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Forecast for the Japanese Economy in Fiscal 2012 and 2013

**— Even if the Economy Can Quickly Emerge from a Period of Downturn,
Its Resilient Power for Recovery Is Weak —**



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1. Outlook for the Japanese Economy in Fiscal 2012 and Fiscal 2013

-- Even if the Economy Can Quickly Emerge from a Period of Downturn, Its Resilient Power for Recovery Is Weak.

(1) Current State of the Economy: High Possibility that the Economy Has Entered a Period of Downturn

Announced on November 12, 2012, the real GDP growth rate for the July-September quarter was -0.9% compared with the previous quarter (-3.5% at an annualized rate), as the economy recorded a rather large downturn against the backdrop of a fall in domestic demand. In addition, the real GDP growth rate for the April-June quarter was adjusted downward to +0.1%—growth had approximately leveled off in that period. When these figures are considered together with other economic indicators announced previously, it appears that there is a high likelihood that the economy has already entered into a period of downturn.

Examining the contribution to real GDP of domestic and external demand, the contribution of domestic demand was -0.2 percentage point, while the contribution of external demand (net exports = exports – imports) was -0.7 percentage point. This was the first time domestic demand has made a negative contribution since six quarters previously, when a domestic demand drop was seen in the January-March quarter of 2011 owing to the Great East Japan Earthquake disaster. Following the disaster, domestic demand had been pushed upward by demand associated with reconstruction and recovery work, but it is believed that the benefits of that factor have diminished completely. On the other hand, external demand made a negative contribution for the second consecutive quarter, reflecting the deterioration of exports.

By component of domestic demand, private consumption declined 0.5% from the previous quarter for the second consecutive quarterly decrease, and the rate of decrease grew. Real employment compensation remained firm, increasing 0.4% from the previous quarter, but consumption of durable and nondurable goods dropped, owing to the impact of a fall in automobile sales that reflected the end of the upward pressure on sales of the government's eco-car subsidies and owing to slack sales of such seasonal goods as apparel products that reflected unfavorable weather

conditions. Private residential investment for the quarter grew 0.9% from the previous quarter for the second consecutive quarterly increase, reflecting a gradual recovery in the number of new housing starts.

Private capital investment turned downward, falling 3.2% from the previous quarter. Despite the existence of investment needs associated with replacement investments, investments for recovery after the earthquake, and other factors, there is a possibility that corporations have adopted a more-cautious investment stance owing to the increasing sense of uncertainty with respect to future domestic and overseas economic trends. The contribution of private inventory investment to the GDP growth rate compared to the previous quarter turned to a small positive figure (+0.2) despite an increasingly strong trend of adjustment, reflecting the continued accumulation of inventories in certain manufacturing industries owing to the weakness of demand.

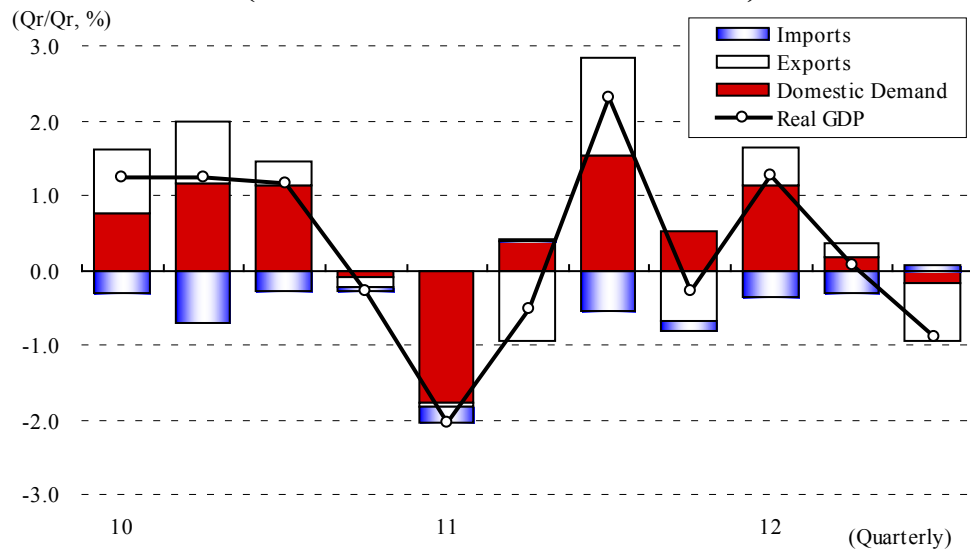
Within public-sector demand, government final consumption expenditure rose 0.3% for the quarter, maintaining its upward trend, in part owing to the effects of expenditures related to the earthquake disaster. In addition, public investment continued to increase at a robust pace of 4.0% for the quarter because of the continued usage of fiscal 2011 supplementary budgetary allocations for reconstruction. As a consequence, public-sector demand as a whole expanded 1.1% for the quarter and provided support for the economy.

Looking next at external demand, exports fell by the considerable margin of 5.0% from the previous quarter, reflecting decreases seen in exports to each of Japan's principal export markets—Asia, the United States, and Europe. On the other hand, the decline in imports from the previous quarter was kept to the small margin of 0.3%. As a result, the contribution of external demand to real GDP growth was -0.7 percentage point and was, therefore, a factor placing a large downward pressure on the growth rate.

The GDP deflator, which reflects overall price trends in the economy as a whole, was 0.7% below the same quarter of the previous year, indicating that the downtrend in the margin of decline is continuing. However, the growing margin of decline in the import deflator had a substantial effect, and, as a consequence, the domestic demand deflator was down 0.8% from the same quarter of the previous year, representing a widening in the margin of decline. Compared with the previous quarter, the deflator was

virtually level (−0.0%).

**Chart 1: Contribution Rates to Real GDP Growth by Demand
(on a Quarter-on-Quarter Basis)**



(2) The Key Points Regarding Economic Trends Going Forward: When Will the Economy Shift to Recovery?

