Provisional translation

Fiscal 2011 Economic Outlook and Basic Stance for Economic and Fiscal Management —Toward Step 3 for the Realization of the New Growth Strategy—

January 24, 2011
Cabinet Decision

After overcoming the economic crisis in the wake of the Lehman Shock, the Japanese Economy has picked up under the impetus of external demand and policy measures to create demand and support employment. Since last summer, however, the yen's rapid appreciation and concerns about slowing of the overseas economy have generated increasing uncertainty about the future outlook, while the employment situation remains severe. Given these severe economic conditions, in order to preemptively address the downside risk around the end of 2010 and after, the Kan Cabinet formulated the Step 1[1] of "The Three -Step Economic Measures" using a contingency reserve, and the Step 2[2], backed by a supplementary budget, and thereby underpinning the economy and employment with emphasis on speed.

In addition to steadily carrying out these economic measures, the Government will seamlessly implement the Step 3 comprising of FY2011 budget and the tax-system revision that place emphasis on growth and employment, so as to ensure an exit from deflation and the achievement of economic growth with focus on employment, both of which are the goals of the New Growth Strategy.

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1 "Emergent Action" in the Three-Step Economic Measures for the Realization of the New Growth Strategy (Cabinet decision on Sept. 10, 2010)

2 Comprehensive Emergency Economic Measures in Response to the Yen's Appreciation and Deflation (Cabinet decision on Oct. 8, 2010)

I. Economic Trends in FY2010

In FY2010 the Japanese economic movements have been appeared to be pausing since the autumn, but are expected to make progress and emerge from this lull.

With regard to prices, the mild deflationary phase is persisting. Consumer prices declined for the second successive year, but owing to factors such as the shrinkage of the GDP gap (excess supply), the extent of the decline will be reduced.

The real GDP growth rate in FY2010 has been impacted by rapid growth in the second half of FY2009 resulting from the impetus of external demand and policy measures to create demand and prop up employment. In consequence, the real GDP growth rate in FY2010 is expected to return to positive, at around 3.1%, for the first time in three years. The nominal GDP growth rate, which more directly reflects people's sentiment toward the economy, is forecast at around 1.1%.

II. Basic Stance for FY2011 Economic and Fiscal Management

- The Government will further implement Steps 1 and 2 of the Three-Step Economic Measures, guarding against the downside risk in business activity and employment, thereby reassuring the sentiment of the private sector.

- In FY2011, the first year of full implementation of the New Growth Strategy, Step 3 will entail comprehensive use of budget, tax-system, and other measures that place emphasis on growth and employment, so as to ensure placing the economy on the path toward the Strategy's Phase I goals of exiting from deflation and achieving self-sustaining economic recovery.

- In addition to the implementation of demand-side measures, the Government will implement the measures to prepare for medium- to long-term supply-side growth constraints, with looking ahead to the Phase II.

- Foreign exchange and monetary policy to address the yen's appreciation and deflation.

Full Implementation of the New Growth Strategy with Emphasis on Growth and Employment

FY2011 is the first year of full implementation of "the New Growth Strategy" (Cabinet decision on June 18, 2010). In order to ensure placing the economy on the path toward the Strategy's Phase I (Period of overcoming deflation) goals of exiting from deflation and achieving self-sustaining economic recovery, the economic and fiscal policy will make maximum use of the budget, tax-system, and regulatory and institutional spheres, placing emphasis on growth and employment along "Realization of the New Growth Strategy 2011".

Addressing Risk of Economic Deterioration through Implementation of Steps 1 and 2

To that end, the Steps 1 and 2 of the Three-Step Economic Measures that are already in the course of implementation will be promoted further. Risk of future deterioration in the economy and employment will be addressed from the demand-side, in order to ease household and business sentiment. In this regard, the close review of economic situation and thorough progress management based on the PDCA (plan-do-check-action) cycle are conducted by the newly established “Special Team on Economic Management” so as to bring out the effects of the measures as quickly as possible and to the maximum extent .

Building the Foundation for Self-Sustaining Economic Growth through the Step 3

Step 3 will follow these steps seamlessly, employing all policy measures, primarily on the demand-side, including the FY2011 budget, the tax-system revision, and regulatory and institutional reforms. These measures will be directed at ensuring the creation of a virtuous economic cycle in which job creation in growth fields forms the basis, leading eventually to increases in household income and expenditure. The government will take decisive actions, depending upon the economic and employment conditions, while remaining vigilant against the downside risks.

