World Economic Trends

The Autumn Report in 2010

-Report on the Global Economy for the Second Half of 2010-

-- Successes and Failures of Fiscal Consolidation: Lessons of the Past and Prospects for the Future --

(Summary)

November 2010

Cabinet Office

Government of Japan

Contents

This report is created based on the data obtained by November 12 (Friday) in principle.

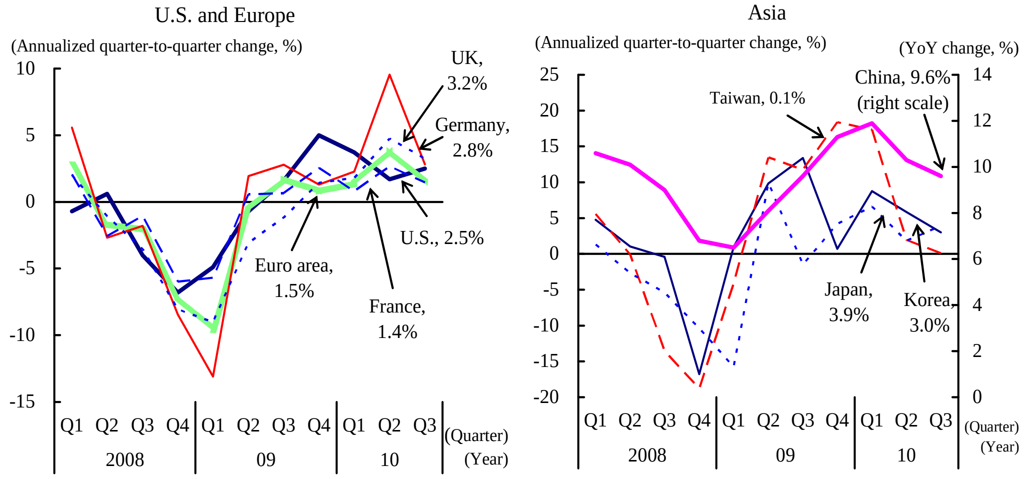
Chapter 1　Changes in the Trend of the Global Economic Recovery

Section 1　Overview of the Global Economy

Global Economic Recovery is at a Moderate Pace

● The global economy has been recovering moderately, due partly to economic stimulus measures. However, the pace of the economic recovery has slightly lost its previous momentum since the middle of 2010 and became more moderate.

Figure 1-1-1　Real GDP Growth Rates of Major Countries: Overall Growth Has Tended to Slow

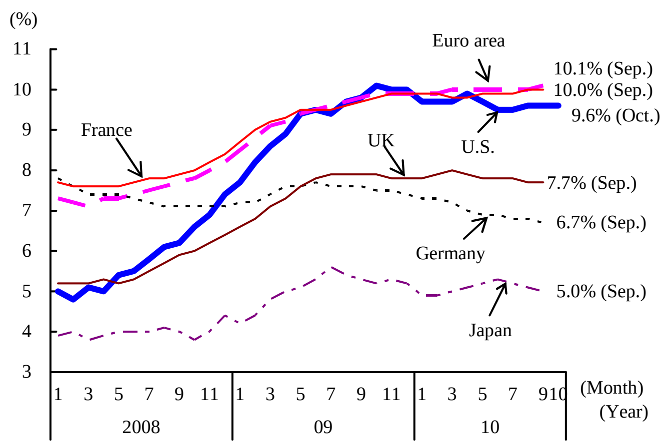


(Notes) 1. Source: National and regional statistics.
2. Data for China are those compared to the previous year.
Figures are those of July to September of 2010.

Unemployment Rates Remain at a High Level in Europe and the U.S., with the Credit Crunch Continuing

● Despite an economic recovery, the unemployment rates remain high at around 10% and a credit crunch is continuing in Europe and the U.S., which is still exerting strong downward pressure on the economy.

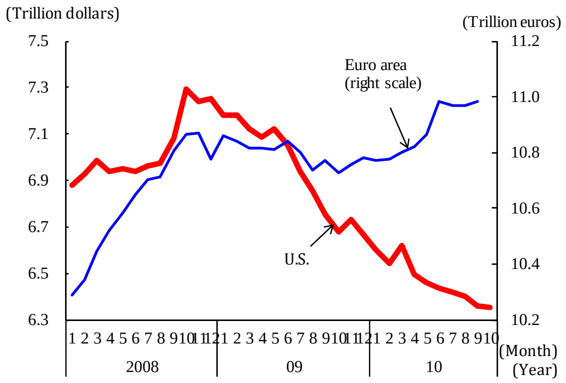
Figure 1-1-2　Unemployment Rates of Major Countries: Continuing to Remain at a High Levels



(Note) Source: National statistics and Eurostat.

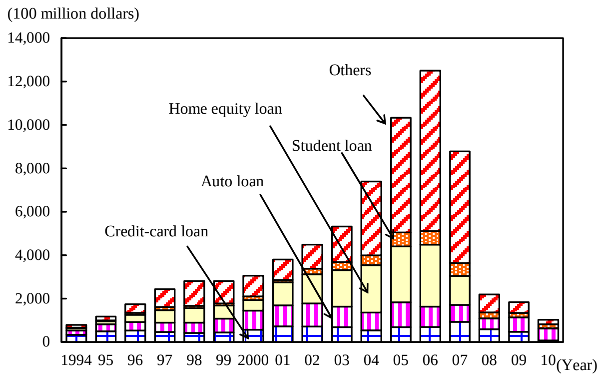
● In the U.S., banking loans are substantially on the decline, and the securitized products market has not yet recovered.

Figure 1-1-3 Outstanding Banking Loans in the U.S. and Europe: Remaining on a Downward Trend in the U.S.



(Notes) 1. Source: FRB and ECB.
2. In the U.S., certain assets and liabilities that were previously off-balance sheet have started to be recorded on the balance sheet since April 2010. The U.S. data for and after April 2010 are thus estimates adjusting the impact of this change.

Figure 1-1-4 New Issuance of Asset Backed Securities of the U.S.: Continuing to Decrease

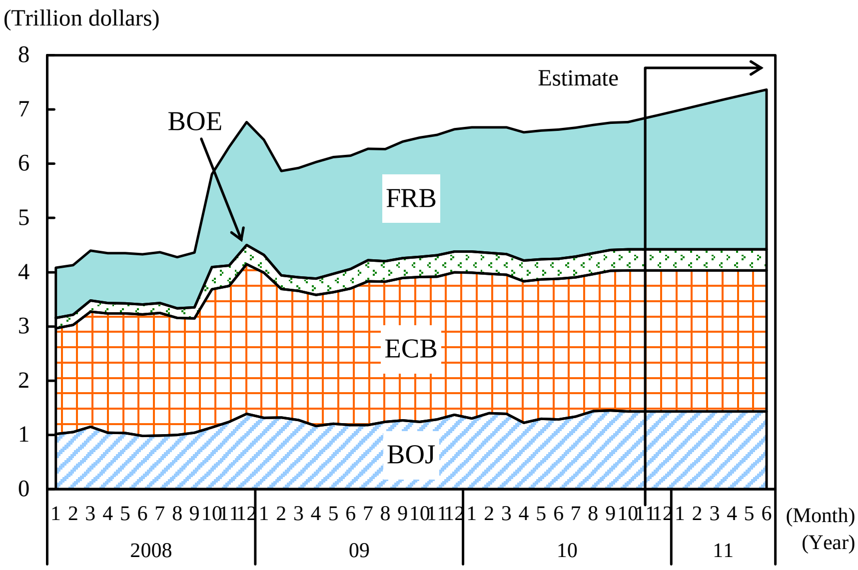


(Notes) 1. Source: Bloomberg.
2. Asset Backed Securities refer to securities which are issued based on funds from cash flows generated from such assets by securitizing loans receivable (credit-card loan, auto loan, etc.) and real estate, etc.
3. Data for 2010 are as of the end of October.

Global Liquidity Expansion due to Monetary Easing in the Developed Countries and the Dollar's Depreciation

● Since the occurrence of the global financial crisis in 2008, monetary easing policies have rapidly expanded the central banks' balance sheets of the developed countries, making the total assets of major central banks amount to \$6.8 trillion: 1.6 times those of the pre-crisis level (as of August 2008). As a result, a massive amount of funds has been provided to the markets, creating a global liquidity expansion.

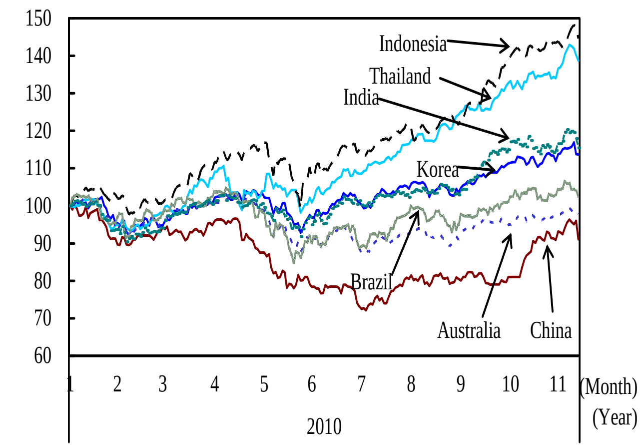
Figure 1-1-5 Asset Balance of Major Central Banks: Rapid Expansion after the Global Financial Crisis



(Note) Source: FRB, ECB, BOE, BOJ and Bloomberg.

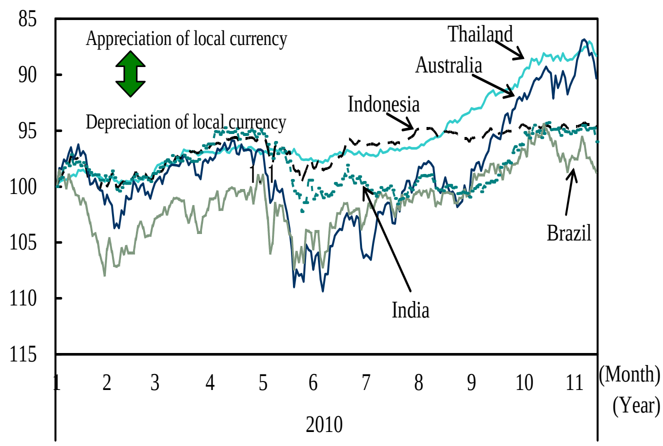
● As capital inflow into the emerging countries and resource-rich countries is increasing, asset prices have risen in some countries and concern about overheating have been arising. Some countries/regions have strengthened short-term capital control or regulations on real estate transactions.

Figure 1-1-6 Stock Price Movement in Emerging Countries and Resource-Rich Countries



(Note) Source: Bloomberg.

Figure 1-1-7 Currency Movement in Emerging Countries and Resource-Rich Countries



(Note) Source: Bloomberg.

Table 1-1-8 Recent Movement to Strengthen Capital Control Measures and Regulations on Real Estate Transactions in Asian Countries and Regions

[Capital control measures, etc.]

China	• More stringent regulations of foreign-currency short-term obligations • Closer watch on investments in Chinese stocks by foreign corporations and others (Released on Nov. 9)
Korea	• Set a ceiling to a bank's FX derivative position (*gave a grace period of maximum 2 years for a bank to adjust its position) • More stringent regulations on use of bank loans in foreign currency and others (Released on Jun. 13)
Taiwan	Restrained the investment in public bonds and short-term financial products within 30% of the asset that a foreign investor holds (Released on Nov. 9)
Thailand	• Eased the ceiling of foreign currency savings by domestic individuals/corporations and others (released on Sep. 23) • Lifted the tax exemption on investment in governement bonds by foreign investors and others (released on Oct. 12)

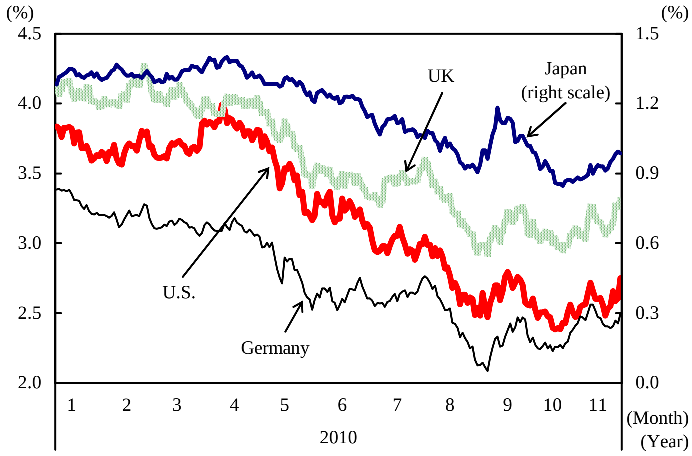
[Regulations on real estate transactions]

China	• Set a ratio of the downpayment for a purchase of the 1st housing over 30% and others (released on Apr. 17) • Temporarily suspended loans for purchasing the 3rd housing or subsequent houses (released on Sep. 29)
India	Restrained the ceiling of loans in purchasing houses within 80% and others (released on Nov. 2)
Singapore	Lowered the ceiling of a loan ratio for purchasing the 2nd house from 80% to 70% and others (released on Aug. 30)
Malaysia	Restrained the ceiling of a loan ratio for purchasing the 3rd house within 70% (released on Nov. 3)

Worldwide Expansion of Fiscal Deficits

- After the global financial crisis, countries have significantly increased their fiscal deficits and the issuance of government bonds has increased sharply due to the large-scale fiscal stimulus measures as well as decreasing tax revenues as a result of the recession.
- The yields of government bonds are, except in some countries, generally decreasing amid the global expansion of liquidity, and fiscal deficits are currently being financed. However, securing fiscal sustainability from the medium-to-long term perspective is an important issue.

