The Outlook for the Japanese Economy

Economic Research Office
The Bank of Tokyo-Mitsubishi UFJ, Ltd.

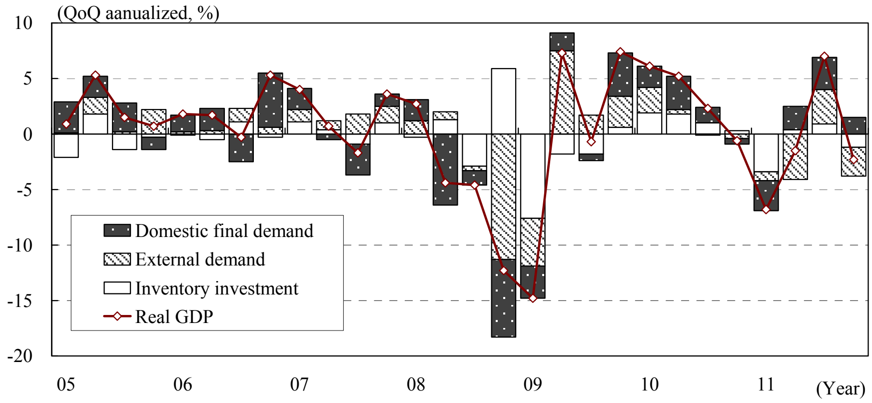
~ Economy Expected to Emerge From Holding Pattern and Return to Recovery Path~

1. Current Economic Conditions

Oct-Dec real GDP fell again due to sluggish external demand

The Japanese economy had been overcoming the turmoil after the March 11 earthquake and electricity supply problems of last summer, steadily regaining momentum. Since last fall, however, the economy has entered a holding pattern due to greater downward pressure from slowing overseas economies—particularly Europe, which has been facing deepening sovereign debt problems—as well as the persistently-high JPY. In fact, the Oct-Dec real GDP growth rate once again turned negative, to an annualized -2.3% QoQ (Figure 1). By final demand item, exports decreased significantly as expected, while fuel imports increased because of expanded thermal power generation to make up for the drop in nuclear power supply capacity following the March 11 accident or suspended operations. As a result, net exports pushed down the real GDP growth rate by an annualized -2.6% QoQ.

Figure 1: Real GDP Growth Rate by Final Demand Item



Notes: 1. *Domestic final demand* consists of private consumption, housing investment, capital investment, government final consumption, and public investment.
2. *Inventory investment* is a sum of private and public investment.
Source: Compiled by BTMU Economic Reserarch Office from Cabinet Office data.

Domestic demand stays robust as economy avoids stumbling

On the other hand, domestic demand has stayed relatively robust (Figure 1). Personal consumption rose an annualized +1.2% QoQ, for three straight quarters of increase. Private fixed investment expanded an annualized +7.9% QoQ, the highest growth rate since the Apr-Jun 2010 quarter. Because of this, the decline in overall Oct-Dec real GDP was within the margin of the Jul-Sep backlash, when growth jumped a high +7.0% annualized. (Real GDP for the latter half of 2011 was an annualized +2.5%.) The monthly All Industrial Activities Indices also showed that the Oct-Dec negative growth was partly attributable to a low starting point. The index's three-month change over the Oct-Dec quarter when excluding the starting point was positive (+0.9% MoM in October, -1.0% MoM in November and +1.3% MoM in December). Furthermore, the coincident CI of the Indexes of Business Conditions, which tracks the movements of economically-sensitive monthly indicators, has alternately risen and fallen on month since last August. However, December marked the biggest gain since the earthquake, and overall, the Japanese economy has avoided stumbling.

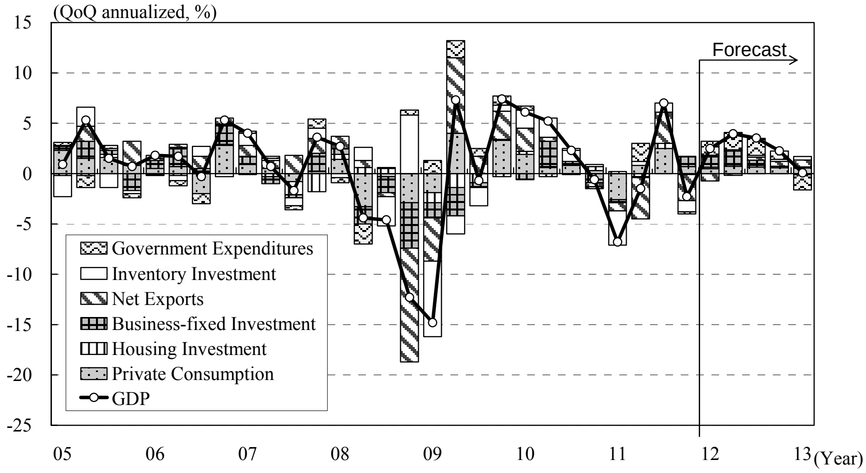
2. Outlook

＜Summary＞

Economic momentum projected to build gradually

The Japanese economy is likely to pull out of its holding pattern sooner or later and grow at a faster pace. As disaster-related spending in the large FY11 third supplementary budget is implemented, earthquake-related reconstruction and rebuilding activities are expected to get underway in full force in both the public and private sectors. These drivers are likely to negate recent downward pressures and support stronger economic momentum, according to our Main Scenario. While the quarterly real GDP growth rate was negative in Oct-Dec, gap is expected to turn positive in Jan-Mar and stay relatively high through the end of 2012 (Figure 2). The real GDP for FY12 is likely to increase by +2.5% YoY.

Figure 2: Real GDP Growth Rate

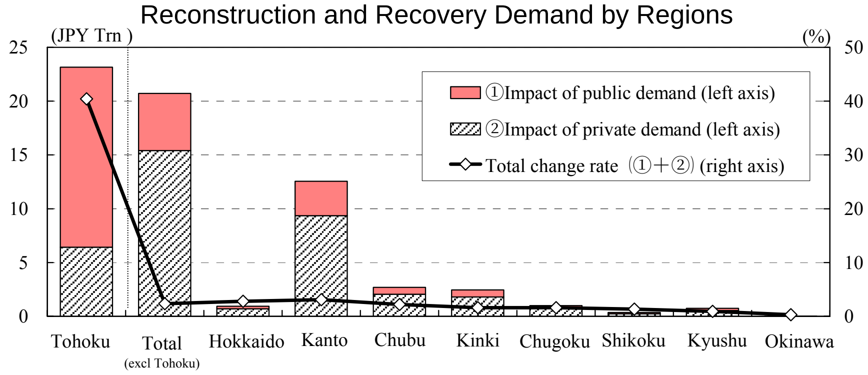


Source: Compiled by BTMU Economic Research Office from Cabinet Office materials.

Reconstruction and rebuilding demand to support nationwide production significantly

Public and private sector reconstruction and restoration demand, which has been driving the economy recently, is estimated to exceed JPY20 trn. Of course, much of that final demand will arise in the Tohoku area, but increased production resulting from such demand could be spread across the country. According to an analysis based on the 2005 Inter-Regional Input-Output Table, production is estimated to increase by JPY23 trn (2005 producer price basis) a year in the Tohoku region, and nearly same amount in other areas as well (Figure 3). Nationwide production is calculated to increase by 4.6%.

Figure 3: Production Ripple Effects from Reconstruction and Recovery Demand by Regions



Notes: 1. Estimates are based on *2005 Inter-regional Input-Output Model* (12 sectors, partly modified 29 sectors into 12).
2. Impact amount is based on 2005 producer price basis, annual ammount. Percent change is versus 2005 figures.
3. Public demand is a sum of government consumption and gross public fixed capital formation.
Private demand is gross private fixed capital formation (capital investment and housing investment).
Source: Compiled by BTMU Economic Research Office from METI and Cabinet Office materials.

