

Not to be released until 2:00 p.m.  
Japan Standard Time on Thursday,  
May 1, 2008.

May 1, 2008  
Bank of Japan

# **Outlook for Economic Activity and Prices**

April 2008

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

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**[The Bank's View]**<sup>1</sup>

### **Outlook for Economic Activity and Prices**

Japan's economic growth is slowing, mainly due to the effects of high energy and materials prices. Compared with the projection in the October 2007 *Outlook for Economic Activity and Prices* (Outlook Report), housing investment and business fixed investment have been weaker than expected while exports have been stronger. As a result, the rate of real GDP growth in fiscal 2007 seems likely to be around the potential growth rate,<sup>2</sup> as projected in the October Outlook Report.

From fiscal 2008 through fiscal 2009, the economy is likely to continue its moderate growth at a pace around the potential growth rate. In the first half of fiscal 2008, while housing investment is expected to recover gradually, deceleration in the economy seems likely to continue due mainly to the slowdown in overseas economies, especially the United States, and the effects of high energy and materials prices. Thereafter, the growth rate is likely to pick up gradually, as overseas economies are expected to move out of their deceleration phase and the effects of high energy and materials prices are likely to abate. As a result, the rate of real GDP growth for fiscal 2008 is likely to register around 1.5 percent, lower than the previous projection. The growth rate for fiscal 2009 is expected to be in the range around 1.5-2.0 percent. There are, however, downside risks to the economy stemming from uncertainties regarding future developments in overseas economies and global financial markets as well as the effects of high energy and materials prices.

The outlook rests on the following underlying assumptions and mechanisms.

First, exports are expected to continue rising, as overseas economies, especially emerging economies, are likely to grow although at a slower pace. Second, in the corporate sector where firms currently face no pressures to adjust production capacity, inventory, and

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<sup>1</sup> The text of "The Bank's View" was decided by the Policy Board at the Monetary Policy Meeting held on April 30, 2008.

<sup>2</sup> The Bank's estimate of the current potential growth rate is around 1.5 percent or somewhat higher, having risen moderately from a level of approximately 1 percent in fiscal 2003 through fiscal 2004.

employment, they are likely to carry on investment to meet medium- to long-term demand, and so business fixed investment, particularly at large firms, is expected to keep increasing. The pace of growth in business fixed investment is, however, likely to be moderate not only because pressure on corporate profits is expected to remain intense due mainly to elevated materials prices, but also because strong growth in capital investment over the last several years has resulted in a higher level of capital stock. Third, in the household sector, private consumption is likely to remain firm against the background of moderate growth in employee income. The number of employees is likely to continue rising, as many firms are feeling a shortage of labor. In this situation, upward pressure on wages is likely to increase gradually, as tight labor market conditions are expected to become prolonged. However, the pace of wage increases is likely to remain moderate because persistent labor cost restraint by firms, especially small and medium-sized firms, is likely to continue in the face of sluggish growth in corporate profits. And fourth, the accommodative financial conditions are likely to continue to support private demand. The level of short-term interest rates has been very low relative to the potential growth rate and inflation. Despite the continued disruptions in global financial markets, the increase in credit spreads in Japan has been relatively small and the adverse effects on financial institutions in Japan have been limited compared to the United States and Europe. Under these circumstances, the lending attitude of financial institutions has been generally accommodative. However, financing conditions at small firms and some nonmanufacturers are becoming somewhat less accommodative, and this seems likely to continue for a while.

Given this economic outlook, the environment surrounding prices can be summarized as follows. First, the level of resource utilization, in terms of labor and production capacity, is close to its historical average, and this suggests that aggregate supply and demand in the economy are more or less balanced. Going forward, resource utilization is likely to stay more or less at the same level, as the economy is expected to grow at around the potential growth rate. Estimates of the output gap are also likely to remain around the current level. Second, it is likely that unit labor costs (labor costs per unit of output) will decline at a slower pace as wages gradually rise. And third, the private sector expects future price increases. The results of various surveys indicate an upward shift in private-sector expectations of inflation due to rises in the prices of frequently purchased items and an

increase in the number of items undergoing price hikes.

Looking at price indices, the domestic corporate goods price index (CGPI) in fiscal 2007 turned out to be higher than the previous projection in October, recording its highest rate of increase since fiscal 1989, due to rises in international commodity prices. As for the outlook, the CGPI is likely to continue increasing,<sup>3</sup> although this will be subject to future developments in the prices of crude oil and other commodities as well as foreign exchange rates. The rate of increase in fiscal 2008 is projected to be higher than the October projection.

The consumer price index (CPI, excluding fresh food) for fiscal 2007 was somewhat higher than previously projected due to increased prices of petroleum products and food products. It seems likely that, with the output gap remaining more or less at the same level, the year-on-year rate of change in the CPI (excluding fresh food) will be in the 1.0-1.5 percent range until the middle of fiscal 2008, reflecting the sharp rises in the prices of petroleum products and food products, and decline slightly thereafter. On a fiscal-year basis, the rate of increase is projected to be around 1.0 percent in fiscal 2008, higher than the October projection, and to continue to register around 1.0 percent in fiscal 2009.

### **Upside and Downside Risks**

The outlook described above is the most likely projection based on the underlying assumptions and mechanisms mentioned earlier. It should be noted that the outlook is subject to the following upside and downside risks, and that these require close attention especially when the outlook for economic activity and prices is highly uncertain.

The first risk concerns developments in overseas economies and global financial markets. Global financial markets have been unstable due to continued disruptions stemming from the U.S. subprime mortgage problem. In this situation, deceleration in the U.S. economy is becoming more pronounced and the economy has recently lost momentum, as adjustments in the housing market have intensified and the financial environment has

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<sup>3</sup> This outlook is based on the 2005-base CGPI.

deteriorated sharply. Looking forward, if the housing correction and the financial market disruptions intensify and become prolonged, the U.S. economy may weaken further. In this case, there is a risk of slower global economic growth, as the adverse effects of sluggish growth in the U.S. economy may spill over to economies in other parts of the world via channels such as international trade and global financial markets. The European economy is continuing to grow, although the pace of growth is slowing. However, possible adverse effects of global financial market disruptions on European financial conditions may pose a downside risk. In China, the economy continues to expand strongly, and, depending on developments in domestic demand such as fixed asset investment, the economic growth rate may exceed expectations during the projection period (fiscal 2008 through fiscal 2009). At the same time, there is also a risk of the growth rate falling below expectations if the effects of the strengthened measures to curtail increased inflationary pressures and the deceleration in the U.S. economy turn out to be greater than expected. In countries that export natural resources, high prices for such resources have supported increased expenditure on, for example, infrastructure investment, and this may further push up world economic growth.

If downside risks to overseas economies and global financial markets should materialize, Japan's economy may be adversely influenced through, for example, changes in external trade, corporate profits, and financial market conditions.

The second risk concerns developments in energy and materials prices. In this Outlook Report, it is assumed that the prices of crude oil and other international commodities will remain elevated, supported by growing demand especially in emerging economies. If, however, international commodity prices increase more than expected, this could increase inflationary pressures across the world, posing the risk of a subsequent economic slowdown. Moreover, higher prices of international commodities mean that the outflow of income from Japan to abroad will increase, and this may have negative consequences for the expenditure of Japanese firms and households.

The third risk concerns firms' expectations of future growth. In this Outlook Report, it is assumed that firms' growth expectations concerning medium- to long-term demand growth

will remain unaffected by the current slowdown in the economy, and thus that a moderate increase in business fixed investment will continue. However, if the firms' growth expectations weaken, the projections in this Outlook Report, especially those concerning business fixed investment, may deviate downward. On the other hand, if the various downside risks mentioned above, which may already have been incorporated into firms' decision-making, do not materialize, firms' expectations of future growth may strengthen, leading to higher economic growth than projected.

The fourth risk concerns possible larger swings in financial and economic activity under continuing accommodative financial conditions. The recent economic slowdown seems to have reduced the risk that firms, households, and financial institutions will overextend themselves based on overly optimistic assumptions of future financial conditions. However, given that accommodative financial conditions have been in place for a long time and are expected to continue, there remains a risk that a change in economic agents' expectations of future growth may lead them to overextend themselves, resulting in a long-run misallocation of resources.

Turning to the outlook for inflation, it should be noted that there are also uncertainties that could cause inflation to deviate either upward or downward from the rate projected. If any of the above-mentioned upside and downside risk factors affecting the level of economic activity should materialize, prices may be expected to respond accordingly. There are also the following risk factors that are unique to prices. The first of these concerns changes in the inflation expectations of households and the price-setting behavior of firms. Against the backdrop of recent developments such as rises in the prices of frequently purchased consumer goods and services, consumers' inflation expectations may increase further. At the same time, firms' pass-through of increased materials prices may become more pronounced. If these changes were to materialize, prices would be likely to deviate above the projection. However, given the severity of competition in the goods and services markets, it is possible that firms will redouble their cost reduction efforts and the extent of pass-through may not be as large as expected. The second risk concerns fluctuations in the prices of primary commodities such as crude oil. Considerable uncertainty surrounds developments in these prices, leaving the potential for movement in either direction.

It needs to be kept in mind that the upside and downside risk factors outlined above are mutually interrelated. If downside risks to overseas economies and global financial markets should decrease, firms' expectations of future growth are likely to become stronger and financial conditions to be correspondingly more accommodative. Consequently, economic growth and inflation may deviate upward from their projected paths. As for energy and materials prices, decreased downside risks to overseas economies and global financial markets could induce either further price rises due to stronger than expected global demand, or price declines due to diminished speculative activity and hence an outflow of such funds from these markets.

### **Conduct of Monetary Policy**

To realize sustainable growth with price stability, the Bank assesses the economic and price situation from two perspectives and then outlines its thinking on the future conduct of monetary policy, taking account of the "understanding of medium- to long-term price stability" -- that is, the level of inflation that each member of the Policy Board understands, when conducting monetary policy, as being consistent with price stability over the medium to long term (hereafter the "understanding").

The "understanding" expressed in terms of the year-on-year rate of change in the CPI currently falls in the range approximately between 0 and 2 percent, with most Policy Board members' median figures at around 1 percent.<sup>4</sup>

The first perspective involves assessing the most likely outlook for economic activity and prices through fiscal 2009 with reference to the view of market participants regarding the future course of the policy interest rate -- a view that is incorporated in market interest rates. It is expected that the growth rate of Japan's economy will decelerate for the time being, but that over the projection period as a whole it will likely grow at a pace around its potential growth rate. The year-on-year rate of change in the CPI (excluding fresh food) is likely to

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<sup>4</sup> The "understanding" has recently been reviewed -- a process which, in principle, occurs annually -- since about a year has now passed since the last such review.



remain at around 1.0 percent on average. Such developments can be regarded as broadly in line with the "understanding." In sum, Japan's economy is likely to realize sustainable growth with price stability.

The second perspective assesses the risks considered most relevant to the conduct of monetary policy, including risks that have a longer time horizon than the first perspective. As noted earlier, those that demand most attention are the downside risks to the economy stemming from uncertainties regarding future developments in overseas economies and global financial markets as well as the effects of high energy and materials prices. However, the risk of the economy falling into a vicious circle of declining prices and deteriorating economic activity seems to be small, since the corporate sector and the financial system have become more resilient. The outlook for prices is subject to upside risks stemming from further increases in energy and materials prices as well as changes in consumers' inflation expectations and the price-setting behavior of firms; nevertheless, the possibility of the inflation rate deviating significantly from the "understanding" is small. In the long run, however, there remains the risk of possible swings in economic activity and prices if the period of accommodative financial conditions is further prolonged and, for instance, the expectation takes hold that interest rates will remain low for a long time regardless of developments in economic activity and prices. The significance of this risk will increase if the downside risks mentioned above should turn out to decrease.

Regarding the conduct of monetary policy, the Bank's basic thinking had been that (1) given the extremely low level of short-term interest rates relative to the economy's potential growth rate and inflation, these were to be raised if Japan's economy was to follow a path of sustainable growth with price stability, and (2) the pace of increase in interest rates should be determined in accordance with improvements in the economic and price situation without any predetermined view. In terms of its actual policy implementation, the Bank raised the level of the policy interest rate to 0.5 percent in February 2007, but has thereafter kept it unchanged. This is because, although the outlook for the economy deemed most likely by the Bank has remained for sustainable growth with price stability, the following factors have also had to be taken into consideration: firstly, that the pace of economic growth has decelerated mainly due to the drop in housing investment and the effects of high

energy and materials prices; and secondly, that there have been increased downside risks to the economy stemming from uncertainties regarding future developments in overseas economies and global financial markets as well as the effects of high energy and materials prices. Against the background of decelerating economic growth and increased downside risks, market expectations of a future increase in the policy interest rate have lessened and there have been corresponding declines in the interest rates on term instruments.

Given the current situation where the outlook for economic activity and prices is highly uncertain, it is not appropriate to predetermine the direction of future monetary policy. Rather, close attention needs to be paid to future developments in economic activity and prices: whether downside risks will decrease, thereby increasing the likelihood of the economy realizing sustainable growth with price stability; or whether the probability of such risks materializing will rise. The Bank will carefully assess the future outlook for economic activity and prices, closely considering the likelihood of its projections as well as factors posing upside or downside risks, and will implement its policies in an accordingly flexible manner.

For monetary policy to be effective, it is necessary for financial markets to be kept stable. To ensure such stability, the Bank has at its disposal various tools for providing sufficient liquidity and has been exerting itself to keep the money market functioning. It has, since last summer, been appropriately providing liquidity through money market operations while market disruptions continue in the United States and Europe. As a result, Japan's money market has been stable. The Bank will continue to carefully monitor market developments and to ensure, via appropriate money market operations, the proper functioning of the money market.

### **(Box) Risk Balance Charts**

Given the high degree of uncertainty regarding the outlook for economic activity and prices, the Bank has decided to release, in addition to the Forecasts of the Majority of Policy Board Members (Appendix 1), the aggregated probability distributions compiled from the distributions attributed by individual Policy Board members to the likelihood of divergence upward or downward from their forecasts (Risk Balance Charts, shown in Appendix 2).

The process of compilation is as follows:

- (1) Each Policy Board member submits his or her forecasts in the form of point estimates, the values to which he or she attaches the highest probability of realization, for the year-on-year rates of change in real GDP, the domestic corporate goods price index (CGPI) and the consumer price index (CPI, excluding fresh food). These forecasts are summarized in Appendix 1, as in the past.
- (2) For the year-on-year rates of change in real GDP and the CPI (excluding fresh food), each Policy Board member also indicates, in the form of a probability distribution, the likelihood that upside or downside risks will materialize and cause divergence from the forecast value.
- (3) Probability distributions are then aggregated and divided by the number of Policy Board members, that is, they are averaged.<sup>(Note)</sup>

The Risk Balance Charts given in this Outlook Report display the following properties.

#### Real GDP

The probability distribution for the rate of real GDP growth in fiscal 2008 is skewed to the left. This suggests that Policy Board members consider the downside risks to be greater than the upside risks. On the other hand, the probability distribution for fiscal 2009 is more or less evenly balanced, implying that Policy Board members attach similar probabilities to both upside and downside risks. Comparison of the probability distributions for fiscal 2008 and 2009 points to greater uncertainty ahead since the distribution is flatter for fiscal 2009 than for 2008.

#### The CPI (excluding fresh food)

The probability distributions for the year-on-year rate of change in the CPI (excluding fresh food) for fiscal 2008 and 2009 are both somewhat skewed to the left. As in the case of the rate of growth in real GDP, the distribution is flatter for fiscal 2009 than for fiscal 2008.

(Note)

Some central banks, such as the Bank of England, publish probability distributions of economic indicators expressing the distribution of risks as "fan charts." At these central banks, board members agree on a single forecast and its distribution, which are then published. In contrast, the Risk Balance Charts of the Bank of Japan represent an average of the probability distributions assumed by individual Policy Board members.

(Appendix 1)

**Forecasts of the Majority of Policy Board Members<sup>5</sup> and Actuals for Fiscal 2007**

y/y % chg.

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Forecasts made in October 2007	+1.7 to +1.8 [+1.8]	+1.9 to +2.1 [+2.0]	0.0 to +0.1 [0.0]
Actual	+1.6	+2.2	+0.3

**Forecasts of the Majority of Policy Board Members<sup>5,6</sup> for Fiscal 2008 and Fiscal 2009**

y/y % chg.

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2008	+1.4 to +1.6 [+1.5]	+2.4 to +2.8 [+2.5]	+0.9 to +1.1 [+1.1]
Forecasts made in October 2007	+1.9 to +2.3 [+2.1]	+0.9 to +1.2 [+1.0]	+0.2 to +0.4 [+0.4]
Fiscal 2009	+1.6 to +1.8 [+1.7]	+1.3 to +1.8 [+1.5]	+0.8 to +1.0 [+1.0]

- Notes: 1. Figures in brackets indicate forecast medians.
2. "Actual" real GDP for fiscal 2007 is calculated on the assumption that real GDP in the first quarter of 2008 equals that in the fourth quarter of 2007.
3. Domestic CGPI forecasts made in October 2007 were based on the 2000-base CGPI, while the actual figure for fiscal 2007 and forecasts for fiscal 2008 and 2009 are based on the 2005-base CGPI.
4. Individual Policy Board members make the above forecasts with reference to the view of market participants regarding the future course of the policy interest rate -- a view that is incorporated in market interest rates.

<sup>5</sup> The forecasts of the majority of Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate, namely the figure to which he or she attaches the highest probability. These forecasts are then shown as a range, with the highest and lowest figures excluded. It should be noted that the range does not indicate the forecast errors.

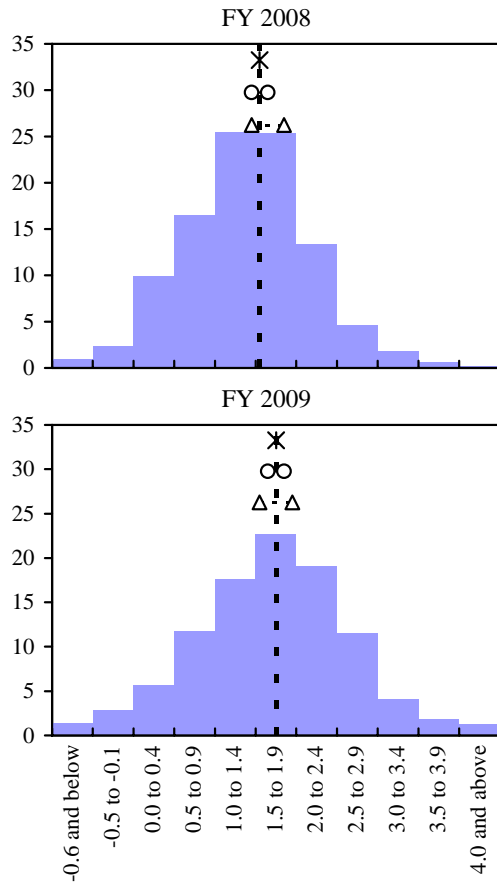
<sup>6</sup> The forecasts of all Policy Board members may be summarized as follows.

y/y % chg.

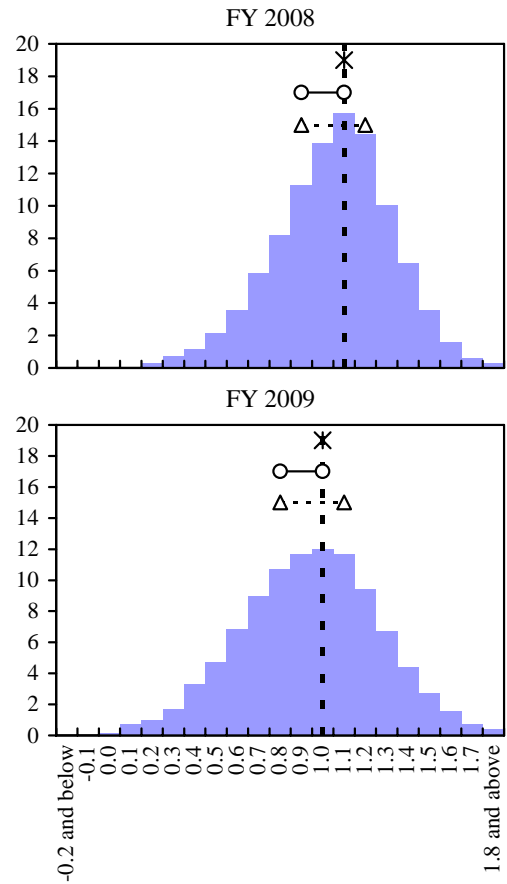
	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2008	+1.4 to +1.8	+2.3 to +2.9	+0.9 to +1.2
Forecasts made in October 2007	+1.9 to +2.4	+0.8 to +1.5	+0.2 to +0.5
Fiscal 2009	+1.5 to +1.9	+1.3 to +1.9	+0.8 to +1.1

### Risk Balance Charts

(1) Real GDP



(2) CPI (Excluding Fresh Food)



- Notes: 1. Vertical axes in the charts represent probability (%), while horizontal axes represent the year-on-year percentage changes in the respective indicators.
2. \* on the dashed line indicates the median of the Policy Board members' forecasts (point estimates).
3. ○—○ indicates the range of the forecasts of the majority of Policy Board members.
4. Δ-...-Δ indicates the range of the forecasts of all Policy Board members.

## **[The Background]**

### **1. Economic Activity, Prices, and Monetary and Financial Developments in Fiscal 2007**

#### **Economic Developments**

Looking back at developments in fiscal 2007, Japan's economy continued to expand moderately until around the middle of fiscal 2007, but thereafter the virtuous circle of growth in production, income, and spending weakened gradually and the pace of economic growth slowed, mainly due to the drop in housing investment and the effects of high energy and materials prices (Chart 1).<sup>7</sup>

Japan's exports to the United States were weak, but overall exports continued to increase to a broader range of destinations as overseas economies as a whole kept growing (Chart 2). Public investment remained sluggish due to tight national and local fiscal conditions, and housing investment dropped substantially in the second half of fiscal 2007 due mainly to the revised Building Standard Law coming into force (Chart 3). Partly reflecting substantial rises in energy and materials prices, corporate profits, although remaining at a high level, appeared to lose momentum, especially at small and medium-sized firms, and toward the end of fiscal 2007 business sentiment became cautious (Chart 4). In this situation, business fixed investment continued to trend upward, but the pace of increase gradually became slower (Chart 5). Private consumption, especially of durable consumer goods, held firm in a situation where employee income continued rising moderately (Chart 6 [1]). Consumer sentiment, however, became generally cautious, due mainly to rises in the prices of petroleum products and food products and to the weakness in stock prices (Chart 6 [2]). With these developments in demand both at home and abroad, industrial production posted a relatively strong gain in the latter half of 2007 partly due to progress in inventory adjustments in electronic parts and devices and to the accelerated production of automobiles to make up for the disruption caused by the earthquake in July 2007. Industrial production

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<sup>7</sup> The Bank conducts research and analysis on regional economic conditions at its branches, and releases its assessment in the "Regional Economic Report" quarterly. The April 2008 issue provides the results of the Bank's detailed research in each region on measures to attract global demand at nonmanufacturers and small and medium-sized manufacturers, and on developments in wages and employment. For a brief summary of the assessment of recent regional economic conditions, see the Reference attached.

has been more or less flat in early 2008 due to firms' cautious stance with regard to production, mainly reflecting uncertainty about the outlook for overseas economies (Chart 7).

In the *Outlook for Economic Activity and Prices* (Outlook Report) released in October 2007, it was projected that the rate of real GDP growth in fiscal 2007 was likely to be around the potential growth rate, within the range of 1.5-2.0 percent, somewhat lower than the growth rates slightly above 2.0 percent recorded during the several years up to fiscal 2006.<sup>8</sup> The rate of real GDP growth in fiscal 2007 seems likely to turn out broadly as projected. Exports were stronger than projected in October, supported by robust growth in emerging economies and countries that export natural resources. Meanwhile, housing investment and business fixed investment were weaker than projected as the effects of revisions to the Building Standard Law deepened and the substantial rise in international commodity prices resulted in deterioration in the terms of trade. Reflecting the weakening of the economy's capacity to generate income mainly due to high energy and materials prices, it became difficult for exports to generate growth momentum for the economy. These economic developments are also reflected in the fact that the growth rates of real gross domestic income (GDI) and real gross national income (GNI), both of which incorporate the effects of changes in the terms of trade on income, are lower than the growth rate of real GDP (Chart 8).<sup>9</sup>

Reflecting these economic developments, resource utilization, in terms of labor and production capacity, increased through fiscal 2006 and remained at its historical average or

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<sup>8</sup> The Bank's estimate of the current potential growth rate is around 1.5 percent or somewhat higher, having risen moderately from a level of approximately 1 percent in fiscal 2003 through fiscal 2004. It should be noted, however, that these estimates of the potential growth rate as well as the output gap (conceptually the difference between actual and potential output -- to be described later) need to be treated as approximations because they are subject to a certain margin of error arising from the detrending of factors of production such as labor input.

<sup>9</sup> Real GDI = real GDP + trading gains/losses

Real GNI = real GDI + net income from the rest of the world (for example, interest income and dividend income)

Trading gains/losses = nominal net exports / weighted average of export and import deflators - real net exports

Trading gains/losses are changes in real income, reflecting changes in the terms of trade.

somewhat higher in fiscal 2007 (Chart 9). The *Tankan* (Short-Term Economic Survey of Enterprises in Japan) composite indicator, a weighted average of the diffusion indices of production capacity and employment conditions where indices are weighted by capital and labor income shares in the national accounts, remained essentially at around the same level, indicating slight shortages. Estimates of the output gap (or the GDP gap) also indicated that in fiscal 2006 operating levels had climbed somewhat higher than their historical averages in past economic cycles and remained more or less unchanged in fiscal 2007.

### **Price Developments**

As for prices, while aggregate supply and demand in the economy remained more or less balanced, further increases in international commodity prices generated stronger upward pressure on prices toward the end of fiscal 2007, mainly at the wholesale level (Charts 10 and 11). The year-on-year rate of change in the domestic corporate goods price index (CGPI) remained positive throughout fiscal 2007 and rose toward the end of the fiscal year to the 3.0-4.0 percent level -- the highest since 1981 on a monthly basis. The year-on-year rate of change in the consumer price index (CPI, excluding fresh food) remained at around 0 percent until around fall 2007, but then rose to slightly above 1.0 percent due to the increases in the prices of petroleum products and food products (Chart 12). Disregarding the effects of the rise in the consumption tax, the CPI (excluding fresh food) registered its highest rate of increase since 1993.

The rates of growth in both the CGPI and the CPI (excluding fresh food) were stronger than projected in the October Outlook Report due to the rise in international commodity prices. At the retail level, due to substantial rises in the prices of crude oil and crops, firms increasingly passed higher materials prices through to final prices of related products. However, as firms, particularly major retailers, continued to be generally reluctant to increase prices given fierce competition, the year-on-year rate of change in the CPI excluding food and energy increased only to around 0 percent from a negative level.

### **Financial Market Developments**

Global financial markets have been unstable since summer 2007 due to disruptions stemming from the U.S. subprime mortgage problem. The functioning of markets for



securitized products, where the problem originated, deteriorated as these products were downgraded and their prices consequently declined. As for corporate finance in the United States and Europe, yield spreads between corporate bonds and government securities widened, and the lending attitude of financial institutions tightened. In the United States and Europe, spreads between interbank rates and short-term government securities increased, as liquidity pressures in money markets rose toward the end of 2007 (Chart 13). To deal with the situation, five central banks in North America and Europe announced measures to provide liquidity to the markets on December 12, 2007. Reflecting these measures, yield spreads in the money markets fell temporarily, but liquidity pressures mounted again from around the end of February 2008 due partly to market concerns that financial institutions might incur further losses. To address the elevated pressures in money markets, the five central banks announced new measures to provide liquidity to the markets on March 11, 2008.

In Japan, the money market remained calm relative to the U.S. and European markets. The uncollateralized overnight call rate stayed at around 0.5 percent (Chart 14). Interest rates on term instruments were also stable, although they rose slightly when demand increased for funds maturing beyond the fiscal year-end. Euroyen futures rates and various forward rates declined through the beginning of 2008 but rose again and more recently have remained more or less unchanged (Chart 15). The current level of short-term interest rates is low relative to the potential growth rate and inflation, and therefore the stimulative effect on economic activity appears to remain strong (Chart 16).

Long-term interest rates, stock prices, and foreign exchange rates were strongly influenced by developments in overseas financial markets. After the release of the October Outlook Report, long-term interest rates declined following the decline in U.S. and European long-term interest rates (Chart 17). Stock prices fell sharply in response to declines in U.S. and European stock prices and the appreciation of the yen. They have been more or less unchanged recently (Chart 18). The yen appreciated from summer 2007 onward and was continuing to do so toward the fiscal year-end, as the global reassessment of risk proceeded (Chart 19).

## **Financial Environment**

Looking at the financial environment in Japan, there have so far been only limited effects from the volatility in overseas financial markets and financial conditions have continued to be accommodative.

On the credit supply side, lending attitudes of financial institutions continued to be generally accommodative. The issuing environment for CP and corporate bonds has also been generally favorable, except for some issues by firms with low credit ratings (Chart 20). However, faced with high materials prices, a greater number of firms -- especially small ones -- have been taking a more cautious stance with regard to their financial positions. Firms also perceive lending attitudes of financial institutions as becoming a little less accommodative (Chart 21).

On the demand side, the amount of funds required by firms for fixed investment purposes has been at a high level while also increasing moderately for dividend payments and stock buybacks. Needs for operating funds have also been increasing due to rises in materials prices. However, as firms' cash flow remains ample, credit demand in the private sector has been more or less unchanged.

Under these circumstances, lending rates have generally been at extremely low levels. Average contracted interest rates on new loans and discounts, with the monthly fluctuations smoothed out, have been more or less unchanged (Chart 22 [1]). The pace of increase in the amount outstanding of lending by private banks has been modest (Chart 22 [2]). The amount outstanding of CP and corporate bonds issued has been above the previous year's level.

The year-on-year rate of growth in the money stock ( $M_2$ +CDs) has been in the range of 2-3 percent, while the year-on-year rate of growth in broadly-defined liquidity, which includes investment trusts and Japanese government bonds in addition to the money stock, has been around 3-4 percent (Chart 22 [3]).

Land prices have been rising in metropolitan areas while those in other areas have

continued to fall, although the rates of decline are slowing (Chart 23). According to the Land Price Publication (as of January 1, 2008), the rate of increase of commercial land prices in the three major metropolitan areas (Tokyo, Osaka, and Nagoya) has been relatively high against the backdrop of robust demand for office space, and residential land prices in the metropolitan areas have also risen. In Tokyo, however, the pace of increase in land prices has recently been slowing slightly.

## **2. The Outlook for Economic Activity and Prices from Fiscal 2008 through Fiscal 2009**

### **Projections for Economic Activity and Prices**

From fiscal 2008 through fiscal 2009, the economy is likely to follow a path of moderate growth at a pace around the potential growth rate. In the first half of fiscal 2008, while housing investment is expected to recover gradually, deceleration in the economy seems likely to continue due to factors such as the slowdown in overseas economies, especially the United States, and the effects of the appreciation of the yen and high energy and materials prices.<sup>10</sup> It seems likely that industrial production will remain more or less flat and the economy's capacity to generate income will continue to be relatively weak. Thereafter, however, the Japanese economy's capacity to generate income is likely to improve, as overseas economies are expected to move out of their deceleration phase and the effects of high energy and materials prices are likely to abate. As a result, the rate of real GDP growth for fiscal 2008 is likely to register around 1.5 percent and that for fiscal 2009 is expected to be in the range of around 1.5-2.0 percent.

In this Outlook Report, it is assumed that although the deceleration in the pace of growth may continue through the first half of fiscal 2008, Japan's economy will not fall into open recession and will thereafter follow a path of moderate growth at around the potential

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<sup>10</sup> Looking at Indexes of Business Conditions (Composite Indexes), the leading index has continued to fall and the coincident index, which had been on a moderate upward trend, has recently exhibited ups and downs due mainly to the leveling-off of production (Chart 1 [3]). If data relating to production do not indicate growth momentum in the near future and the weakness in production continues for some time, it is possible that it will be judged *ex post* in the Reference Dates of Business Cycle that the expansion phase of the cycle has already ended, even though the economy remains basically firm.

growth rate. The basic thinking behind this projection can be summarized as follows. The view that Japan's economy will not fall into recession is based mainly on the assumptions of (1) relatively high growth in overseas economies; (2) accommodative financial conditions; and (3) minimal adjustment pressure on firms with regard to inventories, production capacity, and employment. On the other hand, the projection that the economy will be unlikely to regain enough momentum for growth to clearly exceed the potential growth rate through fiscal 2009 is based mainly on the following factors. First, the capital investment cycle indicates that business fixed investment is entering a phase of slower growth following the rapid increases in capital investment of the last several years. Second, the pace of growth in overseas economies is expected to be moderate compared to the period leading up to 2007. Third, it is assumed that international commodity prices will remain elevated and will likely continue to exert downward pressure on corporate profits. And fourth, the flow of income from the corporate sector to the household sector is likely to remain modest, reflecting slower growth in corporate profits.

Looking at the environment surrounding future price developments, the level of resource utilization, in terms of labor and production capacity, is likely to stay at generally the same level as the economy is expected to grow at around the potential growth rate, and as a result aggregate supply and demand in the economy are likely to remain more or less balanced, as at present. Unit labor costs (labor costs per unit of output), which have been falling, are likely to decline at a slower pace as wages gradually rise (Chart 24). Meanwhile, based on the assumption that growth in overseas economies will continue to be relatively robust, the prices of international commodities are expected to remain elevated, although they may fluctuate due to, for instance, speculative transactions (Chart 27 [3]). Given these points, more firms are likely to gradually pass on cost increases, including those from past rises in materials prices, at the retail level in addition to the wholesale level, although this may be offset to some extent by persistent competitive pressure (Chart 25). Meanwhile, the private sector expects future price increases. The results of various surveys and some indicators suggest an upward shift in private-sector expectations of inflation due mainly to rises in the prices of daily necessities such as petroleum products and food products (Chart 26).

Based on the assessment above, it is likely that the CGPI will continue increasing. The year-on-year rate of change in the CPI (excluding fresh food) is projected to increase, mainly led by rises in the prices of petroleum products and food products, registering an increase of around 1.0 percent in both fiscal 2008 and 2009.

### **Environment Surrounding Exports**

For positive momentum to be maintained in the corporate sector, it is important that Japan's exports continue to increase against the background of overseas economic expansion. With regard to the outlook for overseas economies, although the U.S. economy has recently lost momentum, it is assumed that growth in emerging economies and countries that export natural resources will be more or less maintained, and thus the world economy as a whole will decelerate only moderately (Charts 27 [1] and [2]).<sup>11</sup> In this situation, while the pace of increase in Japan's exports is expected to moderate somewhat in the first half of fiscal 2008 as the effects of the slowdown in the world economy and of the appreciation of the yen are felt, the increasing trend is expected to be maintained.

