



Economic Outlook

SHORT-TERM ECONOMIC OUTLOOK

Revised Forecast Followed by the Second Update
of June-September GDP Estimation
(Published on December 7th)

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- Executive Summary -

Outlook for Japanese economy revised downward in response to second preliminary estimate of third quarter GDP

Following the downward revision of the Government's second preliminary estimate of GDP in July-September 2007, announced December 7, we have amended the forecasts described in the "Short and Medium-term Economic Outlook" dated November 12, 2007. As a result, the forecast real GDP growth rates for fiscal 2007 and 2008 have been revised downward from 1.9% and 1.9% to 1.5% and 1.5%. In the process, changes in present conditions were taken into consideration and an analysis made of risks inherent in the standard forecast scenario to produce a risk scenario. At the present point in time, there are numerous uncertainties, and the probability of the standard scenario is estimated to be around 60%.

The main factors behind the downward revision are housing investment and capital investment in fiscal 2007, and the exchange rate of the yen and exports in fiscal 2008. Housing investment is a factor due to the greater than anticipated impact of the revised Building Standards Law, which was amended to prevent a recurrence of the fabricated quake-data scandal and went into effect on June 20, while capital investment is a factor due to the Government's downward revision of its second preliminary estimate of GDP. The projected exchange rate was changed from ¥110 to ¥105 = US\$1. A downward revision was made assuming the greater impact of economic adjustment in China after the Beijing Olympics.

Three destabilizing factors to have repercussions for world and Japanese economies

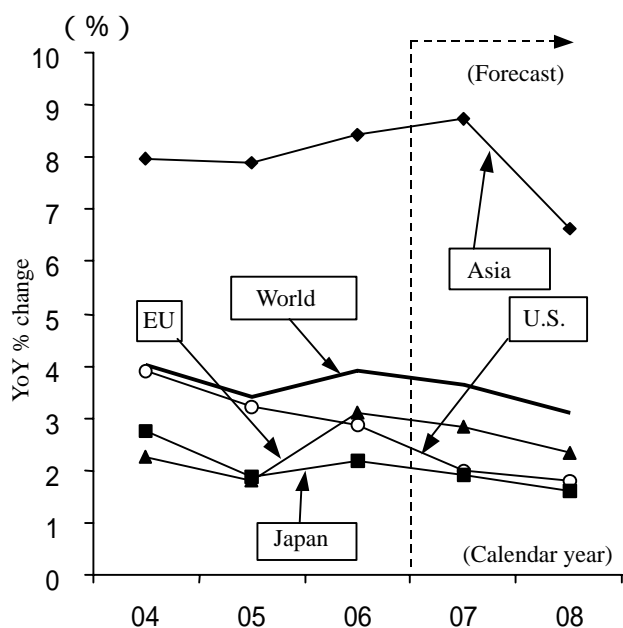
The world economy presently faces three destabilizing factors—(1) the U.S. subprime loan crisis, (2) crude oil prices, and (3) the overheating of the Chinese economy—which will become intertwined, causing the world to enter an adjustment in 2008.

For the standard scenario, it was assumed regarding these three factors that: (1) the U.S. subprime loan crisis would become protracted (taking the form of a 15% decline in U.S. housing prices), (2) crude oil prices would stay high (at US\$80/barrel), and (3) Chinese economic growth would decelerate to 8%. The depreciation of the dollar due to the slowdown of the U.S. economy and policy rate cuts (resulting in an exchange rate of ¥105 to US\$1) and decline in exports to the U.S. will deal a blow to the Japanese economy. The still high level of oil prices will also squeeze corporate earnings. Nevertheless, growth in personal consumption due to the economy's escape from deflation and growth in housing investment as it rebounds from the turmoil of fiscal 2007, combined with continued firm growth in exports to China and other developing economies, will allow the Japanese economy to continue to expand until the first half of fiscal 2008. In the second half of the year, however, exports to China will slow owing to the slowdown of the Chinese economy following the Beijing Olympics, and there is a strong probability that the growth phase lasting since the trough in January 2002 will also come to an end. The Japanese economy is forecast to grow 1.5% in fiscal 2008 (1.9% in the first half and 1.0% in the second half).

