

21 October 2013 (No. of pages: 15)

Japanese report: 18 Oct 2013

Japan's Economy: Monthly Review

Four possible risks facing Japan's economy

Japan's economy to continue steadily growing; four risks warrant watch

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Summary

- **Main scenario—Japanese economy to continue steadily growing:** After hitting a trough in November 2012, Japan's economy entered a recovery phase and we believe it will continue to expand steadily. The economic policies of the Abe administration ("Abenomics") represent an appropriate set of policies with the potential of jump-starting the revival of the Japanese economy, and monetary policy measures in particular are yielding marked results. We believe that there is little basis to the two criticisms leveled against Abenomics, namely (1) it will have an adverse impact on the economy overall if long-term interest rates rise and (2) employee income will fail to increase amid rising inflation, and living standards will fall. Going forward, we believe that the Abe administration will need to actively engage in measures such as (1) maintaining fiscal discipline by making fundamental reforms to the social security system and (2) enhancing comprehensive growth strategies through deregulation and reducing the effective corporate tax rate.
- **Four possible risks facing Japan's economy:** Risks that will need to be kept in mind regarding the Japanese economy are: (1) turbulence in emerging economies, (2) China's shadow banking problem, (3) a reignition of the European sovereign debt crisis, and (4) a surge in crude oil prices stemming from geopolitical risk. Of these four risks, it is worth noting that the first is closely related to the second and third. In this report, we examine the world economic cycle. In the past, advanced economies led by the US drove emerging economies. However, a decoupling is currently occurring—advanced economies are performing well but emerging economies are stagnating. We believe that this decoupling is occurring for three reasons: (1) the dwindling amount of loans from European financial institutions to emerging economies in light of the European debt crisis, (2) the sluggishness of the Chinese economy, and (3) concerns that money will be taken out of emerging economies based on worries that the Fed will adopt a hasty exit from quantitative easing. We anticipate that a further deterioration of emerging economies will be avoided as the US economy continues to expand. Nevertheless, we think the state and the future direction of the Chinese economy will continue to require close monitoring.

1. Main Scenario: Japan's economy on a steady path towards recovery

Abenomics represents an appropriate set of economic policies in accordance with global standards

Supported in part by Abenomics, Japan's economy is on a path towards recovery. After hitting a trough in November 2012, Japan's economy entered a recovery phase and we believe it will continue to expand steadily. This expansion will be supported by (1) the expansion of the US economy, (2) persistent reconstruction demand related to the 2011 Great East Japan Earthquake and the formation of a large-scale supplementary budget, and (3) the ongoing depreciation of the yen and the ascent in stock prices accompanying the Bank of Japan (BOJ)'s bold monetary easing. Abenomics consists of three "arrows" (three priority areas): (1) bold monetary policy (2) flexible fiscal policy and (3) growth strategies to stimulate private-sector investment. We have argued from the beginning that Abenomics has the potential of jump-starting the revival of the Japanese economy and that its basic direction is set on the right course.

Bold monetary policy, in particular, has made a smooth start

Of the three "arrows", the first arrow, bold monetary policy, has made a particularly smooth start.

Since mid-November 2012 when the dissolution of the House of Representatives became all but certain, cumulative market capitalization in Japan has increased by around Y160 trillion. It is amazing that wealth exceeding the national government budget for a single year (around Y90 tril on an initial budget basis) was generated with the change of power. During the period, the yen has depreciated around Y18 against the dollar. According to the Daiwa short-term macroeconomic forecasting model, the yen depreciating by Y10 against the dollar would lift Japan's real GDP by around 0.3-0.5% (Y1.5-2.5 tril). To put it simply, yen depreciation accompanying the change in administration has had the effect of lifting real GDP by around Y3-5 trillion.

Going forward, we think the Abe administration will need to actively engage in measures such as (1) the maintenance of fiscal discipline by making fundamental reforms to the social security system and (2) enhancing comprehensive growth strategies through deregulation and the reduction of the effective corporate tax rate. However as of now, we rate Abenomics extremely high.

(1) Bold monetary policy: Already yielding results

(2) Flexible fiscal policy: Uncertainty remains

Issue: Maintaining fiscal discipline

- Strengthening resilience of nation's infrastructure: Risk of public spending bloating under the guise of protecting lives and assets of citizens
- Risk of expanding budget deficit leading to triple weakness in the form of plunge in JGBs (rise in long-term interest rate), weaker yen, and lower stock prices

(3) Growth strategy: Uncertainty remains

Issue: Improving/restructuring economic structure over medium/long term

- Need to tackle issues like deregulation and lowering effective tax rate for corporations

2. Four Risks Facing Japan's Economy: Examination of the world economic cycle

Four risks facing Japan's economy

In this report, we examine four risks facing Japan's economy. Risks that will need to be kept in mind regarding the Japanese economy are: (1) turbulence in emerging economies, (2) China's shadow banking problem, (3) a reignition of the European sovereign debt crisis, and (4) a surge in crude oil prices stemming from geopolitical risk. Of these four risks, it is worth noting that the first is closely related to the second and third.

Of these four risks, it is worth underscoring that the first (turbulence in emerging economies) and the second (China's shadow banking problem) are of crucial importance, and we will analyze them more closely in the paragraphs below.

Risk 1: Turbulence in emerging economies

First, to examine turbulence in emerging economies, we analyze the world economic cycle. In the past, advanced economies led by the US drove emerging economies. However, a decoupling is currently occurring—advanced economies are performing well but emerging economies are stagnating.

We believe that this decoupling is occurring for three reasons: (1) the dwindling amount of loans from European financial institutions to emerging economies in light of the European debt crisis, (2) the sluggishness of the Chinese economy, and (3) concerns that money will be taken out of emerging economies based on worries that the Fed will adopt a hasty exit from quantitative easing. We anticipate that a further deterioration of emerging economies will be avoided as the US economy continues to expand. Nevertheless, we think the state and the future direction of the Chinese economy will continue to require close monitoring.

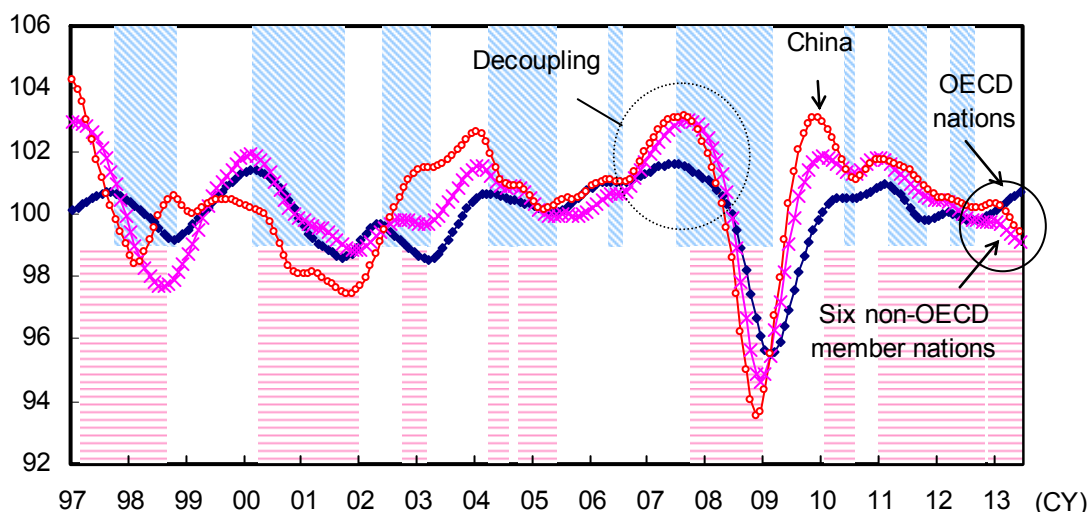
Current situation of the world economy: Is a new decoupling occurring?

