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A Revised Economic Forecast for FY 2003-2004

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**July-September Quarter:
Extraordinary Factors Slow Recovery but Upturn Continues**

The real growth rate for the July-September quarter of 2003 was up 0.6 points on the previous quarter (equivalent to annualized growth of 2.2%), confirming that the economy is still recovering at a gentle pace. Although the slump in the government sector continued to exert a downward pressure on the economic trend for a fourth quarter, capital investment continued to rise and external demand also made a positive contribution. The movements of the major elements of demand were as follows.

(1) Household sector

Consumer spending remained level with the previous quarter. A slump in demand for summer goods and services due to the cool weather and the fall in disposable incomes due to the deduction of social insurance contributions from summer bonuses exerted downward pressure on spending, but this was offset by positive factors such as (i) strong sales of digital consumer electronics, cellular phones, personal computers and other consumer durables and (ii) the beginnings of a recovery in spending on services such as cinema-going and financial services. It could be said that consumption in the household sector held up well overall, given the slowness of the recovery in income conditions among other factors. Meanwhile, investment in housing rose substantially, but this was a temporary phenomenon due to the rush in housing starts ahead of the deadline for preferential tax treatment of housing loans.

(2) Corporate sector

Capital investment decelerated in reaction to the substantial increase registered in the April-June quarter, yet still maintained two-digit annualized growth on the previous quarter as investment in computers continued to rise and the decline in construction investment began to slow.

(3) External demand

Although exports to the United States and EU continued to show little promise of recovery, exports to Asia saw a major increase, centering on electronic devices, general machinery and imaging equipment components, resulting in two-digit annualized growth.

Outlook: Recovery Set to Continue Until First Half of 2004

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

- (1) Exports to Asia continue to grow and, given the recovery of the EU and US economies, exports to these regions are also expected to recover. Moreover, an upturn in exports of industrial plant to the Middle East will gradually emerge, following the surge in orders in the spring and early summer.
- (2) The major boost to real capital investment provided by the fall in the price of computers and other capital goods is set to continue*. Given the continued recovery in corporate incomes, the increased pulling power of exports and the solidity of domestic private sector demand, it is likely that capital investment

will also begin to recover on a nominal basis, especially among large corporations and in the manufacturing sector.

(3) Thanks to the emerging recovery of consumer confidence prompted by a slowing of the deterioration in employment and income conditions, consumer spending is holding firm overall. The stimulus to propensity to consume provided by 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.

However, owing to (i) the slowing of the pace of recovery of overseas economies, especially the United States, (ii) the slowing of the growth of investment in computers, which has led capital investment in recent months and (iii) the beginnings of a decline in the number of housing starts in reaction to the demand rush, the growth rate is likely to slow in the second half of 2004.

* Because the computer price index reflects an improvement in performance as a fall in price, growth is higher on a real basis than on a volume basis. When demand is increasing, the share on a real basis rises and the contribution to the whole is still greater. Looking to the future, as the recovery of demand for computers is likely to continue in the household and corporate sectors and on the external demand side, it is highly likely that the phenomenon of a substantial fall in the GDP deflator during a period of economic expansion will persist.