

# Economic Outlook for FY2009, FY2010 and FY2011

(revised to reflect the *Second Preliminary Quarterly Estimates of GDP* for the Oct-Dec quarter of 2009)

March 2010

## Key points of Mizuho Research Institute's (MHRI) outlook on the economy in FY2009, FY2010 and FY2011

(reflecting the *Second Preliminary Quarterly Estimates of GDP (2<sup>nd</sup> QE)* for the Oct-Dec quarter of 2009)

Japan's basic fiscal policy stance under the slogan "From Concrete to People" provides income transfer measures such as the child allowance which will push up household demand in contrast to the sharp fall of public investment. Even though corporate investment activity has bottomed out, it lacks sufficient momentum to stage a rebound. In the meantime, the ongoing rise of exports reflecting the overseas economic recovery mainly in Asia will prop up Japan's domestic production. In view of these factors, we expect the Japanese economy to follow a moderate recovery path during the forecast horizon.

### <The Japanese Economy>

**FY2010** +1.2% (previous outlook +1.0%)

Private sector demand will be sluggish as companies remain burdened by excess labor and capacity

**FY2011** +1.7% (previous outlook +1.7%)

Private sector demand will strengthen but will be insufficient to push Japan's economy out of deflation

### <The US Economy>

The US economy will gradually pick up, given the improvement of both the inventory cycle and income environment

**2010** +2.9% (previous outlook +2.8%)

**2011** +2.2% (previous outlook +2.2%)

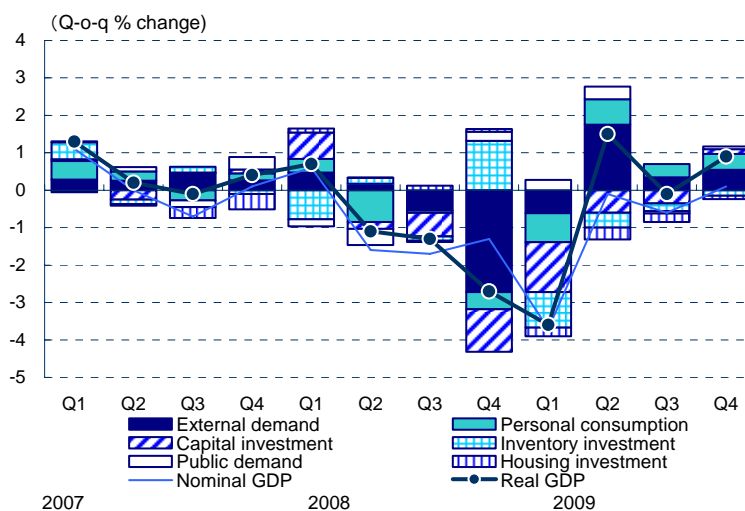
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# I. The current state of the Japanese economy

Oct-Dec quarter real GDP  
growth revised down  
slightly in 2<sup>nd</sup> QE

The *Second Preliminary Quarterly Estimates of GDP* (“2<sup>nd</sup> QE”) for the Oct-Dec quarter of 2009 released by the Cabinet Office on March 11, 2010 revealed a slight downward revision of Japan’s real GDP growth to +0.9% q-o-q (+3.8% p.a.) from +1.1% q-o-q (+4.6% 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, capital investment was revised down from +1.0% q-o-q in the 1<sup>st</sup> QE to +0.9% q-o-q in the 2<sup>nd</sup> QE, to reflect the results of the *Financial Statements Statistics of Corporations by Industry*. Furthermore, given the addition of data on raw materials and goods-in-process inventories regarding private-sector inventory investment, the latest release revealed that moves to reduce inventories are accelerating. The contribution by private sector inventory investment to quarterly real GDP growth was revised down from +0.1% pt in the 1<sup>st</sup> QE to -0.1% pt in the 2<sup>nd</sup> QE. As a result of the above, the contribution by private sector demand to quarterly real GDP growth was revised down from +0.7% pt to +0.4% pt. Turning to public sector demand, public investment was revised upward (-1.6% q-o-q → -1.3% q-o-q) and government consumption was revised downward (+0.8% q-o-q → +0.6% q-o-q). The contribution by domestic demand combining both public and private demand was revised down from +0.6% pt to +0.4% pt. The contribution by external demand remained unchanged at +0.5% pt. The GDP deflator was revised up slightly from -3.0% y-o-y to -2.9% y-o-y. Even though corporate investment activity turned out weaker than at the time of the 1<sup>st</sup> QE, the results most likely reflect the evaluation that the economy is continuing to recover due to the rise of consumer spending supported by government measures to stimulate purchases of durable goods and the growth of exports stemming from the recovery of overseas economies.

