

# Economic Outlook for FY2010 and FY2011

(revised to reflect the *Second Preliminary Quarterly Estimates of GDP* for the Apr-Jun quarter of 2010)

September 2010

**Key points of Mizuho Research Institute's (MHRI) outlook on the economy in FY2010 and FY2011**  
(reflecting *the Second Preliminary Quarterly Estimates of GDP (2<sup>nd</sup> QE)* for the Apr-Jun quarter of 2010)

## <The Japanese Economy>

**FY2010** +2.0% (previous outlook +1.7%)

Growth will stall in the second half of the fiscal year due to the fading impact of the economic stimulus measures

**FY2011** +1.5% (previous outlook +1.6%)

Despite the gradual recovery of the economy, growth will be insufficient to emerge out of deflation

## <The US Economy>

Even though the US economy will continue to follow a gradual recovery, downside risks linger due to fiscal tightening

**2010** +2.7% (previous outlook +2.8%)

**2011** +2.0% (previous outlook +2.3%)

This English-language translation is based upon the outlook in Japanese released on September 10, 2010. This publication is compiled solely for the purpose of providing readers with information and is in no way meant to encourage readers to buy or sell financial instruments. Although this publication is compiled on the basis of sources which we believe to be reliable and correct, Mizuho Research Institute does not warrant its accuracy and certainty. Readers are requested to exercise their own judgment in the use of this publication. Please also note that the contents of this publication may be subject to change without prior notice.

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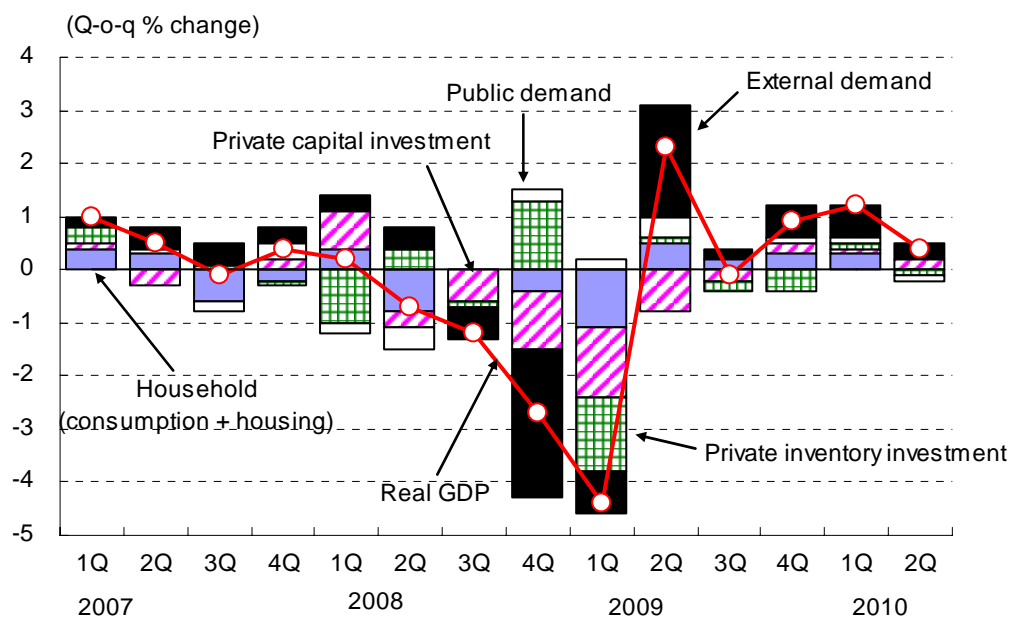
# I. The current state of the Japanese economy

The 2<sup>nd</sup> QE revealed an upward revision of both capital investment and inventory investment

