

REVISED  
to reflect the  
2<sup>nd</sup> QE for the  
Jul-Sep Qtr  
of 2016

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# FY2016, FY2017 Economic Outlook

- Considering the coming Trump administration's policy agenda, forecasts have been revised upward mainly on the US economy -

December 8, 2016

Mizuho Research Institute

## Key points of our forecast

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- ❑ We have revised upward our outlook on the US economy in view of the impact of the coming Trump administration's policy agenda such as its fiscal policy measures
- ❑ Our outlook on the global economy has also been upwardly revised, given the upward revision of our outlooks on the Eurozone, Japan and Asian economies (ex China)
- ❑ As for US fiscal policy, our forecast is based upon the assumption of a large-scale tax cut in the summer of 2017 and increase of budget expenditures from the turn of the new fiscal year
- ❑ However, note the existence of downside risks stemming from Donald Trump's attacks upon individual corporations, excessive dollar appreciation and protectionism and upside risks due to deregulation and the rise of growth expectations
- ❑ On US monetary policy, we expect two interest rate hikes in 2017 following a rate hike in December 2016
- ❑ Since the US policy mix of fiscal expansion and interest rate hikes will serve as dollar-strengthening pressures, we have revised our forex forecast to a weaker yen and stronger dollar. We have also revised upward our forecasts on long-term interest rates and stock markets
- ❑ However, an excessive dollar appreciation may serve as downside pressures upon the US and emerging market (EM) economies and trigger the intensification of US protectionism
- ❑ We have revised upward our outlooks on Japan's economic growth and inflation in FY2017, reflecting the depreciation of the yen stemming from optimism toward Trumponomics
- ❑ The benchmark year revision of Japan's GDP raises the average rate of real GDP growth since the launch of Abenomics by 0.5%pt

## 1. Overview: the global economy will pick up in 2017 and keep a close eye upon the coming US administration's policy agenda

- We have revised upward MHRI's *Economic Outlook* mainly with respect to the US in view of the impact of the economic policies of the coming US Trump administration.
  - However, since we have not factored in any protectionist policies, it should be noted that the implementation of such policies would serve as downside risks upon both the US and global economies.

### [ Outlook on the global economy ]

| Calendar year                  | (Y-o-y % change) |                  |                    |                    | (%pt)                     |      |                                      |      |
|--------------------------------|------------------|------------------|--------------------|--------------------|---------------------------|------|--------------------------------------|------|
|                                | 2014<br>(Actual) | 2015<br>(Actual) | 2016<br>(Forecast) | 2017<br>(Forecast) | 2016<br>(Forecast in Nov) | 2017 | 2016<br>(Breadth of change from Nov) | 2017 |
| Total of forecast area         | 3.6              | 3.4              | 3.3                | 3.7                | 3.3                       | 3.6  | -                                    | 0.1  |
| Japan, US, Eurozone            | 1.7              | 2.2              | 1.5                | 1.7                | 1.4                       | 1.6  | 0.1                                  | 0.1  |
| US                             | 2.4              | 2.6              | 1.6                | 2.2                | 1.5                       | 2.1  | 0.1                                  | 0.1  |
| Eurozone                       | 1.2              | 2.0              | 1.6                | 1.3                | 1.6                       | 1.1  | -                                    | 0.2  |
| Japan                          | 0.3              | 1.2              | 1.0                | 1.1                | 0.7                       | 1.0  | 0.3                                  | 0.1  |
| Asia                           | 6.4              | 6.1              | 6.0                | 6.0                | 6.1                       | 6.0  | -0.1                                 | -    |
| China                          | 7.3              | 6.9              | 6.7                | 6.5                | 6.7                       | 6.5  | -                                    | -    |
| NIEs                           | 3.5              | 2.0              | 2.0                | 2.2                | 1.9                       | 2.1  | 0.1                                  | 0.1  |
| ASEAN5                         | 4.6              | 4.8              | 4.8                | 4.7                | 4.8                       | 4.6  | -                                    | 0.1  |
| India                          | 7.0              | 7.2              | 7.0                | 7.6                | 7.6                       | 7.5  | -0.6                                 | 0.1  |
| Australia                      | 2.7              | 2.4              | 2.4                | 2.5                | 2.8                       | 2.5  | -0.4                                 | -    |
| Brazil                         | 0.1              | -3.8             | -3.4               | 1.0                | -3.2                      | 1.2  | -0.2                                 | -0.2 |
| Russia                         | 0.7              | -3.7             | -0.7               | 1.0                | -0.7                      | 1.0  | -                                    | -    |
| Japan (FY)                     | -0.4             | 1.3              | 1.2                | 1.2                | 0.9                       | 1.0  | 0.3                                  | 0.2  |
| Crude oil price (WTI, USD/bbl) | 93               | 49               | 43                 | 55                 | 43                        | 55   | -                                    | -    |

Note: The total of the forecast area is calculated upon the 2014 GDP share (PPP) by the IMF

Sources: Made by MHRI based upon International Monetary Fund (IMF) and statistics of relevant countries and regions

**The financial markets: outlooks have been revised on the foreign exchange rate (weaker yen), interest rates and stock markets (both revised upward) due to impact of Trumponomics**

[ Outlook on the financial markets (December 2016) ]

|   | 2015<br>FY | 2016<br>FY | 2017<br>FY | 2016      |           | 2017      |           |           |           | 2018      |
|---|------------|------------|------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
|   |            |            |            | Jul-Sep   | Oct-Dec   | Jan-Mar   | Apr-Jun   | Jul-Sep   | Oct-Sep   | Jan-Mar   |
| Japan   |            |            |            |           |           |           |           |           |           |           |
| Uncollateralized overnight call rate (End of period, %) | -0.00      | -0.05      | -0.05      | -0.06     | -0.05     | -0.05     | -0.05     | -0.05     | -0.05     | -0.05     |
| Euroyen TIBOR (3-mo, %)                                 | 0.16       | 0.06       | 0.06       | 0.06      | 0.06      | 0.06      | 0.06      | 0.06      | 0.06      | 0.06      |
| Interest rate swaps (5-yr, %)                           | 0.17       | -0.03      | 0.05       | -0.10     | 0.02      | 0.05      | 0.05      | 0.05      | 0.05      | 0.05      |
| Newly-issued JGBs (10-yr, %)                            | 0.29       | -0.05      | 0.00       | -0.13     | -0.01     | 0.00      | 0.00      | 0.00      | 0.00      | 0.00      |
| Nikkei average (JPY)                                    | 18,841     | 17,400     | 19,800     | 16,497    | 17,700    | 18,800    | 19,100    | 19,600    | 19,900    | 20,400    |
| US  |            |            |            |           |           |           |           |           |           |           |
| Federal funds rate (End-of-period, %)                   | 0.25~0.50  | 0.50~0.75  | 1.25~1.50  | 0.25~0.50 | 0.50~0.75 | 0.50~0.75 | 0.75~1.00 | 0.75~1.00 | 1.00~1.25 | 1.25~1.50 |
| Newly-issued government bonds (10-yr, %)                | 2.12       | 1.95       | 2.50       | 1.56      | 2.10      | 2.40      | 2.40      | 2.50      | 2.50      | 2.60      |
| Dow Jones average (USD)                                 | 17,298     | 18,500     | 19,600     | 18,368    | 18,600    | 19,100    | 19,200    | 19,500    | 19,700    | 20,000    |
| Eurozone  |            |            |            |           |           |           |           |           |           |           |
| ECB key policy interest rate (End-of-period, %)         | 0.00       | 0.00       | 0.00       | 0.00      | 0.00      | 0.00      | 0.00      | 0.00      | 0.00      | 0.00      |
| German government bonds (10-yr, %)                      | 0.53       | 0.10       | 0.35       | -0.07     | 0.15      | 0.25      | 0.25      | 0.35      | 0.35      | 0.35      |
| Foreign exchange rate                                   |            |            |            |           |           |           |           |           |           |           |
| JPY/USD (JPY/USD)                                       | 120        | 108        | 115        | 102       | 109       | 114       | 114       | 115       | 116       | 117       |
| USD/EUR (USD/EUR)                                       | 1.10       | 1.09       | 1.03       | 1.12      | 1.08      | 1.04      | 1.04      | 1.03      | 1.02      | 1.02      |
| Crude oil price (WTI nearest term contract) USD/bbl     | 45         | 47         | 58         | 45        | 49        | 50        | 52        | 56        | 59        | 62        |

