FY2013, FY2014, FY2015
Economic Outlook

February 18, 2014

<The US Economy >

- **Personal consumption and housing investment will hold up well due to the progress of household balance sheet adjustment. Also expect the steady expansion of employment**

2014: +2.6% (forecast in December +2.4%)
2015: +2.7%

<The Eurozone Economy >

- **Despite the continuation of an export and capital investment-led recovery, eurozone growth is forecast to remain at the lower half of the 1%-level, given the ongoing slump among southern European countries**

2014: +1.1% (forecast in December +0.9%)
2015: +1.3%

<The Asian Economy >

- **Despite forecasts of a gradual economic recovery, the rate of economic growth should continue to slow down in China due to constraints upon excessive investment**

2014: +6.1% (forecast in December +5.9%)
2015: +5.9%

<The Japanese Economy >

- **Strong growth in the Jan-Mar quarter due to a rush of demand prior to the consumption tax hike**

FY2013: +2.2% (forecast in December +2.5%)

- **Despite a temporary dip due to the impact of the consumption tax hike, external demand and public demand will prop up the economy**

FY2014: +0.8% (forecast in December +0.8%)

- **Exports and private demand will recover. A fall into recession will be avoided even after the consumption tax hike**

FY2015: +1.6%

I. The Chief Economist's View

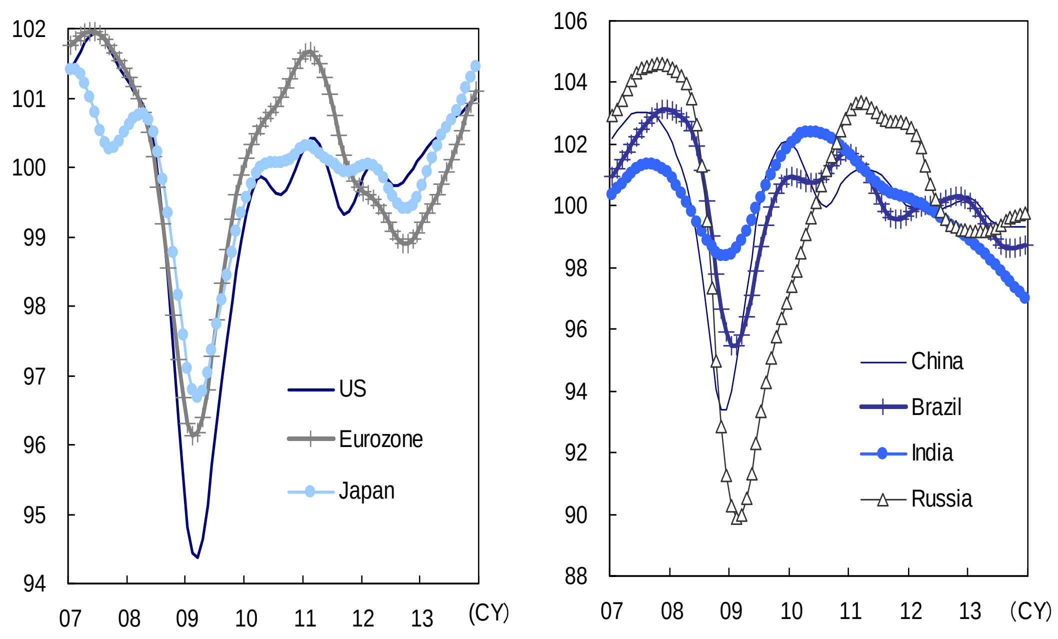
A year of "neo-decoupling" in 2014: stalled growth among emerging countries in contrast to solid growth among developed countries

The emerging countries stall in contrast to an improvement among the US and eurozone economies

At the beginning of last year, Mizuho Research Institute Ltd. (MHRI) shifted its outlook on the basis of the perception that the US economy was nearing its final stage of its balance sheet adjustment process. In our latest Economic Outlook, we have made a further upward revision of our forecast on the US. We have revised up our forecast on the eurozone economy to 1% in 2014 from growth in negative territory for two years in a row in 2012 and 2013. Although a temporary slowdown is expected this year due to the consumption tax hike in April 2014, our basic outlook on the Japanese economy in 2014 is one of sustainable recovery. In contrast, the emerging countries - mainly the BRICs - will slow down in comparison to 2013. Despite the recent uncertainties regarding the emerging countries, our basic scenario on the global economy in 2014 is a "neo-decoupling" in which the global economy will continue to improve driven mainly by the US and eurozone economies.

In 2014, we have raised our outlook on the US economy to the upper half of the 2%-level since it will no longer be restrained by the fiscal crunch up to last year, and that the ebb of balance sheet adjustment pressures among consumers and corporate enterprises will lead to an upturn of capital investment and the housing

Chart 1: OECD leading indicators



Source: OECD.

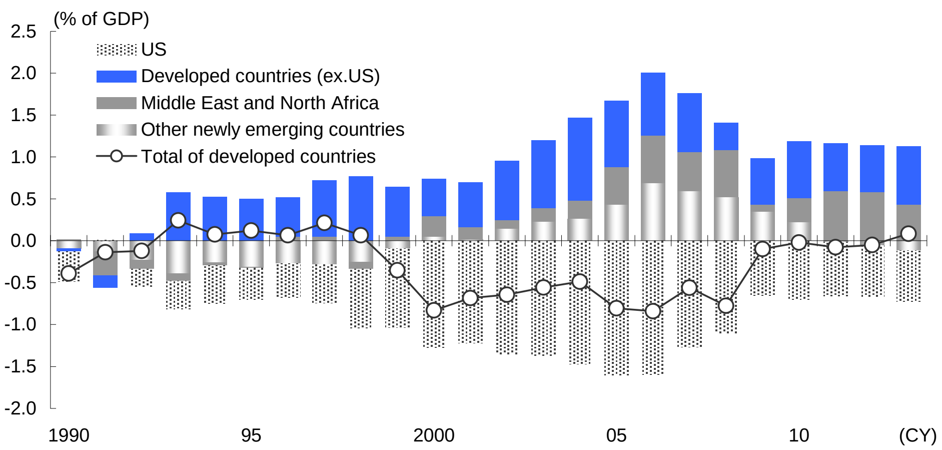
sector. At the same time, the global economy should also gather momentum and grow +3.5%, due to the upward revision of eurozone growth and a slight mitigation of the downward pressures from fiscal constraints in the US and Europe in 2014. We have revised upward our forecasts on Japan, China, the NIEs and the ASEAN5 reflecting the upturn of the US and eurozone economies. On the other hand, we have revised down our forecasts on India and Brazil which are subject to the deterioration of their macro-balances stemming from the expansion of their domestic demand thus far and current account deficits. Even though the developed countries of Japan, the US and Europe face emerging market uncertainties, we focus upon their monetary policy measures toward economic recovery and rise of asset prices.

According to the OECD leading indicators in **Chart 1**, the direction of growth may be divided into the developed countries and emerging countries. In the developed countries such as Japan, the US, Europe, China and Russia, the direction of growth is turning upward in contrast to the downward direction of growth among the emerging countries such as Brazil and India. The difference stems most likely from the degree and stages of their respective balance sheet adjustment processes. In other words, the two groups are the developed countries which now see light at the end of the tunnel of the balance sheet adjustment process and the principal emerging countries which are facing new balance sheet adjustment pressures.

