

February, 2004

**Revised Forecast for the Japanese Economy
In Fiscal 2004**



Economic Research Department

1. Current State of the Japanese Economy and Outlook for Fiscal 2004

(1) Current State of the Japanese Economy

During the October-December period of 2003, Japan's real GDP rose 1.7% over the previous quarter (an annualized growth rate of 7.0%), the fourth consecutive quarter of positive growth and the highest quarterly rate of expansion since the April-June period of 1990. Although the rate of decline in the GDP deflator expanded to -2.6% compared with the same quarter of the previous year, GDP growth in nominal terms was 0.7%, the third consecutive quarter of positive expansion.

By major component of GDP, accompanying the improvement in corporate profitability and the recovery in the world economy, the driving forces for growth continued to be expansion in private capital investment, which grew 5.1% in real terms over the previous quarter, and real exports, which were up 4.2% from the prior quarter. In addition, while severe conditions continued in the employment and income environments, private consumption rose 0.8% for the fourth consecutive quarterly increase, thus providing support for the economy. On the other hand, housing investment began to decline again, edging down 1.0% from the previous quarter, reflecting a reaction to the previous surge in the number of housing starts stimulated by the approaching deadline for the expiration of a housing loan tax relief measure. Although the margin of decline in government public works investment shrank, slipping 0.2% from the previous quarter, it continued on a downward trend under the government's basic policy of fiscal reforms.

Real growth for calendar 2003 amounted to 2.7%, almost as high as in 2000, when the economy was boosted by the IT boom. Nominal growth was a marginal 0.2% but was the first positive expansion since 2000. By major component of demand, trends in 2003 were virtually the same as in 2000. Exports and capital investment showed high rates of growth, while expansion in consumption was gradual. Housing investment remained virtually level, and government investment posted a significant decline.

(2) Issues Considered in Preparing the Economic Outlook

At the time of the IT boom, the economy reached a peak in October 2000 and began to trend downward, but what will happen this time? In the following paragraphs, we consider the factors that may slow the economy and other key points influencing the outlook.

(a) The World Economy and Trends in High-Tech Demand

At the time of the IT boom, demand for high-technology products and services became overheated, leading to speculative demand and expansion in manufacturing production. For this reason, supply exceeded actual demand, leading to a rapid rise in inventories. As a consequence, production subsequently dropped sharply as producers adjusted their inventories. Thereafter, the U.S. economy moved into recession, and, for this and other reasons, export demand declined further.

During the current recovery phase, demand for digital-related products has risen, and exports have increased, especially to the rest of Asia. In considering trends in the economy, it will be important to look at trends in the world economy and in demand for digital-related products. First, is there a possibility that demand for digital-related products may suddenly weaken? According to the most recent data, demand for such products is rising rapidly, and shipments in volume terms are running at levels comparable with those during the IT boom. However, manufacturers are fully informed about trends in final demand and are expanding supply at levels appropriate for growth in demand. For this reason, we believe the risk of excessive supply and a sharp rise in inventories similar to 2000 is small.

On the other hand, the world economy, including the United States, is forecast to enter a slowdown in the second half of fiscal 2004. Accordingly, even if demand for digital-related products does not weaken, exports from Japan will decline as overseas demand slows. As exports decelerate, there is a possibility that this will bring declines in production and corporate profitability in Japan and act as a drag on the economy.

In particular, the rise in Japan's exports thus far has been dependent on shipments to the rest of Asia, especially to China. If the tone of the Chinese economy—where concerns about the emergence of overheating have arisen—changes, then there is a risk that exports from Japan may decline.

(b) Recovery to Spread from Large to Small and Medium-Sized Companies and from the Corporate to the Individual Sector

The recovery trend is currently spreading among large corporations, principally export-linked manufacturing companies, but permeation of the trend among small and medium-sized enterprises and nonmanufacturing companies is weak. According to the diffusion indexes (DIs) issued by the Bank of Japan in its *Short-Term Economic Survey of Enterprises (Tankan)*, the recovery trend is spreading among small and medium-sized companies and nonmanufacturing corporations, but the pace of improvement is slower than among large manufacturing companies. Similarly, profitwise, the companies showing substantial increases in profitability are large exporters in the electric machinery, steel, automobile, and certain other industries, and this trend is not spreading across corporate size and industry categories.

The same holds true for the individual sector. Companies are putting strong restraints on personnel costs, and, even as the economy recovers, they are taking a cautious stance toward expanding employment and raising wages. During 2003, the margin of expansion in the number of employed persons and the rate of increase in wages were weak compared to the time of the IT boom. Viewed in real terms, private consumption is rising gradually, benefiting from deflation but is declining in nominal terms. Although the employment and income environments have improved, compared with some periods in the past, they remain severe, and private consumption is not gaining momentum.

Although the spreading of the recovery trend to small and medium-sized enterprises and the individual sector is relatively slow, this is probably not a sufficient reason for the economy as a whole to falter. However, it is a factor that is weakening the momentum of the recovery.

(c) Environment Influencing Corporate Profitability

Selling prices are continuing on a downward trend, and companies are experiencing difficulties in expanding revenues. The margins of decline in price indexes have shrunk and they are at levels comparable with the previous year, but companies are having difficulty in increasing prices. Under these conditions, expansion in the volume of shipments along with expansion in overseas demand is providing support for the level of sales. However, as indicated in (a) above, if overseas economies slow, the conditions influencing corporate profitability will deteriorate suddenly.

There is also concern that a further appreciation of the yen will have an adverse impact on profitability, principally among exporters. Certainly, if a collapse in the value of the U.S. dollar results in appreciation of ¥20 to ¥30 in the yen/dollar rate, this would bring a sharp deterioration in the profitability of exporters. However, if the yen continues at the currently relatively strong level or appreciates gradually, exporters should be able to adapt, and the impact on corporate profits will be marginal.

We must watch carefully for any increase in inflationary pressures resulting from upstream pressures, namely, higher raw material costs. Prices of many commodities have exceeded the levels prevailing at the time of the IT boom. Manufacturers of basic materials and other upstream suppliers that have completed industrial restructuring and realignment may be able to raise prices to cover these higher raw materials prices, but passing on these higher costs to the final demand level, where strong deflationary pressures persist, will not be easy. Downstream companies, caught between rising materials costs and weak prices for their products, are feared likely to experience even stronger pressures on profitability. The deterioration in profits will have an impact on the upward trend in capital investment and could be a factor leading to an economic downturn.

(3) Dangers of Ending Deflation Too Quickly

A review of the economy in 2003 appears to deny the logic of the belief that “If the Japanese economy does not escape from deflation, it will not recover.”

As we indicated in our previous economic outlook (*Current State of the Japanese Economy and Outlook for Fiscal 2003/2004*, Research Report 03/83), issued in November 2003, we believe the phrase that best describes the state of the Japanese economy is “deflationary recovery.” Under this scenario, deflation, as indicated by continuing declines in prices, and economic recovery are co-existing. In today’s deflationary recovery, the economic recovery is not robust, but the risk of a downturn is limited. Since there are no inflationary expectations, companies are less likely to increase inventories, and a slowdown due to inventory adjustments is unlikely. However, we cannot completely deny the risk of a replay of the IT boom scenario, namely, a sharp rise in inventories if high-tech related demand should collapse. Nevertheless, for the reasons we have mentioned, the risk of a replay of the year 2000 scenario seems minimal.

Purging the economy of deflation has become a rally cry, but economic agents—such as households and companies, which are currently acting on the assumption that deflation will continue—will change their behavior patterns when deflation ends and then begin to take it for granted that inflation will continue. When final demand strengthens and gathers momentum, if inflationary pressures from downstream begin to grow, the strengthening of the economy will bring an end to deflation, leaving no major problems in its wake.

However, if inflationary pressures from upstream rise, this will mean increasing costs for companies in downstream sectors. This is what we are experiencing now with the increase in prices of primary commodities, including crude oil. In cases where supply is restrained, such as in instances where producer countries close mines and OPEC cuts production—or when speculative funds flow into commodity markets and boost prices more than is justified by actual demand—then the pressure of rising costs will mount, thus squeezing profits. If downstream final demand does not strengthen sufficiently, it will be difficult to pass on increases in costs, and profitability will come under pressure. If companies attempted and were successful in forcing buyers to pay higher prices, we would escape from deflation, but final demand would weaken. However, passing on cost increases to final prices is difficult, and, in actual practice, corporate profits

will come under pressure.

Deterioration in corporate profits will increase the risk of a downturn in the economy. Among basic materials industries and other upstream suppliers, there are some sectors where restructuring and realignments may make it possible to pass on cost increases to selling prices. However, (i) manufacturers that buy materials from these sectors, (ii) small and medium-sized companies that supply large corporations and are subject to severe price competition, and (iii) companies in the distribution (wholesaling/retailing) sector that face strong downstream deflationary pressures may experience a profit squeeze.

Therefore, escaping from deflation is not the cure-all for bringing economic recovery, and, what is more important, in some cases escaping from deflation could be a factor further weakening the economy. We need to exercise caution about making an overly hasty escape from deflation and the consequences of inflationary pressures coming from upstream sources.

2. Outlook for the Economy in Fiscal 2004

(1) Assumptions Underlying the Forecast

The following assumptions have been made in preparing this outlook.

(a) World Economy

The U.S. economy has shown a firm upward trend since the second half of 2003, boosted by expansion in domestic demand accompanying a major tax reduction and an increase in exports fueled by recovery in overseas demand. At present, employment, which had lagged other sectors in recovery, is improving, and the rate of inflation is showing signs of bottoming out. Through mid-2004, the favorable impact of the tax cut is expected to continue, and the pace of increase in private consumption and private capital investment is expected to accelerate, thus increasing the chances that a robust recovery will continue. In the latter half of 2004, a series of factors are expected to bring about a slowdown in the economy, including the diminishing impact of the tax cut, rising interest rates, and

higher inventories.

The economies of the euro region began to recover in the July–September quarter of 2003, led by growth in external demand. Although there is concern about the sharp rise in the value of the euro, at present this has not had a particularly strong impact on exports and other components of demand. However, there is a possibility that the impact of fluctuations in foreign currency exchange rates will emerge in the months to come. To date, there has been some negative effects on corporate profitability. On the other hand, in Germany, France, and other countries, recovery in consumer confidence has lagged, and private consumption has stagnated because of the effects of reforms in social welfare, which have led to a higher burden on individuals, and other factors. While the economies of the euro region are expected to continue to recover, the speed of expansion is likely to be gradual.