Notes: The shaded areas are forecasts. The forecasts are averages of the relevant periods. However, the uncollateralized overnight call rate, federal funds rate and the ECB key policy interest rate are end-of-period rates.

Euroyen TIBOR (360-day basis). 5-yr swaps are fixed interest payments on 6-mo LIBOR. Foreign exchange rate based upon New York end-of-day rates.

Source: Made by MHRI based upon Bloomberg

## 2. The US economy: the new administration's fiscal policy measures will push up the economy from mid-2017

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- ❑ US real GDP grew a strong +3.2% q-o-q p.a. in the Jul-Sep quarter of 2016 reflecting upward pressures from inventory investment and external demand (revised upward from the Advance estimate of +2.9% q-o-q p.a.). Our outlooks on real GDP growth are +1.6% for 2016 and +2.2% for 2017, both revised upward by +0.1%pt from MHRI's *Economic Outlook* in November
- ❑ The rate of real GDP growth in 2016 takes into consideration the upward revision of actual growth in the Jul-Sep quarter and prospects of solid personal consumption growth in the Oct-Dec quarter. However, exports will likely be subject to a backlash to the Jul-Sep quarter and corporate investment in equipment and facilities etc. are also expected to be tepid
- ❑ Although our forecast scenario in MHRI's November *Economic Outlook* was that growth in 2017 would "recover, albeit moderately", the latest *Economic Outlook* factors in US president-elect Donald Trump's fiscal policy agenda (tax cuts, infrastructure investment, increase of defense spending). In spite of the sharp rise of the US dollar since the end of the US presidential election, and in view of its downward impact upon personal consumption and external demand, the US economy is forecast to grow slightly stronger than previously expected
- ❑ In MHRI's latest *Economic Outlook*, fiscal policy measures are assumed to be implemented from the second half of 2017, based upon the assumption of smooth policy management between president-elect Donald Trump and the Republican Party. There are lingering downside risks due to the rise of uncertainties stemming from currency and trade policy. On the other hand, the rise of corporate expectations due to deregulation will serve as upside risks
- ❑ Turning to US monetary policy, we expect two interest rate hikes a year amid cross-currents of inflationary pressures stemming from fiscal policy and disinflationary pressures due to the appreciation of the US dollar

## The US economy: we have revised upward our outlook, reflecting the impact of the coming Trump administration's fiscal policy agenda and appreciation of the US dollar

- We have revised upward our outlook on US economic growth in 2016 to +1.6% (November forecast: +1.5%) and in 2017 to +2.2% (September forecast: +2.1%).
  - Jul-Sep quarter results have been revised upward. In addition, we have revised our forecast on the Oct-Dec quarter, reflecting the solid growth of personal consumption.
  - In 2017, fiscal policy measures are expected to take effect around mid-year. Furthermore, our revision takes into consideration the impact of the appreciation of the dollar upon personal consumption and external demand.
    - Downside risks linger due to the rise of uncertainties stemming from currency and trade policy. On the other hand, the rise of corporate expectations due to deregulation will serve as upside risks.

### [ Outlook on the US economy ]

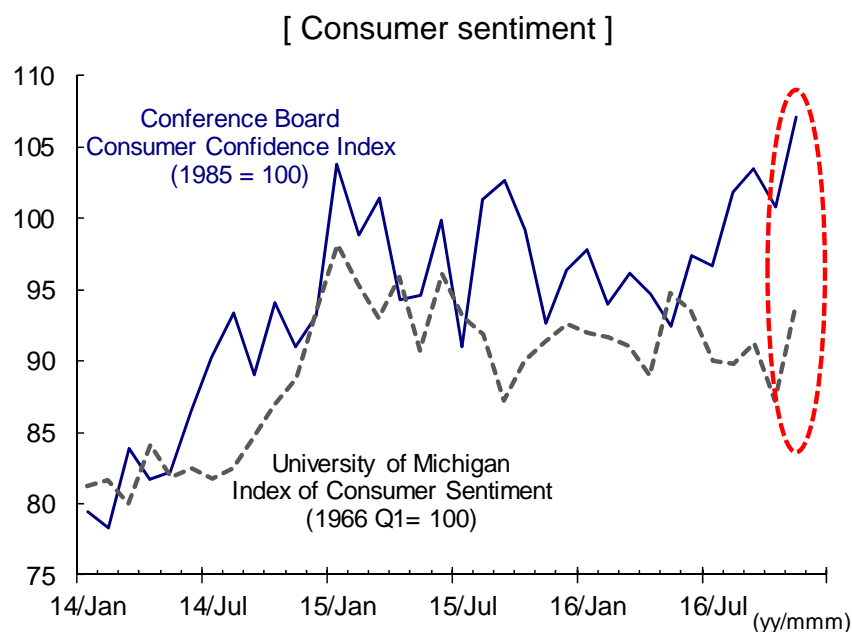
|                                      |                                | 2015 | 2016 | 2017 | 2015    |         |         |         | 2016    |         |         |         | 2017    |         |         |         |
|--------------------------------------|--------------------------------|------|------|------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
|                                      |                                | CY   |      |      | Jan-Mar | Apr-Jun | Jul-Sep | Oct-Dec | Jan-Mar | Apr-Jun | Jul-Sep | Oct-Dec | Jan-Mar | Apr-Jun | Jul-Sep | Oct-Dec |
| Real GDP                             | Q-o-q % ch, p.a.               | 2.6  | 1.6  | 2.2  | 2.0     | 2.6     | 2.0     | 0.9     | 0.8     | 1.4     | 3.2     | 1.9     | 1.8     | 2.3     | 2.3     | 2.3     |
| Personal consumption                 | Q-o-q % ch, p.a.               | 3.2  | 2.7  | 2.5  | 2.4     | 2.9     | 2.7     | 2.3     | 1.6     | 4.3     | 2.8     | 2.8     | 2.3     | 2.3     | 2.0     | 2.0     |
| Housing investment                   | Q-o-q % ch, p.a.               | 11.7 | 4.4  | 1.8  | 13.3    | 14.9    | 12.6    | 11.5    | 7.8     | -7.7    | -4.4    | 2.7     | 3.2     | 3.5     | 5.2     | 4.6     |
| Capital investment                   | Q-o-q % ch, p.a.               | 2.1  | -0.7 | 1.9  | 1.3     | 1.6     | 3.9     | -3.3    | -3.4    | 1.0     | 0.1     | 0.7     | 2.1     | 3.2     | 3.0     | 3.0     |
| Inventory investment                 | Contribution, q-o-q % ch, p.a. | 0.2  | -0.2 | -0.0 | 1.0     | -0.5    | -0.6    | -0.4    | -0.4    | -1.2    | 0.5     | 0.1     | -0.2    | 0.0     | 0.0     | 0.0     |
| Government spending                  | Q-o-q % ch, p.a.               | 1.8  | 0.8  | 0.3  | 2.6     | 3.2     | 1.9     | 1.0     | 1.6     | -1.7    | 0.2     | 0.5     | 0.5     | 0.4     | 0.4     | 0.4     |
| Net exports                          | Contribution, q-o-q % ch, p.a. | -0.7 | 0.2  | 0.1  | -1.7    | -0.1    | -0.5    | -0.5    | 0.0     | 0.2     | 0.9     | -0.4    | -0.1    | 0.1     | 0.1     | 0.1     |
| Exports                              | Q-o-q % ch, p.a.               | 0.1  | 0.4  | 1.7  | -5.8    | 2.9     | -2.8    | -2.7    | -0.7    | 1.8     | 10.1    | -3.6    | 1.0     | 2.0     | 2.3     | 2.0     |
| Imports                              | Q-o-q % ch, p.a.               | 4.6  | 0.6  | 0.9  | 5.6     | 2.9     | 1.1     | 0.7     | -0.6    | 0.2     | 2.1     | -0.1    | 1.2     | 1.1     | 0.9     | 0.7     |
| Unemployment rate                    | %                              | 5.3  | 4.9  | 4.6  | 5.6     | 5.4     | 5.2     | 5.0     | 4.9     | 4.9     | 4.9     | 4.8     | 4.8     | 4.7     | 4.6     | 4.5     |
| Nonfarm payrolls                     | (per month, 1,000)             | 229  | 186  | 221  | 190     | 251     | 192     | 282     | 196     | 146     | 206     | 195     | 188     | 225     | 225     | 244     |
| PCE deflator                         | Y-o-y % ch                     | 0.3  | 1.1  | 2.1  | 0.3     | 0.3     | 0.3     | 0.4     | 0.9     | 1.0     | 1.0     | 1.5     | 2.0     | 2.0     | 2.2     | 2.2     |
| Core PCE deflator ex food and energy | Y-o-y % ch                     | 1.4  | 1.7  | 1.8  | 1.4     | 1.4     | 1.3     | 1.4     | 1.6     | 1.6     | 1.7     | 1.8     | 1.8     | 1.8     | 1.8     | 1.9     |

