

# Monthly Economic Report

July 21, 2021

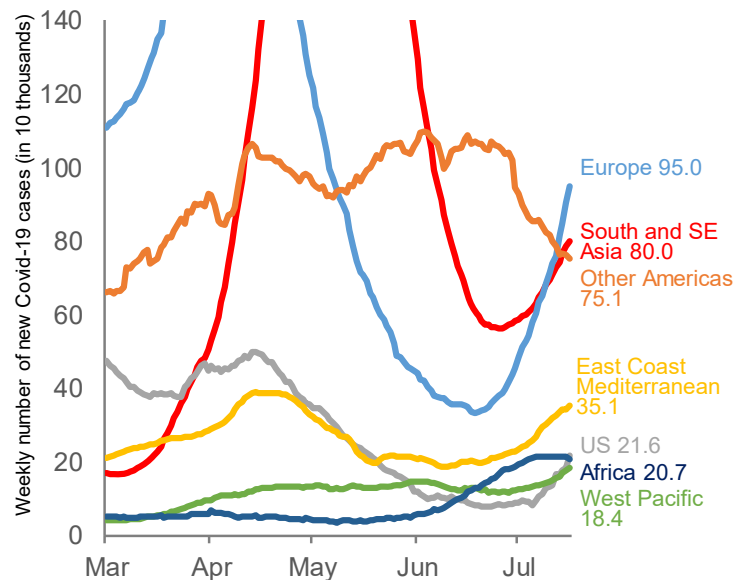
Mizuho Research & Technologies, Ltd.

**MIZUHO**  


# The number of new Covid-19 cases around the world is soaring at an accelerated pace

- The number of Covid-19 cases worldwide (cumulative) reached 190.28 million as of the morning of July 19.
- The number of Covid-19 cases worldwide shows no sign of abating, rising at a pace of 3.45 million/week (previous week: 2.98 million).
  - Infections are resurging in Europe, Asia and the US. In Europe, in addition to the UK, infections are rapidly spreading in the Netherlands, Spain and Portugal. In Asia, the spread of infections remains unabated in Indonesia, Thailand, and Malaysia.
  - While the number of new cases is soaring rapidly in Europe, the increase in the number of hospitalizations has so far been limited. Vaccinations appear to be effective in protecting against the onset of symptoms, but there is a risk of increased burden on the medical system, especially in southern Europe, as the vacation season is in full swing and the flow of people is expected to increase.

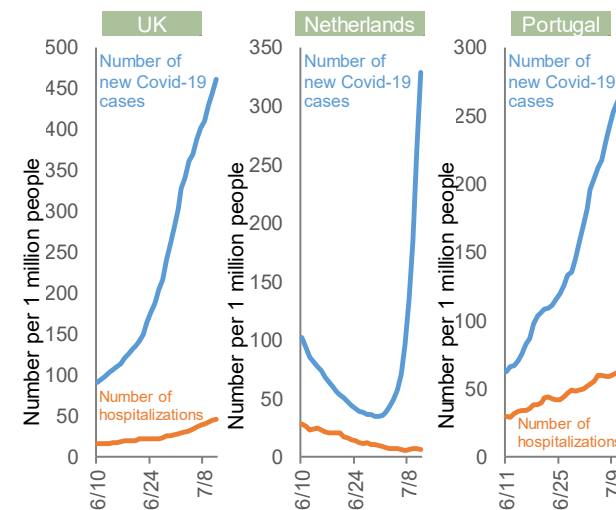
## Number of weekly new Covid-19 cases reported worldwide



Note: Figures represent number of cases counted as of July 18 (latest data as of July 16).  
Regional classification based upon the WHO

Source: Made by MHRT based upon Johns Hopkins University and WHO

## Number of new Covid-19 cases and hospitalizations in the UK, Netherlands and Portugal (per million population)



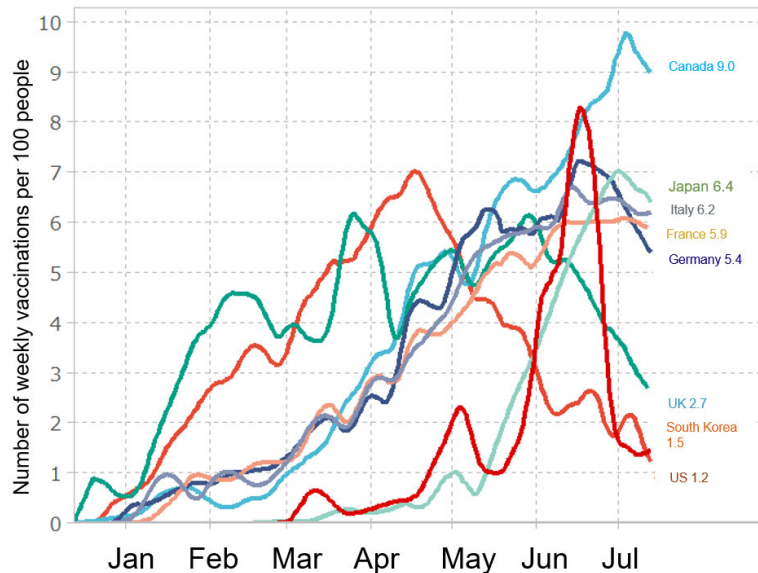
Note: Figures represent number of cases counted as of July 18 (latest data as of July 12)

Source: Made by MHRT based upon Our World in Data

# Global vaccination trends show that continental Europe's vaccination rate has reached around 40%

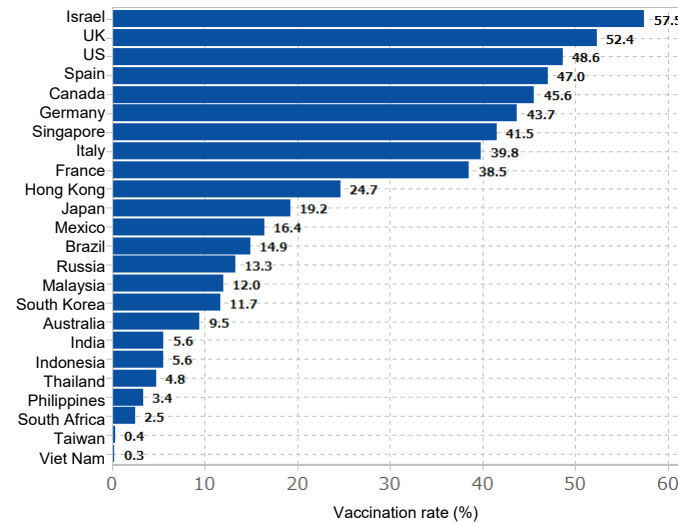
- Overseas, vaccine rollouts continue to progress steadily in continental Europe and Canada.
  - The pace of vaccination in continental Europe is steady at around six doses a week per 100 people. However, there are signs of a slowdown in Germany. With the vaccine penetration rate reaching 40%, whether the pace of vaccinations will slow down in continental Europe or not requires attention.
- In terms of vaccination rates, the gap between the US and the UK, which had been ahead of other countries, and continental Europe/Singapore has narrowed further.
  - On the other hand, there is still a 20% gap between continental Europe/Singapore and other major countries (including Japan).

**Number of weekly vaccinations per 100 people by country**



Note: Figures represent data as of July 15 (latest data is from July 13).  
Source: Made by MHRT based upon Our World in Data

**Vaccination rates in major countries (percentage of the total population administered a second dose of vaccine)**

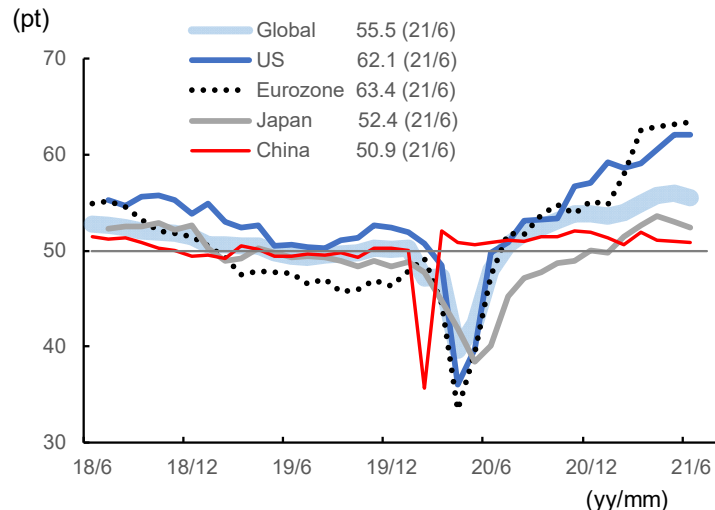


Note: Figures represent data as of July 15 (latest data is from July 13).  
Source: Made by MHRT based upon Our World in Data

# Current state of the global economy: while the US economy continues to expand, the momentum of the Chinese economy is slowing down

- The US economy is continuing to follow an expansion track.
  - In the US, both the manufacturing and nonmanufacturing PMI remained at a high level over 60. Although the economy is on an expansionary trend, such as a recovery trend in mobility to commercial facilities, supply constraints due to a shortage of materials and manpower are continuing to weigh on further economic expansion.
  - The PMI for the European economy also suggests economic expansion. However, it should be noted that Covid-19 infections are currently resurging in the area.
- The real GDP growth rate for the Apr-Jun quarter of the Chinese economy declined to +7.9% y-o-y. Despite signs that the expansion track will continue, the pace of growth is slowing.
- In Japan, the nonmanufacturing PMI fell below 50 in June due to the impact of the declaration of a state of emergency. The nonmanufacturing sector is expected to remain sluggish until the spread of Covid-19 infections subsides.

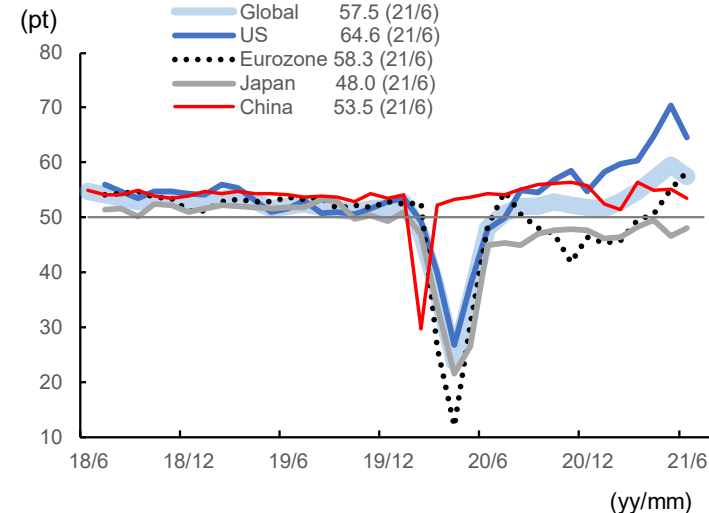
## Manufacturing PMI



Note: The Purchasing Managers' Index (PMI) is an index calculated by weighting indexes such as new orders, output, order backlogs, prices, employment, and quantity of purchases. The reading of 50 in the PMI is the "expansion-contraction" threshold.

Source: Made by MHRT based upon the National Bureau of Statistics of China, Markit Economics

## Nonmanufacturing PMI



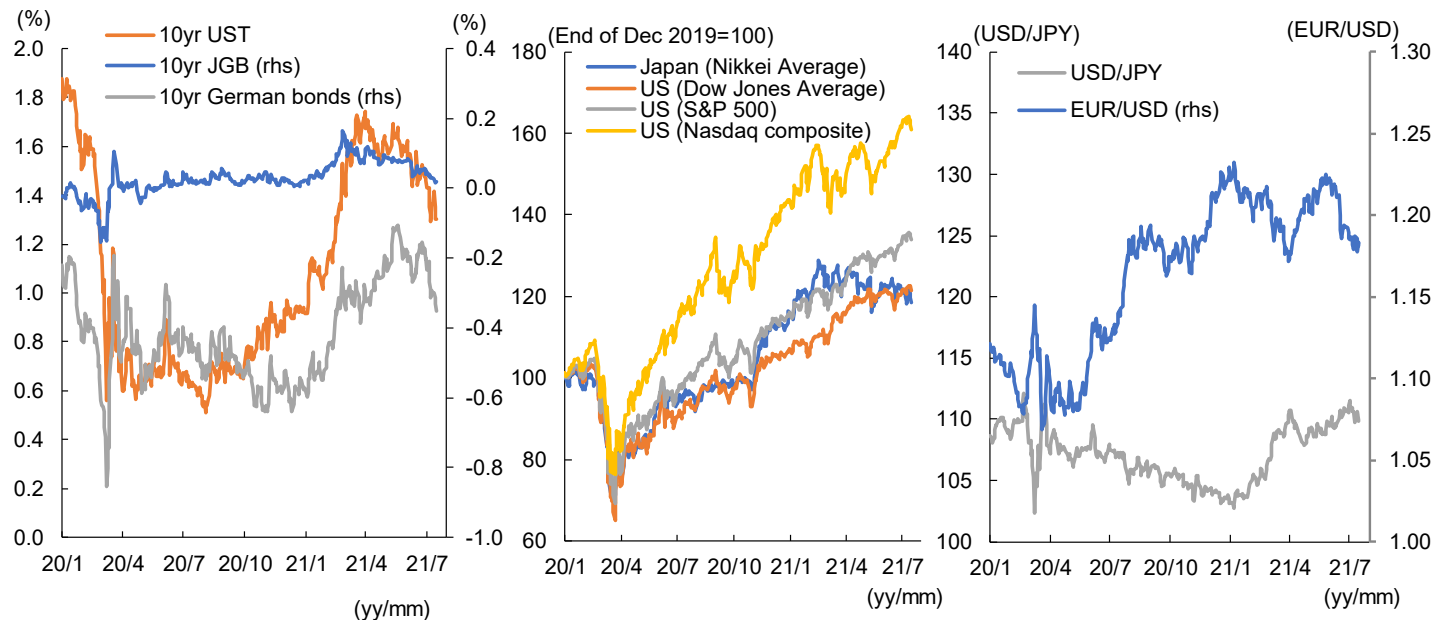
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Source: Made by MHRT based upon the National Bureau of Statistics of China, Markit Economics

# Overview of financial markets: interest rates declined mainly in the US due to concerns about slowing pace of economic recovery

- Interest rates fell mainly in the US due to worsening business sentiment, mainly in the US and China, and growing concerns about a slowdown in the pace of economic recovery against the backdrop of the spread of Covid-19 infections.
  - The 10yr UST yield temporarily fell to the 1.2% level for the first time in about five months. Since then, the yield has remained near 1.3% partly due to FRB Chair Powell's dovish comments. The German 10yr government bond yield fell to -0.35% for the first time in approximately four months due to the fall of US interest rates and concerns regarding the spread of Covid-19 infections in Europe.
  - In the stock market, the three major US stock indices all hit new highs on July 12, reacting favorably to the fall of interest rates. Even so, the market subsequently softened, reflecting concerns over the spread of Covid-19 infections.

