Mitsubishi UFJ Securities Co., Ltd.

【Macroeconomics: Japan & Overseas】

Macroeconomic Focus for 2010-2011

Emerging Economies Key to GNP Growth for Japan

March, 2010

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Please refer to important disclosures and certifications located in Appendix A of this report.

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CY2010 Japanese Economy: Presence in rapidly-growing emerging markets

✓DPJ monetary and fiscal measures

⇒ **Monetary easing, supplementary budget**

- 12/1: BoJ decides on further monetary easing at extraordinary meeting
  Measures: Inject up to ¥10trn via three-month loans
- 12/8: Cabinet unveils ¥7.2trn emergency stimulus package
  Measures: ¥4.2trn in real new spending, ¥3trn in grants to local governments to offset lower tax revenue

✓Demand growth in China

⇒ **Government-driven urban migration, real estate price growth**

- 12/5-7: Delegates at Central Economic Work Conference draft macroeconomic policy for 2010
  Measures: New Five-Year Plan to promote urban migration, relaxation of rural household registration system
- Capital from industrial reorganization send urban real estate prices soaring
  Shanxi coal magnate pays RMB1.6bn cash for 20,000m^2 retail space in central Beijing (from visit to China)

✓Emergence of outwardly-focused Japanese firms

⇒ **Looking to emerging markets**

- Japan first in GNP/GDP gap due to position as net creditor (¥519trn in external assets)
  GNP/GDP gaps: Japan 3.28%, Germany 1.79%, US 0.93%, Taiwan 2.69%
- World's economic powers inwardly-focused for first 100 years after Industrial Revolution
  China and India accounted for 57.3% of the world's total industrial output in 1750

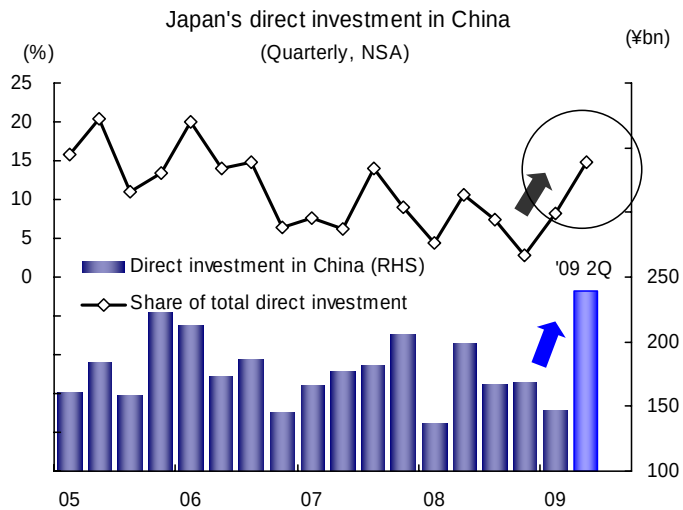
✓Outlook for global economy ⇒ External demand over internal demand

- Downward pressure on US real estate prices remains, but 0% interest rate policy to wind down from 2H 2010
  ISM manufacturing index bottomed in Dec 2008, unemployment may have peaked in Oct 2009
- Japan's household savings rate near 0% since 2008 (we estimate 0.9% for Jul-Sep 2009)
  Among 24 OECD nations, Japan has third lowest rate and Finland has sole negative rate

Real GDP growth in major regions
(provisional forecast on 25th Dec) Unit: %

FY/CY	2007	2008	(2009)	(2010)
Japan	1.9	-3.2	-2.6	1.0
US	2.0	0.8	-2.4	2.4
Euro zone	2.6	0.5	-4.0	0.6
China	13.0	9.6	8.7	9.0

Note: FY basis for Japan, CY basis for other regions
Source: MUS, from respective national statistics and IMF, MUS estimates

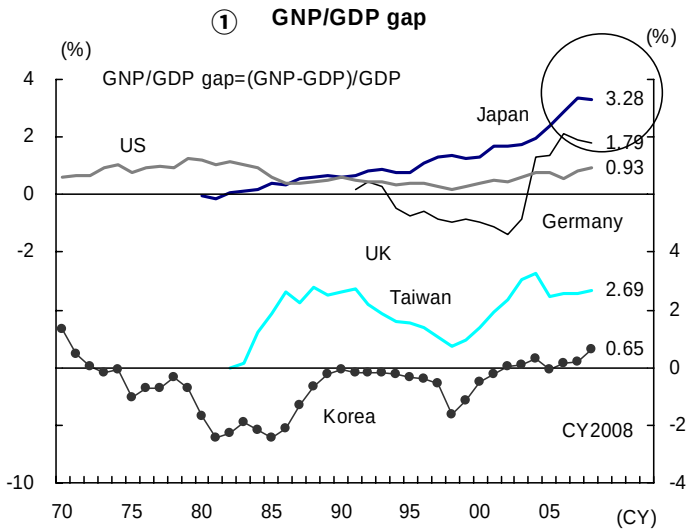


Source: MUS, from MoF and BoJ's data

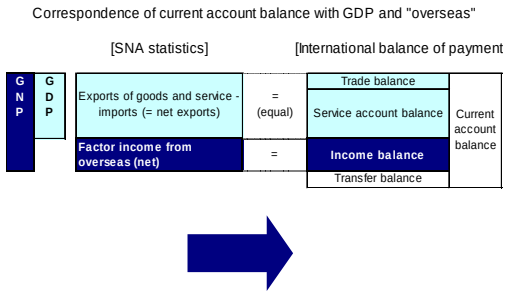
Japan's real GDP growth to turn positive in FY2010 (+1.0%) after -2.9% in FY2009 → What comes next?

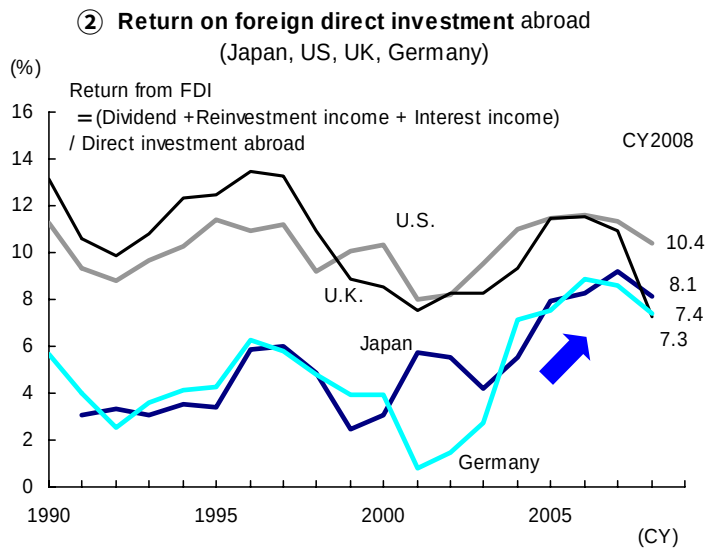
1) Emergence of outwardly-focused firms 2) Emergence of self-sustaining economy in China's interior, 3) Japanese daily goods gain popularity overseas (130mn consumers in Japan vs. 1.3bn in China); Where is Japan's Colgate?

