

December 2005

Outlook for Fiscal 2006

Bipolarization to Proceed as the Economy Recovers Gradually



Economic Research Department

Overview

While the strength of the economic recovery does not appear to be sufficient to “break away from the current period of slower expansion,” recovery is continuing. During the July-September period, real GDP grew 0.2% over the previous quarter (1.0% at an annualized rate), for the fourth consecutive quarter of positive growth. Components of the GDP contributing to growth were personal consumption, private capital investment, and private residential investment, all of which are domestic demand components. The margin of growth in these indicators, however, was small, and no single component could be described as the driving force; nevertheless, growth for the quarter was balanced.

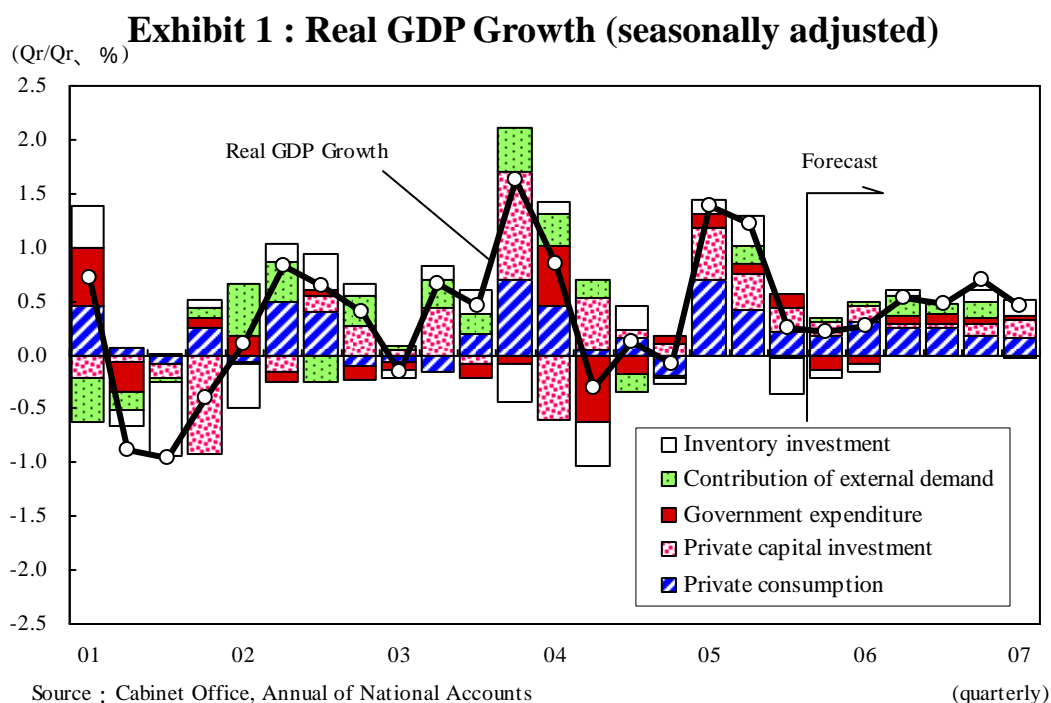
On the other hand, the external sector (or net exports = exports – imports) made a negative contribution during the quarter because of the rise in imports, but exports are still on an upward trend. Expansion in exports, sustained by recovery in the world economy, continues to be an important factor sustaining the growth of the Japanese economy. As a result of growth in domestic and overseas demand, industrial production is holding firm and corporate profitability has increased. The improvement in profitability is a factor leading to expansion in private capital investment and, at the same time, will bring recovery in employment and individual incomes. As a consequence, private consumption is increasing gradually and is contributing to the stability of the economy overall.

During fiscal 2006, although growth in private capital investment is expected to slow, because of some weakness in corporate profitability, personal consumption is forecast to remain firm, and the economic recovery is likely to continue. While growth in fiscal 2006 will be lower than in fiscal 2005, we are forecasting 1.6% expansion in real terms, the fifth consecutive fiscal year of positive growth. In addition, we are looking for growth of 1.1% in nominal GDP, the fourth consecutive year of positive growth in nominal terms. Moreover, the GDP deflator is forecast to continue to decline, by 0.6%, in fiscal 2006, but, reflecting the recovery in the economy, the margin of decline in the deflator will shrink.

The principal factors behind our forecast for the Japanese economy in fiscal 2006 will be the following:

- (1) Cyclical restraining factors, namely excessive inventories and excessive production capacity, will be absent, suggesting the recovery will be prolonged.
- (2) However, the global economy is expected to slow, thus bringing only moderate recovery in Japan.
- (3) Corporate management will have to address the issues of higher raw material and labor costs.
- (4) Depending on how effectively management addresses these issues, bipolarization in performance will emerge among companies and industries.

Risk factors that may have an effect on our forecasts include (1) trends in the international economy (both upside and downside risks), (2) increases in crude oil prices (a downside risk), and (3) higher interest rates (a downside risk).



