

Economic Outlook for FY2010, FY2011 and FY2012

February 2011

Key points of Mizuho Research Institute's (MHRI) outlook on the economy in FY2010, FY2011 and FY2012

reflecting *The First Preliminary Quarterly Estimates of GDP (1st QE)* for the Oct-Dec quarter of 2010

<The US Economy>

The US economy will continue to pick up on the tailwinds of more economic stimulus

2011 +3.1% (previous outlook +1.9%)

2012 +2.4%

<The Japanese Economy>

FY2010 +2.9% (previous outlook +3.3%)

The Japanese economy appears to have emerged out of its "lull" at the end of 2010

FY2011 +1.7% (previous outlook 1.4%)

The economy will recover, driven mainly by exports and capital investment.

Personal consumption will remain sluggish

FY2012 +1.8%

End to deflation unlikely even as the economy recovers

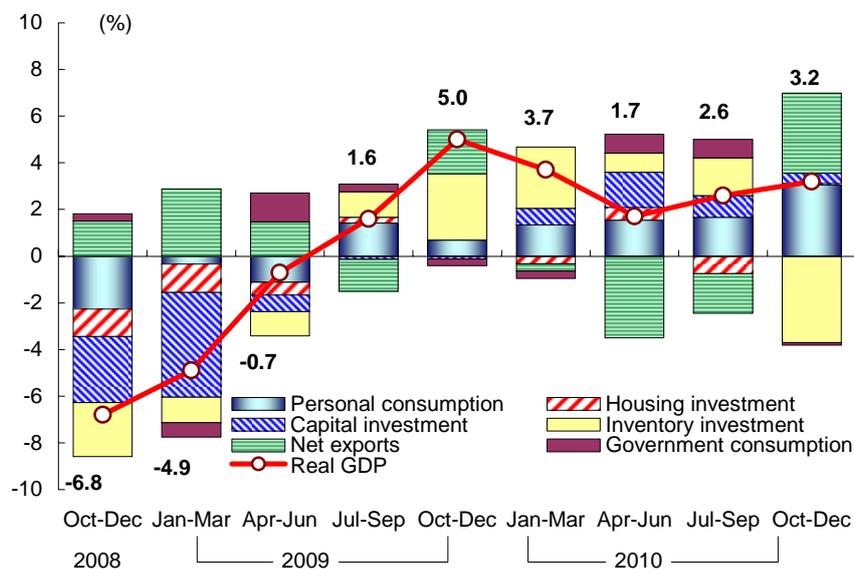
This English-language translation is based upon the outlook in Japanese released on February 16, 2011. This publication is compiled solely for the purpose of providing readers with information and is in no way meant to encourage readers to buy or sell financial instruments. Although this publication is compiled on the basis of sources which MHRI believes to be reliable and correct, MHRI 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 US economy

The US economy grew +2.9% in 2010, recovering at the fastest pace since 2005

According to advance estimates released by the Bureau of Economic Analysis, US real gross domestic product (GDP) grew +3.2 % q-o-q p.a. in the Oct-Dec quarter of 2010, indicating that the US economy is continuing to grow at a mild pace (**Chart 1**). Full-year growth in 2010 reached +2.9% y-o-y, and +2.8% y-o-y in terms of the year-on-year rate of real GDP growth at the end of each year not affected by the carry-over of growth (the rate of growth in the Oct-Dec quarter of 2010 over the same period a year ago). In terms of the year-on-year rate of real GDP growth at the end of each year, the pace of recovery has picked up to the level last seen in 2004 (+3.1%) and the level last reached in 2005 (+3.1%) in terms of annual average growth.

[Chart 1: US real GDP growth]



Note: The line and the figures represent the rate or real GDP growth (q-o-q % ch, p.a.). The bars represent the contributions by each of the components.
Source: US Department of Commerce.

Inventory investment will slow down and affect overseas export-oriented firms

As shown in **Chart 1**, one of the characteristics of growth in the Oct-Dec quarter of 2010 was the rise of contribution by external demand (net exports) in contrast to the sharp contraction of the contribution by inventory investment. Thus far, Mizuho Research Institute (MHRI) has predicted that the US economy would fall into a temporary stagnation or “lull” accompanied by an adjustment of inventory growth some time from the second half of 2010 to the first half of 2011. In fact, the pace of inventory replenishment slowed sharply in the Oct-Dec quarter of 2010 and the contribution by inventory investment reached -3.7% pt. However, as indicated by solid business conditions, the inventory adjustment has had virtually no impact as anticipated upon US domestic production activity. Instead, it appears that it has affected overseas export-oriented companies. Given the sharp fall of US imports (-13.6% q-o-q p.a.), coupled with the strength of exports, the contribution by external demand reached +3.4% pt.

The US economy has shifted from a “recovery” to an “expansion” phase

But it’s still “conditional”

While the economy will shift from a “contraction” to an “expansion” after it bottoms out, it is said that there are generally two phases in an expansion. The period until the level of real GDP reaches the previous peak of the economic cycle is deemed a “recovery” while the period thereafter is considered the “expansion”.

Since US real GDP in the Oct-Dec quarter has edged above the level (slightly above 0.15%) last visited during the peak of the economic cycle (Oct-Dec quarter of 2007), we can say that the US economy has shifted from a “recovery” to an “expansion” phase. Looking closer at each of the components of demand, although investment in housing and construction remain deeply depressed, the recovery of personal consumption, government spending and external demand served as drivers, compensating for the lost demand for housing and construction stemming from the collapse of the bubble (**Chart 2**).

However, a recovery of investment in housing and construction is unlikely anytime soon, and there are lingering uncertainties regarding demand which have thus far served as drivers. This leads to our view that the expansion cycle is only “conditional”.

