Not to be released until 2:00 p.m.
Japan Standard Time on
Thursday, April 30, 2026.

日本銀行
BANK OF JAPAN

# *Outlook for Economic Activity and Prices*

*April 2026*

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

# Outlook for Economic Activity and Prices (April 2026)

## The Bank's View[1]

### Summary

- Japan's economic growth is likely to decelerate in fiscal 2026, since the rise in crude oil prices reflecting the impact of the situation in the Middle East is expected to push down corporate profits and households' real income through factors such as a deterioration in the terms of trade. However, the economy is expected to continue growing moderately, albeit at a decelerated rate, since it is likely to be underpinned by factors such as the government's various measures and accommodative financial conditions, in addition to developments such as continued high levels of profits in the corporate sector. Japan's economic growth rate is likely to rise moderately from fiscal 2027 onward, since it is projected that the adverse effects of high crude oil prices will wane and that a virtuous cycle from income to spending will gradually intensify.
- The year-on-year rate of increase in the consumer price index (CPI, all items less fresh food) is likely to be in the range of 2.5-3.0 percent in fiscal 2026, as the rise in crude oil prices is expected to push up prices, mainly of energy and goods, with moves to pass on wage increases to selling prices continuing. Thereafter, with the waning of the effects of high crude oil prices, the rate of increase is expected to decline to the range of 2.0-2.5 percent in fiscal 2027 and to around 2 percent in fiscal 2028. Meanwhile, with a sense of labor shortage continuing to be strong, it is projected that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained, and that medium- to long-term inflation expectations will rise. In this situation, underlying CPI inflation is expected to increase gradually, coming to a level that is generally consistent with the price stability target between the second half of fiscal 2026 and fiscal 2027 and remaining at around that level thereafter.
- Comparing the projections through fiscal 2027 with those presented in the previous *Outlook for Economic Activity and Prices* (Outlook Report), the projected real GDP growth rate for fiscal 2026 is lower, and the projected year-on-year rate of increase in the CPI (all items less fresh food) for fiscal 2026 is significantly higher, both reflecting the rise in crude oil prices.
- There are various risks to the outlook. For the time being, it is necessary to pay particular attention to the impact of the future course of the situation in the Middle East on financial and foreign exchange markets and on Japan's economic activity and prices.
- With regard to the risk balance -- particularly for fiscal 2026 -- risks to economic activity are skewed to the downside, and risks to prices are skewed to the upside. While these risks could both heighten, it is necessary to pay due attention, in particular, to keep the risk of inflation significantly deviating upward from materializing and thereby exerting an adverse impact on the economy afterward, given factors such as underlying CPI inflation approaching 2 percent and firms' behavior shifting more toward raising wages and prices.

[1] "The Bank's View" was decided by the Policy Board at the Monetary Policy Meeting held on April 27 and 28, 2026.

## I. Current Situation of Economic Activity and Prices in Japan

Japan's economy has recovered moderately, although some weakness has been seen in part, partly due to the impact of the situation in the Middle East. Overseas economies have grown moderately on the whole, although some weakness has been seen in part. Exports and industrial production have continued to be more or less flat as a trend. Corporate profits have remained at high levels on the whole, although downward effects due to U.S. tariff policy have been seen in manufacturing. Business sentiment has also been at a favorable level, while it has been affected by the situation in the Middle East. Under these circumstances, business fixed investment has been on a moderate increasing trend. Private consumption has been resilient against the background of an improvement in the employment and income situation, although it has been affected by price rises. On the other hand, housing investment has been on a declining trend. Public investment has continued to be more or less flat. Meanwhile, labor market conditions have remained tight. Financial conditions have been accommodative. On the price front, with moves to pass on wage increases to selling prices continuing, the year-on-year rate of increase in the CPI (all items less fresh food) had been above 2 percent, partly due to the effects of the rise in food prices, such as rice prices; however, the rate of increase has recently been in the range of 1.5-2.0 percent due to factors such as the effects of the government's measures to reduce the household burden of higher energy prices. Inflation expectations have risen moderately.

## II. Baseline Scenario of the Outlook for Economic Activity and Prices in Japan[2,3]

### A. Baseline Scenario of the Outlook for Economic Activity

In fiscal 2026, Japan's economic growth is likely to decelerate, since corporate profits and households' real income are expected to be pushed down by factors such as a deterioration in the terms of trade reflecting the rise in crude oil prices.

Reflecting the impact of the situation in the Middle East, crude oil prices have risen significantly; in particular, Dubai crude oil prices have surged. This will lead to a deterioration in the terms of trade for Japan, which is highly dependent on crude oil produced in the Middle East, and will push down corporate profits and households' real

[2] The baseline scenario in this Outlook Report is developed based on the assumption that, regarding the situation in the Middle East, which has been unclear recently, with the impact expected to ease, crude oil prices will decline, and large-scale disruptions in supply chains will not occur. Under this assumption, based, for example, on developments in futures markets, Dubai crude oil prices are expected to decline from around 105 U.S. dollars per barrel to the range of around 70-80 dollars per barrel toward the end of the projection period. Attention is warranted on the possibility that the outlook for economic activity and prices could change considerably depending on the future course of the situation in the Middle East.

[3] Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.

income through price rises in energy and raw materials. However, Japan's economy is expected to continue growing moderately, albeit at a decelerated rate. This is because the economy is likely to be underpinned by factors such as the government's various measures (e.g., measures to reduce the household burden of higher energy prices, such as fuel oil subsidies, and policies concerning the provision of free education) and accommodative financial conditions, in addition to continued high levels of profits in the corporate sector and solid wage increases being achieved thus far in this year's annual spring labor-management wage negotiations.

In the corporate sector, although global AI-related demand is expected to remain strong, exports and production are likely to be more or less flat for the time being, as the impact of the situation in the Middle East is likely to exert downward pressure on, for example, automobile exports to the Middle East. Corporate profits are likely to decline due to the impact of the deterioration in the terms of trade, despite remaining at high levels. In this situation, the growth momentum in business fixed investment is likely to slow, although the government's economic measures and accommodative financial conditions, in addition to order backlogs for existing projects, are expected to provide support for business fixed investment.

In the household sector, regarding the employment situation, labor market conditions are likely to remain tight despite the impact of the slowdown in the economy. In this situation, although affected by the decline in corporate profits, the growth in nominal wages is projected to remain at around its current pace, mainly reflecting the outcome of this year's annual spring labor-management wage negotiations. Private consumption is expected to be more or less flat due to the impact of price rises, particularly in energy prices, although it is likely to be underpinned by income transfers to households through the government's various measures in addition to wage increases. Housing investment is expected to follow a moderate declining trend, mainly reflecting a rise in housing prices and demographic developments. Meanwhile, public investment is expected to be more or less flat, and government consumption is expected to increase moderately reflecting factors such as an uptrend in healthcare and nursing care expenditures and a rise in defense-related spending.

From fiscal 2027 onward, Japan's economic growth rate is expected to rise moderately, since it is projected that the adverse effects of high crude oil prices will wane and that the virtuous cycle from income to spending will gradually intensify. Exports and production are likely to increase moderately, as the impact of the situation in the Middle East eases, and as overseas economies continue to grow moderately. Corporate profits are likely to improve, supported by an improvement in the terms of trade reflecting a decline in crude oil prices and by an increase in domestic and external demand. In this situation, business fixed investment is likely to remain on an upward trend, pushed up by labor-saving investment to address labor shortages, investment for capacity expansion, and

investment projects to adapt to changes in the trade structure and supply chains, among other investments. Looking at the employment and income situation, labor market conditions are likely to remain tight, and nominal wages are expected to continue increasing steadily. In addition, with the pace of price rises expected to moderate gradually, private consumption is projected to return to a moderate increasing trend.

Comparing the projections through fiscal 2027 with those presented in the previous Outlook Report, the projected real GDP growth rate for fiscal 2026 is lower due to the significant rise in crude oil prices. Meanwhile, the projected growth rates for fiscal 2025 and 2027 are more or less unchanged.

Meanwhile, the potential growth rate is expected to remain slightly positive.[4] This is mainly because productivity is likely to increase due to advances in digitalization and investment in human capital, and because capital stock is projected to increase steadily. Potential growth is likely to be supported by the government's various measures and other factors.

## B. Baseline Scenario of the Outlook for Prices

The year-on-year rate of increase in the CPI (all items less fresh food) is likely to be in the range of 2.5-3.0 percent in fiscal 2026, as the rise in crude oil prices is expected to push up prices, mainly of energy and goods, with moves to pass on wage increases to selling prices continuing. Thereafter, with the waning of the effects of high crude oil prices, the rate of increase is expected to decline to the range of 2.0-2.5 percent in fiscal 2027 and to around 2 percent in fiscal 2028. Meanwhile, with a sense of labor shortage continuing to be strong, it is projected that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained, and that medium- to long-term inflation expectations will rise. In this situation, underlying CPI inflation is expected to increase gradually, coming to a level that is generally consistent with the price stability target between the second half of fiscal 2026 and fiscal 2027 and remaining at around that level thereafter. From the perspective of sustainable and stable achievement of the price stability target, it will also be necessary to examine whether underlying CPI inflation becomes anchored at a level around 2 percent.

Comparing the projections through fiscal 2027 with those presented in the previous Outlook Report, the projected year-on-year rate of increase in the CPI (all items less fresh food) for fiscal 2026 is significantly higher and that for fiscal 2027 is also somewhat higher, reflecting the effects of the rise in crude oil prices.

[4] Under a specific methodology, Japan's recent potential growth rate is estimated to be around 0.5-1.0 percent. However, the rate should be interpreted with considerable latitude. This is because the estimate is subject to change depending on the methodologies employed and could be revised as the sample period becomes longer over time. In addition, there are high uncertainties over how factors such as advances in digitalization will affect the trends in productivity or labor supply.

The year-on-year rate of increase in the CPI (all items less fresh food and energy) is likely to be at a level exceeding 2 percent, as the rise in crude oil prices is expected to push up prices, mainly of goods. Thereafter, the rate of increase in this CPI is likely to decline, with the waning of the effects of high crude oil prices.

The main factors that determine underlying inflation are assessed as follows. The output gap, which captures the utilization of labor and capital, has followed an improving trend, albeit with fluctuations, and has been slightly positive recently. Based on the aforementioned outlook for economic activity, it is likely that the output gap will temporarily narrow within positive territory in fiscal 2026 but improve moderately again from fiscal 2027 onward. Meanwhile, labor market conditions have tightened to a greater extent than can be explained by the changes in the output gap, partly due to a deceleration in the pace of increase in labor force participation of women and seniors. In this situation, upward pressure on wages and prices likely has become stronger than suggested by the output gap, given that firms -- particularly in labor-intensive industries -- have started to face labor supply constraints.

Medium- to long-term inflation expectations have risen moderately. Regarding the outlook, as firms' active wage- and price-setting behavior is expected to continue on the back of factors such as the tightening of labor market conditions, inflation expectations are likely to continue to rise moderately. Medium- to long-term inflation expectations are expected to come to a level around 2 percent between the second half of fiscal 2026 and fiscal 2027 and remain at around that level thereafter.

## III. Risks to Economic Activity and Prices

The aforementioned baseline scenario of the outlook for economic activity and prices is based on the assumption, among others, that, with the impact of the situation in the Middle East expected to ease, crude oil prices will decline, and large-scale disruptions in supply chains will not occur. That said, given that such an outlook could change considerably depending on the future course of the situation in the Middle East, the following first outlines the risks regarding the situation in the Middle East and their impact on the outlook for economic activity and prices. Risks other than the situation in the Middle East are then examined.

### A. Risks regarding the Situation in the Middle East

The first is the risk that adverse effects, such as the deterioration in the terms of trade, will strengthen to a greater extent than expected, if the turmoil surrounding the situation in the Middle East becomes prolonged, and crude oil prices remain elevated. Under the baseline scenario, it is expected that Japan's economy will not enter a significant adjustment phase, despite being affected by downward pressure from high crude oil

prices. However, if crude oil prices remain elevated for longer than expected, the economy could slow further through a significant decline in corporate profits and households' real income. Such an economic slowdown could push down underlying CPI inflation through factors such as a deterioration in the output gap and a strengthening of moves among firms to cut costs, and in turn could weaken the mechanism in which wages and prices rise moderately in interaction with each other.

With regard to prices, however, risks are skewed to the upside, as follows. Given that crude oil is widely used as a raw material from the upstream to downstream stages of the production process in various industries, elevated crude oil prices could push up not only energy prices, but also prices in general, particularly of a wide range of goods. Moreover, considering the current situation of Japan's economy that, for example, firms' behavior has shifted more toward raising wages and prices compared with the period such as when commodity prices rose after Russia's invasion of Ukraine, it is possible that the rise in crude oil prices is passed on to the price of various goods and services more easily than before. Furthermore, attention should also be paid to the possibility that such moves have become more likely to lead to a pushing up of underlying CPI inflation through a rise in inflation expectations.

In addition, given that a considerable portion of raw materials for fertilizers that are essential for the production of crops is produced in the Middle East, if the turmoil surrounding the situation in the Middle East persists and bottlenecks in logistics remain for a prolonged period, attention will also need to be paid to the possibility that food prices could rise by more than expected through higher market prices for raw materials.

The second point is the risk that large-scale disruptions in supply chains will occur, exerting a significant impact on the production activity of Japanese firms. If the impact on logistics becomes prolonged, the supply of not only crude oil, but also raw materials, intermediate goods, and other items with a high share of imports from the Middle East, could be disrupted. On this point, some material manufacturers have already started reducing the utilization rates of their plants, and attention should be paid to the possibility that such moves could become further widespread. As such, if large-scale disruptions in supply chains occur, firms' production activity could decline, leading to a significant slowdown in the economy. Moreover, such an economic slowdown could push down underlying CPI inflation. On the other hand, if supply-side constraints materialize, there is a possibility that the price of related products will rise significantly, leading to a pushing up of underlying CPI inflation while further heightening the upside risks to prices.

The aforementioned two risks assume that the impact of the situation in the Middle East will become prolonged. Conversely, however, if tension over the situation in the Middle East eases swiftly, leading to a faster-than-expected decline in crude oil prices, downward pressure on corporate profits and household's real income could weaken, and upward

pressure on prices could decline. In that case, there is a possibility that the GDP growth rate will deviate upward and the rate of increase in the CPI (all items less fresh food) will deviate downward from the baseline scenario.

## B. Other Risks

Risks other than those arising from the situation in the Middle East that require attention are as follows.

The first is developments in overseas economic activity and prices, including AI-related demand. Regarding AI, amid the continued increase in global demand, strong business fixed investment could push up the global economy; on the other hand, if profits do not expand in line with such investment, adjustment pressure could arise, accompanied by, for example, changes in asset prices. With regard to the U.S. economy, although uncertainties regarding the impact of its tariff policy have declined, attention continues to be warranted on factors such as the impact of tariffs on employment and income formation through a deterioration in corporate profits, as well as the impact on private consumption through the pass-through to consumer prices of increased costs due to tariffs. Moreover, attention also needs to be paid to the possibility that developments such as recent moves toward fiscal expansion, particularly in the United States and Europe, could affect global economic activity and prices. Regarding the Chinese economy, there remain high uncertainties surrounding the future pace of growth, as adjustment pressure has continued in the real estate and labor markets. In addition, it is necessary to pay attention to how excessive supply capacity for some goods will affect global economic activity and prices.

The second risk is the effects of future developments in foreign exchange rates on Japan's economic activity and prices. There are various possible channels in this regard. For instance, if factors such as the rise in crude oil prices result in a depreciation of the yen, this would have a positive impact on, for example, the profits of global firms. On the other hand, such a depreciation of the yen would push down households' real income and exert downward pressure on the profits particularly of small and medium-sized firms, mainly through a rise in import prices. Attention should also be paid to the point that, with firms' behavior shifting more toward raising wages and prices recently, exchange rate developments are, compared to the past, more likely to affect prices, and that such moves could affect underlying CPI inflation through changes in inflation expectations.

The third risk considered from a somewhat long-term perspective is the impact of various changes in the environment surrounding Japan on firms' and households' medium- to long-term growth expectations and on Japan's potential growth rate. Intensifying labor shortages -- which are partly due to structural demographic changes -- could accelerate labor-saving investment, such as for digitalization and the use of AI, and this, together

with the government's efforts, could push up growth expectations and the potential growth rate. On the other hand, if such a substitution of labor with capital does not sufficiently progress, there is a risk that supply-side constraints will push down the growth rate. Moreover, the trade policies announced so far have partly led to a change in the trend of globalization, and depending on the future course of these policies, this change may accelerate.

## IV. Conduct of Monetary Policy

In the context of the price stability target, the Bank assesses the aforementioned economic and price situation from two perspectives and then outlines its thinking on the future conduct of monetary policy.[5]

The first perspective involves an examination of the baseline scenario of the outlook. The year-on-year rate of increase in the CPI (all items less fresh food) is likely to be in the range of 2.5-3.0 percent in fiscal 2026, as the rise in crude oil prices is expected to push up prices, mainly of energy and goods, with moves to pass on wage increases to selling prices continuing. Thereafter, with the waning of the effects of high crude oil prices, the rate of increase is expected to decline to the range of 2.0-2.5 percent in fiscal 2027 and to around 2 percent in fiscal 2028. Meanwhile, with a sense of labor shortage continuing to be strong, it is projected that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained, and that medium- to long-term inflation expectations will rise. In this situation, underlying CPI inflation is expected to increase gradually, coming to a level that is generally consistent with the price stability target between the second half of fiscal 2026 and fiscal 2027 and remaining at around that level thereafter.

The second perspective involves an examination of the risks considered most relevant to the conduct of monetary policy. There are various risks surrounding Japan's economic activity and prices. For the time being, it is necessary to pay particular attention to the impact of the future course of the situation in the Middle East on financial and foreign exchange markets and on Japan's economic activity and prices. In this regard, if the impact of the situation in the Middle East becomes prolonged, crude oil prices could remain elevated and firms' production activity could come under downward pressure through large-scale disruptions in supply chains. Thus, with regard to the risk balance -- particularly for fiscal 2026 -- risks to economic activity are skewed to the downside, and risks to prices are skewed to the upside. While these risks could both heighten, it is necessary to pay due attention, in particular, to keep the risk of inflation significantly deviating upward from materializing and thereby exerting an adverse impact on the

[5] As for the examination from two perspectives in the context of the price stability target, see the Bank's statement released on January 22, 2013, entitled "The 'Price Stability Target' under the Framework for the Conduct of Monetary Policy."

economy afterward, given factors such as underlying CPI inflation approaching 2 percent and firms' behavior shifting more toward raising wages and prices.

Examining risks on the financial side, financial intermediation activities, such as lending, have operated smoothly, and no major financial imbalances have been seen in current financial activities, although attention continues to be warranted on developments in asset prices, such as real estate and stock prices. Japan's financial system has maintained stability on the whole. Even in the case of an adjustment in the real economy at home and abroad and in global financial markets, the financial system is likely to remain highly robust on the whole, mainly because Japanese financial institutions have sufficient capital bases. In this regard, it is necessary to carefully monitor the impact that factors such as the future course of the situation in the Middle East, the profitability of AI-related investment, and developments in the foreign non-bank financial intermediary (NBFI) sector have on the financial system through various channels.[6]

As for the conduct of monetary policy, given that underlying CPI inflation has been approaching 2 percent and real interest rates are at significantly low levels, the Bank will continue to raise the policy interest rate and adjust the degree of monetary accommodation, in response to developments in economic activity and prices as well as financial conditions. In this regard, it will consider the timing and pace of adjustment, while closely monitoring the impact of the future course of the situation in the Middle East on Japan's economic activity and prices and examining the likelihood of realizing the baseline scenario of the outlook for economic activity and prices and the risks to the outlook. With the price stability target of 2 percent, the Bank will conduct monetary policy as appropriate from the perspective of sustainable and stable achievement of the target.

[6] For details, see the Bank's *Financial System Report* (April 2026).

(Appendix)

## Forecasts of the Majority of the Policy Board Members

y/y % chg.

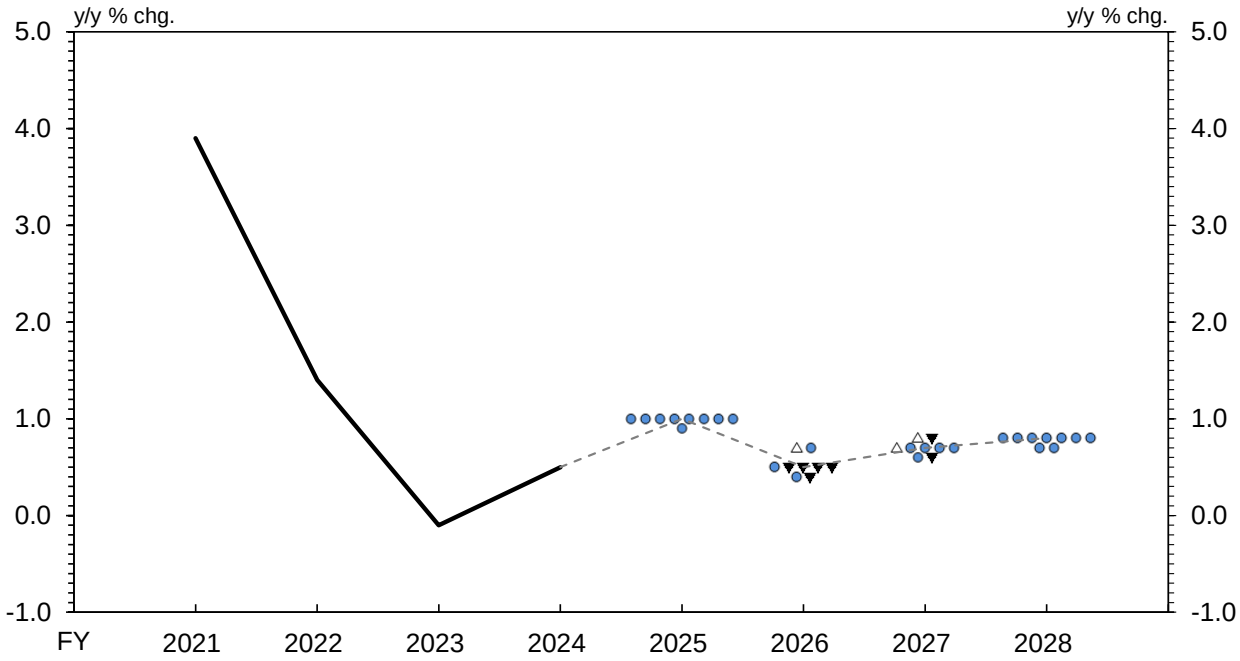
| | Real GDP | CPI (all items less fresh food) | (Reference) CPI (all items less fresh food and energy) |
|---|---|---|---|
| Fiscal 2025 | +1.0 to +1.0 [+1.0] | +2.7 | +3.0 |
| Forecasts made in January 2026 | +0.8 to +0.9 [+0.9] | +2.7 to +2.8 [+2.7] | +2.9 to +3.1 [+3.0] |
| Fiscal 2026 | +0.4 to +0.7 [+0.5] | +2.8 to +3.0 [+2.8] | +2.5 to +2.7 [+2.6] |
| Forecasts made in January 2026 | +0.8 to +1.0 [+1.0] | +1.9 to +2.0 [+1.9] | +2.0 to +2.3 [+2.2] |
| Fiscal 2027 | +0.6 to +0.8 [+0.7] | +2.3 to +2.4 [+2.3] | +2.6 to +2.7 [+2.6] |
| Forecasts made in January 2026 | +0.8 to +1.0 [+0.8] | +1.9 to +2.2 [+2.0] | +2.0 to +2.3 [+2.1] |
| Fiscal 2028 | +0.7 to +0.8 [+0.8] | +2.0 to +2.2 [+2.0] | +2.1 to +2.4 [+2.2] |

Notes: 1. Figures in brackets indicate the medians of the Policy Board members' forecasts (point estimates).

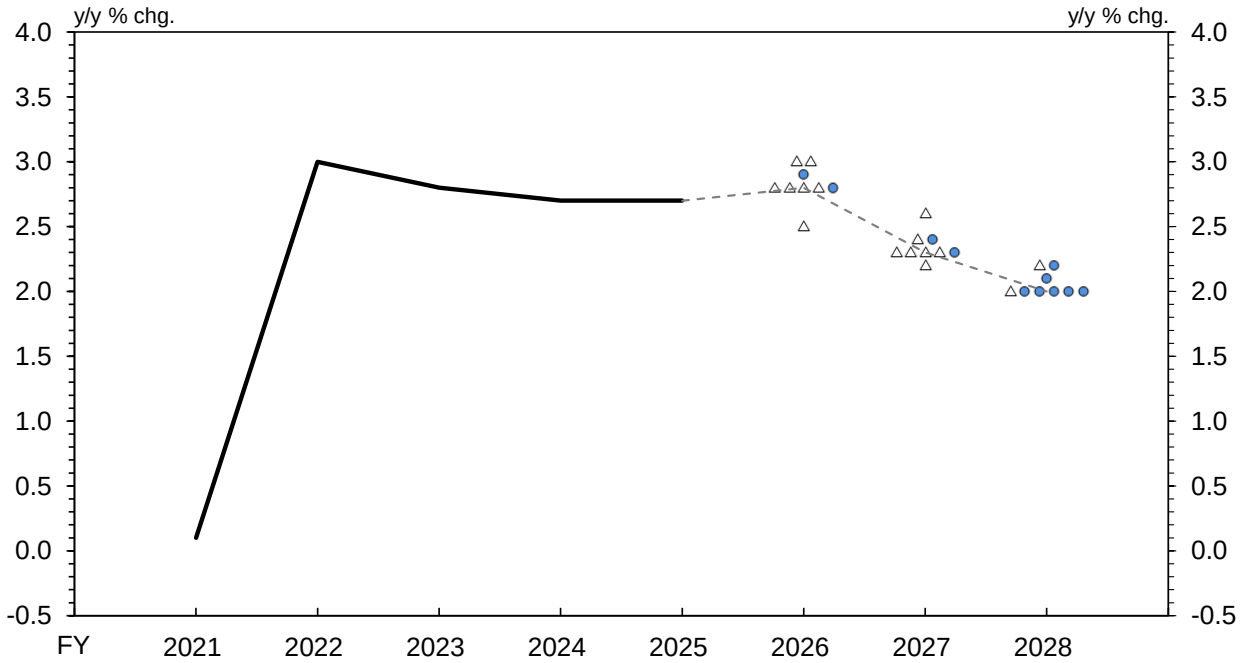
2. The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which they attach the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.
3. Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.
4. The CPI figures for fiscal 2025 are actual values.

