

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

**December 22, 2014**

**Bank of Japan**

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

**December 2014**

**Summary**

Japan's economy has continued to recover moderately as a trend, and effects such as those of the decline in demand following the front-loaded increase prior to the consumption tax hike have been waning on the whole.

Overseas economies -- mainly advanced economies -- have been recovering, albeit with a lackluster performance still seen in part. In this situation, exports have shown signs of picking up. Business fixed investment has been on a moderate increasing trend 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 been waning on the whole. Housing investment, which continued to decline following the front-loaded increase, has recently started to bottom out. Against the backdrop of these developments in demand both at home and abroad, industrial production has started to bottom out, due in part to the progress in inventory adjustments. Business sentiment has generally stayed at a favorable level, although some cautiousness has been observed.

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

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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 December 18 and 19, 2014.

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 for the time being and thereafter gradually enter a declining trend. Business fixed investment is projected to continue a moderate increasing trend as corporate profits follow 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 dissipate gradually. Housing investment is projected to regain its resilience gradually. Reflecting these developments in demand both at home and abroad, industrial production is expected to resume its moderate increase.

Meanwhile, risks to the outlook include developments in the emerging and commodity-exporting economies, the prospects regarding the debt problem and the risk of low inflation rates being protracted in Europe, 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 declining relative to three months earlier, reflecting the significant fall in international commodity prices, and the year-on-year rate of increase in consumer prices (all items less fresh food) is around 1 percent. Inflation expectations appear to be rising on the whole from a somewhat longer-term perspective.

With regard to the outlook, excluding the direct effects of the consumption tax hike, producer prices are expected to continue declining for the time being, reflecting movements in international commodity prices, and the year-on-year rate of increase in consumer prices is likely to be at around the current level for the time being.

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 35 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 2.5-3.0 percent. The year-on-year rate of change in the amount outstanding of CP and corporate bonds has been negative. Firms' financial positions have been favorable. 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, long-term interest rates have fallen. Meanwhile, the value of the yen against the U.S. dollar and stock prices have remained at more or less the same levels as last month.