

May 2007

**Forecast for the Japanese  
Economy in Fiscal 2007 and 2008**  
— Moderate Recovery to Continue, Overcoming Four Concerns —



Mitsubishi UFJ Research and Consulting

**Economic Research Department**

# **1. Forecast for the Japanese Economy in Fiscal 2007 and Fiscal 2008 -- Moderate Recovery to Continue, Overcoming Four Concerns**

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

The Japanese economy is continuing on a moderate recovery trend, with slowdowns in some sectors. The latest gross domestic product (GDP) statistics, for the January-March quarter, released on May 17, 2007, showed quarter-to-quarter real growth of 0.6% (2.4% at an annualized rate), the ninth consecutive quarter of positive growth. GDP in nominal terms continued to rise moderately, expanding 0.3% for the quarter (1.2% at an annualized rate). In fiscal 2006, ended March 31, 2007, real GDP rose 1.9% (1.3% in nominal terms), the fourth consecutive year of expansion at about 2% in real terms. These figures suggest that the Japanese economy is on a highly stable growth path. Note that the GDP deflator showed a marginal decline from the prior quarter, and real and nominal GDP growth again reversed their normal positions (with the rate of expansion in nominal GDP dropping below the rate of growth in real GDP). Nevertheless, the margin of decline in the quarterly GDP deflator data has shrunk steadily in comparison with the previous year, suggesting the end of deflation is near.

An examination of the components of final demand shows that, first, growth in exports is driving the economy. Although expansion in the U.S. economy is slowing as a result of the sharp drop in housing investment, growth is continuing in Asia, Europe, and other economies around the world, supporting firm expansion of 3.3% in Japan's exports. While imports rose (edging up 0.9% over the previous quarter), the contribution of the external sector (net exports) made a major contribution of 0.4 percentage point to growth in the January-March quarter.

On the other hand, the contribution of domestic demand for the quarter was only 0.2 percentage point. This was due to a decline of 0.9% in private capital investment, which had been one of the key supports of domestic demand, for the first time in five quarters. In the latest GDP statistics, the rate of growth in capital investment in previous quarters has been revised

downward, giving a stronger impression that investment is decelerating. Private capital investment had been on an upward trend over the past four years, in part owing to major investments by companies manufacturing digital-related products, such as semiconductors and LCDs as well as manufacturers of basic materials; however, recently, the attitude of corporations toward capital investment appears to have become somewhat cautious. In addition, slight declines in private housing investment, government public works spending, and government final consumption for the quarter restrained growth in domestic demand.

Domestic demand was still able to maintain its contribution to GDP, albeit small, because personal consumption is still showing firm expansion. Although consumer spending dropped significantly in the July-September quarter because of unseasonable weather conditions, it rebounded and rose markedly in the October-December period. For this reason, the January-March results received attention, and consumer spending for the quarter returned to a moderate expansionary path, against a background of improvement in employment conditions, and is providing support for the economic recovery.

## **(2) Outlook for Fiscal 2007 and Fiscal 2008**

How long will the deceleration in the Japanese economy last? Judging from orders for machinery and equipment, which are a forward indicator for capital investment, there is a possibility that deceleration in capital investment may continue. Moreover, there is also still a possibility that the slowdown in the U.S. economy will have an impact on exports from Japan. In addition, inventories of digital-related products, including semiconductors and LCDs, have increased substantially, and companies are restraining production to reduce inventory levels.

Nevertheless, in the latter half of 2007, the economy is expected to accelerate once again. First, the slowdown in the U.S. economy will have run its course by that time. In the United States, along with the sharp decline in housing investment, private-sector capital investment is also decelerating. However, the concern that personal consumption might

