**October. 2003**

# Forecast for the Japanese Economy

# In Fiscal 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 July-September period, real GDP rose +0.6% from the previous quarter, for the seventh consecutive quarterly increase, but in nominal terms, the GDP was virtually unchanged from the previous quarter, showing a decline of -0.0%. The GDP deflator was down -2.7% from the previous year, a slightly larger margin of decline than in the prior quarter, suggesting that deflation is continuing. By major component of GDP, the driving force for growth was expansion in private capital investment (+2.8% in real terms over the previous quarter) accompanying the improvement in corporate profitability. In addition, private consumption was virtually level with the previous quarter (+0.0% in real terms over the previous quarter) but continued to be firm, in part because of the improvement in the employment and income environments. Exports, which had slowed temporarily, showed a stronger performance (+2.8% in real terms over the previous quarter), accompanying the acceleration in the world economy. Government public investment spending, however, continued on a downward trend (-3.9% in real terms below the previous quarter). On the other hand, housing investment rose for the second consecutive quarter (+2.7% in real terms over the previous quarter), reflecting the implementation of revisions to the building code and a surge in the number of housing starts stimulated by the approaching deadline for expiration of a housing loan tax relief measure.

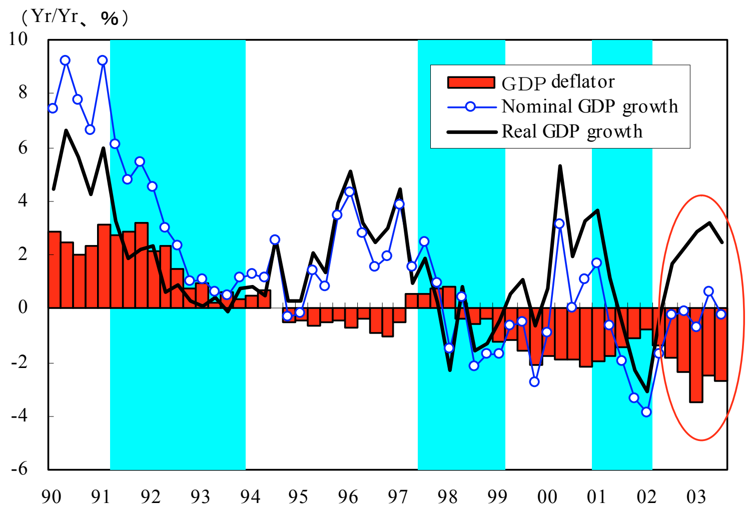
In our previous forecast, released on August 15, 2003, we indicated that recovery would continue, led by private capital investment, but, in the latter half of the year, that industrial production would turn downward because of a build up in inventories and the commencement of a deterioration in corporate profitability. We also forecast the beginning of a decline in private capital investment after the start of 2004. However, there have been no signs to date of an increase in inventories, and it appears that production will continue to expand in

October and later months, led by IT-related products and parts—including PCs, cellular phones, semiconductors, and LCDs—and general machinery, supported by the rise in capital investment.

## (2) Views of the Economic Outlook—Key Features of a Deflationary Economic Recovery

If the recovery trend lasts longer that we anticipated in our previous forecast, how long should we assume the recovery will continue? Before we discuss the outlook for the economy, let us analyze the most recent developments in the recovery. If we selected a phrase to characterize the current upward trend in the economy, which started at the beginning of 2002, it would probably be “deflationary economic recovery.” When we consider the relation between “deflation” and “economic climate” , we immediately think of a “deflationary spiral,” however, what we are seeing now is the coexistence of gradual deflation with gradual economic recovery. At least, it appears that individual economic agents are behaving as though they were assuming the persistence of gradual deflation. In addition, as adaptation to deflation progresses, it appears we are seeing a sustained recovery in the midst of deflation. Therefore, what are the key features of a deflationary economic recovery? The next paragraphs summarize our analysis by component of final demand.

**Exhibit 1 : Nominal/Real GDP growth and GDP deflator**




Note : The shaded region is designated as recession period. The business peak in October-December quarter of 2000 and the business bottom in January-March quarter of 2003 are interim.
Source : Cabinet Office, Annual of National Accounts

### ① Private Consumption Continues to Be Firm

First, let us look at private consumption, which accounts for more than half the GDP. Incomes, which are the basic resource needed for consumption, are still showing weak growth. Although corporate profits have improved, companies are still cautious about increasing their personnel expenses, and employee incomes are still rising by only a small margin. Consequently, consumption in nominal terms is continuing to decline. Nonetheless, the decline in prices is boosting real growth, leading to small increases in real consumer spending. Recent data show that consumers are expanding their purchases of PCs, cellular phones, digital cameras, DVDs, and other high-tech items, and these are the items showing the pronounced declines in prices.

### ② Improvement in Corporate Earnings Structure and Expansion in Capital Investment

The economic activities of the corporate sector, which have a major impact on trends in the economy, are also showing progress in dealing with deflation. The recovery in corporate profits is symbolic of this. Profits are rising as a result of cost cutting, including reductions in fixed expenses such as wages and salaries, and improvement in financial positions through repayment of borrowings. Therefore, even though there is relatively little growth in sales, profits are expanding. Recently, however, it appears that the effectiveness of corporate restructuring has about run its course. Moreover, under deflationary conditions, companies find it difficult to raise sales prices, meaning that the key factor accounting for expansion in sales is growth in the volume of products sold. As a result, growth in sales in monetary terms is marginal. However, because companies now have a stronger capability for generating earnings than before, even a slight rise in sales can boost profits.

Along with the recovery in corporate profits, private capital investments to replace existing facilities and improve efficiency as well as investments in R&D and other areas are recovering. Some might hold the view that companies are not likely to boost capital investment if they are seriously concerned about deflation and lack confidence in the future. Certainly, in a deflationary climate it is difficult to rely on capital investment to increase profits. However, the cost of investing is also declining. Compared with the decline in the consumption deflator, the drop in the investment deflator is much larger. Provided companies can anticipate expansion in the unit volume of sales, contrary to what some might think, the environment for capital investment is relatively good under deflationary conditions. In short, if corporate profits and cash flow rise, capital investment is likely to follow. In other words, in a deflationary economic climate, companies can make the necessary capital investments at low cost. Therefore, even though the recovery in investment in nominal terms is moderate, deflation gives growth in real terms a boost.

### ③ Stagnation in Inventories

However, the impact of deflation on inventories is not the same as the effect on capital investment. If deflation is continuing, corporations have little incentive to increase inventories. Since prices of goods held in inventory are declining because of deflation, the burden of holding such stocks of goods become heavier. For example, even if companies think demand is going to recover, they will not expand inventories in anticipation of stronger demand, but will begin to manufacture in response to actual demand as evidenced by orders for goods. Companies reduce their inventories as quickly as possible and are reluctant to expand stocks of goods.

Under conditions of mild deflation, private consumption continues to be firm and capital investment is showing a gradual recovery. However, consumption and investment are not showing firm expansion in nominal terms. Instead, they are showing growth in real terms, as consumers and corporations exercise selectivity in their spending behavior. At the same time, companies are being cautious about increasing inventories, so it is difficult for the economic recovery to gain momentum. On the other hand, provided companies do not increase inventories, a downturn in the economy due to an inventory adjustment is ruled out. In our previous forecast in August, we considered trends in consumption and investment under deflationary conditions, but we apparently did not take sufficient account of the cautious attitude of corporations in making inventory investments.

### (3) Outlook for the Economy—The Sustainability of a Deflationary Economic Recovery

#### ① Firm Consumption and Expanding Investment

The deflationary economic recovery will most likely continue. First, gradual recovery in real consumption will continue. Under deflationary conditions, companies will maintain their stance of restraining increases in personnel costs, and, as a result, there will be no dramatic improvement in the employment and income environments. However, it is also unlikely that either of these environments will show a marked deterioration, and, as a result of deflation, private consumption in real terms will remain firm.

Private capital investment is also likely to continue on an upward trend. Corporate profitability is continuing to recover, and there is no reason for investment to be reduced because of cash flow. However, corporations are being selective in their investments, giving due consideration to whether such investments are truly necessary. Therefore, the expansion in investment is expected to be gradual. Moreover, when companies have completed the investments they deem necessary, any further expansion in profits is likely to be allocated to repaying debt. Therefore, a gradual economic recovery is expected to continue under deflationary conditions.

#### ② Factors Detrimental to Sustainability of the Deflationary Economic Recovery

How long will this gradual recovery continue? Will it last as long as the uptrend in 1994 and 1996, which continued for 43 months? Certainly, that is a possibility, but there are a number of factors that may cause the economy to slow.

#### (a) Deceleration in Overseas Economies

The first factor that may be an obstacle to the continuation of the current deflationary economic climate would be a slowdown in overseas economies. In an environment where price increases are not expected, expansion in volume is responsible for supporting the economy, and the contribution of increasing exports is quite high. The U.S. economy is continuing to expand, supported by a tax reduction, and the domestic economy is growing along with the expansion in the world economy. However, in the latter half of fiscal 2004, when the positive effect of the tax reduction wears off and the current wave of IT investments is completed, we expect that growth in the U.S. economy will begin to slow. The resulting loss of momentum in exports from Japan, will have a dampening effect on production activity in Japan.

**(b) A Build-up of Inventories**

Another factor that may have a negative impact would be a build-up of inventories. As we mentioned previously, increasing inventories in a deflationary scenario is unlikely. In fact, if companies manufacture products only after receiving firm orders, there should be no increase in inventories. However, this does not mean that the inventory cycle will disappear and that there will never be another build-up of inventories. In the general merchandise industries, where companies manufacture goods in anticipation of future demand, if demand fails to expand as much as companies have anticipated, or, if companies overproduce because of duplicate speculative orders placed in anticipation of higher demand, inventories will rise. For example, around the end of 2000, when the IT boom was declared to be at an end, inventories of high-tech goods expanded, and this triggered an inventory adjustment. Even if concern about deflation persists, there is a possibility that inventories of producers' goods, such as IT parts, will rise. At present, the semiconductor market is relatively quiet, and there are no signs of speculative demand like that which emerged during the IT bubble. However, if production of high-tech good expands rapidly, there may be a risk that inventories will rise. Close monitoring of trends in demand for high-tech goods will be necessary.

**(c) Upward Cost Pressure on the Supply Side**

There is a possibility that price increases in upstream sectors, such as energy fuels and raw materials may put pressure on corporate profits. International commodity prices, which saw their most recent low at the end of 2001, have already climbed back to the levels prevailing in 1995 through 1997. Increases in commodity prices are usually said to indicate recovery in economic conditions. However, if costs rise on the supply side and corporations are unable to pass these costs on to sales prices, corporate profitability will suffer, and this will have a negative impact on the economy. However, to date, the rise in commodity prices has not had an adverse impact on the economy.

Factors (a) “the slowdown in overseas economies in the latter half of fiscal 2004 will have a restraining impact on the Japanese economy” and (b) “the rise in inventories” were cited in our August forecast as the principal reasons for a coming economic slowdown. To date, there have been no signs of a movement toward a build-up in inventories, but we do not believe, as some have said, that the inventory cycle has disappeared. In our current forecast, we indicate a belief that there will be some degree of inventory build-up in fiscal 2004 and that this will have a restraining effect on production. However, in view of the features of a deflationary economic climate, which we mentioned previously, we are forecasting that the impact of a build-up in inventories will be mild. Regarding point (c) “upward cost pressure on the supply side,” provided there are no sudden increases in commodity market prices and no major increase in wages, the impact of this factor is likely to be marginal. In addition, we believe the possibility of such a turn of events is unlikely.

Although we have described recent trends as a “deflationary economic recovery,” that does not mean economic conditions will improve due to deflation. On the other hand, persistent deflation is not likely to lead to deterioration in the economy. Even if deflation continues, the economy has been recovering for almost two years since January 2002. Both deflation and inflation are given conditions that are influencing economic agents and cannot be avoided. Under the current deflationary conditions, consumers are using their incomes skillfully and making wise purchases. In addition, corporations are working to improve their financial positions and profitability and making selected strategic capital investments. As deflation continues, we cannot hope for rapid economic growth, but structural reforms that companies have been forced to implement because of deflation have made them stronger, and, at the same time, provided a foundation for sustainable economic growth in the years ahead.

## 2. Outlook for Fiscal 2003/2004

### (1) Assumptions Underlying the Forecast

The following assumptions have been made in preparing this outlook.

