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A Revised Economic Forecast for FY 2003-2004

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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 China continue to grow and, thanks to the recovery of the EU and US economies, the growth of exports to Asian countries other than China is also expected to accelerate. Moreover, following a surge in orders in the spring and early summer, an upturn in exports of industrial plant to the Middle East will gradually emerge.

(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.

(3) Thanks to a slowing of the deterioration in income conditions (among other factors, bonuses have begun to rise) and the underpinning provided by the older generations, which have a higher propensity to consume, consumer spending is expected to hold firm overall. 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.

In the second half of 2004, owing to (i) the weaker pulling power of exports due to the slowing of overseas economies and (ii) the end of the cyclical recovery in

demand for information technology, the economy is likely to undergo a degree of adjustment. However, given that (i) corporate profitability is recovering, especially among large corporations and (ii) the corporate sector remains cautious with regard to excess production capacity, the economy is unlikely to suffer a major slump.

* For more detail, see " The Medium-Term Outlook for the Japanese Economy (FY 2004-2008) — Establishing a New Pattern of Sustained Growth —", published on December 5, 2003.

Reasons for Downward Revision of Forecast

Basically, our forecast of the economic trend is unchanged. The downward revision reflects the upward adjustment of the GDP deflator following the release of the final figures for 2002. The first preliminary report for the July-September quarter suggested that the GDP deflator had fallen by 2.7% on the same quarter in the previous year, but the second preliminary report, published after adjustment to reflect the final figures, suggested a fall of only 2.1%. The smaller fall in the GDP deflator lowers the real GDP forecast for fiscal 2003 by approximately 0.5%. The nominal GDP forecast is unchanged.

Analysis of the Latest Economic Developments

The recovery appears to have accelerated in the October-December quarter. The growth of industrial production, led by the growth of exports, has been accelerating since September. Meanwhile, the effects of this year's cool summer

having worn off, leading to a recovery in consumer confidence and a slight rise in consumer spending, the real growth rate is also expected to recover to around 3% on the same quarter in 2002.

Outlook for Capital Investment

Capital investment slowed sharply in the July-September quarter, owing partly to the slacker pace of capital investment in the manufacturing sector reflecting the slowdown in industrial production since the second half of 2002, and partly to a reaction to the substantial increase in the non-manufacturing sector (real estate, land transportation, broadcasting, etc.) registered in the April-June quarter. Looking to the future, given that (i) capital investment is expected to begin to rise once more in the manufacturing sector, following the rapid recovery of production in recent months, (ii) in the non-manufacturing sector, the fluctuation of capital investment due to transitory factors is expected to settle down, and (iii) there are signs of a recovery in capital investment even among medium and small-sized enterprises, especially in the manufacturing sector, it is likely that, overall, capital investment will begin to recover once more.