Chapter 1. Global Economic Slowdown, Narrowing Policy Leeway
~ Great Expectations of Monetary Policy, which has Little Freedom ~

- Inflation Rates (Fig. 10): Amidst a global rise in inflation, unemployment rates jumped in Europe and USA. The situation can be called stagflation.
- Interest Rates (Fig. 11): In Europe & USA, interest rates are at low levels, with real interest rates also in a downward trend. Also, government bond purchases, etc. have expanded central bank balance sheets. On the other hand, China & India are tightening by raising interest rates each month, etc.
- Difficult Situation is expected to continue.
  - Europe & USA: Weak economic growth is expected to continue, but there is little leeway for lower interest rates. Negative stance towards further expansion of balance sheets.
  - Emerging Market Countries: Strong inflationary pressures continue, with deeply rooted concerns about inflation. Cannot easily change restrictive stance.
- Cannot expect fiscal stimulus, and with large expectations of financial policies, how to work on forming expectations is even more important. Must also consider the risks that accommodative policy of developed countries create for the global economy.

Fig. 10 Inflation & Unemployment Rates in Several Countries

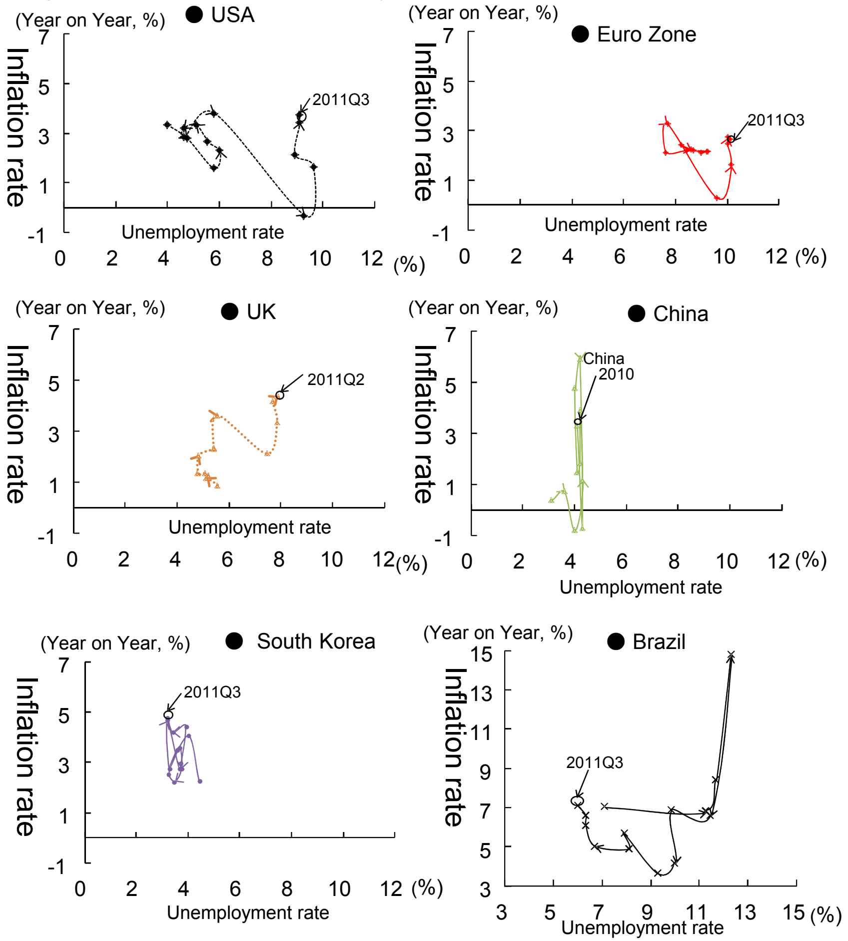
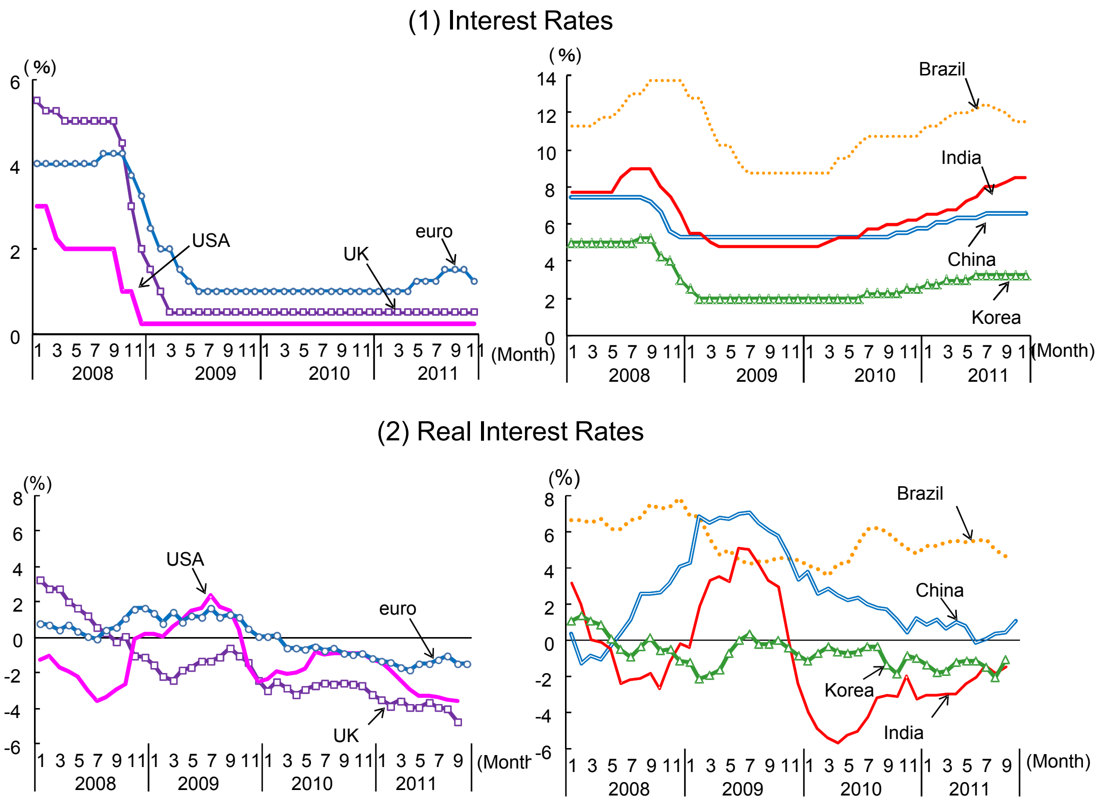
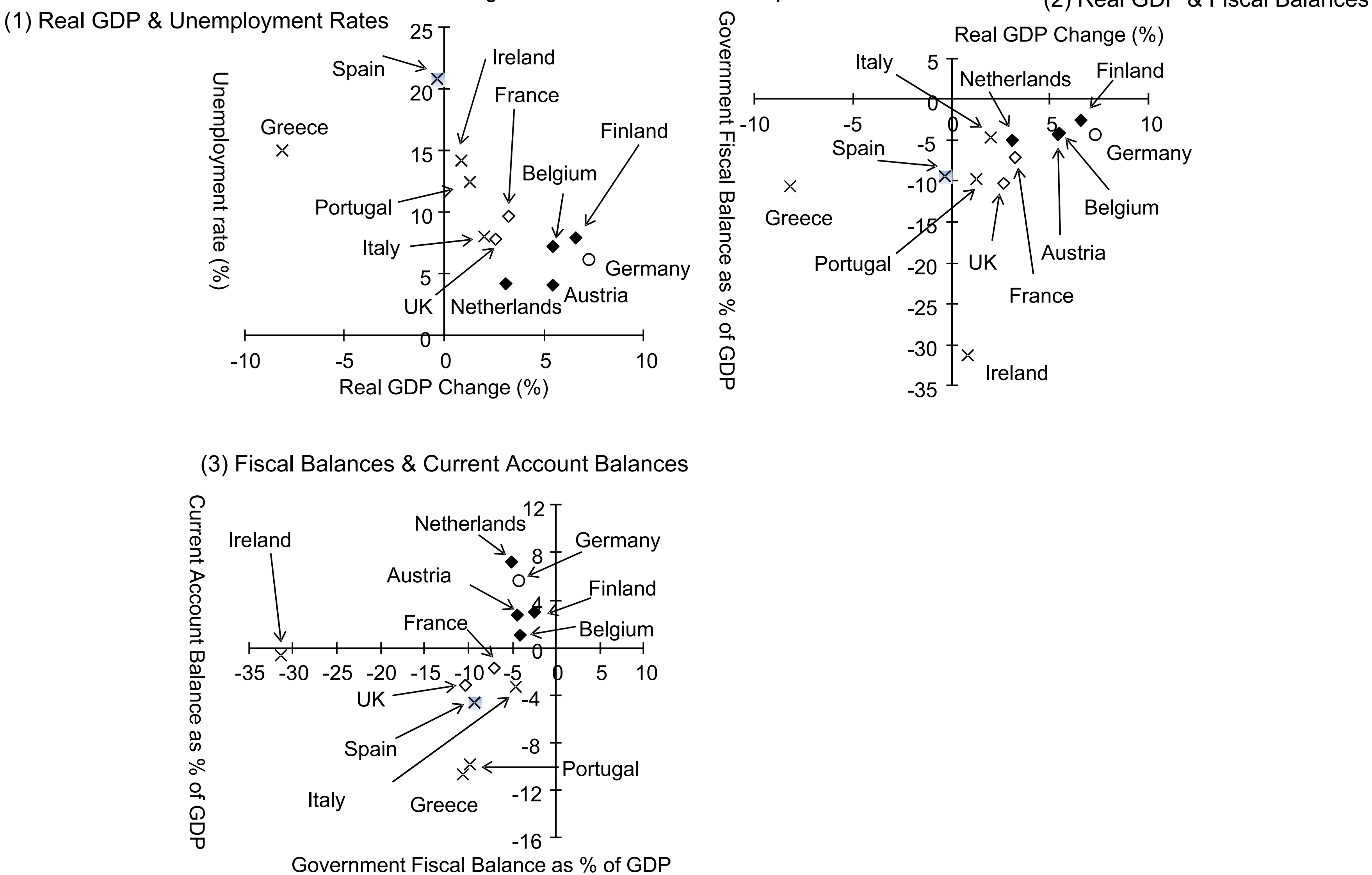


