

Monthly Report of Prospects for Japan's Economy

April 2007

Macro Economic Research Centre
Economics Department



The Japan Research Institute, Limited

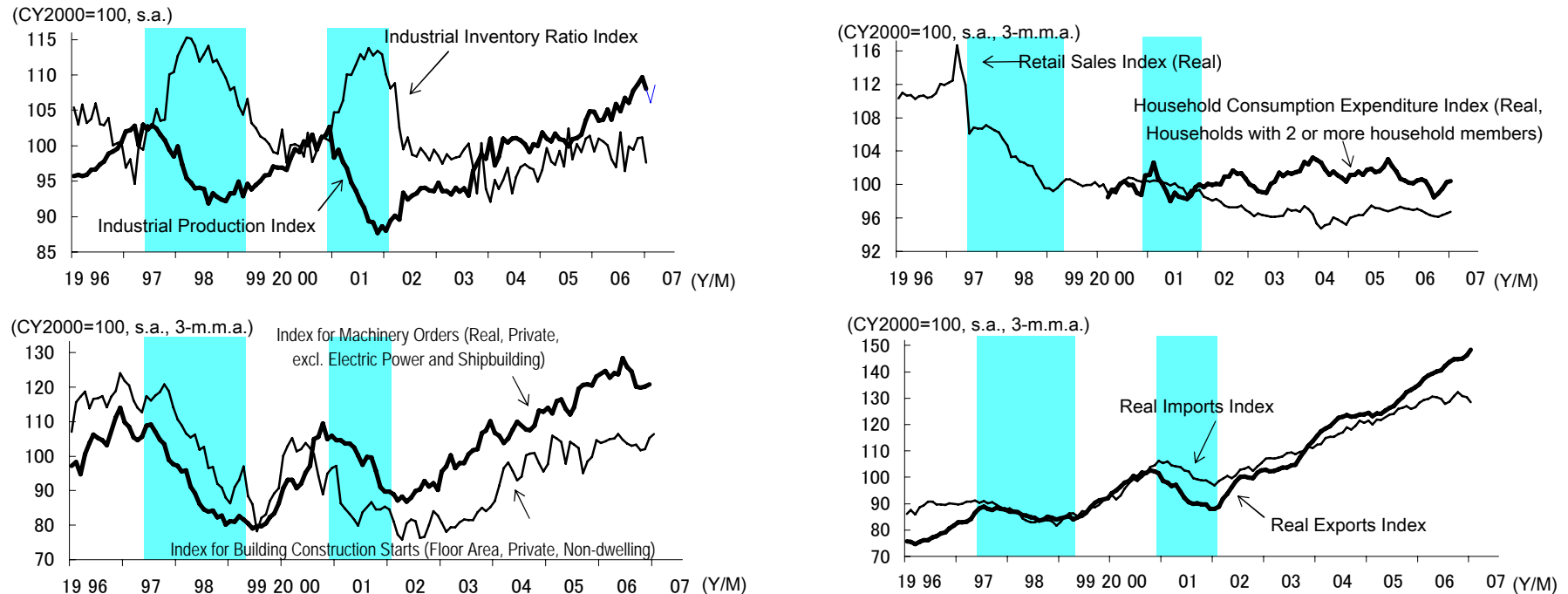
<http://www.jri.co.jp/thinktank/research/>

This report is the English version of the March 2007 issue of the original Japanese version.

Current situation of Japan's economy – Seems to have been decelerating during Q1

Japan's economy as a whole is following its recovery path, and it extended the post-war record length (58 months) of economic recovery in November last year. This tendency is bolstered especially by solid business activities in the corporate sector. However, in the new year, the economy seems to have been slightly decelerating in its pace of expansion. The industrial production index, which indicates the direction and the level of economic activity, appears to have fallen in Q1 CY2007 over the previous quarter, a quarterly decline for the first time in six quarters, reflecting in part a setback from the surge in Q4 last year. Based on the preliminary figure in the index in January as well as the prediction figures in February and March by The Ministry of Economy, Trade and Industry, the industrial production index is estimated to have declined 1.1 per cent in the first quarter of this year.

Figure 1 Main Indicators for Japan's Economy



Source: The Ministry of Economy, Trade and Industry, The Ministry of Internal Affairs and Communications, The Cabinet Office, The Ministry of Land, Infrastructure and Transport, The Bank of Japan

Note 1: Indices of Household Consumption Expenditure, Retail Sales, Machinery Orders, Building Construction Starts, Exports, and Imports are calculated as seasonally adjusted and 3-month moving averages.

Note 2: The Industrial Production Index in February and March 2007 is based on METI forecasts. Note 3: Shaded areas indicate periods of recession according to the Cabinet Office.

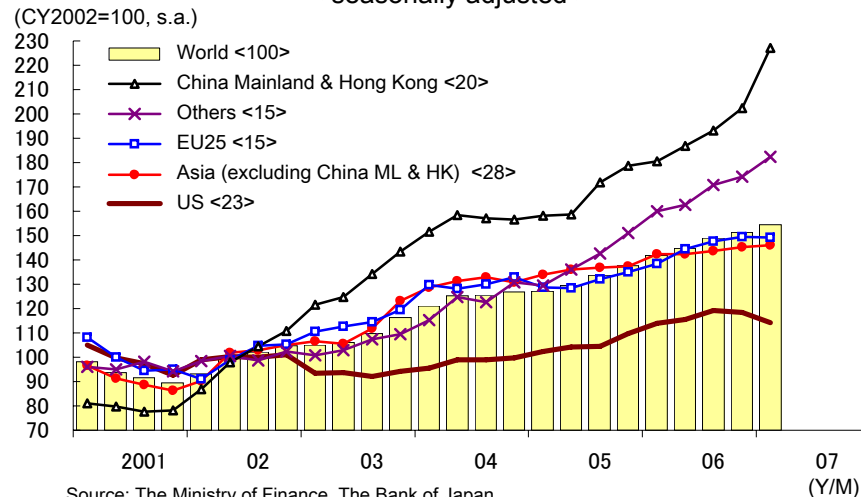
Exports – Estimated to have decelerated temporarily

Japan's economy is on a recovery track. However, looking at the economic phase for the present, the pace of the recovery would continue a moderate slowdown mainly because of a slowing of exports, as well as an adjustment of the production pace in the IT parts and devices sector.

As for exports, real exports in January are estimated to have maintained an increasing tendency based on our calculation, a 2.1 per cent rise over the final quarter of last year. However, it should be noted that that figure seems to have been counted larger than those on an underlying trend due to the lunar New Year factor in exports to China, as seen in the irregularity in the number of days worked there. Exports to the US seem to have begun to lose momentum to an estimated 3.6 per cent decline in January due to a slowing in exports of motor vehicles in addition to an ongoing decline in exports of general machinery. Looking further, brisk exports to resource-rich countries could continue to bolster the growth in real exports in the aggregate. Moreover, the leading Japanese products worldwide such as motor vehicles as well as digital household appliances and gadgets do have strong non-price competitiveness. Judging from these factors, it is unlikely that exports as a whole would turn downward, although they may well continue to decelerate for the moment, reflecting a slowdown in the US economy and a curbing of investment in China.

Figure 2-1 Japan's Real Exports by Region

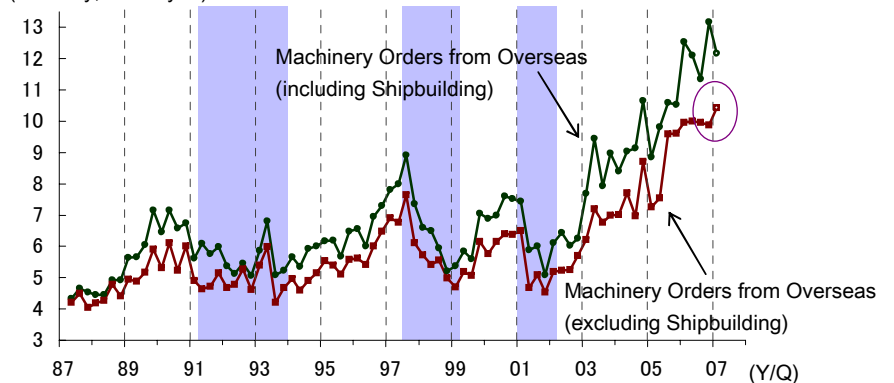
< seasonally adjusted >



- Note 1: The figures in angle brackets in the legend indicate the share of each region in total nominal exports of Japan (JY 75.3 trillion in FY2006). Percentage discrepancy due to rounding of figures.
- 2: Others: Middle Eastern countries, South American countries, Russia and so on.
- 3: The figure in Q1 2007 is for January 2007. The figure of exports to China mainland and Hong Kong in the same period rose due to the lunar New Year factor.

