

Key Points about the Japanese Economy

July 5, 2010

I . Trends and Forecasts of the Japanese Economy

• **Monthly Economic Report (June 18)**

Although the Japanese economy has been picking up steadily and the foundation for a self-sustaining recovery is being laid, it remains in a difficult situation such as a high unemployment rate.

- Exports are increasing moderately. Industrial production is picking up.
- Corporate profits are improving. Business investment is leveling off.
- Firms' judgment on current business conditions is improving. However, small and medium-sized enterprises are cautious about the immediate future.
- While the employment situation remains severe, movements of an incipient recovery can be seen recently.
- Private consumption is picking up.
- Recent price developments show that the Japanese economy is in a mild deflationary phase.

• **Indexes of Business Conditions**

Based upon the view of the Working Group of Indexes of Business Conditions, the Economic and Social Research Institute at the Cabinet Office has determined provisionally that a trough in business cycle occurred in the Japanese economy in March 2009.

(The duration of the last economic downturn phase since November 2007 is 17 months.)

• **Mid-year Economic Projection for FY 2010 (June 22)**

- The Japanese economy has been in phase of expansion, having bottomed out in the spring of 2009. In addition to the moderate recovery of the world economy, the Emergency Economic Measures formulated at the end of 2009 have brought about relatively higher growth. Recently, slight improvement can be observed in the employment and income environment. Such movement is expected to be secured through the implementation of the FY2010 budget.
- A virtuous cycle of economic growth could be created as an increase in demand improves both corporate profits and the employment and income environment, spilling over to stimulate private demand. As the mechanism of such cycle is established, the momentum for a self-sustaining recovery in the Japanese economy is expected to strengthen.
- Regarding future risks, there are uncertainties concerning developments in the world economy, including financial capital markets, and their impacts on the Japanese economy.

• **Economic Analysis on Japanese Economy by OECD ("Economic Outlook 87")**

- The recovery from the global crisis remains on track, thanks to a strong rebound in exports and fiscal stimulus that has supported household income in the face of falling employment and wages. Output growth is projected to reach 3% in 2010 on a year-average basis, but to slow somewhat in the second half of the year and average 2% in 2011. Nevertheless, the unemployment rate is likely to stay above 4½ per cent through 2011 and deflation will persist, as production remains below capacity.
- The Bank of Japan should fight deflation through a strong commitment to keep interest rates at their very low current levels and to implement quantitative measures effectively until underlying inflation is firmly positive. Given Japan's very high public debt, the government should scale back expenditure increases in FY 2011 and develop a credible and detailed medium-term fiscal consolidation programme, including tax

reform, to bring the budget into balance. The Growth Strategy should focus on reforms that will boost productivity growth, particularly in the service sector, to improve living standards in the face of a shrinking working-age population.

Economic Outlook by several institutions (Real GDP)

Calendar Year		09(actual)	10	11
IMF “World Economic Outlook”	(April)	-5.2	1.9	2.0
OECD “Economic Outlook 87”	(May)		3.0	2.0
Fiscal Year		09(actual)	10	11
Government (Cabinet Decision)	(January)	-2.0	1.4	—
Cabinet Office	(June)		2.6	2.0* ¹
BOJ	(April)		1.8* ²	2.0* ²

*1 automatic calculation, used only for the discussion of FY2010 macroeconomic situation.

*2 median of forecasts by the Policy Board members

- **Financial and Capital Markets**

As of July 2, 1 US\$: 88.05 yen. Nikkei: 9207 yen.

BOJ’s target for the uncollateralized overnight call rate: 0.1 %

II. Economic and Fiscal Policy

In order to realize the potential growth power of Japan by generating new demand and employment, the government implements policy management to get Japanese economy back on a path toward a full-scale recovery and to terminate deflation under a new policy system and a new policy idea centering on a demand side.

For the simultaneous achievements of “Strong economy” (sustainable economic growth), “Strong public finances” (sound public finance) and “Strong social security system” (stable social security), the government promotes “New Growth Strategy”, “Fiscal Management Strategy” and the reform of the social security system jointly and coherently.