Looking at developments in global trade by country and region from 2001 to 2006, substantial growth in imports from the rest of the world was recorded by Asia -- mainly in China -- as well as the Middle East and other regions (such as Russia and Latin America), rather than the United States or other advanced economies (Chart 28 [1]).<sup>12</sup> In other words, global economic growth is supported by a more diverse range of countries than in the past as emerging economies and countries that export natural resources continue their high

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<sup>11</sup> The *World Economic Outlook* released in April 2008 by the International Monetary Fund (IMF) forecasts that although in 2008 and 2009 the world economy as a whole will grow at a slower pace than in 2004 to 2007, the growth rate is unlikely to decline as sharply as in 1998 or 2001 and is expected to remain relatively high due mainly to growth in emerging economies and countries that export natural resources.

<sup>12</sup> Looking at nominal export shares by country/region of origin, the increase in China's share, which has registered remarkable growth in exports in real terms, is striking, but the shares of the Middle East and other regions, whose exports in real terms have grown in line with the global average, are also increasing (Chart 28 [2]). This reflects the higher prices of primary commodities, the main exports from these regions, and when combined with the increase in exports to these regions, it is clear that the increased income from high natural resource prices is being returned to other countries through international trade.

economic growth. This change in the overall picture of world trade is also reflected in the pattern of Japan's exports.

The increase in exports especially to emerging economies and countries that export natural resources and the increase in profits of Japanese firms from overseas corporate activity have so far been higher than the increase in the outflow of income from Japan to overseas economies caused by the deterioration in the terms of trade, that is, the increase in trading losses (Chart 29). The ratio of cumulative trading losses to GDP in the current phase of economic expansion is greater than that observed at the time of the two oil crises. However, unlike at the time of the oil crises, Japan's real trade surplus (net exports) and interest and dividend income (net income from the rest of the world) have increased, showing that Japan's economy has been responding well to global demand, which has increased in line with the rises in the prices of primary commodities, with the result that total income from external activity has actually increased. The positive interaction between trading gains and the real trade balance has generally been in place for the last several years not only in Japan but across the world (Chart 30). This is the basic structure that, until now, has made it possible for increases in international commodity prices and high global economic growth to coexist.

If global economic growth were to continue in this fashion, Japan's exports to a wide range of economies would maintain an increasing trend and would continue to support the economy. However, faced with continuing disruptions in global financial markets stemming from the U.S. subprime mortgage problem, U.S. and European financial institutions have tightened their lending standards. Depending on the outcome of these developments and their effects on the economies of the United States and Europe as well as other areas, there is a downside risk that global economic growth may turn out weaker than expected. If this downside risk were to materialize, then it could, depending on its severity, have the following impact on Japan's economy: (1) the virtuous circle may no longer operate, mainly due to weaker than expected exports and business fixed investment, possibly causing the economic growth rate to fall below the potential growth rate; and (2) this coupled with declines in international commodity prices may cause the rate of increase in consumer prices to decline.

On the other hand, depending on the strength of domestic demand in emerging economies, particularly China, and countries that export natural resources as well as the momentum of recovery of the U.S. economy, the world economy may turn out to be significantly stronger than expected. In such a scenario, increased inflationary pressure worldwide may become a problem. In this Outlook Report, it is assumed that relatively high growth in the world economy and elevated international commodity prices can coexist. Nevertheless, there is significant uncertainty as to whether this delicate balance will continue, and it remains possible that a marginal upward shift in the growth rate of the world economy could cause the rise in international commodity prices to accelerate. If this risk were to materialize, world economic growth may strengthen in the short run but could be held back thereafter by stronger inflationary pressures. As for Japan's economy, there may come a time when the negative effects from the decline in trading gains continuously exceed the positive effects from growth in net exports, and this would have negative implications for the spending behavior of firms and households.

### **Firms' Profits and Spending Behavior**

Corporate profits have recently been leveling off, although they remain at a high level. According to the March *Tankan*, firms, especially small and medium-sized ones, have in general revised their estimates of current profits for fiscal 2007 downward, mainly due to high energy and materials prices, and these are now estimated to have decreased from the previous year, albeit slightly, for the first time in six years. For the first half of fiscal 2008 current profits are projected to register a year-on-year decline, following their decrease in the second half of fiscal 2007. However, for fiscal 2008 as a whole they are projected to increase (Chart 31).

The sluggishness in corporate profits seems to be largely due to the appreciation of the yen during the past months and the sharp rises in energy and materials prices. Therefore, unless external factors like these worsen further, corporate profits will likely resume their upward trend in fiscal 2009.

Nevertheless, since labor market conditions have continued to be tight so that reductions in labor costs are increasingly difficult, profit growth is unlikely to recover the pace set during the period up to fiscal 2006 unless firms' ability to produce value added increases as a result of, for instance, the opening up of new markets or productivity improvements. Many small and medium-sized firms in particular are heavily dependent on domestic demand and thus more susceptible to higher materials costs, so that it is highly likely that they will continue to face a business environment which is harsher than that for large firms.

As for business fixed investment, since the level of capital investment has already risen to a level generally compatible with the economy's potential growth rate following the continued expansion of the last few years, business fixed investment is entering a phase where the rapid pace of growth is unlikely to continue (Chart 32). In this situation, the pace of increase in business fixed investment has become slower due partly to the effects of the revision of the Building Standard Law, the sluggishness in the pace of increase in profits, particularly of small and medium-sized firms, and heightened uncertainty about the future course of the economy. However, it seems that firms as a whole are currently under no pressure to adjust capital stocks because they have been disciplined in their investment activity and as a result there has been no excessive build-up of capital stocks. In addition, corporate profits are likely to resume increasing without experiencing a sharp decline as long as the strength in medium- to long-term demand is maintained and there is no sharp increase in energy or materials prices. Meanwhile, high energy prices and other factors are expected to generate more rationalization and energy-saving investments. Given these points and with the effects of the revision of the Building Standard Law weakening, business fixed investment is likely to follow a moderate increasing trend that is generally compatible with the potential growth rate of the economy.

However, since part of the recent increase in business fixed investment has been led by firms' business strategies aiming to capture the opportunities in growing overseas markets, attention should be paid to the risks associated with developments in overseas economies mentioned earlier. Although business fixed investment does not appear to be particularly vulnerable to negative shocks, if some shock seriously damages the growth prospects of external demand or if the period of heightened uncertainty about future developments in



external demand continues for a long time, business fixed investment may be affected accordingly. On the other hand, should uncertainty regarding overseas economies be dispelled earlier than expected, overall corporate activity may become stronger than expected, as firms, particularly globally active firms, may increase capital spending further and may expand their production. Even in this situation, the spending behavior particularly of small and medium-sized firms may be affected negatively if international commodity prices rise sharply.

### **The Employment and Income Situation and Households' Spending Behavior**

In the labor market, although the tightening trend in supply and demand conditions has reached a hiatus due to the slowing of Japan's economic growth, firms have continued to feel strongly that they are short of labor. The current level of tightness in supply and demand conditions in the labor market is likely to continue, given that Japan's economy is likely to grow at a pace around its potential growth rate.

A labor survey indicates that growth in the number of employees has slowed as corporate profits have been leveling off and production has been decelerating. However, in general, the number of employees has been increasing as firms have continued to feel short of labor, and is likely to remain on a moderate increasing trend that is in line with the pace of economic growth (Chart 33 [1]). The working-age population -- the number of persons from 15 to 64 years of age -- will continue to decrease by around 1 percent every year. Nevertheless, the number of employees is likely to increase gradually and there will be no sharp tightening in supply and demand conditions in the labor market, due mainly to an increase in recruitment of new graduates, greater labor force participation by the elderly and women resulting from the diversification of employment patterns, and the inflow of labor from among those previously self-employed or working for family businesses (Chart 34 [1]).

The year-on-year rate of change in nominal wages per worker has been around 0 percent recently. A breakdown shows that special payments have decreased due to the sluggishness in the pace of increase in corporate profits, while regular payments have

started slightly to exceed the previous year's level (Chart 33 [2]). Factors behind the upturn in regular payments include the following: (1) the prolonged labor shortage gradually exerting upward pressure on wages; (2) improvements in the working conditions of non-regular employees and an increase in the numbers attaining the status of regular employees, following changes in the legal environment such as the coming into force of the revised Part-time Work Law in April 2008; and (3) the mitigation of downward pressure on the average wage per worker, which has started to be felt as the pace of baby-boomer retirement has begun to slack off (Chart 34 [3]). As for the outlook, the increase in regular payments is likely to continue. However, the growth in wages is likely to be modest, given that supply and demand conditions in the labor market are unlikely to tighten further and that profit growth particularly at small and medium-sized firms has been sluggish.

Given the above environment for employment and income, private consumption has been firm and is likely to remain firm supported by the introduction of new products, particularly of durable goods, and by an increase in outlays for services in response to the aging of the population. Consumer sentiment, however, has become cautious as a whole, due to rises in the prices of petroleum products and food products as well as the weakness in stock prices, as seen earlier. The diffusion index in the March *Tankan* for business conditions for firms in private consumption-related industries suggests more circumspection with regard to business conditions (Chart 35). Taking this into account, due attention should be paid to the possibility that private consumption may turn weaker than expected as a result of the rise in general prices and the weakness in stock prices.

Meanwhile, the number of housing starts has recovered to around 1.2 million on an annualized basis after the sharp fall due to the effects of the revision of the Building Standard Law. However, in the market for condominiums, inventories have accumulated as a result of a drop in sales caused partly by the rise in their prices since 2006, and pressure for price adjustments is rising (Chart 3 [3]). Moreover, as the financial environment for the real estate industry has become less accommodative, investment in housing for rent, particularly by real estate funds, has paused. Given these developments, although housing investment is expected to recover, the pace is likely to be modest.

## Environment Surrounding Price Changes

During the current phase of economic expansion, the rise in consumer prices has proved sluggish despite high resource utilization (Chart 36). The sluggishness was because firms in the distribution and services sectors made various efforts to hold down retail prices in the face of the slow recovery of private consumption and intensified competition among firms amid economic globalization and deregulation.<sup>13</sup>

Recent developments in price data suggest that although, faced with fierce competition, firms' basic stance of holding back from increasing prices remains deep-seated, sharp rises in purchasing costs have increasingly led more firms, especially retailers, to raise retail prices (Chart 37). Reflecting these developments, the year-on-year rate of change in the CPI (excluding fresh food) has been rising. A breakdown by item indicates that price rises are particularly large for petroleum products and food products, while price rises of other items remain very moderate (Chart 12). These developments seem to be attributable to two factors: the rise in input costs for petroleum products and food products has been particularly large; and the price elasticity of demand for these products, which are daily necessities, is low. Meanwhile, a breakdown of the CPI by item characteristic reveals that while there was a conspicuous increase in the prices of items classified as basic expenditures, which could be regarded as daily necessities, price increases of items classified as selective expenditures remained very moderate (Chart 38). This tendency can be confirmed also from the fact that the increase in the prices of frequently purchased items is high, while that of infrequently purchased items, such as durable goods, remains low. Noticeable rises in the prices of frequently purchased items may have pushed up consumers' perceptions of inflation by more than the actual level of increases in price indices.

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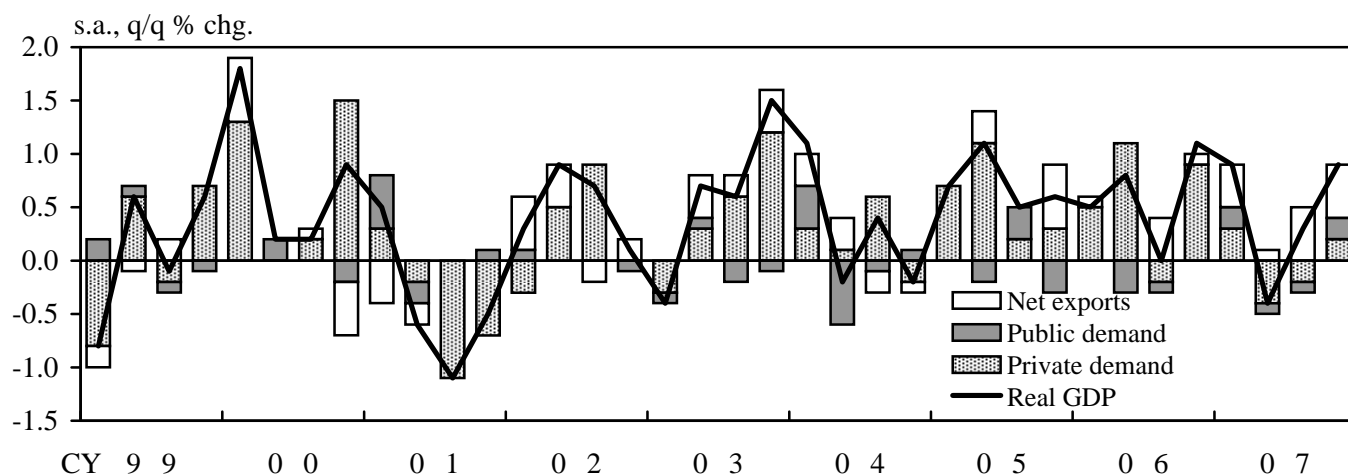
<sup>13</sup> According to the *Tankan*, there was no significant gap between the level of the diffusion index for output prices and that for input prices in the retail sector until around 1990. However, since the mid-1990s, when competition became more intense and the so-called price destruction and distribution revolution occurred, the level of the diffusion index for output prices has been markedly lower than that for input prices (Chart 37 [1]). This is to an extent attributable to the constant cost reduction efforts made by firms in the distribution industry. Similar developments in the diffusion indexes have been observed in the services sector since the mid-1990s, and the gap has recently been expanding further (Chart 37 [2]).

With regard to the Bank's projections for prices based on these recent developments, it is likely that the year-on-year rate of change in the CPI (excluding fresh food) will be in the 1.0-1.5 percent range until the middle of fiscal 2008 mainly due to rises in the prices of petroleum products and food products. Further ahead, upward pressure on prices of food products, including the pass-through of past cost increases, will likely continue, while the rate of increase in the prices of petroleum products is expected to slow if the pace of increase in crude oil prices moderates. Regarding the environment surrounding consumer prices, it is expected that (1) aggregate supply and demand in the economy will likely remain more or less balanced, and (2) cost reduction efforts are likely to continue at the retail level. Consequently, on a fiscal year basis, the year-on-year rate of change in the CPI (excluding fresh food) in fiscal 2008 and 2009 is projected to be around 1.0 percent, after registering 0.3 percent in fiscal 2007.

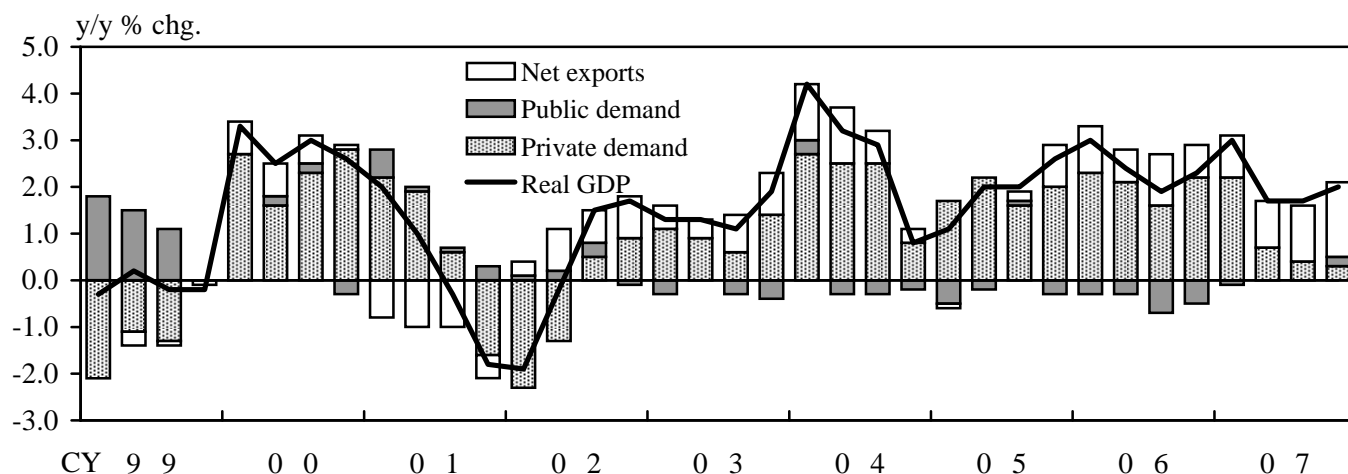
The outlook above is subject to uncertainties that could cause the inflation rate to deviate either upward or downward depending on the level of economic activity. Possible deviation of inflation may also result from the following developments that are peculiar to prices: (1) increases in materials prices may lead to trend increases in inflationary pressures; also, although with opposite effect, (2) various cost reduction efforts, including the wide-ranging introduction of own-brand products by major retailers, may lead to lower than expected increases in prices of food products and other consumer goods. Regarding the former risk, there is no clear indication, at present, that higher materials prices have led to trend increases in inflationary pressure. Nevertheless, if increases in prices of frequently purchased goods continue, households will likely perceive stronger inflationary tendencies. Should, in this situation, economic activity become stronger, firms may agree to raise wages to compensate for increases in consumer prices, and this may raise the risk of a trend increase in inflationary pressure. In addition, considerable uncertainty surrounds developments in the prices of primary commodities such as crude oil, leaving the potential for movement in either direction.

## Real GDP and Indexes of Business Conditions

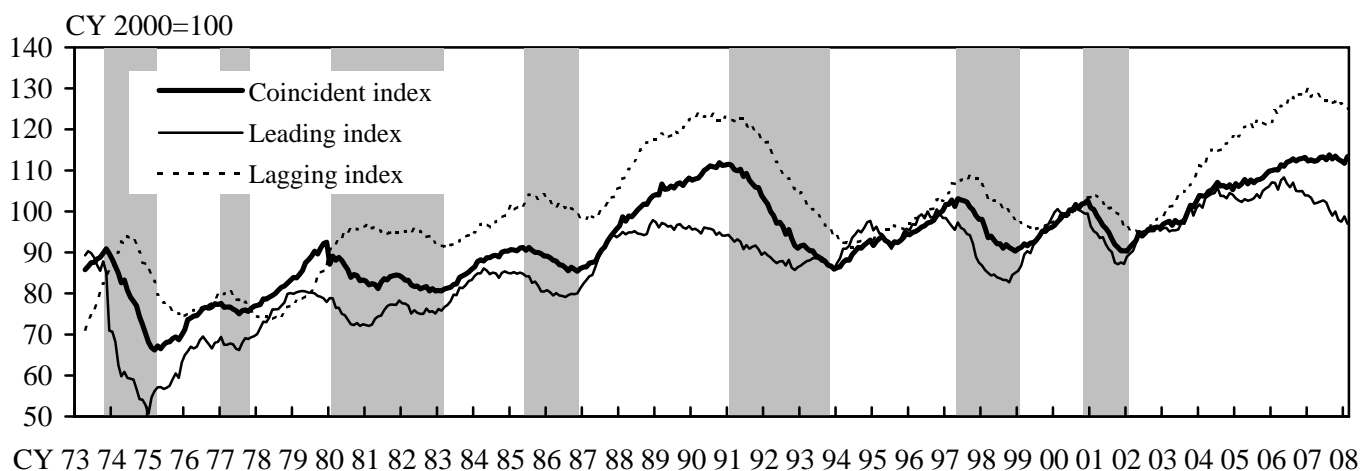
(1) Real GDP (Quarter-to-Quarter Changes)



(2) Real GDP (Year-to-Year Changes)



(3) Indexes of Business Conditions (Composite Indexes)

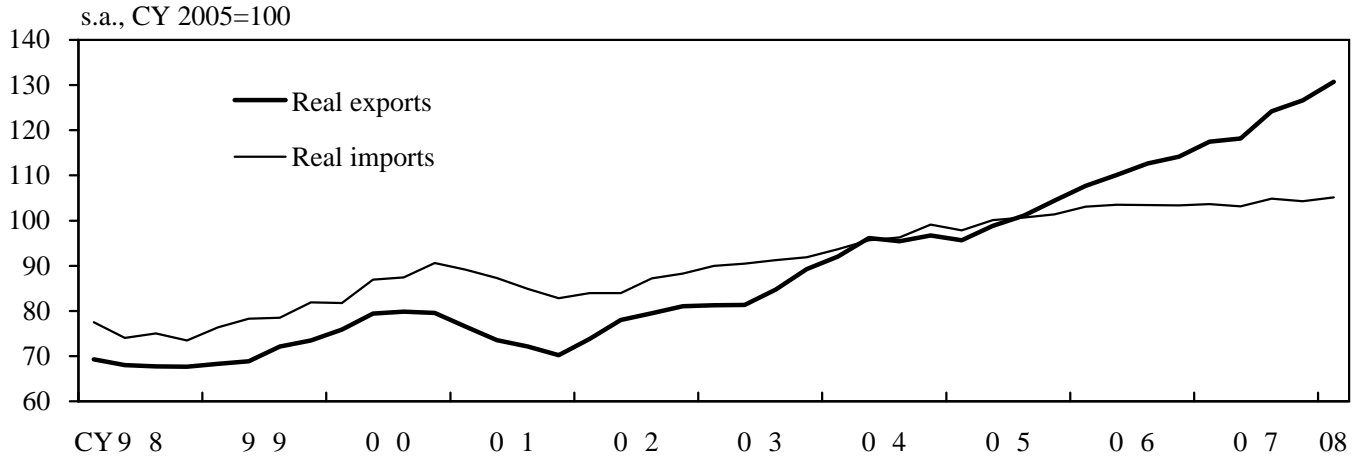


Note: Shaded areas indicate recession periods.

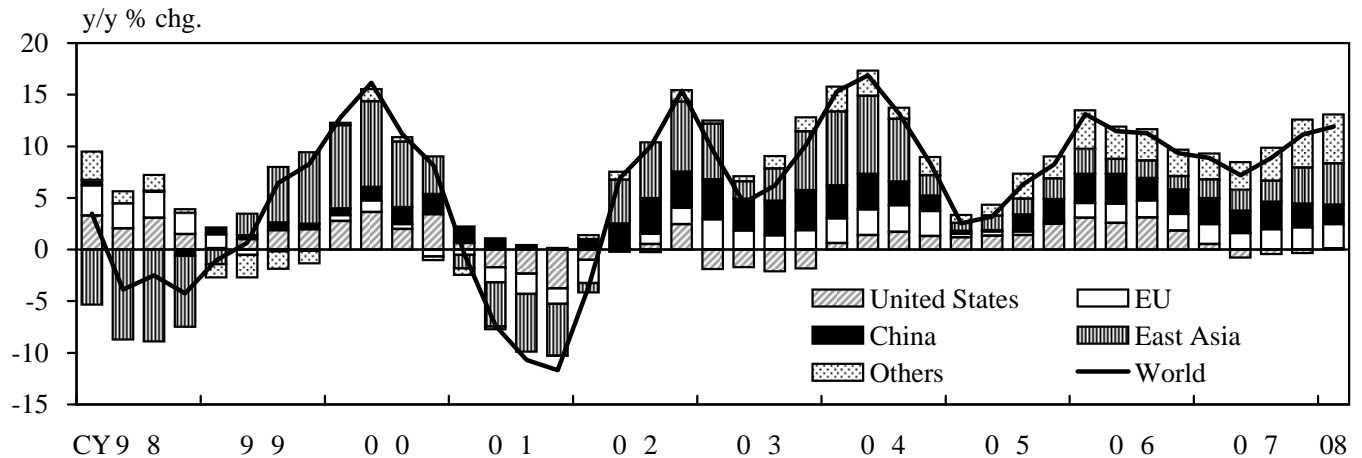
Source: Cabinet Office, "National Accounts," "Indexes of Business Conditions."

## Exports and Imports

### (1) Real Exports and Real Imports

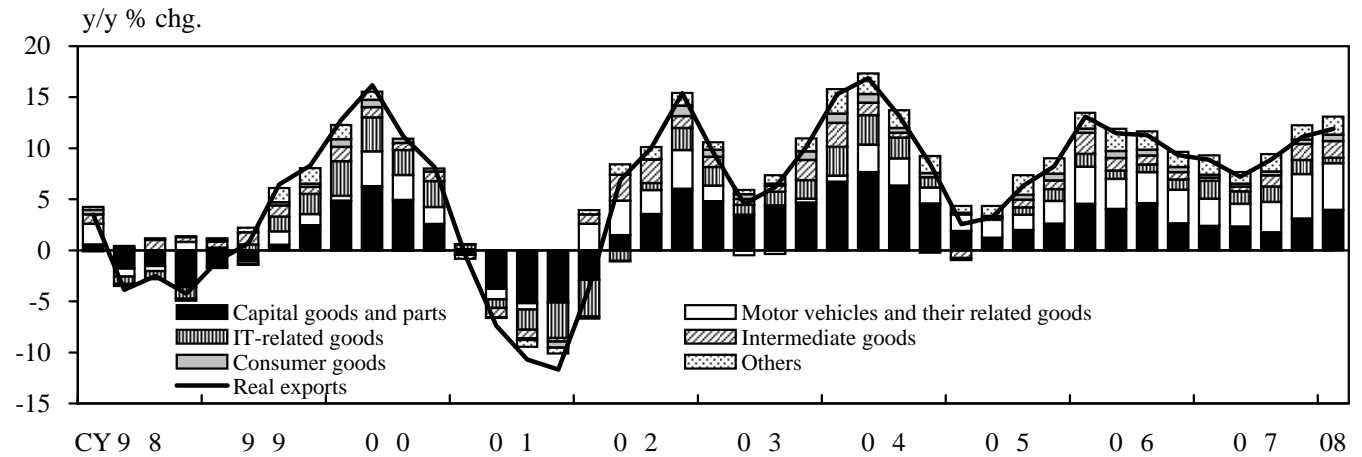


### (2) Real Exports (Breakdown by Region)



Note: Data for East Asia: NIEs and ASEAN4.

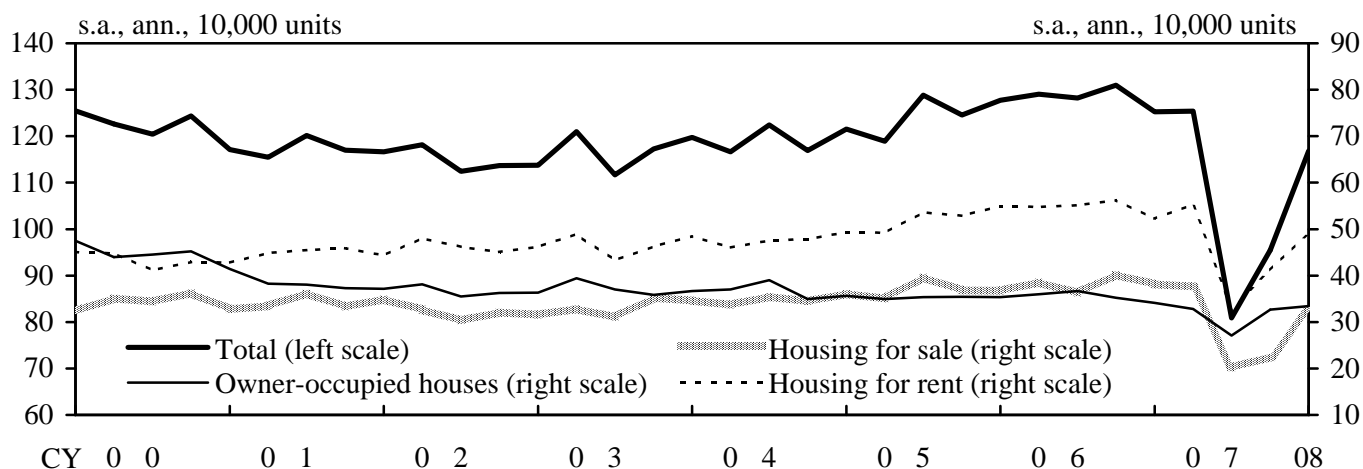
### (3) Real Exports (Breakdown by Goods)



Sources: Ministry of Finance, "The Summary Report on Trade of Japan";  
Bank of Japan, "Corporate Goods Price Index."

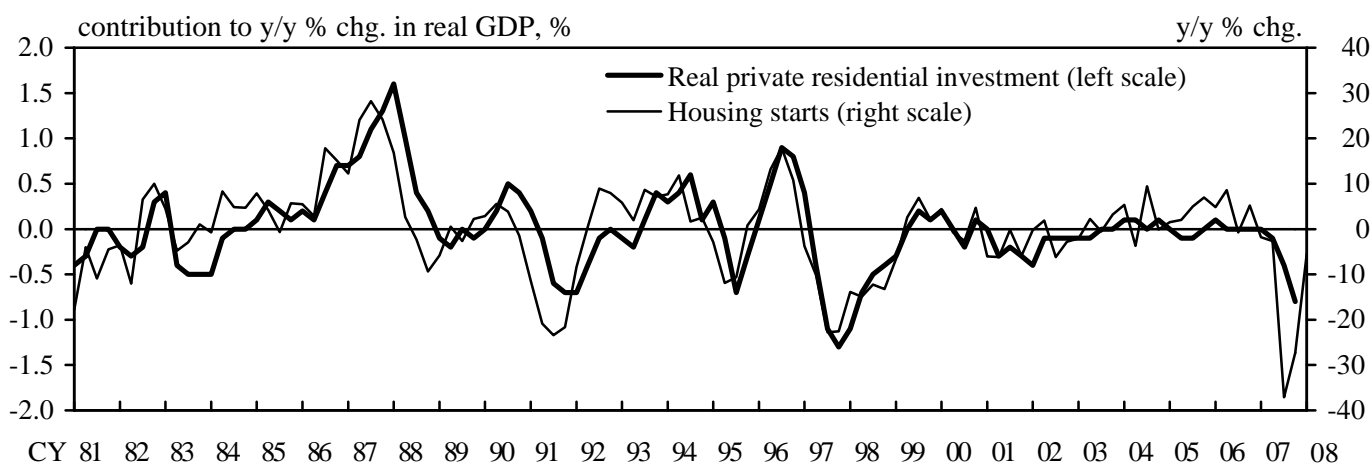
## Housing Investment

### (1) Housing Starts



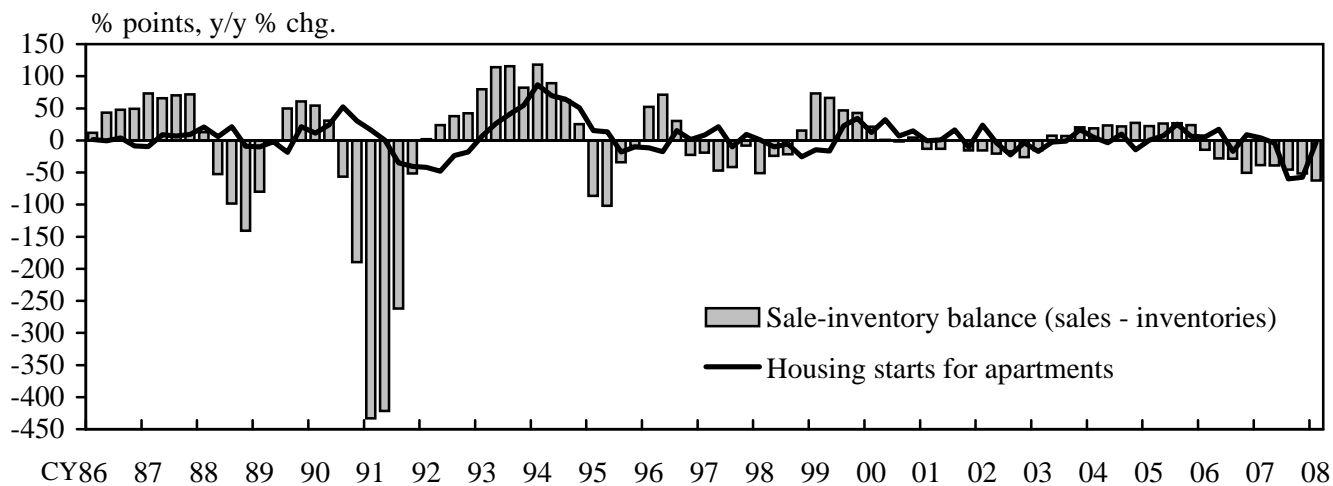
Note: Figures for 2008/Q1 are those of the January-February average.

### (2) Housing Starts and Contribution of Housing Investment to Change in GDP



Note: Figure of housing starts for 2008/Q1 is the January-February average.

### (3) Sale-Inventory Balance of Condominiums



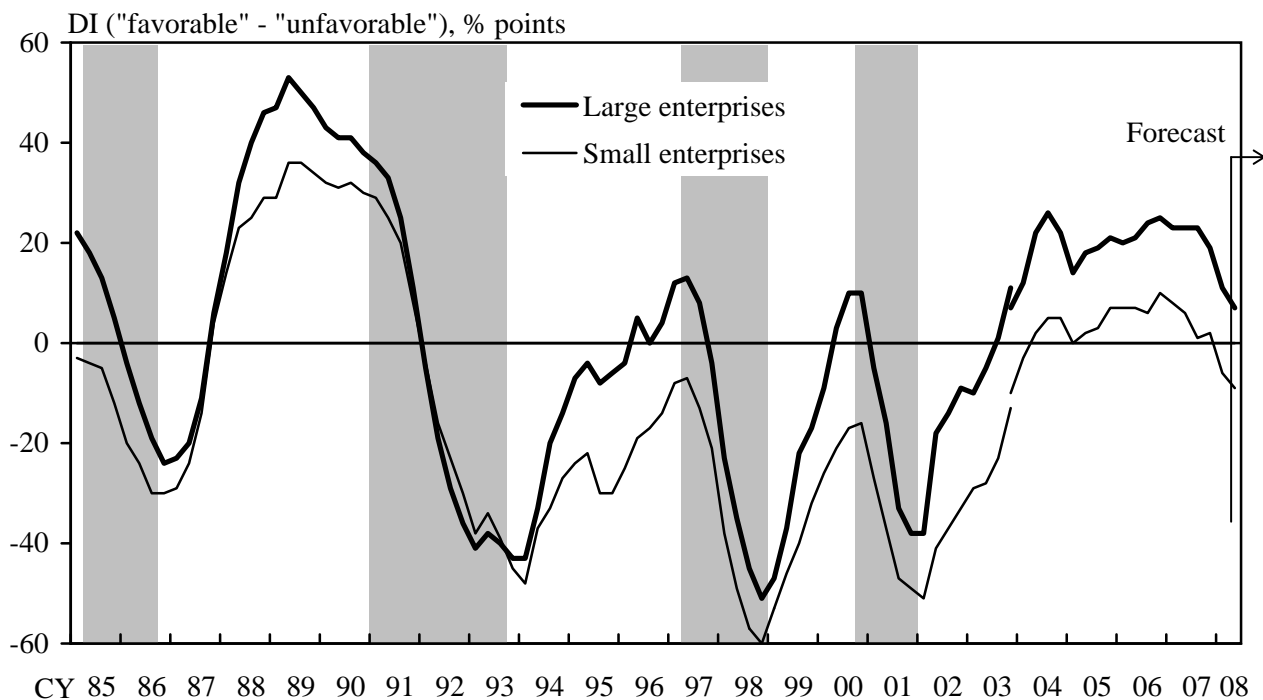
Notes: 1. Total for the Tokyo metropolitan area and the Kinki region.

