

May. 2003

**Forecast for the Japanese Economy
In Fiscal 2003/2004**

 **UFJ Institute**

Economic Research Department

1. Current State of the Japanese Economy and Outlook for Fiscal 2003/2004

(1) Current State of the Japanese Economy

During the January–March quarter of 2003, the Japanese economy recorded virtually zero growth (+0.0%) in real GDP over the previous quarter. Although the income and employment environments continued to be harsh, private consumption remained firm, rising 0.3%, in part as a result of healthy automobile sales. Private capital investment rose 1.9%, marking its fourth consecutive quarterly increase against the backdrop of improvement in corporate profits. Meanwhile, housing investment slipped 1.2%, marking its second consecutive quarterly decline, reflecting depressed owner-built home starts and fewer condominium starts. Despite expectations of a beneficial impact from a supplementary budget last autumn, public investment remained on a downtrend, sliding 3.5% as a result of a decline in construction projects in financially distressed regions. Domestic demand made a slightly positive contribution to GDP growth, at +0.2%, while the contribution of external demand was slightly negative, at –0.2%, owing to weak exports, mainly to the United States.

Evaluating the GDP figures for the January–March quarter is difficult. Nominal growth was –0.6%, marking the second consecutive quarterly decline, while the GDP deflator declined 3.5% year on year, a larger drop than in the previous quarter. Considering that exports are weak and deflationary pressures remain strong, some think the economy is already in recession. Meanwhile, growth in private consumption remained positive, albeit by a small margin, and private capital investment continues to recover. Looking at these statistics, it is possible to argue that the economy is continuing to recover.

Thus, the state of the Japanese economy was as follows, looking not only at the January–March quarter of 2003 but also back to the beginning of 2002.

(a) Private consumption remains relatively firm amid harsh employment and income environments. Even so, consumer sentiment is worse than it was around last summer, and growth in private consumption

is slowing. Moreover, prices are continuing to fall; therefore, compared with nominal GDP, real GDP has remained relatively firm.

(b) Private capital investment has recovered modestly since the April–June quarter of last year. Despite weak sales, corporate profits are expanding, mainly in the manufacturing sector. Consequently, demand for capital investment is emerging among electrical machinery manufacturers, automobile companies, and other manufacturers that had previously cut back on capital outlays.

(c) Because of lingering concern about the course of the economy, companies are cautious about inventory buildups, and producer inventories are still falling. However, inventory levels are fairly low compared with the level of shipments; thus, it is doubtful that inventory declines will persist going forward.

(d) Exports, mainly to the United States and Asia, had been on a rising trend, but export growth has now slowed as the pace of growth of overseas economies has decelerated. However, the slowdown in export growth in the January–March quarter was likely due to temporary factors, namely, a decline in automobile exports to the United States as a result of local inventory adjustments.

(e) Although deflationary trends persist, the corporate goods price index dropped at a slower rate year on year along with increases in commodity prices and recovery in the economy. The GDP deflator dropped by a larger margin in the January–March quarter, but this was attributable to special factors, namely, a sharp decline in the government consumption expenditures deflator that accompanied wage reductions for civil servants. Consequently, the sharp decline in the GDP deflator does not mean that deflationary pressures have grown stronger.

(2) Outlook for Fiscal 2003/2004

We foresee the following scenarios for the Japanese economy from fiscal 2003 through fiscal 2004:

(a) The modest recovery that began last year is likely to continue through the first half of fiscal 2003, led by a moderate expansion in private capital investment. Although we do not expect high export growth as in 2002, we think exports will continue to show growth year on year. We expect contributions from external demand will be virtually neutral.

(b) The economy is likely to enter a recessionary phase from mid-fiscal 2003, with production slowing because of inventory buildups and corporate profits deteriorating. Following a rise in private capital investment that was centered on replacement investment, capital spending will again turn down because of a slowdown in production and worsening corporate profits. Meanwhile, the contribution of external demand will be virtually neutral as the global economy, including the United States, strengthens. Also, despite harsh wage and employment environments, under the prevailing deflationary environment, private consumption in real terms will remain firm.

(c) The economy will remain in recession through fiscal 2004 and the decline rate of price levels will accelerate again. Still, signs that the decline in production has abated will emerge as companies approach their inventory adjustment targets toward the end of the fiscal year.

(d) The spread of severe acute respiratory syndrome (SARS) has already adversely affected the real economy, bringing a decline in the number of travelers, mainly tourists. In addition, there is a risk that SARS will negatively affect the Japanese economy by way of a slump in Asian production activity. SARS has unquestionably resulted in significantly curtailed business travel to China; so, it has already affected negotiations and other business activities. Moreover, some plants in China have suspended operations. Still, there has been no across-the-board suspension of production activities in China; therefore, Chinese imports/exports have not diminished significantly. Assuming that SARS infections are gradually

contained, the impact on the Japanese economy is likely to be limited.

2. Economic Outlook for Fiscal 2003/2004

(1) Assumptions Underlying the Forecast

The following assumptions have been made in preparing this outlook.

(a) World Economy

The U.S. economy had decelerated because of tension over the situation in Iraq since the end of last year. Now, however, there are signs that the slowdown is abating, as stock prices stabilize and consumer sentiment improves. Although the U.S. economy has been weak in terms of production and employment through the first half of 2003, private consumption and private capital investment should rise modestly from the second half of 2003 through the first half of 2004 as stock prices rise and both consumer and business sentiment improve. We forecast real GDP growth of +2.0% in fiscal 2003 and +2.8% in fiscal 2004.

The economies of the Eurozone are likely to improve in the second half of 2003 as overseas economies recover. We forecast a modest recovery centered on the corporate sector, including a bottoming out of fixed capital investment. However, we forecast real GDP growth of only +0.8% for all of 2003 because of stagnant business conditions in the first half of the year. In 2004, we expect the recovery to spread from the corporate sector to the household sector as exports grow stronger. We forecast real GDP growth will rise to +2.0%, underpinned by the first rise in fixed capital investment in four years and a faster pace of growth in personal consumption.

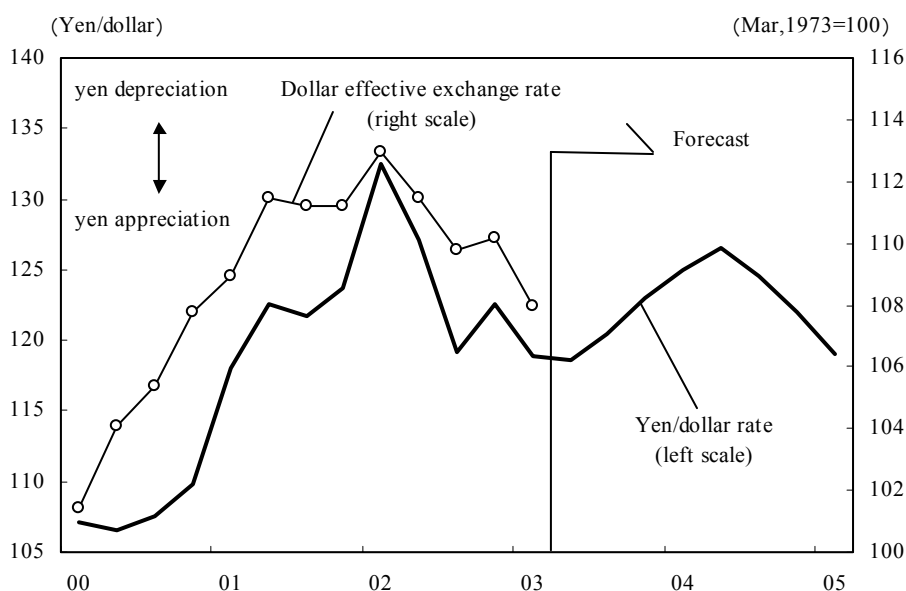
The economies of Asia outside Japan shifted from surefooted expansion to greater uncertainty in 2003, owing to the spread of SARS, especially in China. We forecast real GDP growth of +5.0% for Asian economies as a whole, given the possibility that sharply lower sales in the tourist, transportation, and certain other industries will depress growth for the overall region by 0.5–1.0 percentage point for the full year. The impact of SARS should weaken beginning in the second half of 2003, and stronger exports and production should accompany economic recoveries in Europe

and the United States. Based on this prognosis, we expect the economies of Asia outside Japan to resume a growth trajectory in 2004. For the full year, we forecast growth of +5.9%.

