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

Bank of Japan, 19 September 2002.

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The Bank's View[2]

Japan's economy, despite persistent weakness in domestic demand and large uncertainty regarding the global economy, has almost stabilized as a whole with exports and production continuing to increase.

With regard to final demand, while the decline in business fixed investment has become moderate, private consumption remains weak. Moreover, housing investment remains sluggish and public investment is declining. Meanwhile, net exports (real exports minus real imports) continue to increase due to the recovery in overseas economies.

Industrial production remains on an upward trend in response to the rise in exports and adequate reduction of excess inventory stocks. Against this background, corporate profits have started to recover. In addition, the rebound in production has been effecting labor markets, albeit marginally, with an increase in overtime hours worked and in new job offers mainly for part-time workers. However, as firms are still maintaining their stance on reducing personnel expenses, household income continues to decrease noticeably with a plunge in summer bonuses. Thus, the employment and income situation of households overall remains severe.

Turning to the economic outlook, the growth in exports is expected to slow temporarily with the impetus from overseas restocking coming to a halt, but the uptrend in exports will be maintained against the background of the moderate recovery in overseas economies. Thus, industrial production is also expected to follow a moderate uptrend despite a temporary slowdown.

With respect to domestic demand, public investment is projected to follow a declining trend and private consumption is likely to remain weak for some time due to the severe employment and income situation. Leading indicators suggest that business fixed investment will stop declining, but a distinct recovery in the immediate future is unlikely partly due to large uncertainty regarding overseas economies. Nevertheless, if the uptrend in exports and production continues, corporate profits will stay on a track to recovery, and this will gradually have a positive impact on domestic private demand.

Overall, it can be envisaged that the stabilization of Japan's economy will gradually become definite as overseas economies continue the moderate recovery. However, it will take a while for the economy to show clear signs of recovery, as the pace of increase in exports and production is expected to slow temporarily while restraining forces such as excessive labor input and debt persist. Furthermore, there is large uncertainty regarding exports such as the developments in stock prices in the United States and worldwide, the outlook for IT-related goods, and geopolitical factors and oil prices. In these circumstances, the recent weakness in domestic stock prices and its potential adverse effects on the financial system and the economy should be monitored carefully.

On the price front, import prices are declining mainly due to the U.S. dollar's depreciation against the yen from spring toward summer, but international commodity prices including crude oil have recently risen. Domestic wholesale prices have weakened, reflecting the decrease in import prices to date. Moreover, consumer prices remain on a gradual downtrend and corporate services prices continue to decline.

As for the conditions surrounding price developments, the balance between supply and demand is expected to keep exerting downward pressure on prices for a while amid persistently weak domestic demand, although the completion of inventory adjustment and the rise in capacity utilization rates will support prices to some degree. Moreover, factors such as the ongoing technological innovations in machinery, deregulation, and the streamlining of distribution channels will continue to restrain prices.

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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 September 17 and 18, 2002.

2 The Bank's view of recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on September 17 and 18 as the basis for monetary policy decisions.

Under these circumstances, domestic wholesale prices are projected to continue to be weak for a while. Consumer prices are expected to stay on a declining trend for the time being at the current gradual pace. While the slower growth in imports of consumer goods is expected to alleviate the downward pressure on prices to some extent, the faster pace of decline in wages may possibly reinforce the ongoing decline in prices, especially for services prices.

As for the financial market, the outstanding balance of the current accounts at the Bank of Japan is moving around 15 trillion yen as the Bank continues to provide ample liquidity. Under these circumstances, in the short-term money markets, more market participants have come to feel that there is an excess of liquidity in the market and the overnight call rate continues to move at very close to zero percent. Also, longer-term interest rates are declining.

Yields on long-term government bonds followed a downtrend in line with a decline in yields on overseas long-term government bonds and in domestic and overseas stock prices, in addition to widespread perceptions among market participants that there is an excess of liquidity. Yield spreads between private bonds (bank bonds and corporate bonds) and government bonds are virtually level.

Meanwhile, stock prices have been declining since the start of September in line with a decline in U.S. and European stock prices, as more investors preferred to hold off buying stocks. Stock prices are mainly moving around 9,000-9,500 yen recently.

In the foreign exchange market, the yen, after being fluctuating without trend until early September, dropped in mid-September. It is currently being traded in the range of 122-123 yen to the U.S. dollar.

With regard to corporate finance, private banks remain cautious in extending loans to firms with high credit risks while they continue to be more active in extending loans to blue-chip companies. The lending attitudes of financial institutions as perceived by firms continue to be severe. In the corporate bonds and CP markets, the issuing environment for firms with low credit ratings is still severe, but the environment for firms with high credit ratings is accommodative.

Credit demand in the private sector continues to follow a downtrend mainly because firms are decreasing their business fixed investment while continuously reducing their debts.

Amid these developments, private banks' lending continues to decline by about 2-3 percent on a year-on-year basis. The amount outstanding of corporate bonds and CP issued is recently moving near the previous year's level.

The monetary base increased substantially—by around 20-30 percent—from the previous year's level. The year-on-year growth rate of the money stock remained around 3.5 percent.

Funding costs for firms continue to be at extremely low levels on the whole.

Overall, the recent financial environment remains extremely easy on the whole in terms of money market conditions. The deterioration in the financing situation of firms has come to a halt. However, the stance of investors toward firms with high credit risks remains severe and the lending attitudes of private banks remain cautious. Hence, the developments in the behavior of financial institutions and corporate financing continue to require close monitoring.