Fiscal consolidation is driving the outlook

Negotiations on the debt limit in 2011 and “fiscal cliff” a year ago led to significant fiscal tightening. Further initiatives to tighten fiscal policy are not expected in 2014.
Credit conditions are easing

Credit was harder to get (lhs)

<table>
<thead>
<tr>
<th></th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit was harder to get</td>
<td>6</td>
<td>6</td>
<td>7</td>
</tr>
</tbody>
</table>

Expecting credit conditions to ease (rhs, inverted)

<table>
<thead>
<tr>
<th></th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expecting credit conditions to ease</td>
<td>-8</td>
<td>-7</td>
<td>-7</td>
</tr>
</tbody>
</table>
Priorities for the FOMC

- The FOMC has focused on its employment mandate because unemployment has been so high
- That asymmetry in priorities should moderate

**Difference between the unemployment rate and inflation and the FOMC targets**

**“Optimal control”: Squared Deviations of Inflation and the Unemployment Rate from the FOMC’s Targets**

---

**Note:** Black bars show the difference between inflation the FOMC’s target at the time of the first FOMC meeting of each year. The red bars show, on an inverted scale, the difference between the unemployment rate and the midpoint of the central tendency of the FOMC’s long-term forecasts at the same points in time. The symbols show the where the FOMC’s 8-quarter ahead forecasts for those indicators were at the same points in time.

“Hysteresis” in labor markets (cont’d)

- Labor markets performance is still deteriorating.
- Is this still a justification for accommodative policy, is the damage reversible?

Actual vs projected labor force participation rate

<table>
<thead>
<tr>
<th>Year</th>
<th>Labor force participation rate</th>
<th>Participation based on demographic trend</th>
<th>Adjusted for severe downturns</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>63.5%</td>
<td>63%</td>
<td>62.5%</td>
</tr>
<tr>
<td>2020</td>
<td>61%</td>
<td>61%</td>
<td>60.5%</td>
</tr>
</tbody>
</table>

Employment population ratio

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>54%</td>
</tr>
<tr>
<td>1980</td>
<td>62%</td>
</tr>
<tr>
<td>1990</td>
<td>66%</td>
</tr>
<tr>
<td>2000</td>
<td>63%</td>
</tr>
<tr>
<td>2010</td>
<td>61%</td>
</tr>
</tbody>
</table>


Note: Trend estimated through 2007q1, and projected beyond that date based on the average rate of change over the period 2001-2007.
Short vs long-term unemployment

- Short-term unemployment has fallen well below its long-term average.
- The long-term unemployed have less impact on inflation.

Unemployment rate for all workers and those unemployed for 26 weeks or less.

Source: Bureau of Labor Statistics, and Nomura Global Economics
Global Economics © Nomura Global Economics February 10, 2014
Labor market slack and inflation

- Broader Measures of Labor market slack are not better predictors of inflation

Alternative measures of slack in labor markets

<table>
<thead>
<tr>
<th>Percentage points</th>
<th>Labor market Slack and Inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Phillips Curve Coefficient</td>
</tr>
<tr>
<td></td>
<td>R²</td>
</tr>
<tr>
<td><strong>Short-term Unemployment &quot;Gap&quot;</strong></td>
<td>0.24 (3.00) 0.401</td>
</tr>
<tr>
<td><strong>Unemployment Gap</strong></td>
<td>0.10 (2.51) 0.388</td>
</tr>
<tr>
<td><strong>Employment-population ratio &quot;Gap&quot;</strong></td>
<td>0.08 (2.15) 0.379</td>
</tr>
</tbody>
</table>

Source: BLS, Nomura Economics
Key questions for monetary policy

1) What is the output gap, i.e., how far are we from “maximum employment?”

2) Can damage to potential output – i.e., negative “hysteresis” effects on workers and the economy – be reversed?

3) “Forecast of Commitment” – how aggressive should forward guidance be?

4) How should the FOMC respond to a “flat” Phillips curve?