- **New Growth Strategy (cabinet decision, June 18)**

Targets

2020	2010
Achieve nominal & real growth in excess of 3% and 2%.	Sluggish growth (real growth rate at 1% in the past decade; potential growth rate at 1%)
Return consumer prices to positive increase in FY2011.	Trapped in deflation (consumer price increase rate at 0% in the past 20 years)
Lower the unemployment rate to 3% - 4% at an early time.	Unemployment rate at 5%

7 strategic areas

- 1) Green Innovation
- 2) Life Innovation
- 3) Asia
- 4) Tourism-oriented nation & local revitalization
- 5) Science-and-technology IT oriented nation
- 6) Employment & human resources

7) Financial sector

Creation of new demand and jobs

Area	Demand creation	Job creation
Environment (Green Innovation)	¥ 50 trillion	1.4 million jobs
Health (Life Innovation)	¥ 50 trillion	2.84 million jobs
Asia	¥ 12 trillion	190,000 jobs
Tourism	¥ 11 trillion	560,000 jobs

• **Fiscal Management Strategy (cabinet decision, June 22)**

New Fiscal Management Strategy

- Implementation of the New Growth Strategy
- Reconstruction of sustainable social security
- Sharing of the expense for security and growth

→Fiscal consolidation that brings a bright hope to the people and promotes economic growth

Fiscal consolidation targets

(Flow targets)

- By FY2015 at latest halve the primary balance (national and local governments) deficit relative to GDP
- By FY2020 at latest achieve primary balance surplus
(The same targets are set for the national government alone.)

(Stock target)

- Stable reduction in the amount of public debt relative to GDP from FY2021

Medium-term Fiscal Framework : Multi-year measures on both revenue and expenditure

- Aiming that the new government bonds issuance in FY2011 does not exceed that in FY2010 (around ¥44tn), and steadily decreases thereafter
- Determine soon details of the comprehensive reform of taxes including consumption tax
- Overall Expenditure Limit : During FY2011~2013, general account expenditure (excluding debt repayment and interest payment) will remain the same or below that of the previous FY (can be increased when permanent revenue sources are secured for policies such as integrated enhancement of economy, public finances and social security).

III. Monetary Policy

Placing top priority on casting off deflation, the government will work as one with the Bank of Japan to launch vigorous and comprehensive policy efforts. The government expects the Bank of Japan to make the utmost efforts toward the termination of deflation by sharing basic perspectives on macroeconomic management.

• **Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth (June 15)**

Overview

- The fund-provisioning measure supplies long-term funds at a low interest rate against eligible collateral to financial institutions in accordance with their efforts in terms of lending and investment toward strengthening the foundations for economic growth.

- As for financial institutions that utilize the measure, the Bank expects that they will utilize the fund-provisioning measure appropriately and effectively, taking it as an opportunity to expand lending and investment to businesses that will contribute to raising productivity or creating new demand.
- The fund-provisioning measure aims to act as a catalyst for financial institutions in making efforts toward strengthening the foundations for economic growth and to support, as broadly as possible, financial institutions' various efforts of their own accord.

Details

- **Schedule**

The Bank will make necessary preparations so as to be able to start providing funds by around the end of August, 2010

- **Duration of Loans, Maximum Number of Times for Rollover of Loans**

The duration of each loan shall be one year in principle, and the loan can be rolled over up to three times (the maximum duration of the loan shall be four years).

- **Loan Rates**

The loan rate will be the Bank's target for the uncollateralized overnight call rate on the day of disbursement of the loan (current rate: 0.1%).

- **Maximum Amount of Loan**

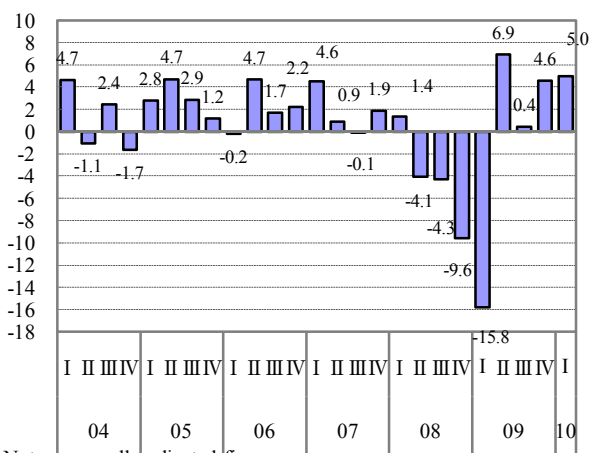
The total amount of loans shall not exceed 3 trillion yen; the total amount of loans at each loan disbursement shall not exceed 1 trillion yen.

