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Forecast for the Japanese Economy in Fiscal 2014 and 2015

—Improvement in the Economy Will Continue Even after the Increase in the Consumption Tax Rate —

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1. Outlook for the Japanese Economy in Fiscal 2014 and Fiscal 2015 —Improvement in the Economy Will Continue Even after the Increase in the Consumption Tax Rate

(1) Current State of the Economy: Continuing Gradual Improvement

The real GDP growth rate for the October–December quarter of 2013, which was announced on March 17, 2014, was +0.3% compared with the previous quarter (+1.0% at an annualized rate), the fourth consecutive quarter of growth. This latest data enables us to confirm that the economy is still showing gradual improvement.

Growth in total private-sector demand strengthened to +0.8% over the previous quarter, suggesting that the surge in demand prior to the increase in the consumption tax rate is strengthening in some sectors. Private consumption rose 0.5% over the previous quarter, a slightly higher rate of increase than that during the July–September quarter. Because of the increase in the rate of expansion in the deflator, however, the margin of increase remained lower in comparison with the nominal rate of increase in consumption, which was +0.9% over the previous quarter. Although consumers are increasing their expenditures in nominal terms owing to improvement in consumer confidence and other factors, upward pressures on prices are growing, thus restraining the growth in real consumption. In addition, although worker compensation rose 0.7% in nominal terms as a result of a possible rise in winter bonuses above the level of the previous year and other factors, growth in real compensation was virtually level with the previous quarter and rose only +0.1%.

Housing investment expanded a firm +4.2% over the previous quarter. This increase was the seventh consecutive quarterly rise, and the rate of expansion is moving upward. New housing starts are currently rising, reflecting the low interest rates on housing loans and the surge in demand prior to the consumption tax hike, and this is pushing housing investment upward.

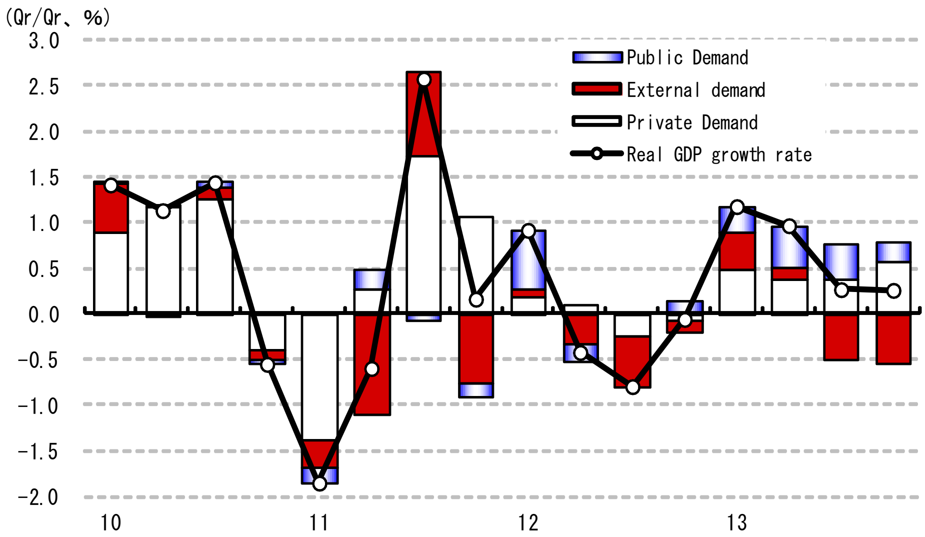
Corporate capital investment increased for the third consecutive quarter, and the rate of expansion rose to +1.3%. As corporate performance continues to be favorable, confidence within the corporate sector is rising, and the drive to invest is finally strengthening. Inventory investment posted a slight decline (making a contribution to GDP over the previous quarter that rounds off to –0.0%), reflecting the decrease in the inventory index.

The contribution of these private-sector demand components to growth in real GDP was +0.8 percentage point, the fourth consecutive quarter of positive contributions. This figure was also the largest contribution since the beginning of the current recovery phase. Also, overall public-sector demand contributed +0.9 percentage point to GDP growth, a figure that was somewhat lower than previously but was still relatively high. Public investment increased 2.3% over the previous quarter. This was slightly lower growth than previously, as budgetary allocations related to government economic policy were beginning to run their course, but this was still the eighth consecutive quarterly increase, and the total of these investments reached the level of the January–March period of 2006. Government final consumption expanded 0.5% for the quarter. As a consequence, the contribution of domestic demand was +0.8 percentage point over the previous quarter, thus boosting the economy as a whole.

On the other hand, the quarter-to-quarter contribution of external demand was negative for the second consecutive quarter and amounted to –0.5%, a rather large drop that was similar to the negative figure in the July–September quarter. Reflecting the weakening in the pace of recovery in overseas economies, Japan's exports rose only a marginal +0.4% over the previous quarter. On the other hand, imports showed a steady increase of 3.5% quarter to quarter. There is a possibility that import growth was boosted because of the surge in demand prior to the consumption tax hike.

