

The Current Economic Situation

- Private sector demand-led growth pattern firmly established under the Koizumi Administration
- Improving corporate profits → The reduction of debt

The Three Excesses of the Past

(1) Excess Debts

- Liability to sales ratio has improved to the pre-bubble period levels for manufacturing industries but remains high for non-manufacturing industries

(2) Excess Capacity

- Receding excessiveness in capacity. Capital coefficient has slowed down.

(3) Excess Employment

- Labor share falls in large manufacturing enterprises but remains high in others

Challenges for Future Competitiveness

(1) Aging of equipment resulting from insufficient new investment

(Improved corporate profits were appropriated for repayment of past debts instead of for business investment)

→ Introduction of bold IT and R&D investment tax reductions

(2) Reduction in human resources investment by enterprises

→ Introduction of the policy package for fostering youth

Industrial Revitalization

- **Finally advanced from the stage of cost cuts to the stage of full-fledged structural reform. This process is accelerated through policy measures.**
- **Start-ups (10,000 enterprises established per year under the deregulation of the minimum capital requirement)**

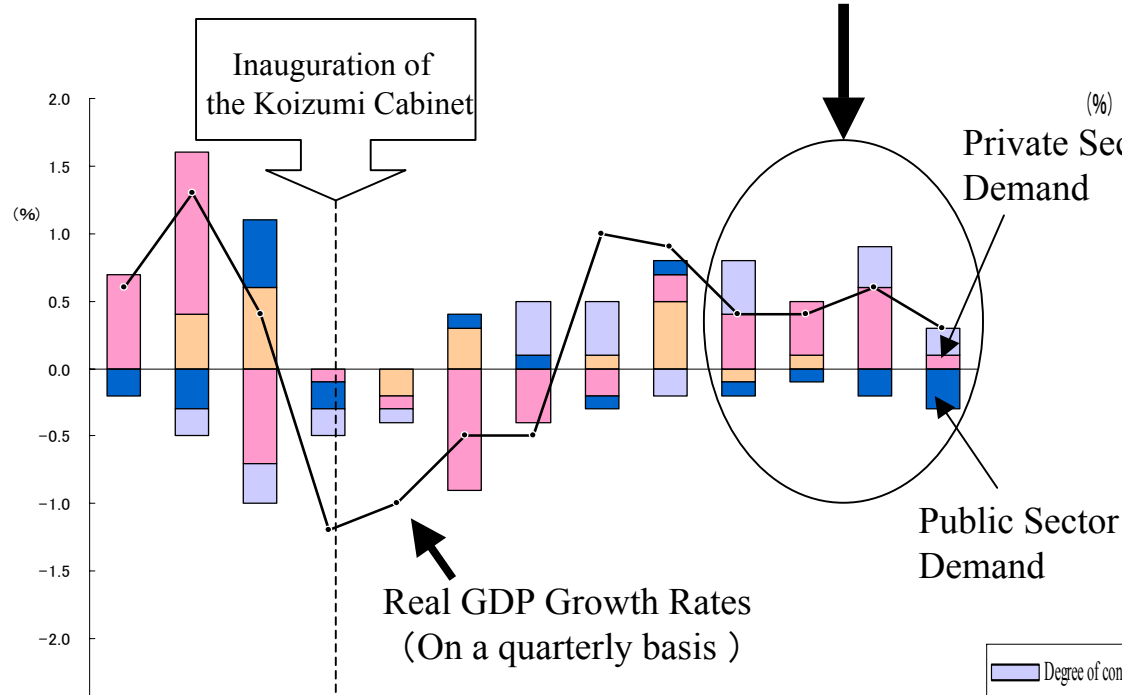
The Issue of Financing

- **Steady progress in the disposal of non-performing loans**
- **Introduction of the policy package for strengthening industrial finance functions**

The Current Economic Situation

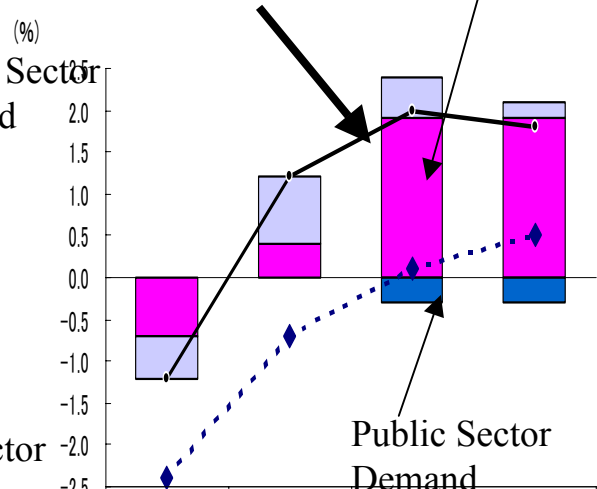
Private sector demand-led growth pattern firmly established under the Koizumi administration

Negative public demand and positive private demand for four consecutive quarters



Private Sector Demand

Real GDP Growth Rates (On a fiscal year basis)



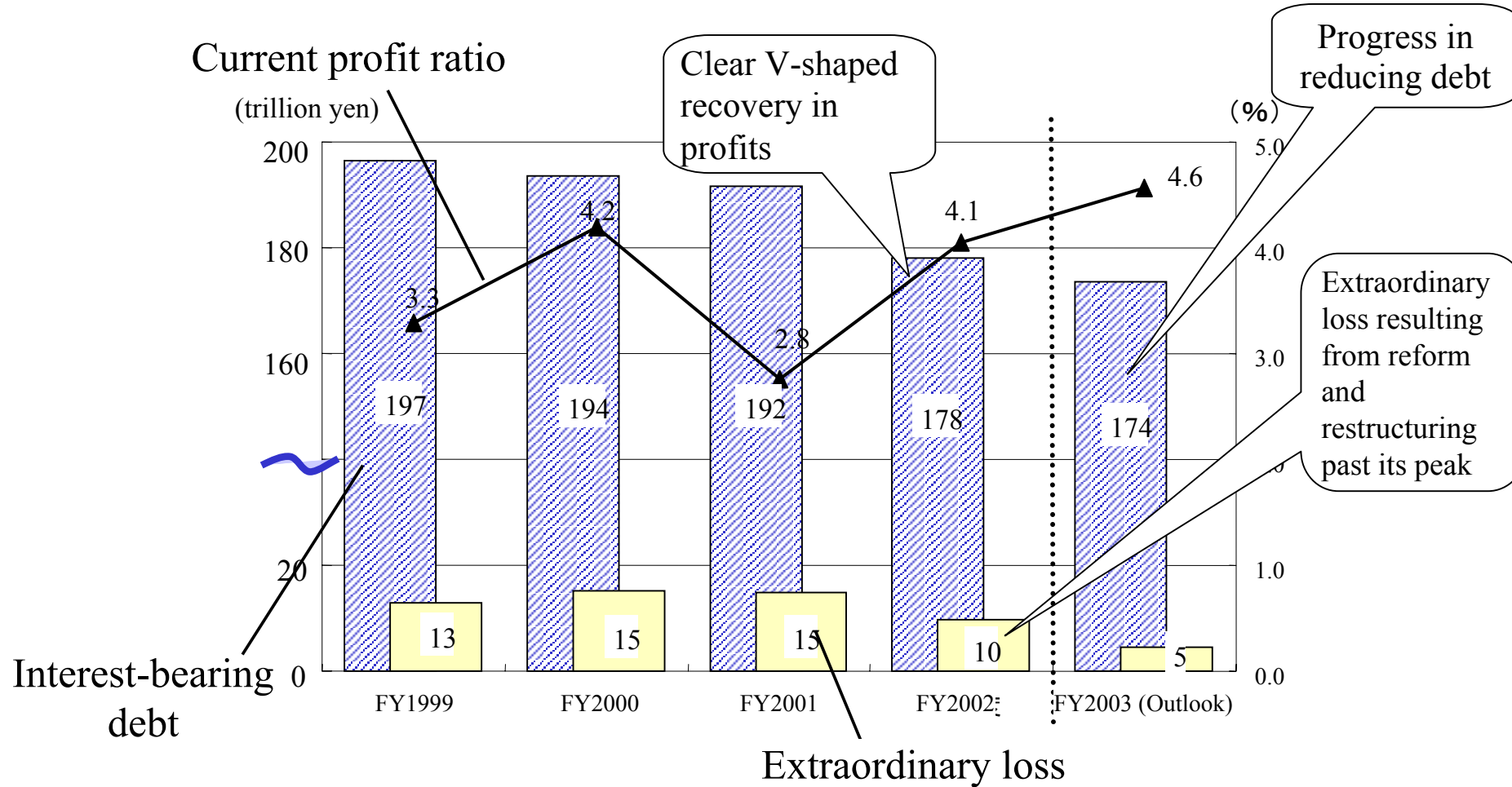
	2000/7-9	00/10-12	01/1-3	01/4-6	01/7-9	01/10-12	02/1-3	02/4-6	02/7-9	02/10-12	03/1-3	03/4-6	03/7-9
Degree of contribution of external exports	0.0	-0.2	-0.3	-0.2	-0.1	0.0	0.4	0.4	-0.2	0.4	0.0	0.3	0.2
Degree of contribution of public demand	-0.2	-0.3	0.5	-0.2	0.0	0.1	0.1	-0.1	0.1	-0.1	-0.1	-0.2	-0.3
Degree of contribution of private demand (capital investment)	0.7	1.2	-0.7	-0.1	-0.1	-0.9	-0.4	-0.2	0.2	0.4	0.4	0.6	0.1
Degree of contribution of private demand (consumption)	0.0	0.4	0.6	0.0	-0.2	0.3	0.0	0.1	0.5	-0.1	0.1	0.0	0.0
GDP	0.6	1.3	0.4	-1.2	-1.0	-0.5	-0.5	1.0	0.9	0.4	0.4	0.6	0.3

	FY2001	FY2002	FY2003 (Expected results)	FY2004 (Outlook)
Degree of contribution of external exports	-0.5	0.8	0.5	0.2
Degree of contribution of public demand	0.0	0.0	-0.3	-0.3
Degree of contribution of private demand	-0.7	0.4	1.9	1.9
Real GDP	-1.2	1.2	2.0	1.8
Nominal GDP	-2.4	-0.7	0.1	0.5

Excess debts (1)