2. Figure of housing starts for 2008/Q1 is the January-February average.

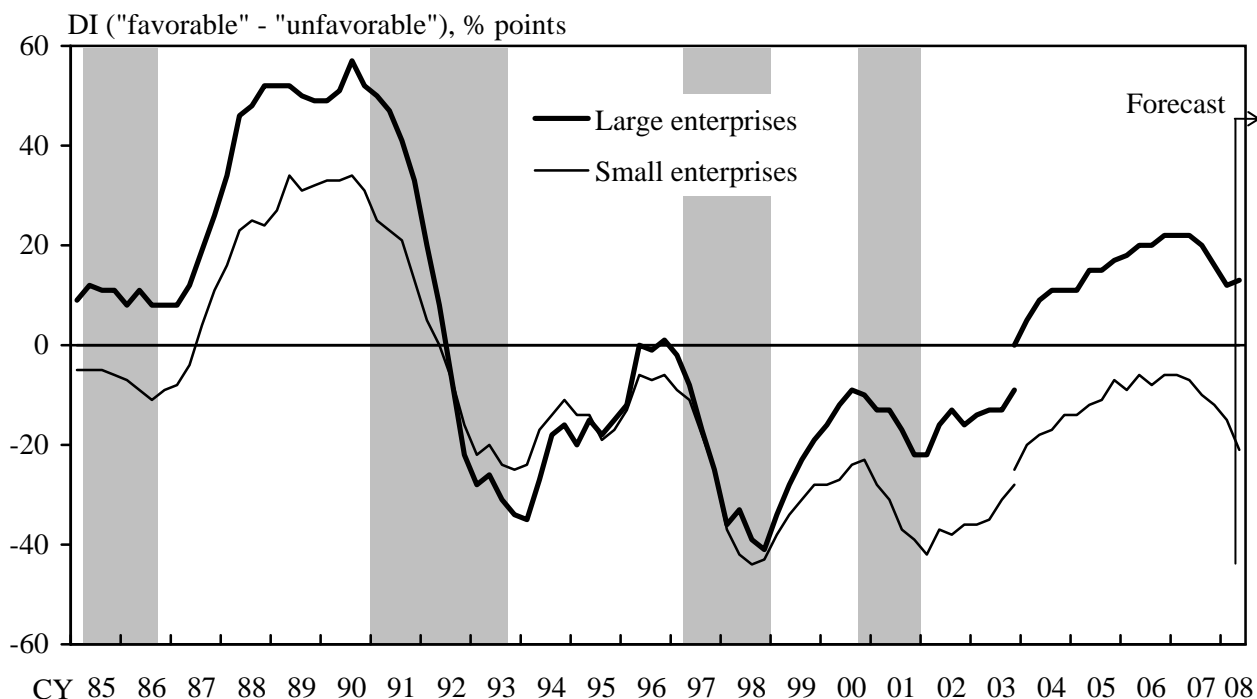
Sources: Ministry of Land, Infrastructure and Transport, "Statistics on Building Construction Starts"; Cabinet Office, "National Accounts," etc.

## Business Conditions

### (1) Manufacturing



### (2) Nonmanufacturing



Notes: 1. The *Tankan* has been revised from the March 2004 survey. Figures based on the previous data set are up to the December 2003 survey. Figures on a new basis are from the December 2003 survey.  
 2. Shaded areas indicate recession periods.

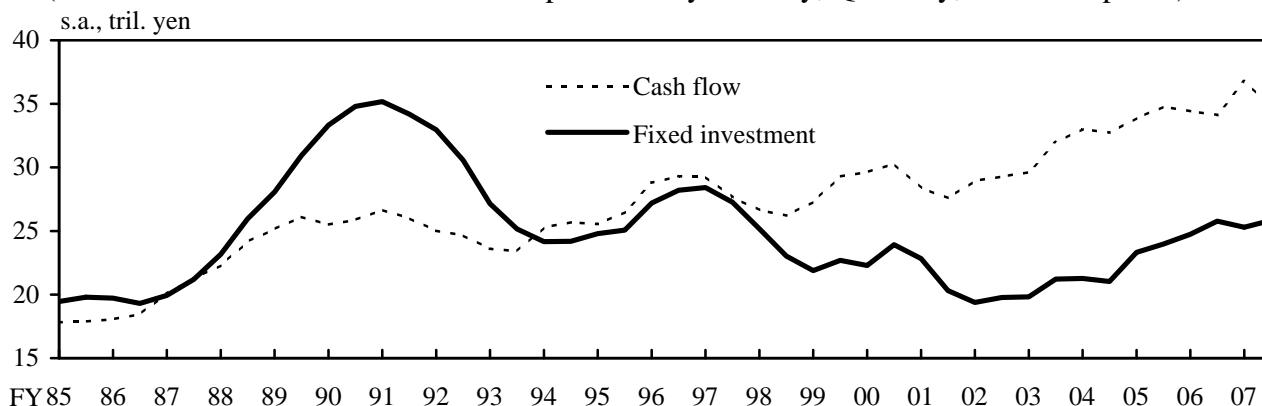
Source: Bank of Japan, "*Tankan*, Short-Term Economic Survey of Enterprises in Japan."



## Fixed Investment

### (1) Fixed Investment and Cash Flow

("Financial Statements Statistics of Corporations by Industry, Quarterly," All Enterprises)

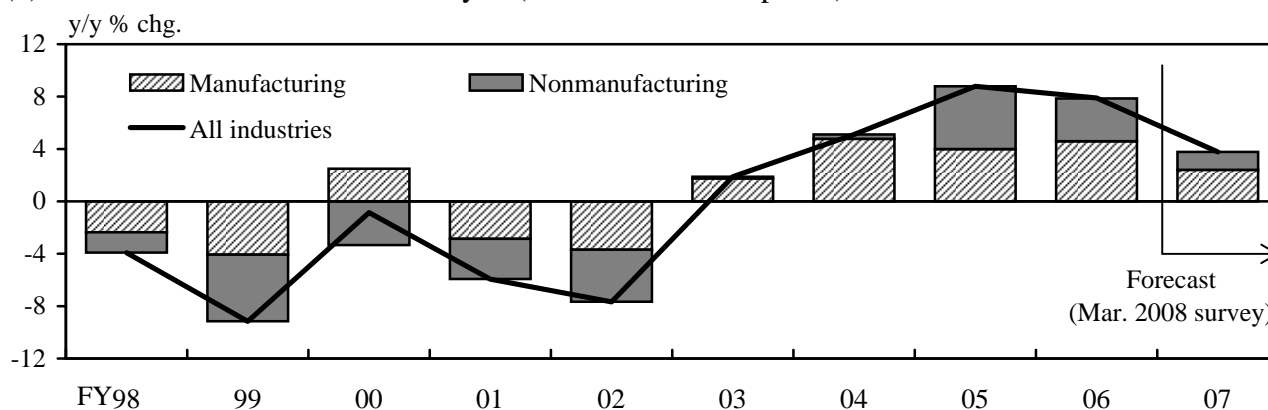


Notes: 1. Figures are adjusted for sample changes.

Cash flow = current profits/2 + depreciation expenses

2. Figures for the second half of FY 2007 are calculated on the assumption that the year-on-year growth rate of 2008/Q1 is the same as that of 2007/Q4.

### (2) Fixed Investment Plans as Surveyed (*Tankan*, All Enterprises)

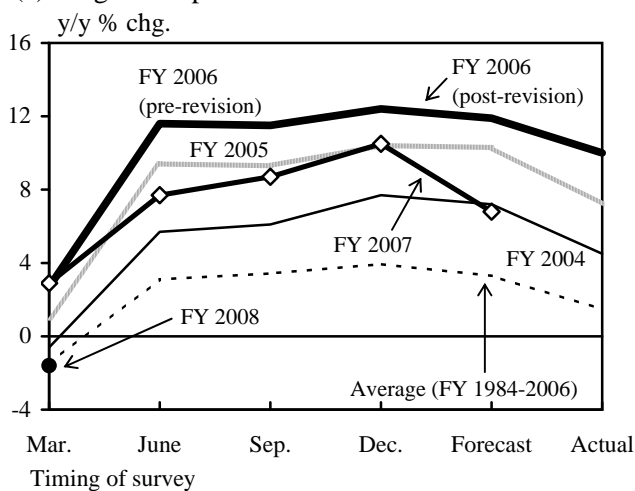


Note: Figures up to FY 2002 include land purchasing expenses and exclude software investment.

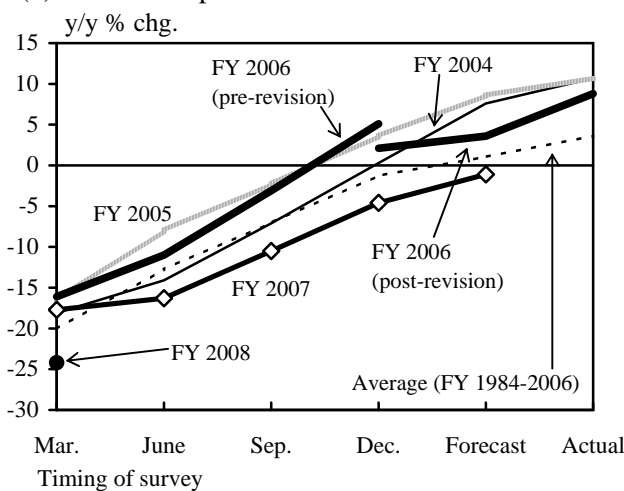
Figures from FY 2003 exclude land purchasing expenses and include software investment.

### (3) Developments of Fixed Investment Plans (*Tankan*, All Industries)

#### (a) Large Enterprises



#### (b) Small Enterprises



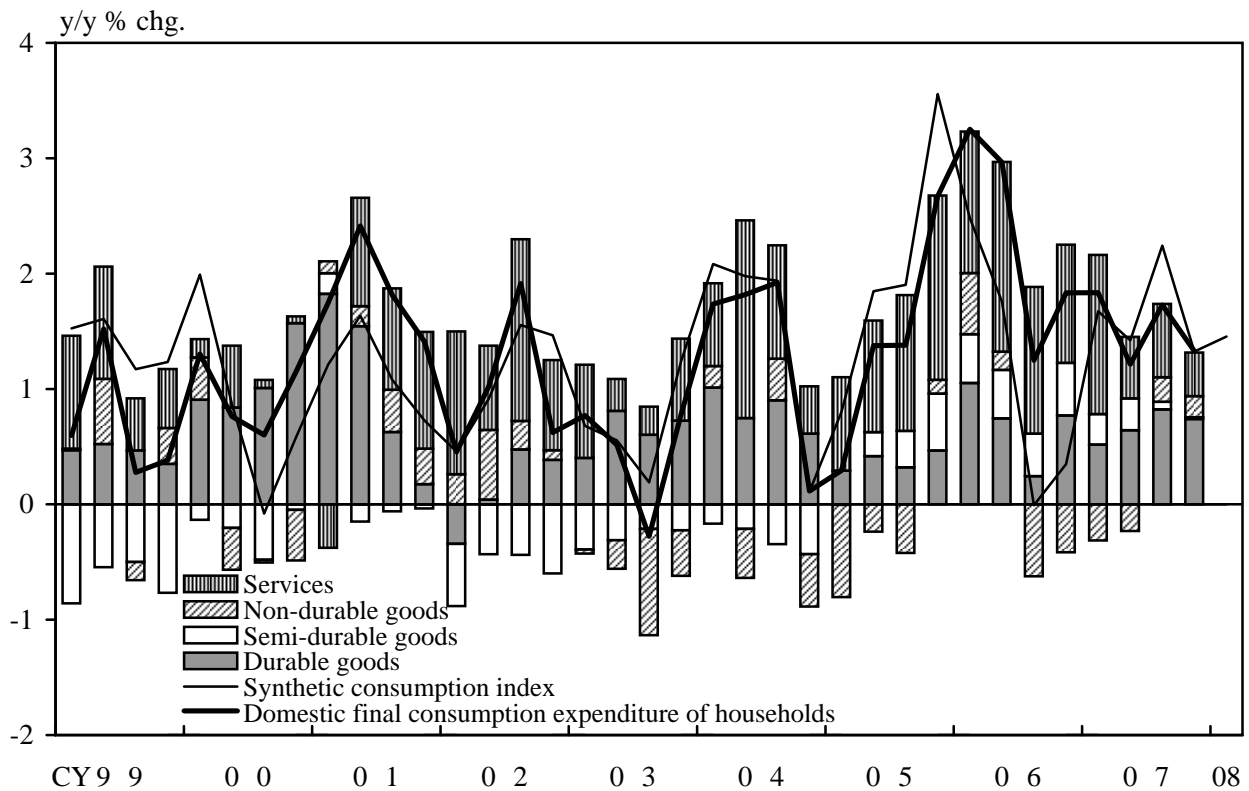
Notes: 1. Figures include land purchasing expenses and exclude software investment.

2. In the March 2007 survey, regular revisions were made to the sample enterprises.

Sources: Ministry of Finance, "Financial Statements Statistics of Corporations by Industry, Quarterly"; Bank of Japan, "*Tankan*, Short-Term Economic Survey of Enterprises in Japan."

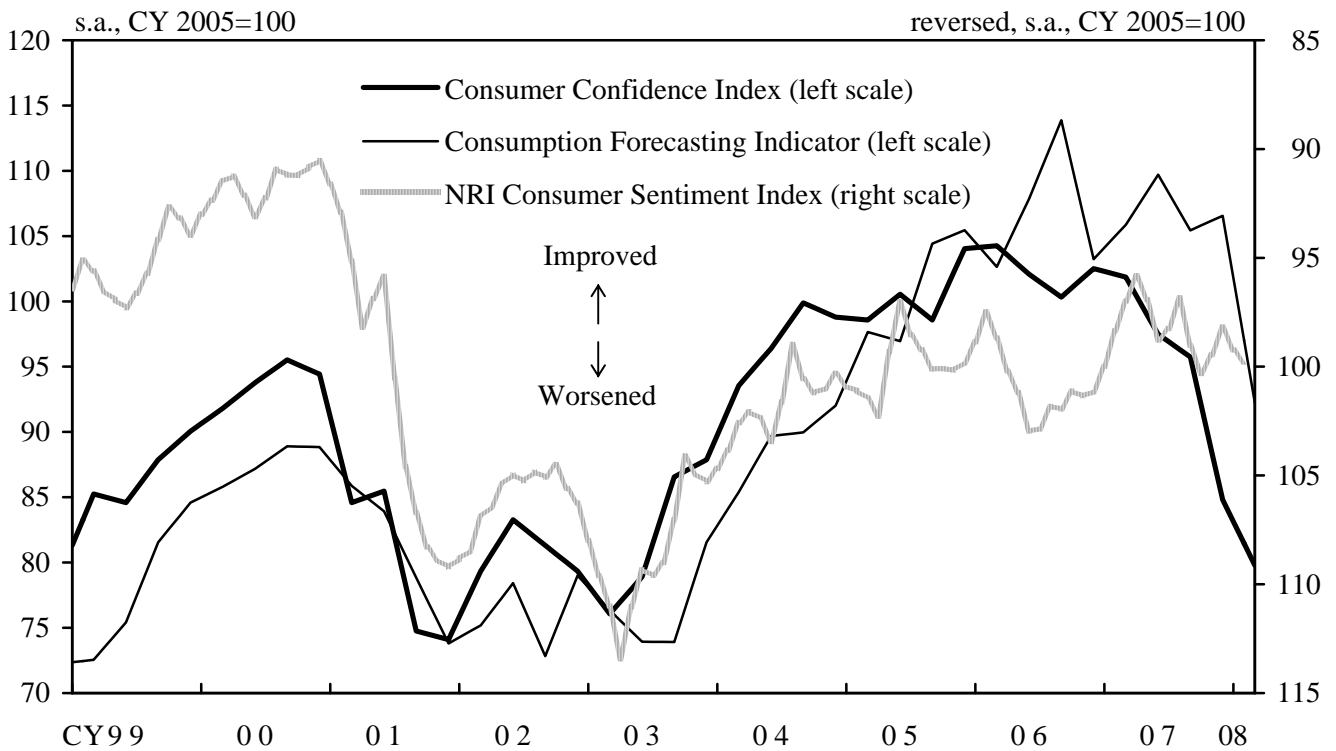
## Private Consumption

(1) Breakdown of Real Domestic Final Consumption Expenditure of Households



Note: Figure of the synthetic consumption index for 2008/Q1 is the January-February average.

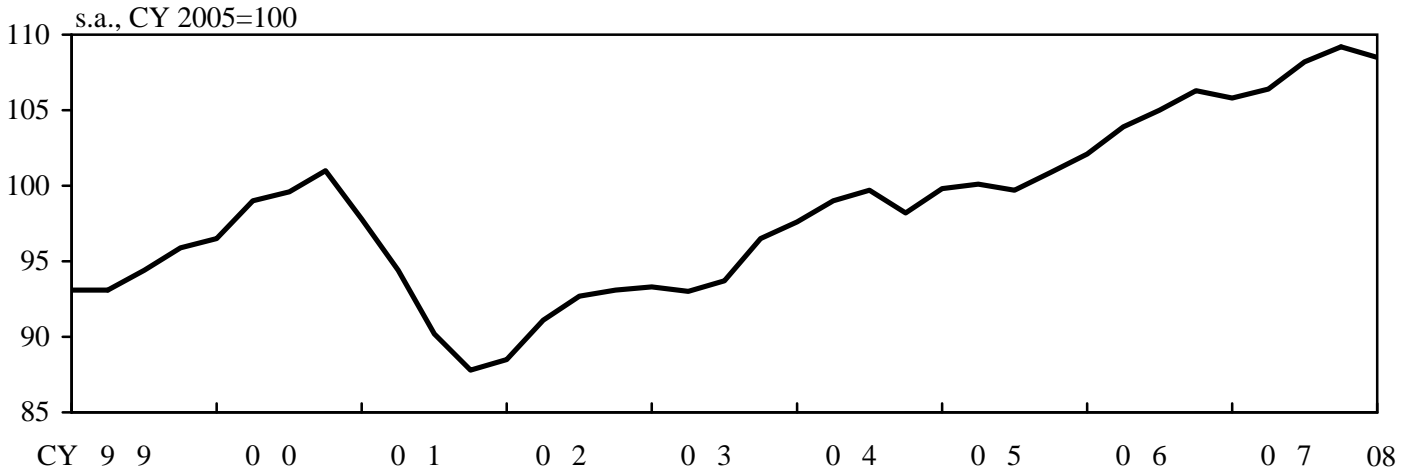
(2) Consumer Confidence



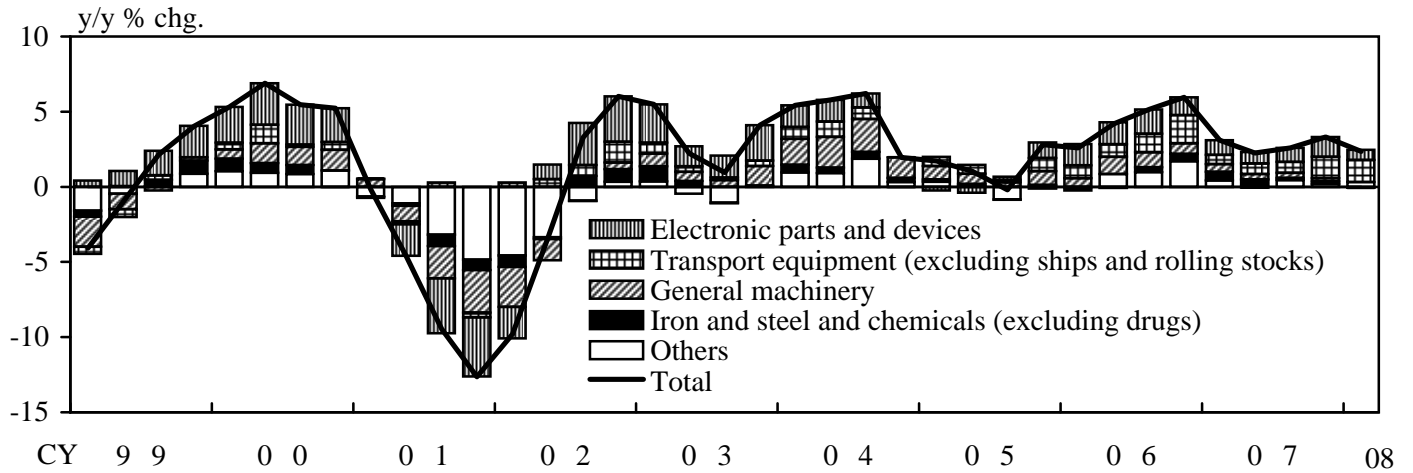
Sources: Cabinet Office, "National Accounts," "Consumer Confidence Survey," "Synthetic Consumption Index"; Nikkei Inc., "Consumption Forecasting Indicator"; Nippon Research Institute (NRI), "Consumer Sentiment Survey."

# Production

(1) Production

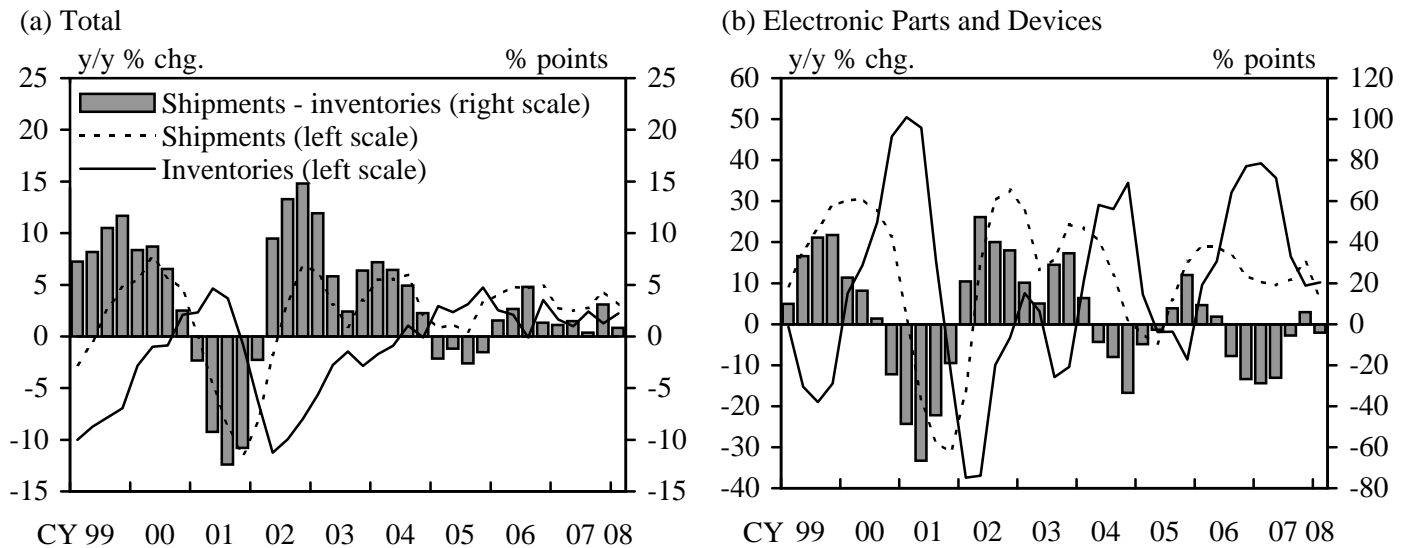


(2) Production (Breakdown by Industry)



Note: Figures up to CY 2003 are on the 2000 base.

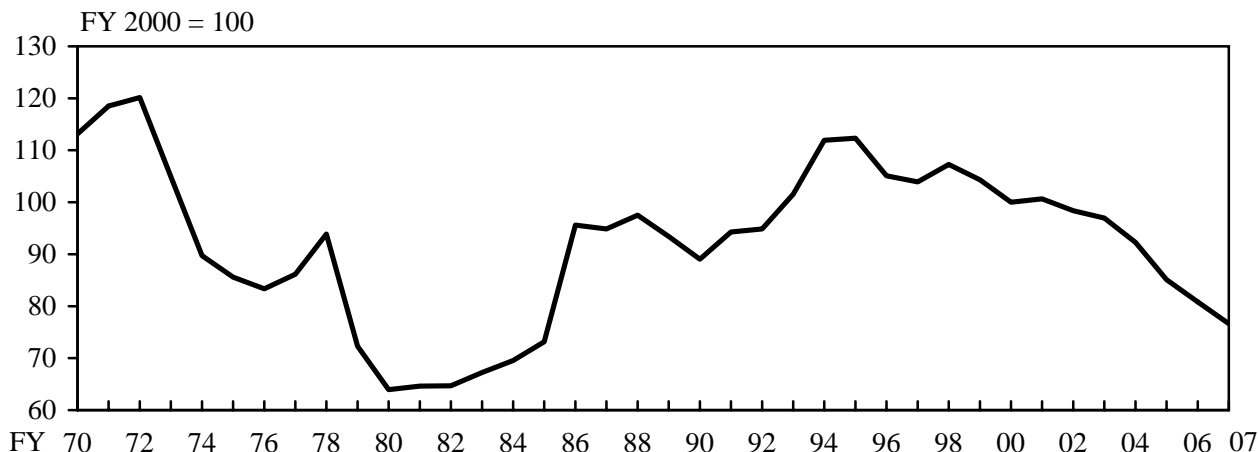
(3) Inventory Cycle



Source: Ministry of Economy, Trade and Industry, "Indices of Industrial Production."

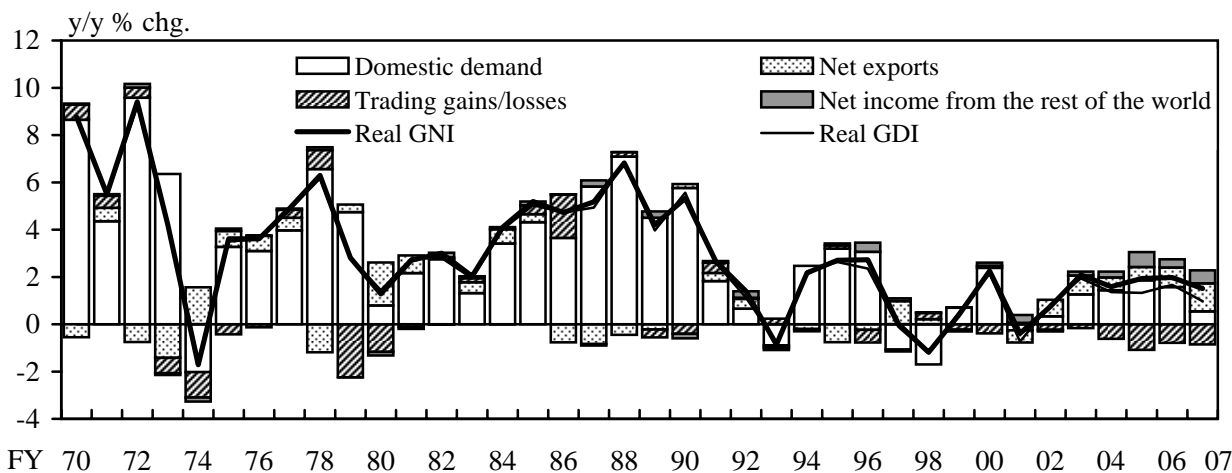
## Aggregate Income Formation

### (1) Terms of Trade Index (Export Deflator / Import Deflator)



Note: Figure for FY 2007 is that of the April-December average.

### (2) Real GDI and Real GNI



Notes: 1. Figures for FY 2007 are those of the April-December averages.

2. Figures of components indicate contributions to changes in real GNI.

3. Real GDP = Domestic demand + net exports

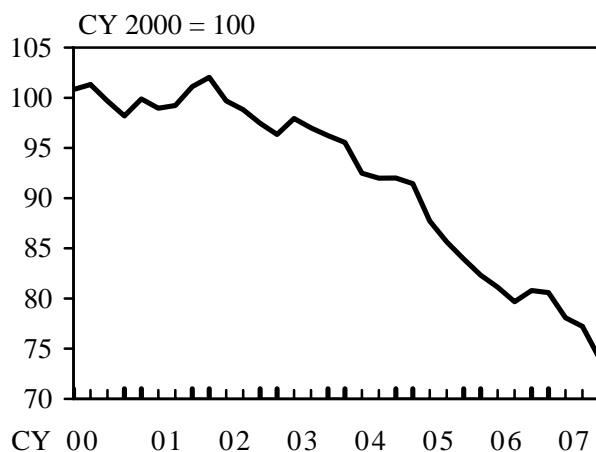
Real GDI = Real GDP + trading gains/losses

Real GNI = Real GDI + net income from the rest of the world

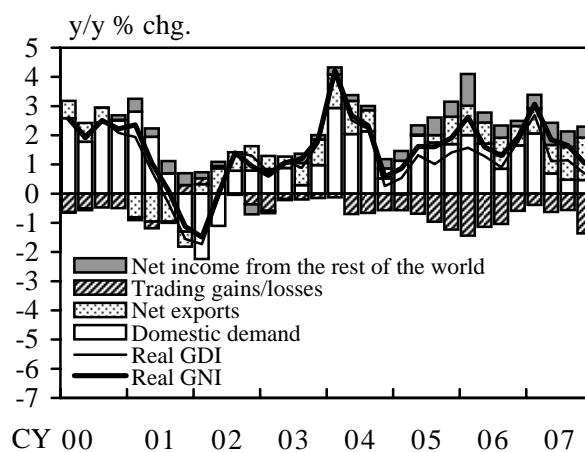
= Real GDP + trading gains/losses + net income from the rest of the world

### (3) Current Situation

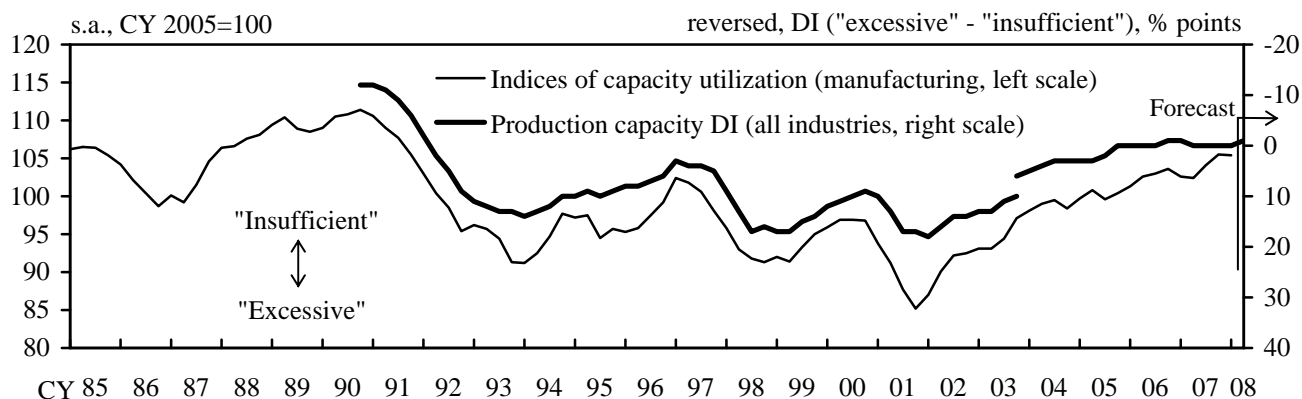
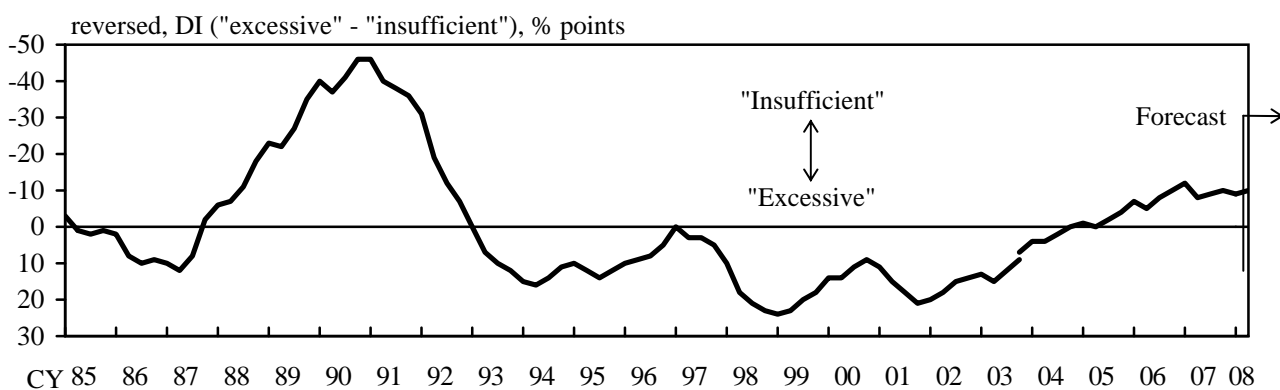
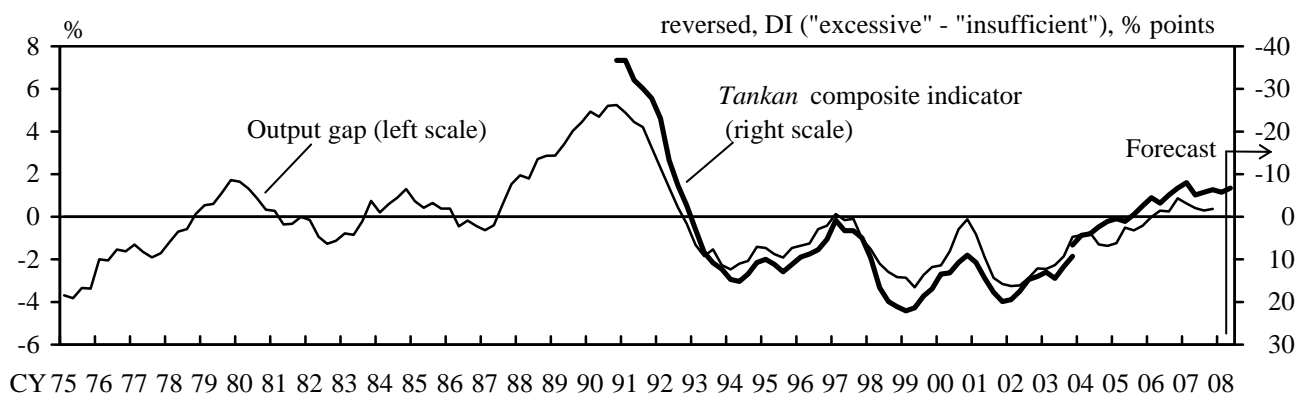
#### (a) Terms of Trade Index



#### (b) Real GDI and Real GNI



## Resource Utilization

(1) Production Capacity DI (*Tankan*) and Indices of Capacity Utilization<sup>1,2</sup>(2) Employment Conditions DI (*Tankan*)<sup>1</sup>(3) *Tankan* Composite Indicator and Output Gap<sup>1,3</sup>

Notes: 1. Production capacity DI and employment conditions DI are based on all-size enterprises.

