Bank of Japan's June report of recent economic and financial developments in Japan BANK OF JAPAN, COMMUNICATION, 16/6/98.

The Bank's View[1]

Final demand remains weak and production continues to decline in Japan. As a consequence, employment and income conditions have recently shown a significant deterioration.

With respect to final demand, public-sector investment seems to have bottomed out. Growth in net exports, however, has virtually peaked out as exports to other Asian countries declined. Business fixed investment continues to be on the decline. Private consumption shows little sign of recovery, although the deterioration has slowed. Housing investment has decreased further. Against the background of weak final demand, inventories have accumulated further and industrial production continues to decrease. As a result, corporate profits have worsened, and employment and income conditions have deteriorated evidently, as seen recently in the rapid rise of the unemployment rate.

As for the outlook of the economy, the implementation of the supplementary budget for fiscal 1998 is assumed to boost demand through additional public works and special income tax-reduction, and cease the negative interactions of production, income, and expenditure. However, such positive effects of the fiscal policy may be weakened, if the ongoing rapid deterioration in employment and income conditions further dampens the overall economic activities. Therefore, the overall economic activities, including corporate and household confidence, should be carefully monitored.

With regard to prices, wholesale prices continue to fall and consumer prices (excluding the effects of institutional changes) have declined slightly below the previous year's level. With respect to the factors affecting the outlook, the downward pressure on domestic prices induced by the decline in import prices including overseas commodity prices has already weakened. Also, the expansion in the output gap in the economy is expected to slow in line with the implementation of the economic stimulus package. However, reflecting the present high inventory level and the relatively large output gap, prices are likely to be weak for some time. There may also be additional downward pressures if domestic demand weakens further.

As for financial markets, rates on term instruments (for both spots and futures) have been generally steady in the money markets. Yields on long-term government bonds recorded historical lows from late April to early June with the releases of weak economic indicators, and are recently showing a slight turnaround. Stock prices have been slightly declining, indicating the weak market sentiment on the economy.

Market concern towards credit risk remains strong, and the yield differential between bonds issued by the private sector and those by the government has been significant since the end of last year.

With respect to monetary aggregates, growth in M2+CDs has been slowing and private bank lending remains sluggish. This reveals the fall in credit demand following stagnant economic conditions as well as the continued cautious lending attitudes of private banks.

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1 The Bank's view on recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on June 12, as the basis of monetary policy decisions.

Meanwhile, some firms, especially small and medium-sized firms, have been facing difficult financing conditions in terms of both funds availability and fund-raising costs. This influence on the overall economy continues to warrant a careful monitoring.