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Forecast for the Japanese Economy in Fiscal 2015 and 2016

— Even if the Economy Continues to Improve,
the Pace of Recovery Will Be Moderate—

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1. Outlook for the Japanese Economy in Fiscal 2015 and Fiscal 2016

—Even if the Economy Continues to Improve,
the Pace of Recovery Will Be Moderate—

(1) Current State of the Economy: First Positive Growth in Three Quarters, but Economy Lacks Robustness

The real GDP growth rate for the October-December period of 2014, which was announced on February 16, was +0.6% compared with the previous quarter (+2.2% at an annualized rate), the first positive growth in three quarters. However, growth in private-sector demand was marginal, suggesting that even after the economy has begun to improve, the momentum of recovery lacks strength.

Private consumption, following growth of +0.3% over the previous quarter in the July-September period, expanded +0.3% in the October-December quarter, for the second consecutive quarterly rise; however, the pace of growth remained weak. The effects of the reactionary decline in consumer spending that followed the increase in Japan's consumption tax rate are diminishing, and purchases of consumer durables were up 0.7% for the October-December quarter, the third consecutive positive quarter-to-quarter growth figure. Nevertheless, this rebound is weak, and consumer spending was virtually level with the previous quarter. Growth in consumption of services advanced +0.5% for the quarter, the first positive figure in three quarters, but the level remained low. Additionally, growth in semi-durables (–0.4%) and non-durable goods (+0.1%) was also lackluster. The fact that real worker compensation only expanded a weak 0.1% for the quarter, suggests that low growth in worker compensation is continuing to act as a restraint on real consumer spending. Private residential investment remained in the reactionary slump that followed the rise in the consumption tax rate and decreased 1.2% from the previous quarter, the third consecutive quarterly drop.

In the corporate sector, private capital investment rose for the first time in three quarters, but with expansion of only 0.1%, it remained virtually level with the previous quarter. Corporate performance is improving, especially among large companies, and corporations are thought to have ample cash flows, but the attitude among companies toward capital investment remains cautious. Also, in part because the contribution of inventory investment to the real GDP growth rate dropped suddenly in the July-September quarter, the contribution in the October-December period rebounded to +0.2 percentage point, thus contributing to GDP growth. Adjustments in inventories are proceeding, but the speed of adjustment has weakened.

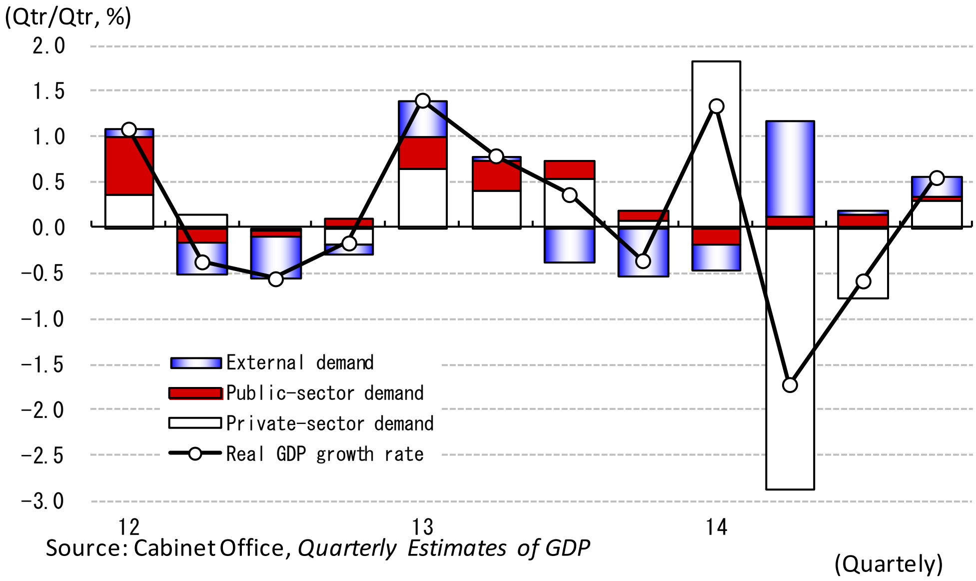
The contribution of private-sector demand to GDP growth was +0.3 percentage point over the previous quarter, the first positive figure since the January-March quarter when demand swelled prior to the rise in the consumption tax rate. However, the contribution of the rise in inventories was only +0.2 percentage point, showing that the pace of improvement is extremely slow. In addition, the contribution of the public sector was a very small +0.0 percentage point and did not have much boosting effect on growth in the economy. Since the positive effects of economic policies in fiscal 2013 are running their course, the contribution of public investment remained at a low +0.6 percentage point, and the contribution of government consumption declined year on year, to a low +0.1 percentage point. As these data suggest, movement in both the private and public sectors are weak, and, for this reason, the contribution of domestic demand to GDP growth was a small +0.3 percentage point.