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

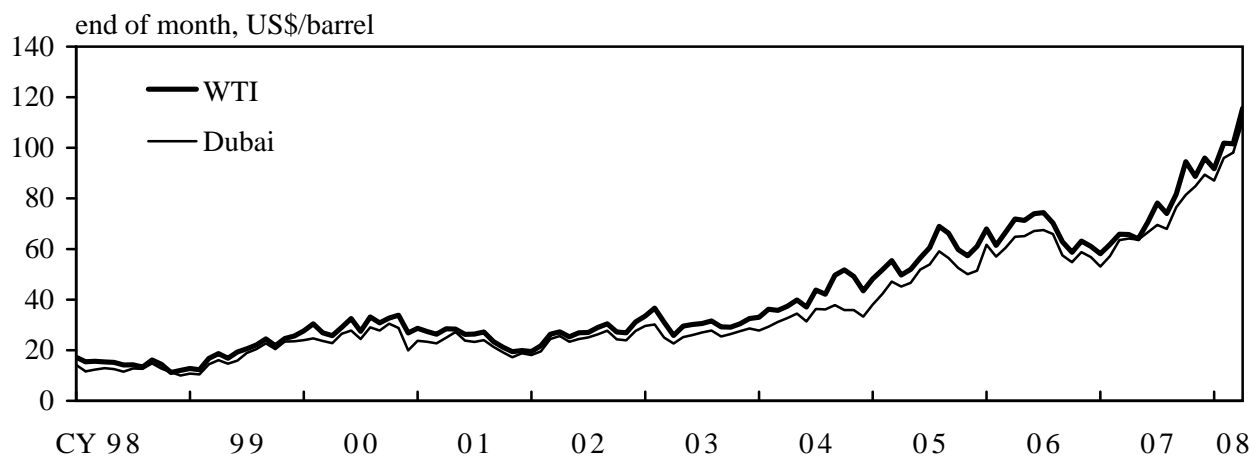
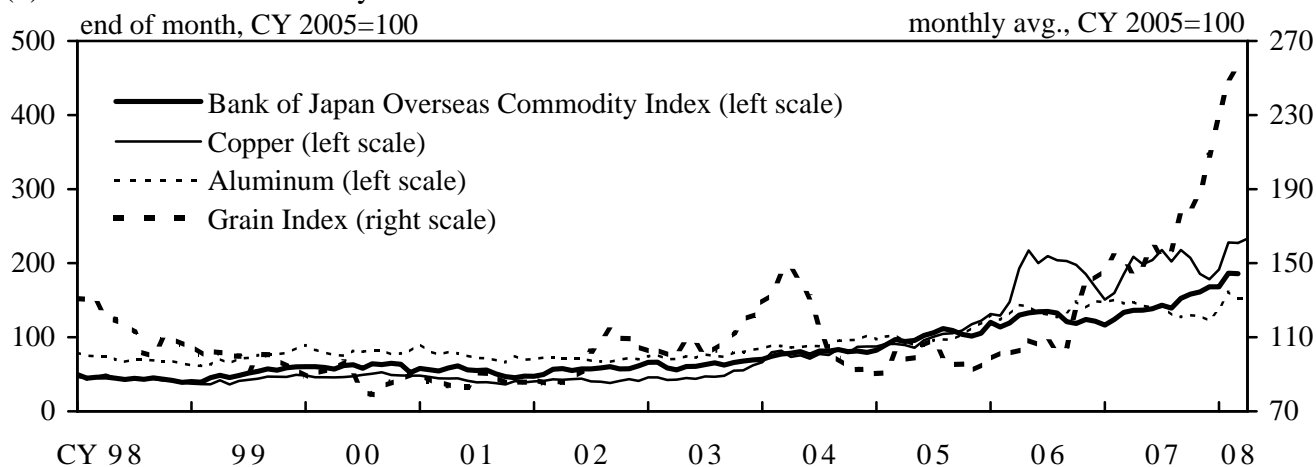
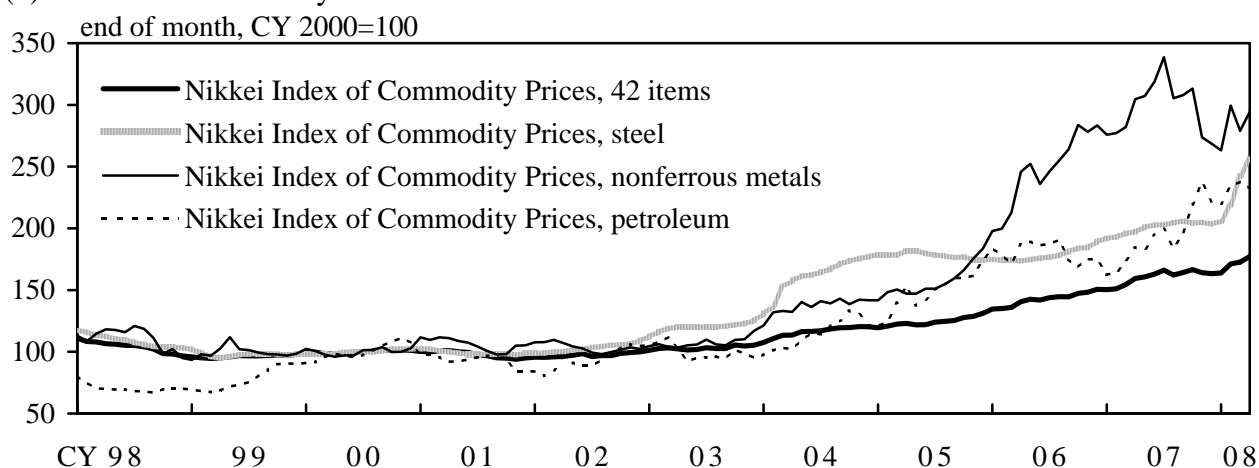
2. Figure of indices of capacity utilization for 2008/Q1 is the January-February average.

3. The *Tankan* composite indicator is calculated as the average of the diffusion indices of production capacity and employment conditions, weighted by capital and labor shares in the national accounts (FY 1990-2006 average).

The output gap is estimated by the Research and Statistics Department, Bank of Japan.

Sources: Cabinet Office, "National Accounts"; Cabinet Office and Ministry of Finance, "Business Outlook Survey"; Ministry of Internal Affairs and Communications, "Labour Force Survey"; Ministry of Health, Labour and Welfare, "Monthly Labour Survey," "Report on Employment Service"; Ministry of Economy, Trade and Industry, "Indices of Industrial Production"; Bank of Japan, "*Tankan*, Short-Term Economic Survey of Enterprises in Japan," etc.

## Commodity Prices

(1) Oil Prices<sup>1</sup>(2) International Commodity Prices<sup>1,2</sup>(3) Domestic Commodity Prices<sup>1,3</sup>

Notes: 1. Figures for April 2008 are the latest available data.

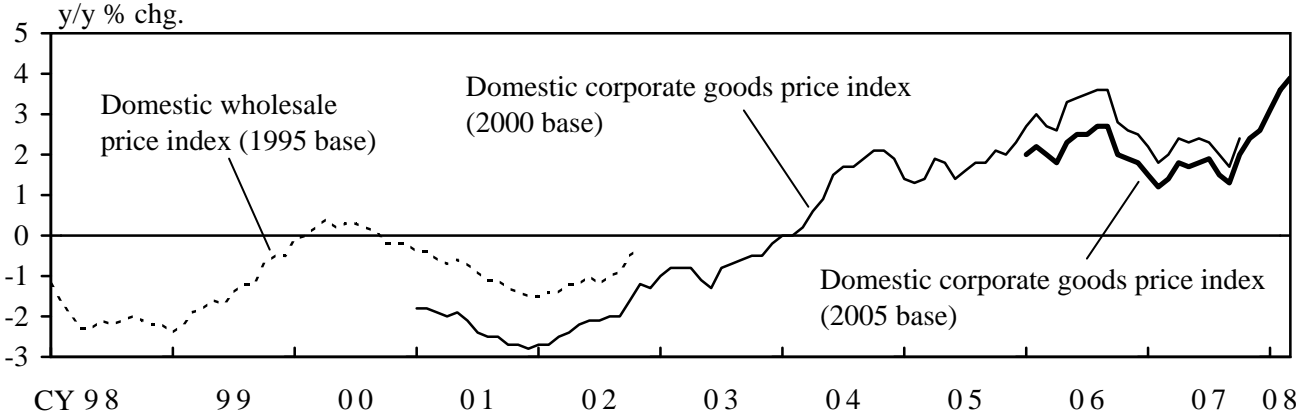
2. The Grain Index is the weighted average of prices of three selected items (wheat, soybeans, corn) in overseas commodity markets. The weights are based on Japanese Import Value in the Trade Statistics of Japan.

3. Steel: steel bars, H sections, steel plates, etc. Nonferrous metals: unwrought copper, unwrought aluminum, etc. Petroleum: gasoline, kerosene, gas oil, fuel oil C.

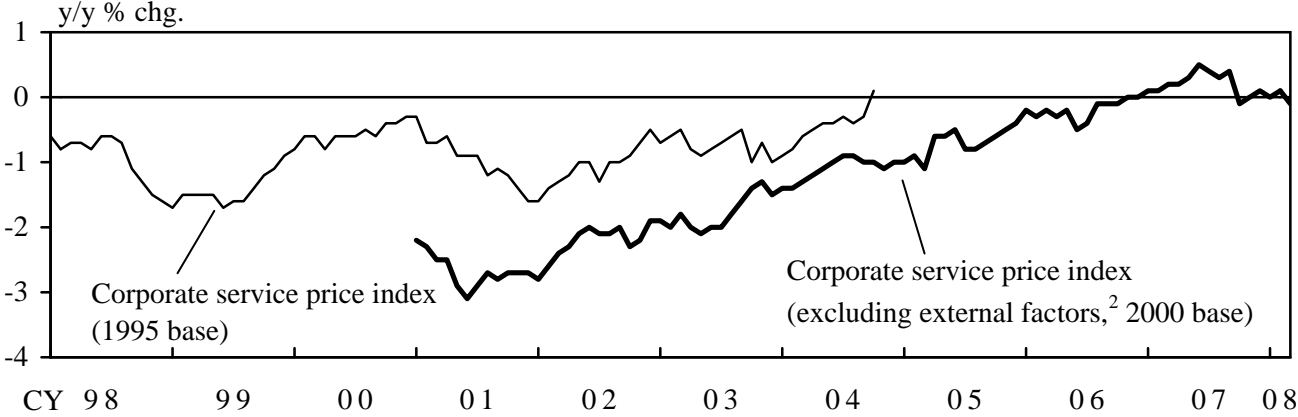
Sources: Bank of Japan, "Bank of Japan Overseas Commodity Index"; *The Nihon Keizai Shimbun*, etc.

# Prices

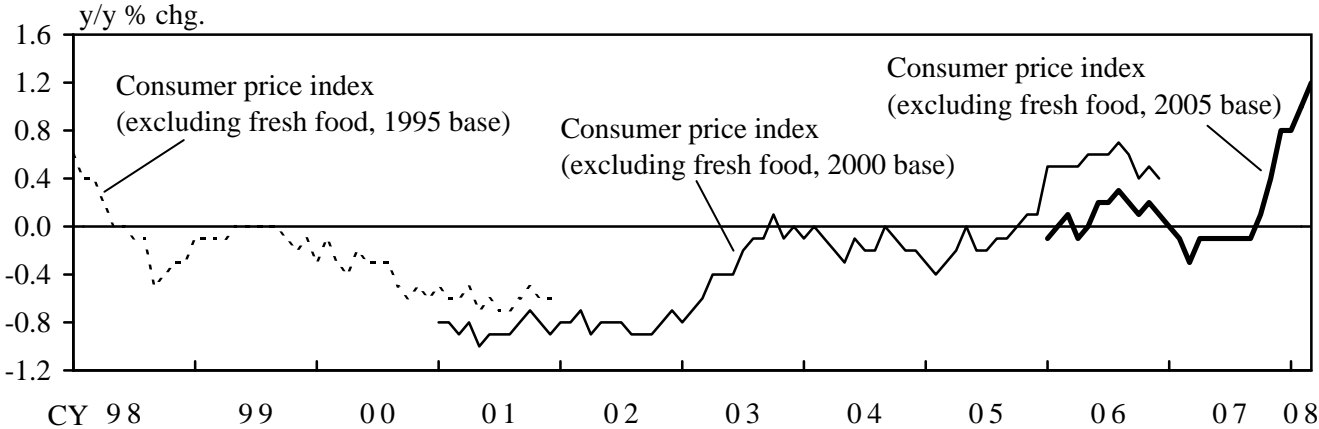
(1) Domestic Corporate Goods Price Index<sup>1</sup>



(2) Corporate Service Price Index<sup>1</sup>



(3) Consumer Price Index<sup>1</sup>

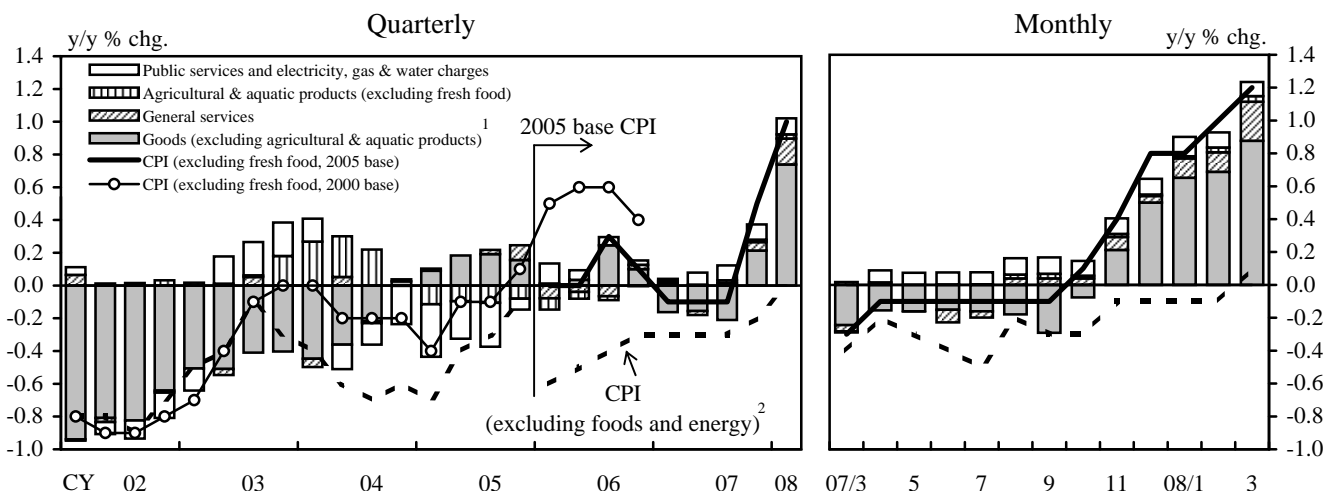


Notes: 1. Adjusted to exclude the effects of changes in consumption tax rate.  
 2. External factors: international air passenger transportation, ocean liner, ocean tramper, ocean tanker, oceangoing ship chartering services, and international air freight transportation.

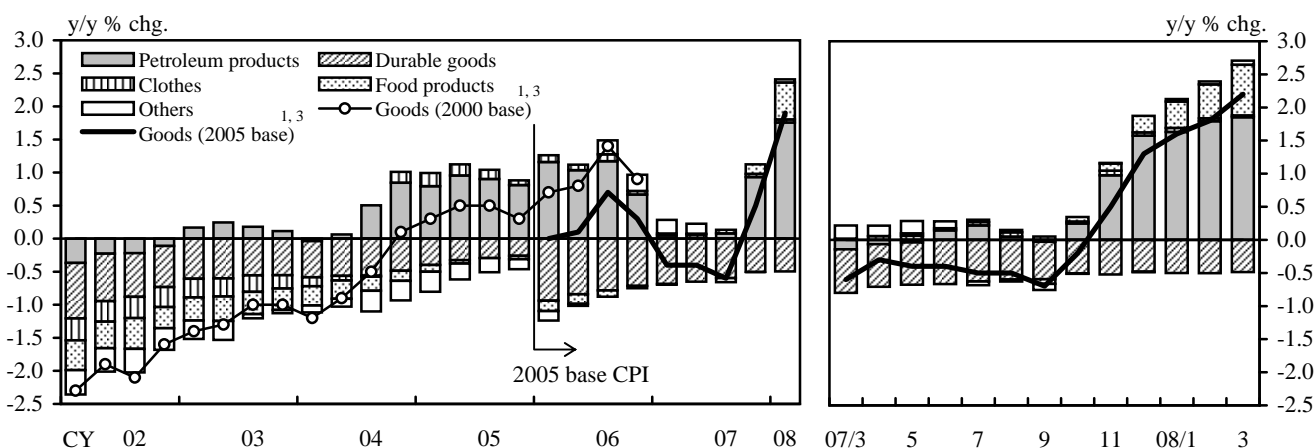
Sources: Ministry of Internal Affairs and Communications, "Consumer Price Index"; Bank of Japan, "Corporate Goods Price Index," "Wholesale Price Index," "Corporate Service Price Index."

# Consumer Price Index

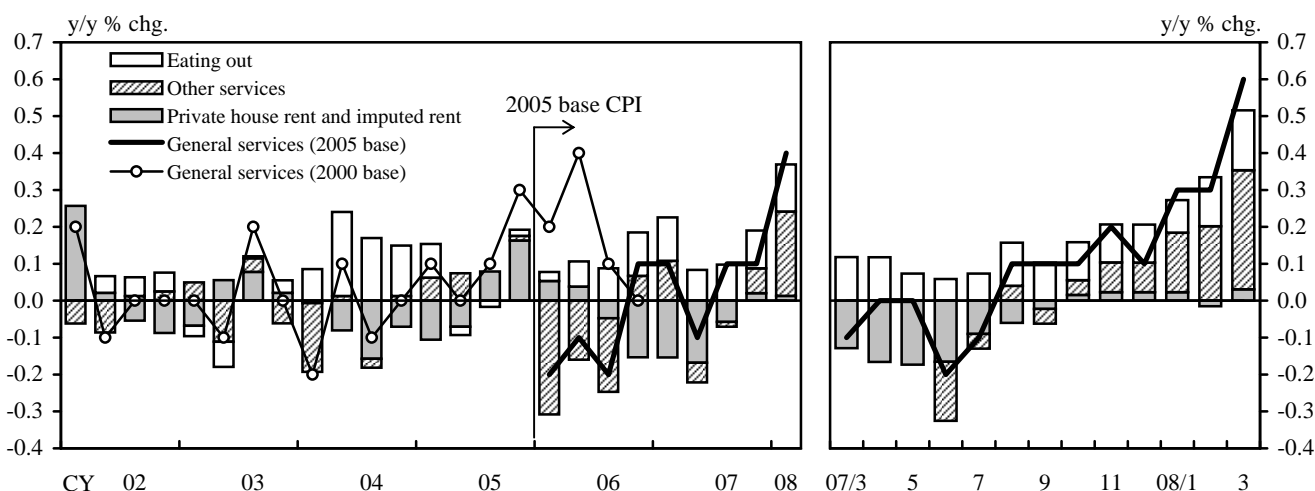
(1) Consumer Price Index (Excluding Fresh Food)



(2) Goods (Excluding Agricultural & Aquatic Products)<sup>1</sup>



(3) General Services



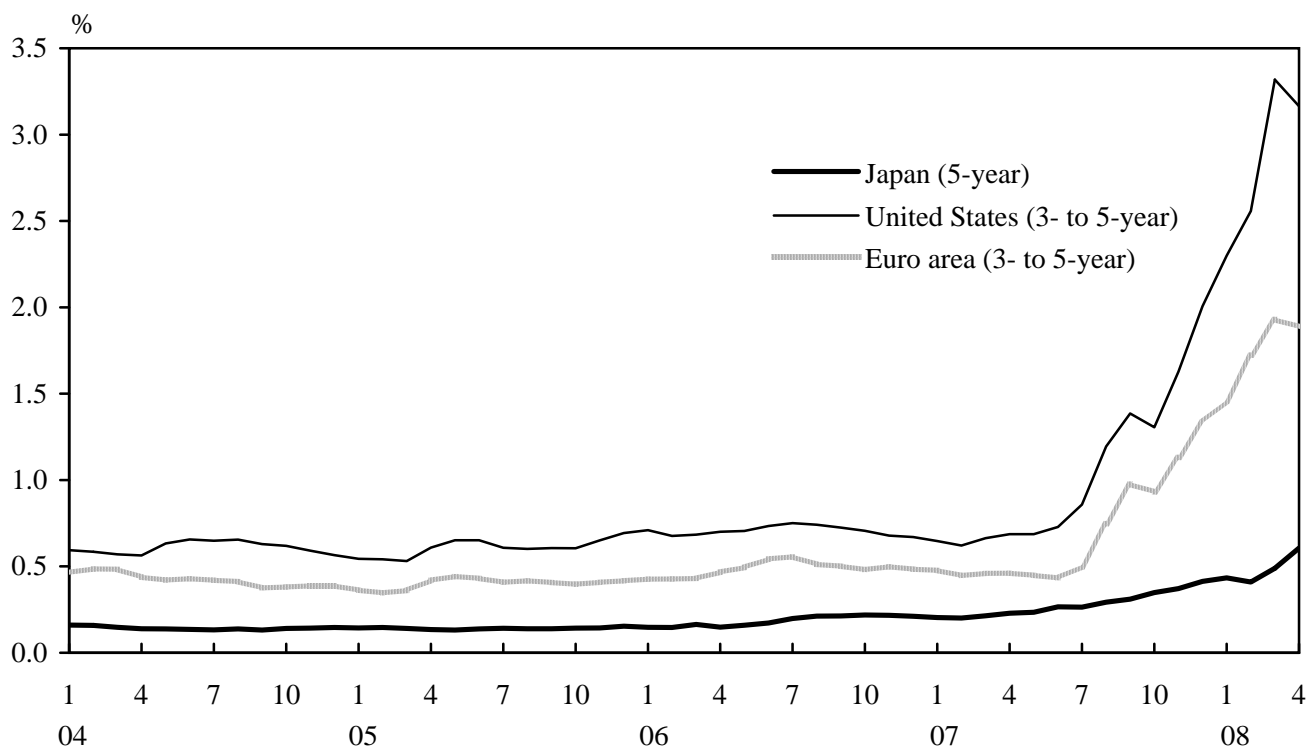
- Notes: 1. The items are basically the same as the definition published by the Ministry of Internal Affairs and Communications. However, electricity, gas & water charges are excluded from goods.  
 2. Alcoholic beverages are excluded from foods.  
 Energy: electricity, gas manufactured & piped, liquefied propane, kerosene, and gasoline.  
 3. Excluding agricultural & aquatic products.

Source: Ministry of Internal Affairs and Communications, "Consumer Price Index."



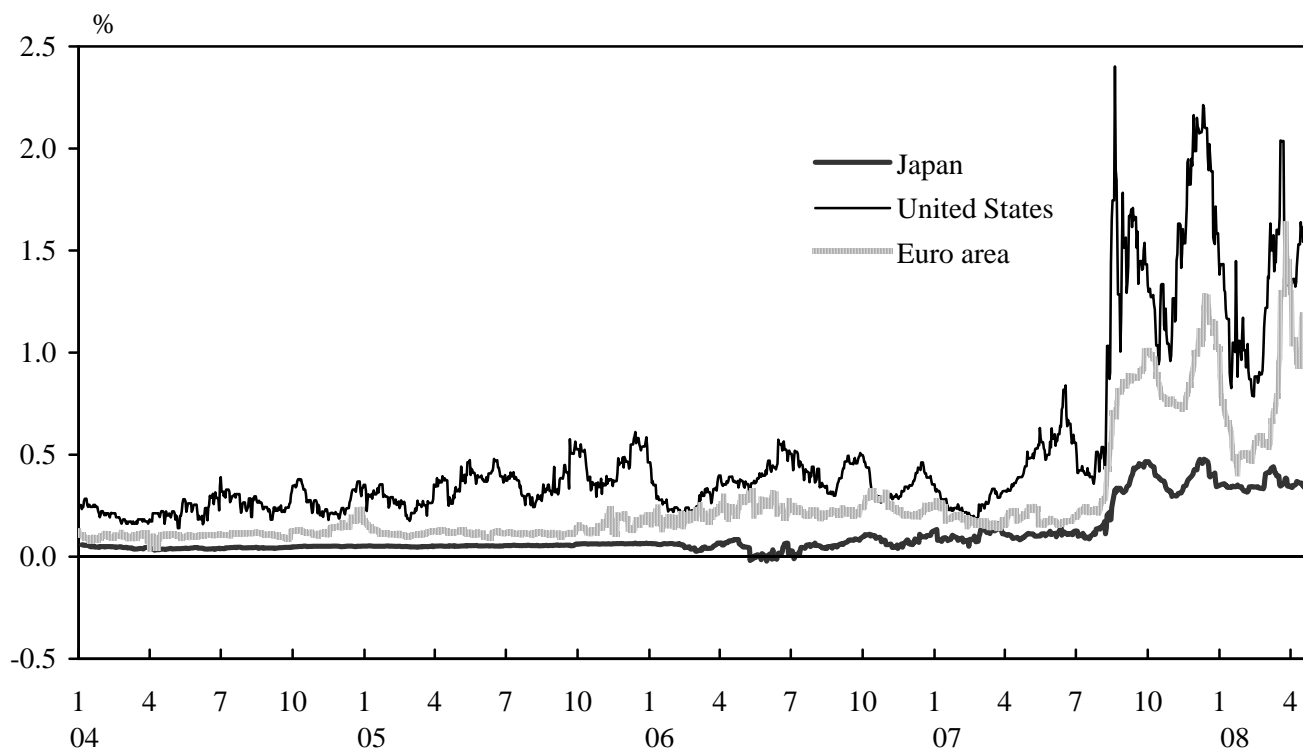
## Credit Spread in Major Economies

### (1) Spread for Corporate Bonds in Major Economies (A-Rated)



- Notes: 1. The spread for corporate bonds in April 2008 is the averages up to the latest available data.  
 2. The spread for corporate bonds is the corporate bond yield minus the government bond yield.  
 3. The indicated rating of corporate bonds is of Moody's and S&P.

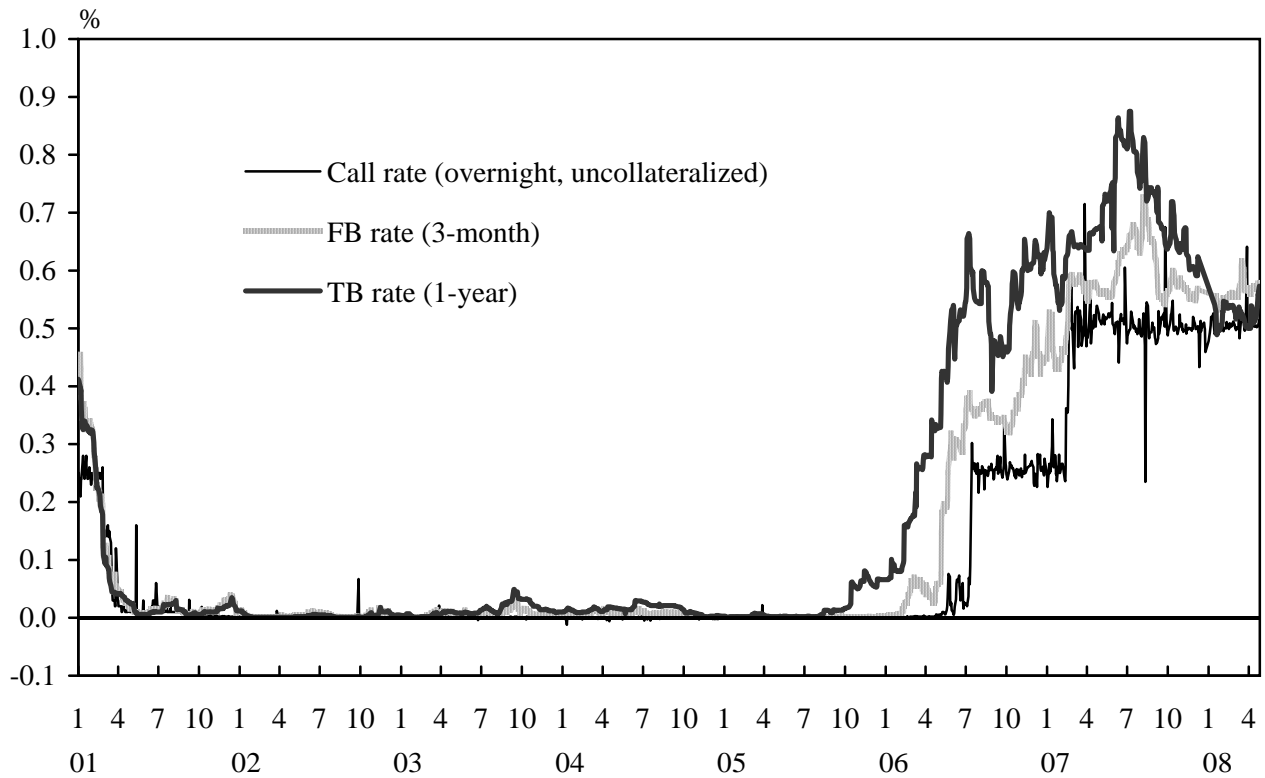
### (2) Spread for Term Instruments in Major Economies (LIBOR - TB/FB, 3-Month)



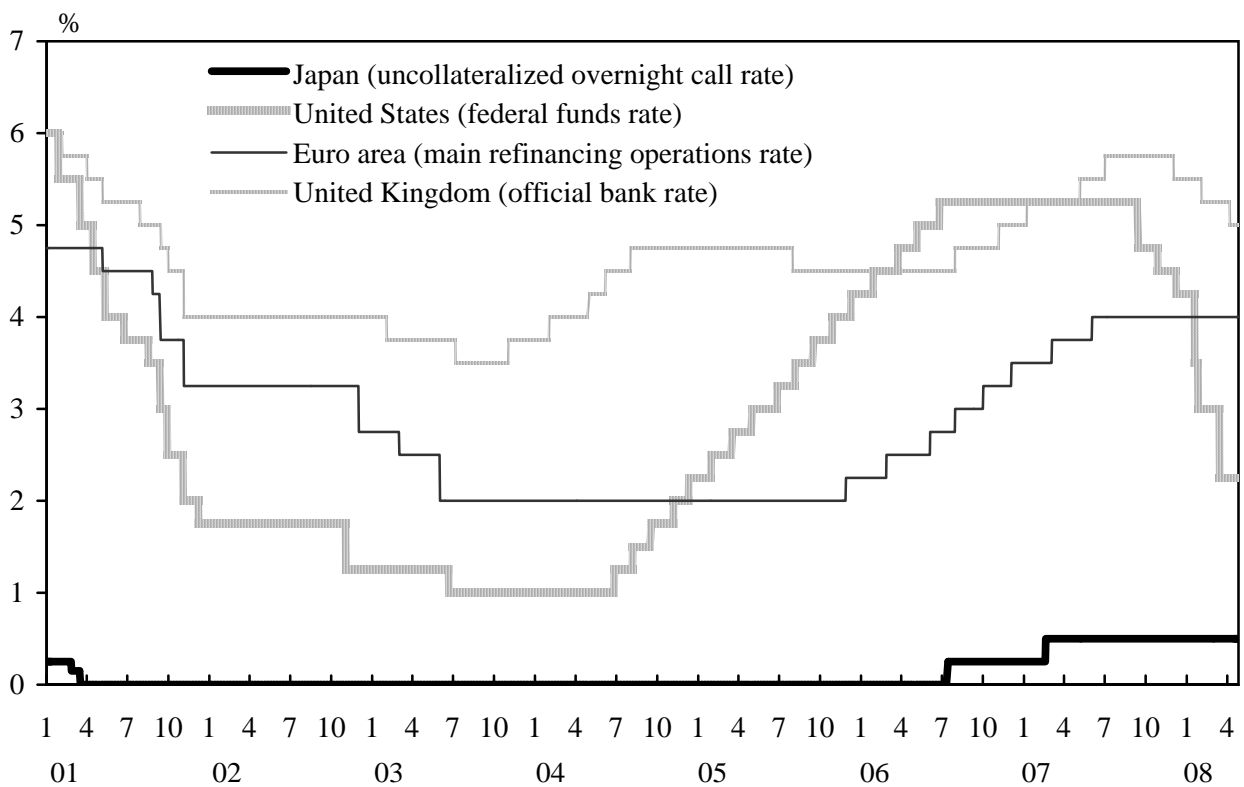
Sources: Japan Securities Dealers Association; Merrill Lynch; Bloomberg; Japan Bond Trading Co., Ltd.

## Short-Term Interest Rates

(1) Short-Term Interest Rates



(2) Policy Interest Rates in Major Economies

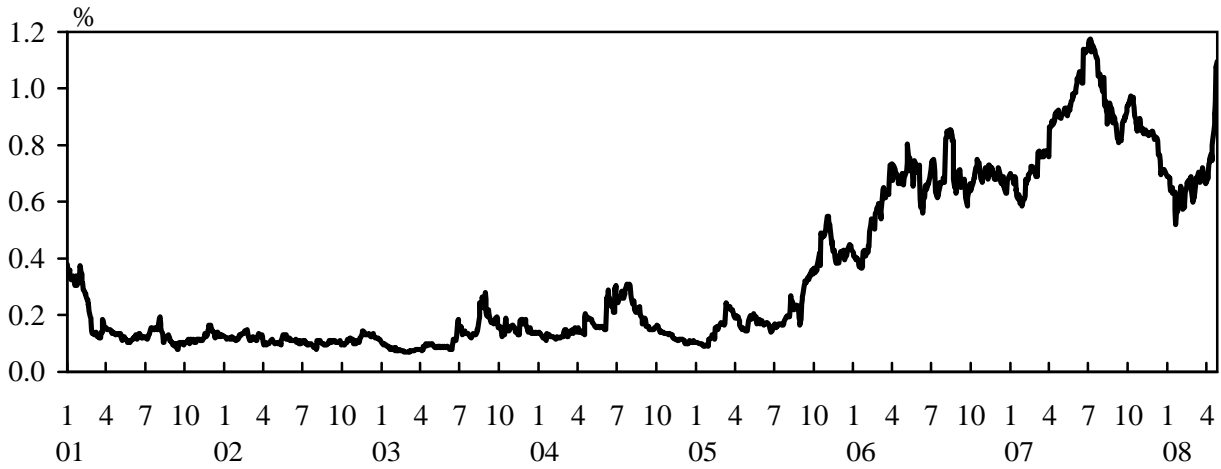


Note: The policy interest rate of Japan is considered zero percent, while the operating target of money market operations was the outstanding balance of current accounts at the Bank of Japan.

