

April 28, 2011
Bank of Japan

**Outlook for Economic Activity and Prices
(April 2011)**

The Bank's View¹

I. Introduction

The outlook for Japan's economy, which since early 2011 had been emerging from a phase of deceleration, changed significantly with the Great East Japan Earthquake that struck on March 11. As a result of the disaster, the economy will inevitably continue to face strong downward pressure for the time being. The following aspects are important in examining the outlook for Japan's economy through fiscal 2012 presented in this April 2011 issue of the *Outlook for Economic Activity and Prices* (Outlook Report). First, there has been no significant change in the fundamental conditions that supported Japan's economic recovery prior to the earthquake, including strong growth in overseas economies. The earthquake disaster is exerting downward pressure on the economy essentially in the form of a supply-side shock mainly due to damage to production facilities. In this respect, the situation differs from the economic conditions following the failure of Lehman Brothers, when the financial crisis triggered a sharp drop in global demand. Second, the effects of the disaster will change over time. In the short run, the effects of supply-side constraints will dominate, but such constraints will eventually ease and instead the effects of investment to restore damaged capital stock will become more evident. From an even longer-term perspective, what is also important is how the disaster affects the growth potential of Japan's economy. Third, there is considerable uncertainty regarding the way these effects of the disaster -- including their timing and scale -- will play out. Therefore, when making projections of future developments in economic activity and prices, it has become even more important than usual for the Bank of Japan to carefully assess not only its baseline scenario but also risk factors.

¹ The text of "The Bank's View" was decided by the Policy Board at the Monetary Policy Meeting held on April 28, 2011.

Keeping the above points in mind, this Outlook Report first provides a description of developments in overseas economies and global financial markets affecting trends in Japan's economy, followed by the Bank's assessment of Japan's financial environment. Next, the scenario considered to be the most likely by the Bank -- its baseline scenario -- is described, and upside and downside risks associated with the scenario are examined. Finally, a summary of the Bank's basic thinking on the conduct of monetary policy is provided.

II. Overseas Economies and Global Financial Markets

The pace of growth in overseas economies slowed somewhat from summer 2010, partly because inventory restocking carried out in the early phase of economic recovery had run its course. However, the recovery trend itself in overseas economies remained intact, and since autumn 2010 the global economy has again been growing at historically high rates, led by strong growth in emerging and commodity-exporting economies. On the back of this high growth, upward pressure on prices has gradually been increasing worldwide. Emerging and commodity-exporting economies have continued monetary tightening, and some advanced economies have started to withdraw monetary easing. Looking at developments by region, in the United States concern about the sustainability of the recovery has receded since autumn 2010, against the backdrop of monetary easing and fiscal stimulus measures, including the extension of tax cuts. Economic activity in Europe as a whole has continued to recover at a modest pace. At the same time, the contrast has become more pronounced between countries enjoying export-led growth, such as Germany, and peripheral countries experiencing sluggish growth as a result of fiscal austerity to cope with sovereign risk problems. Meanwhile, strong growth in emerging and commodity-exporting economies continues amid robust domestic demand and capital inflows from abroad.

Overseas economies are expected to continue recovering, led by strong growth in emerging and commodity-exporting economies. As in 2010, the growth rate of the global economy in 2011 and 2012 is expected to surpass the average of the ten years preceding the financial

crisis, a period of high global economic growth.² Looking at developments by region, the U.S. economy is likely to continue recovering, as exports -- mainly to emerging and commodity-exporting economies -- will likely continue their uptrend, and private consumption and business fixed investment will likely continue to increase moderately on the back of an accommodative monetary environment. As for Europe, with rising exports gradually boosting domestic demand, economic activity -- despite differences between core and peripheral countries -- is likely to continue recovering modestly. Emerging and commodity-exporting economies are likely to continue monetary tightening on the back of heightened concern over inflation but maintain relatively high growth amid continued robust domestic demand and capital inflows from abroad. Specifically, the Chinese economy is expected to continue showing high growth due to the continued uptrend in private consumption, housing investment, and investment in various infrastructures on the back of higher household incomes and continuing urbanization. Economic activity in the NIEs and ASEAN countries is likely to follow an expansionary trend, as not only exports but also domestic private demand such as business fixed investment and private consumption are expected to continue increasing.