Exports expanded 2.7% over the previous quarter, reflecting the continued improvement in economic conditions overseas and the taking hold of the weaker values of the yen. For these reasons, reflecting the weakness in domestic demand, quarter-to-quarter growth in real imports was only 1.3%, below the rate of growth in exports. Due to this and other factors, the contribution of external demand to GDP was +0.2%, the third consecutive quarterly positive figure, and the margin of increase was larger than in the previous quarter.

The GDP growth rate in nominal terms was +1.1% over the previous quarter (+4.5% at an annualized rate), the first positive figures in two quarters. The GDP deflator, which reflects the overall price trends in the economy, was 2.3% above the previous year, a relatively high level due to the effects of the increase in the consumption tax, and was 0.5% higher than in the previous quarter.

The growth rate of real GDP during the October-December quarter suggests that the economy has moved out of the worst phases of the downturn and begun to improve. However, the pace of recovery is only moderate. Although the forecast is for continued positive quarter-to-quarter growth going forward, whether the pace of improvement will increase will depend largely on recovery in private-sector demand, including consumption and private capital investment. In this sense, the behavior of corporations will hold the key to faster recovery. In other words, since corporate performance is staging a smooth recovery, especially among large companies, a key point for economic trends will be whether the benefits of this improvement in corporate performance are reflected in rising employment and wages, which will benefit households. Another key point will be whether corporations use their ample cash flows for capital investment in the domestic market. Moreover, making judgments about trends in real household incomes will depend on major factors that include the outcome of labor's spring wage offensive, the extent to which the decrease in crude oil prices will lower the price level, and the impact of the cheaper yen in pushing prices upward.

Chart 1: Trends in Real GDP



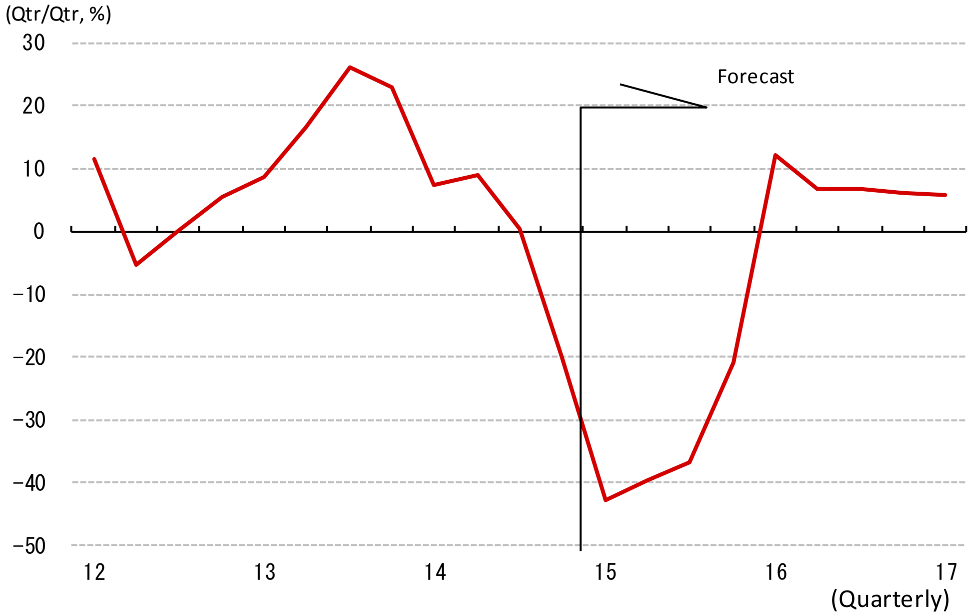
Source: Cabinet Office, *Quarterly Estimates of GDP*

(2) What Conditions Will Be Needed for Steady Improvement?

