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BANK OF JAPAN

Outlook for Economic Activity and Prices

January 2026

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

Outlook for Economic Activity and Prices (January 2026)

The Bank's View[1]

Summary

- Japan's economy is likely to continue growing moderately, with overseas economies returning to a growth path, and as a virtuous cycle from income to spending gradually intensifies, supported by factors such as the government's economic measures and accommodative financial conditions, while the economy is projected to be affected by trade and other policies in each jurisdiction.
- The year-on-year rate of increase in the consumer price index (CPI, all items less fresh food) is likely to decelerate to a level below 2 percent in the first half of this year, with the waning of the effects of the rise in food prices, such as rice prices, and partly due to the effects of government measures to address rising prices. However, it is likely that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained, and that underlying CPI inflation will continue rising moderately. Thereafter, since it is projected that a sense of labor shortage will grow as the economy continues to improve and that medium- to long-term inflation expectations will rise, it is expected that underlying CPI inflation and the rate of increase in the CPI (all items less fresh food) will increase gradually and, in the second half of the projection period, be at a level that is generally consistent with the price stability target.
- Comparing the projections with those presented in the previous *Outlook for Economic Activity and Prices* (Outlook Report), the projected real GDP growth rates for fiscal 2025 and 2026 are somewhat higher, mainly due to the effects of the government's economic measures; on the other hand, the projected growth rate for fiscal 2027 is somewhat lower. The projected year-on-year rates of increase in the CPI (all items less fresh food) are more or less unchanged.
- Risks to the outlook include developments in overseas economic activity and prices under the impact of trade and other policies in each jurisdiction, wage- and price-setting behavior of firms, and developments in financial and foreign exchange markets, and it is necessary to pay due attention to the impact of these risks on Japan's economic activity and prices.
- With regard to the risk balance, risks to both economic activity and prices are generally balanced.

[1] "The Bank's View" was decided by the Policy Board at the Monetary Policy Meeting held on January 22 and 23, 2026.

I. Current Situation of Economic Activity and Prices in Japan

Japan's economy has recovered moderately, although some weakness has been seen in part. 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, while they have been affected by the increase in U.S. tariffs. Corporate profits have remained at high levels on the whole, although downward effects due to tariffs have been seen in manufacturing, and business sentiment has been at a favorable level. In this situation, business fixed investment has been on a moderate increasing trend. Private consumption has been resilient against the background of an improvement in the employment and income situation, although it has been affected by price rises. On the other hand, housing investment has declined. Meanwhile, public investment has continued to be more or less flat. Financial conditions have been accommodative. On the price front, with moves to pass on wage increases to selling prices continuing, the year-on-year rate of increase in the CPI (all items less fresh food) has been at around 2.5 percent recently, due to the effects of the rise in food prices, such as rice prices, and other factors. Inflation expectations have risen moderately.

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

A. Baseline Scenario of the Outlook for Economic Activity

Japan's economy is likely to continue growing moderately, with overseas economies returning to a growth path, and as a virtuous cycle from income to spending gradually intensifies, supported by factors such as the government's economic measures and accommodative financial conditions, while the economy is projected to be affected by trade and other policies in each jurisdiction.

In the corporate sector, although downward pressure stemming from the impact of tariff increases is expected to remain for the time being, exports and production are likely to recover moderately as overseas economies return to a growth path, partly supported by global AI-related demand. Corporate profits for the time being are likely to remain at high levels on the whole, although downward effects due to tariffs are expected to continue to be seen in manufacturing; thereafter, the uptrend in corporate profits is likely to become more pronounced due to an increase in domestic and external demand. In this situation, supported in part by the government's economic measures and accommodative financial conditions, business fixed investment is likely to remain on an increasing trend, including labor-saving and digital-related investment to address labor shortages, as well as research and development (R&D) investment.

[2] 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.

In the household sector, regarding the employment situation, labor market conditions are likely to tighten further as the economy improves, with it becoming more difficult for labor supply of women and seniors to increase. Against this backdrop, it is likely that a wide range of firms will continue to raise wages steadily in this year's annual spring labor-management wage negotiations, following the solid wage increases last year, and the growth in nominal wages is projected to remain relatively high. Although private consumption is expected to be more or less flat for the time being due to the remaining impact of price rises, it is projected to gradually return to a moderate increasing trend, with a continued rise in employee income. Meanwhile, private consumption is projected to be underpinned by the government's initiatives such as the measures to reduce the household burden of higher energy prices and the tax reform in fiscal 2026. Housing investment is expected to continue recovering for the time being; thereafter, however, it is likely to follow a moderate declining trend, mainly reflecting a rise in housing prices and demographic developments. Public investment is expected to be more or less flat, and government consumption is expected to increase moderately reflecting factors such as an uptrend in healthcare and nursing care expenditures and a rise in defense-related spending.

Comparing the projections with those presented in the previous Outlook Report, the projected real GDP growth rate for fiscal 2025 is somewhat higher due to higher-than-expected growth in overseas economies and the impact of the statistical revision to the GDP figures. The projected growth rate for fiscal 2026 is also somewhat higher, mainly reflecting the effects of the government's economic measures. The rate for fiscal 2027 is somewhat lower due to the dissipation of the effects of these economic measures.

Meanwhile, the potential growth rate is expected to rise moderately.[3] 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.

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 decelerate to a level below 2 percent in the first half of this year, with the waning of the effects of the rise in food prices, such as rice prices, and partly due to the effects of government measures to address rising prices. However, it is likely that the mechanism in

[3] 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.

which wages and prices rise moderately in interaction with each other will be maintained, and that underlying CPI inflation will continue rising moderately. Thereafter, since it is projected that a sense of labor shortage will grow as the economy continues to improve and that medium- to long-term inflation expectations will rise, it is expected that underlying CPI inflation and the rate of increase in the CPI (all items less fresh food) will increase gradually and, in the second half of the projection period, be at a level that is generally consistent with the price stability target.

The projected year-on-year rates of increase in the CPI (all items less fresh food) are more or less unchanged from those presented in the previous Outlook Report.

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, based, for example, on developments in futures markets. Regarding the government's measures, the abolition of the former provisional gasoline tax rate, measures to reduce the household burden of higher electricity and gas charges, and measures to make high school tuition and elementary school lunches effectively free, among other measures, will push down the year-on-year rate of increase in the CPI (all items less fresh food), particularly in fiscal 2025 and 2026.

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 decelerate to around 2 percent, mainly due to the waning of the effects of the rise in food prices, such as rice prices. Thereafter, with moves to pass on wage increases to selling prices continuing, the rate of increase in this CPI is likely to remain at around the same level.

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 output gap will widen moderately within positive territory. 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, as the economy continues to improve and labor market conditions tighten further, firms' active wage- and price-setting behavior is expected to become more widespread, and it is therefore likely that inflation expectations will continue to rise moderately and be at around 2 percent in the second half of the projection period.

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

The second risk is developments in import prices. Reflecting the effects of trade and other policies in each jurisdiction, if disruptions arise on the supply side, such as in logistics, or moves to restructure supply chains take place, this could incur considerable costs. In addition, attention continues to be warranted on the risk that prices of grains and other commodities will fluctuate significantly, particularly due to geopolitical factors and weather conditions. If import prices were to rise significantly, households' defensive attitude 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. In the medium to long term, there are extremely high uncertainties surrounding, for example, efforts by countries around the world toward addressing climate change.

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

with the government's efforts, could push up growth expectations and the potential growth rate. On the other hand, if such a substitution of labor with capital does not sufficiently progress, there is a risk that supply-side constraints will push down the growth rate. Moreover, the trade policies announced so far 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 highly likely that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained. On this basis, moves to reflect wages in selling prices could strengthen to a greater extent than expected, and there could be growing expectations that labor market conditions will tighten further; these developments could heighten upward pressure on wages. 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. On the other hand, if the impact of tariffs on corporate profits, for example, becomes prolonged, this could lead firms to focus more on cost cutting. As a result, moves to reflect price rises in wages could also weaken. Meanwhile, the recent rise in food prices, such as rice prices, largely reflects temporary supply-side factors, and it is therefore expected that the contribution of this rise to the CPI will gradually wane. That said, if new temporary factors, such as irregular weather events, arise or if the pass-through of increased personnel expenses and distribution costs to selling prices strengthens, the rise in food prices could persist for longer than expected. Since consumers purchase food items on a frequent basis, if the price rises persist, the CPI could be pushed up through changes in inflation expectations. On the other hand, it is also possible that the CPI could be pushed down, as private consumption could decline through a deterioration in household sentiment.

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. Uncertainties remain over the outlook for the global economy, such as the impact of trade policies, 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, attention should be paid to the point that, with firms' behavior shifting more toward raising wages and prices recently,

exchange rate developments are, compared to the past, more likely to affect prices, and that such moves could affect underlying CPI inflation through changes in inflation expectations.

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.[4]

The first perspective involves an examination of the baseline scenario of the outlook. The year-on-year rate of increase in the CPI (all items less fresh food) is likely to decelerate to a level below 2 percent in the first half of this year. However, it is likely that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained, and that underlying CPI inflation will continue rising moderately. Thereafter, since it is projected that a sense of labor shortage will grow as the economy continues to improve and that medium- to long-term inflation expectations will rise, it is expected that underlying CPI inflation and the rate of increase in the CPI (all items less fresh food) will increase gradually and, in the second half of the projection period, 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. Risks surrounding Japan's economic activity and prices include developments in overseas economic activity and prices under the impact of trade and other policies in each jurisdiction, wage- and price-setting behavior of firms, and developments in financial and foreign exchange markets, and it is necessary to pay due attention to the impact of these risks on Japan's economic activity and prices. With regard to the risk balance, risks to both economic activity and prices are generally balanced.

Examining risks on the financial side, financial intermediation activities, such as lending, have operated smoothly, and no major financial imbalances have been seen in current financial activities, although attention continues to be warranted on developments in asset prices, such as real estate and stock prices. Japan's financial system has maintained stability on the whole. Even in the case of an adjustment in the real economy at home and abroad and in global financial markets, the financial system is likely to remain highly robust on the whole, mainly because Japanese financial institutions have sufficient capital bases. In this regard, it is necessary to carefully monitor the impact that factors such as the trade policy in each jurisdiction, geopolitical risks, and developments in the foreign

[4] 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."

non-bank financial intermediary (NBFI) sector have on the financial system through various channels.

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. With the price stability target of 2 percent, it 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.

(Appendix)

Forecasts of the Majority of the Policy Board Members

y/y % chg.

	Real GDP	CPI (all items less fresh food)	(Reference) CPI (all items less fresh food and energy)
Fiscal 2025	+0.8 to +0.9 [+0.9]	+2.7 to +2.8 [+2.7]	+2.9 to +3.1 [+3.0]
Forecasts made in October 2025	+0.6 to +0.8 [+0.7]	+2.7 to +2.9 [+2.7]	+2.8 to +3.0 [+2.8]
Fiscal 2026	+0.8 to +1.0 [+1.0]	+1.9 to +2.0 [+1.9]	+2.0 to +2.3 [+2.2]
Forecasts made in October 2025	+0.6 to +0.8 [+0.7]	+1.6 to +2.0 [+1.8]	+1.8 to +2.2 [+2.0]
Fiscal 2027	+0.8 to +1.0 [+0.8]	+1.9 to +2.2 [+2.0]	+2.0 to +2.3 [+2.1]
Forecasts made in October 2025	+0.7 to +1.1 [+1.0]	+1.8 to +2.0 [+2.0]	+2.0 to +2.2 [+2.0]

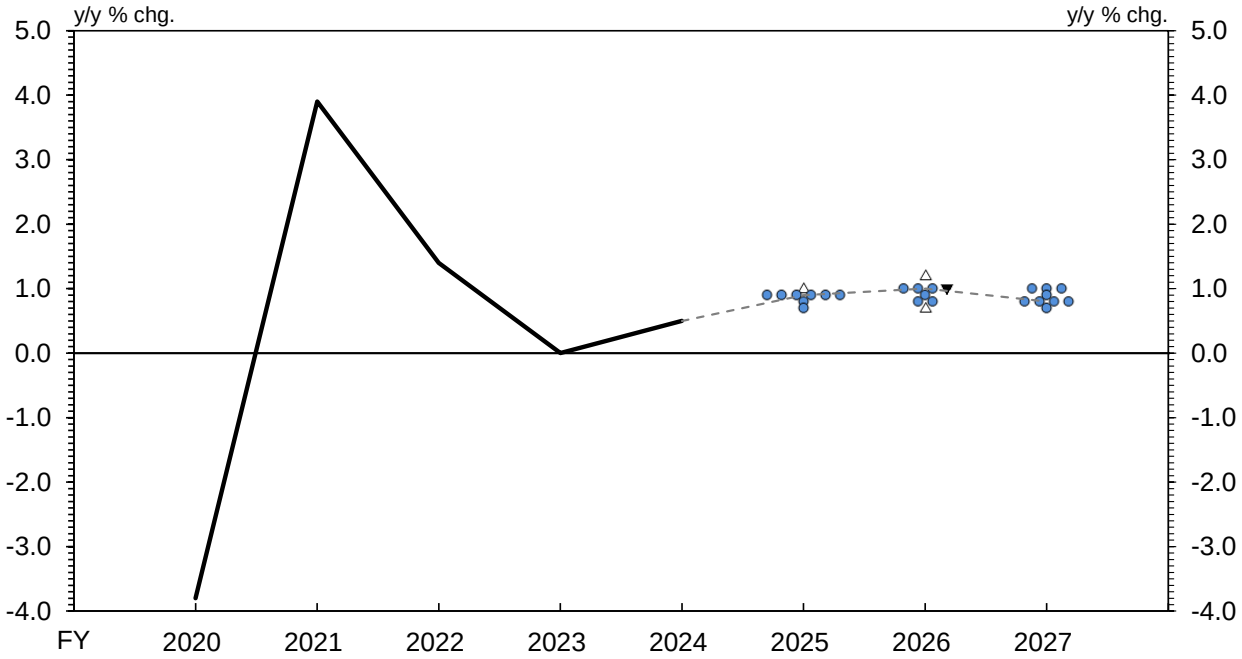
Notes: 1. Figures in brackets indicate the medians of the Policy Board members' forecasts (point estimates).

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.

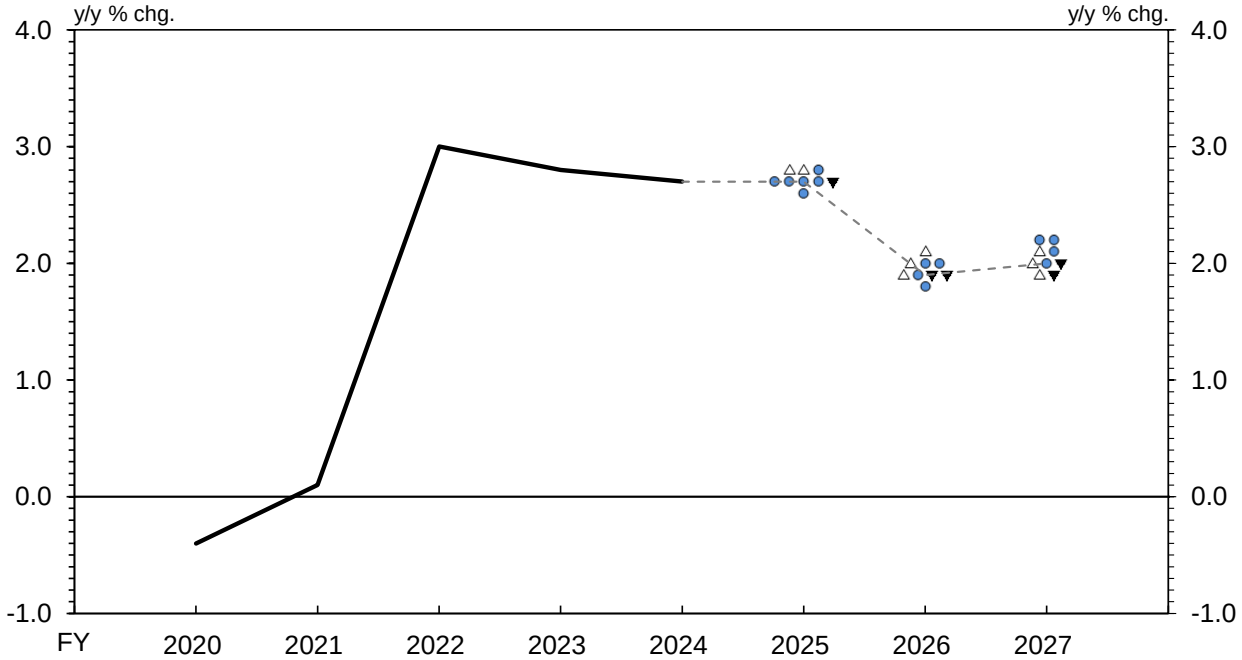
3. Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.

Policy Board Members' Forecasts and Risk Assessments

(1) Real GDP



(2) CPI (All Items Less Fresh Food)



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

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

The Background[5]

I. Current Situation of Economic Activity and Its Outlook

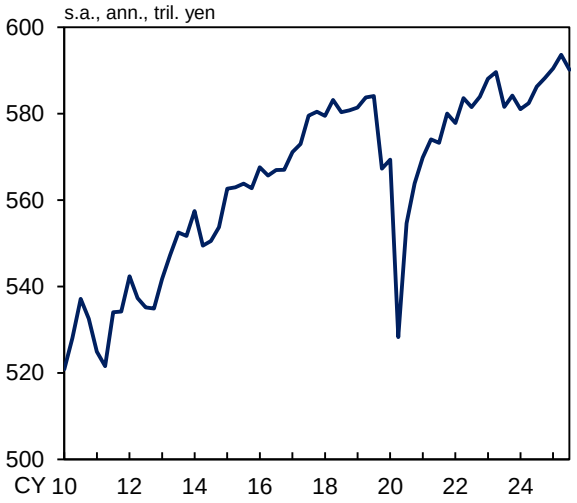
A. Economic Developments

Japan's economy has recovered moderately, although some weakness has been seen in part.

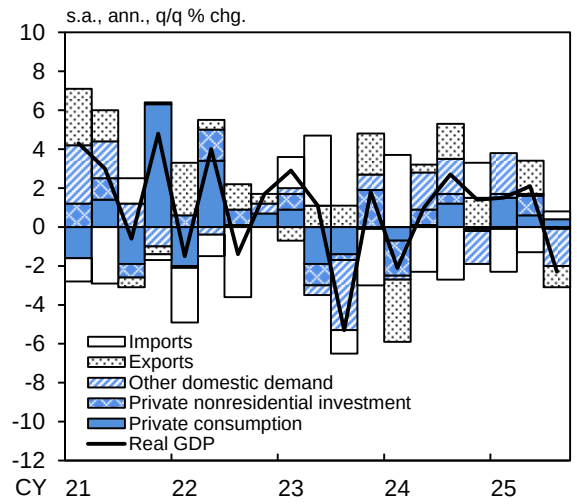
The real GDP growth rate for the July-September quarter of 2025 was minus 0.6 percent on a quarter-on-quarter basis and minus 2.3 percent on an annualized basis, registering negative growth for the first time in six quarters (Chart 1). The negative growth is mainly attributable to (1) a decline in housing investment due to the reactionary decline following the front-loading of construction starts ahead of the enforcement of revisions to the Building Standards Act and other regulations and (2) a decline in exports reflecting factors such as a reactionary decline following the front-loading of demand ahead of tariff increases; on the other hand, domestic demand such as private consumption and business fixed investment remained resilient on the whole. In this situation, labor market conditions continued to be tight. Despite the negative growth in GDP, the output gap -- which captures the utilization of labor and capital -- for the July-September quarter was more or less unchanged from the previous quarter (Chart 2).[6]

Chart 1: Real GDP

1. Level



2. Annualized Quarterly Growth Rate



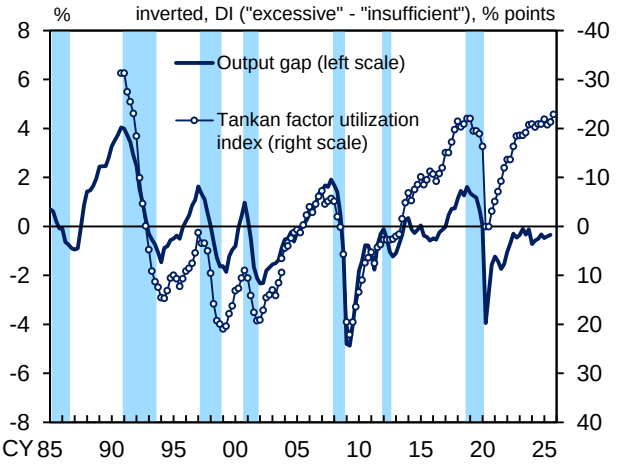
Source: Cabinet Office.