The GDP growth rate in nominal terms was +0.4% (1.6% at an annualized rate), the fifth consecutive quarterly increase. In addition, the GDP deflator, which reflects overall price trends in the economy, was –0.4% below the same quarter of the previous fiscal year, about the same margin of decrease as in the July–September quarter. However, as a consequence of the weakening of the yen, the import price deflator rose sharply (by 13.8% over the year) thus having a depressing effect on the GDP, and reducing imports in real terms. In addition, the domestic deflator rose 0.5%, the second consecutive positive figure. Factors accounting for this included the fact that the deflators for the overall capital formation components of GDP—including housing investment, capital investment, and public investment—rose by a larger margin of 1.8% over the year. In addition, the rate of increase in the private consumption deflator is on a rising trend and climbed to +0.6% over the year. Therefore, the impact of higher prices of energy and construction materials, rising wages because of labor shortages in the construction industry, and higher import prices due to the depreciation in the value of the yen is gradually beginning to have effects on the overall price level.

Chart 1: Trends in Real GDP
(on a Quarter-on-Quarter Basis)



Source: Cabinet Office, *Quarterly Estimates of GDP*

(2) A Downturn Following the Consumption Tax Hike Will Be Avoidable, but the Risk of a Temporary Weakening Remains

During the January–March quarter, the surge in demand prior to the consumption tax hike is forecast to gain momentum. There is a strong possibility that the real GDP growth rate will increase significantly and rise to +2.2% for fiscal 2013 as a whole. While the contribution of the external sector will be –0.5 percentage point, the third consecutive negative contribution to GDP growth, the growth in domestic demand will contribute 2.7 percentage points, thus expanding to the highest level since fiscal 1996. After the exclusion of a carryover effect of +0.6 percentage point, the outlook for the rate of real growth calculated during the fiscal year will be +1.6%.

Among GDP components, growth in consumption will rise substantially as we approach the fiscal year-end, and consumer spending is expected to be a driving force for the economy. However, this increase in consumption will be largely due to the surge in demand prior to the consumption tax hike, and the boosting effect coming from rising expectations about the future directions of the economy appears to be weakening. Forecasts call especially for purchases of large durable goods and new housing construction together to become more active as we approach the end of the fiscal year, and this surge in demand will eat into future demand.

The number of housing starts is expected to peak out, but the rising trend in housing investment will continue to the end of the fiscal year.

In the corporate sector, companies, especially large-scale manufacturing enterprises, are reporting steady improvement in performance, and this trend is expected to continue through fiscal 2013. These gains in performance among manufacturing companies has mainly been due to the rise in their export prices caused by the depreciation of the yen. In the nonmanufacturing sector, positive benefits are coming from the increase in demand owing to the expanding activity in the manufacturing sector and growth in consumption. In the latter half of fiscal 2013, the surge in demand prior to the consumption tax hike is expected to have a further positive impact on corporate profitability. As a consequence, there is a strong possibility that in fiscal 2013 ordinary income will rise to set new records.

Along with this improvement in corporate performance, the outlook is for continued increases in capital investment. Orders for machinery and equipment (private-sector orders, excluding shipping and electric power), which are a leading indicator for capital investment, are showing firm increases. If these orders are carried over into fiscal 2014, this is likely to be a factor that may soften the slump in demand that is forecast immediately following the hike in the consumption tax rate.

Public investment may not be sustainable at recent high levels because of budgetary constraints and the shortage of labor in the construction industry. In comparison with the previous quarter, the positive effects of public investment may diminish, and, during fiscal 2014, they may fall below the levels of the previous quarter.

Moreover, since improvement in exports may be delayed on the one hand and, on the other hand, imports may continue to show a strong rising trend along with expansion in domestic demand, there is a strong possibility that the contribution of the external sector may continue to be negative.

One of the causes for concern about the economy following the hike in the consumption tax will be conditions in overseas economies and trends in Japan’s exports. Among these, an important point will be the extent of the disturbance in the financial markets of emerging countries caused by the tapering of U.S. monetary policy. At present, financial markets have settled down for the time being, and the possibility of unsettled conditions in emerging countries causing a slump in Japan’s exports seems to be low. However, if the currencies of these countries begin to depreciate again, and this causes disturbances in world financial markets, there are concerns that this could lead to a slump in Japan’s exports as conditions in overseas economies weaken and the yen appreciates.

Another cause for concern is that upward pressures on prices may rise.

However, since the markets for crude oil and other international commodities are stable, and foreign currency rates are fluctuating within a narrow range, the upward pressure on domestic corporate prices is gradually subsiding. For this reason, the rate of increase in domestic corporate prices, although continuing to be relatively high, is peaking out. Nevertheless, these upstream price pressures are permeating downstream with a time lag, and the consumer price index (CPI) (excluding fresh food, comprehensive index, nationwide) in December was +1.2% above the same month of the previous year, which was the highest rate of increase since October 2008. Certain items in the CPI, such as rents, are continuing to decline, but increases in the CPI are spreading and include energy-related goods and services, such as electricity, city gas, and gasoline; consumer goods, including those with a high import component, such as apparel; electric appliances; and PCs; as well as other items, such as package tours and restaurant meals. As households cling firmly to their preferences for lower-priced goods, it is difficult for companies to fully pass the increases in their input costs onto the prices of final goods. If the impact of the consumption tax hike is excluded, the rate of increase in the CPI is forecast to peak out during fiscal 2014. However, if inflationary pressures rise more than currently expected, there are concerns that this combined with the impact of the higher consumption tax could become a major factor restraining household consumption.

