Economic Outlook for FY2011 and FY2012

November 2011

Key points of Mizuho Research Institute's (MHRI) outlook on the economy in FY2011 and FY2012
reflecting *The First Preliminary Quarterly Estimates of GDP (1st QE)* of Japan for the Jul-Sep quarter of 2011

<The US Economy>

Weak growth due to fiscal tightening amid balance sheet adjustment

2011 +1.8 % (previous forecast +1.6 %)

2012 +1.4 % (previous forecast + 1.4%)

<The Eurozone Economy>

A slide into recession from around the turn of the calendar year

2011 + 1.6% (previous forecast +1.7 %)

2012 + 0.1% (previous forecast +1.0 %)

<The Asian Economy>

Sluggish exports to the US and the eurozone will lead to the moderation of growth

2011 + 7.6% (previous forecast + 7.8%)

2012 + 7.0% (previous forecast + 7.6%)

<The Japanese Economy>

FY2011 + 0.4% (previous forecast + 0.5%)
Maintenance of economic recovery amid reconstruction demand

FY2012 + 1.7% (previous forecast + 2.0%)
Growth will peter out due to export slowdown and peak-out of reconstruction demand

Mizuho Research Institute

I. The global economy

Ongoing signs of stagnation in the global economy

The global economy continued to stall in the Jul-Sep quarter of 2011 as the eurozone and US sovereign debt crisis and concerns regarding the future course of the real economy continued to rock the financial markets.

US real GDP picked up slightly in the Jul-Sep quarter of 2011 (+2.5% q-o-q p.a.) from growth in the Apr-Jun quarter (+1.3% q-o-q p.a.). (**Chart 1**). In contrast to the strong growth of personal consumption and capital investment, export growth remained stagnant.

[Chart 1: Real GDP growth of major countries and areas]

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

	2010				2011		
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep
US	3.9	3.8	2.5	2.3	0.4	1.3	2.5
Eurozone	1.3	3.8	1.6	1.1	3.1	0.7	0.6
Germany	2.1	8.0	3.2	1.9	5.5	1.1	2.0
France	0.4	2.1	1.7	1.3	3.8	-0.2	1.6
Italy	2.6	1.9	1.3	0.3	0.5	1.2	n.a.
Japan	10.2	0.1	2.9	-2.7	-2.7	-1.3	6.0
South Korea	8.6	5.7	2.6	2.0	5.4	3.6	3.0
Taiwan	17.8	2.4	3.7	1.2	14.6	0.9	-1.1
Hong Kong	7.6	7.8	3.5	6.3	12.8	-1.4	0.3
Singapore	39.9	29.7	-16.7	3.9	27.4	-6.3	1.3
Thailand	12.1	0.7	-1.5	5.3	8.1	-0.8	n.a.
Philippines	17.2	7.2	0.6	2.0	8.0	2.5	n.a.
(Y-o-y % change)							
China	11.9	10.3	9.6	9.8	9.7	9.5	9.1
Malaysia	10.1	9.0	5.3	4.8	4.9	4.0	n.a.
Indonesia	5.6	6.1	5.8	6.9	6.5	6.5	6.5
Vietnam	5.8	6.4	7.2	7.3	5.4	5.7	6.1
India	9.4	8.8	8.9	8.3	7.8	7.7	n.a.

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

Eurozone real GDP growth remained weak in the Jul-Sep quarter (+0.6% q-o-q p.a.) as the previous quarter from April to June (+0.7% q-o-q p.a.). Despite the upturn of growth in Germany (+2.0% q-o-q p.a.) and France (+1.6% q-o-q p.a.), the Spanish economy remained flat and Portugal fell into negative territory, revealing a widening gap with the countries of southern Europe.

In Asia, many of the countries slowed down due to the impact of monetary tightening and inventory adjustment in the IT sector. China's economy continued to soften, slowing from +9.5% y-o-y in the Apr-Jun quarter to +9.1% y-o-y in the Jul-Sep quarter. Apart from the moderation of export growth, investments also slowed down due to the tightening of monetary policy. Amid the global stagnation of IT-related demand, the South Korean economy slowed down (+3.0% q-o-q p.a.) and the Taiwanese economy dipped into negative territory (-1.1% q-o-q p.a.) Even though Singapore climbed back to positive territory, economic growth stood at a weak +1% p.a.-level.

