

August. 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 April–June quarter of 2003, the Japanese economy recorded real GDP growth of 0.6% over the previous quarter. This was the sixth consecutive quarter of positive growth and confirmed the continuation of the gradual recovery that commenced at the beginning of last year.

By component of final demand, private consumption rose 0.3% over the previous quarter for the seventh consecutive quarterly increase. Consumption is showing improvement, despite the continuation of harsh employment and income environments, and consumer confidence is no longer declining. Private capital investment expanded 1.3% over the previous quarter, for the fifth consecutive quarterly rise. Therefore, along with the improvement in corporate profitability, capital investment—principally replacement investment—is continuing to expand and play a leading role in the economic recovery.

Housing investment, however, declined 0.4% from the previous quarter, for the sixth consecutive quarterly decrease. With some temporary periods of growth, housing investment has been on a declining trend for about three years. Nevertheless, in June, there was a surge in the number of housing starts, stimulated by the approaching deadline for expiration of a housing loan tax relief measure, and the decline in housing starts in the April–June quarter was comparatively smaller than in previous quarters. Public investment dropped 0.9% from the previous quarter, marking the fifth consecutive quarterly decrease, indicating a declining trend is continuing as the government continues to make structural financial reforms. However, it appears that the positive impact of the supplementary budget enacted in fall 2002 has emerged, as reflected in a relatively small margin of decline in public investment for the quarter.

As a consequence of the increase in the percentage of medical costs borne by the patients under the national health-care insurance program (a factor resulting in a decline in social welfare benefits in kind), government

consumption has begun to decline, thus resulting in a further drop of 0.1% from the previous quarter in the contribution of public demand (including public investment). On the other hand, the contribution of private demand continued to be positive, standing at 0.5% for the April–June quarter, and the contribution of domestic demand (including public and private sectors) was +0.4% for the quarter. Moreover, the contribution of external demand rose 0.2% over the previous quarter, thus turning positive, compared with no change in the previous quarter. Exports rose 1.0% over the previous quarter, for the sixth consecutive quarterly increase, and recovered from the impact of a substantial decline in shipments to the United States in the January–March quarter. On the other hand, imports showed the first decline in six quarters, as service imports fell along with the drop in overseas travel from Japan, owing to the impact of severe acute respiratory syndrome (SARS).

The GDP deflator was down 2.1% year on year, a smaller margin of decline than in the previous quarter. This was because of the substantial fluctuation in the deflator for government consumption accompanying a reallocation of expenditures resulting from a change in the month for payment of bonuses to public servants. Adjusting for this special factor, we believe that deflationary pressures are continuing as in previous quarters.

(2) Views of the Economic Outlook

The GDP results for the April–June quarter may have been stronger than anticipated, but this was not sufficient for us to make a change in our appraisal of the current state of the economy and our outlook. However, views of the economy in various quarters continue to show wide variation. Therefore, we would like to summarize the key points related to the economic outlook in 2003 and 2004 as follows.

(a) Will the Recovery Gain or Lose Momentum?

Recent economic indicators, including the GDP data for the April–June quarter, are stronger than previously anticipated. As a result of this and other factors, the view that the economy will gain momentum is gaining greater currency. Reasons given for this view include the likelihood that

recovery momentum in the world economy, including the United States, will strengthen and that private capital investment will show further recovery as corporate profitability improves. Our forecast also assumes that recovery in the world economy will gain momentum. However, we do not believe it is possible to say with full confidence that the Japanese economy will necessarily continue to recover. For example, even if the U.S. economy sustains a recovery trend, we believe it is difficult to imagine that Japan's automobile exports will expand as rapidly as in 2002 when they were boosted by sales campaigns offering zero-interest rate financing and other factors.

Moreover, we also have to consider the economic environment in Japan. Although the feeling that recovery is actually taking place is weak, the Japanese economy reached a low point in January 2002 and has been recovering for about a year and a half. Therefore, the economy could very well reach a peak in the coming months and enter a downturn. In fact, an examination of data on the shipment and inventory cycle suggests the outlook that production levels may decline as inventories rise. Since a slowdown in production will put pressure on corporate profits, private capital investment, which has supported the recovery thus far, might begin to decline.

Thus far, the pace of recovery in production has been relatively slow and the recovery momentum has been weak. As a result, the peak in the economy may not be as clear than in previous cases, but, in our forecast outlined in the following pages, we believe the economic recovery will continue through the first half of the current fiscal year, but, in the second half, the economy will enter a downturn.

(b) How Serious Will the Downturn Be?

If the economy enters a downturn in the second half, how extensive will the adjustments be? Our conclusion is that the downward trend will not be sharp or sudden. Corporations are cautious about adding to inventories and inventory levels at present are extremely low. Although companies may enter a period of unintended inventory investment in the months ahead, the increase in inventories is expected to be marginal and the subsequent

adjustment in inventories is not likely to be severe. In addition, we believe recovery in overseas economies will continue, thus creating a favorable environment for exports and helping to alleviate pressures for inventory adjustments. Accompanying the adjustment in inventories, production will decline, but the bottoming out point for production levels this time is not expected to be as low as in the previous downturn.

(c) When Will the Economy Begin to Recover Again?

If a sharp downturn can be avoided, when will the economy reach bottom and resume recovery? In our outlook, we are looking for the economy to bottom out by the end of fiscal 2004 (the year ending March 31, 2005). The first condition for bottoming out will be the completion of inventory adjustments. If the inventory adjustment is not too severe, as previously mentioned, we expect the adjustment to be completed in the January–March quarter of 2005.

What will be the driving forces in the economy after it bottoms out? There is a possibility that the U.S. economy will be slowing in 2005 and that external demand may not be a support factor for recovery. However, the bottoming out of production following the completion of inventory adjustments will have a positive impact on corporate profits. Moreover, individual companies have continued their efforts to improve their operating and financial positions and are likely to continue these activities into the future. Through these efforts, companies have already made progress toward reducing excess production capacity and excess borrowings and this is reflected in improved profitability. The completion of short-term adjustments, combined with medium-to-long-term efforts to improve operating and financial positions, is expected to bring recovery again in private capital investment. In addition, there is a possibility that the medium-term growth trend in other economies in Asia will have a positive impact on Japan's recovery.

2. Revised 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 has shown signs of deceleration since the end of last year because of tensions caused by the situation in Iraq. However, since spring, stock prices have begun to rise, both consumer and corporate confidence levels are beginning to improve, and the economy is beginning to show signs of an upward trend. During the latter half of 2003, the positive effects of tax reductions, lower interest rates, and other government measures are expected to emerge, and there is a strong possibility that the pace of expansion in the economy may increase. However, as the end of 2004 approaches, the economy is expected to slow as interest rates rise and inventories build. We are forecasting 2.2% real growth for the U.S. economy in 2003 and 3.1% in 2004.

In the euro region, expectations about economic performance are improving following the reduction in European Central Bank (ECB) interest rates and increases in stock prices, but the pace of recovery in production, consumption, and other indicators of trends in the real economy is extremely gradual. During the latter half of 2003, although exports will begin to recover, along with improvement in economies outside the euro region, and economic recovery is likely to proceed, principally in the corporate sector, real GDP growth for 2003 as a whole will remain at about 0.6% because of the negative impact of stagnation in the first half of 2003. Moving into 2004, the recovery trend will spread from the corporate sector to the household sector as exports show a substantially stronger performance, and we are forecasting 2.0% growth in real GDP for 2004 as a whole.

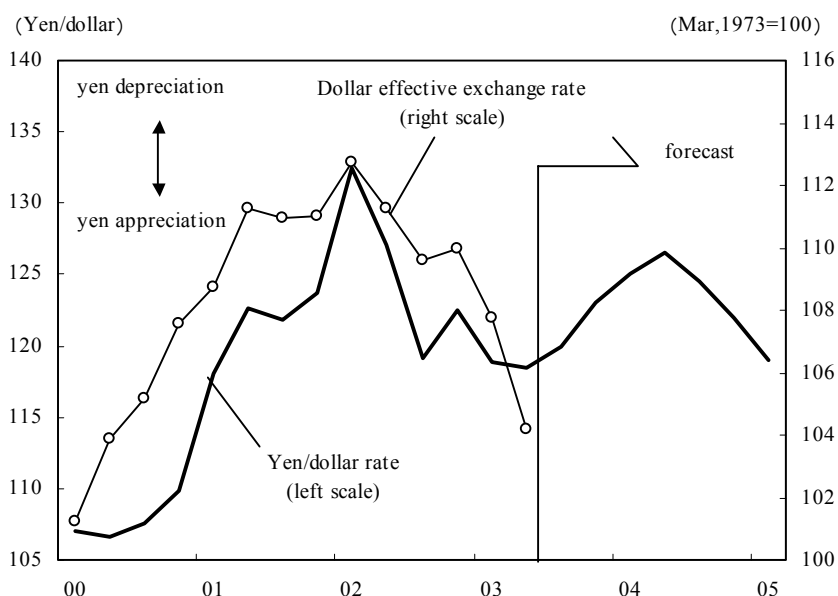
Turning to Asia outside Japan, SARS dealt a severe blow, principally to tourism, transportation, and services, during the first half of 2003. We are forecasting 4.9% real growth for Asia outside Japan as a whole (nine countries and regions), which will unavoidably fall below the 5.6% growth recorded for the previous year. In 2004, we anticipate a rebound from the

stagnation caused by SARS and, along with recovery in Europe and the United States, expect steady expansion in exports, which will act as the driving force for growth. In addition, as economic prospects improve, consumption and investment are likely to gain momentum. We are forecasting 6.0% growth for Asia as a whole outside Japan.