Note: The shaded areas are forecasts

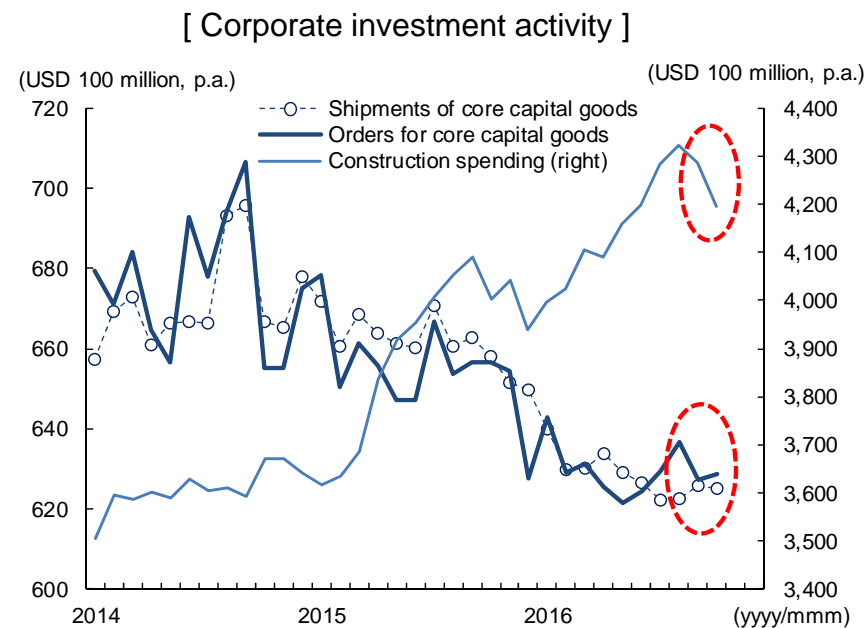
Source: Made by MHRI based upon the US Department of Commerce, US Department of Labor

## The US economy: economic indicators are generally improving after the presidential election

- Personal consumption is following firm footing. Corporate business sentiment is also improving. However, latest data indicate lingering weaknesses in corporate investment activity.
  - Consumer sentiment is favorable, reflecting the strength of employment conditions and the rise of the stock market.
    - November employment data revealed that unemployment rate (the “U-6 unemployment rate which has the broadest coverage of unemployment) fell 0.2 pt from the previous month to 9.3%, reaching the lowest level since April 2008.
  - The ISM index rose in both the manufacturing and nonmanufacturing sectors, indicating that corporate business sentiment is continuing to improve.
    - The ISM manufacturing index stood at 53.2 (up 1.3pt from the previous month) and the ISM nonmanufacturing index rose to 57.2 (up 2.4pt from the previous month).
  - On the other hand, the recovery of core capital goods orders/shippments remains tepid and construction investment is peaking out.



Source: Made by MHRI based upon University of Michigan, Conference Board



Source: Made by MHRI based upon the US Department of Commerce

## The US economy: large-scale tax cuts and government spending hike assumed around the summer of 2017 and the turn of the fiscal year respectively

- Tax cuts with respect to both personal income and corporate income are assumed to be implemented by July 2017. Infrastructure investment and increase of defense spending are assumed in the FY2018 budget.
  - The average tax rate for personal income tax is assumed to be reduced 2%pt and the highest corporate tax rate is assumed to be slashed 20%pt.
    - Donald Trump’s campaign pledge also includes various tax cut measures apart from the foregoing.
    - However, the chances are slim that all of Mr. Trump’s campaign pledges will be realized due to the existence of Republican congressional members who are concerned about the expansion of the fiscal deficit.
  - Our outlook on domestic demand has been revised upward while our outlook on external demand has been revised downward from our forecast in November due to the appreciation of the US dollar and the fiscal expansion from mid-2017.

