

**Bank of Japan's June review of monetary and economic trends in Japan**  
BANK OF JAPAN, COMMUNICATION, 20/6/97.

Japan's economy continues on a moderate recovery trend on the whole. While declines in demand have been widely observed in reaction to the stepped-up demand prior to the rise in the consumption tax rate, production and income have been firm. With respect to final demand, public-sector investment has been decreasing, and housing investment has been somewhat lackluster, mainly in reaction to stepped-up demand ahead of the consumption tax hike. However, net exports have continued to rise and business fixed investment is increasing steadily. Although personal consumption has declined in reaction to stepped-up demand, the recovery trend of personal consumption does not seem to have been hindered, under the improvement in labor market conditions and income formation. In these circumstances, industrial production has been firm, partly supported by the rebuilding of inventories which had fallen below appropriate levels owing to the temporary surge in demand ahead of the consumption tax hike. Meanwhile, prices have remained virtually unchanged, excluding the influence of the consumption tax hike. The growth of monetary aggregates has continued at around 3.0 per cent year to year.

With regard to personal consumption, outlays for travel have continued on a moderately increasing trend. With respect to goods, sales, particularly of expensive items, have been declining since April following increased demand prior to the consumption tax hike. Passenger-car sales recorded buoyant double-digit growth year to year for six consecutive months from October 1996 to March 1997, but marked double-digit declines year to year in April and May. Sales of electrical appliances, as well as sales at department stores and supermarkets, fell significantly below the previous year's level in April. May figures available for department stores in Tokyo also show negative growth year to year, although with a smaller decline compared to that in April. However, the recovery trend in personal consumption does not seem to have been hindered, as labor market conditions as well as income formation are improving steadily, albeit moderately.

Among leading indicators of business fixed investment, machinery orders have been on a steadily increasing trend, despite some large fluctuations particularly in the nonmanufacturing sector. Construction floor area has also continued to recover moderately.

With respect to housing investment, housing starts in terms of the seasonally-adjusted annual rate reached a significantly high level in the fourth quarter 1996, partly reflecting the stepped-up demand ahead of the rise in the consumption tax rate. Later, they declined in reaction and recorded a level somewhat below 1.5 million starts in both March and April 1997.

Regarding public-sector investment, the amount of public works contracted has recently picked up somewhat, owing to orders included in the supplementary budget for fiscal 1996. However, public-sector investment has followed a declining trend since spring 1996 when orders from the large economic stimulus package peaked.

Real exports are increasing, reflecting steady overseas demand and the yen's depreciation to date. Real imports have also continued to increase, owing to such elements as the rise in domestic demand. However, the pace of growth has been moderate against the background of significantly narrowing price differentials between Japan and abroad. Mirroring

these developments in exports and imports, the real trade surplus has been rising since the second half of 1996. The nominal current-account surplus is also increasing, but the increase has remained moderate because of the rise in crude oil prices until early 1997 and also movements in the income account.

Industrial production posted high growth in the fourth quarter 1996 and the first quarter 1997, and, in the second quarter 1997 is expected to decrease in reaction to the surge in final demand prior to the consumption tax hike. Supported by stimulative factors, however, such as the rebuilding of inventories which had declined at the end of March 1997 and the increase in exports, production has been firm and the decline so far has been small.

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, the growth in nominal wages has been on an increasing trend, reflecting the rise in production and corporate profits.

Prices rose in April 1997 reflecting the hike in the consumption tax. Excluding this factor, however, they remained virtually unchanged on the whole. Although downward pressure remains strong, including that from technological innovation in electrical machinery, domestic wholesale prices (adjusted for seasonal electricity rates) have remained virtually unchanged. This reflects the moderate improvement in domestic supply and demand conditions. The year-to-year declines in corporate service prices are narrowing steadily on the whole, partly owing to the improvement in supply and demand conditions, particularly in real estate and information service industries, although leasing charges continue to decline. Consumer prices (nationwide, excluding perishables) overall are marginally above the previous year's level mainly because year-to-year declines in goods prices have slowed.

The growth in monetary aggregates, measured in terms of the year-to-year growth of M2 + CDs average outstanding, has slowed somewhat compared to summer 1996, reflecting a shift of assets to those outside M2 + CDs. Recently, M2 + CDs average outstanding has been growing at around 3 per cent on the whole.

Regarding money market rates, the overnight call rate (uncollateralized) has moved at a level slightly below the official discount rate with some fluctuations. The 3-month CD rate has stayed at around 0.6 per cent. Meanwhile, the long-term government bond yield declined in early April to a record low of below 2.1 per cent, but began to rise in late April in line with the recovery in stock prices and reached 2.65 - 2.70 per cent in late May. It has recently declined again and has 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 declined to a record low of 2.5 per cent in December 1996. It was raised by 0.6 percentage points in May, and then lowered by 0.2 percentage points in June to 2.9 per cent. In these circumstances, short- and long-term contracted interest rates on new loans and discounts (up to April) have moved at record low levels.

On the stock exchange, the Nikkei 225 stock average began to recover in the second half of April 1997, reflecting the fact that market uncertainties about the economic

outlook and about the Japanese financial system had gradually subsided. Recently, it has been moving at over ¥20,000.

In the foreign exchange market, the yen depreciated in early May to ¥127-128 to the U.S. dollar. However, the yen's depreciation reversed rapidly, particularly in the first half of May, as concern about the appreciation of the U.S. dollar strengthened, and as interest rate differentials between Japan and the United States narrowed somewhat. The yen has recently moved at around ¥113-114 to the U.S. dollar. Meanwhile, the yen has also been appreciating against the Deutsche mark since May and has recently moved at around ¥65-66.