[ Chart 1: Japan’s GDP growth ]



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

Japan's economic growth should remain in positive territory in the Jan-Mar quarter

In the Jan-Mar quarter of 2010, the rate of Japan's economic growth should remain in positive territory. In terms of quarterly growth, real GDP is forecast to grow approximately +0.5% q-o-q. As shown by the peaking of car sales, domestic private sector demand is showing signs that the marginal effect of the measures to stimulate purchases of durable goods is starting to fade. Even though personal consumption will remain in positive territory, the pace of growth will moderate. On the other hand, private sector investment activity such as investment in housing, plant & equipment and inventories which had served as strong downward pressures upon economic growth is showing signs of bottoming out. Public demand will most likely continue to decline amid the gradual increase of government consumption. The contribution by domestic demand toward Japan's economic growth is predicted to be approximately +0.3% pt. As for exports, even though the mass recall of vehicles manufactured by a major Japanese car maker provides reason to be concerned, exports as a whole should keep growing due to the ongoing recovery of the overseas economies. Since imports are also predicted to grow at a faster pace, reflecting the recovery of domestic production, the contribution by external demand should contract from +0.5% pt in the Oct-Dec quarter of 2009 to approximately +0.1% pt.

## II. Forecast of the Japanese economy in FY2009, FY2010 and FY2011

Outlook on FY2010 real GDP growth: +1.2%

We have revised our outlook on Japan's economic growth in FY2009, FY2010 and FY2011 as follows in view of the 2<sup>nd</sup> QE and developments which have unfolded since the release of our previous *Economic Outlook* (on February 17, 2010). Japan's rate of real GDP growth is predicted to land at -2.4% y-o-y (previous outlook -2.2% y-o-y) in FY2009 and rise to +1.2% y-o-y (previous outlook +1.0% y-o-y) in FY2010 (**Chart 2**). On the basis of Japan's basic fiscal policy stance under the slogan "From Concrete to People", the FY2010 initial budget provides major income transfer measures such as the "child allowance", "effectively free public high school tuition", and "individual (household) income support for agriculture". Even though a full-fledged recovery of labor market conditions is unlikely, the odds are high that the foregoing measures will prop up income and demand in the household sector. However, on the reverse side of the coin, public investment is predicted to fall sharply. In the corporate sector, we foresee a state of sluggish demand amid the difficulty of corporate demand and production to climb back to levels prior to the financial crisis, despite budding signs that the decline of demand is coming to a halt. External demand should continue to grow, given the ongoing recovery of overseas economies - primarily among the countries of Asia. That said, the momentum will fade due to a pause in the re-stocking of inventories in the US and the gradual emergence of the impact of monetary tightening measures in China.

**FY2011 real GDP growth:  
+1.7 %**

Looking forward on the basis of the foregoing premises, real GDP growth in FY2011 should stand at +1.7% (previous outlook: +1.7%). Domestic demand will accelerate, given the ongoing transfer of income to the household sector through measures such as the full provision of the child allowance, and the gradual recovery of corporate capital investment activity. Even though external demand should continue to follow an uptrend, the pace of growth should turn out lower than in FY2010, reflecting the slowdown of overseas economic recovery continuing from the second half of FY2010.

**Forecasts of prolonged  
deflation due to persistent  
output gap**

The output gap (the gap between actual GDP and potential GDP) estimated by MHRI stood at -5.6% (excess supply of approximately JPY31 trillion) as of the Oct-Dec quarter of 2009 (**Chart 3**). If the Japanese economy proceeds as set forth in our outlook, the output gap will contract since the economy is predicted to grow at a pace surpassing the potential rate of GDP growth. Even so, an excess supply of approximately 2.9% (JPY16.6 trillion) will remain as of the end of FY2011. Taken together with the decline of the expected rate of inflation (**Chart 4**), the odds are high that deflation will linger over a prolonged period of time. The CPI (excluding fresh food) is forecast to fall in FY2010 (-0.5% y-o-y) and FY2011 (-0.1% y-o-y). Even though the Bank of Japan expressed its resolve that it would “not tolerate zero or negative growth in the CPI (on a y-o-y basis)” at the end of last year, it has not taken any additional measures amid the fall of the CPI. There are press reports that the BOJ will decide to increase the amount of the Fixed-Rate Funds-Supplying Operation against Pooled Collateral at the monetary policy meeting on March 16<sup>th</sup> and 17<sup>th</sup>. We look forward to the BOJ’s utilization of all possible tools, in addition to quantitative monetary easing, such as the guidance of term interest rates lower through the extension of operations and the guidance of short-term interest rates lower through a clearer articulation of the time span of the BOJ’s stance.

