

## Economic Outlook for FY2009 and FY2010

*(revised to reflect the Second Preliminary Quarterly Estimates of GDP for the Apr-Jun quarter of 2009)*

September 2009

**Key points of Mizuho Research Institute's (MHRI) outlook on the economy in FY2009 and FY2010**  
(reflecting *The Second Preliminary Quarterly Estimates of GDP (2<sup>nd</sup> QE)* for the Apr-Jun quarter of 2009)

In view of the shift of power in Japan to an administration led by the Democratic Party of Japan (DPJ), MHRI's economic outlook takes into account the impact of the economic initiatives which are expected to materialize. In the second half of FY2009, public demand is predicted to decline due to the partial suspension of the supplementary budget. In contrast, we have revised upward our outlook on growth in FY2010 due to prospects of the rise of household purchasing power due to income transfer initiatives such as the "child allowance".

### <The Japanese Economy>

**FY2009** -3.3% (previous outlook -3.1%)

Public demand will fall slightly due to the shift of power amid the weakness of private demand

**FY2010** +1.4% (previous outlook +0.5%)

Dramatic income transfers from the government sector will lead to expansion of personal consumption

### <The US Economy>

Fragile recovery of final demand despite the improvement of the inventory cycle

**2009** -2.7% (previous outlook -2.7%)

**2010** +1.8% (previous outlook +1.8%)

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## I. The current state of the Japanese economy

**Downward revision of real GDP growth in the 2<sup>nd</sup> QE for the Apr-Jun quarter due to capital investment, inventory investment and public investment**

**The economy will continue to achieve mild growth in the Jul-Sep quarter**

The *Second Preliminary Quarterly Estimates of GDP* (“2<sup>nd</sup> QE”) for the Apr-Jun quarter of 2009 released on September 11, 2009 revealed a downward revision of Japan’s real GDP growth to +0.6% q-o-q (+2.3% p.a.) from +0.9% q-o-q (+3.7% p.a.) in the *First Preliminary Quarterly Estimates of GDP* (“1<sup>st</sup> QE”) (Charts 1, 2). Looking closer at each of the components of demand, corporate capital investment was revised down from -4.3% q-o-q in the 1<sup>st</sup> QE to -4.8% q-o-q in the 2<sup>nd</sup> QE, to reflect the results of the *Financial Statements Statistics of Corporations by Industry*. Furthermore, the contribution by private sector inventory investment to quarterly real GDP growth was revised down sharply from -0.5% pt in the 1<sup>st</sup> QE to -0.8% pt in the 2<sup>nd</sup> QE. Personal consumption was also subject to a slight downward revision from +0.8% q-o-q to +0.7% q-o-q, resulting in a downward revision of the contribution by domestic private sector demand to quarterly real GDP growth from -1.0% pt to -1.3% pt. Furthermore, given the downward revision of public investment (+8.1% q-o-q → +7.5% q-o-q), the contribution by domestic demand - combining both public and private demand - was revised down from -0.7% pt to -1.1% pt. The contribution by external demand remained unchanged from the 1<sup>st</sup> QE at +1.6% pt.

In the Jul-Sep quarter, the Car Allowance Rebate System in the US (known colloquially as the “Cash for Clunkers” program) should serve as tailwinds, leading to the ongoing rise of exports. Turning to domestic demand, even though capital investment will continue to decline due to the ongoing stagnation of corporate business sentiment, the capital investment slowdown should moderate. Inventory investment is projected to fall at a faster pace along with the progress of the inventory adjustment process, leading to a high possibility that it will continue to contribute negatively to the rate of economic growth. Housing investment is predicted to remain on a sharp downswing. In contrast, given the impact of the economic stimulus measures set forth under the administration of former Prime Minister Taro Aso, personal consumption and public demand should continue to rise and serve to prop up the economy. In view of the foregoing, we are inclined to believe that Jul-Sep quarter real GDP growth will continue to register mild positive growth, turning out to portray a similar picture as in the Apr-Jun quarter, with external demand and the government’s economic stimulus measures offsetting the weakness of domestic private demand.

