

ECONOMIC AND FINANCIAL CONDITIONS

During fiscal 2005, ended March 31, 2006, the world economy continued to expand at a moderate pace until the early part of the northern summer. However, from around the middle of 2005, the rate of growth once again accelerated and the global economy overall enjoyed a sustained period of robust expansion. In the United States, employment conditions continued to improve, while consumer spending and housing investment generally remained firm. In Asia as well, economic conditions remained strong, driven by growth in the Chinese economy.

The Japanese economy, influenced by conditions abroad, ebbed and flowed somewhat in the early part of the term. From mid-2005 onward, however, supply and demand conditions in the information technology (IT) sector became more favorable and exports in general recovered thanks to the impetus of economic growth overseas. Domestic demand also tracked upward, leading to clear indications at the end of the period that the recovery had moved into full swing.

During the period under review, although rising prices for crude oil and raw materials placed downward pressure on corporate earnings, structural adjustments to eliminate the so-called “triple burden” carried by many Japanese firms—excess capacity, surplus labor and unsustainable debt—made significant progress. Coupled with this, domestic and overseas demand both remained robust, and helped sustain the trend toward higher corporate sales and earnings and buoyed capital investment levels. For households, the recovery in the labor market gained momentum, and wages turned upward. With income conditions improving and a strong rebound on the stock market providing a wealth effect, a pickup in personal consumption levels became more widespread.

Business conditions for small and medium-sized enterprises (SMEs) seesawed in the early part of the fiscal year, with the index of the Bank’s Monthly Survey of SME Business Sentiment dipping below 50—the demarcation point between positive and negative sentiment. Later on, as the economic recovery gathered momentum, the index registered over 50 for most months from September 2005 onward, indicating a general turnaround in business conditions for SMEs. However, the strength of the recovery for

SMEs was modest in comparison with large companies and the degree of improvement continued to vary markedly between industries and regions.

On the financial front, the Bank of Japan (BOJ) ended its quantitative easing policy in March 2006, as the consumer price index moved into positive territory toward the end of the fiscal period on a year-on-year basis. Long-term interest rates (newly issued 10-year government bond yields) moved only slightly from the levels seen at the start of the fiscal year, but as the economic recovery took hold signs that Japan’s deflationary period was drawing to a close helped push long-term interest rates upward. Following the end of BOJ’s quantitative easing policy, the upswing accelerated, and long-term yields ended the fiscal year in a band between 1.75% and 1.80%.

In the foreign exchange market, dollar buying became pronounced as attention focused on the nominal interest rate differential between Japan and the United States. Consequently, from the northern autumn of 2005, the yen gradually weakened vis-à-vis the U.S. dollar. Toward the end of the period under review, with Japanese interest rates rising and the view becoming entrenched that the Federal Reserve was nearing the end of its monetary tightening cycle, the market began to anticipate future shrinkage in the Japan–U.S. interest rate differential. As a result, yen weakening tapered off and at the close of the period the dollar hovered around the ¥117 level.

From mid-2005, with the domestic economic recovery becoming clearly discernable and a medium- to long-term outlook for rising corporate profitability taking hold, the upward trend in stock prices gained strength. By the end of the fiscal year, Japan’s benchmark index, the Nikkei Stock Average, had moved past 17,000 for the first time in five and a half years.

During the period, the Japanese government maintained its policy aimed at providing a robust safety net for SMEs along with efforts to insure a smooth flow of funds and promote diversification in funding sources for SMEs. In addition, the government implemented a range of policies to support the revitalization of SMEs, particularly through the SME Revitalization Support Council.

SUMMARY OF RESULTS

Loans

The balance of outstanding loans as of the end of fiscal 2005 declined ¥161.2 billion, to ¥9,427.6 billion at year-end. The balance of loans through agencies, including credit cooperatives, totaled ¥14.9 billion. There were 157 agencies at fiscal year-end.

Debentures

Interest-bearing debentures increased ¥106.7 billion compared with the previous year and discount debentures decreased ¥85.3 billion, for an overall increase in the balance of debentures of ¥21.3 billion. As a result, the balance of debentures at year-end totaled ¥7,832.6 billion, a figure that includes ¥75.0 billion underwritten by the government.

Deposits and Negotiable Certificates of Deposit

The balance of deposits increased ¥29.9 billion, to ¥2,420.0 billion at the end of fiscal 2005. Negotiable certificates of deposit increased ¥0.8 billion compared with previous year-end, to ¥21.7 billion.

Securities

Over-the-counter sales of government bonds and other securities amounted to ¥1.2 billion. Dealings in government bonds and other securities totaled ¥21.5 billion. The balance of trading securities at the end of fiscal 2005 was ¥1.2 billion.

Domestic and Foreign Exchange

Domestic exchange transactions in fiscal 2005 totaled ¥24,951.3 billion. Foreign exchange transactions totaled US\$3,599 million.

Income and Expenditures

Total operating income amounted to ¥186.1 billion, while operating expenses totaled ¥157.6 billion, resulting in income before income taxes and others of ¥28.5 billion. Other gains amounted to ¥6.6 billion and other losses totaled ¥15.5 billion. Provision for income taxes amounted to ¥1.8 billion, and adjustment for income taxes totaled ¥4.9 billion. As a result, net income for the fiscal year amounted to ¥12.8 billion.

