Bank of Japan's March report of recent economic and financial developments[1]

Bank of Japan, Communication, 10 March 2000.

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The Bank's view[2]

Japan's economy has recently started to improve. The economic environment surrounding private demand continues to improve, as seen in the increase in corporate profits. However, clear signs of a self-sustained recovery in private demand have not been observed yet.

With regard to final demand, housing investment and public investment are decreasing moderately. Recovery in private consumption continues to be weak through lack of notable improvements in employment and income conditions. Meanwhile, business fixed investment, which had been on a downward trend, seems to have almost leveled off. Net exports (real exports minus real imports) continue to follow an upward trend due to an upturn in overseas economies.

Reflecting such developments in final demand, industrial production continues to rise, and an increase in corporate profits is becoming distinct. In this situation, corporate sentiment continues to improve. Regarding the employment condition, the decrease in the number of employees is slowing. However, the improvements in corporate profits and sentiment have not stimulated business activities of many firms, because these firms still strongly feel that they have excess capacity and employees and that they should reduce their debts to restore financial soundness. In addition, efforts by firms to reduce personnel expenses have prolonged the severity of households' income conditions.

As for the outlook, public investment is likely to pick up reflecting the progress in the implementation of the supplementary budget for fiscal 1999. This, along with the favorable financial environment created partly by the Bank's monetary easing, is expected to continue underpinning the economy. Moreover, the positive impact on domestic production of the recovery of overseas economies is likely to continue for some time, having favorable effects on corporate profits and spending, and then on household income and consumption. By contrast, it is highly probable that housing investment will continue to decline moderately. In the corporate sector, restructuring is gradually improving profitability to some extent, and some firms in high-growth sectors are inclining toward increasing capital spending. Many firms, however, are expected to maintain a cautious stance toward fixed investment based on their modest prospects for sales. It seems that the appreciation of the yen since the summer of 1999 will have an adverse effect on corporate profits in the near term. In these circumstances, future economic developments still require careful monitoring in spite of the continued improvements in the environment for private demand. Furthermore, it is important to promote structural reform in order to facilitate a recovery in private demand.

With regard to prices, import prices are rising due to the increase in international commodity prices such as crude oil prices, along with the recent depreciation of the yen. Domestic wholesale prices, notwithstanding the fall in prices of electric machinery, are flat mainly due to the rise in prices of petroleum and chemical products reflecting an increase in crude oil prices. Meanwhile, consumer prices are somewhat weak due to a decline in prices of imported products reflecting the past

1 This report was written based on data and information available when the Bank of Japan Monetary Policy Meeting was held on 8 March 2000.

2 The Bank's view on recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on 8 March as the basis of monetary policy decisions.

appreciation of the yen. Corporate service prices are still falling slowly. As for the outlook, upward pressure on prices is likely to arise from the gradual improvement in domestic supply-demand balance, as shown in the decline in inventories, and from the rise in crude oil prices. On the other hand, downward pressure is expected from the long-term declining trend of machinery prices due to technological innovations and from the fall in prices of imported products reflecting the past appreciation of the yen. On balance, overall prices are likely to remain unchanged for the time being. However, attention should still be paid to the downward pressure on prices stemming from weak demand, as clear signs of a self-sustained recovery in private demand have not yet been observed and wages continue to fall.

In the financial market, the overnight call rate has generally stayed near zero, except for a temporary rise reflecting concerns about the possible computer problems related to the leap year, and financial institutions have been confident about the availability of overnight funds. The amount outstanding of funds in the call money market increased slightly in late February, and decreased thereafter.

Interest rates on term instruments have generally been stable at an extremely low level. The Japan premium remains negligible.

Yields on long-term government bonds were generally above 1.8% in February, but declined somewhat from the beginning of March, and are recently ranging between 1.7% and 1.8%. The yield spread between private bonds (bank debentures and corporate bonds) and government bonds continues narrowing, primarily that between private bonds with relatively low credit ratings and government bonds.

Stock prices have been firm on the whole, and are currently moving around 20,000 yen.

In the foreign exchange market, the yen weakened against the US dollar for most part of February. However, the trend was reversed late in the month, and the yen is recently being traded in the range of 106-108 yen.

With regard to corporate finance, private banks have basically retained their cautious lending attitude. However, constraint that had been caused by severe fund-raising conditions and insufficient capital base has eased considerably. Under these circumstances, major banks are becoming more active in extending loans, while carefully evaluating the credit risks involved.

However, credit demand for economic activities such as business fixed investment remains weak. In addition, firms continue to reduce debts as part of their balance-sheet restructuring measures. As a result, credit demand in the private sector has continued to be basically stagnant, and thus private banks’ lending has remained sluggish. Issuance of corporate bonds and CP has been steady.

The growth in money stock (M_2+CDs) continues to slow reflecting the above-mentioned situation.

In this financial environment, corporate financing conditions are easing, and the lending attitude of financial institutions is perceived by firms as becoming less severe. It continues to warrant careful monitoring how these favorable developments in the corporate financing environment will affect economic activities.