Note that recently the GDP deflator has been below the level of the same period of the previous year, but it is scheduled to move into the positive range in the January–March quarter of 2014.

(3) Outlook for Fiscal 2014 and Fiscal 2015: A Downturn Can Be Avoided with the Underlying Support of Exports

We have prepared this outlook based on the assumption that the consumption tax rate will be increased, as scheduled, to 10% in October 2015. We have also assumed that the government will implement economic measures amounting to a total of ¥5.5 trillion under the supplementary budget for fiscal 2013 and forecast that these government expenditures will provide underlying support for the economy in fiscal 2014. Please note that, although agreements under the Trans-Pacific Partnership (TPP) negotiations may be reached in the near future, we think that these will have only a slight effect on the economy during the forecast period. We also think that serious electric power shortages will continue to be averted going forward. Regarding the 2020 Tokyo Summer Olympics, we believe that the effects will be limited in the short term to pushing stock prices upward in the short term and improving consumer confidence. The effects on the economy during the forecast period will be marginal.

In fiscal 2014, the effects of the rise in the consumption tax will be apparent mainly in the household sector, and the outlook is for growth in real GDP to remain at a marginal +0.5% over the previous fiscal year. Although a downturn in the economy will be avoided due to the support provided by external demand, because of weak growth in domestic demand, after the exclusion of a carryover effect of +0.8%, the rate of real growth in fiscal 2014, calculated during the fiscal year, is forecast to be –0.3%.

A sudden decline in personal consumption from the previous quarter during the April–June period, in reaction to the surge in demand, will be unavoidable. Sales of eco-friendly electric appliances, such as flat-panel TVs, air conditioners, and refrigerators, as well as automobiles increased temporarily due to the series of economic measures taken after the collapse of Lehman Brothers. Also, sales of air conditioners have been rising steadily because of the effects of the unseasonably hot weather during the summer of 2013. This series of developments was joined by the surge in demand before the rise in the consumption tax, and there is a possibility that this combination of events may have a considerable restraining impact on future demand. However, since there are limitations on how much demand for services and non-durable goods can be brought forward, it appears that increases over the previous quarter will begin during the July–September period, but, thereafter, the pace of the rise in sales is expected to be more moderate. This is because, in an economic environment where wages are not increasing, real disposable income is being forced downward by price increases, and this will unavoidably have a negative effect on consumer spending behavior. Worker compensation in real terms is expected to decline 1.4% from the previous fiscal year due to the rise in the consumption tax, and this will be the first time in five years, since 2009, for this indicator to decline.

Consumer spending, which had been increasing up to fiscal 2013 as households raised their propensity to consume, is forecast to decline 1.0% from the previous fiscal year in fiscal 2014. This will be the first time in six years, since 2008, for consumption growth to be negative.

Corporate capital investment is forecast to continue on a moderate rising trend as corporate performance improves. Companies will continue to restrain aggressive investments in expansion of capacity, but will make investments in the maintenance and renewal of facilities to maintain their competitiveness, and these investments are expected to provide underlying support for the economy. However, the pace of improvement in corporate performance is expected to weaken significantly because companies will likely experience a temporary slump in sales after the increase in the consumption tax, and the boost to exports coming from the weaker yen is expected to run its course. On the other hand, the cost burden on companies will rise because of the cheaper yen, and the improvement in profit margins will gradually approach a ceiling.

Maintaining public investment at recent high levels will be difficult because of budgetary restraints, shortages of labor in the construction industry, and other factors. After the beginning of fiscal 2014, the rate of expansion over the previous quarter is expected to become negative, and, even taking into consideration the positive impact of total economic measures amounting to about ¥5.5 trillion in the supplementary budget for fiscal 2013, this cannot be expected to boost the growth rate significantly. However, there is a possibility that the implementation of these budgetary allocations has not yet boosted public investment due to the delay in construction and other factors. Accordingly, the pace of decline is thought likely to be moderate.

On the other hand, as economic conditions in countries overseas bottom out and improve, the recovery in the pace of growth in exports will be a factor supporting the economy. In manufacturing, since exports can make up for the weakness of domestic demand, there is a possibility that a movement to increase the unit volume of exports by lowering export prices may emerge. For imports, on the other hand, the rate of increase is expected to remain moderate, even after a temporary slump, because of the weakness in domestic demand after the increase in the consumption tax. Since the growth in demand for LNG and other energy sources, which has boosted imports thus far, will run its course, the pace of increase in import volumes going forward will be in line with the rate of increase in domestic demand for electric power.

Turning next to the contributions of domestic and overseas demand, the contribution of domestic demand is expected to be virtually flat, rising only about 0.1% year on year, but the contribution of overseas demand will rise to +0.3%. Therefore, overseas demand will cover for the slump in the household sector after the consumption tax hike and stagnation in the corporate sector.

As a consequence of the underlying support provided by overseas demand, the forecast is for the quarter-to-quarter real GDP growth rate to become negative only in the April–June quarter of 2014. Therefore, it is expected that the economy will avoid slipping into a recession because of the increase in the consumption tax. However, a sharp weakening in the pace of recovery in comparison with fiscal 2013 will be unavoidable, and, in the event that the stagnation in consumer spending is prolonged and economic conditions in overseas economies deteriorate, causing a slump in Japan's exports, the risk of entering a downturn will emerge.