For the time being, positive factors for the economy will be the effects of the decline in crude oil prices and the increase in wages against a background of the tightening of the supply and demand balance for labor.

Looking at the influence of declining crude oil prices first, since the value of the yen has declined, there will be a tug of war between higher prices of imports and lower prices of crude oil. Since the decline in oil prices is greater than the decline in the value of the yen, at the present time, in yen terms, the price of crude oil has dropped substantially, and, during 2015, this is forecast to have a lowering effect on prices (Chart 2). Moving into 2016, as the price of crude oil begins to rise moderately, this will combine with the lower values of the yen to push prices upward, and the outlook is for crude oil prices in yen terms to rise over the previous year.

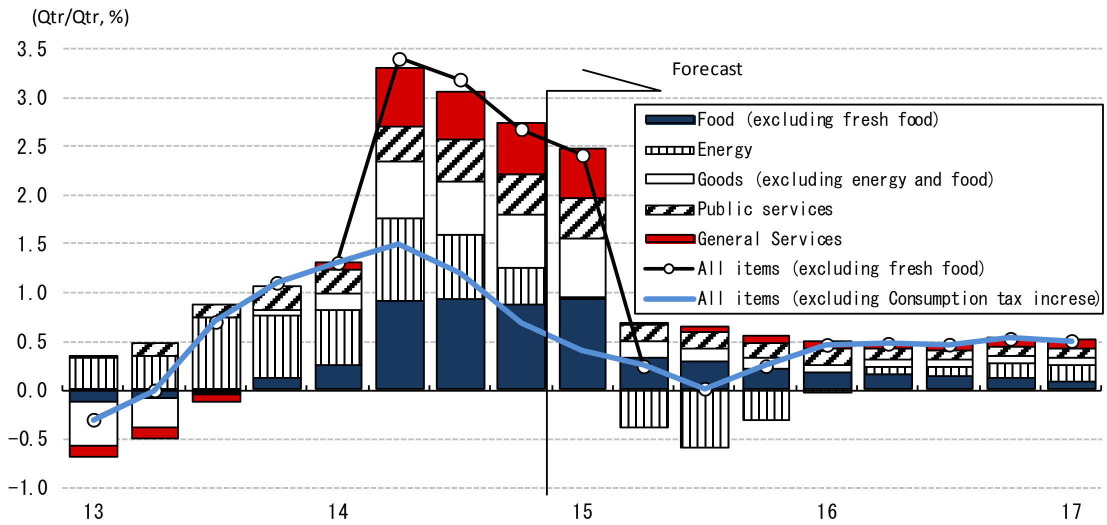
Chart2: Forecast of Yen-based Crude Oil Price(Dubai)



Source: Nihon Keizai shimbun

The rate of increase in the consumer price index (CPI) (comprehensive, excluding fresh food) at present is diminishing along with the marked decline in the rate of increase in energy prices, and it stood at +2.5% in December compared with the same month of the previous year. If the effects of the increase in the consumption tax rate are excluded, the actual rate of increase in the CPI is +0.5% (Chart 3). Entering fiscal 2015, the impact of the tax rate hike will run its course and gasoline as well as other energy prices are forecast to begin to fall below the level of the same period of the previous year, and these factors may temporarily lower the rate of increase in prices. In addition, before summer begins, the month-to-month pace of increase may become negative temporarily.