Figure 1-1-10 Long-Term Interest Rates of Major Countries: On a Downward Trend

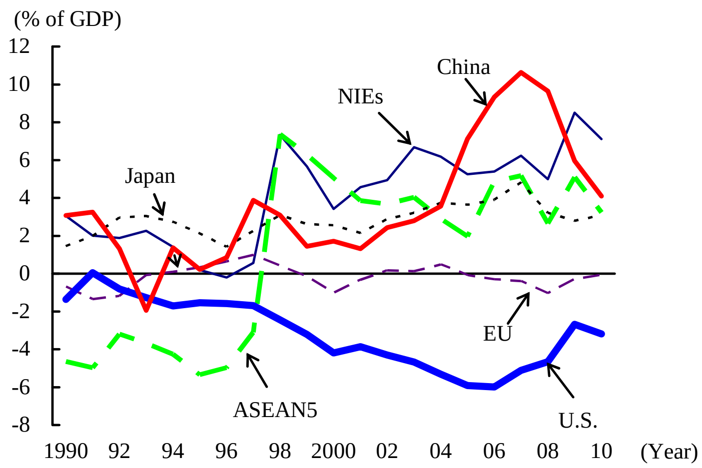


(Note) Source: Datastream.

International Cooperation on the Macroeconomic Policies is Required

- Amid the slowing pace of the recovery of the global economy, the importance of international cooperation on fiscal, monetary, and foreign exchange policies is rising further.
- Recently efforts have been made to establish a scheme of supervision to correct the macro economic imbalances, including the excessive imbalance of current account. The recognition has become common that cooperation in macroeconomic policies and efforts towards structural reforms by each country are essential to correcting imbalances.

Figure 1-1-11 Current Accounts of Each Country and Region (as % of GDP)



(Notes) 1. Source: IMF "World Economic Outlook Database, October 2010."
2. ASEAN 5: Indonesia, Malaysia, Philippines, Thailand and Vietnam
3. Data for 2010 are an estimate.

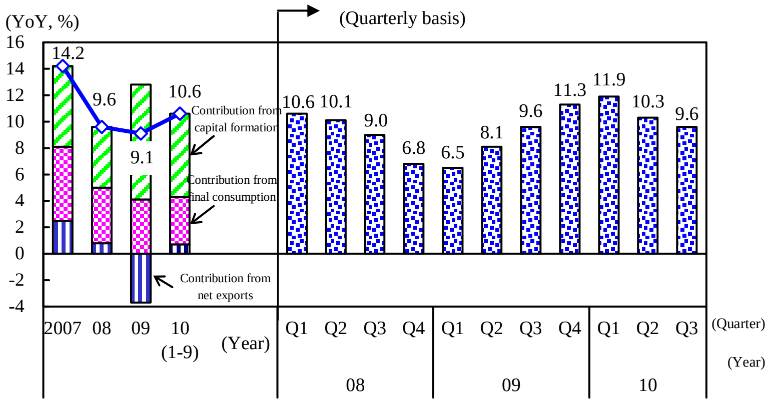
Section 2 Asian Economy

Economic Trends in China

(1) Current economic situation

● The Chinese economy has been expanding mainly in terms of domestic demand, but its pace of expansion is moderating slightly. The reasons for this include (1) a temporary pause in the increase in domestic demand, which has surged by the effect of the stimulus policy and, (2) the impact of policy stance change of the government from the beginning of 2010.

Figure 1-2-1 Real GDP Growth Rate (Contribution from Domestic & External Demand): Peaked in Q1 of 2010 and Slowed Down Thereafter



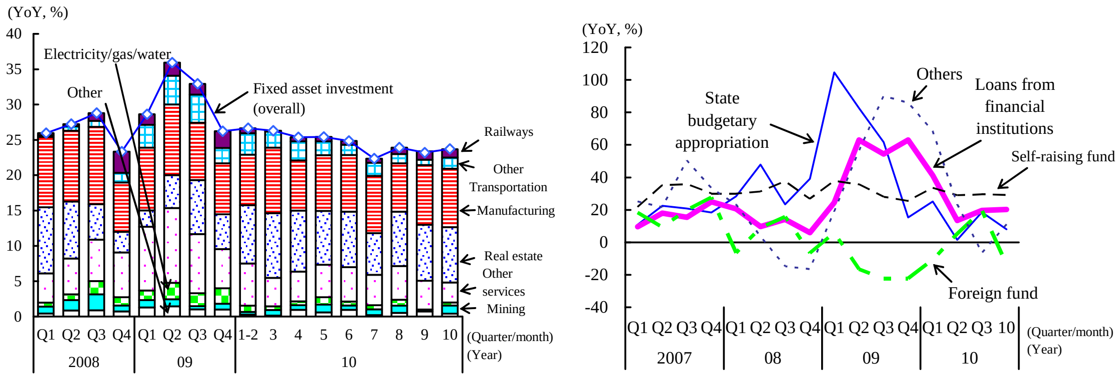
(Note) Source: National Bureau of Statistics of China.

● Growth in fixed asset investment has slowed compared to 2009. It is affected by slowdown of contribution to growth from public investment with the 4 trillion Yuan package entering its second year and policy measures such as restraining the total volume of bank loan. However, it is still keeping a high rate due to the recovery of investment in real estate development. For sources of funds for fixed asset investment, those based on "other" sources (issuance of bonds by companies or financial institutions, etc.) as well as the "state budgetary appropriation" and "loans from financial institutions" rapidly increased during 2009, but now are tending to decrease. This is considered to be partly related to the fact that after a rapid expansion in the raising of funds through borrowings and bond issuance by the fund raising platform of local government, policy measures to strengthen control over them have been taken since the middle of 2010.

Figure 1-2-2 Fixed Asset Investment in Urban Areas: Slightly Slower Growth for 2010

(1) Fixed asset investment (contribution by industry)

(2) Sources of funds for fixed asset investment

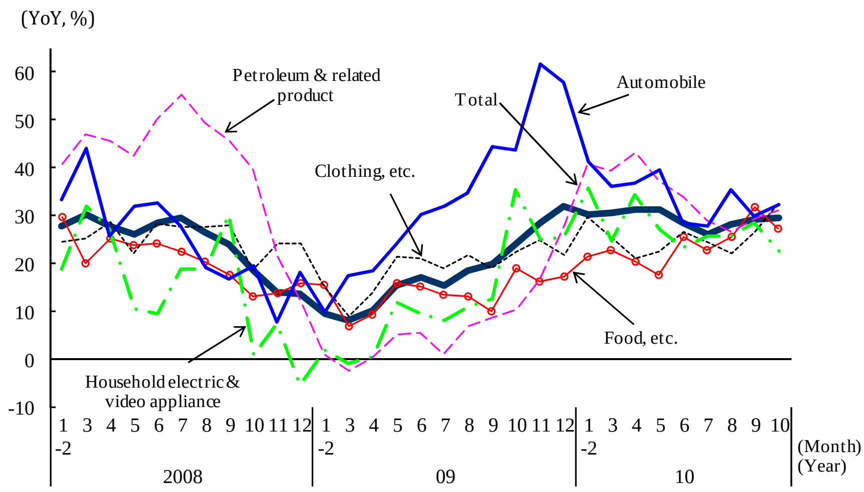


(Notes) 1. Source: "Fixed Asset Investment in Urban Areas", National Bureau of Statistics of China.
2. With regard to real estate development, statistics on land purchasing costs were revised in November 2009.

(Notes) 1. Source: National Bureau of Statistics of China.
2. Others are funds, etc. which have been procured through issuance of bonds by companies or financial institutions.

● The growth of consumption has been steady, in part due to the stimulus measures, and this growth is being driven by strong auto sales. Home appliances sales also started rising from around the fall of 2009, and enjoys a steady increase.

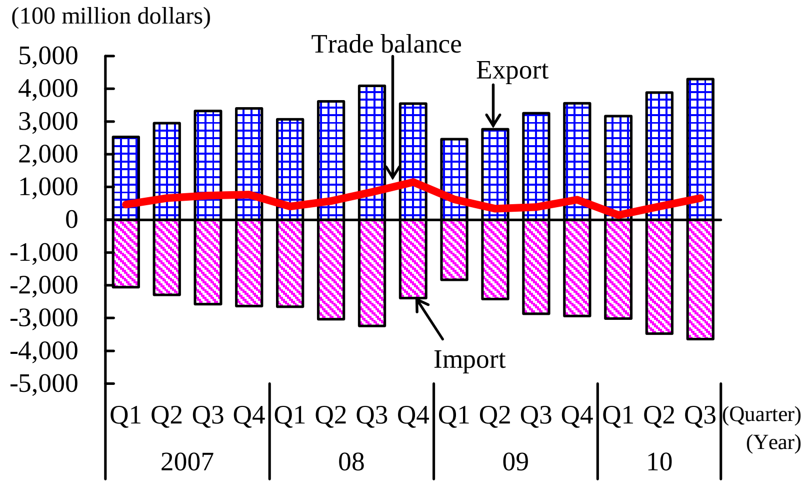
Figure 1-2-4 Retail Sales (Breakdown by Item): Recovery Driven by strong Auto Sales



(Notes) 1. Source: National Bureau of Statistics of China.
2. Only companies of a certain size (annual sales over 5 million yuan) were polled.
3. In order to exclude the influence of the Chinese New Year, growth rates of each month were averaged for January and February.
4. Share in 2009: automobile (27%), petroleum product (18%), food, etc. (13%), clothing, etc. (11%), household electric & video appliance (7%).

● Both exports and imports have been steady. The value of exports and imports has recovered to the level before the global financial crisis. The recovery of imports is more prominent than exports. On the details of imports on a quantitative basis, growth in automobiles (including parts), primary products and basic materials have been increasing from the beginning in 2010 over the middle of the year. The implementation of 4 trillion yuan package focusing on investment in infrastructure and consumption stimulus measures seems to have increased imports for China's domestic demand, pushing total imports upward.

Figure 1-2-6 Value of Exports and Imports, and the Trade Balance: Both Exports and Imports Have Recovered to the Level before the Global Financial Crisis

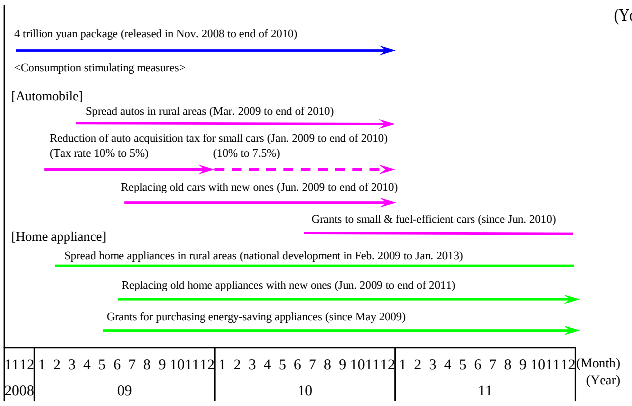


(Notes) 1. Source: General Administration of Customs of the People's Republic of Cl
2. Figures are not seasonally adjusted.

(2) The policy stance change of the Chinese government

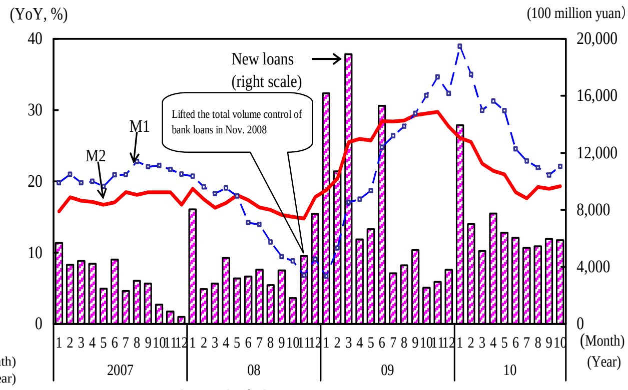
- The massive fiscal stimulus and monetary easing measures that the Chinese government adopted since November 2008, covered the drop in foreign demand due to the global financial crisis and became the engine for China's quick recovery from the recession. However, this has raised fears of overheating economy and caused side effects.

Table 1-2-13 List of Economic Stimulus Measures



(Note) Source: Data released by the Chinese government.

Figure 1-2-14 New Loans and Money Supply



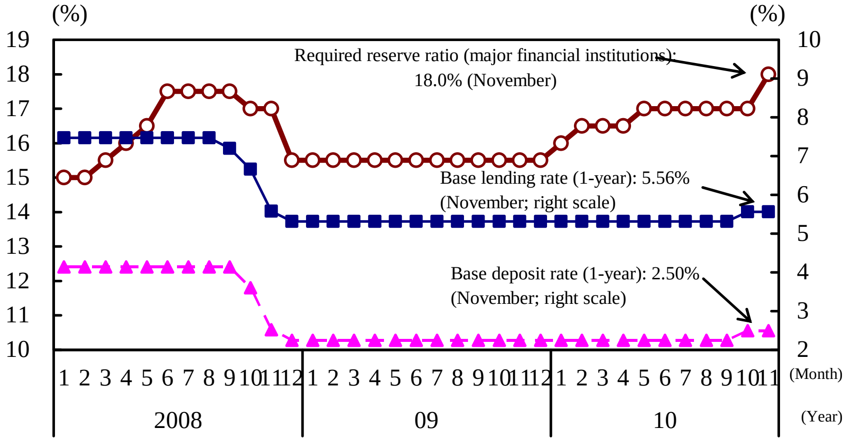
(Note) Source: People's Bank of China.

