May 21, 2026

Bank of Japan

Economic Activity, Prices, and Monetary Policy in Japan

Speech at a Meeting with Local Leaders in Fukuoka

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(English translation based on the Japanese original)

I. Current Situation and Outlook for Economic Activity and Prices

When considering the current situation and outlook for economic activity and prices, this time I believe it is necessary to address the geopolitical risks related to the situation in the Middle East, which materialized this spring. Please refer to the geopolitical risk index in the left panel of Chart 1.[1] Generated through text analysis of newspaper articles, this index has risen to a level comparable to its level during the Ukraine crisis in 2022, reflecting the risks surrounding the current situation in the Middle East.

In response to the situation in the Middle East, Dubai crude oil prices, i.e., the spot prices at which crude oil from the Middle East is actually traded, have risen more than they did during the Ukraine crisis, as shown in the right panel of Chart 1. Global food prices, also shown in the right panel of Chart 1, are currently relatively stable; however, they could be affected by factors such as a surge in the price of some fertilizers that are mainly produced in the Middle East.

Japan relies on overseas sources for energy and food, and being an island nation, most imports by volume depend on sea transport. For a country like Japan that is highly dependent on energy imports, the current situation in the Middle East may be interpreted as a negative supply shock accompanied by soaring crude oil prices, and it is natural to think that this shock will weaken economic activity while pushing up prices.

During the Ukraine crisis around spring 2022, there were unprecedented supply-side constraints on a global basis, coinciding with the post-pandemic reopening of economic activity in Europe and the United States, as well as China's zero-COVID policy. As a result, market factors -- specifically, soaring crude oil and food prices -- drove up import prices, leading to a deterioration in the terms of trade (left panel of Chart 2). Exchange rate factors also contributed to the significant increase in import prices, as the yen depreciated at that time (right panel of Chart 2 and left panel of Chart 10). Meanwhile, export prices increased in yen

[1] Caldara, Dario and Matteo Iacoviello (2022), "Measuring Geopolitical Risk," *American Economic Review*, April, 112(4), pp.1194-1225.

terms, reflecting the effects of the yen's depreciation, but this increase has not fully offset the effects of past deterioration in the terms of trade (right panel of Chart 2).

Against this recent background, I believe the Bank of Japan needs to assess how long the present situation in the Middle East will last, what kind of impact it will have on the global economy, to what extent external demand will weaken, and, under these circumstances, how Japan's net exports will change in light of current exchange rate levels. In doing so, the Bank should monitor not only the situation in the Middle East but also developments in global IT demand and the status of global supply chains. Strong global IT demand is reflected, for example, in the recent surge in copper prices (right panel of Chart 1). The Bank also needs to monitor how the rise in crude oil prices will affect Japan's economic activity and prices.

With these issues in mind, today I will explain my assessment of the current situation and outlook for economic activity and prices.

Economic Developments Abroad

Let me begin with developments in overseas economies. The reference forecast released by the International Monetary Fund (IMF) in April 2026 assumes that the heightened risks stemming from the Middle East situation will persist until around the summer. In this forecast, the global economy is projected to grow moderately on the whole, despite being affected by the situation in the Middle East (left panel of Chart 3). That said, intensified supply-side constraints due to the prolonged Middle East situation may become a factor that significantly influences the outlook. The suppliers' delivery times Purchasing Managers' Index (PMI) in the right panel of Chart 3 suggests that the impact seems to be limited so far, compared with the time of the global supply-side constraints observed around 2022, although there are signs of delivery times becoming longer. Supply quantity constraints may intensify through the impact on supply chains, and therefore I remain alert to how this unfolds.

The outlook for overseas economies depends on to what extent the adverse economic shocks that could arise from the situation in the Middle East are offset by the robust global IT demand and fiscal policy in each jurisdiction. Specifically, it is important to assess where in the supply chain and to what extent supply-side constraints may emerge amid strong IT demand. It is

also necessary to take into account the possible effects of fiscal policies. The economic effects of increased defense spending, however, may not necessarily be significant, as the multiplier effects may vary depending on, for example, the degree of import inducement arising from increased spending.

Economic Developments in Japan

Next, I would like to turn to Japan's economy.

With Japan possessing petroleum reserves, the situation in the Middle East is yet to be significantly reflected in recent hard data on components such as business fixed investment (Chart 4). Corporate profits have recently been at high levels (left panel of Chart 5). As can be seen from progress in wage revisions this spring, wage increases for 2026 also seem to be solid overall, including at small firms as defined by the number of union members (Chart 6). However, as shown in the diffusion index (DI) for business conditions in the Bank's March 2026 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), firms are taking a cautious view on future business conditions (right panel of Chart 5).

Regarding exports, the share of Japan's exports to the Middle East is not so large for both goods and services overall, but the share of its transportation machinery exports is relatively high. It is necessary to monitor not only developments in exports to the Middle East but also in exports to other economies that are highly dependent on energy resources from the Middle East. The NIEs and ASEAN economies, in particular, are examples of such energy-dependent economies, including in terms of crude oil and liquefied natural gas (LNG). Japan's IT-related exports to these economies have been increasing in recent years, as these economies have expanded their IT-related exports to the United States, which is a key driver of global IT investment. With respect to services exports, which account for about a quarter of Japan's total exports, attention needs to be paid to developments in inbound tourism consumption. Although the number of visitors to Japan from China has declined markedly since autumn 2025, the impact on inbound tourism consumption as a whole seems to have been limited so far, owing to a significant increase in the number of visitors from other regions.

Turning to household spending, the higher inflation expected as a result of the recent situation in the Middle East may reduce households' purchasing power. It is therefore important to examine to what extent this could weaken domestic consumption. Consumer confidence for March 2026 onward has deteriorated significantly amid an already weakening trend in consumption of nondurable goods, including food (Chart 7). That said, wage increases have taken hold and scheduled cash earnings have been rising stably, as shown in Chart 9, reflecting firms' strong sense of labor shortage under tight labor market conditions overall (right panel of Chart 8). It is necessary to continue monitoring the sustainability of the interaction of wages and prices, i.e., the situation in which a moderate rise in prices and wages, accompanied by a rise in labor productivity, results in an increase in real wages and consumption.

The situation in the Middle East seems yet to have been fully reflected in recent hard data. Meanwhile, the output gap has recently been positive (left panel of Chart 8). The Bank's view in the April 2026 *Outlook for Economic Activity and Prices* (Outlook Report) is that the economy "has recovered moderately, although some weakness has been seen in part, partly due to the impact of the situation in the Middle East." I will discuss the outlook and the risk balance for economic activity later.

Price Developments in Japan

Next, I would like to discuss prices.

Chart 10 suggests that the producer price index (PPI) has been influenced by developments in import prices. The year-on-year rate of increase in import prices has widened significantly for April 2026, due to developments in commodity prices and foreign exchange rates, and that in the PPI has also increased to around 5 percent, driven by energy-related factors. On this point, the final demand-intermediate demand (FD-ID) price indices, which can represent business-to-business (B2B) prices, or price pass-through between firms, indicate that energy prices were passed on swiftly at the upstream stage of the production process during the Ukraine crisis in 2022 (Chart 11). The rise in energy prices is expected to be transmitted downstream.

The pace of price pass-through by firms seems to have accelerated compared with a few years ago. The latest March 2026 *Tankan* suggests that firms seem to be ready to pass on any increase in input prices to output prices. In fact, looking at the breakdown of changes in the output prices DI (the percentage of firms that expect output prices to "rise" minus the percentage expecting them to "fall"), the increase in the percentage of firms that expect output prices to rise is evident for both the manufacturing and nonmanufacturing sectors (left panels of Chart 12). In addition, regarding business-to-consumer (B2C) price pass-through, the DI for price changes, in terms of the share of price-increasing items minus the share of price-decreasing items, has been elevated, confirming that prices have continued to rise across a wide range of items (right panel of Chart 12). Anecdotal information indicates that some firms are considering price increases after the summer due to the situation in the Middle East.[2]

Please refer to the consumer price index (CPI) in Chart 13. The year-on-year rate of change in the CPI was on a downtrend through March 2026 due to the easing of food price-driven inflation and also due to the effects of the government's measures to reduce the household burden of higher energy prices. Looking ahead, it is necessary to assess the pace and magnitude of inflation that is brought about by the situation in the Middle East. Services prices, which had been declining until a few years ago, have recently been stably pushing up the CPI. This is because amid sustained solid wage growth, firms have been passing on such wage increases to selling prices.

Based on these price developments, the Bank's view in the April 2026 Outlook Report is that "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." I will discuss the outlook and the risk balance for prices in the following.

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[2] See the annex paper to the *Regional Economic Report*, "Chiiki no shōhi kanren kigyō no kakaku settei kōdō no henka to 2026 nendo no kakaku kaitei hōshin" [Changes in price-setting behavior of and price revision plans for fiscal 2026 at regional consumption-related firms] released in May 2026 (available only in Japanese).

Outlook for Economic Activity and Prices

The Bank's nine Policy Board members indicate their respective forecasts for Japan's economic activity and prices at the Monetary Policy Meetings (MPMs) held in the month in which the Outlook Report is released. Chart 14 shows their forecasts for real GDP and the CPI for all items excluding fresh food (core CPI) for each fiscal year. The latest April 2026 Outlook Report projects that, reflecting the situation in the Middle East, Japan's economic growth will decelerate and prices will be pushed up.

