

## **Fiscal 2002 Economic Outlook and Basic Stance for Macroeconomic & Fiscal Management**

### 1. Fiscal 2001 Macroeconomic Management and the Japanese Economy

The Japanese economy entered a phase of mild-paced recovery in the spring of 1999. However, the recovery remained anemic throughout and proved to be short-lived by quickly losing its momentum after the start of 2001.

A major factor contributing to this negative growth was the downturn in private demand resulting from non-performing loans and excess indebtedness, deteriorating employment conditions, continued concern for mounting fiscal deficits and the sustainability of social security systems. Parallel to this, opportunities for the expression of private-sector initiative have remained unexploited under Japan's current economic framework including the institutions and regulations which have failed to keep up with the changes in the present age and environment.

With this reality in mind, since April 2001, the government has fundamentally overhauled and strengthened its programs for structural reform based on the understanding that "no growth without reform." In June, the government formalized its "Basic Policies for Macroeconomic Management and Structural Reform of the Japanese Economy." This was followed by the formulation of the "Reform Schedule" in September, providing a road map for the process of structural reform. In October, the government adopted the "Front-loaded Reform Program" for accelerating the pace of structural reform, and formulated the first supplementary budget for the current fiscal year. Through these initiatives, the government has endeavored to promote a full range of structural reforms covering the economy, the fiscal system, government administration and various aspects of society.

It was against the backdrop of these conditions that the terrorist attacks on the United States took place. The events of September 11 and ensuing developments have created an enhanced risk for global recession. Meanwhile, economic conditions in Japan have deteriorated further. In addition to weakened personal consumption, exports and output have declined sharply. Business investment is also declining. As a result, Japan's unemployment rate has risen to the highest levels ever. Furthermore, the Japanese economy is currently experiencing deflation (continuous downward trend in price levels).

Given this situation, the Japanese economy will face severe conditions throughout the remainder of the current fiscal year and is expected to register a negative real GDP growth rate of about 1.0% in fiscal 2001.

In response to the developments, the government has formulated the “Immediate Action Program for Structural Reform” and has decided to draft a second supplementary budget for the current fiscal year. By steadily implementing these initiatives, the government intends to further accelerate the process of structural reform and to prevent the Japanese economy from falling into a so-called “deflationary spiral” wherein business conditions deteriorate at an accelerating pace through the interplay of falling prices and the contraction of production.

## 2. Basic Stance for Macroeconomic & Fiscal Management in Fiscal 2002

In view of these conditions, during fiscal 2002, the government’s management of macroeconomic policies shall focus on further promoting the process of structural reform “leaving no sanctuary untouched,” while aiming to contribute to the achievement of sustained development of the global economy.

### (1) Further Promoting the Process of Structural Reform Leaving No Sanctuary Untouched

To achieve the rebirth of the Japanese economy, the government shall commit itself to the fundamental reform of existing social and economic structures and the construction of a new social and economic framework that will lead to the full realization of Japan’s potentialities. Specific lines of action shall include the speedy disposal of non-performing loans and the resolution of excess indebtedness, regulatory reform and the reform of special public corporations for the development of an environment conducive to the full expression of the vitality of the private sector, and the enhancement of fiscal responsiveness through budgetary reform.

The following concrete steps shall be taken with regard to the disposal of non-performing loans and the resolution of excess indebtedness. By implementing special inspections, financial institutions shall be encouraged to appropriately categorize borrowers, undertake write-offs and to generate sufficient reserves. Active measures shall be taken for the rehabilitation of corporations through the Resolution and Collection Corporation (RCC) and other measures.

In the area of regulatory reform, the recommendations of the Council for Regulatory Reform shall be respected as far as possible, and shall be

included in the “Three-Year Program for Promoting Regulatory Reform.” Through the steady implementation of the recommended measures, efforts will be made to support the expansion of service industries and other growth areas. Competition policy will be strengthened to establish competitive economic system.

The reform of special public corporations shall be pursued through the implementation of the “Reorganization and Rationalization Plan for Special Public Corporations.” Measures shall be taken to reduce total fiscal disbursements to special public corporations by approximately 1 billion yen. With regard to government employees, measures shall be taken to realize a more sharply modulated allocation of posts and to achieve a net reduction in the overall number of civil servants employed by the national government.

The following line of action shall be pursued toward fiscal structural reform. The fiscal 2002 budget shall be identified as the “Budget Committed to Reform,” and bold measures shall be taken to shift budgetary allocations in order to promote the transformation of the economic structure.

In the area of tax reform, special tax measures shall be subjected to a thorough review. Consolidated taxation systems both excellent in comparison with the international standard and appropriate for the 21<sup>st</sup> century shall be introduced in fiscal 2002.