5) Should concerns about systemic risk constrain monetary policy?
Stable inflation expectations

Inflation expectation measures have been stable or slightly weaker recently

Wages in the goods industries have increased at a modest pace, but have shown little acceleration in services

Alternative measures of inflation expectations

Alternative measures of Labor Cost

Credit Trends, Recent Decades

*United States*, deviations of the Ratio of Private Credit to GDP in the United States from Trend, Q41961-Q12011 (Percent)

Source: Federal Reserve's Flow of Funds accounts and Bureau of Economic Analysis.
United States, deviations of the ratio of bank’s loans and investments to GDP from trend, 1830-1950 (Percent)

Source: Historical Statistics of the United States.
Any Authors named on this report are Research Analysts unless otherwise indicated

Analyst Certification
I, Lewis Alexander, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Important Disclosures

Online availability of research and conflict-of-interest disclosures
Nomura research is available on www.nomuranow.com/research, Bloomberg, Capital IQ, Factset, MarkitHub, Reuters and ThomsonOne. Important disclosures may be read at http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx or requested from Nomura Securities International, Inc., on 1-877-865-5752. If you have any difficulties with the website, please email grpsupport@nomura.com for help.

The analysts responsible for preparing this report have received compensation based upon various factors including the firm’s total revenues, a portion of which is generated by Investment Banking activities. Unless otherwise noted, the non-US analysts listed at the front of this report are not registered/qualified as research analysts under FINRA/NYSE rules, may not be associated persons of NSI, and may not be subject to FINRA Rule 2711 and NYSE Rule 472 restrictions on communications with covered companies, public appearances, and trading securities held by a research analyst account.

Nomura Global Financial Products Inc. (“NGFP”) Nomura Derivative Products Inc. (“NDPI”) and Nomura International plc. (“NIplc”) are registered with the Commodities Futures Trading Commission and the National Futures Association (NFA) as swap dealers. NGFP, NDPI, and NIplc are generally engaged in the trading of swaps and other derivative products, any of which may be the subject of this report.

ADDITIONAL DISCLOSURES REQUIRED IN THE U.S.

Principal Trading: Nomura Securities International, Inc and its affiliates will usually trade as principal in the fixed income securities (or in related derivatives) that are the subject of this research report. Analyst Interactions with other Nomura Securities International, Inc. Personnel: The fixed income research analysts of Nomura Securities International, Inc and its affiliates regularly interact with sales and trading desk personnel in connection with obtaining liquidity and pricing information for their respective coverage universe.

Valuation methodology - Fixed Income
Nomura’s Fixed Income Strategists express views on the price of securities and financial markets by providing trade recommendations. These can be relative value recommendations, directional trade recommendations, asset allocation recommendations, or a mixture of all three. The analysis which is embedded in a trade recommendation would include, but not be limited to:
• Fundamental analysis regarding whether a security’s price deviates from its underlying macro- or micro-economic fundamentals.
• Quantitative analysis of price variations.
• Technical factors such as regulatory changes, changes to risk appetite in the market, unexpected rating actions, primary market activity and supply/ demand considerations.

The timeframe for a trade recommendation is variable. Tactical ideas have a short timeframe, typically less than three months. Strategic trade ideas have a longer timeframe of typically more than three months.
Disclaimers

This document contains material that has been prepared by the Nomura entity identified at the top or bottom of page 1 herein, if any, and/or, with the sole or joint contributions of one or more Nomura entities whose employees and their respective affiliations are specified on page 1 herein or identified elsewhere in the document. The term "Nomura Group" used herein refers to Nomura Holdings, Inc. or any of its affiliates or subsidiaries and may refer to one or more Nomura Group companies including: Nomura Securities Co., Ltd. ("NSC") Tokyo, Japan; Nomura International plc ("Nlplc"); UK; Nomura Securities International, Inc. ("NSI"); New York, US; Nomura International (Hong Kong) Ltd. ("NIHK"); Hong Kong; Nomura Financial Investment (Korea) Co., Ltd. ("NFIK"); Korea (Information on Nomura analysts registered with the Korea Financial Investment Association ("KOFIA") can be found on the KOFIA Intranet at http://dis.kofia.or.kr); Nomura Singapore Ltd. ("NSL"); Singapore (Registration number 197201440E, regulated by the Monetary Authority of Singapore); Nomura Australia Ltd. ("NAL"); Australia (ABN 48 003 032 513), regulated by the Australian Securities and Investment Commission ("ASIC") and holder of an Australian financial services licence number 246412; P.T. Nomura Indonesia ("PTNI"); Indonesia; Nomura Securities Malaysia Sdn. Bhd. ("NSM"); Malaysia; NIHK, Taipei Branch ("NITB"); Taiwan; Nomura Financial Advisory and Securities (India) Private Limited ("NFASL"); Mumbai, India (Registered Address: Ceejay House, Level 11, Plot F, Shivsagar Estate, Dr. Annie Besant Road, Worli, Mumbai - 400 018, India; Tel: +91 22 4037 4037, Fax: +91 22 4037 4111; SEBI Registration No: BSE INB011299030, NSE INB231299034, INF231299034, INE 231299034, MCX: INE261299034) and Nlplc, Madrid Branch ("Nlplc, Madrid"). 'CNS Thailand' next to an analyst’s name on the front page of a research report indicates that the analyst is employed by Capital Nomura Securities Public Company Limited ("CNS") to provide research assistance services to NSL under a Research Assistance Agreement. CNS is not a Nomura entity.

