The Outlook for the Japanese Economy

Economic Research Office
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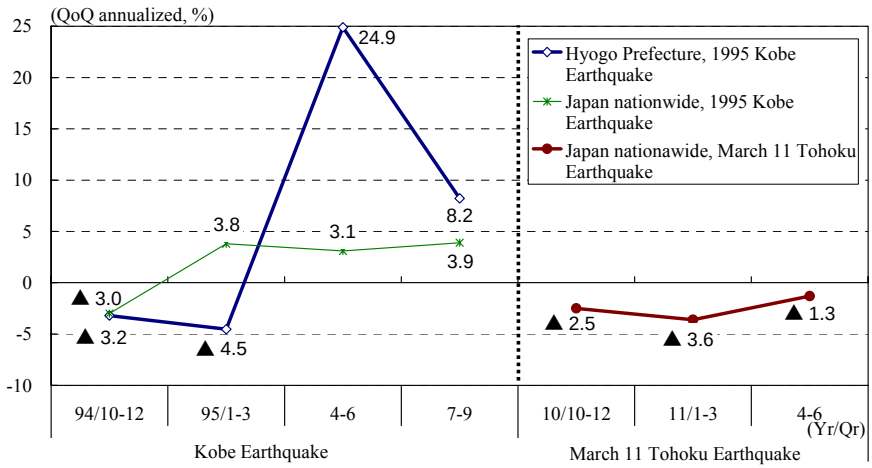
Economy's Numerous Downside Risks Persist, Improvement Expected to Gain Traction

1. Current Economic Conditions

Apr-Jun GDP resulted in three straight quarters of decline

The Apr-Jun 2011 quarter began amidst deep concerns about the impact of the March 11 Tohoku Earthquake on a number of areas in Japan's economy. Quarterly GDP figures released August 15 showed that Japan's economy contracted at an annualized rate of -1.3% QoQ (Figure 1). This marked the third straight quarter of GDP decline, on the heels of the Oct-Dec (-2.5% QoQ annualized) and Jan-Mar (-3.6% QoQ annualized) quarters. Looking back, although the GDP of Hyogo Prefecture, hardest hit in the 1995 Kobe Earthquake, plunged -4.5% QoQ annualized in Jan-Mar 1995, prefectural GDP surged the following quarter by +24.9% then +8.2% in Jul-Sept. (Nationwide GDP was positive even in Jan-Mar, at +3.8% QoQ annualized.) The recent figures once again highlight the scale and depth of the impact of the March 11 Tohoku Earthquake.

Figure 1: Real GDP, Before and After March 11 Earthquake



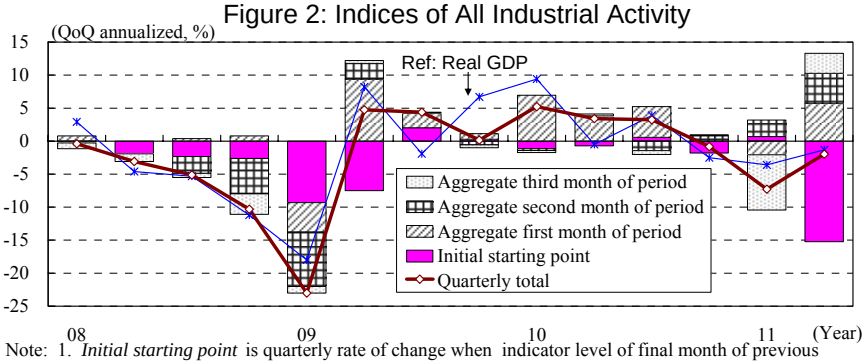
Source: Compiled by BTMU Economic Research Office from Hyogo Prefecture, Cabinet Office data.

Economic trends improving month by month

However, Apr-Jun trends were positive overall. Despite the quarterly contraction, monthly data show that the drop in March in the immediate aftermath of the earthquake was big, so that the starting point for Apr-Jun (initial figures) was extremely low. On the other hand, throughout the quarter, although the March drop had not been recovered, positive movements

prevailed. For example, METI's Indices of All Industrial Activity (excluding agriculture, forestry, and fisheries), which approximates real GDP, dropped -6.4% MoM in March, then rose +1.7% MoM in April, +1.8% MoM in May, and +2.3% MoM in June. Growth in every month of the Apr-Jun quarter was positive (Figure 2).

Figure 2: Indices of All Industrial Activity

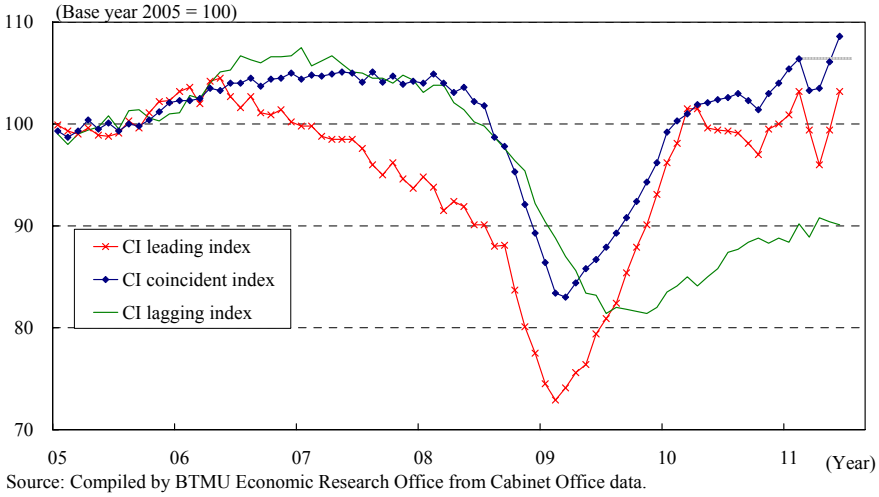


Note: 1. *Initial starting point* is quarterly rate of change when indicator level of final month of previous quarter is sustained.
2. *Aggregate first month of period* is quarterly rate of change when two-month future level is unchanged from first month (flat MoM) minus *Initial starting point*.
3. *Aggregate second month of period* is quarterly rate of change when third month level is unchanged from second month level minus *Initial starting point* and *Aggregate first month of period*. *Aggregate third month of period* also calculated the same way.
Source: Compiled by BTMU Economic Research Office from METI, Cabinet Office data.

Monthly economic indicators better across the board, with some even exceeding pre-quake levels

Many other economic indicators have also been improving, with many even recovering to their February levels, before the earthquake struck. The coincident indexes in the Cabinet Office's Indexes of Business Conditions, a composite of a number of monthly indicators that is very sensitive to the economy, are an example. The Index of Industrial Production has risen for three straight months (+0.2% points MoM in April, +2.6 points MoM in May, and +2.7 points MoM in June). The index now stands +2.4 points higher than in February, before the earthquake (Figure 3). It appears that Japan's economy has emerged from the immediate shock of the earthquake and is steadily improving.

Figure 3: Index of Business Conditions



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

2. Outlook

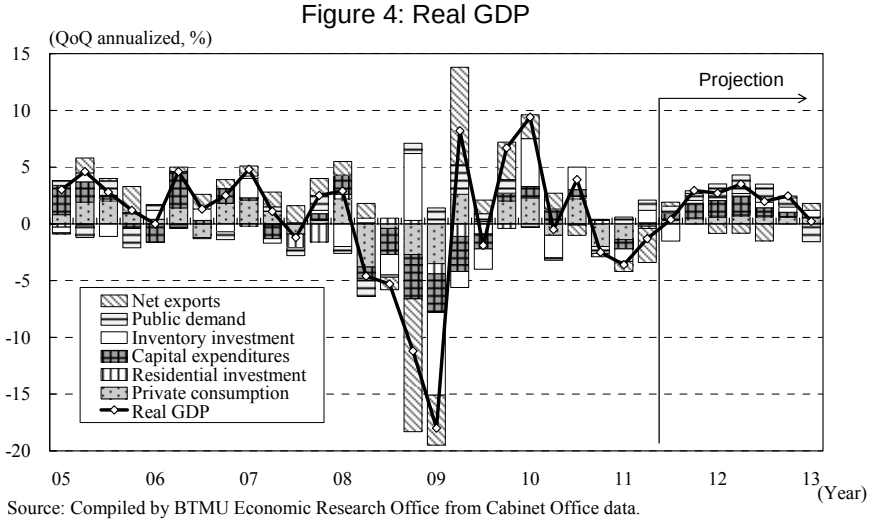
＜Summary＞

Improvement to continue as economic recovery builds strength

Looking ahead, by extension of Apr-Jun figures, Japan's economic recovery is likely to continue to make progress, and the economy's expansion becomes clearer. One of the driving forces will be reconstruction demand resulting from the loss of capital stock in the March 11 earthquake (private company facilities, housing, and public capital stock). Because the devastation wrought by the recent earthquake was so severe—capital stock losses across 13 prefectures have been estimated to total approximately JPY20 trillion, concentrated in Iwate, Miyagi, and Fukushima prefectures—the potential reconstruction demand is also estimated to be considerable. Assuming that sudden slowdowns in overseas economies and further JPY strengthening are averted and that the government continues to steadily implement earthquake response measures, domestic Japanese demand and production are expected to rise as reconstruction activity gets underway more fully from H2 2011. This is also expected to result in increasing exports as the economic recovery becomes more widespread. Japan's economy as a whole will then be expected to strengthen.

In terms of quarterly real GDP growth, we project Jul-Sept GDP to be positive, albeit only slightly, then remain fairly strong through H1 2012 (Figure 4). In fiscal year terms, we expect FY11 real GDP to fall -0.5% YoY, then rebound to +2.5% YoY in 2012.

Figure 4: Real GDP



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

Risks skewed toward downside

At the same time, a number of issues have been emerging—the electricity issue becoming more widespread, slowdowns in overseas economies and a strengthening of the JPY, turmoil in the political sphere and delays in government responses to the disaster. As a result, we think Japan's economy

will recover at a slower pace in H2 2011 than previously estimated. Furthermore, with those fires not extinguished, any of them have the potential to once again conflagrate and threaten the economy's ability to recover. Particular concerns include sudden slowdowns or recessions in overseas economies and JPY strengthening that would inevitably threaten an export recovery as well as the increasing political turmoil and delayed government responses that hold back greater reconstruction and rebuilding demand. Downside risks to Japan's economy continue to bear watching.

Electricity supply restrictions remain but apparent harm to economic activity to be averted

All 54 nuclear reactors throughout Japan could be shut down by next spring, and the country's ability to supply electricity will inevitably be even further curtailed. According to the government's Energy and Environment Council, assuming that none of the nuclear reactors will be re-started following regular inspections, Japan's nine electric companies will fall short of maximum demand by -1.13 million kW (supply reserve rate -0.7%) this winter, and by -16.56 million kW (supply reserve rate -9.2%) next summer (findings released July 29, Table 1). Considering the supply reserve rate necessary for stable supply (normally 8% or more), the electricity usage restrictions in effect in Tohoku Electric Power Co (Tohoku EPCO) and Tokyo Electric Power Company (TEPCO) service areas this summer (cuts of 15% from the previous summer's peak usage for large-lot users of 500kW or more) are likely to be expanded to a -10% cut this winter and a -20% cut next summer nationwide. Rather than electricity supply restrictions that impact primarily the summer and winter being treated as concerns, these may have to be accepted as assumptions for some time to come. That said, however, happily, orders to limit electricity usage were effective in evening out peak time demand (daytime maximum demand fell as much as -16% YoY on average in July in the Tohoku EPCO and TEPCO service areas) throughout the day and week. Furthermore, private company electricity usage restrictions and efforts to conserve electricity appear to have been successful and have had minimal impact on production and economic activities. If this summer's restriction levels continue through the winter and next summer, we think that the problem will have been overcome to some degree through policy responses and company efforts.

Table 1: Nine Electric Companies' Supply-Demand Projections (figures released July 29)

('000 kW)

	Summer 2011	Winter 2011-12	Summer 2012
Supplye reserve			
②-①	-4,830	-1,130	-16,560
(②-①) ÷① (%)	-27	-7	-92
① Maximum demand	179,540	158,110	179,540
② Supply capacity	174,710	156,980	162,970
Nuclear power	11,760	4,090	0
Thermal power	129,310	126,850	132,000
Private power generation	2,850	2,060	1,640
Hydraulic power	12,870	10,240	12,960
Pumps	20,860	15,930	18,040
Geothermal power, etc.	350	430	470
Flexible, etc.	-440	-570	-490

Note: 1. Total figures for Hokkaido, Tohoku, Tokyo, Hokuriku, Chubu, Kansai, Chugoku, Shikoku, and Kyushu electric power companies.
2. *Maximum demand* is *Summer 2011* Tohoku Electric Power Co and TEPCO service area summer 2010 peak usage (daily peak), seven other service areas are summer 2010 peak figures. Also, company 2011 summer peak projections are all higher end. Same for Winter 2011-12 and Summer 2012.
3. *Supply capacity* is projection as of July 27. Of this, Nuclear power is assuming that nuclear reactors are not re-started after periodic inspections. Pumps based on capacity to pump water with night-time electric power.

Source: Compiled by BTMU Economic Research Office from government Energy and Environment Council materials.