Chart 1 illustrates the trend of the composite leading indicator (CLI) for OECD member nations and for six non-OECD nations (Brazil, China, India, Indonesia, Russia, and South Africa). The former represents the business cycle of advanced economies and the latter of emerging economies.

The chart tells us that the business cycles of advanced economies and emerging economies have more or less been in sync. The upper portions of shaded areas are periods when the CLI of OECD member nations declined m/m, and the lower portions are periods when the CLI of non-OECD nations declined. The chart reveals that there are hardly any periods when only advanced economies or emerging economies deteriorated. However, if we look at the current situation, the CLI of advanced economies has turned upward, but emerging economies' CLI has continued to decline since the start of 2011. In the mid-2000s, a decoupling theory came to prominence in the midst of a boom in emerging economies. It argued that emerging economies would continue to expand even if advanced economies stagnate. Currently, a decoupling in the opposite direction of that of the 2000s is occurring, where advanced economies expand as emerging economies contract.

In this context, we should not overlook the clear deceleration of the Chinese economy. After peaking in 2009, China's CLI has continued to slow. Since China's economy is quite large compared to other emerging economies, it is reasonable to think that the slowing of Chinese economy is responsible for a considerable portion of the slowing of emerging economies as measured by CLI.

Composite Leading Indicator (CLI): OECD vs. Non-OECD Member Economies Chart 1



Source: OECD; compiled by DIR.

Notes: 1) Non-OECD member economies: Brazil, China, India, Indonesia, Russia, and South Africa.

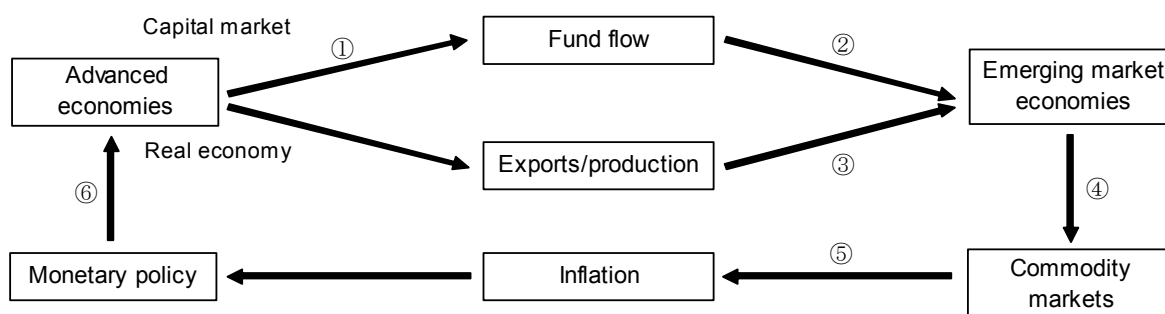
2) Blue shaded areas in upper half of graph denote periods when CLI declined m/m for OECD nations; pink shaded areas in lower half denote periods when CLI declined m/m for six non-OECD economies.

World economic cycle

When we divide the world economy into advanced and emerging economies to simplify its structure, we find the existence of a cycle as illustrated in Chart 2. First, advanced economies influence emerging economies through financial markets and through the real economy. Emerging economies then influence commodity markets, which in turn affects the inflation rate all over the world. Since central banks are responsible for maintaining price stability, changes in the inflation rate influence the monetary policies globally. Monetary policy affects the growth rates of countries through various channels and impact advanced economies, bringing us back to our starting point.

Based on the above framework, we analyze what factors are contributing to the decoupling of advanced and emerging economies as shown in Chart 1. Obviously, the world economy is more complex and each factor influences each other through many other routes than those shown above. Hence, it should be kept in mind that our discussion here examines only one aspect of the world economy.

World Economic Cycle Chart 2



Source: Compiled by DIR.

Flow of funds from advanced economies into emerging economies

First, we examine how advanced economies influence emerging economies through financial markets (Arrow 1 of Chart 2).

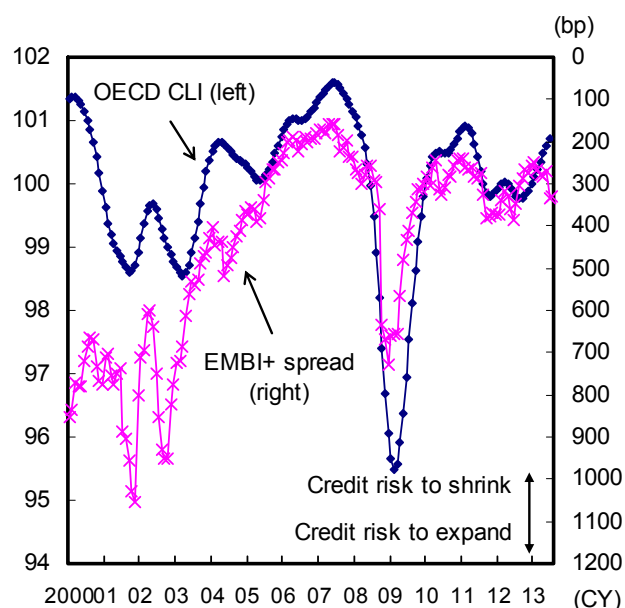
The left-hand graph of Chart 3 compares the OECD CLI, representing advanced economies, and the yield on the government bonds of emerging economies (EMBI+; JP Morgan's Emerging Markets Bond Index). EMBI+ is presented as a spread with the yield on US Treasuries and expresses the credit risk of emerging economies. We can see in the chart that OECD CLI and EMBI+ spread generally move in step with each other. While the credit risk of emerging economies is basically determined by domestic economic conditions, it is also determined by the economic conditions and risk tolerance of advanced economies which are the lenders of funds. Although this spread has increased slightly (credit risk has risen) in recent months, it tends to decline mostly in line with improvements in advanced economies.

Should the credit risk of emerging economies lessen and the inflow of funds grow, their currencies will appreciate. A comparison of the EMBI+ and foreign exchange rates of emerging economies reveals that emerging market currencies tend to appreciate in periods when the EMBI+ spread narrows. From around 2011, however, currencies of emerging economies continued to weaken even as their credit risk declined. This suggests the possibility that, even as risk tolerance increased globally, the inflow of funds to emerging economies had faltered.