The Japanese Economy in Fiscal 2006: Bipolarization to Proceed as the Economy Recovers Gradually

(1) Current State of the Economy

While the strength of the economic recovery does not appear to be sufficient to “break away from the current period of slower expansion,” recovery is continuing. During the July-September period, real GDP grew 0.2% over the previous quarter (1.0% at an annualized rate), for the fourth consecutive quarter of positive growth. Components of the GDP contributing to growth were personal consumption, private capital investment, and private residential investment, all of which are domestic demand components. The margin of growth in these components was small, and no single element could be described as the driving force, but growth for the quarter was balanced. In addition, in the public sector, government final consumption is on an upward trend, influenced by increases in social welfare payments accompanying the demographic aging of the population. Another factor during the July-September period was the second consecutive increase in government investment spending, as a consequence of increases in construction work in the wake of natural disasters.

On the other hand, the external sector (or net exports = exports – imports) made a negative contribution during the quarter because of the rise in imports, but exports are still on an upward trend. Expansion in exports, sustained by recovery in the world economy, continues to be an important factor sustaining the growth of the Japanese economy. As a result of growth in domestic and overseas demand, industrial production is holding firm and corporate profitability has increased. The improvement in profitability is a factor leading to expansion in private capital investment and, at the same time, will bring recovery in employment and individual incomes. As a consequence, private consumption is increasing gradually and is contributing to the stability of the economy overall.

(2) Outlook for the Economy in Fiscal 2006

How long will this recovery mechanism continue? Will growth in fiscal 2006 exceed that in fiscal 2005, or will signs of a slowdown emerge? In our forecast, we are looking for a continuation of economic recovery, even though growth in private capital investment may slow because of some weakness in corporate profitability, as personal consumption remains firm. While growth in fiscal 2006 will be lower than in fiscal 2005, we are forecasting 1.6% expansion in real terms, the fifth consecutive year of positive growth. In addition, we are looking for growth of 1.1% in nominal GDP, the fourth consecutive year of positive growth in nominal terms. Moreover, the GDP deflator is forecast to continue to decline, by 0.6%, in fiscal 2006, but, reflecting the recovery in the economy, the margin of decline in the deflator will shrink.

The principal factors behind our forecast for the Japanese economy in fiscal 2006 will be the following:

(a) Emergence of a Prolonged Period of Recovery

Provided there are no external shocks, such as a loss of momentum in the U.S. and other overseas economies or further major increases in crude oil prices, there appear to be no factors that might bring the recovery in the Japanese economy to a sudden halt. We are therefore looking for continued recovery in the economy.

Factors accounting for firmness of the recovery trend include progress among financial institutions toward resolution of their nonperforming loan issues and substantial improvement in the financial position and profitability of the corporate sector as a whole. Moreover, businesses are still cautious about expanding their inventories and capital investment, and, therefore, the possibilities have receded of substantial adjustments in inventories and investment levels resulting from overexpansion in inventories and production capacity. In addition, the pressure to cut back on personnel costs through restructuring has also receded, and companies are hiring new staff, in part to replace the “baby boom” generation, which is

approaching retirement age. These developments are serving to put a brake on further deterioration in the employment and income environments and are working to enhance the stability of consumer spending.

(b) Gradual Recovery Will Continue

The view has emerged that the Japanese economy has moved into a period of relatively strong recovery, with domestic demand taking over the role of the driving force from the external sector and households playing a stronger role than corporations in leading the uptrend. As we have already mentioned, the improvement in the employment and income environments has brought greater stability to the economy. However, in comparison with the significant improvement in corporate profitability, wage increases have been rather restrained, and it appears unlikely that strong growth in consumer spending fueled by rising incomes will become the driving force for the economic recovery.

Instead, we believe that the activities of the corporate sector will be the driving force for the economic recovery and these will be dependent on trends in external demand. In our forecast, we assume that the recovery in the world economy will continue, but that it will lose some momentum. In the U.S. economy, we believe that the rise in real estate prices, which has had the effect of increasing consumer spending and boosting overall growth, will diminish. This development will combine with a reactionary decline in automobile sales, which have been pushed upward by the sales incentives offered by car manufacturers, and the impact of hurricanes to bring slower growth in the U.S. economy.

As a result, these trends are also likely to restrain growth in exports from Japan temporarily, and, even if industrial production has broken away from its period of weaker growth, growth going forward is likely to be more gradual. On the one hand, sales growth will be gradual and, on the other, rising costs due to higher raw material prices will put downward pressure on profits, leading to a peaking out of growth in corporate profits. Accordingly, growth in capital investment will slow in the first half of fiscal 2006.

(c) Responding to the “Escape from Deflation” Will Be an Issue

Moving into calendar 2006, the consumer price index is expected to rise above the levels of the previous year. This may bring stronger expectations of a more powerful economic recovery now that the economy appears finally to have escaped from deflation. However, to forecast future trends, we have to consider the circumstances of how this “escape from deflation” occurred. The specific developments behind this “escape” have been, or will be, (a) increases in the costs of raw materials, including oil, (b) higher labor costs, and (c) the expected rise in interest rates. All of these factors will bring higher costs and put pressure on corporate profits. The most difficult of these developments to deal with is the rise in raw material costs. Thus far, companies have been able to absorb these substantial increases in costs by expanding export volumes and raising prices of exports as the world economy has recovered. If the world economy decelerates, this mechanism may no longer be effective and corporate profits may decline.