The risk balances assessed by each Policy Board member are shown by the shapes of the markers. A comprehensive look at the members' latest forecasts as of April indicates that risks to economic activity are skewed to the downside for fiscal 2026 and balanced for fiscal 2027; on the other hand, risks to prices are skewed to the upside for both fiscal years.

Please take a look at the box in Chart 14. As for risks regarding the situation in the Middle East, the Outlook Report points out the risks of turmoil becoming prolonged and crude oil prices remaining elevated, and of large-scale disruptions in supply chains. Close monitoring is warranted on how constraints evolve in quantitative terms looking ahead, as this will significantly affect the Bank's outlook. Conversely, the likelihood of realizing the baseline scenario of the outlook could rise again, if risks surrounding economic activity and prices decline due to, for example, progress in ceasefire negotiations.

II. Conduct of Monetary Policy

Financial Conditions and the Degree of Monetary Accommodation

Following the policy interest rate hike in December 2025, the uncollateralized overnight call rate has increased to around 0.75 percent, reaching a level last seen 30 years ago (left panel of Chart 15). I believe it is important to examine how the change in the policy interest rate affects the financial environment as well as economic activity and prices. From this perspective, I would like to explain the current situation for households, firms, and the government.

Regarding households, the liability side of their balance sheets shows that housing loans make up the bulk of liabilities, equivalent to roughly 40 percent of GDP. Since variable-rate loans

represent the majority of housing loans in Japan, nominal interest payments can increase when interest rates rise.[3] Also, the proportion of non-recourse loans is extremely small in Japan, and loans are often designed without the assumption of the sale of the property during the repayment period. It is therefore necessary to keep in mind the cumulative changes in the repayment burden.[4] With household income increasing, however, the loan delinquency rate remains low at present. There has also been no significant change in the overall scale of housing loans at a macro level. According to the Bank's March 2026 *Opinion Survey on the General Public's Views and Behavior*, there continues to be a proportion of respondents who answered that the current interest rate level is "too low." Furthermore, when those who answered that their household circumstances "have become worse off" were asked about the reasons, many cited that "prices have risen."

With regard to firms, firms' funding costs have been increasing following the policy rate hikes, as shown in the right panel of Chart 15; however, financial positions remain favorable on the whole, as presented in Chart 16, and bankruptcies and other issues related to higher interest rates do not seem to be on the rise. That said, amid uncertainties in the Middle East, the extent to which high corporate profits can serve as a buffer against future business fixed investment and wage increases needs to be examined. For example, for the oil and chemical industries, import prices have risen along with the significant impact of the situation in the Middle East, but in the IT sector, yen-denominated export prices have risen on the back of strong global demand, proving that there are differences between industries. It is also necessary to monitor the extent to which the terms of trade for Japan as a whole will deteriorate on a macro level, as well as how U.S. trade policy introduced in 2025 and the recent situation in the Middle East will affect the investment behavior of individual firms on a micro level.

The government is the largest borrower in Japan, and therefore, I believe the future of government financing is a key point to consider amid the changes in Japan's demographics and macroeconomic savings balance. Some market participants point out that the market's

[3] For developments in the repayment burden of housing loans, see Box 1 in the October 2025 issue and Box 2 in the April 2026 issue of the *Financial System Report* (FSR).

[4] Non-recourse loan is a type of loan in which, if it becomes difficult to repay the debt, debt repayment can be settled using only the proceeds from the sale of the collateral property, without affecting other assets. Thus, the debt will be discharged if the homeowner surrenders their home.

perception of fiscal policy has influenced the formation of yields on Japanese government bonds (JGBs) recently in the long-term and super-long-term zones. Despite risk-off sentiment reflecting the situation in the Middle East, a "flight to quality" seems to be limited. This may reflect the increasing risk of global inflation stemming from the rise in crude oil prices and market participants' perceptions of fiscal policy. Conversely, if risk premiums affected by inflation can be contained, even if short-term interest rates rise, long-term interest rates will not necessarily follow suit.

I have explained the situation for different entities -- households, firms, and the government -- but overall, I believe Japan's financial conditions have remained accommodative, even after policy interest rate hikes. Please refer to Chart 17. Short-term real interest rates have been negative and at low levels relative to other economies. Meanwhile, real interest rates in the long-term zone have recently been positive, reflecting the rise in nominal JGB yields. Still, a prolonged period of negative long-term real interest rates may lead investors to view Japan's economy as an unattractive investment destination in terms of expected returns. I believe it is therefore desirable for real long-term interest rates to remain positive over the long run to maintain market health.

Under such accommodative financial conditions, my view is that underlying inflation is already around 2 percent (Charts 18 and 19). I therefore believe the Bank needs to 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.

Points regarding Future Policy Interest Rate Hikes

With that in mind, I would like to raise two points regarding future interest rate hikes. The first is the degree to which monetary policy should address potential price rises. On the supply side, there is debate as to what extent the increase in energy prices stemming from the situation in the Middle East should be considered temporary and "looked through." Developments over the past month or two may have increased the likelihood of a risk scenario in which high crude oil prices persist. On the demand side, strong AI demand may be one factor contributing to higher energy prices. Considering such supply and demand contexts, prices could continue to increase across a wider range of items down the road.

Given the situation in the Middle East, I see some possibility that underlying inflation may exceed 2 percent looking ahead. In fact, both survey- and market-based indicators of long-term inflation expectations have already increased slightly, which warrants attention (Chart 19). I think the Bank needs to continue examining the extent to which underlying inflation is anchored.

I therefore believe it is reasonable for the Bank to raise the policy interest rate at an appropriate pace to address high inflation while also considering the trade-offs for the economy.

The second point regarding future policy interest rate hikes is interest rate normalization -- that is, for real interest rates to return to a state of equilibrium. As I mentioned in my previous speech, if real interest rates continue to deviate markedly in a negative direction from the natural rate of interest, which is the equilibrium rate, unintended distortions could arise in future resource allocation.[5] Moreover, short-term real interest rates will fall further if the Bank does not change its policy interest rate in response to a rise in inflation or inflation expectations. How to address this in terms of interest rate normalization is a topic of discussion, and I believe the Bank's judgement will depend on factors such as the size of the output gap and the stability of the natural rate of interest. Let me elaborate on this point.

Please refer to the output gap shown in the left panel of Chart 8. Assuming that the gap does not become significantly negative -- that is, the economy does not see a major downturn -- during the projection period of the latest Outlook Report, I believe more attention needs to be paid to the side effects of a further decline in real interest rates. Considering the currently positive output gap, together with the strong global IT demand and the efficacy of the government's various measures, it is less likely at this point that a major economic downturn, as seen during the Global Financial Crisis or the COVID-19 pandemic, will occur within the projection period.

[5] Koeda, J., "Economic Activity, Prices, and Monetary Policy in Japan," speech at a meeting with local leaders in Niigata, November 20, 2025.

Theoretically, the natural rate of interest, shown in the right panel of Chart 20, generally moves in line with the potential growth rate in the long term. This suggests that the stability of the natural rate of interest can depend on developments in the potential growth rate (left panel of Chart 20). If the potential growth rate remains stable, real interest rates could deviate further from the natural rate of interest in a negative direction when inflation or inflation expectations rise. It will therefore become even more important to proceed with interest rate normalization through policy interest rate hikes.

To elaborate on Japan's potential growth rate, it has been stable in recent years, supported by a solid rise in total factor productivity (TFP) (left panel of Chart 20). On the other hand, a decline in labor input, particularly in working hours, has put downward pressure on the potential growth rate. With the number of senior, women, and foreign workers increasing, the extent to which there remains room for an increase in working hours will be a key issue in assessing the future potential growth rate. Moreover, amid rapidly changing circumstances, whether appropriate investment is made from the perspective of future value standards will likely affect the potential growth rate. It has been suggested these days that AI is changing economic trends. In this regard, I think it is necessary to examine various aspects of the impact of the IT industry on Japan's economy, including the impact on each industry of trends in investment in data centers and other hardware, of infrastructure environments, and of AI's labor complementarity or substitutability. Looking back at past surges in crude oil prices, the oil shocks in the 1970s prompted advances in energy efficiency and conservation and led to structural changes in economic activity. I believe that whether Japan's economy has the momentum to change in a proactive and sustainable way will also affect its potential growth rate.

Normalization of the Bank's Balance Sheet

Lastly, while the primary focus of its monetary policy conduct is to control the policy interest rate, the Bank is also currently normalizing its balance sheet, which expanded exceptionally under the long period of unconventional monetary policy. My view is that the Bank should proceed steadily with normalizing its balance sheet in a predictable manner, while ensuring flexibility. The amount of the Bank's holdings of JGBs accounts for a significant portion of its balance sheet and is therefore an essential factor in terms of balance sheet normalization.

The Bank's JGB holdings are expected to decline moderately, as the amount of bonds redeemed exceeds the amount purchased. When considering the long-term balance between redemption and purchase, it is important to comprehensively assess factors such as the situation in the JGB market and the issue of liquidity, including reserve balances. At the next MPM, to be held in June, the Bank will conduct an interim assessment of its reduction in JGB purchases. I would therefore like to discuss this topic again on another occasion.

