INFORMATION

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Outlook for Japanese and Overseas Economies during Fiscal 2002 – 2003

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Overview

Japanese economy pushed down by the bursting of the IT bubble

The Japanese economy in Fiscal 2001 entered into a full-scale recession due to a severe decline in exports caused by the bursting of the IT bubble in the U.S., finally bringing a slump in consumer spending and housing investment through the worsened earnings of the manufacturing sector in the economy. Furthermore, Japanese corporate managers' sentiment on the prospect for the economy has fast deteriorated due to the simultaneous and multi-terrorism occurring on September 11 and so forth, and as a result, capital investment has begun to be compelled to shrink. In the midst of a simultaneous slump in the world economy, the Japanese economy will show a negative rate of growth of 1.0% in Fiscal 2001, lower than the negative one of 0.8% in Fiscal 1998 and the lowest since 1970s.

In Fiscal 2002, the Japanese economy will gradually recover supported by a pickup in exports centering on electrical machinery due to a gradual recovery in the U.S. economy. However, it takes some time for employment and capital spending to improve because of the aftermath of a sharp decline in the earnings of the manufacturing sector, resulting in the rate of growth in the economy to be limited to a slightly positive rate of 0.1%.

In Fiscal 2003, the rate of economic growth will rise to 2.0% due to increased employment and resurgence of full-scale capital investment supported by an increase of corporate earnings, on condition that the economic recovery is sustained for 6-12 months. Capital investment, in particular, is likely to increase sharply if corporations, abundant in cash flows, have a positive view on the prospect for the economy in the future.

In a great contrast to such standard view on the economy as aforementioned, the possibility that the Japanese economy will temporarily enter into a critical situation from the end of Fiscal 2001 to the beginning of Fiscal 2002 cannot be denied. Part of Japanese corporations has considerably weakened its power of viability due to the prolonged low rate of economic growth, resulting in the largest number of bankruptcies in history, and a domestic demand may decrease even more sharply through an increase of non-performing assets and seriously uneasy sentiment on employment. Besides, a recession in the U.S. economy is likely to become much deeper and more prolonged than expected due to the structural problems of low savings and no improvement in a large amount of deficit in the current account balance, although a successive reduction of interest rate and a tax cut can be expected to stimulate the U.S. economy. An economic trend, domestic and overseas inclusive, for the next few months will have a decisive impact on the future of the world economy.

I. Present state of the Japanese and overseas economies

1. Present state of the Japanese economy

In Fiscal 2001, the Japanese economy is anticipated to show the lowest rate of its growth of a negative 1.0% since 1970s due to a serious recession caused by a much sharper reduction in the IT related exports than expected. The volume of exports in electrical machinery centering on the IT related for the past year decreased more than 30% from the previous year. A decrease in exports of the IT related starting in the autumn of the year 2000 initially caused only a limited effect to decrease production and capital spending in the electrical machinery industry. However, electrical machinery makers began to reduce employees in a full-scale from the spring in 2001 to quickly worsen employment environment with a rise of the unemployment rate to 5.4% in October, resulting in the deterioration of consumer and housing spending.

As to consumer spending, consumer durable goods showed a marked decline in sales. The level of sale of refrigerator, washing machine and autos with a high price, in particular, among home electrical appliances has declined since the autumn in 2001. With a backdrop of the worsened employment environment and a decline in wages, consumers postpone the replacement of high-priced consumer durables. Besides, housing investment has begun to decrease. In addition to a decrease in demand for new houses due to a reaction against advanced demand created by the special tax cut for housing loans implemented from January 1999 till June 2001 (extended from December 2000, initially scheduled), the deterioration of employment situation has caused the reconstruction of single-family homes to be postponed, similar to spending in consumer durables, and as a result, the number of housing starts has begun to decrease since the autumn in 2001.

In the meantime, capital spending had sustained an unexpectedly strong trend until the first half of Fiscal 2001 supported by that of small enterprises to cover a decrease in the capital spending of large corporations, but it has recently shown a clear sign of fast decreasing. Capital spending by large manufacturing corporations centering on the electrical machinery industry had already started decreasing since the beginning of Fiscal 2001 due to a sharp decrease in exports and the deterioration of earnings. Meanwhile, capital spending by small enterprises in the non-manufacturing sector had continued to rise until the first half of Fiscal 2001 due to the recovery of earnings in Fiscal 2000 as well as the sector being relatively insulated from the unfavorable effect caused by a decrease in exports. However, strong machinery orders from the non-manufacturing sector have begun to decrease since September in 2001. This is partly because orders temporarily rushed by electrical power companies peaked out, but more basically, because corporate managers' sentiment on the prospect for the economy has quickly deteriorated due to the worsening of consumer spending, a decrease of corporate earnings, the occurrence of simultaneous and multi-terrorism on September 11 and so forth. The fact that the number of trucks sold has started fast decreasing should be a danger sign of a decrease of capital spending in the future. For reasons as aforementioned, capital spending in the second half of Fiscal 2001 is most likely to be sharply reduced.

A fall in exports centering on electrical machinery, which triggered a recession this time, seems to have stopped. A decrease of Japanese exports caused by a fast decline in capital spending in the IT related in the U.S. has calmed down due to the investment adjustment in the U.S running its course and the liquidation of excess inventory of cellular phones in Europe. As to other products, exports directed to Asian countries, which also experienced the severe impact of the bursting of the IT bubble in the U.S., have started showing a sign of stopping falling from a sheer decline. Besides, an additional public spending of about 5 trillion yen for the supplementary budget in Fiscal 2000 (enacted in November 2000) seems to be temporarily working for stopping decreasing capital spending.

