

**Development Bank of Japan
Research Report
No. 51**

**Recent Trends in the Japanese Economy:
Pause in Recovery**

March 2005

**Economic and Industrial Research Department
Development Bank of Japan**

This report was originally published in Japanese as *Chosa* No. 77
in February 2005.

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This report is based on statistical data published by January 20, 2005.

Recent Trends in the Japanese Economy: Pause in Recovery

Summary

I. World Economy: Expansion Slows

Expansion of the world's major economies has slowed as a whole; the U.S. economy continues to expand, while the growth is easing in Europe and Asia.

The U.S. economy continues to expand, buoyed by rising personal consumption as the employment situation improves. However, the continued growth of outstanding household liabilities is a cause for concern. Business investment is on the rise particularly in information technology, but the growth of corporate profits is slowing mainly due to high crude oil prices, thus raising concern about possible adverse impacts on business investment. Production is growing mildly. Regarding the current account balance, the trade deficit continues to rise particularly with China, and the total deficit for 2004 is expected to reach a record high. Although prices are increasing partly due to rising crude oil prices, core prices remain stable. The federal funds rate was raised five times in 2004, by a total of 1.25%. Nonetheless, long-term interest rates and share prices have held steady as cautiousness persists about the future of the U.S. economy.

Major European economies (Germany, France and the U.K.) are slowing down slightly. In Germany, economic growth slowed as exports fell after leading the recovery. The French economy recorded the first negative growth in five quarters due to a drop in personal consumption and business investment. In the U.K., economic growth slowed largely due to cutbacks in business investment, although private consumption remains strong backed by the low unemployment rate. Consumer prices exceed the reference value for inflation, but the European Central Bank has not changed its official interest rate since June 2003 reflecting concerns of economic slowdown due to the higher euro. The euro is now making its presence felt across international markets: the value of euro-denominated straight

bond issues in 2002 surpassed that of their dollar-denominated counterparts, and the lead widened in 2003.

Major Asian economies (Korea, Taiwan and Singapore) have started to slow following rapid growth led by exports, and the downtrend in production is raising concerns of possible inventory adjustment. Korea is experiencing a prolonged slump in consumption; the rapid appreciation of the won (against the dollar) may also have an adverse impact on Korean exports. China has become increasingly important as an export market for the major Asian economies. Although the growth of the major Asian economies is expected to slow slightly in 2005, the adjustment will be mild as the U.S. and Chinese economies are expected to continue to expand, albeit more slowly.

The Chinese economy continues to grow rapidly despite cooling measures. The current growth of investment in fixed assets still exceeds the level recorded in 2003. Consumption and exports are also increasing substantially. The growth of money stock has been slowing, and price inflation has paused. The total value of Chinese trade has doubled in the three years since China's accession to the WTO (November 2001), thus substantially strengthening the presence of the country in world trade.

II. Japanese Economy: Pause in Recovery

The Japanese economic recovery appears to have paused. The recovery phase, which started in early 2002, strengthened particularly in late 2003 and early 2004, as exports and business investment increased on the back of the revitalized world economy. Since mid-2004, however, the recovery has almost halted as exports leveled off and production weakened largely due to the slower world economy and the inventory adjustment in electric parts & devices and related industries. Looking ahead, production is unlikely to suffer a major further fall, as the recent expansion in the world economy is expected to con-

tinue broadly, and inventory adjustment has so far been limited to the above producer goods industries. Thus, the Japanese economy as a whole is expected to show perseverance, led by the corporate sector. Although incomes remain flat in general and employee compensation is considered to have bottomed-out, the growth of personal consumption has been slowing recently due largely to the impact of unseasonable weather and consumer confidence has wavered temporarily. Business investment has been increasing so far in FY2004, supported by back-to-back substantial increases in corporate profits. However, business investment is expected to slow as machinery orders, the leading indicator, have weakened slightly since late 2004 in manufacturing industries including electric machinery. Nevertheless, a substantial drop is unlikely, given the improvement in capacity utilization and reduction in perceived overcapacity in general. Residential investment remains flat in general, with housing starts (seasonally adjusted annual rate) steady at just under 1.2 million units since 2001. Public investment has been declining continually since FY2001, reflecting the financial difficulties of both central and local governments. Exports are leveling off following a surge mainly to China that started in mid-2003 as

the overseas economies recovered. Imports are rising slightly. The current account surplus is shrinking, as the trade surplus starts to decline due to flat exports and high crude oil prices while the service account deficit continues to widen, particularly in travel.

Prices of corporate goods show signs of leveling off as crude oil prices stabilize. Consumer prices are still weak.

On the financial side, the monetary base remains high as the Bank of Japan maintains its quantitative easing policy, but the money stock continues to grow slowly. Outstanding private bank loans have been on a downward trend, but the shrinking pace has somewhat eased recently. Attention is now focused on the possible impact on deposits of the full lifting of the guarantee on bank deposits, scheduled in April 2005. So far, substantial movements, such as the massive shift from time and savings deposits to demand deposits that occurred before the partial removal in April 2003, have not been observed.

(As of January 20, 2005)

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I World Economy: Expansion Slows

1. U.S. (1): Strong Personal Consumption and Business Investment Continued, with Some Concerns over Future Downside Risk (see p. 15 for figures)

The U.S. economy continues to expand. Real GDP in July-September 2004 (final estimate) grew 4.0% on the previous quarter (figure 1-1), the twelfth consecutive quarter-on-quarter increase. Personal consumption recovered from a temporary slowdown in the previous quarter, while growth continued in business investment. Meanwhile, residential investment is peaking at a solid level.

Consumer confidence is improving slightly as the employment situation and incomes pick up, contributing to the continued rise in personal consumption (figure 1-2). Regarding disposable income (figure 1-3), statistical data do not show any positive effect of tax cuts; in fact, the tax factor has had a negative effect. Steady consumption is partially sustained by the increase in household liabilities including home mortgages and consumer credits (figure 1-4). It has been noted that the rise in housing prices, by raising collateral values, has resulted in increased borrowing through home equity loans,¹ effectively supporting consumption, but the rapid accumulation of household liabilities could become a concern in the future.

The strong growth of corporate profits that was observed throughout 2003 has been slowing since January-March 2004 largely due to rising raw material prices (figure 1-5). Considering that higher corporate profits have been boosting business investment, their slowdown could have an adverse impact on such investment.

2. U.S. (2): Healthy Growth of Production and Employment, Stable Share Prices and Interest Rates (see p. 16 for figures)

Industrial production has been rising gradually since July-September 2003 and has regained the peak of 2000 (figure 1-6). However, inventories

and shipments are both up over a year earlier, so the inventory cycle seems to be at a mature stage. By category of goods, equipment production has been stronger than consumer goods production. In parallel with the increase in production, capacity utilization in the manufacturing sector has risen slightly, although the level remains low².

The employment situation continues to improve. The number of employees has been increasing, led by services (figure 1-7). It rose by 2.23 million throughout 2004, providing a major reason for the FRB to raise interest rates as described below. The rising employment has also had a substantial impact on share prices. The unemployment rate has declined gradually to the mid-5% range.

As regards prices, the producer price index (PPI) and the consumer price index (CPI) both rose faster over the previous year following the hike in raw material prices including crude oil (figure 1-8). However, the ripple effect of expensive crude oil on overall prices has been limited so far, as the core index – excluding energy and food – remains relatively stable. Looking at the PPI by stage of processing, the rise in crude material and intermediate goods prices has been accelerating, but the increase has scarcely been passed on to finished goods prices, so overall prices have remained relatively stable.

In finance (figures 1-9 and 1-10), the Dow Jones Industrial Average has risen gradually thanks to brisk consumption and employment, after fluctuating due to various factors such as the state of the domestic economy including the employment recovery, rising tensions in the Middle East and the surge in crude oil prices. In view of the rise in the number of employees, the FRB raised the federal funds target rate five times in 2004 (in June, August, September, November and December – by 0.25% each time) to correct its excessive monetary easing policy. Thus, the target rate was raised by a total of 1.25%, to 2.25%, and many expect the rate to exceed 3% by the end of 2005. However, long-term interest rates (distribution rates of 10-year U.S. bonds) have already taken these

¹ One type of home mortgage.

² The level of capacity utilization might not be accurate as some consider that production capacity is overestimated particularly for information-related equipment, which would bias the capacity utilization rate downward.

factors into account and are stable.

3. U.S. (3): Current Account Deficit and Savings-Investment Balance (see p. 17 for figures)

The U.S. current account deficit has been growing as a percentage of GDP, averaging 5.5% in January-September 2004. Thus, the deficit is expected to reach a record high for the year 2004 (figure 1-11). Looking more closely at the trade deficit by partner, the deficit with Japan has fallen sharply from the high level of the early 1990s. Instead, the deficit with China has emerged as the major contributor to the total trade deficit, exceeding that with Japan since 2000 on a calendar year basis (figure 1-12). This is the primary reason why the U.S. is calling for the revaluation of the renminbi (yuan). However, the current account balance in the medium to long term is determined by the domestic savings-investment balance. In this sense, the expansion of the U.S. current deficit since 2001 has been caused by the decline in household savings due to active consumption and the widening budget deficit due to the burgeoning cost of war and tax cuts (figure 1-13). The current account deficit increased throughout this period despite the decline in the effective exchange rate of the dollar. Therefore, any revaluation of the yuan may have some impact on the U.S. trade deficit with China, but the level of the current account deficit itself is unlikely to shrink much without any change in the savings-investment balance in domestic sectors.

4. U.S. (4): External Credits/Debts and Balance on Income (see p. 18 for figures)

The U.S. has been a so-called net debtor nation since 1986,³ with external debts exceeding external credits. Whereas the amount of net debts has since increased each year, the balance on income has remained in the black (figure 1-14) because the return on U.S. investment abroad has exceeded the return on foreign investment in the U.S. This section examines the balance on in-

³ This is the case when U.S. direct investment abroad is valued at current cost. The country has been a net debtor nation since 1989 if market value is used instead.

come and external credits/debts to identify the factors behind this difference.

figure 1-15 shows the composition of the balance on income. Apparently, profits from direct investment abroad affect the balance on income, as direct investment accounts for almost half of income receipts. Interest payments from the government sector (on Treasury bonds, etc.) account for a substantial share in the payment column.

figure 1-16 shows the share of direct investment in external credits and debts. At the end of 2003 (the latest data available), direct investment accounted for almost 30% of external credits, but represented only 16% of external debts.

Yields on external debts, external credits, direct investment abroad and foreign direct investment in the U.S. should be seen in this light. In this section, *yields* refers to receipts or payments in the balance on income divided by the average of outstanding external credits or debts for the period. figure 1-17 shows yields on external debts, external credits, direct investment abroad and foreign direct investment in the U.S. Since the country has an income account surplus despite being a net debtor nation, yields on external credits exceed those on external debts. And yet yields on U.S. direct investment abroad far exceed those on foreign direct investment in the U.S. A comparison of yields on direct investment by partner (figure 1-18) also indicates that yields on U.S. direct investment in partner countries largely exceed those on incoming investment. Thus, it is the high profitability of U.S.-based multinationals that helps maintain the income account surplus.

5. European Economies (1): Mild Slowdown (see p. 19 for figures)

The euro zone economies are experiencing a slight slowdown. The real GDP of the EU25 grew only 1.3% (annualized quarter-on-quarter growth in July-September 2004, the same applies to all GDP growth data in this section), the second consecutive quarter of slowdown in growth. The increase in government outlays and inventories was largely offset by the decline in exports (figure 1-20).

Looking at the economies of major Euro-

pean countries, France's economy contracted while Germany's and the U.K.'s both experienced slower growth.

In Germany, personal consumption continues to slump as the unemployment rate stays high. Although investment in inventories increased, exports fell abruptly after having led the whole economy. On balance, real GDP growth declined to 0.4% (figure 1-19 (1)).

The French economy recorded the first negative growth in five quarters, as private consumption and fixed capital formation both fell after having led the growth (figure 1-19 (2)).

In the U.K., personal consumption is still strong thanks to the low unemployment rate, but growth slowed largely due to the decline in fixed capital formation (figure 1-19 (3)).

As regards the employment situation, the unemployment rate (according to the ILO standard) is still stable at over 4% in the U.K. and is leveling off in France at around 9.5%. In Germany, however, unemployment is still rising gradually and is now almost 10% (figure 1-21).

Unit labor cost is declining in Germany as a result of restructuring, effectively pushing up corporate profits. Thus, German firms have been able to increase investment in machinery and equipment in spite of the current economic slowdown (figure 1-22).

6. European Economies (2): Increased Presence of Euro (see p. 20 for figures)

Following a steep appreciation at the beginning of 2004, the euro temporarily stabilized against the dollar, only to climb again towards the end of 2004. However, the rise in the effective exchange rate has been relatively mild (figure 1-23).

Although the CPI in the euro zone has been rising and has surpassed the reference value of 2%, the European Central Bank has been holding the official interest rate at 2% since June 2003 due to fears of euro appreciation causing an economic slowdown (figure 1-24).

One of the factors behind the euro appreciation may be its increased presence as an international currency. Indeed, the value of euro-denominated straight bond issues in inter-

national markets surpassed that of their dollar-denominated counterparts in 2002, and the gap increased in 2003 (figure 1-25). The share of the euro in foreign currency reserves has also risen, reaching almost 20% at the end of 2003 (figure 1-26).

Trade with other members accounts for a high percentage of total trade in the euro zone economies. In Germany, a major exporting country, exports to the 12 euro zone countries represent 43.5% of total exports, far exceeding the shares of exports to the U.S. and Asia – both around 10%. Hence, the direct impact of the euro appreciation against the dollar may be limited (figure 1-27).

7. Economies of Major Asian Countries (Korea, Taiwan and Singapore) (1): Rapid Growth Led by Exports, Slight Slowdown in 2005 (see p. 21 for figures)

The rapid export-led growth of the major Asian economies since the latter half of 2003 slowed in July-September 2004. By component, exports and fixed capital formation are boosting growth in Korea, Taiwan and Singapore. Consumption also contributes positively except in Korea. Although inventories are another positive factor, weakening production in IT-related industries implies possible inventory adjustment in the quarters ahead (figures 1-28 and 1-29).

In general, economic growth in 2004 is expected to reach the level recorded in 2000 during the IT bubble, other than in Korea, thanks to strong growth in the first half of the year. Growth is expected to slow in 2005, as the Chinese and U.S. economies may weaken. However, any such slowdown will represent only a mild adjustment (figure 1-32).

The growth of the Korean economy is slowing amid slumping consumption, as the positive contribution of net exports shrank in July-September 2004. Moreover, the won has been rising rapidly (against the dollar) since October-December 2004, and could adversely impact exports that have led the overall growth (figure 1-30). Fixed capital formation is remaining healthy, largely due to the exceptionally low level of construction investment recorded in the

previous year, which was beset by typhoons. Although prices are tending to rise in general due to expensive crude oil, core price inflation is remaining within the monetary policy target (figure 1-31). In response to the prolonged slump in consumption and the problem of household debts, the Bank of Korea eased monetary policy further, lowering the overnight call rate by 0.25% in both August and November.

Likewise, the Taiwanese economy slowed down in July-September 2004. However, this followed exceptional year-on-year growth in April-June 2004, in reaction to the unusual drop in economic activity a year earlier due to the SARS epidemic. The contribution of net exports is currently limited, as imports are growing more rapidly than exports. Although fixed capital formation has been contributing to economic growth, possible weakening is expected as plant construction plans are being revised in view of reduced profits for LC panel manufacturers and deteriorating market price conditions (figure 1-28).

In Singapore, economic growth has been slowing since July-September 2004, although the same caveat mentioned for the Taiwanese economy applies (unusually low growth and exceptionally rapid growth in April-June 2003 and 2004, respectively). The growth rate stood at 5.4% in October-December (figure 1-28).

8. Economies of Major Asian Countries (Korea, Taiwan and Singapore) (2): Increased Dependency on Exports to China (see p. 22 for figures)

This section examines the trends in exports, which have led the growth of major Asian economies since the latter half of 2003.

First, figure 1-33 indicates that in all three countries, exports to other Asian countries and the U.S. were booming in the first half of the 1990s, followed by a substantial increase of China's share, particularly since 2000. China is thus developing an increasing presence as a major export market.

Second, Taiwan's direct investment abroad has been rising as a whole in recent years. By country, China's overwhelming share indicates that Taiwanese firms are active in mainland

China. Factors behind this trend may include (1) cutbacks on labor cost and (2) development of new markets. Taiwanese firms operating in China are assumed to be procuring materials from Taiwan for local production (figure 1-34).

Likewise, Korea's dependency on exports to China has been rising generally. However, major export markets vary by products. Looking at the country's major export goods (semiconductors,⁴ other electronic parts & devices,⁵ communication equipment and automobiles) by trading partner since 2003, semiconductors and other electronic parts & devices are mostly exported to the U.S., Japan and Taiwan, as well as to China, while an overwhelming percentage of communication equipment and automobile exports goes to the U.S. Thus, products at different stages of processing (producer goods and finished goods) may be exported to different countries (figure 1-35).

9. China (1): Mild Slowdown in Investment (see p. for 23 figures)

Real GDP grew 9.1% in July-September 2004. Although this is slightly less than the 9.6% recorded in the previous quarter (April-June), the booming economy will result in annual GDP growth of about 9.2% for the year 2004. Active investment and consumption are driving the continuing rapid growth. At the National Development and Reform Work Forum held on December 8, 2004, the National Development and Reform Commission announced that it would set the GDP growth target at 8% for 2005, up 1 percentage point from the 2004 target. The Chinese government has maintained a tight money policy since the spring of 2004 to dispel concerns about overheating of the economy. By raising the growth target, however, the government officially recognized the faster-than-expected economic growth (figure 1-36).

The growth of fixed asset investment in July-September (26.8%) declined slightly from the previous quarter (31.0%), but still exceeded the annual growth of 26.7% in 2003. Thus, the growth of fixed asset investment will likely be

⁴ Chips, wafers, DRAMs, SRAMs, flash memories, CPUs, etc.

⁵ Main boards, sound cards, etc.

higher in 2004 than in 2003 (figure 1-37). By region, in July-September 2004 the share of central and western provinces (inland area) in total fixed asset investment increased slightly. By industry, real estate and industries related to transport infrastructure continue to lead investment (figure 1-38).

Consumption in July-September increased substantially on the previous year. Personal spending boomed in housing and communication equipment including cellular phones as living standards rose. Service consumption related to culture and education also remained strong. Although data indicate a quarter-on-quarter decline, the substantial increase in the previous quarter involved extraordinary factors such as the reaction to sluggish consumption due to SARS a year earlier. Rather, a comparison with earlier data to January-March 2004 indicates that consumption is accelerating (figure 1-39).

As regards prices, the sharp rise in food prices eased in July-September with the prospect of a good harvest in agriculture, largely dissipating concern about consumer price inflation. The growth of money stock has been slowing as the tight money policy takes effect (figure 1-40).

Trade continued to expand smoothly in July-September on the back of booming electric machinery exports, and the trade balance stayed in the black for two straight quarters (figure 1-41).

10. China (2): Trade Structure in Three Years following WTO Accession (see p. 24 for figures)

Three years have passed since China joined the WTO in November 2001. China's trade expanded rapidly throughout the three years, and the value of total trade in 2004 (annualized) was almost twice that recorded in 2001. China's shares of world exports and imports have both exceeded 5%. Looking at the composition of trading partners, the weights of the U.S. and EU have increased in exports, while the shares of

Korea and Taiwan have risen significantly in imports (figure 1-42). A comparison of trade balance between 2000 and 2004 by major trading partner indicates a widening trade deficit with Taiwan, Japan and Korea, as well as increasing trade surplus with the U.S. and EU. In particular, the trade surplus with the U.S. has been rising strongly (figure 1-43).

The expansion of Chinese trade is largely supported by foreign affiliates operating in the country. Indeed, the structural dependency of Chinese trade on foreign affiliates has been rising. The share of foreign affiliates in Chinese trade has increased since China's accession to the WTO, as their weight in Chinese exports rose to 54.8% in 2003 from less than 50% in 2000. With the government actively favoring foreign capital, direct investment in China has been rising steadily. Under these circumstances, the structural dependency on foreign affiliates is expected to continue for some time (figure 1-44). Looking at the share of foreign affiliates in industrial production, high foreign capital ratios are observed in specific industries such as electronics and textiles. Only a few industries experienced substantial fluctuation in the foreign capital ratio between 2000 (before accession) and 2003 (after accession) (figure 1-45).

At the time of China's accession to the WTO, various scenarios regarding the impact on the Chinese economy were discussed. Expected outcomes included the expansion of trade volume through the reduction of trade barriers, increased foreign investment in the country due to market opening measures and, in some industries, local businesses being swamped by foreign affiliates with advanced technologies and services. The growth of Chinese trade and the expansion of foreign investment in China seem to be progressing as expected. However, the expected structural adjustment by foreign affiliates in some industries has not yet materialized, judging from the share of foreign capital in each industry's production.

II Japanese Economy: Pause in Recovery

1. Overview: Showing Perseverance Supported by Brisk Corporate Sector (see p. 25 for figures)

The Japanese economy's recovery appears to have paused. This recovery phase, which started in early 2002, strong particularly in late 2003 and early 2004, as exports and business investment increased on the back of the revitalized world economy. Since mid-2004, however, it has almost halted as exports leveled off and production weakened largely due to the slower world economy and the inventory adjustment in electric parts & devices and related industries. According to the quarterly estimates of GDP (second preliminary estimates) for July-September 2004, real GDP (figure 2-1) in July-September fell 0.2% on a year earlier, following negative growth of 0.6% in April-June. By component, the year-on-year growth of exports declined sharply to 2.5% in July-September 2004 largely due to the slowdown in the world economy, after four consecutive quarters of double-digit increase from July-September 2003. Domestic private demand including business investment and personal consumption continued to increase but at a slower pace.

Looking at the current trend of each demand item based on the quarterly GDP data for July-September 2004 and monthly indicators thereafter, the growth of consumption is slowing largely due to unseasonable weather, although the employment situation remains generally flat with employee compensation bottoming out due to the increase in the number of employees. Thus, consumer confidence has temporarily stopped improving. According to the Family Income and Expenditure Survey, the nominal living expenditure of all households increased on a year earlier for three consecutive quarters in 2004, but currently is declining slightly due to relatively moderate temperatures and to natural disasters including typhoons and earthquakes.

Business investment has been increasing so far in FY2004, supported by back-to-back substantial increases in corporate profits. A slowdown in business investment is expected, how-

ever, as machinery orders, the leading indicator, have weakened slightly since late 2004 in manufacturing industries including electric machinery. Nevertheless, business investment is unlikely to drop sharply, given the high level of capacity utilization and perceived under-capacity in general.

Residential investment remains flat in general, with housing starts (seasonally adjusted annual rate) remaining at just under 1.2 million units since 2001. Land prices continue to decline and greater demand for housing is observed in expectation of rising interest rates. Thus, further improvement in the employment and income situations will keep up housing investment, despite some negative factors such as the phasing out of tax breaks for mortgage loans.