[5] "The Background" provides explanations of "The Bank's View" decided by the Policy Board at the Monetary Policy Meeting held on January 22 and 23, 2026.

[6] The output gap and the potential growth rate, which is discussed later, should be interpreted with considerable latitude because they are estimated based on specific assumptions regarding trends in production factors.

Monthly indicators and high-frequency data since then show that, although the effects of tariff increases continue to be observed on the exports side, resilience in domestic demand has increased. Exports have remained somewhat slow, as the reactionary decline following the front-loading of demand ahead of tariff increases has continued to exert downward pressure, and partly reflecting the waning of moves to increase production of components for new smartphones. That said, corporate profits have remained at high levels on the whole. This reflects the fact that profits in manufacturing have stopped declining because the impact of the deterioration in export profitability due to tariffs has been partly offset by the yen's depreciation, and that the uptrend of profits in nonmanufacturing has been maintained on the back of resilient domestic demand and progress in the pass-through of cost increases to selling prices. Business sentiment has been at a favorable level, as seen, for example, in the diffusion index (DI) for business conditions in the December 2025 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), which has marked its highest level since the start of the recovery phase from the COVID-19 pandemic. In this situation, business fixed investment -- especially digital-related investment and investment related to urban redevelopment projects -- has been on a moderate increasing trend, and the adverse effects stemming from tariff policies have been limited. Looking at the employment and income situation, employee income has continued to increase steadily, as the number of employed persons has continued to rise steadily and nominal wages, including winter bonuses, have increased. The resilience of private consumption has increased somewhat on the whole: although the effects of consumers'

Chart 2: Output Gap



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

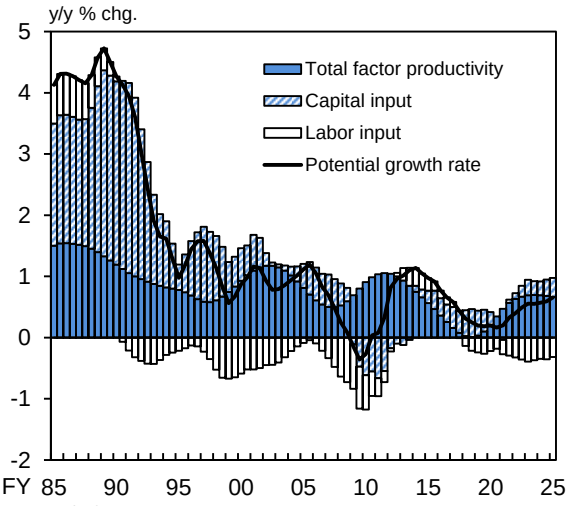
increased thriftiness have remained entrenched in the consumption of nondurable goods, the pace of increase in food prices has decelerated, and consumer sentiment has also improved clearly, partly supported by the rise in stock prices. As for housing investment, although demand has continued on a weak trend reflecting factors such as a rise in housing prices, the impact of the reactionary decline following the front-loading of construction starts ahead of the enforcement of revisions to the Building Standards Act and other regulations in April 2025 has been waning. In reflection of the aforementioned developments in domestic and external demand, the employment conditions DI for all industries and enterprises in the December *Tankan* shows net "insufficient employment" at about the same level as in the early 1990s, particularly in nonmanufacturing, indicating a pronounced sense of labor shortage. As a result, the weighted average DI for production capacity and employment conditions has also continued to show a significantly large net "insufficient" (Chart 2). As explained, regarding the impact of the increase in U.S. tariffs on Japan's economy, although this has exerted downward pressure on profits to some degree, the impact has remained limited on the whole.

With regard to the outlook for Japan's economy, the economic recovery -- particularly in exports -- is likely to be moderate for the time being due to the impact of trade and other policies in each jurisdiction; thereafter, however, the improving trend in the economy is likely to become more pronounced, as a virtuous cycle from income to spending gradually intensifies, supported by factors such as the government's economic measures and accommodative financial

conditions. On this point, it is expected that the government's economic policy package, called the "Comprehensive Economic Measures to Build a 'Strong Japanese Economy,'" will lead to boosting private consumption and business fixed investment through income transfers to households and firms, in addition to pushing up government consumption and public investment, particularly in fiscal 2026. Toward the end of the projection period, as the effects of the government's economic measures wane, Japan's economic growth is likely to moderate, approaching the potential growth rate. Comparing the projections with those presented in the previous Outlook Report, the projected real GDP growth rates for fiscal 2025 and 2026 are somewhat higher, mainly due to the effects of the government's economic measures; on the other hand, the projected growth rate for fiscal 2027 is somewhat lower, partly due to the reactionary decline following the increase up through the previous fiscal year.

The estimate of the potential growth rate has been at around 0.5 percent recently: while the downtrend in working hours reflecting working-style reforms has continued to push down the rate, capital stock has increased moderately and total factor productivity (TFP) has continued to rise (Chart 3).[7] As for the outlook, the potential growth rate is expected to rise moderately. This is based on the projection that, although there will be less room for the number of employed persons to increase, (1) growth in TFP

Chart 3: Potential Growth Rate



Source: Bank of Japan.
Notes: 1. Figures are staff estimates. The chart shows figures as of the October 2025 Outlook Report, as capital stock data reflecting the revision of the benchmark year to 2020 are not yet available.
2. Figures for the first half of fiscal 2025 are those for 2025/Q2.

[7] The estimated figures for the potential growth rate in Chart 3 are identical to those presented in the October 2025 Outlook Report, as the capital stock series consistent with business fixed investment in the GDP statistics on a 2020 base year basis have not yet been released.

will accelerate, mainly on the back of advances in digitalization and the resulting improvement in the efficiency of resource allocation, as well as an expansion in investment in human capital; (2) the decline in working hours will come to a halt, reflecting the diminishing effects of working-style reforms; and (3) capital stock will continue to increase. These developments are likely to be encouraged by the government's various measures and by accommodative financial conditions.

Details of the outlook for each fiscal year are as follows. In the second half of fiscal 2025, Japan's economic recovery is likely to be moderate, since it is projected that, while domestic demand will remain resilient, external demand will continue to be under downward pressure, mainly due to the impact of tariff increases and geopolitical factors. Goods exports are likely to remain somewhat slow for the time being. This is because, although solid global AI-related demand is expected to provide some support, goods exports are likely to be pushed down by the reactionary decline following the front-loading ahead of the U.S. tariff increase and by the adverse effects on final demand reflecting progress in the pass-through of tariff hikes to selling prices. The growth momentum in inbound tourism demand, which is categorized under services exports, is also highly likely to slow temporarily, mainly due to the impact of the Chinese government's request for its citizens to refrain from travelling to Japan. Corporate profits are expected to be more or less flat on the whole against the background of resilient domestic demand, although profits, mainly in manufacturing, are likely to be affected by a deterioration in export profitability and a

decrease in export volume due to tariffs. Despite being pushed down by the slowdown in corporate profits and a rise in construction costs, business fixed investment is likely to continue on an increasing trend, supported by moves to clear the high levels of order backlogs and by labor-saving investment to address labor shortages, mainly in nonmanufacturing. Employee income is highly likely to continue to see a steady increase, partly supported by the rise in minimum wages. In this situation, private consumption is projected to remain resilient, partly supported by the government's measures to reduce the household burden of higher energy prices, although it is likely to be under downward pressure due to elevated food prices. Housing investment is likely to continue recovering from the reactionary decline following the front-loading of construction starts due to the enforcement of revisions to the Building Standards Act and other regulations in April 2025, although the pace of recovery is likely to remain moderate.

In fiscal 2026, Japan's economic growth is likely to clearly exceed the potential growth rate, since it is expected that, with exports following a recovery trend, the government's economic measures will directly lead to increasing government spending and will also push up private consumption and business fixed investment through income transfers to households and firms. Goods exports are expected to recover moderately, with the impact of tariff policies waning. Business fixed investment is likely to continue on an increasing trend, supported by the government's various economic measures, in addition to an increase in corporate profits. Nominal wages are highly likely to continue rising steadily, with the rate of base

pay increases expected to be at around the same level as in fiscal 2025, and due to the impact of higher wages of part-time employees reflecting minimum wage increases. In this situation, as real disposable income will increase partly due to the effects of the government's various economic measures, private consumption is highly likely to return to a moderate increasing trend. Meanwhile, although housing investment is projected to continue its recovery trend for a while, it is likely to follow a moderate declining trend thereafter, mainly reflecting a rise in housing prices and demographic developments.

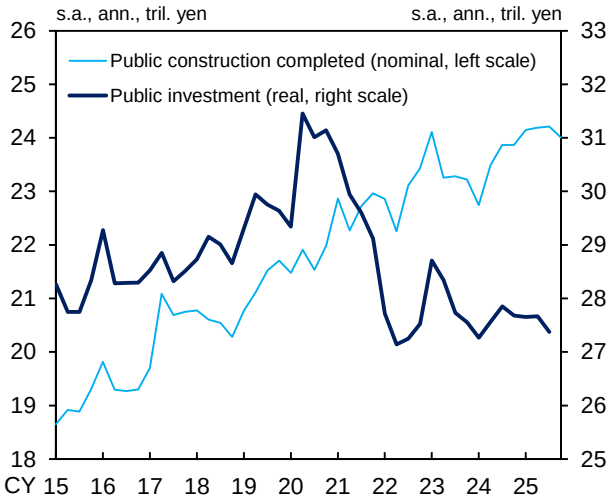
In fiscal 2027, Japan's economic growth is likely to moderate, approaching the potential growth rate, since the pace of increase in domestic demand is expected to decelerate as the effects of the government's economic measures wane. Goods exports are expected to continue increasing moderately on the back of a recovery in overseas economies. With a continued improvement in corporate profits, business fixed investment is likely to remain on a steady upward trend, pushed up by labor-saving investment to address labor shortages, investment for capacity expansion, and investment projects to adapt to changes in the trade structure and supply chains, among other investments. Employee income is likely to increase firmly, as the growth rate in nominal wages accelerates again reflecting the improvement in corporate profits. In this situation, private consumption is expected to continue on an increasing trend, although the pace of increase is likely to decelerate somewhat as the effects of the government's economic measures wane.

B. Developments in Major Expenditure Items and Their Background

Government Spending

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

Chart 4: Public Investment



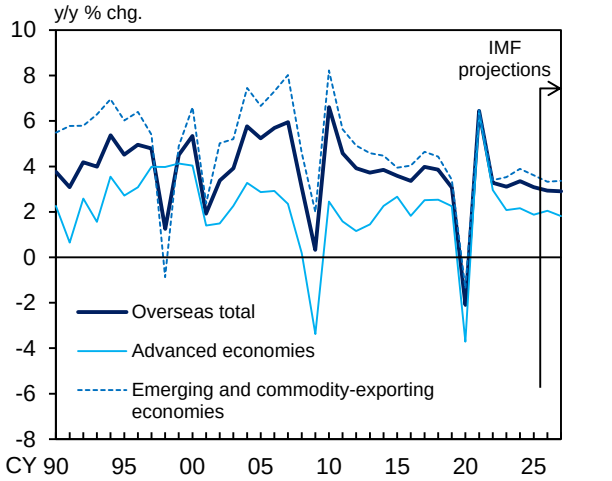
Sources: Cabinet Office; Ministry of Land, Infrastructure, Transport and Tourism.
Note: The figure for 2025/Q4 is the October-November average.

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

Overseas Economies

Overseas economies have grown moderately on the whole, although some weakness has been seen in part, reflecting trade and other policies in each jurisdiction (Chart 5).[8] By region, the U.S. economy has maintained solid growth on the whole, although some weakness has been seen in part. European economies have continued to be relatively weak on the whole, partly reflecting that exports saw a reactionary decline following earlier front-loading. The Chinese economy has

Chart 5: Overseas Economies



Sources: IMF; Ministry of Finance.
Note: Figures are the weighted averages of real GDP growth rates using countries' share in Japan's exports as weights. The real GDP growth rates are compiled by the IMF, and the rates from 2026 onward are its projections in the October 2025 *World Economic Outlook* (WEO) and the January 2026 WEO *Update*. Figures for advanced economies are those for the United States, the euro area, and the United Kingdom. Figures for emerging and commodity-exporting economies are those for the rest of the world.

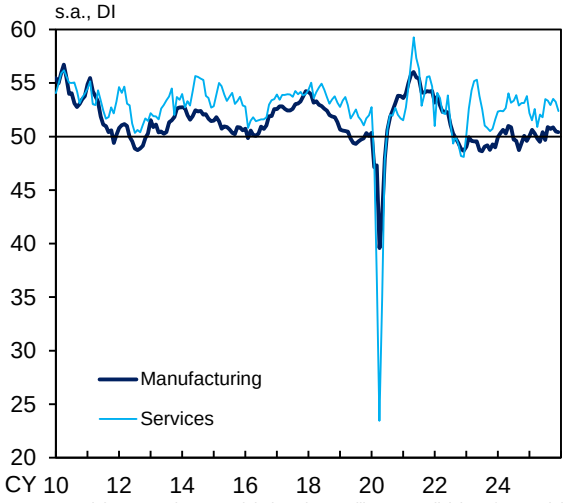
[8] See Box 1 for the impact of tariff policies on the U.S. economy and robust global AI-related demand.

decelerated, mainly due to the impact of tariff increases and the gradually diminishing effects of government policies, and as adjustment pressure has continued in the real estate and other markets. Emerging and commodity-exporting economies other than China have improved moderately on the whole. Among those in Asia, which have close links to Japan's economy, the NIEs and ASEAN economies have improved as global demand for IT-related goods has expanded moderately, driven by AI-related demand.

Looking at the Global PMI to see the current situation for the global economy, figures for the services industry have been clearly above 50 -- the break-even point between improvement and deterioration in business conditions -- and figures for the manufacturing industry have been slightly above 50 (Chart 6).

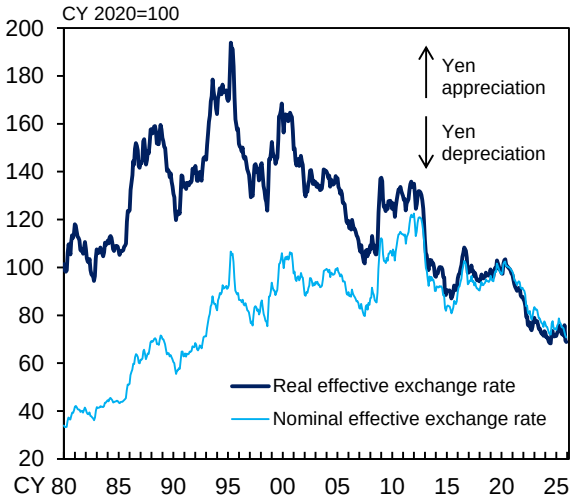
As for the outlook, although downward pressure stemming from the impact of trade and other policies in each jurisdiction is expected to remain for the time being, overseas economies are projected to return to a growth path, partly supported by global AI-related demand. By region, downward pressure stemming from the impact of trade and other policies is expected to remain in each region for the time being. Thereafter, U.S. economic growth is expected to return to a pace around the same level as the potential growth rate, partly reflecting AI-related demand and support from economic policies. European economies are projected to see a gradual acceleration in their growth rate, partly reflecting support from economic policies. The Chinese economy is likely to improve moderately, partly reflecting support

Chart 6: Global PMI



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

Chart 7: Effective Exchange Rates



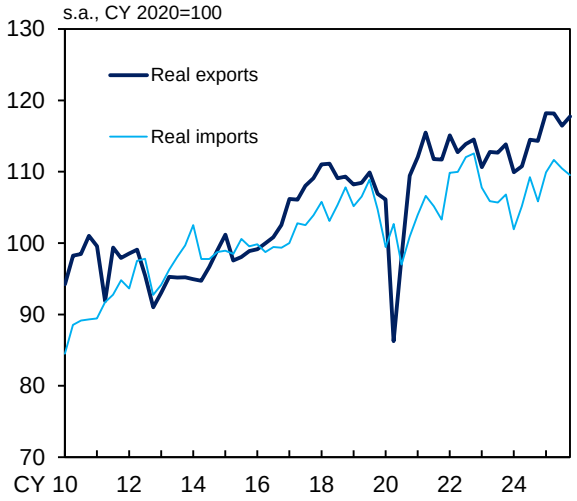
Source: BIS.
Note: Figures are based on the broad effective exchange rate indices. Figures prior to 1994 are calculated using the narrow indices.

from economic policies. Emerging and commodity-exporting economies other than China are likely to improve moderately, partly supported by global AI-related demand.

Exports and Imports

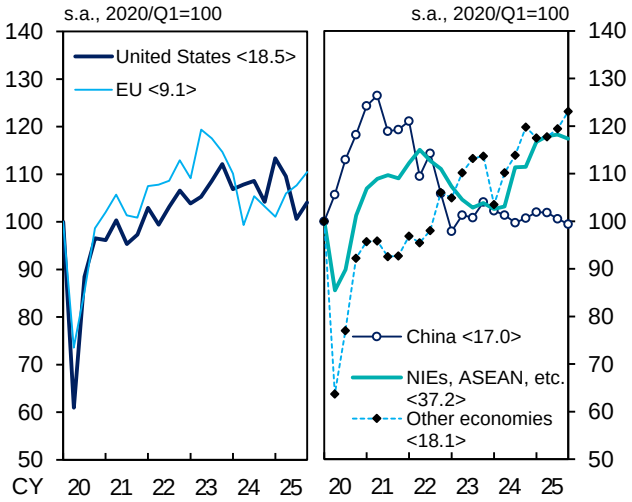
Exports have continued to be more or less flat as a trend, while they have been affected by the increase in U.S. tariffs (Chart 8). By region, exports to the United States decreased in the July-September quarter reflecting a reactionary decline following the earlier front-loading ahead of the increase in tariffs and the impact of the suspension of production lines at some automakers; they picked up in the October-December quarter, reflecting the partial resumption of production lines (Chart 9). Exports to Europe have picked up, especially of capital goods and automobile-related goods, reflecting a recovery in domestic demand in the region. Exports to China have gradually declined to a lower level, due to greater local production of automobiles, IT-related goods, and other products by Chinese manufacturers reflecting their increased competitiveness, and pushed down by the peaking-out of demand for semiconductor production equipment. Exports to the NIEs, ASEAN, and some other Asian economies had continued on an increasing trend, supported by solid global AI-related demand and the increase in production of components for new smartphones; more recently, however, exports to these economies have leveled off, as upward pressure from increased production of these components has been waning. Exports to other economies have been on a moderate increasing trend, mainly led by those to the Middle East. By type of goods, exports of automobile-related

Chart 8: Real Exports and Imports



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

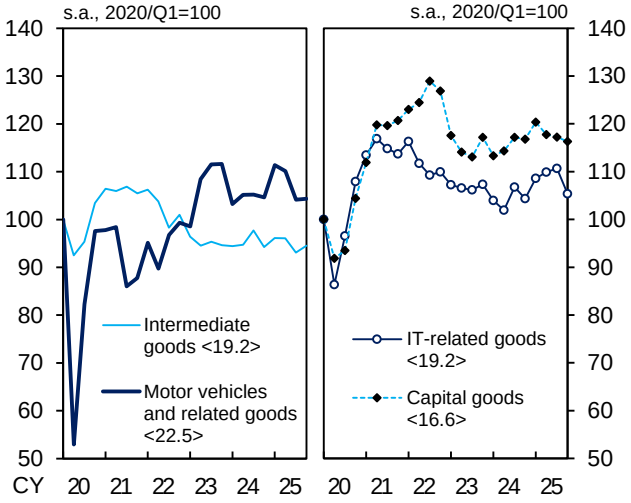
Chart 9: Real Exports by Region



Sources: Bank of Japan; Ministry of Finance.
Notes: 1. Based on staff calculations. Figures in angular brackets show the share of each country or region in Japan's total exports in 2025.
2. Figures for the EU exclude those for the United Kingdom for the entire period.

goods declined for two consecutive quarters, in the April-June quarter and the July-September quarter, reflecting factors such as the reactionary decline following the front-loading ahead of the U.S. tariff increase and the impact of the suspension of production lines at some automakers; more recently, however, exports of automobile-related goods have stopped declining (Chart 10). Exports of capital goods have been more or less flat recently: while demand related to data centers, including equipment for power facilities, has been resilient, demand for semiconductor production equipment in China has peaked out. Exports of IT-related goods had continued to increase firmly, supported by solid AI-related demand, such as for data servers, and by moves to increase production of components for new smartphones; more recently, however, exports of these goods have decreased somewhat significantly, as moves to increase production of these components have waned. Meanwhile, exports of intermediate goods have been more or less flat at low levels, due to continued oversupply, particularly in Asia, against the background of excess production capacity in China.

