

Outlook for Economic Activity and Prices (April 2025)

The Bank's View¹

Summary

- Japan's economic growth is likely to moderate, as trade and other policies in each jurisdiction lead to a slowdown in overseas economies and to a decline in domestic corporate profits and other factors, although factors such as accommodative financial conditions are expected to provide support. Thereafter, Japan's economic growth rate is likely to rise, with overseas economies returning to a moderate growth path.
 - The year-on-year rate of increase in the consumer price index (CPI, all items less fresh food) is likely to be in the range of 2.0-2.5 percent for fiscal 2025, in the range of 1.5-2.0 percent for fiscal 2026, and at around 2 percent for fiscal 2027. The effects of the past rise in import prices and of the recent rise in food prices such as rice prices -- these factors have pushed up the inflation rate so far -- are expected to wane. Meanwhile, underlying CPI inflation is likely to be sluggish, mainly due to the deceleration in the economy. Thereafter, however, underlying CPI inflation is expected to increase gradually, since it is projected that a sense of labor shortage will grow as the economic growth rate rises, and that medium- to long-term inflation expectations will rise. In the second half of the projection period, underlying CPI inflation is likely to be at a level that is generally consistent with the price stability target.
 - Comparing the projections through fiscal 2026 with those presented in the previous *Outlook for Economic Activity and Prices* (Outlook Report), the projected real GDP growth rate for fiscal 2024 is somewhat higher, but the projected growth rates for fiscal 2025 and 2026 are lower due to the effects of trade and other policies in each jurisdiction. The projected year-on-year rates of increase in the CPI (all items less fresh food) for fiscal 2025 and 2026 are lower, mainly reflecting the decline in crude oil prices and the downward revision of the GDP growth rates.
 - There are various risks to the outlook. In particular, it is extremely uncertain how trade and other policies in each jurisdiction will evolve and how overseas economic activity and prices will react to them. It is therefore necessary to pay due attention to the impact of these developments on financial and foreign exchange markets and on Japan's economic activity and prices.
 - With regard to the risk balance, risks to economic activity are skewed to the downside for fiscal 2025 and 2026. Risks to prices are also skewed to the downside for fiscal 2025 and 2026.
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¹ "The Bank's View" was decided by the Policy Board at the Monetary Policy Meeting held on April 30 and May 1, 2025.

I. Current Situation of Economic Activity and Prices in Japan

Japan's economy has recovered moderately, although some weakness has been seen in part. Overseas economies have grown moderately on the whole, although some weakness has been seen in part, reflecting trade and other policies in each jurisdiction. Exports and industrial production have continued to be more or less flat as a trend, although there has been some front-loading due to the increase in U.S. tariffs. Corporate profits have been on an improving trend and business sentiment has stayed at a favorable level. In this situation, business fixed investment has been on a moderate increasing trend. Private consumption has maintained its moderate increasing trend against the background of an improvement in the employment and income situation, despite weakness in consumer sentiment due to the impact of price rises and other factors. Housing investment has been relatively weak. Public investment has been more or less flat. Financial conditions have been accommodative. On the price front, the year-on-year rate of increase in the CPI (all items less fresh food) has been in the range of 3.0-3.5 percent recently, as moves to pass on wage increases to selling prices have continued, and as there have been effects of the past rise in import prices and of the rise in food prices, such as rice prices. Inflation expectations have risen moderately.

II. Baseline Scenario of the Outlook for Economic Activity and Prices in Japan^{2,3}

A. Baseline Scenario of the Outlook for Economic Activity

Japan's economic growth is likely to moderate, as trade and other policies in each jurisdiction lead to a slowdown in overseas economies and to a decline in domestic corporate profits and other factors, although factors such as accommodative financial conditions are expected to provide support.