Regarding the financial market, interest rate has basically continued a sideways move at the ultra-low level for 3 years since 1999. In response to the even worsening condition of the economy, the Bank of Japan shifted a direct target for the financial policy from the interbank short-term interest rate into the current deposit balance held by the Bank of Japan and revived a zero interest rate policy at the Financial Policy Decision Meeting held on March 19. Thereafter, the Bank of Japan increased the amount of current deposit balance as its policy target successively in August, September and December, and though symbolic, reduced the discount rate from 0.25% to 0.1% in September.

Much to our regret, the revision of monetary policy resorting to such method has not proven fully effective in putting on the brakes against a recessionary trend. Some people believe the current money supply to be insufficient to bolster the economy and insist that the Bank of Japan should make a furious dash at increasing money supply by creating an inflation target. However, in order to increase money supply to an extent that the rate of growth in prices significantly rise under such a serious economic slump, the Bank of Japan will have to purchase land, corporate bonds, etc. in the order of a few trillion yen held by the private sector. This is, in substance, nothing but financial spending without the resolution of the Diet and the distribution of subsidies. It should be understood from a fundamental viewpoint that monetary policy alone can improve the economy.

Weakness in yen rate has continued steadily since the end of last year from a range of 100-110 yen to a dollar to 120- 130 yen. This has been caused by a increased concern about the Japanese economy and a shrinking trend in the current account surplus. The stock market also declined from 13,000 yen or higher in terms of Nikkei 225 index at the beginning of this year to around 10,000 yen in the summer in response to a serious threat to recession, and then, plunged temporarily to 9,500 yen when the simultaneous and multi-terrorism occurred on September 11. Stock prices at present continue to show a relatively wide fluctuation in a range of 10,000 – 11,000 yen. Consumer price index continues to show a negative rate of increase of more than 1% on a year-to-year basis due to a decline of food prices, the penetration of import goods into the domestic market, a reduction of rent, etc. Items consisting of consumer price index were revised as from August to newly include PC, *gyudon*, the fee for a cellular phone call, etc., whose influence over the index, however, was smaller than expected, resulting in somewhat wider negative rate of growth.

If we re-examine the background of a recession this time to have become more serious than initially expected, we can, needless to say, first point out the furious collapse of the IT bubble in the U.S. In addition, consumer spending could not play a role of sustaining the economy because consumer sentiment continued deterioration during Fiscal 2000 while the economy managed to expand somehow. In addition to a bleak prospect for the employment situation, people in a middle and old age bracket seems to have refrained from spending to protect their future life whenever a social security system as a whole was discussed by politicians to cope with an era of the aged.

Second, corporations continue to give a priority to the repayment of borrowing using free cash flows (fund on hand that can be used freely) of around 10 trillion yen a year by curtailing capital investment. While the management of financial institutions remains unstable due to the aftermath of the bursting of the bubble, corporations endeavor, irrespective of their business results, to reinforce financial stability by repaying debts as much as possible. This may be called, in reality, as hesitation in borrowing rather than hesitation in lending.

It cannot but be said at all events that the Japanese economy is now confronted with the severest economic conditions since the World War II. Furthermore, the fiscal and monetary policies have been almost fully used out for the last 10 years, and new measures to effectively stimulate the economy cannot be expected. Due to the highest level of the number of bankruptcies since 1970s and an additional increase in the rate of unemployment to become inevitable, consumer and corporate managers' sentiment will further deteriorate, and a vicious deflationary spiral arising from a decrease of demand may be accelerated all at once. People seem to pay much severer attention to financial institutions before the cancellation of payoff to be implemented in April 2002, and thus, the next few months should be a critical period for deciding the future of the Japanese economy.

2. Present State of Overseas Economies

The world economy is experiencing a serious and simultaneous recession, first time since 1974-'75, immediately after the first oil shock. The recession was mainly caused by the bursting of the IT bubble, naturally pushing the U.S. economy into a full-scale recession. The U.S. economy peaked in March 2001 just after the 10-year (or 120 months) expansion of the economy starting from April 1991, the longest booming period after the World War II. The rate of economic growth in 2001 will stand at 1.3%, much lower than 4.1% in 2000, which is certainly the lowest in the past 10 years. The rate of economic growth in the 3rd quarter of 2001 showed a annual rate of decrease of 1.1%, the first negative growth recorded since the 1st quarter in 1993. This was caused by a decelerated growth in consumer spending affected by a decrease of employment and terrorism occurred on September 11, in addition to a slowdown in capital spending.

The bursting of the IT bubble, pushing the world economy into a sump, has naturally started having grave consequences against the U.S. economy as well. The IT related investment began to decrease about one year after the beginning of the bursting of the bubble when NASDAQ stock index peaked in March last year. The time lag seems to indicate that many projects planned during the bubble period continued for one year regardless of a change in the business environment. This reminds us of the fact that projects relating to land development in Japan were difficult to be suspended after the bursting of the bubble about 10 years ago. It is very difficult to suspend halfway the construction works for a long-distance fiber-optic cable and a large-scale local area network (LAN).

However, the IT related investment began, at long last, to quickly decrease in the beginning of the year 2001, which started affecting consumer spending after the summer through a reduction in employment. In response to a slowdown in consumer spending, the U.S. government implemented a large-scale tax cut of as much as 40 billion dollar from July to September. As a result of negative factors such as a reduction of employment and the aftermath of terrorism and positive factors such as tax cut and zero-interest loans granted by auto makers fearful of a sharp decrease in demand, a consumer spending move became random, making it difficult to find a trend. However, judging from the movement of consumer spending until the middle of December, a decrease in employment seems, after all, to have determined a general trend in consumer spending. The annual rate of growth in real consumer spending showed 5% until the first half of Fiscal 2000, decelerating to 4% in the second half of Fiscal 2000, to 3% in the first half of Fiscal 2001, and then declined to 0-1% at present. The tempo of a decrease in employment stands at around 1.5 million people on an annual basis, similar to that in the previous recession in 1990-'91 and it is usual for the rate of growth in consumer spending to be negative, but the effect of tax cut seems to be supporting such rate of growth to be in the positive territory.