## Major market trends

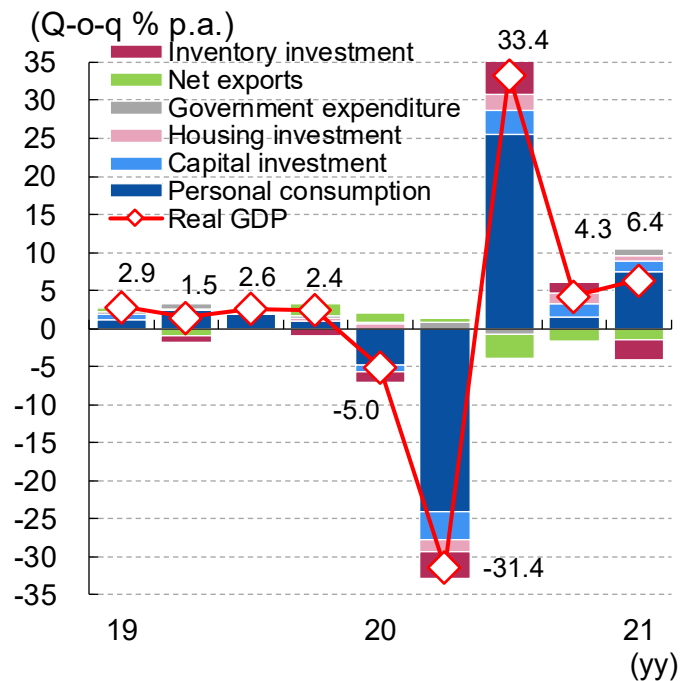


Note: All indexes show actual results up to July 16.  
Source: Made by MHRT based upon Refinitiv

# US Economy: GDP third estimate remains unchanged and reconfirmed that the acceleration was driven mainly by domestic demand

- The real GDP growth rate in the Jan-Mar quarter (third estimate) was +6.4% q-o-q p.a., remaining unchanged from the second estimate.
  - Although domestic final demand was favorable, domestic supply could not keep up, and inventories and net exports remain drawn down. The results reconfirmed that the US economy has accelerated due to policy effects and the relaxation of restrictions.
    - ◆ Revisions to each components of demand were generally minor (however, imports were revised upward substantially)

## Real GDP growth



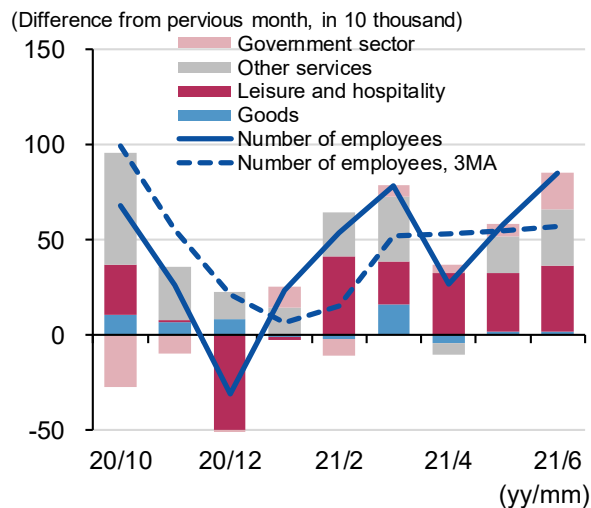
Source: Made by MHRT based upon US Department of Commerce

	20Q4	21Q1 (Second estimate)	21Q1 (Third estimate)	Key Points
<b>Real GDP</b>	+4.3	+6.4	+6.4	Confirmed that the pace of economic recovery in the Jan-Mar quarter accelerated
<b>Personal consumption</b>	+2.3	+11.3	+11.4	Consumption is generally strong, including services requiring face-to-face interactions, against the backdrop of cash benefits, increased employment income, and relaxation of restrictions
<b>Housing investment</b>	+36.8	+12.7	+13.1	Housing construction continues to increase, especially for single-family homes
<b>Capital investment</b>	+13.1	+10.8	+11.7	Machinery investment (especially information-processing related) and intellectual property investment increased significantly. On the other hand, construction investment remains sluggish overall
<b>Inventory investment (※)</b>	+1.4	-2.8	-2.7	Manufacturers and retailers (exclusively car dealers) withdraw inventory amid tight supply constraints
<b>Government expenditure</b>	-0.8	+5.8	+5.7	Significant increase in federal expenditures, especially in small business lending programs (Paycheck Protection Program, PPP) and vaccine related purchases
<b>Net exports (※)</b>	-1.5	-1.2	-1.5	Contribution of external demand is negative due to decreased exports and increased imports
<b>Exports</b>	+22.3	-2.9	-2.1	Decreased mainly in goods. Supply constraints seem to have weighed on production for export-related items
<b>Imports</b>	+29.8	+6.7	+9.5	Imports of consumer goods and capital goods boosted overall, driven by strong consumer goods and machinery investment

# Number of employees rose sharply in June, but labor shortage will take time to resolve

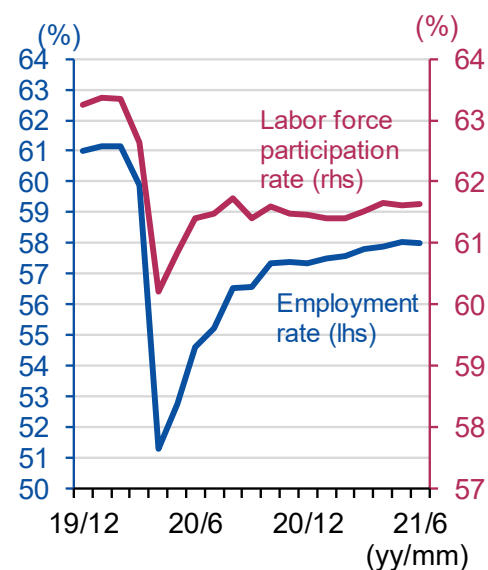
- The growth in the number of employees in June accelerated by +850 thousand (May m-o-m change +583 thousand m-o-m), exceeded market expectations (+771 thousand m-o-m).
  - By industry, the leisure/hospitality industry continues to increase against the backdrop of relaxing restrictions. Services excluding leisure/hospitality and the government sector also contributed to the increase.
- The return of the non-labor force population to the market has not progressed. The labor shortage is expected to take time to resolve.
  - The labor force participation rate was 61.6%, unchanged from May. The number of people who did not work due to Covid-19 infection concerns decreased in the first half of June compared to the first half of May. On the other hand, the number of people who were unable to work due to child care and other reasons increased as face-to-face lessons did not resume.

## Number of employees by industry



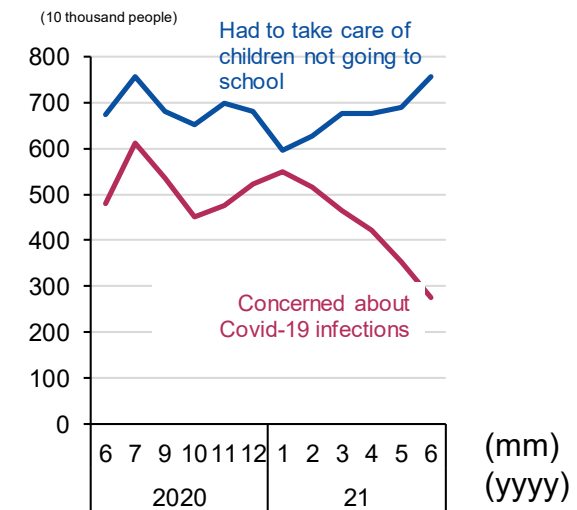
Source: Made by MHRT based upon US Department of Labor

## Labor force participation rate and employment rate



Source: Made by MHRT based upon US Department of Labor

## Trends of people who cannot work due to concern over Covid-19 infections and child care

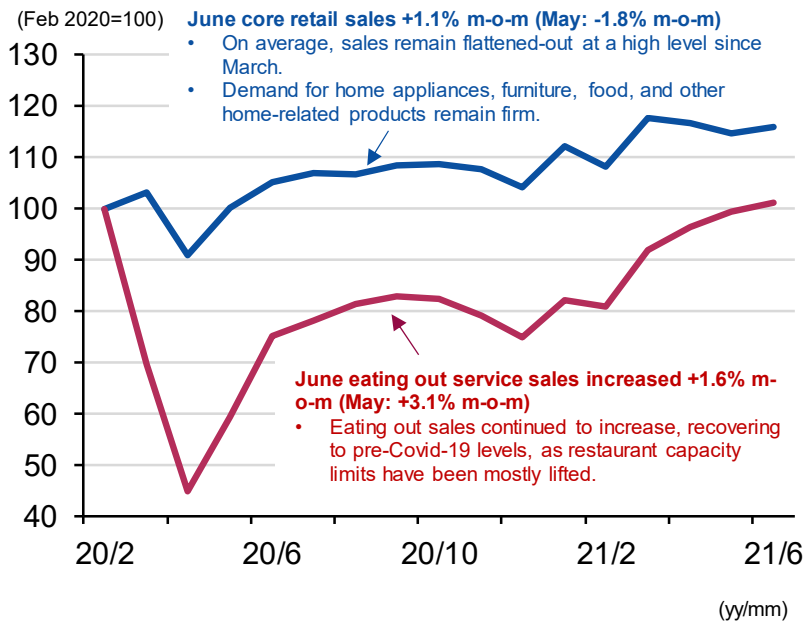


Source: Made by MHRT based upon US Department of Commerce

# Service consumption is recovering on the back of easing restrictions, while goods consumption remains firm

- In June, dining out sales in real terms (MHRT estimate) continued to increase, recovering to pre-Covid-19 levels. Real core retail sales (MHRT estimate) remained high.
  - Despite the shift of consumption from goods to services along with the relaxation of restrictions, people still tend to spend more time at home, which leads to strong demand for home-related products.
- The Beige Book pointed out surges in areas such as airline tickets and hotel reservations, confirming the strength of demand for hospitality services this summer. The Beige Book also suggested that for service consumption a similar upturn from the pre-Covid-19 trend observed in goods consumption is unlikely, as the hospitality sector faces a labor shortage.

## Retail sales



Note: Estimated real value by MHRT. Core retail excludes motor vehicles, building materials, gasoline, and eating out.  
 Source: Made by MHRT based upon US Department of Commerce

## Comments on hospitality services from the Beige Book

Comments	
Demand Trends	<ul style="list-style-type: none"> <li>• Hotel reservations have been <b>stronger than expected</b>. Restaurants expect <b>demand to hold steady for the next few months</b> (St. Louis).</li> <li>• Airline <b>bookings surged, exceeding expectations</b> (Dallas).</li> <li>• Short-term rentals (for holidays) were <b>booked solid through the summer and into the fall</b> (Richmond).</li> <li>• <b>Demand for leisure travel</b> is expected to continue <b>to grow at a healthy pace over the summer</b> (Atlanta).</li> </ul>
Impact of labor shortages	<ul style="list-style-type: none"> <li>• Many hotels and restaurants <b>faced labor shortages</b> that led them to <b>limit capacity or services</b> (Richmond).</li> <li>• <b>Due to an inability to fully staff</b>, some <b>restaurants and retailers reduced hours</b>, and some <b>hotels offered limited guest services and amenities</b> (Atlanta).</li> <li>• It has been observed that rental car and lodging <b>shortages were hampering otherwise-strong tourism activity</b> (Minneapolis).</li> </ul>

Note: Survey period is until July 2.  
 Source: Made by MHRT based upon FRB

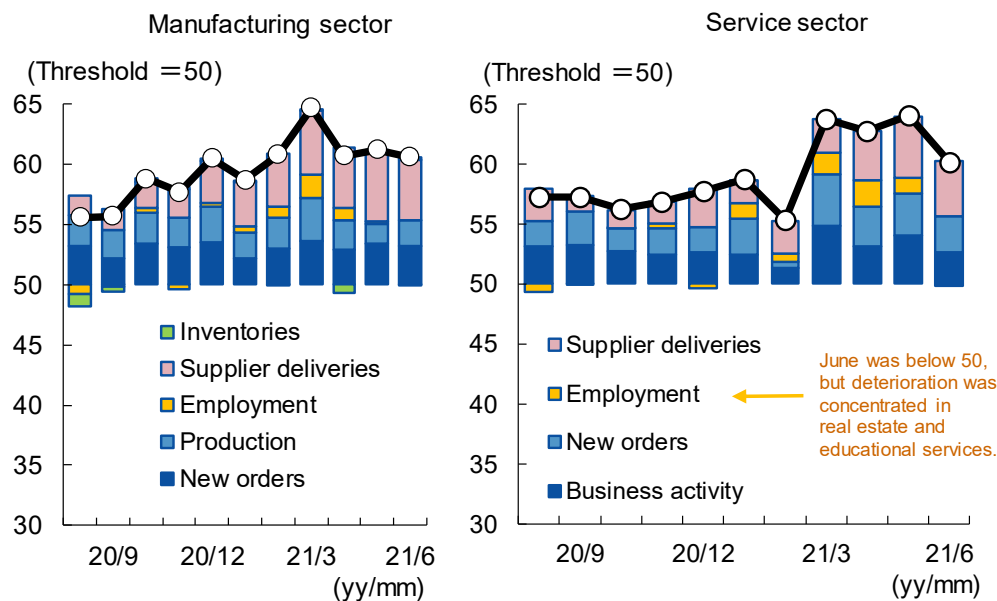


# Supply constraints continued to dampen business activity

- In June ISM index remained at a high level of over 60 for both the manufacturing and service sectors. Both the new orders and supplier deliveries indices were at high levels. The coexistence of strong demand and severe supply constraints remained unchanged.
  - Corporations reported a shortage of parts and materials for a wide range of items, particularly steel, chemical products, and electronic components. Against the backdrop of tight supply and demand, purchase prices (in the manufacturing sector) rose to the highest level since 1979.
  - The employment indicators fell below 50 for the first time in approximately six months in both the manufacturing and service sectors. In the service sector, supply-side factors such as labor shortages leading to shortened business hours, were said to be hindering business expansion.