Improving Corporate Profits / Reduction of Debt

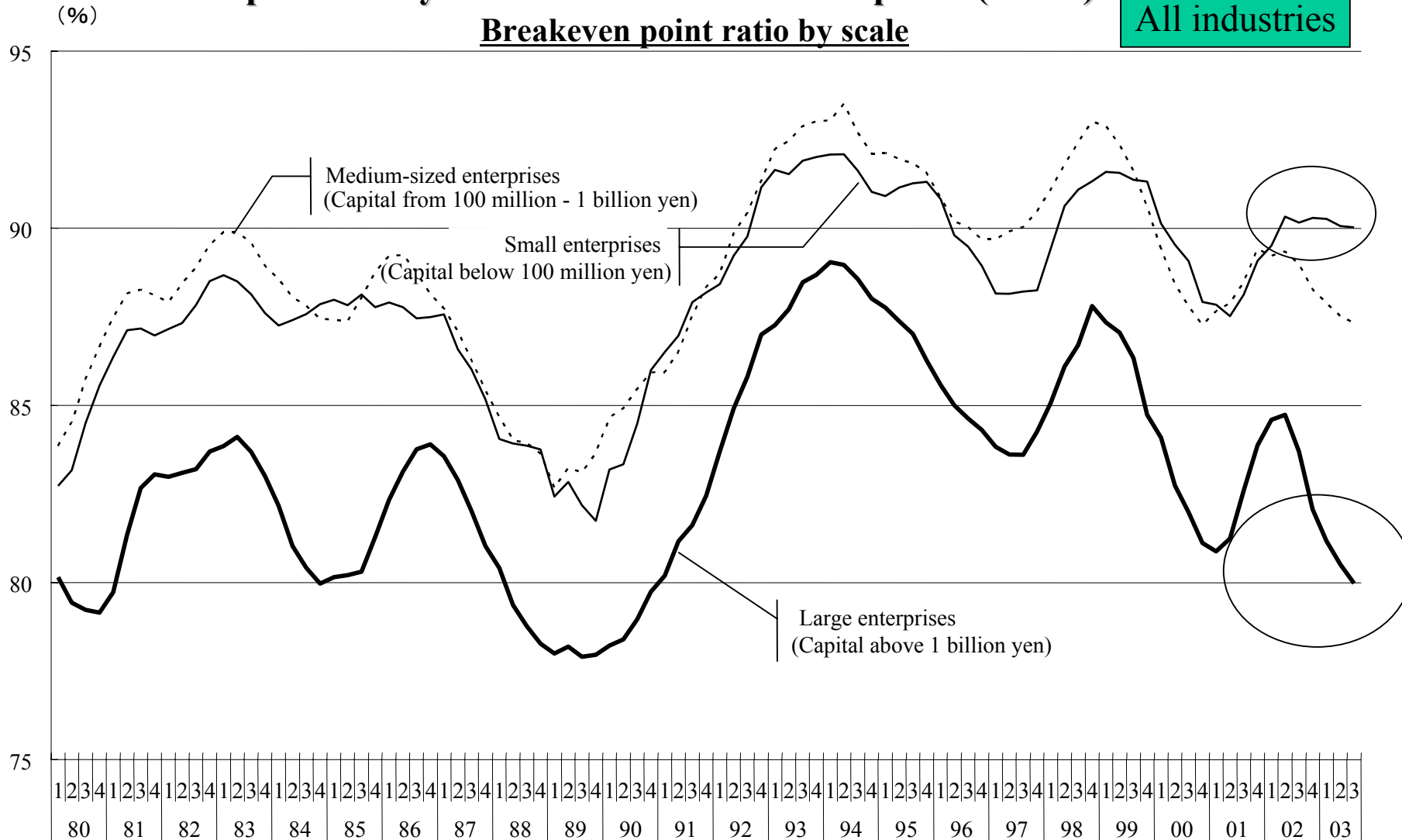
(The trend for profit increase continues at FY2003 interim closing)



Excess debts (2) – Profit structure

Rapid and drastic improvement of the profit structure of large enterprises; still low profitability of small and medium enterprises (SMEs)

All industries



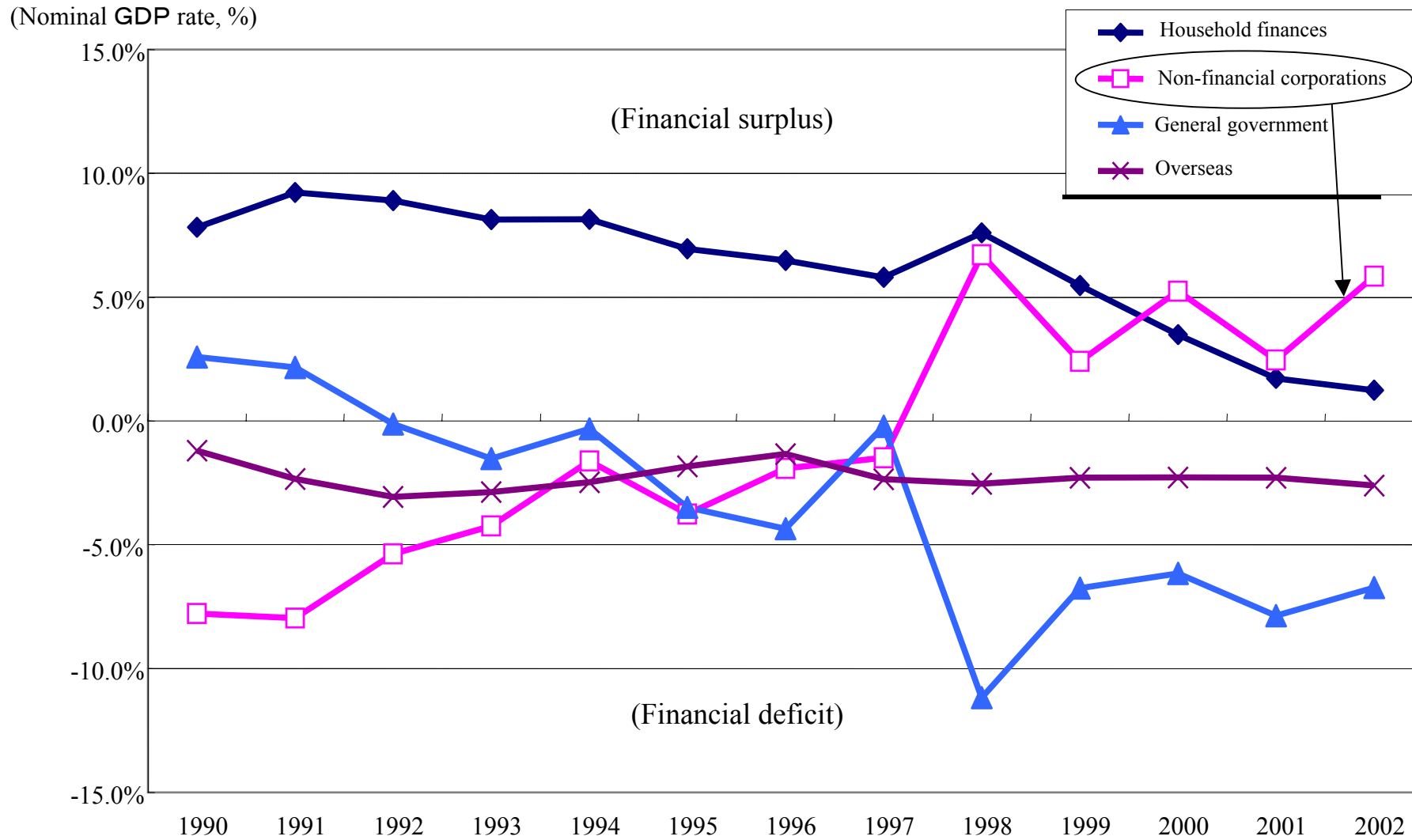
Breakeven point ratio = $\left[\frac{\text{fixed costs}}{\text{sales volume} - \text{variable costs}} \right] \times 100$
 Fixed costs = personnel costs + depreciation costs + interest cost, commission
 Variable costs = sales volume - current profits - fixed costs

Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly.*

Excess debts (3)

Corporate sector is now a supplier of funds

Trends in the financial surplus or deficit by sector



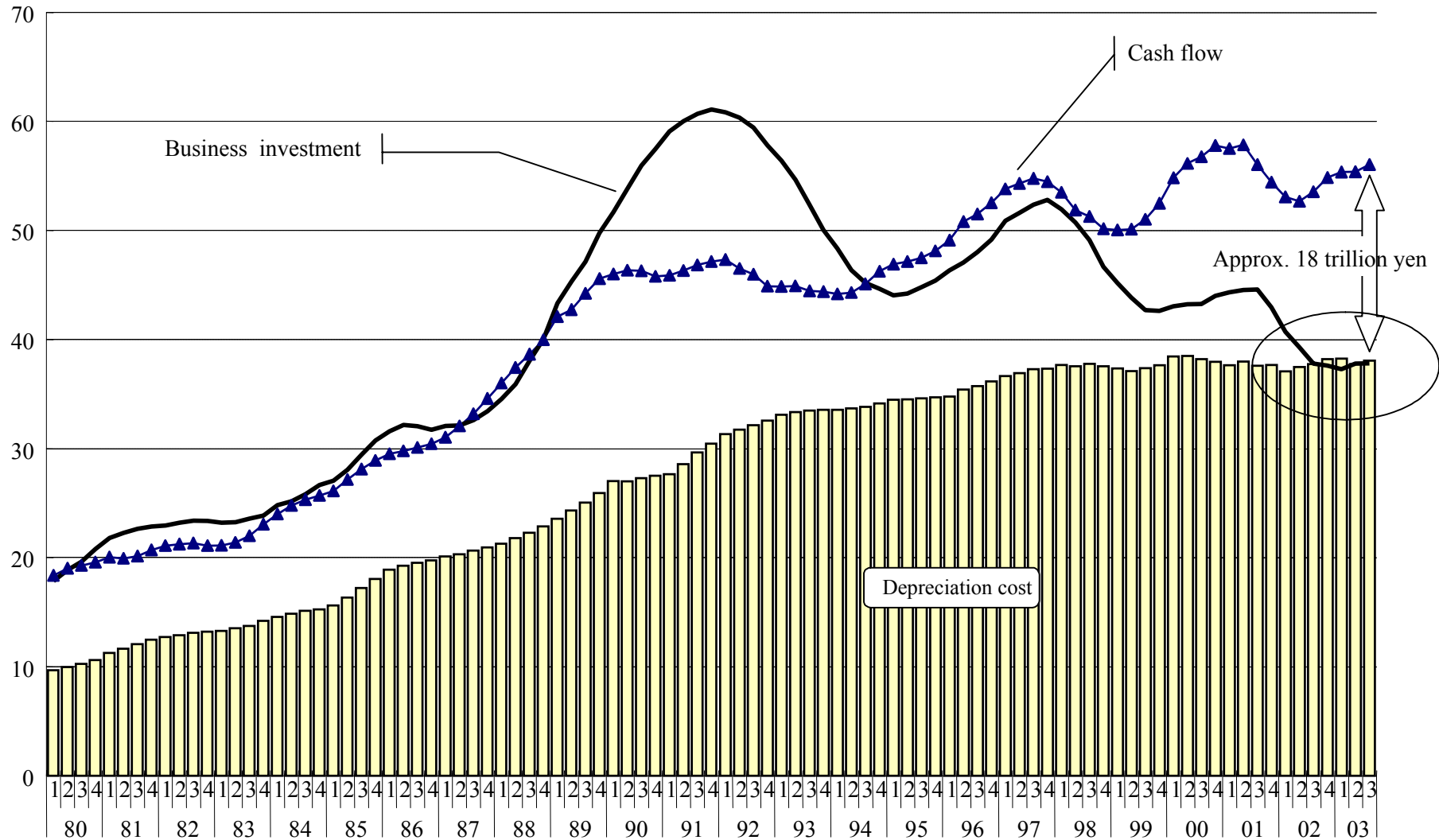
Source: Bank of Japan, *Flow of Funds Statistics*.

