Chapter 1. Global Economic Slowdown, Narrowing Policy Leeway ~ Financial & Capital Market Contraction: Flight to Quality ~

- Flight to Quality: Since July 2011, in an environment with European sovereign debt crisis, U.S. economic slowdown concerns and debt ceiling, there was a trend towards risk avoidance. Investor funds fled stocks and crude oil which are considered to be risk assets, and flowed into U.S. bonds and gold which are considered to be safe assets. (Fig. 4)
  - Stock Prices: Europe is the epicenter of European sovereign debt crisis, so Europe (DAX) fluctuated much more than the U.S. (NY Dow).
  - Bonds: Greece and other bonds had inverse yield curves, due to default worries. (Fig. 5)
- Currencies (Fig. 6): Weak euro, due to European sovereign debt crisis, etc. The dollar was weaker overall in summer, and stronger overall since autumn.
  - From July to early August, the euro and dollar fell, while the yen and Swiss franc rose. Since September, the euro continued to be weak, while funds returned to the dollar as a safe asset. Despite such dollar movements, the yen was continually purchased.
  - Asian & resource country currencies quickly fell against the dollar since September, due to risk avoidance.

Fig. 4 Asset Prices in 2011

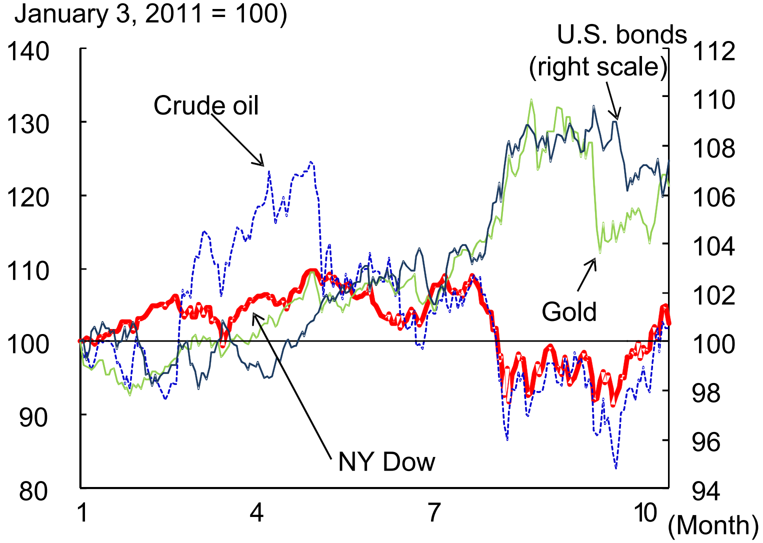


Fig.5 European Bond Yield Curves

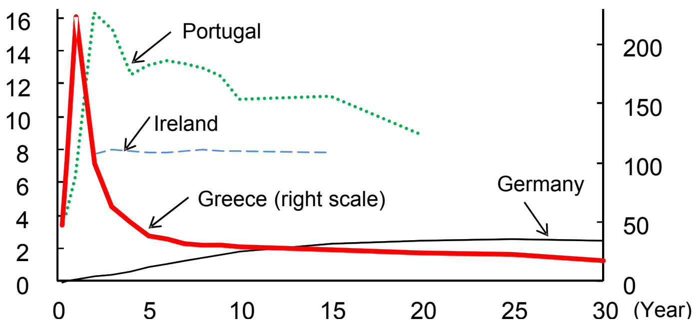
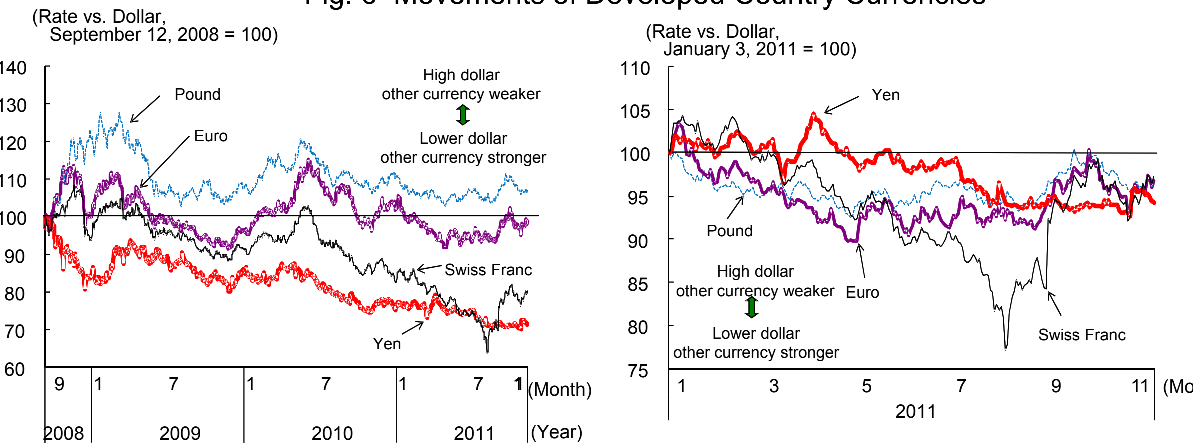
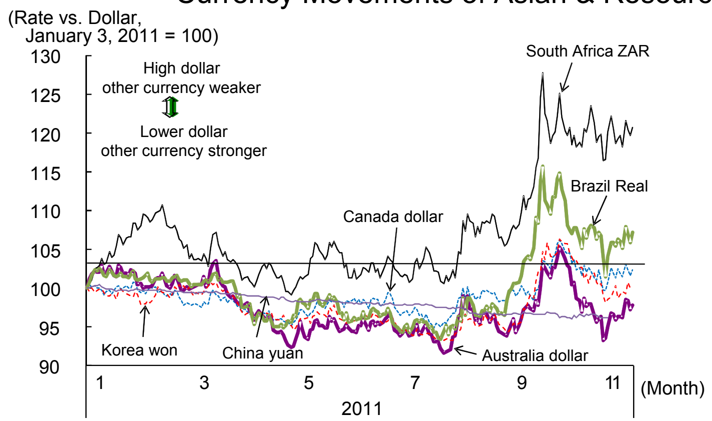


Fig. 6 Movements of Developed Country Currencies



Currency Movements of Asian & Resource Countries



Chapter 1. Global Economic Slowdown, Narrowing Policy Leeway
~ Major Developed Countries' Fiscal Policies are in a Contractionary Direction ~

- Due to fiscal mobilization after the global financial crisis, fiscal deficits grew in major developed countries, and government consolidated gross debt increased (Figures 7 & 8).
- European sovereign debt crisis and debt ceiling sparked greater market concerns about each country's fiscal situation. This greatly swayed financial and capital markets, causing great risks for real economies.
- Creation of fiscal deficit reduction plan and execution of building strong frameworks to boost feasibility (Fig. 9). On the other hand, one cannot expect fiscal stimulus, so an issue is how to support the economy while proceeding with fiscal reconstruction.
- In creating & executing credible growth strategies, and in fiscal reconstruction, one must consider the following 3 points:
  1) Build a highly feasible framework which is credible among citizens and market participants, 2) Obtain and promote citizens' understanding of fiscal constructing, 3) Maintain appropriate pace in light of economic recovery forecasts, and consider fiscal reconstruction and economic trends of own country and also of other countries

Fig. 7 General Government Fiscal Balances of Major Developed Countries (% of GDP)

