

Economic Outlook for FY2009 and FY2010

(revised to reflect the Second Preliminary Quarterly Estimates of GDP for the Jan-Mar quarter of 2009)

June 2009

Key points of Mizuho Research Institute's (MHRI) outlook on the economy in FY2009 and FY2010
(reflecting *The Second Preliminary Quarterly Estimates of GDP (2nd QE)* for the Jan-Mar quarter of 2009)

<The US Economy>

A weak recovery due to strong adjustment pressures upon employment and capital investment

2009 -2.6% (previous outlook -2.7%)

2010 +1.2% (previous outlook +1.2%)

<The Japanese Economy>

FY2009 -3.8% (previous outlook -4.2%)

Growth will turn positive on a fiscal 4Q/4Q basis (the Jan-Mar quarter of 2010 over a year ago) driven by the recovery of domestic demand due to the economic stimulus measures

FY2010 +0.6% (previous outlook +0.5%)

Deflationary risks will linger as the economic stimulus measures lose steam

This English-language translation is based upon the outlook in Japanese released on June 12, 2009. This publication is compiled solely for the purpose of providing readers with information and is in no way meant to encourage readers to buy or sell financial instruments. Although this publication is compiled on the basis of sources which we believe to be reliable and correct, Mizuho Research Institute does not warrant its accuracy and certainty. Readers are requested to exercise their own judgment in the use of this publication. Please also note that the contents of this publication may be subject to change without prior notice.

I. The current state of the Japanese economy

Investment in plant and equipment and inventories led to an upward revision of real GDP growth in the 2nd QE for the Jan-Mar quarter

The *Second Preliminary Quarterly Estimates of GDP* (“2nd QE”) for the Jan-Mar quarter of 2009 revealed an upward revision of Japan’s real GDP growth to -3.8% q-o-q (-14.2 % p.a.) from -4.0% q-o-q (-15.2% p.a.) in the *First Preliminary Quarterly Estimates of GDP* (“1st QE”) (Chart 1).

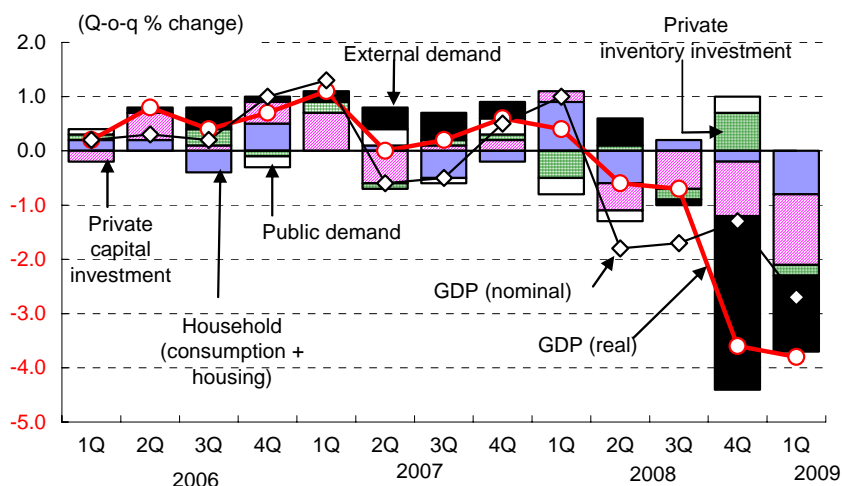
Looking closer at each of the components of demand, capital investment was revised upward from -10.4% q-o-q in the 1st QE to -8.9% q-o-q in the 2nd QE, to reflect the results of the *Financial Statements Statistics of Corporations by Industry*. The contribution by private-sector inventory investment to quarterly real GDP growth was revised up from -0.3% pt to -0.2% pt. Even though housing investment was subject to a slight downward revision from -5.4% q-o-q to -5.5% q-o-q, the contribution by domestic private-sector demand to quarterly real GDP growth was revised upward from -2.7% pt to -2.3% pt. On the other hand, despite a slight upward revision of public investment (-0.0% q-o-q → +0.1% q-o-q), the contribution by public demand to quarterly growth was revised down from +0.1% pt to +0.0% pt because of a downward revision of government consumption (+0.3% q-o-q → +0.0% q-o-q). The contribution by domestic demand combining both private and public demand was revised upward from -2.6% pt to -2.3% pt. The contribution by external demand remained unchanged from the 1st QE at -1.4% pt.