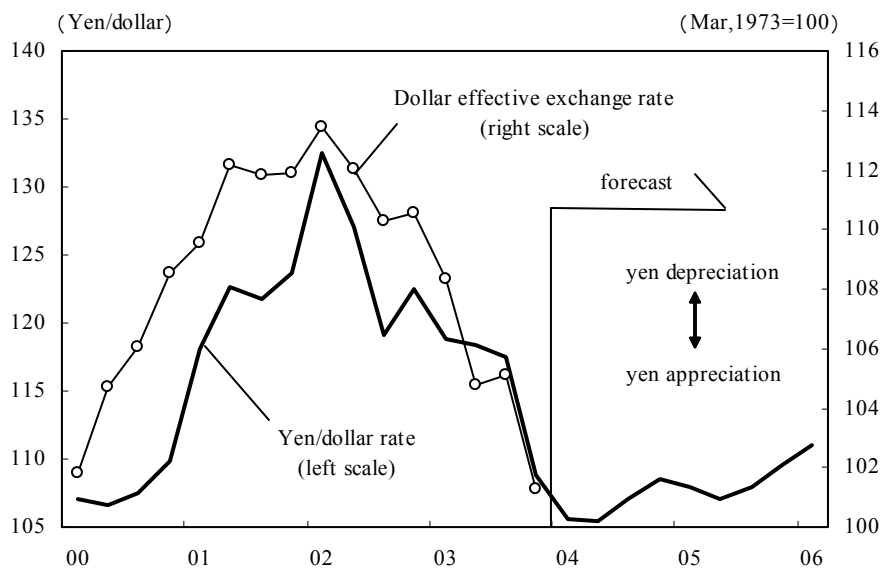
Turning to Asia outside Japan, the overall performance of these economies is continuing to improve—supported by healthy conditions in China and firmness in exports due to recovery in the world economy—and employment as well as stock prices are staging a recovery. With the beginning of 2004, the SARS threat has been replaced by a bird influenza epidemic, but this has not created the turmoil evident during the SARS epidemic, thus underscoring the growing confidence in economic trends. Nevertheless, these favorable trends are forecast to weaken and may give way to an economic slowdown in the latter half of 2004, because of the deceleration in the U.S. economy and the effect of stronger Asian currencies. With the beginning of 2004, concern about an overheating in the investment climate in China has finally begun to increase. Through mid-2004, strong investment and robust consumer confidence, coupled with the impact of the rebound from the SARS epidemic in the previous year, will sustain the Chinese economy, but beginning in the second half, government policies to restrain investment and other measures will begin to take effect, and China will move toward a soft landing.

(b) Exchange Rates

From around the time of the G7 summit in Dubai on September 20, 2003, doubts arose about the sustainability of the intervention efforts of Japan's

currency authorities, thus leading to a weakening of the U.S. dollar and a strengthening of the yen. In the G7's statement issued following their summit meeting in Boca Raton on February 7, 2004, one of the sentences from the statement following the previous summit—which was viewed as supporting a stronger yen—appeared again: “For major countries and economic regions that lack flexibility in their exchange rates, greater flexibility will be desirable to facilitate smooth and broad-ranging adjustments in the international financial system based on market mechanisms.” However, a new sentence was added, “Excessive fluctuations and disorderly movements in exchange rates are undesirable for economic growth.” This latter statement was taken to mean that the G7 understood the intervention stance of Japan's currency authorities. Although pressure for yen appreciation has remained strong as expectations for recovery in the Japanese economy have risen and purchases of Japanese stocks by overseas investors have expanded, anxiety about possible intervention at high values of the yen is strong, and the yen is expected to continue to fluctuate within a narrow range for the time being. Looking toward the rest of fiscal 2004 and into fiscal 2005, the economies of Japan and the United States are expected to show parallel trends, and we are forecasting that the yen/dollar rate will remain relatively stable.

Exhibit 1: Outlook for the Yen-Dollar Exchange Rate



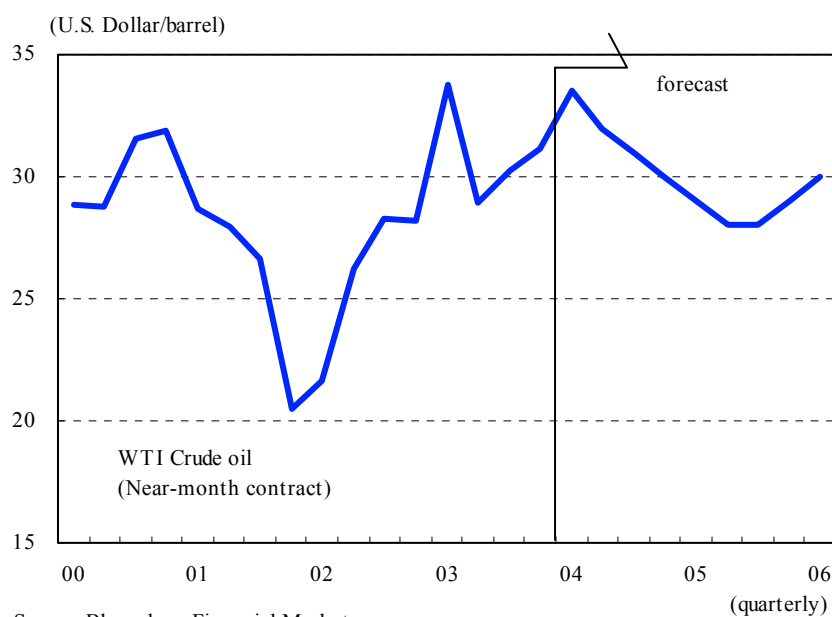
Sources: Bank of Japan, Financial and Economic Statistics Monthly,
FRB [Federal Reserve Bulletin]

(c) Crude Oil Prices

As a result of the prolonged period of high crude oil prices, inventories have fallen to a low level, and the supply/demand balance is tight because of the combined effects of the recovery in the world economy and relatively high seasonal demand during the winter months. In addition, demand in China is expanding along with high economic growth and, to further complicate matters, OPEC has reached agreement on a quota cutback even though crude oil prices are already at a high level. As a result, the West Texas Intermediate (WTI) index (near month contract) has climbed around \$35/barrel. Although an expansionary trend in demand is expected to continue because of the recovery in the world economy, seasonal demand has already passed its peak. Accordingly, for the near term, the supply/demand balance is expected to loosen and prices to soften. However, since OPEC decided on a major cutback in production at its February meeting (amounting to a cut of 2.5 million barrels a day—consisting of the reduction of excess production above the current quota, of about 1.5 million barrels a day and a quota cutback from April, amounting to 1 million barrels a day), the outlook is for no major downward adjustment, such as a decline to below \$30 a barrel.

However, as crude oil prices will remain at a high level, OPEC member nations that place priority on securing revenues will take a negative stance toward cutting output, and the excess production above the current quota is not likely to decline very much. The effect of quota cutbacks will be less than assumed, and, in the latter half of 2004, in addition to the slowdown in the world economy, the recovery in Iraq oil production and the expansion in crude oil supply from non-OPEC countries, such as Russia, will combine to substantially loosen the supply/demand balance, thus leading to a drop in prices to below \$30 a barrel. However, along with the decline in prices, OPEC is expected to implement further cutbacks, thus making a major downward adjustment in prices unlikely. Thereafter, in the latter half of 2005, the world economy is expected to move toward recovery, and prices will begin to rise again.

Exhibit 2 : Outlook for WTI Crude Oil Price



(d) Government Fiscal Policy

In the national government budget for fiscal 2004 (government proposal) public works related expenditures will be reduced 3.5% from the previous fiscal year. Similarly, regional government budgets will also be cut, thus resulting in a reduction of 9.5% in outlays for projects undertaken by local governments on their own initiative and a decrease of 8.4% in their expenditures of an investment nature. Also, in fiscal 2005, we are assuming that national public works related expenditures will be reduced 3.0% from the previous fiscal year and that outlays for projects undertaken by local governments on their own initiative will be cut 5.7% (with expenditures of an investment nature in local budgets declining 4.7%). In both fiscal 2004 and fiscal 2005, we assume that no further allocations for public works will be made in a supplementary budget.

(e) Monetary Policy

The Bank of Japan (BOJ) has left the pace of its monthly purchases of long-term Japanese government bonds (JGBs) unchanged at ¥1.2 trillion since October 2002. However, on January 20, 2004, the BOJ raised its target for its current account deposits from between ¥27 trillion and ¥32

trillion to between ¥30 trillion and ¥35 trillion.

At present, since recovery trends are stronger, stock prices have moved back from the levels they reached temporarily, and, due to other developments, requests have quieted for further monetary relaxation, such as the introduction of inflation targeting and the expansion of the BOJ's purchases of assets beyond JGBs to include exchange traded funds (ETFs), real estate investment trusts (REITs), and foreign securities. However, in the event of a rise in uncertainty about the economy caused by a sharp appreciation of the yen or a steep decline in stock prices, the BOJ may take other measures, including a further increase in its target for its current account deposits. Nevertheless, these additional measures are expected to have virtually no impact on the economy.

On the other hand, the condition that the BOJ has announced for suspending its policy of monetary relaxation—namely, “when the core portion of the consumer price index rises and remains stable above 0% in comparison with the same period of the previous year”—has not been met. Accordingly, during the forecast period, the policy of monetary relaxation is not likely to be suspended.

(2) Economic Outlook for Fiscal 2004: Third Consecutive Year of Positive Growth, Movement into Adjustment Phase in the Second Half

Fiscal 2004 will begin with a continuation of the recovery trend in fiscal 2003. We are forecasting real GDP growth of 1.9%, the third consecutive year of positive growth, but adjustments will become more pronounced in the latter half of the fiscal year as overseas economies begin to slow. For this reason, real GDP growth will be lower than the 2.7% expected for fiscal 2003. In addition, in nominal terms, the GDP will shrink 0.2%, thus showing virtually zero growth, and the GDP deflator will decline 2.1%.

By major component of final demand, exports and private capital investment will be deciding factors for overall economic trends. First, exports are expected to show a major increase owing to the contribution in

the first half of the fiscal year, but, in the second half, owing to the slower growth in the U.S. and other economies around the world, Japan's exports will also decelerate. Imports will expand along with the growth in domestic production, but the external sector is expected to make a small positive contribution to overall GDP growth. Production will continue to rise during the first half of the fiscal year, supported by the increase in exports, but will begin to decline in the second half. Capital investment will continue to expand throughout 2004, sustained by growth in corporate profits, but will decelerate toward the end of the fiscal year as profits begin to weaken.

Private consumption will remain firm and is expected to continue to show gradual expansion in real terms. However, major improvements in the income and employment environments are not expected, and, as a consequence, consumption will lack robustness. Housing investment is forecast to show a slight decline.

Government-sector spending is expected to have a neutral effect on the economy. On the one hand, public works spending at the national and local government levels will continue to decline, but government consumption expenditures, which are already comparable in size to private capital investment, will increase along with higher spending on health-care and nursing for senior citizens.

Reflecting the trends toward recovery, the margin of decline in domestic corporate goods prices and in consumer prices is expected to diminish, but in the latter half of fiscal 2004, the margin of decline may increase as a result of the deceleration in the economy.

Moving into fiscal 2005, the slowdown that will begin in the latter half of fiscal 2004 will continue into the first half of fiscal 2005, but in the latter half of fiscal 2005, exports will begin to rebound along with the recovery in overseas economies. We are forecasting real GDP growth of 0.4% in fiscal 2005, thus making it the fourth consecutive year of positive growth for the Japanese economy, but growth will be slower than in fiscal 2004. In addition, while the nominal GDP will decline 1.0%, a larger margin than in fiscal 2004, the GDP deflator will fall by a smaller margin of 1.4%.

