Bank of Japan's July report of recent economic and financial developments[1]

Bank of Japan, Communication, 19 July 2000.

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The Bank's View[2]

Japan's economy is recovering gradually, with corporate profits and business fixed investment continuing to increase.

With regard to exogenous demand, net exports (real exports minus real imports) continue to follow a moderate 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, business fixed investment is increasing. The recovery in private consumption continues to be weak as a whole through lack of notable improvements in employment and income conditions, although there are somewhat positive signs in some indicators. Housing investment is mostly unchanged.

Reflecting such developments in final demand, industrial production is increasing. Corporate profits and sentiment continue to improve, and the number of firms that take positive action, such as increasing the amount of fixed investment, is increasing, especially in high-growth sectors. Income conditions of households still remain severe, but the decreases in the number of employees and in wages are slowing, while regular and overtime payments as well as new job offers are increasing in line with the recovery in corporate activities.

As for the outlook, public investment is likely to start decreasing in the near future, but net exports are expected to continue increasing gradually, reflecting the expansion in overseas economies. In the corporate sector, firms still strongly feel that they have excess equipment and that they should reduce their debts to restore financial soundness. However, it is very likely that fixed investment in high-growth sectors, including those related with information technology services, will increase as corporate profits continue to recover. Moreover, an improvement in corporate profits will increase household income and this in turn is expected to boost private consumption. However, the pace of recovery in household income will be modest for the time being, since firms' perceptions of excess employment still persist, and thus significant changes have not been observed in their efforts to reduce personnel expenses. Overall, the economy is likely to recover gradually led mainly by business fixed investment, unless there are major adverse external shocks. In addition, the favourable financial environment created partly by the Bank's monetary easing is expected to continue underpinning the economy.

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.

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[1] This report was written based on data and information available when the Bank of Japan Monetary Policy Meeting was held on July 17, 2000.

[2] The Bank's view on recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on July 17, 2000 as the basis of monetary policy decisions.

As for the outlook on prices, downward pressure on prices stemming from weak demand is declining significantly while an economic recovery is expected to continue moderately. Upward pressure on prices is likely to arise temporarily from the increase in crude oil prices. On the other hand, in addition to the declining trend of machinery prices due to technological innovations, the decline in prices of consumer goods arising from the past appreciation of the yen and the streamlining of distribution channels will exert downward pressure on prices. Thus, prices overall are expected to be stable or weak somewhat.

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 has increased slightly.

Interest rates on term instruments have been increasing from mid-June reflecting a possible termination of the zero interest rate policy. The Japan premium remains negligible.

Yields on long-term government bonds increased somewhat from mid-June and are recently moving around 1.7 percent. The yield spread between private bonds (bank debentures and corporate bonds) and government bonds remains mostly unchanged.

Stock prices fell towards mid-June, but have recovered thereafter along with the rise in US stocks.

In the foreign exchange market, the yen temporarily rose to around 104 yen in late June against the US dollar, but then started to decline. The yen is currently being traded in the range of 107-109 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 CPs has been steady.

Money stock (M_2 + CDs) grew slower in June compared with the previous month on a year-on-year basis.

In this financial environment, the lending attitude of financial institutions is perceived by firms as less severe, and corporate financing conditions are easing.