Fig. 11 Interest Rates & Real Interest Rates



- Large recoveries in Germany, Finland, Austria, etc. On the other hand, delayed recoveries in Greece and Portugal, etc. (Fig. 12)
  - Delayed recovery in real GDP with 1) High unemployment rate, 2) Lack of steady progress in improving the fiscal situation.
  - Countries with a current account surplus (such as Germany) have a fiscal deficit which is small % of GDP. On the other hand, the countries such as Greece and Portugal have both current account deficits and fiscal deficits. These countries must rely on fund inflows from other countries, and lack fiscal policy freedom, thus they have a vulnerable structure in terms of internal and external sustainability.

Fig. 12 Current Status of European Economies



- After the global financial crisis, Germany relied on exports (Fig. 13) to recover from recession, and exports affected internal demand such as personal consumption and investment, achieving a very early autonomous recovery.
  - Advantages of export environment. For example: 1) Introduction of euro removed currency risks in region, and Germany benefitted from weaker currency (Fig. 14), 2) Existence of internationally competitive industries and companies (Fig. 15), 3) Advantageous production structure from cost aspect.
  - Strong company profitability: Compared to other major European countries, manufacturing return on assets is highest in Europe (Fig. 16), and balance sheet adjustment pressure is lighter.
  - Labor market reform: Since April 2011, unemployment rate was lowest since unification of East and West Germany (Fig. 17). This is in an environment of 1) Unemployment benefit system reform, 2) Stronger employment placement & work support system, 3) More flexible labor market. Even during recessions, short-time working allowances are used to ease employment losses, and human capital is maintained (Fig. 18).
- Since spring 2011, real economic growth rate slowed. This is in an environment of 1) Weak personal consumption due to worse household income environment, 2) Weak foreign demand.