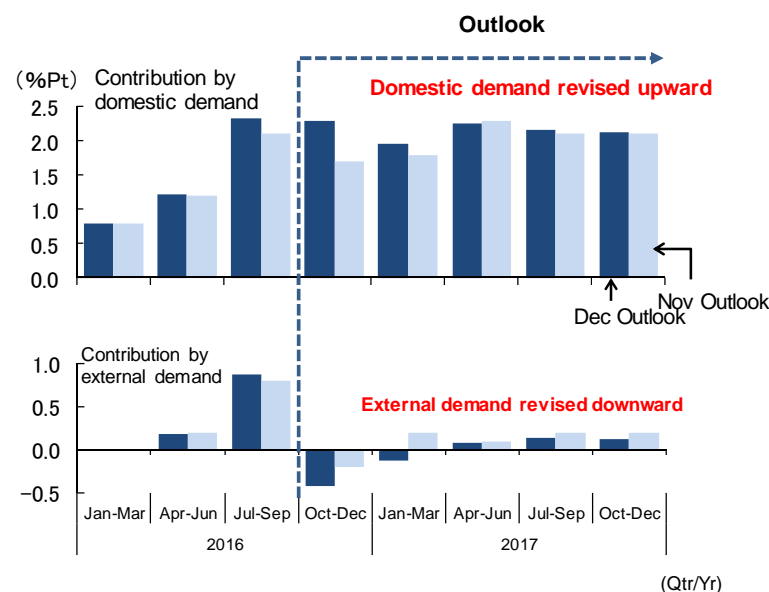
### [ Assumptions on fiscal policy ]

|                                  |   |
|----------------------------------|---|
| <b>Personal income tax cut</b>   | Income tax rate of a standard household will fall by 2%pt<br>To be implemented in July 2017   |
| <b>Corporate income tax cut</b>  | Corporate income tax rate will fall by 20%pt<br>To be implemented in July 2017  |
| <b>Infrastructure investment</b> | USD550 billion in 10 years (according to the presidential transition website). To be divided evenly on a quarterly basis<br>To start in the Oct-Dec quarter of 2017 |
| <b>Defense spending increase</b> | Increase defense spending level by a repeal of sequestration<br>To start in the Oct-Dec quarter of 2017   |

Note: The impact of the above measures are simulated by the FRB/US model.  
The change in the USD exchange rate is also reflected

Source: Made by MHRI

### [ Comparison of MHRI’s outlooks in November and December ]



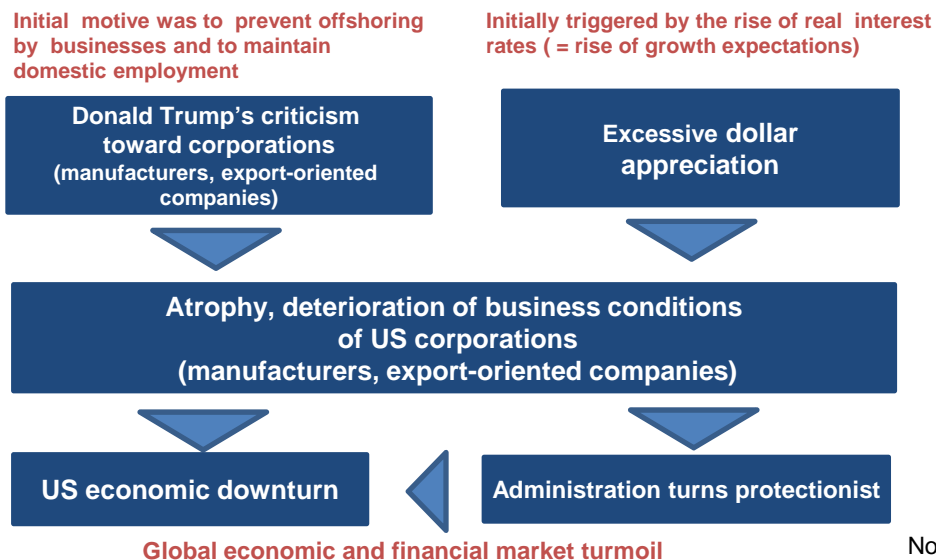
Source: Made by MHRI



## The US economy: downside risks of corporate criticism and protectionism. Upside risks of deregulation and rise of growth expectations

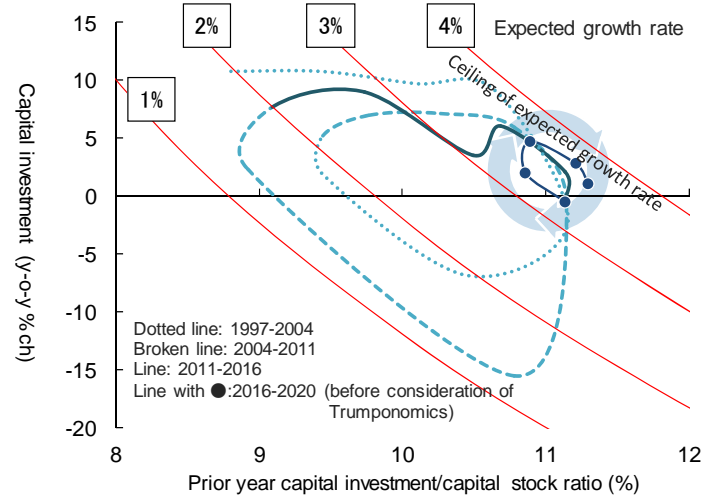
- Donald Trump's attacks upon individual corporations, excessive dollar appreciation and protectionism are downside risks. Deregulation and the rise of growth expectations are upside risks.
  - Mr. Trump's corporate criticism and excessive dollar appreciation may well serve as a trigger of protectionism as a result of the deterioration of business sentiment among the manufacturing and export-oriented sectors.
    - Mr. Trump's criticisms may raise concerns among corporations that "it would become difficult to adjust labor in times of business difficulties", and lead to curbs upon employment and investment.
    - There is the risk of the US administration shifting to a protectionist stance in the event of a significant deterioration of corporate business sentiment and employment as a result of the excessive appreciation of the US dollar.
  - On the other hand, if market exploitation stemming from deregulation leads to the rise of corporate growth expectations, it would serve as upside risks upon the US economy.
    - Success in raising corporate growth expectations may lead to a prolonged capital investment boom.

### [ Downside risks of the US economy ]



Source: Made by MHRI

### [ Relationship between capital investment and expectations on economic growth ]



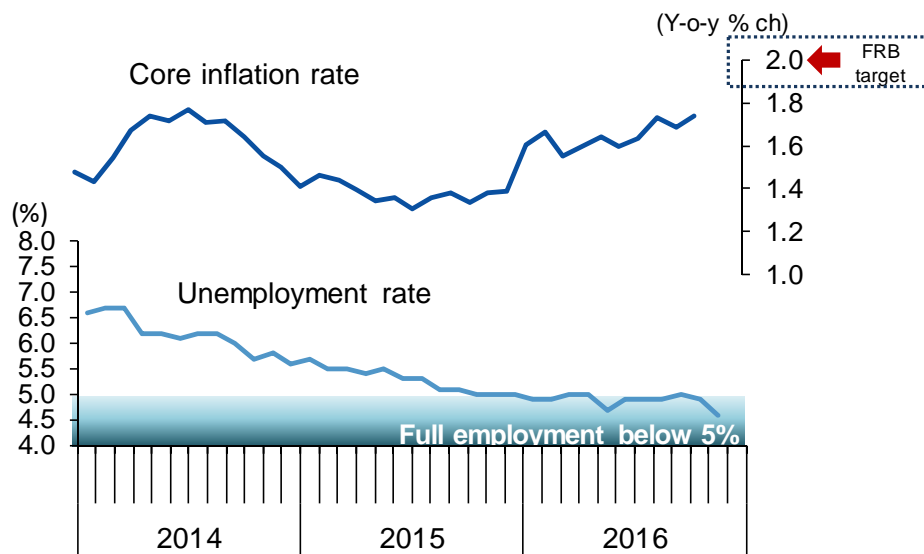
Note: The expected growth rate is based upon the assumption of zero growth of capital coefficient, 8.0% depreciation rate

Source: Made by MHRI based upon US Department of Commerce

## US: FOMC is forecast to implement two interest rate hikes a year in 2017

- The Federal Open Market Committee (FOMC) is expected to implement interest rate hikes twice a year (in June and December), keeping a close eye upon Trumponomics market movements.
  - Subsequent to a rate hike in December 2016, the FOMC will likely take a wait-and-see stance for six months or so while monitoring economic indicators, the policy agenda and financial market developments.
  - The odds are high that Congressional Republicans will review financial regulations (repeal of Dodd-Frank Act) and intervene more aggressively in monetary policy (such as the introduction of monetary policy rules).
    - The coming administration's currency policy may also have an impact upon the FOMC's policy of raising rates in gradual steps.

