

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

February 19, 2014

Bank of Japan

Monthly Report of Recent Economic and Financial Developments¹

February 2014

Summary

Japan's economy has continued to recover moderately, and a front-loaded increase in demand prior to the consumption tax hike has recently been observed.

Overseas economies -- mainly advanced economies -- are starting to recover, although a lackluster performance is still seen in part. In this situation, exports have generally been picking up. Business fixed investment has been picking up as corporate profits have improved. Public investment has continued to increase. With improvement in the employment and income situation, housing investment has continued to increase and private consumption has remained resilient; in these segments of the economy, the front-loaded increase in demand prior to the consumption tax hike has also been observed. Reflecting these developments in demand both at home and abroad, industrial production has been increasing moderately.

With regard to the outlook, Japan's economy is expected to continue a moderate recovery as a trend, while it will be affected by the front-loaded increase and subsequent decline in demand prior to and after the consumption tax hike.

Exports are expected to increase moderately mainly against the background of the recovery in overseas economies. As for domestic demand, public investment is expected to trend upward for the time being and then become more or less flat at a high level. Business fixed investment is projected to follow a moderate increasing trend as corporate profits continue to improve. Private consumption and housing investment, albeit with some fluctuations, are expected to remain resilient as a trend,

¹ This report is based on data and information available at the time of the Bank of Japan Monetary Policy Meeting held on February 17 and 18, 2014.

supported mainly by improvement in the employment and income situation. Under these circumstances, industrial production is expected to follow a moderate increasing trend.

Meanwhile, risks to the outlook include developments in the emerging and commodity-exporting economies, the prospects for the European debt problem, and the pace of recovery in the U.S. economy.

On the price front, domestic corporate goods prices are rising moderately relative to three months earlier, mainly against the backdrop of movements in international commodity prices and foreign exchange rates. The year-on-year rate of increase in consumer prices (all items less fresh food) is around 1¼ percent. Inflation expectations appear to be rising on the whole.

With regard to the outlook, excluding the direct effects of the consumption tax hike, domestic corporate goods prices are expected to continue rising moderately for the time being, and the year-on-year rate of increase in consumer prices is likely to be around 1¼ percent for some time.

Financial conditions are accommodative.

The monetary base has increased significantly as asset purchases by the Bank of Japan have progressed, and the year-on-year rate of growth has been at around 50 percent.

Firms' funding costs have been hovering at low levels. 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. Firms' credit demand has been increasing moderately, mainly for working capital and funds related to mergers and acquisitions. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending has been at around 2.5 percent. The year-on-year rate of change in the amount outstanding of CP and corporate bonds has been positive. Firms have retained their recovered financial positions. Meanwhile, the year-on-year rate of growth in the money stock has been at around 4.5 percent.

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