Looking at developments in global financial markets, investors' risk aversion has receded since autumn 2010 partly due to an improvement in market perceptions of the U.S. economy, and stock prices in many countries followed an uptrend. In bond markets, U.S. long-term interest rates increased, leading to a rise in long-term interest rates in other countries. Meanwhile, in Europe, since the Greek crisis progress has been made in establishing various mechanisms to achieve stability, based on which Ireland and Portugal have requested financial support, but there continues to be concern about the sovereign risk problems in some peripheral European countries and the potential effects on global financial markets. Immediately after the earthquake in Japan, investors' risk aversion heightened and stock prices and long-term interest rates temporarily fell globally due to increased uncertainty about the economic outlook. However, financial markets subsequently

² According to the projections for global economic growth (calculated as the aggregate of purchasing-power-parity weighted GDP growth projections for individual countries or regions) released by the International Monetary Fund in April 2011, the global economy is expected to grow by 4.4 percent in 2011 and 4.5 percent in 2012. The average growth rate during the ten years preceding the financial crisis -- from 1998 to 2007 -- was 4.0 percent.

regained stability. After the earthquake, volatility in foreign exchange markets increased substantially and the exchange rate of the yen against the U.S. dollar hit a historical high of 76.25 yen; however, triggered by concerted intervention by the Group of Seven (G-7) countries, the yen depreciated and stayed in a range of 82-83 yen. With regard to developments in global financial markets, careful attention needs to be paid to changes in investors' risk-taking stance as a result of the sovereign risk problems in some peripheral European countries and potential shifts in capital flows due to adjustments to monetary easing around the world.

III. Japan's Financial Environment

Looking at financial developments in Japan, even in the wake of the earthquake, the financial intermediation function has been maintained and smooth funds settlement has been secured. Financial markets have also remained stable as the Bank continued to provide ample funds. While financial conditions have generally continued to ease, the financial position of some firms, mainly small ones, has deteriorated since the earthquake.

As for the outlook, firms' demand for credit is likely to increase. A growing number of firms, especially small ones, are likely to face a deterioration in their financial position, mainly due to the drop in turnover as a result of the earthquake disaster. Because of the heightened uncertainty, some firms have started to build up on-hand liquidity. As for firms' funding conditions, looking at the CP and corporate bond markets, the issuing conditions for CP have remained favorable. In the corporate bond market, although the new issuance of bonds came to a halt after the earthquake due to heightened uncertainty, firms have gradually started issuing bonds again as credit spreads on corporate bonds have recently declined from the levels seen immediately after the earthquake. In terms of bank lending, which accounts for a large share of small firms' funding, private financial institutions are fully able to meet any future increase in demand for funds, as they have been increasing their own capital by issuing common shares and accumulating retained earnings. Moreover, firms' funding is supported by various financial measures including disaster-related guarantees provided by credit guarantee corporations. In this situation, the easing trend in financial conditions will likely continue as the effects of the Bank's

significant monetary easing spread further, and this is likely to support the momentum toward recovery in domestic private demand.

IV. Baseline Scenario of the Outlook for Economic Activity and Prices in Japan

A. Outlook for Economic Activity

On the basis of the aforementioned developments in overseas economies and the financial environment at home and abroad, the following examines the scenario for Japan's economy considered to be the most likely by the Bank -- that is, the baseline scenario.

The pace of recovery in Japan's economy slowed from the beginning of autumn 2010. Sales of some durable consumer goods declined substantially following the earlier rush in demand, while exports almost remained flat against the backdrop of a temporary slowdown in the pace of growth in overseas economies, the appreciation of the yen in the summer, and inventory adjustments in IT-related goods. However, from early 2011, prior to the earthquake, Japan's economy was emerging from the deceleration phase, with exports and production showing signs of resuming their uptrend as growth in overseas economies accelerated again. Thus, economic activity prior to the earthquake was broadly in line with the projections presented in the October 2010 Outlook Report.