Exhibit 3: Real GDP Growth (seasonally adjusted)

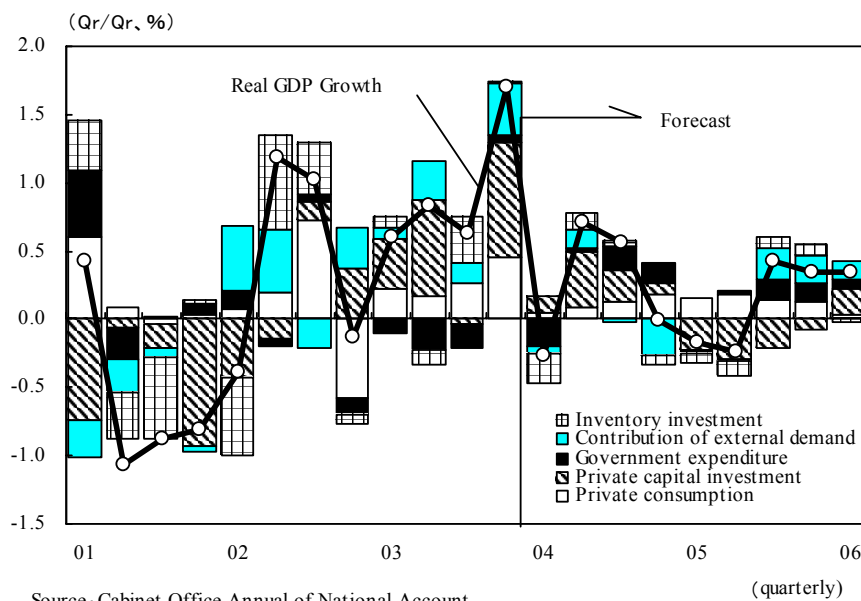
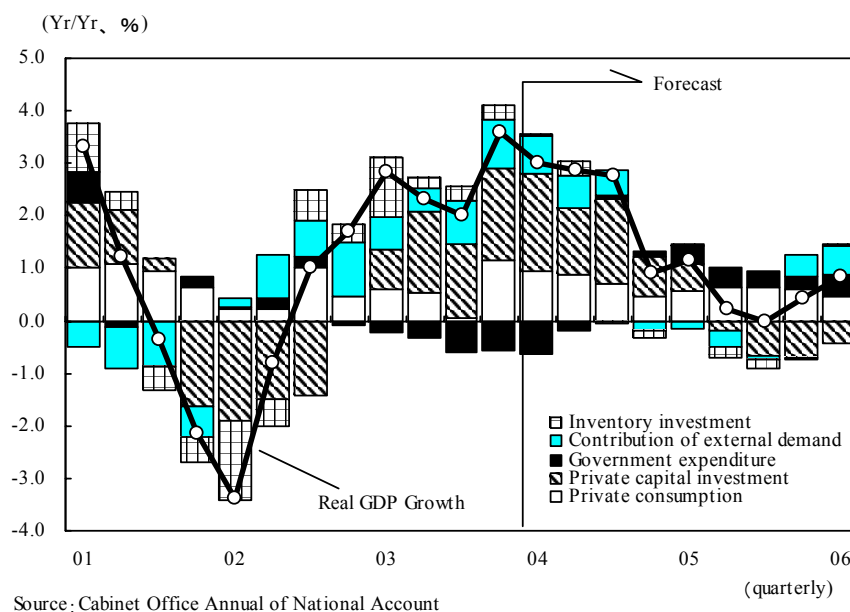


Exhibit 4: Real GDP Growth



3. Outlook by Demand Component

- (a) **External Demand:** The contribution of external demand will continue to be positive in the first half of fiscal 2004 but will have a negative influence in the latter half of fiscal 2004.

Exports in volume terms were stagnant in the first half of fiscal 2003 because of the weakness in overseas economies and the impact of the SARS epidemic. However, in the October–December quarter of 2003, major increases were reported principally in electronics-related parts and components, including semiconductors. By region, exports to the United States continued below the levels of the previous year, but shipments to the EU and Asia reported strong performances.

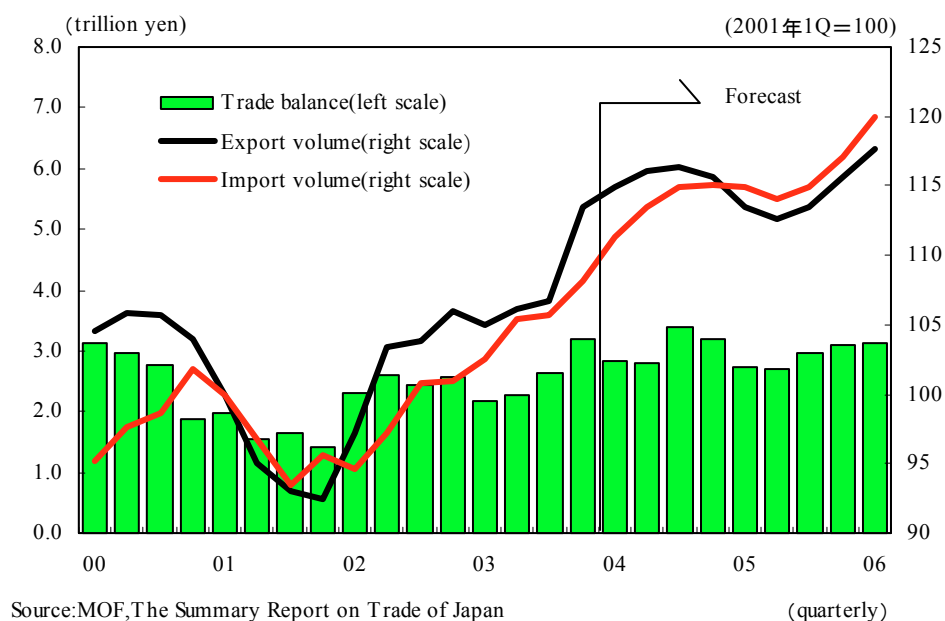
Through the first half of fiscal 2004, recovery in overseas economies is expected to continue, and favorable conditions will prevail worldwide in demand for electronics-related products. Exports are, therefore, forecast to continue on an upward trend. The driving force for growth in Japan's exports will continue to be shipments of electronics parts and components as well as capital goods to other countries in Asia. Although exports to the United States are currently weak, exports of information-related capital goods and producers' goods are expected to recover. In addition, the decline in automobile exports will bottom out. However, in the latter half of fiscal 2004, the economies of the United States and the EU are forecast to decelerate, while economic activities in Asia may weaken, thus leading to the beginning of a decline in exports in volume terms. In the first half of fiscal 2005, the stagnation in exports is forecast to continue, but during the second half, the recovery in overseas economies will bring an increasing trend.

Imports are now rising along with the recovery in the domestic economy. Through the first half of fiscal 2004, we expect the domestic recovery to continue and are forecasting further increases in imports of materials needed for manufacturing activities and imports of machinery from production centers in Asia. In the latter half of fiscal 2004, the domestic economy is expected to slow and production levels will decline. For this reason, imports will also weaken, particularly parts, materials, and other producers' goods. Imports are likely to remain stagnant during the first half of fiscal 2005, but in the second half, along with the recovery in the domestic economy, imports will begin to rise again. Because of the shift of Japan's production centers from the domestic market to elsewhere in Asia, the share and market penetration of imports have increased structurally, and

the trend toward higher rates of growth in imports than in exports, both in volume terms, will continue.

The contribution of external demand to GDP growth in fiscal 2003 is forecast to be +0.7 percentage point, which will boost GDP growth significantly. In the first half of fiscal 2004, as a result of the reaction to the effects of SARS in the previous fiscal year, overseas travel (which is treated as a service import) by Japanese citizens will increase substantially, thus lowering the contribution of the external sector to GDP. However conditions in overseas economies will be strong. And, as result of the increase in exports, the external sector will continue to contribute to GDP growth. In the latter half of fiscal 2004, however, as a consequence of the slower growth in overseas economies, the contribution of the external sector is forecast to be negative. The stagnation in exports will continue through the beginning of fiscal 2005, and external demand will not contribute to growth, but from midyear onward, we are forecasting a positive contribution as exports begin to recover. For both fiscal 2004 and fiscal 2005, the contribution of the external sector is expected to be 0.2 percentage point.

Exhibit 5: Outlook for Trade



(b) Corporate Sector: This sector will remain strong but reach a peak during fiscal 2004.

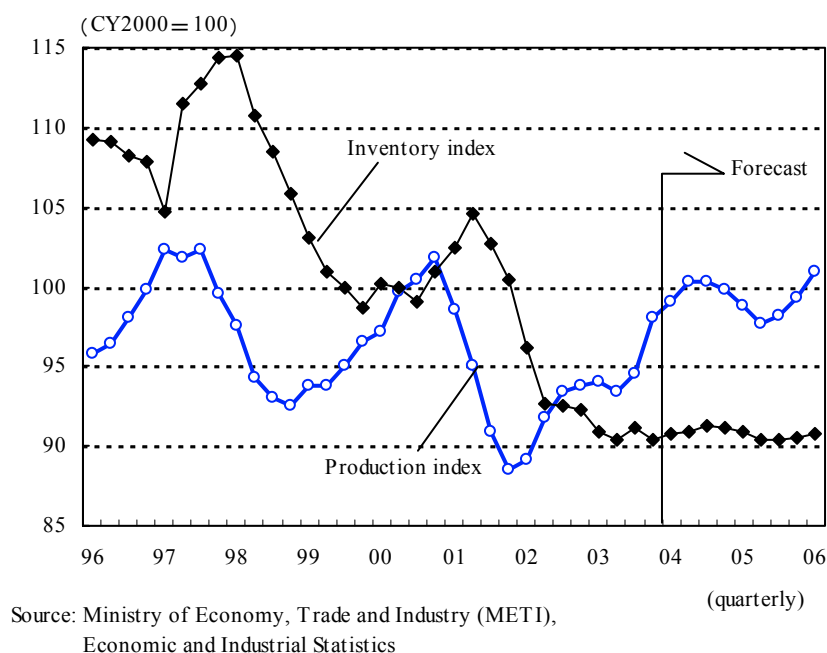
***Production:** Production will continue to rise through the first half of fiscal 2004 but lose momentum in the second half.*

Industrial production was marking time at the beginning of 2003, but—along with the bottoming out of exports, strengthening of demand for digital appliances, and other factors—production levels began to rise in the latter half of 2003. Production rose 3.7% over the previous quarter during the October–December period, and, according to current statistics based in the year 2000, this quarterly rate of growth was the highest on record in 27 years (since 1976). Demand for exports and digital appliances is expected to remain firm for the time being, and, together with expansion in the production of investment-related capital goods and other items, the upward trend in industrial production is likely to continue through the middle of fiscal 2004.

However, in the latter half of fiscal 2004, growth in exports is expected to slow as a result of the deceleration in overseas economies, including the United States. At present, production is recovering led by exports, and, along with the slowdown in exports, production is forecast to show a declining trend. Although demand for digital appliances is likely to remain strong throughout fiscal 2004, the shift of production to overseas manufacturing centers, including China, is expected to continue. In addition, capital investment is likely to level off, thus acting as a restraining factor on production.

The decline in production is likely to continue from the latter half of fiscal 2004 through the middle of fiscal 2005, but, because of the low levels of inventories, production adjustments are expected to be relatively mild. Production is likely to recover in the latter half of fiscal 2005, along with the bottoming out of overseas economies and the beginning of recovery in exports.

