

## State of the Economy

After an unusually prolonged stagnation during the 1990s, the Japanese economy finally started showing a recovery in official statistics in February 2002, and the recovery is steadily continuing. According to an announcement by the Cabinet Office in March 2007, Japan's gross domestic product (GDP) rose 1.3% in real terms in the October–December 2006 quarter and 5.5% on an annualized basis (preliminary), registering the eighth straight quarterly growth. The figure brought the 2006 annual GDP growth to 2.2% in real terms and 1.3% in nominal terms.

The unemployment rate, which peaked at 5.4% in 2002, dropped to 5.3% in 2003, the first improvement in 13 years, and continued to improve to 4.1% in 2006 for four consecutive years of decline. Stock prices recovered dramatically from their post-bubble low of 7,603.76 posted in April 2003 to 17,225.83 on the last trading day in 2006. Private consumption marked a 0.6% increase in real terms in 2006. Japan's exports in 2006 increased 14.6% to ¥75.3 trillion thanks to brisk shipments of electronic products, steel, and other raw materials to China and other Asian countries and to the United States. And capital spending on an all-industry basis rose 8.0% in real terms.

These developments led the Bank of Japan to decide on March 9, 2006, to end its unprecedented “quantitative monetary easing” policy, which was implemented in March 2001 as an emergency measure to keep the nation's banking system from breakdown and save the economy from a deflationary spiral. On two occasions in July 2006 and February 2007, the central bank raised the benchmark interest rate by a quarter of a percentage point each time to the present 0.5%.

According to the government's economic forecast for fiscal 2007, the Japanese economy will continue to grow at 2.2% in nominal and 2.0% in real terms, driven by private consumption and capital investment. Nominal GDP is expected to total around ¥521.9 trillion, achieving positive growth for the fourth consecutive year. The GDP deflator, which widely reflects consumer prices, is expected to rise 0.2%, moving into positive territory for the first time in 10 years and lifting the economy out of deflation. The unemployment rate is also expected to further improve to 4.0%.

## Trends in Gross Domestic Product (Gross Domestic Expenditure)

|      | Nominal              |                                  | Real                 |                                  |
|------|----------------------|----------------------------------|----------------------|----------------------------------|
|      | Total<br>(¥ billion) | Change over<br>previous year (%) | Total<br>(¥ billion) | Change over<br>previous year (%) |
| 1995 | 496,457.3            | 1.9                              | 482,749.5            | 2.5                              |
| 1996 | 508,432.8            | 2.4                              | 496,903.8            | 2.9                              |
| 1997 | 513,306.4            | 1.0                              | 496,877.2            | -0.0                             |
| 1998 | 503,304.4            | -1.9                             | 489,438.1            | -1.5                             |
| 1999 | 499,544.2            | -0.7                             | 493,048.7            | 0.7                              |
| 2000 | 504,118.8            | 0.9                              | 505,621.9            | 2.6                              |
| 2001 | 493,644.7            | -2.1                             | 501,617.5            | -0.8                             |
| 2002 | 489,875.2            | -0.8                             | 507,014.9            | 1.1                              |
| 2003 | 493,747.5            | 0.8                              | 517,699.2            | 2.1                              |
| 2004 | 498,280.4            | 0.9                              | 527,856.1            | 2.0                              |
| 2005 | 503,366.8            | 1.0                              | 540,442.1            | 2.4                              |

Source: Economic and Social Research Institute, Cabinet Office, *Kokumin keizai keisan* (National Accounts), FY 2005.