## Breakdown of ISM index

## Materials, etc., that manufacturers cited as being "deficient"



		2020												21					
		3	4	5	6	7	8	9	10	11	12	1	2	3	4	5	6		
Hygiene/Medical equipment		7	6	8	4	4	1	4	1	3	2	1	1	1	1				
Metal	Steel								1	2	3	4	5	5	5	7	6		
	Aluminum						1	1	1	1	2		1		1	2	2		
	Copper											1							
Electrical/ Electronic	Semiconductors										1	1	1	1	1	1	1		
	Others		3					4	3	1	2	2	4	3	3	2	2		
Chemical products								2	1			5	9	5	9	4			
Others	Wood products							1						3	2	3	1		
	Paper																1		
	Plastics & Rubber products												2	3	3	2			
	Clothing & parts																1		
	Cardboard									1	1	2	2	1	1	1	2		

Note: The table represents a categorization of materials, etc., that were cited as "deficient" in press release materials. The numerical values of each category is the number of citations of said materials, etc., included in that category.

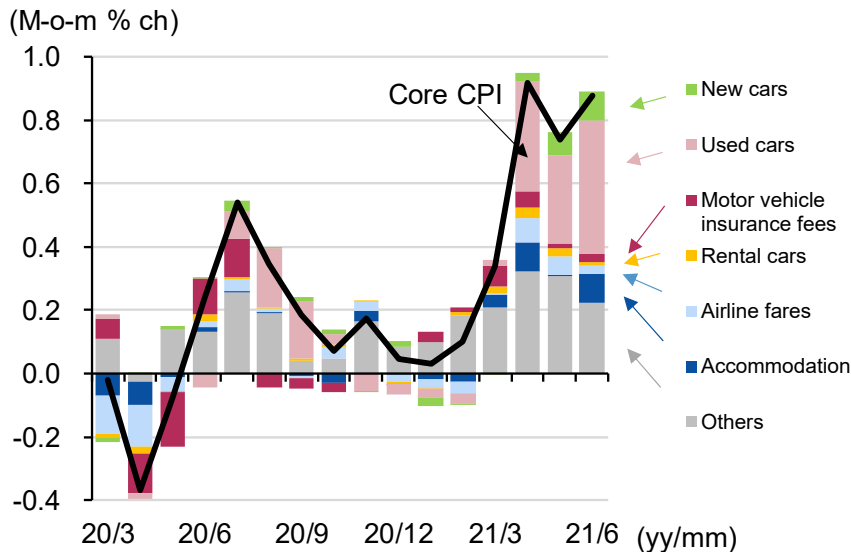
Source: Made by MHRT based upon Institute for Supply Management.

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# Inflation remains at a high level, especially for items that are strongly affected by tight supply/demand and normalization

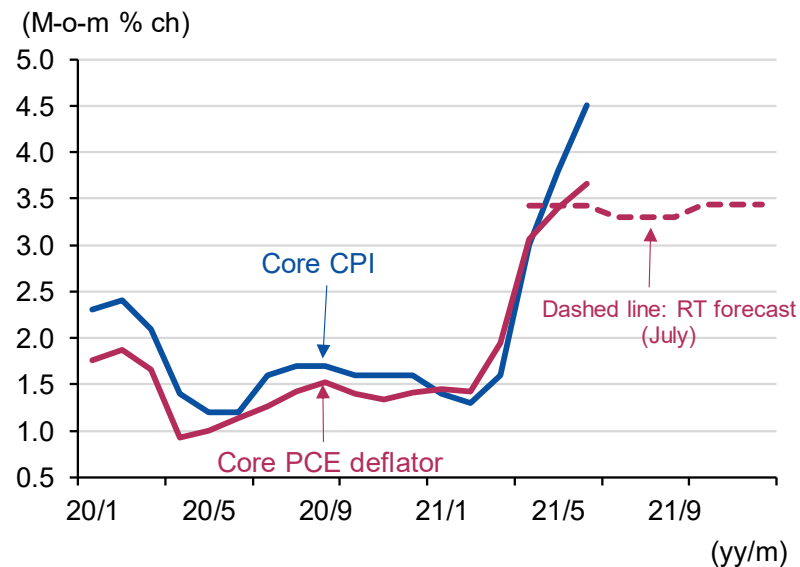
- In June, the core CPI continued to rise at a high rate of +0.9% m-o-m (May +0.7% m-o-m). On a year-on-year (y-o-y) basis, core CPI rapidly accelerated to +4.5% (May +3.8% y-o-y).
  - Used car and new car prices, for which the supply-demand balance is considerably tight due to inventory shortages, and accommodation and airline fares, which are still in the process of normalization, lifted the overall core CPI.
  - On the other hand, growth rate for items other than those mentioned above (indicated in "Others" in the chart below).
- Based on these results, the core PCE deflator in June is expected to accelerate to +3.7% y-o-y (May +3.4% y-o-y).
  - Given the firm demand for goods, the odds are high that the inflation rate will remain at the current level also in the Jul-Sep and Oct-Dec quarters after the base effect diminishes.

## Core CPI (m-o-m)



Source: Made by MHRT based upon US Department of Labor

## Core CPI and core PCE deflator



Note: The June 2021 core PCE deflator is the forecast value based on CPI, etc., of the same month  
 Source: Made by MHRT based upon US Department of Labor, US Department of Commerce

## “In coming meetings, [the Committee] will begin to discuss [tapering]” (June FOMC minutes)

- Participants stated that the Committee should be patient until uncertainty recedes as the economy resumes. On the other hand, participants recognized the importance of preparations for tapering as "a matter of prudent planning" (presumably with an eye to early implementation of tapering).
  - Only a few pointed out the need to bring forward the rate hike. On the other hand, participants pointed out that the Committee should emphasize that its policy reaction function had not changed.

### Overview of the minutes of the June FOMC meeting

#### Employment and Pricing Situation

- Labor market conditions to continue to improve with labor shortages expected to ease throughout the summer and into the fall as progress on vaccinations continues, social distancing unwinds further, more schools reopen, and unemployment benefits expire.
- Rise in inflation was larger than anticipated, against the backdrop of widespread supply constraints in product and labor markets than anticipated and a larger-than-expected surge in consumer demand as the economy reopened.
- [A substantial majority] judged that inflation risks were tilted to the upside because of concerns that supply disruptions and labor shortages might linger for longer and might have larger or more persistent effects on prices and wages than they currently assumed.

#### Monetary policy

- [A few] expect the economic conditions for rate hike set out to be met somewhat earlier than they had projected.
- [Several] emphasized, however, that uncertainty around the economic outlook was elevated and that it was too early to draw firm conclusions about the paths of the labor market and inflation. This heightened uncertainty implied significant uncertainty about the appropriate path of the federal funds rate.
- [Some] noted the path of policy would be a focus of market participants. It is important to emphasize that the FOMC's reaction function or commitment to its monetary policy had not changed.

#### Tapering

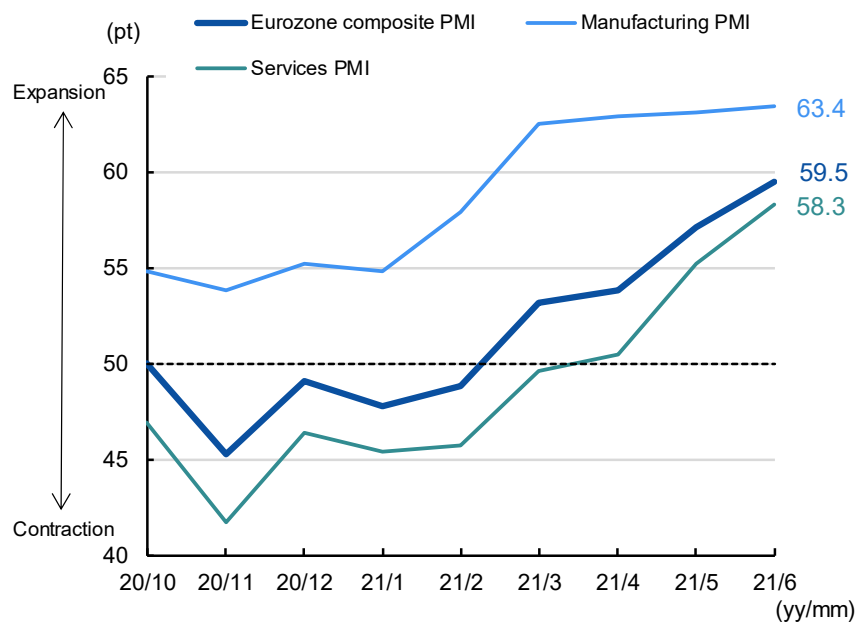
- The Committee's standard since December 2020 of "substantial further progress" is seen as having not yet been met, though progress is continuing.
- [Various] expect the time to begin tapering will be somewhat earlier than was expected at the previous meeting.
- [Some] saw the incoming data as providing a less clear signal about the underlying economic momentum. Information in the coming months will allow for a better assessment of the path of the labor market and inflation. [Several of these] stated the Committee should be patient in assessing progress toward its goals.
- [Generally] as a matter of prudent planning, it was important to make preparations to be able to taper against unexpected economic conditions, such as faster-than-anticipated progress toward the Committee's goals, or heightened risks that could impede that attainment of the Committee's goals.
- [Several] saw benefits to tapering MBS purchases more quickly or earlier than Treasury purchases, in light of valuation pressures in housing markets.
- [Several other]s commented that reducing the pace of Treasury and MBS purchases commensurately was preferable. This is aligned with previous communications, and Treasury and MBS purchases both contribute to broader conditions.
- [Agreement] In coming meetings, continue assessing the progress, and begin to discuss plans for tapering. Confirmed that plans would be made public well in advance of the actual tapering.

Source: Made by MHRT based upon FRB

# The Eurozone economy: services sector boosts composite PMI in Apr-Jun quarter. Manufacturing sector stalled due to supply constraints

- The Eurozone composite PMI in June (final) rose to 59.5 from May (57.1). The service sector continued to improve, serving to boost the overall PMI.
  - Mobility in major Eurozone countries has recovered further since late May due to progress in the relaxation of infection control measures, leading to the improvement of business sentiment in the service sector.
- The manufacturing PMI (63.4) flattened out. Despite the high level of business sentiment in the manufacturing sector, actual output is likely to remain stagnant close to pre-Covid-19 levels for the time being due to supply constraints.
  - According to the European Commission's survey, while the DI for the current conditions of the entire manufacturing sector remained high, motor vehicles slowed sharply due to supply constraints. It will be necessary to keep a close eye on the possibility that supply constraints due to shortages of parts and materials may spread to other industries.

## Eurozone: PMI



Note : The reading of 50 is the "expansion-contraction" threshold.  
Source: Made by MHRT based upon Refinitiv and IHS Markit

## Eurozone: DI for current conditions by industry

(DI, Pt)

Industry	2021					
	Jan	Feb	Mar	Apr	May	Jun
Manufacturing sector	-1	0	6	20	20	20
Metal processing	3	4	11	21	30	27
PC, electronics & optical	13	15	21	27	27	26
Electrical equipment	11	17	26	37	33	30
Machinery & Equipment	0	5	14	26	31	29
Motor vehicle	3	5	12	43	12	1
Service sector	-26	-24	-18	-7	4	14
Accommodation	-80	-70	-61	-46	-37	-12
Food and Beverage Services	-80	-75	-63	-48	-28	-5
Tourism	-79	-77	-62	-50	-30	10

Worsened (red to yellow) | Improved (green)

Comparison with long-term historical

Supply constraints due to semiconductor shortages weigh on the industry (Motor vehicle)

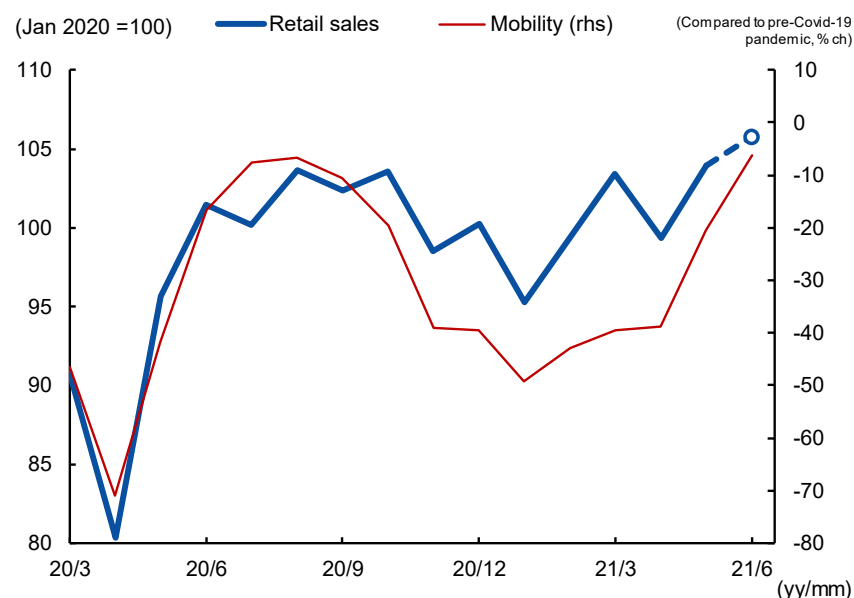
Further recovery due to relaxed mobility restrictions (Tourism)

Note: The reading of zero is the "expansion-contraction" threshold  
Source: Made by MHRT based upon European Commission

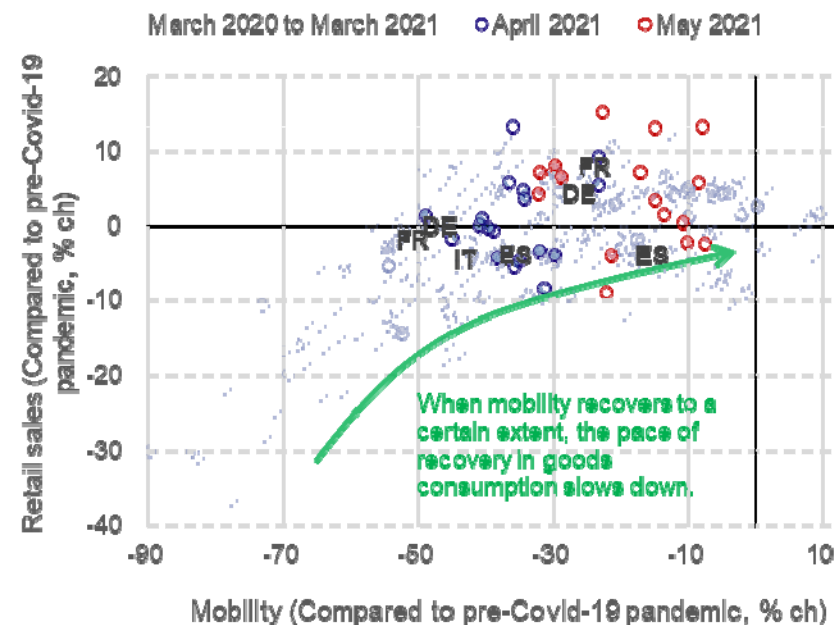
# Retail sales surged in May due to relaxation of restrictions. As mobility is near pre-Covid-19 levels, goods consumption is expected to slow

- Eurozone real retail sales in May (excluding motor vehicles) rose by +4.6% m-o-m, against the backdrop of progress in the relaxation of infection control measures in major countries.
  - Consumer spending in the Apr-Jun quarter appears to have increased significantly from the previous quarter.
- On the other hand, since the pace of recovery in goods consumption tends to slow down when the relaxation of infection prevention measures/recovery of mobility progress to a certain extent, goods consumption is expected to level off in the second half of the year. The service sector is expected to be the main driver of consumption.
  - According to German retail sales statistics, the special demand caused by the Covid-19 pandemic, such as for PCs and home appliances, is likely to fade by April.