Exports and production are likely to show some weakness, against the background of the slowdown in overseas economies. Reflecting these developments, corporate profits are also likely to decrease, while being at high levels. In this situation, the growth rate of business fixed investment is likely to decelerate, affected by the slowdown in overseas economies, although it is expected that investment to address labor shortages, digital-related investment, research and development (R&D) investment related to growth areas and decarbonization, and investment associated with strengthening supply chains

² There are extremely high uncertainties regarding the future course of trade and other policies in each jurisdiction and the impact of these policies on economic activity and prices at home and abroad. The baseline scenario in this Outlook Report is developed based on assumptions including the following: negotiations between jurisdictions will progress to some extent, and significant disruptions of global supply chains will be avoided. Attention is warranted on the possibility that the outlook for economic activity and prices could change considerably depending on the future course of the policies in each jurisdiction and the response of firms and households in these jurisdictions to the policies.

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

will continue and that accommodative financial conditions will provide support. Regarding the employment and income situation, despite the deceleration in the economy, labor market conditions are likely to remain tight, as it will become more difficult for labor supply of women and seniors to increase. Against this backdrop, the growth rate of nominal wages is likely to remain high for the time being, reflecting factors such as the outcome of this year's annual spring labor-management wage negotiations. Thereafter, nominal wages are highly likely to continue increasing, although the growth rate is likely to decelerate somewhat, affected by the decline in corporate profits. Although private consumption is expected to be affected by the price rises for the time being, it is projected to maintain its moderate increasing trend, mainly due to a continued rise in employee income. Private consumption is also projected to be underpinned by the government's initiatives such as the measures to reduce the household burden of higher gasoline prices and the tax reform in fiscal 2025. Meanwhile, public investment is expected to be more or less flat, and government consumption is expected to increase moderately in reflection of an uptrend in healthcare and nursing care expenditures.

Thereafter, Japan's economic growth rate is likely to rise, with overseas economies returning to a moderate growth path. Exports and production are likely to return to an uptrend. Corporate profits are likely to improve with an increase in domestic and external demand, and business fixed investment is likely to continue on an increasing trend, partly due to investment for capacity expansion to address the rise in demand. Looking at the employment and income situation, the growth rate of nominal wages is expected to accelerate again, with a growing sense of labor shortage, and private consumption is projected to increase moderately.

Comparing the projections through fiscal 2026 with those presented in the previous Outlook Report, the projected real GDP growth rate for fiscal 2024 is somewhat higher, mainly led by private consumption. The projected growth rates for fiscal 2025 and 2026 are lower due to the effects of trade and other policies in each jurisdiction.

Meanwhile, the potential growth rate is expected to rise moderately.⁴ This is mainly because productivity is likely to increase due to advances in digitalization and investment in human capital, and because capital stock growth is projected to accelerate due to a rise in business fixed investment. Potential growth is likely to be supported by the government's various measures and other factors.

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

B. Baseline Scenario of the Outlook for Prices

The year-on-year rate of increase in the CPI (all items less fresh food) is likely to be in the range of 2.0-2.5 percent for fiscal 2025, in the range of 1.5-2.0 percent for fiscal 2026, and at around 2 percent for fiscal 2027. The effects of the past rise in import prices and of the recent rise in food prices such as rice prices -- these factors have pushed up the inflation rate so far -- are expected to wane. Meanwhile, underlying CPI inflation is likely to be sluggish, mainly due to the deceleration in the economy. Thereafter, however, underlying CPI inflation is expected to increase gradually, since it is projected that a sense of labor shortage will grow as the economic growth rate rises, and that medium- to long-term inflation expectations will rise. In the second half of the projection period, underlying CPI inflation is likely to be at a level that is generally consistent with the price stability target.

Comparing the projections through fiscal 2026 with those presented in the previous Outlook Report, the projected year-on-year rates of increase in the CPI (all items less fresh food) for fiscal 2025 and 2026 are lower, mainly reflecting the decline in crude oil prices and the downward revision of the GDP growth rates.

