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

Bank of Japan, 18 June 2001

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The Bank's view[2]

Adjustments in economic activities are gradually intensifying, as production is declining substantially reflecting a fall in exports.

With regard to final demand, the recovery in private consumption continues to be weak as a whole, but there are somewhat positive signs in some indicators. Housing investment is declining. Public investment is increasing. On the other hand, net exports (real exports minus real imports) continue to decrease, reflecting not only a slowdown in overseas economies such as those of the United States and East Asia but also sluggish demand for information technology (IT) related goods. Business fixed investment is starting to decrease while exporting conditions continue to deteriorate.

Industrial production continues to decline sharply, reflecting such developments in final demand and a further buildup of excess inventories of electronic parts and some materials. The environment surrounding corporate profits is becoming more severe in line with the substantial decline in exports and production, and business sentiment is worsening particularly in manufacturing. Income conditions of households have not yet deteriorated, but the decline in production is starting to affect the household sector mainly through the decrease in hours worked.

As for the outlook, public investment is likely to continue increasing for the time being but is expected to start declining in the near future. Net exports, however, are likely to continue decreasing for a while amid the deceleration in overseas economies and ongoing inventory adjustments in IT-related goods worldwide. Judged from leading indicators and investment plans of firms, business fixed investment is projected to follow a downward trend. In addition, inventory adjustments in goods such as electronic parts and materials will continue for the time being. Industrial production is, therefore, expected to follow a declining trend. In these circumstances, corporate profits are likely to start decreasing and thus household income is expected to weaken gradually.

Overall, the adjustments, mainly in production, are likely to continue for some time. Among factors affecting exports, it is generally thought that inventory adjustments in IT-related goods are expected to finish by early fall and overseas economies, particularly the United States, will follow a gradual recovery trend from around the end of this year. In this case, exports are expected to underpin the economy once again. However, a prolonged deceleration of overseas economies could yield the risk of economic adjustments spreading further. Also, attention should be paid to the risk of a negative impact on the economy induced by developments in foreign and domestic capital markets via corporate and household confidence.

With regard to prices, import prices are rising, mainly reflecting the rebound in crude oil prices in addition to the prior depreciation of the yen. Domestic wholesale prices are declining mainly due to the decrease in prices of electrical machinery. Consumer prices continue to be somewhat weak owing to the decline in prices of imported products and their substitutes. Corporate service prices continue to decrease.

As for the conditions surrounding price developments, the prior yen depreciation is exerting upward pressure on prices. However, with the ongoing adjustments in economic activities, the balance between supply and demand in the domestic market is likely to exert downward pressure on prices. Furthermore, in addition to the declining trend of machinery prices caused by technological innovations, the decreases in the prices of goods and services reflecting deregulation and the streamlining of distribution channels will continue to restrain price developments. Overall, prices are expected to be weak for the time being. Moreover, given the high degree of uncertainty regarding future economic developments, the possibility that weak demand will intensify downward pressure on prices warrants careful monitoring.

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1 This report is based on data and information available at the time of the Bank of Japan Monetary Policy Meeting held on June 14 and 15, 2001.

2 The Bank's view of recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on June 14 and 15 as the basis for monetary policy decisions.

In the financial market, the overnight call rate is basically moving at about 0.01 percent under the guideline for money market operations to maintain the current-account balance at the Bank of Japan at around 5 trillion yen.

Interest rates on term instruments are level on the whole. The Japan premium remains negligible.

Yields on long-term government bonds recently decreased to 1.1-1.2 percent after remaining flat at 1.2-1.3 percent. The yield spreads between private bonds (bank debentures and corporate bonds) and government bonds are mostly unchanged or contracting somewhat.

Stock prices continue to be weak, reflecting the somewhat more cautious views of market participants toward future corporate profits.

In the foreign exchange market, the yen appreciated against the U.S. dollar toward early June, but has weakened thereafter and is currently being traded in the range of 120-123 yen to the U.S. dollar.

With regard to corporate finance, private banks continue to be more active in extending loans, mainly to blue-chip companies, while carefully evaluating the credit risks involved. However, there are some signs indicating that the lending attitude of financial institutions perceived by small firms is becoming slightly more cautious. Meanwhile, the fund-raising conditions of firms in the markets for such instruments as corporate bonds and CP are improving further owing to the decline in market interest rates and the more active stance of investors to take credit risks.

On the other hand, credit demand of private firms continues to lack momentum as the level of corporate expenditures such as business fixed investment remains below firms' cash flow. Moreover, firms continue to reduce their debts as part of their balance-sheet restructuring measures. As a result, credit demand in the private sector has continued to be basically stagnant.

In view of this, the underlying tone of private banks' lending remains sluggish. The growth rate of amount outstanding of corporate bonds issued is slightly below 2 percent year-on-year. The amount outstanding of CP issued is well above that of the previous year and marking the highest level to date, reflecting the favorable environment for issuing CP.

The growth rate of money stock (M_2 + CDs) in May was higher than that of the previous month due mainly to the inflow from postal savings.

Funding costs for firms are on a declining trend reflecting developments in market interest rates.

In this financial environment, the lending attitude of financial institutions and corporate financing conditions remain easy as a whole. For the time being, attention should be paid to the effects of the monetary easing measures taken by the Bank, while careful monitoring is required for the effects of stock price developments and corporate profit conditions on the behavior of financial institutions and the fund-raising conditions of firms.