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Outlook for Japanese and Overseas Economies during Fiscal 2001-2002

Overview

To achieve structural reforms by overcoming a sharp decline in exports

The Japanese economy in the second half of fiscal 2000 quickly started to stagnate due to an unexpectedly large decline in exports caused by the influence of the bursting of the IT bubble in the U.S. In the meantime, consumer spending decreased and the amount of public spending to be curtailed increased. Thus, the rate of economic growth declined to 0.9% in fiscal 2000 from 1.4% in fiscal 1999. However, taking into account the most likely distortion in statistics on consumer spending, the actual rate of economic growth in fiscal 2000 should be about the same as in fiscal 1999. In fiscal 2001, the effect of the decrease in exports will be fully felt on the economy, causing the rate of growth to decline as low as 0.7%. However, the negative impact of a decrease in exports will be concentrated on limited industry sectors such as the IT-related industry, and thus, there should not likely be a significant deterioration in the economy as a whole.

In fiscal 2002, consumer spending will start to show a full-scale expansion supported by improvement in the employment environment and a rise in wages. Capital investment will also increase its rate of growth again backed by abundant cash flows. However, the public sector will be thoroughly reviewed under the Koizumi administration, limiting the rate of economic growth to 2.1%, which is a low level in the recovery phase in the economy.

Under these circumstances, the unexpected factors to the economy continue to be the U.S. economy entering into recession and bad debt problems to be disposed of. The U.S. economy is not likely to collapse in the near future, taking into account the tax cut (which comes at a good time) and positive measures taken by FRB. Regarding bad debts, the public and private sectors have reconfirmed that the final disposal of bad debts of about 5 to10 trillion yen on an annual basis starting in fiscal 2000 ought to be continued for the following 3 fiscal years. This does not seem to create new deflationary pressures on the economy.

I. Present Status of the Japanese and Overseas Economies

1. Present status of the Japanese Economy

The Japanese economy experienced totally different environments in the first and second half of fiscal 2000. In the first half, an economic recovery was led by exports centering on the IT-related and also by capital spending, but in the second half, the IT-related exports were reduced much more sharply than expected due to the bursting of the IT bubble in the U.S. As a result, business sentiment deteriorated quickly and the Nikkei 225 index recorded the lowest level in recent history of 11,820 yen on March 13 near the end of fiscal 2000. In the second half of fiscal 2000, the Japanese economy most likely entered into recession caused by a decrease in overseas demand.

However, the actual trend of the economy seems to have been underestimated by the rate of growth of 0.9% by virtue of the preliminary report of GDP. This is because a decrease of 0.2% in consumer spending indicated by the preliminary report appears to be an underestimation caused by a distortion of statistics, and because the rate of growth is considered to have actually grown at about 1.5%, similar to fiscal 1998 and 1999. The specific reasons are the following: a) The statistics relating to "Research on Households", or "Research on Income and Expenditure of Single Households" in particular, which are utilized for estimating demand for personal spending in the preliminary report figures for GDP are not reliable and spending by single households was most likely underestimated; b) According to the industrial production as supply side statistics, the shipment of consumer goods in fiscal 2000 grew 3.1% and that of consumer durables, in particular, grew as much as 6.8%.; c) From the viewpoint of income, the number of employees increased 0.9% in fiscal 2000 and the total cash compensation per capita increased 0.4%, a clear improvement over the situation of the negative growth of 0.5% in the number of employees and 0.8% in total cash compensation in fiscal 1999. If specific items are referred to, the number of passenger cars sold (including light cars) increased 1.7% from the previous year and the number of TV sets sold just before the enforcement of the Recycle Law increased 5.6%. In addition, major tourist companies increased their sales 2.4%. If consumer spending grew at the same rate as in 1999, the rate of economic growth in fiscal 2000 would have been 1.8% (exceeding 1.4% in fiscal 1999).