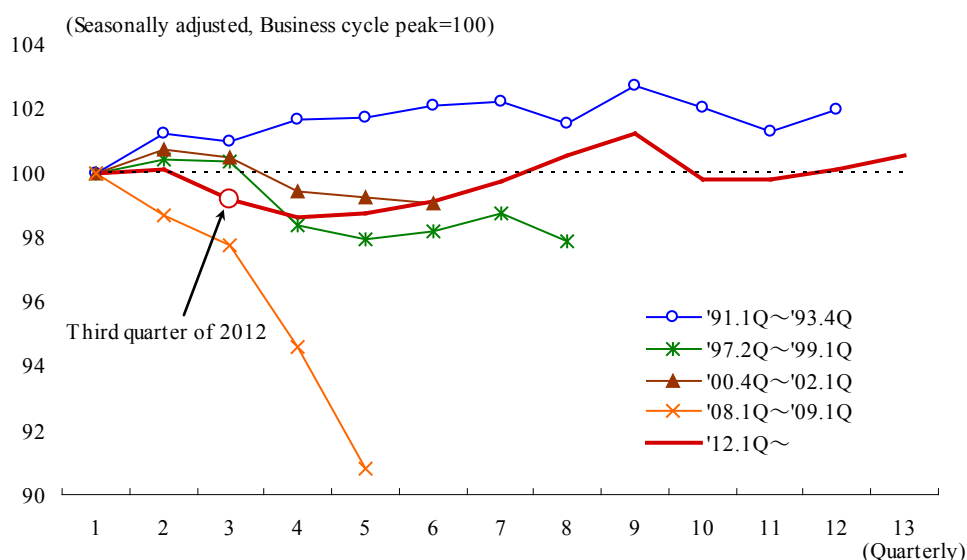
When the shift to considerable negative growth in real GDP during the July-September quarter is considered along with weak trends in the industrial production index (a coincident indicator of economic conditions) and other economic indices, it appears that there is a high likelihood that the economy has already entered a period of downturn. The industrial production index moved within a narrow, virtually level, range from the end of 2011 through April of this year, and then the level of the index shifted to a clear trend of decrease beginning from May, so there is a possibility that the most-recent peak of economic conditions was seen some time around the spring of 2012.

While domestic demand had been a driving force for the economy since the Great East Japan Earthquake, the outlook has always been for the domestic demand-related boost to the economy to end at some point. However, many observers appear to have expected that external demand would recover and offset the decline in domestic demand, enabling the Japanese economy to

avoid falling into a period of downturn.

Going forward, attention will be focused on the question of when the economy will bottom out, and our outlook is projecting that the bottoming out will take place during the January-March quarter of 2013 or the April-June quarter of 2013 at the latest. Accordingly, we are anticipating that the downturn period will be approximately one year, which is roughly the average length of such periods. Regarding the depth of the economic adjustment, also, based on the fact that the magnitude of the preceding economic upturn was not very large and on our assessment that the economy is not suffering from large structural problems, we believe that the depth of the downturn will not be severe in comparison to other downturns that have taken place since the 1990s (Chart 2).

Chart 2: Trends in Real GDP during Recession Periods



Note: Regarding the latest cycle, we assume that the trough was in the first quarter of 2012.

Figures after the third quarter of 2012 are our own forecasts.

Source: Cabinet Office, "Quarterly Estimates of GDP"

However, there is a need to consider the risk that the economy will remain in an approximately zero-growth situation. This need stems from the facts that the only factor that can be expected to generate a driving force for economic recovery is exports and that even if the decline in domestic demand is halted, such a halt would not be sufficient to drive a strong recovery.

Regarding private consumption, if the impact of a drop in sales of

automobiles and other products dissipates, it is possible that a recovery in consumption focused largely on such spending as service-related expenditures may eventuate, but, amid the weak recovery in income, it cannot be expected that there will be a recovery as strong as that seen following the earthquake disaster. Regarding public investment, also, there will be efforts to maintain the high level of investments that has been supported by recovery and reconstruction demand so far, but there is a limit to the boost that can be derived from period-on-period increases in public investment.

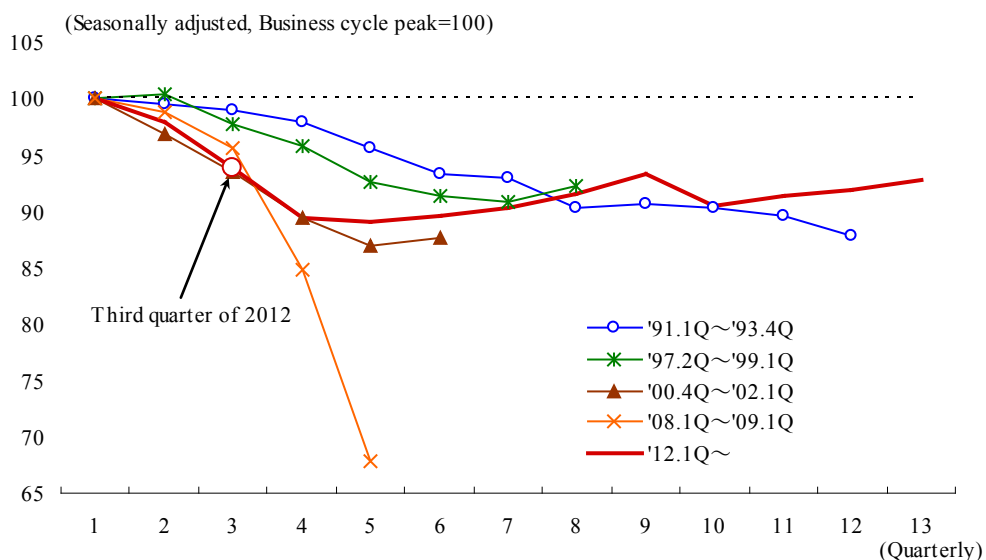
With respect to private capital investment, it is likely that the minimum level of necessary investments will be implemented, but given the likelihood that corporations will not change their cautious approach to new investments, it appears that any prospective trend of increase in private capital investment will be only gradual.

Regarding expectations that exports will boost the Japanese economy, also, the nature of the export situation will be subject to considerable change depending on the question of whether the Chinese economy realizes a rapid recovery. Our outlook projects that the Chinese government's infrastructure investment promotion measures and other factors will enable the Chinese economy to bottom out during the October-December quarter of 2012, but if this bottoming out is delayed, the timing of an export-driven recovery in the Japanese economy will be similarly delayed. Moreover, at the time that demand in China increases, there will remain political risks related to the question of whether Japan can realize the kind of exports to China that it has in the past. On the other hand, the underlying firmness of the U.S. economy and the economic strength of the ASEAN countries are factors that will be providing support to Japan's exports.

Using the industrial production index level to compare the depth of the current economic downturn to that of previous downturns, it appears that the depth will be approximately the same as that seen during the period of adjustment following the end of the IT bubble (Chart 3). We are projecting that the Japanese economy will bottom out during the January-March quarter of 2013 primarily owing to an export recovery, but we expect the bottoming out level to be higher than that seen during the April-June quarter of 2011, immediately after the earthquake. If the economy were to descend further before bottoming out, the situation would be even worse

than the situation during the period when the economy finally began to recover from the chaos created by the Great East Japan Earthquake, a period characterized by lingering supply constraints associated with such situations as broken supply chains and electric power shortages. While the current economic downturn is quite serious, it currently appears that there is only a small likelihood that the situation will deteriorate to the extent seen following the earthquake.

Chart 3: Trends in Industrial Production during Recession Periods



Note: Regarding the latest cycle, we assume that the trough was in the first quarter of 2012.