Public investment has been declining continually since FY2001, reflecting financial difficulties in both central and local governments. Indeed, it accounted for less than 5% of GDP (nominal basis) in 2004, and further declines are expected as structural reform and financial difficulties continue.

Exports are leveling off after surging since mid-2003, mainly to China, on the back of economic recovery overseas. Imports are on a mild uptrend. The current account surplus is shrinking as the trade surplus starts to decline and the service account deficit continues to widen, particularly in travel.

Production (figure 2-2) is falling as adjustments proceed in electronic parts & devices and related industries amid flat exports. The tertiary industry activity index is rising slightly as consumption stays brisk. The construction activity index continues to decline due to reductions in public works, although private construction is bottoming out.

Looking ahead, production is unlikely to suffer a major further fall, as the recent expansion in the world economy is expected to continue broadly, and inventory adjustment has so far been limited to the above producer goods industries. Thus, the Japanese economy as a whole is expected to show perseverance, led by the corporate sector.

2. Inventories Stay Low despite Adjustment in Some Producer Goods (see p. 26 for figures)

Looking at the inventory cycle of the overall industrial and mining sector (figure 2-3), inventories are currently below the previous year's level for both producer goods and consumer goods as a whole, although some producer goods including electronic parts & devices have entered an inventory adjustment phase. Also, capital goods are in a buildup phase as a whole, backed by increased business investment. Thus, pressure towards inventory adjustment is relatively small in the whole industrial and mining sector.

Figure 2-4 shows the level of inventories in electronic parts & devices. The inventory ratio index is declining in parallel with reduced production, suggesting that inventory accumulation is peaking. Compared with a similar phase after the burst of the IT bubble, the current phase of inventory accumulation may be characterized as follows.

- (1) Although production adjustment started at similar levels of the inventory ratio index (100-110), the ratio leveled off earlier in the current phase.
- (2) The inventory ratio index peaked at a lower level in the current phase.

Figure 2-5 projects the future movement of production adjustment in electronic parts & devices based on the trend of shipment-inventory balance (year-on-year growth of "shipment index" – year-on-year growth of "inventory index"). Production is expected to bottom out in the latter half of 2005 after declining by about 20% on the previous year towards the middle of the year.

3. Employment Situation Continues to Improve as Job Offers Increase (see p. 27 for figures)

The ratio of active job openings to applicants has been rising since bottoming at 0.51 in January-March 2002 (figure 2-6), reaching 0.83 in July-September 2004, the highest level since January-March 1993 (0.88). The unemployment rate has declined gradually since July-September 2003, with monthly fluctuations.

Despite the continued improvement in both the ratio of active job openings to applicants and the unemployment rate, overtime hours are perceived to be leveling off particularly in the manufacturing sector (figure 2-7). This corresponds to the current downtrend in production.

The number of workers has increased since hitting the bottom in April-June 2002. However, the recovery has been slow and lacks dynamism (figure 2-8 (1)). By industrial sector,⁶ the number of workers has been decreasing in manufacturing and construction, and the increase has been led by the service sector, particularly industries related to medical care and welfare.

By type of employment, the recovery has become more clear as the number of regular employees has risen over the previous year after a prolonged decline, in addition to the structural increase in temporary and daily employees⁷ (figure 2-8 (2)). The number of self-employed and family workers is on a declining trend in the long-term, but at a slower pace at the moment.

By size of corporation, the number of employees in large corporations (employing 500 or more workers), which declined substantially from the second half of 2001, has been rising since 2003, boosting the total number of employees (figure 2-8 (3)). The recovery is spreading to medium-sized corporations (employing 30-499 workers). Meanwhile, small-sized corporations (employing fewer than 30 workers) are still shedding employees despite signs of improvement. On balance, the number of employees is rising only slowly.

The ongoing increase in the number of new job openings (figure 2-9), which is a leading indicator of employment, suggests that the number of employees will increase in the months ahead. However, the number is unlikely to rise rapidly for the moment, as the increase in new job openings has not shown a sign of acceleration. Employment is expected to increase gradually as overtime hours seem to be leveling off.

⁶ Based on the new industrial classification (revised in March 2002).

⁷ Temporary and daily employees refer to those hired for a period of one year or less, and regular employees refer to executives and those hired for a period of over one year or for an undetermined period.

4. Income Situation Stays Flat (see p. 28 for figures)

The year-on-year change in total cash earnings per person reveals continued sub-par performance despite some signs of recovery (figure 2-10). Specifically, overtime pay continues to rise on the previous year as overtime hours increase (figure 2-7). Bonuses and special earnings also rose in July-September 2004.⁸ However, regular wages and salaries show no improvement, partly due to the downward pressure from the rising share of part-time workers in the workforce.⁹

Nominal compensation of employees,¹⁰ which is useful for understanding the income situation in terms of the whole economy, appears to be bottoming out after falling since 2001 (figure 2-11). This is mainly because the number of employees is recovering slightly, although per capita wages continue to decline (figure 2-8 (3)). Thus, the income situation overall remains unchanged, and so the negative impact of reduced income on consumption has faded recently.

Figure 2-12 shows the evolution of labor's share¹¹ as an indicator of future income situation. The share has been declining since 2002 and is now below the levels recorded during the two most recent economic peaks.¹² Although views

⁸ Bonuses still follows a downtrend as the 2004 summer bonuses (June-August) declined 1.2% on the previous year.

⁹ Part-time workers receive just over 20% of the wages earned by full-time workers, in part due to the difference in hours worked. Therefore, any increase in the share of part-time workers in the workforce exerts downward pressure on wages per person.

¹⁰ Compensation of employees refers to that part of value added which is distributed to employees for the provision of labor. This includes not only cash payments to employees but also social insurance contributions by employers and allowances in kind such as meals and commuter passes. As a rule of thumb, compensation of employees is approximately (per capita wages) \times (number of employees).

¹¹ Labor's share refers to the ratio of consideration for labor service (i.e. labor cost) to the total value added by production activities. For the purpose of this report, labor's share is defined according to the Financial Statements Statistics of Corporations by Industry as personnel expenses \div (current profits + personnel expenses + interest and discounting expenses + depreciation expenses).

For discussion on the definition of labor's share and calculating methods, see Wataru Miyana (2002), "Labor's Share and the Adjustment of Wages and Employment," *DBJ Research Report* No. 27, for instance.

¹² October-December 2000 and April-June 1997 (according

to the quarterly reference dates of business cycle). It is certain that firms have more funds for distribution to labor. Further improvement in corporate profits is expected to have some spillover effect on income.

Against this backdrop, private final consumption according to the GDP estimate has been growing since bottoming in April-June 2003, even on a nominal basis (figure 2-13). Consumption based on the GDP estimate necessarily diverges upwards from consumption based on the Family Income and Expenditure Survey due to such factors as the larger population and the inclusion of imputed rent, which is growing steadily. Nonetheless, the data reveal active consumption compared with employee compensation (figure 2-11).

5. Respite in Savings Drawdown to Compensate for Reduced Income (see p. 29 for figures)

As observed in the previous section, consumption is stronger than income; so, savings, which represents the difference between income and consumption, should be shrinking. The trend of household savings (figure 2-14), however, indicates that the savings ratio is bottoming out for workers' households in the Family Income and Expenditure Survey as well as on an SNA basis.¹³ The SNA-based savings ratio has been flat since 2002, and the ratio for workers' households is considered to be bottoming out in 2004.¹⁴

The most recent SNA-based data are for 2003, so we must rely on the workers' household data to examine current trends in income and consumption (figure 2-15). Income and con-

to the quarterly reference dates of business cycle).

¹³ The savings ratio for workers' households in the Family Income and Expenditure Survey is considerably higher than the SNA-based ratio, apparently because the former do not include jobless households (see figure 2-17 for the savings ratio of jobless households). For further information on the causes of divergence between the two sources, see Yasushi Iwamoto, Tetsu Ozaki and Yuki Maekawa (1995 and 1996), "Divergence between 'Family Income and Expenditure Survey' and 'National Accounts' on the Trend of Household Savings Ratio (1) and (2)," *Financial Review* No. 35 and 37, Ministry of Finance Institute of Fiscal and Monetary Policy.

¹⁴ Calculated from seasonally adjusted values for January-November.

sumption have both been declining since 1997 in workers' households. However, consumption has been decreasing less steeply than income, resulting in the reduction of savings (i.e., income minus consumption) since 1998. The phenomenon that consumption does not decline as fast as income in a recession is known as the "ratchet effect".¹⁵ However, savings are increasing in 2004¹⁶ as consumption has not kept pace with the increase in income.

Figure 2-16 shows the surplus or deficit trend of financial asset flows in the household sector. As a rule of thumb, a surplus or deficit in financial asset flows is equivalent to the SNA-based amount of savings excluding funds invested in real estate. The data indicate that the financial surplus declined and finally reversed in 2003, but then returned in 2004. Thus, financial asset flows in the household sector are bottoming out in 2004, almost in parallel with savings.

In the final analysis, the decline in the savings ratio has halted as income has bottomed out. A further recovery in household income would certainly end the decline in the savings ratio, due to the income factor.

However, the savings ratio will inevitably shrink as the population ages. The share of jobless households has risen in recent years as the number of elderly households rises (figure 2-17).¹⁷ Since the savings ratio of jobless households is negative, the progress of aging will depress the savings ratio as a whole; thus so the savings ratio will likely resume its decline in the future. The pace of decline, however, will depend on the extent of recovery in income.

6. Personal Consumption on the Rise but Slightly Slowing (see p. 30 for figures)

The nominal living expenditure of all households in the Family Income and Expenditure Survey (figure 2-18) rose on the previous year for three consecutive quarters in 2004,¹⁸ but is now falling due to relatively moderate temperatures as well as natural disasters including typhoons¹⁹ and earthquakes.

On the supply side, the retail sales index is now bottoming out (figure 2-19). We cannot be optimistic about the sales trend, however, because much of the increased sales value of fuel-related products is due to higher crude oil prices. By product, sales of home appliances are increasing, as buoyant sales continue for flat-panel TV sets and DVD players.²⁰

Consumer confidence indicators are rather weak in general. As regards the Consumer Confidence Index (expectations for the coming six months)²¹ (figure 2-20 (1)), the latest survey found that the "employment" situation was expected to continue to improve while other items including "overall livelihood" were expected to deteriorate, effectively halting the improvement in consumer confidence. The Living Insecurity Index (figure 2-20 (2)) remains flat, although it has been improving in general. Also, improvement in the Nikkei Consumption Forecast Index has been slowing, showing no significant movement recently.

Thus, consumer confidence indicators are weakening slightly as personal consumption slows down. However, this is mostly due to extraordinary factors such as weather and natural disasters, and the underlying income situation is

¹⁵ The ratchet effect occurs primarily because consumers do not immediately change their traditional behavior, regarding economic fluctuation as temporary.

¹⁶ Calculated from seasonally adjusted values for January-November.

¹⁷ Jobless households whose heads are 60 or older accounted for 93.0% of the total jobless households (as of 2003).

¹⁸ Some attribute the extraordinary year-on-year increase recorded in January-June 2004 to possible overestimation caused by a change in the sample households surveyed.

¹⁹ Japan Meteorological Agency data indicate that four typhoons landed in Japan in September-November 2004, tying the record number since 1951.

²⁰ Data according to the Nippon Electric Big-Stores Association (NEBA).

²¹ In April 2004, the Cabinet Office consolidated the former Consumer Confidence Survey, Monthly Consumer Confidence Survey and One-person Households Consumer Confidence Survey into the new Consumer Confidence Survey. Also, the item "perception of price" was excluded from the calculation of the consumer confidence index.

not deteriorating. The disappearance of those factors should cause personal consumption to rise, as the income situation bottoms out.

7. Continued Increase in Business Investment Shows Signs of Slowdown (see p. 31 for figures)

Business investment continues to increase, but weakness is observed in some leading indicators.

According to the Financial Statements Statistics of Corporations by Industry, business investment in all industries grew 14.4% on a year earlier, the sixth consecutive quarter of increase. Data by industry (figure 2-21) indicate that investment is increasing in both the manufacturing and the non-manufacturing sector, as return on investment rises in line with growing corporate profits. In the manufacturing sector (up 14.8% on a year earlier), business investment increased for the sixth consecutive quarter, led by active investment in electrical machinery for digital home electronics and new model investment in automobiles. Investment rose for the fourth straight quarters in non-manufacturing (up 14.2%), led by retail and services.

Figure 2-22 shows the movement of machinery orders (private demand excluding ships and electric power), a good leading indicator of business investment. In the manufacturing sector, the year-on-year growth of machinery orders has been slowing in general since mid-2004, with a decrease in orders received from electrical machinery, mainly for semiconductor equipment. Machinery orders in the non-manufacturing sector remain flat overall, depending on orders received from the heavyweight communications industry. The floor area of building construction started (figure 2-23), a leading indicator of building investment, has been rising mainly for plants and stores, continuing to record double-digit increases in 2004. Since machinery orders generally lead business investment by two to three quarters, machinery investment in the years ahead may decrease on a year earlier, particularly in the manufacturing sector, while building investment is expected to follow its up-trend.

However, the capacity utilization ratio (figure 2-24) remains high in the manufacturing

sector as a whole, despite slight declines in some industries including electrical machinery due to production adjustment. The high ratio may be explained by the reduction in production capacity with the progress in corporate restructuring, as well as the continuation of substantial capacity utilization in materials industries (including iron & steel) and automobiles amid the tight supply-demand condition. Moreover, the diffusion index of production capacity (“excessive capacity” minus “insufficient capacity”) has been improving in the manufacturing sector as a whole, although the improvement in perceived excessive capacity is peaking in some industries including electrical machinery. Thus, business investment is not likely to drop much, at least in the near future.

8. Residential Investment Stays Flat (see p. 32 for figures)

Housing starts (seasonally adjusted annual rate) have stayed just under 1.2 million units since 2001 (figure 2-25).

However, the trend by region indicates some changes (figure 2-26). Housing starts were traditionally led by the Tokyo metropolitan area but the contribution in that area has waned recently, whereas improvement in “other” regions²² has become more prominent.

The diffusion index of orders received for single-dwelling, custom-built houses (figure 2-27) is often regarded as a good leading indicator of construction starts for owner-occupied houses. According to the index, improvement in construction starts is expected in the quarters ahead. Thus, the number of construction starts for owner-occupied houses, which has stayed relatively flat, is not likely to drop significantly.

Residential land prices (figure 2-28) are still falling, thus encouraging housing purchases.

As a reference on interest rates, figure 2-29 shows the trends in the lending rate of the Government Housing Loan Corporation (basic interest rate on personal loans). The rate turned up in the second half of 2003, effectively raising expectations of higher interest rates. Thus, the cur-

²² Regions other than the Tokyo metropolitan area, Kinki region and Chubu region.

rent housing investment may be partially supported by greater demand in expectation of a possible rise in interest rates.

Thus, the fall in land prices and expectations of higher interest rates will have a positive impact on housing investment. It is true that the phasing out of tax breaks for mortgage loans is a negative factor (figure 2-30), but further recovery in the employment and income situations will support housing investment in the years ahead.

9. Constant Decline in Public Investment due to Financial Squeeze (see p. 33 for figures)

Public investment continues to decline. As shown in figure 2-31, public investment (public fixed capital formation²³) has been declining due to cuts in expenditures forced by financial difficulties. Consequently, public investment now accounts for only 4.6% of nominal GDP (seasonally adjusted nominal value). Although government final consumption has leveled off since 2000, it remains substantial, largely due to increased pension benefit payments and medical care expenses. Indeed, it accounts for as much as 17% of nominal GDP.

The value of public works contracted, a leading indicator, fell 13.7% year on year in FY2003, the fifth straight year of decline (figure 2-32). Public works implemented by the central government continue to decline due to spending cuts in line with the budget reform policy of the Koizumi cabinet. Public works by local governments have also been decreasing, largely due to the lack of financial resources. Thus, the total value has continued to decline, down 15.7% in October-December 2004.

The supplementary budget for FY2004 included public investment of ¥1 trillion for relief efforts following the major earthquake in Niigata-Chuetsu and damages caused by typhoons.²⁴ In the FY2005 budget (government draft),²⁵ however, expenditures related to public works

projects will be cut 3.6% (year on year), as public investment continues to shrink.

As regards revenues, the supplementary budget for FY2004 does not envisage additional government bond issues, for tax revenues are expected to rise by about ¥2 trillion, thanks to increased corporate and income tax payments on the back of economic recovery. Nonetheless, public finance remains tight, as the outstanding long-term debts of central and local governments will exceed ¥700 trillion for the first time, totaling ¥719 trillion at the end of FY2004 according to the initial budget (figure 2-33).

How does Japan fare in comparison with other developed countries in terms of public finance? Public investment of general government in Japan is declining as a percentage of nominal GDP, but still exceeds the levels of other developed countries including the U.S. and the U.K. (figure 2-34). As regards the outstanding debts of general government (as a percentage of nominal GDP), the Japanese government has been far more deeply indebted in recent years than its U.S. and euro-area counterparts. An OECD estimate predicts that the outstanding debts of Japanese general government will account for 175% of nominal GDP in 2006. The primary balance (budgetary balance excluding bond issues, interest payments and bond redemptions) remains poor, but a slight improvement is expected starting in 2004 thanks to reduced public investment and recovery in tax revenues (figure 2-35).

10. Exports Level Off, Current Account Surplus Shrinks (see p. 34 for figures)

Trends in foreign exchange rates are shown in figure 2-36. Since 2002, the yen/dollar market rate has declined almost 30% from ¥130/\$ to near ¥100/\$, but the real effective exchange rate has hardly changed, due to the unilateral depreciation of the dollar against the euro and other major currencies and lower price inflation in Japan than in the U.S. This can also be attributed to the decline in the share of the U.S. dollar in Japanese merchandise trade. Indeed, the appreciation of the yen against the dollar has had little impact on Japanese exports so far in the current economic recovery phase.

²³ Public fixed capital formation includes general government, plant and equipment of public corporations and public dwellings.

²⁴ FY 2004 Supplementary Budget (Ministry of Finance website, December 20, 2004).

²⁵ December 24, 2004.

Japanese exports have leveled off since mid-2004 after increasing in line with economic expansion in the U.S. and Asia. Imports have been rising gradually as the domestic economy recovers (figure 2-37). One of the structural factors behind the simultaneous increase in exports and imports is the international division of labor within the Asian region.

Looking at a breakdown of exports by country (figure 2-38), booming exports to Asia, particularly to the fast-growing China, have led the overall growth in the current economic recovery phase since April-June 2002. Exports to the U.S. continued to decline throughout 2003 as local auto production facilities became operational and office equipment production for the U.S. was transferred to plants in other Asian countries. The decline almost halted in 2004, but total exports are leveling off as the growth in exports to Asia slows down.

Figure 2-39 shows the trend of exports by type of goods, based on the estimates of industrial and mining shipments for export, published by the Ministry of Economy, Trade and Industry. Producer goods made the greatest contribution at the start of the economic recovery in the first half of 2002, as well as in mid-2003 when exports rebounded after a temporary lull. Subsequently, the contribution of capital and consumer goods also increased, led by strong demand in China. However, exports of producer goods and capital goods are now leveling off.

Figure 2-40 shows the trade balance. The trade surplus has been shrinking gradually since April-June 2004 as exports have slowed and crude oil prices have risen. In October and November 2004 the trade surplus declined on a year-on-year basis. The rise in crude oil and other fuel prices is estimated to reduce the trade surplus by some ¥3 trillion per year. Nonetheless, the impact is not comparable to the previous two oil crises, as crude oil now accounts for a smaller share of imports.

In addition to the decline in trade surplus, the rebound in the number of overseas travelers following the end of the Afghan and Iraq wars and the SARS epidemic has increased the service trade deficit. Thus, the current account surplus has reduced to some ¥16 trillion on an annual basis (figure 2-41).

11. Exports – Characteristics of the Current Recovery Phase (see p. 35 for figures)

This section compares the trend of exports that have led the current economic recovery phase (since January 2002)²⁶ and past export trends in the four previous recovery phases since the 1980s.

As compared with the four previous cases, the current recovery is typically led by external demand, with substantial contribution from exports and net exports (figures 2-42 and 2-43). The rate of contribution is even more significant because the contribution has increased while overall GDP growth has been declining. Exports played a small role in the recovery phase starting in November 1986, which was led by domestic demand; indeed, net exports made a negative contribution overall. In the most recent previous recovery phase (Q1 1999 to Q4 2000), the contribution of exports and net exports at the initial stage was comparable to that in the current phase. The substantial contribution and the recovery phase itself were short-lived, however, as exports fell soon afterwards due to the accumulation of IT-related inventories.

Industrial and mining shipments for export by type of goods (figure 2-44) indicate a growing contribution of producer goods, which may be explained as follows: increased direct investment overseas for the development of local production facilities stimulates exports of investment goods; once the production facilities become operational, they start to import producer goods from Japan for product assembly. However, the contribution of investment goods has been more significant in the current recovery phase than in the previous one, due to increased exports of capital goods in response to buoyant fixed capital investment in China.

Figure 2-45 shows the value of exports by destination. The largest contribution comes from exports to NIEs in the two previous recovery phases as well as in the current phase. In the current phase, however, exports to China make a comparable contribution. In contrast, the contribution of exports to the U.S. is negative despite the economic recovery.

²⁶ Preliminary date.

Even though direct exports to the U.S. are falling, producer goods exported to Asia might be assembled and then exported to the U.S. as finished products. In other words, indirect exports to the U.S. could actually be increasing. To what extent do direct and indirect U.S. imports affect Japanese exports? To answer this question, we analyzed the chronological change in this impact. Figure 2-46 shows the result of our estimation.²⁷ Here, the explained variable is the Japanese export volume index, while the explanatory variables include real U.S. imports and the nominal effective yen rate. We compared the values of coefficients among the periods between two peaks of the Japanese economy. The results showed that the coefficient of real U.S. imports (β) was highest in the periods between October-December 1997 and October-December 2000 and between October-December 2000 and July-September 2004. Thus, the impact of U.S. imports on Japanese exports has been rising in recent years, which implies that increased exports to the U.S. from Asia are stimulating Japanese exports as a whole.

12. Upward Pressure on Corporate and Consumer Prices to be Checked as Crude Oil Prices Stabilize (see p. 36 for figures)

Prices of corporate goods (domestic demand products²⁸) have been rising year on year since April-June 2004 mainly due to the rapid rise in international commodity prices. By industry, the negative contribution of machinery has been diminishing, while there has been a positive contribution from energy (crude oil and petroleum & coal products in particular) and iron & steel. Currently, the positive impact is rising from chemicals & plastics including styrene monomer (figure 2-47).

Meanwhile, corporate service prices continue to decline by about 1% as a whole (figure 2-48). Nonetheless, there has been a positive contribution from transportation (overseas factor) due to rising ocean tramp rates, whereas the

negative contribution of information services is now shrinking.

Consumer prices (goods) have become almost flat, with the increase due to petroleum products offset by the disappearance of the positive contribution of food, which had exerted upward pressure due to the poor rice harvest²⁹ (figure 2-49).