(Annex) Major Economic Indicators of Japan

2010/07/05 International Economy Division, Economic Affairs Bureau

Real GDP Growth Rate

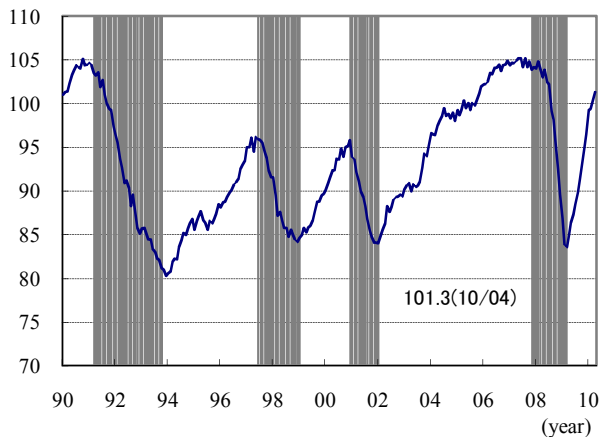
(at annual rate, %)



Note: seasonally-adjusted figures
Source: Cabinet Office

Cyclical Index (Coincident CI)

(2005=100)



Note: Shaded areas indicate recession.
Source: Cabinet Office

Stock Prices (Nikkei)

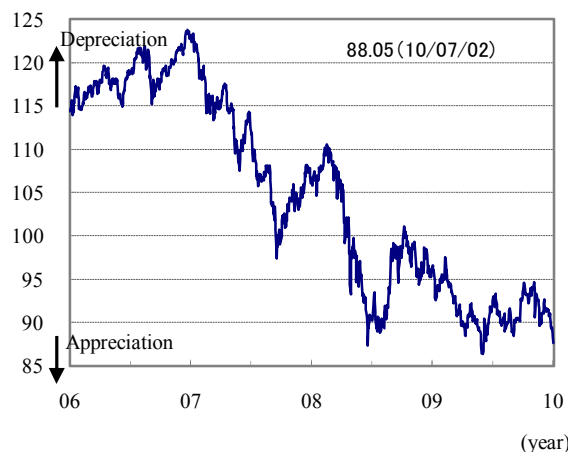
(yen)



Source: Datastream

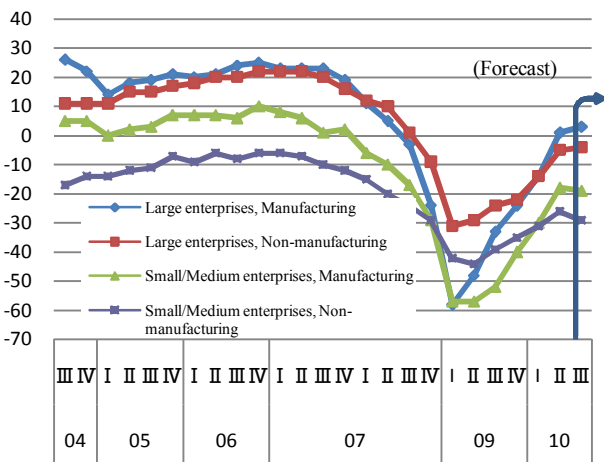
Yen/Dollar Rate

(yen/\$)



Source: Datastream

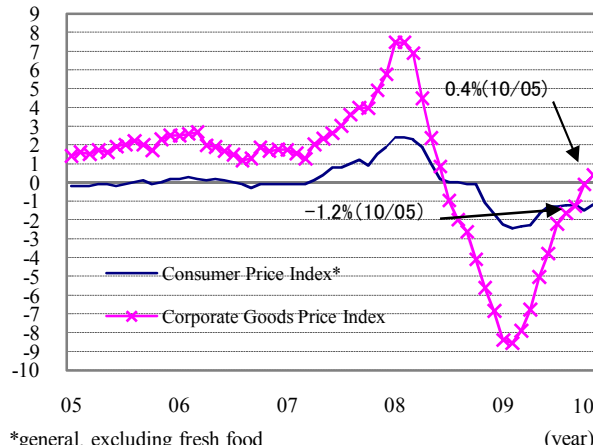
Tankan Survey



Source: Bank of Japan

Price Indices

(at annual rate, %)



*general, excluding fresh food
Source: MIC, Bank of Japan