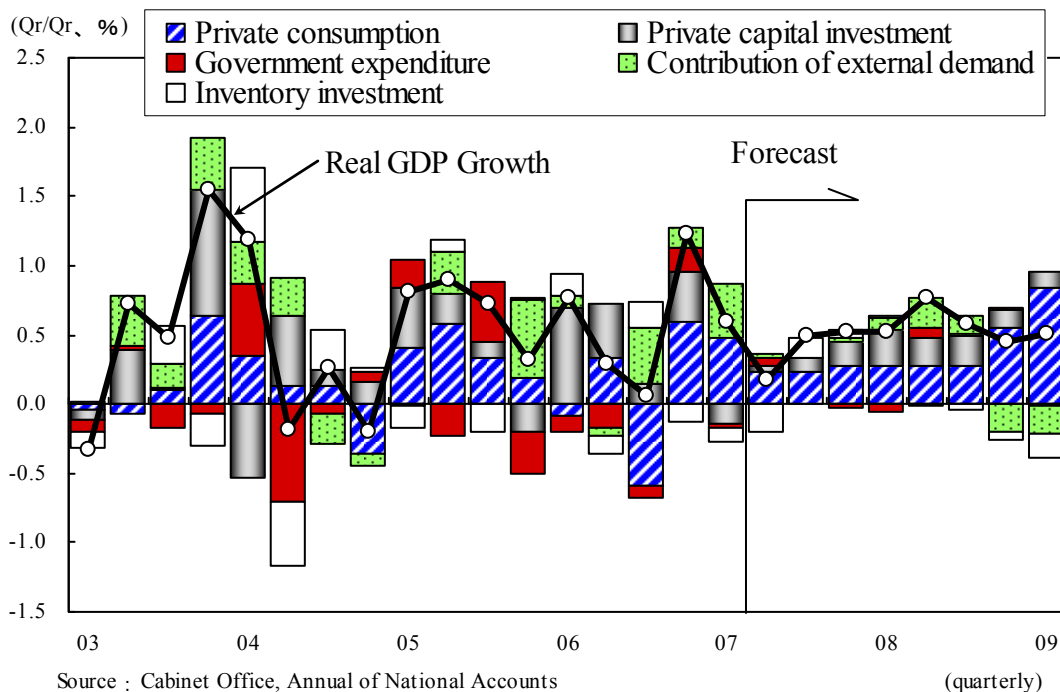
decline, because of the negative wealth effect of the decline in real estate prices, has receded, and consumer spending is holding firm along with the increase in incomes. Along with the bottoming out in housing investment and capital investment, the U.S. economy will continue to grow again at an annual rate of about 3%, and, as the pace of expansion in the world economy rises, this will have a positive impact on Japan's exports. In addition, adjustments in inventories of digital-related products will be well along the way by the middle of 2007, and, by the latter half of the year, production will begin to expand again. Since acceleration in exports and production will lead to improvement in corporate profitability, the rate of growth in private capital investment should begin to rise again.

On the other hand, the number of employed persons is continuing to rise, and the employment and income environments are expected to show further gradual improvement. Reflecting the tightening of the balance between labor supply and demand, wages, which are currently declining, are expected to begin to rise moderately. Although exports and capital investment may weaken, real growth in fiscal 2007 will continue at a moderate rate of 2%, due mainly to increasing consumer spending, thus enabling the economy to post its sixth consecutive year of positive growth. Similarly, the economy will expand at 2.1% in nominal terms in fiscal 2007, the fifth consecutive year of positive growth. The GDP deflator will begin to rise for the first time in 10 years, since 1997, when an increase in the consumption tax resulted in an increase in the deflator.

Moderate growth is expected to continue in fiscal 2008 as well. As growth in the world economy continues to provide a favorable external environment, expansion in exports will bring increases in production, and, as corporate profits improve, capital investment will also rise. There will be no change in the trend toward improvement in the employment and income environments, although the degree of recovery will not match that of the corporate sector, and consumption will increase moderately, providing support for overall growth. In addition, in our latest forecast, we have assumed an increase in the consumption tax (from 5% to 7%) in April 2009 and, as a result, are anticipating a surge in consumption demand in the latter half of fiscal 2008. Although we anticipate declines in government

public works spending and private housing investment, we are forecasting real growth of 2.3% in fiscal 2008, which will be the seventh consecutive year of positive growth, and growth in nominal terms of 2.6%, the sixth consecutive year of expansion.

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



**(3) Four Principal Concerns Regarding a Prolonged Slowdown**

The economy is continuing to recover as it decelerates, but some analysts have pointed to certain concerns that might bring a prolonged deceleration in the economy or even a downturn. There appear to be four principal causes for concern. While developments related to these concerns need to be watched, we believe that they will have only a temporary decelerating effect on the Japanese economy and that the economy will continue its moderate recovery trend.

