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**Forecast for the Japanese  
Economy in Fiscal 2006 and 2007**  
— Temporary Slowdown on the Path of Stable, Medium-Term Growth —



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# **1. Forecast for the Japanese Economy in Fiscal 2006 and Fiscal 2007**

## **--Temporary Slowdown on the Path of Stable, Medium-Term Growth**

### **(1) Current State of the Economy**

Concerns about future trends in the Japanese economy are increasing. Without doubt, among the indexes of economic trends released by the Prime Minister's Cabinet Office, the leading indicator, which shows future trends in the economy, has been below 50%, which is the dividing line between "favorable" and "unfavorable" economic conditions, for three consecutive months. Moreover, the coincident indicator, which reflects current trends, dropped below 50% in September for the first time in six months.

However, amid the rise in concerns about future trends in the economy, the GDP data released for the July-September period indicate that the Japanese economy is still continuing to recover. Real GDP for the quarter rose 0.5% over the previous quarter (representing an annualized rate of 2.0%), thus recording the seventh consecutive quarter of positive growth. By component of GDP, government public works investment remained on a declining trend, falling 6.7% from the previous quarter, and government consumption expenditures showed only a slight increase of 0.1% from the previous quarter. As a result, the contribution of total government spending was negative for the fourth consecutive quarter. On the other hand, the margin of increase in exports expanded, and exports were 2.7% over those of the previous quarter, while imports posted a decline, albeit a small drop of only 0.1%, from the previous quarter. As a consequence, the contribution of the external sector was relatively large, amounting to 0.4% over the prior quarter, thus pushing the overall growth rate upward.

Among private-sector components of GDP, private capital investment rose for the 10th consecutive quarter. Growth in private capital investment has been especially high over the last three quarters, rising 2.9% from the previous quarter during the July-September period, and thus acting as a driving force for the economy. In contrast, personal consumption showed a marked decline of 0.7% from the previous quarter, in part because of the

influence of unfavorable weather conditions. As a result, domestic private-sector final demand in the July-September quarter was virtually level with the previous quarter, even after inclusion of a slight rise of 0.1% over the previous quarter in private housing investment. We should take note, however, that, as a result of the rise in digital product related inventories, including semiconductors and LCDs, inventory investment helped to boost the growth rate, contributing 0.3 percentage point to GDP growth.

In nominal terms, GDP rose 0.5% for the quarter, expanding at an annualized rate of 1.9%, thus recording (along with real GDP) the seventh consecutive quarter of positive growth. The GDP deflator remained below the level of the same quarter of the previous year and stood 0.8% below the same quarter of the previous year, but the margin of decline shrank for the third consecutive quarter. In addition, the deflator for domestic demand was 0.1% above the previous year. With the exception of the October-December quarter of 2004, when the domestic demand deflator was level with the previous year, this increase in the July-September period, albeit small, marked the first rise in approximately eight years.

## **(2) Outlook for Fiscal 2006 and Fiscal 2007**

During the latter half of fiscal 2006, the economy is likely to experience a slowdown. The real growth rate in fiscal 2006 is forecast to be 2.2%, the fifth consecutive year of positive expansion, but this will be lower than the 3.3% reported for fiscal 2005. In addition, the margin of decline in the GDP deflator will diminish significantly, and growth in nominal terms of 1.7% is expected, the fourth consecutive year of positive expansion and virtually the same nominal rate of growth as in fiscal 2005.

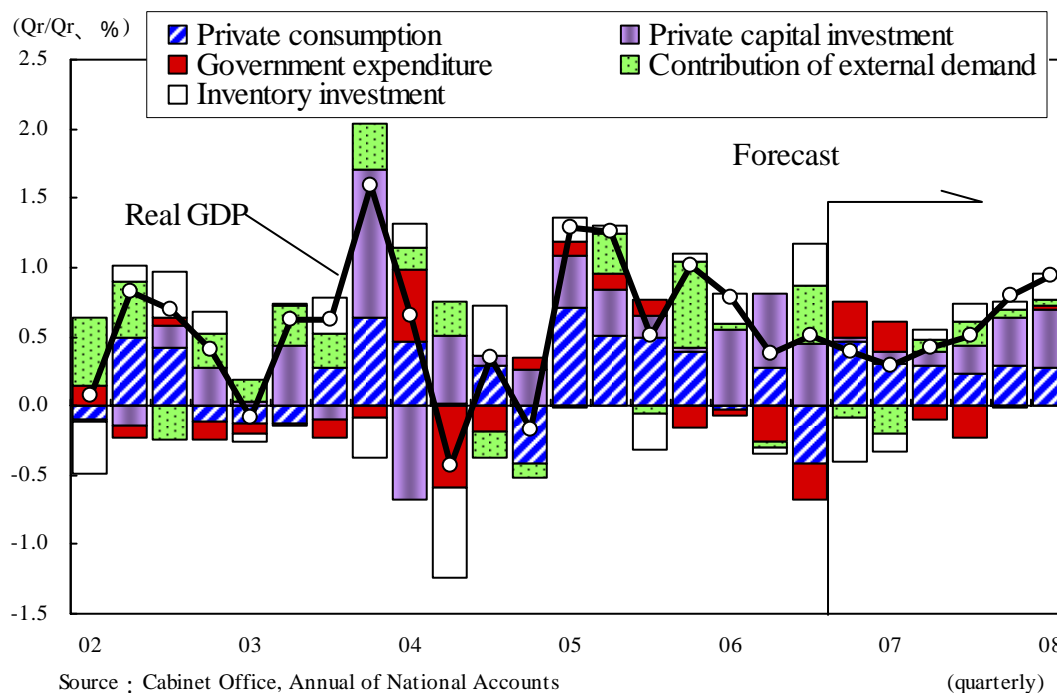
Factors that will slow the economy include the rise in inventories in digital-related products, such as semiconductors and LCDs. In some sectors, the rise in inventories will be in line with the increase in shipments, but in other sectors there will be unintended increases in inventories, thus giving rise to the strong possibility that adjustments in production will be necessary. In addition, as a result of the slowdown in the world economy,