**① World Economy**

The U.S. economy experienced a progressive slowdown from the end of 2002 through the beginning of 2003, owing to growing tensions caused by the situation in Iraq and other factors. However, an expansionary trend gradually emerged from spring 2003, and the economy attained annualized growth of over +8% in the July-September quarter. For the time being, the positive impact of government policies, including the reduction in taxes and continued low interest rates, have emerged and are adding momentum to the economic expansion. In addition, IT-related demand, principally for PCs, is showing a strong comeback. However, toward the end of 2004, a number of factors are expected to bring a slowdown, including a diminishing of the effect of the tax reduction, increases in interest rates, a build-up of inventories, and a completion of the latest round of IT-related investments.

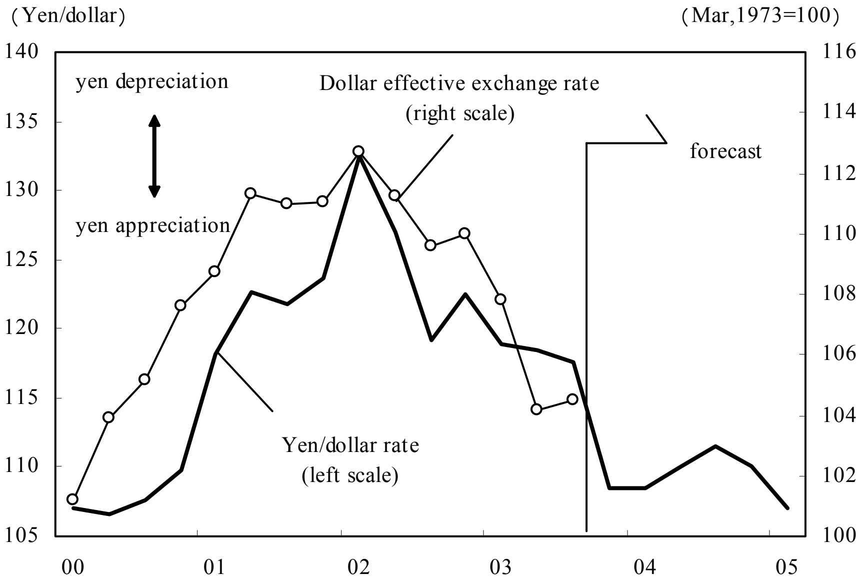
In the euro region, the improvement in business confidence, which preceded actual improvement in the economies of the region, is finally becoming a reality as production and other indicators are showing recovery. The economy of Germany, which has had to deal with a high cost structure as well as other issues and has therefore experienced a delay in recovery, is now showing signs of an upward trend. In addition, neighboring countries are moving toward economic recovery. Looking forward, exports are expected to rise along with the recovery in economies outside the region, and gradual recovery is forecast, especially in the corporate sector. However, toward the end of 2004, higher interest rates and slower growth in economies outside the region are likely to restrain demand and bring a pause in recovery.

Turning to Asia outside Japan, SARs brought stagnation in economic activity during the first half of 2003, but demand that was pent-up during the first half emerged beginning in the summer. Especially in China, recovery in fixed capital investment is continuing and consumer spending, which was somewhat weak, has begun to strengthen, thus leading to the possibility of growth in 2003 as a whole of more than +8%. Nevertheless, during the latter half of 2004, capital investment is expected to slow as a result of a more stringent monetary policy. Also, as the economies of developed nations begin to slow, economic activity in the NIEs and ASEAN economies is viewed as likely to decelerate.

### ② Exchange Rates

From the beginning of 2003, the yen fluctuated in a narrow band between ¥115 to ¥122 to the U.S. dollar, but, beginning around the time of the G7 summit on September 20 (in Dubai), doubts emerged about the sustainability of the intervention efforts of Japan's monetary authorities, and the yen strengthened temporarily to less than ¥108 to the dollar. Although pressures for yen appreciation are strong, market participants are wary of intervention if the yen strengthens too much, and for the immediate future the yen is expected to fluctuate within a narrow band. Even looking forward to 2004, the economies of Japan and the United States are expected to show similar trends. Therefore, we are anticipating that the yen/dollar rate will remain relatively stable.

**Exhibit 2:Outlook for the Yen-Dollar Exchange Rate**

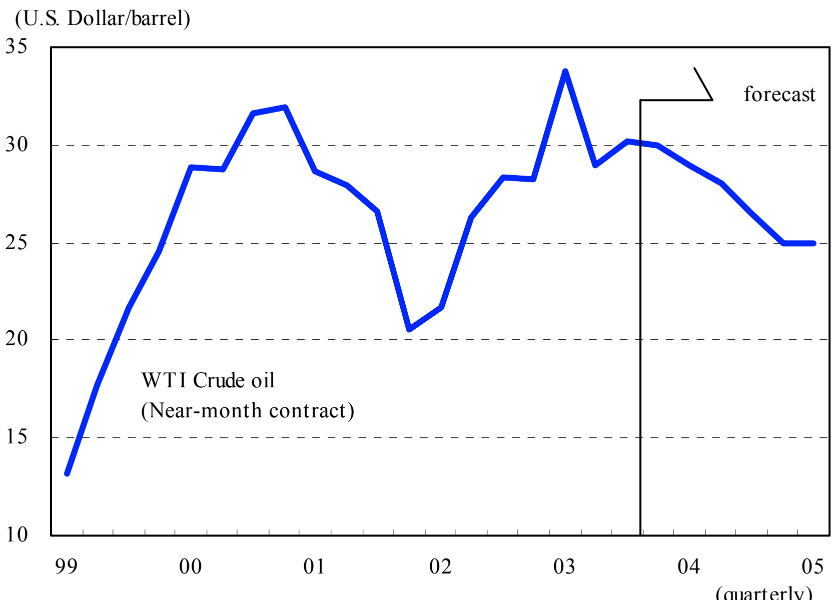



Sources: Bank of Japan, Finacial and Economic Statistics Monthly,
FRB「Federal Reserve Bulletin」

### ③ Crude Oil Prices

Inventories of crude oil continue to be low, and the supply/demand balance remains tight, leading to relatively high prices of around $30 a barrel. For the time being, as a result of OPEC's unexpected decision to reduce production quota at its September meeting and its adoption of a stance of placing emphasis on oil prices rather than market share, attention is focused on OPEC's next moves. On the other hand, the recovery of the U.S. economy and concern about tight supplies during the winter months are expected to lead to continued high prices. However, moving into 2004, the recovery of production in Iraq and increased output from non-OPEC countries are expected to exceed the increase in demand stemming from recovery in the world economy and the effects of cutbacks in OPEC production. For this reason, the supply/demand balance is expected to loosen and oil prices to weaken gradually. As a result of these developments, even though OPEC may decide on further production cutbacks in March 2004, these will be offset by recovery in Iraqi production, thus leading to only marginal upward pressure on oil prices. By the end of 2004, the slowdown in the U.S. economy will be putting downward pressure on oil prices and they may approach the lower end of OPEC's price band of $22 dollars, based on a basket of OPEC's crude oil types. As a result, OPEC is likely to adopt more aggressive production cutbacks thus most likely preventing any major drop in prices.

**Exhibit 3 : Outlook for WTI Crude Oil Price**




Source : Bloomberg Financial Markets

### ④ Government Fiscal Policy

Although the government is expected to adopt a supplementary budget in response to trends in tax revenues in fiscal 2003, we are assuming that, with the economy in recovery, no additions will be made to government public investment expenditures. The initial budget for fiscal 2004 is assumed to contain further cuts in such expenditures, with a decline of -3.0% in the national budget and reductions of -5.0% in expenditures of an investment nature in local budgets. In fiscal 2004, we are assuming that no further allocations for public works will be made in a supplementary budget.

### ⑤ Monetary Policy

The Bank of Japan (BOJ) has left the pace of its monthly purchases of long-term Japanese government bonds (JGBs) unchanged at ¥1.2 trillion since October 2002. However, in October 2003, the BOJ hiked its target for its current account deposits from between ¥27 trillion and ¥30 trillion to between ¥27 trillion and ¥32 trillion.

At present, since expectations of recovery are high, and, with stock prices having receded temporarily from the levels they reached in the recent past, calls have quieted for further monetary relaxation, including the introduction of inflation targeting and expansion of BOJ's purchases of assets beyond JGBs to include ETFs, REITs, and foreign securities. However, in the event of a rise in uncertainty about the economy caused by a sharp appreciation of the yen or steep decline in stock prices, requests for the further easing of monetary conditions are expected to rise again. In that case, the BOJ may well take additional steps to relax monetary conditions, including measures to increase outright purchases of long-term JGBs and further boosting the target for the BOJ's current account deposits; however, we believe the BOJ will remain cautious about introducing inflation targeting and expanding its purchases of assets beyond JGBs.

On the other hand, the condition that BOJ has announced for suspending its policy of monetary relaxation, namely "when the core portion of the consumer price index rises and remains stable at levels above 0% from the previous year," has not been met. Accordingly, during the forecast period, the policy of quantitative monetary relaxation is not likely to be suspended.

### (2) Economic Outlook for Fiscal 2003/2004

#### ① Fiscal 2003: Recovery Led by Exports and Private Capital Investment, Second Consecutive Year of Positive Growth

We are forecasting real GDP growth of +2.6% in fiscal 2003, the second consecutive year of expansion. We have raised our forecast issued in August to take into account the sharp upward revision of GDP growth in the April-June quarter in the second preliminary estimate and continued indications that recovery is continuing, including increases in production. However, our forecast for nominal GDP in fiscal 2003 is a drop of -0.4%, the third consecutive year of declines. We are also forecasting a major decline of -3.0% in the GDP deflator.

We anticipate that inventory levels will remain low and the increase in industrial production will be led by cellular phones, semiconductors, and other high-tech products and by capital goods in response to strong private capital investment. In addition, growth over the previous fiscal year in real capital investment is expected to reach double-digit levels as corporate profitability continues to improve. The deflator for capital investment has declined significantly, thus pushing investment in real terms upwards, but even in nominal terms, the rate of expansion in capital investment is expected to be relatively high and recovery in investment is spreading to more sectors.

Reflecting the slow expansion in incomes, growth in private consumption in nominal terms will be negative, but, in real terms, consumption is forecast to show slight increases as a result of declines in prices. Although the employment and income environments will remain harsh, there are signs of recovery, and, because consumer confidence is improving, we are forecasting that private consumption will remain firm.

Exports also, especially to the rest of Asia, are recovering along with improvement in economic conditions overseas and are expected to continue to expand. In addition to the favorable impact of growth in domestic demand, the external sector will also contributing to overall economic expansion.

Among other components of GDP, private housing investment is expected to continue to decrease, but the margin of decline will be relatively small because of the influence of the surge in demand in advance of the implementation of the revised building code and the expiration of the housing loan tax relief measure. Government public investment spending is also forecast to continue on a downward trend. Since there will be no additional allocations for public investment in a supplementary budget, the decline in government public investment spending will be substantial.

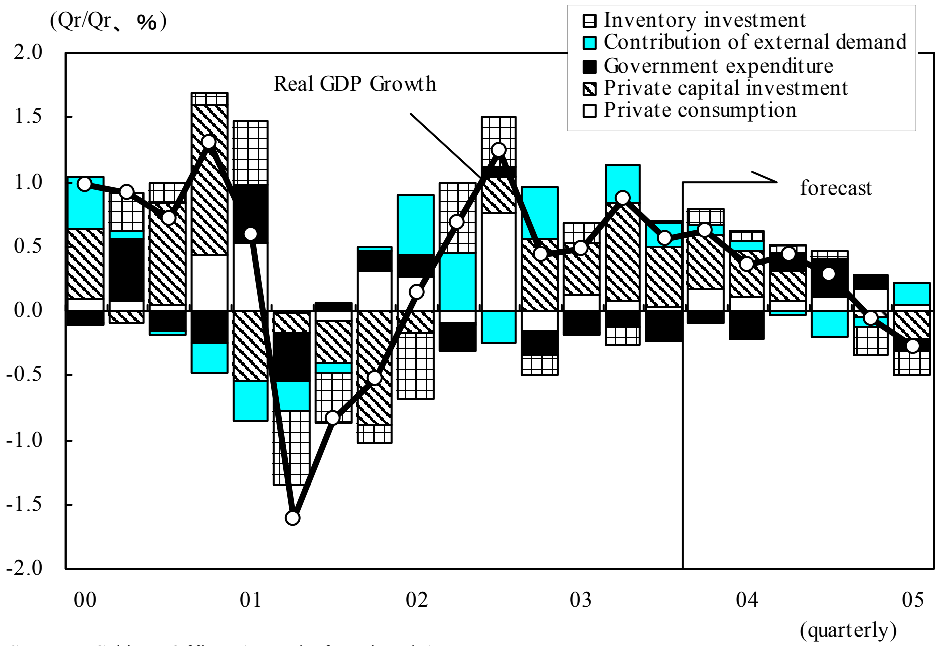
**② Fiscal 2004: Third Consecutive Year of Positive Growth, Movement into Adjustment Phase as Economies Overseas Slow**

The recovery trend in fiscal 2003 is expected to continue into fiscal 2004, but there will be growing signs of adjustment. We are forecasting +1.3% growth in real GDP, for a third consecutive year of expansion, but the rate of growth is forecast to be lower than in fiscal 2003. In addition, in nominal terms we are expected a slight decline of -0.3% in GDP, thus marking the fourth consecutive year of negative growth. However, the rate of decline in the GDP deflator will shrink to -1.5%.