1. What can Japan capitalize on in 2010? Outward focus

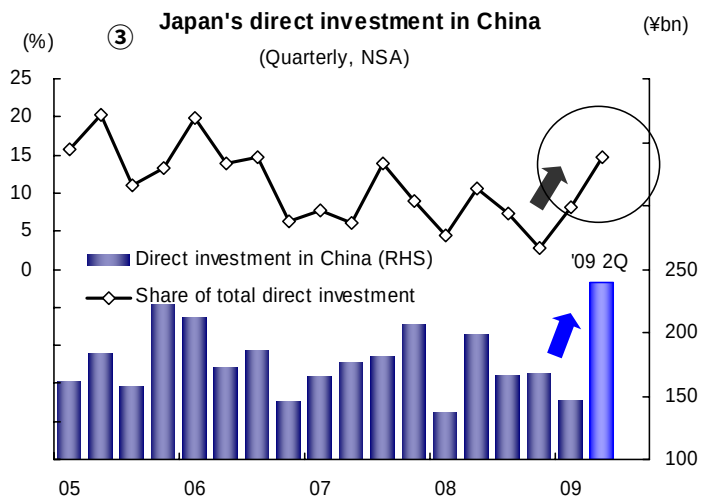


Source: MUS based on respective national statistics





Source: MUS, from respective nations' BoP data and IMF statistics



Source: MUS, from MoF and BoJ's data

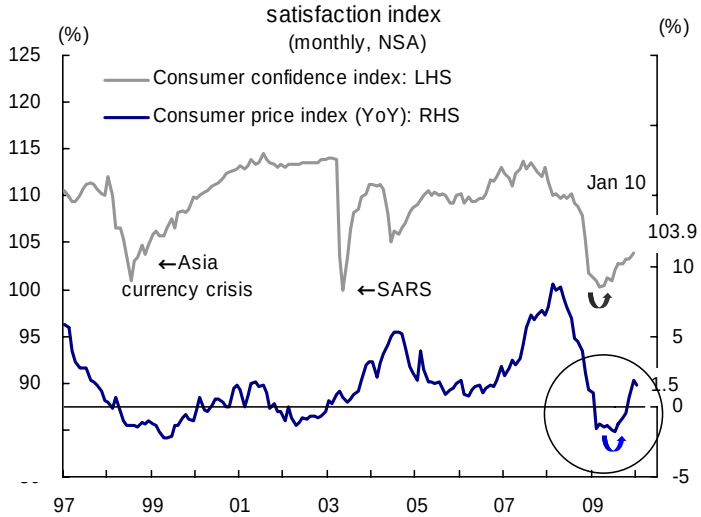
(1) Japan's GDP/GNP gap has risen to 3.28% (2008). This suggests that firms' overseas activities (via direct and securities investment) are substantially impacting the macro economy. Japan has the largest GDP/GNP gap in the developed world.

(2) Our focus is on gains from overseas direct investment. IMF data shows that Japanese direct investment was ¥61.74trn at end-2008, up 35% from 3 years earlier. These investments returned ¥5.034trn (8.1%) in 2008, and although the rate of return is lower than that of the US (10.4%), it is up sharply from 1999 (2.5%).

(3) Japanese direct investment in China turned sharply higher again from 2Q 2009. Particular increases were seen in foods, pharma, and chemicals. 2Q investment by the foods sector (¥68.5bn) easily eclipsed the previous high. The Central Economic Work Conference's decision to promote urban migration should boost demand for Japanese consumer goods in China.

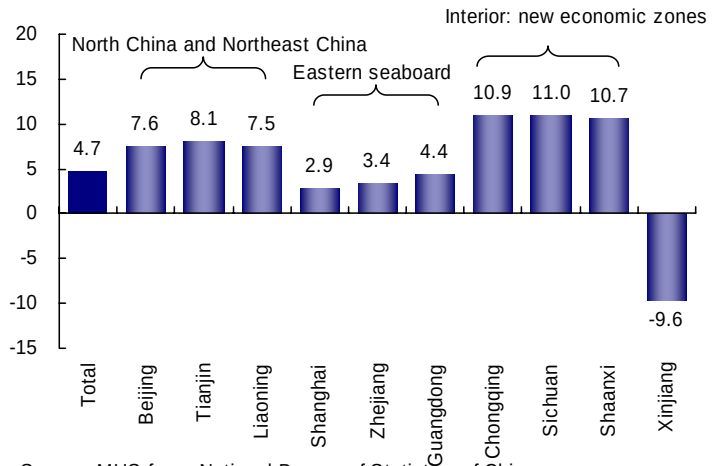
2. China's Economy: Rate hike, yuan revaluation on tap for 2010

①**China's consumer price index** and consumer satisfaction index (monthly, NSA)



Source: MUS, from National Bureau of Statistics of China

③**China's nominal GDP growth by region**, Jan-Sep 2009 (NSA, YoY, %)



Source: MUS from National Bureau of Statistics of China

② International **urban population** percentages(%)

		Historical					Forecast		2005
		1960	1970	1980	1990	2000	2005	2015	→2015
Advanced	Japan	43.1	53.2	59.6	63.1	65.2	66.0	68.0	2.0
	US	70.0	73.6	73.7	75.3	79.1	80.8	83.7	2.9
	France	61.9	71.1	73.3	74.1	75.8	76.7	79.0	2.3
	Germany	71.4	72.3	72.8	73.1	73.1	73.4	74.6	1.2
	Italy	59.4	64.3	66.6	66.7	67.2	67.6	69.5	1.9
	UK	78.4	77.1	87.9	88.7	89.4	89.7	90.6	0.9
Asia (emerg)	China	16.0	17.4	19.6	27.4	35.8	40.4	49.2	8.8
	India	17.9	19.8	23.1	25.5	27.7	28.7	31.9	3.2
	Indonesia	14.6	17.1	22.1	30.6	42.0	48.1	58.5	10.4
	Korea	27.7	40.7	56.7	73.8	79.6	80.8	83.1	2.3
	Thailand	19.7	20.9	26.8	29.4	31.1	32.3	36.2	3.9
Other	Russian	53.8	62.5	69.8	73.4	73.4	72.9	73.1	0.2
	Argentina	73.6	78.9	82.9	87.0	90.1	91.4	93.2	1.8
	Brazil	44.9	55.8	67.4	74.8	81.2	84.2	88.2	4.0
	Mexico	50.8	59.0	66.3	71.4	74.7	76.3	79.3	3.0
	Nigeria	16.2	22.7	28.6	35.3	42.5	46.2	53.4	7.2

Source : MUS, from the UN "World Urbanization Prospects: The 2007 Revision"

(1) China's consumer confidence index (based on 700 households from each of 20 cities) has dropped to levels not seen since the 1998 Asian currency crisis due to falling prices. Lower prices for farm produce and processed foods directly impact rural incomes. Price declines are no longer accelerating, and consumer sentiment appears to have bottomed.

(2) Urban migration is accelerating in China. The UN forecasts that 49.2% of China's population will live in urban areas by 2015, up from 40.4% in 2005. The 2009 Central Economic Work Conference (Dec 5-7) proposed encouraging urban migration by relaxing the rural household registration system. This will be a core element in China's 12th Five-Year plan (2011-2015).

(3) China's nominal GDP growth was just 4.7% for Jan-Sep 2009. Economic growth slowed in coastal regions owing to a slump in exports, but interior regions continue to log steady double-digit growth. An independent auto industry is invigorating the interior with help from the government (purchase incentives, etc.). Also, the rural healthcare system is expanding (90% subscription rate).