including the United States, the pace of growth in exports is expected to decline somewhat. Private capital investment in Japan is expanding firmly propelled by high levels of corporate profitability, but toward the end of the fiscal year, slower growth in profits will result in slower expansion in capital investment. Personal consumption, which has been supported by improvements in employment conditions, will continue to expand, but the pace of expansion may slow along with lower growth in wages.

In the first half of fiscal 2007, the economic slowdown that began in the previous fiscal year may continue, but this will not lead to an overall downturn in the economy. Since the economy will begin to accelerate again in the second half of fiscal 2007, real economic growth for the whole of fiscal 2007 is forecast to amount to 2.0%, the sixth consecutive year of positive expansion. Moreover, the GDP deflator is expected to rise 0.4%, the first increase in 10 years, or since 1997, when the consumption tax was increased. As a consequence, growth in nominal terms will be 2.4%, exceeding the real growth rate and representing the fifth consecutive year of positive nominal growth.

By component of demand, in the second half of fiscal 2007, exports will accelerate and the pace of expansion in production will rise following the completion of adjustments in inventories of digital-related products around the middle of fiscal 2007 and faster growth in the world economy. In addition, since corporate profits will begin to improve again, private capital investment, which slowed temporarily, will regain momentum. On the other hand, consumer spending will continue to expand moderately as in the previous fiscal year and will provide support for economic growth. Companies are expected to continue to restrain wages, and, while substantial expansion in employee compensation is not expected, the movement toward recovery in the corporate sector is expected to have a positive impact on the environment for household income and consumption.

### Exhibit 1: Real GDP Growth (seasonally adjusted)



### (3) An Examination of Concerns about Economic Slowdown

Since our forecast was issued in the previous outlook, our scenario for continued recovery in the economy, with a temporary slowdown in the latter half of fiscal 2006 continuing into fiscal 2007, remains unchanged. The factors that will bring the deceleration in the economy are as follows.

The slowdown in overseas economies will restrain exports and bring a slower pace of increase in production.

The increase in inventories of digital-related products, including semiconductors and LCDs, will bring adjustments in inventories and restraints on production.

Growth in production and shipments is expected to level off, while increases in raw material prices and fixed costs, including personnel expenses, will have a negative impact on corporate profits, thus leading to a deceleration in private capital investment.

Even though corporate profits may be at record levels, growth in wages is still low, making it difficult to believe that the rate of expansion in consumer spending will accelerate.

Recently, concerns about future trends in the economy have mounted significantly. For example, the extent of the deceleration in the economy has been greater than anticipated, and some have raised questions about the possibility of moving into an economic downtrend. Others have expressed the concern that the current deceleration will not be temporary, but may become prolonged.

The reason for the emergence of these concerns is that some recently announced economic indicators have given the impression that conditions are weaker than anticipated. Movements in specific indicators that we can point to are the following.

The real GDP growth rate in the U.S. economy during the July-September quarter was 1.6% at an annualized rate, lower than anticipated. Private housing investment, which signaled the end of the boom, has declined for four consecutive quarters, and the margin of decline was the largest in 15-and-a-half years.

September statistics for industrial production in Japan showed a sharp rise in inventories of electronic parts and devices, including semiconductors and LCDs, the fifth consecutive significant month-to-month increase. Compared with the previous year, the level of inventories in September was up 36.9%. Although shipments are also rising, the ratio of inventories to shipments has risen substantially.

Shipments of capital goods (excluding transportation equipment), which are closely related to capital investment demand, continued their decline and were 1.4% lower in the July-September period than in the previous quarter. In addition, orders for machinery and equipment (private-sector orders excluding those from the shipping and electric power industries) fell 11.1% from the previous quarter during the July-September period, with major declines centered on the non-manufacturing industries.

The number of employed persons is gradually increasing, but wages are not rising. Overtime payments are increasing over the same period of the previous year along with increases in production, and bonuses are also rising. However, regularly scheduled salary payments, which are

the core of employee compensation, continue to be lower than the levels of a year earlier. As a consequence, doubts have grown about the scenario that calls for the recovery in the corporate sector to lead eventually to recovery in the household sector.

In view of these trends in economic indicators, attention is focusing on whether the deceleration in the economy in the latter half of the current fiscal year will just be a temporary adjustment through the early part of fiscal 2007 or whether it will be more serious than previously imagined. Next, let us examine the various factors that are leading to the slowdown.