Chart3: Forecast of Consumer Price Index

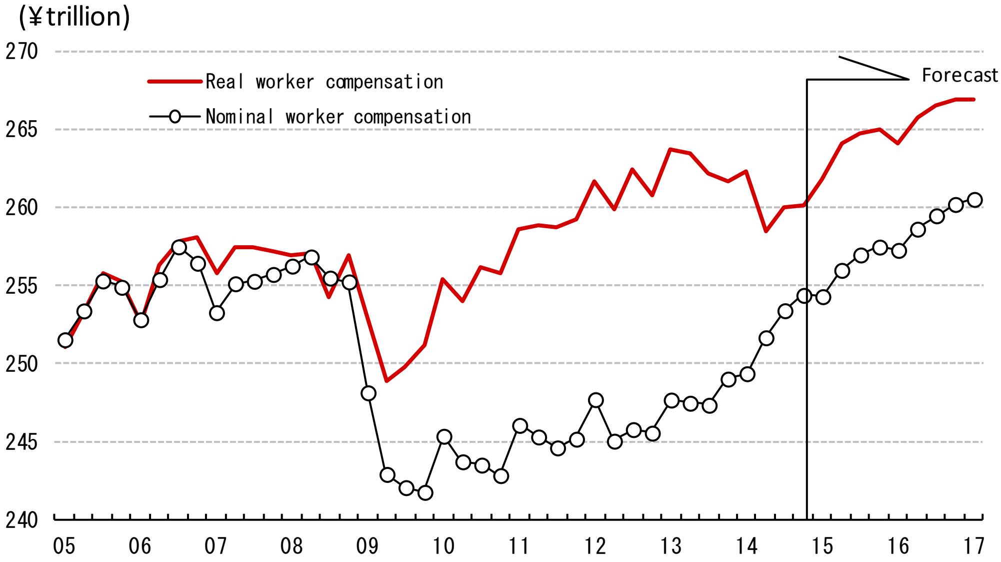


Source Ministry of Internal Affairs and Communications「monthly report Consumer Price Index」 (Quarterly)

Since this decline in the rate of price increases will be contrary to the aims of the Bank of Japan (BOJ) quantitative and qualitative easing policies, and the economy will recede from the goal of eliminating Japan's deflationary mind-set, this will be an unfavorable factor for the economy. However, lower rates of increase in price levels, which will raise real incomes, may contribute to pushing consumer spending upward.

Wages in nominal terms fell sharply after the collapse of Lehman Brothers Holdings, and employment conditions were improving gradually thereafter, but, as labor market conditions have subsequently tightened, wages began to rise again in fiscal 2014 (Chart 4). However, as a result of price increases, wages in real terms moved to a downward trend in 2013, and the downtrend accelerated in 2014.

Chart 4: Trends in Worker Compensation



Note: Figures are mid-month averages.
Source: Cabinet Office, *Quarterly Estimates of GDP*

From fiscal 2015 onward, the outlook is for this trend to change. In other words, nominal wages will continue to rise at about the current pace, but prices will continue to be stable, and the forecast will be for an increasing trend in wages. This is expected to be a factor pushing consumer spending higher.

In addition, the decline in crude oil prices will lower the cost of sales and have a positive effect on corporations, other than those in the oil distribution and trading company industries. Among various industries, transportation, chemicals, and certain other sectors that have a high dependency on oil are expected to show a major improvement in performance. In addition, through reductions in electric power costs, the costs in many industries will decrease, and the purchasing power of households will increase. For this reason, if the money saved because of lower energy costs is redirected by households to consumption, then retailing and service industries, which are domestically centered industries, will benefit indirectly.

If corporate performance improves, it will be easier for corporations to raise wages and increase hiring. Similarly, as corporate performance improves, cash flows will rise, thus providing leeway for capital investment.

In this outlook, we are forecasting that corporations will not change their cautious stance regarding the future directions in the economy and will remain concerned about increasing their fixed costs by raising wages and expanding employment. In addition, corporations are also worried about having excess capacity that might emerge if they make more-aggressive capital investments. As a result, our outlook is that corporations will not accelerate the rate of increase in wages nor their capital investments. However, if corporations become bolder and more forward-looking, and a desire emerges among them to make the effective use of their cash flows, the actual outcomes in the economy may be more positive.

(3) Outlook for the Japanese Economy in Fiscal 2015 and Fiscal 2016: Even if the Economy Continues to Improve, the Pace of Recovery Will Be Moderate

We have prepared this outlook based on the assumption at the present time that, after postponing the increase in the consumption tax rate to 10% to April 2017, the government will not take any further economic measures in preparation for the next consumption tax rise.

In fiscal 2014, we are forecasting that the trend toward improvement in the economy will continue through the end of the current fiscal year. In part because the effects of the reactionary decline will run their course, personal consumption will continue to improve gradually and private capital investment, which has been stagnant, will begin to rise. In addition, reflecting the recovery in overseas economies, we are forecasting that exports will continue on a rising trend. However, since the slump in the first half of the fiscal year was steep, the outlook for real growth in GDP for fiscal 2014 as a whole will be –0.9% compared with the previous year, the first negative figure in five years since fiscal 2009. After the exclusion of a carryover effect of +0.9%, the rate of growth in fiscal 2014 is forecast to be a substantial decline of 1.8%.

