

## ECONOMIC AND FINANCIAL CONDITIONS

During fiscal 2006, ended March 31, 2007, the world economy overall enjoyed a sustained period of robust expansion. While the United States economy saw a slowdown in growth owing to a significant fall in housing investment, the economic expansion continued apace in China and other parts of Asia, and growth rates accelerated in Europe.

The Japanese economy, buoyed by the continuing global economic expansion, remained on a recovery path. In November 2006, the length of the current recovery, which began in 2002, overtook that of the Izanagi Economic Boom, which ran for 57 months from October 1965 to July 1970. As a result, facility utilization rates trended at high levels and firms began to experience difficulties in securing sufficient labor.

During the period under review, although rising prices for crude oil and raw materials—along with upward pressure on wages—acted as a drag on corporate earnings, domestic and overseas demand both remained robust. Consequently, corporate revenue and earnings continued to rise and capital investment activity was strong. For households, the recovery in the labor market continued, and, although wage growth was relatively low, the generally moderate improvement in incomes was sustained. With these basic conditions prevailing, personal consumption was somewhat weakened by unseasonable weather during the summer, but a gradual rebound ensued from the autumn onward.

For small and medium-sized enterprises (SMEs), according to the Bank's Monthly Survey of SME Business Sentiment, turnover trended upward as sales and orders maintained their underlying strength. However, profitability remained tight as rising raw materials prices led to higher input costs, which firms found hard to pass on through increased prices to customers. As the dearth of spare capacity for both plant and labor became apparent, the SME Business Sentiment Index began to retreat closer to 50—the demarcation point between positive and negative sentiment—in a repeated pattern of advancement and decline. A marked variance in sentiment among industries and regions also persisted.

On the financial front, after early indications that the consumer price index had moved into a year-on-year

increasing trend, the Bank of Japan (BOJ) ended its zero-interest-rate policy in July 2006, and, in February 2007, the BOJ once again raised its target for the unsecured overnight call rate. Long-term interest rates (newly issued 10-year government bond yields) moved higher from the start of the fiscal period onward, and at one stage even crossed the 2.00% threshold. However, long-term yields subsequently receded to track in a band between 1.60% and 1.80%.

In the foreign exchange market, from late April 2006, the yen temporarily entered a strengthening phase against the US dollar as the market focused on the likelihood of both an early end to the monetary tightening cycle in the United States and the abandoning of the zero-interest-rate policy in Japan. Subsequently, despite the Federal Reserve Board making the last of its consecutive federal funds rate hikes in June 2006, the market took the view that an interest rate differential of a certain level would persist between Japan and the United States. Consequently, the yen moved into a weakening phase and at the close of the period the dollar had moved back to around the ¥117 level.

From May 2006, buffeted by a strengthening yen and rising crude oil prices—as well as a fall in U.S. stock prices—Japanese stock prices moved into retreat. A renewed rally in stock prices took hold in August 2006, with Japan's benchmark index, the Nikkei Stock Average, surpassing 18,000 for the first time since 2000. In late February 2007, the rising trend in stock prices was temporarily interrupted on a global scale—triggered by a sudden tumble on the Chinese stock market—before upward momentum resumed.

During the period, the Japanese government maintained its policy aimed at providing a robust safety net for SMEs. It also worked to insure a smooth flow of funds and promote diversification in funding sources for SMEs—specifically, funding methods that are not overly dependent on collateral and personal guarantees. In addition, the government achieved steady progress in its programs to support SMEs in the manufacturing sector, with particular focus on fostering firms at the leading edge of technology.

## SUMMARY OF RESULTS

### Loans

The balance of outstanding loans as of the end of fiscal 2006 declined ¥72.3 billion, to ¥9,355.2 billion at year-end. The balance of loans through agencies, including credit cooperatives, totaled ¥12.1 billion. There were 155 agencies at fiscal year-end.

### Debentures

Interest-bearing debentures decreased ¥451.0 billion compared with the previous year and discount debentures decreased ¥152.6 billion, for an overall decrease in the balance of debentures of ¥603.6 billion. As a result, the balance of debentures at year-end totaled ¥7,228.9 billion, a figure that includes ¥40.0 billion underwritten by the government.

### Deposits and Negotiable Certificates of Deposit

The balance of deposits increased ¥119.8 billion, to ¥2539.9 billion at the end of fiscal 2006. Negotiable certificates of deposit decreased ¥9.1 billion compared with previous year-end, to ¥12.6 billion.

### Securities

Over-the-counter sales of government bonds and other securities amounted to ¥0.5 billion. Dealings in government bonds and other securities totaled ¥28.4 billion. The balance of trading securities at the end of fiscal 2006 was ¥0.2 billion.

### Domestic and Foreign Exchange

Domestic exchange transactions in fiscal 2006 totaled ¥24,896.3 billion. Foreign exchange transactions totaled US\$3,748 million.

### Income and Expenditures

Total operating income amounted to ¥192.2 billion, while operating expenses totaled ¥164.0 billion, resulting in income before income taxes and others of ¥28.2 billion. Other gains amounted to ¥0.4 billion and other losses totaled ¥0.2 billion. Provision for income taxes amounted to ¥0.6 billion, and adjustment for income taxes totaled ¥13.6 billion. As a result, net income for the fiscal year amounted to ¥14.2 billion.

