

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

May 23, 2011

Bank of Japan

Monthly Report of Recent Economic and Financial Developments¹

May 2011

Summary

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

Production has declined sharply due to the supply-side constraints caused by the disaster. As a result, exports have decreased substantially, and domestic private demand has also been weak partly affected by a deterioration in business and household sentiment.

Japan's economy is likely to continue facing 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 ease and production regains traction.

Production is expected to remain at a low level for the time being, but is likely to start increasing as supply-side constraints ease. 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 the purposes of restoring capital stock. Meanwhile, private consumption is expected to pick up partly due to the improvement in household sentiment 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 May 19 and 20, 2011.

year-on-year rate of decline in consumer prices (excluding fresh food) has continued to slow, and has been around 0 percent.

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.²

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, although 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 being on an improving trend. Issuing conditions for CP have continued to be favorable, and in the corporate bond market, new issuances have recently resumed at a gradual pace after a pause following the earthquake. As for credit demand, firms have recently 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 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, firms have retained their recovered financial positions on the whole, although weakness has been observed in those of some firms, mainly small ones, since the earthquake.

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.

Meanwhile, the year-on-year rate of change in the money stock has been in the range of 2.5-3.0 percent.