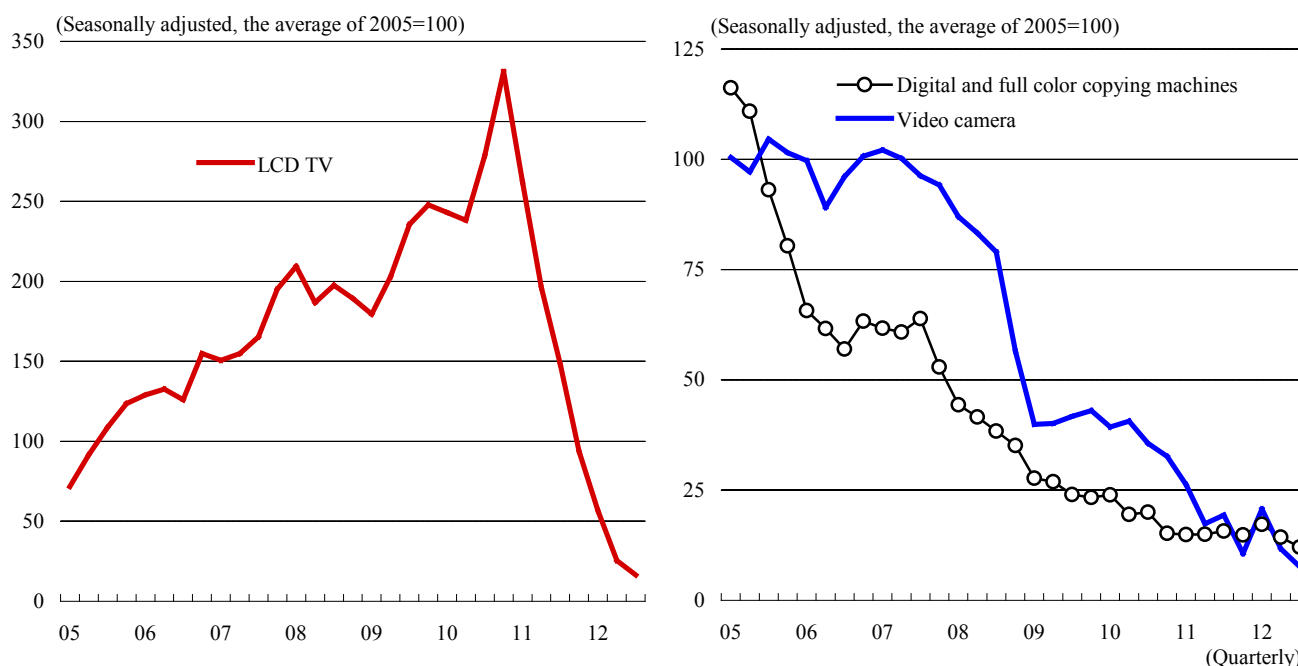
Figures after the third quarter of 2012 are our own forecasts.

Source: Ministry of Economy, Trade and Industry, "Indices of Industrial Production"

There is a need to recognize that, even when economic conditions bottom out in a cyclical manner, the background to the bottoming out involves the occurrence of structural changes. While the Japanese economy faces problems associated with the progressive decline of Japan's population, there are also changes taking place—such as the discontinuation of domestic production of a growing number of products—that indicate a possibility that the country's manufacturing industries are atrophying. Chart 4 shows trends in the industrial production index for LCD televisions, video cameras, and color copiers—which were previously among Japan's mainstay products and were actively exported. Currently, the domestic manufacture of those products has generally been discontinued, and even if demand for those products returns to previous levels, the domestic

manufacture of those products will not re-attain its previous levels. There is a possibility that the Japanese economy's rebound power has become significantly weaker than it was during previous economic bottoming out periods.

Chart 4: Industrial Production Indices of LCD TV, Digital and full color copying machines, and Video camera



Source: Ministry of Economy, Trade and Industry, "Indices of Industrial Production"

(3) Outlook for Fiscal 2012 and Fiscal 2013: Recovery Dependent on External Demand with Continued Risk of a Prolonged Downturn

We prepared this outlook based on the assumptions that the consumption tax will be increased to 8% in April 2014 and that serious electric power shortages will be averted owing to the construction of new thermal power plants, efforts to conserve electric power similar to those made in summer 2011, and increases in corporations' in-house power generating capacity. We have not based the outlook on assumptions with respect to economic stimulus measures during the current fiscal year, as the value and content of such measures have not been determined in detail.

Regarding fiscal 2012, it is expected that severe economic conditions will persist throughout 2012, but we are projecting that the economy will bottom out as early as the start of 2013. The principal factor underlying this projection is the expectation of an export recovery from the start of 2013, but we anticipate that the recovery in domestic demand will lack power. The length of the economic downturn is expected to be approximately one year, which is a length roughly equivalent to the average length of downturns in the past.

Among domestic demand components, there is a possibility that private consumption may continue to trend downward during the latter half of the fiscal year owing to a persistent decrease in automobile sales and to a year-on-year decrease in the level of winter bonuses and other factors weakening the level of income.

Regarding private capital investment, while corporations have adopted a cautious stance toward investments, there are some kinds of investments that are necessary—such as investments related to post-earthquake recovery and reconstruction as well as replacement investments—so it is likely that private capital investment will wax and wane repeatedly during the course of the fiscal year. In light of the severe export environment and concern that domestic demand will taper off, it will be difficult for corporations to undertake such large-scale investments as those aimed at increasing production capacities. It is believed that corporations will maintain a cautious approach to domestic replacement investments and continue to restrain their capital investments to within the limits of depreciation. Private capital investment cannot be expected to have the strength to be a driving force for the economy.

The level of public investment is rising owing to the full-scale demand for reconstruction work. However, the progress of this work is limited by reconstruction project planning delays and such supply-side problems as labor shortages in earthquake-impacted regions, so it will be difficult to maintain year-on-year growth in public investment. Going forward, we anticipate a shift to year-on-year declines in public investment, although the margins of declines are expected to be small, and public investment will lose its ability to boost the economy.

In these ways, in the absence of an outlook for a rapid recovery in domestic demand during the fiscal year, it is likely that the timing of a shift to

economic recovery will be determined by movements in external demand. Although exports are projected to continue decreasing during 2012, it is anticipated that exports will progressively recover from the start of 2013 and subsequently. The U.S. economy is expected to sustain a fundamental trend of gradual recovery, and that is likely to maintain the firmness of exports to the United States. Moreover, domestic demand is strong in the ASEAN countries and other Asian countries, excluding China, and it is likely that the basic trend of increase in Japan's exports to those countries will continue. While exports to China are currently flagging, there is a possibility that the Chinese economy will bottom out during 2012, and it is expected that the weakening impact of anti-Japanese demonstrations will enable a shift to a renewed basic trend of increase from the start of 2013. There is a strong possibility that trends in exports to Europe, which is experiencing economic stagnation, will remain weak at least during the remainder of the current fiscal year.