Thank you.

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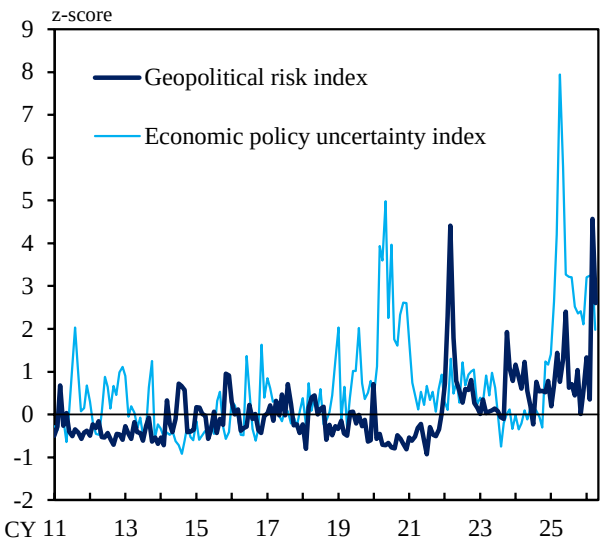
Bank of Japan

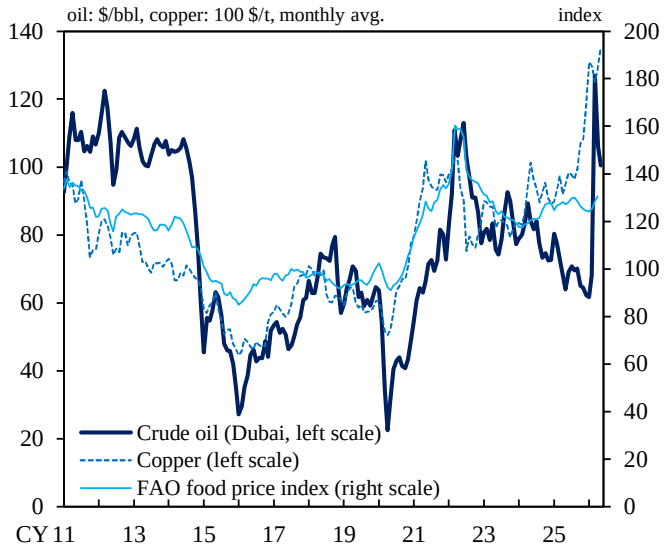
Chart 1

Geopolitical Risks and Commodity Prices

Geopolitical Risks and Economic Policy Uncertainties



International Commodity Prices



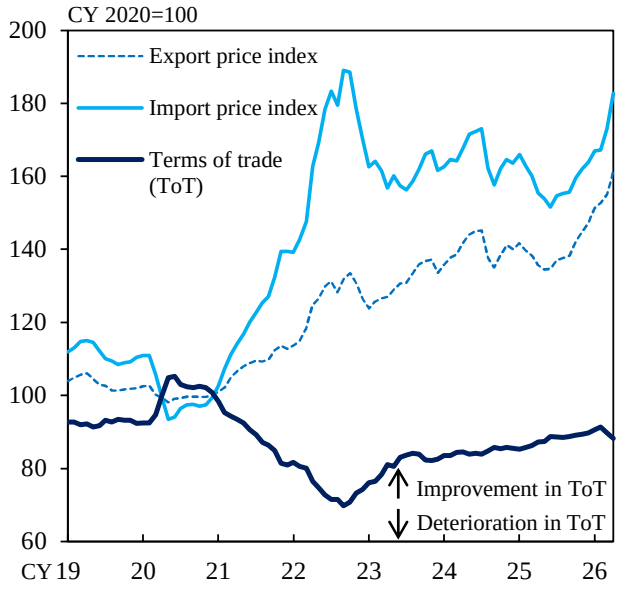
Notes: 1. In the left panel, figures are normalized using the average and standard deviation for the period from 1985 onward. Figures for the geopolitical risk index are global figures, while those for the economic policy uncertainty index are those for the United States.
2. In the right panel, the FAO food price index is a price index comprising meat, dairy, cereals, vegetable oils, and sugar (CY 2014-2016 average=100).

Sources: Bloomberg; Caldara, D. and Iacoviello, M., https://www.matteoiacoviello.com/gpr.htm; Economic Policy Uncertainty; FAO; Nikkei Inc.

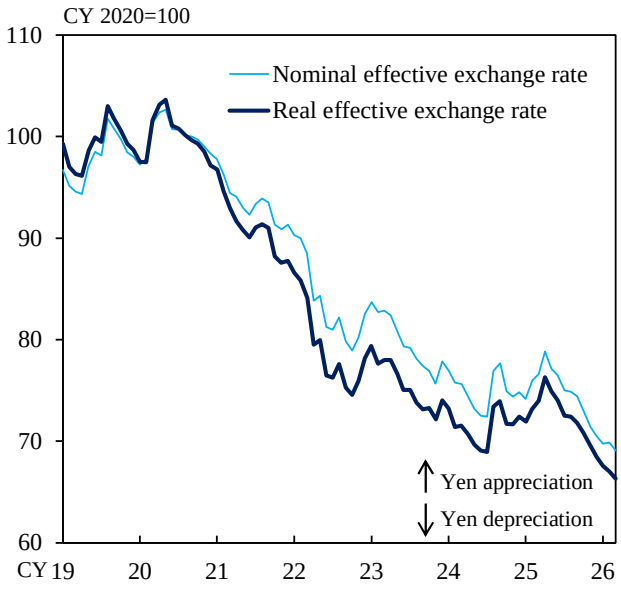
Chart 2

Terms of Trade and Effective Exchange Rates

Terms of Trade



Effective Exchange Rates

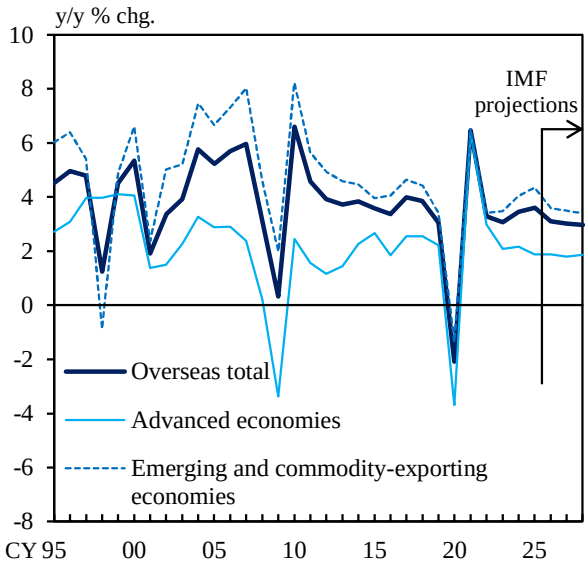


Notes: 1. In the left panel, both the export and import price indices are on a yen basis.
ToT = Export price index / Import price index × 100.
2. In the right panel, figures are based on the broad effective exchange rate indices.
Sources: BIS; Bank of Japan.

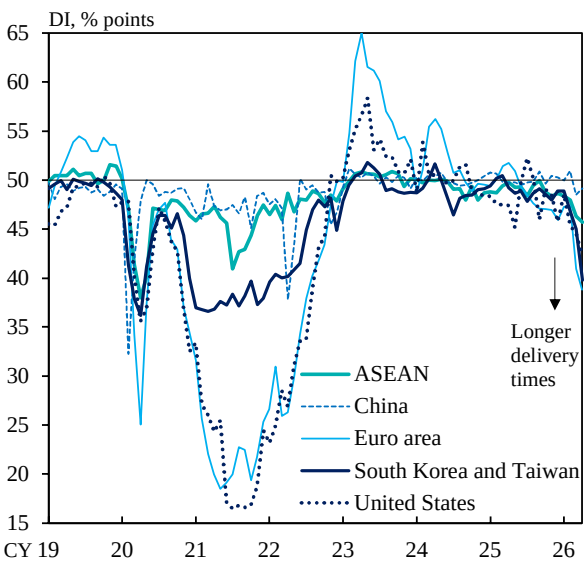
Chart 3

Overseas Economies and Supply-Side Constraints

Overseas Economies



Suppliers' Delivery Times PMI

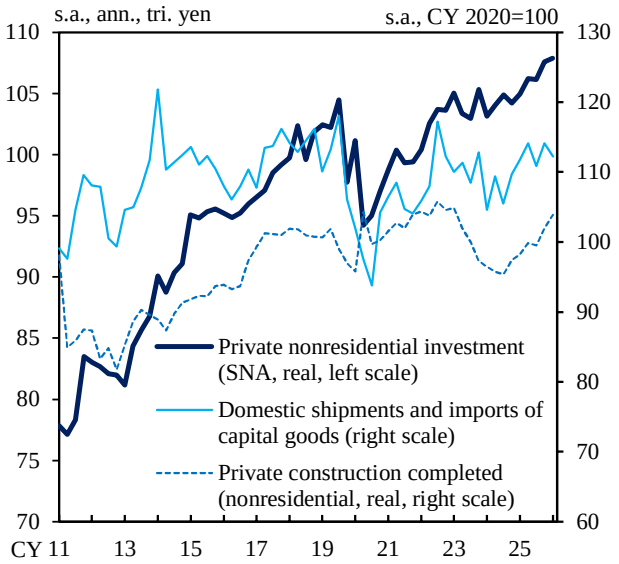


Notes: 1. In the left panel, figures are the weighted averages of real GDP growth rates using countries' share in Japan's exports as weights. The real GDP growth rates are compiled by the IMF, and the rates from 2026 onward are its projections in the April 2026 *World Economic Outlook* (WEO). Figures 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.
2. In the right panel, figures for "South Korea and Taiwan" and "ASEAN" are the weighted averages of figures for each country and region, using purchasing power parity (PPP) as weights. Figures for "China" are from the RatingDog China PMI.
Sources: IMF; Ministry of Finance;

