

Economic Outlook for FY2006

February 2006

The following are the key points of Mizuho Research Institute's (MHRI) outlook on the economy for FY2006 subsequent to the release of *The Preliminary Quarterly Estimates of GDP* ("QE") for the Oct-Dec quarter of 2005.

<The Overseas Economies>

The US Economy	Despite ongoing solid growth, the economy will slow down as the residential real estate market cools down (2006: 3.2%, 2007: 3.0%)
The Euro Zone Economy	Exports will serve as a drag upon economic growth (2006: 1.9%, 2007: 1.7%)
The Asian Economies	The economy will grow strongly, underpinned by IT demand and the rise of investment in China (2006: 6.8%, 2007: 7.0%)

<The Japanese Economy>

FY2005	Full-fledged recovery of domestic private demand will serve as the driver of strong economic growth (real GDP: 3.4%, nominal GDP: 2.0%)
FY2006	Continuation of self-sustained recovery will lift Japan out of deflation (real GDP: 2.7%, nominal GDP: 2.5%)
FY2007	Ebb of corporate business profit growth will drag down capital investment (real GDP: 1.7%, nominal GDP: 1.8%)

This English-language translation is based upon the outlook in Japanese released on February 21, 2006. 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.

I. The Japanese Economy

1. The current state of the Japanese economy

The Japanese economy grew a dramatic 5.5% q-o-q p.a. in the Oct-Dec quarter of 2005

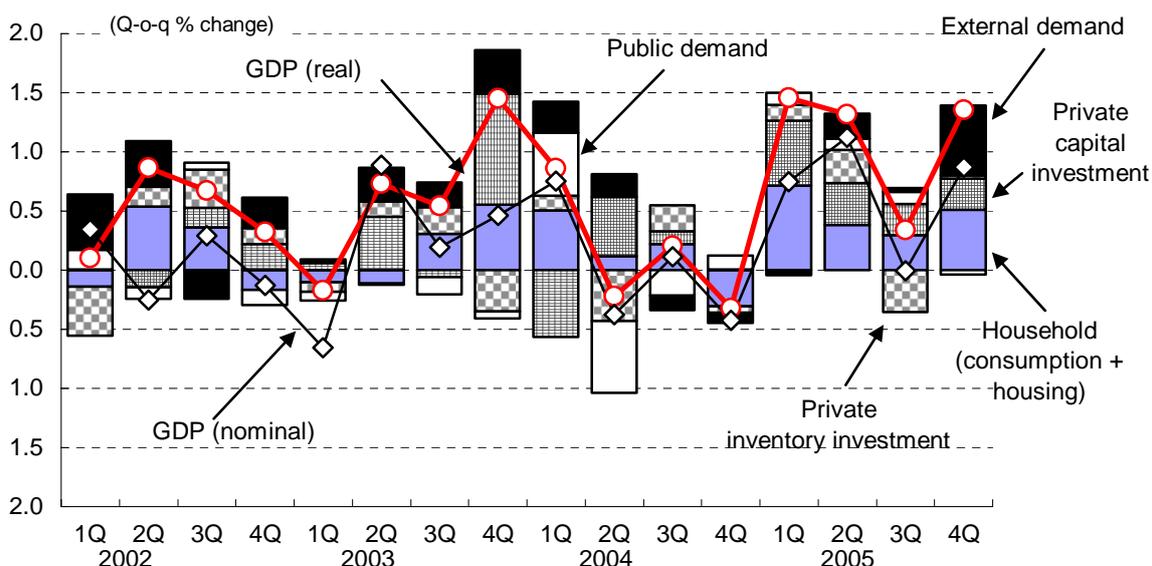
The GDP deflator fell further into negative territory

Japan's real GDP grew 1.4% q-o-q (translated into an annualized rate of 5.5%) in the Oct-Dec quarter of 2005, up from 0.3% q-o-q (1.4% p.a.) in the Jul-Sep quarter, revealing that the economy gained momentum at the end of last year (Chart 1).

Looking closer at the components of demand, personal consumption (0.8% q-o-q) picked up from the previous quarter (0.4% q-o-q) and capital investment (1.7% q-o-q) kept growing at the same pace as the previous quarter (1.8%), underscoring the ongoing strength of private-sector final demand. As for external demand, the ongoing expansion of exports and the downturn of imports led to a dramatic rise of the contribution by net exports (0.6% pt). Furthermore, the downturn of public investment was offset by the rise of government consumption, making the contribution to growth by public demand zero.

The GDP deflator, a broad measure of price changes, fell 1.6% y-o-y, in falling deeper into negative territory in comparison to 1.3% o-y-a in the previous quarter. Note, however, that this is a result of a sharp rise of the import deflator (13.4% y-o-y) due to by the rise of crude oil prices and does not indicate the rise of deflationary pressures. With the exception of the Jul-Sep quarter when inventory investment served as a drag upon growth, the Japanese economy has been growing above 1% q-o-q since the start of 2005. The output gap is contracting steadily, providing us with reason to believe that Japan is nearing the end of deflation.

[Chart 1: Japan's quarterly GDP growth]



Note: Seasonal adjustments by MHRI.