Preparation in Anticipation of the New Growth Strategy Phase II

In addition to the demand-side measures, actions are also to be taken to prepare for mounting supply-side growth constraints caused by population decline and aging over the medium- to long-term. To that end, efforts are to be made during FY2011 in anticipation of Phase II of the New Growth Strategy, including human-resource development and the encouragement of new business start-ups.

Action through foreign exchange and monetary policy

Regarding exchange rates, the rapid yen’s appreciation has entered a relative lull. Nevertheless, based on the recognition that yen’s rapid apppreciation for an extended period is an intolerable problem as it would adversely affect the stability of the economy and the financial system, the decisive actions including foreign exchange intervention will be taken when necessary.

It is expected that the Bank of Japan will help to ensure a prompt exit from deflation and to underpin the economy by continuing to manage monetary policy in an appropriate and flexible manner, engaging in close liaison and exchanges of information with the government.

It is also intended to execute one-year extension of the SME Financing Facilitation Act.

III. Specific Actions for Step 3 toward the Realization of the New Growth Strategy

1. Comprehensive measures in the budget, tax-system, and regulatory and institutional spheres

Following the implementation of Steps 1 and 2, “Step 3 toward the Realization of the New Growth Strategy” will be implemented in FY2011. This will entail comprehensive use of policy measures, including budget, tax-system revision, and regulatory and institutional reforms as set out below, so as to ensure placing the economy on the path toward the exit from deflation and the achievement of self-sustaining economic recovery.

Budget
Since FY2011 is the first year for full implementation of the New Growth Strategy and the Fiscal Management Strategy, the Government will execute the budget which puts emphasis on growth and employment, including the use of the Special Allocation to Rejuvenate Vibrant Japan, while moving forward fiscal consolidation.

Tax-system revision
Based on the FY2011 Tax Reform Outline, the reduction of the effective corporate tax rate and other measures will be executed, giving utmost priority to the overcoming deflation and the job creation in order to contribute to the implementation of the New Growth Strategy.

Regulatory and institutional reforms
Following Steps 1 and 2, the regulatory and institutional reforms will be further strengthened to serve as demand stimulants that do not entail financial resources and as policy tools that expedite the progress of the New Growth Strategy.

(1) Budget

The FY2011 budget will, against the background of severe fiscal conditions, pursue fiscal consolidation in accordance with “the Fiscal Management Strategy” (Cabinet decision on June 22, 2010), and will execute the budget that puts emphasis on promoting growth and employment from demand-side amid limited financial resources.

Specifically, the Government will, along with necessary institutional reforms, steadily implement the measures included in Special Allocation to Rejuvenate Vibrant Japan such as subsidy for the purchase of electric automobile, support for overcoming intractable disease and cancer and for R&D of innovative drug and medical equipment, and provision of housing for elderly with medical and nursing care service. The measures contributing to “the National Strategy Projects” including green innovation, life innovation, and the Asian economy will also be implemented.

(2) Tax-system revision

Based on the FY2011 Tax Reform Outline (Cabinet decision on Dec. 16, 2010) , the reduction of the effective corporate tax rate and other measures will be executed, giving utmost priority to the overcoming deflation and the job creation in order to contribute to the implementation of the New Growth Strategy.

Reduction of effective corporate tax rate

The effective corporate tax rate is to be reduced by 5%, for such purposes as strengthening the international competitiveness of Japanese companies and enhancing Japan's attractiveness as a place for overseas companies to establish business bases, and thereby stimulating domestic investment and job creation. The corporate tax rate for SMEs is also to be reduced by 3%.

Introduction of employment-promotion tax-system

With the objective of maintaining and increasing employment in order to give impetus to economic growth, favorable tax treatment will be given to companies that increase employment above certain levels.

Others

• With a view to boosting Japan's development of environmental and energy technologies conducive to economic growth, and to addressing global warming, favorable tax measures will be formulated for investment in advanced low-carbon and energy-conserving equipment.

• Facing fierce international competition, improvements will be made to the environment for overseas companies to establish business bases in Japan. For this purpose, favorable tax treatment will be formulated to facilitate the comprehensive special zone system and to promote Japan as an Asian industrial center.

• In order to promote so-called "New Public Commons", an income tax credit will be introduced for contributions to authorized NPOs and other organizations. The system of authorized NPOs will be revised, while a new authorization system will be developed under the new law.