The uncertainties regarding the emerging countries stem from current account deficits – in the background is the rise of developed countries' current account surpluses

Chart 2 depicts the trends in the current account balances of the major countries of the world. As shown in **Chart 2**, the uncertainties regarding the emerging countries stem largely from a sharp fall of their current account balances from a surplus to a deficit, and the resulting need for domestic fiscal austerity due to current account constraints. Many of the countries which were subject to triple sell-offs in mid-2013 were either countries with current account deficits or those which were subject to a sharp deterioration of their current accounts. As with the resurgence of the emerging economy crisis since the Argentine crisis toward the end of January this year, the economies of India, Turkey and South Africa which

Chart 2: Trends in current account balances of the world



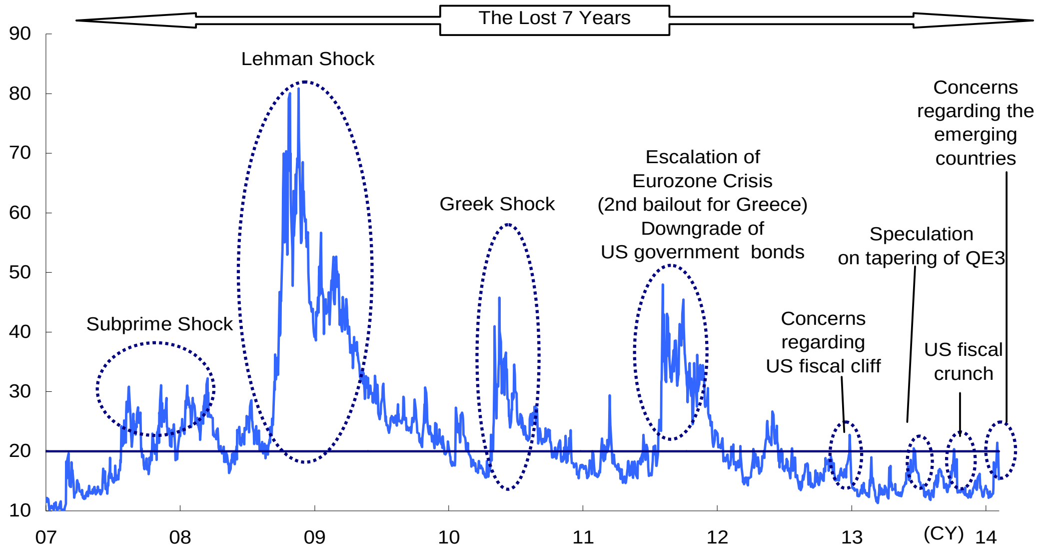
Source: Made by MHRI based upon releases by the IMF.

were compelled to raise their interest rates in a bid to protect their currencies were all mired in current account deficits. From the perspective of the I-S (investment-savings) balance, it would be necessary to curb domestic demand in order to normalize the current account balance. However, a policy interest rate hike would exacerbate the economic slowdown even further. Another point which should be noted in **Chart 2** is the upturn of the developed countries' current accounts into surpluses. The current account deficits among the developed countries such as the US reached a peak around 2007 subsequent to the credit expansion, US subprime loan boom and euro-bubble in the 2000s. On the other hand, the balance sheet adjustment accompanying the collapse of the US and eurozone bubbles and the subsequent fiscal austerity led to a sharp contraction of the current account deficit, reaching a surplus and normalizing in 2013.

Despite temporary volatility, the "lost 7 years" invited by the US and eurozone adjustment will come to an end

The adjustment in the US and the eurozone from 2007 to 2013 shown in **Chart 3** was a period of extraordinary market turmoil which may dubbed the "lost 7 years". Let us look at the VIX (volatility index) which gauges the market's fear or uncertainty in which a value of 20 is considered the threshold of stress (with a greater value indicating more investor fear). While the VIX has remained above this threshold since 2007, the index only touched this level from time to time since last year. Although the VIX rose far above 20 in early February 2014 for the first time since June and October of 2013, reflecting the rise of emerging market uncertainties, conditions differ greatly from the level stemming from the US and eurozone crisis up to 2012. The US and eurozone credit crunch which was the "lost 7 years" since 2007 was essentially a state of "emergency". During this time, it was the emerging countries that prevented a global economic slowdown by expanding their balance sheets. In this process, the emerging countries upset

Chart 3: Trends in the VIX



Note: The VIX is a volatility index of market expectations of near-term volatility conveyed by S&P500 stock index option Prices

Source: Made by MHRI based upon releases by Bloomberg.

their macro-balances and fell into current account deficits. In the "decoupling" theory discussed in the market since 2007, the emerging countries were said to be solid amid the slowdown of the developed countries. In contrast, as the US and eurozone economies return to "ordinary times" through a normalization from the most serious balance sheet adjustment in post-WWII history, the emerging countries are unable to avoid a slowdown, resulting in a "neo-decoupling". At the same time, the condition may also be described as a period of transition until the US economy enters a full-fledged recovery and its current account deficit starts to widen again, and the emerging countries return to a current account surplus. In 2014, the global economy will set foot on a path to stability, albeit in a transitional state.

In light of the Federal Reserve Bank's (FRB) decision to continue to taper QE3 on January 29, 2014, the comments by Raghuram Ragan, Governor of the Reserve Bank of India, to the effect that the US is only placing importance upon its own normalization and lacks consideration toward the emerging countries, may represent the views among the emerging countries.

The uncertainties regarding the emerging countries will test the stability of the US and eurozone economies

The key point in our latest *Economic Outlook* is whether the developed countries will be able to remain solid, unscathed amid the economic slowdown among the emerging countries. The potential risks, if any, would depend upon (1) the ripple effect upon the real economy stemming from the fall of exports of the developed countries as a result of the emerging economy slowdown, and (2) how to evaluate the reverse wealth effect upon the assets held by developed countries in the emerging countries stemming from the financial and stock market turmoil. The economic recovery mainly among the developed countries since 2013 is fragile due to vulnerabilities to events such as an emerging market shock, given its expectations-driven and bubble-like nature reflecting the monetary easing in Japan, the US and the eurozone. Therefore, should the emerging market uncertainties continue to linger intermittently, the market may switch temporarily from a "risk-on" to "risk-off" mode, prompting uncertainties which push up the VIX over 20 as in **Chart 3**. However, the impact upon the real economy should be limited unless large countries such as China flounder among the emerging countries amid the recovery of the developed countries. Even though the uncertainties revolving around the emerging countries should continue to serve as a potential market destabilizing risk, we look toward a "neo-decoupling" in which the global economy continues to follow a recovery.

Will the three-pronged "three-step rocket strategy for exit from deflation" be able to switch into the third rocket?

On January 23, 2014, MHRI released an emergency report titled "Abenomics in the first year deserves 70 points (out of 100)" (in Japanese only). During the past year, MHRI has consistently depicted the road map of the "three-pronged" "three-step rocket strategy for exit from deflation" in **Chart 4**. Currently, the second rocket is facing a crucial stage in which a growth strategy (comprised of structural reforms) toward self-sustained recovery and private-sector vitality is at

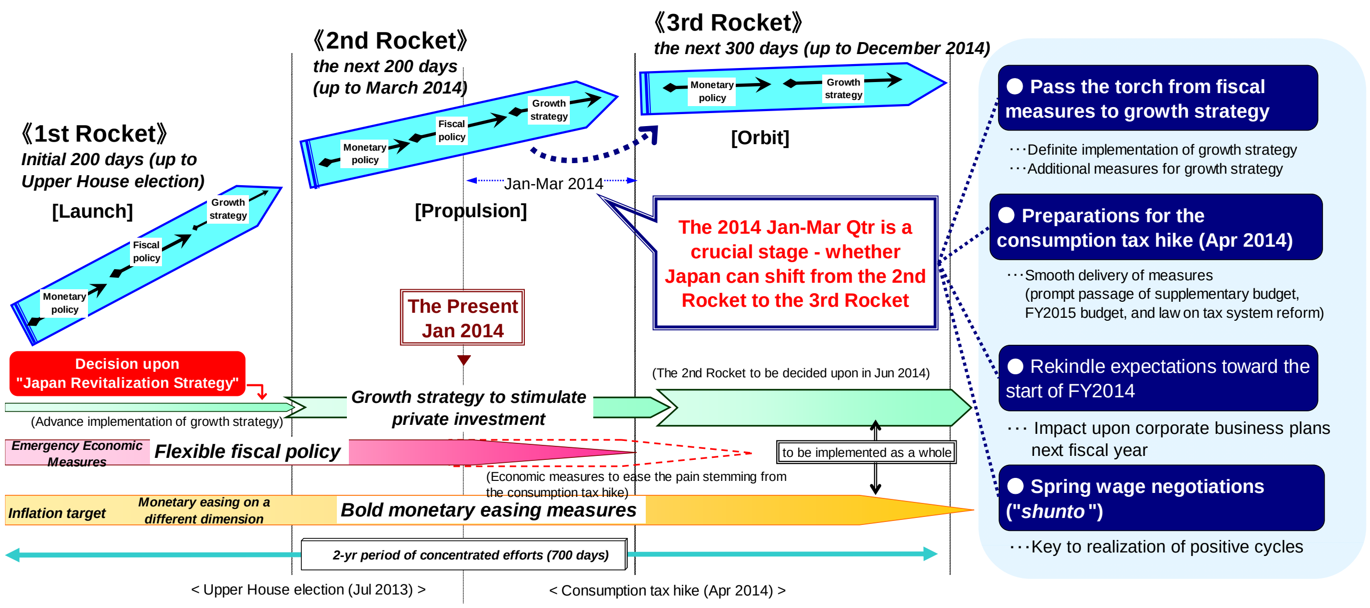
The Japanese economy will reach a crucial stage in the first half of 2014

stake. At the same time, a key question is whether the "three-step rocket strategy" will be able to switch into the third rocket from April this year.