In view of these trends in Japan and overseas, industrial production is forecast to bottom out early in 2013. At that time, it is expected that the current round of automobile production cuts will be completed and exports will progressively recover. Moreover, because the completion of inventory adjustments is within sight, the restraining effect of such adjustments on production will be fading away.

We are forecasting that the year-on-year rate of real GDP growth will remain at a low level, amounting to +0.5% in fiscal 2012, compared with +0.0% in fiscal 2011. However, this forecast growth rate includes a relatively large carryover effect of +1.4%, but after the elimination of this effect, the actual year-on-year growth rate for the fiscal year is expected to be negative, at -0.9%.

We are forecasting that the nominal year-on-year GDP growth rate will remain negative, amounting to -0.3% in fiscal 2012, compared with -1.9% in fiscal 2011. While the gap between supply and demand was tending to diminish early in fiscal 2012, the margin of decline in the GDP deflator has begun expanding again. The year-on-year change in the deflator in fiscal 2012 is forecast to be -0.8%, compared with -1.9% in fiscal 2011, as deflationary trends continue.

Reflecting the deterioration of exports, the contribution of external demand for the fiscal year is forecast to be -0.8%. On the other hand, the

contribution of domestic demand is projected to be +1.3 percentage points, with private-sector demand contributing +0.5 percentage point and public-sector demand accounting for +0.8 percentage point. Amid a drop in exports owing to the deceleration of overseas economies, Japanese economic conditions in fiscal 2012 are expected to be supported by government policies for post-earthquake recovery and reconstruction.

Chart 5: Contribution Rates to Real GDP Growth by Demand (on a Quarter-on-Quarter Basis)

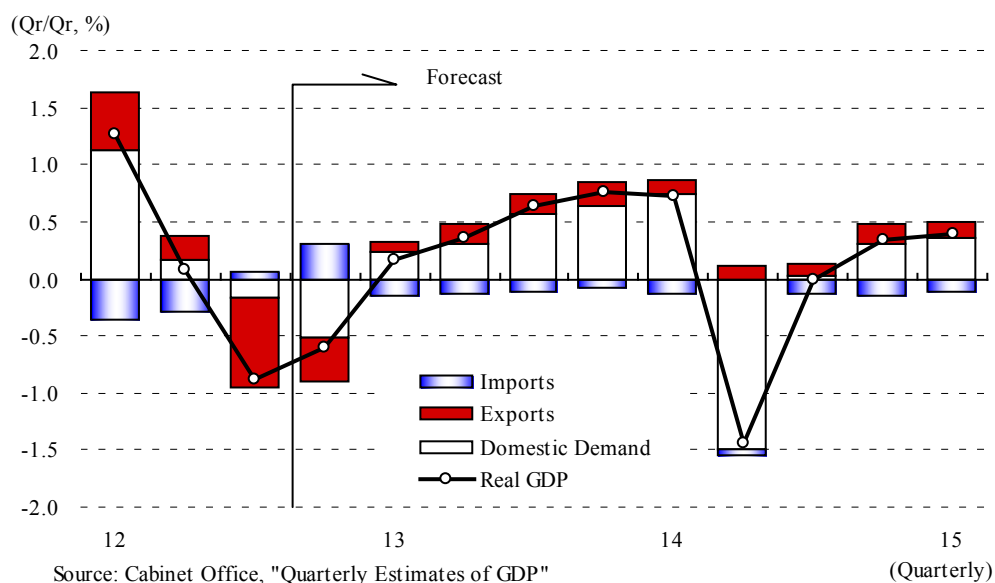
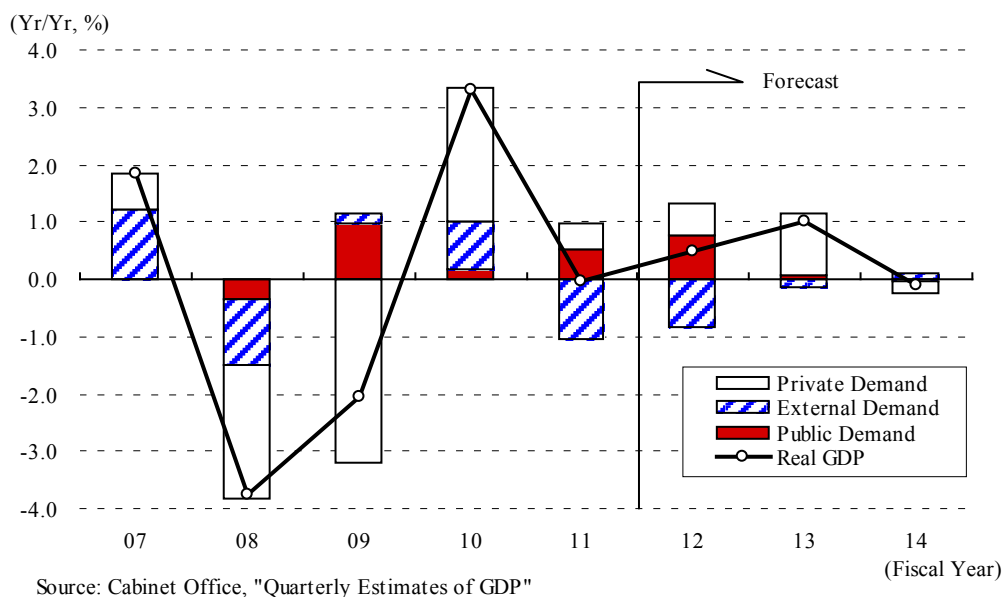


Chart 6: Contribution Rates to Real GDP Growth by Demand (on a Year-on-Year Basis)



In fiscal 2013, the trend toward recovery is forecast to become increasingly definite. Because of additional demand toward the end of the fiscal year owing to efforts to accelerate purchases to before the raising of the consumption tax rate, it is likely that the trend toward recovery will gain additional momentum. Although the contribution of public investment will continue to be negative, it is believed that the recovery in exports will be sustained and supplemented by the maintenance of firmness in private demand. On the other hand, the Japanese economy's recovery power is weak, and there is concern that if the expected export recovery is delayed, the timing of the economic bottoming out will be postponed.

Private consumption is forecast to shift to a fundamental trend of increase owing to the end of a period of decline in automobile sales as well as to the firmness of spending on services, reflecting a gradual improvement in the employment and income situation. Toward the end of the fiscal year, it is projected that a portion of future demand will be brought forward in time to enable purchases prior to the upcoming consumption tax rate hike, and this is expected to have the effect of increasing demand for products centered on durables. Regarding private residential investment, also, demand is likely to continue expanding owing to efforts to complete transactions prior to the consumption tax rate hike.

