

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

**March 15, 2011**

**Bank of Japan**

**Monthly Report of Recent Economic and Financial Developments<sup>1</sup>**

**March 2011**

**Summary**

Japan's economy is emerging from the current deceleration phase.

Exports and production are showing signs of resuming their uptrend. Business fixed investment is picking up. The employment and income situation has remained severe, but the degree of severity has eased somewhat. Private consumption is showing signs of picking up. Housing investment has started to pick up. On the other hand, public investment is declining.

Japan's economy is expected to return to a moderate recovery path. However, the damage of the earthquake has been geographically widespread, and thus, for the time being, production is likely to decline and there is also concern that the sentiment of firms and households might deteriorate.

Exports are expected to increase moderately as a trend, reflecting the improvement in overseas economic conditions. Private consumption is expected to pick up. Meanwhile, business fixed investment is expected to continue picking up 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 basically expected to increase modestly.

On the price front, the three-month rate of change in domestic corporate goods prices is rising, mainly due to the increase in international commodity prices. The year-on-year rate of decline in consumer prices (excluding fresh food) has continued to slow, while there remains substantial slack in the economy as a whole.

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<sup>1</sup> This report is based on data and information available at the time of the Bank of Japan Monetary Policy Meeting held on March 14, 2011.

Domestic corporate goods prices are expected to continue rising for the time being, reflecting movements in international commodity prices. The year-on-year rate of change in consumer prices is expected to become slightly positive in the near future.<sup>2</sup>

The weighted average of the overnight call rate has generally been slightly below the 0.1 percent level, and interest rates on term instruments have been more or less unchanged. Long-term interest rates and stock prices have fallen compared with last month. Meanwhile, the value of the yen against the U.S. dollar has remained at more or less the same level 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 strengthening 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 at around 2.5 percent.

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<sup>2</sup> The base year for the consumer price index (CPI) is scheduled to be changed to 2010 in August 2011, and year-on-year figures retroactive to January 2011 will be revised accordingly. This rebasing is likely to cause the year-on-year rate of change in the CPI to be revised downward.