Please note that the rate of growth in nominal GDP will continue to be positive and will rise to +2.0%. However, this figure will reflect the inflating effect of the hike in the consumption tax, and the GDP deflator will rise +1.5% year on year.

Taking account of these movements in the economy, although the index of industrial production will continue to recover, the pace of improvement is expected to remain moderate. The outlook is for an increase of 1.6% in fiscal 2014, compared with an increase of 3.3% in fiscal 2013. Moreover, although the moderate improvement in the employment situation will continue, annual increases in base wages will be confined to a portion of companies reporting robust performances because companies in general will continue to restrain personnel costs. Overall growth in wages is, therefore, forecast to remain marginal.

Under these circumstances, upward pressures on prices are unlikely to gain momentum. The CPI (excluding fresh food) is forecast to rise 2.7% over the previous fiscal year, but when the effects of the consumption tax hike are excluded, the CPI will rise only 0.7%. Upstream inflationary pressures are expected to weaken as international commodity prices, including the price of crude oil, begin to decline and the weakening of the yen runs its course. The timing for this will be as we approach the deadline for reaching the Bank of Japan's inflation target, and it seems likely that upward pressures on prices will still be moderate.

In fiscal 2015, it is assumed that the consumption tax will be increased to 10% in October 2015. A surge in demand will occur prior to the increase and the reactionary decline in demand thereafter, but because this will occur during the fiscal year, on average, the negative impact will be small in comparison with fiscal 2014. Personal consumption will continue to rise, by +0.4% for the fiscal year as a whole, because of increases in the first half of the fiscal year, but there is a possibility of a substantial slump in the second half of the fiscal year. As real wages remain below the previous year's levels, consumer spending is forecast to continue to be weak.

Although the improving trend in corporate performance will continue, in the midst of a further increase in the consumption tax, it will lack robustness. For this reason, the drive among corporations to make capital investments will not rise, and there is a possibility that companies will continue to restrain new investments to the minimum level deemed necessary.

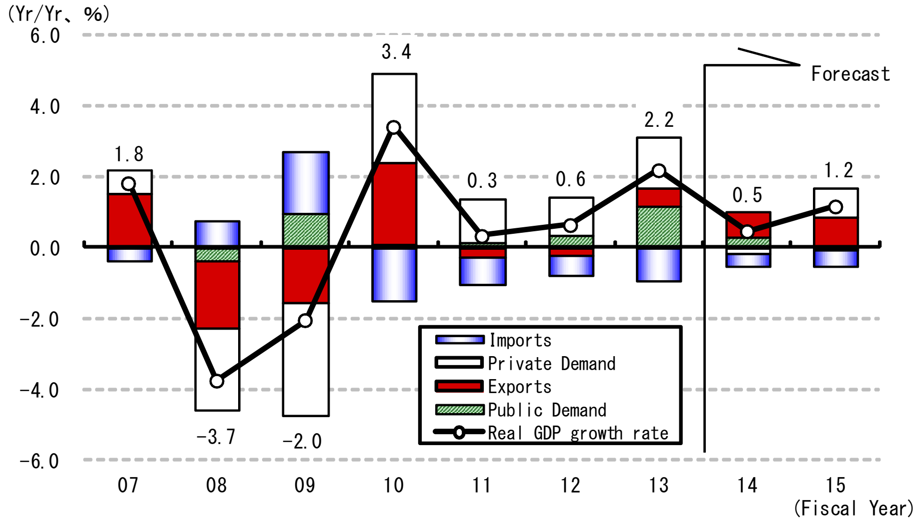
The highest expectations for providing support for the economy during fiscal 2015 are being placed on exports. It is believed likely that the recovery trend in overseas economies will continue and that competitiveness of Japan's exports will gradually strengthen as the weaker yen takes hold. On the other hand, however, since growth in imports will be moderate, reflecting the weakness of domestic demand, the contribution of overseas demand will continue to be positive, standing at 0.4 percentage point.

Public investment is expected to fall below the previous year's levels by a significant margin as the effectiveness of government economic policies diminishes. However, although not expected at present, there is a possibility that the government will implement further economic policies along with the October 2015 increase in the consumption tax, and these will reduce the margin of decline in public investment.

We are forecasting real GDP growth of +1.2% year on year in fiscal 2015. During the first half of the fiscal year, the economy will show improvement along with the surge in demand, but, in the second half, the outlook is for a reactionary decline. The economy will be supported by external demand, but, if the growth in exports is weak, concerns about a possible downturn in the economy may emerge. After the exclusion of a carryover effect of

+0.9%, the rate of real growth calculated during the fiscal year will slow to +0.3%. However, considering the likely condition of the economy around December 2014, when the decision on the consumption tax hike in 2015 will be made, we cannot rule out the possibility that the tax increase may be delayed.