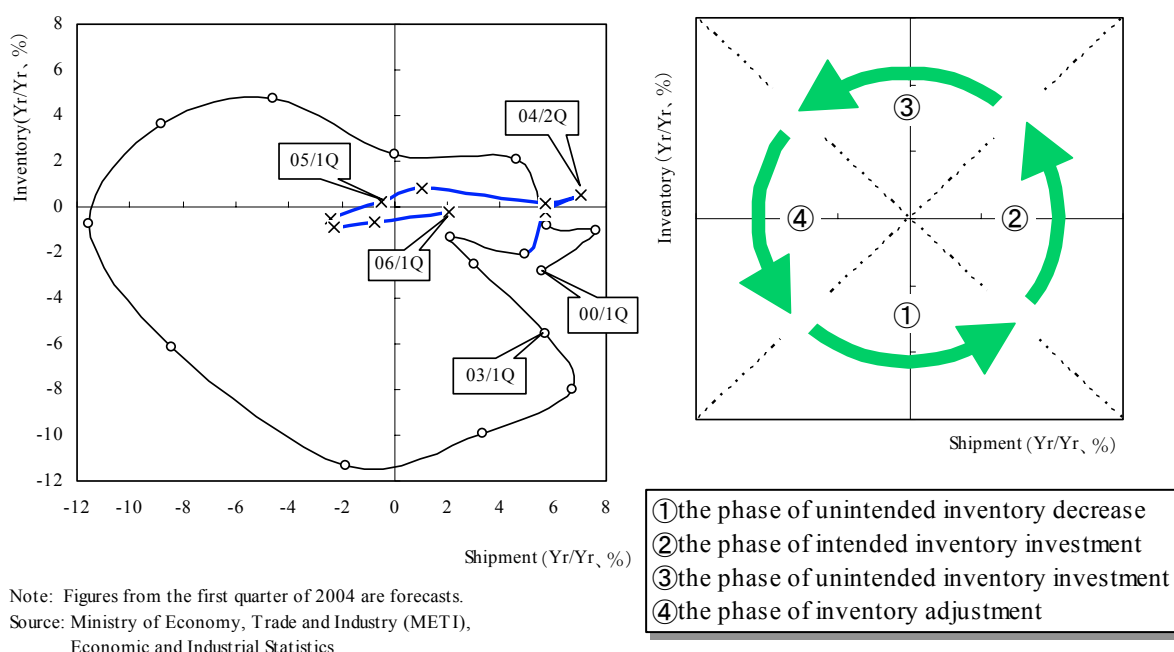
Exhibit 6: Outlook for Industry Production



At present, there are no signs that companies are building up inventories, in contrast with previous recoveries in production, and inventories remain at relatively low levels. Factors accounting for this include improvements in corporate inventory management technologies and the maintenance of a cautious attitude toward inventory investment among corporations because of the risk of declining prices of inventory stocks in the current deflationary economic setting. Other factors include the trend toward holding lower inventories in Japan as overseas production—principally of electric machinery in China and elsewhere—rises rapidly.

However, to cope with the current rapid growth in IT-related and certain other goods, we believe that a gradual trend toward building up inventories may emerge around the middle of 2004. Thereafter, if growth in demand levels off, there is a possibility of a rapid adjustment in production before the buildup in inventories becomes significant and a movement into an inventory adjustment phase through the beginning of fiscal 2005. Nevertheless, because the buildup in inventories is expected to be small, the adjustment will be relatively mild and will not result in a major reduction in production.

Exhibit 7: Inventory Cycle Movements



Corporate Profitability: Profits will remain on an upward trend but then decline in the latter half of fiscal 2004.

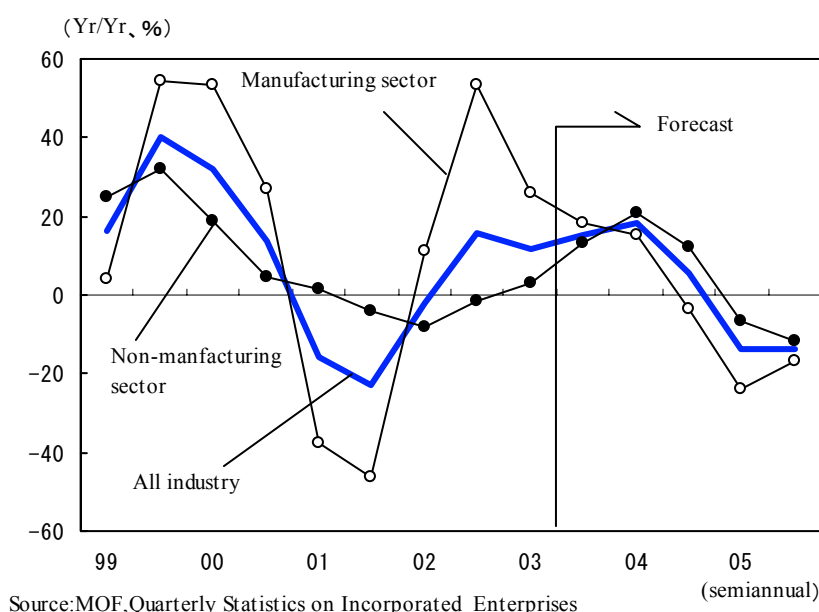
Corporate profitability is expected to show solid growth through the middle of fiscal 2004. In the manufacturing sector, although selling prices will remain weak, strong shipments of IT-related goods, including investment goods and digital appliances, are expected to bring increases in total sales. External demand is expected to remain favorable, and, despite the appreciation of the yen, exports are forecast to remain firm, thus acting as a factor boosting sales and profitability. In the nonmanufacturing sector, weakness in selling prices will have a minus effect on profitability, but, along with the increase in the flow of goods for export and for the domestic market, employment conditions are expected to begin to bottom out, thus bringing an increase in the tempo of improvement, lagging behind that in the manufacturing sector.

However, in the latter half of fiscal 2004, the environment for profitability will take a turn for the worse. First, the momentum of

domestic demand will weaken, including a slowdown in demand for capital goods. In addition, toward the end of 2004, exports will enter a slump, thus causing sales to plateau, and then begin to decline at year-end. On the one hand, the rise in international commodity prices will drive input costs upward, and the difficulty of passing higher costs onward to final consumers, on the other hand, will place downward pressures on profitability. In addition, companies may find that the positive effects of previous restructuring measures have run their course and that the increase in depreciation charges stemming from the rise in capital investment will be another factor pushing costs upward. For these reasons, we are forecasting that profitability in the manufacturing sector will begin to decline and that the margin of increase in profitability in the nonmanufacturing sector will diminish rapidly.

In fiscal 2005, we are looking for a larger margin of decline in profitability. However, as the recent rise in the ratio of current profit to sales shows, companies are successfully implementing measures that permit them to secure profits despite weakness in sales growth. Therefore, they are expected to avert a sharp plunge in profitability, and signs of recovery may emerge by the end of fiscal 2005.

Exhibit 8: Outlook for Corporate Performance



Private Capital Investment: Forecast to peak out at the end of fiscal 2004

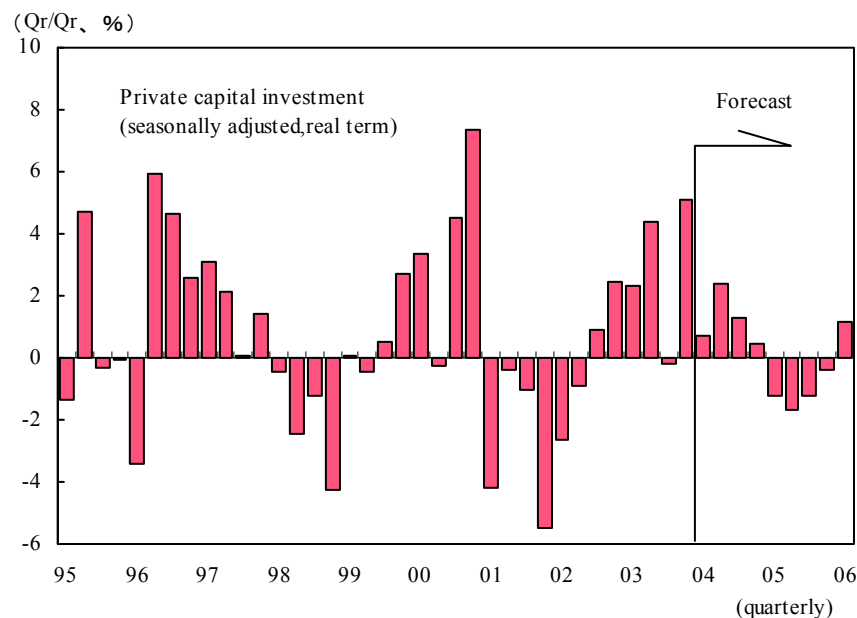
Private capital investment is continuing on a steady upward trend and is a driving force for the economy. Orders for machinery and equipment, which are a leading indicator for capital investment, climbed a substantial 11.3% over the previous quarter during the October–December period. According to outlook surveys, a slight decline of 0.2% is expected in the January–March quarter, but the level will remain high. We are forecasting growth in capital investment for fiscal 2004 as a whole, supported by recovery in corporate profitability.

The current recovery in capital investment began with corporations making outlays mainly for small-ticket items, including replacement and maintenance investments. For this reason, the pace of increase in investment was slower than the tempo of improvement in corporate earnings. However, corporate confidence is improving, as indicated by the return of the DIs(BOJ's Tankan survey) of corporate business sentiment among leading manufacturing companies to the positive range. Along with this development, large-scale investments, including those for the expansion of production capacity, which had been delayed previously, are now moving into the implementation phase. In addition, the DIs of business sentiment among small and medium-sized companies are also showing gradual improvement, and we believe that the range of companies making capital investments will gradually broaden.

Nevertheless, we are forecasting that the increase in capital investment will reach a peak during 2004; then, investment will begin to decline in fiscal 2005. The justification for this scenario is that corporations have allowed their investment expenditures to rise for more than two years and that the time has come for a pause. Corporations are reluctant to make investment expenditures that exceed their available cash, and this stance is likely to restrain investment spending. Another restraining factor will be deterioration in corporate performance. However, since production is likely to bottom out and the decline in performance is expected to be relatively mild, the reduction in investment will not be prolonged, and we are looking

for a bottoming out of investment by the end of fiscal 2005.

Exhibit 9: Private Capital Investment

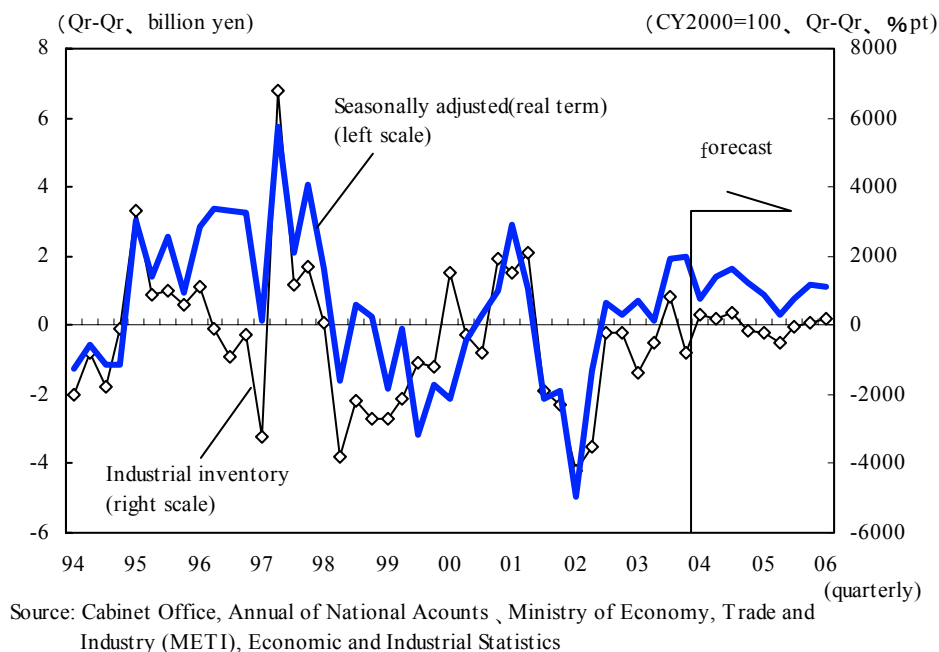


Sources: Cabinet Office, Annual of National Accounts

Private Inventory Investment: Fluctuations will remain small

Since companies have been cautious about adding to their inventories, inventory investment have made only a small contribution to GDP growth. However, as demand remains strong in the coming months, companies are expected to begin to increase their inventories, and inventory investment will make a positive, but small, contribution to growth. Nevertheless, since unintended inventory investment may take place gradually as the pace of shipments slows, the contribution of inventory investment to growth is likely to become negative in the latter half of fiscal 2004 as a result of inventory adjustments. For fiscal 2004 as a whole, the contribution of inventory investment to growth will be virtually unchanged. Inventory adjustments are likely to be completed in the first half of fiscal 2005, and the contribution to growth for fiscal 2005 as a whole is forecast to be slightly negative.