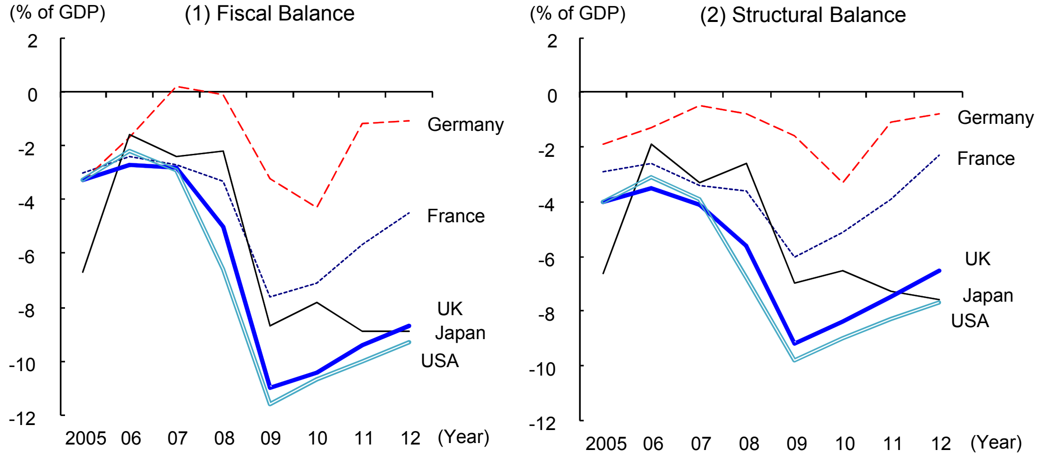


Fig. 8 General Government Consolidated Gross Debt of Major Developed Countries (Gross, Stock)

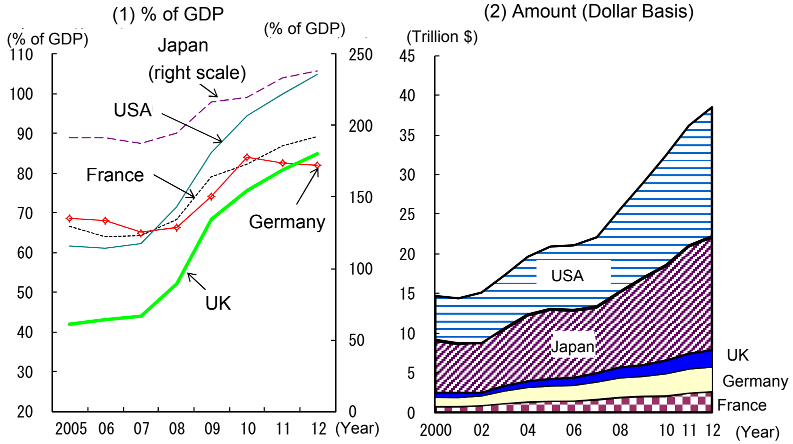


Fig. 9 Fiscal Reconstruction Initiatives of USA & Major European Countries

	Fiscal Reconstruction Targets	Moves to Legislate Fiscal Discipline in Recent Years
Italy	Fiscal deficit as 3.9% of GDP in 2011, 1.6% in 2012, 0.1% in 2013, creating a plan which aims to achieve fiscal balance by 2013 (August 2011).	Approved a law on September 14, 2011, which stipulates that fiscal balance is incorporated into the constitution as a duty of the government.
Spain	Created plan to hold fiscal deficit to 3% by 2013 (May 2010). Also considering a 4.9 billion euro additional fiscal reconstruction measure.	Approved a constitutional amendment on September 7, 2011, which incorporates fiscal balance as a duty of the government
France	• Created plan to hold fiscal deficit to 5.7% of GDP in 2011, 4.6% in 2012, 3% in 2013 (October 2010). • Due to slow economic growth thereafter, decided to implement an additional 12 billion euro of cuts (August 2011).	Lower house approved constitutional amendment bill which stipulates fiscal balance. Debate planned in upper house.
USA	• Announced target of "basic fiscal balance" by 2015 (February 2010). • Decided to cut 2.1 trillion dollars of expenditures over a 10 year period (August 2011).	Budget Control Act of 2011 enacted (August 2011)