Private capital investment is forecast to recover and shift to a fundamental trend of moderate increase. Aggressive investments will continue to be restrained; however, reflecting an improvement in corporate performance, such capital investments as those designed to help maintain competitiveness and those involving the maintenance and replacement of equipment are expected to continue to be implemented, and this is likely to be a factor that provides support for the economy.

Since reconstruction and recovery-related demand will peak out during fiscal 2012, public investment is likely to shift to a trend of decline. However, since a certain level of public investment will continue to be implemented by drawing on the government's ample budgetary allocations for reconstruction and recovery, it is believed that the period-on-period drop will be restrained to a moderate pace.

The movement toward a recovery in exports is expected to become increasingly strong. The recovery in the U.S. economy will continue, and trend of economic recovery will also become clearer in China, as a result of

the positive effects of monetary policy relaxation measures and other economic measures. Moreover, the outlook is for European economies to begin to bottom out as a result of expansion in exports to the United States and China. In connection with the recovery in the global economy, it is projected that there will be movement toward correction of the excessive appreciation of the yen, and the export environment is likely to gradually improve.

The year-on-year rate of real GDP growth in fiscal 2013 is forecast to be +1.0%. The Japanese economy is expected to bottom out and shift to a trend of recovery by the beginning of the fiscal year at the latest, and the addition of a rising level of accelerated demand centered on private consumption toward the end of the fiscal year is likely to support the continuation of relatively firm economic growth. The progress of recovery in overseas economies will increase the rate of growth in exports, but because imports will also be increasing, the contribution of external demand will continue to be negative, at -0.1%. After the exclusion of a carryover effect of -0.4%, the rate of real growth for the fiscal year is expected to be +1.4%, an expansion pace approximately equivalent to the rapid pace of recovery achieved in fiscal 2011 in connection with disaster recovery and reconstruction demand. In addition, the year-on-year rate of growth in nominal GDP is forecast to rise to +0.7%. However, the year-on-year GDP deflator is forecast to continue to be negative, at -0.3%.

In fiscal 2014, since the effects of the consumption tax rate hike will become apparent in sectors centered on the household sector, there is a risk that the year-on-year rate of growth in real GDP will become negative again, descending to -0.1%. It is likely that the year-on-year rate of growth in nominal GDP will be 0.8% and that the year-on-year GDP deflator will rise to +0.9%.

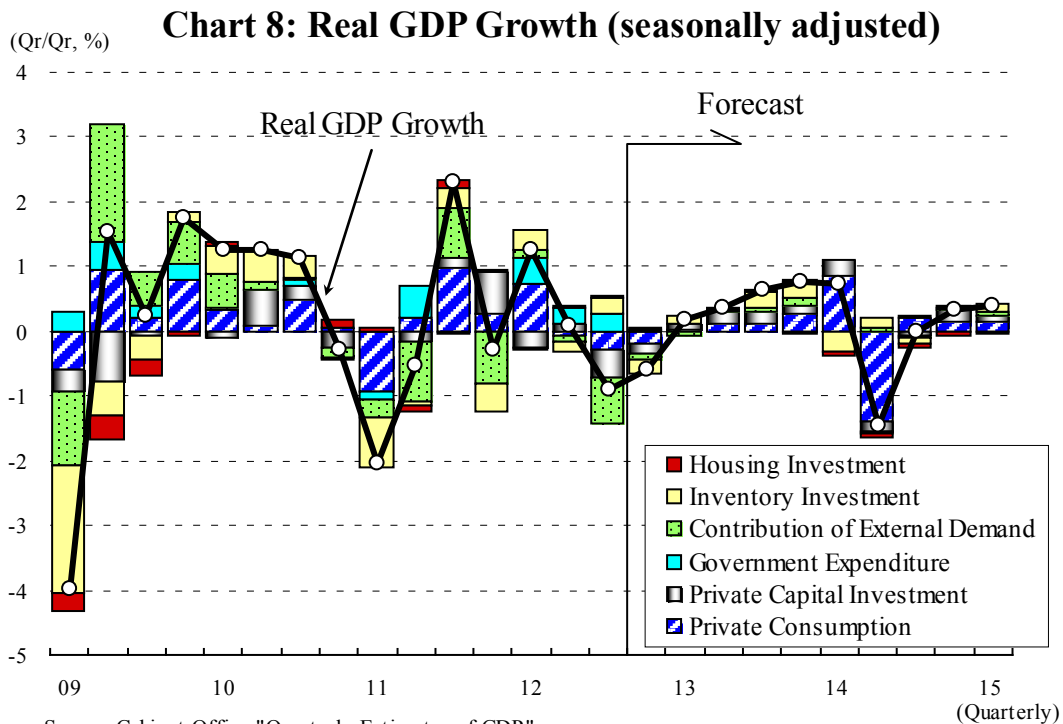
Comparing the upcoming situation with the situation associated with the consumption tax rate increase in 1997, there is a possibility that the magnitude of accelerated demand and the subsequent reactionary decline in demand will be relatively small, because the introduction of economic countermeasures has already been bringing forward future demand for such eco appliances as flat-screen televisions, air conditioners, refrigerators, and washing machines as well as for automobiles. In view of this, the

likelihood of the tax rise resulting in a period of downturn in the economy is small. However, rising prices at a time when wages are not rising will lower real disposable income, and this will inevitably have some impact on household consumption behavior. While year-on-year change in private consumption has been positive since fiscal 2008, it is forecast to be -0.5% in fiscal 2014—the first instance of negative growth in private consumption in six years.

Chart 7: Real GDP Growth (Fiscal Year)

	Carry-over from the previous year (A)	Growth rate during the year (B)	Real GDP growth rate (A)+(B)
FY2011 (actual)	-1.4 %	1.4 %	-0.0 %
FY2012 (forecast)	1.4 %	-0.9 %	0.5 %
FY2013 (forecast)	-0.4 %	1.4 %	1.0 %
FY2014 (forecast)	1.1 %	-1.2 %	-0.1 %

Source: Cabinet Office, "Quarterly Estimates of GDP"



2. Forecasts of Economic Activity by Sector

(1) Corporations

- When they entered the 21st century, Japanese corporations had completed their disposal of negative assets left over from Japan's bubble economy, and their financial positions and profitability recovered substantially, supported by strong exports. Accordingly, the risk of major downturns in production, capital investment, or other aspects of corporate activities had receded for the time being.
- However, as a result of the collapse of Lehman Brothers Holdings in autumn 2008, economic conditions changed markedly, domestic and overseas aggregate demand dropped sharply, and companies made adjustments in production to reduce their inventories. As a result, corporate profitability dropped substantially, mainly in the automobile and other manufacturing industries. Corporations were confronted with deterioration in their cash flows and rates of capacity utilization, and they adopted a stronger posture of refraining from capital investment.
- After the beginning of fiscal 2009, industrial production began to bottom out, as a result of the recovery in the world economy and the positive effects of government policy measures. Owing to recovery in production activities and the positive effect of reductions in personnel and other costs, corporate profitability began to show rapid improvement. Although the economy moved into a temporary lull, as a result of the slowdown in exports and other factors, production in the corporate sector remained generally on a rising trend.
- The Great East Japan Earthquake of March 2011 dealt a serious blow to corporate activities. The aftereffects of the earthquake constrained production over a wide range of industries as the production facilities in the affected region were seriously damaged, supply chains were disrupted, and electric power service was interrupted. Corporate activities centered on the automobile industry recovered following the temporary confusion immediately after the earthquake, but the impact of global economic deceleration from fiscal 2012 has decreased exports, and the level of manufacturing activities has once again been depressed.