## Eurozone: real retail sales



## Eurozone: real retail sales by country and mobility



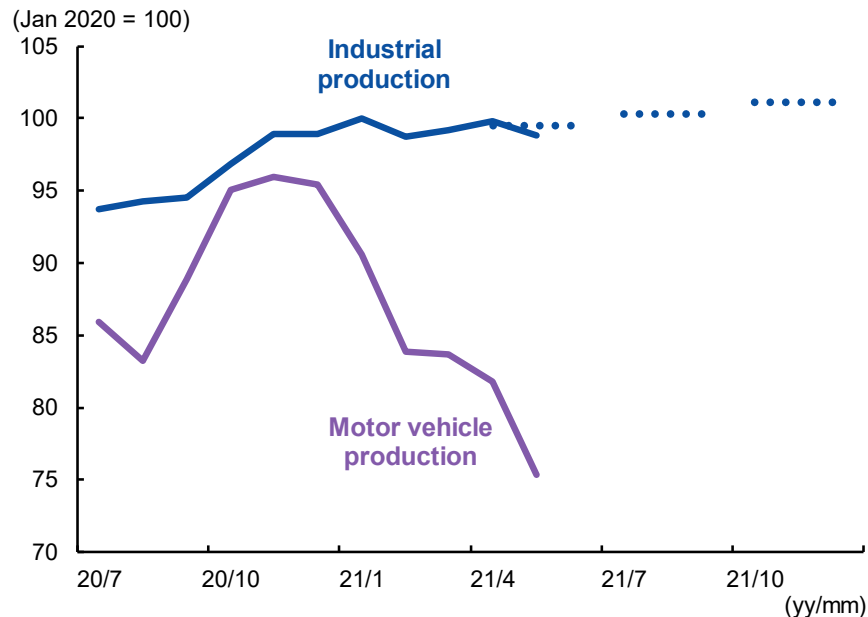
Note: Excludes motor vehicles. June 2021 retail sales are MHRT's forecast based on mobility.  
Source: Made by MHRT based upon Eurostat and Google LCC

Note: 1. Each point represents 18 countries in the eurozone excluding Cyprus.  
2. Retail sales exclude motor vehicles. Mobility is the average for the month.  
Source: Made by MHRT based upon Eurostat and Google LCC

# Industrial production fell in May reflecting output cuts of motor vehicles. Production should remain flat during the rest of year due to supply constraints

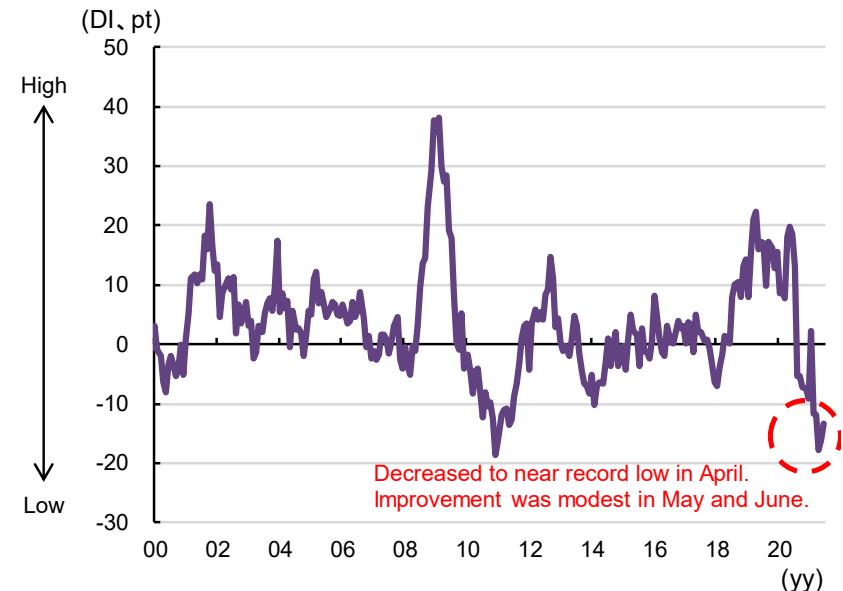
- Eurozone industrial production fell in May (-1.0% m-o-m), continuing to stagnate at the pre-Covid-19 level (Jan 2020 = 100, 98.8). The reduction in motor vehicle production (-7.8% m-o-m) due to semiconductor shortages was the major factor.
  - The DI for motor vehicle inventories is closest to the lowest level in the 2000s. Although it has been bottoming out since May, it is expected to take time for inventories to recover to an appropriate level.
- Motor vehicle production by country declined m-o-m in all major countries. Even in Italy, where motor vehicle production had been following a gradual recovery, production fell a steep -6.7% m-o-m. Among the background factors was the suspension of production among Italian finished motor vehicle makers in early May, mainly caused by the shortage of semiconductors.

## Eurozone: industrial production



Note: The dotted line is the forecast by MHRT (quarterly average).  
Source: Made by MHRT based upon Eurostat.

## Eurozone: DI for motor vehicle inventories

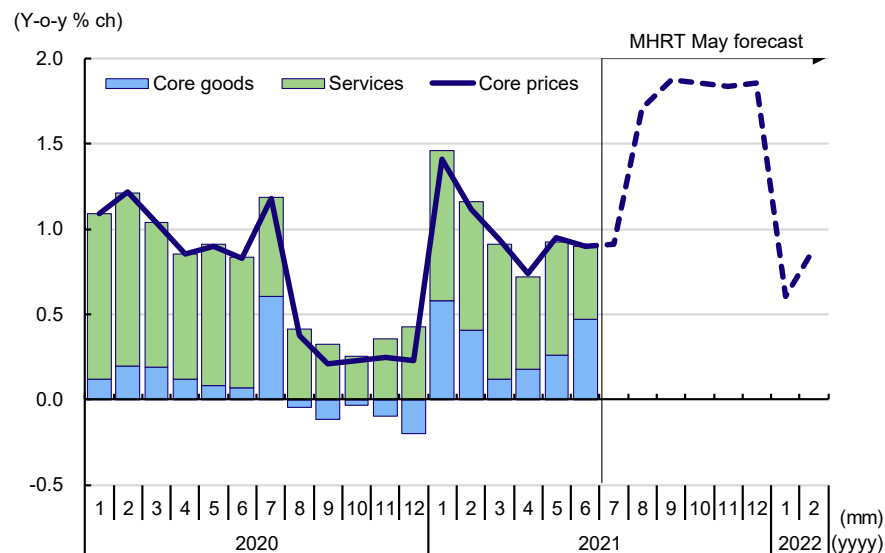


Note: The reading of zero is the "expansion-contraction" threshold.  
Source: Made by MHRT based upon European Commission.

# Eurozone consumer prices flattened out in June. Core prices likely to rise temporarily from August

- In June, Eurozone consumer prices (flash estimate) was +1.9% y-o-y, largely unchanged (-0.1% Pt from the previous month due to the slowdown of energy prices).
  - In the second half of the year, the pace of energy price increases is expected to slow down, serving as a drag on prices.
- Core prices (+0.9% y-o-y) remain near 1% (-0.1% Pt from the previous month). They are expected to rise temporarily to near 2% from August, mainly due to a rebound from the previous year (base effect).
  - Core goods rose for the third consecutive month. For the time being, upstream prices will continue to rise due to the resumption of the economy and supply constraints, and are likely to be shifted partially to final prices.
  - Labor shortages reflecting the resumption of the economy is expected to be limited, due to the fact that employment has been mostly maintained by using the shortened working hour subsidy system.

## Eurozone: core prices



Note: Degree of each components' contribution is based on a simplified estimate.  
Source: Made by MHRT based upon Eurostat

## Germany: PPI and CPI

(Y-o-y % ch)

	2021				
	Jan	Feb	Mar	Apr	May
Intermediate goods	+ 1.1	+ 2.1	+ 3.7	+ 5.7	+ 8.3
Durable consumer goods	+ 1.4	+ 1.5	+ 1.4	+ 1.6	+ 1.7
Food	-2.5	-2.7	-1.4	-0.6	+ 1.3
Non-durable consumer goods	-1.8	-2.0	-1.4	-0.6	+ 0.5
Consumer prices	+ 1.6	+ 1.6	+ 2.0	+ 2.1	+ 2.4

Source: Made by MHRT based upon Eurostat

# ECB clarified its inflation target of 2%. Moderate overshoot will also be tolerated

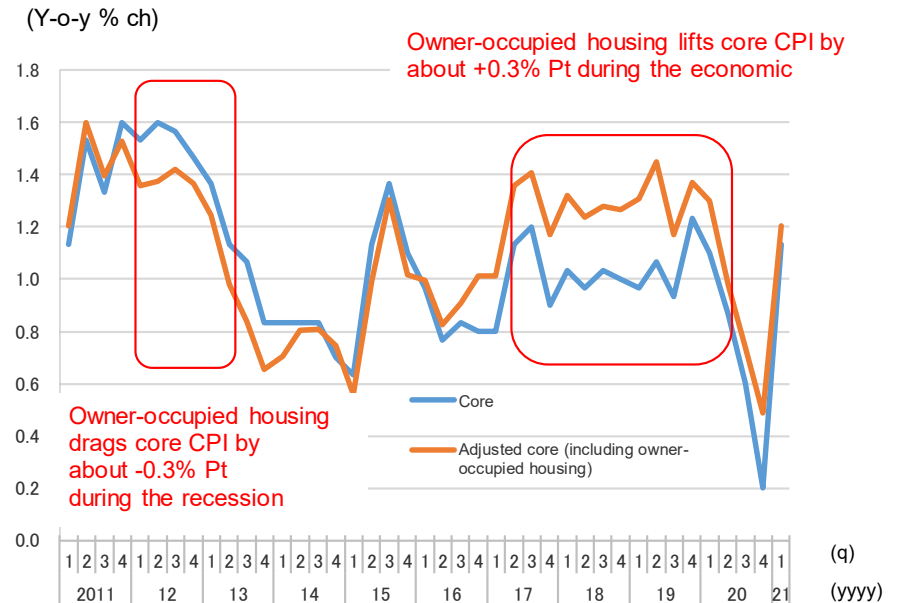
- At the Governing Council meeting on July 8, the ECB published the review its monetary policy strategy, including its inflation target and response to climate change.
- The inflation target was clarified from “[below, but close to,] 2%...over the medium term” to “2%...over the medium term.” Although it is not an “average inflation target,” the toleration of a moderate overshoot from 2%, suggests a prolonged period of monetary easing.
  - The Governing Council recommended including the cost of owner-occupied housing in the HICP. Although the HICP will likely be subject to negative and positive deviations reflecting the inclusion, we do not expect a sustained rise above 2% during the ECB’s forecast horizon.

## Points of the ECB Monetary Policy Strategy Review (July 8)

	Before change	After change
Inflation target	• Below, but close to, 2% over the medium term	• 2% over the medium term → Emphasizing its intention to respond symmetrically to negative and positive deviations from the target
Analysis base and method	• HICP is used as price index • Economic analysis and financial analysis are analyzed and verified independently (emphasis on current economic situation analysis)	• Inclusion of the cost of owner-occupied housing in the HICP over multiple years. For the time being, the Council will mainly use the current HICP • Integrate economic and monetary analyses (further emphasize stability of monetary environment)
Response to climate change	• From 2021, the Council starts accepting Sustainability Linked Bonds as eligible collateral	• Formulated and committed to a climate action plan through 2024. Plans to develop a climate risk monitoring system, and requires disclosure of climate risks at the time of collateral acceptance and asset purchase
Next strategy review		• Periodically assess the monetary policy strategy. The next assessment planned for 2025 (during President Lagarde’s term)

Source: Made by MHRT based upon ECB

## Eurozone: core prices



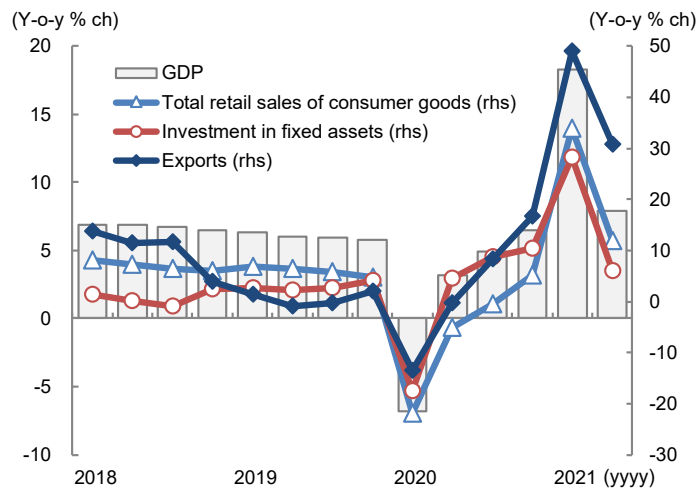
Note: The adjusted core is an MHRT estimate based on previous studies.  
Source: Made by MHRT based upon Eurostat



## Chinese economy: growth rate continues to improve in 2021 Apr-Jun quarter

- China's real GDP growth in the Apr-Jun quarter declined to +7.9% y-o-y (previous quarter +18.3% y-o-y) due to the previous year's factors fading, but still improved to +1.3% q-o-q (previous quarter: +0.6% q-o-q).
  - Exports remained at a high level as durable goods such as home appliances remained firm, against the backdrop of the global economic recovery, despite a lull in exports of communications and electronics.
  - In investment, real estate investment slowed down due to measures to curb the bubble economy, but was driven by the manufacturing sector, especially in high-tech sectors such as communication and medical equipment.
  - Retail sales continued to recover against the backdrop of an improved employment environment, but the pace slowed down due to the fading of special Covid-19 related demand, such as for communication equipment.
- Manufacturing investment and personal consumption are expected to remain stable, but the pace of growth is expected to slow gradually due to the peak-out of exports.

