

(Translation)

Forecast on the *Preliminary Quarterly Estimates of GDP* for the Jul-Sep Quarter of 2004

October 29, 2004

On November 12th, 2004 (Friday), the Cabinet Office will release the *Preliminary Quarterly Estimates of GDP (QE)* for the Jul-Sep quarter of 2004. On the basis of currently available statistics, Mizuho Research Institute, Ltd. (MHRI) estimates that Japan's gross domestic product (GDP) in real terms grew 0.5% on a quarter-on-quarter (q-o-q) basis (1.8% in annualized terms) in the Jul-Sep quarter. The *QE* should ascertain that the Japanese economy is continuing to cruise at its potential rate of growth subsequent to the previous quarter from April to June. In nominal terms, Japan's GDP growth probably grew 0.8% q-o-q (3.4% in annualized terms), turning positive for the first time in two quarters.

Looking further at the components of demand, public investment continued to fall sharply and the contribution by net exports fell into negative territory. However, personal consumption and capital investment continued to expand, maintaining the strong growth of the economy driven mainly by domestic private-sector demand.

Despite forecasts of a slowdown of capital investment growth in the Oct-Dec quarter, consumer spending should remain strong, thus keeping the rate of GDP growth in cruise mode driven mainly by domestic private-sector demand.

This English-language translation is based upon MHRI's forecast in Japanese released on October 29, 2004. This publication is compiled solely for the purpose of providing readers with information and is in no way meant to encourage readers to buy or sell financial instruments.

1. Overview

Japan's real GDP growth is forecast to reach 0.5% q-o-q (1.8% q-o-q p.a.) in the Jul-Sep quarter of 2004, recording positive growth for the sixth quarter in a row.

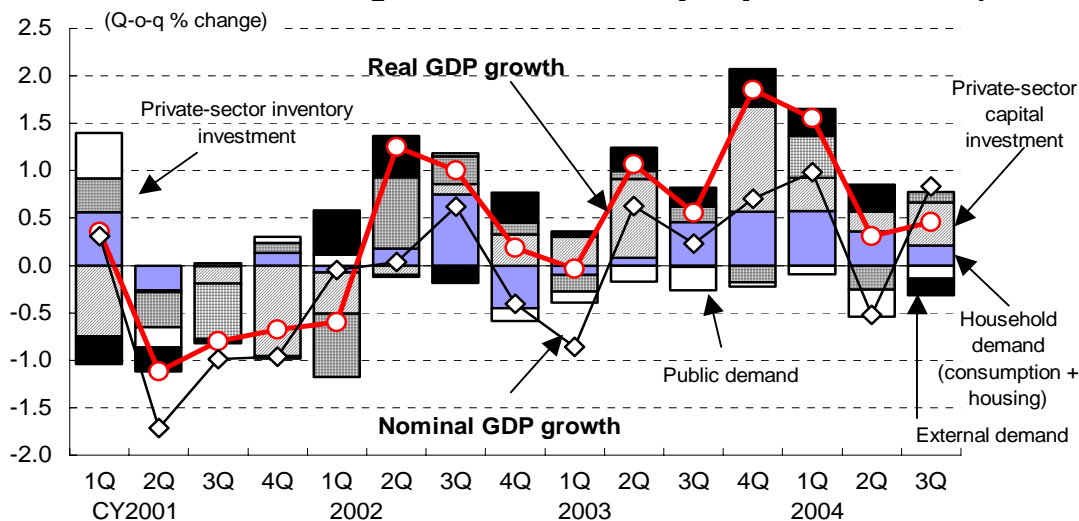
On November 12th (Friday), the Cabinet Office will release the *Preliminary Quarterly Estimates of GDP (QE)* for the Jul-Sep quarter of 2004. On the basis of currently available statistics, MHRI estimates that Japan's GDP in real terms grew 0.5% q-o-q (1.8% q-o-q p.a.) in the Jul-Sep quarter of 2004. Despite the persistence of weak growth from the previous quarter, Japan's economy still continued to grow positively for the sixth consecutive quarter since the Apr-Jun quarter of 2003, underscoring that the economy is continuing to cruise at its potential rate of growth. In terms of the components of demand, the sluggish growth of exports reflecting the slowdown of the US and Chinese economies and the ongoing downswing of public investment amid a greater emphasis upon fiscal rehabilitation served as downward pressures upon the rate of economic growth. However, despite the slowdown given the impact of the successive typhoons, personal consumption remained strong due to demand spurred by the Athens Olympic Games and the summer heat wave. Capital investment picked up mainly among manufacturers, contributing to the strong growth of domestic private-sector demand.

Nominal GDP growth looks to have grown 0.8% q-o-q (3.4% q-o-q p.a.), turning positive for the first time in two quarters. Although the GDP deflator is still deep in negative territory (-2.1% from the same quarter a year ago), the breadth of the deflator is contracting, indicating the gradual abatement of deflationary pressures.