THIS MATERIAL IS: (I) FOR YOUR PRIVATE INFORMATION, AND WE ARE NOT SOLICITING ANY ACTION BASED UPON IT; (II) NOT TO BE CONSTRUED AS AN OFFER TO SELL OR A SOLICITATION OF AN OFFER TO BUY ANY SECURITIES IN ANY JURISDICTION WHERE SUCH OFFER OR SOLICITATION WOULD BE ILLEGAL; AND (III) BASED UPON INFORMATION FROM SOURCES THAT WE CONSIDER RELIABLE, BUT HAS NOT BEEN INDEPENDENTLY VERIFIED BY NOMURA GROUP.

Nomura Group does not warrant or represent that the document is accurate, complete, reliable, fit for any particular purpose or merchantable and does not accept liability for any act (or decision not to act) resulting from use of this document and related data. To the maximum extent permissible all warranties and other assurances by Nomura group are hereby excluded and Nomura Group shall have no liability for the use, misuse, or distribution of this information.

Opinions or estimates expressed are current opinions as of the original publication date appearing on this material and the information, including the opinions and estimates contained herein, are subject to change without notice. Nomura Group is under no duty to update this document. Any comments or statements made herein are those of the author(s) and may differ from views held by other parties within Nomura Group. Clients should consider whether any advice or recommendation in this report is suitable for their particular circumstances and, if appropriate, seek professional advice, including tax advice. Nomura Group does not provide tax advice.

Nomura Group, and/or its officers, directors and employees, may, to the extent permitted by applicable law and/or regulation, deal as principal, agent, or otherwise, or have long or short positions in, or buy or sell, the securities, commodities or instruments, or options or other derivative instruments based thereon, of issuers or securities mentioned herein. Nomura Group may also act as market maker or liquidity provider (within the meaning of applicable regulations in the UK) in the financial instruments of the issuer. Where the activity of market maker is carried out in accordance with the definition given to it by specific laws and regulations of the US or other jurisdictions, this will be separately disclosed within the specific issuer disclosures.

This document may contain information obtained from third parties, including ratings from credit ratings agencies such as Standard & Poor’s. Reproduction and distribution of third party content in any form is prohibited except with the prior written permission of the related third party. Third party content providers do not guarantee the accuracy, completeness, timeliness or availability of any information, including ratings, and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such content. Third party content providers give no express or implied warranties, including, but not limited to, any warranties of merchantability or fitness for a particular purpose or use. Third party content providers shall not be liable for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including lost income or profits and opportunity costs) in connection with any use of their content, including ratings. Credit ratings are statements of opinions and are not statements of fact or recommendations to purchase hold or sell securities. They do not address the suitability of securities or the suitability of securities for investment purposes, and should not be relied on as investment advice.

Any MSCI sourced information in this document is the exclusive property of MSCI Inc. ("MSCI"). Without prior written permission of MSCI, this information and any other MSCI intellectual property may not be reproduced, re-disseminated or used to create any financial products, including any indices. This information is provided on an "as is" basis. The user assumes the entire risk of any use made of this information. MSCI, its affiliates and any third party involved in, or related to, computing or compiling the information hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of this information. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. MSCI and the MSCI indexes are services marks of MSCI and its affiliates.
Investors should consider this document as only a single factor in making their investment decision and, as such, the report should not be viewed as identifying or suggesting all risks, direct or indirect, that may be associated with any investment decision. Nomura Group produces a number of different types of research product including, among others, fundamental analysis, quantitative analysis and short-term trading ideas; recommendations contained in one type of research product may differ from recommendations contained in other types of research product, whether as a result of differing time horizons, methodologies or otherwise. Nomura Group publishes research product in a number of different ways including the posting of product on Nomura Group portals and/or distribution directly to clients. Different groups of clients may receive different products and services from the research department depending on their individual requirements. Clients outside of the US may access the Nomura Research Trading Ideas platform (Retina) at http://go.nomuranow.com/equities/tradingideas/retina/ Figures presented herein may refer to past performance or simulations based on past performance which are not reliable indicators of future performance. Where the information contains an indication of future performance, such forecasts may not be a reliable indicator of future performance. Moreover, simulations are based on models and simplifying assumptions which may oversimplify and not reflect the future distribution of returns.