An important point in the "three-step rocket strategy" is that the weight of the "three prongs (or arrows)" will shift, meaning that it will gradually switch into the growth strategy. In this roadmap, the current Jan-Mar quarter of 2014 is a critical juncture in which the Japanese economy must prepare to enter the "Orbit Phase". The timing of this juncture also coincides with numerous other challenges and issues such as (1) preparatory efforts to pass the torch from fiscal policy to the growth strategy, (2) measures to assuage the impact of the consumption tax hike in April, (3) an important time to nurture corporate expectations prior to their preparation of business plans for next fiscal year, and (4) the spring annual labor-management wage negotiations ("*shunto*"). As such, the future course and consequences of Abenomics will depend upon how Japan addresses these challenges.

However, note that Prime Minister Shinzo Abe's visit to Yasukuni Shrine at the end of December 2013 is raising concerns on Japan's right-wing shift, thereby leading to a loss of support by overseas investors. This indicates the rise of uncertainties toward Abenomics' pro-business stance putting economic recovery first. Even before the rise of such concerns, the law on protection on specified

Chart 4: The "three-step rocket strategy for exit from deflation" using three arrows



Source: MHRI

state secrets (the “state secrets law”) developed into a major issue in Japan’s domestic politics in the second half of 2013. The state secrets law turned out to dominate deliberations in the Diet session which should have discussed the growth strategy, raising concerns overseas. Furthermore, note that there are also concerns that the Bank of Japan (BOJ) would scale back its monetary easing – the “first prong” of Abenomics – essentially a “Japanese-version tapering” and exit from monetary easing.

Japan currently faces a crucial juncture at which it must switch from the second rocket to the third rocket from April onward by accelerating the economic recovery and drying the “damp logs” (turning around the cautious corporate sentiment) through the rise of the asset markets accompanying the global monetary easing and weakening of the yen. Looking forward, Japan will need more support from the BOJ by a further bout of monetary easing.

Hajime Takata, Chief Economist

II. The global economy

Global growth picked up slightly in the Oct-Dec quarter of 2013

In the Oct-Dec quarter of 2013, the global economy picked up slightly from the Jul-Sep quarter.

The US economy grew +3.2% q-o-q p.a. in the Oct-Dec quarter (Jul-Sep quarter: +4.1% q-o-q p.a.), maintaining growth above 3% (**Chart 5**). Even though government spending fell due partially to the federal government shutdown, personal consumption and exports grew at a faster pace.

Eurozone real GDP grew +1.1% q-o-q p.a. in the Oct-Dec quarter of 2013 (Jul-Sep quarter: +0.5% q-o-q), recording growth in positive territory for the third quarter in a row. In addition to Germany maintaining growth at the 1%-level, the pace of France's economic growth also rose into positive territory for the first time in two quarters. Among the countries of southern Europe, Spain's growth rate picked up and Italy's economic growth rose – albeit slightly – into positive territory for the first time in 10 quarters.

In contrast, China's real GDP moderated to +7.7% y-o-y (Jul-Sep quarter: +7.8% y-o-y). Even though personal consumption and exports grew at a faster pace than the previous quarter, the moderation of investment in fixed assets served as a drag upon growth.

[Chart 5: Real GDP growth of major countries and areas]

(Q-o-q % change, p.a.)

	2012				2013			
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec
US	3.7	1.2	2.8	0.1	1.1	2.5	4.1	3.2
Eurozone	-0.3	-1.1	-0.7	-2.1	-0.8	1.2	0.5	1.1
Japan	3.7	-1.7	-3.1	-0.2	4.8	3.9	1.1	1.0
South Korea	3.3	1.2	0.2	1.1	3.4	4.5	4.3	3.7
Taiwan	7.4	-0.5	4.3	5.2	-2.4	3.1	1.1	10.1
Hong Kong	1.0	-0.4	4.3	5.7	0.9	2.8	2.1	
Singapore	7.8	0.1	-4.6	3.3	2.2	17.1	2.2	-2.7
Thailand	50.7	12.8	6.5	12.1	-8.2	2.3	5.8	2.4
Malaysia	7.3	5.1	4.0	9.2	-1.1	5.8	7.0	8.6
Philippines	9.4	5.4	8.0	7.0	9.4	6.2	5.2	6.1
Australia	4.9	1.7	2.8	2.0	2.1	2.9	2.3	
Brazil	0.6	0.8	2.3	3.8	-0.0	7.2	-1.9	

(Y-o-y % change)

China	7.9	7.6	7.4	7.9	7.7	7.5	7.8	7.7
Indonesia	6.3	6.4	6.2	6.1	6.1	5.8	5.6	5.7
Vietnam	4.6	4.8	5.1	5.4	4.8	5.0	5.5	6.0
India	5.1	5.4	5.2	4.7	4.8	4.4	4.8	
Russia	4.8	4.3	3.0	2.1	1.6	1.2	1.2	

Sources: Datastream, CEIC, statistics of relevant countries and areas

In other parts of Asia (ex China), the Singapore economy fell into negative territory in contrast to the acceleration of growth in Taiwan, Malaysia, the Philippines, Indonesia and Vietnam. The South Korean economy also continued to grow at nearly 4% p.a., leading to our judgment that the recovery of the overall Asian economy firmed slightly.

On the other hand, Japan's real GDP growth stagnated, growing +1.0% q-o-q p.a. in the Oct-Dec quarter (Jul-Sep quarter: +1.1% q-o-q p.a.) due mainly to the ongoing sharp rise of imports.

The global economy should pick up, driven mainly by the developed countries

The global economy (the weighted average of all the countries and areas within the scope of MHRI's economic forecast) is forecast to grow around +3.5% in 2013, accelerating from +3.0% in 2013 (**Chart 6**). The pace of US economic growth is forecast to rise to the upper half of the 2%-level, considering the ebb of downward pressures from fiscal constraints and the expansion of private demand. Likewise, the eurozone economy should rise into positive territory for the first time in three years as the negative impact of fiscal constraints starts to fade. On the other hand, while the emerging countries should maintain growth to some extent, the overall pace of growth of the emerging countries should remain around the same level as 2013 in the event of a gradual slowdown of the Chinese and Indian economies. In 2015, the global economy should continue to be driven by the US and eurozone economies, in contrast to a slight stagnation of the emerging countries. The global economy in 2015 should maintain growth of 3.5%, driven by the US and eurozone economies.