While there seems to have been steady consumer spending in fiscal 2000, it cannot be denied that exports plummeted in the second half of fiscal 2000. The export volume index increased 4.8% through fiscal 2000 from fiscal 1999, but this was caused by the low level in fiscal 1999 (the export level at the end of fiscal 1999 was 7.3% higher than the average one in fiscal 1999). The export volume index has shown a decrease at a pace of more than 10% on an annual basis since July 2000 until recently. Electric machinery, in particular, experienced a sharp decline in exports of more than 40% on an annual basis in the first quarter in 2001, almost reaching the lowest level recorded after the Asian economic crisis. The decline resulted from the drop in IT demand in the U.S. and its after effects. However, this sharp decline of export in electric machinery as well as general machinery, metal and chemical products, which we have never seen in recent years, most likely ran its course by the second quarter in fiscal 2001. In the meantime, the import volume index continued to show a high rate of growth until the end of 2000, recording an increase of 9.8% in fiscal 2000, more than twice as much as that of export index. Particularly striking was a high rate of growth in the import of electric machinery and textile products, indicating that low-priced products were further replaced by imported goods. However, the high rate of import growth has been quickly decelerating due to the weakening yen in 2001 and also to a shrink of trade in the IT equipment with the Asian area due to the worldwide slump in IT business.

As for other demand items, housing investment was slightly reduced (1.9%) due to a decrease of housing starts with the effect of the tax cut on housing loans disappearing, but the condominium business is doing well as it succeeds in finding new purchasers. As for capital spending, the manufacturing sector centering on electric machinery posted a double digit growth in investment, but the non-manufacturing sector (heavily affected by the capital investment of electric power companies, which continued to curtail investment), showed sideways movement in capital investment. Thus, the rate of growth in capital investment as a whole was limited to 4.6%. As to the non-manufacturing sector, statistics on capital investment were negatively affected by the overestimation of investment in fiscal 1999 concerning middle-and small-sized companies (particularly the inn business). In the meantime, public spending decreased 6.1% due to the negative effect caused by local governments sharply cutting their own capital investment because of financial difficulties.

In the financial market, long- and short-term rates have moved toward the bottom since BOJ restored a zero interest rate policy on March 19. In fact, the rates have been in a very low range since the beginning of 1999. The yen exchange rate had stayed at 100-110 yen to one US dollar for about a year until the fall of 2000, and it thereafter weakened from the end of last year due to increased concern over the Japanese economy. The yen has continued to fluctuate at 120-125 yen since March this year. In the meantime, consumer prices have continued to decline as a result of a decline in food prices, penetration of cheap imports, lower rents for houses, etc., but the rate of negative growth has started to narrow recently.

2. Present Status of Overseas Economies

The U.S. economy has decelerated its growth since the second half of 2000 to 2% on an annual basis from about 5% previously, but it currently gives no sign of declining further. The sudden deceleration of the economy resulted from a decrease of demands in consumer durables and housing, and also in the IT related sector. Excess demands in these areas had been already feared and a reactionary setback could be anticipated. Among the IT related business, investment in large-scale communication networks in anticipation of strong demand for communication was quickly curtailed, which caused a decline of worldwide demand for IT-related equipment. In the meantime, thanks to the positive effect of easy monetary policy aggressively pursued by FRB since the beginning of this year (the short-term rate declined 2.75% until June 27), the Dow Jones average recovered to around 10,500 from the bottom of

9,389 on March 22, enabling consumer spending to avoid a sharp decline. Besides, the reductions in interest rates have started to have a positive effect on corporate earnings. The deficit in the balance of current account, which had been increasing, seems to have peaked at the level of around US$400-450 billion on an annual basis. The consumer price index rose around 3.5%, but it is gradually declining due to the peaking of energy prices.

The European economy experienced a more-than-expected negative impact of the U.S. slowdown and in the meantime, the effect of tax cuts seems to have been offset by a rise in consumer prices. Thus, the economy is not gathering momentum for its recovery. It has also become even clearer that the French economy is fairy well while the German is doing poorly.