[ Chart 1: Japan's GDP growth ]

(Q-o-q % change)	2007	2008	2008				2009		2009Q2 Contribution
			Q1	Q2	Q3	Q4	Q1	Q2	
GDP (real)	1.8	-3.2	0.9	-0.7	-1.3	-3.4	-3.3	0.6	***
(converted into annualized terms)	***	***	3.5	-2.8	-5.1	-12.8	-12.4	2.3	***
Domestic demand	0.6	-2.1	0.3	-0.4	-1.2	-0.5	-2.3	-1.0	-1.1
Private sector demand	0.6	-2.5	0.6	-0.2	-1.5	-1.0	-3.2	-1.7	-1.3
Personal consumption	0.9	-0.5	1.3	-0.9	0.1	-0.7	-1.2	0.7	0.5
Housing investment	-13.5	-3.1	4.6	0.0	3.5	2.6	-5.7	-9.5	-0.3
Capital investment	2.1	-9.6	1.2	-1.5	-4.9	-7.1	-8.5	-4.8	-0.7
Inventory investment	***	***	***	***	***	***	***	***	-0.8
Public sector demand	0.5	-0.5	-1.0	-1.4	0.1	1.5	0.5	1.1	0.3
Government consumption	2.1	0.3	-0.3	-0.7	-0.2	1.3	0.1	-0.3	-0.1
Public investment	-6.3	-4.4	-3.5	-4.9	1.6	2.1	2.5	7.5	0.3
External demand	***	***	***	***	***	***	***	***	1.6
Exports	9.3	-10.2	6.0	-4.1	-0.7	-13.6	-22.5	6.4	0.8
Imports	1.7	-3.7	3.0	-3.1	0.2	2.5	-14.9	-5.1	0.8
GDP (nominal)	1.0	-3.5	0.9	-1.1	-2.6	-1.2	-2.7	-0.5	***
GDP deflator (y-o-y change)	-0.9	-0.3	-1.3	-1.5	-1.5	0.7	0.9	0.5	***

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

[ Chart 2: Comparison of the 1<sup>st</sup> QE with the 2<sup>nd</sup> QE ]

	GDP (real)													GDP (nominal)		
	(%)		Contribution to real GDP				Q-o-q change (the figures on inventory investment refer to its contribution to real GDP)							(%)		
	(p.a.)		Domestic demand	Private sector demand	Public sector demand	External demand	Personal consumption	Housing investment	Capital investment	Inventory investment	Government consumption	Public investment	Exports	Imports	(p.a.)	
2 <sup>nd</sup> QE	0.6	(2.3)	-1.1	-1.3	0.3	1.6	0.7	-9.5	-4.8	-0.8	-0.3	7.5	6.4	-5.1	-0.5	(-2.1)
1 <sup>st</sup> QE	0.9	(3.7)	-0.7	-1.0	0.3	1.6	0.8	-9.5	-4.3	-0.5	-0.3	8.1	6.3	-5.1	-0.2	(-0.7)

## II. Forecast of the Japanese economy in FY2009 and FY2010

The regime change in Japan leads to a dramatic shift of underlying preconditions to our economic outlook

Given the landslide victory of the Democratic Party of Japan (DPJ) in the recent lower house election, it now looks certain that Yukio Hatoyama, DPJ President, will be nominated as Prime Minister at the coming special Diet session, creating a new DPJ-led administration. The policies advocated by the DPJ will start to be implemented, such as the formulation of the budget framework following the DPJ Manifesto by the “National Strategy Bureau” and the elimination of wasteful spending by the “Administrative Reform Council”. The macroeconomic impact of the regime change may not be ignored. According to MHRI’s estimates, the rate of Japan’s real GDP growth would be pushed up by approximately 1% in FY2010, assuming that all of the DPJ’s initiatives (including the measures to secure fiscal resources) are carried out. Therefore, we have revised our economic outlook on the premise that these initiatives will be carried out along with the shift of power. The preconditions of our revised outlook differ greatly from our previous economic outlook as of August 19, 2009 since the previous outlook only takes into account the policy measures decided under the Aso administration. Thus, note that the growth rates have been subject to substantial revisions.