Chart 2: Forecast of Real GDP Growth Rates (on a Year-on-Year Basis)



Source: Cabinet Office, *Quarterly Estimates of GDP*

Chart 3: Real GDP Growth (Fiscal Year)

	Carry-over from the previous year (A)	Growth rate during the year (B)	Real GDP growth rate (A)+(B)
FY2012 (actual)	1.4 %	-0.7 %	0.6 %
FY2013 (forecast)	0.6 %	1.6 %	2.2 %
FY2014 (forecast)	0.8 %	-0.3 %	0.5 %
FY2015 (forecast)	0.9 %	0.3 %	1.2 %

Source: Cabinet Office, "Quarterly Estimates of GDP"

2. Forecasts of Economic Activity by Sector

(1) Corporations

- Production bottomed out in autumn 2012 and began recovering against the backdrop of improvement in domestic and overseas demand. Growth in export shipments is weak, but shipments to the domestic market are holding strong because of the increase in production to meet the surge in domestic demand in advance of the hike in the consumption tax rate and other factors, and are acting as a driving force for the economy. A reactionary decline in demand is forecast following the increase in the consumption tax rate, but exports are expected to remain firm, and the robustness of exports will prevent a sharp drop in production. However, since manufacturing corporations are expected to continue to move their production facilities overseas, the pace of improvement in production is likely to continue to be moderate.
- Corporate performance, principally in the manufacturing sector, is continuing to post gains as a result of the improvement in economic conditions and the increase in sales owing to the depreciation of the yen. In fiscal 2013, the outlook is for the margins of increase in corporate profitability to rise, as the surge in demand prior to the consumption tax rate increase joins with other positive factors. However, in fiscal 2014 and fiscal 2015, the margins of increase in profits are forecast to shrink, as sales decline temporarily following the consumption tax rate hike, and higher costs will bring a deterioration in profitability.
- 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 the 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 projected. There is a strong possibility that the rising trend in capital investment will continue for the time being, against a background of improvement in corporate performance, but the outlook is for the pace of increase to continue to be moderate as a strong drive to invest is not likely to emerge.

(2) Households

- The employment situation is continuing to improve as evidenced by the decline in the unemployment ratio and the rise in the job opening to application ratio. In some industries, the balance between labor supply and demand is becoming tighter, especially in the market for temporary workers. On the other hand, in part because of structural factors—namely, the expansion in the number of temporary workers—scheduled worker compensation continues to stagnate, and the income environment remains challenging. When the consumption tax rate is raised, companies are not expected to raise wages to compensate for the higher taxes; therefore, real wages are forecast to show a significant decline.
- In part because the surge in demand prior to the increase in the consumption tax rate has begun in earnest, robust consumer spending is continuing. During the January–March quarter of 2014, consumption is expected to gather further momentum, but the reactionary decline during the April–June quarter, which will follow the consumption tax hike, cannot be avoided. Subsequently, amid a projected decline in real income, growth in consumption is likely to be restrained to a gradual pace.
- At present, the number of housing starts is running in excess of one million units annually, supported by low housing loan interest rates and the additional push provided by the surge in demand prior to the consumption tax rate hike. Also, because the tight supply and demand balance for workers and materials is causing a rise in wages and construction materials, construction costs are rising. Going forward, the level of new housing starts is expected to

gradually approach a ceiling. A major drop in housing starts is seen as likely along with the reactionary decline in demand following the consumption tax increase, but a major downturn should be averted through the expansion of tax breaks on housing loans and other measures to lighten the burden of housing construction costs.

(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 as well as a marked rise in the balance of government debt outstanding. Moreover, social welfare expenditures have continued to rise against the backdrop of demographic aging, and the fact that the government has been unable to secure stable funding for those welfare costs is one factor behind the rising fiscal deficits. The dual objectives of realizing fiscal soundness and making the social welfare system stable have become major concerns for the Japanese economy.
- To address these issues, Prime Minister Shinzo Abe made the decision to increase the consumption tax rate to 8% in April 2014, based on a reform law that was passed in August 2012 to deal with both social welfare and taxation policies comprehensively. The increase in revenues from this source is to be used to fund social security. Going forward, the government will give due consideration to economic trends and decide whether or not to make a further increase in the consumption tax to 10%, as scheduled, in October 2015.
- To provide for reconstruction and recovery in the aftermath of the March 2011 earthquake, the government has passed and implemented supplementary budgets for disaster recovery, and these are bringing continued increases in public investment, especially in the areas directly impacted by the earthquake. In addition, the administration of Prime Minister Abe has announced

that one of its principal policy objectives is to eliminate deflation and revive the economy, and that one of his three main policies to accomplish this is to pursue "a flexible public finance policy." Under the supplementary budget for fiscal 2012, the government implemented economic measures amounting to more than ¥10 trillion and has increased expenditures related to public investment substantially. The results of these measures are emerging in fiscal 2013, and public investment has been boosted significantly. Moreover, the government is scheduled to implement economic measures amounting to about ¥5.5 trillion under a supplementary budget for fiscal 2013 with the objective of dealing with the risks of a downturn and other contingencies that may accompany the increase in the consumption tax rate.

- As a consequence of the implementation of government economic measures for two consecutive years, government expenditures (on a GDP basis) will likely rise as the economy moves into fiscal 2014. Although government final consumption will continue to rise in fiscal 2015, since public investment will start to decrease, total government expenditures are expected to remain virtually level.