Asian economies except the Chinese experienced a seriously negative impact of the IT slump in the U.S. The fact that China plays a more important role for acting as a base for producing popular products is contributing to a good performance of its economy. Other Asian countries continue to experience the negative impact caused by a decline in demand for IT related equipment, and the recurrence of bad debt problems seems to be exacerbating the situation in Taiwan and Thailand, in particular. Indonesia and the Philippines continue to suffer from unstable political situations.

II. Prospect for the Japanese Economy

1. Japanese Economy in Fiscal 2001

The rate of growth in the Japanese economy in fiscal 2001 will be limited to 0.7% due to the negative effect of a sharp decline in export fully felt on statistics. However, it is possible for the domestic demand to grow 1.3%, about the same level as in fiscal 1999 (If underestimation of personal consumption were adjusted, the rate of domestic demand in fiscal 2000 would have been 1-1.5%). It cannot be totally denied that a decrease in export will lead to a reduction in employment and income, bringing a full-scale recession, but the negative effect has been limited almost only to the exporting industries. Bad debts amounting to about 5 to 10 trillion yen will continue to be disposed of the same as last year, creating negative effects such as an increase of the unemployed to a certain extent, but it is not likely for the economic situation to quickly worsen.

(Personal Consumption)

Personal consumption will grow at 1.2%, in real terms, in a steady trend continuing since fiscal 1998. The rate of growth in disposable income, the most important factor to determine personal consumption, will turn positive due to a positive growth in summer bonus in 2001, first time in 4 years and the negative effect of low interest rate on deposit almost disappearing. These will prepare conditions for a full-scale recovery of personal consumption.

In personal consumption, high-priced goods continue to sell well, while consumers have become more sensitive to price toward popular goods, causing their unit prices to gradually continue declining. Concerning consumer items, a demand for the upgraded new models of passenger cars, flat and large-sized TVs and domestic and overseas tourism is expected to rise. The next generation cellular phones have decided to be launched in a full-scale in October 2001, temporarily slowing down the incremental spending in the cellular phone related. The rate of growth in the sale of personal computers will decelerate as PCs have been sold to almost all the individual purchasers.

(Housing Investment)

Housing starts in fiscal 2001 will decrease from 1.21 million units in fiscal 2000 to 1.16 million posting a decline of 4.1% in real terms. Tax cut on housing loans was decided to be continued after July 2001 although the amount of tax cut became smaller, but it will become less effective so that a decrease in housing starts for a single-family house cannot be avoidable. In the meantime, real estate companies can constantly find land for constructing condominiums mainly in the center of the Metropolis and they will be able to increase demand for condos with a reasonable price. Thus, the rate of decline for condominium construction will be limited. The construction of houses for rent had continued decreasing because people who were likely to rent houses bought condominiums instead. However, such housing starts fell to the level in early 1980s when the holders of houses for rent experienced a long slump in business, and thus, a pace of decline will slow down. In conclusion, housing investment has fluctuated in a narrow range of 1.1-1.2 million units a year since fiscal 1998. As a result of the government's concentrated policy to stimulate potential demand for housing in early 1990s, a demand for housing has become less sensitive to the fluctuation of the economy and tax cut on housing investment, resulting in more or less the same number of housing starts each year.

(Capital Investment)

The rate of growth in capital investment will decelerate from 4.6% in fiscal 2000 to 3.6% in fiscal 2001. This will be caused mainly by a reactionary decrease from a sharply increased investment in the IT related in fiscal 2000 and a large amount of investment in opening many stores just before the enforcement of the Large Scale Retail Store Location Law. The manufacturing sector will be certain to experience a decline of earnings due to a decrease in export, but its cash flows are still abundant as compared to the investment, which will keep a strong demand for new investment. Thus, a decrease of earnings in a range of 5-10% will not likely reduce capital investment quickly. In the non-manufacturing industry, the rate of growth in capital investment will remain positive due to a continued high level of investment in the IT related and the bottoming out of curtailment of investment by electric power companies, although investment by retailers will inevitably decrease.

