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A Revised Economic Forecast for Fiscal 2003-2004

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4th Quarter Assessment: Growth Accelerates on Strength of Domestic Private Demand and External Demand

The pace of economic recovery accelerated in the October-December quarter of 2003, the real growth rate rising to +1.7% (equivalent to an annualized rate of +7.0%). This growth was due to the acceleration of the pace of recovery in the corporate sector, thanks to a surge in exports and production, coupled with faster growth in the household sector. Although the economy is still heavily dependent on external demand, the pulling power of domestic demand is growing, especially in the digital consumer electronics sector. The principal trends by demand category were as follows:

(1) Exports

With the recovery of the global economy gathering momentum, exports recorded quarter-on-quarter growth equivalent to an annualized rate of +17.9%. Among exports to Asia in particular, there has been substantial growth of exports thought to be to satisfy internal demand, such as chemical products and general machinery, as well as growth of exports of intermediate goods, such as electronic devices and audio equipment components, for use in the manufacture of products for export, and it would appear that Asia is gaining importance as a source of final demand and is no longer regarded solely as a location for overseas production bases.

(2) Capital investment

Capital investment recorded a substantial rise, due partly to the reaction to the sudden deceleration observed in the July-September quarter as well as to strong

external and internal demand. In particular, recovery of capital investment in the manufacturing sector appears to have accelerated, centering on electrical and general machinery.

(3) Household expenditure

With the deterioration in employment and income conditions slowing and consumer confidence improving, consumer spending continued to rise thanks to (i) the continued firm sales performance of digital consumer electronics and (ii) a gentle recovery of spending on services, among other factors. Meanwhile, although investment in the construction of condominiums in the Tokyo area continued to rise, construction starts on detached houses recorded a sharp fall across the country, and overall housing investment figures began to fall once more.

Outlook: Adjustment in Second Half of Fiscal 2004 Likely to be Slight

Looking to the future, the following three factors suggest that the economic recovery will continue in the short term.

- (1) With the recovery of the European, US and Asian economies growing increasingly clear, exports will continue to exert economic pulling power. In particular, exports to China are likely to grow across a wide range of sectors, including materials, components and capital goods, owing to the establishment of China's position as "factory to the world" and to the fact that domestic demand can be expected to grow.

(2) The fall in the price of computers and other capital goods is likely to continue to boost capital investment on a real basis. Moreover, with the economic pulling power of exports growing and domestic private demand holding firm, capital investment is also likely to continue to grow on a nominal basis, centering on the manufacturing sector.

(3) Thanks to the slowing of the deterioration in employment and income conditions and the underpinning provided by the older generations, which have a higher propensity to consume, consumer spending is expected to hold firm. The stimulus to propensity to consume resulting from the efforts of the corporate sector to develop new products in areas such as cellular phones and digital consumer electronics is also likely to continue for some time.

Given the difficulty of passing it on as an increase in the price of final goods, the worldwide rise in the price of materials is highly likely to exert a downward pressure on business profitability but as sales growth is likely to bring profit growth, it should be possible to offset the negative impact of the deterioration in trade conditions.

In the second half of fiscal 2004, the pace of recovery is likely to slow to some extent, owing to the strengthening of the yen against foreign currencies and the decline in the pulling power of exports as overseas economies decelerate. However, given that (i) the recovery of overseas demand will continue on the strength of the continued growth of the Chinese economy and (ii) progress with restructuring programs in the corporate sector is beginning to strengthen the foundations of the economic recovery there is little risk that the economy will suffer a major slump.

We have revised our estimates of the economic growth rate for fiscal 2003 and fiscal 2004 upward by 0.6% and 0.5% as compared with the forecasts issued on December 9, 2003.