Figure 2-2 Machinery Orders from Overseas

(annually, trillion yen)

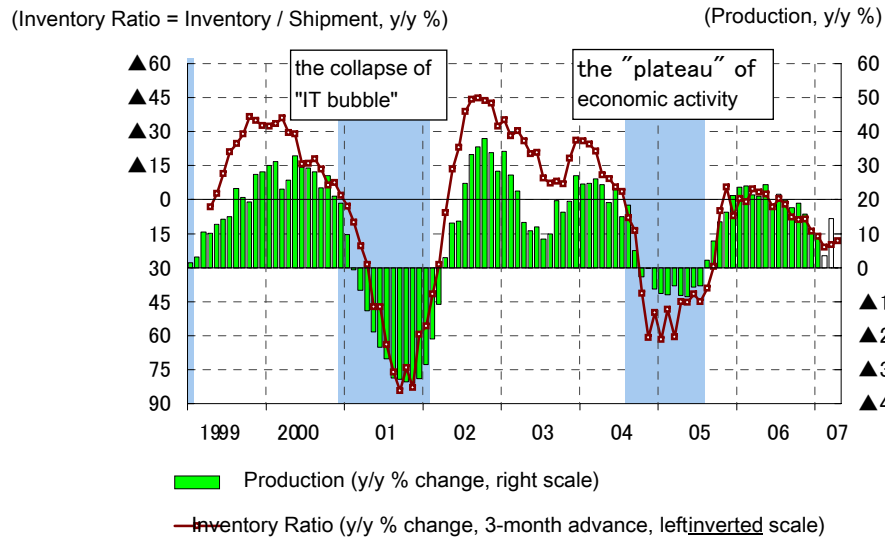


- Note 1: The figure including shipbuilding in Q1 2007 is the forecast by The Cabinet Office as of December 2006. The figure excluding shipbuilding in the same period is our estimate based on the forecast method of The Cabinet Office.
- 2: The circle mark on the line of machinery orders from overseas excluding shipbuilding as a volatile factor highlights recent moves. These seem to indicate a slowing in exports for the present and a subsequent possible re-acceleration from around the middle of the year.

The IT devices sector – Continuing slowdown in its pace of production

In the electronic parts and devices sector, of which moves are important for economic predictions, the pace of production which had accelerated last year would continue to decelerate for the moment, mainly due to a tailing-off of the piling-up in inventory in the run-up to the year-end and new-year sales. The production prediction index of the sector by The Ministry of Economy, Trade and Industry forecasts rather a 0.1 per cent quarterly decline in Q1 this year, even after taking account of a monthly bounce in March. However, looking further especially from this spring onwards, there appears no need to take a gloomy view of the outlook, because recent inventory ratios (inventory / shipment) in not a few leading products in the sector have been hitting a ceiling or maintaining a low level. In addition, it is probable that production would require only a minor adjustment, given the earlier appropriate supply-demand adjustment measures, against the backdrop of the latest solid demand both for final IT products and for IT parts and devices. Nonetheless, a close watch would be still needed as to how long that adjustment would continue, especially in the production of important products such as liquid crystal devices and charge coupled devices (CCD, IC parts for digital cameras), because the move largely depends on the future sales situation of the final products such as liquid crystal TVs and mobile phones.

Figure 3-1 Year-on-Year Change of Inventory Ratio and Production in the Electronic Parts and Devices Sector

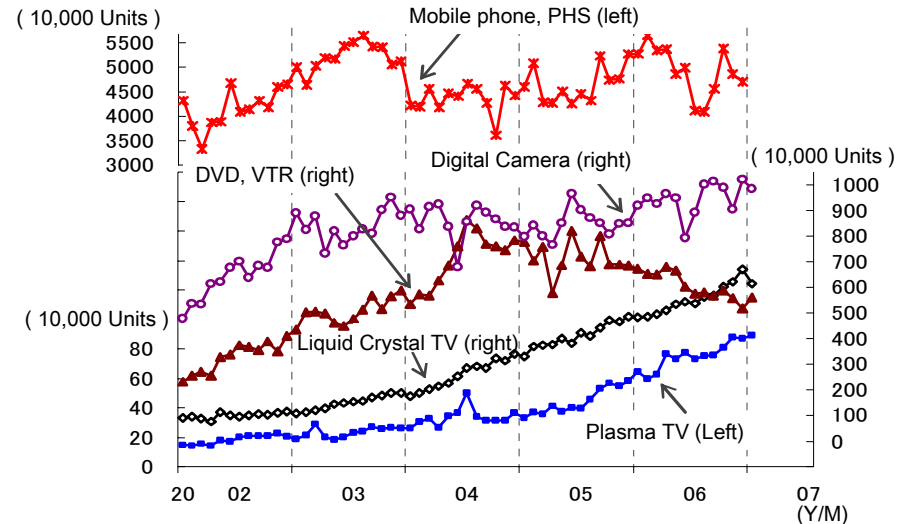


Source: The Ministry of Economy, Trade and Industry

Note 1: The figures in February and March 2007 are our estimates based on the prediction index by The Ministry of Economy, Trade and Industry.

2: The recent "plateau" of economic activity is indicated as the shaded area from August 2004 to July 2005.

Figure 3-2 Shipment of Household Electronic Equipment to the Domestic Market < seasonally adjusted >



Source: Seasonally adjusted by The Japan Research Institute, Ltd. based on the data of Japan Electronics and Information Technology Industries Association (JEITA) and Camera & Imaging Products Association (CIPA).

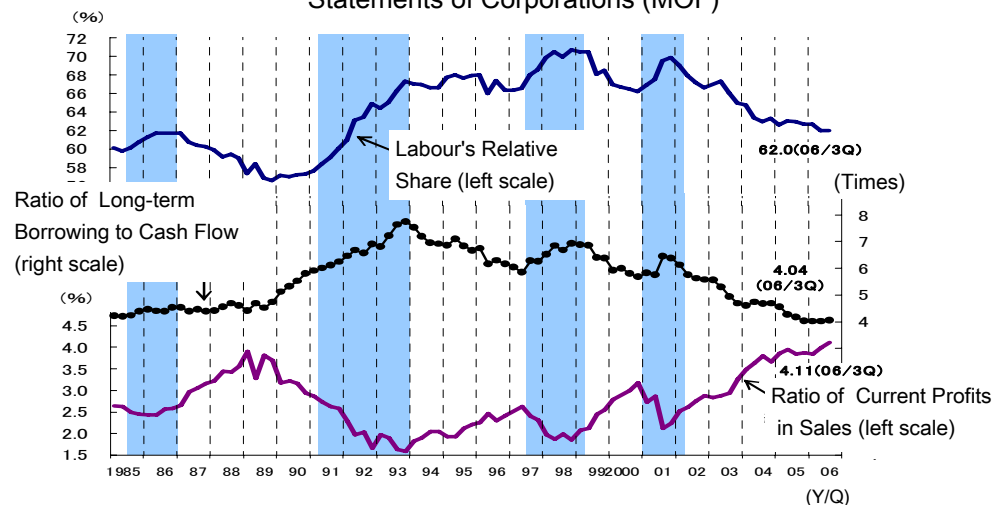
Monthly Report of Prospects for Japan's Economy April 2007

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Appreciable ability to absorb shocks – Backdrop of continuous recovery

It is widely recognised that Japan's economy retains appreciable abilities to absorb shocks. This seems to constitute the reason there is a low risk that the recovery trend of the economy could falter in the short run. The main advantages seen are as follows: (i) A low level of inventory ratio in manufacturing industry except for the IT parts and devices sector, for a short-term factor. Among those, the ratio in the metal and machinery sectors continues at its lowest level ever. Therefore, even if the IT parts and devices sector requires an adjustment, a major production adjustment across all sectors of manufacturing industry could be avoided. (ii) The dissipation of structural adjustment pressures in the corporate sector as well as abundant liquidity as its financial strength, for a medium-to-long-term factor. Statistics show, for example, that the ratio of current profits in sales in nonfinancial enterprises rose to a record 4.11 per cent in Q3 last year, and that net financial assets in nonfinancial enterprises amounted to 137.8 trillion yen at the end of September last year, which is the equivalent of 2.7 times total current profits during FY2005. With the management focus shifting from the "adjustment of excessive labour, capital equipment and debt" to "active business expansion aiming at survival against fierce global competition", the positive attitude toward business fixed investment as well as employment would continue.