Strong possibility of global downturn if losses from writing off non-performing subprime loans in the U.S. deepen

In the risk scenario, it was assumed that (1) the subprime loan crisis would deepen and become protracted (resulting in a 30% decline in U.S. housing prices), (2) the price of oil would soar further (to US\$100/barrel), and (3) Chinese economic growth would slow to 6%. In this case, U.S. housing prices will decline excessively, causing the subprime loan crisis to worsen. There will be a flight of funds from the financial markets into the commodities markets, and the price of oil will rise to US\$100/barrel. The yen will also appreciate sharply (to ¥90 = US\$1) due to the plummeting dollar. Losses from write-offs of subprime loans and other non-performing loans, meanwhile, are expected to balloon to around ¥50 trillion (compared with ¥16 trillion in the standard scenario). Although this is less than the official loss of ¥96 trillion on disposal of non-performing loans in Japan in the 1990s in absolute value, the annual average impact will be greater. This will trigger an international credit crunch, and the money glut will begin to draw to a close. Japan and the U.S. will register zero growth and Chinese growth will slow to 6% as the world enters a global downturn. This is expected to cause volatility in the price of oil, which may fall sharply to US\$60.

Global economic outlook



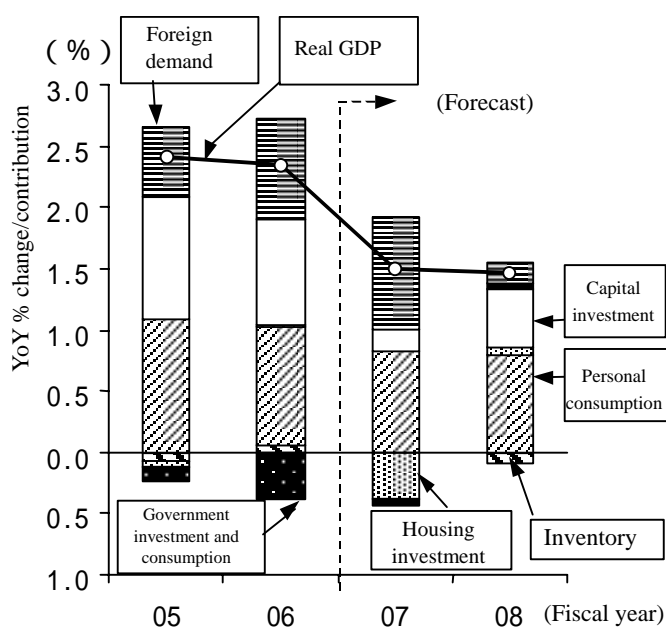
Source: Compiled by HRI from various sources. Forecasts by HRI.

Calendar year	2006 (actual)	Present forecast		Nov. 12 forecast	
		2007 (forecast)	2008 (forecast)	2007 (forecast)	2008 (forecast)
World total	3.9	3.7	3.1	3.7	3.2
(excluding Japan)	4.1	3.9	3.3	Same as left	
U.S.	2.9	2.0	1.8	Same as left	
EU	3.1	2.8	2.3	Same as left	
Germany	3.1	2.8	2.2	Same as left	
U.K.	2.8	2.6	2.0	Same as left	
France	2.2	2.0	2.1	Same as left	
Japan	2.2	1.9	1.6	1.9	2.1
Asia (excluding Japan)	8.4	8.7	6.6	Same as left	
China	11.1	11.9	8.0	Same as left	
NIEs	5.4	5.0	4.3	Same as left	
ASEAN	5.6	5.8	5.6	Same as left	
BRICs	9.0	9.4	7.2	Same as left	

Note: The present revision concerns only Japan.

As the above figures are presented on a calendar year basis, they differ from those presented on a fiscal year basis in the table below.

Japanese economic outlook



Source: Compiled by HRI from Cabinet Office, *System of National Accounts*, and other sources. Forecasts by HRI.