Exhibit 10: Inventory Investment



(c) Employment and Income Environments: Major improvement is not expected, but the individual sector will show slight increases.

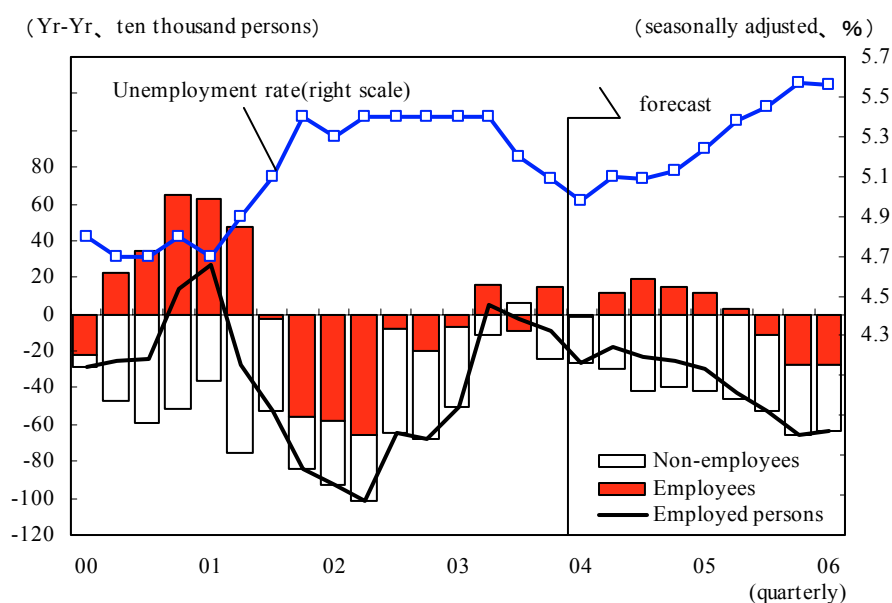
***Employment and Income Environments:** No major improvement is expected, and the unemployment rate may begin to rise again in fiscal 2005.*

The margin of decline in the number of employed persons has diminished along with recovery in the economy, and the most recent data show the number has returned to the level of the previous year. Factors accounting for this have been the lull in restructuring activities compared with the past and the increase in the employment of part-time and short-term contract workers, especially women. Although corporations still believe they have excess staff, if the recovery continues, some increase in the number of employees persons is expected as profitability improves. On the other hand, the number of other persons in the workforce, including self-employed and family workers, is expected to continue to decline, with relatively little relationship to the overall employment environment. Accordingly, the total

size of the workforce is forecast to decline from the previous year's level. In addition, in fiscal 2005, the number of employed persons is expected to begin to decline, lagging behind the deceleration in the economy, thus bringing an expansion in the margin of decline in the total workforce.

Although the unemployment rate will remain high because of the mismatching of supply and demand for workers, the lull in restructuring has brought a decline to 4.9%. If the employment environment improves, people who have lost the desire to work and dropped out of the workforce may begin to look for jobs again, but, on the other hand, some workers may leave their jobs voluntarily to look for new work. For these reasons, a major improvement in the unemployment rate is not expected, and it may begin to rise again in fiscal 2005 as the effects of the deceleration of the economy emerge.

Ehibit11: Employed Persons and Unemployment Rate



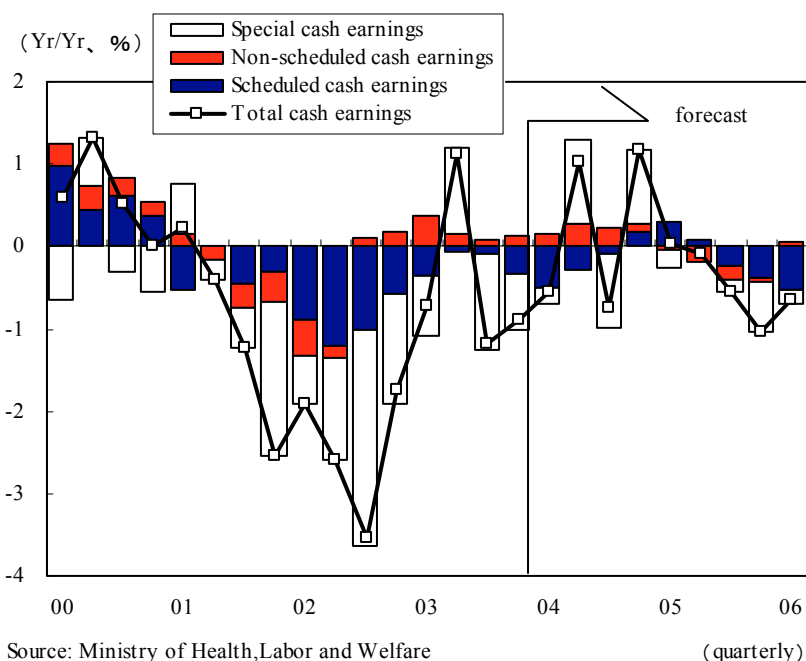
Note: 'Non-employees' consists of 'Self employed' and 'Family workers'.

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

Regarding wages, unscheduled compensation has begun to increase along with the recovery in production, and scheduled compensation is continuing to decline because of the impact of the rising percentage of

part-time and short-term contract workers. Moreover, special compensation in December 2003 declined 2.6% from the same month of the previous year, and there is a possibility that data to be released will show a decline in winter bonuses. Companies responding so far to requests from employees for spring wage increases in fiscal 2004 have replied “zero increase in base wages.” Since the rate of increase in wages is expected to about the same as in fiscal 2003, a major rise in scheduled wages is not expected. However, recovery in production and improvement in corporate profitability are likely to bring increases in unscheduled compensation and bonuses. In fiscal 2005, wages may begin to drop from the previous year as production levels decline and corporate profitability decelerates.

Ehibit12: Cash Earnings of Employees



Private Consumption: *Improvement in the employment and income environments will be marginal; private consumption will continue to expand gradually.*

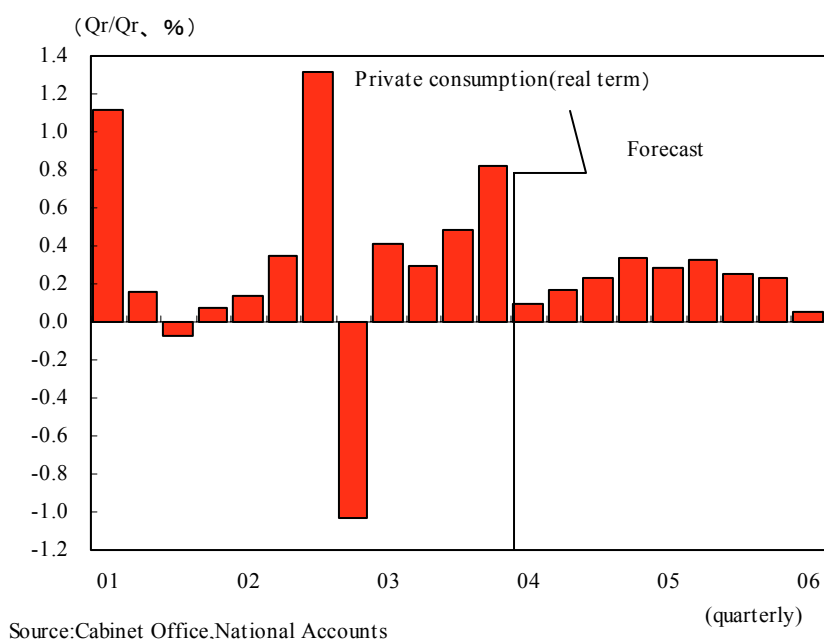
Real private consumption in the October–December quarter of 2003 showed relatively high growth of 0.8% over the previous quarter. Growth

in the January–March period of 2004 is expected to slow, in part as a reaction to the rapid growth in the previous quarter, but, for fiscal 2003 as a whole, private consumption is expected to grow 1.2% in real terms.

In fiscal 2004, growth in employment incomes will be weak and expansion in consumption will be restrained. However, consumption expenditure items that are difficult to restrain, such as health-care and education costs, will continue to be stable. In addition, consumer purchasing power in real terms will continue to be boosted by deflation, and real consumption for fiscal 2004 as a whole will rise 1.2%, about the same rate of growth as in the previous fiscal year.

Moving into fiscal 2005, signs of economic slowdown will become more prominent, and the employment and income environments will deteriorate. As a result, growth in private consumption is expected to decline.

Exhibit13: Real Private Consumption



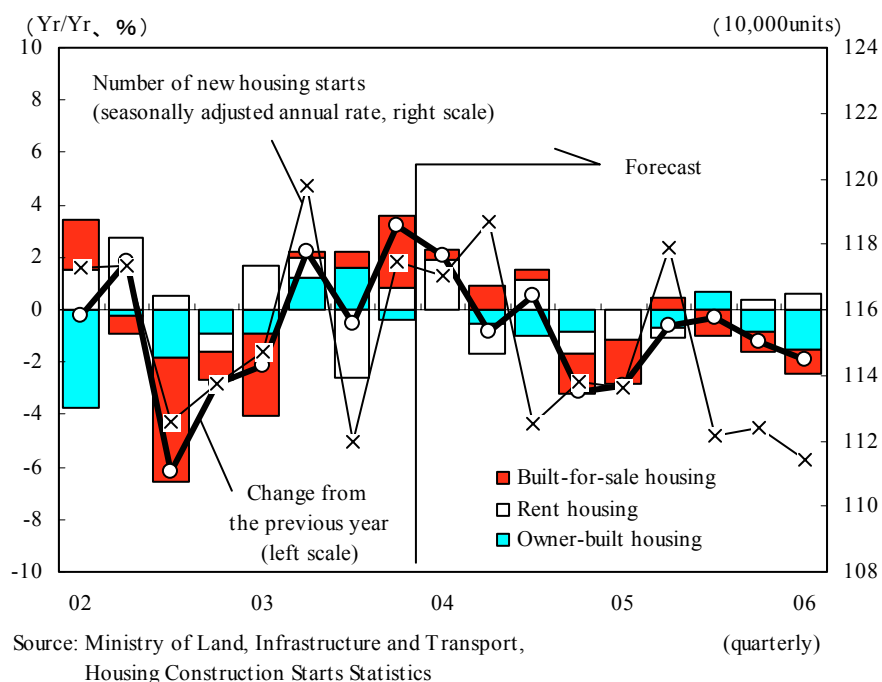
Private Residential Investment: *The number of new housing starts will be stagnant in fiscal 2004.*

Housing starts in calendar 2003 rose to 1.16 million units and stood 0.8% over those of the previous year, the first time for starts to rise above the prior year's level in three years. Factors accounting for this included the surge in demand created by the approaching deadline for the expiration of the housing loan tax relief measure and the implementation of revisions to the building code as well as a major rise in condominium starts in the Tokyo metropolitan area at year-end. Since starts of rental and built-for-sale housing are expected to rise in the January–March quarter of 2004, housing starts for fiscal 2003 are forecast to climb to 1.165 million units, an increase of 1.7% over the previous fiscal year and the first time in four years for them to rise above the prior year's level.