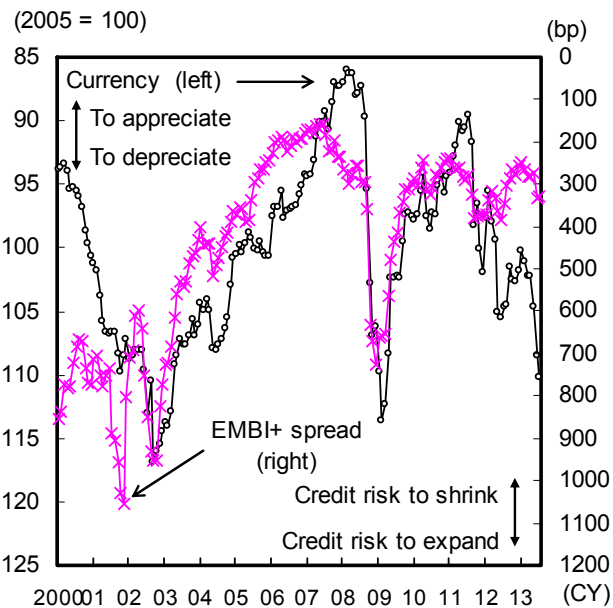
Fund Flows: Advanced Economies to Emerging Market Economies

Chart 3

Credit risk: advanced vs. emerging market economies



Emerging market economies: credit risk vs. currency



Source: OECD, IMF, JPMorgan, Haver Analytics; compiled by DIR.

Notes 1): Emerging market currency=average exchange rate against US\$ of currencies of Brazil, India, Indonesia, Hong Kong, South Korea, Malaysia, Philippines, Russia, Singapore, Taiwan, and Thailand weighted by GDP.

2) EMBI+=JP Morgan's Emerging Markets Bond Index.

European sovereign debt crisis is behind the stagnation in the flow of funds into emerging economies

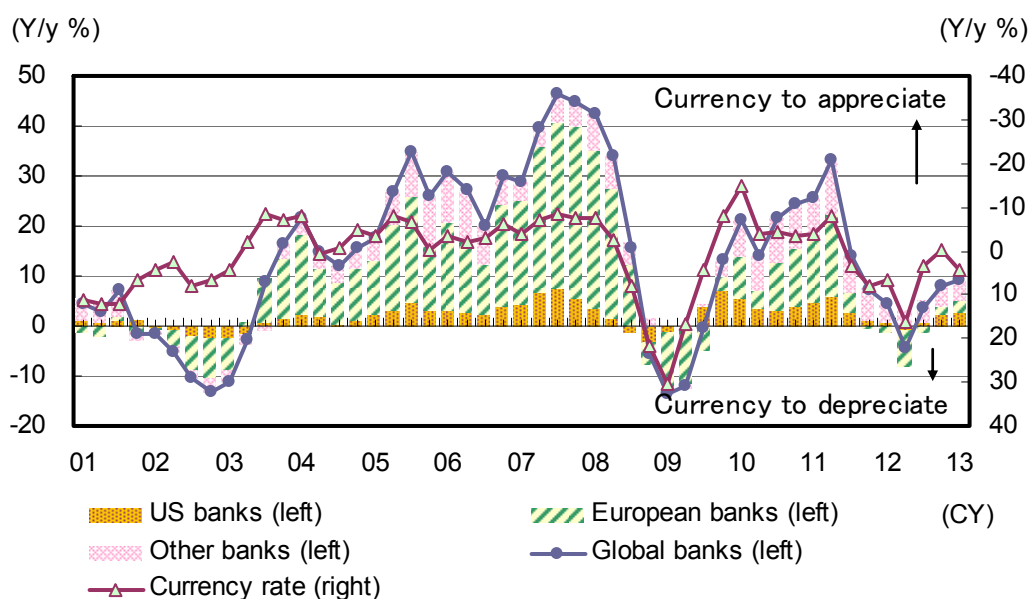
The depreciation of emerging market currencies—in other words, the stagnation in the flow of funds into such economies—is thought to be behind the lackluster credit growth in emerging economies. Chart 4 illustrates the trend of credit extended to emerging economies. Here we see that, after peaking in 2011, the growth rate of credit has gradually decelerated and momentarily turned negative y/y in

2012. Largely in line with the shrinkage of credit to emerging economies, their currencies have also weakened.

Moreover, when we examine lenders of credit to emerging economies, the majority of such credit is extended by European banks. The decline in credit from Europe is therefore the main reason why credit to emerging economies has shrunk. Financial system turbulence has continued for several years in Europe due to the fiscal problems in Greece and other peripheral nations. Such problems in Europe appear to be behind the stagnant flow of funds in the form of credit extended to emerging economies. To conclude, it is reasonable to think that the deviation between the credit risk of emerging economies and their currency values that has continued for the last few years originates to a considerable degree in the stagnant inflow of funds from Europe prompted by the European sovereign debt crisis.

Credit to/Currency Rate of Emerging Market Economies

Chart 4



Source: BIS; compiled by DIR.

Note: Credit to Brazil, India, Indonesia, Malaysia, Russia, Thailand, and Vietnam.

Emerging economies influenced by the inflow of funds and by exports and production

The source of growth for emerging economies is the inflow of funds from advanced economies, and the stagnation of such flows will worsen their economies (Arrow 2 of Chart 2). The left graph in Chart 5 examines the exchange rate and CLI of emerging economies, the former serving as a proxy for the inflow of funds and the latter representing the business cycle of emerging economies. According to this chart, the economies of emerging market nations tend to move in tandem with their foreign exchange rates. While advanced economies trend firmly, emerging economies are continuing to shrink as noted above. This suggests the possibility that a major reason for this downturn is the decline in the inflow of funds to emerging economies.