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

Ongoing growth in the Jan-Mar quarter of 2006 will result in a solid 3.4% growth in FY2005

Japan's economic expansion reached 47 consecutive months as of December 2005

Judging from recent economic indicators, private sector demand is continuing to grow since the turn of the year, leading to our view that Japan's real GDP will continue to expand in the Jan-Mar quarter. Even so, the impact of seasonal consumption such as the demand for winter clothing and heating due to the cold winter weather should fade and imports, which had fallen after a jump in aircraft imports in the Jul-Sep quarter, should pick up along with the rise of domestic demand. The foregoing leads to our forecast that Japan's economy will continue to grow in the Jan-Mar quarter of 2006 albeit at a slower pace in comparison to the Oct-Dec quarter, and that full-year growth in FY2005 will reach 3.4%.

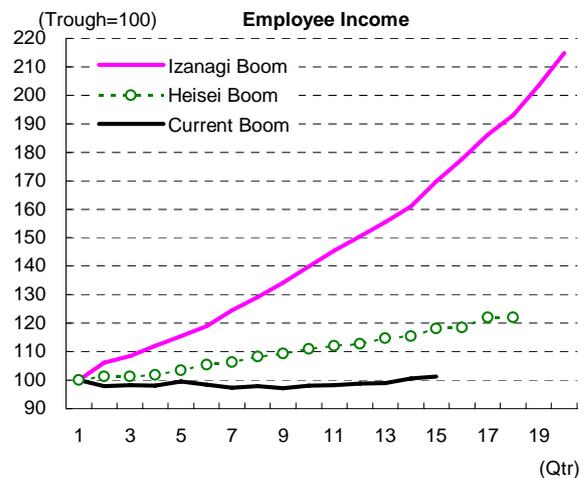
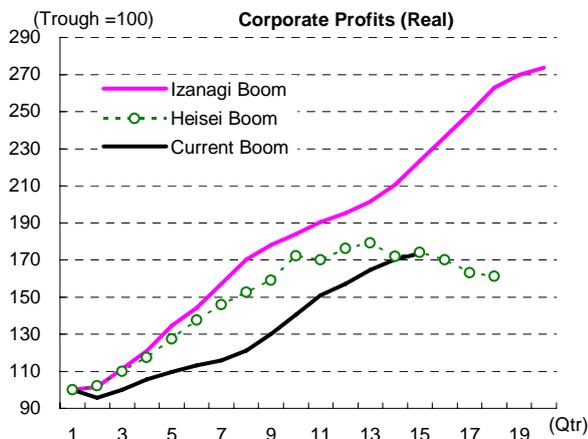
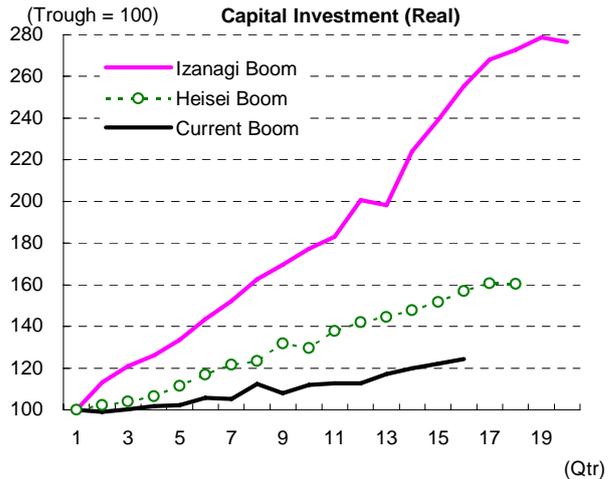
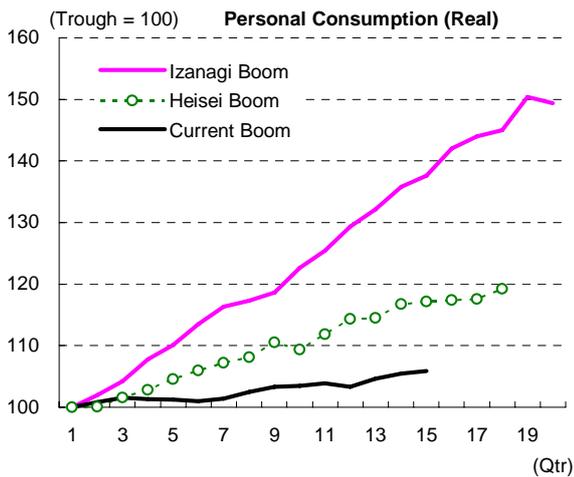
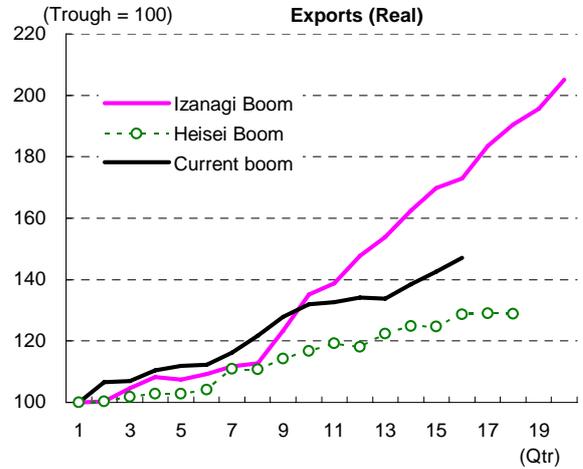
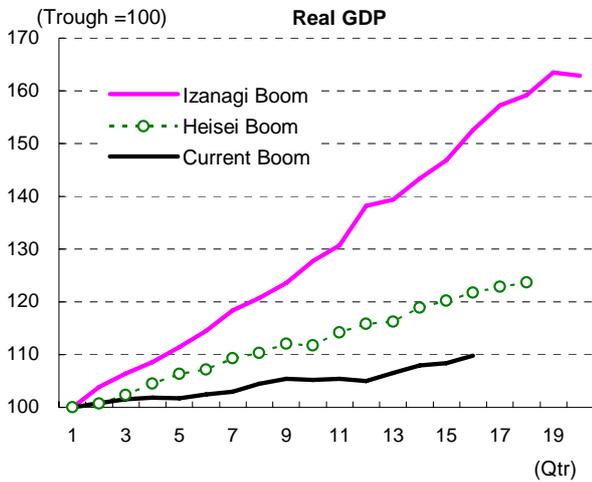
The current expansion cycle from the trough in January 2002 reached 47 months as of December 2005 (barring the remote possibility that the "soft patch" in the second half of 2004 might be deemed as a recession). This makes the current expansion cycle the third longest in Japan's history since the end of World War II (WWII) after the Izanagi Boom (57 months from October 1965 to July 1970) and the Heisei ("Bubble") Boom (51 months from November 1986 to February 1991). If the current economic expansion continues, it would become the longest economic boom in post-WWII history, surpassing the Heisei Boom in May 2006 and overtaking the Izanagi Boom in November.