Figure 4-1 Main Indicators based on Financial Statements of Corporations (MOF)

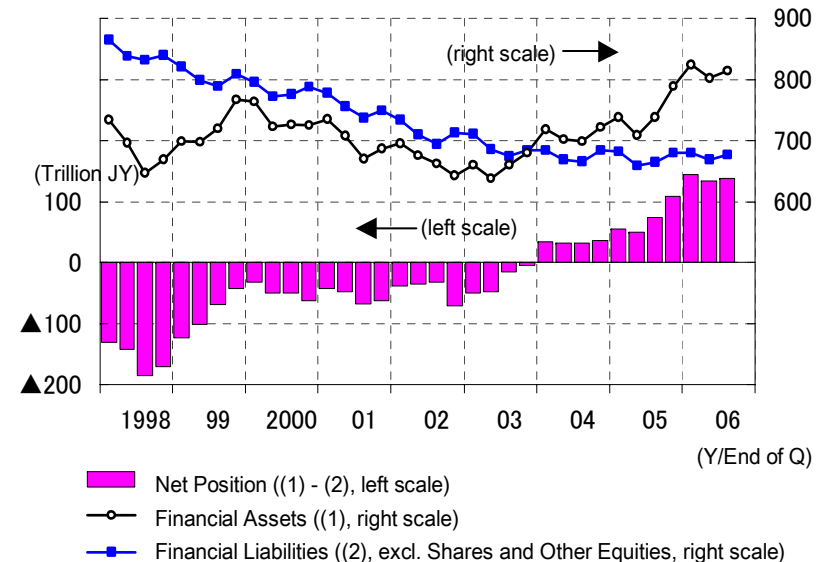


Source: The Ministry of Finance, "Financial Statements Statistics of Corporations by Industry: Quarterly"

Note: Labour's relative share = Personnel expenses / (Personnel expenses + Depreciation expenses + Interest expenses + Current profits)

Ratio of Long-term borrowing to Cash flow = (Bonds + Long-term borrowing) / (Current profits x 0.5 + Depreciation expenses)

Figure 4-2 Net Position in Financial Assets and Liabilities of Nonfinancial Enterprises (Trillion JY)



Source: The Bank of Japan

Business fixed investment - Continuing solid expansionary trend

According to the BOJ's Tankan December 2006 survey, enterprises forecast that their business fixed investment as a whole would accelerate in the second half of FY2006, partly due to the surge in investment brought forward from the first half among the motor vehicles and financial institutions sectors. There is scope for double-digit capital investment growth during FY2006 as a whole, for the first time since FY1991, if materialised. Looking further, business fixed investment would continue a firm tendency over FY2007 as well, led in the main by projects with medium-to-long-term perspectives, such as those related to research and development (R&D), as well as product and/or service development. This positive prospect is against the background of the favourable factors which include a continuing tendency of improvement in business fixed investment efficiency, an expected firm trend of corporate profits, and abundant liquidity as the financial strength of enterprises.

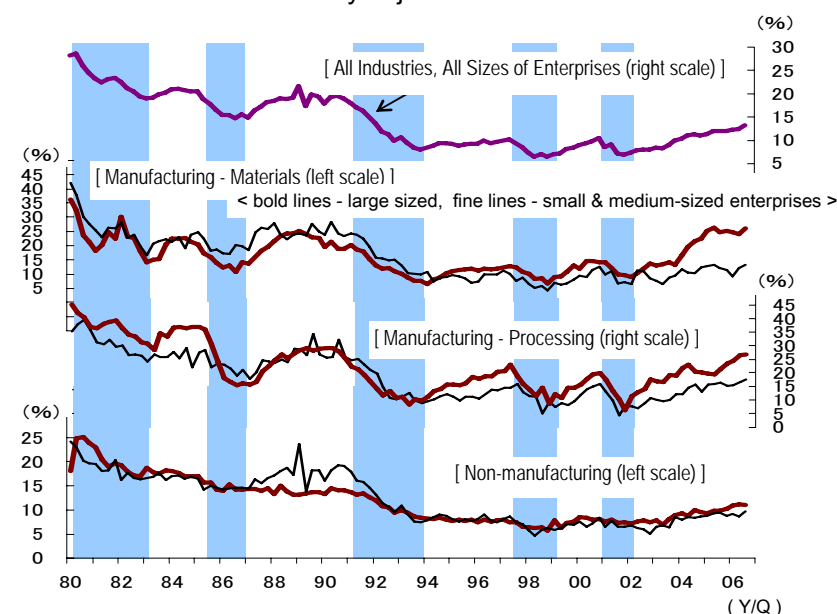
Figure 5-1 Annual Projections of Business Fixed Investment
< The BOJ's Tankan December 2006 Survey >

	Weight (FY2005)	(% change, on a year-on-year basis)				FY2006		FY2005 (forecast, as of Dec. 05)
		H1 FY05 (actual)	H2 FY05 (actual)	H1 FY06 (estimate)	H2 FY06 (forecast)	(actual)	(forecast)	
[Large Enterprises]								
All Industries (excluding Financial)	64.6	7.9	5.9	7.7	15.5	6.8	12.0	11.3
Manufacturing	23.1	14.9	12.0	11.1	20.8	13.3	16.4	17.6
Chemicals	2.8	16.8	10.7	5.3	20.4	13.5	13.3	20.7
Iron & Steel	1.4	41.5	30.8	32.7	52.4	35.5	43.4	36.7
Electrical Machinery	6.1	▲ 1.8	1.7	11.8	18.9	0.0	15.6	3.3
Motor Vehicles	5.0	40.2	23.0	▲ 11.5	11.5	30.1	1.2	32.6
Nonmanufacturing (excluding Financial)	41.5	4.4	2.7	5.8	12.6	3.5	9.5	8.1
Leasing	15.2	5.2	▲ 3.1	▲ 3.1	1.8	0.8	▲ 0.6	2.7
Information & Communications	8.7	16.2	17.0	9.5	8.2	16.6	8.8	15.8
Transportation	4.9	0.8	▲ 0.9	15.8	32.4	▲ 0.2	25.9	10.5
Electric & Gas Utilities	4.3	▲ 1.9	8.0	7.7	17.7	3.9	13.7	18.0
Wholesaling & Retailing	4.3	0.9	6.9	8.3	12.3	4.0	10.4	9.1
Construction & Real Estate	2.1	6.2	▲ 16.8	16.8	52.6	▲ 7.8	36.6	10.9
[Small & Medium-sized Enterprises]								
All Industries (excluding Financial)	15.7	11.3	14.3	8.2	3.3	12.8	5.7	9.3
Manufacturing	4.2	10.1	0.9	7.0	24.5	5.0	16.2	4.8
Nonmanufacturing (excluding Financial)	11.5	11.8	20.2	8.6	▲ 4.6	16.0	1.8	11.1
[All Enterprises]								
All Industries (including Financial)	100.0	8.5	8.8	7.9	12.9	8.7	10.6	11.3
Manufacturing	32.1	13.9	11.1	10.9	20.1	12.4	15.9	15.4
Nonmanufacturing (excluding Financial)	64.5	6.2	7.8	6.4	7.6	7.1	7.0	9.0
Financial Institutions	3.4	4.5	5.5	7.1	46.1	5.1	29.3	18.6

Source: The Bank of Japan

Note: The figures include software investment and exclude land purchase expenses

Figure 5-2 Business Fixed Investment Efficiency by Industry
< seasonally adjusted >



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note 1: Business Fixed Investment Efficiency is calculated as:

Operating Profits / Operating Tangible Fixed Assets (average outstanding balance)

Operating Tangible Fixed Assets = Tangible Fixed Assets - Construction in Progress

2: Shaded areas indicate periods of recession according to the Cabinet Office.

