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April 30, 2004
Bank of Japan

Outlook for Economic Activity and Prices

April 2004

"Outlook and Risk Assessment of the Economy and Prices," "Standard Scenario" and "Risk Assessment" are renamed as "Outlook for Economic Activity and Prices," "Outlook for Fiscal 2004" and "Positive and Negative Deviations" respectively.

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

[The Bank's View][1]

(Outlook for Fiscal 2004)

Japan's economy has continued to recover at a moderate pace since the second half of 2003. The stimulus from exports has contributed to the rise in production and corporate profits. This, in turn, has generated an uptrend in business fixed investment. Household consumption has been somewhat firm. In fiscal 2004, the economy is expected to continue its recovery as momentum increases gradually. Economic activity in general is deviating above the "Standard Scenario" described in the "Outlook and Risk Assessment of the Economy and Prices" (October 2003).

Overseas economies, the U.S. and East Asian economies in particular, are expected to grow relatively fast. As a result, exports and production are likely to increase, and corporate profits will be on an uptrend thanks to cost reductions and the strengthening of the financial position. Although firms continue to cut their interest-bearing debts, the overall pace of debt reduction is likely to ease off. Under these circumstances, business fixed investment is expected to increase mainly in the manufacturing sector. While firms continue to restrain labor costs, the increases in production and corporate profits are expected to exert positive effects gradually on the household sector through changes in employment and income as well as in asset prices. As a result, household consumption is anticipated to recover at a moderate pace.

The year-on-year rate of change in domestic corporate goods prices in fiscal 2004 is likely to be slightly above zero percent, reflecting the increase in commodity prices at home and abroad as well as the improvement in domestic supply and demand conditions. Looking into the background of consumer price developments, the output gap, which affects the underlying trend of prices, is likely to narrow steadily with the economic recovery. However, such factors as the rise in medical costs and rice prices, which contributed to a temporary slowdown of the fall in consumer prices in fiscal 2003, will dissipate, and the impact of the rise in commodity prices on the prices of intermediate and finished products will be largely absorbed by higher productivity. Against such a background, consumer

[1] The Bank's View was determined by the Policy Board at the Monetary Policy Meeting held on April 28, 2004.

prices in fiscal 2004 are projected to be on a slight downtrend on a year-on-year basis.

(Positive and Negative Deviations)

The following factors could make the economy deviate either above or below the "Outlook for Fiscal 2004" (the Outlook).

The first factor is the developments in overseas economies. The economic outlook for the U.S. and Asia, China in particular, could make the global economy deviate either above or below the Outlook. Geopolitical risks as well as the twin deficits of the U.S. and its ramification in financial and foreign exchange markets could adversely affect not only the U.S. economy but also the global economy.

The second factor is the developments in domestic financial and foreign exchange markets. Markets reflect the developments in real economic activity in the medium to long term, but they may fluctuate due to various factors in the short run. The changes in stock prices, long-term interest rates and foreign exchange rates, depending on their extent and direction, could make the economy deviate either above or below the Outlook.

The third factor is the developments in domestic private demand. On one hand, if prospects for growth improve and the confidence in the corporate and household sectors rises, business fixed investment and household consumption could make the economy deviate above the Outlook. In this regard, the current lean level of inventory is considered to set the stage for production to expand quickly as final demand increases. On the other hand, if firms continue to restrain labor costs, the spillover effect of the recovery from the corporate sector to the household sector could delay, which is likely to make the economy deviate below the Outlook.

The fourth factor is the progress in the disposal of nonperforming loans (NPLs) and financial system developments. The outstanding amount of NPLs is declining, particularly at large banks, and the disposal of NPLs is making some progress at regional banks as well. Concerns over the financial system are subsiding partly due to the rise in stock prices, and this is evidenced in the recent reduction in demand for banknotes among the public. While concerns that the financial system problem could adversely affect corporate finance and economic activity are receding, it should be recognized that these concerns would make the economy deviate below the Outlook, if they materialize.

(Overcoming Deflation and Conduct of Monetary Policy)

In order to put Japan's economy on a sustainable growth path and to extricate Japan from deflation, it is a prerequisite that private demand increases and prospects for long-term growth improve. In this regard, the initiatives of the private sector are as important as the efforts of the government and the Bank of Japan. Firms have been striving to increase profitability by redesigning their business strategy, reducing costs, and strengthening their financial position. Banks have been making progress in disposing of their NPLs. The government has been backing the initiatives of the private sector for economic revitalization by accelerating deregulation as well as implementing structural reforms in the areas of finance, tax system, and public expenditures. The Bank of Japan has been pursuing aggressive monetary easing.

With these initiatives, the economy has been gathering momentum. The year-on-year rate of decline in prices has been decelerating, as the output gap narrows steadily. If various economic agents persist in their initiatives and momentum for the recovery builds up further, the output gap will narrow, which leads to a higher possibility of overcoming deflation.

The Bank of Japan has been providing ample liquidity under the quantitative easing policy, and short-term interest rates have been at almost zero percent. Furthermore, the Bank has made a firm commitment to continuing the current policy until the year-on-year rate of change in consumer price index (excluding fresh food, on a nationwide basis) registers zero percent or higher on a sustainable basis.

Such a framework of monetary easing has been giving strong support for economic activity of the private sector through the following channels. First, the provision of ample liquidity contributes to ensuring financial market stability and maintaining the accommodative environment for corporate finance. Second, the expectations about interest rates in the near future will be stable with the above-described commitment, and thus the returns on investment will rise as the economy recovers. The positive effect of this channel will be greater as the recovery accelerates and corporate profits increase.

The Bank of Japan aims at putting Japan's economy on a sustainable growth path and overcoming deflation by firmly maintaining the quantitative easing policy. Moreover, the Bank will continue to back the initiatives of market participants to improve credit markets, including loan trading and securitization markets. This is intended to make the credit intermediation in the market more diversified and efficient, and to strengthen the transmission mechanism of monetary easing.

Forecasts of the Majority of Policy Board Members[2] and Actuals for Fiscal 2003

(y/y % chg.)

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Forecasts made in October 2003	+2.3 to +2.6	–0.9 to –0.5	–0.3 to –0.1
Actual	+2.8	–0.5	–0.2

Notes: 1. The forecasts of the majority of Policy Board members for fiscal 2003 are shown in the *Outlook and Risk Assessment of the Economy and Prices* in October 2003.
2. Actual real GDP is an estimation on the assumption that real GDP in the first quarter of 2004 equals that in the fourth quarter of 2003.
3. Actual CPI is an estimation on the assumption that the year-on-year change in the CPI in March equals that in February (0.0%).

Forecasts of the Majority of Policy Board Members[2] for Fiscal 2004

(y/y % chg.)

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2004	+3.0 to +3.2 [+3.1] (+2.3 to +2.6 [+2.5])	+0.1 to +0.3 [+0.2] (–0.8 to –0.4 [–0.6])	–0.2 to –0.1 [–0.2] (–0.5 to –0.2 [–0.3])

Notes: 1. Brackets indicate the median of the forecasts.
2. Parentheses indicate forecasts made in October 2003.
3. The forecasts of Policy Board members are based on the assumption that there will be no change in monetary policy.

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2 Forecasts of the majority of Policy Board members are shown as a range, with the highest and lowest figures excluded. The forecasts of all Policy Board members are as follows.

(y/y % chg.)

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2004	+2.9 to +3.5 (+2.0 to +2.8)	+0.1 to +0.5 (–0.9 to 0.0)	–0.2 to +0.5 (–0.5 to +0.5)

Note: Parentheses indicate forecasts made in October 2003.

[The Background]

1. Economic Activity, Prices, and Financial Developments

(Economic Activity and Prices in Fiscal 2003)

In fiscal 2003, overall activity remained flat in the first half of the year. As domestic demand gathered strength, the economy began to recover gradually in the second half of the year. Against the background of accelerating growth in the U.S. and East Asian economies, exports and production were again on a clear uptrend from last summer, and business fixed investment, particularly in the manufacturing sector, continued to recover (Charts 1-3). Although the spillover effect of income from the corporate to the household sector was limited, household consumption was somewhat firm, as the decline in household income was gradually coming to a halt and consumer sentiment was improving. Under such circumstances, business sentiment improved mainly in large manufacturers with some spillover effects to non-manufacturers as well as small- to medium-sized firms (Chart 4). Housing investment remained sluggish as a whole, despite some improvements in housing for rent and for sale toward the financial year-end. Public investment declined.

The year-on-year rates of change in both domestic corporate goods prices and consumer prices (excluding fresh food, on a nationwide basis) came close to zero percent (Chart 5). They were fundamentally driven by the gradual improvement in supply and demand conditions. Temporary factors also played a role in exerting upward pressures on prices.[3] Furthermore, a sharp increase in commodity prices at home and abroad, triggered by the expansion of global demand, China in particular, contributed to the deceleration of the rate of decline in domestic corporate goods prices.

The “Outlook and Risk Assessment of the Economy and Prices” in October 2003 illustrated the standard scenario, in which assuming overseas economies to grow relatively fast, Japan’s economy would gain momentum as exports and production increased in the second half of fiscal 2003. Compared with this scenario, overall economic activity deviated above it, due to the stronger than expected increase in exports with higher growth of overseas economies as well as to some firming of household consumption. Domestic corporate

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[3] Temporary factors herein include the increase in medical costs (April 2003), the increase

goods prices deviated above the scenario due to the greater than expected rise in commodity prices both at home and abroad, whereas consumer prices were more or less in line with the scenario.

(Outlook for Fiscal 2004)

In fiscal 2004, the economy is expected to continue its recovery, gradually gathering momentum with the increases in production and corporate profits.

Public investment will be on a downtrend under the severe budget condition. Overseas economies, the U.S. and East Asian economies in particular, are expected to grow at a relatively rapid pace. Against such a background, exports and production will continue to increase, and corporate profits will also rise (Chart 6). In the meantime, although firms continue to cut their interest-bearing debts, the overall pace of debt reduction is likely to ease off. Given these conditions, business fixed investment is expected to continue increasing mainly in the manufacturing sector. While firms continue to restrain labor costs, the increases in production and corporate profits are expected to exert positive effects gradually on the household sector through changes in employment and income as well as in asset prices. As a result, household consumption is anticipated to recover at a moderate pace. Although the pace of economic recovery is not expected to accelerate, Japan's economy is likely to gather momentum steadily and to approach a phase of sustainable recovery, as the spillover effects of recovery spread widely.

(Outlook for Prices)

The output gap in the domestic economy, which affects the underlying trend of prices, is expected to narrow steadily, as the economy recovers.[4] However, in view of the relatively

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in tobacco tax (July 2003), and the rise in rice prices since last autumn.

[4] As was described in the "Outlook and Risk Assessment of the Economy and Prices" in October of last year, the GDP deflator (the Paasche index) tends to decline at a faster pace than other price indexes (the Laspeyres index). This is partly because the Paasche index, unlike the Laspeyres index, reflects changes in product weighting, and heavy weighting tends to be given to the products that experience significant price declines and improvements in quality, and also because the discrepancy between the Paasche index and the Laspeyres index widens as the year to calculate the index moves away from the base year. If the recent GDP deflator is calculated lower than otherwise due to the changes in relative prices and weighting of the products as the year to calculate the deflator moves

large output gap[5] (Chart 7), the reduction of the output gap will be rather marginal. It is thus expected that small downward pressures on prices persist during fiscal 2004.

The rise in commodity prices at home and abroad is likely to exert upward pressures on prices of raw materials and intermediate products. However, as the rise in commodity prices such as oil has been cushioned by the appreciation of the yen since last autumn, the rise in overall import prices has been largely contained. Unit labor costs (labor costs per output) are expected to continue declining for the time being as firms restrain labor costs amid the increase in production. Taking account of these factors, overall upward pressures on finished goods prices and services prices are expected to be rather limited (Chart 8).

In sum, the year-on-year rate of change in domestic corporate goods prices is likely to be slightly above zero percent in fiscal 2004. Consumer prices in fiscal 2004 are projected to be on a slight downtrend on a year-on-year basis because upward pressures, which affected prices temporarily in fiscal 2003, dissipate in fiscal 2004.

(Financial Developments)

The Bank of Japan continues to provide ample liquidity, and accommodative monetary conditions are likely to persist.

Credit demand in the corporate sector is unlikely for the time being to show a clear turnaround to an increase, though the rate of decline in demand is slowing down. Business fixed investment, which is expected to be on an uptrend, will be made within cash flow, and firms are expected to continue cutting their interest-bearing debts (Chart 9). Banks will continue easing somewhat their lending attitude, though they are likely to remain cautious in making loans to borrowers with low credit ratings. Bank lending is likely to decline, albeit at a milder pace. The expansion of economic activity will contribute to higher growth of the money stock (M2+CD). Nevertheless, a marked rise in the money stock

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away from the base year (1995), the calculated value of real GDP growth could be higher to that extent. Given this possibility, the growth rate of real GDP needs to be at least around 2% in order to narrow the output gap.

[5] The output gap varies, depending on the way it is calculated and measurement errors involved (See, "The Output Gap and the Potential Growth Rate," Quarterly Bulletin of the Bank of Japan, May 2003). Still, the current output gap is considered to be relatively wide.

growth is rather unlikely because bank lending in general is expected to continue declining, and the pace of increase in investment in highly liquid assets, such as deposits, is decelerating (Chart 10).

2. Positive and Negative Deviations

(Developments in Overseas Economies)

In the Outlook, overseas economies, the U.S. and East Asian economies in particular, are expected to grow at a relatively rapid pace.

The recovery of the U.S. economy has been well-balanced. Consumer outlays have been on a gradual uptrend, and business outlays have been expanding steadily, sustained by the increase in production in the manufacturing sector and higher corporate profits. The labor market has been improving gradually. East Asian economies have been growing relatively fast against the backdrop of strong global demand for IT-related goods and a brisk expansion of domestic demand in China. If the improvement in the U.S. labor market and the rise in China's investment demand accelerate, momentum for global economic expansion will likely increase further. Demand for IT-related goods has come to exert a large impact on the global economy, including the U.S. and East Asian economies, with the progress of internationally-linked production process for IT-related goods. Close monitoring is needed in the developments of such demand in addition to demand for raw materials, as they could make the economy deviate either above or below the Outlook.

In China, it is still uncertain whether the macroeconomic policy response to the overheating of the domestic economy, mainly in business fixed investment, will be successful to put the economy on a sustainable growth path. While there is a possibility that the Chinese economy could deviate above the Outlook in the short run, there is a possibility of adjustment in the long run. In Europe where buoyant forces are yet to materialize due to the recent appreciation of the euro and uncertainties over structural adjustments, such as the pension reform, there remains a possibility that the European economies could deviate below the Outlook.

If geopolitical risks, notably in the Middle East, and the twin deficits in the U.S. create large fluctuations in financial and foreign exchange markets, these fluctuations could cause aberrations in global capital flows, including those in and out of the emerging markets, and exert negative impacts on not only the U.S. economy but also the global economy. Oil prices, if they rise further, could make the global economy deviate below the Outlook.

(Developments in Financial and Foreign Exchange Markets)

Markets reflect the developments in real economic activity in the medium to long term, but they may fluctuate due to various factors in the short run. The changes in stock prices, long-term interest rates and foreign exchange rates, depending on their extent and direction, could make the economy deviate either above or below the Outlook.

Stock prices continue to rise at a solid pace with the improved prospects for Japan's economic recovery. Large fluctuations in stock prices could affect the spending behaviors of firms and households through changes in their sentiment as well as changes in corporate balance sheets and profits. They could affect the lending attitude of banks through changes in the value of their shareholdings.

Long-term interest rates rose during last summer, and came down thereafter. Since then, they have been at around the mid-1% level. The level of outstanding government bonds in Japan is the highest among industrialized countries, and banks hold a large amount of these government bonds. Volatility in long-term interest rates could adversely affect the profitability and capital adequacy of banks as well as real economic activity through changes in the firms' funding costs. The net impact of such volatility needs to be evaluated with the contemporaneous movement of stock prices.

In the foreign exchange market, the yen has risen since last autumn. Developments of foreign exchange rates could affect the economy as a whole through changes in exports and imports as well as corporate profits.

(Developments in Domestic Private Demand)

In the Outlook, the recovery of business fixed investment in the non-manufacturing sector is expected to be weaker than that in the manufacturing sector, due to such constraints as the reduction in interest-bearing debts. Household consumption is expected to recover at a moderate pace, as firms continue to restrain labor costs and the spillover effect of the increase in production and corporate profits on the household sector appears gradual. If prospects for growth improve further with the economic recovery and the confidence in the corporate and household sectors rises, not only household consumption but also business fixed investment could increase. Because the current lean level of inventory is considered to set the stage for production to expand quickly as final demand increases, the movement of inventory could make the economy deviate above the Outlook. On the contrary, if firms continue to restrain labor costs persistently, the spillover effect from the corporate sector to the household sector and the recovery in household consumption could delay.

(Disposal of Nonperforming Loans and Financial System Developments)

Banks, particularly large banks, have been strengthening the soundness, though Japan's financial system is facing not a few problems to overcome (Chart 11). At large banks, the outstanding amount of NPLs has been declining; the provisioning has been increasing; and the capital adequacy ratio has been improving. At regional banks, the outstanding amount of NPLs has been declining as well. In the meantime, credit costs have been decreasing with the improvement in business conditions (Chart 12). Concerns over the financial system have been subsiding partly due to the rise in stock prices. In light of these developments, the Outlook assumes that accommodative conditions in corporate funding will be maintained.

While concerns that the financial system problem could adversely affect corporate finance and economic activity are receding, it should be recognized that these concerns would make the economy deviate below the Outlook, if they materialize. The full removal of blanket deposit insurance is scheduled in April 2005, and its impact on financial markets and real economic activity warrants monitoring.

3. Evaluation of Financial Environment and Conduct of Monetary Policy

Since the adoption of quantitative easing in March 2001, the Bank of Japan has been raising the target balance of current accounts, taking due account of the changes in economic and financial conditions. It is now set at around 30-35 trillion yen (Chart 13, Upper panel).

Under the ample liquidity provision by the Bank, short-term interest rates, including term rates, have been moving at around zero (Chart 13, Lower panel). In March 2004, a fiscal year-end phenomenon, a temporary spike in interest rates, had not been observed for the first time during the last several years.

Short-term interest rate futures have been generally stable at low levels, while they picked up somewhat from the mid year to the autumn of 2003 (Chart 14).

The rates on 10-year government bonds declined to 0.4% in June 2003. Since then, they have been rising somewhat with improved business sentiment and the rise in the U.S. long-term interest rates, and recently they are at the level between 1.3% and 1.5%. Though their volatility rose sharply during the summer of 2003, it came down gradually toward the end of 2003. It has been at low levels since the beginning of 2004 (Chart 15).

The credit spread between treasury bills (TBs) and commercial paper (CP) has generally been at low levels under quantitative easing (Chart 16, Upper panel). The credit spread between government bonds and corporate bonds with high credit ratings increased somewhat from the mid year to the autumn of 2003 along with the rise in long-term interest rates. Since then, it has returned to low levels. The credit spread between government bonds and corporate bonds with low credit ratings has been narrowing down (Chart 16, Lower panel).

The overall condition in corporate finance has become more accommodative, though firms with low credit ratings still face difficulties. The funding environment for firms in bond and CP markets, particularly for firms with high credit ratings, has been generally favorable, with the issuance spread remaining stable at low levels. Banks are expected to continue easing somewhat their lending attitude, though they are likely to remain cautious in making loans to borrowers with low credit ratings. The lending attitude of banks perceived by firms and the funding condition of firms have been improving (Chart 17). Average lending rates remain at low levels. Credit demand remains lackluster, but the pace of its decline has become somewhat moderate, because corporate activity has started to recover as seen in the increase in business fixed investment.

Bank lending has been declining by 2-3 percent year on year, although the rate of its decline has been slowing down marginally since last autumn. The total outstanding of CP and corporate bond issuance has been exceeding that of last year (Chart 18).

The monetary base (the sum of currency in circulation and current account balances held at the Bank of Japan) has been rising in relation to nominal GDP, and its outstanding balance is extremely high. Its rate of growth has been around 10 percent due to the declining growth of banknotes in circulation, which make up almost 70% of the monetary base (Chart 19). The declining growth rate of banknotes in circulation mainly reflects the fact that additional demand for banknotes resulting from extremely low short-term interest rates, opportunity costs of holding cash, has become marginal, and the fact that concerns over the financial system have subsided significantly.[6] The year-on-year growth rate of the money stock has been around 1-2 percent, as firms continue to cut interest-bearing debts and bank lending continues to decline. The ratio of the money stock to nominal GDP, nevertheless, remains at high levels (Chart 21).

Stock prices have been rising substantially since around the mid-2003, reflecting improved prospects for Japan's economy and continued aggressive equity investment from abroad (Chart 22). Equity finance by firms has been firm.

Since last autumn, the yen exchange rate has appreciated, with some volatility, against the backdrop of concerns over the U.S. twin deficits and the elevated vigilance against foreign exchange market intervention (Chart 23).

Real estate prices generally continue a downtrend, though the decline has come to a halt in some part of the Tokyo metropolitan area (Chart 24).

Since the adoption of quantitative easing in March 2001, the Bank of Japan has continued to provide ample liquidity, and as a result, short-term interest rates have been at around zero percent. The Bank has made a commitment to continuing the quantitative easing policy until the year-on-year change of consumer price index (excluding fresh food, on a nationwide basis) registers zero percent or higher on a sustainable basis, and clarified this commitment in October 2003.

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[6] Demand for banknotes increases with income. Short-term interest rates are the largest factor to influence the ratio of banknote outstanding to nominal GDP. Concerns over the financial system also affect this ratio significantly. Banknotes had been growing fast due to the precautionary demand regarding concerns over financial system stability in 1997 through 1998, the Y2K problem, and the partial lifting of deposit payoffs. Recently, the growth rate of banknotes has been slowing down as concerns over financial system stability have subsided. Daily fluctuations of banknote outstanding have become smaller since the outstanding is high under low interest rates. The issuance of banknotes does not increase as it used to in such periods as the year-end and financial year-end where demand for

Such a framework of monetary easing has been giving steady support for economic activity of the private sector through the following channels. First, the provision of ample liquidity contributes to ensuring financial market stability and maintaining the accommodative environment for corporate finance by dispelling liquidity concerns. Second, the expectations about interest rates in the near future will be stable with the above-described commitment, and thus the returns on investment will rise as the economy recovers. The positive effect of this channel will be greater as the recovery accelerates and corporate profits increase (Chart 25).

The Bank of Japan has been backing the initiatives of market participants to improve credit markets, including loan trading and securitization markets, with the aim to make the credit intermediation in the market more diversified and efficient. For example, the Bank has relaxed the terms and conditions for the outright purchase of asset-backed securities, and accepted syndicated loans arranged in the form of loans on deeds as eligible collateral.

4. Returning to a Sustainable Recovery Path and Overcoming Deflation

In order to put Japan's economy on a sustainable growth path and to extricate Japan from deflation, it is a prerequisite that private demand increases and prospects for growth improve. In this regard, the initiatives of the private sector are as important as the efforts of the government and the Bank of Japan.

Firms have been striving to improve their management by redesigning their business strategy, reducing costs, strengthening their financial position, and pursuing efficient relocation of production. As a result, in the manufacturing sector, the outstanding debts and the share of labor in income distribution have come down as low as those recorded before the period of the bubble economy, and corporate profits remain at high levels. In the non-manufacturing sector, the outstanding debts have been declining and corporate profits have been recovering (Chart 9 and Chart 26). Banks have been making progress in disposing of their NPLs. The government has been pursuing deregulation and implementing structural reforms in the areas of finance, tax system, and public expenditures under the "Basic Policies for Economic and Fiscal Management and Structural Reform 2003." The Bank of Japan has been pursuing aggressive monetary easing with the clear

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banknotes increases substantially (Chart 20).

and concrete commitment based on the consumer price index (excluding fresh food, on a nationwide basis).

