

# Economic Outlook for FY2010 and FY2011

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

June 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 Jan-Mar quarter of 2010)

Amid the gradual spread of “external demand to domestic demand”, the Japanese economy should keep growing throughout FY2010 and FY2011 without straying off course its recovery track. Even so, given that domestic private demand lacks power for a self-sustained recovery, the future course of the Japanese economy will remain dependent upon exports and the overseas economies. In such context, the most serious issue gathering attention is the spread of the fiscal crisis in Southern Europe.

## <The Japanese Economy>

**FY2010** +2.2% (previous outlook +2.1%)

Export growth will gradually spread to the recovery of domestic demand

**FY2011** +1.8% (previous outlook +1.8%)

Despite the continuation of a gradual recovery, it will be insufficient to push Japan's economy out of deflation

## <The US Economy>

The US economy will continue to follow a gradual recovery

**2010** +2.9% (previous outlook +3.0%)

**2011** +2.4% (previous outlook +2.4%)

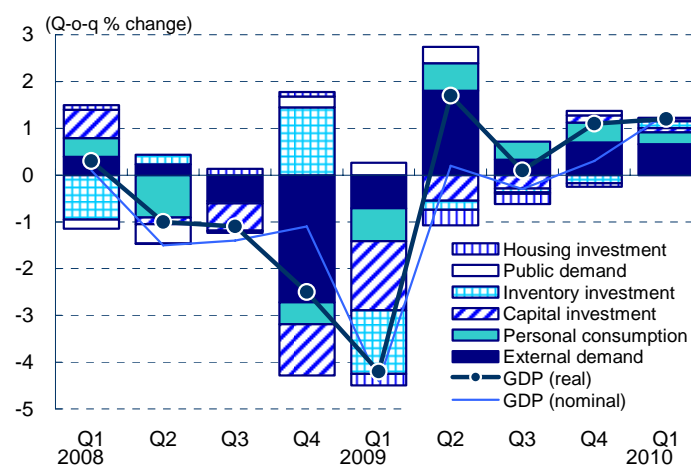
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# I. The current state of the Japanese economy

In 2<sup>nd</sup> QE, Jan-Mar quarter  
real GDP grew slightly  
faster than initial estimate

The *Second Preliminary Quarterly Estimates of GDP* (“2<sup>nd</sup> QE”) for the Jan-Mar quarter of 2010 released by the Cabinet Office on June 10, 2010 revealed a slight upward revision of Japan’s real GDP growth to +1.2% q-o-q (+5.0% p.a.) from +1.2% q-o-q (+4.9% 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

[ Chart 1: Japan’s GDP growth ]



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

investment was revised down from +1.0% q-o-q in the 1<sup>st</sup> QE to +0.6% 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 contribution by private sector inventory investment to quarterly real GDP growth was revised down from +0.2% pt in the 1<sup>st</sup> QE to +0.1% pt in the 2<sup>nd</sup> QE. While corporate sector demand served as a background factor of the slight downward revision, household sector-related demand such as personal consumption (+0.3% q-o-q → +0.4% q-o-q) and housing investment (+0.3% q-o-q → +0.4% q-o-q) was revised up slightly. As a result, the growth of domestic private demand remained unchanged at +0.7% q-o-q. Turning to the government sector, overall public demand was revised up from +0.1% to +0.3% q-o-q as a result of an upward revision of public investment (-1.7% q-o-q → -0.5% q-o-q) and a downward revision of government consumption (+0.5% q-o-q → +0.4% q-o-q). The contribution by external demand remained unchanged at +0.7% pt. The GDP deflator was revised up slightly from -3.0% y-o-y to -2.8% y-o-y. Overall, the state of the economy turned out to be what was described in the evaluation of the current state of the economy at the time of the 1<sup>st</sup> QE, namely that “a balanced economic recovery resting upon both domestic and external demand was recorded as the growth of exports stemming from the overseas economic recovery gradually spread to domestic production, income and demand”.