Fiscal year	2006 (actual)	Present forecast		Nov. 12 forecast	
		2007 (forecast)	2008 (forecast)	2007 (forecast)	2008 (forecast)
Real GDP growth rate	2.3	1.5	1.5	1.9	1.9
Personal consumption	1.7	1.5	1.4	1.6	1.5
Housing investment	0.2	11.3	2.1	2.6	2.2
Capital investment	5.6	1.1	3.0	3.7	3.2
Government investment	9.2	4.6	3.5	5.1	3.6
Exports	8.2	7.6	3.6	6.3	5.9
Imports	3.0	1.9	3.6	2.4	4.3
Domestic demand contribution	1.5	0.6	1.4	1.2	1.5
Foreign demand contribution	0.8	0.9	0.1	0.6	0.4
Nominal GDP growth rate	1.6	0.8	1.7	1.6	1.9
Industrial production index	4.8	3.2	2.3	3.2	3.3
Consumer price index	0.3	0.3	1.0	0.3	1.0
Yen exchange rate (Yen/dollar)	117.0	115.0	105.0	116.0	110.0
Crude oil price (CIF US\$/barrel)	63.5	73.9	80.0	73.9	80.0

Table 1 Japanese economic overview

(Units: ¥ billion, upper right figures indicate YoY % growth)