Excess debts (4)

Improvement in corporate profits appropriated for repayment of past debts instead of for business investment

(trillion yen)

Cash flow and business investment

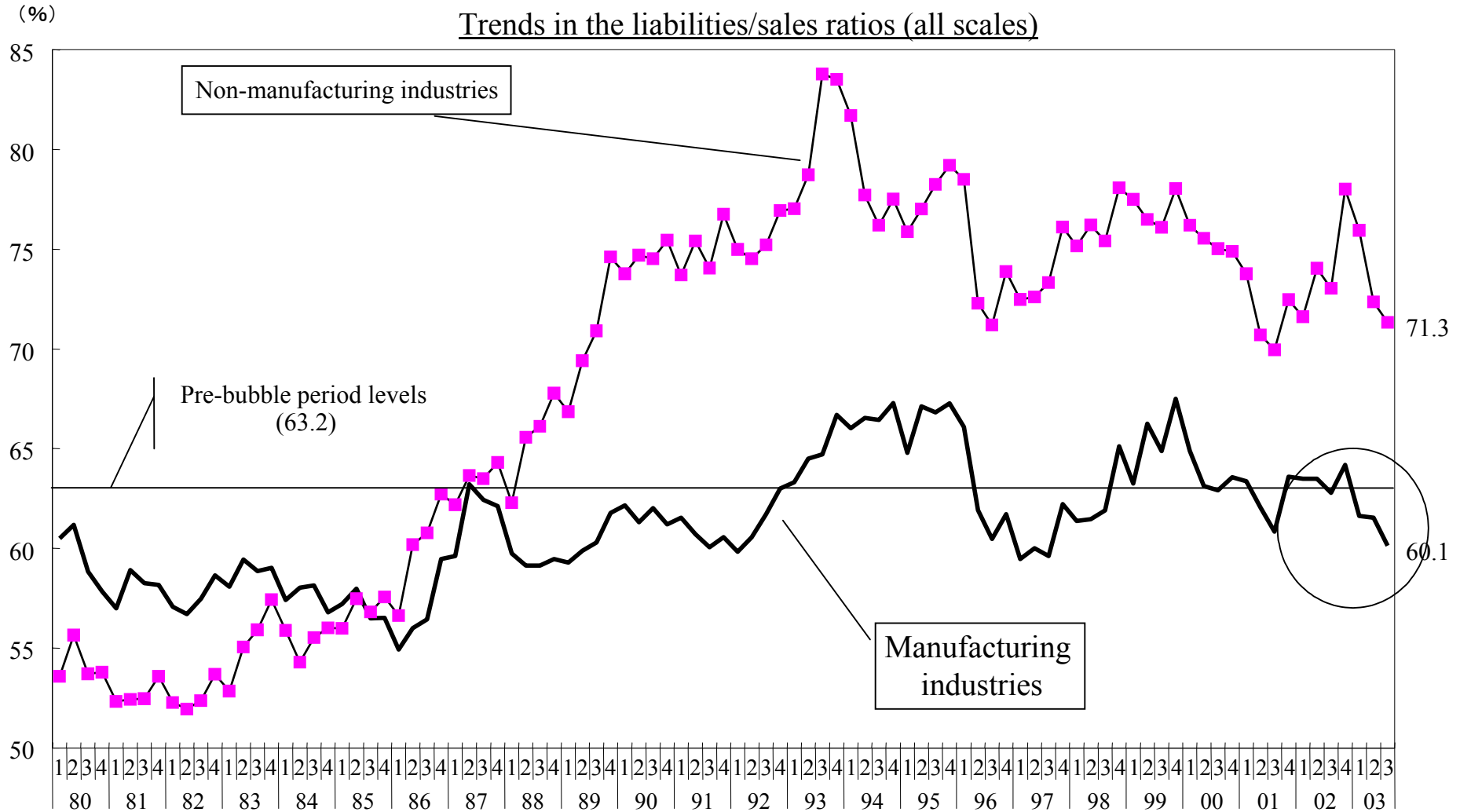


Cash flow = current profits * 0.5 + depreciation cost

Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly.*

Excess debts (5)

Liability to sales ratio has improved to the pre-bubble period levels for manufacturing industries but still remains high for non-manufacturing industries

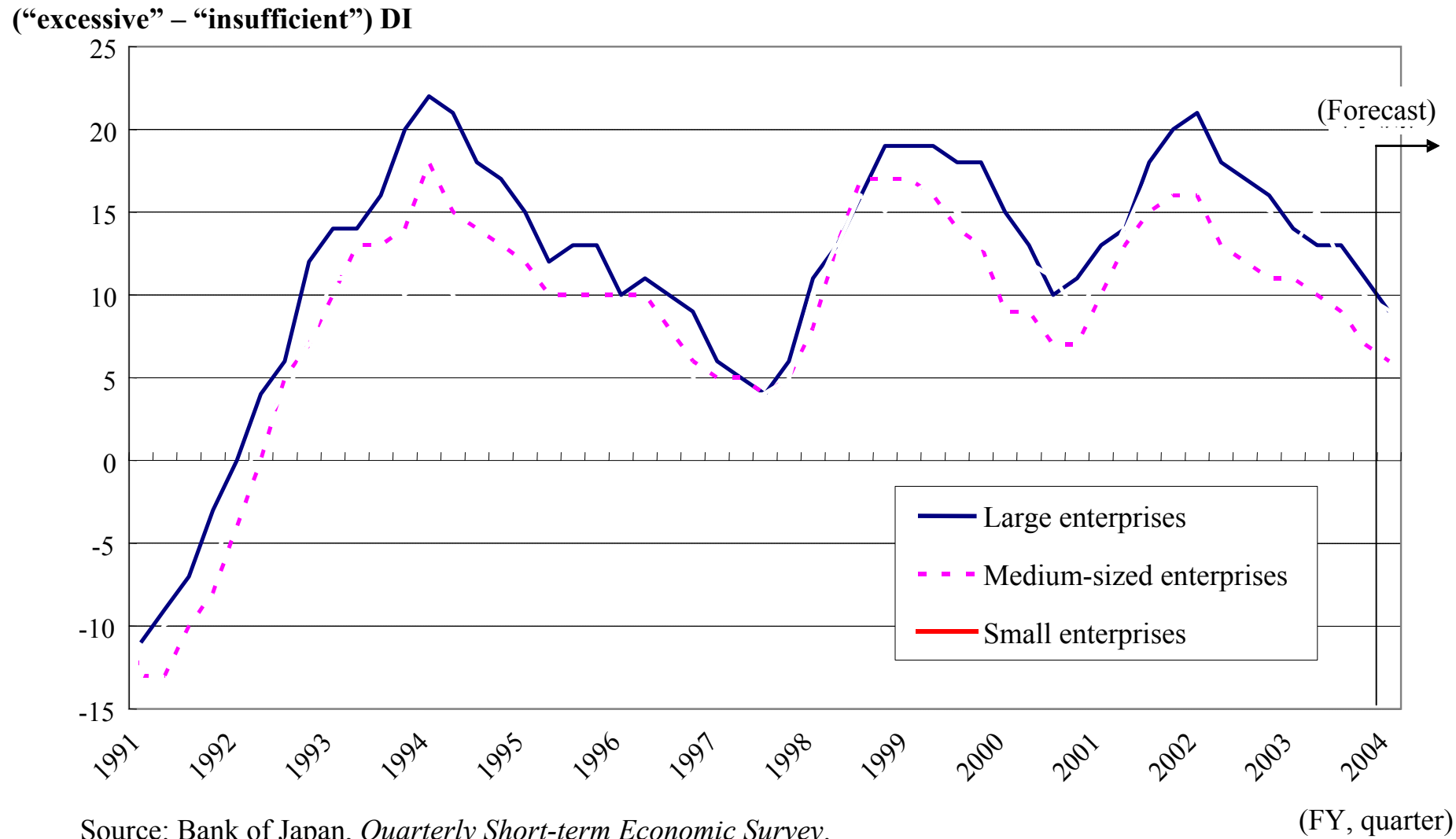


Liability to sales ratio = liabilities / sales volume (total for four quarters)
 Liabilities = floating liabilities + fixed liabilities

Source: Ministry of Finance,
 Financial Statements Statistics of Corporations by Industry, Quarterly.

