

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

September 5, 2014

Bank of Japan

Monthly Report of Recent Economic and Financial Developments¹

September 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 shown some weakness. 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 has remained resilient as a trend with the employment and income situation improving steadily, and the effects of the decline in demand following the front-loaded increase have gradually begun to wane. As for housing investment, a decline following the front-loaded increase has continued. Reflecting these developments in demand both at home and abroad, industrial production has recently shown some weakness, although it has continued to increase moderately as a trend.

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 head for a moderate increase 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

¹ This report is based on data and information available at the time of the Bank of Japan Monetary Policy Meeting held on September 3 and 4, 2014.

fixed investment is projected to follow a moderate increasing trend as corporate profits continue their improving trend. Private consumption is expected to remain resilient with the employment and income situation continuing to improve steadily, and the effects of the decline in demand following the front-loaded increase are expected to wane further. Housing investment is projected to regain its resilience gradually, while the effects of the decline following the front-loaded increase are expected to remain for the time being. Reflecting these developments in demand both at home and abroad, industrial production is expected to follow a moderate increasing trend, albeit with some weakness remaining for the time being.

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. 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 at around 40 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' 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 been more or less unchanged. Compared with last month, stock prices have risen, while the value of the yen against the U.S. dollar has fallen. Meanwhile, long-term interest rates have remained at more or less the same level as last month.