(d) Bipolarization Proceeding as the Recovery Continues

The economic recovery is continuing, but recovery momentum is gradual, and, if cost pressures from upstream continue, differences, or bipolarization, in performance will emerge by industry and by company. Companies that can increase their prices to pass on higher costs will be limited to those that are competitive. If there is excess capacity in various industries, shakeouts may occur among less competitive companies. The closer downstream to the final consumer, the stronger will be pressures to cut prices. The higher the input ratio of oil and other primary commodities in upstream markets, the stronger will be pressures leading to higher costs. Smaller companies that supply parts and materials to large corporations will be caught between these two forces and experience substantially greater pressure on their profitability.

(3) Risk Factors

Risk factors that may have an impact on the economic outlook presented here (our main scenario) include the following:

(a) Trends in the World Economy (Upside and Downside Risks for the Economy)

We have assumed that the world economy will decelerate temporarily but continue to recover. Depending on whether the growth rate in the global economy rises above or falls below our assumption, the outlook for Japan's growth rate may be above or below our forecast. In a pessimistic scenario for the United States, if the housing bubble, which has been sustained by low interest rates, or the current account deficit proves to be unsustainable, sudden adjustments may become necessary. We believe that the probability of making such adjustments is low, but in the event that they become necessary, they may bring a "hard landing" for the U.S. economy, and this would have a major negative impact on the Japanese economy.

(b) Increases in Crude Oil Prices (Downside Risk for the Economy)

After rising to \$70 a barrel, crude oil prices (on a WTI basis) have softened to some degree. Although prices may begin to rise again, as a general trend, we assume that they are not likely to show major increases to new record levels but will fluctuate at high levels. If, contrary to our assumption, oil prices experience further substantial increases, corporate profitability may deteriorate and corporate activities, including capital investment, may move into a slump, thus giving rise to greater risk of an economic downturn.

(c) Higher Interest Rates (Downside Risk for the Economy)

Along with the recovery in the economy, long-term interest rates are expected to rise. There will be no problem if interest rates rise in accord with real conditions in the economy, but the removal of the quantitative easing policy and anticipation of this removal may cause long-term interest

rates to increase more than what is justified by economic conditions. However, even if the quantitative easing policy is removed, short-term interest rates are expected to remain at about 0%. Therefore, even if long-term interest rates move upward, this increase will be temporary and the margin of the increase will be limited.

In addition, there is concern that the government deficit, which could become a latent cause of higher interest rates, may lead to substantially higher long-term interest rates that would plunge the economy into a downturn. However, growth in demand for funds in the private sector is still moderate, and we believe that the possibility is small of the emergence of a shortage of funds in the private sector that might bring sharp rises in interest rates.

2. Forecasts from the Perspective of Economic Sectors

(a) Corporate Sector

- Companies have almost completed the disposal of the negative assets left over from the time of Japan's economic bubble, and their financial positions and earnings power have recovered. Therefore the risk of a major downturn in production and capital investment has diminished.
- Although production has leveled off temporarily, it is expected to begin to expand again, along with the completion of inventory adjustments in the digital product related industries and recovery in the world economy. However, inventories are rising in steel and certain other industries; this may lead to adjustments in production, which would imply that the recovery in production, from the perspective of the manufacturing sector as a whole, would be gradual.
- Corporate earnings power has risen, but the environment for earnings is becoming more challenging. With the exception of certain industries, it is difficult for companies to pass on their higher costs to their sales prices, and current high levels of raw material prices are placing pressure on profits. In addition, since corporate restructuring efforts have paused and capital investment is expanding, personnel costs and depreciation are pushing fixed costs upward.

- Slower growth in corporate profitability will restrain expansion in capital investment. However, since continuing investment is necessary to sustain competitiveness, the deceleration in capital investments is expected to be slight.

(b) Household Sector

- Employment and wages are recovering gradually, and the improvement in economic conditions that thus far had been confined to the corporate sector is finally moving into the household sector. Corporate restructuring efforts have run their course, and the trends toward improvement in the employment and income environments are expected to continue. However, since corporate profits are likely to decelerate, the margin of improvement will be limited. In addition, the expected increases in taxes and the social welfare burden on households will tend to lower disposable incomes. Moreover, increases in energy prices will also place additional pressure on households.
- Even taking account of these negative factors, incomes are expected to show gradual increases going forward. Therefore, consumer spending is likely to remain firm and continue to expand. Also, while there may be fluctuations in housing investment, it is expected to continue firm.
- The trend toward bipolarization is also expected to be evident in the household sector, depending on the level of benefits different households receive due to trends in income and increases in stock prices.

(c) Government Sector

- The Cabinet of Prime Minister Junichiro Koizumi and that of his successor are likely to continue policies of fiscal structural reforms. Therefore, expenditures for public investments at the national and local levels are expected to show further declines.
- The basic policy of the government will be to restrain its consumption expenditures to reduce the fiscal deficit. However, no change is expected in the upward trend in government consumption because social welfare payments will continue to expand along with the

demographic aging of the population.

