

Bank of Japan's August review of monetary and economic trends in Japan
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Japan's economy continues on a moderate recovery trend. Production and income are showing firmness although the effects of the consumption tax hike remain. With respect to final demand, public-sector investment has been on a decreasing trend, and housing investment has declined. Meanwhile, net exports have recently been on an increasing trend, and business fixed investment has been rising steadily. Despite the continued influence of the consumption tax hike, the recovery trend of personal consumption does not seem to have been hindered given the improvement in labor market conditions and income formation. Industrial production has been firm. Meanwhile, prices have remained stable on the whole, and the growth of monetary aggregates has continued at around 3.0 per cent year to year.

With regard to personal consumption, outlays for travel have continued to increase moderately. However, passenger-car sales marked the fourth month of consecutive decline year to year from April and sales of electrical appliances are also negative year to year. Sales at department stores and supermarkets continued to be below the previous year's level. These reflect some temporary factors, such as the typhoons which hit Japan in June and July, in addition to the continued reaction to the surge in demand ahead of the consumption tax hike. However, given that labor market conditions as well as income formation are improving steadily, albeit moderately, the recovery trend in personal consumption does not seem to have been hindered.

Among leading indicators of business fixed investment, machinery orders have been increasing steadily, although at a somewhat slower pace compared to the sharp rise in the second half of 1996. The increase in the construction floor area has recently been weak, but it is following a moderate recovery trend.

With respect to housing investment, housing starts in terms of the seasonally-adjusted annual rate reached a substantially high level in the fourth quarter 1996, partly reflecting the stepped-up demand ahead of the rise in the consumption tax rate. Later, they declined in reaction. Housing starts recorded around 1.5 million in spring 1997, but fell to 1.34 million in June, the lowest level recorded since January 1993.

Regarding public-sector investment, the amount of public works contracted has recently picked up somewhat from the level recorded in early 1997 owing to orders included in the supplementary budget for fiscal 1996. However, public-sector investment has been following a declining trend on average, reflecting the restrained budget for fiscal 1997.

Against the background of the steady overseas demand and the yen's depreciation to date, real exports stayed firm in July after having increased significantly in the second quarter reflecting some additional temporary factors. Real imports had been stagnant since April, but rose in July reflecting the rise in imports of foodstuffs and airplanes, in addition to the increasing trend of information-related goods. As a result, the real trade surplus stopped rising in July after the significant increase in the second quarter. The nominal current-account surplus showed a large expansion in the second quarter 1997, partly reflecting the decline in crude oil prices since early 1997.

Industrial production in the second quarter has been firm and remained virtually unchanged after recording high growth during the second half of 1996 and the first quarter 1997. Despite the decline in demand following the surge ahead of the consumption tax hike, factors

such as the substantial increase in exports and the rebuilding of inventories have supported production. Production is expected to increase slightly in July and August compared to the second quarter. Meanwhile, inventories are at appropriate levels on the whole, despite some accumulation in industries such as in automobiles.

Labor market conditions have continued to improve on the whole. Although the unemployment rate remains at a high level, the growth in nominal wages has been increasing and the year-to-year employment growth has started to gather pace, albeit gradually, reflecting the increase in production and corporate profits.

Prices remained stable on the whole, excluding the effect of the consumption tax hike. Although downward pressures remain, including that from the decline in import prices, as well as that from technological innovation in electrical machinery, domestic wholesale prices (adjusted for seasonal electricity rates) have remained virtually unchanged. This reflects the moderate improvement in overall domestic supply and demand conditions. The year-to-year declines in corporate service prices are narrowing steadily on the whole, partly owing to the improvement in supply and demand conditions, particularly for real estate rents and information services, although leasing charges continue to decline. Consumer prices (nationwide, excluding perishables) overall are marginally above the previous year's level mainly because the year-to-year declines in goods prices have narrowed.

The growth in monetary aggregates, measured in terms of the year-to-year growth of M2 + CDs average outstanding, has been growing at around 3 per cent.

Regarding money market rates, the overnight call rate (uncollateralized) has moved at a level slightly below the official discount rate. The 3-month CD rate has stayed at around 0.55 - 0.60 per cent. Meanwhile, the long-term government bond yield rose to 2.65 - 2.70 per cent in late May. Later, it started to decline as the market confirmed the moderate pace of the economic recovery, and reached a historically low level below 2.1 per cent in mid August.

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 raised by 0.6 percentage points in May, and was then lowered by 0.2 percentage points both in June and July to 2.7 per cent. (The record low level is 2.5 per cent.) In these circumstances, short and long-term contracted interest rates on new loans and discounts (up to June) have moved at record low levels.

On the stock exchange, the Nikkei 225 stock average moved at around ¥20,000 - 21,000 between May and July 1997, but later declined, reflecting such factors as the fall in U.S. stock prices. Recently, it has been moving at around ¥19,000.

In the foreign exchange market, the yen appreciated to ¥110 to the U.S. dollar in the first half of June. The yen later depreciated slightly, and has recently stayed at around ¥115 - 120. Meanwhile, the yen has also been appreciating against the Deutsche Mark since May, and recently has moved at around ¥63 - 65.