FY2009 real GDP growth is revised down to -3.3%

Looking forward on the basis of the foregoing premises, our outlook on real GDP growth in FY2009 has been revised down to -3.3% (previous outlook: -3.1%) (**Chart 3**). In addition to the revised estimates reflecting the downward revision of growth in the 2<sup>nd</sup> *QE* for the Apr-Jun quarter of 2009, the high possibility that part of the supplementary budget for the current fiscal year will be suspended upon the inauguration of the DPJ administration led to a downward revision of our outlook on public investment. Furthermore, we have also revised down our outlook on personal consumption. Our previous economic outlook predicted that there would be a last-minute rush of demand in the Jan-Mar quarter of 2010 to take advantage of the so-called Eco-Point program to stimulate demand for environment-friendly appliances on the assumption that the program would be phased out at the end of FY2009 (end of March 2010). However, on the basis of prospects that the Eco-Point program would be continued in FY2010, in view of comments by top DPJ party members that “good initiatives would be continued” and that the program in terms of flat-screen TVs serves to stimulate the spread of digital terrestrial broadcast, we have altered our scenario that there would not be much of a last-minute rush of demand in the Jan-Mar quarter of 2010. Even so, in terms of a comprehensive overview of economic developments in FY2009, our view remains unchanged that the economic stimulus measures around the world including Japan will prop up the stagnation of Japan’s domestic demand.

**FY2010 real GDP growth is revised up to +1.4%**

On the other hand, we have revised upward our outlook on real GDP growth in FY2010 to +1.4% (previous outlook: +0.5%). Given the DPJ's key initiatives to abolish the provisional tax rates (the abolition or reduction of provisional tax rates on gasoline, etc.) in April 2010 and the payment of the "child allowance" from June, the household sector's real purchasing power is expected to rise from the Apr-Jun quarter of 2010. The odds are high that the level of private sector demand – most notably personal consumption – will rise, serving to push up the rate of economic growth. However, the economic stimulus of the DPJ's initiatives will not have lasting effect. Since the effect of the economic stimulus in FY2010 stems primarily from the transfer of income to the private sector using public funds such as unearthed "buried treasures" (idle government funds or assets), the decline of public demand including public investment and civil service labor costs will have a larger impact and drag down growth from FY2011 onward.

**Deflationary risks will linger despite a slight contraction of the output gap**

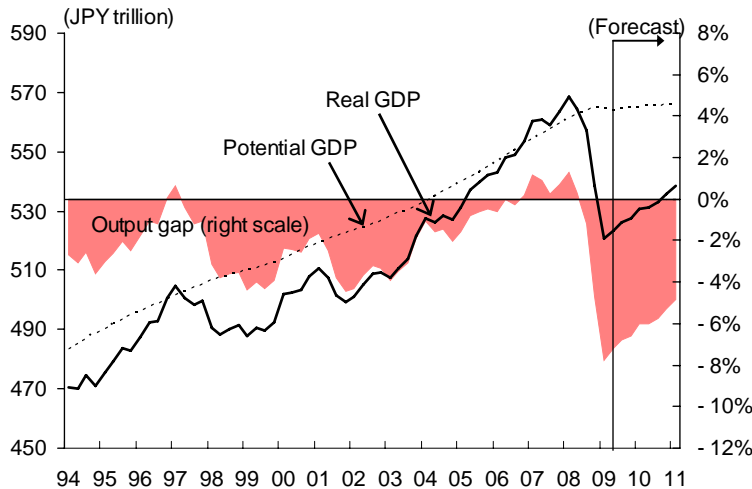
The output gap (the gap between actual GDP and potential GDP) estimated by MHRI stood at -7.2% as of the Apr-Jun quarter of 2009. If the Japanese economy proceeds as set forth in our outlook, the output gap will contract since the economy is predicted to grow at a pace surpassing the potential rate of GDP growth. Even so, an over-supply of approximately 5% (JPY27 trillion) will remain as of the end of FY2010. Looking forward, the risks of deflation are expected to linger.