For example, the recovery of personal consumption has been propped up largely by tax cuts and unemployment benefits, with the recovery of personal income (ex transfer income) being extremely mild (**Chart 2**). In the government sector, the Obama Administration has set forth an austere budget stance in a bid to curb the fiscal deficit. Furthermore, state and local government financial woes are still continuing. While external demand should continue to benefit from the mild expansion of the overseas economies, inflation concerns and interest rate hikes in the emerging economies are leading to rising risks of a global economic slowdown.

[Chart 2: The drivers of the US economic recovery]

	(%)
Real GDP	0.15
Personal consumption	0.69
Government spending	1.06
External demand	1.36
Housing investment	-1.44
Construction investment	-1.21
Machinery & software investment	-0.20
Inventory investment	-0.12
Personal consumption	0.95
Tax cut, transfer income	5.88
Personal income	0.01
Saving rate (a negative figure indicates a rise)	-4.30
Prices (same as above)	-4.79
Others	-2.03

Note: The percentage change of real GDP and personal consumption from the peak of the economic cycle (Oct-Dec qtr of 2007) to the end of 2010 and contributions by component factors.

Personal consumption excludes transfer income.

Sources: US Department of Commerce, MHRI.

Forecast on real GDP growth in 2011 revised up to +3.1%. Growth to slow down to +2.4% in 2012

Looking forward, what is in store for the US economy which has shifted into a “conditional expansion”? We forecast that real GDP will grow at a faster pace of +3.1% in 2011 (previous forecast +1.9%, released on December 6, 2010) and that it will slow down to +2.4% in 2012 (**Chart 3**). The dramatic upward revision of growth in 2011 stems from the carry-over of growth due to the sharp slowdown of imports at the end of 2010 and the upward revision of domestic final demand to +3.0% (previous forecast +2.3%). The upward revision takes into consideration the new package of economic stimulus measures in December 2010 (in particular, the tax cut on payrolls and capital investment). On the other hand, growth in 2012 should slow down due to a backlash stemming from the economic stimulus measures.

[Chart 3: Outlook on the US economy]

	2010 (Actual)	2011 (Forecast)	2012 (Forecast)
GDP (y-o-y % ch)	2.9	3.1	2.4
Personal consumption (y-o-y % ch)	1.8	2.9	1.8
Housing investment (y-o-y % ch)	-3.0	-1.2	0.3
Capital investment (y-o-y % ch)	5.5	8.1	6.1
Inventory investment (USD billion)	60.4	46.5	74.3
Government spending (y-o-y % ch)	1.1	1.1	0.7
Net exports (USD billion)	-421.2	-398.1	-381.1
Exports (y-o-y % ch)	11.7	7.9	7.3
Imports (y-o-y % ch)	12.6	5.2	5.2
Domestic final demand (y-o-y % ch)	1.9	3.0	2.0
Labor force participation rate (%)	64.7	64.4	64.4
Labor force population (y-o-y % ch)	-0.2	0.4	0.8
Unemployment rate (%)	9.6	9.2	8.6
Nonfarm payrolls (per month, 1,000 persons)	-80.8	122.5	168.0
Weekly labor hours (hours)	34.2	34.4	34.5
Hourly wages (y-o-y % ch)	1.8	1.8	1.8
Ratio of disposable income to household net assets (-times)	4.8	4.9	5.0
Personal saving rate (%)	5.8	5.4	5.2
PCE deflator (y-o-y % ch)	1.7	1.6	1.0
Core PCE deflator ex food and energy (y-o-y % ch)	1.3	0.5	0.5
Current account balance (% of GDP)	-3.4	-3.3	-3.3

	2011				2012			
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec
GDP (q-o-q % ch p.a.)	3.0	3.8	3.2	2.9	2.8	1.0	1.9	1.7
Personal consumption (q-o-q % ch p.a.)	2.2	4.0	1.6	2.7	0.9	1.6	2.0	1.9
Housing investment (q-o-q % ch p.a.)	0.0	2.0	3.0	0.0	-5.0	0.0	8.0	2.0
Capital investment (q-o-q % ch p.a.)	7.3	7.9	8.7	9.9	-1.1	8.1	8.1	8.1
Inventory investment (USD billion p.a.)	32.0	42.0	62.0	50.0	112.0	85.0	60.0	40.0
Government spending (q-o-q % ch p.a.)	-1.0	2.0	2.0	2.0	0.0	0.0	0.0	0.0
Net exports (USD billion p.a.)	-387.2	-403.9	-401.3	-399.9	-385.0	-387.1	-377.2	-375.3
Exports (q-o-q % ch p.a.)	7.4	8.2	8.0	7.7	7.0	6.8	7.0	7.0
Imports (q-o-q % ch p.a.)	5.0	10.0	6.0	6.0	3.0	6.0	4.0	5.5
Domestic final demand (q-o-q % ch p.a.)	2.0	3.9	2.4	3.2	0.4	1.9	2.3	2.2
Unemployment rate (%)	9.3	9.3	9.1	9.0	8.8	8.7	8.5	8.4
Nonfarm payrolls (per month, 1,000 persons)	134.3	175.6	166.1	166.7	167.3	168.0	168.6	169.3
Personal income (q-o-q % ch p.a.)	2.3	4.2	3.2	3.7	2.7	3.2	3.8	3.3
Disposable income (q-o-q % ch p.a.)	5.6	4.1	3.2	3.7	2.6	0.0	3.7	3.3
Personal saving rate (%)	5.6	5.1	5.4	5.4	5.5	4.9	5.1	5.1
PCE deflator (y-o-y % ch)	1.3	1.8	1.8	1.6	1.2	0.9	1.0	1.1
Core PCE deflator (y-o-y % ch)	0.7	0.5	0.5	0.5	0.4	0.4	0.5	0.5

