

Economic Outlook for FY2010 and FY2011

**(revised to reflect the Second Preliminary Quarterly Estimates of GDP
for the Jul-Sep quarter of 2010)**

December 2010

Key points of Mizuho Research Institute's (MHRI) outlook on the economy in FY2010 and FY2011
(reflecting the Second Preliminary Quarterly Estimates of GDP (2nd QE) for the Jul-Sep quarter of 2010)

<The Japanese Economy>

FY2010	+3.3% (previous outlook +2.6%) Signs of stagnation due to the slowdown of exports and fading impact of policy measures
FY2011	+1.4% (previous outlook +1.3%) Despite a return to a mild recovery track, growth will not be sufficient for an emergence out of deflation

<The US Economy>

2010	Concerns regarding weak growth and deflation will persist +2.8% (previous outlook +2.7%)
2011	+1.9% (previous outlook +1.8%)

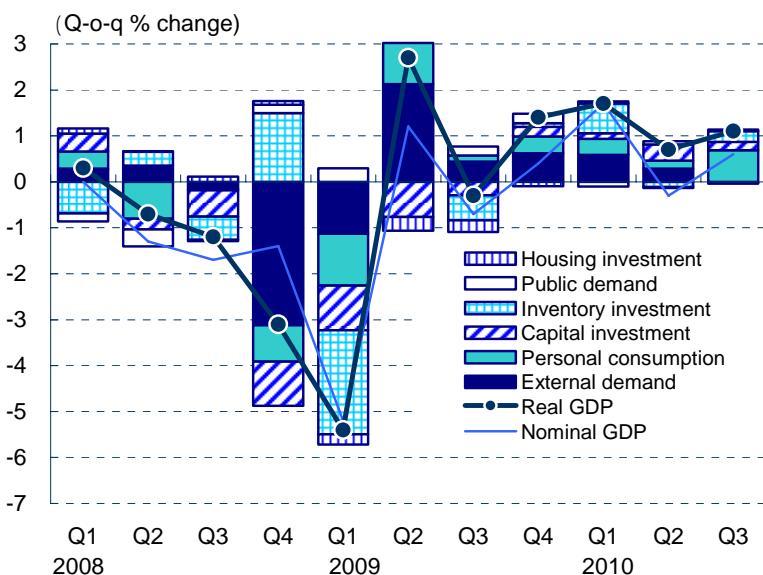
This English-language translation is based upon the outlook in Japanese released on December 9, 2010. This publication is compiled solely for the purpose of providing readers with information and is in no way meant to encourage readers to buy or sell financial instruments. Although this publication is 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

The 2nd QE revealed an upward revision of growth in the Jul-Sep quarter due mainly to capital and inventory investment

The *Second Preliminary Quarterly Estimates of GDP ("2nd QE")* for the Jul-Sep quarter of 2010 released by the Cabinet Office on December 9, 2010 revealed an upward revision of Japan's real GDP growth in the Jul-Sep quarter to +1.1% q-o-q (+4.5% p.a.) from +0.9% q-o-q (+3.9% p.a.) in the *First Preliminary Quarterly Estimates of GDP ("1st QE")* (**Chart 1**). Turning to each of the components of demand, both capital investment (+0.8% q-o-q → +1.3% q-o-q) and private-sector inventory investment (contribution to quarterly growth: +0.1% pt → +0.2% pt) were revised upward, reflecting the results of the *Financial Statements Statistics of Corporations by Industry*. While housing investment was revised downward (+1.3% q-o-q → +1.2% q-o-q), personal consumption turned out to be slightly stronger than initially expected (+1.1% q-o-q → +1.2% q-o-q). As a result, the contribution by domestic private demand toward quarterly real GDP growth stood at +1.1% pt (*1st QE* : +0.9% pt). As for the government sector, government consumption was revised upward (+0.1% q-o-q → +0.2% q-o-q) while public investment was revised down (-0.6% q-o-q → -1.0% q-o-q) from the *1st QE*. Thus, the contribution by public demand to GDP growth was unchanged from the *1st QE* at -0.0% pt. Turning to external demand, despite the upward revision of both exports (+2.4% q-o-q → +2.5% q-o-q) and imports (+2.7% q-o-q → +3.0% q-o-q), the contribution by external demand was revised down from 0.0% pt in the *1st QE* to -0.0% pt due to a larger upward revision of imports.