Inflation expectations unchanged, deflation trend to persist

Consumer price trends have changed somewhat, with the year-on-year decline in prices of goods shrinking significantly in Apr-Jun. However, these have been due to fluctuations from one-time factors, like higher energy prices and the downward push effect dropping off following the elimination of high school tuitions that took effect in April 2010. Thus, the change cannot be considered trends. In fact, discounting a series of upward swings, the pace of decline in prices has virtually not changed since last year. Going forward, although the deflationary gap is expected to shrink and the pace of price declines to slow, the speeds are very likely to slow. We still cannot predict an end to deflation for Japan over our forecast period, through the end of FY12.

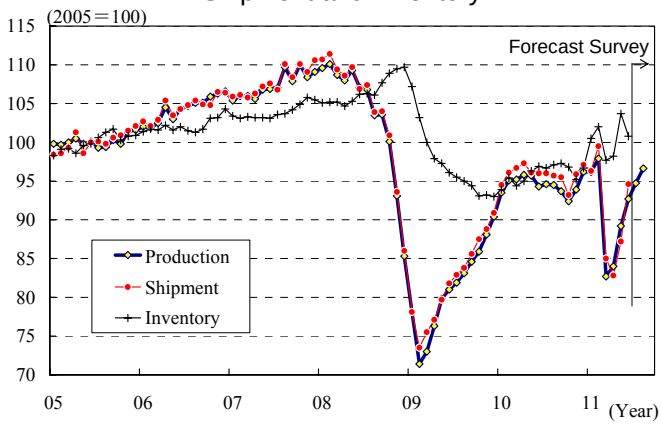
⑴ Corporate Sector

① Production

Industrial production continues to steadily recover from the earthquake shock

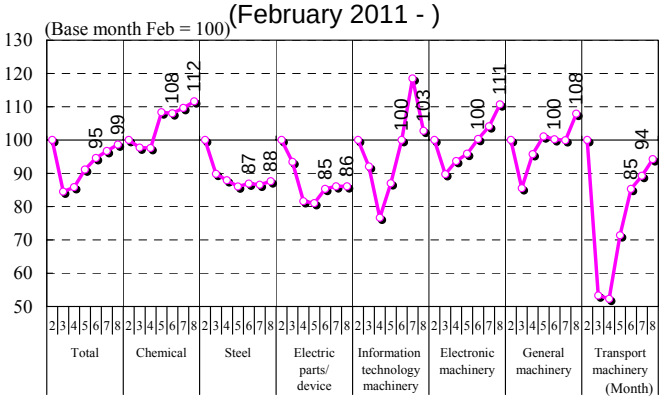
Industrial production has continued to steadily recover from the earthquake shock after April (Figure 5). Monthly industrial production data, which plunged in March following the earthquake, has continued to improve on-month from April. Production levels had already recovered to 95% of the pre-earthquake level by June after falling to 84% in May. Furthermore, according to manufacturing production forecasts, consecutive increases in production are expected from July (July +2.2%, August +2.0%). If those forecasts are realized, production will recover to about the pre-earthquake level in August.

Figure 5：Industrial Production, Shipment and Inventory



Note: Data for July and June are result of the forecast survey.
Source: Compiled by BTMU Economic Research Office from METI data.

Figure 6: Production Levels by Industry (February 2011 -)



Note: 1. July and August levels are manufacturing industries and industry levels based on forecast survey
2. Numbers in figure are for June and August.
Source: Compiled by BTMU Economic Research Office from METI data.

By industry, production of chemicals and information technology machinery, electronic machinery, and general machinery had recovered to their pre-earthquake levels by June (Figure 6). Further, production of transportation machinery, which had plunged dramatically in the wake of the March 11 earthquake, has started to rise again after bottoming in April, with production expected to reach 94% of the February level in August. On the other hand, the Production Survey forecasts that output of electronic parts and devices and steel will still not reach 90% of the pre-earthquake levels even in August. (Levels are expected to be 86% and 88%, respectively.) Of these, electronic parts and devices production faces not only delays in restoring production structures, but also possible lingering effects from worldwide inventory adjustments from the end of 2010. Steel production tends to lag behind the movements of major industries like transportation machinery, but could also be reflecting the fact that reconstruction demand has not grown as much as expected. Either way, although production in all sectors is increasing overall, gaps remain in the degree of growth among industries.

Electricity supply restrictions remain but apparent harm to economic activity to be averted

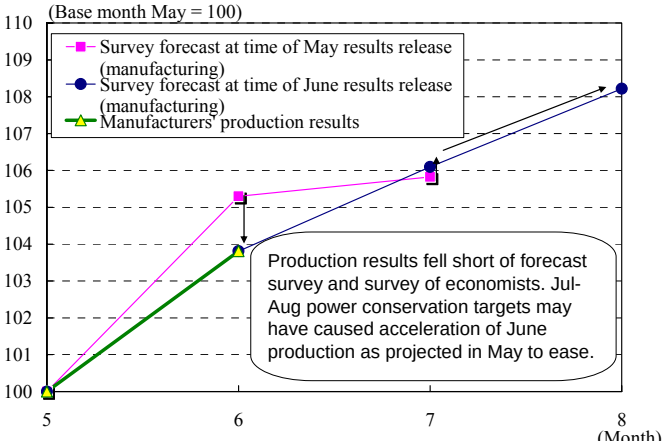
Electricity supply restrictions had been expected to weigh on production over the summer, but production forecast surveys indicate that output will increase in July and August. Considering that June production (+3.8% YoY) fell short of the production forecast in May (calling for a +5.3% YoY increase) and a preliminary economists' survey (QUICK forecast: +4.3% YoY), companies appear to be not only absorbing the usage and supply restrictions but also meeting them with power-saving measures and shifts in working hours. Also, companies may have given up on accelerating production, as projected in June (Figure 7). Conversely, July production forecasts have been raised (from

+0.5% in May to +2.0% in June), and this may have led to forecasts for continued increases in production in August. Even looking ahead, the electricity supply situation will remain challenging, but if the situation remains manageable through company efforts as it was this past summer, we think that any impact on production activities will be limited.

Production restricting factors to be on demand side, reconstruction demand expected to grow from H2 2011.

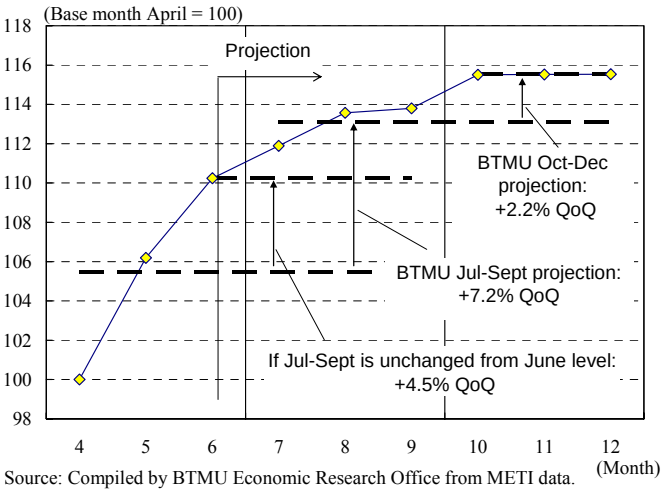
The direction of production is expected to increasingly depend largely on demand going forward. Operations stoppages at damaged production facilities and supply chain disruptions in the immediate aftermath of the March 11 earthquake, as well as implementation and concerns about rolling blackouts, were supply-side restrictions that suppressed production. With these impacts alleviating, more production is expected to be affected by demand, and reconstruction and external demand will be the main points. First of all, shipments of goods related to reconstruction and rebuilding indicate that demand for many goods, primarily construction goods, has not heated up. However, demand for some goods, including general machinery, appears to have already jumped. From H2, if the lags in government response that are hindering growth in related demand are solved, we think that investment related to reconstruction and consumption demand will start to boost production. In particular, we predict that production will jump in Jul-Sept. For one thing, the starting point of Jul-Sept will already be very high, coming off the strong growth in Apr-Jun. In fact, even if production from July onward is only flat on-month, Jul-Sept production will still increase +4.5% QoQ (Figure 8). Furthermore, we anticipate further growth over the quarter. Not only the data, but also details suggest that production is likely to increase going forward.

Figure 7: Manufacturing Production Results and Projections (May 2011 -)



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

Figure 8: Manufacturing Production (July 2011 -)



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

②Exports

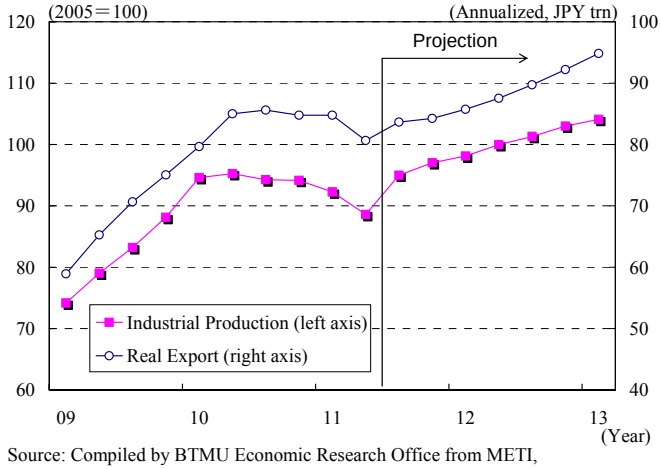
Production, export virtuous cycles expected to gain traction

As noted above, external demand and exports are another point regarding future production, along with reconstruction and redevelopment demand. In short, as overseas economies slow and the JPY strengthens, exports are expected to be sluggish this year, but not crumble. Then export growth is expected to become clearer and firmer next year. Production will likely be boosted by reconstruction demand for the time being, then after that effect ebbs, by exports (Figure 9).

Exports started to rise finally in late June

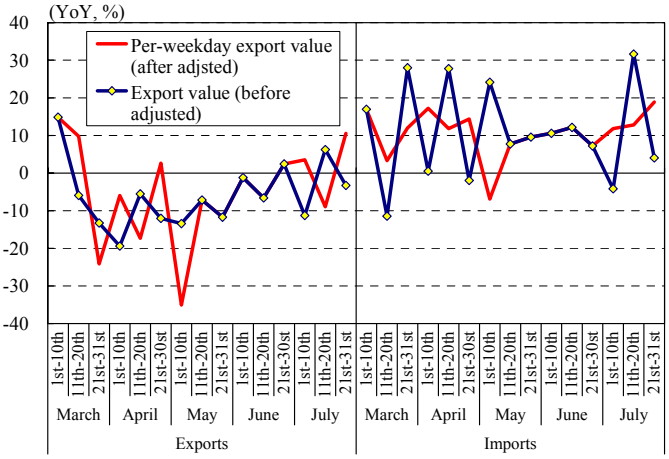
Reviewing recent export trends, after plunging -19.4% YoY in April, nominal export values have slowly improved, recovering to positive year-on-year territory in late June for the first time since the earthquake (+2.4% YoY, Figure 10). Although exports once again contracted in late July, by -3.3% YoY, per-weekday export value (after adjusting for number of weekdays) rose +10.5% YoY, the highest level after the earthquake. This suggests that even on the export side, the shock of the earthquake is wearing off.

Figure 9：Industrial Production, Real Export



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

Figure 10: Nominal Exports, Imports by Time



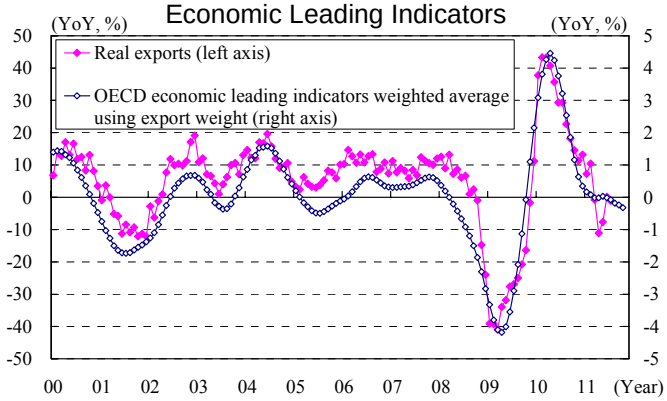
Note: *Export value (after adjusted)* is adjusted for number of weekdays.
Source: Compiled by BTMU Economic Research Office from METI materials.

Overcoming slowdown of overseas economies and surge of JPY through H2 2011, exports to start to increase more rapidly in 2012

On the other hand, a number of concerns still in fact persist. Of these, the directions of overseas economies and exchange rates are most often cited. Indicators of economic sentiment like the ISM Manufacturing Index in the US and PMIs in China and Germany already suggest that economies are slowing in major export destination countries. Also, the OECD economic leading indicators, which tend to lead Japanese exports by about four months, have continued to decline from the beginning of the year through June. This indicates that Japan's exports may weaken through the second half of 2011 (Figure 11). The JPY's recent sudden surge will also clearly weigh on Japanese exports. Historically, a 10% increase in the real effective exchange rate has

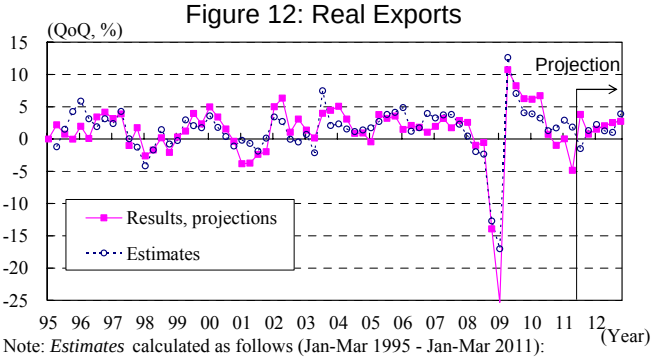
reduced real exports by as much as 3% (Figure 12). The JPY is expected to be 10% stronger versus the USD on-year in H2 2011, and 5% stronger in terms of effective rate. This indicates a strong possibility that approximately 1.5% of downward pressure will weigh on exports. However, in 2012, as major export destination countries start to recover and as Asian economies overcome inflation and regain strength, we expect the JPY's strength to come to a halt. Japanese exports will then once again start to increase more rapidly (Figure 12).