[ Chart 2: Outlook on the Japanese economy ]

		FY2008	FY2009	FY2010	FY2011	2009				2010				2011				2012
						Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
GDP (real)	Q-o-q % ch	-3.7	-2.4	1.2	1.7	-3.6	1.5	-0.1	0.9	0.5	0.2	0.4	-0.4	0.3	0.6	0.6	0.6	0.6
	Q-o-q % ch p.a.	--	--	--	--	-13.7	6.0	-0.6	3.8	1.8	0.8	1.7	-1.5	1.2	2.5	2.4	2.6	2.4
Domestic demand	Q-o-q % ch	-2.6	-2.7	0.3	1.2	-2.9	-0.3	-0.5	0.4	0.3	0.0	0.3	-0.4	0.2	0.5	0.5	0.5	0.5
Private sector demand	Q-o-q % ch	-3.0	-4.3	0.9	1.7	-4.2	-0.8	-0.6	0.4	0.4	0.2	0.5	-0.3	0.3	0.6	0.6	0.6	0.6
Personal consumption	Q-o-q % ch	-1.8	0.6	0.6	0.7	-1.3	1.1	0.6	0.7	0.2	-0.0	0.4	-0.4	0.1	0.3	0.4	0.3	0.3
Housing investment	Q-o-q % ch	-3.7	-18.5	1.9	5.8	-6.5	-9.4	-7.8	-3.3	1.1	2.0	2.1	1.9	0.7	1.0	1.5	2.2	2.3
Capital investment	Q-o-q % ch	-6.8	-15.6	1.5	4.0	-8.7	-4.2	-2.6	0.9	0.3	0.4	0.6	0.7	0.8	1.1	1.1	1.2	1.2
Inventory investment	Q-o-q contribution, % pt	-0.1	-0.6	0.1	0.2	-1.0	-0.4	-0.2	-0.1	0.1	0.1	0.0	-0.1	0.1	0.1	0.0	0.0	0.0
Public sector demand	Q-o-q % ch	-1.3	2.7	-1.5	-0.4	1.2	1.4	-0.3	0.3	0.0	-0.8	-0.2	-0.9	-0.3	0.1	0.1	0.3	0.0
Government consumption	Q-o-q % ch	-0.1	1.8	1.6	1.3	0.8	0.3	0.1	0.6	0.1	0.5	0.6	0.2	0.4	0.5	0.4	0.1	-0.2
Public investment	Q-o-q % ch	-6.6	7.4	-17.6	-10.1	3.6	6.6	-1.5	-1.3	-0.7	-7.8	-5.1	-7.6	-4.3	-2.3	-2.0	1.2	1.2
External demand	Q-o-q contribution, % pt	-1.2	0.2	0.7	0.4	-0.6	1.8	0.3	0.5	0.1	0.2	0.1	0.0	0.1	0.1	0.1	0.1	0.1
Exports	Q-o-q % ch	-10.4	-10.7	11.1	6.0	-23.8	9.2	8.4	5.0	3.5	2.3	1.4	0.4	0.9	1.8	1.8	2.0	2.0
Imports	Q-o-q % ch	-4.2	-12.0	6.1	3.9	-17.6	-3.9	5.4	1.3	2.9	1.0	0.9	0.4	0.4	1.2	1.2	1.4	1.4
GDP (nominal)	Q-o-q % ch	-4.2	-4.0	0.0	0.8	-3.7	-0.1	-0.6	0.1	0.9	-0.6	-0.2	-0.1	0.7	0.0	-0.2	0.3	1.2
GDP deflator	Y-o-y % ch	-0.4	-1.7	-1.1	-0.9	0.3	-0.7	-0.7	-2.9	-2.6	-1.4	-1.6	-0.7	-0.8	-0.4	-0.7	-1.4	-0.9
Domestic demand deflator	Y-o-y % ch	0.4	-2.6	-0.9	0.1	-1.3	-2.7	-2.9	-2.8	-1.8	-0.8	-1.2	-0.7	-0.8	-0.3	0.0	-0.1	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 MHRl based upon Cabinet Office, *Preliminary Quarterly Estimates of GDP*.