3. Japanese companies and the potential of emerging economies

① Earnings by region at European, US, and Japanese firms

Nestle S.A : Switzerland
NESN VX Equity

	FY 2008 %	FY 2007 %	FY 2006 %
Sales / Revenue	100.0	100.0	100.0
Americas	30.2	30.6	31.8
Rest of World	28.7	27.5	25.4
Europe	25.6	26.5	27.1
Asia, Oceania and Africa	15.6	15.4	15.7
Operating profits	100.0	100.0	100.0
Rest of World	36.0	35.2	32.6
Americas	34.9	35.7	37.2
Europe	22.0	22.7	23.4
Asia, Oceania and Africa	18.0	18.0	19.4
Unallocated Items	-10.9	-11.5	-12.6
Operating margin	13.6	13.9	13.5
Of which, emerging nations	26.9	26.9	27.6

Colgate Palmolive Co: U.S.
CL US Equity

	FY 2008 %	FY 2007 %	FY 2006 %
Sales / Revenue	100.0	100.0	100.0
Latin America	26.7	25.3	24.7
Europe/South Pacific	23.4	24.5	24.1
North America	18.6	19.7	21.2
Greater Asia/Africa	17.4	17.0	16.4
Worldwide (Pet Nutrition)	14.0	13.5	13.6
Operating profits	100.0	100.0	100.0
Latin America	32.8	30.6	30.8
Europe/South Pacific	20.7	23.2	24.1
North America	19.1	20.3	19.4
Worldwide (Pet Nutrition)	15.0	14.8	15.8
Greater Asia/Africa	12.4	11.0	9.9
Operating margin	19.7	19.2	17.7
Of which, emerging nations	24.1	23.5	22.9

Unicharm Corporation: Japan
8113 JP Equity

	FY 2008 %	FY 2007 %	FY 2006 %
Sales / Revenue	100.0	100.0	100.0
Japan	62.9	63.1	67.5
Asia	23.0	21.5	18.8
Europe-Netherlands	9.3	10.8	9.9
Middle east, North Africa, North Ame	4.9	4.6	3.7
Operating profits	100.0	100.0	100.0
Japan	67.3	71.2	79.8
Asia	28.6	25.2	17.0
Europe, Middle east	4.2	3.6	3.2
Operating margin	10.0	10.0	9.9
Of which, emerging nations	12.4	11.7	8.9

YAKULT HONSHA CO.,LTD: Japan
2267 JP Equity

	FY 2008 %	FY 2007 %	FY 2006 %
Sales / Revenue	100.0	100.0	100.0
Japan	71.7	74.3	75.6
Mexico, Brazil, Argentina	14.5	13.6	12.6
Asia, Oceania, Europe	13.9	12.1	11.8
Operating profits	100.0	100.0	100.0
Japan	56.2	51.9	55.5
Mexico, Brazil, Argentina	36.1	36.6	31.5
Asia, Oceania	8.4	8.9	6.8
Europe	-0.6	2.6	6.2
Operating margin	5.7	7.1	8.7
Of which, emerging nations	21.1	25.9	27.8

Shiseido: Japan
4911 JP Equity

	FY 2008 %	FY 2007 %	FY 2006 %
Sales / Revenue	100.0	100.0	100.0
Japan	62.0	63.5	67.6
Asia/Oceania	17.2	15.5	13.2
Pharma	12.8	12.8	11.4
US	8.0	8.2	7.8
Operating profits	100.0	100.0	100.0
Japan	39.4	52.4	57.4
Asia/Oceania	35.9	26.2	23.5
Asia, Oceania and Africa	17.7	14.8	13.2
US	7.0	6.6	5.9
Operating margin	7.2	8.8	7.2
Of which, emerging nations	14.1	14.2	12.3

Kirin Holdings: Japan
2503 JP Equity

	FY 2008 %	FY 2007 %	FY 2006 %
Sales / Revenue	100.0	100.0	100.0
Japan	75.1	84.2	85.4
Asia/Oceania	20.2	12.2	11.0
Other	4.7	3.6	3.6
Operating profits	100.0	100.0	100.0
Japan	73.2	68.3	70.2
Asia/Oceania	21.9	27.1	25.8
Other	4.9	4.5	4.1
Operating margin	6.3	6.7	7.0
Of which, emerging nations	7.7	16.4	16.6

Source: MUS, from company data

② Share of total global production value since 1750

Industrial production	1750	1860	1900	1913	1938	1953	1973	1980
Russia	5.0%	7.0%	8.8%	8.2%	9.0%	10.7%	14.4%	14.8%
France	4.0%	7.9%	6.8%	6.1%	4.4%	3.2%	3.5%	3.3%
Japan	3.8%	2.6%	2.4%	2.7%	5.2%	2.9%	8.8%	9.1%
Germany	2.9%	4.9%	13.2%	14.8%	12.7%	5.9%	5.9%	5.3%
Italy	2.4%	2.5%	2.5%	2.4%	2.8%	2.3%	2.9%	2.9%
United Kingdom	1.9%	19.9%	18.5%	13.6%	10.7%	8.4%	4.9%	4.0%
United States	0.1%	7.2%	23.6%	32.0%	31.4%	44.7%	33.0%	31.5%
Sub total	20.1%	52.0%	75.8%	79.8%	76.2%	78.1%	73.4%	70.9%
China	32.8%	19.7%	6.2%	3.6%	3.1%	2.3%	3.9%	5.0%
India [1]	24.5%	8.6%	1.7%	1.4%	2.4%	1.7%	2.1%	2.3%
Sub total	57.3%	28.3%	7.9%	5.0%	5.5%	4.0%	6.0%	7.3%
Grand total	100%	100%	100%	100%	100%	100%	100%	100%
(Index) [2]	(127.3)	(184.4)	(540.8)	(932.5)	(1,684)	(3,070)	(9,359)	(11,041)

1 India & Pakistan through 1938. India won independence from the UK in 1947, and Pakistan became independent of India
2 Index: UK output in 1990 = 100
Source: Paul Bairoch, "International Industrialization Levels from 1750 to 1980" (1982)、International Monetary Fund, World Economic Outlook Database, October 2009

(1) Many US and European companies are doing well in emerging markets. Switzerland's Nestle is one example. 54.0% of Nestle's 2008 OP came from outside Europe and the US. Colgate (US) earned 45.2% of its 2008 OP in South America, Asia, and Africa, and its OPM in South America is 28.9%. Unicharm earned 28.6% of its OP from Asia (excl. Japan) in 2008. South America accounts for 36.1% of Yakult's OP, and the OPM there is 25.2%.

(2) In 1750, as the industrial revolution was beginning in England, China and India accounted for 57.3% of the world's total industrial output (32.8% for China and 24.5% for India). Even after the Opium Wars ended in 1860, China ranked second behind England with a 19.7% share of global industrial output. This means that during the first 100 years after industrial revolution, European countries were growing by producing added value overseas. We think the global economy is turning back toward this model now.

4. Policy measures: BoJ less aggressive

① Comparison of central bank balance sheets

US bn USD、%

End of Dec 2009 (09/12/30)

Assets	Balance	Share	Liability・Capital	Balance	Share
Gold certificate account	11.0	0.5	Bank notes	889.7	39.8
SDR	5.2	0.2	Reverse repurchase agreements	70.5	3.1
Coin	2.0	0.1	Depository institutions	1,025.3	45.8
Loans and discounts	270.0	12.1	US treasury, general account	154.8	6.9
Repurchase agreements	0.0	0.0	Foreign official	2.3	0.1
US treasury securities	159.9	7.1	Other	26.8	1.2
MBS	908.3	40.6	Deferred availability cash items	2.2	0.1
Federal agency debt securities	776.6	34.7	Other liabilities and accrued dividends	13.6	0.6
Items in process of collection	0.3	0.0	Capital	52.1	2.3
Bank premises	2.2	0.1			
Central bank liquidity swaps	10.3	0.5			
Other	91.4	4.1			
Total assets	**2,237.3**	**15.7**			
Nominal GDP	14,242.1				

Japan tn JPY、%

End of Dec 2009

Assets	Balance	Share	Liability・Capital	Balance	Share
Gold	0.4	0.4	Bank notes	81.0	66.1
Cash	0.2	0.2	Current deposits	20.3	16.6
Foreign currency assets	5.5	4.5	Other deposits	0.1	0.1
Receivables under resale agreements	9.8	8.0	Deposits of the government	2.6	2.1
Bills purchased	0.0	0.0	Payables under repurchase agreements	11.9	9.7
Loans and discounts	32.5	26.5	Bills sold	0.0	0.0
Depository Japanese government securities	0.0	0.0	Borrowings of Japanese government securities	0.0	0.0
Japanese government securities	72.0	58.8	Other	4.0	3.3
Asset backed securities	0.0	0.0	Capital and legal & special reserves	2.7	2.2
Pecuniary trusts	1.3	1.1			
Cash collateral for Japanese government securities borrowed	0.0	0.0			
Other	0.8	0.6			
Total assets	**122.5**	**26.0**			
Nominal GDP	471.0				