## Policy Board Members' Forecasts and Risk Assessments

### (1) Real GDP




### (2) CPI (All Items Less Fresh Food)




Notes: 1. The solid lines show actual figures, while the dotted lines show the medians of the Policy Board members' forecasts (point estimates).

2. The locations of ●, △, and ▼ in the charts indicate the figures for each Policy Board member's forecasts to which they attach the highest probability. The risk balance assessed by each Policy Board member is shown by the following shapes: ● indicates that a member assesses "upside and downside risks as being generally balanced," △ indicates that a member assesses "risks are skewed to the upside," and ▼ indicates that a member assesses "risks are skewed to the downside."

## The Background[7]

# I. Current Situation of Economic Activity and Its Outlook[8]

## A. Economic Developments

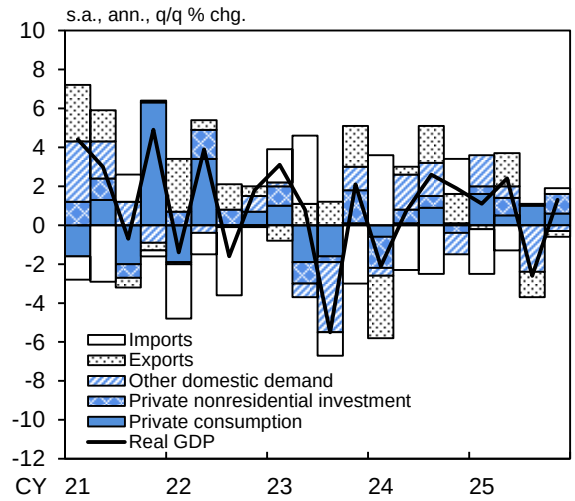
Japan's economy has recovered moderately, although some weakness has been seen in part, partly due to the impact of the situation in the Middle East.

The real GDP growth rate for the October-December quarter of 2025 was 0.3 percent on a quarter-on-quarter basis and 1.3 percent on an annualized basis, registering positive growth for the first time in two quarters (Chart 1). With the impact of the reactionary decline in housing investment following the enforcement of revisions to the Building Standards Act and other regulations dissipating, domestic demand such as private consumption and business fixed investment increased steadily. In this situation, labor market conditions have continued to be tight, and the output gap -- which captures the utilization of labor and capital -- widened slightly within positive territory in the October-December quarter (Chart 2).[9]

**Chart 1:** Real GDP

**1. Level**


**2. Annualized Quarterly Growth Rate**




Source: Cabinet Office.

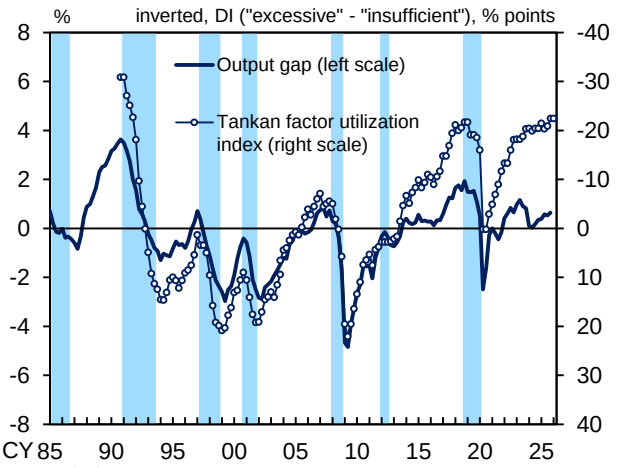
[7] "The Background" provides explanations of "The Bank's View" decided by the Policy Board at the Monetary Policy Meeting held on April 27 and 28, 2026.

[8] See Box 1 for the assumptions underlying the outlook for commodity prices, including crude oil prices.

[9] The output gap and the potential growth rate should be interpreted with considerable latitude because they are estimated based on specific assumptions regarding trends in production factors. For details on the estimation method, see the following paper: Research and Statistics Department, Bank of Japan, "Updates on the Output Gap and Potential Growth Rate, and Monitoring Labor Market Indicators," Bank of Japan Research Paper (forthcoming; the Japanese version was released in March 2026).

Monthly indicators and high-frequency data since the beginning of the year show that, through around February 2026, before the outbreak of the conflict in the Middle East, economic activity appears to have continued to be on a firm improving trend. Exports and production had been on an increasing trend, as a further increase in global AI-related demand coincided with the effects of increased production in Japan's automobile sector. Against this backdrop, the March *Tankan* (Short-Term Economic Survey of Enterprises in Japan) shows that the diffusion index (DI) for business conditions has marked the most favorable level since August 1991, and business fixed investment plans for fiscal 2025 remained on a steady upward trend. In the household sector, the number of employees continued to rise, though at a decelerated pace, and nominal wages continued to increase steadily. In this situation, the resilience of private consumption increased somewhat, accompanied by an improvement in consumer sentiment, as food price increases became less pronounced compared with a while ago. In reflection of the aforementioned developments in domestic and external demand, the employment conditions DI for all industries and enterprises in the March *Tankan* showed net "insufficient employment" at about the same level as in the early 1990s, particularly in nonmanufacturing. As a result, the weighted average DI for production capacity and employment conditions also continued to show a significantly large net "insufficient" (Chart 2).

**Chart 2:** Output Gap




Source: Bank of Japan.
Notes: 1. Figures for the output gap are staff estimates.
2. The *Tankan* factor utilization index is calculated as the weighted average of the production capacity DI and the employment conditions DI for all industries and enterprises. The capital and labor shares are used as weights. There is a discontinuity in the data for December 2003 due to a change in the survey framework.
3. Shaded areas denote recession periods.

However, from March onward, Japan's economy has started to come under downward pressure, reflecting the rise in crude oil prices and bottlenecks in logistics resulting from the growing

instability of the situation in the Middle East. Firms in industries such as petrochemicals, where import procurement of raw materials from the Middle East has been disrupted due to the de facto closure of the Strait of Hormuz, have been compelled to reduce the utilization rate of their plants, although the release of petroleum reserves by the government and the securing of alternative sources of supply have provided support. Moreover, in the automobile sector, exports and production for the Middle East have declined, as sea transport of automobiles to the region has become difficult. In the household sector, price rises, such as in energy prices, appear to have started to weigh on private consumption through adverse effects on real purchasing power and household sentiment.

With regard to the outlook, Japan's economic growth is likely to decelerate to a pace somewhat below the potential growth rate for a time. This is because, although solid global AI-related demand and the government's various measures are likely to provide support, the economy is expected to be pushed down by moves to adjust production reflecting bottlenecks in logistics and by the deterioration in the terms of trade reflecting the surge in energy and raw material prices.[10] Thereafter, based on the assumption that crude oil prices will continue on a declining trend, Japan's economy is projected to return to a growth path at a pace around the same level as the potential growth rate, without entering a significant adjustment phase.[11] Comparing the

[10] See Box 1 for the impact of worsening terms of trade on Japan's economy, and Box 2 for the impact of a surge in crude oil prices on Japan's prices.

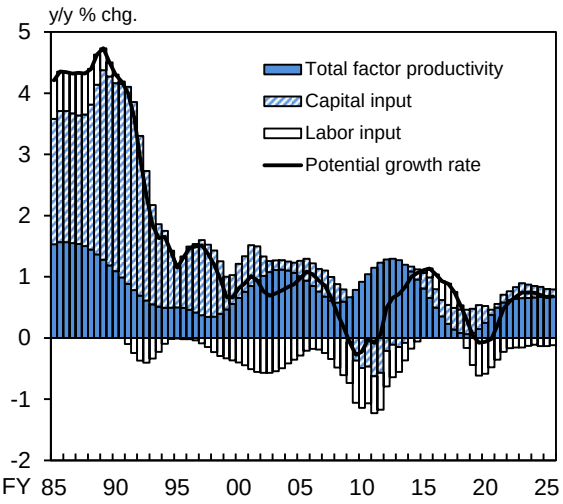
[11] See Box 3 for a risk scenario analysis regarding the impact of the situation in the Middle East.

projections with those presented in the previous Outlook Report, the projected real GDP growth rate for fiscal 2026 is lower due to the impact of the situation in the Middle East.

The estimate of the potential growth rate has been around 0.5-1.0 percent since the recovery from the COVID-19 pandemic, and it is expected to remain at around that level (Chart 3). The breakdown of the outlook for the potential growth rate is as follows: (1) although the decline in potential working hours will come to a halt reflecting the diminishing effects of working-style reforms, the growth in potential labor input will be slightly negative, since the labor force participation of women and seniors will gradually level off and growth in the number of potential workers will decelerate; (2) capital stock will continue to increase steadily, partly supported by the government's various measures, although the pace of increase will decelerate, reflecting the rising share of intangible fixed asset investment, for which economic value depreciates quickly; and (3) growth in total factor productivity (TFP) will remain positive at around its current level, supported by an improvement in productivity due to the use of tools such as AI and by more efficient reallocation of production factors. Based on the aforementioned projections of economic developments and the potential growth rate, it is expected that the output gap will temporarily narrow within positive territory, but will follow an increasing trend again from the middle of the projection period, remaining slightly positive.

Details of the outlook for each fiscal year are as follows. In fiscal 2026, Japan's economic growth

**Chart 3:** Potential Growth Rate




Source: Bank of Japan.
Note: Figures are staff estimates. Figures for the second half of fiscal 2025 are those for 2025/Q4.

is likely to decelerate clearly from the previous fiscal year. This is because it is projected that, while exports will follow a moderate increasing trend on the back of solid global AI-related demand, the growth momentum in domestic private demand will decelerate, as the surge in energy and raw material prices leads to a pushing down of corporate profits and a decline in households' real purchasing power. However, in addition to high levels of corporate profits acting as a buffer, Japan's economy is likely to be underpinned by the government's measures and accommodative financial conditions, and economic growth is thus expected to remain positive, albeit at a level below the potential growth rate. Goods exports are likely to remain more or less flat for the time being due to downward pressure on automobile-related exports and intermediate goods exports reflecting the impact of the situation in the Middle East; however, as the impact of the situation in the Middle East eases, goods exports are expected to follow a moderate increasing trend, mainly led by AI-related goods. Business fixed investment is likely to be resilient, underpinned by moves to clear order backlogs for existing investment projects, although the growth momentum is likely to decelerate due to a deterioration in corporate profits reflecting higher energy prices and to a rise in construction costs. Nominal wages are highly likely to continue rising steadily, with base pay increases being realized at around the same level as in 2025, and due to the impact of higher wages of part-time employees reflecting minimum wage increases. The number of employees is also highly likely to continue increasing moderately. In addition to such increases in employee income, the government's various measures -- including the provision of fuel oil subsidies through its

emergency measures to curb dramatic price fluctuations -- are likely to provide some support for private consumption; however, it is highly likely to slow temporarily, as decreased real purchasing power due to price rises, particularly higher energy prices, is likely to significantly weigh on consumption. Meanwhile, housing investment is likely to follow a declining trend, mainly reflecting a rise in housing prices and demographic developments.

In fiscal 2027, Japan's economic growth is likely to recover to around the same level as the potential growth rate. This is because it is expected that, while downward effects due to price rises will remain, particularly in the first half of the fiscal year, the increasing trend in domestic private demand will gradually become more pronounced, supported by an improvement in trading gains reflecting a decline in crude oil prices. Goods exports are expected to follow a moderate increasing trend, mainly led by automobile-related and AI-related goods, as the impact of the situation in the Middle East eases. Corporate profits are likely to recover, returning to an uptrend, mainly due to the decline in energy and raw material prices. In this situation, business fixed investment is likely to return to an upward trend, pushed up by labor-saving investment to address labor shortages, investment for capacity expansion, and investment projects to adapt to changes in the trade structure and supply chains, among other investments. The rate of increase in nominal wages is likely to decelerate somewhat, pushed down by the earlier decline in corporate profits with a time lag. Even in this situation, private consumption is likely to return to a moderate increasing trend, supported by a

recovery in real disposable income reflecting a decline in the inflation rate.

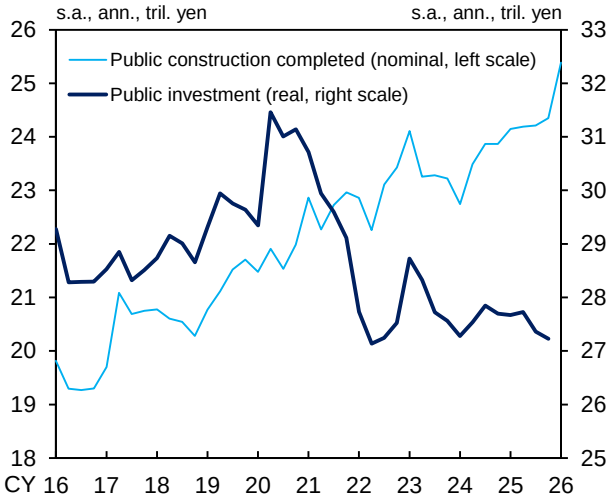
In fiscal 2028, Japan's economic growth is likely to remain at a pace around the same level as the potential growth rate, with crude oil prices projected to remain more or less flat. Goods exports are expected to continue increasing moderately as overseas economies see moderate growth. With a continued improvement in corporate profits, business fixed investment is likely to remain on a steady upward trend. Employee income is likely to increase firmly, as growth in nominal wages accelerates again reflecting the improvement in corporate profits. In this situation, private consumption is expected to follow a moderate increasing trend, as real disposable income continues to improve.

## B. Developments in Major Expenditure Items and Their Background

### Government Spending

Public investment has continued to be more or less flat (Chart 4). While construction based on the government's economic measures, including construction related to building national resilience, has progressed, the amount of public investment (in real terms) has continued to be more or less flat when fluctuations are smoothed out. The amount of public construction completed (in nominal terms) -- a coincident indicator of public investment -- has been on a moderate increasing trend, reflecting a rise in construction costs.

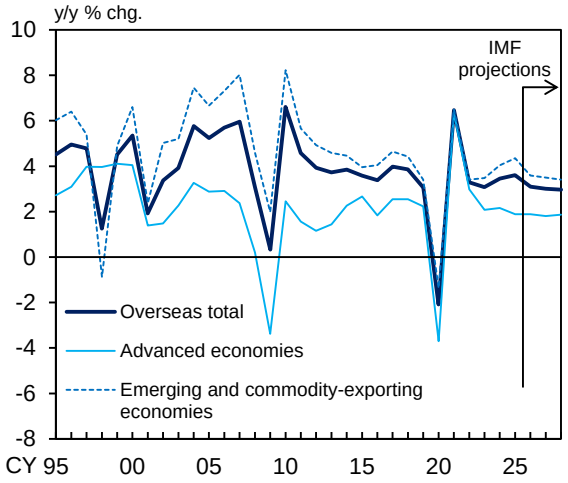
**Chart 4:** Public Investment




Sources: Cabinet Office; Ministry of Land, Infrastructure, Transport and Tourism.
Note: The figure for 2026/Q1 is the January-February average.

Considering the developments in various leading indicators, public investment is likely to be more or less flat. Government consumption is projected to continue increasing steadily, reflecting an increase in spending on the government's economic measures and a rise in defense-related spending, in addition to an uptrend in healthcare and nursing care expenditures.

**Chart 5:** Overseas Economies



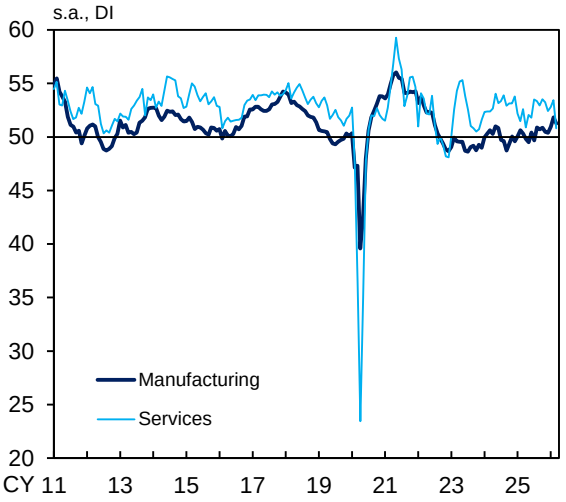

Sources: IMF; Ministry of Finance.
Note: Figures are the weighted averages of real GDP growth rates using countries' share in Japan's exports as weights. The real GDP growth rates are compiled by the IMF, and the rates from 2026 onward are its projections in the April 2026 *World Economic Outlook* (WEO). Figures for advanced economies are those for the United States, the euro area, and the United Kingdom. Figures for emerging and commodity-exporting economies are those for the rest of the world.

### Overseas Economies

Overseas economies have grown moderately on the whole, although some weakness has been seen in part, partly due to the impact of the situation in the Middle East (Chart 5). By region, the U.S. economy has maintained solid growth on the whole, although some weakness has been seen in part. European economies have remained resilient, particularly in domestic demand, although some weakness has been seen in part. The Chinese economy has picked up recently, mainly supported by an increase in exports,

although consumption has lacked momentum. Growth in emerging and commodity-exporting economies other than China has improved moderately on the whole, although some weakness has been seen in part. Among those in Asia, which have close links to Japan's economy, the NIEs and ASEAN economies have improved as global demand for IT-related goods has expanded, driven by AI-related demand; however, economic activity has come under downward pressure in part, reflecting the impact of the situation in the Middle East.

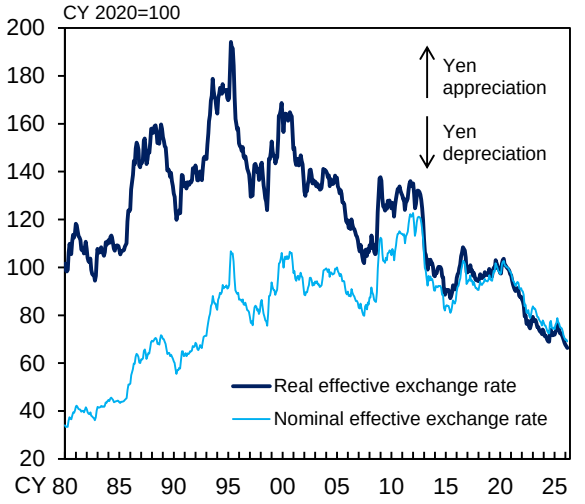
**Chart 6:** Global PMI




Source: Copyright © 2026 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.
Note: Figures for manufacturing are the J.P.Morgan Global Manufacturing PMI. Figures for services are the J.P.Morgan Global Services Business Activity Index.

Looking at the Global PMI to see the current situation for the global economy, figures for the services industry have recently declined to around 50 -- the break-even point between improvement and deterioration in business conditions -- partly due to the impact of the situation in the Middle East. Meanwhile, figures for the manufacturing industry have remained slightly above 50 (Chart 6).

**Chart 7:** Effective Exchange Rates




Source: BIS.
Note: Figures are based on the broad effective exchange rate indices. Figures prior to 1994 are calculated using the narrow indices.

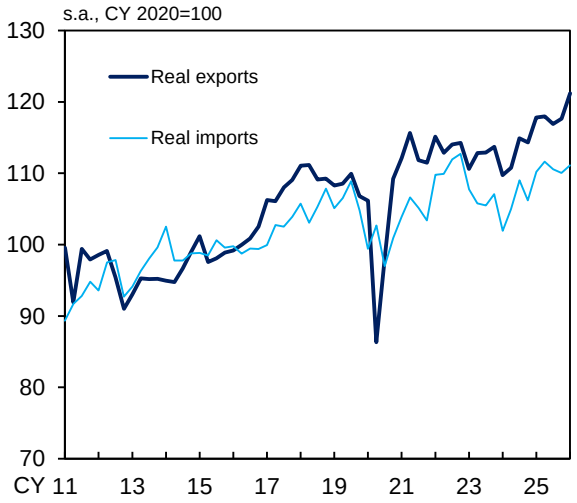
As for the outlook, overseas economies are expected to come under downward pressure for the time being due to the impact of factors such as the situation in the Middle East. Thereafter, however, based on the assumption that the impact of the situation in the Middle East will ease, overseas economies are projected to continue growing moderately, partly supported by global AI-related demand. By region, the impact of the situation in the Middle East is likely to exert downward pressure for the time being, mainly on Asian economies, which are highly dependent on energy imports from the Middle East. Thereafter, based on the assumption that the impact of the

situation in the Middle East will ease, U.S. economic growth is expected to return to a pace around the same level as the potential growth rate, partly reflecting AI-related demand and support from economic policies. European economies are projected to see a gradual acceleration in their growth rate, partly reflecting support from economic policies. The Chinese economy is likely to improve moderately, partly reflecting support from economic policies. Emerging and commodity-exporting economies other than China are likely to improve moderately, partly supported by global AI-related demand.

## Exports and Imports

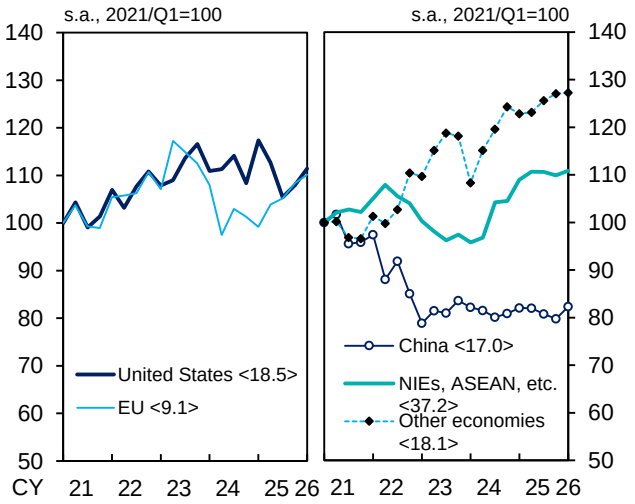
Exports have continued to be more or less flat as a trend (Chart 8).[12] By region, exports to the United States have picked up, mainly reflecting the resumption of production lines at some automakers (Chart 9). Exports to Europe have picked up, especially of automobile-related goods, reflecting a recovery in domestic demand in the region. Exports to China have remained at a low level, due to greater local production of automobiles, IT-related goods, and other products by Chinese manufacturers reflecting their increased competitiveness, and pushed down by the peaking-out of demand for semiconductor production equipment. Exports to the NIEs, ASEAN, and some other Asian economies have been sluggish, reflecting the waning of moves to increase production of components for new smartphones, while solid global AI-related demand has pushed up exports to these economies. Exports to other economies have been on a moderate increasing trend, but the

**Chart 8:** Real Exports and Imports




Sources: Bank of Japan; Ministry of Finance.
Note: Based on staff calculations.

**Chart 9:** Real Exports by Region

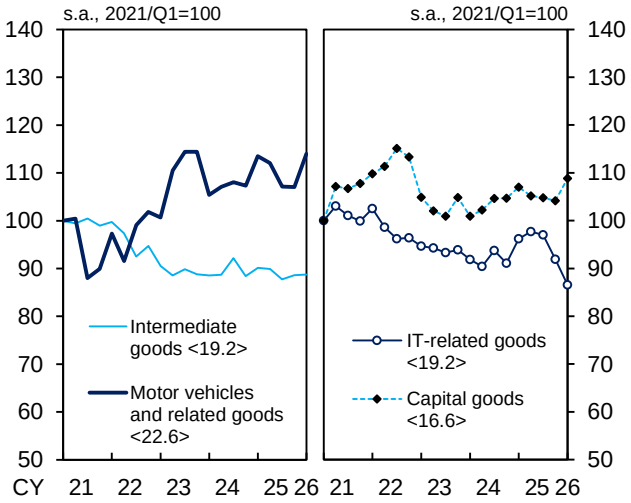



Sources: Bank of Japan; Ministry of Finance.
Note: Based on staff calculations. Figures in angular brackets show the share of each country or region in Japan's total exports in 2025.

[12] See Box 4 for the impact of increased AI-related demand on Japan's exports.

decline in exports of automobiles to the Middle East has exerted downward pressure recently. By type of goods, exports of automobile-related goods had declined through the end of last year, reflecting factors such as the reactionary decline following the front-loading ahead of the U.S. tariff increase and the impact of the suspension of production lines at some automakers; since the turn of this year, however, exports of automobile-related goods have picked up, mainly reflecting the resumption of production lines (Chart 10). Exports of capital goods have increased recently, particularly of semiconductor production equipment and equipment for power facilities, reflecting the increase in global AI-related demand. Exports of IT-related goods have decreased, reflecting factors such as the waning of moves to increase production of components for new smartphones, although AI-related demand, such as for data servers, has been solid.[13] Meanwhile, exports of intermediate goods had been more or less flat at low levels, due to continued oversupply, particularly in Asia, against the background of excess production capacity in China; more recently, exports of intermediate goods have been pushed down by factors such as a decline in the capacity utilization rate in the basic materials industry, reflecting the impact of the situation in the Middle East.

**Chart 10:** Real Exports by Type of Goods




Sources: Bank of Japan; Ministry of Finance.
Note: Based on staff calculations. Figures in angular brackets show the share of each type of goods in Japan's total exports in 2025.

As for the outlook, exports are likely to remain more or less flat for the time being. This is because, while solid global AI-related demand is expected to push up exports of IT-related goods and capital goods in particular, it is expected that

[13] The decrease in real exports of IT-related goods is influenced by factors such as nominal export values not growing in a way that is consistent with export prices, which are being driven up by the rise in market prices of memory chips.