Consumer prices (services) rose on the previous year as a whole from April-June 2003 to January-March 2004, due to upward pressure from public services as the self-pay ratio in medical expenditures was raised. Since April-June 2004, however, the negative contribution of public services³⁰ has been expanding largely due to the reduction in electric utility and fixed telephone rates, as well as the disappearance of the medical expense factor. Despite the positive contribution of eating out, consumer prices continue to show a deflationary trend as a whole (figure 2-49).

Crude oil prices, which were the main cause of the corporate and consumer goods price inflation, finally started to fall in November 2004. Looking at the impact of speculative and commercial contracts³¹ on the growth in total crude oil futures trading³² in the New York Mercantile Exchange (NYMEX), fluctuation in speculative contracts has a greater impact despite their smaller share. Hence, speculative contracts as well as commercial buyers exerted a major effect during the surge in crude oil prices against the backdrop of international financial expansion and active demand in China. As compared with government bond and stock markets, the crude oil market is considered to be more vulnerable to

²⁹ From October-December 2003 to July-September 2004.

³⁰ Here, public services include electricity, gas and water supply.

³¹ "Speculative" and "Commercial" contracts are defined as follows:

"Speculative" = non-commercial positions + non-reportable positions, and

"Commercial" = commercial positions.

Many of the non-reportable traders are said to be speculators.

³² The number of open interests in crude oil (contracts for 1,000 barrels as at the end of the month) held by the traders (commercial and non-commercial) participating in the futures market. Total open interests are distributed among reportable and non-reportable traders. The reportable traders are required to report their trading activities to the Commodity Futures Trading Commission (CFTC).

²⁷ The difference of logarithmic values from the previous quarter is adopted here to remove the trend.

²⁸ Domestic demand products represent the weighted average of domestic products and imports.

speculative behavior, due to the smaller number of players. Since September 2004, the positive contribution of speculative contracts to the growth of total trading has declined and reversed to a negative contribution. Further withdrawal of speculative money may alleviate the upward pressure of high crude oil prices on corporate and consumer prices (figure 2-50).

13. Easy Money Policy Continues (see p. 37 for figures)

As regards quantitative financial indicators, the monetary base remains large although its year-on-year growth has been slowing as quantitative monetary easing policy is still in place with a direct guidance target set for the current account balance. However, the money stock continues to grow slowly, in single-digit territory on the previous year (figure 2-51).

The decline in outstanding private bank loans has eased somewhat recently. There has been a clear improvement in the level after adjustment for extraordinary factors (such as fluctuations caused by the mobilization or amortization of credit loans), although the decline continues (figure 2-52).

Short-term interest rates (overnight unsecured call rate) have stayed near zero due to the quantitative monetary easing policy. Long-term interest rates (yields on 10-year government bonds) continue to fall as concern mounts about an economic slowdown, despite a temporary rise at the end of the year mainly influenced by share prices (figure 2-53).

The attitude of financial institutions toward lending has softened, and contracted interest rates on new bank loans continue to decline (figure 2-53). The diffusion index of lending attitude continues to improve for both large corporations and SMEs, reaching +19 points and +5 points respectively in December 2004 (figure 2-54).

The full lifting of the guarantee on bank deposits, scheduled in April 2005, is drawing near.

Substantial movements, such as the massive shift from time and savings deposits to demand deposits that was observed before the partial removal in April 2003, have not been discerned so far (figure 2-55). As of December 2004, some 32% of the banks have already introduced payment and settlement deposits (meeting the three requirements of no interest, payment on demand and the provision of settlement service), while another 64% are considering or preparing for their introduction. Although the progress differs by type of financial institution, 90% of the financial institutions covered by the new regulation have already introduced, or are considering the introduction of, payment and settlement deposits (figure 2-56).

14. Trends in Non-lending Finance (see p. 38 for figures)

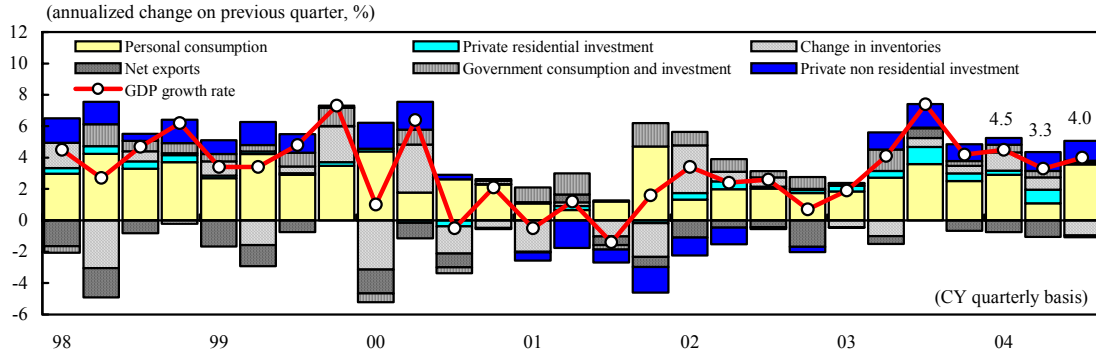
The condition of financing through marketable securities has been improving. As regards straight bonds, the difference in yield spreads has been reduced between A and AAA ratings. Indeed, the difference has shrunk to 1 bp between A and AA ratings, and to 10 bps between AA and AAA ratings (figure 2-57). BBB and lower-rated bond issues, which were extremely difficult to execute in the past, have also been increasing recently (figure 2-58). Moreover, the value of equity financing has been rising sharply since the fourth quarter of 2003, mainly through convertible bonds (figure 2-59).

Other new developments are observed in relation to bank loans. Commitment lines have been expanding in terms of both outstanding contract amount and utilization rate, indicating partial substitution for traditional bank loans (figure 2-60). The transfer of credit risk is also making headway, although its value has had no significant direct impact. Syndicated loans are on the rise, primarily for unlisted firms (figure 2-61). The outstanding amount of credit derivatives, including credit default swaps, has been increasing since 2003 (figure 2-62).

I. World Economy: Expansion Slows

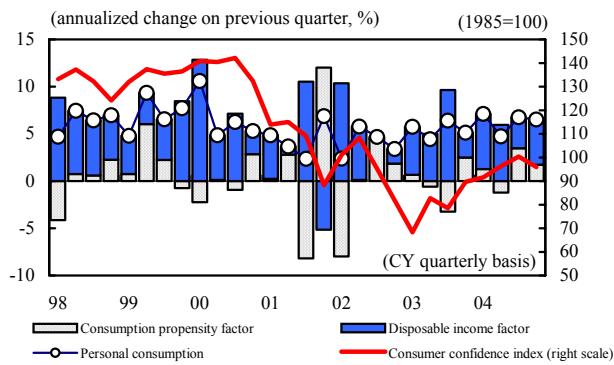
U.S. (1): Strong Personal Consumption and Business Investment Continued, with Some Concerns over Future Downside Risk

Figure 1-1. Trends in Real GDP



Source : U.S. Department of Commerce, "National Income and Product Account."

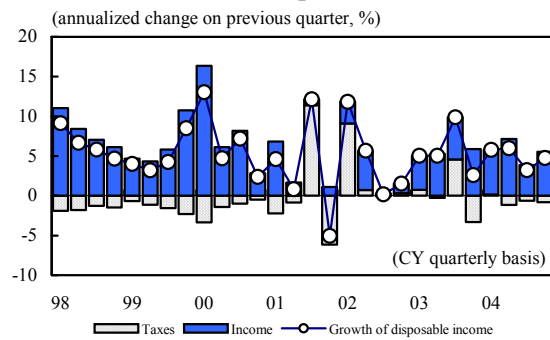
Figure 1-2. Personal Consumption Trends



Note : Data for October-December 2004 represent average for October and November.

Source : U.S. Department of Commerce, "Personal Income and Outlays."

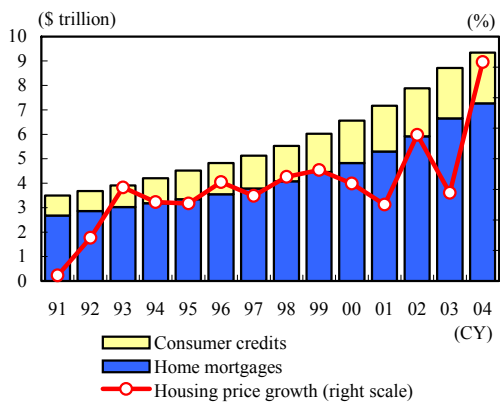
Figure 1-3. Change in Disposable Income by Component



Note : Data for October-December 2004 represent average for October and November.

Source : U.S. Department of Commerce, "Personal Income and Outlays."

Figure 1-4. Household Liabilities and Housing Prices

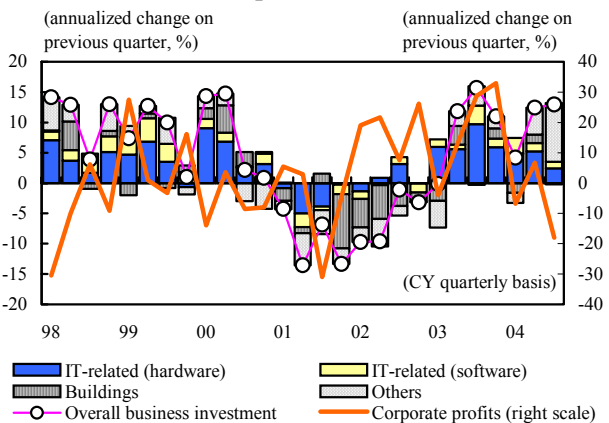


Note : Consumer credits and home mortgages represent outstanding amounts (as at the end of September for 2004).

Housing prices represent medians of new housing sales prices (year-on-year change in January-November prices for 2004).

Sources : FRB, "Flow of Funds"; U.S. Department of Commerce, "Housing Survey."

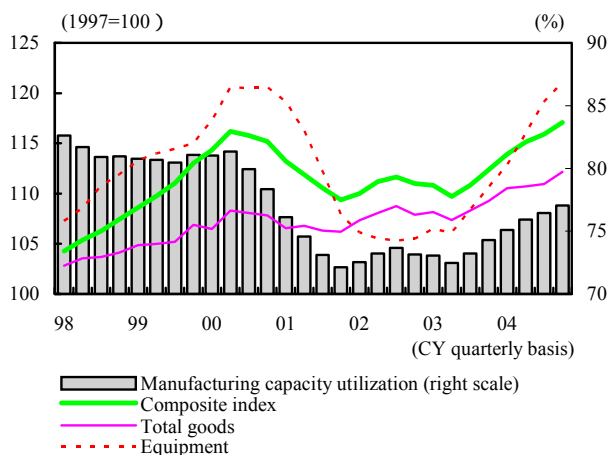
Figure 1-5. Trends in Real Business Investment and Corporate Profits



Source : U.S. Department of Commerce, "National Income and Product Account."

U.S. (2): Healthy Growth of Production and Employment, Stable Share Prices and Interest Rates

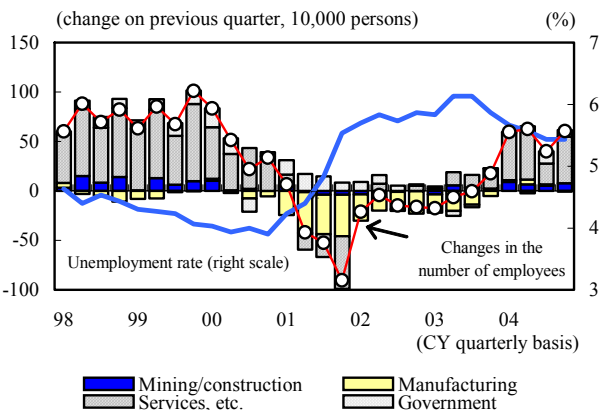
Figure 1-6. Industrial Production Index and Capacity Utilization in Manufacturing



Note: Data for October-December 2004 represent average for October-November.

Source: FRB, "Industrial Production and Capacity Utilization."

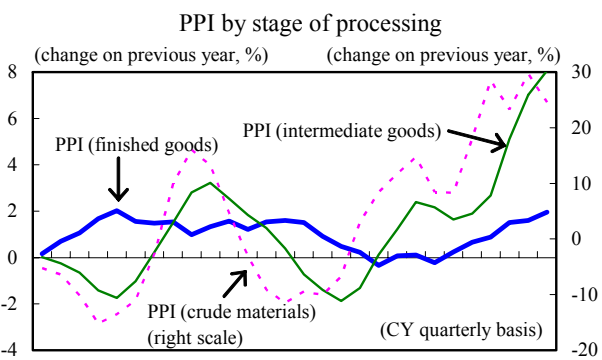
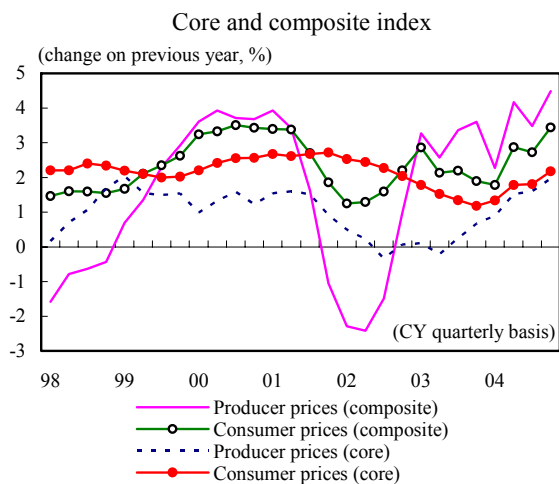
Figure 1-7. Change in Number of Employees and Unemployment Rate



Note: The number of employees represents monthly average for the non-agricultural sector.

Source: U.S. Department of Labor, "Employment Situation."

Figure 1-8. Prices

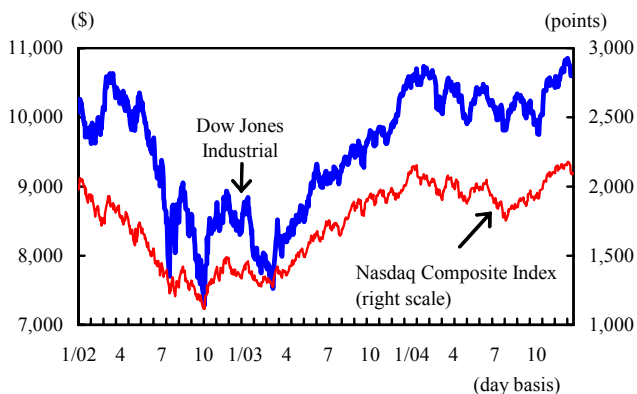


Notes: 1. Consumer prices for October-December 2004 represent year-on-year change for October-November.

2. PPI by stage of processing represents core index.

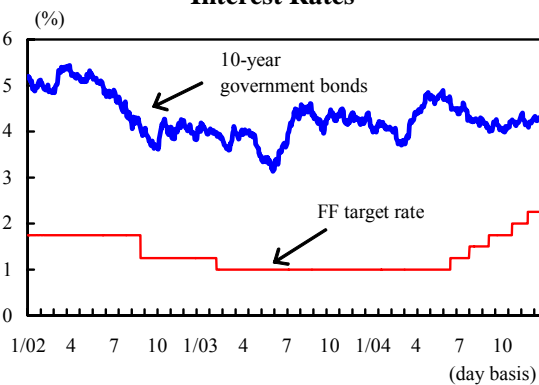
Sources: U.S. Department of Labor, "Producer Price Index" and "Consumer Price Index."

Figure 1-9. Stock Market Indexes



Sources: Dow Jones; DRI database.

Figure 1-10. Long- and Short-term Interest Rates



Sources: FRB data; Wall Street Journal.

U.S. (3): Current Account Deficit and Savings-Investment Balance

Figure 1-11. Current Account Balance and U.S. Dollar Rates

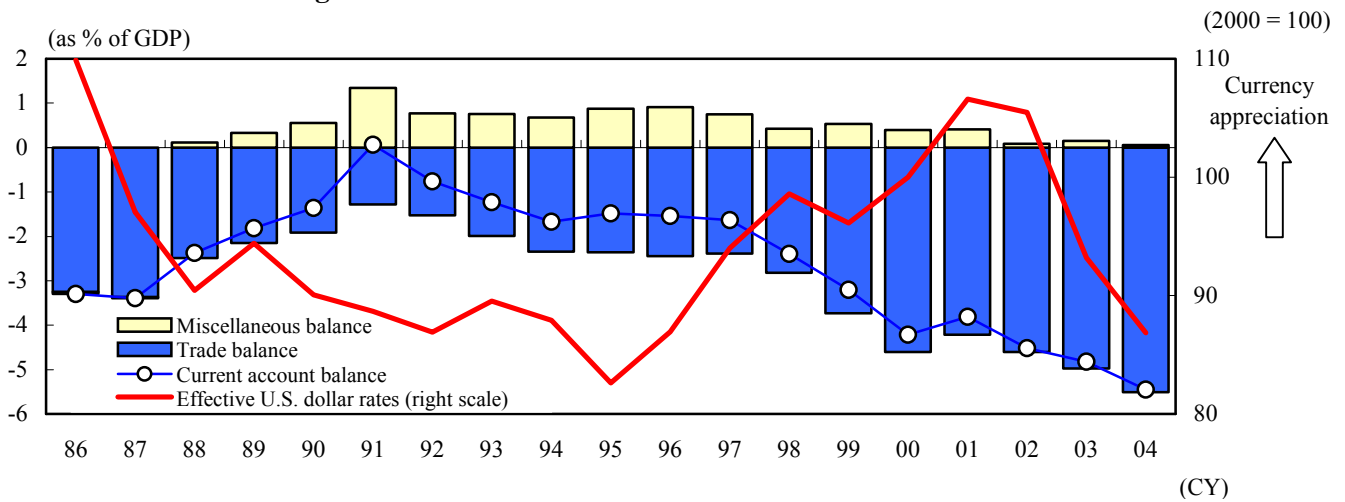


Figure 1-12. Trade Balance by Partner

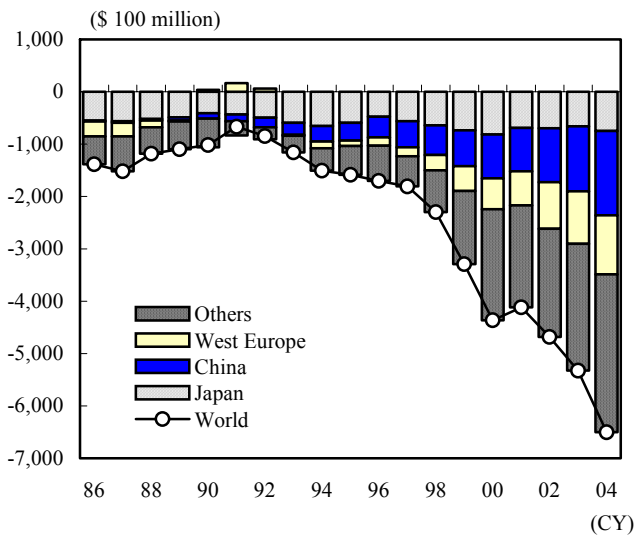
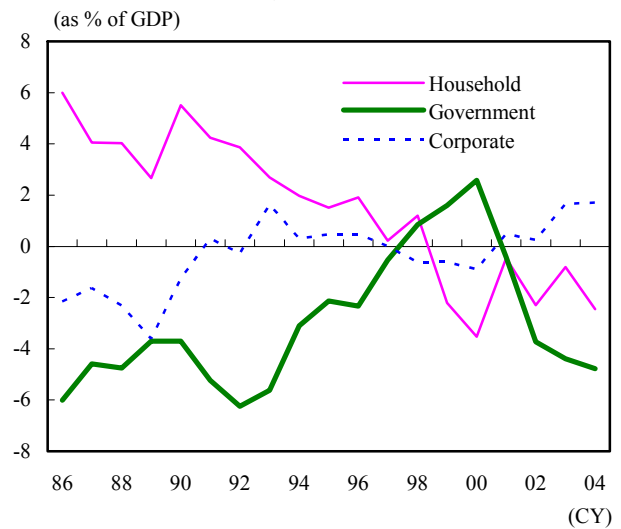


Figure 1-13. Savings-Investment Balance by Sector



Note: Annualized monthly or quarterly values for 2004.

Sources: U.S. Department of Commerce; FRB; IMF.