		FY2008	FY2009	FY2010	FY2011	2009				2010				2011				2012
						Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Industrial production	Q-o-q % ch	-12.6	-9.6	9.0	3.9	-22.2	8.3	7.4	4.6	3.8	1.4	0.7	0.1	0.3	1.0	1.5	1.7	1.7
Ordinary profits	Y-o-y % ch	-39.0	-1.9	28.1	16.5	-69.0	-53.0	-32.4	102.2	130.8	34.3	38.7	22.2	22.2	16.2	16.7	13.3	19.9
Nominal labor compensation	Y-o-y ch	-0.3	-3.9	-0.7	0.2	-2.8	-4.6	-3.8	-4.5	-2.2	-0.3	-0.5	-1.1	-0.7	-0.1	-0.0	0.4	0.4
Unemployment rate	%	4.1	5.2	4.9	4.7	4.5	5.1	5.4	5.2	5.0	5.1	5.0	4.9	4.8	4.8	4.7	4.7	4.6
New housing starts	P.a., 10,000 units	103.9	77.3	83.8	90.5	89.7	76.9	71.3	79.1	83.0	82.9	80.7	84.9	87.3	87.9	86.8	92.6	95.3
Current account balance	P.a., JPY tril	12.3	15.3	18.0	16.4	8.9	14.1	13.9	16.2	15.9	14.7	15.9	19.8	20.2	17.0	16.0	14.0	16.9
Domestic corporate goods prices	Y-o-y % ch	3.2	-5.2	-0.4	1.1	-1.9	-5.5	-8.3	-5.2	-1.7	-0.6	-0.5	0.0	-0.3	0.2	0.8	1.6	1.7
Consumer prices	Y-o-y % ch	1.2	-1.5	-0.5	-0.1	-0.0	-1.0	-2.3	-1.7	-0.9	-0.6	-0.7	-0.4	-0.5	-0.4	-0.1	-0.1	0.2
Uncollateralized overnight call rate	%	0.09	0.10	0.10	0.10	0.09	0.11	0.10	0.09	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Yield on newly-issued 10-yr JGBs	%	1.44	1.35	1.15	1.35	1.29	1.42	1.34	1.32	1.30	1.22	1.15	1.10	1.10	1.20	1.30	1.40	1.50
Nikkei average	JPY	10,802	9,950	10,950	11,800	7,930	9,294	10,141	9,959	10,400	10,500	10,800	11,100	11,300	11,500	11,700	11,900	12,100
Exchange rate	JPY/USD	100.5	93.0	91.0	100.0	93.6	97.3	93.6	89.7	90.0	89.0	90.0	91.0	93.0	96.0	99.0	101.0	102.0
Crude oil price (WTI nearest term contract)	USD/bbl	85.9	71.0	77.0	88.0	43.0	59.6	68.1	76.1	79.0	77.0	81.0	77.0	74.0	82.0	91.0	89.0	88.0

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)*.

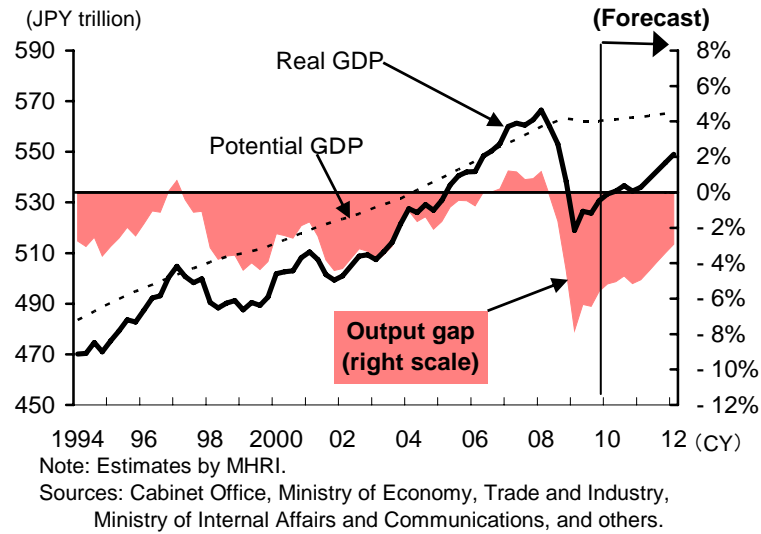
3. Consumer prices exclude fresh food.

