

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

April 8, 2011

Bank of Japan

Monthly Report of Recent Economic and Financial Developments¹

April 2011

Summary

Japan's economy is under strong downward pressure, mainly on the production side, due to the effects of the earthquake disaster.

The earthquake has sharply dampened production in some areas by damaging production facilities, disrupting the supply chain, and constraining electric power supply; exports and domestic private demand have been affected accordingly.

Japan's economy is likely to remain under strong downward pressure, mainly on the production side, for the time being, but is expected to return to a moderate recovery path -- as supply-side constraints are mitigated and production regains traction -- backed by an increase in exports reflecting the improvement in overseas economic conditions and by a rise in demand for restoring capital stock.

Production is expected to remain at a low level for the time being, but is likely to start increasing as supply-side constraints are mitigated. In such a case, exports are expected to turn upward reflecting the improvement in overseas economic conditions. Business fixed investment, housing investment, and public investment are also expected to increase gradually, mainly due to growing demand for restoring capital stock. Meanwhile, private consumption is expected to pick up as production begins to recover.

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

¹ This report is based on data and information available at the time of the Bank of Japan Monetary Policy Meeting held on April 6 and 7, 2011.

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.

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.²

As for financial developments since the earthquake, the financial intermediation function has been maintained and smooth fund settlement has also been secured.

Financial markets have been stable as a whole, as the Bank of Japan has continued to provide ample funds. 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. Compared with last month, long-term interest rates have risen, while the value of the yen against the U.S. dollar has fallen. Meanwhile, stock prices have remained at more or less the same level as last month.

Financial conditions have generally continued to ease, while weakness has been observed in the financial positions of some firms, mainly small ones, since the earthquake.

The overnight call rate has remained at an extremely low level, and the declining trend in firms' funding costs has continued. Stimulative effects from low interest rates are still partly constrained given current developments in economic activity and prices. With regard to credit supply, firms have continued to see financial institutions' lending attitudes as improving. In the corporate bond market, the new issuance of bonds has been at a pause amid somewhat wider credit spreads on corporate bonds, whereas the issuing conditions for CP have continued to be favorable. As for credit demand, some firms have recently shown signs of

² 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.

increasing their demand for working capital as well as accumulating their on-hand liquidity. 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, while weakness has been observed in those of some firms, mainly small ones. Meanwhile, the year-on-year rate of change in the money stock has been at around 2.5 percent.