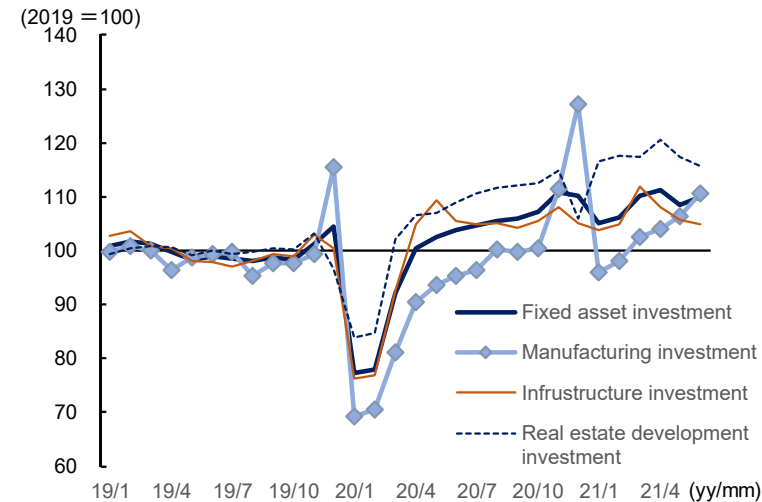
### Real GDP and key indicators



Note: Fixed asset investment is converted into real terms by PPI (construction materials), and total retail sales of consumer goods are converted into real terms by the retail price index. Exports are denominated in USD.

Source: Made by MHRT based upon the National Bureau of Statistics of China, the General Administration of Customs of China, and CEIC data

### Fixed asset investment (breakdown by industry)



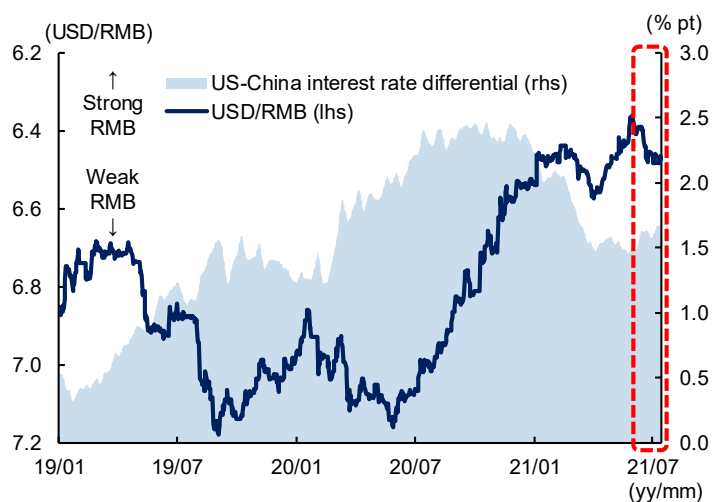
Note: Adjusted for seasonal factors by MHRT

Source: Made by MHRT based upon the National Bureau of Statistics of China and CEIC data

## The RMB weakened further after the FOMC meeting. Reserve requirement ratio lowered to support corporate financing

- Even though the RMB weakened further against the USD after the US FOMC meeting in June, it gained further ground to the USD since the second half of the month, trading around 1 USD = 6.47 RMB.
  - Despite lingering yuan-strengthening pressure due to the US-China interest rate differential, the pressure should gradually ease in view of the narrowing interest rate differential and signs of a pause in China's economic recovery.
- On July 9, the People's Bank of China (PBOC) announced that it would lower its reserve requirement ratio by 0.5% Pt from July 15, and strengthen support for cash-strapped small enterprises.
  - The amount of liquidity provided by lowering the ratio will be about 1 trillion RMB, some of which will be used to repay the medium-term lending facility (MLF), whose payment deadline is approaching.
  - The PBOC stated that "the direction of the monetary policy has not changed." While maintaining the stability of the monetary policy, the PBOC emphasized its stance of refraining from "flood-like" stimulus.

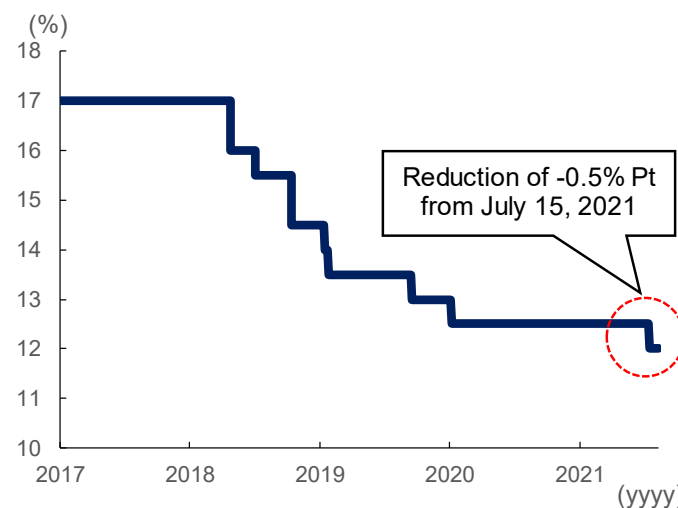
### RMB-USD rate / US-China interest rate differential



Note: The latest value is as of July 14, 2021  
 US-China interest rate differential = 10yr Chinese Bond Yield-10yr UST yield. 7-day moving average.

Source: Made by MHRT based upon CFETS, FRB and CEIC data

### Reserve requirement ratio (large commercial banks, base ratio)

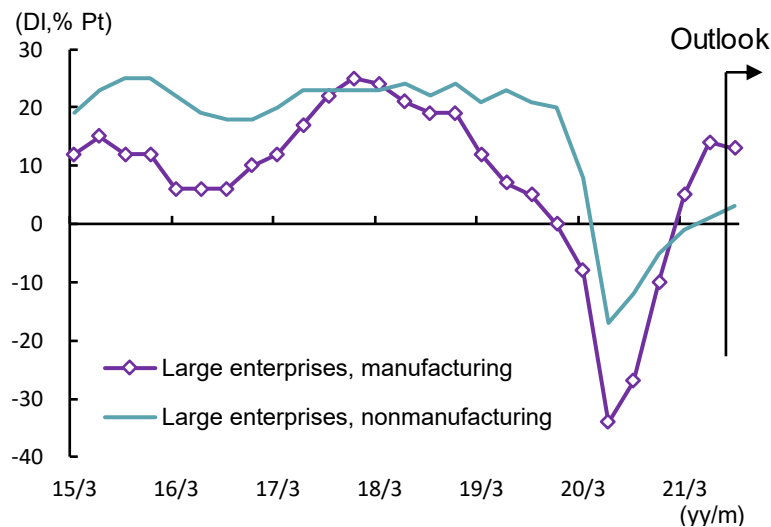


Source: Made by MHRT based upon People's Bank of China and CEIC data

# The Japanese economy: the BOJ *Tankan* revealed a significant improvement of the manufacturing sector. The nonmanufacturing sector turned positive, but the improvement was modest

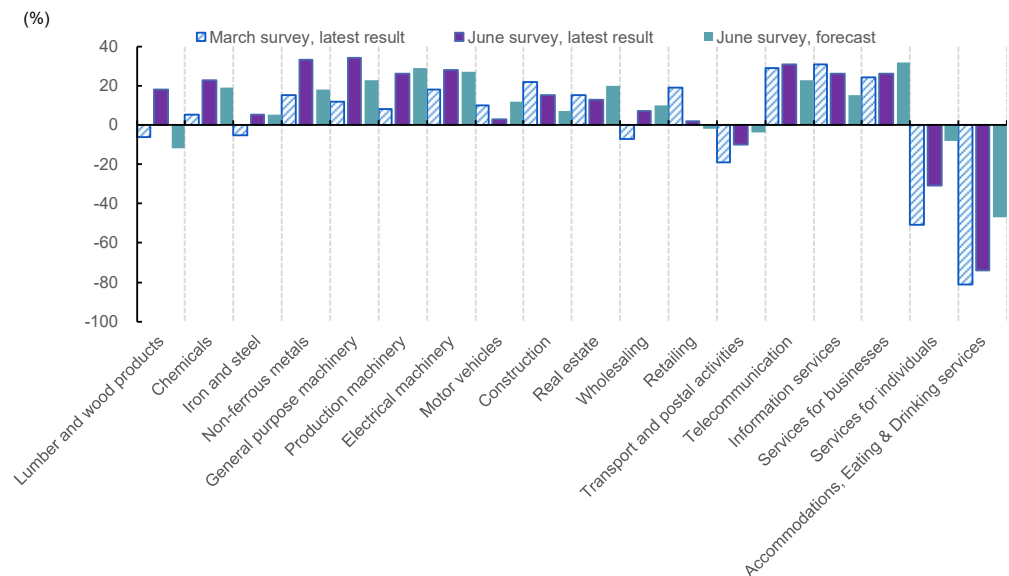
- Business conditions in the manufacturing sector improved significantly. Even though the nonmanufacturing sector turned positive for the first time in five quarters, the improvement was modest.
  - In the manufacturing sector, although the motor vehicle sector deteriorated due to semiconductor shortages, the materials sector, such as nonferrous metals and chemicals, production machinery and electric machinery sectors improved. In the nonmanufacturing sector, services for individuals and accommodation/eating and drinking improved due to progress in vaccinations and increase in mobility since late May. However, retail sales fell sharply, dragging down the overall sector.
- Looking forward, the manufacturing sector will remain at a high level. While services requiring face-to-face contact will improve significantly in the nonmanufacturing sector, due to expectations toward vaccine rollouts, the level will remain low.

**Trends in business conditions DI (large enterprises, manufacturing and nonmanufacturing sector)**



Source: Made by MHRT based upon Bank of Japan, *Short-Term Economic Survey of Enterprises in Japan (Tankan)*

**Comparison of business conditions DI (by industry)**

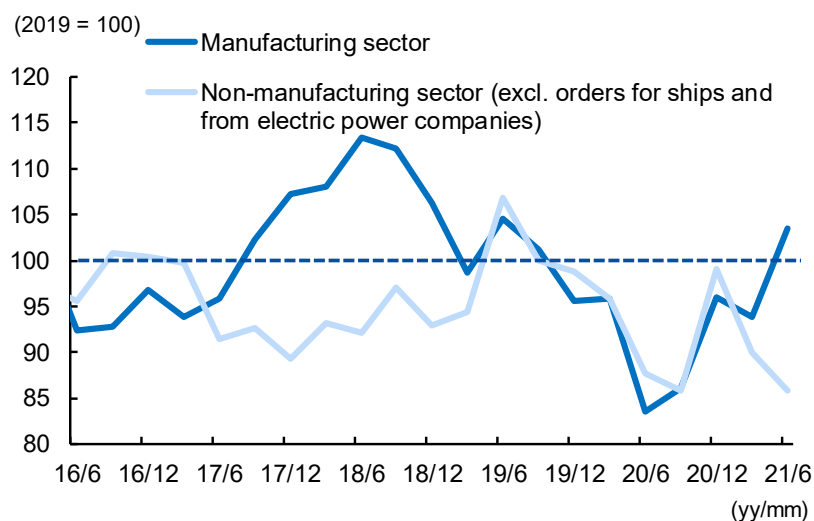


Source: Made by MHRT based upon Bank of Japan, *Short-Term Economic Survey of Enterprises in Japan (Tankan)*

## Capital investment is recovering mainly in the manufacturing sector

- Regarding current capital investment in machinery, the degree of recovery differs between the manufacturing and nonmanufacturing sectors.
  - In May, private sector machinery orders (excluding orders for ships and from electric power companies) increased +7.8% m-o-m (April: +0.6% m-o-m).
  - Comparing the levels in April and May with those before the Covid-19 pandemic, the manufacturing sector is at 103%, above the 2019 pre-Covid-19 level, while the nonmanufacturing sector is at 86%, below said level. The nonmanufacturing sector is taking a cautious investment stance, especially in the transport and postal industries.
- Only a small portion of industries, which benefited from strong semiconductor demand, improved significantly from the pre-Covid-19 level. As a whole, the resumption of renewal investments are viewed as the main factor.

### Private sector machinery orders (quarterly average)



Note: The reading for June 2021 is the values of April and May.  
Source: Made by MHRT based upon Cabinet Office, *Machinery Orders*

### Comparison with pre-Covid-19 (2019) levels, by industry

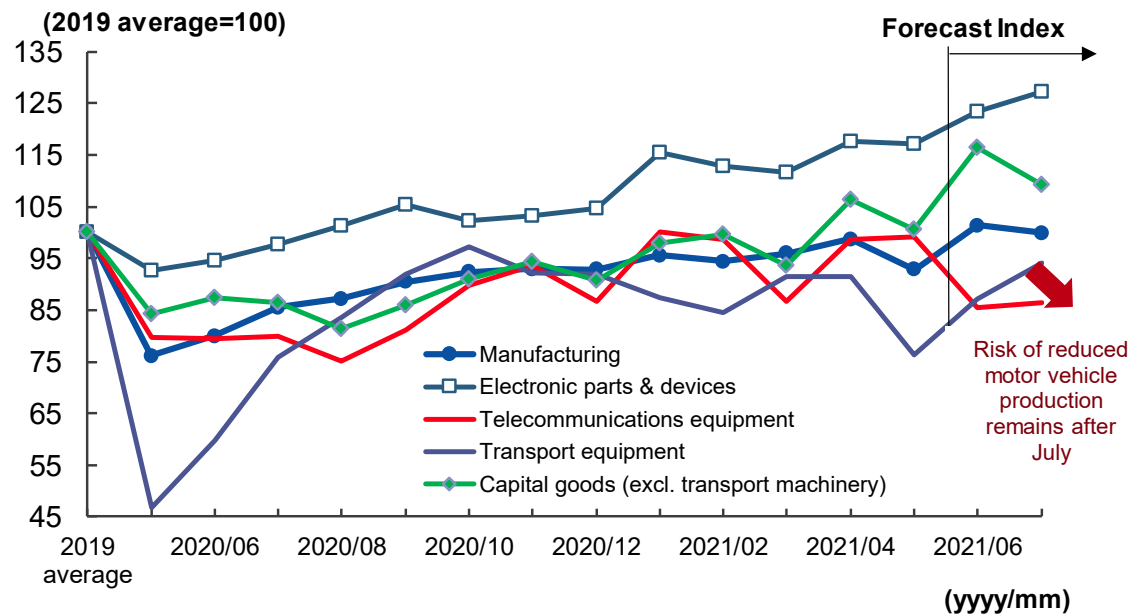
	Weight (%)	Manufacturing sector	Nonmanufacturing sector
Improved from pre-Covid-19 pandemic levels (more than 10%)	11	Electric machinery, Business-oriented machinery Non-ferrous metals Petroleum and coal products	N/A
Less than 10%	30	General purpose machinery Other manufacturing sectors	Telecommunications, Construction, Agriculture, forestry and fishery
Fell below pre-Covid-19 pandemic levels	59	Motor vehicle, Iron and steel, Chemicals, Food products, Shipbuilding, Information and Communication Machinery	Transport and postal activities, Wholesaling and retailing, Real estate, Information services, Electric power, Leasing

Note: Weights are calculated on the basis of 2019 to 2020  
Source: Made by MHRT based upon Cabinet Office, *Machinery Orders*

# Output cuts in motor vehicles served as a drag on production. More time is necessary for normalization

- In May, industrial production fell for the first time in three months to -5.9% m-o-m (Apr: +2.9% m-o-m).
  - Despite a m-o-m decline, capital goods and information-related goods maintained a high level due to demand for equipment and housing investment mainly in the US, and firm online-related demand in Japan and abroad.
  - However, a decline in motor vehicle production (-19.4% m-o-m) due to semiconductor shortages served as a drag.
- Looking forward, capital goods and information-related goods will continue to follow a recovery trend. On the other hand, the recovery of production in the motor vehicle sector will be limited due to prolonged shortage of semiconductors.