[ Unemployment rate and inflation rate ]



Note: Core inflation rate refers to the rate of change of the PCE deflator (ex food and energy)  
 Source: Made by MHRI based upon US Department of Commerce, US Department of Labor

[ Political issues regarding the FOMC/FRB ]

|                             |   |
|-----------------------------|---|
| <b>Financial regulation</b> | <ul style="list-style-type: none"> <li>▪ Review/repeal of Dodd-Frank Act</li> </ul>   |
| <b>Monetary policy</b>      | <ul style="list-style-type: none"> <li>▪ Establishment of oversight committee</li> <li>▪ Introduction of rules regarding monetary policy</li> <li>▪ Currency policy (Secretary of the Treasury Steven Mnuchin)</li> </ul> |
| <b>Key appointments</b>     | <ul style="list-style-type: none"> <li>▪ Appointment of FRB board members (2)</li> <li>▪ Issue regarding renomination of FRB Chair Janet Yellen</li> </ul>  |

Note: There is a bill establishing the oversight committee such as The Centennial Monetary Commission Act of 2015, S.1786  
 Source: Made by MHRI

### 3. The Japanese economy: economic stimulus measures and “Trumponomics-led yen depreciation” will serve as tailwinds for FY2017

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- ❑ Although the *Second Preliminary Quarterly Estimates of GDP* (“2<sup>nd</sup> QE”) for the Jul-Sep quarter of 2016 revealed a downward revision of Japan’s economic growth, a closer look shows that the contents are not so bad. Despite a downward revision of inventory investment, personal consumption was revised upward
- ❑ The benchmark year revision of Japan’s GDP raises the average rate of real GDP growth since the launch of Abenomics by 0.5%pt. As a result, the rate of potential economic growth is also expected to rise. Furthermore, as a result of 2008 SNA implementation which includes “capitalization of R&D”, the level of nominal GDP was revised upward by approximately JPY30 trillion
- ❑ From the Oct-Dec quarter of 2016, the implementation of public investment accompanying economic stimulus measures and the “Trumponomics-led yen depreciation” will serve as underpinnings and lead to a gradual recovery. Growth rate will remain above 1%, reaching +1.2% in both FY2016 and FY2017
- ❑ The impact of Trumponomics will stem mostly from the depreciation of the yen up to the forecast horizon in FY2017. From FY2018 onward, the rise of US economic growth driven by large-scale tax cuts, preferential treatment of infrastructure investment and deregulation will also have a positive impact upon the Japanese economy. Even so, a note of caution is necessary regarding the risks stemming from US protectionism and uncertainties regarding the US policy agenda
- ❑ Given the appreciation of the yen and fall of crude oil prices in 2016, the year-on-year (y-o-y) change of the core CPI will remain in negative territory until around the end of 2016. From then onward, the y-o-y change of energy prices should rise to positive territory, lifting the core inflation rate to the 1%-level toward the latter half of the forecast horizon. The underlying trend in inflation excluding the impact of energy prices should remain slightly positive

**Japan: we have revised upward our forecast on growth in FY2016 and FY2017 from our *Economic Outlook* in November, to reflect factors such as the “Trumponomics-led yen depreciation”**

- We have revised upward our forecasts on growth in FY 2016 and FY2017 from our forecasts as of November to reflect the depreciation of the yen due to optimism toward Trumponomics and the benchmark year revision of GDP.
  - FY2016: the impact of the overseas economic slowdown and appreciation of the yen has served as negative pressures upon Japan’s growth. Even so, the growth rate should remain above 1%, reaching +1.2% as the rise of public demand and bottoming out of personal consumption serves as underpinnings.
    - Upward revision by 0.3%pt from the November *Economic Outlook* (+0.9%), of which 0.2%pt is due to the impact of the upward revision of actual data (from January to June of 2016).
  - FY2017: the growth rate is expected to be +1.2% (November *Economic Outlook*: +1.0%), given the full-fledged progress of economic stimulus measures and the “Trumponomics-led yen depreciation”.

[ Outlook on the Japanese economy ]

|                          |                          |  | 2014 | 2015 | 2016 | 2017 | 2015    |         | 2016    |         |         |         | 2017    |         |         |         | 2018    |
|--------------------------|--------------------------|--|------|------|------|------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
|                          |                          |  | FY   |      |      |      | Jul-Sep | Oct-Dec | Jan-Mar | Apr-Jun | Jul-Sep | Oct-Dec | Jan-Mar | Apr-Jun | Jul-Sep | Oct-Dec | Jan-Mar |
| GDP (real)               | Q-o-q % ch               |  | -0.4 | 1.3  | 1.2  | 1.2  | 0.2     | -0.4    | 0.7     | 0.5     | 0.3     | 0.2     | 0.2     | 0.3     | 0.3     | 0.4     | 0.3     |
|                          | Q-o-q % ch p.a.          |  | --   | --   | --   | --   | 0.8     | -1.8    | 2.8     | 1.8     | 1.3     | 0.9     | 0.9     | 1.1     | 1.3     | 1.4     | 1.3     |
| Domestic demand          | Q-o-q % ch               |  | -1.0 | 1.1  | 0.9  | 1.1  | 0.3     | -0.5    | 0.3     | 0.5     | -0.0    | 0.4     | 0.3     | 0.2     | 0.3     | 0.3     | 0.3     |
| Private sector demand    | Q-o-q % ch               |  | -1.4 | 1.1  | 0.8  | 0.9  | 0.3     | -0.7    | 0.1     | 0.9     | -0.1    | 0.2     | 0.2     | 0.2     | 0.3     | 0.3     | 0.3     |
| Personal consumption     | Q-o-q % ch               |  | -2.7 | 0.5  | 0.7  | 1.0  | 0.5     | -0.7    | 0.4     | 0.2     | 0.3     | 0.1     | 0.2     | 0.3     | 0.3     | 0.3     | 0.3     |
| Housing investment       | Q-o-q % ch               |  | -9.9 | 2.7  | 6.4  | -5.2 | 1.8     | -1.2    | 1.3     | 3.5     | 2.6     | 0.5     | -1.2    | -3.9    | -2.3    | -0.1    | 2.1     |
| Capital investment       | Q-o-q % ch               |  | 2.5  | 0.6  | 1.7  | 1.8  | 0.6     | 0.4     | -0.3    | 1.4     | -0.4    | 0.8     | 0.5     | 0.4     | 0.4     | 0.7     | 0.3     |
| Inventory investment     | Q-o-q contribution, % pt |  | 0.5  | 0.3  | -0.2 | -0.0 | -0.2    | -0.1    | -0.1    | 0.2     | -0.3    | -0.0    | -0.0    | 0.0     | 0.1     | -0.0    | -0.1    |
| Public sector demand     | Q-o-q % ch               |  | -0.1 | 1.2  | 1.1  | 1.8  | 0.2     | 0.0     | 1.0     | -0.6    | 0.3     | 1.0     | 0.5     | 0.4     | 0.3     | 0.3     | 0.3     |
| Government consumption   | Q-o-q % ch               |  | 0.4  | 2.0  | 0.9  | 1.3  | 0.4     | 0.7     | 1.3     | -1.1    | 0.3     | 0.4     | 0.4     | 0.3     | 0.3     | 0.3     | 0.3     |
| Public investment        | Q-o-q % ch               |  | -2.1 | -2.0 | 1.9  | 3.7  | -0.5    | -2.8    | -0.7    | 1.6     | 0.1     | 3.1     | 0.8     | 0.8     | 0.7     | 0.5     | 0.3     |
| External demand          | Q-o-q contribution, % pt |  | 0.6  | 0.2  | 0.3  | 0.1  | -0.1    | 0.1     | 0.4     | -0.1    | 0.3     | -0.2    | 0.0     | 0.0     | 0.0     | 0.1     | 0.0     |
| Exports                  | Q-o-q % ch               |  | 8.7  | 0.8  | 1.5  | 3.1  | 2.1     | -0.6    | 0.8     | -1.3    | 1.6     | 1.5     | 0.6     | 0.5     | 0.6     | 0.7     | 0.5     |
| Imports                  | Q-o-q % ch               |  | 4.1  | -0.2 | -0.3 | 2.8  | 2.5     | -0.9    | -1.2    | -0.9    | -0.4    | 2.7     | 1.0     | 0.2     | 0.4     | 0.4     | 0.4     |
| GDP (nominal)            | Q-o-q % ch               |  | 2.1  | 2.8  | 1.2  | 1.4  | 0.6     | -0.3    | 0.8     | 0.2     | 0.1     | 0.5     | 0.0     | 0.5     | 0.8     | 0.4     | -0.4    |
| GDP deflator             | Y-o-y % ch               |  | 2.5  | 1.4  | -0.0 | 0.3  | 1.8     | 1.5     | 0.9     | 0.4     | -0.2    | -0.1    | -0.3    | 0.0     | 0.7     | 0.5     | 0.0     |
| Domestic demand deflator | Y-o-y % ch               |  | 2.1  | 0.0  | -0.3 | 0.9  | 0.0     | -0.0    | -0.3    | -0.7    | -0.8    | -0.1    | 0.4     | 0.7     | 1.1     | 1.0     | 0.9     |