The *Second Preliminary Quarterly Estimates of GDP* (“2<sup>nd</sup> QE”) for the Apr-Jun quarter of 2010 revealed an upward revision of Japan’s real GDP growth to +0.4% q-o-q (+1.5% p.a.) from +0.1% q-o-q (+0.4% p.a.) in the *First Preliminary Quarterly Estimates of GDP* (“1<sup>st</sup> QE”) (**Chart 1**). Looking closer at each of the components of demand, both capital investment (+0.5% q-o-q → +1.5% q-o-q) and private-sector inventory investment (contribution to quarterly growth: -0.2% pt → -0.1% pt) were revised upward, reflecting the results of the *Financial Statements Statistics of Corporations by Industry*. As a result, the contribution by domestic private demand toward quarterly real GDP growth stood at +0.1% pt (1<sup>st</sup> QE: -0.1% pt). Government consumption (+0.2% q-o-q → +0.3% q-o-q) and public investment (-3.4% q-o-q → -2.7% q-o-q) both edged up from the 1<sup>st</sup> QE, contributing 0.0% pt to domestic demand (1<sup>st</sup> QE: -0.2% pt). Despite a slight downward revision of imports (+4.3% q-o-q → +4.1% q-o-q), the contribution to external demand stood at the same level as the 1<sup>st</sup> QE at +0.3% pt. Although the overall picture of an economy dependent upon external demand remains unchanged, the results show that the recovery of domestic demand was barely maintained due to an upward revision of domestic private-sector demand into positive territory.

The GDP deflator was revised up slightly from -1.8% y-o-y in the 1<sup>st</sup> QE to -1.7% y-o-y. GDP growth in nominal terms was also revised up from -0.9% q-o-q in the 1<sup>st</sup> QE to -0.6% q-o-q.

[ Chart 1: Japan’s GDP growth ]



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

**Despite the maintenance of growth in the Jul-Sep quarter, growth may dip into negative territory in the Oct-Dec quarter**

In the Jul-Sep quarter, the last-minute rush of demand accompanying the termination of Eco-Car subsidies will boost personal consumption. Judging from the high probability that capital investment will continue to follow a mild recovery, domestic demand should pick up. While a slowdown of exports reflecting the overseas economic slowdown appears inevitable, the readings of the *Trade Statistics* up to July indicate that exports are not falling as sharply as a downturn on a quarterly basis. In the Jul-Sep quarter, economic growth should stay in positive territory as domestic private-sector demand gains momentum.

However, in the Oct-Dec quarter, it appears more or less certain that personal consumption will decline due to the fall of automobile sales in a backlash to the last-minute rush of demand. Exports are also expected to stagnate, given forecasts of the ongoing slowdown of overseas economies such as the US and China. The odds are high that growth will dip into negative territory in the Oct-Dec quarter.

## **II. Forecast of the Japanese economy in FY2010 and FY2011**

**The economy will stall in the second half of FY2010**

Subsequent to the Oct-Dec quarter, during which economic growth will most likely fall into negative territory, a significant upturn of growth is unlikely either in the Jan-Mar quarter. Since the Eco-Car subsidies is thought to have accelerated the demand for approximately 600 thousand new cars, personal consumption is predicted to remain weak amid the softening of automobile sales. As the overseas economies of countries such as the US and China stagnate, Japan's export growth should also remain weak. In the second half of FY2010, the Japanese economy is forecast to "pause on the landing", referring to a temporary derailment of the economy from a recovery path.

**Outlook on FY2010 real GDP growth: +2.0%**

The rate of Japan's real GDP growth is predicted to reach +2.0% q-o-q (previous outlook +1.7% q-o-q) in FY2010 (**Chart 2**). Given the upward revision of Apr-Jun quarter real GDP in the 2<sup>nd</sup> QE and the last-minute rush of demand for cars in the Jul-Sep quarter prior to the termination of the Eco-Car subsidies, economic growth should turn out to be relatively strong in the first half of the fiscal year. However, growth will drop sharply in the second half of the year, leading to concerns regarding a double-dip recession.

**The economy should return to a mild recovery path in FY2011**

As the year progresses in FY2011, the economy is expected to return to a mild recovery path. The pace of economic recovery overseas in countries such as the US and China should gradually pick up, centering upon private-sector demand, subsequent to a slowdown stemming from the fading impact of economic stimulus measures. With respect to the Japanese economy, exports are expected to return to a gradual recovery and the growth of domestic demand should also pick up gradually along with the progress of the stock adjustment process.