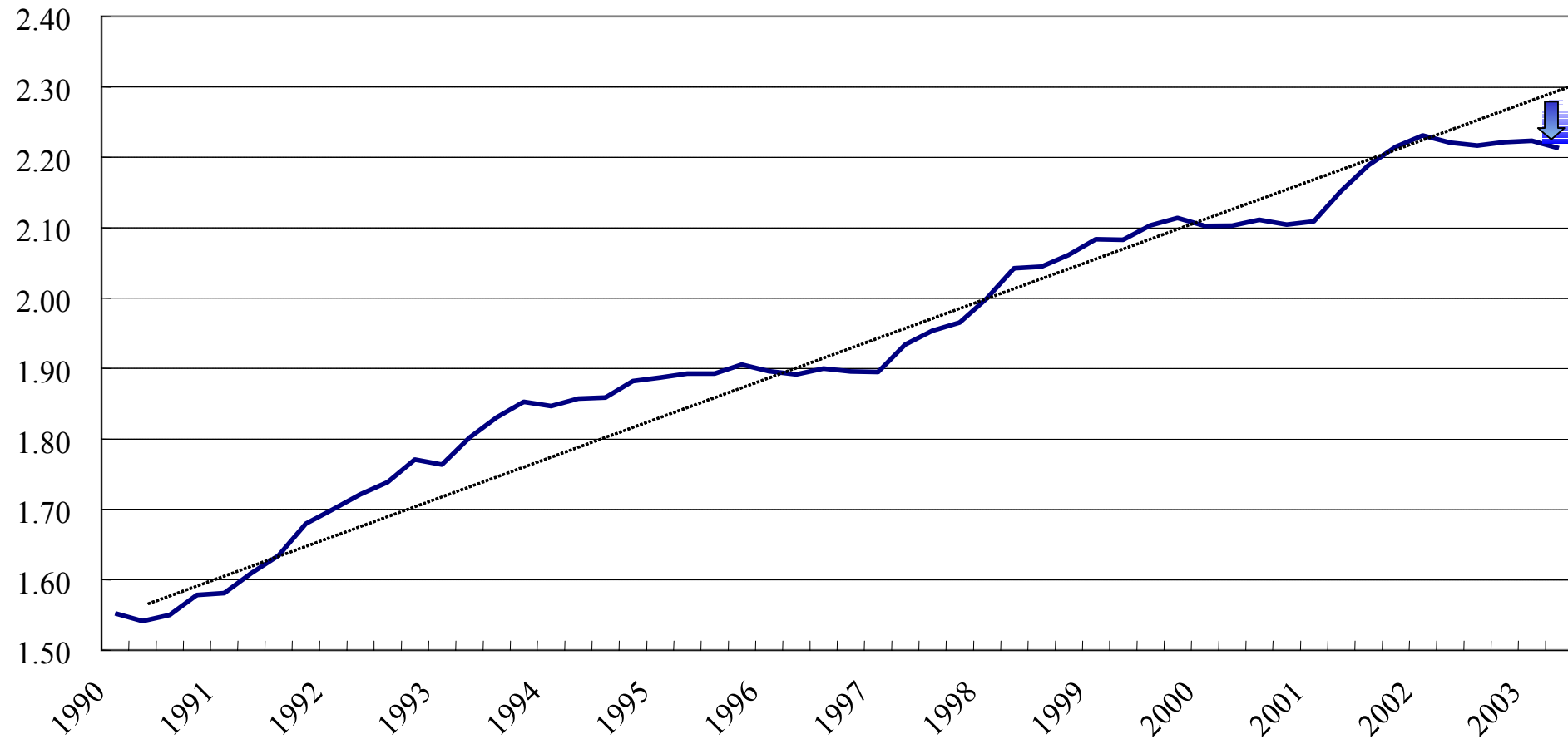
Excess capacity (1)

Receding sense of excessiveness in capacity



Excess capacity (2)

Recent slowdown in the rising trend of the capital coefficient (real capital stock / real GDP)



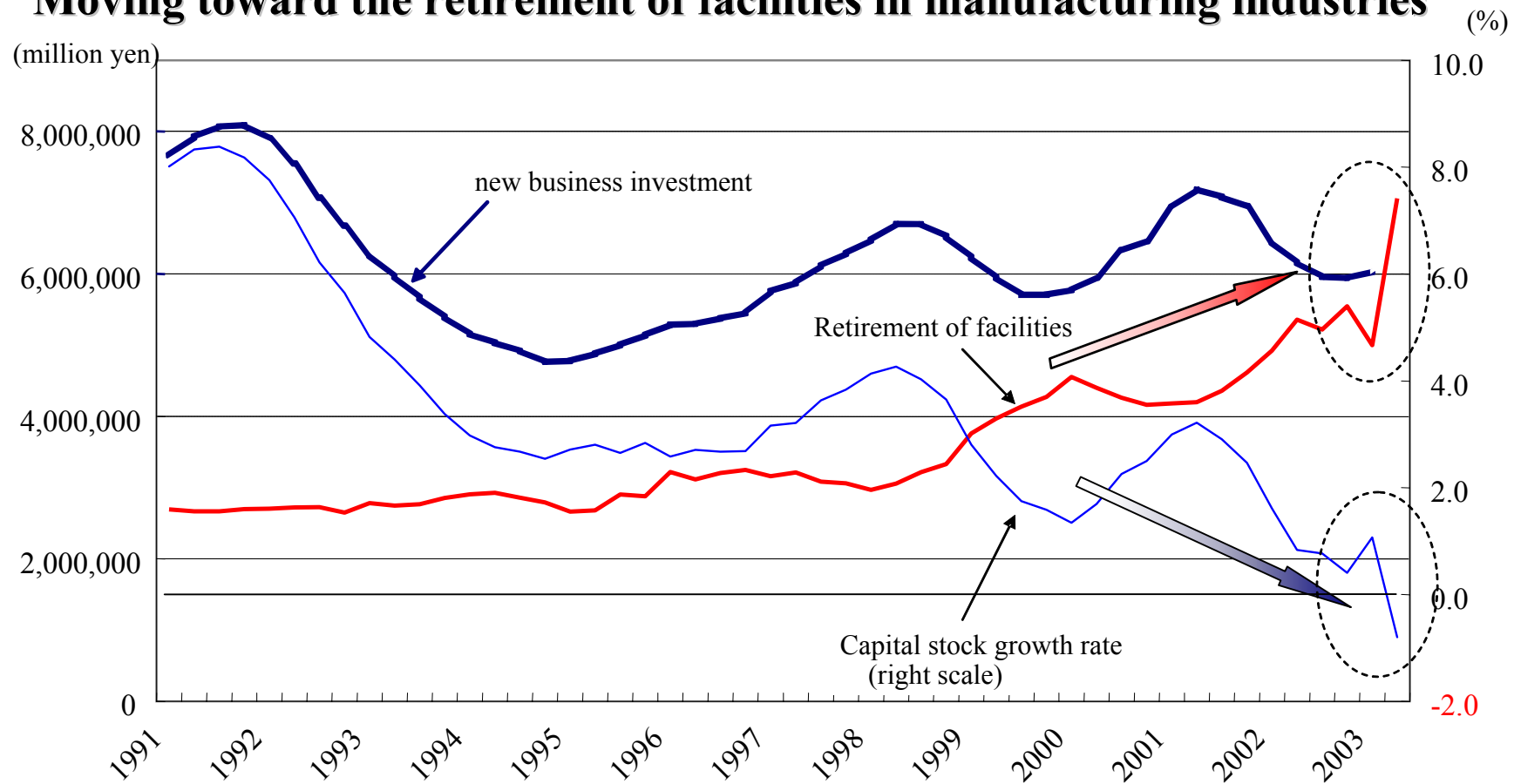
Source: Cabinet Office, "Gross Capital Stock of Private Enterprises" and "National Accounts".

Note: Capital coefficient = real capital stock/real GDP

(FY, quarter)

Excess capacity (3)

Moving toward the retirement of facilities in manufacturing industries



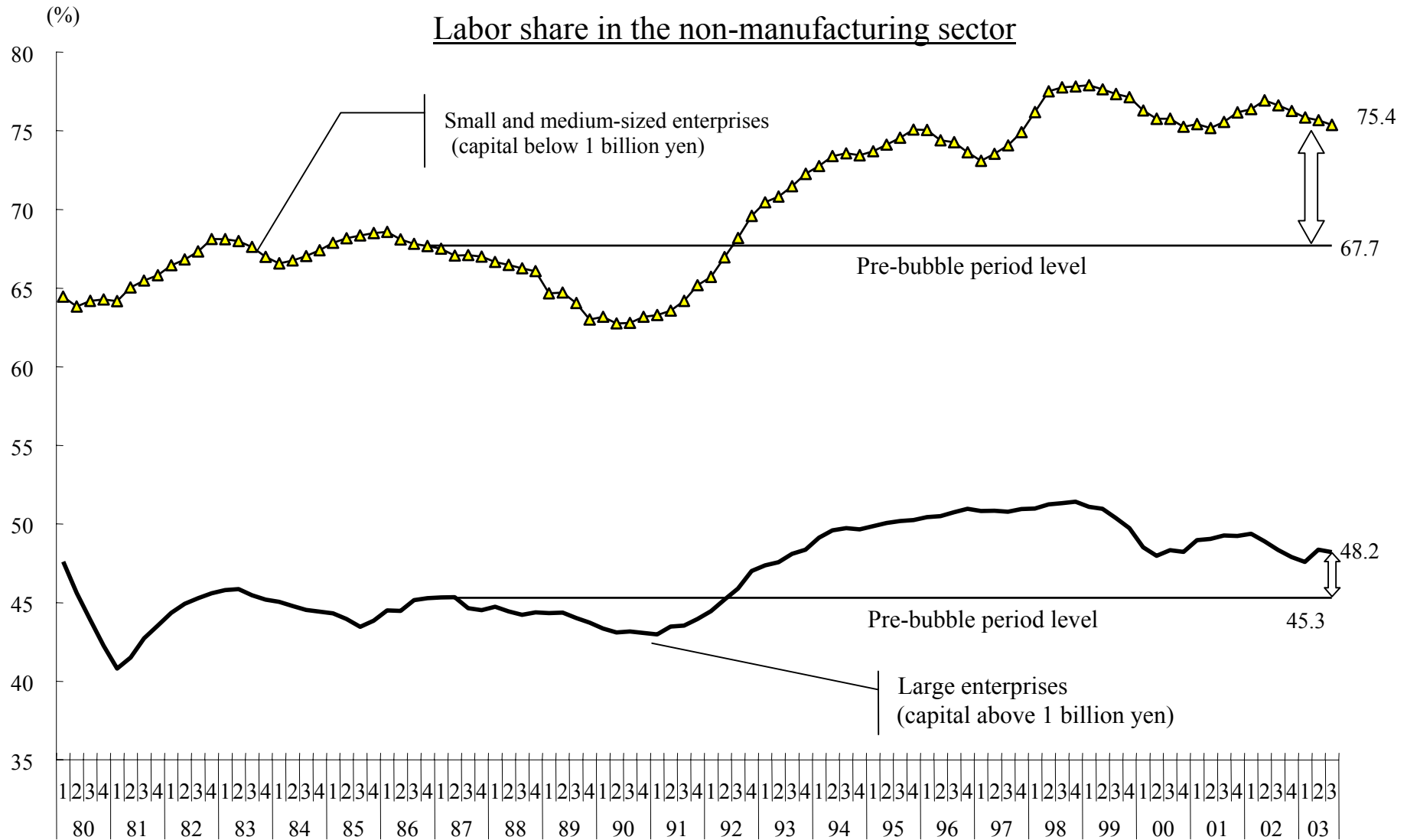
Source: Cabinet Office, *Gross Capital Stock of Private Enterprises*.

【Specific examples】

- Nissan Motor Co., Ltd.: Closed the Murayama Plant in 2000 (book value: 29.6 billion yen).
- Nippon Unipac Holding: Established through a merger of Nippon Paper Industries Co., Ltd. and Daishowa Paper Industries, plans to retire nearly 10% of its facilities by 2005.
- JFE Holdings: Plans to close two of its shaft furnaces by 2005.