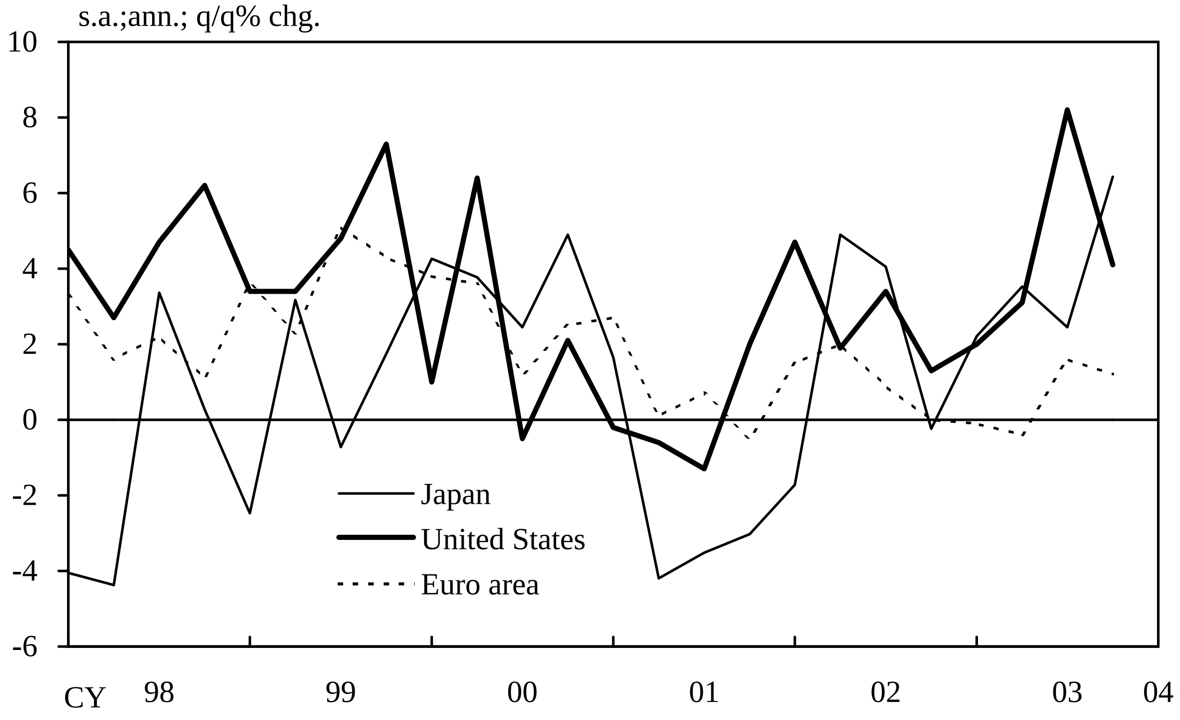
With these initiatives, the economy has been gathering momentum. The year-on-year rate of decline in prices has been decelerating as the output gap narrows steadily. Deflationary expectations have been subsiding (Chart 27).

If various economic agents persist in their initiatives and momentum for the recovery builds up further, the output gap will narrow, which leads to a higher possibility of overcoming deflation.

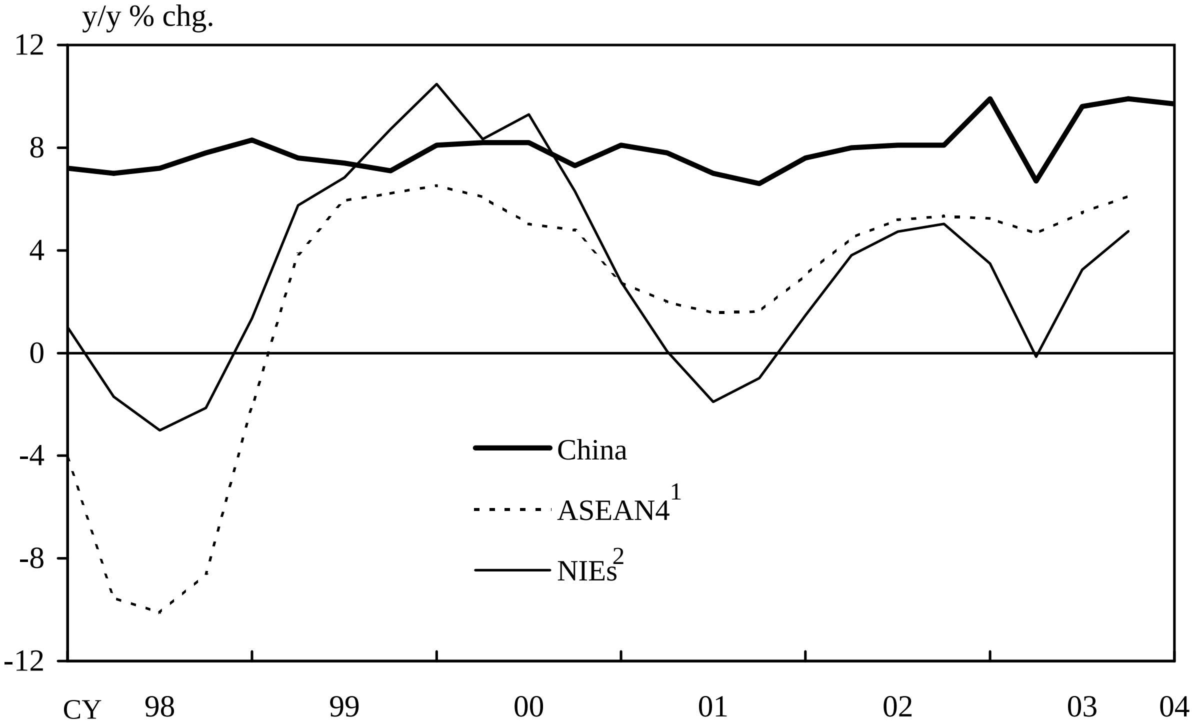
The Bank of Japan aims at putting Japan's economy on a sustainable growth path and overcoming deflation by firmly maintaining the quantitative easing policy. Moreover, the Bank will continue to back the initiatives of market participants to improve credit markets, including loan trading and securitization markets, to make the credit intermediation in the market more diversified and efficient, and to strengthen the transmission mechanism of monetary easing.

Real GDP Growth Rates in Overseas Economies

(1) Real GDP Growth Rates in Advanced Economies



(2) Real GDP Growth Rates in East Asian Economies

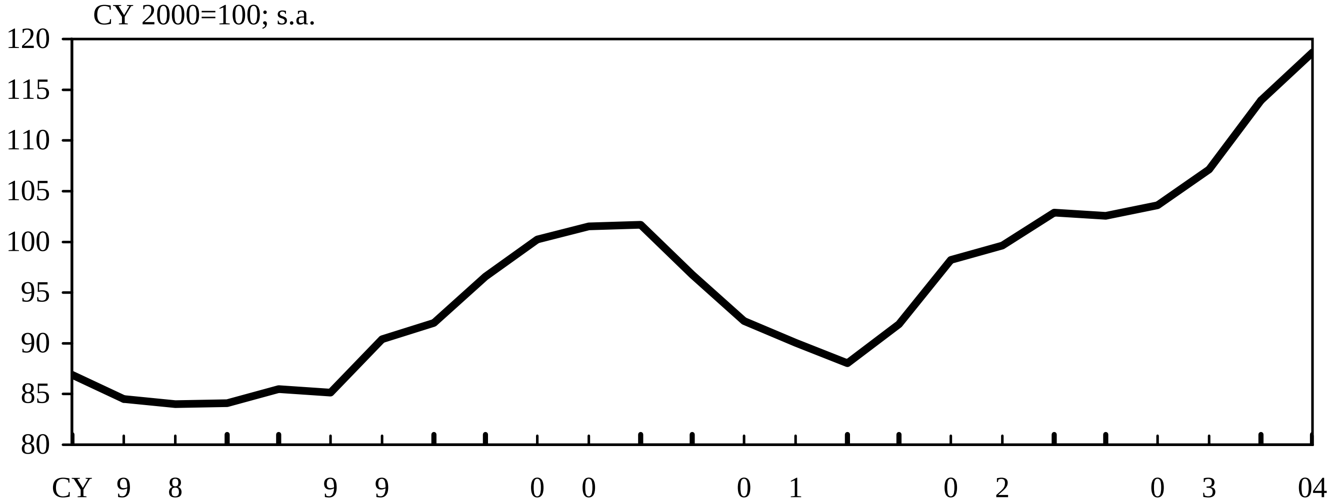


Notes: 1. Data for four members: Thailand, Malaysia, the Philippines, and Indonesia.
2. Data for NIEs: South Korea, Taiwan, Hong Kong, and Singapore.

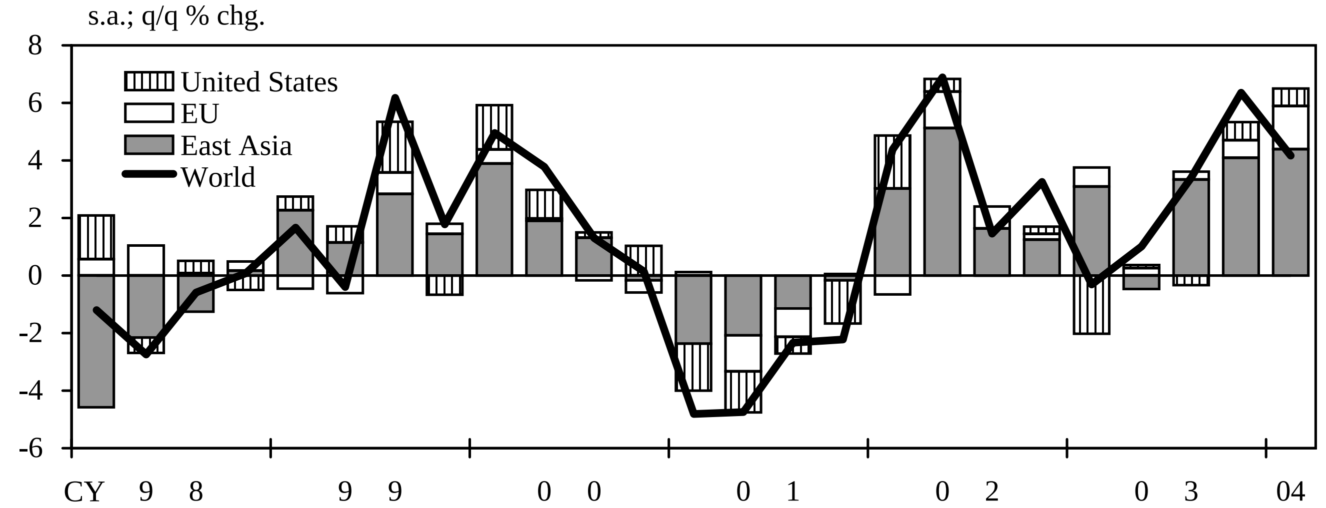
Sources: National governments; central banks; European Commission.

Exports and Production

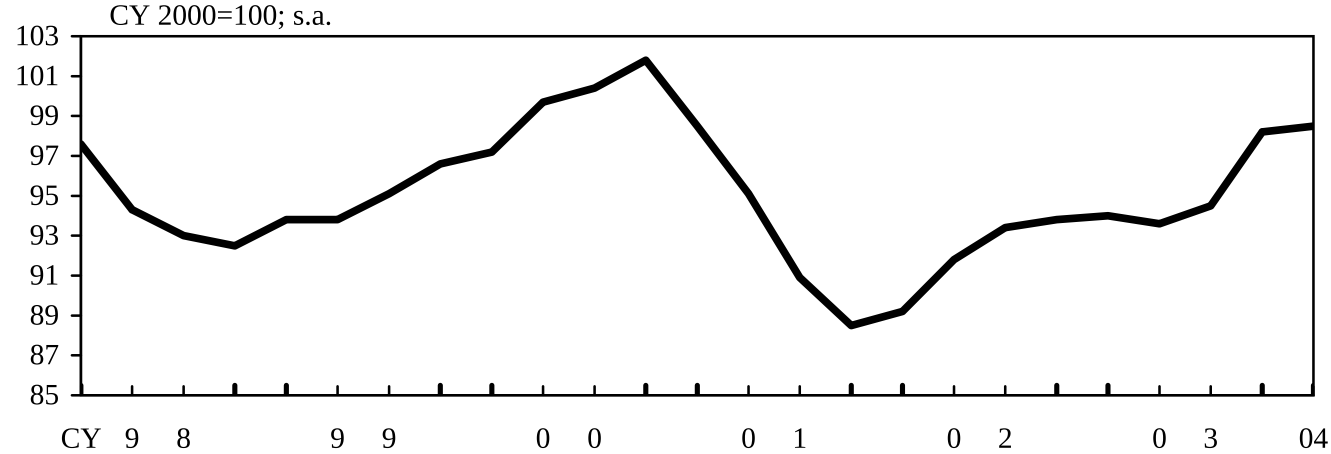
(1) Real Exports



(2) Real Exports (Breakdown by Region)



(3) Production



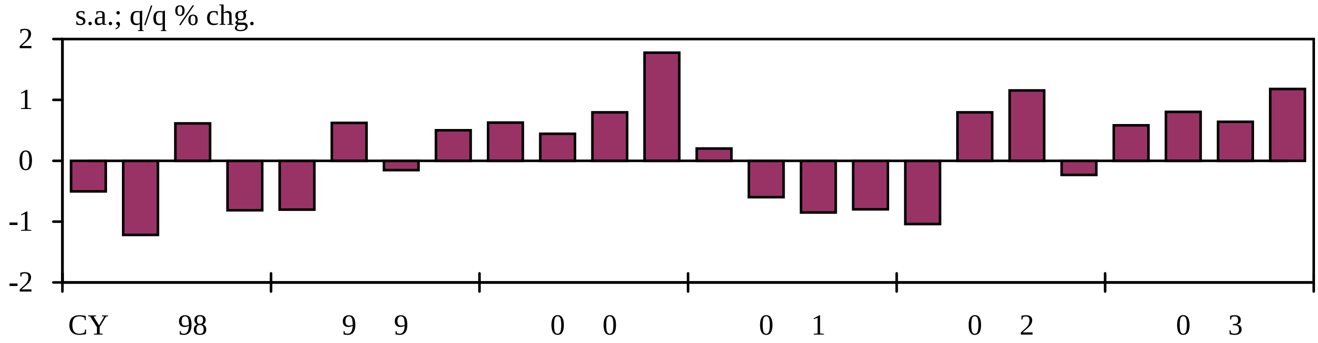
Sources: Ministry of Finance, "The Summary Report on Trade of Japan";
Bank of Japan, "Corporate Goods Price Index";
Ministry of Economy, Trade and Industry, "Indices of Industrial Production."

Real GDP

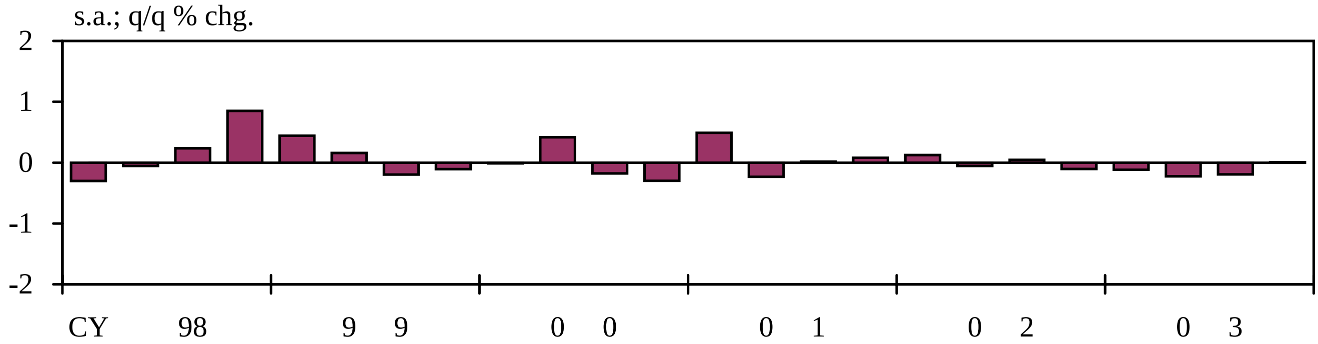
(1) Changes from the Previous Quarter

(2) Each Component's Contribution to Changes in Real GDP

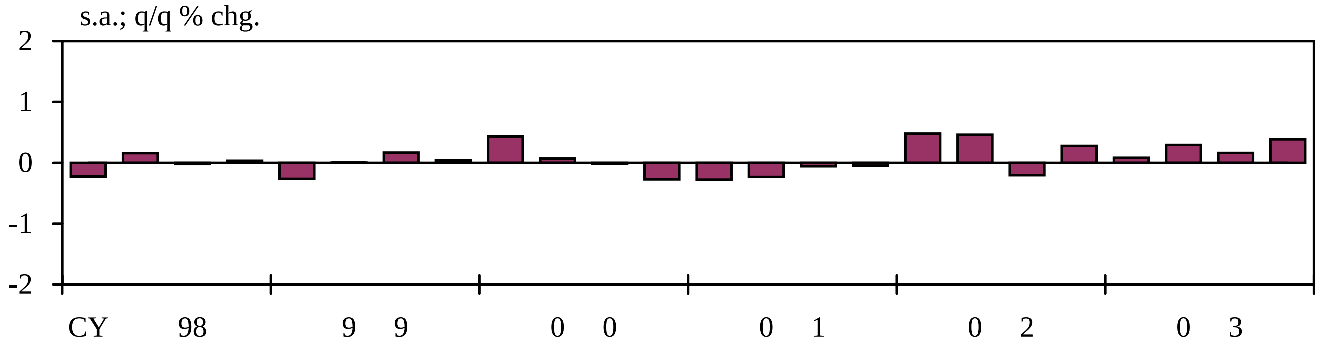
a. Domestic private demand



b. Public demand



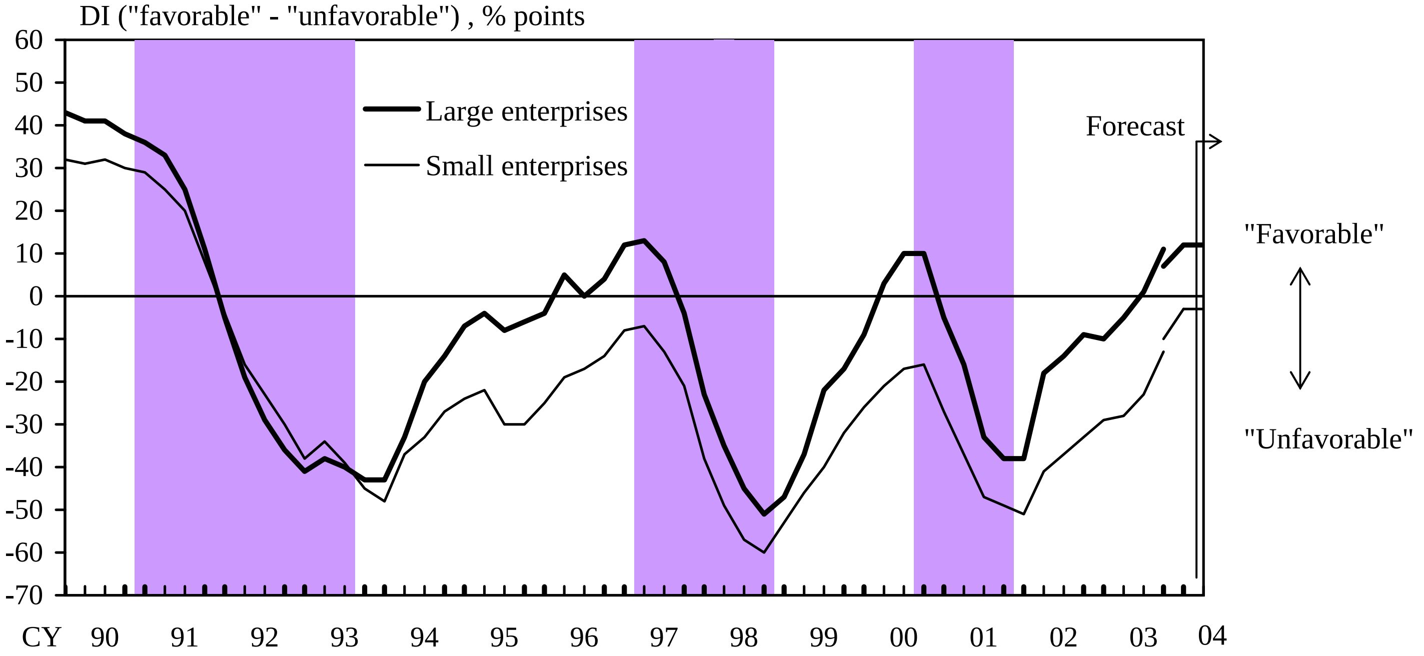
c. Net exports of goods and services



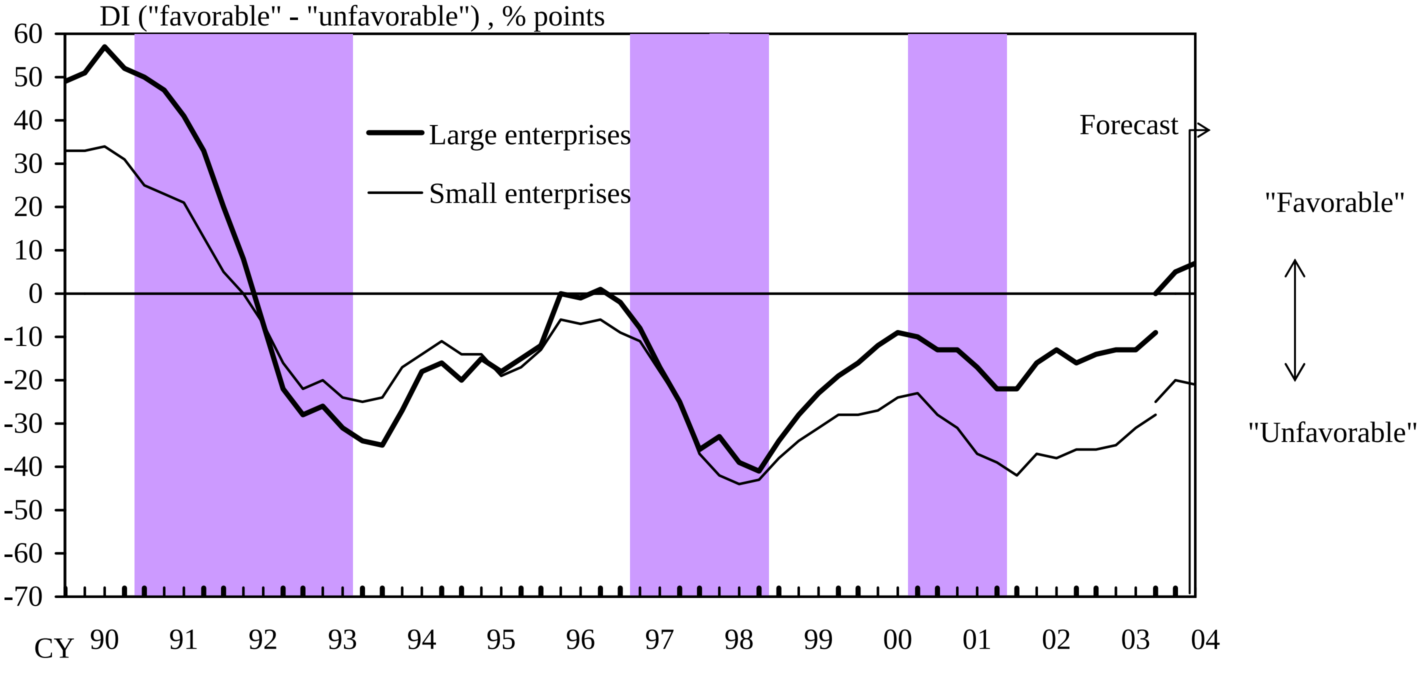
Source: Cabinet Office, "National Accounts."

