

Forecast on the *Preliminary Quarterly Estimates of GDP* for the Oct-Dec Quarter of 2003

January 30, 2004

On February 18th, 2004 (Wednesday), the Cabinet Office will release the *Preliminary Quarterly Estimates of GDP (QE)* for the Oct-Dec quarter of 2003. On the basis of currently available statistics, the Mizuho Research Institute, Ltd. (MHRI) estimates that Japan's gross domestic product (GDP) in real terms grew 1.5% on a quarter-on-quarter (q-o-q) basis (5.9% q-o-q p.a.) in the Oct-Dec quarter. In nominal terms, Japan's GDP probably grew 0.3% (1.3 q-o-q p.a.).

The pace of real GDP growth of 5.9% q-o-q, p.a. is the highest since the Oct-Dec quarter of 1996 (6.0% q-o-q p.a.) on the basis of currently available statistics. Among the plausible factors are (1) the stronger recovery mainly in exports and capital investment reflecting the acceleration of the US and Chinese economies from the Jul-Sep quarter onward, (2) the rebound of personal spending from the slump in the Jul-Sep quarter stemming from the unseasonable cool summer weather, and (3) a temporary halt to the slide of public. While we are inclined toward the view that the Japanese economy will remain strong in the Jan-Mar quarter of 2004, the odds are high that the magnitude of recovery will wane considerably due in part to a reaction to the Oct-Dec quarter.

On the basis of the foregoing estimate, the rate of real GDP growth in CY2003 will most likely reach 2.4%, recording positive growth for the first time in two years. In nominal terms, the rate of growth would be -0.0%, charting negative growth for the third year in a row. In the event growth remains flat (zero percent growth) in the Jan-Mar quarter of 2004, the rate of GDP growth in FY2003 would reach 2.3% in real terms and 0.1% in nominal terms.

Japan's real GDP growth expanded 1.5% q-o-q (5.9 in annualized terms) in the Oct-Dec quarter of 2003, recording positive growth for the seventh quarter in a row

On February 18th (Wednesday), the Cabinet Office will release the *Preliminary Quarterly Estimates for GDP (QE)* for the Oct-Dec quarter of 2003. On the basis of currently available statistics, MHRI estimates that Japan's real GDP most likely grew 1.5% q-o-q (5.9% q-o-q p.a.) in the Oct-Dec quarter. This would be the seventh consecutive quarter of positive growth since the Apr-Jun quarter of 2002, just after the economy bottomed out. The rate of growth in the Oct-Dec quarter is considerably higher than the preceding quarter from July to September (0.3% q-o-q → 1.5% q-o-q). In nominal terms, Japan's GDP probably grew 0.3% q-o-q (1.3% q-o-q p.a.), recording the third quarter of positive growth in a row.

Chart 1: Oct-Dec Quarter 2003 QE Forecast

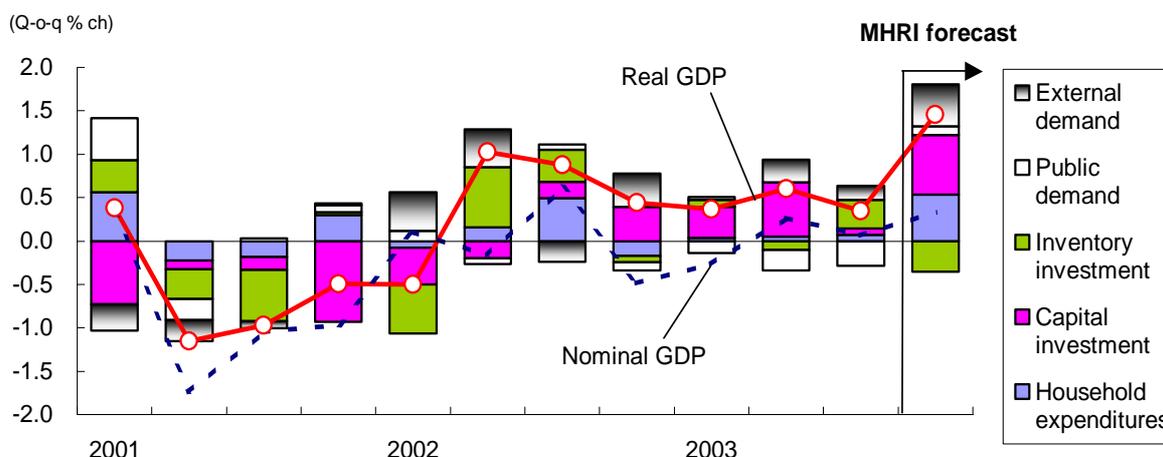
GDP (real) (%)						GDP (nominal) (%)	
Contribution to the rate of real GDP growth							
(p.a.)		Domestic demand	Private demand	Public demand	External demand	(p.a.)	
1.5	(5.9)	1.0	0.9	0.1	0.5	0.3	(1.3)

Percentage change from previous quarter (%)							
Personal consumption	Housing investment	Capital investment	Inventory investment	Government consumption	Public investment	Exports	Imports
1.0	0.5	4.1	-0.4	0.4	0.6	5.0	1.4

Note: Figures in parentheses denote the annualized rate of GDP growth.