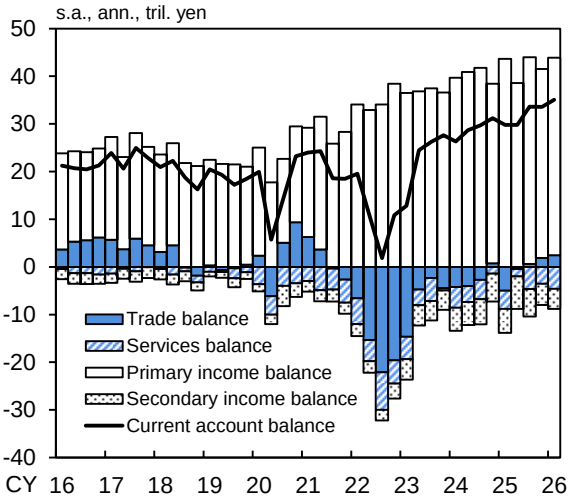
exports of automobiles to the Middle East will decline, reflecting the unstable situation in the Middle East, and the decline in the capacity utilization rate in the basic materials industry will also push down exports of related goods. Thereafter, as the impact of the situation in the Middle East eases, exports are projected to follow a moderate increasing trend, mainly led by automobile-related goods and AI-related goods.

Imports have been relatively weak recently (Chart 8). For the time being, imports are expected to decrease temporarily, against the background of stagnant imports of raw materials and intermediate goods reflecting the situation in the Middle East and a slowdown in domestic demand resulting from the deterioration in the terms of trade. Thereafter, imports are likely to turn to a moderate uptrend, supported by a pick-up in domestic demand, in addition to the normalization of logistics reflecting the easing of tension over the situation in the Middle East.

## External Balance

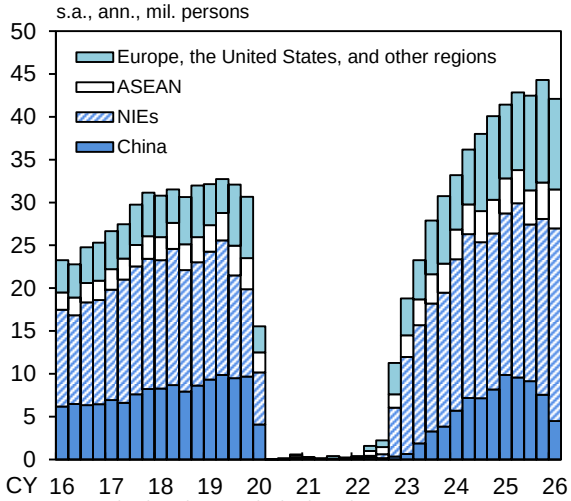
The nominal current account surplus has been at a high level (Chart 11). The trade balance had remained on a slight deficit trend, but it has recently turned to a marginal surplus trend, partly due to the past decline in crude oil prices. Looking at the services balance, while the travel balance -- supported by inbound tourism demand (Chart 12) -- has marked a surplus, it has remained on a slight deficit trend on the whole, as payments for digital-related services have been at high levels. Meanwhile, the primary income balance surplus has remained at a high level, albeit with fluctuations, pushed up by factors such as

**Chart 11:** Current Account




Source: Ministry of Finance and Bank of Japan.
Note: Figures for 2026/Q1 are January-February averages.

**Chart 12:** Number of Inbound Visitors



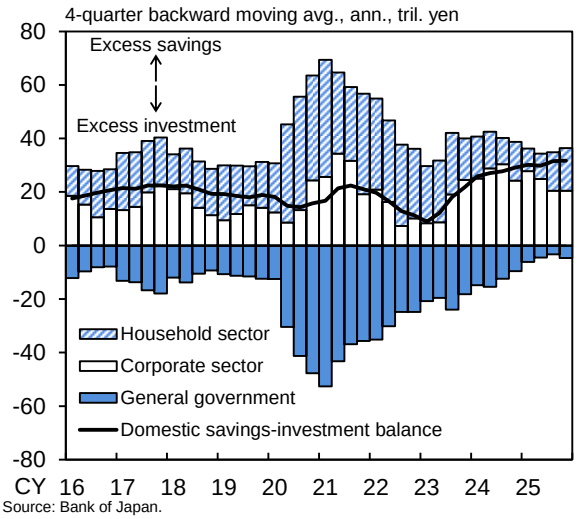

Source: Japan National Tourism Organization (JNTO).
Note: Figures for Europe, the United States, and other regions include seasonal adjustment errors.

receipts of direct investment income and portfolio investment income.

With regard to the outlook for the nominal current account balance, for the time being, the surplus is likely to decline temporarily, as the trade balance is expected to deteriorate against the backdrop of factors such as the rise in crude oil prices. Thereafter, however, the nominal current account surplus is likely to increase moderately again, reflecting that the trade balance is expected to recover due to a decline in crude oil prices, and that the primary income balance surplus is expected to expand due to an improvement in overseas economies.

Meanwhile, in terms of the savings-investment balance, which by definition equals the current account balance, overall excess savings in Japan had continued on a moderate expanding trend, reflecting an increase in corporate profits and a decline in the general government deficit. More recently, overall excess savings have been more or less flat at high levels (Chart 13). Looking ahead, overall excess savings are projected to decline, as excess savings in the household sector are likely to decline, mainly due to the rise in energy prices, and as the fiscal deficit in the government sector is likely to expand due to factors such as the resumption of fuel oil subsidies. Overall excess savings are then expected to expand moderately, against the background of the decline in crude oil prices leading to a recovery in corporate profits and to a decrease in the fiscal deficit in the government sector.

**Chart 13:** Savings-Investment Balance

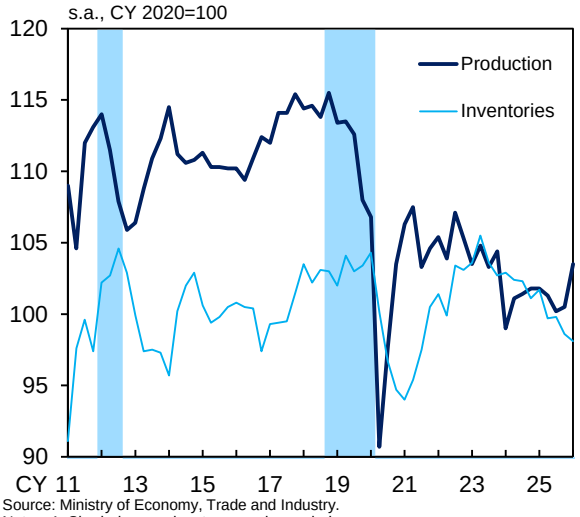



Source: Bank of Japan.

## Industrial Production

Industrial production has continued to be more or less flat from a somewhat long-term perspective (Chart 14). By major industry, production of "transport equipment" has firmly increased recently due to factors such as the resumption of production lines at some automakers, amid resilience in domestic and external demand. Production of "general-purpose, production, and business-oriented machinery" -- despite being affected by fluctuations stemming from that of semiconductor production equipment -- has increased, with the increase in global AI-related demand spreading to the production of a wider variety of items. Production of "electronic parts and devices" had continued to increase on the back of solid AI-related demand; more recently, however, the growth momentum has slowed, reflecting the waning of moves to increase production of components for new smartphones. Meanwhile, production of "electrical machinery, and information and communication electronics equipment" has been more or less flat, as the increase in the production of lithium-ion batteries used in automobiles and the negative effects of the peaking-out of renewal demand for personal computers reflecting the end of support for some operating systems have offset each other. Production of "chemicals (excluding medicine)" has remained at a low level due to persistent downward pressure stemming from oversupply, particularly in Asia. Meanwhile, inventories have seen a clear decline recently, since AI-related demand has been more solid than firms had expected, and inventory adjustments in producer goods have also been making progress.

**Chart 14:** Industrial Production




Source: Ministry of Economy, Trade and Industry.
Notes: 1. Shaded areas denote recession periods.
2. The production figure for 2026/Q1 is the January-February average. The inventories figure for 2026/Q1 is that for February.

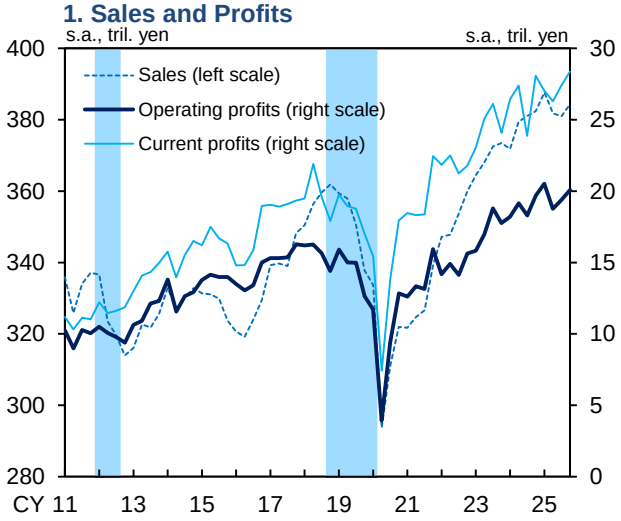
As for the outlook, industrial production is expected to remain more or less flat on the whole. This is because, although underpinned by solid global AI-related demand and resilience in business fixed investment supported by economic measures, industrial production is expected to come under downward pressure from the decline in the capacity utilization rate in the basic materials industry and production adjustments for transport equipment, both reflecting the unstable situation in the Middle East.

## Corporate Profits

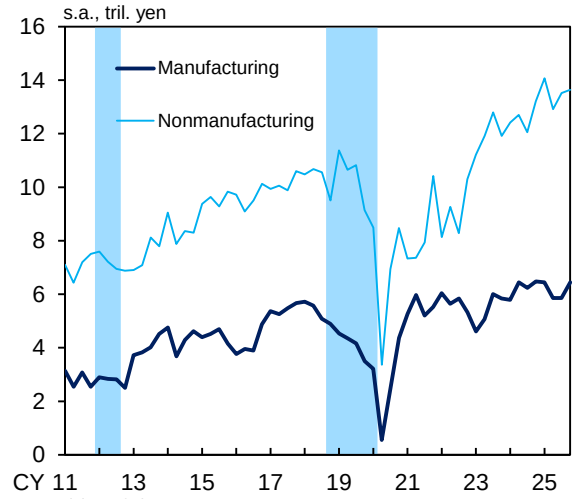
Corporate profits have remained at high levels on the whole, although downward effects due to U.S. tariff policy have been seen in manufacturing. According to the *Financial Statements Statistics of Corporations by Industry, Quarterly*, operating profits for all industries and enterprises have been at a high level, around their historical peak, due to the increase in AI-related demand and progress in the pass-through of cost increases to selling prices, although operating profits have continued to be pushed down by the impact of a deterioration in export profitability in manufacturing due to the increase in U.S. tariffs (Chart 15). By industry, operating profits of manufacturers have picked up recently, supported by solid AI-related demand, although the deterioration in export profitability due to the increase in tariffs has exerted downward pressure on profits, mainly among large firms in transportation machinery. As for nonmanufacturers, operating profits have been more or less flat at high levels, partly due to progress in the pass-through of cost increases to selling prices and robustness in the construction and real estate-related sectors.

**Chart 15:** Indicators Related to Corporate Profits

**1. Sales and Profits**



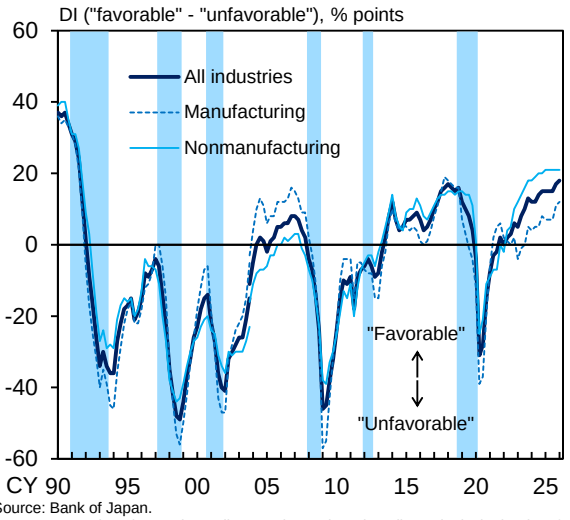

**2. Operating Profits by Industry**




Source: Ministry of Finance.
Notes: 1. Based on the *Financial Statements Statistics of Corporations by Industry, Quarterly*. Excluding "finance and insurance" and "pure holding companies."
2. Shaded areas denote recession periods.

Business sentiment has been at a favorable level on the whole, while it has been affected by the situation in the Middle East. Looking at the March *Tankan*, the business conditions DI for all industries and enterprises registered a net "favorable" value of 18, marking its most favorable level since August 1991. As for the outlook, however, business conditions are projected to deteriorate by a relatively large degree, with the forecast DI registering a value of 11, reflecting concern over the situation in the Middle East (Chart 16). By industry, the business conditions DI for manufacturing has been on an improving trend, reflecting factors such as the increase in AI-related demand and the decline in uncertainty over U.S. trade policy; however, the forecast DIs for a wide range of manufacturing industries have deteriorated due to the impact of the situation in the Middle East. The business conditions DI for nonmanufacturing has been at a high level, supported by resilient domestic demand and progress in the pass-through of cost increases to selling prices; regarding the outlook, however, the forecast DIs indicate that there is concern over adverse effects due to the rise in energy prices.

**Chart 16:** Business Conditions




Source: Bank of Japan.
Notes: 1. Based on the *Tankan*. All enterprises. There is a discontinuity in the data for December 2003 due to a change in the survey framework.
2. Shaded areas denote recession periods.

Regarding the outlook, although corporate profits are likely to be underpinned by the government's fuel oil subsidies and the increase in nominal exports, they are projected to decline, mainly in nonmanufacturing, as the rise in crude oil prices and bottlenecks in logistics are likely to significantly weigh on profits. Thereafter, based on the assumption that crude oil prices will decline moderately, corporate profits are expected to turn to an uptrend again, supported

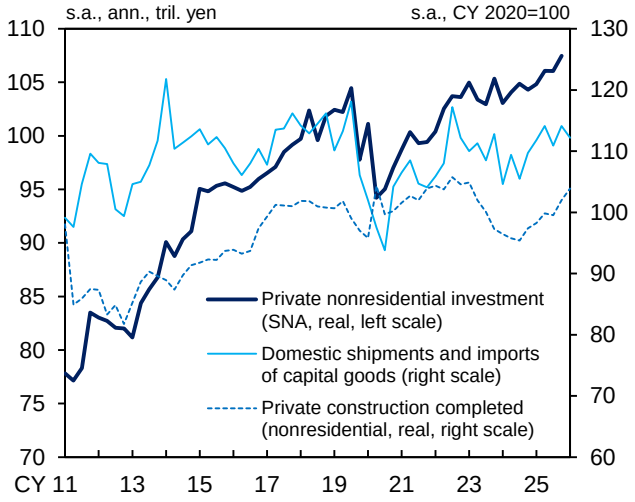
by an improvement in the terms of trade and an increase in domestic and external demand.

## Business Fixed Investment

Business fixed investment has been on a moderate increasing trend (Chart 17). The aggregate supply of capital goods -- a coincident indicator of machinery investment -- has been resilient, albeit with fluctuations in investment in semiconductor production equipment and other goods, as the aggregate supply of capital goods has been supported by demand for AI- and labor saving-related investments. Despite being affected by delays in construction projects due to high construction material prices and labor shortages, private construction completed (nonresidential, real) -- a coincident indicator of construction investment -- has continued on a moderate uptrend, supported by strong construction demand, mainly demand for logistics facilities, demand related to urban redevelopment, and demand related to electricity.

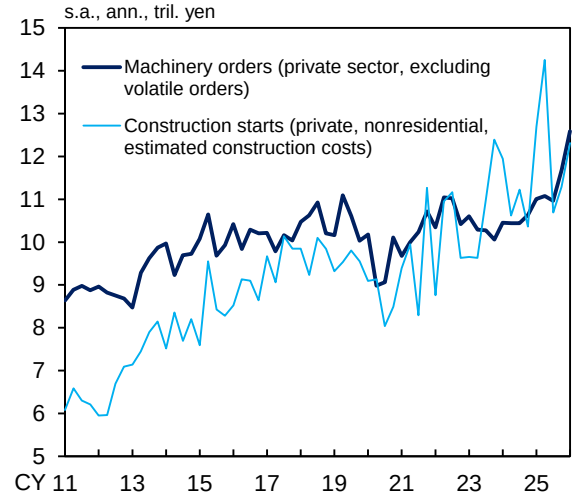
Machinery orders -- a leading indicator of machinery investment -- have increased significantly, due in part to the effects of large-scale projects (Chart 18). Developments in machinery orders by industry are as follows. In manufacturing, orders have increased firmly, supported by large-scale investments by the chemical, nonferrous metal, and shipbuilding industries in addition to resilient demand for investment in growth areas such as semiconductor components. Orders from the nonmanufacturing industry have increased markedly, mainly in industries such as information services and finance and insurance, pushed up

**Chart 17:** Coincident Indicators of Business Fixed Investment




Sources: Cabinet Office; Ministry of Economy, Trade and Industry; Ministry of Land, Infrastructure, Transport and Tourism.
Notes: 1. Figures for 2026/Q1 are January-February averages.
2. Figures for real private construction completed are based on staff calculations using the construction cost deflators.

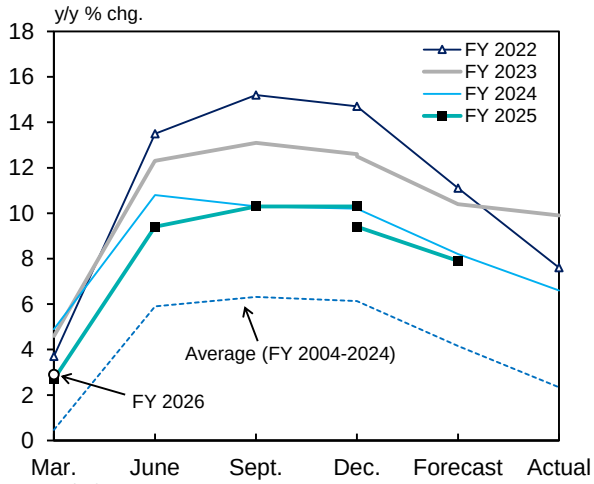
**Chart 18:** Leading Indicators of Business Fixed Investment




Sources: Cabinet Office; Ministry of Land, Infrastructure, Transport and Tourism.
Notes: 1. Volatile orders are orders for ships and orders from electric power companies.
2. Figures for 2026/Q1 are January-February averages.

by strong demand for digital- and labor saving-related investments as a trend. Construction starts (in terms of planned expenses for private and nonresidential construction) -- a leading indicator of construction investment -- have been on an increasing trend, mainly in nonmanufacturing, albeit with fluctuations stemming from large-scale projects, as construction starts have been supported by solid demand related to urban redevelopment and demand for construction such as of new logistics facilities and new data centers. Looking at business fixed investment plans (in nominal terms) in the March *Tankan*, business fixed investment (on a basis close to the GDP definition; business fixed investment -- including software and R&D investments but excluding land purchasing expenses -- for all industries and enterprises including financial institutions) for fiscal 2025 shows a firm increase similar in size to that recorded in the previous fiscal year, registering a year-on-year rate of increase of 7.9 percent (Chart 19). That for fiscal 2026 is likely to increase by 2.9 percent, although this could be revised considerably depending on the future course of the situation in the Middle East.

**Chart 19:** Developments in Business Fixed Investment Plans

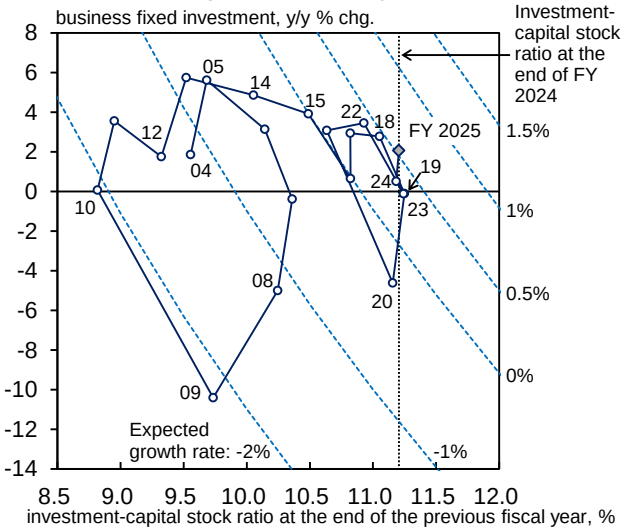



Source: Bank of Japan.
Notes: 1. Based on the *Tankan*. All industries including financial institutions.
2. Including software and R&D investments and excluding land purchasing expenses. R&D investment is not included before the March 2017 survey.
3. There are discontinuities in the data for December 2023 and December 2025 due to changes in the survey sample.

Regarding the outlook, the growth momentum in business fixed investment is highly likely to decelerate gradually. This is because the deterioration in corporate profits reflecting higher energy prices and the rise in construction costs are likely to exert greater downward pressure on business fixed investment, although moves to clear order backlogs from existing investment projects are likely to provide support. Thereafter, with corporate profits recovering on the back of a decline in energy prices, business fixed

investment is likely to follow a moderate uptrend, supported in part by the effects of the government's earlier economic measures. Medium- to long-term investment that is expected to support business fixed investment during the projection period includes (1) labor-saving and efficiency-improving investment to address structural labor shortages and IT-related investment to digitalize business activities; (2) construction investment in logistics facilities, resulting from expanding e-commerce, and in offices and commercial facilities related to urban redevelopment; (3) R&D investment related to growth areas and decarbonization; and (4) semiconductor-related investment mainly aimed at strengthening supply chains and investment related to science and technology support, both of which reflect government support.

**Chart 20:** Capital Stock Cycles




Source: Cabinet Office.
Note: Each broken line represents the combination of the rate of change in business fixed investment and the investment-capital stock ratio at a certain expected growth rate. The figure for fiscal 2025 is the 2025/Q2-Q4 average.

Firm's expected growth rate derived from the pace of increase in capital stock has been at around 0.5 percent, a level generally consistent with the potential growth rate (Chart 20). Although capital stock is likely to accumulate reflecting the uptrend in business fixed investment, the pace of increase in such stock is expected to be moderate, due in part to an increase in the weight of intangible fixed asset investment, which has a high depreciation rate.

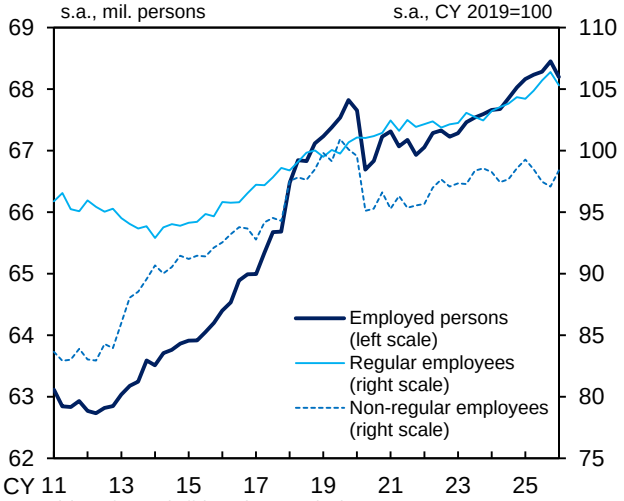
## Employment and Income Situation

The employment and income situation has improved moderately.

The rate of increase in the number of employed persons has decelerated recently, as the growth

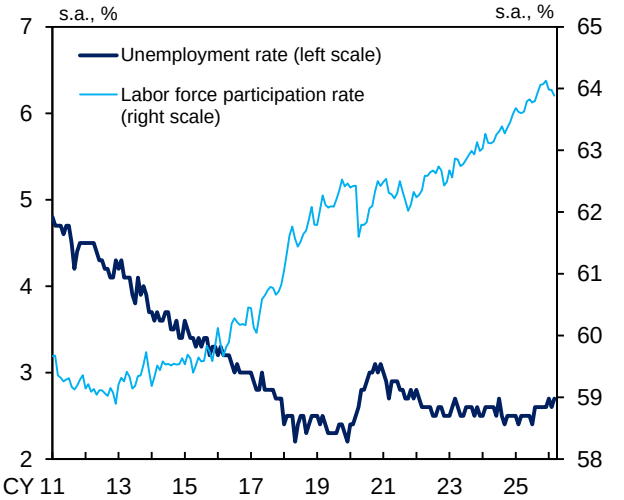
momentum in the number of employees has slowed and the number of self-employed persons has declined (Chart 21). Among employees, the number of regular employees had continued to increase firmly, mainly in the information and communications industry and in the medical, healthcare, and welfare services industry, both of which have faced severe labor shortages; however, this increase has come to a halt recently. Although the number of non-regular employees had declined to a somewhat lower level as firms shifted toward regular employment, it has picked up again recently, mainly in the wholesale and retail trade industries.

**Chart 21:** Number of Employed Persons




Source: Ministry of Internal Affairs and Communications.
Note: Figures for regular employees and non-regular employees prior to 2013 are based on the "detailed tabulation" in the *Labour Force Survey*.

**Chart 22:** Unemployment Rate and Labor Force Participation Rate




Source: Ministry of Internal Affairs and Communications.