Excess employment (2)

Labor share remains high in non-manufacturing industries



Labor share = personnel cost ÷ (current profit + personnel cost + depreciation cost + interest cost, commission)

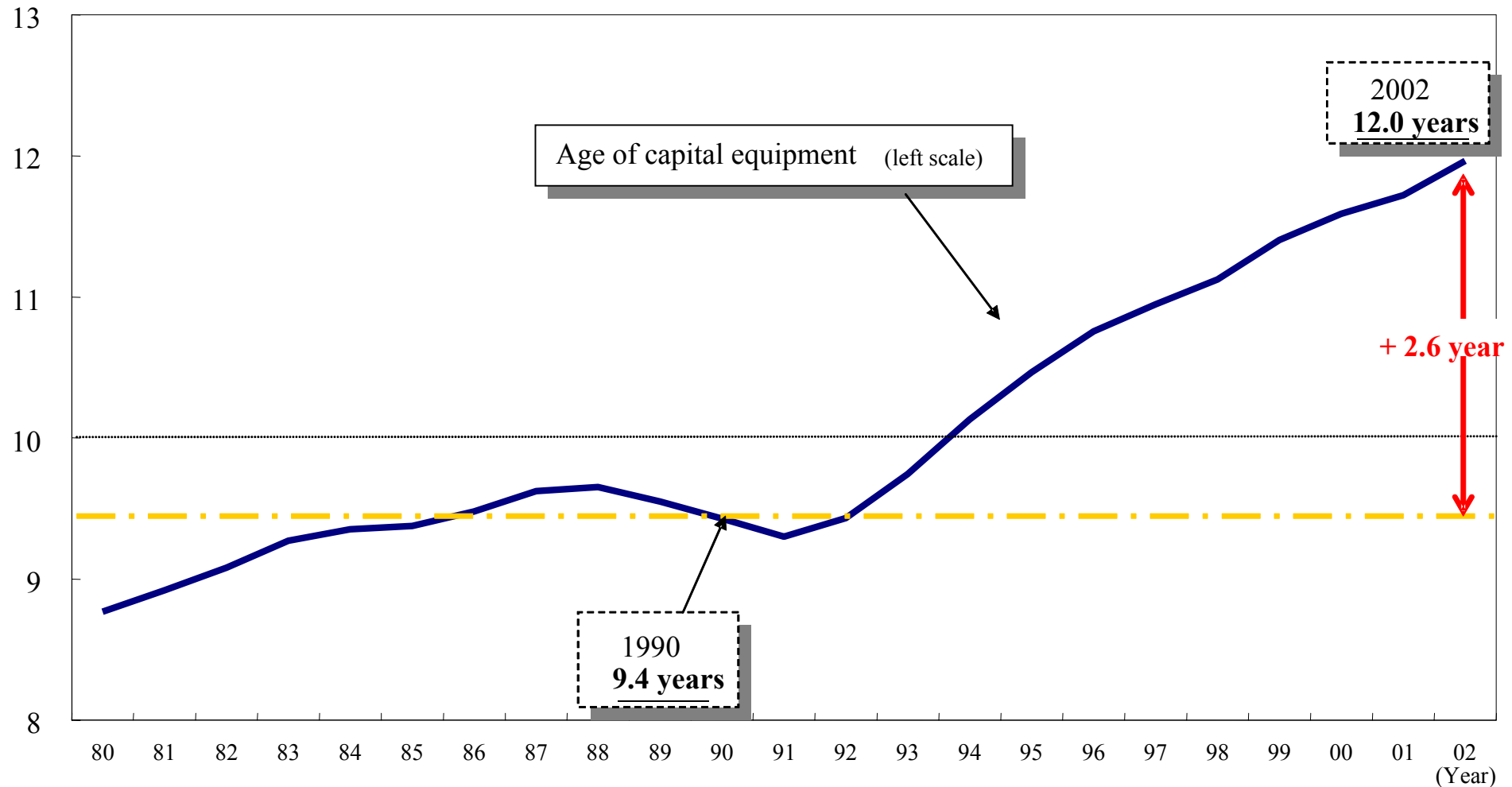
Source: Ministry of Finance, *Financial Statements Statistics of Corporations by Industry, Quarterly*.

Challenges for future competitiveness (1)

Aging of equipment resulting from insufficient new investment

(Number of years)

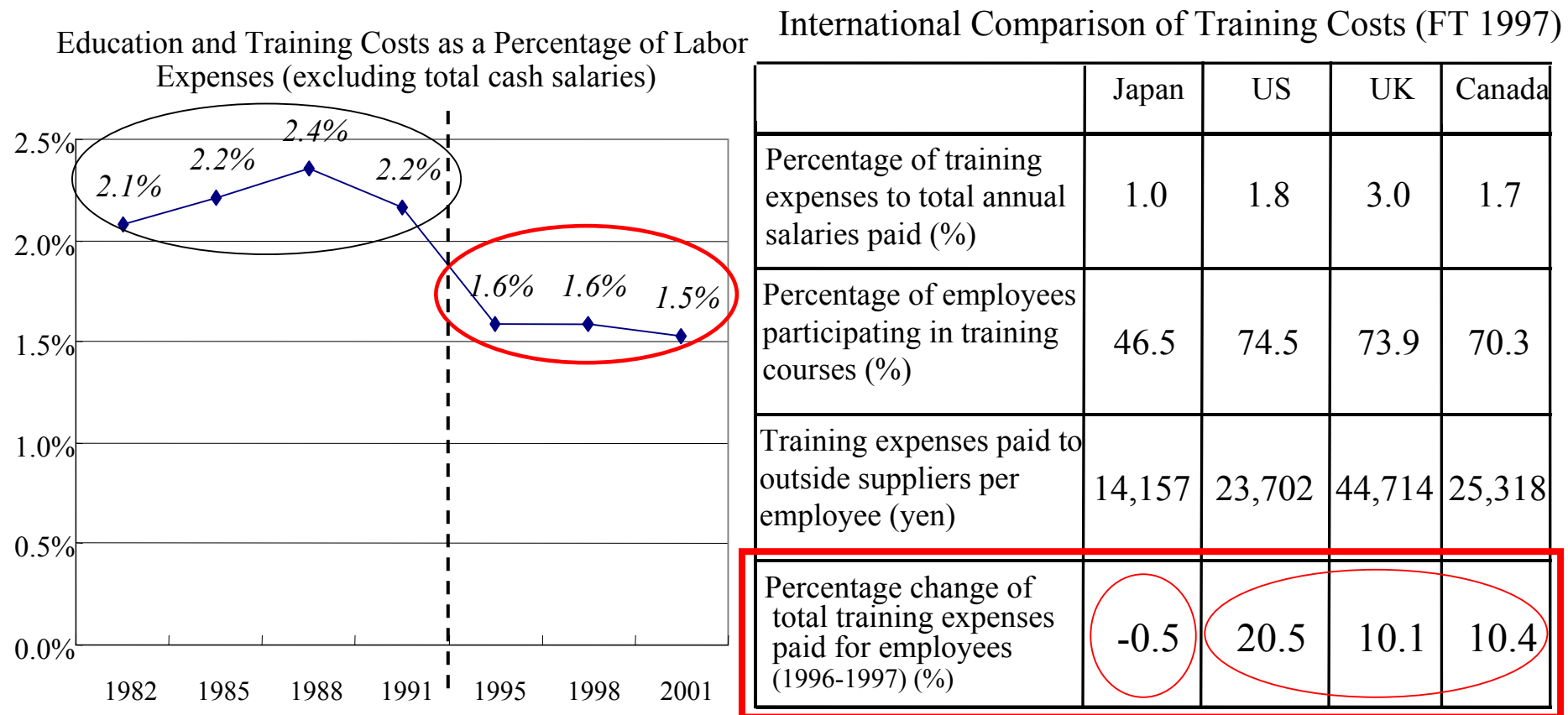
Age of equipment in manufacturing industries (on real basis)



- Notes: 1. Average age of equipment is based on the Cabinet Office's *Gross Capital Stock of Private Enterprises* and *1970 National Wealth Survey*.
 2. Average age = $\frac{(\text{average age of the previous period} + 1) \times (\text{capital stock at the end of the previous period} - \text{withdrawal amount of the current period}) + \text{amount of capital investment in the current period} \times 0.5}{\text{capital stock in the current period}}$
 3. The data before 1990 is based on 68SNA and the data after 1990 is based on 93SNA.

Challenges for future competitiveness (2)

-Japanese corporations are reducing investment in human resources development, whereas corporations in the US and Europe are expanding investment in this area.



Source: Ministry of Health, Labor and Welfare, *Comprehensive Survey of Wages and Working Hours*.

Source: Sanno University of Strategic Investment in New Human Resources- Evaluation and Measuring Results

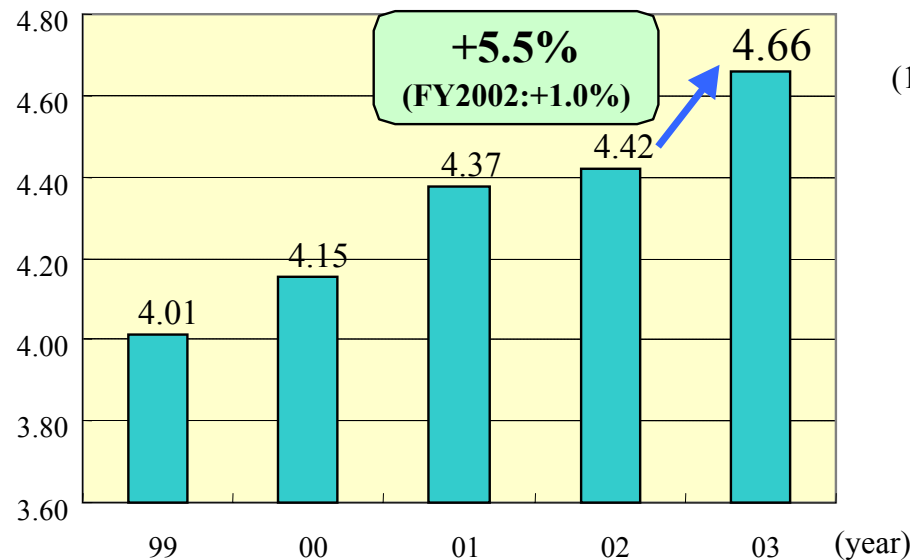
Challenges for future competitiveness (3)