Business Conditions

(1) Manufacturing



(2) Nonmanufacturing



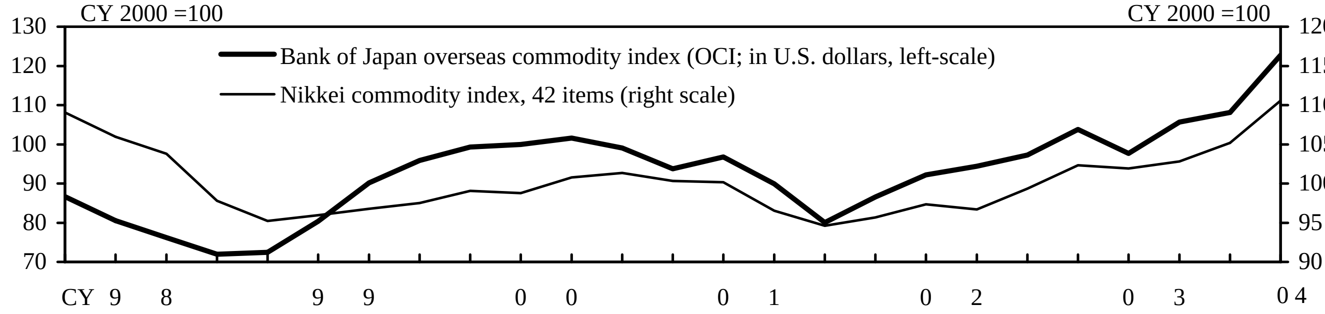
Notes: 1. Large enterprises (pre-revision): 1,000 employees or more
Small enterprises (pre-revision): 50-299 employees (for manufacturing), 20-99 employees (for wholesaling), 20-49 employees (for retailing, services, and leasing), 50-299 employees (for other industries)
Large enterprises (post-revision): capital of 1 billion yen or more
Small enterprises (post-revision): capital of from 20 million yen to less than 100 million yen
2. The *Tankan* has been revised from the March 2004 survey. Figures up to the December 2003 survey are based on the previous data sets. Figures from the December 2003 survey are on a new basis.
3. Shaded areas indicate recession periods.

Source: Bank of Japan, "*Tankan* - Short-Term Economic Survey of Enterprises in Japan."

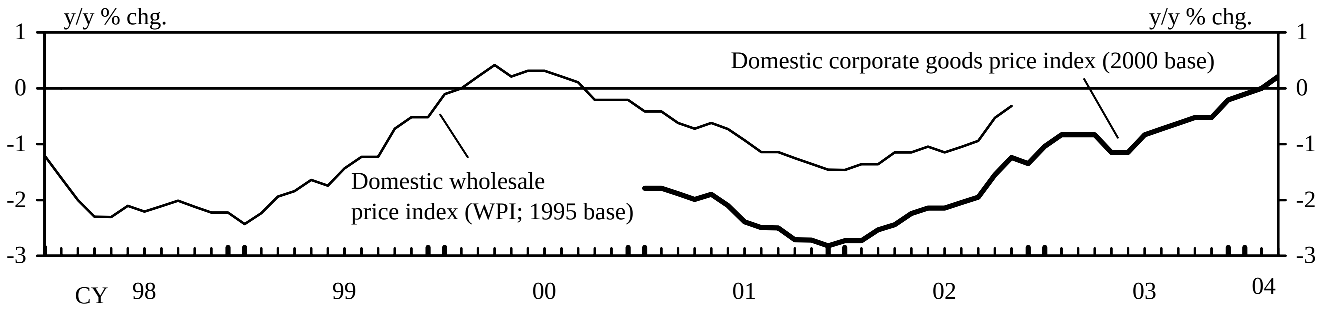
Prices and Factors Affecting Price Developments

(1) Prices

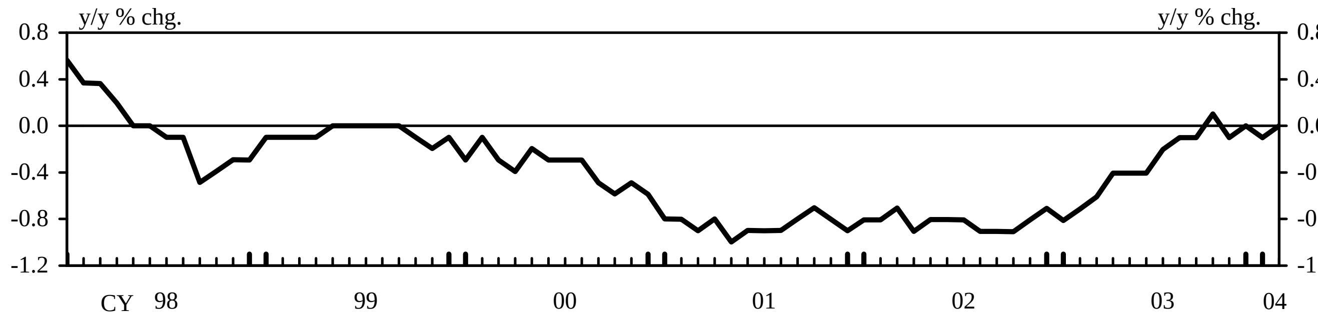
1. Commodity prices



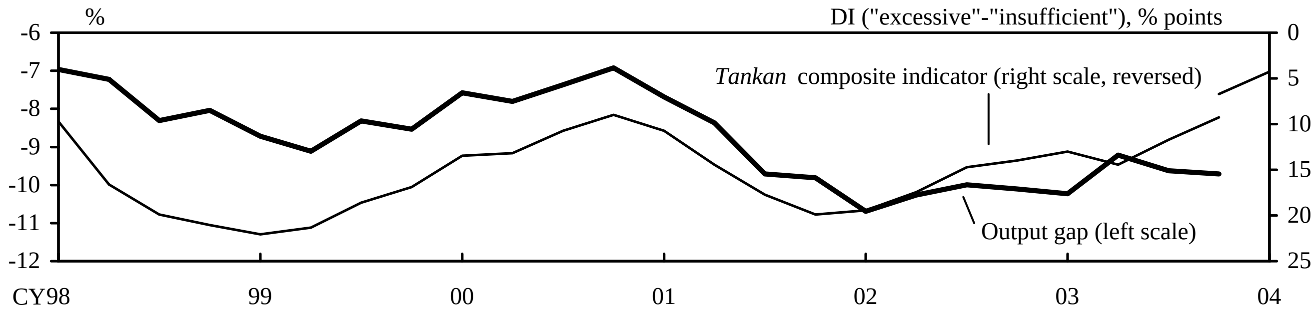
2. Domestic corporate goods price index



3. Consumer price index (CPI; excluding fresh food)



(2) Output Gap and *Tankan* Composite Indicator

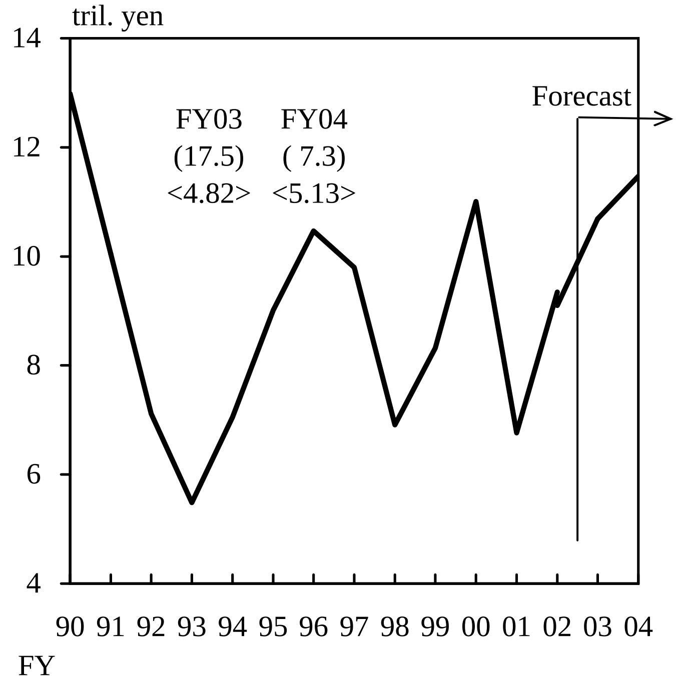


Notes: 1. Quarterly data for the OCI and the Nikkei commodity index, 42 items, are calculated from their respective end-month figures.
2. The WPI and the CPI are adjusted to exclude the effects of the consumption tax hike in April 1997.
3. The CPI before December 2000 is on the 1995 base.
4. *Tankan* composite indicator from the December 2003 survey is on a new basis. For the output gap and the composite indicator, please refer to the notes in Chart 7.

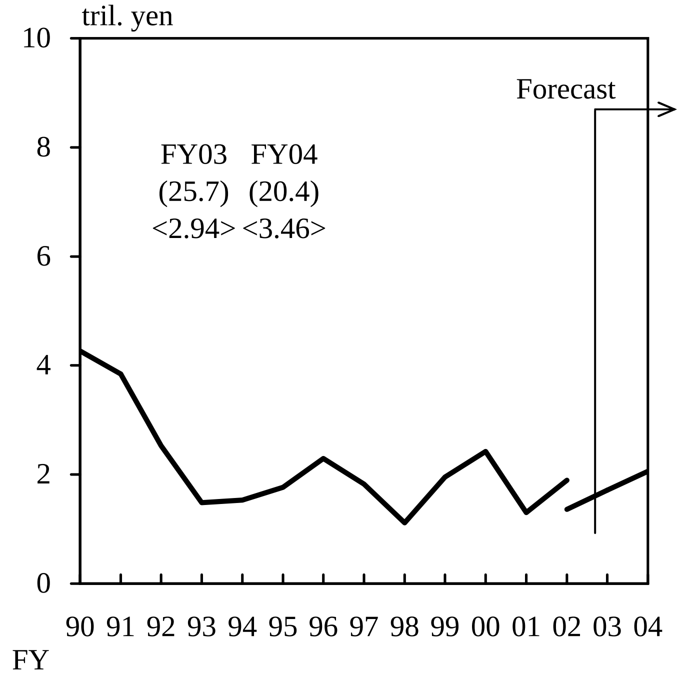
Sources: Cabinet Office, "National Accounts," "Capital Stock of Private Enterprises Statistics"; Ministry of Economy, Trade and Industry, "Indices of Industrial Production"; Ministry of Health, Labour and Welfare, "Monthly Labour Survey"; Ministry of Public Management, Home Affairs, Posts and Telecommunications, "Consumer Price Index"; Nihon Keizai Shimbun, Inc., "Nikkei Commodity Price Index"; Bank of Japan, "Corporate Goods Price Index," "Wholesale Price Indexes," "Bank of Japan Overseas Commodity Index," "*Tankan* - Short-Term Economic Survey of Enterprises in Japan," etc.

Current Profits

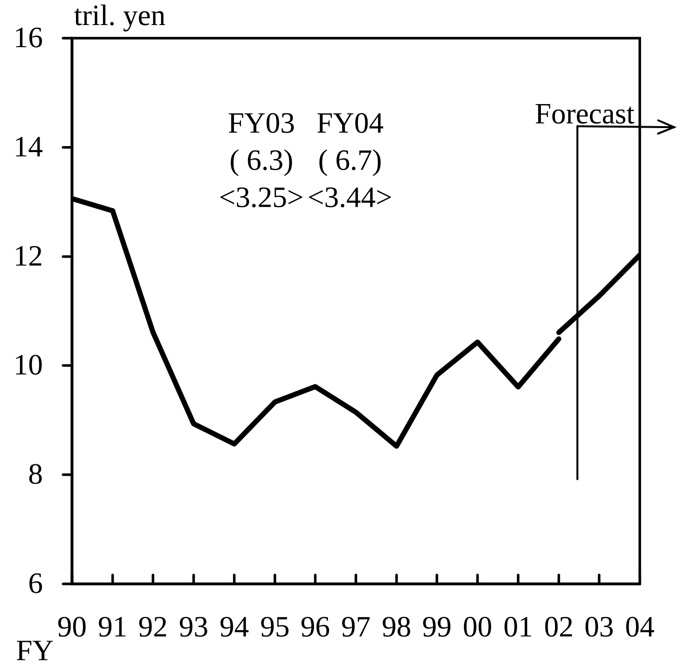
(1) Large Manufacturing Enterprises



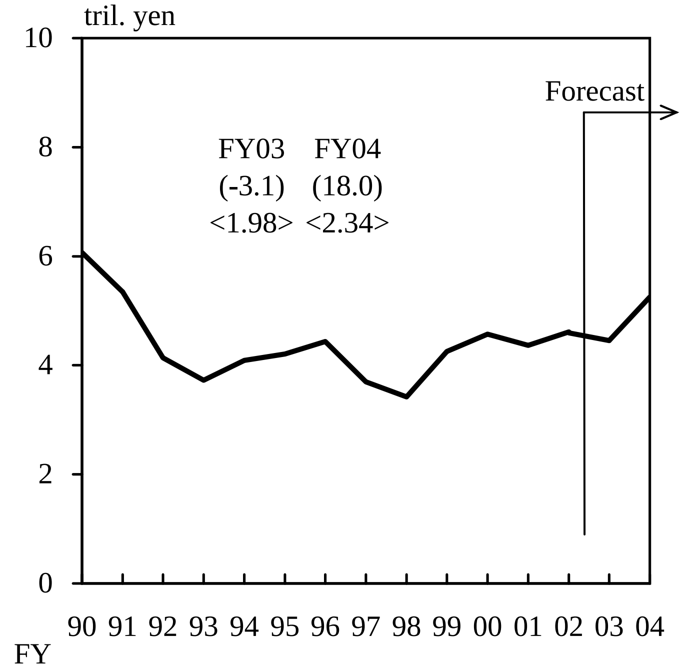
(2) Small Manufacturing Enterprises



(3) Large Nonmanufacturing Enterprises



(4) Small Nonmanufacturing Enterprises

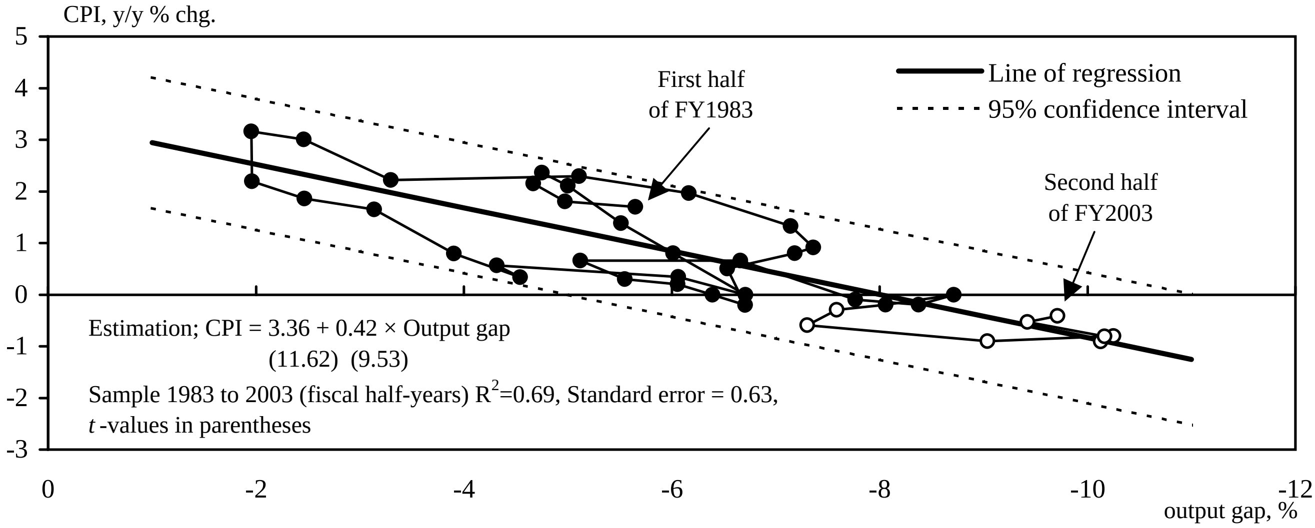


Notes: 1. Large enterprises (pre-revision): 1,000 employees or more
Small enterprises (pre-revision): 50-299 employees (for manufacturing), 20-99 employees (for wholesaling),
20-49 employees (for retailing, services, and leasing),
50-299 employees (for other industries)
Large enterprises (post-revision): capital of 1 billion yen or more
Small enterprises (post-revision): capital of from 20 million yen to less than 100 million yen
2. Parentheses indicate current profits (year-on-year percentage change). Angular brackets indicate ratio of current profits to sales (percent). Post-revison.
3. The *Tankan* has been revised from the March 2004 survey. Figures up to the December 2003 survey are based on the previous data sets. Figures from the December 2003 survey are on a new basis.

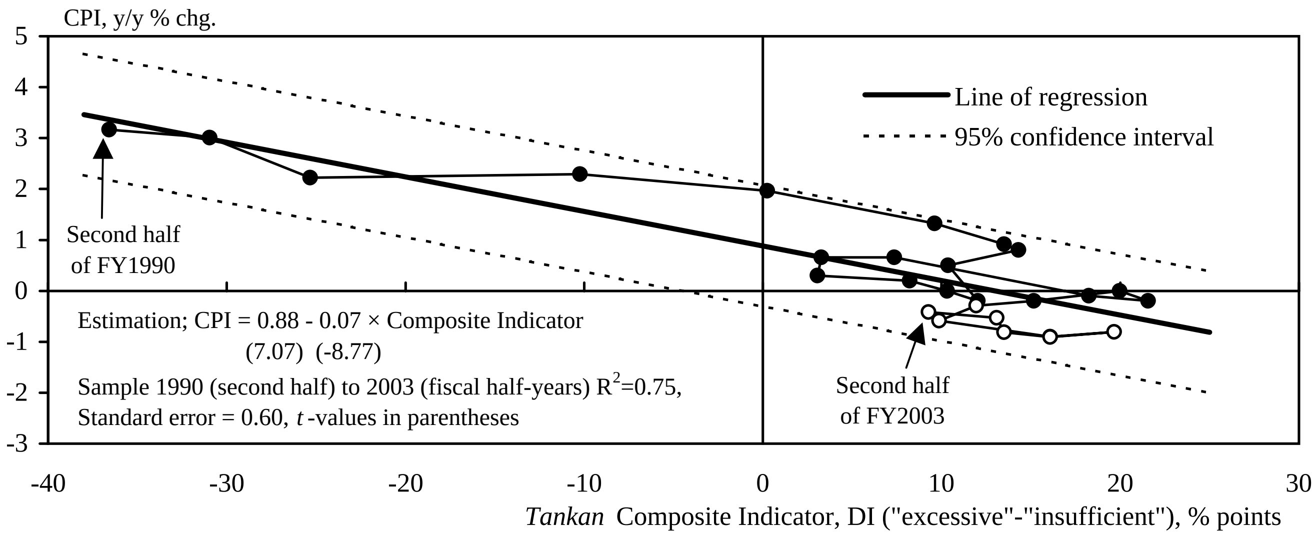
Source: Bank of Japan, "*Tankan* - Short-Term Economic Survey of Enterprises in Japan."

Output Gap and Prices

(1) Output Gap and Changes in Consumer Price Index



(2) *Tankan* Composite Indicator and Changes in Consumer Price Index



Notes: 1. Output gap is calculated as the wedge between actual and maximum outputs (BoJ staff estimation). Unlike other output gap estimates which can move in the positive territory, this estimation always takes negative values.

2. The *Tankan* Composite Indicator aims at constructing a series similar to the output gap directly from the *Tankan* survey data that show firms' judgment of excessiveness as to the number of employees and the production capacity. It is calculated as the average of the diffusion indices of production capacity and employment conditions, weighted by capital and labor shares in the national accounts (FY1990-FY2002 averages). The survey coverage for the production capacity DI was limited to the manufacturing industry before 1990/Q3. For this reason, the figures are calculated for the period from 1990/Q4, when the survey was extended to include the nonmanufacturing industry.

3. The CPI (excluding fresh food) is consumption-tax adjusted. Figures until 2000 are on the 1995 base.

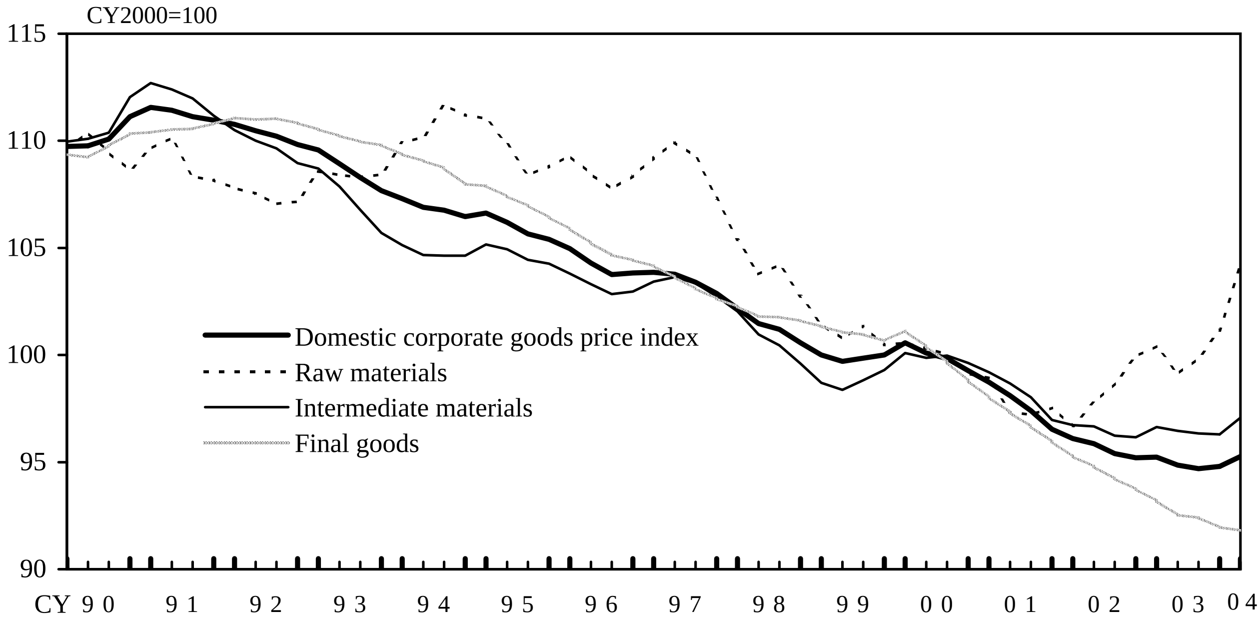
4. Points from 2000 onwards are shown by white dots.

5. The CPI in FY 2003 excludes, in addition to fresh food, medical treatment, cigarettes, and rice.

Sources: Cabinet Office, "National Accounts," "Capital Stock of Private Enterprises Statistics"; Ministry of Economy, Trade and Industry, "Indices of Industrial Production"; Ministry of Health, Labour and Welfare, "Monthly Labour Survey"; Ministry of Public Management, Home Affairs, Posts and Telecommunications, "Consumer Price Index"; Bank of Japan, "*Tankan* - Short-Term Economic Survey of Enterprises in Japan," etc.

