

CHAPTER 1 OVERVIEW OF THE ECONOMY

As of December 2008, the impact of the economic downturn that began in the United States had impacted the real economy throughout the world. In Japan, the monthly economic report for December 2008 noted that the economy had worsened for the first time in six years and 10 months. The overall assessment of nation's economy was revised downward for the third consecutive month.

The reduced demand both in Japan and overseas created a sense of excess inventory, equipment, and employment in all industries. Therefore, we expect that in the future, companies will cut back on production, limit investment, accelerate the trend to reduce their workforce, and limit new hiring.

This chapter will present an overview of the indicators for the Japanese economy today. We will examine in detail the situations of industrial sectors closely related to the IT services industry.

1-1. OVERVIEW OF THE JAPANESE ECONOMY

1.1.1 GDP Trends and Growth Rate

The preliminary quarterly GDP report released in December 2008 shows that the growth rate for real GDP in the July-September 2008 period slid 0.5% from the previous quarter (April-June). Converted to an annual rate, the decline would be 1.8% (Fig. 1-1). This was the second consecutive decline in quarterly growth, confirming again that the Japanese economy is in recession.

A look at the degree of contribution, showing the extent to which demand in specific areas boosted GDP within the overall growth rate, reveals that domestic demand fell 0.3% and overseas demand (exports and imports of goods and services) slid 0.2% (Fig. 1-2).

The economic crisis originated with the subprime loan problem in the United States in 2007. This caused a credit squeeze in American financial markets, which in turn resulted in a downturn in the real economy. The repercussions, which included the repatriation of capital, were felt beyond the shores of the United States and extended worldwide, including developing countries. The growth rate of overseas demand in the April-June quarter was 0.0%, which is a manifestation of the effects of the financial crisis.

For domestic demand, meanwhile, individual demand fell 0.2% from the previous quarter, while final government consumption expenditures slid 0.3%. Capital investment plunged 2.0% in the same period as companies grew uncertain about future developments. Overall domestic demand fell two consecutive quarters.

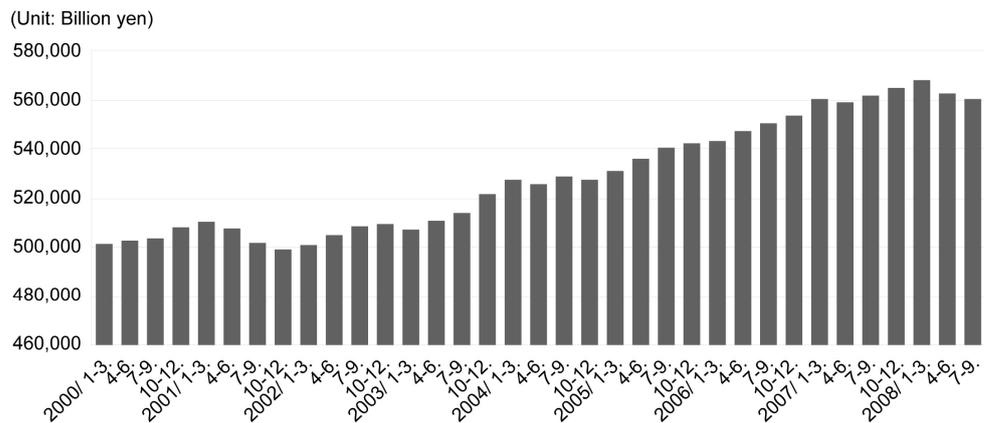


Figure 1-1
Trends in Real GDP

Note: Real Value of Seasonally Adjusted GDP
 Note: Calendar year Seasonally-Adjusted Chain Method, 2000

Source: Cabinet Office "National Economic Accounting", The 2nd Preliminary Quarterly GDP Report for July-September 2008