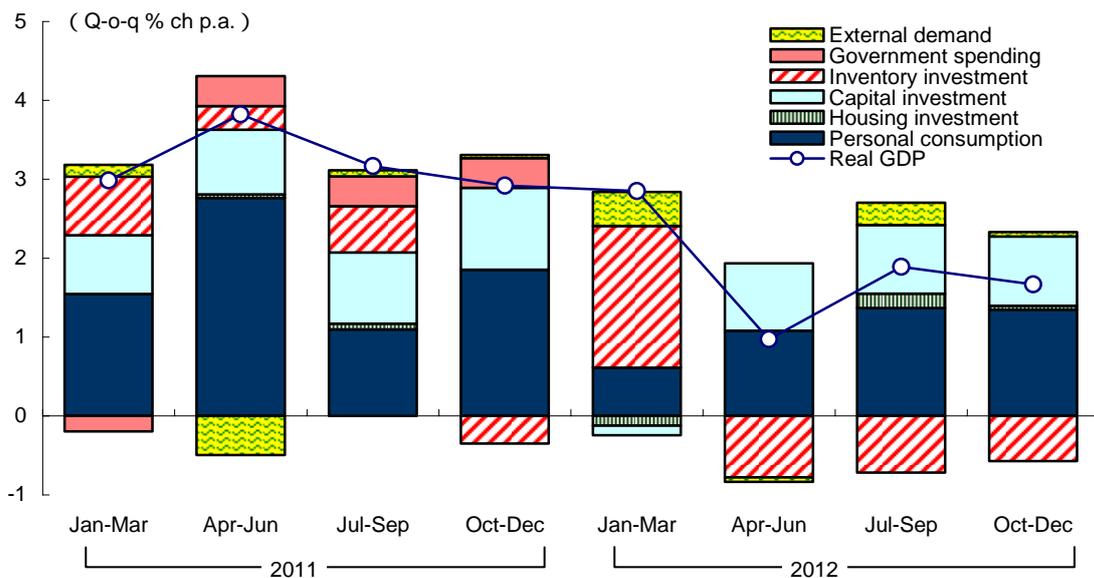
Sources: US Department of Commerce, US Department of Labor, US Department of the Treasury, MHR.

The economic stimulus measures will lift growth in 2011. 2012 will suffer a backlash

Our main forecast scenario is as follows. (1) In 2011, the economic stimulus measures will lift personal consumption and capital investment. Even though its backlash will emerge in early 2012, it is unlikely that the US economy will lose steam (**Chart 4**). (2) The impact from the fluctuation of final demand accompanying the economic stimulus measures will be absorbed more or less by inventory investment. The inventory cycle appears to have reversed course due to the adjustment in the Oct-Dec quarter of 2010. The drive to replenish inventories should continue during the forecast horizon. Although the contribution by inventory investment to real GDP growth is approximately zero on a full-year basis, its contribution will be more or less positive on a quarterly basis up to early 2012 and dip into negative territory from then onward.

(3) In addition to the backlash accompanying the expiration of tax cuts, the budget tightening in the government sector mentioned above will serve as a drag in 2012. Our economic outlook stands upon the premise that the so-called “Bush Tax Cuts” of 2001 and 2003 and relief for the Alternative Minimum Tax (AMT) will be extended for all taxpayers regardless of income level.

[Chart 4: 2011 and 2012 real GDP growth and contributions by demand components]



Source: MHRI.

Corporate sector strength to continue

(4) The overseas economies will continue to follow a recovery and expansion path, leading to the strong growth of US exports. Exports will also serve as tailwinds for capital investment. Even though the rise of risk aversion in the stock market triggered by the political upheaval in Tunisia and Egypt and its spread through the Middle East is a risk factor, export orders and indicators gauging capital investment sentiment have been high at least up to the eruption of the political upheaval, indicating that the corporate sector would remain on solid footing. Thus, while we take into consideration the possible rise of geopolitical turmoil as a risk scenario, our main forecast scenario sets forth the solid growth of

Recovery of the job and income environment and the payroll tax cut will boost personal consumption in 2011

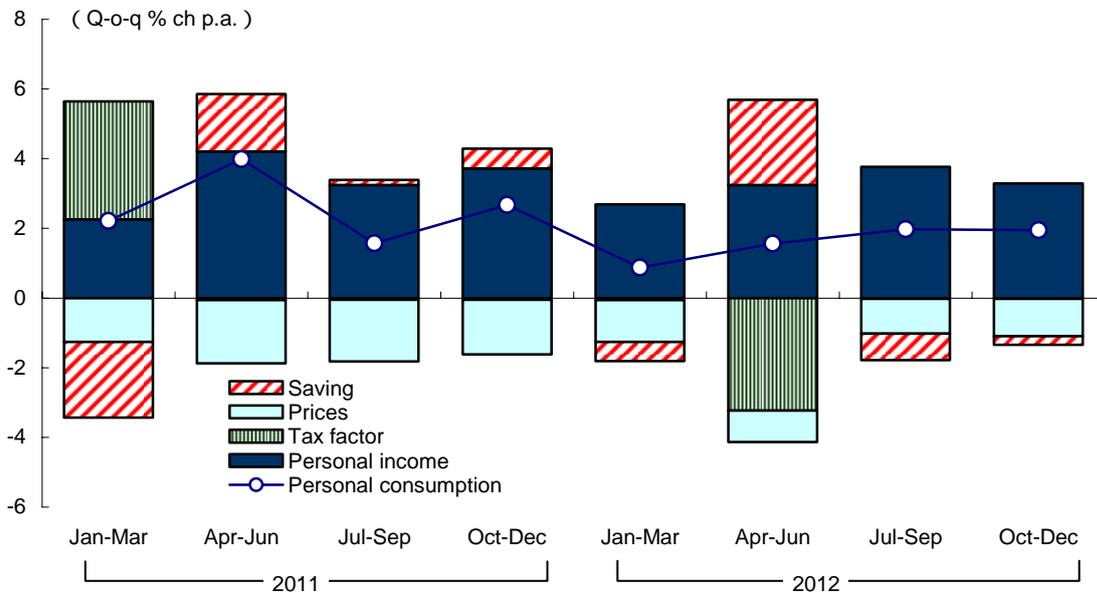
Rise of stock prices serve to ease the impact of house price downturn

the corporate sector.