## Actual production / forecasted production indices by major industry/goods, compared to pre-Covid-19 levels

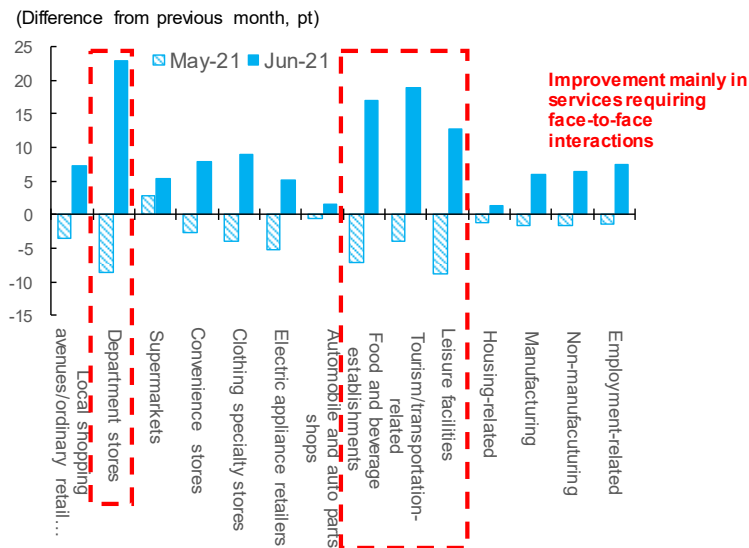


Note: Actual results are based on the industrial production index, and plans are based upon the index of industrial production forecast.  
 Source: Made by MHRT based upon Ministry of Economy, Trade and Industry, *Indices of Industrial Production*

# Business sentiment improved significantly in June due to the lifting of the state of emergency

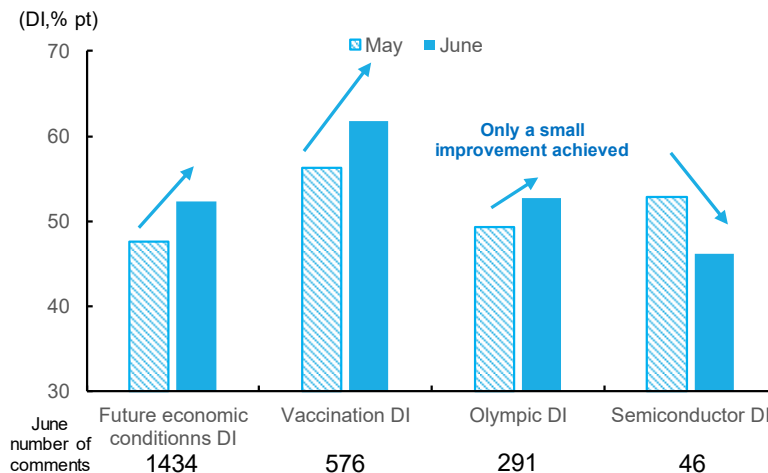
- Given the lifting of the declaration of a state of emergency, business sentiment in June improved significantly, especially for services requiring face-to-face interactions.
  - The DI for current conditions (direction) in June improved for the third consecutive month, up +9.5 Pt m-o-m.
  - However, the DI for current conditions (June: 35.2) was lower than pre-Covid-19 pandemic levels (2019 average: 42.9).
  - The DI for passenger car dealers and housing-related industries only turned out to be slightly positive due to a shortage of semiconductors for motor vehicles and rise of material prices.
- Expectations toward vaccinations continue to support judgments on future economic conditions. On the other hand, Olympic Games-related expectations are limited.
  - Business sentiment in July is expected to deteriorate due to the issuance of the fourth declaration of a state of emergency and the destabilization of vaccine supplies.

## Economy Watchers Survey: DI for current conditions (by sector)



Source: Made by MHRT based upon Cabinet Office, *Economy Watchers Survey*

## Future economic conditions: vaccination DI, Olympic DI and semiconductor DI

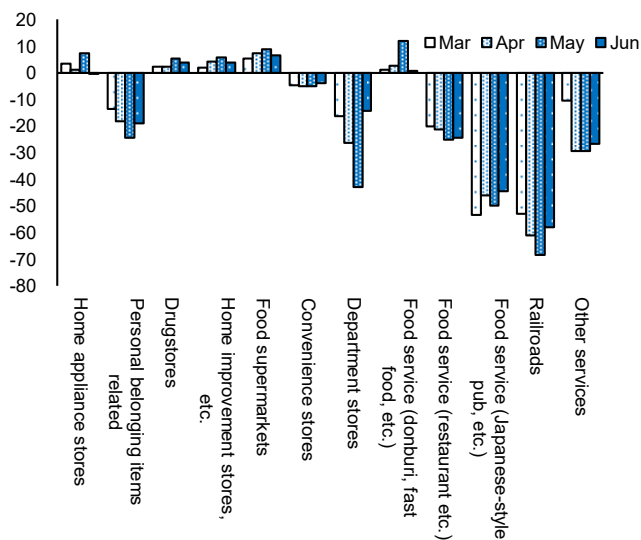


Note: Each DI is the aggregated value of business sentiment of comments including the respective words.  
Source: Made by MHRT based upon Cabinet Office, *Economy Watchers Survey*

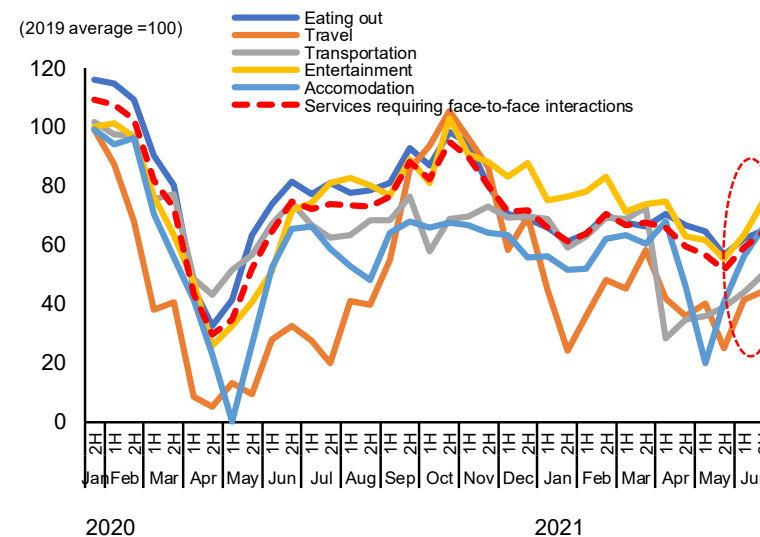
# Despite the improvement of service sector sales in June, we expect service sales to worsen again due to the declaration of a state of emergency

- In June, the breadth of decline of sales among corporations, mainly in the service sector, narrowed in comparison with the pre-Covid-19 period.
  - Sales picked up slightly in eating-out (Japanese pubs, etc.) and railways along with the lifting of the previous declaration of state of emergency (June 20). With respect to goods, sales improved dramatically among department stores.
- According to high frequency data, consumption of services requiring face-to-face interactions also recovered in the second half of June.
  - Overall, the Apr-Jun quarter declined -9.6% q-o-q, in line with the July forecast.
  - However, looking forward, services requiring face-to-face interactions are expected to deteriorate again due to the fourth declaration of a state of emergency. The Jul-Sep quarter as a whole is expected to remain more or less flat from the Apr-Jun quarter (about 60% of the pre-Covid-19 level).

**Change in current sales of corporations compared to pre-Covid-19 pandemic (2019)**



**Consumption of services requiring face-to-face interactions in the second half of June**



Source: Made by MHRT based upon each corporation's monthly IR information

Note: Reference data series. Adjusted for seasonal factors by MHRT  
Source: Made by MHRT based upon JCB and Nowcast, *JCB Consumption NOW*.



## Fourth declaration of a state of emergency issued in Tokyo

- The Japanese government decided upon the issuance of a fourth declaration of a state of emergency in Tokyo.
  - This time, the focus is on the suspension of serving alcoholic beverages at restaurants and request for shorter operating hours (until 8 p.m.). The Olympic Games will be held without spectators at venues in the Tokyo metropolitan area.
  - Depending on the degree of proliferation of the Delta variant of the Covid-19 virus, additional declarations may be issued for Saitama, Chiba, Kanagawa, and Osaka. On the other hand, the emergency declaration is expected to be lifted on August 22 as scheduled, due to the quick issuance of the declaration and progress of vaccine rollouts.
  - In other regions, a further declaration may be issued for Osaka depending on the state of the Delta variant.
  - GDP growth for the Jul-Sep quarter is expected to be a tepid +0.5% q-o-q due to the sluggish personal consumption. This will drag down FY2021 GDP by -0.3%.

### Details of the declarations of a state of emergency

		1st Declaration	2nd Declaration	3rd Declaration	4th Declaration (initial)
Duration of declaration		Apr 7 to May 25, 2020 (7 weeks)	Jan 8 to Mar 21, 2021 (10 weeks)	Apr 25 to Jun 20, 2021 (except for Okinawa)	From Jul 12, 2021 (scheduled to be lifted on Aug 22)
Applied regions		Nationwide	11 prefectures  Tochigi, Saitama, Chiba, Tokyo, Kanagawa, Gifu, Aichi Kyoto, Osaka, Hyogo, Fukuoka	10 prefectures  Hokkaido, Tokyo, Aichi, Kyoto, Osaka, Hyogo, Okayama, Hiroshima, Fukuoka, Okinawa	2 prefectures  Tokyo, Okinawa
Content	Schools	Request for school closures	—	—	—
	Commercial and Entertainment facilities	Request for suspension of operations	Encouragement of shorter operating hours	Request for suspension of operations	Request for shorter operating hours (until 8 p.m.)
	Restaurants and bars, etc.	Request for shorter operating hours (until 8 p.m.)	Request for shorter operating hours (until 8 p.m.)	Alcohol-serving establishments requested to suspend operation	Alcohol-serving establishments requested to suspend operation
		Alcohol-serving allowed until 7 p.m.	Alcohol-serving allowed until 7 p.m.	Establishments not serving alcohol requested to close by 8 p.m.	Establishments not serving alcohol requested to close by 8 p.m.
Large-scale events	Request to refrain from holding events	Capped at less than 50% of venue capacity, up to a maximum of 5,000 people	As a general rule, ban spectators from attending events	Capped at less than 50% of venue capacity, up to a maximum of 5,000 people	

Source: Made by MHRT



# BOJ's July meeting announced the outline of the Fund-Provisioning Measure to Support Efforts on Climate Change, with applied interest rate of 0%

- At the July Monetary Policy Meeting (July 15 and 16), the Bank of Japan (BOJ) decided to maintain its current monetary policy stance. The preliminary outline of the Fund-Provisioning Measure to Support Efforts on Climate Change was announced.
  - The climate change measure will be implemented as a general rule until the end of FY2030. Twice as much as the amount outstanding will be added to Macro Add-on Balances, and the applied interest rate is 0%.
  - Since the BOJ's Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth covers energy-related companies, the measure was established as a new framework. In Japan, which focusses on indirect finances, the measure will be structured as financial institutions being responsible for making financing decisions, while enabling the immediate start of initiatives.
- In the *Outlook for Economic Activity and Prices (Outlook Report)*, the projected growth rate for FY2021 was revised down from the previous outlook due to the impact of Covid-19, but was revised upward for FY2022. Prices for FY2021 were revised upward due to such factors as the upturn in energy prices. The outlook on prices indicates a substantial downward risk.

## Outline of the Fund-Provisioning Measure to Support Efforts on Climate Change

- To be implemented within 2021, until the end of FY2030 in principle
- Eligible counterparties will be financial institutions that disclose a certain level of information on their efforts to address climate change.
- Funds will be provided to those that invest in Japan's actions to address climate change.
- Yen-denominated funds
- The interest rate will be 0%.
- The loan period will be provided for one year in principle, but rollovers can be made, effectively providing long-term financing.
- "Twice as much as the amount outstanding" will be added to the Macro Add-on Balances in their current accounts.
- The applied interest rate is 0% (Category III).

Source: Made by MHRT based upon the Bank of Japan

## Bank of Japan Outlook Report (July 2021)

	Real GDP	CPI (excluding fresh food)
<b>FY2021</b>	+3.5 to +4.0 (+3.8) ↓	+0.3 to +0.6 (+0.6) ↑
Forecasts made in April 2021	+3.6 to +4.4 (+4.0)	0.0 to +0.2 (+0.1)
<b>FY2022</b>	+2.6 to +2.9 (+2.7) ↑	+0.8 to +1.0 (+0.9)
Forecasts made in April 2021	+2.1 to +2.5 (+2.4)	+0.5 to +0.9 (+0.8)
<b>FY2023</b>	+1.2 to +1.4 (+1.3)	+0.9 to +1.1 (+1.0)
Forecasts made in April 2021	+1.2 to +1.5 (+1.3)	+0.7 to +1.0 (+1.0)

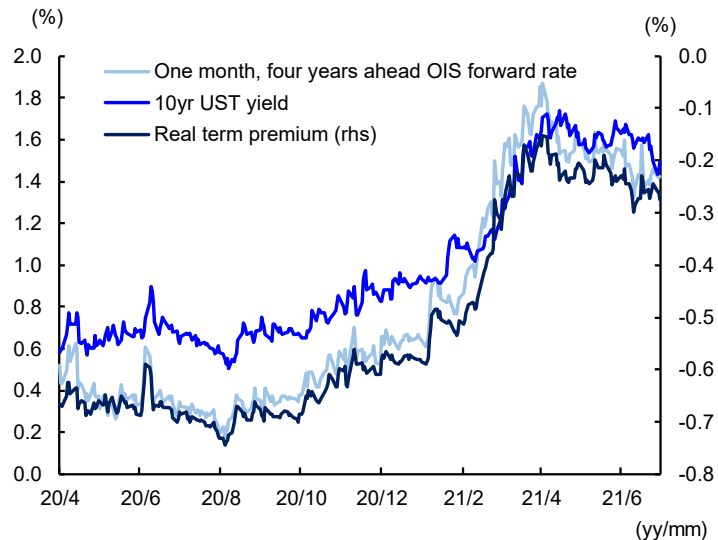
Note: Majority outlook of the Policy Board members. FY y-o-y comparisons, % and figures in brackets indicate the medians of the Policy Board members' forecasts. Arrows are added by MHRT.