- In 2010, the Chinese government has specifically come out with policies focusing on restraint of the overheating economy, elimination of side effects of previous measures and the adjustment of economic structure. In addition, because the consumer price accelerated to rise and the price of real estate started to increase again around the fall, the Chinese government has further strengthened its policies.

(i) Monetary policy adjustment

➢ The People's Bank of China (PBC) has raised the reserve requirement ratio by 50 basis points several times since January 2010. In October, it raised its policy interest rate as well.

Figure 1-2-16 Required Reserve Ratio and Base Interest Rate: Towards Tightening from 2010



(Notes) 1. Source: People's Bank of China.
2. Since required reserve ratios at major financial institutions prior to August 2008 have not been released, overall data for the institutions is used instead.

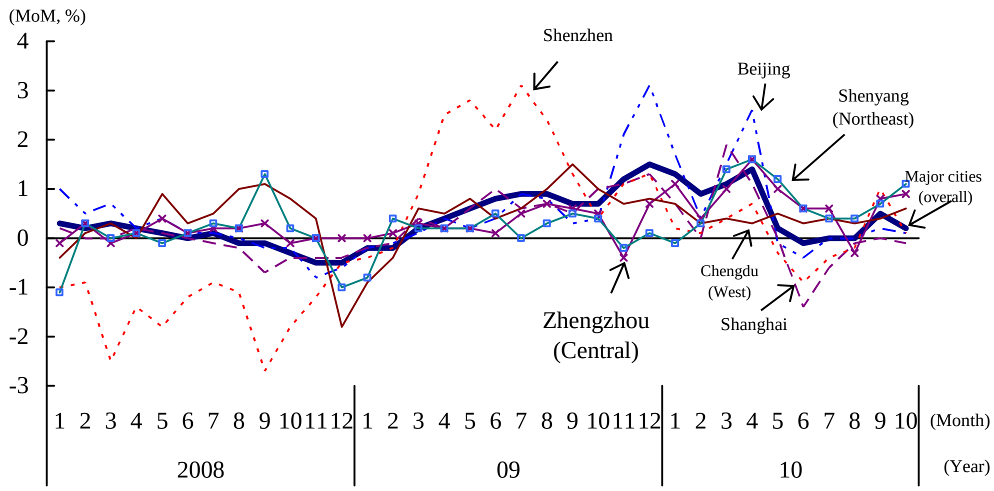
(ii) Strengthening of financial regulations/supervision

- The State Council gave instructions to local governments to strengthen their management in response to public interest or profitability, etc. for each investment project by the fund raising platform of local governments. According to the China Banking Regulatory Commission (CBRC), the outstanding bank loan to the fund raising platform of local governments as of the end of June 2010 was 7.66 trillion
- yuan, accounting for approximately 17% of the total, of which 1.76 trillion yuan, or 23%, is subject to the serious risk of reimbursement. Small- and medium-sized banks that are said to have lent a lot to the fund raising platform of local governments have kept their ratio of non-performing loans at a low 2.2% as of the end of September 2010, but the ratio is higher than the 1.2% for all commercial banks.
- The CBRC conducted a stress test in June 2010. The result turned out to be not so serious: the ratio of non-performing loans at banks will increase by 2.2 points from the end of 2009 and income before taxes will decrease by 20% on the assumption that real estate prices will decline by 30%. In addition, the CBRC instructed the banks and trust companies to stop the new securitization of finances receivable and consolidated onto the balance sheet by the end of 2011.

(iii) Control of real estate prices

- Real estate prices were somewhat stable in some cities mainly in the coastal regions until around June since the measures to curb loans for purchasing real estate were implemented in April 2010. However, the prices have begun to rise from around the summer.
- In response to this situation, the Chinese government worked out in September additional measures to restrain real estate prices, including measures to curb loans In October, the real estate prices declined in some cities mainly in the coastal regions, but still remained high. For the time being, the risk of the real estate market overheating will coexist with the risk of a plunge in prices if the measures turn out to be more effective than anticipated.

Figure 1-2-19 Building Sales Prices in Major Cities (MoM): Increasing Again Since September 2010

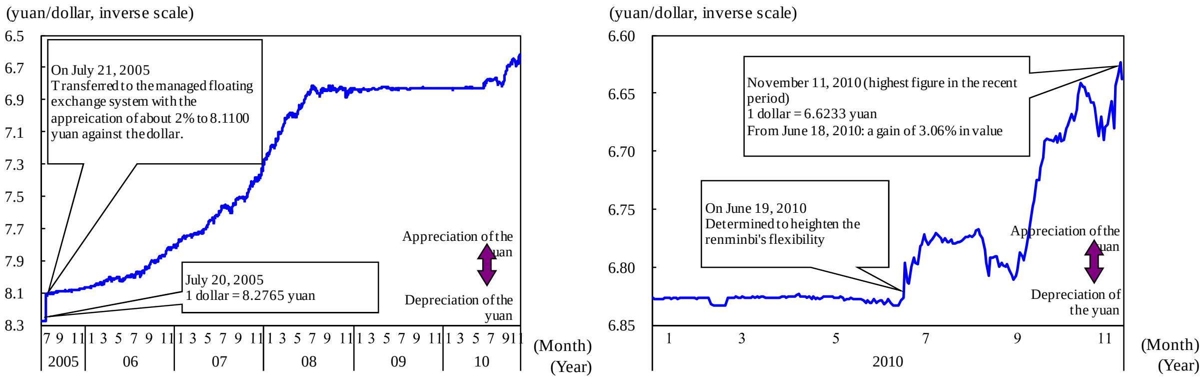


(Notes) 1. Source: National Bureau of Statistics of China.
2. Selected capitals of provinces with high GRP (gross regional product) for the central/western regions and the northeastern region.
East: Shanghai, Beijing, Shenzhen (Guangdong province)
Central: Zhengzhou (Henan province)

(iv) More flexible exchange rate for the Yuan

- The PBC decided on June 19, 2010 to enhance the flexibility of the exchange rate of the Yuan that had been de facto dollar pegged since July 2008. At about the same time, the PBC made successive announcements on the relaxation of regulations related to the Yuan to serve as strategic moves for the internationalization of the currency.

Figure 1-2-22 Nominal Yuan/Dollar Rate: Started to Appreciate on June 19, 2010

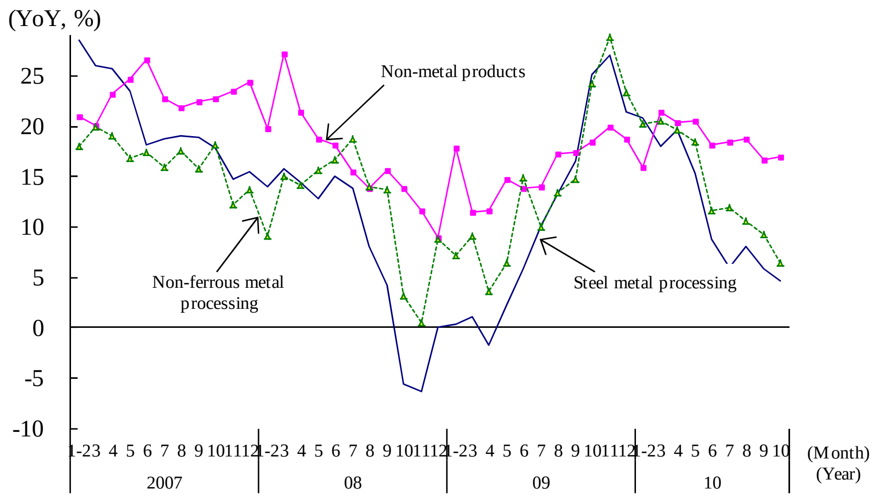


(Note) Source: Bloomberg.

(v) Acceleration of scrap of excessive or old-type production facilities

- The Chinese government has been promoting abolishment of excessive or old-type production facilities in industries which consume large amount of energy, and began to accelerate that in 2010.
- Behind this move are (1) the long-term factors, such as change in its industrial structure and the establishment of a sustainable economic growth model, and (2) the short-term factors, the elimination of the side effects of the economic stimulus measures and achievement of the target of a reduction in energy consumption in the 11th Five Year Plan. Because of the latter factors in particular, it appears that a decline in growth in production will continue for the time being.

Figure 1-2-24 Trends in the Industrial Production Value with Excessive or Old-Type Production Facilities (on a Value-Added Basis): On Downward Trend



(Notes) 1. Source: National Bureau of Statistics of China.

2. Selected industries with large output value of the industries cited in the "Notice to Realize the Targets to Reduce Emissions for Energy Saving of the 11th 5-Year Plan with Further Strengthened Efforts".

3. The classification of the graph includes the specific industries below, respectively.

Non-metal products: cement, flat glass, etc.

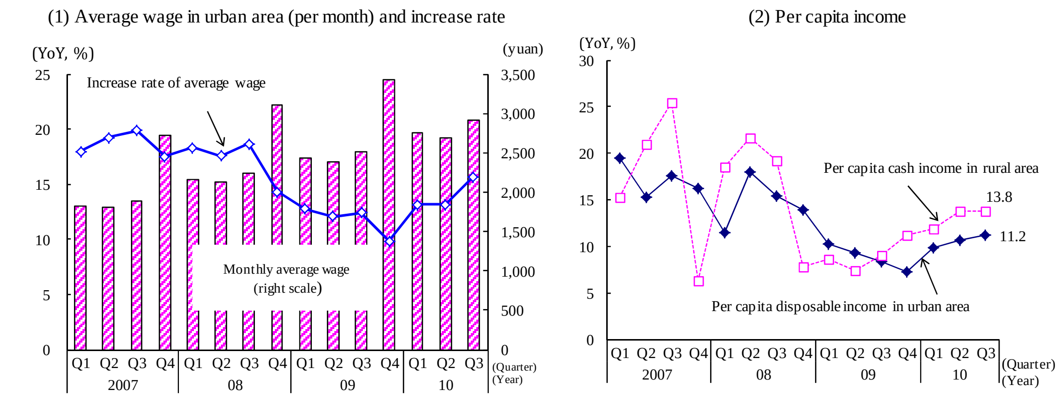
Steel metal processing: steelmaking, ironmaking, etc.

Non-ferrous metal processing: copper refining, zinc refining, etc.

(3) Economic outlook

- Although there are factors slowing the economy, such as the receding effects of the economic stimulus measures after 2011, domestic demand of consumption and investment is estimated to fundamentally stay brisk.
- Consumption, sustained by improvements in the income environment such as the increase in average wages and medium-to-long term policy to promote consumption, is estimated to move favorably here after.
- Although the expansionary effects of public investment will reduce in accordance with the termination of the 4 trillion Yuan package, the private investment is expected to stay robust. The effect of new measures, such as measures for promotion of private investment and promotion for the strategic emerging industries including energy-saving, are also expected.

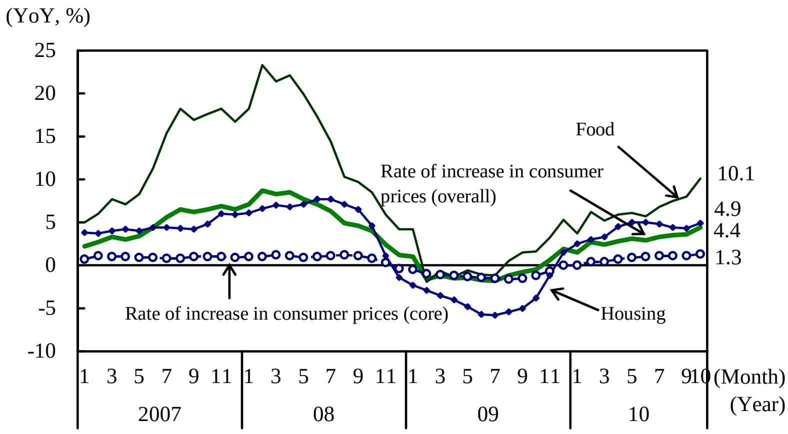
Figure 1-2-28 Average Wages/Disposable Income: Household Income to Improve



(Notes) 1. Source: National Bureau of Statisitics of China.
2. Average wage is a wage of one person at work in urban areas such as state-enterprises, collective ownership corporations, share-holding corporations, foreign funded companies (exluding persons at township enterprises, private enterprises and self-employed).

- Consumer prices are on the uptrend, mainly due to food and house price increase in addition to a reaction to price drop in the previous year. The rate of core consumer prices is also increasing moderately. For the future prospects, it is necessary to watch carefully the upward pressure. It is considered to include the increase in commodity prices due to the flow of funds to international commodity markets supported by the continuing monetary easing policies in developed countries, impact with time lag of the surge in the money supply of 2009, and continuously mounting pressures for wage increases.