Labor market conditions have remained tight. The unemployment rate has risen somewhat, due to factors such as an increase in the number of jobseekers and firms adopting a more cautious stance toward hiring new employees, both in response to minimum wage increases; however, the rate has remained at a low level of around 2.5-3.0 percent (Chart 22). Looking at the estimate of the employment rate gap -- which is calculated as the gap between the actual unemployment rate and the structural unemployment rate, the latter reflecting factors such as mismatches in the labor market -- this gap has also narrowed slightly; however, it still suggests that labor market conditions have remained tight by historical standards (Chart 23[2]). The DI for employment conditions in the *Tankan* has shown the largest net "insufficient" since August 1991, indicating firms' continued strong sense of labor shortage. In this situation, the accession-separation rate gap -- the gap between the accession rate and the separation rate at establishments -- has risen somewhat

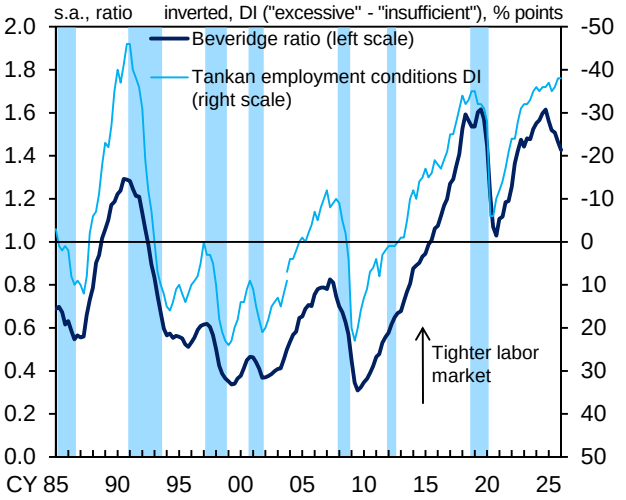
recently, suggesting strong labor demand on the part of firms (Chart 23[3]). On the other hand, the Beveridge ratio has declined to a somewhat lower level, reflecting a decline in the number of job vacancies, although it has remained at a high level (Chart 23[1]). Meanwhile, the labor force participation rate has remained -- albeit with fluctuations -- on a moderate uptrend, particularly for women (Chart 22).

With regard to the outlook for the employment situation, the number of employees is expected to continue increasing moderately, mainly for regular employees in industries with a strong sense of labor shortage, despite being affected by the economic slowdown for the time being. However, with labor force participation of women and seniors having advanced to a high degree thus far, the pace of increase is highly likely to decelerate, because it has become more difficult for labor supply to increase from a demographic perspective. Under these circumstances, the unemployment rate is expected to remain more or less unchanged for a time, due to the effects of the economic slowdown; subsequently, however, the rate is projected to follow a very moderate declining trend.

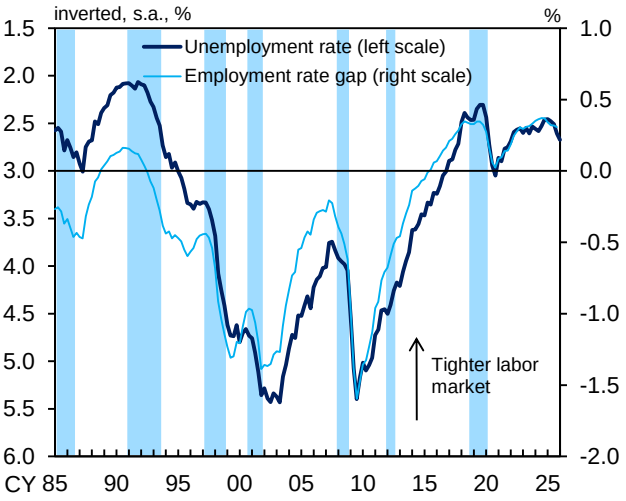
On the wage side, nominal wages per employee have continued to increase steadily, albeit with fluctuations (Chart 24). [14] Looking at the breakdown, the year-on-year rate of increase in scheduled cash earnings had been in the range of

**Chart 23:** Labor Market Indicators

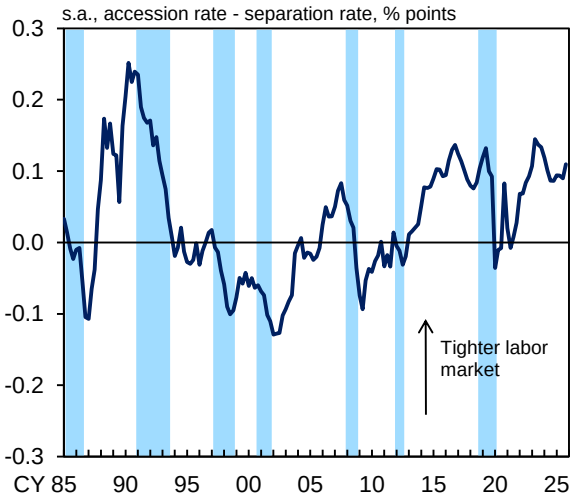
**1. Beveridge Ratio and *Tankan* Employment Conditions DI**




**2. Unemployment Rate and Employment Rate Gap**




**3. Accession-Separation Rate Gap**



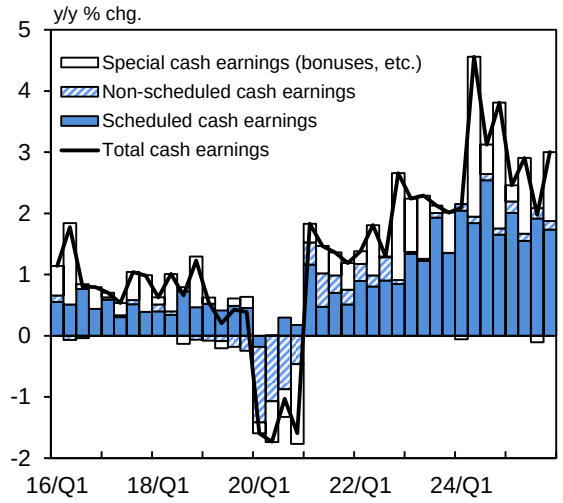

Sources: Bank of Japan; Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare.

Notes: 1. Beveridge ratio = Vacancy rate / Unemployment rate excluding self-employed and family workers. Figures are calculated using vacancy rates calculated based on the *Employment Referral Statistics* until 2019/Q4, and using the *Survey on Labour Economy Trend* from 2020/Q1 onward. Figures from 2025/Q3 onward are estimates based on the DI for enterprises' employment conditions in the survey.
2. Figures for the *Tankan* employment conditions DI are for all industries and enterprises. There is a discontinuity in the data for December 2003 due to a change in the survey framework.
3. Figures for the accession-separation rate gap (for 1989 and earlier, establishments with 30 or more employees) are 3-quarter central moving averages. The figure for 2026/Q1 is the January-February average.
4. Shaded areas denote recession periods.

[14] Wages in the *Monthly Labour Survey* are assessed on the basis of continuing observations, which are less susceptible to fluctuations due to sample revisions. Nonetheless, the effects of such revisions can still be observed to a certain degree among establishments with fewer than 500 employees.

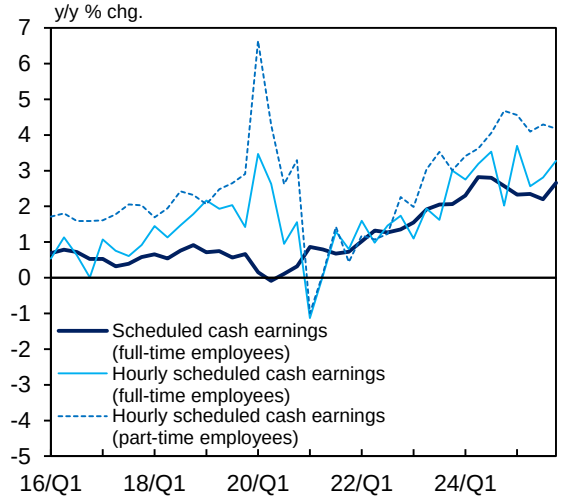
2.0-2.5 percent, but recently has accelerated to around 3 percent (Chart 25). Specifically, the year-on-year rate of increase in scheduled cash earnings per employee for full-time employees had decelerated compared with a while ago, reflecting weak developments particularly in the wholesale and retail trade industries, which may be due to sample bias; however, the rate of increase in these earnings has recently accelerated to around 3 percent as the effects of sample bias have dissipated. Looking at hourly scheduled cash earnings for full-time employees, the rate of increase has been somewhat above that of scheduled cash earnings per employee when fluctuations are smoothed out. The year-on-year rate of increase in hourly scheduled cash earnings for part-time employees, which has been pushed up by tight labor market conditions, has remained at a relatively high level, in the range of 4-5 percent, on the back of moves to revise wages to reflect minimum wage increases.[15] On the other hand, the year-on-year rate of increase in the average hourly wage for temporary and part-time jobs at the time of recruitment has decelerated recently, partly due to firms becoming cautious about posting new vacancies. The year-on-year rate of change in non-scheduled cash earnings has continued to be positive as a trend, mainly led by an increase in hourly wages for overtime work. Meanwhile, looking at the year-on-year rate of increase in special cash earnings (bonuses, etc.) for

**Chart 24:** Nominal Wages




Source: Ministry of Health, Labour and Welfare.
Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.
2. Figures are based on continuing observations following the sample revisions.

**Chart 25:** Scheduled Cash Earnings




Source: Ministry of Health, Labour and Welfare.
Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.
2. Figures are based on continuing observations following the sample revisions.
3. Figures for hourly scheduled cash earnings (full-time employees) are seasonally adjusted.

[15] The year-on-year rate of increase in the minimum wage for fiscal 2025 in terms of the national weighted average was 6.3 percent, which represents a notable increase from the rate of 5.1 percent in fiscal 2024. The revision of minimum wages becomes effective around October in typical years. However, for fiscal 2025, given that the rise in minimum wages was large, a majority of local governments deferred the timing at which the revision becomes effective to November 2025 through March 2026, in order to allow firms to adjust smoothly.

November 2025 through January 2026 -- which covers winter bonuses -- although the rate of increase has declined from the previous fiscal year, such earnings have maintained their firm growth reflecting the high levels of corporate profits and a rise in the rate of base pay increases.

With regard to the outlook for wages, it is expected that a wage growth rate (in terms of the rate of base pay increases) of around 3.5 percent -- around the same level as in 2025 -- will be achieved in this year's annual spring labor-management wage negotiations. In reflection of this, scheduled cash earnings per employee for this fiscal year are highly likely to increase at a rate of around 3 percent for the time being. Regarding the next fiscal year, the wage growth rate to be agreed in the annual spring labor-management wage negotiations is expected to be somewhat lower than in the previous fiscal year, weighed down by a decline in corporate profits due to the rise in energy and raw material prices. Accordingly, the rate of increase in scheduled cash earnings is also likely to decelerate slightly. That said, toward the end of the projection period, the wage growth rate and the rate of increase in scheduled cash earnings are likely to accelerate again as corporate profits improve on the back of a recovery in domestic and external demand and labor market conditions tighten. Meanwhile, the rate of increase in special cash earnings (bonuses, etc.) is expected to decelerate temporarily from the second half of this fiscal year through the first half of the next fiscal year, reflecting changes in corporate profits with a time lag; however, the growth momentum in

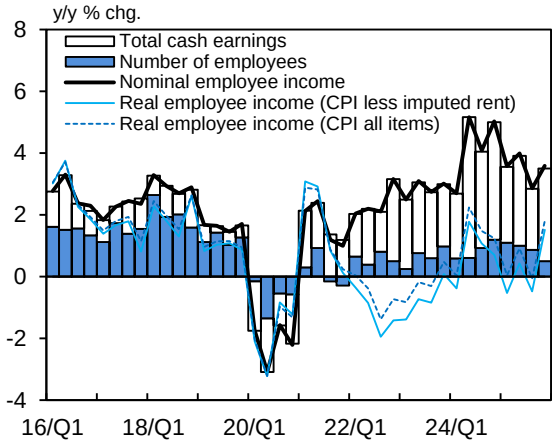
special cash earnings is likely to increase again through the second half of the projection period.

In light of the aforementioned employment and wage conditions, nominal employee income has continued to increase steadily at a pace of around 3-4 percent on a year-on-year basis (Chart 26). The year-on-year rate of change in employee income in real terms -- based on the CPI (all items less imputed rent) -- had been at around 0 percent but has picked up to around 1-2 percent since the end of last year, reflecting factors such as a decline in the inflation rate. With regard to the outlook, nominal employee income is likely to continue to see an increase at its current pace for the time being; subsequently, this increase is likely to slightly decelerate temporarily in the middle of the projection period, reflecting the deterioration in corporate profits with some time lag. Toward the end of the projection period, the growth momentum in nominal employee income is likely to increase somewhat, reflecting the recovery in corporate profits. In real terms, the rate of increase in employee income is expected to slow noticeably for a time, reflecting a rise in the inflation rate; however, it is expected to accelerate again toward the end of the projection period, as the pace of price rises moderates.

## Household Spending

Private consumption has been resilient against the background of the improvement in the employment and income situation, although it has been affected by price rises.

**Chart 26:** Employee Income



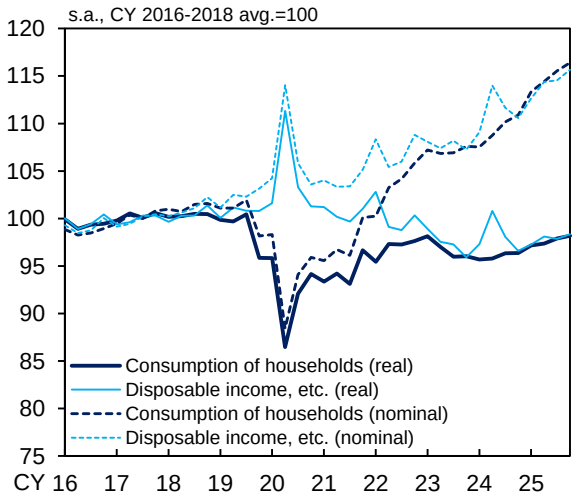

Sources: Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications.
Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.
2. Nominal employee income = Total cash earnings (*Monthly Labour Survey*) × Number of employees (*Labour Force Survey*)
3. Figures are based on continuing observations following the sample revisions of the *Monthly Labour Survey*.
4. Figures for real employee income are based on staff calculations using the price indicators shown in parentheses.

The Consumption Activity Index (CAI; real, travel balance-adjusted) -- which is calculated by combining various sales and supply-side statistics -- has been on a moderate increasing trend recently (Charts 27 and 28). [16] By type, consumption of durable goods had increased through the end of last year but has declined somewhat recently (Chart 28). Automobile sales have been relatively weak. This is because, although automobile sales have been supported by the effects of the introduction of new models, consumers had been holding back on purchases in anticipation of the abolition of the environmental performance levy on automobiles at the end of March. On the other hand, sales of household electrical appliances have remained at high levels. This is because sales of air conditioners have been solid, mainly on the back of an expansion in subsidies provided by some local governments for their purchase, although renewal demand for personal computers reflecting the end of support for some operating systems has started to come to a halt. Consumption of non-durable goods (e.g., "beverages and food" and "clothes") had continued on a decreasing trend against the backdrop of consumers' thriftiness but recently has started to stop declining reflecting a deceleration in the rate of increase in food prices.

Services consumption has increased moderately (Charts 28 and 29). With the shift to dining-out continuing as a trend, dining-out has increased moderately, supported in part by the improvement

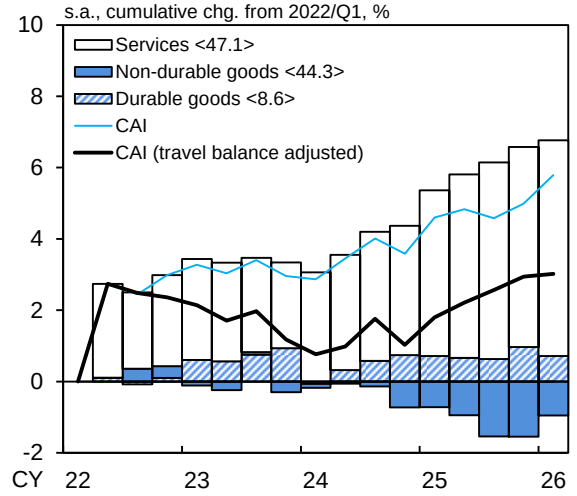
[16] The Bank has recently updated the estimation method for the CAI. For details, see the following paper: "Revision of the Consumption Activity Index Following the 2020 Base Revisions of GDP Statistics," Bank of Japan Research Paper (forthcoming; the Japanese version was released in April 2026).

**Chart 27:** Consumption of Households and Disposable Income



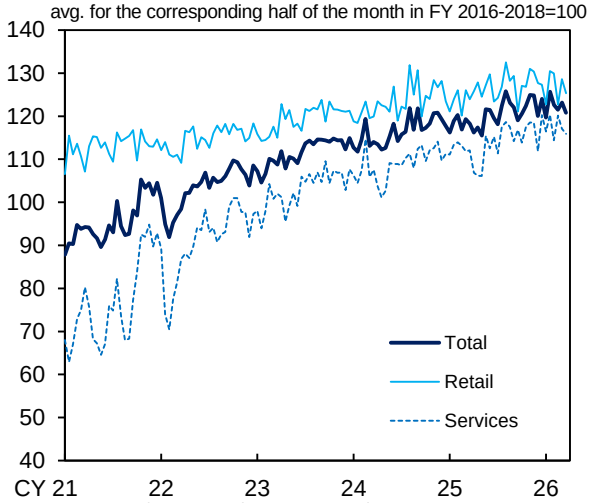

Source: Cabinet Office.
Notes: 1. Figures for consumption of households exclude imputed rent.
2. "Disposable income, etc." consists of disposable income and adjustment for the change in pension entitlements. Real values are based on staff calculations using the deflator of consumption of households.

**Chart 28:** Consumption Activity Index (CAI, Real)




Sources: Bank of Japan, etc.
Notes: 1. Based on staff calculations. Figures for the CAI (travel balance adjusted) exclude inbound tourism consumption and include outbound tourism consumption. Figures for 2026/Q1 are January-February averages.
2. Non-durable goods include goods classified as semi-durable goods in the SNA.
3. Figures in angular brackets show the weights in the CAI.

**Chart 29:** Consumption Developments Based on Credit Card Spending



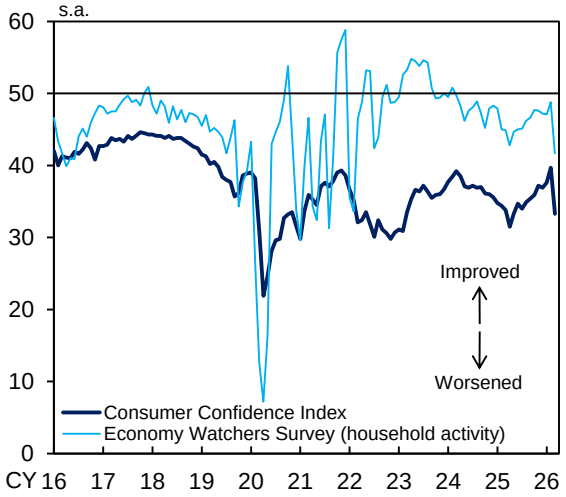

Source: Nowcast Inc./ JCB, Co., Ltd., "JCB Consumption NOW."
Notes: 1. Figures are from the reference series in *JCB Consumption NOW*, which take changes in the number of consumers into account.
2. Figures exclude telecommunications and energy (fuel, electricity, gas, heat supply, and water). Based on staff calculations.

in real income. Domestic travel has been at a relatively high level, supported by a strong willingness to travel among working households who have benefitted from wage increases. Overseas travel has continued to be somewhat weak, mainly reflecting relatively high travel costs due to factors such as exchange rate developments.

Looking at confidence indicators related to private consumption, the Consumer Confidence Index in the *Consumer Confidence Survey* -- which asks consumers for their views on the outlook for the coming six months -- had improved on the back of the decline in the rate of increase in food prices and the government's measures to reduce the household burden of higher energy prices, but has recently deteriorated sharply, reflecting the unstable situation in the Middle East and a rise in gasoline prices (Chart 30). The current economic conditions DI (household activity-related) of the *Economy Watchers Survey* -- which asks firms for their views on the direction of the economy -- had also remained on a moderate improving trend, supported by resilient private consumption. However, the DI has recently deteriorated sharply, reflecting concern over a deterioration in corporate profits due to the rise in energy prices reflecting the situation in the Middle East and its adverse impact on private consumption.

Looking at recent developments in private consumption from various sources, such as high-frequency indicators, statistics published by industry organizations, and anecdotal information from firms, consumption appears to remain resilient, despite the aforementioned deterioration

**Chart 30:** Confidence Indicators Related to Private Consumption



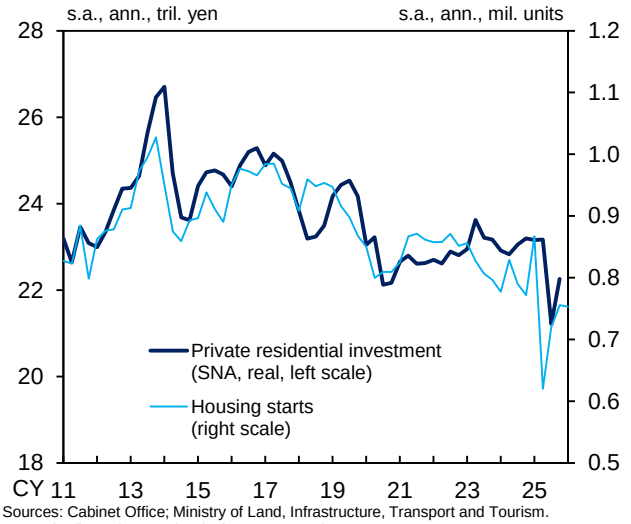

Source: Cabinet Office.
Note: Figures for the *Economy Watchers Survey* are those for the current economic conditions DI.

in sentiment (Chart 29). However, this may partly reflect the front-loading of demand by consumers who expect price rises, and attention is warranted on future developments.

Regarding the outlook, private consumption is highly likely to remain in a deceleration phase for the time being, mainly reflecting a decline in real purchasing power due to price rises, particularly for energy prices, although government measures, such as earlier economic measures and the resumption of fuel oil subsidies, are likely to provide support. Thereafter, private consumption is projected to return to a moderate increasing trend as real disposable income recovers reflecting a decline in the inflation rate.

Housing investment has been on a declining trend (Chart 31). Looking at the number of housing starts -- a leading indicator of housing investment, the recovery from the reactionary decline following the front-loading ahead of the enforcement of revisions to the Building Standards Act and other regulations has mostly peaked out. From a somewhat long-term perspective, the number of housing starts has followed a declining trend, mainly reflecting a rise in housing prices and demographic developments. Housing investment is likely to follow a moderate declining trend.

**Chart 31:** Housing Investment




Sources: Cabinet Office; Ministry of Land, Infrastructure, Transport and Tourism.
Note: The figure for 2026/Q1 is the January-February average.

# II. Current Situation of Prices and Their Outlook

## Developments in Prices

The year-on-year rate of increase in the producer price index (PPI) had been on a decelerating trend, mainly due to the past decline in crude oil prices and a deceleration in the pace of increase in food prices, such as rice prices; however, the rate of increase in the PPI accelerated markedly in March, mainly due to increases in prices of petroleum and coal products, such as gasoline, and of chemicals and related products, such as benzene, reflecting the situation in the Middle East (Charts 32 and 33). With moves to pass on the rise in personnel expenses and other factors to selling prices continuing, the year-on-year rate of increase in the services producer price index (SPPI, excluding international transportation) has recently been in the range of 2.5-3.0 percent, while it has been on a decelerating trend due to factors such as the dissipation of the impact of the price hikes seen in the previous year (Charts 32 and 39).

The year-on-year rate of increase in the CPI (all items less fresh food and energy) has decelerated since last summer and has been at around 2.5 percent recently, mainly reflecting the decline in the rate of increase in food prices, such as rice prices, although moves to pass on increases in wages, distribution costs, and other costs to selling prices have continued (Charts 32 and 34). The year-on-year rate of increase in the CPI (all items less fresh food) has declined to the range of 1.5-2.0 percent of late, due to factors such as the effects of the government's measures to reduce the household burden of higher energy prices

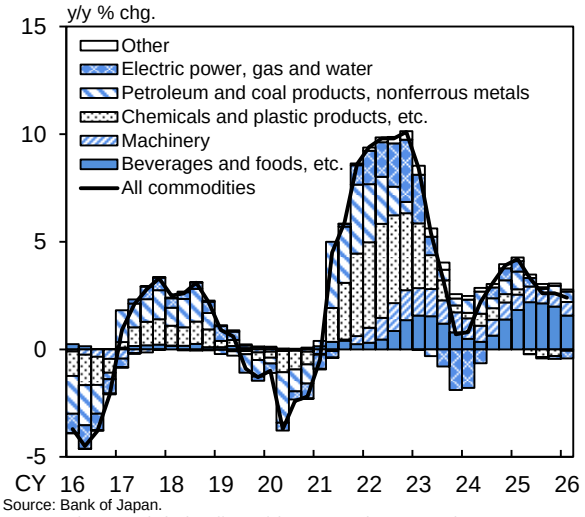
**Chart 32:** Inflation Indicators

y/y % chg.

| | 25/Q2 | 25/Q3 | 25/Q4 | 26/Q1 |
|---|---|---|---|---|
| Consumer Price Index (CPI) | | | | |
| Less fresh food | 3.5 | 2.9 | 2.8 | 1.8 |
| Excluding institutional factors | 2.9 | 2.9 | 2.7 | 2.3 |
| Less fresh food and energy | 3.2 | 3.2 | 3.0 | 2.5 |
| Excluding institutional factors | 3.4 | 3.4 | 3.2 | 2.7 |
| Less food and energy | 1.6 | 1.5 | 1.5 | 1.4 |
| Excluding institutional factors | 1.9 | 1.8 | 1.8 | 1.7 |
| Producer Price Index | 3.3 | 2.6 | 2.6 | 2.4 |
| Services Producer Price Index | 3.2 | 2.9 | 2.7 | 2.7 |
| GDP Deflator | 3.2 | 3.5 | 3.4 | |
| Domestic demand deflator | 2.6 | 2.8 | 2.6 | |

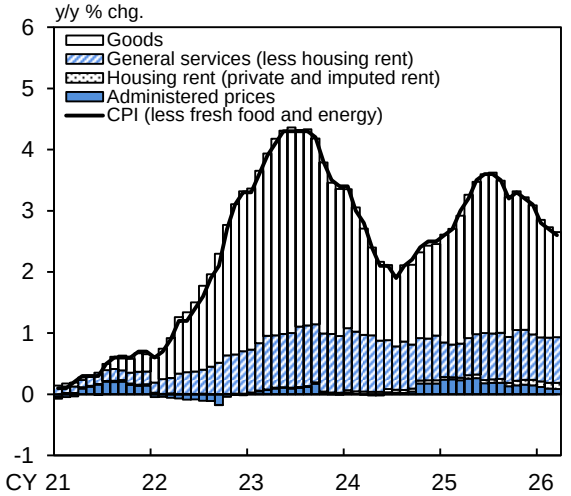
Sources: Ministry of Internal Affairs and Communications; Cabinet Office; Bank of Japan, etc.
Notes: 1. CPI figures "less food and energy" include alcoholic beverages. Institutional factors = the effects of policies concerning the provision of free education + measures to reduce the energy cost burden (such as gasoline prices, electricity and gas charges). Figures are staff estimates.
2. Figures for the services producer price index (SPPI) exclude international transportation.