The GDP deflator was revised down from +1.1% y-o-y to +0.9% y-o-y. As in the case of real GDP growth, nominal GDP growth was revised up to -2.7% q-o-q (-10.4% p.a.) from the 1st QE (-2.9% q-o-q, -10.9% p.a.).

The carry-over of growth rose from -4.9% to -4.6%

Due to the upward revision of FY2008 real GDP growth to -3.3% from -3.5% at the time of the 1st QE, the carry-over of growth to FY2009 rose from -4.9% to -4.6%.

[Chart 1: Japan’s quarterly GDP growth (2nd QE for the Jan-Mar quarter of 2009)]



Source: Cabinet Office, *Preliminary Quarterly Estimates of GDP*.

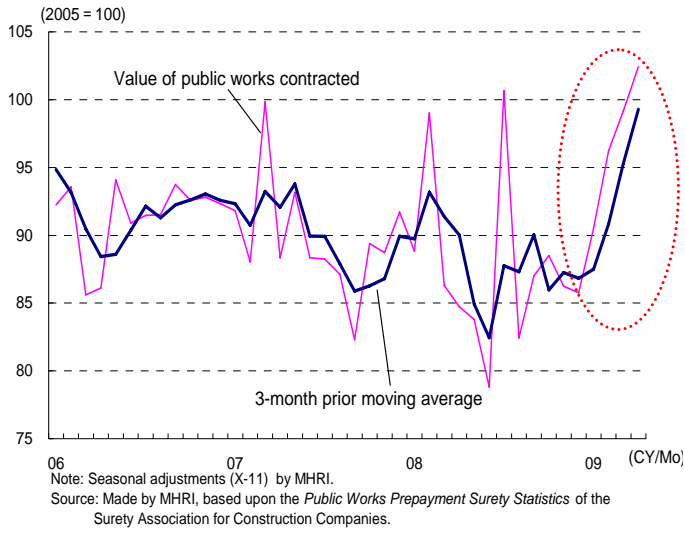
**Apr-Jun quarter: modest
growth into positive
territory**

Subsequent to the sharp fall since last autumn, exports are picking up after bottoming out in February. Real exports (based upon the Bank of Japan) increased for two months in a row in March (+0.1% m-o-m) and April (+7.8% m-o-m). Along with the recovery of exports, industrial production is also picking up since March, providing reasons to believe that the economy has emerged out of its worst moments. Even though real imports are also rising since bottoming in February, the pace of increase is weaker than the pace of export growth, leading to prospects that the contribution by external demand to real GDP growth in the Apr-Jun quarter will turn positive.