First, as a result of the deceleration in the U.S. and other overseas economies, exports are expected to begin to decline in the latter half of fiscal 2004. For this reason, the external sector will not make a major contribution to growth as in fiscal 2003, but will be virtually neutral. Corporations will be cautious about increasing inventories, and, although there may not be a major build-up of inventories, when the current round of demand for PCs, cellular phones, DVD, and other products now showing strong growth ends, inventories are likely to expand slightly. Along with the decline in exports and increase in inventories, the expansion in shipments of capital investment goods and construction materials will slow, thereby leading to a declining trend in production in the latter half of the year. As production falls, corporate profits are expected to peak, and capital investment will begin to decline in the latter half of fiscal 2004.

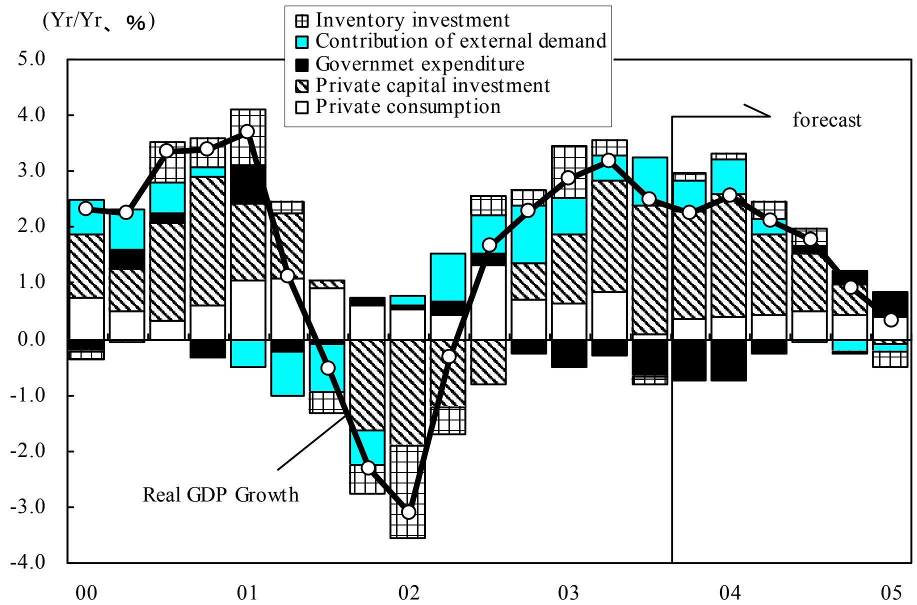
As in fiscal 2003, private consumption will provide support for the economy in fiscal 2004. As deflation continues, the scenario of negative growth in nominal terms and positive growth in real terms will remain unchanged. However, as adjustments in the economy become more pronounced toward the end of fiscal 2004, there is possibility that consumption will weaken slightly. The declining trends in housing investment and government public works spending will continue. However, since fiscal 2004 will be the second year without additional public works allocations in a supplementary budget, the margin of decline in public works will be smaller than in fiscal 2003.

**Exhibit 4:Real GDP Growth (seasonally adjusted)**




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**—Contribution will continue to be positive as the world economy recovers, but will begin to have a negative influence in the latter half of fiscal 2004.

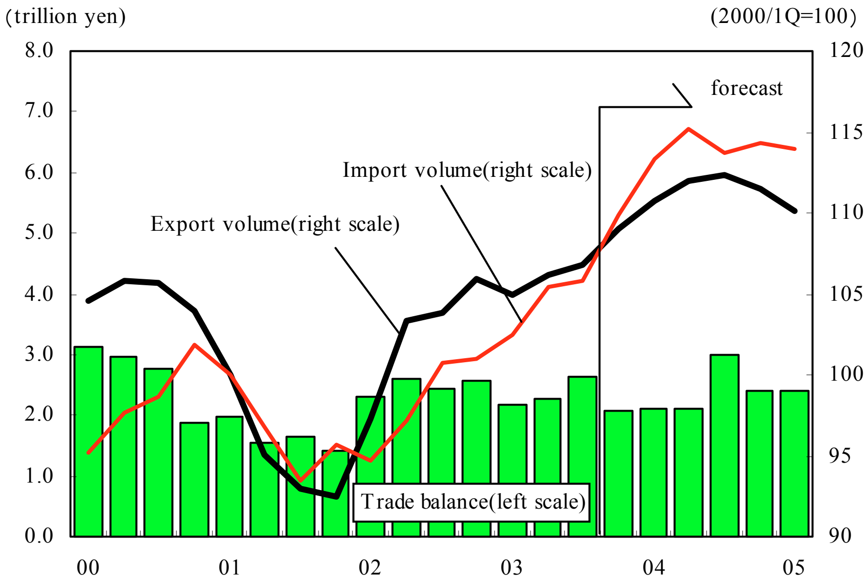
Data on Japan's exports in volume terms shows a sharp decline in growth in the April-June quarter of 2003 due to stagnant conditions in the U.S. economy and the impact of SARS, but signs of a bottoming out and recovery appeared in the July-September quarter. By region, although exports in volume terms to the United States were below the level of the previous year, those to the principal markets of Asia were recovering, especially exports of electronic parts and capital goods, and those to the EU remained firm, principally exports of automobiles and electric machinery. Through the first half of fiscal 2004, we are expecting continuing recovery in the world economy and look for further expansion in Japan's exports. Although exports to the United States are weak at present, we are expecting recovery in shipments of capital goods, especially machine tools and other electric machinery, and are forecasting the beginning of a bottoming out in automobile exports.

In the latter half of fiscal 2004, however, the economies of the United States and the EU are expected to slow, while the performance of Asian economies may also weaken, resulting in the beginning of a slowdown in exports in volume terms.

Imports in volume terms have increased in recent periods, accompanying the recovery in the economy. In addition, imports are being influenced by structural factors, including the relocation of Japan's manufacturing plants to Asia, a trend that tends to increase the penetration of imports into the Japanese market, and we are forecasting that growth in the volume of imports will continue to exceed growth in exports. However, moving into the latter half of fiscal 2004, the domestic economy is expected to weaken and production will decline. We believe this will lead to stagnation in imports, principally of producer's goods such as parts and raw materials.

The contribution of external demand in fiscal 2003 is expected to be +0.6 percentage point, thus continuing at a high level following a +0.8 percentage point rise in fiscal 2002, and thus making a substantial contribution to growth. Another factor boosting the contribution of external demand was the impact of SARS, which led to a sharp decline in the number of travelers from Japan (which is classified in trade statistics as a service import). In the latter half of fiscal 2004, the pace of expansion in the world economy will slow and growth in exports will decline. Since imports will show very similar trends, the contribution of external demand for fiscal 2004 as a whole will be virtually neutral.

## Exhibit 6:Outlook for Trade




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

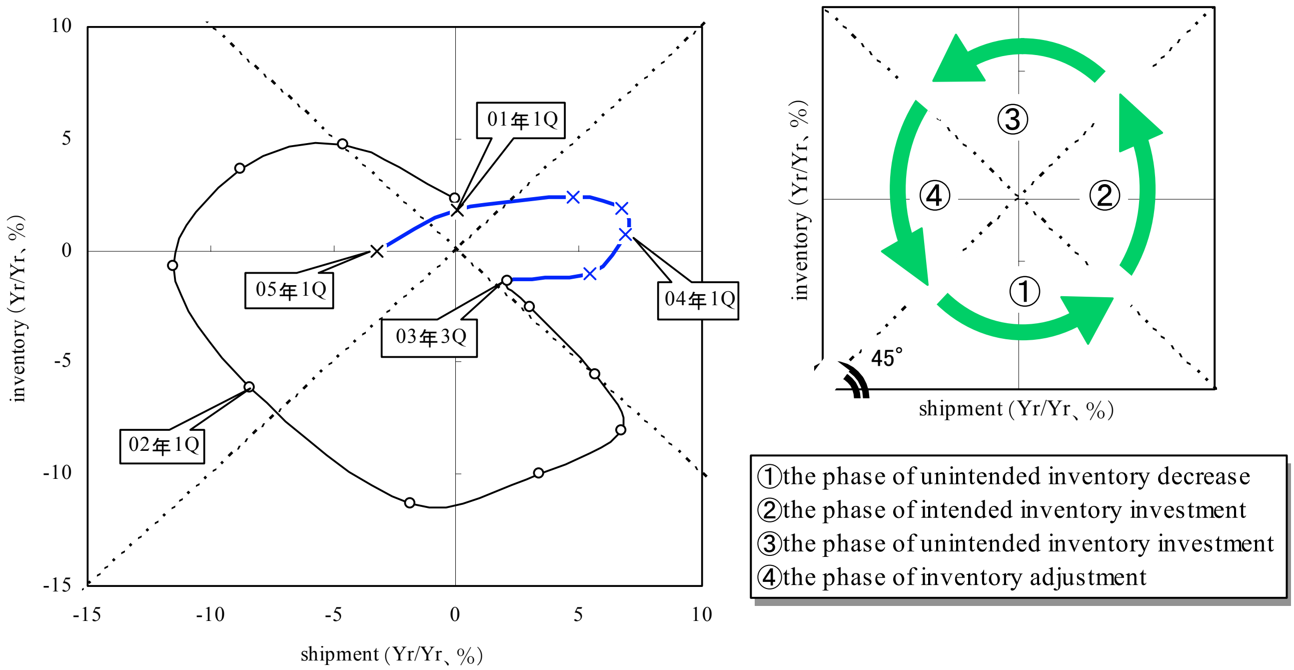
② **Corporate Sector:** Will continue strong in fiscal 2003 but reach a peak in the middle of fiscal 2004

**(a) Production:** Continued strong growth in fiscal 2003, but with a gradual loss of momentum

The index of inventories rose above the previous quarter in the July-September period of 2003 for the first time in nine consecutive quarters, but, because of firm growth in shipments, no sense of excess inventories has emerged. During the current upward trend in the economy, although the inventory adjustment phase has been completed, corporations remain reluctant to make active inventory investments because of the weakness of domestic demand. However, as shipments gradually strengthen, we are forecasting that shipments of capital investment goods and producer’s goods, will continue to experience high growth supported by increasing exports this fiscal year. To respond to this increase in demand, we believe a moderate trend toward gradually expanding inventories will appear.

However, moving into fiscal 2004, we are forecasting that domestic shipments will level off and that growth in exports will slow, beginning in the latter half of fiscal 2004. These trends will bring a period of unintended investment in inventories beginning in the middle of the year. Toward the end of fiscal 2004, we will enter a period of inventory adjustment and this will be a factor restraining production. However, since the build-up in inventories will be small, the adjustment period may be relatively short.