Scattering downward risks and persisting deflationary trend limit a sense of economic recovery

On the other hand, any negative impact from downward pressures is expected to be smaller than the economic driving forces as long as a recession is contained to Europe and the JPY does not appreciate further. Conversely, downward pressure could exceed the driving forces if any of the following occur: if the extent of the economic downturn and strong JPY expands and becomes more global; if adverse impacts from a financial crisis are concentrated over the short term (downward pressures would grow); if reconstruction and rebuilding demand lags or if production spillover effects fail to pervade (driving forces contract). There is also the further risk of a new downward pressure from electricity shortages this summer becoming more severe, so careful watch is warranted. As mentioned above, the growth rate itself is expected to be fairly high; however, the coming recovery is unlikely to feel real due to many risk factors, a persisting deflationary gap, declining prices and a stagnating nominal GDP growth rate.

<Details>

(1) Corporate Sector

①Exports • Production

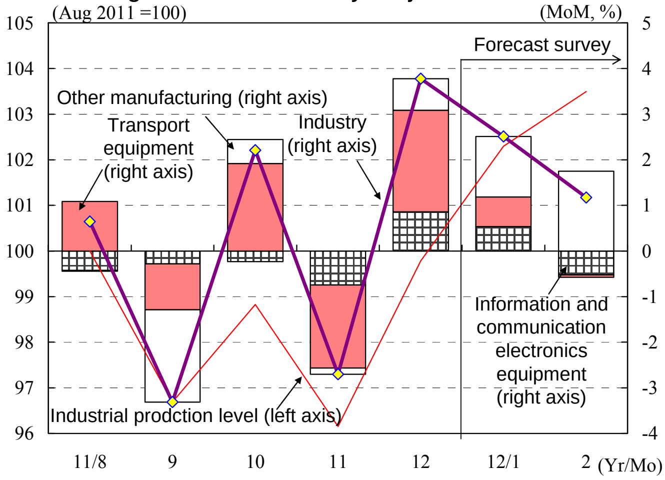
Exports declining, especially to Europe, as production largely overcomes impact of Thai flooding

Japanese export volume declined for two straight months in October and November 2011. Shipments not only to the EU but also to the US and Asia fell, as the concerns mounted about spreading adverse effects from the deepening debt crisis in Europe. Exports to the US and Asia improved in December, as overall shipments rose for the first time in three months. That said, export data appear to still be weak, with shipments to the US and Asia as well as shipments overall dropping once again in January despite the first increase in four months of exports to Europe. Amidst such conditions, industrial production has been lurching along since last summer, with December output only roughly level with August figures (Figure 4). Production inevitably declined in November because of tightened supplies of transport and information communications equipment following the flooding in Thailand. However, both rebounded quickly in December, and the manufacturers' forecast survey projected that output would continue to rise in January. The impact of the flooding in Thailand on Japan's economy appears to have largely dissipated, with even overall industrial production expected to rise through February.

Despite projected recoveries in exports and production, trade deficit to persist because of continued high imports

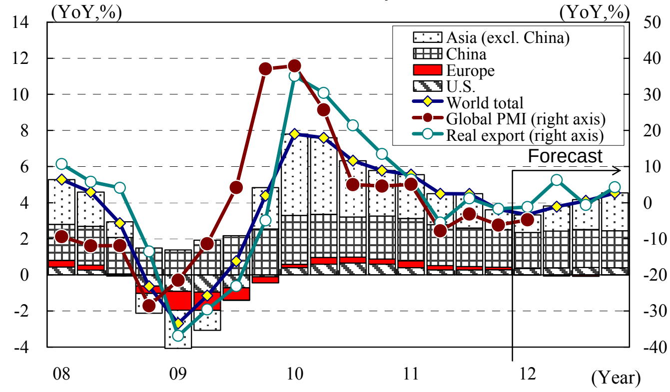
On the other hand, while the real GDPs of major export destination countries and regions have been declining recently, economic growth in Asia and the US in particular is expected to gradually accelerate (Figure 5). Three straight months of rise by the global PMI (which leads exports by approximately one quarter) through last November supports this view. Consequently, Japanese exports are expected to start to recover soon, and, with an expected boost in automobile manufacturing from the Ecocar subsidy program, production is projected to rise. Further, the trade balance (in customs-cleared terms) stood at -JPY2.5 trillion, the first trade deficit since 1980. Exports of course fell amidst challenging conditions like the March 11 earthquake, the flooding in Thailand, slowing overseas economies, and the strong JPY, but greater import volumes of substitute fuels (like liquefied natural gas) and surging prices had an even bigger impact. Such pressures to increase imports are expected to persist through at least mid-FY12, and the trade deficit is likely to continue even as exports recover.

Figure 4: Prodction by Major Industries



Source: Complied by BTMU Economic Research Office from METI Materials.

Figure 5: Real Exports and Growth Rate of Main Export Destinations



Note: 1. *Europe* includes Eurozone and UK. *Asia (excl.China)* includes NIEs, ASEAN4 and India.
2. *World total* is weighted averageby export weigtht of main export destinations' Real GDP growth rate.
Source: Complied by BTMU Economic Research Office from MOF, Bloomberg, countries' data.

②Corporate Profits, Capital Expenditures

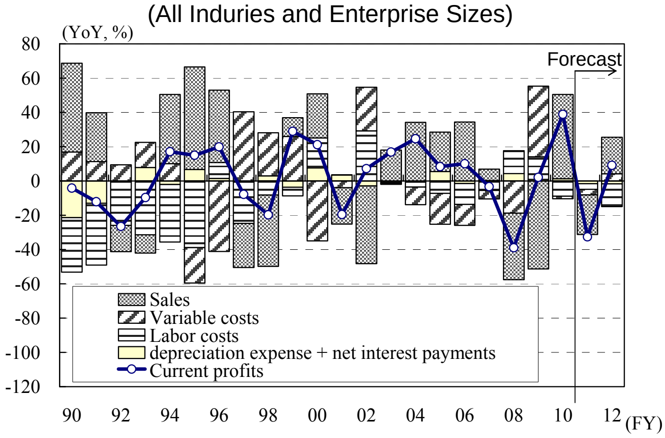
Even as the effects of the March 11 disaster and Thai flooding disappear, recovery momentum of external demand is weak and profits increase only slightly

Corporate profits are likely to once again decline in FY11 due to the impact of the March 11 disaster and the flooding in Thailand (Figure 6). Manufacturers in particular are expected to report bigger drops in profits because of slowing foreign demand and the strong JPY. However, the impacts of the earthquake shock and flooding in Thailand are expected to be largely negated in FY12, and rather greater reconstruction and rebuilding demand are expected to act as positive domestic factors. On the other hand, the adverse effects from weakening overseas economies and the strong JPY are likely to remain deep-rooted. Although the growth rates of Japan's major trading partner countries and regions are accelerating, the paces will be merely limited compared to the past, and with the JPY expected to continue trading at the upper JPY/USD70 and approximately JPY/EUR100 levels, the exchange rate is likely to continue to put downward pressure on corporate profits. As a result, sales recovery momentum will inevitably be weak and corporate profits are expected to increase only slightly in FY12.

Reconstruction demand to support capital expenditures over the near term

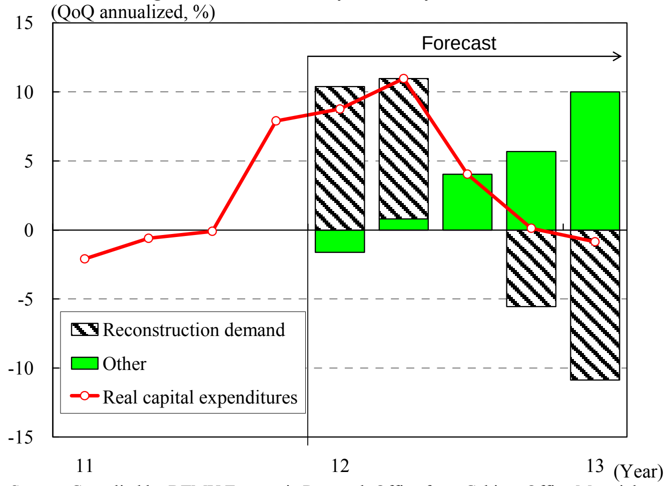
Capital expenditures are expected to recover steadily due to accelerating reconstruction demand. Real capital expenditures in GDP data rose +1.9% QoQ (annualized +7.9%) in Oct-Dec 2011, the first increase in five quarters and the highest rate since the Apr-Jun 2010 quarter. Additionally, new private non-residential starts floorspace surged in Iwate, Miyagi and Fukushima prefectures, the regions hardest hit by the March 11 earthquake. Domestic shipments of investment goods and the value of private non-residential construction increased somewhat. Looking ahead, private sector reconstruction investment is likely to gain momentum as the reconstruction-related budget is implemented more fully (Figure 7). Furthermore, exports are expected to start to improve and corporate profits (especially among manufacturers) to gradually recover in mid-FY12, and base investment demand is expected to slowly increase. Therefore, capital expenditures are projected to continue rising steadily even as reconstruction demand fades.