Furthermore, the amount of decrease in imports this time is larger than in the previous recessions due to a sharp decline in imports of the IT related equipment, which seems to be somewhat working positively for the U.S. economy. In this respect, the contribution of foreign demand to the rate of growth in the economy stood at a negative 0.6% in 2001, and it will considerably shrink to a negative 0.1% in 2001.

Under these circumstance, FRB implemented a reduction of short-term interest rate 11 times from January 3 until December 11 in 2001, reaching a reduction of 4.75% as a whole. As a result, the present short-term market rate stands at less than 2%, the lowest level since 1950s and the market rate of 10-year government bond has reached a little over 5%, the lowest rate in 30 years. Such an aggressive monetary relaxation never seen before was totally initiated by FRB Chairman Greenspan in order to minimize the unfavorable effect of the bursting of the bubble. In the meantime, Dow Jones index recorded the low of 8,326 on September 21 after the terrorism occurred, but it has recovered to around 10,000 supported by a FRB' s positive policy to relax money and consumer spending still sustaining a positive growth. The rate of increase in consumer price index, temporarily rising to around 3.5%, has declined to the level of 2-3% because of a decline in the rate of growth in wages caused by a sharp increase in unemployment rate from the bottom of 3.9% in October 2000 to 5.7% in November 2001 and temporary factors such as the peaking out of energy price.

Europe is experiencing an economic slowdown due to the bursting of the IT bubble in the U.S. in addition to the bursting of the cellular phone bubble spreading all over the European countries, and Germany, in particular, heavily dependent on exports of the IT related products shows a markedly worsened condition in the economy. As a result of a bidding for a license of the third generation cellular phone in Europe, cellular phone companies located in each country shall be liable for the payment of license fee totaling more than 20 trillion yen, which has deteriorated the management condition of each company all at once. This caused the sale of cellular phone to quickly slow down, creating excess inventory of more than 50 million cellular phones (the annual volume of sales: around 400 million phones) centering in European countries, and besides, investment relating to the third generation cellular phone has been postponed due to a shortage of fund. Besides, the IT bubble occurred in Germany though not to the extent as witnessed in the U.S. The price index of Neuemarkt in Germany, similar to NASDAQ index in the U.S., declined temporarily more than 90% from the peak of 9666 in March 2000 to 718 in September 2001. The reasons why the German economy is the worst performer among main European economies seem to be because it has a higher ratio in the export of the IT related equipment than others and the negative effect of the bursting of the IT bubble in a German version has occurred. German economy is considered to barely sustain a positive growth in 2001.

In the meantime, the British economy is expected to continue sustaining a relatively high rate of growth of more than 2%, achieving the best performer among G 7 countries in 2001 for reasons as the following: (a) To begin with, the British economy is difficult to suffer the effect of the bursting of the IT bubble because it has the weak electrical machinery industry including the IT related equipment, (b) The British government can maintain its own monetary policy by rejecting participation in Euro and (c) A shortage of labor in public sector (excessive restructuring carried out in the past) mitigates the worsening of a labor supply and demand situation. The French economy, though slowing down, is expected to sustain the rate of growth of around 2% as well due to a steady employment situation as measures for the deregulation of employment have been already taken ahead of Germany and also to a low degree of dependence on exports of the IT related.

The Asian countries except China have been seriously affected by the effect of the bursting of the IT bubble in the U.S. China, as a worldwide production base for products of a large volume, has been playing a more important role than before, sustaining the high level of direct investment and achieving a good performance in the economy. Other Asian countries continue to experience the negative impact caused by a decrease in the export of the IT related equipment, and Taiwan and Singapore, in particular, which had a good performance in the economy in 1997-1998, were compelled to show a negative rate of economic growth in 2001 due to a sharp decline in exports of the IT related equipment, which would be symbolic of the worldwide, simultaneous IT related slump this time. In the meantime, the Korean economy is expected to grow around 2% in 2001 due to a steady trend in exports excluding the IT related. ASEAN countries, except Malaysia whose dependence on exports of the IT related equipment is high, show a limited decline in the rate of growth in the economy, although their political situation remains unstable.

II. Forecast for the Japanese economy

1. Japanese economy in Fiscal 2002

In Fiscal 2002, the rate of growth in the Japanese economy is limited to 0.1% caused by a slow recovery in demand due to the aftermath of a sharp decline in exports of the IT related. With a backdrop of a recovery of the U.S. economy and the development of weak yen, Japanese exports centering on the IT related will gather momentum starting from the spring in 2002, gradually improving the economy. However, the manufacturing sector whose earnings were forced to deteriorate due to a sharp decline in industrial production in Fiscal 2000-2001 will continue to curtail investment and reduce employment, pulling down the economy as a whole. Problems about the gigantic amount of bad debts and companies whose power was used out to dispose of such debts seem to remain difficult to be solved all at once. Taking into account a weak recovery of the world economy in 2002, this fiscal year should be regarded as a rehabilitation year for the Japanese economy to recover.

(Consumer spending)

Consumer spending will gradually increase in line with the turnaround of employment situation, but the real rate of growth will continue to be limited to a low level of 0.1%. However, a structural change in consumer spending has not been reflected in statistics so far, the rate of growth including Fiscal 2000 – 2001 may be revised upward.