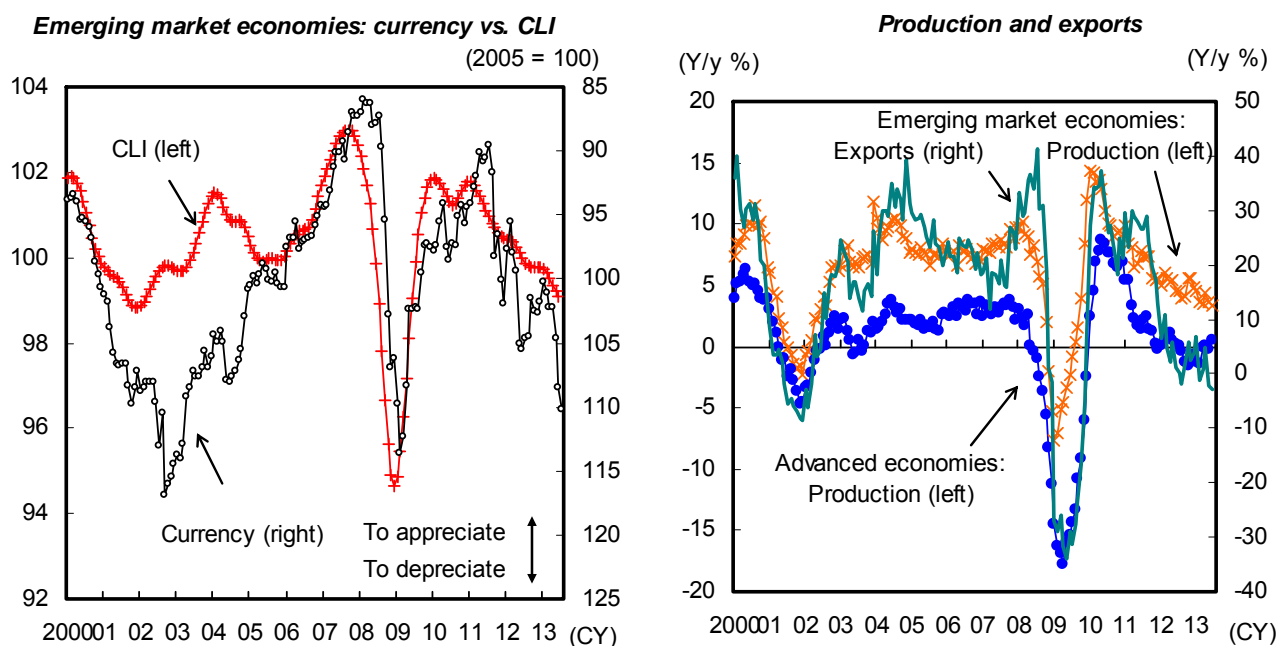
Should currencies of emerging economies weaken, import prices will rise and lead to inflation. As a result, pressures will mount to raise policy interest rates. Moreover, for many emerging economies with external debt, the weakening of currency will mean an increase of real debt as well as added pressure to raise policy interest rates to defend their currency. Thus, the depreciation is associated with the potential of adversely affecting the economies of emerging market nations. On the other hand, when emerging economies are performing well, investments in such economies will be more attractive, which will strengthen their currencies. Thus, the relationship between the foreign exchange rates of

emerging market nations (inflow of funds) and the direction of their economies is not a one-way relationship where the former determines the latter. The fact that economies of emerging market nations show a strong correlation with the value of their home currencies, however, is undeniable.

We have examined the relationship between advanced and emerging economies through financial markets. The way these economies are linked through the real economy of goods and services is also important (Arrow 3 of Chart 2). The graph on the right in Chart 5 portrays the industrial production trend of advanced economies and trends of exports and industrial production of emerging economies. We can see in the graph that exports and production of emerging economies move largely in step with the industrial production of advanced economies. As globalization progresses, emerging economies have taken hold an important role in the global supply chain, so their production activity is closely related to the world economy. In addition, the US and Europe are the final destination for a considerable part of the goods produced in emerging economies, centering on East Asia. Thus, even in terms of the real economy, emerging economies depend to a considerable degree on advanced economies.

Factors Affecting Emerging Market Economies: Fund Flow and Exports/production

Chart 5



Source: OECD, IMF, Netherlands Bureau for Economic Policy Analysis, Haver Analytics; compiled by DIR.

Note: Emerging market currency=average exchange rate against US\$ of currencies of Brazil, India, Indonesia, Hong Kong, South Korea, Malaysia, Philippines, Russia, Singapore, Taiwan, and Thailand weighted by GDP.

Emerging economies influence commodity prices and the rate of inflation

The basic direction of emerging economies is determined by the economic conditions of advanced nations as described above. That being the case, how does emerging economies influence the world economy?

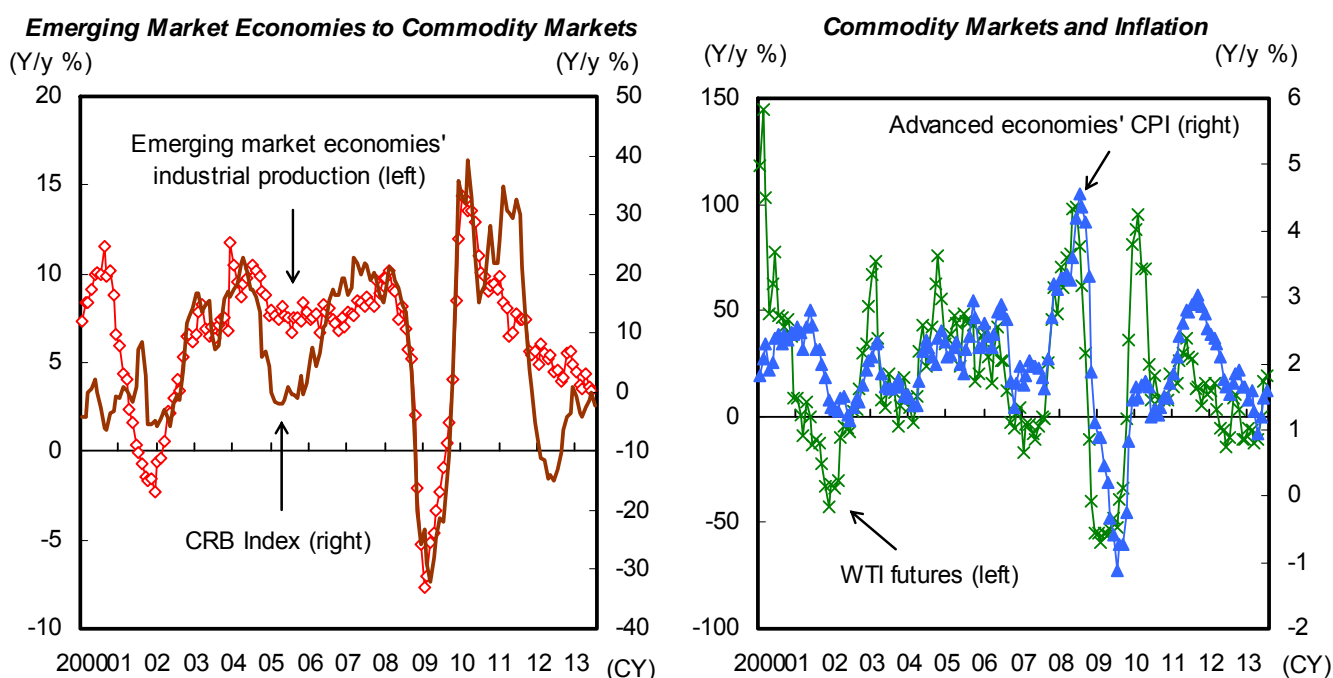
The greatest influence is through commodity prices (Arrow 4 of Chart 2). Emerging economies not only grow at a relatively faster pace than advanced economies, but with their enormous demand for infrastructure investment, demand for raw materials in such economies rapidly increases. For this reason, the movement of international commodity prices is closely correlated to the economies of emerging market nations, and their rapid growth can readily place upward pressure on commodity prices (left-hand graph in Chart 6).

Recently, as economies of emerging market nations have slowed after reaching a peak in 2010, commodity markets have cooled down. Meanwhile, commodity prices are not necessarily determined by real demand alone because commodities can be a target for speculation. However when global risk tolerance is diminishing, the flow of funds to emerging market nations will wane, meaning that their economies will rapidly slow and commodity prices will quickly decline.

It goes without saying that commodity prices influence price trends in each nation (Arrow 5 in Chart 2). The right-hand graph in Chart 6 confirms that commodity markets have remained calm, leading to steady consumer prices.