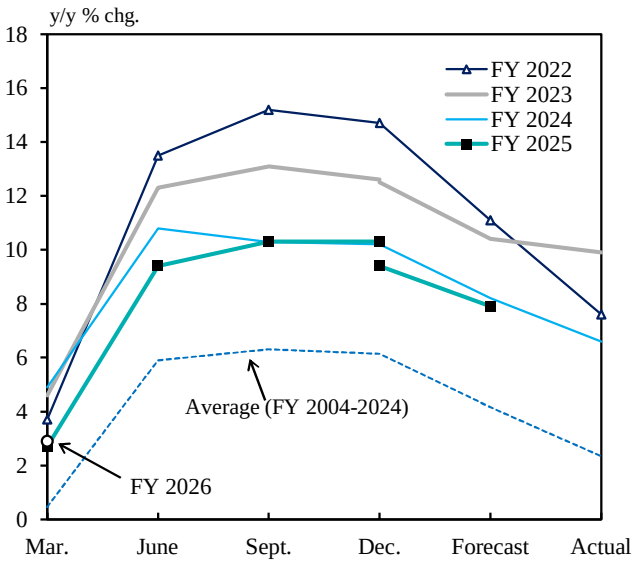
Chart 4

Business Fixed Investment

Coincident Indicators



Developments in Business Fixed Investment Plans



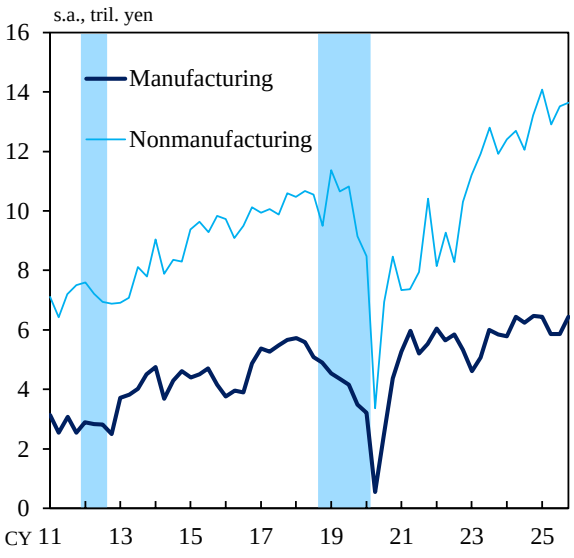
Notes: 1. In the left panel, figures for real private construction completed are based on Bank staff calculations using the construction cost deflators, and those for 2026/Q1 are January-February averages.
2. In the right panel, figures are based on the *Tankan* and are for all industries including financial institutions. Figures include software and R&D investments and exclude land purchasing expenses. R&D investment is not included before the March 2017 survey. There are discontinuities in the data for December 2023 and December 2025 due to changes in the survey sample.

Sources: Cabinet Office; Ministry of Economy, Trade and Industry; Ministry of Land, Infrastructure, Transport and Tourism; Bank of Japan.

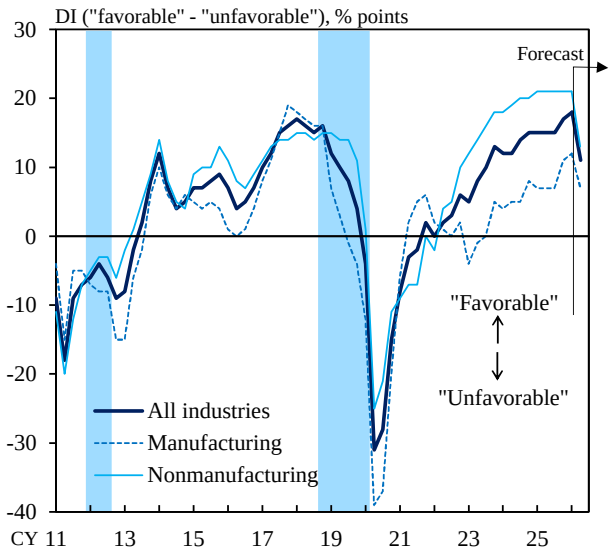
Chart 5

Corporate Sector

Operating Profits



Business Conditions

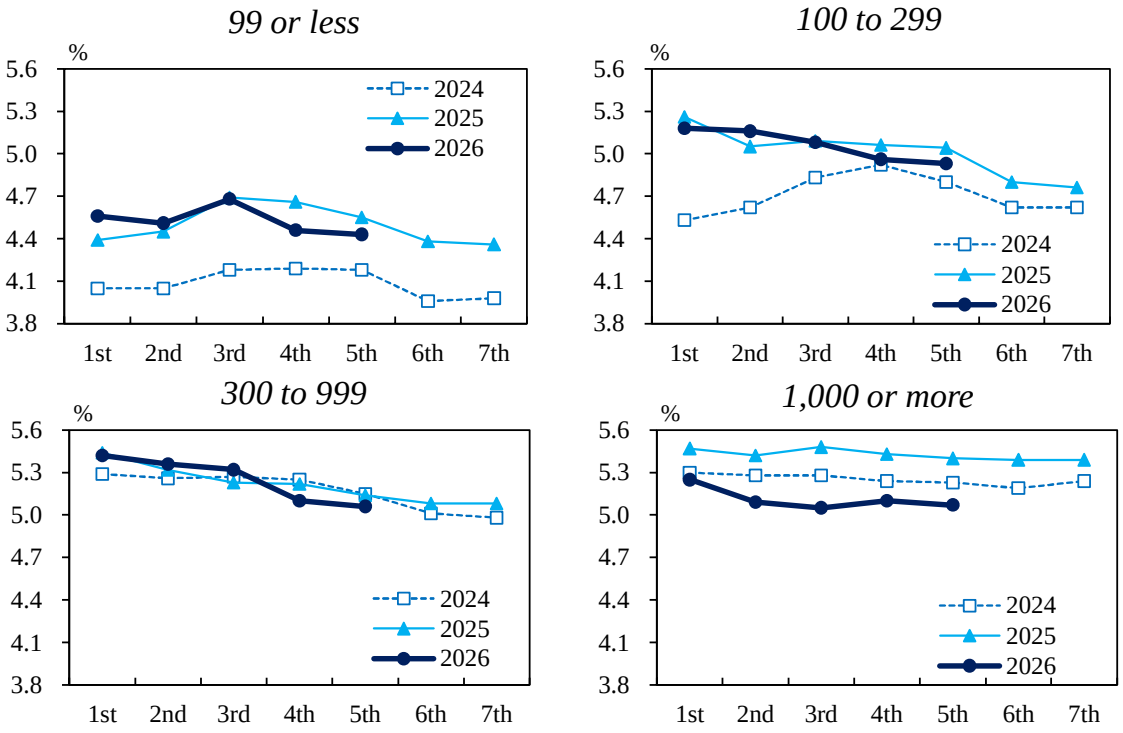


Notes: 1. In the left panel, figures are based on the *Financial Statements Statistics of Corporations by Industry, Quarterly* and exclude "finance and insurance" and "pure holding companies."
2. In the right panel, figures are based on the *Tankan* and are for all enterprises.
3. In both panels, shaded areas denote recession periods.

Sources: Ministry of Finance; Bank of Japan.

