

February 2013

Forecast for the Japanese Economy in Fiscal 2013 and 2014

— The Trend toward Improvement Will Strengthen —



Mitsubishi UFJ Research and Consulting

Economic Research Department

1. Outlook for the Japanese Economy in Fiscal 2013 and Fiscal 2014 -- The Trend toward Improvement Will Strengthen

(1) Current State of the Economy: There Is a Strong Possibility that the Economy Bottomed Out at the End of 2012

Announced on February 14, 2013, the real GDP growth rate for the October-December quarter was -0.1% compared with the previous quarter (-0.4% at an annualized rate). This was the third consecutive quarter-to-quarter drop, but the decline was substantially smaller than previously. Monthly economic indicators suggest that the economy reached bottom during 2012, and real GDP data have now increased the probability of this.

The factors accounting for the shrinkage in the margin of decline included, first, the firmness of conditions in the household sector. Although income conditions have created a severe environment for private consumption and expenditures on consumer durables have declined, spending on travel and other services, food products, and other nondurables has held firm and rose 0.4% over the previous quarter. Residential housing investment also increased and was up 3.5% quarter to quarter, for the third consecutive quarterly gain, reflecting the rise in the number of housing starts.

The second factor was the continued increase in public-sector demand, especially public investment. Since the level of public investment has already risen, the pace of increase slowed somewhat. However, as a result of the boost coming from demand related to recovery in the areas affected by the Great East Japan Earthquake, public investment rose 1.5% for the quarter, the fourth consecutive quarterly gain. In addition, government consumption posted a rise of 0.6% over the previous quarter as a result of increased social welfare payments in kind for medical care and nursing.

In contrast, the corporate sector showed a relatively weak performance. Capital investment declined 2.6% from the previous quarter, the fourth consecutive quarterly drop. Although corporate sentiment has recently been improving because of the weakening of the yen and an increase in stock prices, this improvement is not likely to be reflected in corporate activities until 2013. Moreover, as a consequence of the strengthening of pressures for inventory adjustments, the contribution of inventory investment for the

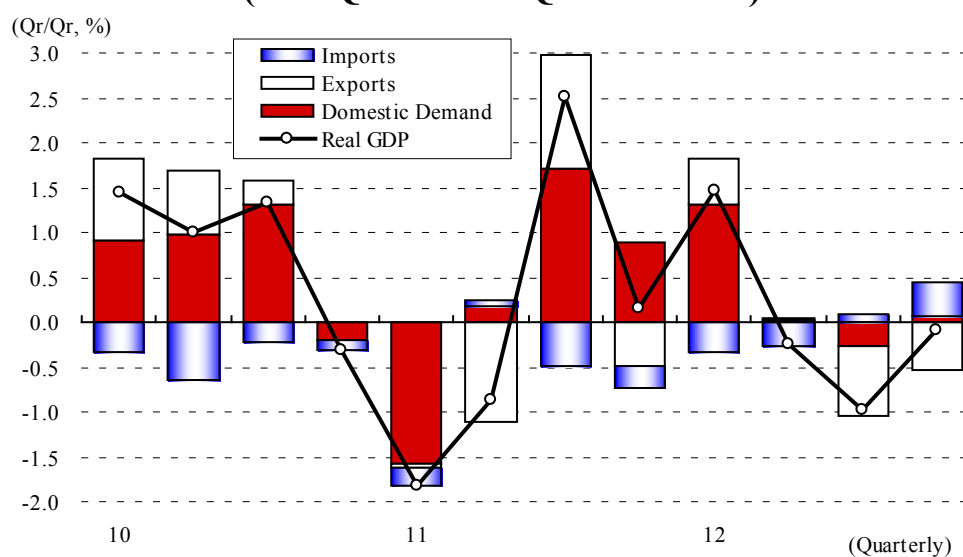
quarter was -0.2 percentage point.

As a result of these trends, the contribution of domestic demand was $+0.1$ percentage point, thus moving into the positive range. On the other hand, the contribution of the external sector was -0.2 percentage point, the third consecutive negative figure.

Exports continued to show only weak movements because of the stagnation of exports to China caused by anti-Japanese demonstrations. For the quarter, exports fell 3.7% and declines were seen especially in automobiles. Imports also decreased and were down 2.3% for the quarter, because of a reactionary decline that followed a surge in demand for crude oil, LNG, and other materials that preceded the introduction of an environmental tax that was imposed in September 2012.

The rate of growth in nominal GDP for the quarter was -0.4% (-1.8% at an annualized rate). The GDP deflator, which reflects overall price trends in the economy as a whole, was 0.6% below the same quarter of the previous year (versus -0.3% in the previous quarter), representing a slight shrinkage in the rate of decline. This decline was due to decreases in the deflator for consumption and other deflators for domestic demand components and occurred despite a positive movement in the import deflator (which is a deduction item in calculating the GDP deflator). Note that this was the sixth consecutive quarter-to-quarter shrinkage in the margin of decline in the GDP deflator.

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



Source: Cabinet Office, "Quarterly Estimates of GDP"

(2) How Should We Evaluate the Impact of the Weaker Yen? The Upward Boost to the Economy May Be Marginal

In forecasting future trends in the Japanese economy, what will be important is considering the effectiveness of the economic policies of the Abe administration, or so-called “Abenomics”. Since mid-November, the yen has depreciated and stock prices have risen, giving rise to optimism about future economic conditions, but this has been because expectations have run ahead of actual conditions. The effects of pending policies have yet to spread into the real economy. The bottoming out of the economy last year was not related to the blessings of Abenomics.

In the short term, the benefits of Abenomics will be the positive impact of yen depreciation and the increase in public investment included in the supplementary budget. Let us look first at the expected impact of the cheaper yen.

(a) Impact on Exports

When the yen depreciates, the first thing we anticipate is that exports will grow and this will give a boost to the economy. Since the price competitiveness of exporters will recover, exports will be expected to show steady expansion.

When we say “the yen becomes cheaper and exports grow,” it actually has two implications. One is that, when exports are denominated in foreign currencies, the yen proceeds after conversion from foreign currency to yen are larger than they would have been otherwise. This improves the financial performance of exporters because their sales increase in yen. However, if the exporters whose performance has improved do not invest in Japan or they do not raise salaries of employees there, it will not have an effect on the domestic economy.

The second implication is that exports rise in unit volume terms. If exporters use a portion of the profit they gain from yen depreciation to discount their sales prices denominated in foreign currencies, then the volume of their sales in unit terms may rise. If the unit volume of exports rises, not only do the sales of exporters rise but also their domestic production increases, and this gives a boost to the domestic economy. The

reason why people are looking with anticipation for benefits from the recent depreciation in the yen seems to be that they are looking for benefits from the rise in production. But, will the unit volume of exports actually increase as expected?

Chart 2 shows indices (with January 2005 as 100) of export prices denominated on a contract currency basis, export prices in yen, and the yen/U.S. dollar exchange rate. This chart shows that export prices on a contract currency basis have shown almost no change. For example, an automobile that was exported with price tag of US\$10,000 is still exported at the same price. On the other hand, the price in yen terms declines when the yen appreciates. This means that in the recent period when the yen was appreciating, exporters did not reflect the decline in their yen profits in the foreign currency price (did not raise their foreign currency prices).