IT / R&D investment promotion tax cut for future competitiveness

→ Increases in IT/ R&D investment at major companies

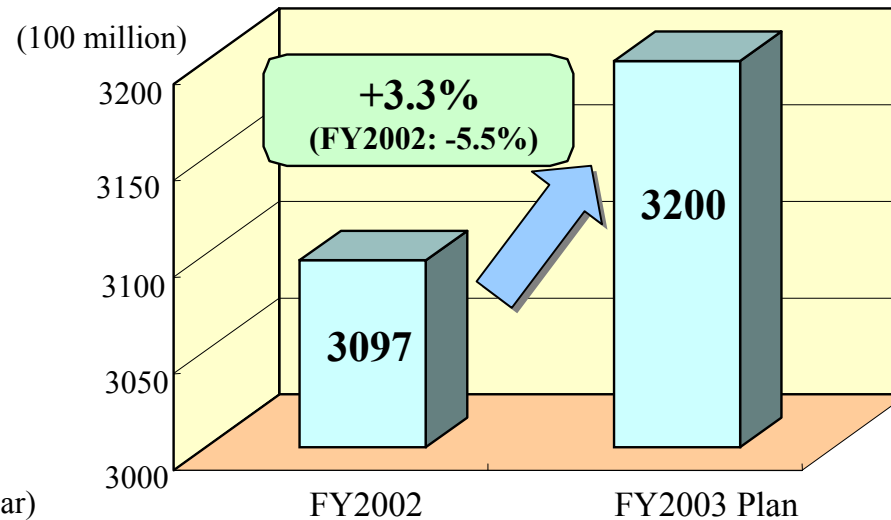
- Tax system to promote R&D and IT investment launched in FY2003
(1.2 billion yen (1 million \$))
 - R&D investment increases 5.5 % compared to previous year.
precision instrument (+13.4 %*), pharmaceuticals (+10.0%*)
 - In addition, IT investment increases 3.3% compared to previous year.
automobiles (+35%*) information processing (+20%*)
- *compared to previous year

(trillion yen) Trends in R&D investment (major 425 companies)



Source: Ministry of Economy, Trade, and Industry Survey

Trends in Information-related investment + Software Expenditure
(858 major companies capitalized at 100 mil. Yen or more)



Source: Ministry of Economy, Trade, and Industry survey

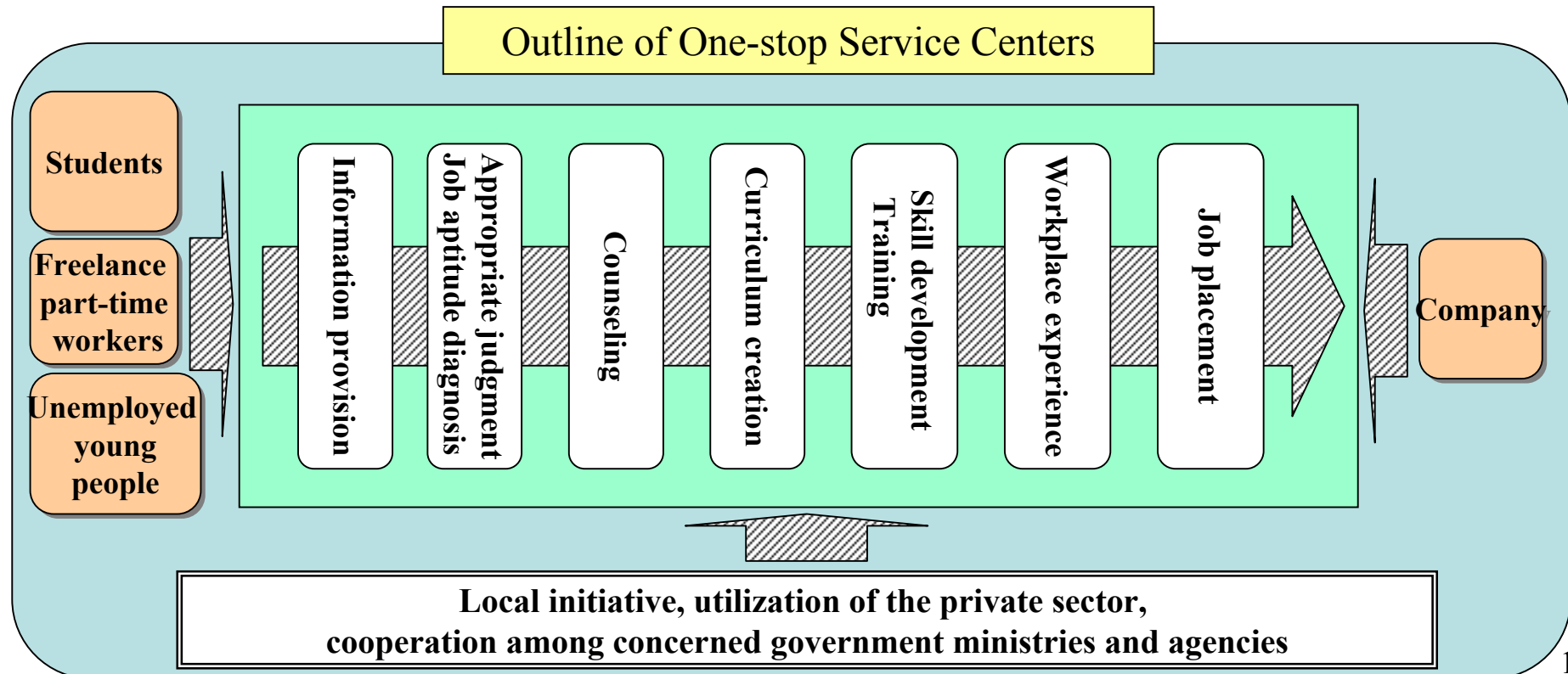
Challenges for future competitiveness (4)

Policy package for fostering youth

- Cooperation among METI, MEXT, MHLW and the Cabinet Office
- In the FY2004 government budget draft, 49.4 billion yen, an amount roughly twice larger than the allotment in the previous year was secured (11.3 billion yen for METI (ten times larger than the previous year)).

I. A new regional framework: Introduction of one-stop service centers for youth

- As a core of the policy package, set up one-stop service centers for youth, by integrating and closely coordinating the policy resources of three relevant Ministries.
 - METI will outsource, in approximately 10 model regions, programs that carefully and meticulously provide integrated services ranging from counseling to actual training, taking full advantage of the private sector.
- (FY2004 METI Budget Draft: 5.25 billion yen)**



II. Policies to enhance and strengthen education, human resources development, employment, and business start-ups

(1) Career development and job assistance from educational stage to work commitment

- Use workplace experience, internships, etc. to promote career education for students.
- Introduce Japanese edition of dual system (e.g., practical on-the-job training three days per week, educational training two days per week).

(2) Development of a youth labor market

- Implement short-term trial employment to encourage shift by youth to regular employment
- Set evaluation standards of abilities and skills for human resources in the field of IT, management of technology, and other specialized fields and develop curricula and educational materials.

(3) Improving abilities of young people

- Promote the establishment of law schools, business schools and other graduate schools for professionals
- Support universities for outstanding reform of educational programs.

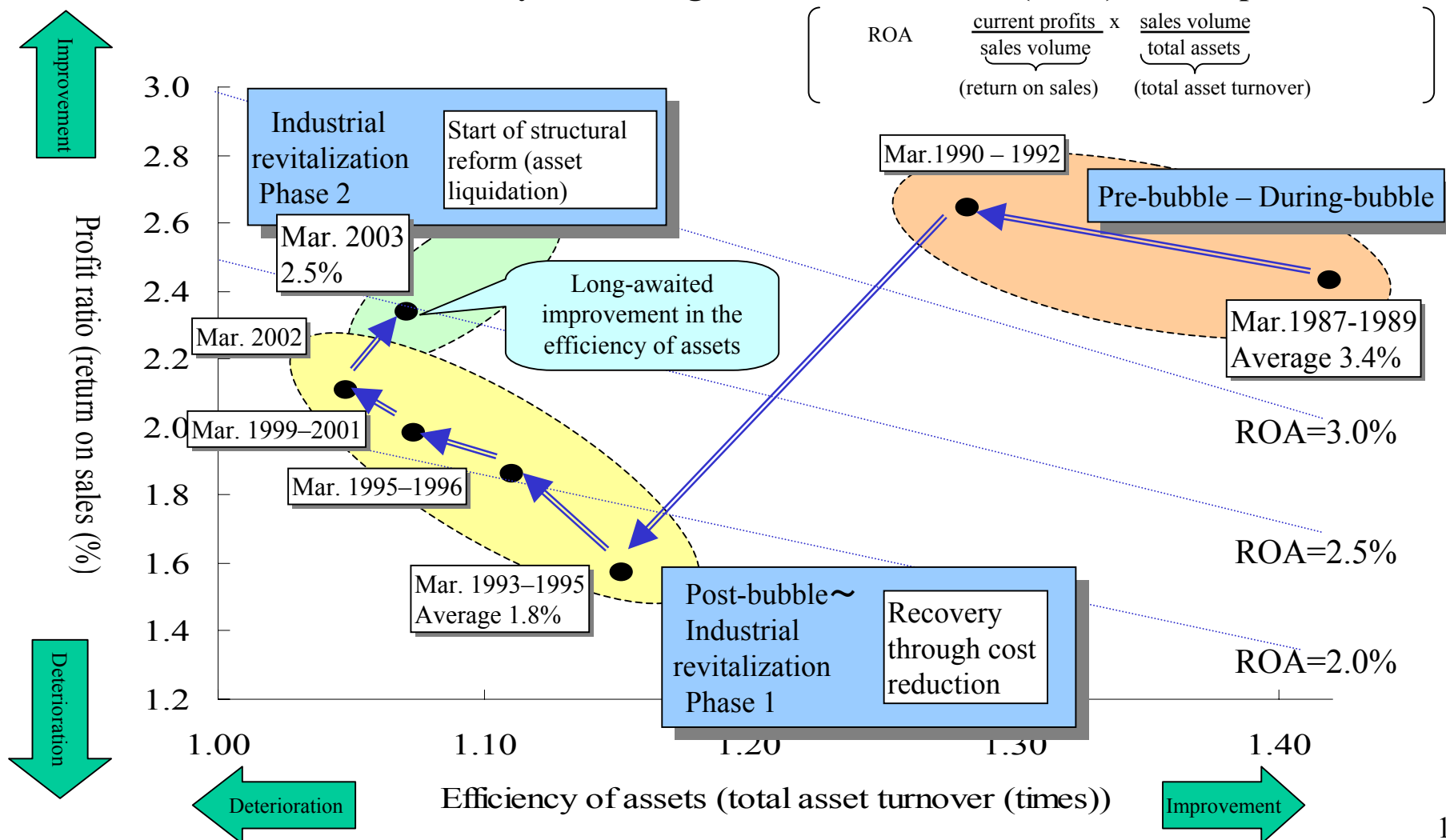
(4) Create employment opportunities for young people through new businesses start ups

Corporate reform – industrial revitalization(1)

Industrial Revitalization into the Stage of Full-fledged Structural Reform

- Return on assets of enterprises has finally advanced from the stage of recovery through cost reduction (Phase 1) to the stage of full-fledged structural reform associated with liquidation of assets (Phase 2). This process is accelerated through policy measures.