However, private residential investment is forecast to be weak in fiscal 2004. During the first half of the year, improvement in the employment and income environments will pause, and starts of owner-built housing will begin to decline. In the second half of the year, starts of condominiums and rental housing, which were on a rising trend up to that time, will decline. Housing starts for fiscal 2004 as a whole will fall below the previous year again, dropping to 1.147 million units.

Private residential investment is likely to remain stagnant in fiscal 2005 as well. Although starts of rental housing will continue at the levels of the previous year, sustained by low interest rates and the needs of landowners to make good use of their assets, as the employment and income environments deteriorate, starts of owner-built and built-for-sale housing will decline.

Exhibit 14: Outlook for Housing Starts



(d) Government Spending: The decline in government public investment spending will continue, but government consumption expenditures will continue to make a positive contribution.

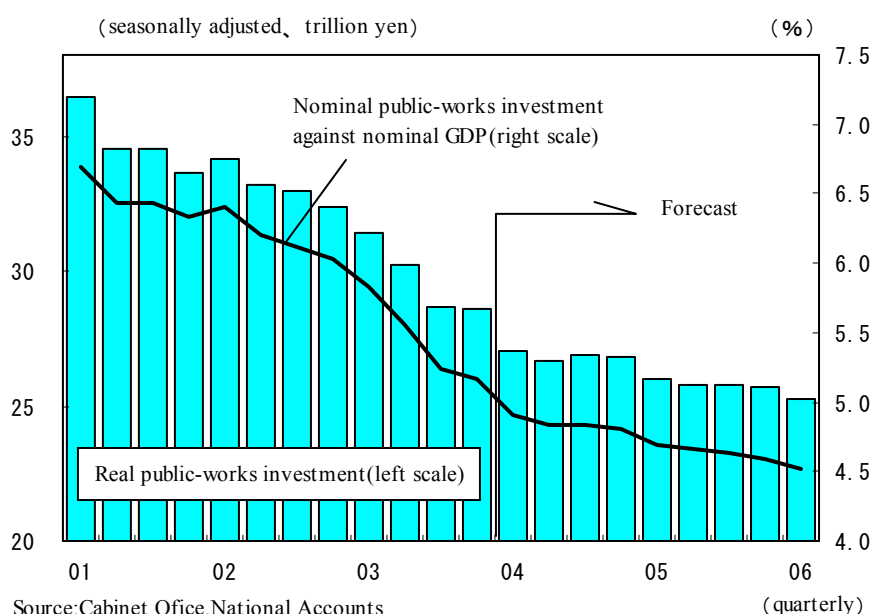
Government Public Investment: *No additional public works allocations will be made in a supplementary budget, and the declining trend will accelerate at the end of fiscal 2003.*

During the first half of fiscal 2003, public works construction was cut because of severe budgetary restraints, and the declining trend in government public investment became more pronounced. The pace of the decline in the October–December quarter of 2003 was relatively mild, but because the government decided not to pass a supplementary budget with additional public investment allocations, the deceleration of public works projects will become more pronounced again at the end of the fiscal year. For fiscal 2003, government public investment is forecast to show a substantial decline of 12.1% from the prior year.

Similarly, in fiscal 2004, public investment budgets will most likely be cut, with national government public works related allocations dropping 3.5% and local government allocations of an investment nature falling 8.4%. From the beginning of fiscal 2004, the government's decision not to pass a supplementary budget with additional public works allocations will act as a restraining factor, and public investment spending will remain at a relatively low level. However, during the July–September quarter, the declining trend will level out as the implementation of the fiscal 2004 budget proceeds. Nevertheless, the volume of government investment for the year as a whole will decline, and expenditures will begin to fall again in subsequent quarters. The margin of decline in public works spending in fiscal 2004 will be smaller than in fiscal 2003.

The downward trend in government public investment spending is expected to continue in fiscal 2005, but, because the extent of the budget cutbacks will be smaller than in prior years, the pace of decline will be more gradual.

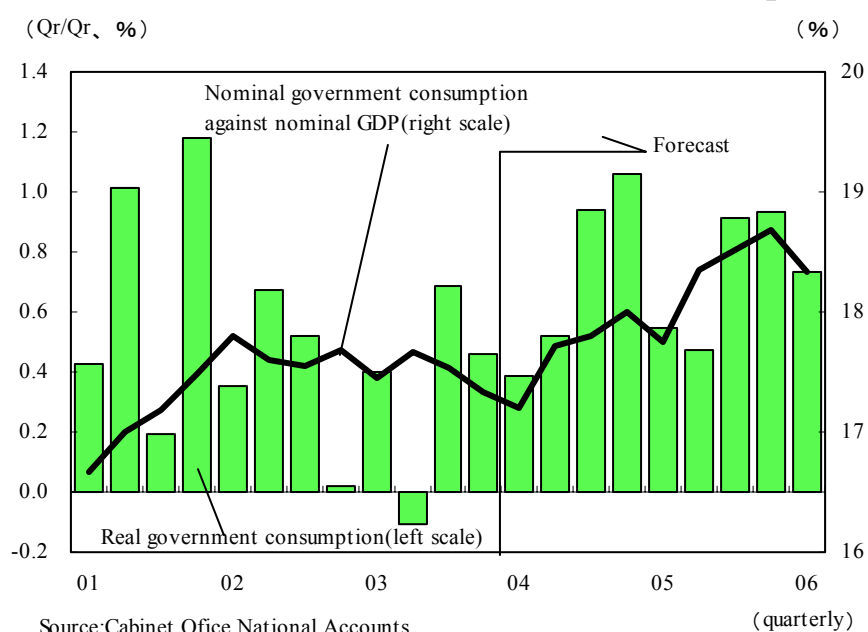
Exhibit 15: Outlook for Public-works Investment



Government Final Consumption Expenditure: Increase in expenditures will continue because of expansion in health-care and nursing costs.

Government final consumption expenditures in real terms during the October–December quarter of 2003 continued to rise, standing 0.5% higher than for the previous quarter. These expenditures fell at the start of the fiscal year because of increases in the percentage of health-care costs borne by recipients, but, as the demographic aging of the population continues, health-care and nursing costs will remain on an upward trend. For this reason, government consumption expenditures are expected to continue to rise, mainly because of a higher level of social welfare goods and services provided in kind. The growth of real government final consumption will increase in fiscal 2004, as the effect of changes in the system for diagnostic benefits run their course, and further steady increases will continue in fiscal 2005.

Exhibit 16: Outlook for Government Consumption

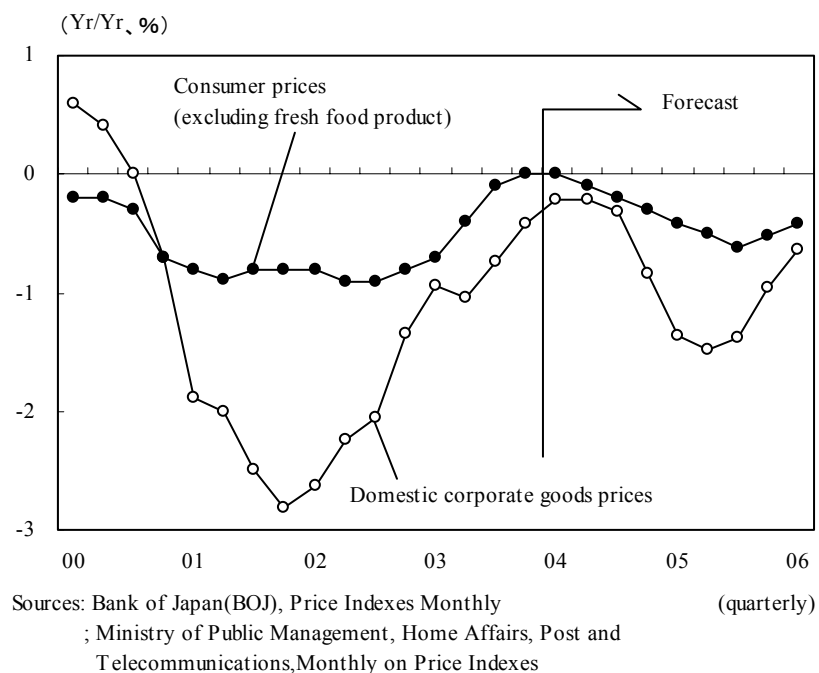


(e) Prices: Deflationary pressures to persist

The margin of decline in domestic corporate goods prices is shrinking along with the bottoming out and increase in demand accompanying the recovery in the economy and the rise in inflationary pressures coming from upstream as international commodity prices rise. However, companies downstream must cope with excess capacity and the expansion of low-cost imports and are therefore finding it difficult to pass on higher costs and raise their selling prices. Even if the upward trend in international commodity prices continues, pressures for increasing prices downstream will be marginal. Since costs of industrial materials and agricultural products are rising, the margin of decline in prices is expected to continue to shrink for the time being, but (i) when supply/demand conditions become more relaxed in the latter half of fiscal 2004 as the economy slows and (ii) deflationary pressures coming from declines in prices of crude oil and international commodities become stronger, the margin of decline in domestic corporate goods prices is expected to increase. In the latter half of fiscal 2005, the supply/demand balance may tighten again along with the recovery in the economy, thus bringing the resumption of a shrinkage in the margin of decline in prices.

The margin of decline in consumer prices has moved back to zero compared with the previous year as a result of a number of special factors, including an increase in the percentage of health-care costs that must be paid by recipients (April 2003) and an increase in the tobacco tax (July 2003) as well as the shrinkage in the margin of decline in domestic corporate goods prices. In the coming quarters, however, the impact of these special factors will run their course, and the margin of decline in consumer prices is forecast to expand again. In the latter half of fiscal 2005, along with a shrinkage in the margin of decline of domestic corporate goods prices, the margin of decline in consumer prices is also likely to diminish.

