

REVISED
to reflect the
2nd QE for the
Jul-Sep Qtr
of 2014

FY2014, FY2015 Economic Outlook

- The “Triple Merits” will boost the Japanese economy -

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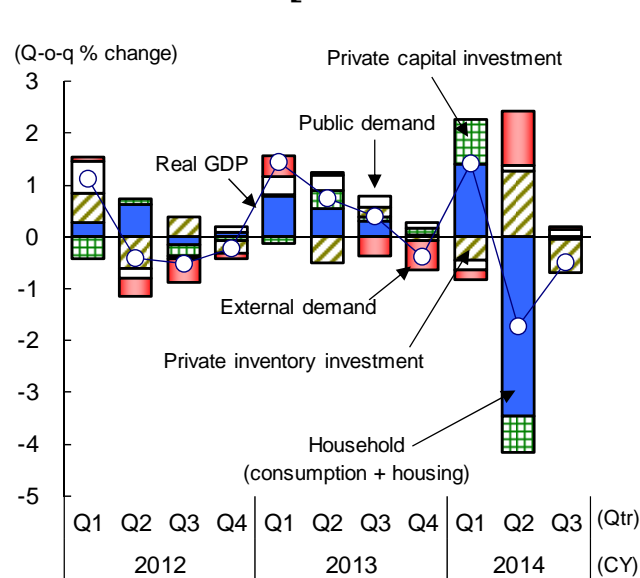
The second consumption tax hike has been postponed – the Japanese economy is set to expand in FY2015, on the back of economic measures to support consumer spending

- In view of the contraction of the economy for the second quarter in a row in the Jul-Sep quarter of 2014, the consumption tax hike scheduled in October 2015 has been postponed to April 2017. At the same time, we expect the compilation of economic stimulus measures to support the low-income bracket of consumers and child rearing families.
- From the Oct-Dec quarter of 2014, the Japanese economy should gradually return to a recovery track as the backlash to the last-minute rush of demand prior to the 2014 consumption tax hike wears off. Personal consumption will continue to pick up amid the improvement of labor market conditions, the materialization of the wealth effect, and financial support toward the low-income bracket of consumers. Even the decision to delay the consumption tax hike will have a positive impact upon confidence among consumers in the low-income bracket. Exports and capital investment should also continue to pick up. Nevertheless, the contraction in the first half of the fiscal year will drag down growth, leading to a contraction (-0.6%) in FY2014.
- In FY2015, a further rise of wages as a result of the *shunto* annual labor-management negotiations should serve as tailwinds, leading to the steady growth of personal consumption. Look forward to the expansion of the economy driven by the recovery of exports and ongoing increase of capital investment. Growth in FY2015 is projected to reach +2.4%.
- Given the peak-out of import prices, the year-on-year change of the core CPI (excluding the impact of the consumption tax hike) will fall to around 0.5% toward the end of FY2014 (end of March 2015). Even though the inflation rate should turn upward due to factors such as the rise of the annual wage hike of base wages (the “base-up”), the achievement of the inflation target of “2% in two years” appears unlikely. Even so, the core inflation rate (excluding the impact of volatile prices such as energy) should improve steadily in FY2015.

1. The *Second Preliminary Quarterly Estimates of GDP (2nd QE)* for the Jul-Sep quarter of 2014: a slight downward revision of capital investment and public investment

- The *Second Preliminary Quarterly Estimates of GDP (2nd QE)* for the Jul-Sep quarter of 2014 released by the Cabinet Office revealed that Japan's real GDP contracted (-0.5% q-o-q or -1.9% p.a.), in a slight downward revision from the *First Preliminary Quarterly Estimates of GDP (1st QE)* (-0.4% q-o-q or -1.6% p.a.).
- Capital investment was revised down from -0.2% q-o-q to -0.4% q-o-q. In addition to activity among individual proprietorships which served as a drag, the high level of components forecasted on a provisional basis (provisional forecasts of demand based upon trend cycle components of supply-side data) was also a major factor.
- Inventory investment remained unchanged from the *1st QE*. Public investment and housing investment were revised down slightly.
- Our view remains unchanged from the *1st QE* that economic growth turned out weak due to the reduction of inventories and the stagnation of personal consumption because of unseasonable weather conditions among other factors.

[GDP in the Jul-Sep quarter of 2014 (2nd QE)]



Source: Made by Mizuho Research Institute (MHRI) based upon Cabinet Office, *National Accounts*.