Euro zone bn Euro、%

End of Dec 2009 (10/1/1)

Assets	Balance	Share	Liability・Capital	Balance	Share
Gold	266.9	14.0	Bank notes in circulation	806.5	42.3
Foreign currency assets	195.5	10.3	Current accounts (covering the minimum reserve system)	233.5	12.3
Claims on euro area residents denominated in foreign currency	32.2	1.7	Other deposits	162.1	8.5
Claims on non-euro ara residents denominated in euros	15.2	0.8	Other liabilities to euro area credit institutions denominated in euros	0.3	0.0
Lending to euro area credit institutions related to monetary policy operations denominated in euros	749.9	39.4	Debt certificates issued	0.0	0.0
Other claims on euro area credit institutions denominated in euros	26.3	1.4	Liabilities to other euro area residents denominated in euros	129.7	6.8
Securities of euro area residents denominated in euros	328.7	17.3	Liabilities to non-euro area residents denominated in euros	46.8	2.5
General governemnt debt denominated in euros	36.2	1.9	Liabilities to other euro area residents denominated in foreign currency	4.0	0.2
Other assets	254.2	13.3	Liabilities to non-euro area residents denominated in foreign currency	9.6	0.5
			Counterpart if special drawing rights allocated by the IMF	51.2	2.7
			Other liabilities	167.8	8.8
			Revaluation accounts	220.2	11.6
			Capital and legal & special reserves	73.0	3.8
Total assets	**1,904.9**	**21.1**			
Nominal GDP	9,007.5				

② Comparison of central bank balance sheets

China bn RMB、%

End of Nov 2009

Assets	Balance	Share	Liability・Capital	Balance	Share
Gold	67	0.3	Bank notes in circulation	3,890	17.3
Foreign currency assets	16,897	75.1	Reserve deposits	8,988	39.9
Other foreign assets	1,236	5.5	Deposits of non-financial institutions	62	0.3
Claims on governments	1,568	7.0	Bonds issued	4,056	18.0
Claims on other depository institutions	778	3.5	Foreign liabilities	75	0.3
Claims on other financial corporations	1,169	5.2	Government deposits	3,030	13.5
Claims on non-financial institutions	4	0.0	Own capital	22	0.1
Other	780	3.5	Other	2,376	10.6
Total assets	**22,499**	**67.1**			
Nominal GDP	33,535				

Russia bn BRY、%

End of Nov 2009

Asset	Balance	Share	Liability・Capital	Balance	Share
Precious metals	746	4.8	Cash in circulation	4,025	26.0
Funds placed with nonresidents and securities issued by nonresidents	12,448	80.4	Funds in accounts with the Bank of Russia	1,214	7.8
Credits and deposits	1,708	11.0	Funds of resident credit institutions	1,865	12.0
Russian government securities	351	2.3	Russian government funds	5,442	35.1
Other securities	109	0.7	Float	52	0.3
Fixed assets	60	0.4	Issued securities	111	0.7
Other assets	61	0.4	Other liabilities	824	5.3
			Capital	1,950	12.6
Total asset	**15,483**	**41.5**			
Nominal GDP	37,306				

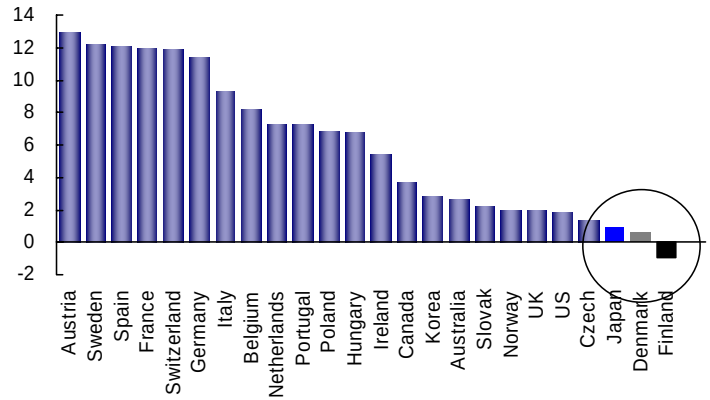
Source: MUS, from respective nations' central bank data

(1) BoJ's balance sheet is relatively large at 26.0% of nominal GDP (the FRB's is 15.7%). However, while the FRB has notes outstanding totaling $889.7bn and deposits totaling $1.0253trn, the BoJ's respective totals are ¥81.0trn and ¥20.3trn. The FRB's ratio of commercial bank deposits to total notes outstanding is 1.15x, but the BoJ's corresponding ratio is just 0.25x.

(2) The notes-deposits ratio at the People's Bank of China is 2.37x. While foreign central banks may have lower asset quality because they supply liquidity using non-traditional means (such as MBS purchases), there is a stark policy difference with respect to providing liquidity. Looking ahead, it will be interesting to see whether the BoJ holds to its "bank note rule" (a self-imposed rule limiting long-term JGB holdings to no more than the total amount of notes in circulation).

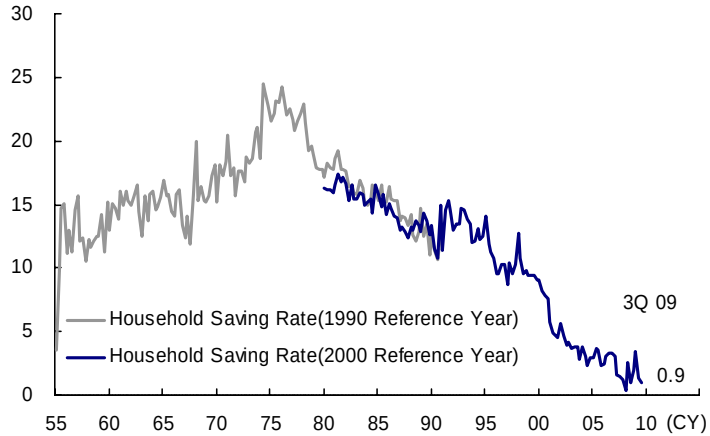
5. Post-financial crisis: Japan's savings rate and stimulus-driven demand

① **Household savings rates** globally (2008)



Note: Japanese figures are MUS estimates for Jul-Sep 2009 based on MIC data; other figures are for 2008
Source: MUS, from OECD "Economic Outlook 85 Database" data

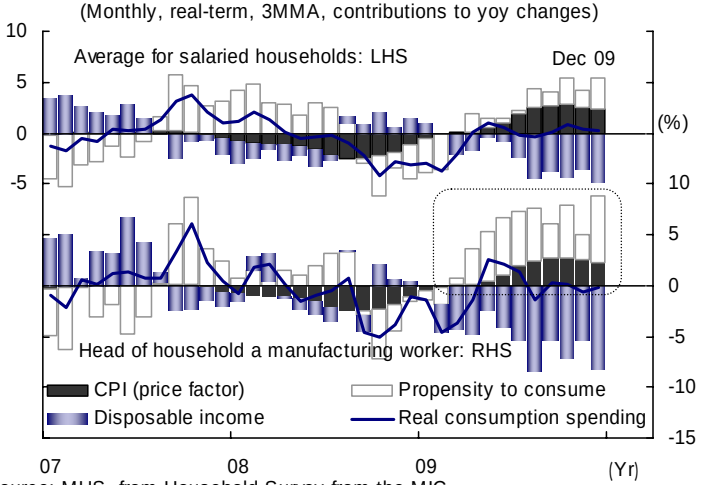
② Japan: **Household savings rate** (quarterly, SA, %)



Note: Figures from 2Q 09 are MUS estimates based on Cabinet Office quarterly estimates
Source: MUS, from Cabinet Office data