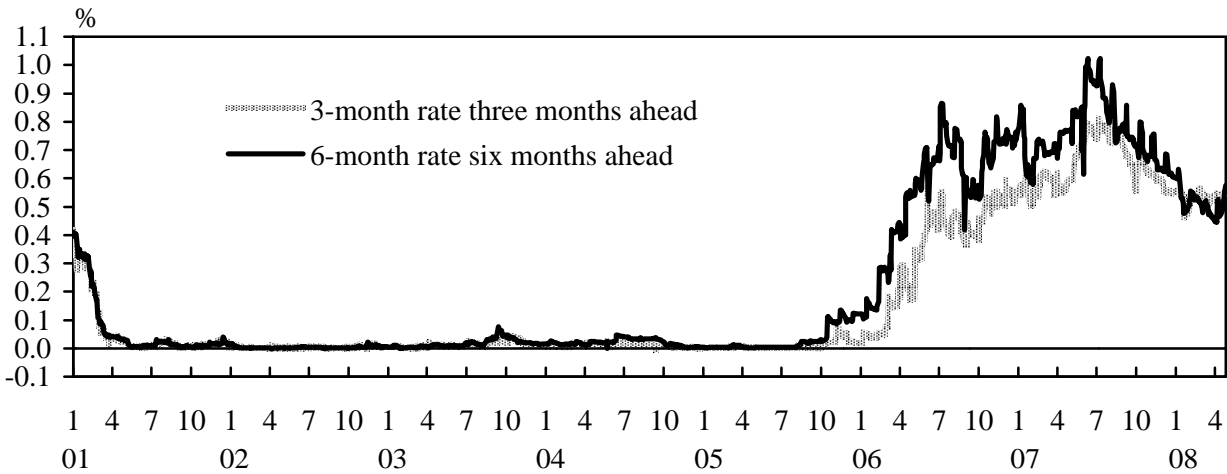
Sources: Bank of Japan; other central banks; Bloomberg.

## Market Participants' Expectations on Interest Rates in the Future

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

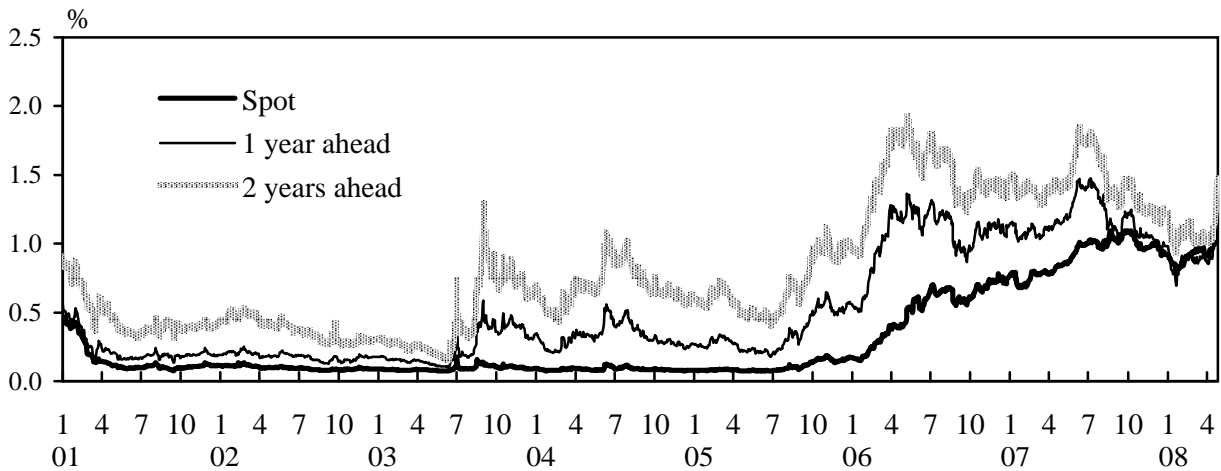


(2) Implied Forward Rates (3-Month, 6-Month)



Note: Calculated from the FB rate (3-month) and TB rates (6-month, 1-year).

(3) Implied Forward Rates (1-Year)

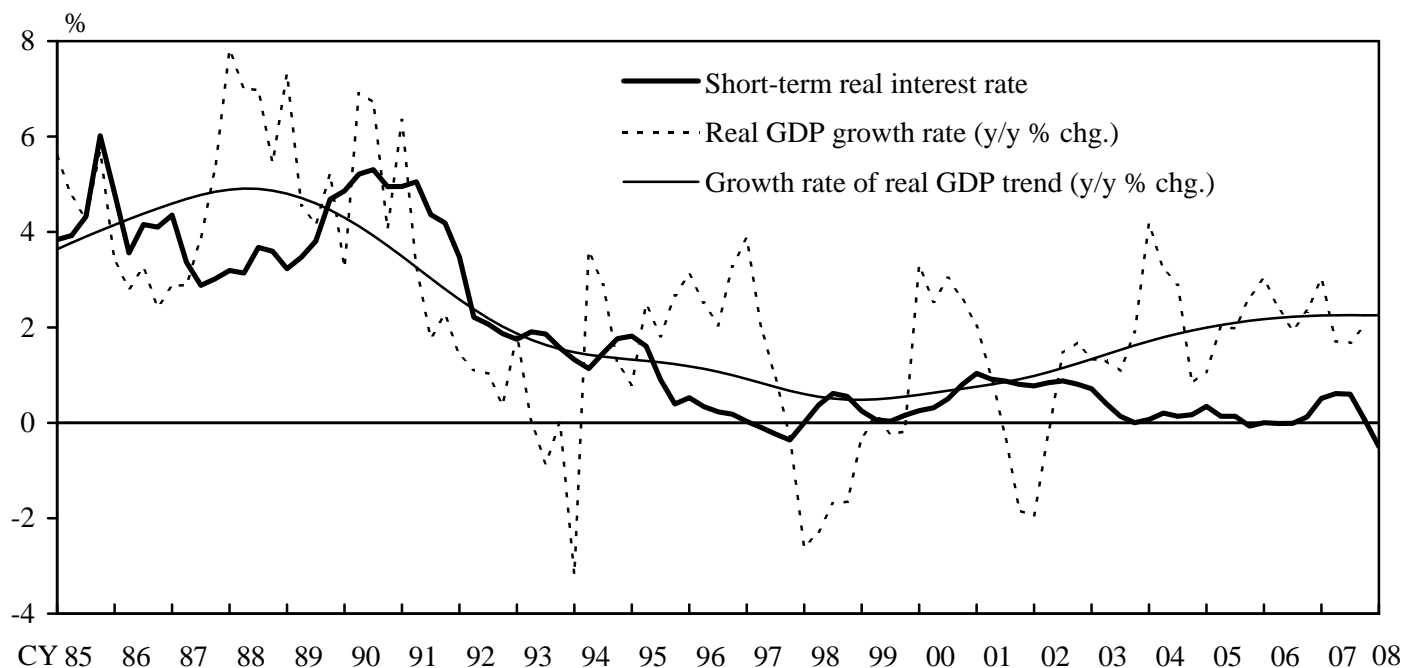


Note: Calculated from yen-yen swap rates.

Sources: Tokyo Financial Exchange; Reuters; Bloomberg.

## Interest Rates and Economic Activity

### (1) Short-Term Real Interest Rate and Real GDP Growth Rate

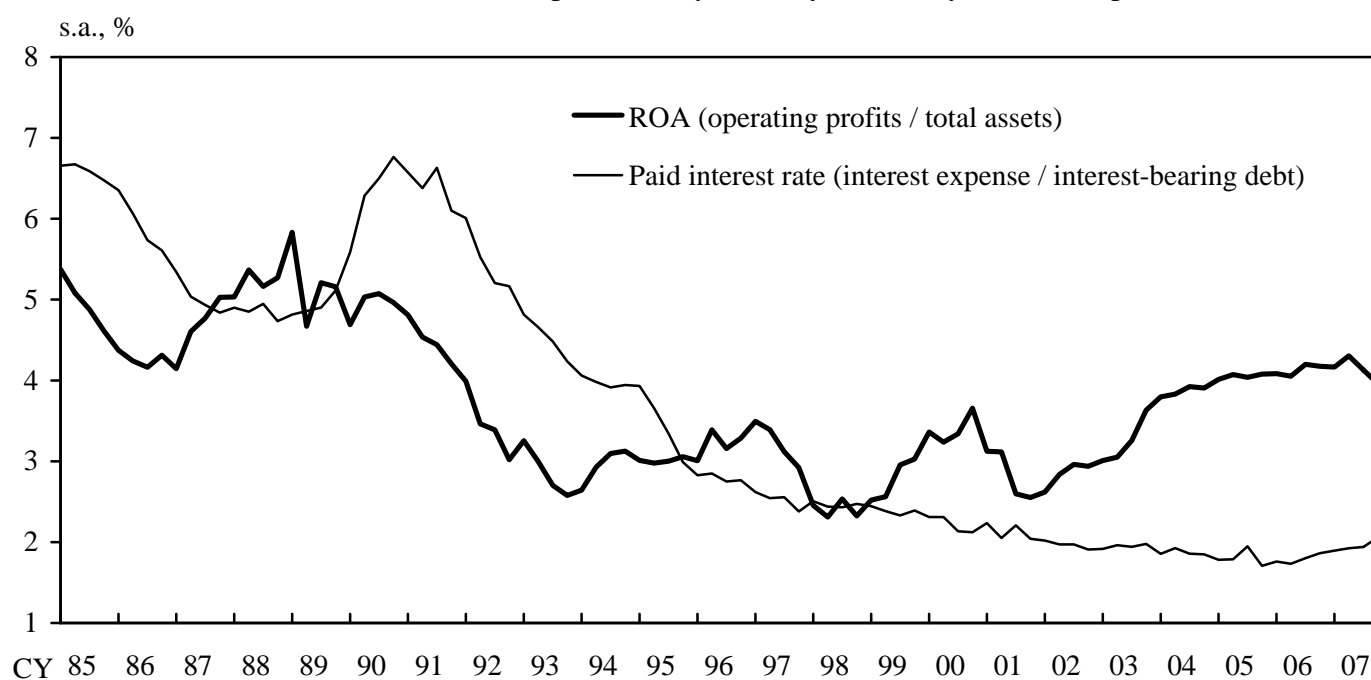


Notes: 1. Short-term real interest rate = call rate (overnight, uncollateralized) - y/y % chg. in the consumer price index (excluding fresh food)

2. Real GDP trend is calculated by applying the HP filter.

### (2) ROA and Paid Interest Rate

("Financial Statements Statistics of Corporations by Industry, Quarterly," All Enterprises)

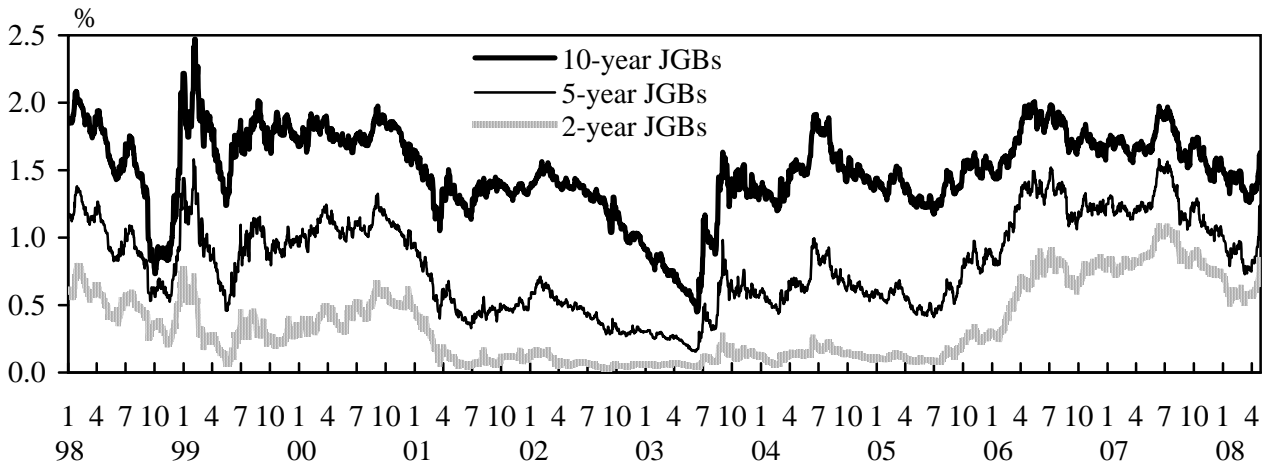


Note: Interest-bearing debt = long- and short-term borrowings + corporate bonds + bills receivable discounted outstanding

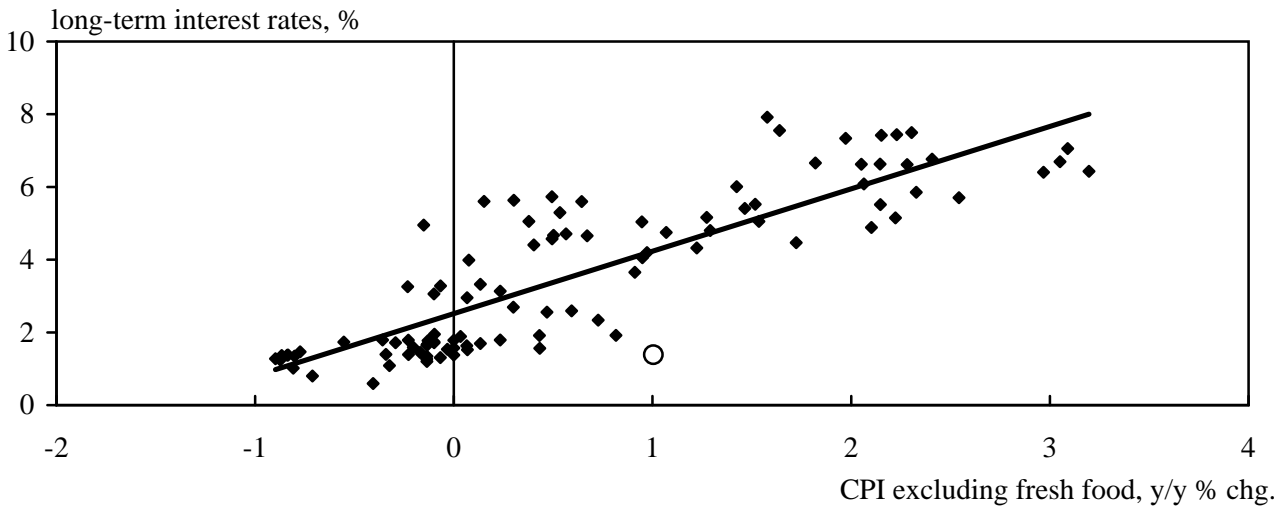
Sources: Cabinet Office, "National Accounts"; Ministry of Internal Affairs and Communications, "Consumer Price Index"; Ministry of Finance, "Financial Statements Statistics of Corporations by Industry, Quarterly"; Bank of Japan.

## Long-Term Interest Rates

(1) Government Bond Yields

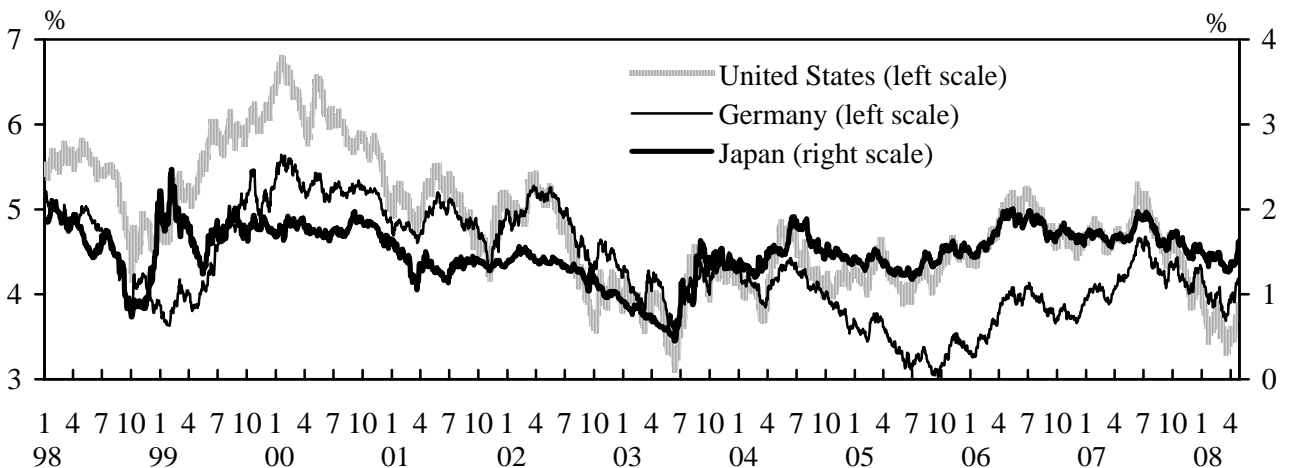


(2) Long-Term Interest Rates and Change in the Consumer Price Index



- Notes: 1. Long-term interest rates are 10-year JGB yields.
- 2. The CPI is adjusted to exclude the effects of changes in consumption tax rate.
- 3. The sample period is 1983/Q3-2008/Q1. The white circle indicates the latest data.

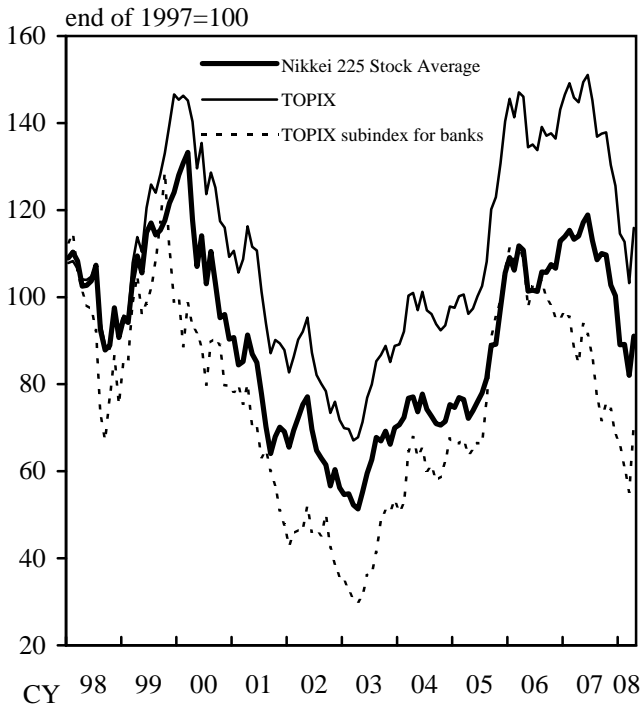
(3) Long-Term Interest Rates in Major Countries (10-Year Government Bond Yields)



Sources: Ministry of Internal Affairs and Communications, "Consumer Price Index"; Japan Bond Trading Co., Ltd.; Bloomberg.

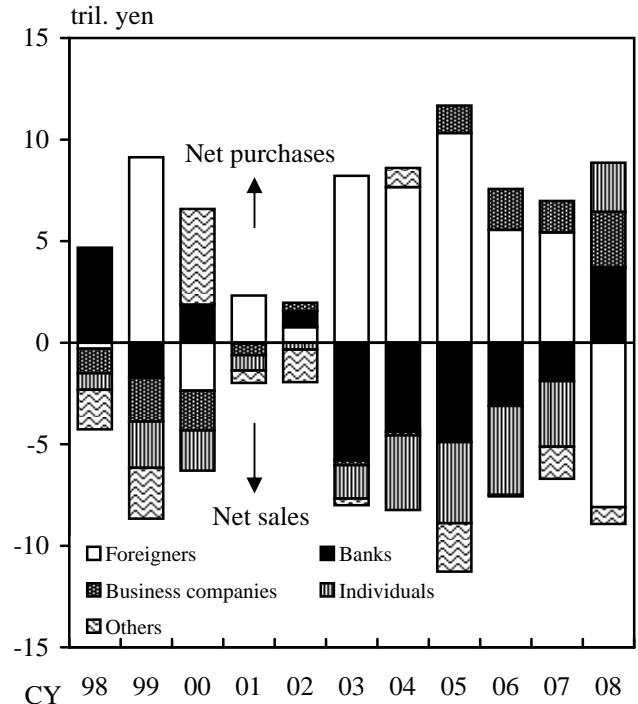
## Stock Prices

(1) Stock Prices



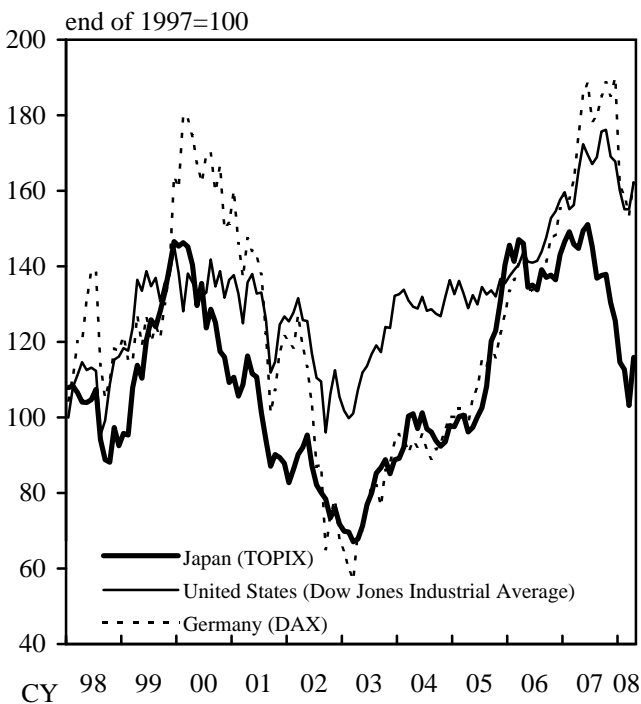
Note: Data are at end of month. Figures for April 2008 are the latest available data.

(2) Trading Volume by Investor Type



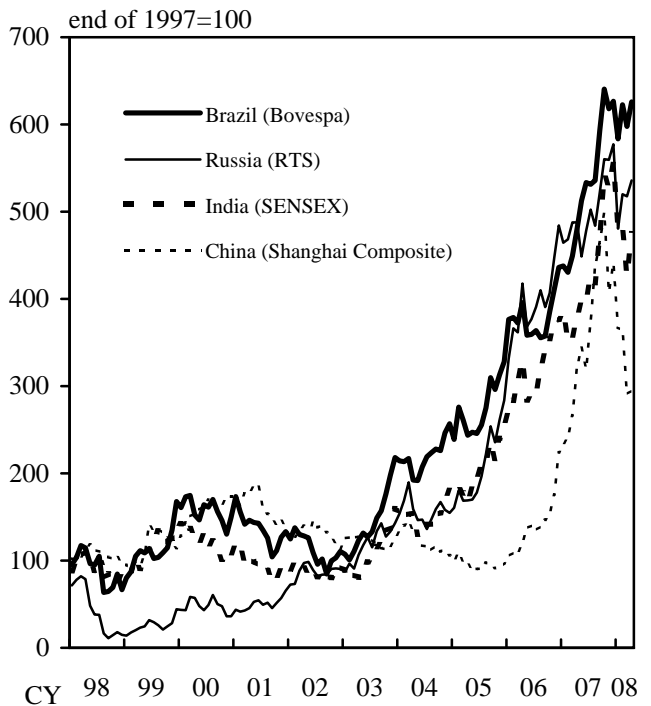
Notes: 1. Figures are the sum of the first and second sections of the Tokyo, Osaka, and Nagoya stock exchanges.  
2. Figures for 2008 are those of January-March in terms of annual amount.

(3) Stock Prices in Major Countries



Note: Data are at end of month. Figures for April 2008 are the latest available data.

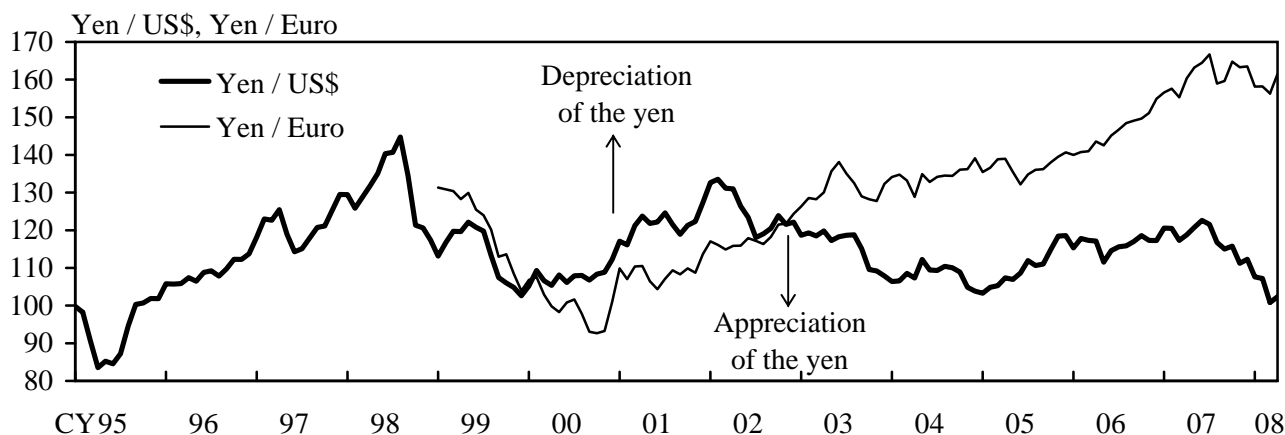
(4) Stock Prices in the BRIC Economies



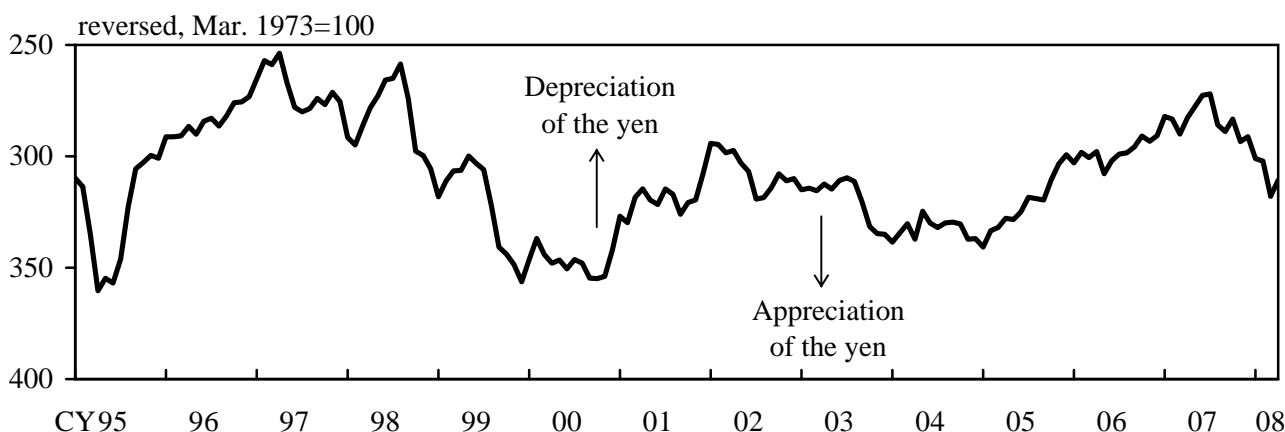
Note: Data are at end of month. Figures for April 2008 are the latest available data.

## Exchange Rates

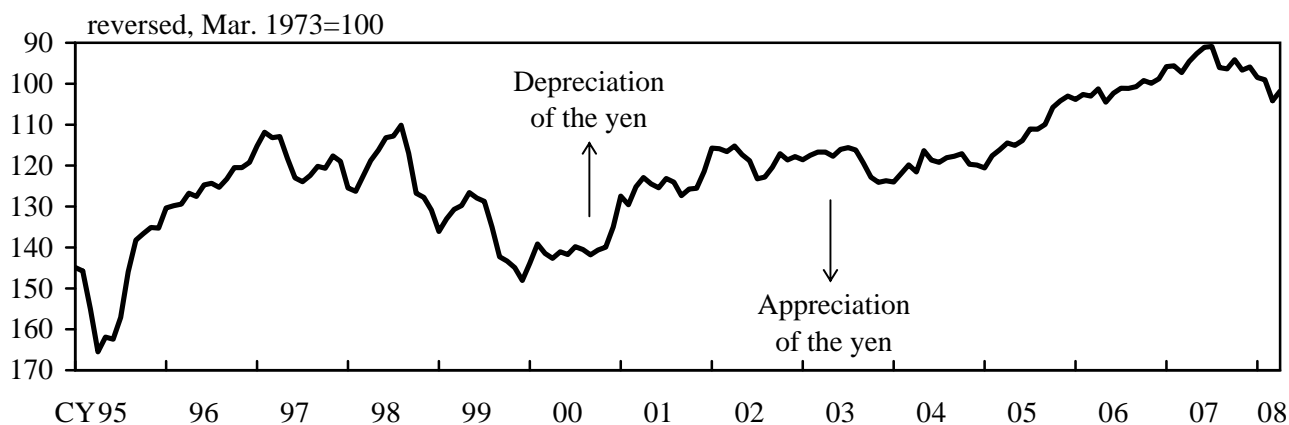
(1) Yen / US\$ and Yen / Euro



(2) Nominal Effective Exchange Rate<sup>2</sup>



(3) Real Effective Exchange Rate<sup>3</sup>



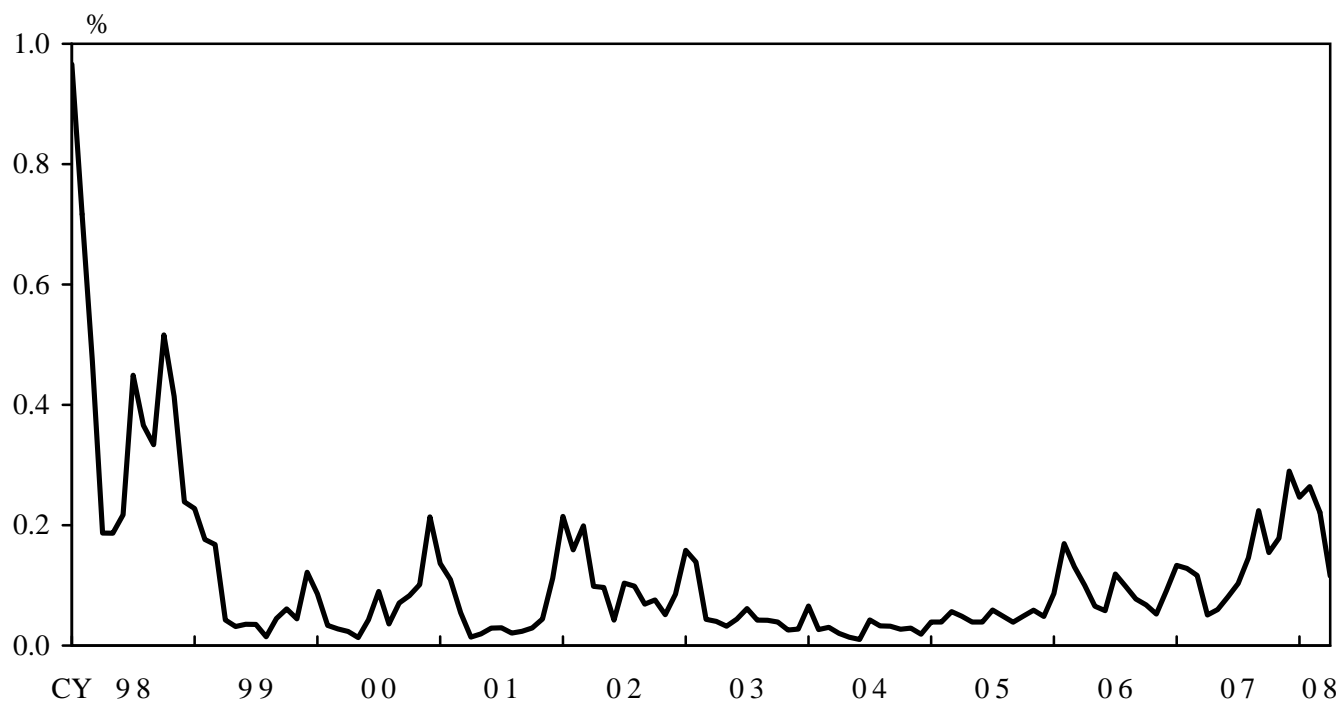
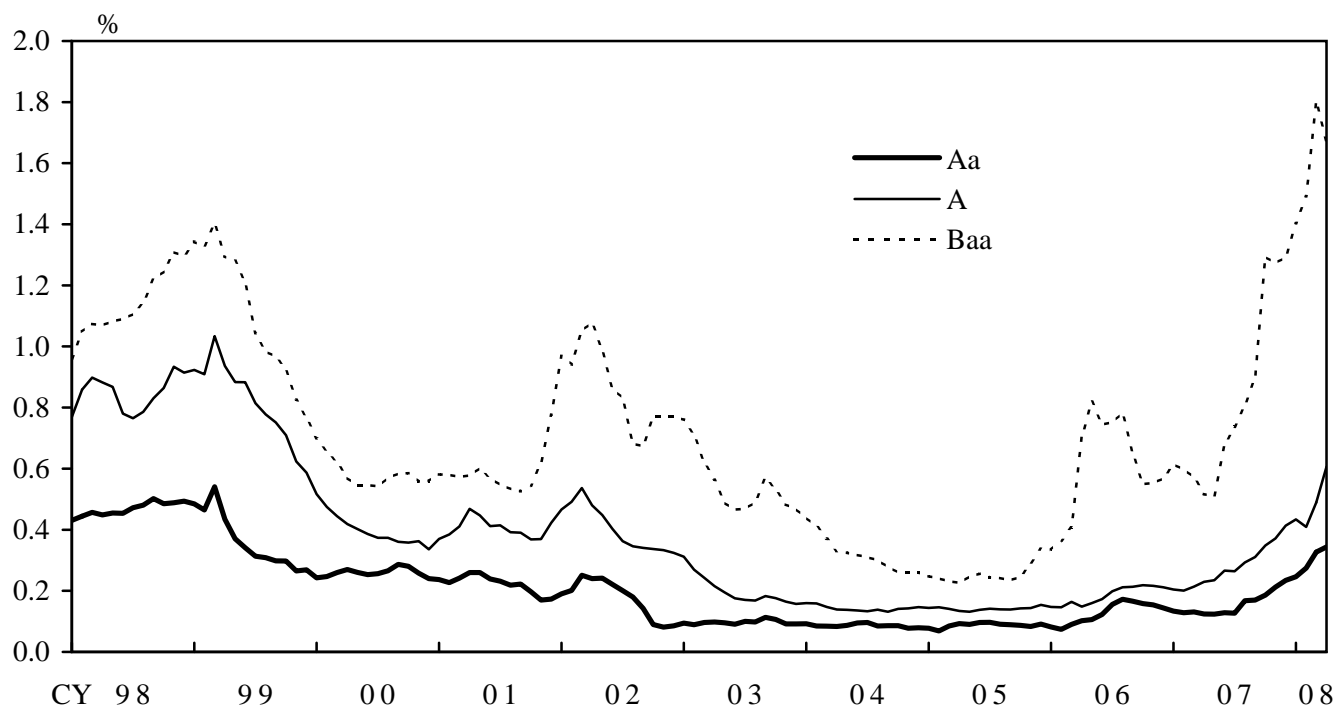
Notes: 1. Monthly average. Figures for April 2008 are averages up to the latest available data.

2. The nominal effective exchange rate is a weighted average of the yen's exchange rates against 15 currencies that have a large share among Japanese total exports.

3. The real effective exchange rate is a weighted average of the yen's real exchange rates against 15 currencies that have a large share among Japanese total exports. The yen's real exchange rates are calculated from the nominal exchange rates and price indexes of the relevant countries.

Source: Bank of Japan.