From Emerging Market Economies to Commodity Markets and Inflation

Chart 6



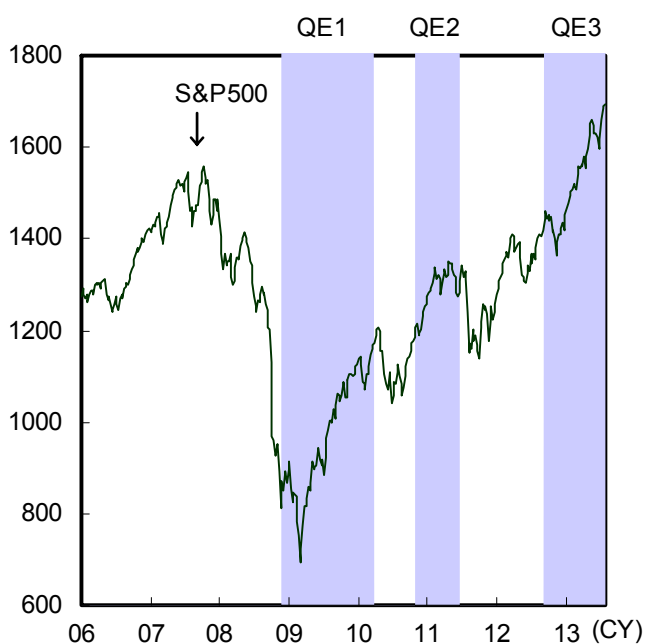
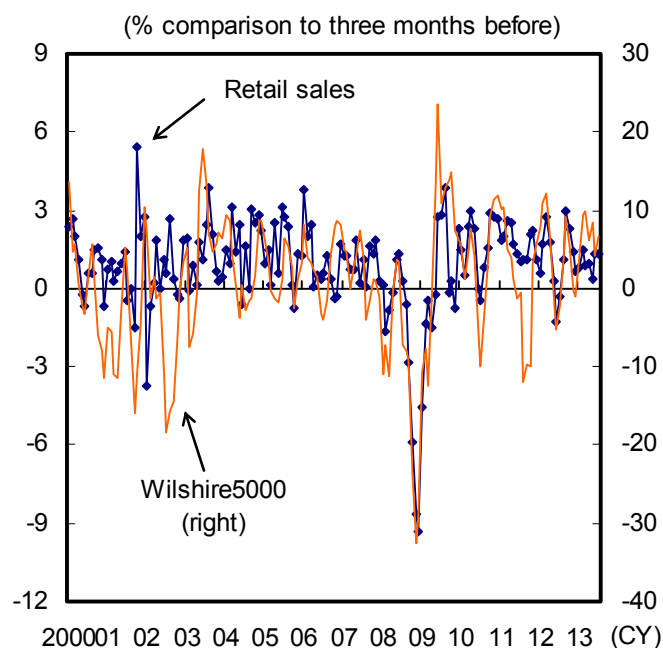
Source: CRB, Netherlands Bureau for Economic Policy Analysis, NYMEX, IMF, Haver Analytics; compiled by DIR.

Monetary policy influences advanced economies

Since central banks are responsible for maintaining price stability, pressure to tighten monetary policy will grow when inflationary pressure materializes. Given that the purpose of monetary policy is price stability and economic stability, when the inflation rate rises and monetary policy is tightened, downward pressure will be exerted on the economy (Arrow 6 in Chart 2).

When we look at inflation, prices have been stable. Economic conditions do not warrant tightening of monetary policy and accommodative monetary environment continues globally. In advanced economies with less leeway to lower the policy interest rate further, central banks have further loosened monetary policy through quantitative easing. In the US, stock prices tend to rise with each round of quantitative easing (left graph in Chart 7). This increase in stock prices influenced personal consumption through the wealth effect (right graph in Chart 7) and boosted the overall economy.

As the US economy expands steadily, debate is growing over the exit strategy of the Federal Reserve Board. Since what the market expected is not a sudden tightening but a gradual tapering of monetary easing, the exit strategy is unlikely to have any immediate effects on the economy. However, should the US economy slow down from a hasty implementation of an exit strategy, it could slow the world economy through both financial markets and through the real economy.

US: Impact of monetary policy on stock prices**US stock prices and retail sales**

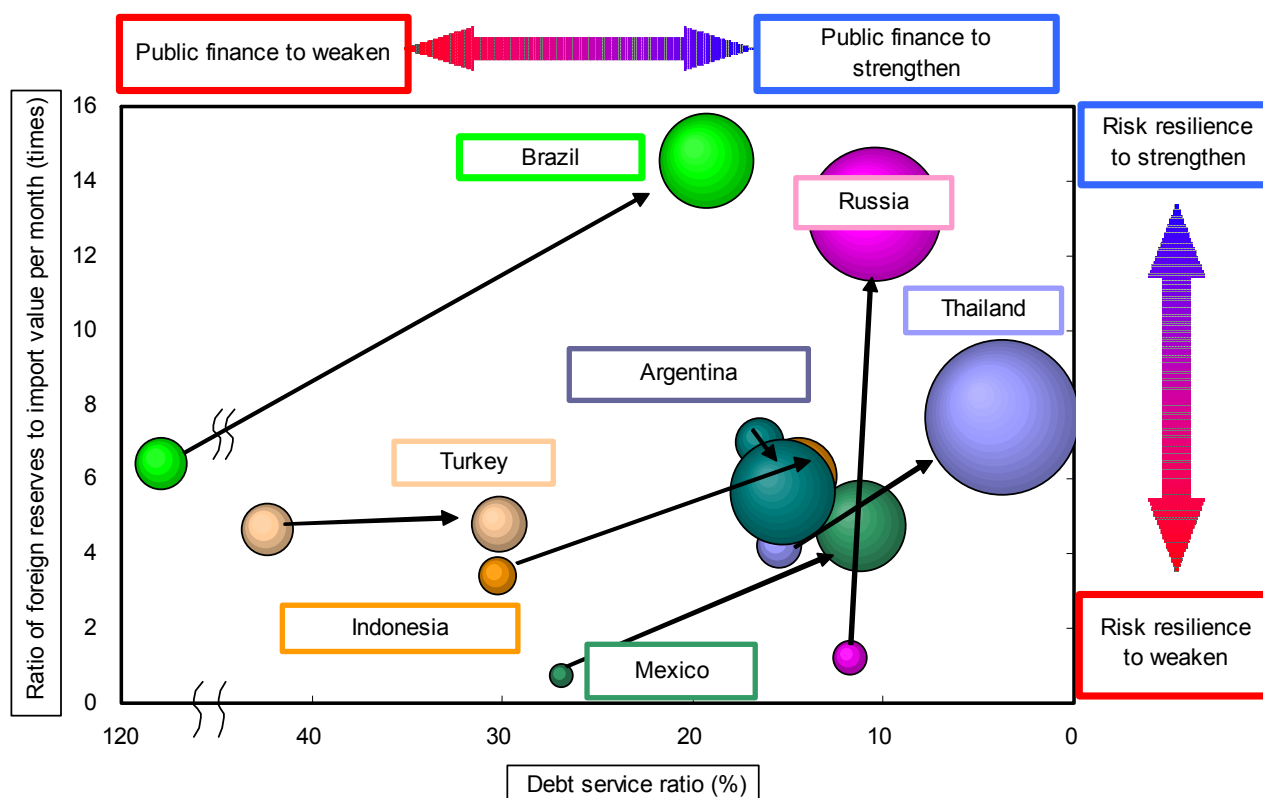
Source: US Census Bureau, Haver Analytics, Standard & Poor's, Dow Jones, Wilshire Associates; compiled by DIR.