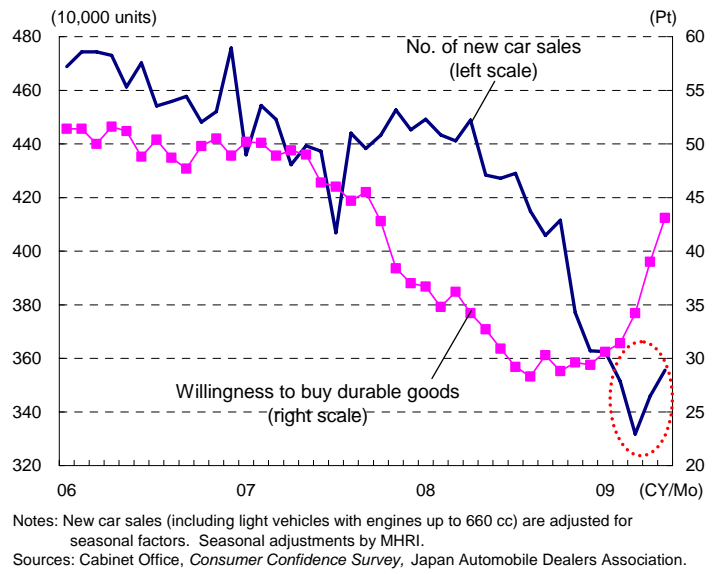
Turning to domestic demand, personal consumption and public investment are predicted to rise, driven by the economic stimulus measures. The value of public works contracted - a leading indicator of public works - is rising sharply since the turn of the year in 2009, reflecting the placement of orders for the additional public works earmarked in the FY2008 supplementary budget (**Chart 2**). Public investment on a work-in-progress basis should serve as a driver of growth from the Apr-Jun quarter. Personal consumption is projected to pick up, mainly with respect to durable goods, due to the impact of the flat-sum benefits, the tax cut on environment-friendly cars (so-called "eco-cars") and the measures to promote the purchase of environment-friendly household electrical appliances. The *Consumer Confidence Survey* (Cabinet Office) revealed a sharp rise of the "willingness to buy durable goods". Although some claim that the tax cuts on eco-cars are not having much effect when looking at the double-digit decline of new car sales in May (-17.4%), **Chart 3** shows that sales of new cars have actually been following a mild uptrend since April when adjusting for seasonal factors. Despite the severity of the income environment, as indicated by forecasts of a sharp fall of bonus payments, spending on durable consumer goods is projected to accelerate toward the summer season due to the stimulus measures such as the provision of eco-points for the purchase of environment-friendly household electrical appliances from May. In contrast, the decline of housing investment and capital investment should persist. Turning to private-sector inventory investment, the odds are high that its contribution to quarterly GDP growth will turn out to be negative again in the Apr-Jun quarter because of the upward revision in the Jan-Mar quarter. Domestic demand is projected to ebb in the Apr-Jun quarter, dragged down by housing investment, capital investment and private-sector inventory investment.

Judging from the trends in demand as set forth above, we expect the pace of real GDP growth in the Apr-Jun quarter to turn positive as a result of the upturn of the contribution by external demand amid an abatement of the decline of domestic demand. However, note that Japan's economy risks another quarter in negative territory, depending upon the breadth of the fall of private-sector inventory investment.

[Chart 2: Value of public works contracted]



[Chart 3: Consumer confidence and new car sales]

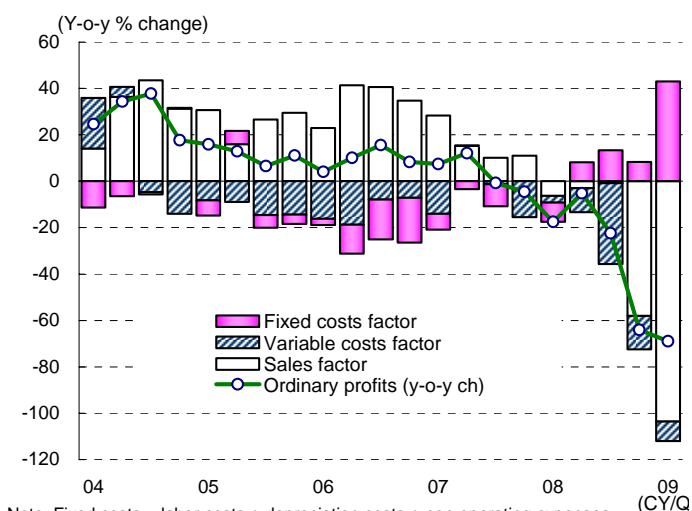


II. Forecast of the Japanese economy in FY2009 and FY2010

Corporate earnings and profits both fell at a double-digit pace. Manufacturers suffered ordinary losses

The *Financial Statements Statistics of Corporations by Industry* for the Jan-Mar quarter of 2009 revealed extremely grim results (total industries basis) regarding sales (-20.4% y-o-y) and ordinary profits (-69.0% y-o-y). A factor decomposition of ordinary profits shows that the sharp fall of sales cancelled out the reduction of fixed costs, leading to the sharp fall of profits (**Chart 4**). In particular, manufacturers hit by the fall of exports suffered ordinary losses. Looking forward, we expect the breadth of the profit decline to narrow as a result of (1) the improvement of sales along with the recovery of production, and (2) the prospects of the improvement of trade terms stemming from the fall of energy prices from a year ago. Even so, it looks inevitable that corporate enterprises will suffer sharp losses surpassing 50% on a total industries basis in FY2009 (**Chart 5**). Although profits will turn around in FY2010, leading to a considerably high rate of profit growth, this is due to the extremely low level of profits in FY2009. In FY2010, ordinary profits are forecast to remain at a low level falling below FY2008.