## Credit Spread in Japan

(1) Spread for Commercial Paper (3-Month)<sup>1,2,3</sup>(2) Spread for Corporate Bonds (5-Year)<sup>3,4,5</sup>

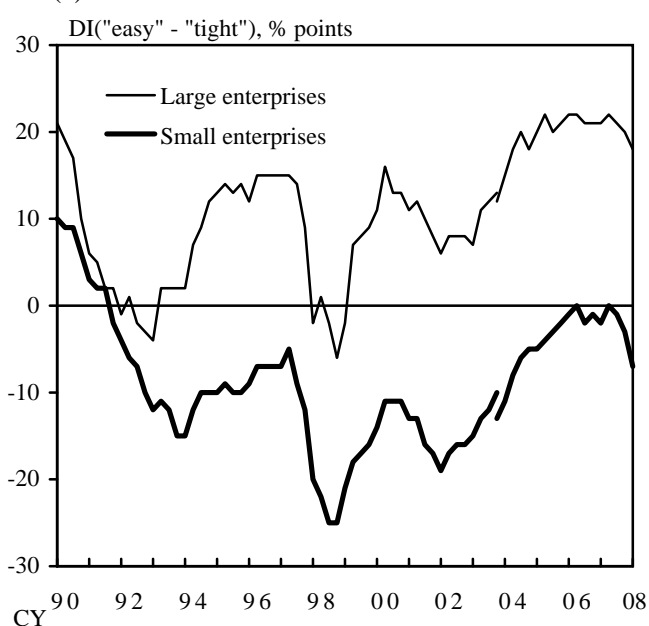
- Notes: 1. The spread for CP is the average issuance rate of CP minus the TB/FB yield.  
 2. CP ratings are A-1 or above.  
 3. The spreads for both CP and corporate bonds in April 2008 are averages up to the latest available data.  
 4. The spread for corporate bonds is the corporate bond yield minus the government bond yield.  
 5. The indicated ratings of corporate bonds are of Moody's.

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

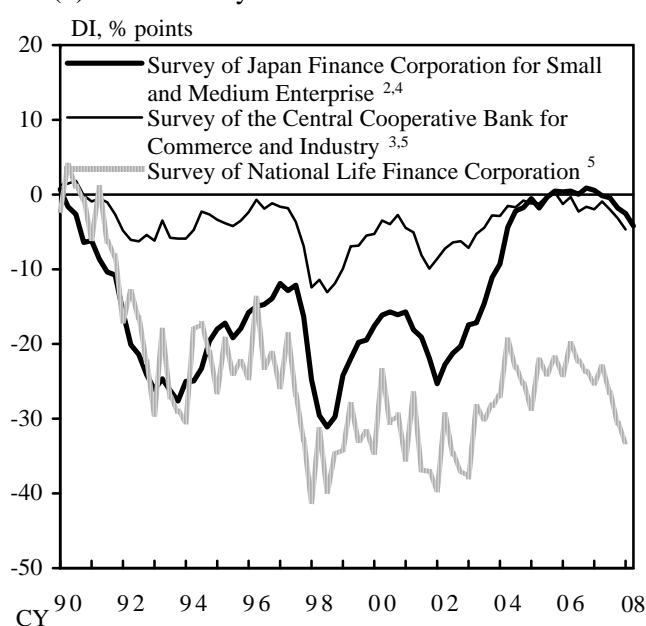


## Corporate Finance-Related Indicators

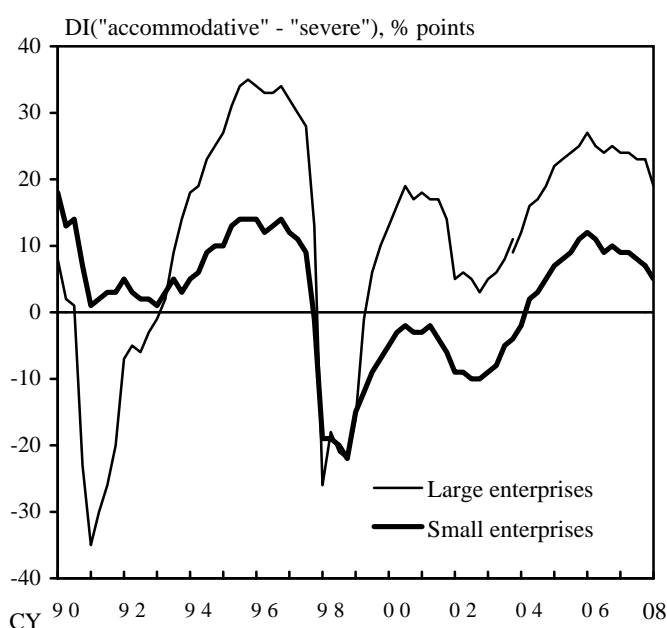
## (1) Financial Position

(a) *Tankan*

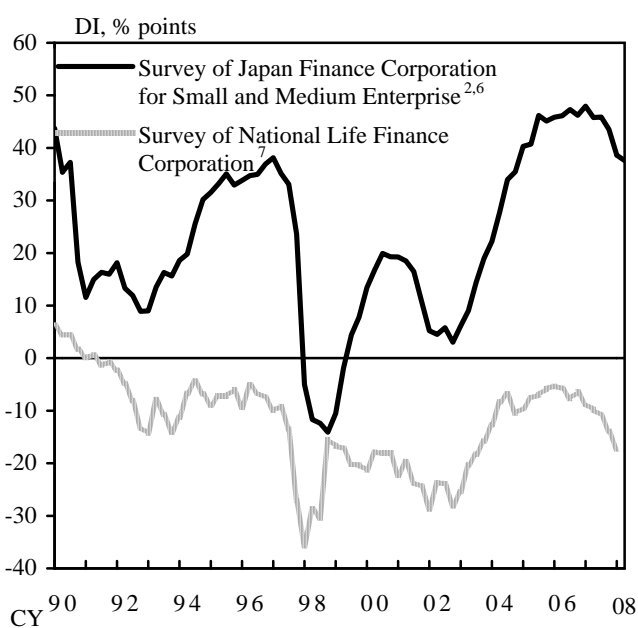
## (b) Other Surveys



## (2) Lending Attitude of Financial Institutions as Perceived by Firms

(a) *Tankan*

## (b) Other Surveys



Notes: 1. Data of the *Tankan* are based on all industries. The *Tankan* has been revised from the March 2004 survey.

Figures up to the December 2003 survey are based on the previous data sets. Figures from the December 2003 survey are on a new basis.

2. Figures are quarterly averages of monthly data. Figure for 2008/Q2 is that of April.

3. Figures are quarterly averages of monthly data.

4. DI of "easy" - "tight."

5. DI of "easier" - "tighter."

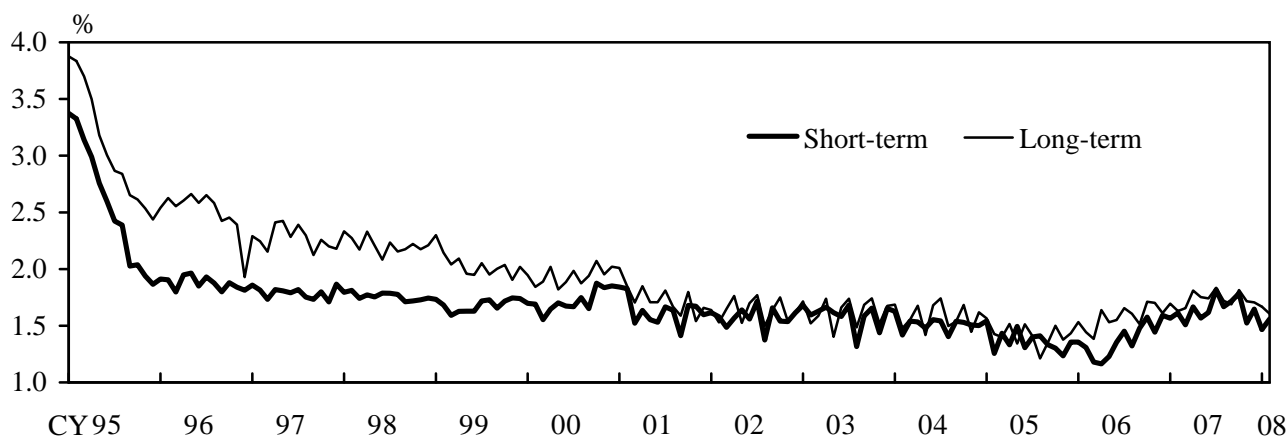
6. DI of "accommodative" - "severe."

7. DI of "more accommodative" - "more severe."

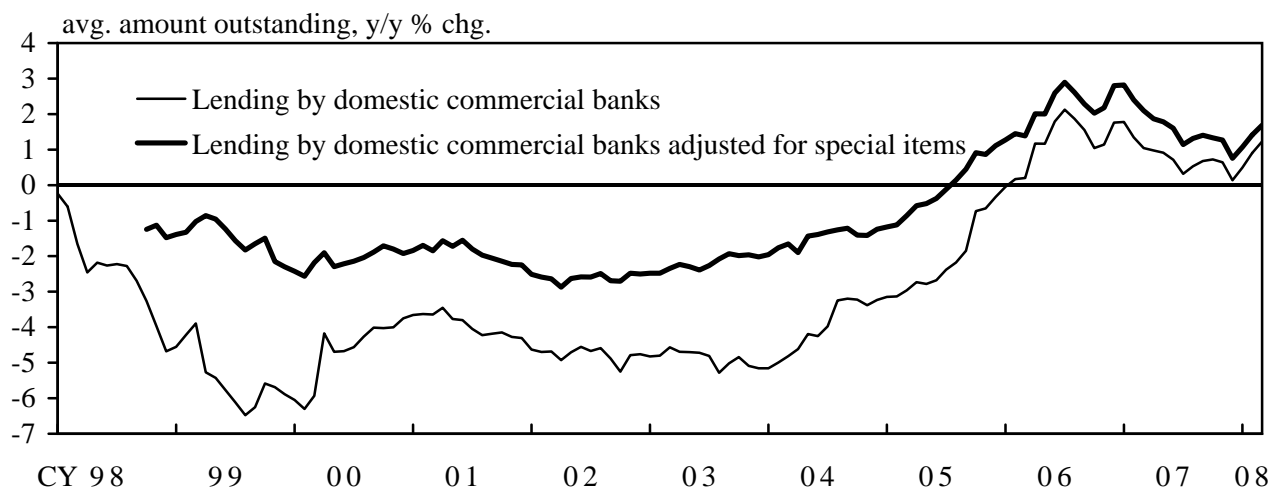
Sources: Bank of Japan, "*Tankan*, Short-Term Economic Survey of Enterprises in Japan"; Japan Finance Corporation for Small and Medium Enterprise, "Monthly Survey of Small Businesses in Japan"; The Central Cooperative Bank for Commerce and Industry, "Business Survey Index for Small and Medium-Sized Businesses"; National Life Finance Corporation, "Quarterly Survey of Small Businesses in Japan."

## Bank Lending and Money Stock

(1) Average Contracted Interest Rates on New Loans and Discounts

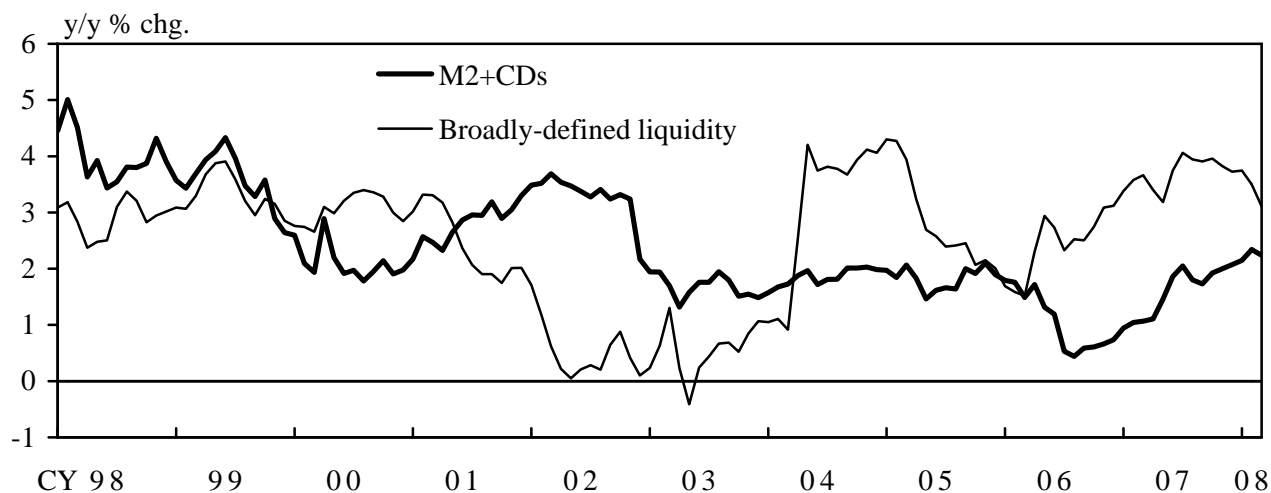


(2) Lending by Domestic Commercial Banks



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

(3) Money Stock

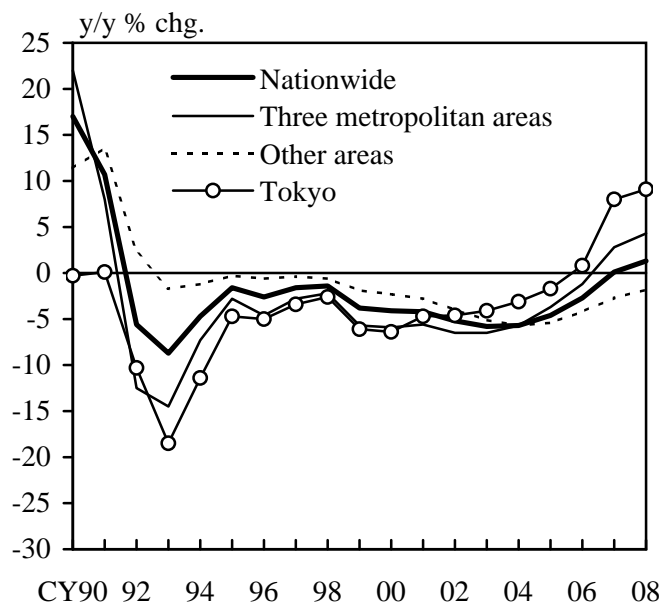


Source: Bank of Japan, "Principal Figures of Financial Institutions," "Money Stock," "Average Contracted Interest Rates on Loans and Discounts."

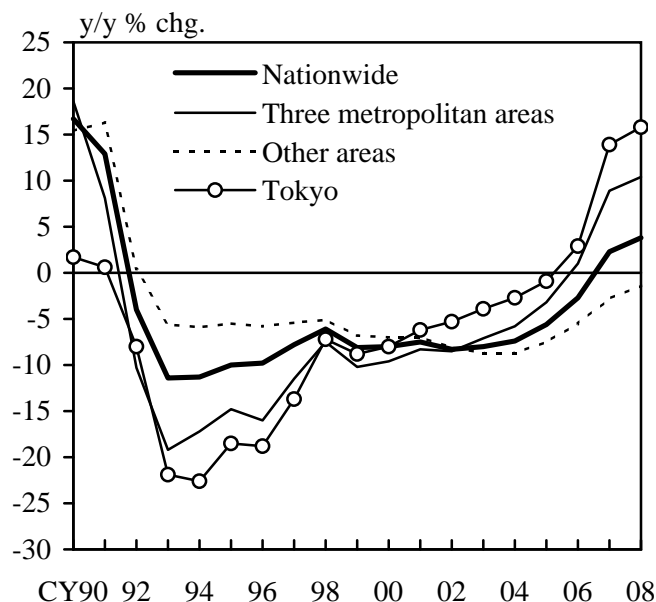
## Land Prices

### (1) Land Price Publication (As of January 1)

#### (a) Residential Land



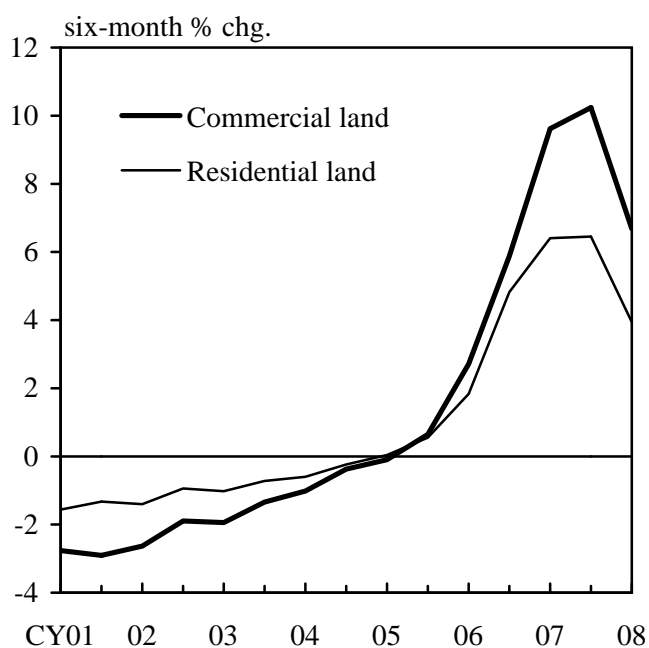
#### (b) Commercial Land



Note: Three metropolitan areas: the Tokyo area (Tokyo, Kanagawa, Saitama, Chiba, and Ibaraki prefectures), the Osaka area (Osaka, Hyogo, Kyoto, and Nara prefectures), and the Nagoya area (Aichi and Mie prefectures). Other areas: Other than the three metropolitan areas.

### (2) Land Prices in 23 Wards of Tokyo

#### (a) Developments since 2001



#### (b) Recent Developments

	% chg.	
	Commercial land	Residential land
Jan. 1, 2007-Jan. 1, 2008	17.7	10.9
Jan. 1, 2007-July 1, 2007	10.3	6.8
July 1, 2007-Jan. 1, 2008	6.7	3.8

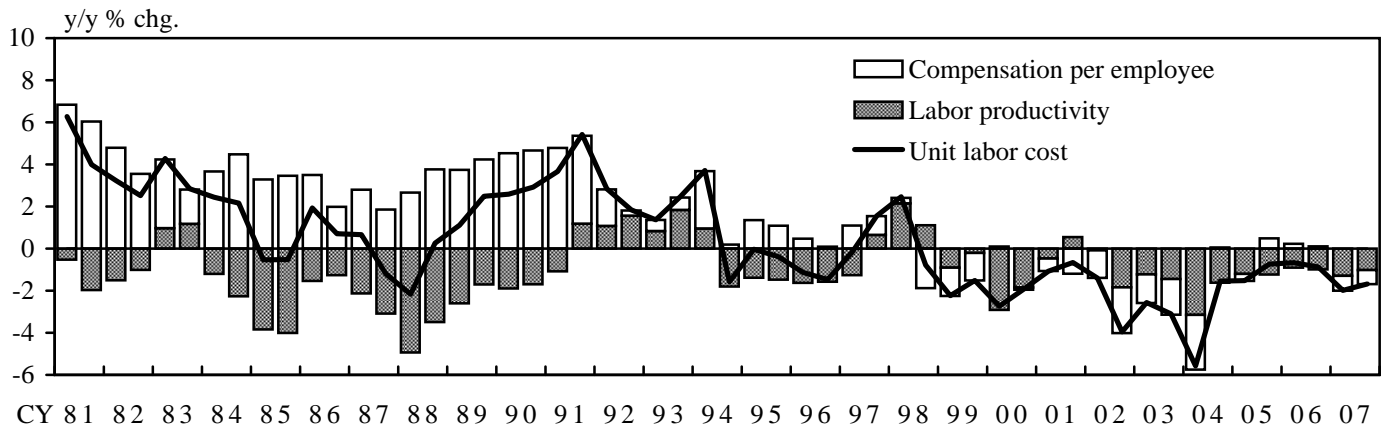
Notes: 1. Figures in the chart are six-month percent change in land prices available in both "Land Price Publication" and "Prefectural Land Price Survey" (residential: 58 points, commercial: 44 points).

2. Figures in the table are percent changes in land prices available in both "Land Price Publication" and "Prefectural Land Price Survey" (residential: 65 points, commercial: 59 points).

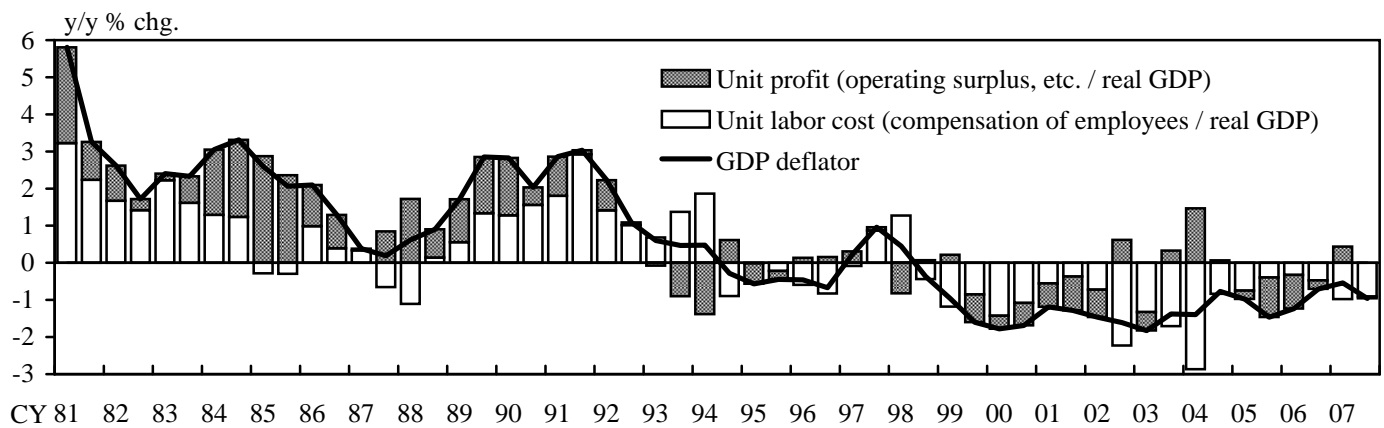
Source: Ministry of Land, Infrastructure and Transport, "Land Price Publication," "Prefectural Land Price Survey."

## Unit Labor Cost

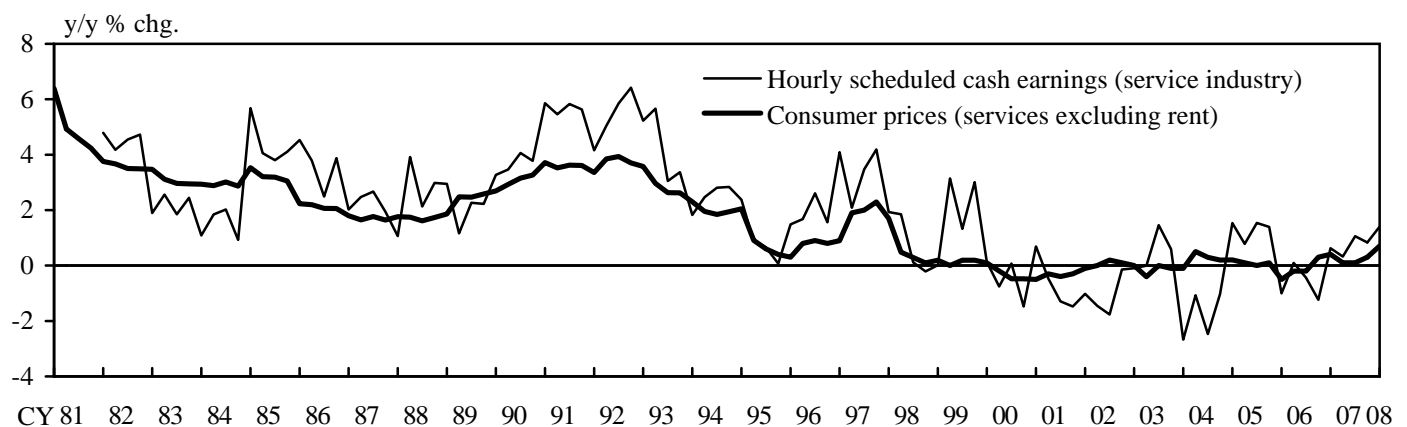
### (1) Unit Labor Cost<sup>1</sup>



### (2) Decomposition of GDP Deflator in Terms of Distribution<sup>1,2</sup>



### (3) Service Prices and Wages<sup>3,4</sup>



Notes: 1. Up to 1994, fixed-based series are used (base year=1995). From 1995, chain-linked series are used (base year=2000).

2. Operating surplus, etc., includes (i) operating surplus and mixed income, (ii) consumption of fixed capital, (iii) taxes on production and imports, (iv) subsidies, and (v) statistical discrepancy.

3. Figure of hourly scheduled cash earnings for 2008/Q1 is the January-February average.

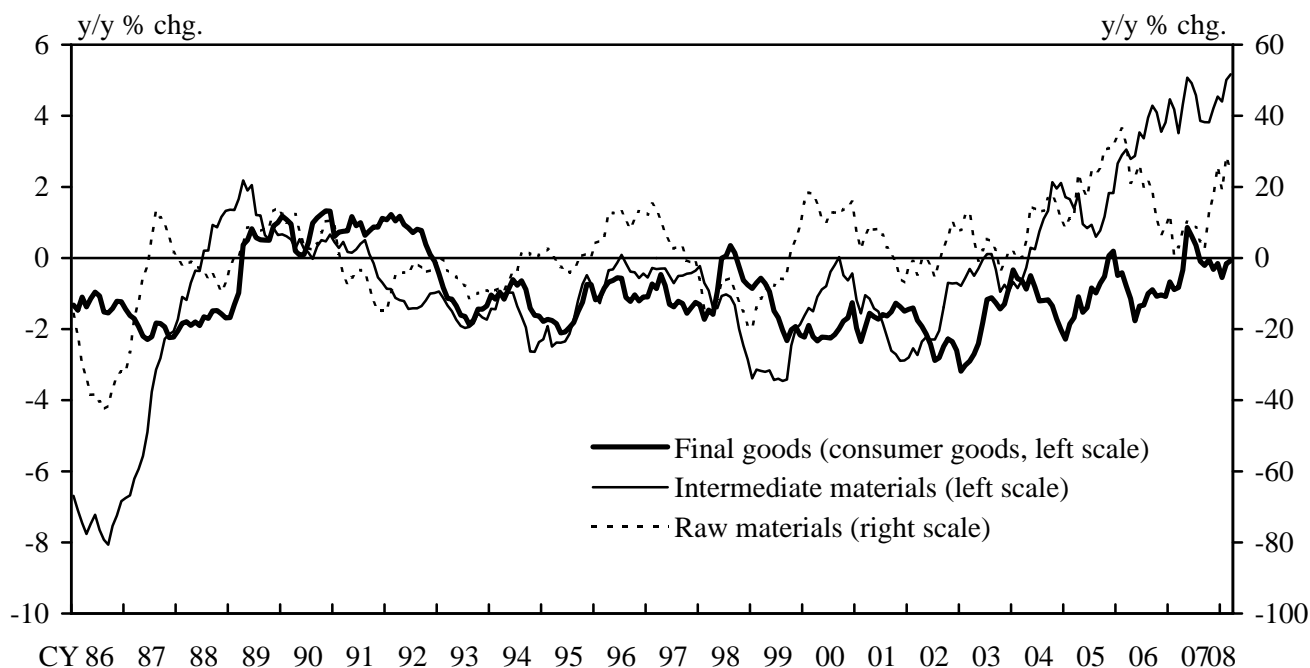
4. Wages are the sum of "eating and drinking places" and "services" of the previous industrial classification until 2000. From 2001, they are the sum of "eating and drinking places", "accommodations" and "miscellaneous education learning support" and "services" of the new industrial classification.

Data are for establishments with at least 30 employees.

Sources: Ministry of Health, Labour and Welfare, "Monthly Labour Survey"; Cabinet Office, "National Accounts"; Ministry of Internal Affairs and Communications, "Labour Force Survey," "Consumer Price Index."

## Price Developments by Stage of Demand

### (1) CGPI by Stage of Demand and Use (Domestic Goods and Imports)

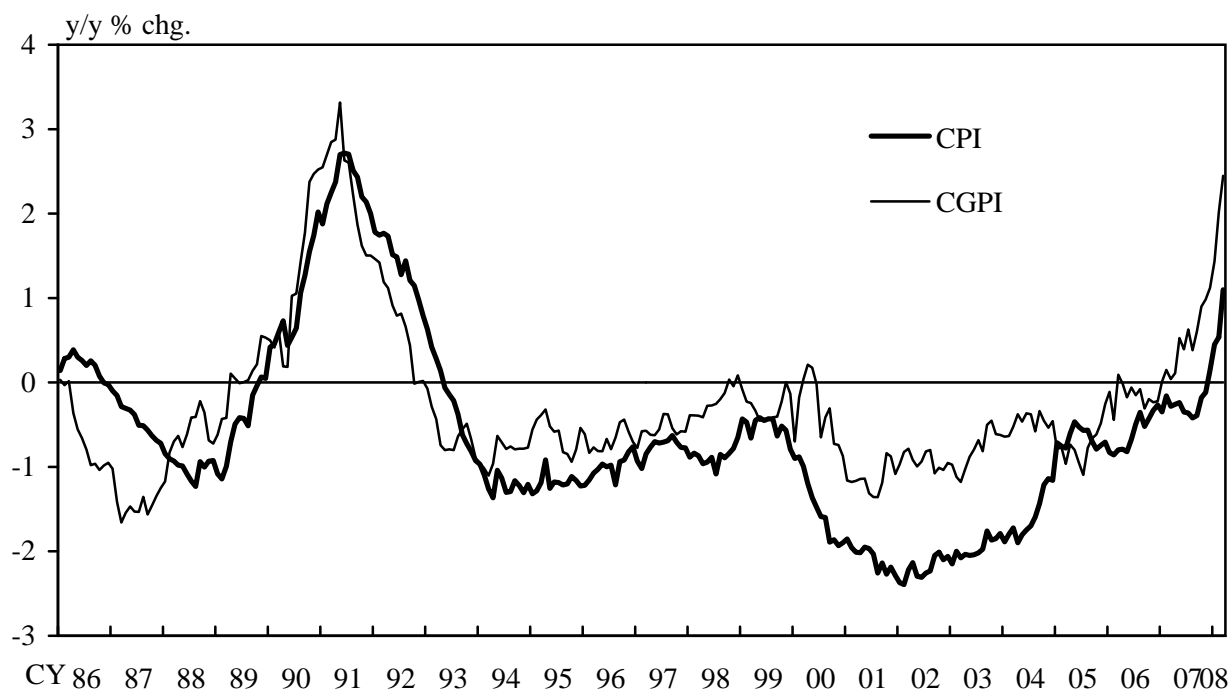


Notes: 1. Figures of the CGPI for CY 1986-1999 are those of the WPI.

2. Figures for intermediate materials are the weighted averages of "group" level indexes based on the weights of consumer goods.

3. Petroleum & coal products are excluded from intermediate materials and final goods.

### (2) Common Goods for the CPI and the CGPI



Notes: 1. Figures of the CGPI for CY 1986-1999 are those of the WPI.

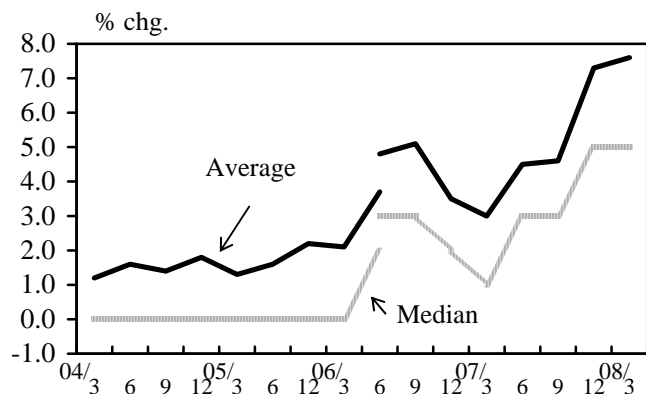
2. Figures are the weighted averages of common goods for the CPI and the CGPI based on the weights in the CPI (base year=2005). However, omitted goods, newly included goods in the 2000 base and 2005 base, agricultural & aquatic products, petroleum & coal products and tobacco are excluded from the figures.

Sources: Ministry of Internal Affairs and Communications, "Consumer Price Index";  
Bank of Japan, "Corporate Goods Price Index," "Wholesale Price Index."

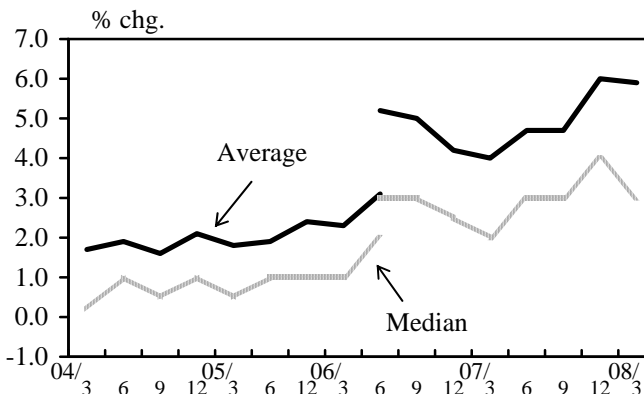
## Outlook for Prices

### (1) Households (Opinion Survey on the General Public's Views and Behavior)

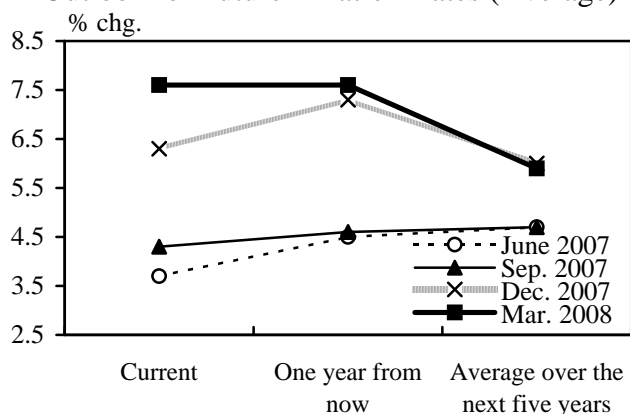
(a) Changes in the Price Levels One Year from Now



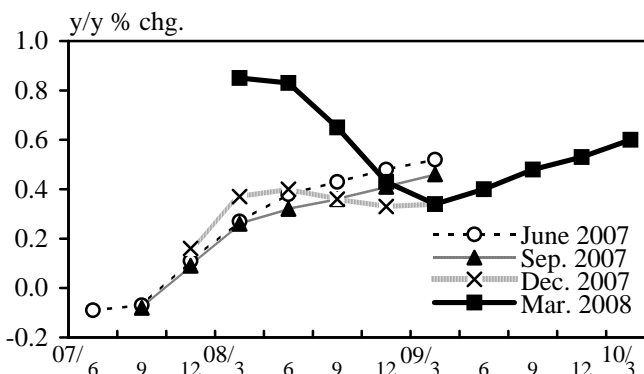
(b) Changes in the Price Levels per Year on Average over the Next Five Years



(c) Perception of the Current Inflation Rate and Outlook for Future Inflation Rates (Average)

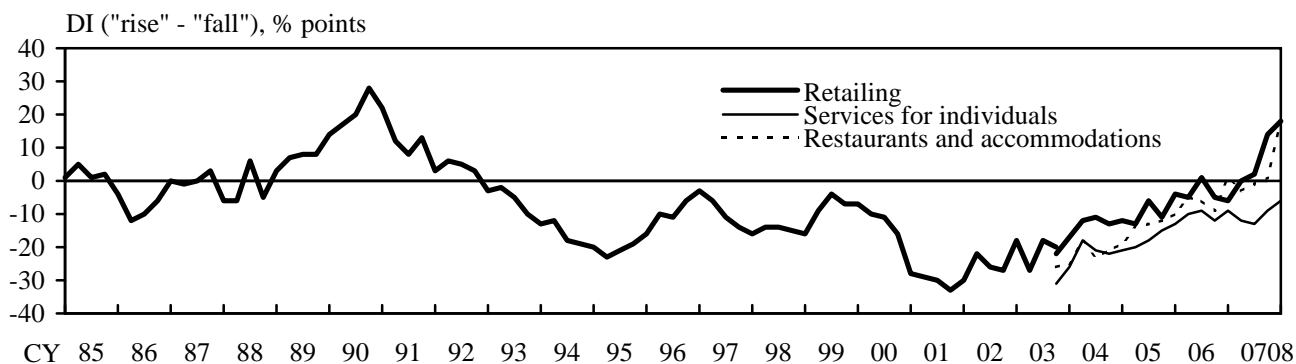


### (2) Economists (ESP Forecast)



Note: Figures for (1) are calculated by excluding 0.5 percent of the highest and the lowest figures, respectively. The survey was not conducted in September 2005. The survey method was changed in September 2006. A preliminary survey was conducted under the new method in June 2006.

