

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

**August 5, 2011**

**Bank of Japan**

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

**August 2011**

**Summary**

Japan's economic activity has been picking up steadily with an easing of the supply-side constraints caused by the earthquake disaster.

After declining sharply following the earthquake, production and exports have continued to increase with the easing of supply-side constraints. In this situation, business fixed investment has been generally picking up, aided partly by the restoration of disaster-stricken facilities. Private consumption has begun to pick up on the whole, although weakness remains in evidence with regard to some aspects of consumer behavior.

Japan's economy is expected to return to a moderate recovery path with supply-side constraints easing further and production regaining traction.

Production is expected to continue picking up as supply-side constraints ease further. In this situation, exports are also expected to be on the rise reflecting the improvement in overseas economic conditions. Business fixed investment, housing investment, and public investment are expected to increase gradually, mainly due to growing demand for the purposes of restoring capital stock. Private consumption is also expected to pick up, due partly to the improvement in household sentiment.

On the price front, the three-month rate of increase in domestic corporate goods prices is slowing as international commodity prices have fallen back. The year-on-year rate of change in consumer prices (excluding fresh food) has been slightly positive.

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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 August 4, 2011.

Domestic corporate goods prices are expected to be more or less flat for the time being, reflecting movements in international commodity prices. The year-on-year rate of change in consumer prices is expected to remain slightly positive.<sup>2</sup>

The weighted average of the overnight call rate has been below the 0.1 percent level, and interest rates on term instruments have been more or less unchanged. Compared with last month, the value of the yen against the U.S. dollar has risen, while long-term interest rates have fallen. Meanwhile, stock prices have remained at more or less the same level as last month.

Financial conditions have generally continued to ease, albeit with weakness observed in the financial positions of some firms, mainly small ones.

The overnight call rate has remained at an extremely low level, and the levels of firms' funding costs have also continued to be low. 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 being on an improving trend. Issuing conditions for CP have continued to be favorable. Those for corporate bonds have been favorable as a whole, leading to an increased variety of corporate bond issuers. As for credit demand, firms have shown signs of increasing their demand for working capital. Against this backdrop, the year-on-year rate of decline in bank lending is slowing. The amounts outstanding of both corporate bonds and CP have exceeded their previous year's levels. In these circumstances, firms have retained their recovered financial positions on the whole, albeit with weakness observed at some firms, mainly small ones. Meanwhile, the year-on-year rate of change in the money stock has been at around 3 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.