[Chart 1: Japan's GDP growth]



Source: Made by MHRI based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*.

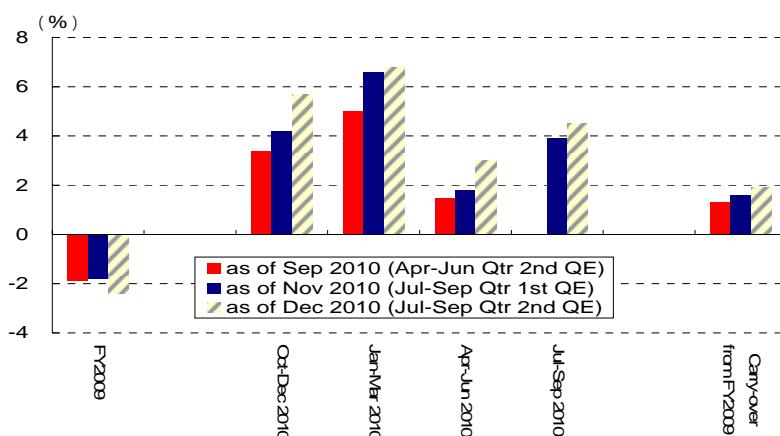
Past data series have been revised along with the release of FY2009 Revised Estimates of GDP

As in the *1st QE*, the pace of Japan's growth in the Jul-Sep quarter may be described as considerably high. However, a closer look reveals that there is not much reason to celebrate since a large part of the growth was driven by a sharp temporary expansion of personal consumption stemming from the last-minute rush of demand to take advantage of the Eco-Car Subsidy program before its expiration and the extremely hot summer weather. On the contrary, the economy may actually be losing momentum, as shown by the weakening of external demand as the driver of growth, reflecting the overseas economic slowdown.

The GDP deflator was revised down from -2.0% y-o-y in the *1st QE* to -2.4% y-o-y. Accordingly, GDP growth in nominal terms was also revised downward from +0.7% q-o-q in the *1st QE* to +0.6% q-o-q.

Along with the *2nd QE*, FY2009 GDP has been revised due to the incorporations of revisions to past data series including re-estimates of the seasonally adjusted series as a result of the *Revised Estimates (Chart 2)*. FY2009 real GDP was revised down sharply from -1.8% to -2.4%. In terms of the components of demand, notable changes were the downward revision of personal consumption (+0.8% → +0.0%) and inventory investment (contribution -0.6% pt → -1.1% pt) and the upward revision of government consumption (+1.7% → +3.4%) and public investment (+9.3% → +14.2%). Furthermore, the pattern of growth on a quarterly basis has also changed considerably. The carry-over of growth from FY2009 to FY2010 (the rate of growth which would be achieved if the economy remains unchanged throughout FY2010 at the level of GDP in the Jan-Mar quarter of 2010) rose from +1.6% to +1.9%, and the rate of growth in the Apr-Jun quarter of 2010 was also revised upward from 1.8% q-o-q to 3.0% q-o-q. As a result of these revisions, FY2010 growth will turn out to be considerably higher. Even though such changes are inevitable to a certain degree due to differences in estimation methods, the data fluctuations at the time of each revision are indeed quite volatile. Improvements are highly desirable from the perspective of statistical reliability.

[Chart 2: Revisions of Japan's past data series]



Note: Quarterly changes are q-o-q, p.a.

Source: Made by MHLW based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*.

II. Forecast of the Japanese economy in FY2010 and FY2011

The economy will ebb and flow in the second half of FY2010

Looking forward, the Japanese economy is forecast to follow an ebb-and-flow pattern in the second half of FY2010, given the stagnation of demand and production.

As the overseas economic recovery slows down, the odds are high that exports will lack momentum for some time and that the mechanism of “external demand spreading to domestic demand” – more specifically the rise of production and the accompanying alleviation of corporate sentiment on excessive labor and capacity triggered by export growth – will also come to a pause. In addition, the ebb of fiscal support to demand, such as the termination of the Eco-Car subsidies and the phase-down of Eco-Point program for household electrical appliances, will likely serve as a drag to domestic demand for a while.