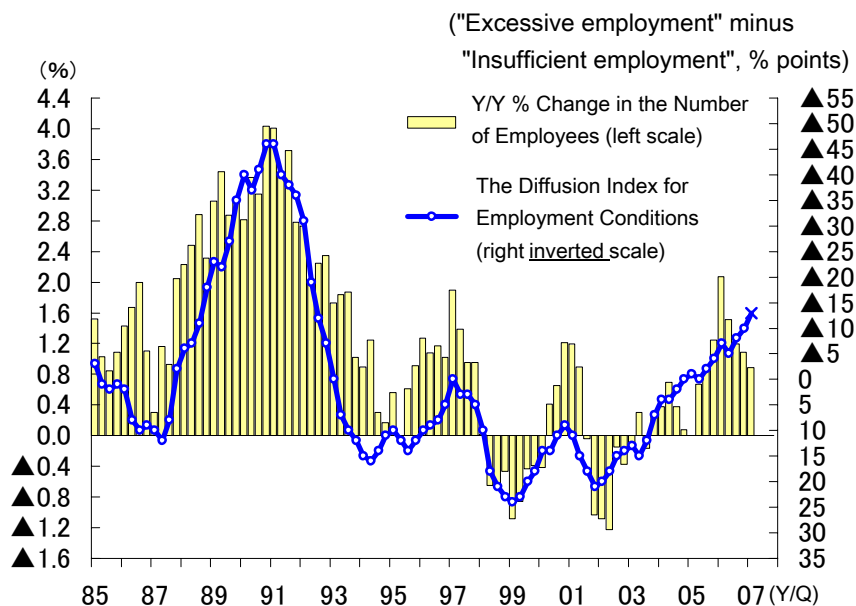
Monthly Report of Prospects for Japan's Economy April 2007

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Employment situation - Continuing improvement in labour demand

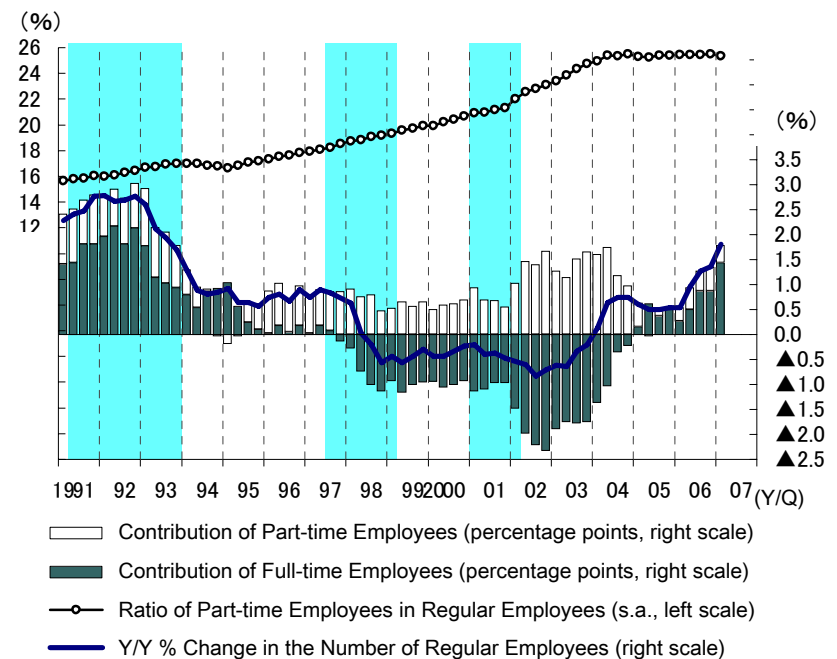
The employment situation continues to be improving in a steady manner. This trend is against the backdrop of a continuing solid expansion of the activities of businesses, as well as the increasing necessity of enterprises to make sure of and to nurture enough talented employees, in anticipation of the mass retirement of the baby-boomer generation. The Tankan Survey last year continued to see the Diffusion Index (DI) on employment conditions staying in the excess "insufficient employment" area, which shows tightness in the labour market, among both large enterprises and small and medium-sized enterprises. Under these circumstances, the number of employees has maintained a growth rate around the 1.0 per cent mark, mainly led by an increase in full-time regular employees, and is expected to do so for the time being.

Figure 6-1 Employment Conditions < Diffusion Index in BOJ's Tankan Survey, all industries > and the Number of Employees



Source: The Bank of Japan, The Ministry of Internal Affairs and Communications
 Note 1: The Employment Condition Diffusion Index is figured on an all-industries basis.
 2: The figure of Y/Y % change in the number of employees in Q1 2007 is for January 2007.
 3: The DI figure in March 2007 (at × mark) is based on the forecast in the December 2006 survey.

Figure 6-2 Contributions to Annual Percentage Change in the Number of Regular Employees by Employment Terms

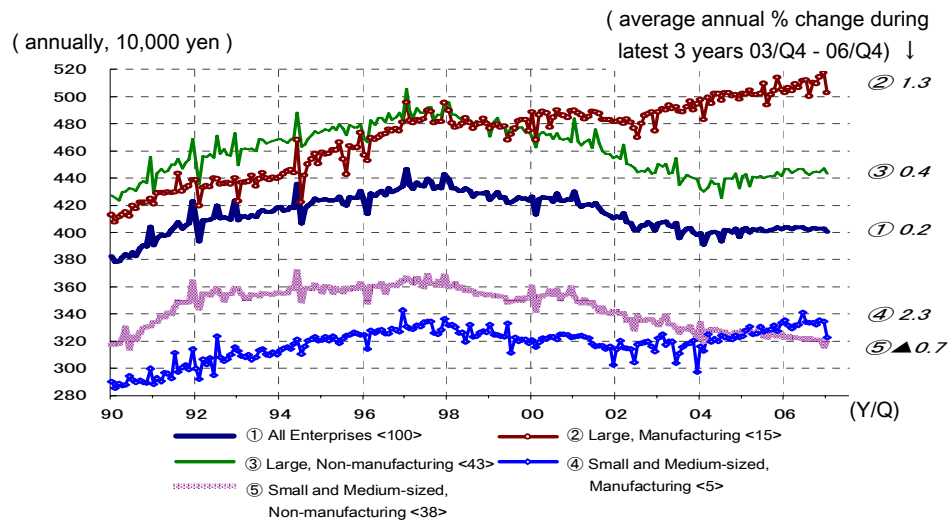


Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Health, Labour and Welfare

Wage situation (1) - Towards gradual recovery, albeit patchy by size and type of industry

Wage growth is still in a sluggish situation, where statistics on total cash earnings by size and type of industry draw a patchy picture. This observation indicates an upward trend in wage growth among manufacturing industries including small and medium-sized enterprises, while the recovery in nonmanufacturing industries remains very fragile, especially with the softening in small and medium-sized businesses. Looking further, encouraging signs can also be seen in the prospect for the wage situation in FY2007. These include; (i) A slight acceleration in average pay increases is likely in wage settlements this spring, the fourth consecutive annual speeding-up. (ii) An improvement in starting pay is spreading out mainly over large enterprises. (iii) The ratio of enterprises which are planning to advance wage growth this fiscal year is larger than those in the last year, according to the results of the questionnaire with respondents including small and medium-sized enterprises. It is true that the situation is still patchy, but a tendency towards a gradual wage growth recovery is growing in the aggregate under the circumstances that a respite from a rise in oil prices could increase scope for an improvement in pay rises, and that a certain number of enterprises are taking steps to promote their part-time employees to full-time status.