## ① Slowdown in the U.S. Economy

If the U.S. economy decelerates, this will have an impact on Japan's exports. The current economic recovery in Japan began in early 2002, and expansion in exports has played a substantial role in driving growth. If the expansion in exports shows signs of slowing, this may endanger the economic recovery.

In the past, it was often said, "When the United States sneezes, Japan catches a cold." but that is not necessarily true. First, the recent slowdown in the U.S. economy has been mainly due to the decline in private housing investment. While the decline in housing investment in the United States has certainly been significant, capital investment there is also showing signs of weakening, and optimism about future trends in the economy is not warranted, consumer spending is firm, supported by growth in incomes; therefore, we believe the possibility of an economic downturn in the United States is not strong.

If we consider the effect on exports from Japan, the decline in housing investment in the United States will have little impact on Japan's exports. The decline in capital investment in the United States will have an impact on Japan's exports of capital goods. In fact, exports of these goods to the United States are declining. However, trends in consumer spending will have the most significant effects on Japan's exports of automobiles and digital-related goods. Therefore, we believe that, as long as recovery in consumer spending is continuing, the impact on the Japanese economy will be minimal.

Another point is that the destinations of exports from Japan are shifting from the United States to China and other countries in Asia. The percentage of exports of materials and parts to production centers in Asia, which are then exported as products to the United States, is rising. In addition, as industrialization proceeds in other countries in Asia, and income levels rise, these economies become larger markets for Japan's exports. These developments have reduced the direct impact of trends in the U.S. economy on Japan's exports. Provided the slowdown in the U.S. economy is

temporary, and it is possible for the economies of Asia and other regions to continue to grow in the interim, Japan's exports will not experience much negative impact.

## ② Slowdown in Private Capital Investment

Japan's capital investment spending is beginning to slow. Judging from past experience, capital investment moves in tandem with overall economic trends but is subject to sharper increases and decreases. In other words, if capital investment slows, the decline is likely to be relatively large and recovery will take time. For this reason, declines in capital investment spending tend to lead to economic downturns in many cases. Drawing inferences from the decline in orders for plant construction in the January-March 2007 quarter, the current slowdown in capital investment was influenced by the completion of factory buildings that are part of major investment projects. Moreover, the rate of growth of orders for machine tools for use in the general machinery sector has declined, in part due to the possibility that demand for the replacement of older equipment among small and medium-sized enterprises, which was strong temporarily, has run its course.

Nevertheless, figures related to capital investment plans contained in the Bank of Japan's quarterly short-term economic survey for March are not low for this time of year, and, if we assume that these plans will be revised upward as they were last year, that would imply that the upward trend in capital investment will continue. Certainly, it is possible that concerns about future trends may be creating a more cautious attitude toward capital investment among corporations. In that case, the rate of growth in investment in fiscal 2007 may not be very high, but fluctuations in capital investment appear to be relatively more stable than in the past.

Thus far, in the current recovery, capital investment has been on an upward trend for almost four years. Over this period, the rate of growth in investment did not rise to conspicuously high levels but, by past standards for capital investment, appears to have continued on a relatively stable upward path. Previously, capital investment expanded because of the

influence of relatively short-term cyclical factors, including rising rates of equipment utilization, growth in profitability, and prospects for rising demand going forward. However, the expansion in capital investment over the past few years appears to have been influenced by medium-term developments, such as the elimination of excess capacity, replacement of equipment that had become obsolete during Japan's "lost decade," and expectations of growth in the medium term following the escape from the worst years after the bursting of Japan's economic bubble. As a consequence, expansion in capital investment appears to have been more stable than previously.

Even if corporate attitudes toward capital investment become more cautious, companies will make investments from a medium-term perspective to maintain their competitiveness. Although investment spending may slow, the possibility of a major decline seems remote.

### **③ Lack of Robustness in Consumer Spending**

Although consumer spending may decelerate temporarily because of weather conditions and other factors, it is generally on a moderate rising trend and is providing support for the economic recovery. However, compared to corporations that are setting new records for historically high profits, recovery in the employment and income environments is slow, and this is causing concern about future trends in consumption. Those who point to the uncertainty of consumption going forward argue that what the growth in consumer spending in the January-March quarter data shows us is that expenditures for dining out and leisure were strong because of relatively warm weather during the winter months. As the effect of warm weather wears off and inhabitants' taxes on individuals increase in June, future trends will be a cause for concern.