**Chart 33:** Producer Price Index




Source: Bank of Japan.
Notes: 1. Figures exclude the effects of the consumption tax rate change.
2. Figures for "beverages and foods, etc." include agriculture, forestry and fishery products.

**Chart 34:** CPI (Less Fresh Food and Energy)



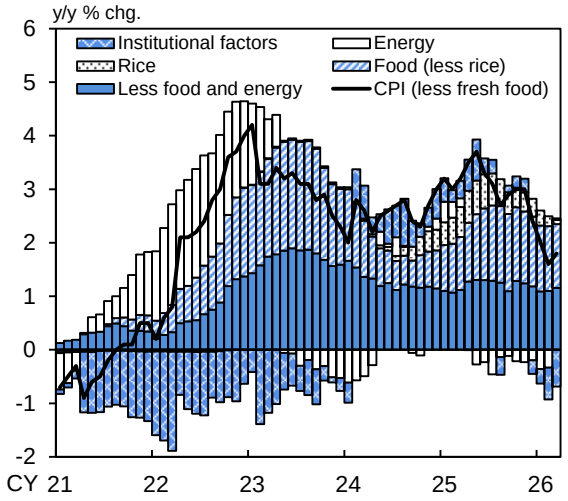

Source: Ministry of Internal Affairs and Communications.
Notes: 1. Administered prices (less energy) consist of "public services" and "water charges."
2. The CPI figures are staff estimates and exclude the effects of the consumption tax rate change and policies concerning the provision of free education, the reduction in mobile phone charges in 2021, and travel subsidy programs.

(Charts 32 and 35). Meanwhile, looking at the CPI (all items less food and energy) -- which is not affected by fluctuations in food and energy prices -- the year-on-year rate of increase has been at around 1.5 percent (Charts 32 and 35).

Regarding the breakdown of the CPI (all items less fresh food and energy), the rate of increase in goods prices has decelerated, mainly due to the decline in the rate of increase in food prices (Chart 34). With the pass-through of wage increases to selling prices continuing, the rate of increase in general services prices has been at around 2 percent of late. The year-on-year rate of change in administered prices (less energy) has been slightly positive, although it has recently declined somewhat due in part to reductions in water charges by some local governments.

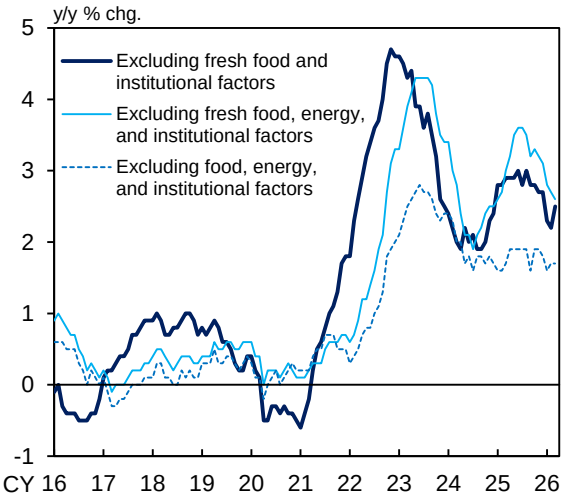
From the perspective of capturing the underlying trend in the CPI, looking at core indicators that exclude institutional factors -- such as the government's measures to reduce the household burden of higher energy prices and the provision of free education -- the year-on-year rates of increase in the CPI (all items less fresh food and energy, excluding institutional factors) and the CPI (all items less fresh food, excluding institutional factors) have both decelerated, mainly due to the deceleration in the rate of increase in food prices; however, the rates of increase in both indicators have remained above

**Chart 35:** CPI (Less Fresh Food)




Sources: Ministry of Internal Affairs and Communications, etc.
Notes: 1. Figures for energy consist of those for petroleum products, electricity, and gas, manufactured & piped. Figures for food (less rice) exclude fresh food and alcoholic beverages.
2. Institutional factors = the effects of the consumption tax rate change and policies concerning the provision of free education + measures to reduce the energy cost burden (such as gasoline prices, electricity and gas charges) + the reduction in mobile phone charges in 2021 + travel subsidy programs. Figures are staff estimates.

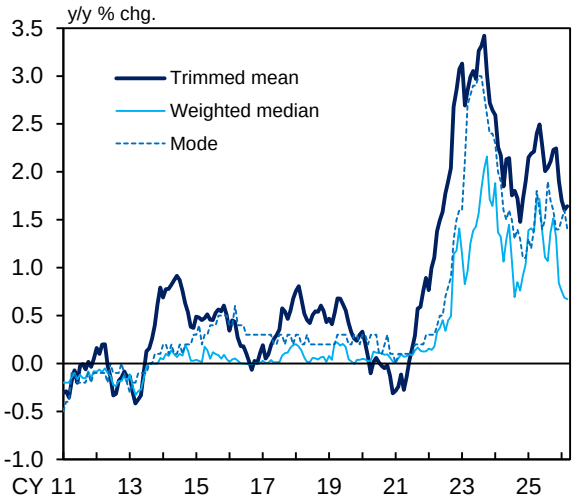
**Chart 36:** CPI (Excluding Institutional Factors)




Sources: Bank of Japan, etc.
Note: Institutional factors = the effects of the consumption tax rate change and policies concerning the provision of free education + measures to reduce the energy cost burden (such as gasoline prices, electricity and gas charges) + the reduction in mobile phone charges in 2021 + travel subsidy programs. Figures are staff estimates.

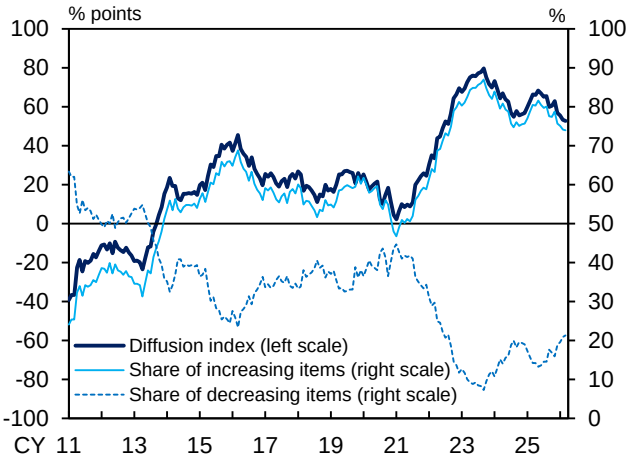
2 percent (Chart 36).[17] On the other hand, the year-on-year rate of increase in the CPI (all items less food and energy, excluding institutional factors) has been at around 1.5-2.0 percent. Core indicators calculated using information such as the price change distribution exhibited the following developments (Chart 37).[18] The rate of increase in the trimmed mean of the year-on-year rate of change in the CPI has decelerated to around 1.5 percent, mainly due to the recent deceleration in the rate of increase in food prices. The rate of increase in the weighted median has decelerated to the range of 0.5-1.0 percent. This is mainly because the year-on-year rate of change in electricity charges -- which have a large weight in the CPI -- has turned negative, reflecting the effects of the government's measures to reduce the household burden. The rate of increase in the mode has also decelerated to around 1.5 percent, reflecting the effects of a decline in the number of items whose prices have increased. Looking at the year-on-year price changes across all CPI items (less fresh food), the share of items whose prices have increased minus the share of items whose prices have decreased has been on a declining trend in positive territory, with moves to raise prices of

**Chart 37:** CPI: Trimmed Mean, etc.



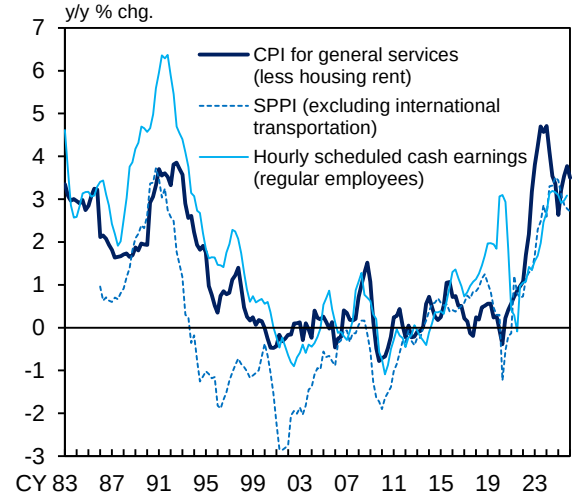

Sources: Bank of Japan, etc.
Note: Based on staff calculations using the CPI. The CPI figures are staff estimates and exclude the effects of the consumption tax rate changes and policies concerning the provision of free education, and travel subsidy programs.

**Chart 38:** Diffusion Index of Price Changes




Sources: Bank of Japan, etc.
Note: The diffusion index is defined as the share of increasing items minus the share of decreasing items. The share of increasing/decreasing items is the share of items for which price indices increased/decreased from a year earlier. Based on staff calculations using the CPI (less fresh food). The CPI figures are staff estimates and exclude the effects of the consumption tax rate changes and policies concerning the provision of free education, and travel subsidy programs.

**Chart 39:** Wages and Prices




Sources: Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare; Bank of Japan.
Notes: 1. Figures for the CPI for general services (less housing rent) are staff estimates and exclude the effects of the consumption tax rate changes and policies concerning the provision of free education, the reduction in mobile phone charges in 2021, and travel subsidy programs.
2. Figures for the SPPI (excluding international transportation) are estimated excluding the effects of the consumption tax rate changes.
3. Figures for hourly scheduled cash earnings (regular employees) are seasonally adjusted (3-quarter central moving averages). Moreover, figures from 2016/Q1 onward are based on continuing observations following the sample revisions.
4. The figure for hourly scheduled cash earnings (regular employees) for 2026/Q1 is the January-February average.

[17] Institutional factors refer to the effects of the consumption tax rate changes and policies concerning the provision of free education, measures to reduce the energy cost burden (such as gasoline prices, electricity and gas charges), the reduction in mobile phone charges in 2021, and travel subsidy programs. The effects of institutional factors are staff estimates.

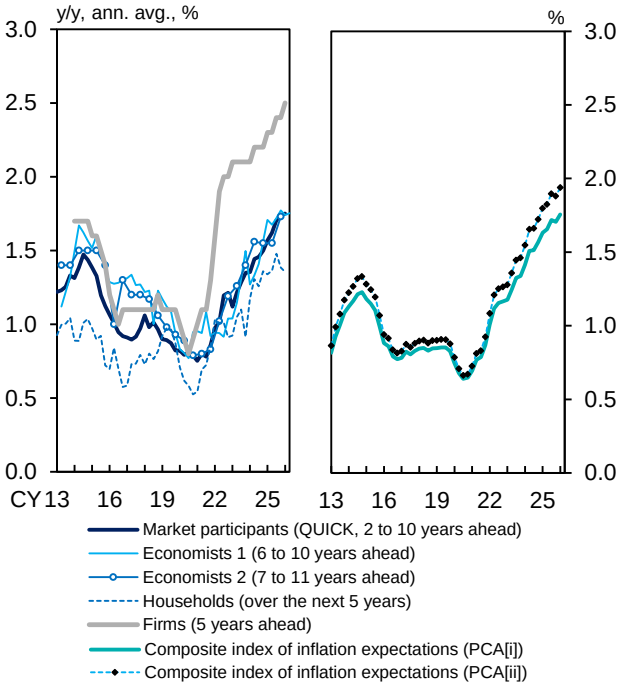
[18] The trimmed mean is calculated by excluding items that belong to a certain percentage of the upper and lower tails of the price change distribution (10 percent of each tail) in order to eliminate the effects of large relative price changes. The mode is the inflation rate with the highest density in the price change distribution. The weighted median is the average of the inflation rates of the items at around the 50 percentile point of the cumulative distribution in terms of weight. Each indicator is calculated using data for each CPI item that excludes the effects of the consumption tax changes and policies concerning the provision of free education, and travel subsidy programs.

food and other items becoming less pronounced compared with a while ago (Chart 38). Meanwhile, looking at the relationship between wages and services prices, with progress in the pass-through of wage increases to services prices of a wide range of items, both wages and services prices have been on a moderate increasing trend (Chart 39).

Indicators of medium- to long-term inflation expectations, which represent people's perceptions of price developments, have increased moderately toward 2 percent on the whole (Chart 40).[19] Medium- to long-term inflation expectations of firms have continued to trend upward and have been above 2 percent. Although medium- to long-term inflation expectations of households and experts have remained below 2 percent, they have been rising moderately overall. The break-even inflation rate (BEI), derived from inflation-indexed government bonds, has also been increasing gradually toward 2 percent, albeit with some fluctuations. Regarding trend inflation estimated from economic models, all of the models have shown a moderate uptrend, with the latest estimates hovering in a range from 1.5 to around 2 percent (Chart 41).[20]

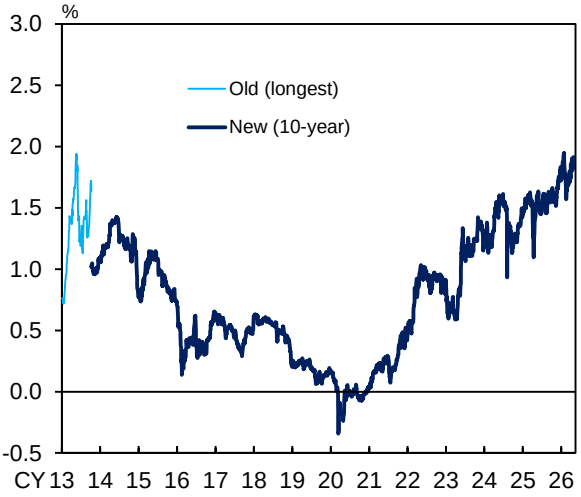
**Chart 40:** Inflation Expectations

**1. Survey**




Sources: Bank of Japan; QUICK, "QUICK Monthly Market Survey <Bonds>"; JCER, "ESP Forecast"; Consensus Economics Inc., "Consensus Forecasts"; Bloomberg.
Notes: 1. "Economists 1" shows the forecasts of economists in the *Consensus Forecasts*. "Economists 2" shows the forecasts of forecasters surveyed for the *ESP Forecast*.
2. Figures for households are from the *Opinion Survey on the General Public's Views and Behavior*, estimated using the modified Carlson-Parkin method for a 5-choice question.
3. Figures for firms show the inflation outlook of enterprises for general prices (all industries and enterprises, average) in the *Tankan*.
4. The composite indexes of inflation expectations are for 10-year-ahead expectations. They are staff estimates and are obtained by extracting the common component, using principal component analysis (PCA), from the inflation expectations of households, firms, and experts. For details on PCA[i] and PCA[ii], see "The Concept and Measurement of Underlying Inflation," Bank of Japan Monetary Affairs Department, March 2026.

**2. BEI**




Source: Bloomberg.
Note: The BEI (break-even inflation) rate is the yield spread between fixed-rate coupon-bearing JGBs and inflation-indexed JGBs. Inflation-indexed JGBs issued since October 2013 are designated as "new," while the rest are designated as "old." Figures for "old (longest)" are calculated using yield data for issue No. 16 of inflation-indexed JGBs, which matured in June 2018.

[19] For details on the concept and measures of underlying inflation, see the following paper: Monetary Affairs Department, Bank of Japan, "The Concept and Measurement of Underlying Inflation," *Bank of Japan Review Series*, March 2026.

[20] Trend inflation should be interpreted with some latitude, taking into account the following points among others: (1) the estimates are susceptible to being influenced by the most recent data; and (2) there is the so-called "real-time problem," in which past estimates are subject to substantial revisions whenever the data used for the estimation are updated.

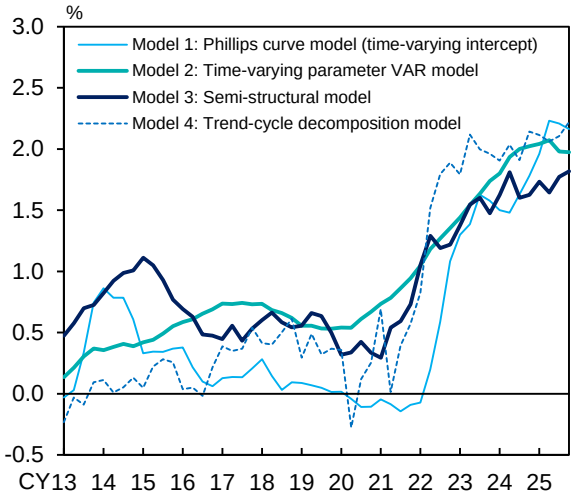
Meanwhile, a decomposition of changes in the GDP deflator from the distribution side shows that, while the acceleration in the rate of increase in the GDP deflator observed in 2023 was mainly led by unit profits, as firms passed on cost increases, since 2024, both unit profits and unit labor costs have been rising in a balanced manner, as the contribution of unit labor costs has also been intensifying in reflection of wage increases (Chart 42).

## Environment Surrounding Prices

In the outlook for prices, the main factors that determine inflation rates are assessed as follows. First, the output gap is likely to narrow within positive territory for the time being against the backdrop of the economic slowdown associated with the rise in crude oil prices; thereafter, however, from the middle of the projection period, the output gap is expected to follow an improving trend again, reflecting the rise in the economic growth rate, and remain slightly positive (Chart 2). Meanwhile, it is likely that labor market conditions have tightened to a greater extent than can be explained by the changes in the output gap, mainly due to a deceleration in the pace of increase in labor force participation of women and seniors (Chart 23). In this situation, upward pressure on wages and prices likely has become stronger than suggested by the output gap, given the current situation that labor shortages have begun to cause supply-side constraints, mainly in industries in nonmanufacturing that are labor-intensive.

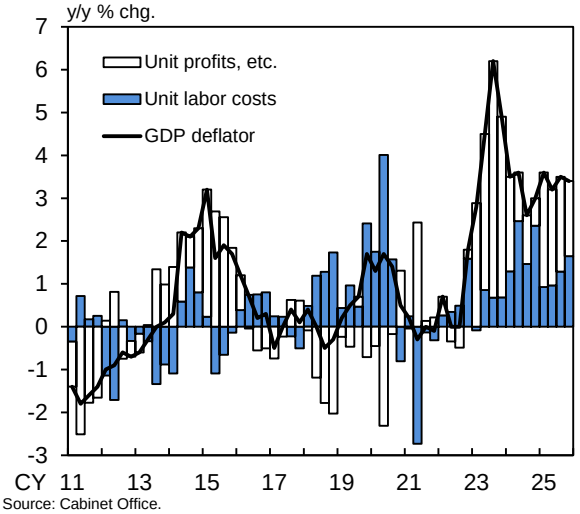
Second, medium- to long-term inflation expectations have risen moderately (Chart 40).

**Chart 41:** Trend Inflation




Sources: Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications; Cabinet Office; Bank of Japan; QUICK, "QUICK Monthly Market Survey <Bonds>"; Consensus Economics Inc., "Consensus Forecasts"; Bloomberg; Google Trends.
Note: Figures are staff estimates.

**Chart 42:** GDP Deflator



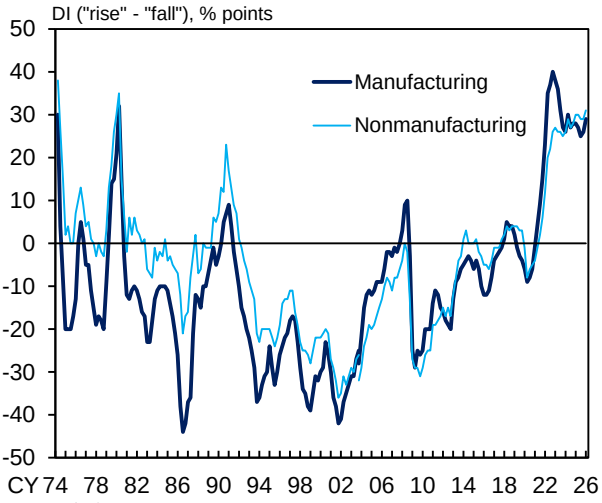

Source: Cabinet Office.
Note: Unit labor costs = Nominal compensation of employees / Real GDP

Regarding the outlook, as firms' active wage- and price-setting behavior is expected to continue on the back of factors such as the tightening of labor market conditions, inflation expectations are likely to continue to rise moderately. Medium- to long-term inflation expectations are expected to come to a level around 2 percent between the second half of fiscal 2026 and fiscal 2027 and remain at around that level thereafter.

Third, the year-on-year rate of increase in the import price index on a yen basis has increased clearly, with the year-on-year rate of change in the index on a contract currency basis turning positive reflecting factors such as a rise in prices of nonferrous metals and memory chips, and affected by the yen's depreciation compared with a year ago (Charts 44 and 45). Import prices are likely to increase significantly in the near term due to the surge in commodity prices, including crude oil, reflecting the situation in the Middle East; subsequently, they are projected to decline toward the end of the projection period.

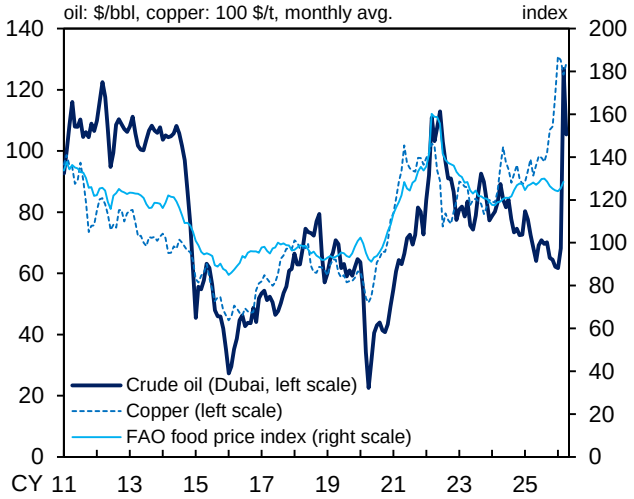
Meanwhile, the year-on-year rate of change in energy prices (e.g., gasoline prices and electricity charges) has been negative recently due to the government's abolition of the former provisional gasoline tax rate and the effects of its measures to reduce the household burden of higher energy prices such as electricity and gas charges. Given the surge in crude oil prices since March and the government's implementation of emergency measures to curb dramatic price fluctuations in response, and assuming that foreign exchange rates will be at around the current levels, energy prices are likely to increase markedly on a

**Chart 43:** Output Prices



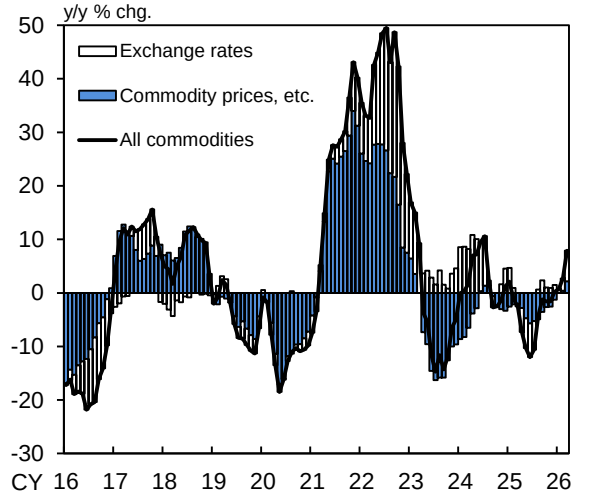

Source: Bank of Japan.
Note: Based on the *Tankan*. All enterprises. There is a discontinuity in the data for December 2003 due to a change in the survey framework.

**Chart 44:** International Commodity Prices




Sources: Nikkei Inc.; Bloomberg; FAO.
Note: The FAO food price index is a price index comprising meat, dairy, cereals, vegetable oils, and sugar (CY 2014-2016 average=100).

**Chart 45:** Import Prices (Yen Basis)



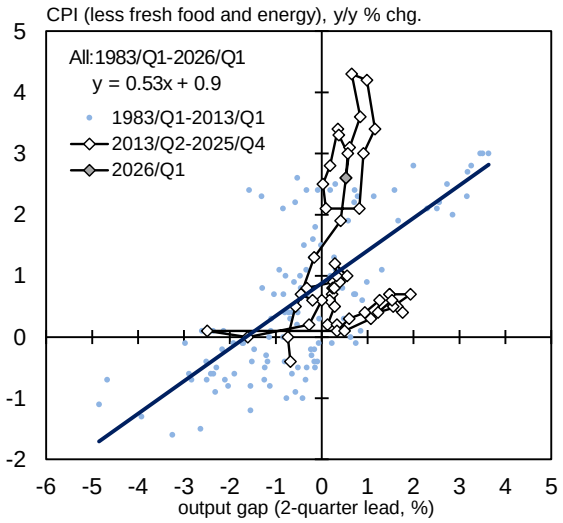

Source: Bank of Japan.
Note: The contribution of changes in commodity prices, etc. is calculated using changes in the import price index on a contract currency basis. The contribution of changes in exchange rates is calculated using the difference between the import price index on a yen basis and that on a contract currency basis.

year-on-year basis through around the end of this year, mainly reflecting rises in electricity and gas charges. Thereafter, assuming that crude oil prices will decline, the year-on-year rate of change in energy prices is likely to follow a decelerating trend, albeit with fluctuations, and turn negative after around the middle of next year.