③ **Factor analysis of real consumption**: salaried households

(Monthly, real-term, 3MMA, contributions to yoy changes)



Source: MUS, from Household Survey from the MIC

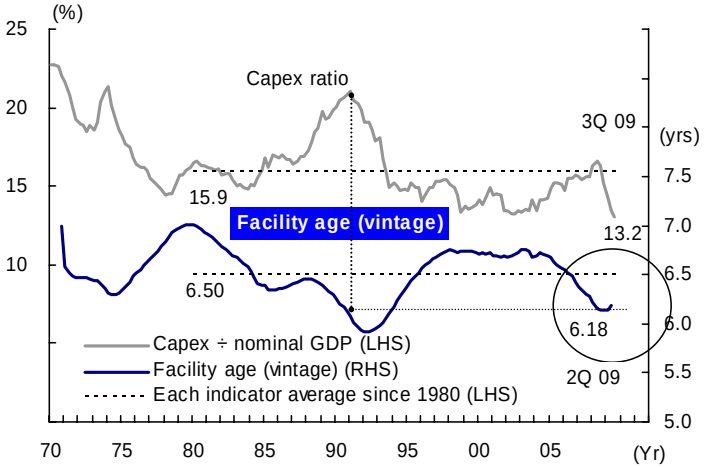
(1) Japan's household savings rate remained positive in 3Q 2009 (0.9%) but was near 0%. Among 24 major OECD nations, only Denmark and Finland rank below Japan. This low rate could dampen consumer spending in Japan.

(2) In Finland (which has a negative savings rate), consumption-related macro data has been weak since Oct-Dec 2008. Consumer spending there amounted to 50.4% of nominal GDP in Jan-Mar 2009, about the same as in Japan (59.4% in Apr-Jun). Both figures are low for developed economies.

(3) A steady decline in disposable incomes dampened consumer spending in 2009. From May, however, consumption picked up, thanks in part to stimulus programs that encourage purchases of automobiles and appliances. Consequently, average propensity to consume has risen and household savings are being used. This can only mean future demand is being brought forward.

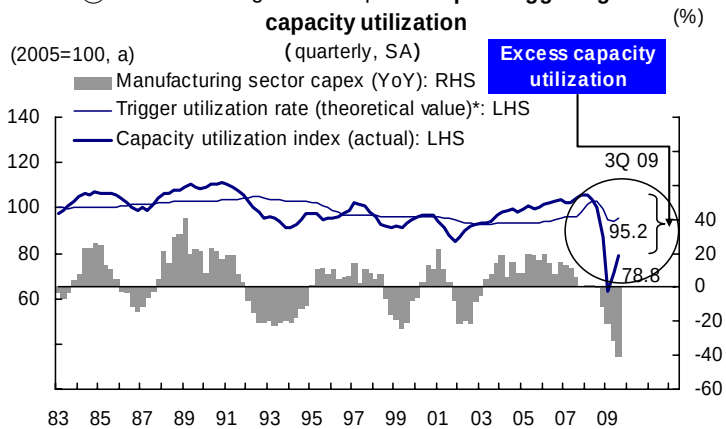
6. Japanese Economy: Upgrades and domestic overcapacity; the next move

① Capex ratio, **Vintage**
(Quarterly; SA)



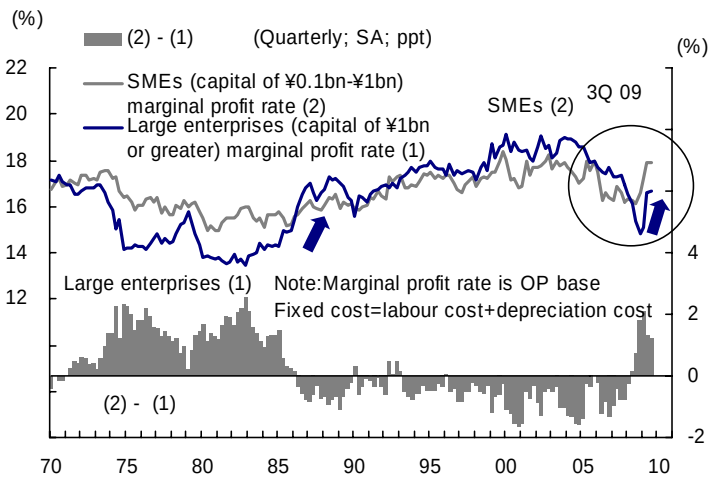
Source: MUS, from the Cabinet Office's National Accounts and Gross Capital Stock of Private Enterprises data

② Manufacturing sector capex & **capex-triggering capacity utilization**



Note: Capacity utilization index = a+b* capex (YoY change): "a" is calculated using regression analysis.
Source: MUS from MoF's Financial Statement Statistics of Corporations by Industry and METI's Indices of Operating Ratio data

③ **Marginal profit ratio** (by size of capital)



Source: MUS from MOF Financial Statements Statistics of Corporations by Industry data

(1) Equipment vintage (6.18years) is now below the average since 1980 (6.50 years). This suggests equipment upgrades have been completed. It appears capex stopped growing in 1H 2008. However, if capex continues declining at the 4Q 2008 pace, equipment could be outdated after 1-2 years.

(2) As the age of equipment had fallen steadily by 1H 2008, companies stopped replacing equipment that could run consistently at a high operating rate. Companies have hiked utilization to meet restocking needs as the impact of the financial crisis has receded. However, the gap between the actual utilization rate and the rate we estimate would trigger new capex suggests that companies have sufficient leeway in terms of utilization.

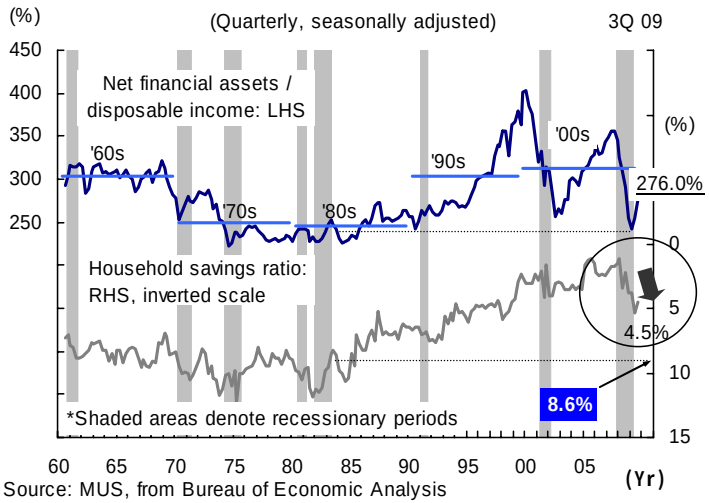
(3) Marginal profitability, which had been declining since 2003, is finally beginning to stabilize. This owes in part to declining raw material costs in 2009. As companies consolidate diversified business lines, we are likely to see the first change in earnings structures in 25 years. The key issue for companies is whether they can turn baby boomer retirements into a positive.

Mitsubishi UFJ Securities Co., Ltd.