Granted that even though the income environment is taking a turn for the better, the improvement is not sufficient to give rise to optimism about the robustness of the recovery in consumer spending. Moreover, the decline in per capita wages evident from monthly labor statistics is severer than forecast. However, the baby boom generation is beginning to retire, and the

decline in the number of younger workers is a cause for concern among companies about a shortage of labor. If the drive among companies to hire new employees grows stronger, first, the workforce will expand, and, if companies cannot secure a sufficient number of workers, upward pressures on wages will increase. Whether the number of workers increases or wages rise, the resulting increase in incomes (which equals per capita wages times the number of persons employed) will have a positive effect in expanding consumption. As long as the drive among companies to hire additional employees is motivated by a feeling that labor will be in short supply going forward, the improvement in employment and income environments is likely to bring moderate recovery in consumer spending.

#### ④ Declines in Consumer Prices

The consumer price index (excluding fresh food), which moved temporarily above the level of the same period of the previous year, has now dropped slightly below the previous year's level again. If deflationary trends return, there is deep-rooted anxiety that economic trends may deteriorate. However, although consumer prices are declining, corporate prices at the producers' level have been increasing for more than three years. It seems somewhat crude, therefore, to describe price trends in the Japanese economy as "deflationary." Instead, we should understand these developments as a combination of inflation upstream, resulting from the impact of the rise in commodity prices, and deflation downstream.

Inflation upstream has spread down through to mid-stream. For example, as a result of higher crude oil costs, prices of petrochemical products are increasing. Similarly, the run-up in prices of iron ore and nickel has resulted in higher prices for stainless steel, and increases in the price of copper have brought higher prices of copper cable. The reason why downstream consumer prices are not rising is that manufacturers of final products are having difficulty in passing on the increases in their costs to the consumer level because of the limited recovery in consumer spending. However, it is not correct to conclude that, because consumer prices are not rising, the recovery momentum of consumption is weak.

Prices are like a mirror that reflects economic trends and the extent of the gap between supply and demand. If the economy overheats, prices rise, but if the economy stagnates, prices have a tendency to decline. Prices are important as a signal that indicates trends in the gap between supply and demand, but they lag behind movements in the economy. In other words, even if the economy slips back toward deflation, this does not mean that economic conditions are going to deteriorate. Under a deflationary scenario, the negative effects are that the real burden on debtors increases and consumers may delay their purchases. We often hear the argument that if deflation continues, the Japanese economy may fall into a deflationary spiral. Fortunately, however, the Japanese economy was able to record its longest period of recovery during the postwar period while experiencing moderate deflation.

Under these circumstances, questions drawing attention include: “When will the economy escape from deflation?” and “when will the government proclaim the end of the deflation?” However, it is incorrect to argue that economic conditions are not showing improvement because deflation is continuing. Similarly, it is not correct to argue that economic conditions will show further improvement when the economy escapes from deflation. Under current conditions—where the problems of excess equipment, labor, and debt have been resolved and the Japanese economy is experiencing sustained recovery—the risk that a small decline in consumer prices will cause the economy to slip into a deflationary spiral has receded.

The Bank of Japan has adopted the stance of gradually adjusting (increasing) interest rates as it confirms that the Japanese economy is moving along a sustained growth path while maintaining price stability. Even if recent data on consumer prices show a slight decline, as long as there is confidence regarding future trends in the economy and prices, the Bank of Japan will most likely increase interest rates. The objective of the Bank of Japan is not to escape from deflation but to escape from the theory that escaping from deflation is the primary objective.