U.S. (4): External Credits/Debts and Balance on Income

Figure 1-14. Net External Assets and Balance on Income

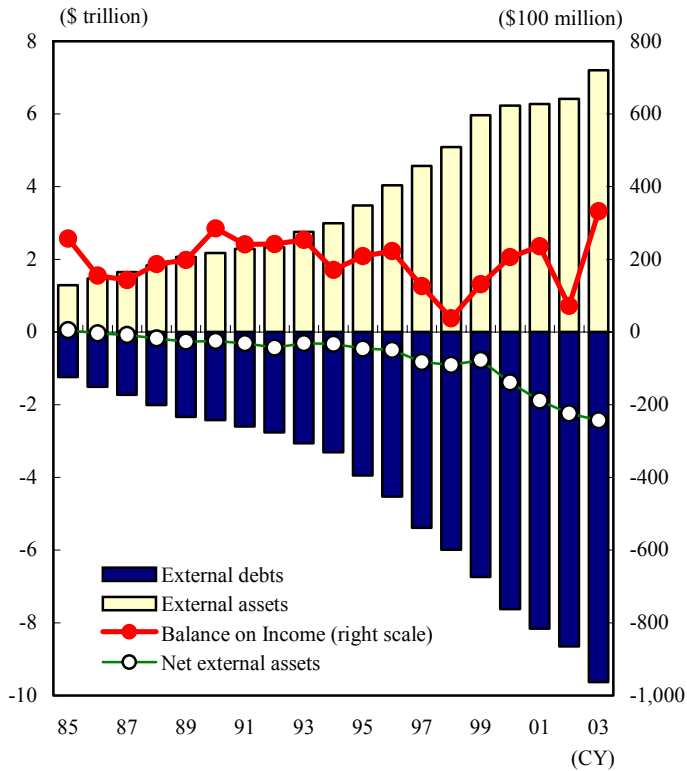


Figure 1-15. Composition of Balance on Income

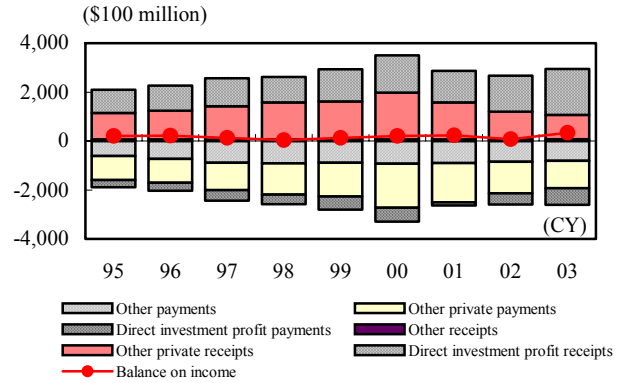


Figure 1-16. Share of Direct Investment in External Credits and Debts

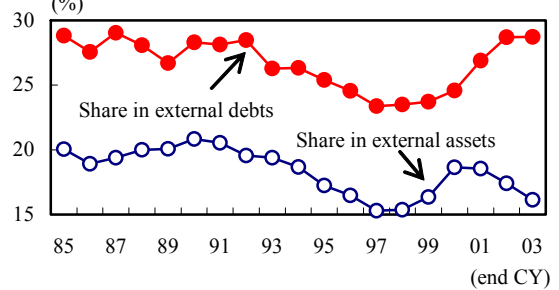


Figure 1-17. Yields on External Credits and Debts

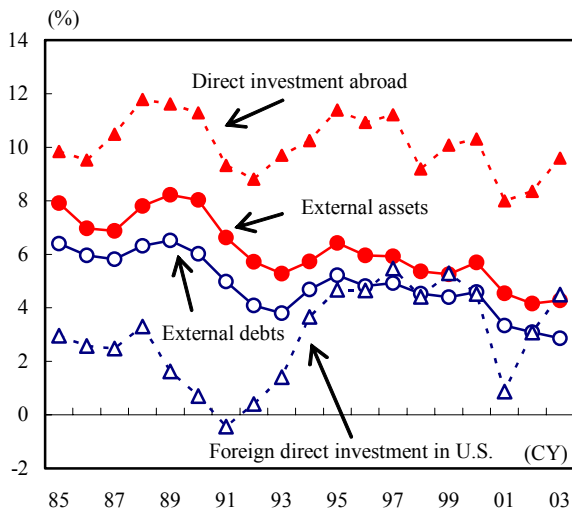
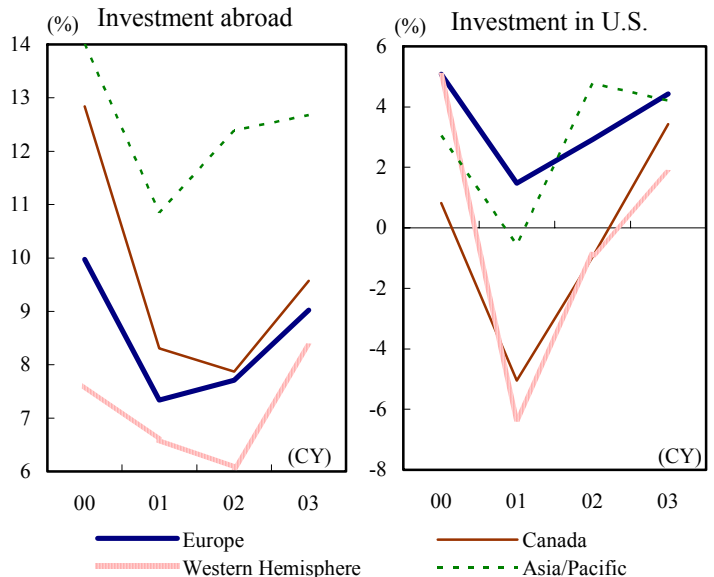


Figure 1-18. Yields on Direct Investment by Partner

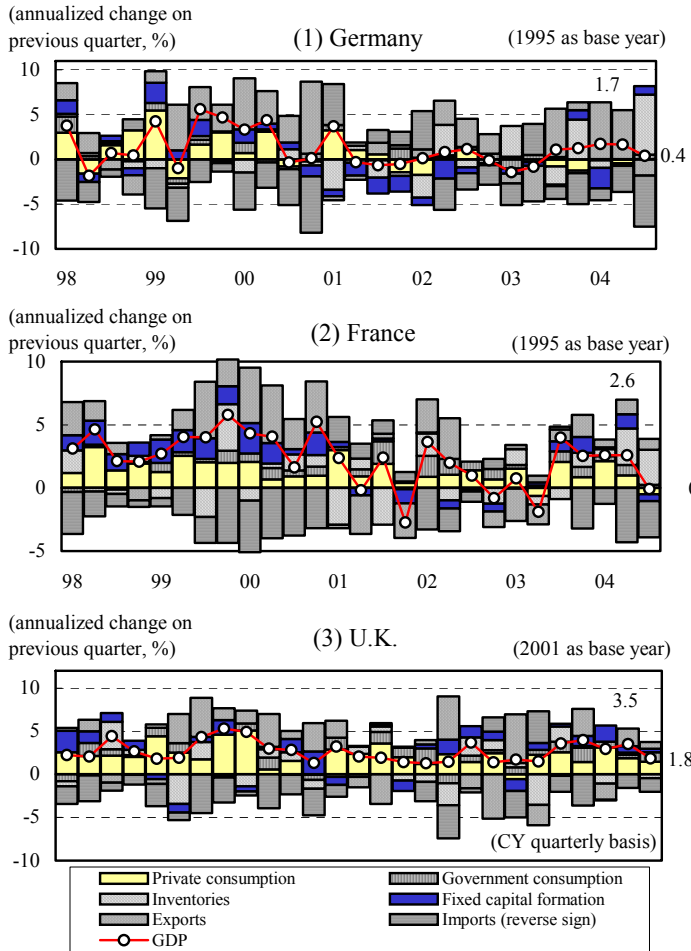


- Notes : 1. For external assets and debts, Figures 1-14 through 1-17 use replacement values and Figure 1-18 uses acquisition values.
 2. Yields on external assets or debts = profit receipts or payments / average amount of assets or debts.

Source U.S. Department of Commerce.

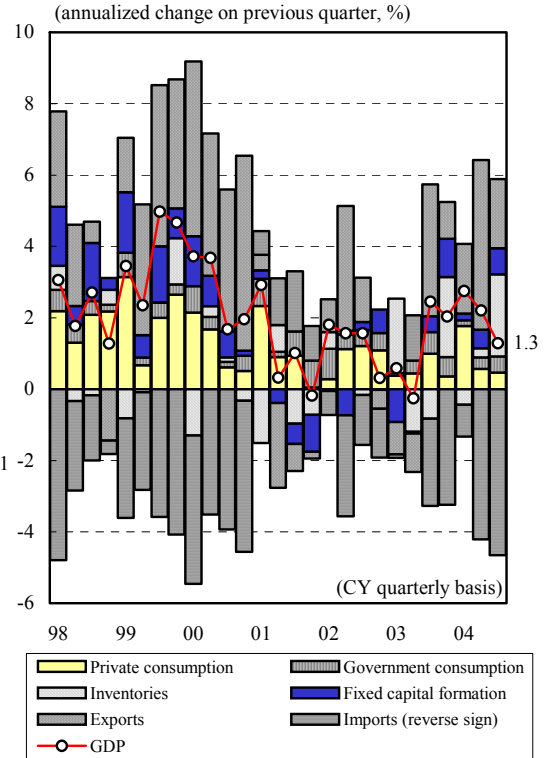
European Economies (1): Mild Slowdown

**Figure 1-19. Real GDP of Major European Countries
(annualized change from previous quarter
by component)**



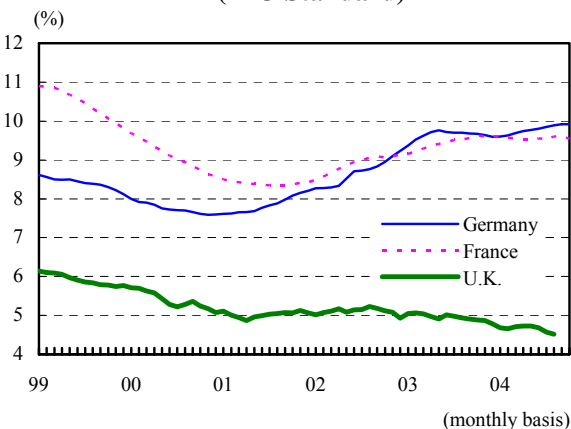
Sources : Statistisches Bundesamt (StBA), Direction Générale de l'Institut National de la Statistique et des Etudes Economiques (INSEE) and U.K. Central Statistical Office data.

**Figure 1-20. Real GDP of EU25
(quarter-on-quarter change
by component)**



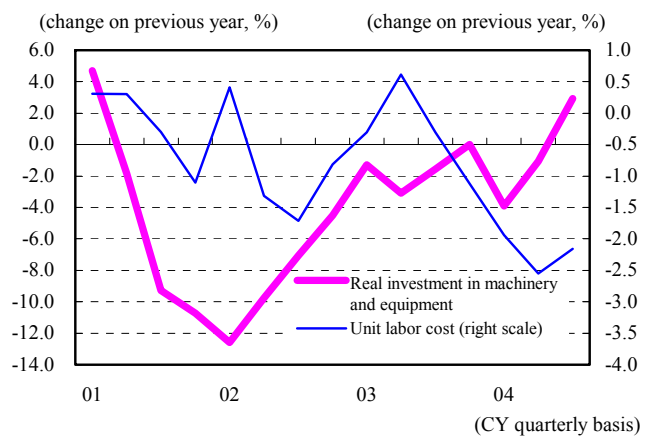
Source : Eurostat.

**Figure 1-21. Trend of Unemployment Rates
(ILO Standard)**



Note : Seasonally adjusted.
Source : OECD.

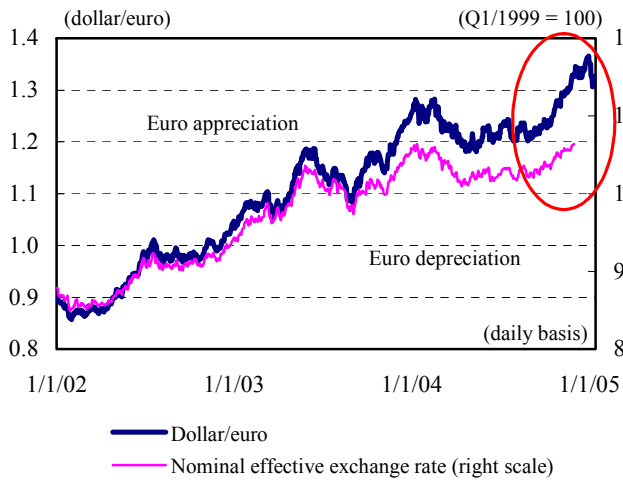
Figure 1-22. German Manufacturing Sector



Source : Bundesbank.

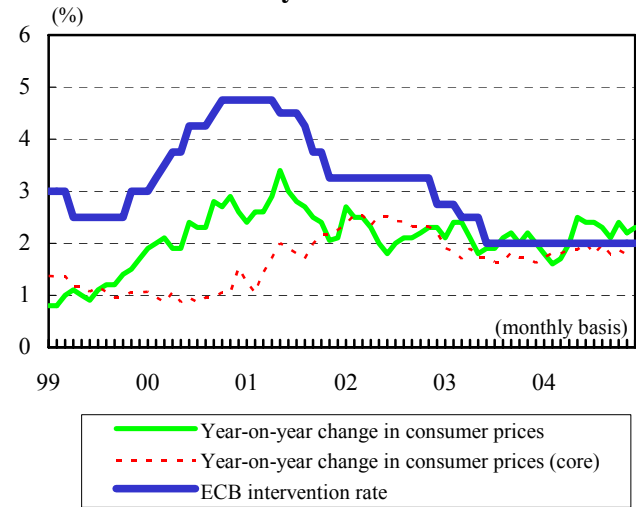
European Economies (2): Increased Presence of Euro

Figure 1-23. Trends in Foreign Exchange Rates



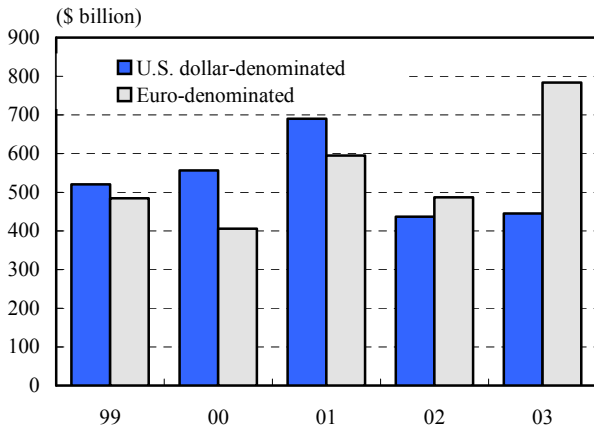
Source: European Central Bank.

Figure 1-24. Consumer Prices and Monetary Policy in Euro Zone



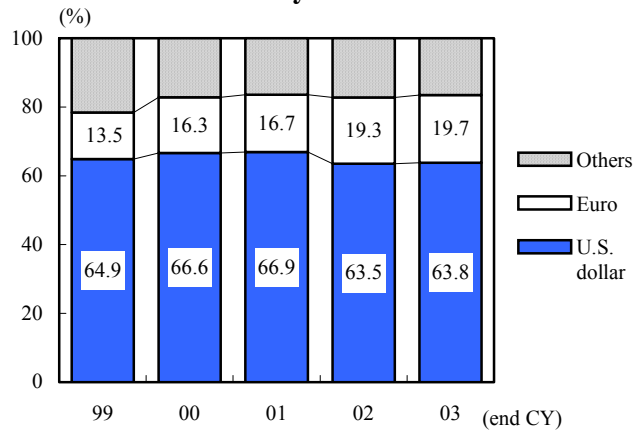
Sources: ECB; Eurostat.

Figure 1-25. Straight Bond Issues by Currency



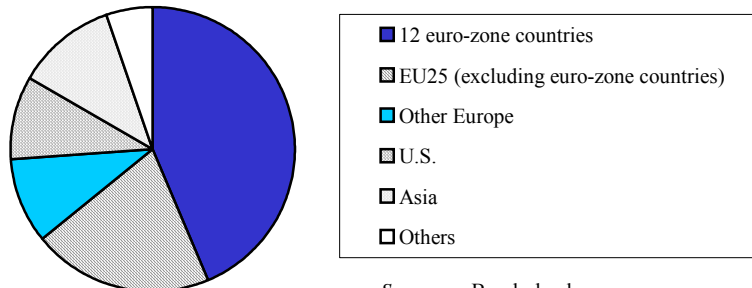
Source: BIS, "Quarterly Review."

Figure 1-26. Composition of World Foreign Currency Reserves



Source: IMF, "Annual Report 2004."

Figure 1-27. Composition of German Exports by Partner (2003)



Source: Bundesbank.

Economies of Major Asian Countries (1): Rapid Growth Led by Exports, Slight Slowdown in 2005

Figure 1-28. Real GDP Growth Rate

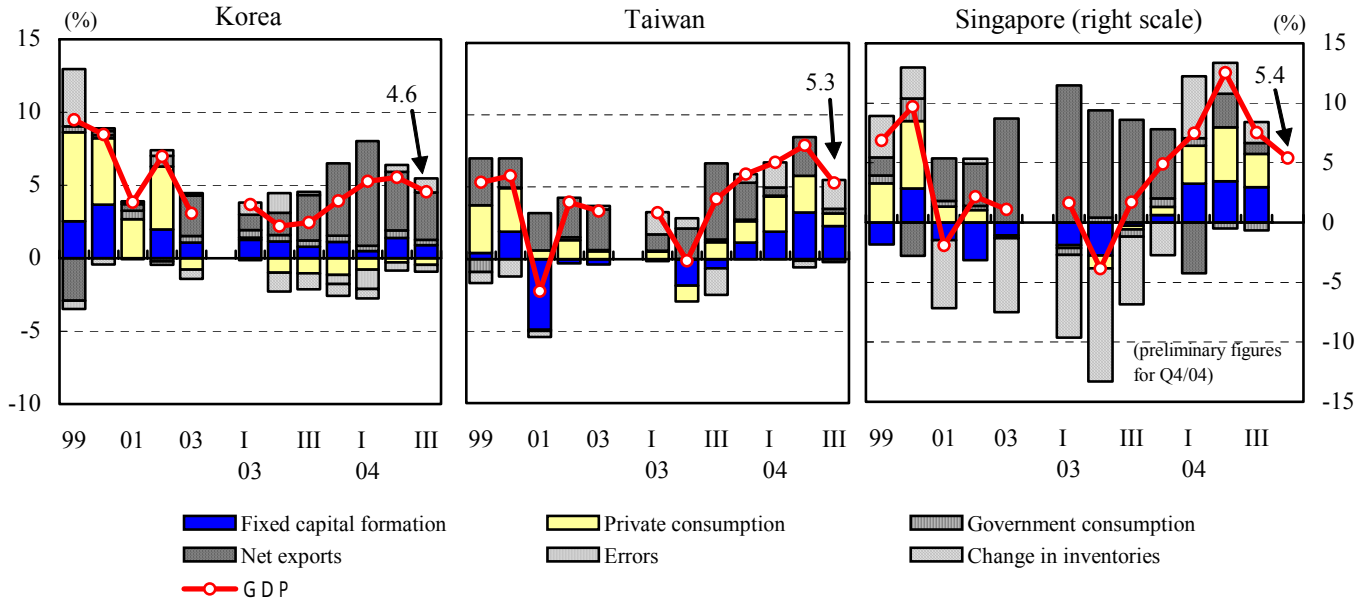


Figure 1-29. Manufacturing Sector Production Index

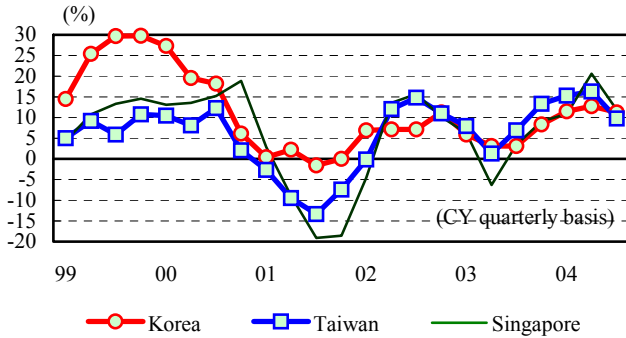


Figure 1-31. Price Inflation

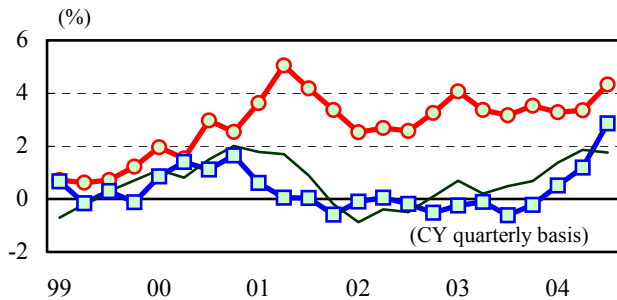


Figure 1-30. Foreign Exchange Rates (against dollar)

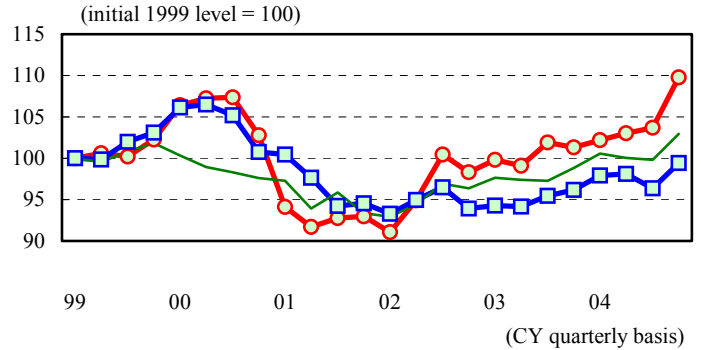


Figure 1-32. Economic Growth Outlook (ADB)

	Korea	Taiwan	Singapore
2003	3.1	3.3	1.1
2004	4.4	6.0	8.1
2005	3.6	4.8	4.2

(CY)

Note: Growth rate represents year-on-year change.

Sources: Korea National Statistical Office; Executive Yuan of the Republic of China; Singapore Department of Statistics; DRI; Asian Development Bank, "Asian Development Outlook October/2004" (for Figure 1-32 only).

Economies of Major Asian Countries (2): Increased Dependency on Exports to China

Figure 1-33. Exports by Trading Partner

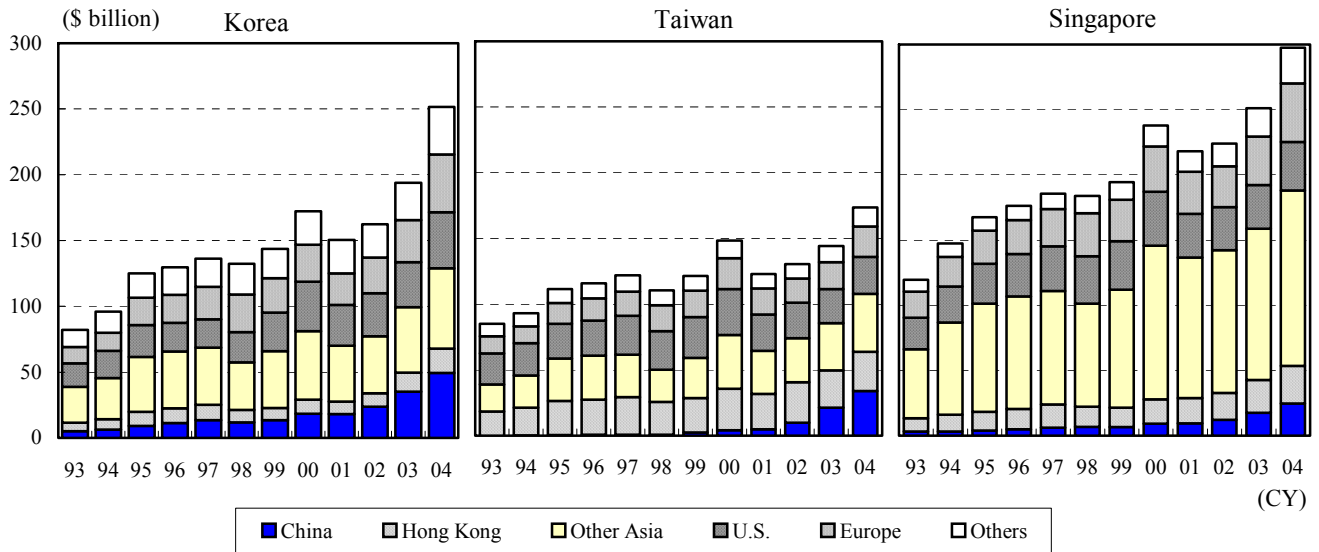


Figure 1-34. Taiwan's Direct Investment Abroad

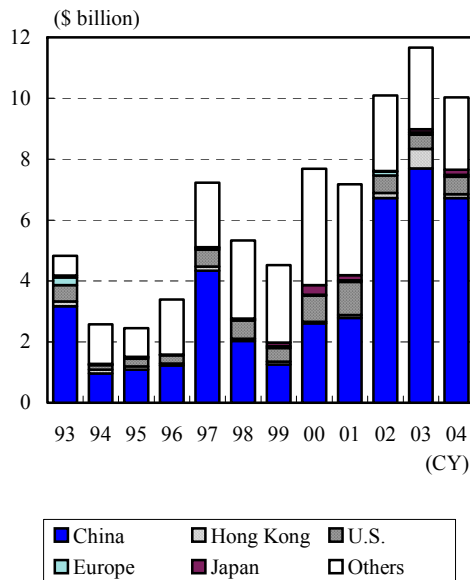
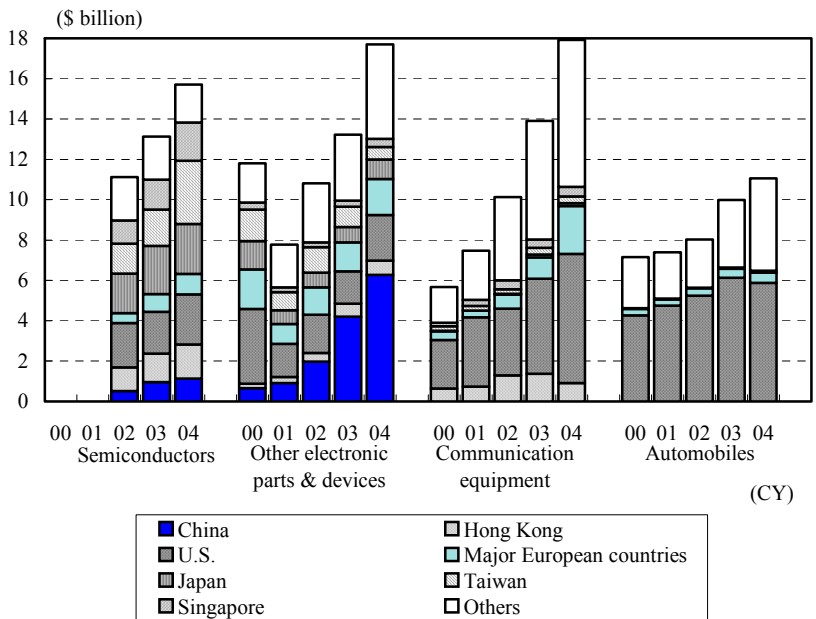


Figure 1-35. Korea's Major Export Goods (Annual Growth by Trading Partner)



- Notes:*
1. Data for 2004 in Figure 1-33 represent cumulative values through November for Korea and Taiwan, and annualized cumulative values through September for Singapore.
 2. Direct investment in Figure 1-34 is based on approvals.
 3. In Figure 1-35, "semiconductors" include chips, wafers, DRAMs, SRAMs, flash memories, CPUs, etc. "Other electronic parts & devices" include main boards and sound cards among others. Data on "semiconductors" are not published for 2000 and 2001.