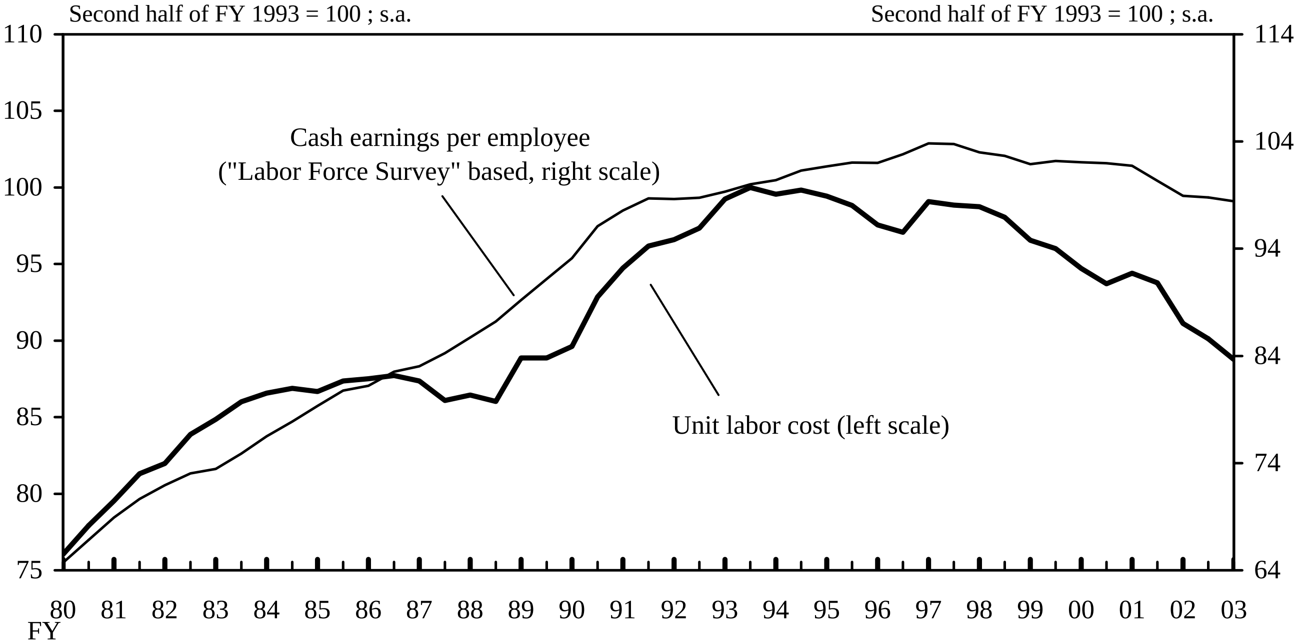
Price by Stage of Demand and Unit Labor Cost

(1) Domestic Corporate Goods Price Index by Stage of Demand



Notes: 1. Data exclude the effect of changes in the consumption tax rate and a hike in electric power charges in the summer.
2. For raw materials and final goods from 2003/Q4 onward, upward contributions from agriculture, forestry & fishery products have been removed.

(2) Unit Labor Cost



Notes: 1. Unit labor cost = cash earnings per employee / labor productivity = compensation of employees / Real GDP.
2. Cash earnings per employee = compensation of employees / number of employees (in "Labour Force Survey").

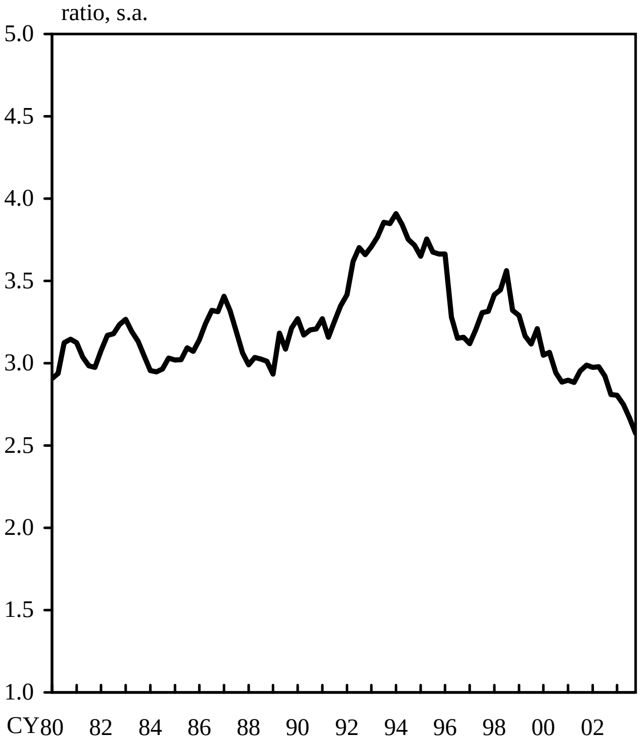
Sources: Cabinet Office, "National Accounts"; Ministry of Public Management, Home Affairs, Posts and Telecommunications, "Labour Force Survey"; Bank of Japan , "Corporate Goods Price Index."

Chart 9

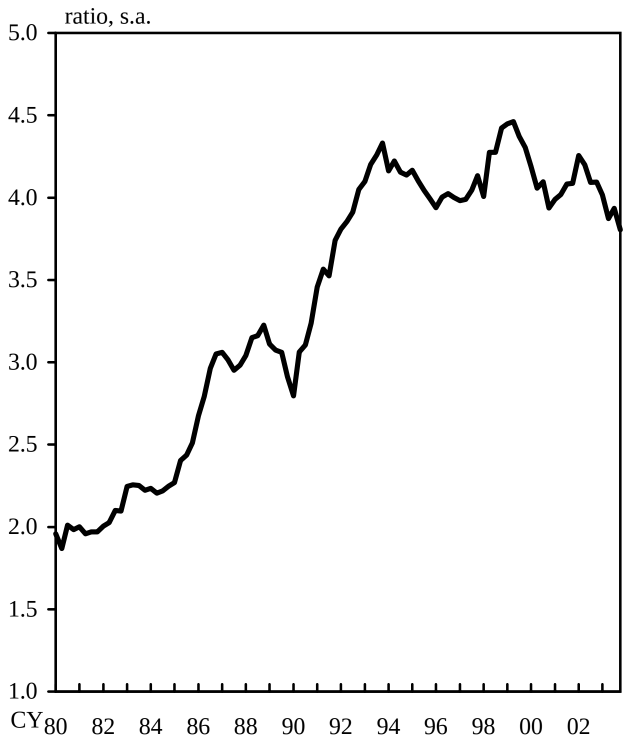
Pressures Arising from Firms' Excess Debt

(1) Large Manufacturing Firms

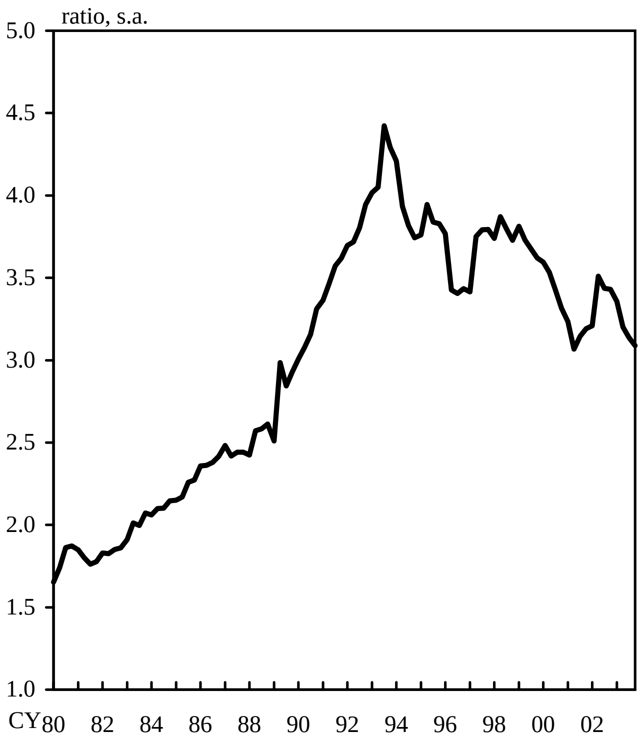
(2) Medium and Small-Sized Manufacturing Firms



(3) Large Nonmanufacturing Firms



(4) Medium and Small-Sized Nonmanufacturing Firms

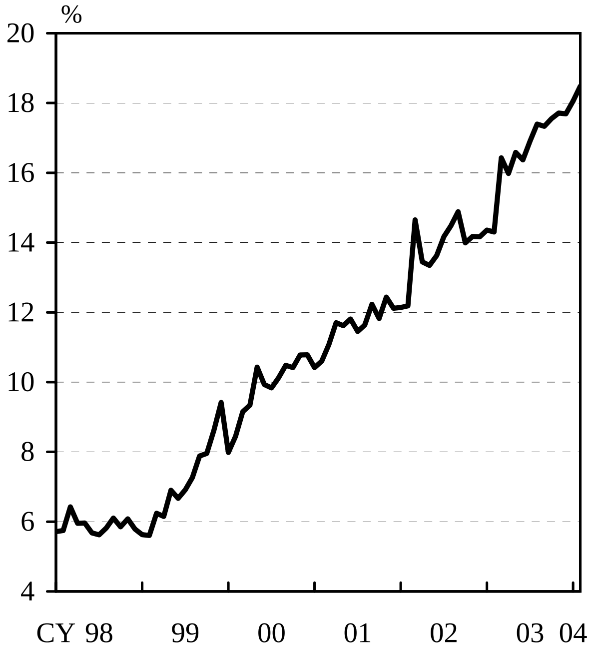


Notes: 1. Ratio of debts to sales (monthly average).
2. Debts = financial debts (corporate bonds + long-term and short-term borrowings + bills discounted) - cash and deposits.
3. Electric, gas and other service industries are excluded from large nonmanufacturing firms.

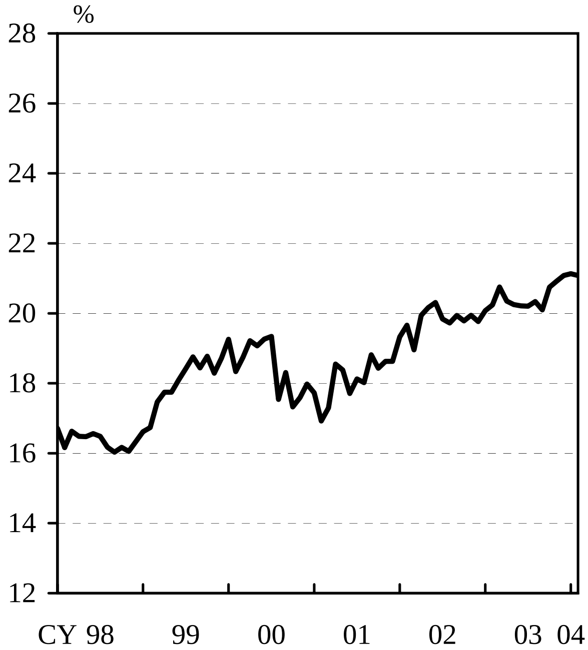
Source: Ministry of Finance, "Financial Statements Statistics of Corporations by Industry, Quarterly."

Ratio of Risk-Free Assets to Total Assets

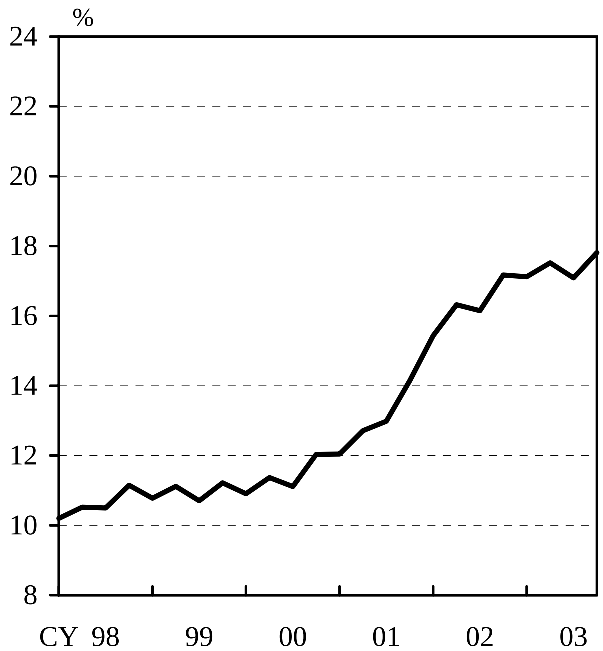
(1) Domestically Licensed Banks



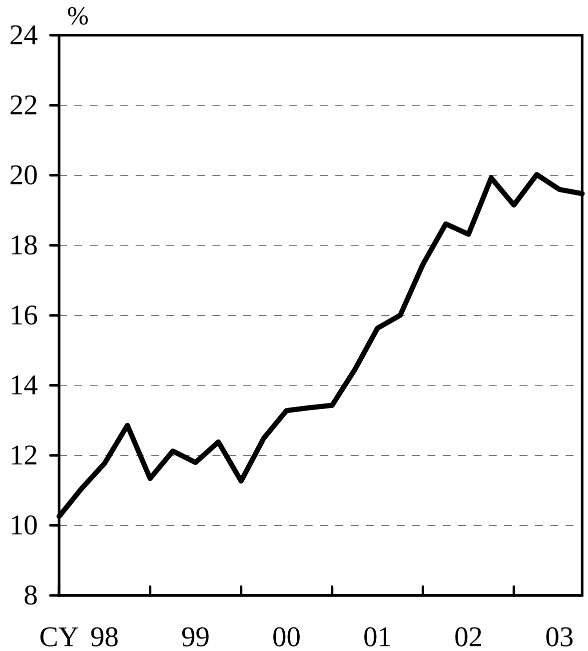
(2) Life and Nonlife Insurance Companies



(3) Households



(4) Private Nonfinancial Corporations



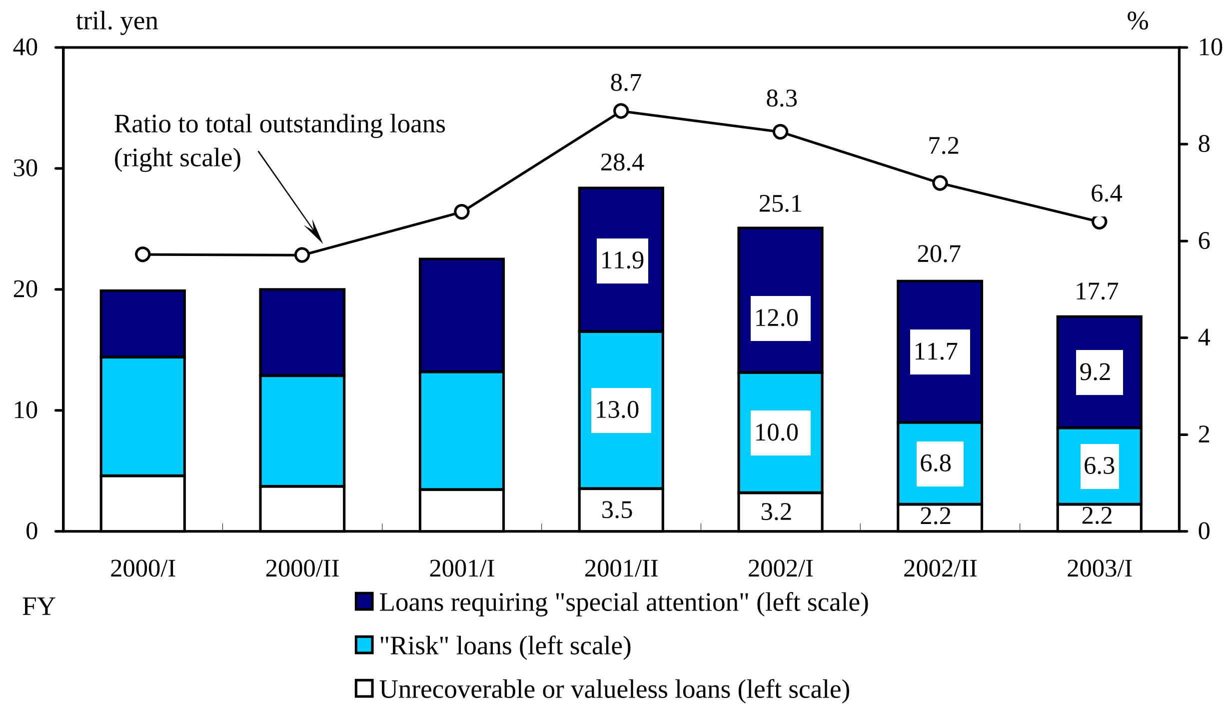
Note: Each sector's ratio of risk-free assets to total assets is calculated as follows:
Domestically licensed banks: (cash + current account balances + government bonds)/total assets.
Life and nonlife insurance companies: (cash and deposits with others + government bonds)/total operating funds.
Households and private nonfinancial corporations: (currency + transferable deposits + central government securities)/total financial assets.

Sources: Life Insurance Association; Marine and Fire Insurance Association of Japan; Bank of Japan.

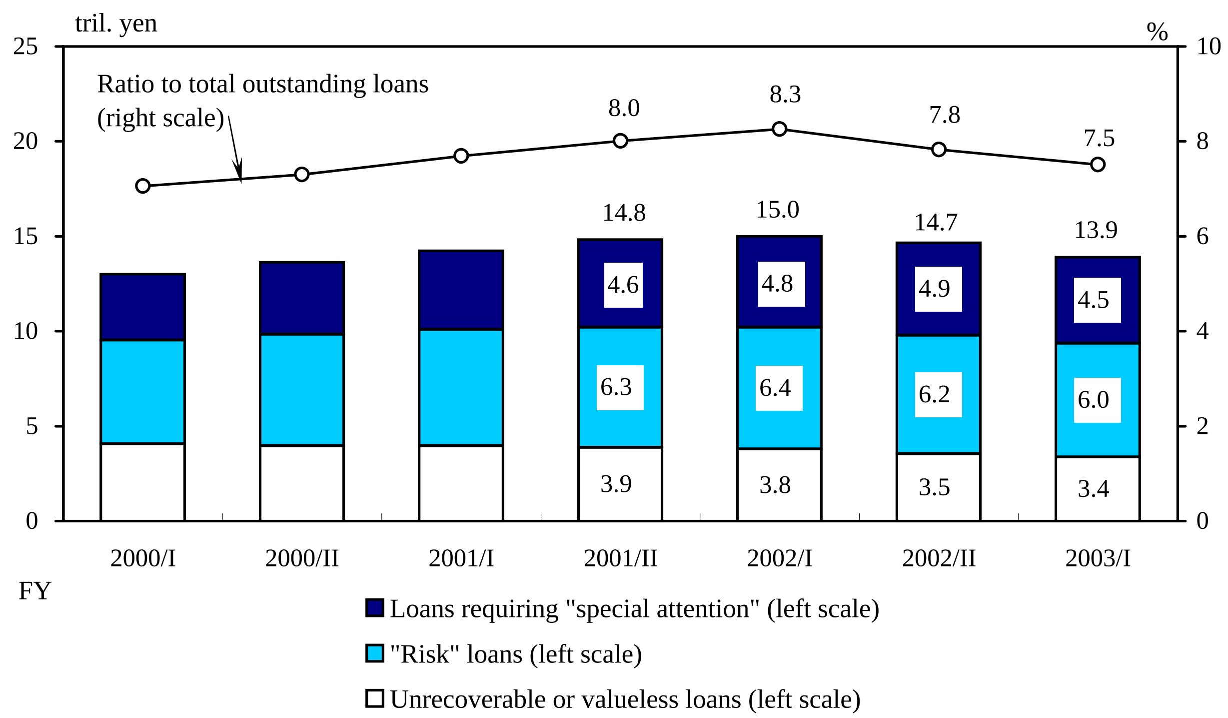
Chart 11

Amount of Nonperforming Loans

(1) Major Banks



(2) Regional Banks and Regional Banks II

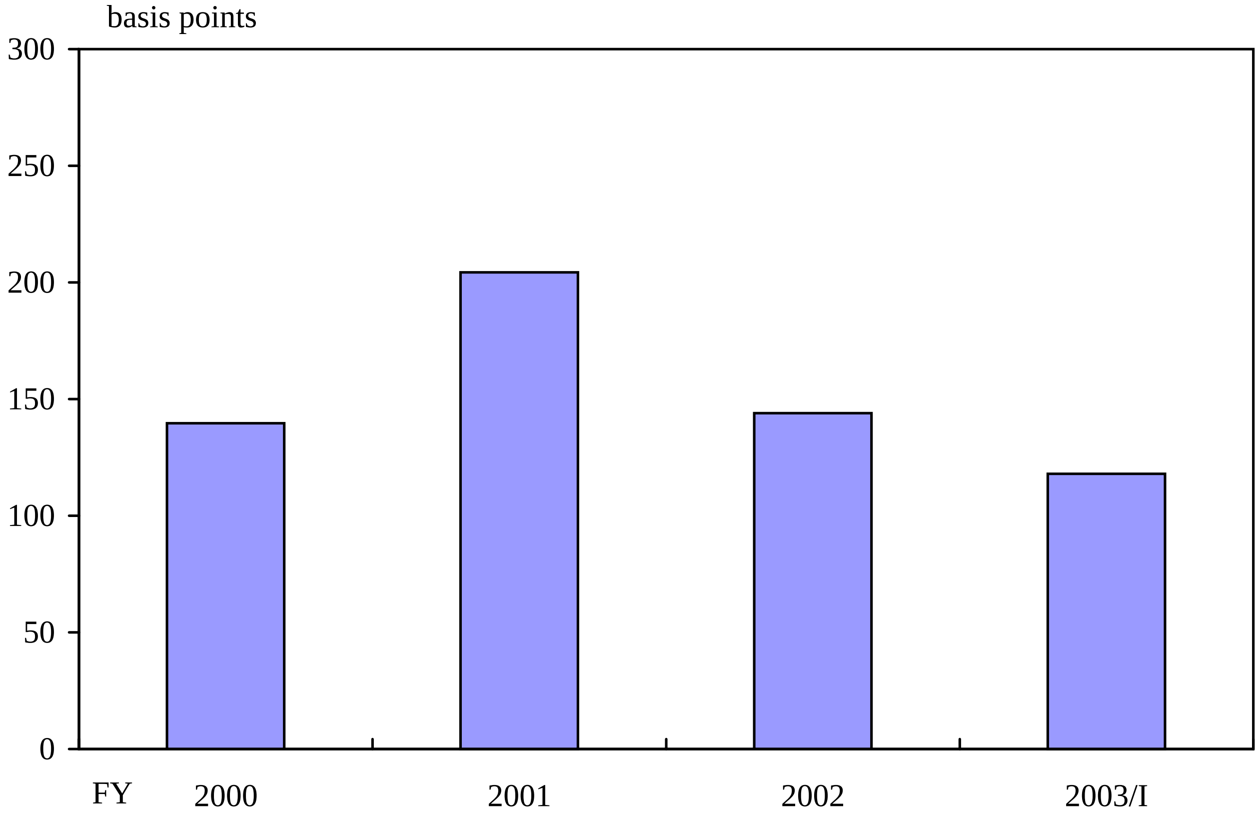


Notes: 1. The amount of Nonperforming Loans disclosed under the Financial Reconstruction Law.
2. Major banks are the total for city banks, long-term credit banks and trust banks.
Saitama Resona Bank is included in regional banks and regional banks II in this chart.

Sources: Bank of Japan; Financial Services Agency.