### **Slowdown in Overseas Economies**

The slowdown in the growth rate of the U.S. economy in the July-September quarter was greater than expected, but that was primarily due to the sharp drop in housing residential investment. On the contrary, personal consumption and private capital investment were stronger than expected. The concern that the decline in housing prices may cause a deceleration in the economy as a whole, including consumer spending, because of the negative wealth effect, thus far has not been substantiated by actual events. Going forward, even if the impact of the end of the housing boom spreads to other sectors, the slowdown in the overall economy may be temporary.

In addition, in the event that the U.S. economy slows, the issue of what impact this will have on the world economy becomes important. The fact that the U.S. economy is running a massive current account deficit means that the growth of other countries is being supported by their exports to the United States. A deceleration in growth of the U.S. economy will likely have negative effects on the growth of the world economy.

On other hand, in those emerging nations that are expanding their exports to the United States, domestic demand is expanding as a result of high economic growth. As a result, the presence of the U.S. economy in the international economy is declining relatively speaking, and the presence of the so-called BRICs (Brazil, Russia, India, and China)' economies is rising.

In this sense, even if the U.S. economy decelerates, the world economy may not be as seriously affected as in the past.

In all likelihood, all these factors will have an impact, but, in recent years, real growth in the world economy has been about 5% annually. The countries supporting this rapid growth, which has been described as the highest in 30 years, are not so much the advanced countries but the newly industrializing countries, such as China, where there is concern about overheating. If the slowdown in the U.S. economy proves to be temporary, it appears unlikely that this will bring a major deceleration in the world economy as a whole.

### **Inventory Adjustments in Digital-Related Products**

Experience shows that shipments of semiconductors and other electronic parts has thus far moved according to the “silicon cycle,” which occurs over a period of about four years. Within this longer cycle, there are also shorter cycles of about two years; thus, since the summer of this year appears to have been a peak, there is a possibility that the industry may be entering a downturn. However, manufacturers of electronic equipment now keep close watch on demand trends among their customers, and, as a result, the silicon cycle is less pronounced than in the past. As a consequence, many observers believe that the cycle adjustment this time may be relatively mild.

However, as previously mentioned, according to output statistics, producers’ inventories have risen significantly in the electronic component and devices industries and have already exceeded the levels at the time of the bursting of the IT bubble in 2001. Expansion in shipments is continuing, but the ratio of inventories to shipments is rising. Accordingly, we cannot really say with certainty that the current increase in inventories is appropriate for the level of shipments. There is a possibility that manufacturers of portable phones may be increasing production and, therefore, inventories, in anticipation of demand following the introduction of “number portability,” as portable phone carriers allow customers to keep the same number when switching to new models. Therefore, trends in

portable phone sales will be watched carefully. In addition, depending on the success of the Christmas sales season in the United States, which will depend in part on sales of newly introduced game consoles, the adjustment in inventories may be more of a burden on producers than anticipated.

In any event, manufacturers have a sufficient grasp of the risks of the current levels of inventories and shipments, and they are expected to move quickly to make appropriate adjustments. Looking ahead, there may be a period when production will be reduced to make adjustments in inventories that have risen excessively, but from the perspective of industrial production as a whole, we expect that the adjustment will be limited to a temporary pause in the current upward trend.

### **Outlook for Capital Investment**

Although corporate profitability is at a high level, the rate of growth in profits has reached a ceiling, and capital investment is expected to decelerate somewhat. However, since orders for machinery and equipment in the July-September quarter experienced a marked decline, concerns have mounted that capital investment may lose momentum. Certainly, the decline in orders for machinery and equipment, which are a leading indicator for capital investment, was substantial, but there would be problems in simply extrapolating from this to forecast future trends in capital investment. At this stage, there would have been nothing unusual about a deceleration in orders for machinery and equipment, but the sharp hike in this indicator in the April-June quarter was due to certain special factors and the reaction to these factors is exacerbating the decline in the July-September quarter.

The special factors include orders related to portable phones in preparation for the transition to number portability in the telecommunications industry and orders from the transportation industry for rolling stock, including Shinkansen railway cars. These orders from non-manufacturing industries had the impact of pushing orders for machinery and equipment upward. Note especially that orders for portable phone equipment are not counted within capital investment.

Within orders for machinery and equipment, if we examine trends in industrial machinery and machine tools that are not influenced by these special factors, there is a slowing trend, but orders remain at a high level. Even after eliminating these special factors, indicators related to capital investment are losing momentum, but this trend is consistent with the outlook for deceleration in capital investment that was assumed initially. It would be difficult to believe that the same kind of major downward adjustment that occurred in orders for machinery and equipment would occur in capital investment.

### **Spreading of the Recovery from the Corporate to the Household Sector**

Although corporate profitability is continuing at record levels, wages are not rising. Corporations are adhering strongly to policies of restraining personnel expenses, and the conduit that should allow the recovery in the corporate sector to be transmitted to the householder sector through expansion in employee compensation has become smaller. However, this is not something that has occurred suddenly but something that has been going on for some time.