7. US economy: Household savings rate adjustment, background to historical rate hikes

① **US household savings ratio** and outstanding net financial assets

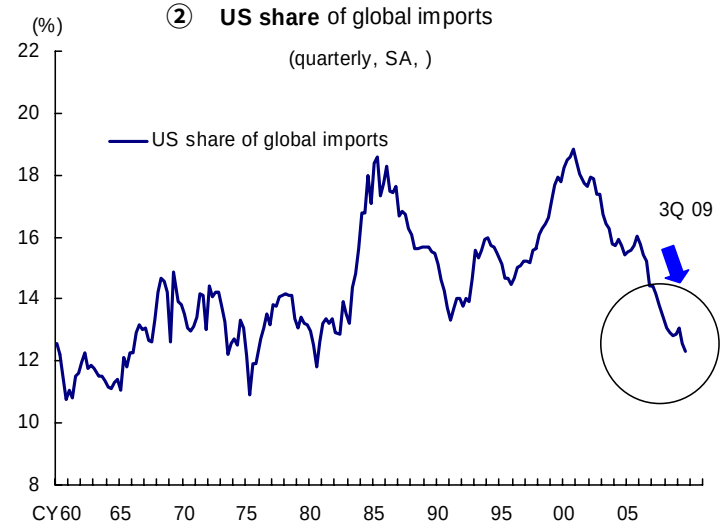
(Quarterly, seasonally adjusted)



Source: MUS, from Bureau of Economic Analysis

② **US share** of global imports

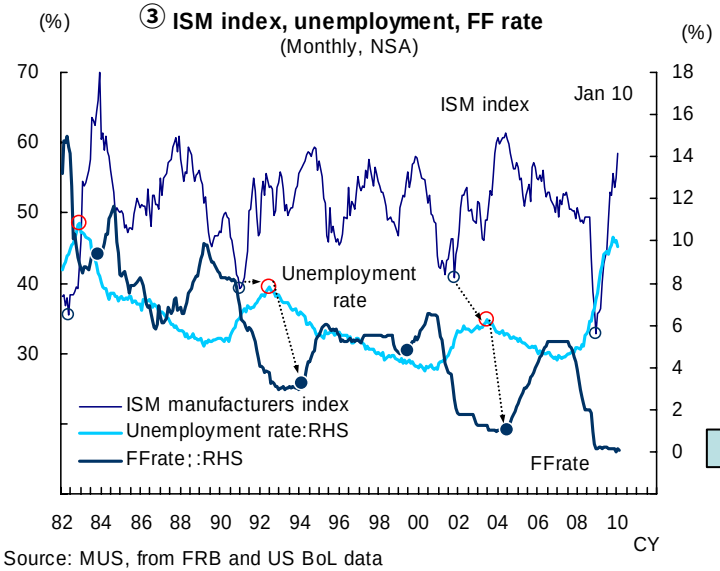
(quarterly, SA,)



Source: MUS, from International Financial Statistics, IMF

③ **ISM index, unemployment, FF rate**

(Monthly, NSA)



Source: MUS, from FRB and US BoL data

(1) US household net financial assets were over 4x higher than disposable income in 1998, but only 2.76x higher in Jul-Sep 2009. With this decline, the household savings rate rose from 2008 to reach 4.50% in Jul-Sep 2009. However, we view a savings rate of 9% as appropriate given the current ratio of net financial assets to disposable income.

(2) US influence on the real global economy is gradually declining as China and other emerging nations gain ground. US imports' share of global trade was 12.6% in Apr-Jun 2009, 6.3ppt lower than in Apr-Jun 2000 at the peak of the Internet bubble. US imports have more or less seen a consistent decline in market share since 2000.

	ISM index bottom	No. of months	Unemployment peak	No. of months	Start of rate hikes
1)	May-82	7	Dec-82		?
2)	Jan-91	17	Jun-92	20	Feb-94
3)	Oct-01	20	Jun-03	12	Jun-04
Avg.		**14.7**		**16.0**	
This time	Dec-08	14.7	**Mar-10**	16.0	**Jul-11**

(3) The US FRB analyzes business sentiment, employment, and short-term interest rates before making monetary policy changes. On average, unemployment peaks 14.7 months after the ISM index bottoms and short-term interest rates are raised 16.0 months thereafter. It then follows that a US rate hike may come in July 2011.

8. European economy: financial firms still face risk of financing crunch

① Balance sheet ratios of major Eurozone banks

(%)

	Eurozone End-Oct 2009	Austria	Belgium	Finland	France	Germany	Greece	Ireland
Loan-deposit ratio	108.4	111.9	67.0	144.3	122.1	88.7	79.4	164.9
Non-deposit funds/total assets	52.2	59.1	42.0	42.2	55.8	51.0	36.6	77.5
o/w, interbank financing/total assets	20.1	24.8	15.2	7.1	23.1	21.4	20.8	27.1

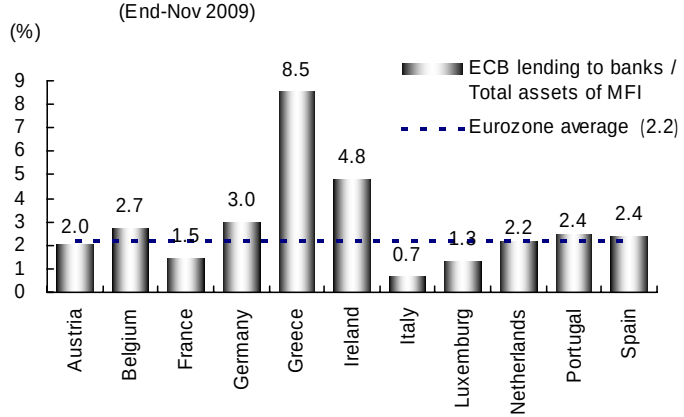
	Eurozone End-Oct 2009	Italy	Luxembourg	Netherlands	Portugal	Spain	Japan End-Sept 2009	US End-Sept 2009
Loan-deposit ratio	108.4	132.6	70.4	122.1	136.9	112.4	54.9	81.5
Non-deposit funds/total assets	52.2	50.2	74.4	49.1	46.9	36.8	19.7	20.3
o/w, interbank financing/total assets	20.1	21.3	23.7	8.1	15.9	14.3	1.7	n.a.

Notes: Loan-deposit ratio for the Eurozone excludes central govt and banks; "Non-deposit funds" refers to the following items recorded under Liabilities in bank balance sheets: deposits (loans) from the central government & banks + bonds + MMF + external liabilities; however, the following liability side items are excluded from Japan figures: cash & deposits, stock & equity interest, and "others"; for the US, non-deposit funds represent total liabilities other than deposits, i.e., the total for commercial banks and savings institutions

Source: MUS, from ECB, BoJ and FDIC data

② Eurozone: **Commercial banks' dependence on ECB** loans

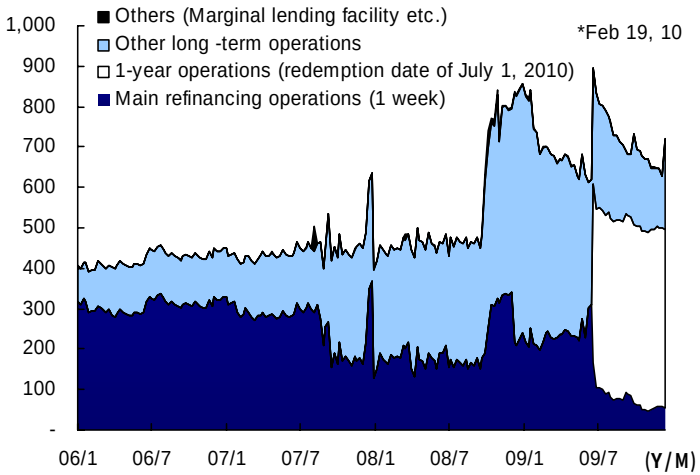
(End-Nov 2009)



Note: ECB loans as a proportion of bank balance sheets in respective countries; I
MUS estimate
Source: MUS, from ECB and respective nation's central bank data

③ ECB: Euro-loans to Eurozone banks

(€bn) (Weekly, NSA)



Source: MUS, from ECB data

(1) Commercial Eurozone banks' loan-deposit ratio was 108.4% as of end-Oct 2009. This is much higher than for Japan and the US, indicating highly leveraged lending. European finance has a unique revolving door system of lending encompassing several countries. Further, interbank lending comprises over 20% of financing. There are concerns that such interbank transactions sharply exceed real financing demand.