In contrast to the sluggish growth of the global economy, the Japanese economy grew a strong +6.0% q-o-q p.a. in the Jul-Sep quarter (Apr-Jun quarter -1.3% q-o-q p.a.) in a rebound from the fall after the Great East Japan Earthquake (the "Earthquake"). Both domestic demand and exports grew strongly, given the alleviation of supply constraints.

The global economy will show more signs of slowdown in 2012

In 2011, global economic growth (the weighted average of countries and areas in MHRI's economic forecast) is forecast to fall short of 4% in a sharp slowdown from growth above 5% in 2010 (**Chart 2**). Signs of slowdown should intensify in 2012, keeping the rate of growth in the mid-3% level. The US and eurozone economies will likely remain weak due to the impact of fiscal austerity measures. Many of the emerging economies are also predicted to moderate due to the stagnation of exports to the US and the eurozone.

[Chart 2: Outlook on the global economy]

(Y-o-y % change)

Calendar year (CY)	2009 (Actual)	2010 (Actual)	2011 (Forecast)	2012 (Forecast)
Total of forecast area	0.2	5.3	3.9	3.4
Japan, US, Eurozone	-3.7	2.7	1.4	1.0
US	-2.6	3.0	1.8	1.4
Eurozone	-4.1	1.8	1.6	0.1
Japan	-6.3	4.1	-0.3	1.9
Asia	6.1	9.3	7.6	7.0
NIEs	-0.8	8.4	4.2	2.7
ASEAN5	1.6	6.9	4.9	4.6
China	9.2	10.4	9.3	8.8
India	7.0	8.9	7.7	7.0
Japan (FY)	-2.4	2.4	0.4	1.7
Crude oil price (USD/bbl)	62	80	94	83

Note: The total of the forecast area is calculated upon the 2010 GDP share (PPP) by the IMF.
Sources: IMF, MHRI.

US economic growth is forecast to remain extremely weak in 2011 (+1.8%) and 2012 (+1.4%). Amid persistent balance sheet adjustment pressures and stronger downward pressures from tight fiscal conditions such as the government spending cuts under the Budget Control Act 2011 which was passed in August, the US economy should remain sluggish.

The eurozone economy is forecast to slip into recession from the end of 2011 to early 2012. Due in part to downward pressures stemming from fiscal tightening, real GDP growth is predicted to slow sharply from +1.6% in 2011 to +0.1% in 2012.

The Asian economies in general are expected to slow down, due mainly to the stagnation of exports reflecting the US and eurozone economic slump. Real GDP growth among the export-dependent NIEs is expected to stand at +4.2% in 2011 and slow down to +2.7% in 2012. In contrast, growth among the ASEAN5 economies, which are expected to see solid domestic demand growth, should follow a relatively solid path in 2011 (+4.9%) and 2012 (+4.6%).

The Chinese economy is forecast to moderate in both 2011 (+9.3%) and 2012 (+8.8%). The stagnation of Europe-bound exports will also serve as a drag upon China's economic growth. On the other hand, monetary policy should turn neutral reflecting the peak-out of inflation, providing reason to believe that investment will continue to grow strongly under the new Five-Year Plan. We also expect to see solid personal consumption growth backed by the rise of wages.

The rate of Japan's real GDP growth will likely fall into negative territory (-0.3%) for the first time in two years on a calendar year (CY) basis in 2011 due to the impact of the Earthquake. From then onward, the rate of growth should rise to +1.9% in 2012, due in part to demand in connection with post-Earthquake reconstruction.

Concerns abound regarding US and eurozone fiscal and economic conditions

In our latest economic outlook, we have made a sharp downward revision to our forecast on eurozone economic growth where concerns regarding sovereign debt have started to affect the real economy.

Even though eurozone economic growth managed to remain in positive territory in the Jul-Sep quarter of 2011, tensions have been rising in the financial markets since the summer season. Turmoil erupted in Greece, given the difficulties in passage of parliamentary resolutions regarding the Greek bail-out among the supporting countries and the riots toward the stringent fiscal tightening measures in Greece. Just as an agreement was about to be reached on a 50% face-value haircut on the part of a private bank consortium of Greek government bondholders and passage of a Greek parliamentary resolution of a fiscal austerity package, uncertainties were reignited as Prime Minister George Papandreou proposed a referendum for Greece's acceptance of the EU's bail-out package. Even though the ruling Panhellenic Socialist Movement and the New Democracy party – the largest opposition party – reached an agreement on November 6th to establish a coalition government, risks of destabilization still linger due to possibilities of a general election next February.