The question is whether the current expansion possesses the sustainability to surpass the Izanagi Boom. A comparison of the movements of major economic indicators during the Izanagi Boom, the Heisei Boom and current expansion set forth in **Chart 2** reveals the following facts.

- (1) The pace of real GDP growth in the current expansion cycle is considerably slower than the Izanagi and Heisei booms. Even when excluding the exceptionally fast pace of growth above 10% during the Izanagi Boom, the level of real GDP has only risen around 10% during the four years since the trough in the current expansion cycle – making it only half the Heisei Boom.
- (2) The pace of real export growth during the initial stage of the current expansion cycle was faster than both the Izanagi and Heisei booms, indicating a relatively high degree of dependence upon external demand.
- (3) The pace of domestic private sector demand falls far below the Izanagi and Heisei booms. Note, in particular, the sluggish recovery of consumer spending.
- (4) Even though the pace of corporate profit growth was also slower than the Izanagi and Heisei booms, the breadth of the recovery is catching up with the Heisei boom as we write this report.
- (5) During the initial stage of the current expansion, the level of real employee income actually took a dip from trough. Despite the recent rise of employee income, the levels are more or less flat from the trough

of the economic cycle. We suspect that this is the cause of the household sector's lack of a solid sense of recovery.

[Chart 2: Comparison of economic indicators during the Izanagi Boom, the Heisei Boom and the current Boom]



Note: 1. The troughs: Izanagi Boom (4Q1965), Heisei Boom (4Q1986), Current Boom (1Q2002).

2. Corporate profits (real) = current profit / GDP deflator.

Sources: Cabinet Office, *Annual Report on National Accounts*, Ministry of Finance, *Financial Statements Statistics of Corporations by Industry (Quarterly)*.

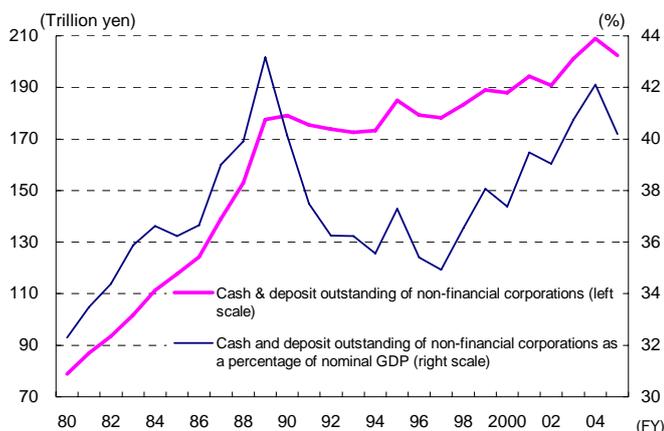
There is more room for further domestic demand growth

Sustainability of corporate profit growth is the key after the current expansion overtakes the Izanagi Boom

As shown above, even though the current expansion cycle is the third longest in post-WWII history, the recovery of the level of economic activity remains far below both the Izanagi and Heisei booms. However, from another perspective, this indicates that there is room for more expansion. Corporate profits are still growing even after achieving the same breadth of recovery during the Heisei Boom. The outstanding balance of cash and deposits (as a percentage of nominal GDP) in the corporate sector is already nearing peak levels during the Heisei Boom (**Chart 3**). Considering that Japan is only at the beginning of a virtuous cycle in which corporate profits lead to the expansion of domestic demand, there is room for further growth of domestic private sector demand (personal consumption and capital investment) as corporate profits are allocated to business fixed investment and employee income. The odds are high that the current expansion cycle will surpass the Izanagi Boom in terms of the length of expansion.

