

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

**July 16, 2014**

**Bank of Japan**

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

**July 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 -- have been recovering, albeit with a lackluster performance 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. Industrial production has continued to increase moderately as a trend, albeit with some fluctuations. Business sentiment has generally stayed at a favorable level, although the effects of the subsequent decline in demand following the front-loaded increase have been observed.

With regard to the outlook, Japan's economy is expected to continue its moderate recovery trend, and the effects of the subsequent decline in demand following the front-loaded increase prior to the consumption tax hike are expected to wane gradually.

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

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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 July 14 and 15, 2014.

investment is projected to follow a moderate increasing trend as corporate profits continue their improving trend. With the continued improvement in the employment and income situation, private consumption and housing investment are expected to remain resilient, and the effects of the subsequent decline in demand following the front-loaded increase are expected to wane gradually. Reflecting these developments in demand both at home and abroad, 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, producer prices are rising moderately relative to three months earlier, and the year-on-year rate of increase in consumer prices (all items less fresh food) is around 1¼ percent.<sup>2</sup> Inflation expectations appear to be rising on the whole.

With regard to the outlook, excluding the direct effects of the consumption tax hike, producer 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 in the range of 40-45 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,

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<sup>2</sup> Producer prices were previously referred to as domestic corporate goods prices.

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 negative. Firms' financial positions have improved further. Meanwhile, the year-on-year rate of growth in the money stock has been at around 3 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 somewhat. Compared with last month, stock prices have risen. 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.