In addition, even though the conduit for transmitting the benefits of recovery from the corporate sector to individuals has become smaller, it has not stopped completely. The number of employed persons is continuing to rise, and wages are not decreasing substantially as they have in the past. The correct view seems to be that employee compensation overall is continuing to show a gradual upward trend.

During the July-September quarter, personal consumption experienced a significant decline of 0.7% from the previous quarter. Factors accounting for this included slow sales of seasonal items because of unseasonable weather conditions, reluctance among consumers to spend when the introduction of new models was expected in the near future, the completion of purchases to replace older appliances, the pause in improvement in consumer psychology, the decline in disposal income because of the

reduction in tax breaks, and many other developments. Certainly, all of these factors can be viewed as factors that had an adverse impact on consumer spending, but it is uncertain whether these can fully explain the major decline in personal consumption of 3% at an annual rate.

If some raised the question of whether consumer spending actually declined 0.7% in the July-September quarter, the correct answer would probably be that these estimates may contain not a small margin of error. This does not mean that we should distrust the estimates, but when we think of trends in consumption thus far and seek to forecast future trends, we probably should not draw the conclusion immediately that the significant decline in the July-September quarter means that consumer spending has experienced a change in trend. Instead, it would probably be more appropriate to conclude that a temporary fluctuation has occurred against a basically gradual rising trend in consumer spending.

Even if we have forecast some slowing of the economy, if some indicators are actually released that suggestion such as slowdown, this may add to the uncertainty about future trends. In addition, if such indicators are weaker than anticipated, this will also add to concerns about future trends. If we examine the indicators that have been released thus far, the possibilities of actual outcomes being worse than the forecasts are not completely absent. However, the likely scenario is that the slowdown in the economy will be temporary and not turn into a downturn and that the economy will accelerate in the latter half of fiscal 2007. We believe that the underlying real growth of the Japanese economy will continue to be about 2% annually.

## **2. Forecasts of Economic Activity by Sector**

### **(1) Corporations**

- Corporations have completed their disposal of negative assets left over from the bubble economy, and their financial positions and profitability have recovered. The risk of a possible downturn in production, capital investment, or other aspects of corporation activities has receded, and

corporations are moving forward with the development of their activities, including the expansion of production capacity.

- Production is expanding against a background of growth in exports of automobiles, digital-related products, and other items as well as favorable trends in domestic demand, especially capital investment.
- As a result of the improvement in corporate profitability and recovery in the economy, recurring profit has already exceeded the previous peak reached during the bubble economy. Profitability is expected to continue at high levels going forward, but certain factors have emerged that may bring some deterioration in the environment for profits. Prices of raw materials have increased, but, with the exception of certain industries, corporations have had difficulty in passing on these higher costs to consumers, and this has resulted in a decline in marginal profits. In addition, the recovery in employment and capital investment has resulted in higher fixed costs, namely, personnel costs and depreciation charges, as well as higher interest costs as overall interest rates have risen.
- If growth in corporate profitability becomes sluggish, this may restrain capital investment. However, corporations are still faced with the need to replace certain older equipment that they have postponed thus far, and they need make further capital investments to increase the value added of their products and improve their competitiveness. For these reasons, the deceleration in capital investments is expected to be slight, and they are likely to continue on an upward trend.

## **(2) Households**

- Employment is continuing to recover, but growth in wages is weak, resulting in only a gradual increase in incomes. As a consequence, the positive benefits of improvement in economic conditions have not spread from the corporate sector to the household sector. Personal consumption is continuing to increase, but it is still not strong enough to be a driving force in the economy.
- The drastic restructurings that companies undertook to reduce excess employment have been completed. A sense that labor is in shorter supply has emerged as companies confront the facts that the baby boom

generation of workers will begin to retire in 2007 and the number of younger workers will decline. Corporations have, therefore, shown growing interest in expanding their workforces. Since profitability is strong, the employment and income environments are expected to show a trend toward continuing improvement.

- However, the restraint that corporations are showing regarding increases in personnel costs is one of the factors supporting profitability, and corporations remain cautious about raising wages. In addition, the increases in taxes and the welfare burden that the workforce is expected to have to bear going forward will reduce disposable incomes primarily of current workers. Increases in consumer spending will, therefore, continue to be moderate.
- The pace of private housing investment is expected to be somewhat slower but remain firm going forward as the sons and daughters of the baby boom generation purchase their first homes. In addition to recovery in the economy, other factors supporting housing investment will be expectations of rising interest rates and the prospects for a bottoming out and increase in land prices.

### **(3) Government**

- Following the bursting of Japan's economic bubble, government finance deteriorated rapidly, making it necessary to issue high levels of government bonds. Along with the decline in nominal economic growth rates, the government lowered tax rates, thus bringing a drop in tax revenues. Moreover, on the expenditure side, as the population has aged demographically, social welfare costs have risen, and, as a result of the implementation of major government spending programs to stimulate the economy, expenditures for public works increased.
- The administration of former Prime Minister Junichiro Koizumi did not undertake any major spending programs to stimulate the economy because he set the goal of making structural reforms in government finances. Instead, he reduced spending on public works. In addition, local governments also experienced deterioration in their financial position, and their spending on public works projects has continued to decline.