In other areas, measures shall be taken to promote the development of regions by capitalizing on their unique characters while respecting their independence. Measures shall also be taken to promote the revitalization of urban areas and the enhancement of their attractiveness and international competitiveness. In the area of information technologies (IT), efforts to promote electronic government and electronic local administration will be made in accordance with the provisions of the “e-Japan Priority Policy Program” and the “e-Japan 2002 Program” to transform Japan into a globally advanced IT nation. With the aim to establish science & technology creating country, measures shall be taken to promote the development of science and technology with emphasis on four priority areas where resources will be concentrated, such as the field of life sciences. Efforts will be made to promote human resources development and education through the further establishment of universities that are of the highest level in the world. With regard to measures related to the declining birth rate and the aging of society, programs will be mounted for creating barrier-free public spaces, creating employment opportunities for the elderly, and developing job environments supportive of working mothers. In the area of environmental problems, efforts will be made for the ratification in 2002 of the COP7 framework for the prevention of global warming. Similarly,

actions will be taken to cope with the problem of dioxin pollution and to promote various forms of recycling.

With attention to the economic conditions, efforts will be made to promote employment and also to reduce mismatch between supply and demand in employment. Efforts will also be made facilitate the financial allocation to the SME sector. Safety net will be utilized to appease the pain resulted from the progress of structural reform.

## (2) Contributing to Sustained Development of the Global Economy

Japan shall contribute to maintaining and strengthening the multilateral trade framework by actively participating in the new round of negotiations agreed upon in the World Trade Organization's 4th Ministerial Conference. Japan shall also support the achievement of sustained development in the global economy by contributing to the construction of a multi-tiered regional cooperation framework, including Asia-Pacific Economic Cooperation (APEC), ASEAN + 3 (Japan, China and South Korea), and the Japan-Singapore Economic Agreement for a New Age Partnership, by working towards strengthening the international financial system, and through its assistance to developing countries, in particular those economically influenced from the event of September 11th.

In order to carry out the above policy measures, the first and second supplementary budgets of fiscal 2001 and the fiscal 2002 budget shall be implemented in an integrated and seamless manner, and due attention shall be paid to all forms of risks that can be anticipated in the process of structural reform. Furthermore, the government stands ready to take bold and flexible macroeconomic policy actions as may be required by economic conditions.

In line with the structural reforms being promoted by the government, it is hoped that the Bank of Japan will adopt appropriate and flexible policy management responses for the prevention of deflation so that the government and the Bank of Japan can work in unison towards resolving the problem of deflation.

## 3. Economic Outlook for Fiscal 2002

As the intensive adjustment period continues in fiscal 2002, it is unavoidable that prolonged severe economic conditions will persist. Without having anxiety for that, it is needed to aim at economic

rejuvenation by overcoming economic fragility with bold implementation of structural reforms.

Keeping the basic attitude of “No growth without reform,” realization of economic growth led by private demand will be pursued in fiscal 2002 by unfolding the potential through further acceleration of structural reforms. The economic development during the year could be depicted as follows. Positive consequences of policy efforts such as the second supplementary budget for fiscal 2001 and anti-deflationary measures will come to be steadily materialized. In addition, improvement in the U.S. economy is likely to result. Accordingly, while severe conditions continue, it is expected that the Japanese economy will get out of the stagnation, and begin to move gradually towards recovery centering on private demand in the second half of the fiscal year.

As a result, the growth rate of real GDP is projected to be about 0.0%. Projections of other principal economic indicators are shown in the attachment.

#### (1) Real GDP

##### [1] Private Consumption

The growth in private consumption will remain low as a result of severe conditions surrounding employment and income that are unavoidable in the short run during the period of structural reforms (up approx. 0.2% from the previous fiscal year).

##### [2] Residential Investment

Residential investment will fall short of the previous fiscal year as a result of weak sentiments for housing acquisition (down approx. 1.9%).

##### [3] Non-residential Investment

While declining from the previous fiscal year, non-residential investment will begin to move towards recovery in the second half of the fiscal year as a result of a pickup in production and improvement in corporate earnings conditions (down approx. 3.5%).

##### [4] Public Demand

Public demand will grow slightly over the previous fiscal year. This is because elderly care insurance payments will rise, while public investment will decline under “Budget Committed to Reform” for fiscal 2002. (Public demand will contribute approx. 0.3% to real GDP growth.)

##### [5] Net Exports

Following the gradual recovery in the world economy, net exports will turn to increase. (Net exports will contribute approx. 0.2% to real GDP growth.)

(2) Labor Conditions

The unemployment rate, which lags behind the economic trend, will rise above the previous year's level, while the structural reforms for job creation proceed (to approx. 5.6%).