(4) Trends in Overseas Economies

- The world economy, especially the industrialized countries, is experiencing moderate growth. In the United States, as economic expansion continues, the Federal Reserve Board (FRB) began the step-by-step phasing down (tapering) of its quantitative monetary easing policy (QE3) in January 2014. The European economies are showing gradual improvement, but, on the other hand, among the emerging countries, while the Chinese economy is continuing to grow at full cruising speed, some countries have begun to suffer from currency instability as a result of the FRB's tapering policy.
- Going forward, the outlook is for moderate growth in the world economy. The U.S. economy is expected to continue a moderate recovery, driven mainly by the private sector, while still experiencing uncertainties related to fiscal and monetary policies. In Europe, as domestic demand remains relatively weak,

improvements will be limited to gradual recovery led by exports. In China, although dealing with excessive production capacity will continue to be a bottleneck, the economy is expected to sustain firm economic growth in the upper half of the 7%-to-7.9% range.

- Japan’s exports (on a customs-clearance, volume basis) are forecast to maintain a trend of increase going forward as the world economy shows moderate expansion. Japan’s imports (on a customs-clearance, volume basis) are expected to trend upward along with the recovery in the domestic economy, despite the possibility of a temporary downturn accompanying the increase of the consumption tax rate.
- Japan’s trade balance (on an international balance of payments basis) moved to a deficit position in fiscal 2011. At present, as a result of the large deficit in Japan’s trade balance, the current account balance is showing a small deficit. However, going forward, the income balance will continue to cover the trade deficit, and the current account balance is expected to move into the black during 2014.

3. Forecasts for Prices and Financial Markets

- The slowing of the Chinese economy has put the brakes on the one-way increase in raw materials prices, but these prices, especially crude oil, have topped out at high levels. While demand in emerging economies is increasing gradually, the shale gas revolution and other developments are expected to increase resource supplies, and resource prices are expected to remain in a generally stable range.
- The margins of increase in domestic corporate prices, as well as consumer prices, are expanding because of the influence of increases in energy prices caused by the decline in the value of the yen. However, there has been a hiatus in the trend toward an increase in international commodity market prices, and, since the decline in the value of the yen has also stopped, upward pressures on prices are weakening. Although the margins of increase in

prices are expected to expand temporarily because of the increase in the consumption tax rate, after the exclusion of this factor, the rates of increase in prices are expected to be small. Consumers are continuing to search for low-priced bargains, and conditions will continue that will make it difficult for companies to raise prices easily.

- Since 2008, Japan has moved ahead with measures to ease monetary policy. In October 2010, a comprehensive policy for monetary easing was implemented, and, subsequently, additional measures were implemented to ease monetary policy. Then, in January 2013, a “2% inflation target” was adopted, and the Abe administration and the BOJ issued a joint communique with the title, “Joint Statement of the Government and Bank of Japan on Overcoming Deflation and Achieving Sustainable Economic Growth.” In April, the BOJ made the decision to implement a policy of “quantitative and qualitative monetary easing.” For the foreseeable future, 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 low, stable short-term rates. However, there is a possibility that the recovery in overseas economies and deterioration in government fiscal structures around the world may place upward pressure on long-term interest rates. In foreign exchange markets, beginning in 2010, the yen appreciated substantially against a background of financial crises in Europe and additional monetary easing in the United States. Thereafter, following the advent of the administration of Prime Minister Abe, dramatic measures to ease monetary conditions have been adopted, and there has been a downward correction in the value of the yen.

Chart 4: Outlook for Fiscal 2014-2015

Forecast

Yr/Yr、%

	FY2010 (actual)	FY2011 (actual)	FY2012 (actual)	FY2013 (forecast)	FY2014 (forecast)	FY2015 (forecast)
Nominal GDP	1.3	-1.4	-0.2	1.9	2.0	1.6
Real GDP	3.4	0.3	0.6	2.2	0.5	1.2
Contribution of domestic demand	2.6	1.4	1.4	2.7	0.1	0.7
Private consumption	1.6	1.4	1.5	2.2	-1.0	0.4
Housing investment	2.2	3.2	5.3	9.3	-1.2	1.1
Private capital investment	3.8	4.8	0.7	1.2	2.9	3.3
Contribution of inventory investment	1.0	-0.3	-0.1	-0.3	0.1	0.0
Government expenditure	0.3	0.5	1.4	4.8	1.2	-0.2
Public investment	-6.4	-3.2	1.3	16.9	-0.3	-7.2
Government final consumption expenditure	2.0	1.2	1.5	2.1	1.6	1.6
Contribution of external demand	0.8	-1.0	-0.8	-0.5	0.3	0.4
Export of goods and services	17.2	-1.6	-1.2	3.3	4.3	5.3
Import of goods and services	12.0	5.3	3.7	5.5	1.9	2.3
GDP deflator	-2.0	-1.7	-0.9	-0.2	1.5	0.4