First, employment, the largest factor to affect consumer spending, will show a gradual improvement. The restructuring of employment in the manufacturing sector fully carried out since the spring in 2001 will be over in the second half of Fiscal 2001 and the tempo of reducing employees will gradually slow down. The service industry, which supported employment in Fiscal 2001, will continue to hire new employees. A rise in the unemployment rate will be limited to 5.4% in fiscal 2002 from 5.2% in Fiscal 2001 because a sharp rise in unemployment can be avoided by a decline in the labor force participation ratio while the number of employees continues to decrease until the spring in 2002. Wages will continue to show a negative trend because the effect of worsened earnings in Fiscal 2001 remains until around the summer in 2002, but they will move toward a positive growth as earnings recover thereafter. Generally speaking, an environment around employment and wages cannot be expected to significantly improve, but the situation where consumer spending will further deteriorate during Fiscal 2002 seems to be able to be avoided.

In the meantime, a demand for consumer durables, entering into a slump in Fiscal 2001, can be expected to recover in Fiscal 2002. Passenger cars, in particular, which had been bought in late 1980s, have already entered into a period for the replacement purchase thereof, and if consumers have a bright prospect for employment and income in the future, a demand for such durables may rise in an unexpectedly large scale. Besides, the sale of TVs in a large size and with higher levels of function and goods with famous brand will continue to fare well due to the replacement effect of the suspension of overseas traveling overshadowed by the occurrence of terrorism. Meanwhile, a demand for PC and cellular phone whose rate of diffusion has risen will continue to be stagnant.

(Housing investment)

Housing starts in Fiscal 2002 will decrease to 1.1 million from 1.16 million, posting the real rate of negative growth of 3.4%. Employment situation and taxation system have given further influence over a demand for housing since the latter half of 1980s when most people basically obtained houses. When the employment environment is favorable and the rate of income growth is high, the reconstruction of single-family homes is promoted and first-time purchasers of houses temporarily increase. Furthermore, if tax cut on housing loan as a measure for stimulating the economy is enforced, a advanced demand for reconstructing houses temporarily increases.

All the positive factors as aforementioned occurred from Fiscal 1999 to the first half of Fiscal 2000, causing the housing investment to increase more than expected. However, such positive factors have disappeared since the second half of Fiscal 2000 and thus, housing investment will remain compelled to be stagnant in Fiscal 2002. Single-family homes, in particular, will continue to be in poor demand as the owners thereof can choose the timing of reconstruction. Furthermore, the construction of a high-rise condominium in the center of the Metropolis once boomed to obtain potential demand from Fiscal 1999 to the beginning of Fiscal 2000 due to a decline in the price of land and corporations taking initiatives to dispose of idle land held, but it has been compelled to slow down thereafter. The number of houses for rent will, however, be built at the same level as in Fiscal 2000 in order to obtain people’ s needs to move out of obsolete houses for rent.

(Capital investment)

The rate of growth in capital investment in Fiscal 2002 will have to be negative 1.4% as compared to 1.3% in Fiscal 2001. This is caused by the fact that the effect of a sharp decline in capital spending in the second half of Fiscal 2001 due to a fast deterioration in earnings will appear in the statistics in Fiscal 2002. Capital spending in Fiscal 2002 will continue to mildly expand for reasons as the following: (a) the curtailment of capital investment by the electrical machinery industry running its course, (b) a turnaround of the store related investment curtailed by a reaction to rushed investments carried out to open new stores before the enforcement of the Large Retail Store Location Law and (c) a continued increase of investment in the communication-related such as the cellular phone related.

From the viewpoint of macro economics, corporate earnings will recover in Fiscal 2002 due to the effect of a reduction of fixed cost by restructuring employment and corporate cash flows remain abundant, which should be factors to support capital investment.

(Public investment)

Public investment will pick up 1.4% in Fiscal 2002 compared with the previous year, which should, however, be a pause in a downtrend. This is because the curtailment of public spending by local governments bottomed out in Fiscal 2000-2001 and much of additional public spending in the second supplementary budget for Fiscal 2001 was carried forward to Fiscal 2002. Public spending in Fiscal 2001, however, decline to the same level as in Fiscal 2000 because the supplementary budget in Fiscal 2000 could not be used in Fiscal 2001.

(Export and import)

The rate of growth in the volume of exports in Fiscal 2002 is expected to make a turnaround to post only 0.7% from the previous fiscal year when exports recorded a negative growth of 11.2% on a year-to-year basis, the largest decline since 1970s. A decline in exports bringing recession this time will be over for a while. Exports of electrical machinery will increase 0.9% in Fiscal 2002 as compared with negative 25.9% in Fiscal 2001 on a year-to-year basis, which should set a general trend for exports. The sale of PCs in the U.S. is picking up due to the introduction of a low-priced new products while the curtailment of investment in the IT related has run its course and the excess inventory of cellular phones mainly in Europe has been almost liquidated by the end of 2001, both of which should augur well for the export of Japanese electrical machinery. Other products except chemical products and autos will make a mild turnaround for export due to positive factors such as weak yen and the recovery of the world economy. The export of chemical products to Asian countries will recover after the decrease affected by starting new local plants in 2001. The export of autos to the U.S. will inevitably decrease due to Japanese automakers' brisk local production in the U.S. Except for electrical machinery, Japanese exports in general have become less affected than before by the fluctuation of overseas economies. It is pointed out that an assembly plant for the final products with a wide fluctuation in response to demand was transferred overseas.

In the meantime, the rate of growth in the volume of imports will increase 1.0% in Fiscal 2002 from a negative 5.2% in Fiscal 2001 on a year-to-year basis. General machinery including electrical machinery decides a trend in import as a whole. Imports are more closely linked with domestic demand than in the past because the import of products has penetrated into the domestic market during 1990s, and thus, a mild recovery of the domestic demand will lead to a rise in imports. The tempo of inflow of clothing and home electrical appliances from China is, however, gradually slowing down.