The situation changed significantly as a result of the earthquake. Substantial supply-side constraints since the earthquake have disrupted the recovery mechanism in which recovery in overseas economies fuels the momentum for recovery in Japan through increases in exports and production. The earthquake has led to the loss of a large number of production facilities in widespread areas directly affected by the disaster. In addition, difficulties in procuring materials and parts have disrupted supply chains on a national scale. Power shortages have become another supply-side constraint. As a result, production in some areas has declined sharply, severely affecting exports as well as domestic shipments and sales. Thus, the disaster has been affecting Japan's economy mainly through supply-side constraints. It also appears to be affecting the demand side by exerting downward pressures on business fixed investment and private consumption through a deterioration in business and household sentiment amid uncertainty about the economic

outlook, especially the effects of the accident at the nuclear power plant in Fukushima Prefecture. The nuclear accident is likely having adverse effects on private consumption and tourism, not only through the impact on sentiment described above but also through other channels including a decline in visitors from abroad.

The economic outlook greatly depends on when and at what pace the various supply-side constraints, including power shortages, are resolved. Examining the outlook for Japan's economy, the economy for the time being is likely to continue facing strong downward pressure, mainly on the production side.³ It is likely to take some time to reconfigure supply chains despite firms' ongoing efforts to restore affected facilities, carry out production at alternative sites, and secure alternative suppliers. Moreover, power supply shortages could put certain constraints on economic activity when electricity demand peaks in the summer. However, from the beginning of autumn 2011, supply-side constraints are likely to ease as the reconfiguration of supply chains will likely have made further progress and the balance of electricity supply and demand starts to improve. If this happens, improvements in overseas economies will lead to increases in Japanese exports and production, which in turn will once again clearly act as a driving force for economic recovery. Moreover, efforts to restore capital stock damaged by the earthquake disaster are projected to gradually provide a boost to Japan's economy.

Against this background, after facing strong downward pressure in the first half of fiscal 2011, Japan's economy is likely to recover at a faster pace throughout the second half, partly due to the rebound from the first half, on the back of clear increases in exports and production. In fiscal 2012, Japan's economy is projected to continue growing at a pace above its potential. It is likely that the transmission mechanism by which the strength in exports and production feeds through into income and spending will be more firmly

³ When the Great Hanshin-Awaji Earthquake struck in January 1995, production in Japan in that month fell 2.6 percent from a month earlier but then increased 2.2 percent in February. Exports showed a similar movement. The nationwide effects of the earthquake dissipated quickly because it was possible to replace lost production using alternative sources in a short period of time, since there were no constraints on electric power and supply chains.

established and demand for restoring capital stock will continue increasing.⁴ The following provides more detailed explanations of the outlook for the corporate and household sectors.

Regarding the corporate sector, supply-side constraints are likely to curtail production significantly in manufacturing and reduce exports substantially for the time being. Business conditions in the nonmanufacturing sector are also likely to deteriorate for the time being due to electricity supply constraints and reduced production levels in manufacturing. Corporate profits will likely fall significantly as a result of the substantial decline in exports and production as well as the effects of the rise in international commodity prices. Therefore, business fixed investment, which had been picking up gradually before the earthquake, is likely to be somewhat weak for a while. However, in the second half of fiscal 2011, as supply-side constraints ease, exports and production are likely to start increasing again on the back of continued strong growth in overseas economies.⁵ Moreover, it is projected that there will be efforts to restore capital stock damaged by the earthquake disaster. Thus, it is expected that corporate profits will start improving again after a temporary decline due to the effects of the disaster, and business fixed investment will also start picking up accordingly.

As for the household sector, employment and income are likely to be somewhat sluggish as the earthquake disaster reduces production and firms' sense of having excess labor heightens. Private consumption is likely to be subdued for the time being, partly because of cautious consumer sentiment reflecting uncertainty about the future. From the second

⁴ Japan's potential growth rate during the projection period is estimated to be "around 0.5 percent" based on a standard production function approach. However, estimates of the potential growth rate are subject to a considerable margin of error as they greatly depend on the specific methodology employed, although their accuracy increases as more data for the relevant period become available. The supply-side constraints caused by the disaster can be considered to be temporary and essentially will not affect the potential growth rate, which corresponds to the pace of increase in supply capacity in the longer run.