**Outlook on FY2011 real  
GDP growth: +1.5%**

The rate of Japan's real GDP growth is forecast to reach +1.5% (previous outlook +1.6%) in FY2011. Even though the pace of growth should pick up slightly compared to the second half of FY2010 when the economy is predicted to reach a plateau, growth on a fiscal year basis should turn out to be weaker than FY2011 because of a low starting point of growth at the end of FY2010. In terms of the year-on-year rate of real GDP at the end of each fiscal year, FY2011 growth is forecast to climb to +2.5% in comparison to the forecast for FY2010 which is +0.8%.

**An output gap will still  
linger at the end of FY2011,  
making an exit out of  
deflation unlikely**

The output gap (the gap between actual GDP and potential GDP) estimated by MHRI stood at -3.9% (excess supply of approximately JPY 22 trillion) as of the Apr-Jun quarter of 2010 (**Chart 3**). Even though the output gap in negative territory will narrow, an excess supply of approximately 1.9% (JPY 10 trillion) will remain as of the end of FY2011. The CPI (excluding fresh food) should continue to fall in both FY2010 (-1.0% y-o-y) and FY2011 (-0.2% y-o-y), making it unlikely that Japan will emerge out of deflation during the forecast horizon.

**Mounting destabilization  
and downside risks**

However, note that there is a good measure of uncertainty in the scenario above. The major point is the extent to which the overseas economies such as the US and China will slow down in the future. In particular, the rise of deflationary concerns in the US would lead to a stronger yen against the dollar and result in the rise of downside risks toward the Japanese economy. Furthermore, uncertainties toward the fiscal and financial systems of European countries have not been dispelled completely.

In addition, Japan faces domestic uncertainties regarding the future course of economic policies after the presidential election of the Democratic Part of Japan (DPJ). This *Economic Outlook* is based upon the assumption that the Eco-Point Program for purchases of environment-friendly household electrical appliances included in the economic stimulus measures unveiled on September 10<sup>th</sup> will be extended up to the end of March 2011. However, in addition to the possibility of an economic policy shift after the DPJ presidential election, there is the risk of policy measures in general coming to a stall over the end of the fiscal year under the so-called "twisted Diet" (where the DPJ has a minority in the upper house).

Given the destabilization and downside risks both within the country and overseas, future uncertainties in the financial markets and anxieties in the household and corporate sectors should persist for some time.

[ Chart 2: Outlook on the Japanese economy ]

		FY2009	FY2010	FY2011	2009			2010				2011				2012
					Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
GDP (real)	Q-o-q % ch	-1.9	2.0	1.5	2.3	-0.1	0.9	1.2	0.4	0.5	-0.3	0.2	0.3	0.6	0.7	0.8
	Q-o-q % ch p.a.	--	--	--	9.7	-0.3	3.4	5.0	1.5	2.2	-1.3	0.9	1.1	2.5	3.0	3.3
Domestic demand	Q-o-q % ch	-2.3	0.7	1.1	0.2	-0.3	0.2	0.7	0.0	0.5	-0.5	0.1	0.2	0.5	0.6	0.7
Private sector demand	Q-o-q % ch	-3.9	1.3	1.5	-0.2	-0.4	0.2	0.7	0.1	1.0	-0.4	0.4	0.3	0.5	0.6	0.7
Personal consumption	Q-o-q % ch	0.7	1.1	0.4	1.3	0.6	0.7	0.5	0.0	0.9	-1.0	0.2	0.1	0.2	0.2	0.3
Housing investment	Q-o-q % ch	-18.5	-3.5	5.3	-9.6	-7.2	-2.9	0.3	-1.3	0.1	0.9	1.2	1.4	1.5	1.7	2.0
Capital investment	Q-o-q % ch	-15.3	3.5	4.3	-5.2	-1.7	1.7	0.8	1.5	0.5	0.7	0.9	1.1	1.1	1.4	1.6
Inventory investment	Q-o-q contribution, % pt	-0.5	0.0	0.2	0.1	-0.2	-0.4	0.1	-0.1	0.1	0.2	0.0	-0.1	0.1	0.1	0.0
Public sector demand	Q-o-q % ch	3.0	-1.3	-0.3	1.7	-0.2	0.4	0.4	-0.3	-1.1	-0.8	-1.0	0.0	0.5	0.8	0.9
Government consumption	Q-o-q % ch	1.7	1.3	0.7	0.2	0.1	0.7	0.6	0.3	0.2	0.2	0.1	0.2	0.2	0.3	0.3
Public investment	Q-o-q % ch	9.3	-15.0	-5.2	8.6	-1.2	-1.3	-0.9	-2.7	-7.8	-6.5	-7.4	-0.8	2.4	4.2	4.9
External demand	Q-o-q contribution, % pt	0.4	1.2	0.3	2.1	0.2	0.6	0.6	0.3	0.1	0.1	0.1	0.0	0.1	0.1	0.1
Exports	Q-o-q % ch	-9.5	18.0	5.5	10.4	8.5	5.7	7.0	5.9	0.9	0.6	1.2	1.1	1.9	1.9	2.1
Imports	Q-o-q % ch	-11.8	9.2	3.9	-4.9	6.3	1.5	3.0	4.1	0.6	-0.4	0.4	1.1	1.5	1.7	1.9
GDP (nominal)	Q-o-q % ch	-3.6	0.5	1.0	0.4	-0.5	0.2	1.6	-0.6	0.0	-0.5	0.8	-0.4	0.2	0.9	1.1
GDP deflator	Y-o-y % ch	-1.8	-1.5	-0.5	-0.7	-0.7	-2.8	-2.8	-1.6	-1.7	-1.5	-1.2	-0.6	-0.6	-0.4	-0.4
Domestic demand deflator	Y-o-y % ch	-2.5	-0.7	0.1	-2.7	-3.0	-2.7	-1.7	-0.7	-0.5	-0.9	-0.8	-0.1	0.0	0.3	0.5