(5) Amid forecasts that corporate profits will continue to remain strong, corporate hiring stance is also expected to pick up. Although the pace of employment growth will remain slow - around the level during the first half of the 1990s - reflecting the rise of labor productivity, thus resulting in a “jobless recovery”, household disposable income should grow strongly in 2011 due to the payroll tax cut and recovery of wages and labor hours.

(6) While the fall of house prices and the surge of energy and food prices will serve as restraints, the abovementioned improvement of the jobs and income environment, the stock market rise reflecting the global economic recovery and expansion and the Federal Open Market Committee’s (FOMC) maintenance of an accommodative monetary stance, should lead to the improvement of consumer sentiment and keep personal consumption on solid grounds (**Chart 5**).

[Chart 5: US personal consumption in 2011 and 2012]



Source: MHRI.

Core inflation to remain low. Labor force participation rate should remain low due to structural factors. Natural rate of unemployment will also be pinned at a high level

(7) The deflationary gap is probably not as large as suggested by the high rate of unemployment. Furthermore, the expected rate of inflation should remain stable. In view of these factors, the core inflation rate will likely continue to hover at a low level. Our surmise that the deflationary gap is not that large stems from two factors, namely the structural decline of the labor force participation rate and the rise of natural unemployment. While the current labor force participation rate has declined to the level last visited in 1984, the US Department of Labor stated in its long-term projection on the labor force population that the labor force participation rate would follow a structural decline from 2010 onward, reflecting the retirement of the baby-boom generation and the rise of the population attending schools to upgrade their academic histories and skills (March 2010). We have shifted our scenario in our outlook from our previous view that “discouraged workers who had given up their search for jobs due to the sharp deterioration of labor market conditions would start to look for jobs again, and that it would push up the labor force participation rate to the level prior to the recession (2007: 66%)” to the view that “the labor force participation rate will remain low in the absence of a major rebound”. The natural rate of unemployment most likely is edging closer to 7%, given lingering long-term unemployment, the difficulty among the unemployed to seek jobs in far-flung geographic areas due to mortgage loan burdens, and the mismatch of skills in the labor market.

Deflationary risks are lingering. QE2 will be terminated as scheduled, but reinvestment of policy will remain in place. FOMC will keep monetary policy stance accommodative

(8) Deflationary risks will linger as the core inflation rate hovers low. The FOMC will most likely keep its current monetary policy stance unchanged. The purchase of long-term Treasuries for the purpose of providing further monetary stimulus (referred to as “quantitative easing 2” or “QE2”) should be terminated by the end of June 2011 as initially scheduled. On the other hand, the reinvestment of Treasuries using the proceeds of earlier investments will likely be continued in order to keep the Federal Reserve Board’s (FRB) balance sheet constant and to keep its monetary policy stance accommodative. A shift into monetary tightening mode is unlikely unless the US economy achieves a stronger-than-expected expansion in 2012 when the impact of the backlash from the economic stimulus and budget tightening is expected to emerge.

II. The Japanese economy

(1) The current state of the economy

The Japanese economy contracted for the first time in five quarters due primarily to the fall of personal consumption and exports

According to the *First Preliminary Quarterly Estimates of GDP (1st QE)*, Japan's real GDP contracted (-0.3% q-o-q, or -1.1% in annualized terms) in the Oct-Dec quarter of 2010, registering negative growth for the first time in five quarters (**Chart 6**). Once again, data releases confirmed that the Japanese economy had fallen into temporary state of stagnation (a "lull") at the end of last year, due to the overseas economic slowdown and fading impact of domestic economic stimulus measures.

Looking closer at each of the components of demand, personal consumption fell sharply (-0.7% q-o-q). Despite the rise in sales of household electric appliances such as flat-panel TVs due to the last-minute rush of demand before the phase-down of the Eco-Point program, the fall of car sales after the end of the Eco-Car subsidies served as a drag, slowing down the demand for durable goods to +3.1% q-o-q (Jul-Sep quarter: +12.2% q-o-q). Furthermore, consumption of nondurable goods fell sharply (-3.6% q-o-q) due primarily to the decline of sales of cigarettes along with the large-scale price hike in October. On the other hand, given the solid growth of housing investment (+3.0% q-o-q) and capital investment (+0.9% q-o-q), and the positive contribution by private inventory investment (+0.2% pt), the contribution by domestic private demand to quarterly real GDP growth stood at +0.0% pt.

Despite a slight uptick of government consumption (+0.2% q-o-q), public demand served as a drag upon growth (-0.2% pt) because public investment fell deeper into negative territory (-5.8% q-o-q). Accordingly, the contribution of domestic demand combining both private and public demand stood at -0.2% pt.