Chart 10: Real Exports by Type of Goods



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

As for the outlook, exports are highly likely to remain somewhat slow for the time being. This is because, although solid global AI-related demand is expected to provide some support, exports are likely to be pushed down by the reactionary decline following the front-loading ahead of the U.S. tariff increase and by the adverse effects on final demand reflecting progress in the pass-through of tariff hikes to selling prices. Thereafter, with the global economy following a stable growth path, exports are projected to

recover moderately, reflecting the waning impact of tariff policies.

The increasing trend in imports has leveled off recently (Chart 8). Imports are expected to follow an uptrend again, reflecting an increase in domestic demand, partly due to the government's economic measures.

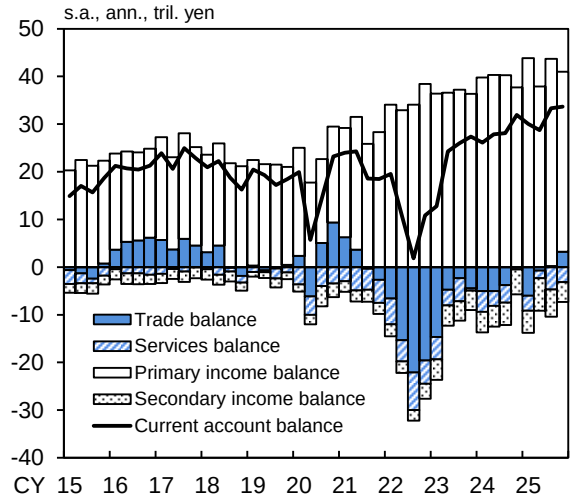
External Balance

The nominal current account surplus has been at a high level (Chart 11). The trade balance had remained on a slight deficit trend, but it has recently been at around zero, partly due to a decline in crude oil prices. Looking at the services balance, while the travel balance -- supported by inbound tourism demand (Chart 12) -- has marked a surplus, it has remained on a slight deficit trend on the whole, as payments for digital-related services have been at high levels. Meanwhile, the primary income balance surplus has remained at a high level, albeit with fluctuations, pushed up by factors such as receipts of direct investment income. In terms of the savings-investment balance, which by definition equals the current account balance, overall excess savings in Japan had continued on a moderate expanding trend, reflecting an increase in corporate profits and a decline in the general government deficit; more recently, however, overall excess savings have been more or less flat at high levels (Chart 13).

Industrial Production

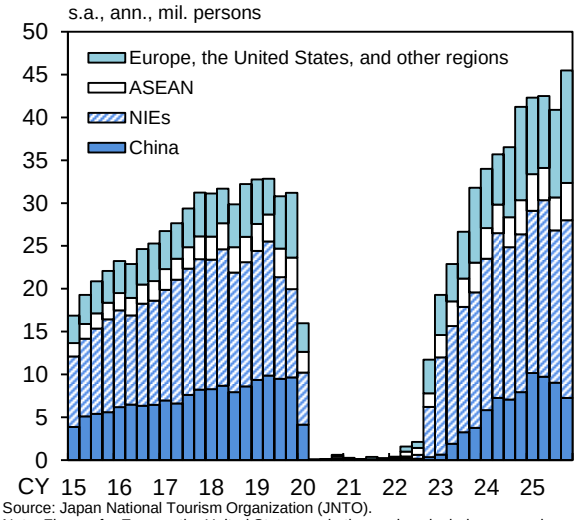
Industrial production has continued to be more or less flat (Chart 14). By major industry, production

Chart 11: Current Account



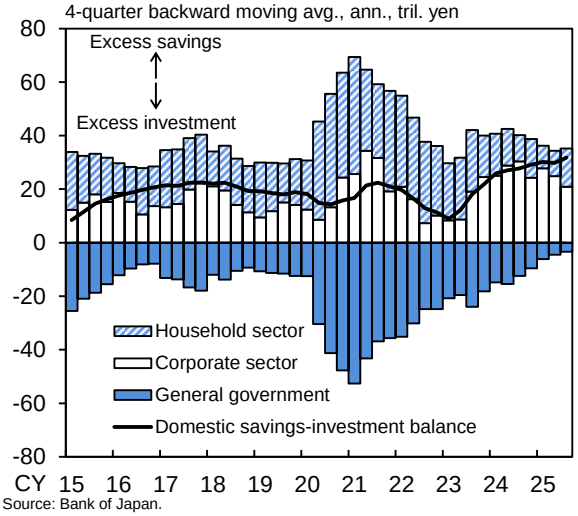
Source: Ministry of Finance and Bank of Japan.
Note: Figures for 2025/Q4 are October-November averages.

Chart 12: Number of Inbound Visitors



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

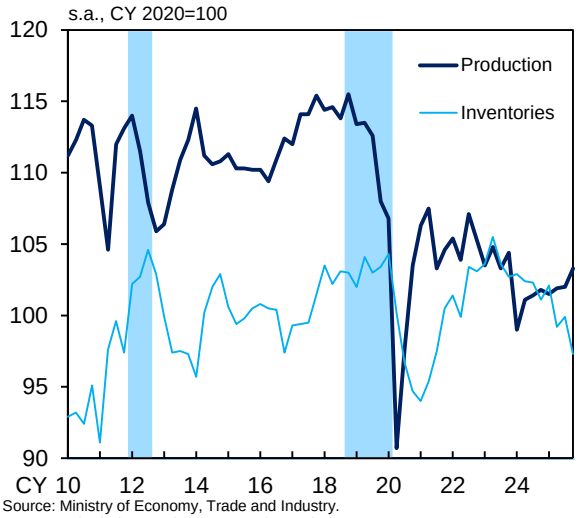
Chart 13: Savings-Investment Balance



Source: Bank of Japan.

of "transport equipment" decreased for two consecutive quarters, in the April-June quarter and the July-September quarter, due to factors such as the suspension of production lines at some automakers, but recently has started to increase again, reflecting the partial resumption of production lines. Production of "electrical machinery, and information and communication electronics equipment" has increased recently, due to a rise in the production of lithium-ion batteries used in automobiles. Production of "chemicals (excluding medicine)" -- despite persistent downward pressure stemming from oversupply, particularly in Asia -- has bottomed out and has recently begun to pick up, partly due to progress in inventory adjustments. Production of "electronic parts and devices" had continued to increase, reflecting solid AI-related demand and the increase in production of components for new smartphones; more recently, however, it has turned to a decline, as moves to increase production of items related to smartphones have diminished. Production of "general-purpose, production, and business-oriented machinery" has been more or less flat on the whole: while shipments of semiconductor production equipment to China appear to have peaked out, the increase in production of metalworking machinery and industrial robots has provided support. Meanwhile, inventories have seen a clear decline recently, reflecting progress in inventory adjustments in capital goods and producer goods.

Chart 14: Industrial Production



Source: Ministry of Economy, Trade and Industry.
Notes: 1. Shaded areas denote recession periods.
2. The production figure for 2025/Q4 is the October-November average. The inventories figure for 2025/Q4 is that for November.

As for the outlook, industrial production is expected to remain more or less flat as a trend. This is because, although downward pressure is likely to be exerted by the reactionary decline

following the front-loading of production ahead of the U.S. tariff increase and by a decrease in final demand reflecting progress in the pass-through of tariff hikes to selling prices, domestic demand is projected to be resilient, partly due to the effects of the government's economic measures.

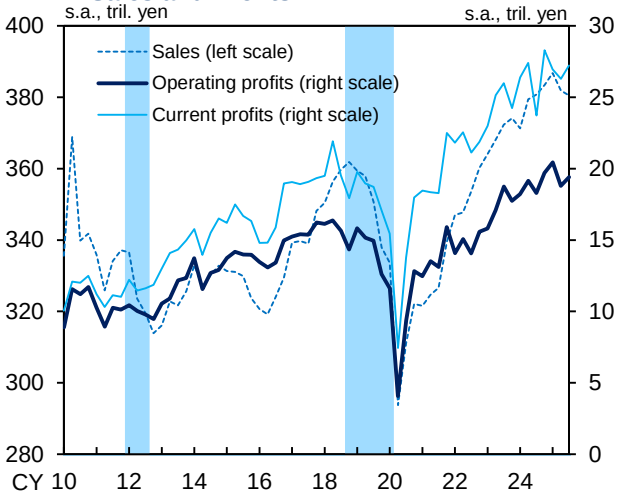
Corporate Profits

Corporate profits have remained at high levels on the whole, although downward effects due to tariffs have been seen in manufacturing. According to the *Financial Statements Statistics of Corporations by Industry, Quarterly*, operating profits for all industries and enterprises in the April-June quarter declined compared to the previous quarter, mainly due to a deterioration in export profitability in manufacturing due to the increase in U.S. tariffs, but then turned to an increase -- albeit slightly -- in the July-September quarter; when fluctuations are smoothed out, operating profits have remained at a high level, around their historical peak (Chart 15). By industry, operating profits of manufacturers have declined to a lower level, as profits, mainly of transportation machinery, have been pushed down by the deterioration in export profitability due to tariffs, although solid AI-related demand has provided support. As for nonmanufacturers, operating profits have been solid, mainly for industries other than those related to consumption, against the background of strong demand for construction and logistics.

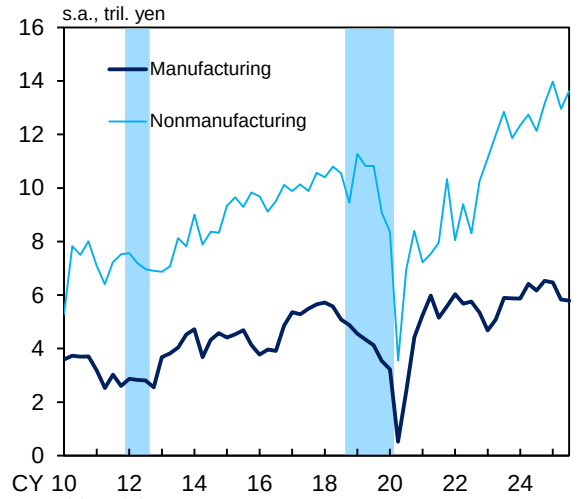
Business sentiment has been at a favorable level on the whole. Looking at the December *Tankan*, the business conditions DI for all industries and enterprises has widened within positive territory

Chart 15: Indicators Related to Corporate Profits

1. Sales and Profits



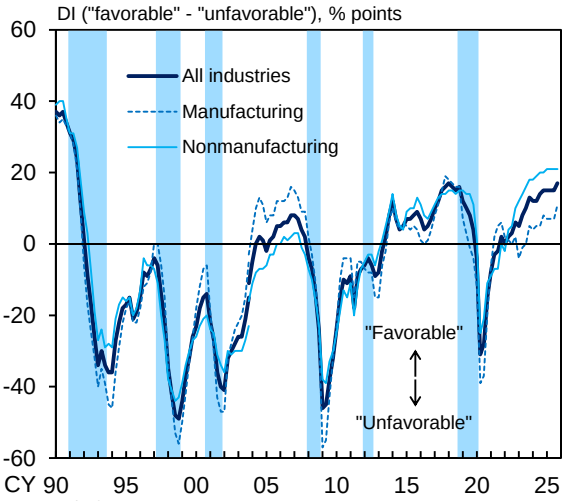
2. Operating Profits by Industry



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

(net "favorable"), registering a value of 17 after having registered 15 in the September survey (Chart 16). By industry, the DI for manufacturing has also widened within positive territory from the previous survey, mainly against the background of an increase in IT-related demand and the waning impact of tariff increases. The DI for nonmanufacturing has been unchanged from the previous survey at a high level, supported by resilient domestic demand and progress in the pass-through of cost increases to selling prices.

Chart 16: Business Conditions



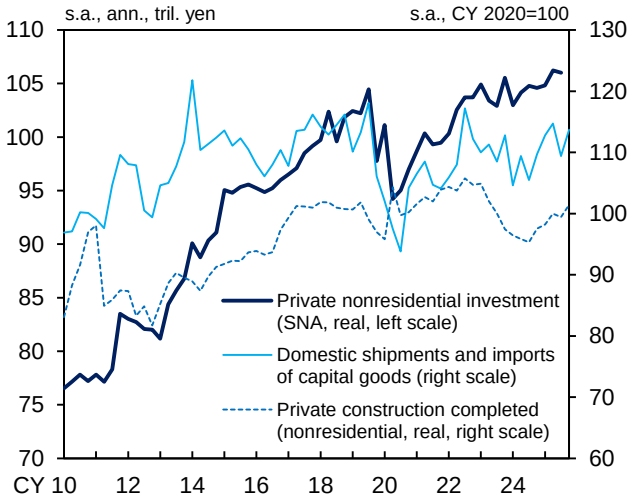
Source: Bank of Japan.
Notes: 1. Based on the *Tankan*. All enterprises. There is a discontinuity in the data for December 2003 due to a change in the survey framework.
2. Shaded areas denote recession periods.

Regarding the outlook, although downward pressure, such as the deterioration in export profitability and a decrease in export volume due to tariffs, is likely to remain in manufacturing, corporate profits on the whole are projected to be more or less flat, supported by resilient domestic demand. Thereafter, corporate profits are expected to return to an improving trend due to an increase in domestic and external demand.

Business Fixed Investment

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

Chart 17: Coincident Indicators of Business Fixed Investment

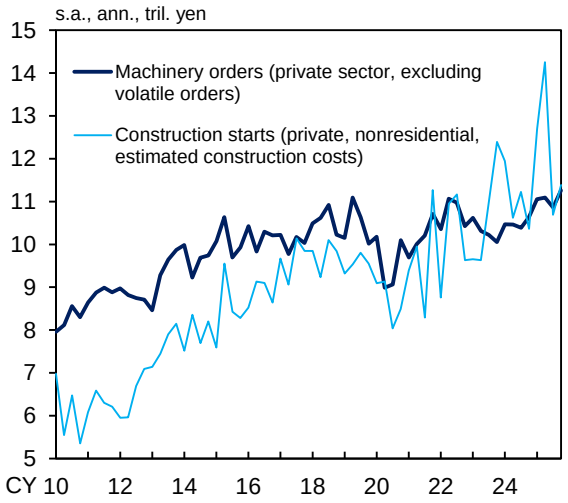


Sources: Cabinet Office; Ministry of Economy, Trade and Industry; Ministry of Land, Infrastructure, Transport and Tourism.
Notes: 1. Figures for 2025/Q4 are October-November averages.
2. Figures for real private construction completed are based on staff calculations using the construction cost deflators.

moderate uptrend, supported by strong construction demand related to logistics facilities and urban redevelopment.

Machinery orders -- a leading indicator of machinery investment -- have continued on an increasing trend, although their growth momentum has decelerated somewhat since the start of last year, mainly in orders by the automobile-related industry (Chart 18). Developments in machinery orders by industry are as follows. In manufacturing, orders have remained at relatively high levels -- albeit with fluctuations stemming from large-scale projects -- supported by resilient demand for investment in growth areas such as semiconductor components. Orders from the nonmanufacturing industry have increased firmly, pushed up by strong demand for digital- and labor saving-related investments as a trend, and with additional support from recent large-scale orders, such as for railway vehicles. Construction starts (in terms of planned expenses for private and nonresidential construction) -- a leading indicator of construction investment -- have increased as a trend, albeit with fluctuations stemming from large-scale projects, as construction starts have been supported by solid demand related to urban redevelopment and demand for construction of new logistics facilities. Looking at business fixed investment plans (in nominal terms) in the December *Tankan*, business fixed investment (on a basis close to the GDP definition; business fixed investment -- including software and R&D investments but excluding land purchasing expenses -- for all industries and enterprises including financial institutions) for fiscal 2025 registered a year-on-year rate of increase of 10.3 percent,

Chart 18: Leading Indicators of Business Fixed Investment

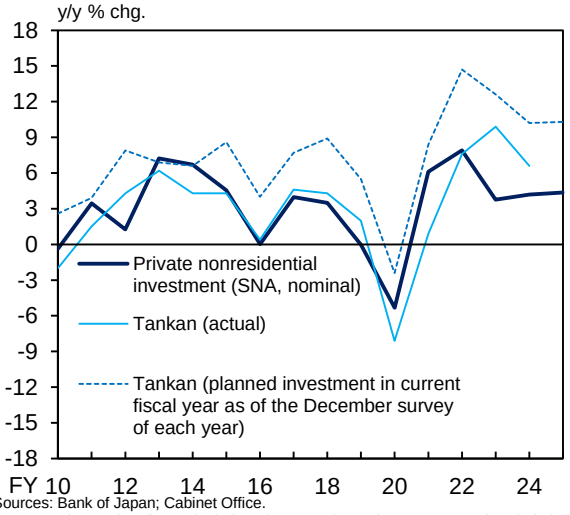


Sources: Cabinet Office; Ministry of Land, Infrastructure, Transport and Tourism.
Notes: 1. Volatile orders are orders for ships and orders from electric power companies.
2. Figures for 2025/Q4 are October-November averages.

which represents a firm increase similar in size to that in the December 2024 survey (Chart 19).

Business fixed investment is likely to continue on an increasing trend, supported by moves to clear order backlogs and by labor-saving investment to address labor shortages; that said, for the time being, downward pressure is likely to be exerted on business fixed investment from a deceleration in corporate profits in manufacturing and a rise in construction costs. Thereafter, with an improvement in corporate profits becoming pronounced again, the growth momentum in business fixed investment is likely to increase, pushed up by the government's various economic measures. Medium- to long-term investment that is expected to support business fixed investment during the projection period includes (1) labor-saving and efficiency-improving investment to address structural labor shortages and IT-related investment to digitalize business activities; (2) construction investment in logistics facilities, resulting from expanding e-commerce, and in offices and commercial facilities related to urban redevelopment; (3) R&D investment related to growth areas and decarbonization; and (4) semiconductor-related investment mainly aimed at strengthening supply chains and investment related to science and technology support, both of which reflect government support. Regarding software investment and R&D investment, capital accumulation tends to take time -- compared with tangible fixed asset investment -- due to high economic depreciation rates, and as a result, stock adjustment pressure is less likely to be exerted.

Chart 19: Planned and Actual Business Fixed Investment



Sources: Bank of Japan; Cabinet Office.
Notes: 1. The *Tankan* figures include software and R&D investments and exclude land purchasing expenses. R&D investment is not included before the March 2017 survey. The figures are for all industries including financial institutions.
2. The figure for private nonresidential investment for fiscal 2025 is the 2025/Q2-Q3 average.

Employment and Income Situation

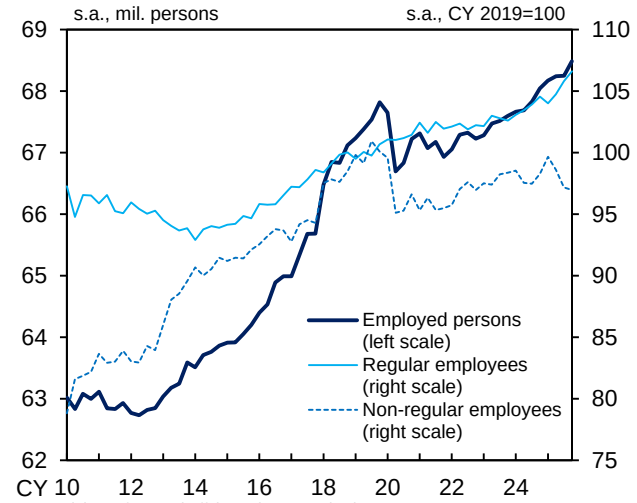
The employment and income situation has improved moderately.

