

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

Bank of Japan, 5 February 2004.

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

Japan's economy is recovering gradually.

Exports are recently increasing substantially and business fixed investment continues a gradual recovery. Reflecting these developments, industrial production is also increasing. The decline in household income is gradually coming to a halt and private consumption is virtually flat. Meanwhile, housing investment remains sluggish and public investment is declining.

As for the outlook, Japan's economy is anticipated to continue recovering, albeit at a moderate pace.

Overseas economies are projected to continue growing relatively fast. Based on this projection, it is expected that exports and production will continue increasing and that the recovery trend in business fixed investment will also become more visible. However, given persisting structural factors such as excessive debt, the increase in business fixed investment is expected to remain moderate. Private consumption is likely to remain virtually flat for some time, since the employment and income situations are unlikely to improve markedly. Meanwhile, public investment is projected to follow a declining trend.

On the price front, domestic corporate goods prices have been firm, due to the rise in rice prices and the strengthening of overseas and domestic commodity prices. The year-on-year rate of change in consumer prices (excluding fresh food) has been close to zero percent, while temporary factors such as the rise in rice prices have exerted upward pressure on prices.

Turning to the outlook, domestic corporate goods prices are expected to remain firm for the immediate future. As for consumer prices, the year-on-year rate of change is likely to be around zero percent for the time being due partly to the rise in rice prices. However, they are basically projected to continue falling slightly, since the imbalance between supply and demand in the economy still remains considerable despite its gradual improvement.

As for the financial environment, the environment for corporate finance is becoming somewhat more accommodative on the whole, although it is still severe for firms with high credit risks. The issuing environment for CP and corporate bonds is favorable on the whole, especially for firms with high credit ratings. Also, the lending attitudes of private banks have been slightly more accommodative. The pace of decline in credit demand in the private sector is becoming somewhat moderate. Under these circumstances, the amount outstanding of CP and corporate bonds issued continues to be above the previous year's level, and the rate of decline in lending by private banks is diminishing slightly. As growth of banknotes in circulation is on a downtrend due mainly to decreasing anxieties about the financial system, the year-on-year growth rate of the monetary base is moving around 15 percent. The year-on-year growth rate of the money stock is at the 1.0-2.0 percent level. As for developments in financial markets, money market conditions continue to be extremely easy, as the Bank of Japan provides ample liquidity. In the foreign exchange and capital markets, while the yen's exchange rate against the U.S. dollar is rising somewhat from the previous month, stock prices are declining slightly. Long-term interest rates are around the same level as last month.

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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 February 4 and 5, 2004.

<sup>2</sup> The Bank's view was determined by the Policy Board at the Monetary Policy Meeting held on February 4 and 5, 2004.