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

### **(1) Corporations**

- Corporations have completed their disposal of negative assets left over from Japan's bubble economy, and their financial positions and profitability have recovered. The risks of a possible downturn in production, capital investment, or other aspects of corporate activities have receded, and companies are moving ahead with the further development of their activities, including the expansion of production capacity.
- Production is expanding, supported by growth in exports of automobiles, digital-related products, and other items as well as favorable trends in domestic demand, especially capital investment. Along with the expansion in shipments, inventory levels are also rising, but companies are adopting a cautious stance toward increasing inventories, and, with the exception of digital-related products and certain other industries, the rate of increase in inventories is moderate.
- As a result of the improvement in corporate profitability and recovery in the economy, recurring profit among corporations has already exceeded the previous peaks reached during the bubble economy and the IT boom and now stands at its highest level in history. Although certain factors are causing a deterioration in the corporate profit environment, including the run-up in raw material prices, increases in personnel costs and depreciation charges, and higher interest payments accompanying higher overall interest rates, companies are still able to report increases in profits because of gains in sales in Japan and overseas, including rising exports.
- If growth in corporate profitability becomes sluggish, this may restrain expansion in capital investment. However, corporations are still faced with the need to replace older equipment, and they must make further capital investments to increase the value added of their products and improve competitiveness. For these reasons, the deceleration in capital investment is expected to be slight, and capital outlays are likely to continue on an upward trend.

## **(2) Households**

- Household incomes are continuing to recover, but the pace of improvement is gradual, and the positive benefits of economic expansion have still not fully spread from the corporate sector to the household sector. Personal consumption is still on a rising trend but is not strong enough to be a driving force in the economy.
- The drastic restructurings that companies undertook to reduce excess employment have been completed for the time being. As the baby boom generation of workers begins to retire in 2007 and the number of younger workers declines, concerns about labor shortages are emerging, and companies have shown growing interest in expanding their workforces. Since profitability is good, the employment and income environments are expected to continue their moderate trend toward improvement.
- However, the restraint that corporations are showing regarding increases in personnel costs is one of the factors supporting profitability, and, therefore, corporations remain cautious about raising wages. In addition, the increases in taxes and the welfare burden that the workforce is expected to bear going forward will put downward pressure on disposable incomes. Increases in consumer spending will, therefore, continue to be moderate.
- The pace of private housing investment is expected to slow somewhat in the medium term because of slower growth in the number of households, but remain firm in the short term 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 as well as the prospects for a bottoming out and an increase in land prices.

## **(3) Government**

- Following the bursting of Japan's economic bubble, government finances deteriorated rapidly, and the public sector has continued to issue large volumes of government bonds. Along with the decline in nominal economic growth rates, the government made major reductions

in taxes that resulted in 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 his goal was to make structural reforms in government finances. Instead, he reduced spending on public works. Moreover, local governments have experienced deterioration in their financial position and have cut their public works spending. Along with the ongoing economic recovery, tax revenues are expanding, but current Prime Minister Shinzo Abe is maintaining the policy of his predecessor of making structural reforms in government finances. Accordingly, continued cutbacks in public works spending are expected at the national and local levels.
- The basic policy of the Japanese government is also to reduce its deficits by restraining government final consumption expenditure. To this end, the public sector is endeavoring to restrain the increase in social welfare expenditures through systemic reforms. 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 factors, however, may bring a temporary slowdown. These include the slowdown in the U.S. housing market, the overheating of the Chinese economy, and demand trends in the digital-related product industries. However, at present, we believe that 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. However, we are forecasting that exports from Japan will continue to rise because worldwide demand for automobiles is expanding rapidly, high rates of growth will continue in the emerging countries and resource-producing nations, and demand for electronic parts, principally in the rest of Asia, is growing.

- Turning to imports, as China and other emerging industrializing countries rapidly expand their production capacity and Japanese companies continue to locate portions of their production capacity overseas to achieve 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 continuing high primary product prices, imports of raw materials in value terms are expected to remain at a high level.
- We are looking for growth in both exports and imports, with net exports making a positive contribution to Japan's 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 increase. As a result, Japan's surplus in the income accounts of its balance of payment 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, remain at relatively high levels by standards of past years. On the other hand, the supply capacity of China and other emerging industrializing countries is expanding, and this and other factors are resulting in declines in prices of industrial products. As a consequence, the world's price structure is undergoing major changes, owing to inflationary pressures upstream and deflationary pressures downstream.
- These developments are having an impact on Japan's domestic prices. While domestic corporate prices are increasing on the one hand, there is no broad-based trend toward a rise in consumer prices, even though the margin of decline in these prices has diminished.