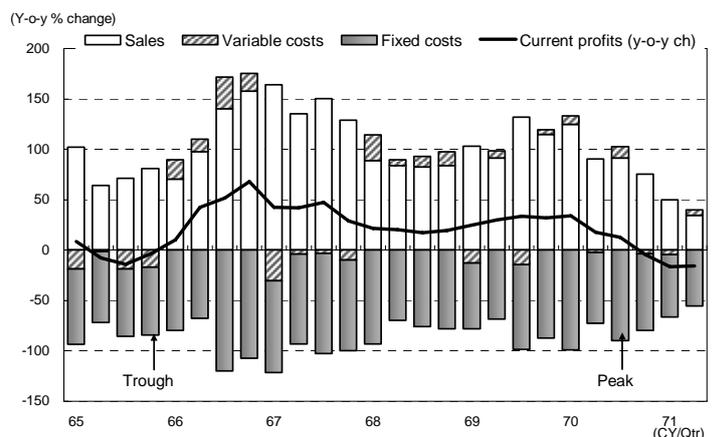
The key to the direction of Japan's economy after it surpasses the Izanagi Boom is the sustainability of corporate profit growth. In the final stages of long expansion cycles in the past, corporate profits frequently decreased because of a slower pace of sales growth amid: (i) the rise of labor costs stemming from tight labor market conditions, (ii) the increase of financial costs along with the rise of interest rates, and (iii) a heavier burden of fixed costs upon corporate profits arising out of larger depreciation burdens stemming from high levels of capital investment. Likewise in the Izanagi Boom, the slowdown of sales growth amid the rising burden of fixed costs led to the decline of corporate profit growth and the fall of investment, hence pushing the economy in to a correction (**Chart 4**).

[Chart 3: Cash and deposit outstanding of non-financial corporations]



Note: Data on FY2005 are based upon data for Jul-Sep qtr (seasonal adjustments by MHIRI).
Sources: Cabinet Office, *Annual Report on National Accounts*,
Bank of Japan, *Flow of Funds Accounts in Japan*.

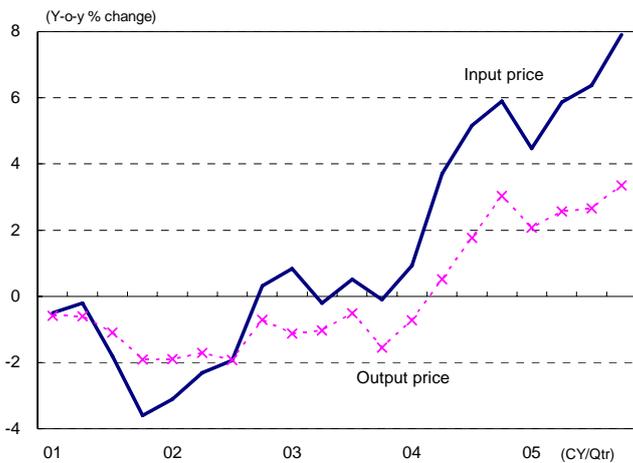
[Chart 4: Trends in current profit (all-industries) during the Izanagi Boom]



Note: Fixed costs = labor costs + depreciation costs + nonoperating expenses.
Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry (Quarterly)*.

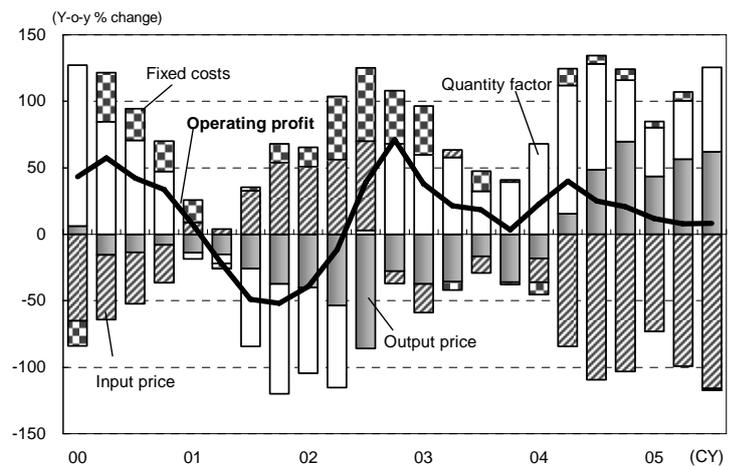
At the moment, corporate profits are continuing to grow despite the rise of costs accompanying higher crude oil prices. While input prices among manufacturers are rising approximately 8% y-o-y, output prices are only rising around the 3% y-o-y-level, leading to the deterioration of corporate profit margins (**Chart 5**). Looking closer at operating profits among manufacturers in terms of the price and quantity factors, input prices are serving as a heavier burden upon operating profit. Even so, the quantity factor and output prices are offsetting the negative effect of input prices, enabling businesses to remain profitable by shifting costs to prices (the rise of output prices) and selling more products (**Chart 6**).

[Chart 5: Trends in input/output prices]



Source: Bank of Japan, *Input-Output Price Index of the Manufacturing Industry by Sector*.

[Chart 6: Operating profit of manufacturers]

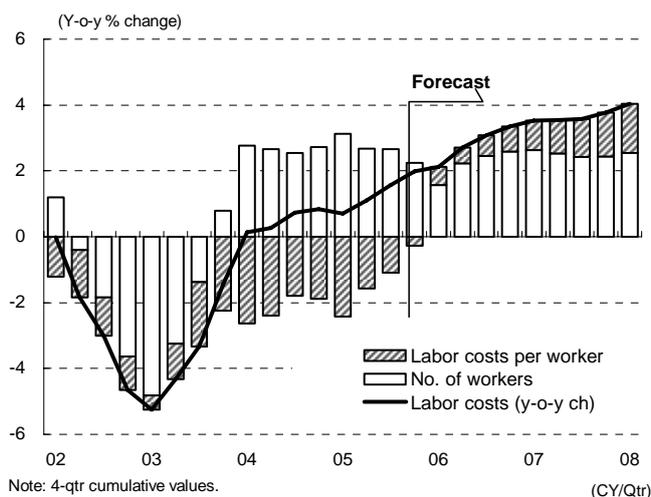


Sources: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry (Quarterly)*, Bank of Japan, *Input-Output Price Index of the Manufacturing Industry by Sector*.