The outlook for the CPI (all items less fresh food) depends on the assumptions regarding crude oil prices and the government's measures. Crude oil prices are assumed to be more or less flat throughout the projection period with reference, for example, to developments in futures markets. Looking at the CPI (all items less fresh food and energy) -- which is not directly affected by fluctuations in energy prices -- the year-on-year rate of increase is likely to be temporarily below 2 percent because it is expected that the effects of the past rise in import prices and of the recent rise in food prices, such as rice prices, will gradually wane and that this CPI will be affected by factors such as the deceleration in the economy. Thereafter, however, the rate of increase in this CPI is likely to be at around 2 percent as the economic growth rate rises.

The main factors that determine underlying inflation are assessed as follows. The output gap, which captures the utilization of labor and capital, has followed an improving trend, albeit with fluctuations. Based on the aforementioned outlook for economic activity, it is likely that the gap will remain at around the current level, but will improve again toward the end of the projection period. Meanwhile, labor market conditions have tightened to a greater extent than can be explained by the changes in the output gap, partly due to a deceleration in the pace of increase in labor force participation of women and seniors. In this situation, upward pressure on wages and prices is likely to be stronger than suggested by the output gap, given that firms in many industries have started to face labor supply constraints.

Medium- to long-term inflation expectations have risen moderately. Regarding the outlook, although it is projected that firms will maintain their active wage- and price-setting behavior and will continue their moves to reflect higher costs -- including increased

personnel expenses and distribution costs -- in selling prices, inflation expectations are expected to be sluggish, mainly due to the deceleration in the economy. Thereafter, as the economic growth rate rises and labor market conditions tighten notably, it is expected that firm's active wage- and price-setting behavior will become more widespread, and that inflation expectations will rise moderately again.

III. Risks to Economic Activity and Prices

A. Risks to Economic Activity

Regarding the aforementioned baseline scenario of the outlook for economic activity, the main upside and downside risks that require attention are as follows.

The first is the evolving situation regarding trade and other policies in each jurisdiction and developments in overseas economic activity and prices under such a situation. The trade policy recently announced in each jurisdiction is likely to push down domestic and overseas economies through various channels. The introduction of wide-ranging tariffs is expected to impact global trade activity, and the heightened uncertainties regarding policies including tariffs are likely to have a large impact on business and household sentiment around the world and on global financial and capital markets. The impact that these policies have on domestic and overseas economies and the degree of the impact will depend largely on the future course of these policies, and therefore it is necessary to pay due attention to their developments. Meanwhile, depending on factors such as the course of the situation surrounding Ukraine and the Middle East, downward pressure on overseas economies could heighten. Regarding the Chinese economy, there remain high uncertainties surrounding the future pace of growth, including the effects of government policies, as adjustment pressure has continued in the real estate and labor markets. In addition, it is necessary to pay attention to how excessive supply capacity of some goods -- coupled with the effects of trade policies -- will affect global economic activity and prices.

The second risk is developments in import prices. Reflecting the aforementioned effects of trade and other policies in each jurisdiction, if disruptions in global logistics were to arise or moves to restructure supply chains were to take place and incur considerable costs, import prices could rise, and this could in turn push down domestic demand. In addition, attention continues to be warranted on the risk that prices of grains and other commodities will fluctuate significantly due to geopolitical factors, such as those concerning Ukraine and the Middle East. Furthermore, in the medium to long term, there are extremely high uncertainties surrounding, for example, efforts by countries around the world toward addressing climate change. Moreover, if import prices were to rise significantly, households' defensive attitudes toward spending could strengthen further,

and this could push down the economy. On the other hand, if import prices decline, the economy could deviate upward.