Figure 7-1 Total Cash Earnings by Size and Type of Industry
< seasonally adjusted, annual amount per regular employee >

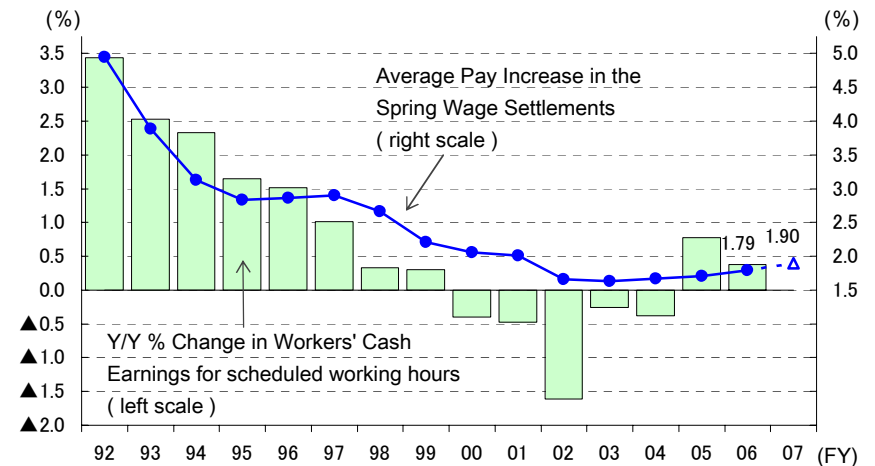


Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Health, Labour and Welfare

Note 1: Large enterprises are establishments with 30 employees or more. Small and medium-sized enterprises are establishments with from 5 to 29 employees.

2: The figures in angle brackets in the legend indicate the share of each size and type of industry in total number of regular employees.

Figure 7-2 Average Pay Increases in Spring Wage Settlements and Its Forecast This Year



Source: The Institute of Labour Administration, The Ministry of Health, Labour and Welfare

Note 1: The figure of an average pay increase in the spring wage settlements in FY2007 is the forecast, based on the questionnaire to labour, management, experts and scholars, conducted by The Institute of Labour Administration as of January 2007.

2: Year-on-year change in workers cash earnings for scheduled working hours in FY2006 is for from April 2006 to January 2007.

Wage situation (2) - Possible fair wind from a pause in oil price increase

It is possible that a pause in the increase in oil prices would bring about scope for an improvement in wage growth. Our estimate shows that a 19% increase in import oil price seems to have eroded current profits by 2.2 trillion yen in FY2006. However, it is probable that the weighing effect on current profits will ebb in FY2007, assuming that the oil price during that period would likely remain at a level similar to that in the last year, even after taking account of the assumed mild upward trend in the price beginning around the middle of the year. In recent years, enterprises have absorbed the impact of the increase in the ratio of variable costs to sales largely caused by oil price increases through decreasing the ratio of personnel expenses to sales, in order to maintain a certain extent of profit growth. Accordingly, it is the centre of attention in the wage situation this year how far softening movements, or rather declines under certain circumstances, in the price of oil would reverse this recent tendency and result in a wage growth improvement.

Figure 8-1 Impact of Increase in Import Price of Oil on Corporate Current Profits < Our Estimate >

	FY2006 <estimate>	FY2007 <simulation>				
Rate of Increase in Oil Price	+19%	▲ 10%	▲ 5%	±0.0%	+5%	+10%
Import Price of Crude Oil (CIF)	64\$/bl.	58\$/bl.	61\$/bl.	64\$/bl.	67\$/bl.	70\$/bl.
Assumed JY/\$ Exchange Rate	117JY/\$	117JY/\$				
* Net Impact on Assumed Current Profits in Each FY	▲ 4.3%	+2.3%	+1.1%	±0.0%	▲ 2.3%	▲ 1.1%
	(▲ 2.2 tril.JY)	(+1.2 tril.JY)	(+0.6 tril.JY)	(±0.0 tril.JY)	(▲ 0.6 tril.JY)	(▲ 1.2 tril.JY)
Share of above * in Personnel Expenses	▲ 1.1%	+0.6%	+0.3%	±0.0%	▲ 0.3%	▲ 0.6%

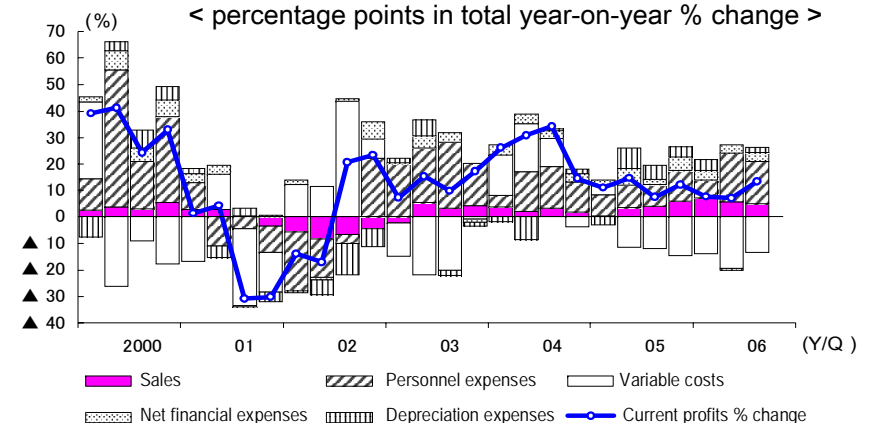
Note 1: The impact of the change in oil price is calculated as the total amount of (i) an increase in costs caused by higher oil prices and (ii) the amount of the costs which enterprises would have passed through to the household sector.

Note 2: The figures in the net impact on estimated current profits in FY2006 are calculated on the assumption that the average import price of crude oil (on a CIF basis) in Q1 CY2007 is \$59/barrel and the average of JY/\$ exchange rate in the same period is 120JY/\$.

Figure 8-2 Contribution to Change in Current Profits

< all industries except financial >

< percentage points in total year-on-year % change >



Source: The Ministry of Finance, "Financial Statements Statistics of Corporations by Industry; Quarterly"

Note: The equation for this analysis is as follows:

$$\Delta \pi / \pi_{-1} = \Delta S \cdot (1 - v - w - r - d) / \pi_{-1} - S \cdot \Delta v / \pi_{-1} - S \cdot \Delta w / \pi_{-1} - S \cdot \Delta r / \pi_{-1} - S \cdot \Delta d / \pi_{-1}$$

π ... Current profits S ... Sales v ... Ratio of variable costs to sales

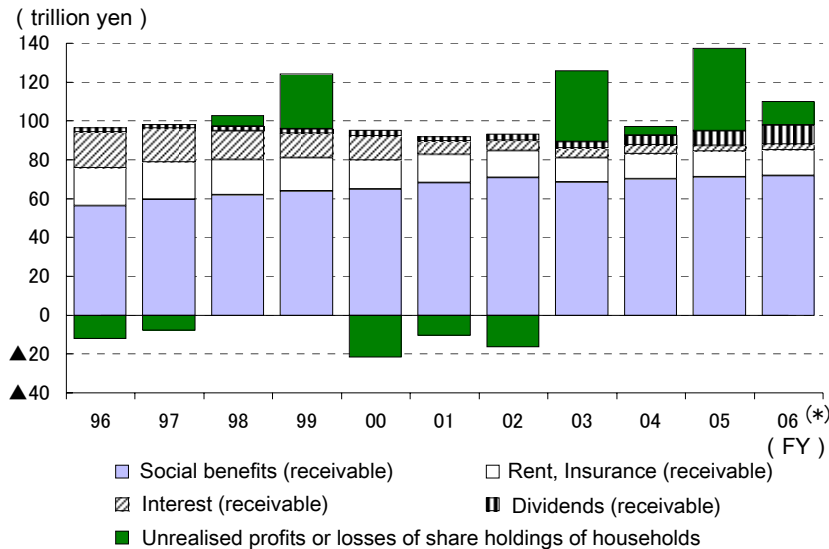
w ... Ratio of personnel expenses to sales r ... Ratio of net financial expenses to sales

d ... Ratio of depreciation expenses to sales Δ ... Difference from the previous year

Private consumption – Expected to strengthen recovery trend in the medium term

Private consumption would have a "now advancing" and "now retreating" movement for the time being, reflecting the situation where the positive factors and negative ones continue to contend with each other. The former includes an improvement in employment environments as well as an increase in dividend income, while the latter is that labour's relative share is curbed among enterprises and there will be an expected increase in the financial burden in households. In the short run, a possibility could be added as a favourable element that a respite from an oil price rise would bring about scope for an improvement in wage growth. By industry, there would still remain a patchy picture in the improvement. Looking further, it is likely that boosting aspects would gradually rise to predominance over weighing aspects, that is, private consumption would have an upward tendency in the medium term. This is against the background that the impacts accompanied by the mass retirement of the baby-boomer generation, such as an increase in the total amount of lump-sum retirement allowances, would start to be incorporated as a private consumption boosting factor in the aggregate.

