

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

**August 10, 2012**

**Bank of Japan**

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

**August 2012**

**Summary**

Japan's economic activity has started picking up moderately as domestic demand remains firm mainly supported by reconstruction-related demand.

Overseas economies have shown moderate improvement, though limited in scope; on the whole, they still have not emerged from a deceleration phase. The pick-up in exports has moderated, and the recent reading on production has been relatively weak. On the other hand, as for domestic demand, public investment has continued to increase. Business fixed investment has been on a moderate increasing trend with improvement in corporate profits. Against the background of improvement in consumer sentiment, private consumption has continued to increase moderately due to the effects of measures to stimulate demand for automobiles. Housing investment has generally been picking up.

With regard to the outlook, Japan's economy is expected to return to a moderate recovery path as domestic demand remains firm and overseas economies emerge from the deceleration phase.

Exports are expected to increase moderately as overseas economies emerge from the deceleration phase. 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 continue a moderate increasing trend, partly due to efforts by firms to restore and reconstruct disaster-stricken facilities, as corporate profits keep improving. Private consumption is expected to remain firm as the employment situation is on an

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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 8 and 9, 2012.

improving trend. Reflecting these developments in demand at home and abroad, production is expected to increase moderately.

Meanwhile, there remains a high degree of uncertainty about the global economy. Specifically, particular attention should be given to global financial market developments associated with the European debt problem.

On the price front, the three-month rate of change in domestic corporate goods prices has turned negative, mainly reflecting the earlier decline 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, for the time being, are expected to continue declining moderately mainly since the effects of the decline in international commodity prices are likely to remain. 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. Meanwhile, the value of the yen against the U.S. dollar, long-term interest rates, and stock prices have remained at more or less the same levels as last month.

Financial conditions are accommodative.

The overnight call rate has remained at an extremely low level, and firms' funding costs have declined moderately. 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. That of CP has also been positive. In contrast, the year-on-year rate of change in the amount outstanding of corporate bonds has been negative as the amount of electric company

bonds redeemed has continued to exceed the amount issued. 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 percent.