**Exhibit 7:Inventory Cycle Movements**

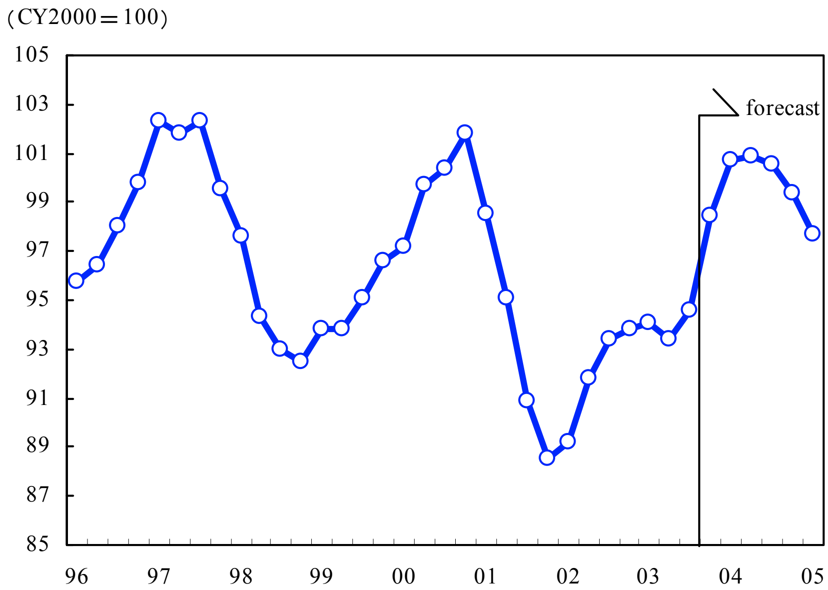



Note: Figures from the fourth quarter of 2003 are forecasts.
Source: Ministry of Economy, Trade and Industry (METI),
Economic and Industrial Statistics

Production had been marking time since the beginning of fiscal 2003, but by September it had regained the previous peak recorded in January 2003 because of the recovery in production of capital investment goods, the strength of demand for IT goods in the domestic market, and firm demand for exports. Demand for capital goods and IT-related products appears likely to continue to be strong, and, together with the build-up of inventories, this should lead to continued increases in production during fiscal 2003. Of these various goods, electronic parts and devices, including semiconductors, PCs, cellular phones, digital cameras, and other digital appliances, are expected to make a major contribution overall. The industrial production index is expected to recover to levels close to the two previous peaks, the first attained in 1997 and the second in 2000.

As we move into fiscal 2004, however, production will lose momentum because the current round of capital investments will have been completed and, in the latter half of fiscal 2004, growth in exports will begin to slow as overseas economies decelerate. Production of IT-related goods, which will have been strong up to that point, will also lose momentum as the current round of replacement purchases comes to an end. For this reason, companies will begin to experience an unintended buildup of inventories, and, in the latter half of the year companies will move to restrain production as they make inventory adjustments. However, because the buildup in inventories is expected to be small, the impact of the ensuing adjustments will be relatively light.

**Exhibit 8:Outlook for Industry Production**



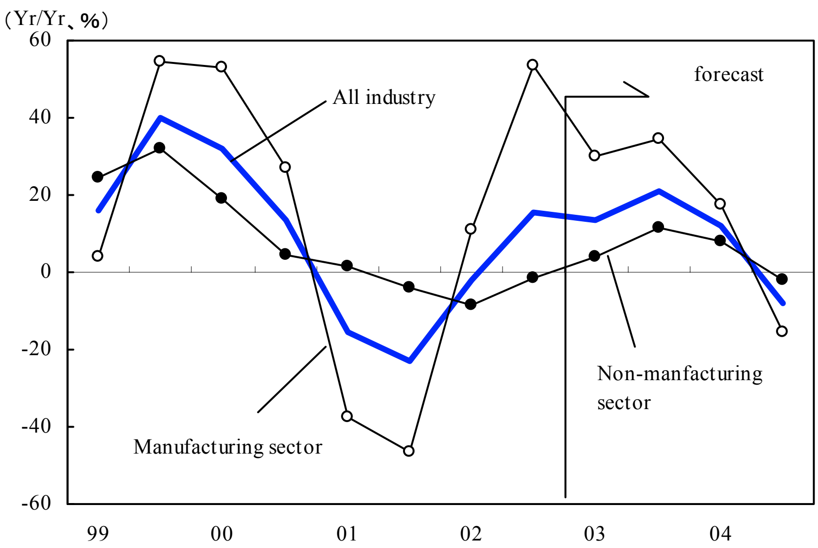

Source: Ministry of Economy, Trade and Industry (METI), Economic and Industrial Statistics

**(b) Corporate Profitability:** Profits will continue to rise, but then decline in the latter half of fiscal 2004.

Through the middle of fiscal 2004, corporate profits are expected to show firm increases. Although sales prices in the manufacturing sector will continue to decline, sales in monetary terms are expected to rise as shipments(volume) of IT-related goods and investment goods remain strong. Moreover, corporations will experience the positive benefits of their restructuring efforts, including reductions in their liabilities and payroll costs, thus contributing to firm increases in profits. In the non-manufacturing sector also, weakness in sales prices will be a negative factor, but movements of goods will rise for cargos shipped overseas and within Japan and signs of recovery in employment will begin to appear, thus leading to a faster tempo of recovery, somewhat behind the pace of recovery in the manufacturing sector.

Beginning in the middle of fiscal 2004, however, the environment for profitability will begin to become harsh. First, the momentum of domestic demand will weaken along with the slowdown in growth in demand for investment goods and other factors and sales will first level off, because of the slump in exports forecast for the latter half of the fiscal year, then may begin to decline. In addition, the positive effects of restructuring will have been achieved, but expenses may begin to increase, including the burden of higher depreciation costs following recent investments in plant and equipment. For these reasons, profitability in both manufacturing and non-manufacturing sectors is expected to begin to decline. However, as the recent increases in the ratio of current profits to sales indicates, companies have strengthened their operating and financial positions to enable them to show profits, even when growth in sales is low. Therefore, we do not expect a sharp deterioration in profitability.

**Exhibit 9:Outlook for Corporate Performance**



Source:MOF,Quarterly Statistics on Incorporated Enterprises (semiannual)

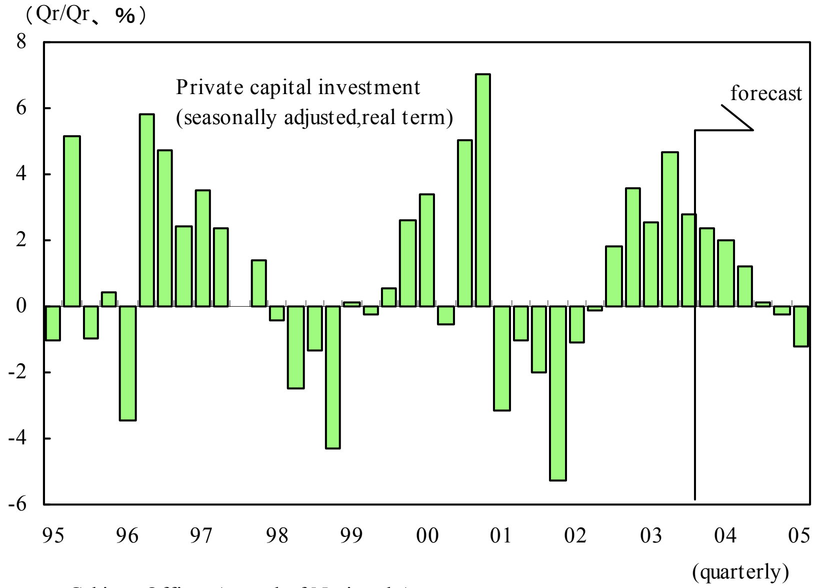
**(c) Private Capital Investment:** Peaking out is forecast in the middle of fiscal 2004

Private capital investment has continued to expand steadily on a quarter-to-quarter basis for five consecutive periods through the July-September period of 2003. Although orders for machinery, which are a leading indicator for investment, declined from the previous quarter during the July-September period, a survey of the outlook for orders shows that they are expected to rise again in the October-December quarter. We are forecasting that growth in capital investment will continue through the middle of fiscal 2004, as corporate profitability remains on a recovery trend.

During the current recovery phase in capital investment, most investments were initially for the replacement and maintenance of existing capacity. As a result, the increase in investment spending seemed to be lagging in comparison with the improvement in corporate profitability. However, judging from such developments as the fact that the BOJ's Tankan's diffusion index (DI) of corporate business sentiment among giant manufacturing companies has moved into the positive range, business confidence among corporations is improving and this will likely lead them to begin to make major investments, including those to increase production capacity. Since corporations are maintaining good performance, we look for capital investment to remain firm for the time being and act as a driving force for the economy.

However, we are forecasting that capital investment will peak in the middle of fiscal 2004. This is because by that time corporations will have been expanding their capital investments for more than two years, and they are expected to pause and reassess conditions at that time. In the past, corporations have been troubled by excess capacity. For this reason, companies should now be carefully considering the necessity of capital investments and selecting investment projects carefully. Companies are not investing simply because they have idle funds. Moreover, the forecast decline in profitability will be another factor restraining investments.

**Exhibit 10: Private Capital Investment**

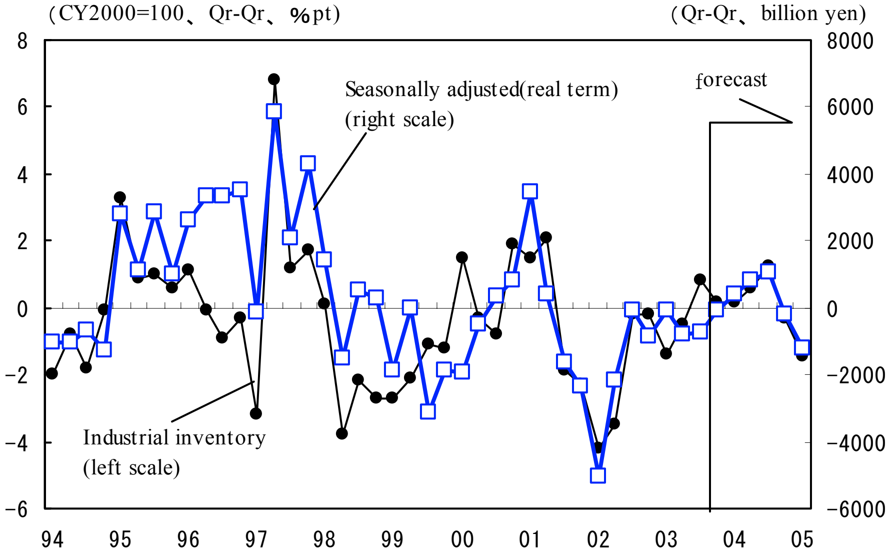


Sources: Cabinet Office, Annual of National Acounts

**(d) Private Inventory Investment:** To make positive contributions in fiscal 2003 and fiscal 2004

Companies are taking a cautious attitude toward building up inventories, and, for this reason, inventory investment has not been a factor boosting the growth rate for the four quarters through the July-September period of 2003. However, with demand continuing to be strong in the coming quarters, we expect a movement toward inventory investments, and this will have a positive impact on growth in fiscal 2003. However, entering fiscal 2004, shipments are forecast to slow, and companies will start to experience unintended inventory investments. As a consequence, in the latter half of fiscal 2004, companies will begin to make adjustments in inventories and the contribution of inventory investment will become negative.

## Exhibit 11: Inventory Investment



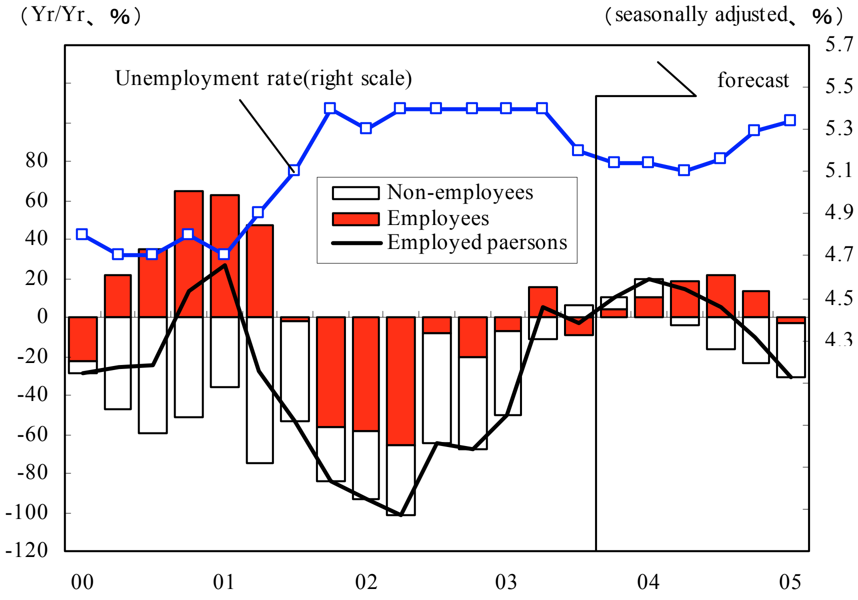

Source: Cabinet Office, Annual of National Acounts、Ministry of Economy, Trade and Industry (METI), Economic and Industrial Statistics

### ③ Major improvement in employment and income environments not expected, but the individual sector will show slight increases

**(a) Employment and Income Environments:** No major improvement expected and the unemployment rate will rise in the latter half of fiscal 2004.