⁵ When production and exports resume their uptrend, rates of increase are likely to be temporarily large as pent-up demand is realized and restocking of depleted inventories takes place. It should be noted, however, that the timing of a renewed increase in production is highly uncertain because it depends on the pace of the reconfiguration of supply chains and developments in the supply and demand of electricity.

half of fiscal 2011, private consumption is expected to pick up again gradually as production recovers and the employment and income situation improves. However, compensation of employees is likely to increase clearly only from fiscal 2012, when the self-sustaining recovery in the economy becomes more pronounced. Thus, the pace of recovery in private consumption will likely remain modest for some time. Meanwhile, regarding housing investment, housing construction may be delayed in some regions for the time being, partly due to shortages of materials caused by the disaster. However, housing investment is projected to recover moderately throughout the projection period on the back of the decline in borrowing rates and efforts to restore damaged housing stock.

B. Outlook for Prices

Based on the above projections for economic activity, the following examines the outlook for price developments. The year-on-year rate of decline in the consumer price index (CPI) for all items excluding fresh food has continued to slow. With the aggregate supply and demand balance improving gradually, the year-on-year rate of change has recently turned slightly positive if the effects of subsidies for high school tuition are excluded, partly due to the rise in international commodity prices.⁶

The outlook for the environment surrounding prices can be summarized as follows. The supply constraints caused by the earthquake disaster will likely bring about bottlenecks in markets for certain goods and services, which could exert upward pressure on prices. However, there is considerable uncertainty in the short run about how the aggregate supply and demand balance will change, because the disaster will not only continue to cause severe supply-side constraints but also probably reduce demand.⁷ In the longer run, the aggregate supply and demand balance is expected to improve gradually as the economy returns to a moderate recovery path. Judging from the results of surveys of households and firms and

⁶ In order to assess the trend change in prices, the CPI for fiscal 2010 excludes the effects of subsidies for high school tuition, which significantly pushed down the year-on-year rate of change in the index for the period.

⁷ Estimates of the aggregate supply and demand balance need to be treated from a longer-term perspective, and a certain margin of error should be allowed for. At present, particular attention needs to be paid to the exceptional circumstances such as electricity supply shortages and supply-chain disruptions.

economists, no significant change in medium- to long-term expected rates of inflation has been observed so far and inflation expectations are assumed to remain stable throughout the projection period. Medium- to long-term expected rates of inflation by market participants and economists have been stable at around 1.0 percent in recent years. International commodity prices are rising continuously on the back of strong growth in emerging and commodity-exporting economies, and are assumed to continue increasing moderately in the future.

As for the outlook for prices against this environment, with the aggregate supply and demand balance on an improving trend, the domestic corporate goods price index (CGPI) is expected to continue rising on a year-on-year basis throughout the projection period reflecting the rise in international commodity prices. The effects of the rise in international commodity prices are likely to spread to the CPI with some time lag. In addition, under the assumption that medium- to long-term inflation expectations remain stable, the year-on-year rate of change in the CPI is expected to remain slightly positive throughout the projection period, as the aggregate supply and demand balance improves as a trend.⁸

V. Upside and Downside Risks

A. Risks to Economic Activity

The aforementioned outlook is the scenario the Bank considers to be the most likely, in other words, the baseline scenario. The following upside and downside risks concerning the outlook for economic activity warrant attention.

First, there is a high degree of uncertainty about the possible effects of the earthquake disaster on Japan's economy. At this point, it is highly uncertain when supply-side constraints will be resolved, because it is difficult to forecast how electricity supply shortages and supply chain disruptions will unfold in the future. The effects of such

⁸ This outlook for inflation is predicated on the 2005-base CPI. The statistics authority has announced that the base year for the CPI is scheduled to be changed to 2010 in August 2011, and year-on-year figures as far back as January 2011 are scheduled to be revised retroactively. This rebasing is likely to cause the year-on-year rate of increase in the CPI to be revised downward.

constraints on economic activity greatly depend on the pace at which the constraints dissipate and the degree to which firms make progress in their response. There is also considerable uncertainty about the timing and scale of the restoration of damaged capital stock. From a longer-term perspective, on one hand, the recent disruptions to supply chains and damage to the electricity infrastructure may accelerate the shift to overseas production. On the other hand, in the process of reconfiguring supply chains, reviewing risk management based on the experience of the disaster, and restoring agriculture and fishery industries, individual economic entities may make proactive and creative efforts to generate new sources of demand. As for the impact of sentiment on the economy, due attention needs to be paid not only to future developments in the situation at the nuclear power plant but also to uncertainty about the outlook for corporate profits and compensation of employees. On the other hand, economic activity in Japan might turn out to be stronger than projected through a favorable turn in business and household sentiment, if the above causes for concern are resolved at an early stage and uncertainty about the economic outlook declines.