### (3) Firms (*Tankan*, Change in Output Prices [Forecast One Quarter Ahead])

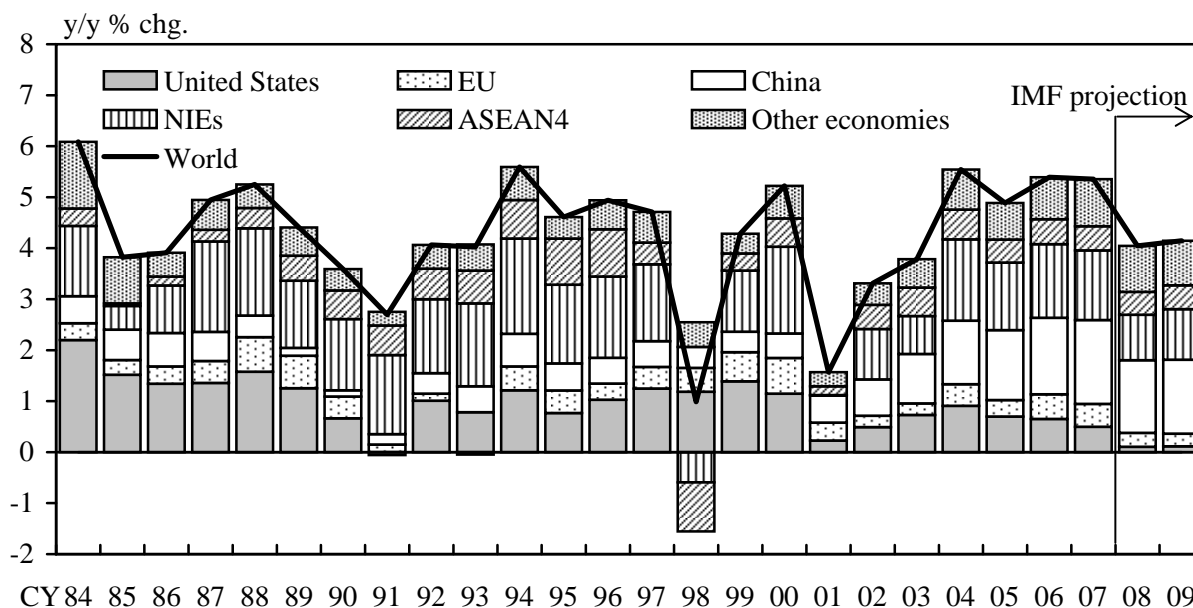


Notes: 1. All-size enterprises.  
2. The *Tankan* has been revised from the March 2004 survey. Figures based on the previous data sets are up to the December 2003 survey. Figures on a new basis are from the December 2003 survey.

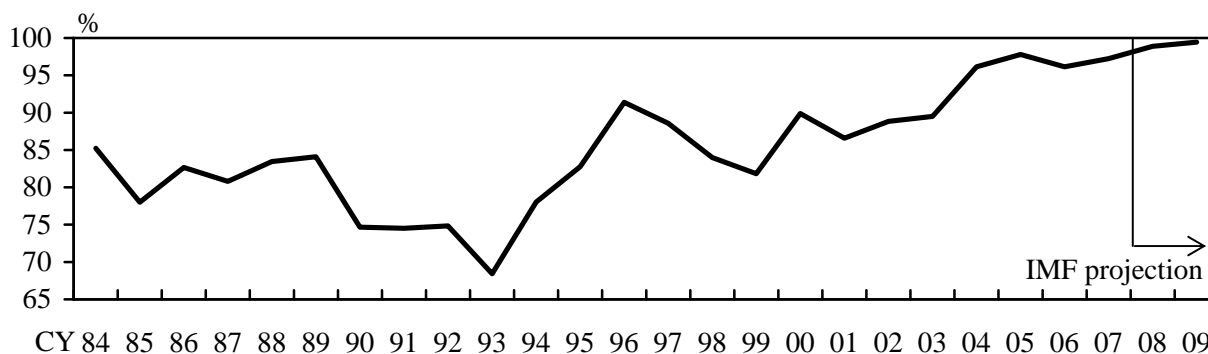
Sources: Bank of Japan, "Opinion Survey on the General Public's Views and Behavior," "*Tankan*, Short-Term Economic Survey of Enterprises in Japan"; Economic Planning Association, "ESP Forecast."

## Overseas Economies

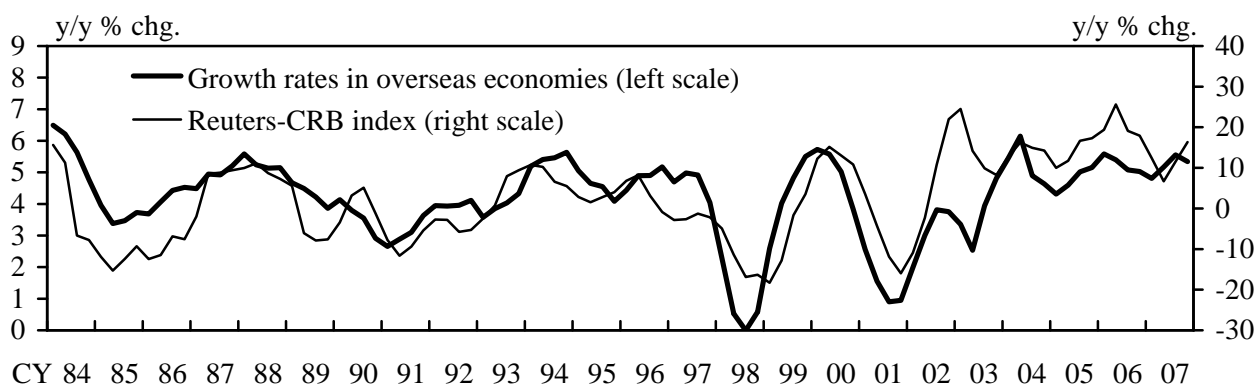
### (1) Real GDP Growth Rates in Overseas Economies



### (2) Percentage Share of the Number of Economies Recording Positive Growth



### (3) Growth Rates in Overseas Economies and Commodity Prices



- Notes: 1. Growth rates in overseas economies in (1) are calculated as the weighted average of real GDP growth rates weighted by value of exports from Japan to each economy. For 2008 and 2009, they are calculated using the IMF's projection of real GDP and value of exports from Japan in 2007.
2. Data for ASEAN4: Thailand, Malaysia, Indonesia, and the Philippines.  
Data for NIEs: South Korea, Hong Kong, Taiwan, and Singapore.

Sources: IMF, "World Economic Outlook"; Ministry of Finance, "The Summary Report on Trade of Japan," etc.

## Diversification of the Global Economy

### (1) Export Growth Rates by Region (Changes between 2001 and 2006)

ann., % chg.

		Exports to								
		Japan	China	NIEs3	ASEAN4	US	EU	Middle East	Others	World
Exports from	Japan	/	23.6	10.1	6.2	2.9	6.3	12.1	12.5	9.1
	China	12.6	/	25.1	27.4	27.3	30.5	29.8	33.6	26.5
	NIEs3	7.2	19.7	/	16.7	3.7	11.7	12.8	13.9	13.0
	ASEAN4	4.5	25.6	8.9	/	4.2	5.9	12.6	12.9	8.9
	US	-1.7	20.5	4.2	1.7	/	3.1	10.9	4.9	4.7
	EU	-1.4	14.4	3.1	-1.0	0.8	/	4.9	6.5	4.8
	Middle East	5.7	20.7	5.4	6.0	1.9	6.2	/	8.4	6.9
	Others	5.4	29.6	4.9	7.6	2.5	10.0	11.6	/	7.6
	World	4.7	21.5	10.9	10.1	4.0	6.5	10.1	9.2	/

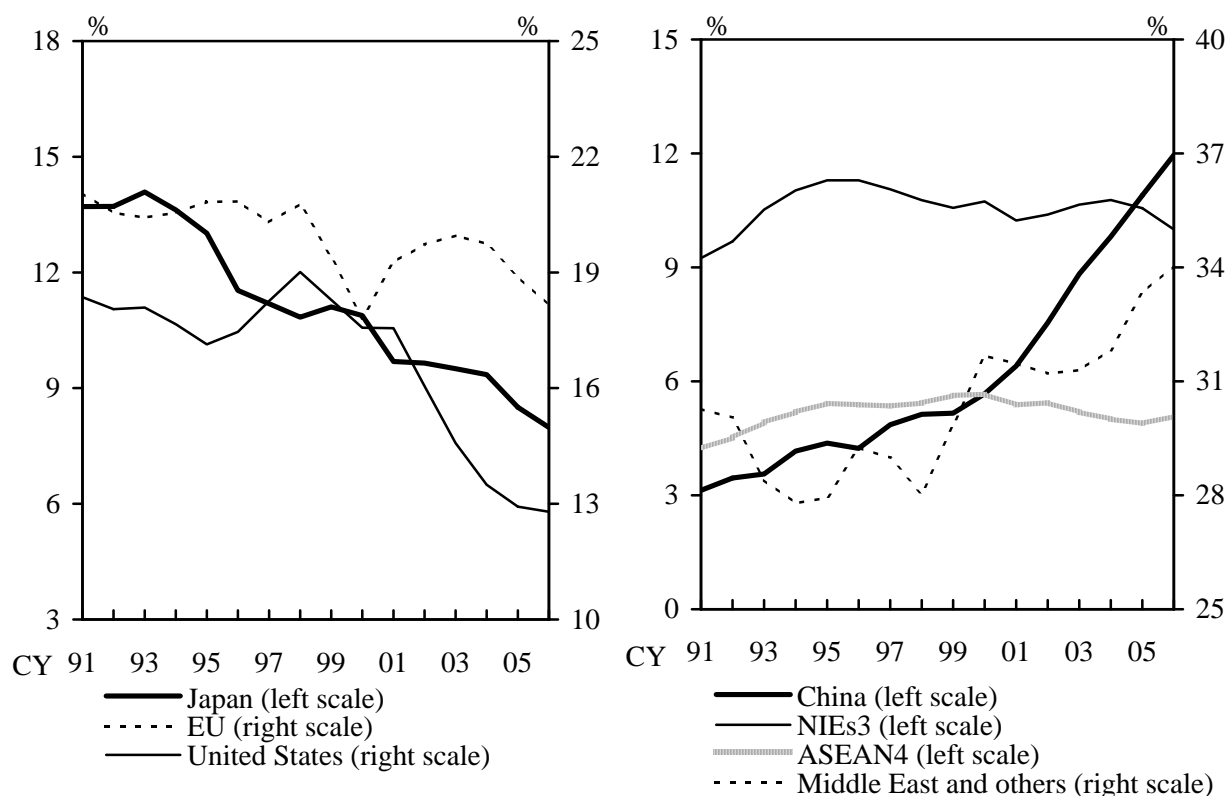
Notes: 1. Data are calculated in real terms: the nominal value of exports in the IMF statistics deflated by the export deflator in the UN statistics.

2. Data for ASEAN4: Thailand, Malaysia, Indonesia, and the Philippines.

Data for NIEs3: South Korea, Hong Kong, and Singapore.

3. Shaded areas indicate higher rates than the growth rate of world exports.

### (2) Percentage Share of Exports to the World Total by Region (Nominal Base)



Note: Data are shares in a nominal value of exports excluding regional trade.

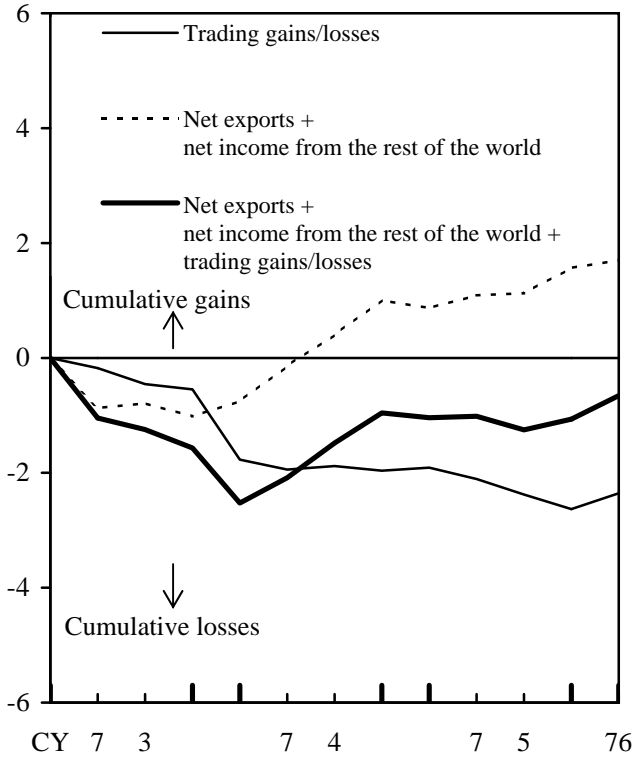
Sources: IMF, "Direction of Trade Statistics"; United Nations, "National Accounts Main Aggregates."



## Trading Gains/Losses and Income from the Rest of the World

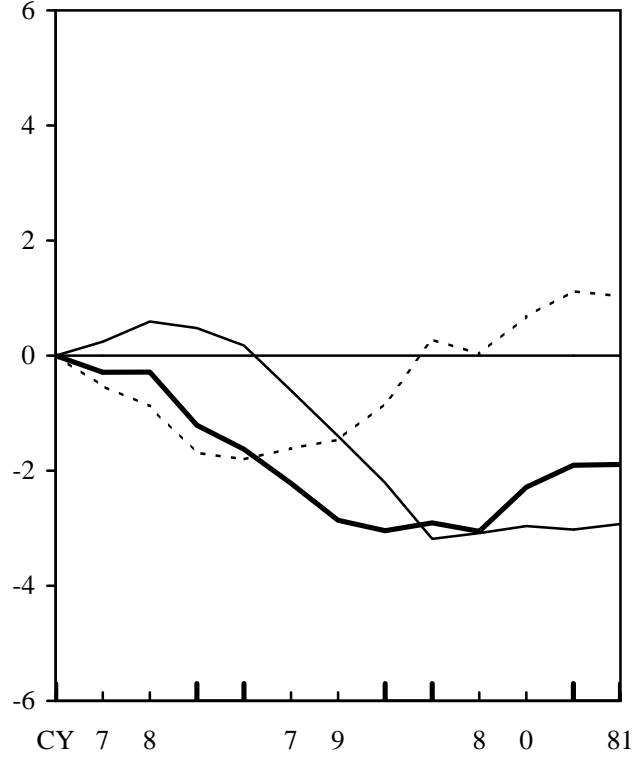
(1) First Oil Crisis

1973/Q1=0, ratio to real GDP, %



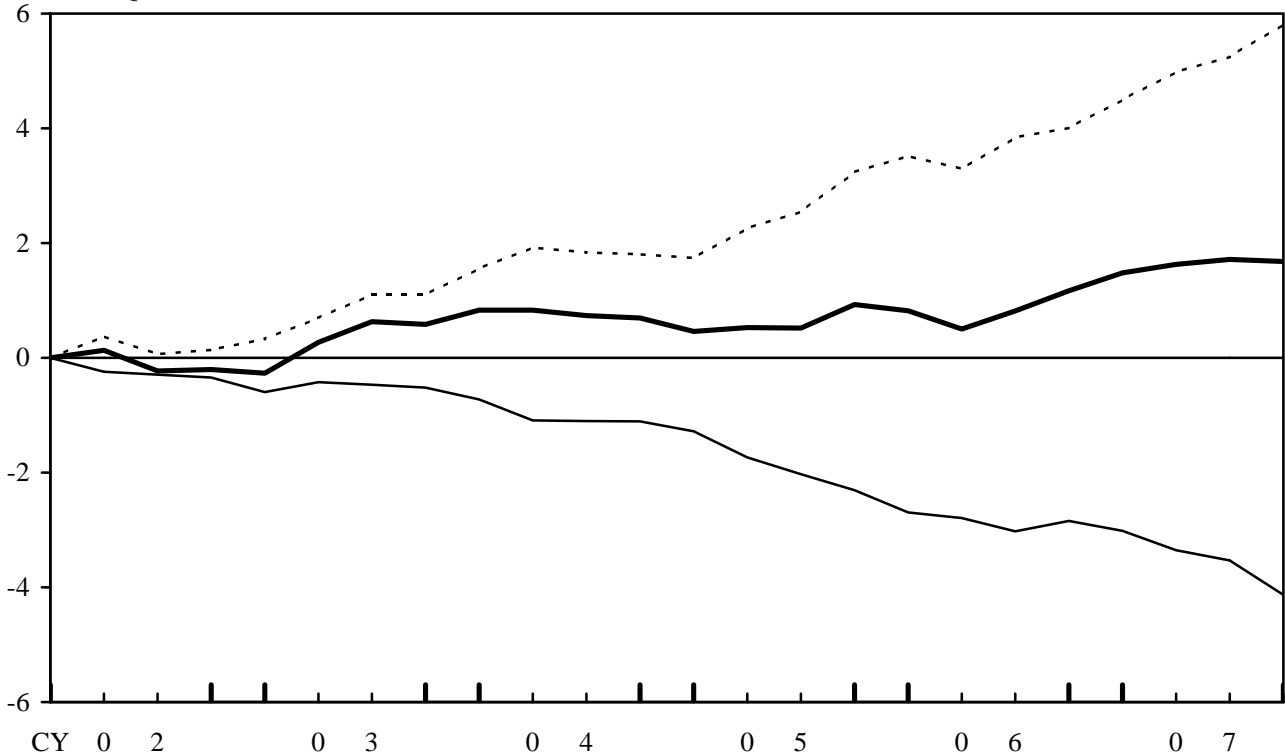
(2) Second Oil Crisis

1978/Q1=0, ratio to real GDP, %



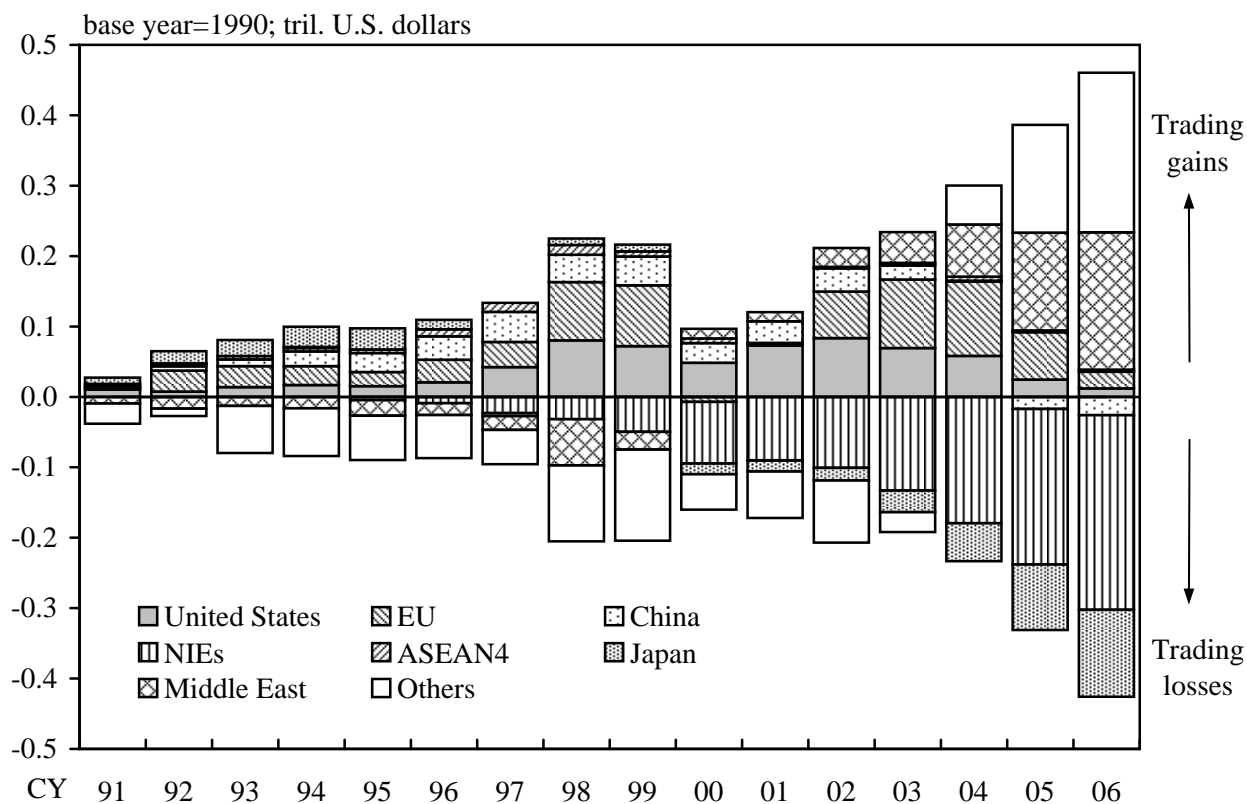
(3) Current Situation

2002/Q1=0, ratio to real GDP, %

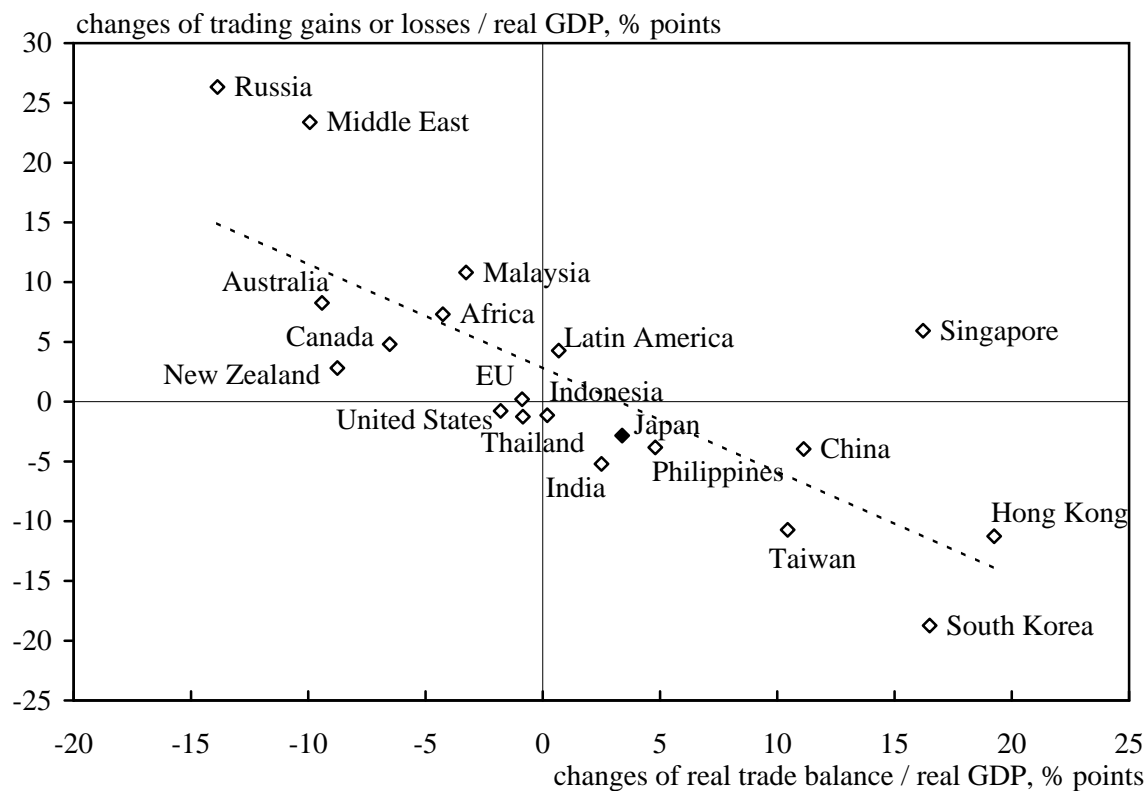


## Trading Gains/Losses and Net Exports

### (1) Trading Gains/Losses in the World

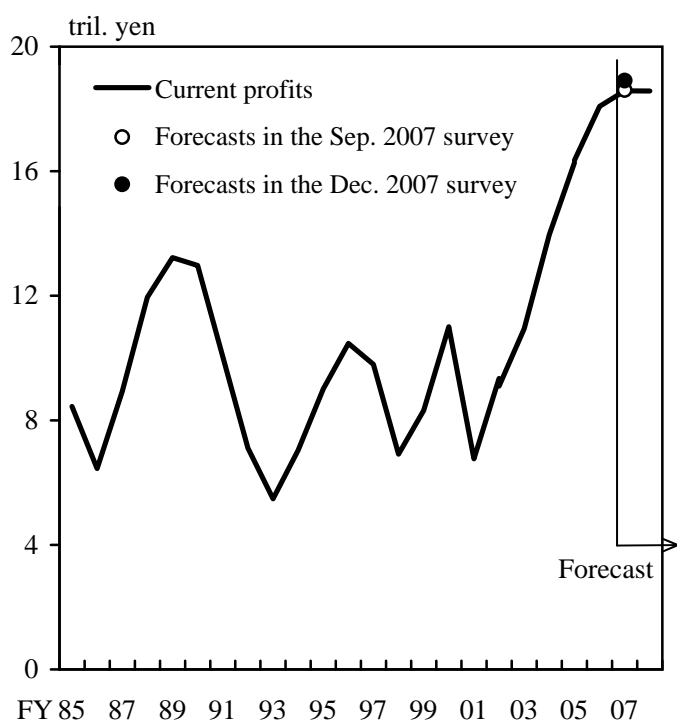


### (2) Relationship between Trading Gains/Losses and Net Exports (Changes between 2001 and 2006)

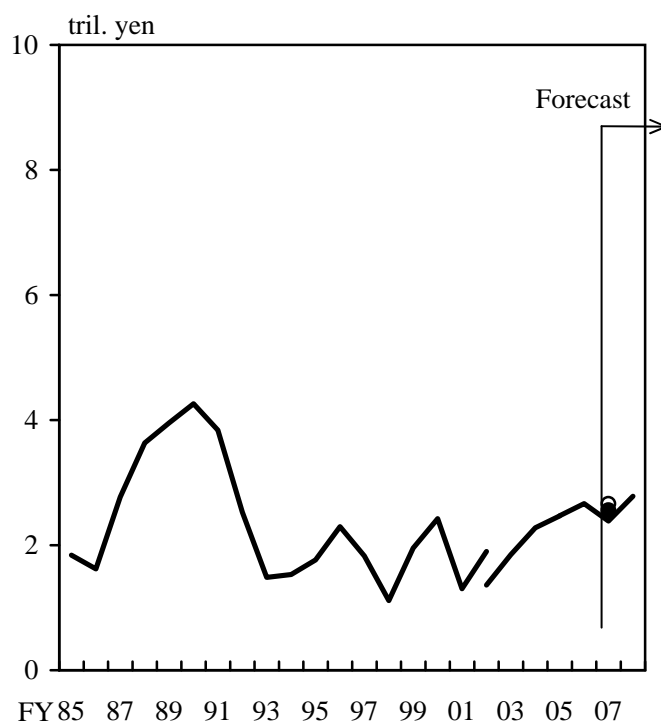


### Current Profits

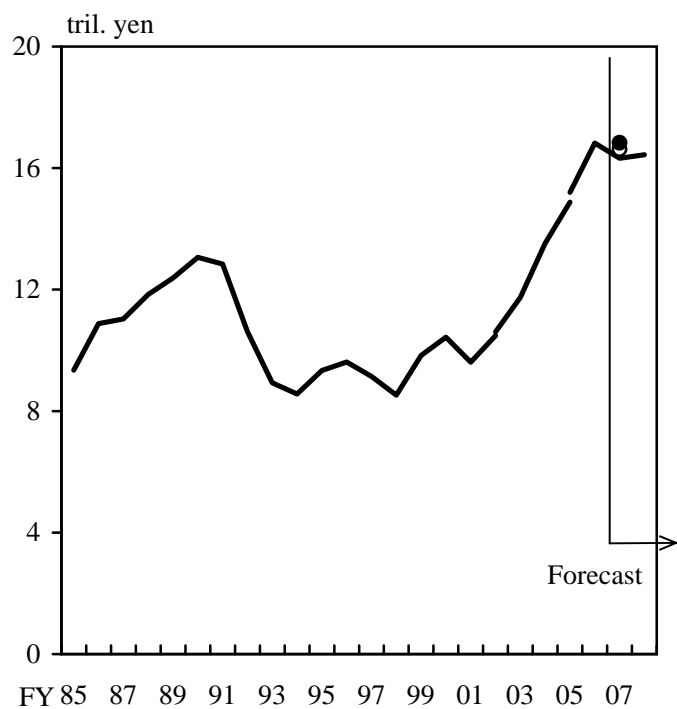
(1) Large Manufacturing Enterprises



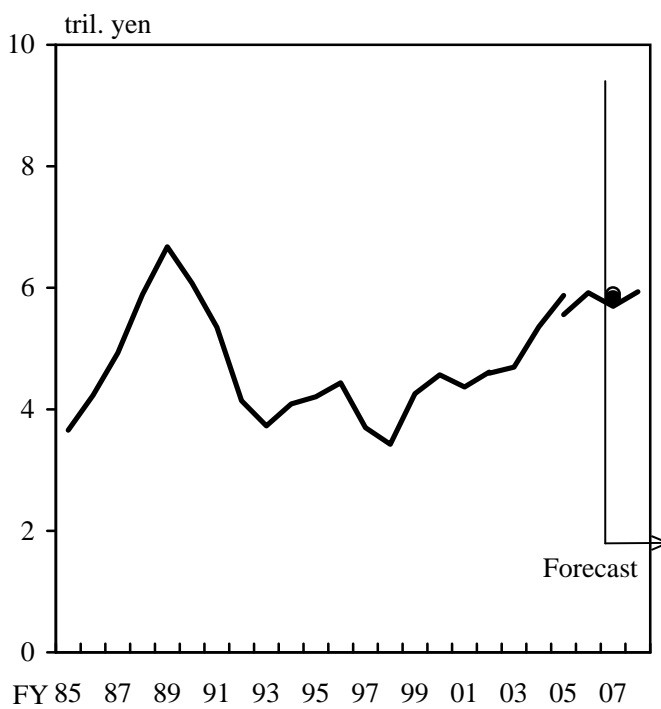
(2) Small Manufacturing Enterprises



(3) Large Nonmanufacturing Enterprises



(4) Small Nonmanufacturing Enterprises

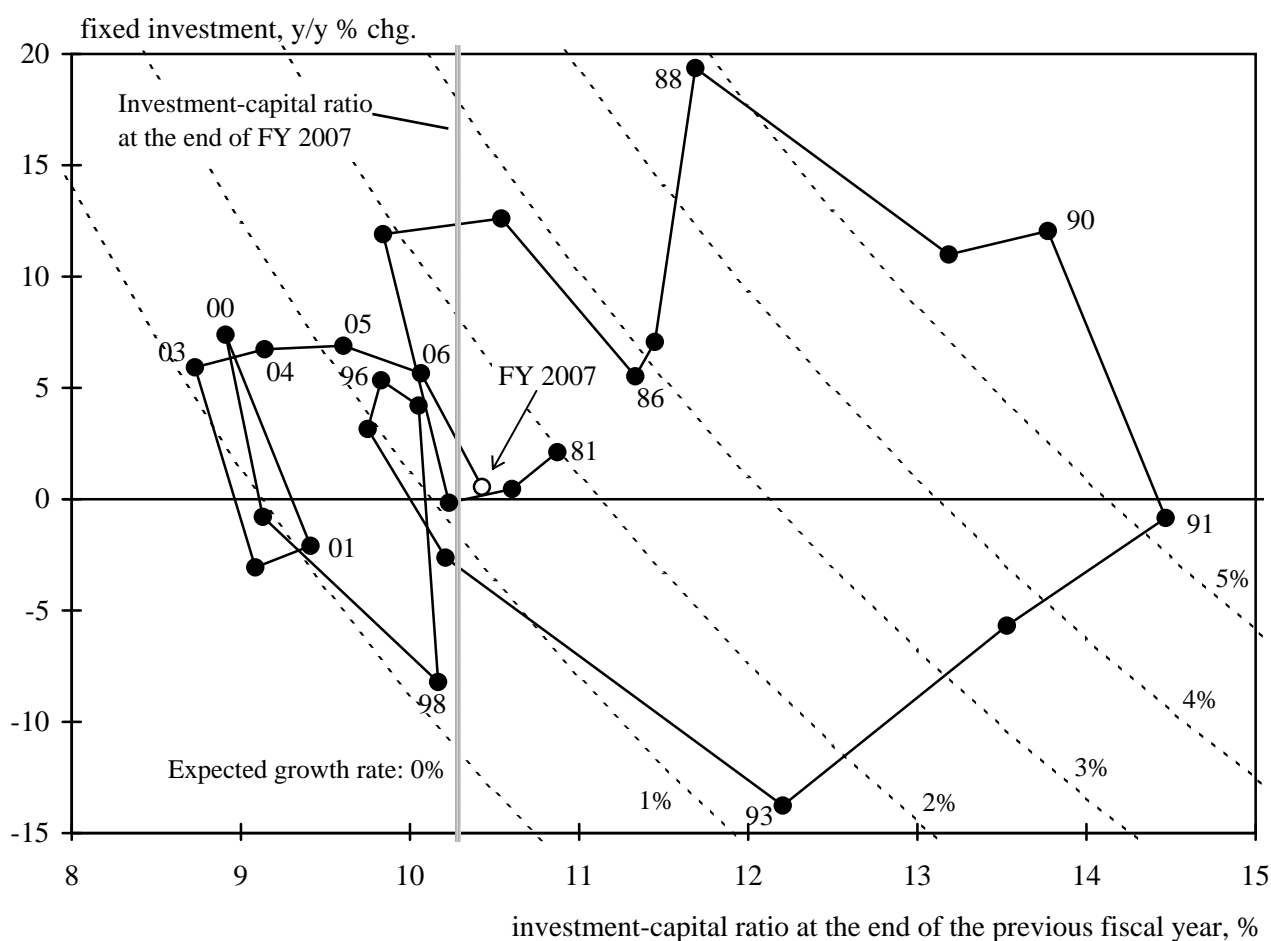


Notes: 1. In the March 2004 survey, the *Tankan* underwent major revisions, including the addition of new sample enterprises to the survey. In the March 2007 survey, regular revisions were made to the sample enterprises. The data show some discontinuities coincided with these timings.