As a result of the tightening of supply and demand in labor markets, total worker compensation in nominal terms will remain on a rising trend as the number of workers increases and as per capita wages increase. For fiscal 2014, nominal worker compensation is expected to rise 1.9% over the previous year. Notwithstanding this, the outlook for worker compensation in real terms in fiscal 2014 is to decline 1.1% because of the substantial increases in prices as a result of the increase in the consumption tax. This will be the first decline in this indicator in five years, since fiscal 2009.

In fiscal 2015, the economy will continue to show gradual improvement throughout the fiscal year, and growth in real GDP is expected to return to the positive range, rising to +1.4% over the previous fiscal year. Although the recovery will be lacking in robustness, in part because of the adverse effects of the consumption tax rate hike will run their course, the outlook is for real GDP growth to rise to +0.9%, after the exclusion of a carryover effect of +0.5%. Note that GDP growth in nominal terms will continue at a relatively high level of +2.8%, but this will be because the increase in the GDP deflator will remain at a high 1.4%. The rate of increase in the deflator will be due to the upward pressure exerted by the decline in import prices. On the other hand, the rise in the deflator for domestic demand will remain at a low +0.3%.

The major factors accounting for improvement in the economy will be lower crude oil prices and increases in wages. Lower oil prices will bring reductions in costs and, thereby, increase the real purchasing power of households and contribute to boosting corporate performance. In addition, since the tightening of the supply and demand balance for labor will continue, wages will rise and create conditions conducive to expanding the number of workers. For this reason, and in part because of the subsiding of price increases, we expect that real incomes will rise and give a boost to consumption. However, since corporations will maintain a cautious stance toward increasing fixed costs, this will probably not bring about a virtuous circle in the economy under which the increase in demand accompanying the rise in wages will make positive contributions to corporate performance, leading in turn to further increases in wages.

During labor's spring wage offensive in 2015, increases in base wages of about the same level as in the previous year are expected. Also, reflecting the improvement in corporate performance, summer and winter bonuses are believed likely to rise over the previous year. For this reason, the combination of the increase in the size of the workforce and higher per capita wages is expected to bring an increase of 1.3% in nominal worker compensation for the fiscal year. Moreover, the effects of the consumption tax increase will run their course, and it is expected that the rate of increase in the CPI will diminish markedly along with the decline in energy prices. For these reasons, real worker compensation in fiscal 2015 will likely begin to rise and grow 1.1% year on year.

In addition to these factors that are pushing incomes up in real terms, the reactionary slump that followed the increase in the consumption tax rate is running its course, and it is expected that improvement in consumer spending will continue. However, there is a possibility that this recovery will only be moderate. Thus far, as incomes have stagnated, there have been movements toward adjustments to increase consumer spending. This is expected to continue during the fiscal year because the margin of increase in real consumption will not be at the same level as the margin of increase in real incomes. The propensity to consume is already at a high level, and households will most likely be cautious about increasing the pace of their consumption. In addition, while the increases in wages and bonuses will continue, this will be mainly true of large corporations, and will not spread widely and become a general trend among corporations as a whole, including small to medium-sized enterprises (SMEs), and this will account for the absence of an overall increase. Consumer spending in real terms is forecast to rise 1.6%, which will represent a major expansion compared to the decline of 3.1% in fiscal 2014; however, this will largely be the result of a reactionary rebound from the previous year. After exclusion of a carryover effect, the rate of expansion for the fiscal year as a whole will be level with the previous year.

Corporate performance is forecast to show continuing improvement. In addition to the positive trends in demand conditions in Japan and overseas, on the one hand, the cheaper yen will boost sales of exporting companies, while, on the other hand, since prices of resources, including crude oil, will remain stable at relatively low levels, this will offset the demerits of yen depreciation, and the improvement in Japan's terms of trade will continue. For this reason, it is likely that profit ratios will move toward improvement. The outlook for ordinary income in fiscal 2015, principally in the manufacturing sector, is for a major rise of 10.9%.

As a result of these developments, the rising trend in corporate capital investment will continue, and the year-on-year growth will reach +3.4%. There is a possibility that corporations will refrain from aggressive capital investments, such as adding new production capacity, and restrain their investments to a bare minimum. However, with ample cash on hand, companies may resume investments that they have postponed, make investments to maintain their competitiveness, invest in the maintenance and replacement of facilities, and make further investments in IT systems. These investments will be a factor providing support for the economy. In addition, expectations are that investments of these kinds will spread to other industries.

