Outlook for Domestic and Overseas Economies during Fiscal 2000-2001
(revision of December 1999 forecast)

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Overview

Self-Sustained Recovery Nears

The recovery of the Japanese economy faltered temporarily in the second half of 1999 due to a downward turn in consumer spending, housing investment and public investment stemming from factors including the anticipated waning effect of economic policy measures. During this period, however, sign of an end in wage restructuring began to emerge, and capital investment bottomed out due to an upturn in corporate profits, which firmed up the foundations for a self-sustained recovery supported by private sector demand. Supported by these development, the economic recovery should begin in earnest in fiscal 2000 centering on consumer spending and capital investment. However, due to the peaking out of housing investment and the slump in exports caused by the strong yen, fiscal 2001 growth will not be as high as would be expected for the third year of an economic recovery. We have lowered the growth rate we forecasted for fiscal 1999 in our previous report (December 1999) from 1.1% to 0.6% in light of the slowdown in public investment and sharp increase in imports; however, we have increased the growth rate for 2000 from 1.7% to 1.8% in recognition of the steady recovery in capital investment. We expect 2.4% growth in fiscal 2001, which is included in the forecast period beginning with this report.

Meanwhile, the U.S. economy remains as strong as ever, and if the effect of monetary tightening do to emerge in 2001, they will not emerge at all. Economic growth is expected to reach 4.0% in 2000 (as opposed to 3.0% in the previous forecast) and 2.8% in 2001.

1.Current State of the Japanese and U.S. Economies

In the second half of 1999, the Japanese economy was buffeted by several developments which led to an inevitable pause in the recovery, including the expected diminution in the effect of tax cuts, the continued slide in consumer spending amid ongoing wage restructuring, the fading impact of government policies on housing investment and public investment, and the sharp rise in imports spurred by the strong yen. However, the rebound in capital investment at the end of 1999 thanks to steady increase in the corporate earnings indicate that the economy is not heading toward bottom again.

An analysis of financial markets reveals a continued leveling off of long- and short-term interest rates at an extremely low level since the beginning of fiscal 1999. After reaching its weakest point in summer of 1998, the yen strengthened somewhat sharply until autumn of 1999 and now is holding steadily in the JPY105 - JPY110 range.

The U.S. economy continues to surge forward, with 4.1% growth in 1999. In February 2000, the U.S. achieved the longest economic expansion in the country's history. Between June of last year and March of this year, the Federal Reserve Board (FRB) raised short-term interest rates a total of 1.25 percentage points, but these hikes have yet to show an effect. Passenger vehicle sales and housing investment appear to have picked up speed again. Meanwhile, the economies of Europe and Asia are on a steady recovery path. Thus, the global economy in 1999 has completely overcome the recession of 1998.

ゆか. Outlook for the Japanese and U.S. Economies

a. Forecast for Japanese economy

Economic growth will reach 1.8% in fiscal 2000 and power a self-sustained recovery. Two engines of the economy - consumer spending and capital investment - will shift into high gear and exports will expand thanks to steady growth of overseas economies. Although public investment will peak out in the first half of 2000, the decline will be offset by private-sector demand and will not slow down the economic expansion. Hope for solutions to the problems of non-performing assets, surplus facilities and excessive personnel emerged in fiscal 1999. The private sector has commenced new activities aimed at the 21st century, such as an expansion of IT investment. In fiscal 2001, the tempo of growth in consumer spending and capital investment will quicken, but housing investment and public investment will slow because of the diminishing effect of fiscal measures, as will exports due to the strong yen. Consequently, growth will reach only 2.4% without any abrupt acceleration.

With the completion of bonus cuts at the end of 1999 and the start of moves to expand employment, especially in the service industry, disposable income grew from the beginning of fiscal 2000, translating into increased consumption. Sales of passenger vehicles and personal computers have been brisk since the start of the year, indicating the start of a recovery in consumer spending. As 2001 approaches, consumer spending will gradually accelerate.