Fig. 13 Comparative Export Reliance of Major European Countries

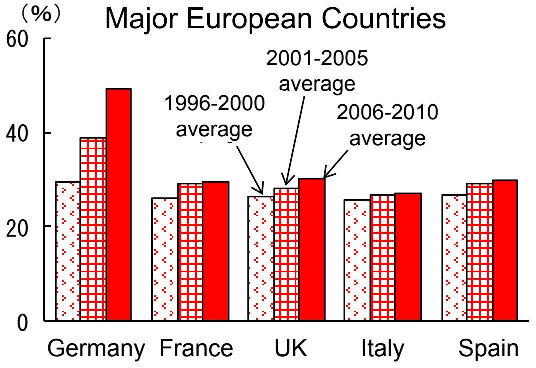


Fig. 15 Competitive Coefficients of German Manufacturing

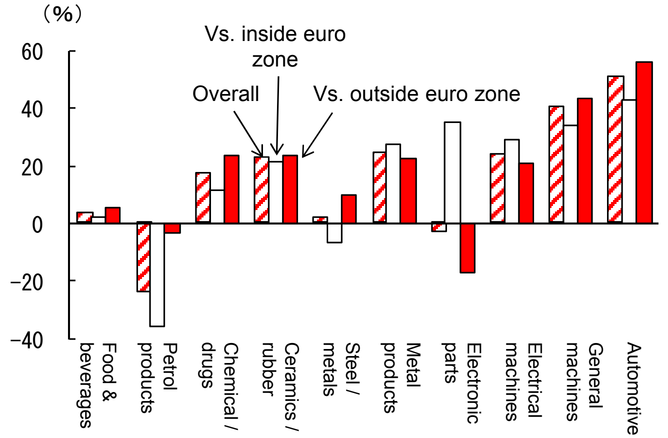


Fig. 17 European Unemployment Rates

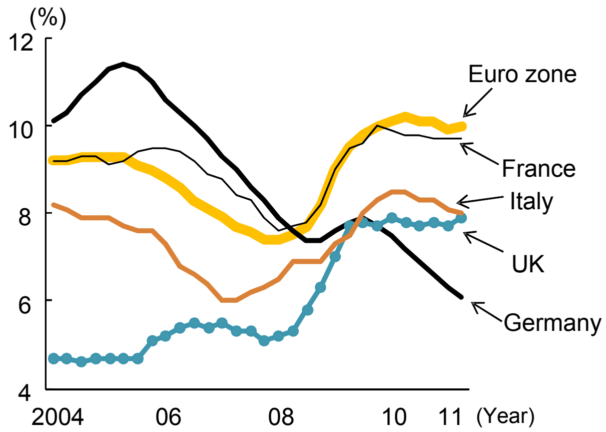


Fig. 14 Index of Price Competitiveness in Euro Zone

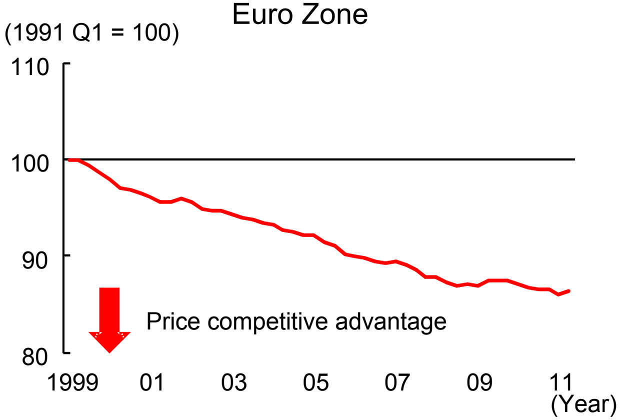


Fig. 16 Return on Assets in Major European Countries (Manufacturing)

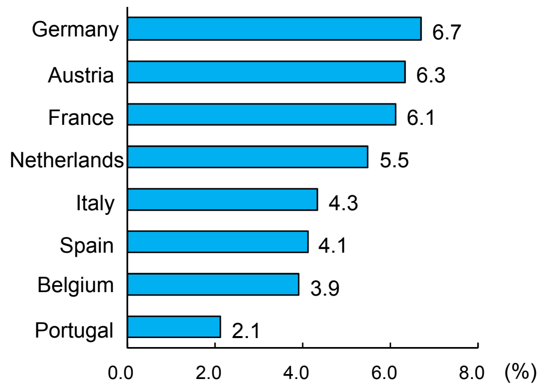
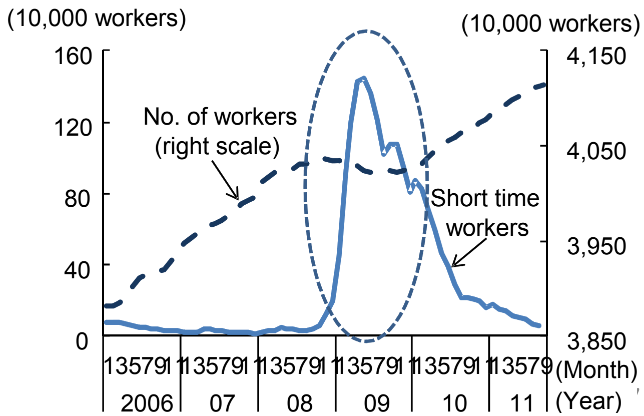