(Public Investment)

The negative rate of growth in public investment in fiscal 2001 will temporarily narrow its deceleration to 1.1% from 6.1% in fiscal 2000. This results from the bottoming out of investment by local public governments in fiscal 2000 and many additional spending plans by the supplementary budget in fiscal 2000 carried forward to fiscal 2001. It was assumed that additional public investment by the supplementary budget to stimulate the economy would not be made in fiscal 2001.

(Export and Import)

The rate of growth in export volume in fiscal 2001 will sharply decline 7.8% from the previous year as compared to a positive growth of 4.8% in fiscal 2000. The Japanese economy will be directly affected by a sharp decline in export as it experiences the negative rate of export volume of over 5% first time since early 1970s. Besides, electric machinery will show a negative rate of growth in export of 17.5%, which occupies about 60% of a decrease in the total volume of export. The bursting of the IT bubble in the U.S. is directly affecting the electronics parts and communication industries in Japan, which have a strong competitive power. Orders from the U.S. will be temporarily reduced to a level well below the actual demand in order to liquidate inventory. Besides, there will be a special factor such as a decrease of passenger car export in connection with the expansion of local production. However, the adjustment of export volume has been rapidly in progress to meet sharply reduced orders of the IT related and a decrease in export volume will bottom out in the third quarter of 2001 and it will gradually pick up toward the end of 2001. In the meantime, the rate of growth in import will decelerate from 9.8% in fiscal 2000 to 1.2% in fiscal 2001. The rate of growth in the import of electric machinery and clothing will slow down as they have penetrated in the market. Besides, import of electric machinery as a result of the slump in the IT related business will decrease and import of raw materials will be reduced following a decrease of industrial production.

(Balance of International Account)

The surplus of current account in fiscal 2001 will stand at 6.2 trillion yen, a sharp decline from 12.1 trillion yen in the previous year. This will be caused by a sharp decline in trade surplus in the first half in fiscal 2001 due to a decrease of export and an increase of import by weak yen. In the meantime, a deficit of service account will slightly increase due to an increase of transportation and tourist spending by weak yen, but a surplus of income account will continue to increase as the Japanese overseas assets expand.

(Price)

Consumer price index will fall 0.3% in fiscal 2001, a negative growth in three years in row, which is a slightly smaller decline than 0.5% in fiscal 2000. This will be caused by vegetables imported from China fully penetrating into the Japanese market to turn their price to a sideways move and also a slowdown in the reduction of rent associated with a decline of land price. However, price decline will continue in such area as communication cost, clothing, electric home appliances, etc. The base year for consumer price index will be revised from 1995 to 2000 and such revision will be reflected in statistics to be released from August 2001. Because items on the statistics are to be replaced, the rate of growth in consumer index will most likely be revised to lower one.

2. Japanese Economy in Fiscal 2002

In fiscal 2002, business sentiment will improve and capital investment will rise due to a shock from a decline in export running its course and the disposal of long-pending bad debts almost behind us. Furthermore, personal consumption will start to increase in a full-scale keeping pace with an increase of income. However, the economy will not be able to accelerate its growth promptly as the government reviews the public sectors to be followed by a reduction of financial deficits.

(Personal Consumption)

In fiscal 2002, personal consumption will show a solid recovery trend. This will be backed by a disposable income growing at nearly 3% caused by an increase in the number of the employed and the higher rate of wage increase. In fiscal 2002, corporations will be positive in hiring new university graduates regardless of the decelerating economy. Once the soft-landing of the economy is confirmed, employment will smoothly expand. Corporations want to adjust the distorted structure of personnel caused by the long-term curtailment of hiring people and to take a chance to increase personnel in new business areas. An increased demand for new upgrading models of passenger cars to be introduced from fiscal 2001 will be distinct. An increase in demand for passenger cars will also be caused by the fact that the ages of all the cars bought in the bubble economy have already passed 10 years and that auto tax will be levied 10% more from fiscal 2002 on cars with the age of 13 years or more due to the introduction of green taxation system. Furthermore, a positive factor will be the next generation cellular phone service and fast speed communication circuit service becoming popular in a full-scale.