[ Chart 3: Outlook on the Japanese economy ]

(%)	FY2008	FY2009	FY2010	FY2008		FY2009		FY2010		FY2008	FY2009	FY2010
	(Actual)	(Forecast)	(Forecast)	1H	2H	1H	2H	1H	2H	(Contribution)	(Contribution)	(Contribution)
	(Actual)	(Forecast)	(Forecast)	(Actual)	(Actual)	(Forecast)	(Forecast)	(Forecast)	(Forecast)	(Actual)	(Forecast)	(Forecast)
GDP (real)	-3.2	-3.3	1.4	-1.9	-10.8	-1.8	1.7	1.1	1.9	-	-	-
Domestic demand	-2.1	-3.1	1.3	-1.8	-4.4	-4.2	0.8	1.0	2.2	-2.0	-3.0	1.2
Private sector demand	-2.5	-5.3	1.5	-1.3	-6.6	-7.0	-0.5	1.6	3.0	-1.8	-4.0	1.1
Personal consumption	-0.5	0.1	1.2	-0.5	-2.5	0.7	1.5	0.4	2.5	-0.3	0.1	0.7
Housing investment	-3.1	-15.6	4.9	8.3	2.8	-26.7	-7.1	12.3	3.0	-0.1	-0.4	0.1
Capital investment	-9.6	-18.8	-0.9	-6.5	-24.9	-19.8	-10.1	1.0	3.9	-1.5	-2.8	-0.1
Public sector demand	-0.5	4.6	0.7	-3.6	3.6	5.1	5.1	-0.7	-0.4	-0.1	1.0	0.2
Government consumption	0.3	2.6	3.2	-1.9	2.6	1.3	5.1	3.0	1.8	0.1	0.5	0.6
Public investment	-4.4	15.3	-11.0	-11.3	8.7	23.9	5.2	-16.8	-11.1	-0.2	0.5	-0.5
Net exports (contribution)	-1.2	-0.4	0.2	-0.2	-6.6	1.3	0.9	0.1	-0.2	-1.2	-0.4	0.2
Exports	-10.2	-16.8	6.4	-3.4	-41.6	-10.9	7.8	6.5	4.9	-1.6	-2.5	0.8
Imports	-3.7	-14.8	6.2	-3.0	-9.9	-23.5	0.7	8.0	8.2	0.4	1.6	-0.6
GDP (nominal)	-3.5	-3.5	-0.2	-3.8	-7.5	-3.6	1.0	-2.1	2.3			
GDP deflator	-0.3	-0.2	-1.6	-1.4	0.9	0.7	-1.2	-1.8	-1.5			
Industrial production	-12.7	-11.9	3.9	-2.7	-22.4	-1.7	5.1	0.6	1.6			
Unemployment rate	4.1	5.7	5.5	4.0	4.2	5.5	5.8	5.7	5.2			
Current account balance (JPY trillion)	12.2	17.5	19.0	18.2	7.6	16.9	17.3	18.1	18.8			
as a percentage of nominal GDP	2.5	3.6	4.0	3.6	1.6	3.5	3.6	3.8	3.9			
Domestic corporate goods prices	3.2	-5.3	-2.1	6.1	0.4	-8.4	-5.0	-2.1	-1.9			
Consumer prices	1.2	-1.3	-1.2	1.9	0.5	-1.6	-0.9	-1.2	-1.3			
Long-term interest rate (%)	1.48	1.38	1.43	1.60	1.35	1.40	1.35	1.40	1.45			
Nikkei stock average (JPY)	10,850	9,800	10,700	13,300	8,400	9,700	9,900	10,500	10,900			
Exchange rate (JPY/USD)	100.5	95	97	106.1	94.8	96	94	96	99			
Crude oil price (WTI)	85.9	68	78	121.0	50.9	64	72	79	78			

Notes: 1. FY = rate of change from the previous year. Half-year GDP = rate of change from the previous term p.a. (the GDP deflator = rate of change from the previous year).  
 2. Half-year industrial production = rate of change from the previous term. The half-year unemployment rate and half-year current account balance are adjusted for seasonal factors and the figures on current account balance are converted into annualized rates.  
 3. Half-year corporate goods prices and half-year consumer prices = rate of change over a year ago. Consumer prices = nationwide (excluding fresh foods).  
 4. Crude oil price = near-term WTI contract. Long-term interest rate = yield on newly-issued 10-yr JGBs.  
 Sources: Cabinet Office, *National Accounts*, Ministry of Economy, Trade and Industry, *Indices of Industrial Production*, Ministry of Internal Affairs and Communications, *Labor Force Survey*, *Consumer Price Index*, Ministry of Finance, *Balance of Payments*, Bank of Japan, *Corporate Goods Price Index*.