Sources: National statistics.

China (1): Mild Slowdown in Investment

Figure 1-36. Real GDP Growth

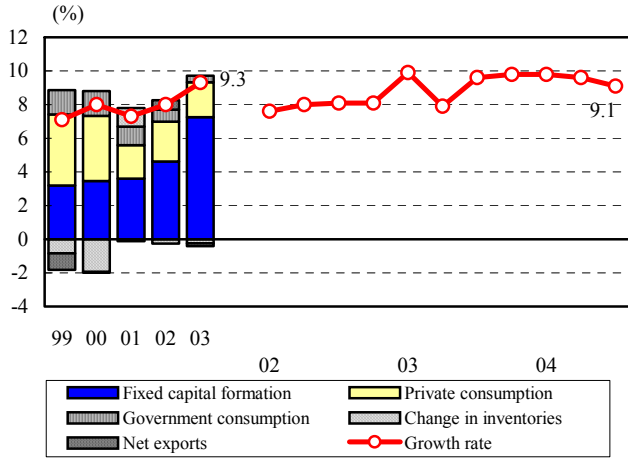


Figure 1-37. Composition of Investment Completed (1)

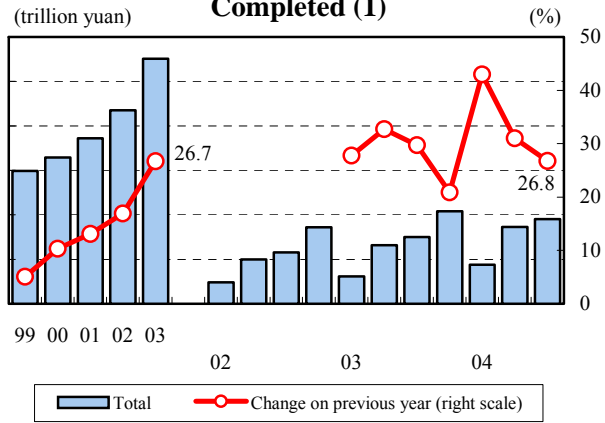


Figure 1-38. Composition of Investment Completed (2)

<Industries with largest contribution> (Jul.-Sept. 2004)			
	Change on previous year	Share	Contribution
1) Real estate	30.7%	24.9%	26.9%
2) Electricity/gas/water	47.4%	7.9%	13.1%
3) Transport	22.4%	12.9%	10.2%

<By region>				
	Apr.-Jun.		Jul.-Sept.	
	Change on previous year	Share	Change on previous year	Share
Eastern provinces	20.0%	54.6%	28.9%	54.3%
Central and western provinces	29.8%	45.4%	27.8%	45.7%
Total	24.3%	100.0%	28.4%	100.0%

Figure 1-39. Retail Sales of Consumer Goods

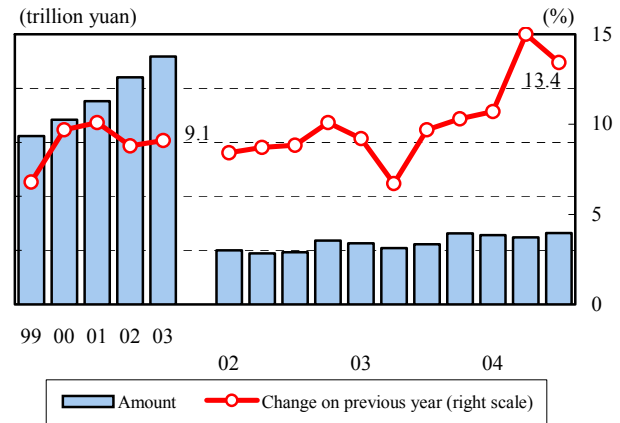


Figure 1-40. Prices and Money Stock

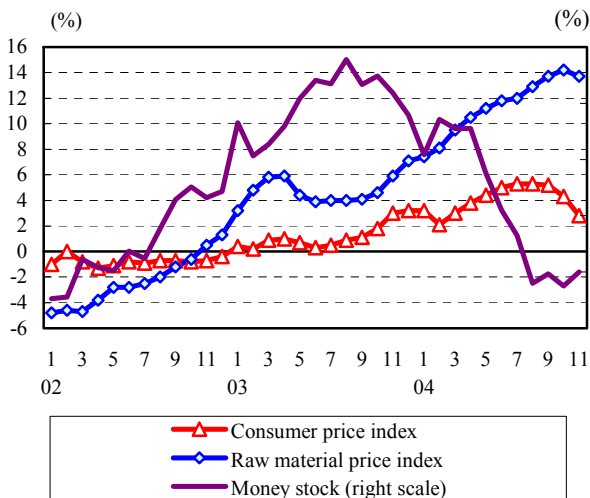
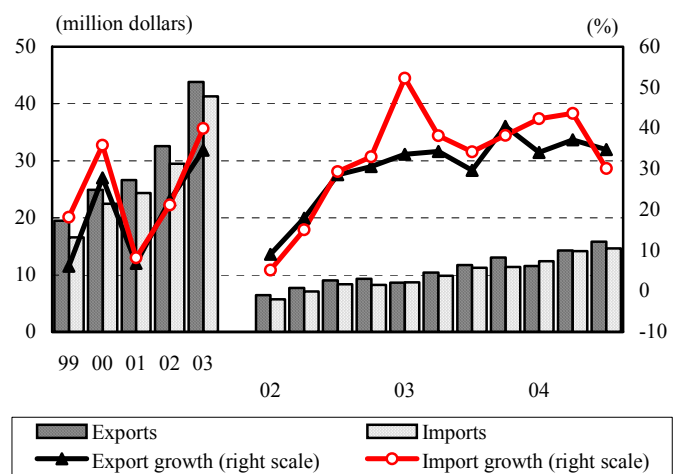


Figure 1-41. Exports and Imports

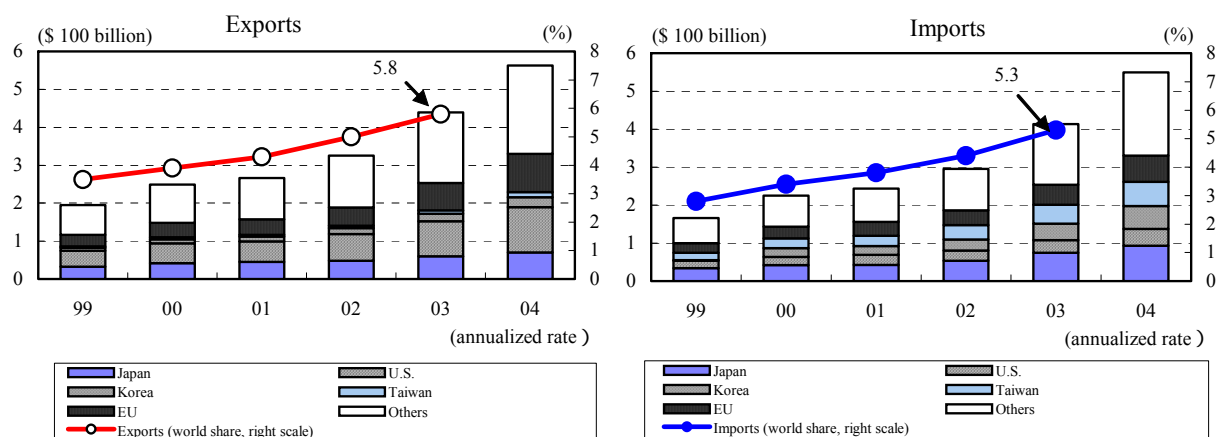


Note: The growth rate represents change on the previous year.

Sources: IMF, "International Financial Statistics"; China Statistical Yearbook; China Monthly Economic Indicators; and People's Bank of China data.

China (2): Trade Structure in Three Years following WTO Accession

Figure 1-42. China's Major Trading Partners and Share in World



Note: 2004 figures represent annualized cumulative values through October.

Figure 1-43. Trade Balance by Partner (before and after accession to WTO)

	(\$100 million)			(\$100 million)		
	Exports	Imports	Trade balance	Exports	Imports	Trade balance
Total	2,492	2,251	241	5,624	5,494	131
Of which						
U.S.	521	224	297	1,196	442	755
EU	382	308	74	1,015	690	325
Japan	417	415	2	701	929	? 228
Korea	113	232	? 119	262	608	? 347
Taiwan	50	255	? 205	126	635	? 509

Note: Data for 2004 represent annualized cumulative values through October.

Figure 1-44. Share of Foreign Affiliates in Chinese Trade and Foreign Direct Investment in China

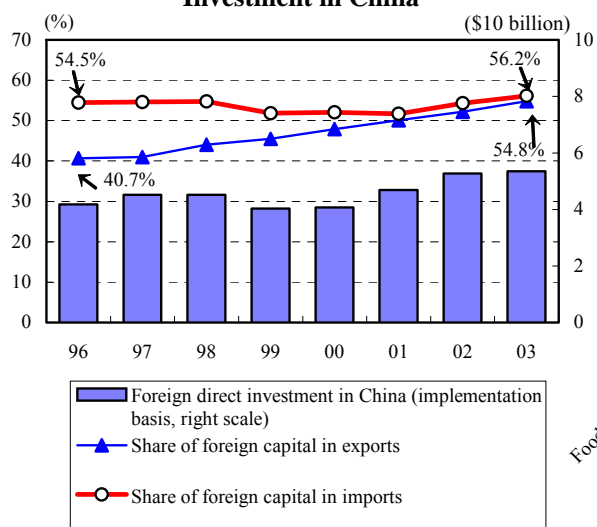
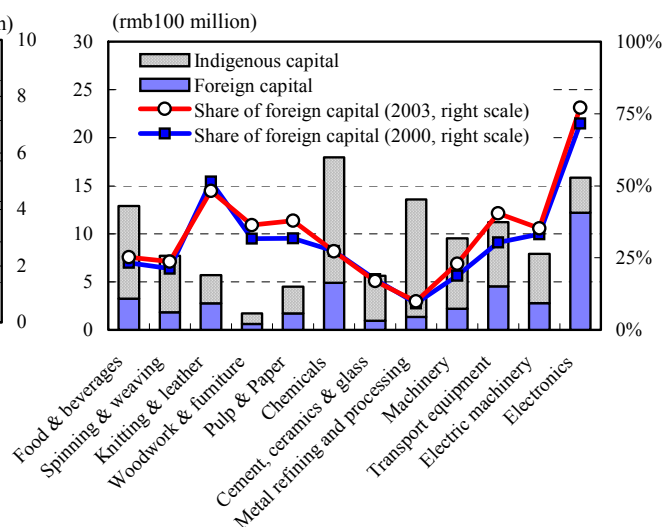


Figure 1-45. Foreign and Indigenous Capital in Industrial Production (2003)

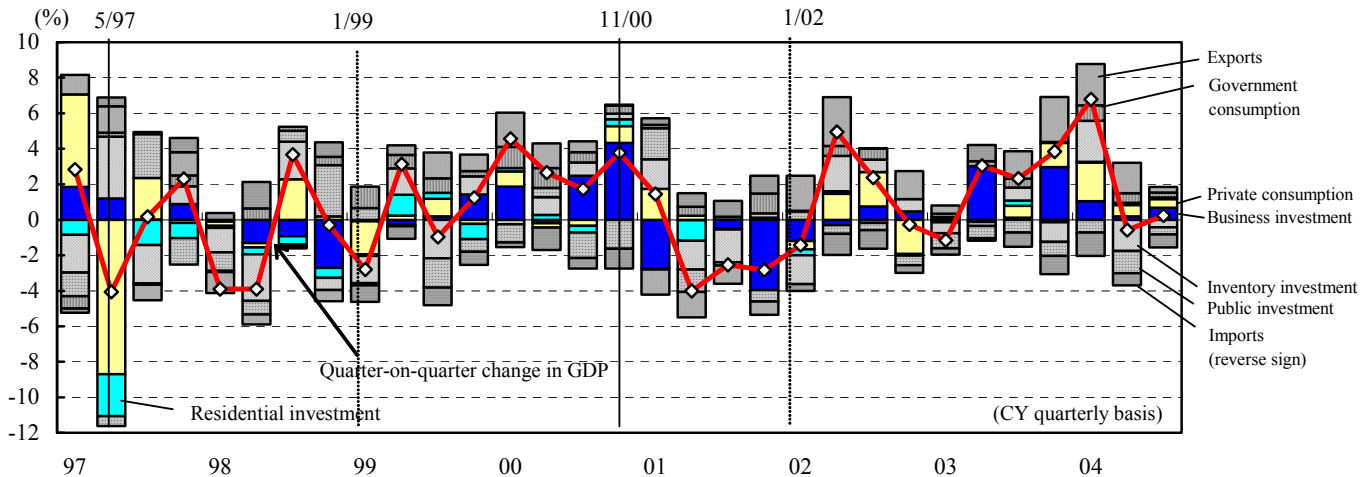


Sources: "China Statistical Yearbook"; "China Monthly Economic Indicators"; WTO, "International Trade Statistics."

II. Japanese Economy: Pause in Recovery

Overview: Showing Perseverance Supported by Brisk Corporate Sector

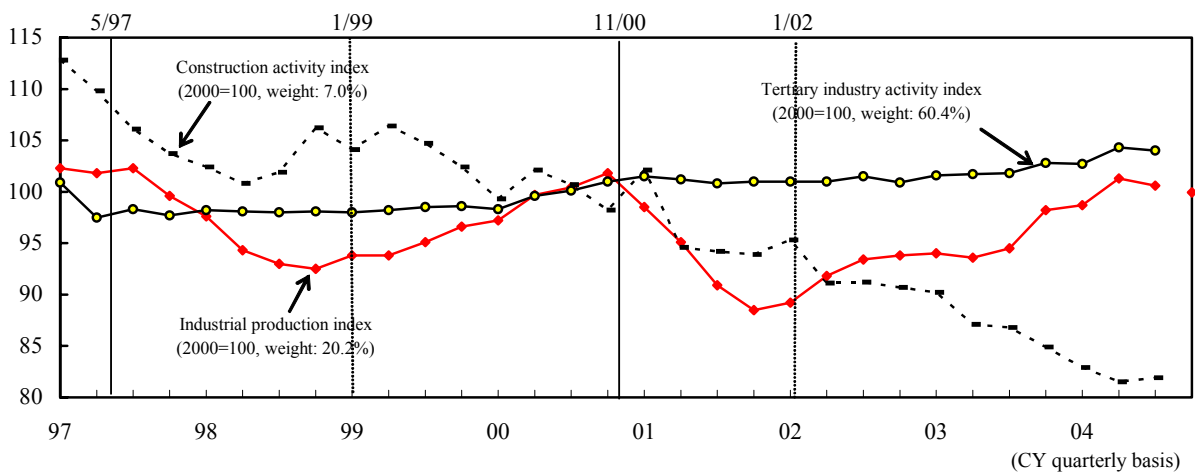
Figure 2-1. Trends in Real GDP
(annualized rate of change from the previous quarter by component, seasonally adjusted)



- Notes:
- Contributions of private business investment and public investment in January-March and April-June 2004 are based on the series of seasonally adjusted real quarter-on-quarter changes excluding the impact of government's large-scale asset purchases from the private sector in January-March 2004 (values published by the Cabinet Office).
 - Contribution to annualized GDP is prorated to each item based on its share in contribution before annualization. Government consumption includes the contribution of public inventories.

Source: Cabinet Office, "National Accounts."

Figure 2-2. Trends in Production Indicators
(seasonally adjusted)



- Notes:
- Weights represent shares in all-industry activity index (GDP from the supply side) and add up to 100 in sum with the agriculture, forestry and fishery production index (weight: 1.6%) and public service activity index (10.8%).
 - For October-December 2004, the industrial production figures represent the average of actual figures for October and November and estimate for December based on the Survey of Manufacturing Production Forecast. The construction and tertiary industry figures represent October only.

Source: Ministry of Economy, Trade and Industry.

Inventories Stay Low despite Adjustment in Some Producer Goods

Figure 2-3. Inventory Cycle

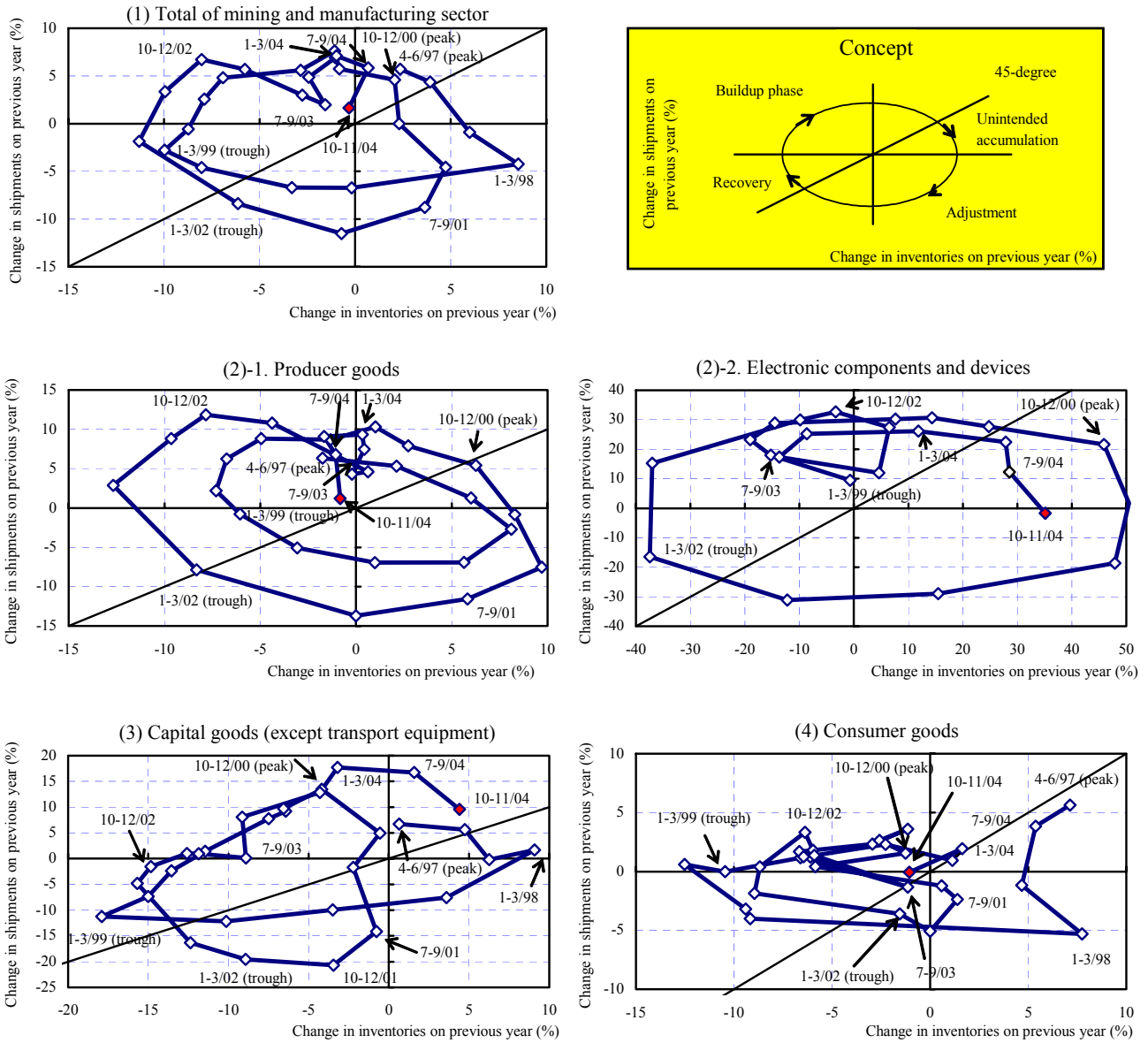


Figure 2-4. Inventories and Production of Electronic Parts & Devices

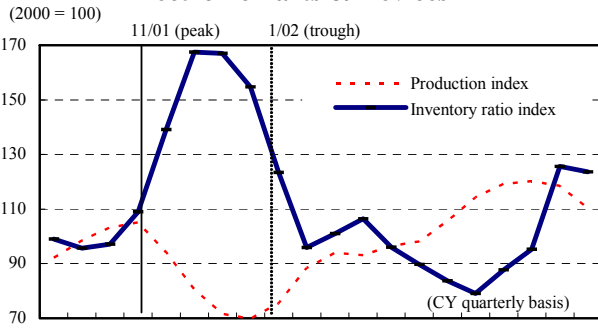
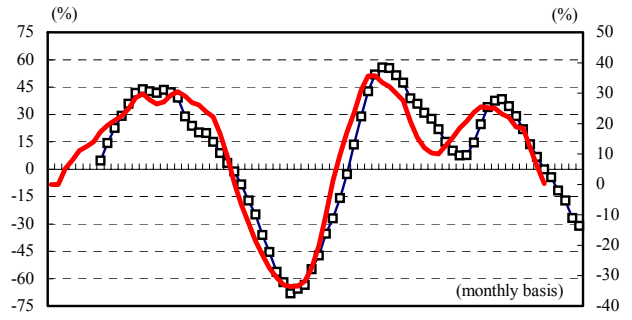


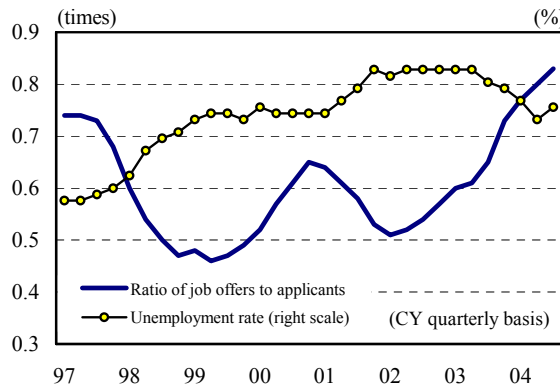
Figure 2-5. Shipment-Inventory Balance for Electronic Parts & Devices



Note : Shipment-inventory balance in Figure 2-5 represents year-on-year change in "shipment" index - year-on-year change in "inventory" index.
 Source : Ministry of Economy, Trade and Industry, "Indices of Industrial Production."