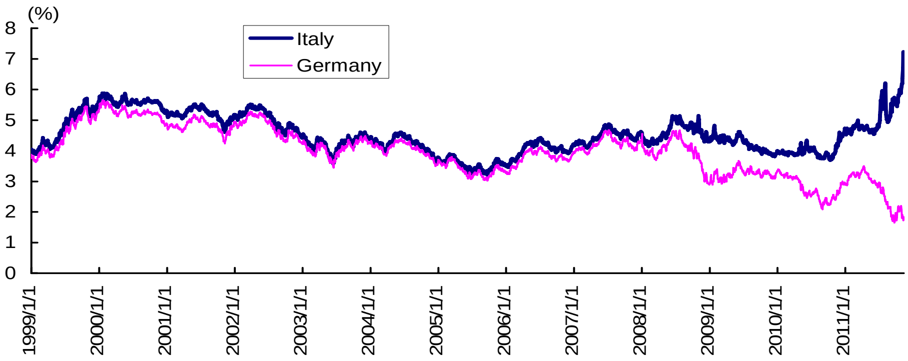
Note also that Italian government bond yields have been rising sharply. The yield on 10-yr Italian government bonds temporarily soared above 7% in November, sending the yield gap with German government bonds which thus far has been trending below 2% to the highest level since the inception of the euro in January 1999 (**Chart 3**). At the G-20 Summit held in Cannes (France) on November 3rd and 4th, Italy agreed to be monitored by the IMF with respect to the progress of its fiscal rehabilitation and economic structure reform. Even though Prime Minister Silvio Berlusconi subsequently stated that he would resign, the statement failed to quell uncertainties in the financial market due to the lack of prospects of the establishment of a stable government after his resignation.

Our latest economic outlook is based upon the premise that the events surrounding Greece and Italy will not spill over into a global financial crisis owing to measures taken by the EU; in other words, that the fall of the real economy accompanying the sovereign debt crisis will be contained within the eurozone. However, the possibility of a development into a global economic crisis at some point in time may not be ruled out altogether. In such an event, there are risks that its impact upon the global economy would equal that of the Lehman Shock.

Subsequent to a sharp downward revision of our outlook on the US economy in our *Economic Outlook* in August, we maintain our forecast of the US economy at a 1%-level in both 2011 and 2012. However, in addition to further downside risks to US economic growth due to fiscal tightening, debate regarding the government debt ceiling may be reignited, leading to the rise of uncertainties in the financial markets.

We are thus inclined toward the view that the uncertainties regarding fiscal and economic conditions in the US and eurozone will persist and continue to cast dark shadows over the global economy during the coming year.

[Chart 3: Yields on German and Italian 10-yr government bonds]



Source: Datastream

II. The Japanese economy

(1) The current state of the economy

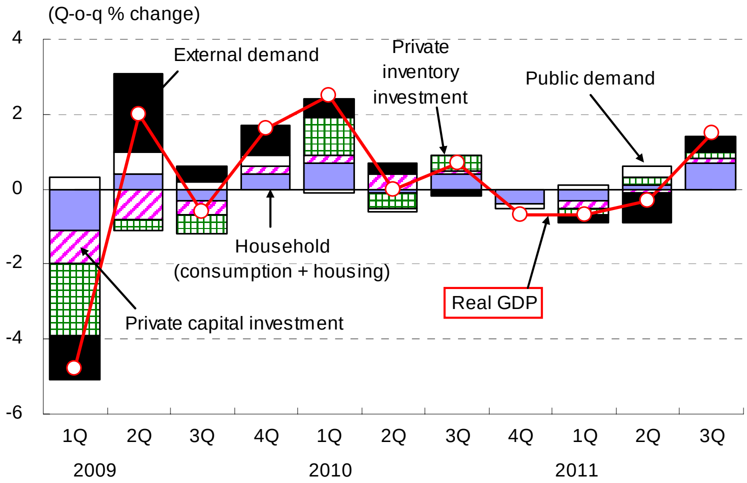
The Japanese economy grew strongly in the Jul-Sep quarter of 2011 in a rebound from the fall after the Earthquake

Japan's real GDP grew +1.5% q-o-q (+6.0% q-o-q p.a.) in the Jul-Sep quarter of 2011, rising into positive territory for the first time in a year (**Chart 4**). Both domestic private demand and exports turned out to grow strongly in a rebound from the fall after the Earthquake.