(Balance of payments)

The current account surplus in Fiscal 2002 will increase slightly to 10.9 trillion yen from 10.2 trillion yen in the previous fiscal year. Due to a sharp decrease in exports, a trade surplus shows a remarkable decline to 7.6 trillion yen in Fiscal 2001 from 11.5 trillion yen in the previous fiscal year, but income balance surplus sharply increases to 9.2 trillion yen in Fiscal 2001 from 6.7 trillion yen in the previous fiscal year. Thus, a decrease in current account surplus is limited to less than 2 trillion yen compared with the previous year. An increase of earnings from reinvestment in overseas subsidiaries is partly attributable to a sharp expansion of income balance surplus. This results most likely from additional earnings booked by a practice of consolidated accounts, which have not been posted before. In Fiscal 2002, both exports and imports will show a mild increase, resulting in the increase of a trade surplus to 7.9 trillion yen from 7.6 trillion yen in Fiscal 2001, but special factors on income balance have been discounted, resulting in the tempo of such increase to slow down. Thus, there should be no significant change in a current account surplus. In the meantime, a deficit in service account will stand at 5-6 trillion yen, which has been stable for the last 10 years, and a decrease in the number of overseas travelers due to the occurrence of terrorism should not have such an impact to change the total amount of deficit in service account.

(Price)

The rate of increase in consumer price index in Fiscal 2002 will be negative 0.4%, a consecutive decline in price for 4 years, but the rate of decline will be slightly decelerated. This will be caused by a declining trend in food price running its course because the influence of the expansion of imports of vegetables from China and mad cow disease will diminish. The largest contributors to a decline in consumer price are agricultural products, rent and home electrical appliances. A decline in the prices thereof has been arisen from the adjustment of a relatively high domestic price to an international standard price with a backdrop of a weak domestic demand in a slump in the economy.

2. Japanese Economy in Fiscal 2003

In Fiscal 2003, a shock in the decrease of exports will run its course and the prospect for the pending problems of non-performing assets will become almost certain. Thus, corporate managers' sentiment improves leading to a brisk revival of renewal investment, which will have been curtailed until that time. Furthermore, consumer spending will increase in a full-scale in line with the tempo of increase in consumers' income. In the meantime, the Bank of Japan has no alternatives but to maintain " Zero Interest Rate Policy" set by its own decision, and a gradual decline in real interest rate will begin to work for the economy. Bad debt problem will have a sign of being solved due to a steady recovery of the economy and a gradual decrease of the occurrence of additional bad debts.

(Consumer spending)

Consumer spending will show a steady recovery in Fiscal 2003. The rate of growth in disposable income will reach near 2% due to an increase in the number of employees and the rate of rise in wages, making consumer sentiment bright. Companies belonging to service business are most willing to hire new employees regardless of the current slowdown in the economy, and in Fiscal 2003, when the restructuring of employment in the manufacturing sector is over, employment will begin to show a smooth expansion. Corporations are seeking to take a chance to implement the adjustment of distorted structure in personnel created by the long-term curtailment of employment and the increase of personnel to be put into new business areas. Besides, the so-called China boom will peak out in Fiscal 2002 when China participates in WTO, and it is hard to imagine for a China shift in employment to be accelerated thereafter.

As to consumer spending, a replacement demand for auto will further expand and a demand for the IT related equipment will rise because the next generation cellular phone service and high-speed communication circuit service enter into a full-scale diffusion phase. In addition, a demand for overseas traveling, curtailed by the occurrence of terrorism from the second half of Fiscal 2001 to the first half of Fiscal 2002, will revive.

(Housing investment)

Housing starts in Fiscal 2003 will stand at 1.1 million, almost the same as in the previous year. Employment situation will improve, limiting a decrease of housing starts for single-family homes, but the reduction of buying land starting from the second half of Fiscal 2001 will result in a decrease of housing starts for condominium. Besides, the present tax cut in housing loans will expire in December 2003, but such tax cut will most likely continue in one way or another. Rushed housing starts to utilize the tax cut should be limited to be insignificant as an advanced demand for the reconstruction of houses occurred from Fiscal 1999 to the beginning of Fiscal 2001.

(Capital investment)

The rate of growth in capital investment in Fiscal 2003 will rise to 5% due to a full-scale recovery of earnings. The renewal investment curtailed by the cottage industry and small and medium enterprises due to fast deterioration in earnings will begin to rise. In addition, large manufacturers centering on electrical machinery producers will make a turnaround for a positive equipment investment supported by abundant cash flows. The aftermath of the bursting of the IT bubble runs its course, so additional investment in expanding the production of semiconductor, an LCD, the long-distance communication related will be made. In the non-manufacturing sector, investment in the communication related will continue to gain momentum and investment in the urban redevelopment related will expand triggered by the construction of large buildings in the center of the Metropolis whose completion is centered around the year 2003. In the distribution industry, investment in the construction of new stores and the remodeling of the existing stores can be expected.

(Public spending)

The rate of decrease in public spending will be accelerated again to negative 7.7% in Fiscal 2003. This is caused by lack of additional public spending by a large-scale supplementary budget in Fiscal 2002. However, the nominal amount of public spending at the end of Fiscal 2003 will return to the level as in the middle of 1980s, and the tempo of a reduction of public spending will decelerate in Fiscal 2004 and thereafter.

(Export and import)

The rate of growth in the volume of exports will expand slightly to 4.4% in Fiscal 2003 from the previous year. This will be caused by a higher rate of growth in the export of the IT related products directed toward the U.S. and Asian countries. However, Japanese yen will start strengthening again and Japanese products will face severer competition with Chinese ones, thus, preventing the rate of growth in exports from rising as in the past, regardless of a full-scale recovery of the world economy. In the meantime, the rate of growth in imports will rise to 4.3% in line with the expansion of domestic demand. It can be said as normal that the rate of growth in domestic demand of around 2% corresponds to the rate of growth in imports of around 4%.