Employment Situation Continues to Improve as Job Offers Increase

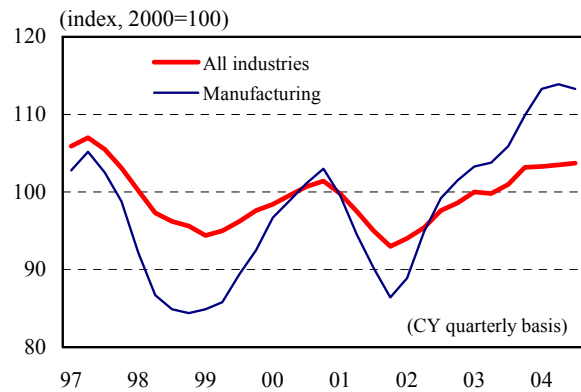
Figure 2-6. Trends in Ratio of Job Offers to Applicants and Unemployment Rate



Note: Seasonally adjusted.

Sources: Ministry of Internal Affairs and Communications, "Labour Force Survey"; Ministry of Health, Labour and Welfare, "Statistics on Placement Activities."

Figure 2-7. Overtime Hours

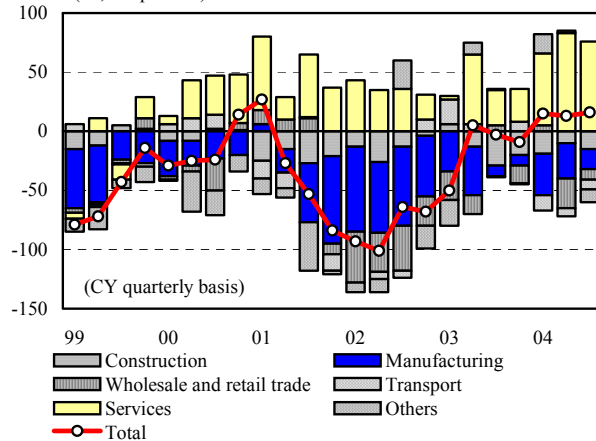


Note: Seasonally adjusted.

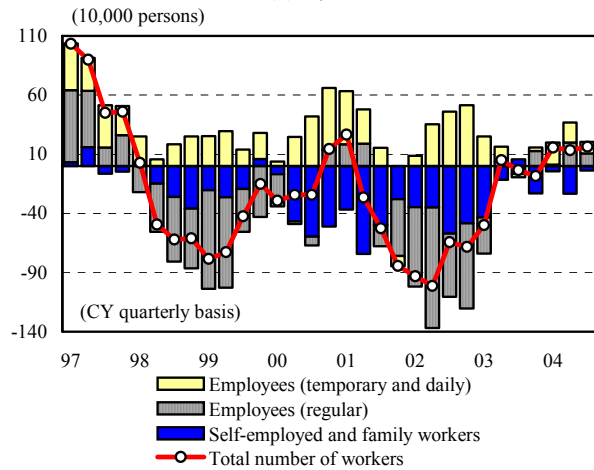
Source: Ministry of Health, Labour and Welfare, "Monthly Labour Survey."

Figure 2-8. Trend of Year-on-Year Change in Number of Workers and Employees by

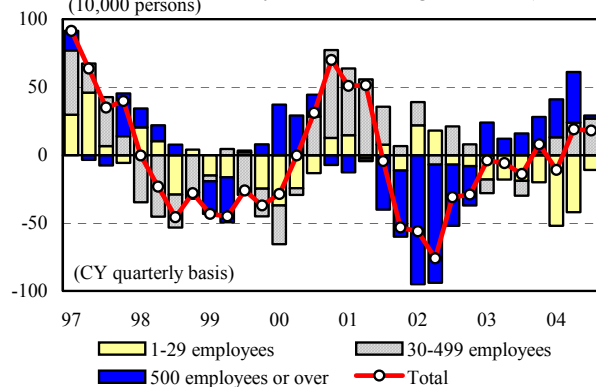
(1) By industry (new industrial classification)
 (10,000 persons)



(2) By status
 (10,000 persons)

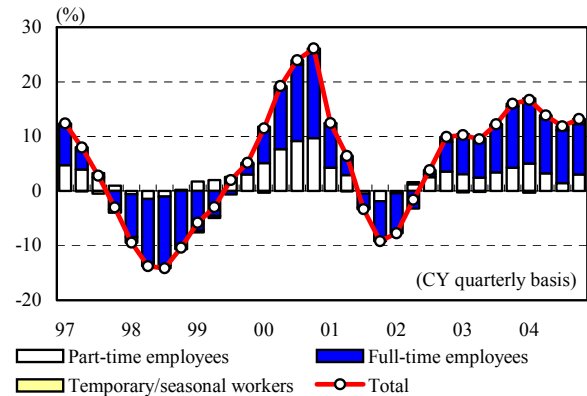


(3) By size of corporation (excluding agriculture, forestry, fisheries and government)
 (10,000 persons)



Source: Ministry of Internal Affairs and Communications, "Labour Force Survey."

Figure 2-9. New Job Openings (year-on-year change by component)

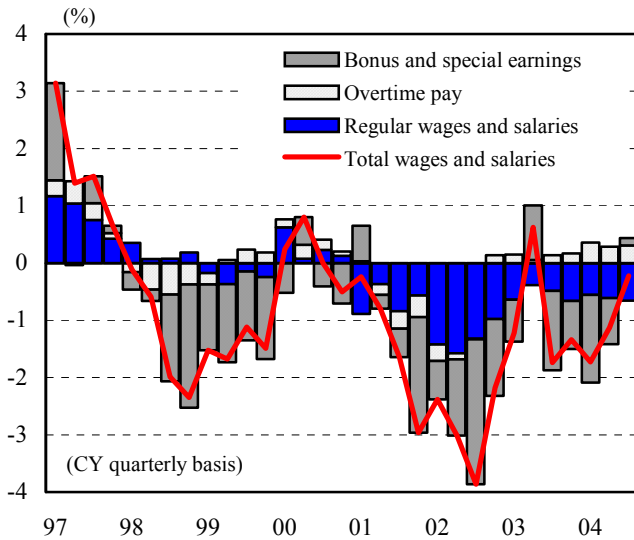


Note: Figures for October-December 2004 represent October-November average.

Source: Ministry of Health, Labour and Welfare, "Report on Employment Service."

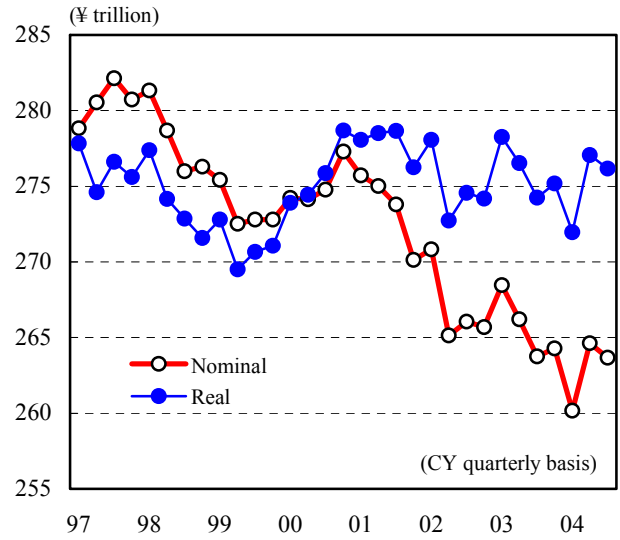
Income Situation Stays Flat

Figure 2-10. Year-on-Year Change in Wages and Salaries per Person



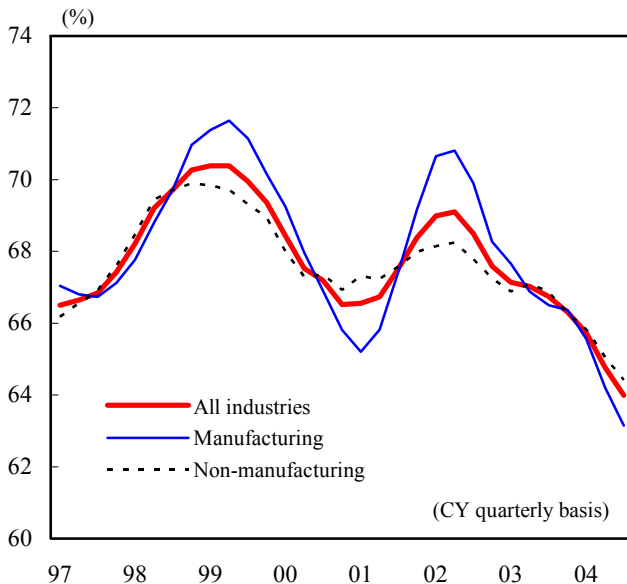
Note: Business establishments with five or more employees.
Source: Ministry of Health, Labour and Welfare, "Monthly Labour Force Survey."

Figure 2-11. Nominal Compensation of Employees



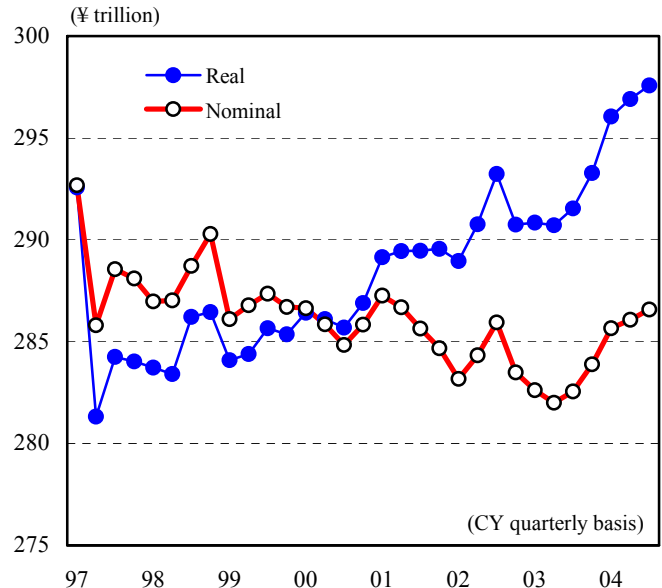
Notes: Seasonally-adjusted annualized rate. Real values are based on the chain-linking method (2000 as reference year).
Source: Cabinet Office, "National Accounts."

Figure 2-12. Labor's Share



Note: Four-period backward moving average.
Source: Ministry of Finance, "Financial Statements Statistics of Corporations by Industry, Quarterly."

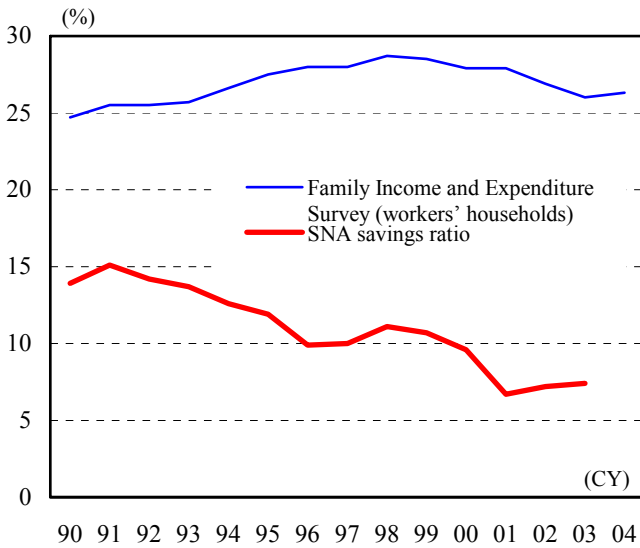
Figure 2-13. GDP-Based Consumption



Notes: Seasonally adjusted annual rate. Real values are based on the chain-linking method (2000 as reference year).
Source: Cabinet Office, "National Accounts."

Respite in Savings Drawdown to Compensate for Reduced Income

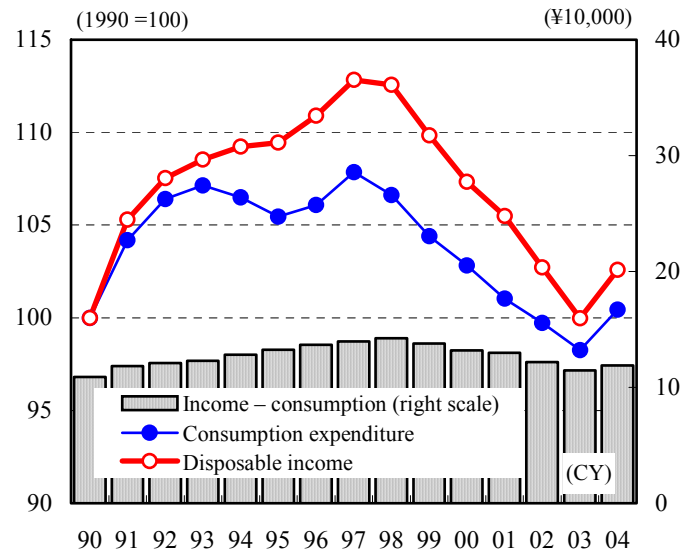
Figure 2-14. Household Savings Ratio



Notes: 1. Family Income and Expenditure Survey data cover two-or-more-person-households.
2. Ratios for 2004 are calculated from January-November data (seasonally adjusted).

Sources: Cabinet Office, "National Accounts"; Ministry of Internal Affairs and Communications, "Family Income and Expenditure Survey."

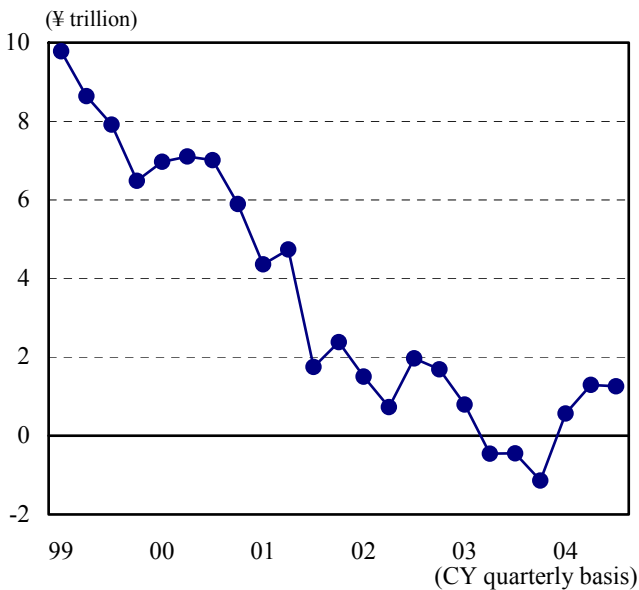
Figure 2-15. Trends in Consumption and Income



Notes: 1. Based on data for worker's households. Monthly average.
2. Data for 2004 represent annualized values for January-November (seasonally adjusted).

Source: Ministry of Internal Affairs and Communications, "Family Income and Expenditure Survey."

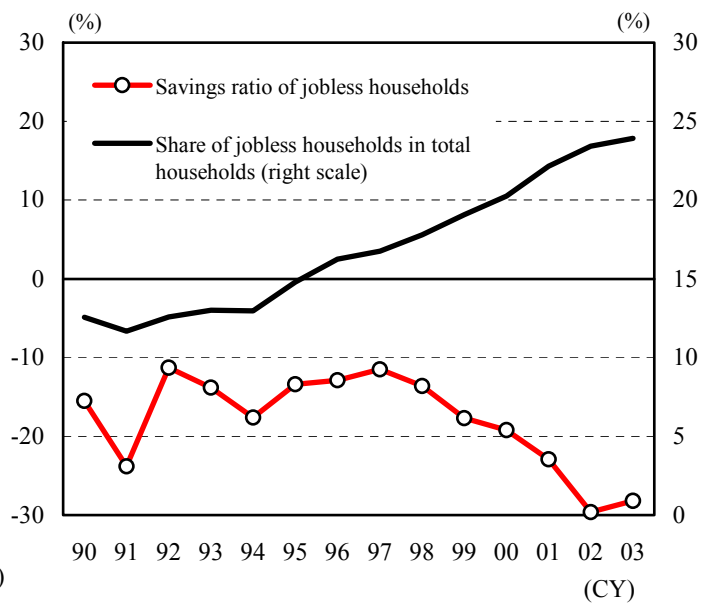
Figure 2-16. Flow of Household Financial Assets (Financial Surplus or Deficit)



Note: Four-period backward moving average.

Source: Bank of Japan, "Flow of Funds."

Figure 2-17. Jobless Households: Saving Ratio and Share in Total Households

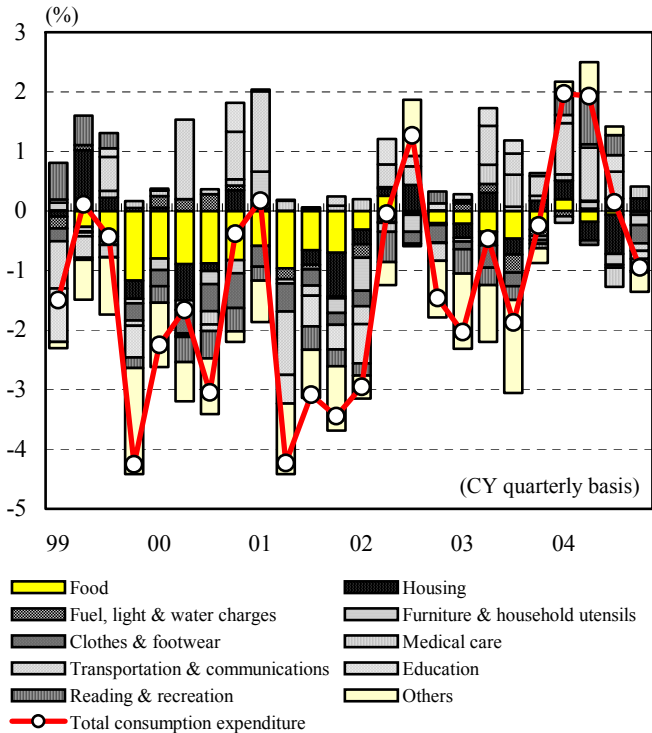


Note: Data cover two-or-more-person households.

Source: Ministry of Internal Affairs and Communications, "Family Income and Expenditure Survey."

Personal Consumption on the Rise but Slightly Slowing

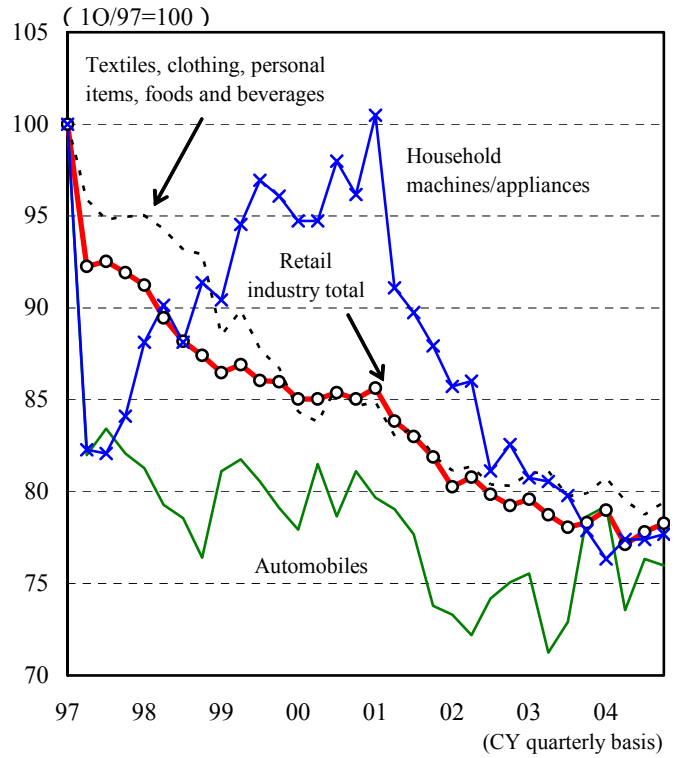
Figure 2-18. Nominal Consumption Expenditure of All Households (change on previous year)



Note: Figures for October-December 2004 represent October-November average.

Source: Ministry of Internal Affairs and Communications, "Family Income and Expenditure Survey."

Figure 2-19. Retail Sales Index (seasonally adjusted)



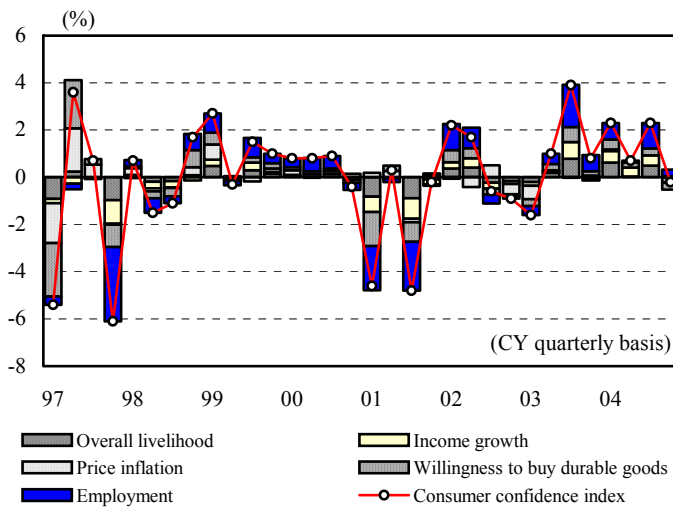
Notes: 1. Retail sales index except for total represents the average of published seasonally adjusted figures weighted by the sales of each industry.

2. Figures for October-December 2004 represent October-November average.

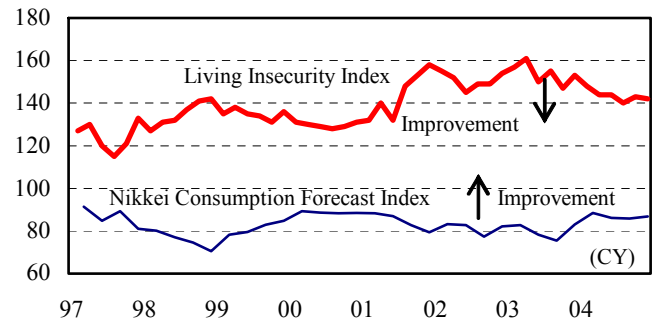
Source: Ministry of Economy, Trade and Industry, "Report of the Current Survey of Commerce."