(b) Exchange Rates

The U.S. dollar has weakened against the yen because of uncertainty about the direction of the U.S. economy and the start of military action against Iraq. With speculation that the U.S. government had retreated from its strong-dollar policy, the dollar at one point fell to ¥115/\$. In fiscal 2003, although the dollar is likely to remain under pressure because of ongoing tension overseas, the yen/dollar exchange rate should tilt toward yen weakness because of growing expectations for a steady recovery in the U.S. economy and increasing indications that the Japanese economy is slowing. We forecast an exchange rate of ¥120/\$–¥125/\$ in fiscal 2003. In fiscal 2004, despite a slow pace of recovery in the Japanese economy, we think the yen may strengthen (and the dollar weaken) from midyear because of a slowdown in the U.S. economy.

Exhibit 1: Outlook for the Yen-Dollar Exchange Rate



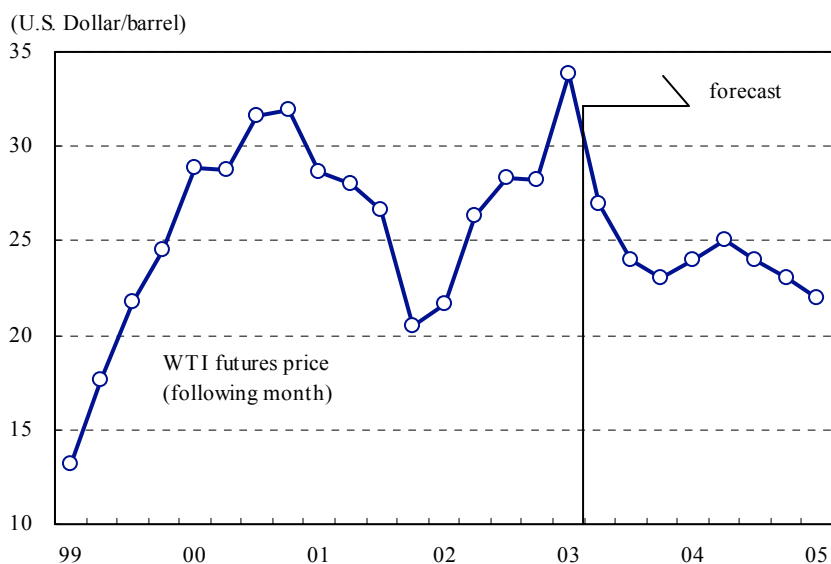
Sources: Bank of Japan, Financial and Economic Statistics Monthly, FRB Federal Reserve Bulletin

(c) Crude Oil Prices

Crude oil prices have remained high at around the latter half of \$20 per barrel following the end of the conflict in Iraq for the following reasons: (1) global oil inventories are low, and (2) the restart of oil production in Iraq is taking longer than expected. Moreover, (3) there is a growing view that OPEC will decide at an extraordinary meeting of conference in June to carry out a second round of production cuts this year, following the one in April, and this prognosis is pushing up oil prices.

Looking ahead, although low worldwide inventories will support oil prices, the restart of oil production in Iraq means that excess supply will not be eliminated; thus, oil prices may fall gradually. Still, OPEC is likely to implement aggressive production cuts if prices fall to the lower end of its price band. Also, the steadily growing resilience of the global economy from the second half of 2003 should foster a pickup in prices. From the second half of 2004, crude oil prices should weaken as the U.S. economy again decelerates.

Exhibit 2: Outlook for WTI Crude Oil Price



(d) Government Fiscal Policy

Although the Japanese government issued more than ¥30 trillion in Japanese government bonds (JGBs) to cover a shortfall in tax revenues, the fiscal 2003 national budget was austere, as the Koizumi administration again focused on the main aim of financial reconstruction. In fiscal 2003, owing to a more pronounced slowdown in Japan, we expect increased calls for adopting a supplementary budget containing additional allocations for public works investment. In this outlook, we assume that a supplementary budget of around ¥4 trillion will be adopted by the end of fiscal 2003, and additional public works investment (excluding disaster restoration works expenditures) will total ¥1.5 trillion.

In fiscal 2004, we expect financially distressed regional governments and the national government to again restrain annual expenditures. Even so, with continuing economic sluggishness we assume that a small amount of additional public works investment (around ¥1 trillion) will be carried out in the last half of the fiscal year.

(e) Monetary Policy

The Bank of Japan (BOJ) has maintained its target for outright purchases of long-term JGBs of ¥1.2 trillion per month. Meanwhile, it has raised its target for the BOJ's current account deposits to between ¥27 trillion and ¥30 trillion. Since the target before new BOJ Governor Toshihiko Fukui assumed his position was ¥15 trillion to ¥20 trillion, the BOJ's current account deposits have risen steeply, by around ¥10 trillion, over the past two months. This move has two primary aims. The first is to respond to the technical increase in current deposits that accompanied the establishment of the Japan Postal Public Corporation. The second is to respond to concerns that the financial markets will be thrown into turmoil by, among other things, lower stock prices and the injection of public funds into one of major banks as well as to respond to increased uncertainty on the international stage, including the conflict in Iraq and the outbreak of SARS.

Going forward, there are likely to be continued calls from the government and the ruling party for greater monetary easing. Specifically, further monetary relaxation measures may include those used to date, such

as raising the BOJ's current account deposit target and increasing purchases of JGBs from the market. They may also include new types of measures, such as introducing inflation targeting and purchasing assets other than JGBs, including ETFs, REITs, and foreign securities. In response, the BOJ plans to start making outright purchases of asset-backed securities (ABS) in the near future. There is also a possibility that the BOJ will indicate a reference rate of inflation which it considers to be desirable.

(2) Economic Outlook for Fiscal 2003/2004

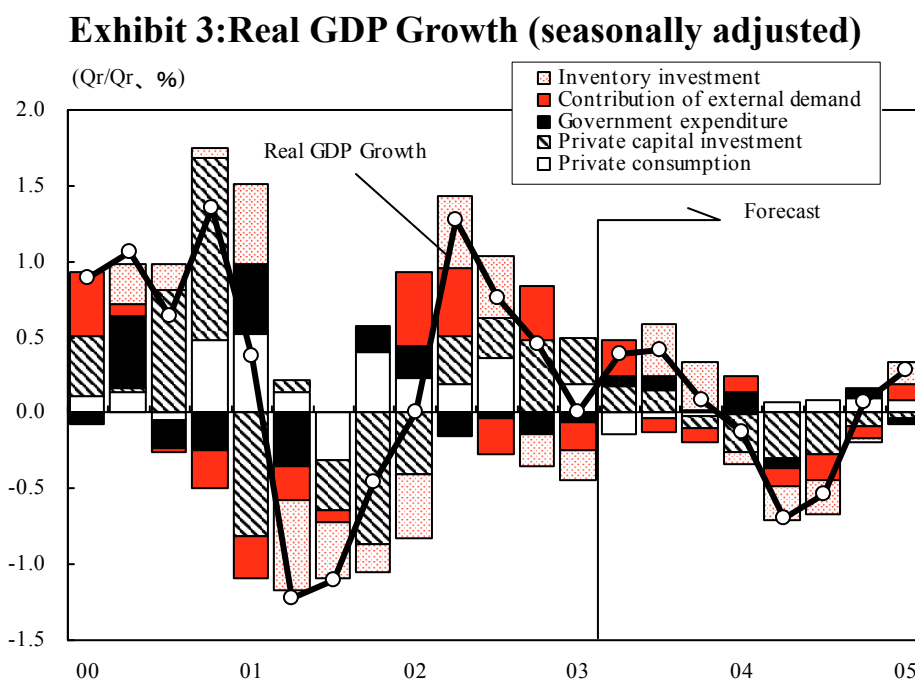
We expect real GDP growth of 1.1% in fiscal 2003, which would mark the second consecutive year of positive growth. However, we project that nominal growth will remain slightly negative at -0.3%. We expect deflationary trends to continue, with the GDP deflator dropping 1.4%.