Figure 6: Current Profits
(All Induries and Enterprise Sizes)



Note: *Variable costs* is (sales costs + sales and general administrative costs) - labor costs - other fixed costs.
Source: Complied by BTMU Economic Research Office from MOF materials.

Figure 7: Real Capital Expenditures



Source: Complied by BTMU Economic Research Office from Cabinet Office Materials.

(2) Household Sector

①Employment • Wage

Though employment indicators show improvement, wage data remain weak

Employment-related indicators are improving overall. Although the total unemployment rate stood at 4.5% in Oct-Dec, higher (worse) than a year earlier, the degree of increase was limited and the level was still below the pre-March 11 level (4.9% in January 2011 and 4.6% in February 2011, Table 1). Further, an increase in worker numbers and higher ratios of offers to job seekers and new openings point to improving employment conditions. On the other hand, wages are still low. Total cash wages declined on-year for two straight quarters after the March 11 disaster and were only flat in the most recent Oct-Dec quarter. However, there are signs of positive changes ahead, such as wages starting to rise for the first time in three quarters as unscheduled working hours increase.

Table 1: Employment- and Wage-Related Indicators

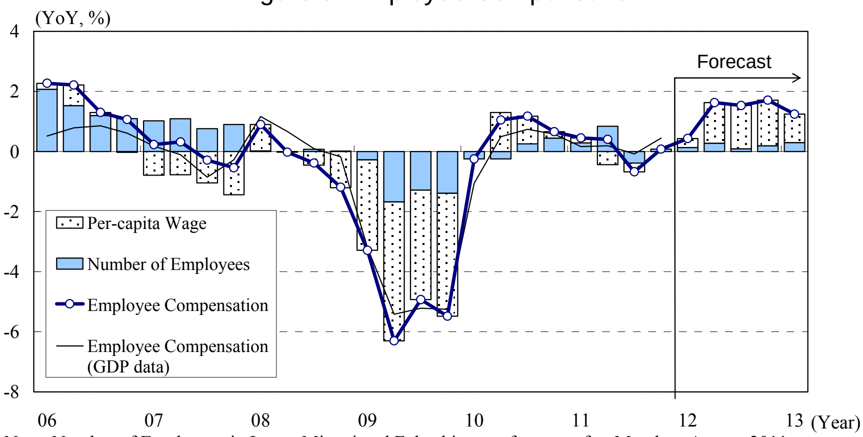
	2011	Jul-Sept	Jul	Aug	Sept	Oct-Dec	Oct	Nov	Dec
Unemployment Rate (%)	4.5	4.4	4.7	4.3	4.1	4.5	4.5	4.5	4.6
Job Seekers (YoY, QoQ, MoM '000 persons)	+13	▲ 6	▲ 44	▲ 12	+37	+5	▲ 7	+23	▲ 2
Job Offers to Applicants Ratio (mult)	0.65	0.66	0.64	0.66	0.67	0.69	0.67	0.69	0.71
New Job Openings (mult)	1.08	1.08	1.07	1.05	1.11	1.18	1.13	1.18	1.22
Total Cash Wages (YoY, %)	▲ 0.2	▲ 0.3	▲ 0.2	▲ 0.4	▲ 0.4	0.0	0.0	▲ 0.2	0.1
Scheduled Wages	▲ 0.4	▲ 0.3	▲ 0.4	▲ 0.2	▲ 0.3	▲ 0.4	▲ 0.4	▲ 0.3	▲ 0.3
Unscheduled Wages	0.9	▲ 0.4	0.3	▲ 1.6	0.1	2.2	2.9	2.2	1.7
Special Wages	0.7	▲ 0.2	0.1	▲ 0.1	▲ 6.5	0.4	7.4	▲ 1.8	0.4

Notes: 1. *Unemployment Rate and Job seekers* excludes Iwate, Miyagi, and Fukushima prefectures.
2. *Monthly Labor Survey* covers companies surveyed with five or more workers.
Source: Compiled by BTMU Economic Research Office from MIC, MHLW data.

Worker incomes recover as working hours again rise and as employment levels hold

As noted earlier, production is projected to expand. Employment levels are thus projected to remain steady and wages to increase as working hours, especially unscheduled hours, increase. Unscheduled working hours are still lower than the average level over the past several years and the impact of expanded production could appear more in terms of working hours (an increase in unscheduled working hours), rather than in terms of employment (an increase in worker numbers). However, either way, worker incomes—the product of worker numbers and per capita worker incomes—can be projected to gradually rise (Figure 8). Worker compensation started to increase in Oct-Dec, according to GDP figures, and are likely to rise steadily further in Jan-Mar.

Figure 8: Employee Compensation



Note: Number of Employees in Iwate, Miyagi and Fukushima prefectures after March to August 2011 added by BTMU.
Source: Compiled by BTMU Economic Research Office based on MHLW and MIC data.

②Private Consumption

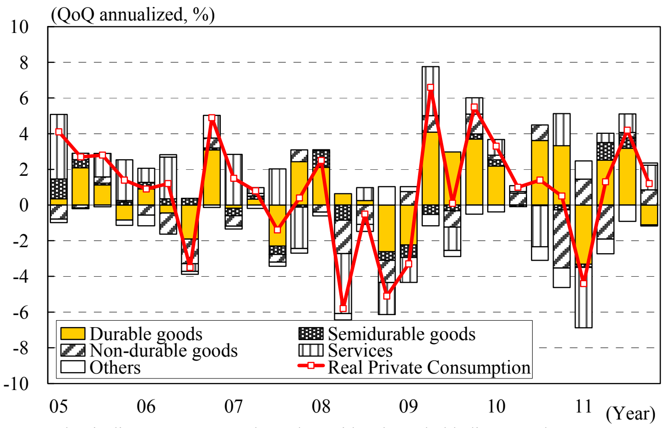
Private consumption has been firm since the earthquake

Real private consumption rose an annualized +1.2% QoQ in Oct-Dec, continuing to accelerate from the strong growth of Jul-Sept (Figure 9). This was the third straight quarter of real private consumption increase since the March 11 disaster. By type of goods, consumption of both non-durable goods (+3.8% QoQ annualized) and services (+2.6% QoQ annualized) accelerated. This offset the decline in consumption of durable goods (including not only automobiles but also household heating and cooling equipment), which posted a reactionary drop of -7.5% QoQ annualized after surging +25.0% QoQ annualized in Jul-Sept.

Private consumption expected to steady further in terms of both income and sentiment

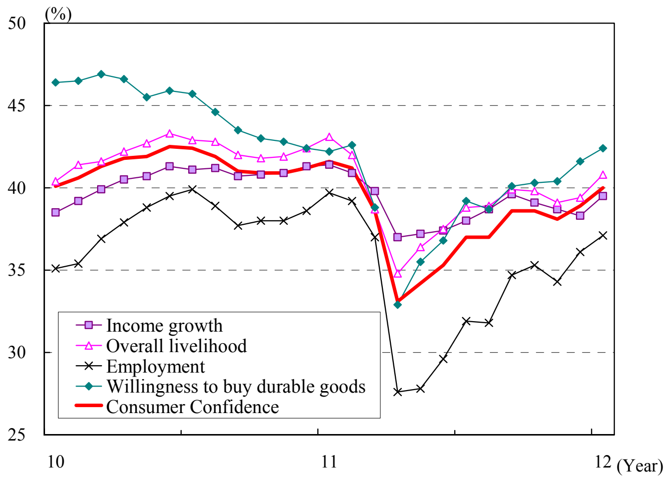
On the other hand, consumer sentiment is steadily improving. The Consumer Confidence Index rose +2.7% QoQ in Oct-Dec, extending the rise of Jul-Sept. The January figure (+2.8% MoM) continued the favorable trend (Figure 10). In particular, the improving views toward employment conditions—which are expected to get better—are striking. As noted earlier, worker incomes and compensation are expected to increase gradually as production and worker hours expand, and this is projected to further steady both consumer sentiment as well as private consumption.

