Monthly Economic Report

June 24, 2019
Mizuho Research Institute
Topic of the month (1) Uncertainties in future course of US-China trade talks, risk of the 4th round of tariff hikes

- US punitive tariffs on Chinese goods and China’s retaliatory tariffs toward the US are already in the third round.
  - Difficulties in US-China trade talks have left the parties without an agreement. The two countries appear wide apart on structural issues such as technology transfer, intellectual property rights and subsidies as well as procedures on the monitoring of enforcement.

- Depending on an outcome of the US-China summit on the side of the G20 Osaka Summit (June 28-29), the US may launch the fourth round of punitive tariffs.
  - US President Donald Trump said previously that he would put in motion the fourth round in the absence of a US-China summit meeting in Osaka. Even though President Trump is likely to move cautious about the fourth round in view of its potentially huge adverse impact on the real economy and the financial markets, that possibility cannot be entirely ruled out. Even when President Trump declares the invocation of the fourth round, he may still take steps such as the postponement of the timing of implementation, the incremental hike of tariff rates, and narrowing of the range of products subject to the higher tariffs.

[ Current status of US punitive measures on Chinese goods and China’s retaliatory measures toward the US ]

### US punitive measures on Chinese goods

<table>
<thead>
<tr>
<th>Imports</th>
<th>Value of imports covered</th>
<th>Additional tariffs</th>
<th>Timing</th>
<th>Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>① $34 billion</td>
<td>25%</td>
<td>July 6, 2018~</td>
<td>Industrial machinery, aircraft, etc.</td>
<td></td>
</tr>
<tr>
<td>② $16 billion</td>
<td></td>
<td>Aug 23, 2018~</td>
<td></td>
<td></td>
</tr>
<tr>
<td>③ $200 billion</td>
<td>10%</td>
<td>Sep 24, 2018~</td>
<td>Food, clothing, etc.</td>
<td></td>
</tr>
<tr>
<td>④ Around $300 billion</td>
<td>10%~25%</td>
<td>May 10, 2019~</td>
<td>Mobile phones, etc.</td>
<td></td>
</tr>
</tbody>
</table>

#### Investment

- Tougher screening by Committee on Foreign Investment in the United States (CFIUS)

#### Exports/transactions

- Export controls under Export Control Reform Act (ECRA)
- Government procurement regulations under National Defense Authorization Act (NDAA)

### China’s retaliatory measures toward the US

<table>
<thead>
<tr>
<th>Imports</th>
<th>Value of imports covered</th>
<th>Additional tariffs</th>
<th>Timing</th>
<th>Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>① $34 billion</td>
<td>25%</td>
<td>July 6, 2018~</td>
<td>Soybeans, chemicals, automobiles, etc.</td>
<td></td>
</tr>
<tr>
<td>② $16 billion</td>
<td></td>
<td>Aug 23, 2018~</td>
<td></td>
<td></td>
</tr>
<tr>
<td>③ $60 billion</td>
<td>5%,10%</td>
<td>Sep 24, 2018~</td>
<td>Lumber, LNG, etc.</td>
<td></td>
</tr>
<tr>
<td>④ Around $500 billion</td>
<td>5%~15%</td>
<td>June 1, 2019~</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Qualitative countermeasures (non-tariff measures)

- Tougher import inspections
- Delays in customs clearance procedure, approvals and licensing

Source: Made by MHRI based on US, Chinese government materials and various news reports
**Scope of fourth-round tariffs larger than the additional tariffs imposed so far**

- Imports from Chinese goods subject to the fourth round of punitive tariffs reach around $282.2 billion (actual imports in 2018), surpassing imports subject to tariff hikes thus far.
  - Imports from China subject to the additional tariffs by the US reach around $267.5 billion, accounting for as much as 10.5% of total US imports (around $2,542.8 billion).
  - The ratio to total US imports will rise to 21.6% if the fourth round of punitive tariffs is launched.

<table>
<thead>
<tr>
<th>Legal basis</th>
<th>Products</th>
<th>Tariff rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 201 (Safeguards)</td>
<td>Washing machines</td>
<td>18-45% (TRQ)</td>
</tr>
<tr>
<td></td>
<td>Solar panels</td>
<td>25% (TRQ)</td>
</tr>
<tr>
<td>Section 232 (Threat to national security)</td>
<td>Steel</td>
<td>25%</td>
</tr>
<tr>
<td></td>
<td>Aluminum</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td>Autos, auto parts</td>
<td>N.A.</td>
</tr>
<tr>
<td></td>
<td>Uranium</td>
<td>N.A.</td>
</tr>
<tr>
<td></td>
<td>Titanium sponge</td>
<td>N.A.</td>
</tr>
<tr>
<td>Section 301 (Sanctions on unfair trade practices)</td>
<td>1st-3rd tariffs on China</td>
<td>25%</td>
</tr>
<tr>
<td></td>
<td>4th tariffs on China</td>
<td>25%?</td>
</tr>
</tbody>
</table>

Note: The dark blue portion already subject to higher tariffs, the light blue portion likely to be subject to punitive tariffs

Source: Made by MHRI based on US Congressional Research Service materials
Invocation of the fourth-round of punitive tariffs would have a large impact on US consumers

- Consumer goods account for some 40% of Chinese goods subject to the fourth round of additional tariffs.
  - Main items include cell phones and notebook PCs, etc., whose dependence on China is large.
  - US industries are vehemently opposed to the fourth round of punitive tariffs.
    - A US corporate consortium (Tariffs Hurt the Heartland, comprising 661 companies and 150 associations, including Japanese firms) said in a letter addressed to President Donald Trump that “tariffs are taxes paid directly by US companies” and “both sides will lose.”
    - A survey commissioned by the consortium (conducted by Trade Partnership Worldwide LLC) estimates that the fourth round would cause two million people to lose jobs and increase burdens on the US households (family of four) by over $2,000 (also calculates that GDP would be pushed down by around 1%).

[ US additional tariffs on Chinese goods (composition by goods) ]

[ Value of imports of Chinese goods subject to 4th round of additional tariffs by the US ]

Note: Based on actual trade in 2017
Source: Made by MHRI based on PIIE materials

Note: Actual results for 2018. Figures in parentheses are HS classifications (two-digit levels)
Source: Made by MHRI based on USA Trade Online, etc.
Topic of the month (2) the Japanese economy: what to make of stagnant personal consumption?

- Japan’s real GDP in the Jan-Mar quarter of 2019 grew +0.6% q-o-q (the second quarterly estimates), almost the same level of growth as +0.5% q-o-q in the first quarterly estimates. While external demand pushed up the growth rate (contribution of +0.4 percentage point) due to import drops, domestic demand roughly leveled off with the rise of +0.1%.