We expect the gradual economic recovery that began last year to continue through the first half of fiscal 2003, underpinned by a recovery in private capital investment against the backdrop of better corporate profits. Although growth in private consumption is likely to be weaker than in fiscal 2002, we doubt that this will be a significant drag on the economy. After falling in the January–March quarter, exports, mainly to the United States, should recover somewhat as local inventory adjustments are completed. Inventory buildups, which are lagging, will start soon, and this factor should also boost growth. Although public investment continues to decline, additional public investment through a supplementary budget in fiscal 2002 and the implementation of the fiscal 2003 budget ahead of schedule should provide support.

We are forecasting that the domestic economy to enter a recessionary phase in the latter half of fiscal 2003. We think that production is likely to fall as inventories rise and that corporate profits will decline. The recovery in private capital investment will be centered on replacement investment, and there will be few large-scale investments to increase production capacity. Consequently, worsening corporate profits and weak cash flow will result in a decline in private capital investment. With the economy in recession, private consumption is unlikely to exhibit high growth. Even so,

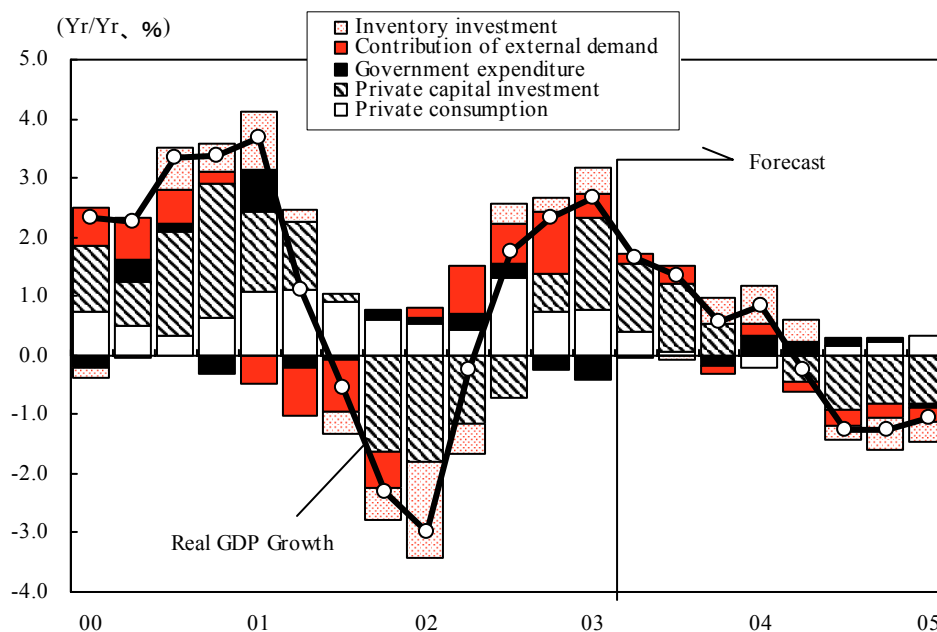
under the deflationary environment, consumption in real terms should continue to hold firm. Although public investment is likely to exhibit a reactionary decline following the early execution of public spending plans, we assume that a supplementary budget will be passed toward the end of the year and that additional public investment will ensue shortly thereafter. Because of an ongoing recovery in the global economy, primarily in the United States, the contribution to growth from external demand should remain virtually neutral.

In fiscal 2004, following the slowdown from the latter half of fiscal 2003, we expect the economy to again register negative growth in fiscal 2004, with real GDP growth of -1.0% . We expect sharply negative nominal growth at -2.5% and forecast that deflation will persist, with the GDP deflator fall 1.6% . An ongoing decline in private capital investment because of worsening corporate profits will hold down GDP growth. In addition, exports will turn downward, and the contribution of external demand to growth will be negative. However, production should bottom out toward the end of the year as companies come within sight of their inventory adjustment targets. Moderation of the declines in private capital investment and inventories should give way to signs that the economy is again recovering.



Source : Cabinet Office, Annual of National Accounts

Exhibit 4: Real GDP Growth



Source : Cabinet Office, Annual of National Accounts

3. Outlook by Demand Component

(1) External Demand: Neutral for the Economy in Fiscal 2003, Negative in Fiscal 2004

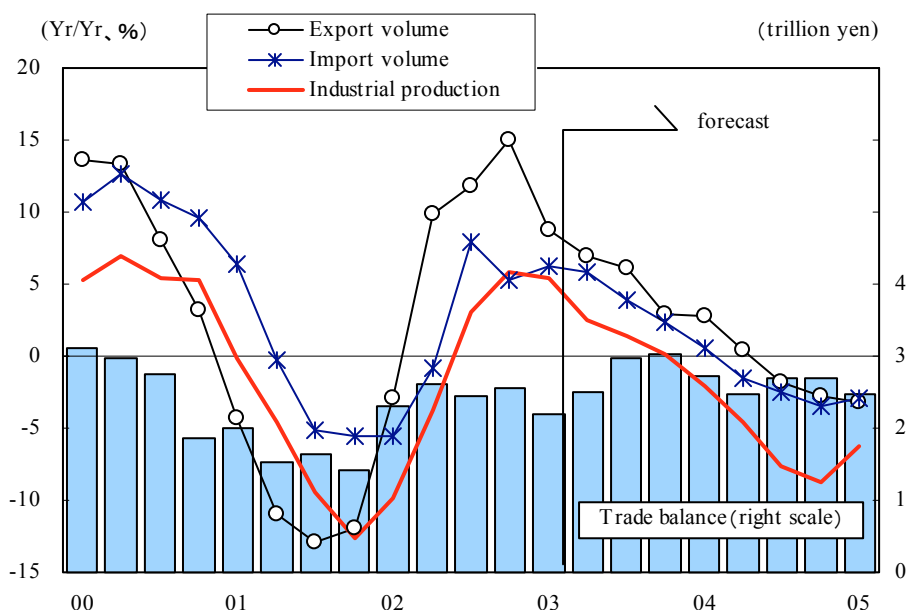
Although exports have remained on an uptrend since the beginning of fiscal 2002, they are gradually slowing. Exports to Asia remain firm and, with the euro strengthening, shipments to EU nations are also firm, but U.S.-bound exports, mainly automobiles, are falling. In fiscal 2003, exports are likely to sustain year-on-year growth but with a smaller margin of increase, underpinned by an economic pickup overseas, mainly in the United States from the last half of 2003 through the first half of 2004. Although automobile exports to the United States will recover after falling in the January–March quarter of 2003, shipments will be below the high levels of 2002. Exports to Asia remain firm, but the pace of year-on-year growth is slowing. The outbreak of SARS is unlikely to stall the recovery in Asia-bound exports, but it might dampen shipments to some extent. Owing to an expected slowdown in economies overseas from the last half of 2004, exports in fiscal 2004 are likely to register negative growth year

on year and trend downward.

Imports are rising along with a modest recovery in production. However, given that the expansion of domestic demand lacks momentum, the pace of import growth is likely to slow. Having said that, we expect year-on-year growth to turn positive during fiscal 2003, partly because of structural factors, including a higher penetration rate for imported goods. In fiscal 2004, production is likely to fall because of a weak domestic economy; therefore we expect to see a downtrend in imports, mainly of producer goods like components and raw materials.

We forecast that the contribution of external demand will be neutral for the economy in fiscal 2003, at +0.1%, with slowing of both export growth and import growth. In fiscal 2004, although both import growth and export growth are likely to slow further, we think the magnitude of the decline in exports will be greater than the magnitude of the fall in imports. Consequently, the contribution from external demand will turn negative, at -0.2%. Exchange rates are likely to move in a comparatively narrow range during the forecast period; so, we think they will not have much impact on exports and imports.