Figure 11: Real Exports and OECD Economic Leading Indicators



Note: *OECD economic leading indicators weighted average using export weight* is weighted average of US, EU, Asia (excl China) and China for four months out.
Source: Compiled by BTMU Economic Research Office from BoJ, OECD data.

Figure 12: Real Exports



Note: *Estimates* calculated as follows (Jan-Mar 1995 - Jan-Mar 2011):
LN (real exports) = -6.8 +0.03* trend term + 4.1*LNG (overseas GDP)
- 0.3 LN (real effective exchange rate two quarter average)
- 0.1* dummy valuable
Overseas GDP is export partner country GDP weighted average using nominal export value weight, and dummy variable is Oct-Dec 2008 - Jan-Mar 2009.
Source: Compiled by BTMU Economic Research Office from Cabinet Office, BoJ, national data.

③Imports, Net Exports

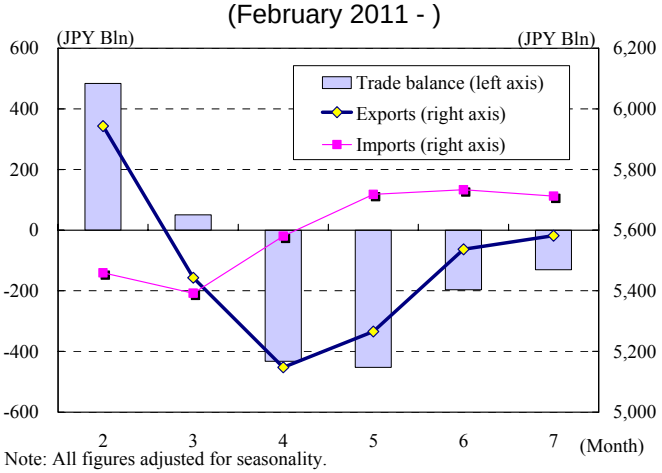
Consistent trade deficits from April through July on surge in imports

In contrast to exports that plunged in the wake of the March 11 earthquake, imports to Japan have jumped. As a result, Japan recorded trade deficits every month from April through July (Figure 13). However, the size of the deficit shrank to less than half in June and July from April and May as exports slowly recovered.

By type of goods, imports of mineral fuels surged in the aftermath of the earthquake, and a considerable trade deficit was recorded in May (+JPY75.3bn from February). Mineral fuel imports were below the February levels in other months, and the relationship to the trade deficit is not clear at this time (Figure 14). On the other hand, imports of foodstuffs and industrial resources other than mineral fuels have exceeded February levels every month since March. This has supported imports. Amidst this, the surge in imports of fuel for industrial use has been striking. METI released a survey of industrial conditions in the wake of the March 11 earthquake (survey conducted June 14 – July 1). The survey showed that 56% of respondents reported alternative procurement sources overseas. Disrupted supply chains appear to have caused

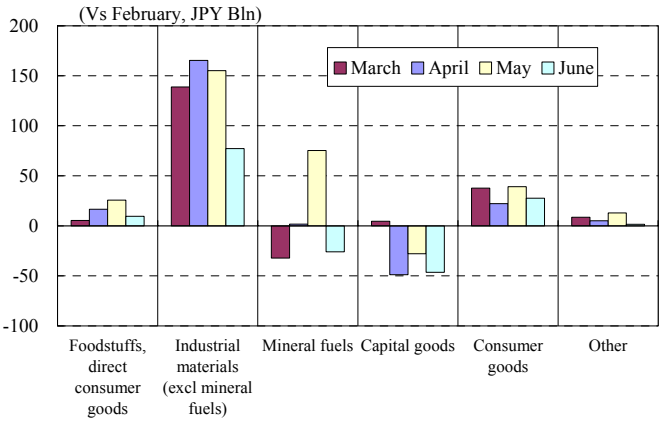
substitute imports of parts and materials to swell. Incidentally, in response to the question '*Once your pre-earthquake procurement sources recover, will you return to those sources?*', more than 40% responded they would continue to procure goods from the overseas sources (multiple responses were possible). The March 11 earthquake could result in changes to commercial distribution systems, such as increased imports of parts and materials by companies diversifying their sources, over the medium to long term.

Figure 13: Trade Balance and Export Import Figures (February 2011 -)



Note: All figures adjusted for seasonality.
Source: Compiled by BTMU Economic Research Office from MoF data.

Figure 14: Nominal Import Values after March 11 Earthquake by Goods (March 2011 -)



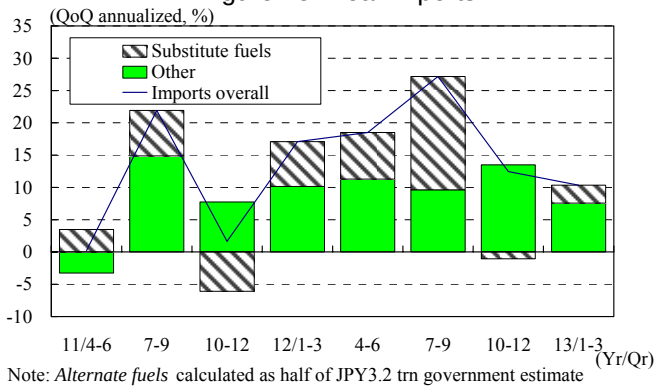
Note: All figures adjusted for seasonality.
Source: Compiled by BTMU Economic Research Office from MoF

Fluctuations in net exports likely as fuel imports expected to jump, but impact on GDP will probably be small

Fuel demand is expected to rise as thermal electric power plants are built and expanded in order to compensate for the drop in nuclear reactors' supply capacity. This is likely to result in imports rising more. According to the government's Energy and Environment Council, fuel costs will increase by JPY3.2 trillion if thermal power is used to cover all lost power supply as nuclear reactors are shut down, and this will cause import value to balloon particularly in the summer and winter demand months (Figure 15). Also, recovering domestic demand is expected to result in imports increasing.

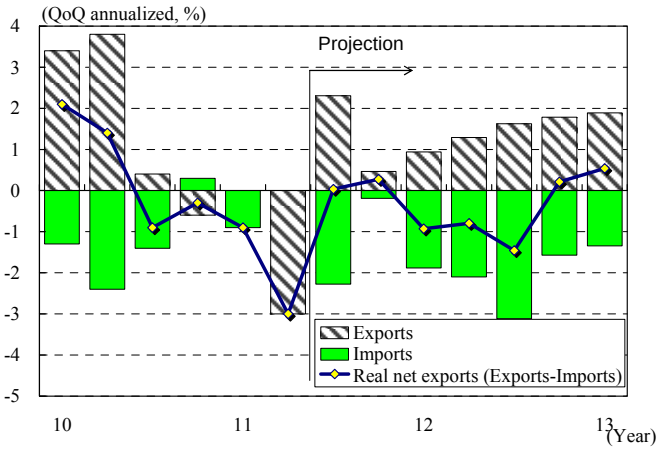
As a result, net exports are expected to continue to be affected by swings in imports due to increases or decreases in fuel demand. Although exports are continuing to rise, any contribution of net exports (exports minus imports) to the economy is very likely to be unsteady and limited (Figure 16).

Figure 15: Real Imports



Note: *Alternate fuels* calculated as half of JPY3.2 trn government estimate (for total substitution) of increase in fuel cost when nuclear power is substituted by thermal power when nuclear reactors go offline (does not consider increase in fuel unit cost).
Source: Compiled by BTMU Economic Research Office from Cabinet Office, Energy and Environment Council materials.

Figure 16: Real Net Exports



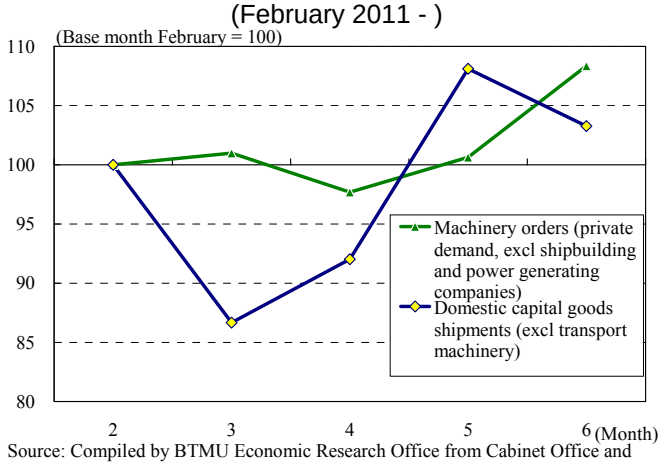
Note: All contributions to real GDP.
Source: Compiled by BTMU Economic Research Office from Cabinet Office data.

④Capital Expenditures

Apr-Jun capital expenditures rise on-quarter, as related indicators also solid

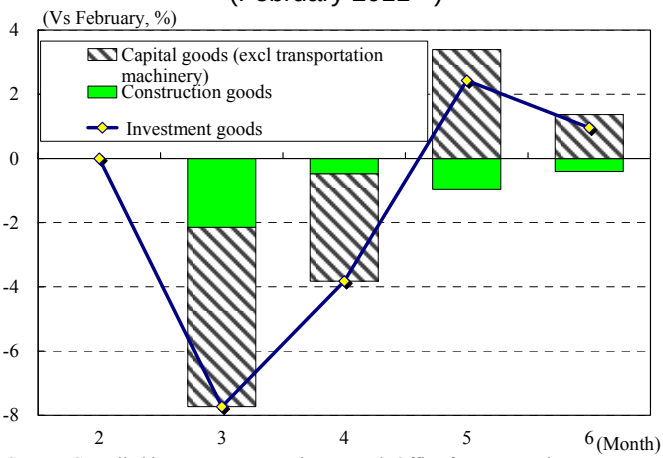
Real capital expenditures in GDP data rose an annualized +0.9% QoQ in Apr-Jun, starting to rise again, although only slightly. Related monthly indicators were also not disappointing. Domestic capital goods shipments (excluding transportation machinery) rose for two straight months in April and May, then dropped in reaction in June (Figure 17). Machinery orders (private sector demand excluding shipbuilding and power generation companies)—a leading indicator of capital expenditures—continue to post strong gains, up +3.3% MoM in May and +7.0% MoM in June. Companies appear to have regained their appetite to invest and reconstruction demand seems to be rising in spots. Amidst these conditions, shipments of construction goods, including steel for building, have been relatively weak compared to capital goods (excluding transportation machinery), which reflect new construction of machinery facilities (Figure 18). This may be because reconstruction of plants and production bases in more hard-hit disaster areas has not progressed as much as expected due to delays in establishing foundations for reconstruction, including rubble removal.

Figure 17: Capital Expenditures-Related Indicators
(February 2011 -)



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

Figure 18: Domestic Investment Goods Shipments
(February 2011 -)

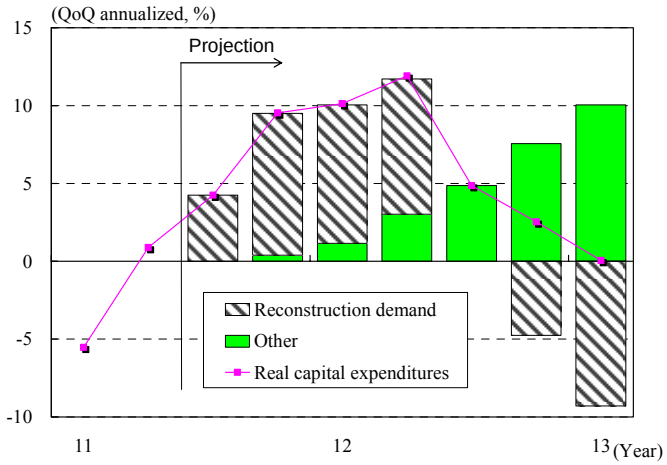


Source: Compiled by BTMU Economic Research Office from METI data.

