

Bank of Japan's March review of monetary and economic trends in Japan

BANK OF JAPAN, MONTHLY ECONOMIC REVIEW, 18/3/97.

A moderate economic recovery continues in Japan as private demand shows increasing firmness. With respect to final demand, public-sector investment has decreased while net exports have continued on an increasing trend. Housing investment has remained at a high level and business fixed investment is increasing steadily. A moderate recovery in personal consumption has continued on the whole, while passenger car sales have increased significantly. Meanwhile, inventories on the whole are at appropriate levels. Reflecting these developments, industrial production has shown a steady increase and labor conditions on the whole have continued to improve moderately. Meanwhile, prices have stopped declining, and monetary aggregates have continued to grow at 3.0 - 4.0 per cent.

With regard to personal consumption, sales at department stores and supermarkets are improving moderately, albeit with some fluctuations owing to such factors as weather conditions. Outlays for travel have continued to increase. Sales of electrical appliances are increasing on the whole, although the pace of growth in personal computers and cellular telephones has decelerated. Passenger car sales have recorded buoyant two-digit growth year-to-year for five consecutive months since October 1996.

Among leading indicators of business fixed investment, machinery orders have increased steadily on average. They rose significantly in the fourth quarter 1996 and showed a marginal decline in January 1997 from the average of the fourth quarter. Construction floor area has also continued to pick up moderately.

With respect to housing investment, housing starts in terms of the seasonally-adjusted annual rate have continued to be at a high level, although they have decreased for three consecutive months owing to the reversal of the rise in demand ahead of the consumption tax rate hike.

Regarding public-sector investment, public works contracted showing developments in orders have decreased significantly since the end of 1996 compared to the high level recorded in the previous year, which reflected the large economic stimulus package. As for actual implementation of public works, with a time lag after orders, the seasonally-adjusted level of shipments of public-related goods increased until summer 1996, but has been decreasing since autumn 1996.

Real exports are on an increasing trend reflecting the moderate expansion of overseas economies and the effects of the yen's depreciation since summer 1995. Although real imports are increasing, reflecting such elements as the rise in domestic demand, the recent pace of increase has been moderate, a reflection of the depreciation of the yen to date. As a result, the real trade surplus turned to an increase in the second half of 1996. The nominal current-account surplus, however, is increasing at a much slower pace compared to the real trade surplus owing to the fluctuations in the income account and the hike in crude oil prices.

Industrial production showed a significant increase in January 1997 after it increased by a seasonally-adjusted annual rate of over 10 per cent in the fourth quarter 1996. This increase was caused by the rise in final demand, particularly in those items conducive to production, such as passenger car sales, machinery investment, and net exports, under the circumstance in which inventories has been at appropriate levels. Although industrial production

is expected to decline in February and March, the figure for the first quarter 1997 on average is also expected to show a steady increase.

Labor market conditions have continued to improve moderately on the whole. Although the unemployment rate remains at a high level and employment growth has been moderate, growth in nominal wages has accelerated, reflecting the increase in production and corporate profits. The ratio of job offers to job applications has continued to improve.

With respect to price developments, domestic wholesale prices (adjusted for seasonal electricity rates) have stopped declining, although downward pressures such as from competition with imports and technological innovation in, e.g., electrical machinery, remain strong. This development has been supported by the yen's depreciation to date, the hike in crude oil prices and the moderate improvement in domestic supply and demand conditions. Corporate service prices have declined, particularly in rents and leasing charges, but the year-to-year decrease has become smaller. Consumer prices (nationwide, excluding perishables) have somewhat exceeded the level of the previous year, as the decline in commodity prices has slowed against the background of the yen's depreciation and the halt in the decline in domestic wholesale prices.

Growth in monetary aggregates, measured in terms of the year-to-year growth rate of M2 + CDs average outstanding, has continued at 3.0 - 4.0 per cent, as corporate demand for funds has been increasing at a moderate pace.

Regarding money market rates, the overnight call rate (uncollateralized), together with the 3-month CD rate, has moved at a low level albeit with small fluctuations. Meanwhile, 3-month Euro-yen futures have shown relatively minor movements at around 0.7 - 0.8 per cent after market's expectations for higher interest rates receded at a brisk pace between summer and autumn 1996. In these circumstances, the long-term government bond yield has moved at about 2.3 - 2.4 per cent since the end of November 1996, but has recently declined to reach a record low of around 2.2 per cent.

With respect to bank lending rates, the short-term prime lending rate has remained at a record low level of 1.625 per cent since September 1995. The long-term prime lending rate was lowered three times by a total of 0.8 percentage points since September 1996 in response to developments in the long-term interest rates, and has been moving at the record low of 2.5 per cent since December 1996. In these circumstances, short-term and long-term average contracted interest rates on new loans and discounts have moved at near record low levels.

On the stock exchange, the Nikkei 225 stock average plummeted temporarily between the end of 1996 and the beginning of 1997, reflecting the market's concerns about Japan's economic outlook and balance-sheet problems. It has since picked up somewhat.

In the foreign exchange market, the yen depreciated to reach ¥124 - 125 against the U.S. dollar temporarily in February 1997 owing to such factors as the interest rate differentials between Japan and the United States. Recently, the yen has moved at around ¥122 - 123 as concerns about the rapid appreciation of the U.S. dollar strengthened somewhat in the market. Meanwhile, the yen has been appreciating against the deutsche mark since mid-February and recently moved at around ¥72 - 73.