Forecast

Yr/Yr、%

	FY2010 (actual)	FY2011 (actual)	FY2012 (actual)	FY2013 (forecast)	FY2014 (forecast)	FY2015 (forecast)
Current account balance (trillion yen)	16.7	7.6	4.4	1.5	3.3	5.8
balance on goods (trillion yen)	6.5	-3.5	-6.9	-12.4	-11.2	-9.2
balance on service (trillion yen)	-1.3	-1.8	-2.5	-1.6	-1.6	-1.4
balance on income (trillion yen)	12.6	14.0	14.7	16.8	17.3	17.7
Industrial production	15.4	-0.6	-3.1	3.4	1.6	3.3
Unemployment rate(%)	5.0	4.5	4.3	4.0	4.0	3.8
New housing starts(annualized, ten thousand units)	77.5	81.9	89.3	100.6	89.9	87.7
Domestic corporate goods prices	0.4	1.4	-1.1	1.9	3.4	0.8
Consumer prices	-0.4	-0.1	-0.3	0.9	2.8	1.0
excluding freshfood	-0.8	0.0	-0.2	0.8	2.7	0.9
Yen/U.S.Dollar	85.7	79.1	83.1	100.2	103.0	104.6
Uncollateralized call rates (O/N) (%)*	0.091	0.077	0.082	0.072	0.070	0.070
Newly issued government bond yields (10years) (%)	1.15	1.05	0.78	0.69	0.75	0.92
WTI future price (near month contract, US dollar/barrel)	83.4	97.3	92.1	98.8	95.4	92.6
Dubai crude oil prices (US dollar/barrel)	84.2	110.1	107.1	104.6	102.5	98.6

* actual=average, forecast=end of period

Chart 5: Outlook for Calendar 2014-2015

Forecast

Yr/Yr、%

	CY2010 (actual)	CY2011 (actual)	CY2012 (actual)	CY2013 (actual)	CY2014 (forecast)	CY2015 (forecast)
Nominal GDP	2.4	-2.3	0.5	1.0	2.2	1.9
Real GDP	4.7	-0.5	1.4	1.6	1.0	1.3
Contribution of domestic demand	2.9	0.4	2.3	1.9	1.2	0.6
Private consumption	2.8	0.3	2.0	2.0	0.0	0.2
Housing investment	-4.5	5.1	2.9	8.9	2.9	-0.1
Private capital investment	0.3	4.1	3.7	-1.4	3.9	3.4
Contribution of inventory investment	1.0	-0.4	0.1	-0.3	0.0	0.1
Government expenditure	1.6	-0.5	1.9	3.7	2.4	-0.1
Public investment	0.7	-8.2	2.8	11.4	5.9	-6.4
Government final consumption expenditure	1.9	1.2	1.7	2.1	1.6	1.6
Contribution of external demand	1.7	-0.9	-0.9	-0.3	-0.3	0.7
Export of goods and services	24.4	-0.4	-0.1	1.6	3.4	6.0
Import of goods and services	11.1	5.9	5.3	3.4	4.2	1.7
GDP deflator	-2.2	-1.9	-0.9	-0.6	1.2	0.6

Forecast

Yr/Yr、%

	CY2010 (actual)	CY2011 (actual)	CY2012 (actual)	CY2013 (actual)	CY2014 (forecast)	CY2015 (forecast)
Current account balance (trillion yen)	17.9	9.6	4.8	3.3	1.4	5.3
balance on goods (trillion yen)	8.0	-1.6	-5.8	-10.6	-12.7	-9.5
balance on service (trillion yen)	-1.4	-1.8	-2.5	-1.6	-1.7	-1.5
balance on income (trillion yen)	12.4	14.0	14.3	16.5	17.1	17.6
Industrial production	15.6	-2.8	0.6	-0.8	4.1	2.5
Unemployment rate (%)	5.1	4.6	4.4	4.0	4.0	3.8
New housing starts(annualized, ten thousand units)	81.3	83.4	88.3	97.8	93.0	89.1
Domestic corporate goods prices	-0.1	1.5	-0.9	1.3	3.2	1.0
Consumer prices	-0.7	-0.3	0.0	0.4	2.5	1.2
excluding freshfood	-1.0	-0.2	-0.1	0.4	2.4	1.2
Yen/U.S.Dollar	87.8	79.8	79.8	97.6	102.8	104.3
Uncollateralized call rates (O/N) (%)*	0.093	0.078	0.083	0.075	0.070	0.070
Newly issued government bond yields (10years) (%)	1.17	1.12	0.85	0.71	0.70	0.88
WTI future price (near month contract, US dollar/barrel)	79.5	95.1	94.2	98.0	96.3	93.1
Dubai crude oil prices (US dollar/barrel)	78.0	106.2	109.1	105.5	103.5	99.2

* actual=average, forecast=end of period

Chart 6: Outlook for 2014-2015 (Quarterly)