Capital expenditures expected to increase more on greater reconstruction demand

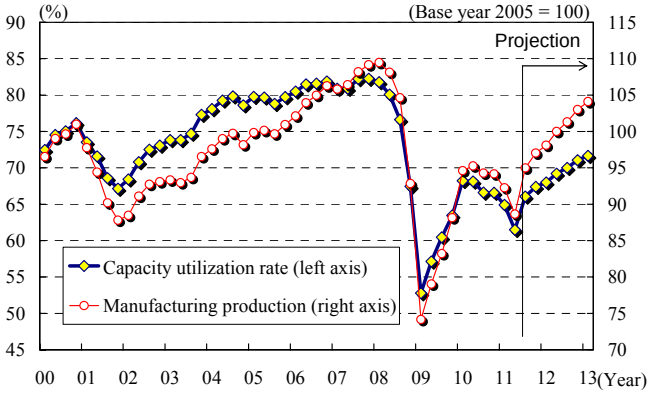
We think that reconstruction demand getting underway in full swing will start to contribute to boosting capital expenditures in H2 2011 (Figure 19). However, with the delay in establishing a foundation as noted above, that contribution is very likely to peak in mid-2012, slightly later than our earlier assumption. Either way, we project that capital expenditures are likely to continue accelerating for some time. Also, based on the direction of production and exports and according to fundamentals including capacity utilization rates and corporate profits, the foundation for a self-sustaining expansion in capital expenditures will be laid in H2 2012 (Figure 20). As a result, capital expenditures are likely to continue increasing while erasing the drop-off in reconstruction demand.

Figure 19: Real Capital Expenditures



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

Figure 20: Manufacturers' Capacity Utilization Rates



Note: *Capacity utilization rate* is 2005 average of 79.5%.
Projection term figure is operational facilities calculated separately divided by production capacity index.

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

(2) Household Sector

① Employment, Wages

Employment-related indicators including worker numbers and unemployment rate improve

According to the Labor Force Survey, a representative study of Japan's employment trends, Japan's unemployment rate improved slightly, by -1.0% QoQ, in Apr-Jun. The number of unemployed also declined on-quarter while the number of job seekers and workers rose. Further, the higher unemployment rate in June was the result of a bigger labor force population, so the number of job seekers and workers continued to grow. All these results, however, excluded data from Iwate, Miyagi, and Fukushima prefectures. Employment conditions in the disaster region continue to be severe, but nationwide conditions have not worsened. Furthermore, the job-offers-to-seekers ratio and new job openings ratio (a leading indicator of employment) also rose as job offers continued to rise in June (Table 2).

Table 2: Employment- and Wage-Related Indicators

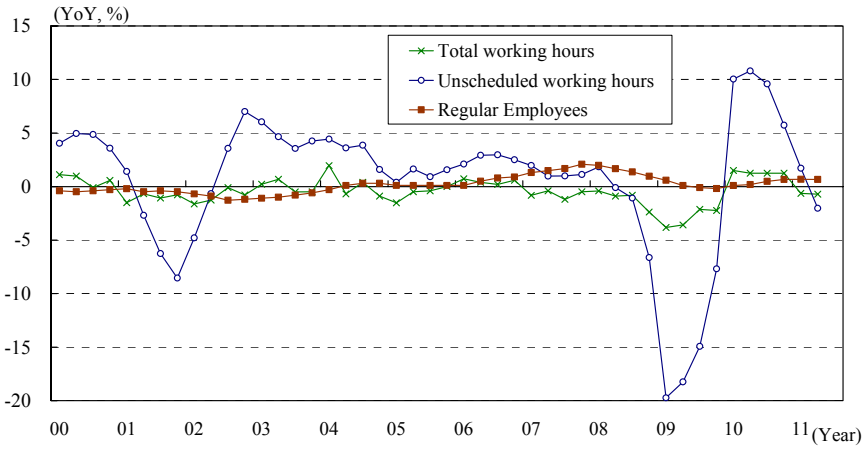
	2010/10-12				2011/1-3				2011/4-6			
		10	11	12		1	2	3		4	5	6
The Labor Force Survey												
Unemployment rate (%)	5.0	5.1	5.1	4.9	4.7	4.9	4.6	4.6	4.6 ○	4.7	4.5	4.6 ×
Unemployed persons (YoY, '000 persons)	-120	-70	-120	-170	-210	-130	-220	-260	-350 ○	-300	-380	-360 ○
Job seekers (YoY, '000 persons)	50	170	-80	50	80	0	360	-130	70 ○	70	90	30 ○
Number of workers	220	370	100	180	280	320	620	-100	440 ○	210	550	560 ○
Report on Employment Service												
Ratio of job offers to applicants (mult)	0.57	0.56	0.57	0.58	0.62	0.61	0.62	0.63	0.62 △	0.61	0.61	0.63 ○
Monthly job offers to job seekers (YoY, %)	22.2	19.6	23.8	23.4	23.6	23.8	25.0	22.2	19.0 ○	19.6	19.6	18.0 ○
Monthly effective job seekers (YoY, %)	-6.4	-6.8	-5.7	-6.7	-6.3	-7.1	-5.8	-6.2	-3.1 ×	-4.7	-2.6	-1.8 ×
New job openings (multiple)	0.97	0.95	0.97	0.99	1.00	1.02	0.99	0.98	0.98 ×	0.95	0.98	1.00 ○
New openings (YoY, %)	17.3	13.9	22.6	15.8	17.2	18.8	22.9	10.5	13.9 ○	12.2	17.3	12.6 ○
New job applications (YoY, %)	-3.0	-6.0	3.3	-5.8	-3.6	-5.0	2.7	-7.5	1.6 ○	0.9	6.5	-2.2 ×
Monthly Labour Survey												
Total cash wages (YoY, %)	0.2	0.5	0.2	0.1	0.1	0.4	0.3	-0.1	-0.4 ×	-1.4	1.0	-0.7 ×
Regularly-paid wages	0.4	0.5	0.3	0.5	-0.3	-0.2	-0.1	-0.6	-0.5 ×	-0.8	-0.6	-0.3 ×
Scheduled wages	0.0	0.0	-0.1	0.1	-0.6	-0.5	-0.4	-0.8	-0.5 ×	-0.7	-0.5	-0.3 ×
Unscheduled wages	6.4	6.5	6.4	6.3	3.2	3.6	4.4	1.7	-1.4 ×	-1.9	-2.3	-0.1 ×
Special wages	-0.4	2.9	-2.3	-0.4	13.0	12.0	36.3	9.3	0.0 △	-19.7	60.7	-1.3 ×
Total working hours (YoY, %)	1.2	0.7	1.5	1.2	-0.6	-0.2	-0.2	-1.3	-0.7 ×	-1.9	-0.4	0.2 ○
Scheduled working hours	0.8	0.3	1.1	0.9	-0.8	-0.6	-0.5	-1.3	-0.6 ×	-1.7	-0.3	0.2 ○
Unscheduled working hours	5.7	6.2	6.1	5.1	1.7	3.2	3.0	-1.0	-2.0 ×	-3.9	-2.1	0.0 ○
Regular workers (YoY, %)	0.7	0.7	0.7	0.6	0.7	0.8	0.7	0.8	0.7 ○	0.7	0.6	0.8 ○

Note 1. *The Labor Force Survey* excludes Iwate, Miyagi, and Fukushima prefectures.
2. *Report on Employment Service* includes part-time workers excluding new graduates.
3. *Monthly Labor Survey* covers companies surveyed with five or more workers.
Source: Compiled by BTMU Economic Research Office from MIC, MHLW data.

However, numerous wage-related indicators weaken

Conversely, wage-related indicators in the Monthly Labor Survey were weak across the board. Cash wages fell on-year in Apr-Jun for the first time in six quarters, and broken down, scheduled wages, unscheduled wages, and special wages all declined. Companies are cutting working hours in advance in case external conditions deteriorate and are tending to reduce employment and permanent workers (Figure 21). For the first time since the March 11 earthquake, although employment is being sustained, overall working hours are contracting and wages are slumping.

Figure 21: Working Hours and Regular Employees

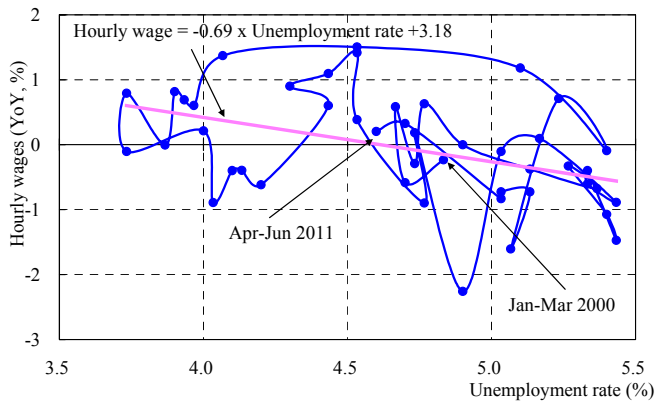


Note: Establishment with 5 or more employees
Source: Compiled by BTMU Economic Research Office from MHLW materials.

With employment level remaining steady, working hours expected to recover and wages to rise as worker incomes improve

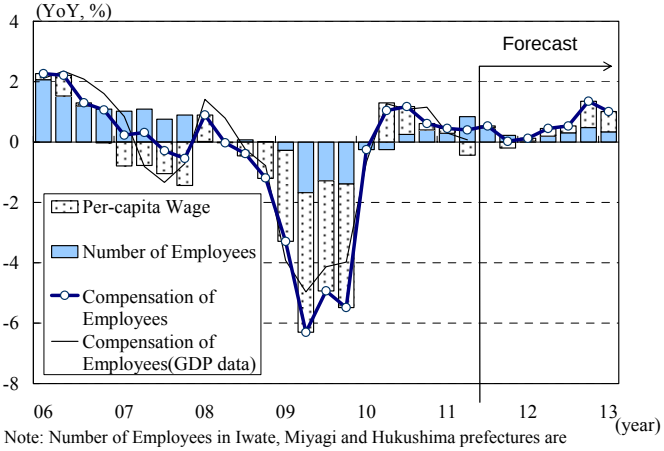
Going forward, with production projected to keep rising, worker numbers are very likely to remain firm. At the same time, strengthening production activity is also expected to contribute to a recovery in working hours. In fact, overall working hours rose on-year for the first time in half a year in June as production continued to increase. Furthermore, hourly wages are expected to remain positive on year as long as the unemployment rate does not rise once again. (The recent Phillips Curve shows that the current unemployment rate of 4.6% marks the make-or-break point between positive and negative yearly growth in hourly wages, Figure 22.) As a result, wages and salaries (or per capita worker income)—the product of working hours and hourly wages—are expected to start to rise, albeit gradually, from Jul-Sept. Further, multiplying this by the number of workers, worker incomes are also expected to rise more quickly (Figure 23). However, smaller winter bonuses this year could be a temporary downward factor in Oct-Dec.

Figure 22: Unemployment Rate and Hourly Wages (Phillips Curve)



Note: Hourly wages for surveyed companies with five or more employees.
Source: Compiled by BTMU Economic Research Office from MIC, MHLW data.

Figure 23: Compensation of Employees



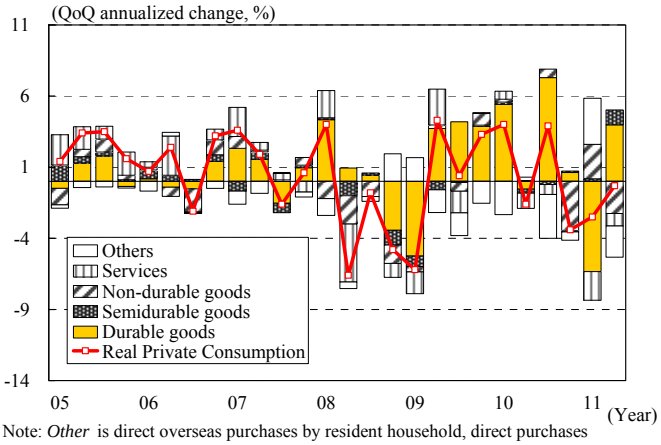
Note: Number of Employees in Iwate, Miyagi and Hukushima prefectures are added by BTMU after March 2011.
Source: Compiled by BTMU Economic Research Office based on MHLW and MIC data.

②Private Consumption

Private consumption declines on quarter in Apr-Jun but trends upward

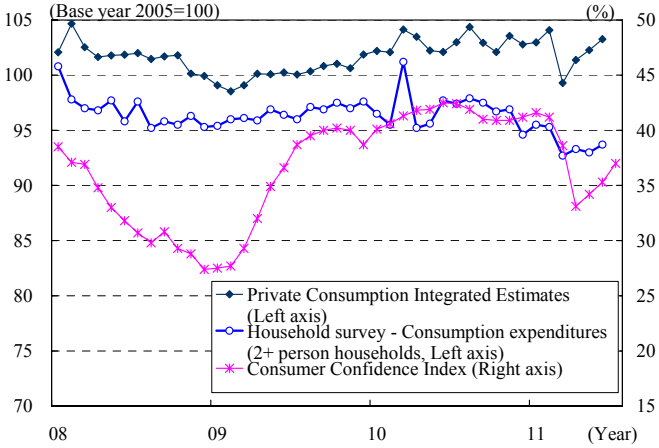
Real private consumption decreased at an annualized rate of -0.3% QoQ in Apr-Jun, the third straight quarter of decline (Figure 24). Consumption of non-durable goods and services, such as travel, fell at an annualized rate of -9.4% QoQ and -1.7% QoQ. On the other hand, consumption of durable goods, such as automobiles and home electrical appliance, and semi-durable goods, such as clothing, surged at an annualized rate of +26.7% QoQ and +16.3% QoQ, respectively. Compared to the decrease in Oct-Dec (annualized rate of -3.4% QoQ) and Jan-Mar (annualized rate of -2.5% QoQ), the rate of decline slowed. In addition, the Consumption Composite Index dropped -4.6% MoM in March but rose +2.1% MoM in April, +0.9% MoM in May and + 1.0% MoM in June. Also, consumption expenditures increased slightly in April and June (Figure 25).