(Housing Investment)

In fiscal 2002, housing starts will slightly increase from 1.16 million units in fiscal 2001 to 1.17 million. While the construction of houses for rent continues decreasing, the rebuilding of the existing single-family houses will increase as the prospect for the economy has a sign of recovery. The construction of condominiums will remain unchanged at a high level.

(Capital Investment)

In fiscal 2002, the rate of growth in capital investment will reaccelerate sharply to 7.4%. Negative factors for capital investment existed in fiscal 2001 such as a cut in capital investment in the IT related and a reactionary slowdown in investment in many stores quickly opened just before the enforcement of the Large Scale Retail Store Location Law will disappear and an increase in earnings and cash flows following the economic recovery will contribute to the expansion of capital investment. Furthermore, the economy will become so solid as to make small-sized companies capital investment. In the manufacturing sector, capital investment mainly in semiconductor and the LCD related in the electric machinery industry will revive after a slowdown in investment in fiscal 2001 and in the general machinery and auto industries, upgrading investment and investment in developing new products will turn to increase. In the non-manufacturing sector, investment in the IT related will increase following a wider use of the next generation cellular phone and fast communication circuit service. Besides, investment in the new construction and refurbishing of buildings for middle-and small-sized stores, which has been delayed so far, will start to increase.

(Public Spending)

In fiscal 2002, public spending will continue decreasing. The Koizumi Administration will prepare the first budget in fiscal 2002, in which public spending by the central government will be drastically cut. Besides, there are almost no public spending carried over from fiscal 2001. These will bring a negative growth in public spending to as large as 4.9%.

(Export and Import)

In fiscal 2002, the volume of export will rise 3.3% from the previous year when it showed a decline of 7.8%. The recovery of export will be basically supported by the actual demand for export of the IT related mainly to the U.S and Asian countries. Weak yen from the second half of fiscal 2000 to the first half of fiscal 2001 will have the effect on export after some time lag. The rate of growth in the volume of import will be 2.9% slightly exceeding

1.2% recorded in the preceding year. Imports have almost penetrated in the Japanese market, and import will show a slow growth even when the economy recovers.

(Balance of Payments)

In fiscal 2002, the current account surplus will stand at 8.3 trillion yen brought by an increase in export, which exceeding 6.2 trillion yen in the previous year. The current account surplus has been fluctuating somewhat widely at the average of around 10 trillion yen since 1980s.

(Price)

In fiscal 2002, the rate of rise in price will show no increase (base year: 1995). A decline in food price has run its course with a reduction of rent further narrowing and part of service price will turn to rise. However, import price has been determining the domestic one and public utilities charges will stop rising due to the rationalization of the public sector, and thus, price stability will remain unchanged.

III. Prospect for the Overseas Economies

1. Trend in the U.S. economy

In 2001, the U.S. economy will achieve the rate of growth of 2.1% as a sharp slowdown of the economy can be avoided by the effect of FRB's easy monetary policy and tax cut, although the rate of growth slows down from 5.0% in 2000. A slowdown in economic growth will be caused by a sharp decrease in the rate of growth in consumer and capital spending. In consumer spending, a slowdown in the expansion of employment and a suspended rise in stock price will contribute to a weak demand for consumer durables. A decline in stock price reduces fund flowing into the IT industry and the rate of growth in corporate earnings slows down due to an increase of personnel expense. Thus, a slowdown in the rate of growth in the economy will be unavoidable.