The margin of decline in the number of employed persons has decreased along with recovery in the economy, and the most recent data show the number has returned to the level of the previous year. 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. Although corporations still believe they have excess workers, if the recovery continues, some increase in the number of employed persons is expected as profitability improves. For this reason, the workforce is forecast to continue rising through the first half of fiscal 2004. Thereafter, in the latter half of fiscal 2004, when the effect of the slowdown in the economy will emerge, the workforce is expected to begin to decline again. Although the unemployment rate remains high because of mismatching of supply and demand for workers, the lull in restructuring has brought a decline to the 5.0% to 5.5% range. If the employment environment improves, people who have lost the desire to work and dropped out of the workforce may begin to look for work again, but, on the other hand, some workers may leave their jobs voluntarily to look for new work. For these reasons, a major improvement in the unemployment ratio is not expected, and it may begin to rise again in the latter half of fiscal 2004 as the effects of the deceleration of the economy emerge.

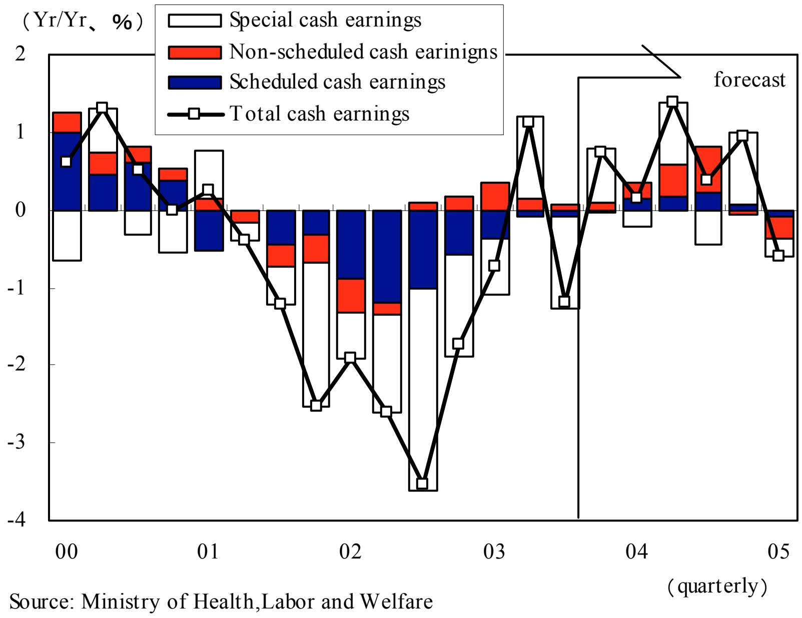
**Ehibit12: Employed Persons and Unemployment Rate**




Note: 'Non-employees' consisits of 'Self employed' and 'Family workers'.
Source: Ministry of public Management, Home Affairs, Posts and Telecommunications, Labor Force Survey

Regarding wages, unscheduled compensation has begun to increase along with the recovery in production, and scheduled compensation has returned to the levels of the previous year. In addition, summer bonuses rose +1.4% over the previous year, the first increase in three years. As a result of these developments, wages overall have begun to rise since the beginning of fiscal 2003. In fiscal 2004, the spring wage increase is expected to be about the same as in the previous fiscal year, and, although growth in scheduled compensation will be limited, unscheduled compensation and bonuses are expected to increase along with the recovery in production and improvement in corporate profitability. However, toward the end of the fiscal year, the slowdown in the economy may have an effect on wage levels.

**Ehibit13: Cash Earnings of Employees**




Source: Ministry of Health,Labor and Welfare

**(b) Private Consumption:** Although the economy may slow, consumption will remain firm in real terms.

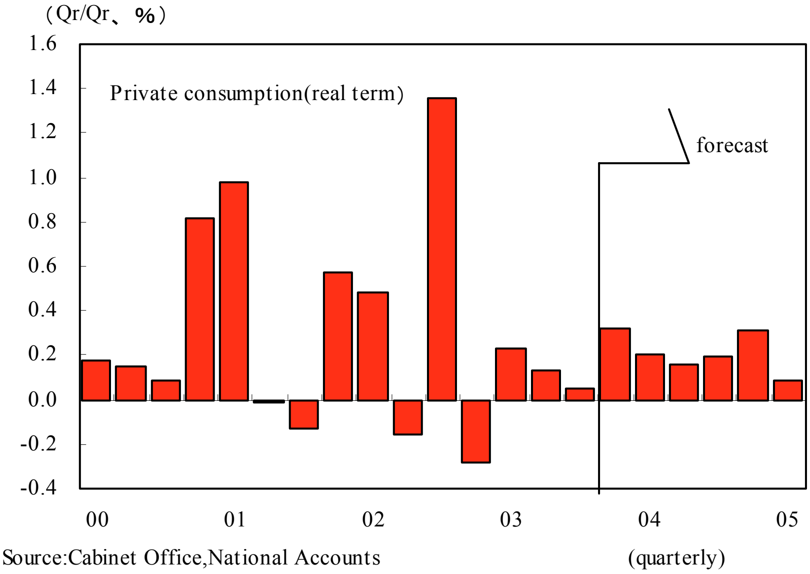
Growth in real private consumption in the July-September quarter of 2003 shrank to +0.0%, owing to a decline in compensation of employees and a decline in reaction to the surge in consumption of tobacco products and home reform expenditures in the April-June quarter. However, in the latter half of fiscal 2003, consumption is expected to recover along with improvement in incomes, and we are forecasting growth in real terms of +0.8% for the fiscal year as a whole.

Consumption expenditures in fiscal 2004 are expected to show little growth as no major increase in compensation of employees is anticipated. In the latter half of the fiscal year, consumer spending is likely to be restrained by the deterioration in consumer confidence accompanying the slowdown in the economy. However, consumer expenditure items that are difficult to restrain, such as medical and educational outlays, will continue to be steady and deflation will continue to boost real purchasing power.

Accordingly, consumption in real terms is forecast to expand +0.8%, approximately the same as in fiscal 2003.

Nominal consumption, which is directly linked with company sales, expanded +0.1% in fiscal 2002, just barely in the positive range, but nominal consumption is forecast to decrease -0.8% in fiscal 2003 and drop -0.4% in fiscal 2004, for two consecutive years of decline.

**Exhibit14: Real Private Consumption**



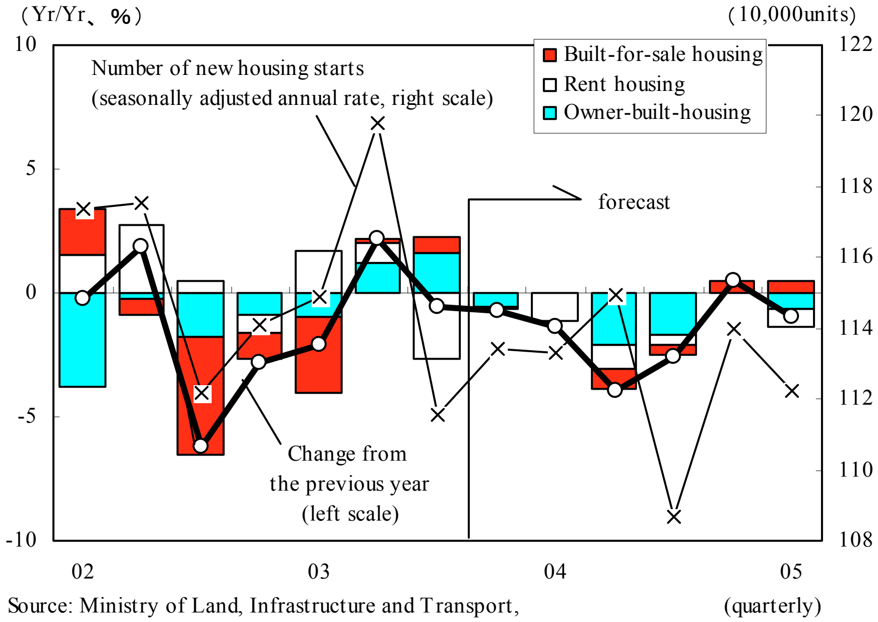
Source:Cabinet Office,National Accounts

**(c) Private Residential Investment:** The number of new housing starts will be stagnant in fiscal 2004.

Growth in residential investment in the July-September quarter rose +2.7% over the previous quarter, for the second consecutive quarterly increase, because of the surge in housing starts preceding the expiration of the housing loan tax relief measure and the implementation of revisions to the building code. In the second half of the year, there is concern about a decline in housing starts in reaction to the surge in the first half of the fiscal year, but along with continued gradual improvement in the income and employment environment, the outlook is for residential investment, principally owner-built housing, to remain firm. We are forecasting housing starts of 1.145 million in fiscal 2003, about the same as for the previous fiscal year.

The outlook is for stagnant residential investment in fiscal 2004. In the first half of the fiscal year, the momentum of improvement in the income and employment environment will slow, and residential investment, principally owner-built housing will be on a declining trend. In the second half of the year, although conditions will recover to some extent, mainly in the market for condominium apartments where there is a low level of unsold units, housing starts will remain stagnant at 1.125 million for the full fiscal year.

**Exhibit 15: Outlook for Housing Starts**




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

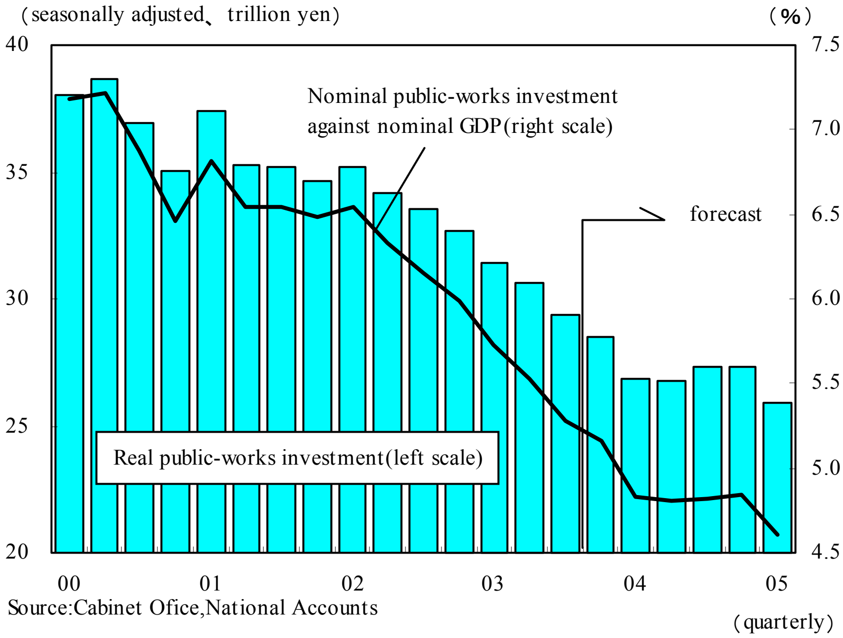
④ **Government Expenditures:** The decline in government public investment spending will continue, but government consumption expenditures will continue to make a positive contribution.

(a)Public-Works Investment

In the first half of fiscal 2003, government public investment remained on a downward trend following reductions in related budget allocations. In fiscal 2003, we anticipate that, unlike in previous years, there will be no additional allocations made for public investment in a supplementary budget. As a result, the slowdown in these expenditures will become even more pronounced toward the end of fiscal 2003.

In fiscal 2004, the public investment budget will be cut as in fiscal 2003, with a reduction of -3.0% in the national budget and -5.0% in the regional budgets. At the beginning of the fiscal year, the absence of additional public investment allocations in a supplementary budget will be a factor restraining expenditures, and public investment will continue at a relatively low level. However, the effect of this factor on the level of public investment will diminish by the summer months, and the margin of decline will be less pronounced thereafter.