Second, although the Bank's baseline scenario projects that medium- to long-term growth expectations by firms and households will remain unchanged, attention needs to be paid to a possible change in firms' and households' growth expectations triggered by the earthquake disaster. Even before the earthquake, Japan was faced with the fundamental challenge of strengthening the growth potential of the economy, but meeting this challenge has now become all the more important. If concern about the medium- to long-term growth potential of Japan's economy heightens due to the effects of the disaster, this could depress firms' and households' appetite for spending and act to reduce economic activity for a protracted period. On the other hand, medium- to long-term growth expectations by firms and households could rise if firms take the disaster as an opportunity to bolster efforts to implement growth strategies.

The third risk concerns developments in overseas economies. In the United States, uncertainty about the economic outlook has receded since autumn 2010; on the other hand, balance-sheet adjustment pressure has continued to weigh on the economy. As for Europe, attention needs to be paid to whether concern about sovereign risk problems in some

peripheral countries acts to reduce economic activity through disturbances in financial markets and, if this happens, whether adverse feedback loops occur. In many advanced economies, including Japan, the amount outstanding of public debt has increased considerably. In this situation, there is an urgent need for efforts toward fiscal consolidation, and if markets judge such efforts to be insufficient, this is likely to have adverse effects on economic activity through a rise in long-term interest rates and a decline in market sentiment. On the other hand, emerging and commodity-exporting economies are likely to maintain relatively high growth led mainly by robust domestic demand, and it is possible that growth will accelerate partly due to capital inflows from abroad. If this happens, the faster growth in these economies might present an upside risk to Japan's economy through an increase in exports. At the same time, although many emerging and commodity-exporting economies have continued monetary tightening, this has not sufficiently calmed concern over overheating or inflation. Therefore, due attention needs to be paid to the possibility that fluctuations in economic activity in these economies may grow and that, from a longer-term perspective, sustainable growth may be undermined.

Fourth, attention also needs to be paid to the effects brought about by a possible further rise in international commodity prices. One factor underlying the rise in international commodity prices is the increase in demand. Emerging economies with low energy efficiency have continued to grow at a rapid pace, and the standard of living in these economies has improved sharply amid such strong growth. If the rise in international commodity prices reflects the strong growth in emerging and commodity-exporting economies, its effects on Japan's economy are likely to be offset by an increase in exports to these economies and in direct investment income receipts. It should be noted, however, that the recent rise in commodity prices is also attributable to the heightened geopolitical risks in the Middle East and North Africa as well as supply-side factors such as adverse weather conditions and natural disasters. Moreover, financial developments on the back of continued accommodative monetary conditions worldwide have partly contributed to the acceleration in the increase in international commodity prices. If international commodity prices rise further, the decline in real purchasing power and deterioration in corporate profits resulting from a further deterioration in the terms of trade could act to reduce private domestic demand in Japan.

B. Risks to Prices

There is also uncertainty regarding the outlook for prices, which could deviate either upward or downward from the projection. To begin with, if any of the aforementioned upside and downside risks to economic activity materialize, prices might be affected accordingly. In this context, it is particularly important to assess the potential impact of the earthquake disaster on prices. As noted earlier, it should be taken into account that, regarding the effects of the disaster on the aggregate supply and demand balance, supply-side constraints work in the direction of tightening the supply and demand balance, while the decline in demand works in the opposite direction. Meanwhile, if the supply capacity of the economy as a whole is constrained for a protracted period, for example due to power shortages, a tightening of the aggregate supply and demand balance is likely to present an upside risk to prices. At the same time, however, attention should be paid to the possibility that, if the economic downturn caused by supply constraints is prolonged and downward pressure on corporate profits and compensation of employees continues, this could lead to a deterioration in the supply and demand balance, which could in turn pose a downside risk to prices.