The third risk considered from a somewhat long-term perspective is the impact of various changes in the environment surrounding Japan on firms' and households' medium- to long-term growth expectations and on Japan's potential growth rate. It is expected that factors such as the experience of COVID-19, intensifying labor shortages, and progress on efforts with a view to decarbonization and on labor market reform will change Japan's economic structure and people's working styles. Intensifying labor shortages -- which are partly due to demographic changes -- could accelerate labor-saving investment, such as for digitalization. On the other hand, if such a substitution of labor with capital does not sufficiently progress, there is a risk that supply-side constraints in some industries will push down the growth rate. Furthermore, the trade policy recently announced in each jurisdiction could trigger a change in the trend of globalization, and depending on the future course of these policies, this change may accelerate.

B. Risks to Prices

If the aforementioned risks to economic activity materialize, prices also are likely to be affected. In addition, it is necessary to pay attention to the following two risks that are specific to prices.

The first is firms' wage- and price-setting behavior and its impact on inflation expectations. Firms' behavior has shifted more toward raising wages and prices, and it is expected in the baseline scenario that this trend will be maintained, despite the deceleration in the economy. However, a prolonged period of high uncertainties regarding trade and other policies in each jurisdiction could lead firms to focus more on cost cutting. As a result, moves to reflect price rises in wages could also weaken. On the other hand, moves to reflect wages in selling prices could strengthen to a greater extent than expected, and upward pressure on wages could intensify with growing expectations that labor market conditions will continue to be tight. In this situation, there is also a possibility that both wages and prices will deviate upward from the baseline scenario, accompanied by a rise in medium- to long-term inflation expectations. Meanwhile, with regard to the recent rise in food prices, such as rice prices, even when price rises themselves mainly result from weather conditions, attention is warranted on the possibility that these rises may induce second-round effects on underlying CPI inflation through changes in household sentiment and inflation expectations.

The second risk is future developments in foreign exchange rates and import prices, including international commodity prices, as well as the extent to which such developments will spread to domestic prices. This risk may lead prices to deviate either upward or downward from the baseline scenario. There are high uncertainties over the

outlook for the global economy, including the future course of trade and other policies in each jurisdiction, which could lead to a rise in import prices from the supply side or to significant fluctuations in foreign exchange rates and international commodity prices. In this regard, with firms' behavior shifting more toward raising wages and prices recently, exchange rate developments are, compared to the past, more likely to affect prices.

IV. Conduct of Monetary Policy

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

The first perspective involves an examination of the baseline scenario of the outlook. The year-on-year rate of increase in the CPI is likely to be in the range of 2.0-2.5 percent for fiscal 2025, in the range of 1.5-2.0 percent for fiscal 2026, and at around 2 percent for fiscal 2027. Meanwhile, underlying CPI inflation is likely to be sluggish, mainly due to the deceleration in the economy. Thereafter, however, underlying CPI inflation is expected to increase gradually, since it is projected that a sense of labor shortage will grow as the economic growth rate rises, and that medium- to long-term inflation expectations will rise. In the second half of the projection period, underlying CPI inflation is likely to be at a level that is generally consistent with the price stability target.

The second perspective involves an examination of the risks considered most relevant to the conduct of monetary policy. There are various risks surrounding Japan's economic activity and prices. In particular, it is extremely uncertain how trade and other policies in each jurisdiction will evolve and how overseas economic activity and prices will react to them. It is therefore necessary to pay due attention to the impact of these developments on financial and foreign exchange markets and on Japan's economic activity and prices. With regard to the risk balance, risks to economic activity are skewed to the downside for fiscal 2025 and 2026. Risks to prices are also skewed to the downside for fiscal 2025 and 2026.