[Chart 4: Ordinary profits]



Note: Fixed costs = labor costs + depreciation costs + non-operating expenses.
 Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*

[Chart 5: Corporate earnings forecast]

(Y-o-y % change)		FY2007	FY2008	FY2009 (Forecast)	FY2010 (Forecast)
Total	Sales	1.5	-8.4	-13.7	-0.0
	Ordinary profits	-3.3	-39.0	-52.0	45.2
Manufacturing	Sales	6.7	-12.3	-15.9	3.3
	Ordinary profits	-1.4	-65.5	-96.9	3005.3
Nonmanufacturing	Sales	-0.8	-6.6	-12.8	-1.4
	Ordinary profits	-4.7	-18.0	-37.0	-3.7
Large corporations	Sales	4.0	-6.5	-16.2	-0.1
	Ordinary profits	-0.7	-43.8	-44.6	55.5
Manufacturing	Sales	5.1	-10.2	-18.9	4.0
	Ordinary profits	-2.2	-67.3	-88.9	943.2
Nonmanufacturing	Sales	3.1	-3.5	-14.1	-3.0
	Ordinary profits	1.0	-17.5	-24.9	-2.8
Small and medium corporations	Sales	-0.3	-9.8	-11.9	-0.0
	Ordinary profits	-6.6	-32.4	-60.5	28.6

Notes: "Large corporations" = corporations with capital of JPY 1 billion or over
 "Medium corporations" = corporations with capital of JPY 100 million to JPY 1 billion
 "Small corporations" = corporations with capital of JPY 10 to 100 million yen
 From FY2008, financial holding companies are included in large nonmanufacturing corporations.
 Source: Made by MHIRI, based upon the *Financial Statements Statistics of Corporations by Industry* of the Ministry of Finance.

FY2009 real GDP growth is revised up to -3.8%

In the recent data revision, the rate of Japan's real GPP growth was revised up to -3.8% (previous outlook: -4.2%) (**Chart 6**). The upward revision stems primarily from the 0.3% rise of the carry-over of growth from FY2008 to FY2009 reflecting the 2nd QE. Given the mild upturn of exports and the effect of the economic stimulus measures, Japan's economy should chart positive growth from the Jul-Sep quarter of 2009 to the Jan-Mar quarter of 2010. However, the economy will stagnate once again as the economic stimulus measures lose steam in FY2010. Hence, we forecast that the rate of real GDP growth in FY2010 will stand at +0.6% (previous outlook: +0.5%).

[Chart 6: Outlook on the Japanese economy]

(%)