Figure 2-20. Consumer Confidence Indicators

(1) Quarterly change in consumer confidence index



(2) Other confidence indexes

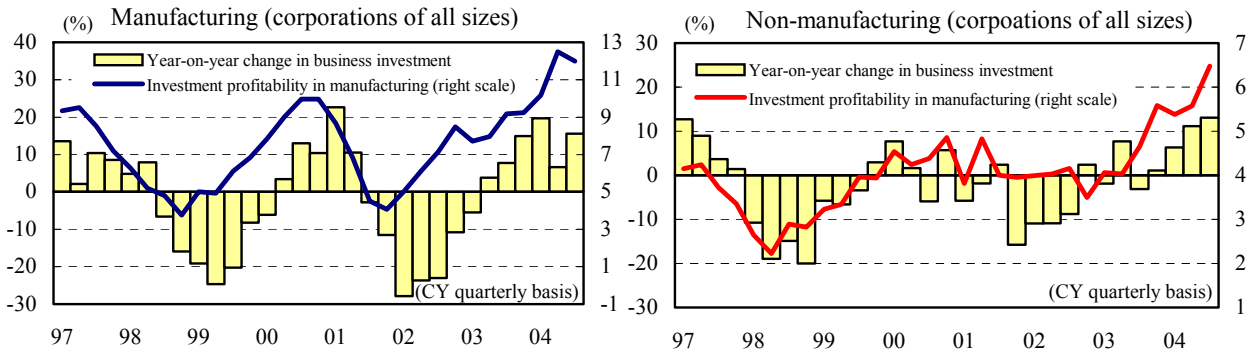


Notes: Consumer confidence index is based on surveys for the coming six months. Figures for individual components were redistributed from seasonally adjusted data.

Sources: Cabinet Office, "Consumer Confidence Survey"; Japan Research Institute, "Consumer Sentiment Index"; Nikkei Industrial Consumption Research Institute data.

Continued Increase in Business Investment Shows Signs of Slowdown

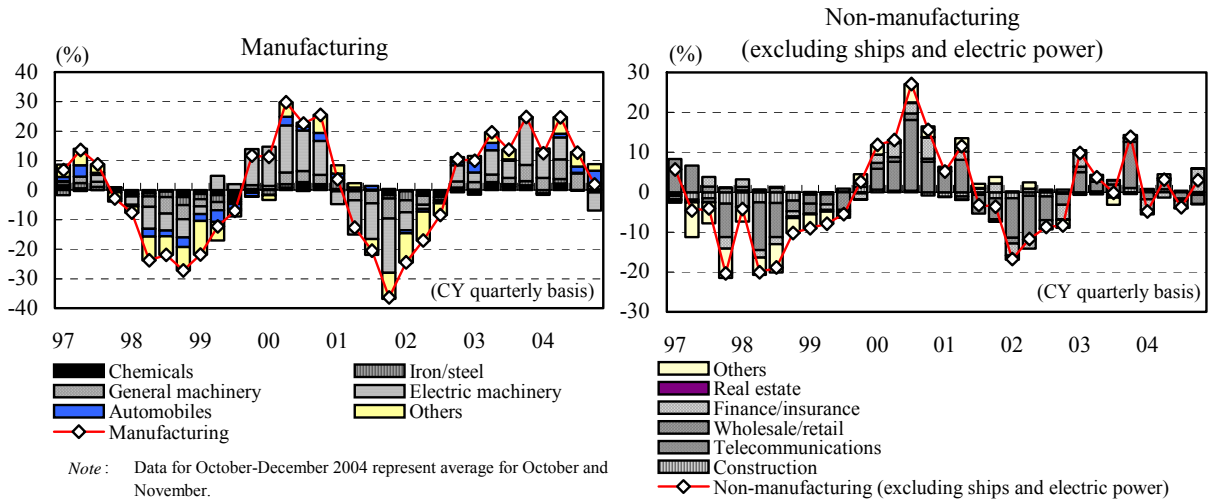
Figure 2-21. Year-on-Year Change in Nominal Business Investment and Investment Profitability



Notes: 1. Business investment excludes software.
 2. Return on investment = operating assets-profit rate – average contracted interest rates of banks (new loans, total), where operating assets-profit rate = operating profit/(tangible fixed assets + inventories).

Sources: Ministry of Finance, “Quarterly Report of Statistical Survey of Incorporated Enterprises,” other.

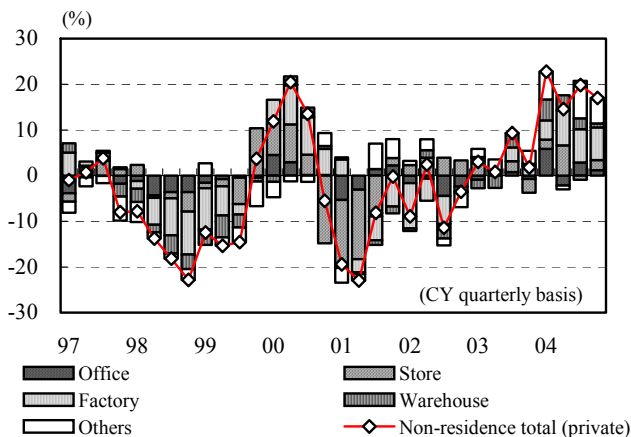
Figure 2-22. Machinery Orders (change on previous year)



Note: Data for October-December 2004 represent average for October and November.

Source: Cabinet Office, “Orders Received for Machinery.”

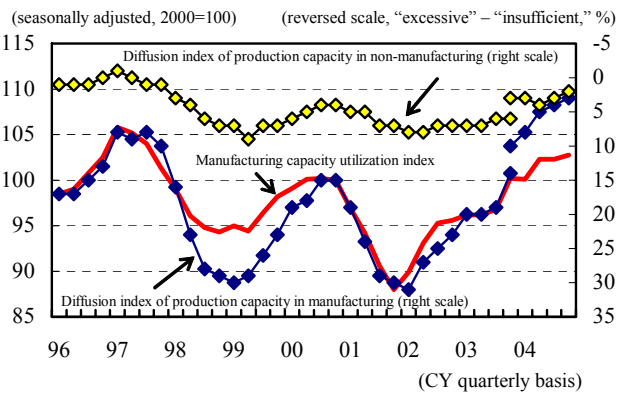
Figure 2-23. Floor Area of Building Construction Started (by use) (change on previous year)



Note: Data for October-December 2004 represent average for October and November.

Source: Ministry of Land, Infrastructure and Transport, “Building Construction Started.”

Figure 2-24. Capacity Utilization Index and Diffusion Index of Production Capacity

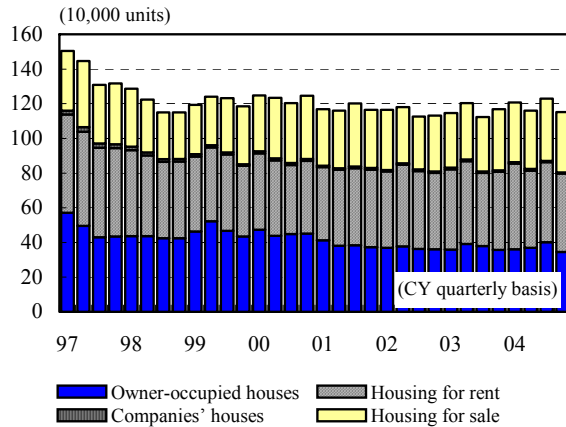


Note: The diffusion index of production capacity has a discontinuity due to a revision to its coverage in March 2004.

Sources: Ministry of Economy, Trade and Industry, “Industrial Index”; Bank of Japan “Short-term Economic Survey of Enterprises in Japan” (*Tankan*).

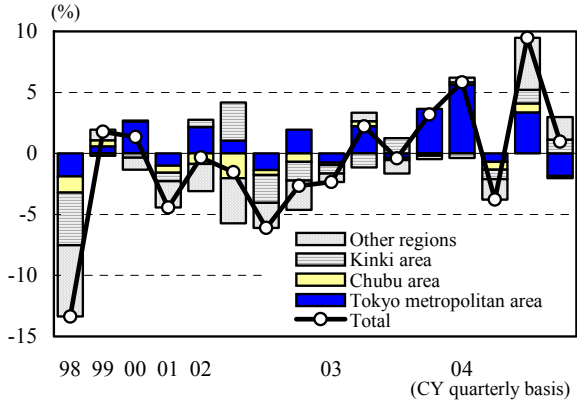
Residential Investment Stays Flat

Figure 2-25. Trend of Housing Starts (seasonally adjusted annual rate)



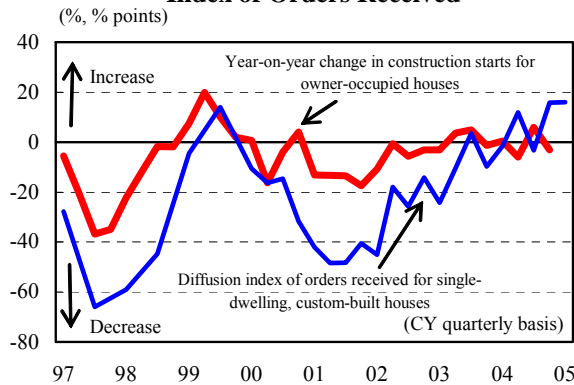
Note: Figures for October-December 2004 represent October-November average.
Source: Ministry of Land, Infrastructure and Transport, "Building Construction Started."

Figure 2-26. Housing Starts (year-on-year change by region)



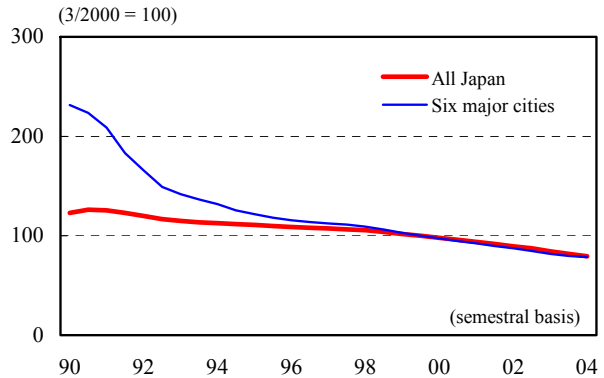
Note: Figures for October-December 2004 represent October-November average.
Source: Ministry of Land, Infrastructure and Transport, "Building Construction Started."

Figure 2-27. Year-on-Year Change in Construction Starts for Owner-Occupied Houses and Diffusion Index of Orders Received



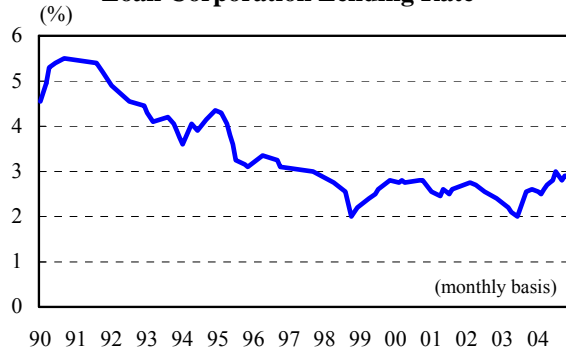
Note: The diffusion index figures for October-December 2004 and January-March 2005 represent estimates in a survey conducted in September 2004.
Sources: Ministry of Land, Infrastructure and Transport, "New Dwellings Started"; Government Housing Loan Corporation, "National Housing Market Survey."

Figure 2-28. Trend of Residential Land Prices



Notes: 1. "Six major cities" refers to the Tokyo Ward area, Yokohama, Nagoya, Kyoto, Osaka and Kobe.
 2. Values are as at the end of March and September.
Source: Japan Real Estate Institute, "Urban Land Price Index."

Figure 2-29. Trends in Government Housing Loan Corporation Lending Rate



Notes: 1. Basic interest rate on personal loans.
 2. Values are as at the end of each month.
Source: Government Housing Loan Corporation.

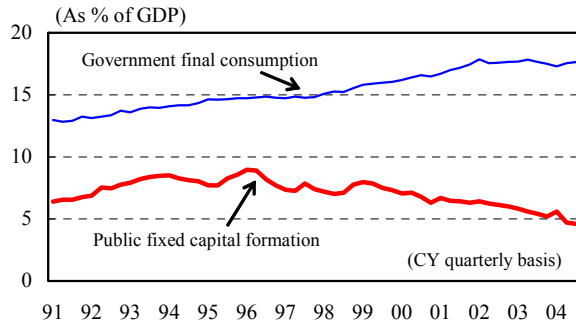
Figure 2-30. Outline of Mortgage Loan Tax Break

	Maximum outstanding amount covered	Applicable year	Deduction rate	Applicable year	Deduction rate	Total
2004	¥50 million	1 st -10 th year	1.00%			¥5 million
2005	¥40 million	1 st -8 th year	1.00%	9 th and 10 th year	0.50%	¥3.6 million
2006	¥30 million	1 st -7 th year	1.00%	8 th -10 th year	0.50%	¥2.55 million
2007	¥25 million	1 st -6 th year	1.00%	7 th -10 th year	0.50%	¥2 million
2008	¥20 million	1 st -6 th year	1.00%	7 th -10 th year	0.50%	¥1.6 million

Note: Deduction is applicable to those who have moved into the new houses before the end of each year.
Source: Ministry of Finance.

Constant Decline in Public Investment due to Financial Squeeze

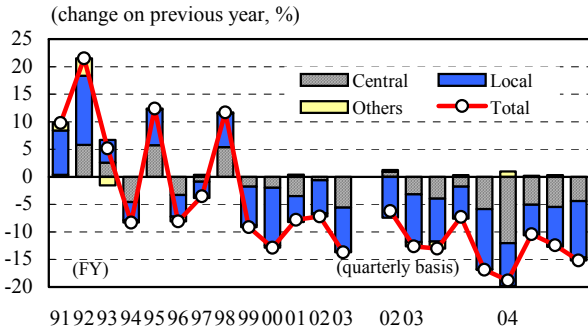
Figure 2-31. Public Investment and Government Consumption



Notes: 1. Data represent seasonally adjusted annual rate.
2. Public fixed capital formation includes general government, plant and equipment of public corporations and public dwellings.

Source: Cabinet Office, "National Accounts."

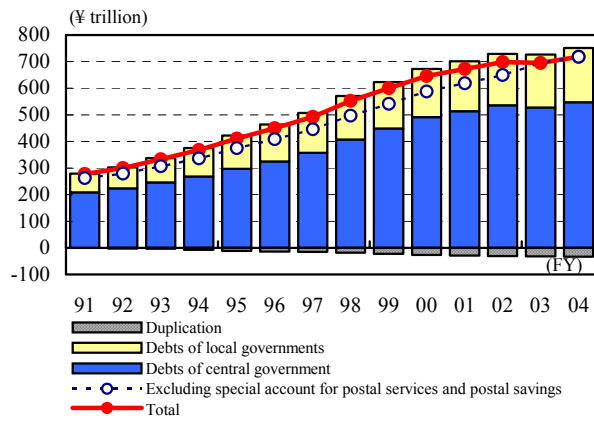
Figure 2-32. Trend of Contract Value for Public Works



Note: In the legend, "Local" represents the total of prefectures and municipalities. "Others" represent the total of central and local public business entities.

Source: East Japan Construction Surety and other, "Public Works Prepayment Surety Statistics."

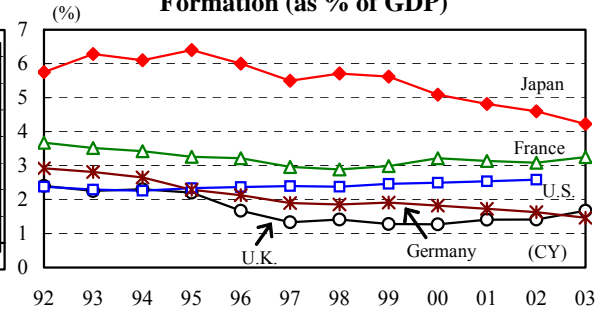
Figure 2-33. Long-term Outstanding Debts of Central and Local Governments



Notes: 1. Figures for fiscal 2003 represent estimates after supplementary budget and those for fiscal 2004 are estimates based on the initial budget.
2. The special account for postal services and postal savings (outstanding debts of some ¥49 trillion as at the end of FY2002) was abolished at the end of FY2002.

Sources: Ministry of Finance, "Budgetary Data (August 2004)," other.

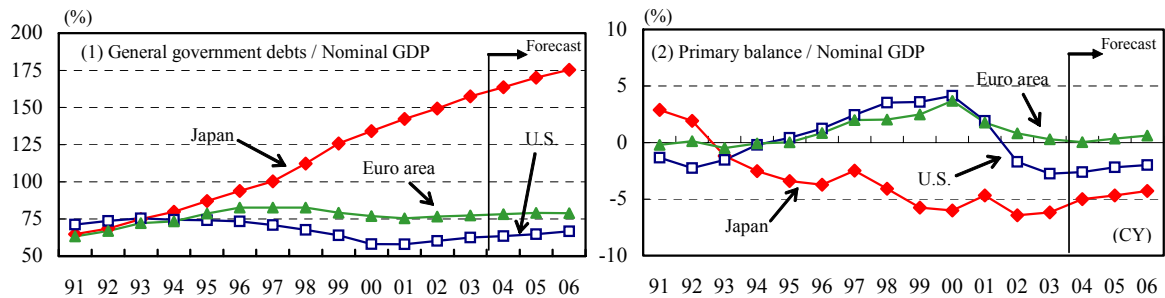
Figure 2-34. International Comparison of Public Investment: Public Fixed Capital Formation (as % of GDP)



Note: Public fixed capital formation includes general government only.

Sources: OECD, "General Government Accounts Vol. IV"; Cabinet Office, "National Accounts."

Figure 2-35. International Comparison of Financial Situations

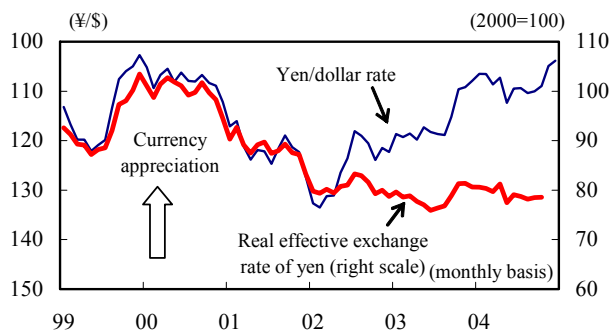


Notes: 1. Values for 2004-2006 are estimates.
2. Figures for some European countries in 2000 include income from the selling of cellular phone licenses (around 1% of the primary balance).

Source: OECD, "OECD Economic Outlook December/2004."

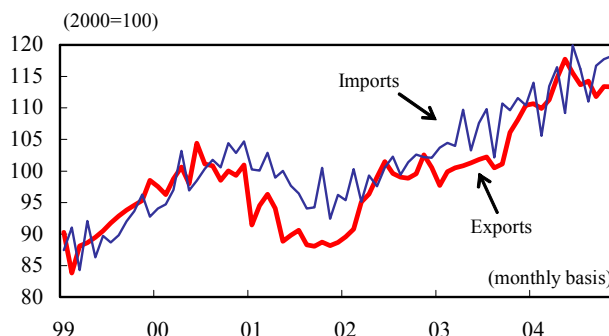
Exports Level Off, Current Account Surplus Shrinks

Figure 2-36. Trends in Foreign Exchange Rate



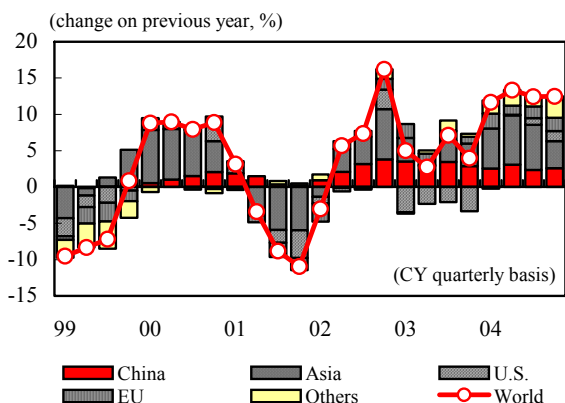
Source: IMF.

Figure 2-37. Export and Import Quantum



Source: Ministry of Finance, "Trade Statistics."

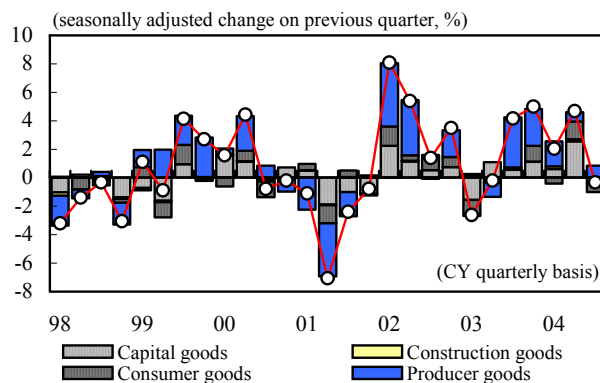
Figure 2-38. Export Value by Region



Notes: 1. Asia excludes China.
2. Figures for October-December 2004 represent October-November average.

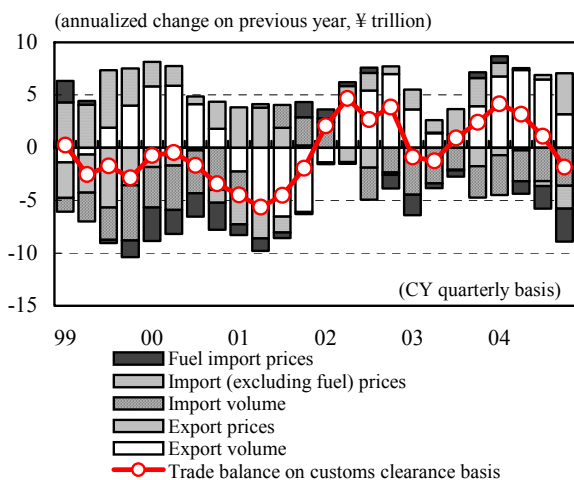
Source: Ministry of Finance, "Trade Statistics."

Figure 2-39. Shipments of Industrial Goods for Export



Source: Ministry of Economy, Trade and Industry, "Analysis of All Industrial Activities."

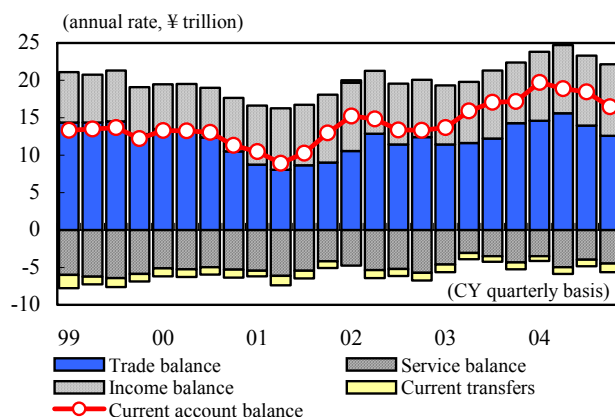
Figure 2-40. Trade Balance on Customs Clearance Basis
(year-on-year change by component)



Note: Figures for October-December 2004 represent October-November average.