(2) Commercial banks in some nations rely more on ECB financing than others, with Greece at the top of the list followed by Ireland. Both of these countries depend on regional funding assistance, mainly from the ECB. With some European institutions more cash-strapped than others, the ECB is looking for an exit strategy from monetary easing and will need to provide a clear reason for implementation.

(3) With the ECB looking for an exit strategy from excessive monetary easing, financial institutions are shifting to short-term financing. The majority of current financing is from a one-year ECB operation and reaches maturity in July 2010. This amount exceeded €440bn as of Feb 19. Deadlines on financial firms' borrowings from central banks will likely be concentrated in July 2010.

Reference (1): Key economic indicators for Japan

Key economic indicators

			CY2005	CY2006	CY2007	CY2008	CY2009	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09	Jan-10
Industrial production	YoY	%	1.3	4.5	2.8	-3.4	-22.4	2.4	0.8	-1.4	-14.5	-34.6	-27.8	-20.1	-5.4	-30.9	-38.4	-34.2	-30.7	-29.5	-23.5	-22.7	-19.0	-18.4	-15.1	-4.2	5.1	–
Shipments	YoY	%	1.4	4.6	3.1	-3.2	-21.7	3.2	1.0	-1.5	-14.9	-33.5	-27.6	-19.3	-4.1	-31.6	-36.7	-32.4	-30.7	-30.0	-22.6	-22.0	-19.0	-16.8	-13.0	-3.1	5.2	–
Inventory	YoY	%	4.8	3.5	1.3	4.8	-14.7	1.9	2.6	3.1	4.8	-5.2	-10.3	-12.1	-14.7	2.8	-1.7	-5.2	-7.2	-8.4	-10.3	-10.6	-10.3	-12.1	-14.4	-14.4	-14.7	–
Inventory ratio	YoY	%	2.7	0.1	0.2	8.3	21.1	1.1	2.3	5.3	24.4	52.6	34.4	12.9	-8.8	51.4	60.8	44.6	41.1	39.6	22.4	20.4	11.7	6.9	3.1	-9.2	-18.4	–
Manufacturing capacity utilization (2000 = 100)	SA		100.1	102.6	103.7	99.3	74.1	105.6	104.0	100.4	87.1	63.4	71.4	78.8	82.6	68.7	60.5	61.0	67.2	72.6	74.3	77.2	79.0	80.3	80.5	83.1	84.3	–
	YoY	%	1.4	2.5	1.1	-4.2	-25.4	2.9	1.6	-3.6	-17.4	-40.0	-31.3	-21.5	-5.2	-34.9	-43.1	-41.8	-35.4	-30.9	-27.8	-24.8	-20.4	-19.1	-15.5	-5.1	7.4	–
All industry activity index	YoY	%	1.5	1.9	0.9	-1.8	-8.0	0.2	-0.9	-1.7	-5.0	-11.1	-9.6	-7.4	-3.8	-8.9	-12.4	-11.8	-10.1	-10.3	-8.3	-8.3	-6.7	-7.2	-6.4	-3.3	-1.6	–
Tertiary industry activity index	YoY	%	1.9	1.8	1.0	-1.0	-5.3	0.6	-0.5	-1.2	-3.0	-6.5	-6.3	-5.0	-3.6	-4.3	-7.3	-7.7	-6.3	-7.3	-5.3	-5.5	-4.4	-5.0	-4.7	-3.1	-2.8	–
Real working household spending	YoY	%	-0.2	-3.1	0.9	-1.1	-0.3	1.4	-0.4	-2.3	-3.2	-2.0	0.5	0.1	0.2	-5.7	-1.0	0.7	0.4	1.8	-0.8	-1.6	1.2	0.6	0.6	0.0	0.1	–
Real working household disposable income	YoY	%	-0.7	-0.2	0.1	-1.5	-1.9	-1.6	-3.5	-1.8	0.4	-2.0	-0.7	-1.2	-3.0	0.6	-3.1	-3.3	1.4	2.1	-3.3	-0.3	-2.9	-0.4	-1.8	-1.1	-4.7	–
Unemployment rate	SA	%	4.4	4.1	3.9	4.0	5.1	3.8	4.0	4.0	4.0	4.4	5.2	5.5	5.1	4.1	4.4	4.8	5.0	5.2	5.4	5.7	5.5	5.3	5.1	5.2	5.1	–
Unemployed	SA	Mln	294	275	257	265	336	258	268	268	268	297	344	363	339	276	295	320	334	343	356	376	362	352	336	342	339	–
Employed	SA	Mln	6356	6382	6412	6385	6282	6409	6397	6364	6370	6360	6266	6252	6250	6395	6373	6311	6305	6261	6233	6231	6260	6264	6244	6247	6260	–
Hours worked	YoY	%	-0.6	0.5	-0.7	-1.2	-2.9	-0.4	-0.9	-0.8	-2.4	-3.8	-3.6	-2.1	-2.2	-1.3	-5.4	-4.5	-2.7	-5.8	-2.2	-2.3	-1.5	-2.7	-4.2	-1.3	-0.9	–
Job offers	YoY	%	8.4	4.3	-6.4	-15.8	-23.0	-13.8	-15.3	-16.1	-18.3	-23.6	-27.8	-22.8	-16.8	-18.4	-30.1	-22.3	-26.5	-34.5	-22.3	-23.4	-24.2	-20.8	-18.8	-13.8	-17.4	–
Core machinery orders	YoY	%	7.1	4.0	-4.0	-6.0	-26.9	0.8	5.3	-6.9	-23.7	-29.4	-33.4	-27.3	-14.0	-39.5	-30.1	-22.2	-32.8	-38.3	-29.7	-34.8	-26.5	-22.0	-21.0	-1.5	-1.5	–
Private sector construction orders	YoY	%	3.1	4.3	4.9	-4.7	-33.1	2.4	-21.0	10.7	-14.1	-43.4	-36.0	-27.2	-20.4	-39.1	-23.2	-53.7	-28.1	-48.6	-32.2	-47.0	-27.3	-14.1	-32.7	-25.5	-4.8	–
Public works construction orders	YoY	%	-4.3	-9.2	-1.3	-2.8	9.7	-5.2	-8.4	4.7	-2.8	7.8	13.0	11.2	6.3	1.9	-2.8	15.3	20.5	2.5	12.7	2.5	8.7	22.1	8.3	0.0	10.3	-3.8
Trade balance	SA	Bn Yen	8533	7796	10876	2276	2794	2117	898	-114	-625	-769	743	1008	1811	-540	-103	-125	55	263	425	301	351	356	602	553	656	728
Customs cleared exports	YoY	%	7.3	14.6	11.5	-3.5	-33.1	5.9	1.8	3.2	-23.1	-46.9	-38.5	-34.4	-8.0	-45.7	-49.4	-45.5	-39.1	-40.9	-35.7	-36.5	-36.0	-30.6	-23.2	-6.3	12.0	40.9
Customs cleared imports	YoY	%	15.7	18.3	8.6	8.0	-34.9	10.5	11.2	21.1	-9.5	-37.0	-40.1	-39.7	-20.9	-31.9	-43.0	-36.6	-35.8	-42.4	-41.9	-40.8	-41.2	-36.9	-35.6	-16.7	-5.5	8.6
Core CPI	YoY	%	-0.1	0.1	0.0	1.5	-1.3	1.0	1.5	2.3	1.0	-0.1	-1.0	-2.3	-1.8	0.0	0.0	-0.1	-0.1	-1.1	-1.7	-2.2	-2.4	-2.3	-2.2	-1.7	-1.3	–
Domestic CGPI (chain weighted)	YoY	%	0.6	1.9	1.5	4.3	-4.5	3.2	4.6	6.8	2.4	-1.6	-5.0	-7.2	-4.3	-1.1	-1.6	-2.2	-3.8	-5.1	-6.1	-7.4	-7.3	-6.8	-5.8	-4.1	-2.9	-1.0
Bank lending (special item adjusted)	YoY	%	-0.1	2.1	1.6	2.4	2.8	1.4	2.1	2.3	3.8	4.4	3.7	2.4	0.5	4.6	4.4	4.2	4.1	3.9	3.1	2.8	2.4	2.1	1.9	0.5	-0.9	-1.4
Average Amounts Outstanding of Money Stock (M	YoY	%	1.8	1.0	1.6	2.1	2.7	2.3	2.1	2.2	1.8	2.1	2.6	2.8	3.3	2.0	2.1	2.2	2.7	2.7	2.5	2.7	2.8	3.0	3.4	3.3	3.1	2.9
Monetary base	YoY	%	2.0	-13.3	-7.8	0.1	5.8	0.0	-1.1	0.0	1.7	5.7	7.5	5.6	4.4	3.9	6.4	6.9	8.2	7.9	6.4	6.1	6.1	4.5	4.4	3.8	5.2	4.9
Corporate profits: large all industry RP	YoY	%	12.4	15.7	5.2	-30.0	0.0	-17.3	-3.6	-24.3	-78.9	-82.7	-56.1	-44.1	–	–	–	–	–	–	–	–	–	–	–	–	–	–
: large manufacturing RP	YoY	%	15.3	16.1	3.8	-42.1	0.0	-21.1	-13.9	-25.9	-106.3	-148.2	-87.4	-74.9	–	–	–	–	–	–	–	–	–	–	–	–	–	–
: large non-manufacturing RP	YoY	%	9.1	15.3	6.8	-16.2	0.0	-13.2	9.0	-22.8	-42.8	-18.6	-26.1	-15.5	–	–	–	–	–	–	–	–	–	–	–	–	–	–