Notes: Figures in the shaded areas are forecasts

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

## Japan: a slight upward revision of the core inflation rate in FY2017 (revised by +0.1%pt), reflecting the revision to a weaker yen

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

|   |                    | 2014   | 2015   | 2016           | 2017         | 2015    |         | 2016    |         |                |         | 2017    |         |                |         | 2018    |
|---|--------------------|--------|--------|----------------|--------------|---------|---------|---------|---------|----------------|---------|---------|---------|----------------|---------|---------|
|   |                    | FY     |        |                |              | Jul-Sep | Oct-Dec | Jan-Mar | Apr-Jun | Jul-Sep        | Oct-Dec | Jan-Mar | Apr-Jun | Jul-Sep        | Oct-Dec | Jan-Mar |
| Industrial production   | Q-o-q % ch         | -0.5   | -1.0   | 1.1            | 2.5          | -1.0    | 0.1     | -1.0    | 0.2     | 1.3            | 1.7     | 0.3     | 0.5     | 0.4            | 0.5     | 0.4     |
| Ordinary profits<br>(lower line: ex special factors)                  | Y-o-y % ch         | 5.1    | 3.5    | -1.5<br>(-5.3) | 0.3<br>(4.4) | 9.0     | -1.7    | -9.3    | -10.0   | 11.5<br>(-5.8) | -1.5    | -3.2    | 0.3     | -12.4<br>(3.7) | 6.3     | 7.6     |
| Nominal compensation of employees                                     | Y-o-y % ch         | 1.8    | 1.5    | -0.7           | 2.0          | 1.4     | 1.7     | 2.6     | 2.2     | 2.3            | 1.9     | 1.9     | 1.9     | 1.9            | 2.1     | 1.9     |
| Unemployment rate   | %                  | 3.5    | 3.3    | 3.0            | 3.0          | 3.4     | 3.3     | 3.2     | 3.2     | 3.0            | 3.0     | 3.0     | 3.0     | 3.0            | 3.0     | 3.0     |
| New housing starts  | P.a., 10,000 units | 88.0   | 92.1   | 97.4           | 91.3         | 91.7    | 86.8    | 94.7    | 100.5   | 98.2           | 96.6    | 93.5    | 91.9    | 91.6           | 91.2    | 90.9    |
| Current account balance   | P.a., JPY tril     | 8.7    | 18.0   | 21.0           | 20.5         | 15.9    | 19.2    | 19.9    | 18.5    | 19.6           | 23.4    | 20.0    | 20.0    | 18.2           | 21.9    | 19.0    |
| Domestic corporate goods prices                                       | Y-o-y % ch         | 2.7    | -3.2   | -2.3           | 2.3          | -3.7    | -3.7    | -3.5    | -4.4    | -3.6           | -1.7    | 0.6     | 2.0     | 2.9            | 2.6     | 2.0     |
| Consumer prices (ex fresh food)                                       | Y-o-y % ch         | 2.8    | -0.0   | -0.2           | 1.0          | -0.2    | -0.1    | -0.1    | -0.4    | -0.5           | -0.3    | 0.2     | 0.5     | 1.0            | 1.2     | 1.3     |
| Consumer prices (ex fresh food, ex consumption tax)                   | Y-o-y % ch         | 0.7    | -0.0   | -0.2           | 1.0          | -0.2    | -0.1    | -0.1    | -0.4    | -0.5           | -0.3    | 0.2     | 0.5     | 1.0            | 1.2     | 1.3     |
| Consumer prices (ex food (ex alcohol) and energy, ex consumption tax) | Y-o-y % ch         | 0.5    | 0.5    | 0.2            | 0.3          | 0.5     | 0.6     | 0.6     | 0.5     | 0.2            | 0.0     | 0.1     | 0.1     | 0.3            | 0.4     | 0.4     |
| Uncollateralized overnight call rate                                  | %                  | 0.02   | -0.00  | -0.05          | -0.05        | 0.01    | 0.04    | -0.00   | -0.06   | -0.06          | -0.05   | -0.05   | -0.05   | -0.05          | -0.05   | -0.05   |
| Yield on newly-issued 10-yr JGBs                                      | %                  | 0.48   | 0.29   | -0.05          | 0.00         | 0.39    | 0.31    | 0.06    | -0.12   | -0.13          | -0.01   | 0.00    | 0.00    | 0.00           | 0.00    | 0.00    |
| Nikkei average  | JPY                | 16,273 | 18,841 | 17,400         | 19,800       | 19,412  | 19,053  | 16,849  | 16,408  | 16,497         | 17,700  | 18,800  | 19,100  | 19,600         | 19,900  | 20,400  |
| Exchange rate   | JPY/USD            | 110    | 120    | 108            | 115          | 122     | 121     | 115     | 108     | 102            | 109     | 114     | 114     | 115            | 116     | 117     |
| Crude oil price (WTI nearest term contract)                           | USD/bbl            | 81     | 45     | 47             | 58           | 47      | 42      | 34      | 46      | 45             | 49      | 50      | 52      | 56             | 59      | 62      |

