the market while being mindful of changes in monetary policy and the possibility of rapid changes in fundamentals.
Global Economic Outlook 1
– Base Case Scenario
Economic growth to slow as effects of monetary tightening surface

U.S. economic slowdown is expected to become apparent

In the U.S., excess savings created by transfer payments from the government have buoyed household consumption even in the high inflationary environment. However, as these savings are being withdrawn, the lingering effect of monetary tightening will weigh more heavily on the economy. Therefore, we maintain our view that the economy will start contracting in the second half of this year. While nonfarm payrolls in the US continue to increase steadily, there are signs of slowdown in hiring and increase in initial jobless claims, based on which we predict that the tight supply and demand conditions in the labor market will be relaxed.

As a result, inflationary pressures will also decrease.

Rate cuts expected to start in 2024

The FOMC meeting held in June maintained the target range for the federal funds rate. On the other hand, two additional rate hikes this year were suggested by the median of FOMC participants’ projections of the federal funds rate.

As it is unlikely that a large number of economic indicators will rapidly worsen before the FOMC meeting in July, we predict that the FOMC will agree on another rate hike in July. However, based on our economic forecast that is more cautious than the FRB’s forecast of relatively solid economic growth, we expect that another rate hike in the October-December period will be difficult.

We maintain our view that both U.S. and European central banks would start cutting rates in 2024 in response to the slowdown in the economy and inflation.
Global Economic Outlook 2

– Risk Scenario

Risk balance is tilted toward upside in the near future, but toward downside in a somewhat longer term.

**Upside risk: Recession to be avoided or delayed**

The global service sector PMI has been trending upward since the beginning of 2023. International mobility of people, which dropped sharply during the COVID-19 pandemic, has been recovering.

Regarding the base case scenario that the U.S. and European economies will start contracting in the second half of the year, the following upside risks exist: 1. Although growth momentum will soften, a recession will be avoided, and 2. A recession will occur, but a little later.

High inflation is driven by both demand and supply factors. If wage growth rates are maintained at sufficiently high levels while the inflation rate declines mainly through the resolution of supply constraints, it is possible that the real income environment will improve and continue to support healthy consumption.

**Downside risk: Significant contraction**

Although our base case scenario has taken into consideration the impact on the economy and prices of a tighter financial environment and central banks’ responses to it, sufficient attention needs to be paid to the downside risk that the financial environment will tighten far more than expected.

According to the Dallas Fed’s survey (the latest survey period was from May 2 to May 10), banks are tightening their lending criteria further.

For the time being, upside risk may outweigh downside risk. However, we should be wary of the latter in a somewhat longer term as the cumulative effect of rate hikes may surface at a time lag and weigh more heavily on the economy than expected.
Global Economic Outlook 3  
– Economic Cycle

According to the latest publication of the global composite leading indicator (CLI) of the Organization for Economic Cooperation and Development (OECD) in May 2023, the global economy has entered the recovery phase after staying in the stagnation phase for 12 months. After entering the recovery phase at the beginning of 2020 last time, the economy has come full circle in about three and a half years.

On the other hand, the trend in the global CLI lacks strength. The main reason for this is the continued weakness of the U.S. CLI, which is a major component of the global CLI. While CLIs have been improving in Europe, Japan, and China, the US CLI remains weak. As the US CLI has a significant impact on other regions, we need to pay sufficient attention to future trends in CLIs in other regions for any signs of worsening again.

The movement of the stock market that started trending upward in the second half of 2022 largely agrees with the trends in past similar periods of the economy. On the other hand, the interest rate environment is significantly different. In past similar periods, there was a clear tendency for the U.S. central bank to continue to cut policy rates until the economy starts to recover. An accommodative monetary environment similar to those in the past may be essential for economic recovery.

The current delay in the recovery of the US economy is largely attributable to the continuation of a tight monetary environment. Some may say that future developments in the global economy and the stock market depend heavily on what will happen in the interest rate environment going forward.

Note: "Global" is based on G7 data.
Source: NAM based on OECD data

Changes in OECD Composite Leading Indicators (May 2022 - May 2023)

Changes in U.S. Policy Rates in Similar Periods over the Past Year (Similar Periods in Economic Cycles in and after 1970)

Note: Similar periods have been identified quantitatively based on global economic cycles. U.S. policy rates are changes from 12 months earlier than the respective similar period, which is set at zero. Ten similar phases have been identified in and after 1970.
Source: NAM based on OECD and Refinitiv Datastream data
U.S.