**The economy will continue to grow, albeit at a slower pace, in the Apr-Jun quarter**

Japan's economic growth should remain in positive territory in the Apr-Jun quarter. The pace of recovery is forecast to moderate, with real GDP growing +0.5% q-o-q. Turning to domestic private demand, personal consumption should continue to grow, given the recovery of overtime payments (non-scheduled cash earnings) along with the rise of production as well as policy initiatives such as effectively-free high school tuition. However, consumer spending should slow due to a likely backlash to the rush of flat-panel TV purchases in March stemming from the change of items covered under the Eco-Point Program. In contrast, investment activity in the private sector such as housing investment, capital investment and inventory investment which are in a fledgling lift-off, should pick up slightly. The contribution by private sector demand to economic growth is estimated to be around +0.3% pt. On the other hand, despite a mild rise of government consumption, the contribution by public demand should serve as drag upon growth (-0.2% pt), given prospects that public investment will fall sharply due to substantial budget cuts. As a result, the contribution by domestic demand should slow down from +0.6% pt in the Jan-Mar quarter to +0.1% pt. Even though exports should continue to grow reflecting the ongoing overseas economic recovery, the pace will likely moderate in comparison to the high growth thus far, mainly with respect to Asia-bound exports. Meanwhile, imports are expected to accelerate, reflecting the recovery of domestic production. The contribution by external demand should contract to approximately +0.3% pt from +0.7% pt in the Jan-Mar quarter.

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

**The economy will remain on recovery track amid the “spread of external demand to domestic demand”**

In the following section, we set forth our outlook on Japan's economic growth in FY2010 and FY2011 on the basis of the 2<sup>nd</sup> QE and recent developments which have unfolded since the release of our previous *Economic Outlook* (on May 21, 2010). Our basic assumptions regarding the future course of the economy remains unchanged from our previous *Economic Outlook*. Namely, we expect the Japanese economy to keep growing without straying off course the recovery track throughout FY2010 and FY2011 as “external demand spreads through to domestic demand”. However, given the weak autonomous recovery of domestic private demand amid the difficulty to dispel the sentiment on excess capacity and labor, the future course of the economy will remain heavily dependent upon exports and the overseas economies.

**Outlook on FY2010 real GDP growth: +2.2%**

The rate of Japan's real GDP growth is predicted to reach +2.2% y-o-y (previous outlook +2.1% y-o-y) in FY2010 (**Chart 2**). Japan's exports will continue to grow along with the overseas economic recovery and domestic production should expand. Inventory investment will enter a build-up phase and capital investment should gradually recover as corporate enterprises feel less

burdened by excess capacity. While a full-fledged recovery of employment is not expected anytime soon due to the existence of millions of workers who remain idle in companies, income conditions should recover due to the upturn of overtime payments along with the expansion of production and the upturn of bonus payments (special cash earnings) along with the improvement of corporate business performance. Furthermore, disposable income on a macroeconomic level should follow an uptrend due to the addition of income support measures such as the child allowance. Under these circumstances, personal consumption should remain on solid footing. Public demand will continue to serve as a drag upon the economy, reflecting the large-scale slashes of public investment.

**FY2011 real GDP growth:  
+1.8%**

Looking forward, real GDP growth in FY2011 should stand at +1.8% (previous outlook: +1.8%). The excessive capacity and labor should start to abate as the level of industrial production rises along with the expansion of production initiated by the rise of exports. Under these conditions, the growth of domestic private demand should rise above FY2010.

**Forecasts of prolonged  
deflation due to Japan's  
persistent output gap**

The output gap (the gap between actual GDP and potential GDP) estimated by MHRI stood at -4.3% (excess supply of approximately JPY24 trillion) as of the Jan-Mar quarter of 2010 (**Chart 3**). If the Japanese economy proceeds as set forth in our outlook, the output gap will narrow since the economy is predicted to grow at a pace surpassing the potential rate of GDP growth. Even so, an excess supply of approximately 1.8% (JPY 10.3 trillion) will remain as of the end of FY2011. The CPI (excluding fresh food) is forecast to fall in FY2010 (-1.0% y-o-y) and FY2011 (-0.0% y-o-y). Thus, it is unlikely that deflationary pressures will be dispelled during the forecast horizon.

**Mounting concerns  
regarding the spread of  
the fiscal crisis in  
Southern Europe**

Our outlook on the economy is based upon the assumption that the overseas economies will not stray off a recovery track and that Japan's exports will continue to grow. However, it is extremely unnerving that the fiscal crisis in Southern Europe which gathered widespread global attention in early May is still not showing signs of abating even after the lapse of a month. Investors are moving their funds away from risky assets such as stocks and commodities to government bonds and gold, serving as a negative effect upon confidence among corporate enterprises and households. Should investor behavior turn cautious on a global scale, it could dampen the recovery of the overseas economies. Furthermore, in the event the crisis deepens as a result of events such as the sluggish progress of fiscal rehabilitation programs in Greece and other countries, it would wreak further havoc in the financial market, making it difficult to dismiss the possibility of a renewed negative spiral in the economy and financial markets. In such context, our assessment of the risk balance is tilted toward the downside.