(Balance of payments)

The current account surplus in Fiscal 2003 will stand at 12.8 trillion yen considerably exceeding 10.9 trillion yen to be recorded in Fiscal 2002. However, such level is much lower than 15.2 trillion yen recorded in Fiscal

1998. The amount of yen-denominated imports will decrease due to higher yen, which is the main cause of the expansion of current account surplus, and the surplus will not necessarily be on the rise in a long-term perspective.

(Price)

The rate of decline in price in Fiscal 2003 will further shrink to negative 0.2%. The price of agricultural products and services will turn upward, but the price of industrial products will continue to decline due to the development of high yen. Thus, the rate of growth in consumer price index will not make a turnaround for a positive one on a year-to-year basis during Fiscal 2003.

III. Forecast for overseas economies

The year 2002 can be regarded as an approach run for the recovery of the world economy. The unfavorable effect of the bursting of the bubble will run its course and the positive influence of ultra-monetary ease simultaneously adopted by all the major countries as a result of a simultaneous slump in the world economy will gradually emerge in the beginning of 2002, which should trigger the recovery of the world economy. In 2003, the positive cycle of increased production, employment, income and consumer spending will be set and the world economy will move back on smooth growth track because IT investment will begin to expand again in a full scale in order to upgrade semiconductor and others.

1. Trend of the U.S. economy

The U.S. economy will gradually turn around from the middle of 2002, but the rate of economic growth will be limited to 0.2%. The bottoming out of a slump in the IT related capital investment and the increasing effect of low interest rate on a reduction of cost for interest payment will trigger the recovery. When corporations have a bright prospect for the recovery of earnings, the restructuring of employment will be over and the rate of growth in consumer spending will gradually go higher. If a demand for semiconductor as a leading indicator for the IT related capital investment is analyzed, it already bottomed out in September 2001, and thus, the IT related capital investment will stop falling in the near future. The recovery of investment in long-distance basic system communication equipment will be postponed to the year 2003 and after due to an excess of equipment, but the construction of a LAN within office and renewal investment in PCs will make a turnaround from the first half of 2002.

Due to FRB’ s aggressive reduction of interest rate of as much as 4.75% for the past one year, corporations’ burdens of the payment of interest will be reduced from US$550 billion to US$ 500 billion, creating the effect of earnings growth of 11%. Furthermore, the positive restructuring of employment in much faster speed than as in economic slumps in the past will sharply reduce the rate of growth in the burdens of personnel expense, naturally working for a growth in corporate earnings. A sharp decrease of earnings occurring in 2001 has already pushed down profit rate to near the bottom as witnessed in the past recessions, and thus, a further deterioration in earnings is most likely to be avoided.

It has taken about one year for the recession this time to become genuine one starting from the bursting of the IT bubble in March 2000 to worsened corporate earnings and a reduction of employment. Similarly, it may take about one year for the IT related investment and corporate earnings to make a turnaround and for the employment to expand. Accordingly, it is anticipated to be around the spring in 2003 that the U.S. economy will enter into a full-scale recovery trend. In addition to the advanced tax cut of US$40 billion implemented in the summer of 2001, the U.S. government is planning to spend the total amount of US$50 billion by tax cut and the expansion of financial expenditure, which is expected to work for mitigating a slowdown in the economy occurring in the first half of 2002 due to a reaction to created demand for autos by zero-interest loans and others.

In the beginning of the year 2003, the pattern of usual economic expansion, namely, increased demand leading to production expansion, increased employment and increased income, will be set, and the rate of economic growth will rise to 2.7%. However, it seems difficult for the rate of growth to be accelerated immediately to near 4-5% as in 1990s. First, the recurrence of asset price bubble (a rise in stock price) which supported the expansion of consumer spending in late 1990s cannot be anticipated anymore. Due to the bursting of the IT bubble, the U.S. institutional investors must hold a potential loss of the gigantic magnitude due to the bursting of the IT bubble, so it is strongly feared that the disposal of such bad debts may become the burdens of the economy in the same way as the Japanese economy has been experiencing since 1990s. Second, the low savings rate, a grave concern since 1980s, and the resultant gigantic current account deficit have not been solved. Such problems do not attract people’ s attention while the economy is booming, but if a low rate of growth in the economy continues, overseas governments and investors are most likely to demand the U.S.

government to solve the problems. One of the end results remains to be a crash in the value of U.S. dollar. Third, the fiscal balance has started deteriorating again. As a result of the economic boom continued for the past 10 years, the U.S. once seemed to be freed from fiscal problems, but the fiscal balance is feared to move into the red as early as Fiscal 2002. Similar to Japan, the U.S. will enter into a real era of the aged after the time lag. It is certain that an increase in budget relating to social security covered thus far by a smooth increase in tax revenues will become a problem again.

The U.S. economy may be forced to experience a low rate of growth in a mid-term perspective, similar to the Japanese economy in 1990s.

2. Trend of the European economy

The European economy has entered into a slowdown in the economy, though milder than in Japan and the U.S. The average rate of economic growth in EU will decline to 1.5% in 2001 from more than 3% in 2000, and then it is expected to further decline to around 1% in 2002. The reasons for such mild decline are the following: (a) EU has a low dependence on exports of the IT related products directed to the U.S., relatively insulating the economy from the effect of the bursting of the IT bubble, (b) The magnitude of decrease in consumer spending during 2001 was small due to the effect of income tax cut implemented by each member countries in the first half of 2001, and (c) Due to the effect of integration of EU countries, corporate activities have become brisk, sustaining steady capital investment.