## Nominal GDP of Major Countries

|             | 2000                 |                      | 2005                 |                      | 2006 <sup>a</sup>    |                      | 2007 <sup>a</sup>    |                      |
|-------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
|             | Total<br>(US\$ bil.) | Per capita<br>(US\$) | Total<br>(US\$ bil.) | Per capita<br>(US\$) | Total<br>(US\$ bil.) | Per capita<br>(US\$) | Total<br>(US\$ bil.) | Per capita<br>(US\$) |
| USA         | 9,817                | 34,774               | 12,456               | 42,000               | 13,262               | 44,315               | 13,928               | 46,085               |
| Japan       | 4,651                | 36,670               | 4,567                | 35,757               | 4,464                | 34,955               | 4,599                | 36,021               |
| Netherlands | 372                  | 23,342               | 630                  | 38,618               | 663                  | 40,552               | 711                  | 42,763               |
| UK          | 1,445                | 24,542               | 2,229                | 37,023 <sup>a</sup>  | 2,358                | 38,947               | 2,553                | 41,960               |
| Germany     | 1,906                | 23,168               | 2,792                | 33,854               | 2,890                | 35,022               | 3,037                | 36,779               |
| France      | 1,333                | 21,955               | 2,127                | 33,918               | 2,227                | 35,336               | 2,371                | 37,417               |
| Canada      | 725                  | 23,659               | 1,132                | 35,133               | 1,273                | 39,135               | 1,357                | 41,348               |
| Italy       | 1,101                | 19,332               | 1,766                | 30,200               | 1,841                | 31,350               | 1,950                | 33,078               |
| Australia   | 390                  | 20,335               | 709 <sup>a</sup>     | 34,740 <sup>a</sup>  | 744                  | 36,016               | 794                  | 37,982               |
| Hong Kong   | 169                  | 25,144               | 178                  | 25,493               | 189                  | 26,824               | 201                  | 28,374               |
| Spain       | 582                  | 14,515               | 1,127                | 27,226 <sup>a</sup>  | 1,217                | 29,266               | 1,325                | 31,727               |
| Korea (ROK) | 512                  | 10,890               | 788                  | 16,308               | 877                  | 18,015               | 930                  | 18,939               |
| Mexico      | 581                  | 5,928                | 768                  | 7,298 <sup>a</sup>   | 811                  | 7,594                | 841                  | 7,756                |
| Russia      | 260                  | 1,775                | 763                  | 5,349                | 975                  | 6,861                | 1,159                | 8,183                |
| Brazil      | 602                  | 3,512                | 796                  | 4,320                | 967                  | 5,177                | 1,045                | 5,518                |
| China       | 1,198                | 946                  | 2,234                | 1,709                | 2,554                | 1,944                | 2,871                | 2,174                |

Source: International Monetary Fund, *The World Economic Outlook Database*, September 2006.

a. Estimates.

**Real GDP Growth in Major Countries and Regions** (change over previous year, %)

|             | 2000 | 2002 | 2003 | 2004 | 2005             | 2006 <sup>a</sup> | 2007 <sup>a</sup> |
|-------------|------|------|------|------|------------------|-------------------|-------------------|
| China       | 8.4  | 9.1  | 10.0 | 10.1 | 10.2             | 10.0              | 10.0              |
| Thailand    | 4.8  | 5.3  | 7.0  | 6.2  | 4.5              | 4.5               | 5.0               |
| Malaysia    | 8.9  | 4.4  | 5.5  | 7.2  | 5.2              | 5.5               | 5.8               |
| Korea (ROK) | 8.5  | 7.0  | 3.1  | 4.7  | 4.0              | 5.0               | 4.3               |
| Hong Kong   | 10.0 | 1.8  | 3.2  | 8.6  | 7.3              | 6.0               | 5.5               |
| Singapore   | 10.0 | 4.0  | 2.9  | 8.7  | 6.4              | 6.9               | 4.5               |
| Taiwan      | 5.8  | 4.2  | 3.4  | 6.1  | 4.1              | 4.0               | 4.2               |
| Indonesia   | 5.4  | 4.5  | 4.8  | 5.1  | 5.6              | 5.2               | 6.0               |
| USA         | 3.7  | 1.6  | 2.5  | 3.9  | 3.2              | 3.4               | 2.9               |
| UK          | 3.8  | 2.1  | 2.7  | 3.3  | 1.9              | 2.7               | 2.7               |
| Australia   | 3.3  | 4.1  | 3.1  | 3.5  | 2.5 <sup>a</sup> | 3.1               | 3.5               |
| Brazil      | 4.4  | 1.9  | 0.5  | 4.9  | 2.3              | 3.6               | 4.0               |
| Japan       | 2.9  | 0.1  | 1.8  | 2.3  | 2.6              | 2.7               | 2.1               |
| Spain       | 5.0  | 2.7  | 3.0  | 3.1  | 3.4              | 3.4               | 3.0               |
| Canada      | 5.2  | 2.9  | 1.8  | 3.3  | 2.9              | 3.1               | 3.0               |
| France      | 4.0  | 1.1  | 1.1  | 2.0  | 1.2              | 2.4               | 2.3               |
| Germany     | 3.1  | 0.0  | -0.2 | 1.2  | 0.9              | 2.0               | 1.3               |
| Netherlands | 3.5  | 0.1  | 0.3  | 2.0  | 1.5              | 2.9               | 2.9               |