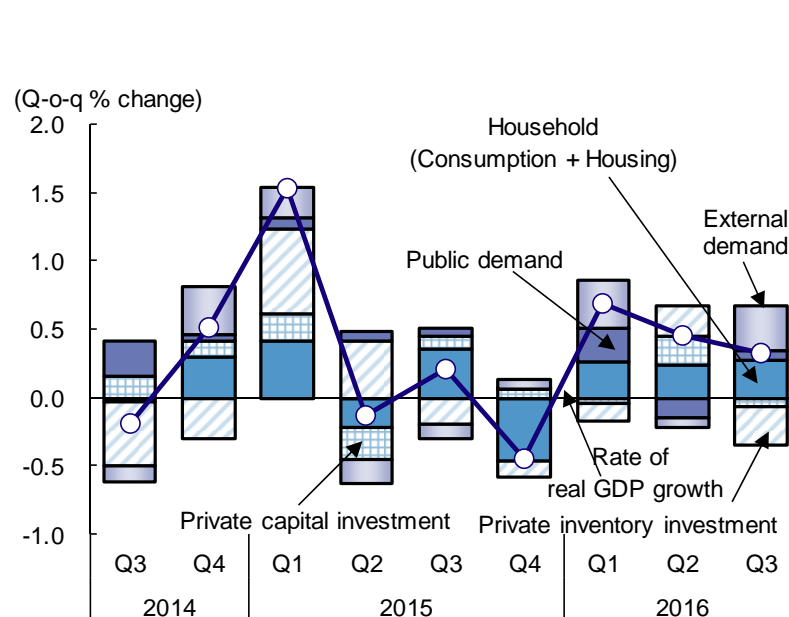
- Notes: 1. Figures in the shaded areas are forecasts. The readings above may differ from public releases because the rates of change are calculated based upon actual results  
2. Ordinary profits are based upon the *Financial Statements Statistics of Corporations by Industry* (all industries) (ex finance & insurance) . The figures in parentheses on the lower line excludes positive effects stemming from factors regarding holding companies in the Jul-Sep quarter of 2016  
3. Quarterly data on the unemployment rate, new housing starts and current account balance are seasonally-adjusted  
4. 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

## Japan: overview of the 2<sup>nd</sup> QE for the Jul-Sep quarter of 2016 – despite downward revision of growth rate, the contents are not so bad

- The 2<sup>nd</sup> QE for the Jul-Sep quarter of 2016 revealed a downward revision of Japan's real GDP to +0.3% q-o-q (+1.3% p.a.) from the 1<sup>st</sup> QE (+2.2% p.a.).
  - Even though inventory investment was the main reason for the downward revision, this indicates that inventory adjustment pressures will ease going forward. Furthermore, personal consumption was revised upward, revealing a clear upturn.
  - Viewed overall, it has turned out that the recovery in the Jul-Sep quarter was driven not only by the upturn of external demand but also to the recovery of the household sector. Thus, even though the 2<sup>nd</sup> QE revealed a downward revision of growth, the contents deserve a favorable evaluation.

[ GDP in the Jul-Sep quarter of 2016 (2<sup>nd</sup> QE) ]



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

|                                 | (Q-o-q % change) |         |         |         |         |         |
|---------------------------------|------------------|---------|---------|---------|---------|---------|
|                                 | 2015             |         | 2016    |         |         | 1st QE  |
|                                 | Jul-Sep          | Oct-Dec | Jan-Mar | Apr-Jun | Jul-Sep | Jul-Sep |
| Gross domestic production       | 0.2              | -0.4    | 0.7     | 0.5     | 0.3     | 0.5     |
| (Q-o-q change, p.a.)            | 0.8              | -1.8    | 2.8     | 1.8     | 1.3     | 2.2     |
| (Y-o-y change)                  | 2.1              | 1.1     | 0.4     | 0.9     | 1.1     | 0.9     |
| Domestic demand                 | 0.3              | -0.5    | 0.3     | 0.5     | -0.0    | 0.1     |
|                                 | (0.3)            | (-0.5)  | (0.3)   | (0.5)   | (-0.0)  | (0.1)   |
| Private demand                  | 0.3              | -0.7    | 0.1     | 0.9     | -0.1    | 0.1     |
|                                 | (0.3)            | (-0.5)  | (0.1)   | (0.7)   | (-0.1)  | (0.0)   |
| Personal consumption            | 0.5              | -0.7    | 0.4     | 0.2     | 0.3     | 0.1     |
| Housing investment              | 1.8              | -1.2    | 1.3     | 3.5     | 2.6     | 2.3     |
| Capital investment              | 0.6              | 0.4     | -0.3    | 1.4     | -0.4    | 0.0     |
| Inventory investment            | (-0.2)           | (-0.1)  | (-0.1)  | (0.2)   | (-0.3)  | (-0.1)  |
| Public demand                   | 0.2              | 0.0     | 1.0     | -0.6    | 0.3     | 0.2     |
|                                 | (0.1)            | (0.0)   | (0.2)   | (-0.1)  | (0.1)   | (0.0)   |
| Government consumption          | 0.4              | 0.7     | 1.3     | -1.1    | 0.3     | 0.4     |
| Public investment               | -0.5             | -2.8    | -0.7    | 1.6     | 0.1     | -0.7    |
| Net exports of goods & services | (-0.1)           | (0.1)   | (0.4)   | (-0.1)  | (0.3)   | (0.5)   |
| Exports                         | 2.1              | -0.6    | 0.8     | -1.3    | 1.6     | 2.0     |
| Imports                         | 2.5              | -0.9    | -1.2    | -0.9    | -0.4    | -0.6    |
| Nominal GDP                     | 0.6              | -0.3    | 0.8     | 0.2     | 0.1     | 0.2     |
| GDP deflator (y-o-y change)     | 1.8              | 1.5     | 0.9     | 0.4     | -0.2    | -0.1    |

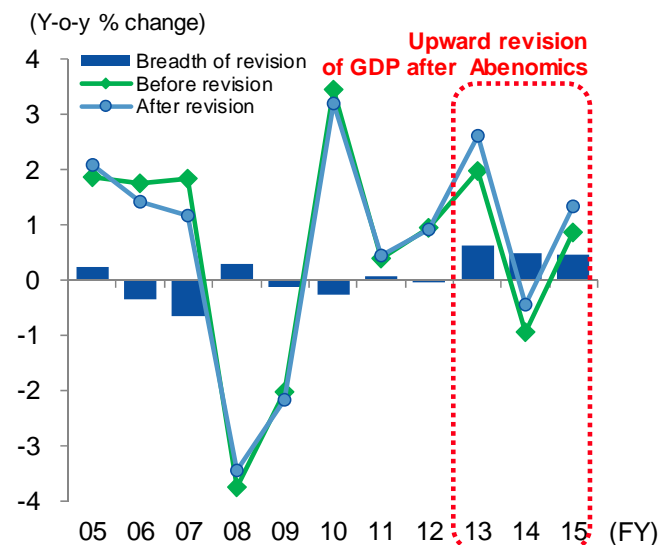
Note: The figures in parentheses indicate the contributions to gross domestic production  
 Source: Made by MHRI based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*

## Japan: impact of benchmark year revision of GDP – growth since launch of Abenomics has been revised up sharply

- ❑ Japan’s economic growth since the start of Abenomics has been revised up sharply due to the benchmark year revision of GDP. The rate of potential growth is also expected to rise.
  - The average rate of GDP growth since the start of Abenomics (from the Jan-Mar quarter of 2013) was revised upward to +1.1% p.a. in real terms from +0.6% p.a. in real terms prior to the benchmark year revision.
    - FY 2013 (GDP growth rate: +2.0% → +2.6%) was revised upward due to an upward revision of capital investment (+3.0% → +7.0%) because of a revision of the way in which construction sector output is calculated.
    - FY2014 (GDP growth rate: -0.9% → -0.4%) was revised upward due to a revision of the way in which R&D costs and machinery investment are accounted.
- ❑ The level of GDP (nominal) was revised up sharply by approximately JPY30 trillion, due mainly to the “capitalization of R&D” (approximately JPY20 trillion).