- At present, along with the recovery in the economy, tax revenues are expanding, and there is a trend toward improvement in government finances. Prime Minister Shinzo Abe has adopted a policy of maintaining the structural reform initiatives of his predecessor. Accordingly, continued cutbacks in government public works spending at the national and local levels are expected.
- The basic policy of the government is to reduce government final consumption expenditure also in order to attain the objective of structure improvements in government finances. The method for restraining these expenditures will be systemic reforms to rein in social welfare expenditures. However, even if these reforms are implemented, they will probably only succeed in lowering the pace of expansion in these expenditures. We anticipate that government final consumption expenditures, principally social welfare payments, will continue to increase.

#### **(4) Trends in Overseas Economies**

- The world economy is continuing on an expansionary trend. A number of adverse developments, however, may result in a temporary slowdown. These include the adoption of more stringent monetary policies in certain countries, the rise in oil prices, the slowing of the U.S. housing market, and overheating of the Chinese economy. However, at present, we believe the risk of a hard landing as a result of a sharp drop in the value of the U.S. dollar that might lead to a downturn in the world economy as a whole is minimal.
- Although there is a possibility that Japan's exports might experience a temporary adjustment because of a deceleration in the world economy, we believe the rising trend in Japan's exports will continue. The expansion in overseas production of Japanese companies will be one factor restraining exports. Nevertheless, the demand for electronic parts, principally in Asia, is rising, and worldwide demand for automobiles is expanding rapidly. We are forecasting, therefore, that exports from Japan will continue to expand. In addition, in view of the increase in prices of primary products, we are looking for expansion in exports to resource-exporting countries, such as the oil producers of the Middle

East.

- Regarding imports, as China and other emerging industrialized countries rapidly expand their production capacity and Japanese companies continue to move to locate portions of their capacity offshore Japan for the optimal division of production, Japan's imports of products and parts, principally from the rest of Asia, will continue to increase. In addition, as a result of the continuing high levels of primary product prices, imports of raw materials in value terms are expected to remain at a high level.
- We are looking for both exports and imports to continue to rise, and net exports will generally make a positive contribution to economic growth. Moreover, reflecting the overseas expansion of Japanese companies, dividends and other income from their overseas subsidiaries will expand, and income from monetary assets held in foreign countries will also rise. As a result, Japan's surplus in the income accounts of its balance of payments is on track to rise to, and then exceed, the levels of the trade surplus.

### **3. Forecasts for Prices and Financial Markets**

- Prices of raw materials, including crude oil, will remain high, but the rapid increases in such prices experienced thus far appear to have run their course. The rate of increase over the previous year in domestic corporate prices is expected to diminish now that the transfer of higher raw materials prices has been reflected in intermediate and final sales prices. However, as we move into the latter half of fiscal 2007 and domestic demand begins to strengthen, the rate of increase in domestic corporate prices may rise again. Consumer prices are expected to experience slight increases as the supply and demand balance tightens along with economic recovery, personnel costs increase, and prices of petroleum-based and other products rise.
- In July, the zero interest rate policy was lifted, and the target level of the monetary policy interest rate (the unsecured overnight call market interest rate) was raised to 0.25%. Looking ahead, we believe there may be a series of further slight increases, as the monetary authorities confirm the state of the economic recovery, consumer prices increase,

and demand for funds rises.

- The upward trend in long-term interest rates is expected to continue as the economic recovery proceeds and the monetary policy interest rate increases. Stock prices are likely to fluctuate in a limited range in the latter half of fiscal 2006 as the pace of improvement in corporate performance slows. In fiscal 2007, however, stock prices may begin to rise again in anticipation of acceleration in the economy. Regarding foreign exchange markets, the value of the yen may appreciate temporarily in the latter half of fiscal 2006, on expectations of higher interest rates in Japan, but in fiscal 2007, the anticipated pickup in the U.S. economy and the differential between interest rates in Japan and the United States are likely to bring a trend toward the strengthening of the dollar and the weakening of the yen.

## Exhibit 2: Outlook for fiscal 2006-2007

|  | FY2003<br>(actual) | FY2004<br>(actual) | FY2005<br>(actual) | Forecast             |                      |
|--|--------------------|--------------------|--------------------|----------------------|----------------------|
|  |                    |                    |                    | FY2006<br>(forecast) | FY2007<br>(forecast) |
| Nominal GDP                                    | 1.0                | 0.5                | 1.8                | 1.7                  | 2.4                  |
| Real GDP                                       | 2.3                | 1.7                | 3.3                | 2.2                  | 2.0                  |
| Contribution of domestic demand (Qr/Qr,%)      | 1.5                | 1.2                | 2.9                | 1.7                  | 1.8                  |
| Private Consumption                            | 0.8                | 1.6                | 2.6                | 1.0                  | 1.8                  |
| Housing investment                             | -0.0               | 1.7                | -0.2               | 0.2                  | 0.7                  |
| Private capital investment                     | 7.0                | 5.6                | 7.3                | 9.1                  | 4.6                  |
| Contribution of Inventory investment (Qr/Qr,%) | 0.2                | -0.3               | 0.2                | 0.1                  | 0.1                  |
| Government expenditure                         | -0.5               | -1.4               | 0.8                | -1.6                 | -0.3                 |
| Public investment                              | -9.5               | -12.4              | -1.4               | -9.5                 | -5.9                 |
| Government final consumption expenditure       | 2.5                | 1.8                | 1.4                | 0.7                  | 1.3                  |
| Contribution of external demand (Qr/Qr,%)      | 0.8                | 0.5                | 0.5                | 0.5                  | 0.2                  |
| Export of goods and services                   | 9.7                | 11.4               | 9.1                | 7.0                  | 6.5                  |
| Import of goods and services                   | 3.2                | 8.7                | 6.5                | 3.8                  | 5.9                  |
| GDP deflator (Yr/Yr,%)                         | -1.3               | -1.2               | -1.5               | -0.5                 | 0.4                  |