Exhibit 5: Outlook for Trade



Source: MOF, The Summary Report on Trade of Japan
METI, Economic and Industrial Statistics

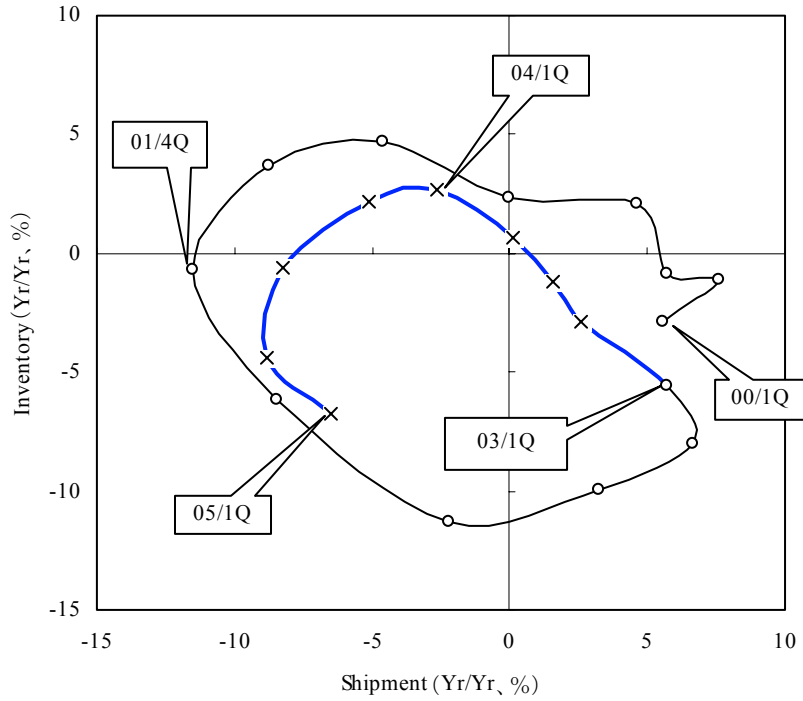
(2) Corporate Sector: to Decelerate in the Second Half of Fiscal 2003

(a) Production: Pause in the First Half of Fiscal 2003, Followed by Downtrend in the Second Half

Although inventory adjustments have already been completed, through the January–March quarter, the inventory index has registered declines for seven consecutive quarters, indicating that companies are not making inventory investments so much. In the past, inventory buildups supported production. Now, however, since domestic demand is weak, companies are operating without aggressively stockpiling inventories, and this is a factor behind the pause in production. Until now, inventories of capital investment related goods, for which inventory adjustments were lagging, showed signs of rising along with increased demand. Consequently, we expect inventories to rise, albeit modestly. However, because demand is weak, we expect the buildup in inventories to be completed in a short period of time, and we think inventories will enter a phase of unintentional accumulation in the latter half of fiscal 2003. Although we think inventories will enter an adjustment phase in fiscal 2004, because of the limited buildup, adjustments are likely to be comparatively light. Consequently, we forecast that companies will be in sight of their inventory adjustment targets toward the end of the fiscal year.

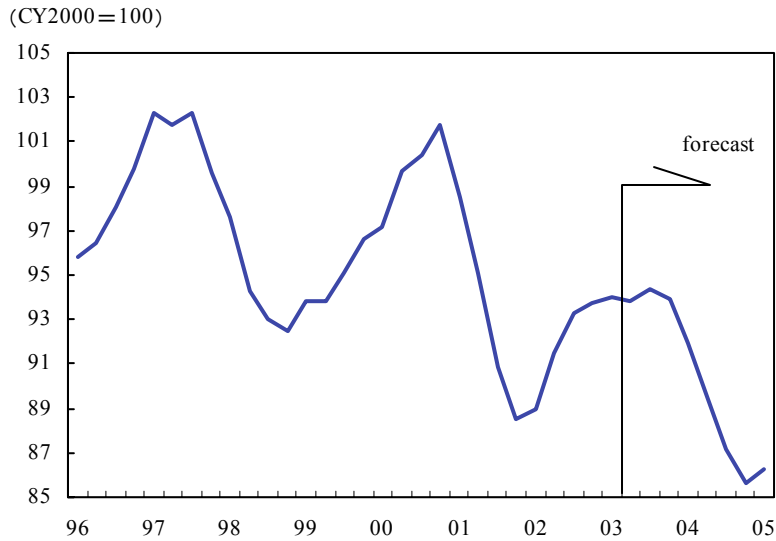
Despite the pause in output, production of capital investment related goods, which had lagged, is rising, and demand for IT-related goods remains firm. As a result, production is likely to pick up somewhat toward the middle of fiscal 2003. Still, inventories are likely to enter a phase of unintentional accumulation in the latter half of the fiscal year, and this will constrain production. In fiscal 2004, we think inventory adjustments will result in a clear downtrend in production. Toward the end of fiscal 2004, production is likely to bottom out and increase as inventory adjustment targets are achieved.

Exhibit 6: Inventory Cycle Movements



Note: Figures from the second quarter of 2003 are forecasts.
 Source: Ministry of Economy, Trade and Industry (METI), Economic and Industrial Statistics

Exhibit 7: Outlook for Industry Production



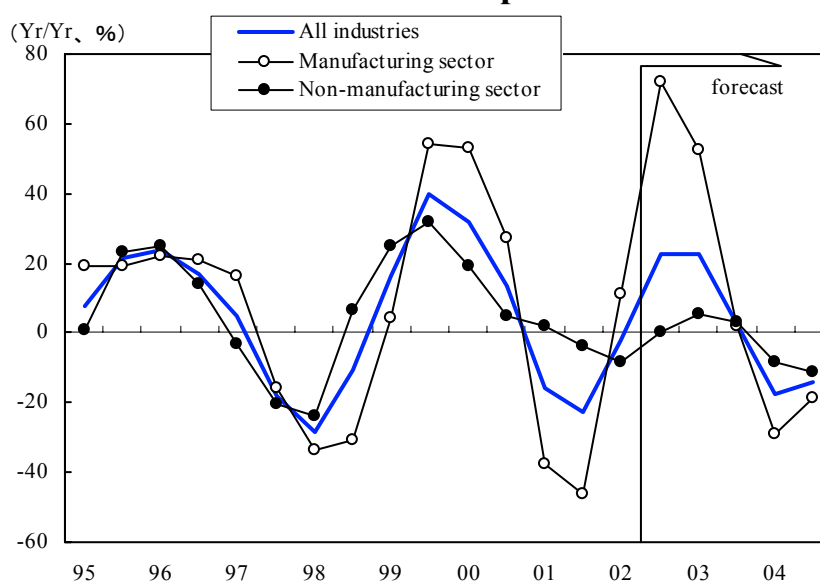
Source: Ministry of Economy, Trade and Industry (METI),
 Economic and Industrial Statistics

(b) Corporate Profits: Ongoing Improvement through the First Half of Fiscal 2003, but Deterioration Thereafter

Profits in the manufacturing sector continue to recover. Although sales growth remains weak because of slumping prices, personnel cost reductions and other benefits of restructuring are continuing. Consequently, profits are likely to continue improving through the first half of fiscal 2003. In the non-manufacturing sector, a serious slump in sales is causing profit improvement to lag compared with that in the manufacturing sector. However, earnings are gradually improving, mainly because of the positive effects of restructuring. Even so, in the latter half of fiscal 2003, earnings growth in both the manufacturing and non-manufacturing sectors will slow significantly because of falling sales resulting from weak domestic demand.

In fiscal 2004, the decline in sales in both the manufacturing and non-manufacturing sectors will accelerate against the backdrop of a slowdown in the economy, and this will squeeze corporate profits. Having said that, the decline in profits is likely to be limited, as the financial conditions of companies are stronger because of restructuring efforts, including reductions in debt and cuts in personnel costs. Corporate profits are likely to exhibit signs of a pickup toward the end of fiscal 2004.