The U.S. economy sustained the average rate of growth of over 4% during 4 years after 1997, which was, indeed, the excessive growth to be slowed down sooner or later. The economy would most likely decline to a zero growth if a reduction of short-term rate by as much as 3% in total and a tax reduction of nearly US$ 40 billion (to be implemented in the third quarter in 2001) were not to be made. Tax refund to be implemented in 2001 is considered to have the significant effect on the economy, as it is concentrated on low-income bracket people with high propensity to expend. The implementation of such positive and typical measures for stimulating the economy will enable the U.S. to avoid hard-landing in the economy, but it is not considered possible for the economy to expand in a large scale again in

2002 to post a rate of growth of over 3%. Reasons are the following: a) The IT related industry, used to be a leader of capital investment, has overcapacity in the communication area making it difficult to expand itself without regard to actual demand and profitability as in the case of the past, b) Individual savings rate has been showing a negative number and a large part of tax cut after 2002 will most likely be appropriated to savings (tax cut after 2002 will be concentrated on high-income bracket people), and c) US dollars will start weakening due to the effect of gigantic current account deficits. These will result in the rate of economic growth being limited to 2.6% in 2002.

Such a relatively low rate of economic growth will continue for 2 years, bring down the current account deficit from US$445 billion to US$400 billion, but the amount of deficit remains gigantic, which may trigger the collapse of the dollar. The rate of rise in the consumer price index will gradually decline to 2.4% in 2002 from 3.4% in 2000 due to a decline of oil price and the decelerated growth in wage cost.

The U.S. economy in 2002 will be a crucial year to see whether the economy can smoothly enter into self-sustained recovery because the effect of the stimulative policies gradually disappears. If the U.S. economy fails in the start of self-sustained recovery, it may have a little chance, if any, to be compelled to experience a low growth for the mid-term similar to Japan in 1990s.

2. Trend in the European Economy

The average rate of economic growth in EU in 2001 is expected to slow down about 1% to more than 2% from more than 3% in 2000. Like the U.S. and Japan, its growth estimates have been considerably revised downward since the beginning of this year. Reasons are a) A slowdown in the U.S. economy gave a negative impact on the European economies more than expected, and b) The rate of rise in the consumer price index was higher than expected due to a rise in energy and food prices, most likely offsetting the effect of a reduction of income tax. However, a reduction of income tax will be implemented for many years to come and a consumer sentiment temporarily worsened in the first half of 2001 due to the occurrence of Foot and Mouth Disease. Thus, there should not be concern over the worsening economy ahead. The economic performance of Germany and France has given a clear contrast. France took initiatives to start reforming the labor market and the public sector, showing better performance than in the case of Germany. Noteworthy is capital investment in France, in particular, continues to grow.

3. Trend in the Asian Economies

The East Asian economies, heavily dependent upon export of the IT related products, have experienced the severest shock from the effect of the bursting of the bubble in the U.S.

IT industry, necessitating to make a sharp adjustment of production from the beginning of 2001. However, like Japan, a pace at which the adjustment is made is much faster than in the past, and a slowdown in demand for the IT related is over in the middle of this year. However, many countries are being confronted with serious problems about bad debts and a sharp rise in demand for the IT related cannot be expected. Thus, the recovery of the economies will have to be relatively gradual one. Besides, there has risen a political instability in Indonesia and the Philippines, which may become a negative factor to curtail direct investment in the Asian countries. In the meantime, China is playing an important role ever than before as a production foothold for popular products through the upgraded quality of the manufacturing industry as a whole and better cost control in the process of reforming national enterprises. As a result, a virtuous circle such as an increase of direct investment in China, an increase of export products and an increase of domestic consumer demand has occurred. If China successfully participates in WTO, many foreign companies will find it favorable to have production footholds in China, and thus, direct investment in China is considered to continue at a high level.

4. Trend in the Price of Primary Products

The price of crude oil is expected to stay around US$25 a barrel all through 2001 due to a negative factor such as a slowdown in the expansion of the world economy to be offset by positive factors such as Iraq problems and a shortage of gasoline in the U.S. In the beginning of 2002, crude oil price will slightly decline due to the gradual materialization of the effect arising from a decelerated growth in demand. The prices of other primary products will continue to move sideways as overcapacity for supply remains intact.