Housing investment should continue to be strong throughout fiscal 2000 due to extension of housing loan tax cuts up to June 2001 occupancy, but will begin to decline in fiscal 2001.

Thanks to the appearance of new investment accompanying the rebound in corporate profits, a genuine expansion of IT investment, and lively urban redevelopment investment, capital investment turned upward from the latter half of fiscal 1999 and will gradually accelerate until fiscal 2001. With growing requirement aimed at maintaining international competitiveness, companies are also moving to invest in IT, new energy and other innovative technologies.

Public investment will decline sharply from fiscal 2000 as it no longer functions to support the economy. The top priority of fiscal policy is reducing government bond issues, which have reached nearly JPY40 trillion.

Thanks to the steady expansion of the world economy, exports will continue to expand during fiscal 2000, particularly in information and communication equipment, but growth will slow beginning in fiscal 2001 due to the appreciation of the yen. Although the sharp upward turn in imports in fiscal 1999 did not appear until fiscal 2000, the tempo of this growth should accelerate due to the strong yen in fiscal 2001.

To reiterate, three prerequisites for a self-sustained recovery were largely confirmed in fiscal 1999: the start of serious measures to deal with non-performing assets, a rebound in capital investment, and completion of wage restructuring. Thus, risk of a downturn in the Japanese economy is clearly diminishing.

b. Forecast for the U.S. Economy

The rapid expansion of the U.S. economy will continue until nearly the end of fiscal 2000. The cyclical pattern of rising employment, expanding consumption and increasing production does not at the present time appear likely to change. Although the assets effects of share price rises is declining, this will be offset by the rapid expansion of disposable income. In the summer of 1999, monetary policy began to tighten, but at the present time, the effect is limited, for the most part, to neutralizing the relaxation of monetary policy of autumn 1998. Moreover, because inflation has been held in check, the FRB must maintain its policy of stepwise increases in interest rates. In 2000, therefore, the effect of financial tightening will be limited, and any real dampening of housing investment and capital investment will not occur until 2001.

In addition, even if the economy plunges into recession due to a stock market crash or collapse of the dollar, it is unlikely that the U.S. economy in 2000 will shift to negative growth given the $100 billion fiscal surplus and the scope for financial relaxation. Whether the sustained pattern of growth is due to an increase in the potential growth rate spurred by the IT revolution or due to the real strength of the private sector based on stable economic policies, the expansion of the U.S. economy will continue for the time being, and an adjustment period on reaction to the low savings rate, the $400 billion trade deficit and overvalued high-tech stocks will not arrive until 2001.

ゅき. Forecast for Interest Rates and Currency Exchange

a. Japanese interest rates

The policy of zero interest rates will begin to change from autumn 2000 upon confirmation that the economy is making a self-sustained recovery. Long-term interest rates have already begun to rise, and long-and short-term interest rates will continue to rise for the one year period up to autumn 2001, with long-term interest rates reaching about 3%.

b. U.S. interest rates

A serious tightening of U.S. monetary policy will begin in 2000, and from April, short-term interest rates will be raised by another 1.5%. Because this tightening will be implemented in stepwise fashion, the effect will not be readily perceived, and thus interest rate hikes will be higher than generally forecasted. Increases in long-term interest rates will be small, however, since the view is growing that the hike in short-term interest rates will reign in the economic expansion and prevent a re-ignition of inflation, and because the fiscal surplus will be directed toward the redemption of government bonds.

c. Yen-dollar exchange rate

Since monetary policy in the U.S. will continue to tighten, the yen is likely to weaken during 2000. However, the large trade imbalance will prevent an acceleration of the yen's slide. In 2001, U.S. interest rates will peack out, and the economic growth rates of Japan and the U.S. will converge, causing a strength of the yen. We expect that the yen-dollar exchange rate will be JPY106 in fiscal 2000 and JPY100 in fiscal 2001.