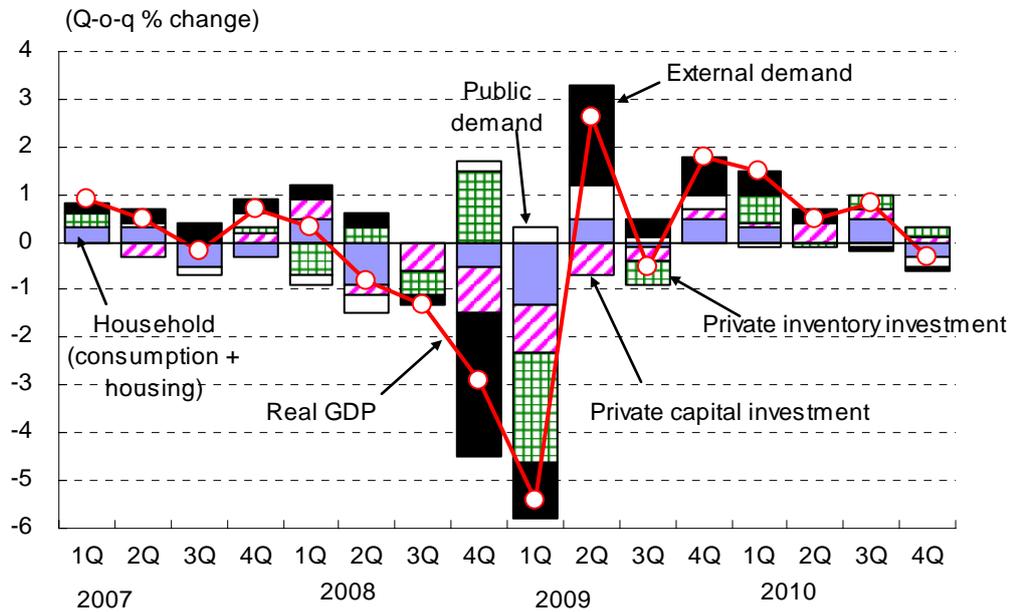
Exports fell for the first time in seven quarters (-0.7% q-o-q), reflecting the overseas economic slowdown and the inventory adjustment in the information technology (IT) sector. Since the breadth of the export decline outpaced that of imports (-0.1% q-o-q), the contribution by external demand (-0.1% pt) remained in negative territory for the second quarter in a row.

Japan has already climbed out of the "lull"

Even though the Japanese economy contracted in the Oct-Dec quarter of 2010, a spate of indicators suggests that the economy has already climbed out of the "lull". Subsequent to the rise in quantity of exports and industrial production for two months in a row after bottoming in October last year, a significant boost of production is projected in January (**Chart 7**). In the background are factors such as the mild recovery of overseas economies mainly in the US and China, and the progress of inventory adjustment in the IT sector. The odds are high that growth will rebound to positive territory on a GDP-basis in the Jan-Mar quarter of 2011. The contribution by external demand should turn positive due to the recovery of exports. In addition to a slight upturn of personal consumption reflecting the

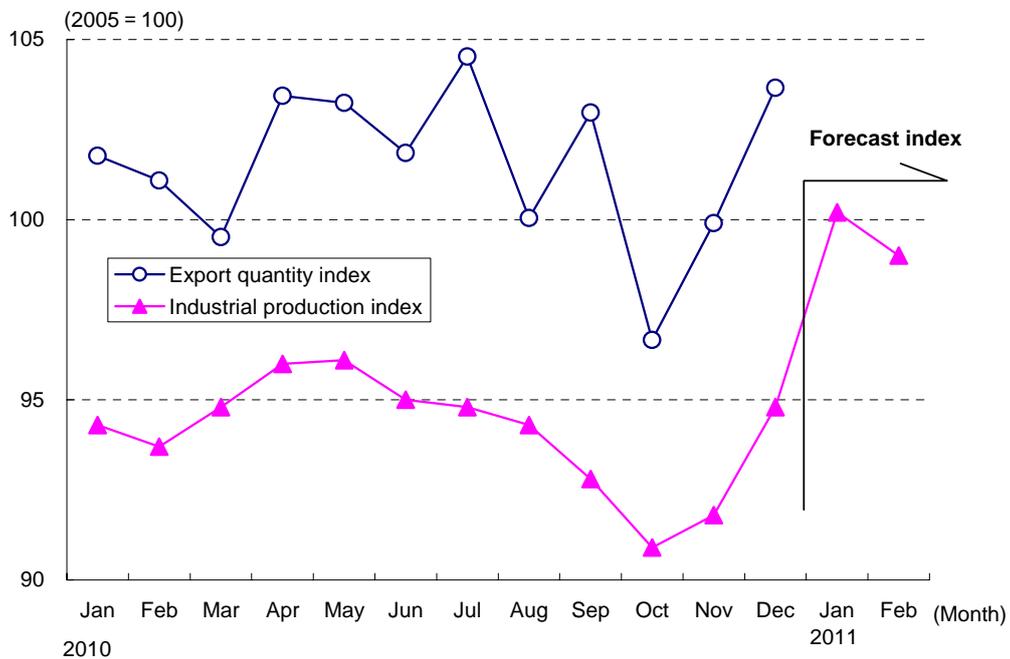
fading impact of the termination of the Eco-Car subsidies and the tax hike on cigarettes, both housing investment and capital investment are expected to keep following an upward trend.