Summary: Three reasons behind the new decoupling

Summarizing the discussion above, we believe that a new decoupling is taking place for three reasons: (1) the dwindling in the amount of loans from European financial institutions to emerging economies in light of the European debt crisis, (2) the slowdown of the Chinese economy, and (3) concerns that money will be taken out of emerging economies based on worries that the Federal Reserve Board will implement exit measures from QE3. In the final analysis, we anticipate that the collapse of emerging economies will be avoided as the US economy continues to expand. Nevertheless, the state and the future direction of the Chinese economy will continue to require close monitoring.

Possibility of a serious crisis in emerging economies is limited

We believe there is a limited possibility that emerging economies will experience a serious crisis similar to the Asian currency crisis in 1997. Chart 8 depicts changes in risk resilience of emerging market nations from the year each nation experienced a financial crisis. Learning from past financial crises, these nations have amassed huge foreign currency reserves. Not only has the absolute size of such reserves increased, but the size of foreign currency reserves relative to good and service imports (vertical axis) and that relative to short-term foreign debt (the sizes of circles) have also improved for most nations. Moreover, the debt service ratio, defined as debt service payments for external debt as a percentage share of good and service exports, a leading indicator used to determine country risk, has fallen for the most part (conditions have improved) since the financial crisis.



Source: Haver Analytics; compiled by DIR.

Notes: 1) Arrows denote shift of positions at critical moments to 2012.

2) Year of crises defined as 1994 for Mexico, 1997 for Thailand and Indonesia, 1998 for Russia, 1999 for Brazil, 2001 for Turkey, and 2002 for Argentina.

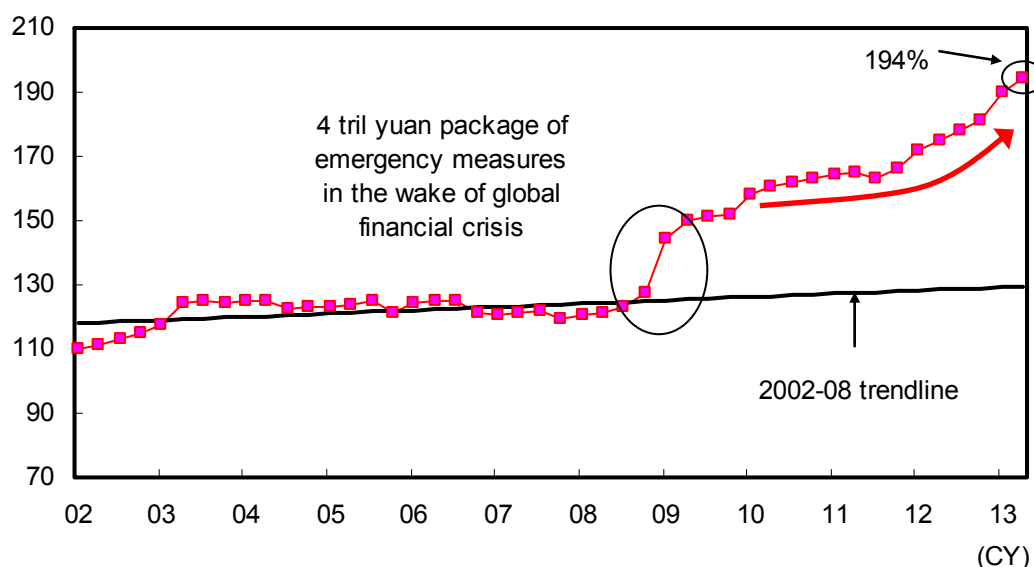
3) Size of circles shows ratio of foreign reserves to foreign debt with less than one-year maturity. The larger the circle, the greater the resilience.

Risk 2: China's shadow banking problem

Risk 2 (a): China's shadow banking problem extremely serious

Excessive lending has become a problem in China in the wake of its response to the global financial crisis in 2008. Chart 9 provides an estimate of total social financing in China as a proportion of China's GDP. Such financing jumped from its long-term trend in 2009 and has continued to expand, reaching 194% of nominal GDP at end-June 2013.

Comparing current levels to the long-term trend, we estimate excessive lending in China to be around Y580 trillion. Should part of these assets become non-performing, this could cause major turbulence in China and global financial markets. Risk scenarios that should be kept in mind include (1) China drawing down its foreign currency reserves (around \$3.5 tril) to deal with non-performing debt, causing long-term interest rates to surge in the US, and (2) the yen appreciating from a global flight to quality.



Source: People's Bank of China, National Bureau of Statistics of China; compiled by DIR.
Assumption: Outstanding balance of total social financing as of end-Mar 2002 to be 1.1 times bank lending.

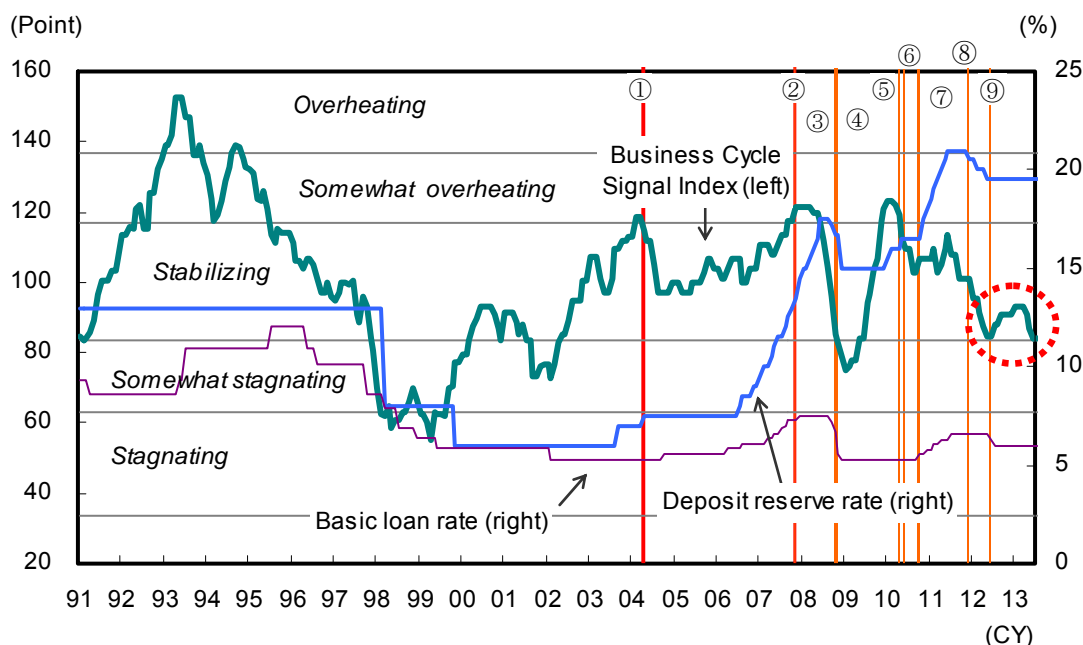
Risk 2 (b): Impact on the world economy of the collapse of China's asset bubble should not be overstated

How will the world economy be affected by the collapse of China's asset bubble?

