

Bank of Japan's monthly report of recent economic and financial developments¹

Bank of Japan, Communication, 21/1/99.

The Bank's View²

The economic deterioration in Japan is easing gradually mainly due to the increase in public investment.

With respect to final demand, business fixed investment has been declining significantly, and housing investment continues to be sluggish. Private consumption, as a whole, remains stagnant. Meanwhile, net exports (exports minus imports) are basically increasing at a moderate pace, and public investment has turned to follow a distinct upward trend. Reflecting this development of final demand and the progress in inventory adjustments, the decline in production is slowing.

Corporate profits continue to worsen. Employment and household income conditions have deteriorated as the unemployment rate has reached a new historical high, the ratio of job offers to applications remains at its lowest ever level, and winter bonuses have decreased significantly. Financial conditions are improving with the effects of the policy measures taken by the government and the Bank. Nonetheless, firms apparently cannot eliminate their anxiety about the availability of funds toward the end of fiscal 1998. Consequently, corporate and household sentiment remains cautious, and a recovery has not yet been observed in private demand.

As for future developments, the increase in public investment is likely to underpin the economy toward the first half of fiscal 1999 with the implementation of the government's economic measures. Furthermore, the Bank's monetary and financial measures and the government's measures to alleviate the credit crunch will remain in effect. Nevertheless, an immediate self-sustained recovery in private demand is hardly expected since corporate profits and household income are deteriorating and the constraints from corporate finance are likely to persist for some time due to the cautious lending attitudes of private banks. Moreover, attention should be paid to the effects of the continued appreciation of the yen since autumn 1998, and to the uncertainty in financial and economic developments abroad. To lead Japan's economy into a steady recovery, it is important to prepare an environment where firms and households can regain confidence in Japan's economic future by, for instance, promptly restoring the stability of the financial system.

With regard to prices, reflecting the large output gap, domestic wholesale prices are on a downtrend, and corporate service prices are weakening. Consumer prices have increased above the previous year's level due to the rise in prices of perishables. Excluding this effect, however, consumer prices basically continue to be weak. As for the outlook, the economic deterioration is likely to continue easing mainly due to the increase in public investment. Nonetheless, distinct narrowing in the output gap is hardly expected for the time being as private demand remains sluggish. Furthermore, the decline in wages and the appreciation of the yen since autumn 1998 are likely to continue exerting downward pressure on prices. Hence, the decline in prices may somewhat accelerate in the future. In the financial markets, a slight increase was observed in the Japan premium and Euro-yen interest rates both on three-month contracts, as these contracts mature beyond the fiscal year-end in March. In general, however, the premium is smaller and the

¹ This report is based on data and information available when the Bank of Japan Monetary Policy Meeting was held on January 19, 1999.

² The Bank's view on recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on January 19, as the basis of monetary policy decisions.

Euro-yen rates are lower than those on contracts maturing beyond the end of accounting terms in 1998.

Between mid-December and early January, yields on Japanese government bonds rose further to reveal the market concern over the deterioration in the supply-demand balance due to the planned massive issuance. Stock prices weakened, reacting to the appreciation of the yen and the rise in the long-term interest rates. Although such movements in these markets appear to have reversed, the ensuing developments and their economic consequences require close attention.

With regard to corporate finance, credit demand for economic activities seems to remain weak, although firms, particularly large ones, are further seeking to secure ample on-hand liquidity. Meanwhile, private banks are keeping their cautious lending stance as they face the worsening performance of borrower companies. However, the enhanced credit guarantee system has been actively utilized. Such government policy measures and the Bank's new measures to facilitate firms' financing activities have presumably contributed to easing the once seriously tightened credit conditions.

Nevertheless, firms, especially those with low credit standings, are still subject to severe fund-raising conditions.

How corporate financing conditions develop and how such developments influence business activities and the economy as a whole continues to warrant careful monitoring.

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