[ 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	-2.0	2.2	1.8	1.7	0.1	1.1	1.2	0.5	0.3	0.0	0.2	0.6	0.5	0.7	0.8
	Q-o-q % ch p.a.	--	--	--	6.9	0.4	4.6	5.0	2.0	1.2	-0.1	0.6	2.6	2.1	3.0	3.2
Domestic demand	Q-o-q % ch	-2.4	0.9	1.4	-0.1	-0.2	0.4	0.6	0.1	0.2	-0.1	0.1	0.5	0.4	0.6	0.7
Private sector demand	Q-o-q % ch	-4.0	1.5	2.0	-0.6	-0.3	0.4	0.7	0.4	0.4	0.1	0.4	0.7	0.5	0.7	0.7
Personal consumption	Q-o-q % ch	0.6	1.1	0.9	1.0	0.6	0.7	0.4	0.2	0.3	-0.2	0.2	0.4	0.2	0.3	0.3
Housing investment	Q-o-q % ch	-18.5	1.0	7.0	-9.8	-7.3	-2.6	0.4	1.9	1.1	1.4	2.1	1.3	1.5	2.4	2.8
Capital investment	Q-o-q % ch	-15.3	2.4	4.4	-3.8	-2.1	1.1	0.6	0.9	0.5	0.7	0.8	1.1	1.1	1.7	1.8
Inventory investment	Q-o-q contribution, % pt	-0.6	0.2	0.2	-0.2	-0.1	-0.2	0.1	0.1	0.0	0.1	0.0	0.1	0.0	0.0	0.0
Public sector demand	Q-o-q % ch	2.9	-1.4	-0.5	1.4	-0.1	0.4	0.3	-1.0	-0.4	-0.6	-0.8	0.1	0.1	0.4	0.4
Government consumption	Q-o-q % ch	1.6	1.8	1.4	0.1	0.1	0.7	0.4	0.4	0.5	0.4	0.4	0.3	0.3	0.2	0.2
Public investment	Q-o-q % ch	9.3	-17.3	-10.4	7.5	-0.8	-0.9	-0.5	-7.7	-5.2	-6.2	-8.2	-1.4	-1.3	1.7	2.2
External demand	Q-o-q contribution, % pt	0.4	1.2	0.3	1.8	0.3	0.7	0.7	0.3	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Exports	Q-o-q % ch	-9.6	17.8	6.5	10.1	8.6	5.8	6.9	5.2	1.6	0.6	1.0	1.9	1.9	2.1	2.1
Imports	Q-o-q % ch	-11.8	9.5	5.3	-3.5	5.7	1.0	2.3	3.9	1.7	0.7	1.0	1.5	1.3	1.7	1.7
GDP (nominal)	Q-o-q % ch	-3.7	0.6	1.6	0.2	-0.3	0.3	1.3	-0.5	-0.6	0.8	0.3	0.1	-0.2	1.6	1.0
GDP deflator	Y-o-y % ch	-1.8	-1.6	-0.2	-0.7	-0.7	-2.8	-2.8	-1.9	-2.5	-1.1	-1.0	-0.3	-0.1	-0.3	0.1
Domestic demand deflator	Y-o-y % ch	-2.5	-0.4	0.2	-2.7	-3.0	-2.7	-1.7	-0.4	-0.6	-0.1	-0.3	0.0	0.2	0.0	0.6