- Regarding monetary policy, following the lifting of the quantitative policy of monetary easing in March 2006 and the ending of the zero interest rate policy in July, a further increase in interest rates was implemented in February 2007. The process of normalizing monetary policy to raise interest rates from their excessively low levels and permit the interest rate mechanism to operate properly has begun. Looking ahead, we believe there will be a series of further slight increases at an unhurried pace, as the monetary authorities examine trends in the overall economy, prices, and the demand for funds.
- The upward trend in long-term interest rates is expected to continue as the economic recovery proceeds and the monetary policy interest rate is increased. Stock prices are expected to continue to rise, reflecting the improvement in profitability of Japanese companies not only in Japan but also in overseas markets. In foreign exchange markets, the yen remains stable and has not appreciated despite the expansion in Japan's current account surplus. Funds flow into the currencies of countries viewed as stronger, based on such factors as differences in perceptions of the state of the economies of the industrialized countries, interest rate differentials, and trends in monetary policy. At present, however, there are no major differences among economic trends in the industrialized countries, and we are forecasting that the yen will remain relatively stable.

## Exhibit 2: Outlook for fiscal 2007-2008

	FY2004 (actual)	FY2005 (actual)	FY2006 (forecast)	Forecast ↘ Yr/Yr, %	
				FY2007 (forecast)	FY2008 (forecast)
Nominal GDP	0.9	1.0	1.3	2.1	2.6
Real GDP	2.0	2.4	1.9	2.0	2.3
Contribution of domestic demand (Qr/Qr,%)	1.4	1.9	1.2	1.5	2.1
Private Consumption	1.3	1.9	0.8	2.0	2.5
Housing investment	1.7	-1.0	0.4	1.1	-1.0
Private capital investment	6.3	5.8	7.2	2.5	4.8
Contribution of Inventory investment (Qr/Qr,%)	0.1	-0.1	-0.0	-0.1	-0.1
Government expenditure	-1.5	0.4	-1.3	0.3	0.2
Public investment	-12.7	-1.4	-9.2	-3.6	-3.7
Government final consumption expenditure	1.7	0.9	0.9	1.3	1.2
Contribution of external demand (Qr/Qr,%)	0.5	0.5	0.8	0.5	0.2
Export of goods and services	11.4	9.0	8.3	6.8	7.5
Import of goods and services	8.4	6.0	3.4	3.8	6.9
GDP deflator (Yr/Yr,%)	-1.0	-1.3	-0.6	0.1	0.3

	FY2004 (actual)	FY2005 (actual)	FY2006 (forecast)	Forecast ↘ Yr/Yr, %	
				FY2007 (forecast)	FY2008 (forecast)
Current account balance (trillion yen)	18.2	19.1	21.3	25.3	26.5
balance on goods (trillion yen)	13.2	9.6	10.5	12.4	13.4
balance on service (trillion yen)	-3.6	-2.2	-2.2	-2.5	-2.5
balance on income (trillion yen)	9.6	12.6	14.2	16.5	16.7
Industrial production (Qr/Qr, %) (Yr/Yr, %)	4.0	1.6	4.8	1.8	3.1
Corporate goods prices(Yr/Yr,%)	1.8	4.1	4.4	1.5	1.2
Domestic corporate goods prices(Yr/Yr,%)	1.5	2.1	2.8	0.7	1.1
Consumer prices(Yr/Yr,%)	0.0	-0.3	0.3	0.1	0.5
excluding freshfood(Yr/Yr,%)	-0.1	-0.1	0.1	0.2	0.5
Yen/U.S.Dollar	107.5	113.3	116.9	120.5	118.3
Newly issued government bond yields(10years)	1.52	1.43	1.77	1.79	1.98
WTI future price(near month contract, US dollar/barrel)	45.1	60.0	64.9	64.5	69.5
Dubai crude oil prices (US dollar/barrel)	36.6	53.7	60.9	62.3	66.0