Figure 24: Real Private Consumption by Goods



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

Figure 25: Consumption Indices



Note: Private Consumption Integrated Estimates and Household Survey are actual figures.
Source: Compiled by BTMU Economic Research Office from MIC, Cabinet Office data.

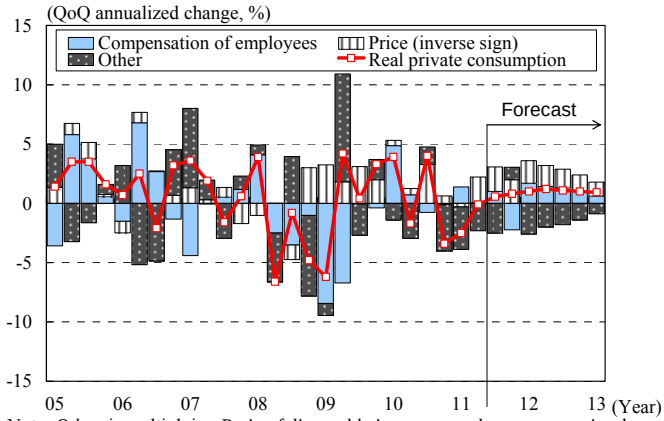
Consumption recovers slowly as confidence, wages improve

We predict that private consumption will rise on increased employee compensation (Figure 26). The Consumption Confidence Index, which dropped sharply after the earthquake, started rising from May, as a recovery in confidence is likely to support consumption.

Individual income taxes may increase to bolster tax resources

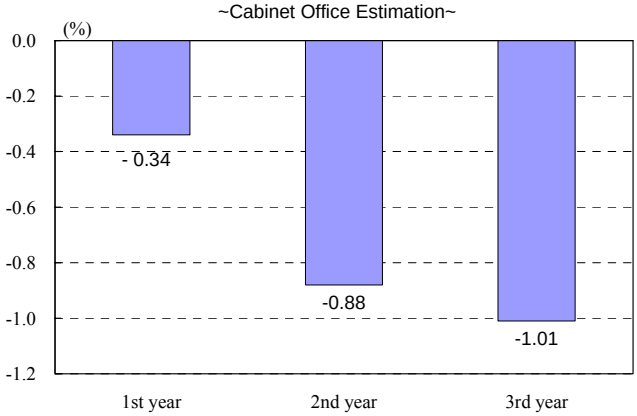
However, one concern is higher individual income taxes, under consideration to fund reconstruction. If income taxes are raised, private consumption could fall, weighed by deteriorating disposable income and consumer sentiment. The Cabinet Office has estimated that private consumption will fall -0.34% the first year and -0.88% the second year after the income tax is raised to 1% of nominal GDP, or 4~5 trillion yen (Figure 27).

Figure 27: Real Private Consumption



Note: *Other* is multiplying *Ratio of disposable income to woker compensation* by *Consumption trend.*
Source: Compiled by BTMU Economic Research Office from Cabinet Office, MIC

Figure 27: Impact of Individual Income Tax Hike (1% of Nominal GDP) on Private Consumption
~Cabinet Office Estimation~



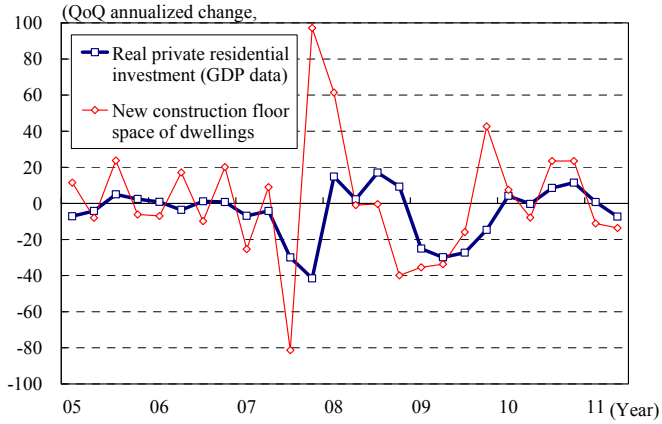
Note: Rate of deviation from standard case.
Source: Compiled by BTMU Economic Research Office from Cabinet Office materials.

③Residential Investment

Residential investment unable to shake off impact of earthquake, plunges

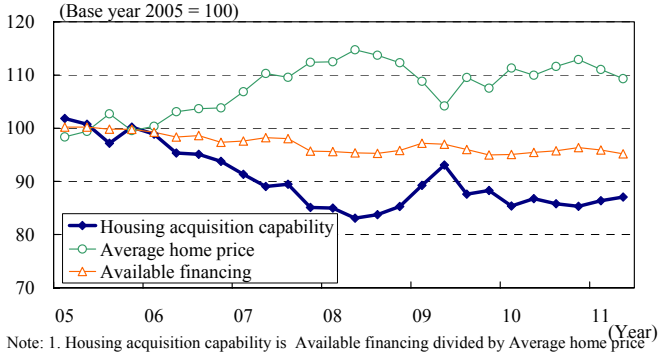
Residential investment fell by an annualized -7.3% QoQ in Apr-Jun in real terms. This was the first decline in four quarters (Figure 28), and the biggest in the past year and a half. Further, new residential construction starts floorspace, which is highly correlated to GDP real residential investment, contracted again, continuing the Jan-Mar decline. Construction of course dropped due to the March 11 earthquake, but on top of that, post-quake reconstruction does not appear to be proceeding very fast. On the other hand, housing acquisition capability started to rise in H1 2011 (Figure 29). The weakening housing market, because of falling prices, appears to be not wholly without positive aspects.

Figure28：Residential Investment and New Construction floor space of dwellings



Source: Compiled by BTMU Economic Rescearch Office from Cabinet Office and MLIT data.

Figure 29: Housing Acquisition Capability

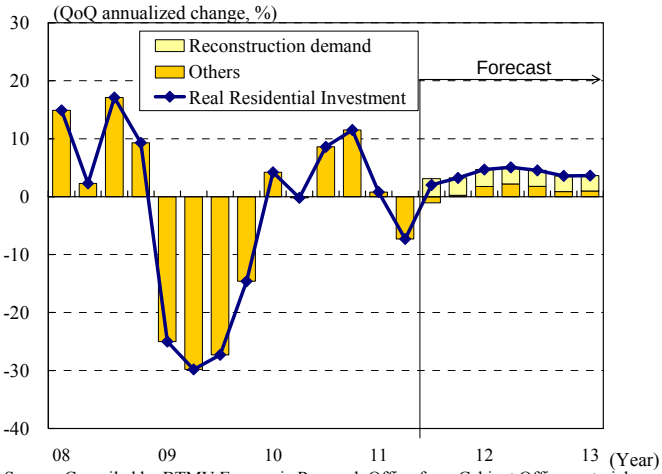


Note: 1. Housing acquisition capability is Available financing divided by Average home price (Tokyo, Kinki region average condominium price, adjusted for seasonality by BTMU).
2. Available financing is sum of amount that can be borrowed (maximum annual repayment is 25% of income, calculated using 25.1 years as repayment period) and savings.
Source: Compiled by BTMU Economic Research Office based on MIC, Real Estate Economic Insititute data.

Future residential investment depends on reconstruction demand

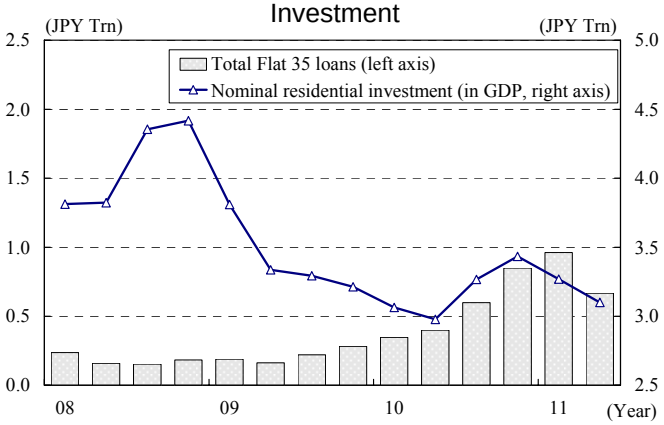
Looking forward, foremost, residential demand and rebuilding construction activity in the disaster-struck region is expected to boost residential investment (Figure 30). In order for this to happen, debris must be removed and reconstruction plans must be drafted quickly. Unfortunately, the government's response to the disaster appears to be slow and reconstruction demand has so far been weaker than expected, and we think demand is very likely to be delayed. Furthermore, in H2 2011, a number of deadlines are slated: for applications for preferential interest rates (a 1% reduction over the first 10 years) for Flat 35S mortgages, which had risen in popularity along with residential investment from mid-2010 at least up until the earthquake (Figure 31); for construction starts for the Residential Ecopoint program; and for eligibility for expanded tax exemptions related to gift taxes. Although continued low interest rate conditions and higher worker incomes as well as higher housing acquisition capability are all expected to support residential investment to some degree, investment is unlikely to rise considerably. We project that residential investment will finally only rise on-quarter because of reconstruction demand.

Figure 30: Real Residential Investment



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

Figure 31: Flat 35 Loans and Nominal Residential Investment



Note: Total Flat 35 loans includes applications through previous quarter.
Source: Compiled by BTMU Economic Research Office from Cabinet Office, Japan Housing Finance Agency materials.

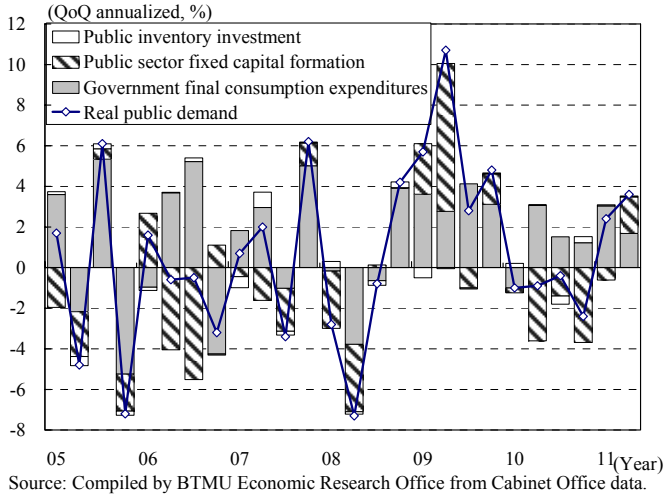
(3) Public Sector

Apr-Jun public demand increases most since Oct-Dec 2009

Real public demand rose at an annualized rate of +3.6% QoQ in Apr-Jun, the highest rate since Oct-Dec 2009 (Figure 32). Not only did government final consumption spending continue to rise, public fixed asset formation (public investment) started to increase again for the first time in six quarters. This supported real public demand. The initial responses following the March 11 earthquake, including rubble removal and reconstruction projects like

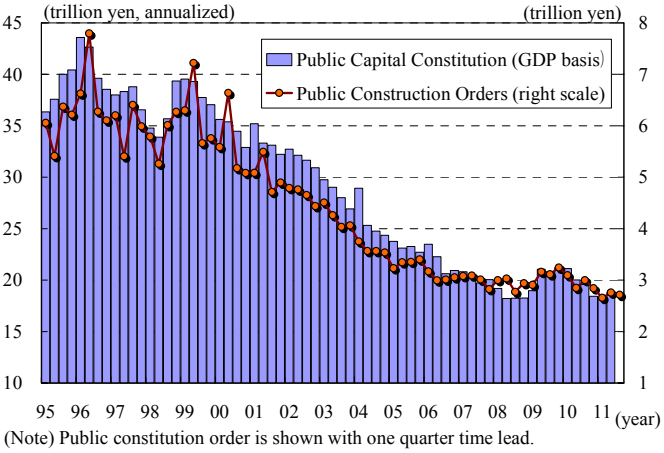
transportation infrastructure, and temporary shelter construction were factors. However, starts of full-scale reconstruction projects for rebuilding in the devastated areas (including moving residential areas to higher ground) appear to be delayed because of lags in drafting plans. Public construction orders, a leading indicator of public fixed asset formation, remain at low levels (Figure 33), and it appears that reconstruction demand in earnest will not get underway for some time.

Figure 32: Real Public Demand



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

Figure 33：Public Investment



(Note) Public constitution order is shown with one quarter time lead.
(Source) Compiled by BTMU Economic Research Office from the Cabinet Office data

Government plans to spend JPY23 trillion on reconstruction projects over 10 years

On July 29, the government approved the Basic Reconstruction Plan, which includes JPY23 trillion in reconstruction project costs over the next 10 years (Table 3). The plan designates 2011-2015 as the 'peak reconstruction period, and JPY19 trillion is slated to be spent during this time. In particular, the funds are weighted in the FY11-FY12 budgets. Although projections are difficult because the projects themselves are still unclear, the portion of the JPY19 trillion not included in the approximately JPY6 trillion in the FY11 first and second supplementary budgets is roughly projected to boost GDP by nearly 3% (Note1).