We believe that the impact on the world economy of the collapse of China's asset bubble should not be excessively overstated. Chart 10 presents the Business Cycle Signal Index for China. According to this index, we can confirm that China's economy has slowed significantly. After peaking at 123.3 in February 2010, the index has fallen to the lower bound of the zone signaling stability, between 83.33 and 116.66. Similar to previous instances when the economy has slowed to this extent, the likelihood is high that authorities will respond with some form of a stimulus measure and that the collapse of China's economy will be avoided one way or another.

Key phrases are "socialist market economy," "collective leadership," and "gradualism"

China being a socialist market economy rather than a pure capitalist economy may also be a factor supporting the economy for the time being. During the change in political leadership that occurs every decade, it is natural for leaders to want to circumvent a rapid deceleration of the economy as much as possible. Politically speaking, collective leadership and a policy of gradualism could also be factors that preclude a short-term relapse of the Chinese economy. In fact, there are growing views that the lower limit for the growth rate of real GDP in China is currently around 7% based on comments such as those recently made by Premier Li Keqiang.

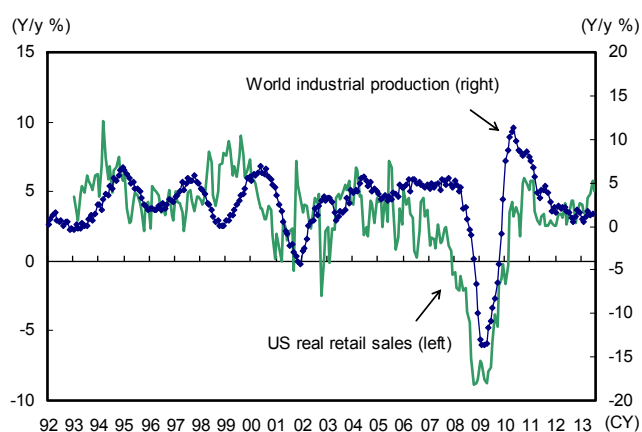


Source: National Bureau of Statistics of China, People's Bank of China, CEIC Data; compiled by DIR.

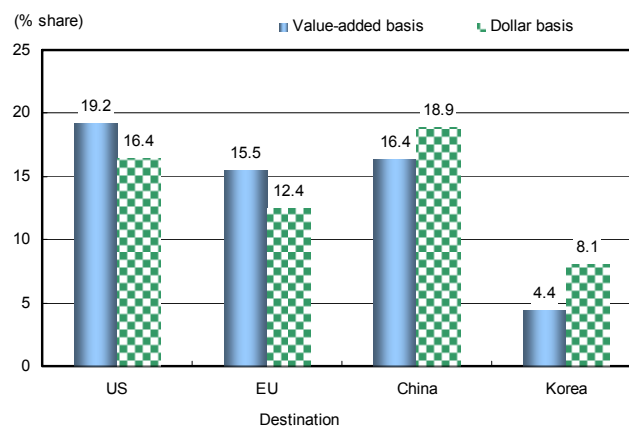
1. Apr 2004: Restrictions on aggregate loans strengthened
2. Oct 2007: Restrictions on aggregate loans strengthened
3. Oct 2008: Restrictions on aggregate loans eased
4. Nov 2008: Stimulus package of 4 tril yuan announced
5. Apr 2010: Real estate regulations strengthened
6. Jun 2010: More flexible regime for control of yuan exchange rate
7. Oct 2010-Jul 2011: Period of loan rate hikes
8. From Dec 2011: A series of deposit reserve rate lowering moves began
9. From Jun 2012: A series of loan rate cuts began

No change to the importance of the US for the world economy

We believe that the US will remain the main engine of the world economy, a point that is worth mentioning. As indicated in Chart 11, US retail sales slightly lead global industrial production. In other words, of the sources for final demand, the US still plays the largest role. Chart 12 compares the shares of exports from Japan by trading partner on a value-added basis and on a dollar basis. Comparing the US and China, the share of exports shipped to China is larger on a dollar basis than that to the US, but exports to the US is larger on a value-added basis. This is extremely interesting since it suggests that there exists a trade structure where intermediate goods is exported from Japan to China and other Asian trading partners, assembled into finished goods and re-exported to European nations and the US, the sources of final demand.

World Industrial Production and US Retail Sales
Chart 11


Source: Netherlands Bureau for Economic Policy Analysis, US Bureau of Economic Analysis; compiled by DIR.

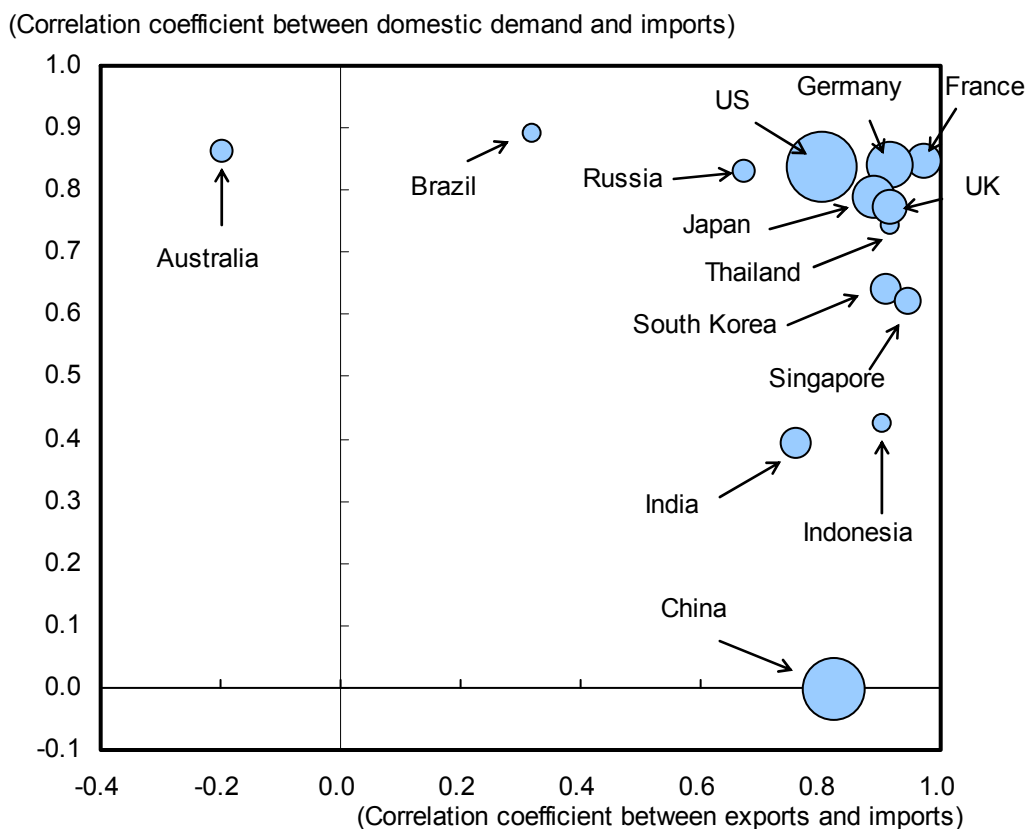
Export of Goods from Japan by Destination
Chart 12


Source: OECD, Haver Analytics; compiled by DIR.
 Note: Export of goods in 2009.