Chart 1: Jul-Sep Quarter 2004 QE Forecast

GDP (real)													GDP (nominal)		
(%)		Contribution to real GDP				Percentage change from previous quarter (%)							(%)		
(p.a.)		Domestic demand	Private demand	Public demand	External demand	Personal consumption	Housing investment	Capital investment	Inventory investment	Government consumption	Public investment	Exports	Imports	(p.a.)	
0.5	1.8	0.6	0.8	-0.1	-0.2	0.4	-0.2	2.6	0.1	0.3	-4.6	0.7	2.9	0.8	3.4

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



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

Japan's economy should remain in cruise mode in the Oct-Dec quarter

Forecasting the Oct-Dec quarter on the basis of recent economic indicators, industrial production, which suffered a drop in the Jul-Sep quarter, should avert a further fall, given the abatement of adjustment pressures upon production in the IT and digital sector. On the demand-side, the chances are slim that net exports will provide positive contribution given a more definite slowdown of the US and Chinese economies. Meanwhile, despite forecasts of a slowdown of capital investment, domestic private-sector demand should continue to grow given the strength of personal consumption supported by the sustained improvement of employment and income. The fall of public investment, which was a major depressant upon the rate of economic growth during the recent two quarters, is also expected to come to a halt. Although the foregoing makes a strong rise of the rate of economic growth unlikely in the Oct-Dec quarter, the economy should continue to grow at cruise speed, driven mainly by private-sector demand.

2. Trends in Major Demand Components

Personal consumption retains momentum driven by the Olympic games and the summer heat wave

Personal consumption most likely maintained momentum, growing 0.4% q-o-q in the Jul-Sep quarter. Although consumer spending faced a heavy upside from the second half of August due to the successive typhoons and the lingering summer heat, the Athens Olympic Games and heat wave from July to mid-August served to underpin consumer spending. The recovery of personal consumption amid the slow improvement of labor market consumptions indicates the strength of consumer confidence.

Housing investment remained broadly flat

Private-sector housing investment remained broadly flat in the Jul-Sep quarter. Despite upward pressures by last-minute housing starts of

owner-occupied houses reflecting forecasts of higher interest rates ahead and the reduction in scope of tax cuts from 2005 onward, the decline in number of housing starts of rental housing and built-for-sale houses from the start of the year to the summer months led to the flat growth of housing investment.

Capital investment is picking up, growing 2.6% q-o-q, reflecting a positive investment stance among manufacturers

Private-sector capital investment appears to have expanded 2.6% q-o-q, picking up from a soft patch in the Apr-Jun quarter (1.2% q-o-q). FY2004 corporate capital investment projections in the Bank of Japan's (BOJ) *Short-Term Economic Survey of Business Enterprises in Japan* (the *Tankan*) in September revealed a positive investment stance in the corporate sector. Capital investment projections were upwardly revised mainly among manufacturers, leading to a 0.6% pt upgrade from the previous survey, reaching 6.9% on a year-on-year (y-o-y) basis excluding land purchasing expenses (actual fixed investment in FY2003 was 1.9%). Furthermore, the September *Tankan* survey also indicated that capital investment growth is spreading from the manufacturing and processing industries to the materials industries. However, as shown by trends in machinery orders, capital investment in the manufacturing and processing industries is peaking out, providing us with reasons to believe that the growth of capital investment will slow down from the Oct-Dec quarter.

Contribution to GDP growth by inventory investment turned positive

Contribution by private-sector inventory investment most likely turned positive (0.1% pt), from the negative contribution in the previous quarter (-0.3% pt). In addition to the sharp rise of the inventory of finished goods, the smaller-than-usual fall of distributor's inventories also contributed positively to the rate of GDP growth on a seasonally-adjusted quarterly basis.

Public investment continued to fall sharply (-4.6% q-o-q)

Public investment appears to have extended its ongoing downswing, falling a sharp 4.6% q-o-q in the Jul-Sep quarter, subsequent to the 7.0% q-o-q drop in the previous quarter from April to June. According to comprehensive statistics on construction, the volume of public works contracts during the Jul-Aug period fell approximately 17% from the same quarter a year before, most likely reflecting efforts to curb expenditures in a bid to restore fiscal health. In addition to the low level of budget supplementations in FY2003, it now appears that public investment-related expenditures in local government budgets in FY2004 have been subject to major cuts. Nevertheless, public works contracts, a leading indicator of public investment, has stopped falling, providing us with reasons to believe that a sharp fall of public investment may be averted from the Oct-Dec quarter onward.

Contribution by external demand to real GDP growth dipped into negative territory (-0.2% pt)

Exports of goods and services grew only 0.7% q-o-q in contrast to the rise of imports (2.9% q-o-q). Reflecting the slowdown of exports, the contribution by external demand to real GDP growth fell into negative territory (-0.2% pt) for the first time since the Jul-Sep quarter of 2002. Looking closer at the export volume index in the Jul-Sep quarter, exports bound for Asia grew a strong 6.1% q-o-q and EU-bound exports managed to remain at a high level of 0.1% q-o-q. In contrast, exports to the US fell a steep 3.3% q-o-q, dragging down overall export growth to -0.9% (seasonal adjustments by MHRI), thus revealing that the US economic slowdown was the main factor exerting negative pressure upon Japan's export growth. Imports appear to have grown at a faster pace than the previous quarter as a result of the ongoing expansion of Japan's domestic demand and the increase of persons traveling overseas.

External demand in the Oct-Dec quarter should remain more or less unchanged. The slim chances of a dramatic rise of exports, due to the slowdown of the US and Chinese economies, and the steady rise of imports reflecting the strength of domestic private-sector demand leads to our view that a surge of the contribution by net exports is unlikely.

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The logo consists of the word "MIZUHO" in a bold, dark blue, sans-serif font. Below the text is a red, curved line that starts under the 'M', dips slightly, and then rises under the 'O'.