Looking closer at each of the components of demand, personal consumption grew a strong +1.0% q-o-q, given the increase of automotive sales along with the resolution of supply-side constraints and the upturn of services consumption in sectors such as restaurants and travel due to the alleviation of self-restraints among consumers. Housing investment (+5.0% q-o-q) and capital investment (+1.1% q-o-q) both took an upturn. Domestic private demand including private inventory investment (contribution to quarterly growth: +0.2% pt q-o-q) grew +1.4% q-o-q, serving as a major positive contribution (+1.1% pt) to quarterly real GDP growth.

Despite the ongoing expansion of government consumption (+0.4% q-o-q), public investment fell for the first time in two quarters (-2.8% q-o-q) due to the slow progress of reconstruction works. As a result, the contribution by public demand to Japan's GDP growth turned to be slightly negative at -0.0% pt.

[Chart 4: Japan's quarterly real GDP growth]



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

Exports grew a dramatic +6.2 % q-o-q, given the restoration of supply chains in sectors such as automobiles. Even though imports also grew a strong +3.4% q-o-q due to factors such as the increase of liquid natural gas (LNG) imports accompanying the reinforcement of thermal electrical power generation, this was surpassed by the growth of exports. Thus, the contribution to real GDP growth by external demand (net exports) stood at +0.4% pt.

Monthly economic indicators reveal a slowdown

Even so, a look at Japan's monthly economic indicators reveals that the pace of recovery is moderating, due in part to the fact that exports and production activity is moving closer to pre-Earthquake levels. Given the end of the sharp recovery from the supply constraints stemming from the Earthquake, a sharp slowdown of growth looks inevitable from the Oct-Dec quarter onward.

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

The economy will remain in recovery mode in 2H FY2011 due to the replenishment of inventories and reconstruction demand

In the second half of FY2011, the Japanese economy should continue to recover on the back of ongoing movements among sectors such as automobiles to replenish inventories which fell due to supply constraints after the Earthquake and the materialization of reconstruction demand.

The environment surrounding exports is turning increasingly severe, such as the further slowdown of the eurozone economy and the ongoing strength of the yen. That said, the odds are high that certain sectors such as automobiles will continue to boost output to replenish inventories, given the low level of local inventories because of the output cuts after the Earthquake. While the impact of the flooding in Thailand is affecting domestic production of items such as cars from the end of October to November, conditions should gradually stabilize. Since most of the parts of cars and electric devices made in Thailand can, presumably, be manufactured at substitute production sites, the impact upon domestic production should turn out to be temporary.

As for demand in connection with post-Earthquake reconstruction, much of the demand thus far consisted of immediate restoration such as the construction of temporary housing and spending for livelihood support of disaster victims. Looking forward, reflecting the passage of the third supplementary budget, we expect to see the rise of public demand along with the materialization of reconstruction demand such as the rebuilding of damaged infrastructure.

Even though a slowdown will be inevitable in comparison to the Jul-Sep quarter which marked strong growth in a rebound from the plunge due to the Earthquake, growth in the Oct-Dec quarter of 2011 and Jan-Mar quarter of 2012 should be maintained at +1% to +2% or so, keeping the economy in recovery mode. Japan's economy is forecast to grow +0.4% in FY2011 (MHRI's previous forecast in September: +0.5%) (**Chart 5**).

The Japanese economy in FY2012: growth will peter out due to overseas economic slowdown and peak-out of reconstruction demand

In the first half of FY2012, the moves to replenish inventories in the automobile sector should run its course, leading to the stagnation of exports. On the other hand, public investment driven by reconstruction demand will continue to expand, serving to prop up the economy. Given the recovery of corporate profits after the Earthquake, summer bonus payments in 2012 are expected to rise above the previous year, providing reasons to believe that personal consumption will gradually expand. Capital investment should follow a solid footing along with the improvement of corporate profits, leading to our view that domestic demand will serve as the engine of growth during this period.