### Exhibit 3: Outlook for calendar 2007-2008

	CY2004 (actual)	CY2005 (actual)	CY2006 (forecast)	Forecast	
				CY2007 (forecast)	CY2008 (forecast)
	Yr/Yr, %				
Nominal GDP	1.6	0.6	1.3	2.1	2.4
Real GDP	2.7	1.9	2.2	2.1	2.2
Contribution of domestic demand	1.9	1.7	1.4	1.4	1.9
Private consumption	1.6	1.6	0.8	2.0	2.0
Housing investment	1.9	-1.3	1.0	1.1	-0.7
Private capital investment	5.6	6.6	7.5	2.8	4.7
Contributoryion of Inventory investment	0.3	-0.1	0.1	-0.2	0.0
Government expenditure	-0.6	0.1	-1.3	0.2	0.0
Public investment	-9.0	-6.2	-7.4	-4.0	-4.5
Government final consumption expenditure	1.9	1.7	0.3	1.3	1.2
Contribution of external demand	0.8	0.3	0.8	0.7	0.3
Export of goods and services	13.9	7.0	9.6	7.0	7.7
Import of goods and services	8.1	5.8	4.5	2.7	6.8
GDP deflator	-1.1	-1.3	-0.9	0.0	0.2

	CY2004 (actual)	CY2005 (actual)	CY2006 (forecast)	Forecast	
				CY2007 (forecast)	CY2008 (forecast)
	Yr/Yr, %				
Current account balance (trillion yen)	18.6	18.3	19.8	25.1	26.7
balance on goods (trillion yen)	13.9	10.3	9.5	12.4	13.6
balance on service (trillion yen)	-3.7	-2.6	-2.1	-2.4	-2.6
balance on income (trillion yen)	9.3	11.4	13.7	16.3	16.7
Industrial production (Qr/Qr, %) (Yr/Yr, %)	5.5	1.1	4.8	2.1	2.8
Corporate goods prices(Yr/Yr,%)	1.2	3.1	5.0	1.9	1.5
Domestic corporate goods prices(Yr/Yr,%)	1.2	1.7	3.0	0.9	1.1
Consumer prices(Yr/Yr,%)	0.0	-0.3	0.2	0.0	0.5
excluding freshfood(Yr/Yr,%)	-0.1	-0.1	0.1	0.1	0.4
Yen/U.S.Dollar	108.2	110.2	116.3	120.2	118.8
Newly issued government bond yields (10years)	1.5	1.4	1.7	1.7	2.0
WTI future price(near month contract, US dollar/barrel)	41.4	56.6	66.2	62.3	69.0
Dubai crude oil prices (US dollar/barrel)	33.6	49.5	61.6	60.2	65.5