Source: Made by MHRT based upon the Bank of Japan

## US bond market: the 10yr UST yield is expected to move around 1.3% to 1.5%

- The 10yr UST yield fell below 1.3%, reflecting factors such as concerns regarding the spread of Covid-19 infections and deterioration of business sentiment, as well as FRB Chair Powell's dovish comments.
  - The interest rate decline that lasted until the end of June was due mainly to the fall of the term premium. As the one month, four years ahead OIS forward rate, which is highly correlated with the term premium, has been declining since the beginning of July, we suspect that the fall of the term premium is still serving as a drag on interest rates.
- The 10yr UST yield is forecast to move around 1.3 to 1.5%.
  - Despite the difficulty for interest rates to rise at the moment due to concerns regarding the spread of Covid-19 infections and deterioration of business sentiment, we forecast a gradual rise of interest rates going forward, given speculation on tapering in August/September amid the persistence of a high level of the expected inflation rate.

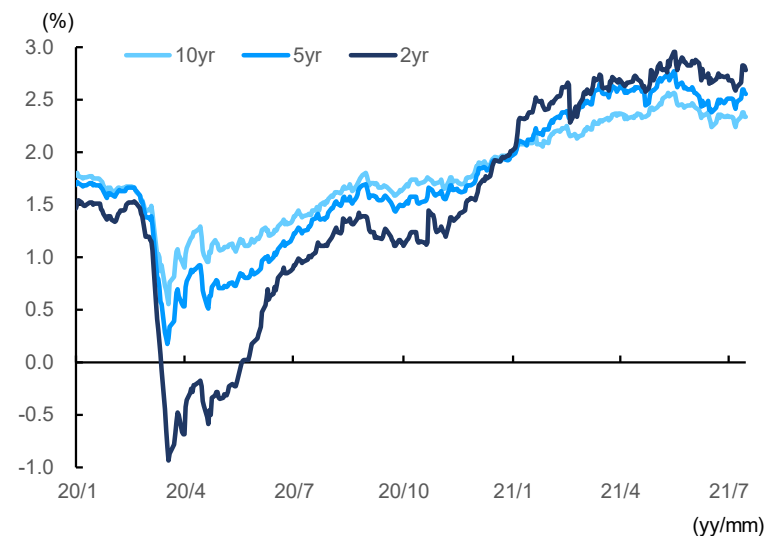
### Term premium and OIS forward rate



Note: Data are through the end of June 2021. The term premium is an estimate based on the FRB's DKW model. The term premium is the additional interest rate that investors expect to be compensated when holding bonds for longer periods, and is one of the components of the 10yr UST yield in the DKW model.

Source: Made by MHRT based upon FRB and Bloomberg

### Expected inflation rate

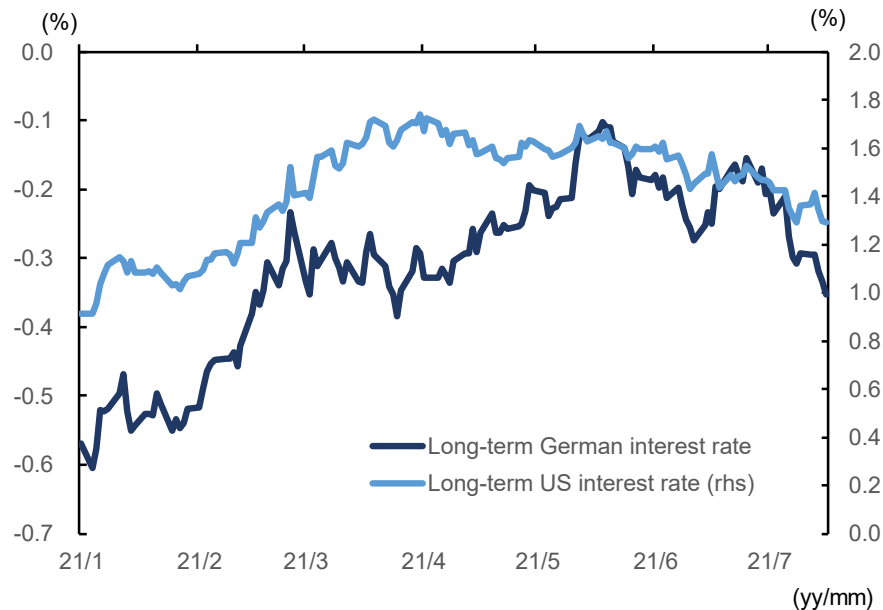


Note: Expected inflation rate is breakeven inflation rate.  
Source: Made by MHRT based upon Bloomberg

## Eurozone bond market: German 10yr government bond yield expected to move around -0.35% to -0.15%

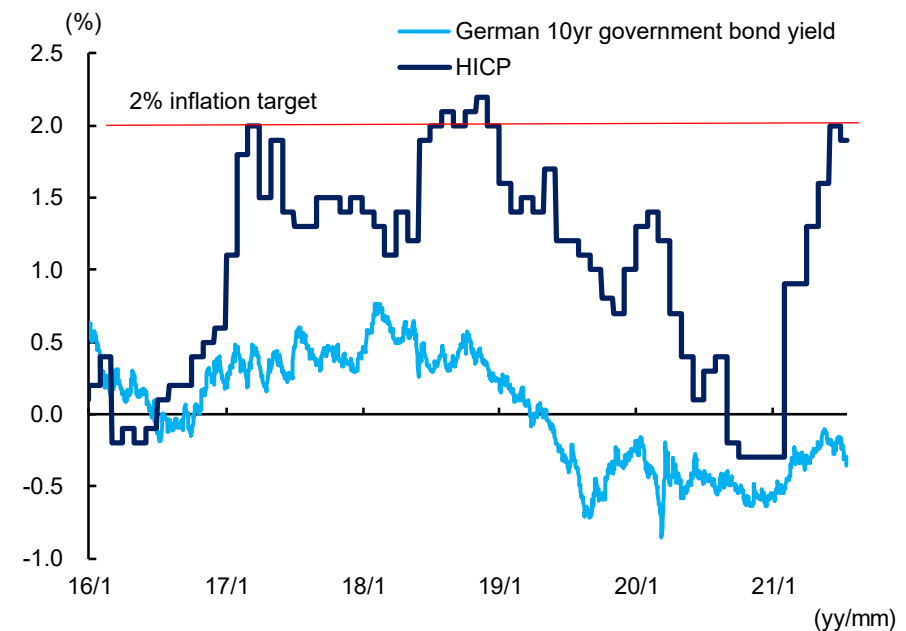
- The German 10yr government bond yield fell to the -0.3% level for the first time in approximately three months against a backdrop of declining US interest rates, together with concerns regarding a slowdown of economic recovery due to the global spread of Covid-19 infections and dovish ECB comments.
- Looking forward, the German 10yr government bond yield is expected to move around -0.35% to -0.15%.
  - The ECB announced the outcome of the monetary policy strategy review (July 8). The inflation target was changed to “2% over the medium term” and approved temporary deviations above 2%. However, according to the ECB's June projection, the inflation rate is not expected to exceed 2% continuously over the outlook period until 2023, indicating a prolonged period of monetary easing. Therefore, the German 10yr government bond yield is expected to trend at a low level.

**Trend of long-term US and German interest rates**



Source: Made by MHRT based upon Bloomberg

**Trend of long-term German interest rate and Eurozone inflation**

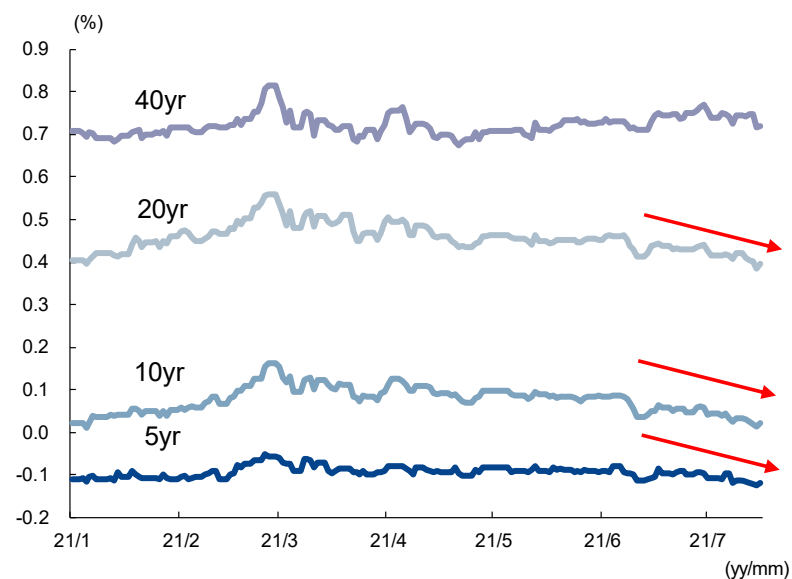


Source: Made by MHRT based upon Bloomberg

## Japanese bond market: 10yr JGB yield is projected to flatten out

- The yield on 10yr JGBs fell to the lower 0.0% level due to factors such as the decline in US long-term interest rates and the fourth declaration of a state of emergency in Tokyo.
  - The schedule of outright purchases of JGBs, which is announced monthly, will be announced quarterly from July 2021 onwards. The planned purchase amount of JGBs for the Jul-Sep quarter is reduced from the previous quarter, but the impact on the market will be limited.
- The decline in long-term US interest rates is expected to pause, and the 10yr JGB yield is projected to remain flat.
  - The FRB is expected to make an announcement on tapering at the September FOMC meeting, but if it is announced at the July FOMC meeting, it could be a factor for the rise in the 10yr JGB yield through the rise in US interest rates.

### Trend in JGB yields



Source: Made by MHRT based upon Bloomberg

### Scheduled purchases of JGBs (2021 Jul-Sep quarter)

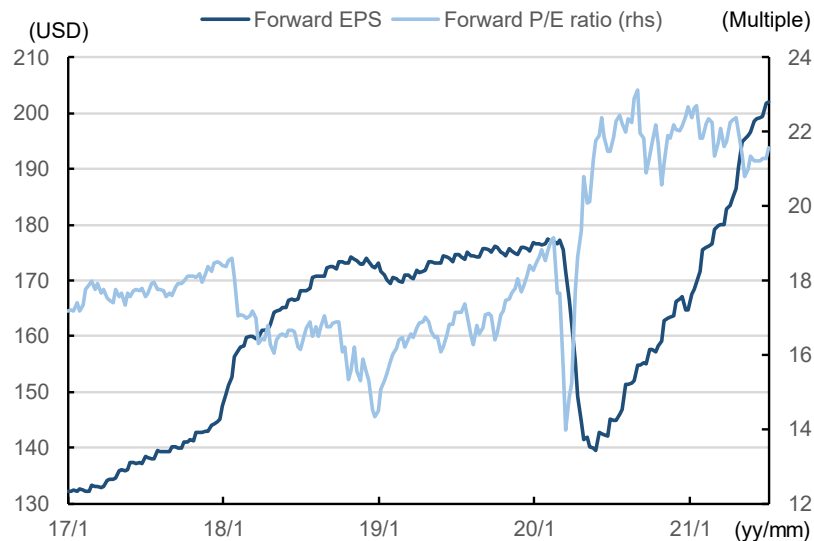
	Amount purchased during Apr-Jun	Purchase amount scheduled during Jul-Sep	Change from Apr-Jun
	(JPY 100 million)	(JPY 100 million)	(JPY 100 million)
Up to 1 year	1,500	1,500	0
More than 1 year and up to 3 years	19,000	18,000	-1,000
More than 3 years and up to 5 years	18,000	18,000	0
More than 5 years and up to 10 years	18,000	17,000	-1,000
More than 10 years and up to 25 years	2,000	1,500	-500
More than 25 years	500	500	0
Inflation-indexed bonds	600	600	0

Note: Amount of purchases per month.  
Source: Made by MHRT based upon the Bank of Japan

# US stock market: expected to follow steady trend due to expansion of corporate earnings

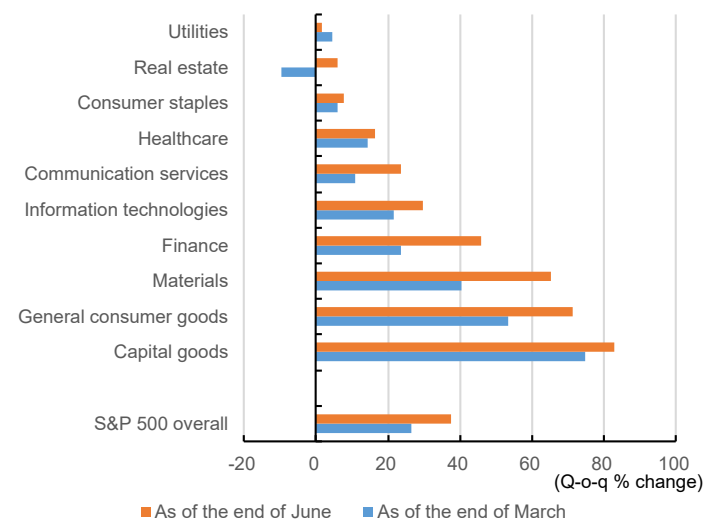
- US stocks rose to record highs given the ebb of caution regarding an early tapering of monetary easing.
  - Although there was temporary weakness due to concerns of economic slowdown, FRB Chair Powell's remarks and other factors have alleviated a sense of caution about an early tapering of monetary easing. US stocks rose mainly in sectors such as information technology and communication services, and all three major US stock indices rose to record highs.
- Despite the current rise of concerns regarding economic slowdown, the forward EPS remained on an expansionary trend due to expectations toward the normalization of economic activities. As a result, the forward P/E ratio remains at the 21x range even in the face of new highs.
- The US stock market should follow firm footing as analysts' earnings forecasts gain further credibility along with the progress in announcement of 2nd quarter earnings reports.