Chart 2: Export Prices and the Yen/U.S. Dollar Rate

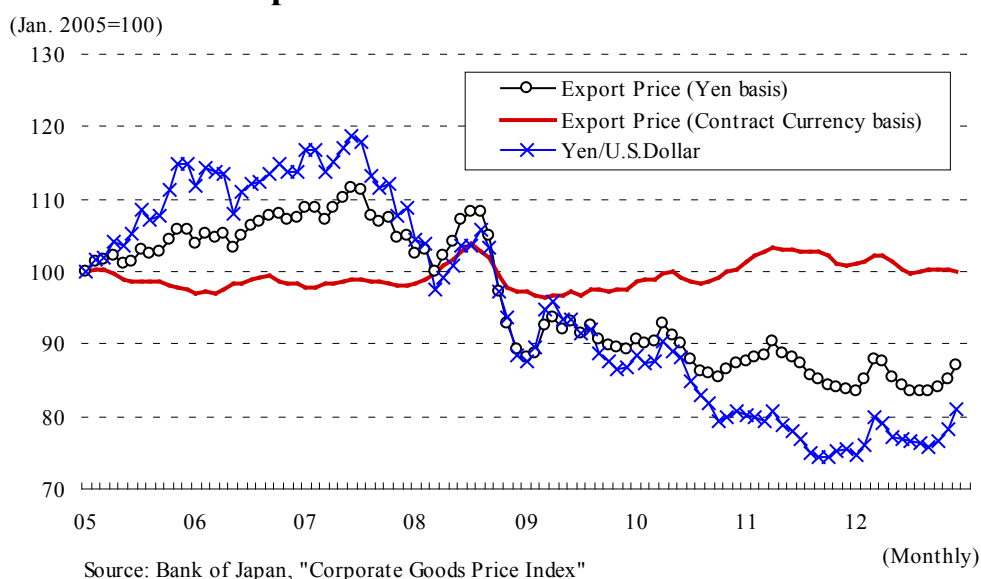
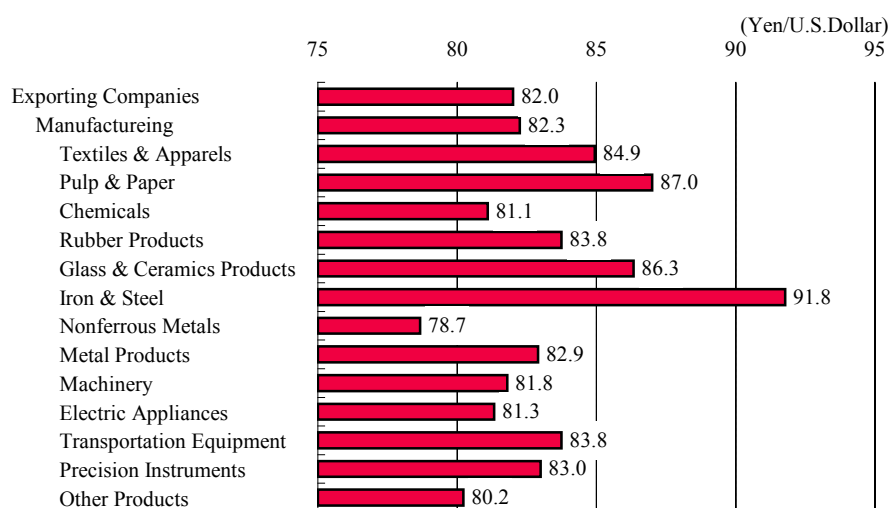


Chart 3 shows that, if we make the judgment that the breakeven exchange rate for exporters was about ¥82=US\$1, during the recent phase of yen appreciation, exporters were operating just barely at, or below, break-even. For this reason, even under the current cheaper yen conditions, exporters are able to turn a profit, but are not engaging in aggressive price competition.

In addition, as a result of more-intense competition in international markets, companies are moving their production from Japan to overseas locations

and, in the case of some products, have exited production, and thus are no longer able to export. Taking flat panel TVs as an example, manufacturers are in the process of exiting this business, and, even if the yen depreciates, they are no longer in a position to commence exports again. Also, in the case of automobile manufacturers, with the cheaper yen, they are expected to generate sufficient profit again, and this will contribute to improvement in their profitability. However, as these companies are aggressively shifting their production to local markets overseas, it is unlikely that they will change their management plans over a short period.

Chart 3: Break-even Exchange Rate for Corporations (2011)



Source: Cabinet Office, "Annual Survey of Corporate Behavior"

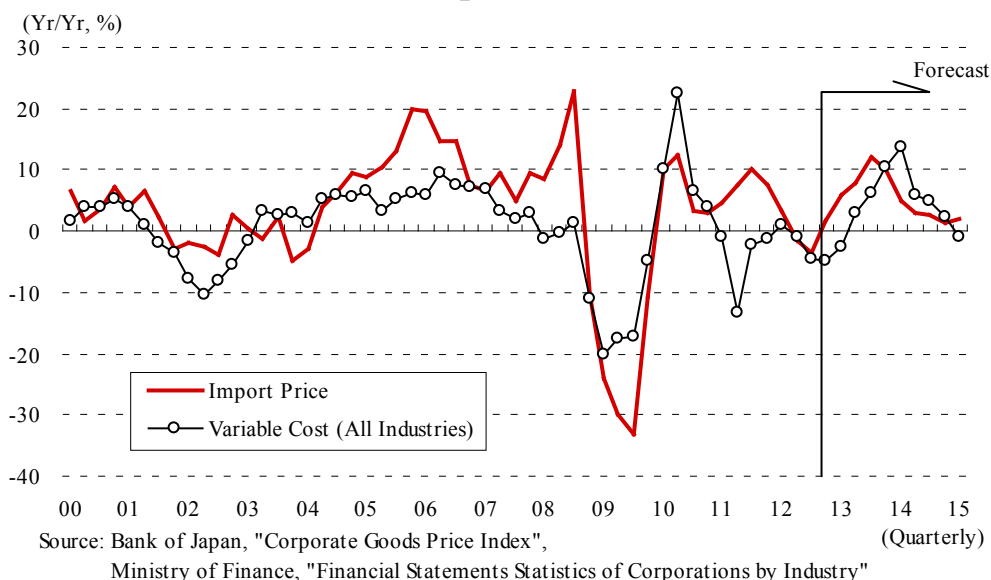
Moreover, as is the case with full-line appliance companies, companies hedge the effects of foreign exchange fluctuations by denominating exports and imports in foreign currency, thus maintaining a neutral position vis-à-vis exchange rates; on the one hand, they are not adversely affected by yen appreciation, but, on the other hand, they give up the benefits of yen depreciation. For this reason, even if the yen appreciates, their price competitiveness does not increase.

If we take these points into consideration, the expectation that some people have that the unit volume of exports will rise sharply because of yen depreciation would probably be better off assuming that exports in volume terms will probably not increase very much.

(b) Impact on Corporate Performance

As a result of the recent depreciation of the yen and increases in prices of crude oil and other international commodities, upward pressure on import prices has increased. The import price index in January 2013 has already risen to 10.8% above the same month of the previous year. Looking ahead, if there is no change in the downward trend in the yen's value, upward pressures on international commodity prices are forecast to grow along with the recovery in the world economy, and Japan's import prices will increase, thus raising procurement costs for corporations (Chart 4).