[Chart 6: MHRI outlook on the global economy]

(Y-o-y % change) (Y-o-y % change)

Calendar year	2011 (Actual)	2012 (Actual)	2013 (Forecast)	2014 (Forecast)	2015 (Forecast)	2013 (Previous: Dec forecast)	2014 (Previous: Dec forecast)
Total of forecast area	3.9	3.2	3.0	3.5	3.5	2.9	3.3
Japan, US, Eurozone	1.4	1.4	1.1	1.9	2.0	0.9	1.7
US	1.8	2.8	1.9	2.6	2.7	1.7	2.4
Eurozone	1.6	-0.6	-0.4	1.1	1.3	-0.4	0.9
Japan	-0.5	1.4	1.6	1.4	1.4	1.7	1.4
Asia	7.5	6.1	6.0	6.1	5.9	6.0	5.9
NIEs	4.1	1.7	2.7	3.3	3.3	2.5	2.9
ASEAN5	4.5	6.2	5.2	5.1	5.0	5.0	4.9
China	9.3	7.7	7.7	7.5	7.3	7.6	7.3
India	7.5	5.1	4.7	4.6	4.6	4.7	4.7
Australia	2.6	3.6	2.4	2.9	2.8	2.4	2.8
Brazil	2.7	1.0	2.2	1.6	1.8	2.3	2.0
Russia	4.3	3.4	1.3	2.2	2.8	1.5	2.5
Japan (FY)	0.3	0.6	2.2	0.8	1.6	2.5	0.8
Crude oil price (WTI, %/bbl)	95	94	98	95	92	98	96

Note: The total of the forecast area is calculated upon the 2012 GDP share (PPP) by the IMF.
Sources: International Monetary Fund (IMF), MHRI.

The pace of US economic growth is forecast to stand at +2.6% in 2014. Even though the US economic indicators weakened over the year-end from 2013 to 2014, the weakness is most likely temporary, stemming from the severely cold winter weather. As the US reduces its government spending cuts, we expect to see the stable expansion of personal consumption, housing investment and capital investment. The rate of US real GDP growth should rise to +2.7% in 2015, maintaining growth at the upper end of the 2%-level, given the ongoing solid growth of private-sector final demand.

Eurozone real GDP is forecast to grow +1.1% in 2014, recording growth in positive territory for the first time in three years. In addition to the solid growth among the countries of northern Europe such as Germany, economic activity is bottoming out also among the countries of southern Europe. The appreciation of the euro in the first half of 2013 is also coming to a pause, serving as tailwinds for Europe's exports going forward. However, given the lingering downward pressures stemming from balance sheet adjustment in both the public and private sectors of the countries of southern Europe, a sharp rise of growth in terms of the entire eurozone economy is unlikely. Even so, the rate of real GDP growth in 2015 should reach +1.3%, recording growth in positive territory for the second year in a row.

Stagnant growth expected among the emerging countries

The Chinese economy is forecast to remain on a gradual downtrend in 2014 (7.5%) and 2015 (7.3%). The Chinese government is expected to keep its policy stance to wean its economy from investment. The slowdown of production accompanying the slower pace of investment should serve as a drag upon household income growth and lead to a slower pace of personal consumption growth. Under these conditions, concerns regarding the so-called "shadow banking problem" should continue to linger.

The Indian economy will be compelled to take a fiscal austerity and monetary tightening stance in a bid to address persistent inflationary pressures stemming from its weak currency. The chances are slim that the general elections scheduled in the spring of 2014 will lead to a stable government, making the progress of economic reforms unlikely. Hence, the pace of India's economic growth is forecast to remain around the 4%-level for three years in a row: 2013 (+4.7%) (estimate by MHRI) , 2014 (+4.6%), 2015 (+4.6%).

The Asian economies other than China and India should continue to follow a gradual expansion in both 2014 and 2015. The NIEs (South Korea, Hong Kong, Taiwan, Singapore) should keep growing at the 3%-level (+3.3% in 2014, and +3.3% in 2015) since the acceleration of growth in the US and Europe should lead to the recovery of exports. On the other hand, the rate of real GDP of the ASEAN5 (Thailand, Malaysia, Indonesia, the Philippines, Vietnam) should keep growing around 5%: 2014 (+5.1%), and 2015 (+5.0%). However, Indonesia's growth may be dragged down by a tighter monetary policy stance in response to the rise of inflation stemming from the fall of the Indonesian rupiah. In Thailand, there are concerns that the ongoing political turmoil may serve as a drag upon domestic demand and its currency, the Thai baht.

Turning to the Australian economy, the downward pressures stemming from fiscal conditions should ease in 2014 and exports and capital investment should pick up due to the weak Australian dollar since 2013 and the economic recovery among the developed countries. The rate of real GDP growth should rise to +2.9% in 2014 from +2.4% in 2013(estimate by MHRI). In 2015, the Australian economy should continue to grow at a rate of +2.8%, slightly below +3%.

The Brazilian economy is showing signs of a slight recovery from the growth in negative territory in the Jul-Sep quarter. However, note that its currency, the Brazilian real, may come under downward pressures due to Brazil's close relations with the Argentine economy. Given the need for fiscal austerity and monetary tightening in order to quell inflation concerns, the rate of Brazil's real GDP growth should remain a feeble +1.6% in 2014 and +1.8% in 2015.

Turning to the Russian economy, the pace of recovery should remain sluggish for some time due primarily to investment, reflecting the fall of the price of crude oil. The Bank of Russia also shelved its anticipated interest rate cut in mid-2013, citing the stubbornly high rate of inflation. Even though the pace of real GDP growth is forecast to pick up slightly to +2.2% in 2014 from +1.3% in 2013, growth is still expected to remain weak. In 2015, while the fall of crude oil prices will serve as a drag, the recovery of eurozone-bound exports and the accompanying upturn of corporate earnings and investment should push up the rate of growth to +2.8%.

The Japanese economy is forecast to keep expanding at a mild pace, growing +1.4% (on a calendar year basis) in both 2014 and 2015 despite the drag upon personal consumption and housing investment due to the two consumption tax hikes scheduled, because of (1) Japan's export growth reflecting the weak yen and recovery of the overseas economies such as the US and eurozone, and (2) the ongoing recovery of capital investment.

The timing and pace of QE3 tapering and its impact upon the financial markets and emerging markets is gathering attention

Unlike in May 2013, when concerns arose regarding a capital exodus from the emerging markets, the financial markets remained calm immediately after the FRB's decision in December 2013 to scale back or "taper" its third round of quantitative monetary easing measures (QE3). This was due to a sigh of relief in the financial markets that interest rates would remain low for a prolonged period on the FRB's announcement that it would keep the federal funds rate at virtually zero as long as the inflation rate stays below 2%.

However, concerns rose regarding the future course of the emerging countries such as Argentina and Turkey with the turn of the year in 2014, leading to the fall of currencies and stock markets in certain emerging countries. Amid the rising risk aversion among investors, the stock markets of developed countries such as the US also shifted into adjustment mode. Since these events coincided with the release of weak US economic data due to the extremely cold weather, concerns regarding the future course of the global economy rose in the financial markets.

In May last year, the FRB's monetary policy shift was perceived as abrupt by the financial markets, leading to the rise of US long-term interest rates and a "triple sell-off" of stocks, currency and bonds among many of the emerging countries. However, note that the emerging countries subject to the recent "sell-off" are only those which are subject to the deterioration of their current account balances and inflation, hence indicating a higher degree of differentiation among the emerging countries. In the course of the US tapering of QE3, the abundant supply of money thus far will gradually shrink, meaning that the "emerging market bubble" will undoubtedly come to an end. Some of the emerging countries may face an adjustment stemming from monetary and fiscal tightening. Amid lingering concerns regarding the emerging countries, the FRB may, at times, ease the pace of the tapering of QE3.

In comparison to conditions at the time of the Latin American Debt Crisis in the 1980s and Asian Currency Crisis in the 1990s, the major emerging countries such as the BRICs possess more foreign currency reserves than in the past, making a significant capital exodus or currency crisis unlikely in the emerging countries as a whole. Even so, certain countries may still fall into a currency crisis and lead to the rise of financial market uncertainties. There is no doubt that the future of the tapering of QE3 and its impact upon the emerging countries is the greatest risk to the global economy.

China's shadow banking also remains a source of concern.