[Chart 6: Japan's quarterly real GDP growth]



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

[Chart 7: Japan's exports (by quantity) and industrial production]



Note: The export quantity index is adjusted for seasonal factors by MHRI.
Sources: Made by MHRI based upon Ministry of Finance, *Trade Statistics*,
Ministry of Economy, Trade and Industry, *Indices of Industrial Production*,

(2) Outlook on the Japanese economy in FY2010, FY2011 and FY2012

FY2010 real GDP

projection: +2.9%

The Japanese economy will continue to recover in FY2011, driven mainly by exports and capital investment

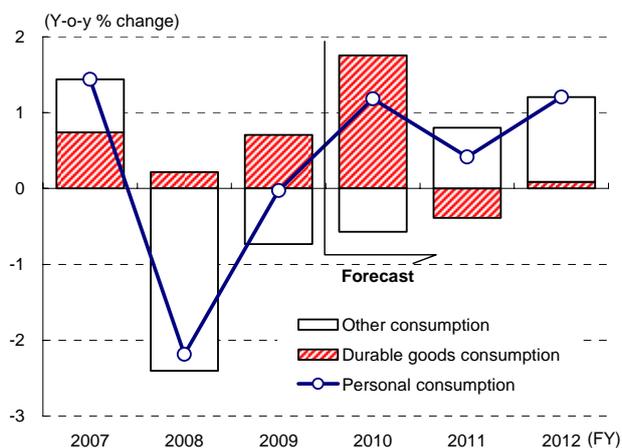
The Japanese economy is expected to rebound into positive territory in the Jan-Mar quarter of 2011 and grow +2.9% in FY2010. The downward revision from our previous *Economic Outlook* in December (+3.3%) stems primarily from the downward revision of the rate of growth in the Apr-Jun quarter and Jul-Sep quarter of 2010 mainly with respect to personal consumption.

The rate of real GDP growth in FY2011 is forecast to reach +1.7% (previous outlook: +1.4%). Subsequent to emerging out of a temporary stagnation, the Japanese economy should continue to recover, underpinned by the growth of exports reflecting the overseas economic recovery.

Even so, we do not expect a spectacular rise of personal consumption in FY2011. In addition to the stagnant growth of car sales due to the termination of the Eco-Car subsidies, purchases of flat-panel TVs - which surged in FY2010 - will inevitably decline due to the expiration of the Eco-Point program for household electrical appliances at the end of March 2011. Durable goods consumption, which served as the driver of personal consumption in FY2009 and FY2010, will decline in FY2011 and turn into a drag upon personal consumption (**Chart 8**). Even though consumption of goods other than durable goods should increase due to the gradual improvement of income conditions, personal consumption will likely stagnate throughout FY2011.

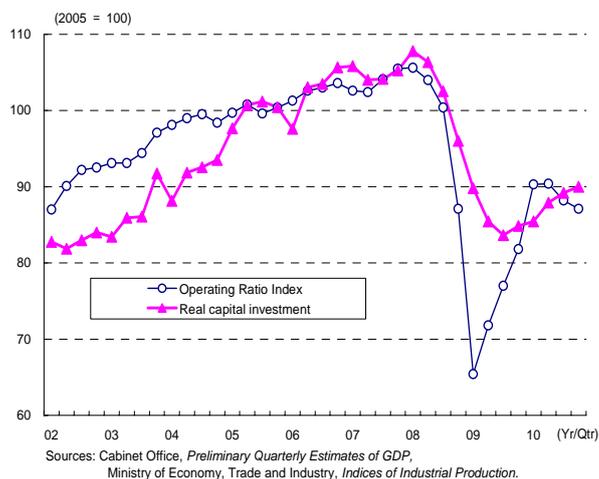
Turning to domestic private demand other than personal consumption, capital investment is expected to grow and serve as the driver of the economy. Capital investment has been recovering at a moderate pace from the bottom in the Jul-Sep quarter of 2009 (two quarters after industrial production bottomed out in the Jan-Mar quarter of 2009) to the Oct-Dec quarter of 2010 (**Chart 9**). Although production activity softened and capacity utilization ebbed during the lull over the end of last year, capacity utilization should rise along with the recovery of production activity during FY2011. Capital investment will likely continue to recover as businesses feel less burdened by excessive capacity.

[Chart 8: Personal consumption and durable goods (contribution to growth)]



Source: Estimates by MHRI based upon releases by the Cabinet Office.

[Chart 9: Capacity utilization ratio and capital investment]



Sources: Cabinet Office, Preliminary Quarterly Estimates of GDP, Ministry of Economy, Trade and Industry, Indices of Industrial Production.

Given the ongoing sharp decline of public investment, overall public demand is forecast to ebb slightly in FY2011 despite the increase of government consumption. Government consumption should continue to remain on a mild uptrend due to the current administration's tolerance of the natural growth of social security spending,. On the other hand, the odds are high that the government will continue to cut budget layouts for public investment because of the difficulty to increase the total amount of expenditures in light of its fiscal management strategy.

As shown above, MHRI forecasts that the Japanese economy will remain on a recovery, with exports and capital investment as the drivers, amid the stagnant growth of personal consumption and sluggish public demand in FY2011.

The Japanese economy should continue to recover in FY2012, as personal consumption gathers steam amid the fading impact of the termination of stimulus measures to boost purchases of durable goods. In the first half of FY2012, a minor inventory adjustment is likely due to the slowdown of exports stemming from factors such as the deceleration of the US economy. However, given the support by exports to China, which is continuing to enjoy strong economic growth, the Japanese economy will avoid falling into a recession. The growth of industrial production should pick up in the second half of FY2012. On the back of the rise of the capacity utilization ratio and the improvement of corporate earnings, capital investment should continue to grow. In FY2012, Japan's real GDP is forecast to grow +1.8%, expanding at around the same level as FY2011.

Production activity as of the end of FY2012 should climb back to the level before the outbreak of the Lehman Shock (Jul-Sep quarter of 2008). The unemployment rate, which is forecast to remain high around 5% during FY2011 should decline to the lower half of the 4%-level on the back of more definite signs of recovery in FY2012.

According to estimates by MHRI, the breadth of the output gap in negative territory (the "deflationary gap") is around -3.7% of GDP (excess output of JPY20.9 trillion) in the Oct-Dec quarter of 2010 (**Chart 11**). In the event Japan's economic growth continues to grow as in our forecast, the output gap should contract to -1.1% (excess output of JPY6.3 trillion) as of the end of FY2012.