The number of employed persons has continued to increase steadily (Chart 20). The number of regular employees has continued to increase firmly, mainly in the information and communications industry and in the medical, healthcare, and welfare services industry, both of which have faced severe labor shortages. The number of non-regular employees has recently declined to a somewhat lower level, as firms have shifted toward regular employment. Labor market conditions have remained tight. The unemployment rate has remained at a low level of around 2.5 percent (Chart 21). The DI for employment conditions in the *Tankan* and the DI for enterprises' employment conditions for full-time employees, etc. in the *Survey on Labour Economy Trend* have been more or less flat at levels indicating a strong sense of labor shortage (Chart 22). The labor force participation rate has remained -- albeit with fluctuations -- on a moderate uptrend, particularly for women (Chart 21).[9]

With regard to the outlook for the employment situation, the number of employed persons is expected to continue increasing moderately, mainly for regular employees in industries with a strong sense of labor shortage. However, with labor force participation of women and seniors having advanced to a high degree thus far, the pace of increase is highly likely to decelerate

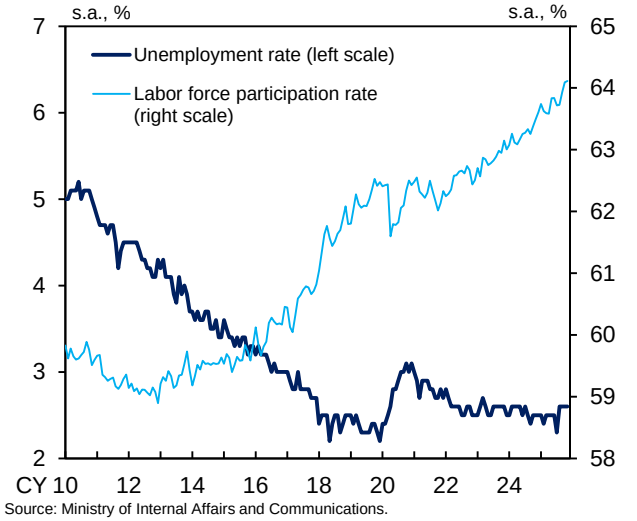
[9] See Box 2 for recent developments in labor market conditions.

Chart 20: Number of Employed Persons



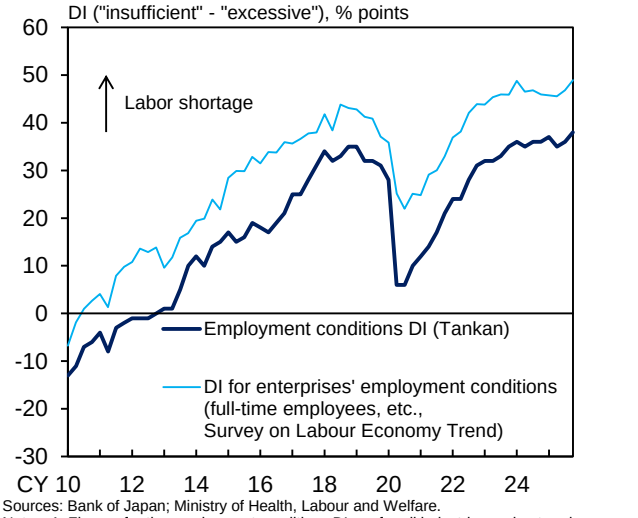
Source: Ministry of Internal Affairs and Communications.
Note: Figures for regular employees and non-regular employees prior to 2013 are based on the "detailed tabulation" in the *Labour Force Survey*. Figures for 2025/Q4 are October-November averages.

Chart 21: Unemployment Rate and Labor Force Participation Rate



Source: Ministry of Internal Affairs and Communications.

Chart 22: Measures of Labor Market Conditions

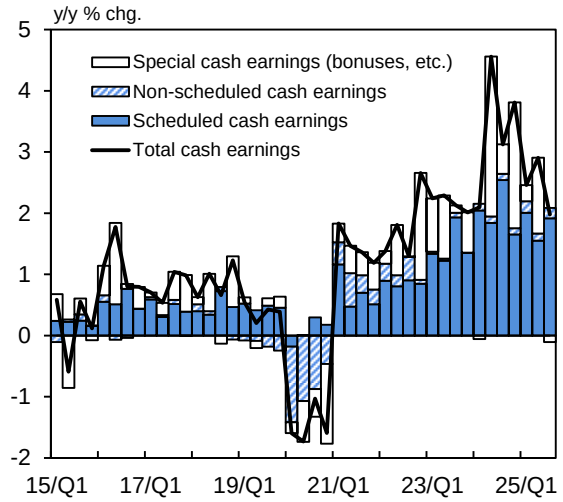


Sources: Bank of Japan; Ministry of Health, Labour and Welfare.
Notes: 1. Figures for the employment conditions DI are for all industries and enterprises.
2. Figures for the DI for enterprises' employment conditions (full-time employees, etc.) are seasonally adjusted.

gradually, because it has become more difficult for labor supply to increase from a demographic perspective. Under these circumstances, the unemployment rate is expected to follow a very moderate declining trend, and is likely to be more or less flat at a low level from the middle of the projection period, as the pace of increase in labor demand reflecting economic growth and that in labor force participation are expected to be more or less the same.

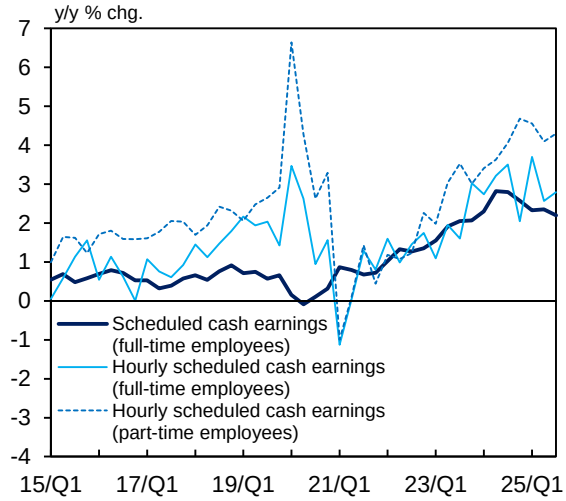
On the wage side, nominal wages per employee have continued to increase steadily, albeit with fluctuations (Chart 23). [10] Looking at the breakdown, the pace of increase in scheduled cash earnings has decelerated recently (Chart 24). Specifically, the year-on-year rate of increase in scheduled cash earnings per employee for full-time employees has declined from the previous fiscal year, and has been in the range of 2.0-2.5 percent recently, reflecting a decline in the number of working days as compared with the previous year, as well as weak developments in scheduled cash earnings in the wholesale and retail trade industries, which may be due to sample bias. Looking at hourly scheduled cash earnings for full-time employees, the rate of increase has been somewhat above that of scheduled cash earnings per employee when fluctuations are smoothed out. The year-on-year rate of increase in hourly scheduled cash earnings for part-time employees, which has been pushed up by tight labor market conditions, has somewhat accelerated recently, as the effects of minimum wage increases -- the timing of which

Chart 23: Nominal Wages



Source: Ministry of Health, Labour and Welfare.
Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.
2. Figures from 2016/Q1 onward are based on continuing observations following the sample revisions.

Chart 24: Scheduled Cash Earnings



Source: Ministry of Health, Labour and Welfare.
Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.
2. Figures from 2016/Q1 onward are based on continuing observations following the sample revisions.
3. Figures for hourly scheduled cash earnings (full-time employees) are seasonally adjusted.

[10] Wages in the *Monthly Labour Survey* are assessed on the basis of continuing observations, which are less susceptible to fluctuations due to sample revisions.

had been delayed compared with typical years -- have gradually materialized.[11] On the other hand, the year-on-year rate of increase in the average hourly wage for temporary and part-time jobs at the time of recruitment has decelerated recently. The year-on-year rate of change in non-scheduled cash earnings has been positive, mainly led by an increase in hourly wages for overtime work. Meanwhile, looking at special cash earnings (bonuses, etc.), although the rate of increase has decelerated from the previous fiscal year, such earnings have been on an increasing trend, reflecting the high levels of corporate profits and a rise in the rate of base pay increases.

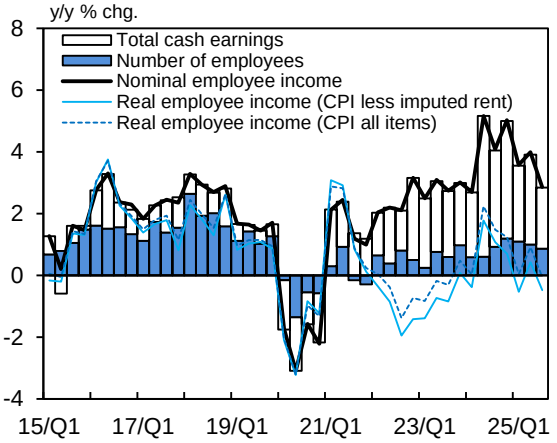
With regard to the outlook, nominal wages per employee are likely to continue increasing at their current pace for the time being; thereafter, toward the end of the projection period, the rate of increase in nominal wages per employee is likely to accelerate again as corporate profits improve on the back of a recovery in domestic and external demand and labor market conditions tighten. On this point, regarding developments in wage hikes in the next fiscal year, considering factors such as the stances of both labor and management on the annual spring labor-management wage negotiations and anecdotal information gathered through the Bank's Head Office and branches, it is highly

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

likely that firms will continue to raise wages steadily at around the same level as this fiscal year, and the probability of firms' active wage-setting behavior continuing has increased.[12]

In light of the aforementioned employment and wage conditions, employee income has continued to increase steadily in nominal terms (Chart 25). The year-on-year rate of change in employee income in real terms -- based on the CPI (all items less imputed rent) -- has been at around 0 percent, albeit with fluctuations. With regard to the outlook, nominal employee income is likely to continue to see a steady increase at its current pace for the time being, albeit with fluctuations. Toward the end of the projection period, the growth momentum in nominal employee income is likely to increase somewhat, as the nominal wage growth rate accelerates again in reflection of the recovery in corporate profits.

Chart 25: Employee Income



Sources: Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications.
Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.
2. Nominal employee income = Total cash earnings (*Monthly Labour Survey*) × Number of employees (*Labour Force Survey*)
3. Figures from 2016/Q1 onward are based on continuing observations following the sample revisions of the *Monthly Labour Survey*.
4. Figures for real employee income are based on staff calculations using the price indicators shown in parentheses.

Household Spending

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

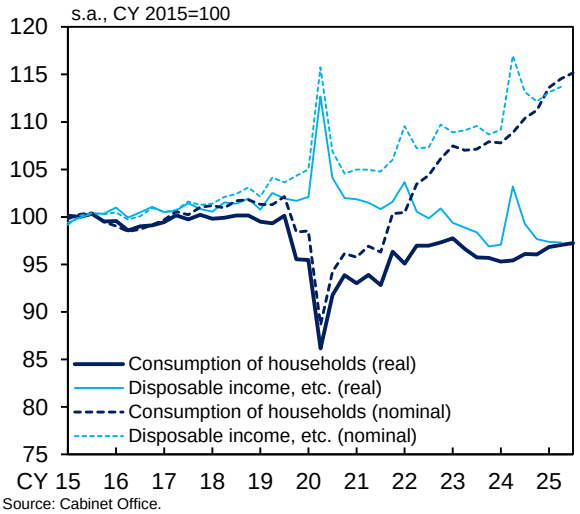
The Consumption Activity Index (CAI; real, travel balance-adjusted) -- which is calculated by combining various sales and supply-side statistics -- increased slightly in the July-September quarter,

[12] For anecdotal information gathered through the Bank's Head Office and branches, see "Firms' Stance on Wage Growth for Fiscal 2026 (As of December 3, 2025)," released by the Research and Statistics Department of the Bank of Japan, and the January 2026 *Regional Economic Report*.

and continued to increase on average in the October-November period relative to the July-September quarter, mainly for durable goods, such as automobiles and household electrical appliances (Charts 26 and 27).[13] Looking at recent developments in private consumption from various sources, such as high-frequency indicators, statistics published by industry organizations, and anecdotal information from firms, it appears that consumers have continued to be selective in their consumption on the whole: while consumers' increased thriftiness regarding items such as daily necessities has been entrenched partly due to elevated food prices, spending has been firm in areas that consumers perceive as offering high value-added, supported by improvement in the employment and income situation and by the rise in stock prices (Chart 28).

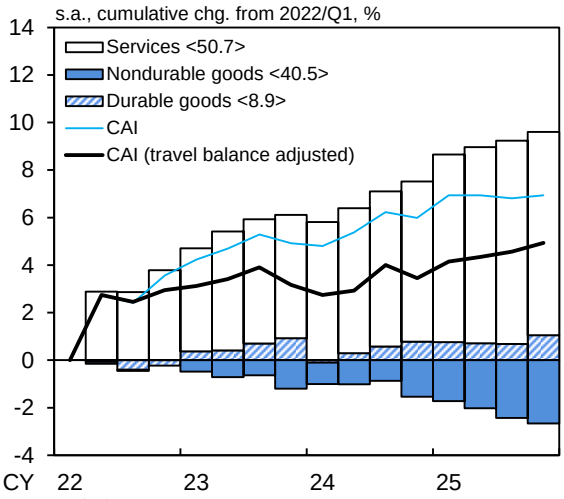
By type, consumption of durable goods has increased recently (Chart 27). Automobile sales have picked up recently due to factors such as the introduction of new models and the resumption of production lines at some automakers. Sales of household electrical appliances have increased firmly, supported by solid sales of air conditioners, mainly on the back of an expansion in subsidies provided by some local governments for their purchase, and by renewal demand for personal computers reflecting the end of support for some operating systems. Consumption of nondurable goods (e.g., "beverages and food" and "clothes") has continued on a decreasing trend due to consumers' thriftiness reflecting the rise in food prices.

Chart 26: Consumption of Households and Disposable Income



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

Chart 27: Consumption Activity Index (CAI, Real)

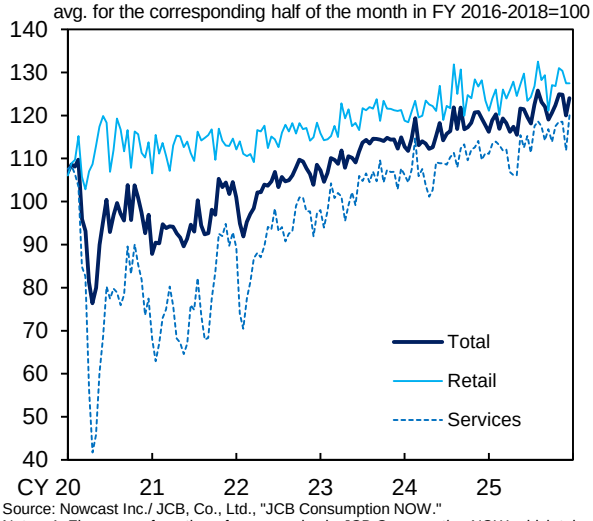


Sources: Bank of Japan, etc.
Notes: 1. Based on staff calculations. Figures for the CAI (travel balance adjusted) exclude inbound tourism consumption and include outbound tourism consumption. Figures for 2025/Q4 are October-November averages.
2. Nondurable goods include goods classified as semi-durable goods in the SNA.
3. Figures in angular brackets show the weights in the CAI.

[13] Regarding the CAI, see the Bank's research paper "Revision of the Consumption Activity Index to Capture Recent Changes in Consumption Patterns" released in July 2021.

Services consumption has been more or less flat on the whole (Charts 27 and 28). Although the shift to dining-out has continued as a trend, the growth momentum in dining-out has slowed compared with a while ago, partly due to the impact of price rises in dining-out. Domestic travel has been at a relatively high level, supported by a strong willingness to travel among working households who have benefitted from wage increases. Overseas travel has continued to be somewhat weak, mainly reflecting relatively high travel costs due to factors such as exchange rate developments.

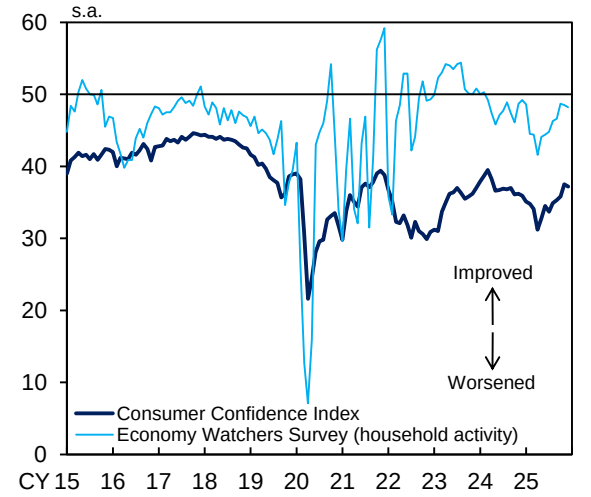
Chart 28: Consumption Developments Based on Credit Card Spending



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

Looking at confidence indicators related to private consumption, although the Consumer Confidence Index in the *Consumer Confidence Survey* -- which asks consumers for their views on the outlook for the coming six months -- has seen a clear improvement recently, mainly on the back of a decline in the rate of increase in food prices and the rise in stock prices (Chart 29). The current economic conditions DI (household activity-related) of the *Economy Watchers Survey* -- which asks firms for their views on the direction of the economy -- had continued to improve, mainly led by services-related industries; more recently, however, the improvement has come to halt, reflecting concerns over a decline in inbound tourism demand due to the Chinese government's request for its citizens to refrain from traveling to Japan.

Chart 29: Confidence Indicators Related to Private Consumption



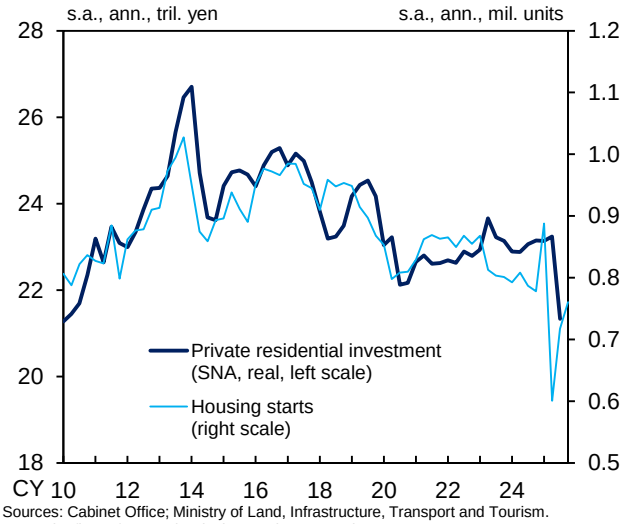
Source: Cabinet Office.
Note: Figures for the *Economy Watchers Survey* are those for the current economic conditions DI.

Regarding the outlook, despite being under downward pressure stemming from elevated food prices, private consumption is expected to remain resilient, supported by a rise in employee income

and by the government's measures to reduce the household burden of higher energy prices. Thereafter, private consumption is projected to return to a moderate increasing trend, supported by income transfers to households due to the government's economic measures and by an improvement in real disposable income on the back of a decline in the inflation rate.

Housing investment has declined (Chart 30). The number of housing starts -- a leading indicator of housing investment -- has followed a declining trend from a somewhat long-term perspective, mainly reflecting a rise in housing prices and demographic developments. However, the number of housing starts recently has recovered from the reactionary decline following the front-loading of housing starts ahead of the enforcement of revisions to the Building Standards Act and other regulations in April 2025. Housing investment is likely to continue recovering for the time being; thereafter, however, it is expected to follow a moderate declining trend due to the rise in housing prices and to a decrease in housing demand reflecting demographic developments.

Chart 30: Housing Investment



Sources: Cabinet Office; Ministry of Land, Infrastructure, Transport and Tourism.
Note: The figure for 2025/Q4 is the October-November average.

II. Current Situation of Prices and Their Outlook

Developments in Prices

The year-on-year rate of increase in the producer price index (PPI) has been on a decelerating trend, mainly due to a decline in crude oil prices, and has been at around 2.5 percent recently (Charts 31 and 32). The year-on-year rate of increase in the services producer price index (SPPI, excluding international transportation) has remained at a relatively high level, mainly on the back of the rise in personnel expenses. However, the rate of increase has been on a decelerating trend due to factors such as the dissipation of the impact of the price hikes seen in 2024, and has recently been in the range of 2.5-3.0 percent (Charts 31 and 37).