The so-called "shadow banking" in China also requires ongoing scrutiny. In January this year, the media reported that a wealth management product (WMP) maturing at the end of January 2014 would default on its principal and interest payments. Even though the default was avoided, it remains unchanged that the Chinese economy continues to be haunted by a problem in its financial system which is the reverse side of the coin to its excessive dependence upon investment. The Chinese government faces a difficult task of maneuvering policy so as to curb the expansion of shadow banking while avoiding a default. The solution of the problem will likely require considerable time. In the event the credit risks of sectors engaging in excessive investment through shadow banking-dependent funds surfaces at some point in time, this would wreak havoc in the financial market in ways such as the rise of losses on WMPs and increase of nonperforming loans. Furthermore, it may have a negative impact upon personal consumption and capital investment, leading to the risk of sharp slowdown of the Chinese economy. Since a slowdown of the Chinese economy will serve as a factor causing the deterioration of business of global corporations, it may lead to the fall of stock markets around the world. In such event, it would have an adverse effect upon the real economies mainly of Asia which have close trade relations with China.

In 2014 - 2015, it would be necessary to keep a close eye upon the policy measures in the US and China - the two largest economies of the world – and how they affect the global economy in terms of both the real economy and financial markets.

[Chart 7:　Key political and economic events]

2014 Feb	G20 Meeting of Finance Ministers and Central Bank Governors (Sydney), (22nd, 23rd)	
Mar	China	National People's Congress (5th)
	Europe	ECB Governing Council Meeting (6th)
	Japan	BOJ Monetary Policy Meeting (10th, 11th)
	US	FOMC (18th, 19th)
	Europe	EU summit meeting (20th, 21st)
Apr	Japan	Consumption tax hike (5% → 8%, 1st)
	Europe	ECB Governing Council Meeting (3rd)
	Japan	BOJ Monetary Policy Meeting (7th, 8th)
	Indonesia	General elections (9th)
	G20 Meeting of Finance Ministers and Central Bank Governors (Washington D.C., US) (11th)	
	US	FOMC (29th, 30th)
	Japan	BOJ Monetary Policy Meeting (*Outlook for Economic Activity and Prices*) (30th)
	South Africa Presidential election and Lower House elections (April)	
May	Europe	ECB Governing Council Meeting (8th)
	Europe	EU summit meeting (15th, 16th)
	Japan	BOJ Monetary Policy Meeting (20th, 21st)
	Europe	European parliament election (22nd - 25th)
	India	General elections (- May)
Jun	G8 summit meeting (Sochi, Russia) (4th)	
	Europe	ECB Governing Council meeting (5th)
	Japan	BOJ Monetary Policy Meeting (12th, 13th)
	FIFA World Cup Soccer, Brazil (June 12th - Jul 13th)	
	US	FOMC (17th, 18th)
	Europe	EU summit meeting (26th, 27th)
	Japan	New growth strategy (June?)
	Egypt	Presidential election (June - July)
Jul	Europe	ECB Governing Council meeting (3rd)
	Indonesia	Presidential election (9th)
	Japan	BOJ Monetary Policy Meeting (14th, 15th)
	US	FOMC (29th, 30th)
	US	FRB Chairman Semiannual Monetary Policy Report to Congress (July)
Aug	Europe	ECB Governing Council meeting (7th)
	Japan	BOJ Monetary Policy Meeting (7th, 8th)
Sep	Japan	BOJ Monetary Policy Meeting (3rd, 4th)
	Europe	ECB Governing Council (4th)
	US	FOMC (16th, 17th)
	Europe	Scottish independence referendum (18th)
	G20 Summit meeting (Cairns, Australia) (20th, 21st)	
	Europe	French Senate elections (September)
Oct	Europe	ECB Governing Council Meeting (2nd)
	Japan	BOJ Monetary Policy Meeting (6th, 7th)
	G20 Meeting of Finance Ministers and Central Bank Governors (Washington D.C., US) (10th)	
	US	FOMC (28th, 29th)
	Japan	BOJ Monetary Policy Meeting (Outlook for Economic Activity and Prices) (31st)
	APEC Economic Leaders' Meeting (Beijing, China) (mid-October)	
	Brazil	Presidential election (October)
Nov	US	US midterm elections (4th)
	Europe	ECB unification of banking supervision (4th)
	Europe	ECB Governing Council Meeting (6th)
	G20 Summit meeting (Brisbane, Australia) (15th, 16th)	
	Japan	BOJ Monetary Policy Meeting (18th, 19th)
Dec	Europe	ECB Governing Council Meeting (4th)
	US	FOMC (16th, 17th)
	Japan	BOJ Monetary Policy Meeting (18th, 19th)
	China	Central Economic Work Conference (December)

Source: Made by MHRI.

III. The Japanese economy

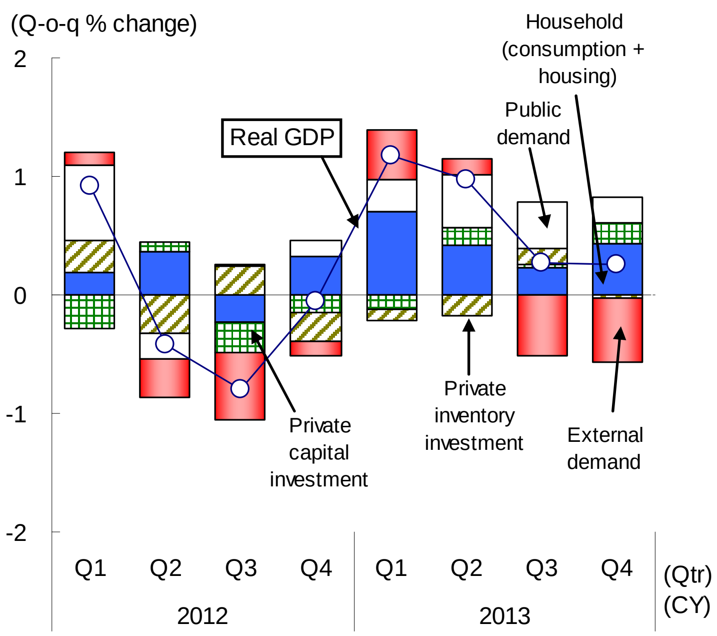
(1) Overview of the Oct-Dec quarter 2013 *1st QE*

The Japanese economy grew at a tepid +1.0% q-o-q p.a. in the Oct-Dec quarter

According to the *First Preliminary Quarterly Estimates of GDP (1st QE)* for the Oct-Dec quarter of 2013, Japan's real GDP grew +0.3% q-o-q (or +1.0% in annualized terms). Even though the economy continued to grow for four consecutive quarters, the pace of growth remained tepid as in the Jul-Sep quarter (+0.3% q-o-q) (**Chart 8**). Even though private demand grew at a faster pace, public demand slowed down as the projects related to the emergency economic stimulus measures ran their course and external demand continued to fall sharply reflecting the significant rise of imports.

Domestic private demand accelerated to +0.8% q-o-q, serving to support Japan's growth. In addition to the rise of housing investment (+4.2 q-o-q), driven by the progress of housing starts which were front-loaded in a rush before the consumption tax hike (the 5% consumption tax would apply for construction contracts concluded before the end of September 2013), capital investment also rose +1.3% q-o-q. Personal consumption also grew at a faster pace of +0.5% q-o-q, as the last-minute rush of demand prior to the consumption tax hike started to emerge with respect to items such as cars. However, since the growth of personal consumption can be explained more or less by the rush of demand for cars (the contribution to personal consumption is estimated to be approximately +0.5% pt), consumer spending other than the last-minute rush of demand prior to the consumption tax hike appears to have been weak.

[Chart 8: Japan's quarterly real GDP growth]



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

Public demand slowed down from the Jul-Sep quarter to +0.9% q-o-q. Despite the strong growth of government consumption (+0.5% q-o-q) reflecting factors such as the rise of social security-related expenditures, pubic investment slowed down to +2.3% q-o-q from the strong growth in the first half of FY2013 as the projects related to the emergency economic stimulus measures (in the FY2012 supplementary budget passed in February 2013) ran their course.

Exports grew +0.4% q-o-q for the first time in two quarters. Even though exports related to cars and general machinery picked up from the summer slump, the pace of growth turned out to be tepid given the ongoing weakness of exports bound for Southeast Asia. On the other hand, the rise of construction demand, the materialization of the last-minute rush of demand before the consumption tax hike, and expansion of fuel imports for electrical power led to a further acceleration of imports (+3.5% q-o-q), keeping the contribution by external demand deep in negative territory (-0.5% pt).