Source: International Monetary Fund, *The World Economic Outlook Database*, September 2006.

a. Estimates.

## Private- and Public-Sector Economic Trends

(real values, %)

### Private Sector

|      | Private consumption expenditure |                            | Housing investment        |                            | Corporate capital investment |                            |
|------|---------------------------------|----------------------------|---------------------------|----------------------------|------------------------------|----------------------------|
|      | Change over previous year       | Contribution to GDP growth | Change over previous year | Contribution to GDP growth | Change over previous year    | Contribution to GDP growth |
| 1995 | 2.5                             | 1.4                        | - 5.6                     | - 0.3                      | 3.1                          | 0.5                        |
| 1996 | 2.7                             | 1.5                        | 13.3                      | 0.6                        | 5.7                          | 0.8                        |
| 1997 | - 1.1                           | - 0.6                      | - 18.9                    | - 1.0                      | 4.0                          | 0.6                        |
| 1998 | 0.3                             | 0.1                        | - 10.6                    | - 0.5                      | - 8.2                        | - 1.3                      |
| 1999 | 1.1                             | 0.6                        | 3.5                       | 0.1                        | - 0.6                        | - 0.1                      |
| 2000 | 0.7                             | 0.4                        | - 0.1                     | - 0.0                      | 7.2                          | 1.0                        |
| 2001 | 1.4                             | 0.8                        | - 7.7                     | - 0.3                      | - 2.4                        | - 0.3                      |
| 2002 | 1.2                             | 0.7                        | - 2.2                     | - 0.1                      | - 2.9                        | - 0.4                      |
| 2003 | 0.6                             | 0.4                        | - 0.2                     | - 0.0                      | 6.1                          | 0.8                        |
| 2004 | 1.3                             | 0.8                        | 1.7                       | 0.1                        | 6.2                          | 0.9                        |
| 2005 | 1.9                             | 1.1                        | - 1.0                     | - 0.0                      | 5.8                          | 0.8                        |

### Public Sector

|      | Governmental final consumption expenditure |                            | Public fixed capital formation |                            | Export of goods and services |                            |
|------|--|----------------------------|--------------------------------|----------------------------|------------------------------|----------------------------|
|      | Change over previous year                  | Contribution to GDP growth | Change over previous year      | Contribution to GDP growth | Change over previous year    | Contribution to GDP growth |
| 1995 | 4.1  | 0.6                        | 7.5                            | 0.6                        | 4.5                          | 0.4                        |
| 1996 | 2.2  | 0.3                        | - 2.9                          | - 0.2                      | 7.4                          | 0.7                        |
| 1997 | 0.8  | 0.1                        | - 6.3                          | - 0.5                      | 8.8                          | 0.9                        |
| 1998 | 2.6  | 0.4                        | 1.5                            | 0.1                        | - 3.9                        | - 0.4                      |
| 1999 | 4.1  | 0.6                        | - 0.6                          | - 0.0                      | 6.0                          | 0.6                        |
| 2000 | 4.3  | 0.7                        | - 7.6                          | - 0.6                      | 9.5                          | 1.0                        |
| 2001 | 2.8  | 0.5                        | - 4.7                          | - 0.3                      | - 7.9                        | - 0.9                      |
| 2002 | 2.1  | 0.4                        | - 5.4                          | - 0.4                      | 11.5                         | 1.2                        |
| 2003 | 2.6  | 0.5                        | - 9.5                          | - 0.6                      | 9.8                          | 1.1                        |
| 2004 | 1.7  | 0.3                        | - 12.7                         | - 0.7                      | 11.4                         | 1.4                        |
| 2005 | 0.9  | 0.2                        | - 1.4                          | - 0.1                      | 9.0                          | 1.2                        |

Source: Economic and Social Research Institute, Cabinet Office, *Kokumin keizai keisan* (National Accounts), FY 2005.