|   | FY2003<br>(actual) | FY2004<br>(actual) | FY2005<br>(actual) | Forecast             |                      |
|---|--------------------|--------------------|--------------------|----------------------|----------------------|
|   |                    |                    |                    | FY2006<br>(forecast) | FY2006<br>(forecast) |
| Current account balance (trillion yen)                  | 17.3               | 18.2               | 19.1               | 19.3                 | 19.8                 |
| balance on goods (trillion yen)                         | 13.3               | 13.5               | 9.6                | 9.3                  | 9.5                  |
| balance on service (trillion yen)                       | -3.4               | -3.6               | -2.2               | -2.2                 | -2.3                 |
| balance on income (trillion yen)                        | 8.5                | 9.6                | 12.6               | 13.3                 | 13.6                 |
| Industrial production (Qr/Qr, %)<br>(Yr/Yr, %)          | 3.5                | 4.0                | 1.6                | 3.2                  | 2.2                  |
| Corporate goods prices(Yr/Yr,%)                         | -1.0               | 1.8                | 4.1                | 4.4                  | 1.6                  |
| Domestic corporate goods prices(Yr/Yr,%)                | -0.5               | 1.5                | 2.1                | 2.7                  | 0.9                  |
| Consumer prices(Yr/Yr,%)                                | -0.2               | 0.0                | -0.3               | 0.4                  | 0.6                  |
| excluding freshfood(Yr/Yr,%)                            | -0.2               | -0.1               | -0.1               | 0.2                  | 0.6                  |
| Yen/U.S.Dollar  | 113.0              | 107.5              | 113.3              | 116.6                | 119.3                |
| Newly issued government bond yields (10years)           | 1.12               | 1.52               | 1.43               | 1.83                 | 2.19                 |
| WTI future price(near month contract, US dollar/barrel) | 31.4               | 45.1               | 60.0               | 66.4                 | 67.8                 |
| Dubai crude oil prices (US dollar/barrel)               | 27.0               | 36.6               | 53.7               | 61.7                 | 63.8                 |

### Exhibit 3: Outlook for calendar 2006-2007

|  | CY2003<br>(actual) | CY2004<br>(actual) | CY2005<br>(actual) | Forecast             |                      |
|--|--------------------|--------------------|--------------------|----------------------|----------------------|
|  |                    |                    |                    | CY2006<br>(forecast) | CY2007<br>(forecast) |
|  | Yr/Yr, %           |                    |                    |                      |                      |
| Nominal GDP                              | 0.2                | 1.1                | 1.3                | 1.8                  | 2.1                  |
| Real GDP                                 | 1.8                | 2.3                | 2.7                | 2.7                  | 1.7                  |
| Contribution of domestic demand          | 1.2                | 1.5                | 2.5                | 2.1                  | 1.6                  |
| Private consumption                      | 0.6                | 1.9                | 2.3                | 1.3                  | 1.6                  |
| Housing investment                       | -0.9               | 1.9                | -0.7               | 1.1                  | 0.3                  |
| Private capital investment               | 5.9                | 4.9                | 7.5                | 9.3                  | 4.7                  |
| Contribution of Inventory investment     | 0.4                | -0.2               | 0.2                | 0.3                  | -0.1                 |
| Government expenditure                   | -1.1               | -0.4               | 0.1                | -1.4                 | 0.0                  |
| Public investment                        | -10.8              | -8.6               | -6.0               | -8.7                 | -4.1                 |
| Government final consumption expenditure | 2.3                | 2.0                | 1.7                | 0.6                  | 1.2                  |
| Contribution of external demand          | 0.6                | 0.8                | 0.2                | 0.4                  | 0.1                  |
| Export of goods and services             | 9.0                | 13.9               | 7.0                | 9.7                  | 4.1                  |
| Import of goods and services             | 3.9                | 8.5                | 6.2                | 5.2                  | 3.7                  |
| GDP deflator                             | -1.6               | -1.2               | -1.4               | -0.9                 | 0.4                  |