Chart 12

Ratio of Credit Costs to Total Outstanding Loans (All Banks)

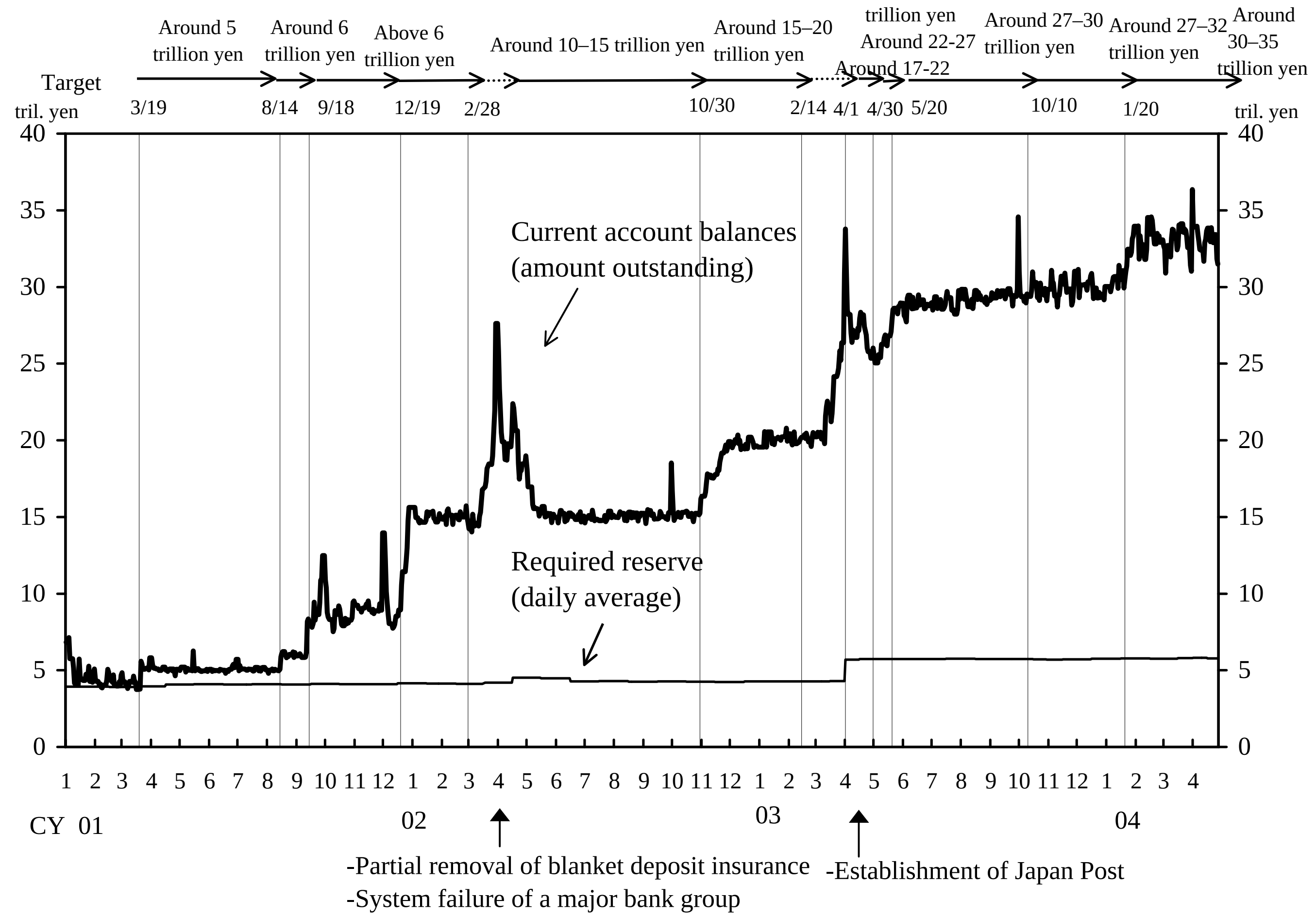


Note: "All banks" refers to all banks that hold current accounts at the Bank of Japan (154 banks at end-September 2003).

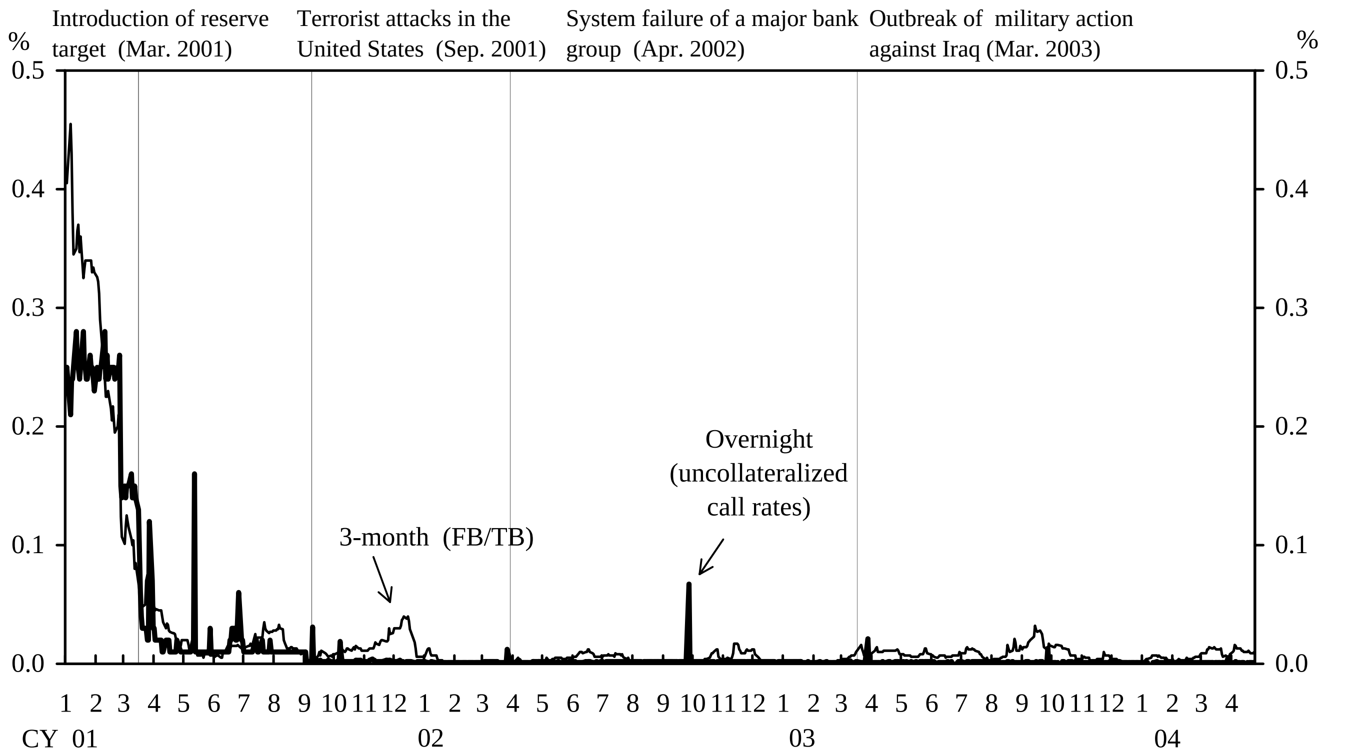
Source: Bank of Japan.

BOJ Current Account Balances and Money Market Rates

(1) BOJ Current Account Balances



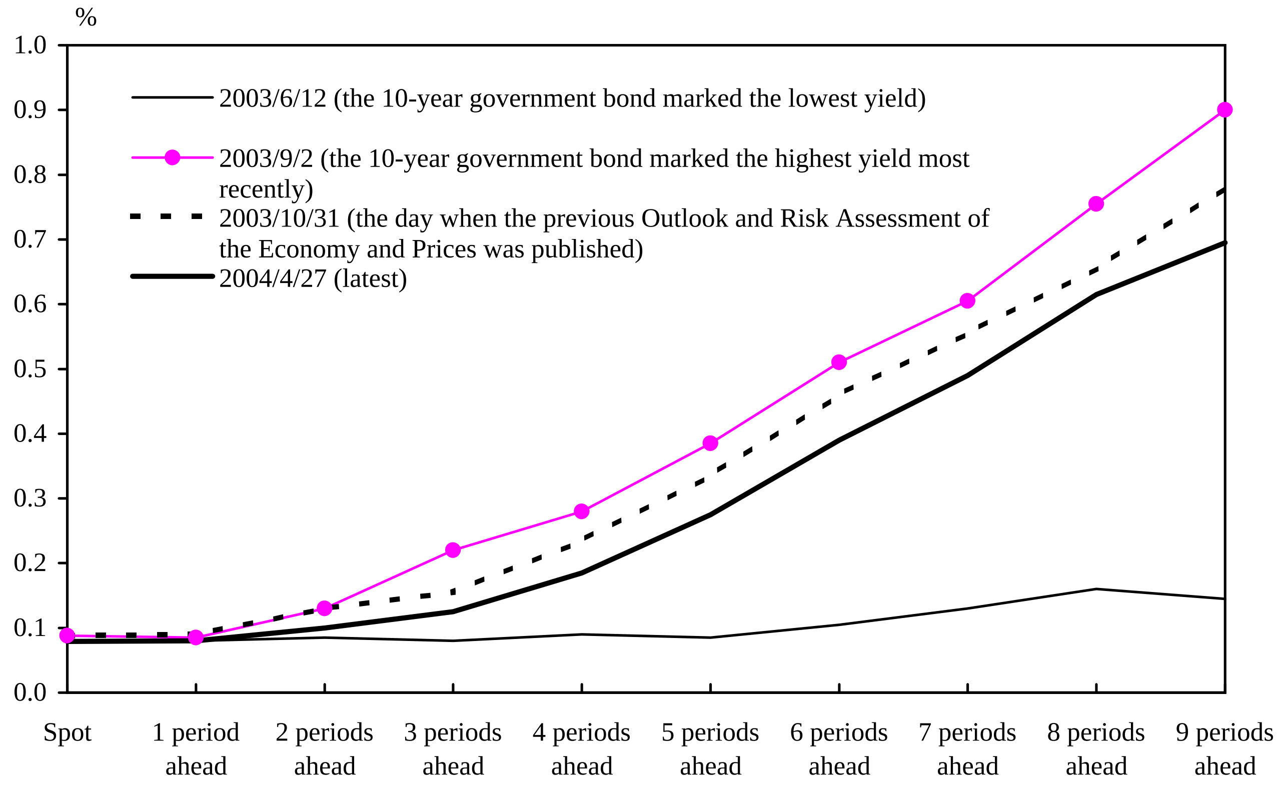
(2) Money Market Rates



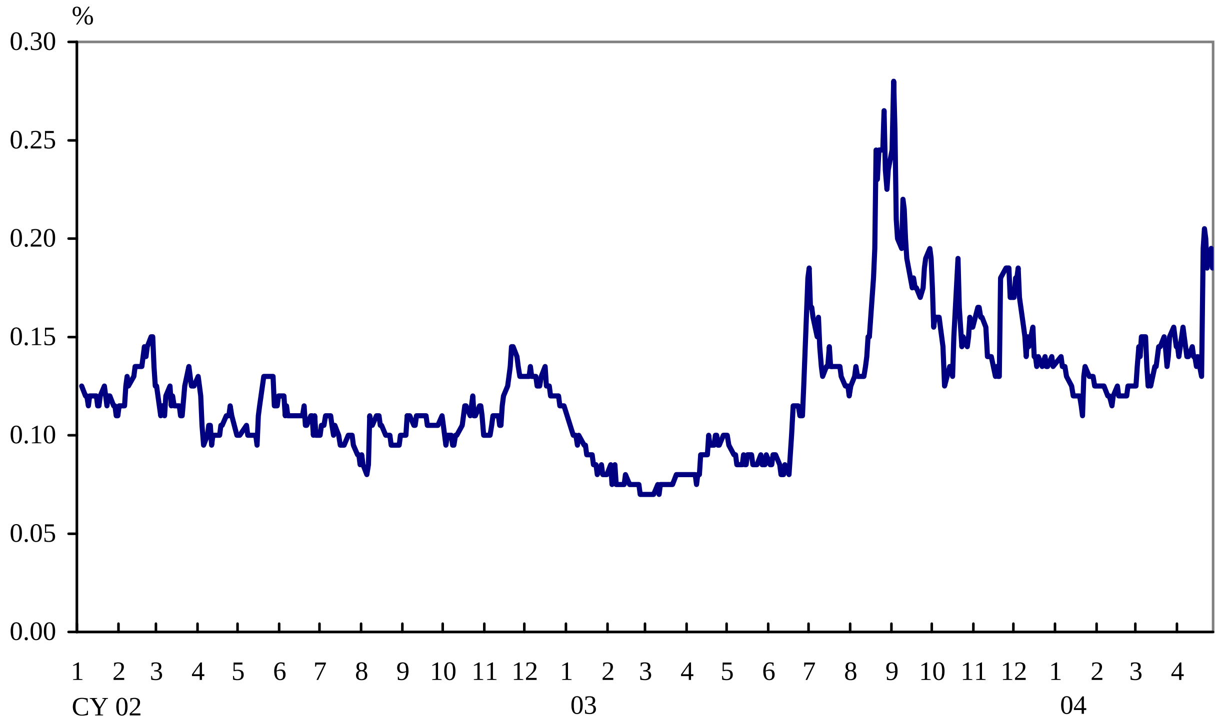
Sources: Bank of Japan; Japan Bond Trading Co., Ltd.

Interest Rates Futures

(1) Euroyen Interest Rate Futures (3-Month)



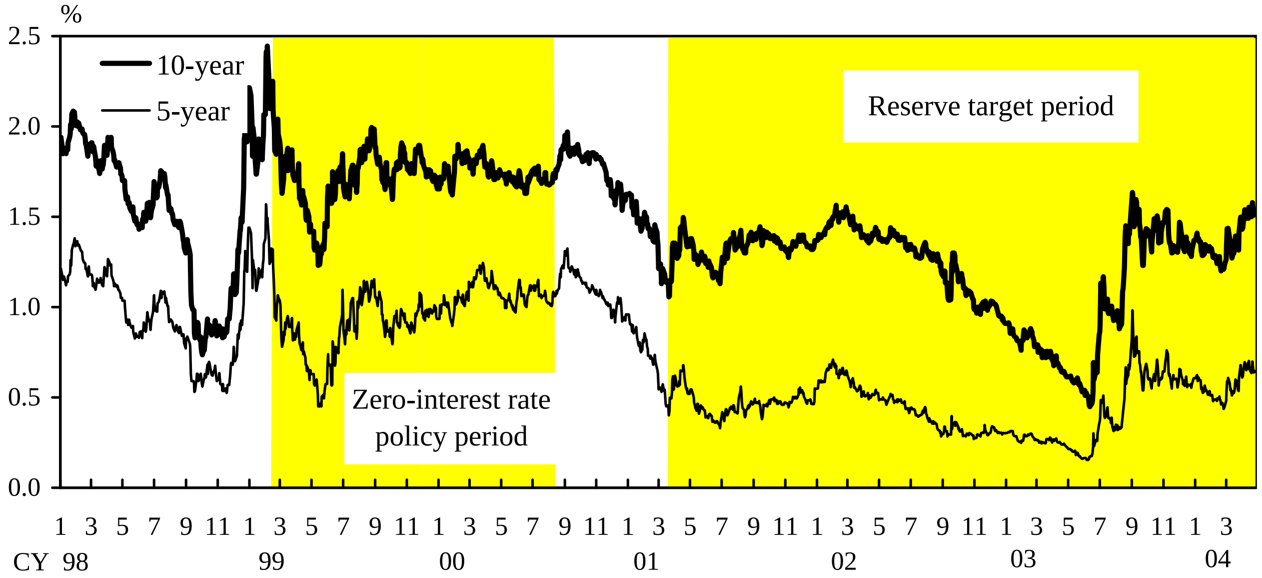
(2) Euroyen Interest Rate Futures (3-Month) Leading Contract Months



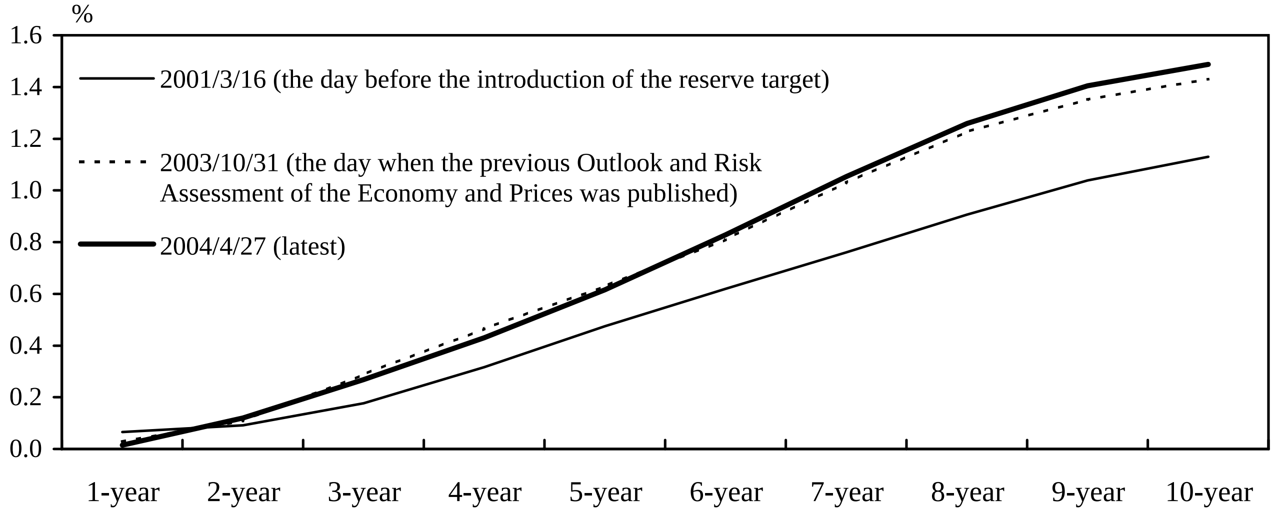
Source: Tokyo International Financial Futures Exchange.

Long-Term Interest Rates

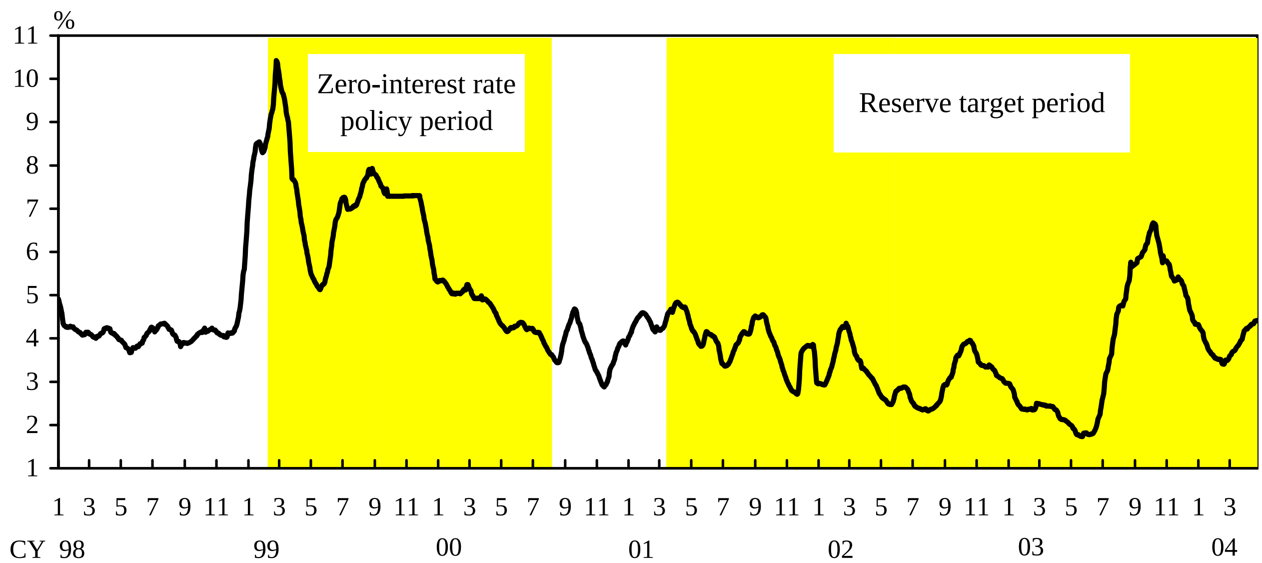
(1) Rate Developments



(2) Yield Curve



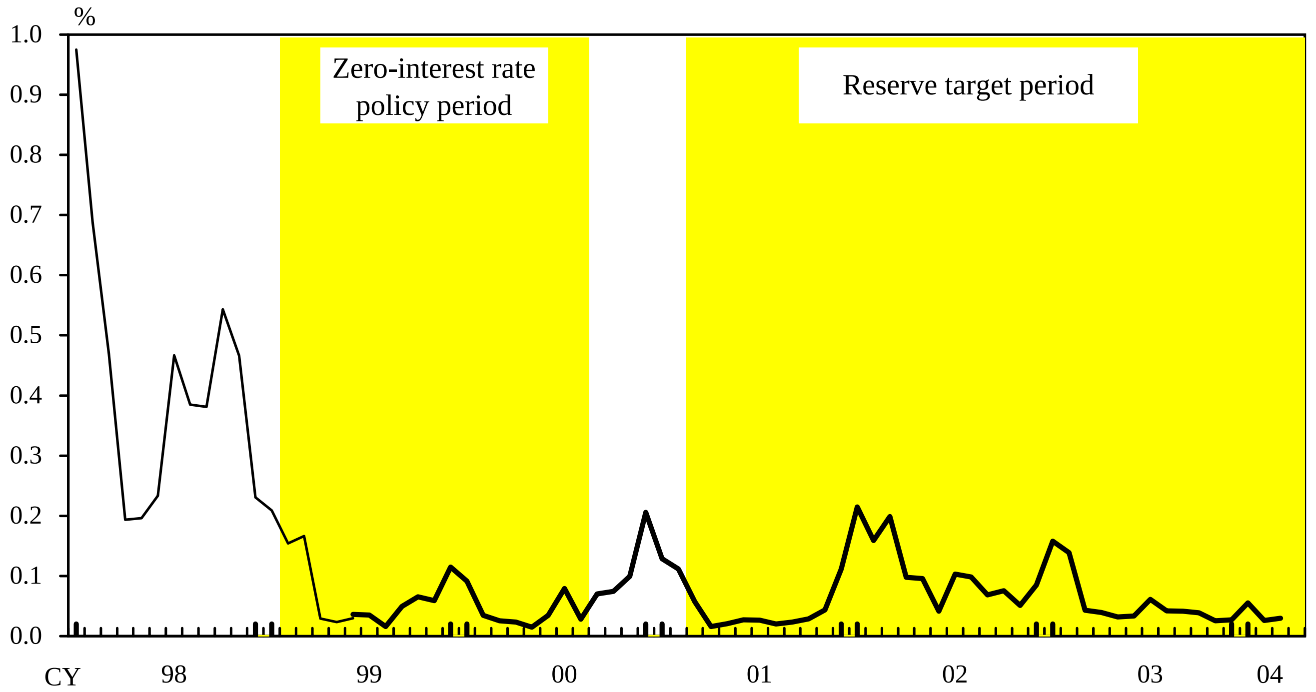
(3) Implied Volatility



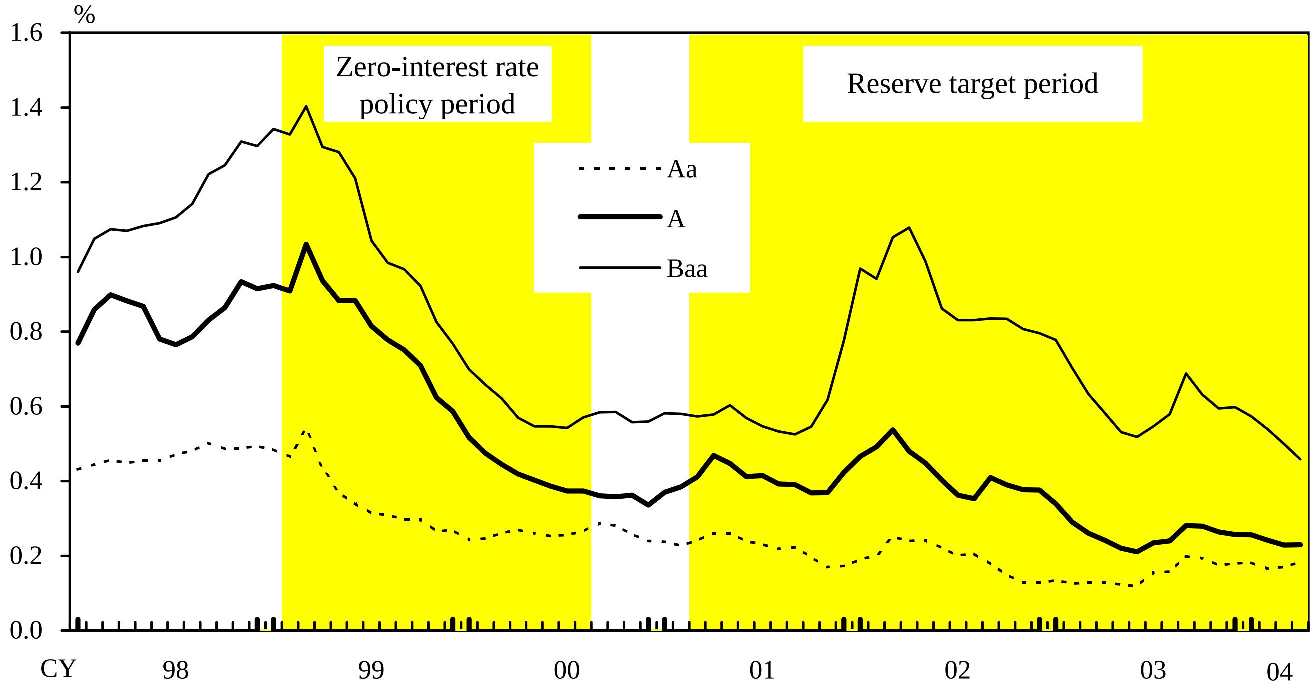
Sources: Bloomberg; Japan Securities Dealers Association; Tokyo Stock Exchange.