(d) External Sector

- Recovery in the global economy is expected to continue. The U.S. economy will continue to expand, and rapid growth will prevail in China. European economies, which had experienced stagnation, are bottoming out and the economies of the oil-producing countries, including Russia, Middle Eastern nations, and others, are reporting favorable performance. However, the pace of expansion in the United States is likely to slow as adjustments occur in housing investment and consumption, which have expanded owing to low interest rates.
- Exports are forecast to show continued gradual recovery. Exports of consumer goods and capital goods, where Japanese products are highly competitive, to the advanced and newly emerging countries are expected to post further increases. On the other hand, even though global adjustments in the electronics field, including electronic parts, have run their course, this does not imply that any particular sources of demand can act as the driving force. Moreover, in the intermediate materials industries, such as chemicals and steel, demand in Asia has weakened somewhat in comparison to supply capacity and China and other areas have increased their own supply capacity; therefore there is a possibility that these developments may restrain Japan's exports.
- Imports of products and parts from the rest of Asia will continue to rise. Some Japanese companies are relocating their production facilities back in Japan, and it appears the wave of shifting production plants to Asia has run its course. However, imports are expected to continue to grow as Japanese companies expand existing offshore facilities and companies based in Asia (outside Japan) enlarge their production capacity.
- The high price of crude oil has significantly boosted the value of Japan's imports, and the trade surplus is on a declining trend. At present, the rise in oil prices appears to have paused, and we have assumed that they will remain high without any major downturn, thus making it unlikely that the trade and current account balance surpluses will rise.

3. Outlook for Prices and Financial Markets

- Prices of raw materials, including oil, will remain high, but the sudden increases experienced thus far appear to have run their course. Corporate prices are continuing to show a rising trend compared with the previous year, but the margin of increase is expected to decline and they may fall below previous year levels by a small margin in the latter half of fiscal 2006. Consumer prices are forecast to begin to rise slightly above previous year levels in fiscal 2006, reflecting the tightening of the demand and supply balance accompanying the recovery, higher personnel costs, increases in oil-related prices, and other factors.
- The quantitative easing policy is expected to be repealed during the April – June quarter, confirming that consumer prices (excluding fresh foods) have risen about the levels for the previous year. After the ending of this policy, the zero interest rate policy is expected to be reinstated; therefore, the zero interest rate policy will be in effect throughout fiscal 2006.
- Long-term interest rates will continue on a rising trend as the economic recovery continues. However, short-term interest rates will remain around 0%, thus limiting the room for upward movement in long-term interest rates. Also, stock prices are likely to remain at high levels as the economic recovery proceeds. The value of the yen is expected to continue to be relatively weak, but as the Japanese economy shows further recovery, the yen may gradually become stronger.

Exhibit 2: Outlook for fiscal 2005-2006 (1)

	Forecast						half/half, % Yr/Yr, %		
	FY2004		FY2005		FY2006		FY2004	FY2005	FY2006
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Nominal GDP	-0.2 1.0	0.3 0.0	1.1 1.4	0.2 1.4	0.2 0.5	1.4 1.6	0.5	1.4	1.1
Real GDP	0.2 2.6	0.7 0.9	2.0 2.7	0.5 2.6	0.9 1.3	1.2 2.0	1.7	2.7	1.6
Contribution of domestic demand (Qr/Qr,%)	-0.1	0.8	1.9	0.4	1.9	0.4	1.2	2.6	1.3
Private Consumption	0.6 2.5	0.4 1.0	1.5 2.0	0.7 2.4	0.9 1.5	0.7 1.5	1.7	2.2	1.5
Housing investment	1.7 1.6	-0.0 1.7	-1.9 -1.9	2.4 0.5	-2.5 -0.2	2.6 0.0	1.7	-0.7	-0.1
Private capital investment	1.6 6.5	2.7 4.4	4.9 7.7	2.3 7.0	0.8 3.1	1.5 2.2	5.4	7.3	2.6
Contribution of Inventory investment (Qr/Qr,%)	-0.3	0.1	0.2	-0.3	0.0	0.2	-0.3	0.1	-0.0
Government expenditure	-1.9 -1.0	0.2 -1.8	0.9 1.1	-0.6 0.4	0.4 0.2	0.5 0.6	-1.4	0.8	0.4
Public investment	-11.5 -11.9	-2.2 -12.9	1.0 -1.1	-5.4 -4.1	-2.3 -7.6	-0.8 -3.0	-12.4	-2.8	-5.0
Government final consumption expenditure	0.8 1.9	0.8 1.6	0.9 1.7	0.9 2.0	1.1 2.3	0.7 1.6	1.8	1.9	2.0
Contribution of external demand (Qr/Qr,%)	0.2	-0.1	0.2	0.0	0.2	0.0	0.5	0.1	0.3
Export of goods and services	5.7 15.7	1.7 7.5	4.4 6.2	2.9 7.4	5.0 8.0	4.1 9.2	11.4	6.8	8.6
Import of goods and services	4.7 9.5	3.1 8.0	3.8 7.0	3.1 7.0	3.6 6.8	3.2 6.9	8.7	7.0	6.8
GDP deflator (Yr/Yr,%)	-1.5	-0.8	-1.3	-1.2	-0.8	-0.4	-1.2	-1.2	-0.6

