

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

Bank of Japan, 16 July 2001

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The Bank's view²

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

With regard to final demand, private consumption remains flat on the whole. Housing investment is declining and public investment is also about to decrease since the implementation of the supplementary budget for fiscal 2000 has peaked out. Net exports (real exports minus real imports) continue to decrease, reflecting not only a slowdown in overseas economies but also sluggish demand for IT-related goods. Business fixed investment has started 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. Corporate profits and business sentiment are also 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 expected to follow a declining trend. Net exports 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, a decline in corporate profits seems inevitable for the time being 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 will have come to an end 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 mostly unchanged. Domestic wholesale prices are weak 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 past 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.

¹ This report is based on data and information available at the time of the Bank of Japan Monetary Policy Meeting held on July 12 and 13, 2001.

² The Bank's view of recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on July 12 and 13 as the basis for monetary policy decisions.

In the financial market, the overnight call rate is basically moving around zero 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 basically level on the whole. The Japan premium remains negligible.

Yields on long-term government bonds rose after moving at around 1.15-1.2 percent until the end of June and are recently moving around 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 are declining due mainly to the decrease in U.S. stocks.

In the foreign exchange market, the yen is depreciating against the U.S. dollar and is currently being traded in the range of 124-126 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 continue to improve 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. Meanwhile, the growth rate of amount outstanding of corporate bonds issued is recently rising slightly. 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 ($M_2 + \text{CDs}$) in June 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 attitudes 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.