

Bank of Japan's November report of recent economic and financial developments¹

Bank of Japan, Communication, 20 November 2000.

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The Bank's View²

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

With regard to exogenous demand, public investment is decreasing gradually 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 continue decreasing for the time being. While the U.S. economy is decelerating gradually, the expansion in overseas economies is projected to continue, albeit at a slower pace. In these circumstances, the increase in exports is likely to slow down, as inventories of some raw materials and electronics parts are somewhat excessive at present in Asian economies. Meanwhile, imports are projected to continue increasing, particularly for those of consumer goods, and capital goods and parts. Therefore, net 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. The increase in industrial production is expected to slow down somewhat for a while mainly because of the slower rise in exports. 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 and the new economic stimulus package are expected to underpin the economy.

1 This report was written based on data and information available when the Bank of Japan Monetary Policy Meeting was held on November 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 November 17 as the basis of monetary policy decisions.

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 electrical machinery. Meanwhile, although prices of petroleum products increased, consumer prices continue to be somewhat weak owing to the decline in prices of other imported products and their substitutes. Corporate service prices are still falling slowly.

As for the condition surrounding price development, the balance between supply and demand in the domestic market is projected to be on a gradual improving trend, while an economic recovery is expected to continue moderately. In these circumstances, 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 and the weakening of semiconductor prices, the decline in prices of consumer goods arising from the streamlining of distribution channels will exert downward pressure on prices. Overall, prices are expected to be stable or weak somewhat for the time being.

In the financial market, the overnight call rate is moving around 0.25 percent.

As for interest rates on term instruments, Euro-yen transactions maturing beyond the year-end are rising somewhat while TB and FB rates are declining slightly. The Japan premium remains negligible.

Yields on long-term government bonds have been declining since mid-October and are recently moving around the level below 1.8 percent. The yield spread between private bonds (bank debentures and corporate bonds) and government bonds remains mostly unchanged as a whole.

Stock prices remain weak overall and are recently moving around the lowest level since the beginning of this year.

In the foreign exchange market, the yen continues to be stable and is currently being traded in the range of 107-110 yen to the U.S. 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. Meanwhile, issuance of corporate bonds continues to be steady. Issuance of CPs is increasing towards the year-end.

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

Funding costs for firms basically remain unchanged although the short-term funding rates maturing beyond the year-end increased somewhat.

In this financial environment, the lending attitude of financial institutions and corporate financing conditions remain easy.