Chart 6

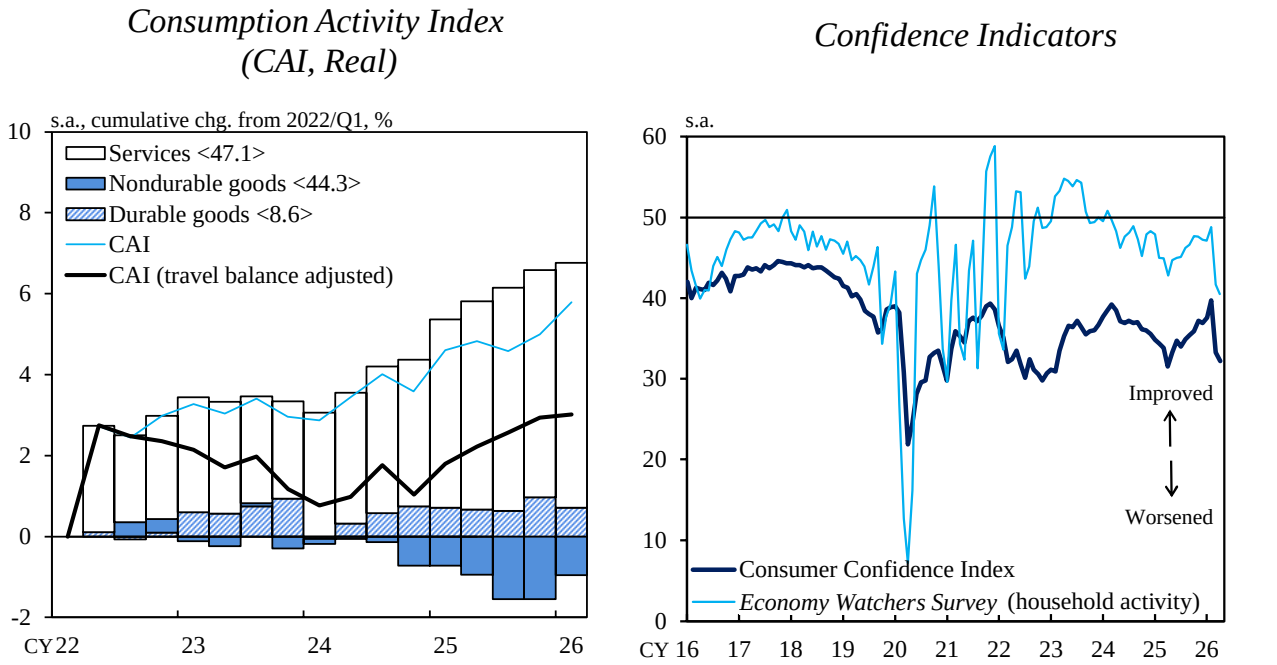
Japan's Annual Spring Wage Negotiations



Note: Figures are average wage increase rates including regular pay rises, at each round of Rengo's aggregation from "1st" through "7th." The numbers at the top of each panel are the number of union members.
Source: Japanese Trade Union Confederation (Rengo).

Chart 7

Household Spending

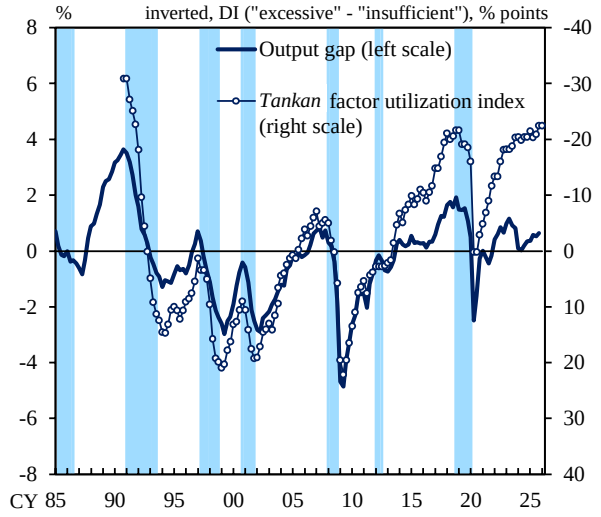


Notes: 1. In the left panel, figures are based on Bank staff calculations. Figures for the CAI (travel balance adjusted) exclude inbound tourism consumption and include outbound tourism consumption. Nondurable goods include goods classified as semi-durable goods in the SNA. Figures in angular brackets show the weights in the CAI. Figures for 2026/Q1 are January-February averages.
2. In the right panel, figures for the *Economy Watchers Survey* are those for the current economic conditions DI.
Sources: Cabinet Office; Bank of Japan; etc.

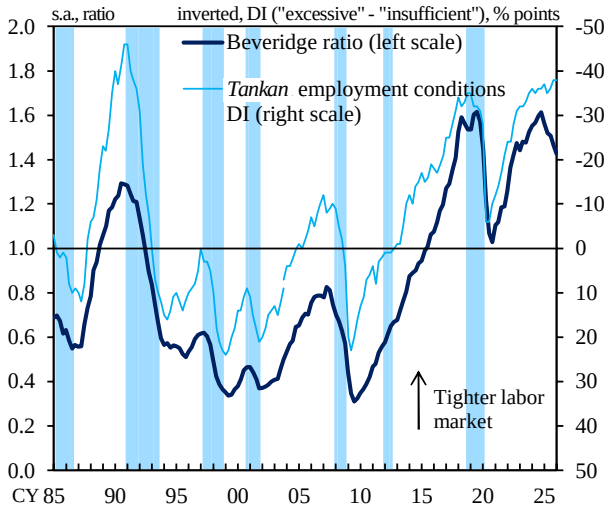
Chart 8

Indicators of Supply and Demand Conditions

Output Gap



Measures of Labor Market Conditions



Notes: 1. In the left panel, figures for the output gap are Bank staff estimates. 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.

2. In the right panel, 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. 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.

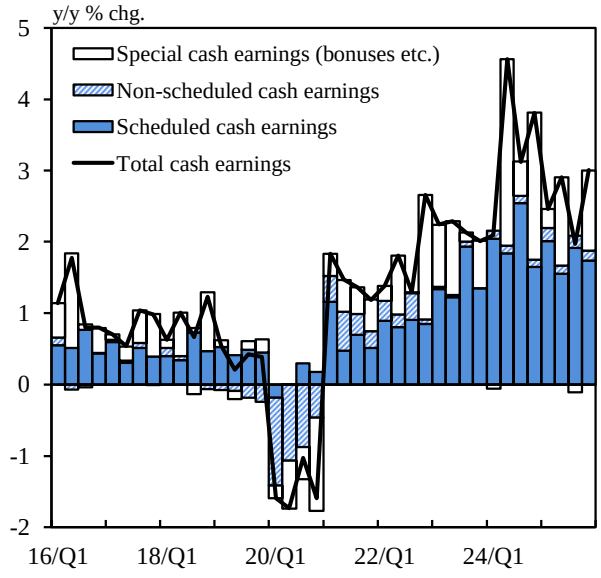
3. In both panels, shaded areas denote recession periods.

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

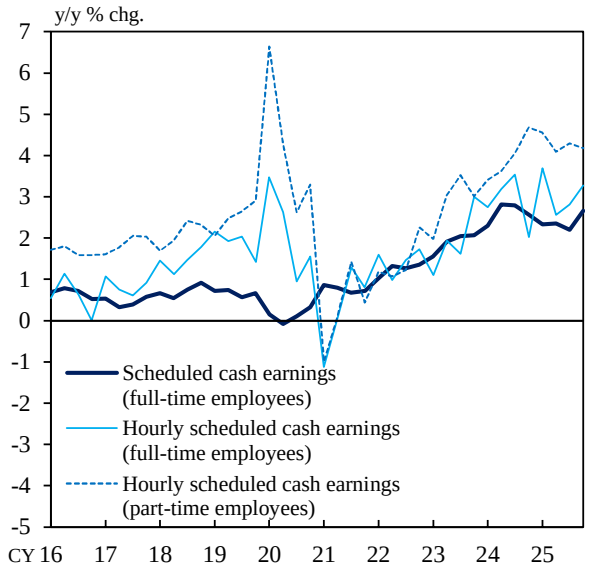
Chart 9

Wages

Nominal Wages



Scheduled Cash Earnings



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.

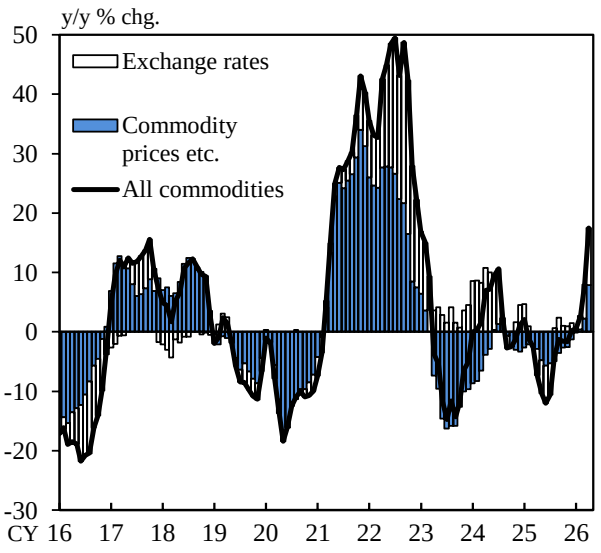
3. In the right panel, figures for hourly scheduled cash earnings (full-time employees) are seasonally adjusted.

Source: Ministry of Health, Labour and Welfare.