[ Chart 4: Outlook on the output gap ]



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

[ Chart 5: Outlook on corporate earnings ]

(Y-o-y % change)		FY2008	FY2009	FY2010
		(Actual)	(Forecast)	(Forecast)
Total	Sales	-8.4	-12.9	1.0
	Ordinary profits	-39.0	-39.9	31.3
Manufacturing	Sales	-12.3	-16.3	4.4
	Ordinary profits	-65.5	-80.2	380.6
Nonmanufacturing	Sales	-6.6	-11.4	-0.4
	Ordinary profits	-18.0	-26.5	-0.1
Large corporations	Sales	-6.5	-16.0	1.5
	Ordinary profits	-43.8	-39.4	31.9
Manufacturing	Sales	-10.2	-19.0	5.4
	Ordinary profits	-67.3	-59.0	170.6
Nonmanufacturing	Sales	-3.5	-13.7	-1.3
	Ordinary profits	-17.5	-30.6	-4.6
Small and medium corporations	Sales	-9.8	-10.6	0.6
	Ordinary profits	-32.4	-40.6	30.7

Notes: "Large corporations" = corporations with capital of JPY1 billion or over  
 "Medium corporations" = corporations with capital of JPY100 million to JPY1 billion  
 "Small corporations" = corporations with capital of JPY10 to 100 million yen  
 From FY2008, financial holding companies are included in large nonmanufacturing corporations.  
 Source: Made by MHIRI, based upon Ministry of Finance, *Financial Statements Statistics of Corporations by Industry*.

[ Chart 6: Outlook on the US economy ]

(%)

	2008	2009 (Forecast)	2010 (Forecast)	2008		2009 (Forecast)		2010 (Forecast)	
				1H	2H	1H	2H	1H	2H
GDP	0.4	-2.7	1.8	0.5	-2.3	-4.8	1.3	2.1	1.7
Personal consumption	-0.2	-0.9	0.7	0.0	-2.5	-0.7	0.3	0.7	1.0
Housing investment	-22.9	-23.3	-1.6	-25.7	-17.7	-31.0	-11.2	1.2	3.0
Capital investment	1.6	-18.4	0.4	2.9	-7.8	-28.3	-6.5	2.4	3.8
Inventory investment (USD 100 million)	-259	-1,119	-108	-183	-336	-1,366	-873	-218	2
Government consumption	3.1	2.0	2.2	2.6	3.6	0.5	3.6	1.9	1.5
Net exports (USD 100 million)	-4,943	-3,396	-3,255	-5,135	-4,751	-3,592	-3,201	-3,240	-3,271
Exports	5.4	-12.4	3.5	6.4	-4.2	-21.8	0.7	3.7	6.0
Imports	-3.2	-16.8	2.1	-3.4	-6.7	-26.9	-3.8	3.5	5.3
Domestic final demand	-0.4	-3.0	0.9	-0.3	-2.5	-4.7	0.0	1.1	1.4
Unemployment rate	5.8	9.4	10.9	5.2	6.5	8.7	10.1	10.8	10.9
Nonfarm payrolls (per month, 1,000 persons)	-189	-368	-16	-82	-297	-599	-180	-48	15
PCE deflator <y-o-y change>	3.3	0.1	1.8	3.7	3.0	0.1	-0.0	1.8	1.8
Core PCE deflator <y-o-y change>	2.4	1.5	1.6	2.5	2.3	1.7	1.4	1.6	1.6
Current account balance (USD 100 million)	-7,061	-3,746	-3,802	-3,670	-3,391	-1,953	-1,793	-1,867	-1,935
<as a percentage of nominal GDP>	-4.9	-2.6	-2.6	-5.1	-4.7	-2.8	-2.5	-2.6	-2.6

Notes: 1. Calendar-year figures refer to the rate of change from the previous year. Half-year term figures refer to the rate of change from the previous half-year term (annualized).

2. The shaded columns are forecasts.

3. Regarding the current account balance, figures for the half-year terms are adjusted for seasonal factors and the calendar-year figures are the totals. The percentages of nominal GDP are annualized.

Sources: US Department of Commerce, US Department of Labor, MHRI.

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