During the first half in 2002, the economy will appear somewhat stagnant due to the light adjustment of capital spending centering in Germany, but in the second half, the economy will be fully felt by the effect of monetary ease (ECB has reduced a short-term interest rate1.5% in total since October 2000) and a pickup of the U.S. economy will give a positive effect on the European economy after some time lag. However, the European economy is clearly more self-sustaining than the Japanese and Asian economies, resulting in having smaller influence by the U.S. economy. Thus, the tempo of the economic recovery will be limited to be mild during 2002. Germany, the worst performer in the economy among the EU countries, will show a somewhat higher rate of recovery due to a reaction to a sharp decline in the economy.

The effect of the integration of EU will be further enhanced in the beginning of 2003, and besides, a move to the re-enlargement of the EU integration will be carried out in earnest, raising the rate of growth in capital investment and restoring the rate of economic growth to over 2% in 2003.

3. Trend of the Asian economies

The temp of economic recovery of Asian countries except China during 2002 will have to be slow, similar to other economies. This can be said as the fate of Asian countries whose dependence on exports is high. Furthermore, NIEs countries have excess capacity to make production equipment for the IT related, and the adjustment of capital investment will continue in 2002. In conclusion, it must be the year 2003 when the world economy gets back on track for smooth growth that the Asian economies will show a genuine recovery. Taiwan, Singapore and Malaysia who are suffering from the bursting of the IT bubble will regain a relatively favorable position in 2003 and thereafter. Indonesia and Philippine will continue to be confronted with political instability, giving concern about a negative effect on the economy through a diminished direct investment by foreign capital.

In the meantime, China has sustained an exceptionally high rate of economic growth amidst a simultaneous slump in the world economy, but its boom is likely to peak out in 2002, immediately after China participated in WTO and its growth may pause in 2003 and thereafter. China maintains its high economic growth by receiving direct investment from all over the world as a supply base for the assembly, but if consumer demand in the U.S., the largest customer for its exports, slows down, China will have to face the adjustment of the economy to some extent. Besides, China will have to gradually bear various obligations as a result of its participation in WTO and also to cope with, in earnest, environmental problems left untouched so far. Chinese business has been successful so far taking a strategy to make private companies specialize in the assembly through making use of the abundant labor force, but if the economy slows down, the problems of nationalized companies in the material and service sectors left untouched thus far may recur.

4. Trend of the price of primary products

Crude oil price will continue to have pressures to go down all through the year 2002 due to a stagnant demand caused by a slowdown in the world economy. The average crude oil price on a WTI basis will decline to US$ 19 a barrel in 2002 from US$ 24 in 2001, and recover slightly to US$ 21 in 2003 due to a pickup in demand. Provided, however, that if a reduction of production by oil producing countries including non-OPEC is not smoothly maintained, a sharp decline in crude oil price as witnessed in 1997-1998 will likely recur. The prices of other primary products will continue either to move sideways or to decline under basically excess supply capacity conditions.

IV. Interest rate and forecast of exchange

1. Trend of interest rate in Japan

Bank of Japan will continue to keep zero interest rate policy throughout Fiscal 2003. This policy is based on the Bank of Japan's clear statement on the conditions to thereby cancel zero interest policy, saying "To confirm consumer price index to rise steadily above 0%". Bank of Japan will begin to seek to have a chance to raise short-term interest rate in the beginning of Fiscal 2003, but the Bank will continue to be restricted by such express conditions on the policy initiative.

In the meantime, long-term interest rate will be on the gradual rise from the end of 2002 to reach 1.5 – 2.0% when uncertainty about a trend in the economy is cleared after the ultra-low level of interest rate of 1.0 - 1.5% has continued until the middle of 2002. Around the summer in 2003, however, the peaking out of the Japanese financial deficit will be confirmed and Japanese Yen will begin to move toward 100 yen for one dollar, so long-term interest rate will move sideways thereafter.

2. Trend of interest rate in the U.S. and Europe

The easy monetary policy taken by FRB has entered into the final stage as the real short-term interest rate reached near zero. It still remains to be seen that FRB will make the additional and final reduction of interest rate in the very beginning of 2002, but the discount rate was reduced to 1.5% on December 11, leaving not much room for FRB to reduce interest rate in the future. FRB will maintain a posture to monitor the effect of such monetary ease until around the autumn in 2002. The recovery of the economy will be confirmed around the end of 2002 and FRB will begin to shift its policy from a very low interest rate policy for emergency evacuation to the moderate monetary relaxation to cause short-term rate (3-month TB) to rise above 3%. The timing of raising short-term rate will likely be somewhat sooner than expected, but FRB should be hesitant in raising the rate while the rate of rise in prices continues to be negative by the beginning of the autumn in 2002. In the second half of 2003, the economy will show an accelerated growth, necessitating FRB to shift its monetary policy to the neutral one to cause a short-term rate to rise above 4%.

In the meantime, a long-term interest rate in the U.S. (10-year government bond) will stay at around the present 5% until the middle of 2002. The long-term rate will, thereafter, enter into a gradual uptrend from the autumn of 2002 ahead of short-term rate rise to reach around 6% by the end of 2003. The fiscal balance will change from a surplus to a deficit, but the tempo of a rise in long-term rate will be more moderate than as in the usual recovery phases in the past because a stable trend in prices is maintained.

ECB will cautiously maintain a monetary ease throughout the year 2002. ECB believes that ECB's cautious attitude toward easy monetary relaxation will enhance a credibility of ECB, and thus, leading to the improvement of long-term performance of the economy and prices. Long-term rate will continue to move sideways at a little less than 5%. In the beginning of 2003, ECB will gradually restore the level of short-term interest rate to the neutral one (4 - 5%) to cause the long-term rate to rise to 5.5 - 6.0%.