(3) Regulatory and institutional reforms

The New Growth Strategy will be realized not only by means of fiscal measures such as those involving the budget and tax-system, but also by measures to stimulate demand that do not require financial resources, such as the reform of regulations and institutions that constitute obstacles to the realization of latent demand and job creation. In addition, in anticipation of Phase II, regulations and systems will be reformed in ways that help to boost productivity to ensure that supply capacity does not constrain the economic growth in the aging society.

Implementation of Regulatory Reform 100 to Revitalize Japan, etc.

Necessary measures, including the revision of laws, will be taken to progress with regulatory and institutional reforms under “the Regulatory Reform 100 to Revitalize Japan” and other programs, primarily in such fields as urban redevelopment and housing, the environment and energy, and economically strategic fields for opening up the country.

Addressing further issues for realization of the New Growth Strategy

With regard to fields such as medical and nursing care, the environment and energy, and agriculture and local revitalization, a new program of regulatory and institutional reforms to aid the realization of the New Growth Strategy is to be formulated by March 2011, and the reforms will be implemented. As part of that process, issues such as regulatory and institutional reforms that assist the promotion of domestic investment and comprehensive economic partnerships with overseas economies will also be addressed. In addition, a comprehensive special zone system will be established for the purpose of facilitating the development of growth fields and local revitalization.

2. Implementation of Principal Policies for Growth and Employment

In order to achieve economic growth stemming from employment, in tandem with the full implementation of the New Growth Strategy, the following principal policies will be addressed through comprehensive use of budget, tax-system, and other spheres.

(1) Pursuit of policies to match up, create, and protect employment

To bring about the rapid realization of employment-focused economic growth, comprehensive measures to create and support employment will be formulated on the basis of the 2011 Employment Strategy: Basic Policy (Employment strategy dialogue on Dec. 15, 2010) devised through government-labor-management dialogue. They will match up, create, and protect jobs, including by steady implementation of measures included in the Step 1 and Step 2 economic measures.

(2) Promotion of domestic investment

Given that it is corporate sector that creates employment, steps will be taken to encourage private-sector corporations to reinforce their domestic investment and create new employment. In accordance with “the Domestic Investment Promotion Program” (Domestic investment promotion roundtable decision on Nov. 29, 2010), measures to assist investment promotion and growth promotion will be implemented vigorously.

(3) Comprehensive economic partnerships

Based on “the Basic Policy on Comprehensive Economic Partnerships” (Cabinet decision on Nov. 9, 2010), while pressing ahead with fundamental domestic reforms in agriculture and other fields, Japan will promote high-level economic partnerships with major trading economies both in the Asia-Pacific region and worldwide. The objective of this is to harvest the fruits of globalization by tapping latent demand for Japanese goods and services in other countries, thereby creating the strong economy described in the New Growth Strategy.

IV. Economic Outlook for FY2011

In FY2011, with the modest recovery of the world economy, Japanese economy will pick up and move toward a virtuous cycle of economic growth. This is on the back of the improvement in employment and incomes spilling over gradually, and with increasing force, into private demand, which is led by the factors such as the full-scale implementation of the New Growth Strategy through budget, tax-system, and other measures.

With regard to prices, the rate of increase in consumer prices is forecast to be approximately 0.0%, owing to factors such as the shrinkage of the GDP gap, while the GDP deflator will continue to decline slightly. Owing to an increase in the number of employees, the unemployment rate is set to decrease.

In consequence, the real GDP growth rate in FY2011 is expected to be around 1.5%, and the nominal growth rate 1.0%, both positive for the second year in succession.

As for future risks, we should consider a possibility of a downturn in the overseas economy and development in foreign exchange markets.

(1) Real Gross Domestic Product

(i) Private Consumption Expenditure

Private consumption is expected to maintain its modest uptrend (up by approximately 0.6% from the previous fiscal year) as the employment and income conditions improve.

(ii) Private Residential Investment

Private residential investment should rise (up by approximately 5.4% from the previous fiscal year) thanks to the impact both of the improvement in the employment and income conditions and of policy measures on housing.

(iii) Private Non-Residential Investment

Private non-residential investment is expected to continue to rise gently (up by approximately 4.2% from the previous fiscal year), owing to increases in corporate earnings and the impact of policy measures such as budget and tax-system.

(iv) Government Expenditure

Government final consumption expenditure is expected to rise gradually, while public-sector fixed capital formation will decrease below the level of previous fiscal year (down by approximately 0.9% from the previous fiscal year) for the second year in a row.