There are also the following risks specific to prices. The first concerns firms' and households' medium- to long-term inflation expectations. Going forward, Japan's economy is expected to return to a recovery path, but the pace of recovery is likely to remain moderate. In these circumstances, if firms and households expect a continued decline in prices, this might exert downward pressure on actual prices, together with wages. In addition, if the year-on-year rate of change in the CPI is revised downward with the base-year change scheduled for August 2011, attention needs to be paid to whether this affects firms' and households' inflation expectations.

The second risk concerns developments in import prices. Considerable uncertainty surrounds developments in prices of primary commodities such as crude oil, with potential for movement in either direction. Depending on the political situation in the Middle East and North Africa, economic developments in relatively energy-inefficient emerging economies, and capital inflows to commodity markets on the back of accommodative

monetary conditions worldwide, primary commodity prices might see large fluctuations both up and down. Fluctuations in foreign exchange rates can also affect consumer prices to a certain extent, not only by causing swings in economic activity but also through changes in import prices.

VI. Conduct of Monetary Policy

Since immediately after the earthquake, the Bank has been taking swift measures focusing on three major aspects: maintaining the functioning of financial and settlement systems, ensuring the stability of financial markets, and supporting economic activity. First, in terms of maintaining the functioning of financial and settlement systems, the Bank has been doing its utmost to provide cash in the disaster areas and to ensure the stable operation of Japan's core payment and settlement systems, including the Bank of Japan Financial Network System (BOJ-NET). In response to increased precautionary demand for funds, with a view to ensuring stability in financial markets, the Bank has also been providing ample funds sufficient to meet demand in the markets. Moreover, it further strengthened monetary easing by increasing the amount of the Asset Purchase Program, mainly of the purchases of risk assets, by about 5 trillion yen, with a view to preventing any deterioration in business sentiment and heightening of risk aversion in financial markets from adversely affecting economic activity. In addition to such measures, the Bank decided to introduce a funds-supplying operation that provides financial institutions in disaster areas with longer-term funds in order to provide financial support to their initial response efforts to meet the demand for funds for restoration and rebuilding. The Bank also decided to broaden the range of eligible collateral for money market operations with a view to ensuring that financial institutions in the disaster areas have sufficient financing capacity.

The Bank assesses the economic and price situation from two perspectives and then outlines its thinking on the future conduct of monetary policy. In this process, the Bank takes into account the "understanding of medium- to long-term price stability" (hereafter "understanding") -- that is, the level of inflation that each Policy Board member understands, when conducting monetary policy, as being consistent with price stability over the medium to long term. The Bank has made clear that it will continue the virtually zero interest rate policy until it judges, on the basis of the "understanding," that price stability is in sight, on

condition that no problem is identified in examining risk factors, including the accumulation of financial imbalances. The "understanding" was reviewed at the Monetary Policy Meeting on April 28, and showed that each Policy Board member's "understanding" falls in a positive range of 2 percent or lower, centering around 1 percent.

The first perspective from which the Bank assesses the economic and price situation is to examine the baseline scenario for the outlook for economic activity and prices -- that is, the scenario considered to be the most likely -- through fiscal 2012. As noted earlier, due to the effects of the earthquake disaster, Japan's economy is likely to continue facing strong downward pressure, mainly on the production side, for the time being. However, backed by an increase in exports reflecting the improvement in overseas economic conditions and by a rise in demand for restoring capital stock, the economy is expected to return to a moderate recovery path from the second half of fiscal 2011 as supply-side constraints ease and production regains traction. As for prices, with the aggregate supply and demand balance improving as a trend, the year-on-year rate of change in the CPI is expected to remain slightly positive throughout the projection period. Based on a comprehensive assessment of the outlook for economic activity and prices described above, the Bank expects that, although some more time will be needed to confirm that price stability is in sight on the basis of the "understanding," Japan's economy will eventually return to a sustainable growth path with price stability in the longer run.