In the household sector, personal consumption is predicted to lack momentum under a lackluster jobs and income environment due to the fall of labor demand accompanying production cuts. In particular, durable consumer goods are expected to weaken considerably for some time. Even though it appears that flat-panel TV sales surged toward the end of November in a last minute rush before the cutback of Eco-Points (which are redeemable for later discounts) provided to those purchasing energy-efficient household electrical appliances, and that this would contribute to push up personal consumption over the short term, we do not expect it to offset the negative impact stemming from the sharp fall of car sales after the termination of the Eco-Car subsidies.

Turning to the corporate sector, the pace of recovery of investment activity should remain mild due to the fall of the capacity utilization ratio and sharp slowdown of earnings growth.

The rate of Japan’s real GDP growth is forecast to reach +3.3% (previous outlook +2.6%) in FY2010. The dramatic upward revision of the growth rate is due primarily to the major retroactive revision of past GDP data series mentioned above. In the second half of FY2010, the economy is not expected to grow much, reaching +0.2% over the previous term (previous forecast: +0.0% over the previous term).

The economy should return to a mild recovery path in FY2011

As the year progresses in FY2011, the economy is expected to return to a mild recovery path. Even though the US economy will remain on heavy footing, Japan’s exports will follow an uptrend amid the self-sustained recovery of the Asian economies including China. Domestic production will likely shift into expansion mode as a result of (1) the alleviation of the impact from the termination of measures to boost durable goods purchases, and (2) a slight shift of Japan’s fiscal policy stance toward economic stimulation such as the implementation of

**Fiscal factors may lead to
stronger-than-expected
US economic growth**

the economic stimulus measures launched this autumn. This, in turn, should lead to the recovery of capital investment, employment and consumption. Even so, the pace of recovery will most likely be mild, considering the large possibility that companies will start to feel burdened by excess capacity and labor due to the output cuts in the second half of FY2010. FY2011 real GDP growth is forecast to reach +1.4% y-o-y (previous outlook +1.3% y-o-y).

Lastly, a word of mention on the emerging possibility that the US economy may grow stronger than initially expected. On December 6th, President Barak Obama and Republican Party members in Congress reached an agreement regarding the extension of the Bush-era tax cuts. In addition to the extension of the 2001 and 2003 tax cuts for all taxpayers including the wealthy, the Alternative Minimum Tax (AMT) relief which had lapsed at the end of 2009 was also revived. Even though these developments have been factored into our outlook above, some aspects of the agreement were unexpected. For example, in addition to the revival of certain tax credits (USD40 billion in two years) under the American Recovery and Reinvestment Act of 2009 (ARRA), the agreement also includes a one-year reduction of the payroll tax (USD120 billion). In 2011 alone, the impact is equivalent to 1% of GDP and would push up FY2011 real GDP growth by approximately 0.5%, in view of the multiplier effect according to the Council of Economic Advisers (CEA). Despite uncertainties regarding its enactment such as opposition by Democratic Party members of Congress, the US economy may grow stronger than initially expected depending upon the future course of developments (provided, that it goes hand in hand with the rise of fiscal tightening risks in the long run).

[Chart 3: Outlook on the Japanese economy]