Source: Nikkei NEEDS, METI, MoF, MPM, JAMA, Cabinet Office ESRI, MLIT, BoJ

Reference (2): Japanese economic outlook for 2010-2011

Economic Outlook for FY2009-2010

(YoY, %) As of December 25, 2009	FY09 Forecast	FY10 Forecast	FY11 Forecast	FY09 prior	FY10 prior
Nominal GDP	-4.8	-0.5	0.7	-4.5	-0.7
Real GDP	-2.6	1.0	1.5	-3.0	0.8
Private sector demand	-4.0	0.4	0.8	-4.9	0.5
Private sector consumption	0.7	0.6	0.6	0.1	0.5
Housing investment	-18.2	-1.4	0.5	-12.0	-0.5
Capital investment	-16.4	-0.3	1.8	-16.8	-2.0
Inventories(¥trn)	0.2	0.5	0.4	-1.4	0.5
Public sector demand	2.3	-0.3	0.5	3.5	-0.4
Government consumption	1.9	1.2	1.1	1.8	1.1
Public fixed asset investment	4.8	-7.8	-2.8	12.4	-7.6
Net exports (goods and services)	-----	-----	-----	-----	-----
Exports (goods and services)	-12.4	13.3	13.6	-13.8	11.2
Imports (goods and services)	-12.3	7.5	8.5	-13.6	7.4
Contributions to growth by segment					
Domestic demand	-2.6	0.3	0.7	-3.0	0.3
Private sector	-3.1	0.3	0.6	-3.8	0.4
Households sector	-0.2	0.3	0.4	-0.4	0.3
Corporate sector	-2.9	0.0	0.2	-3.5	0.1
Public sector	0.5	-0.1	0.1	0.8	-0.1
Net exports (goods and services)	0.0	0.7	0.8	0.0	0.5
Nominal GNP (=GNI)	-4.5	0.0	1.4	-4.6	-0.6
Real GNP (=GNI)	-1.5	0.9	1.8	-2.1	0.1
Industrial production	-9.7	6.7	8.4	-10.0	5.4
Domestic CGPI	-5.4	-1.2	-0.4	-5.3	-1.0
CPI (excluding fresh foodstuff)	-1.6	-0.7	0.0	-1.8	-0.5
Unemployment rate (%)	5.2	5.2	5.0	5.7	6.2
Current account balance (¥trn)	15.2	19.1	25.6	13.4	13.6
% of nominal GDP (%)	3.2	4.1	5.4	2.8	2.9
Trade balance (¥trn)	5.6	8.6	12.6	3.9	3.9
Assumptions: ¥/$ exchange rate	92.6	95.0	95.0	93.3	95.0

Note: Previous forecasts were made on 28 September 2009
Source: Forecasts by MUS

Feb.24, 2010 forecast	Latest(2/24)	end-3/10	end-6/10	end-12/10
Long-term interest rates (%) : Domestic economic downturn, fund supply after BOJ reduces rates to zero	1.325	1.35	1.40	1.50
Yen vs. dollar (¥) : US Fed's balance sheet expands, US-Japan real interest rate gap, emerging economies invest in dollar assets	90.24	90.0	93.0	95.0
Euro vs. dollar ($) : US business sentiment, interest rate gap, international flow of funds, confidence in European currency	1.3539	1.35	1.30	1.35
Nikkei 225 (¥) : Corporate earnings downgraded, linkage with Asian stocks, and foreign investor trading trends	10,018.83	10,000	10,500	11,000

•Twenty years have passed since December 29, 1989, when the Nikkei marked its record high of ¥38,915.87. Since then, the Japanese economy has been led (somewhat by design) into a deflationary environment on a path marked by NPLs at banks, the introduction of mark-to-market accounting, the bursting of the US dot-com and housing bubbles, and decline in the domestic population. Emerging markets meanwhile saw accelerated growth. In the wake of the financial crisis of 2008, the emerging markets have moved increasingly toward promoting growth via domestic demand. They hope to build a new economic cornerstone around massive infrastructure investment (e.g., China's RMB4trn program).

•**Forecast:** Japanese exports are recovering. Exports to elsewhere in Asia turned to growth for the first time in 14 months in November 2009, rising 4.7% YoY. We look for Japan's real GDP to grow 1.0% in FY2010 (we estimated 0.8% growth as of September) after falling 2.6% in FY2009 (a 3.0% fall). We look for nominal GDP to fall 0.5% in FY2010 but expect nominal GNP (=GNI) to rise slightly (+0.0%).

•**Background:** We expect exports to emerging markets to continue to grow. High savings rates (e.g., China's 28.8% savings rate in 2008) and deep government pockets make growth a certainty, in our view. We also expect the program set forth at the BoJ's special monetary policy meeting on December 1 to be only the beginning of moves by the bank to enhance liquidity in Japan. As such, extreme yen appreciation should be avoidable. Also, Japanese firms are ramping up overseas direct investment. Direct investment in China by Japanese firms rose 20.5% YoY in Apr-Jun 2009 to ¥239.2bn.

•**Opportunities and risks:** The gap between GNP and GDP in Japan (3.3%) is greater than elsewhere in the world (Germany: 1.8%, US: 0.9%, South Korea: 0.7%), and Japan is the creditor nation with the highest return on overseas assets. However, with the elderly accounting for an increasing percentage of the population, the country's household savings rate fell into negative territory in 2008 (we estimate the savings rate at -0.5% for 2009). While the severity of the situation varies from country to country, we see limited growth potential in the advanced nations because of the aging of these societies. Moreover, Asia is home to 3.5bn people versus the G7's 700mn. We therefore look for emerging markets to drive Japan's GNP growth.

Financial Market Forecasts

•**Interest rates:** BoJ will maintain 0% rate and accommodative policy. Long-term rates will depend JGB bonds to be issued stemming from the Hatoyama cabinet's ¥7.2trn supplementary FY09 budget and initial FY2010 budget.

•**Forex:** Upward pressure on the yen will linger owing to inflation fears stemming from global stimulus spending and central bank balance sheet expansion, but fundamentals favor a weaker yen.

•**Equities:** Corporate profit growth in 2010 depends on earnings from Asia. Several companies already boast double-digit operating margins in Asia. Focus on outwardly-focused Japanese firms.

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