- Real private final consumption expenditure in the Jan-Mar quarter of 2019 fell -0.1% q-o-q, the first drop in two quarters.
  - Growth of consumption took a breather, centering on consumption of durables. Consumption in the Jan-Mar quarter was also pulled down by the coming off of the positive effects of large-scale refund campaigns by some cashless payment service providers, which were one of factors that pushed up consumption in the Oct-Dec quarter of 2018.

- While the consumption activity index in April rose m-o-m, the positive effects of the consecutive holidays appear to have helped lift it. On average, the index is continuing to move sideways.
Employee wage income growth is slowing down. Sharper fall of consumer sentiment from the summer of 2018

- Wage incomes of employees have been slowing recently after peaking out in mid-2018.
  - This stems from the fact that the increase in the number of employees has slowed in addition to the weaker growth of wages.

- Consumer sentiment has been falling at a faster pace since the summer of 2018.
  - The increase of uncertainties over the future course of the global economy, the rise of energy prices and peak out of the replacement cycle of durables served as negative pressures upon consumer sentiment.

[Compensation of employees]

<table>
<thead>
<tr>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
</tr>
</thead>
</table>

(Y-o-y % change)

- Price factor
- Number of employees
- Nominal wages
- Real wage income

Note: Based on actual values following sample adjustments in January 2019

[Consumer confidence index]

<table>
<thead>
<tr>
<th>16/06</th>
<th>16/12</th>
<th>17/06</th>
<th>17/12</th>
<th>18/06</th>
<th>18/12</th>
</tr>
</thead>
<tbody>
<tr>
<td>39</td>
<td>40</td>
<td>41</td>
<td>42</td>
<td>43</td>
<td>44</td>
</tr>
</tbody>
</table>

(Point)

Note: Seasonally adjusted
Source: Made by MHRI based on Cabinet Office, Consumer Confidence Survey
Slowdown of wages and the number of employees likely to dampen personal consumption ahead

- Given the weakness of production reflecting US-China trade tensions, non-scheduled hours worked fell sharply since early 2019. If the weakness of production and deterioration of corporate earnings persists, they may serve as drags upon wages through non-scheduled and special cash earnings.
  - The ceilings set on overtime hours may be serving as a factor pushing down non-scheduled cash earnings.
- New job openings fell mainly in manufacturing, including electronic parts and devices and electric machinery equipment. Against a backdrop of uncertainties regarding the future course of the global economy, this suggests that external demand-related companies may be getting somewhat cautious about employment. Employee wage incomes are forecast to decline due to the slowdown in increase of employees and stagnant growth of wages.
  - New job openings are waning also in sectors other than manufacturing. They appear to be taking a cautious stance toward the expansion of operations in the face of the labor shortage and rising labor costs.

[Production and non-scheduled hours worked]

[Changes in new job openings by industry (manufacturing)]

Note: On a regular employee basis

Note: Including part-time workers
Source: Made by MHRI based on Ministry of Health, Labour and Welfare Ministry, Employment Referrals for General Workers
Price levels of familiar goods remain high, surveys point to likelihood of the consumer that tax hike making households more budget-minded

- Since the last consumption tax hike in 2014, price levels of familiar goods for households have greatly diverged from consumer prices. If the tax rate hike in October 2019 expands and prolongs the divergence, there may arise concern that households become all the more budget-minded.

- Households have strong anxieties and fears over the consumption tax hike.
  - The survey shows around 60% of households intend to review spending following the consumption tax hike.

[Consumer price index and price levels of familiar goods]

<table>
<thead>
<tr>
<th>Survey results</th>
<th>Survey organ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you have concerns over the consumption tax hike's possible adverse impact on the economy?</td>
<td>Asahi Shimbun “National Opinion Survey” (May 2019)</td>
</tr>
<tr>
<td>“Feel concerned” 75%</td>
<td></td>
</tr>
<tr>
<td>Will you review household spending plans following the consumption tax hike?</td>
<td>Jiji Press “Opinion Survey on Latitude in Life” (March 2019)</td>
</tr>
<tr>
<td>“Review spending” 57.2%</td>
<td></td>
</tr>
<tr>
<td>Are you aware of the consumption tax hike to be carried out in October 2019?</td>
<td>Dentsu “Attitude Survey on 10,000 People across Japan” (February 2019)</td>
</tr>
<tr>
<td>“Clearly aware” 80.7%</td>
<td></td>
</tr>
<tr>
<td>Are you planning to take any steps prior to the consumption tax hike, such as “buying in advance/buying for stocking”?</td>
<td></td>
</tr>
<tr>
<td>“Considering some steps” 67.2%</td>
<td></td>
</tr>
</tbody>
</table>

Note: 1. Price levels of familiar goods to households show the median value of replies to the question on the “Perception of the Present Price Levels Compared with One Year Ago.”
2. CPI is the general index excluding imputed rent of owner-occupied houses
Source: Made by MHRI based on Bank of Japan, Opinion Survey on the General Public's Views and Behavior, Ministry of Internal Affairs and Communication, Consumer Price Index

Source: Made by MHRI based on various news reports
1. Global economy and market trends: adjustment pressures on global manufacturing continuing

- The global manufacturing PMI declined for 13 consecutive months to break below 50. The manufacturing PMI declined in May in the US, Eurozone and Japan, falling below 50 among the developed market (DM) economies. Among the emerging market (EM) economies, the manufacturing PMI dropped closer to 50.

- Leading indicators suggest the continuation of an economic slowdown in DM economies. While the leading indicator for China indicates that the Chinese economy may bottom out in the second half of 2019, it will depend largely on the future course of US-China trade tensions.
Overview of financial markets: fall of long-term interest rates and rebound of stocks amid the rise of expectations on US interest rate cut

- Amid rising expectations toward US interest rate cut, stock prices rebounded, while long-term interest rates declined. The yield on 10yr US treasury bonds temporarily fell below 2.0% following the FOMC meeting in June. The yield on 10yr German bonds dropped to the -0.3%-range, renewing historical lows. Yields on 10yr JGBs also fell close to -0.2%. The yen strengthened slightly against the USD subsequent to the FOMC meeting.

