

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

May 24, 2012

**Bank of Japan**

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

**May 2012**

**Summary**

It has become increasingly evident that Japan's economy is shifting toward a pick-up phase, although its economic activity has remained more or less flat.

Overseas economies on the whole still have not emerged from a deceleration phase, but some improvement has been observed. Exports have so far remained more or less flat. As for domestic demand, public investment has been increasing. Business fixed investment has been on a moderate increasing trend with some improvement in business sentiment. Against the background of improvement in consumer sentiment, private consumption has been increasing moderately due to the effects of measures to stimulate demand for automobiles. Housing investment has generally been picking up. Reflecting these developments in demand at home and abroad, production has shown some signs of picking up, although it has remained more or less flat.

With regard to the outlook, Japan's economy is expected to return to a moderate recovery path as the pace of recovery in overseas economies picks up, led by emerging and commodity-exporting economies, and as reconstruction-related demand after the earthquake disaster gradually strengthens.

Exports are expected to gradually emerge from the current phase of flat growth and increase moderately, mainly reflecting a pick-up in the pace of recovery in overseas economies. As for domestic demand, public investment is expected to be on the rise and housing investment to continue to generally pick up, mainly supported by reconstruction-related demand. Business fixed investment is projected to

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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 May 22 and 23, 2012.

continue a moderate increasing trend, partly due to efforts by firms to restore and reconstruct disaster-stricken facilities, as corporate profits improve gradually. Private consumption is expected to remain firm as the employment situation gradually heads toward improvement. Reflecting these developments in demand at home and abroad, production is expected to increase moderately.

On the price front, the three-month rate of change in domestic corporate goods prices is rising moderately, mainly due to the earlier increase in international commodity prices. The year-on-year rate of change in consumer prices (all items less fresh food) is currently around 0 percent.

Domestic corporate goods prices are expected to increase at a reduced pace for the time being, mainly reflecting movements in international commodity prices. The year-on-year rate of change in consumer prices is expected to remain at around 0 percent for the time being.

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. 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.

The overnight call rate has remained at an extremely low level, and firms' funding costs have declined moderately. 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 also remained favorable on the whole. As for credit demand, firms have shown signs of increasing their demand mainly for working capital and funds related to mergers and acquisitions. Against this backdrop, the year-on-year rate of change in the amount outstanding of bank lending has been positive. The year-on-year rate of change in

the total amount outstanding of corporate bonds and CP has been moving around 0 percent, while that of corporate bonds has been slightly negative. In these circumstances, firms have retained their recovered financial positions on the whole. Meanwhile, the year-on-year rate of change in the money stock has been positive at around 2.5 percent.