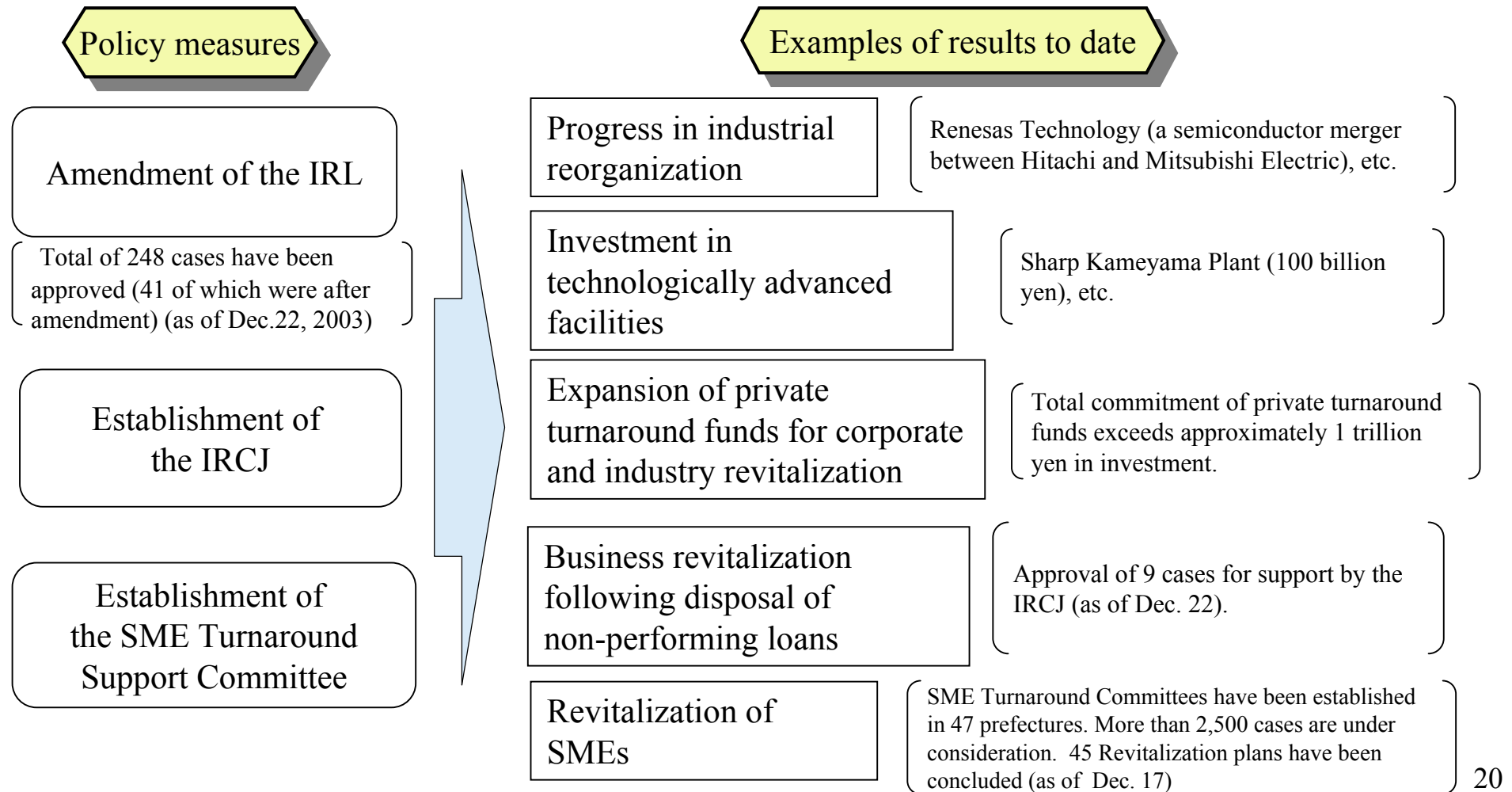
Factor analysis of changes in return on assets (ROA) of enterprises



Corporate reform – industrial revitalization(2)

Progress of Industrial Revitalization

- Industrial revival in Japan has begun to make concrete progress with the effect of policy measures such as the amendment of the Industrial Revitalization Law (IRL), the establishment of the Industrial Revitalization Corporation of Japan (IRCJ) and of the SME Turnaround Support Committee.
- It is now necessary to further accelerate these moves by making further use of these measures.

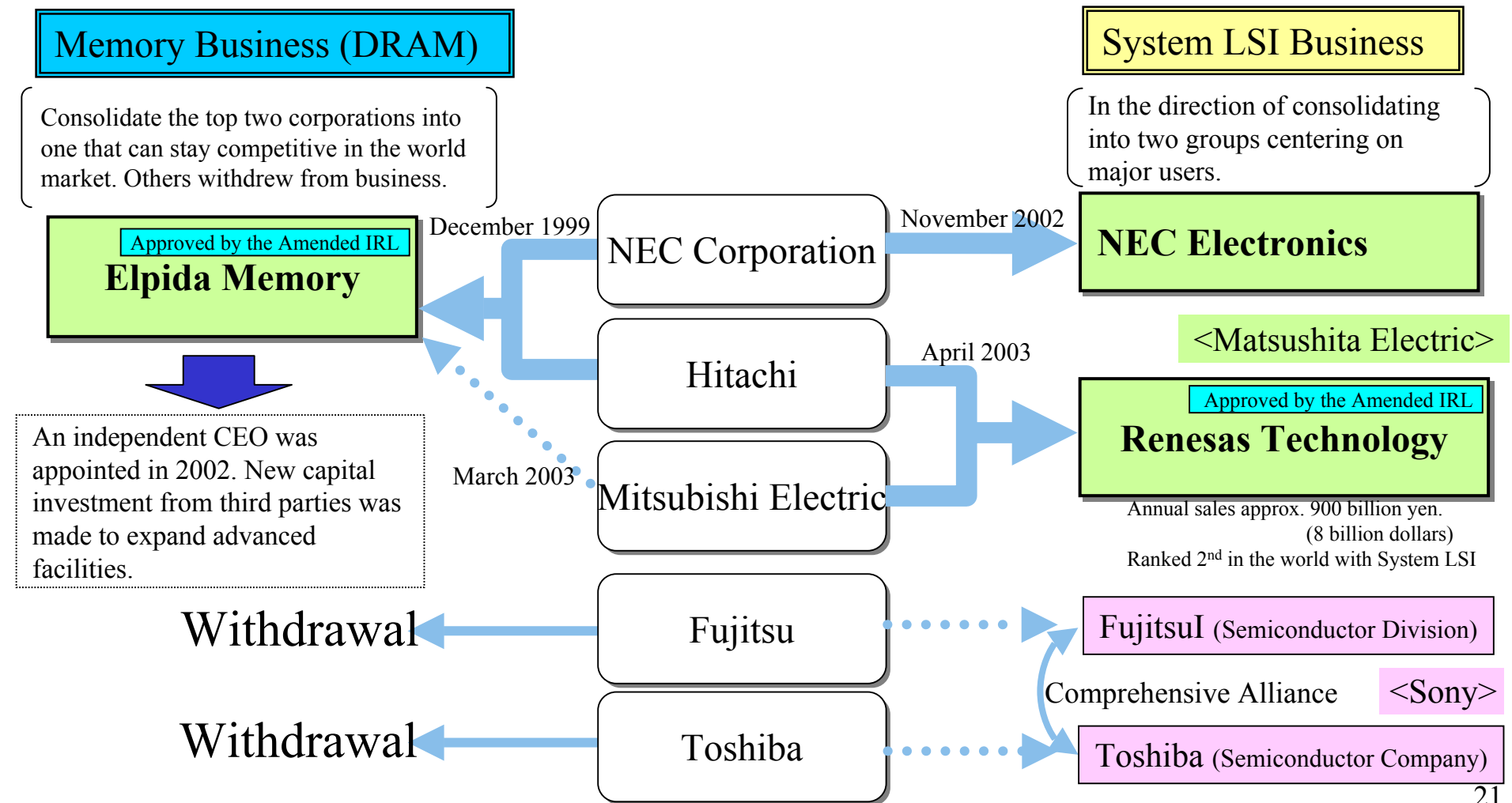


Corporate reform – industrial revitalization (3)

Example of Industrial Reorganization

Semiconductor Industry 1

- Consolidation of five major corporations as specialized producers centering on business fields with competitive power in progress.



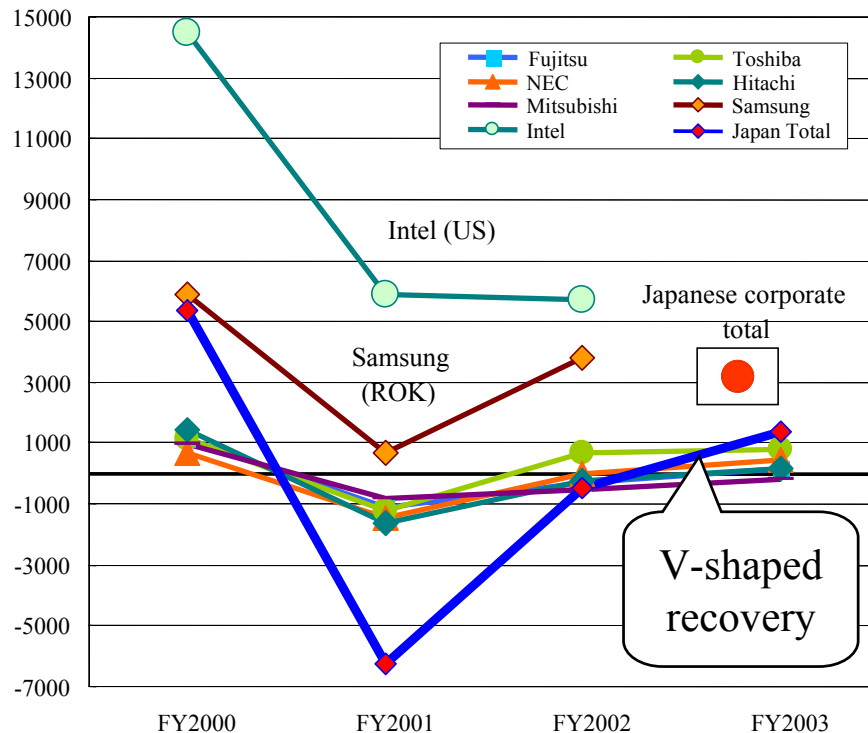
Corporate reform – industrial revitalization (4)

Example of Industrial Reorganization (4)

