

## **Bank of Japan's June report of recent economic and financial developments<sup>1</sup>**

Bank of Japan, Communication, 14 June 2000.

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### **The Bank's View<sup>2</sup>**

The improvement in Japan's economy is becoming distinct. Recovery has been observed in some areas of private demand, with business fixed investment continuing to increase.

With regard to exogenous demand, net exports (real exports minus real imports) continue to follow an upward trend due to steady developments in overseas economies, and public investment is picking up reflecting the progress in the implementation of the supplementary budget for fiscal 1999. As regards domestic private demand, housing investment is on a moderate declining trend, and the recovery in private consumption continues to be weak through lack of notable improvements in employment and income conditions. Meanwhile, business fixed investment is increasing.

Reflecting such developments in final demand, industrial production is increasing, and corporate profits and sentiment continue to improve. Firms as a whole still strongly feel that they have excess capacity and employees, and that they should reduce their debts to restore financial soundness. Nevertheless, the number of firms that take positive action, such as increasing the amount of fixed investment, has been increasing, especially in high-growth sectors. Regarding employment conditions, although the decrease in the number of employees and in wages is slowing, efforts by firms to reduce personnel expenses have prolonged the severity of households' income conditions.

As for the outlook, public investment is likely to increase for some time. This, along with the favorable financial environment created partly by the Bank's monetary easing, is expected to continue underpinning the economy. Moreover, net exports are likely to follow an upward trend reflecting the recovery of overseas economies, and it is also highly probable that business fixed investment will increase gradually with an improvement in corporate profits and sentiment. However, housing investment is expected to decline for the time being. While there seems to be no substantial change in firms' stance to reduce personnel expenses, an improvement in households' income conditions, which should support private consumption, is likely to be moderate at the most. In addition, since firms' prospects for sales remain modest, careful monitoring is still required to determine whether the recovery in business fixed investment is sustainable and whether it is likely to spread to a wider range of industries.

With regard to prices, import prices are decreasing slightly, reflecting a temporary decline in international commodity prices such as crude oil prices. Domestic wholesale prices, notwithstanding the fall in prices of electric machinery, are unchanged mainly due to the rise in prices of petroleum and chemical products reflecting the increase in crude oil prices to date. Meanwhile, consumer prices continue to be somewhat weak owing to the slight decrease in the prices of private-sector services and the decline in prices of imported products reflecting the past appreciation of the yen. Corporate service prices are still falling slowly.

As for the outlook, upward pressure on prices is likely to arise from the gradual improvement in domestic supply-demand balance and from the rise in crude oil prices. On the other hand, downward

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<sup>1</sup> This report was written based on data and information available when the Bank of Japan Monetary Policy Meeting was held on 12 June 2000.

<sup>2</sup> The Bank's view on recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on 12 June 2000 as the basis of monetary policy decisions.

pressure is expected from the long-term declining trend of machinery prices due to technological innovations and from the fall in prices of imported products reflecting the past appreciation of the yen. On balance, overall prices are likely to remain unchanged. However, attention should still be paid to the downward pressure on prices stemming from weak demand, although the pressure has weakened given some recovery in private demand.

In the financial market, the overnight call rate has generally stayed near zero, and financial institutions have been confident about the availability of overnight funds. The amount of funds outstanding in the call money market is declining gradually.

Interest rates on term instruments basically continue to be stable but have increased somewhat from the start of June. The Japan premium remains negligible.

Yields on long-term government bonds have been moving in the range of 1.6-1.8 percent. The yield spread between private bonds (bank debentures and corporate bonds) and government bonds remains mostly unchanged.

Stock prices fell sharply until the end of May triggered by the drop in U.S. stocks but have recovered thereafter.

In the foreign exchange market, the yen temporarily rose to around 110 yen in mid-May but then strengthened against the U.S. dollar. The yen is currently being traded in the range of 105-107 yen.

With regard to corporate finance, private banks have basically retained their cautious lending attitude. However, constraint that had been caused by severe fund-raising conditions and insufficient capital base has eased considerably. Given this, major banks are becoming more active in extending loans, while carefully evaluating the credit risks involved.

On the other hand, the improvement in economic activities has not stimulated corporate demand for external funds, since firms' cash flow is increasing in parallel with a recovery in profits. Moreover, firms continue to reduce debts as part of their balance-sheet restructuring measures. As a result, credit demand in the private sector has continued to be basically stagnant.

In view of this, the underlying tone of private banks' lending remains sluggish. Issuance of corporate bonds and CP has been steady.

Money stock ( $M_2 + \text{CDs}$ ) grew slower in May compared with the previous month on a year-on-year basis.

In this financial environment, corporate financing conditions are easing, and the lending attitude of financial institutions is perceived by firms as less severe. It continues to warrant careful monitoring how these favorable developments in corporate financing environment will affect economic activities.