Public investment is believed likely to remain on a declining trend since the impact of expenditures under the supplementary budget for fiscal 2014 will become marginal. Due to delays in construction and other factors, the implementation of budgeted allocations will not provide a boost to public investment, and, for this reason, while there is a possibility that this may make the pace of decline more moderate, over fiscal 2015 as a whole, the outlook is for a decline of 4.0% in public investment, the first negative figure in four years.

Exports will likely remain on an upward trend during fiscal 2015. Overseas economies will continue on a recovery trend, and the settling down of the yen at lower levels is expected to lead to recovery of the competitiveness of Japanese exporting companies.

However, it will be difficult to alter the course of structural changes, such as the shifting of production centers to other countries, in a short period, and the pace of increase will be moderate. The movements seen among some manufacturing companies to relocate production facilities in Japan again to avert increases in costs of imports remain small in scale and will probably not portend a major resumption of exports from Japan. On the other hand, reflecting the moderate improvement in domestic demand, and since the rate of increase in imports is lower than the rate of increase in exports, the contribution of the external sector in fiscal 2015 is forecast to be +0.1%, the second consecutive positive contribution on an annual basis. Imports of energy fuels, including LNG, which have boosted the overall level of imports, have already run their course, and, going forward, the growth in the volume of imports will be more in line with domestic electric power demand.

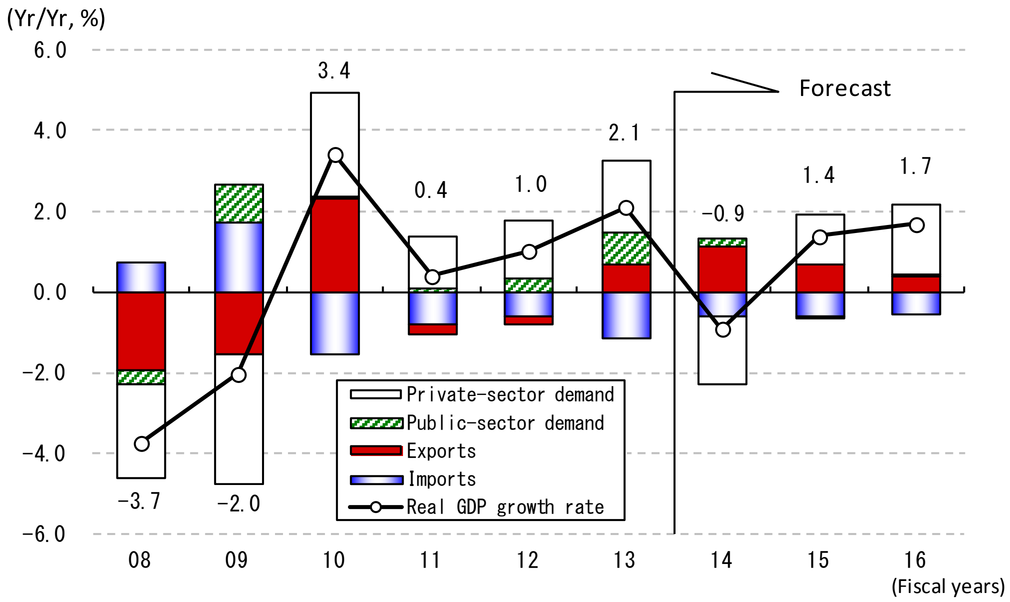
In view of these various developments, the rising trend in the index of industrial production is also expected to continue. For the fiscal year as a whole, the change in the index will move from –0.7% in fiscal 2014 to +2.1% in fiscal 2015.

The rate of change in the CPI (excluding fresh food) in fiscal 2015 is forecast to be +0.2% year on year, which will represent a substantial decline from the +2.9% year on year in fiscal 2014. The impact of the consumption tax hike on the CPI will gradually diminish, and, together with the drop in energy prices caused by lower crude oil prices, these factors will tend to push prices downward. There is even a possibility that the CPI may drop below the levels of the same period of the previous year just before summer begins. However, the increase in personnel costs will be a factor pushing the prices of services upward, and, since the lower values of the yen are putting upward pressure on prices of other imports, toward the end of fiscal 2015, the effects of the decline in crude oil prices may run their course. For this reason, there will be few concerns about the possible return of deflationary conditions, and the CPI will not settle down at levels below the previous year.