Exhibit 17: Outlook for Price



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

Economic Outlook for fiscal 2004-2005

			Forecast										half/half, %
	FY2002		FY2003		FY2004		FY2005		FY2002 (actual)	FY2003 (forecast)	FY2004 (forecast)	FY2005 (forecast)	Yr/Yr, %
	First half	Second half	First half	Second half	First half	Second half	First half	Second half					
Nominal G D P	0.4	-0.6	0.6	0.3	-0.2	-0.4	-0.9	0.2	-0.7	0.4	-0.2	-1.0	
	-1.1	-0.2	0.1	0.7	0.2	-0.6	-1.3	-0.7					
Real G D P	1.5	0.7	1.5	1.9	0.9	0.2	-0.1	0.7	1.2	2.7	1.9	0.4	
	0.1	2.2	2.2	3.3	2.8	1.0	0.1	0.6					
Contribution of domestic demand(Qr/Qr, %)	0.9	0.5	1.0	1.5	0.8	0.5	-0.2	0.4	0.4	2.0	1.7	0.2	
Private consumption	1.1	-0.2	0.7	1.1	0.3	0.6	0.6	0.4	1.0	1.2	1.2	1.1	
	1.1	0.9	0.5	1.9	1.4	1.0	1.2	1.0					
Housing investment	-0.7	-1.7	0.9	1.0	-1.2	-2.5	-0.3	-4.5	-2.1	0.5	-2.0	-3.8	
	-1.9	-2.3	-0.8	1.9	-0.3	-3.6	-2.8	-4.8					
Private capital investment	-1.8	4.1	5.5	5.3	3.4	0.4	-2.9	-0.5	-3.3	10.4	6.2	-2.9	
	-8.9	2.3	9.8	11.1	9.0	3.7	-2.5	-3.3					
Contribution of Inventory investment	0.6	0.2	0.1	0.1	0.0	-0.1	-0.1	0.1	0.4	0.2	0.0	-0.1	
Government expenditure	0.2	-0.7	-1.6	-0.6	0.0	1.1	0.4	1.1	0.1	-2.3	0.3	1.6	
	0.9	-0.6	-2.1	-2.6	-0.3	1.0	1.7	1.5					
Public investment	-2.3	-3.7	-7.6	-5.5	-3.8	-1.4	-2.4	-1.1	-5.0	-12.1	-6.8	-3.6	
	-4.3	-5.5	-11.5	-12.5	-9.1	-5.1	-3.9	-3.4					
Government final consumption expenditure	1.1	0.5	0.4	1.0	1.2	1.8	1.2	1.8	2.1	1.2	2.6	3.0	
	2.5	1.6	0.9	1.5	2.2	3.0	3.0	3.0					
Contribution of external demand	0.6	0.2	0.4	0.4	0.1	-0.3	0.1	0.4	0.8	0.7	0.2	0.2	
Export of goods and services	10.0	4.3	3.9	6.7	5.0	-2.1	0.5	5.6	12.0	9.6	7.2	2.2	
	9.2	14.9	8.2	10.9	12.0	2.8	-1.6	6.1					
Import of goods and services	5.4	3.0	0.5	4.2	5.8	-0.0	-0.3	3.5	5.5	4.3	7.9	1.4	
	2.5	8.5	3.5	4.9	10.1	5.8	-0.4	3.1					
G D P deflator (Yr/Yr, %)	-1.2	-2.4	-2.1	-2.5	-2.5	-1.6	-1.4	-1.3	-1.8	-2.3	-2.1	-1.4	

Forecast												
	FY2002		FY2003		FY2004		FY2005		FY2002	FY2003	FY2004	
	First half	Second half	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)	
Current account balance (trillion yen)	7.0	6.4	8.4	8.3	7.0	6.7	6.8	8.6	13.4	16.7	13.7	
balance on goods (trillion yen)	6.0	5.6	6.0	7.2	6.1	6.3	5.7	7.1	11.6	13.2	12.4	
balance on service (trillion yen)	-2.7	-2.5	-1.7	-2.3	-2.2	-2.5	-2.4	-2.5	-5.2	-4.0	-4.6	
balance on income (trillion yen)	4.1	3.9	4.3	3.8	3.5	3.3	3.8	4.4	8.0	8.1	6.8	
Industrial production	(4.2)	(1.5)	(0.1)	(4.9)	(1.8)	(-1.0)	(-1.4)	(2.2)	2.8	3.1	3.6	
Corporate goods prices	-2.3	-1.3	-0.9	-1.6	-0.8	-0.6	-1.4	-0.7	-1.8	-1.2	-0.7	
Domestic corporate goods prices	-2.1	-1.1	-0.9	-0.3	-0.3	-1.1	-1.4	-0.8	-1.6	-0.6	-0.7	
Consumer prices	-0.9	-0.4	-0.3	-0.3	-0.3	-0.3	-0.6	-0.5	-0.6	-0.3	-0.3	
excluding freshfood	-0.9	-0.8	-0.3	0.0	-0.2	-0.4	-0.6	-0.5	-0.8	-0.1	-0.3	
Yen/U.S.Dollar	123.1	120.7	118.0	107.3	106.3	108.3	107.5	110.3	121.9	112.6	107.3	
Newly issued government bond yields (10years)	1.3	0.9	0.9	1.3	1.4	1.3	1.2	1.4	1.1	1.1	1.3	
Crude oil price (U.S.dollar/barrel)	27.3	31.0	29.6	32.3	31.5	29.5	28.0	29.5	29.1	30.9	30.5	
U.S. Real GDP (CY) (seasonally-adjusted annual rate)	3.3	2.5	2.1	5.9	4.4	3.7	1.7	2.0	2.2	3.1	4.6	
Spring wage increases *	—	—	—	—	—	—	—	—	1.66	1.63	1.63	

Notes:

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

(Compiled by the Ministry of Health, Labour and Welfare)

【Exports and Imports】

	FY2002		FY2003		FY2004		FY2005		FY2002	FY2003	FY2004	FY2005
	First half	Second half	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)	(forecast)
Exports (yen basis)	6.5	10.5	4.9	5.6	6.7	2.1	-2.9	4.8	8.5	5.3	4.3	0.9
Volume	10.2	11.1	2.8	8.4	9.1	0.3	-2.7	1.7	10.7	5.6	4.5	-0.5
Imports (yen basis)	-1.2	8.8	6.4	-0.8	7.8	6.8	-2.0	2.4	3.7	2.6	7.3	0.2
Volume	4.1	6.9	6.7	7.8	8.2	4.8	0.2	3.0	5.5	7.3	6.4	1.6
Exports surplus (trillion yen)	5.1	4.6	5.1	6.3	5.1	5.4	4.8	6.2	9.7	11.3	10.5	11.0

【Income and Employment】

	FY2002		FY2003		FY2004		FY2005		FY2002	FY2003	FY2004	FY2005
	First half	Second half	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)	(forecast)
Cash earnings of employees (per capita)	-3.1	-1.3	0.0	-0.7	0.2	0.7	-0.3	-0.9	-2.2	-0.4	0.4	-0.6
Regular compensation*	-1.5	-0.7	-0.1	-0.5	-0.2	0.3	-0.1	-0.6	-1.1	-0.3	0.0	-0.3
Overtime compensation	-0.7	4.9	2.3	2.4	4.9	0.7	-3.3	-0.1	2.1	2.4	2.7	-1.7
Number of employees	-0.7	-0.3	0.1	0.1	0.3	0.3	-0.1	-0.5	-0.5	0.1	0.3	-0.3
Compensation of employees*	-3.5	-1.8	-0.5	-0.3	0.7	1.1	-0.1	-1.1	-2.6	-0.4	0.9	-0.6
Unemployment rate	5.4	5.4	5.3	5.0	5.1	5.2	5.4	5.6	5.4	5.2	5.1	5.5

Notes:

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

【New Housing Starts】

	FY2002		FY2003		FY2004		FY2005		FY2002	FY2003	FY2004	FY2005
	First half	Second half	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)	(forecast)
New housing starts	114.9	114.4	115.9	117.3	115.6	113.7	115.0	111.9	114.6	116.5	114.7	113.6
(change from the previous year)	-2.2	-2.5	0.9	2.7	-0.2	-3.0	-0.5	-1.6	-2.4	1.7	-1.6	-1.0
Owner-built housing	36.9	36.3	38.2	36.3	37.2	35.8	37.2	34.4	36.6	37.3	36.5	35.9
Rental housing	45.5	45.5	44.6	47.0	44.5	45.8	44.3	46.4	45.5	45.6	45.1	45.2
Built-for-sale housing	31.5	31.7	32.2	33.3	33.0	31.5	32.7	30.6	31.6	32.8	32.3	31.7
	-9.5	-7.8	1.6	5.7	2.5	-5.3	-0.9	-2.8	-8.1	3.7	-1.5	-1.8

Economic Outlook (Quarterly)

	FY2003				FY2004				FY2005			
	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3
	Forecast											
Nominal GDP	0.6	0.3	0.7	-0.9	0.0	0.5	-0.2	-0.9	-0.7	0.4	0.3	-0.5
	0.3	-0.1	0.9	0.5	0.2	0.2	-0.6	-0.7	-1.1	-1.5	-0.8	-0.6
Real GDP	0.8	0.6	1.7	-0.3	0.7	0.6	-0.0	-0.2	-0.2	0.4	0.3	0.3
	2.3	2.0	3.6	3.0	2.9	2.8	0.9	1.2	0.2	-0.0	0.4	0.8
Contribution of domestic demand(Qr/Qr, %)	0.5	0.5	1.3	-0.2	0.6	0.6	0.3	-0.2	-0.2	0.2	0.1	0.2
Private consumption	0.3	0.5	0.8	0.1	0.2	0.2	0.3	0.3	0.3	0.3	0.2	0.1
	1.0	0.1	2.1	1.7	1.6	1.3	0.9	1.0	1.2	1.2	1.1	0.9
Housing investment	-0.1	2.9	-1.0	1.1	-1.9	0.3	-2.6	-0.2	-0.9	1.4	-4.2	-1.9
	-3.2	1.4	1.0	2.9	0.9	-1.4	-3.0	-4.3	-3.4	-2.3	-4.0	-5.6
Private capital investment	4.4	-0.2	5.1	0.7	2.4	1.3	0.4	-1.2	-1.7	-1.2	-0.4	1.2
	10.8	8.9	12.4	10.0	8.3	9.5	5.0	2.7	-1.1	-3.8	-4.4	-2.2
Contribution of inventory investment(Qr/Qr, %)	-0.1	0.3	0.0	-0.2	0.1	0.0	-0.1	-0.1	-0.1	0.1	0.1	-0.0
Government expenditure	-1.0	-0.8	0.2	-0.9	0.1	0.8	0.7	-0.1	0.2	0.7	0.7	0.3
	-1.4	-2.7	-2.5	-2.7	-0.9	0.3	0.5	1.5	1.8	1.5	1.2	1.7
Public investment	-3.7	-5.1	-0.2	-5.5	-1.3	0.7	-0.3	-2.9	-1.0	0.1	-0.3	-1.6
	-9.2	-13.5	-11.7	-13.4	-11.9	-6.5	-6.4	-3.5	-3.5	-4.2	-4.1	-2.7
Government final expenditure	-0.1	0.7	0.5	0.4	0.5	0.9	1.1	0.5	0.5	0.9	0.9	0.7
	0.8	1.0	1.5	1.4	2.0	2.3	3.0	3.1	3.0	3.0	2.9	3.1
Contribution of external demand(Qr/Qr, %)	0.3	0.2	0.4	-0.1	0.1	-0.0	-0.3	-0.0	-0.0	0.2	0.2	0.1
Export of goods and services	1.6	3.2	4.2	1.6	4.0	0.4	-1.7	-1.3	-0.4	3.2	3.0	1.8
	6.6	9.8	10.9	11.0	13.5	10.5	4.3	1.3	-3.0	-0.3	4.5	7.8
Import of goods and services	-1.2	2.6	1.4	2.8	3.9	0.8	0.4	-1.7	-0.4	1.8	2.0	1.2
	3.5	3.6	3.7	6.2	10.9	9.2	8.2	3.4	-0.8	0.1	1.7	4.6
GDP deflator (Yr/Yr, %)	-2.0	-2.1	-2.6	-2.4	-2.6	-2.4	-1.5	-1.8	-1.3	-1.5	-1.2	-1.5