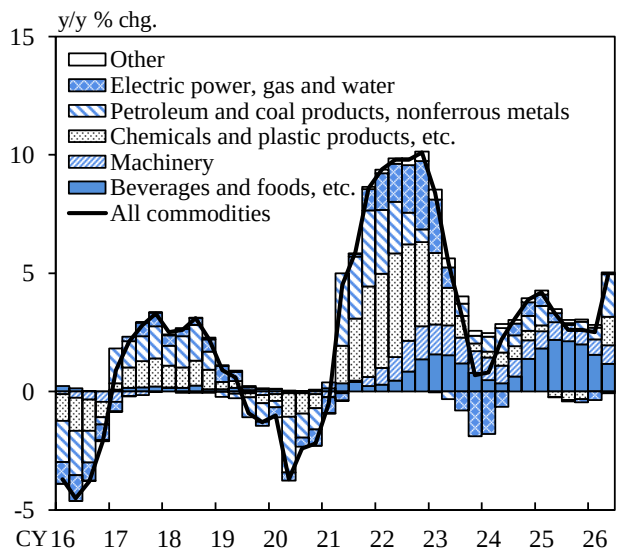
Chart 10

Environment Surrounding Prices

Import Prices (Yen Basis)



Producer Price Index



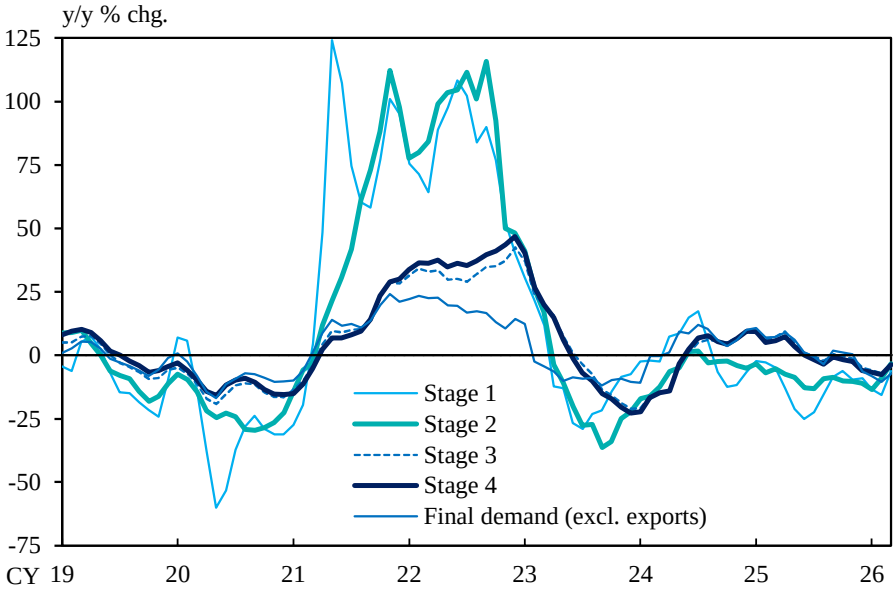
Notes: 1. In the left panel, the contribution of changes in commodity prices etc. is calculated using changes in the import price index on a contract currency basis. The contribution of changes in exchange rates is calculated using the difference between the import price index on a yen basis and that on a contract currency basis.
2. In the right panel, figures exclude the effects of the consumption tax rate change. Figures for "beverages and foods, etc." include agriculture, forestry and fishery products. Figures for 2026/Q2 are those for April.

Source: Bank of Japan.

Chart 11

Price Pass-Through (1)

FD-ID (Energy)

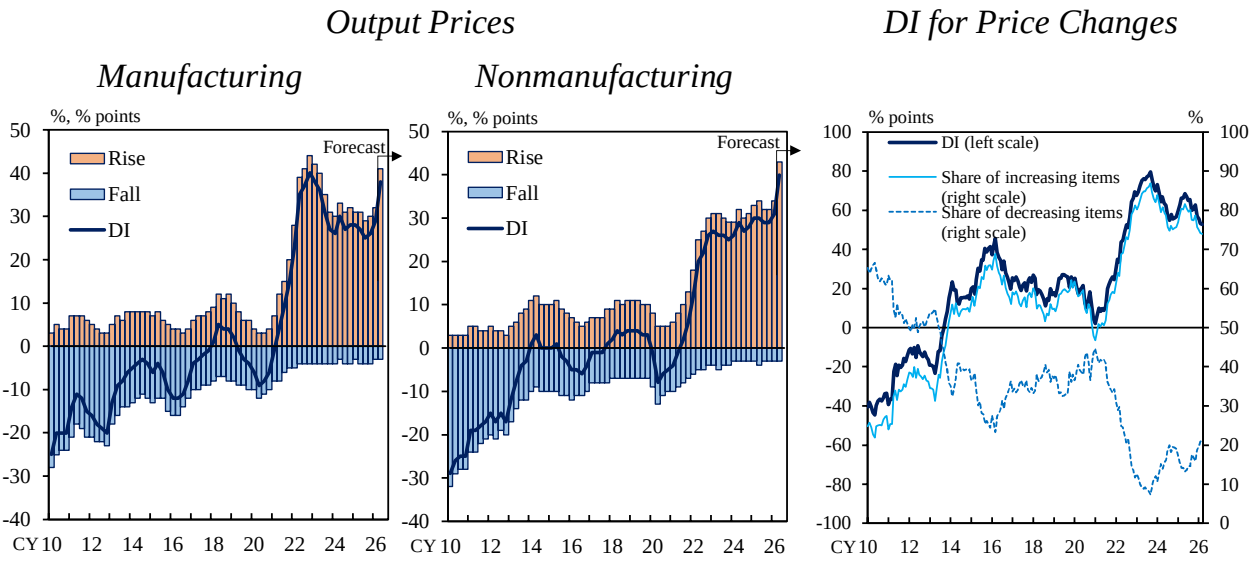


Note: The FD-ID indices are price indices that reorganize and aggregate producer prices of goods and services by classifying them from upstream to downstream stages of the economy-wide production flow. Figures show the year-on-year rate of change in the price index of energy goods at each demand stage. Stages 1 to 4 represent the four stages of intermediate demand, from upstream to downstream.

Source: Bank of Japan.

Chart 12

Price Pass-Through (2)



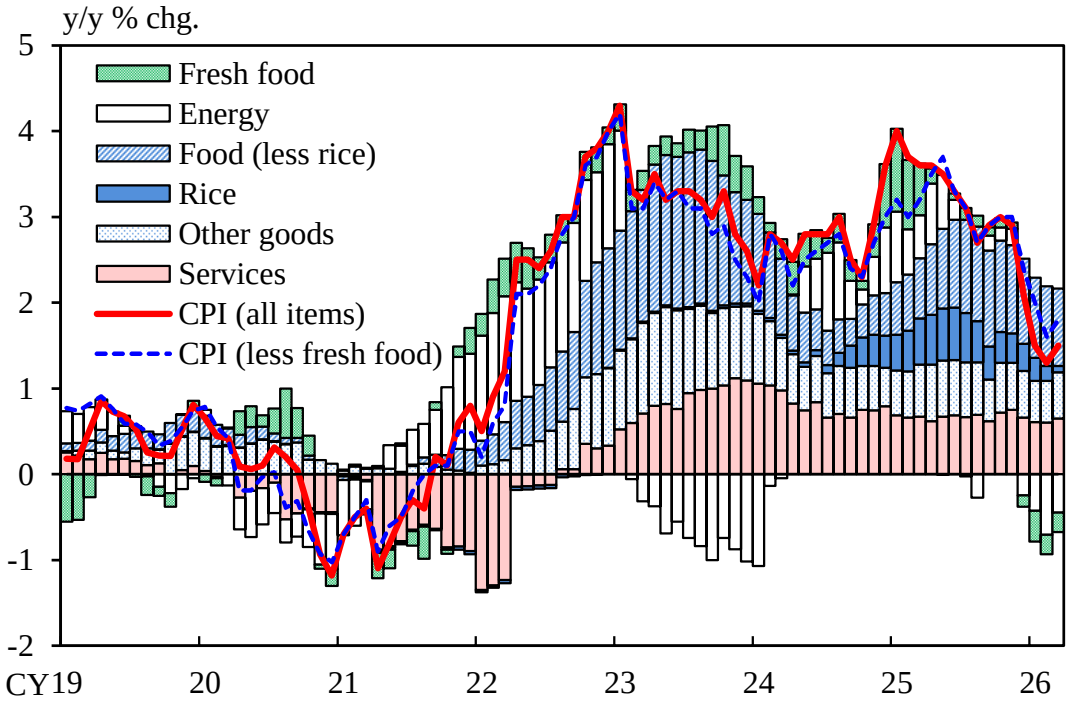
Notes: 1. In the left two panels, figures are based on the *Tankan* and are for all enterprises. The output prices DI is calculated by deducting the percentage of enterprises answering "fall" regarding selling prices of their main products or services from the percentage of those answering "rise."

2. In the right panel, the DI 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. Figures for the DI are based on Bank staff calculations using the CPI (less fresh food). The CPI figures are Bank staff estimates and exclude the effects of the consumption tax rate changes, policies concerning the provision of free education, and travel subsidy programs.

Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

Chart 13

Consumer Price Index (CPI)



Source: Ministry of Internal Affairs and Communications.