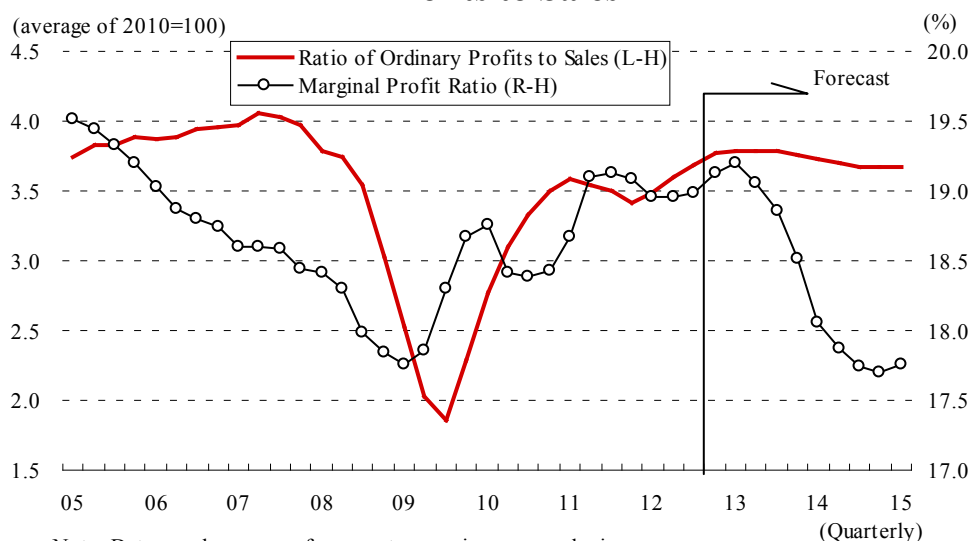
Chart 4: Forecast of Import Price and Variable Cost



If corporations cannot pass these higher costs on to the prices of goods and services they produce, their performance will deteriorate. Going forward, as exports rise along with the recovery in overseas economies, some corporations are believed likely to pass their higher procurement costs on to their customers, thus resulting in increases in corporate sales. However, since it will be difficult to shift the full amount of these cost increases, corporations will experience a deterioration in their marginal profits, and there is a strong possibility that growth in their profits will be constrained. For this reason, the forecast is for corporate profits to continue to rise, but profit ratios may weaken and the margin of increase in profits will be constrained (Chart 5).

Accordingly, some exporters are expected to show improvement in their profitability as a result of the depreciation of the yen. However, if these companies do not spend some of their gains on capital investments in Japan, increase wages, or otherwise return their profits to the domestic economy, the benefits of the cheaper yen will not be felt.

Chart 5: Forecast of Marginal Profit Ratio and Ratio of Ordinary Profits to Sales



Note: Data are shown on a four-quarter moving average basis.
 Source: Ministry of Finance, "Financial Statements Statistics of Corporations by Industry"

(c) Impact on Private Consumption

Even if some corporations absorb a portion of the increase in import prices, the outlook is for these increases to be passed on to the household sector through higher prices of gasoline, electricity, and food products. For this reason, the consumer price index is forecast to show a small margin of increase in 2013, quite independent of the Bank of Japan’s bold monetary easing policies and the adoption of an inflation target, as upward pressure on prices builds along with the rise in import prices.

This increase in consumer prices will have a negative effect on private consumption because it will lower real incomes. Chart 7 shows trends in nominal and real employment compensation. First, the level of nominal employment compensation dropped sharply following the collapse of Lehman Brothers Holdings, and, since that time, has shown only slight recovery. On the other hand, real employment compensation, after a

downward adjustment, began to rise and climbed to the highest level in history during the July-September quarter because of the positive effect of declining prices on real income.

Chart 6: Forecast of Prices

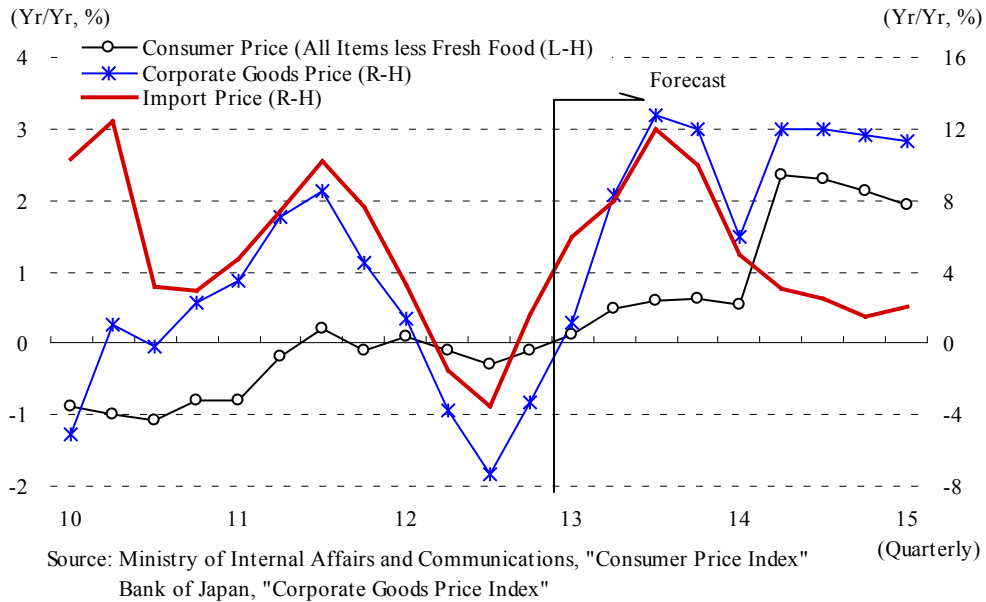
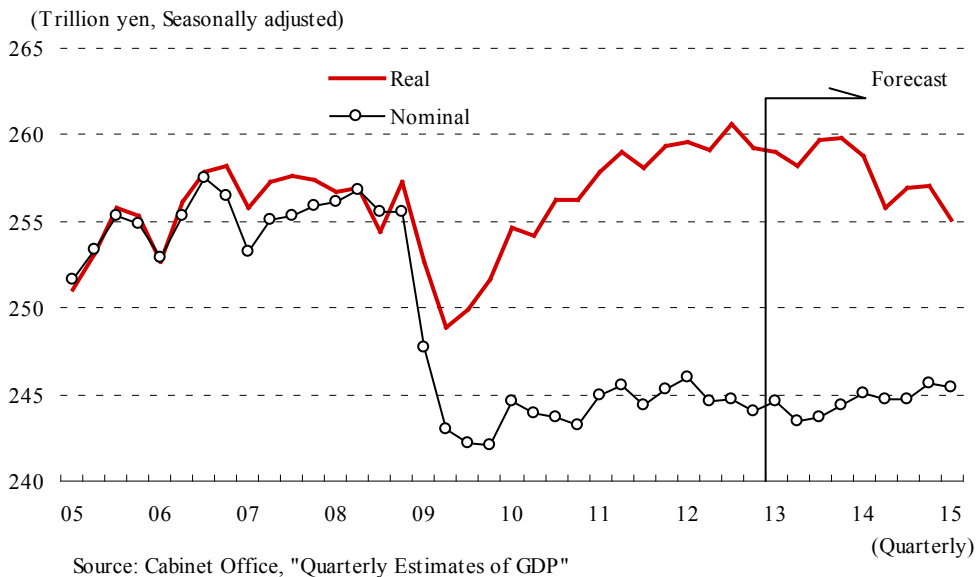


Chart 7: Forecast of Compensation of Employees



Nominal employment compensation cannot be expected to post steady increases. Although there is a movement among some corporations to increase wages, most companies are adopting a cautious stance toward

increasing personnel costs. Accordingly, as a result of rising prices, there is a strong possibility that real employment compensation will show a declining trend. Especially in fiscal 2014 when the consumption tax is raised, consumer prices will be ratcheted upward automatically and the margin of decline in real compensation will expand (Judging from the mix of products affected, the margin of the upward slide will be about 2%).

As we have seen, the depreciation of the yen will not necessarily have just positive effects. However, it is clear that, compared to the time when the yen remained at overvalued levels and domestic export industries could have been dealt fatal blows, these risks have been reduced under the recent cheaper yen scenario. However, now that the yen has depreciated in value, this does not mean that positive effects will be forthcoming immediately. Instead, we must keep in mind that the volume of energy imports will rise and that, in a situation where corporations have already adjusted to high values of the yen, there is some risk that lower values of the yen may bring negative effects.