	FY2003				FY2004				FY2005			
	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3	4-6	7-9	10-12	1-3
	Forecast											
Current account balance (trillion yen)	3.8	4.6	4.0	4.4	3.5	3.5	3.1	3.6	3.3	3.5	3.7	4.8
Balance on goods (trillion yen)	2.8	3.2	3.7	3.5	3.0	3.1	3.3	3.0	2.8	2.9	3.4	3.6
Balance on service (trillion yen)	-0.7	-0.9	-1.2	-1.1	-1.1	-1.1	-1.3	-1.2	-1.2	-1.2	-1.3	-1.2
Balance on income (trillion yen)	1.9	2.4	1.7	2.1	1.8	1.7	1.3	1.9	1.9	1.9	1.9	2.6
Industrial production	-0.7	1.3	3.7	1.0	1.2	0.1	-0.6	-1.0	-1.2	0.5	1.1	1.7
	2.2	0.9	4.0	5.3	7.6	5.9	1.4	-0.3	-2.5	-2.3	-0.7	2.1
Corporate goods prices	-1.4	-0.3	-1.9	-1.2	-0.9	-0.7	-0.3	-0.8	-1.4	-1.5	-1.1	-0.3
Domestic corporate goods prices	-1.0	-0.7	-0.4	-0.2	-0.2	-0.3	-0.8	-1.4	-1.5	-1.4	-1.0	-0.6
Consumer prices	-0.3	-0.2	-0.3	-0.2	-0.3	-0.2	-0.2	-0.4	-0.5	-0.6	-0.5	-0.4
excluding freshfood	-0.4	-0.1	0.0	0.0	-0.1	-0.2	-0.3	-0.4	-0.5	-0.6	-0.5	-0.4
Yen/U.S.Dollar	118.4	117.6	108.9	105.7	105.5	107.0	108.5	108.0	107.0	108.0	109.5	111.0
Newly issued government bond yields (10years)	0.6	1.2	1.4	1.3	1.4	1.4	1.3	1.2	1.2	1.3	1.3	1.4
Crude oil price (U.S.dollar/barrel)	28.9	30.2	31.2	33.5	32.0	31.0	30.0	29.0	28.0	28.0	29.0	30.0

【Exports and Imports】

	FY2003				FY2004				FY2005				Yr/Yr, %
	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)	2.8	7.1	4.0	7.3	6.6	6.8	3.9	0.1	-3.5	-2.4	2.0	7.8	
Volume	2.8	2.9	7.3	9.5	9.3	8.9	1.7	-1.3	-3.0	-2.4	0.0	3.6	
Imports (yen basis)	6.3	6.5	-0.5	-1.2	6.3	9.3	8.8	4.7	-2.2	-1.8	0.8	4.1	
Volume	8.4	5.0	7.1	8.6	7.7	8.7	6.3	3.3	0.5	0.0	1.8	4.3	
Exports surplus (trillion yen)	2.4	2.7	3.2	3.1	2.6	2.6	2.8	2.6	2.3	2.5	3.0	3.2	

【Income and Employment】

	FY2003				FY2004				FY2005				Yr/Yr, %
	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)	1.1	-1.2	-0.9	-0.6	1.0	-0.7	1.2	0.0	-0.1	-0.6	-1.0	-0.7	
Regular compensation*	-0.1	-0.1	-0.5	-0.6	-0.4	-0.1	0.3	0.3	0.1	-0.3	-0.6	-0.6	
Overtime compensation	3.1	1.5	2.6	2.3	5.4	4.3	2.0	-0.5	-3.4	-3.2	-1.0	0.8	
Number of employees	0.3	-0.2	0.3	0.0	0.2	0.4	0.3	0.2	0.1	-0.2	-0.5	-0.5	
Compensation of employees*	1.0	-2.2	-0.2	-0.4	1.4	-0.1	1.5	0.5	0.2	-0.5	-1.2	-0.9	
Unemployment rate	5.4	5.2	5.1	5.0	5.1	5.1	5.1	5.2	5.4	5.5	5.6	5.6	

Notes:

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

【New Housing Starts】

	FY2003				FY2004				FY2005				ten thousand units(annualized) Yr/Yr, %
	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	119.8	112.0	117.5	117.0	118.7	112.5	113.8	113.6	117.9	112.2	112.4	111.4	
(change from the previous year)	2.2	-0.6	3.2	2.1	-0.8	0.5	-3.2	-2.9	-0.6	-0.3	-1.3	-1.9	
Owner-built housing	38.5	37.9	36.2	36.3	37.8	36.6	35.1	36.4	37.1	37.3	34.1	34.6	
Rental housing	45.9	43.2	45.5	48.5	44.3	44.8	44.6	47.0	43.8	44.9	45.0	47.7	
Built-for-sale housing	32.7	31.7	34.6	32.0	33.8	32.2	32.7	30.3	34.4	31.1	31.9	29.3	
	0.8	2.5	9.8	1.3	3.5	1.4	-5.1	-5.5	1.6	-3.5	-2.6	-3.1	

Economic Outlook for calendar 2004-2005

	Forecast						half/half, % Yr/Yr, %		
	CY2003		CY2004		CY2005		CY2003	CY2004	CY2005
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Nominal G D P	-0.4	0.9	-0.6	0.4	-1.4	0.2	0.2	0.1	-1.0
	-0.1	0.4	0.3	-0.2	-0.9	-1.1			
Real G D P	1.0	1.9	0.9	0.9	-0.3	0.5	2.7	2.4	0.4
	2.6	2.8	2.9	1.8	0.7	0.2			
Contribution of domestic demand	0.6	1.4	0.7	1.0	-0.1	0.2	2.0	2.0	0.5
Private consumption	0.0	1.1	0.6	0.5	0.6	0.5	1.1	1.4	1.1
	1.0	1.1	1.7	1.1	1.1	1.2			
Housing investment	-1.3	2.3	-0.4	-1.9	-1.9	-1.2	-0.6	-0.3	-3.5
	-2.5	1.2	1.9	-2.2	-3.8	-3.1			
Private capital investment	5.8	4.5	4.4	2.7	-1.9	-2.3	8.8	8.2	-1.6
	7.1	10.6	9.2	7.3	0.9	-4.1			
Contributory of Inventory investment	-0.0	0.3	-0.2	0.1	-0.2	0.1	0.5	0.0	-0.1
Government expenditure	-1.2	-1.2	-0.8	1.2	0.3	1.1	-1.9	-0.7	1.5
	-1.1	-2.6	-1.8	0.4	1.7	1.3			
Public investment	-5.7	-7.0	-6.2	-0.1	-3.5	-0.5	-10.2	-9.6	-3.9
	-7.8	-12.5	-12.8	-6.5	-3.5	-4.1			
Government final consumption expenditure	0.4	0.9	0.9	1.7	1.3	1.6	1.2	2.2	3.0
	1.2	1.3	1.7	2.6	3.1	3.0			
Contribution of external demand	0.4	0.5	0.2	-0.1	-0.1	0.3	0.7	0.4	-0.0
Export of goods and services	3.9	6.2	5.8	1.5	-2.4	4.5	9.9	9.7	0.6
	9.4	10.4	12.3	7.3	-0.9	2.1			
Import of goods and services	0.9	2.7	5.6	3.0	-1.7	2.6	4.7	8.6	1.1
	5.8	3.6	8.6	8.7	1.3	0.9			
GDP deflator	-2.6	-2.3	-2.5	-2.0	-1.6	-1.3	-2.4	-2.2	-1.4

	Forecast						Yr/Yr, %		
	CY2003		CY2004		CY2005		CY2003	CY2004	CY2005
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Current account balance (trillion yen)	7.3	8.5	7.9	6.6	6.9	7.2	15.8	14.5	13.7
balance on goods (trillion yen)	5.3	6.9	6.5	6.3	5.8	6.4	12.3	12.9	12.2
balance on service (trillion yen)	-1.7	-2.2	-2.2	-2.4	-2.4	-2.5	-3.9	-4.6	-4.9
balance on income (trillion yen)	4.2	4.1	3.9	3.1	3.8	3.8	8.3	7.0	7.6
Industrial production	0.2	2.8	3.5	0.4	-1.8	0.5	3.1	5.0	-1.4
	3.9	2.4	6.4	3.6	-1.4	-1.5			
Corporate goods prices	-1.5	-1.1	-1.1	-0.5	-1.1	-1.3	-1.3	-0.8	-1.2
Domestic corporate goods prices	-1.0	-0.6	-0.2	-0.6	-1.4	-1.2	-0.8	-0.4	-1.3
Consumer prices	-0.3	-0.3	-0.3	-0.2	-0.5	-0.6	-0.3	-0.2	-0.5
excluding freshfood	-0.6	-0.1	-0.1	-0.3	-0.5	-0.6	-0.3	-0.2	-0.5
Yen/U.S.Dollar	118.6	113.2	105.6	107.8	107.5	108.8	115.9	106.7	108.1
Newly issued government bond yields (10year)	0.70	1.29	1.30	1.35	1.20	1.28	0.99	1.33	1.24
Crude oil price (U.S.dollar/barrel)	31.4	30.7	32.8	30.5	28.5	28.5	31.0	31.6	28.5
U.S. Real GDP (CY)									
(seasonally-adjusted annual rate)	2.1	5.9	4.4	3.7	1.7	2.0	3.1	4.6	2.3
Spring wage increases *	—	—	—	—	—	—	1.63	1.63	1.61

Notes:

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

【Exports and Imports】

	Forecast						Yr/Yr, %		
	CY2003		CY2004		CY2005		CY2003	CY2004	CY2005
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Exports (yen basis)	3.9	5.5	7.0	5.3	-1.7	-0.2	4.7	6.1	-0.9
Volume	5.2	5.2	9.4	5.2	-2.2	-1.2	5.2	7.2	-1.7
Imports (yen basis)	7.2	2.8	2.5	9.0	1.1	-0.5	5.0	5.8	0.3
Volume	8.4	6.1	8.1	7.5	1.8	0.9	7.2	7.8	1.4
Exports surplus (trillion yen)	4.4	5.9	5.7	5.3	4.9	5.4	10.2	12.2	11.4

【Income and Employment】

	Forecast						Yr/Yr, %		
	CY2003		CY2004		CY2005		CY2003	CY2004	CY2005
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Cash earnings of employees (per capita)	0.3	-1.0	0.3	0.3	0.0	-0.8	-0.4	0.3	0.5
Regular compensation*	-0.3	-0.3	-0.5	0.1	0.2	-0.4	-0.3	-0.2	-0.1
Overtime compensation	4.6	2.0	3.8	3.1	-2.0	-2.1	3.3	3.5	-2.0
Number of employees	0.1	0.0	0.1	0.3	0.1	-0.4	0.1	0.2	-0.1
Compensation of employees*	0.0	-1.1	0.6	0.8	0.3	-0.9	-0.6	0.7	-0.3
Unemployment rate	5.4	5.2	5.0	5.1	5.3	5.5	5.3	5.1	5.4

Notes:

* 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, %		
	CY2003		CY2004		CY2005		CY2003	CY2004	CY2005
	First half	Second half	First half	Second half	First half	Second half	(actual)	(forecast)	(forecast)
Number of new housing starts	117.2	114.7	117.9	113.2	115.8	112.3	114.9	112.7	112.2
(change from the previous year)	-0.2	1.4	0.5	-1.3	-1.8	-0.8	-0.2	-1.9	-0.4
Owner-built housing	37.3	37.0	37.1	35.9	36.7	35.7	36.9	35.8	35.3
Rental housing	46.0	44.4	46.4	44.7	45.4	45.0	45.3	44.7	44.6
Built-for-sale housing	32.2	33.1	32.9	32.5	32.3	31.5	31.8	31.5	32.0
	-4.6	6.3	2.4	-2.0	-1.9	-3.0	-1.8	-0.8	1.4