Outlook for Economic Activity and Prices (as of April 2026)

Risks regarding the situation in the Middle East

- The situation becoming prolonged, leading to persistently elevated crude oil prices and a deterioration in the terms of trade
- Large-scale disruptions in supply chains, exerting a significant impact on the production activity of Japanese firms

Other risks

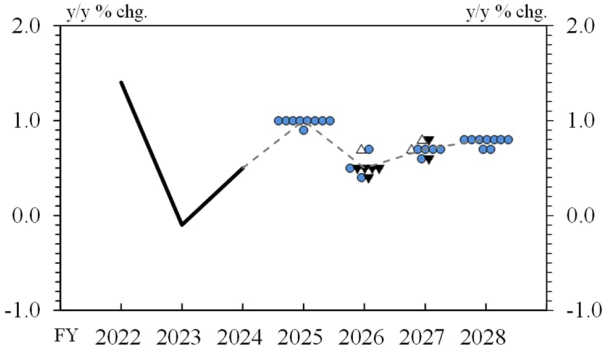
- Developments in overseas economic activity and prices, including AI-related demand
- Future developments in foreign exchange rates and their effects on Japan's economic activity and prices
- Changes affecting firms' and households' expectations and the potential growth rate

Risk balance

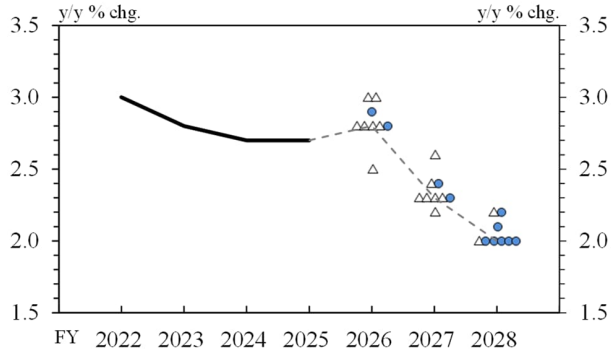
Risks to economic activity are skewed to the downside, and risks to prices are skewed to the upside, particularly for fiscal 2026.

Policy Board Members' Forecasts and Risk Assessments

Real GDP



CPI (All Items Less Fresh Food)

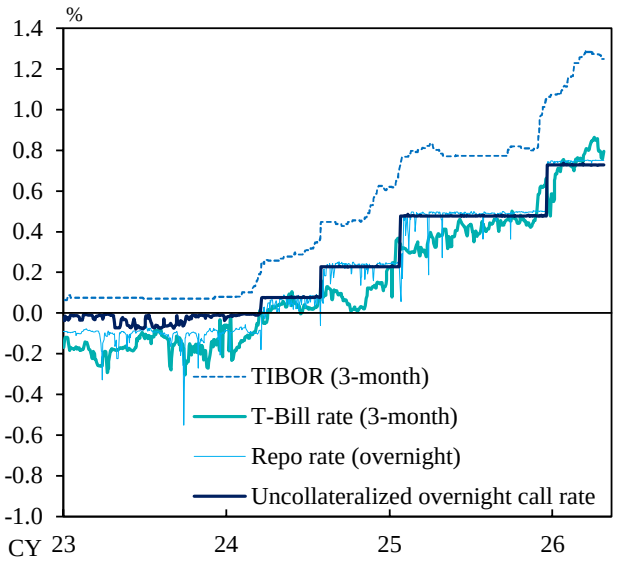


Notes: 1. The solid lines show actual figures, while the dotted lines show the medians of the Policy Board members' forecasts (point estimates).
2. The locations of ●, △, and ▼ in the charts indicate the figures for each Policy Board member's forecasts to which they attach the highest probability. The 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."

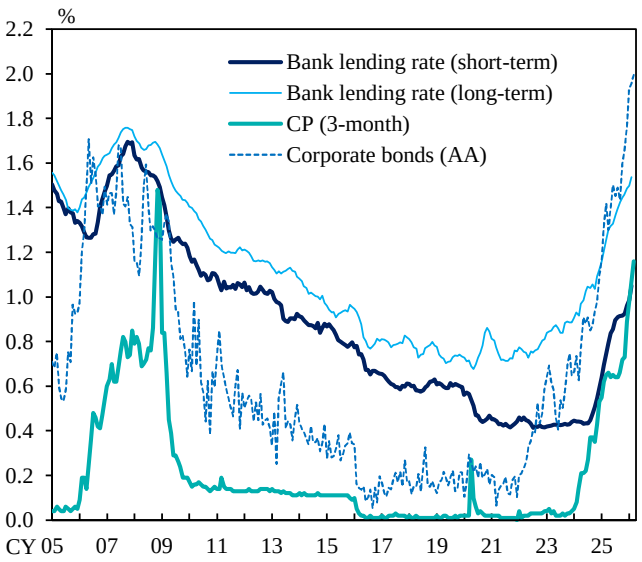
Source: Bank of Japan.

Financial Conditions (1)

Short-term Interest Rates



Bank Lending Rates and Issuance Yields for CP and Corporate Bonds



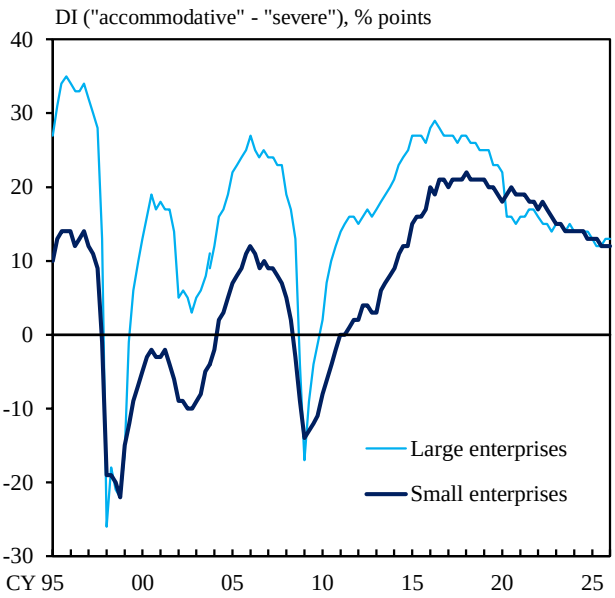
Notes: 1. In the left panel, figures for repo rate are the *Tokyo Repo Rate*.
2. In the right panel, figures for issuance yields for CP up through September 2009 are the averages for CP (3-month, rated a-1 or higher). Those from October 2009 onward are the averages for CP (3-month, rated a-1). Figures 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. Figures for bank lending rates are 6-month backward moving averages.

Sources: Bloomberg; Capital Eye; I-N Information Systems; Japan Securities Depository Center; JBA TIBOR Administration; Bank of Japan.

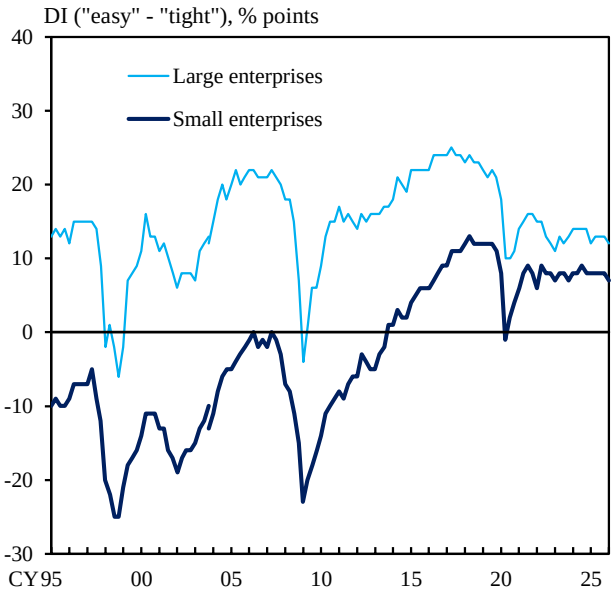
Chart 16

Financial Conditions (2)

Lending Attitudes of Financial Institutions as Perceived by Firms



Firms' Financial Positions

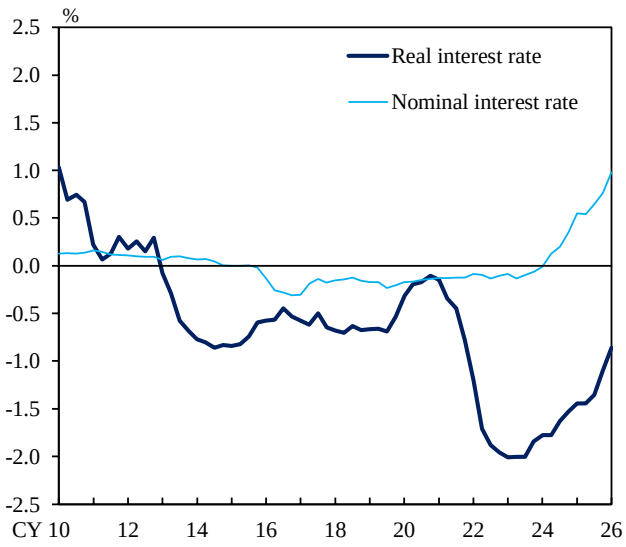


Note: Figures are based on the *Tankan* and are for all industries. There is a discontinuity in the data for December 2003 due to a change in the survey framework.
Source: Bank of Japan.

