

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

Bank of Japan, 19 November 2001

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The Bank's View²

Adjustments in economic activity are becoming more severe, as the substantial decline in production is beginning to have an adverse effect on private consumption through decreases in employment and income.

With regard to final demand, net exports (real exports minus real imports) continue to decline, reflecting not only a slowdown in overseas economies but also sluggish demand for IT-related goods. Business fixed investment also continues to decrease while the deterioration in exporting conditions persists. Housing investment remains sluggish and public investment is on a downward trend. Moreover, private consumption seems to be weakening gradually.

Industrial production continues to decline considerably, reflecting these developments in final demand and also strong excessiveness in inventories of electronic parts and materials. Corporate profits are deteriorating, particularly in manufacturing, and the weakness in household income is becoming evident amid the decrease in the hours worked and the rise in unemployment.

Turning to the outlook, as for exporting conditions, the prevailing view is that inventory adjustments in IT-related goods worldwide are expected to be mostly completed by around next spring. However, while the world economy has decelerated further since the terrorist attacks in the U.S., final demand of IT-related goods is likely to be stagnant for the time being. Moreover, if the downturn in U.S. private consumption persists, it may induce another round of adjustments in the Japanese economy, starting from the decline in exports such as of consumer goods.

Meanwhile, with respect to domestic demand, business fixed investment is expected to follow a downward trend, particularly in the IT-related sector, amid the decline in corporate profits. Private consumption will also continue to be weak along with deteriorating employment and income conditions and the more cautious consumer sentiment. Government spending is projected to follow a downtrend at the time when the substantial decline in exports and production is negatively affecting private consumption through the decrease in household income. Consequently, it may take quite a while for overall production activity to stop declining, although the decrease in the production of IT-related goods may eventually come to an end.

Overall, adjustments in economic activity, starting from the decline in exports since the beginning of this year, will surely dampen domestic demand further. At the same time, concern that another substantial decline in exports will exert downward pressure on the economy is growing. Moreover, while the economy continues to be in a fragile state, continuous attention should be paid to the risk 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 continue to decline mainly reflecting the softening of international commodity prices. Domestic wholesale prices are also declining faster from the effects of the decline in crude oil prices in addition to the continuous decreases in prices of electrical machinery and materials. Consumer prices are weakening owing mainly to the decline in prices of imported products and their substitutes. Corporate service prices continue to decrease.

As for the conditions surrounding price developments, international commodity prices such as of crude oil and nonferrous metals remain weak. Also, with the prolonged adjustments in economic activity, the balance between supply and demand in the domestic market will increasingly exert downward pressure on prices. Furthermore, in addition to the declining trend of machinery prices caused by technological innovations, the decreases in the prices of goods and services reflecting deregulation

¹ This report is based on data and information available at the time of the Bank of Japan Monetary Policy Meeting held on November 15 and 16, 2001.

² The Bank's view of recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on November 15 and 16 as the basis for monetary policy decisions.

and the streamlining of distribution channels will continue to restrain price developments. Overall, prices are expected to follow a gradual declining trend for the time being. Moreover, given the high degree of uncertainty regarding future economic developments, the possibility that weak demand will further intensify downward pressure on prices warrants careful monitoring.

In the financial market, the overnight call rate is moving around zero percent as the Bank of Japan provided ample liquidity to the money market by aiming at maintaining the current account balances held at the Bank at above 6 trillion yen.

Interest rates on term instruments basically continue to be level. The Japan premium remains negligible.

Yields on long-term government bonds dipped and are recently moving around 1.35 percent. As for the yield spreads between private bonds (bank debentures and corporate bonds) and government bonds, while spreads between bonds with relatively high credit ratings and government bonds remain mostly unchanged, those between bonds with low credit ratings and government bonds continue to expand slightly.

Stock prices continued to be weak, but are recently rebounding.

In the foreign exchange market, the yen is currently being traded in the range of 121 -123 yen to the U.S. dollar.

With regard to corporate finance, private banks appear to be more cautious in extending loans to firms with higher credit risks while they continue to be more active in extending loans to blue-chip companies. The lending attitudes of financial institutions as perceived by small firms are becoming more cautious. In corporate bonds and CP markets, the fund-raising conditions for firms continue to be generally favorable, although the issuing environment for firms with low credit ratings is deteriorating slightly.

Credit demand in the private sector is declining faster mainly because firms are decreasing their business fixed investment while continuously reducing their debts.

Amid these developments, private banks' lending continues to decline at about 2 percent on a year-on-year basis. As for the amount outstanding of corporate bonds issued, the year-on-year growth rate is slowing due to the decrease in the issuance of corporate bonds with low credit ratings. Meanwhile, the amount outstanding of CP issued continues to be at a high level, significantly exceeding that of the previous year, due to the generally favorable environment for issuing CP.

The growth rate of money stock ($M_2 + \text{CDs}$) in October remained relatively high while the rate declined slightly from the previous month.

Funding costs for firms continue to be at extremely low levels on the whole.

Overall, the recent financial environment remains extremely easy in terms of money market conditions and interest rate levels. However, as private banks and investors are becoming slightly cautious in taking credit risks, the fund-raising conditions of firms with higher credit risks and small firms are apparently becoming severe. Hence, the developments in the behavior of financial institutions and corporate financing need closer monitoring.