However, in the second half of FY2012, demand related to reconstruction from the Earthquake should peak out amid the ongoing stagnation of exports reflecting the weakness of the US and eurozone economies. According to the *Basic Guidelines for Reconstruction in response to the Great East Japan Earthquake*, public works for reconstruction is estimated to run up to approximately JPY23 trillion in 10 years, of which JPY19 trillion or so will be invested during the initial five-year period of concentrated reconstruction. On a fiscal year basis, the odds are high that reconstruction-related expenditures will be the largest in FY2012 and that public demand accompanying reconstruction will reach a peak in the middle of FY2012. Moreover, the tax hike for reconstruction (a surtax of 2.1% on income taxes) will start from January 2013, serving as a drag upon personal consumption. In the second half of FY2012, the Japanese economy is expected to peter out due to the slowdown of private demand amid the slow growth of exports and peak-out of public demand.

Due in part to the large carry-over of growth (forecast to be +1.0%) to FY2012 stemming from the strong growth during FY2011, the Japanese economy is forecast to rise to +1.7% in FY2012 but slow down in the second half of the fiscal year.

We have revised down our outlook on FY2012 from our previous forecast in September (+2.0%) primarily because of the downward revision of our outlook on exports along with the downward revision of our outlook on the overseas economies, mainly with respect to Europe and Asia.

[Chart 5: Outlook on the Japanese economy]

		FY2009	FY2010	FY2011	FY2012	2010		2011				2012				2013
						Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
GDP (real)	Q-o-q % ch	-2.4	2.4	0.4	1.7	0.7	-0.7	-0.7	-0.3	1.5	0.5	0.3	0.4	0.4	0.2	0.1
	Q-o-q % ch p.a.	--	--	--	--	2.9	-2.7	-2.7	-1.3	6.0	1.9	1.2	1.7	1.8	0.6	0.3
Domestic demand	Q-o-q % ch	-2.7	1.6	1.1	1.5	0.9	-0.6	-0.5	0.5	1.0	0.4	0.4	0.4	0.4	0.1	0.0
Private sector demand	Q-o-q % ch	-5.0	2.0	0.9	1.7	1.2	-0.6	-0.8	0.2	1.4	0.3	0.3	0.4	0.4	0.3	0.2
Personal consumption	Q-o-q % ch	-0.0	1.0	0.4	0.9	0.7	-0.9	-0.5	0.2	1.0	0.0	0.2	0.1	0.2	0.2	0.1
Housing investment	Q-o-q % ch	-18.2	-0.2	5.1	2.1	1.1	2.1	1.4	-1.1	5.0	1.2	-2.1	0.4	1.9	0.2	0.3
Capital investment	Q-o-q % ch	-13.6	4.2	0.6	4.0	0.6	-0.1	-1.1	-0.5	1.1	1.4	0.7	1.1	1.2	0.7	0.5
Inventory investment	Q-o-q contribution, % pt	-1.1	0.5	0.3	0.1	0.4	-0.0	-0.2	0.2	0.2	0.0	0.0	0.1	-0.0	-0.0	-0.0
Public sector demand	Q-o-q % ch	5.2	0.1	1.8	1.2	-0.0	-0.6	0.6	1.2	-0.1	0.5	0.7	0.4	0.5	-0.5	-0.4
Government consumption	Q-o-q % ch	3.5	2.3	2.0	0.8	0.4	0.4	0.9	0.7	0.4	-0.1	0.2	0.3	0.3	-0.1	0.2
Public investment	Q-o-q % ch	14.3	-9.8	1.0	2.9	-1.2	-5.9	-1.1	3.7	-2.8	3.9	3.6	0.9	1.2	-2.5	-4.0
External demand	Q-o-q contribution, % pt	0.3	0.9	-0.7	0.0	-0.2	-0.0	-0.2	-0.8	0.4	0.0	-0.1	-0.0	-0.0	0.1	0.0
Exports	Q-o-q % ch	-9.6	17.1	0.5	4.1	0.1	-0.5	0.2	-5.0	6.2	1.7	0.2	0.7	0.6	0.7	0.4
Imports	Q-o-q % ch	-11.0	10.9	5.3	3.7	1.5	-0.2	1.7	0.1	3.4	1.5	0.9	0.7	0.7	0.3	0.2
GDP (nominal)	Q-o-q % ch	-3.7	0.4	-1.3	1.9	0.1	-0.9	-1.1	-1.5	1.4	0.4	0.6	0.3	0.4	0.3	0.3
GDP deflator	Y-o-y % ch	-1.3	-2.0	-1.7	0.2	-2.3	-1.7	-1.9	-2.2	-1.9	-1.7	-1.0	-0.1	0.1	0.3	0.4
Domestic demand deflator	Y-o-y % ch	-2.2	-1.2	-0.6	-0.5	-1.6	-1.1	-0.9	-0.8	-0.4	-0.7	-0.7	-0.8	-0.7	-0.4	-0.1