	Forecast						Yr/Yr, %		
	FY2004		FY2005		FY2006		FY2004	FY2005	FY2006
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Current account balance (trillion yen)*	9.4	9.1	8.6	7.2	7.2	8.0	18.2	15.9	15.3
balance on goods (trillion yen)*	7.2	6.4	4.5	4.0	3.3	4.5	13.5	8.3	7.8
balance on service (trillion yen)*	-2.0	-1.6	-1.5	-1.4	-1.5	-1.7	-3.6	-2.9	-3.2
balance on income (trillion yen)*	4.7	5.0	5.9	5.6	6.3	5.8	9.6	11.4	11.6
Industrial production (Qr/Qr, %)	2.2	-0.1	0.3	2.5	0.3	0.4	4.1	1.4	1.6
(Yr/Yr, %)	6.8	1.6	0.2	2.6	2.7	0.5			
Corporate goods prices(Yr/Yr,%)	1.3	2.4	2.8	5.1	2.3	-0.7	1.8	4.0	0.8
Domestic corporate goods prices(Yr/Yr,%)	1.4	1.7	1.6	1.8	0.8	-0.1	1.5	1.8	0.3
Consumer prices(Yr/Yr,%)	-0.2	0.2	-0.2	0.1	0.4	0.3	0.0	-0.1	0.3
excluding freshfood(Yr/Yr,%)	-0.2	-0.3	-0.1	0.4	0.4	0.3	-0.2	0.1	0.3
Yen/U.S.Dollar	109.8	105.2	109.4	117.5	116.3	113.3	107.5	113.5	114.8
Newly issued government bond yields (10years)	1.62	1.42	1.31	1.60	1.85	2.00	1.52	1.45	1.93
WTI future price(near month contract, US dollar/barrel)	41.1	49.2	58.2	58.5	58.5	60.5	45.1	58.4	59.5
Dubai crude oil prices (US dollar/barrel)	34.7	38.5	51.8	54.0	55.5	57.5	36.6	52.9	56.5
Spring wage increases**	-	-	-	-	-	-	1.67	1.71	1.72

*Seasonally adjusted annual rate

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

Exhibit 3: Outlook for fiscal 2005-2006 (2)

【Exports and Imports】

	Forecast						Yr/Yr, %		
	FY2004		FY2005		FY2006		FY2004	FY2005	FY2006
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Exports (yen basis)	12.9	7.5	5.9	12.6	10.6	5.9	10.1	9.3	8.1
Volume	12.9	1.1	-0.1	4.3	6.6	6.4	6.8	2.0	6.5
Imports (yen basis)	11.1	13.5	15.5	27.3	18.3	4.0	12.3	21.5	10.6
Volume	6.6	4.3	3.7	5.6	7.6	6.1	5.4	4.6	6.8
Exports surplus (trillion yen)	6.1	5.3	4.1	2.2	2.3	2.9	11.4	6.2	5.2

【Income and Employment】

	Forecast						Yr/Yr, %		
	FY2004		FY2005		FY2006		FY2004	FY2005	FY2006
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Cash earnings of employees* (per capita)	-0.7	0.0	0.8	0.9	0.8	0.6	-0.4	0.8	0.7
Regular compensation	-0.9	-0.5	0.4	0.3	0.5	0.5	-0.7	0.4	0.5
Overtime compensation	6.2	1.0	1.8	2.5	1.3	0.8	3.5	2.2	1.0
Number of employees	0.5	0.0	0.8	1.0	0.8	0.8	0.3	0.9	0.8
Compensation of employees*	-0.2	0.1	1.9	1.9	1.4	1.4	-0.1	1.9	1.4
Unemployment rate	4.7	4.6	4.3	4.1	3.9	3.8	4.6	4.2	3.9

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

【New Housing Starts】

	Forecast						ten thousand units(annualized) Yr/Yr, %		
	FY2004		FY2005		FY2006		FY2004	FY2005	FY2006
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
New housing starts* (change from the previous year)	119.3	119.4	123.6	122.5	122.0	123.2	119.3	123.0	122.6
Owner-built housing	2.6	0.7	3.6	2.6	-1.3	0.6	1.7	3.1	-0.4
Rental housing	38.1	35.2	35.3	34.4	34.6	33.9	36.7	34.8	34.2
Built-for-sale housing	-0.3	-3.1	-7.4	-2.5	-2.0	-1.5	-1.6	-5.2	-1.8
Owner-built housing	45.5	48.2	49.9	50.9	50.1	51.1	46.7	50.4	50.6
Rental housing	1.1	2.7	9.6	5.5	0.4	0.5	1.9	7.8	0.5
Built-for-sale housing	35.0	34.8	37.8	36.1	36.7	37.0	34.9	36.9	36.8
Owner-built housing	8.5	0.9	8.1	3.7	-3.0	2.4	4.6	5.9	-0.3

*Seasonally adjusted annual rate

Exhibit 4: Outlook for calendar 2005-2006 (1)

