

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

Bank of Japan, Communication, 13 April 1999.

The Bank's View²

Japan's economy, at present, appears to have stopped deteriorating.

With regard to final demand, business fixed investment has been declining, and recovery in private consumption continues to be weak on the whole. Net exports (exports minus imports) are leveling off. Housing investment has started recovering, and public works orders are increasing considerably.

Reflecting such development of final demand and progress in inventory adjustment, industrial production has stopped decreasing. The deterioration in corporate and consumer sentiment seems to have ceased, due to this economic situation as well as the subsidence of the public's anxiety about the stability of Japan's financial system. However, corporate profits remain weak, and employment and household income conditions continue to deteriorate. In corporate finance, firms' concern about the availability of funds in the future is gradually abating, but has not completely disappeared.

As for the outlook, with the progress in inventory adjustment gradually paving the way for a recovery in production, the government's economic measures and the monetary easing by the Bank will underpin the economy. In addition, the anxiety about the stability of the financial system is easing against the background of the injection of public funds into banks, and stock prices are recovering. These improvements in the financial environment are also expected to exert positive effects on the economy gradually. With respect to corporate activities, however, firms have started taking steps toward full-scale restructuring, facing the continued decline in profits and strongly becoming aware of a need to improve their balance sheet. Although such corporate restructuring is expected to improve productivity, it may, in the short run, reduce fixed investment and discourage household expenditure through the resulting deterioration in employment and income conditions. Under such circumstances, it is still difficult to expect an immediate, self-sustained recovery in private demand. Overall economic developments require careful monitoring in consideration of the above points. It is also important to prepare an environment for a smooth structural reform that assures the economy's sustained growth in the medium term.

With regard to prices, reflecting the large output gap, domestic wholesale prices are on a downtrend, and corporate service prices are weakening. Consumer prices also remain weak. In relation to price developments in the future, distinct narrowing in the output gap is unlikely for the time being even though the economy appears to have stopped deteriorating. Furthermore, the decline in wages is likely to continue exerting downward pressure on prices. Hence, prices are expected to remain on a downtrend.

In the financial markets, the overnight call rate has stayed at nearly zero, and financial institutions' anxiety about the availability of liquidity has rapidly subsided. With the injection of public funds, the Japan premium has almost disappeared, and interest rates on term instruments have been at a low level.

¹ This report was written based on data and information available when the Bank of Japan Monetary Policy Meeting was held on April 9, 1999.

² The Bank's view on recent economic and financial developments, determined by the Policy Board at the Monetary Policy Meeting held on April 9, as the basis of monetary policy decisions.

The amount outstanding of funds in the call money market, after showing a recovery toward the previous fiscal-year end, has been decreasing again since the beginning of the new fiscal year, as institutional investors shifted part of their funds to highly-liquid deposits of banks. Although the shrinkage of the market has not led to any difficulty in funds settlement, close attention should be paid to the market development.

Long-term interest rates are declining gradually reflecting sluggish credit demand in the private sector. Stock prices have been firm against the background of the market's appreciation of moves toward corporate restructuring and the rise in U.S. stock prices.

With regard to corporate finance, credit demand for economic activities such as fixed investment remains weak. Firms' moves to increase their on-hand liquidity in the face of difficult fund-raising conditions are settling down.

Private banks have basically retained their cautious lending stance, facing the worsening performance of borrower companies. However, severity in their fund-raising conditions has been alleviated, and their insufficient capital base has been increased. Under these circumstances, it seems that banks have started to extend loans more actively than before especially for projects involving relatively small credit risks.

As a result, credit conditions, which tightened previously, are now easing somewhat. It should be noted, however, that firms with relatively low credit ratings remain under severe financing conditions. The situation continues to warrant careful monitoring on the extent to which private banks will ease their lending stance, and how the change will affect firms' propensity to invest.