With moves to pass on wage increases to selling prices continuing, the year-on-year rate of increase in the CPI (all items less fresh food and energy) has been at around 3 percent recently, due to the effects of the rise in food prices, such as rice prices, and other factors (Charts 31 and 33). The year-on-year rate of increase in the CPI (all items less fresh food) has declined and has recently been at around 2.5 percent, due to the impact of an increase in gasoline subsidies with a view to the abolition of the former provisional gasoline tax rate (Charts 31 and 34). Meanwhile, looking at the CPI (all items less food and energy) -- which is not affected by fluctuations in food and energy prices -- the year-on-year rate of increase has been at around 1.5 percent (Charts 31 and 34). Regarding the breakdown of the CPI (all items less fresh food and energy), the rate of increase in goods prices has decelerated

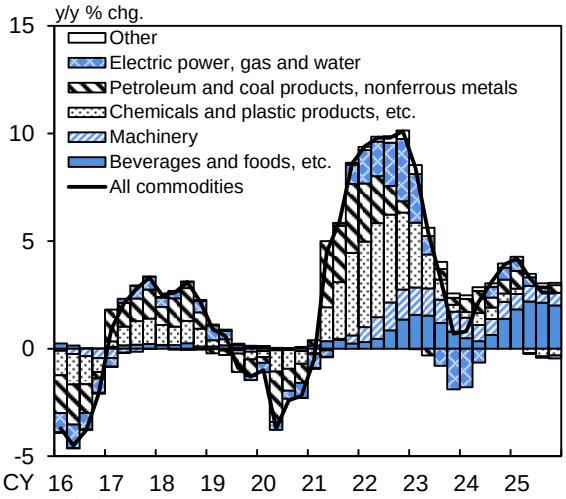
Chart 31: Inflation Indicators

y/y % chg.

	25/Q1	25/Q2	25/Q3	25/Q4
Consumer Price Index (CPI)				
Less fresh food	3.1	3.5	2.9	2.8
Less fresh food and energy	2.7	3.2	3.2	3.0
Less food and energy	1.5	1.6	1.5	1.5
Producer Price Index	4.2	3.3	2.6	2.6
Services Producer Price Index	3.5	3.2	2.9	2.8
GDP Deflator	3.6	3.3	3.4	
Domestic demand deflator	3.1	2.6	2.8	

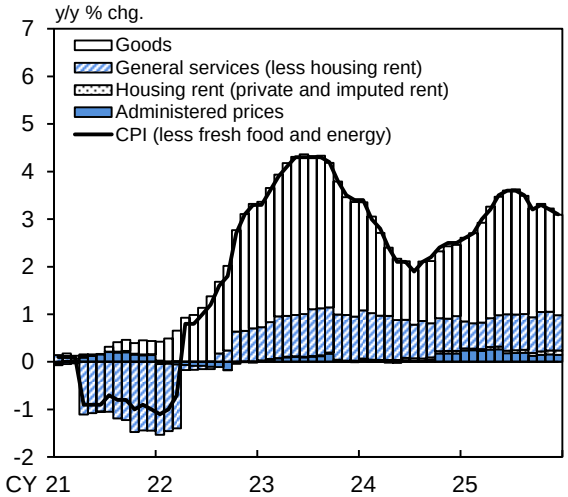
Sources: Ministry of Internal Affairs and Communications; Bank of Japan; Cabinet Office.
Notes: 1. Figures for the services producer price index (SPPI) exclude international transportation. The figure for 2025/Q4 is the October-November average.
2. CPI figures "less food and energy" include alcoholic beverages.

Chart 32: Producer Price Index



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

Chart 33: CPI (Less Fresh Food and Energy)

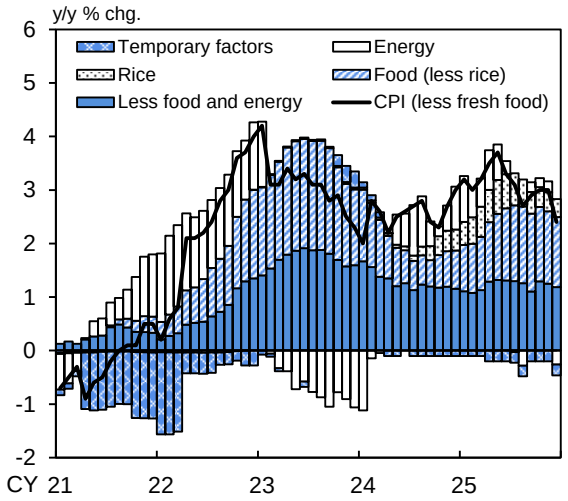


Source: Ministry of Internal Affairs and Communications.
Notes: 1. Administered prices (less energy) consist of "public services" and "water charges."
2. The CPI figures are staff estimates and exclude the effects of the consumption tax hike, policies concerning the provision of free education, and travel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

moderately, mainly due to a decline in the rate of increase in food prices (Chart 33). The rate of increase in general services prices had been flat at around 2 percent of late, partly due to the dissipation of the impact of the price hikes seen in 2024; more recently, however, the rate of increase in general services prices has accelerated somewhat due to factors such as a rise in hotel charges. The rate of change in administered prices (less energy) has been slightly positive.

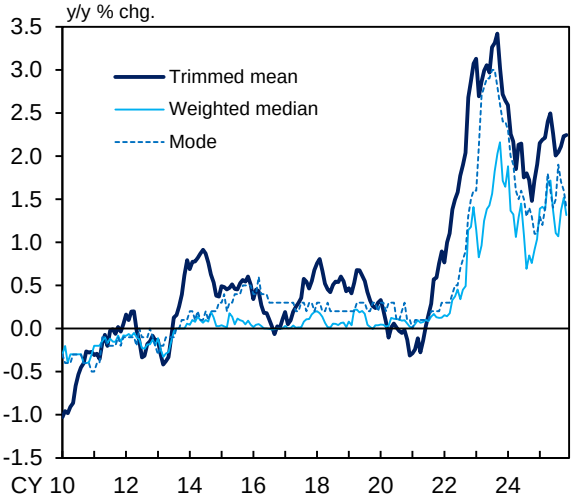
Core indicators for capturing the underlying trend in the CPI have exhibited the following developments (Chart 35).[14] The rate of increase in the trimmed mean of the year-on-year rate of change in the CPI had decelerated temporarily through the middle of last year; more recently, however, the rate of increase in the trimmed mean has risen slightly to around 2 percent, reflecting factors such as an acceleration in the rates of increase in electricity charges and auto insurance premiums. The rates of increase in the weighted median and the mode have been in the range of around 1.5-2.0 percent, albeit with fluctuations. Looking at the year-on-year price changes across all CPI items (less fresh food), the share of items whose prices have increased minus the share of items whose prices have decreased has been on a declining trend in positive territory, with moves to raise prices of

Chart 34: CPI (Less Fresh Food)



Source: Ministry of Internal Affairs and Communications.
Notes: 1. Figures for energy consist of those for petroleum products, electricity, and gas, manufactured & piped. Figures for food (less rice) exclude fresh food and alcoholic beverages.
2. Figures for "temporary factors" are staff estimates and include the effects of the consumption tax hike, policies concerning the provision of free education, and travel subsidy programs, in addition to the contribution of mobile phone charges from fiscal 2021 to 2022.

Chart 35: CPI: Trimmed Mean, etc.



Sources: Bank of Japan; Ministry of Internal Affairs and Communications.
Note: Based on staff calculations using the CPI excluding the effects of the consumption tax hikes, policies concerning the provision of free education, and travel subsidy programs. The CPI figures from April 2020 onward are staff estimates and exclude the effects of measures such as free higher education. The latest figures are for November 2025.

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

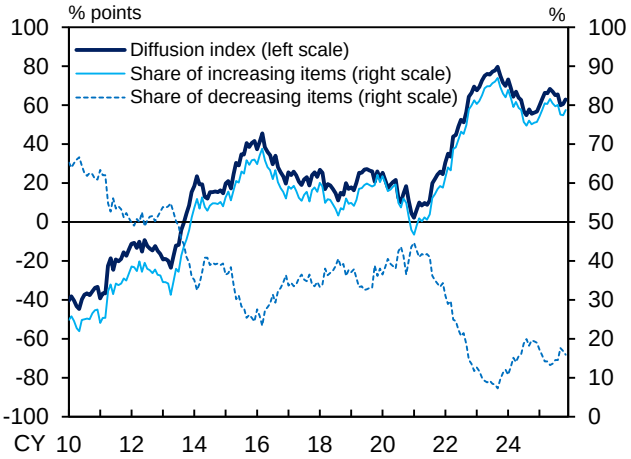
food and other items becoming less pronounced compared with a while ago (Chart 36). Meanwhile, looking at the relationship between wages and services prices, with progress in the pass-through of wage increases to services prices of a wide range of items, both wages and services prices have risen moderately (Chart 37). In addition, indicators of inflation expectations, which represent people's perceptions of price developments and are closely related to the underlying inflation trend, have increased moderately (Chart 38).[15]

Meanwhile, a decomposition of changes in the GDP deflator from the distribution side shows that, while the acceleration in the rate of increase in the GDP deflator observed in 2023 was mainly led by unit profits, as firms passed on cost increases, since 2024, both unit profits and unit labor costs have been rising in a balanced manner, as the contribution of unit labor costs has been intensifying in reflection of wage increases (Chart 39).

Environment Surrounding Prices

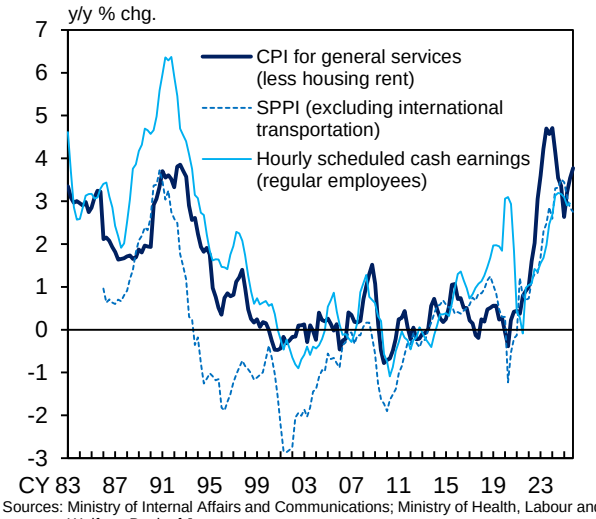
In the outlook for prices, the main factors that determine inflation rates are assessed as follows. First, the output gap is likely to remain negative at around its current level for the time being; thereafter, however, from the middle of the projection period, an improving trend is likely to gradually become evident, reflecting the rise in the economic growth rate (Chart 2). Meanwhile, it is likely that labor market conditions have tightened to a greater extent than can be

Chart 36: Diffusion Index of Price Changes



Sources: Bank of Japan; Ministry of Internal Affairs and Communications.
Note: The diffusion index is defined as the share of increasing items minus the share of decreasing items. The share of increasing/decreasing items is the share of items for which price indices increased/decreased from a year earlier. Based on staff calculations using the CPI (less fresh food) excluding the effects of the consumption tax hikes, policies concerning the provision of free education, and travel subsidy programs. The CPI figures from April 2020 onward are staff estimates and exclude the effects of measures such as free higher education. The latest figures are for November 2025.

Chart 37: Wages and Prices



Sources: Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare; Bank of Japan.
Notes: 1. Figures for the CPI for general services (less housing rent) are staff estimates and exclude the effects of the consumption tax hikes, policies concerning the provision of free education, and travel subsidy programs, as well as the contribution of mobile phone charges from fiscal 2021 to 2022.
2. Figures for the SPPI (excluding international transportation) are estimated excluding the effects of the consumption tax hikes.
3. Figures for hourly scheduled cash earnings (regular employees) are seasonally adjusted (3-quarter central moving averages). Moreover, figures from 2016/Q1 onward are based on continuing observations following the sample revisions.
4. Figures for the SPPI (excluding international transportation) and hourly scheduled cash earnings (regular employees) for 2025/Q4 are October-November averages.

[15] For details on indicators for capturing the underlying inflation trend, see Box 4 in the April 2024 Outlook Report.

explained by the changes in the output gap, mainly due to a deceleration in the pace of increase in labor force participation of women and seniors. In this situation, upward pressure on wages and prices is more likely to be stronger than suggested by the output gap, given the current situation that labor shortages have begun to constrain the economic activity of firms, mainly in the nonmanufacturing industry, from the supply side.

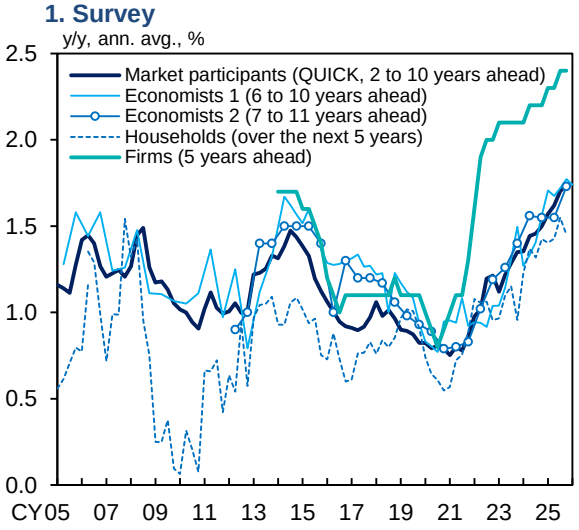
Second, medium- to long-term inflation expectations have risen moderately (Chart 38). Regarding the outlook, as the economy continues to improve and the tightening of labor market conditions becomes more pronounced, firms' active wage- and price-setting behavior is expected to become more widespread, and it is therefore likely that inflation expectations will continue to rise moderately and be at around 2 percent in the second half of the projection period.

Third, the year-on-year rate of change in the import price index on a yen basis has narrowed within negative territory of late, and recently has been at around 0 percent, reflecting factors such as the yen's depreciation and a rise in prices of nonferrous metals, while the year-on-year rate of change in the index on a contract currency basis has continued to be slightly negative, mainly due to a decline in crude oil prices (Charts 41 and 42).[16]

[16] For the pass-through of import price increases to domestic prices, see Box 3.

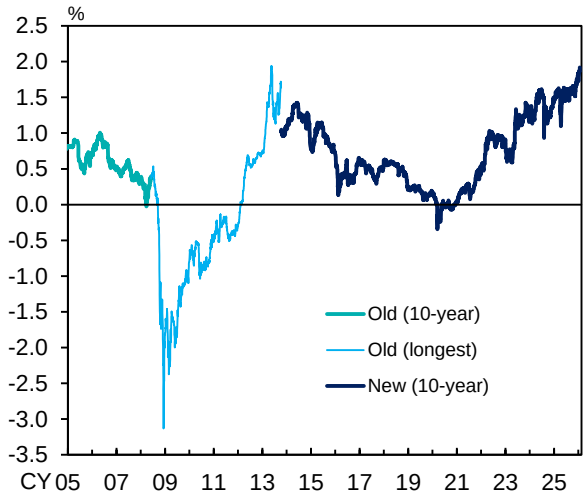
Chart 38: Inflation Expectations

1. Survey



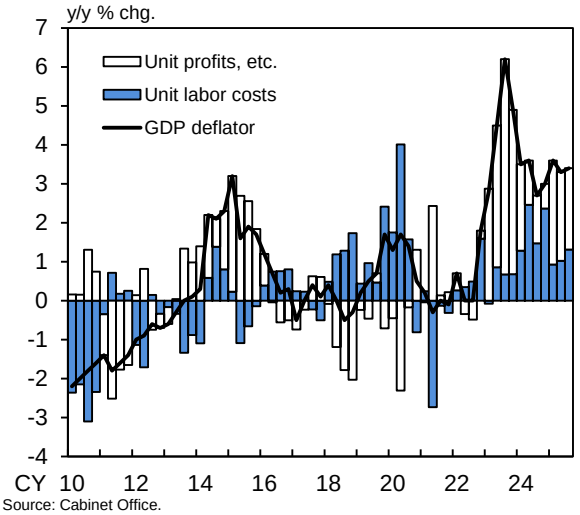
Sources: Bank of Japan; QUICK, "QUICK Monthly Market Survey <Bonds>"; JCER, "ESP Forecast"; Consensus Economics Inc., "Consensus Forecasts."
Notes: 1. "Economists 1" shows the forecasts of economists in the *Consensus Forecasts*. "Economists 2" shows the forecasts of forecasters surveyed for the *ESP Forecast*.
2. Figures for households are from the *Opinion Survey on the General Public's Views and Behavior*, estimated using the modified Carlson-Parkin method for a 5-choice question.
3. Figures for firms show the inflation outlook of enterprises for general prices (all industries and enterprises, average) in the *Tankan*.

2. BEI



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

Chart 39: GDP Deflator



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

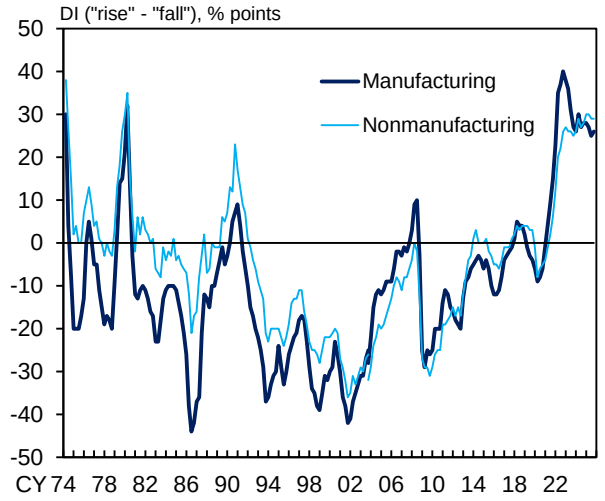
Meanwhile, the year-on-year rate of change in energy prices (e.g., gasoline prices and electricity charges) has been negative recently, pushed down by the decline in crude oil prices and also affected by the increase in gasoline subsidies. If foreign exchange rates and crude oil prices are assumed to be at around the current levels, and given the government's abolition of the former provisional gasoline tax rate as well as its measures to reduce the household burden of higher energy prices such as electricity and gas charges, energy prices are likely to fall further on a year-on-year basis for the time being, albeit with fluctuations.

Outlook for Prices

Based on this underlying scenario, the year-on-year rate of increase in the CPI (all items less fresh food and energy) is likely to decelerate to around 2 percent because it is expected that the effects of the rise in food prices, such as rice prices, will gradually wane. Thereafter, with expansion in the economy and tightening of labor market conditions continuing, the rate of increase in this CPI is likely to be at around 2 percent, as moves to pass on wage increases to selling prices take hold in a wide range of items in both goods and services (Chart 43).

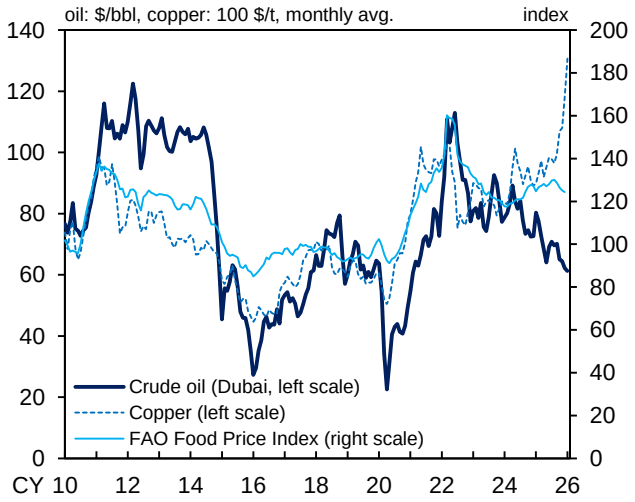
The year-on-year rate of increase in the CPI (all items less fresh food) is likely to decelerate to a level below 2 percent in the first half of this year, with the waning of the effects of the rise in food prices, such as rice prices, and pushed down by a decline in energy prices reflecting the government's measures to reduce the household burden of higher energy prices. However, it is

Chart 40: Output Prices



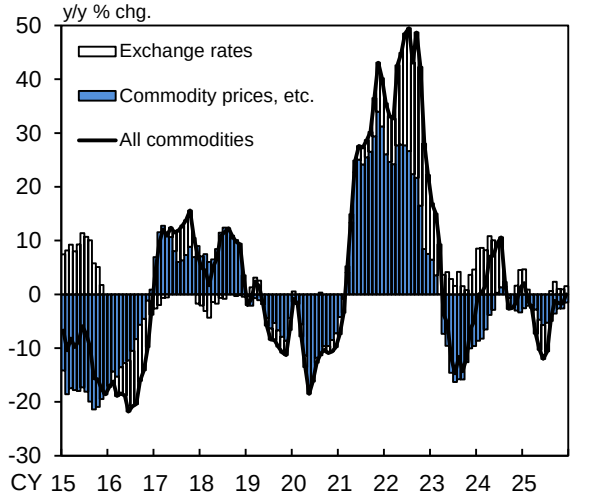
Source: Bank of Japan.
Note: Based on the *Tankan*. All enterprises. There is a discontinuity in the data for December 2003 due to a change in the survey framework.