(b) Exchange Rates

The yen strengthened temporarily to ¥115 to the U.S. dollar because of the conditions in Iraq and concern about future trends in the U.S. economy, but, thereafter, because of continued intervention by the monetary authorities in Japan, the lower bound on the value of the dollar has strengthened, and, since June the yen has fluctuated between ¥117 and ¥121 to the dollar. During the latter half of fiscal 2003, the recovery trend in the U.S. economy is expected to strengthen but the Japanese economy will show slower growth, leading to a weakening of the yen against the dollar, generally within the ¥120 to ¥125 range. In fiscal 2004, although the Japanese economy is expected to continue a downtown trend, the pace of expansion in the U.S. economy will decline in the latter half of the year. We are, therefore, expecting a strengthening of the yen against the dollar beginning in the middle of fiscal 2004.

Exhibit 1: Outlook for the Yen-Dollar Exchange Rate



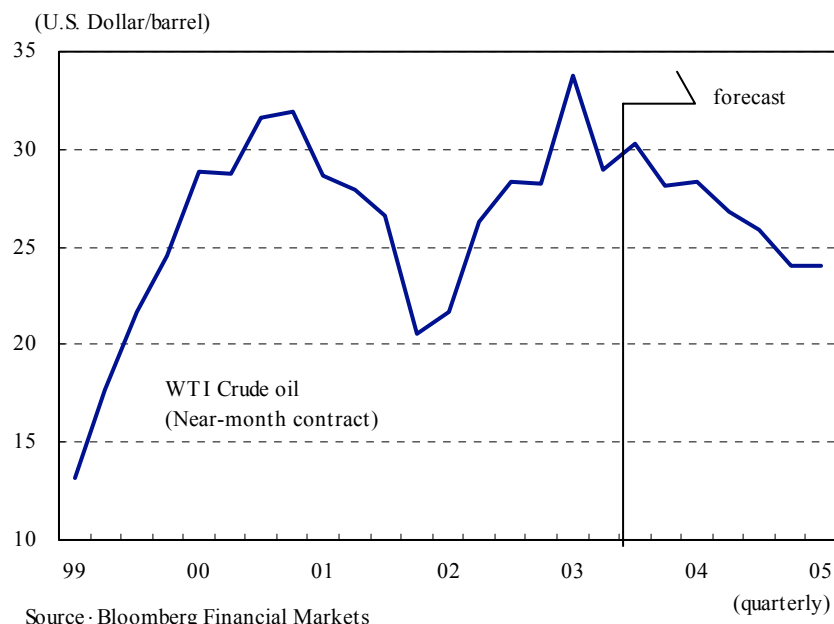
Sources: Bank of Japan, Financial and Economic Statistics Monthly, FRB [Federal Reserve Bulletin]

(c) Crude Oil Prices

Following the conclusion of the war in Iraq, crude oil prices have remained relatively high at around \$30 a barrel. Factors accounting for this have included the decline in oil inventories in the United States, reflecting firm demand; the delay in recovery in oil production in Iraq, because of difficulties in restoring public order and safety; and the relatively close observance of the new production quota instituted by OPEC in June. As a result of these circumstances, OPEC, at its meetings in June and July decided to leave the current production quota unchanged.

Looking forward, although relatively low inventories will provide support for crude oil prices for the time being, inventories are expected to begin to rise after the peak demand for gasoline passes around September, and oil prices may drop into the \$25-to-\$30 range. However, along with the recovery of oil production in Iraq, OPEC is expected to decide on production cutbacks at the meeting to be held in December, and this may lead to a temporary leveling out of oil prices. Thereafter, during the first half of fiscal 2004, the recovery in the world economy will provide support for oil prices, but excess supplies are expected to emerge as a result of increased production in Iraq, the decline in demand due to seasonal factors, and other circumstances, thus leading to a drop in oil prices. In the latter half of fiscal 2004, the expected decline in the momentum of recovery in the United States will have a depressing effect on oil prices, and, although a declining trend may continue, as prices approach the lower end of OPEC's price band (\$22 for a basket of oil types), OPEC is expected to adopt an aggressive policy of production cutbacks, thus preventing a major decline in crude oil prices.

Exhibit 2: Outlook for WTI Crude Oil Price



(d) Government Fiscal Policy

During fiscal 2003, ending March 31, 2004, we expect the government to adopt a supplementary budget of about ¥4 trillion in January 2004, including additional public works spending of approximately ¥1.5 trillion. In the fiscal 2004 budget, we expect that outlays at the national government level related to public works investment will decline 3.0% from the previous fiscal year on an initial budget basis. Similarly, we anticipate that expenditures on projects undertaken by local governments on their own initiative will decline 5.0% from fiscal 2003. However, we are assuming that in fall 2004 the government will adopt a supplementary budget, including about ¥1 trillion in additional public investment, to deal with the slowdown in the economy.

(e) Monetary Policy

Although the Bank of Japan (BOJ) has left its pace of outright purchases of long-term Japanese government bonds (JGBs) unchanged at ¥1.2 trillion a month, in May the BOJ raised its target for its current account deposits to between ¥27 trillion and ¥30 trillion and in July began outright purchases of asset-backed securities (ABS), which are backed primarily by assets related to small and medium-sized companies.

Since May, the bottoming out of the stock market and the ebbing of pessimism about the economy, calls for further monetary relaxation—including the introduction of inflation targeting, the purchase of assets other than JGBs, including exchange traded funds (ETFs), real estate investment trusts (REITs), and foreign securities—have quieted for the time being. However, if stock prices fall or the outlook for the economy becomes uncertain, requests for the further easing of monetary conditions are expected to rise again.

The BOJ may well take additional steps to relax monetary conditions, including an increase in outright purchases of long-term JGBs and a further boosting of the target for the BOJ's current account deposits. In addition, although the BOJ continues to take a cautious stance toward the introduction of inflation targeting and purchasing assets other than JGBs, there is a possibility it may implement these measures in some form. However, even if new policy tools are introduced, just as with strengthening existing policies, these measures may have little impact on the real economy.

(2) Economic Outlook for Fiscal 2003/2004

(a) Fiscal 2003: Second Consecutive Year of Positive Growth, But Slowdown Is Expected in Second Half

We are forecasting real GDP growth of 1.4% in fiscal 2003, the second consecutive year of expansion, but nominal GDP will show a further slight decline of 0.8%. The GDP deflator will drop 2.2%, indicating the continuation of deflationary conditions.

During the first half of fiscal 2003, the gradual recovery trend of the previous year will continue. Private capital investment will show further expansion as corporate profitability improves and play the leading role in driving the economy. Private consumption may remain stagnant in the July-September quarter. This is because of lower net take-home payments from summer bonuses (due to the introduction of the total compensation system for calculating social insurance premiums, which bases premiums on total compensation and no longer gives favorable treatment to bonus

income) and the impact of unseasonable weather, including a long rainy season and a cool summer. However, in general, consumption is expected to remain approximately level. Exports, principally to the United States, are likely to strengthen, and shipments of capital goods are expected to increase, supported by the recovery in private capital investment. As a consequence, production levels are expected to show a gradual rise. Inventory investment, which has lagged, is likely to expand and boost economic growth. Public investment will continue on a downward trend, but the combination of the positive effects of the supplementary budget for fiscal 2002 and accelerated spending from the 2003 budget will reduce the margin of decline. Since housing starts are expected to surge, prior to the expiration of the previously mentioned housing loan tax relief measure, residential investment will receive a temporary boost.

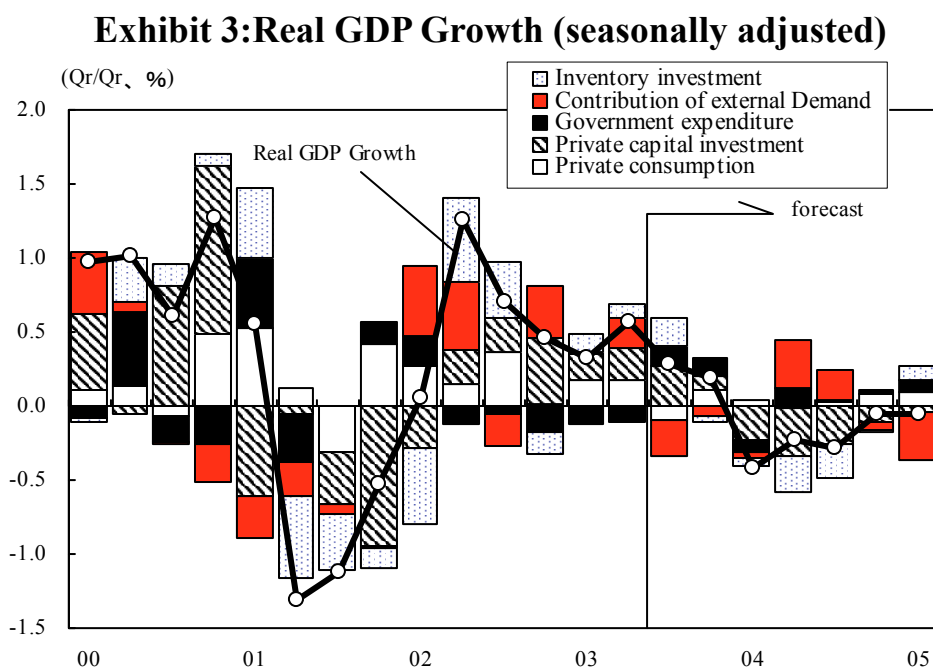
In the second half of fiscal 2003, the economy will experience a downturn. Increases in inventory levels will bring reductions in industrial production, and corporate profits will also decline. Since the recovery in private capital investment is fueled mainly by replacement investment rather than capital outlays for major expansions in capacity, as corporate cash flows begin to slow, capital investment is also expected to show slower growth. Along with the downturn in the economy, employment and income conditions will become harsher and will rule out high rates of growth in private consumption. Although real purchasing power will be supported by deflationary trends, growth in private consumption is expected to be marginal. Public investment will remain on a downward trend, and the acceleration of budget allocations will be followed by a reactionary decline later in the fiscal year.