Forecast

Qr/Qr、%
Yr/Yr、%

	FY2013				FY2014				FY2015			
	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	1.0	0.2	0.4	1.0	0.3	0.2	0.9	0.6	0.3	0.3	0.2	0.0
	0.6	1.9	2.4	2.8	1.7	1.8	2.3	2.1	2.1	2.2	1.3	0.7
Real GDP	1.0	0.3	0.3	0.8	-1.0	0.3	0.6	0.5	0.5	0.4	-0.8	0.1
	1.2	2.3	2.7	2.5	0.1	0.4	0.8	0.6	2.0	2.1	0.5	0.1
Contribution of domestic demand (Qr/Qr,%)	0.8	0.8	0.8	1.0	-1.6	0.2	0.4	0.4	0.5	0.5	-1.2	0.0
Private consumption	0.6	0.2	0.5	1.0	-2.5	0.4	0.2	0.2	0.4	0.8	-1.8	0.0
	1.7	2.2	2.4	2.3	-0.8	-0.6	-0.9	-1.7	1.2	1.6	-0.5	-0.6
Housing investment	0.9	3.3	4.2	2.4	-4.1	-1.9	-0.7	1.1	1.4	1.2	-1.5	-1.8
	6.9	8.6	10.5	11.2	5.7	0.4	-4.3	-5.6	-0.1	3.0	2.2	-0.7
Private capital investment	1.1	0.2	1.3	3.0	-1.6	0.9	1.0	1.7	0.6	1.4	-1.1	0.8
	-2.6	-0.8	1.8	5.6	2.9	3.5	3.4	2.0	4.4	4.8	2.7	1.7
Contribution of inventory investment (Qr/Qr,%)	-0.2	0.1	0.0	-0.1	0.3	-0.2	0.1	0.0	0.1	-0.2	0.1	-0.1
Government expenditure	1.8	1.6	0.9	0.2	0.2	0.2	0.0	-0.1	-0.2	-0.1	0.1	0.2
	3.3	4.9	5.8	4.9	2.6	1.6	0.6	0.2	0.3	-0.2	-0.5	-0.3
Public investment	6.9	7.2	2.3	0.2	-0.9	-0.5	-1.5	-1.8	-2.4	-2.2	-1.7	-0.9
	8.1	19.0	20.9	17.2	8.9	1.3	-2.5	-4.6	-6.0	-7.6	-7.8	-7.0
Government final consumption expenditure	0.6	0.2	0.5	0.3	0.5	0.4	0.4	0.4	0.4	0.3	0.4	0.4
	2.5	2.2	2.1	1.7	1.5	1.7	1.6	1.6	1.6	1.5	1.6	1.6
Contribution of external demand (Qr/Qr,%)	0.1	-0.5	-0.5	-0.2	0.6	0.2	0.3	0.2	0.1	-0.1	0.3	0.0
Export of goods and services	2.9	-0.7	0.4	0.4	0.8	2.3	2.0	1.6	1.0	0.8	1.2	1.2
	0.0	3.2	6.9	3.1	0.7	4.1	5.5	6.8	6.7	5.5	4.8	4.2
Import of goods and services	1.8	2.4	3.5	1.2	-2.4	1.1	0.4	0.6	0.6	1.2	-0.5	0.9
	0.8	3.2	9.1	8.8	5.0	3.4	0.2	-0.6	2.7	2.7	1.8	2.1
GDP deflator (Yr/Yr,%)	-0.5	-0.4	-0.4	0.3	1.6	1.4	1.5	1.5	-1.1	-0.7	-0.7	-1.0

Forecast

Yr/Yr、%

	FY2013				FY2014				FY2015			
	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)*	2.2	0.6	-0.3	-1.0	0.7	0.5	1.2	0.9	1.3	1.2	1.8	1.5
balance on goods (trillion yen)*	-1.9	-2.9	-3.4	-4.3	-2.9	-3.1	-2.4	-2.7	-2.4	-2.5	-2.0	-2.3
balance on service (trillion yen)*	-0.2	-0.4	-0.6	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.3	-0.3
balance on income (trillion yen)*	4.6	4.1	4.0	4.1	4.3	4.3	4.3	4.4	4.4	4.4	4.5	4.5
Industrial production (Qr/Qr、%)	1.5	1.7	1.9	4.0	-3.5	0.5	1.0	0.8	1.2	2.3	-2.0	0.3
(Yr/Yr、%)	-3.1	2.3	5.8	8.6	4.0	2.2	2.3	-1.6	3.5	5.4	2.3	1.6
Unemployment rate (%)*	4.0	4.0	3.9	3.9	4.0	4.0	3.9	3.9	3.8	3.7	3.8	3.9
New housing starts(annualized, ten thousand units)	98.0	99.0	104.1	101.4	93.1	89.1	88.5	89.2	91.3	89.4	86.6	83.5
Domestic corporate goods prices (Yr/Yr,%)	0.7	2.2	2.5	2.2	4.2	3.6	3.0	2.7	-0.1	-0.2	1.8	1.9
Consumer prices (Yr/Yr,%)	-0.2	0.9	1.4	1.6	3.1	2.9	2.6	2.6	0.3	0.3	1.6	1.6
excluding freshfood (Yr/Yr,%)	0.0	0.7	1.1	1.2	3.0	2.9	2.6	2.5	0.3	0.3	1.6	1.6
Yen/U.S.Dollar	98.7	98.9	100.4	102.8	102.3	102.7	103.3	103.8	104.1	104.4	104.7	105.0
Uncollateralized call rates (O/N) (%)**	0.073	0.073	0.072	0.070	0.070	0.070	0.070	0.070	0.070	0.070	0.070	0.070
Newly issued government bond yields (10years) (%)	0.73	0.77	0.64	0.63	0.65	0.73	0.79	0.83	0.86	0.90	0.94	0.97
WTI future price (near month contract, US dollar/barrel)	94.2	105.8	97.5	97.6	96.8	95.8	95.0	94.3	93.5	92.8	92.0	92.0
Dubai crude oil prices (US dollar/barrel)	100.8	106.2	106.8	104.8	104.3	103.1	101.9	100.7	99.5	98.8	98.0	98.0

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