(2) Households

- Factors including a shift to decline in the ratio of job openings to job applications—following a trend of increase sustained since July 2009—indicate that there is currently a temporary hiatus in the trend of improvement in the employment environment. Moreover, in addition to a decrease in ordinary wages, the upward pressure on overall wages stemming from a temporary rise in overtime wages has run its course, and overall wages are continuing to be slack. Against the backdrop of corporations' strong stance with respect to restraining personnel costs, the employment and income situations are continuing to be harsh.
- While private consumption had been a driver of the domestic economy since the earthquake disaster, it is currently decreasing. The eco car subsidy system, which had been boosting durable goods consumption, ended in September. In view of those situations and projections of a decline in winter bonus payments, we believe that private consumption will temporarily be slack for some time going forward. While it is projected that private consumption will recover and resume a fundamental trend of increase in tandem with a recovery in domestic economic conditions, it is likely that there will be some accelerated demand prior to the consumption tax hike along with a subsequent reactionary decline in demand.
- The number of housing starts is continuing to be approximately level. Prior to the consumption tax rate increase, there is a possibility that accelerated demand will be seen in a period centered on the middle portion of fiscal 2013 and that the number of housing starts will rise. Compared to private consumption, it is likely that the impact of the consumption tax rate increase on housing starts and private residential investment will emerge gradually over the long term.

(3) Government

- Since the collapse of Lehman Brothers Holdings, the implementation of a series of economic measures designed to deal with the economic downturn combined with a major drop in tax revenues amid the deterioration of economic conditions has led to a substantial expansion

of the government's fiscal deficit. Moreover, social welfare expenditures have continued to rise against the backdrop of demographic graying, but the government has continued to be unable to secure stable funding for those welfare costs. The dual objectives of realizing fiscal soundness and making the social welfare system stable have become major issues with respect to the Japanese economy.

- To address these issues, a reform law was passed in August 2012 to deal with both social welfare and taxation policies comprehensively. Although conditional on the improvement of the economy, the law calls for increasing the consumption tax rate to 8% in April 2014 and then to 10% in October 2015. Plans call for using the revenues from this source to strengthen and expand social welfare programs, including those related to pensions, healthcare, nursing care, and child rearing.
- Under these difficult fiscal conditions, the level of public investment had been trending downward since the mid-1990s with the exception of the period when economic countermeasures were implemented after the collapse of Lehman Brothers. Government expenditures for reconstruction and recovery following the Great East Japan Earthquake of March 2011 are expected to amount to at least approximately ¥19 trillion during the five-year period through fiscal 2015. Designed to promote a full-scale recovery, the third supplementary budget for fiscal 2011 established an earthquake disaster recovery budget of about ¥9.2 trillion (excluding the portion that was borrowed temporarily from the national pension fund and must be returned), which included supplemental allocations for public works investment, Great East Japan Earthquake grants to support the rebuilding of communities in earthquake regions, and other allocations. The full-scale disbursement of these budgetary allocations has begun, and public investment has continued to rise since the start of 2012.
- Real total government expenditures on a GDP basis—the total of government final consumption expenditures and public investment—are expected to continue rising in fiscal 2012 owing to demand associated with reconstruction and other factors. In fiscal 2013 and thereafter, although government final consumption will continue to rise, a shift to decline in public investment owing to the diminution of the boost from reconstruction-related demand is likely to cause the pace

of increase in overall government expenditures to become more moderate.

(4) Trends in Overseas Economies

- The pace of recovery in the global economy is slowing. The pace of economic recovery in the United States is sluggish, and signs of stagnation are spreading among European economies owing to the impact of the fiscal and monetary crises. In China also, despite the shift to the relaxation of monetary policy, there is a persistent trend toward deceleration as a result of rising inventory adjustment pressures stemming from excess supply capacity.
- However, the fundamental recovery trend in the global economy is continuing. In addition to the continued gradual recovery in the United States, the rate of growth is expected to pick up in China. Although the tempo of economic recovery in Europe is sluggish, progress has been seen in the crisis response measures of the ECB and individual countries, and the risk of a further downtrend has been diminished.
- Japan's exports (on a customs-clearance, volume basis) are expected to level off in the latter half of 2012 because of the deceleration in the Chinese economy and other factors. In 2013 and beyond, however, exports are projected to increase in response to the rising rate of recovery in the global economy. Going forward, Japan's imports (on a customs-clearance, volume basis) are projected to be weak, but they are expected to begin rising again from the start of 2013 against the backdrop of improvement in the domestic economy.
- Japan's trade balance in fiscal 2011 moved to a deficit position against the backdrop of the sluggishness of exports and a rise in imports accompanying an increase in oil prices. This trade deficit is expected to continue in fiscal 2012 and thereafter. The surplus in the income account is likely to continue rising at a moderate rate owing to growing earnings from overseas direct investments and other factors. The current account surplus is expected to decrease considerably in fiscal 2012 and subsequently increase gradually while remaining at low levels.

3. Forecasts for Prices and Financial Markets

- The slowdown of the Chinese economy has caused drops in market prices of coal and iron ore, but market prices of crude oil and grain have remained high. Against the backdrop of expansion in the demand as well as the supply capacities of China and other newly emerging economies, it is likely that upstream inflationary pressures on resources and other commodities and downstream deflationary pressures on industrial and other products will persist over the medium term.
- Domestic corporate prices are being impacted by trends in international commodity markets but are expected to continue at stable low levels. Although electric power rate hikes will have an impact, it will be difficult to push domestic corporate prices upward because supply capacity in Japan is likely to continue to exceed demand, and domestic producers will be exposed to competition from cheaper imported products. Prices charged to final consumers are generally expected to move within a narrow range because of strong downward pressures stemming from consumers' continued preference for low-priced products.
- Since 2008, Japan has moved ahead with measures to ease monetary policy. In December 2009, stronger measures were adopted to ease monetary policy because of concerns about the risks of a downturn and progressive deflation. In October 2010, a "comprehensive policy for monetary easing" was implemented to cope with the increasing risk of economic downturns in Japan and overseas. Subsequently, a series of seven additional "monetary easing policies" have been implemented. For the time being, the Bank of Japan is expected to continue its stance of maintaining an easy monetary policy.
- Long-term interest rates are expected to remain at low levels against a background of stable and low short-term rates. However, there is a possibility that the recovery in overseas economies and the deterioration in government fiscal positions around the world may place upward pressure on long-term interest rates. In foreign exchange markets, since 2010, the yen has appreciated sharply because of the weakness of the euro, owing to government fiscal crises in EU countries, and because of the decline in the value of the U.S. dollar,

reflecting speculation about additional quantitative monetary easing. Going forward, movements are expected toward the correction of the high value of the yen, but the many uncertainties associated with the economic and fiscal budget situations in Japan, the United States, and Europe will make it difficult to take unilateral measures.

