

Economic Outlook for FY2005  
and  
Basic Economic and Fiscal Management Measures

December 20th, 2004  
Cabinet Approval

1. Main Economic Indicators for FY2004 and FY2005

	FY2003 (actual)	FY2004 (estimate)	FY2005 (forecast)	Percentage changes over the previous fiscal year											
				FY2003		FY2004		FY2005							
				¥ trillion current prices	¥ trillion (approx.) current prices	¥ trillion (approx.) current prices	% current prices	% constant prices	%(approx.) current prices	%(approx.) constant prices	%(approx.) current prices	%(approx.) constant prices			
Gross domestic product	501.3	505.1	511.5	0.8	1.9	0.8	2.1	1.3	1.6						
Private consumption expenditure	283.5	286.7	288.9	- 0.2	0.5	1.1	1.7	0.8	0.9						
Private residential investment	17.8	18.3	18.2	- 0.4	- 0.5	2.6	1.7	- 0.2	- 0.6						
Business investment	75.2	78.7	80.9	5.3	8.2	4.6	5.6	2.8	3.3						
Increase in private inventory	0.3	- 0.4	0.4	(0.1)	(0.1)	(- 0.1)	(- 0.1)	(0.1)	(0.1)						
Exports of goods & services	60.4	67.7	72.6	6.5	9.9	12.2	12.9	7.3	7.1						
Less: Imports of goods & services	51.2	58.6	62.5	1.4	3.4	14.5	9.0	6.7	5.6						
Contribution of domestic demand	/			(0.2)	(1.1)	(0.8)	(1.4)	(1.1)	(1.2)						
Contribution of private demand				(0.7)	(1.5)	(1.3)	(1.8)	(1.0)	(1.1)						
Contribution of public demand				(- 0.5)	(- 0.4)	(- 0.5)	(- 0.4)	(0.1)	(0.1)						
Contribution of external demand				(0.6)	(0.8)	(- 0.0)	(0.7)	(0.2)	(0.4)						
Labor & Employment	ten thousands	ten thousands (approx.)	ten thousands (approx.)	%		%(approx.)		%(approx.)							
Total labor force	6,662	6,640	6,625	- 0.2		- 0.3		- 0.3							
Total employment	6,320	6,330	6,325	0.0		0.2		- 0.1							
Employees	5,340	5,360	5,365	0.2		0.4		0.1							
Unemployment rate	%	%(approx.)	%(approx.)	/											
	5.1	4.7	4.6												
Production	%	%(approx.)	%(approx.)												
Industrial production	3.5	4.0	1.8	/											
Prices	%	%(approx.)	%(approx.)												
Corporate goods price index	- 0.5	1.4	0.4												
Consumer price index	- 0.2	- 0.1	0.1	/											
Balance of Payments	¥ trillion	¥ trillion (approx.)	¥ trillion (approx.)							%		%(approx.)		%(approx.)	
Balance of goods and services	9.6	9.5	10.1							/					
Trade balance	13.3	13.4	13.1												
Exports	53.4	59.4	63.0	6.5	11.2	6.2									
Imports	40.1	46.0	50.0	4.0	14.8	8.7	/								
Current balance	17.3	18.4	19.9												
Current balance as a percentage of GDP	%	%(approx.)	%(approx.)	3.5	3.6	3.9									

\* The figures in the parentheses are the contribution to GDP growth.

## 2. Economic Trend in FY2004 and Economic Outlook for FY2005

### (1) Economic Trend in FY2004

Despite recent slack movements observed in certain areas, the Japanese economy throughout FY2004 will, sustained by a solid recovery of corporate sectors as shown in a significant improvements in corporate profits for instance, expect a pickup in the employment situation and a continuing recovery led by private demand.

With regard to prices, although corporate goods prices have been rising due to soaring raw material prices including crude oil, consumer prices are expected to remain on a slightly declining trend compared with the previous year. Taken together, these movements show that the Japanese economy is in a mild deflationary phase.

In sum, the growth rate of real GDP in FY2004 is expected to be approximately 2.1% (with the growth rate of nominal GDP of approximately 0.8%).

### (2) Economic Outlook for FY2005

In FY2005, under the ongoing recovery in the world economy and with the continuing improvement in domestic corporate sectors as shown in increasing industrial production and business investment, the economic recovery is expected to spread over to household sectors through the improvement in employment and income situations, and private consumption is expected to follow a steady growth path. As a consequence, the Japanese economy is expected to continue a moderate recovery led by private demand.

With regard to prices, by making joint efforts of the government and the Bank of Japan, a steady progress towards overcoming deflation is expected.

In sum, the growth rate of real GDP in FY2005 is expected to be approximately 1.6% (with the growth rate of nominal GDP of approximately 1.3%).

#### □ Real Gross Domestic Product

##### (i) Private Consumption

Stable improvement is expected in private consumption as employment and income situations are improved (approximately 0.9% of increase from the previous year)

(ii) Private Residential Investment

Although declining from FY2004 which posts a comparatively high growth, private residential investment will remain at a sound level (approximately 0.6% of decrease from the previous year).

