

Bank of Japan's November review of monetary and economic trends in Japan BANK OF JAPAN, COMMUNICATION, 26/11/97.

Japan's economic growth is decelerating further. Although corporate profits, employment and income conditions continue to improve moderately, weak household expenditures since April have gradually begun to affect production, and corporate sentiment is also weakening.

With respect to final demand, public-sector investment has been decreasing, and housing investment has also dropped significantly. Personal consumption has continued to be weak on the whole, although the impact of the consumption tax hike has gradually begun to subside. On the other hand, net exports have continued to increase and business fixed investment has been rising moderately against the background of the increase in corporate profits. Excessive inventories are seen in some industries. Owing to weak final demand and inventory adjustments, industrial production has recently declined somewhat. The pace of improvement in employment and income conditions has slowed somewhat. Prices have remained stable on the whole, with the exception of wholesale prices which have declined somewhat. The growth of monetary aggregates has recently slowed.

Personal consumption has continued to be weak on the whole. Outlays for travel have been increasing moderately, and there are some signs in the sales of goods which suggest that the impact of the consumption tax hike has gradually begun to subside. However, sales at department stores and supermarkets have been below the previous year's level, while passenger car sales have fallen below the level recorded in the second half of fiscal 1996 when sales surged, and have not even recovered the levels recorded before then.

Among leading indicators of business fixed investment, machinery orders have continued on an increasing trend since early 1997 after having surged in the second half of 1996. Recently, however, orders from non-manufacturing firms have been weak. Construction floor area has followed a moderate recovery trend, albeit with some fluctuations.

With respect to housing investment, housing starts in terms of the seasonally-adjusted annual rate declined in July to 1.24 million, the lowest level since September 1985, following the surge in demand in the second half of 1996 ahead of the consumption tax hike. Housing starts have since remained weak at around 1.3 - 1.35 million.

Regarding public-sector investment, the amount of public works contracted has followed a decreasing trend reflecting the restrained budget for fiscal 1997.

Against the background of steady overseas demand and the yen's depreciation to date, real exports remained high in the third quarter 1997, although they decreased somewhat from the second quarter when exports showed a significant rise. Real exports rose again in October. Real imports, on the other hand, have remained virtually unchanged on average. As a result, the real trade surplus has been increasing with some fluctuations. Reflecting these developments in exports and imports, the nominal current-account surplus has also been expanding significantly since April 1997.

Industrial production has recently been somewhat weak. Production in the third quarter 1997 remained virtually unchanged on the whole. This is because production has been

cut back mainly in the industries with excessive inventories, such as consumer durables and construction-related goods, although production of electrical machinery continued to increase, reflecting steady exports. Production in October and November is expected to decrease as a result of inventory adjustment pressures.

With respect to labor market conditions, the unemployment rate has remained at a high level, and the ratio of job offers to job applications has recently eased somewhat. Growth in overtime working hours and nominal wages has slowed slightly reflecting weak production. However, year-to-year employment growth has been moderate but steady. Thus, employment and income conditions continue to improve moderately on the whole, but the pace of recovery has slowed somewhat.

Prices remained stable on the whole, excluding the effect of the consumption tax hike. Domestic wholesale prices (adjusted for seasonal electricity rates) have declined to some extent as domestic demand and supply conditions started to ease, particularly in construction-related goods. The year-to-year declines in corporate service prices on the whole have been narrowing further owing to the improvement in supply and demand conditions, particularly for real estate rents and information services, although leasing charges continue declining. Consumer prices (nationwide, excluding perishables) rose year to year in September, reflecting the temporary factor; i.e., a rise in medical charges which resulted from medical insurance reform. Excluding this, however, consumer prices have remained stable at a level slightly above that of the previous year.

Monetary aggregates, measured in terms of year-to-year growth of M2 + CDs average outstanding, declined somewhat in October to 2.7 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 0.50 - 0.55 per cent. Against the background of uncertainties about future economic growth, the long-term government bond yield had been declining since the end of May and reached the record low of 1.5 - 1.6 per cent at the end of October, but recently rose to 1.6 - 1.8 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 has been lowered since June and reached a record low of 2.3 per cent in October. In these circumstances, short- and long-term contracted interest rates for new loans and discounts (up to September) have stayed at record low levels.

On the stock exchange, the Nikkei 225 stock average has been declining since August, partly reflecting uncertainties about future economic growth and the fall in U.S. stock prices, and fell below ¥18,000 in early September. It dropped further after late October as a result of the precipitous decline in Hong Kong stock prices and temporarily reached around ¥15,000, but has recently recovered to around ¥16,000.

In the foreign exchange market, the yen moved at around ¥119-123 to the U.S. dollar between September and October. However, the yen later depreciated in early November, owing to growing concerns about future economic growth, as well as the fall in stock prices. Recently, it has moved at around ¥125-128. Meanwhile, the yen started to depreciate against the Deutsche Mark, after having peaked at around ¥62 in mid-August, and has recently moved at around ¥71-74.