Figure 9: Real Private Consumption by Goods



Note: Other is direct overseas purchases by resident household, direct purchases within Japan by non-resident household (exemption).
Source: Compiled by BTMU Economic Research Office based on Cabinet Office data.

Figure10: Indicators in the Consumer Confidence Survey



Source: Compiled by BTMU Economic Research Office from Cabinet Office data.

③Housing Investment

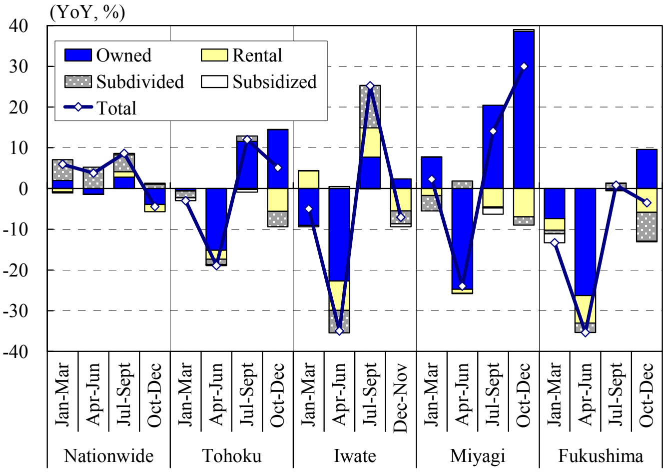
Despite decline in housing investment and starts, this is within expected scope of reaction

Real residential investment (in GDP data) fell an annualized -3.1% QoQ and residential housing starts floorspace by -29.5% QoQ in Oct-Dec. However, a rush of demand occurred ahead of the expiration of various home purchase programs in Jul-Sept, manifesting for example as a +19.0% QoQ annualized jump in GDP figures. A reactionary plunge was naturally expected to occur, and the rate of decline was well within the range expected. Amidst such conditions, residential construction starts (floorspace) in the Tohoku region, particularly in the heaviest-hit Iwate, Miyagi, and Fukushima prefectures, continued to rise, especially for owned homes (Figure 11). The number of owned homes destroyed appears to have been high compared to other disasters, and this suggests that reconstruction and rebuilding activity will steadily arise.

Residential investment expected to accelerate as reconstruction and rebuilding demand build

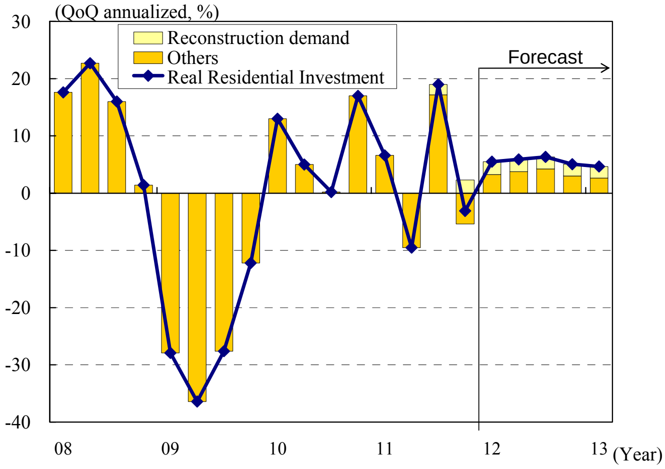
Residential rebuilding activity is projected to continue for some time in the disaster region. Furthermore, the third supplementary budget passed last November included not only the Flat 35S Eco (expanded cuts in applied interest rates) and Reconstruction Support and Residential Ecopoint programs, but also widened preferential tax treatments in the tax revisions currently being debated for next fiscal year. Such support measures, like continued low interest rate conditions and rising worker incomes, are likely to support home purchases. Despite showing a reactionary decline in Oct-Dec, residential investment can be expected to steadily increase going forward (Figure 12).

Figure 11: New Residential Construction Floor Space



Source: Compiled by BTMU Economic Research Office from MLIT

Figure 12: Real Residential Investment



Source: Compiled by BTMU Economic Research Office from Cabinet Office materials.

(3) Public Sector

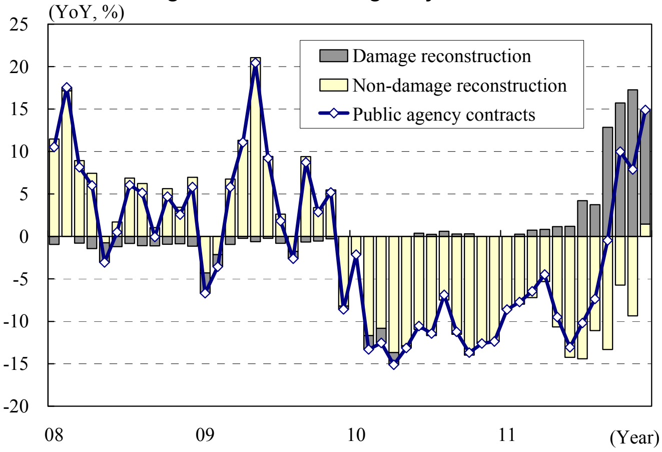
Public demand increased significantly in Tohoku but decreased nationally

Real public demand declined by an annualized -0.9% QoQ in Oct-Dec, decreasing for the second straight quarter. Public sector fixed capital formation is increasing dramatically in the Tohoku area, where earthquake-related reconstruction and rebuilding projects are underway; however, work is decreasing in other areas and pushing down overall public demand. But according to the *Monthly Report on Current Survey of Orders Received for Construction*, public construction orders, a leading indicator for public construction, have increased significantly in post-disaster projects since October, offsetting declines in other projects (Figure 13). Additionally, in December, orders for non-disaster-related projects increased as well, indicating a robust rise in public fixed investment across the country in the near future.

Reconstruction to boost GDP by more than 3%

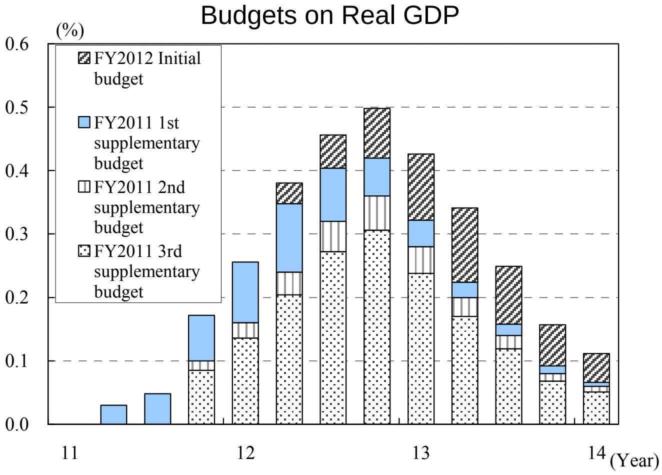
Earthquake-related expenditures in the FY11 first, second, and third supplementary budgets and FY12 initial budget total JPY18 trn and are expected to boost GDP by approximately 3.2%. In the past, additional demand resulting from economic measures appears over four or five quarters. Thus, the effects of increased spending this time are expected to peak around the end of 2012 (Figure 14).

Figure 13: Public Agency Contracts



Note: Contracts totaling JPY5 mn or more from public agencies.
Source: Compiled by BTMU Economic Research Office from MLIT data.

Figure 14: Impact of FY11 The Earthquake-Related Budgets on Real GDP



Source: Compiled by BTMU Economic Research Office from Cabinet Office materials.