## Trends in National Income

|      | Total<br>(¥ billion) | Change over<br>previous year (%) | Per capita<br>(¥1,000) | Change over<br>previous year (%) |
|------|----------------------|----------------------------------|------------------------|----------------------------------|
| 1996 | 380,621.1            | –                                | 3,025                  | –                                |
| 1997 | 381,998.9            | 0.4                              | 3,029                  | 0.1                              |
| 1998 | 368,921.5            | – 3.4                            | 2,917                  | – 3.7                            |
| 1999 | 364,340.9            | – 1.2                            | 2,876                  | – 1.4                            |
| 2000 | 371,803.9            | 2.0                              | 2,929                  | 1.8                              |
| 2001 | 361,333.5            | – 2.8                            | 2,840                  | – 3.0                            |
| 2002 | 355,761.0            | – 1.5                            | 2,791                  | – 1.7                            |
| 2003 | 358,079.2            | 0.7                              | 2,804                  | 0.5                              |
| 2004 | 362,900.9            | 1.3                              | 2,841                  | 1.3                              |
| 2005 | 367,630.3            | 1.3                              | 2,878                  | 1.3                              |

Source: Economic and Social Research Institute, Cabinet Office, *Kokumin keizai keisan* (National Accounts), FY 2005.

## National Wealth

(¥ trillion)

|  | 2000           | 2001           | 2002           | 2003           | 2004           |
|--|----------------|----------------|----------------|----------------|----------------|
| <b>Net assets (national wealth)</b>          | <b>2,902.6</b> | <b>2,841.4</b> | <b>2,732.0</b> | <b>2,654.7</b> | <b>2,647.0</b> |
| Inventories                                  | 87.7           | 82.5           | 78.6           | 77.1           | 75.4           |
| Work-in-progress                             | 34.7           | 30.2           | 28.0           | 27.1           | 25.1           |
| Tangible fixed assets                        | 1,128.5        | 1,112.3        | 1,094.5        | 1,096.3        | 1,119.3        |
| Dwellings                                    | 256.6          | 251.4          | 246.7          | 246.6          | 249.0          |
| Other buildings                              | 248.0          | 242.4          | 238.4          | 239.5          | 246.4          |
| Other structures                             | 445.8          | 445.8          | 445.1          | 453.1          | 470.5          |
| Transport equipment                          | 28.1           | 28.7           | 29.1           | 29.4           | 29.9           |
| Other machinery and equipment                | 175.3          | 172.7          | 165.9          | 161.1          | 159.7          |
| Cultivated assets                            | 1.7            | 1.2            | 1.8            | 1.7            | 1.8            |
| Intangible fixed assets (computer, software) | 15.2           | 17.5           | 19.0           | 19.5           | 20.3           |
| Tangible nonproduced assets                  | 1,538.2        | 1,449.8        | 1,364.7        | 1,288.9        | 1,246.1        |
| Land   | 1,536.9        | 1,448.6        | 1,363.5        | 1,287.8        | 1,244.9        |
| Net external assets                          | 133.0          | 179.3          | 175.3          | 172.8          | 185.8          |

Source: Economic and Social Research Institute, Cabinet Office, *Kokumin keizai keisan* (National Accounts), FY 2004.

Note: Figures are as of end of year.