Chart 9: Outlook for Fiscal 2012-2013

				Forecast ↘		Yr/Yr, %
	FY2009 (actual)	FY2010 (actual)	FY2011 (actual)	FY2012 (forecast)	FY2013 (forecast)	FY2014 (forecast)
Nominal GDP	-3.2	1.2	-2.0	-0.3	0.7	0.8
Real GDP	-2.1	3.3	0.0	0.5	1.0	-0.1
Contribution of domestic demand	-2.2	2.5	1.0	1.3	1.1	-0.2
Private consumption	1.2	1.6	1.2	0.9	0.7	-0.5
Housing investment	-21.0	2.6	3.8	2.6	2.1	-5.0
Private capital investment	-12.0	3.9	1.1	-0.7	2.7	1.4
Contribution of inventory investment	-1.4	0.8	-0.5	0.0	0.2	0.1
Government expenditure	4.2	0.8	2.2	3.1	0.2	-0.1
Public investment	11.5	-6.0	2.9	7.8	-3.1	-5.5
Government final consumption expenditure	2.7	2.5	1.9	2.0	1.0	1.2
Contribution of external demand	0.2	0.8	-1.0	-0.8	-0.1	0.1
Export of goods and services	-9.8	17.4	-1.4	-1.5	0.7	3.8
Import of goods and services	-10.7	12.3	5.6	3.8	1.4	2.6
GDP deflator	-1.2	-2.1	-1.9	-0.8	-0.3	0.9

				Forecast ↘		Yr/Yr, %
	FY2009 (actual)	FY2010 (actual)	FY2011 (actual)	FY2012 (forecast)	FY2013 (forecast)	FY2014 (forecast)
Current account balance (trillion yen)	16.3	16.7	7.6	3.9	4.0	4.4
balance on goods (trillion yen)	6.6	6.5	-3.5	-6.4	-7.2	-7.4
balance on service (trillion yen)	-1.8	-1.3	-1.8	-3.0	-2.5	-2.5
balance on income (trillion yen)	12.6	12.6	14.0	14.4	14.8	15.5
Industrial production	-8.8	9.3	-1.0	-5.0	-1.5	0.5
Unemployment rate(%)	5.2	5.0	4.5	4.3	4.2	3.9
New housing starts(annualized, ten thousand units)	77.5	81.9	84.1	87.4	89.1	84.4
Domestic corporate goods prices	-5.1	0.4	1.4	-1.4	-0.1	2.9
Consumer prices	-1.7	-0.4	-0.1	-0.4	0.0	2.3
excluding freshfood	-1.6	-0.8	0.0	-0.3	0.0	2.2
Yen/U.S.Dollar	92.8	85.7	79.1	79.6	81.3	83.7
Uncollateralized call rates (O/N) (%)*	0.102	0.091	0.077	0.081	0.080	0.080
Newly issued government bond yields (10years) (%)	1.36	1.15	1.05	0.79	0.85	0.96
WTI future price (near month contract, US dollar/barrel)	70.7	83.4	97.3	90.3	91.3	94.8
Dubai crude oil prices (US dollar/barrel)	69.7	84.2	110.1	106.1	101.3	100.0

* actual=average, forecast=end of period

Chart 10: Outlook for Calendar 2012-2013

				Forecast		Yr/Yr, %
	CY2009 (actual)	CY2010 (actual)	CY2011 (actual)	CY2012 (forecast)	CY2013 (forecast)	CY2014 (forecast)
Nominal GDP	-6.0	2.3	-2.8	0.6	-0.4	1.3
Real GDP	-5.5	4.5	-0.7	1.5	0.1	0.7
Contribution of domestic demand	-4.0	2.8	0.1	2.3	0.5	0.6
Private consumption	-0.7	2.6	0.1	2.1	-0.1	0.4
Housing investment	-16.6	-4.2	5.7	1.8	2.5	-3.1
Private capital investment	-14.3	0.8	1.3	0.9	0.4	2.8
Contribution of inventory investment	-1.5	0.8	-0.6	0.0	0.2	0.1
Government expenditure	3.0	1.9	1.0	3.5	0.9	-0.1
Public investment	7.0	0.9	-3.5	8.9	-0.2	-5.2
Government final consumption expenditure	2.3	2.2	2.0	2.2	1.1	1.1
Contribution of external demand	-1.5	1.7	-0.9	-0.8	-0.4	0.1
Export of goods and services	-24.2	24.3	-0.1	0.3	-1.6	3.9
Import of goods and services	-15.7	11.2	6.3	5.4	0.9	2.6
GDP deflator	-0.5	-2.2	-2.1	-0.9	-0.5	0.7

				Forecast		Yr/Yr, %
	CY2009 (actual)	CY2010 (actual)	CY2011 (actual)	CY2012 (forecast)	CY2013 (forecast)	CY2014 (forecast)
Current account balance (trillion yen)	13.7	17.9	9.6	4.7	3.8	4.2
balance on goods (trillion yen)	4.0	8.0	-1.6	-5.7	-7.1	-7.4
balance on service (trillion yen)	-1.9	-1.4	-1.8	-2.7	-2.5	-2.5
balance on income (trillion yen)	12.8	12.4	14.0	14.1	14.7	15.2
Industrial production	-21.9	16.4	-2.3	-1.4	-5.3	1.9
Unemployment rate (%)	4.2	5.1	4.6	4.4	4.3	4.0
New housing starts(annualized, ten thousand units)	78.8	81.3	83.4	87.3	88.7	86.0
Domestic corporate goods prices	-5.3	-0.1	1.5	-0.9	-0.6	2.2
Consumer prices	-1.4	-0.7	-0.3	-0.1	-0.3	1.8
excluding freshfood	-1.3	-1.0	-0.2	-0.2	-0.1	1.7
Yen/U.S.Dollar	93.5	87.8	79.8	79.4	80.8	83.1
Uncollateralized call rates (O/N) (%)*	0.105	0.094	0.078	0.082	0.080	0.080
Newly issued government bond yields (10years) (%)	1.34	1.17	1.12	0.85	0.82	0.93
WTI future price (near month contract, US dollar/barrel)	61.8	79.5	95.1	94.1	89.8	94.3
Dubai crude oil prices (US dollar/barrel)	61.8	78.0	106.2	108.9	102.8	99.8