Labor costs are creeping up and serving as a drag upon corporate profits

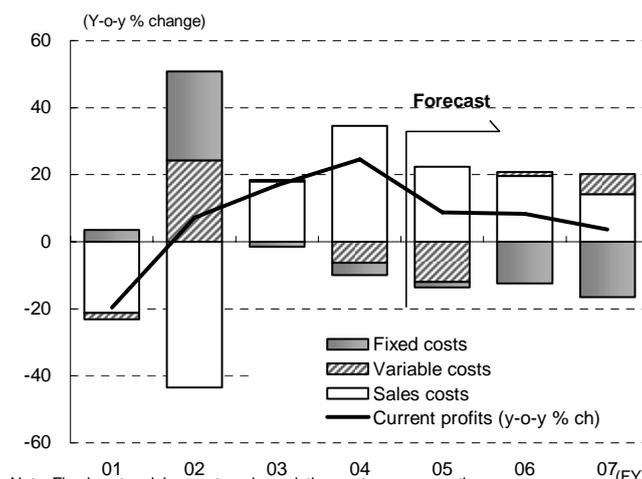
Looking forward, the negative pressures upon corporate profit stemming from the decline of profitability (the rise of the variable ratio) should ease along with the gradual stabilization of crude oil prices. On the other hand, tighter labor market conditions will lead to the rise of labor costs (**Chart 7**). The growing burden of fixed costs such as labor costs will gradually start to serve as a drag upon corporate profits. In FY2006, corporate profit growth should remain close to double-digit levels because the growth of sales driven by the booming domestic and overseas economies will cover the burden of fixed costs. However, in FY2007, the corporate sector may not avoid a sharp slowdown of profits because of a further rise of fixed costs (**Chart 8**). Even so, our main scenario forecast is that businesses will be able to maintain profit growth, barring unexpected events causing a sharp fall of domestic and overseas demand. Nevertheless, corporate profits in FY2007 will be vulnerable to fluctuations in sales because of a larger burden of fixed costs.

[Chart 7: Labor costs]



Note: 4-qr cumulative values.
Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry (Quarterly)*.

[Chart 8: Current profits]



Note: Fixed costs = labor costs + depreciation costs + nonoperating expenses.
Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry (Quarterly)*.

The household sector will be able to withstand the rise of burdens given the increase of labor compensation

Turning to the household sector, the abolition of special tax cuts and pension premium hikes should lead to additional burdens totaling approximately 2.1 trillion yen in FY2006 and approximately 1.4 trillion yen in FY2007 (Chart 9). According to MHRI's Macroeconometric Model, the larger burden upon the household sector will depress personal consumption by -0.44% in FY2006 and -0.30% in FY2007. However, since the rise of labor compensation reflecting favorable labor market conditions should surpass the rise of burdens and household disposable income should continue to grow, we do not expect the rise of burdens to derail the recovery of consumer spending. However, in the event of a sharp deterioration of consumer confidence such as an early and drastic consumption tax hike may lead to a sharper decline of personal consumption.

[Chart 9: The impact of the rise of household burdens]

		FY2005	FY2006	FY2007
Total additional burden (billion yen)		1,124	2,057	1,422
Breakdown	Halving/abolishment of special tax cuts	185	1,575	1,132
	Pension premium hike	186	290	290
	Employment insurance premium hike	175	0	0
	Rise of nursing care insurance premiums borne by the insured	130	150	0
	Abolishment of special tax exemptions for the elderly	240	0	0
The drag upon growth (%)				
	GDP (real)	-0.17	-0.30	-0.20
	Personal consumption (real)	-0.25	-0.44	-0.30
(Ref) Rise of labor compensation (billion yen)		6,644	8,119	9,254

The negative effect of the mass retirement of the baby-boom generation will be mitigated by rehiring programs for elderly workers

One foreseeable shift during the forecast horizon is the mass retirement of the baby-boom generation. Since the employment conditions DI in the Bank of Japan's (BOJ) *Short-Term Economic Survey of Enterprises in Japan (the "Tankan")* already indicates a labor shortage, the mass retirement of the baby-boom generation will serve as restraints upon the supply of labor and lead to the risks of a sharp rise of wages due to a labor crunch. Given the labor force participation rate of the current age structure, the labor force population will start to decline from FY2007. However, this will not develop into a major issue as a result of a program to be introduced in April 2006 which will raise the retirement age or extend the employment of the elderly. According to a legal amendment on the employment of elderly workers, business owners setting a mandatory retirement age younger than 65 will be obliged to take either one of the following measures to all applicants from FY2006: (1) raise the retirement age, (2) adoption of rehiring plans, or (3) abolition of the mandatory retirement age. Even though approximately 40% of employees reaching 60 years of age would become non-employees (the non-labor population or the self-employed) under normal circumstances, a certain percentage of the elderly should remain as workers as a result of the rehiring program in FY2006. **Chart 10** sets forth the results of calculations on the impact of three main probable cases: (1) a quarter of employees reaching 60 years of age become non-employees ("Case 1"), (2) one-half of employees reaching 60 years of age become non-employees ("Case 2"), and (3) none of the employees reaching 60 years of age become non-employees ("Case 3"). In either of the cases, Japan will be able to avert a serious decline of the labor force population until FY2007. The unemployment rate would also remain around the upper-3% to 4% level, above the structural unemployment rate of 3.5%. We are thus inclined to believe that Japan will be able to avoid a serious labor crunch during the forecast horizon up to FY2007.

