

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

BANK OF JAPAN, MONTHLY ECONOMIC REVIEW, 22/9/97.

The consumption tax hike continues to have an impact on Japan's economy. Production has stayed virtually unchanged. The moderate economic recovery in Japan has not been undermined, however, given the continued improvement in income and expenditure which is centered on the business sector.

With respect to final demand, public-sector investment has been on a decreasing trend, and housing investment has recently declined significantly. On the other hand, the increasing trend in net exports has continued, and business fixed investment has been rising steadily, particularly in machinery investment, against the background of the recovery in corporate profits. Meanwhile, economic indicators for personal consumption have recently been lackluster on the whole, reflecting the continued influence of the consumption tax hike. However, labor market conditions and income formation have been improving, albeit moderately. In these circumstances, industrial production has stayed virtually unchanged. Prices have remained stable on the whole, and 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 to increase moderately. With respect to goods, however, sales of passenger cars, electrical appliances, as well as sales at department stores and supermarkets have been below the previous year's level since April, reflecting the continued effects of the consumption tax hike.

Among leading indicators of business fixed investment, machinery orders have been increasing steadily, although at a somewhat slower pace compared to the sharp rise in the second half of 1996. The increase in construction floor area has recently been weak, but it is basically following a moderate recovery trend.

With respect to housing investment, housing starts in terms of the seasonally-adjusted annual rate have continued to decline following the surge in demand in the second half of 1996 ahead of the consumption tax hike. Housing starts had stayed at around 1.5 million since spring 1997, but declined to 1.34 million in June and to 1.24 million in July, the lowest level recorded since September 1985.

Regarding public-sector investment, the amount of public works contracted peaked as orders included in the supplementary budget for fiscal 1996 were concluded, and the amount has followed a decreasing trend, reflecting the restrained budget for fiscal 1997.

Against the background of steady overseas demand and the yen's depreciation to date, real exports have stayed firm since July after having increased significantly in the second quarter. Real imports, on the other hand, have been stagnant on average. As a result, the real trade surplus has been increasing with some fluctuations. The nominal current-account surplus has also been expanding significantly since April 1997, partly reflecting the decline in crude oil prices since early 1997.

After recording high growth during the second half of 1996 and the first quarter 1997, industrial production in the second quarter remained virtually unchanged as the decline in demand following the surge ahead of the consumption tax hike was offset by factors such as the substantial increase in exports and the rebuilding of inventories. Production in the third quarter is expected to remain mostly unchanged from the second quarter. This is because a minor production cutback is expected in the transportation machinery industry where inventories have accumulated, while production will continue a steady increase in the electrical machinery industry. Inventories are at appropriate levels on the whole, except for the transportation machinery industry.

With respect to labor market conditions, the unemployment rate remains at a high level, and the increase in overtime working hours has slowed somewhat, reflecting developments in production. However, year-to-year growth in nominal wages and employment has been moderate but steady, reflecting the increase in corporate profits. Thus, labor market conditions and income formation continue to improve moderately on the whole.

Prices remained stable on the whole, excluding the effect of the consumption tax hike. Domestic wholesale prices (adjusted for seasonal electricity rates) have remained virtually unchanged. This is because overall domestic supply and demand conditions have improved moderately, except for some construction goods, while import prices have declined. 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 for real estate rents and information services, although leasing charges continue to decline. Consumer prices (nationwide, excluding perishables) overall are stable, marginally above the previous year's level, mainly because the year-to-year declines in goods prices have narrowed.

The growth in monetary aggregates, measured in terms of the year-to-year growth of M2 + CDs average outstanding, has continued at around 3 per cent.

Regarding money market rates, the overnight call rate (uncollateralized) has moved at a level slightly below the official discount rate. The 3-month CD rate has stayed at around 0.55 per cent. Meanwhile, the long-term government bond yield has been declining since the end of May as the market confirmed the moderate pace of the economic recovery, and reached below 2.0 per cent in early September. Recently, it has moved at a record low level of around 1.95 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 by 0.2 percentage points each in June, July and September and has again reached the record low level of 2.5 per cent. In these circumstances, short- and long-term contracted interest rates for new loans and discounts (up to July) have moved at record low levels.

On the stock exchange, the Nikkei 225 stock average moved at around ¥20,000 - 21,000 between May and July 1997, but later declined, partly reflecting the fall in U.S. stock prices. It fell below ¥18,000 in early September, and has recently been moving at around ¥18,000.

In the foreign exchange market, the yen appreciated to ¥110 to the U.S. dollar in the first half of June. However, the yen later reversed its course and depreciated, with some fluctuations, and has recently moved at around ¥120. Meanwhile, the yen had also been appreciating against the Deutsche Mark since May, but recently depreciated somewhat to ¥67 - 69.