(3) How Much Effect Will Economic Policies Have? Supply Constraints in the Construction Industry Will Be an Obstacle

Next, let us turn to the question of how much effect the supplementary budget for fiscal 2012 (Emergency Economic Policy for Revitalizing the Japanese Economy), which contains ¥20.2 trillion in project allocations and ¥10.3 trillion in government fiscal expenditures, will have on the economy. The government has announced that the positive effects of this supplementary budget will be to raise real GDP growth by about 2% and create approximately 600,000 new jobs. Can we really look forward to the positive effects of this magnitude?

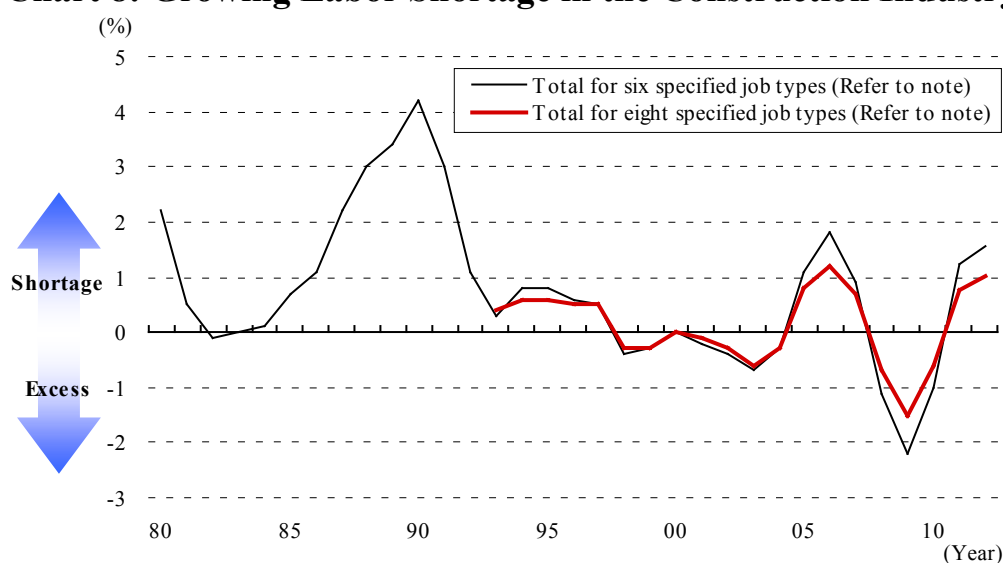
The biggest factor that may limit the effectiveness of government policy is that the implementation of public investment projects may not move according to schedule because of limitations on supply capacity in the construction industry. There is a growing feeling that skilled laborers, in particular, are in short supply in the construction industry (Chart 8). Among various regions, this shortage is especially pronounced in the regions devastated by the March 2011 earthquake, and, as a result, this has been an

obstacle for reconstruction and recovery.

Under these conditions, no matter how much the government adds to its backlog of public investments, it will be difficult to move forward with these projects as planned. Already, worker wages and prices of construction materials are on the rise, and implementing public works projects without cost overruns is becoming tough. With costs forecast to rise further, this situation may become even more difficult. These budgetary issues may result in further delays in carrying out public works projects as the number of bids is reduced. In addition, the number of housing starts is forecast to rise as households rush to place orders for construction before the increase in the consumption tax. Therefore, the government will be competing with the private sector for construction industry services, and this will be another factor that may be an obstacle to government projects.

Public works construction in the upcoming economic policies includes a wide range of activities, such as measures for recovery and disaster prevention, policies for rebuilding aging infrastructure, and infrastructure improvement projects. For these reasons, in those regions where there is some supply capacity available in the construction industry, there is a possibility that work may proceed rapidly. However, from a nationwide perspective, it may difficult for the government to obtain the desired positive benefits it is expecting.

Chart 8: Growing Labor Shortage in the Construction Industry



Note: The six specified job types include workers skilled in preparing forms for pouring concrete (in civil engineering and general construction projects), plasterers, workers engaging in erecting and working on scaffolding, and steel material handlers (in civil engineering and general construction). The eight specified job types include the previously mentioned six types plus electricians and plumbers.

Source: Ministry of Land, Infrastructure, Transport and Tourism

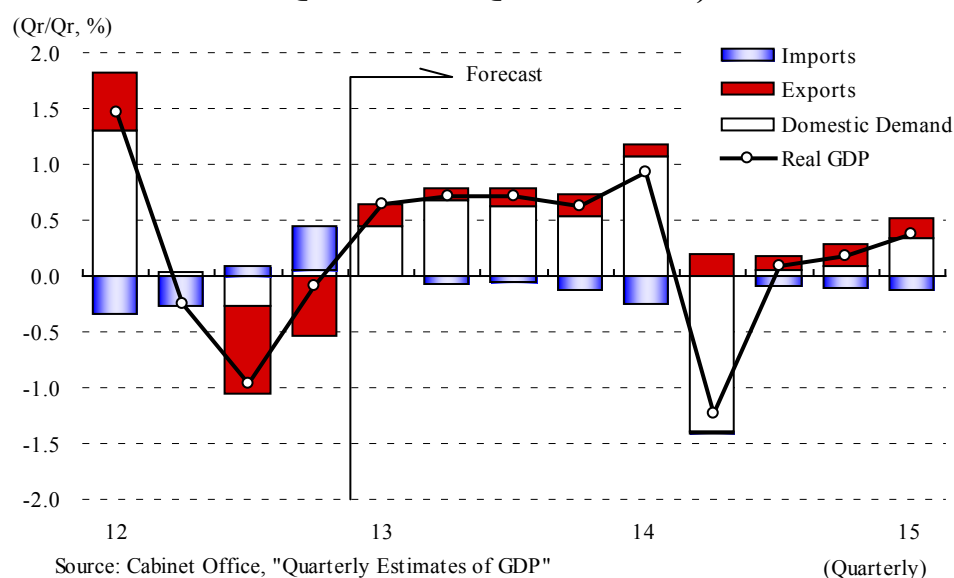
(4) Outlook for Fiscal 2013 and Fiscal 2014: As the Increase in the Consumption Tax Draws Attention, the Trend toward Improvement in the Economy Will Strengthen

We prepared this outlook based on the assumptions that the consumption tax will be increased, as scheduled, to 8% in April 2014. Regarding the government's Emergency Economic Policy for Revitalizing the Japanese Economy, which were approved by the Cabinet on January 11, 2013, we have assumed that these will be passed in their approved form. We have also assumed that serious electric power shortages will be averted by the construction of new thermal power plants, that efforts will be made to conserve electric power similar to those made in summer last year, and that there will be increases in corporations' in-house power generating capacity.

In fiscal 2012, the real GDP growth rate during the January-March period is forecast to move back to the positive range, and this will enable us to reconfirm that the economy reached bottom during mid-2012. As a result, real GDP growth for fiscal 2012 as a whole will rise to +0.9%, compared with +0.3% in fiscal 2011. However, this includes a relatively large carryover effect, but after the elimination of this effect, the actual year-on-year growth rate is expected to be negative, at -0.8%.

During the January-March quarter, corporate performance will improve, and the outlook is for the recovery in the corporate sector, which has been delayed, to proceed. In addition, robust increases in public investment are forecast to continue, and private consumption is expected to remain firm. Also, exports, which had been showing lackluster performance, will begin to rise again along with the recovery in overseas economies. The contribution of external demand to GDP growth is forecast to become positive for the first time in four quarters.