(4) Inflation

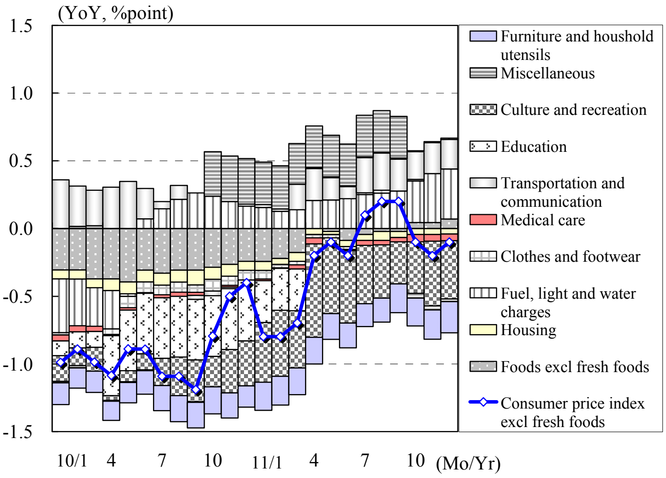
Core CPI once again in negative territory

The Consumer Price Index (excluding fresh foods, core CPI) has remained negative for three consecutive months since October, when temporary boosting factors such as higher cigarette taxes and casualty insurance premiums fell off (Oct: -0.1% YoY, Nov: -0.2% YoY, Dec: -0.1% YoY Figure 15). On quarter, the Oct-Dec average was once again negative, at -0.1% YoY, following the first positive reading in 11 quarters in Jul-Sep. By component, the upward trends have been striking for energy-related prices such as utilities (electricity, gas and heating oil) and transportation (gasoline). Foodstuff prices have also risen, however slightly. On the other hand, prices for culture and recreation (TVs) and household durable goods (refrigerators and washing machines) have kept falling, pushing down the overall figure. The core-core CPI (excluding foods except alcoholic beverages and energy) has stayed in negative territory since Jan 2009, and there is no doubt that the deflationary trend has been persistent.

CPI to stay in negative range over forecast period as deflationary gap persists

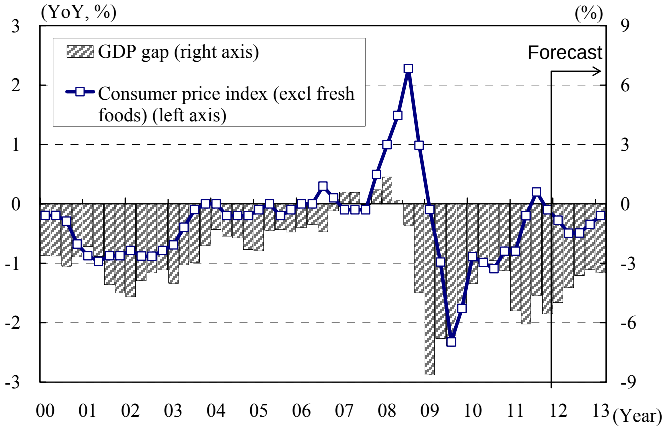
The higher oil prices of the previous year will likely further push down both core and core-core CPIs through mid-year. Even thereafter, the CPI is projected to stay negative because the deflationary gap is expected to persist (Figure 16). Furthermore, the downward trend of both manufacturers' and non-manufacturers' output prices could pull down consumer prices downstream. On the other hand, energy and food prices may rise sharply because of speculative money pouring into the commodity markets and also because of tighter supply-demand conditions.

Figure 15: Consumer Price Index by Subcategoris



Source: Compiled by BTMU Economic Research Office from MIC data.

Figure16: Consumer Price Index and GDP Gap



Notes: 1. *GDP Gap* = (Real GDP- Potential GDP) / Potential GDP.
2. *Potential GDP* is calculated by BTMU Economic Research Office.
Source: Compiled by BTMU Economic Research Office from MIC data.

3. Monetary Policy, Financial Markets

(1) Monetary Policy

BoJ agrees on medium to long-term price stability goal and additional monetary easing at February meeting

At the February 13-14 monetary policy meeting, the BoJ agreed to release *The Price Stability Goal in the Medium to Long Term* (Table 2). With this, the BoJ clarified that *For the time being, the Bank will pursue powerful monetary easing…, with the aim of achieving the goal of 1 percent in terms of the year-on-year rate of increase in the CPI* (February meeting statement). The new wording is more decisive than the previous *Understanding of Medium-to Long-Term Price Stability*. At the February meeting, the BoJ also agreed to increase asset purchases by raising the limit of long-term government bond purchases from JPY9 trn to JPY19 trn.

BoJ to maintain virtually zero interest rate policy over foreseeable future

In the foreseeable future, the BoJ is expected to maintain its current virtually zero interest rate policy. According to the January review of *Outlook for Economic Activity and Prices*, Board Members project a CPI (excluding fresh foods) below the price stability goal of 1% even for FY13 (Table 3). This indicates it will be some time before monetary easing policies are lifted.

Table 2: Outline of *Medium- to Long-Term Price Stability Guidelines*

- The inflation rate the Bank judges to be consistent with price stability sustainable in the medium to long term.
- The BoJ judges that this is in a positive range of 2 percent or lower in terms of the year-on-yearchange in the…CPI , and the goal is 1 percent for the time being.
- *An inflation rate goal of 1 percent for the time being* in its monetary policy operations has been clearly stated.
- *The price stability goal in the medium to long term* will be reviewed once a year in principle.

Reference: Previous *Understanding of Price Stability*

- The level of inflation that each member of the Policy Board understands, when conducting monetary policy, as being consistent with price stability over the medium to long term.
- In a positive range of 2 percent or lower, and the midpoints of most Policy Board members' *understanding* are around 1 percent.

Source: Compiled by BTMU Economic Research Office from BoJ materials.

Table3: Outlook on Economy and Prices by the BOJ Policy Board Members (Jan)

(YoY, %)

	Real GDP	Domestic Corporate Goods Price Index	Consumer Price Index (excl. fresh food)
FY2011	-0.4～-0.3 〈-0.4〉	+1.8～+1.9 〈+1.8〉	-0.1～0.0 〈-0.1〉
Outlook as of Oct	+0.2～+0.4 〈+0.3〉	+1.7～+2.0 〈+1.8〉	0.0～0.0 〈0.0〉
FY2012	+1.8～+2.1 〈+2.0〉	-0.1～+0.2 〈+0.1〉	0.0～+0.2 〈+0.1〉
Outlook as of Oct	+2.1～+2.4 〈+2.2〉	+0.1～+0.3 〈+0.2〉	0.0～+0.2 〈+0.1〉
FY2013	+1.4～+1.7 〈+1.6〉	+0.6～+1.0 〈+0.8〉	+0.4～+0.5 〈+0.5〉
Outlook as of Oct	+1.3～+1.6 〈+1.5〉	+0.7～+0.9 〈+0.8〉	+0.4～+0.6 〈+0.5〉

Note: Figures in < > are the median figures of the outlook
Source: Compiled by BTMU Economic Research Office from BoJ materials.

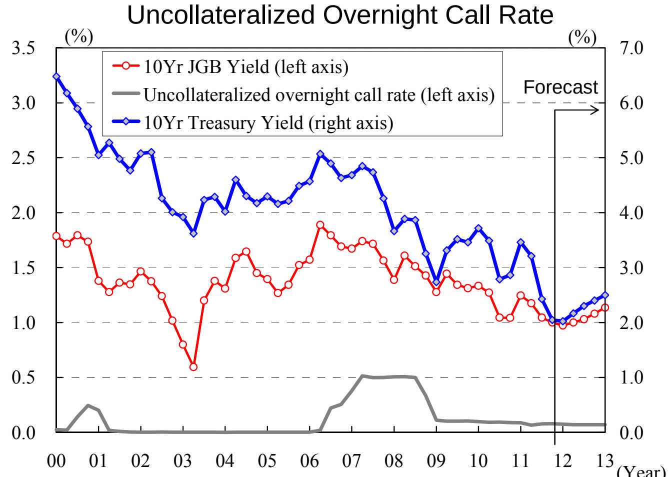
(2) 10-Year JGB Yield

Long-term interest rates to move in current range

The yield on newly-issued 10Yr JGBs remains at a low level of around 1% due to increased speculation that the Fed's monetary easing will be extended and the BoJ's additional monetary easing in February (Figure 17). For the future, the yield is likely to move in the current range on concerns about domestic and overseas economies deteriorating and the BoJ's virtually zero interest rate policy. From the fall of 2012, we expect yields to rise somewhat along with US long-term yields, supported by the US economy regaining momentum.