The economy is expected to slow and inflation rate to fall to the 2% target due to the effect of rate hikes, although both economy and inflation are subject to upside risk

Downward pressure on the economy from rate hikes will likely increase

The U.S. economy is resilient. Personal consumption continues to grow on the back of improvements in household income driven by employment and wage growth. More than one year has passed since the beginning of rate hikes by the Fed, but the downward pressure on the economy from these rate hikes has so far been limited. In terms of prices, inflationary pressures are softening as rises in prices of goods have been restrained, and rises in prices of services, which have been accelerating, have started to slow down. Even so, the inflation rate continues to be a concern as it remains above the Fed’s inflation target of 2%. Moving forward, we expect that the US economy will soften as downward pressure on the economy from rate hikes will gain strength, and the inflation rate will drift down to the target. However, we need to pay attention to upside risks in both the economy and inflation as the forced savings that were accumulated during the COVID-19 pandemic may delay the materialization of the effect of rate hikes.

Downward pressure on the economy from rate hikes will likely increase

The rate hike phase is near the end, but has not reached the end yet

The FOMC decided to raise the policy rate by 0.25 percentage points at its meeting in May, and the policy rate reached a point that had been projected by FOMC participants in March. The phrase “some additional policy firming may be appropriate” has been deleted from the statement, suggesting that the rate hike phase is near the end. However, while deciding to keep the policy rate at the current level in June, the FOMC also raised the expected final destination of rate hikes by 0.50 percentage point. Federal Reserve Chair Jerome Powell explained that “given how far we’ve come, it may make sense to move rates higher but to do so at a more moderate pace, and the FOMC’s decision in June to pause rate hikes is part of the process of rate hikes.” Given the FOMC participants’ projections and the comment of Powell, it is likely that rate hikes will still continue although the rate hike phase is near the end.
Eurozone

The economy is expected to slow due to the effect of rate hikes, but significant uncertainty remains

The economy appears to be bottoming out right now, but the effect of rate hikes will likely weigh on the economy going forward

The Eurozone economy is emerging out of the stagnation phase. Although Eurozone GDP growth for the January-March period was negative, business confidence improved in the April-June period mainly in the service sector. The basis of personal consumption may have strengthened as inflation has peaked out and its downward pressure on household income has softened. Although inflation has peaked out, the inflation rate remains above the European Central Bank (ECB)'s inflation target of 2%. While the pace of increase in prices of goods is slowing down, the pace of increase in prices of services is accelerating. As the effect of past rate hikes will gain strength going forward, we predict that the economy will soften, and inflationary pressures will also soften. The fading effect of past energy price hikes is also expected to help reduce inflationary pressures. However, significant uncertainty remains with regard to the outlook of both the economy and inflation.

Another rate hike at the Governing Council meeting in July is suggested by ECB President Christine Lagarde

Having slowed the pace of rate hikes down to 0.25 percentage points at its meeting in May, the ECB decided to raise the policy rate also by 0.25 percentage points at its meeting in June. At the press conference, ECB President Christine Lagarde said that “we are likely to raise interest rates again at the next meeting,” strongly suggesting another rate hike at the Governing Council meeting in July. Also regarding the upward revision of the inflation rate projections through 2025 in the recently published ECB staff projections, Lagarde commented that she was not pleased with the projections. These projections appear to have been prepared based solely on the expected rate hike of 0.25 percentage points at the Governing Council meeting in July. Therefore, Lagarde’s comments suggest that rate hikes will likely continue in and after September if the future courses of Eurozone economy and inflation will indeed coincide with these projections.
Japan

BOJ’s YCC policy is likely to be modified following the monetary policy meeting in July

Domestic and inbound demand to support growth

The wage increase rates from annual spring wage negotiations were at the highest levels for the last 30 years. In the Basic Policies for Economic and Fiscal Management and Reform, which were approved by the Cabinet in mid-June, the Kishida administration confirmed that it would work to achieve a minimum wage (weighted average) of 1,000 yen this summer. While the acceleration of wage growth is hinted, year-on-year real wage growth remains negative according to the Monthly Labor Survey partly due to high inflation. However, while the tight supply and demand conditions in the labor market in combination with the recovery in inbound demand will continue to apply upward pressure on wages, cost-push pressure from import prices is expected to soften. As a result, real income is expected to improve and support consumption.

In terms of prices, we need to pay attention to whether a cycle will be created in which such wage growth will lead to higher service prices, which will in turn cause next wage growth pressure.

The next BOJ monetary policy meeting in July will be a focus of attention

Until immediately before the announcement by Prime Minister Kishida in the evening of June 15 that he would postpone the dissolution of the House of Representatives, the possibility of a dissolution on 16th, which is the same day as the second day of the BOJ’s monetary policy meeting, was talked about. If the BOJ is considerate to the political situation to some extent, it may become cautious in modifying its policies at the policy meeting in September-October if dissolution during the extraordinary Diet session in fall becomes likely. In December, rate cuts by U.S. and European central banks from 2024 may already be drawing attention. In this situation, it would be difficult for the BOJ to take measures to permit long-term interest rates to rise even if the Japanese economy remains firm. Given such a possibility, the BOJ may not be able to implement policy adjustments for some time if it misses the opportunity in July.