[ Major market trends ]

Note: Currency exchange rates are based upon the nominal effective exchange rates as released by the authorities of each country.
Source: Made by MHRI based on Bloomberg
2. (1) The US economy: the economic expansion matches the longest record

- In the Jan-Mar quarter of 2019, the rate of US real GDP growth stood at +3.1% q-o-q p.a., down slightly from the advance estimate. Private inventory investment, residential investment and nonresidential fixed investment were revised downward.
  - Domestic private final demand slowed to +1.3% q-o-q (Oct-Dec 2018: +2.6% q-o-q). The fall of imports served to push up the rate of GDP growth.
  - The probability of a recession in the US estimated on the basis of the yield curve stood at 13% as of July, 2019. This will rise to 32% in April 2020.
  - While the short-term recession risk still remains low, the risk is likely to increase rapidly from 2020 onward.

Note: The shaded areas indicate an economic recession.
Source: Made by MHRI based on BEA, NBER

Note: 1. The shaded areas indicate an economic recession.
2. Estimation of the probability of a recession in the US twelve months ahead by the probit model, using the spread between 10-year and 3-month US treasury bond rates
Source: Made by MHRI based on FRED, NBER
Corporate business sentiment keeps falling. Firms, particularly manufacturers, fear the risk of additional tariffs

- Corporate business sentiment is on the decline. In particular, there are no signs of a decline in sentiment among manufacturers.
  - In May, the ISM Manufacturing PMI fell for the second consecutive month to 52.1 (April: 52.8).
  - In May, the ISM Non-Manufacturing PMI rose marginally to 56.9 (April: 55.5). Business sentiment remains on a moderate decline.
  - Comments among corporations suggest that manufacturers are anticipating higher procurement costs and changes in the supply chains due to the additional tariffs.

![ISM Manufacturing/Non-Manufacturing indexes](image1)

*Source: Made by MHRI based on US Institute for Supply Management*

![Corporate comments (ISM, excerpt)](image2)

**Manufacturing**
- “Ongoing tariffs [issue is] impacting costs and influencing supplier realignment on country of origin.” (Computer & Electronic Products)
- “The threat of additional tariffs has forced a change in our supply chain strategy.” (Chemical Products)
- “Tariffs are affecting some, but doesn’t seem to matter.” (Food, Beverage & Tobacco Products)

**Non-Manufacturing**
- “Waiting to see [the] impact of Chinese import tariff affect.” (Utilities)
- “Tariffs are affecting some, but doesn’t seem to matter.” (Accommodation & Food Services)
- “There is a concern that tariffs on pharmaceuticals could be on the horizon.” (Retail Trade)
- “Current trade war does not let investors have a clear sight. In this sense, it has been very difficult to plan in a long term ahead.” (Mining)

*Source: Made by MHRI based on US Institute for Supply Management*
May employment statistics show a slowdown in the pace of employment expansion

- In May, nonfarm payrolls rose +75 thousand m-o-m, revealing a sharp contraction of the pace of increase in jobs. The unemployment rate stayed low at 3.6%.
  - The increase in nonfarm payrolls was revised downward for the previous two months.
    - March: +189 thousand m-o-m → +153 thousand m-o-m, April: +263 thousand m-o-m → +224 thousand m-o-m
  - On the other hand, employment conditions remain favorable in the eyes of consumers, suggesting that the slowing increase in nonfarm payrolls is partially due to the shortage of manpower.

Note: Shows the difference between the ratio of consumers saying, “jobs are sufficiently available” and the ratio of consumers saying, “jobs are not sufficiently available (hard to find jobs).”
Source: Made by MHRI based on Conference Board
In April, the core PCE deflator turned out lower than expected at +1.6% y-o-y, due primarily to temporary factors such as housing expenses and healthcare costs.

- The Federal Reserve Bank of Dallas’ trimmed mean PCE inflation rate trended around +2% y-o-y. The underlying trend of prices shows no sign of slowing.
- Average hourly wages rose +3.1% y-o-y in May, revealing a slower pace of rise.
  - The pace of wage increases is slowing down after peaking out in early 2019. Amid a lower-than-expected inflation rate, upward pressure on prices from the rise of wages is limited.
(2) US monetary policy: FRB indicates it will not shy away from rate cut if needed without being “patient”

- FRB Chairman Jerome H. Powell said the FRB will “act as appropriate” without referring to the “patient” wait-and-see stance (on June 4 at the Conference on Monetary Policy Strategy, Tools, and Communication Practices (hereafter, “Conference”).
  - FRB Vice Chairman Richard Clarida also said in a speech on May 30, “If we saw a downside risk to the outlook, then that would be a factor that could call for a more accommodative policy” in terms of risk management.
  - However, as long as President Donald Trump sticks harder to trade protectionism, the effects of the (preventive) rate cut could be undermined.

- Presentations submitted at the Conference on June 4 noted an advantage of flexible average-inflation targeting and pointed to the urgent need of the review of FOMC statements and SEP.

**[ FRB Chairman Powell’s speech (June 4) ]**

“I’d like first to say a word about recent developments involving trade negotiations and other matters. We do not know how or when these issues will be resolved. We are closely monitoring the implications of these developments for the U.S. economic outlook and, as always, we will act as appropriate to sustain the expansion.”

(May FOMC statement)

“In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes.”

**[ Research conference on monetary policy framework ]**

Comparison among flexible inflation targeting, price-level targeting, temporary price-level targeting under ZLB, and flexible average-inflation targeting shows that flexible average-inflation targeting has an advantage in terms of the continuity with the current framework and the possibility of flexible changes in the future.—Presentation by Svensson

Statements should clearly present communications on policy decisions, reasonableness of decisions, divergences of views, policy uncertainty and risks. The Survey of Economic Projections (SEP) should connect and publicize the respective economic and policy interest rate outlooks of FOMC participants.—Presentation by Cecchetti and Schoenholtz

Source: Made by MHRI based on FRB

Note: Some of presentations submitted
Source: Made by MHRI based on FRB
FRB tilts toward a rate cut in response to mounting uncertainties (US trade policy)

- At its June meeting, the FOMC made a policy shift toward the preparation for easing from a “patient” wait-and-see stance in preparation of both a rate hike or rate cut.
  - In the dot plot forecasts, FOMC participants wishing to keep the target federal funds rate unchanged until the end of the year and those wishing to cut the rate before the year-end are on par at eight vs. eight.
- Mounting uncertainties are behind the shift in policy stance. Given the recognition that the policy targets have yet to be attained in both full employment and price stability, the low interest rate is highly likely to stay for long.
  - While the dot plot forecasts signals an interest rate hike in 2020, a rate hike would be difficult insofar as the FRB sticks to its symmetric inflation objective.