Semiconductor Industry 2

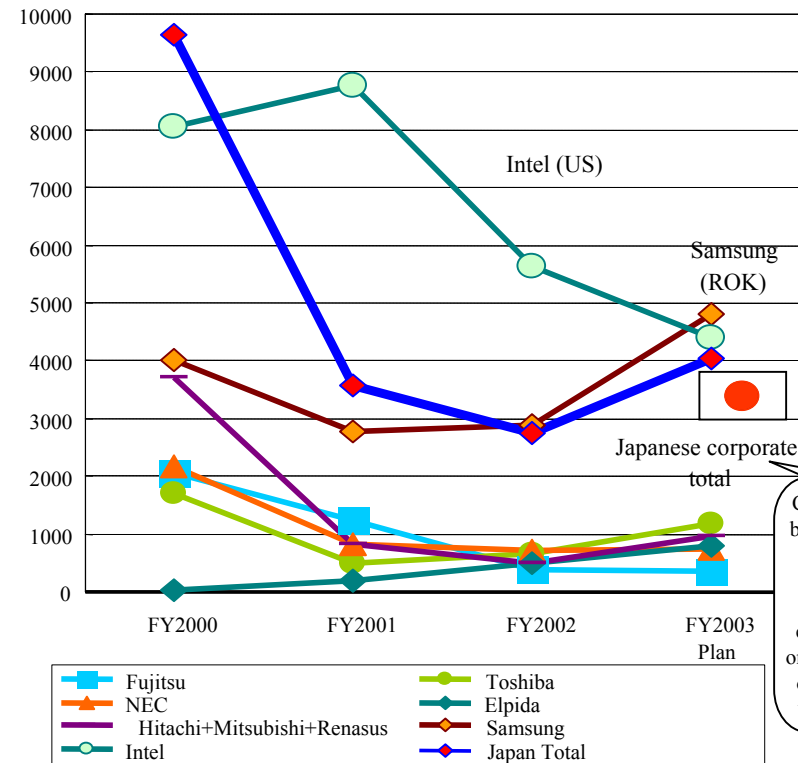
- Achieved a *V-shaped recovery* in operating profits, which indicates the income and expenditures of the business
- Urgent need to establish a structure to pursue the two world leaders, Intel and Samsung, by promptly utilizing the effects of consolidation

Trends in Operating Profits of Each Semiconductor Manufacturer



Source: Compiled by METI. Both Figures are in the semiconductor division calculated at 10 won = 1 yen, US\$ = 120 yen.

Trends in Capital Investment of Each Semiconductor Manufacturer

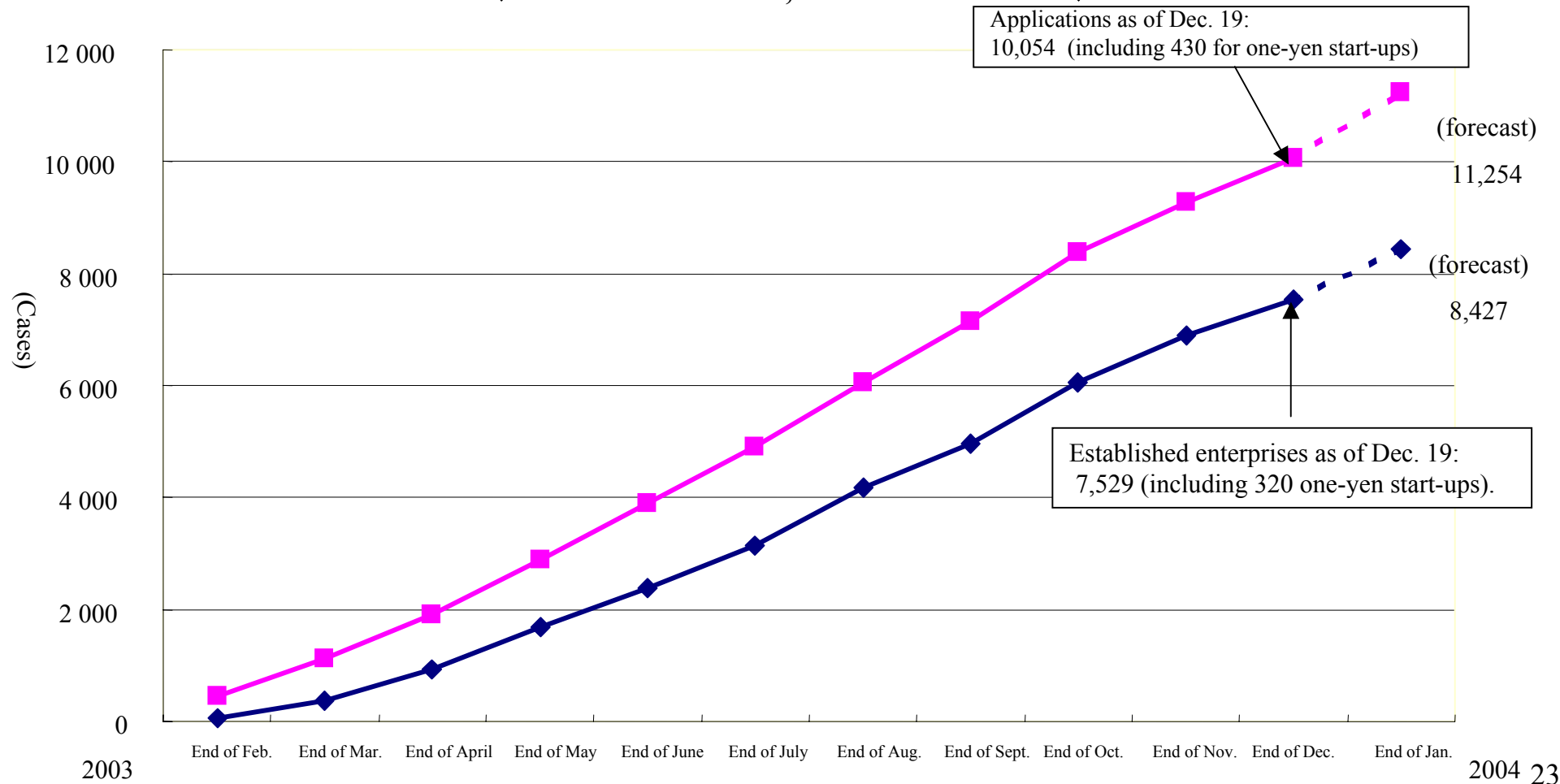


Capital investment bottomed out. Yet, even when combining major Japanese corporations, they only match the level of the world's top two corporations.

Corporate reform – industrial revitalization (5)

10,000 enterprises established per year under the minimum capitalization special exemption

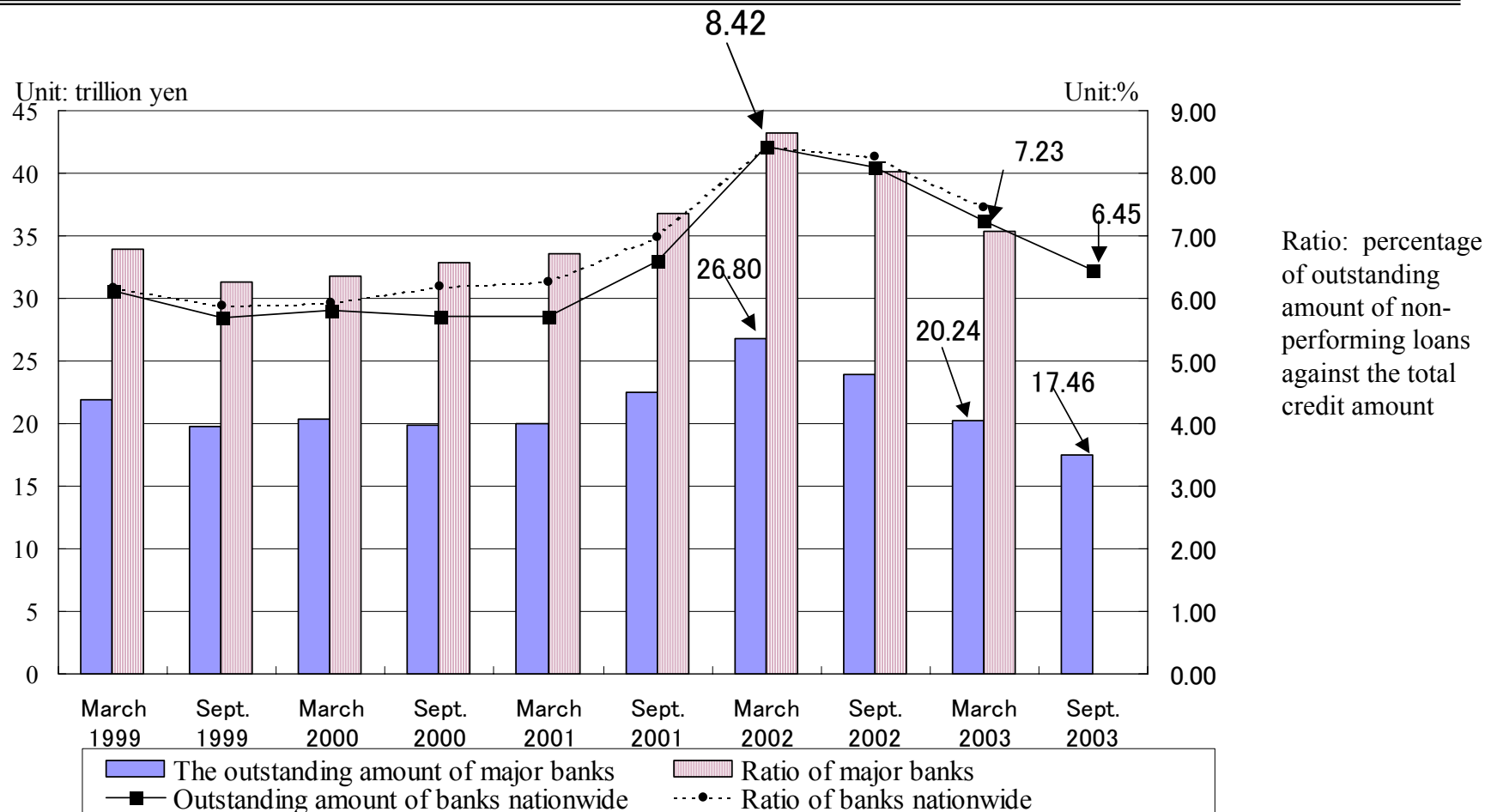
Number of applications received for minimum capitalization special exemption and enterprises established
(As of December 19, METI Calculation)



Financial reform – the issue of Financing(1)

Steady progress in the disposal of non-performing loans

Changes in the outstanding amount of non-performing loans



The outstanding amount of non-performing loans peaked in March 2002 and has been decreasing since.

※Regarding major banks, data for the periods after March 2003 are not included for Shinsei Bank and Aozora Bank.

Source: Materials released by the Financial Services Agency (regarding the status of non-performing loans).

Financial reform – the issue of Financing(2)

Policy Package for strengthening industrial finance functions towards economic revitalization (direction of reforms)