The fall of consumer prices (general, excluding fresh food, referred to below as the "core CPI") has been slowing, registering -0.4% y-o-y as of December 2010. The core CPI under current standards is predicted to take an upturn from FY2011 in view of the fading impact of the measure to make high school tuitions essentially free and the rise of energy prices (FY2011: +0.2% y-o-y, FY2012: +0.5% y-o-y). However, the revision of the base year of the CPI expected around August this year should result in a downward revision by approximately 0.5%, leading to a downturn of the CPI.

In FY2012, personal consumption will pick up, reflecting the ebb of the backlash to the economic stimulus measures

The unemployment rate will decline to around the lower half of the 4%-level

An emergence out of deflation is unlikely during FY2012

[Chart 10: Outlook on the Japanese economy]

		FY2009	FY2010	FY2011	FY2012	2010				2011				2012				2013
						Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
GDP (real)	Q-o-q % ch	-2.4	2.9	1.7	1.8	1.5	0.5	0.8	-0.3	0.5	0.6	0.3	0.5	0.5	0.3	0.5	0.5	0.6
	Q-o-q % ch p.a.	--	--	--	--	6.0	2.1	3.3	-1.1	2.1	2.5	1.1	2.2	2.1	1.1	2.1	2.2	2.4
Domestic demand	Q-o-q % ch	-2.7	2.0	1.3	1.6	1.0	0.3	1.0	-0.2	0.2	0.5	0.2	0.5	0.6	0.2	0.4	0.5	0.5
Private sector demand	Q-o-q % ch	-5.0	2.7	1.9	2.0	1.5	0.4	1.4	0.0	0.3	0.6	0.2	0.7	0.8	0.2	0.5	0.6	0.6
Personal consumption	Q-o-q % ch	-0.0	1.2	0.4	1.2	0.5	0.0	0.9	-0.7	0.1	0.3	-0.3	0.4	0.6	0.1	0.3	0.4	0.4
Housing investment	Q-o-q % ch	-18.2	0.2	9.3	4.6	1.6	-0.3	1.8	3.0	2.4	1.8	2.5	2.9	0.3	1.0	1.0	0.7	0.4
Capital investment	Q-o-q % ch	-13.6	5.6	4.9	4.4	0.7	2.9	1.5	0.9	1.0	1.2	1.5	1.3	1.1	0.8	1.0	1.3	1.3
Inventory investment	Q-o-q contribution, % pt	-1.1	0.6	0.2	0.0	0.6	-0.1	0.3	0.2	0.0	0.0	0.0	-0.0	0.0	-0.0	0.0	0.0	0.0
Public sector demand	Q-o-q % ch	5.2	-0.2	-0.4	0.1	-0.5	0.1	-0.2	-0.7	-0.3	0.2	0.1	0.0	0.0	0.1	0.0	0.0	0.0
Government consumption	Q-o-q % ch	3.4	1.9	1.1	0.8	-0.3	1.1	0.3	0.2	0.2	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.1
Public investment	Q-o-q % ch	14.2	-9.9	-7.8	-4.5	-1.4	-4.1	-2.1	-5.8	-3.3	-0.2	-1.2	-2.1	-1.4	-0.6	-1.0	-1.4	-1.0
External demand	Q-o-q contribution, % pt	0.3	1.0	0.3	0.2	0.5	0.3	-0.1	-0.1	0.3	0.1	0.1	0.0	-0.1	0.1	0.1	0.0	0.1
Exports	Q-o-q % ch	-9.6	17.8	5.8	4.9	6.6	5.3	1.5	-0.7	2.8	1.8	1.4	1.2	0.5	1.0	1.7	1.5	1.8
Imports	Q-o-q % ch	-11.0	10.8	4.3	4.1	3.0	4.0	2.9	-0.1	1.0	1.2	1.0	1.2	1.0	0.6	1.0	1.4	1.5
GDP (nominal)	Q-o-q % ch	-3.7	1.0	0.3	1.3	1.7	-0.6	0.6	-0.6	0.2	-0.1	0.0	0.5	0.6	-0.1	0.3	0.5	1.0
GDP deflator	Y-o-y % ch	-1.3	-1.9	-1.4	-0.5	-2.8	-2.0	-2.0	-1.6	-2.0	-1.6	-1.7	-1.4	-0.8	-0.6	-0.5	-0.6	-0.1
Domestic demand deflator	Y-o-y % ch	-2.2	-1.1	-0.5	-0.2	-1.4	-0.8	-1.4	-1.0	-1.0	-0.6	-0.5	-0.6	-0.3	-0.4	-0.3	-0.3	0.0

Note: The readings above may differ from public releases because the rates of change are calculated based upon actual results.
Source: Made by MHR based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*.