Chart 9: Contribution Rates to Real GDP Growth by Demand (on a Quarter-on-Quarter Basis)



GDP growth over the previous year in nominal terms is forecast to rise to +0.2%, compared with -1.4% in fiscal 2011. The GDP deflator is forecast to decline 0.7% in fiscal 2012 versus a drop of 1.7% in fiscal 2011, indicating that, while deflationary conditions are continuing, the margin of decline in the deflator on a quarter-to-quarter basis has shrunk from -0.9% at the beginning of the fiscal year to -0.5% in the January-March quarter.

In fiscal 2013, the trend toward recovery is forecast to gradually become more solid. Public investment will continue to make a positive contribution to GDP growth as the government implements its emergency economic policies, and recovery in exports will move forward as overseas economies show improvement. In addition, private demand is believed likely to remain firm. Also, around the end of the fiscal year, demand is expected to surge in anticipation of the rise in the consumption tax, and this will add further momentum to the recovery.

Private consumption is forecast to be on a rising trend. Factors contributing to this will be that the slump in automobile sales will run its course and expenditures for services show a firm rising trend as consumer confidence improves. However, since consumer prices will begin to rise gradually as improvement in the employment and income environment is delayed, the growth in consumption will remain relatively small. Toward fiscal year-end,

there is expected to be a surge in demand related to the upcoming rise in the consumption tax, and this is forecast to boost consumption, particularly for consumer durables. Private residential investment is forecast to be on a rising trend in advance of the increase in the consumption tax.

Corporate capital investment is forecast to return to a moderate rising trend. Although corporations will forego making aggressive investments, as their performance improves, they are expected to make investments for maintaining competitiveness as well as investment for the maintenance and replacement of existing equipment. This will be a factor supporting the economy.

Public investment will remain on an upward trend throughout the fiscal year as the government's economic policies are implemented. However, the rate of growth over the previous year will gradually become more moderate because public investment expenditures are already at a high level and because of the issue of labor shortages in the construction industry.

The trend toward recovery in exports is expected to strengthen gradually. Recovery will continue in the United States, and in China also the recovery trend will become more pronounced as a result of the effect of easing of monetary policy, the implementation of stimulatory economic policies, and other factors. Moreover, as a result of expansion in exports to the United States and China, European economies are expected to bottom out. In addition, there is a possibility that the yen will depreciate further and the export environment will show further improvement. However, there are believed to be limitations on how much yen depreciation can raise the unit volume of exports. Therefore, it is difficult to think of a scenario in which exports become a driving force for the Japanese economy.

Real GDP growth in fiscal 2013 is forecast to be +2.0%. The economy will continue on an upward trend, and, near the end of the fiscal year, a surge in demand, especially in private consumption, is anticipated. As a result, the economy is likely to continue to show relatively firm growth. Since recovery will remain in overseas economies, Japan's export growth is expected to rise, but, since imports will also increase, the contribution of the external sector will remain around -0.0 percentage point. After the exclusion of the carryover effect (of +0.2%), the rate of growth year on year will be +1.9%, which will be a faster pace than when the economy made a comeback in fiscal 2011 supported by demand for reconstruction

and recovery following the March 2011 earthquake. In addition, the nominal GDP growth rate is expected to rise to +1.6%. However, the GDP deflator is forecast to remain 0.4% below the previous fiscal year.

In fiscal 2014, because there will be a reactionary decline in demand, mainly in the household sector, following the surge that will precede the increase in the consumption tax, real GDP growth will drop sharply from the level of fiscal 2013, to +0.2%. In addition, the positive effects on the economy from public investment that will be felt in fiscal 2013 will run their course, thus pushing the growth rate downward. On the other hand, the corporate sector will continue on an improving trend, and expansion in overseas economies will also continue. Against this background, growth in exports will rise and provide support for the economy. As a consequence, the only quarter when the economy will show negative real GDP growth from quarter to quarter is forecast to be the April-June period. The outlook is for the economy to avoid moving into a downturn set off by the increase in the consumption tax.

The rate of GDP growth in nominal terms is forecast to be a high +1.4%. This growth will have been influenced by the increase in the consumption tax, and the GDP deflator will rise to 1.2% over the previous year.

Compared with developments in 1997, when the consumption tax was last increased, in the case of eco-friendly appliances, such as flat panel TVs, air conditioners, and refrigerators as well as automobiles, much demand has already been satisfied because of previous economic policies to stimulate purchases of these items. Therefore, there is a possibility the surge in demand, followed by a reactionary decline, may not be strong this time. However, some negative impact on household consumption behavior may be unavoidable because of the effects of rising prices and stagnant wages, which have reduced real disposable incomes. As a result, we are forecasting a 0.6% decline in private consumption in fiscal 2014. This will be the first year-to-year decline since fiscal 2008, six years ago.

Chart 10: Forecast of Real GDP Growth Rates (on a Year-on-Year Basis)

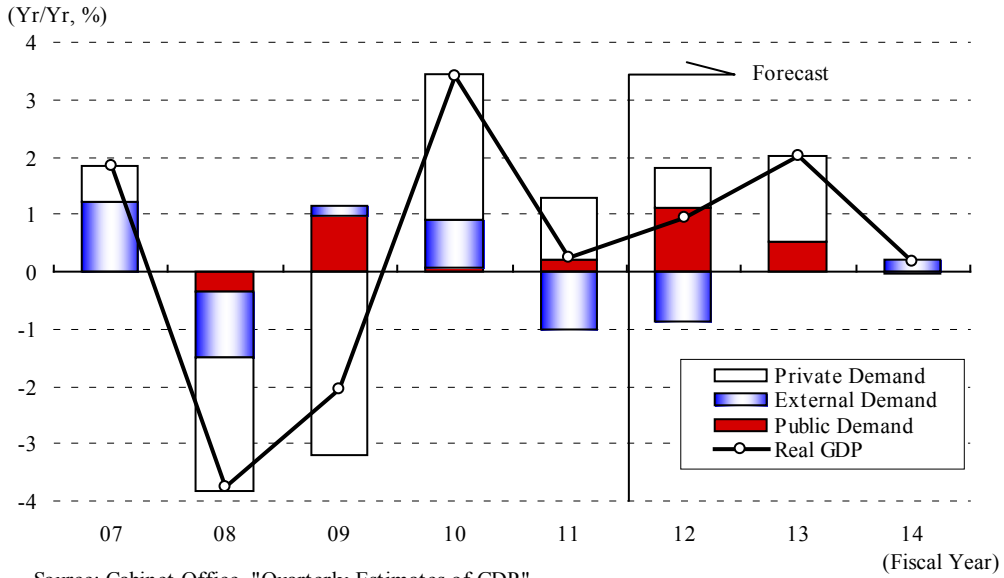


Chart 11: Forecast of Real GDP Growth Rates (on a Quarter-on-Quarter Basis)