## Outlook for Prices

Based on the aforementioned environment surrounding prices, the year-on-year rate of increase in the CPI (all items less fresh food and energy) is likely to be in the range of 2.0-2.5 percent for the time being, pushed down by a decline in the year-on-year rate of increase in food prices, such as rice prices, as well as by institutional factors such as the provision of free education; subsequently, however, the rate of increase in this CPI is expected to accelerate to a level above 3 percent toward the beginning of the next fiscal year. This is because the recent surge in crude oil prices is expected to exert greater upward pressure on the prices of goods, such as food, durable goods, and daily necessities, and some services prices, while the yen's depreciation since last autumn has been passed on to prices. The rate of increase in this CPI is likely to decline in the middle of the projection period, as firm's price-setting stance becomes more cautious reflecting a slowdown in consumption with some time lag. Toward the end of the projection period, with a recovery trend in the economy and tightening of labor market conditions becoming clear, the rate of increase in this CPI is likely to be in the rage of 2.0-2.5 percent, as moves to pass on wage increases to selling prices take hold in a wide range of items in both goods and services (Chart 46).

**Chart 46:** Phillips Curve




Sources: Ministry of Internal Affairs and Communications; Bank of Japan.
Notes: 1. The CPI figures are staff estimates and exclude mobile phone charges and the effects of the consumption tax rate changes and policies concerning the provision of free education, and travel subsidy programs.
2. Figures for the output gap are staff estimates.

The year-on-year rate of increase in the CPI (all items less fresh food) is likely to temporarily accelerate to around 4 percent. This is because, although the government's fuel oil subsidies are likely to curb a rise in gasoline prices, the upward contribution of energy prices is expected to expand as electricity and gas charges rise from summer driven by higher import prices of liquefied natural gas (LNG), and this will have a significant impact on this CPI. After the middle of the projection period, the rate of increase in the CPI (all items less fresh food) is expected to follow a decelerating trend and be at around 2 percent, when fluctuations are smoothed out, as the contribution of energy prices turns negative based on the assumption that a decline in crude oil prices will continue.

Firms' behavior has shifted more toward raising wages and prices, and it is likely that the mechanism in which both wages and prices rise moderately will be maintained if the economy develops as assumed in the baseline scenario. That said, since changes in foreign exchange rates have exerted a greater impact on domestic prices partly reflecting a rise in the import penetration ratio, if the rise in crude oil prices and other factors lead to a depreciation of the yen, there is also a possibility that the rates of increase in wages and prices will both deviate upward from the baseline scenario, accompanied by a rise in medium- to long-term inflation expectations. On the other hand, if the downward effects of a deterioration in trading gains on corporate profits, for example, become prolonged, this could lead firms to focus on cost cutting to a greater extent than expected; consequently, upward pressure on

wages could weaken, and inflation could decline from a somewhat long-term perspective.

## III. Financial Developments in Japan

### Financial Conditions

Financial conditions have been accommodative.

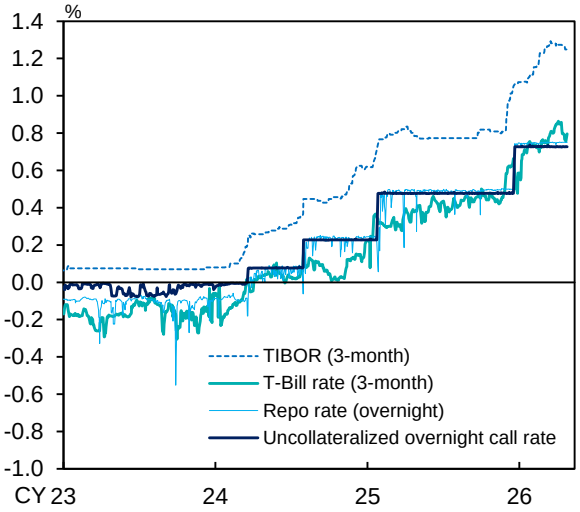
Looking at short-term interest rates, the uncollateralized overnight call rate has been at around 0.75 percent (Chart 47). Regarding interest rates on term instruments, both the 3-month TIBOR and the 3-month treasury discount bill (T-Bill) rate have risen.

Real interest rates have been negative (Chart 48).

Firms' funding costs have increased (Chart 49). As for lending rates (the average interest rates on new loans and discounts), both long-term and short-term ones have risen, due to rises in market interest rates and short-term prime rates, both of which serve as base rates. Issuance rates for CP have increased, in tandem with the rise in short-term interest rates. Issuance rates for corporate bonds have risen, reflecting the increase in their base rate.

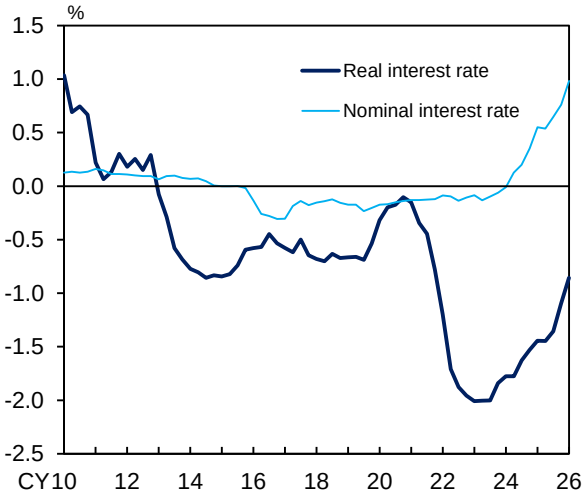
The DI in the *Tankan* for financial institutions' lending attitudes as perceived by firms suggests that such attitudes have remained accommodative on the whole (Chart 50). The DI for issuance conditions for CP has continued to show net "easy" conditions. As suggested by the latter, issuance conditions for CP have been favorable. In the corporate bond market, issuance conditions have been favorable, although some firms have delayed issuance of bonds due to the

**Chart 47:** Short-term Interest Rates



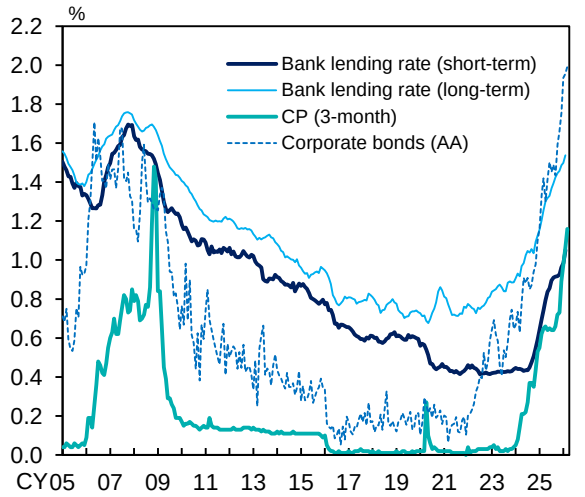

Sources: Bank of Japan; JBA TIBOR Administration; Bloomberg.
Note: Figures for repo rate are the *Tokyo Repo Rate*.

**Chart 48:** Real Interest Rate (1-Year)




Sources: Bank of Japan; QUICK, "QUICK Monthly Market Survey <Bonds>"; Consensus Economics Inc., "Consensus Forecasts"; Bloomberg.
Note: Figures for the real interest rate are calculated as government bond yields (1-year) minus the composite index of inflation expectations (staff estimates).

**Chart 49:** Bank Lending Rates and Issuance Yields for CP and Corporate Bonds

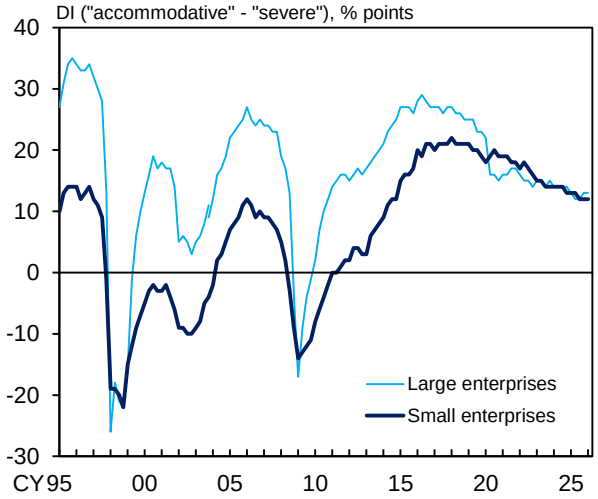



Sources: Bank of Japan; Japan Securities Depository Center; Capital Eye; I-N Information Systems; Bloomberg.
Notes: 1. Figures for issuance yields for CP up through September 2009 are the averages for CP (3-month, rated a-1 or higher). Those from October 2009 onward are the averages for CP (3-month, rated a-1).
2. Figures for issuance yields for corporate bonds are the averages for domestically issued bonds launched on a particular date. Bonds issued by banks and securities companies, etc. are excluded.
3. Figures for bank lending rates are 6-month backward moving averages.

impact of increased tension over the situation in the Middle East. Meanwhile, the DI for firms' financial positions in the *Tankan* suggests that they have been at favorable levels on the back of the recovery in economic activity and progress in the pass-through of cost increases to selling prices (Chart 51).

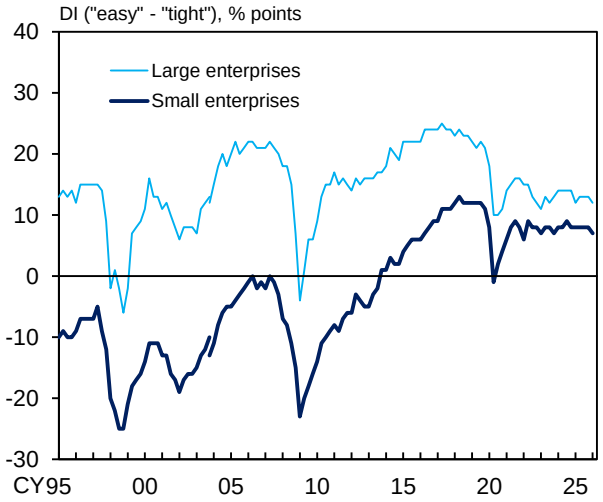
Firms' demand for funds has increased on the back of, for example, the recovery in economic activity as well as mergers and acquisitions of firms. In this situation, the year-on-year rate of increase in the amount outstanding of bank lending has been in the range of 5.0-5.5 percent (Chart 52). The year-on-year rate of increase in the aggregate amount outstanding of CP and corporate bonds has been at around 6.5 percent, pushed up in part by past large-scale issuances.

**Chart 50:** Lending Attitudes of Financial Institutions as Perceived by Firms



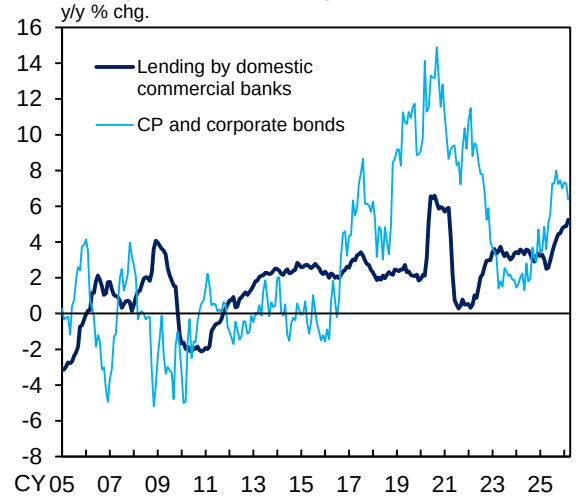

Source: Bank of Japan.
Note: Based on the *Tankan.* All industries. There is a discontinuity in the data for December 2003 due to a change in the survey framework.

**Chart 51:** Firms' Financial Positions




Source: Bank of Japan.
Note: Based on the *Tankan.* All industries. There is a discontinuity in the data for December 2003 due to a change in the survey framework.

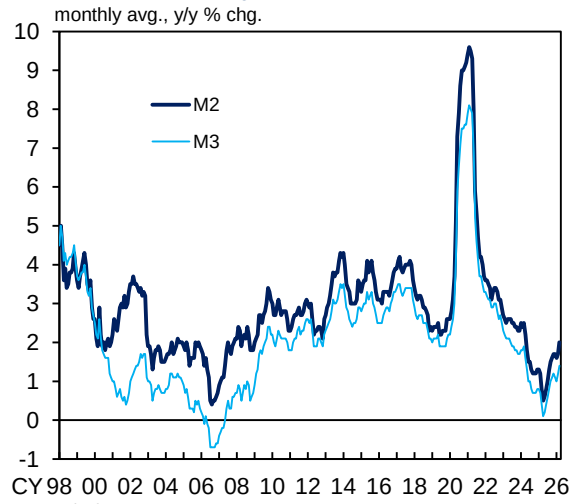
**Chart 52:** Amounts Outstanding of Bank Lending, CP, and Corporate Bonds




Sources: Bank of Japan; Japan Securities Depository Center; Japan Securities Dealers Association; I-N Information Systems.
Note: Figures for lending by domestic commercial banks are monthly averages. Figures for CP and corporate bonds are those at the end of the period.

The year-on-year rate of change in the money stock (M2) has been at around 2 percent, as an increase in the amount outstanding of bank lending has continued to push up the rate (Chart 53).

**Chart 53:** Money Stock




Source: Bank of Japan.

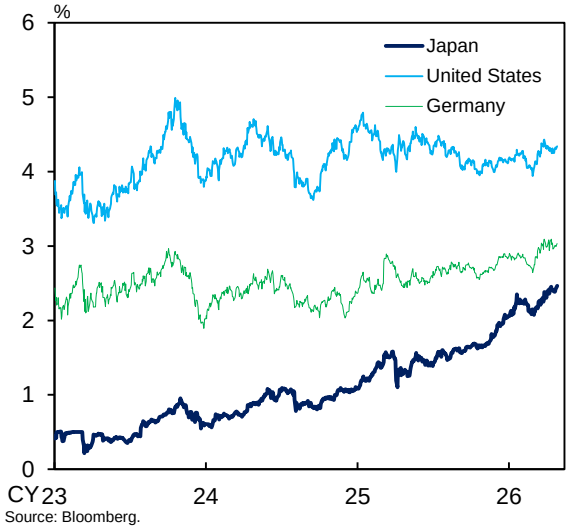
## Developments in Financial Markets

In global financial markets, market sentiment turned sharply cautious from the end of February to late March, amid the significant rise in crude oil prices reflecting increased tension over the situation in the Middle East (Chart 44). While sentiment has somewhat improved recently, as seen in the rebound in stock prices reflecting expectations that the tension over the situation in the Middle East would ease, market participants have continued to pay attention to uncertainties over the outlook.

Yields on 10-year government bonds in the United States declined through late February, reflecting lower employment-related indicators. Since then, yields have risen, as attention has been drawn to heightened inflationary pressure reflecting the rise in crude oil prices amid increased tension over the situation in the Middle East (Chart 54). Yields on 10-year government bonds in Europe showed developments similar to those in the United States and have risen since the end of February. In Japan, yields on 10-year government bonds declined through late February, as investors bought back Japanese government bonds after the House of Representatives election. Since then, yields have risen significantly, like those in the United States and Europe, with attention being drawn to heightened inflationary pressure reflecting the rise in crude oil prices, and partly because domestic investors have maintained a cautious investment stance.

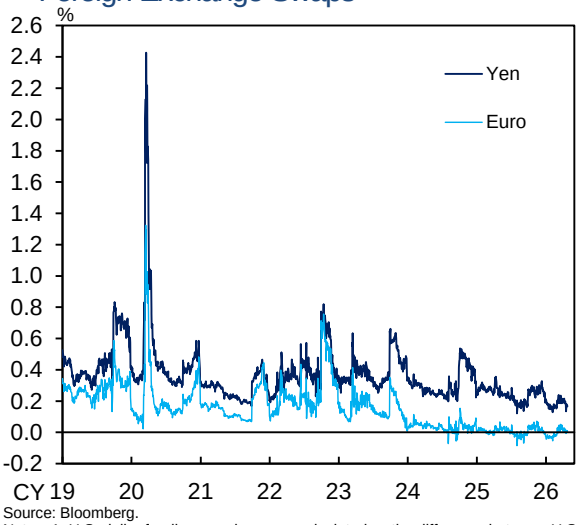
Premiums for U.S. dollar funding through the dollar/yen foreign exchange swap market have generally been at low levels, although they

**Chart 54:** 10-Year Government Bond Yields in Selected Advanced Economies



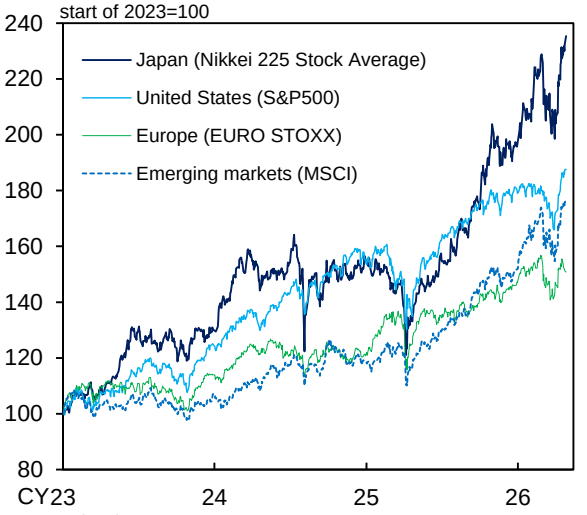

Source: Bloomberg.

**Chart 55:** Dollar Funding Premiums through Foreign Exchange Swaps




Source: Bloomberg.
Notes: 1. U.S. dollar funding premiums are calculated as the difference between U.S. dollar fundings rates (3-month) in the dollar/yen or euro/dollar foreign exchange swap market and those in the money market.
2. The interest rates used for the calculation are as follows: for the yen, the OIS rate; for the euro, the EONIA-referencing OIS rate before October 4, 2019, and the €STR-referencing OIS rate thereafter; for the U.S. dollar, the OIS rate before January 3, 2019, and the SOFR thereafter.

**Chart 56:** Selected Stock Price Indices



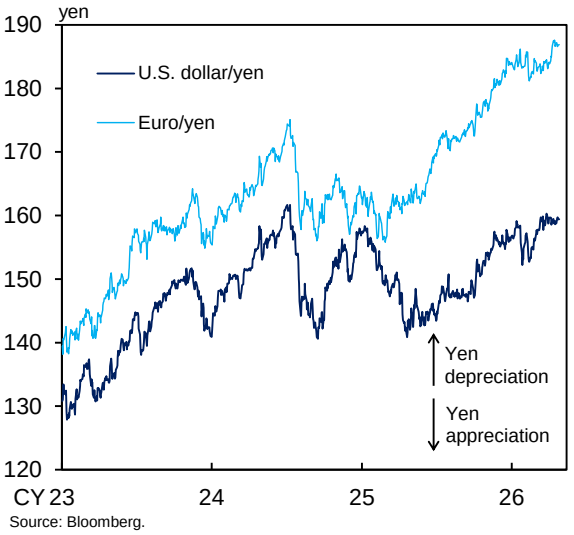

Source: Bloomberg.
Note: Figures for emerging markets are those for the MSCI Emerging Markets Index (local currency).

temporarily widened somewhat due to seasonal transactions conducted in view of the fiscal year-end and to increased tension over the situation in the Middle East (Chart 55).

Stock prices in the United States and Europe declined significantly through the end of March as market sentiment turned cautious, reflecting increased tension over the situation in the Middle East. More recently, however, they have risen significantly, reflecting expectations that the tension over the situation in the Middle East would ease, and as attention has continued to be drawn to solid AI-related demand (Chart 56). Stock prices in Japan rose through late February, mainly due to heightened expectations for the government's economic measures. Thereafter, like those in the United States and Europe, mainly reflecting the impact of the situation in the Middle East, they declined significantly through late March, but recently have risen significantly. Meanwhile, stock prices in emerging economies have shown developments similar to those in advanced economies.

In foreign exchange markets, the yen has depreciated against the U.S. dollar, as market expectations for policy interest rate cuts by the Federal Reserve have subsided, and due to the view that Japan's trade deficit is likely to expand reflecting the rise in crude oil prices (Chart 57). The yen has depreciated against the euro because market expectations of policy interest rate hikes by the European Central Bank (ECB) have increased.

**Chart 57:** U.S. Dollar/Yen and Euro/Yen

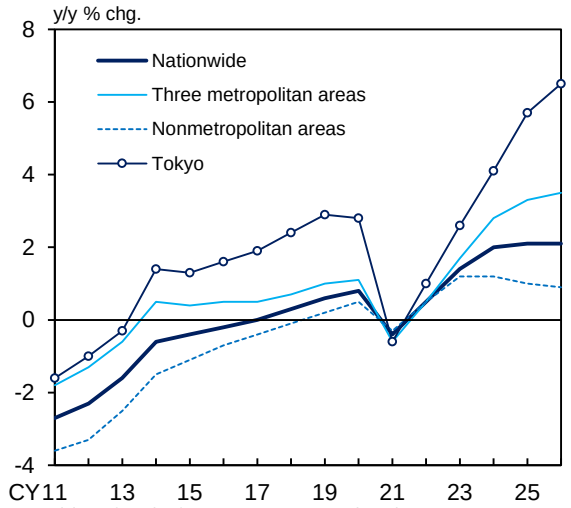


Source: Bloomberg.

## Land Prices

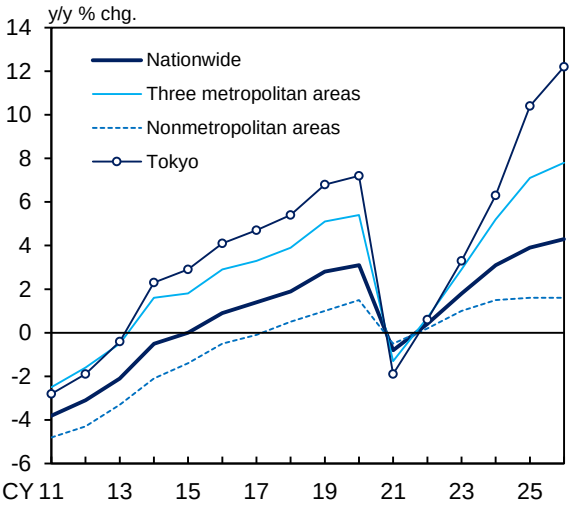
Land prices have increased, mainly in the three major metropolitan areas (Tokyo, Osaka, and Nagoya), reflecting the economic recovery. According to the *Land Market Value Publication* for 2026 (as of January 1), the year-on-year rate of increase in residential land prices has been flat, whereas that in commercial land prices has accelerated (Charts 58 and 59). In the three major metropolitan areas, the year-on-year rates of increase in both residential and commercial land prices have accelerated. In nonmetropolitan areas, the rate of increase in residential land prices has decelerated, while the rate of increase in commercial land prices has been flat.

**Chart 58:** Residential Land Prices




Source: Ministry of Land, Infrastructure, Transport and Tourism.
Notes: 1. Based on the *Land Market Value Publication*. Figures are as of January 1.
2. The three metropolitan areas are the Tokyo area (Tokyo, Kanagawa, Saitama, Chiba, and Ibaraki prefectures), the Osaka area (Osaka, Hyogo, Kyoto, and Nara prefectures), and the Nagoya area (Aichi and Mie prefectures). Nonmetropolitan areas are areas other than the three metropolitan areas.

**Chart 59:** Commercial Land Prices



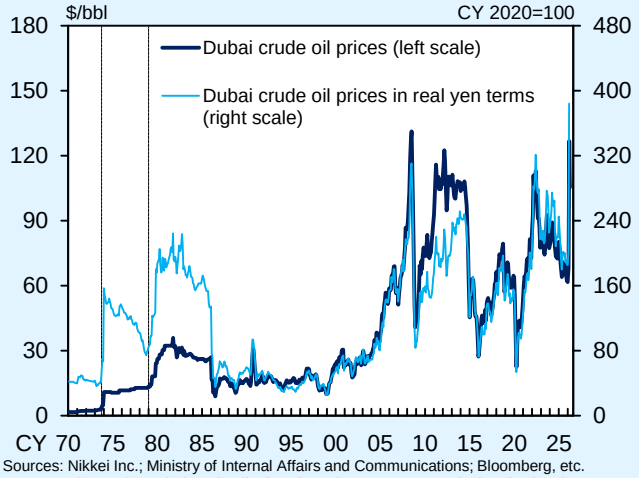

Source: Ministry of Land, Infrastructure, Transport and Tourism.
Notes: 1. Based on the *Land Market Value Publication*. Figures are as of January 1.
2. The three metropolitan areas are the Tokyo area (Tokyo, Kanagawa, Saitama, Chiba, and Ibaraki prefectures), the Osaka area (Osaka, Hyogo, Kyoto, and Nara prefectures), and the Nagoya area (Aichi and Mie prefectures). Nonmetropolitan areas are areas other than the three metropolitan areas.

## (Box 1) Assumptions for Crude Oil Prices in the Baseline Scenario and the Impact of Worsening Terms of Trade on Japan's Economy

This box outlines the underlying assumptions for Dubai crude oil prices that underpin the baseline scenario in this Outlook Report, and then examines how the outflow of income abroad associated with higher crude oil prices affects Japan's real economy.

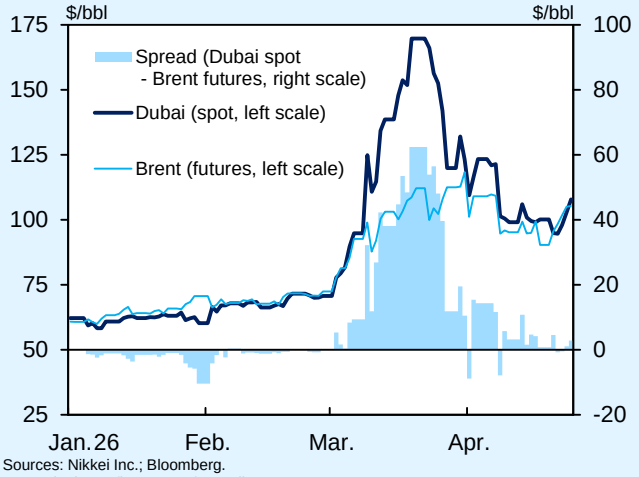
The monthly average spot price of Dubai crude oil was around 65 U.S. dollars per barrel in January-February this year, but, reflecting the situation in the Middle East, it rose in March to around 130 dollars -- about twice its pre-conflict level. Although the rate of increase immediately after the shock was not as large as during the first oil crisis (1973), it is comparable in magnitude to that during the second oil crisis (1979) and to the period following Russia's invasion of Ukraine (2022) (Chart B1-1). [21] Moreover, the gap between Dubai and Brent spot crude oil prices has been widening following the decline in Middle East crude oil supply, and the gap between crude oil spot prices and futures prices has also been widening, reflecting the current tightening of supply and demand in crude oil. As a result, the spread between the Dubai crude oil spot price and Brent futures price has widened substantially (Chart B1-2).