|   | CY2003<br>(actual) | CY2004<br>(actual) | CY2005<br>(actual) | Forecast             |                      |
|---|--------------------|--------------------|--------------------|----------------------|----------------------|
|   |                    |                    |                    | CY2006<br>(forecast) | CY2007<br>(forecast) |
|   | Yr/Yr, %           |                    |                    |                      |                      |
| Current account balance (trillion yen)                  | 15.8               | 18.6               | 18.3               | 19.7                 | 19.3                 |
| balance on goods (trillion yen)                         | 12.3               | 14.3               | 10.3               | 9.3                  | 9.2                  |
| balance on service (trillion yen)                       | -3.6               | -3.7               | -2.6               | -2.1                 | -2.2                 |
| balance on income (trillion yen)                        | 8.3                | 9.3                | 11.4               | 13.6                 | 13.3                 |
| Industrial production<br>(Qr/Qr, %)<br>(Yr/Yr, %)       | 3.1                | 5.5                | 1.1                | 3.7                  | 2.6                  |
| Corporate goods prices(Yr/Yr,%)                         | -1.3               | 1.2                | 3.1                | 5.1                  | 1.7                  |
| Domestic corporate goods prices(Yr/Yr,%)                | -0.8               | 1.2                | 1.7                | 3.0                  | 1.0                  |
| Consumer prices(Yr/Yr,%)                                | -0.2               | 0.0                | -0.3               | 0.3                  | 0.5                  |
| excluding freshfood(Yr/Yr,%)                            | -0.3               | -0.1               | -0.1               | 0.2                  | 0.5                  |
| Yen/U.S.Dollar  | 115.9              | 108.2              | 110.2              | 116.4                | 118.6                |
| Newly issued government bond yields ( 10years )         | 1.0                | 1.5                | 1.4                | 1.8                  | 2.1                  |
| WTI future price(near month contract, US dollar/barrel) | 31.0               | 41.4               | 56.6               | 66.5                 | 66.0                 |
| Dubai crude oil prices (US dollar/barrel)               | 26.8               | 33.6               | 49.5               | 61.5                 | 62.0                 |

## Exhibit 4: Outlook for 2006-2007 (Quarterly)

|   | Forecast |      |       |      |        |       |       |      |        |      |       |       |
|---|----------|------|-------|------|--------|-------|-------|------|--------|------|-------|-------|
|   | FY2005   |      |       |      | FY2006 |       |       |      | FY2007 |      |       |       |
|   | 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                                   | 0.7      | 0.2  | 0.6   | 0.5  | 0.2    | 0.5   | 0.6   | 0.5  | 0.3    | 0.5  | 1.3   | 0.7   |
|   | 1.5      | 1.4  | 2.0   | 2.3  | 1.4    | 1.9   | 1.5   | 2.0  | 1.9    | 2.1  | 2.5   | 3.1   |
| Real GDP                                      | 1.3      | 0.5  | 1.0   | 0.8  | 0.4    | 0.5   | 0.4   | 0.3  | 0.4    | 0.5  | 0.8   | 0.9   |
|   | 2.7      | 2.9  | 3.8   | 3.9  | 2.6    | 2.8   | 1.8   | 1.8  | 1.6    | 1.6  | 1.9   | 2.8   |
| Contribution of domestic demand(Qr/Qr,%)      | 1.0      | 0.6  | 0.4   | 0.7  | 0.4    | 0.1   | 0.5   | 0.5  | 0.3    | 0.3  | 0.7   | 0.9   |
| Private Consumption                           | 0.9      | 0.9  | 0.7   | -0.1 | 0.5    | -0.7  | 0.8   | 0.5  | 0.5    | 0.4  | 0.5   | 0.5   |
|   | 2.1      | 2.2  | 3.6   | 2.4  | 2.1    | 0.3   | 0.5   | 1.2  | 1.1    | 2.3  | 1.9   | 1.9   |
| Housing investment                            | -1.4     | 1.5  | 1.6   | 1.2  | -2.5   | 0.1   | 1.1   | 0.4  | -0.9   | -0.0 | 1.5   | -0.0  |
|   | -2.7     | -1.3 | 0.5   | 3.1  | 1.5    | 0.2   | -0.1  | -0.9 | 0.6    | 0.5  | 0.9   | 0.5   |
| Private capital investment                    | 2.3      | 1.1  | 0.2   | 3.7  | 3.5    | 2.9   | 0.2   | 0.5  | 0.7    | 1.2  | 2.2   | 2.5   |
|   | 7.7      | 7.9  | 6.0   | 7.6  | 8.8    | 10.4  | 10.4  | 7.3  | 4.3    | 2.6  | 4.6   | 6.7   |
| Contribution of Inventory investment(Qr/Qr,%) | 0.1      | -0.3 | 0.1   | 0.2  | -0.0   | 0.3   | -0.3  | -0.1 | 0.1    | 0.1  | 0.1   | 0.2   |
| Government expenditure                        | 0.5      | 0.5  | -0.7  | -0.2 | -1.2   | -1.2  | 1.2   | 1.0  | -0.4   | -1.0 | -0.1  | 0.2   |
|   | 0.5      | 1.8  | 0.8   | 0.2  | -1.2   | -3.0  | -1.7  | -0.3 | 0.6    | 0.7  | -0.7  | -1.6  |
| Public investment                             | 1.3      | 1.5  | -3.6  | -0.8 | -6.5   | -6.7  | 5.6   | 3.9  | -4.3   | -6.2 | -0.1  | -0.3  |
|   | -3.4     | 0.8  | -1.8  | -1.4 | -9.2   | -16.8 | -8.7  | -4.2 | -2.1   | -1.7 | -6.9  | -10.6 |
| Government final consumption expenditure      | 0.3      | 0.3  | 0.1   | 0.0  | 0.2    | 0.1   | 0.3   | 0.4  | 0.5    | 0.1  | 0.1   | 0.3   |
|   | 1.4      | 2.1  | 1.6   | 0.8  | 0.6    | 0.4   | 0.6   | 1.0  | 1.4    | 1.4  | 1.2   | 1.1   |
| Contribution of external demand(Qr/Qr,%)      | 0.3      | -0.1 | 0.6   | 0.1  | -0.0   | 0.4   | -0.1  | -0.2 | 0.1    | 0.2  | 0.1   | 0.0   |
| Export of goods and services                  | 3.6      | 2.9  | 3.7   | 2.5  | 0.9    | 2.7   | -0.4  | -1.1 | 1.7    | 3.7  | 2.8   | 3.0   |
|   | 4.9      | 7.6  | 10.5  | 13.3 | 10.3   | 10.1  | 5.8   | 2.1  | 2.9    | 3.9  | 7.3   | 11.7  |
| Import of goods and services                  | 1.7      | 3.9  | -0.8  | 2.4  | 1.4    | -0.1  | 0.2   | 0.2  | 1.2    | 2.9  | 2.7   | 3.0   |
|   | 6.2      | 7.9  | 4.7   | 7.4  | 7.1    | 2.7   | 3.8   | 1.6  | 1.5    | 4.5  | 7.2   | 10.2  |
| GDP deflator(Yr/Yr,%)                         | -1.2     | -1.4 | -1.8  | -1.5 | -1.2   | -0.8  | -0.3  | 0.2  | 0.3    | 0.5  | 0.6   | 0.3   |