Chart 41: International Commodity Prices



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

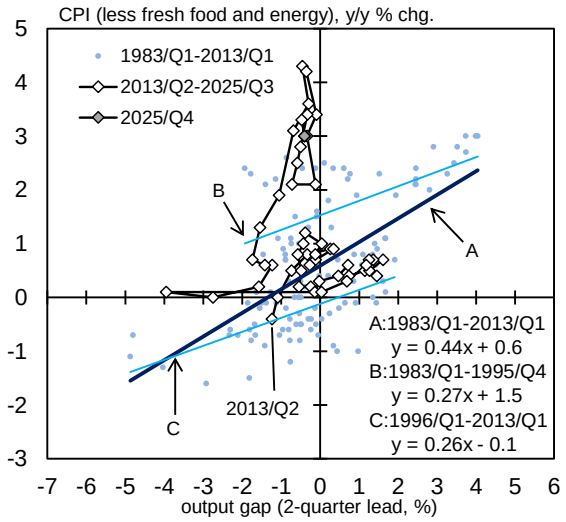
Chart 42: Import Prices (Yen Basis)



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

likely that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained, and that underlying CPI inflation will continue rising moderately. Thereafter, since it is projected that a sense of labor shortage will grow as the economy continues to improve and that medium- to long-term inflation expectations will rise, it is expected that underlying CPI inflation and the rate of increase in the CPI (all items less fresh food) will increase gradually and, in the second half of the projection period, be at a level that is generally consistent with the price stability target.

Chart 43: Phillips Curve



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

Firms' behavior has shifted more toward raising wages and prices, and it is highly likely that the mechanism in which both wages and prices rise moderately will be maintained. On this basis, moves to reflect wage increases in selling prices could strengthen to a greater extent than expected, and there could be growing expectations that labor market conditions will continue to be tight; these developments could heighten upward pressure on wages. 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. On the other hand, if the impact of tariffs on corporate profits, for example, becomes prolonged, this could lead firms to focus more on cost cutting. As a result, moves to reflect price rises in wages could also weaken.

III. Financial Developments in Japan

Financial Conditions

Financial conditions have been accommodative.

Looking at short-term interest rates, the uncollateralized overnight call rate had been at around 0.5 percent and has been at around 0.75 percent since the policy interest rate was raised at the December 2025 Monetary Policy Meeting (Chart 44). Regarding interest rates on term instruments, both the 3-month TIBOR and the 3-month treasury discount bill (T-Bill) rate have risen.

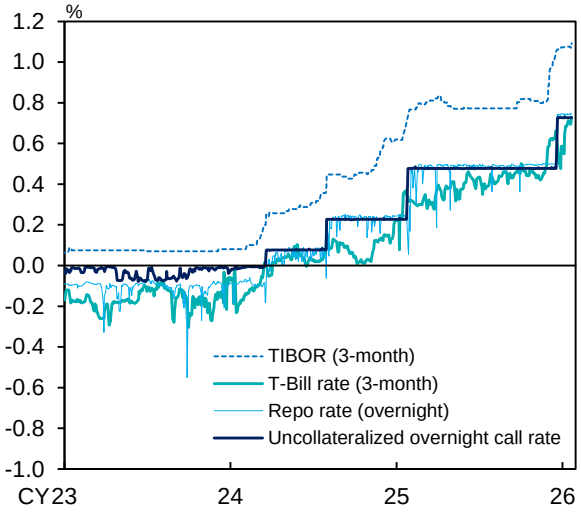
Real interest rates have been negative (Chart 45).[17]

Firms' funding costs have increased (Chart 46). As for lending rates (the average interest rates on new loans and discounts), both long-term and short-term ones have risen, due to a rise in market interest rates, which serve as base rates. Issuance rates for CP have increased, in tandem with the rise in short-term interest rates. Issuance rates for corporate bonds have risen, reflecting the increase in their base rate.

The DI in the *Tankan* for financial institutions' lending attitudes as perceived by firms suggests that such attitudes have remained accommodative on the whole (Chart 47). The DI for issuance conditions for CP has continued to

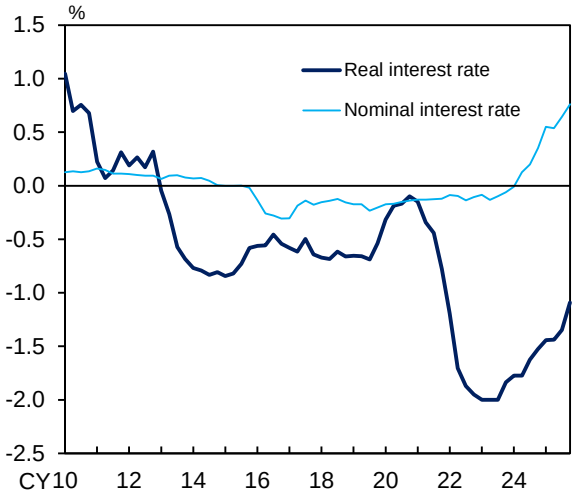
[17] See Box 5 of the April 2024 Outlook Report for an assessment of financial conditions in terms of real interest rates.

Chart 44: Short-term Interest Rates



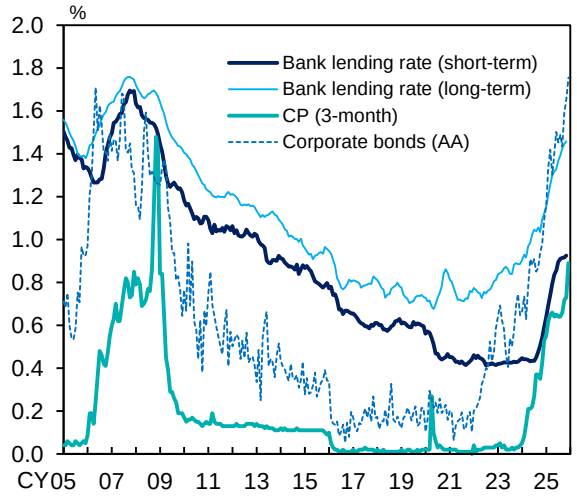
Sources: Bank of Japan; JBA TIBOR Administration; Bloomberg.
Note: Figures for repo rate are the *Tokyo Repo Rate*.

Chart 45: Real Interest Rate (1-Year)



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

Chart 46: Bank Lending Rates and Issuance Yields for CP and Corporate Bonds

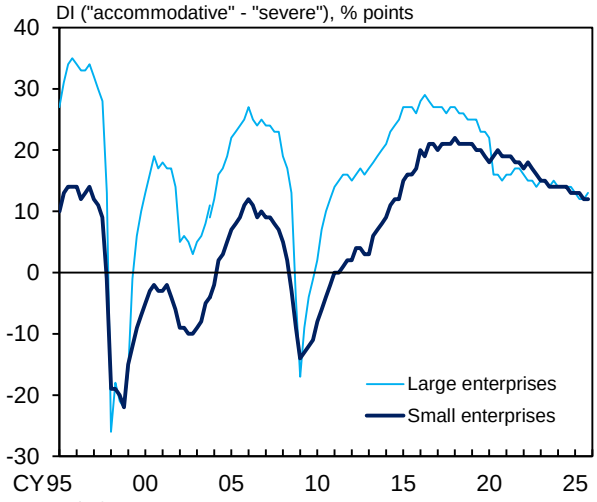


Sources: Bank of Japan; Japan Securities Depository Center; Capital Eye; I-N Information Systems; Bloomberg.
Notes: 1. Figures for issuance yields for CP up through September 2009 are the averages for CP (3-month, rated a-1 or higher). Those from October 2009 onward are the averages for CP (3-month,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

show net "easy" conditions. As suggested by the latter, issuance conditions for CP and corporate bonds have been favorable. Meanwhile, the DI for firms' financial positions in the *Tankan* suggests that they have been at favorable levels on the back of the recovery in economic activity and progress in the pass-through of cost increases to selling prices (Chart 48).

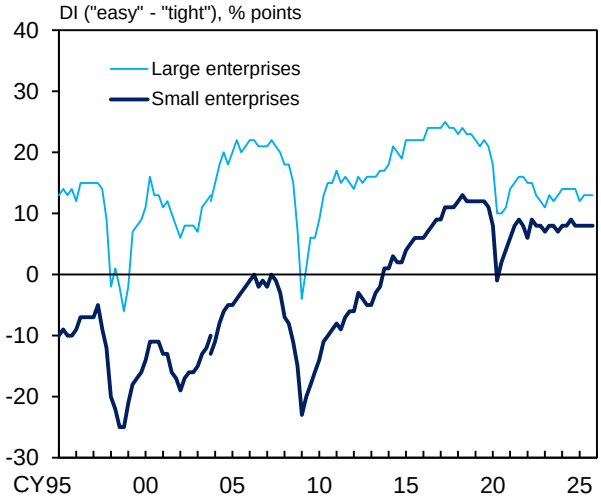
Firms' demand for funds has increased moderately on the back of, for example, the recovery in economic activity as well as mergers and acquisitions of firms. In this situation, the year-on-year rate of increase in the amount outstanding of bank lending has been in the range of 4.5-5.0 percent (Chart 49). The year-on-year rate of increase in the aggregate amount outstanding of CP and corporate bonds has been in the range of 6.5-7.0 percent, pushed up in part by past large-scale issuances.

Chart 47: Lending Attitudes of Financial Institutions as Perceived by Firms



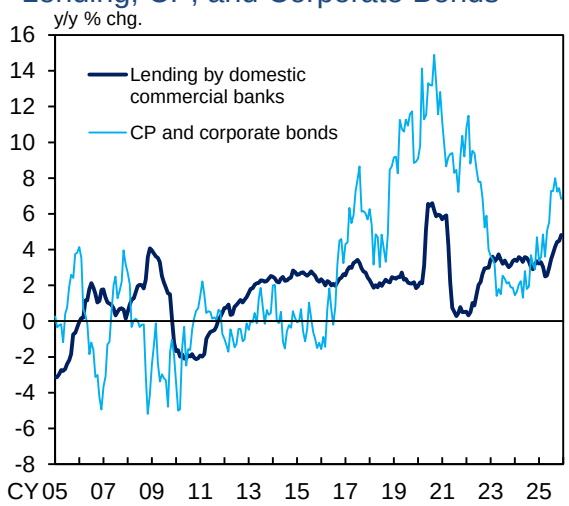
Source: Bank of Japan.
Note: Based on the *Tankan*. All industries. There is a discontinuity in the data for December 2003 due to a change in the survey framework.

Chart 48: Firms' Financial Positions



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

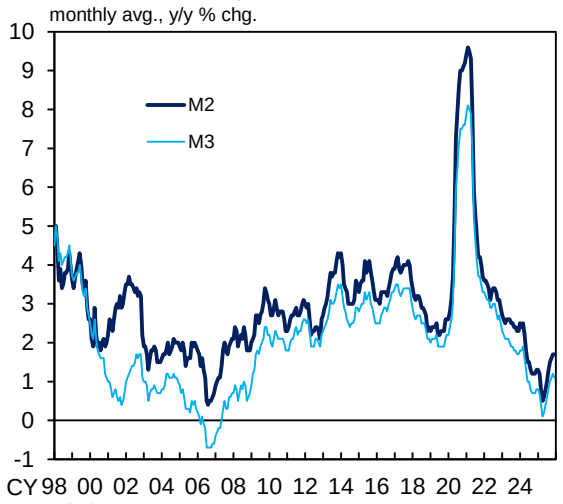
Chart 49: Amounts Outstanding of Bank Lending, CP, and Corporate Bonds



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

The year-on-year rate of change in the money stock (M2) has been in the range of 1.5-2.0 percent, as an increase in the amount outstanding of bank lending has continued to push up the rate (Chart 50).

Chart 50: Money Stock



Source: Bank of Japan.

Developments in Financial Markets

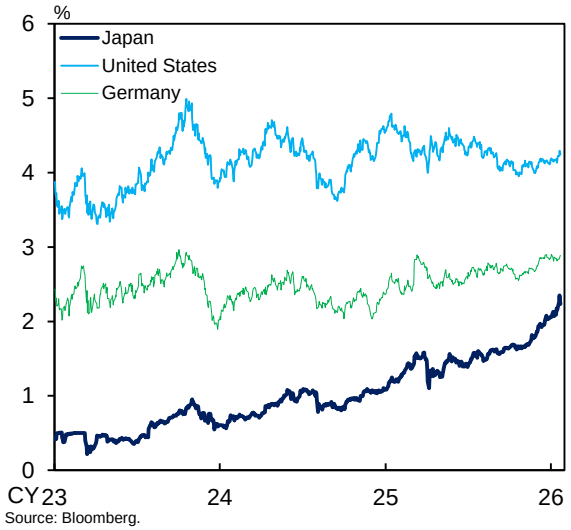
In global financial markets, market sentiment has improved, reflecting reduced uncertainties over the outlook for the global economy.

Yields on 10-year government bonds in the United States declined somewhat through the end of November 2025, mainly reflecting the increase in market expectations of policy interest rate cuts by the Federal Reserve; however, yields have risen since then, with U.S. economic indicators generally remaining solid (Chart 51). Yields on 10-year government bonds in Europe have risen, mainly because market expectations of policy interest rate cuts by the European Central Bank (ECB) have subsided. In Japan, yields on 10-year government bonds have risen significantly, in tandem with the increase in U.S. yields, and reflecting factors such as market views on future developments in Japan's economic activity and prices.

Premiums for U.S. dollar funding through the dollar/yen foreign exchange swap market have declined, due to dissipation of the effects of pushing up the premiums from the seasonal tightening of supply and demand conditions for this funding in view of the year-end (Chart 52).

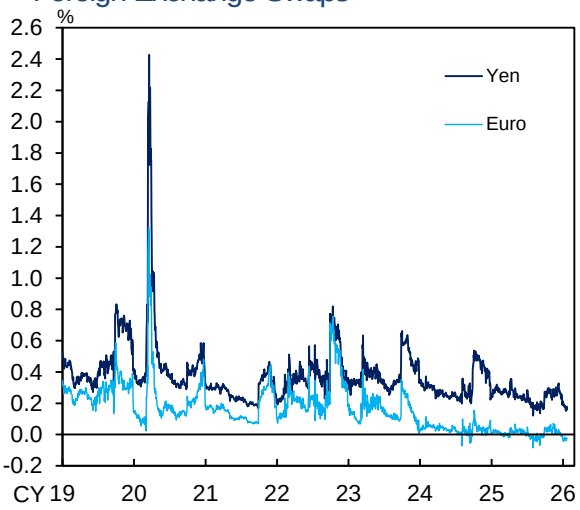
With the expansion of AI-related demand continuing and the U.S. economy remaining solid, stock prices in the United States have risen slightly over the observed period, although they declined at times reflecting market attention to the high valuation of high-tech related stocks (Chart 53). Stock prices in Europe have risen, mainly

Chart 51: 10-Year Government Bond Yields in Selected Advanced Economies



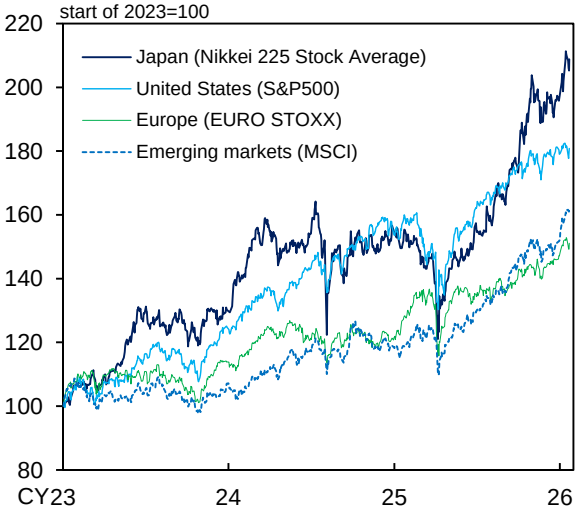
Source: Bloomberg.

Chart 52: Dollar Funding Premiums through Foreign Exchange Swaps



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

Chart 53: Selected Stock Price Indices

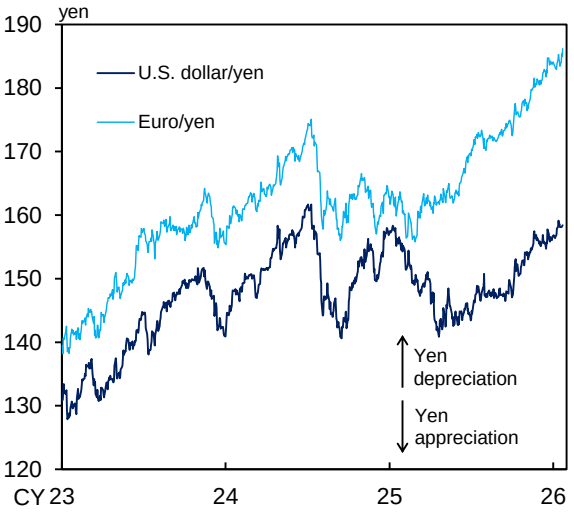


Source: Bloomberg.
Note: Figures for emerging markets are those for the MSCI Emerging Markets Index (local currency).

reflecting solid business performance and expectations of improvement in the growth outlook for the euro area. Stock prices in Japan have risen, mainly on the back of solid business performance and expectations for the economic measures of Japan's new administration, although they declined at times in line with U.S. stock prices. Meanwhile, stock prices in emerging economies have also risen, like those in advanced economies.

In foreign exchange markets, the yen has depreciated against the U.S. dollar (Chart 54). The yen has also depreciated against the euro, mainly because market expectations of policy interest rate cuts by the ECB have subsided.

Chart 54: U.S. Dollar/Yen and Euro/Yen



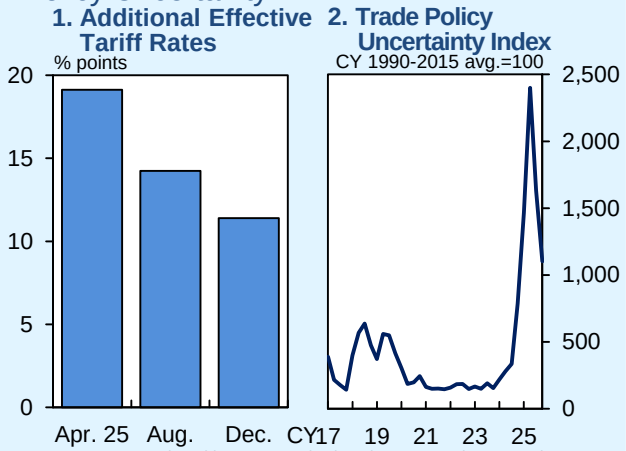
Source: Bloomberg.

(Box 1) Impact of Tariff Policies on the U.S. Economy, and Robust Global AI-Related Demand

Overseas economies are expected to remain affected by trade and other policies in each jurisdiction, but it appears there is a growing possibility that this downward pressure will remain relatively small. One reason is that the U.S. economy, which had been expected to decelerate substantially due to the impact of trade policies, has maintained solid growth. This box explains the factors underpinning the continued strength of the U.S. economy amid high tariffs, and outlines the implications for Japan's economy.

The U.S. effective tariff rate rose sharply in the spring of last year, mainly reflecting the introduction of "reciprocal" tariffs and the tariff hike on China (Chart B1-1). However, the increase in tariffs has subsequently been reduced, mainly reflecting progress in trade negotiations between the United States and its trading partners. Against this backdrop, uncertainty surrounding trade policy developments has declined. While private-sector economists revised their forecasts for U.S. economic growth significantly downward in April, following the announcement of "reciprocal" tariffs, with some even projecting negative growth, forecasts have since been revised upward, recovering to around 2 percent recently, a level generally regarded as the potential growth rate (Chart B1-2). In fact, although the U.S. economy temporarily recorded negative growth due to a front-loaded increase in imports ahead of the imposition of tariffs, it has maintained solid growth thereafter, avoiding the significant slowdown once feared (Chart B1-3).