	FY2008	FY2009	FY2010	FY2008		FY2009		FY2010		FY2008	FY2009	FY2010
	(Actual)	(Forecast)	(Forecast)	1H	2H	1H	2H	1H	2H	(Contribution)	(Contribution)	(Contribution)
				(Actual)	(Actual)	(Forecast)	(Forecast)	(Forecast)	(Forecast)	(Actual)	(Forecast)	(Forecast)
GDP (real)	-3.3	-3.8	0.6	-1.5	-11.1	-2.8	2.2	-0.0	0.4	-	-	-
Domestic demand	-2.1	-1.9	-0.3	-2.6	-3.6	-2.8	1.8	-1.2	-0.4	-2.0	-1.8	-0.3
Private sector demand	-2.5	-3.8	-0.4	-2.5	-5.3	-5.2	0.7	-1.6	0.9	-1.9	-2.9	-0.3
Personal consumption	-0.5	0.7	-0.5	-0.4	-2.5	1.2	2.9	-2.5	0.2	-0.3	0.4	-0.3
Housing investment	-3.1	-9.5	3.6	4.0	8.1	-19.5	-4.0	6.4	5.7	-0.1	-0.3	0.1
Capital investment	-9.8	-17.8	-0.1	-8.4	-23.5	-20.0	-7.3	2.0	2.5	-1.6	-2.6	-0.0
Public sector demand	-0.5	5.0	-0.2	-2.8	2.6	5.6	5.5	0.1	-4.4	-0.1	1.1	-0.0
Government consumption	0.3	3.1	0.7	-2.3	3.1	3.4	2.7	0.1	0.0	0.1	0.6	0.1
Public investment	-4.4	14.7	-4.3	-5.7	0.9	17.4	19.8	-0.1	-23.5	-0.2	0.5	-0.2
Net exports (contribution)	-1.3	-2.1	0.8	0.8	-7.5	-0.5	0.4	1.1	0.8	-1.3	-2.1	0.8
Exports	-10.2	-20.4	8.3	1.7	-44.4	-17.5	9.8	8.2	7.2	-1.6	-3.0	1.0
Imports	-3.5	-8.6	1.7	-4.5	-7.6	-16.1	7.7	-1.1	1.5	0.4	0.9	-0.2
GDP (nominal)	-3.6	-2.8	-0.2	-4.3	-6.8	-2.5	0.7	-1.0	0.6			
GDP deflator	-0.3	1.0	-0.9	-1.4	0.9	2.4	-0.5	-1.2	-0.5			
Industrial production	-12.7	-12.6	2.8	-2.7	-22.4	-1.7	3.5	-0.1	2.5			
Unemployment rate	4.1	5.3	5.5	4.0	4.2	5.2	5.4	5.6	5.4			
Current account balance (JPY tril)	12.2	15.8	20.8	18.2	7.6	14.4	15.8	19.6	20.2			
as a percentage of nominal GDP	2.5	3.3	4.3	3.6	1.6	3.0	3.3	4.1	4.2			
Domestic corporate goods prices	3.2	-6.5	-2.3	6.1	0.4	-7.3	-5.7	-3.5	-1.1			
Consumer prices	1.2	-1.5	-0.4	1.9	0.5	-1.6	-1.3	-0.6	-0.2			
Long-term interest rate (%)	1.48	1.38	1.43	1.60	1.35	1.40	1.35	1.40	1.45			
Nikkei stock average (JPY)	10,850	9,100	10,000	13,300	8,400	9,100	9,100	9,700	10,300			
Exchange rate (JPY/USD)	100.5	97	102	106.1	94.8	96	98	101	104			
Crude oil price (WTI)	85.9	57	64	121.0	50.9	58	56	61	66			

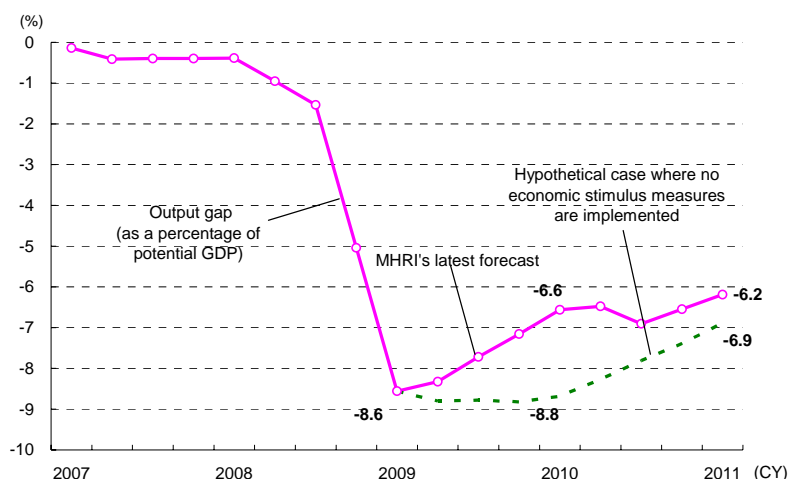
Notes: 1. FY = rate of change from the previous year. Half-year GDP = rate of change from the previous term p.a. (the GDP deflator = rate of change from the previous year).
 2. Half-year industrial production = rate of change from the previous term. The half-year unemployment rate and half-year current account balance are adjusted for seasonal factors and the figures on current account balance are converted into annualized rates.
 3. Half-year corporate goods prices and half-year consumer prices = rate of change over a year ago. Consumer prices = nationwide (excluding fresh foods).
 Sources: Cabinet Office, *National Accounts*, Ministry of Economy, Trade and Industry, *Indices of Industrial Production*, Ministry of Internal Affairs and Communications, *Labor Force Survey*, *Consumer Price Index*, Ministry of Finance, *Balance of Payments*, Bank of Japan, *Corporate Goods Price Index*.