(v) External Demand

External demand is expected to increase, backed by the expected modest recovery of the world economy (the contribution of external demand to the real GDP growth rate will be approximately 0.5%).

(2) Labor and Employment

Premised upon a recovery by the economy backed by the effects of policy measures to create and prop up employment, the unemployment rate will decline for the second successive year (approximately 4.7%). The number of employees will continue to increase moderately (up by approximately 0.7% from the previous fiscal year).

(3) Industrial Production

Industrial production will pick up under the impact of a recovery in exports and increase in domestic demand (up by approximately 2.5% from the previous fiscal year).

(4) Prices

The rate of increase in consumer prices will be approximately 0.0%, owing to factors such as the shrinkage of the GDP gap[3]. The domestic corporate goods prices will show a slight increase (up by approximately 0.4% from the previous fiscal year). The GDP deflator will continue to decline slightly (declining by approximately 0.5% from the previous fiscal year).

(5) Balance of Payments

Both the trade surplus and current account surplus are expected to widen on the back of a moderate recovery of the world economy. (The current account balance will be approximately 3.6% as a percentage of nominal GDP.)

[3] Note that the benchmark data and year for consumer price statistics are rebased in August this year.

Note 1: The preparation of these economic forecasts is premised on the economic and fiscal management set out in “II. Basic Stance for FY2011 Economic and Fiscal Management” and “III. Specific Actions for Step 3 toward the Realization of the New Growth Strategy.”

Note 2: The Japanese economy consists mainly of private economic activity, and is influenced by unforeseeable market fluctuations and other changes in the international environment. Accordingly, the above indicators should be recognized as being subject to upside and downside risks.

Main Economic Indicators

	FY2009 (Actual)	FY2010 (Estimate)	FY2011 (Forecast)	Percentage changes over the previous fiscal year					
				FY2009		FY2010		FY2011	
	Trillion yen (Current prices)	Trillion yen (Approx.) (Current prices)	Trillion yen (Approx.) (Current prices)	% (Current prices)	% (Constant prices)	% (Approx.) (Current prices)	% (Approx.) (Constant prices)	% (Approx.) (Current prices)	% (Approx.) (Constant prices)
Gross domestic product	474.0	479.2	483.8	-3.7	-2.4	1.1	3.1	1.0	1.5
Private consumption expenditure	280.7	281.7	282.2	-2.3	0.0	0.4	1.5	0.2	0.6
Private residential investment	12.9	13.0	13.8	-21.3	-18.2	0.7	0.1	5.8	5.4
Private non-residential investment	63.7	66.4	69.2	-16.6	-13.6	4.2	4.9	4.2	4.2
Increase in private inventory *1	-3.6	-3.2	-2.5	(-0.9)	(-1.1)	(0.1)	(0.2)	(0.1)	(0.1)
Government expenditure	116.3	116.2	115.4	2.8	5.2	-0.1	0.0	-0.7	-0.9
Government final consumption expenditure	94.9	96.6	97.3	1.7	3.4	1.7	2.1	0.7	0.6
Public-sector fixed capital formation	21.3	19.5	17.9	8.6	14.2	-8.5	-9.2	-8.2	-8.5
Exports of goods and services	64.2	73.4	77.3	-18.0	-9.6	14.3	18.7	5.2	6.2
Less: Imports of goods and services	60.2	68.3	71.4	-25.0	-11.0	13.5	10.5	4.6	3.5
Contribution of domestic demand				-4.9	-2.7	0.8	1.9	0.8	1.0
Contribution of private demand				-5.5	-3.9	0.9	1.9	1.0	1.2
Contribution of public demand				0.6	1.2	-0.0	0.0	-0.2	-0.2
Contribution of external demand				1.2	0.3	0.2	1.2	0.2	0.5
National income	339.2	345.5	351.1	-3.6		1.8		1.6	
Compensation of employees	251.4	253.4	256.1	-3.6		0.8		1.1	
Income from properties	14.1	12.9	13.0	-3.2		-8.4		1.0	
Business income	73.7	79.2	82.0	-3.7		7.4		3.5	
Labor and employment	Ten thousands	Ten thousands (Approx.)	Ten thousands (Approx.)	%		% (Approx.)		% (Approx.)	
Labor force	6,608	6,588	6,593	-0.6		-0.3		0.1	
Employed persons	6,265	6,258	6,285	-1.7		-0.1		0.4	
Employees	5,457	5,466	5,503	-1.1		0.2		0.7	
Unemployment rate	%	% (Approprox.)	% (Approprox.)						
	5.2	5.0	4.7						
Production	%	% (Approx.)	% (Approx.)						
Industrial production	-8.9	8.6	2.5						
Prices	%	% (Approx.)	% (Approx.)						
Domestic corporate goods price index	-5.2	0.3	0.4						
Consumer price index	-1.7	-0.6	0.0						
GDP deflator	-1.3	-2.0	-0.5						
Balance of payments	Trillion yen	Trillion yen (Approx.)	Trillion yen (Approx.)	%		% (Approx.)		% (Approx.)	
Balance of goods and services	4.8	6.6	7.5						
Trade balance	6.6	7.8	8.4						
Exports	55.6	64.3	68.3	-17.9		15.8		6.2	
Imports	49.0	56.5	59.9	-26.4		15.4		6.1	
Current balance	15.8	16.4	17.6						
Current balance as a percentage of GDP	%	% (Approprox.)	% (Approprox.)						
	3.3	3.4	3.6						