(3) Industrial Production

Reflecting the recovery in exports and other factors, industrial production will begin to pick up from the second half of the fiscal year. Nevertheless, it will fall short of the previous fiscal year as a yearly average (down approx. 2.4%).

(4) Prices

While prices will continue to fall, the rate of decline will be somewhat reduced by a slight improvement in oversupply conditions. (Domestic wholesale prices will decline approx. 0.8% from the previous fiscal year, and consumer prices will decline approx. 0.6%.)

(6) Balance of Payments

With the gradual recovery in the world economy, the surplus in the trade balance in goods and services as well as the current account balance will rise slightly. (Current account surplus will reach approx. 2.3% of GDP.)

Note: The projections of principal economic indicators should be understood with a certain degree of allowances because private economic activities constitute the main part of the Japanese economy, and there are many unforeseeable changes especially in the international economic environment.

## Main Economic Indicators

	FY2000 (actual)	FY2001 (estimate)	FY2002 (forecast)	Percentage changes over the previous fiscal year					
				FY2000(actual)		FY2001(estimate)		FY2002(forecast)	
				%	%	% (approx.)	% (approx.)	% (approx.)	% (approx.)
	¥ trillion	¥ trillion	¥ trillion	OUTPUT KR100%	CONSTANT KR100%	OUTPUT KR100%	CONSTANT KR100%	OUTPUT KR100%	CONSTANT KR100%
Gross domestic product	513.0	500.6	496.2	-0.3	1.7	-2.4	-1.0	-0.9	0.0
Private consumption expenditure	286.9	280.5	277.9	-1.3	-0.1	-2.2	-0.9	-0.9	0.2
Private residential investment	20.2	18.5	18.0	-1.7	-1.5	-8.4	-8.4	-2.5	-1.9
Private non-residential investment	80.0	79.4	75.6	6.3	9.3	-0.7	1.6	-4.8	-3.5
Increase in private inventory*	-1.8	-2.0	-1.8	(0.0)	(-0.0)	(-0.0)	(-0.0)	(0.0)	(0.0)
Exports of goods & services	55.6	50.8	50.7	6.7	9.4	-8.6	-9.7	-0.2	-0.3
Less:Imports of goods & services	49.4	47.7	46.1	11.5	9.6	-3.6	-6.5	-3.4	-3.0
Contribution of domestic demand				0.1	1.5	-1.8	-0.5	-1.2	-0.2
Contribution of private demand				0.1	1.3	-1.7	-0.6	-1.3	-0.5
Contribution of public demand				-0.1	0.1	-0.1	0.1	0.2	0.3
Contribution of external demand				-0.3	0.2	-0.6	-0.5	0.3	0.2
Labor & Employment	ten thousands	ten thousands	ten thousands	%		% (approx.)		% (approx.)	
Total labor force	6,772	6,725	6,705	-0.0		-0.7		-0.3	
Total employment	6,453	6,375	6,330	-0.0		-1.2		-0.7	
Employees	5,372	5,350	5,330	0.9		-0.4		-0.4	
Unemployment rate	%	%	%	4.7		5.2		5.6	
Production	%	% (approx.)	% (approx.)						
Industrial production	4.0	-10.2	-2.4						
Prices	%	% (approx.)	% (approx.)						
Domestic wholesale price index	-0.1	-1.1	-0.8						
Consumer price index	-0.5	-0.8	-0.6						
Balance of Payments	¥ trillion	¥ trillion	¥ trillion	%		% (approx.)		% (approx.)	
Balance of goods and services	6.4	3.2	4.3						
Trade balance	11.5	8.6	9.6						
Exports	49.8	44.9	44.6	6.6		-9.8		-0.7	
Imports	38.3	36.3	35.0	16.1		-5.2		-3.5	
Current balance	12.1	11.0	11.5						
Current balance as a percentage of GDP	%	% (approx.)	% (approx.)	2.4		2.2		2.3	

\*The figures in the parenthesis are contributions to GDP growth.

(Note) The main assumptions are as follows. These assumptions are not projections nor forecasts of government.

	FY2000	FY2001	FY2002
World GDP (excluding Japan)	4.2%	1.1%	1.9%
Exchange Rate (yen/dollar)	110.5	122.2	122.3
Crude Oil Prices (dollar/barrel)	28.2	24.7	22.3

(N.B.)

- World GDP (excluding Japan) is calculated based on the outlook of international organizations and other institutions.
- Exchange rate is assumed to be unchanged after December 1st at the one-month average (122.3 yen/dollar) from November 1st to 30th.
- Crude oil prices are assumed to be unchanged after December 1st at the three-month average (22.3 dollar/barrel) from September 1st to November 30th.