Figure 1-2-31 Rate of Increase in Consumer Prices: On the Increase



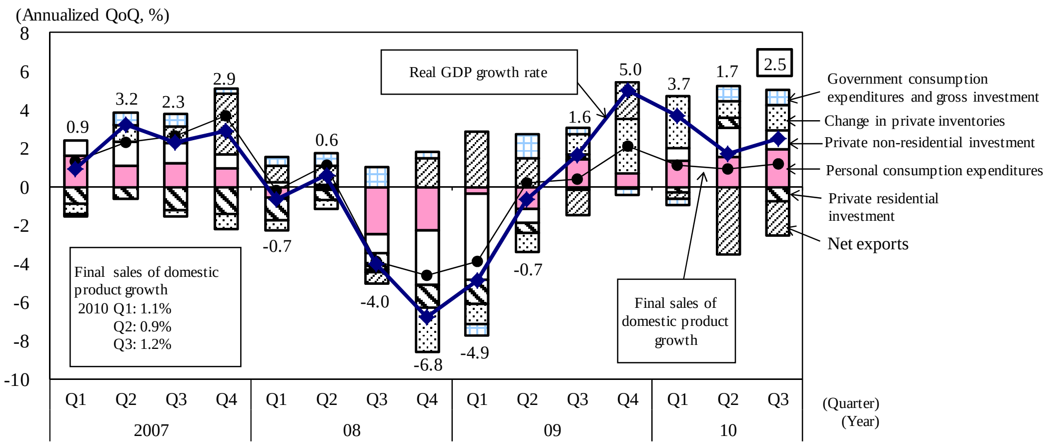
(Notes) 1. Source: National Bureau of Statistics of China.
2. Core consumer prices exclude food and energy prices.

Section 3 U.S. Economy

1. Changes in the Trend

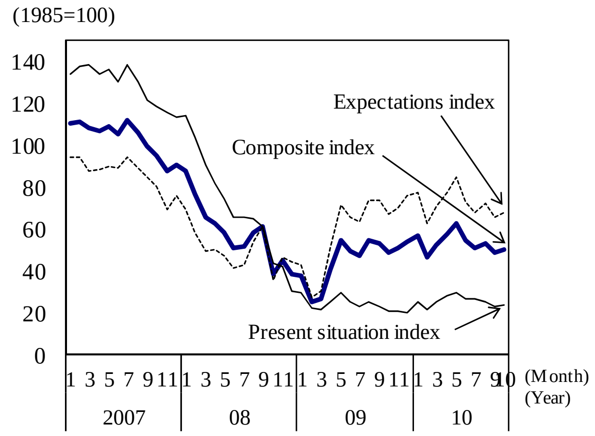
- Although the U.S. economy reached the trough in June 2009, and started to expand again, the pace of recovery is slow facing a "jobless recovery".
- Since the end of 2009 to the spring of 2010, the economy showed a vigorous recovery due to the impact of an accumulation of inventory and the fiscal stimulus measures. However, after the spring of 2010, the pace of recovery slowed down together with the reducing effects of policies such as tax breaks for home buyers and the declining sentiment owing to the Greek financial crisis. There was an increased concern that the economy was heading into the recession again in the summer 2010.
- Concern over an economic recession after the fall of 2010 has declined, however, the pace of economic recovery will remain moderate for the time being.

Figure 1-3-1 Real GDP Growth Rate: Moderate Recovery Continuing



(Notes) 1. Source: U.S. Department of Commerce.
2. Final sales of domestic product refers to an item which is gained by deducting investment in inventory from GDP.

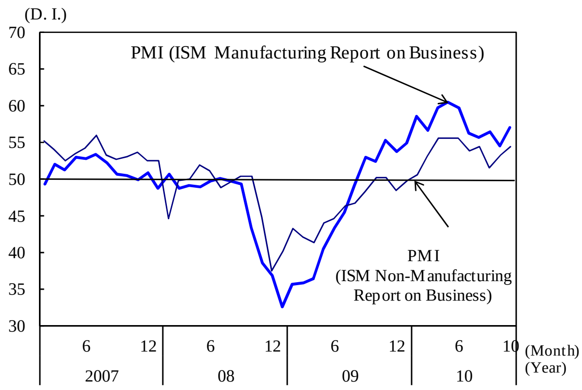
Figure 1-3-5 Consumer Confidence Remaining Weak



(Notes) 1. Source: Conference Board.
2. The expectations index is consumers' outlook for the next six months.

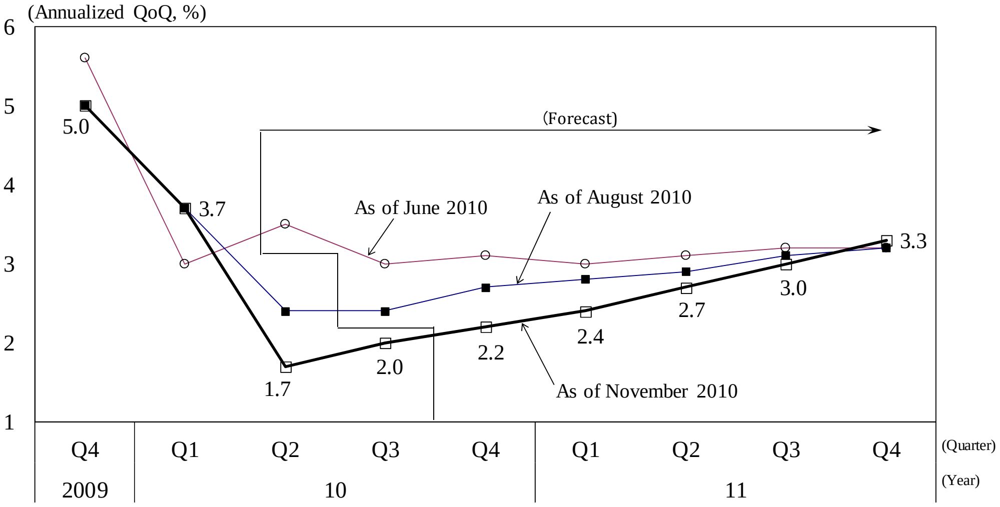
Figure 1-3-6 Trends in Business Sentiment

Although business sentiment is improving, indexes are on the decline since May 2010



(Notes) 1. Source: Institute for Supply Management (ISM).
2. The indexes are composite. D. I. over 50 suggests that the economy is favorable, and that less than 50 shows the opposite situation.

Figure 1-3-11 Private-sector outlook for the Real GDP Growth Rate Gradually being Revised Downwards



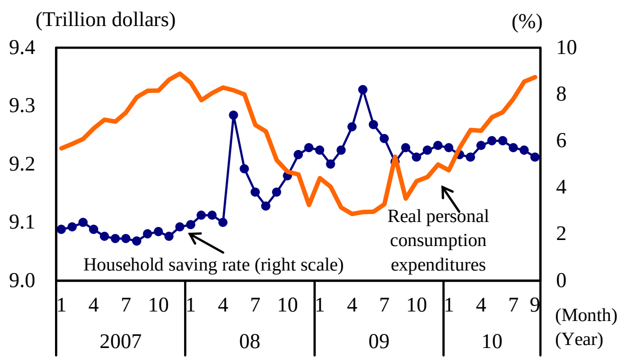
(Note) Source: U.S. Department of Commerce, Blue Chip Economic Indicators.

2. Current Situation and Future Outlook for the U.S. Economy

(1) Personal consumption expenditures

- Although personal consumption expenditures (PCE) continues to moderately pick up due mainly to an improvement in the income environment owing to the recovery in employment and the rise in stock prices, the growth in compensation for employees, which accounts for approximately 65% of personal income, is low compared to past recovery phases. Personal current transfer receipts such as tax reductions and unemployment benefits are the main factors supporting personal income.
- The situation surrounding PCE is weak as is shown by the continuing high unemployment rate, the continuation of balance sheet adjustments by households and the credit crunch. Debate in the Congress over the extension of unemployment benefits and the Bush Tax Cuts bills has been stuck. If these measures are shelved or curtailed, it may discourage PCE.
- The number of people who receive the Supplemental Nutrition Assistance Program (Food Stamp) surpassed 40 million in March 2010, a record high. One out of 7.3 persons in the U.S. is receiving Food Stamp as a low income earner, suggesting the possibility that the population-wide consumption would not expand favorably.

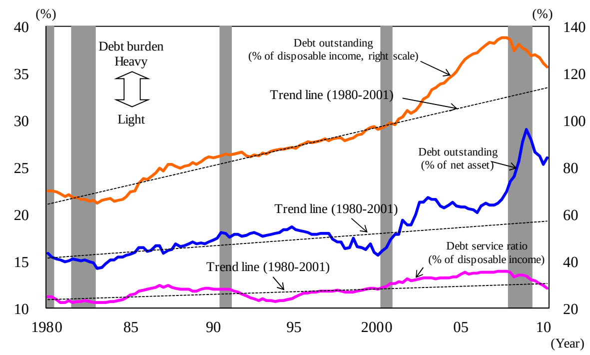
Figure 1-3-12 Personal Consumption Expenditures: On a Moderate Increase



(Note) Source: U.S. Department of Commerce.

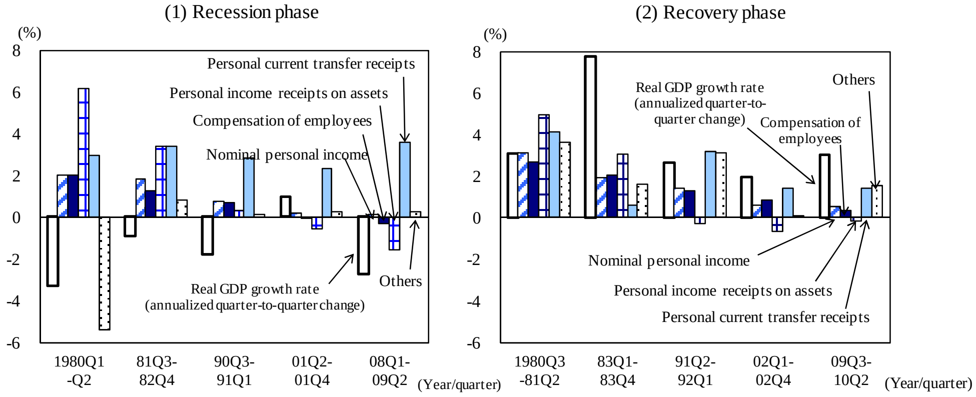
Figure 1-3-19 Household Debt Burden

Debt outstanding ratios remain above the trends



(Notes) 1. Source: U.S. Department of Commerce, FRB.
2. Shaded area are periods of recession.
3. "Buden of repayment of principal and interest" indicates the burden of housing loans and consumer loans.

Figure 1-3-15 Personal Income during Recessionary/Recovery Phases
Compensation for employees is stagnating

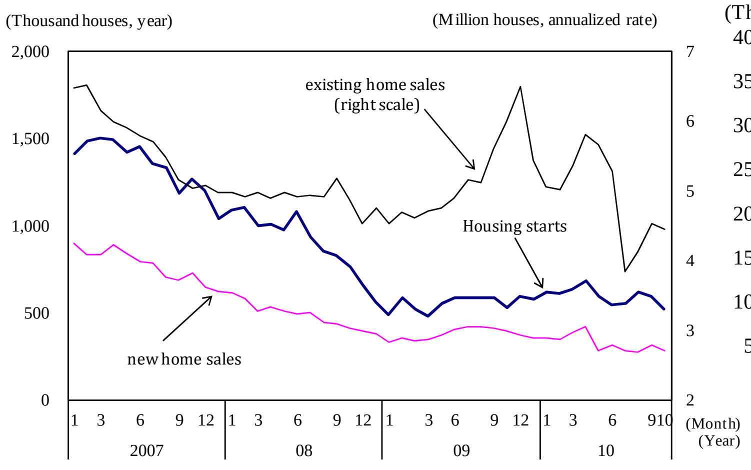


(Notes) 1. U.S. Department of Commerce, NBER.
2. The figures are obtained by categorizing quarters closest to the economic cycles (months) released by NBER into recessionary phases and recovery phases and averaging these quarter-to-quarter change rates (However, real GDP growth rates are annualized figures).
For an economic recovery phase, we used figures of the four quarters from the next quarter when each recession was over.

(2) Housing

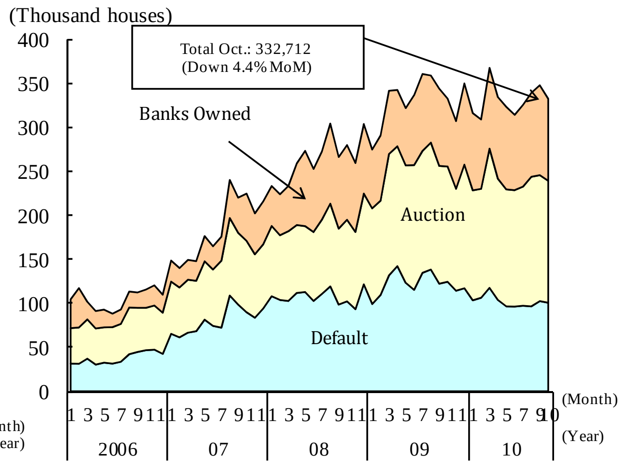
- The housing market has rapidly after the tax credit for housing was terminated at the end of April 2010. In particular, home sales, both new home and existing ones, having substantially declined after May, is staying at a record low level.
- Although the environment for the purchase of a home is favorable, people are hesitating to buy one mainly because they are concerned about the future of employment and income. From the supply side as well, the number of foreclosed properties is stuck at a high level with such houses continuing to come onto the market; becoming a factor delaying the recovery of house prices.
- Misconduct case by some financial institutions about foreclosure procedures has become a problem, causing the spread of a nationwide foreclosure freezes. Delays in the disposal of banks' non-performing loans may delay the recovery of the housing market.