[Chart 10: The impact of elderly rehiring programs upon the labor force population]

(10,000 workers)

		FY2005	FY2006	FY2007	Unemployment rate
No change		6,654	6,656	6,637	3.3%
Y-o-y change		16	2	-19	-
Increase due to rehiring program	Case 1	-	+ 12	+ 29	3.7%
	Case 2	-	+ 18	+ 44	3.9%
	Case 3	-	+ 35	+ 88	4.5%

Note: MHRI's forecast is based upon Case 1.

The risks: the surge of crude oil prices, collapse of the US housing bubble and appreciation of the yen stemming from political issues in the US

Even in consideration of the rise of household burdens and the mass retirement of the baby boom generation predicted during the forecast horizon, the odds are high that the Japanese economy will continue to expand and surpass the Izanagi Boom.

The possible external risk factors are: (1) a further rise of crude oil prices, (2) a sharp correction of the US residential real estate market, and (3) the appreciation of the yen due to mounting frictions with the US government in the run-up to the presidential election.

Crude oil: the risks are that a supply disruption due to an embargo in connection with the nuclear weapons investigations in Iran would lead to a surge of crude oil prices. However, even though extreme cases such as the WTI (West Texas Intermediate – a benchmark price for crude futures) surging to 80~100 dollar/barrel would lead to the decline of profits among Japanese businesses, the likelihood of such a case would be slim since an embargo would also hurt Iran.

The US residential real estate market: A sharp correction of the US housing market would have a negative impact upon Japan in ways such as the fall of exports and the appreciation of the yen. Even so, a sharp rise of US long-term interest rates – which would trigger a sharp drop of US residential prices – is unlikely, judging from the ongoing flow of global money into the US bond market.

The appreciation of the yen: Another risk factor stemming from the US is the recent decline of confidence in the Bush administration. If such conditions persist, the focus of debate in Congress in the mid-term election would turn to the state of the economy and employment and lead to trade frictions with overseas trade partners as a result of efforts by the Bush administration to garner popular support by, for example, implementing the Anti-Dumping Act. Even though the US trade deficit with Japan is going largely unnoticed at the moment because of attention upon the trade deficit with China, it should be noted that Japan's trade surplus with the US is ballooning to historical highs. Since the rise of friction might lead to a sharp appreciation of the yen, the course of US political developments must be monitored closely.

2. Forecast of the Japanese economy in FY2006

1HFY2006:
continuation of
self-sustained
recovery driven mainly
by private demand

2HFY2006: external
demand and capital
investment will drag
down growth

FY2006: Full year
growth will reach a
robust 2.7%

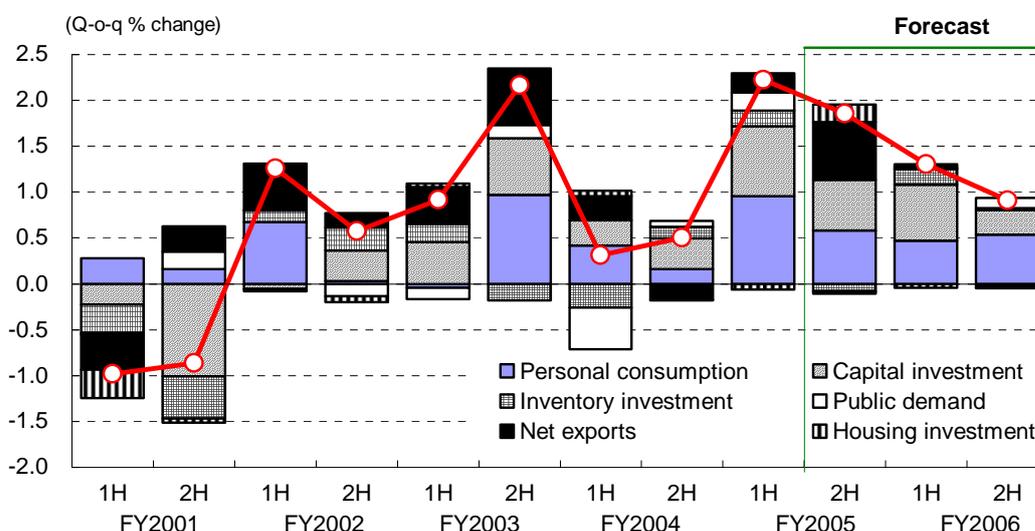
Given the ongoing growth of domestic private-sector final demand in the Jan-Mar quarter of 2006, the Japanese economy is poised to grow a solid 3.7% q-o-q p.a. in the second half of FY2005, extending the strong growth in the first half of the fiscal year (4.5% p.a.) (**Chart 11**).

1H FY2006: the twin engines of personal consumption and capital investment should keep the economy on an autonomous recovery, driving the pace of growth to 1.3% q-o-q (2.6% p.a.), above 2% in annualized terms. Personal consumption will continue to grow against a backdrop of better employment and income conditions while businesses with abundant cash flow will continue to spend on equipment and facilities. The pace of economic growth will slow down in comparison to the second half of FY2005 because of a smaller contribution by external demand due to the rise of imports along with the growth of domestic demand.