Credit Spreads

(1) Commercial Paper (3-Month)



(2) Corporate Bonds (5-Year)

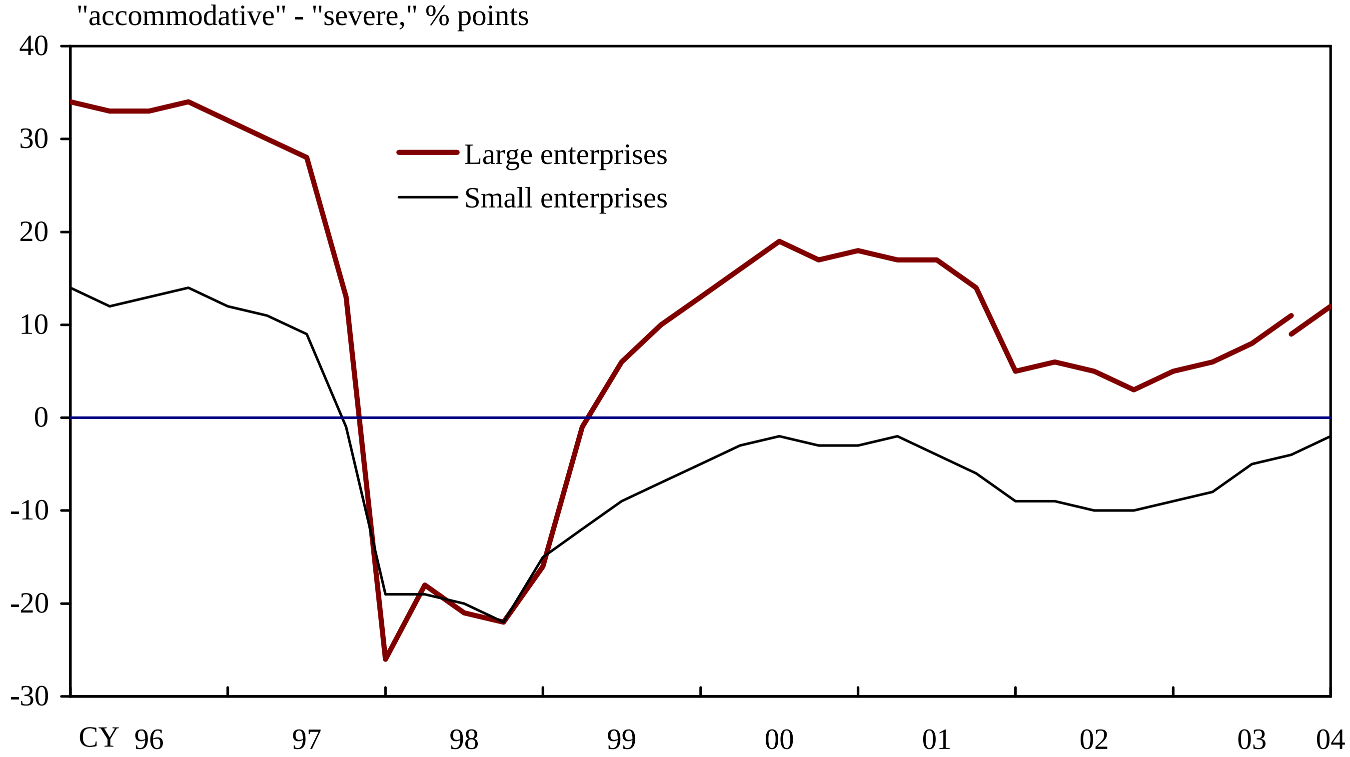


Notes: 1. The spread of CP is the average issuance rate of CP minus the FB/TB yield.
2. The spread of corporate bonds is the corporate bond yield minus the government bond yield.
3. CP ratings are A-1 or better.
4. FB/TB yields before May 1999 are on bills with a 6-month maturity.
5. The indicated ratings of corporate bonds are of Moody's.
6. The spread on corporate bonds in April 2004 is an average of data from April 1 to 27.

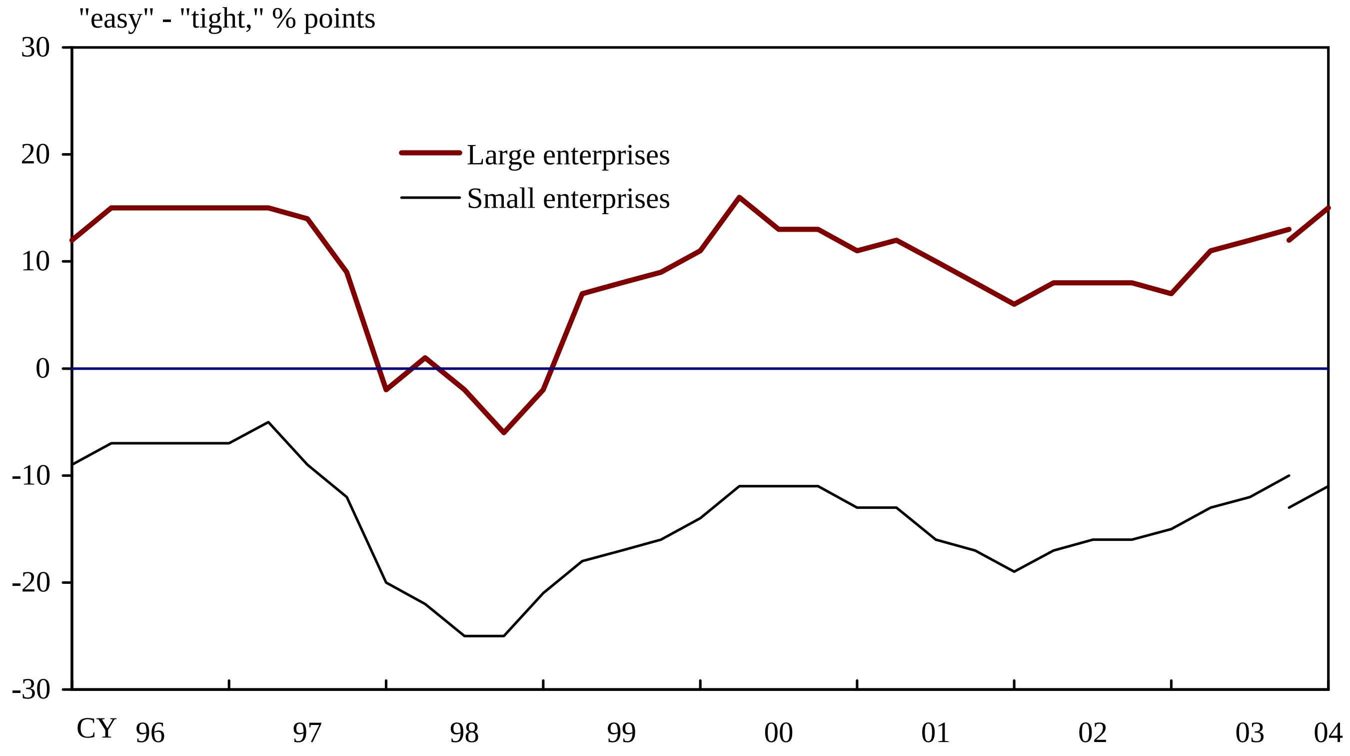
Sources: Bank of Japan; Japan Bond Trading Co., Ltd.; Japan Securities Dealers Association.

Lending Attitude of Financial Institutions and Financial Position of Firms

(1) Lending Attitude of Financial Institutions (D.I.)



(2) Financial Position (D.I.)

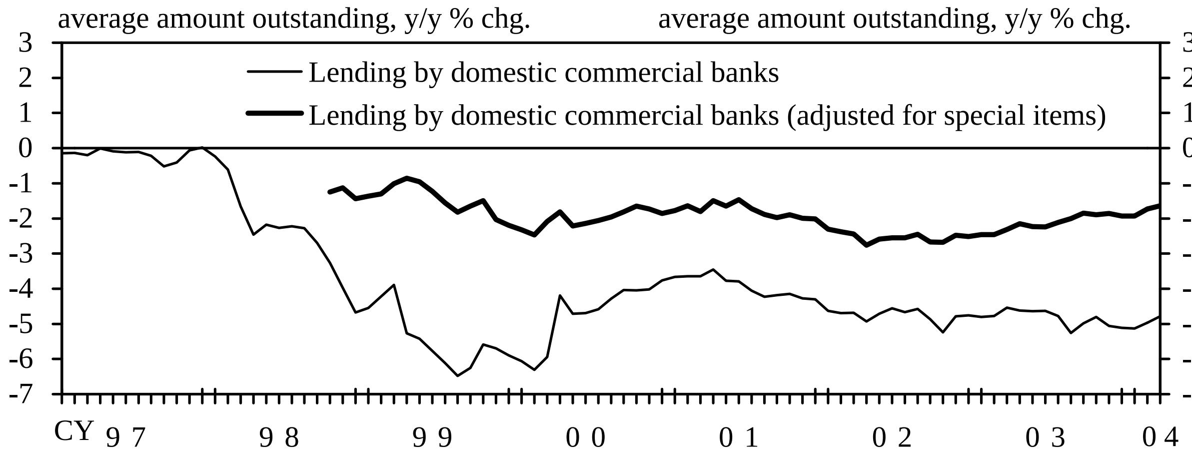


Note: The *Tankan* has been revised from the March 2004 survey. Figures up to the December 2003 survey are based on the previous data sets. Figures from the December 2003 survey are on a new basis.

Source: Bank of Japan, "*Tankan* - Short-Term Economic Survey of Enterprises in Japan."

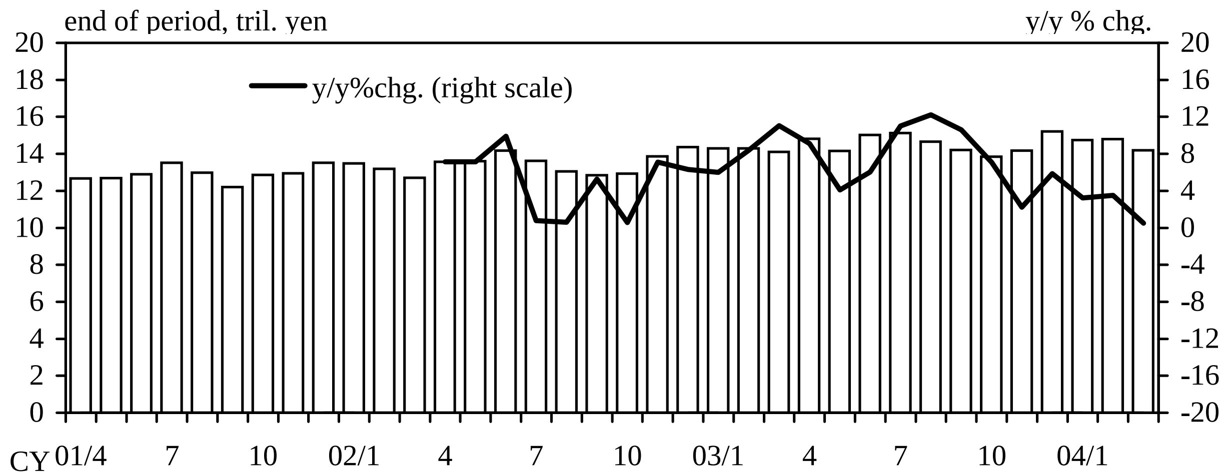
Fund-Raising for Firms

(1) Lending by Domestic Commercial Banks



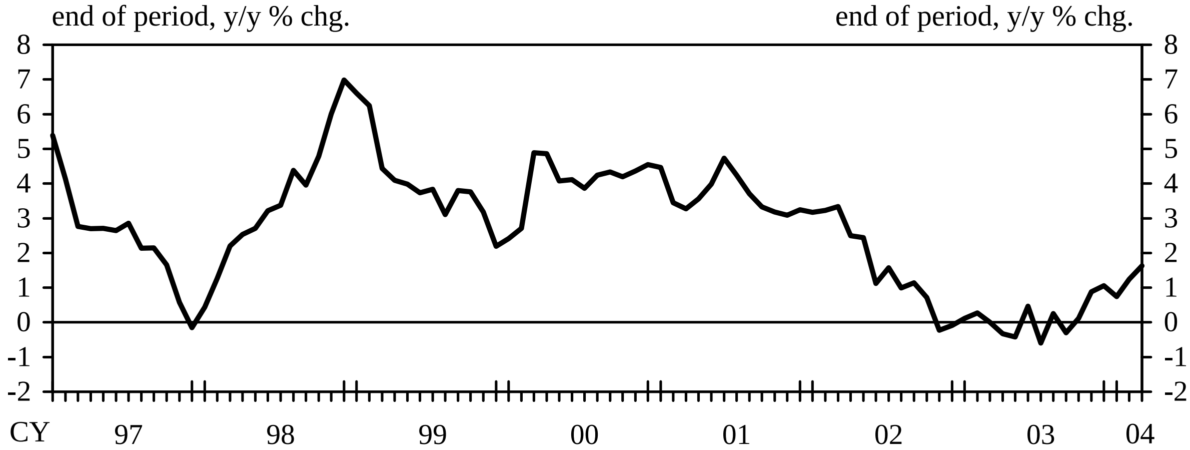
Note: Adjusted figures exclude the fluctuations from the liquidation of loans, loan write-offs, etc.

(2) Amount Outstanding of Commercial Paper



Notes: 1. Figures are those of the client financial institutions of the Bank of Japan.
2. Excludes those issued by banks.

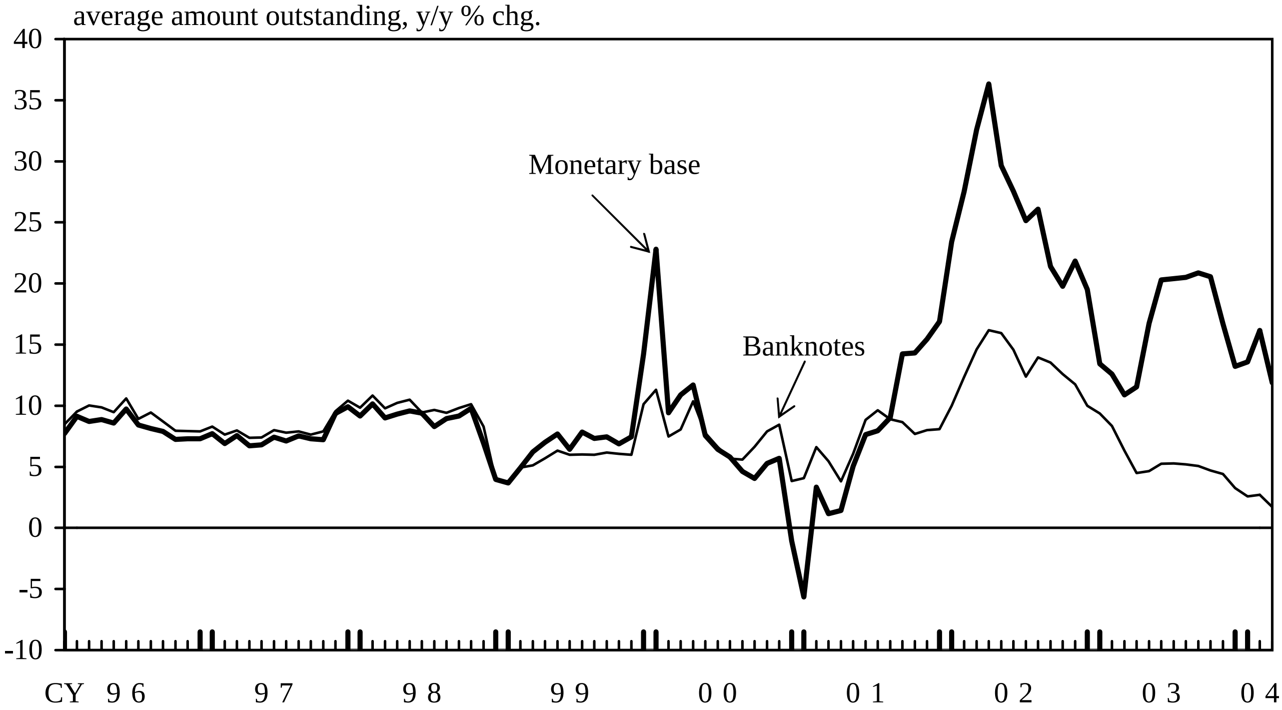
(3) Amount Outstanding of Corporate Bonds (Changes from a Year Earlier)



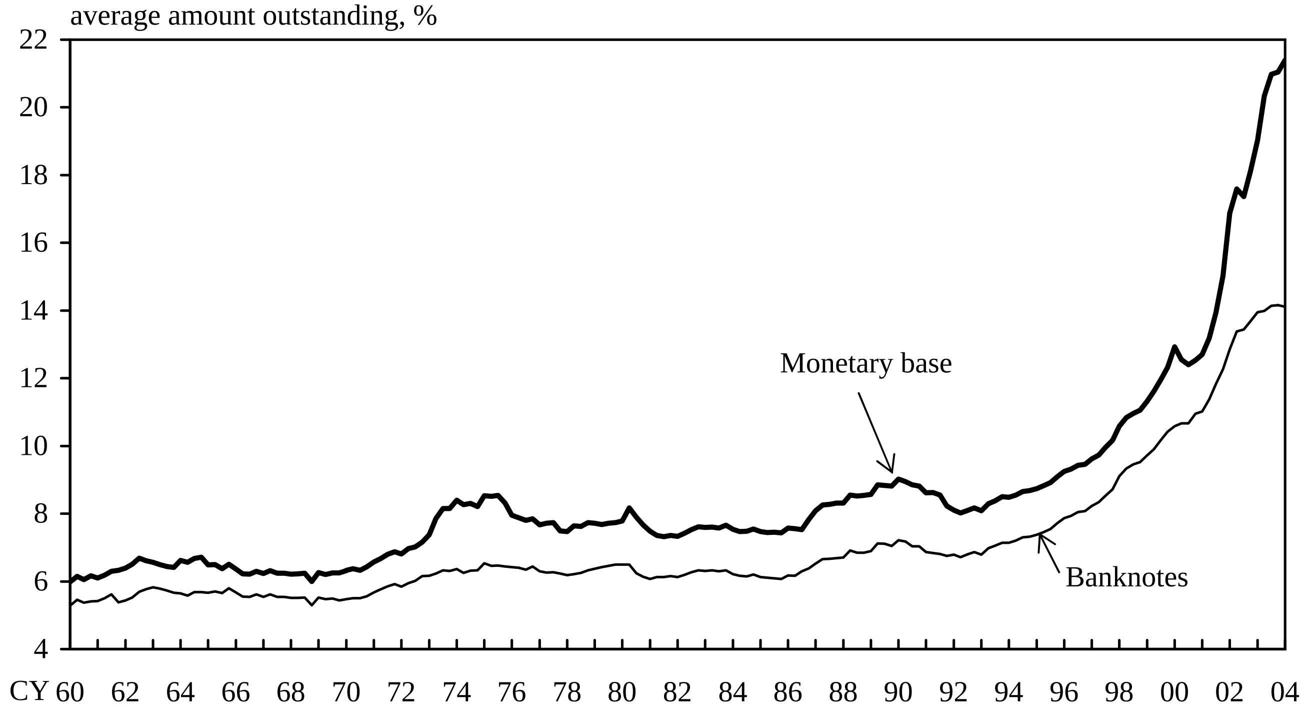
Sources: Bank of Japan; Japan Securities Dealers Association; IN Information Center.

Monetary Base

(1) Changes from a Year Earlier



(2) Ratio of Monetary Base to Nominal GDP



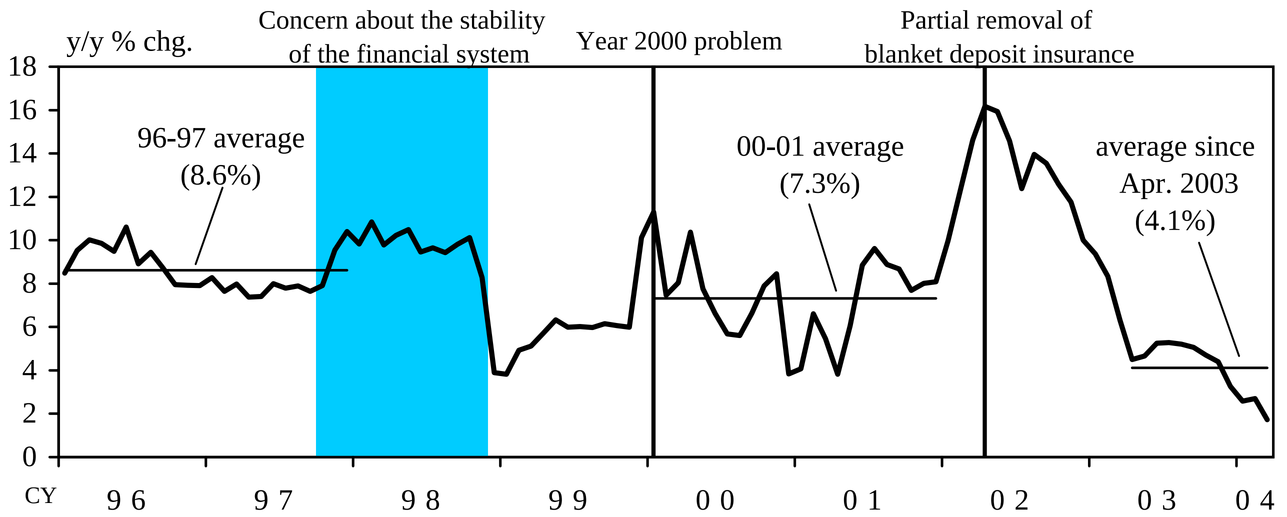
Notes: 1. Monetary base = currency in circulation (banknotes + coins) + current deposits at the Bank of Japan. Data for currency in circulation include holdings of financial institutions.
2. For figures up to March 1981, reserve balances are used in place of current deposits. For figures up to 1969, amounts outstanding of coins in circulation are those at the end of the month.
3. Figure for nominal GDP in 2004/Q1 is assumed to be unchanged from the previous quarter.