Figure 1-3-7 Housing Market Trends (Housing starts and Sales) Plunged after May 2010



(Note) Source: U.S. Department of Commerce and National Association of Realtors (NAR).

Figure 1-3-9 Trends in Foreclosed Houses: Stuck at a High Level

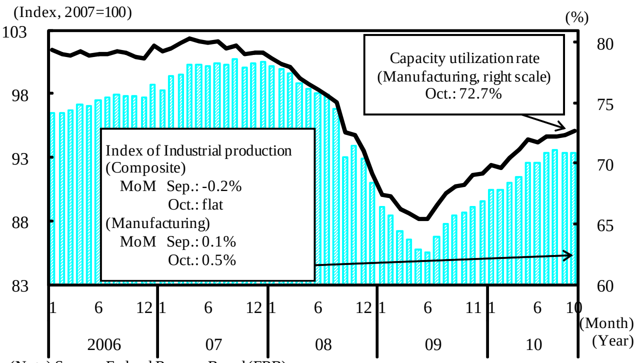


(Note) Source: RealtyTrac.

(3) Production/investment

- Production has turned toward an increase in the middle of 2009, since there has been an accelerated buildup of inventories by companies and orders have recovered, it has been registering a consistent recovery since then. The auto industry and high tech industries such as semiconductors in particular are drivers of the recovery. However, reflecting a temporary pause in the inventory accumulation and the declining business sentiments, the pace of the recovery has slowed down.
- Private capital investment has stayed brisk as it began to increase since Q1 of 2010 and the recovery has spread to sectors other than IT. However, orders for capital goods and the sentiments to invest have currently weakened and the pace of the recovery may slow in future.
- The balance sheets of companies are relatively sound, with their efforts to accumulate internal funds. Large corporations find it easy to finance, but they have limited investment in facilities and proceed with share buy-back schemes or M&As with the mounting uncertainty in policy measures and economic outlook.
- Small- and medium-sized enterprises account for 50% of employment in the private sector and have created 64% of new jobs domestically in the past 15 years; accordingly, such enterprises are playing an important role. However, the environment surrounding their management is severe, and their economic sentiments are declining.
- Financial demand of SMEs has declined due mainly to uncertainty over economic outlook. The management of small- and medium-sized financial institutions on which such enterprises rely is in a difficult situation, limiting the availability of favorable financing for SMEs.

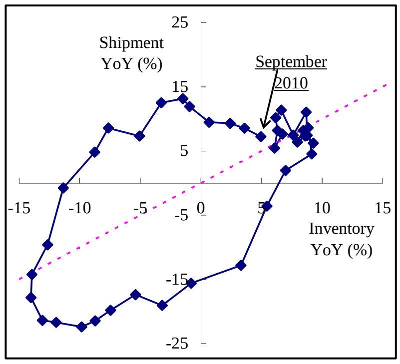
Figure 1-3-21 Trends in Industrial Production/Capacity Utilization Rates



(Note) Source: Federal Reserve Board (FRB).

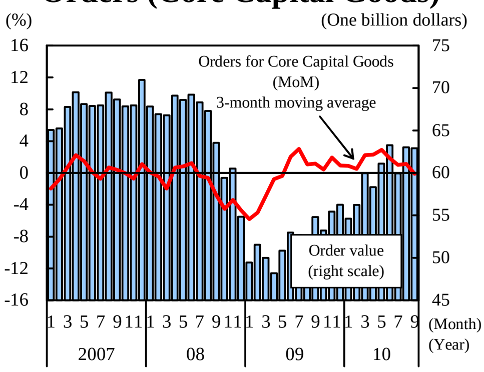
Figure 1-3-22 Inventory Cycle Chart

Manufacturing



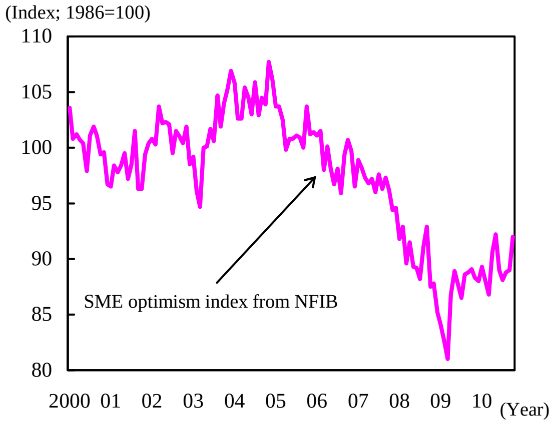
(Note) Source: U.S.Department of Commerce.

Figure 1-3-23 Trends in Manufacturer's Orders (Core Capital Goods)



(Note) Source: U.S. Department of Commerce.

Figure 1-3-25 NFIB Optimism Index

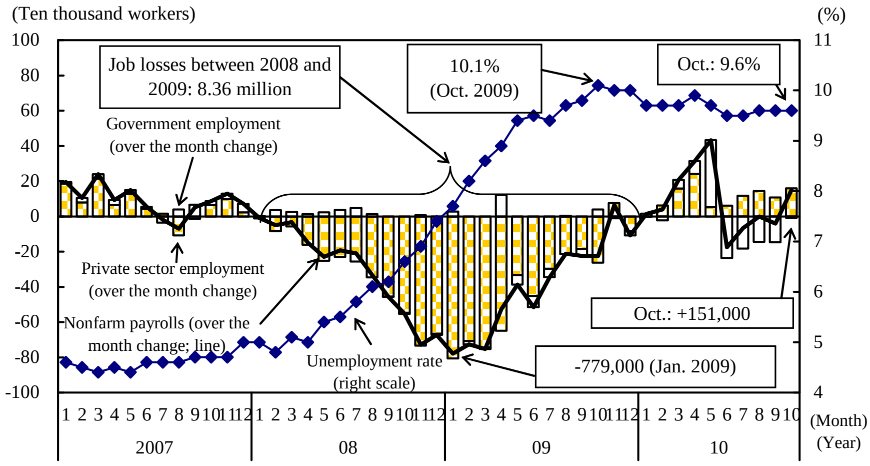


(Note) Source: National Fedration of Independent Business (NFIB)

(4) Employment

- The unemployment rate has stayed at a high level of around 10%. Since May 2010, the number of employed people has increased at a rate that has been insufficient to bring down the unemployment rate: this is actually the situation of a jobless recovery.
- Nonfarm payrolls increased substantially until May 2010 due to temporary employment for the national census. The termination of the census reduced payrolls from June to September. The number of employed excluding the effect of the national census increased, by more than 150,000 from the previous month over the spring of 2010 due to the increase in production from the buildup of inventories and the effects of the stimulus package. In and after May 2010, the effects of these measures were paused and the economic sentiment worsened due mainly to the Greek financial crisis. As a result, the pace of the increase has slackened.
- While online labor demand and employer confidence indicate that the attitude of companies towards recruitment is moderately getting better, it is feared that the mismatch in employment may not lead to actual employment and the number on payrolls may stay flat in future. Concerning the unemployment rate, if the number of the employed continues to be lower than the number that is necessary to reduce the unemployment rate (about 120,000), it may not decline. Moreover, partly because discouraged workers may reenter the labor market in 2011, and the rate may hit approximately 10% again.

Figure 1-3-27 Nonfarm Payrolls over the Month Change and the Unemployment Rate: the Pace of Increase in Payrolls is Moderate



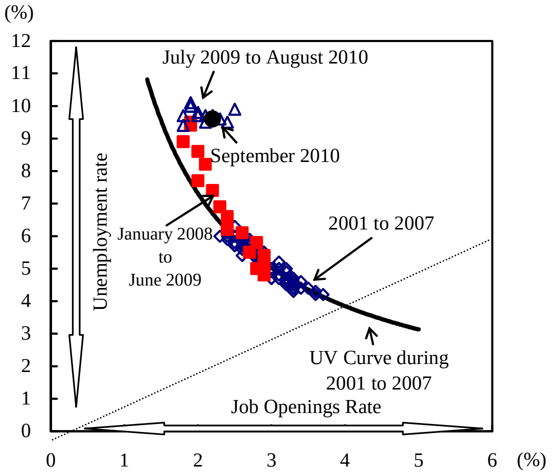
(Note) Source: U.S. Department of Labor.

- There is a structural factor that may be included in factors for the slow pace of the employment recovery in addition to the cyclical factor. UV curve on the demand and supply of the labor market shows that during the recovery phase after July 2009, the relationship between the vacancy rate and the unemployment rate is deviating from the curve of 2001 to 2007.
- As a structural factor, skill and geography mismatch may have happened. The ratio of job offers to job seekers by type of job concerning skill mismatch indicates that the ratio in the construction is low, but the ratios among engineers, medical, finance and legal jobs are high. During this recession, the number of unemployed persons has increased substantially for jobs in, for example, the construction industry. But finding a job by changing type of job is difficult.
- Long-term unemployment may make the mismatch more serious. The trend in the length of

the period of unemployment shows that it is becoming much longer (33.9 weeks on average) compared to past peaks, resulting in a lowering of the skill of those who lose their jobs, which in turn aggravates the skill mismatch.

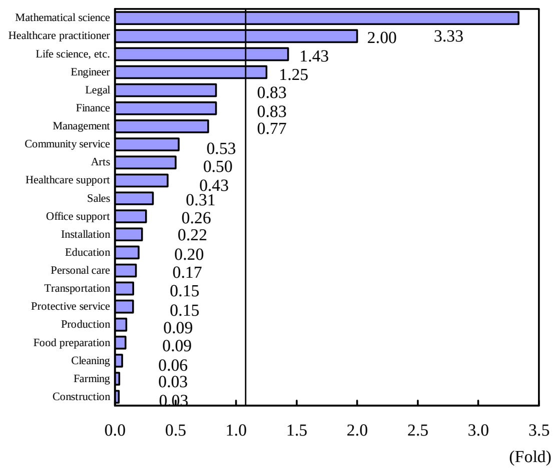
● The structural unemployment rate may have increased through the recession after December 2007 due to a mismatch in employment. If this is true, even if the economic recovery continues, it is feared that the increase in the number of people who are employed will continue to be limited and the high unemployment rate may be extended for a much longer period unless structural factors are eliminated mainly as a result of a change in the industrial structure, the strengthening of job training for the unemployed and a rise in prices for residential houses.

Figure 1-3-29 Job Openings Rate and Unemployment Rate
UV curve may have shifted upward



(Notes) 1. Source: U.S. Department of Labor.
2. The UV Curve is estimated by the Cabinet Office with "ln(U)=-6.24+(-0.93) ln(V)" (R-squared= 0.90).

Figure 1-3-30 Ratio of Job Offers to Job Seekers (by Type of Job)
Large gaps among the types of jobs



(Notes) 1. Source: Conference Board.
2. As of September 2010.

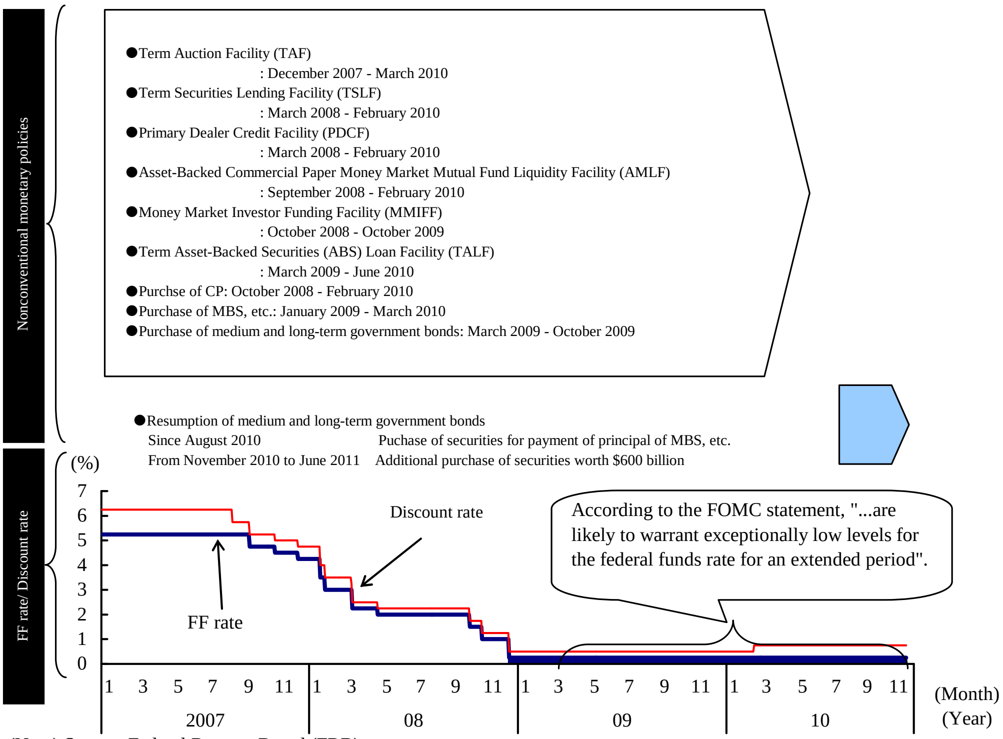
3. Trends in Fiscal Policy and Monetary Policy

(1) Monetary policy

● On the policy interest rates, although the FRB lowered the federal fund rate (FF rate) to 0 to 0.25% and has not changed it since, it terminated the nonconventional monetary policy such as the purchasing of medium- and long-term government bonds and assets with higher risks by June 2010 on the basis of the further stabilization of the financial system. The Federal Open Market Committee held until April 2010 examined the means of shrinking the FRB's balance sheet that had become bloated due to the purchase of assets and the exit strategy on the hike in the FF rate that is at an unusually low level.