		FY2009	FY2010	FY2011	FY2012	2010				2011				2012				2013
						Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Industrial production	Q-o-q % ch	-8.9	10.0	6.5	4.3	7.0	1.5	-1.8	-1.6	4.5	2.0	1.4	1.8	0.9	0.1	1.7	1.2	1.3
Ordinary profits	Y-o-y % ch	2.1	31.2	8.1	5.5	163.8	83.4	54.1	8.2	4.7	1.2	7.3	15.9	9.1	5.4	4.6	4.8	6.9
Nominal labor compensation	Y-o-y % ch	-3.6	0.9	0.9	0.9	-0.2	1.2	1.2	0.7	0.3	0.4	0.9	1.5	0.8	0.9	0.9	0.8	0.9
Unemployment rate	%	5.2	5.0	4.8	4.5	4.9	5.2	5.1	5.0	4.8	4.9	4.9	4.8	4.8	4.7	4.6	4.5	4.4
New housing starts	P.a., 10,000 units	77.5	82.7	89.9	94.1	81.6	77.6	81.5	84.3	86.1	87.5	89.1	91.6	91.4	92.7	93.8	94.6	95.3
Current account balance	P.a., JPY tril	15.8	16.5	16.1	17.1	18.6	15.1	17.7	16.7	15.7	15.4	16.1	16.5	16.0	16.1	16.9	17.0	18.0
Domestic corporate goods prices	Y-o-y % ch	-5.2	0.7	1.7	0.4	-1.7	0.2	-0.1	0.9	1.7	1.7	2.4	1.9	1.0	0.4	0.2	0.5	0.6
Consumer prices	Y-o-y % ch	-1.6	-0.8	0.2	0.5	-1.2	-1.2	-1.1	-0.5	-0.4	0.1	0.3	0.1	0.3	0.2	0.4	0.5	0.7
Uncollateralized overnight call rate	%	0.08	0 ~ 0.10	0 ~ 0.10	0 ~ 0.10	0.08	0.10	0.11	0.08	0 ~ 0.10	0 ~ 0.10	0 ~ 0.10	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	1.17	1.14	1.13	1.34	1.21	0.99	1.07	1.23	1.22	1.20	1.10	1.05	1.10	1.10	1.15	1.15
Nikkei average	JPY	9,974	10,000	10,950	11,900	10,503	10,343	9,357	9,836	10,400	10,700	10,700	11,000	11,300	11,500	11,700	12,000	12,300
Exchange rate	JPY/USD	93.0	86.0	84.0	87.0	90.7	92.0	85.9	82.6	83.0	83.0	83.0	84.0	85.0	86.0	86.0	87.0	88.0
Crude oil price (WTI nearest term contract)	USD/bbl	71.0	82.0	96.0	98.0	78.9	78.1	76.2	85.2	89.0	97.0	96.0	95.0	97.0	97.0	97.0	98.0	101.0

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 MHR 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*, Ministry of Finance, *Financial and Economic Statistics Monthly*, *Foreign Exchange Rates*, Japan Bond Trading Co., Ltd., *Latest Daily JGB Rates*, Nikkei Inc. and Bloomberg.

The “US-based core CPI” (general, excluding food (ex alcohol) and energy), which has a closer correlation with the output gap and is affected less by overseas market trends such as crude oil prices, should rise temporarily into positive territory in the Apr-Jun quarter of 2011 along with the fading impact of the measure to make high school tuition essentially free. Subsequently, the US-based core CPI is forecast to dip into negative territory in the Oct-Dec quarter when the impact of the tax hike on cigarettes wears off and rise again in FY2012 (**Chart 12**). Even so, we expect the US-based core CPI to be revised down by approximately 0.6% as a result of the rebase and remain in negative territory in terms of the y-o-y percentage change despite a slower pace of decline from the end of FY2012. Considering that CPI trends generally lag output gap trends by approximately one year, it would take another year or so after the output gap is closed for Japan to emerge out of deflation. Thus, it would be difficult for Japan to emerge out of deflation during FY2012.

In view of the possibility that the year-on-year change of the rebased core CPI may turn positive depending upon energy price trends, it would be necessary to take a cautious stance when judging such cost-push type of inflation. To determine whether or not deflation has indeed ended, it would be necessary not only to see whether the core CPI is in positive territory but also to judge comprehensively the movements of indicators such as the US-based core CPI, the output gap, and terms of trade.

Chart 11: Japan’s output gap

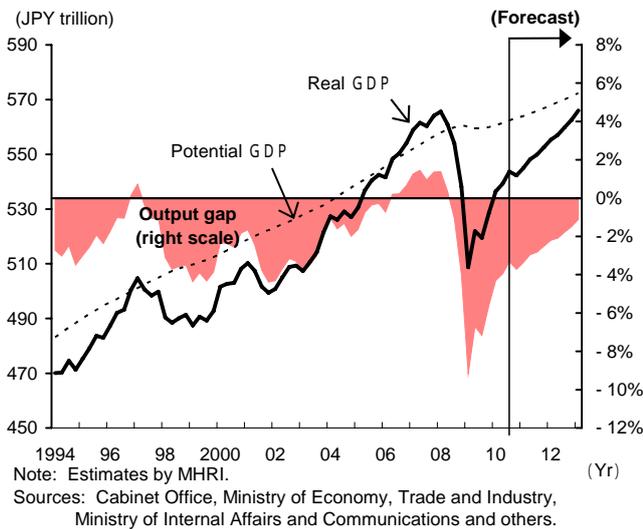
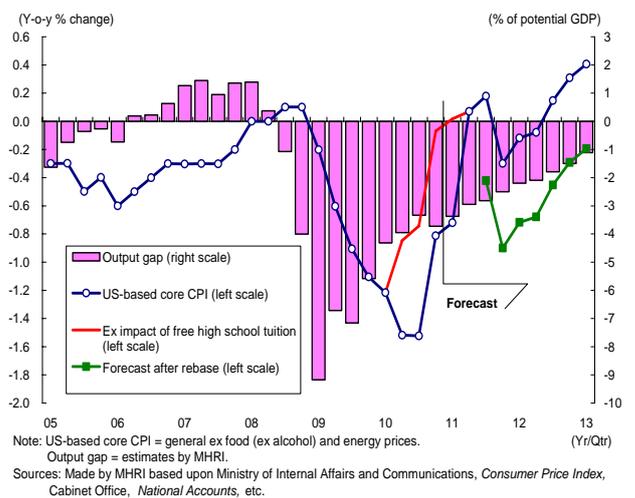


Chart 12: Japan’s output gap and US-based core CPI



* * * * *