2H FY2006: In the second half of FY2006, we expect a slowdown of exports along with the slower pace of US economic growth and the appreciation of the yen. In turn, the stagnation of production and corporate profits due to the slowdown of external demand should serve as a drag upon capital investment. Even so, the ongoing improvement of income conditions should maintain the strength of consumer spending. Thus, even though external demand and capital investment will serve as a drag, the strength of personal consumption provides us with reason to believe that the rate of growth in the second half of FY2006 will reach 0.9% q-o-q (1.8% p.a.).

FY2006: As a result, we expect full-year real GDP growth in FY2006 to maintain the strength in FY2005 and reach 2.7% (previous forecast: 1.9%) in real terms and 2.5% (previous forecast: 1.6%) in nominal terms.

[Chart 11: Forecast on Japan's real GDP growth]



Source: Cabinet Office, Preliminary Quarterly Estimates of GDP.

FY2007: capital investment will serve as a drag upon growth

FY2007: Fixed costs such as labor costs will serve as negative pressures upon corporate profits and slow down the pace of profit growth. Despite forecasts that personal consumption will continue to grow reflecting the ongoing rise of income, corporate business performance will start to wane and lead to a sharp slowdown of capital investment growth. Given the slight deceleration of the overseas economies, exports are also predicted to slow from FY2006.

The rate of GDP growth in FY2007 should reach 1.7% in real terms and 1.8% on a nominal basis (**Chart 12**).

[Chart 12: Outlook on the Japanese economy (FY)]

	FY2004	FY2005	FY2006	FY2007	FY2004	FY2005	FY2006	FY2007
	(Actual)	(Forecast)	(Forecast)	(Forecast)	(Contribution)	(Contribution)	(Contribution)	(Contribution)
	(Actual)	(Forecast)	(Forecast)	(Forecast)	(Actual)	(Forecast)	(Forecast)	(Forecast)
GDP (real)	1.7	3.4	2.7	1.7	-	-	-	-
Domestic demand	1.3	3.0	2.4	1.5	1.2	3.0	2.4	1.5
Private sector demand	2.1	3.6	3.1	1.7	1.6	2.7	2.3	1.3
Personal consumption	1.7	2.3	1.8	1.9	1.0	1.3	1.0	1.1
Housing investment	1.7	0.7	1.3	-0.3	0.1	0.0	0.0	-0.0
Capital investment	5.4	8.5	6.8	2.0	0.7	1.2	1.0	0.3
Public sector demand	-1.4	0.9	0.3	0.7	-0.3	0.2	0.1	0.2
Government consumption	1.8	1.7	2.2	2.1	0.3	0.3	0.4	0.4
Public investment	-12.4	-1.8	-6.9	-5.1	-0.7	-0.1	-0.3	-0.2
Net exports (contribution)	0.5	0.4	0.3	0.2	0.5	0.4	0.3	0.2
Exports	11.4	8.7	7.5	4.8	1.4	1.2	1.1	0.7
Imports	8.7	6.2	6.2	3.9	-0.9	-0.7	-0.8	-0.5
GDP (nominal)	0.5	2.0	2.5	1.8				
Industrial production	4.1	1.7	3.8	2.4				
Unemployment rate	4.6	4.4	4.0	3.7				
Current account balance (trillion yen)	18.3	18.0	20.1	22.2				
as a percentage of nominal GDP	3.7	3.6	3.9	4.2				
Corporate goods prices	1.5	2.0	1.2	-0.3				
Consumer prices	-0.3	0.0	0.2	0.4				
Long-term interest rate (%)	1.52	1.41	1.90	2.15				
Nikkei stock average (yen)	11,321	13,597	17,400	18,200				
Exchange rate (yen/dollar)	107.5	113	109	107				
Crude oil price (WTI \$/barrel)	45.1	59.4	59.5	51.8				

- Notes: 1. FY = rate of change from the previous year.
 2. Consumer prices = nationwide (excluding fresh foods).
 3. Figures on current account balance are converted into annualized rates.
 4. Crude oil price = near-term contract for WTI crude futures.
 The long-term interest rate = newly-issued 10-yr government bonds.

Sources: Cabinet Office, *Annual Report on National Accounts*,
 Ministry of Economy, Trade and Industry, *Indices of Industrial Production, Producer's Inventory of Finished Goods and Producer's Inventory Ratio of Finished Goods (Index)*
 Ministry of Internal Affairs and Communications, *Labor Force Survey, Consumer Price Index*,
 Ministry of Finance, *Balance of Payments*,
 Bank of Japan, *Corporate Goods Price Index*.

[Chart 13: Outlook on the Japanese economy (half-year)]

(%)