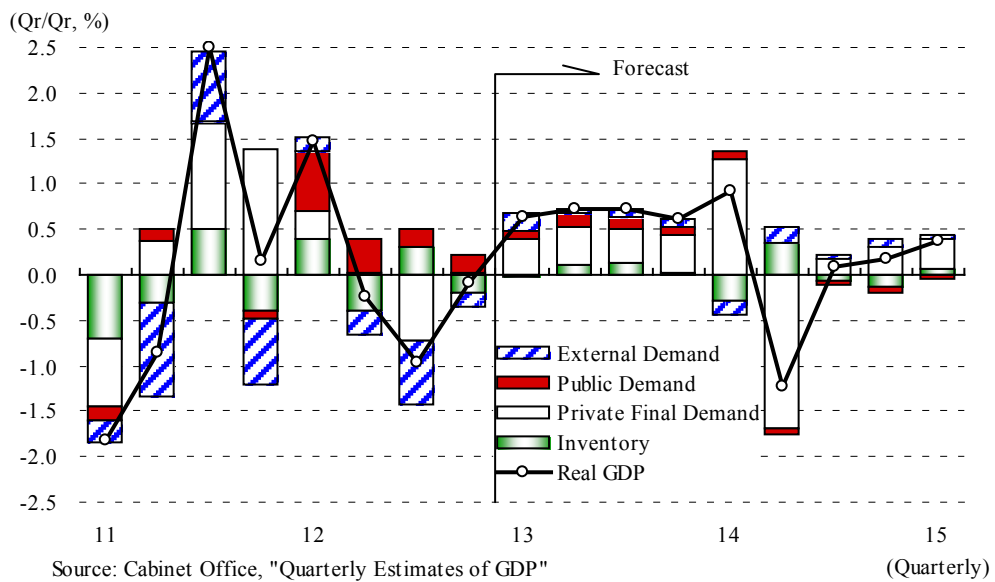
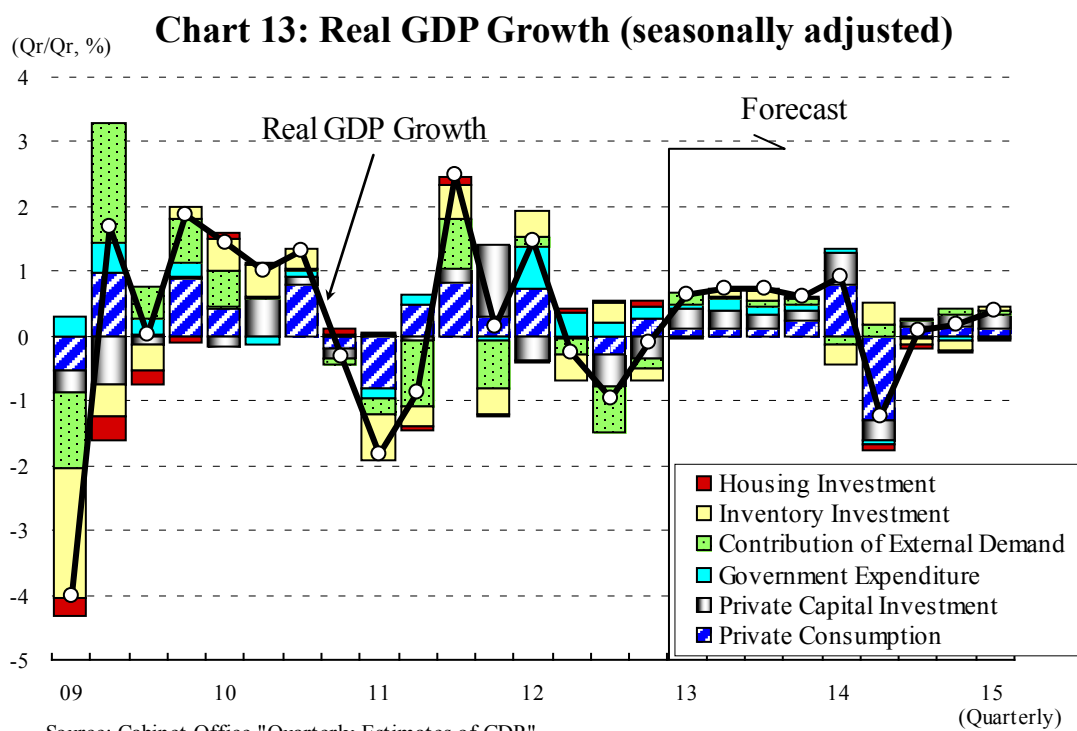


Chart 12: Real GDP Growth (Fiscal Year)

	Carry-over from the previous year (A)	Growth rate during the year (B)	Real GDP growth rate (A)+(B)
FY2011 (actual)	-1.2 %	1.5 %	0.3 %
FY2012 (forecast)	1.8 %	-0.8 %	0.9 %
FY2013 (forecast)	0.2 %	1.9 %	2.0 %
FY2014 (forecast)	1.1 %	-1.0 %	0.2 %

Source: Cabinet Office, "Quarterly Estimates of GDP"



2. Forecasts of Economic Activity by Sector

(1) Corporations

- Industrial production turned downward after the beginning of fiscal 2012 because of a slowdown in exports accompanying the slower growth in overseas economies and the cutbacks in production by automobile manufacturers owing to the expectation of lower sales after the exhaustion of funds for eco-car subsidies. Another factor leading to restraints on production was a piling up of inventories in materials industries because of the weakness in domestic and external demand. However, there is a strong possibility that industrial production had already hit bottom by mid-2012 and had begun to trend upward. Going forward, the economy is forecast to continue on an upward trend because of recovery in automobile production, the completion of inventory adjustments, improvement in exports along with recovery in overseas economies, and stronger demand for construction materials due to the effects of economic policies.
- Corporate performance, principally in manufacturing, deteriorated following the Great East Japan Earthquake and the sharp appreciation of the yen, and recurring income declined. During the first half of fiscal 2012, income stagnated along with the weakening of economic conditions, but, during the latter half, income is forecast to turn upward because of the improvement in the domestic and overseas economies and the weakening of the yen. However, since corporations will not be able to sufficiently pass on higher costs resulting from the weaker yen to their selling prices, profit ratios are forecast to decline. As a result, the margin of increase in income will be smaller in fiscal 2013.
- Since a certain minimum level of capital investment is required to maintain and replace the existing capital stock as well as to increase efficiency, this will provide support for private capital investment. However, as the trends toward demographic aging of the population and the decline in the birthrate remain unchanged, corporations are adopting a cautious stance toward making capital investments in Japan. This has brought a shift in corporate investment behavior toward investing in overseas production locations in the emerging and other countries

where demand is expected to increase. For this reason, although the yen has depreciated from previous high levels, a recovery of capital investment in Japan is not expected. Reflecting recovery in corporate performance, investment is forecast to trend upward, but the margin of increase will be relatively small.

(2) Households

- The trend toward improvement in labor conditions that began in summer 2012 has now paused. Moreover, since the latter half of the 1990s, per capita income has shown a continuing declining trend. At present, even though the economy has stopped declining, corporations are still continuing to hold the line on personnel costs, and there is a strong possibility that improvement in employment and household income conditions will be delayed.
- Private consumption continued to be firm. Looking ahead, the forecast is for moderate increases in consumption along with recovery in the domestic economy. Nevertheless, it is likely that there will be a surge in consumption prior to the increase in the consumption tax, followed by a reactionary decline in demand thereafter. As incomes continue to stagnate, consumer prices are expected to continue to show moderate increases, thus bringing an increase in the burden on households.
- On average, the number of housing starts is expected to continue to increase moderately. Going forward, although the increase in the consumption tax is likely to bring a surge in demand and boost the number of starts, there is a possibility that the expansion of tax relief on housing loans and other measures to decrease the burden on households may have a diluting effect. In addition, there are also concerns that supply constraints on labor, equipment, and other resources may tend to place downward pressure on the number of housing starts.

(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 aging, 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 for 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. To achieve full-scale recovery from the March 2011 earthquake, a third supplementary budget for disaster recovery was passed amounting to about ¥9.2 trillion (excluding the portion that was borrowed temporarily from the national pension fund and must be returned). Public investment began to increase after the beginning of 2012, mainly for recovery-related projects in the areas stricken by the earthquake.
- The Abe administration, which took office late in 2012, has announced that one of his principal policies to escape from deflation will be to pursue “a flexible public finance policy.” In the supplementary budget for fiscal 2012, the government will include a major increase in public investment for the purpose of preventing and moderating the effects of disasters. For this reason, public investment is expected to continue to rise in fiscal 2013. In 2014, the positive effects of these measures on the economy will run their course, and public investment is likely to begin to decline.