## S&P 500 forward EPS and forward P/E ratio



Note: Forward EPS and forward P/E ratio are based on 12-month forward forecast.  
Source: Made by MHRT based upon Refinitiv

## Forward EPS growth rate by sector for US stocks in FY2021

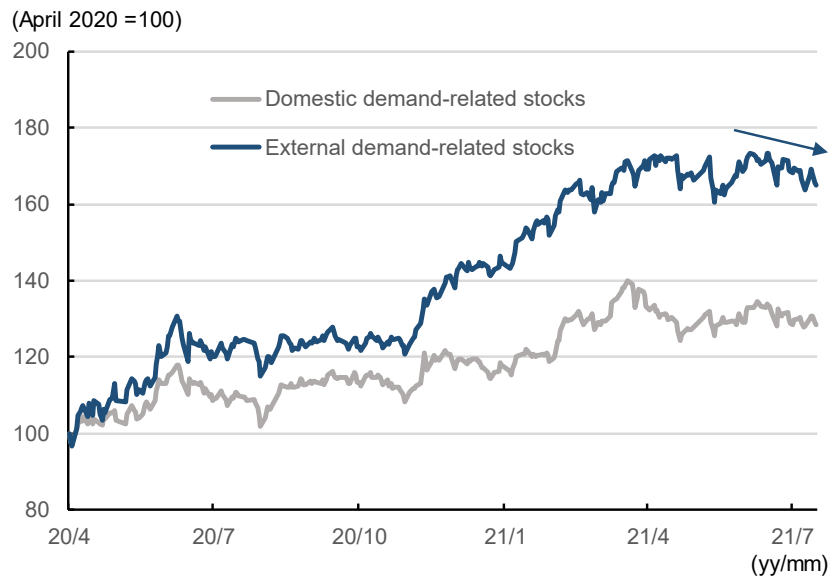


Source: Made by MHRT based upon Refinitiv

# Japanese stock market: although the resurgence of Covid-19 serves as a drag, a gradual rise is expected going forward

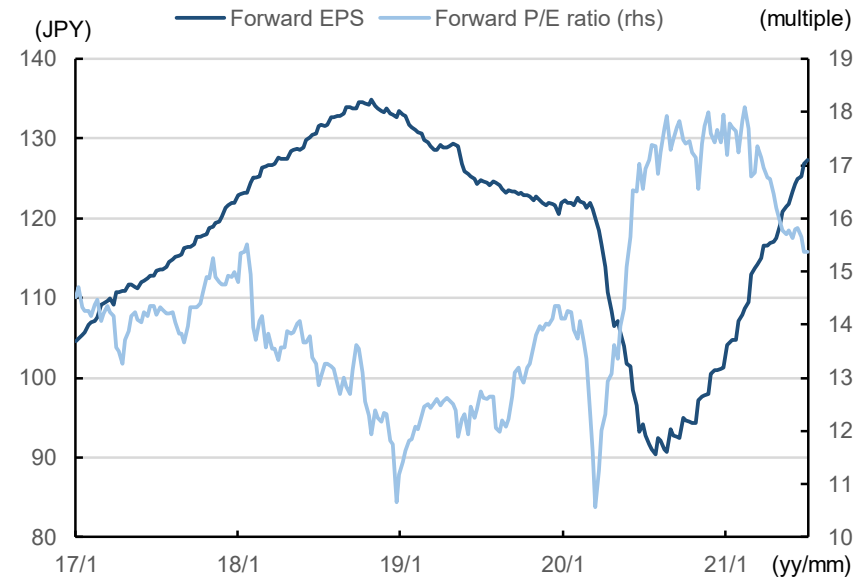
- The Nikkei Stock Average remained weak due to the resurgence of Covid-19 infections and the declaration of a state of emergency.
  - External demand-related stocks, which have driven the market so far, are also at a slight standstill.
- The forward EPS has largely recovered to pre-Covid-19 pandemic levels (end of 2019), and corporate earnings have been firm.
  - On the other hand, the forward P/E ratio declined to 15.4x amid the resurgence of Covid-19 infections.
- Although the resurgence of Covid-19 infections in Japan will serve as a drag on stock prices for now, they are expected to rise gradually during the second half of 2021 given the expansion of corporate earnings due to the recovery of the real economy.

## Trends in domestic demand-related stocks and external demand-related stocks



Note: Domestic demand-related stocks and external demand-related stocks are represented by Nikkei 225 Domestic Exposure 50 Index and Nikkei Global Exposure 50 Index, respectively  
 Source: Made by MHRT based upon Bloomberg

## TOPIX forward EPS and forward P/E ratio

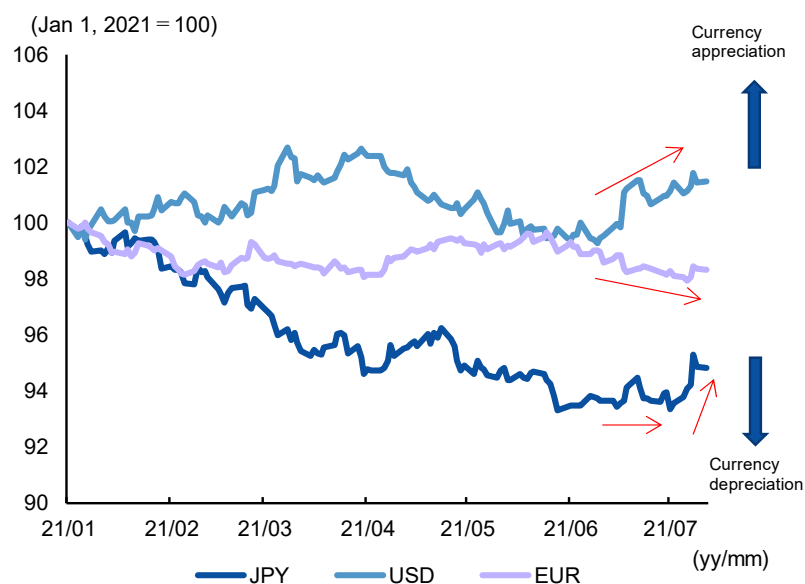


Note: Forward EPS and forward P/E ratio are based on 12-month forward forecast.  
 Source: Made by MHRT based upon Refinitiv

## Forex market: a gradual strengthening of the dollar is expected going forward

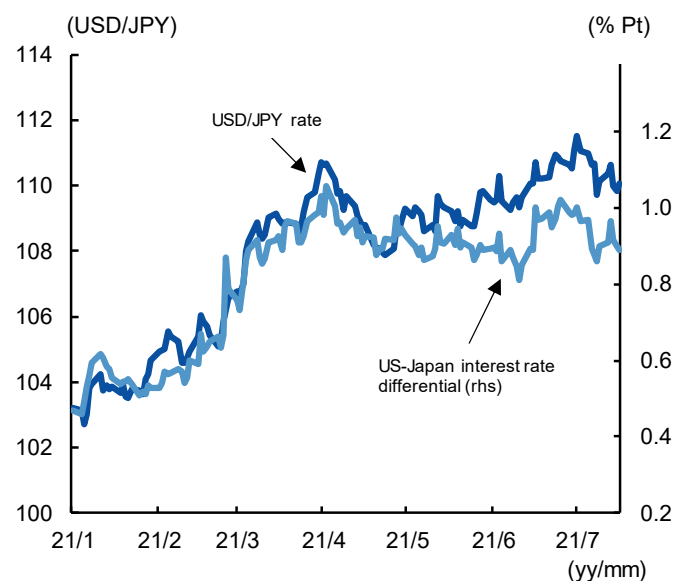
- The dollar has been strengthening since mid-June, reflecting the FOMC's hawkish stance. The dollar should remain strong in July and beyond, reflecting concerns regarding the slowdown in pace of economic recovery.
  - Looking at the nominal effective exchange rate, the dollar has been appreciating due to the hawkish stance of the FOMC and concerns about the slowdown in the pace of economic recovery stemming from the spread of Delta variants worldwide.
  - The yen leveled off in June. Since July, the yen appreciation against major currencies has progressed.
- Looking forward, the dollar is expected to strengthen gradually against the yen, amid the rise of US interest rates reflecting the US economic recovery. However, given lingering concerns regarding a slowdown in the pace of economic recovery due to the spread of Covid-19 infections, it will be necessary to keep a close eye upon the possibility of both the dollar and yen appreciating against other major currencies.

### Nominal effective exchange rate



Note: Nominal effective exchange rate is on BIS Broad basis.  
Source: Made by MHRT based upon Bloomberg

### USD/JPY exchange rate and US-Japan interest rate differential

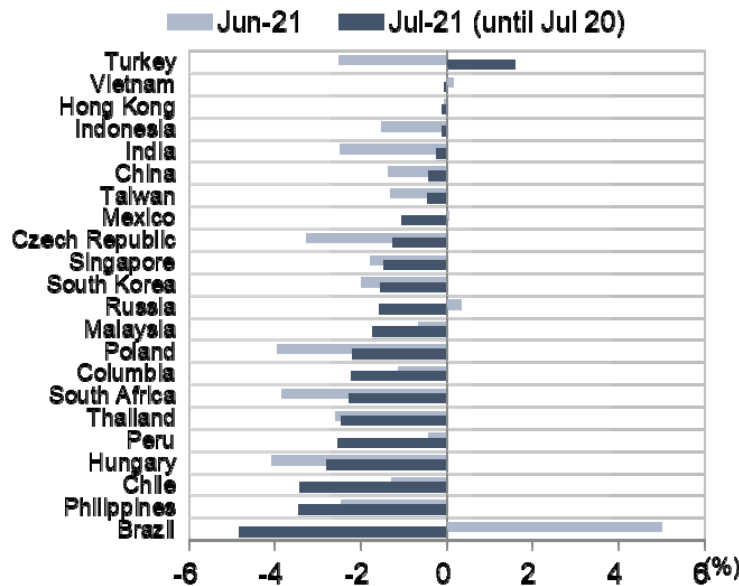


Note: US-Japan interest rate differential = US 5yr bond yield – Japan 5yr bond yield.  
Source: Made by MHRT based upon Bloomberg

# EM financial markets: generally weak against the backdrop of resurging Covid-19 infections

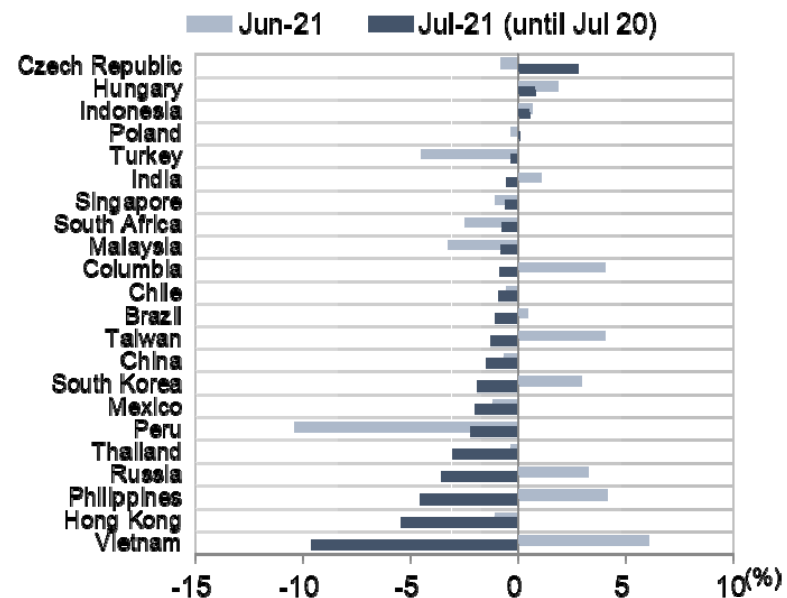
- Asian currencies fall due to the resurgence of Covid-19 infections.
  - The currencies are weakening in countries such as Malaysia, the Philippines, and South Korea, in addition to Thailand, where the number of new Covid-19 cases surged. In Indonesia, where mobility restrictions have been tightened, the rupiah (exchange rate to the dollar) remained weak, and stock prices fell sharply in Vietnam.
- Political factors in South Africa and Brazil, and a pause in the rise of copper prices in Chile served as factors behind the currency depreciation.
  - In South Africa, the deteriorating security situation prompted by demonstrations against the imprisonment of the former president, and in Brazil the president's corruption allegations, served as currency selling incentives.
  - On the other hand, in Turkey, where the central bank has tightened monetary policy, the depreciation of its currency has paused, but remains at historical-low levels.

**EM currencies' percentage change in prices against the dollar**



Source: Made by MHRT based upon Refinitiv

**EM stocks' percentage change in prices**



Source: Made by MHRT based upon Refinitiv



## Outlook on the financial markets

		July 20, 2021	Jul-Sep	Oct-Dec	Jan-Mar
Japan	Interest rate on Policy-Rate balances (End of quarter, %)	-0.10	-0.10	-0.10	-0.10
	Newly-issued JGBs (10yr, %)	0.01	0.00 to 0.10	0.05 to 0.15	0.05 to 0.15
	Nikkei Stock Average (JPY)	27,388	28,500 to 29,500	29,500 to 30,500	30,000 to 31,000
US	Federal Funds rate (End-of-quarter, %)	0.00 to 0.25	0.00 to 0.25	0.00 to 0.25	0.00 to 0.25
	Long-term UST (10yr, %)	1.22	1.40 to 1.60	1.60 to 1.80	1.60 to 1.80
	Dow Jones Average (USD)	34,512	34,100 to 35,100	34,500 to 35,500	34,500 to 35,500
Eurozone	ECB deposit facility rate (End of quarter, %)	-0.50	-0.50	-0.50	-0.50
	Long term government bond (Germany, 10yr, %)	-0.41	-0.35 to -0.15	-0.30 to -0.10	-0.30 to -0.10
Forex	USD/JPY rate (USD/JPY)	109.85	109 to 111	110 to 112	110 to 112
	EUR/USD rate (EUR/USD)	1.178	1.17 to 1.19	1.16 to 1.18	1.15 to 1.17

Note: 1. The foreign exchange rates (actual) are NY closing rates.

2. The projected policy interest rate indicated for the Jul-Sep, Oct-Dec, and Jan-Mar quarter is the end of quarter closing rate, while others indicate that the average value in the quarter will fall within the range indicated.

Source: Made by MHRT based Bloomberg

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