Category	Fiscal year (half year)		2006		2007		2008		2006	2007	2008
	1H	2H	1H	2H	1H	2H	(actual)	(forecast)	(forecast)		
Real gross domestic expenditure (real GDP, 2000 base)	2.1	2.5	1.7	1.3	1.9	1.0	2.3	1.5	1.5		
	271,824	281,616	276,462	285,253	281,803	288,127	553,440	561,715	569,930		
Domestic demand	1.3	1.8	0.7	0.5	1.6	1.1	1.6	0.6	1.4		
	261,869	269,981	263,657	271,390	267,968	274,464	531,849	535,048	542,432		
Personal consumption	1.8	1.7	1.7	1.3	1.6	1.3	1.7	1.5	1.4		
	152,165	155,529	154,772	157,551	157,172	159,601	307,694	312,323	316,774		
Housing investment	0.5	0.1	7.1	15.5	1.0	3.4	0.2	11.3	2.1		
	9,266	9,206	8,606	7,781	8,691	8,044	18,472	16,387	16,735		
Capital investment	4.1	7.0	0.5	1.6	3.7	2.4	5.6	1.1	3.0		
	42,103	46,159	42,306	46,918	43,872	48,065	88,262	89,224	91,937		
Private inventory investment											
	2,935	430	2,691	400	2,500	1,000	2,505	2,291	1,500		
Public inventory investment											
	117	103	119	5	11	17	220	124	6		
Government consumption	0.3	0.4	0.5	1.0	1.0	1.0	0.1	0.7	1.0		
	47,146	47,517	47,359	47,992	47,832	48,472	94,663	95,350	96,304		
Government investment	11.8	7.3	1.2	6.9	4.9	2.5	9.2	4.6	3.5		
	8,525	12,509	8,424	11,651	8,007	11,359	21,033	20,075	19,366		
Foreign demand											
	9,972	11,520	12,714	13,862	13,835	13,663	21,491	26,576	27,498		
Exports	9.6	6.8	7.8	7.4	5.2	2.0	8.2	7.6	3.6		
	39,998	42,010	43,114	45,115	45,365	46,025	82,009	88,229	91,390		
Imports	4.1	2.0	1.2	2.5	3.7	3.6	3.0	1.9	3.6		
	30,027	30,491	30,400	31,252	31,530	32,362	60,517	61,653	63,892		
Residual	404	496	529	106	95	95	899	635	190		
Domestic demand contribution	1.3	1.8	0.7	0.5	1.6	1.1	1.5	0.6	1.4		
Foreign demand contribution	0.8	0.8	1.0	0.8	0.3	0.1	0.8	0.9	0.1		
Nominal gross domestic expenditure (nominal GDP)	1.2	2.0	1.3	0.4	1.7	1.6	1.6	0.8	1.7		
	250,966	260,911	254,213	261,918	258,651	266,208	511,877	516,130	524,859		
Domestic demand	1.3	1.7	0.7	0.8	2.4	2.0	1.5	0.8	2.2		
	248,187	256,557	249,864	258,715	255,853	263,890	504,744	508,579	519,743		
Personal consumption	1.5	1.1	1.1	1.6	2.3	1.9	1.3	1.4	2.1		
	144,421	146,955	146,031	149,334	149,398	152,103	291,375	295,364	301,501		
Housing investment	2.6	2.2	5.3	13.8	3.0	5.4	2.4	9.5	4.2		
	9,384	9,444	8,889	8,143	9,158	8,586	18,828	17,031	17,744		
Capital investment	4.6	7.7	1.3	2.7	5.3	4.0	6.2	2.0	4.6		
	38,543	42,437	39,027	43,575	41,081	45,310	80,981	82,603	86,391		
Private inventory investment											
	2,786	488	2,679	400	2,500	1,000	2,297	2,279	1,500		
Public inventory investment											
	107	94	105	5	11	17	201	109	6		
Government consumption	0.9	0.5	0.4	1.4	1.9	1.9	0.7	0.9	1.9		
	44,410	45,502	44,572	46,132	45,429	47,013	89,912	90,704	92,442		
Government investment	10.4	6.3	0.3	5.4	3.1	0.6	8.0	3.1	1.6		
	8,536	12,613	8,563	11,926	8,299	11,860	21,149	20,489	20,159		
Foreign demand											
	2,779	4,354	4,349	3,202	2,798	2,318	7,134	7,551	5,116		
Exports	14.1	10.1	11.7	4.8	1.1	0.5	12.0	8.1	0.8		
	40,534	43,355	45,291	45,432	45,779	45,646	83,889	90,724	91,426		
Imports	16.6	8.3	8.4	8.3	5.0	2.6	12.2	8.4	3.8		
	37,755	39,001	40,943	42,230	42,982	43,328	76,756	83,173	86,310		
Industrial production index (2000 = 100)	5.1	4.5	2.6	3.7	2.6	2.0	4.8	3.2	2.3		
	104.9	109.1	107.6	113.2	110.4	115.4	107.0	110.4	112.9		
Corporate goods price index (domestic) (2000 = 100)	3.3	2.3	2.2	1.8	2.5	2.6	2.8	2.0	2.5		
	101.1	101.4	103.3	103.2	105.9	105.8	101.2	103.2	105.8		
Corporate service price index (2000 = 100)	0.1	0.3	1.3	0.7	1.1	0.8	0.1	1.0	0.9		
	93.0	93.6	94.2	94.3	95.2	95.0	93.3	94.2	95.1		
Consumer price index (2005 = 100)	0.4	0.1	0.1	0.7	1.1	0.9	0.3	0.3	1.0		
	100.5	100.1	100.3	100.8	101.5	101.8	100.3	100.6	101.6		
Trade balance as proportion of nominal GDP	1.8	2.3	2.5	2.0	1.9	1.7	2.0	2.2	1.8		
	4,488	5,996	6,321	5,159	4,865	4,445	10,484	11,481	9,310		
Current account as proportion of nominal GDP	3.7	4.6	4.9	4.2	4.6	4.3	4.1	4.5	4.5		
	9,266	11,887	12,424	10,925	11,839	11,540	21,154	23,350	23,378		
Yen exchange rate (yen/dollar)	115.3	118.6	119.3	110.0	105.0	105.0	117.0	115.0	105.0		
(yen/euro)	146.0	148.1	148.1	156.6	160.0	160.0	147.0	152.0	160.0		
Crude oil price (CIF US\$/barrel)	29.0	1.7	0.0	35.2	17.8	0.0	14.6	16.4	8.2		
	67.9	59.2	67.9	80.0	80.0	80.0	63.5	73.9	80.0		

Source: Compiled by HRI from Cabinet Office, *System of National Accounts*, and other sources. Forecasts by HRI.