		FY2009	FY2010	FY2011	2009			2010				2011				2012 Q1
					Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
		Q-o-q % ch	Q-o-q % ch p.a.	Q-o-q % ch												
GDP (real)		-2.4	3.3	1.4	2.7	-0.3	1.4	1.7	0.7	1.1	-0.4	0.1	0.4	0.5	0.6	0.6
	Q-o-q % ch p.a.	--	--	--	11.3	-1.2	5.7	6.8	3.0	4.5	-1.4	0.2	1.6	2.1	2.4	2.6
Domestic demand	Q-o-q % ch	-2.7	2.1	1.2	0.6	-0.7	0.8	1.1	0.5	1.1	-0.5	0.0	0.4	0.5	0.5	0.5
Private sector demand	Q-o-q % ch	-5.0	2.9	1.5	-0.2	-1.2	0.7	1.6	0.5	1.5	-0.3	0.2	0.3	0.5	0.6	0.6
Personal consumption	Q-o-q % ch	0.0	1.6	0.2	1.5	0.2	0.6	0.6	0.3	1.2	-0.7	0.1	0.1	0.0	0.2	0.3
Housing investment	Q-o-q % ch	-18.2	-1.5	7.6	-8.9	-8.2	-3.4	1.8	-0.8	1.2	1.1	1.6	2.0	2.5	2.9	0.3
Capital investment	Q-o-q % ch	-13.6	5.0	3.9	-5.0	-2.1	1.5	0.9	2.7	1.3	0.6	0.2	1.2	1.0	1.4	1.5
Inventory investment	Q-o-q contribution, % pt	-1.2	0.5	0.3	0.0	-0.5	0.1	0.6	-0.1	0.2	0.1	0.1	0.0	0.1	0.1	0.0
Public sector demand	Q-o-q % ch	5.2	-0.1	0.0	2.9	0.8	0.8	-0.4	0.3	-0.1	-1.1	-0.9	0.5	0.5	0.3	0.4
Government consumption	Q-o-q % ch	3.4	1.8	0.9	0.9	1.2	0.9	-0.3	1.0	0.2	0.1	0.1	0.3	0.4	0.3	0.3
Public investment	Q-o-q % ch	14.2	-10.1	-4.0	12.8	-0.7	0.3	-1.2	-3.0	-1.0	-7.2	-6.4	2.2	1.6	0.6	1.0
External demand	Q-o-q contribution, % pt	0.2	1.2	0.2	2.1	0.4	0.6	0.6	0.3	0.0	0.1	0.1	0.0	0.0	0.0	0.1
Exports	Q-o-q % ch	-9.6	18.7	4.5	10.1	9.4	4.9	7.2	5.6	2.5	0.2	0.8	1.0	1.3	1.6	1.7
Imports	Q-o-q % ch	-11.0	10.8	3.7	-5.2	5.6	0.7	3.2	4.2	3.0	-0.5	0.3	0.9	1.3	1.5	1.2
GDP (nominal)	Q-o-q % ch	-3.7	1.2	0.5	12	-0.7	0.4	1.7	-0.3	0.6	-0.8	0.3	-0.2	0.2	0.4	1.0
GDP deflator	Y-o-y % ch	-1.3	-2.1	-0.9	0.2	0.1	-2.5	-3.0	-2.3	-2.4	-2.0	-1.7	-1.1	-1.1	-0.9	-0.5
Domestic demand deflator	Y-o-y % ch	-2.2	-1.3	-0.4	-2.2	-2.7	-2.5	-1.5	-1.1	-1.5	-1.3	-1.1	-0.9	-0.6	-0.2	0.1

Note: The readings above may differ from public releases because the rates of change are calculated based upon actual results.

Source: Made by MHRI based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*.

		FY2009	FY2010	FY2011	2009			2010				2011				2012 Q1
					Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
		Q-o-q % ch	Y-o-y % ch													
Industrial production	Q-o-q % ch	-8.9	8.8	2.7	6.6	5.3	5.9	7.0	1.5	-1.8	-2.1	1.0	1.2	1.4	1.7	1.5
Ordinary profits	Y-o-y % ch	2.1	29.1	5.9	-53.0	-32.4	102.2	163.8	83.4	54.1	4.7	1.0	1.3	8.0	9.8	5.7
Nominal labor compensation	Y-o-y ch	-3.6	0.8	0.5	-5.0	-4.0	-4.4	-0.2	1.2	1.1	0.9	-0.1	0.3	0.4	0.5	0.9
Unemployment rate	%	5.2	5.0	5.0	5.1	5.4	5.2	4.9	5.2	5.1	5.0	4.9	5.0	5.0	4.9	4.9
New housing starts	P.a., 10,000 units	77.5	81.8	88.8	76.9	71.3	79.1	83.7	76.0	81.2	83.6	85.1	86.4	88.0	90.5	90.5
Current account balance	P.a., JPY tril	15.8	16.7	16.3	14.1	14.5	15.9	18.6	15.1	17.2	17.5	17.0	16.1	17.4	15.4	16.2
Domestic corporate goods prices	Y-o-y % ch	-5.2	0.4	1.1	-5.5	-8.3	-5.2	-1.7	0.2	-0.1	0.9	0.6	0.5	1.1	1.3	1.6
Consumer prices	Y-o-y % ch	-1.6	-0.9	-0.3	-1.0	-2.3	-1.7	-1.2	-1.2	-1.1	-0.6	-0.6	-0.4	-0.2	-0.4	-0.1
Uncollateralized overnight call rate	%	0.08	0 ~ 0.10	0 ~ 0.10	0.11	0.10	0.09	0.08	0.10	0.11	0 ~ 0.10	0 ~ 0.10	0 ~ 0.10	0 ~ 0.10	0 ~ 0.10	0 ~ 0.10
Yield on newly-issued 10-yr JGBs	%	1.35	1.09	0.79	1.42	1.34	1.32	1.34	1.21	0.99	1.01	0.95	0.85	0.80	0.75	0.75
Nikkei average	JPY	9,974	9,900	10,900	9,294	10,141	9,959	10,503	10,343	9,357	9,700	10,000	10,300	10,700	11,100	11,500
Exchange rate	JPY/USD	93.0	85.0	83.0	97.3	93.6	89.7	91.0	92.0	86.0	82.0	81.0	80.0	81.0	83.0	85.0
Crude oil price (WTI nearest term contract)	USD/bbl	71.0	82.0	90.0	59.8	68.2	76.1	79.0	78.0	76.0	85.0	87.0	88.0	89.0	91.0	93.0

