

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

Bank of Japan, 16 April 2001.

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

Adjustments in economic activities have been under way, as production is declining reflecting a fall in exports.

With regard to domestic demand, business fixed investment is increasing. The recovery in private consumption continues to be weak as a whole, but there are somewhat positive signs in some indicators. Housing investment is declining slightly. On the other hand, public investment is starting an upturn.

While domestic demand remains steady, net exports (real exports minus real imports) are falling rapidly reflecting a sharp slowdown in overseas economies such as in the U.S. and East Asia. Mainly due to these developments, industrial production is declining more sharply, and excessive inventories of electronic parts and some materials are building up. The pace of improvement in corporate profits seems to be slowing significantly as exports and production are recently declining, and business sentiment of firms are worsening particularly in the manufacturing industries. Income conditions of households have not yet deteriorated but the effects of the decline in production are starting to be observed in new job offers and overtime working hours.

As for the outlook, public investment is expected to continue increasing for the time being. Net exports, however, are likely to continue decreasing for a while, reflecting the ongoing adjustments in overseas economies. Leading indicators suggest that business fixed investment is likely to peak out gradually, although the implementation of a backlog of orders is expected to sustain investment. In addition, the need for inventory adjustments, although not to a large extent, is intensifying for some goods. Thus, industrial production is expected to follow a declining trend. In these circumstances, the increase in corporate profits is likely to be subdued, and recoveries in household income and consumption are projected to be sluggish.

Overall, the adjustments are expected to continue for some time, mainly in production. Meanwhile, it is generally thought that overseas economies, particularly the U.S., will follow a gradual recovery trend from the latter half of 2001. In this case, helped also by the depreciation of the yen, exports are expected to underpin the economy once again. However, attention should still be paid to the possibility of a prolonged deceleration of overseas economies and risks of a negative impact on the economy induced by developments in foreign and domestic capital markets via corporate and household confidence.

With regard to prices, import prices are rising, mainly reflecting the depreciation of the yen. Domestic wholesale prices are declining mainly due to the decrease in prices of electrical machinery. Consumer prices continue to be somewhat weak owing to the decline in prices of imported products and their substitutes. Corporate service prices are falling slowly.

As for the conditions surrounding price developments, the recent yen depreciation is exerting upward pressure on prices. However, with the ongoing adjustments, the balance between supply and demand in the domestic market is likely to exert downward pressure on prices. In addition, the declining trend of machinery prices caused by technological innovations, the decrease in prices of consumer goods arising from the streamlining of distribution channels, and the reduction in communications charges aided by deregulation will continue to restrain price developments. Overall, prices are expected to be weak for the time being. Moreover, given the high degree of uncertainty regarding future economic

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<sup>1</sup> This report is based on data and information available at the time of the Bank of Japan Monetary Policy Meeting held on April 12 and 13, 2001.

<sup>2</sup> The Bank's view of recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on April 12 and 13 as the basis for monetary policy decisions.

developments, the possibility that weak demand will intensify downward pressures on prices warrants careful monitoring.

In the financial market, the overnight call rate has declined reflecting the increase in the current-account balance at the Bank of Japan to around 5 trillion yen, following the decision at the Monetary Policy Meeting held on March 19 to adopt new procedures for money market operations, and is currently moving around zero percent.

Interest rates on term instruments are declining further mainly due to the monetary easing by the Bank. The Japan premium remains negligible.

Yields on long-term government bonds increased to 1.4-1.5 percent. The yield spreads between private bonds (bank debentures and corporate bonds) and government bonds are mostly unchanged or expanding somewhat.

Stock prices are rising reflecting the above-mentioned monetary easing and expectations toward the progress in disposal of non-performing bank assets.

In the foreign exchange market, the yen has depreciated and is currently being traded in the range of 123-126 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. There seem to be no significant changes in firms' perception on the lending attitude of financial institutions and the fund-raising conditions of firms in the markets for such instruments as corporate bonds and CP.

On the other hand, credit demand of private firms continues to lack momentum as corporate demand for external funds is subdued, since firms' cash flow is at a high level. 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. The amount outstanding of corporate bonds issued continues to be above the previous year's level but the growth rate is slowing somewhat. Meanwhile, the amount outstanding of CP issued remains at a high level.

Recently, the growth rate of money stock ( $M_2 + \text{CDs}$ ) is increasing reflecting the inflow from postal savings.

Funding costs for firms continue to decline as both short- and long-term prime lending rates were lowered, reflecting the decrease in market interest rates.

In this financial environment, the lending attitude of financial institutions and corporate financing conditions remain easy. For the time being, attention should be paid to the effects of the additional monetary easing measures taken by the Bank, while careful monitoring is still required for the effects of stock price developments on the behavior of financial institutions and the fund-raising conditions of firms.