**Exhibit 16: Outlook for Public-works Investment**

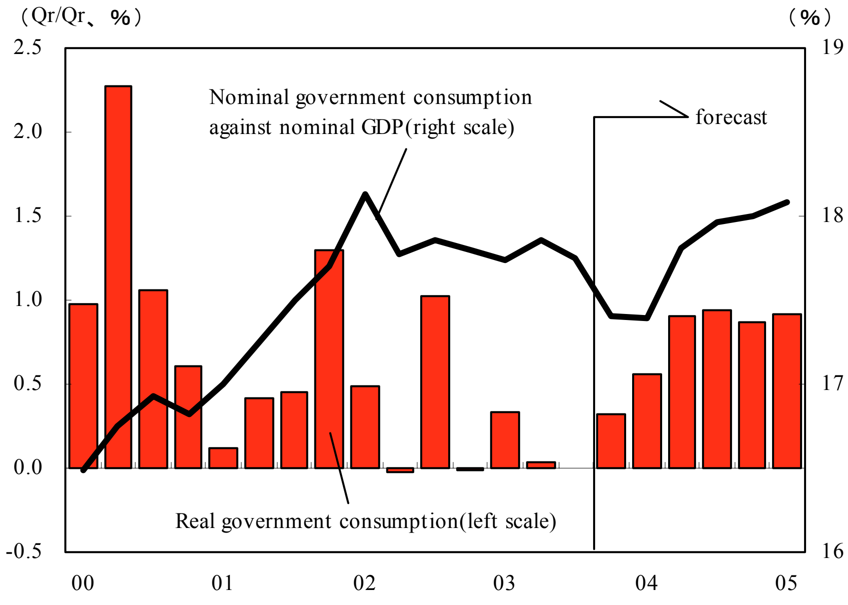


Source:Cabinet Ofice,National Accounts

**(b)Government Final Consumption:** Will continue to rise because of expansion in medical and nursing costs.

Real government final consumption in the July-September quarter was approximately the same as for the previous period, owing in part to restraints on social welfare benefits in kind accompanying the reduction in April of the percentage coverage of medical insurance payments. However, since medical and nursing care expenditures are expected to rise along with the demographic aging of the population, social welfare benefits in kind are expected to continue to increase. For this reason, although the rate of growth in government final consumption expenditures will decline in fiscal 2003, they will remain above the level of the previous year. In fiscal 2004, the margin of increase in these expenditures is forecast to expand. Moreover, as a result of a reduction in the number of months salary paid as bonuses and monthly salaries of government employees, there will be a marked decline in government final consumption expenditures in nominal terms in the latter half of fiscal 2003, but this change will be adjusted by the deflator, and, in real terms, expenditures are expected to continue to rise.

**Exhibit 17: Outlook for Government Consumption**



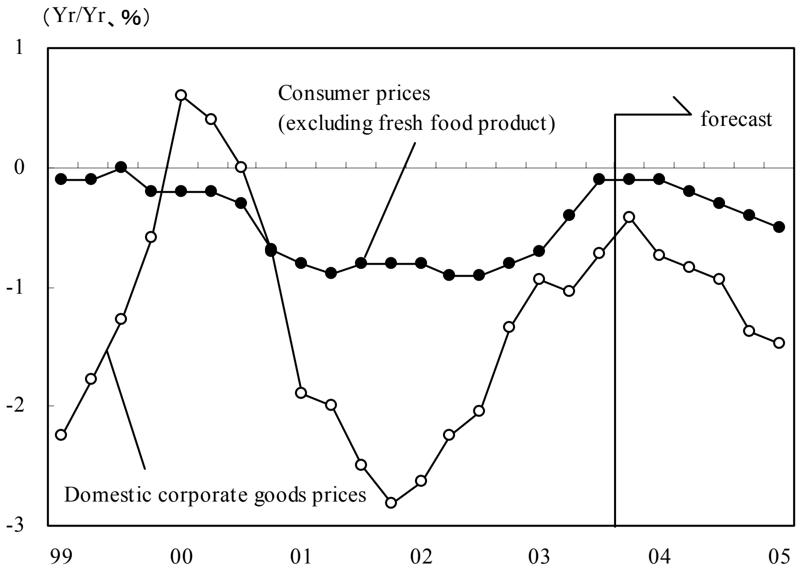
Source:Cabinet Ofice,National Accounts

## ⑤ Deflationary price trends will continue

The margin of decline in domestic corporate goods prices (formerly "wholesale prices") has diminished along with the increase in international commodity market prices, high 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 the continuation of high crude oil prices and the movement among companies to pass on higher costs of raw materials that have accompanied the rise in prices of agricultural, lumber, and other primary products. However, moving into fiscal 2004, the outlook is for larger declines in corporate prices because of the appreciation of the yen and decline in crude oil prices forecast for the first half of the fiscal year and the downward pressure on prices in the second half that will result from the economic slowdown and a loosening of the supply/demand balance.

The margin of decline in consumer prices is expected to shrink markedly owing to the smaller margin of decline in corporate goods prices and special factors, including the increase in the burden of medical expenses on individuals (from April 2003) and the hike in the tobacco tax (in July 2003). Although the margin of decline in prices may continue at current levels for the time being, the effect of the previously mentioned special factors will wear off after the beginning of fiscal 2004, and the margin of decline may increase thereafter.

**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

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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.

## Economic Outlook for fiscal 2004

Forecast

half/half、%
Yr/Yr、%

| | FY2002 | | FY2003 | | FY2004 | | FY2002 | FY2003 | FY2004 |
|---|---|---|---|---|---|---|---|---|---|
| | First half | Second half | First half | Second half | First half | Second half | (actual) | (forecast) | (forecast) |
| Nominal GDP | -0.1<br>-1.0 | -0.2<br>-0.4 | 0.2<br>0.2 | -1.1<br>-1.0 | 0.7<br>-0.3 | -0.8<br>-0.2 | -0.7 | -0.4 | -0.3 |
| Real GDP | 1.4<br>0.7 | 1.3<br>2.6 | 1.4<br>2.8 | 1.1<br>2.4 | 0.8<br>1.9 | -0.1<br>0.6 | 1.6 | 2.6 | 1.3 |
| Contribution of domestic demand | 0.8 | 1.0 | 1.0 | 0.9 | 0.8 | 0.0 | 0.8 | 2.0 | 1.3 |
| Private consumption | 0.8<br>1.6 | 0.5<br>1.2 | 0.3<br>0.8 | 0.5<br>0.7 | 0.4<br>0.9 | 0.4<br>0.8 | 1.4 | 0.8 | 0.8 |
| Housing investment | -1.3<br>-2.9 | -1.7<br>-2.9 | 1.2<br>-0.5 | -1.6<br>-0.3 | -2.0<br>-3.6 | 0.6<br>-1.3 | -2.9 | -0.4 | -2.5 |
| Private capital investment | 0.2<br>-6.2 | 5.8<br>5.9 | 7.5<br>14.1 | 4.8<br>12.5 | 2.3<br>7.3 | -0.8<br>1.3 | -0.1 | 13.2 | 4.2 |
| Contriburyion of Inventory investment | 0.5 | 0.1 | -0.1 | 0.2 | 0.1 | -0.3 | 0.3 | 0.1 | 0.1 |
| Government expenditure | -0.3<br>1.0 | -1.0<br>-1.6 | -1.4<br>-2.1 | -1.5<br>-3.2 | 0.8<br>-0.3 | 0.9<br>1.5 | -0.3 | -2.7 | 0.6 |
| Public investment | -3.1<br>-4.0 | -5.3<br>-8.2 | -6.4<br>-11.6 | -7.8<br>-13.6 | -2.1<br>-9.7 | -1.6<br>-3.7 | -6.4 | -12.7 | -6.4 |
| Government final consumption expenditure | 0.7<br>2.5 | 0.7<br>1.4 | 0.2<br>0.9 | 0.6<br>0.8 | 1.7<br>2.3 | 1.8<br>3.5 | 1.9 | 0.8 | 2.9 |
| Contribution of external demand | 0.6 | 0.3 | 0.4 | 0.2 | -0.1 | -0.1 | 0.8 | 0.6 | -0.0 |
| Export of goods and services | 9.6<br>9.3 | 4.9<br>15.1 | 3.1<br>8.1 | 5.9<br>9.2 | 4.5<br>10.7 | -2.7<br>1.7 | 12.2 | 8.7 | 6.1 |
| Import of goods and services | 5.3<br>2.5 | 3.1<br>8.6 | -0.0<br>3.1 | 5.6<br>5.6 | 7.1<br>13.1 | -2.6<br>4.3 | 5.5 | 4.4 | 8.6 |
| GDP deflator | -1.6 | -2.9 | -2.6 | -3.3 | -2.2 | -0.9 | -2.3 | -3.0 | -1.5 |

Forecast

Yr/Yr、%

| | FY2002 | | FY2003 | | FY2004 | | FY2002 | FY2003 | FY2004 |
|---|---|---|---|---|---|---|---|---|---|
| | First half | Second half | First half | Second half | First half | Second half | (actual) | (forecast) | (forecast) |
| Current account balance (trillion yen) | 7.0 | 6.4 | 8.4 | 6.7 | 7.5 | 6.9 | 13.4 | 15.0 | 14.4 |
| balance on goods (trillion yen) | 6.0 | 5.6 | 6.0 | 5.1 | 6.2 | 5.6 | 11.6 | 11.1 | 11.8 |
| balance on service (trillion yen) | -2.7 | -2.5 | -1.6 | -1.9 | -2.3 | -2.0 | -5.2 | -3.6 | -4.2 |
| balance on income (trillion yen) | 4.2 | 3.8 | 4.4 | 3.9 | 2.9 | 3.7 | 8.0 | 8.3 | 6.6 |
| Industrial production | (4.2)<br>-0.1 | (1.5)<br>5.8 | (0.1)<br>1.5 | (6.0)<br>6.0 | (1.1)<br>7.2 | (-2.2)<br>-1.0 | 2.8 | 3.8 | 2.9 |
| Corporate goods prices | -2.3 | -1.3 | -0.9 | -1.8 | -1.7 | -1.7 | -1.8 | -1.3 | -1.7 |
| Domestic corporate goods prices | -2.1 | -1.1 | -0.9 | -0.6 | -0.9 | -1.4 | -1.6 | -0.7 | -1.2 |
| Consumer prices | -0.9 | -0.4 | -0.3 | -0.3 | -0.3 | -0.4 | -0.6 | -0.3 | -0.3 |
| exccluding freshfood | -0.9 | -0.8 | -0.3 | -0.1 | -0.3 | -0.5 | -0.8 | -0.2 | -0.4 |
| Yen/U.S.Dollar | 123.1 | 120.7 | 118.0 | 108.5 | 110.8 | 108.5 | 121.9 | 113.3 | 109.6 |
| Newly issued government bond yields | 1.3 | 0.8 | 1.2 | 1.4 | 1.4 | 1.3 | 1.1 | 1.3 | 1.3 |
| Crude oil price (U.S.dollar/barrel) | 27.3 | 31.0 | 29.6 | 29.5 | 27.3 | 25.0 | 29.1 | 29.5 | 26.1 |
| U.S. Real GDP (CY) (seasonally-adjusted annual rate) | 3.5 | 2.7 | 1.9 | 5.3 | 3.4 | 3.7 | 2.4 | 2.9 | 3.9 |
| Spring wage increases＊ | — | — | — | — | — | — | 1.66 | 1.63 | 1.63 |

Notes:

＊ Figures are spring wage increases compiled from data on the 290 companies listed on the First sections of the Tokyo and Osaka

**【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 | 4.9 | 3.5 | 5.3 | 0.6 | 8.5 | 4.2 | 3.0 |
| Volume | 10.2 | 11.1 | 2.8 | 4.2 | 5.3 | 0.9 | 10.7 | 3.5 | 3.1 |
| Imports (yen basis) | -1.2 | 8.8 | 6.4 | 6.9 | 5.7 | -2.0 | 3.7 | 6.6 | 1.7 |
| Volume | 4.1 | 6.9 | 6.7 | 9.7 | 8.4 | 2.3 | 5.5 | 8.2 | 5.2 |
| Exports surplus (trillion yen) | 5.1 | 4.6 | 5.1 | 4.0 | 5.2 | 4.7 | 9.7 | 9.0 | 9.9 |

**【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 | 0.0 | 0.5 | 0.9 | 0.3 | -2.2 | 0.2 | 0.6 |
| Regular compensation* | -1.5 | -0.7 | -0.1 | 0.0 | 0.3 | 0.0 | -1.1 | 0.0 | 0.1 |
| Overtime compensation | -0.7 | 4.9 | 2.3 | 2.6 | 9.2 | -3.0 | 2.1 | 2.4 | 2.9 |
| Number of employees | -0.7 | -0.3 | 0.1 | 0.1 | 0.4 | 0.1 | -0.5 | 0.1 | 0.2 |
| Compensation of employees* | -2.7 | -1.4 | -0.7 | 0.4 | 1.0 | 0.3 | -2.1 | -0.1 | 0.7 |
| Unemployment rate | 5.4 | 5.4 | 5.3 | 5.1 | 5.1 | 5.3 | 5.4 | 5.2 | 5.2 |