	(Q-o-q change)				1 st QE Jul-Sep
	2013 Oct-Dec	2014 Jan-Mar	Apr-Jun	Jul-Sep	
Gross domestic production	-0.4	1.4	-1.7	-0.5	-0.4
(Q-o-q change, p.a.)	-1.5	5.8	-6.7	-1.9	-1.6
(Y-o-y change)	2.3	2.5	-0.3	-1.3	-1.2
Domestic demand	0.2	1.6	-2.7	-0.5	-0.5
	(0.2)	(1.6)	(-2.8)	(-0.5)	(-0.5)
Private demand	0.1	2.3	-3.7	-0.9	-0.9
	(0.1)	(1.8)	(-2.9)	(-0.7)	(-0.7)
Personal consumption	-0.1	2.2	-5.1	0.4	0.4
Housing investment	2.2	2.3	-10.0	-6.8	-6.7
Capital investment	1.0	6.2	-4.7	-0.4	-0.2
Inventory investment	(-0.1)	(-0.4)	(1.3)	(-0.6)	(-0.6)
Public demand	0.4	-0.8	0.5	0.5	0.7
	(0.1)	(-0.2)	(0.1)	(0.1)	(0.2)
Government consumption	0.1	-0.3	0.3	0.3	0.3
Public investment	1.6	-2.7	0.9	1.4	2.2
External demand	(-0.6)	(-0.2)	(1.0)	(0.1)	(0.1)
Exports	0.2	6.4	-0.5	1.3	1.3
Imports	3.7	6.2	-5.4	0.7	0.8
Nominal GDP	0.2	1.3	0.1	-0.9	-0.8
GDP deflator (y-o-y change)	-0.3	0.1	2.1	2.0	2.1

Note: The figures in parentheses indicate the contributions to gross domestic production.
Source: Cabinet Office, *National Accounts*.

2. Outlook on the Japanese economy (1): look forward to economic expansion driven by the “Triple Merits”

- In Japan, the consumption tax hike was postponed to April 2017. A virtuous cycle will start to unfold, leading to the expansion of the economy.
 - In FY2014, the economy should return to a recovery track in the second half of the fiscal year. Having said so, the contraction in the first half of the fiscal year will serve as a drag, keeping growth in negative territory (-0.6%) even on a full-year basis.
 - In FY2015, the economy should start to expand, driven by the “Triple Merits” (fiscal policy measures such as economic stimulus measures, additional monetary easing by the Bank of Japan, fall of crude oil prices).
 - Real GDP growth is projected to grow 2.4% in FY2015. Nominal GDP should grow +3.5% in FY2015, reaching the highest level since FY1991 (+4.9%).

[Outlook on the Japanese economy]

		2012	2013	2014	2015	2013	2014				2015				2016
		FY				Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Sep	Jan-Mar
GDP (real)	Q-o-q % ch	1.0	2.1	-0.6	2.4	-0.4	1.4	-1.7	-0.5	0.8	0.8	0.6	0.6	0.6	0.4
	Q-o-q % ch p.a.	--	--	--	--	-1.5	5.8	-6.7	-1.9	3.3	3.2	2.6	2.5	2.4	1.5
Domestic demand	Q-o-q % ch	1.8	2.5	-1.1	2.2	0.2	1.6	-2.7	-0.5	0.8	0.8	0.6	0.6	0.5	0.3
Private sector demand	Q-o-q % ch	1.9	2.3	-1.6	2.8	0.1	2.3	-3.7	-0.9	1.1	1.1	0.7	0.6	0.6	0.3
Personal consumption	Q-o-q % ch	1.8	2.5	-2.7	2.2	-0.1	2.2	-5.1	0.4	0.8	0.8	0.5	0.4	0.4	0.3
Housing investment	Q-o-q % ch	5.7	9.3	-11.4	3.1	2.2	2.3	-10.0	-6.8	-0.8	2.3	2.2	1.3	0.6	-0.0
Capital investment	Q-o-q % ch	1.2	4.0	1.9	4.7	1.0	6.2	-4.7	-0.4	3.6	1.4	0.7	0.8	1.0	0.8
Inventory investment	Q-o-q contribution, % pt	0.0	-0.5	0.5	0.0	-0.1	-0.4	1.3	-0.6	-0.1	0.1	0.1	0.1	0.0	-0.1
Public sector demand	Q-o-q % ch	1.4	3.2	0.4	0.6	0.4	-0.8	0.5	0.5	-0.2	-0.2	0.1	0.3	0.4	0.5
Government consumption	Q-o-q % ch	1.5	1.6	0.5	1.4	0.1	-0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.5
Public investment	Q-o-q % ch	1.0	10.3	-0.3	-2.9	1.6	-2.7	0.9	1.4	-2.3	-2.4	-0.9	0.2	0.2	0.2
External demand	Q-o-q contribution, % pt	-0.8	-0.4	0.5	0.2	-0.6	-0.2	1.0	0.1	-0.0	0.0	0.0	0.0	0.1	0.1
Exports	Q-o-q % ch	-1.3	4.7	6.0	5.6	0.2	6.4	-0.5	1.3	1.1	1.2	1.4	1.5	1.6	1.6
Imports	Q-o-q % ch	3.6	6.7	2.4	4.2	3.7	6.2	-5.4	0.7	1.0	1.0	1.0	1.1	1.1	1.2
GDP (nominal)	Q-o-q % ch	0.1	1.8	1.8	3.5	0.2	1.3	0.1	-0.9	1.9	1.1	0.9	0.5	1.2	-0.1
GDP deflator	Y-o-y % ch	-0.9	-0.3	2.4	1.1	-0.4	0.1	2.1	2.0	2.5	2.9	1.4	1.7	1.1	0.4
Domestic demand deflator	Y-o-y % ch	-0.8	0.4	2.0	0.3	0.5	0.8	2.5	2.4	1.8	1.4	-0.1	0.2	0.4	0.6