The assessment from the second perspective examines the risks considered most relevant to the conduct of monetary policy, including risks that have a longer time horizon than the first perspective. In the area of economic activity, there is a high degree of uncertainty about the effects of the earthquake disaster on Japan's economy. Moreover, growth in emerging and commodity-exporting economies could turn out to be stronger than expected due to robust domestic demand and capital inflows from abroad. In the United States, growth could be higher than expected, but there is also a risk that balance-sheet adjustments could act to reduce economic activity. Regarding European economies, the possible consequences of the sovereign risk problems continue to warrant attention. Meanwhile, turning to the implications of the rise in international commodity prices, on the one hand, the high growth in emerging and commodity-exporting economies that lies behind the price

rise is likely to provide a boost to Japan's exports; on the other hand, the decline in real purchasing power resulting from the deterioration in the terms of trade could reduce private domestic demand in Japan. Regarding the outlook for prices, there is a possibility that inflation will rise more than expected if international commodity prices increase further, while there is also a risk that the rate of inflation will deviate downward from the Bank's baseline scenario due, for example, to a decline in medium- to long-term inflation expectations.

Based on the examination from the two perspectives described above, Japan's economy is expected to return to a sustainable growth path with price stability in the longer run. However, for the time being, attention should be paid to the downside risks to economic activity, especially the possible effects of the disaster.

As for the future conduct of monetary policy, the Bank -- in order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, and based on the examination from the two perspectives described above -- will continue to consistently make its utmost contributions as the central bank through the three-pronged approach of pursuing powerful monetary easing consisting of comprehensive monetary easing, ensuring financial market stability, and providing support to strengthen the foundations for economic growth. The Bank will continue to carefully examine the outlook for economic activity and prices, including the effects of the disaster, and take appropriate policy actions as necessary.

Forecasts of the Majority of Policy Board Members

y/y % chg.

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2010	+2.8 to +2.8 [+2.8]	+0.7	-0.3
Forecasts made in January 2011	+3.3 to +3.4 [+3.3]	+0.5 to +0.6 [+0.5]	-0.4 to -0.3 [-0.3]
Fiscal 2011	+0.5 to +0.9 [+0.6]	+1.6 to +2.6 [+2.2]	+0.5 to +0.8 [+0.7]
Forecasts made in January 2011	+1.4 to +1.7 [+1.6]	+0.7 to +1.2 [+1.0]	0.0 to +0.4 [+0.3]
Fiscal 2012	+2.7 to +3.0 [+2.9]	+0.3 to +0.7 [+0.6]	+0.5 to +0.7 [+0.7]
Forecasts made in January 2011	+1.9 to +2.2 [+2.0]	+0.5 to +0.8 [+0.7]	+0.2 to +0.8 [+0.6]

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

2. The forecasts of the majority of Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate, namely, the figure to which he or she attaches the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.

3. Individual Policy Board members make their forecasts with reference to the view of market participants regarding the future course of the policy interest rate -- a view that is incorporated in market interest rates.

4. The real GDP figures for fiscal 2010 are Policy Board members' estimates. The figures for the domestic CGPI and the CPI (excluding fresh food) are actual values.

5. The CPI for fiscal 2010 excludes the effects of the introduction of subsidies for high school tuition fees, a factor that substantially lowered the year-on-year rate of change in the CPI for the year. Specifically, this measure is estimated to have lowered the year-on-year rate of change in the CPI (excluding fresh food) by approximately 0.5 percentage point.

6. The outlook for inflation is predicated on the 2005-base CPI. The statistics authority has announced that the base year for the CPI is scheduled to be changed to 2010 in August 2011, and year-on-year figures as far back as January 2011 are scheduled to be revised retroactively. This rebasing is likely to cause the year-on-year rate of increase in the CPI to be revised downward.

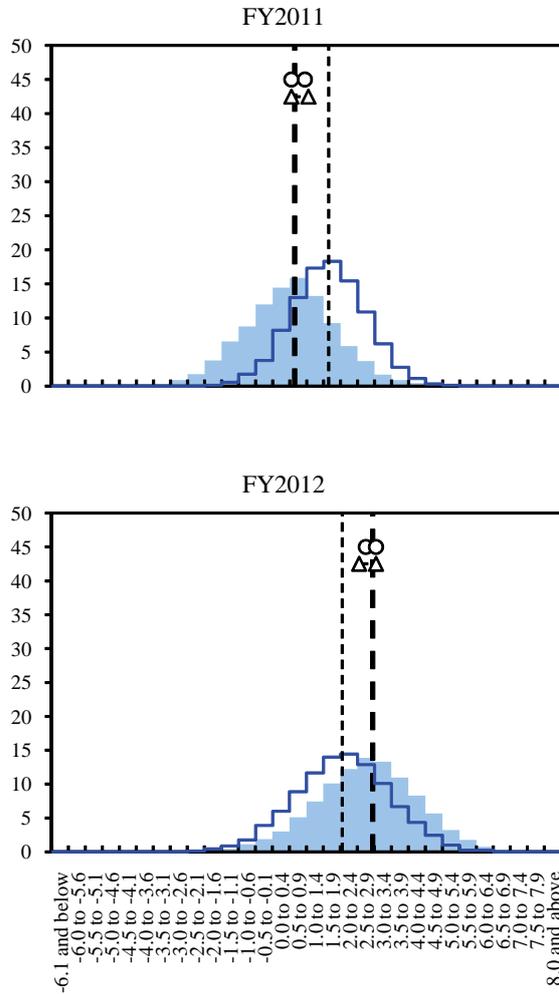
7. The ranges shown below include the forecasts of all Policy Board members.