(Note 1) The Cabinet Office estimates that the total JPY6 trillion in earthquake-related spending in the first and second FY11 supplementary budgets will boost real GDP by 0.9%. Extrapolating this ratio to the full JPY19 trillion figure, the upward effect on GDP would be 2.85% (approximately JPY15.2 trillion). Also, assuming project costs of JPY17 trillion in FY11-FY12, the upward effect would be 2.55% (approximately JPY13.6 trillion).

Table 3: Basic Reconstruction Plan Outline

	FY11 - FY15 (intensive reconstruction period)	FY16 - FY20	Total
Project cost	JPY19 trillion (FY11 - FY12 priority items)	JPY4 trn	JPY23 trn
Budget	1st supplementary budget: Approx JPY4 trn (approx +0.6% positive effect on real GDP) 2nd supplementary budget: Approx 2 trn (approx +0.3% positive effect on real GDP) 3rd supplementary budget onward: Approx JPY13 trn		
Measures	Disaster relief: JPY4 trn Infrastructure, urban development: JPY8-9 trn Livelihood restoration (school facilities, employment measures, etc.): JPY3 trn Disaster prevention, damage measures: JPY1 trn		

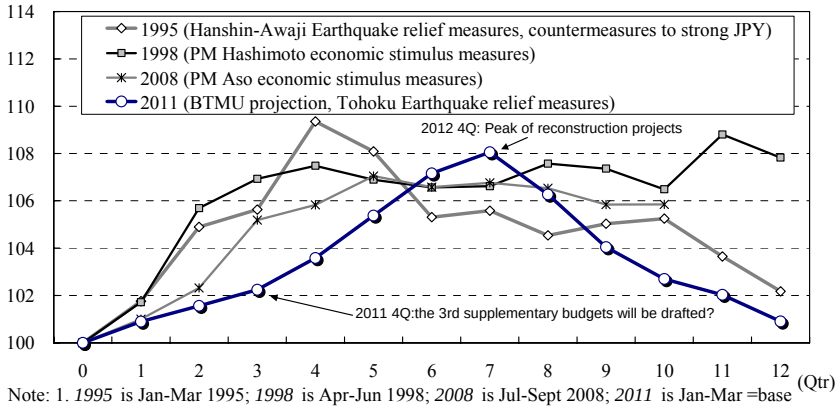
Note: Effects on real GDP calculated by Cabinet Office.
Source: Compiled by BTMU Economic Research Office from Great East Japan Reconstruction Headquarters materials.

Reconstruction projects to gain speed from end-2011, public demand expansion expected to continue through end-2012

However, a big budget for earthquake reconstruction was first expected to be drafted over the summer, but the possibility of a delay until autumn is now greater. As a result, reconstruction projects will probably not get underway in full swing until the end of 2011. Also, based on public demand trends following the 1995 Kobe Earthquake and large-scale economic stimulus measures, public demand tends to rise for four to five quarters. Therefore, we think that public demand from reconstruction projects is likely to peak from the end of this year for one year, through around the end of 2012 (Figure 34).

The government has adhered to its medium-term fiscal frame for the non-reconstruction related budget, planning to limit spending not related to JGB servicing through FY14 to less than JPY71 trillion. Thus, the non-reconstruction related budget is not expected to be a major factor stimulating public demand.

Figure 34: Public Demand (GDP data)



Note: 1. *1995* is Jan-Mar 1995; *1998* is Apr-Jun 1998; *2008* is Jul-Sept 2008; *2011* is Jan-Mar =base 100, 0 quarter.
2. *1998* is high for extended period because of PM Obuchi economic stimulus measures.
Source: Compiled by BTMU Economic Research Office from the Cabinet Office data.

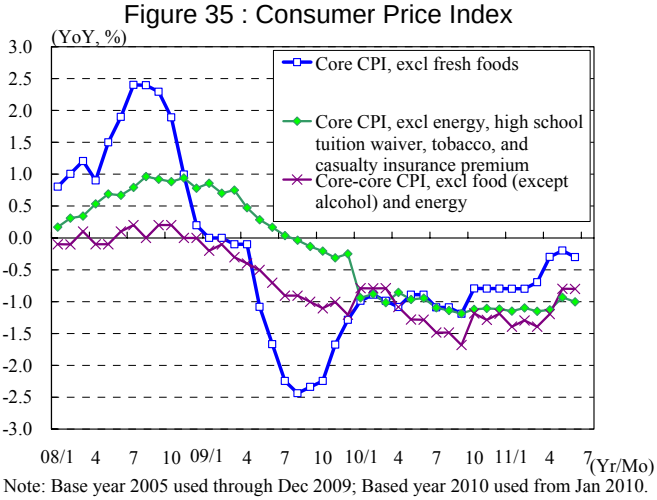
(4) Inflation

Consumer prices not yet out of downward trend

Consumer prices have not yet emerged from the downward trend although the pace of decline has been shrinking. The Consumer Price Index excluding fresh foods, or the Core CPI, was -0.2% YoY in Apr-Jun, an improvement from Oct-Dec 2010 and Jan-Mar 2011 (both -0.8% YoY). June core CPI fell to -0.2% YoY, while the core-core CPI (excluding foods except alcohol and energy) stood at -0.8% YoY (Note 2) (Figure 35). However, the recent rise in the CPI is mainly because of price hikes for energy-related items, cigarette taxes and casualty insurance premiums, as well as the dropping off of downward pressure from high school tuition waivers introduced in April 2010 (Figure 36). Excluding these matters, the June CPI stood at -1.0% YoY, an indication that price trends have not changed since last year. The deflationary trend still appears strong.

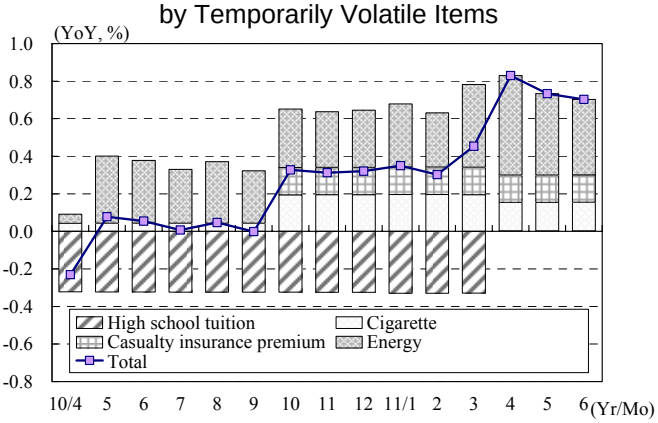
(Note 2) The results of the base year revision to 2010 were released on Aug 12th. The June core CPI using the 2005 base is now +0.4% YoY, a third straight month of rise, and core-core CPI is +0.1%, two straight months of rise. However, the revision to base year 2010 adds -0.6 point and -0.9 point respectively. This downward revision is mainly due to the negative impact of greater weighting for TVs and video recorders and decreased weighting for cigarettes and kerosene, which have resulted in smaller positive contributions. The revision is also due to the "reset effect" of laptops. The "reset effect" weighs on consumer prices as indexes of items with prices that fall quickly are reset back to 100 based on a new base year.

Figure 35 : Consumer Price Index



Note: Base year 2005 used through Dec 2009; Based year 2010 used from Jan 2010.
Source: Compiled by BTMU Economic Research Office from MIC data.

Figure 36 : Impact on Core CPI by Temporarily Volatile Items

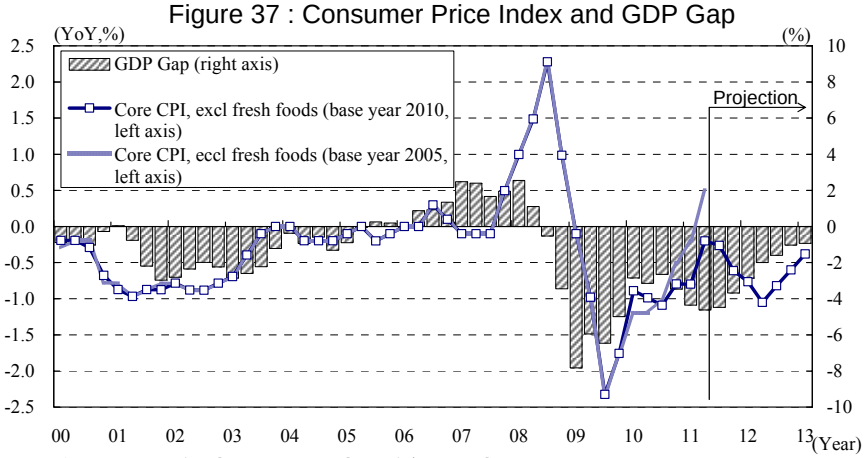


Note: *Energy* includes *Electricity; Gas, manufactured and piped; Liquefied propane; Kerosene;* and *Gasoline*.
Source: Compiled by BTMU Economic Research Office from MIC data.

Deflationary trend to persist for some time though its decreasing speed keeps shrinking

Downward pressure on consumer prices is likely to continue for some time. The deflationary gap is projected to shrink as the real economy recovers step by step (Figure 37), and this will ease the deflationary trend, though quite slowly. On the other hand, statistically, the base year revision delays the shift to price increases on a year-on-year basis. Core and core-core CPI will not both show positive growth before FY13.

Figure 37 : 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 increases asset purchase fund by JPY10 trn

The Bank of Japan agreed to increase the fund to purchase assets by JPY10 trillion at its August 4 Monetary Policy Board meeting, further easing monetary policy (Table 4).

Table 4：BoJ Asset Purchase Funds

(bil. Yen)

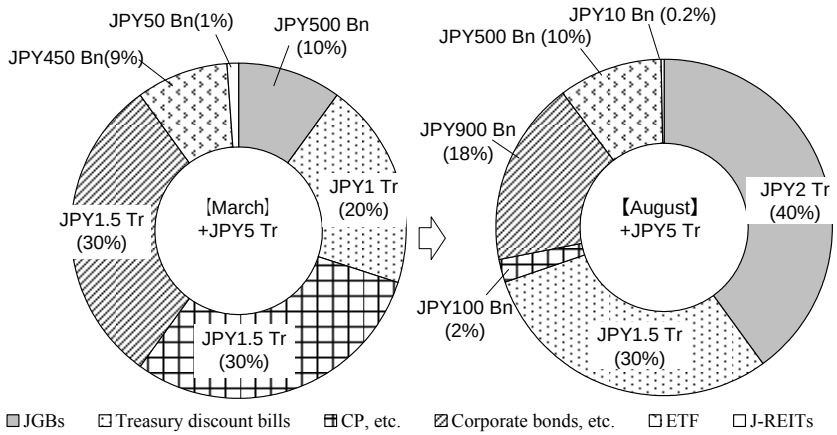
Assets to be purchased	Ammount of fund			Balance as of July	②－③
	before August MPC①	after August MPC②	②-①		
Purchase	10,000	15,000	(5,000)	6,556.0	8,444.0
JGBs	2,000	4,000	(2,000)	1,306.6	2,693.4
Treasury discount bills	3,000	4,500	(1,500)	2,503.7	1,996.3
CP, etc.	2,000	2,100	(100)	1,580.3	519.7
Corporate bonds, etc.	2,000	2,900	(900)	802.1	2,097.9
ETF	900	1,400	(500)	340.6	1,059.4
J-REITs	100	110	(10)	22.7	87.3
Pooled collateral operations	30,000	35,000	(5,000)	30,428.0	4,572.0
Total	40,000	50,000	(10,000)	36,984.0	13,016.0

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

This was the second increase in the asset purchase fund, following the boost on March 14. However, the aim this time appears to differ slightly from in March. The fund is comprised of asset purchases and fixed interest rate pooled collateral lending operations, and the purchase portion was increase by JPY5 trillion, the same as in March. However, while in March purchases of private sector securities like CP and corporate bonds were mainly increased, this time, purchases of short and long-term JGBs increased by JPY3.5 trillion, accounting for 70% of the increase (Figure 38). Also, in March the BoJ limited the scale of operations for fixed interest rate pooled collateral lending operations, but this time it was increased by JPY5 trillion. The March increase, which came in the days following the Tohoku earthquake, was in large part to

ease credit in order to prevent a deterioration in market functions, while the August increase was primarily for monetary easing in order to head off downside risks to the economy from slowing overseas economies and the strengthening JPY.

Figure 38: Breakdown of Increase in Asset Purchase Fund (Purchases)



Note: Figure in parentheses is share of increase.
Source: Compiled by BTMU Economic Research Office from BoJ materials.

Possibility of further easing lingers

We think there is a good possibility that the BoJ will further ease monetary policy. Reviewing past BoJ monetary easing efforts, in many instances the central bank acted when the JPY was strengthening or in lock-step with government economic measures (Table 5). It appears that JPY strengthening pressures cannot be avoided as the US economy appears to be slowing more clearly and on expectations of prolonged monetary easing measures by the FRB. Also, the Japanese Government plans to include measures to address the strong JPY and hollowing out of industry in its third supplementary budget to be submitted by the autumn. Of course, monetary policy is not determined solely on the basis of exchange rates, but with downside risks to Japan's economy building because of the increasingly strong JPY, the BoJ is likely to consider once again boosting the asset purchase fund.