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

		FY2009	FY2010	FY2011	FY2012	2010		2011				2012				2013
						Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Industrial production	Q-o-q % ch	-8.8	8.9	-1.7	4.9	-1.0	-0.1	-2.0	-4.0	4.3	1.0	1.8	0.3	1.3	0.9	0.8
Ordinary profits	Y-o-y % ch	-0.0	39.0	-2.8	9.7	55.1	25.6	11.0	-13.2	-6.1	2.6	5.3	14.1	14.2	9.3	2.9
Nominal labor compensation	Y-o-y % ch	-3.6	1.0	0.2	0.9	1.2	0.9	0.6	0.2	-0.3	0.2	0.6	0.8	0.9	1.0	0.6
Unemployment rate	%	5.2	5.0	4.4	4.0	5.0	5.0	4.7	4.6	4.4	4.2	4.2	4.1	4.1	4.0	4.0
New housing starts	P.a., 10,000 units	77.5	81.9	84.5	86.2	81.5	84.3	84.2	81.0	87.8	82.3	83.3	85.6	88.1	90.6	93.1
Current account balance	P.a., JPY tril	15.8	16.1	10.3	15.3	17.6	17.3	13.0	7.6	10.4	12.0	11.3	13.8	16.5	16.3	15.4
Domestic corporate goods prices	Y-o-y % ch	-5.2	0.7	1.9	-0.9	-0.1	1.0	1.8	2.5	2.7	1.9	0.4	-1.4	-1.2	-0.9	-0.3
Consumer prices	Y-o-y % ch	-1.6	-0.8	-0.1	-0.3	-1.1	-0.5	-0.8	-0.2	0.2	-0.1	-0.2	-0.5	-0.3	-0.3	-0.2
Uncollateralized overnight call rate	%	0.08	0.06	0~0.10	0~0.10	0.11	0.08	0.06	0.07	0.08	0~0.10	0~0.10	0~0.10	0~0.10	0~0.10	0~0.10
Yield on newly-issued 10-yr JGBs	%	1.35	1.13	1.04	1.01	0.99	1.07	1.24	1.18	1.05	0.97	0.95	0.95	1.00	1.05	1.05
Nikkei average	JPY	9,974	9,961	9,100	9,150	9,357	9,836	10,308	9,612	9,255	8,700	8,700	8,500	9,000	9,500	9,500
Exchange rate	JPY/USD	93.0	86.0	78.0	76.0	85.9	82.6	82.3	82.0	78.0	78.0	76.0	74.0	76.0	77.0	77.0
Crude oil price (WTI nearest term contract)	USD/bbl	71.0	84.0	92.0	84.0	76.2	85.2	94.6	102.3	89.5	91.0	85.0	79.0	83.0	86.0	87.0

Notes: 1. The readings above may differ from public releases because the rates of change are calculated based upon actual results.
2. Ordinary profits are based upon the *Financial Statements Statistics of Corporations by Industry* (all industries) (ex finance & insurance, and production, transmission and distribution of electricity services).
3. Consumer prices exclude fresh food (2010 base).
4. Quarterly data on the unemployment rate, new housing starts and current account balance are seasonally-adjusted.
5. Of the finance-relate indices, the uncollateralized overnight call rate refers to the rate at the end of term and all others are averages during the relevant terms.

