

Bank of Japan's December Report of Recent Economic and Financial Developments¹

Bank of Japan, Communication, 18 December 2000.

* * *

The Bank's View²

Japan's economy continues to recover gradually, albeit at a somewhat slower pace due to decelerating export growth.

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), which had been increasing, are starting to level off as inventories of some raw materials and electronics parts became somewhat excessive in East Asian 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 declining slightly.

Reflecting such developments in final demand, industrial production remains on a rising trend although the pace is somewhat slowing. Corporate profits continue to improve, and the number of firms that take positive action, such as increasing the amount of fixed investment, is rising, 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 maintain the current level for the time being, but is likely to start increasing again in the future along with the implementation of the new economic stimulus package by the government. 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, exports are likely to remain level for the time being mainly due to inventory adjustments in East Asian economies. Meanwhile, imports are projected to continue increasing, particularly for those of consumer goods, and capital goods and parts. Therefore, net exports will decline slightly 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.

Industrial production is expected to remain on a rising trend, although the pace of increase may slow down further temporarily.

¹ This report was written based on data and information available when the Bank of Japan Monetary Policy Meeting was held on December 15, 2000.

² The Bank's view on recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on December 15 as the basis of monetary policy decisions.

Overall, the economy is likely to follow a gradual upward trend led mainly by business fixed investment, while the developments in overseas economies as well as in foreign and domestic capital markets, along with their effects on the economy, need to be carefully monitored. In addition, the favorable financial environment created partly by the Bank's sustaining easy monetary stance and the new economic stimulus package by the government are expected to underpin the economy.

With regard to prices, import prices are rising, reflecting an increase in international commodity prices such as crude oil prices. Domestic wholesale prices, notwithstanding the rise in prices of petroleum products reflecting the increase in crude oil prices, are declining somewhat mainly due to the decrease in prices of electrical machinery. Consumer prices continue to be somewhat weak owing to the decline in prices of other imported products and their substitutes, although prices of petroleum products increased. Corporate service prices are still falling slowly.

As for the condition surrounding price developments, 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. On the other hand, semiconductor prices are declining reflecting softer international semiconductor prices, and crude oil prices, which had been exerting upward pressure on prices, are dropping recently. In addition to the declining trend of machinery prices due to technological innovations, the decrease in prices of consumer goods arising from the streamlining of distribution channels will exert downward pressure on prices. Overall, prices are expected to be somewhat weak 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, TB and FB rates maturing beyond the year-end are rising somewhat. The Japan premium remains negligible.

Yields on long-term government bonds have been on a downward trend since mid-October, having decreased to around 1.55 percent temporarily, and are recently moving around 1.65 percent. The yield spreads between private bonds (bank debentures and corporate bonds) and government bonds are mostly unchanged or decreasing somewhat.

Stock prices continue to be weak, having recorded this year's lowest level towards the end of November.

In the foreign exchange market, the yen has been depreciating from the beginning of November, and is currently being traded in the range of 111-113 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, although the expansion in the year-to-year decline is ceasing. Meanwhile, the amount outstanding of corporate bonds issued is slightly above the previous year's level. Issuance of CPs is increasing towards the year-end.

Money stock (M_2 + CDs) continues to grow at around 2 percent on a year-on-year basis.

As for the funding costs for firms, the short-term funding rates basically remain flat but the long-term funding rates are declining slightly reflecting the decrease in market interest rates.

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