(b) Fiscal 2004: Negative Growth in Real and Nominal GDP, But with Signs of Recovery at Fiscal Year-End

In fiscal 2004, the downturn during the latter half of fiscal 2003 will continue, and real GDP is forecast to decline 0.7%, thus bringing a return to negative growth. In nominal terms, GDP will fall a relatively large 2.4%. The GDP deflator will decline 1.8%, indicating a continuation of deflationary trends. As corporate profitability declines, private capital investment will remain on a downward trend, thus depressing economic

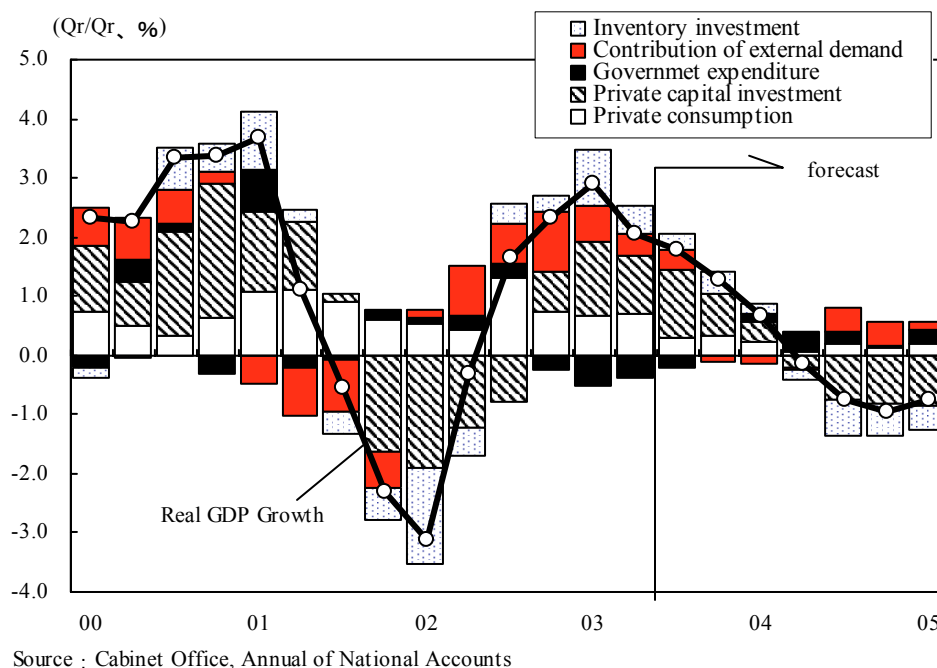
growth rates. Since employment and income conditions will continue to be harsh, private consumption will show only slight increases.

As the world economy is expected to recover in fiscal 2004, external demand is forecast to make a small positive contribution to Japan's growth. In addition, since the corporate sector will be in sight of completing inventory adjustments by the end of fiscal 2004, production is likely to bottom out. Along with the improvement in profitability and financial positions in the corporate sector, private capital investment will begin to show signs of recovery. In addition to the completion of inventory adjustments, which will be a short-term business cycle factor, the beneficial effects of efforts to improve profitability and financial positions in the medium-term are also expected to emerge. As a consequence, toward the end of fiscal 2004, we anticipate the economy will begin to show signs of recovery again.



Source : Cabinet Office, Annual of National Accounts

Exhibit 4: Real GDP Growth



3. Outlook by Demand Component

(1) External Demand: Will make a positive contribution as the world economy recovers

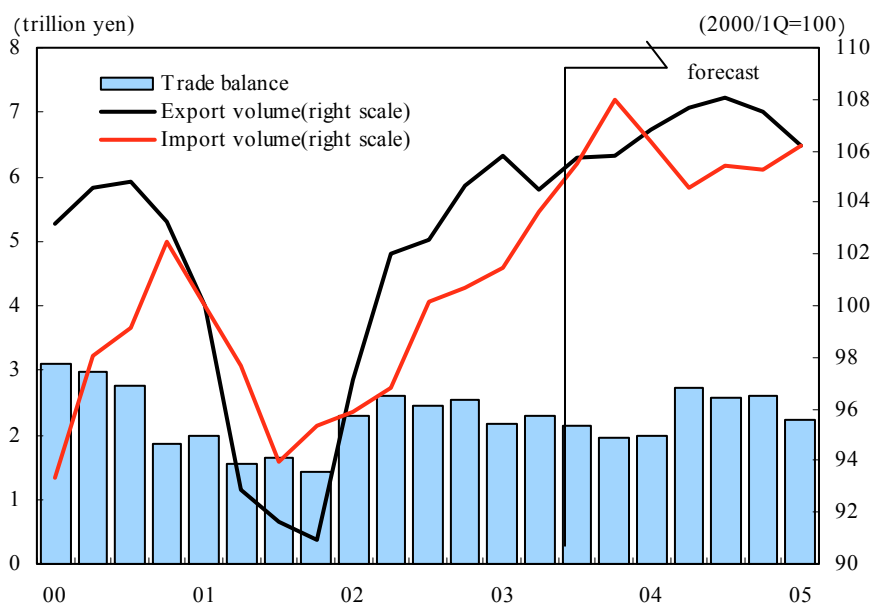
Exports to the rest of Asia and the EU, which had shown firm expansion through early spring 2003, have begun to slow, but since the effects of war in Iraq are beginning to diminish, the drop in exports to the United States is coming to an end. During the second half of fiscal 2003, the world economy will move toward recovery, and exports are expected to show an upward trend. Exports to Europe, where the pace of economic recovery is lagging, will show weak expansion, but exports to the United States of capital goods, especially machine tools and electric machinery, are likely to recover, and the slide in automobile exports is expected to bottom out as adjustments in local inventories are completed and new models are introduced. Exports to the rest of Asia, especially capital goods and producers' goods, are likely to increase because of the recovery in the United States, which is a source of final demand for many Asian products, and the shifting of production facilities of Japanese corporations elsewhere

in Asia. During the first half of fiscal 2004, exports are forecast to remain firm, but in the latter half of the year, overseas economies will begin to slow, resulting in only a small increase in exports for the full year.

Imports are rising along with the recovery in the Japanese economy. Although expansion in domestic demand is not robust, structural factors, including the higher penetration rate for imported goods, are expected to keep imports on an upward growth path throughout fiscal 2003. In fiscal 2004, the domestic economy is forecast to weaken and industrial production will fall; as a consequence, imports especially of producers' goods, such as parts and raw materials, are likely to become sluggish.

The contribution of external demand in fiscal 2003 is forecast to be slightly positive, standing at +0.1%. As a result of the SARS epidemic, expenditures by Japanese on overseas travel (corresponding to imports of services) fell significantly in the April–June quarter, thus boosting the contribution of the external demand. In the coming months, however, the number of travelers visiting overseas will recover, leading to a reactionary decline in contribution from this source. Moreover, the decline in the number of business-people going overseas at the time of the SARS issue resulted in a stoppage of negotiations, and this may be a factor slowing imports in the months ahead, but the overall effect is expected to be marginal. In the latter half of fiscal 2004, growth in exports will likely decline as the pace of expansion in the world economy slows, but, as a result of the weakness in the domestic economy, growth in imports will also slow, resulting in a net contribution of external demand to GDP of +0.2%.