3. Move of exchange

Japanese Yen will temporarily weaken to over 130 yen for one dollar in the first half of 2002 when the Japanese economy is in a serious slump. However, in the latter half of 2002, Yen will strengthen to around 120 yen for one dollar by confirming that the worst period of the economy is over. Yen will become stronger by making sure of the softlanding of the Japanese economy in the beginning of Fiscal 2003, and reach around 100 yen for one dollar at the end of Fiscal 2003. The purchasing power parity of yen-dollar rate has clearly declined about 15% for the last 5 years due to the differential of a rise in consumer prices between Japan and the U.S., and it will be difficult to insist that the level of 100 yen for one dollar is excessively high for the Japanese Yen. The average yen rate for one dollar is estimated at 124 yen in Fiscal 2001, 118 yen in Fiscal 2002 and 107 yen in Fiscal 2003.

Dollar for one euro will reach 1.1 at the end of 2003 due to the gradual correction of excessive weakness in the present level of euro. The inflow of fund into the U.S. will peak out and the existence of the gigantic amount of a current account deficit will, again, come to the fore. Thus, U.S. dollar will show overall weakness against other major currencies.

End

Outlook for Japanese Economic Indicators

GDP-Related Indicators

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

	FY2001 (forecast)	FY2002 (forecast)	FY2003 (forecast)
GDP (real)	530.5 (-1.0)	530.9 (0.1)	541.2 (2.0)
Private consumption	287.9 (-0.8)	288.3 (0.1)	295.8 (2.6)
Residential investment	18.5 (-8.4)	17.9 (-3.4)	18.0 (0.7)
Non-residential investment	90.4 (1.3)	89.2 (-1.4)	93.6 (5.0)
Government consumption	90.0 (2.9)	91.0 (1.0)	91.7 (0.9)
Public investment	35.5 (-5.3)	36.0 (1.4)	33.2 (-7.7)
Increase in inventories	-1.8 [-0.0]	-0.7 [0.2]	0.3 [0.2]
Net exports of goods & services	10.0 [-0.5]	9.3 [-0.1]	8.6 [-0.1]
Exports	54.8 (-8.4)	54.4 (-0.7)	55.9 (2.7)
Imports	44.8 (-4.9)	45.1 (0.6)	47.2 (4.8)
GDP (nominal)	501.2 (-2.3)	497.3 (-0.8)	505.4 (1.6)
GDP Deflator	94.5 (-1.4)	93.7 (-0.8)	93.4 (-0.3)
Industrial production index	94.4 (-9.9)	92.7 (-1.8)	95.7 (3.2)
Wholesale price index (overall)	96.9 (0.1)	95.9 (-1.1)	94.5 (-1.5)
Consumer price index	99.2 (-0.7)	98.8 (-0.4)	98.6 (-0.2)

Notes: Real gross domestic products and real gross national products are in 1995 prices.
Industrial production index and wholesale price index: 100 for 1995.
Consumer price Index: 100 for 2000.
[ ] = contribution to changes.

Balance of Payments Indicators

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

	FY2001 (forecast)	FY2002 (forecast)	FY2003 (forecast)
Current account balance	10.2	10.9	12.8
Trade balance	7.6	7.9	9.9
Exports	45.5 (-8.7)	44.2 (-2.9)	44.8 (1.5)
Imports	37.9 (-0.9)	36.3 (-4.3)	35.0 (-3.7)
Services	-5.3	-5.0	-5.2
Income	9.2	9.2	9.2
Current transfers	-1.2	-1.2	-1.1
Yen-dollar rate	123.6	118.0	107.3

Customs Clearance Volume Index

(100 for 1995)

	FY2001 (forecast)	FY2002 (forecast)	FY2003 (forecast)
Exports volume index	109.6 (-11.2)	110.4 (0.7)	115.3 (4.4)
Imports volume index	119.0 (-5.2)	120.2 (1.0)	125.4 (4.3)

Outlook for US Economic Indicators

GDP-Related Indicators

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

	2001 (estimate)	2002 (forecast)	2003 (forecast)
GDP (real)	9,343.9 (1.3)	9,358.3 (0.2)	9,614.5 (2.7)
GDP (nominal)	10,215.5 (3.5)	10,357.7 (1.4)	10,784.5 (4.1)
Personal consumption	6,444.1 (3.0)	6,496.0 (0.8)	6,634.3 (2.1)
Residential investment	376.8 (1.5)	349.2 (-7.3)	366.2 (4.9)
Non-residential investment	1,304.7 (-3.4)	1,208.3 (-7.4)	1,243.0 (2.9)
Government consumption & investment	1,623.4 (3.2)	1,659.6 (2.2)	1,694.3 (2.1)
Federal	558.4 (2.3)	573.3 (2.7)	584.3 (1.9)
State & local	1,064.4 (3.7)	1,086.3 (2.1)	1,110.0 (2.2)
Increase in inventories	-35.1 [-0.9]	16.3 [0.5]	46.3 [0.3]
Net exports of goods & services	-407.7 [-0.1]	-420.9 [-0.1]	-427.6 [-0.1]
Exports	1,085.5 (-4.2)	1,031.0 (-5.0)	1,063.6 (3.2)
Imports	1,493.2 (-2.6)	1,451.9 (-2.8)	1,491.1 (2.7)
Industrial production index	140.2 (-3.8)	136.9 (-2.4)	139.8 (2.2)
Producer price index	141.4 (2.4)	140.8 (-0.4)	141.9 (0.8)
Consumer price index	177.3 (2.9)	179.5 (1.3)	182.9 (1.9)

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.*

Balance of Payments Indicators

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

	2001 (estimate)	2002 (forecast)	2003 (forecast)
Balance on current account	-410.3	-382.8	-390.9
Balance on goods and services	-340.5	-309.5	-317.2
Balance on goods	-431.1	-417.1	-429.5
Exports	721.9 (-6.5)	662.9 (-8.2)	695.5 (4.9)
Imports	1,153.0 (-5.8)	1,080.1 (-6.3)	1,125.0 (4.2)