Notes: Figures in the shaded areas are forecasts.
Source: Made by MHRI based upon Cabinet Office, *National Accounts*.

2. Outlook on the Japanese economy (2): although the CPI will fall to 0.5%, it will start to improve thereafter

[Outlook on the Japanese economy (major economic indicators)]

		2012	2013	2014	2015	2013	2014				2015				2016
		FY				Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Sep	Jan-Mar
Industrial production	Q-o-q % ch	-2.9	3.2	-0.9	2.9	1.8	2.9	-3.8	-1.9	1.2	1.1	0.7	0.8	0.9	0.7
Ordinary profits	Y-o-y % ch	8.1	20.9	7.4	9.7	25.1	17.2	2.8	7.4	10.6	8.6	14.3	14.1	6.4	5.5
Nominal compensation of employees	Y-o-y % ch	0.1	1.0	1.7	1.7	1.5	0.6	1.7	2.4	1.3	1.2	1.4	1.7	2.0	1.5
Unemployment rate	%	4.3	3.9	3.6	3.5	3.9	3.6	3.6	3.6	3.6	3.6	3.5	3.5	3.5	3.5
New housing starts	P.a., 10,000 units	89.3	98.7	88.1	92.0	104.1	93.4	88.7	85.5	88.3	90.0	91.5	92.5	92.2	92.0
Current account balance	P.a., JPY tril	4.2	0.8	5.6	11.2	0.0	-5.5	2.8	2.6	9.9	8.3	11.2	11.5	15.0	8.3
Domestic corporate goods prices	Y-o-y % ch	-1.1	1.9	3.2	0.2	2.5	2.0	4.3	4.0	2.7	1.9	-0.5	-0.0	0.4	1.0
Consumer prices	Y-o-y % ch	-0.2	0.8	2.9	0.8	1.1	1.3	3.3	3.2	2.7	2.5	0.6	0.7	1.0	1.1
Consumer prices (ex consumption tax)	Y-o-y % ch	-0.2	0.8	0.9	0.8	1.1	1.3	1.4	1.2	0.7	0.5	0.6	0.7	1.0	1.1
Uncollateralized overnight call rate	%	0.06	0.04	0~0.10	0~0.10	0.07	0.04	0.06	0.03	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	%	0.78	0.69	0.54	0.70	0.64	0.63	0.60	0.53	0.47	0.55	0.60	0.70	0.70	0.80
Nikkei average	JPY	9,650	14,424	16,300	18,900	14,972	14,964	14,650	15,562	16,800	18,200	18,400	18,600	19,100	19,400
Exchange rate	JPY/USD	83.0	100.0	111.0	123.0	101.0	103.0	102.0	104.0	115.0	121.0	121.0	122.0	124.0	124.0
Crude oil price (WTI nearest term contract)	USD/bbl	92.0	99.0	83.0	61.0	98.0	99.0	103.0	97.0	74.0	60.0	61.0	61.0	61.0	63.0

- Notes: 1. Figures in the shaded areas are forecasts. 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) (ex finance & insurance, and production, transmission and distribution of electricity services).
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, the yield on newly-issued 10-yr JGBs refers to the average of the end-of-month rates during the relevant term, and all others are averages during the relevant terms.

Sources: Made by MHRl 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

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