* actual=average, forecast=end of period

Chart 11: Outlook for 2012-2013 (Quarterly)

	FY2011				FY2012				FY2013				Forecast	Qr/Qr, % Yr/Yr, %
	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3		
Nominal GDP	-1.4	2.1	-0.6	1.4	-0.3	-0.9	-1.2	0.3	0.5	0.5	0.3	0.8		
	-4.1	-2.7	-2.4	1.5	2.3	-0.6	-1.0	-2.1	-1.2	0.2	1.5	2.2		
Real GDP	-0.5	2.3	-0.3	1.3	0.1	-0.9	-0.6	0.2	0.4	0.6	0.8	0.7		
	-1.8	-0.6	-0.7	2.9	3.3	0.1	-0.1	-1.3	-0.9	0.7	1.8	2.4		
Contribution of domestic demand (Qr/Qr,%)	0.4	1.5	0.5	1.1	0.2	-0.2	-0.5	0.2	0.3	0.6	0.6	0.8		
Private consumption	0.4	1.6	0.5	1.2	-0.1	-0.5	-0.3	0.0	0.2	0.2	0.5	1.4		
	-0.3	0.5	0.9	3.7	3.2	1.2	0.3	-0.9	-0.6	0.1	0.9	2.3		
Housing investment	-2.7	4.2	-0.1	-1.1	1.5	0.9	0.4	0.2	0.6	1.0	0.7	-1.1		
	3.6	8.3	3.4	0.0	4.5	1.4	1.7	2.9	2.2	2.3	2.5	1.1		
Private capital investment	-1.3	1.3	5.0	-1.9	0.9	-3.2	-1.2	0.8	1.5	1.2	1.0	1.8		
	-1.3	-2.2	4.9	2.9	5.6	0.5	-5.2	-2.7	-2.0	2.2	4.6	5.5		
Contribution of inventory investment (Qr/Qr,%)	-0.1	0.3	-0.4	0.3	-0.2	0.2	-0.2	0.1	0.0	0.2	0.2	-0.3		
Government expenditure	2.0	-0.1	0.1	1.6	0.9	1.1	0.1	0.0	0.0	0.0	-0.1	0.0		
	1.9	1.6	1.3	3.7	2.5	3.8	3.9	2.2	1.2	0.3	-0.2	-0.3		
Public investment	8.0	-2.6	-0.5	4.2	2.6	4.0	-0.3	-0.9	-1.1	-1.1	-1.3	-1.2		
	2.1	0.0	-0.2	8.8	4.0	11.4	10.4	5.2	1.7	-3.1	-4.5	-4.7		
Government final consumption expenditure	0.6	0.4	0.3	1.1	0.5	0.3	0.3	0.3	0.2	0.3	0.2	0.3		
	1.8	1.7	1.6	2.3	2.3	2.2	2.2	1.3	1.1	1.0	1.0	1.0		
Contribution of external demand (Qr/Qr,%)	-0.9	0.8	-0.8	0.1	-0.1	-0.7	-0.1	-0.1	0.0	0.1	0.1	0.0		
Export of goods and services	-6.0	8.8	-4.3	3.3	1.3	-5.0	-2.6	0.6	1.2	1.2	1.4	0.8		
	-5.2	1.0	-2.5	1.0	9.2	-4.9	-3.4	-5.8	-5.8	1.1	4.2	3.8		
Import of goods and services	-0.1	3.6	0.9	2.2	1.8	-0.3	-1.8	0.9	0.8	0.6	0.5	0.8		
	4.1	5.6	5.9	6.7	8.9	4.7	1.5	0.7	-0.5	0.5	2.9	2.7		
GDP deflator (Yr/Yr,%)	-2.4	-2.1	-1.8	-1.3	-0.9	-0.7	-0.9	-0.9	-0.3	-0.5	-0.2	-0.2		

	FY2011				FY2012				FY2013				Forecast	Yr/Yr, %
	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3		
Current account balance (trillion yen)*	1.9	2.5	1.7	1.5	1.5	0.9	0.7	0.9	1.0	0.9	1.1	1.0		
balance on goods (trillion yen)*	-1.1	-0.2	-1.2	-1.1	-1.1	-1.7	-1.9	-1.7	-1.8	-1.9	-1.8	-1.8		
balance on service (trillion yen)*	-0.4	-0.5	-0.6	-0.4	-0.7	-0.8	-0.8	-0.7	-0.6	-0.6	-0.6	-0.6		
balance on income (trillion yen)*	3.6	3.5	3.7	3.3	3.6	3.7	3.6	3.6	3.7	3.8	3.7	3.7		
Industrial production (Qr/Qr, %)	-4.2	5.4	0.4	1.2	-2.0	-4.2	-4.7	-0.5	0.5	0.8	1.5	1.8		
(Yr/Yr, %)	-5.8	-0.9	-1.6	4.7	5.3	-4.6	-10.1	-10.0	-8.5	-4.0	1.9	5.2		
Unemployment rate (%)*	4.7	4.4	4.5	4.5	4.4	4.2	4.3	4.4	4.3	4.2	4.2	4.1		
New housing starts(annualized, ten thousand units)	82.4	88.3	79.6	86.2	87.8	87.5	87.6	87.1	87.9	89.3	90.3	89.2		
Domestic corporate goods prices (Yr/Yr,%)	1.8	2.2	1.1	0.3	-1.0	-1.9	-1.1	-1.5	-1.1	0.2	0.1	0.3		
Consumer prices (Yr/Yr,%)	-0.5	0.1	-0.3	0.3	0.2	-0.4	-0.5	-0.8	-0.5	-0.1	0.2	0.3		
excluding freshfood (Yr/Yr,%)	-0.2	0.2	-0.1	0.1	-0.1	-0.3	-0.3	-0.4	-0.3	-0.1	0.2	0.3		
Yen/U.S.Dollar	81.7	77.8	77.4	79.3	80.2	78.6	79.7	80.0	80.4	81.0	81.6	82.2		
Uncollateralized call rates (O/N) (%)**	0.067	0.078	0.079	0.083	0.078	0.085	0.080	0.080	0.080	0.080	0.080	0.080		
Newly issued government bond yields (10years) (%)	1.18	1.05	1.00	0.98	0.88	0.79	0.75	0.76	0.80	0.84	0.87	0.91		
WTI future price (near month contract, US dollar/barrel)	102.6	89.8	94.1	102.9	93.5	92.2	87.9	87.5	89.0	90.5	92.0	93.5		
Dubai crude oil prices (US dollar/barrel)	110.6	107.0	106.7	116.2	106.5	106.1	106.9	105.0	103.5	102.0	100.5	99.0		

*seasonally adjusted ** actual=average, forecast=end of period

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