Exhibit 8: Outlook for Corporate Performance



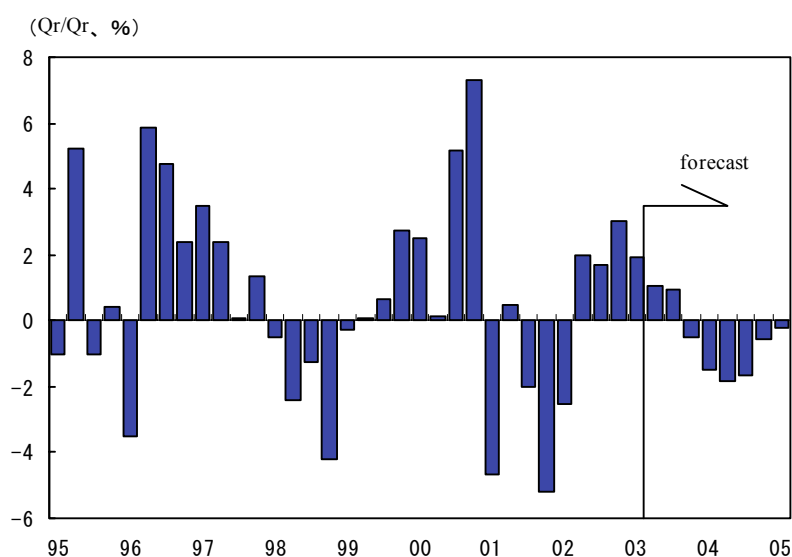
Source: MOF, Quarterly Statistics on Incorporated Enterprises

(c) Private Capital Investment: Modest Recovery Continues in the First Half of Fiscal 2003, but Decline Likely in the Second Half

Private capital investment continued its steady rise in the January–March quarter of 2003, registering positive growth year on year for the fourth consecutive quarter, as investment in real terms was boosted by the decline in capital goods prices. Gauging from the recovery in corporate profits and the rise in machinery orders, a leading indicator of capital investment, through the January–March quarter, capital investment is likely to continue trending upward through the first half of fiscal 2003. However, in the absence of an improvement in corporate sentiment, most private capital investment will be concentrated on small projects, including replacement/maintenance investment, rather than large projects to increase capacity. Consequently, it is doubtful that the pace of recovery in private capital investment will accelerate. Limited to within the scope of surplus cash, private capital investment is likely to decline in the second half of the fiscal year as corporate profits worsen.

The pace of the decline in private capital investment will accelerate through the first half of fiscal 2004, partly because of weak corporate profits. In the second half, the appearance of indications that production is bottoming out and the decline in corporate earnings is abating should halt the decline in private capital investment.

Exhibit 9: Private Capital Investment

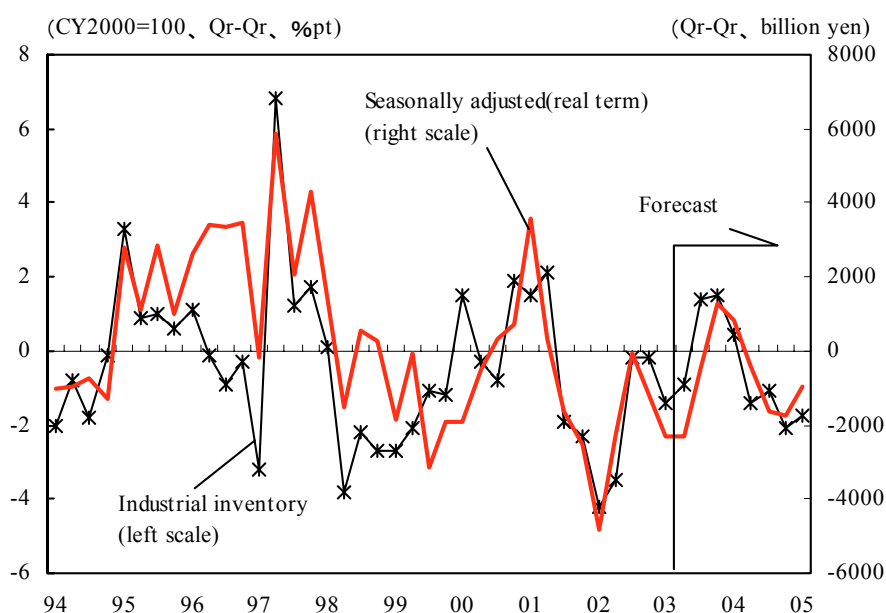


Sources: Cabinet Office, Annual of National Accounts

(d) Inventory Investment: Positive Contributions to Growth in Fiscal 2003

At this point, inventories continue to fall, and this has emerged as one of the factors restraining economic growth. During fiscal 2003, inventory buildups should contribute positively to growth. However, shipments are weak, which will lead to the gradual unintended accumulation of inventories. As a result, inventory adjustments will start in fiscal 2004, and we expect this to make negative contributions to the economic growth rate.

Exhibit 10: Inventory Investment



Source: Cabinet Office, Annual of National Accounts, Ministry of Economy, Trade and Industry (METI), Economic and Industrial Statistics

3. Employment and Income Environments Will Remain Severe, but Household Sector Will Be Flat

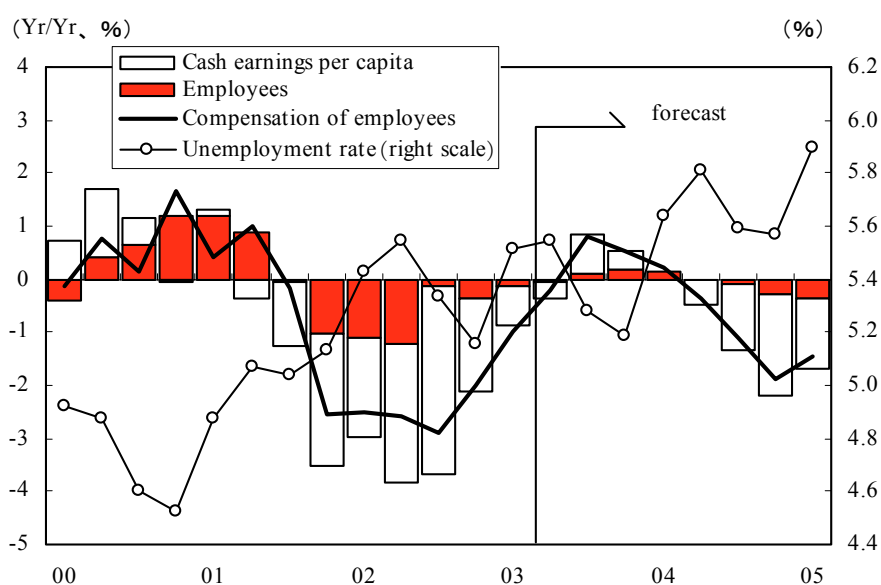
(a) Employment and Income Environments: No Expectation of Major Improvement, Downtrend in Fiscal 2004

The pace of decline in the number of employed persons is slowing along with the recovery in production. However, companies are still taking a hard line on keeping down personnel expenses; therefore, the number of employed persons is not expected to rise significantly even if production

picks up. We expect the number of self-employed persons and the number of persons employed by family-owned businesses to remain on a downtrend against the backdrop of chronic low growth. Consequently, although the pace of decline in the number of employed persons will shrink in fiscal 2003, we expect the pace of decline to accelerate again in fiscal 2004. The overall unemployment rate will show signs of declining at some point in fiscal 2003, but we expect it to remain at a high level, as previously unsuccessful job seekers return to the labor market.

Regarding income in fiscal 2003, scheduled cash earnings will rise year on year against the backdrop of a recovery in corporate profits. Meanwhile, growth in unscheduled cash earnings will slow because of weak production momentum. After falling until the end of last year, bonuses may increase year on year in the second half of fiscal 2003, but we do not expect great improvement. In fiscal 2004, we expect income, mainly unscheduled cash earnings and bonuses, to trend downward because of worsening corporate profits and lower production as recessionary conditions persist.

Ehibit11: Unemployment Rate and Compensation of Employees



Note: 'Non-employees' consists of 'Self employed' and 'Family workers'.