IV. Projections of Interest Rate and Exchange

1. Trend in Japanese Interest Rates

BOJ will be compelled to continue a zero interest rate policy until the summer 2002. This results from BOJ's statement to the effect that the policy will be cancelled by the condition "The rate of rise in consumer price will remain steadily more than zero %". After the fall of 2002, BOJ will seek a chance to raise short-term rates, but it will have to take care of economic conditions, domestic and overseas, and the resultant effect on bad debt problems, and thus, BOJ will have to make a minor adjustment in raising short-term rates for a certain narrow range.

In the mean time, long-term rates will enter into a stage for a gradual rise due to an improvement of economic trend starting from the beginning of 2002 after a continued super low interest rate of 1-1.5% until the end of 2001. However, because the government will turn to a restraining financial policy to cut financial deficits, yen will be stronger, keeping long-term rates from rising. Thus, the rates are limited to rise to around 2% at the end of fiscal 2002.

2. Trend in Interest Rates in the U.S. and Europe

FRB's monetary policy entered into the final stage where short-term rates in real terms were near zero. Discount rate cut to 3.25% on June 27 is most likely to be further reduced to 3%, but FRB will thereafter take a wait-and-see stance to monitor the effect of monetary ease and tax cut policies without further change in monetary policy. If the economy does not fare well in the middle of 2002, FRB may reduce short-term interest rate again, but to lower short-term rate below 3% may trigger concern over the collapse of the dollar, necessitating FRB to deal with monetary policy with more caution. Long-term rates in the U.S. will take a trend of gradual decline throughout the second half in 2001 supported by a decline of short-term rates and a decelerated rate of price index and the yield of 10-year government bond will decline slightly below 5%. In 2002, budget surplus will narrow due to the implementation of a full-scale tax cut and the economy successfully soft-landing, and thus, long-term rates will continue move sideways.

ECB will keep taking a cautious, but easier monetary stance. ECB will judge it prudent not to resort easily to monetary ease in order to enhance its credibility, leading to an improvement in the long-term economic and price performance. Long-term rates will continue to move sideways at 5-5.5%, and as a result, nominal long-term rates in the U.S. and Europe will converge into around 5%.

3. Trend in Exchange Rate

Yen will gradually weaken against the dollar until the fall in 2001 due to continued uncertainty of the Japanese economy and a fast decline in current account surplus. Yen will gradually strengthen against the dollar after the end of 2001 around when the soft-landing of the Japanese economy is confirmed. Yen will show a gradual strength against the dollar throughout fiscal 2002 to reach around 110 yen to the dollar at the end of fiscal 2002. The average rate of yen against the dollar will stand at 125 yen to the dollar in fiscal 2001 and 113 yen in fiscal 2002.

Euro will start strengthening against the dollar from the end of 2001 to adjust excessively weakened Euro and continue to gradually rise into 2002. The fund entering into the U.S. market will peak out and the gigantic current account deficit will be closely examined again, and thus, the dollar will weaken against all the major currencies.

End

Outlook for Japanese Economic Indicators

GDP-Related Indicators

(In trillions of yen; percentage growth over previous year in parentheses)

	FY2000 (actual)	FY2001 (forecast)	FY2002 (forecast)
GDP (real)	530.3 (0.9)	533.9 (0.7)	544.9 (2.1)
Private consumption	289.0 (-0.2)	292.3 (1.2)	298.2 (2.0)
Residential investment	20.1 (-1.9)	19.3 (-4.1)	19.6 (1.8)
Non-residential investment	84.9 (4.6)	87.9 (3.6)	94.4 (7.4)
Government consumption	86.0 (3.3)	87.1 (1.3)	88.4 (1.5)
Public investment	37.9 (-6.1)	37.5 (-1.1)	35.7 (-4.9)
Increase in inventories	-0.0 [0.1]	0.7 [0.1]	0.8 [0.0]
Net exports of goods & services	12.5 [0.2]	9.1 [-0.6]	7.9 [-0.2]
Exports	59.7 (9.3)	56.4 (-5.4)	57.0 (1.0)
Imports	47.2 (9.8)	47.3 (0.3)	49.2 (3.9)
GDP (nominal)	510.4 (-0.6)	510.1 (-0.1)	520.9 (2.1)
GDP Deflator	96.2 (-1.5)	95.5 (-0.7)	95.6 (0.1)
Industrial production index	104.9 (4.0)	99.8 (-4.9)	102.6 (2.8)
Wholesale price index (overall)	96.8 (0.2)	98.7 (2.0)	97.3 (-1.5)
Consumer price index	101.5 (-0.5)	101.1 (-0.3)	101.1 (0.0)

