Bank of Japan's April report of recent economic and financial developments[1]

Bank of Japan, 12 April 2002.

*   *   *

The Bank's view[2]

Japan's economy still continues to deteriorate as a whole, but the pace has moderated somewhat.

With regard to final demand, net exports (real exports minus real imports) are gradually starting to increase while overseas economies are clearly gaining momentum for recovery. Meanwhile, business fixed investment continues to decrease and private consumption remains weak. Moreover, housing investment remains sluggish and public investment is also declining.

Final demand overall is still weak, but exports—which have a large impact on production—are starting to turn up recently. Also, inventory adjustment is progressing further in many industries. Reflecting these developments, industrial production appears to have stopped declining and also, the deterioration in business sentiment of firms, mainly in manufacturing, has almost ceased. However, firms maintain their stance on reducing personnel expenses given persistently strong excessiveness in employment. Therefore, employment and income conditions of households continue to worsen, with the ongoing decrease in the number of employees and the growing trend in the rate of decline in wages.

Turning to the outlook, as for exporting conditions, the synchronized inventory adjustment in IT-related goods worldwide is coming to an end except for some goods such as networking equipment. Overseas economies, mainly in the U.S. and East Asia, are likely to follow a recovery path. Moreover, the yen is at low levels compared to last autumn. Under these circumstances, exports are expected to pick up moderately for the time being.

Meanwhile, with respect to domestic demand, business fixed investment is expected to follow a downtrend for a while, judged mainly from leading indicators and firms' investment plans. Private consumption is also likely to remain lackluster mainly due to worsening employment and income conditions. In addition, government spending is basically projected to continue a downward trend. While the recovery in exports and the weakness in domestic demand are mixed, industrial production is expected to remain almost flat for the time being. As for the further outlook, assuming that exports will continue to recover steadily, the economy as a whole will eventually hit bottom through the increase in production and rebound in corporate profits, mainly in manufacturing.

Overall, the economic deterioration in Japan is projected to stop steadily, as production stops declining and then turns up reflecting the improvement in exporting conditions. Still, the rebound in exports is expected to be modest for a while and there also remain various uncertain factors regarding the pace of recovery in overseas economies. In addition, domestic demand continues to be weak for some time. Consequently, it will take quite a while for the economy as a whole to stop declining evidently. While the economy continues to be in a fragile state, continuous attention should be paid to the fact that unstable movements in the foreign and domestic financial markets are apt to have a negative impact on the real economy.

With regard to prices, import prices are increasing reflecting the depreciation of the yen since around the end of last year and the rise in international commodity prices. The decline in domestic wholesale prices is contracting against the background of the increase in import prices and the progress in inventory adjustment. Consumer prices continue to decline with the persisting effects of the fall in crude oil prices in the latter half of last year, while the prices of imported products and their substitutes keep on falling. Corporate service prices continue to decline.

As for the conditions surrounding price developments, the depreciation of the yen from around the end of last year and the rise in international commodity prices including crude oil are regarded as factors to

---

[1] This report is based on data and information available at the time of the Bank of Japan Monetary Policy Meeting held on April 10 and 11, 2002.

[2] The Bank's view of recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on April 10 and 11 as the basis for monetary policy decisions.

support prices for the time being. However, since domestic demand is projected to remain weak for a time, the balance between supply and demand is expected to keep exerting downward pressure on prices. Furthermore, factors such as the ongoing technological innovations in machinery, deregulation, and the streamlining of distribution channels will restrain prices. In addition, the growing trend in the rate of decline in wages may also work as a factor to push prices downward, mainly in services prices which are apt to be influenced by this aspect. 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 continuously warrants careful monitoring.

As for the financial market, in the short-term money markets, the end-of-March outstanding balance of the current accounts at the Bank of Japan was 27.6 trillion yen as the Bank provided further ample liquidity to the money market toward the fiscal year-end in reaction to the increase in liquidity demand.

Under this condition, the overnight call rate, including transactions beyond the fiscal year-end, is steadily moving around zero percent. Moreover, interest rates on term instruments have been declining since late March when pressures on fund-raising beyond the fiscal year-end alleviated.

Yields on long-term government bonds are mainly moving around 1.4 percent recently. As for yield spreads between private bonds (bank bonds and corporate bonds) and government bonds, the widening since last fall has been constrained recently, but spreads between bonds with low credit ratings and government bonds still remain wide.

Stock prices are level on the whole.

In the foreign exchange market, the yen is currently traded in the range of 130-133 yen to the U.S. dollar.

With regard to corporate finance, private banks are becoming more cautious in extending loans to firms with high 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 firms are becoming more severe. In corporate bonds and CP markets, the fund-raising conditions are generally favorable particularly for firms with high credit ratings, but the issuing environment for those with low credit ratings continues to be severe on the whole.

Credit demand in the private sector continues to follow a downtrend 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. Meanwhile, the amount outstanding of corporate bonds issued is growing at around 2-3 percent on a year-on-year basis. The year-on-year growth rate of the amount outstanding of CP issued continues to decline, although the amount is still well above the previous year's level.

The year-on-year growth rate of the monetary base in March increased further due to heightened liquidity demand for the fiscal year-end, showing a significant increase of over 30 percent. The year-on-year growth rate of the money stock (M_2 + CDs) remained around 3.5-4.0 percent.

Funding costs for firms continue to be at extremely low levels on the whole, although market funding costs for some firms are rising somewhat.

Overall, the recent financial environment remains extremely easy on the whole in terms of money market conditions. However, the fund-raising conditions of firms with high credit risks, especially of small firms, are gradually becoming more severe as the stance of investors toward taking credit risks remains severe and the lending attitudes of private banks are becoming more cautious. Hence, the developments in the behavior of financial institutions and corporate financing continue to require closer monitoring.