Examining risks on the financial side, overheating has generally not been seen in asset markets and financial institutions' credit activities, although attention continues to be warranted on the pace of increase in real estate prices. Japan's financial system has maintained stability on the whole. In addition, even in the case of an adjustment in the real economy at home and abroad and in global financial markets, the financial system is likely to remain highly robust on the whole, mainly because Japanese financial institutions have sufficient capital bases. In this regard, given the extremely high uncertainties regarding

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

trade and other policies in each jurisdiction, it is necessary to carefully monitor the impact these policies have on the financial system through various channels.⁶

As for the conduct of monetary policy, given that real interest rates are at significantly low levels, if the aforementioned outlook for economic activity and prices will be realized, the Bank, in accordance with improvement in economic activity and prices, will continue to raise the policy interest rate and adjust the degree of monetary accommodation. In this regard, considering the extremely high uncertainties regarding the future course of trade and other policies in each jurisdiction and the impact of these policies, it is important for the Bank to carefully examine factors such as developments in economic activity and prices as well as in financial markets at home and abroad, and judge whether the outlook will be realized, without any preconceptions. With the price stability target of 2 percent, the Bank will conduct monetary policy as appropriate, in response to developments in economic activity and prices as well as financial conditions, from the perspective of sustainable and stable achievement of the target.

⁶ For details, see the Bank's *Financial System Report* (April 2025).

Forecasts of the Majority of the Policy Board Members

y/y % chg.

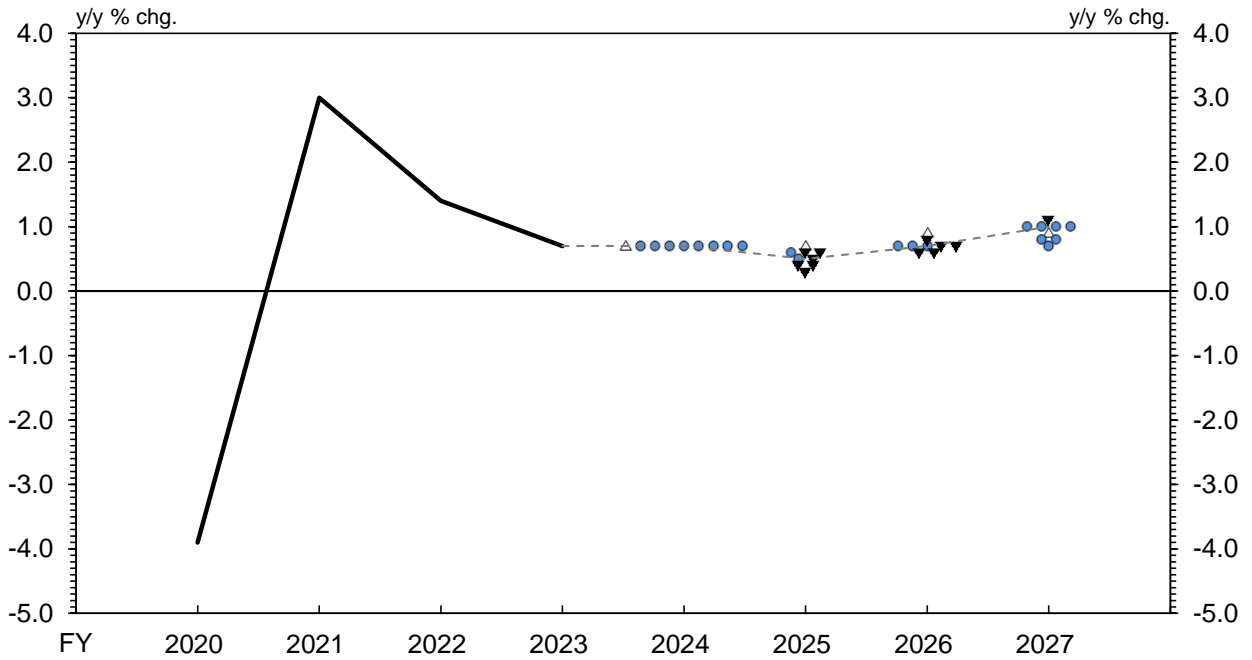
	Real GDP	CPI (all items less fresh food)	(Reference) CPI (all items less fresh food and energy)
Fiscal 2024	+0.7 to +0.7 [+0.7]	+2.7	+2.3
Forecasts made in January 2025	+0.4 to +0.6 [+0.5]	+2.6 to +2.8 [+2.7]	+2.1 to +2.3 [+2.2]
Fiscal 2025	+0.4 to +0.6 [+0.5]	+2.0 to +2.3 [+2.2]	+2.2 to +2.4 [+2.3]
Forecasts made in January 2025	+0.9 to +1.1 [+1.1]	+2.2 to +2.6 [+2.4]	+2.0 to +2.3 [+2.1]
Fiscal 2026	+0.6 to +0.8 [+0.7]	+1.6 to +1.8 [+1.7]	+1.7 to +2.0 [+1.8]
Forecasts made in January 2025	+0.8 to +1.0 [+1.0]	+1.8 to +2.1 [+2.0]	+1.9 to +2.2 [+2.1]
Fiscal 2027	+0.8 to +1.0 [+1.0]	+1.8 to +2.0 [+1.9]	+1.9 to +2.1 [+2.0]