Notes:

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

**【New Housing Starts】**

Forecast

ten thousand units(annualized)

Yr/Yr、%

| | FY2002 | | FY2003 | | FY2004 | | FY2002 | FY2003 | FY2004 |
|---|---|---|---|---|---|---|---|---|---|
| | First half | Second half | First half | Second half | First half | Second half | (actual) | (forecast) | (forecast) |
| Number of new housing starts | 114.9 | 114.5 | 115.7 | 113.3 | 111.8 | 113.1 | 114.6 | 114.5 | 112.5 |
| (change from the previous year) | -2.2 | -2.5 | 0.9 | -1.0 | -3.3 | -0.2 | -2.4 | 0.0 | -1.8 |
| Owner-built | 36.9 | 36.1 | 38.1 | 35.8 | 35.9 | 35.4 | 36.6 | 37.2 | 35.9 |
| housing | -3.1 | -3.1 | 4.2 | -1.1 | -5.5 | -0.9 | -3.1 | 1.8 | -3.5 |
| Rental | 45.5 | 45.7 | 44.8 | 45.2 | 44.2 | 44.8 | 45.5 | 44.6 | 44.0 |
| housing | 4.4 | 1.1 | -2.2 | -1.3 | -1.8 | -0.9 | 2.8 | -1.8 | -1.3 |
| Built-for-sale | 34.8 | 33.9 | 31.5 | 31.6 | 32.0 | 31.6 | 31.6 | 31.8 | 31.8 |
| housing | -9.7 | -6.5 | 1.6 | -0.1 | -2.3 | 1.7 | -8.1 | 0.8 | -0.3 |

## Economic outlook for fsical 2004（Quarterly）

half/half、%
Forecast
Yr/Yr、%

| | FY2002 | | | | FY2003 | | | | FY2004 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 4-6 | 7-9 | 10-12 | 1-3 | 4-6 | 7-9 | 10-12 | 1-3 | 4-6 | 7-9 | 10-12 | 1-3 |
| Nominal ＧＤＰ | -0.6 | 0.7 | -0.5 | -0.1 | 0.3 | -0.0 | -1.0 | -0.0 | 0.2 | 1.0 | -0.8 | -1.1 |
| | -1.7 | -0.2 | -0.1 | -0.7 | 0.6 | -0.3 | -1.1 | -0.9 | -0.7 | 0.1 | 0.4 | -0.9 |
| Real ＧＤＰ | 0.7 | 1.2 | 0.4 | 0.5 | 0.9 | 0.6 | 0.6 | 0.4 | 0.4 | 0.3 | -0.1 | -0.3 |
| | -0.3 | 1.7 | 2.3 | 2.9 | 3.2 | 2.5 | 2.2 | 2.5 | 2.1 | 1.8 | 0.9 | 0.3 |
| Contribution of domestic demand | 0.2 | 1.5 | 0.0 | 0.5 | 0.6 | 0.4 | 0.5 | 0.3 | 0.5 | 0.5 | 0.0 | -0.5 |
| Private consumption | -0.2 | 1.4 | -0.3 | 0.2 | 0.1 | 0.0 | 0.3 | 0.2 | 0.2 | 0.2 | 0.3 | 0.1 |
| | 0.8 | 2.4 | 1.3 | 1.1 | 1.5 | 0.2 | 0.7 | 0.7 | 0.8 | 0.9 | 0.8 | 0.7 |
| Housing investment | 0.1 | -0.6 | -1.1 | -0.7 | 0.2 | 2.7 | -2.1 | -1.5 | -1.7 | 1.1 | 0.3 | -0.3 |
| | -3.3 | -2.6 | -3.4 | -2.2 | -2.4 | 1.2 | 0.2 | -0.8 | -2.8 | -4.2 | -1.9 | -0.7 |
| Private capital investment | -0.1 | 1.8 | 3.6 | 2.5 | 4.7 | 2.8 | 2.4 | 2.0 | 1.2 | 0.2 | -0.3 | -1.2 |
| | -7.8 | -4.7 | 4.6 | 7.1 | 13.9 | 14.2 | 13.2 | 11.9 | 9.0 | 5.8 | 3.3 | -0.3 |
| Contriburyion of Inventory investment | 0.5 | 0.4 | -0.1 | 0.1 | -0.1 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | -0.2 | -0.2 |
| Government expenditure | -0.8 | 0.3 | -0.8 | -0.7 | -0.6 | -1.0 | -0.4 | -1.0 | 0.6 | 1.3 | 0.5 | -0.4 |
| | 1.1 | 1.0 | -1.1 | -2.0 | -1.2 | -3.1 | -3.2 | -3.1 | -1.2 | 0.5 | 1.2 | 1.9 |
| Public investment | -3.1 | -1.7 | -2.6 | -3.9 | -2.6 | -3.9 | -3.0 | -5.9 | -0.1 | 2.1 | -0.1 | -5.2 |
| | -3.1 | -4.7 | -6.4 | -10.0 | -10.3 | -12.6 | -13.1 | -14.3 | -12.5 | -7.1 | -4.3 | -3.1 |
| Government final consumption expenditure | -0.0 | 1.0 | -0.0 | 0.3 | 0.0 | 0.0 | 0.3 | 0.6 | 0.9 | 0.9 | 0.9 | 0.9 |
| | 2.2 | 2.9 | 1.4 | 1.3 | 1.4 | 0.4 | 0.7 | 0.9 | 1.8 | 2.8 | 3.3 | 3.7 |
| Contribution of external demand | 0.4 | -0.2 | 0.4 | -0.0 | 0.3 | 0.2 | 0.1 | 0.1 | -0.0 | -0.2 | -0.1 | 0.2 |
| Export of goods and services | 7.0 | -0.2 | 4.7 | 0.5 | 1.5 | 2.8 | 3.6 | 1.8 | 3.4 | 0.5 | -2.6 | -0.6 |
| | 7.8 | 10.9 | 17.7 | 12.5 | 6.5 | 9.6 | 8.5 | 9.9 | 12.0 | 9.4 | 2.9 | 0.5 |
| Import of goods and services | 3.5 | 2.5 | 1.5 | 0.7 | -1.2 | 1.7 | 4.0 | 1.5 | 4.8 | 2.7 | -2.7 | -2.5 |
| | -0.2 | 5.3 | 8.8 | 8.4 | 3.5 | 2.7 | 5.2 | 6.0 | 12.5 | 13.7 | 6.4 | 2.2 |
| GDP deflator | -1.4 | -1.9 | -2.4 | -3.5 | -2.5 | -2.7 | -3.2 | -3.4 | -2.8 | -1.6 | -0.5 | -1.2 |

Forecast
Yr/Yr、%

| | FY2002 | | | | FY2003 | | | | FY2004 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 4-6 | 7-9 | 10-12 | 1-3 | 4-6 | 7-9 | 10-12 | 1-3 | 4-6 | 7-9 | 10-12 | 1-3 |
| Current account balance (trillion yen) | 3.6 | 3.4 | 2.9 | 3.5 | 3.8 | 4.6 | 2.9 | 3.8 | 3.4 | 4.1 | 3.1 | 3.8 |
| balance on goods (trillion yen) | 3.1 | 2.9 | 3.1 | 2.5 | 2.8 | 3.2 | 2.6 | 2.4 | 2.7 | 3.5 | 2.9 | 2.7 |
| balance on service (trillion yen) | -1.3 | -1.4 | -1.5 | -1.0 | -0.7 | -0.9 | -1.1 | -0.8 | -1.1 | -1.1 | -1.1 | -0.8 |
| balance on income (trillion yen) | 2.1 | 2.1 | 1.9 | 2.0 | 2.0 | 2.4 | 1.9 | 2.0 | 0.9 | 2.0 | 1.8 | 1.9 |
| Industrial production | 2.9 | 1.7 | 0.4 | 0.3 | -0.7 | 1.3 | 4.1 | 2.3 | 0.2 | -0.3 | -1.2 | -1.7 |
| | -3.4 | 3.3 | 6.0 | 5.5 | 2.2 | 0.9 | 5.0 | 7.0 | 8.3 | 6.1 | 0.9 | -3.0 |
| Corporate goods prices | -2.2 | -2.4 | -0.9 | -1.6 | -1.4 | -0.3 | -1.7 | -1.9 | -1.7 | -1.7 | -1.4 | -2.1 |
| Domestic corporate goods prices | -2.2 | -2.0 | -1.3 | -0.9 | -1.0 | -0.7 | -0.4 | -0.7 | -0.8 | -0.9 | -1.4 | -1.5 |
| Consumer prices | -0.9 | -0.8 | -0.5 | -0.2 | -0.3 | -0.2 | -0.2 | -0.3 | -0.3 | -0.3 | -0.3 | -0.4 |
| exccluding freshfood | -0.9 | -0.9 | -0.8 | -0.7 | -0.4 | -0.1 | -0.1 | -0.1 | -0.2 | -0.3 | -0.4 | -0.5 |
| Yen/U.S.Dollar | 127.1 | 119.2 | 122.5 | 118.8 | 118.4 | 117.6 | 108.5 | 108.5 | 110.0 | 111.5 | 110.0 | 107.0 |
| Newly issued government bond yields（10year | 1.4 | 1.2 | 0.9 | 0.7 | 0.9 | 1.4 | 1.4 | 1.5 | 1.4 | 1.4 | 1.3 | 1.2 |
| Crude oil price (U.S.dollar/barrel) | 26.3 | 28.3 | 28.2 | 33.8 | 28.9 | 30.2 | 30.0 | 29.0 | 28.0 | 26.5 | 25.0 | 25.0 |

【Exports and Imports】

Forecast

Yr/Yr、%

| | FY2002 | | | | FY2003 | | | | FY2004 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 4-6 | 7-9 | 10-12 | 1-3 | 4-6 | 7-9 | 10-12 | 1-3 | 4-6 | 7-9 | 10-12 | 1-3 |
| Exports (yen basis) | 5.7 | 7.4 | 16.2 | 5.1 | 2.8 | 7.1 | 1.9 | 5.3 | 5.4 | 5.2 | 2.8 | -1.6 |
| Volume | 8.7 | 11.7 | 14.4 | 7.8 | 2.8 | 2.9 | 2.9 | 5.5 | 5.4 | 5.2 | 2.3 | -0.6 |
| Imports (yen basis) | -4.4 | 2.1 | 9.4 | 8.2 | 6.3 | 6.5 | 6.7 | 7.1 | 8.2 | 3.2 | 0.4 | -4.5 |
| Volume | 0.5 | 7.9 | 5.5 | 8.3 | 8.4 | 5.0 | 8.9 | 10.6 | 9.3 | 7.5 | 4.0 | 0.5 |
| Exports surplus (trillion yen) | 2.7 | 2.4 | 2.6 | 2.0 | 2.4 | 2.7 | 2.1 | 1.9 | 2.2 | 3.0 | 2.4 | 2.2 |

【Income and Employment】

Yr/Yr、%

| | FY2002 | | | | FY2003 | | | | FY2004 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 4-6 | 7-9 | 10-12 | 1-3 | 4-6 | 7-9 | 10-12 | 1-3 | 4-6 | 7-9 | 10-12 | 1-3 |
| Cash earnings of employees (per capita) | -2.6 | -3.5 | -1.7 | -0.7 | 1.1 | -1.2 | 0.7 | 0.1 | 1.4 | 0.4 | 0.9 | -0.6 |
| Regular compensation* | -1.6 | -1.3 | -0.9 | -0.4 | -0.1 | -0.1 | -0.1 | 0.2 | 0.2 | 0.3 | 0.1 | -0.1 |
| Overtime compensation | -3.2 | 1.9 | 3.8 | 6.0 | 3.1 | 1.5 | 1.8 | 3.3 | 7.5 | 10.9 | -1.4 | -4.5 |
| Number of employees | -1.2 | -0.1 | -0.4 | -0.1 | 0.3 | -0.2 | 0.1 | 0.2 | 0.4 | 0.4 | 0.3 | -0.1 |
| Compensation of employees* | -2.6 | -2.9 | -2.0 | -0.7 | 0.6 | -2.2 | 0.6 | 0.2 | 1.5 | 0.5 | 1.0 | -0.6 |
| Unemployment rate | 5.4 | 5.4 | 5.4 | 5.4 | 5.4 | 5.2 | 5.1 | 5.1 | 5.1 | 5.2 | 5.3 | 5.3 |