Source: Mizuho Research Institute (MHRI).

Chart 2: Real GDP Growth and the Degree of Contribution by Major Demand Components



Source: Cabinet Office, *Preliminary Quarterly Estimates of GDP*.

The strongest growth since the Oct-Dec quarter of 1996

The pace of real GDP growth expected in the Oct-Dec quarter of 2003 (5.9% q-o-q p.a.) is the highest since the Oct-Dec quarter of 1996 (6.0% q-o-q p.a.). Among the plausible factors are (1) the stronger recovery mainly in exports and capital investment reflecting the acceleration of the US and Chinese economies from the Jul-Sep quarter onward, (2) the rebound of personal spending from the slump in the Jul-Sep quarter stemming from the unseasonable cool summer weather, and (3) a temporary halt to the slide of public investment.

The rise of personal consumption (1.0%) is due largely to a reaction to the cool summer

Personal consumption most likely grew 1.0% in the Oct-Dec quarter, growing positive for the first time in two quarters. Turning to the environment surrounding employment and income which comprises the source of consumption expenditures, labor compensation is bottoming out on a cyclical basis. Nevertheless, the pace of growth is still tepid. The rise of personal spending in the Oct-Dec quarter is due most likely to a reaction to the slump in the Jul-Sep quarter (-0.1% q-o-q) stemming from the unusually cool summer weather last year. Thus the odds are high that the pace of growth will slow down again in the Jan-Mar quarter of 2004.

Housing investment most likely grew slightly (0.5%) above the previous quarter. Last-minute demand should ebb.

Private-sector housing investment grew a mild 0.5% above the previous quarter. Although housing investment in the Jul-Sep quarter was pushed up by a rush of housing starts amid worries that the tax breaks on housing loans might be scaled down and forecasts of higher interest rates ahead, the upswing has run its course in the Oct-Dec quarter. Looking forward, we expect to see a clear reaction to the rush thus far. Even so, the reactionary drop be benign for the time being since the tax break up to 2003 will continue to apply for homeowners if they actually move into their new homes by the end of December 2004.

Capital investment grew faster at 4.1% q-o-q, charting positive territory once again even in nominal terms

Private sector capital investment grew at a faster pace of 4.1% q-o-q. Although quarterly growth of capital investment dipped into negative territory in nominal terms in the Jul-Sep quarter, the odds are high that investment in plant and equipment will grow positive again in the Oct-Dec quarter. Statistics on machinery orders – moving more and more in lockstep with capital investment – indicate that there is strong capital investment incentive mainly among manufacturers of information technology and digital goods reflecting the rise of exports. Meanwhile, despite an upturn of capital investment in the telecommunications sector, investment in the non-manufacturing sector falls short of a definite uptrend given the slump among construction and real estate companies.

Although public investment grew above the previous quarter for the first time in seven quarters, this is only a temporary phenomenon.

Exports pick up speed reflecting a faster pace of growth in the US and China. A higher degree of contribution to GDP by external demand.

Although the Japanese economy should remain on solid footing in the Jan-Mar quarter of 2004, the odds are high that the rate of growth will slow sharply. On the basis of MHRI's estimate, the rate of real GDP growth in CY2003 would come out to 2.4%. In nominal terms, the rate of growth would be -0.0%

Public investment grew 0.6% q-o-q, reaching into positive territory for the first time in seven quarters. Even so, in view of the fact that public works orders – a leading indicator of public investment – is starting to follow a downhill path, public investment will most likely turn negative on a quarterly basis again from the Jan-Mar quarter of 2004. Given the prevailing stance among the central and local government bodies to cut down upon public investment, we are inclined to believe that public investment will follow a downward trajectory over the medium term.