			Forecast				half/half, % Yr/Yr, %		
	CY2004		CY2005		CY2006		CY2004	CY2005	CY2006
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Nominal GDP	0.8	-0.3	1.1	0.4	0.2	0.7	1.1	1.2	0.9
	1.8	0.5	0.8	1.6	0.7	1.0			
Real GDP	1.5	-0.1	2.0	1.0	0.6	1.1	2.3	2.5	1.7
	3.2	1.4	2.0	2.9	1.7	1.6			
Contribution of domestic demand	0.9	0.0	1.9	0.9	0.5	0.8	1.5	2.5	1.4
Private consumption	1.4	0.2	1.4	0.9	0.9	0.8	1.9	2.0	1.7
	2.3	1.6	1.6	2.3	1.8	1.6			
Housing investment	0.7	0.9	-2.0	1.6	-1.1	0.7	1.9	-0.7	-0.1
	2.1	1.8	-1.1	-0.3	0.3	-0.4			
Private capital investment	0.9	2.7	4.9	3.3	1.5	0.8	4.9	8.0	3.6
	6.2	3.6	7.7	8.2	4.9	2.3			
Contributory of Inventory investment	-0.3	0.0	0.2	-0.2	-0.5	0.6	-0.2	0.2	0.0
Government expenditure	1.1	0.4	1.2	0.9	1.0	1.0	-0.4	0.1	0.1
	0.3	-1.1	-1.1	1.3	0.3	0.0			
Public investment	-0.1	-10.7	0.1	-1.1	-5.4	-1.1	-8.6	-6.3	-6.2
	-6.6	-10.5	-11.3	-1.3	-6.1	-6.2			
Government final consumption expenditure	1.1	0.4	1.2	0.9	1.0	1.0	2.0	1.9	2.0
	2.5	1.5	1.6	2.2	2.1	1.8			
Contribution of external demand	0.6	-0.1	0.1	0.1	2.2	4.7	0.8	0.0	0.3
Export of goods and services	9.3	2.6	2.2	4.7	3.2	5.2	13.9	5.9	8.3
	15.8	12.1	4.8	7.0	8.1	8.6			
Import of goods and services	5.4	4.0	2.1	4.8	2.5	3.7	8.5	6.6	6.9
	7.2	9.7	6.2	7.0	7.5	6.4			
GDP deflator	-1.4	-0.9	-1.2	-1.3	-1.0	-0.6	-1.2	-1.3	-0.8

			Forecast				Yr/Yr, %		
	CY2004		CY2005		CY2006		CY2004	CY2005	CY2006
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Current account balance (trillion yen)*	9.6	9.0	8.8	7.7	7.6	7.3	18.6	16.5	14.9
balance on goods (trillion yen)*	7.3	7.0	5.3	4.2	3.4	3.8	14.3	9.5	7.2
balance on service (trillion yen)*	-1.8	-2.0	-1.3	-1.7	-1.2	-1.7	-3.7	-3.0	-2.9
balance on income (trillion yen)*	4.7	4.6	5.4	5.6	5.9	5.6	9.3	11.0	11.5
Industrial production (Qr/Qr, %)	3.6	0.4	1.0	0.8	1.5	0.3	5.5	1.4	1.9
(Yr/Yr, %)	7.0	4.1	0.9	1.9	2.0	1.8			
Corporate goods prices(Yr/Yr,%)	-0.1	2.4	2.3	4.0	4.2	0.4	1.2	3.1	2.3
Domestic corporate goods prices(Yr/Yr,%)	0.6	1.9	1.5	1.7	1.4	0.2	1.2	1.6	0.8
Consumer prices(Yr/Yr,%)	-0.2	0.2	-0.2	-0.3	0.4	0.4	0.0	-0.2	0.4
excluding freshfood(Yr/Yr,%)	-0.1	-0.2	-0.3	0.1	0.5	0.3	-0.2	-0.1	0.4
Yen/U.S.Dollar	108.5	107.9	106.1	113.9	117.8	114.8	108.2	110.0	116.3
Newly issued government bond yields (10years)	1.4	1.5	1.3	1.4	1.7	2.0	1.5	1.4	1.8
WTI future price(near month contract, US dollar/barrel)	36.8	46.1	51.6	61.6	57.5	59.5	41.4	56.6	58.5
Dubai crude oil prices (US dollar/barrel)	31.3	35.9	44.7	55.3	54.0	56.5	33.6	50.0	55.3

*Seasonally adjusted annual rate

Exhibit 5: Outlook for calendar 2005-2006 (2)

【Exports and Imports】

	CY2004		CY2005		CY2006		CY2004	CY2005	CY2006
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Exports (yen basis)	12.5	11.8	4.1	9.2	13.5	7.3	12.1	6.7	10.2
Volume	13.5	7.9	-1.5	1.8	6.3	6.5	10.6	0.2	6.4
Imports (yen basis)	6.8	15.1	12.1	21.6	24.6	10.1	10.9	17.1	16.7
Volume	7.8	6.2	3.0	4.0	7.5	6.9	7.0	3.5	7.2
Exports surplus (trillion yen)	6.2	5.8	4.5	3.1	2.2	2.5	12.0	7.6	4.7