In fiscal 2016, the economy will continue on an improving trend, and the outlook is for real GDP growth of +1.7% over the previous year, somewhat higher than in fiscal 2015. The moderate trend toward improvement will continue, but during the latter half of fiscal 2016, behavior of the household sector is likely to be influenced by the next increase in the consumption tax rate, which is scheduled for April 2017, and the outlook is for a quickening in the pace of recovery.

Along with the decline in the population of workforce-age, employment conditions are expected to remain favorable, and the number of persons employed as well as nominal wages will likely continue to rise. In addition, reflecting the rise in personnel costs, prices of services will show moderate increases, and the lower values of the yen combined with some recovery in crude oil prices will tend to push price levels upward. However, the outlook is for price increases to remain moderate. For this reason, growth in nominal worker compensation and real worker compensation will continue to be positive year-on-year and we expect consumer spending to gradually become more active.

Chart 5: Contributions to the GDP Growth Rate by Demand Component (Fiscal years)



Source: Cabinet Office, *Quarterly Estimates of GDP*

2. Forecasts of Economic Activity by Sector

(1) Corporations

●Industrial production was on a declining trend previously because of the effects of the reactionary decline in demand that followed the increase in the consumption tax rate. However, exports continued to rise in the October-December quarter, and this, combined with improvement in domestic demand, led to the first gain in industrial production in three quarters. Looking ahead, against a background of rising domestic and external sector demand, the outlook is for a continuing upward trend in industrial production. However, as manufacturing corporations continue to move their production facilities overseas, the pace of improvement in production is likely to continue to be moderate.

●Corporate performance in fiscal 2013 improved substantially in the manufacturing sector, owing to depreciation of the yen, and, together with the surge in demand prior to the consumption tax rate hike, corporate profitability on an all-industries basis rose by a large margin. In fiscal 2014, although there was some adverse impact because of the weakness in demand that followed the rise in the consumption tax, in the latter half of the fiscal year, the decrease in the value of the yen and the declines in crude oil prices brought an improvement in Japan's terms of trade, and the outlook for the full fiscal year is for ordinary income in the corporate sector to rise. Looking ahead, in fiscal 2015, the domestic economy is expected to continue to show improvement and Japan's terms of trade in fiscal 2015 will also improve. Looking to fiscal 2016, the surge in demand prior to the next increase in the consumption tax rate, scheduled for April 2017 will contribute to an increase in ordinary profits.

●Going forward, as the decline in Japan's population accelerates and it becomes more difficult to expect growth in domestic demand, corporations are maintaining a cautious stance toward making new capital investments in Japan. Although the yen has declined in value, it is believed likely that the trend toward moving overseas production centers back to Japan will only be marginal. Therefore, while large-scale investments in additions to production capacity in Japan are not expected, against the background of improvement in corporate performance thus far, it is thought likely that the rising trend in capital investment, centered around the replacement and upgrading of facilities, will continue for the time being.

(2) Households

- ●Employment conditions are continuing to be favorable. Among types of per capita worker compensation, along with rises in non-scheduled cash earnings (overtime pay) and special earnings (bonuses), scheduled payments have also begun to increase. Even though corporate performance continues to improve, corporations are taking a cautious stance toward increases in personnel costs, and it appears that increases in wages are still small. Looking ahead, as the rate of increase in prices remains moderate, real wages are expected to show gradual improvement.
- ●Private consumption showed only a small increase in the October–December quarter of 2014. The effects of the reactionary decline in demand that followed the surge in demand prior to the consumption tax hike are diminishing, and consumer spending is rising; however, the improvement lacks robustness. Although consumer spending is expected to continue to improve, at present, the propensity to consume is at a relatively high level, and the pace of improvement in consumption is expected to be moderate.
- ● New housing starts rose for the first time in four quarters during the October-December period of 2014. Housing starts are viewed as likely to continue to fluctuate at about current levels. However, from the latter half of fiscal 2015, as consumers become gradually more aware of the impending rise in the consumption tax rate to 10%, which was postponed to April 2017, the increase in housing starts is expected to rise gradually.