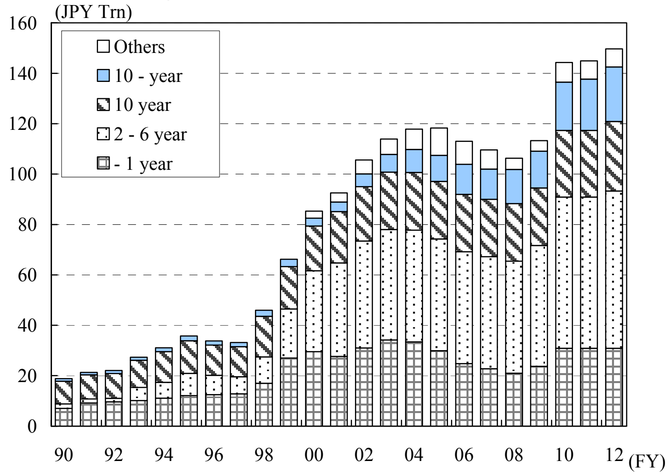
JGB market issuance will total JPY149.7 trn in FY12, the third straight year of record-high issuance. A possible rise in long-term yields due to concerns for Japan's fiscal stability is a risk that bears watching. Though long-term yields are expected to stay low as a trend, they are expected to rise over the short term.

Figure 17: US-Japan Long-Term Yields and Uncollateralized Overnight Call Rate



Source: Compiled by BTMU Economic Research Office from Bloomberg data.

Figure18: JGB Market Issuance



Source: Compiled by BTMU Economic Research Office based on MOF data

(3) Exchange Rates

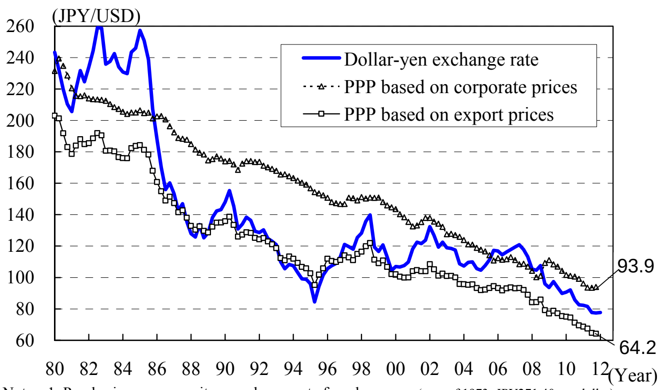
JPY appreciation/ USD depreciation pressure easing somewhat

The recent brisk US economy and the BoJ's additional monetary easing are causing JPY appreciation / USD depreciation pressures to ease. However, The US Federal Reserve Board expects to maintain its exceptionally low interest rate policy through late 2014, and a narrow spread between US and Japanese interest rates is likely to persist. There is also no sign of an end to the European sovereign debt problems. Therefore, it appears to be premature to conclude that the JPY appreciation trend has ended.

Narrow US-Japanese interest rate spread and European sovereign debt problems to prolong JPY appreciation trend

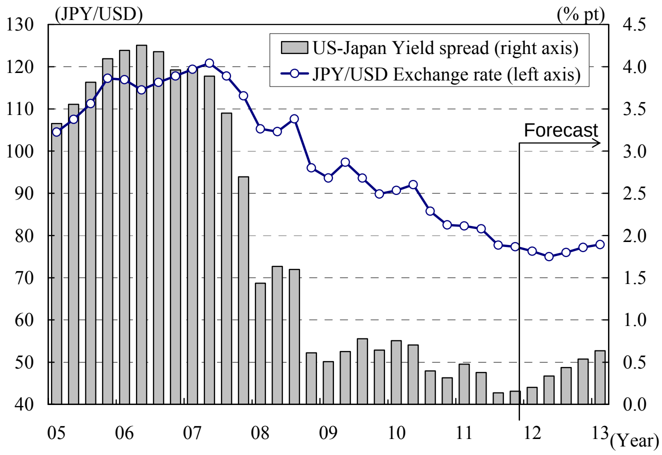
In terms of purchasing power parity, the JPY is on an appreciating trend against the USD, even though levels differ by price indicators. The actual JPY/USD rate has also been following an appreciating trend (Figure 19). In the mid-2000s, when the US-Japanese interest rate spread widened, the JPY/USD rate diverged from movements indicated by purchasing power parity; however, this is unlikely to reoccur in the foreseeable future. Although the US economy's recovery is expected to ease JPY appreciation pressure somewhat through the end of FY12, any movement would be limited to within the JPY appreciation trend (Figure 20).

Figure19: Yen Exchange Rate : Purchasing



Notes: 1. Purchasing power parity = exchange rate for a base year (avg. of 1973: JPY271.40 per dollar) × (Japanese price index/U.S. price index)
2. Data for export prices are the averages of those based on corporate prices and those based on GDP deflator.
Source: Compiled by BTMU Economic Research Office from Bank of Japan, Cabinet Office, U.S. DOL, U.S. DOC, and Bloomberg data.

Figure20: JPY/USD Exchange Rate and US-Japan Yield



Note: US-Japan yield spread is US 2Yr Treasury yield minus 2Yr JGB yield.
Source: Compiled by BTMU Economic Research Office from Bloomberg data.

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Outlook for the Japanese Economy

27-Feb-2012

Forecast → (from 2012 1Q)

Bank of Tokyo-Mitsubishi UFJ Economic Research Office

(%, billion yen)

	2010				2011				2012				2013	FY2010	FY2011	FY2012
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q			
1. The Real Economy (QoQ annualized change)																
Real GDP	6.1	5.2	2.3	-0.6	-6.8	-1.5	7.0	-2.3	2.5	3.9	3.5	2.2	0.1	3.1	-0.5	2.5
Private Consumption	3.3	1.0	1.4	0.5	-4.4	1.3	4.2	1.2	0.8	1.2	1.1	1.0	0.9	1.5	0.6	1.2
Housing Investment	13.0	5.0	0.2	17.0	6.6	-9.5	19.0	-3.1	5.5	5.9	6.3	5.1	4.7	2.3	4.0	5.3
Private Business Fixed Investment	-4.7	21.4	3.1	-6.4	-2.1	-0.6	-0.1	7.9	8.8	11.0	4.0	0.1	-0.9	3.5	0.5	5.9
Business Inventory (Contribution)	1.8	1.9	1.1	0.2	-3.4	0.4	0.9	-1.1	0.1	0.1	0.2	0.2	0.3	0.8	-0.4	0.0
Government Expenditures	1.5	-1.2	0.6	-0.7	-0.2	7.4	-0.1	-0.9	5.9	7.3	7.2	3.5	-6.1	0.5	2.0	4.2
Public Investment	13.8	-25.4	0.3	-12.1	-9.5	28.9	-6.2	-9.5	12.6	19.3	18.3	8.2	-15.1	-6.8	1.6	8.8
Net Exports (Contribution)	2.3	0.4	-0.1	-0.4	-0.8	-4.1	3.1	-2.6	-0.7	-0.2	0.3	0.5	0.7	0.8	-1.0	-0.1
Exports	27.5	25.5	5.1	-1.2	-1.2	-22.7	39.0	-11.9	0.8	3.5	6.2	6.8	7.4	17.2	-1.8	3.9
Imports	9.8	26.3	6.9	1.4	4.2	1.3	14.2	4.1	6.3	5.3	4.7	4.3	3.5	12.0	5.3	5.5
Nominal GDP	5.8	2.5	0.2	-3.0	-7.5	-5.7	6.1	-3.1	1.4	3.6	3.3	1.5	-0.9	1.1	-2.4	1.9
GDP Deflator (YoY)	-2.4	-2.1	-2.0	-1.9	-1.9	-2.3	-2.1	-1.6	-1.6	-0.8	-0.7	-0.7	-0.4	-1.9	-1.9	-0.7
Industrial Production Index (QoQ)	7.3	0.7	-1.0	-0.1	-2.0	-4.0	4.3	-0.4	2.9	2.3	2.4	2.0	1.3	8.9	-2.2	8.7
Domestic Corporate Goods Price Index (YoY)	-1.6	0.2	-0.1	1.0	1.8	2.5	2.6	1.5	1.2	0.5	0.8	0.8	0.9	0.7	1.9	0.8
Consumer Price Index (excl. fresh food, YoY)	-0.9	-1.0	-1.1	-0.8	-0.8	-0.2	0.2	-0.1	-0.3	-0.5	-0.5	-0.4	-0.2	-0.9	-0.1	-0.4
2. Balance of Payments																
Trade Balance (billion yen)	2,380	1,811	1,967	1,778	910	-1,249	-126	-1,118	-1,416	-1,054	-440	-792	-1,012	6,496	-3,909	-3,298
Current Balance (billion yen)	4,531	3,904	4,405	4,321	3,260	1,899	2,708	1,751	1,571	1,990	2,661	2,365	2,203	16,126	7,929	9,219
3. Financial																
Uncollateralized overnight call rate	0.1	0.1	0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1	0-0.1
Euro-Yen TIBOR (3-mo.)	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.3	0.3
Newly Issued 10-Year Government Bonds Yield	1.3	1.3	1.0	1.0	1.2	1.2	1.0	1.0	1.0	1.0	1.0	1.1	1.1	1.2	1.0	1.1
Exchange Rate (Yen / U.S.$)	91	92	86	83	82	82	78	77	76	75	76	77	78	86	78	77