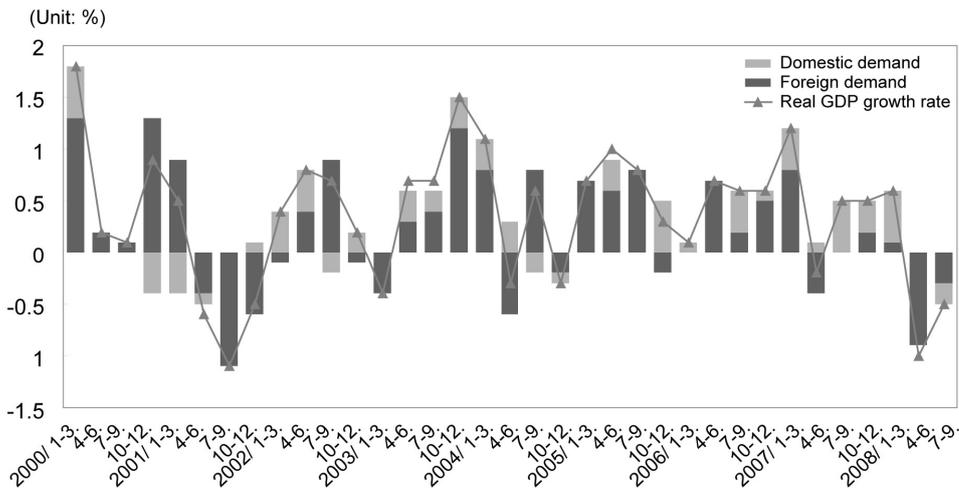


Figure 1-2
Trends in Real GDP
Growth Rate Along with
the Degree of Contribution
to its Growth

Note: Real seasonally-adjusted GDP growth rate
 Note: Seasonally-adjusted chain method, 2000

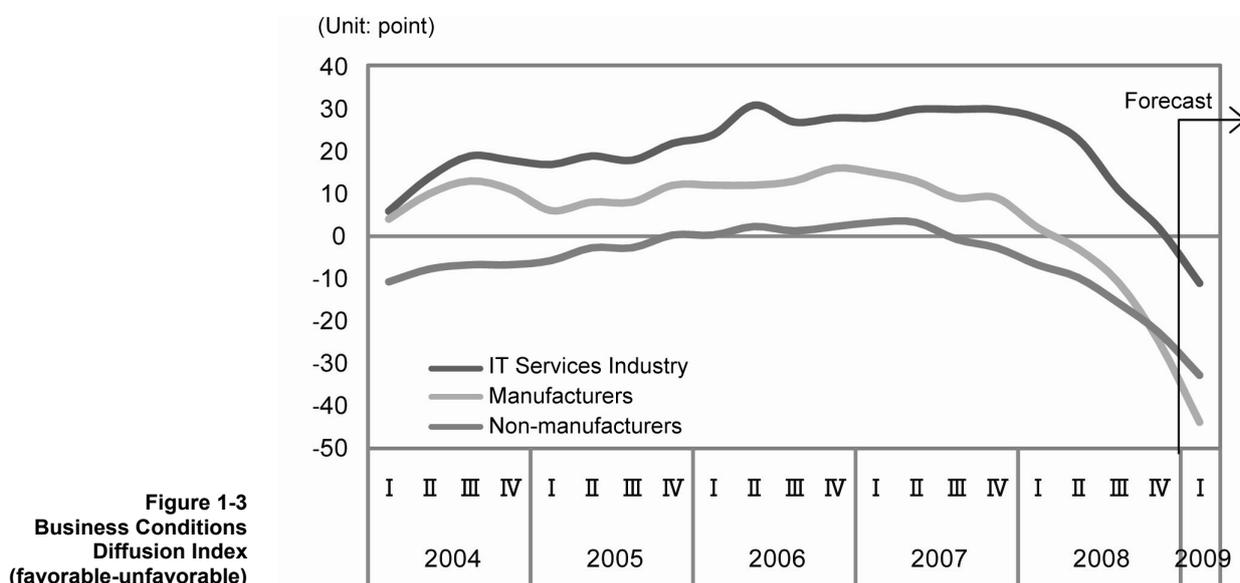
Source: Cabinet Office "National Economic Accounting", The 2nd Preliminary Quarterly GDP Report for July-September 2008

1.1.2 Evaluation of Corporate Business Conditions

Business conditions for Japanese companies grew weaker from the first half of 2007, and the trend overall is for conditions to worsen (Fig.1-3). Conditions have rapidly deteriorated for the manufacturing industry in particular.

As for the direction in the future, the decline in crude oil prices is expected to have a positive effect, but concerns are mounting because the extent of the global economic downturn has yet to become apparent. There is also substantial volatility in stock and foreign exchange markets. These factors contribute to the negativity of our evaluation.

Conditions in the IT service industry lag those of other industries to an extent, and a rapid downturn is expected sometime in FY 2008. Our December survey showed two points, down nine points from the September survey. We anticipate a rating of -11 points in the future.



Note: The diffusion index is calculated by subtracting the percentage of companies reporting unfavorable business conditions from the percentage reporting favorable conditions.