Exhibit 5: Outlook for Trade



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

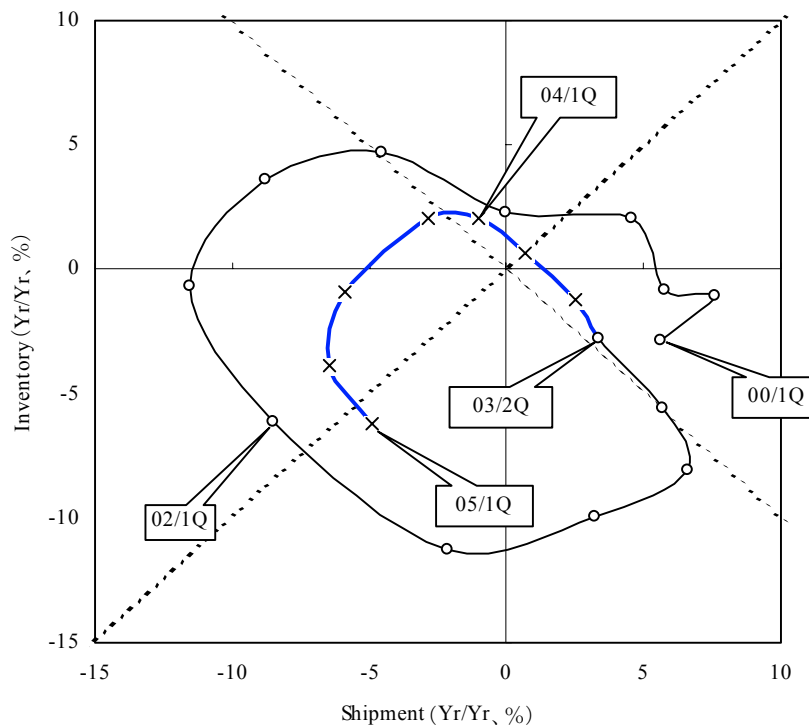
(2) Corporate Sector: Slowdown in the Second Half of Fiscal 2003

(a) Production: Declining Trend to Begin in Latter Half of Fiscal 2003

Although the index of inventories showed its eighth consecutive quarterly decline in the April–June quarter and other data suggest that inventory adjustments should have been completed, companies are not taking steps to increase inventories. During previous periods, inventory investments provided support for production, but this time corporations are not taking active measures to expand inventories because of the weakness of domestic demand, and this is one of the factors leading to stagnation in production. In the area of investment-related goods and producers' goods, which are related to exports, there is evidence of inventory stockpiling along with the increase in demand and inventories are expected to rise gradually in the months ahead. However, the stockpiling of inventories when demand is weak is likely to be short-lived, and companies will enter a period of unintended inventory investment toward the end of the fiscal year. In fiscal 2004, producers will enter an inventory adjustment phase, but, if the increase in inventories is relatively small, the adjustment may be relatively mild, and corporations are expected to be in sight of completing

adjustments by the end of the fiscal year.

Exhibit 6: Inventory Cycle Movements

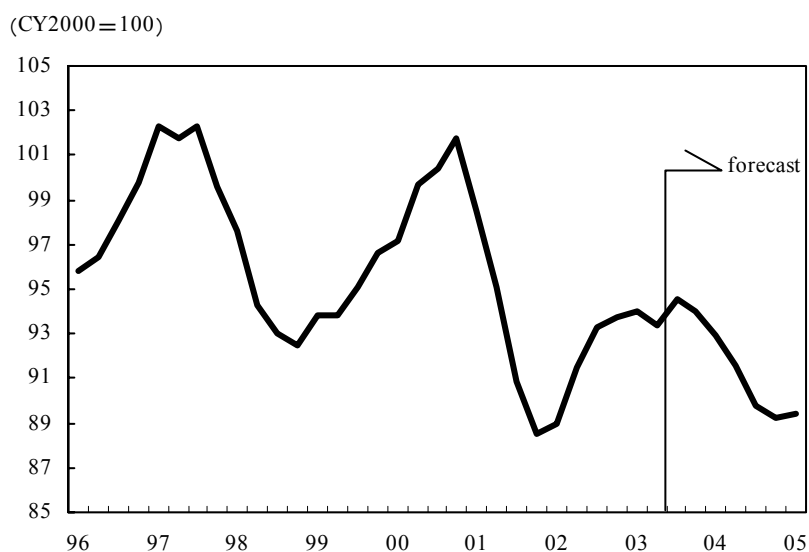


Note: Figures from the third quarter of 2003 are forecasts.

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

Although production activities are not robust at present, increases are expected to continue through the first half of fiscal 2003 as production of capital goods continues to rise and demand for IT-related goods remains firm. Nevertheless, since producers will enter a phase of unintended inventory investment in the latter half of fiscal 2003, production levels will be restrained, and producers will enter an inventory adjustment phase in fiscal 2004, leading to a clear decline in output. However, toward the end of fiscal 2004, producers are expected to be nearing the completion of inventory adjustments; therefore, production is likely to bottom out and begin to recover. Since the increase in inventories is expected to be small, the adjustment in production will also be relatively mild.

Exhibit 7: Outlook for Industry Production



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

(b) Corporate Profitability: Pace of Improvement Is Slow, and a Downturn Is Expected in Latter Half of Fiscal 2003.

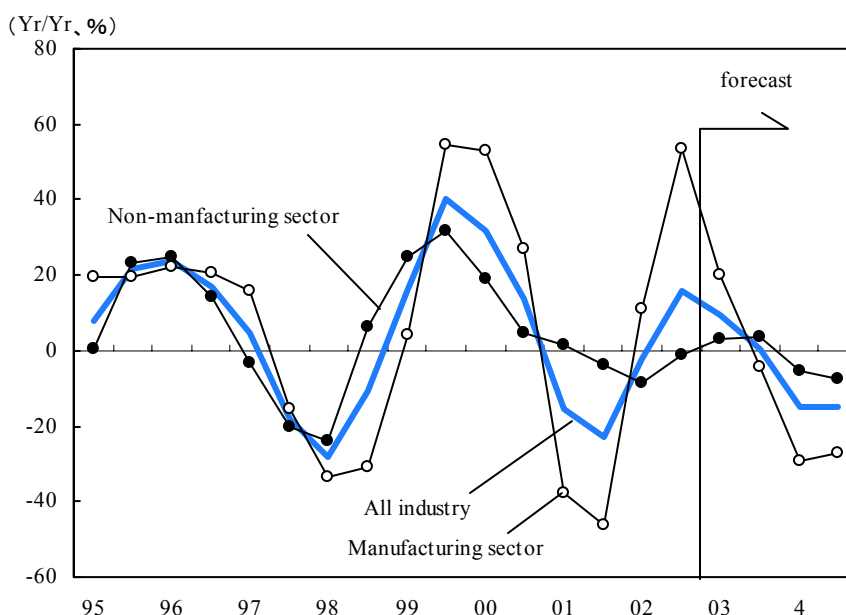
Corporate profitability is not as strong as previously, as evidenced by a decline in current profit from the previous quarter in the January–March period of 2003. Although an upward trend is likely to continue through the first half of fiscal 2003, a quarter-to-quarter decline is expected, beginning in the second half, and the margin of decline year on year will increase through the first half of fiscal 2004.

While growth in sales is sluggish because of weakness in market prices in manufacturing and non-manufacturing sectors, profitability has been on an upward trend because of the positive effects of restructuring, including reductions in personnel costs. However, as sales have declined, because of the weakness in domestic demand, and the effects of restructuring have now run their course, the benefits of restructuring will no longer be able to compensate for lower sales, thus leading to deterioration in profitability in both manufacturing and non-manufacturing in the latter half of fiscal 2003.

During fiscal 2004, the decline in sales in manufacturing and

non-manufacturing is forecast to accelerate along with the slowdown in the economy as a whole, thus placing downward pressure on corporate profitability. Nevertheless, the decline in corporate profits is expected to be relatively small because corporate financial positions are stronger than previously—owing to restructuring efforts, including reductions in liabilities and personnel costs—and exports are expected to rise along with the recovery in overseas economies. We are looking for profitability to begin to show signs of recovery toward the end of fiscal 2004.

Exhibit 8: Outlook for Corporate Performance



Source: MOF, Quarterly Statistics on Incorporated Enterprises

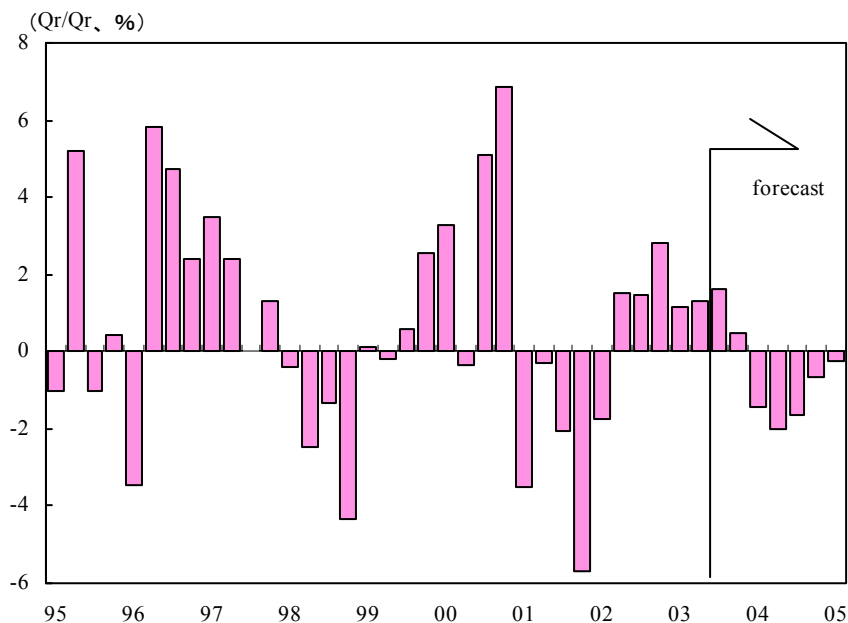
(c) Private Capital Investment: Slowdown Forecast Entering 2004

Private capital investment is continuing on an upward trend, as evidenced by the fifth consecutive quarterly increase in the April–June quarter of 2003. Orders for machinery and equipment, which are a leading indicator for capital investment, continued on an upward trend through the April–June quarter, and, judging from the prospects that orders will continue to be firm through the July–September period, capital investment is believed likely to show continued increases through 2003, supported by the improvements in corporate profitability to date.