## Prices

The Japanese economy has sustained persistent deflationary pressure, which reflects insufficient aggregate demand relative to supply in recent years, and the government's economic policy has made fighting deflation its top priority. The consumer price index (CPI), which was generally on a downward trend from 1999 to 2005, in 2006 registered the first increase in eight years at 100.3 against the 2005 base of 100. Excluding the volatile prices of perishable fresh food items, the index had marked a decrease for six consecutive years up to 2005. In 2006, however, the CPI registered a rise of 0.1% to 100.1, a sign taken to indicate that the Japanese economy was finally escaping from deflationary pressure.

The corporate service price index (CSPI) in 2005 dropped 0.5% from the previous year to 93.2 against the 2000 base of 100, the eighth year-on-year decline in a row. However, the rate of decrease had decelerated from 2.1% in 2002 and 1.5% in 2003, and the index remained at 93.2 in 2006. On the other hand, the domestic corporate goods price index (CGPI) recovered to 96.1 in 2004 from 94.9 in 2003, the first rise in seven years. The figure further improved to 97.7 in 2005 and 100.7 in 2006.

### Trends in Price Indexes

|      | Consumer price index<br>(2005 average = 100) | Domestic corporate goods price index<br>(2000 average = 100) |
|------|--|--|
| 2000 | 102.2  | 100.0  |
| 2001 | 101.5  | 97.7   |
| 2002 | 100.6  | 95.7   |
| 2003 | 100.3  | 94.9   |
| 2004 | 100.3  | 96.1   |
| 2005 | 100.0  | 97.7   |
| 2006 | 100.3  | 100.7  |

Source: Ministry of Internal Affairs and Communications, *Shohisha bukka shisu* (Report on the Consumer Price Index), 2006; Bank of Japan, *Kigyo bukka shisu* (Monthly Report on the Corporate Service Price Index), January 2007.

Note: The corporate goods price index (CGPI) has replaced the wholesale price index (WPI) to improve the accuracy of price changes. The CGPI includes such new components as goods related to information technology and gives more weight to electronic goods.

# Investment in Plant and Equipment

## Change of Investment in Plant and Equipment by Industry (¥100 million, %)

|                       | FY 2000        |                  | FY 2003        |                  | FY 2004        |                  | FY 2005        |                  |
|-----------------------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|------------------|
|                       | Amount         | Rate of increase | Amount         | Rate of increase | Amount         | Rate of increase | Amount         | Rate of increase |
| <b>All industries</b> | <b>388,962</b> | <b>8.6</b>       | <b>316,319</b> | <b>6.3</b>       | <b>400,722</b> | <b>26.7</b>      | <b>385,501</b> | <b>- 3.8</b>     |
| Manufacturing         | 132,383        | 18.6             | 96,835         | 7.1              | 129,819        | 34.1             | 143,434        | 10.5             |
| Chemical              | 13,678         | 7.9              | 9,850          | - 21.9           | 13,610         | 38.2             | 13,140         | - 3.5            |
| Electric machinery    | 39,266         | 62.2             | 17,096         | 20.1             | 13,778         | n/a              | 13,470         | - 2.2            |
| Information machinery |                |                  |                |                  | 16,440         | n/a              | 14,074         | - 14.4           |
| Transport machinery   | 14,900         | - 1.0            | 18,983         | 19.2             | 20,938         | 10.3             | 26,051         | 24.4             |
| Nonmanufacturing      | 256,579        | 4.0              | 219,484        | 6.0              | 270,903        | 23.4             | 242,067        | - 10.6           |
| Wholesale/Retail      | 49,550         | 26.1             | 55,420         | 69.7             | 36,861         | n/a              | 33,902         | - 8.0            |
| Transportation        | 67,379         | 34.6             | 19,719         | - 59.9           | 35,247         | n/a              | 27,300         | - 22.5           |
| Communications        |                |                  |                |                  | 35,044         | n/a              | 39,715         | 13.3             |
| Service               | 87,746         | 7.1              | 95,458         | 12.2             | 113,704        | 19.1             | 88,551         | - 22.1           |

Source: Ministry of Finance, *Nenjibetsu hojinkigyo tokei chosa* (Annual Fiscal Statement Statistics of Corporations by Industry), 2005.

Note: Investment in plant and equipment = amount of increase of tangible fixed assets (excluding land) + depreciation expense.