

# Bank of Japan's January report of recent economic and financial developments<sup>1</sup>

Bank of Japan, 20 January 2006.

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## The Bank's view<sup>2</sup>

Japan's economy continues to recover steadily.

Exports have continued to increase, and the uptrend in industrial production has become evident. Business fixed investment has continued to increase against the background of high corporate profits. Household income has also continued rising moderately, reflecting the improvement in employment and wages. In this situation, private consumption has been steady. Housing investment has continued to show some strength. Meanwhile, public investment has basically been on a downtrend.

Japan's economy is expected to continue to recover steadily.

Exports are expected to continue rising against the background of the expansion of overseas economies. Domestic private demand is likely to continue increasing against the background of high corporate profits and the moderate rise in household income, while structural adjustment pressure, such as the excess debt of firms, has almost dissipated. In light of these increases in demand both at home and abroad, production is also expected to follow an increasing trend. Public investment, meanwhile, is projected to remain on a downtrend.

On the price front, domestic corporate goods prices have continued to increase, mainly reflecting the rise in international commodity prices and the depreciation of the yen in the second half of last year. The year-on-year rate of change in consumer prices (excluding fresh food) has turned slightly positive.

Domestic corporate goods prices are expected to continue increasing for the time being, mainly due to the effects of the rise in international commodity prices. As for the year-on-year rate of change in consumer prices, a positive trend is projected to be established, as supply-demand conditions continue improving gradually and the effects from the reduction in telephone charges dissipate.

As for the financial environment, the environment for corporate finance is becoming more accommodative on the whole. The issuing environment for CP and corporate bonds is favorable. Also, the lending attitude of private banks is becoming more accommodative. The lending attitude of financial institutions as perceived by firms has been improving. The pace of decline in credit demand in the private sector is very moderate. Under these circumstances, the rate of increase in the amount outstanding of lending by private banks is accelerating, and the amount outstanding of CP and corporate bonds issued has been above the previous year's level. The year-on-year growth rate of the monetary base is 1.0 percent, and that of the money stock has been around 2.0 percent. As for developments in financial markets, money market conditions continue to be extremely easy, as the Bank of Japan continues to provide ample liquidity. In the foreign exchange and capital markets, the yen's exchange rate against the U.S. dollar and long-term interest rates have been around the same level as last month. Meanwhile, stock prices rose significantly through mid-January, and later fell. They are currently above the level of last month.

Japan's economy is expected to deviate slightly above the outlook presented in the *Outlook for Economic Activity and Prices* (the Outlook Report) released in October last year, as both domestic and external demand continue to increase steadily. As for prices, domestic corporate goods prices are expected to deviate slightly above the outlook, reflecting the rise in international commodity prices and the depreciation of the yen in the second half of last year. Meanwhile, consumer prices are projected to be broadly in line with the outlook.

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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 January 19 and 20, 2006.

<sup>2</sup> The text of "The Bank's View" was decided by the Policy Board at the Monetary Policy Meeting held on January 19 and 20, 2006.