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

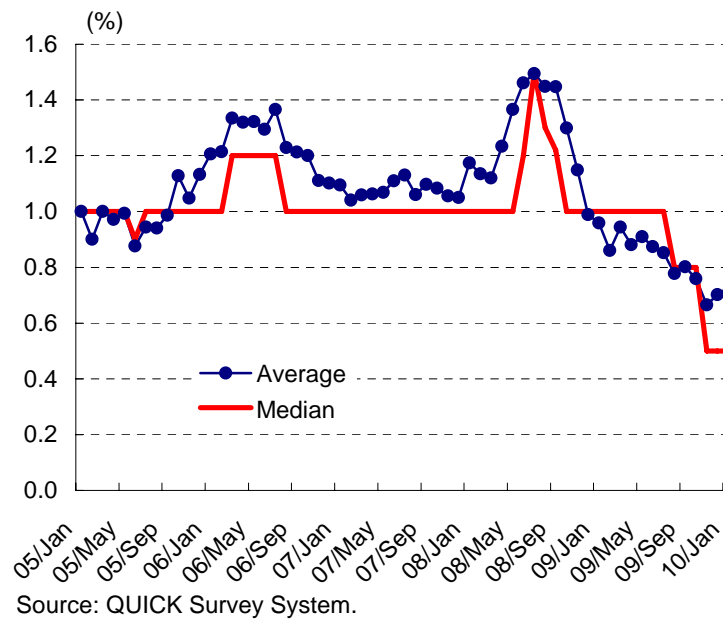
5. Of the finance-related indices, the uncollateralized overnight call rate refers to the rate at the end of term and all others are averages during the relevant terms.

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

[ Chart 3: The output gap ]



[ Chart 4: Average expected inflation rate (next 10 years) ]



[ Chart 5: Outlook on the US economy ]

(%)

	2009	2010 (Forecast)	2011 (Forecast)	2009		2010 (Forecast)		2011 (Forecast)	
				1H	2H	1H	2H	1H	2H
GDP	-2.4	2.9	2.2	-4.8	2.4	3.6	1.9	2.3	2.4
Personal consumption	-0.6	1.9	1.7	-0.7	1.6	2.1	1.7	1.7	1.7
Housing investment	-20.4	0.4	0.3	-31.1	3.2	1.6	-4.6	0.7	4.5
Capital investment	-17.7	4.3	6.9	-28.0	-3.9	6.3	8.8	7.2	4.5
Inventory investment (USD100 million)	-1,076	125	215	-1,371	-781	120	129	149	280
Government consumption	1.9	1.6	1.2	0.6	2.7	1.1	1.5	1.1	1.2
Net exports (USD100 million)	-3,554	-3,709	-3,651	-3,585	-3,523	-3,585	-3,833	-3,721	-3,581
Exports	-9.6	12.1	8.3	-21.6	13.0	14.1	7.6	8.1	9.4
Imports	-13.9	10.6	6.5	-26.8	9.6	12.0	8.8	5.4	6.4
Domestic final demand	-2.7	2.0	2.1	-4.7	1.3	2.3	2.2	2.1	2.0
Unemployment rate	9.3	9.8	10.3	8.7	9.8	9.7	9.9	10.2	10.4
Nonfarm payrolls (per month, 1,000 persons)	-490	-73	47	-651	-350	-2	63	38	50
PCE deflator <y-o-y change>	0.2	1.7	1.3	0.1	0.2	1.9	1.5	1.3	1.3
Core PCE deflator <y-o-y change>	1.5	1.3	1.0	1.7	1.4	1.4	1.2	1.0	1.0
Current account balance (USD100 million)	-4,302	-5,085	-5,423	-2,024	-2,278	-2,434	-2,651	-2,772	-2,892
<as a percentage of nominal GDP>	-3.0	-3.4	-3.6	-2.9	-3.2	-3.3	-3.6	-3.7	-3.7

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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