Fig. 18 No. of Workers & Short Time Workers



- UK and French economies lack progress. Both countries have domestic demand led economies, with weak movement of personal consumption. In the background are harsh employment and income environments.
  - Unemployment Rate: Remains high, and signs of decline are not seen. Especially high employment levels in youth. (Fig. 19)
  - Real Disposable Income: UK in declining trend. France continues to increase slowly, but consumption could be suppressed due to precautionary savings. (Figures 20 & 21)
- Capital investment is not growing. The excess capacity has been eased and the corporate profit has been increasing, but there remains great pressure to adjust balance sheets.
- Foreign demand is mainly from the euro zone, and was in a growth trend since mid 2009. However, since summer 2011, there is weak movement in export orders, with concerns about weaker foreign demand.

Fig. 19 Unemployment Rates in UK & France

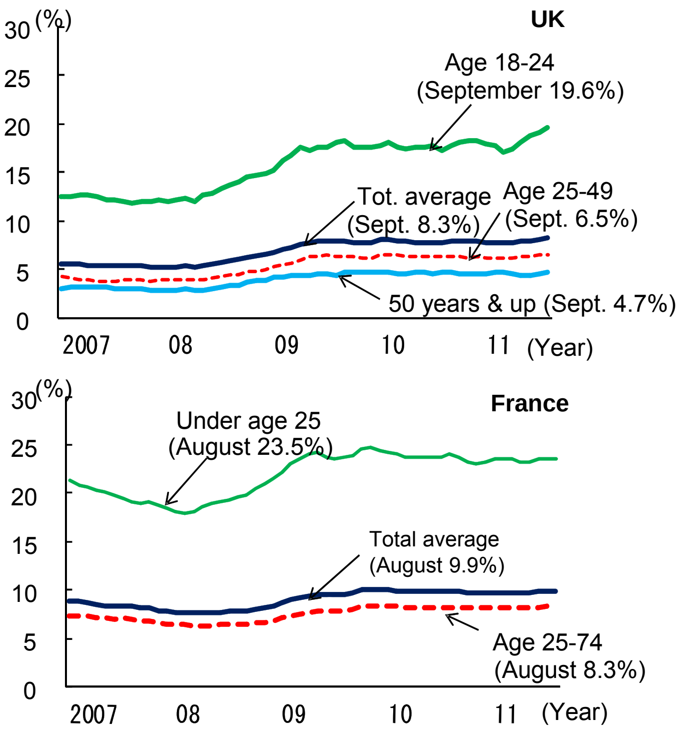


Fig. 20 Household Disposable Income in UK & France

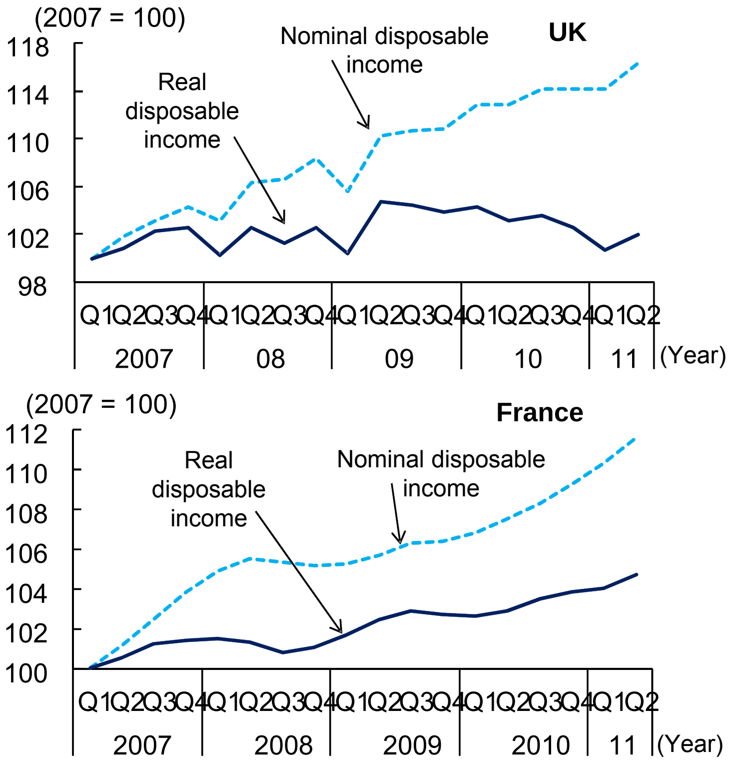


Fig. 21 Household Savings Rates in UK & France