An output gap around -6% will linger even at the end of FY2010

The output gap (the gap between actual GDP and potential GDP) estimated by MHRI stood at -8.6% as of the Jan-Mar quarter of 2009 (Chart 7). If the Japanese economy proceeds as set forth in our outlook, the output gap should contract by approximately 2% over the end of FY2009. Nevertheless, the output gap will more or less flatten out in FY2010 when the economic stimulus measures lose steam. Thus, an output gap surpassing -6% will still linger even at the end of FY2010, indicating the persistence of deflationary risks.

Despite the difficulty to foretell the future course of economic policy following the general election of the House of Representatives, it would be desirable to minimize the backlash subsequent to the economic stimulus measures. For example, it would be necessary to discuss (1) the extension of the measures to stimulate consumer spending in FY2010, and (2) restraints upon the spending cuts on public works in the FY2010 initial budget.

[Chart 7: Outlook on the output gap]



Note: The broken line represents the output gap extrapolating the actual GDP readings for the Jan-Mar quarter of 2009 on the basis of our outlook in March.

Sources: Estimates by MHIRI based upon Cabinet Office, National Accounts and Gross Capital Stock of Private Enterprises.

[Chart 8: Outlook on the US economy]

	2008	2009 (Forecast)	2010 (Forecast)	2008		2009 (Forecast)		2010 (Forecast)	
				1H	2H	1H	2H	1H	2H
GDP	1.1	-2.6	1.2	1.1	-1.2	-4.7	0.4	1.4	1.7
Personal consumption	0.2	-1.2	0.4	1.0	-2.7	-0.8	-0.4	0.6	0.9
Housing investment	-20.8	-24.4	-10.9	-22.9	-17.1	-30.6	-18.3	-12.0	0.0
Capital investment	1.6	-19.5	-1.2	2.7	-6.1	-28.9	-11.6	1.6	4.5
Inventory investment (USD100 million)	-291	-190	269	-304	-277	-605	225	345	193
Government consumption	2.9	2.1	5.9	2.1	4.2	-0.6	5.5	6.1	5.9
Net exports (USD100 million)	-3,902	-3,035	-3,258	-4,217	-3,588	-3,013	-3,056	-3,189	-3,327
Exports	6.2	-12.9	1.6	6.7	-2.2	-23.0	-0.6	2.0	3.0
Imports	-3.5	-14.8	2.7	-2.8	-8.1	-24.2	0.0	3.3	4.1
Domestic final demand	-0.0	-3.1	1.2	0.4	-2.3	-4.8	-0.6	1.6	2.3
Unemployment rate	5.8	9.2	9.6	5.2	6.5	8.7	9.8	9.6	9.5
Nonfarm payrolls (per month, 1,000 persons)	-189	-333	-13	-82	-297	-556	-110	-38	13
PCE deflator <y-o-y change>	3.3	0.5	2.0	3.6	3.1	0.5	0.5	2.2	1.8
Core PCE deflator <y-o-y change>	2.2	1.8	1.8	2.2	2.1	1.8	1.8	1.9	1.7
Current account balance (USD 100 million)	-6,733	-3,197	-3,729	-3,591	-3,141	-1,642	-1,555	-1,741	-1,988
<as a percentage of nominal GDP>	-4.7	-2.2	-2.5	-5.1	-4.4	-2.3	-2.2	-2.4	-2.7

Notes: 1. Calendar-year figures refer to the rate of change from the previous year. Half-year term figures refer to the rate of change from the previous half-year term (annualized).

2. The shaded columns are forecasts.

3. Regarding the current account balance, figures for the half-year terms are adjusted for seasonal factors and the calendar-year figures are the totals. The percentages of nominal GDP are annualized.

Sources: US Department of Commerce, US Department of Labor, MHIRI.

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