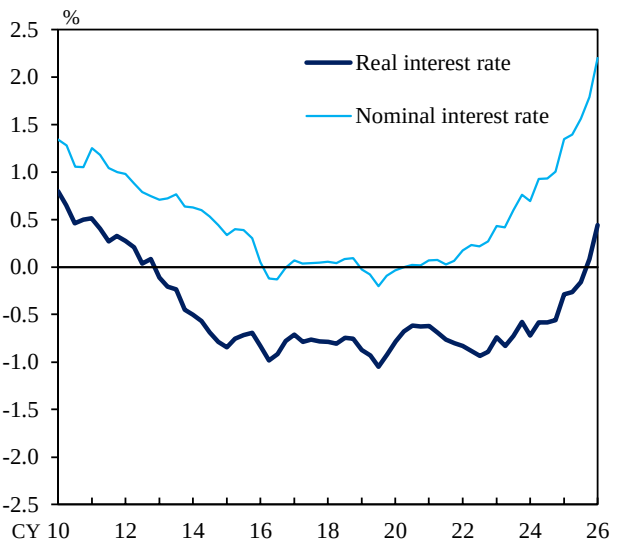
Chart 17

Real Interest Rates by Maturity

1-Year



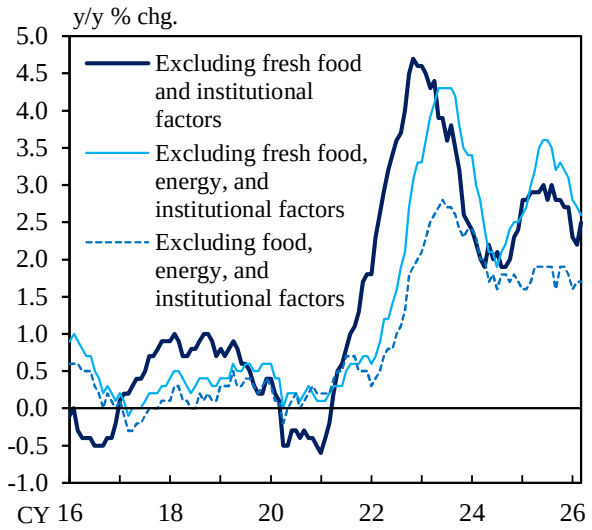
10-Year



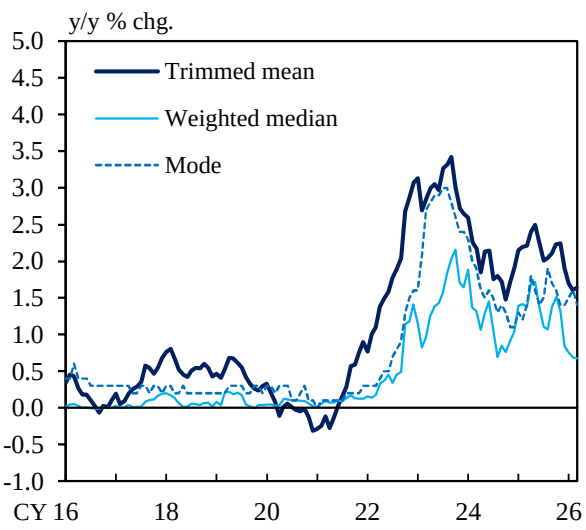
Note: Figures for real interest rates for each maturity are calculated as government bond yields minus the composite index of inflation expectations (Bank staff estimates) for the corresponding maturity.
Sources: Bloomberg; Consensus Economics Inc., *Consensus Forecasts*; QUICK, *QUICK Monthly Market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

Underlying Inflation (1)

CPI Excluding Institutional Factors



Trimmed Mean etc.



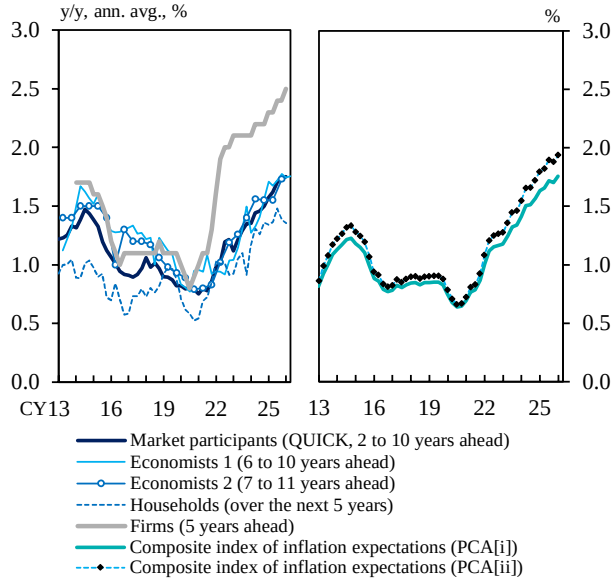
Notes: 1. In the left panel, institutional factors include the effects of the consumption tax rate change, policies concerning the provision of free education, measures to reduce the energy cost burden (such as gasoline prices, electricity charges, and gas charges), the reduction in mobile phone charges in 2021, and travel subsidy programs. Figures are Bank staff estimates.

2. In the right panel, figures are based on Bank staff calculations using the CPI. The CPI figures are Bank staff estimates and exclude the effects of the consumption tax rate change, policies concerning the provision of free education, and travel subsidy programs.

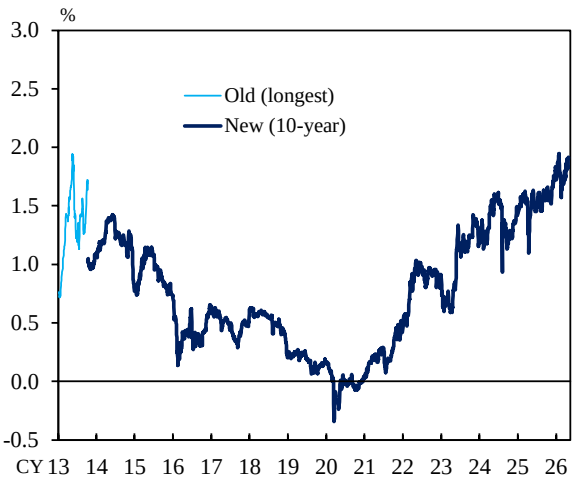
Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

Underlying Inflation (2)

Inflation Expectations (Survey-Based)



BEI



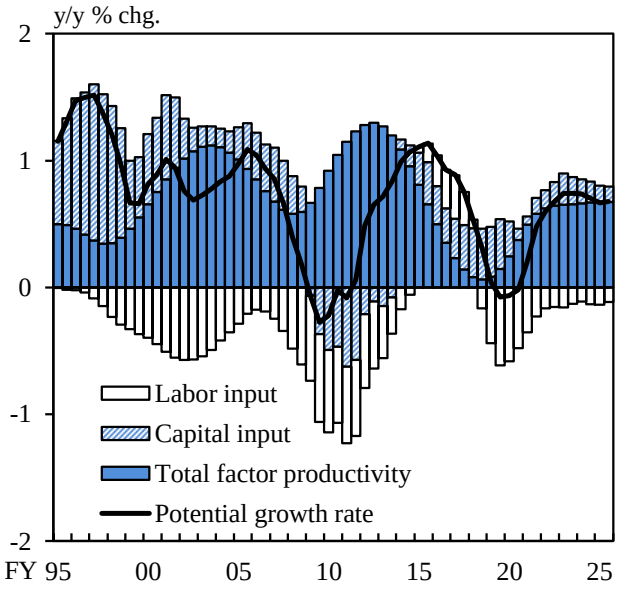
Notes: 1. For details on the left two panels, see Bank of Japan, Monetary Affairs Department, "The Concept and Measurement of Underlying Inflation," *Bank of Japan Review Series*, no. 26-E-5 (March 2026).

2. In the right panel, 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.

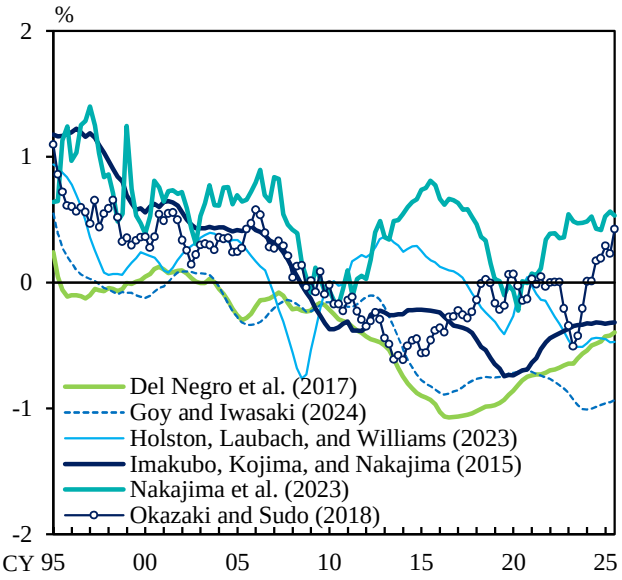
Sources: Bloomberg; Consensus Economics Inc., *Consensus Forecasts*; JCER, *ESP Forecast*; QUICK, *QUICK Monthly Market Survey <Bonds>*; Bank of Japan.

Potential Growth Rate and Natural Rate of Interest

Potential Growth Rate



Natural Rate of Interest



Notes: 1. In the left panel, figures are Bank staff estimates. Figures for the second half of fiscal 2025 are those for 2025/Q4.
2. In the right panel, estimates are based on Bank staff calculations using the models proposed in the different papers listed.

Sources: Bloomberg; Cabinet Office; Consensus Economics Inc., *Consensus Forecasts*; Ministry of Finance; Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications; Bank of Japan.