Note: The readings above may differ from public releases because the rates of change are calculated based upon actual results.

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

		FY2009	FY2010	FY2011	2009			2010				2011				2012
					Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Industrial production	Q-o-q % ch	-8.9	10.9	3.7	6.6	5.3	5.9	7.0	1.5	0.0	-0.6	0.6	1.2	1.4	1.6	1.7
Ordinary profits	Y-o-y % ch	2.1	29.1	8.7	-53.0	-32.4	102.2	163.8	83.4	35.9	11.2	6.5	8.1	9.2	11.3	6.5
Nominal labor compensation	Y-o-y % ch	-3.5	0.3	0.4	-4.6	-3.8	-4.5	-0.2	1.2	0.6	0.9	-1.8	-0.2	0.8	0.4	0.6
Unemployment rate	%	5.2	5.1	4.9	5.1	5.4	5.2	4.9	5.2	5.2	5.1	5.1	5.0	5.0	4.9	4.7
New housing starts	P.a., 10,000 units	77.5	79.1	85.6	76.9	71.3	79.1	83.7	76.0	78.7	80.2	81.7	83.0	84.7	86.5	88.2
Current account balance	P.a., JPY tril	15.8	15.9	16.6	14.1	14.5	15.9	18.6	14.6	14.7	16.4	17.4	16.8	16.4	16.1	16.6
Domestic corporate goods prices	Y-o-y % ch	-5.3	0.2	1.2	-5.5	-8.3	-5.2	-1.7	0.2	0.0	0.5	0.3	0.2	1.2	1.8	1.7
Consumer prices	Y-o-y % ch	-1.6	-1.0	-0.2	-1.0	-2.3	-1.7	-1.2	-1.2	-1.1	-0.8	-0.8	-0.5	-0.2	-0.1	0.1
Uncollateralized overnight call rate	%	0.08	0.10	0.10	0.11	0.10	0.09	0.08	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Yield on newly-issued 10-yr JGBs	%	1.35	1.09	1.11	1.42	1.34	1.32	1.34	1.21	1.04	0.95	1.00	1.00	1.05	1.15	1.25
Nikkei average	JPY	9,974	9,850	10,600	9,294	10,141	9,959	10,503	10,343	9,300	9,600	10,000	10,200	10,400	10,700	11,000
Exchange rate	JPY/USD	93.0	87.0	90.0	97.3	93.6	89.7	91.0	92.0	86.0	85.0	86.0	87.0	88.0	90.0	93.0
Crude oil price (WTI nearest term contract)	USD/bbl	71.0	78.0	86.0	59.8	68.2	76.1	79.0	78.0	76.0	81.0	75.0	82.0	91.0	88.0	83.0

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)*.