[ Real GDP growth before and after GDP revision ]

|                           | Since start of Abenomics |                 | Overall (from 1994) |                 |
|---------------------------|--------------------------|-----------------|---------------------|-----------------|
|                           | After revision           | Before revision | After revision      | Before revision |
| <b>Rate of change (%)</b> |                          |                 |                     |                 |
| GDP                       | 1.1                      | 0.6             | 0.9                 | 0.8             |
| Personal consumption      | -0.0                     | -0.2            | 0.9                 | 0.8             |
| Housing investment        | 1.5                      | 1.0             | -1.9                | -2.0            |
| Capital investment        | 3.4                      | 2.1             | 1.3                 | 0.9             |
| Government consumption    | 1.3                      | 1.0             | 1.8                 | 1.9             |
| Public investment         | 0.4                      | 0.5             | -2.4                | -2.8            |
| Exports                   | 4.4                      | 3.8             | 4.1                 | 3.9             |
| Imports                   | 2.8                      | 2.7             | 3.2                 | 3.2             |
| <b>Contribution (%pt)</b> |                          |                 |                     |                 |
| Private sector demand     | 0.6                      | 0.3             | 0.6                 | 0.5             |
| Public sector demand      | 0.3                      | 0.2             | 0.2                 | 0.2             |
| External demand           | 0.2                      | 0.1             | 0.2                 | 0.2             |



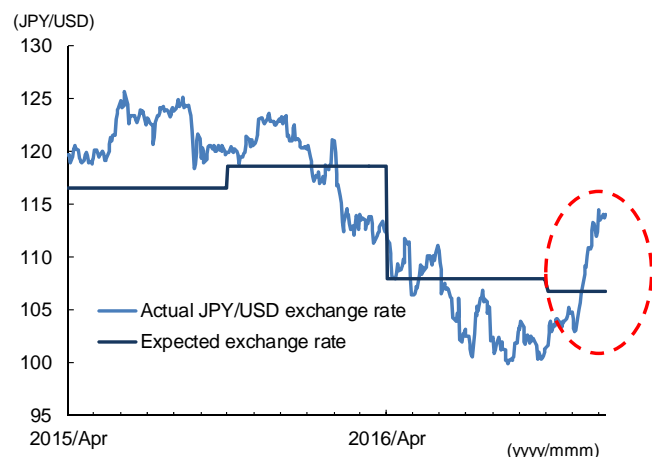
Note: “After start of Abenomics” refers to Jan-Mar quarter of 2013 onward  
 Source: Made by MHRI based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*

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

## Japan: the impact of the Trump administration - “Trumponomics-led yen depreciation” will serve as tailwinds in FY2017

- The impact of Trumponomics upon the Japanese economy will consist mainly of its effect through the foreign exchange rate during the forecast period up to FY2017.
  - The yen is depreciating against the dollar due to optimism toward Trumponomics. While the depreciation of the yen has both merits and demerits, the overall effect is positive.
  - We have revised our view on the JPY/USD exchange rate in FY2017 to JPY115/USD, which is approximately 10% weaker to the dollar than in our November *Economic Outlook* (JPY105/USD). Reflecting the revision to a weaker yen, our forecasts on Japan’s economic growth in FY2017 has been revised upward to +1.2% (November *Economic Outlook*: +1.0%) and the year-on-year change of core CPI to +1.0% (November *Economic Outlook*: +0.9%).
- From FY2018 onward, the upturn of the US economy accompanying the large-scale tax cuts and preferential treatment of infrastructure investment, will also have a positive impact upon the Japanese economy. However, note the rise of risks in the event of a protectionist stance and uncertainties regarding the US policy agenda.

[ The actual JPY/USD exchange rate and the expected exchange rate by corporations (all enterprises, all industries) ]



Note: The expected exchange rate is on an “All Enterprises, All Industries” basis of the BOJ *Short-term Economic Survey of Enterprises in Japan (TANKAN)*. The expected exchange rate for 1H based on the June Survey and the 2H on the December Survey.

Source: Made by Mizuho Research Institute (MHRI) based upon Bank of Japan, Bloomberg

[ The merits and demerits of yen depreciation ]

|            | Merits   | Demerits   |
|------------|--|--|
| Short-term | [Export-oriented industries]<br>• Rise of earnings due to increase of yen-denominated value of exports<br>[Domestic demand-oriented industries]<br>• Improvement of price competitiveness against imported goods<br>[Inbound demand-related]<br>• Rise of inbound demand | [Import-oriented industries]<br>• Increase of import costs, pressure upon earnings<br>[Households]<br>• Decline of purchase power due to rise of prices  |
| Long-term  | [Export-oriented industries]<br>• Rise of price competitiveness/increase of export quantity due to price cuts in currencies of export destinations<br>[Domestic demand-oriented industries]<br>• Ripple-through of production from export-oriented industries            | [Manufacturers] Reshoring<br>[Foreign corporations] Rise of inward investment<br>[Inbound demand-related] Rise of capital investment<br>[Corporations] Rise of costs for overseas business expansion |

Source: Made by MHRI



**(Reference) Key political events**

|        | 2017                         |   | 2018                         |   |
|--------|------------------------------|---|------------------------------|---|
| US     | Jan                          | Inauguration of new administration/<br>new congress   | Feb<br>Nov                   | FRB Chair Yellen's term of office ends<br>Mid-term election   |
| Europe | Mar<br>Apr-May<br>Jun<br>Sep | Netherlands: Legislative election<br>France: Presidential election<br>France: Legislative election<br>Germany: Legislative election   | May                          | Italy: General election   |
| Japan  |                              |   | Apr<br>Sep<br>Dec            | BOJ Governor Kuroda's term of office ends<br>LDP Presidential election<br>Lower House members' term of office end           |
| Asia   | Mar<br>Autumn<br>Dec<br>Dec  | Hong Kong: Chief Executive election<br>China: 19th National Congress of the<br>Communist Party of China<br>South Korea: Presidential election<br>Thailand: General election | May<br>Autumn<br>By year end | Malaysia: Legislative election<br>China: 3rd Plenary Session of the CPC<br>Central Committee<br>India: Upper house election |
| Others |                              |   | Mar<br>Jul<br>Oct            | Russia: Presidential election<br>Mexico: Presidential election<br>Brazil: Presidential election                             |

Source: Made by MHRI

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