【Income and Employment】

	CY2004		CY2005		CY2006		CY2004	CY2005	CY2006
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Cash earnings of employees (per capita)	-1.3	-0.2	0.6	0.8	0.7	0.7	-0.7	0.7	0.7
Regular compensation*	-0.8	-0.8	0.1	0.3	0.5	0.5	-0.8	0.2	0.5
Overtime compensation	7.0	3.8	0.8	2.4	1.6	1.2	5.4	1.6	1.4
Number of employees	0.5	0.2	0.3	0.8	0.9	1.0	0.4	0.6	0.9
Compensation of employees*	-1.7	0.1	0.9	1.9	1.5	1.6	-0.8	1.4	1.6
Unemployment rate	4.8	4.7	4.4	4.2	4.0	3.8	4.7	4.3	3.9

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

【New Housing Starts】

	CY2004		CY2005		CY2006		CY2004	CY2005	CY2006
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Number of new housing starts	118.0	119.9	120.1	124.7	121.9	123.1	118.9	119.6	119.7
(change from the previous year)	0.7	4.5	1.8	4.0	1.5	-1.2	2.5	0.5	0.1
Owner-built housing	36.5	37.2	35.1	34.9	34.4	34.2	37.0	35.5	35.8
Rental housing	47.1	46.5	48.9	50.7	50.6	50.6	46.5	47.5	47.3
Built-for-sale housing	34.3	34.9	35.7	37.8	36.5	36.9	34.6	35.7	35.8
	7.3	4.7	4.0	8.2	2.4	-2.3	5.8	3.3	0.4

*Seasonally adjusted annual rate

Exhibit 6: Outlook for 2005-2006 (Quarterly) (1)

	Forecast				Qr/Qr, %				Yr/Yr, %			
	FY2004				FY2005				FY2006			
	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	-0.5	-0.1	0.0	0.7	0.9	-0.2	0.2	0.1	0.1	0.2	1.0	0.5
	1.0	1.1	-0.0	0.1	1.4	1.5	1.6	1.1	0.3	0.7	1.3	1.9
Real GDP	-0.3	0.1	-0.1	1.4	1.2	0.2	0.2	0.3	0.5	0.5	0.7	0.5
	2.8	2.4	0.4	1.4	2.6	2.9	2.9	2.2	1.2	1.4	1.8	2.1
Contribution of domestic demand(Qr/Qr,%)	-0.5	0.3	-0.1	1.4	1.1	0.3	0.2	0.2	0.4	0.4	0.5	0.5
Private Consumption	0.1	0.3	-0.3	1.2	0.7	0.4	0.3	0.5	0.4	0.4	0.3	0.3
	2.5	2.5	0.7	1.2	2.0	2.0	2.5	2.3	1.4	1.5	1.6	1.3
Housing investment	1.2	0.1	0.5	-1.2	-2.1	1.6	2.3	-1.3	-2.0	0.3	2.8	-0.7
	2.5	0.9	2.7	0.6	-2.7	-1.2	0.6	0.4	0.1	-0.5	-0.2	0.3
Private capital investment	3.6	0.5	0.7	3.3	2.4	1.6	1.0	1.0	0.2	0.3	0.7	1.1
	6.3	6.7	0.4	7.8	7.5	8.0	8.5	5.7	3.9	2.3	2.2	2.3
Contributory of Inventory investment(Qr/Qr,%)	-0.4	0.2	-0.1	0.1	0.3	-0.3	-0.1	-0.1	0.1	-0.0	0.1	0.1
Government expenditure	-2.6	-0.8	0.3	0.6	0.4	0.5	-0.7	-0.3	0.4	0.4	0.2	0.2
	-0.7	-1.3	-1.0	-2.6	0.5	1.8	0.9	-0.1	0.6	-0.2	0.1	1.1
Public investment	-13.3	-3.8	-0.1	-0.5	1.1	0.3	-3.9	-3.5	-0.1	-0.9	-0.4	-0.1
	-11.8	-12.0	-9.4	-16.3	-3.4	0.8	-2.9	-5.5	-7.1	-8.1	-4.7	-1.1
Government final consumption expenditure	0.6	-0.0	0.3	0.9	0.2	0.6	0.4	0.5	0.5	0.6	0.3	0.3
	2.2	1.7	1.4	1.8	1.4	2.0	2.4	1.7	2.5	2.1	1.5	1.7
Contribution of external demand(Qr/Qr,%)	0.2	-0.2	-0.0	-0.0	0.2	-0.0	0.0	0.0	0.2	0.1	0.1	-0.0
Export of goods and services	2.9	0.3	1.6	-0.1	3.1	2.7	0.8	1.4	2.8	2.7	1.9	1.6
	17.5	14.0	10.3	4.7	4.9	7.4	6.6	8.2	8.0	8.0	9.1	9.4
Import of goods and services	2.1	1.9	2.1	-0.0	2.2	3.3	0.8	1.2	1.8	2.3	1.0	1.9
	9.3	9.7	9.7	6.3	6.2	7.7	6.3	7.7	7.3	6.2	6.5	7.2
GDP deflator(Yr/Yr,%)	-1.7	-1.3	-0.4	-1.2	-1.2	-1.4	-1.3	-1.1	-0.9	-0.7	-0.5	-0.2