Certain securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of, or income derived from, the investment. The securities described herein may not have been registered under the US Securities Act of 1933 (the ‘1933 Act’), and, in such case, may not be offered or sold in the US or to US persons unless they have been registered under the 1933 Act, or except in compliance with an exemption from the registration requirements of the 1933 Act. Unless governing law permits otherwise, any transaction should be executed via a Nomura entity in your home jurisdiction. This document has been approved for distribution in the UK and European Economic Area as investment research by Niperc. Niperc is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Niperc is a member of the London Stock Exchange. This document does not constitute a personal recommendation within the meaning of applicable regulations in the UK, or take into account the particular investment objectives, financial situations, or needs of individual investors. This document is intended only for investors who are ‘eligible counterparties’ or ‘professional clients’ for the purposes of applicable regulations in the UK, and may not, therefore, be redistributed to persons who are ‘retail clients’ for such purposes. This document has been approved by NiHK, which is regulated by the Hong Kong Securities and Futures Commission, for distribution in Hong Kong by NiHK. This document has been approved for distribution in Australia by NAL, which is regulated and regulated in Australia by the ASIC. This document has also been approved for distribution in Malaysia by NSM. In Singapore, this document has been distributed by NSL. NSL accepts legal responsibility for the content of this document, where it concerns securities, futures and foreign exchange, issued by their foreign affiliates in respect of recipients who are not accredited, expert or institutional investors as defined by the Securities and Futures Act (Chapter 289). Recipients of this document in Singapore should contact NSL in respect of matters arising from, or in connection with, this document. Unless prohibited by the provisions of Regulation S of the 1933 Act, this material is distributed in the US, by NSI, a US-registered broker-dealer, which accepts responsibility for its contents in accordance with the provisions of Rule 15a-6, under the US Securities Exchange Act of 1934. This document has not been approved for distribution to persons other than ‘Authorised Persons’, ‘Exempt Persons’ or ‘Institutions’ (as defined by the Capital Markets Authority) in the Kingdom of Saudi Arabia (‘Saudi Arabia’) or ‘professional clients’ (as defined by the Dubai Financial Services Authority) in the United Arab Emirates (‘UAE’) or a ‘Market Counterparty’ or ‘Business Customers’ (as defined by the Qatar Financial Centre Regulatory Authority) in the State of Qatar (‘Qatar’) by Nomura Saudi Arabia, Niperc or any other member of Nomura Group, as the case may be. Neither this document nor any copy thereof may be taken or transmitted or distributed, directly or indirectly, by any person other than those authorised to do so into Saudi Arabia or in the UAE or in Qatar or to any person other than ‘Authorised Persons’, ‘Exempt Persons’ or ‘Institutions’ located in Saudi Arabia or ‘professional clients’ in the UAE or a ‘Market Counterparty’ or ‘Business Customers’ in Qatar. By accepting to receive this document, you represent that you are not located in Saudi Arabia or that you are an ‘Authorised Person’, an ‘Exempt Person’ or an ‘Institution’ in Saudi Arabia or that you are a ‘professional client’ in the UAE or a ‘Market Counterparty’ or ‘Business Customers’ in Qatar and agree to comply with these restrictions. Any failure to comply with these restrictions may constitute a violation of the laws of the UAE or Saudi Arabia or Qatar.

NO PART OF THIS MATERIAL MAY BE (I) COPIED, PHOTO-COPIED, OR DUPLICATED IN ANY FORM, BY ANY MEANS; OR (II) REDISTRIBUTED WITHOUT THE PRIOR WRITTEN CONSENT OF A MEMBER OF NOMURA GROUP. If this document has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. The sender therefore does not accept liability for any errors or omissions in the contents of this document, which may arise as a result of electronic transmission. If verification is required, please request a hard-copy version.

Nomura Group manages conflicts with respect to the production of research through its compliance policies and procedures (including, but not limited to, Conflicts of Interest, Chinese Wall and Confidentiality policies) as well as through the maintenance of Chinese walls and employee training. Additional information is available upon request and disclosure information is available at the Nomura Disclosure web page: http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx Copyright © 2013 Nomura. All rights reserved.