Note: All enterprises

Source: Bank of Japan's Short-term Economic Survey of Enterprises in Japan (Tankan)

1.1.3 The Employment Climate

The employment climate in Japan began to rapidly deteriorate in 2007. The effective ratio of job offers to applicants increased and the unemployment rate had continuously declined since 2002, but companies began putting a lid on hiring in the second half of 2007. The unemployment rate began climbing in FY 2008 and reached a seasonally adjusted level of 4.2% in August that year (Fig. 1-4).

An examination of conditions related to corporate employment based on the Bank of Japan's tankan survey provides a sense of a surplus of employed workers, particularly in the manufacturing industry. We expect the climate for employment to remain harsh, including further moves to lay off existing workers and limit new hires.

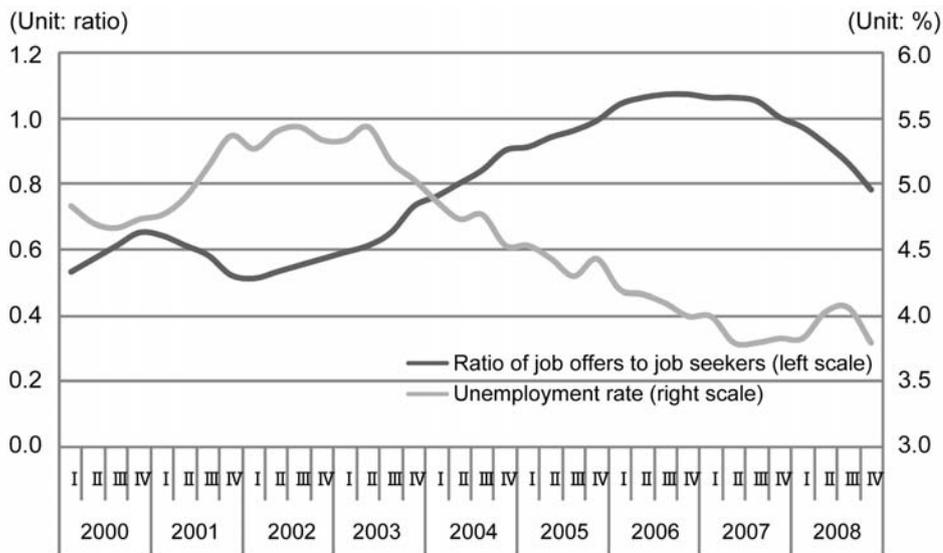


Figure 1-4
Trends in the Ratio of Job Offers to Job Seekers and Unemployment Rate

Note: Seasonally-adjusted

Source: Ministry of Internal Affairs and Communications “Labor Force Survey”, Ministry of Health, Labor and Welfare “Employment Security Statistics”

1.1.4 Corporate Capital Investment

Growth in corporate capital investment was flat starting in 2007, and is expected to be in negative territory compared to the year before in 2008 (Fig. 1-5, Fig. 1-6).

