

Bank of Japan's February review of monetary and economic trends in Japan

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A moderate economic recovery continues in Japan as private demand shows increasing firmness. With respect to final demand, public-sector investment has decreased while net exports are on an increasing trend. Housing investment has remained at a high level and business fixed investment is increasing steadily. While growth in personal consumption has been moderate on the whole, passenger car sales, which have a strong influence on production, have accelerated significantly. Meanwhile, inventories on the whole are at appropriate levels. In these circumstances, industrial production has recently increased at a somewhat fast pace and labor market conditions have continued to improve moderately. Meanwhile, prices have stopped declining, and monetary aggregates continue to grow at 3.0 - 4.0 per cent.

With regard to personal consumption, sales at department stores and supermarkets are improving moderately, albeit with some fluctuations. Outlays for travel have remained firm. Growth in sales of electrical appliances has become somewhat moderate as the pace of expansion in personal computers and cellular telephones decelerated. Passenger car sales have recorded buoyant two-digit growth year-to-year for four consecutive months since October 1996.

Among leading indicators of business fixed investment, machinery orders are increasing steadily on average, although they are expected to show a decline in the first quarter of 1997 as a reaction to the large increase recorded in the fourth quarter of 1996 in both the manufacturing and non-manufacturing sectors. Construction floor area has also continued to pick up moderately.

With respect to housing investment, housing starts have remained strong reflecting low interest rates and reasonable housing prices. They recorded a high seasonally-adjusted annual rate of over 1.7 million starts in the fourth quarter of 1996, partly reflecting the rise in orders ahead of the consumption tax rate hike.

Regarding public-sector investment, public works contracted showing developments in orders have decreased significantly since autumn 1996 compared to the high level recorded in the previous year which reflected the large economic stimulus package. As for actual implementation of public works, with a time lag after orders, the seasonally adjusted level of shipments of related goods has been decreasing since autumn 1996 after having increased until the summer.

Real exports have recently shown an increasing trend as the effects of the yen's depreciation since summer 1995 have gradually permeated. Meanwhile, the increase in real imports has slowed, also reflecting the depreciation of the yen. As a result, the real trade surplus turned to an increase in autumn 1996. The nominal current account surplus is also beginning to rise, although the pace of increase is slower than that of the real trade surplus, partly because the rise in oil prices is pushing up import volume.

Industrial production has increased significantly by an annual rate of over 10 per cent quarter-to-quarter in the fourth quarter of 1996. This increase was caused by the rise in final demand, particularly in demand conducive to production, such as passenger car sales, machinery orders, and net exports, in addition to the completion of inventory adjustments. Industrial production is expected to continue increasing significantly in January and February 1997, reflecting the rise in demand ahead of the consumption tax rate hike.

Labor market conditions have continued to improve moderately on the whole. Although the unemployment rate remains at a high level and employment growth has been moderate, overtime working hours have significantly exceeded the level of the previous year in line with production growth, and the ratio of job offers to job applications has continued its rise.

With respect to price developments, domestic wholesale prices (adjusted for seasonal electricity rates) have stopped declining, although downward pressures such as from competition with imports and technological innovation in, e.g., electrical machinery, remain strong. This development has been supported by the yen's depreciation to date, the rise in crude oil prices and the moderate improvement in domestic supply and demand conditions. Corporate service prices have declined, particularly in rents and leasing charges, but the year-to-year decrease has become smaller. Consumer prices (nationwide, excluding perishables) have exceeded the level of the previous year, as the decline in commodity prices has slowed against the background of the yen's depreciation and the halt in the decline in domestic wholesale prices.

Growth in monetary aggregates, measured in terms of the year-to-year growth rate of M2 + CDs average outstanding, has remained stable on the whole at 3.0 - 4.0 per cent. Although lending by private financial institutions has been weak, that by public financial institutions has been firm.

Regarding money market rates, the overnight call rate (uncollateralized) on the whole has stayed somewhat below the official discount rate of 0.5 per cent. The 3-month CD rate has moved at 0.50 - 0.55 per cent. Meanwhile, with regard to the market's interest rate expectations, 3-month Euro-yen futures are showing relatively minor movements after declining at a brisk pace between summer and autumn 1996. In these circumstances, the long-term government bond yield had been declining since summer 1996, and has recently moved at around 2.4 per cent.

With respect to bank lending rates, the short-term prime lending rate has remained at a record low level of 1.625 per cent since September 1995. The long-term prime lending rate was lowered three times by a total of 0.8 percentage points since September 1996 in response to the developments in the long-term interest rates, and has been moving at the record low of 2.5 per cent since December. In these circumstances, short-term and long-term average contracted interest rates on new loans and discounts have moved at around record low levels.

On the stock exchange, the Nikkei 225 stock average plummeted between the end of 1996 and early 1997 reflecting market's uncertainties about Japan's economic outlook and balance-sheet problems. It became stable in late January 1997 and has recently stayed around ¥18,000 - 19,000.

In the foreign exchange market, the yen depreciated moderately on the whole against the U.S. dollar in 1996, but the pace of depreciation has accelerated since the end of 1996. The yen has recently moved at around ¥123 - 124 to the U.S. dollar. Meanwhile, the yen has been relatively stable against the deutsche mark at around ¥73 - 74.