Chart B1-1: U.S. Tariff Rates and Trade Policy Uncertainty



Sources: USITC; USTR; The White House; Federal Register; BEA; "The Economic Effects of Trade Policy Uncertainty" by Dario Caldara, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo.
Note: In the left-hand chart, figures are additional tariff rates after January 2025 (world average). Based on staff calculations using the share of each country and region in U.S. total imports in 2024 and tariffs implemented as of the end of each month (the USMCA tariff exemptions for Mexico and Canada are estimated based on certain assumptions).

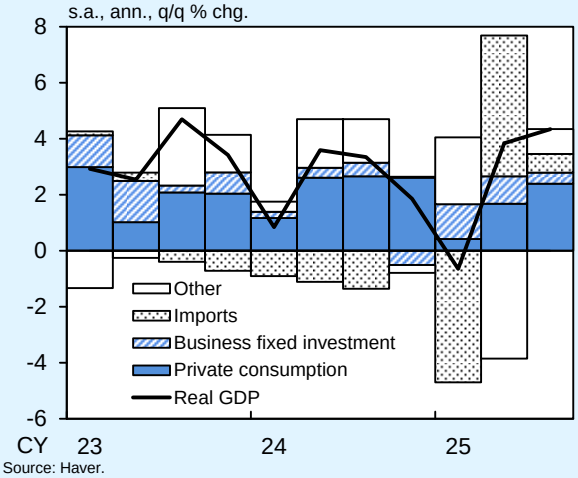
Chart B1-2: Economists' U.S. Economic Outlook

Sources: Wolters Kluwer; Haver.
Note: Figures are the mean of economists' forecasts for real GDP growth, as compiled by Blue Chip. The latest figure for the growth rate for CY 2025 is as of the December 2025 survey and that for the growth rate for CY 2026 is as of the January 2026 survey.

Turning to factors that have contributed to the stronger-than-expected growth rate, the first is solid private consumption. Initially, it was expected that private consumption would slow as firms swiftly passed on tariffs to selling prices. However, despite facing increased import costs due to tariffs, firms in the United States have so far kept the pass-through of tariffs to selling prices moderate by drawing down inventories accumulated before the tariffs took effect and by compressing past high profit margins. As a result, the downward impact on consumption has been mitigated (Chart B1-4). Moreover, it appears that the wealth effects arising from higher U.S. stock prices have also contributed to an increase in consumption, particularly among high-income households. In terms of the outlook for consumption, the extent to which tariffs are passed on to selling prices will be an important factor. In this regard, private-sector economists initially projected that U.S. consumer prices would rise rapidly and substantially due to the pass-through of tariffs; however, their inflation projections have been gradually scaled back, and expectations have shifted to the view that the pass-through will continue, but only at a moderate pace (Chart B1-5).

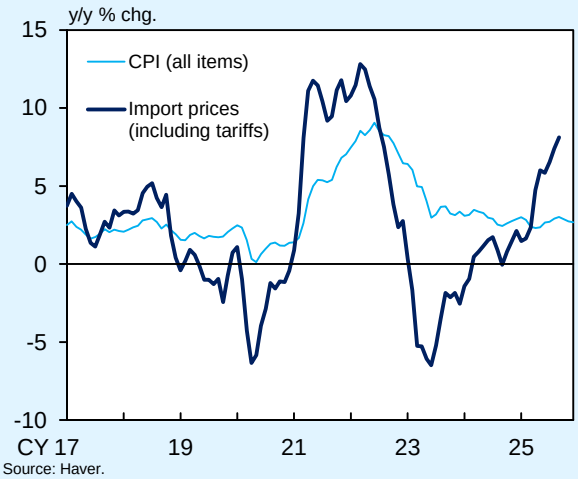
The second factor is the expansion of AI-related demand. In response to rising AI-related demand, firms with large-scale cloud facilities (hyperscalers) have significantly increased their IT-related business fixed investment in the United States, including for AI data centers and software (Chart B1-6[1]). This expansion of AI-related investment in the United States has also stimulated growth in economies such as Taiwan and South Korea, through increased demand

Chart B1-3: U.S. Real GDP



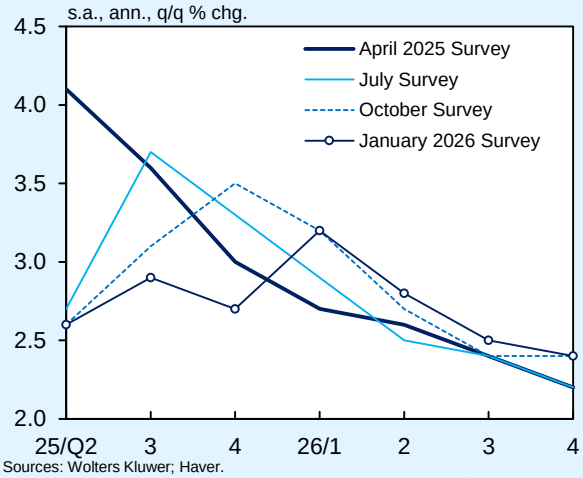
Source: Haver.
Note: Based on the initial estimate of GDP.

Chart B1-4: U.S. Prices



Source: Haver.
Notes: 1. Import prices (including tariffs) are based on staff calculations using published import price figures and the effective tariff rates.
2. The figure for the CPI (all items) for October 2025 is linearly interpolated using figures for September and November.

Chart B1-5: Economists' U.S. Inflation Outlook



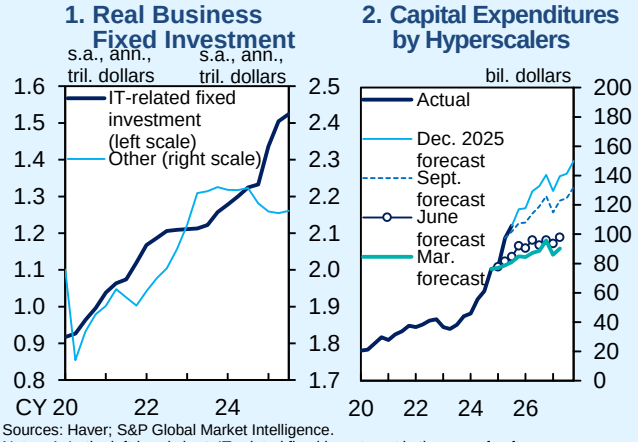
Sources: Wolters Kluwer; Haver.
Note: Figures are the mean of economists' forecasts for the PCE deflator (excluding food and energy), as compiled by Blue Chip.

mainly for semiconductors (Chart B1-7). As for the outlook for AI-related investment in the United States, the current active investment stance is expected to continue for the time being, given that hyperscalers have been revising their business fixed investment plans upward since last autumn (Chart B1-6[2]).

In contrast, non-IT-related business fixed investment remained sluggish throughout 2025. Moreover, employment conditions have weakened somewhat, with job growth slowing and the unemployment rate rising moderately. These developments warrant attention, as they likely reflect, at least in part, more cautious corporate behavior in response to policy uncertainties and the burden of tariffs.

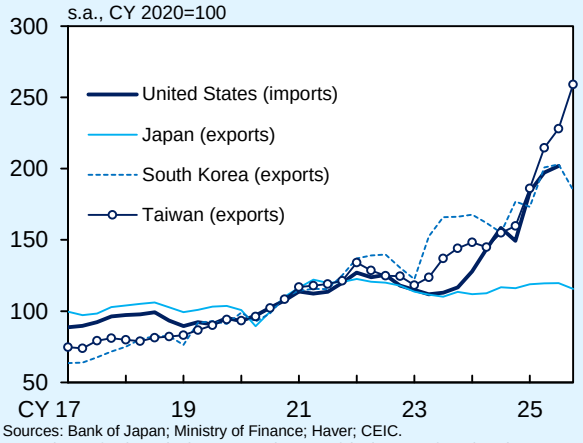
Looking ahead, U.S. economic growth is expected to return to a pace around the same level as the potential growth rate, partly supported by AI-related demand and fiscal and monetary policies, although downward pressure is likely to persist due to the continued moderate pass-through of tariffs. In this regard, while the risk of a significant slowdown in the U.S. economy appears to have declined, attention continues to be warranted on the impact of trade and other policies on U.S. economic activity and prices, as well as developments in AI-related demand and asset prices.

Chart B1-6: U.S. Business Fixed Investment



Sources: Haver; S&P Global Market Intelligence.
Notes: 1. In the left-hand chart, IT-related fixed investment is the sum of software investment, information processing equipment (within machinery investment), and data centers (within construction investment). Based on staff calculations using the initial estimate of GDP.
2. In the right-hand chart, figures are the sum of capital expenditures of Alphabet, Amazon, Meta, Microsoft, and Oracle. Forecasts are aggregated by S&P Global Market Intelligence from analysts' forecasts that mainly reflect information published by the companies.

Chart B1-7: Semiconductor-Related Real Exports and Imports

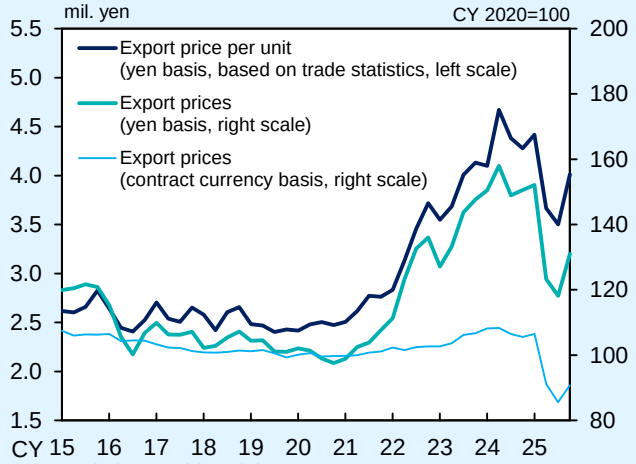


Sources: Bank of Japan; Ministry of Finance; Haver; CEIC.
Note: Figures for the United States are the sum of the imports of semiconductors, computers, computer accessories, and telecommunications equipment among capital goods. Figures for Japan are the sum of the exports of IT-related goods and semiconductor production equipment. Figures for South Korea are the export volume index for semiconductors. Figures for Taiwan are the export volume index for machinery and electrical equipment.

Finally, the impact of these developments on Japan's economy is examined.[18] Starting with the direct effects of tariff hikes on the profitability and volume of exports to the United States, Japanese automakers have sought to avoid passing on the impact of tariffs and raising local selling prices, by reducing export prices for the U.S. market (Chart B1-8). The rate of decline in export prices of passenger motor cars to North America has been decreasing since last autumn, partly reflecting the reduction in tariff rates on automobiles. Even so, the deterioration in export profitability has placed downward pressure on the profits of Japanese automakers. On the other hand, for export items other than automobiles, moves to lower export prices have not been widely observed, and it appears that most of the burden of costs arising from tariff increases has been borne by U.S. firms, including U.S.-based subsidiaries of Japanese firms. That said, with final demand in the United States remaining robust, as noted earlier, exports of these items have not experienced a substantial decline.

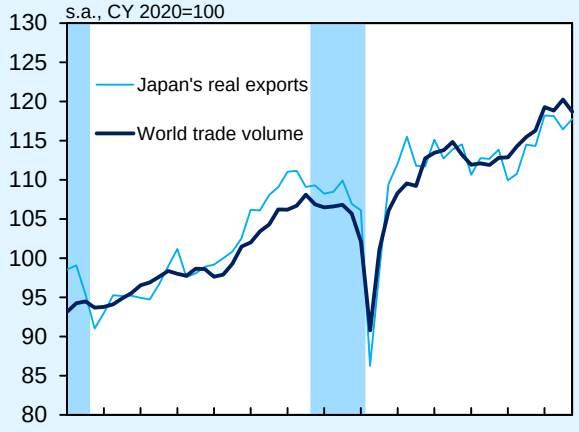
Turning to the indirect effects through global trade activity, world trade volume has continued to show solid growth, driven by AI-related demand, even after the tariff hikes, and a decline in Japan's real exports has been avoided (Chart B1-9). While stronger AI-related demand has provided some support for Japan's exports such as capital goods for power facilities and semiconductor production equipment, overall, the positive impact has been limited when compared with Taiwan and South Korea. The impact of these indirect effects

Chart B1-8: Automobile Export Prices from Japan to the United States



Sources: Bank of Japan; Ministry of Finance.
Note: Figures for the export price per unit are for passenger motor cars exported to the United States. Figures for export prices are for passenger motor cars exported to North America.

Chart B1-9: World Trade Volume and Japan's Real Exports



Sources: Bank of Japan; Ministry of Finance; CPB Netherlands Bureau for Economic Policy Analysis.
Notes: 1. Figures for the trade volume are those for real imports. The figure for the trade volume for 2025/Q4 is that for October.
2. Shaded areas denote recession periods.

[18] For the impact of U.S. tariff hikes on Japan's economy, see Box 1 of the October 2025 Outlook Report.

greatly depends on the resilience of final demand in the United States once tariffs are passed on to prices and on the sustainability of AI-related demand, so these developments continue to warrant attention.

(Box 2) Tightness in Labor Market Conditions and Differences between Industries

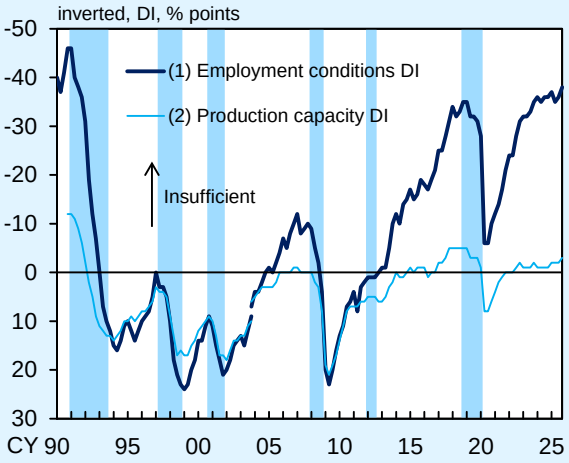
Labor market conditions in Japan have remained tight and the number of employees has been increasing steadily, even though there was negative economic growth in the July-September quarter of 2025. This box summarizes the current situation in the labor market and the characteristics of particular industries.

First, the employment conditions DI in the *Tankan* shows that net "insufficient employment" has been increasing. Most recently, it marked the highest net "insufficient employment" since 1991 (Chart B2-1). Unlike in previous labor shortage phases, recent years have seen a wide gap between the employment conditions DI and the production capacity DI. Indeed, while the two DIs fluctuated nearly in parallel in past economic cycles, their correlation has weakened considerably in recent years. This suggests the possibility that the recent tightness in labor market conditions can be attributed not only to an expansion in aggregate demand, which affects both DIs, but also to factors that are specific to labor supply.

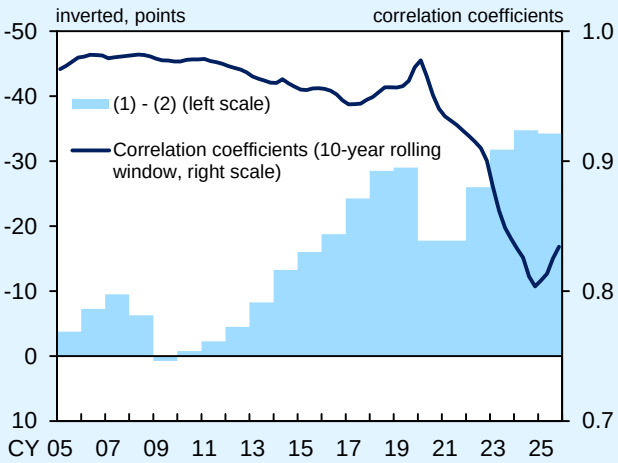
Next, the employment conditions DI by industry shows that, while labor shortages have intensified across a wide range of industries, particularly in non-manufacturing, there are significant differences between industries. The shortages are especially pronounced in industries such as "accommodations, eating and drinking services," "transport and postal activities," and "construction" (Chart B2-2). These differences are

Chart B2-1: Employment Conditions DI and Production Capacity DI

1. Developments over Time

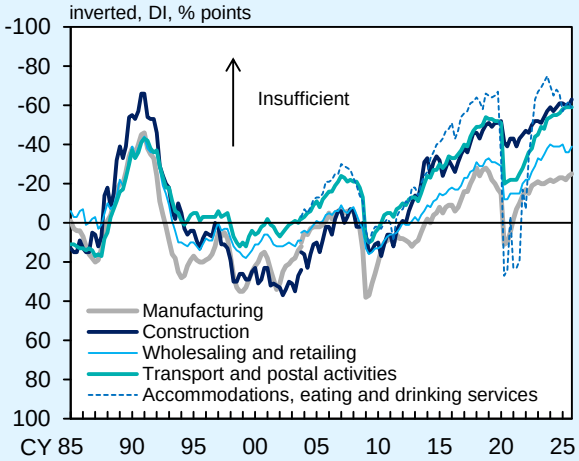


2. Correlation Coefficients



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

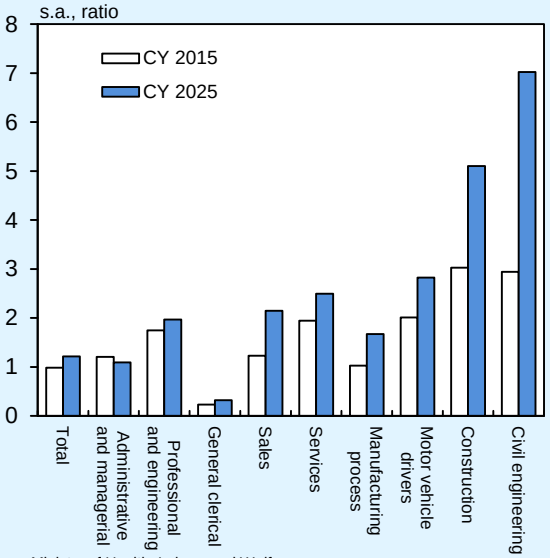
Chart B2-2: Employment Conditions DI by Industry



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

also evident in the active job openings-to-applicants ratio by job type. That is, while the ratio for "general clerical" is far below 1, the ratios for "construction" and "civil engineering" are exceptionally high, and the disparity in the level of labor shortages is accelerating more than 10 years ago, compared to other job types (Chart B2-3). It seems that, as the overall labor market has been tightening, the imbalance in supply and demand across industries and job types has been growing in recent years.

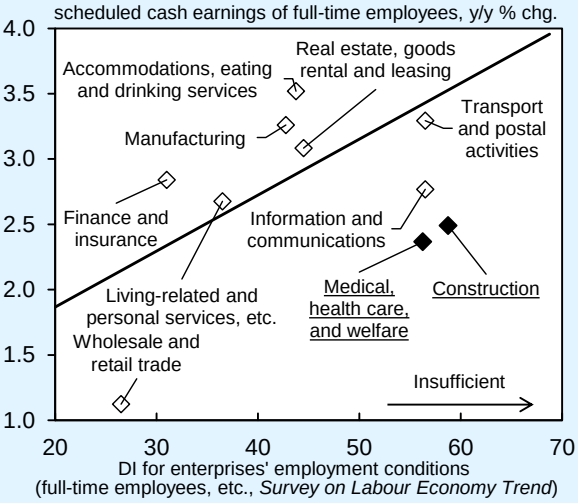
Chart B2-3: Active Job Openings-to-Applicants Ratio by Job Type



Source: Ministry of Health, Labour and Welfare.
Note: Regular employees excluding part-time employees. The figures for 2025 are January-November averages.

Meanwhile, the relationship between the degree of labor market tightness and wage growth shows a mild correlation, where the more severe the labor shortage in an industry, the stronger the wage growth becomes in that industry (Chart B2-4). That being said, in "construction" and "medical, healthcare, and welfare," although labor shortages are severe, wages of workers in those industries do not seem to have increased as much as in other industries. This can be attributed to a combination of various regulatory factors (for example, medical and nursing care fees) and industry-specific market structure (for example, multilayered subcontracting chains in the construction industry); moreover, it may also be due to the fact that increasing wages does not necessarily guarantee an influx of sufficient labor.