y/y % chg.

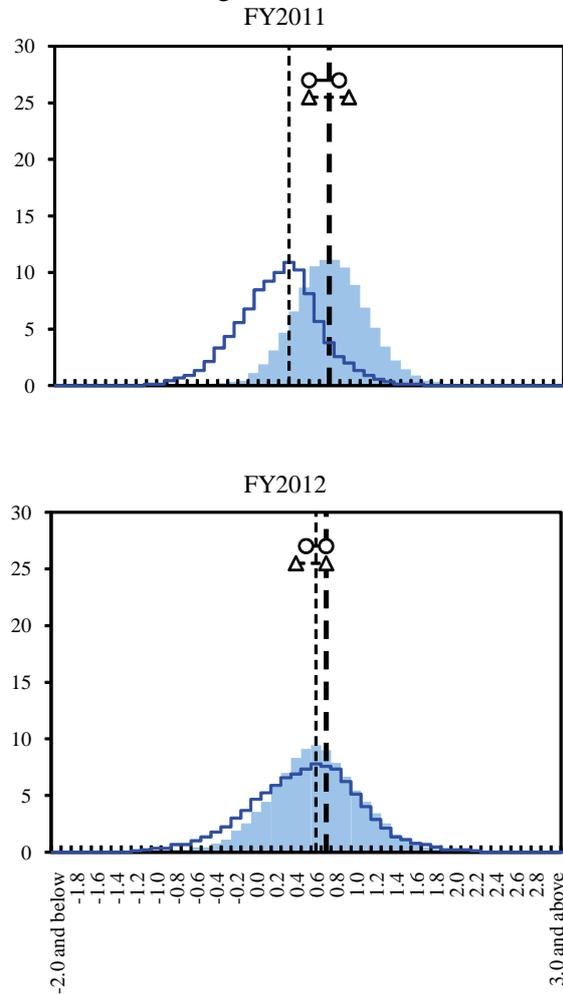
	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2010	+2.7 to +2.9	+0.7	-0.3
Forecasts made in January 2011	+3.2 to +3.5	+0.4 to +0.6	-0.4 to -0.2
Fiscal 2011	+0.5 to +1.0	+1.5 to +2.7	+0.5 to +0.9
Forecasts made in January 2011	+1.4 to +1.8	+0.6 to +1.2	-0.1 to +0.4
Fiscal 2012	+2.5 to +3.0	+0.1 to +1.0	+0.4 to +0.7
Forecasts made in January 2011	+1.8 to +2.4	+0.3 to +1.0	0.0 to +0.8

Risk Balance Charts

(1) Real GDP



(2) CPI (Excluding Fresh Food)



- Notes: 1. Vertical axes in the charts represent probability (%), while horizontal axes represent the year-on-year percentage changes in the respective indicators. Bar charts represent the probability distributions in April 2011, and solid lines represent those in January 2011.
2. Vertical dashed heavy lines indicate the median of the Policy Board members' forecasts (point estimates).
○—○ indicates the range of the forecasts of the majority of Policy Board members. △---△ indicates the range of the forecasts of all Policy Board members.
3. Vertical dashed thin lines indicate the median of the Policy Board members' forecasts (point estimates) in January 2011.
4. For the process of compilation of the Risk Balance Charts, see the box on page 9 of the April 2008 *Outlook for Economic Activity and Prices*.