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	12.6	4.0	6.6	5.3	5.9	7.0	1.7	1.0	0.4	0.7	1.1	1.2	1.2	1.5
Ordinary profits	Y-o-y % ch	2.1	26.6	14.1	-53.0	-32.4	102.2	163.8	65.3	33.6	20.8	2.5	12.5	16.3	13.8	14.5
Nominal labor compensation	Y-o-y % ch	-3.5	0.1	0.4	-4.6	-3.8	-4.5	-0.3	-0.3	0.4	0.9	-0.5	0.2	0.3	0.6	0.6
Unemployment rate	%	5.2	5.0	4.7	5.1	5.4	5.2	4.9	5.1	5.0	4.9	4.9	4.8	4.8	4.7	4.6
New housing starts	P.a., 10,000 units	77.5	83.2	90.9	76.9	71.3	79.1	83.7	81.4	80.3	84.5	87.0	87.7	86.7	93.2	96.8
Current account balance	P.a., JPY tril	15.7	15.6	16.5	14.1	14.5	15.9	18.2	13.4	12.9	16.3	19.9	13.5	14.3	17.2	21.1
Domestic corporate goods prices	Y-o-y % ch	-5.2	0.8	1.2	-5.5	-8.3	-5.2	-1.7	0.1	0.8	1.4	1.1	1.1	0.9	1.3	1.4
Consumer prices	Y-o-y % ch	-1.6	-1.0	0.0	-1.0	-2.3	-1.7	-1.2	-1.4	-1.2	-0.7	-0.7	-0.2	0.0	0.0	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	1.18	1.35	1.42	1.34	1.32	1.34	1.30	1.20	1.15	1.15	1.20	1.30	1.40	1.50
Nikkei average	JPY	9,974	10,650	11,500	9,294	10,141	9,959	10,503	10,400	10,400	10,700	11,000	11,200	11,400	11,600	11,800
Exchange rate	JPY/USD	93.0	93.0	101.0	97.3	93.6	89.7	91.0	92.0	92.0	94.0	95.0	98.0	100.0	102.0	103.0
Crude oil price (WTI nearest term contract)	USD/bbl	71.0	80.0	87.0	59.8	68.2	76.1	79.0	77.0	84.0	81.0	79.0	85.0	91.0	88.0	86.0

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)*.

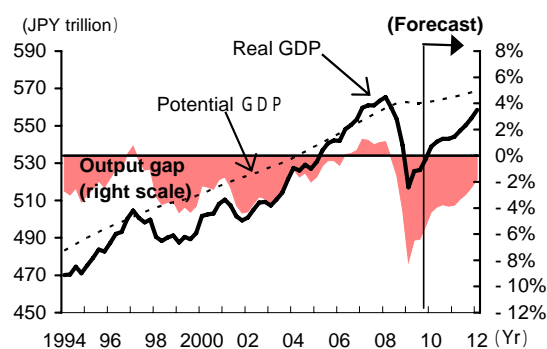
3. Consumer prices exclude fresh food.

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

5. Of the finance-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.

[ Chart 3: The output gap ]



Note: Estimates by MHIRI.

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

[ Chart 5: Outlook on the US economy ]

	2009 (Actual)	2010 (Forecast)	2011 (Forecast)	2009		2010 (Forecast)		2011 (Forecast)	
				1H	2H	1H	2H	1H	2H
GDP	-2.4	2.9	2.4	-4.8	2.3	3.6	2.2	2.4	2.6
Personal consumption	-0.6	2.5	2.2	-0.7	1.6	2.9	2.5	2.0	2.1
Housing investment	-20.5	2.1	1.9	-31.1	2.9	2.0	1.5	0.8	4.7
Capital investment	-17.8	3.1	6.7	-28.0	-4.2	4.5	8.0	7.1	4.7
Inventory investment (USD 100 million)	-1,083	226	410	-1,371	-795	220	232	291	530
Government consumption	1.8	-0.1	-0.4	0.6	2.6	-1.1	-0.9	-0.4	0.0
Net exports (USD 100 million)	-3,556	-3,761	-3,636	-3,585	-3,527	-3,708	-3,814	-3,698	-3,574
Exports	-9.6	10.8	8.4	-21.6	13.1	11.2	7.7	8.0	9.6
Imports	-13.9	9.8	6.2	-26.8	9.8	11.1	7.3	5.3	6.7
Domestic final demand	-2.7	2.0	2.1	-4.7	1.3	2.2	2.3	2.0	2.0
Unemployment rate	9.3	9.7	9.7	8.7	9.8	9.8	9.6	9.7	9.8
Nonfarm payrolls (per month, 1,000 persons)	-489	-31	122	-649	-351	46	134	120	112
PCE deflator (y-o-y change>	0.2	1.8	1.3	0.1	0.3	2.0	1.5	1.3	1.3
Core PCE deflator <y-o-y change>	1.5	1.2	1.0	1.7	1.4	1.3	1.0	1.0	1.0
Current account balance (USD 100 million)	-4,199	-5,027	-4,934	-2,019	-2,179	-2,503	-2,524	-2,410	-2,321
<as a percentage of nominal GDP>	-2.9	-3.4	-3.3	-2.9	-3.0	-3.4	-3.4	-3.2	-3.0

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, MHIRI.

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