The breadth of the domestic demand deflator in positive territory expanded

Given the rise of the personal consumption deflator and construction-related deflator due to the rise in prices of energy, food and construction materials, the breadth of the domestic demand deflator (original data) expanded to +0.5. That said, the GDP deflator remained in negative territory (-0.4%).

(2) Outlook on the Japanese economy in FY2013, FY2014 and FY2015

Growth in Jan-Mar 2014 will accelerate due to a last-minute rush of demand. FY2013 real GDP growth: +2.2%

Even though the export recovery should continue in the Jan-Mar quarter of 2014 amid the gradual recovery of the overseas economies, external demand is only expected to have a minor positive impact upon growth given the high level of imports related to the last-minute rush of demand prior to the consumption tax hike. Public investment should take a downturn along with the fading impact of the public works projects related to the emergency economic stimulus measures. On the other hand, the last-minute rush of demand prior to the consumption tax hike in April should materialize in items other than cars, leading to a sharp rise of personal consumption. Capital investment should also maintain its momentum, reflecting the recovery of business performance.

As shown above, the pace of growth should rise to the +4%-level in the Jan-Mar quarter, driven mainly by personal consumption pushed up by the last-minute rush of demand prior to the consumption tax hike. This leads to our forecast that real GDP will grow +2.2% in FY2013 (forecast in December: +2.5%), and record growth over 2% for the first time in three years (**Chart 9**).

[Chart 9: Outlook on the Japanese economy]

		2012	2013	2014	2015	2013		2014				2015				2016
		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	0.6	2.2	0.8	1.6	0.3	0.3	1.2	-1.1	0.8	0.3	0.3	0.7	0.9	-1.0	0.6
	Q-o-q % ch p.a.	--	--	--	--	1.1	1.0	4.8	-4.5	3.3	1.4	1.2	2.8	3.7	-3.9	2.4
Domestic demand	Q-o-q % ch	1.4	2.5	0.2	1.1	0.8	0.8	0.9	-1.6	0.4	0.3	0.3	0.8	0.7	-1.5	0.3
Private sector demand	Q-o-q % ch	1.4	1.9	-0.2	1.3	0.5	0.8	1.4	-2.4	0.5	0.4	0.4	1.0	0.9	-2.2	0.3
Personal consumption	Q-o-q % ch	1.5	2.4	-1.2	1.1	0.2	0.5	1.9	-3.6	0.6	0.3	0.2	0.8	1.5	-2.9	0.7
Housing investment	Q-o-q % ch	5.3	8.2	-5.3	-0.5	3.3	4.2	-1.9	-8.4	0.9	2.5	0.4	6.2	-3.8	-7.3	-6.6
Capital investment	Q-o-q % ch	0.7	0.7	3.5	2.9	0.2	1.3	1.4	1.0	0.4	0.6	0.7	0.8	1.0	0.3	0.7
Inventory investment	Q-o-q contribution, % pt	-0.1	-0.3	0.3	-0.1	0.1	0.0	-0.3	0.5	-0.1	0.0	0.1	-0.0	-0.2	0.3	-0.1
Public sector demand	Q-o-q % ch	1.4	4.4	1.3	0.6	1.6	0.9	-0.5	0.7	0.4	-0.1	-0.2	0.1	0.1	0.7	0.4
Government consumption	Q-o-q % ch	1.5	2.1	1.7	1.5	0.2	0.5	0.2	0.5	0.5	0.5	0.4	0.4	0.3	0.3	0.3
Public investment	Q-o-q % ch	1.3	15.6	-1.0	-3.2	7.2	2.3	-3.6	1.6	0.2	-2.6	-3.0	-0.9	-0.8	2.4	0.5
External demand	Q-o-q contribution, % pt	-0.8	-0.4	0.6	0.5	-0.5	-0.5	0.2	0.5	0.4	0.0	0.0	-0.2	0.2	0.5	0.3
Exports	Q-o-q % ch	-1.2	3.5	5.0	5.4	-0.7	0.4	1.2	2.0	1.2	1.4	1.4	1.1	1.1	1.9	1.5
Imports	Q-o-q % ch	3.7	5.2	1.2	2.5	2.4	3.5	-0.2	-1.0	-1.2	1.3	1.2	1.8	-0.1	-0.9	-0.2
GDP (nominal)	Q-o-q % ch	-0.2	2.0	2.4	2.1	0.2	0.4	1.1	0.2	0.9	0.8	0.2	0.4	0.9	0.1	0.6
GDP deflator	Y-o-y % ch	-0.9	-0.2	1.5	0.4	-0.4	-0.4	0.2	1.1	1.5	1.7	1.8	0.2	0.1	0.6	0.8
Domestic demand deflator	Y-o-y % ch	-0.8	0.4	1.6	0.7	0.4	0.5	1.0	1.7	1.7	1.4	1.5	0.4	0.4	1.0	1.2

Notes: Figures in the shaded areas are forecasts.
Source: Made by MHRI based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*

		2012	2013	2014	2015	2013		2014				2015				2016
		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	-2.9	3.1	2.2	2.6	1.7	1.8	2.4	-1.2	-0.4	0.7	1.0	0.9	1.5	-0.7	-0.3
Ordinary profits	Y-o-y % ch	8.1	13.5	1.2	3.4	20.1	10.7	4.4	-1.3	2.6	2.1	1.9	5.8	2.4	3.8	1.7
Nominal labor compensation	Y-o-y % ch	0.1	1.2	1.2	1.3	0.6	1.8	1.1	1.0	1.1	1.4	1.0	1.4	1.3	1.2	1.2
Unemployment rate	%	4.3	3.9	3.7	3.6	4.0	3.9	3.8	3.7	3.7	3.7	3.6	3.6	3.6	3.6	3.5
New housing starts	P.a., 10,000 units	89.3	98.9	91.3	88.8	99.0	104.1	94.7	89.4	89.6	91.5	95.2	94.0	88.9	85.5	87.1
Current account balance	P.a., JPY tril	4.4	2.0	5.7	7.6	2.4	-1.2	-1.4	5.7	5.3	6.7	5.6	7.3	5.2	8.9	9.9
Domestic corporate goods prices	Y-o-y % ch	-1.1	2.0	3.9	2.3	2.2	2.5	2.4	4.0	4.0	3.7	3.8	1.1	1.4	3.1	3.4
Consumer prices	Y-o-y % ch	-0.2	0.8	3.0	1.5	0.7	1.1	1.2	3.1	2.9	2.9	2.9	0.8	0.9	2.1	2.1
Consumer prices (ex consumption tax)	Y-o-y % ch	-0.2	0.8	0.9	0.9	0.7	1.1	1.2	1.0	0.8	0.8	0.8	0.8	0.9	0.9	1.0
Uncollateralized overnight call rate	%	0.06	0～0.10	0～0.10	0～0.10	0.06	0.07	0～0.10	0～0.10	0～0.10	0～0.10	0～0.10	0～0.10	0～0.10	0～0.10	0～0.10
Yield on newly-issued 10-yr JGBs	%	0.78	0.69	0.85	1.19	0.77	0.64	0.64	0.68	0.80	0.90	1.00	1.10	1.20	1.20	1.25
Nikkei average	JPY	9,650	14,400	16,400	17,600	14,139	14,972	15,000	15,500	16,300	16,800	17,000	17,100	17,300	17,700	18,100
Exchange rate	JPY/USD	83.0	100.0	106.0	113.0	99.0	101.0	103.0	105.0	106.0	107.0	108.0	110.0	112.0	114.0	115.0
Crude oil price (WTI nearest term contract)	USD/bbl	92.0	98.0	94.0	91.0	106.0	98.0	96.0	95.0	95.0	93.0	93.0	93.0	92.0	91.0	90.0

Notes: 1. Figures in the shaded areas are forecasts.The readings above may differ from public releases because the rates of change are calculated based upon actual results.
2. Ordinary profits are based upon the *Financial Statements Statistics of Corporations by Industry* (all industries) (ex finance & insurance, and production, transmission and distribution of electricity services).
3. Consumer prices exclude fresh food (2010 base). Based upon the assumption that the consumption tax will be raised to 8% in Apr 2014 and 10% in Oct 2015 (with a reduced tax rate to be applied to food (ex alcoholic beverages and restaurant meals) in Oct 2015.
4. Quarterly data on the unemployment rate, new housing starts and current account balance are seasonally-adjusted.
5. Of the finance-related indices, the uncollateralized overnight call rate refers to the rate at the end of term, the yield on newly-issued 10-yr JGBs refers to the average of the end-of-month rates during the relevant term, and all others are averages during the relevant terms.