Figure 9-1 Private Consumption Boosting Factors in the Aggregate except for Compensation of Employees (Receivable)



Source: The Cabinet Office, The Bank of Japan

Note 1: The figures in FY2006 (*) are our estimates.

2: Unrealised profits or losses of share holdings of households are based on the comparison between values at the end of each fiscal year and the previous fiscal year.

Figure 9-2 Diffusion Index for Current Economic Condition by Household Activity-Related Industry < the Economy Watchers Survey by the Cabinet Office >

(points)

	Sep 05	Dec 05	Mar 06	Jun 06	Jul 06	Aug 06	Sep 06	Oct 06	Nov 06	Dec 06
Household activity-related	44.2	50.0	51.5	43.5	42.3	45.3	44.8	44.9	43.3	43.7
Retail	44.0	49.4	49.8	41.3	39.9	44.3	44.8	43.1	40.8	40.1
Shopping area, High street shop	39.9	43.9	46.9	40.7	36.1	37.3	40.4	40.5	38.9	39.8
Department store	48.5	64.2	60.1	40.7	43.6	50.7	57.5	45.0	46.4	38.2
Supermarket	42.7	56.3	44.7	47.5	46.1	55.5	51.2	46.6	45.4	43.1
Convenience store	45.2	40.1	41.8	42.6	36.3	48.3	44.6	46.6	43.4	44.2
Clothing shop	41.5	48.4	45.5	34.5	39.1	35.6	35.8	38.3	32.6	33.8
Electrical appliance retailer	53.5	62.5	57.1	48.8	44.2	46.3	44.2	47.5	43.2	43.9
Automobile	48.0	36.9	58.2	37.5	36.7	37.3	38.6	40.1	35.4	35.9
Others	39.4	47.2	47.1	40.2	39.2	43.3	42.6	42.8	38.9	42.7
Food and beverage	41.0	48.0	52.1	42.6	44.1	40.4	36.7	38.0	40.4	43.8
Services	45.5	53.7	55.2	48.0	46.4	48.2	45.7	49.6	48.9	51.6
Travel, transportation	44.3	55.4	55.5	47.0	45.9	47.1	45.0	51.8	50.0	51.5
Telecom company	52.2	59.9	59.7	52.9	53.7	47.7	49.2	54.6	51.9	53.8
Leisure facility operator	44.5	48.0	55.0	46.9	40.5	53.9	48.0	49.2	52.0	52.7
Other services	42.7	47.8	48.5	46.6	45.7	45.6	41.1	38.4	39.2	48.0
Housing	43.7	42.2	50.9	45.5	44.8	46.8	48.1	47.4	44.2	42.2

Source: The Cabinet Office

Note: Shaded area indicates figures over 50 points in each period.

Impact of higher interest rates – Beneficial to households, limited in enterprises

It is estimated that an increase in interest rates would be beneficial to households, while it would have only a limited impact on enterprises for the present. The household sector would feel a positive influence, and our calculation shows that an annual 0.5 percentage point rise in interest rates would bring about a 2 trillion yen annual increase in household income in the aggregate. Most of those gains are expected to be seen in households with an elder person as its head. On the other hand, the corporate sector would see an adverse effect on their current profits, mainly because of higher interest payments. However, enterprises' continuous efforts to cut interest bearing liabilities thus far, and to maintain abundant liquidity, seem likely to contribute to minimising the negative impact, at least in the short run. Accordingly, although the degree of impact will vary by sector, the influence in the aggregate would be limited. Our estimate indicates that an assumed 1.4 trillion yen of negative impact on current profits, which would be caused by a 0.5 percentage point rise in interest rates on annual average, could be absorbed into a positive influence produced by an estimated around 0.5 percentage point rise in sales during the same period.

Figure 10-1 Impact of a 0.5 Percentage Point Increase in Interest Rates on Household Income < our estimate, annually >

	All households (a)	Per household (b) (a family of two or more)						
		Average	The age of the head of the household					
			<100>	<3>	<15>	<19>	<23>	<22>
Increase in interest receipts (1) ((a): trillion yen (b): 10,000 yen)	+ 3.7	+ 5.0	+ 1.0	+ 1.9	+ 3.0	+ 4.9	+ 6.9	+ 7.7
Increase in interest payments (2) ((a): trillion yen (b): 10,000 yen)	+ 1.6	+ 2.6	+ 1.2	+ 3.7	+ 4.8	+ 2.9	+ 1.3	+ 0.8
Impact on household income [(1) - (2)] ((a): trillion yen (b): 10,000 yen)	+ 2.0	+ 2.4	▲ 0.2	▲ 1.8	▲ 1.8	+ 2.0	+ 5.6	+ 7.0
Annual income for reference (3) ((a): trillion yen (b): 10,000 yen)	329.1	648	439	584	763	819	569	488
[(1) - (2)] / (3) (%)	+ 0.6	+ 0.4	▲ 0.0	▲ 0.3	▲ 0.2	+ 0.2	+ 1.0	+ 1.4

Source: The Japan Research Institute, Ltd. based on the data of The Cabinet Office, The Bank of Japan, The Ministry of Internal Affairs and Communications.

Note 1: The figures in angle brackets under the age of the head of the household indicate the share of each bracket of household in the total number of households with a family of two or more.

2: The figures in all households (a) are based on the amounts of interest income receivable and payable during FY2005 in "the National Accounts", and the amounts of deposits and loans at the end of FY2005 in "the Flow of Funds Accounts".

3: The figures per household (b) are based on the average amounts of annual income during Q1 and Q2 CY2006, and saving and liabilities at the end of each quarter in the same period in "the Family Income and Expenditure Survey".

Figure 10-2 Impact of a 0.5 Percentage Point Increase in Interest Rates on Corporate Profits < our estimate, annually >

	All enterprises	Enterprise types			
		Large enterprises		Small and medium-sized enterprises	
		Manufacturing	Non-manufacturing	Manufacturing	Non-manufacturing
Increase in interest receipts (1) (trillion yen)	+ 0.9	+ 0.1	+ 0.2	+ 0.1	+ 0.5
Increase in interest payments (2) (trillion yen)	+ 2.3	+ 0.2	+ 0.6	+ 0.3	+ 1.2
Impact on corporate profits [(1) - (2)] (trillion yen)	▲ 1.4	▲ 0.1	▲ 0.4	▲ 0.2	▲ 0.7
Current profits in FY2005 for reference (3) (trillion yen)	51.7	15.5	14.0	6.3	15.9
[(1) - (2)] / (3) (%)	▲ 2.7	▲ 0.4	▲ 2.9	▲ 2.9	▲ 4.6

Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance

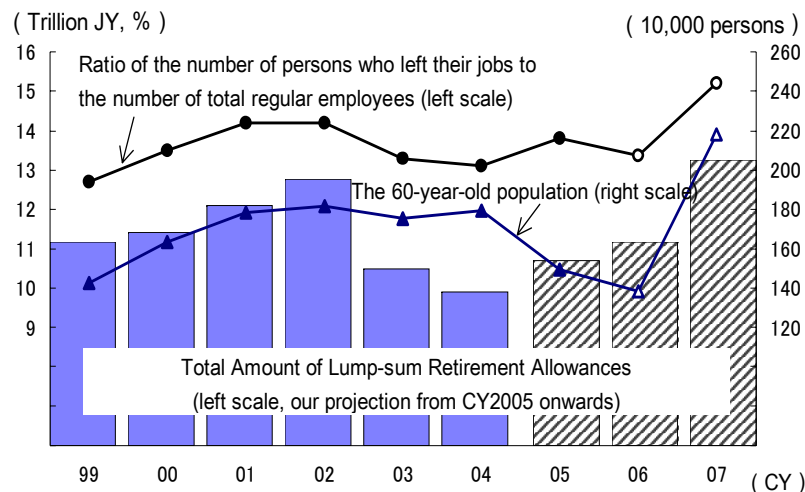
Note 1: The figures are based on the amounts during and at the end of FY2005 in "Financial Statements Statistics of Corporations by Industry; Annual".