(3) Government

- ●Since the collapse of Lehman Brothers, 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 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 sustainable have become major concerns for the Japanese economy. To deal with these concerns, a reform law was passed previously to address the issues of social welfare and taxation comprehensively, and the consumption tax rate was

increased to 8% in April 2014. This rate is now scheduled to be increased to 10% in April 2017. Notwithstanding, the government is still not expected to reach its goal of moving the primary balance of the government's accounts into surplus by 2020. Therefore, to reach this objective, further initiatives will be needed to improve the soundness of government finances.

●The administration of Prime Minister Shinzo Abe has announced that its principal policy objectives are to eliminate deflation and revive the economy, and that one of the 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, with objectives that included preventing and minimizing the effects of disasters. As a result of the implementation of measures in the supplementary budget, public investment in fiscal 2013 showed a marked rise. Moreover, the government has begun the full-scale implementation of 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. The outlook is for the implementation of a supplementary budget in fiscal 2014 also, but the size of public works spending will not be large in comparison with the levels of the two previous economic policies. For this reason, the outlook is for public works investment in fiscal 2015 to decline, for the first time in four years.

(4) Trends in Overseas Economies

●The world economy is sustaining moderate growth. In the United States, gradual economic expansion is continuing, and attention has turned to the timing of the first increases in interest rates since the financial crisis in 2008. The economies of Europe are reporting moderate recovery, but the European Central Bank (ECB) is scheduled to implement quantitative monetary easing policies to provide support for the economies of the region and price levels. Among the emerging countries, China is continuing to show a moderate deceleration, but India and certain other countries are showing movements toward accelerated growth.

●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. In Europe, conditions are forecast to show improvement, albeit at a slow pace. In China, although dealing with excessive production capacity will continue to be a bottleneck, the economy is expected to sustain an economic growth rate within the 7.0%-to-7.5% range.

- ●Japan's exports (on a customs-clearance, volume basis) are forecast to maintain an increasing trend as the world economy shows moderate expansion, although the pace of the increase is likely to be gradual. Japan's imports (on a customs-clearance, volume basis) are expected to trend upward along with the continuing recovery in the domestic economy.
- ●The outlook for Japan's trade balance (on an international balance of payments basis) is for a rapid decline in the deficit because of the decline in the value of the yen and drop in crude oil prices. Also, as the yen remains relatively weak and economic activities of Japanese companies overseas continue to expand, the primary income balance is expected to show surpluses. For this reason, the surplus in the current account will increase through fiscal 2015 and be at a high level in fiscal 2016.

3. Forecasts for Prices and Financial Markets

- ●The price of crude oil dropped substantially in the latter half of fiscal 2014. As the supply of crude oil has risen, especially the production of shale oil in the United States, the OPEC Conference at its meeting in November 2014 postponed any reductions in crude oil production, and the conviction in the market is that the relaxation of the supply and demand balance will continue. The possibilities for further decreases in demand linked to the slowing of the world economy and the appreciation of the dollar in foreign exchange markets are both putting downward pressures on crude oil prices. However, in some respects, the declines in international commodity prices, including the price of oil, are thought likely to have gone too far because of anxiety in the market, and the outlook is for gradual recovery in prices.
- ●Due to the effects of the increase in the consumption tax rate, domestic price levels in fiscal 2014 have risen. However, recently, the pace of increases in price levels has diminished due to the marked decline in crude oil prices. If the yen depreciates further, the margin of decline in crude oil prices will be larger, and this is expected to bring a decline in the rates of price increase. Rising personnel costs and the cheaper yen are factors pushing prices upward, and the decline in energy prices will run its course; however the economy is not overheating, suggesting that the rates of increase in prices will be moderate.
- ●Since 2008, Japan has moved ahead with measures to ease monetary policy. After implementing a comprehensive policy for monetary easing in October 2010, the BOJ adopted a "2% inflation target" in January 2013 and made the decision to implement

a policy of “quantitative and qualitative monetary easing” in April 2013. Moreover, in October 2014, further monetary easing measures were implemented. In the event that it becomes difficult to attain the BOJ’s inflation target, there is a possibility that the BOJ may implement further monetary easing policies; however, it may be obliged at some point to push the timing for reaching the inflation target further into the future.

- Long-term interest rates are expected to remain at low levels against a background of low and 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 because of negative circumstances elsewhere, including 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 an increasingly strong downward correction in the value of the yen. Going forward, the yen is likely to continue to be easily susceptible to progressive depreciation based on foreign exchange markets’ consideration of the Japan-U.S. interest rate gap.