However, since the principal components of capital investment now are smaller-sized outlays for the replacement and maintenance of facilities and equipment, rather than major projects for the expansion of capacity, the rate of expansion is duller than in previous recovery phases. In addition, companies are restraining their capital investments to within the limits of their available cash. Accordingly, we anticipate that private capital investment may start to show quarter-to-quarter declines starting in 2004, reflecting the deterioration in profitability that we expect to begin in the latter half of fiscal 2003.

The margin of decline in capital investment is likely to expand, in part because of the deterioration in corporate profitability in the first half of fiscal 2004. However, toward the end of fiscal 2004, signs of improvement in corporate performance are likely to emerge, thus acting as a brake on the slide in private capital investment. In addition, corporations are limiting capital investment within necessary minimum levels to avoid any increase in excess capacity; therefore, the decline in investment is forecast to be relatively mild.

Exhibit 9: Private Capital Investment

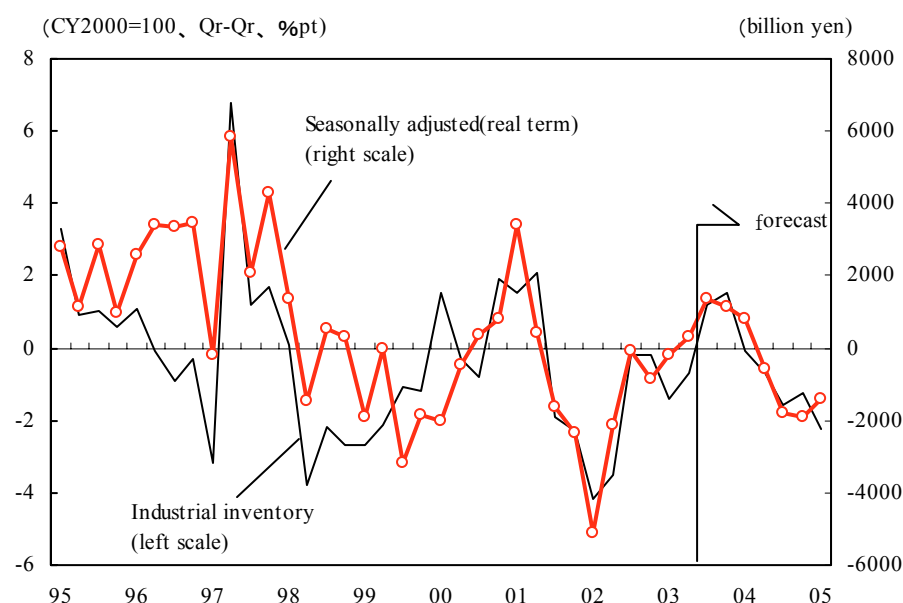


Sources: Cabinet Office, Annual of National Accounts

(d) Private Inventory Investment: Positive Contribution in Fiscal 2003

The corporate sector is exercising caution in expanding its inventories, and, as a result, the contribution of inventory investment to the economic growth rate in the April–June quarter of 2003 was marginal. In the quarters ahead, the trend toward gradually increasing inventories will combine with sluggishness in shipments, thus leading to unintended inventory investment and a positive contribution to economic growth in fiscal 2003. However, as a result of efforts to adjust inventories, the contribution of inventory investment in fiscal 2004 will be negative.

Exhibit 10: Inventory Investment



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

(3) Harsh Employment and Income Environments Will Continue, but Household Sector Spending to Increase Marginally

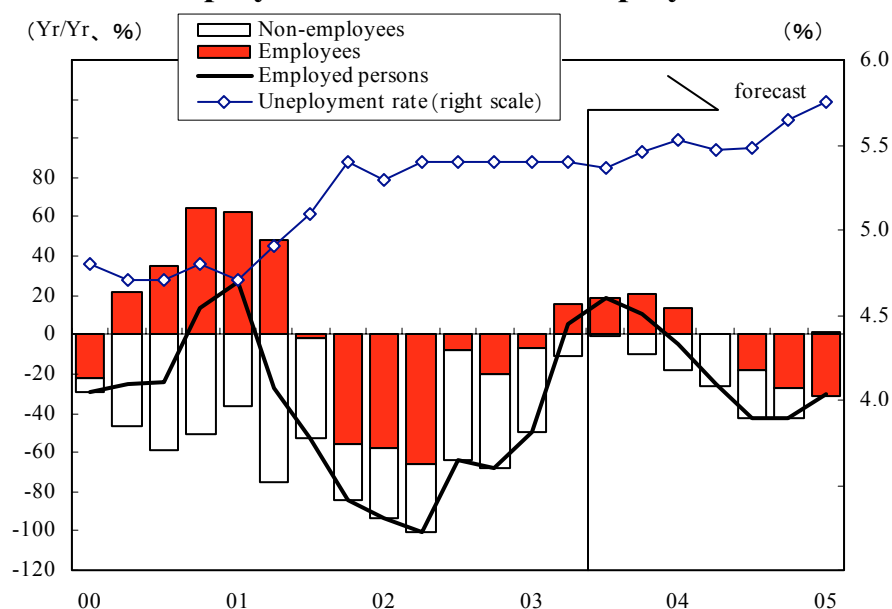
(a) Employment and Income Environments: No Major Improvement

Expected, Number of Employed Persons on Downtrend in Fiscal 2004

The margin of decline in the number of employed persons has decreased along with recovery in the economy and, with the beginning of fiscal 2003, the number of employed persons has started to rise. Factors accounting for this have been the lull in restructuring activities, compared with the recent

past, and the increase in employment of part-time and short-term contract workers, especially women. However, corporations still believe they have excess staff, and labor's share of income remains at a relatively high level. Accordingly, if corporate profitability declines along with the slowdown in the economy, adjustments may be made in the work-force, principally in the number of part-time and short-term contract workers. In addition, although the margin of decline in the number of self-employed persons and persons employed by family-owned businesses is shrinking, the position of businesses run by self-employed persons has weakened because of the prolonged stagnation in the economy. Therefore, if the economy slows, the number of self-employed persons may begin to decline again. For this reason, we expect the number of employed persons to continue to rise year-on-year through 2003, but to begin to decline along with the economic slowdown in 2004. The unemployment rate is continuing at a high level, and, when the impact of the economic slowdown begins to emerge in the latter half of fiscal 2004, it may show further increases.

Ehibit11: Employed Persons and Unemployment Rate



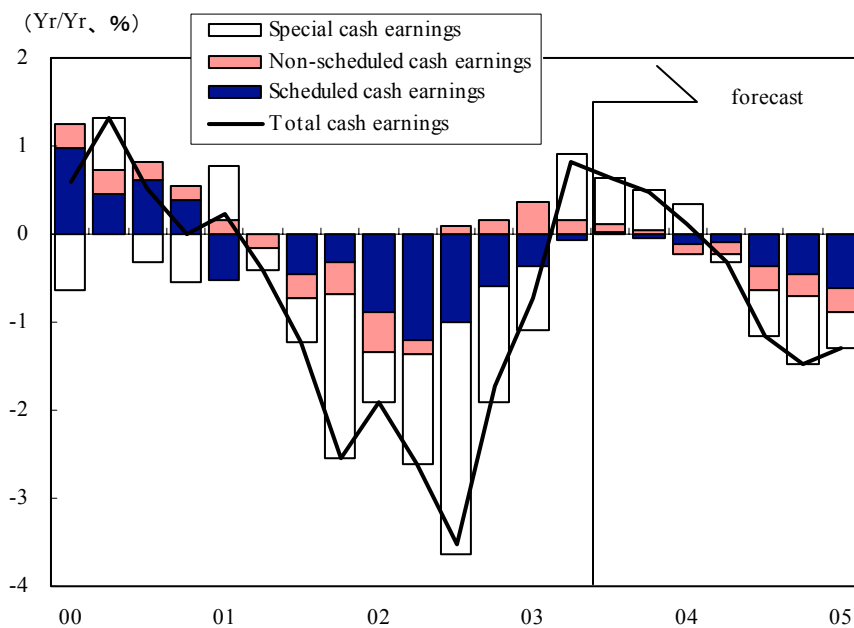
Note: 'Non-employees' consists of 'Self employed' and 'Family workers'.

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

Wages, which had dropped significantly because of rising pressures for restructuring, have begun to show some improvement; first, nonscheduled compensation has begun to increase along with the recovery in industrial production and subsequently, scheduled compensation has returned to the same level as in the previous year. Moreover, along with the improvement in corporate profitability, it appears that summer bonuses rose above the previous year's levels, and compensation levels have generally begun to rise since the beginning of fiscal 2003.

