

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

May 22, 2014

Bank of Japan

Monthly Report of Recent Economic and Financial Developments¹

May 2014

Summary

Japan's economy has continued to recover moderately as a trend, although the subsequent decline in demand following the front-loaded increase prior to the consumption tax hike has been observed.

Overseas economies -- mainly advanced economies -- are starting to recover, although a lackluster performance is still seen in part. Exports have recently leveled off more or less. Business fixed investment has increased moderately as corporate profits have improved. Public investment has more or less leveled off at a high level. Private consumption and housing investment have remained resilient as a trend with improvement in the employment and income situation, although the subsequent decline in demand following the front-loaded increase has recently been observed. Reflecting these developments in demand both at home and abroad, industrial production has been on a moderate increasing trend.

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 subsequent decline in demand following the front-loaded increase prior to 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 continue leveling off more or less at a high level. Business fixed investment is projected to follow a moderate increasing trend as corporate profits continue their improving trend. Private consumption and housing investment are expected to remain resilient as a trend, supported mainly by improvement in 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 20 and 21, 2014.

employment and income situation, while they will be affected by the subsequent decline in demand following the front-loaded increase. 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, excluding the direct effects of the consumption tax hike, domestic corporate goods prices are more or less flat 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 remain more or less flat 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 and corporate bonds have continued to be favorable. 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 in the range of 2.0-2.5 percent. The year-on-year rate of change in the amount outstanding of CP and corporate bonds has been negative. Firms have retained their recovered financial positions. Meanwhile, the year-on-year rate of growth in the

money stock has been at around 3.5 percent.

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