The function of the bond market has improved slightly. We expect the BOJ to watch for a good opportunity for policy adjustments by looking ahead to the future although it is not an immediate concern.
China

As recovery momentum slows, the focus is shifting to stimulus measures

The economy will likely decelerate, and the sustainability of recovery will be challenged

With economic reopening, China’s GDP for the January-March quarter recovered rapidly, up 9.1% quarter on quarter (seasonally adjusted annual rate). The recovery momentum slowed down suddenly after that as the normalization of people’s mobility following economic reopening has run its course earlier than expected, providing no additional positive effect, and reactions occurred to the pent-up demand and acceleration of policy implementation that were observed at the beginning of the year. However, the stalled momentum occurred mainly in the manufacturing and constructions sectors, and normalization still continues in the services sector. As long as the service sector, which accounts for more than half of the economy, continues to recover, it is unlikely that economic growth or employment will collapse significantly. However, we predict that the economy will slow down further in the second half of the year as the normalization of the service sector will have run its course. We believe that the Chinese economy is facing an impasse in terms of the sustainability of recovery.

Stimulus measures will be introduced, but will be focused rather than all-inclusive

As the momentum of economic recovery is being lost, expectations for stimulus measures are rising. In June, the loan prime rate, which is the policy rate, was raised by 0.1 percentage point. It is likely that additional policy responses will be announced going forward. However, it is unlikely that major stimulus packages will be announced, and we predict that any stimulus measures to be announced will be focused and concise. This is because room for additional easing is more limited than before for both monetary and fiscal policies. In addition, as the circumstances of each sector are varied, sweeping stimulus measures may produce adverse reactions, such as financial risk, in the future. Therefore, we expect that major policy measures will include relaxation of purchase restrictions to stimulate housing demand and subsidies and tax cuts for the high technology manufacturing sector.
Emerging

With slowing economies and inflation, central banks to start lowering rates cautiously, but with regional differences to watch

Economic and inflation slowdown to continue, and monetary policies to turn to cautious rate cuts

Emerging economies as a whole are slowing due to the effects of weak external demand, high inflation, and monetary tightening. Inflation rates have peaked out as food and energy prices have fallen and the economies have softened. We expect that the inflation rates in emerging countries on the whole will continue to fall as the economy continues to soften.

In terms of monetary policies, more central banks are taking a wait-and-see stance by keeping policy rates unchanged. However, as they continue to be wary of inflation, cautious monetary policy expectations are expected to continue. We expect that there will be some countries that will start moderate rate cuts later this year or early next year, while closely monitoring the trends in inflation and economy and actions of major central banks. Emerging currencies are expected to remain firm under cautious policy operations.

Regional differences to watch

There are regional differences particularly between Asia and other regions. In Asian countries, economies are relatively healthy, and inflation rates remain at low levels. Therefore, the monetary policy stance of Asian central banks remains neutral from the perspective of real interest rates. On the other hand, countries in Eastern Europe and Latin America are facing higher inflation, and their monetary policies are very restrictive in terms of real interest rates.

In Asia, we expect that stable fundamentals will lead to stable currencies. On the other hand, in Eastern Europe and Latin America, currencies are expected to be supported by high interest rates. Once inflation subsides going forward, Eastern Europe and Latin America will have more room for rate cuts. It will be important going forward to select countries and regions based on the evaluation of such regional differences while paying attention also to changes in risk appetite of the entire market.
## Global Financial Market Forecast

### Major Economic and Market Forecast

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### Emerging FX and Policy Interest Rate Forecast

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Note: Forecast as of June 26, 2023. 1) YoY, 2) GDP weighted average of U.S., Eurozone, Japan, UK, Canada, Australia, 3) GDP weighted average of China, India, Brazil, Korea, Taiwan, Indonesia, Thailand, Malaysia, the Philippines, Hungary, Poland, Russia, Turkey, Mexico, and South Africa, 4) GDP weighted average of 2) and 3), 5) core consumer price, 6) for Japan the policy interest rate imposed on the current account deposits held by financial institutions at the Bank of Japan, for the US the upper limit of the FF target range, for the Eurozone the central bank deposit interest rate, for China the 1-year loan prime rate, for Turkey, weighted average funding ratio of the central bank.

*As for forecast columns, actuals are prioritized if available.

Source: Oxford Economics, Bloomberg, and Nomura Asset Management
Index Hedge Clause

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- Kuala Lumpur
- Hong Kong
- Shanghai
- Seoul
- Taiwan
- Nomura China AM (Shenzhen)

Japan
- Tokyo
- Wealth Square

Americas
- New York
- NCRAM (New York)
- American Century Investments®

Australia
- Sydney

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