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

Even though FY2014 real GDP growth will slow down to +0.8%, a recession will be averted

In FY2014, the Japanese economy will fall deep into negative territory in the Apr-Jun quarter immediately after the consumption tax hike. However, the economy should return to a recovery track from the Jul-Sep quarter on the back of external demand and the implementation of additional public works projects in the economic stimulus package.

In the Apr-Jun quarter, public investment should serve to underpin growth due to the implementation of the projects in the economic stimulus package (the "Economic Measures for Realization of Positive Cycles") compiled by the FY2013 supplementary budget. Of the economic stimulus measures worth JPY5.5 trillion, we expect that approximately JPY2 trillion will be earmarked for public works possessing immediate stimulus upon the economy. Furthermore, given the fall of imports in contrast to efforts to strengthen exports along with the fall of domestic demand after the consumption tax hike, external demand should serve as a significant positive contribution to growth. Even so, the Apr-Jun quarter may not avoid a sharp plunge of growth into negative territory (forecast: -4.5% q-o-q p.a.) due to (1) a backlash to the last-minute rush of demand prior to the consumption tax hike, and (2) the fall of personal consumption and housing investment due to the erosion of household real income.

From the Jul-Sep quarter of 2014, the Japanese economy should return to a gradual recovery track, driven by the growth of exports reflecting the weakness of the yen and recovery of the overseas economies, and the ongoing upturn of capital investment supported by the improvement of corporate earnings. Personal consumption (in real terms) will likely fall below previous-year levels throughout the year because of the erosion of real income due to the consumption tax hike. However, personal consumption should gradually pick up from the level in the Apr-Jun quarter which slumped due to the backlash to the last-minute rush of demand.

Our latest *Economic Outlook* is based upon the assumption (as of February 18th) that several of the 17 nuclear power reactors currently applying for screening under the new safety standards would be restarted (**Chart 10**). More accurately,

[Chart 10: Assumptions regarding the restart of nuclear power reactors]

		Electric power company	Name of nuclear power reactor	Rated output (10,000 kW)
2014	3Q	Kyushu Electric Power Co., Inc.	Kawauchi (Reactors No. 1,2)	89.0×2
	4Q	Kansai Electrical Power Co., Inc.	Ooi (Reactors No. 3,4)	118.0×2
			Takahama (Reactors No. 3,4)	87.0×2
2015	3Q	Kyushu Electric Power Co., Inc.	Genkai (Reactors No. 3,4)	118.0×2
		Shikoku Electric Power Co. Inc.	Ikata (Reactor No. 3)	89.0
	4Q	Hokkaido Electric Power Co., Inc.	Tomari (Reactor No. 3)	91.2
			Tomari (Reactors No. 1,2)	57.9×2
			Total	1120

Note: Assumption in MHRI's latest *Economic Outlook*
Sources: Made by MHRI based upon various media reports.

[Chart 11: Assumptions regarding the consumption tax hike]

	Details
Consumption tax rate	・Raised to 8% in Apr 2014 ・Raised to 10% in Oct 2015
Reduced tax rate	・Introduced in Oct 2015 ・Applied to food (ex alcoholic beverages and restaurant meals)
Economic stimulus measures (for consumption tax hike)	・JPY5.5 tril economic stimulus package at the time of the FY2014 tax hike (approximately JPY2 tril for public works) ・JPY2 tril economic stimulus package at the time of the FY2015 tax hike (approximately JPY1.5 tril for public works)

Note: Assumption in MHRI's latest *Economic Outlook*
Sources: Made by MHRI based upon various media reports.

we assumed that in FY2014, reactors No. 1 and 2 at the Kawauchi Nuclear Power Plant (Kyushu Electric Power Co., Inc.) would be restarted in the Jul-Sep quarter, and that reactors No. 3 and 4 at the Ooi Nuclear Power Plant and reactors 3 and 4 of the Takahama Nuclear Power Plant (Kansai Electrical Power Co., Inc.) would be restarted in the Oct-Dec quarter. The restart of the nuclear power reactors should serve to push up the rate of real GDP growth by curbing imports (expected to push up the rate of FY2014 growth by approximately +0.1% pt).

As such, the pace of real GDP growth in FY2014 is forecast to slow down to +0.8% (forecast in December: +0.8%).

FY2015 real GDP growth will rise to +1.6%. While growth in 1H will be pushed up by the last-minute rush of demand, a backlash will ensue in 2H

In FY2015, we assume that the consumption tax rate will be raised as scheduled to 10% in October (**Chart 11**). While the final decision on the consumption tax hike will be made at the end of 2014, our *Economic Outlook* is based upon the assumption that the tax hike will be decided upon confirmation of a return to positive growth in the Jul-Sep quarter of 2014. Therefore, the last-minute rush of demand and its backlash accompanying the consumption tax hike will serve as a volatile factor upon growth in FY2015. According to a trial calculation based upon movements at the time of the tax hike in FY1997 as well as recent trends (Oct-Dec quarter of 2013), the rate of real GDP growth (on a q-o-q basis) would be pushed up by approximately 0.5% pt in the first half of FY2015 and be dragged down by approximately 1.5% pt in the second half of FY2015.

Again in FY2015, we also expect the compilation of an economic stimulus package (*) totaling approximately JPY2 trillion (of which approximately JPY1.5 trillion will be earmarked for public works) to prevent the economy from falling into a recession after the consumption tax hike. We expect the additional public works projects to be implemented in the second half of the fiscal year and push up the rate of real GDP in FY2015 by approximately 0.3% pt. Furthermore, we also assume that a reduced tax rate will be applied for food (excluding alcoholic beverages and restaurant meals) at the time of the consumption tax hike in FY2015.

* A FY2014 supplementary budget will be compiled for the economic stimulus measures. We expect the supplementary budget to be funded by contingency reserves, unnecessary national debt service and government bond issues to the extent that the medium-term fiscal plan can be achieved (improvement of the primary balance by JPY4 trillion in FY2014).

As shown above, we expect growth in FY2015 to be pushed up by a last-minute rush of demand in the first half of the fiscal year, followed by a sharp fall into negative territory again in the Oct-Dec quarter immediately after the consumption tax hike. Even so, the Japanese economy should pick up toward the end of the fiscal year (end of March 2016) due to the rise of exports reflecting the overseas economic recovery and the upturn of capital investment. Hence, we forecast that the Japanese economy will grow +1.6% in FY2015.

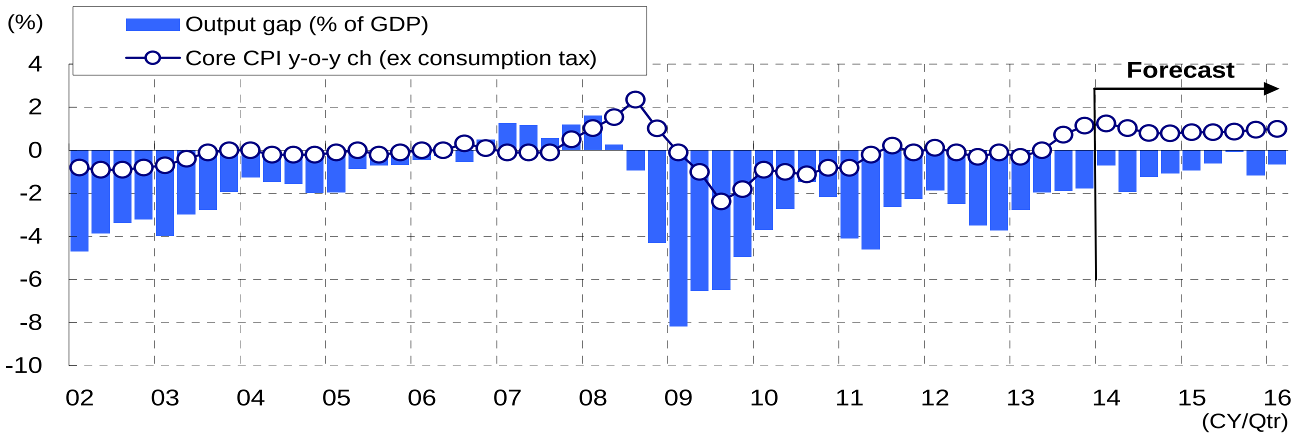
The y-o-y change of the core CPI (ex impact of consumption tax hike) will fail to reach 2% in FY2015