(4) Trends in Overseas Economies

- The world economy, which has decelerated thus far, is expected to pick up speed again. In the United States, a moderate recovery is continuing in the housing market. Europe has moved out of the worst phases of its crises, and the rate of growth in China is rising again.
- Going forward, the outlook is for moderate recovery in the world economy. In the United States, moderate recovery is expected to continue, and the growth rate in China is expected improve. Although the pace of recovery in Europe will be weak, the European Central Bank (ECB) and individual countries have made progress in responding to the crises, and the risk of a further downturn has diminished.
- Japan's exports (on a customs-clearance, volume basis) are forecast move onto a rising trend going forward as the pace of recovery in the world economy picks up. Japan's imports (on a customs-clearance, volume basis) are likely to trend upward along with the recovery in the domestic economy.
- Japan's trade balance (on an international balance of payments basis) in fiscal 2011 moved to a deficit position against the backdrop of sluggish exports and a rise in imports accompanying an increase in oil prices. In fiscal 2012, this deficit is forecast to increase. Going forward, the magnifying effect on import prices of the depreciation of the yen will bring further increases in the value of imports. Since this will be a major factor, the size of Japan's trade deficit will expand. The surplus in the income account is likely to continue to rise because of the increase in income from overseas direct investments and the effect of yen depreciation. The current account surplus is believed likely to shrink significantly in fiscal 2012, and thereafter increase moderately while remaining at a relatively low level.

3. Forecasts for Prices and Financial Markets

- Prices of raw materials, especially crude oil, have plateaued at a high level. 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 the prices of industrial and other products will persist over the medium term.

- Domestic corporate prices are beginning to show signs of the effects of rising inflationary pressures owing to the depreciation of the yen and increases in international commodity prices, even though the declining trend in prices of machinery and equipment remains unchanged. Consumers are continuing to search for low-priced bargains, and the downward pressures on prices paid by final consumers remain unchanged. However, upward pressure on prices is mounting steadily, principally prices of energy, including electric power and gasoline, and it is now certain these prices will rise above the levels of the previous year.
- 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 an economic 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, and, subsequently, additional measures were implemented to ease monetary policy. Then, in January 2013, a “2% inflation target” was introduced, and the Abe administration and the Bank of Japan (BOJ) issued a joint communique. For the time being, the BOJ 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 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 had appreciated substantially against a background of financial crises in Europe and additional monetary easing in the United States. Thereafter, there has been a sudden move toward a downward correction in the yen’s value based on the belief that the Abe administration may take dramatic measures to ease monetary conditions.

Chart 14: Outlook for Fiscal 2013-2014

	Forecast ↘						Yr/Yr, %
	FY2009 (actual)	FY2010 (actual)	FY2011 (actual)	FY2012 (forecast)	FY2013 (forecast)	FY2014 (forecast)	
Nominal GDP	-3.2	1.3	-1.4	0.2	1.6	1.4	
Real GDP	-2.0	3.4	0.3	0.9	2.0	0.2	
Contribution of domestic demand	-2.2	2.6	1.3	1.8	2.0	0.0	
Private consumption	1.2	1.7	1.5	1.4	1.1	-0.6	
Housing investment	-21.0	2.2	3.7	4.6	3.4	-4.0	
Private capital investment	-12.0	3.6	4.1	-1.4	4.5	2.6	
Contribution of inventory investment	-1.4	1.0	-0.5	-0.1	0.1	0.1	
Government expenditure	4.2	0.4	0.9	4.4	2.1	-0.1	
Public investment	11.5	-6.4	-2.3	13.9	4.6	-5.5	
Government final consumption expenditure	2.7	2.0	1.5	2.4	1.5	1.3	
Contribution of external demand	0.2	0.8	-1.0	-0.9	0.0	0.2	
Export of goods and services	-9.7	17.2	-1.6	-2.3	0.2	4.3	
Import of goods and services	-10.7	12.0	5.3	3.3	0.2	2.4	
GDP deflator	-1.2	-2.0	-1.7	-0.7	-0.4	1.2	

	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	4.1	4.2	5.3	
balance on goods (trillion yen)	6.6	6.5	-3.5	-6.7	-8.9	-8.4	
balance on service (trillion yen)	-1.8	-1.3	-1.8	-2.9	-2.6	-2.5	
balance on income (trillion yen)	12.6	12.6	14.0	15.0	17.0	17.5	
Industrial production	-8.8	9.3	-1.0	-2.5	2.8	1.0	
Unemployment rate(%)	5.2	5.0	4.5	4.3	4.1	3.9	
New housing starts(annualized, ten thousand units)	77.5	81.9	84.1	89.2	91.3	86.5	
Domestic corporate goods prices	-5.1	0.4	1.4	-0.9	2.5	2.9	
Consumer prices	-1.7	-0.4	-0.1	0.0	0.6	2.2	
excluding fresh food	-1.6	-0.8	0.0	-0.1	0.6	2.2	
Yen/U.S.Dollar	92.8	85.7	79.1	83.1	96.1	97.5	
Uncollateralized call rates (O/N) (%)*	0.102	0.091	0.077	0.082	0.080	0.080	
Newly issued government bond yields (10years) (%)	1.36	1.15	1.05	0.80	0.84	0.97	
WTI future price (near month contract, US dollar/barrel)	70.7	83.4	97.3	92.7	102.4	104.6	
Dubai crude oil prices (US dollar/barrel)	69.7	84.2	110.1	107.7	113.0	109.5	

* actual=average, forecast=end of period

Chart 15: Outlook for Calendar 2013-2014

	CY2009 (actual)	CY2010 (actual)	CY2011 (actual)	CY2012 (actual)	Forecast	
					CY2013 (forecast)	CY2014 (forecast)
	Yr/Yr, %					
Nominal GDP	-6.0	2.4	-2.4	1.1	0.6	2.0
Real GDP	-5.5	4.7	-0.6	1.9	1.1	1.1
Contribution of domestic demand	-4.0	2.9	0.3	2.8	1.3	1.0
Private consumption	-0.7	2.8	0.5	2.3	0.6	0.3
Housing investment	-16.6	-4.5	5.5	2.9	4.5	-1.8
Private capital investment	-14.3	0.3	3.3	1.7	0.9	4.6
Contribution of inventory investment	-1.5	1.0	-0.7	0.0	0.1	0.0
Government expenditure	3.0	1.6	-0.2	4.3	2.5	0.7
Public investment	7.0	0.7	-7.5	12.3	6.4	-1.6
Government final consumption expenditure	2.3	1.9	1.5	2.6	1.6	1.3
Contribution of external demand	-1.5	1.7	-0.9	-0.9	-0.2	0.1
Export of goods and services	-24.2	24.4	-0.4	-0.3	-2.6	4.2
Import of goods and services	-15.7	11.1	5.9	5.3	-0.9	2.8
GDP deflator	-0.5	-2.2	-1.9	-0.8	-0.5	0.8

	CY2009 (actual)	CY2010 (actual)	CY2011 (actual)	CY2012 (actual)	Forecast	
					CY2013 (forecast)	CY2014 (forecast)
	Yr/Yr, %					
Current account balance (trillion yen)	13.7	17.9	9.6	4.7	4.1	4.8
balance on goods (trillion yen)	4.0	8.0	-1.6	-5.8	-8.5	-8.9
balance on service (trillion yen)	-1.9	-1.4	-1.8	-2.6	-2.7	-2.5
balance on income (trillion yen)	12.8	12.4	14.0	14.3	16.5	17.4
Industrial production	-21.9	16.4	-2.3	-0.3	0.3	2.3
Unemployment rate (%)	4.2	5.1	4.6	4.3	4.2	4.0
New housing starts(annualized, ten thousand units)	78.8	81.3	83.4	88.3	91.0	88.3
Domestic corporate goods prices	-5.3	-0.1	1.5	-0.8	2.1	2.6
Consumer prices	-1.4	-0.7	-0.3	0.0	0.5	1.8
excluding freshfood	-1.3	-1.0	-0.2	-0.1	0.4	1.9
Yen/U.S.Dollar	93.5	87.8	79.8	79.8	95.1	97.1
Uncollateralized call rates (O/N) (%)*	0.105	0.094	0.078	0.083	0.080	0.080
Newly issued government bond yields (10years) (%)	1.34	1.17	1.12	0.85	0.81	0.94
WTI future price (near month contract, US dollar/barrel)	61.8	79.5	95.1	94.2	100.6	104.4
Dubai crude oil prices (US dollar/barrel)	61.8	78.0	106.2	109.1	112.8	110.0