● However, owing to the slow pace of economic recovery resulting from deteriorating policy effects or declining sentiment triggered by the Greek financial crisis since the spring of 2010, the economic outlook has become unusually uncertain, and downward risks for economic growth, unemployment and prices have increased. The FOMC held in August 2010 announced that it would reinvest principal payments of mortgage-backed securities (MBS) and others that the FRB owns in longer-term Treasury securities in order to limit the shrinkage of the FRB's balance sheet; they have changed their stance to monetary easing again.

Figure 1-3-37 Trends in Policy Interest Rates/Nonconventional Monetary Policies: Resumption of the Purchasing of Government Bonds

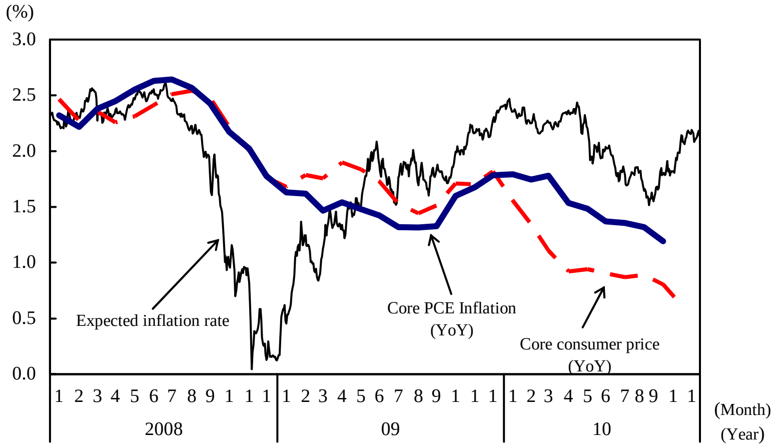


(Note) Source: Federal Reserve Board (FRB).

● The FRB examined as additional monetary stimulus (i) conducting additional purchases of longer-term securities, (ii) modifying the Committee's communication, and (iii) reducing the interest paid on excess reserves. However, since the money multiplier is still at a low level, even if the monetary base is made to increase with (i) above, credit may not be sufficient and the effect on the actual economy may be limited. Furthermore, the short-term financial market has already factored in the low probability of a raise in the FF rate in and after 2012, and so the time axis effect based on (ii) may be limited. In addition, as the interest paid on excess reserve is already at a low level, sufficient credit will not be brought about with (iii) and the effect on the real economy is likely to be relatively small.

● Regarding consumer prices, the price index for personal consumption expenditure excluding food and energy (Core PCE Inflation) declined to 1.2% year-on-year in September 2010. The core consumer price index also posted a 0.6% year-on-year increase in October 2010, the lowest since the start of the statistics in 1957, raising concern for deflation. Furthermore, the lowering trend in the rate of increase in wages as well as the substantial GDP gap has led to a significant reduction in the expected inflation rate as seen in the spread between 10-year U.S. Treasury and Treasury Inflation-Protected Securities after April 2010.

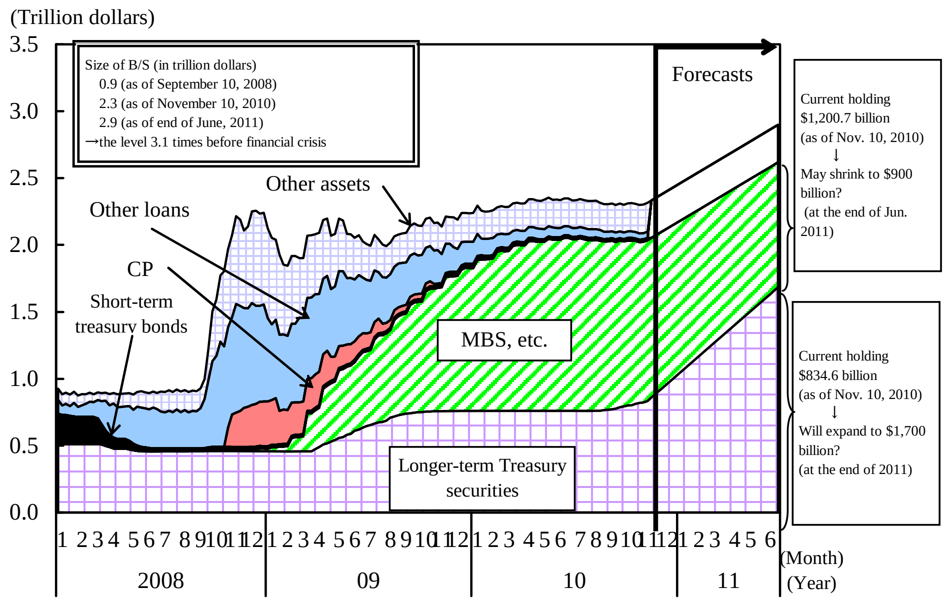
Figure 1-3-41 Consumer Price and the Expected Inflation Rate: Price on the Decline



(Notes) 1. Source: U.S. Department of Commerce, Department of Labor, Bloomberg.
2. Expected inflation rates are obtained by "yield of the U.S. treasury bonds (10-year) - yield of the U.S. Treasury Inflation-Protected Securities (10-year)".

- Meanwhile, active discussions have been held on the targets for medium- to long-term monetary policies. The FRB examined (i) providing more detailed information about the rates of inflation the FOMC considered consistent with its dual mandate, (ii) targeting a path for the price level rather than the rate of inflation, and (iii) targeting a path for the level of nominal GDP.
- The FRB decided at the FOMC in November 2010 that it would purchase additionally longer-term Treasury securities worth $600 billion ($75 billion per month) by the end of second quarter of 2011. This will increase the size of purchases together with the purchase of longer-term Treasury securities for principal payments of MBS and others to $850 billion to $900 billion ($110 billion per month). With this, the balance sheet of the FRB is estimated to expand to around $3 trillion (approximately three times the B/S before the global financial crisis) in June 2011.

Figure 1-3-38 Balance Sheet of the FRB (Asset Side): The Size of the B/S will be Further Expanded



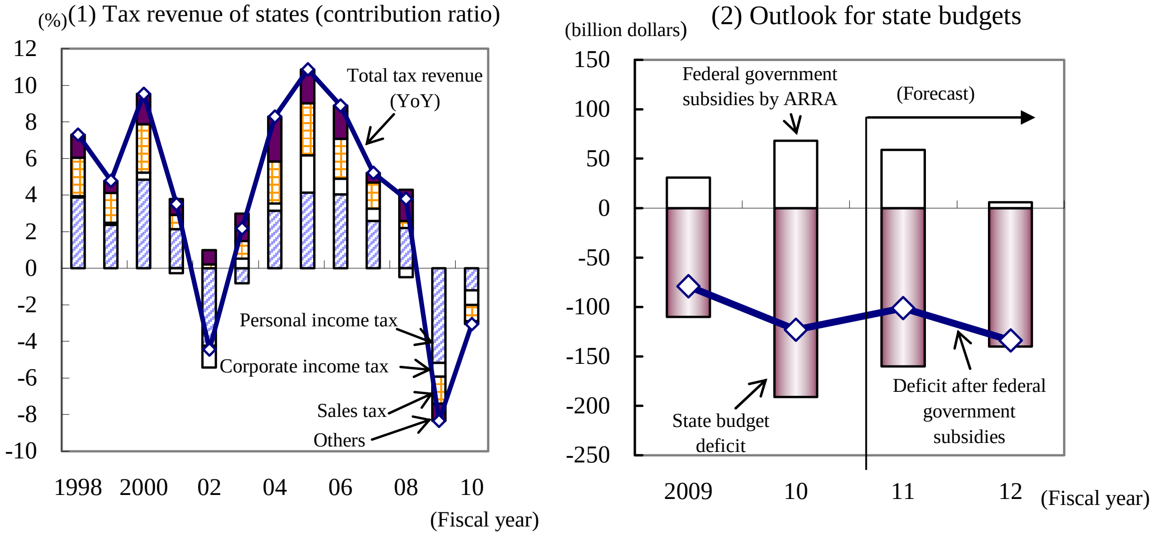
(Note) Source: Federal Reserve Board (FRB).

- With regard to the effect on credit of the additional easing measures taken after August 2010, some people hold the view that the ripple effects on the actual economy will appear six months to one year after their implementation. It is therefore necessary to watch the future trends. Meanwhile, the expected inflation rate is recovering. In addition, after the additional monetary easing policies were determined, the U.S. stock markets have returned to the level prior to the collapse of Lehman Brothers in September 2008.
- The timing of the transition to a tight monetary policy will be 2012 or later, taking into account the fact that the unemployment rate will remain at a high level or there will be a continuation of the low rate of price increases. Furthermore, in consideration of the fact that the financial sector retains vulnerability during the recovery phase after the financial crisis and there is rising concern regarding deflation, the FRB should not induce a substantial decline in the expected inflation rate by carrying out an unrefined exit strategy. It is desirable that the FRB adopts such a prudent stance that it executes any exit strategy after confirming the decline in downward risks to the real economy or the rate of increase in prices.

(2) Fiscal Policy

- The financial deficits of the Federal Government for fiscal 2010 were $1.3 trillion (8.9% of GDP), almost $120 billion lower than the deficit recorded for fiscal 2009. However, significant deficits exceeding $1 trillion have been continuing. For fiscal 2011 and subsequent years, fiscal deficits are expected to gradually shrink. However, the worsening fiscal condition of state and local governments and the issue of the management of government-sponsored enterprises (GSE) Fannie Mae and Freddie Mac will remain as a risk factor for the finances of the Federal Government.
- The finances of the state government are suffering from a shortfall in their budgets on the basis of a substantial drop in revenues. Personal income taxes and sales taxes are the main pillars of their revenue. However, after peaking in fiscal 2008, revenues have substantially declined and have not recovered to the level before the recession phase. Although the Federal Government provides support to the states for financing through fiscal stimulus measures, substantial revenue shortfalls are expected to remain.

Figure 1-3-47 Status of Budget Shortfalls

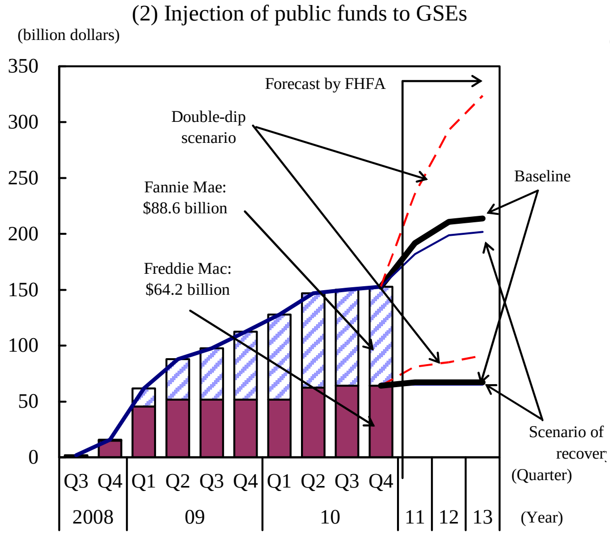


(Notes) 1. Source: Census Bureau, U.S. Department of Commerce.
2. A fiscal year is one year from July of the previous year to June of the relevant year.

(Notes) 1. Source: Center on Budget and Policy Priorities (CBPP).
2. Federal government subsidies are provided in accordance with the American Recovery and Reinvestment Act enacted in February 2009.

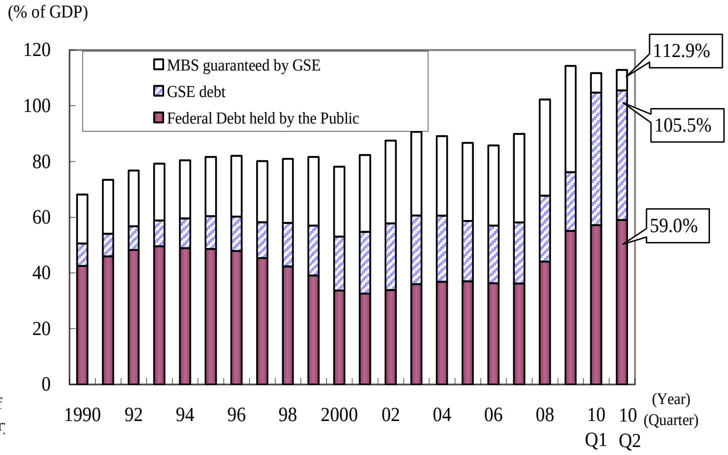
- In response to this situation, the U.S. states have made extensive efforts to reduce expenditures, and expenditures for education and health care have been slashed to a larger extent in particular. The total amount cut by 50 states in the previous recession phase was approximately $14 billion (in 2002), but the size expanded in the latest phase; $31 billion for 2009 and $22 billion for 2010. It is feared that this will affect not only health care and education, but also the real economy.
- The management of Fannie Mae and Freddie Mac deteriorated when the housing bubble collapsed. The Federal government has poured a considerable amount of public funds into these two entities since 2008. The cumulative public funds that were put into the GSEs by the end of 2010 will amount to $152.8 billion. Further injections of public funds into these two organizations are expected to occur in the future, and the estimated amount to be put into them will reach $221 to $363 billion in all as of the end of 2013.
- The outstanding debt of the Federal Government, including that of the GSEs, has reached 112.9% of the GDP. If concerns rise about the sustainability of U.S. finances, including the situation of the GSEs, this may result in turmoil in the global financial markets.