Sources: Cabinet Office, "National Accounts"; Bank of Japan.

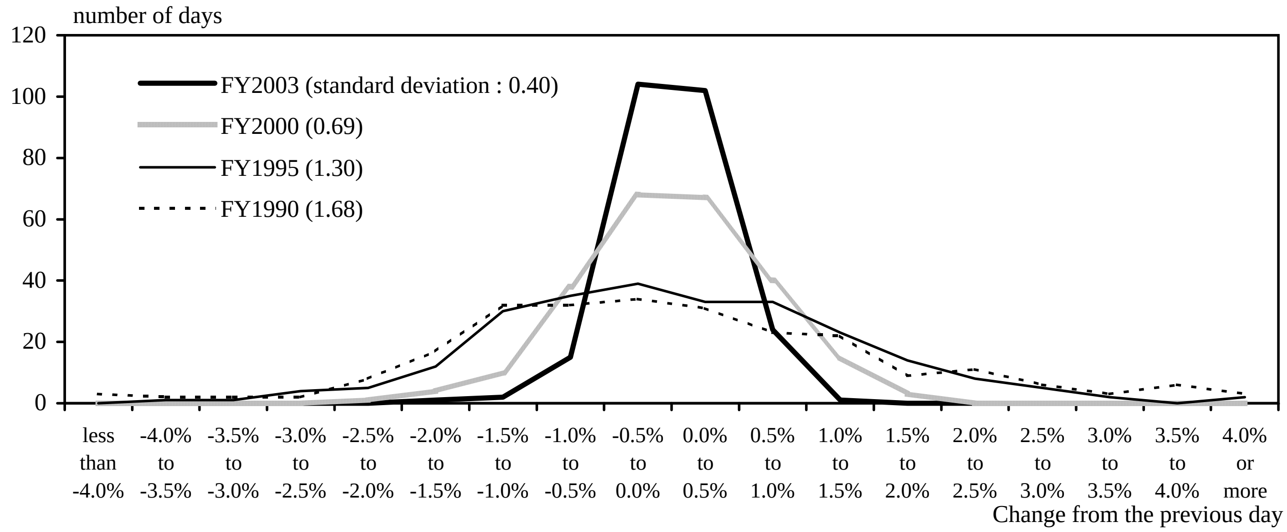
Banknotes in Circulation

(1) Outstanding Amount of Banknotes in Circulation and Interest Rates on Ordinary Deposits

(2) Outstanding Amount of Banknotes in Circulation



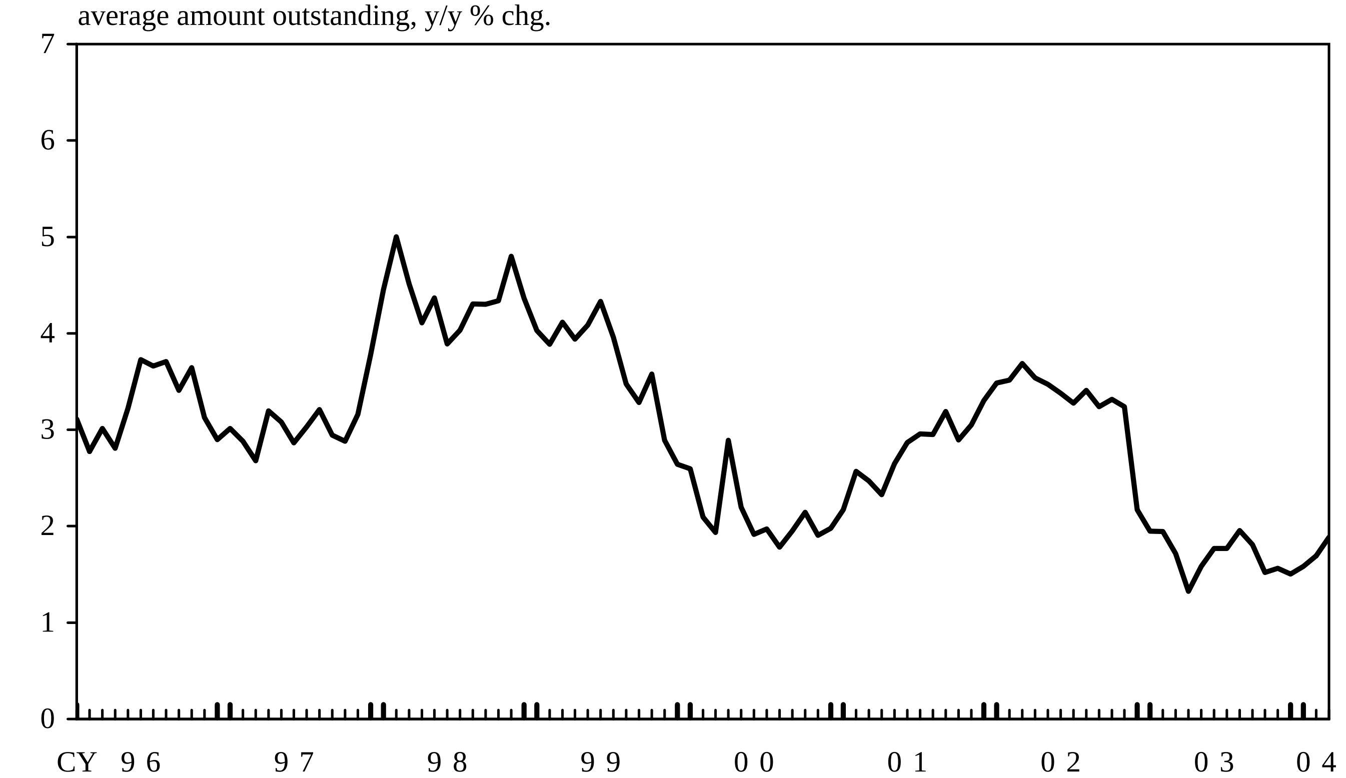
(3) Distribution of Daily Changes in Outstanding Amount of Banknotes in Circulation



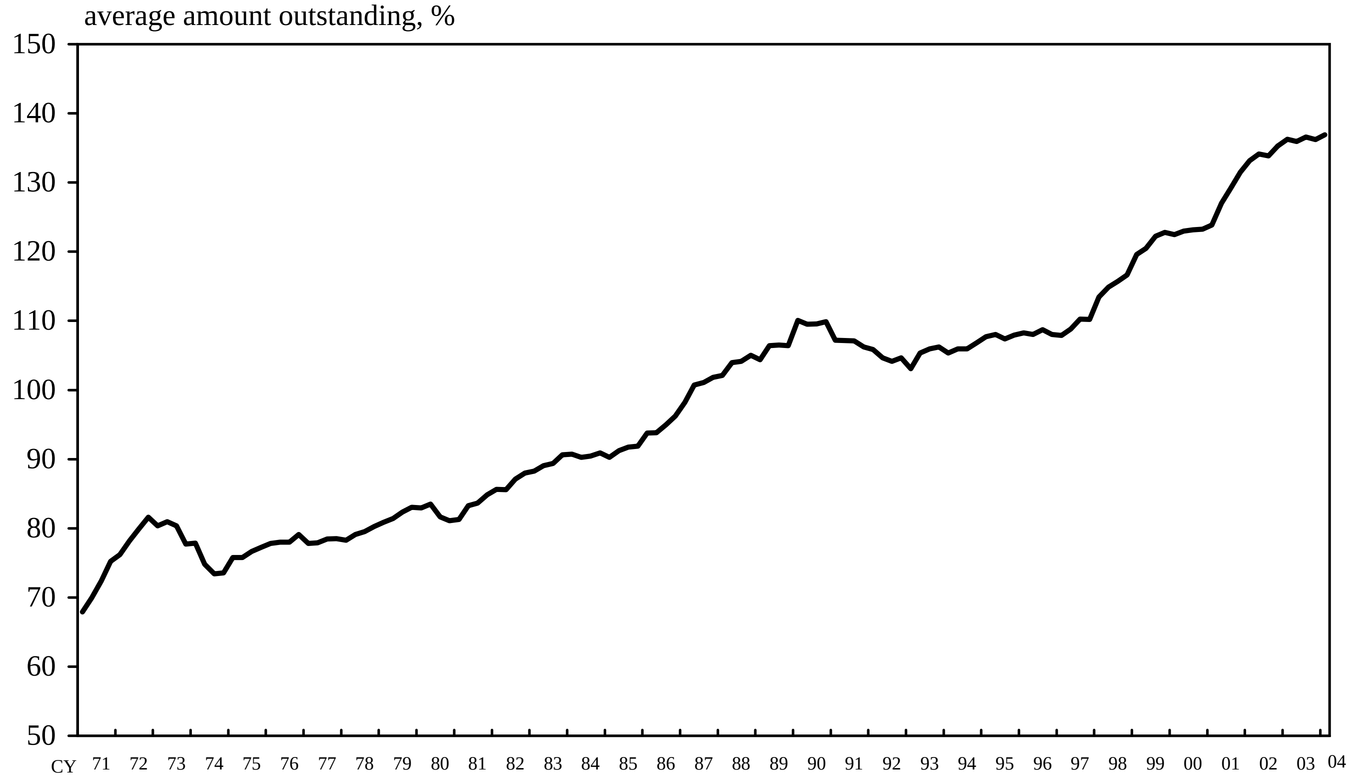
Sources: Cabinet Office, "National Accounts"; Bank of Japan.

Money Stock (M2+CDs)

(1) Changes from a Year Earlier



(2) Ratio of Money Stock to Nominal GDP

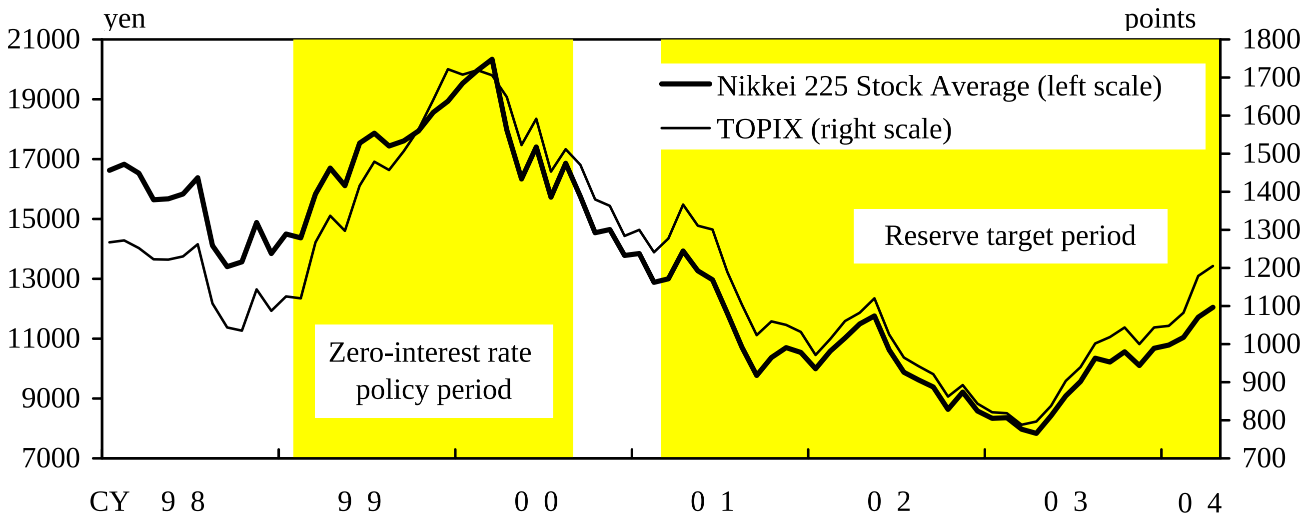


Note: The nominal GDP in 2004/Q1 is assumed to be unchanged from the previous quarter.

Sources: Cabinet Office, "National Accounts"; Bank of Japan.

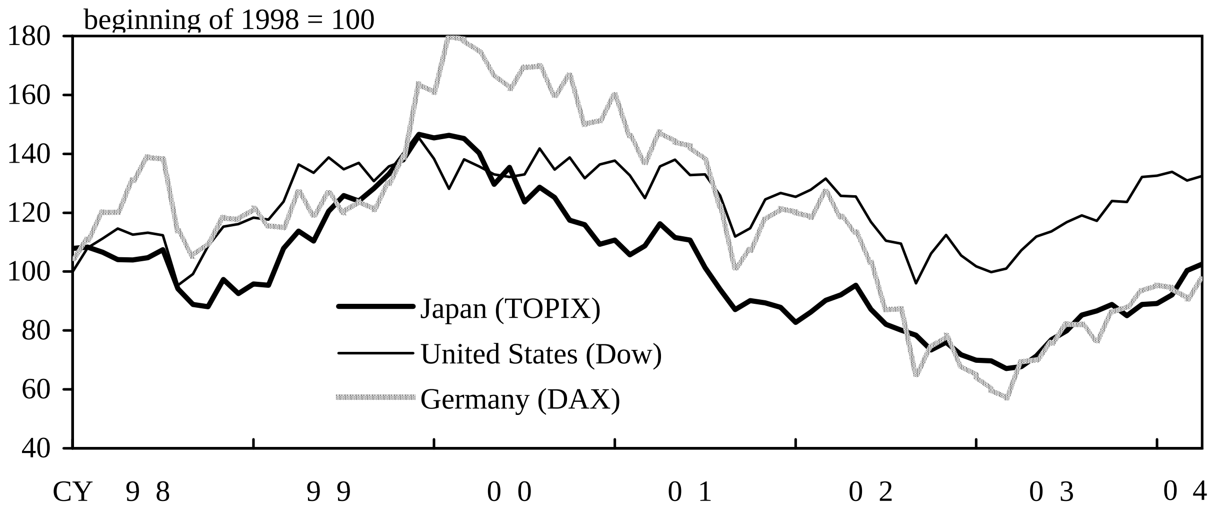
Stock Prices

(1) Japan



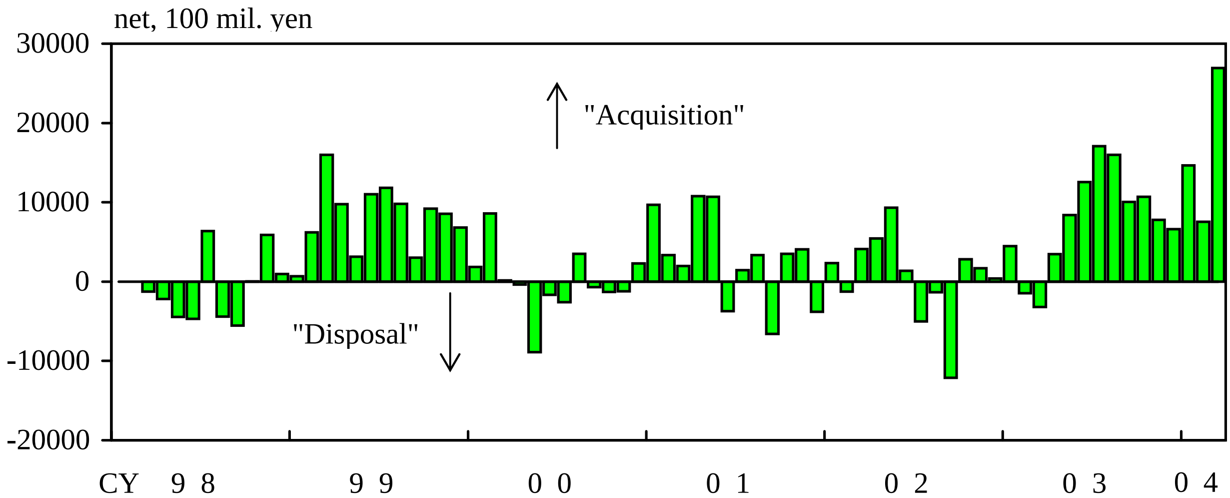
Note: Data are at end of month. Figures for April 2004 are those of April 27.

(2) Major Countries



Note: Data are at end of month. Figures for April 2004 are those of April 27.

(3) Inward Stocks Investment

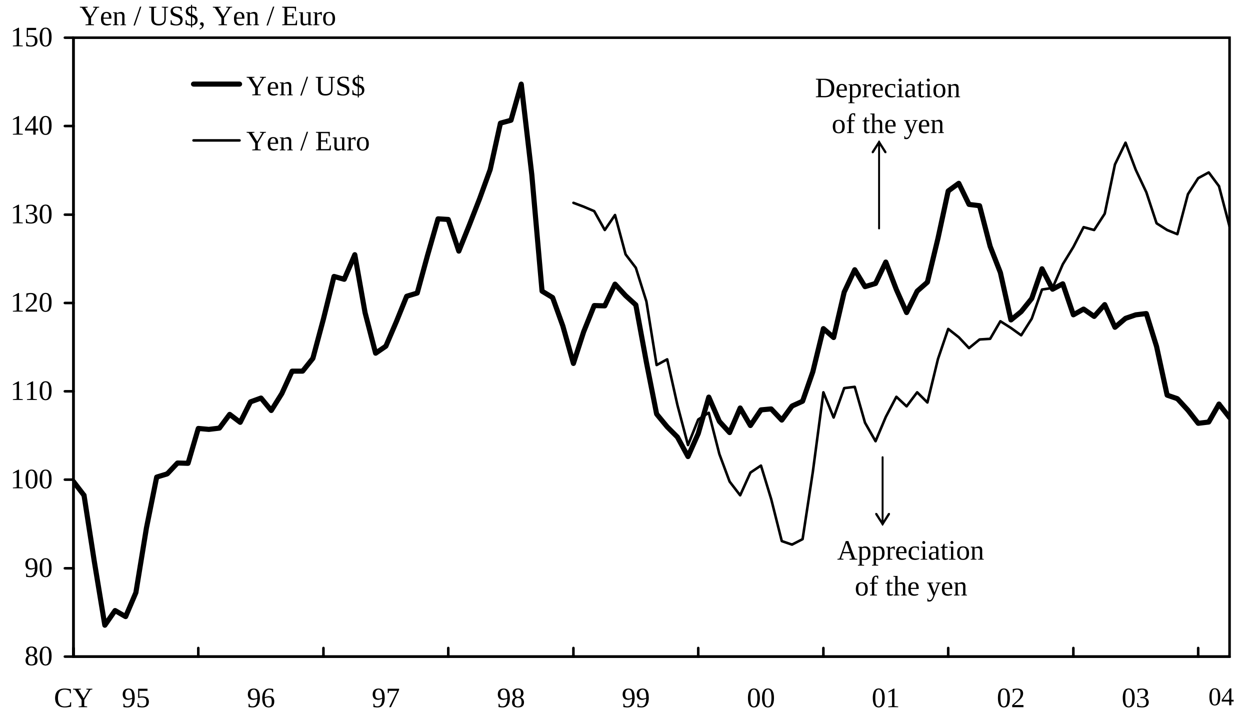


Note: Contract basis.

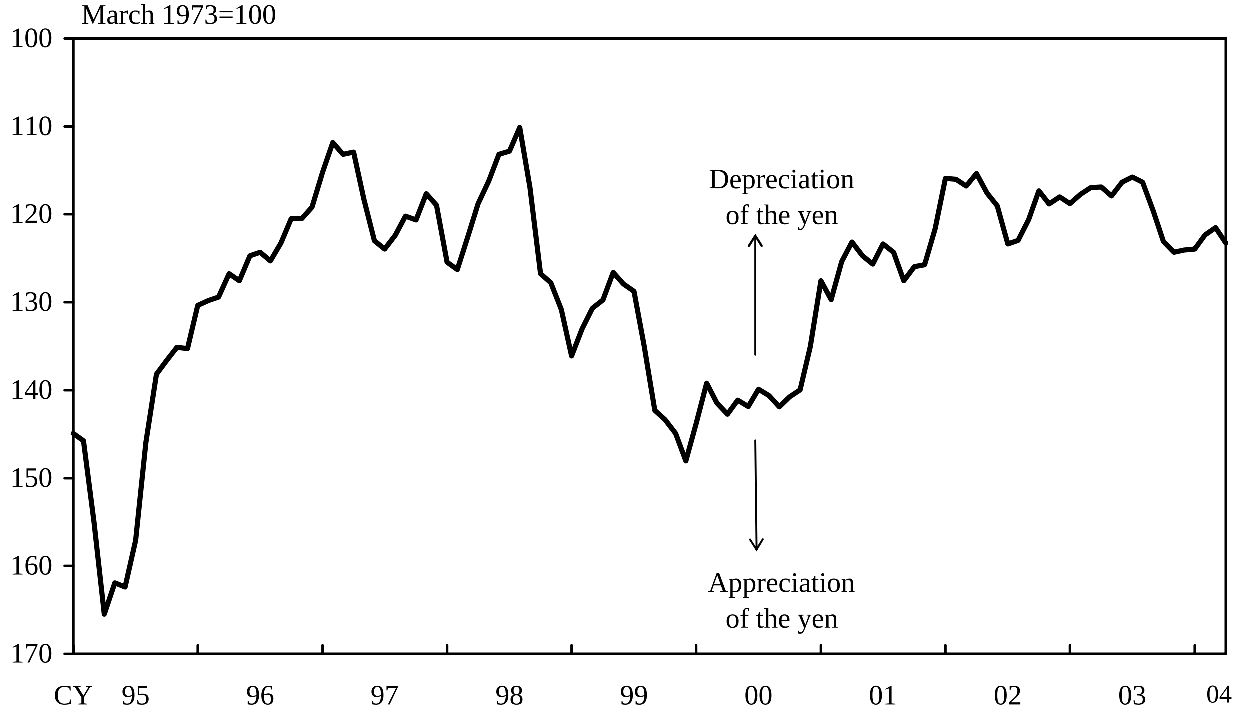
Sources: *Nihon Keizai Shimbun* ; Ministry of Finance, "Securities Investment at Home and Abroad."