	FY2004		FY2005		FY2006	
	1H (Actual)	2H (Actual)	1H (Actual)	2H (Forecast)	1H (Forecast)	2H (Forecast)
GDP (real)	0.3	0.5	2.2	1.9	1.3	0.9
Domestic demand	0.0	0.7	2.1	1.3	1.3	1.0
Private sector demand	0.7	0.8	2.4	1.7	1.7	1.1
Personal consumption	0.7	0.3	1.7	1.0	0.8	0.9
Housing investment	1.8	-0.2	-1.8	5.3	-1.2	-0.2
Capital investment	2.0	2.3	5.3	3.7	4.0	1.8
Public sector demand	-1.9	0.3	0.9	-0.1	0.1	0.5
Government consumption	0.8	0.9	0.9	0.8	1.2	1.2
Public investment	-11.5	-2.2	1.1	-3.5	-4.1	-2.4
Net exports (contribution)	0.3	-0.2	0.2	0.6	0.0	-0.0
Exports	6.0	1.3	4.9	5.9	3.7	1.5
Imports	4.6	3.1	3.8	1.6	4.2	2.1
GDP (nominal)	0.1	0.0	1.5	1.1	1.9	0.1
Industrial production	2.2	-0.1	0.3	2.8	2.0	1.0
Unemployment rate	4.7	4.6	4.3	4.4	4.1	4.0
Current account balance (trillion yen)	18.7	18.3	17.2	18.8	18.3	21.8
as a percentage of nominal GDP	3.8	3.7	3.4	3.7	3.5	4.2
Corporate goods prices	1.4	1.7	1.6	2.4	1.9	0.5
Consumer prices	-0.2	0.2	-0.1	0.2	0.2	0.2
Long-term interest rate (%)	1.62	1.42	1.29	1.53	1.80	2.00
Nikkei stock average (yen)	11,339	11,303	11,794	15,400	17,200	17,600
Exchange rate (yen/dollar)	109.8	105.2	109.4	117	112	107
Crude oil price (WTI \$/barrel)	41.1	49.2	58.2	60.6	61.4	57.5

Notes: 1. FY = rate of change from the previous year. Half-year = rate of change from the previous term (excluding the unemployment rate, current account balance and prices).

2. Half-year corporate goods prices and half-year consumer prices = rate of change over a year ago.

Consumer prices = nationwide (excluding fresh foods).

3. Half-year unemployment rate and half-year current account balance are adjusted for seasonal factors.

Figures on current account balance are converted into annualized rates.

4. Crude oil price = near-term contract for WTI crude futures.

The long-term interest rate = newly-issued 10-yr government bonds.

Sources: Cabinet Office, *Annual Report on National Accounts*,

Ministry of Economy, Trade and Industry, *Indices of Industrial Production, Producer's Inventory of Finished Goods and Producer's Inventory Ratio of Finished Goods (Index)*,

Ministry of Internal Affairs and Communications, *Labor Force Survey, Consumer Price Index*,

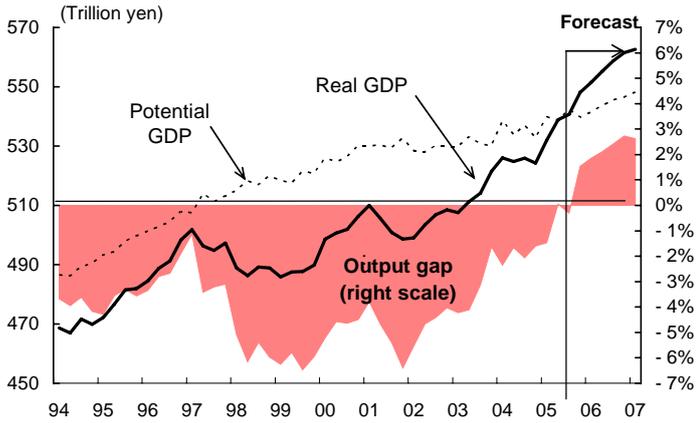
Ministry of Finance, *Balance of Payments*,

Bank of Japan, *Corporate Goods Price Index*.

The output gap is turning positive

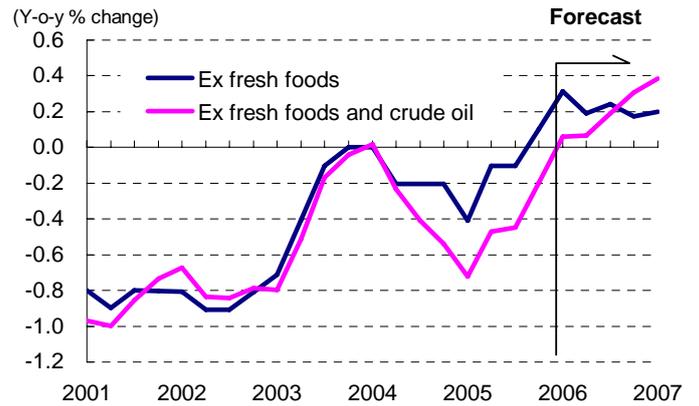
Given the rise of economic growth above the potential growth rate, the output gap (the gap between demand and supply) calculated by MHRI rose into positive territory in the Oct-Dec quarter of 2005 (**Chart 14**). The percentage rise of the consumer price index (general "CPI", excluding fresh foods) remained in positive territory in December (0.1% y-o-y) after rising to 0.1% y-o-y in November 2005 to (**Chart 15**). If the Japanese economy continues to follow a self-sustained recovery as predicted, the positive breadth of the output gap should continue to widen from the Jan-Mar quarter of 2006. Even though petroleum-related prices may decline depending upon crude oil prices, the CPI (general, excluding fresh foods) will likely stay in positive territory. Thus, given the foregoing, the precondition for the termination of the quantitative easing policy set forth by the BOJ is more or less fulfilled, namely that "the consumer price index registers stably a zero percent or an increase year on year".

[Chart 14: The output gap]



Note: Estimates by MHRI.
Sources: Cabinet Office, Ministry of Economy, Trade and Industry, Ministry of Internal Affairs and Communications, and others.

[Chart 15: The CPI]



Note: "Ex fresh foods and crude oil" = "Ex fresh foods" minus gasoline and heating oil.

Source: Ministry of Internal Affairs and Communications, *Consumer Price Index*.

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The logo for Mizuho, featuring the word "MIZUHO" in a bold, dark blue, sans-serif font. Below the text is a red, curved swoosh that underlines the letters.