Table 5: Financial Market and Government Moves Under BoJ Monetary Easing

	Financial Markets	Government	Monetary Policy
2008/10	JPY strengthens to JPY/USD92 level Nikkei Average falls below 8,000	Cabinet approves economic measures	Policy rate lowered to 0.50% from 0.30%
2008/12	JPY strengthens to JPY/USD 87 level Nikkei Average once again falls below 8,000	Cabinet approves economic measures	Policy rate lowered to 0.10% from 0.30% Special corporate financing support operations
2009/12	JPY strengthens to JPY/USD84.82 at end-November Nikkei Average falls to lowest level in two and a half months	Cabinet approves economic measures	Fixed-interest rate funding against pooled collateral operations introduced
2010/3	JPY strengthens to JPY/USD88 level for first time in three months Nikkei Average falls below 10,000 for first time in two months in February	—	Increase in fixed interest rate funding against pooled collateral operations
2010/8	JPY strengthens to JPY/USD84.73 Nikkei Average hits year-to-date low	Commits to drafting economic measures	Increase in fixed interest rate funding against pooled collateral operations
2010/10	JPY hits JPY/USD82 in September, highest level in approximately 15 years Nikkei Average falls below 9,000 for first time since Lehman Brothers collapse in August	Commits to economic stimulus measures Intervenes in forex market on September 15	'Comprehensive easing' introduced
2011/3	Nikkei Average drops more than 1,600 points over two days, Mar 14-15 JPY hits JPY/USD76.25 on March 17, record high	Launches budget revisions to fund earthquake relief measures	Asset purchase fund increased (JPY5 tr)
2011/8	JPY hits JPY/USD76 level on Jul 29 for first time in four months Nikkei Average plunges 460 points over six days through Aug 3	Govt starts to consider measures to stem hollowing out of industry Intervenes in forex market on August 4	Asset purchase fund increased (JPY10 tr)

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

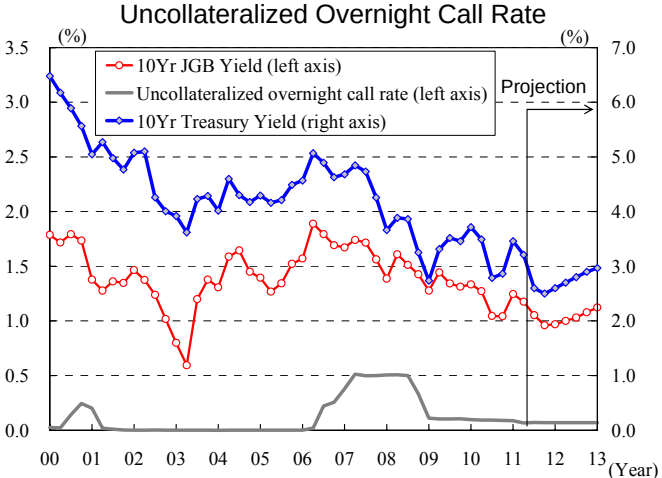
(2) 10Yr JGB Yield

Benchmark JGB yield likely to remain low

The newly-issued 10Yr JGB yield has moved around 1% recently, falling on concerns about a slowdown in the US economy, deepening of the European sovereign debt crisis, and further monetary easing by the BoJ. The 10Yr yield is very likely to remain at a low level for some time. The main factors impacting the 10Yr JGB yield are 1) BoJ monetary policy and 2) the direction of 10Yr Treasuries. Of the two, there is a possibility of further easing and this would act to weigh on the 10Yr JGB even more. Also, the benchmark Treasury yield (2) is likely to remain low as the US economy slows, and this will also weigh on the benchmark JGB yield. As a result, we think that the yield on new issues of 10Yr JGBs will remain around 1% and will start to turn upward from fall 2012, once the Treasury benchmark nears 3% (Figure 39).

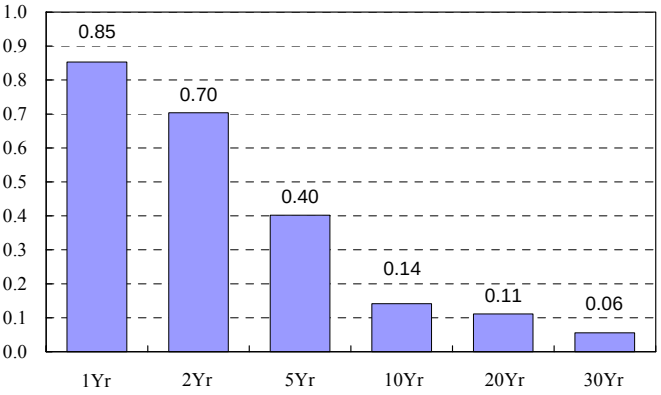
Although JPY10 trillion in reconstruction bonds are expected to be issued, most of the bonds will be for terms of five years or less. This is in order to avoid burdening future generations. Because yields on shorter-term JGBs are highly correlated to monetary policy (Figure 40), yields are very likely to be capped as long as the BoJ continues to maintain monetary easing. The issuance of reconstruction bonds are not expected to be a factor boosting long-term JGB yields much.

Figure 39: US-Japan Long-Term Yields and Uncollateralized Overnight Call Rate



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

Figure 40: Correlation Between JGB Yield by Tenor and Monetary Policy



Note: Coefficient of determination using Jan 2000 - July 2011 monthly average sample revised for latitude

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

(3) Exchange Rates

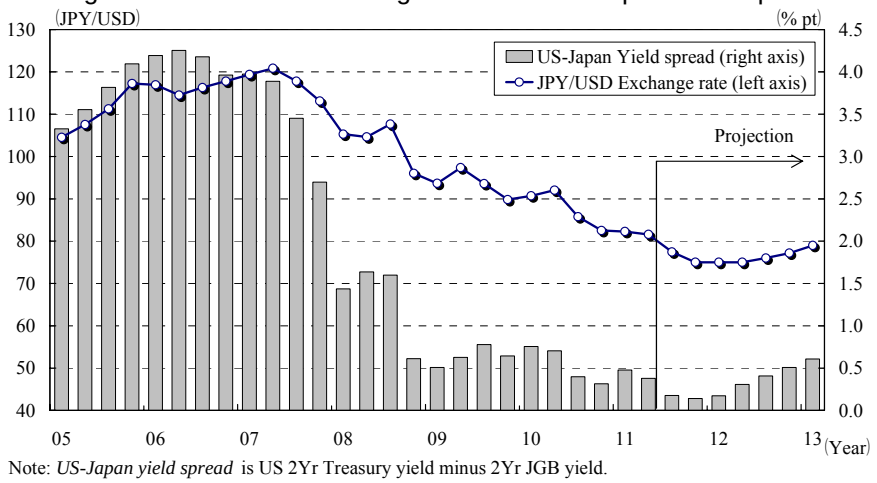
JPY strengthening gains speed from July

The JPY strengthening trend gained speed from late July following the debt ceiling deadlock and concerns about a slowing economy in the US, with the JPY currently trading in the JPY/USD77 range. On August 4, Japan unilaterally intervened in the foreign exchange markets, with the government and BoJ selling JPY and buying USD. However, the efforts did not change the flow of the markets and the JPY continues to trade at record high levels.

JPY strengthening pressures expected to persist

We expect the JPY strengthening pressures to persist for some time. First, US and European monetary authorities did not enthusiastically welcome Japan's intervention in the forex market, and it remains unclear whether the Japanese Government and BoJ will continue with large-scale interventions. Furthermore, the US FRB indicated at its August FOMC meeting the possibility of maintaining a super-low interest rate policy through at least mid-2013. This is likely to support JPY strengthening. With the US-Japan yield spread continuing to shrink, we think the JPY could continue to rise easily for some time (Figure 41). Our forecast range for the JPY/USD through end-FY2012 is from the mid- to upper JPY/USD70 range.

Figure 41: JPY/USD Exchange Rate and US-Japan Yield Spread

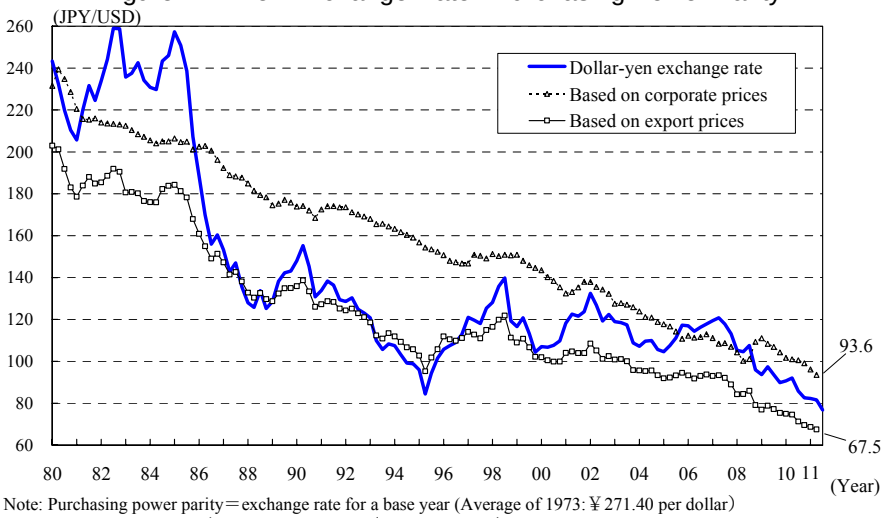


Note: *US-Japan yield spread* is US 2Yr Treasury yield minus 2Yr JGB yield.
Source: Compiled by BTMU Economic Research Office from Bloomberg data.

JPY might even break above JPY/USD70, depending on conditions in the US and Europe

Note that in the past, purchasing power parity in terms of export prices, which have marked the JPY's peak strength, stood at the upper JPY/USD60 level in current terms (Figure 42). If concerns about a US recession gain traction or if the European sovereign debt issue deepens more than expected, the risk that the JPY could overshoot and even break above the JPY/USD70 point might arise.

Figure 42：Yen Exchange Rate : Purchasing Power Parity



Note: Purchasing power parity＝exchange rate for a base year (Average of 1973: ¥271.40 per dollar)
×（Japanese price index／U.S. price index）
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.

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Outlook for the Japanese Economy

9-Sep-2011

Bank of Tokyo-Mitsubishi UFJ Economic Research Office

(%, billion yen)

Forecast →

	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	9.3	-0.7	4.0	-2.4	-3.7	-2.1	1.3	3.0	2.7	3.6	1.9	2.6	0.2	2.3	-0.5	2.5
Private Consumption	3.9	-1.7	4.0	-3.4	-2.5	-0.1	0.6	0.8	1.0	1.2	1.1	1.0	0.9	0.8	-0.4	1.0
Housing Investment	4.3	-0.4	8.6	11.6	0.9	-7.1	2.0	3.2	4.7	5.0	4.5	3.6	3.6	-0.3	1.2	4.2
Private Business Fixed Investment	6.8	10.7	4.2	0.0	-5.5	-3.6	5.5	9.6	10.2	12.0	4.9	2.5	0.0	4.2	1.3	7.4
Business Inventory (Contribution)	4.1	-2.0	2.0	0.2	-1.3	0.4	-0.4	0.2	0.2	0.3	0.4	0.5	0.6	0.5	0.0	0.3
Government Expenditures	-1.0	-1.2	-0.3	-2.3	2.4	4.8	2.4	2.7	5.3	7.1	7.0	3.4	-6.5	0.0	2.7	4.6
Public Investment	-0.7	-21.9	-7.1	-20.6	-2.8	18.3	2.8	6.1	12.6	19.3	18.3	8.2	-18.2	-10.0	3.3	11.0
Net Exports (Contribution)	2.1	1.4	-0.9	-0.3	-0.8	-3.0	0.0	0.4	-0.8	-0.8	-1.5	0.3	0.6	0.9	-1.0	-0.5
Exports	26.9	29.7	2.9	-3.9	0.0	-18.1	16.0	3.0	6.1	8.4	10.5	11.3	11.8	17.0	-1.8	8.7
Imports	11.2	21.1	10.9	-2.6	5.8	-0.2	22.5	0.9	16.3	18.8	28.2	11.7	9.6	11.0	6.4	16.4
Nominal GDP	8.7	-3.4	2.1	-3.9	-5.8	-6.0	-0.8	2.2	1.4	2.4	0.3	1.1	-1.3	0.4	-2.7	1.2
GDP Deflator (YoY)	-2.8	-2.0	-2.1	-1.6	-1.9	-2.2	-2.4	-2.1	-1.9	-1.2	-1.3	-1.3	-1.3	-1.9	-2.2	-1.3
Industrial Production Index (QoQ)	7.3	0.7	-1.0	-0.1	-2.0	-4.0	7.2	2.2	1.1	1.9	1.3	1.7	1.1	9.0	0.8	7.8
Domestic Corporate Goods Price Index (YoY)	-1.6	0.2	-0.2	1.0	1.7	2.4	2.9	2.2	1.2	0.9	1.0	1.0	1.1	0.7	2.1	1.0
Consumer Price Index (excl. fresh food, YoY)	-0.9	-1.0	-1.1	-0.8	-0.8	-0.2	-0.3	-0.6	-0.8	-1.1	-0.8	-0.6	-0.3	-0.9	-0.5	-0.7
2. Balance of Payments																
Trade Balance (billion yen)	2,380	1,811	1,967	1,778	910	-1,254	-416	-371	-447	480	909	163	-142	6,465	-2,488	1,409
Current Balance (billion yen)	4,531	3,904	4,405	4,321	3,260	1,860	2,759	2,863	2,845	3,831	4,318	3,630	3,385	15,889	10,327	15,164
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	1.1	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	77	75	75	75	76	77	79	86	77	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 Sep 12, 2011