[ Dot plot forecasts (June FOMC) ]

[ FRB Chairman Powell’s press conference ]
- Incoming data show that it (consumption) has bounced back and is now running at a solid pace. In contrast, the limited evidence available at this time suggests that growth in business fixed income has slowed. Many FOMC participants cited the investment picture and weaker business sentiment and the crosscurrents I mentioned earlier as supporting their judgment that the risk of less favorable outcomes has risen.
- Inflation has been running somewhat below our objective
- The case for additional accommodation has strengthened since our May (FOMC) meeting.
- Eight actually wrote down rate cuts. A number of others see that the case has strengthened. But the Committee wanted to see more, as I mentioned.
- (Replying to the question if an agreement in US-China trade talks would take the possibility of rate cuts off the table) I would say that we’re not looking at any one thing.
- The presence of dissenting votes provides proof of sound discussions.
- Lower inflation expectations on the market are one of the reasons why we think additional easing is necessary. The lower rate of inflation is what we have been pursuing for long years, and we started discussing a review of the policy framework to that end.
- Generally speaking, it is a wise policy to act (early and boldly) to prevent an economic weakness from continuing.
- We’ll always be willing to adjust balance sheet policy so that it serves our dual-mandate objectives.
US bond market: long-term interest rates fall on renewed US-China trade tensions and rising rate cut expectations

- The yield on 10yr US treasury bonds (UST) temporarily dipped below 2.0%, falling to the lowest level since September 2017.
  - The rekindling of US-China trade tensions and comments by high-ranking FRB officials justifying an interest rate cut served as downward pressures upon interest rates.
  - While the spread between 2yr and 10yr UST yields steepened, the spread between 3-month and 10yr UST yields remain inverted.

- As long-term interest rates already stand at levels factoring in approximately three interest rate cuts by the end of the year, there is limited room for a further decline. For the time being, 10yr UST yields are expected to move around the lower half of the 2% range.

Source: Made by MHRI based on Bloomberg
(4) US stock market: while expectations toward a rate cut are underpinning stocks, the sense of economic slowdown is weighing down the upside

- Stock prices remain high, as the rise of expectations toward an interest rate cut serve as support of the stock market.
- Despite the rise of the forward EPS, it is leveling off when averaged out.
  - On the other hand, the forward P/E ratio has risen to 16-17 times, levels seen somewhat overvalued.
- Looking forward, stock prices are expected to remain high on the back of rate cut expectations. Even so, the upside is likely to be limited, as lingering uncertainties and the sense of economic slowdown will weigh down the upside.

Note: Forward EPS and forward P/E ratio are for 12 months ahead.
Source: Made by MHRI based on Datastream
3. The European economy: fears of a recession in the Eurozone easing, but weakness lingering ahead

- In the Jan-Mar quarter of 2019, eurozone real GDP growth (preliminary flash estimate) rose +0.4% q-o-q, more or less on par with growth in the Apr-Jun quarter of 2018.
  - It should be noted that the GDP growth rate was lifted by transient developments, such as increased activity in construction projects helped by favorable weather and a rebound from cuts in automobile output due to the introduction of the Worldwide Harmonized Light Vehicles Test Procedure (WLTP).
- Corporate sentiment remained weak, and eurozone economic activity is continuing to slow down since the turn of the year, with a deterioration in business conditions in the manufacturing sector particularly noteworthy.
  - Of the Purchasing Managers’ indexes (synthetic PMI) having a high correlation to GDP, the Manufacturing PMI fell below the expansion/contraction threshold of 50 for four months in a row.

![Graph of Eurozone real GDP growth rate (by demand component)]

![Graph of Eurozone PMI]

Note: PMI at 50 is the expansion/contraction threshold.
Source: Made by MHRI based on Markit, Bloomberg
- Eurozone exports of goods in March rose +5.4% y-o-y.
  - However, exports to the US fell -0.3% y-o-y to suffer the first negative growth in 13 months.
- Industrial production in the eurozone in March dropped -0.5% y-o-y.
  - The auto production expectation DI, which shows auto output expectations over the next three months, fell below the threshold of zero for three consecutive months up to May.

Corporate sector: eurozone production is still flagging

- **Eurozone exports of goods (by region)**
  - Brazil + Russia + Turkey
  - China
  - Asia (excluding China)
  - EU outside eurozone
  - Total

- **Current status of eurozone auto output and future auto output DI**

Note: The threshold of judgment is zero. The DI is based on the current auto production situation and expectations about production in the next three months.
Source: Made by MHRI based on the European Commission.
The unemployment rate in the eurozone in April declined -0.1% pt to 7.6% from 7.7% in March.

Compensation per employee in the eurozone in the Oct-Dec quarter of 2018 was steady, rising +2.3% y-o-y.

However, the employment expectation DI that shows employment expectations in the next three months fell in Germany and other countries, moving closer to the judgment threshold of zero.

- In May, the DI dropped to the level in August 2016.

[ Eurozone unemployment rate and compensation per employee ]

[ Eurozone employment expectations DI ]

Note: The threshold of judgment is zero. The DI is based on employment expectations over the next three months.

Source: Made by MHRI based on Eurostat, ECB

Source: Made by MHRI based on the European Commission
**Prices: underlying inflation in the eurozone still flat at low levels**

- The eurozone CPI (flash estimate) rose +1.2% y-o-y in May, 0.5%pt lower than previous month (April: +1.7% y-o-y) due to lower energy prices.
  - Core inflation (excluding items with large swings like energy and food) stood at +0.8% y-o-y, also down from the previous month (April: +1.3% y-o-y).
  - The fall in May was due to a backlash to the rise of travel-related charges during the Easter holidays in April.
- The inflation swap forward rate (five-year, five year), which shows the inflation expectation of market participants, started to follow a downtrend from May against the backdrop of falling crude oil prices.

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**Source:** Made by MHRI based on Eurostat

**Note:** Estimates made by using the inflation swap forward rate. "T-year, N-year" means market participants’ expectations of the average inflation rate for the period of N years from T years later.

**Source:** Made by MHRI based on Bloomberg
Monetary policy: higher likelihood of ECB’s additional easing

- At the ECB Governing Council meeting on June 6, the ECB revised its interest rate forward guidance, indicating the first rate hike will not come until the second half of 2020.
  - ECB President Mario Draghi, at a press conference following the meeting, emphasized that the ECB can move for additional easing or the resumption of quantitative easing (QE) depending on economic developments going forward. At the same time, the ECB announced the details of TLTRO III, which allows bank funding at rate levels 0.1% higher than the policy rate.
- In a speech at the ECB Forum on June 19, Draghi suggested the possibility of additional easing.
  - The possibility is increasing that the ECB will go for additional easing while paying attention to exchange rate movements after the G20 Summit or the next FOMC meeting. The most likely option may be a policy rate cut along with measures to mitigate the impact. The timing of the rate cut is likely to be after the ECB Governing Council meeting in September.