Source: Ministry of Finance, "Trade Statistics."

Figure 2-41. Current Account Balance



Notes: 1. Seasonally adjusted.
2. Figures for October-December 2004 represent October-November average.

Source: Ministry of Finance; Bank of Japan, "Balance of Payments."

Exports – Characteristics of the Current Recovery Phase

Figure 2-42. Contribution of Net Exports (Exports – Imports) to GDP Growth

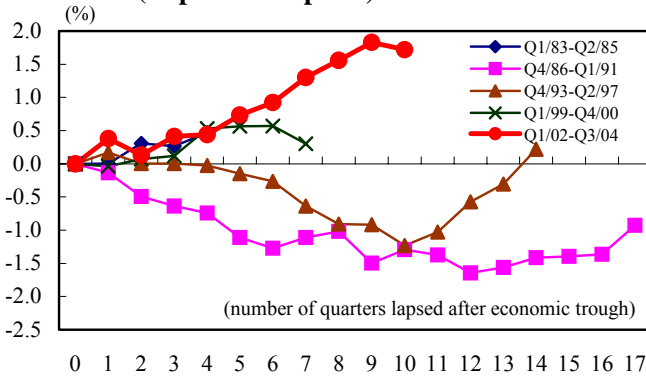
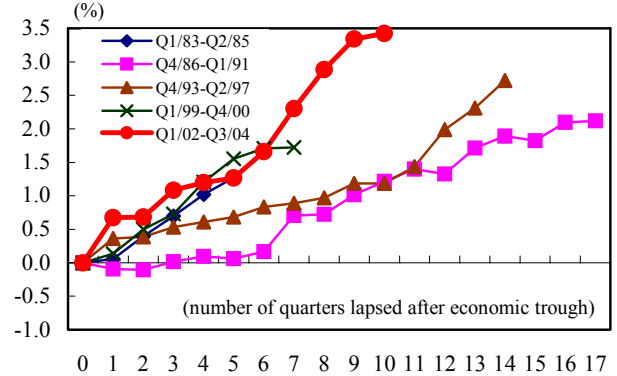
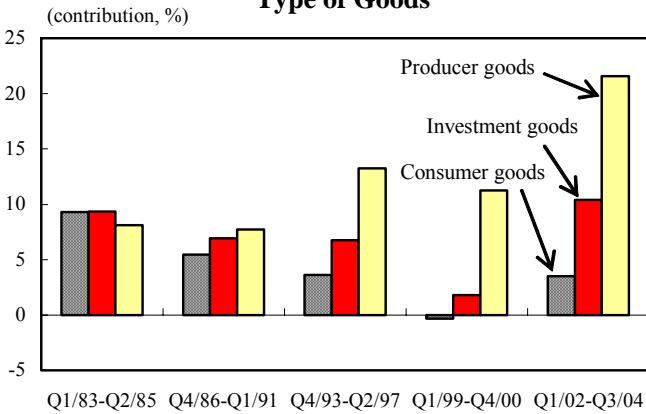


Figure 2-43. Contribution of Exports to GDP Growth



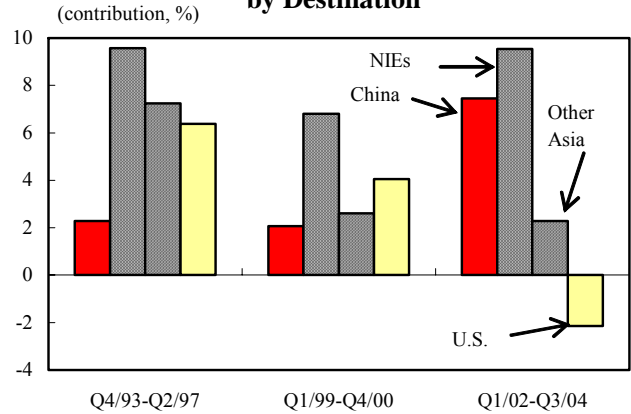
Notes: 1. Reference series are used for the periods to Q4/93-Q2/97.
2. Values indicate contribution to GDP growth after the economic trough.
Source: Cabinet Office, "Preliminary Estimates of National Expenditure."

Figure 2-44. Shipments for Export by Type of Goods



Source: Ministry of Economy, Industry and Trade, "Analysis of All Industrial Activities."

Figure 2-45. Value of Exports by Destination



Source: Ministry of Finance, "Trade Statistics."

Figure 2-46. Impact of U.S. on Japanese Exports

Estimation formula: $\log EX - \log EX(-1) = \alpha + \beta * (\log USI - \log USI(-1)) + \gamma * (\log JPY - \log JPY(-1))$

Estimation period	β	γ	DW	R2-adj
Q1/80-Q3/04	0.50 (3.51)	-0.20 (-2.51)	1.70	0.13
Q1/80-Q2/85	0.48 (1.84)	-0.15 (-0.64)	1.77	0.02
Q2/85-Q1/91	0.33 (0.68)	-0.19 (-1.25)	2.62	-0.09
Q1/91-Q2/97	0.78 (2.00)	-0.16 (-1.21)	2.40	0.12
Q2/97-Q4/00	1.36 (0.98)	0.17 (0.80)	1.85	0.04
Q4/00-Q3/04	1.09 (5.65)	-0.21 (-1.18)	2.43	0.90

Notes: 1. Volume of Japanese exports: EX
Real U.S. imports: USI
Nominal effective yen rate: JPY
2. Almon lag is adopted for each explanatory variable.
Sources: Ministry of Finance, "Trade Statistics"; U.S. Department of Commerce; IMF.

Upward Pressure on Corporate and Consumer Prices to be Checked as Crude Oil Prices Stabilize

Figure 2-47. Trends in Corporate Goods Prices (domestic demand products)

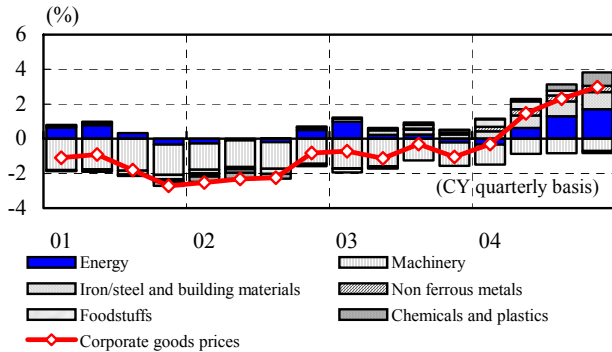


Figure 2-48. Trends in Corporate Service Prices

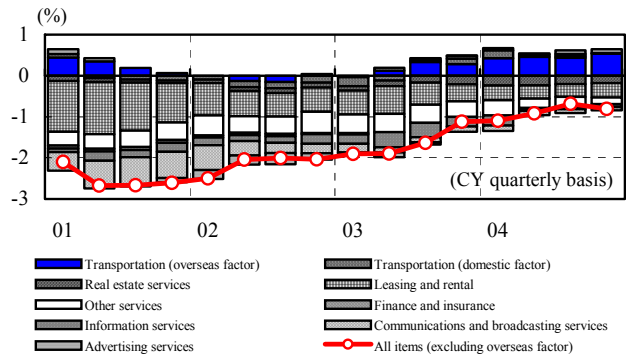


Figure 2-49. Trends in Consumer Prices (excluding fresh food)

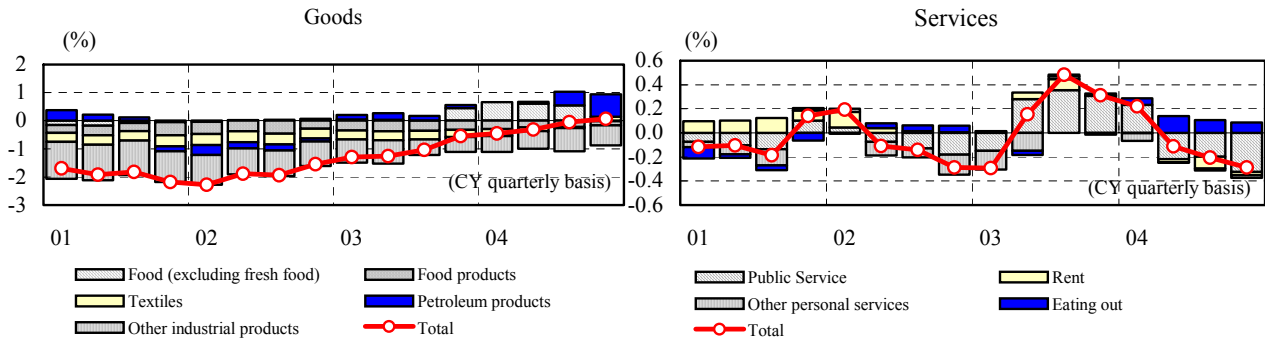
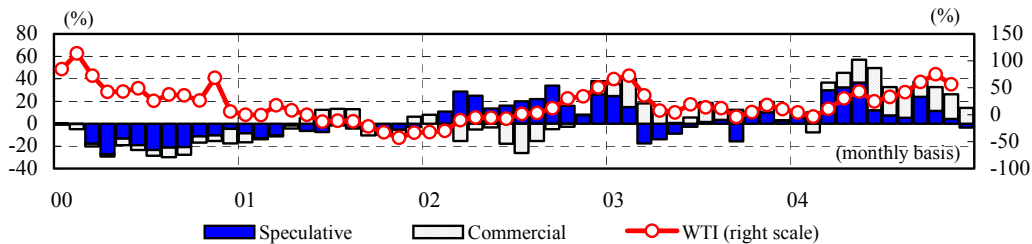


Figure 2-50. Trends in NY Crude Oil Trading (Futures) and WTI

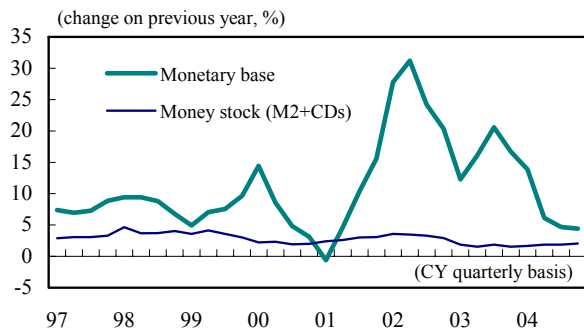


- Notes :*
- In Figure 2-47, “Machinery” includes electrical machinery & equipment, general machinery & equipment, precision instruments and transportation equipment. “Iron/steel and building materials” includes iron & steel, metal products, ceramic, stone & clay products, lumber & wood products and scrap & waste. “Energy” includes electric power, gas & water, petroleum & coal products and minerals. “Others” includes agriculture, forestry & fishery products; processed foodstuffs; other manufacturing industry products; pulp, paper & related products; and textile products.
 - In Figure 2-48, “Transportation (overseas factor)” includes ocean freight transportation, international air freight transportation and international air passenger transportation. Due to revision to the statistics system, the present report adopts a corporate service price index (2000 as reference year).
 - In Figure 2-49, data for October-December 2004 represent October-November average.
 - In Figure 2-49, “Other personal services” includes publications. “Public services” includes electricity, gas and water charges. “Rent” includes private house rent and imputed rent.
 - In Figure 2-50, the bars indicate year-on-year change in the number of open interests in crude oil (contracts of 1,000 barrels as at the end of the month) held by traders (commercial and speculative) participating in the futures market. “Speculative” and “Commercial” contracts are defined as follows:
 “Speculative” = non-commercial positions + non-reportable positions.
 “Commercial” = commercial positions.
 Total open interests are distributed among reportable and non-reportable traders. Of the reportable traders, those involved in petroleum refining and related businesses are defined as holding commercial positions. Other reportable traders hold non-commercial positions. Many of the non-reportable traders are assumed to be speculators.
 - Growth indicates change on previous year.

Sources : Bank of Japan, “Price Indexes Monthly”; Ministry of Internal Affairs and Communications, “Monthly Report on Consumer Price Index” (Figures 2-47 though 2-49); Commodity Futures Trading Commission (CFTC) (Figure 2-50 only).

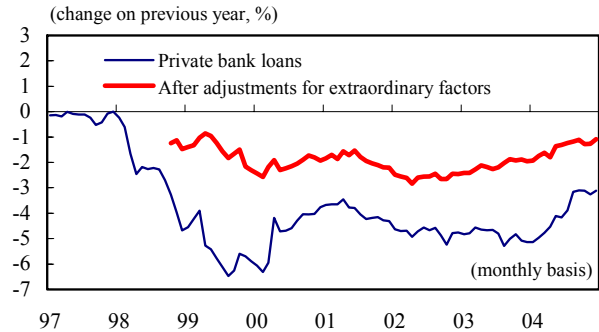
Easy Money Policy Continues

Figure 2-51. Monetary Base and Money Stock



Source: Bank of Japan, "Financial and Economic Statistics Monthly."

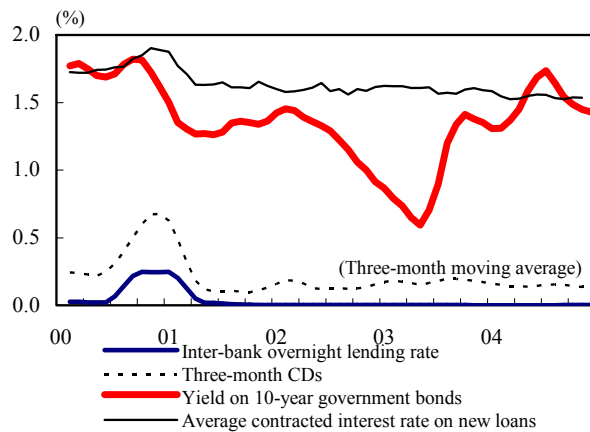
Figure 2-52. Loans and Discounts Adjusted for Special Items



Note: Adjustments for extraordinary factors include adjustments for fluctuation caused by the mobilization or amortization of credited loans.

Source: Bank of Japan, "Financial and Economic Statistics Monthly."

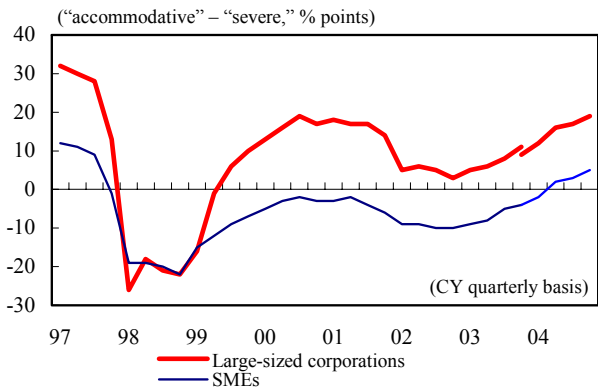
Figure 2-53. Selected Interest Rates



Notes: Average contracted interest rate on new loans is based on monthly statistics. Others represent the monthly averages of daily closing prices.

Sources: Nihon Keizai Shimbun; Bank of Japan, "Financial and Economic Statistics Monthly."

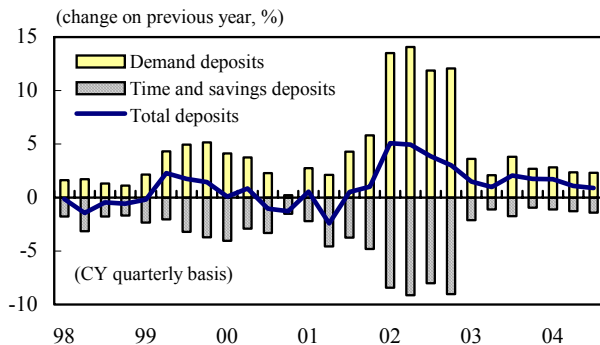
Figure 2-54. Diffusion Index of Lending Attitude of Financial Institutions



Note: The diffusion index of lending attitude of financial institutions has a discontinuity due to a revision to its coverage in March 2004.

Source: Bank of Japan, "Short-term Economic Survey of Enterprises in Japan" (*Tankan*).

Figure 2-55. Change in Deposits by Component (city banks, first- and second-tier regional banks)



Source: Bank of Japan, "Monthly Report of Recent Economic and Financial Developments."

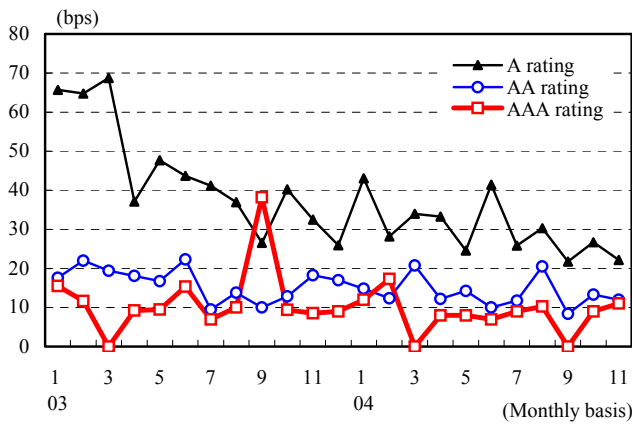
Figure 2-56. Introduction of Payment and Settlement Deposits by Financial Institutions

Financial institutions covered	Already introduced (%)	Under consideration or in preparation (%)	Total (%)
Banks	31.8	63.6	95.5
Credit associations	72.4	27.6	100.0
Credit unions	19.6	72.1	91.6
Labor credit associations	0.0	100.0	100.0
Total	47.2	49.4	96.6

Source: Financial Service Agency, "Preparation of Financial Institutions for the Introduction of Payment and Settlement Deposits (as of December 2004)."

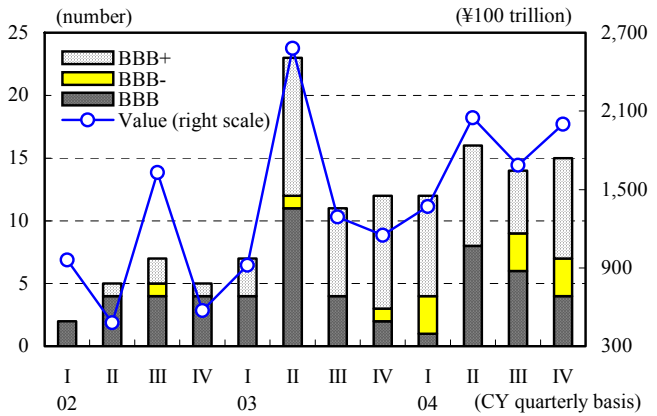
Trends in Non-lending Finance

Figure 2-57. Straight Bond Yields
(spreads over government bond distribution rate)



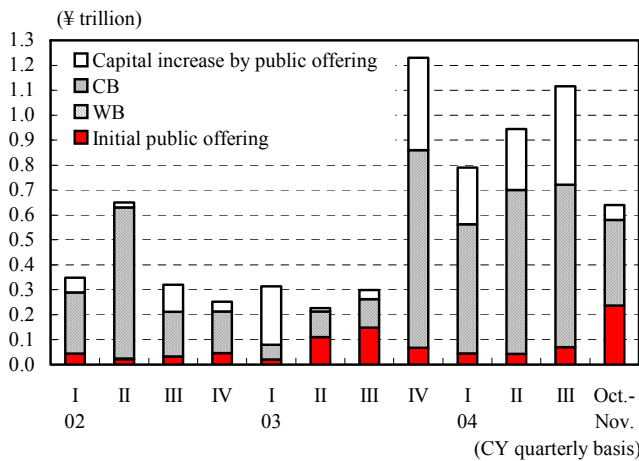
Source: Japan Securities Dealers Association (Thomson Deal Watch for individual bond yields).

Figure 2-58. Issues of BBB and Lower-rated Domestic Industrial Debentures



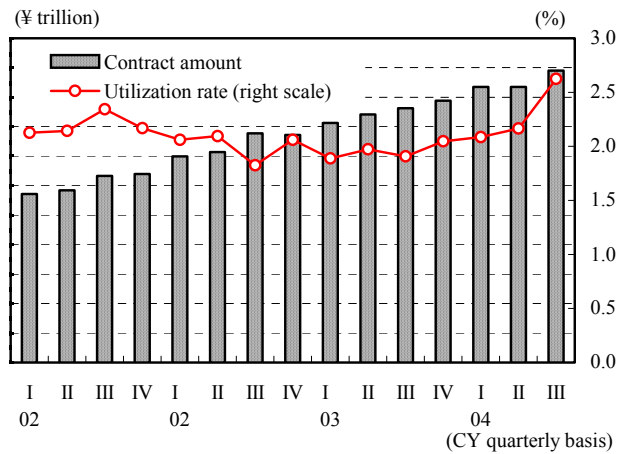
Source: Nomura Securities Co., Ltd.

Figure 2-59. Value of Equity Financing



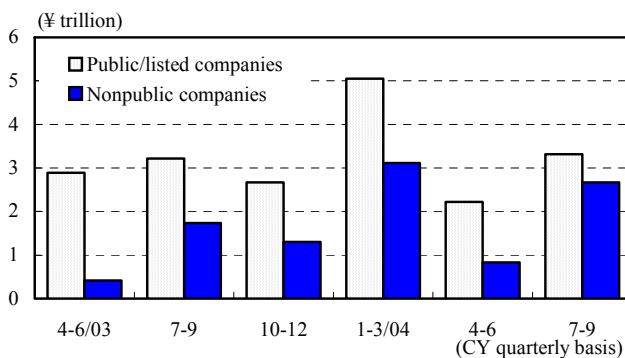
Note: Total of domestic and overseas financing.
Source: Japan Securities Dealers Association.

Figure 2-60. Commitment Lines Outstanding



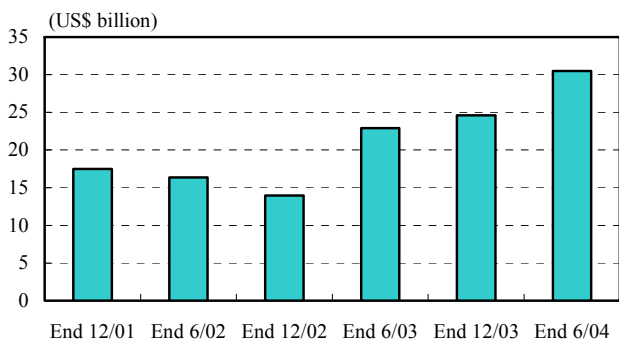
Note: Data cover five categories of banks: city banks, long-term credit banks, credit banks, first-tier regional banks and second-tier regional banks.
Source: Bank of Japan.

Figure 2-61. Loans Syndicated



Source: Bank of Japan, "Monthly Report of Recent Economic and Financial Developments."

Figure 2-62. Credit Derivatives Outstanding



Note: Credit derivatives are mostly intended to transfer default risks.
Source: Bank of Japan, "Monthly Report of Recent Economic and Financial Developments."

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