

(English translation prepared by the Bank's staff based on the Japanese original)

January 26, 2011

Bank of Japan

Monthly Report of Recent Economic and Financial Developments¹

January 2011

Summary

Japan's economy still shows signs of a moderate recovery, but the recovery seems to be pausing.

Business fixed investment has started to pick up. The employment and income situation has remained severe, but the degree of severity has eased somewhat. As for private consumption, demand for some goods has suffered a reverse after the sharp increase seen previously. Housing investment is showing signs of picking up. On the other hand, exports have been somewhat weak and public investment is declining. With these developments in demand both at home and abroad, production has declined slightly.

Japan's economy is expected to gradually overcome the deceleration in the pace of improvement and return to a moderate recovery path.

Exports are expected to increase moderately again, reflecting the improvement in overseas economic conditions. Private consumption is expected to pick up again as the reverse following the sharp increase in demand becomes less pronounced. Meanwhile, signs of picking up in business fixed investment are expected to gradually become more evident as the improvement in corporate profits continues. However, with firms' persistent sense of excessive capital stock, the pace of improvement in business fixed investment is likely to remain moderate. In these circumstances, production is expected to resume a moderate increasing trend.

On the price front, the three-month rate of change in domestic corporate goods prices is rising moderately, mainly due to the increase in international commodity

¹ This report is based on data and information available at the time of the Bank of Japan Monetary Policy Meeting held on January 24 and 25, 2011.

prices. Consumer prices (excluding fresh food) are declining on a year-on-year basis due to the substantial slack in the economy as a whole, but the slowing trend in the pace of decline has continued.

Domestic corporate goods prices are expected to be on an uptrend for the time being, reflecting movements in international commodity prices. The year-on-year pace of decline in consumer prices is expected to slow as a trend as the aggregate supply and demand balance improves gradually.

The weighted average of the overnight call rate has been slightly below the 0.1 percent level. Interest rates on term instruments have declined somewhat as a whole. Meanwhile, the value of the yen against the U.S. dollar, long-term interest rates, and stock prices have remained at more or less the same levels as last month.

Financial conditions have continued to ease further.

The overnight call rate has remained at an extremely low level, and the declining trend in firms' funding costs has continued. While stimulative effects from low interest rates are still partly constrained given current developments in economic activity and prices, such effects are beginning to strengthen in light of improved corporate profits. With regard to credit supply, firms have continued to see financial institutions' lending attitudes as improving. Issuing conditions for CP and corporate bonds have become more favorable as seen in an increased variety of corporate bond issuers. As for credit demand, firms' need to fund working capital and fixed investment has declined, and some firms have reduced the on-hand liquidity that they had accumulated. Against this backdrop, bank lending has declined on a year-on-year basis. On the other hand, the amount outstanding of corporate bonds has exceeded the previous year's level, and the pace of decline in the amount outstanding of CP has been on a decelerating trend. In these circumstances, the financial positions of firms have been improving as a whole. Meanwhile, the year-on-year rate of change in the money stock has been in the range of 2.0-2.5 percent.