	Forecast				Yr/Yr, %			
	FY2004				FY2005			
	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3
Current account balance (trillion yen)*	4.7	4.7	4.6	4.5	4.3	4.3	3.3	3.9
balance on goods (trillion yen)*	3.7	3.5	3.2	3.2	2.5	2.1	1.6	2.3
balance on service (trillion yen)*	-1.1	-0.9	-0.8	-0.8	-0.7	-0.8	-0.6	-0.7
balance on income (trillion yen)*	2.3	2.4	2.5	2.5	2.8	3.1	2.7	2.9
Industrial production (Qr/Qr, %)	1.9	-0.1	-0.9	1.7	-0.4	-0.2	2.5	0.2
(Yr/Yr, %)	7.2	6.4	1.8	1.4	0.3	0.0	3.7	1.5
Corporate goods prices(Yr/Yr,%)	0.7	1.9	3.0	1.9	2.7	3.0	5.0	5.1
Domestic corporate goods prices(Yr/Yr,%)	1.1	1.8	2.0	1.4	1.7	1.6	1.8	1.8
Consumer prices(Yr/Yr,%)	-0.3	-0.1	0.5	-0.2	-0.1	-0.3	-0.2	0.3
excluding freshfood(Yr/Yr,%)	-0.2	-0.2	-0.2	-0.4	-0.1	-0.1	0.2	0.5
Yen/U.S.Dollar	109.7	109.9	105.9	104.5	107.6	111.2	116.5	118.5
Newly issued government bond yields (10years)	1.59	1.65	1.45	1.40	1.27	1.34	1.55	1.65
WTI future price(near month contract, US dollar/barrel)	38.3	43.9	48.3	50.0	53.2	63.2	60.0	57.0
Dubai crude oil prices (US dollar/barrel)	33.2	36.3	35.6	41.4	47.9	55.7	55.0	53.0

*seasonally adjusted

Exhibit 7: Outlook for 2005-2006 (Quarterly) (2)

【Exports and Imports】

Forecast

Yr/Yr, %

	FY2004				FY2005				FY2006			
	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)	13.4	12.3	11.2	3.8	4.3	7.4	10.9	14.4	12.6	8.7	6.0	5.7
Volume	13.9	12.0	4.1	-1.9	-1.1	0.8	2.7	6.0	6.7	6.5	6.5	6.3
Imports (yen basis)	9.0	13.1	17.0	10.0	14.1	16.8	26.2	28.3	21.2	15.5	5.3	2.7
Volume	6.6	6.6	5.8	2.7	3.2	4.1	3.9	7.4	7.7	7.5	6.3	5.9
Exports surplus (trillion yen)	3.2	2.9	2.9	2.4	2.1	1.9	1.2	1.0	1.2	1.1	1.4	1.5

【Income and Employment】

Forecast

Yr/Yr, %

	FY2004				FY2005				FY2006			
	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)	-1.0	-0.4	0.0	0.0	1.0	0.4	1.2	0.6	0.8	0.8	0.7	0.4
Regular compensation	-0.9	-0.8	-0.7	-0.2	0.4	0.3	0.3	0.4	0.5	0.6	0.5	0.4
Overtime compensation	7.0	5.5	2.3	-0.2	1.9	1.8	3.0	2.0	1.2	1.5	1.0	0.5
Number of employees	0.7	0.4	0.1	0.0	0.7	0.9	0.8	1.2	0.6	1.1	0.9	0.6
Compensation of employees*	-0.1	-0.3	0.4	-0.4	2.0	1.7	2.0	1.8	1.2	1.7	1.6	1.2
Unemployment rate	4.6	4.8	4.6	4.5	4.3	4.4	4.1	4.1	4.0	3.9	3.8	3.9

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

【New Housing Starts】

Forecast

ten thousand units(annualized)

Yr/Yr, %

	FY2004				FY2005				FY2006			
	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3
New housing starts*	116.4	122.3	117.5	121.4	118.9	128.3	121.0	124.0	119.9	124.1	122.2	124.3
(change from the previous year)	-3.7	9.4	-0.1	1.5	2.0	5.0	3.0	2.1	0.8	-3.3	1.0	0.2
Owner-built housing	36.9	39.3	35.1	35.3	34.9	35.7	34.1	34.7	34.2	34.9	33.4	34.3
Rental housing	-6.0	5.9	-2.8	-3.3	-5.5	-9.2	-3.0	-2.0	-2.0	-2.0	-2.0	-1.0
Built-for-sale housing	44.8	46.3	46.7	49.7	48.0	51.8	49.6	52.2	49.1	51.1	50.1	52.2
	-6.4	9.4	3.0	2.3	7.4	11.7	6.0	5.0	2.0	-1.0	1.0	0.0
	34.2	35.7	34.1	35.5	35.8	39.8	35.7	36.5	36.6	36.8	37.0	37.0
	3.1	14.1	-2.1	4.2	4.4	11.5	4.9	2.8	2.0	-7.7	3.6	1.4

*Seasonally adjusted annual rate