Note: Uncollateralized overnight call rate is end-of-period rate. Euro-Yen TIBOR (3-mo.), newly issued 10-year government bonds yield, and exchange rate (Yen/U.S.$) are period average.Domestic Corporate Goods Price and Consumer prices reflect 2005 base revision.

MAIN ECONOMIC AND FINANCIAL INDICATORS (JAPAN)

１. Main Economic Indicators

As of Mar. 6, 2012

	Fiscal	Fiscal	2011			2011				2012
	2009	2010	2Q	3Q	4Q	SEP	OCT	NOV	DEC	JAN
Real GDP Growth Rate <% changes from	-2.1	3.1	-6.8	-1.5	7.0	***	***	***	***	***
previous period at SA annual rate>			(-0.3)	(-1.7)	(-0.5)					
Index of All Industries Activity	-4.2	2.0	-1.9	-0.4	2.0	-0.8	0.9	-1.0	1.3	
			(-0.5)	(-1.7)	(-0.4)	(-0.7)	(0.2)	(-1.1)	(-0.5)	
Industrial Production Index	-8.8	8.9	-2.0	-4.0	4.3	-3.3	2.2	-2.7	3.8	2.0
Production			(-2.5)	(-6.8)	(-2.1)	(-3.3)	(0.1)	(-4.2)	(-4.3)	(-1.2)
Shipments	-8.3	9.3	-1.9	-5.9	6.6	-2.0	0.2	-1.6	4.6	-0.7
			(-2.6)	(-8.4)	(-2.0)	(-2.9)	(-0.3)	(-4.6)	(-3.0)	(-1.4)
Inventory	-6.1	3.5	1.0	3.2	1.9	-0.1	0.9	-0.6	-2.9	3.1
			(3.5)	(4.0)	(5.5)	(5.5)	(7.0)	(8.2)	(3.4)	(2.6)
Inventory/Shipments Ratio	120.4	108.2	106.9	119.1	116.8	119.2	118.1	116.2	111.9	113.2
(2005=100)			[106.3]	[106.5]	[108.7]	[109.1]	[117.0]	[108.0]	[108.0]	[107.9]
Domestic Corporate Goods Price Index	-5.2	0.7	1.2	1.2	-0.1	-0.1	-0.8	0.0	0.0	-0.1
			(1.8)	(2.5)	(2.6)	(2.5)	(1.6)	(1.6)	(1.2)	(0.5)
Consumer Price Index(SA, total, excl.fresh foods)	-1.6	-0.8	-0.3	0.5	-0.1	-0.1	-0.1	0.0	0.0	0.1
			(-0.8)	(-0.3)	(0.2)	(0.2)	(-0.1)	(-0.2)	(-0.1)	(-0.1)
Index of Capacity Utilization	80.0	88.0	86.1	80.4	87.2	85.8	89.3	86.7	89.4	
(2005=100)			[89.5]	[89.8]	[88.4]	[88.1]	[86.7]	[88.2]	[90.2]	[91.1]
Machinery Orders(Private Demand,	-20.4	9.1	5.6	2.5	1.5	-8.2	-6.9	14.8	-7.1	
Excl.Electric Power and Ship building)			(8.9)	(9.8)	(5.8)	(9.8)	(1.5)	(12.5)	(6.3)	
Manufacturing	-27.9	18.3	5.3	-0.2	2.5	-17.5	5.5	4.7	-7.1	
			(16.3)	(17.2)	(4.4)	(4.8)	(2.4)	(7.1)	(3.0)	
Non-manufacturing	-14.7	2.7	1.4	5.0	5.0	8.5	-7.3	6.2	-6.0	
Excl.Electric Power & Ship building			(3.5)	(4.2)	(7.2)	(13.2)	(1.0)	(16.0)	(9.0)	
Shipments of Capital Goods	-24.2	21.3	-2.4	6.1	-0.1	-6.0	3.5	0.7	1.7	-3.3
(Excl.Transport Equipment)			(6.6)	(9.0)	(4.1)	(-1.3)	(1.0)	(3.1)	(2.7)	(2.7)
Construction Orders	-14.2	-5.2								
			(-4.9)	(18.0)	(-0.6)	(-9.3)	(24.3)	(21.0)	(1.5)	(24.6)
Private	-15.3	-2.6								
			(1.5)	(20.1)	(-2.1)	(-14.0)	(7.1)	(18.0)	(5.8)	(22.6)
Public	-11.1	-12.1								
			(-20.1)	(15.1)	(21.7)	(31.1)	(115.8)	(-10.7)	(-0.6)	(39.0)
Public Works Contracts	4.9	-8.8								
			(-3.2)	(-9.3)	(-3.4)	(3.3)	(3.2)	(6.8)	(0.6)	(8.5)
Housing Starts	77.5	81.8	83.2	82.4	88.3	74.9	78.1	82.4	78.3	82.2
10,000 units at Annual Rate, SA	(-25.4)	(5.6)	(3.2)	(4.1)	(7.9)	(-10.8)	(-5.8)	(-0.3)	(-7.3)	(-1.1)
Total floor	(-21.5)	(9.0)	(6.0)	(3.8)	(8.6)	(-10.3)	(-5.8)	(-0.1)	(-7.3)	(-2.7)
Sales at Retailers	-0.4	0.8								
			(-3.0)	(-1.7)	(-1.0)	(-1.1)	(1.9)	(-2.2)	(2.5)	(1.9)
Real Consumption Expenditures	1.0	-0.9	-2.8	0.4	0.9	0.8	0.3	-0.4	-0.1	-0.1
of Households over 2 persons (SA)			(-3.0)	(-2.1)	(-2.8)	(-1.9)	(-0.4)	(-3.2)	(0.5)	(-2.3)
Propensity to Consume	74.7	73.4	71.9	74.1	73.0	74.1	72.7	74.1	74.5	73.7
(SA,%)			[74.1]	[72.4]	[75.2]	[75.1]	[71.7]	[75.7]	[74.3]	[75.9]
Overtime Hours Worked	-8.5	6.8	1.2	-2.6	1.3	1.1	-0.1	0.0	2.3	0.5
(All Industries, 5 employees or more)			(1.7)	(-2.0)	(-0.6)	(1.0)	(1.0)	(0.0)	(1.8)	(1.0)
Total Cash Earnings (Regular Employees	-3.3	0.6								
Only; All Industries, 5 employees or more)			(0.1)	(-0.4)	(-0.3)	(-0.4)	(0.0)	(-0.2)	(0.1)	(0.0)
Employment Index(Regular Employees Only;'All Industries,	-77,894	23,384	33,848	28,033	27,711	24,538	21,493	28,986	25,572	21,322
5 employees or more) (Change over the M/Q/Y)			1,683	10,188	21,464	24,836	28,054	28,971	27,087	32,797
Ratio of Job Offers to Applicants	0.45	0.56	0.61	0.62	0.66	0.67	0.68	0.69	0.71	0.73
(SA,Times)			[0.46]	[0.50]	[0.54]	[0.55]	[0.56]	[0.57]	[0.58]	[0.60]
Unemployment Rate	5.2	5.0	4.7	4.7	4.4	4.2	4.4	4.5	4.5	4.6
(SA,%)										
Economy Watcher Survey	39.9	44.2	40.1	38.0	48.4	45.3	45.9	45.0	47.0	44.1
(Judgment of the present condition D.I,%)			[42.8]	[48.3]	[45.4]	[41.2]	[40.2]	[43.6]	[45.1]	[44.3]
Bankruptcies (Number of cases)	14,732	13,065	3,211	3,312	3,108	1,001	976	1,095	1,032	985
	(-8.7)	(-11.3)	(-7.3)	(-0.3)	(-3.8)	(-9.1)	(-14.0)	(3.2)	(-6.3)	(-5.3)

(Notes)

Unless otherwise indicated, tabulated figures and those in parentheses show % changes from previous quarter/month as applicable.