Figure 1-3-52 Capital Injection to the GSEs



(Note) Source: Federal Housing Finance Agency (FHFA), materials released by companies.

Figure 1-3-55 Debt of the Federal Government



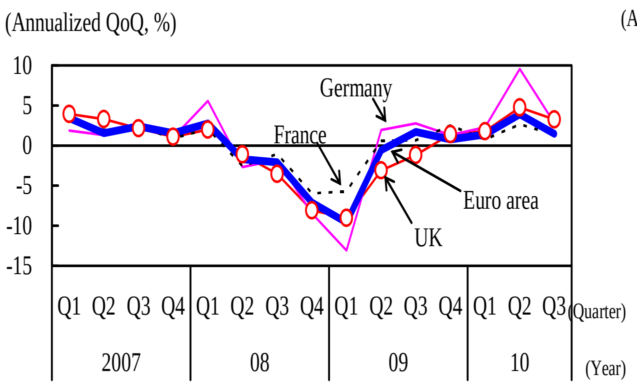
(Notes) Source: Federal Reserve Board (FRB), Bureau of Economic Analysis of the U.S. Department.

Section 4 European Economy

1. Current Situation of the European Economy

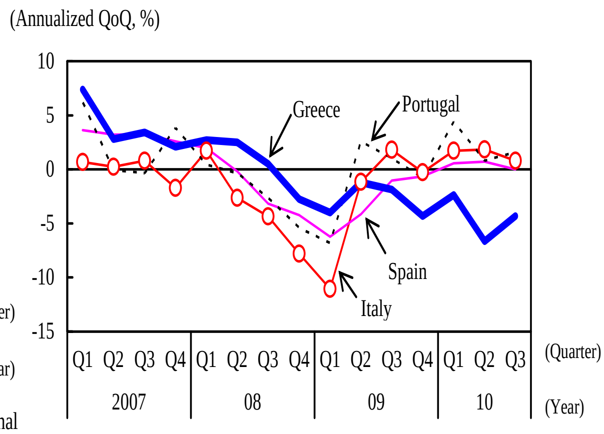
- Although the European economy has generally picked up, the situation of each country differs greatly, such as differences between the major countries including Germany and the Southern European countries, etc.
- Germany, which has a large economy which has shown high growth rates, has been the driver of the euro area economy.
- Among the Southern European countries, Greece has posted a negative figure for eight quarters in a row since the third quarter in 2008 for real economic growth rates (annualized quarter-to-quarter basis). Portugal, Italy and Spain have posted lower growth rates. Southern European countries have also presented diverse rates of economic improvement.

Figure 1-4-1 Real GDP Growth Rates of Major European Countries



(Note) Source: Eurostat, Federal Statistical Office for Germany, INSEE (National Institute of Statistics and Economic Studies, France) and Office for National Statistics, UK.

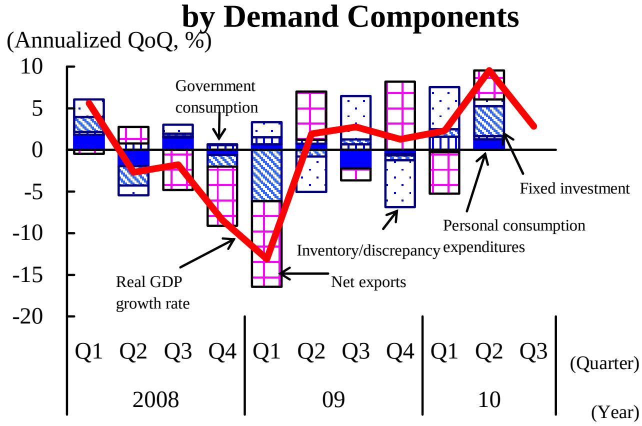
Figure 1-4-3 Real GDP Growth Rates of the Southern European Countries



(Note) Source: Eurostat.

- Germany posted an annualized quarter-to-quarter real economic growth rate of 9.5% for the second quarter in 2010, the highest growth rate since the unification of East and West Germany in 1990. In terms of demand components, the recovery of exports has pushed the German economy to higher levels. The external-demand driven economic recovery has also diffused to domestic demand as personal consumption expenditures have begun to increase.

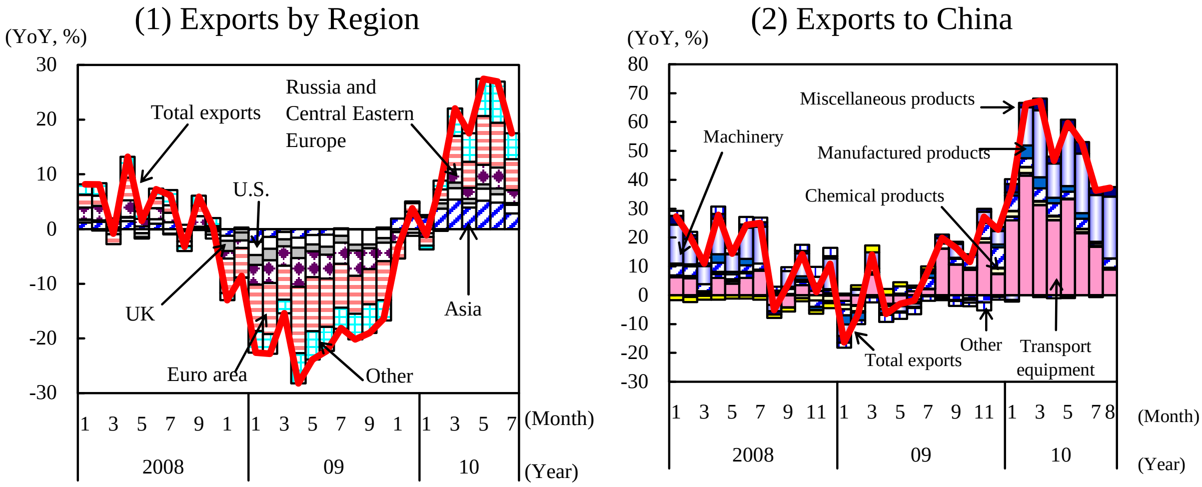
Figure 1-4-4 Real GDP Growth Rate of Germany and a Breakdown by Demand Components



(Note) Source: Eurostat.

● Exports by Germany have substantially increased on the basis of the recovery of the Asian economy and the moderate recovery of the U.S. economy. By region, Asia has emerged as a new export destination. Although the ratio of exports to China to total exports was only 4.5% in 2009, the rate of growth has been substantial and its contribution to total exports has been substantial. By the category of the goods exports to China have increased in transport equipment, machinery and chemical products.

Figure 1-4-5　German Export Trends by Region and Product



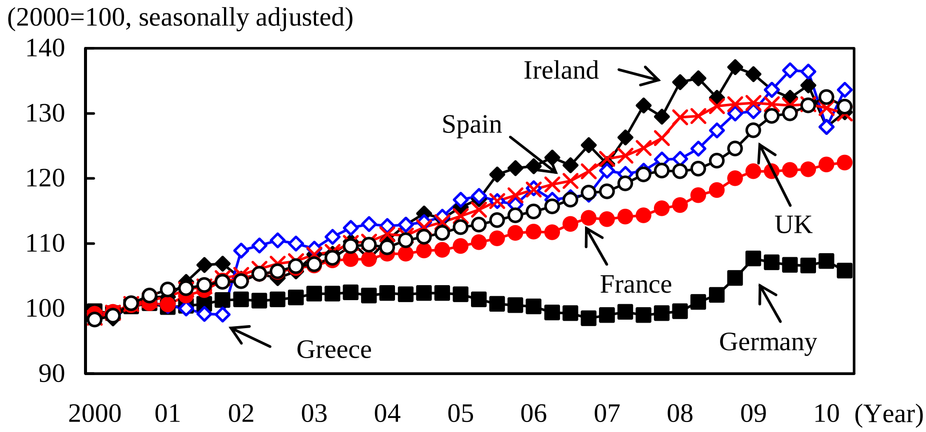
(Note) Source: Eurostat.

(Note) Source: Eurostat.

● In the euro area where a single currency is used, since each country cannot restore price competitiveness through adjustments in the foreign exchange rate, whether such countries can keep labor costs or prices levels comparatively low is important for their enhancement of price competitiveness.

● Germany's unit labor costs have increased moderately compared to Spain and Greece as a result of past labor market reform, and Germany has had an advantage in export competitiveness in terms of wages.

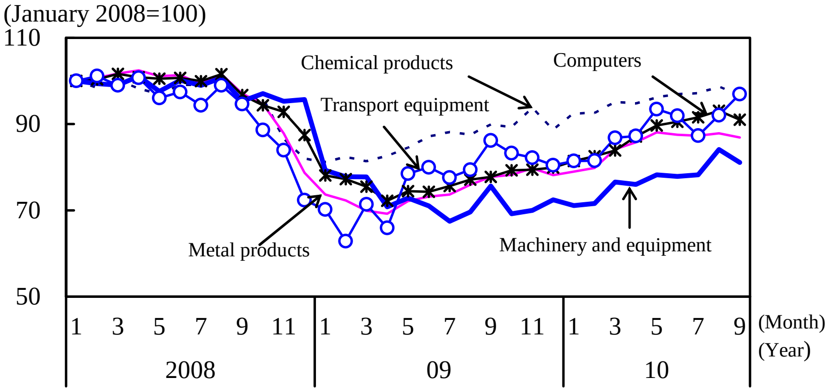
Figure 1-4-10　Unit Labor Cost Trends by Country



(Note) Source: Eurostat.

- The pick-up of the German economy has a limited effect on the Southern European economies and others. Exports to Germany from those countries posted a year-on-year increase of 12.8% in July 2010, up for six months consecutively. However, the contributions of exports to Germany to the GDP are low in them.
- Production has increased in Germany through an increase in export. Supported by the moderate recovery of the world economy, Germany's exports of machinery, transport equipment and chemical products, etc. have increased. A production increase of such items has made a major contribution to the increase in total production.

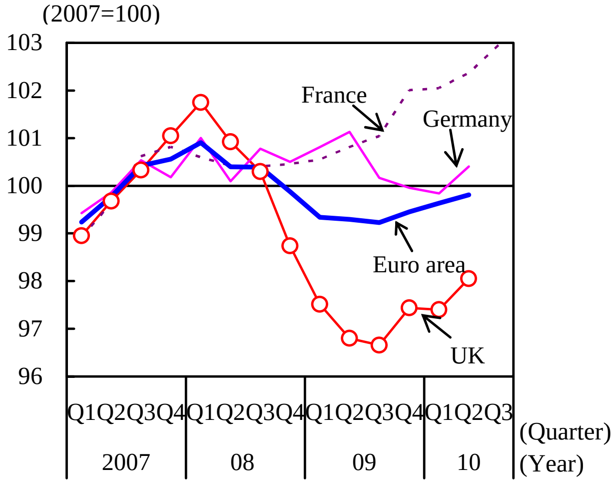
Figure 1-4-13 German Production by Industry Group



(Note) Source: Eurostat.

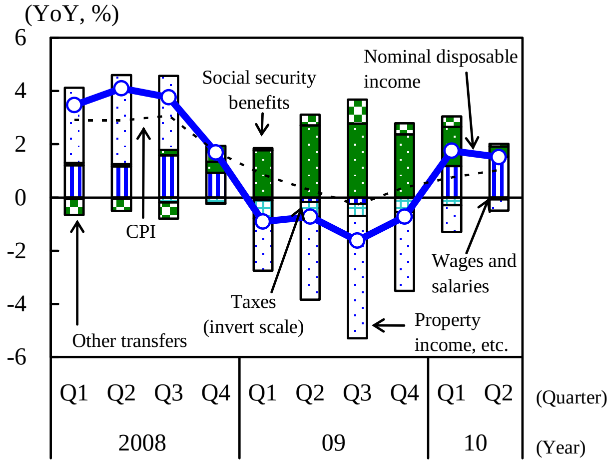
- The trend in households indicates that personal consumption expenditures in Europe have picked up.
- In Germany, the ongoing improvement of the sentiment as well as the improvement of the income environment due to an increase in production sustains the recovery of personal consumption expenditures.

Figure 1-4-14 Personal Consumption Expenditures



(Note) Source: Federal Statistical Office for Germany, INSEE (National Institute of Statistics and Economic Studies, France) and Office for National Statistics, UK

Figure 1-4-15 Household Income Trends in Germany

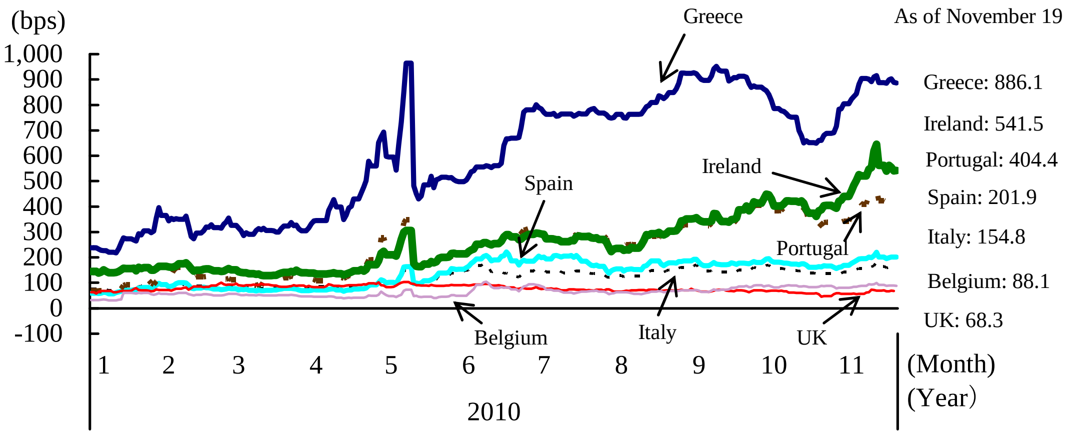


(Note) Source: Federal Statistical Office for Germany

2. Trends in Fiscal and Monetary Policies

- Concern for the sustainability of the public finances and the financial systems of Southern European countries and others such as Greece remains, and the yield spread between government bonds of such countries and German government bonds as well as sovereign CDS are on the increase again.
- Since October 2010, yields of Irish and Portuguese government bonds and sovereign CDS have leaped up on concern for their fiscal sustainability and posted record highs in November.