Chart B2-4: Labor Market Conditions and Wage Increases by Industry



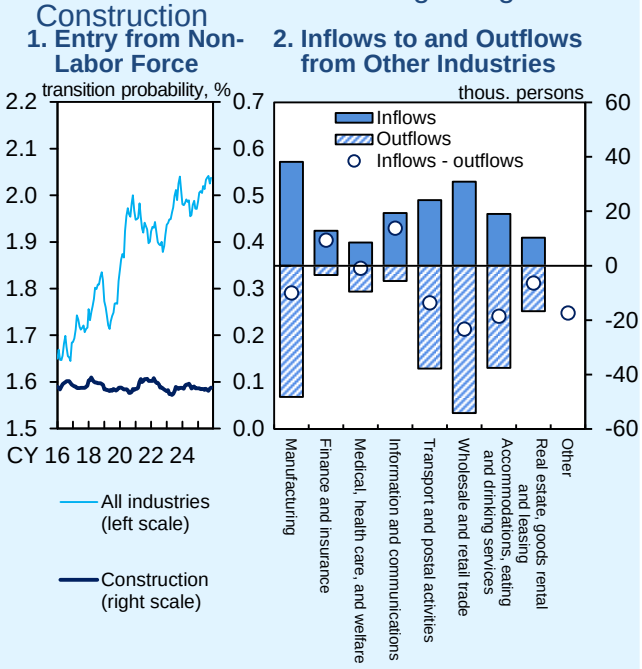
Source: Ministry of Health, Labour and Welfare.
Note: Figures show 4-quarter backward moving averages (the latest figures are for 2025/Q3). Scheduled cash earnings of full-time employees are based on continuing observations following the sample revisions. The solid line shows the fitted regression line excluding "construction" and "medical, health care, and welfare."

This section takes the construction industry as an example and examines labor flows surrounding the industry (Chart B2-5). There has been a clear rise in the probability of transition from "non-labor force" to "employed," in all industries, based on the *Labour Force Survey*, reflecting an increase in the labor force participation rate, mainly among

women and seniors. In the construction industry, however, the share of labor participation has remained more or less flat since the 2010s. This shows that the industry has hardly benefited from the macro-level effect of the increase in labor force participation. Next, labor mobility between the construction industry and other industries is examined using the *Survey on Employment Trends*. Both inflows and outflows of labor force have been observed to some extent between the construction industry and manufacturing, in which workers with a relatively similar set of skills are required. In contrast, in nonmanufacturing, such as "transport and postal activities" and "accommodations, eating and drinking services," which are faced with labor shortages as severe as those in the construction industry, net outflows from the construction industry have been observed. This phenomenon can be attributed not only to the wage gap between industries, but also to a mismatch between the demands of the construction industry, such as workers' skills and age, and the nature of the workforce itself.

As for the outlook, labor demand is likely to increase steadily and labor market conditions are expected to tighten further, on the back of a rise in domestic demand, partly reflecting the impact of the government's economic measures. As there is a mismatch in supply and demand due to skills and age requirements, some industries are likely to continue facing even more severe labor shortages compared to overall labor market conditions. It is therefore necessary to closely monitor not only the overall trends but also the differences between industries and job types regarding labor market conditions.

Chart B2-5: Labor Flows regarding Construction



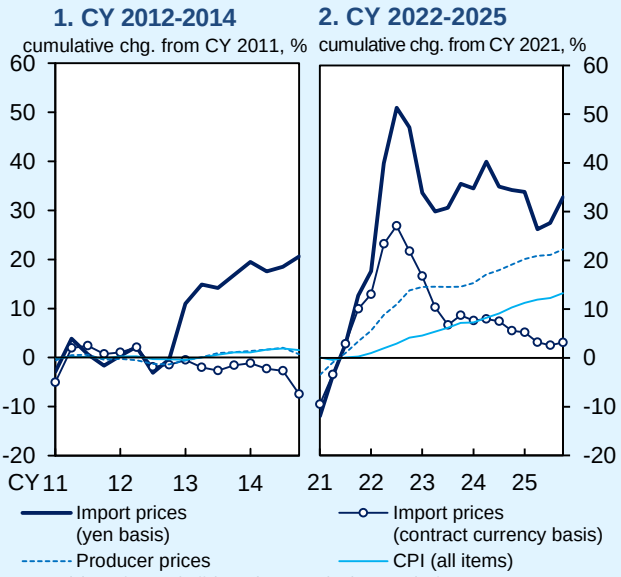
Sources: Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare.
Notes: 1. In the left-hand chart, figures are based on the *Labour Force Survey*, 12-month backward moving averages.
2. In the right-hand chart, figures are based on the *Survey on Employment Trends*, cumulative changes from 2022 to 2024.

(Box 3) Pass-Through of Import Price Increases to Domestic Prices

Recent price developments in Japan suggest that changes in import prices, reflecting factors such as exchange rate fluctuations, have tended to affect consumer prices more than in the past. This box examines, from various aspects and using several analytical approaches, whether the pass-through of exchange rate fluctuations to consumer prices has increased.

This box begins by focusing on two periods since the 2010s during which import prices rose significantly due to the yen's depreciation and other factors (2012-2014 and 2022-2024) and uses data to examine the extent to which higher import prices were passed through to consumer prices in each period. Looking at price developments from 2022 to 2024, import prices on a yen basis rose substantially through 2022, reflecting the yen's depreciation and higher international commodity prices; however, since then, price increases have moderated, albeit with some fluctuations. As of 2024, the cumulative increase of import prices from 2021 was 36.2 percent (Chart B3-1[2]). In contrast, producer prices (prices for domestic corporate goods) and consumer prices have continued to rise almost consistently, as the catch-up with past increases in import prices has exerted steady upward pressure, even during phases when import prices were falling. As of 2024, producer prices have increased cumulatively by 17.4 percent and consumer prices by 8.7 percent, relative to 2021. Conducting similar calculations for the 2012-2014 period shows that, while import prices on a yen basis rose cumulatively by 19 percent, producer

Chart B3-1: Cumulative Changes in Import Prices and the CPI

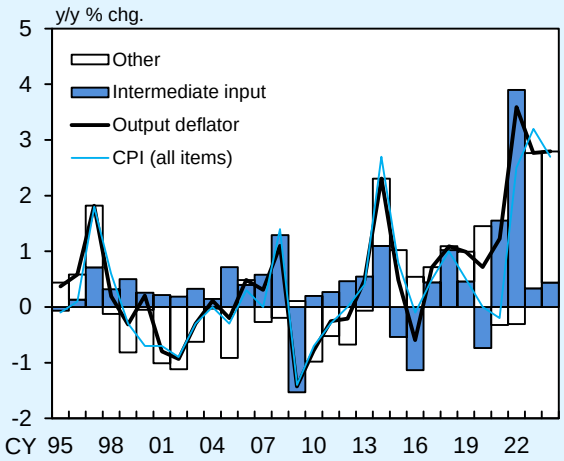


Sources: Ministry of Internal Affairs and Communications; Bank of Japan.
Notes: 1. Figures for the CPI (all items) and producer prices exclude the effects of the consumption tax hike.
2. The figure for the CPI (all items) for 2025/Q4 is the October-November average.

prices increased by 1.4 percent and consumer prices by 1.5 percent (Chart B3-1[1]).[19]

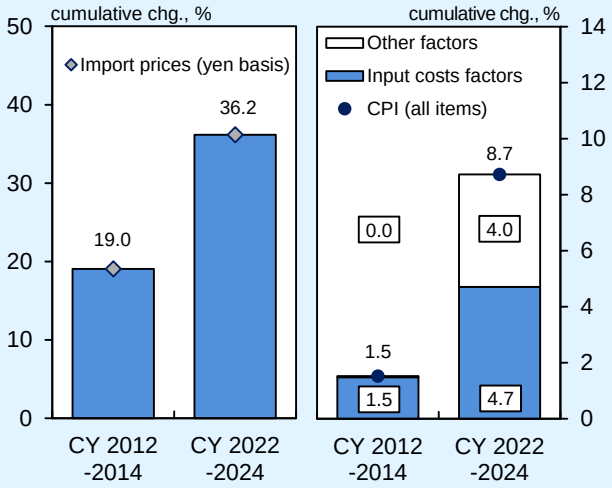
The following presents a decomposition based on the input-output structure in the input-output tables, to quantitatively examine how much of the increase in consumer prices during these two periods can be explained by the direct pass-through of higher import prices and how much is attributable to secondary spillover effects and others that cannot be explained by such direct effects. Specifically, the analysis treats the output deflator for nonmanufacturing as a consumer price indicator, taking into account the fact that consumer prices are the selling (output) prices of nonmanufacturing industries such as retail and services (Chart B3-2), and decomposes changes in this output deflator into, (1) the contribution of changes in input costs, which directly reflect developments in import prices; and (2) the contribution of other factors.[20] Other factors include costs associated with value added, such as unit profits and unit labor costs. Applying this decomposition to the increase in consumer prices in the 2022-2024 period indicates that the rise in input costs due to rising import prices accounts for 4.7 percentage points, while the contribution of other factors -- the residual -- is relatively large, at 4.0 percentage points (Chart B3-3). Other factors represent changes in margins that cannot be directly explained by the

Chart B3-2: Output Deflator and the CPI



Sources: Cabinet Office; Ministry of Internal Affairs and Communications.
Note: Figures for the output deflator are based on the nonmanufacturing sector (excluding "construction" and "finance and insurance") in the SNA.

Chart B3-3: Pass-Through of Import Prices



Sources: Cabinet Office; Ministry of Internal Affairs and Communications; Bank of Japan.
Note: "Input costs factors" refers to the contribution of changes in intermediate inputs to changes in the output deflator for the nonmanufacturing sector (excluding "construction" and "finance and insurance") in the SNA. "Other factors" is calculated as the residual. Figures are staff estimates and exclude the effects of the consumption tax hike.

[19] The figures for producer prices and consumer prices are calculated excluding the effects of the April 2014 consumption tax hike.

[20] Similar analyses have been conducted for other countries. See, for example, Schneider (2025), "What Contributes to Consumer Price Inflation? A Novel Decomposition Framework with an Application to Austria," *Journal of Economic Structures*, vol. 14, no. 2.

increase in import prices. They are considered to include secondary spillover effects (increases in unit labor costs and unit profits stemming from tightness in labor market conditions and the more active wage- and price-setting behavior of firms), induced by the rise in import prices in a broad sense. Conducting the same decomposition for changes in consumer prices in the 2012-2014 period reveals that the rise in input costs due to higher import prices contributed 1.5 percentage points, while the contribution of other factors was 0.0 percentage points, indicating that essentially all of the increase in consumer prices during this period can be explained by the direct pass-through of higher import prices. The above analysis based on the input-output tables rests on the strong assumption that all changes in import prices from one point in time to another are consequently passed on to consumer prices in line with the input-output structure. As a result, it does not take into account dynamic elements such as the lag with which changes in import prices are transmitted.

To address this, the following presents the estimation of a simple vector autoregression (VAR) with five variables -- (1) the U.S. dollar/yen exchange rate, (2) intermediate input costs,[21] (3) the output gap, (4) medium- to long-term inflation expectations, and (5) consumer prices -- and quantitatively examines when and how much consumer price inflation rises when a yen depreciation shock pushes up import prices. The

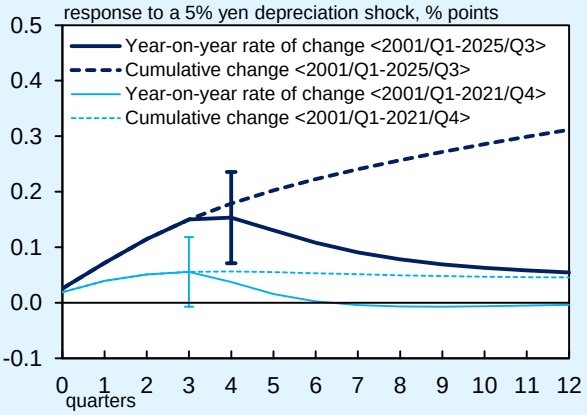
[21] For intermediate input costs, an index is used that estimates the intermediate input costs for the production of consumer goods and services, excluding fresh food and energy, based on the transaction structure in the input-output tables. For details, see Box 3 of the April 2022 Outlook Report.

results show that the year-on-year rate of increase in consumer prices following a yen depreciation shock peaks after three to four quarters (Chart B3-4[1]). Across goods categories, and against the backdrop of the recent rise in import penetration ratios (Chart B3-5), the short-term price response is particularly pronounced for durable consumer goods and food products (Charts B3-4[2] and B3-4[3]). Although the rate of increase in consumer prices subsequently declines, the empirical results indicate that consumer prices continue to rise for a relatively long period due to secondary spillover effects through wage increases and other factors. Moreover, comparing these VAR results for the period through 2025 with results obtained when restricting observations to the period just up to the onset of the recent global inflation phase in 2021 shows that the responsiveness of consumer prices to exchange rate fluctuations has increased in recent years.

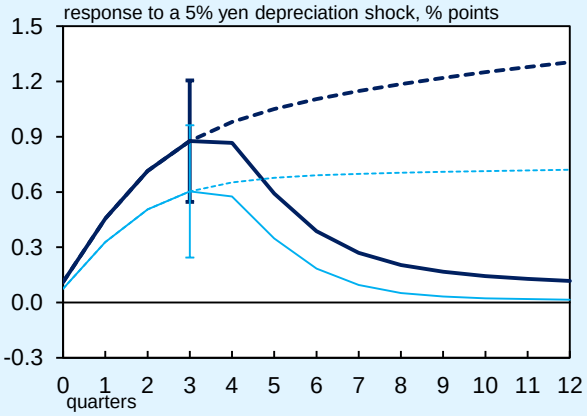
Finally, the robustness of these analyses is checked using the Bank's large-scale macroeconomic model (Q-JEM) developed by the Research and Statistics Department. In Q-JEM's Phillips curve, the exchange rate is included as an explanatory variable, so changes in the exchange rate become a direct driver of changes in consumer prices. In addition, because exchange rate changes also affect the output gap and inflation expectations, they influence consumer prices through these indirect channels as well (general-equilibrium effects). Using Q-JEM to simulate the response of the CPI for all items less fresh food to a yen depreciation shock shows that, in the version of the model that incorporates recent structural changes, the increase in the CPI

Chart B3-4: Response of the CPI to a 5% Yen Depreciation (VAR)

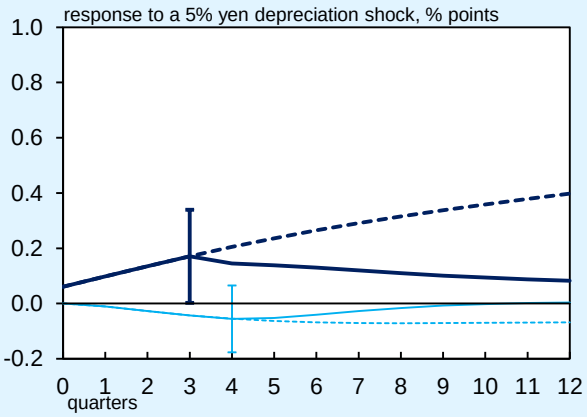
1. Less Fresh Food and Energy



2. Durable Consumer Goods



3. Food Products



Sources: Ministry of Internal Affairs and Communications; Bank of Japan; QUICK, "QUICK Monthly Market Survey <Bonds>"; Bloomberg; Consensus Economics Inc., "Consensus Forecasts"; JCER, "ESP Forecast."

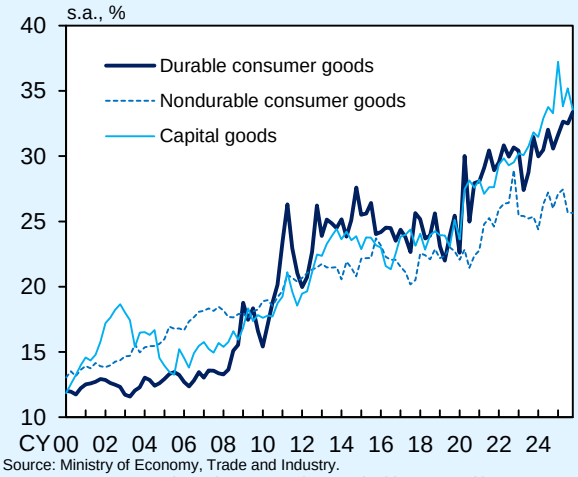
Notes: 1. Figures in angular brackets show the estimation periods. The bands indicate the 90 percent confidence intervals at the peak of the year-on-year rate of change.

2. The VAR models are estimated using the following five variables: the U.S. dollar/yen exchange rate, medium- to long-term inflation expectations, intermediate input costs, the output gap, and the CPI. Shocks are identified by Cholesky decomposition, where variables are ordered as above. Figures for the CPI are staff estimates and exclude the effects of the consumption tax hikes, policies concerning the provision of free education, travel subsidy programs, and mobile phone charges. Intermediate input costs are calculated by multiplying the intermediate input ratio of each sector in the *2015 Input-Output Tables for Japan* by price data from the corporate goods price index (CGPI) or the services producer price index (SPPI) and then taking the weighted average using consumption expenditure shares as weights.

following a depreciation shock is larger than in simulations based on the standard model that is based on long-run average relationships (Chart B3-6).[22] Furthermore, initially, the direct impact is the main driver of price increases -- that is, the direct pass-through of exchange rate fluctuations to consumer prices -- in the first year after the shock. However, by the third year, the contribution of other impact, secondary spillover effects, is comparable to that of the direct impact.

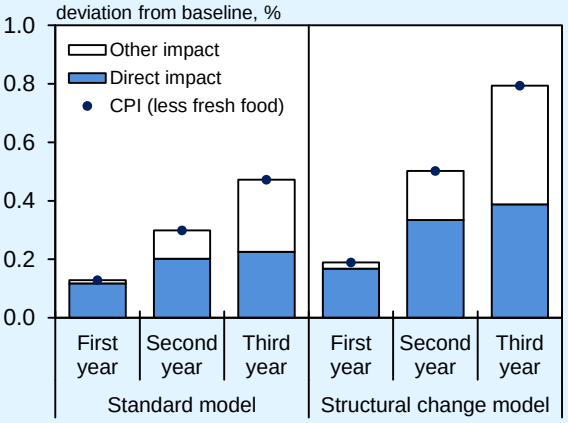
The above analyses using the input-output tables, VAR, and the Bank's macroeconomic model suggest that, (1) the pass-through from exchange rate changes to consumer prices has risen in recent years; and (2) this reflects not only greater direct price pass-through stemming from higher import penetration ratios, but also stronger secondary spillover effects, such as more active wage- and price-setting behavior of firms. Looking ahead, it is necessary to keep these points firmly in mind and to continue carefully monitoring developments in the exchange rate and international commodity markets, as well as their effect on consumer prices.

Chart B3-5: Import Penetration Ratio



Source: Ministry of Economy, Trade and Industry.
Notes: 1. Import penetration ratio = Imports / Domestic shipments and imports.
2. Figures for 2025/Q4 are October-November averages.

Chart B3-6: Response of the CPI to a 5% Yen Depreciation (Model)



Sources: Ministry of Internal Affairs and Communications; Bank of Japan, etc.
Notes: 1. The change in the CPI in response to a 5% yen depreciation against the U.S. dollar is estimated using the macroeconomic model (Q-JEM).
2. In the standard model, the explanatory variables for the Phillips curve (the CPI, all items less fresh food and energy) are the lagged dependent variable, medium- to long-term inflation expectations, the output gap, the U.S. dollar/yen exchange rate, the wage gap, contract currency-based import prices, and a dummy for the period up to 2012. The structural change model additionally incorporates changes in the coefficient on the U.S. dollar/yen exchange rate.

[22] The standard model assumes an average historical pass-through rate from exchange rates to the CPI in the Phillips curve specification. The structural change model incorporates the recent rise in the pass-through rate from exchange rates to the CPI by adding a post-2015 period dummy to a parameter of the exchange rate (the U.S. dollar/yen exchange rate), which is an explanatory variable in the Phillips curve specification. With regard to the coefficient on the exchange rate from 2015 onward, there is a statistically significant structural break in the first quarter of 2015; however, the coefficient size should be interpreted with caution because of the subsequent short sample period and the fact that the yen was mostly on a weakening trend during that period.