**Chart B1-1:** Crude Oil Prices and Past Supply Shocks




Sources: Nikkei Inc.; Ministry of Internal Affairs and Communications; Bloomberg, etc.
Notes: 1. Figures for Dubai crude oil prices in real yen terms are calculated using the U.S. dollar/yen exchange rate and the CPI (all items, excluding institutional factors). Figures for Dubai crude oil prices up through October 1986 are based on the rates of change in Arab light crude oil prices. The latest figure for Dubai crude oil prices is for April 2026 (average for April 1-24), and that for Dubai crude oil prices in real yen terms is for March 2026.
2. The vertical lines indicate the start of the first and second oil crises.

**Chart B1-2:** Dubai and Brent Crude Oil Prices

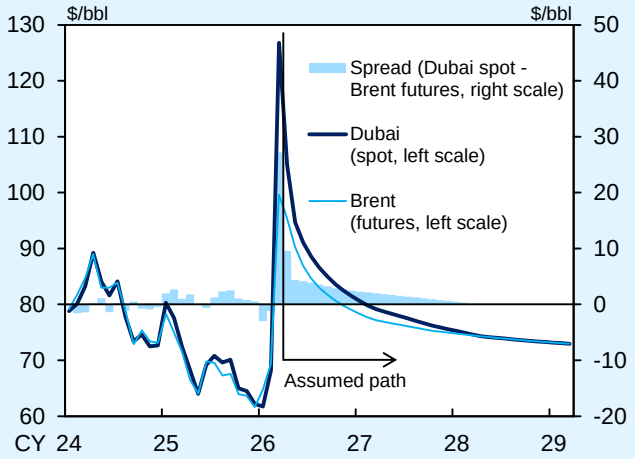



Sources: Nikkei Inc.; Bloomberg.
Note: The latest figures are for April 24.

[21] During the first oil crisis, the price rose 3.8-fold, from 2.9 dollars per barrel in September 1973 to 10.9 dollars in January 1974, while during the second oil crisis it rose 2.5-fold, from 12.8 dollars per barrel in December 1978 to 32.3 dollars in November 1980. Following Russia's invasion of Ukraine, the price rose 1.6-fold, from 72.7 dollars per barrel in December 2021 to 113.0 dollars in June 2022.

In the baseline scenario of this Outlook Report, crude oil prices are assumed to start from around 105 dollars per barrel, observed in April 2026, and subsequently decline to the range of around 70-80 dollars toward the end of the projection period (Chart B1-3). This assumption is based on the following two premises: (1) Brent crude prices will decline going forward in line with its futures curve; and (2) the spread will follow a narrowing trend and disappear toward the end of the projection period.[22]

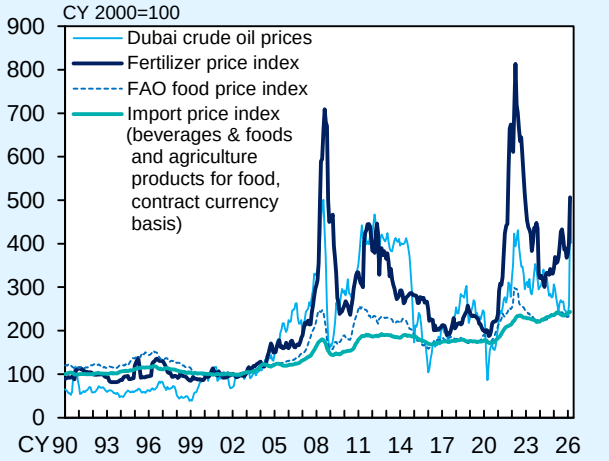
**Chart B1-3:** Assumed Path of Crude Oil Prices




Sources: Nikkei Inc.; Bloomberg.
Note: Figures for the assumed path are prepared with reference to the Brent crude oil futures curves (as of April 20).

It appears that prices in the crude oil futures market reflect market participants' view that the tension in the Middle East will ease and that the supply of Middle Eastern crude oil will gradually recover. While the baseline scenario of this Outlook Report factors in to some extent the recent disruptions in imports of crude oil and related products from the Middle East and the associated decline in plant operating rates in basic materials industries, it also assumes that imports of these products from the Middle East will recover and that, in the meantime, the necessary raw materials will be secured through the release of petroleum reserves and inventory drawdowns, so that large-scale supply-chain disruptions with a substantial negative impact on economic activity in quantitative terms will not occur. However, these assumptions could change substantially depending on how the situation in the Middle East evolves, and it is therefore

**Chart B1-4:** Crude Oil, Fertilizer, and Food Prices




Sources: Nikkei Inc.; World Bank; Bank of Japan; FAO.
Note: The latest figure for Dubai crude oil prices is for April 2026 (average for April 1-24), while the latest figures for other indicators are for March 2026.

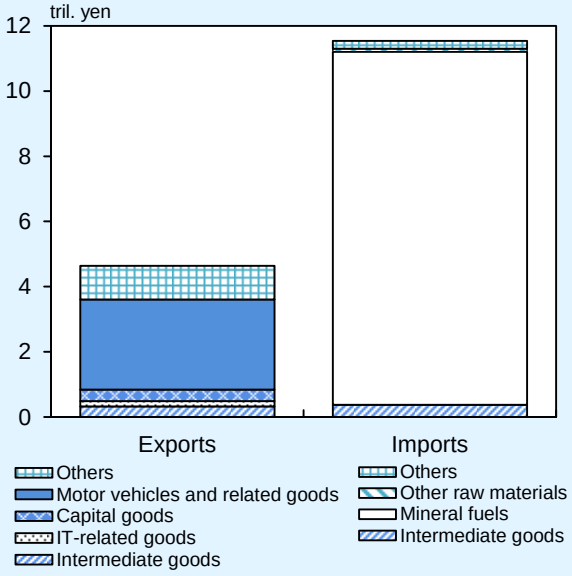
[22] Ideally, Dubai crude oil futures prices should be used when assuming the outlook for Dubai crude oil prices. However, as the Dubai market is primarily centered around spot trading, Brent crude oil futures prices, which are widely recognized and frequently referred to by many market participants as a representative benchmark, are used instead for the baseline scenario.

important to note that uncertainty surrounding these assumptions is higher than in usual projections.

For other international commodity markets, the forecast assumes that import prices of liquefied natural gas (LNG) will rise with a lag of around half a year behind developments in crude oil prices and will then decline moderately as crude oil prices fall. As for global fertilizer and food prices, given their strong co-movement with crude oil prices and the recent disruption in fertilizer exports from the Middle East, the baseline scenario assumes that these prices will also trend upward (Chart B1-4).

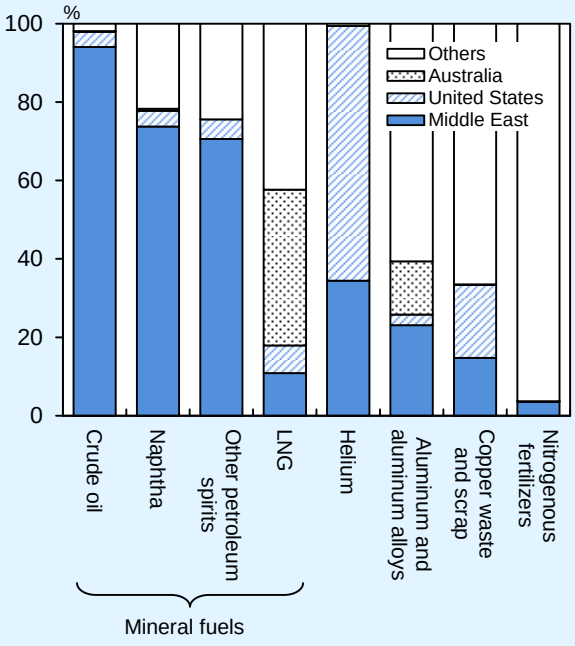
Looking at Japan's imports from the Middle East, roughly 90 percent consists of mineral fuels; within this category, crude oil accounts for about 80 percent and petroleum products such as naphtha for about 10 percent (Chart B1-5). In particular, more than 90 percent of Japan's annual crude oil imports are sourced from the Middle East, and Japan's dependence on the region for crude oil is higher than that of economies such as South Korea, China, and Europe. There are also a number of other raw materials and intermediate goods, including naphtha and helium, for which dependence on the Middle East is high (Chart B1-6). On the export side, motor vehicles and related goods account for the bulk of Japan's exports to the Middle East (Chart B1-5). Given this structure, a slowdown in trade with the Middle East is expected, for the time being, to exert downward pressure on Japan's exports and production.

**Chart B1-5:** Exports to and Imports from the Middle East




Source: Ministry of Finance.
Note: Figures are nominal values for 2025. The Middle East refers to the Islamic Republic of Iran, Iraq, the Kingdom of Bahrain, Saudi Arabia, Kuwait, Qatar, Oman, Israel, Jordan, the Syrian Arab Republic, Lebanon, the United Arab Emirates, the Republic of Yemen, and the West Bank and Gaza Strip.

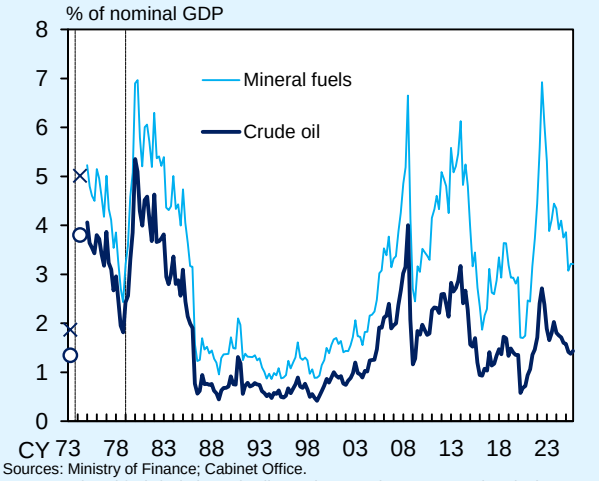
**Chart B1-6:** Import Dependence on the Middle East by Item




Source: Ministry of Finance.
Note: Figures are nominal values for 2025. The definition of the Middle East is the same as that in Chart B1-5.

A rise in commodity prices, including crude oil prices, leads to an outflow of income abroad for net commodity-importing economies such as Japan. In 2025, Japan's crude oil imports amounted to 1.4 percent of nominal GDP, and imports of mineral fuels including naphtha and LNG stood at 3.3 percent of nominal GDP. Based on the crude oil price assumptions described above, and under certain simplifying assumptions, a rough estimate of the scale of this income outflow suggests that, on average in fiscal 2026, the increase in crude oil prices alone will generate an income outflow equivalent to around 0.5 percent of GDP, and that this figure will be around 1.4 percent of GDP when import prices of commodities linked to developments in crude oil prices and basic chemical products are also taken into account (Chart B1-7).

**Chart B1-7:** Ratio of Mineral Fuels Imports to Nominal GDP




Sources: Ministry of Finance; Cabinet Office.
Notes: 1. Mineral fuels include crude oil, petroleum products, LNG, and coal. The cross and round markers denote values for mineral fuels and crude oil in 1973 and 1974, respectively.
2. The vertical lines indicate the start of the first and second oil crises.

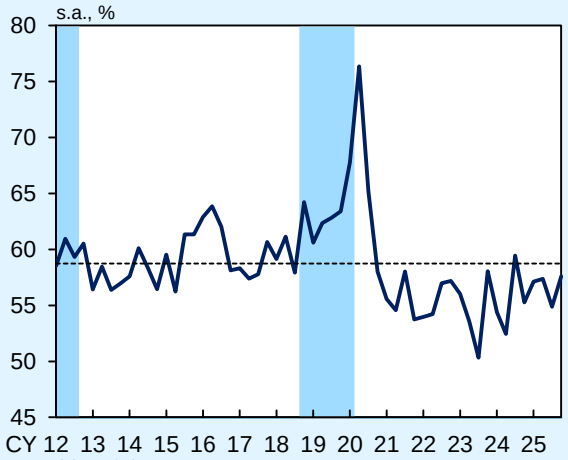
Such a deterioration in trading gains exerts downward pressure on Japan's economy, as it is borne by the corporate, household, and government sectors in the form of lower profits and incomes and higher expenditure. Meanwhile, the government's current emergency measures to curb dramatic price fluctuations will reduce the burden on firms and households by limiting the rise in fuel prices they face.

In the corporate sector, firms are likely to attempt to avoid a squeeze on profit margins in response to higher input costs from rising import prices as much as possible, by passing those costs on to importers and households and by improving their energy intensity; but operating profits are still highly likely to come under considerable downward pressure for the time being (Chart 15).

That said, historically high levels of profits are expected to provide some buffer against higher raw material costs, and existing investment projects whose progress has been delayed by supply constraints, particularly in construction, will also lend support, so business fixed investment is likely to decelerate but remain firm (Chart B1-8).

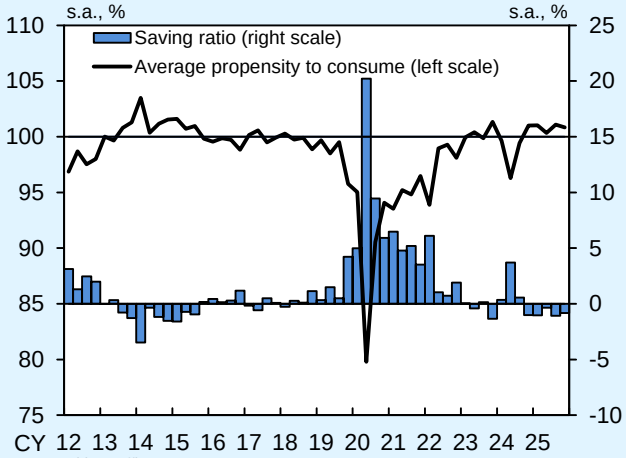
On the other hand, turning to the income situation for households, household income is expected to come under stronger downward pressure in real terms, especially for low-income households whose spending is heavily weighted toward necessities, as higher energy prices for items such as electricity and gas, stemming from the current situation in the Middle East, are added on top of the rise in food prices seen since the second half of 2024. Moreover, since the propensity to consume has already risen to above 100 percent (with the saving rate having declined to slightly negative territory), households' resilience to price increases appears to have weakened compared with the period following Russia's invasion of Ukraine (Chart B1-9). As a result, private consumption is likely to slow due to the impact of higher prices and to remain sluggish for some time.

**Chart B1-8:** Ratio of Business Fixed Investment to Cash Flow




Source: Ministry of Finance.
Note: Based on the *Financial Statements Statistics of Corporations by Industry, Quarterly*. Excluding "finance and insurance." For cash flow, "pure holding companies" are also excluded. Shaded areas denote recession periods. The broken line represents the historical average (from 2012 to 2025). Cash flow = Depreciation expenses + Current profits / 2.

**Chart B1-9:** Average Propensity to Consume

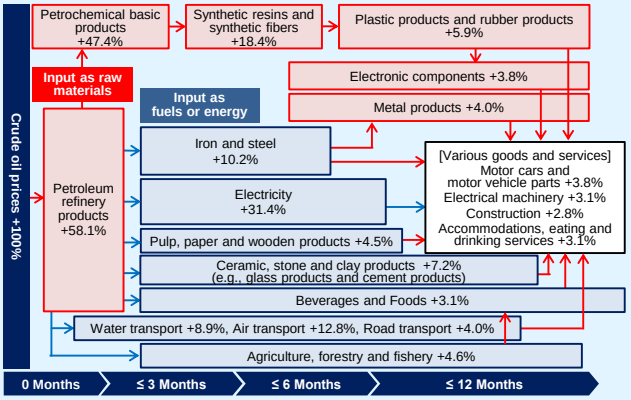



Source: Cabinet Office.
Note: Average propensity to consume = Consumption of households / Disposable income, etc.
Saving ratio = Saving / Disposable income, etc.
"Disposable income, etc." consists of disposable income and adjustment for the change in pension entitlements.

## (Box 2) Impact of a Surge in Crude Oil Prices on Japan's Prices

Increased crude oil prices are thought to push up prices of a wide range of goods and services through (1) the direct pass-through of increased input costs to selling prices (first-round pass-through) and (2) indirect inflationary pressure induced by expanded profit margins and wage increases (second-round pass-through following a rise in inflation expectations). This box examines the impact of a surge in crude oil prices on prices in Japan by separating the first- and second-round pass-through, while also taking into account past episodes of increased crude oil prices.

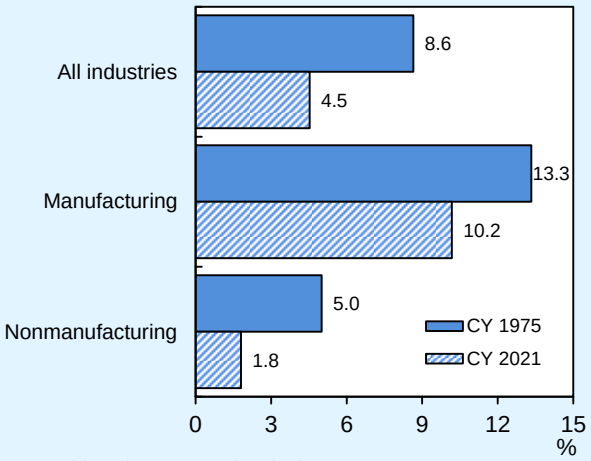
### **Chart B2-1:** The Pass-Through Lags of Corporate Transaction Prices




Sources: Ministry of Economy, Trade and Industry; Bank of Japan; Nikkei NEEDS-Financial QUEST.
Notes: 1. Figures show the rate of price increase when prices in the "coal mining, crude petroleum and natural gas" sector increase by 100 percent.
2. The pass-through lag of a crude oil price increase is estimated based on factors such as the results of an econometric analysis using the 2020-base corporate goods price index (CGPI), the 2020-base services producer price index (SPPI), and crude oil prices.
3. The pass-through lag of "electricity" reflects the latest fuel cost adjustment system of some electric power companies.

As for the first-round pass-through, increased costs are passed on successively through the supply chain from crude oil importers in the upstream to manufacturers of intermediate goods in the midstream, then to final goods and service providers in the downstream. Here, the analysis employs the input-output table to quantitatively grasp the impact of increased crude oil prices on prices of domestic goods and services through the supply chain across industries, taking into account the lag in the pass-through of prices observed in the past (Chart B2-1). For example, if crude oil prices increase by 100 percent, cost increases are likely to be passed on to prices relatively quickly, from the upstream to the midstream, with prices of petrochemical basic products likely to be raised by about 47 percent approximately one month after the shock, and crude oil-based intermediate goods, such as synthetic resins and synthetic fibers, likely to be raised by about 18 percent mainly 3-5 months

### **Chart B2-2:** Impact of an Increase in Crude Oil Prices on Output Prices



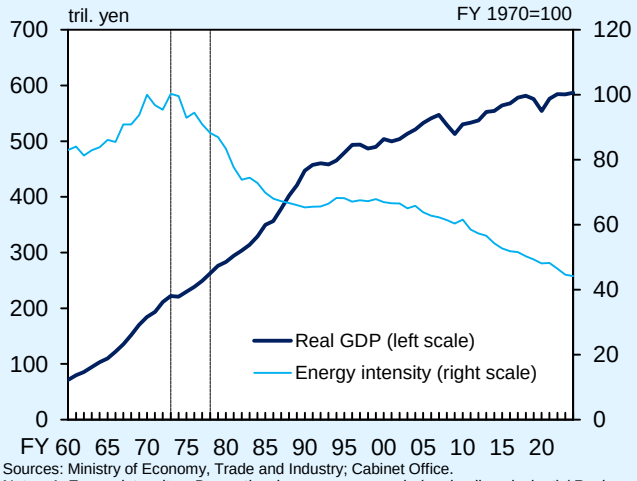

Source: Ministry of Economy, Trade and Industry.
Notes: 1. Figures show the rate of price increase when prices in the "coal mining, crude petroleum and natural gas" sector increase by 100 percent.
2. Figures for manufacturing include electricity, gas, and heat supply. Figures for nonmanufacturing exclude construction, finance and insurance, agriculture, forestry, and fishery, and mining.

after the shock. From 3 to 6 months after the shock, the price increases extend to items such as plastic products and rubber products, and to cost pressures on electricity, water transport, and air transport, where petroleum refinery products are used as fuel. Over the course of a year after the shock, cost increases will also likely be passed on to final goods and services, such as motor cars and motor vehicle parts, electrical machinery, construction, and accommodations, eating and drinking services.

The first-round pass-through of increased crude oil prices through inter-industrial relationships is, however, likely to be smaller than was observed in the oil crises in the 1970s. That is, the rate of increase in output prices in recent years in response to a 100 percent rise in crude oil prices is estimated to have decreased by about 50 percent since the 1970s in all industries, and by about 25 percent in manufacturing (Chart B2-2). This can be attributed to the fact that the industrial structure has changed since the oil crises in the 1970s, including a decrease in the share of heavy industry and energy intensity having continued to improve gradually across industries, owing to developments in energy-saving engineering technologies (Chart B2-3).

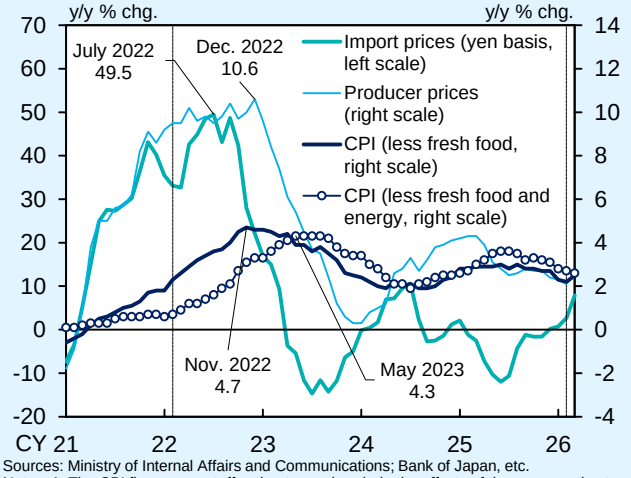
Looking back at the speed of the price pass-through in 2021-2022, when import prices rose, domestic producer prices peaked half a year after import prices hit their peak, and consumer prices (less fresh food and energy) reached their peak a year after import prices (Chart B2-4). In the current phase, as firms' price-setting stance has become more active, the speed of

**Chart B2-3:** Energy Intensity




Sources: Ministry of Economy, Trade and Industry; Cabinet Office.
Notes: 1. Energy intensity = Domestic primary energy supply (crude oil equivalent) / Real GDP. There is a discontinuity in the data for the domestic primary energy supply for fiscal 1990 due to a change in the calculation method.
2. The vertical lines indicate the start of the first and second oil crises.

**Chart B2-4:** Corporate Goods Prices and Consumer Prices



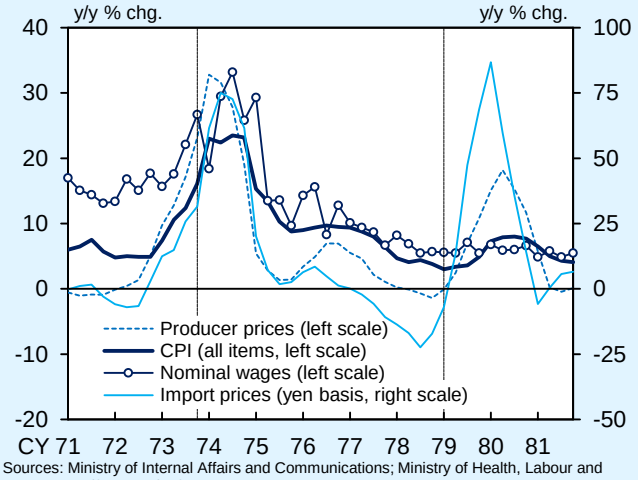

Sources: Ministry of Internal Affairs and Communications; Bank of Japan, etc.
Notes: 1. The CPI figures are staff estimates and exclude the effects of the consumption tax rate change and policies concerning the provision of free education, measures to reduce the energy cost burden (such as gasoline prices, electricity and gas charges), the reduction in mobile phone charges in 2021, and travel subsidy programs.
2. The vertical lines indicate February 2022 and February 2026.

pass-through from the upstream to the midstream and downstream may be faster, mainly reflecting (1) the revised formula used in the fuel cost adjustment system for business-use electricity, (2) the introduction of a surcharge system in the chemical industry, and (3) the implementation of the Act on Preventing Delay in Payment to Small and Medium-Sized Entrusted Business Operators in Relation to Manufacturing Consignment.

Regarding the second-round pass-through in the current phase, firms are exhibiting more proactive pricing behavior than before. In this context, firms facing increased raw material costs are likely to put upward pressure on prices in their efforts to maintain a certain level of profit margins. Nevertheless, the likelihood of an acceleration in wage growth leading to higher inflation is currently considered to be not very high.