Source: Ministry of public Management, Home Affairs, Posts and Telecommunications, Labor Force Survey

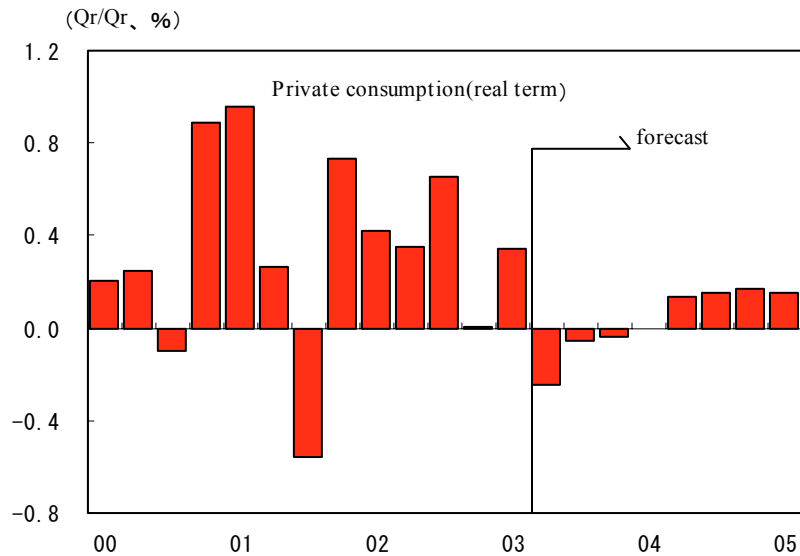
(b) Private Consumption: Harsh Environment to Continue, Flat on a Real Basis and Negative on a Nominal Basis

Private consumption remains firm, even amid a harsh income environment. Private consumption on a real basis rose 1.5% year on year in fiscal 2002. However, we expect consumption to be weak in fiscal 2003. Although incomes of employed workers are recovering, pension income levels are being adjusted downward because of the introduction of a linkage to price levels and because health insurance premiums are being hiked, both of which are pushing down household disposable incomes. Meanwhile, higher out-of-pocket expenditures for health care and hikes in alcohol and tobacco taxes are also squeezing household budgets. Moreover, in the second half of fiscal 2003, signs that the economy is decelerating are likely to further dampen consumer sentiment. We forecast that private consumption will rise only 0.1% in fiscal 2003.

In fiscal 2004, consumption will be held down as the ongoing domestic recession continues to lower employee incomes. Even so, deflation will boost real purchasing power, and this will support consumption to some extent. Toward the end of the fiscal year, consumption is likely to pick up somewhat along with the emergence of indications that the economy is bottoming out. We forecast growth in real private consumption of +0.3% in fiscal 2004.

Private consumption on a nominal basis, which is directly related to corporate sales, was just barely positive, at +0.1%, in fiscal 2002. However, we are forecasting two consecutive years of negative growth, -0.9% in fiscal 2003 and -1.0% in fiscal 2004.

Exhibit12: Real Private Consumption



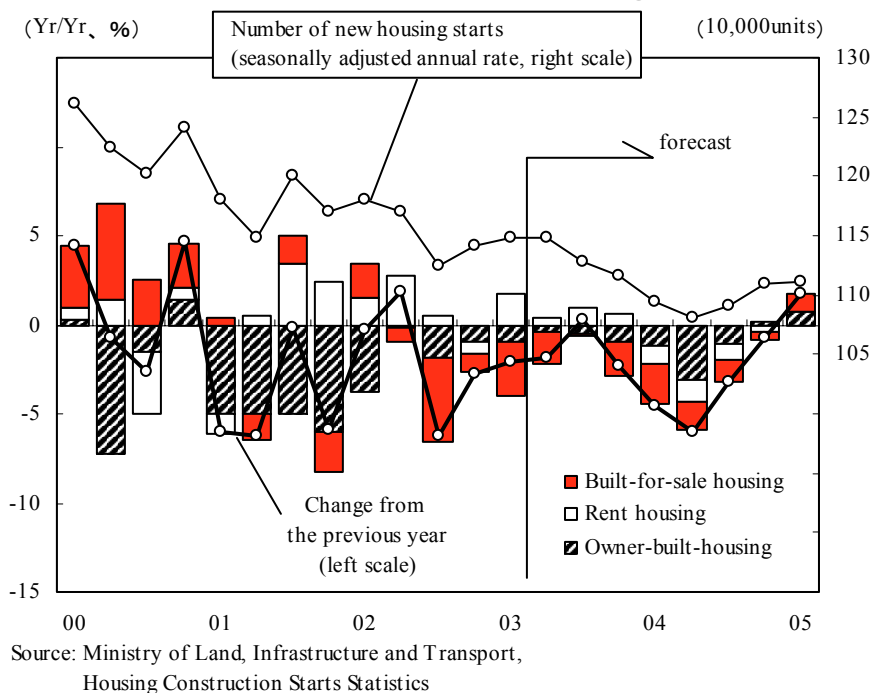
Source:Cabinet Office,National Accounts

(c) Private Residential Investment: Downward Trend to Continue; Surge in Demand Prior to Expiration of Housing Loan Tax Relief Measure Not Expected to Be Great

Housing starts totaled 1.145 million units in fiscal 2002. Condominium starts trended down amid a slump in owner-built home starts. Housing starts are forecast to total 1.123 million units in fiscal 2003 and then slip to 1.097 million units in fiscal 2004.

Currently, rental housing starts are firm because of their popularity as investments amid the low-interest-rate environment. In addition, there is a possibility that there will be a rush of housing starts, primarily of owner-built houses and condominiums, prior to the expiration of a housing loan tax relief measure (available to people who move into their newly purchased homes before the end of December 2003). However, in any event, we doubt that the number of housing starts will be boosted significantly. The number of housing starts will again be held down in the second half of fiscal 2003, as deceleration of the economy creates concerns about the future. Housing starts are likely to register year-on-year growth in 2005, when we think signs that the economy is recovering will start to appear.

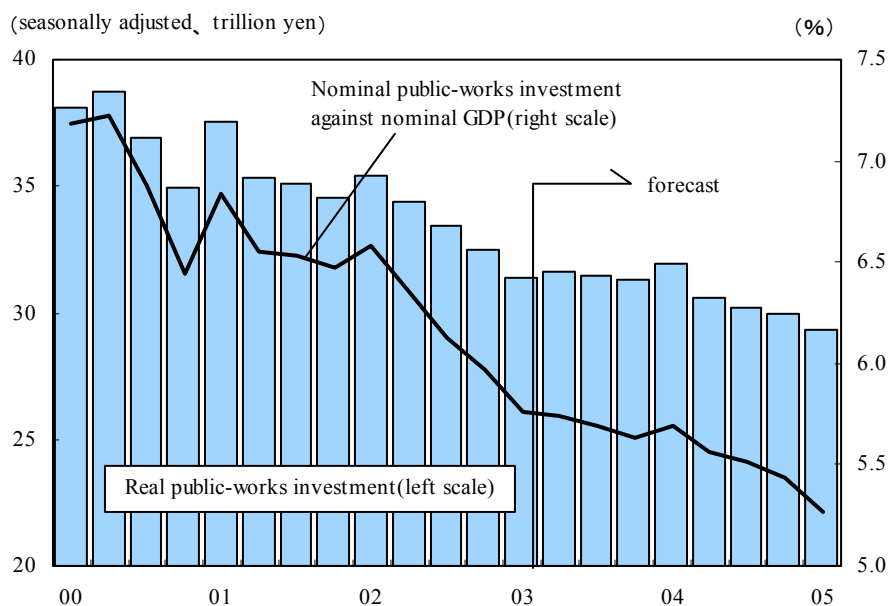
Exhibit 13: Outlook for Housing Starts



(d) Public Works Investment: Downtrend to Remain Intact Despite Outlook for Supplementary Budget

On an initial budget basis, national government public investment related expenditures will decline 3.7% year on year in fiscal 2003, with regional government expenditures also continuing to fall because of harsh fiscal conditions. In the second half of the fiscal year, public investment should be boosted by a supplemental budget, but this will only slow somewhat the pace of decline for the full year (-5.0%). In fiscal 2004, public investment will remain constrained, and we anticipate negative growth on a par with that in fiscal 2003, even though we expect additional construction investment (roughly ¥1 trillion) under a supplementary budget.