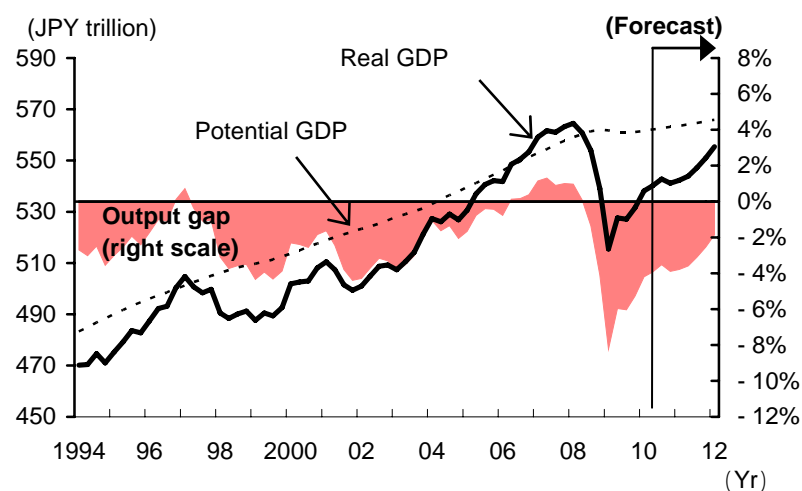
3. Consumer prices exclude fresh food.

4. Quarterly data on the unemployment rate, new housing starts and current account balance are seasonally-adjusted.

5. Of the finance-related indices, the uncollateralized overnight call rate refers to the rate at the end of term 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.

[ Chart 3: The output gap ]



Note: Estimates by MHRI.

Sources: Cabinet Office, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications and others.

[ Chart 4: Outlook on the US economy ]

	2009 (Actual)	2010 (Forecast)	2011 (Forecast)	2009		2010 (Forecast)		2011 (Forecast)	
				1H	2H	1H	2H	1H	2H
GDP	-2.6	2.7	2.0	-4.3	1.9	3.5	2.0	1.8	2.3
Personal consumption	-1.2	1.5	1.9	-1.5	0.8	1.7	2.0	1.8	2.0
Housing investment	-22.9	-0.9	2.5	-31.6	-0.7	-0.7	-1.5	3.5	4.7
Capital investment	-17.1	5.5	5.6	-26.0	-3.1	7.8	9.8	4.8	3.3
Inventory investment (USD 100 million)	-1,131	504	430	-1,438	-825	537	471	325	535
Government consumption	1.6	0.2	-0.7	0.3	1.9	-0.1	-0.9	-0.9	0.0
Net exports (USD 100 million)	-3,630	-3,910	-3,664	-3,656	-3,605	-3,917	-3,903	-3,727	-3,602
Exports	-9.5	11.1	7.6	-20.4	11.6	13.8	5.3	7.8	9.6
Imports	-13.8	10.4	5.0	-26.7	8.6	14.6	4.1	4.5	6.7
Domestic final demand	-3.1	1.6	1.8	-4.9	0.6	1.8	2.1	1.6	1.8
Unemployment rate	9.3	9.7	9.7	8.7	9.8	9.7	9.8	9.6	9.8
Nonfarm payrolls (per month, 1,000 persons)	-489	-54	97	-649	-351	30	75	103	107
PCE deflator <y-o-y change>	0.2	1.6	0.5	-0.0	0.4	2.2	1.1	0.5	0.5
Core PCE deflator <y-o-y change>	1.5	1.4	0.5	1.5	1.5	1.6	1.1	0.6	0.4
Current account balance (USD100 million)	-3,784	-4,762	-4,507	-1,800	-1,984	-2,430	-2,332	-2,175	-2,075
<as a percentage of nominal GDP>	-2.7	-3.3	-3.0	-2.6	-2.8	-3.3	-3.2	-2.9	-2.7

Notes: 1. Calendar-year figures refer to the rate of change from the previous year. Half-year term figures refer to the rate of change from the previous half-year term (annualized).

2. The shaded columns are forecasts.

3. Regarding the current account balance, figures for the half-year terms are adjusted for seasonal factors and the calendar-year figures are the totals. The percentages of nominal GDP are annualized.

Sources: US Department of Commerce, US Department of Labor, MHRI.

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