Exchange Rates

(1) Yen / US$ and Yen / Euro



(2) Real Effective Exchange Rate

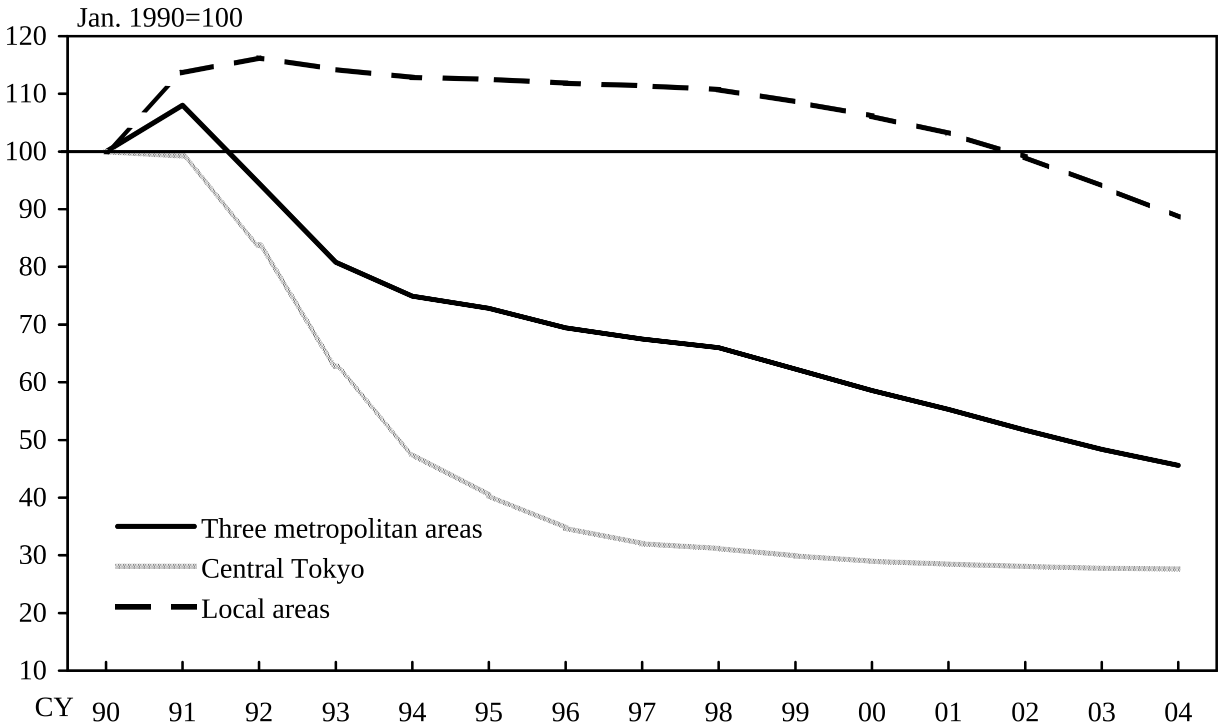


Notes: 1. Monthly average. Figures for April 2004 are averages up to the latest available data
2. The real effective exchange rate is set against 15 currencies that have large share among the Japanese total exports. Producer price indices (PPI), or wholesale price indices (WPI) are used to deflate the nominal effective exchange rates.

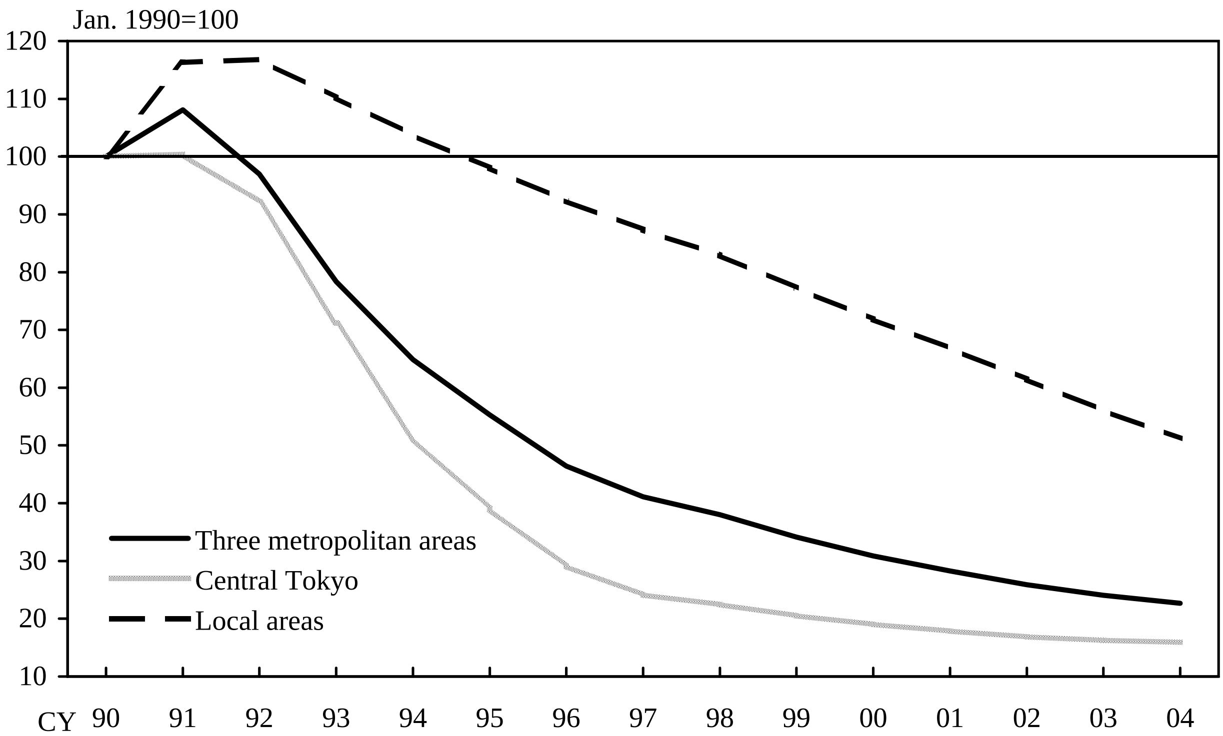
Source: Bank of Japan.

Land Prices

(1) Residential Land



(2) Commercial Land

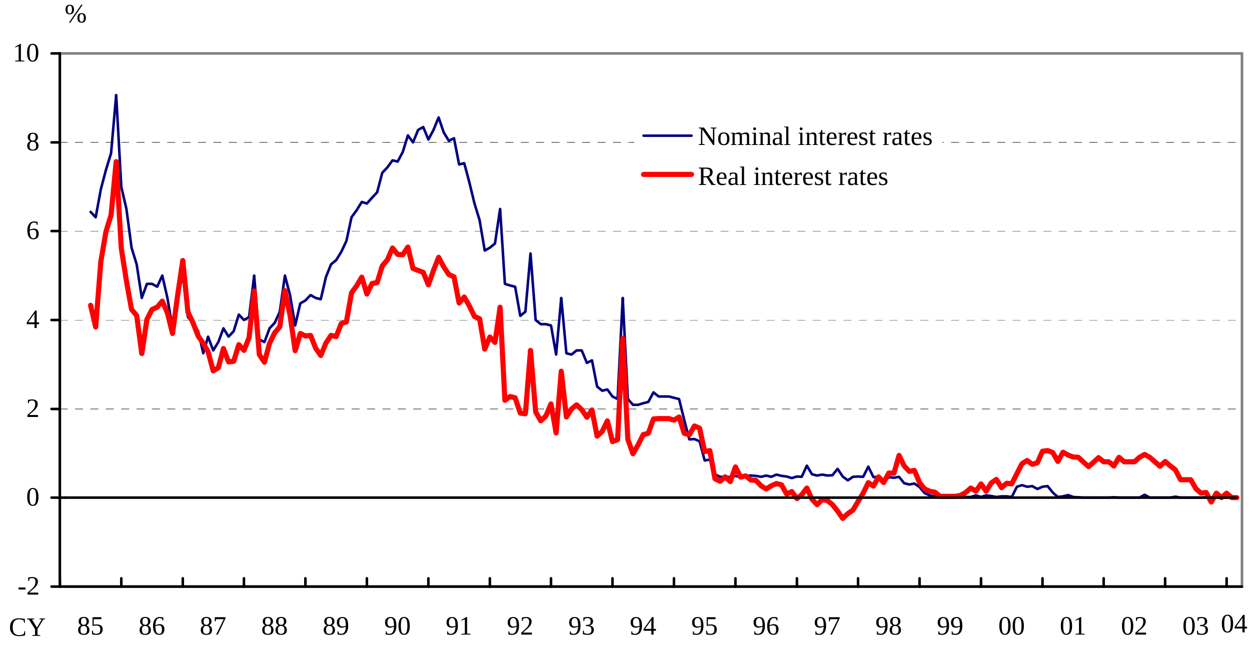


Note: Central Tokyo: average of eight wards in central Tokyo, such as Chiyoda Ward, Chuo Ward, and Minato Ward.

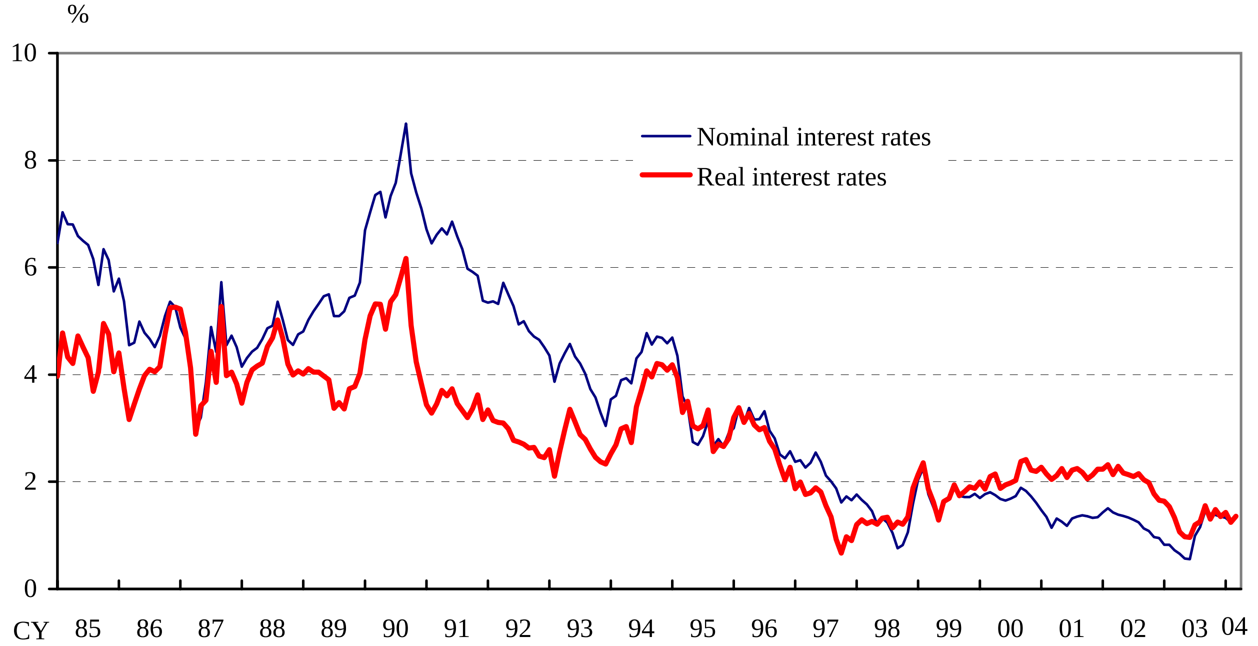
Source: Ministry of Land, Infrastructure and Transport, "Publication of Land Price."

Real Interest Rates

(1) Short-Term Interest Rates (Overnight Uncollateralized Call Rates)



(2) Long-Term Interest Rates (10-year Government Bond Rates)

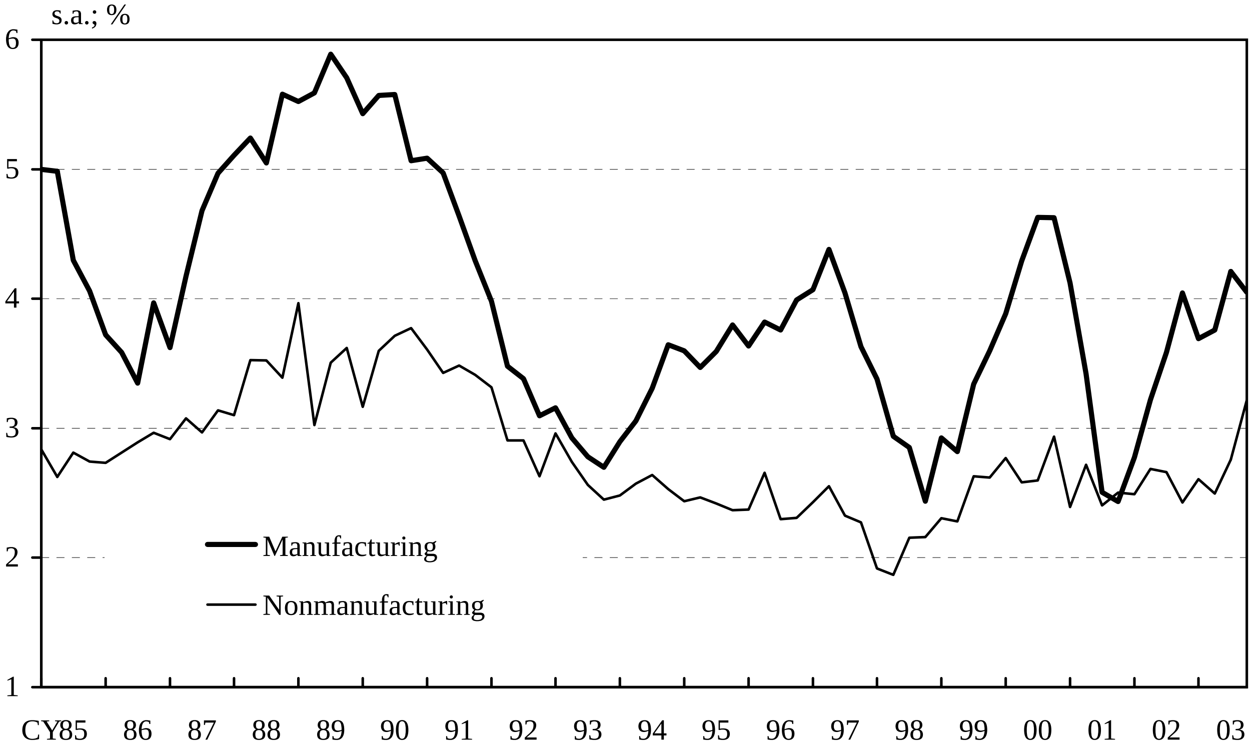


Notes:1. Real interest rate = nominal interest rate - the year-on-year change in the CPI.
2. The CPI (excluding fresh food) , adjusted to exclude the effects of the consumption tax introduction in April 1989 and its hike in April 1997.

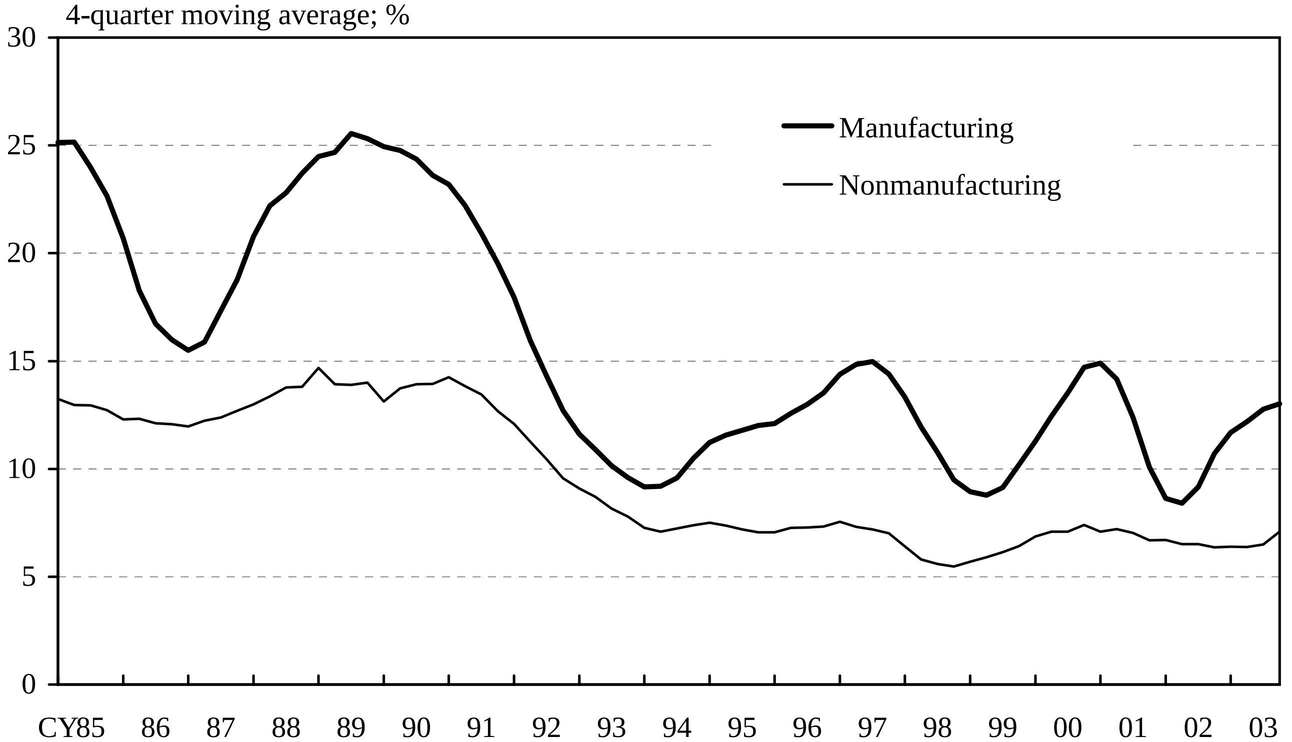
Sources: Ministry of Public Management, Home Affairs, Posts and Telecommunications, "Consumer Price Index"; Bank of Japan; Japan Bond Trading Co., Ltd.

Corporate Profits

(1) Ratio of Operating Profits to Sales



(2) Return on Assets (ROA)

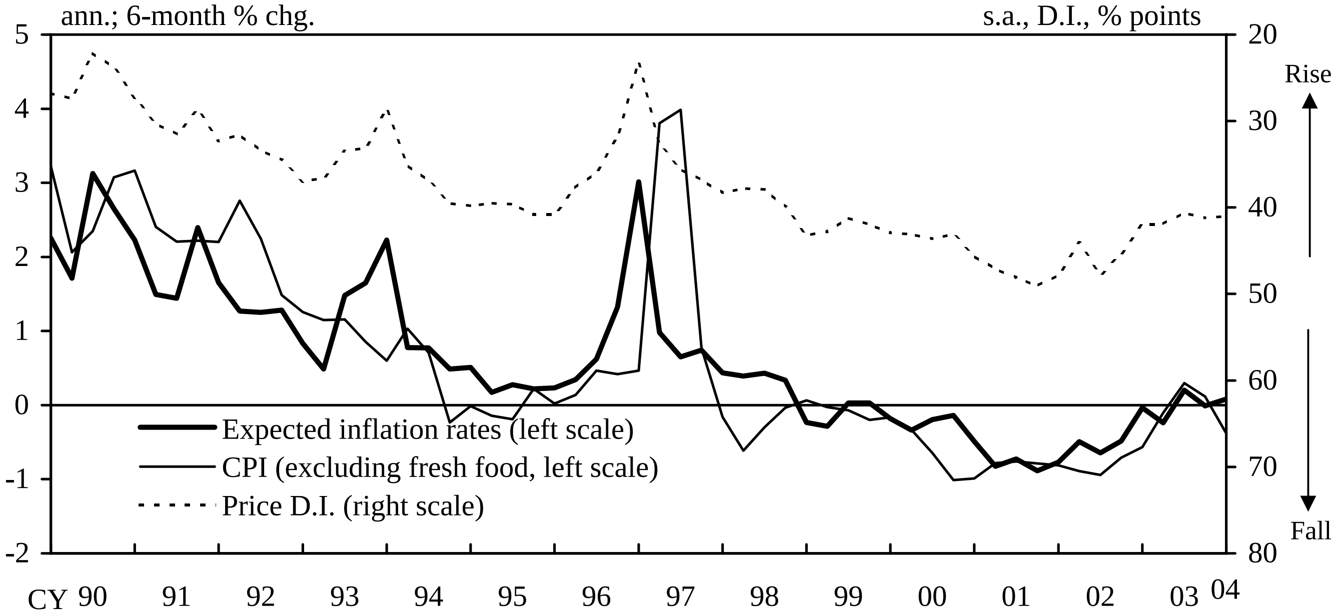


Notes: 1. Large firms of the other services industry are excluded from nonmanufacturing firms.
2. ROA = operating profits / (land + other property, plant, and equipment).

Source: Ministry of Finance, "Financial Statements Statistics of Corporations by Industry, Quarterly."

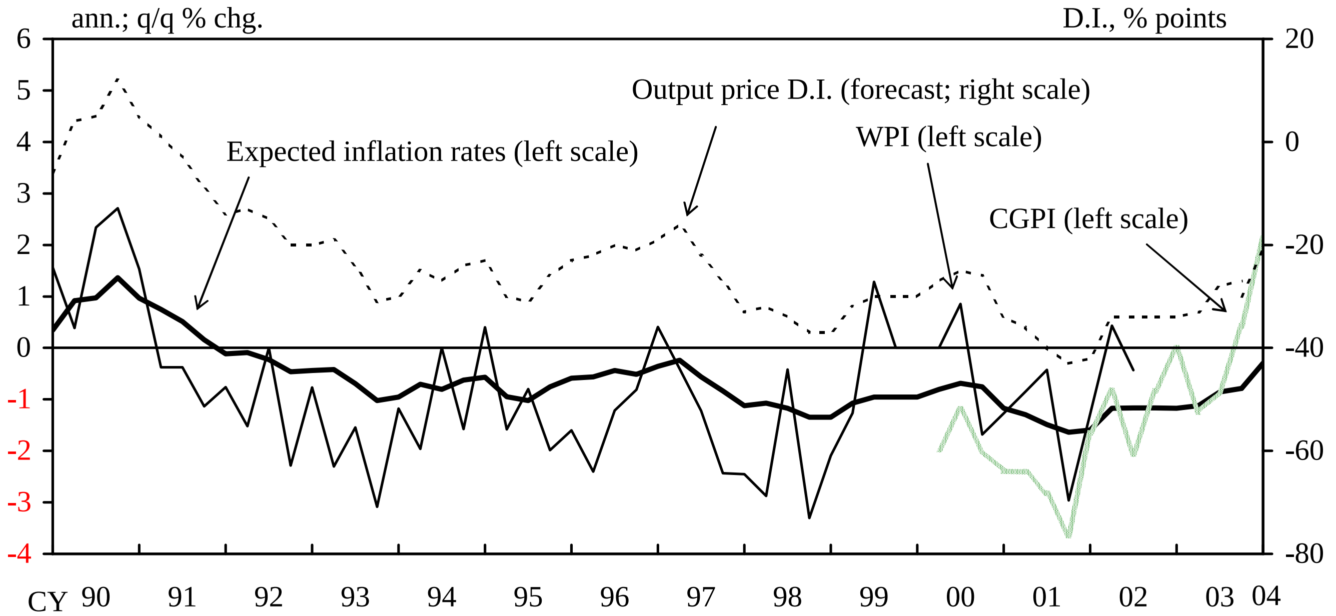
Expected Inflation Rates

(1) Expected Inflation Rates of Consumers Estimated by the Carlson-Parkin Method



Notes: 1. Figures are estimated by the Carlson-Parkin method using the price D.I. in "Consumer Confidence Survey". The restriction that the middle of the two thresholds, i.e., unchanging inflation rate equals zero percent, is not imposed.
2. Figure of the CPI for 2004/Q1 is the average of January and February.
3. Estimation period is 1990/Q1-2003/Q4.

(2) Expected Inflation Rates of Firms Estimated by the Carlson-Parkin Method



Notes: 1. Figures are estimated by the Carlson-Parkin method using output price D.I. for manufacturing (forecast) in the *Tankan* . The restriction that the middle of the two thresholds, i.e., unchanging inflation rate equals zero percent, is not imposed.
2. The influences of changes in the survey methods for the D.I. and the price index are adjusted.
3. Estimation period is 1990/Q1-2004/Q1.

Sources: Ministry of Public Management, Home Affairs, Posts and Telecommunications, "Consumer Price Index"; Cabinet Office, "Consumer Confidence Survey"; Bank of Japan, "*Tankan* - Short-Term Economic Survey of Enterprises in Japan," "Corporate Goods Price Index," "Wholesale Price Indexes."