2: In the process of the estimation of interest payments, interest-bearing liabilities are defined as follows; long-term borrowing + corporate bonds + short-term borrowing + discount bills.

The GDP growth rate – Maintaining an underlying recovery trend

Taken all in all, Japan's economy should continue to recover and maintain a sustainable underlying trend, although the pace of the economic recovery would go on with a mild slowdown for the present. According to our projection, the GDP during FY2006 is expected to grow at 2.1 per cent in real terms in the aggregate, reaching the 2.0 per cent mark for the fourth consecutive fiscal year. It is also projected that the real GDP growth rate in FY2007 would accelerate to around 2.4 per cent as a whole, with the pace over the second half of the fiscal year accelerating further. This would be due to the favourable influence of the re-acceleration in the US economy, given its soft landing, as well as the emerging positive impact of the mass retirement of the baby-boomer generation. As for the latter, it is expected to have a gradual impact on the economy mainly through the boosting effect of the increase in the total amount of lump-sum retirement allowances on private consumption as mentioned in the forecast.

Figure 11-1 Estimate and Projection of Total Amount of Lump-sum Retirement Allowances



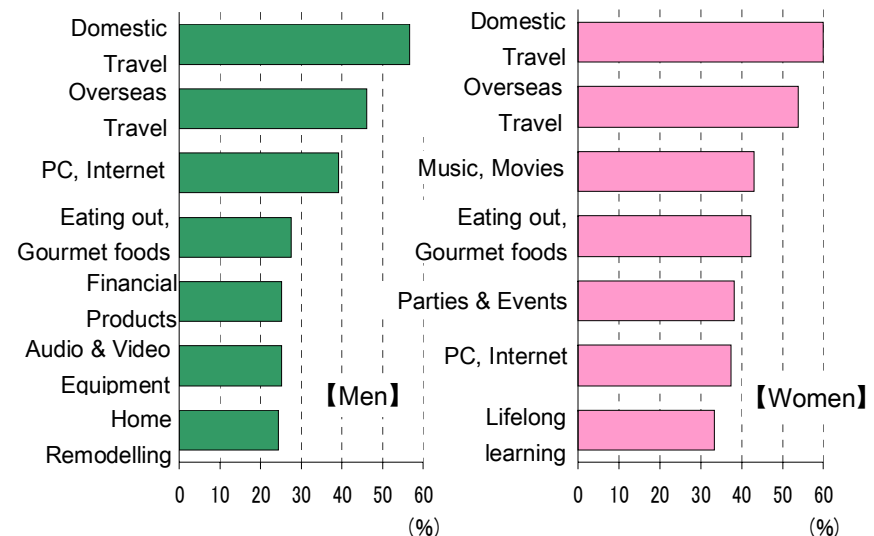
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Health, Labour and Welfare, The National Institute of Population and Social Security Research, The Ministry of Internal Affairs and Communications.

Note 1: The total amount of lump-sum retirement allowances is for the amount of employers' imputed social contributions in national accounts.

2: The ratio from CY2006 and the amount from CY2005 above are our estimates.

3: The 60-year-old population from Cy2006 is adjusted by our estimate, on the basis of the central projection by The National Institute of Population and Social Security Research.

Figure 11-2 Survey on the Baby-boomer Generation's Spending Choices After Retirement < Conducted by HAKUHODO Inc. >



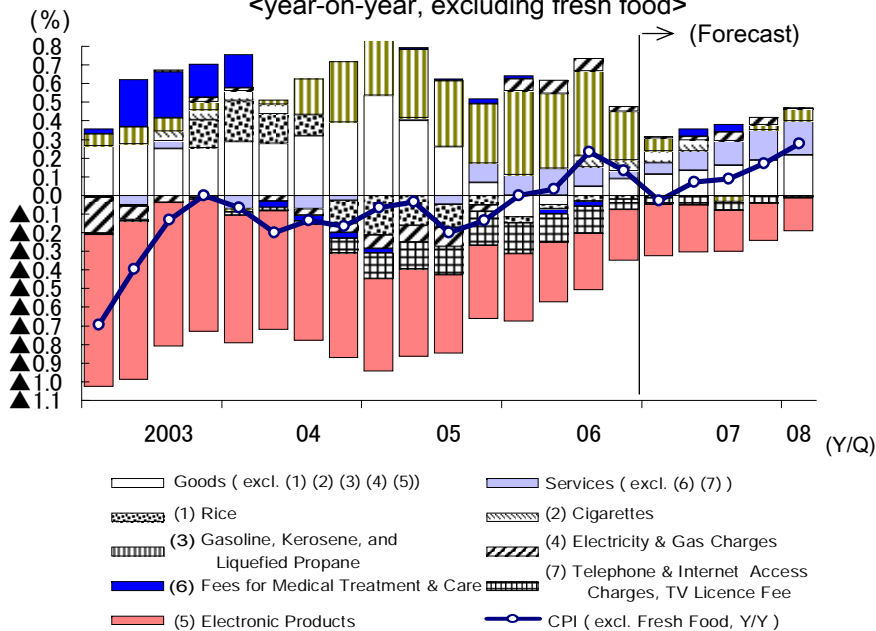
Source: HAKUHODO Inc., Elder Business Development Division, HOPE Report XIX, "The Baby-boomer Generation - A Survey on the Life-style after Retirement"

Note : The above are the top seven items for both men and women.

Consumer price index – Very mild rate of increase to continue from Q2 onwards

It is forecast that the CPI excluding fresh food, that is the core CPI, would maintain a stable trend in positive territory at a very mild rate of increase from Q2 onwards after monthly moves at zero, or possibly in slightly negative territory as the case may be, during the first quarter of this year. The factors putting downward pressure on the moves of the index include: (i) annual growth of unit labour costs is expected to stay negative, influenced by the recent sluggish trend of wage growth recovery, (ii) market competition would continue to intensify against the backdrop of a severe price-selective attitude of consumers, and (ii) the upward pressure from high petroleum product prices would ease in response to the recent decrease or decelerating pace of the increase in the price of oil. In the short run, a cut in mobile phone charges would also have a downward effect on the CPI. On the other hand, the aggregate supply-demand gap would continue to narrow gradually, which could have a bolstering effect on the prices of products.