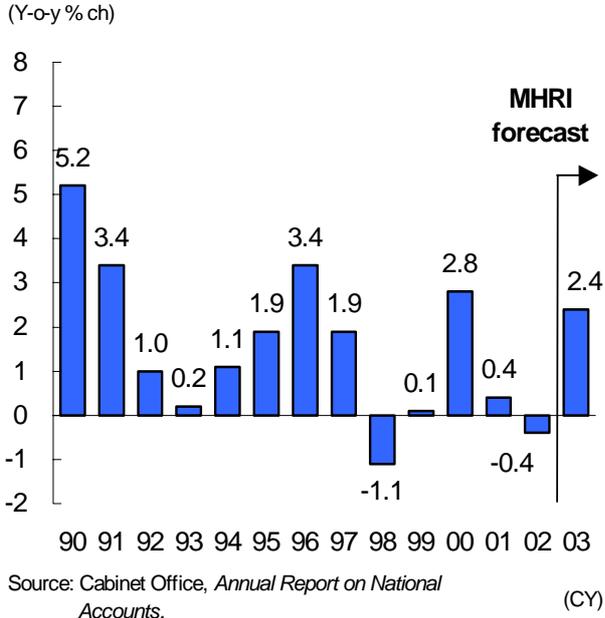
Exports of goods and services surged 5.0% q-o-q while imports grew 1.4% q-o-q. The degree of contribution to real GDP growth by external demand rose 0.5%, growing wider again since the Jul-Sep quarter of 2003 (0.2%). A closer look at exports by geographic destinations in the Oct-Dec quarter by the export volume index reveals that the growth of exports bound for Asia rose from 3.6% q-o-q in the Jul-Sep quarter to 4.5% q-o-q and that exports to the US also turned upward from -3.4% q-o-q to 8.3% q-o-q. In the background to brisk Asia-bound exports are factors such as the ongoing expansion of intr0industry trade in ITR and digital products within Asia, the expansion of material exports to China stemming from the surge of fixed capital investment in China. As for exports to the US, the acceleration of economic growth and the bottoming of auto-exports reflecting the pause in adjustment of US auto inventories served as a tailwind.

In the Jan-Mar quarter of 2004, the Japanese economy should continue to recover as it did in the Oct-Dec quarter of 2003, driven mainly by exports and capital investment, and thus remaining on solid footing. Nevertheless, the odds are high that the rate of growth on a quarter-on-quarter basis will slow sharply due in part to a reaction to the Oct-Dec quarter. The rate of GDP growth in the Jan-Mar quarter of 2004 will most likely be flat and maintain a plateau.

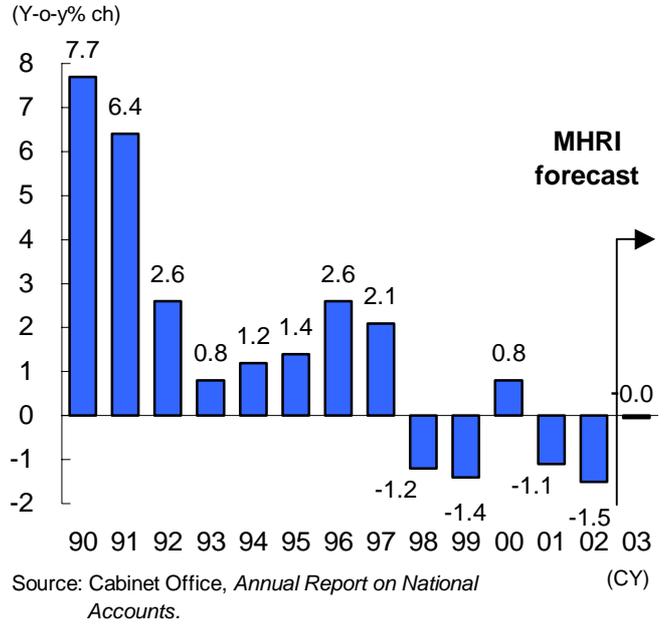
On the basis of MHRI's estimate on GDP growth in the Oct-Dec quarter of 2003, the rate of Japan's real GDP growth in CY2003 would reach 2.4%, achieving positive growth for the first time in two years. The rate of nominal GDP growth would stand at -0.0%, recording the third consecutive year of negative growth. Furthermore, in the event growth remains flat (zero percent growth) in the Jan-Mar quarter of 2004, the rate of GDP growth would reach 2.3% in real terms and 0.1% in nominal terms (MHRI's forecast as of December 11, 2003 is 2.2% (real GDP) and -0.2% (nominal GDP)).

Chart 3: Japan's GDP Growth (on a calendar year basis)

(1) Real GDP growth



(2) Nominal GDP growth



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