## Exhibit 4: Outlook for 2007-2008 (Quarterly)

	Forecast											
	FY2006				FY2007				FY2008			
	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	0.2	-0.1	1.3	0.3	0.5	0.6	0.6	0.0	1.4	0.7	0.5	0.1
	1.0	0.7	1.7	1.8	2.0	2.7	2.0	1.8	2.6	2.7	2.5	2.8
Real GDP	0.3	0.1	1.2	0.6	0.2	0.5	0.5	0.5	0.8	0.6	0.4	0.5
	2.1	1.4	2.2	2.0	2.1	2.5	1.8	1.7	2.3	2.4	2.2	2.3
Contribution of domestic demand(Qr/Qr,%)	0.4	-0.3	1.1	0.2	0.1	0.5	0.5	0.4	0.6	0.5	0.6	0.7
Private Consumption	0.6	-1.0	1.1	0.9	0.4	0.4	0.5	0.5	0.5	0.5	1.0	1.5
	1.4	-0.4	0.4	1.6	1.3	2.8	2.2	1.8	1.9	2.0	2.5	3.5
Housing investment	-1.9	-0.3	2.2	-0.3	0.1	0.5	0.6	-1.5	0.5	-0.6	0.2	-1.5
	1.2	-0.1	0.9	-0.2	1.6	2.3	0.8	-0.4	-0.1	-1.1	-1.4	-1.3
Private capital investment	2.6	0.9	2.3	-0.9	0.3	0.7	1.1	1.6	1.2	1.4	0.8	0.7
	7.1	6.9	10.9	4.7	2.7	2.3	1.2	3.6	4.7	5.3	5.1	4.1
Contribution of Inventory investment(Qr/Qr,%)	-0.1	0.2	-0.1	-0.1	-0.2	0.1	0.1	0.0	0.0	0.0	-0.1	-0.2
Government expenditure	-0.8	-0.4	0.8	-0.1	0.3	0.0	-0.1	-0.3	0.4	0.1	0.1	-0.1
	-0.6	-2.7	-1.2	-0.6	0.6	1.0	-0.2	-0.3	0.1	0.1	0.1	0.3
Public investment	-6.2	-4.7	4.0	-0.1	-1.5	-2.3	-1.0	-1.2	-1.0	-0.6	-0.8	-0.6
	-6.5	-14.8	-8.9	-6.8	-2.9	-0.3	-4.7	-5.6	-5.4	-3.8	-3.4	-2.8
Government final consumption expenditure	0.7	0.6	0.1	-0.1	0.7	0.5	0.0	0.0	0.7	0.3	0.2	0.1
	0.6	0.3	1.3	1.2	1.4	1.4	1.2	1.3	1.3	1.1	1.2	1.3
Contribution of external demand(Qr/Qr,%)	-0.1	0.4	0.1	0.4	0.0	0.0	0.0	0.1	0.2	0.1	-0.2	-0.2
Export of goods and services	0.8	2.3	0.8	3.3	0.6	1.0	2.3	2.4	2.7	1.4	0.1	1.3
	10.1	9.4	6.5	7.4	7.3	5.9	7.4	6.5	8.6	9.1	6.7	5.6
Import of goods and services	1.4	-0.4	-0.1	0.9	0.6	1.1	2.4	2.1	1.6	0.9	1.4	2.6
	6.6	2.5	2.6	2.0	1.0	2.5	5.2	6.4	7.5	7.2	6.1	6.6
GDP deflator(Yr/Yr,%)	-1.1	-0.7	-0.5	-0.2	-0.1	0.2	0.2	0.1	0.3	0.3	0.2	0.4

	Forecast											
	FY2006				FY2007				FY2008			
	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)*	4.6	4.8	5.7	5.7	6.6	6.1	6.4	6.3	6.9	6.5	7.0	6.2
balance on goods (trillion yen)*	2.1	2.1	2.9	3.1	3.1	2.7	2.7	3.8	3.2	3.2	3.0	3.1
balance on service (trillion yen)*	-0.7	-0.7	-0.3	-0.5	-0.7	-0.7	-0.6	-0.6	-0.8	-0.6	-0.6	-0.6
balance on income (trillion yen)*	3.4	3.5	3.6	3.6	4.6	4.3	4.0	4.2	4.8	4.4	4.0	4.2
Industrial production (Qr/Qr, %)	1.3	1.3	2.2	-1.3	0.3	0.8	0.7	0.6	0.9	0.8	0.7	0.9
(Yr/Yr, %)	4.7	5.6	6.0	3.1	2.8	1.7	0.8	2.1	3.1	2.9	3.1	3.2
Corporate goods prices(Yr/Yr,%)	5.0	5.7	3.7	3.2	2.0	1.0	1.3	1.7	1.9	1.4	0.8	0.6
Domestic corporate goods prices(Yr/Yr,%)	3.1	3.6	2.6	1.9	1.1	0.3	0.5	0.8	1.4	1.3	1.1	0.8
Consumer prices(Yr/Yr,%)	0.2	0.6	0.3	-0.1	0.0	0.0	0.3	0.4	0.5	0.5	0.5	0.5
excluding fresh food(Yr/Yr,%)	0.0	0.3	0.1	-0.1	0.0	0.1	0.3	0.4	0.5	0.5	0.5	0.5
Yen/U.S.Dollar	114.4	116.2	117.8	119.4	119.5	120.5	121.5	120.5	119.0	118.0	117.5	118.5
Newly issued government bond yields (10years)	1.89	1.79	1.69	1.71	1.70	1.75	1.80	1.90	1.95	2.00	2.00	1.95
WTI future price(near month contract, US dollar/barrel)	70.7	70.5	60.2	58.2	63.0	63.0	65.0	67.0	69.0	70.0	70.0	69.0
Dubai crude oil prices (US dollar/barrel)	64.8	66.0	57.4	55.3	62.6	61.0	62.0	63.5	65.5	66.5	66.5	65.5

\*seasonally adjusted