

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

Bank of Japan, Communication, 16 October 2000.

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

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

With regard to exogenous demand, public investment is starting to decrease since the implementation of the supplementary budget for fiscal 1999 has peaked out. Net exports (real exports minus real imports) continue to follow a moderate upward trend due to steady developments in overseas economies. As regards domestic private demand, business fixed investment is on an increasing trend. 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 regular and overtime payments as well as new job offers continue to increase in line with the recovery in corporate activities, and compensation of employees has stopped decreasing.

As for the outlook, public investment is expected to decrease. While the expansion in overseas economies is likely to continue, the increase in exports is likely to slow down as restocking activity in Asian economies has peaked out. Meanwhile, imports are projected to continue increasing, particularly for those of information-related goods. Therefore, real exports will level off for a while. 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, while the developments in crude oil prices as well as foreign and domestic capital markets, along with their effects on the economy, need careful monitoring. In addition, the favorable financial environment created partly by the Bank's sustaining easy monetary stance is expected to continue underpinning the economy.

With regard to prices, import prices are rising, reflecting an increase in international commodity prices such as crude oil prices since April. Domestic wholesale prices, notwithstanding the rise in prices of petroleum products reflecting the increase in crude oil prices, are mostly unchanged mainly due to the decrease in prices of electric machinery. Meanwhile, consumer prices continue to be somewhat weak

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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 13 October 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 13 October as the basis of monetary policy decisions.

owing to the decline in prices of imported products reflecting the past appreciation of the yen, although prices of petroleum products and electricity increased from the rise in crude oil prices. Corporate service prices are still falling slowly.

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 is generally moving around 0.25%. The amount of funds outstanding in the call money market has increased slightly.

As for interest rates on term instruments, those on contracts maturing beyond the year-end have risen somewhat. The Japan premium remains negligible.

Yields on long-term government bonds are generally moving in the range of 1.8-1.9%. The yield spread between private bonds (bank debentures and corporate bonds) and government bonds remains mostly unchanged as a whole.

Stock prices dropped from early October and are recently moving around the lowest level since the beginning of this year.

In the foreign exchange market, the yen depreciated gradually from the end of September and the yen-dollar exchange rate temporarily rose to ¥109-110. The yen is currently being traded in the range of ¥107-109 to the US dollar.

With regard to corporate finance, private banks continue to be more active in extending loans mainly to blue-chip companies, 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 at a high level in parallel with recovery in profits. Moreover, firms continue to reduce their 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. Recently, however, the expansion in the year-to-year decline seems to be ceasing. Issuance of corporate bonds and CPs has been steady.

Money stock (M2 + CDs) grew faster in September compared with the previous month on a year-on-year basis.

Recently, funding costs for firms are somewhat increasing, due to the rise in money market rates after the termination of the zero interest rate policy.

In this financial environment, there seem to be no substantial changes in the lending attitude of financial institutions and easing of corporate financing conditions.