	Fiscal	Fiscal	2010	2011		2011				
	2009	2010	4Q	1Q	2Q	APR	MAY	JUN	JUL	AUG
Real GDP Growth Rate <% changes from previous period at SA annual rate>	-2.4	2.3	-2.4 (2.2)	-3.7 (-1.0)	-2.1 (-1.1)	***	***	***	***	***
Index of All Industries Activity	-4.2	2.0	-0.2 (2.1)	-1.9 (-0.5)	-0.4 (-1.7)	1.7 (-4.0)	1.8 (-1.4)	2.3 (0.2)		
Industrial Production Index	-8.8	8.9	-0.1	-2.0	-4.0	1.6	6.2	3.8	0.6	
Production			(5.9)	(-2.5)	(-6.8)	(-13.6)	(-5.5)	(-1.7)	(-2.8)	
Shipments	-8.3	9.3	-0.3 (6.4)	-1.9 (-2.6)	-5.9 (-8.4)	-2.6 (-16.1)	5.3 (-8.0)	8.1 (-1.8)	0.2 (-2.9)	
Inventory	-6.1	3.5	-0.6 (3.8)	1.0 (3.5)	3.2 (4.0)	0.5 (3.3)	5.6 (7.7)	-2.8 (4.0)	-0.2 (4.0)	
Inventory/Shipments Ratio (2005=100)	120.4	108.2	111.0 [114.7]	106.9 [106.3]	119.1 [106.5]	124.8 [105.0]	120.7 [107.5]	111.9 [106.9]	116.3 [109.0]	[108.0]
Domestic Corporate Goods Price Index	-5.2	0.7	0.4 (1.0)	1.1 (1.7)	1.2 (2.4)	0.9 (2.5)	-0.2 (2.1)	0.0 (2.5)	0.3 (2.9)	-0.2 (2.6)
Consumer Price Index(SA, total, excl.fresh foods)	-1.6	-0.8	0.1 (-0.8)	-0.3 (-0.8)	0.5 (-0.2)	0.2 (-0.4)	0.0 (-0.4)	-0.3 (-0.4)	0.1 (0.2)	
Index of Capacity Utilization (2005=100)	80.0	88.0	88.4 [81.8]	86.1 [89.5]	80.4 [89.8]	72.8 [90.0]	82.1 [90.5]	86.4 [88.9]	[88.5]	[88.5]
Machinery Orders(Private Demand, Excl.Electric Power and Ship building)	-20.4	9.1	-4.3 (5.6)	5.6 (8.9)	2.5 (9.8)	-3.3 (-0.2)	3.0 (10.5)	7.7 (17.9)	-8.2 (4.0)	
Manufacturing	-27.9	18.3	-1.7 (11.5)	5.3 (16.3)	-0.2 (17.2)	-2.7 (7.4)	-1.4 (22.5)	9.3 (21.1)	-5.2 (3.2)	
Non-manufacturing Excl.Electric Power & Ship building	-14.7	2.7	-5.1 (0.3)	1.4 (3.5)	5.0 (4.2)	2.9 (-5.2)	-5.4 (1.5)	15.7 (15.4)	-1.4 (5.8)	
Shipments of Capital Goods (Excl.Transport Equipment)	-24.2	21.3	1.2 (23.9)	-2.4 (6.6)	6.1 (9.0)	8.0 (1.9)	8.4 (16.9)	1.1 (9.3)	0.6 (7.5)	
Construction Orders	-14.2	-5.2	(2.0)	(-4.9)	(18.0)	(31.4)	(25.5)	(6.0)	(5.7)	
Private	-15.3	-2.6	(4.8)	(1.5)	(20.1)	(33.5)	(20.2)	(13.1)	(12.0)	
Public	-11.1	-12.1	(-3.6)	(-20.1)	(15.1)	(31.0)	(51.6)	(-8.0)	(9.1)	
Public Works Contracts	4.9	-8.8	(-14.8)	(-3.2)	(-9.3)	(-11.2)	(-14.1)	(-3.4)	(-15.9)	
Housing Starts	77.6	81.9	84.3	84.2	81.0	79.8	81.5	81.7	95.5	
10,000 units at Annual Rate, SA	(-25.4)	(5.6)	(6.9)	(3.2)	(4.1)	(0.3)	(6.4)	(5.8)	(21.2)	
Total floor	(-21.5)	(9.0)	(11.0)	(6.0)	(3.8)	(1.1)	(5.8)	(4.6)	(22.5)	
Sales at Retailers	-0.4	0.8	(-0.4)	(-3.0)	(-1.7)	(-4.8)	(-1.3)	(1.2)	(0.7)	
Real Consumption Expenditures of Households over 2 persons (SA)	1.0	-0.9	-1.5 (-1.5)	-1.7 (-3.0)	-0.9 (-2.1)	1.0 (-2.0)	-0.3 (-1.2)	0.8 (-3.5)	0.7 (-2.1)	
Propensity to Consume (SA,%)	74.7	73.4	74.5 [74.8]	71.9 [74.1]	74.1 [72.4]	72.9 [72.7]	74.7 [72.9]	73.6 [71.8]	71.9 [75.4]	[75.5]
Overtime Hours Worked (All Industries, 5 employees or more)	-8.5	6.8	-0.6 (5.7)	1.2 (1.7)	-2.6 (-2.0)	-1.8 (-3.9)	0.9 (-2.1)	2.2 (0.0)	-0.1 (-1.0)	
Total Cash Earnings (Regular Employees Only; All Industries, 5 employees or more)	-3.3	0.6	(0.2)	(0.1)	(-0.5)	(-1.4)	(1.0)	(-0.7)	(-0.1)	
Employment Index(Regular Employees Only;'All Industries, 5 employees or more) (Change over the M/Q/Y)	-77,894	23,384	28,038 -109,743	33,848 1,683	28,033 10,188	28,654 3,912	24,914 15,833	30,531 10,821	27,348 20,627	18,928
Ratio of Job Offers to Applicants (SA,Times)	0.45	0.56	0.57 [0.44]	0.62 [0.47]	0.62 [0.50]	0.61 [0.48]	0.61 [0.50]	0.63 [0.52]	0.64 [0.53]	[0.54]
Unemployment Rate (SA,%)	5.2	5.0	5.0	4.7	4.7	4.7	4.5	4.6	4.7	
Economy Watcher Survey (Judgment of the present condition D.I,%)	39.9	44.2	43.0 [36.7]	40.1 [42.8]	38.0 [48.3]	28.3 [49.8]	36.0 [47.7]	49.6 [47.5]	52.6 [49.8]	47.3 [45.1]
Bankruptcies (Number of cases)	14,732 (-8.7)	13,065 (-11.3)	3,299 (-6.5)	3,211 (-7.3)	3,312 (-0.3)	1,076 (-6.7)	1,071 (4.8)	1,165 (1.4)	1,081 (1.4)	1,026 (-3.5)

(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 2011.

2. Balance of Payments

As of Sep 12, 2011

	Fiscal 2009	Fiscal 2010	2010 4Q	2011 1Q	2011 2Q	2011 APR	MAY	JUN	JUL	AUG
Customs Clearance(Exports in Yen Terms)	-17.1	14.9	(10.0)	(2.5)	(-8.1)	(-12.4)	(-10.3)	(-1.6)	(-3.4)	
Value	-7.0	0.2	(1.2)	(-0.0)	(0.2)	(-0.9)	(0.5)	(1.1)	(2.0)	
Volumes	-9.9	14.6	(8.6)	(2.4)	(-8.3)	(-11.6)	(-10.8)	(-2.7)	(-5.3)	
Imports(In Yen terms)	-25.2	16.0	(11.3)	(11.4)	(10.4)	(9.0)	(12.4)	(9.8)	(9.9)	
Value	-18.4	3.3	(1.6)	(4.0)	(7.4)	(7.6)	(6.5)	(8.0)	(12.9)	
Volumes	-7.3	12.4	(9.6)	(7.2)	(2.8)	(1.3)	(5.5)	(1.7)	(-2.6)	
Current Balance(100 mil. yen)	157,817	161,255	36,482	39,866	15,232	4,056	5,907	5,269	9,902	
Trade Balance(100 mil. yen)	65,996	64,955	19,233	5,577	-10,587	-4,175	-7,727	1,315	1,233	
Services(100 mil. yen)	-18,185	-12,730	-3,984	-771	-5,595	-4,213	-176	-1,206	-3,062	
Capital and Financial Accounts(100 mil. yen)	-123,113	-97,221	-10,192	-34,301	7,914	11,466	-1,638	-1,914	-7,531	
Gold & Foreign Exchange Reserves($1mil.)	1,042,715	1,116,025	1,096,185	1,116,025	1,137,809	1,135,549	1,139,524	1,137,809	1,150,877	1,218,501
Exchange Rate(V$)	92.80	85.69	82.59	82.32	81.70	83.35	81.23	80.51	79.47	77.22

3. Financial Market Indicators

	Fiscal 2009	Fiscal 2010	2010 4Q	2011 1Q	2011 2Q	2011 APR	MAY	JUN	JUL	AUG
Uncollateralized Overnight Call Rates	0.102	0.091	0.090	0.088	0.067	0.062	0.069	0.069	0.073	0.081
			[0.104]	[0.098]	[0.093]	[0.093]	[0.091]	[0.095]	[0.094]	[0.095]
Euro Yen TIBOR	0.516	0.356	0.336	0.336	0.332	0.333	0.332	0.332	0.332	0.329
(3 Months)			[0.498]	[0.443]	[0.388]	[0.396]	[0.388]	[0.381]	[0.373]	[0.363]
Newly Issued Japanese Government Bonds Yields	1.353	1.127	1.072	1.242	1.160	1.200	1.150	1.130	1.080	1.030
(10 Years)			[1.317]	[1.337]	[1.208]	[1.280]	[1.260]	[1.085]	[1.055]	[0.975]
Average Contracted Interest Rates	1.449	1.357								
on Loans and Discounts(City Banks)			1.382	1.357	1.349	1.359	1.346	1.349	1.338	
(% changes from previous period)			(-0.010)	(-0.025)	(-0.008)	(0.002)	(-0.013)	(0.003)	(-0.011)	
The Nikkei Stock Average	11,090	9,755	10,229	9,755	9,816	9,850	9,694	9,816	9,833	8,955
(TSE 225 Issues)			[10,546]	[11,090]	[9,383]	[11,057]	[9,769]	[9,383]	[9,537]	[8,824]
M2(Average)	(2.9)	(2.7)	(2.6)	(2.4)	(2.8)	(2.7)	(2.7)	(2.9)	(3.0)	(2.7)
Broadly-defined Liquidity(Average)	(0.5)	(0.6)	(0.3)	(-0.3)	(-0.0)	(-0.2)	(-0.3)	(0.3)	(0.7)	(0.6)
Principal Figures of Financial Institutions										
Loans and Discount (Average) — Banks & Shinkin	(0.8)	(-1.9)	(-2.0)	(-1.8)	(-0.8)	(-1.0)	(-0.8)	(-0.6)	(-0.6)	(-0.5)
Loans and Discount (Average) — Banks	(0.8)	(-2.0)	(-2.1)	(-1.9)	(-0.8)	(-1.0)	(-0.8)	(-0.6)	(-0.6)	(-0.5)
Loans and Discount (Average) — City Banks etc.	(-0.4)	(-4.2)	(-4.6)	(-4.6)	(-2.8)	(-3.1)	(-2.7)	(-2.7)	(-2.7)	(-2.6)
Loans and Discount (Average) — Regional Banks	(2.4)	(0.6)	(0.9)	(1.2)	(1.5)	(1.4)	(1.4)	(1.7)	(1.8)	(1.8)
Loans and Discount (Average) — Regional Banks II	(1.3)	(-0.4)	(-0.5)	(-0.0)	(0.9)	(0.7)	(0.7)	(1.1)	(1.3)	(1.2)
Loans and Discount (Average) — Shinkin	(0.8)	(-1.3)	(-1.3)	(-1.1)	(-0.7)	(-0.8)	(-0.7)	(-0.6)	(-0.5)	(-0.3)
Deposits and CDs (Average) — Total(3 Business Condition)	(2.9)	(2.6)	(2.7)	(2.2)	(2.7)	(2.7)	(2.6)	(2.8)	(2.6)	(2.1)
Deposits and CDs (Average) — City Banks	(3.0)	(2.6)	(3.0)	(1.8)	(2.3)	(2.5)	(2.1)	(2.2)	(1.5)	(0.6)
Deposits and CDs (Average) — Regional Banks	(3.1)	(3.1)	(3.0)	(3.1)	(3.4)	(3.0)	(3.4)	(3.7)	(4.0)	(3.8)
Deposits and CDs (Average) — Regional Banks II	(1.8)	(0.6)	(0.1)	(0.9)	(2.0)	(1.9)	(1.9)	(2.2)	(2.6)	(2.7)

(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.