Exhibit 14: Outlook for Public-works Investment



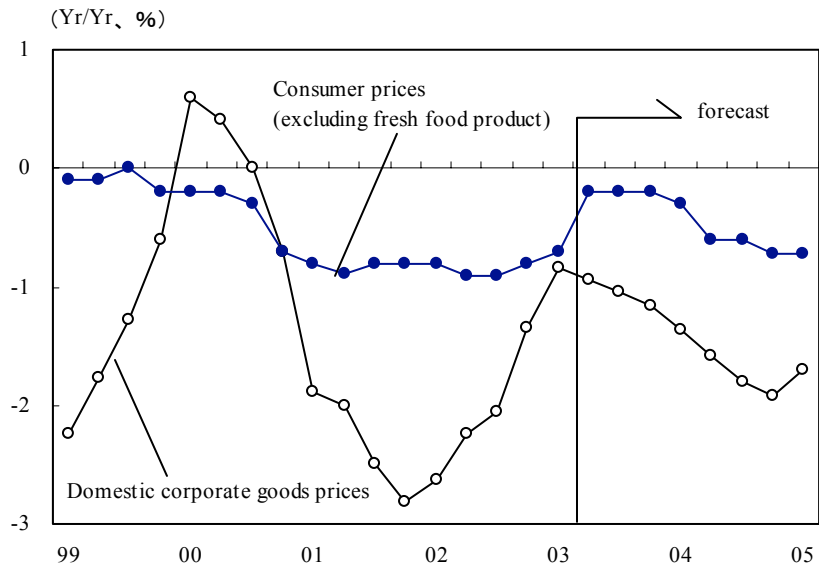
(e) Price Levels: Deflationary Trends to Persist

The decline in domestic corporate goods price levels had moderated against the backdrop of higher crude oil prices and a tightening of the supply-demand balance as a result of economic recovery and production adjustments. However, in fiscal 2003, crude oil prices are down and the yen is stronger in the first half. In the second half, domestic prices are likely to come under pressure from the easing of the supply-demand balance as the economy decelerates. Consequently, we think the rate of decline in domestic corporate goods price levels will again accelerate.

Consumer prices have fallen at a slower rate, albeit slightly. This slowdown is attributable to higher prices for petroleum products as a result of higher crude oil prices and smaller negative contributions from the telecommunications and culture/entertainment categories, where prices fell sharply the year before. In fiscal 2003, the pace of decline in consumer prices will slow sharply as the effects of electric power rate cuts run their course and out-of-pocket expenditures for health care are hiked. In fiscal 2004, when these factors fade, the pace of decline in consumer prices is

likely to accelerate, partly because the economy will enter a recessionary phase.

Exhibit 15: Outlook for Price



Sources: Bank of Japan(BOJ), Price Indexes Monthly
; Ministry of Public Management, Home Affairs, Post and
Telecommunications, Monthly on Price Indexes

Economic Outlook for fiscal 2003/2004

Yr/Yr, %
(half/half, %)

	Forecast						FY2002 (actual)	FY2003 (forecast)	FY2004 (forecast)
	FY2002		FY2003		FY2004				
	First half	Second half	First half	Second half	First half	Second half			
Nominal GDP	-0.9 (0.2)	-0.4 (-0.6)	0.0 (0.5)	-0.5 (-0.9)	-2.4 (-1.6)	-2.6 (-1.0)	-0.7	-0.3	-2.5
Real GDP	0.7 (1.7)	2.5 (0.8)	1.5 (0.6)	0.7 (0.2)	-0.8 (-1.0)	-1.2 (-0.1)	1.6	1.1	-1.0
Contribution of domestic demand	0.0	1.8	1.2	0.7	-0.5	-0.9	0.9	1.0	-0.7
Private consumption	1.6 (0.9)	1.4 (0.5)	0.4 (-0.1)	-0.2 (-0.1)	0.1 (0.2)	0.5 (0.3)	1.5	0.1	0.3
Housing investment	-2.9 (-1.4)	-2.9 (-1.6)	-1.7 (0.1)	-2.8 (-3.2)	-5.0 (-1.9)	2.0 (3.9)	-2.9	-2.2	-1.6
Private capital investment	-5.8 (1.5)	6.8 (4.9)	7.5 (2.5)	1.5 (-0.8)	-4.2 (-3.4)	-4.8 (-1.5)	0.5	4.3	-4.5
Contribution of Inventory investment	-0.1	0.3	0.0	0.5	0.1	-0.4	0.1	0.3	-0.2
Government expenditure	1.0 (-0.3)	-1.4 (-0.8)	-0.1 (0.4)	0.4 (0.6)	0.8 (0.1)	0.1 (0.2)	-0.2	0.2	0.4
Public investment	-3.8 (-3.1)	-8.6 (-5.8)	-6.8 (-1.3)	-3.6 (-0.9)	-3.7 (-2.8)	-6.3 (-3.4)	-6.5	-5.0	-5.2
Government final consumption expenditure	2.5 (0.7)	1.9 (1.1)	2.1 (0.9)	1.9 (1.2)	2.1 (0.9)	2.4 (1.5)	2.2	2.0	2.3
Contribution of external demand	0.8	0.7	0.3	0.0	-0.2	-0.3	0.7	0.1	-0.2
Export of goods and services	9.3 (9.6)	14.3 (4.2)	5.8 (1.5)	2.7 (1.1)	-1.1 (-2.2)	-3.2 (-1.0)	11.8	4.2	-2.2
Import of goods and services	2.5 (5.2)	9.0 (3.7)	4.6 (0.8)	3.2 (2.3)	1.0 (-1.2)	-1.3 (-0.1)	5.7	3.9	-0.2
Current account balance (trillion yen)	7.0	6.4	7.6	8.3	7.6	7.3	13.3	15.9	14.9
balance on goods (trillion yen)	6.0	5.6	6.5	6.5	6.4	6.0	11.6	13.0	12.4
balance on service (trillion yen)	-2.7	-2.5	-2.1	-2.7	-2.7	-2.9	-5.2	-4.8	-5.6
balance on income (trillion yen)	4.1	3.9	3.7	4.8	4.4	4.5	8.0	8.5	8.9
Industrial production	-0.4 (4.1)	5.7 (1.6)	2.0 (0.3)	-1.0 (-1.3)	-6.1 (-5.0)	-7.5 (-2.7)	2.6	0.5	-6.8
Corporate goods prices	-2.3	-1.3	-1.5	-1.4	-0.9	-2.0	-1.8	-1.4	-1.5
Domestic corporate goods prices	-2.1	-1.1	-1.0	-1.3	-1.7	-1.8	-1.6	-1.2	-1.7
Consumer prices	-0.9	-0.4	-0.2	-0.4	-0.6	-0.7	-0.6	-0.3	-0.6
excluding freshfood	-0.9	-0.8	-0.2	-0.3	-0.6	-0.7	-0.8	-0.3	-0.6
Yen/U.S.Dollar	123.1	120.7	119.6	124.0	125.5	120.5	121.9	121.8	123.0
Newly issued government bond yields (10years)	1.3	0.8	0.7	0.8	0.6	0.8	1.1	0.7	0.7
Crude oil price (U.S.dollar/barrel)	27.3	31.0	25.5	23.5	24.5	22.5	29.1	24.5	23.5
U.S. Real GDP (CY) (seasonally-adjusted annual rate)	3.5	2.7	1.6	2.3	3.4	2.3	2.4	2.0	2.8
Spring wage increases *	—	—	—	—	—	—	1.66	1.56	1.30

Notes:

* Figures are spring wage increases compiled from data on the 290 companies listed on the First sections of the Tokyo and Osaka stock exchanges that have a labor union and capital of 2billion yen or more as well as 1,000 or more employees.
(Compiled by the Ministry of Health, Labour and Welfare)

【Exports and Imports】

Forecast ↘

(Yr/Yr, %)

	FY2002		FY2003		FY2004		FY2002	FY2003	FY2004
	First half	Second half	First half	Second half	First half	Second half	Actual	Forecast	Forecast
Exports (yen basis)	6.5	10.5	4.2	3.0	0.3	-5.0	8.5	3.6	-2.4
Volume	10.8	11.9	6.5	2.8	-0.7	-3.0	11.4	4.7	-1.8
Imports (yen basis)	-1.2	8.8	2.7	-0.9	0.8	-4.1	3.7	0.9	-1.7
Volume	3.4	5.7	4.8	1.4	-2.0	-3.2	4.6	3.1	-2.6
Exports surplus (trillion yen)	5.1	4.6	5.6	5.6	5.5	5.1	9.7	11.2	10.6

【Income and Employment】

Forecast ↘

(Yr/Yr, %)

	FY2002		FY2003		FY2004		FY2002	FY2003	FY2004
	First half	Second half	First half	Second half	First half	Second half	Actual	Forecast	Forecast
Cash earnings of employees (per capita)	-3.1	-1.3	0.2	0.2	-0.9	-1.7	-2.2	0.2	-1.3
Regular compensation*	-1.5	-0.7	0.2	0.2	-0.3	-0.9	-1.1	0.2	-0.6
Overtime compensation	-0.7	4.1	2.7	-0.6	-5.1	-3.8	1.7	1.0	-4.4
Number of employees	-0.7	-0.3	0.0	0.2	0.0	-0.3	-0.5	0.1	-0.2
Compensation of employees*	-2.7	-1.6	0.3	0.4	-0.7	-1.7	-2.1	0.3	-1.2
Unemployment rate	5.4	5.3	5.4	5.4	5.7	5.7	5.4	5.4	5.7

Notes:

* Figures are for establishments of five employees or more, Ministry of Health, Labour and Welfare, Monthly Labour Statistics.