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

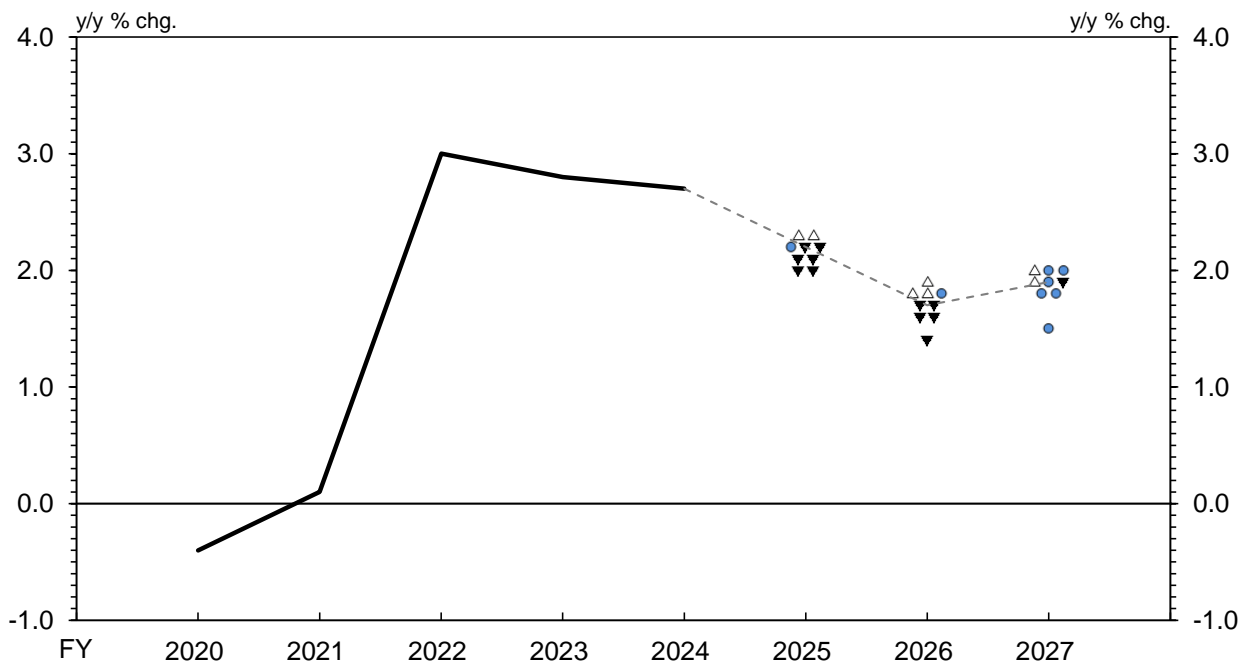
2. The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which they attach the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.
3. Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.
4. The CPI figures for fiscal 2024 are actual values.

Policy Board Members' Forecasts and Risk Assessments

(1) Real GDP



(2) CPI (All Items Less Fresh Food)



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

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