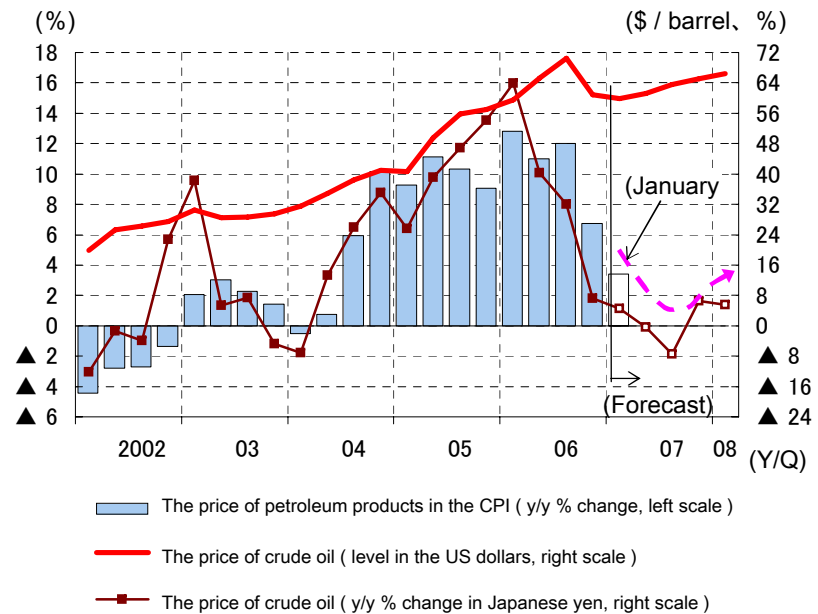
Figure 12-1 Change in Consumer Price Index on CY2005-base <year-on-year, excluding fresh food>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Note: The assumed average price of imported crude oil (on a CIF base) is \$64/barrel both in FY2006 and FY2007 (the actual result in FY2005 was \$55/barrel)

Figure 12-2 Change in Prices of Crude Oil and Petroleum Products



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Internal Affairs and Communications.

Note: The Japanese yen is assumed to appreciate against the US dollar from the middle of CY2007, with the the average of JY/\$ exchange rate during FY2007 117JY/\$.

Prospects for Japan's economy - Re-acceleration into FY2007

(1) Projection for economic growth

Japan's economy should continue to recover and maintain a sustainable underlying trend, although the pace of the economic recovery would continue a mild slowdown for the present.

(i) The ongoing deceleration is mainly due to a slowing of exports, reflecting the slowdown of the US economy, as well as an adjustment of the production pace in the IT parts and devices sector. According to our projection, the GDP during FY2006 as a whole is expected to grow at 2.1 per cent in real terms. Looking further, the real GDP growth rate would accelerate to around 2.4 per cent in FY2007, with the pace over the second half accelerating further. This would be due to the favourable influence of the re-acceleration in the US economy, and the emerging positive and gradual impact of the mass retirement of the baby-boomer generation as stated below.

(ii) As for prices, the rate of increase in the CPI excluding fresh foods would stay positive, and remain very modest from the second quarter of this year onwards, reflecting a mild narrowing of the aggregate supply-demand gap. Intense market competition and an easing in natural resource prices are expected to make a move in the CPI more moderate and stable.

(2) Factors which would make the recovery period longer

It is also widely recognised that Japan's economy retains appreciable abilities to absorb shocks, which would seem to lead to a lowering of the risk that the recovery trend of the economy could falter in the short run. The main abilities seen are as follows:

(i) A low level of inventory ratio in manufacturing industry except for the IT parts and devices sector, for a short-term factor. Among those, the ratio in the metal and machinery sectors continues at its lowest level ever. Therefore, a major production adjustment across all sectors of manufacturing industry could be avoided.

(ii) The dissipation of structural adjustment pressures in the corporate sector as well as abundant liquidity as its financial strength, for a medium-to-long-term factor. With the management focus shifting from the "adjustment of excessive labour, capital equipment and debt" to "active business expansion aiming at survival against fierce global competition", the positive attitude toward business fixed investment and employment would continue.

(3) Prospects for private consumption in both short- and medium-term

(i) Private consumption would have a "now advancing" and "now retreating" movement for the time being, reflecting the situation where the positive factors and negative ones continue to contend with each other. The former includes an improvement in employment environments as well as an increase in dividend income, while the latter is that labour's relative share is curbed among enterprises and there will be an expected increase in the financial burden in households. In the short run, a possibility could be added as a favourable element that a respite from a rise in oil prices would bring about scope for an improvement in wage growth.

(ii) Looking further, it is likely that boosting aspects would gradually rise to predominance over weighing aspects, that is, private consumption would have an upward tendency in the medium term. This is against the background that the impacts accompanied by the mass retirement of the baby-boomer generation, such as an increase in the total amount of lump-sum retirement allowances, would start to be incorporated as a private consumption boosting factor in the aggregate.

Figure 13 Projections for GDP Growth and Main Indicators of Japan

(seasonally adjusted, annual % changes from the previous quarter)

	CY2006			CY2007				CY2008	FY2005	FY2006	FY2007
	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3			
	(Actual)			(Projection)					(Actual)	(Projection)	
Real GDP	1.3	0.5	5.5	1.4	2.0	2.2	2.5	2.7	2.4	2.1	2.4
Private Consumption Expenditure	2.2	▲ 4.2	4.2	1.7	1.9	2.1	2.3	2.4	1.9	0.7	1.9
Housing Investment	▲ 8.0	▲ 0.3	9.1	0.8	1.0	1.3	1.6	2.0	▲ 1.0	0.6	2.0
Business Fixed Investment	13.3	4.5	13.2	4.3	4.1	3.6	3.4	3.1	5.7	8.6	4.9
Private Inventories (percentage points contribution)	(▲ 0.6)	(0.8)	(▲ 0.4)	(▲ 0.2)	(0.1)	(▲ 0.1)	(0.2)	(0.4)	(▲ 0.1)	(0.0)	(0.0)
Government Consumption Expenditure	3.0	2.7	0.5	0.3	0.5	0.5	0.6	0.6	0.9	0.9	0.6
Public Investment	▲ 22.6	▲ 17.9	15.6	▲ 8.0	▲ 7.0	▲ 6.0	▲ 4.8	▲ 4.5	▲ 1.4	▲ 9.9	▲ 5.0
Net Exports (percentage points contribution)	(▲ 0.2)	(1.6)	(0.5)	(0.2)	(0.3)	(0.6)	(0.5)	(0.5)	(0.6)	(0.7)	(0.5)
Exports of Goods and Services	2.5	9.9	2.4	3.4	5.5	8.6	9.0	8.8	9.0	7.4	6.2
Imports of Goods and Services	5.6	▲ 1.9	▲ 1.0	3.0	4.6	5.6	7.7	7.9	6.0	3.2	4.0

(% changes from the same quarter of the previous year)

Real GDP	2.1	1.5	2.3	2.5	2.4	2.8	1.9	2.4	2.4	2.1	2.4
Nominal GDP	1.0	0.8	1.8	2.1	2.2	2.9	2.0	2.6	1.0	1.4	2.4
Consumer Price Index (excl. fresh food)	0.0	0.2	0.1	▲ 0.0	0.1	0.1	0.2	0.3	▲ 0.1	0.1	0.2
Industrial Production Index	4.1	5.4	5.7	3.5	2.8	3.0	1.8	3.8	1.6	4.7	2.8
Unemployment Rate (%)	4.1	4.1	4.1	4.0	3.9	3.9	3.8	3.8	4.4	4.1	3.8
Current Account Balances (trillion JY)	3.97	5.29	5.27	5.22	5.17	5.16	5.03	4.72	19.12	19.76	20.07
Share of Nominal GDP (%)	3.1	4.2	4.1	4.1	4.0	4.0	3.8	3.6	3.8	3.9	3.8
Exchange Rates (JY/US\$)	114.4	116.2	117.8	121.0	121.0	118.0	116.0	114.0	113.3	117.3	117.2

Source: The Cabinet Office, The Ministry of Internal Affairs and Communications, The Ministry of Economy, Trade and Industry, The Ministry of Finance.

The projection figures are based on those of The Japan Research Institute, Ltd.

Note: The projections are made based on the second preliminary quarterly estimates of GDP in Q4 2006 released on March 12 2007 by The Cabinet Office and on our following assumptions;

(1) A slowdown in the US economy is expected to be levelling off to re-acceleration beginning around the middle of CY2007 (the projected real GDP growth rate is 3.3% in CY2006 and 2.6% in CY2007 after the actual result of 3.2% in CY2005).

(2) The assumed average price of imported crude oil is \$64/barrel both in FY2006 and FY2007 (the actual result in FY2005 was \$55/barrel).