As of the Oct-Dec quarter of 2013, the output gap (the gap between actual GDP and potential GDP) estimated by MHRI stood at -1.8% of potential GDP (meaning an excess of supply of approximately JPY9.5 trillion) (**Chart 12**). In the Jan-Mar quarter of FY2014, the negative output gap should contract to approximately -0.5% pt, due partially to the last-minute rush of demand prior to the consumption tax hike. However, the negative output gap is forecast to widen again in the Apr-Jun quarter of 2014 and remain in negative territory during FY2014. In FY2015, even though the demand and supply should balance at one point in time during the Jul-Sep quarter, the output gap should turn negative again after the consumption tax hike

The core CPI (general, excluding fresh food) rose to +1.3% y-o-y as of December 2013. However, this stems largely from the rise of energy prices such as the upturn of gasoline prices and electrical power charges reflecting the weak yen and rise of crude oil prices. The upward pressures stemming from these factors upon the percentage change of the CPI should gradually fade. In the Jan-Mar quarter of 2014, the year-on-year change of the core CPI is expected to reach +1.2%, slowing slightly from the pace of in December 2013. During the full-year FY2013, the year-on-year change of the core CPI is expected to reach +0.8% y-o-y, rising for the first time since FY2008.

In FY2014, as the upward pressures upon prices stemming from factors such as the weak yen fades and domestic demand falls temporarily due to the consumption tax hike, the negative output gap will widen and serve as a drag upon the rise of prices toward the middle of the fiscal year. That said, we expect to see moves to pass on the recovery of wages to prices along with the gradual recovery of domestic demand. The year-on-year change of the core CPI should stand at +0.9% in FY2014 (+3.0% when including the impact of the consumption tax hike)

[Chart 12: The output gap and the core CPI]



Notes: The core CPI refers to the CPI (ex fresh food). The output gap is estimated by MHRI.
Sources: Made by MHRI based upon Ministry of Internal Affairs and Communications, *Consumer Price Index*, Cabinet Office, *National Accounts*, and others

rising slightly above the level in FY2013.

Again in FY2015, the fall of demand after the consumption tax hike should keep the rise of the inflation rate subdued. During the full-year FY2015, the year-on-year change of the core CPI is expected to reach +0.9% (+1.5% when including the impact of the consumption tax hike), rising at a pace on par with FY2014.

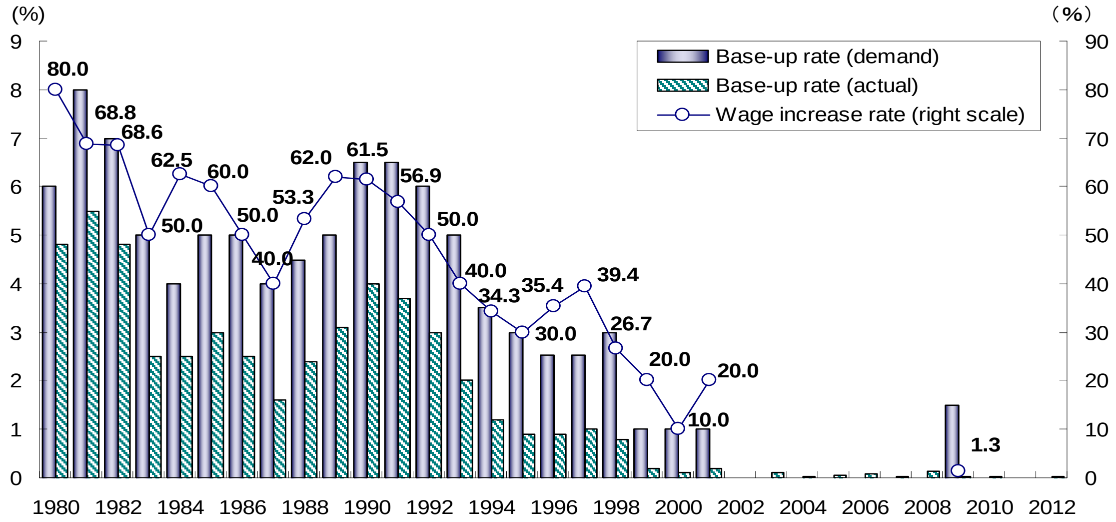
As shown above, despite a gradual rise of the inflation rate, the rise will still fall short of the Bank of Japan's (BOJ) inflation target of "2% in two years". The BOJ will likely decide to extend its quantitative and qualitative monetary easing measures when it becomes evident that it is difficult to achieve its target.

Focus of attention upon the *shunto* wage negotiations

In a bid to forecast the future course of the economy and prices, attention is gathering around the spring labor-management wage negotiations ("*shunto*") in 2014. Subsequent to the Japanese Trade Union Confederation (RENGO) declaring a "base-up" (an increase of the overall level of wages) of at least 1%, many labor unions are requesting a base-up rate of 1% or so in the labor-management wage negotiations.

A look at the past trends in wage hikes in the *shunto* negotiations provides some insight in forecasting how high wages will be raised in the 2014 *shunto* negotiations. The long-term trends of the wage increase rate shows that the rate continued to hover above 50% during the "bubble era" from the 1980s to the early 1990s. From then onward, the wage increase rate fell to around 30% - 40% in the mid-1990s and fell to approximately 20% in the late 1990s. From the early 2000s, the practice of presenting forth unified wage hike demands was shelved altogether (**Chart 13**).

[Chart 13: Trends in wage increase rate (demands, actual)]



Notes: 1. The "base-up" rate in the demand-stage of negotiations refer to the unified demand level (for years in which the wage hike is comprised only of the regular wage hike, the "base-up" is calculated on the basis of the regular wage hike being 2%).
2. The actual "base-up" rate is based upon releases by the Central Labor Relations Commission (as a rule, large corporations with at least 1,000 workers).
3. "Wage increase rate" = "base-up" rate (actual) / "base-up" rate (demand) × 100

Sources: Made by MHRI based upon releases by the Ministry of Health, Labor and Welfare, Central Labor Relations Commission, and other media reports.

In view of RENGO's (labor) aggressive stance in ways such as presenting uniform wage hike demands, and Keidanren's (management) acceptance of such wage hike in the 2014 *shunto* negotiations, the wage increase rate should improve to some extent. Even so, in view of forecasts of a temporary slowdown of demand accompanying the consumption tax hike, a dramatic improvement of the wage increase rate is unlikely. The *shunto* negotiations in 2014 would be considered a success if the wage increase rate improves to around 30% - 40% as in the mid-1990s. In the event the regular annual wage hike (which is said to be approximately 1.6% - 1.8%) is included, the *shunto* wage increase rate (the total of the "base-up" and regular wage hike) among major corporate enterprises would be approximately 2%.

If the *shunto* negotiations in 2014 results in a "base-up", however small the increase may turn out to be, it would induce a movement to meet the rise of costs stemming from the wage hike by increasing the price of products and services as the economy returns to a recovery track from the second half of the fiscal year. Moreover, if this movement to pass on the labor costs to prices of products and services takes root, this would gradually lower the hurdles for corporate enterprises to raise wages and lead to a further spread of "base-up" hikes in the *shunto* negotiations in 2015. MHRI forecasts that the *shunto* wage increase rate will turn out to be 2.01% in 2014 and 2.30% in 2015. If the economic expansion is sustained over the medium to long term, the wage increase rate would gradually rise from FY2016 onward.

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