<table>
<thead>
<tr>
<th>Key points of ECB Governing Council (June 6)</th>
<th>Key points of ECB President Draghi’s statement (June 19)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic conditions</td>
<td>In the absence of improvement (in the price situation), such that the sustained return of inflation to our aim is threatened, additional stimulus will be required.</td>
</tr>
<tr>
<td>Economic outlook</td>
<td>In the coming weeks, the Governing Council will deliberate how our instruments can be adapted commensurate to the severity of the risk to price stability.</td>
</tr>
<tr>
<td>Prices</td>
<td>Further cuts in policy interest rates and mitigating measures to contain any side effects remain part of our tools.</td>
</tr>
<tr>
<td>Forward guidance on the key ECB interest rates</td>
<td>The euro area is a relatively open economy for its size, with total trade (exports of goods and services) making up 51% of GDP, compared with 27% in the United States. This means that the impact of negative rates on inflation and financing conditions via the exchange rate is more powerful.</td>
</tr>
<tr>
<td>Additional easing measures</td>
<td>Sources: Made by MHRI based on ECB</td>
</tr>
</tbody>
</table>

Source: Made by MHRI based on ECB
German long-term interest rates sink to all-time lows

- Amid falling US interest rates, German 10yr government bond yields sank to all-time lows, falling below -0.3%.
  - In addition to the decline of the expected inflation rate, political risks in the UK and Italy are pushing down interest rates.

- In the absence of fears regarding the acceleration of inflation, German 10yr government bond yields are expected to remain in negative territory for some time to come.
  - 10yr government bond yields also declined to record low levels in France, Spain and Portugal as investors went on to obtain yields.

![Graph showing German 10yr government bond yields and the expected inflation rate](image1)

Note: The expected inflation rate is the 5-year, 5-year inflation swap forward rate.
Source: Made by MHRI based on Bloomberg

![Graph showing 10yr government bond yields in the Eurozone](image2)

Source: Made by MHRI based on Bloomberg
4. The Chinese economy and EM financial markets trends: the Chinese economy is continuing to slow down

- The slowdown of the Chinese economy was confirmed again in May, with the pace of both production and investment decelerating.
  - In May, production stood at +5.0% y-o-y, slowing for the second consecutive month due, among others, to a larger decline in motor vehicle output. The growth of investment also slowed, led by infrastructure-related investment and real estate investment. Retail sales, which fell sharply in April due to the fewer number of holidays than in 2019, recovered to the level of March.
  - Manufacturing PMI in May fell to dip below the expansion-contraction threshold of 50 for the first time in three months. Orders for exports that were showing signs of improvement turned down again. The renewed intensification of US-China trade tensions apparently pressed down business sentiments of manufacturers.

- It is expected that it will only be in or after the second half of 2019 that the Chinese economy bottoms out, as it will take some time for monetary and fiscal policy measures to produce the intended economic support effects. If the intensification of US-China trade tensions sends further downward pressures on the economy, the Chinese government may be compelled to take additional stimulus measures.
China trying to stabilize RMB under pressure, placed troubled bank under public management for the first time in 20 years

- Concerns regarding US-China trade tensions sent the renminbi weakening in May. On a closing basis, the Chinese currency fell to the level of RMB 6.9 to USD for the first time in approximately six months.
  - Subsequent comments by high-ranking Chinese officials on the importance of the renminbi’s stability, continuing to set the middle rate by adding countercyclical factors to seek the currency’s stability.
  - While the RMB is likely to remain under pressure stemming from the US-China trade confrontation, China’s monetary authorities are expected not to tolerate the currency’s excessive depreciation and try to stabilize RMB by setting the middle rate at higher levels.

- On May 24, the People’s Bank of China (PBoC) announced that Baoshang Bank in the Inner Mongolia Autonomous Region will be placed under public management for serious credit risks.
  - Even though short-term interest rates rose temporarily along with this announcement, the subsequent provision of liquidity by the PBoC led to the fall of short-term interest rates to levels around mid-May.
  - While the PBoC explained that the problem at Baoshang Bank is an isolated case, troubled banks should be watched closely since there are other smaller banks in management difficulties.
EM financial markets: EM stocks factoring in US rate cut by the end of the year

- EM stocks have been recovering in June.
  - US stocks rose amid mounting expectations about a US interest rate cut by the end of the year. EM stocks have been recovering in tandem with the rise of US stocks.
  - Concerns regarding US-China trade tensions, which sent stock prices declining in May, eased following the decision to hold an US-China summit meeting on the side of the G20 Summit in Osaka, Japan (June 28-29.)
  - Speculation of an US rate cut are serving as downward pressure upon the US dollar, prodding EM currencies to grow stronger.

- However, given lingering concerns over a global economic slowdown, it is necessary to monitor the possibility of EM financial markets weakening again in the second half of 2019.

[ EM, Chinese and US stocks ]

[ Rate of rise/fall of EM currencies against USD ]

Note: MSCI Emerging represents EM stocks
Source: Made by MHRI based on Refinitiv, MSCI

Note: Positive bars show EM currencies’ rate of rise against USD, while negative bars show EM currencies’ rate of drop against USD.
Source: Made by MHRI based on Refinitiv
5. (1) The Japanese economy trends: the overall assessment of economic conditions kept unchanged as “worsening”

- Even though the *Indexes of Economic Conditions* in April rose for the first time in two months, the overall assessment on economic conditions was kept unchanged as “worsening” for two months in a row.
  - While the three-month backward moving average moved up +0.5Pt, the increase failed to reach +0.9Pt, a prerequisite for an upward revision of the assessment to “halting to fall”.
  - In the Cabinet Office *Monthly Economic Report* for June 2019, the government kept unchanged its assessment of the current state of the Japanese economy, saying, “the Japanese economy is recovering at a moderate pace while weakness in exports and industrial production continues.”