【New Housing Starts】

Forecast ↘

(10,000 units)

	FY2002	FY2003	FY2004
	Actual	Forecast	Forecast
Number of new housing starts	114.6	112.3	109.7
(change from the previous year)	(-2.4)	(-2.0)	(-2.2)
Owner-built housing	36.6	35.7	34.7
Rental housing	45.5	45.8	45.1
Built-for-sale housing	31.6	29.8	29.1
	(-8.1)	(-5.5)	(-2.5)

Economic Outlook for calendar 2003/2004

Yr/Yr, %
(half/half, %)

	Forecast						CY2002 (actual)	CY2003 (forecast)	CY2004 (forecast)
	CY2002		CY2003		CY2004				
	First half	Second half	First half	Second half	First half	Second half			
Nominal GDP	-2.7 (-0.1)	-0.1 (-0.0)	-0.5 (-0.5)	-0.2 (0.5)	-1.2 (-1.8)	-2.9 (-1.1)	-1.4	-0.3	-2.1
Real GDP	-1.6 (0.4)	2.0 (1.6)	2.2 (0.4)	1.0 (0.7)	0.3 (-0.4)	-1.3 (-0.9)	0.2	1.5	-0.5
Contribution of domestic demand	-2.1	1.2	1.9	0.9	0.3	-1.0	-0.5	1.3	-0.4
Private consumption	0.9 (1.0)	1.8 (0.8)	1.0 (0.2)	0.0 (-0.2)	-0.2 (0.0)	0.3 (0.3)	1.4	0.5	0.1
Housing investment	-6.6 (-2.6)	-3.0 (-0.5)	-1.7 (-1.1)	-2.4 (-1.5)	-4.7 (-3.2)	-1.4 (1.8)	-4.8	-2.1	-3.0
Private capital investment	-8.5 (-4.2)	-0.2 (4.3)	8.4 (4.0)	5.4 (1.2)	-1.4 (-2.7)	-5.4 (-2.9)	-4.5	6.9	-3.4
Contribution of Inventory investment	-1.1	0.3	0.2	0.2	0.5	-0.4	-0.4	0.2	0.0
Government expenditure	0.7 (0.9)	-0.1 (-0.8)	-0.9 (-0.4)	-0.4 (0.6)	1.2 (0.5)	0.5 (0.1)	0.3	-0.7	0.9
Public investment	-3.8 (0.3)	-5.6 (-5.6)	-9.6 (-4.5)	-6.3 (-0.5)	-1.6 (-1.1)	-4.4 (-3.1)	-4.7	-7.9	-3.1
Government final consumption expenditure	2.5 (1.1)	2.2 (1.1)	2.2 (1.1)	1.9 (1.0)	2.1 (1.0)	2.2 (1.2)	2.3	2.0	2.1
Contribution of external demand	0.5	0.9	0.3	0.1	0.0	-0.3	0.7	0.2	-0.1
Export of goods and services	2.3 (8.3)	14.3 (5.6)	8.3 (2.5)	4.1 (1.6)	1.3 (-0.3)	-2.5 (-2.3)	8.2	6.1	-0.7
Import of goods and services	-2.9 (1.7)	7.1 (5.3)	7.3 (2.0)	4.2 (2.1)	1.7 (-0.4)	-0.4 (0.0)	2.0	5.7	0.6
Current account balance (trillion yen)	7.9	6.3	7.0	7.7	8.4	7.0	14.1	14.7	15.4
balance on goods (trillion yen)	5.8	6.0	5.6	6.9	6.3	6.4	11.7	12.5	12.6
balance on service (trillion yen)	-2.4	-2.9	-1.9	-2.7	-2.4	-3.1	-5.3	-4.7	-5.5
balance on income (trillion yen)	4.6	3.7	3.9	4.1	4.9	4.3	8.3	7.9	9.2
Industrial production	-6.9 (0.6)	4.5 (3.6)	4.0 (0.4)	0.8 (0.3)	-3.4 (-3.7)	-8.2 (-4.8)	-1.4	2.4	-5.8
Corporate goods prices	-2.1	-1.7	-1.6	-1.5	-1.0	-1.5	-1.9	-1.6	-1.2
Domestic corporate goods prices	-2.4	-1.7	-0.9	-1.1	-1.5	-1.9	-2.1	-1.0	-1.7
Consumer prices	-1.2	-0.7	-0.2	-0.3	-0.6	-0.7	-0.9	-0.2	-0.6
excluding freshfood	-0.9	-0.9	-0.5	-0.2	-0.5	-0.7	-0.9	-0.3	-0.6
Yen/U.S.Dollar	129.8	120.9	118.7	121.8	125.8	123.3	125.3	120.2	124.5
Newly issued government bond yields (10years)	1.4	1.1	0.6	0.8	0.7	0.7	1.3	0.7	0.7
Crude oil price (U.S.dollar/barrel)	24.0	28.2	30.4	23.5	24.5	23.5	26.1	27.0	24.0
U.S. Real GDP (CY) (seasonally-adjusted annual rate)	—	—	—	—	—	—	2.4	2.0	2.8
Spring wage increases(FY)*	—	—	—	—	—	—	1.66	1.56	1.30

Notes:

* Figures are spring wage increases compiled from data on the 290 companies listed on the First sections of the Tokyo and Osaka stock exchanges that have a labor union and capital of 2billion yen or more as well as 1,000 or more employees.
(Compiled by the Ministry of Health, Labour and Welfare)

【Exports and Imports】

	CY2002		CY2003		CY2004		CY2002	CY2003	CY2004
	First half	Second half	First half	Second half	First half	Second half	Actual	Forecast	Forecast
Exports (yen basis)	1.2	11.8	4.3	3.7	2.7	-2.8	6.4	4.0	-0.1
Volume	3.4	13.6	7.9	4.0	2.0	-2.3	8.3	5.9	-0.2
Imports (yen basis)	-6.3	5.8	6.2	0.2	0.2	-1.2	-0.4	3.1	-0.5
Volume	-3.1	6.6	5.9	3.1	-0.6	-2.9	1.6	4.5	-1.8
Exports surplus (trillion yen)	4.9	5.0	4.7	6.0	5.3	5.5	9.9	10.7	10.8

【Income and Employment】

	CY2002		CY2003		CY2004		CY2002	CY2003	CY2004
	First half	Second half	First half	Second half	First half	Second half	Actual	Forecast	Forecast
Cash earnings of employees (per capita)	-2.3	-2.6	-0.5	0.5	-0.3	-1.6	-2.4	0.0	-1.0
Regular compensation*	-1.3	-1.1	-0.2	0.2	-0.1	-0.7	-1.2	0.0	-0.4
Overtime compensation	-5.1	2.9	3.9	1.4	-3.2	-5.9	-1.2	2.6	-4.5
Number of employees	-1.2	-0.3	-0.1	0.1	0.1	-0.2	-0.7	0.0	-0.1
Compensation of employees*	-2.5	-2.4	-0.6	0.7	-0.1	-1.5	-2.5	0.1	-0.9
Unemployment rate	5.3	5.4	5.4	5.4	5.6	5.8	5.4	5.4	5.7

Notes:

* Figures are for establishments of five employees or more, Ministry of Health, Labour and Welfare, Monthly Labour Statistics.

【New Housing Starts】

	Forecast		
	CY2002 Actual	CY2003 Forecast	CY2004 Forecast
Number of new housing starts (change from the previous year)	115.1 (-1.9)	113.4 (-1.5)	109.3 (-3.6)
Owner-built housing	36.8 (-4.9)	36.0 (-2.1)	34.5 (-4.2)
Rental housing	45.0 (2.7)	46.0 (2.3)	45.1 (-2.1)
Built-for-sale housing	32.4 (-4.4)	30.4 (-6.1)	28.9 (-5.1)