For fiscal 2003 as a whole, scheduled compensation is not expected to rise significantly because the spring wage increase was at the same level as for the previous year and due to other factors. In addition, the rate of increase in nonscheduled compensation will decline as production levels drop. On the other hand, bonuses—which experienced a substantial decrease in the previous year—are likely to rise along with the improvement in corporate profitability. In fiscal 2004, nonscheduled compensation and bonuses are forecast to decline, owing to the continuation of the economic downturn, which is expected to bring lower production and deterioration in profitability. In addition, the margin of decline in scheduled compensation will grow.

Ehibit12: Cash Earnings of Employees



Source: Ministry of Health, Labor and Welfare

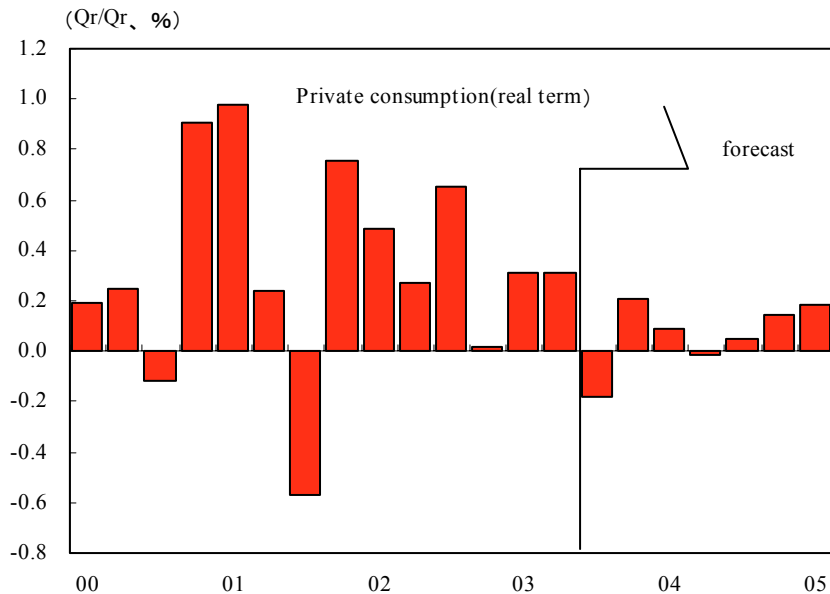
(b) Private Consumption: Will Continue to Be Restrained Because of Harsher Conditions Accompanying the Economic Downturn

Private consumption in the April–June quarter expanded 0.3% over the previous quarter as a result of improvement in consumer confidence, a temporary surge in demand for cigarettes in advance of an increase in the tax on tobacco products, and other factors. However, although the improvement in incomes will continue in fiscal 2003, certain factors, including the increase in the percentage of medical costs borne by patients under the national health-care insurance system, will have a depressing effect on disposable incomes. For this reason, growth in consumption will gradually slow, and the rate of expansion in real private consumption in fiscal 2003 will amount to only 0.7%, compared with 1.4% in fiscal 2002.

During fiscal 2004, further restraints will be placed on private consumption owing to a decline in consumer confidence accompanying the economic downturn and the decline in incomes of employed persons. Although deflation will boost purchasing power, real private consumption will rise only 0.3% over the previous year, thus remaining virtually unchanged.

Consumption in nominal terms, which has a direct effect on corporate sales, grew only 0.1% in fiscal 2002, which was just barely in the positive range, but nominal consumption will decline 0.5% in fiscal 2003 and drop 1.0% in fiscal 2004, for two consecutive years of negative growth.

Exhibit13: Real Private Consumption



Source: Cabinet Office, National Accounts

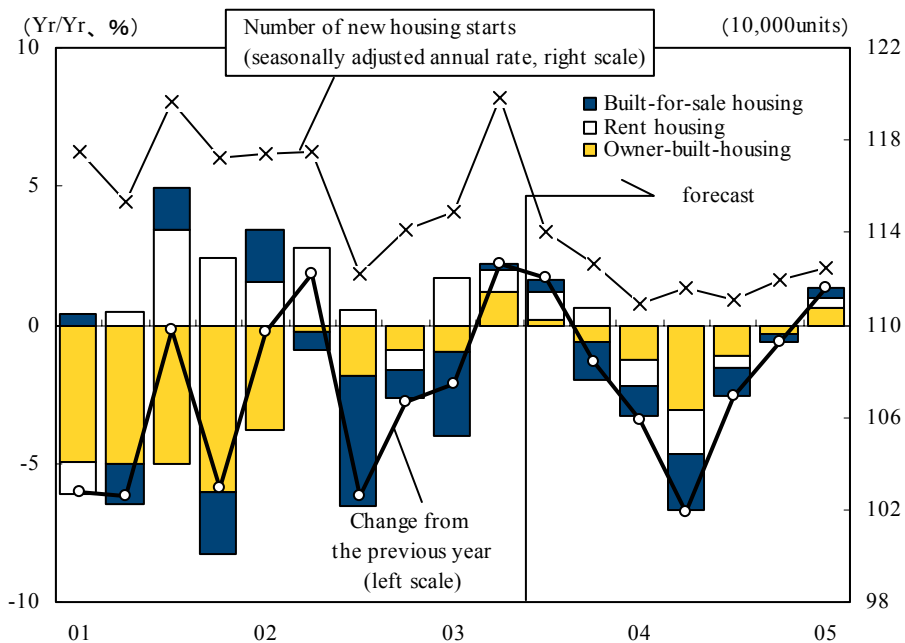
(c) Private Residential Investment: Surge in Demand due to Upcoming Expiration of Housing Loan Tax Relief Will Be Temporary, Underlying Downtrend to Continue

The number of housing starts in the April–June quarter was up 2.2% year on year (standing at an annualized rate of 1.198 million), the first year-on-year increase in four quarters, owing a surge in demand stimulated by the approaching expiration of the housing loan tax relief measure (available to people who move into their newly purchased homes before the end of December 2003) and the implementation of revisions to the building code (which took effect on July 1) that tighten restrictions on dwellings suffering from “sick house syndrome.” The surge in demand related to the tax relief measure is expected to continue through the end of summer, principally for owner-built and built-for-sale houses. However, a decline in housing starts in reaction to the surge earlier in the year is expected to set in the latter half of fiscal 2003, leading to a continuation of the downward trend in housing starts. Total housing starts in fiscal 2003 are forecast to amount to 1.145 million, approximately the same as in fiscal 2002.

In fiscal 2004, housing starts are forecast to remain sluggish. In the current low interest rate environment, investing in rental housing properties

is popular, but purchases of owner-built and built-for-sale houses are likely to show a continuing downtrend as the environment for housing purchases deteriorates along with the downturn in the economy. Housing starts will probably not expand year on year again until signs of economic recovery emerge in 2005.

Exhibit 14: Outlook for Housing Starts



Source: Ministry of Land, Infrastructure and Transport, Housing Construction Starts Statistics

(4) Government Expenditure: Public Investment to Continue to Decline but Government Consumption Will Remain a Positive Contributor

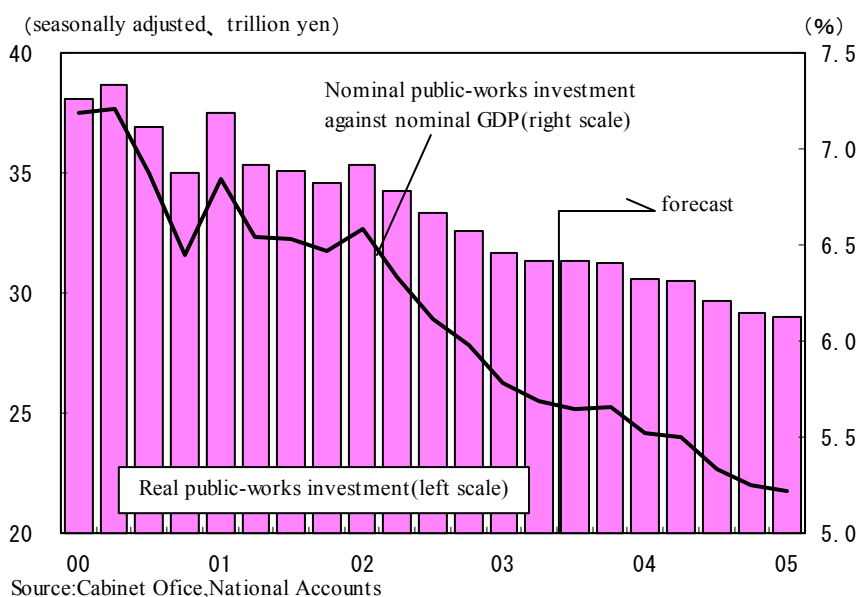
(a) Public Investment: Downtrend Will Continue

Expenditures related to public investment in the national government budget for fiscal 2003 are scheduled to fall 3.7% below the level for the previous fiscal year. However, this represents a smaller margin of decline than the 10.7% reduction in fiscal 2002. In addition, as a result of the positive effect of the supplementary budget for fiscal 2002, which was passed in January 2003, real public investment in the April–June quarter showed a moderate decline of only 0.9% from the previous quarter. As a result of the early implementation of the budget for fiscal 2003, public

investment in the first half of fiscal 2003 will be approximately level with the previous quarter, but these expenditures are likely to slow toward the end of fiscal 2003 because the next supplementary budget will not be drawn up until early 2004.