*1 Figures in parentheses represent contribution to GDP growth.

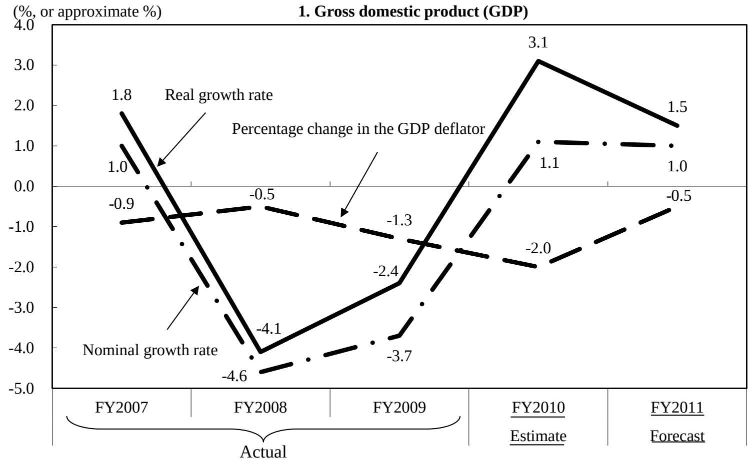
(Note) We have assumed the real growth rate of world GDP (excluding Japan), the yen's exchange rate and the crude oil import price as follows.
These assumptions are not projections of the Government.

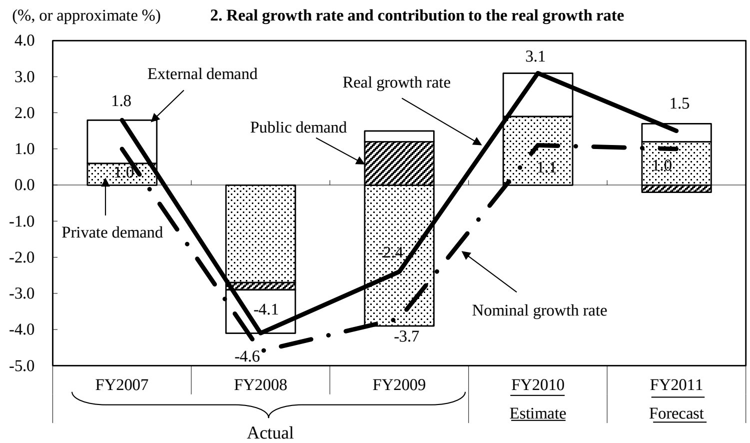
	FY2009	FY2010	FY2011
Real growth rate of world GDP (excluding Japan) (%)	-0.1	3.9	3.2
Exchange rate (yen/dollar)	92.8	85.6	82.4
Crude oil import price (dollar/barrel)	69.1	81.9	86.6

(Remarks)
1. The real growth rate of world GDP (excluding Japan) has been calculated based on economic forecasts of international organizations and other institutions.
2. The exchange rate is assumed to stay constant after December 1, 2010 at the monthly average (82.4 yen/dollar) from November 1 through 30, 2010.
3. The crude oil import price is assumed to stay constant after December 1, 2010 at 86.6 dollar/barrel, which includes the monthly average spot crude oil price from November 1 through 30, 2010.

(Reference)

Main Economic Indicators





※Note: Contribution ratios of private demand, public demand, and external demand show their contributions to the real growth rate.