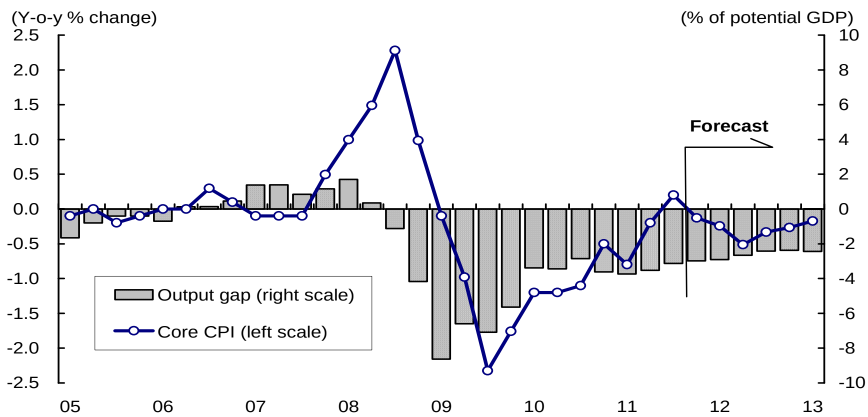
Sources: Made by MHRI based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*, Ministry of Economy, Trade and Industry, *Indices of Industrial Production*, Ministry of Finance, *Financial Statements, Statistics of Corporations by Industry, Quarterly*, Ministry of Internal Affairs and Communications, *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.

An emergence out of deflation is unlikely until FY2013

The output gap (the gap between actual GDP and potential GDP) estimated by MHRI stood at -3.1% of potential GDP (meaning an excess of supply of JPY17.5 trillion) as of the Jul-Sep quarter of 2011. In the event the Japanese economy grows according to our latest *Economic Outlook*, the output gap should reach -2.4% (an excess of supply of JPY13.8 trillion) as of the end of FY2012 (**Chart 6**).

The consumer price index (excluding fresh food, the “core CPI”) stood at +0.2% y-o-y as of September 2011. As the impact of the tobacco price hike since last year runs its course in October, the core CPI is predicted to fall into negative territory. From then onward, the core CPI is expected to remain negative during the forecast horizon, given the excess of supply in terms of the output gap and the downturn of energy prices. Our forecast on the percentage change of the core CPI is -0.1% y-o-y in FY2011 and -0.3% y-o-y in FY2012. Japan’s emergence out of deflation is unlikely during FY2012.

[Chart 6: The output gap and core CPI (forecast)]



Notes: 1. CPI = general, excluding fresh food (2010-base).
2. 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.*

The overseas economic downturn and appreciation of the yen are major risk factors

While our main scenario outlook is as set forth in the preceding paragraphs, there are various factors providing uncertainties to the Japanese economy in FY2012.

The largest risk is the overseas economic downturn and appreciation of the yen. Our current *Economic Outlook* is based upon the premise that the eurozone sovereign debt crisis will not spill over into a worldwide financial crisis and credit crunch. In the event such global financial crisis and credit crunch should occur, the odds are high that Japan's economic growth will dip into negative territory in FY2012 and that the yen will gain further ground to other currencies, just as in the aftermath of the Lehman Shock.

An economic downturn will be inevitable in FY2012 in the event all of Japan's nuclear power plants are suspended

The largest domestic risk factor is the shortage of electrical power. Subsequent to the summer of 2011 when the areas served by the Tokyo Electric Power Company (TEPCO) and Tohoku Electric Power Co. were subject to an electrical power regulation order, the government will make a request (a request for voluntary electrical power conservation and not an electrical power regulation order which possesses legal binding power) accompanying numerical electrical power conservation targets in the areas served by the Kansai Electric Power Co. (-10%) and the Kyushu Electric Power Co. (-5%) this winter.

In the summer of 2011, the impact of electrical power conservation upon production activity was minimized by reducing air conditioning and lighting in office buildings and commercial facilities and by shifting peak manufacturing hours to nighttime and weekend shifts. Even so, the fall of industrial production in the Tohoku and Kanto areas was larger than other areas, showing that a negative impact of electrical power conservation upon economic activity could not be avoided (**Chart 7**).

Judging from the fact that the request for electrical power conservation in the winter of 2011 will only affect the areas served by KEPCO and Kyushu Electric Power Company as well as the relatively small breadth of electrical power conservation requested, the impact upon economic activity should be negligible.

However, in the event all the nuclear power plants in Japan remain suspended after their regular inspections, all the nuclear power plants will be shut down by next spring, leading to the expansion of the area and magnitude of the electrical power shortage in the summer of 2012, and serve to aggravate the negative impact upon Japan's economy.

[Chart 7: Regional industrial production in Jul-Aug 2011]

(Y-o-y % change)

Hokkaido	Tohoku	Kanto	Chubu	Kinki	Chugoku	Shikoku	Kyushu
2.4	-6.9	-4.6	-2.3	3.8	-1.3	0.6	4.0

Source: Made by MHRI based upon data of each district's Bureau of Economy, Trade and Industry

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