Notes:

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

【New Housing Starts】

Forecast

ten thousand units(annualized)

Yr/Yr、%

| | FY2002 | | | | FY2003 | | | | FY2004 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 4-6 | 7-9 | 10-12 | 1-3 | 4-6 | 7-9 | 10-12 | 1-3 | 4-6 | 7-9 | 10-12 | 1-3 |
| Number of new housing starts | 117.5 | 112.2 | 114.1 | 114.9 | 119.8 | 111.5 | 113.4 | 113.3 | 114.9 | 108.7 | 114.0 | 112.2 |
| (change from the previous year) | 1.8 | -6.2 | -2.8 | -2.1 | 2.2 | -0.6 | -0.7 | -1.4 | -3.9 | -2.6 | 0.5 | -0.9 |
| Owner-built | 37.4 | 36.4 | 36.3 | 36.0 | 38.4 | 37.9 | 35.5 | 36.0 | 36.0 | 35.8 | 35.5 | 35.3 |
| housing | -0.6 | -5.6 | -3.1 | -3.1 | 3.6 | 4.9 | -2.0 | 0.0 | -6.0 | -5.0 | 0.0 | -2.0 |
| Rental | 45.4 | 45.5 | 44.8 | 46.6 | 46.3 | 43.3 | 45.0 | 45.4 | 45.2 | 43.3 | 45.0 | 44.6 |
| housing | 7.5 | 1.4 | -1.7 | 4.8 | 2.0 | -6.5 | 0.0 | -3.0 | -2.5 | -1.0 | 0.0 | -2.0 |
| Built-for-sale | 32.5 | 30.6 | 31.7 | 31.6 | 32.6 | 31.3 | 31.7 | 31.5 | 31.5 | 30.8 | 32.3 | 32.0 |
| housing | -2.6 | -16.1 | -3.7 | -9.4 | 0.8 | 2.5 | -0.1 | -0.1 | -3.1 | -1.5 | 1.8 | 1.6 |

## Economic Outlook for calendar 2004

Forecast

half/half、%
Yr/Yr、%

| | CY2002 | | CY2003 | | CY2004 | | CY2002 | CY2003 | CY2004 |
|---|---|---|---|---|---|---|---|---|---|
| | First half | Second half | First half | Second half | First half | Second half | (actual) | (forecast) | (forecast) |
| Nominal G D P | -0.4 | 0.1 | -0.3 | -0.4 | -0.5 | 0.7 | -1.5 | -0.4 | -0.3 |
| | -2.8 | -0.2 | -0.1 | -0.7 | -0.8 | 0.3 | | | |
| Real G D P | 0.2 | 1.8 | 1.1 | 1.3 | 0.9 | 0.5 | 0.1 | 2.7 | 1.8 |
| | -1.7 | 2.0 | 3.0 | 2.4 | 2.3 | 1.3 | | | |
| Contribution of domestic demand | -0.5 | 1.6 | 0.8 | 0.9 | 0.8 | 0.7 | -0.6 | 2.1 | 1.7 |
| Private consumption | 0.7 | 1.1 | 0.2 | 0.3 | 0.4 | 0.4 | 1.4 | 0.9 | 0.8 |
| | 0.9 | 1.8 | 1.3 | 0.4 | 0.7 | 0.9 | | | |
| Housing investment | -2.1 | -1.1 | -1.1 | 1.8 | -3.4 | 0.3 | -4.8 | -0.8 | -2.5 |
| | -6.6 | -3.0 | -2.3 | 0.7 | -1.8 | -3.1 | | | |
| Private capital investment | -3.8 | 3.6 | 6.8 | 6.4 | 3.8 | 0.6 | -4.9 | 11.9 | 7.5 |
| | -9.0 | -0.3 | 10.1 | 13.7 | 10.6 | 4.6 | | | |
| Contriburyion of Inventory investment | -0.3 | 0.6 | 0.0 | 0.0 | 0.2 | -0.0 | -0.4 | 0.3 | 0.2 |
| Government expenditure | 0.6 | -0.5 | -1.4 | -1.5 | -0.9 | 1.9 | 0.3 | -2.4 | -0.7 |
| | 0.7 | -0.1 | -1.6 | -3.1 | -2.2 | 0.9 | | | |
| Public investment | -0.7 | -4.5 | -6.4 | -6.6 | -7.4 | 2.0 | -4.9 | -11.5 | -9.5 |
| | -4.0 | -5.7 | -10.2 | -12.9 | -13.5 | -5.6 | | | |
| Government final consumption expenditure | 1.1 | 1.0 | 0.3 | 0.2 | 1.2 | 1.8 | 2.3 | 0.9 | 2.2 |
| | 2.5 | 2.1 | 1.4 | 0.5 | 1.4 | 3.0 | | | |
| Contribution of external demand | 0.5 | 0.9 | 0.5 | 0.7 | 0.5 | -0.1 | 0.7 | 0.6 | 0.1 |
| Export of goods and services | 8.3 | 5.6 | 3.5 | 5.4 | 5.3 | 0.8 | 8.2 | 9.2 | 8.4 |
| | 2.3 | 14.3 | 9.4 | 9.1 | 10.9 | 6.1 | | | |
| Import of goods and services | 1.9 | 5.0 | 0.9 | 3.0 | 6.0 | 3.7 | 2.0 | 4.9 | 9.6 |
| | -2.9 | 7.1 | 5.9 | 4.0 | 9.3 | 9.9 | | | |
| GDP deflator | -1.1 | -2.1 | -3.0 | -3.0 | -3.1 | -1.1 | -1.6 | -3.0 | -2.1 |

Forecast

Yr/Yr、%

| | CY2002 | | CY2003 | | CY2004 | | CY2002 | CY2003 | CY2004 |
|---|---|---|---|---|---|---|---|---|---|
| | First half | Second half | First half | Second half | First half | Second half | (actual) | (forecast) | (forecast) |
| Current account balance (trillion yen) | 7.9 | 6.3 | 7.3 | 7.4 | 7.2 | 7.2 | 14.1 | 14.8 | 14.4 |
| balance on goods (trillion yen) | 5.8 | 6.0 | 5.3 | 5.8 | 5.1 | 6.4 | 11.7 | 11.2 | 11.5 |
| balance on service (trillion yen) | -2.4 | -2.9 | -1.7 | -2.0 | -1.9 | -2.3 | -5.3 | -3.8 | -4.2 |
| balance on income (trillion yen) | 4.3 | 4.0 | 4.0 | 4.3 | 3.0 | 3.8 | 8.3 | 8.2 | 6.7 |
| Industrial production | 0.9 | 3.4 | 0.2 | 3.0 | 4.4 | -0.8 | -1.2 | 3.4 | 5.5 |
| | -6.7 | 4.6 | 3.9 | 2.9 | 7.6 | 3.4 | | | |
| Corporate goods prices | -2.1 | -1.7 | -1.5 | -1.0 | -1.8 | -1.5 | -1.9 | -1.3 | -1.6 |
| Domestic corporate goods prices | -2.4 | -1.7 | -1.0 | -0.6 | -0.8 | -1.2 | -2.1 | -0.8 | -1.0 |
| Consumer prices | -1.2 | -0.7 | -0.3 | -0.2 | -0.3 | -0.3 | -0.9 | -0.2 | -0.3 |
| exccluding freshfood | -0.9 | -0.9 | -0.6 | -0.1 | -0.2 | -0.4 | -0.9 | -0.3 | -0.3 |
| Yen/U.S.Dollar | 129.8 | 120.9 | 118.6 | 113.0 | 109.3 | 110.8 | 125.3 | 115.8 | 110.0 |
| Newly issued government bond yields（10year | 1.42 | 1.09 | 0.78 | 1.42 | 1.43 | 1.33 | 1.25 | 1.10 | 1.38 |
| Crude oil price (U.S.dollar/barrel) | 24.0 | 28.2 | 31.4 | 30.1 | 28.5 | 25.8 | 26.1 | 30.7 | 27.1 |
| U.S. Real GDP (CY) (seasonally-adjusted annual rate) | 3.5 | 2.7 | 1.9 | 5.3 | 3.4 | 3.7 | 2.4 | 2.9 | 3.9 |
| Spring wage increases＊ | — | — | — | — | — | — | 1.66 | 1.63 | 1.63 |

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 lavor 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 First half | CY2002 Second half | CY2003 First half | CY2003 Second half | CY2004 First half | CY2004 Second half | CY2002 (actual) | CY2003 (forecast) | CY2004 (forecast) |
|---|---|---|---|---|---|---|---|---|---|
| Exports (yen basis) | 1.3 | 11.8 | 3.9 | 4.4 | 5.3 | 4.0 | 6.4 | 4.2 | 4.6 |
| Volume | 2.9 | 13.1 | 5.2 | 2.9 | 5.5 | 3.7 | 8.0 | 4.0 | 4.6 |
| Imports (yen basis) | -6.3 | 5.8 | 7.2 | 6.6 | 7.6 | 1.8 | -0.4 | 6.9 | 4.6 |
| Volume | -2.6 | 6.7 | 8.4 | 7.0 | 9.9 | 5.7 | 2.0 | 7.6 | 7.8 |
| Exports surplus (trillion yen) | 4.9 | 5.0 | 4.4 | 4.8 | 4.1 | 5.5 | 9.9 | 9.1 | 9.6 |

**【Income and Employment】**

Forecast

Yr/Yr、%

| | CY2002 First half | CY2002 Second half | CY2003 First half | CY2003 Second half | CY2004 First half | CY2004 Second half | CY2002 (actual) | CY2003 (forecast) | CY2004 (forecast) |
|---|---|---|---|---|---|---|---|---|---|
| Cash earnings of employees (per capita) | -2.3 | -2.6 | 0.3 | -0.1 | 0.8 | 0.7 | -2.4 | 0.1 | 0.8 |
| Regular compensation* | -1.3 | -1.1 | -0.3 | -0.1 | 0.2 | 0.2 | -1.2 | -0.2 | 0.2 |
| Overtime compensation | -5.1 | 2.9 | 4.6 | 1.7 | 5.4 | 4.6 | -1.2 | 3.1 | 5.0 |
| Number of employees | -1.2 | -0.3 | 0.1 | 0.0 | 0.3 | 0.3 | -0.7 | 0.0 | 0.3 |
| Compensation of employees* | -2.5 | -2.4 | 0.0 | -0.7 | 0.9 | 0.8 | -2.5 | -0.3 | 0.8 |
| Unemployment rate | 5.4 | 5.4 | 5.4 | 5.2 | 5.1 | 5.2 | 5.4 | 5.3 | 5.2 |

**【New Housing Starts】**

Forecast

ten thousand units(annualized)

Yr/Yr、%

| | CY2002 First half | CY2002 Second half | CY2003 First half | CY2003 Second half | CY2004 First half | CY2004 Second half | CY2002 (actual) | CY2003 (forecast) | CY2004 (forecast) |
|---|---|---|---|---|---|---|---|---|---|
| Number of new housing starts | 117.5 | 113.1 | 117.3 | 112.5 | 114.1 | 111.3 | 115.1 | 114.9 | 112.7 |
| (change from the previous year) | 0.9 | -4.5 | -0.1 | -0.6 | -2.8 | -1.0 | -1.9 | -0.2 | -1.9 |
| Owner-built | 37.2 | 36.4 | 37.2 | 36.7 | 36.0 | 35.7 | 36.8 | 37.2 | 36.1 |
| housing | -5.6 | -4.6 | 0.0 | 0.9 | -3.2 | -2.8 | -4.9 | 1.1 | -3.1 |
| Rental | 44.7 | 45.2 | 46.4 | 44.1 | 45.3 | 44.1 | 45.0 | 44.9 | 44.2 |
| housing | 5.3 | 0.5 | 3.8 | -2.3 | -2.5 | 0.0 | 2.7 | -0.2 | -1.6 |
| Built-for-sale | 33.7 | 31.2 | 32.1 | 31.5 | 31.5 | 31.6 | 32.4 | 31.9 | 31.6 |
| housing | 1.7 | -10.1 | -4.8 | 1.1 | -1.8 | 0.2 | 0.8 | -1.7 | -0.7 |