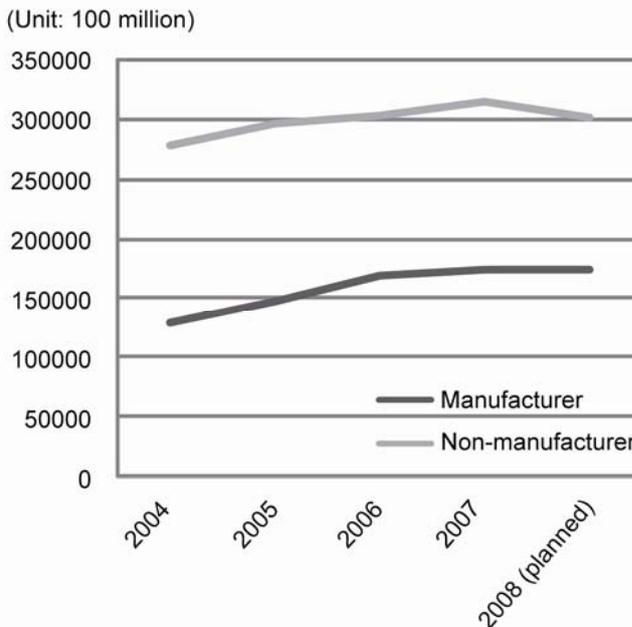


Figure 1-5
Corporate Capital Investment

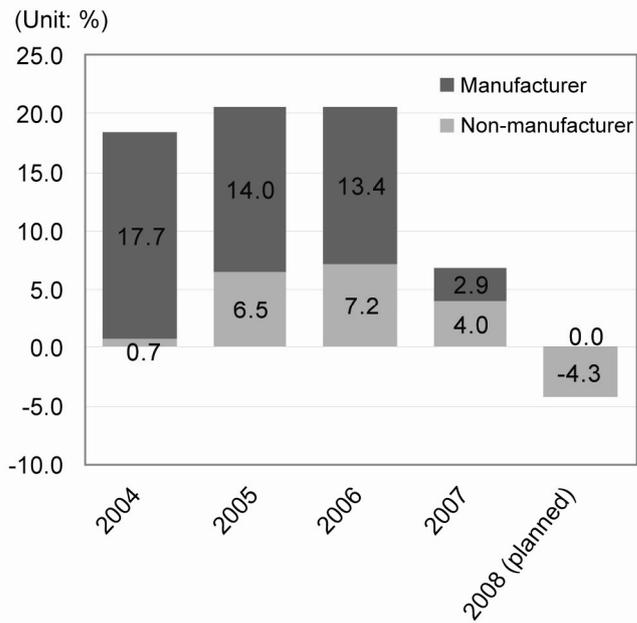


Figure 1-6
Corporate Capital Investment (year on year comparison)

Note: Figures for non-manufacturer do not cover financial and insurance sectors.
 Note: Capital investments cover land investments but do not cover software investments

Source: Bank of Japan's Short-term Economic Survey of Enterprises in Japan (Tankan)

1.1.5 Corporate Software Investment

Corporate software investments are not shown statistically, including any limitation on investments due to a deceleration in the economy. Overall, they are steady for the most part (Fig. 1-7, Fig. 1-8).

Considering business conditions for all industries and the sharp decline in capital investment, however, attention must be focused on future trends for software investment.

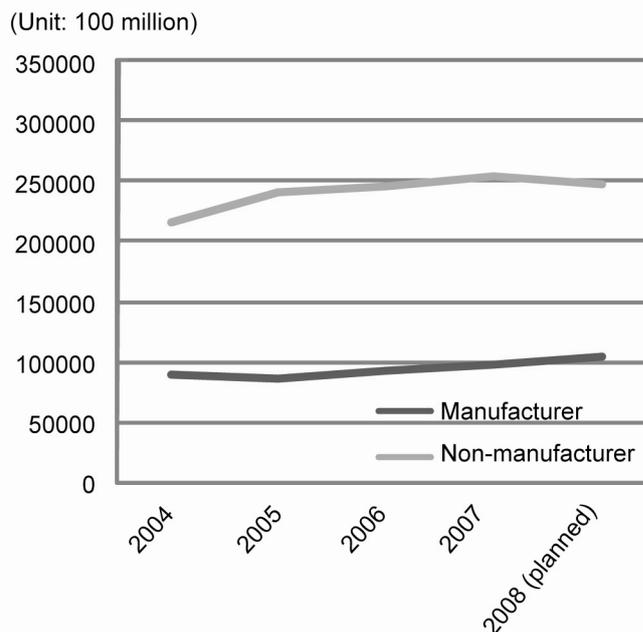


Figure 1-7
Corporate Software Investments

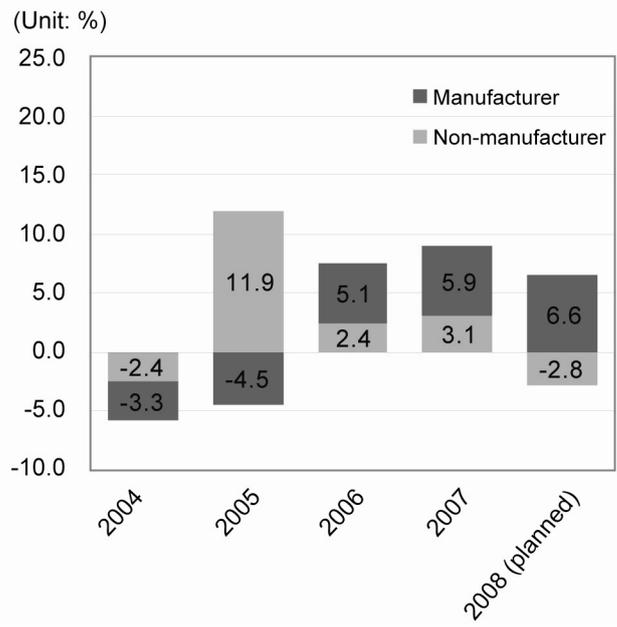


Figure 1-8
Corporate Software
Investments (year-on-year
comparison)

Note: Figures for non-manufacturer do not cover financial and insurance sectors.

Source: Bank of Japan's Short-term Economic Survey of Enterprises in Japan (Tankan)