|   | Forecast |       |       |       |        |       |       |       |        |       |       |       |
|---|----------|-------|-------|-------|--------|-------|-------|-------|--------|-------|-------|-------|
|   | FY2005   |       |       |       | FY2006 |       |       |       | FY2007 |       |       |       |
|   | 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)*                 | 4.3      | 4.4   | 5.3   | 5.1   | 4.3    | 4.7   | 5.5   | 4.8   | 4.6    | 4.6   | 5.3   | 5.2   |
| balance on goods (trillion yen)*                        | 2.5      | 2.2   | 2.5   | 2.3   | 2.1    | 2.1   | 2.3   | 2.6   | 2.4    | 1.9   | 1.9   | 2.7   |
| balance on service (trillion yen)*                      | -0.7     | -0.8  | -0.3  | -0.4  | -0.7   | -0.7  | -0.3  | -0.5  | -0.7   | -0.7  | -0.3  | -0.5  |
| balance on income (trillion yen)*                       | 2.8      | 3.0   | 3.3   | 3.6   | 3.3    | 3.5   | 3.2   | 3.3   | 3.8    | 3.6   | 3.3   | 3.5   |
| Industrial production (Qr/Qr, %)                        | -0.1     | -0.5  | 2.8   | 0.6   | 0.9    | 1.0   | -0.3  | -0.2  | 0.5    | 1.2   | 1.2   | 1.4   |
| (Yr/Yr, %)  | 0.3      | -0.2  | 3.0   | 3.2   | 4.1    | 5.4   | 1.8   | 1.5   | 1.1    | 1.0   | 2.5   | 4.4   |
| Corporate goods prices(Yr/Yr,%)                         | 2.7      | 3.1   | 4.9   | 5.6   | 5.0    | 5.6   | 4.1   | 2.9   | 1.7    | 0.9   | 1.4   | 2.3   |
| Domestic corporate goods prices(Yr/Yr,%)                | 1.7      | 1.7   | 2.2   | 2.8   | 3.1    | 3.5   | 2.5   | 1.9   | 0.9    | 0.4   | 0.8   | 1.2   |
| Consumer prices(Yr/Yr,%)                                | -0.1     | -0.3  | -0.7  | -0.1  | 0.2    | 0.6   | 0.4   | 0.3   | 0.5    | 0.6   | 0.6   | 0.7   |
| excluding freshfood(Yr/Yr,%)                            | 0.0      | -0.2  | -0.1  | 0.0   | 0.0    | 0.3   | 0.3   | 0.3   | 0.5    | 0.5   | 0.6   | 0.6   |
| Yen/U.S.Dollar  | 107.6    | 111.2 | 117.3 | 116.9 | 114.4  | 116.2 | 118.3 | 117.5 | 118.0  | 119.0 | 120.0 | 120.0 |
| Newly issued government bond yields (10years)           | 1.27     | 1.34  | 1.52  | 1.58  | 1.89   | 1.79  | 1.75  | 1.90  | 1.95   | 2.10  | 2.30  | 2.40  |
| WTI future price(near month contract, US dollar/barrel) | 53.2     | 63.2  | 60.0  | 63.5  | 70.7   | 70.5  | 61.5  | 63.0  | 65.0   | 67.0  | 69.0  | 70.0  |
| Dubai crude oil prices (US dollar/barrel)               | 47.9     | 55.6  | 52.9  | 58.2  | 64.8   | 66.0  | 57.0  | 59.0  | 61.0   | 63.0  | 65.0  | 66.0  |

\*Seasonally adjusted annual rate