As in fiscal 2003, the fiscal 2004 budget for public investment is likely to be reduced by approximately 3%. Although expenditures will be supported by the fiscal 2003 supplementary budget (assumed to include ¥1.5 trillion in public investment), at the beginning period of fiscal 2004, its effect will fade by summer, leading to a downward trend in public investment. However, by the end of the year, the government is expected to pass a smaller supplementary budget for fiscal 2004 (assumed to include ¥1.0 trillion in public investment). The resulting increase in expenditures will reduce to some extent the pace of decline in public investment.

Exhibit 15: Outlook for Public-works Investment

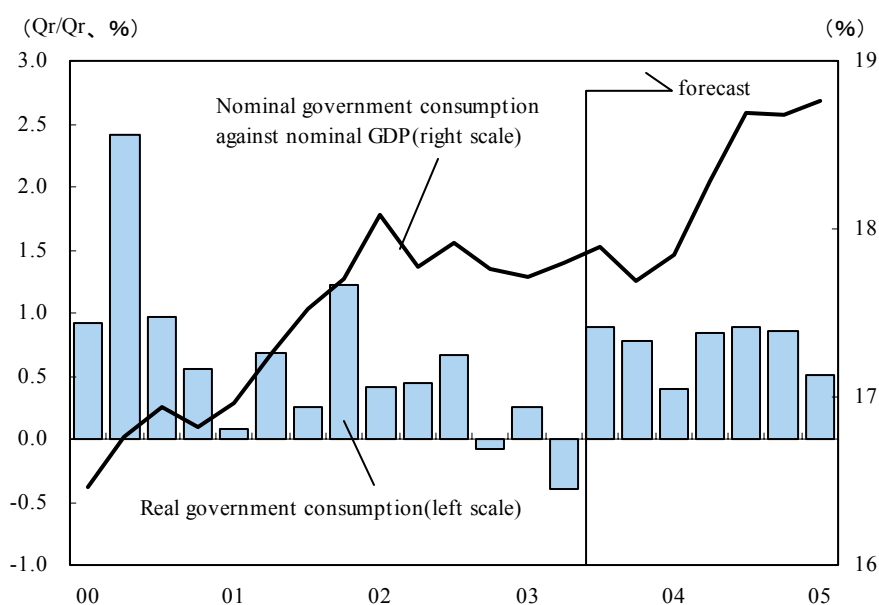


(b) Government Consumption: Upward Trend due to Expansion in Medical and Nursing Care Expenses

Government consumption in real terms during the April–June quarter of 2003 declined 0.4% from the previous quarter as a result of a decrease in the percentage of medical insurance benefits. However, since medical and

nursing care expenses are expected to rise, along with the demographic aging of the population, social welfare benefits in kind are likely to continue to increase. For this reason, government consumption will expand in fiscal 2003 and 2004. Moreover, as a result of a reduction in the monthly salaries and the number of month's salary paid as bonuses to government employees, government consumption is expected to decline significantly in nominal terms in the second half of fiscal 2003. However, in the conversion to real terms, these factors will be adjusted by changes in the deflator, and real government consumption will continue to increase.

Exhibit 16: Outlook for Government Consumption



Source: Cabinet Office, National Accounts

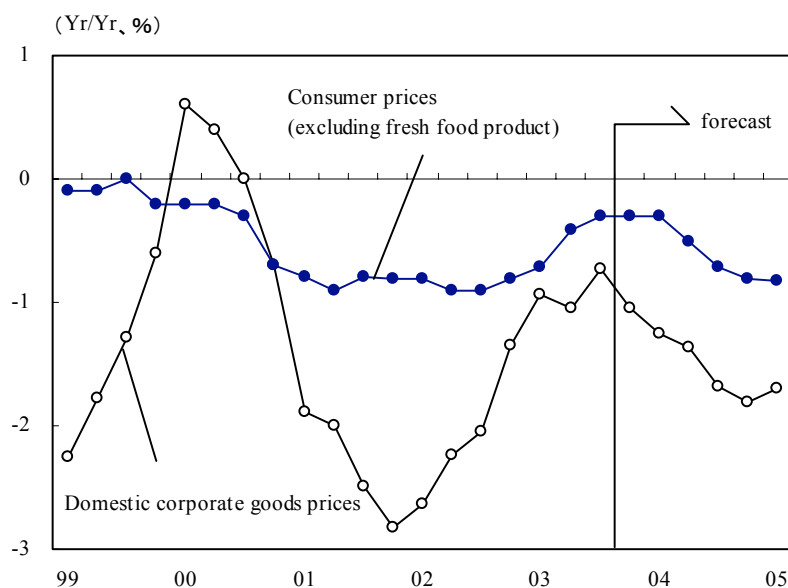
(5) Price Levels: Deflationary Trends to Persist

The margin of decline in domestic corporate goods prices has been shrinking along with the increase in crude oil prices and the tightening of the supply/demand balance accompanying economic recovery and production adjustments. Looking forward, the margin of decline in domestic corporate goods prices is expected to show further shrinkage because of such recent developments as the continuation of relatively high crude oil prices and the increase in electric power rates. However, from the second half of fiscal 2003 onward, the margin of decline in domestic

corporate goods prices may expand as crude oil prices begin to decline and downward pressures emerge along with the loosening of the supply/demand balance accompanying the slowdown in the economy.

The margin of decline in consumer prices has shrunk gradually along with the rise in petroleum product prices caused by higher crude oil costs and some weakening of the downward pressure on prices of education and entertainment durable goods, such as PCs, as well as clothing. In addition, since the beginning of fiscal 2003, the margin of decline in consumer prices has continued to shrink as the effect of the reduction in electric power rates has run its course and the percentage of medical costs borne by patients has increased. However, in fiscal 2004, the effect of such factors will weaken, and, as the economy moves into a downturn, the margin of declines in consumer prices will expand.

Exhibit 17: 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	-1.0 (0.2)	-0.4 (-0.5)	-0.3 (0.1)	-1.4 (-1.4)	-2.4 (-1.1)	-2.4 (-1.3)	-0.7	-0.8	-2.4
Real GDP	0.7 (1.7)	2.6 (1.0)	1.9 (0.9)	1.0 (0.1)	-0.4 (-0.6)	-0.9 (-0.2)	1.6	1.4	-0.7
Contribution of domestic demand	-0.1	1.8	1.6	1.1	-0.6	-1.1	0.8	1.3	-0.9
Private consumption	1.6 (0.8)	1.3 (0.5)	0.9 (0.4)	0.5 (0.2)	0.2 (0.1)	0.3 (0.3)	1.4	0.7	0.3
Housing investment	-2.9 (-1.6)	-2.8 (-1.4)	-1.9 (-0.5)	-1.4 (-1.0)	-5.1 (-4.1)	-3.8 (0.4)	-2.9	-1.6	-4.4
Private capital investment	-6.2 (1.3)	5.8 (4.2)	7.0 (2.8)	3.3 (0.6)	-3.0 (-3.5)	-5.0 (-1.6)	-0.2	5.1	-4.0
Contributory of Inventory investment	-0.1	0.6	0.4	0.3	-0.4	-0.5	0.3	0.3	-0.4
Government expenditure	1.0 (-0.2)	-1.5 (-1.1)	-1.3 (-0.4)	0.2 (0.7)	1.2 (0.4)	0.5 (0.3)	-0.3	-0.5	0.9
Public investment	-4.0 (-3.4)	-8.2 (-5.0)	-7.3 (-2.4)	-3.7 (-1.4)	-4.2 (-2.7)	-5.9 (-3.2)	-6.3	-5.3	-5.1
Government final consumption expenditure	2.5 (1.0)	1.4 (0.4)	0.5 (0.2)	1.6 (1.4)	2.9 (1.5)	3.1 (1.6)	1.9	1.1	3.0
Contribution of external demand	0.8	0.8	0.4	-0.1	0.2	0.3	0.8	0.1	0.2
Export of goods and services	9.3 (9.8)	15.1 (4.7)	5.9 (1.1)	3.8 (2.7)	5.9 (3.1)	1.7 (-1.5)	12.2	4.8	3.7
Import of goods and services	2.5 (5.3)	8.6 (3.2)	3.7 (0.4)	6.3 (5.8)	5.6 (-0.2)	-0.9 (-0.7)	5.6	5.0	2.2
GDP deflator	-1.6 (-1.6)	-2.9 (-2.9)	-2.1 (-2.1)	-2.4 (-2.4)	-2.0 (-2.0)	-1.6 (-1.6)	-2.3	-2.2	-1.8
Current account balance (trillion yen)	7.0	6.4	7.1	6.4	7.4	7.0	13.4	13.5	14.4
balance on goods (trillion yen)	6.0	5.6	5.5	4.7	6.3	5.4	11.6	10.3	11.7
balance on service (trillion yen)	-2.7	-2.5	-1.9	-2.4	-2.5	-2.3	-5.2	-4.3	-4.8
balance on income (trillion yen)	4.1	3.9	3.9	4.5	4.1	4.3	8.0	8.3	8.4
Industrial production	-0.4 (4.1)	5.7 (1.6)	2.0 (0.1)	-0.4 (-0.5)	-3.3 (-3.0)	-4.4 (-1.5)	2.6	0.8	-3.9
Corporate goods prices	-2.3	-1.3	-1.1	-1.1	-1.1	-2.4	-1.8	-1.1	-1.8
Domestic corporate goods prices	-2.1	-1.1	-0.9	-1.2	-1.5	-1.8	-1.6	-1.0	-1.6
Consumer prices	-0.9	-0.4	-0.3	-0.5	-0.6	-0.8	-0.6	-0.4	-0.7
excluding freshfood	-0.9	-0.8	-0.4	-0.3	-0.6	-0.8	-0.8	-0.4	-0.7
Yen/U.S.Dollar	123.1	120.7	119.2	124.0	125.5	120.5	121.9	121.6	123.0
Newly issued government bond yields (10years)	1.31	0.81	0.80	0.90	0.70	0.70	1.06	0.85	0.70
Crude oil price (U.S.dollar/barrel)	27.3	31.0	29.6	28.2	26.3	24.0	29.1	28.9	25.2
U.S. Real GDP (CY) (seasonally-adjusted annual rate)	3.5	2.7	1.7	2.9	3.3	3.1	2.4	2.2	3.1
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	2.0	0.3	2.8	-2.5	8.5	1.1	0.1
Volume	10.8	11.9	3.2	1.1	2.6	0.5	11.4	2.1	1.6
Imports (yen basis)	-1.2	8.8	5.1	4.3	-0.7	-6.6	3.7	4.7	-3.7
Volume	3.4	5.7	5.2	6.0	0.4	-1.4	4.6	5.6	-0.5
Exports surplus (trillion yen)	5.1	4.6	4.6	3.7	5.4	4.6	9.7	8.3	10.0