The figures in ( ) indicate % changes from previous year.

[ ] show the comparable figure of the previous year.

Unemployment Rate excludes Iwate, Miyagi, and Fukushima prefectures from March to August 2011.

2. Balance of Payments

	Fiscal 2009	Fiscal 2010	2011 2Q	2011 3Q	2011 4Q	2011 SEP	2011 OCT	2011 NOV	2011 DEC	2012 JAN
Customs Clearance(Exports in Yen Terms)	-17.1	14.9	(2.5)	(-8.1)	(0.5)	(2.3)	(-3.8)	(-4.5)	(-8.0)	(-9.3)
Value	-7.0	0.2	(-0.0)	(0.2)	(1.6)	(0.9)	(0.2)	(-0.1)	(-1.5)	(0.5)
Volumes	-9.9	14.6	(2.4)	(-8.3)	(-1.1)	(1.5)	(-3.9)	(-4.4)	(-6.6)	(-9.7)
Imports(In Yen terms)	-25.2	16.0	(11.4)	(10.4)	(13.8)	(12.2)	(17.9)	(11.4)	(8.1)	(9.9)
Value	-18.4	3.3	(4.0)	(7.4)	(12.1)	(11.1)	(11.3)	(12.6)	(8.8)	(6.5)
Volumes	-7.3	12.4	(7.2)	(2.8)	(1.5)	(1.0)	(6.0)	(-1.0)	(-0.6)	(3.1)
Current Balance(100 mil. yen)	157,817	161,255	39,866	15,372	31,007	16,107	5,624	1,385	3,035	
Trade Balance(100 mil. yen)	65,996	64,955	5,577	-10,534	-1,762	3,723	-2,061	-5,851	-1,458	
Services(100 mil. yen)	-18,185	-12,730	-771	-5,040	-5,146	-904	-2,754	-1,151	-1,544	
Capital and Financial Accounts(100 mil. yen)	-123,113	-97,221	-34,301	8,947	4,590	-19,171	-5,277	77,048	8,968	
Gold & Foreign Exchange Reserves($1mil.)	1,042,715	1,116,025	1,116,025	1,137,809	1,200,593	1,200,593	1,209,882	1,304,763	1,295,841	1,306,668
Exchange Rate(\/$)	92.80	85.69	82.32	81.70	77.84	76.84	76.77	77.54	77.85	76.97

3. Financial Market Indicators

	Fiscal 2009	Fiscal 2010	2011 2Q	2011 3Q	2011 4Q	2011 SEP	2011 OCT	2011 NOV	2011 DEC	2012 JAN
Uncollateralized Overnight Call Rates	0.102	0.091	0.088	0.067	0.078	0.080	0.081	0.077	0.078	0.080
			[0.098]	[0.093]	[0.093]	[0.091]	[0.091]	[0.091]	[0.087]	[0.085]
Euro Yen TIBOR	0.516	0.356	0.336	0.332	0.330	0.329	0.329	0.329	0.329	0.331
(3 Months)			[0.443]	[0.388]	[0.364]	[0.355]	[0.336]	[0.335]	[0.335]	[0.335]
Newly Issued Japanese Government Bonds Yields	1.353	1.127	1.242	1.160	1.043	1.020	1.045	1.065	0.980	0.965
(10 Years)			[1.337]	[1.208]	[0.987]	[0.930]	[0.920]	[1.185]	[1.110]	[1.215]
Average Contracted Interest Rates	1.449	1.357								
on Loans and Discounts(City Banks)			1.357	1.349	1.315	1.315	1.317	1.313	1.292	1.294
(% changes from previous period)			(-0.025)	(-0.008)	(-0.034)	(-0.022)	(0.002)	(-0.004)	(-0.021)	(0.002)
The Nikkei Stock Average	11,090	9,755	9,755	9,816	8,700	8,700	8,988	8,435	8,455	8,803
(TSE 225 Issues)			[11,090]	[9,383]	[9,369]	[9,369]	[9,202]	[9,937]	[10,229]	[10,238]
M2(Average)	(2.9)	(2.7)	(2.4)	(2.8)	(2.8)	(2.7)	(2.8)	(3.0)	(3.2)	(3.0)
Broadly-defined Liquidity(Average)	(0.5)	(0.6)	(-0.3)	(-0.0)	(0.5)	(0.3)	(0.1)	(0.3)	(0.4)	(0.4)
Principal Figures of Financial Institutions										
Loans and Discount (Average): Banks & Shinkin	(0.8)	(-1.9)	(-1.8)	(-0.8)	(-0.5)	(-0.3)	(-0.0)	(0.2)	(0.4)	(0.6)
Banks	(0.8)	(-2.0)	(-1.9)	(-0.8)	(-0.5)	(-0.3)	(0.1)	(0.2)	(0.5)	(0.7)
City Banks etc.	(-0.4)	(-4.2)	(-4.6)	(-2.8)	(-2.6)	(-2.3)	(-1.6)	(-1.4)	(-1.0)	(-0.6)
Regional Banks	(2.4)	(0.6)	(1.2)	(1.5)	(1.9)	(1.9)	(2.0)	(2.1)	(2.2)	(2.3)
Regional Banks II	(1.3)	(-0.4)	(-0.0)	(0.9)	(1.2)	(1.2)	(1.2)	(1.1)	(1.2)	(1.2)
Shinkin	(0.8)	(-1.3)	(-1.1)	(-0.7)	(-0.5)	(-0.4)	(-0.4)	(-0.4)	(-0.4)	(-0.4)
Deposits and CDs (Average): Total(3 Business Condition)	(2.9)	(2.6)	(2.2)	(2.7)	(2.3)	(2.3)	(2.5)	(3.0)	(3.3)	(3.3)
City Banks	(3.0)	(2.6)	(1.8)	(2.3)	(1.0)	(0.9)	(1.2)	(2.2)	(3.0)	(2.9)
Regional Banks	(3.1)	(3.1)	(3.1)	(3.4)	(3.9)	(4.0)	(4.1)	(4.0)	(3.8)	(3.8)
Regional Banks II	(1.8)	(0.6)	(0.9)	(2.0)	(2.8)	(2.9)	(3.2)	(3.1)	(3.1)	(3.3)

(Notes)
Interest rates are averages. The Nikkei Stock Average is as of month-end.
Unless otherwise indicated, tabulated figures and those in parentheses show % changes from previous quarter/month as applicable.
The figures in ( ) indicate % changes from previous year.
[ ] show the comparable figure of the previous year.

(Sources) Cabinet Office, National Accounts, Machinery Orders; METI, Indices of Tertiary Industry Activity, Industrial Production, Current Survey of Commerce; MOF, Trade Statistics, Balance of Payments; MPMHAPT, Consumer Price Index, Family Income and Expenditure Survey, Labour Force Survey; MHLW, Monthly Labour Survey; Ministry of Land, Infrastructure, and Transport, Economic Construction Statistics; BOJ, Corporate Price Index, Financial and Economic Statistics Monthly, etc.