* actual=average, forecast=end of period

Chart 16: Outlook for 2013-2014 (Quarterly)

	Forecast												Qr/Qr, %
	FY2012				FY2013				FY2014				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	-0.5	-1.1	-0.4	1.0	0.8	0.2	0.1	1.6	0.1	-0.1	-0.2	1.0	
	2.9	-0.4	-0.3	-1.1	0.2	1.5	1.9	2.9	2.0	1.6	1.3	0.7	
Real GDP	-0.2	-1.0	-0.1	0.6	0.7	0.7	0.6	0.9	-1.2	0.1	0.2	0.4	
	3.8	0.4	0.3	-0.6	0.3	2.1	2.6	3.1	1.1	0.5	-0.1	-0.6	
Contribution of domestic demand (Qr/Qr,%)	0.0	-0.3	0.1	0.5	0.7	0.6	0.5	1.1	-1.4	0.1	0.1	0.3	
Private consumption	0.0	-0.5	0.4	0.2	0.2	0.2	0.4	1.3	-2.1	0.2	0.2	0.2	
	3.1	1.3	1.1	0.1	0.3	1.0	1.0	2.2	-0.2	-0.2	-0.4	-1.5	
Housing investment	2.2	1.6	3.5	-0.5	0.4	0.9	1.2	0.0	-2.3	-2.0	-1.6	-1.0	
	4.6	1.4	5.6	6.9	5.1	4.4	2.0	2.5	-0.2	-3.1	-5.8	-6.7	
Private capital investment	-0.2	-3.6	-2.6	2.3	2.2	1.5	1.0	3.4	-2.3	0.6	1.5	1.6	
	7.3	1.5	-8.7	-4.2	-1.7	3.3	7.3	8.4	3.7	2.6	3.2	1.4	
Contribution of inventory investment (Qr/Qr,%)	-0.4	0.3	-0.2	0.0	0.1	0.1	0.0	-0.3	0.4	-0.1	-0.1	0.1	
Government expenditure	1.5	0.8	0.7	0.3	0.6	0.5	0.4	0.3	-0.2	-0.2	-0.3	-0.2	
	3.7	4.6	5.9	3.5	2.4	2.2	1.8	1.9	1.1	0.4	-0.6	-1.2	
Public investment	6.1	2.5	1.5	0.1	1.7	1.3	0.9	0.3	-2.3	-2.8	-2.3	-1.9	
	11.2	15.0	18.9	10.3	6.3	4.9	3.8	4.2	0.3	-3.7	-7.1	-9.1	
Government final consumption expenditure	0.4	0.4	0.6	0.4	0.3	0.3	0.3	0.4	0.3	0.4	0.3	0.3	
	2.6	2.6	2.9	1.8	1.7	1.6	1.3	1.3	1.3	1.3	1.3	1.2	
Contribution of external demand (Qr/Qr,%)	-0.3	-0.7	-0.2	0.2	0.0	0.1	0.1	-0.1	0.2	0.0	0.1	0.0	
Export of goods and services	0.0	-5.1	-3.7	1.4	0.7	1.1	1.5	0.7	1.2	0.8	1.2	1.1	
	9.2	-4.8	-5.7	-7.0	-7.2	-0.5	4.9	4.0	4.5	4.3	4.1	4.5	
Import of goods and services	1.7	-0.5	-2.3	0.0	0.4	0.4	0.7	1.4	0.1	0.5	0.6	0.7	
	9.1	5.1	0.7	-1.2	-2.6	-1.9	2.1	3.3	2.5	2.6	2.6	1.9	
GDP deflator (Yr/Yr,%)	-0.9	-0.8	-0.6	-0.5	-0.1	-0.5	-0.6	-0.2	0.9	1.1	1.4	1.4	

	Forecast												Yr/Yr, %
	FY2012				FY2013				FY2014				
	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)*	1.5	1.0	0.7	1.0	1.0	1.1	1.0	1.1	1.1	1.2	1.4	1.6	
balance on goods (trillion yen)*	-1.1	-1.7	-1.9	-2.0	-2.1	-2.2	-2.3	-2.4	-2.3	-2.2	-2.1	-1.9	
balance on service (trillion yen)*	-0.7	-0.8	-0.7	-0.7	-0.7	-0.7	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	
balance on income (trillion yen)*	3.6	3.7	3.7	3.9	4.1	4.3	4.2	4.3	4.3	4.4	4.4	4.5	
Industrial production (Qr/Qr, %)	-2.0	-4.2	-1.9	3.0	0.6	0.8	1.2	2.0	-2.5	0.6	1.0	0.8	
(Yr/Yr, %)	5.3	-4.6	-5.9	-4.2	-2.5	2.4	6.1	5.2	1.5	1.2	1.3	0.1	
Unemployment rate (%)*	4.4	4.2	4.2	4.2	4.2	4.2	4.1	4.1	4.0	4.0	3.9	3.9	
New housing starts(annualized, ten thousand units)	87.6	87.6	91.8	90.1	90.5	91.3	92.0	91.6	89.2	86.9	85.3	84.7	
Domestic corporate goods prices (Yr/Yr,%)	-0.9	-1.8	-0.8	0.3	2.1	3.2	3.0	1.5	3.0	3.0	2.9	2.8	
Consumer prices (Yr/Yr,%)	0.2	-0.4	-0.2	0.2	0.5	0.6	0.6	0.6	2.4	2.3	2.2	2.0	
excluding freshfood (Yr/Yr,%)	-0.1	-0.3	-0.1	0.1	0.5	0.6	0.6	0.5	2.3	2.3	2.1	1.9	
Yen/U.S.Dollar	80.2	78.6	81.2	92.5	95.3	96.0	96.5	96.5	96.8	97.3	97.7	98.1	
Uncollateralized call rates (O/N) (**)	0.078	0.085	0.084	0.080	0.080	0.080	0.080	0.080	0.080	0.080	0.080	0.080	
Newly issued government bond yields (10years) (%)	0.88	0.79	0.75	0.76	0.78	0.82	0.86	0.90	0.93	0.95	0.98	1.01	
WTI future price (near month contract, US dollar/barrel)	93.5	92.2	88.2	96.9	100.5	102.0	103.0	104.0	104.3	104.5	104.8	105.0	
Dubai crude oil prices (US dollar/barrel)	106.5	106.1	107.4	110.7	115.0	113.5	112.0	111.5	109.5	109.5	109.5	109.5	

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

- This report is based on information believed to be reliable, but we do not guarantee its accuracy.
- This report is intended only for information and should not be construed as solicitation to take any action such as purchasing/selling/investing financial market products. In taking any action, each reader is requested to act on the basis of his or her own judgment.
- Use of this report is limited to "reproduction for personal use" or "quotation" as stipulated in the Copyright Law. For such use, please explicitly cite this report as the source of the information or quotation.
- Any use that exceeds the scope of "reproduction for personal use" or "quotation" requires explicit permission for such use from us prior to its use.