【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	0.7	0.3	-0.7	-1.4	-2.2	0.5	-1.1
Regular compensation*	-1.5	-0.7	0.0	-0.1	-0.3	-0.7	-1.1	-0.1	-0.5
Overtime compensation	-0.7	4.9	2.6	0.2	-2.9	-3.0	2.1	1.4	-3.0
Number of employees	-0.7	-0.3	0.3	0.3	-0.2	-0.5	-0.5	0.3	-0.4
Compensation of employees*	-2.7	-1.4	0.6	0.4	-0.7	-1.4	-2.1	0.5	-1.1
Unemployment rate	5.4	5.4	5.4	5.5	5.5	5.7	5.4	5.4	5.6

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	FY2002	FY2003	FY2004
	Actual	Forecast	Forecast	Actual	Forecast	Forecast
Number of new housing starts	114.6	114.5	111.7	114.6	114.5	111.7
(change from the previous year)	(-2.4)	(-0.1)	(-2.4)	(-2.4)	(-0.1)	(-2.4)
Owner-built housing	36.6	36.5	35.2	36.6	36.5	35.2
Rental housing	45.5	45.9	45.4	45.5	45.9	45.4
Built-for-sale housing	31.6	31.1	30.2	31.6	31.1	30.2
	(-8.1)	(-1.5)	(-3.0)	(-8.1)	(-1.5)	(-3.0)

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	-2.8 (-0.2)	-0.2 (-0.0)	-0.4 (-0.4)	-0.7 (-0.4)	-1.9 (-1.5)	-2.5 (-1.1)	-1.5	-0.6	-2.2
Real GDP	-1.7 (0.4)	2.0 (1.6)	2.5 (0.8)	1.5 (0.7)	0.3 (-0.4)	-0.8 (-0.4)	0.2	2.0	-0.3
Contribution of domestic demand	-2.2	1.1	2.0	1.4	0.4	-1.3	0.7	0.6	0.1
Private consumption	0.9 (1.0)	1.8 (0.8)	1.2 (0.5)	0.6 (0.1)	0.3 (0.2)	0.3 (0.1)	1.4	0.9	0.3
Housing investment	-6.6 (-2.5)	-3.0 (-0.7)	-2.4 (-1.6)	-1.2 (0.4)	-3.0 (-3.3)	-5.5 (-2.3)	-4.8	-1.8	-4.3
Private capital investment	-9.0 (-3.9)	-0.3 (3.7)	6.9 (3.3)	6.1 (2.6)	0.4 (-2.2)	-5.0 (-2.9)	-4.8	6.5	-2.3
Contribution of Inventory investment	-1.1	0.3	0.7	0.3	0.0	-0.6	-0.4	0.5	-0.3
Government expenditure	0.7 (0.9)	-0.1 (-0.9)	-1.8 (-1.1)	-0.4 (0.7)	1.0 (0.2)	0.4 (0.4)	0.3	-1.1	0.7
Public investment	-4.0 (-0.1)	-5.7 (-5.3)	-9.5 (-4.5)	-5.1 (-0.6)	-3.0 (-2.5)	-6.2 (-3.7)	-4.9	-7.2	-4.7
Government final consumption expenditure	2.5 (1.2)	2.1 (0.8)	0.8 (0.0)	1.1 (1.1)	2.3 (1.2)	3.0 (1.7)	2.3	1.0	2.6
Contribution of external demand	0.5	0.9	0.5	0.1	-0.1	0.4	0.7	0.3	0.2
Export of goods and services	2.3 (8.2)	14.3 (5.7)	9.2 (3.2)	4.8 (1.5)	4.8 (3.3)	4.3 (1.0)	8.2	6.9	4.5
Import of goods and services	-2.9 (1.8)	7.1 (5.1)	6.1 (0.9)	4.9 (3.9)	7.3 (3.3)	0.9 (-2.2)	2.0	5.5	4.0
Current account balance (trillion yen)	7.9	6.3	7.2	6.1	7.3	7.1	14.1	13.3	14.4
balance on goods (trillion yen)	5.8	6.0	5.4	5.1	5.5	6.0	11.7	10.5	11.5
balance on service (trillion yen)	-2.4	-2.9	-1.8	-2.4	-2.4	-2.3	-5.3	-4.3	-4.8
balance on income (trillion yen)	4.6	3.7	4.2	3.9	4.6	3.9	8.3	8.1	8.5
Industrial production	-6.9 (0.6)	4.5 (3.6)	4.0 (0.2)	0.9 (0.6)	-1.5 (-2.1)	-5.0 (-3.0)	-1.4	2.4	-3.3
Corporate goods prices	-2.1	-1.7	-1.5	-1.0	-1.0	-1.8	-1.9	-1.2	-1.4
Domestic corporate goods prices	-2.4	-1.7	-1.0	-0.9	-1.3	-1.7	-2.1	-0.9	-1.5
Consumer prices	-1.2	-0.7	-0.3	-0.4	-0.5	-0.8	-0.9	-0.3	-0.6
excluding freshfood	-0.9	-0.9	-0.6	-0.3	-0.4	-0.8	-0.9	-0.4	-0.6
Yen/U.S.Dollar	129.8	120.9	118.6	121.5	125.8	123.3	125.3	120.1	124.5
Newly issued government bond yields (10years)	1.42	1.09	0.65	0.98	0.80	0.65	1.25	0.81	0.73
Crude oil price (U.S.dollar/barrel)	24.0	28.2	31.4	29.2	27.6	24.9	26.1	30.3	26.2
U.S. Real GDP (CY) (seasonally-adjusted annual rate)	—	—	—	—	—	—	2.4	2.2	3.1
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】

	Forecast ↘						(Yr/Yr, %)		
	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	3.9	0.7	2.0	0.4	6.4	2.2	1.2
Volume	3.4	13.4	5.8	2.1	2.0	1.9	8.4	3.9	1.9
Imports (yen basis)	-6.3	5.8	7.2	5.1	1.6	-4.3	-0.4	6.1	-1.4
Volume	-3.3	6.5	5.6	6.3	2.9	-1.3	1.6	5.9	0.7
Exports surplus (trillion yen)	4.9	5.0	4.4	4.1	4.6	5.2	9.9	8.5	9.8

【Income and Employment】

	Forecast ↘						(Yr/Yr, %)		
	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	0.1	0.5	-0.1	-1.3	-2.4	0.3	-0.8
Regular compensation*	-1.3	-1.1	-0.3	-0.0	-0.1	-0.6	-1.2	-0.1	-0.3
Overtime compensation	-5.1	2.9	4.6	1.5	-1.3	-4.1	-1.2	3.0	-2.7
Number of employees	-1.2	-0.3	0.1	0.4	0.1	-0.4	-0.7	0.2	-0.1
Compensation of employees*	-2.7	-2.3	-0.2	0.5	-0.1	-1.4	-2.5	0.2	-0.8
Unemployment rate	5.4	5.4	5.4	5.4	5.5	5.6	5.4	5.4	5.5

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)		
	CY2002	CY2003	CY2004	CY2002	CY2003	CY2004
	Actual	Forecast	Forecast	Actual	Forecast	Forecast
Number of new housing starts	115.1	115.3	111.4	115.1	115.3	111.4
(change from the previous year)	(-1.9)	(0.2)	(-3.4)	(-1.9)	(0.2)	(-3.4)
Owner-built housing	36.8	36.8	35.1	36.8	36.8	35.1
Rental housing	45.0	46.2	45.3	45.0	46.2	45.3
Built-for-sale housing	32.4	31.4	30.1	32.4	31.4	30.1
	(-4.4)	(-3.0)	(-4.2)	(-4.4)	(-3.0)	(-4.2)

Note: The opinions, forecasts, and other statements in this report are judgments based on data available at the time of preparation and may change without notice.