Notes: Real gross domestic products and real gross national products are in 1995 prices.
Industrial production index, wholesale price index, and consumer price Index: 100 for 1995.
[ ] = contribution to changes.

Balance of Payments Indicators

(In trillions of yen; percentage growth over previous year in parentheses)

	FY2000 (actual)	FY2001 (forecast)	FY2002 (forecast)
Current account balance	12.1	6.2	8.3
Trade balance	11.6	6.0	7.6
Exports	49.8 (6.6)	48.3 (-2.9)	47.2 (-2.3)
Imports	38.3 (16.1)	42.4 (10.7)	39.6 (-6.4)
Services	-5.2	-5.6	-5.4
Income	6.7	7.1	7.3
Current transfers	-0.9	-1.3	-1.2
Yen-dollar rate	110.5	124.5	112.5

Customs Clearance Volume Index

(100 for 1995)

Exports volume index	123.4 (4.8)	113.8 (-7.8)	117.5 (3.3)
Imports volume index	125.5 (9.8)	127.0 (1.2)	130.7 (2.9)

Outlook for US Economic Indicators

(In billions of US Dollar; percentage growth over previous year in parentheses)

GDP-Related Indicators

	2000 (actual)	2001 (forecast)	2002 (forecast)
GDP (real)	9,318.5 (5.0)	9,517.0 (2.1)	9,767.3 (2.6)
GDP (nominal)	9,963.0 (7.1)	10,378.0 (4.2)	10,783.3 (3.9)
Personal consumption	6,294.3 (5.3)	6,458.9 (2.6)	6,584.6 (1.9)
Residential investment	366.3 (-0.5)	355.1 (-3.1)	331.3 (-6.7)
Non-residential investment	1,413.7 (12.6)	1,441.5 (2.0)	1,487.3 (3.2)
Government consumption & investment	1,578.7 (2.8)	1,628.9 (3.2)	1,693.8 (4.0)
Federal	548.2 (1.5)	562.7 (2.7)	579.6 (3.0)
State & local	1,030.5 (3.5)	1,066.1 (3.5)	1,114.2 (4.5)
Increase in inventories	60.9 [0.2]	25.8 [-0.4]	58.0 [0.3]
Net exports of goods & services	-412.4 [-1.0]	-413.6 [-0.0]	-407.7 [0.1]
Exports	1,126.3 (9.0)	1,145.4 (1.7)	1,183.2 (3.3)
Imports	1,538.7 (13.5)	1,559.0 (1.3)	1,590.9 (2.0)
Industrial production index	147.5 (5.6)	147.2 (-0.2)	150.9 (2.5)
Producer price index	138.0 (3.7)	142.1 (3.0)	143.6 (1.1)
Consumer price index	172.3 (3.4)	177.5 (3.0)	181.9 (2.4)

Notes *"Real" estimates are in chained(1996)dollars.*
Industrial production index: 100 for 1992, Producer price index: 100 for 1982.
Consumer price index: 100 for 1982-84.
**[ ] = contribution to changes.*

(In billions of US Dollar; percentage growth over previous year in parentheses)

Balance of Payments Indicators

	2000 (actual)	2001 (forecast)	2002 (forecast)
Balance on current account	-444.7	-410.5	-400.5
Balance on goods and services	-375.7	-358.2	-347.9
Balance on goods	-452.2	-432.9	-426.1
Exports	772.2 (12.8)	786.0 (1.8)	818.9 (4.2)
Imports	1,224.4 (18.9)	1,218.8 (-0.5)	1,244.9 (2.1)