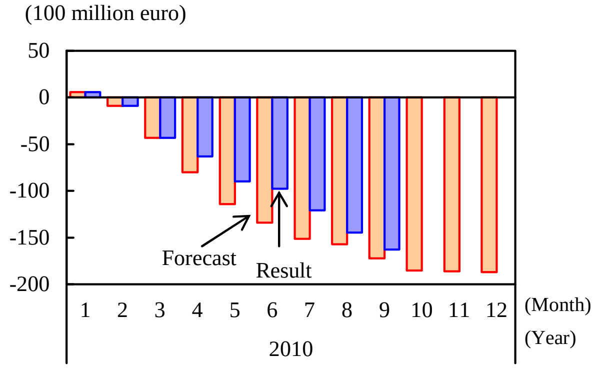
Figure 1-4-26 Trends of the Spread of the Yield on German Government Bonds (10-year)



(Note) Source: Bloomberg.

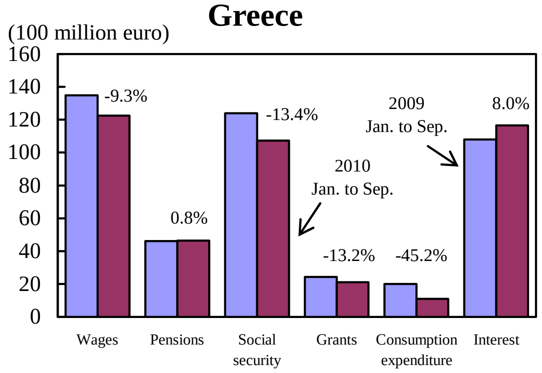
- Over the progress in the fiscal consolidation of Greece, an investigation team comprising the IMF, the European Commission and the ECB presented some concerns in its first review but gave a favorable evaluation stating that the country has made a strong start. Following the results of the review, the second tranche of finances was made in September 2010.
- Reductions in expenditures have made a great contribution that wages, social security, subsidies and current expenditures have substantially decreased.

Figure 1-4-28 Trends in the General Government Debt of Greece



(Notes) 1. Source: Ministry of Finance of Greece.
2. Accumulated figures for 2010.

Figure 1-4-29 Changes in the Main Expenditure Items in Finances of Greece

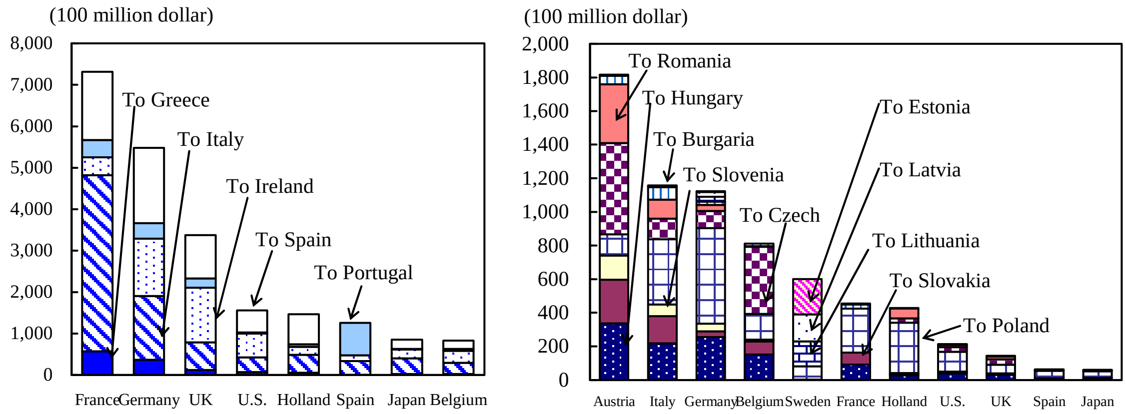


(Notes) 1. Source: Ministry of Finance of Greece.
2. Figures in the graph are year-on-year expenditure items.

- On the situation of loans by financial institutions, claims to Southern European countries and others, Central and Eastern Europe has been intensively provided with loans from the French and German financial institutions. Markets have voiced more concern about the possibility of suffering larger losses in the financial institutions of foreign countries such as France or Germany due to the decline in the price (increase in the yields) of the government bonds of Southern European countries and others, Central and Eastern European countries.
- The results of the EU Stress Test released on July 23, 2010, show that seven banks out of the tested 91 banks in the EU area failed to pass the test under the adverse scenario.

Figure 1-4-31 Foreign Claims on Southern European and Other Countries, Central and Eastern European Countries by Financial Institutions

(1) To Southern European and other countries　　(2) To Central and Eastern Europe



(Note) Source: BIS (as of end of June 2010).

- On September 30, 2010, the Central Bank of Ireland announced estimates that an additional capital injection to the nationalized Anglo Irish Bank would make up the gross capital injection to 29.3 billion euros, and 34.3 billion euros under the scenario of the stress test.
- On the same day, the Department of Finance of Ireland announced that if Ireland carries out support worth as much as 20% of the GDP to its banking system, the fiscal spending of the country for 2010 would be around minus 32% of the GDP.
- The government of Ireland on November 26 made a request to the EU and others for financial support. On that day, at the request of the government of Ireland, the EU, member countries of the euro and the IMF determined that support should be given to Ireland primarily based on the European Financial Stabilisation Mechanism (EFSM).
- The government of Ireland carries out a policy program worth 15 billion euros in total over four years comprising of fiscal consolidation and structural reforms as part of the terms for this support. The policy program has determined that a fund for the capital needed in future in the banking sector of Ireland is prepared and a wide range of measures such as the elimination of leverages and realignment in the banking sector are to be taken.
- The U.K. and Sweden, which are not members of the euro system, have also stated that they will provide bilateral loans.
- European countries have strengthened their efforts for fiscal consolidation more than ever after the Greek financial crisis.

Table 1-4-33 Fiscal Conditions and the Credit Ratings of Southern European and Other Countries

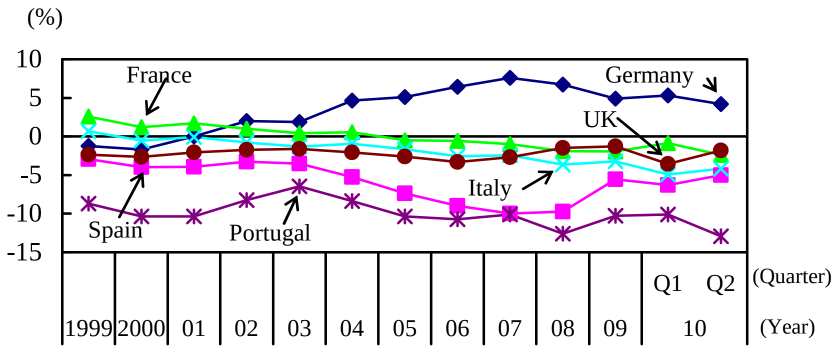
	Population (10,000 people)	2009 Nominal GDP ($100 mil.)	Credit ratings by major rating agencies			General government debt as a percentage of GDP	General government fiscal balance as a percentage of GDP		Target of fiscal restructuring
			Moody's	S&P	Fitch	2009	2009	2010	
Portugal	1,062	2,329	A1	A-	AA-	76.1	-9.3	-7.1	Reducing the fiscal deficit below the 3% of GDP by 2013
Italy	5,893	21,128	Aa2	A+	AA-	116.0	-5.3	-5.0	Reducing the fiscal deficit below the 3% of GDP by 2012
Ireland	430	2,218	Aa2	A	A+	65.5	-14.4	-32.3	Reducing the fiscal deficit below the 3% of GDP by 2014
Greece	1,125	3,237	Ba1	BB+	BBB-	126.8	-15.4	-9.4	Reducing the fiscal deficit below the 3% of GDP by 2014
Spain	4,451	14,641	Aa1	AA	AA+	53.2	-11.1	-9.1	Reducing the fiscal deficit below the 3% by 2013
Belgium	1,054	4,712	Aa1	AA+	AA+	96.2	-6.0	-4.9	Reducing the fiscal deficit below the 3% by 2012
Germany	8,281	33,300	Aaa	AAA	AAA	73.4	-3.0	-4.3	Reducing the fiscal deficit below the about 1.5% of GDP by 2014
France	6,215	26,494	Aaa	AAA	AAA	78.1	-7.5	-7.4	Reducing the fiscal deficit below the 3% of GDP by 2013
UK	6,186	21,695	Aaa	AAA	AAA	68.2	-11.4	-9.6	Achieving cyclically-adjusted current balance by 2015-16
Japan	12,740	50,689	Aa2	AA	AA-	192.9	-7.1	-7.7	Halving a percentage of the GDP of the deficit of the primary balance by fiscal 2015 at the latest, turning to a surplus by fiscal 2020 at the latest
U.S.	30,721	140,439	Aaa	AAA	AAA	83.0	-11.3	-10.8	"Equilibrating the primary balance (fiscal deficit equal to 3% of the GDP) by 2015

(Notes) 1. Source: OECD, European Commission, Government of Greece, Bloomberg.
2. The general government fiscal balance as a percentage of GDP for Greece in 2010 is based on the outlook of the government of Greece.

3. Imbalance in the Macroeconomy

- Europe's plunge into a crisis was basically due to the emergence of problems that had accumulated since the inauguration of the euro in 1999: (1) lax fiscal discipline that had sustained confidence in the euro, and (2) the imbalances in the macroeconomy.

Figure 1-4-40 Balance of the Current Account (To the GDP)



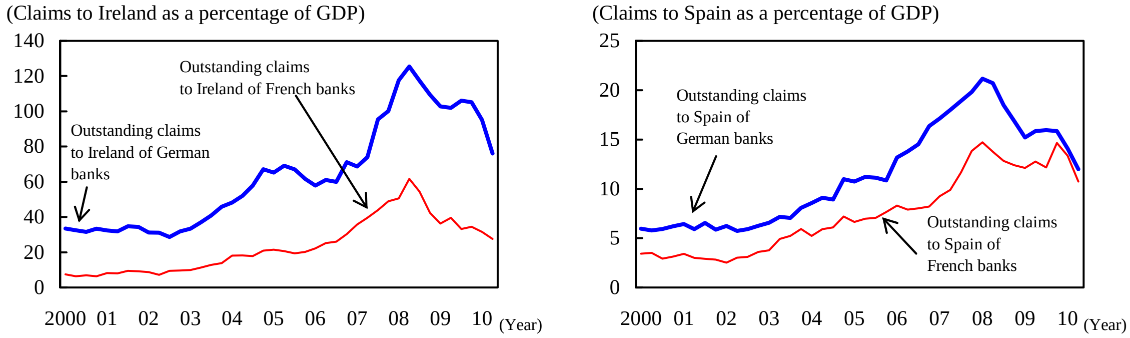
(Note) Source: Eurostat.

● In Spain and Ireland, participation in the Euro substantially reduced the real long-term interest rates, resulting in an expansion of demand for funds for housing and equipment investment. Because there has been no foreign exchange risk due to the creation of the Euro, vast amounts of money have been flowing to Southern European countries and Ireland from German and French financial institutions, causing the real estate bubble.

● The outstanding balance of claims for Ireland and Spain by German financial institutions shows the rapid increase in the first 10 years of the 21st century. As of the end of June 2010, it accounted for 76.1% of Ireland's GDP and 12.0% of Spain's GDP.

Figure 1-4-41 Trend in Outstanding Claims(% of the GDP)

(2) To Ireland (4) To Spain



(Note) Source: BIS.

● The European Union (EU) has agreed on the following efforts in EU summit meeting to prevent a recurrence of the crisis.

(i) Enforcement of fiscal discipline

- An inadequate pace in the reduction of debt where the outstanding debt is over 60% of the GDP even if the fiscal deficit is below 3% of GDP, is subject to sanctions consisting of preventive measures.
- The EU will adopt the "reverse majority" system, which automatically determines a proposal for sanctions by the European Commission unless it is disapproved; sanctions would be determined under the highly automated manner.

(ii) Macroeconomic surveillance

- Evaluation of the macroeconomic imbalances with a warning mechanism using a scoreboard of multiple economic indicators.
- Euro member countries that would not abide by the recommendations of preventive measures might be subject to sanctions.

(iii) Permanent crisis response mechanism

- Necessity to create a permanent crisis response mechanism that will replace the European Financial Stabilisation Mechanism, which is a temporary measure for three years until 2013.
- The role of the private sector, the role of the IMF and stringent conditionality, etc., are points to be discussed.