(iii) Business Investment

With continuing improvement in corporate profits, business investment is expected to follow through on growth (approximately 3.3% of increase from the previous year).

(iv) Public Demand

Public demand will, under continued efforts to restrain expenditure under the “Budget for Reform Resolution,” be around the same level with the previous year despite an imperative increase in payments of public medical and nursing care insurance, and the outlays for disaster-restoration works (Public demand contributes approximately 0.1% to the real GDP growth rate).

(v) Net Export

As the world economy continues to recover, net export is expected to continue growing (Net export contributes approximately 0.4% to the real GDP growth rate).

□ Labor and Employment

Employment and income situations will, while still severe, gradually improve and the unemployment rate will show a little improvement from the previous year (approximately 4.6%).

□ Industrial Production

As both domestic and external demands increase, industrial production is expected to continue expansion (approximately 1.8% of increase from the previous year).

□ Prices

Corporate goods prices continue to grow in a modest way (approximately 0.4% of increase from the previous year). Consumer prices move back into a positive territory while slight (approximately 0.1% of increase from the previous year).

□ Balance of Payment

Due to a continuing growth of the world economy and domestic demand, both exports and imports will increase and the current account surplus as a percentage of GDP will be increased a little (current account surplus will be

approximately 3.9% of GDP).

\*It should be noted that the future movements in crude oil prices and the world economy could have influence on the Japanese economy.

(Note 1) These economic trend and outlook premise the policies listed in the following “3. Basic Economic and Fiscal Management Measures for FY2005.”

(Note 2) The assumptions of the world GDP, exchange rate, and crude oil prices are as follows. Please be noted that these are not projections nor forecasts of the government, but supposition for making estimates and forecasts.

	FY2003	FY2004	FY2005
World GDP (excluding Japan)	3.0%	3.8%	3.2%
Exchange rate (yen / dollar)	113.0	107.7	104.9
Crude oil price (dollar / barrel)	29.5	38.2	39.8

(N.B.)

1. World GDP (excluding Japan) is based on the outlook of international organizations and other institutions.
2. Exchange rate is assumed to stay constant after December 1, 2004 at the one-month average from November 1 to 30, 2004 (104.9 yen / dollar).
3. Crude oil price is assumed to constant after December 1, 2004 at the three-month average from September 1 to November 30, 2004 (39.8 dollar / barrel).

(Note 3) As Japanese economy mainly consists of private activities, the above indicators should be recognized as being subject to upside and downside risks relating to market fluctuations and other changes in circumstances.

### 3. Basic Economic and Fiscal Management Measures for FY2005

Under the principles of “No growth without reforms,” “Leave to the private sector what can be done by the private sector,” and “Leave to local governments what can be done by local governments,” the Government, based on the “Basic Policies for Economic and Fiscal Management and Structural Reform 2004,” will continue to carry out the structural reforms in every field in an integrated, consistent and swift manner, aiming to bring out eagerness for challenge of individuals and corporations and initiative of local governments, and will

achieve the sustainable economic growth driven by private demand. Moreover, the Government, in a body with the Bank of Japan, will further strengthen its policy efforts to ensure a breakaway from deflation.

Furthermore, the Government will continue to practice decisive and flexible policy managements in accordance with the economic situations.

The following are the major basic economic and fiscal management measures which the Outlook is based on.

- Regulation : The Government will drive regulatory reform and opening up to the private sector in the fields directly related to daily lives and contributing to create business chances, for example, through making efforts at “Market Testing.”
- Financial system : The Government will implement measures based on the “Program for Concentrated Strengthening of Financial System”(tentative name), aiming to achieve the financial system that satisfies users of financial services and is highly appreciated in the global market.
- Tax system : Based on the “Outline of Tax Reform for FY2005 of the Ruling Parties”(December 15, 2004), the Government will implement necessary measures on the proportional tax reductions, the taxation of housing and so on.
- Government expenditure : Based on the “Basic Principles of FY2005 Budget Formulation”(Cabinet Decision on December 2, 2004), the Government will continue the “Budget for Reform Resolution” and stick to and strengthen the basic principle for expenditure reform.
- The “Three-Part Reform Package” : In accordance with the agreement reached at the meeting of the Government and ruling parties on November 26, 2004 concerning the overall picture of the “Three-Part Reform Package” until FY2006, the Government will implement necessary measures for the reform of state subsidy system, the transfer of tax sources and the reform of local allocation tax.
- The reforms of the social security system : Based on discussions on integrated reforms of the entire social security system in order to establish a sustainable system to the future, in FY2005, the Government will practice the reforms of nursing care insurance, livelihood protection and so on.
- Regional revitalization : The Government, by preparing the full-fledged schemes for regional revitalization which expands authority and responsibility of local governments, will promote efforts of the

“Strategies on Maximizing the Capability of Regions” that combines various policy measures.