Table 2 World economic overview

Region	Calendar year		Real GDP growth rate (%)					
	Nominal GDP (2005) (US\$ billion)	Share (%)	2003 (actual)	2004 (actual)	2005 (actual)	2006 (forecast)	2007 (forecast)	2008 (forecast)
World total	44,118.0	100.0	2.6	4.0	3.4	3.9	3.7	3.1
(excluding Japan)	39,560.9	89.7	2.7	4.2	3.6	4.1	3.9	3.3
Developed countries	33,619.8	76.2	1.8	3.1	2.5	2.9	2.4	2.1
U.S.	12,433.9	28.2	2.5	3.9	3.2	2.9	2.0	1.8
Japan	4,557.1	10.3	1.4	2.7	1.9	2.2	1.9	1.6
Western Europe	14,671.8	33.3	1.3	2.5	2.0	3.2	2.9	2.4
EU	13,618.4	30.9	1.3	2.3	1.8	3.1	2.8	2.3
Germany	2,796.2	6.3	0.2	0.8	1.1	3.1	2.8	2.2
U.K.	2,246.3	5.1	2.7	3.3	1.9	2.8	2.6	2.0
France	2,137.5	4.8	1.1	2.0	1.2	2.2	2.0	2.1
Italy	1,772.8	4.0	0.1	1.0	0.2	1.9	1.7	1.4
Canada	1,135.5	2.6	1.8	3.3	2.9	2.8	2.6	2.0
Australia	712.6	1.6	3.1	3.7	2.8	2.7	4.0	3.3
New Zealand	108.8	0.2	3.3	4.5	2.2	1.9	2.7	2.8
Developing countries/regions	9,368.5	21.2	5.1	7.1	6.5	7.1	7.3	6.0
Asia	5,319.0	12.1	7.0	8.0	7.9	8.4	8.7	6.6
China	2,243.7	5.1	10.0	10.1	10.4	11.1	11.9	8.0
NIEs	1,441.2	3.3	3.2	5.8	4.7	5.4	5.0	4.3
South Korea	791.6	1.8	3.1	4.7	4.2	5.0	4.9	3.6
Taiwan	355.2	0.8	3.4	6.1	4.0	4.7	4.4	4.7
Hong Kong	177.8	0.4	3.2	8.6	7.5	6.9	5.6	5.8
Singapore	116.7	0.3	3.1	8.8	6.6	7.9	6.8	5.0
ASEAN	745.8	1.7	5.6	6.0	5.4	5.6	5.8	5.6
Thailand	176.2	0.4	7.1	6.3	4.5	5.0	4.5	4.9
Malaysia	130.8	0.3	5.5	7.2	5.3	5.9	5.8	5.5
Philippines	98.7	0.2	4.9	6.2	5.0	5.4	6.3	5.2
Indonesia	287.0	0.7	4.8	5.0	5.7	5.5	6.1	5.6
South Asia	888.3	2.0	8.0	8.1	9.1	9.0	8.6	7.3
India	778.7	1.8	8.4	8.3	9.2	9.4	8.9	7.5
Latin America	2,216.6	5.0	1.3	6.1	4.1	5.7	5.1	4.7
Mexico	767.7	1.7	1.4	4.2	2.8	4.8	3.0	3.0
Brazil	882.0	2.0	0.5	5.7	2.9	5.3	5.7	5.3
Middle East	1,015.7	2.3	4.5	6.9	6.3	4.2	5.6	5.3
Africa	817.3	1.9	4.8	5.1	5.0	5.5	5.9	5.8
South Africa	241.9	0.5	3.1	4.8	5.1	5.0	4.8	5.0
Former Soviet Union and Eastern Europe	1,129.7	2.6	7.6	8.2	6.8	8.1	8.1	7.3
Russia	764.1	1.7	7.3	7.2	6.4	6.7	6.5	6.4
Eastern Europe	126.1	0.3	5.0	7.9	4.4	7.4	6.4	6.0
(Reference)								
North America	14,337.1	32.5	2.4	3.9	3.2	3.0	2.1	1.9
Europe (including former Soviet Union)	15,801.5	35.8	1.7	2.8	2.3	3.5	3.3	2.8
China + Hong Kong	2,421.5	5.5	9.5	10.0	10.2	10.8	11.5	7.9
BRICs	4,668.5	10.6	7.2	8.4	8.1	9.0	9.4	7.2

Source: Compiled by HRI from various sources. Forecasts by HRI.