![Graph of Economic Conditions](image)

<table>
<thead>
<tr>
<th>Overall assessment</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Improving</td>
<td>Indicates the likelihood of an economic expansion.</td>
</tr>
<tr>
<td>(2) At a standstill</td>
<td>Indicates the likelihood of an economic expansion coming to a standstill.</td>
</tr>
<tr>
<td>(3) Upward turning point</td>
<td>Indicates the likelihood that the economic trough to be determined ex post facto existed in the prior few months.</td>
</tr>
<tr>
<td>(4) Worsening As of April</td>
<td>Indicates the likelihood of an economic recession.</td>
</tr>
<tr>
<td>(5) Halting to fall</td>
<td>Indicates the likelihood that economic conditions are halting to fall</td>
</tr>
</tbody>
</table>

Source: Made by MHRI based on Cabinet Office, *Indexes of Business Conditions*
Real GDP for Jan-Mar quarter in 2nd QE roughly matches 1st QE. Our view remains unchanged that the economy lacks strength

- According to the Second Preliminary Quarterly Estimates of GDP (2nd QE) for the Jan-Mar quarter of 2019, Japan’s real GDP grew +0.6% q-o-q (+2.2% p.a.), remaining more or less unchanged from the First Preliminary Quarterly Estimates of GDP (“1st QE”).
  - In contrast to a slight upward revision of capital investment, housing investment was revised downward.
  - Given the weak growth of domestic demand, our view remains unchanged that the Japanese economy lacks strength.
  - Looking forward, the Japanese economy will likely continue to lack strength. If trade tensions intensify, Japan’s economic growth may dip into negative territory due to the fall of investment and exports.

### 2019 Jan-Mar quarter GDP (2nd QE)

<table>
<thead>
<tr>
<th></th>
<th>2018 Jan-Mar</th>
<th>Apr-Jun</th>
<th>Jul-Sep</th>
<th>Oct-Dec</th>
<th>2019 Jan-Mar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>-0.1</td>
<td>0.6</td>
<td>-0.6</td>
<td>0.5</td>
<td>0.6</td>
</tr>
<tr>
<td>(Q-o-q change, p.a.)</td>
<td>-0.4</td>
<td>2.3</td>
<td>-2.6</td>
<td>1.8</td>
<td>2.2</td>
</tr>
<tr>
<td>(Y-o-y change)</td>
<td>1.3</td>
<td>1.5</td>
<td>0.1</td>
<td>0.3</td>
<td>0.9</td>
</tr>
<tr>
<td>Domestic demand</td>
<td>-0.2</td>
<td>0.6</td>
<td>-0.5</td>
<td>0.8</td>
<td>0.1</td>
</tr>
<tr>
<td>Private demand</td>
<td>-0.2</td>
<td>0.9</td>
<td>-0.5</td>
<td>0.9</td>
<td>0.1</td>
</tr>
<tr>
<td>Personal consumption</td>
<td>-0.1</td>
<td>0.6</td>
<td>-0.3</td>
<td>0.3</td>
<td>-0.1</td>
</tr>
<tr>
<td>Housing investment</td>
<td>-2.3</td>
<td>-2.0</td>
<td>0.8</td>
<td>1.4</td>
<td>0.6</td>
</tr>
<tr>
<td>Capital investment</td>
<td>1.0</td>
<td>2.6</td>
<td>-2.6</td>
<td>2.7</td>
<td>0.3</td>
</tr>
<tr>
<td>Inventory investment</td>
<td>(-0.2)</td>
<td>(-0.0)</td>
<td>(0.2)</td>
<td>(0.1)</td>
<td>(0.1)</td>
</tr>
<tr>
<td>Public demand</td>
<td>-0.1</td>
<td>-0.1</td>
<td>-0.2</td>
<td>0.3</td>
<td>0.2</td>
</tr>
<tr>
<td>Government consumption</td>
<td>0.3</td>
<td>0.1</td>
<td>0.2</td>
<td>0.7</td>
<td>-0.1</td>
</tr>
<tr>
<td>Public investment</td>
<td>-1.1</td>
<td>-0.7</td>
<td>-2.0</td>
<td>-1.5</td>
<td>1.2</td>
</tr>
<tr>
<td>External demand</td>
<td>(0.0)</td>
<td>(-0.1)</td>
<td>(-0.2)</td>
<td>(-0.3)</td>
<td>(0.4)</td>
</tr>
<tr>
<td>Exports</td>
<td>1.0</td>
<td>0.7</td>
<td>-2.0</td>
<td>1.2</td>
<td>-2.4</td>
</tr>
<tr>
<td>Imports</td>
<td>0.7</td>
<td>1.0</td>
<td>-1.0</td>
<td>3.0</td>
<td>-4.6</td>
</tr>
<tr>
<td>Nominal GDP</td>
<td>-0.2</td>
<td>0.3</td>
<td>-0.6</td>
<td>0.5</td>
<td>0.8</td>
</tr>
<tr>
<td>GDP deflator (y-o-y change)</td>
<td>0.5</td>
<td>-0.1</td>
<td>-0.4</td>
<td>-0.3</td>
<td>0.1</td>
</tr>
</tbody>
</table>

Note: In the table on the right hand side, the readings are q-o-q ch in real terms unless otherwise stated. The figures in parentheses indicate the contributions to gross domestic production.

Source: Made by MHRI based upon Cabinet Office, Quarterly Estimates of GDP
Exports weak, production lacks strength despite the first growth in two months

In May, the export volume index fell -5.8% m-o-m (April: +0.4% m-o-m) falling for the first time in two months.

- Exports to the US and the EU dipped into negative territory. Goods such as general machinery and electrical equipment declined.

In April, the industrial production index rose +0.6% m-o-m (March: -0.6% m-o-m), recording a rise for the first time in two months. Production increased in a broad range of industries due to a rebound from the previous month, among other factors.

- It is possible that the last-minute rush of production prior to the long Golden Week holidays lifted the production index. Even though production plans point to the rise of production, actual output may turn out to be lower than expected due to of the recent intensification of trade frictions.

- Looking ahead, while production in Japan may continue to lack strength against the backdrop of slowing overseas economies and sluggish IT demand, a temporary uptick is expected prior to the consumption tax hike in October.

---

[ Export volume index ]

[ Indices of Industrial Production ]

Note: Seasonally adjusted by MHR
Source: Made by MHRI based on Ministry of Economy, Trade and Industry, Trade Statistics

Source: Made by MHRI based on Ministry of Finance, Indices of Industrial Production
Corporate earnings rising, but the recovery is only in the absence of special factors. Capital investment remains robust

- Sales in the Jan-Mar quarter grew +3.0% y-o-y and ordinary income also rose +10.3% y-o-y for higher income on higher sales.
  - While the manufacturing sector’s earnings saw a drop of -6.3% y-o-y to incur the decrease for three quarters on end in the face of slowing overseas economies and higher costs of raw materials, the non-manufacturing sector enjoyed a large increase of +18.4% y-o-y.
  - However, excluding the special factor of the large profit rise for pure holding companies, the improvement is only moderate with a profit rise of +0.1% y-o-y.