Regarding this point, looking back at the two oil crises in the 1970s, crude oil prices surged during the first oil crisis in 1973, mainly triggered by reduced oil production by OPEC, and import prices rose significantly. As a result, firms raised prices aggressively, amid the overheating in the economy and the consequent lack of goods. Wage growth reached a record high of 33 percent in 1974, as firms accepted higher wage demands by labor unions, clearly surpassing the rate of increase in the CPI, which stood at around 25 percent that year, leading to further inflationary pressure (Chart B2-5). In contrast, during the second oil crisis in 1979, as fiscal and monetary policies were conducted in a restrictive manner, wage increases were constrained, due to coordinated efforts between labor and

**Chart B2-5:** Developments in Wages and Prices during the Oil Crises

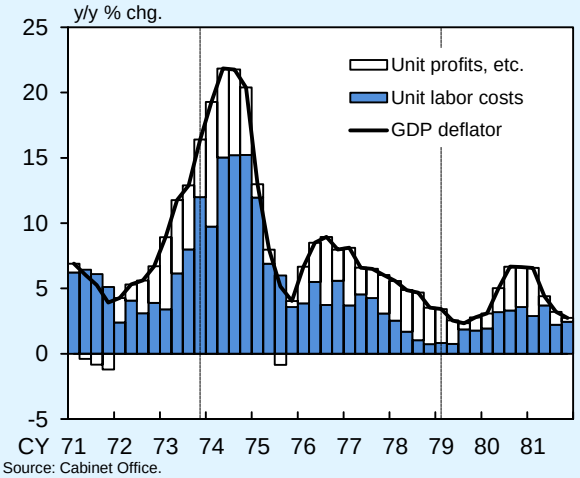



Sources: Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare; Bank of Japan.
Notes: 1. Figures for nominal wages are total cash earnings of regular employees. Figures are for establishments with 30 or more employees.
2. The vertical lines indicate the start of the first and second oil crises.

management, and the rate of increase in real wages was in negative territory in 1980, resulting in limited inflationary pressures thereafter, based on the lessons learned from the first oil crisis. The income side of the GDP deflator, which illustrates clearly the second-round pass-through, shows that while unit labor costs (ULCs) grew even faster following the first oil crisis, having already accelerated prior to the shock, their growth was constrained during the second oil crisis (Chart B2-6). Based on the experience during the oil crises, how much the second-round pass-through will be enhanced in the current phase is likely to depend on how the wage growth rate and ULCs react. As Japan's economy is expected to slow down and corporate profits are highly likely to see a decline, the possibility that the wage growth rate accelerates significantly and leads to a further heightening of the inflation rate is likely not high.

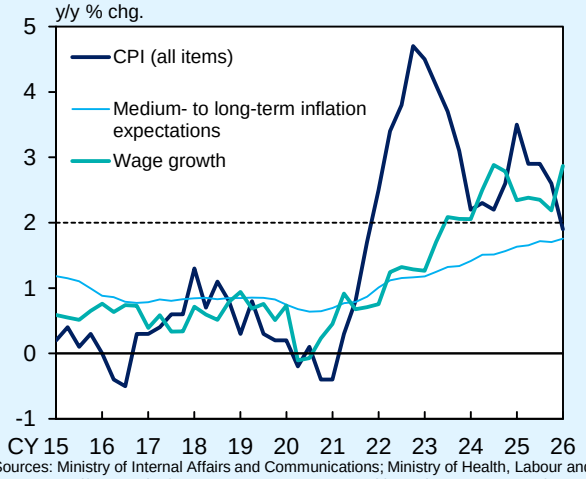
Looking back at the period following Russia's invasion of Ukraine in 2022, a significant rise in import prices at that time likely had mild effects of the second-round pass-through, as it led to a moderate, linked increase in wages and prices (Chart B2-7). This is because the rise in import prices at that time was induced not only by increased international commodity prices, including crude oil prices, but also by the depreciation of the yen (Chart 45); a considerable increase in corporate profits likely supported wage increases at the time, together with pent-up demand following the COVID-19 pandemic and the improved output gap owing to increased labor shortages (Charts 2 and 15).

**Chart B2-6:** Developments in the GDP Deflator during the Oil Crises




Source: Cabinet Office.
Notes: 1. Unit labor costs = Nominal compensation of employees / Real GDP
2. The vertical lines indicate the start of the first and second oil crises.

**Chart B2-7:** Developments in Wages and Inflation during Russia's Invasion of Ukraine

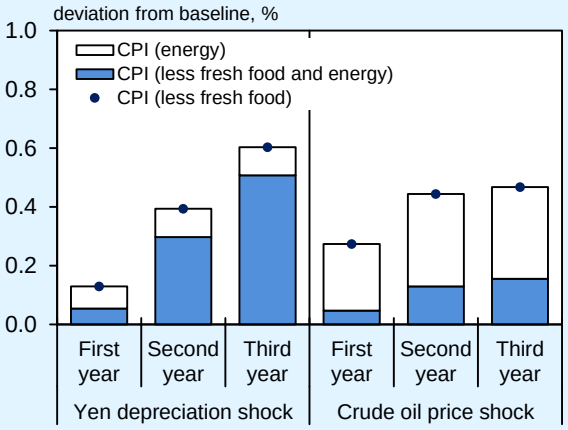



Sources: Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare; Bank of Japan; QUICK, "QUICK Monthly Market Survey <Bonds>"; Consensus Economics Inc., "Consensus Forecasts"; Bloomberg, etc.
Notes: 1. Figures for the CPI (all items) are staff estimates and exclude the effects of the consumption tax rate changes and policies concerning the provision of free education, measures to reduce the energy cost burden (such as gasoline prices, electricity and gas charges), the reduction in mobile phone charges in 2021, and travel subsidy programs.
2. Figures for medium- to long-term inflation expectations are the composite index of inflation expectations (PCA[i]) in Chart 40.
3. Figures for wage growth are the scheduled cash earnings of full-time employees. Figures from 2016/Q1 onward are based on continuing observations following the sample revisions. The figure for 2026/Q1 is the January-February average.

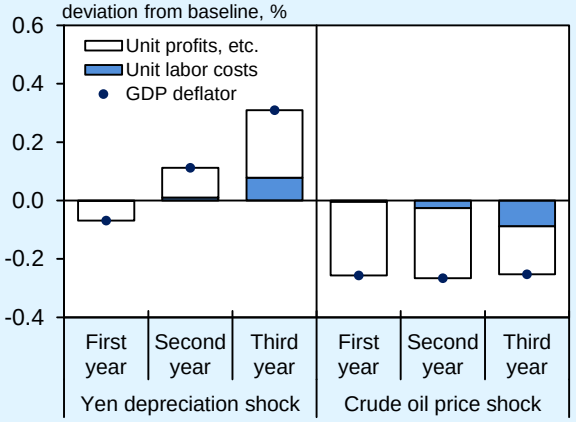
Lastly, to see the difference in the second-round pass-through in the case of an increase in crude oil prices compared with that of a depreciation of the yen, the Bank's large-scale macroeconomic model (Q-JEM), developed by the Research and Statistics Department, is used to simulate the impact on prices of a crude oil price shock and a yen depreciation shock that would induce the same rise in import prices. The results show that the cumulative rate of increase in the CPI (less fresh food) is higher in the case of a yen depreciation shock (Chart B2-8[1]). This is because the depreciation of the yen exerts broader upward pressure on the prices of a wide range of goods and services, resulting in the rate of increase in the CPI (less fresh food and energy) being pushed up as a whole, reflecting a rise in the import penetration ratio in recent years. In contrast, increased crude oil prices exert relatively strong upward pressure on prices in a narrower range, mainly on energy prices, and the rate of increase in the CPI (less fresh food and energy) is not very significant. The response of the GDP deflator differs greatly in the case of a yen depreciation shock compared with an increased crude oil price shock (Chart B2-8[2]). Specifically, while a yen depreciation shock tends to lead to a rise in the GDP deflator through wage increases and greater profit margins, an increased crude oil price shock tends to cause a decline in the GDP deflator through compressed profit margins and wages, reflecting worsened trading gains (outflow of income to overseas).[23] In the current phase, it is possible that both shocks could occur at the same time, as there is the possibility of increased crude oil prices

**Chart B2-8:** Price Response to Depreciation of the Yen and an Increase in Crude Oil Prices

**1. CPI (Less Fresh Food)**




**2. GDP Deflator**




Sources: Ministry of Internal Affairs and Communications; Cabinet Office; Bank of Japan, etc.
Notes: 1. The changes in the CPI and GDP deflator in response to a 5 percent yen depreciation against the U.S. dollar and an 18 percent increase in crude oil prices, which lead to a corresponding rise in the import deflator, are estimated using the macroeconomic model (Q-JEM).
2. Unit labor costs = Nominal compensation of employees / Real GDP

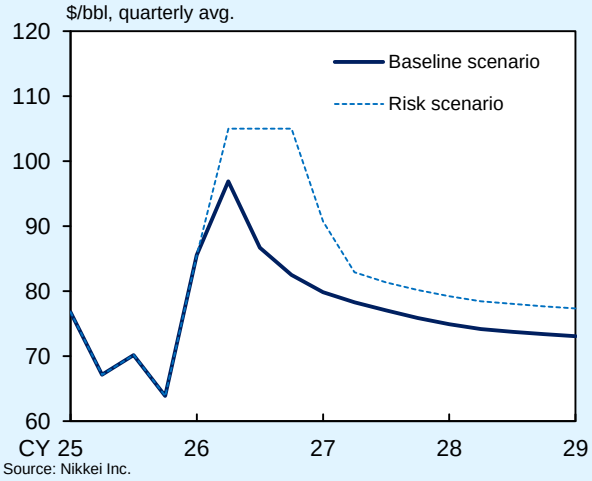
[23] Regarding this point, see Box 3 of the January 2026 Outlook Report ("Pass-Through of Import Price Increases to Domestic Prices").

leading to the yen's depreciation mainly through a deterioration in the trade balance. It is necessary to carefully examine the impact of the situation in the Middle East on prices, taking into account the discussion in this box.

## (Box 3) Risk Scenario Analysis regarding the Impact of the Situation in the Middle East

In the baseline scenario of this Outlook Report, it is assumed that, as the tension in the Middle East begins to ease, Dubai crude oil prices will decline from the current level. The future course of the situation in the Middle East is very unclear, and there is a risk that the turmoil surrounding the situation in the region could become prolonged. This box estimates quantitatively the impact on Japan's economy and prices should this risk materialize and crude oil prices remain elevated.

**Chart B3-1:** Assumptions about Dubai Crude Oil Prices




Source: Nikkei Inc.

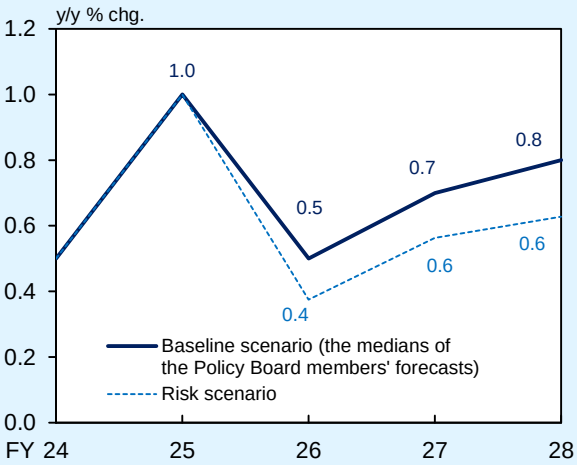
Specifically, the following risk scenario and exogenous conditions are assumed (Chart B3-1): (1) crude oil prices remain at the high level observed in April 2026, around 105 U.S. dollars per barrel, through the end of the year; (2) in this situation, the yen depreciates 10 percent relative to the current level, mainly due to an increase in selling pressure on the yen that follows a deterioration in the trade balance; and (3) stock prices decline by 20 percent, reflecting growing concerns over a slowdown in the global economy. To what extent the outlook for real GDP and the CPI (less fresh food) deviates from the baseline scenario (the medians of the Policy Board members' forecasts) is simulated using the Bank's large-scale macroeconomic model (Q-JEM) developed by the Research and Statistics Department. In this scenario, it is assumed that large-scale disruptions in supply chains due to crude oil-related resource shortages will not take place within this year owing to measures such as the release of petroleum reserves and the securing of alternative sources of supply.

The results show that the growth rate of real GDP is projected to be 0.4 percent in fiscal 2026, 0.6 percent in fiscal 2027, and 0.6 percent in fiscal 2028, on the back of an increase in the outflow of income abroad (a deterioration in trading gains) following crude oil prices remaining elevated, deviating downward by about 0.1 to 0.2 percentage points relative to the baseline (Chart B3-2[1]). Cumulatively, the growth rate of real GDP is projected to deviate downward by about 0.5 percentage points throughout the projection period. As for the year-on-year rate of change in the CPI (less fresh food), it is projected to be 3.1 percent in fiscal 2026, 3.0 percent in fiscal 2027, and 2.3 percent in fiscal 2028; it is projected to deviate upward to a considerable extent, pushed up mainly by energy prices and prices of goods, throughout the projection period (it is projected to deviate upward by about 1.2 percentage points, cumulatively). It is especially notable that a rise of about 3 percent is expected for two years in a row in fiscal 2026 and 2027 (Chart B3-2[2]). This upward deviation in the CPI could become a factor that pushes up medium- to long-term inflation expectations through the adaptive expectations formation.

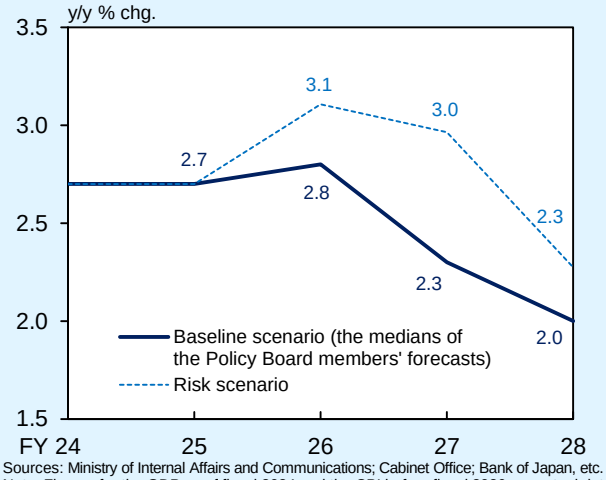
In addition to the abovementioned impact through crude oil prices remaining elevated, if large-scale disruptions in supply chains were to occur, firms' production activity could decline further and the downward deviation from the baseline could be significantly larger in real GDP. Such bottleneck events could also give rise to the risk of a nonlinear increase in the inflation rate.

**Chart B3-2:** Outlook for Economic Activity and Prices under the Scenarios

**1. Real GDP**




**2. CPI (All Items Less Fresh Food)**




Sources: Ministry of Internal Affairs and Communications; Cabinet Office; Bank of Japan, etc.
Note: Figures for the GDP as of fiscal 2024 and the CPI before fiscal 2026 are actual data. Figures for the risk scenario are based on the simulation using a macroeconomic model (Q-JEM).

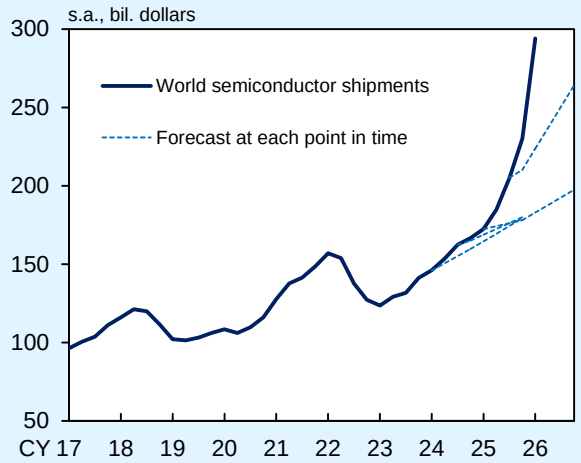
At any rate, developments in economic activity and prices could deviate considerably from the baseline scenario presented in this Outlook Report, depending on the future course of the situation in the Middle East, and it is therefore necessary to be especially thorough in examining various risk factors.

## (Box 4) Impact of Increased AI-Related Demand on Japan's Exports

Global semiconductor shipments have been increasing significantly on the back of robust global AI-related demand (Chart B4-1). As discussed in the previous Outlook Report, AI-related demand has been pushing up Japan's exports less than those of, for example, Taiwan and South Korea (Chart B4-2).[24] Nevertheless, the number of Japanese firms pointing to AI-related demand as a reason for increased exports and production has been steadily rising across a wider range of industries.[25] This box examines and analyzes in detail the impact of global AI-related demand on Japan's exports using data of trade statistics by item.

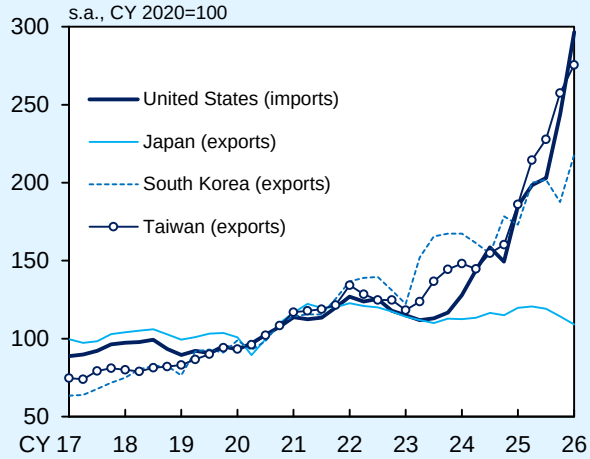
First, items exported from Japan for which increased demand has been induced by AI-related demand (hereafter "AI-related goods") are categorized according to the following criteria (Chart B4-3). Items that are included in Japan's intermediate goods, capital goods, and IT-related goods exports and fall into either of the following two categories are classified as AI-related goods: (A) items that are on the World Trade Organization (WTO) list of AI-enabling products; and (B) items for which the year-on-year export value correlates closely with year-on-year figures for semiconductor shipments in the World Semiconductor Trade Statistics (WSTS). (B)

**Chart B4-1:** World Semiconductor Shipments



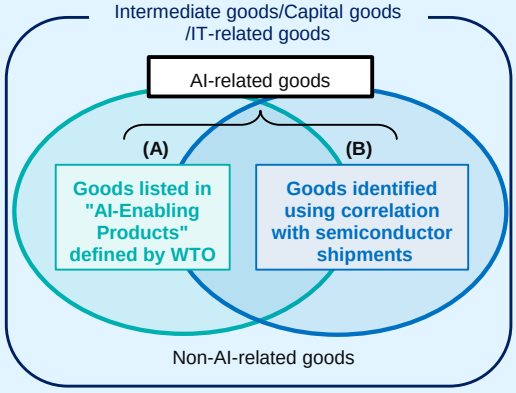

Source: WSTS.
Notes: 1. Based on staff calculations using WSTS data.
2. The figure for world semiconductor shipments for 2026/Q1 is the January-February average.
3. The forecasts are as of May 2024, November 2024, May 2025, and November 2025.

**Chart B4-2:** Semiconductor-Related Real Exports and Imports




Sources: Bank of Japan; Ministry of Finance; Haver; CEIC.
Notes: 1. Figures for the United States are the sum of the imports of semiconductors, computers, computer accessories, and telecommunications equipment among capital goods. Figures for Japan are the sum of the exports of IT-related goods and semiconductor production equipment. Figures for South Korea are the export volume index for semiconductors. Figures for Taiwan are the export volume index for machinery and electrical equipment.
2. The figure for the United States for 2026/Q1 is the January-February average.

**Chart B4-3:** Definition of AI-Related Goods




[24] See Box 1 of the January 2026 Outlook Report ("Impact of Tariff Policies on the U.S. Economy, and Robust Global AI-Related Demand").

[25] See, *Chiiki Keizai Hōkoku (2026 nen 4 gatsu)* [Regional Economic Report, April 2026] (the full report is only available in Japanese).

allows for the extraction of items not covered by the WTO's list, including general-purpose items for which demand is linked to the IT cycle and items for which increased demand has been induced by AI-related demand.[26] Aggregating AI-related goods identified by this method shows that they made up about 20 percent of overall exports from Japan in 2025.

Items identified as AI-related goods include (1) items that have a large weight in overall exports and have previously been recognized as AI-related, such as semiconductor production equipment, memory chips, and equipment for power facilities and infrastructure-related equipment; and (2) items with a small weight in overall exports but for which exports have been increasing rapidly, such as fiber-optic cable and photosensitive film. Overall, this indicates that the range of AI-related goods is fairly extensive (Chart B4-4). However, except for some items, most of the items identified as AI-related goods make up only a small fraction of overall exports, and their contribution to the growth rate in exports is not significant when aggregated. The structure of Japan's exports differs from that of Taiwan and South Korea, where the weight of specific items that are key to the AI-related industry is considerable, such as advanced semiconductors, including graphics processing units (GPUs), and data servers; Taiwan and South Korea have been increasing exports of these goods significantly,

[26] Specifically, an item is selected (1) if the correlation coefficient between its export value and world semiconductor shipments -- both of which are measured on the basis of the year-on-year rate of change -- is 0.5 or higher; and (2) if it has a higher correlation with world semiconductor shipments than with the OECD's Composite Leading Indicator, so as to control factors related to economic developments.

**Chart B4-4:** Growth Rates and Weights in Japan's Goods Exports by Item

**Items with High Growth Rates**

| | Major items | y/y % chg. | Weight % | Group |
|---|---|---|---|---|
| 1 | Connectors for fiber-optic cables | 70.3 | 0.04 | B |
| 2 | Tantalum capacitors | 65.4 | 0.02 | B |
| 3 | Instruments and apparatus; specially designed for measurement or inspection | 63.7 | 0.01 | A |
| 4 | Liquid chillers | 60.7 | 0.04 | B |
| 5 | Fiber-optic cables | 57.0 | 0.04 | A |
| 6 | Air conditioning machines incorporating a refrigerating unit | 53.8 | 0.00 | B |
| 7 | Photosensitive film | 40.7 | 0.06 | A |
| 8 | Electric motors and generators | 30.1 | 0.02 | A |

**Items with Large Weights**

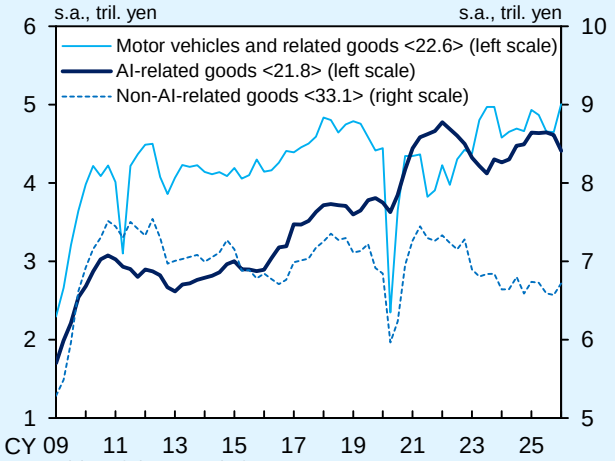
| | Major items | y/y % chg. | Weight % | Group |
|---|---|---|---|---|
| 1 | Semiconductor production equipment (SPE) | -2.4 | 2.5 | A, B |
| 2 | Memory chips | 9.5 | 1.9 | A, B |
| 3 | Parts and accessories of SPE | 8.4 | 0.8 | A |
| 4 | Wafers | 5.5 | 0.6 | A |
| 5 | Ceramic capacitors | 3.4 | 0.6 | B |

Sources: Ministry of Finance; WTO; OECD; WSTS; Trade Map, International Trade Centre: https://marketanalysis.intracen.org.
Note: Figures are based on nominal U.S. dollar values for 2025. Regarding the group classifications, see Chart B4-3.

goods in which they have a comparative advantage.

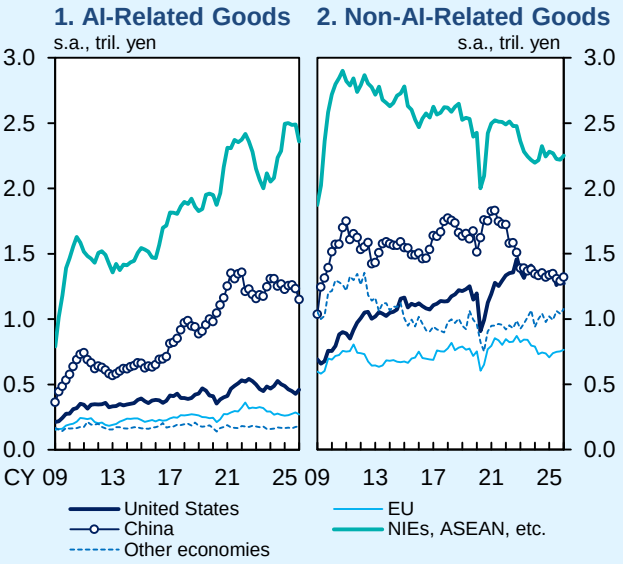
Moreover, dividing Japan's exports into AI-related, non-AI-related, and motor vehicles and related goods, while exports of AI-related goods have continued to be on an increasing trend, those of non-AI-related goods have followed a moderate decreasing trend (Chart B4-5). By region, exports of AI-related goods have been on a moderate increasing trend, mainly to NIEs and ASEAN, as well as to China (Chart B4-6). In contrast, exports of non-AI-related goods increased significantly immediately after the COVID-19 pandemic, due to pent-up demand; thereafter, they have been on a decreasing trend, mainly due to a considerable decline in exports to China, where domestic production by Chinese manufacturers has been accelerating rapidly, reflecting industrial policies. As for the outlook, Japan's exports of AI-related goods are likely to be pushed up by robust global AI-related demand; however, a weak trend in non-AI-related demand is likely to push down exports, therefore exports are likely to continue to lack momentum as a whole, relative to the world trade volume. Moreover, it is necessary to pay attention to the risk of exports in general declining substantially, in the case of an acute decrease in AI-related demand should hyperscalers' investment in data centers peak out.

**Chart B4-5:** Real Exports of AI-Related and Non-AI-Related Goods




Sources: Ministry of Finance; Bank of Japan; WTO; OECD; WSTS.
Notes: 1. Non-AI-related goods are defined as intermediate goods, capital goods, and IT-related goods excluding AI-related goods.
2. Figures in angular brackets show the share of each type of goods in Japan's total exports in 2025. Figures for 2026/Q1 are January-February averages.

**Chart B4-6:** Real Exports by Region




Sources: Ministry of Finance; Bank of Japan; WTO; OECD; WSTS.
Notes: 1. Non-AI-related goods are defined as intermediate goods, capital goods, and IT-related goods excluding AI-related goods.
2. Figures for 2026/Q1 are January-February averages.