Slowing of China's economy will have only a limited impact on the world economy

Of the routes through which the economy of one nation influences that of another, the route through trade is the easiest to understand. If one nation's imports increase, this means that there is an equal amount of increase in the exports of others. In other words, imports determine the degree to which the real economy of a nation influences the world economy. What then determines imports? Imports can go towards satisfying domestic demand (consumption and investment), can be re-exported, or can become intermediate goods as a factor of production. The demand for intermediate goods will in the end depend on the demand for the final goods that are produced. Thus, imports are determined by domestic demand and exports.

Given the argument above, Chart 13 illustrates the relationship between imports, domestic demand and the relationship between imports and exports for major nations. The horizontal axis shows the correlation coefficient between exports and imports, with the right-hand side indicating a higher correlation between exports and imports. The vertical axis shows the correlation coefficient between domestic demand and imports, with the upper-hand-side indicating a higher correlation between domestic demand and imports. The sizes of the circles indicate the percentage share of a nation's imports against imports as a whole. The chart reveals that a majority of major nations are positioned to the upper right, confirming that imports are correlated to a certain degree with both exports and domestic demand. China, however, is different. It is in the lower right-hand, suggesting that while its imports and exports are correlated, the correlation between domestic demand and imports is minimal. Recently, the problem of shadow banking in China has raised concerns that its economy will falter. If the Chinese economy rapidly deteriorate, as long as the deterioration comes from the contraction of domestic demand such as personal consumption and investments, the impact on Chinese imports and in turn the world economy should be minimal.



Source: UN, IMF; compiled by DIR.

Notes: 1) Size of circles denotes world import share.

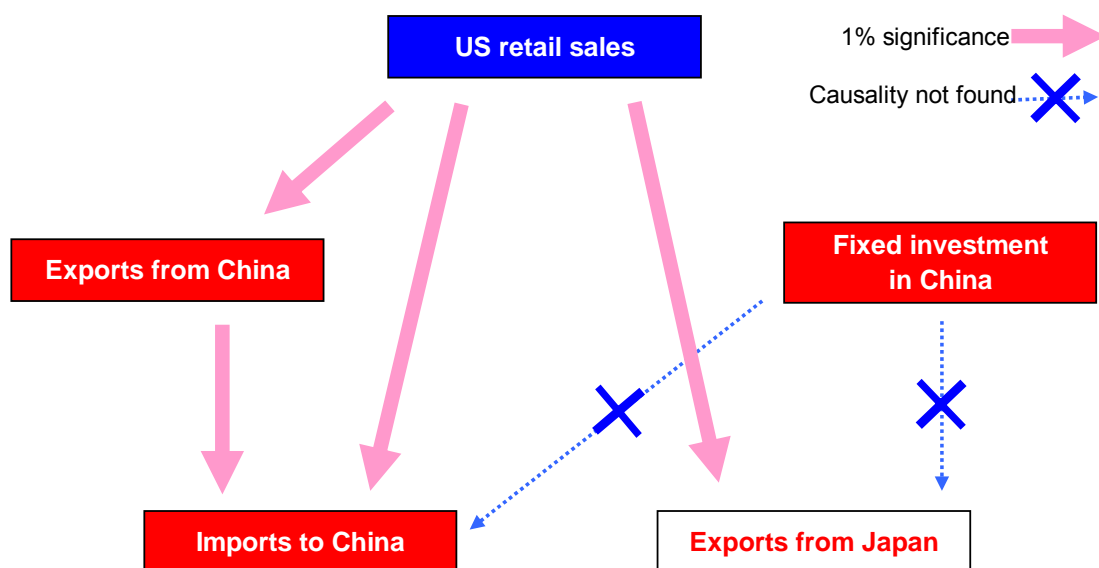
2) Correlation coefficients and import shares are for 2000-11 and 2012, respectively.

US retail sales found to have causality in relation to Chinese exports, Chinese imports, and Japanese exports

To supplement the discussion above, Chart 14 illustrates a Granger causality test using a five-variable vector autoregression model with the variables being (1) US retail sales, (2) Chinese exports, (3) Chinese imports, (4) Chinese fixed investments, and (5) Japanese exports. Granger causality is set to be established when variable X is viewed as Granger-causing Y while past information about variable X is useful in improving the prediction of variable Y.

As indicated in Chart 14, when the global economy is viewed in broad terms, US retail sales are found to have causality in relation to Chinese exports, Chinese imports, and Japanese exports. In contrast, Chinese fixed investments were not found to have any significant causality in relation to Chinese imports or Japanese exports in statistical terms.

Granger Causality Test on Economic Activity in the US, China, and Japan Chart 14



Source: Haver Analytics, Ministry of Finance; compiled by DIR.
Estimation period: Jul 2001 to May 2013.

Summary

Risks that will need to be kept in mind regarding the Japanese economy are: (1) turbulence in emerging economies, (2) China’s shadow banking problem, (3) a reignition of the European sovereign debt crisis, and (4) a surge in crude oil prices stemming from geopolitical risk. Of these four risks, it is worth noting that the first is closely related to the second and third. We anticipate that a further deterioration of emerging economies will be avoided as the US economy continues to expand. Nevertheless, we think the state and the future direction of the Chinese economy will continue to require close monitoring.

Outlook for Japanese Economy, Interest Rates Chart 15

Indicator	2012	2013				2014	FY11	FY12	FY13	FY14
	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar				
	Actual				DIR estimates		Actual		DIR estimates	
Real GDP										
Q/q %, annualized	1.1	4.1	3.8	3.2	4.2	5.4				
Y/y %	0.4	0.3	1.2	3.0	3.8	4.0	0.3	1.2	3.0	1.2
Current account balance										
SAAR (Y tril)	4.3	3.1	8.5	8.6	9.2	9.5	7.6	4.4	8.9	14.3
Unemployment rate (%)	4.2	4.2	4.0	4.0	4.0	3.9	4.5	4.3	4.0	3.9
CPI (excl. fresh foods; 2010 prices; y/y %)	-0.1	-0.3	0.0	0.6	0.7	0.9	-0.0	-0.2	0.6	2.9
Unsecured overnight call rate (period end; %)	0.100	0.100	0.100	0.100	0.100	0.100	0.100	0.100	0.100	0.100
10-year JGB yield (period average; %)	0.76	0.66	0.77	0.73	0.80	0.85	1.05	0.76	0.79	1.00

Source: Compiled by DIR based on various statistics.
Note: Estimates taken from DIR’s *Japan’s Economic Outlook No. 178 Update*.