- Capital investment in the Jan-Mar quarter (seasonally adjusted, excluding software) grew +1.1% q-o-q, increasing for two quarters on end.
  - While capital investment by the manufacturing sector fell -1.7% q-o-q, the non-manufacturing sector’s investment was robust with a rise of +2.8% q-o-q, apparently pushed up by labor-saving investment and construction investment.

[ Corporate earnings ]

[ Capital investment ]

Source: Made by MHRI based on Ministry of Finance, Statistical Survey of Incorporated Enterprises

Note: Seasonally adjusted figures
Source: Made by MHRI based on Ministry of Finance, Statistical Survey of Incorporated Enterprises
The breadth of decline of real wages narrowed. Personal consumption is flat

- In April, real wages fell -1.1% y-o-y. The breadth of decline of real wages narrowed, given the moderation of the decline of nominal wages.
  - Real wages on a common office basis more or less flattened out at -0.5%. The rise of consumer prices served to push down real wages.
  - Looking ahead, nominal wages are expected to stay firm on a stronger sense of labor shortages, and a slowdown in rise of consumer prices should serve to push up real wages.

- In April, the Consumer Activity Index (the travel balance adjusted) rose +1.6% m-o-m, rising for the first time in three months. However, the index flattened out when averaged out.
  - The index increased for all of durable goods, non-durable goods and services. Temporary positive factors stemming from the long, Golden Week holidays contributed to the rise.

[ Real wages (continuous samples) ]

[ Consumption Activity Index ]
The rise of the core CPI slowed from the previous month. Price pass-through yet to come in B2C commerce

- In May, the nationwide core CPI (all items less fresh food) rose +0.8% y-o-y, slowing down from April (+0.9% y-o-y).
  - The rise of energy prices slowed, and overseas packaged tours, accommodation charges and mobile phones also served as to push down prices.
  - While pressures to pass through costs to prices are growing in response to rising logistics costs, raw materials costs and labor costs, moves to raise prices in B2C commerce remain limited.
  - Looking forward, the nationwide core CPI is forecast to slow down due to the fading impact of overseas packaged tours pushing up prices during the long Golden Week holidays, the slower rises in energy prices, including electrical power rates, and the scheduled reduction of mobile phone communication charges from June.

[ Consumer Price Index (nationwide) ]

[ Examples of key items with price increases ]

<table>
<thead>
<tr>
<th>Items with price hikes</th>
<th>Reasons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Edible oil</td>
<td>Higher logistics costs, raw materials costs</td>
</tr>
<tr>
<td>Potato chips</td>
<td>Higher logistics costs, labor costs</td>
</tr>
<tr>
<td>Plastic bottle beverages</td>
<td>Higher logistics costs, raw materials costs</td>
</tr>
<tr>
<td>Ice cream</td>
<td>Higher labor costs due to manpower shortage, Higher logistics costs, Higher prices of dairy products, raw materials for ice cream</td>
</tr>
<tr>
<td>Eating-out</td>
<td>Higher labor costs, raw materials costs</td>
</tr>
<tr>
<td>Admission fees to movie theaters</td>
<td>Higher labor costs, logistics costs</td>
</tr>
</tbody>
</table>

Source: Made by MHRI based on Ministry of Internal Affairs and Communications, Consumer Price Index

Source: Made by MHRI based on various news reports
(2) Domestic monetary policy: BOJ kept policy unchanged at June MPM. Keep a close eye upon overseas economic developments

- The Bank of Japan (BOJ) kept its policy unchanged at its Monetary Policy Meeting on June 19-20. Even though the BOJ kept its assessment of the Japanese economy unchanged, it will continue to monitor downside risks related to overseas economies. Focus is gathering around the Outlook for Economic Activity and Prices in July in view of developments in US-China trade negotiations.

- Market speculation is rising on an interest rate cut by the BOJ reflecting the rise of market speculation on further monetary in the US and Europe. Going forward, if the yen keeps strengthening, the BOJ may discuss additional easing steps. While Policy Board member Sakurai said he does not see any need for additional easing at the moment, he added that the BOJ may be pressed for a very hard decision going forward, indicating that the BOJ may move toward further easing, such as pushing down already negative interest rates further (May 31).

[ Comments by BOJ Governor Haruhiko Kuroda (downside risks of the global economy: May 27) ]

### Impact of trade tensions
- Due to the widening range of tariff increases, trade costs may rise
- Corporate activity could be subdued due to reconsideration of production sites and global value chains

### Effects of economic policy measures, such as those in China
- The effect of these tax reductions, … is affected by their sentiments and prospects for the economy. … We should be cautious about the effectiveness of these policy measures

### Political risks
- In addition to Brexit and political uncertainties in Europe, political destabilization due to increasing income inequality could affect the global economy through a decline in confidence and instability in financial and capital markets.

### Accumulated debt in the private and public sectors
- Accumulated private debt … increase(s) the financial vulnerability of firms and households, making them susceptible to changes in interest rates and financial market conditions.

Source: Made by MHRI based on Bank of Japan

[ OIS curve ]

Source: Made by MHRI based on Bloomberg
(3) Japanese long-term interest rates: 10yr JGB yields hover in negative territory

- The 10yr JGB yield declined closer to -0.2%, reflecting the fall of interest rates overseas. As super-long JGB yields declined, the yield curve flattened. At the Monetary Policy Meeting in June, BOJ Governor Kuroda indicated his tolerance of the fall of 10yr JGB yields.

- The pace of the BOJ’s JGB purchases slowed to a pace falling below the annual increase target of 10 trillion yen. The BOJ is expected to respond to interest rate declines by reducing its purchase amounts. In the event of an interest rate cut in the US, 10yr JGB yields could decline to the range of -0.2%.

Source: Made by MHRI based on Bloomberg
(4) Japanese stock market: amid continuing risk-off sentiment, the upside is limited due to concerns regarding the appreciation of the yen

- Against the backdrop of rising uncertainties in the wake of heightened trade tensions, investors continued to take a risk-off stance. Foreign investors were net sellers of both cash stocks and futures for the sixth consecutive week.
  - The Nikkei Average is hovering around ¥21,000, but is somewhat weaker relative to US stock prices.
- The forward P/E ratio is below 13x, undervalued in terms of valuation. However, lingering uncertainties are weighing down the upside.
- The upside of Japanese stocks appears to be limited for some time to come, given market concerns regarding a further appreciation of the yen against the backdrop of mounting expectations toward an interest rate cut by the FRB.