Notes: 1. The readings above may differ from public releases because the rates of change are calculated based upon actual results.

2. Ordinary profits are based upon the *Financial Statements Statistics of Corporations by Industry (all industries)*.

3. Consumer prices exclude fresh food.

4. Quarterly data on the unemployment rate, new housing starts and current account balance are seasonally-adjusted.

5. Of the finance-related indices, the uncollateralized overnight call rate refers to the rate at the end of term and all others are averages during the relevant terms.

Sources: Made by MHRI based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*, Ministry of Economy, Trade and Industry, *Indices of Industrial Production*, Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*, Ministry of Internal Affairs and Communications, *Labor Force Survey*, *Consumer Price Index*, Ministry of Land, Infrastructure, Transport and Tourism, *Current Survey on Construction Statistics*, Bank of Japan, *Balance of Payments*, *Corporate Goods Price Index*, *Financial and Economic Statistics Monthly*, *Foreign Exchange Rates*, Japan Bond Trading Co., Ltd., *Latest Daily JGB Rates*, Nikkei Inc. and Bloomberg.

[Chart 4: Outlook on the US economy]

	2009 (Actual)	2010 (Forecast)	2011 (Forecast)	2009		2010 (Forecast)		2011 (Forecast)	
				1H	2H	1H	2H	1H	2H
GDP	-2.6	2.8	1.9	-4.3	1.9	3.5	2.1	1.6	2.4
Personal consumption	-1.2	1.7	2.1	-1.5	0.8	1.7	2.6	1.9	1.8
Housing investment	-22.9	-2.9	-0.3	-31.6	-0.7	-1.0	-9.0	1.8	4.7
Capital investment	-17.1	5.7	7.8	-26.0	-3.1	7.7	10.9	6.5	7.3
Inventory investment (USD 100 million)	-1,131	786	617	-1,438	-825	565	1,008	594	640
Government consumption	1.6	1.3	0.9	0.3	1.9	-0.2	3.5	-0.0	0.0
Net exports (USD 100 million)	-3,630	-4,534	-5,007	-3,656	-3,605	-3,937	-5,130	-5,058	-4,955
Exports	-9.5	11.5	7.7	-20.4	11.6	13.8	6.9	7.4	9.0
Imports	-13.8	14.1	8.3	-26.7	8.6	14.9	18.0	5.0	6.0
Domestic final demand	-3.1	1.9	2.3	-4.9	0.6	1.8	3.2	2.0	2.0
Unemployment rate	9.3	9.7	9.9	8.7	9.8	9.7	9.7	9.9	9.9
Nonfarm payrolls (per month, 1,000 persons)	-489	-54	93	-649	-351	31	72	96	107
PCE deflator <y-o-y change>	0.2	1.7	0.6	-0.0	0.4	2.2	1.2	0.7	0.5
Core PCE deflator <y-o-y change>	1.5	1.3	0.3	1.5	1.5	1.6	1.0	0.4	0.2
Current account balance (USD100 million)	-3,784	-5,104	-5,462	-1,800	-1,984	-2,324	-2,780	-2,682	-2,594
<as a percentage of nominal GDP>	-2.7	-3.5	-3.7	-2.6	-2.8	-3.2	-3.8	-3.6	-3.4

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, MHLI.

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