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Source: Made by MHRI based on Tokyo Stock Exchange, Bloomberg

Source: Made by MHRI based on Bloomberg
6. Forex market: pressure for a higher yen may rise in the wake of US-China trade talks

- The USD/JPY exchange rate moved somewhat toward a stronger yen after the FOMC meeting to above USD = JPY107. Upward pressure on the yen is expected to grow stronger depending on developments in US-China trade talks.

- The US Department of the Treasury (USDOT) released the semiannual Report on Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States. The USDOT refrained from branding China as a currency manipulator. In addition to the four countries of China, Japan, Germany and South Korea, an additional five countries including Italy were newly placed on the Monitoring List.
  - The USDOT expressed strong concern over the price formation of the renminbi, and urged China to strengthen its economic fundamentals by securing transparency and taking corrective measures toward a market-oriented economy.

[ Japan-US long-term interest rate spread and USD/JPY exchange rates ]

[ Report on Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States ]

<table>
<thead>
<tr>
<th>Evaluation axis</th>
<th>Big trade surplus with US</th>
<th>Big current account surplus</th>
<th>Sustained, unilateral forex intervention</th>
</tr>
</thead>
<tbody>
<tr>
<td>Key criteria</td>
<td>Huge and unsuitable</td>
<td>Surplus with US over $20 billion</td>
<td>Current account surplus over Net annual forex intervention</td>
</tr>
<tr>
<td>Unit</td>
<td>(USD billion)</td>
<td>(%)</td>
<td>(%)</td>
</tr>
<tr>
<td>China</td>
<td>✔</td>
<td>419</td>
<td>0.4%</td>
</tr>
<tr>
<td>Japan</td>
<td></td>
<td>68</td>
<td>3.5%</td>
</tr>
<tr>
<td>Germany</td>
<td></td>
<td>68</td>
<td>7.4%</td>
</tr>
<tr>
<td>Ireland</td>
<td></td>
<td>47</td>
<td>9.2%</td>
</tr>
<tr>
<td>Vietnam</td>
<td></td>
<td>40</td>
<td>5.4%</td>
</tr>
<tr>
<td>Italy</td>
<td></td>
<td>32</td>
<td>2.5%</td>
</tr>
<tr>
<td>Malaysia</td>
<td></td>
<td>27</td>
<td>2.1%</td>
</tr>
<tr>
<td>South Korea</td>
<td></td>
<td>18</td>
<td>4.7%</td>
</tr>
<tr>
<td>Singapore</td>
<td></td>
<td>-6</td>
<td>17.9%</td>
</tr>
</tbody>
</table>

Note: The criteria to assess the nine countries placed on the Monitoring List. Figures in the table are those for January-December 2018. The current account balance of Vietnam alone is for the period between July 2017 and June 2018.

Source: Made by MHRI based on US Department of the Treasury, Report on Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States
7. Crude oil market trends: rebounded on fears about the Mideast situation, but may weaken again in the second half of 2019

- Despite the absence of signs that crude oil supply and demand is tightening, the price of crude oil (WTI) which fell to the $51 range in early June rebounded to the $57 range.
  - Among the factors behind the rise of crude oil prices was the rise of Middle East tensions due to Iran’s shooting of an unmanned US aircraft (drone) subsequent to attacks on oil tankers in the Strait of Hormuz.
  - The FRB’s suggestion of a possible interest rate cut, to which the crude oil market showed little reaction initially, is now underpinning crude oil prices via higher stock prices.

- Note the risk of a surge of crude oil prices in the event a military clash is triggered by additional sanctions against Iran by the US.

- However, upward pressures on crude oil prices stemming from geopolitical factors is currently benign. In the second half of 2019, the global economic slowdown should serve to contain the upside of the crude oil market.

[Crude oil prices]

[Crude oil prices and supply-demand balance]
8. Outlook on the financial markets

<table>
<thead>
<tr>
<th>Sub-scenario 1 (upside scenario)</th>
<th>Sub-scenario 2 (downside scenario)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term interest rates and stocks rise on heightened interest rate hike expectations driven by the acceleration of US economic recovery. The dollar continues to strengthen against the yen.</td>
<td>Global economic slowdown, including Europe and the US, due to tariff hikes accompanying US protectionist policy. Long-term interest rates fall and stock prices fall. The dollar continues to weaken against the yen.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>2.25 ~ 2.50</td>
<td>2.25 ~ 2.50</td>
<td>2.00 ~ 2.25</td>
<td>1.75 ~ 2.00</td>
<td>1.75 ~ 2.00</td>
<td>2.25 ~ 2.50</td>
<td>2.25 ~ 2.50</td>
<td>2.50 ~ 2.75</td>
<td>2.75 ~ 3.00</td>
</tr>
<tr>
<td>10yr UST bond yield (%)</td>
<td>2.65</td>
<td>2.30</td>
<td>2.20</td>
<td>2.30</td>
<td>2.30</td>
<td>2.30</td>
<td>2.30</td>
<td>1.90</td>
<td>1.70</td>
</tr>
<tr>
<td>Dow Jones Average (USD)</td>
<td>25,162</td>
<td>26,100</td>
<td>26,500</td>
<td>27,000</td>
<td>27,000</td>
<td>26,100</td>
<td>27,500</td>
<td>30,500</td>
<td>32,500</td>
</tr>
<tr>
<td>Euroyen TIBOR (three months, %)</td>
<td>0.03</td>
<td>0.05</td>
<td>0.03</td>
<td>0.03</td>
<td>0.03</td>
<td>0.05</td>
<td>0.10</td>
<td>0.10</td>
<td>0.10</td>
</tr>
<tr>
<td>10yr JGB yield (%)</td>
<td>-0.02</td>
<td>-0.07</td>
<td>-0.15</td>
<td>-0.15</td>
<td>-0.10</td>
<td>-0.07</td>
<td>0.00</td>
<td>0.10</td>
<td>0.10</td>
</tr>
<tr>
<td>Nikkei 225 Average (JPY)</td>
<td>21,000</td>
<td>21,400</td>
<td>21,500</td>
<td>21,500</td>
<td>22,000</td>
<td>21,400</td>
<td>23,000</td>
<td>25,500</td>
<td>27,000</td>
</tr>
<tr>
<td>ECB repo rate (qtr-end value, %)</td>
<td>0.00</td>
<td>0.00</td>
<td>-0.10</td>
<td>-0.10</td>
<td>-0.10</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>10yr government bond yield (German bonds, %)</td>
<td>0.00</td>
<td>0.00</td>
<td>-0.10</td>
<td>-0.10</td>
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<td>0.00</td>
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