2. "Forecast" is as in the March 2008 survey.

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

## Capital Stock Cycle



1. Capital stock cycle in the chart shows the relationship between the investment-capital ratio and the year-on-year rate of change in fixed investment.
2. As these variables have the following relation, a hyperbolic curve can be drawn for a given expected growth rate.  

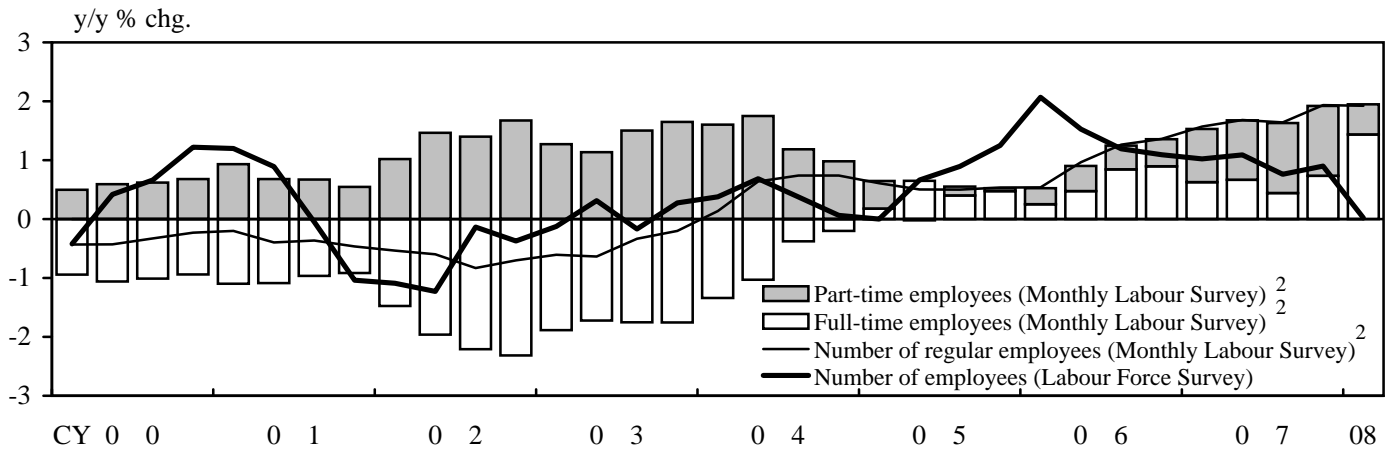
$$\text{Year-on-year rate of change in fixed investment (y-axis)} \times \text{investment-capital ratio at the end of the previous fiscal year (x-axis)} = \text{expected growth rate} + \text{trend of capital coefficient} + \text{depreciation rate}$$
3. The phase of fixed investment at a certain time can be evaluated in relation to the hyperbolic curve corresponding to the expected growth rate at that time.

Note: Fixed investment in FY 2007 is calculated on the assumption that the year-on-year change in investment in 2008/Q1 is the same as the year-on-year change in investment in 2007/Q2-Q4.

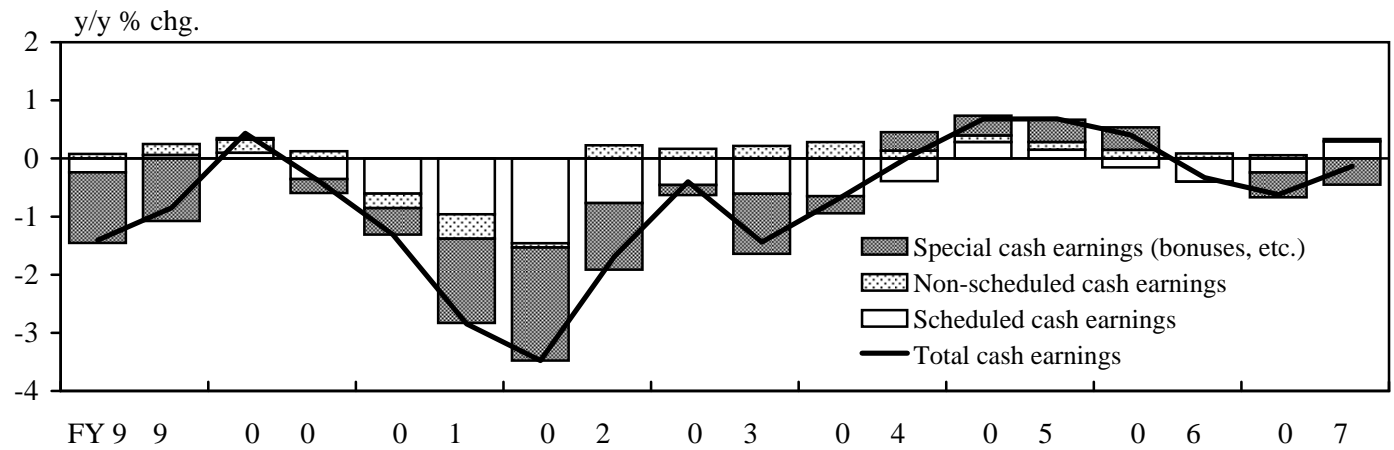
Sources: Cabinet Office, "National Accounts," "Annual Report on Gross Capital Stock of Private Enterprises," "Preliminary Quarterly Estimates of Gross Capital Stock of Private Enterprises"; Ministry of Economy, Trade and Industry, "Census of Manufactures"; Research Institute of Economy, Trade and Industry, "Japan Industrial Productivity Database 2008."

## Labor Market Conditions

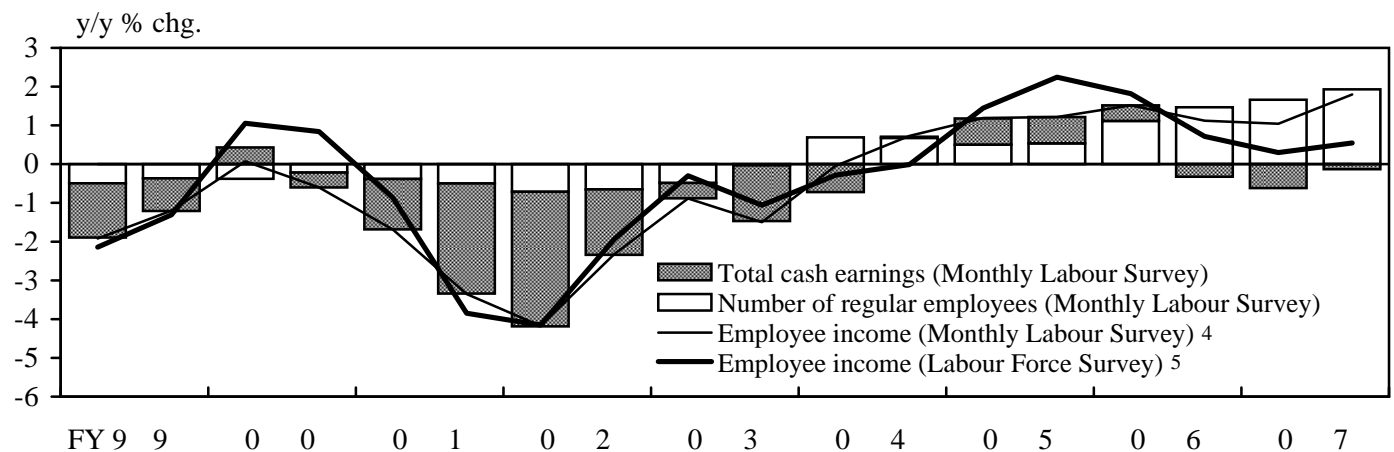
### (1) Number of Employees<sup>1</sup>



### (2) Total Cash Earnings (Monthly Labour Survey)<sup>1,3</sup>



### (3) Employee Income<sup>1,3</sup>



Notes: 1. Data from "Monthly Labour Survey" are for establishments with at least five employees.

2. Figures for 2008/Q1 are those of the January-February average.

3. Figures for the second half of FY 2007 are those of the October 2007-February 2008 average.

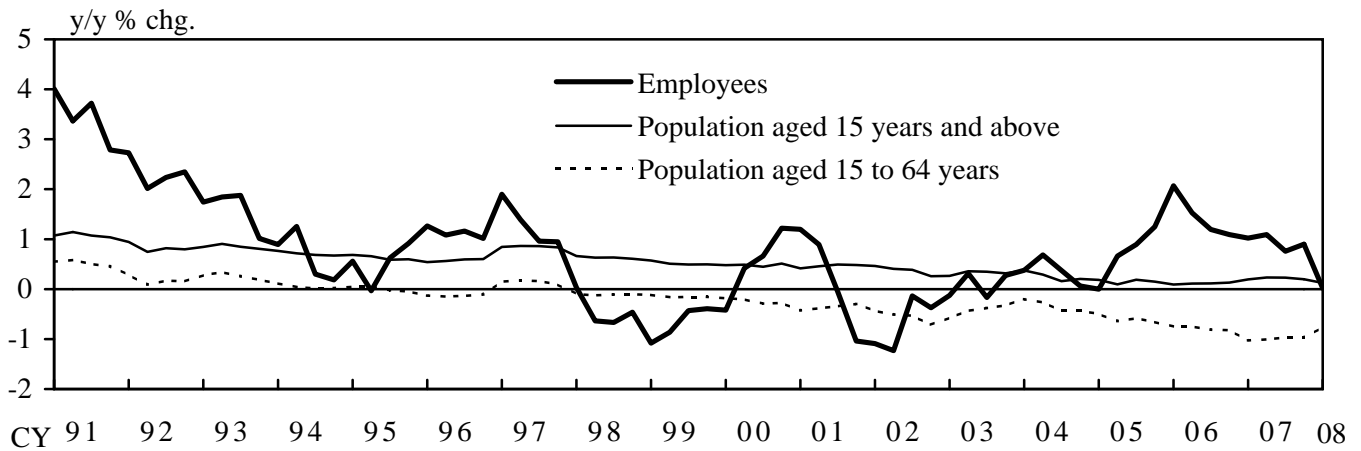
4. Calculated as the number of regular employees (Monthly Labour Survey) multiplied by total cash earnings (Monthly Labour Survey).

5. Calculated as the number of employees (Labour Force Survey) multiplied by total cash earnings (Monthly Labour Survey).

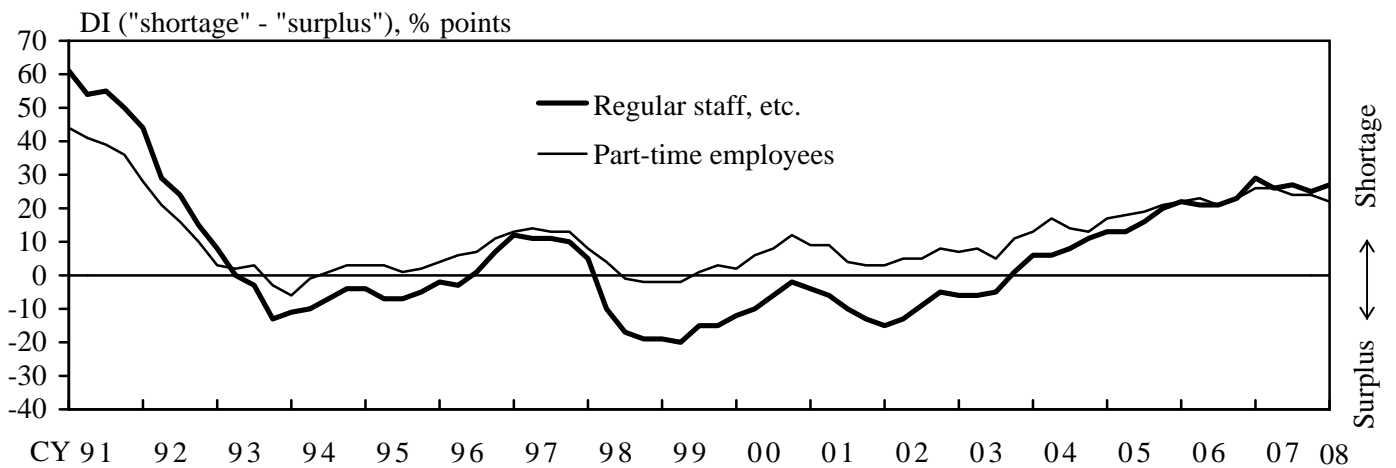
Sources: Ministry of Health, Labour and Welfare, "Monthly Labour Survey";  
Ministry of Internal Affairs and Communications, "Labour Force Survey."

## Labor Market and Wages

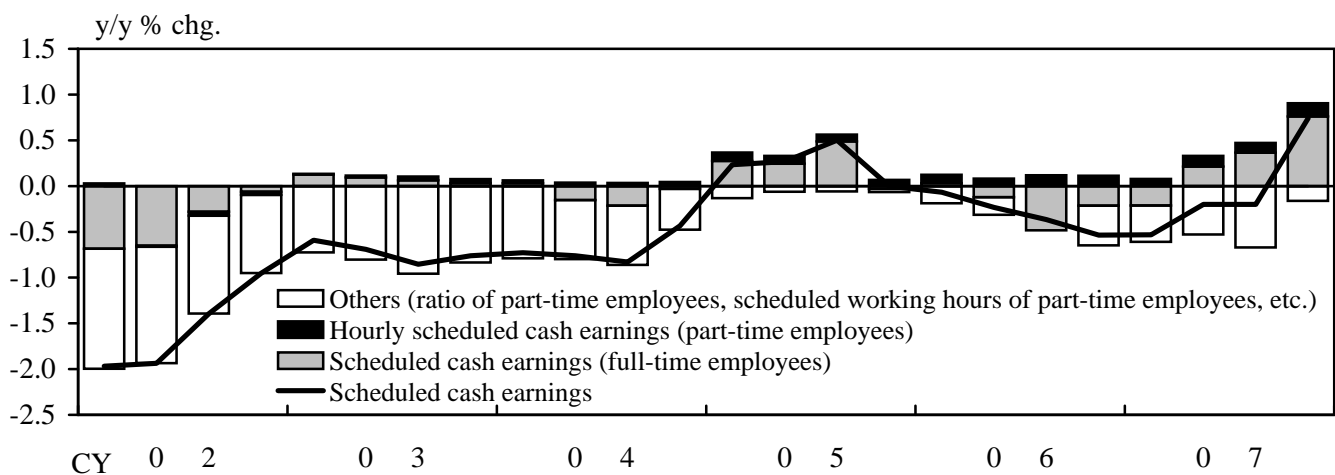
(1) Number of Employees and Population Aged 15 Years and Above



(2) Judgment on the Situation of Overs and Shorts of Workers (All Industries<sup>1</sup>)



(3) Scheduled Cash Earnings<sup>2,3</sup>



Notes: 1. Figures up to 1998 exclude "finance and insurance" and "real estate."

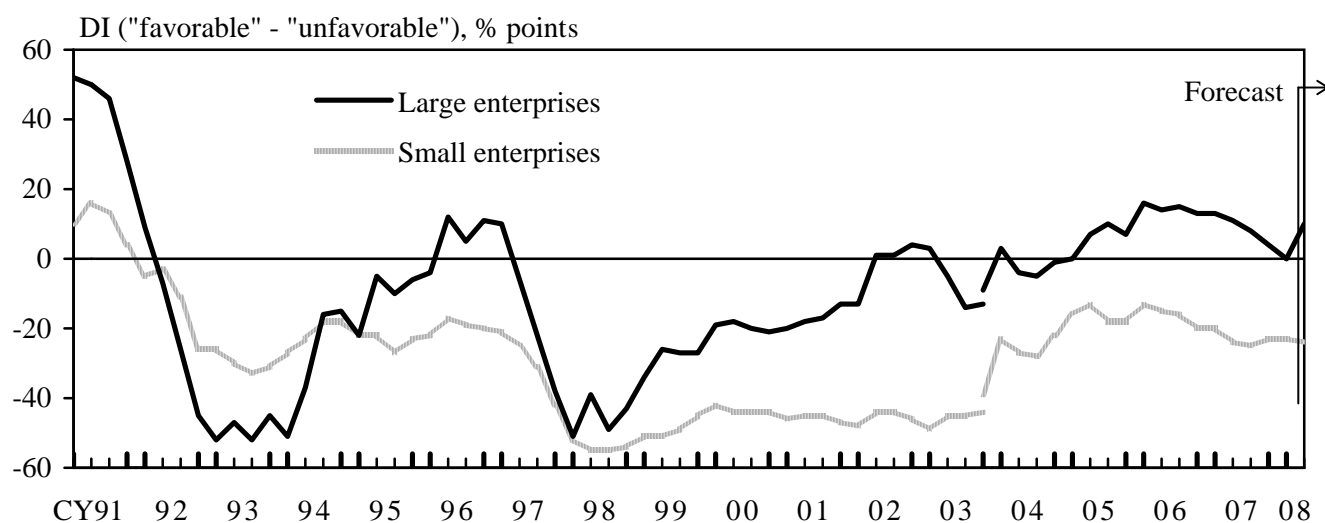
2. Data are for establishments with at least five employees.

3. Q1=March-May, Q2=June-August, Q3=September-November, Q4=December-February.

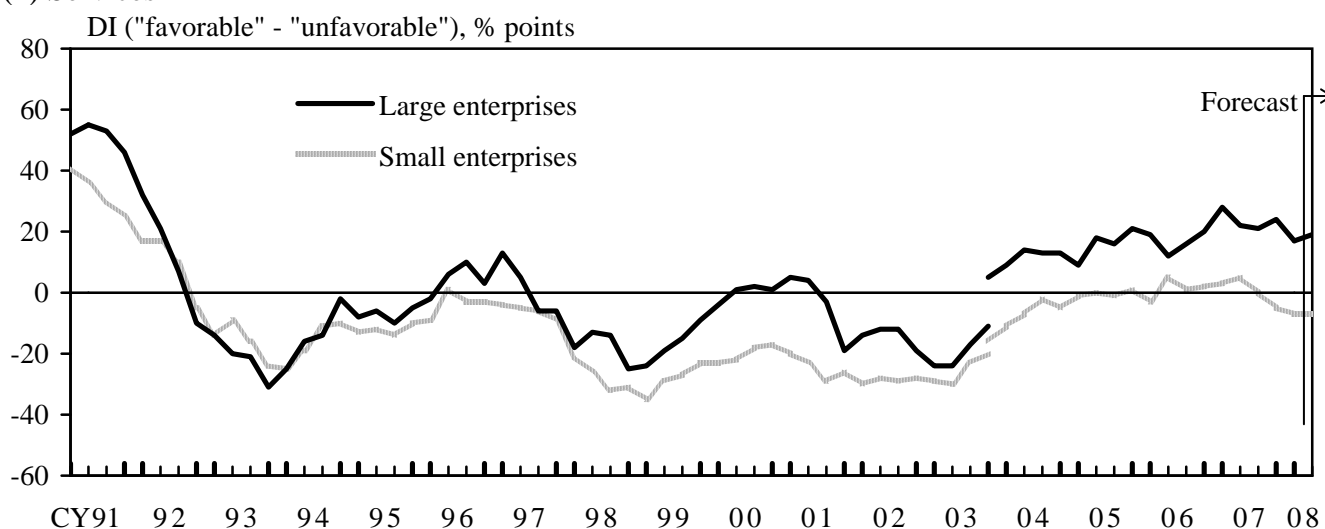
Sources: Ministry of Health, Labour and Welfare, "Monthly Labour Survey," "Survey on Labour Economy Trend"; Ministry of Internal Affairs and Communications, "Labour Force Survey."

## Business Conditions of Consumer Sector

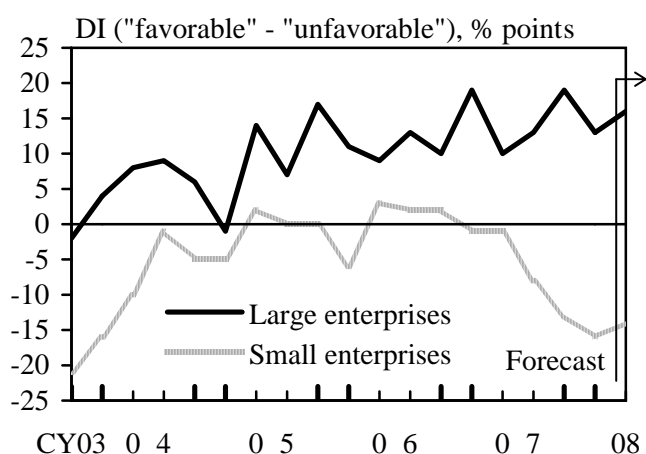
### (1) Retailing



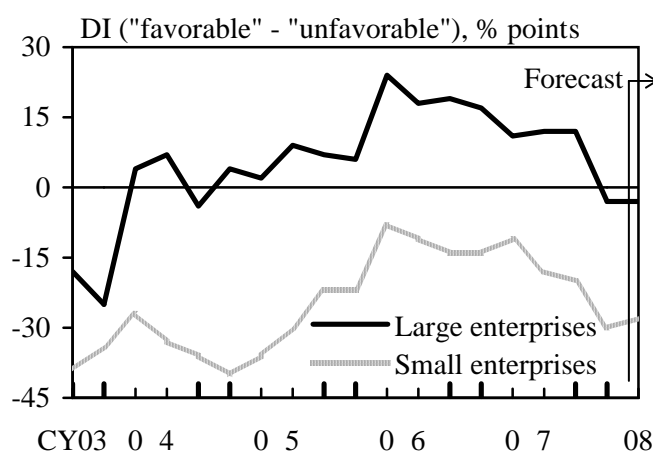
### (2) Services



### (3) Services for Individuals



### (4) Restaurants and Accommodations

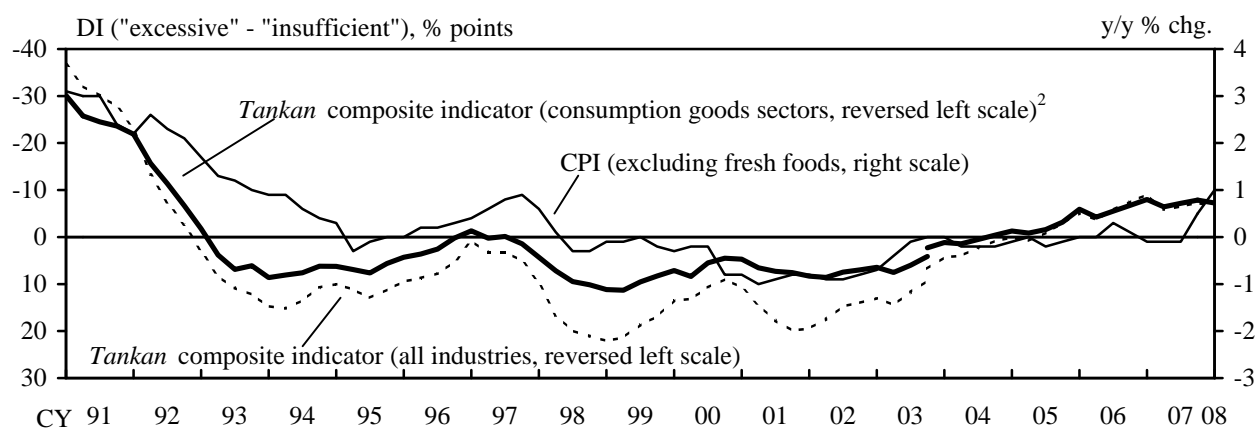


Note: The *Tankan* has been revised from the March 2004 survey. Figures based on the previous data set are up to the December 2003 survey. Figures on a new basis are from the December 2003 survey.

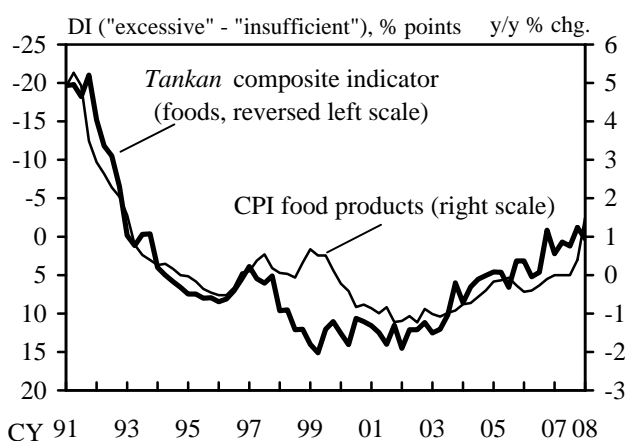
Source: Bank of Japan, "*Tankan*, Short-Term Economic Survey of Enterprises in Japan."

## Resource Utilization and CPI

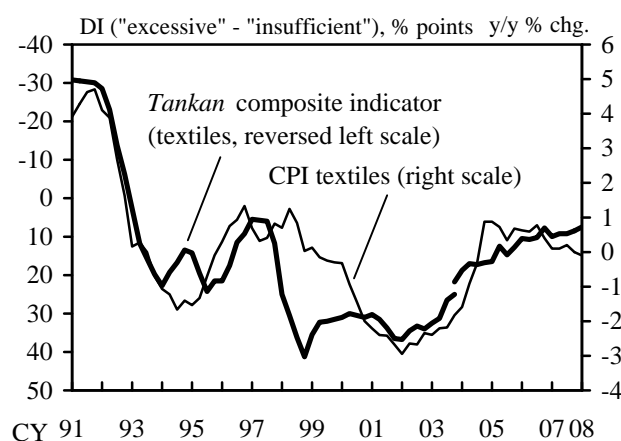
## (1) CPI and Resource Utilization



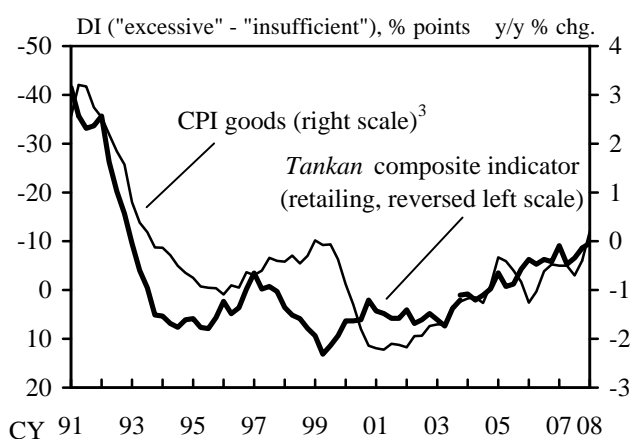
## (2) Foods



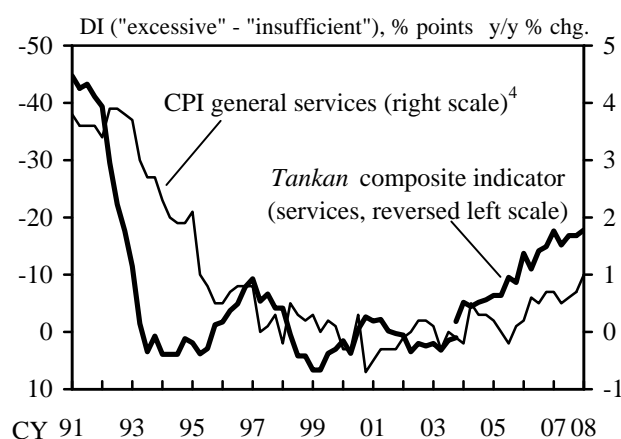
## (3) Textiles



## (4) Retailing



## (5) Services



Notes: 1. The *Tankan* composite indicator is calculated as the average of the diffusion indices (all enterprises) of production capacity and employment conditions, weighted by capital and labor shares in the national accounts (FY 1990-2006 average).

2. The *Tankan* composite indicator of consumption goods sectors is calculated as the average of the sectoral indicators, weighted by sectoral shares in the private consumption in the Input-Output Table.

3. Excluding agricultural and aquatic products and petroleum products.

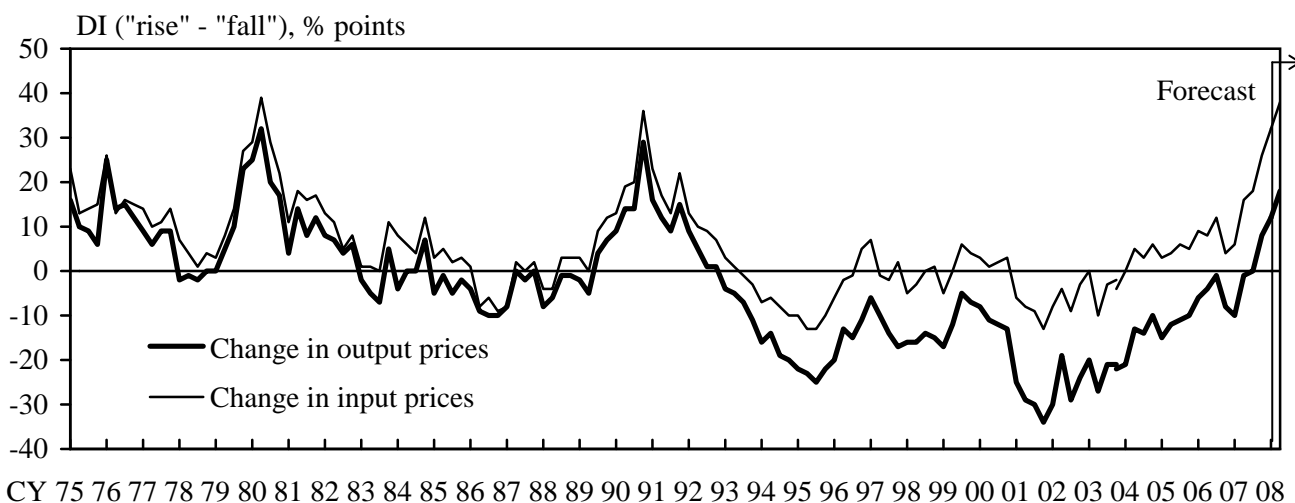
4. Excluding rent and mobile telephone charges.

Sources: Ministry of Internal Affairs and Communications, "Consumer Price Index," "Input-Output Table"; Bank of Japan, "*Tankan* , Short-Term Economic Survey of Enterprises in Japan"; Cabinet Office, "National Accounts."

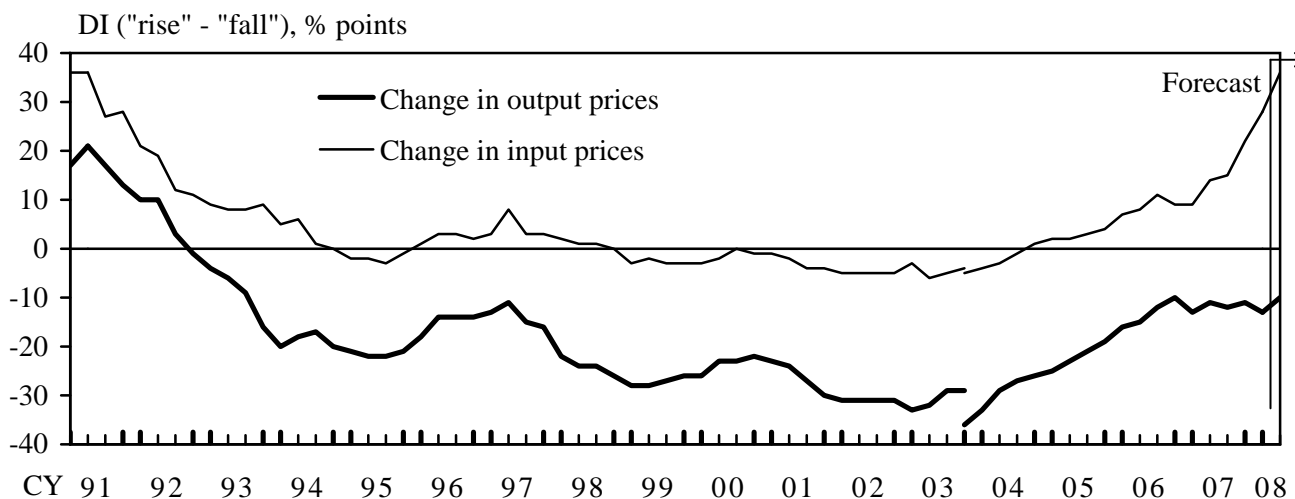


## Change in Output Price and Input Price

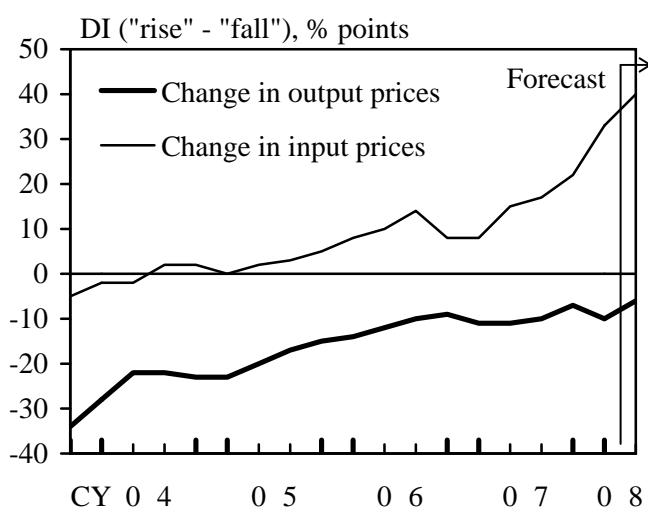
### (1) Retailing



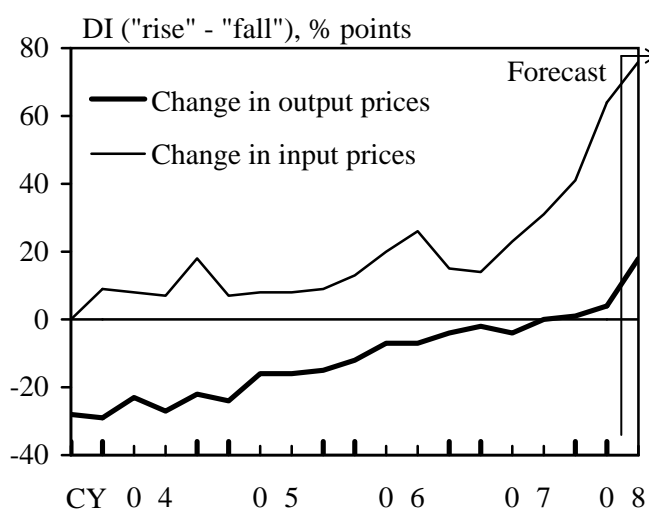
### (2) Services



### (3) Services for Individuals



### (4) Restaurants and Accommodations



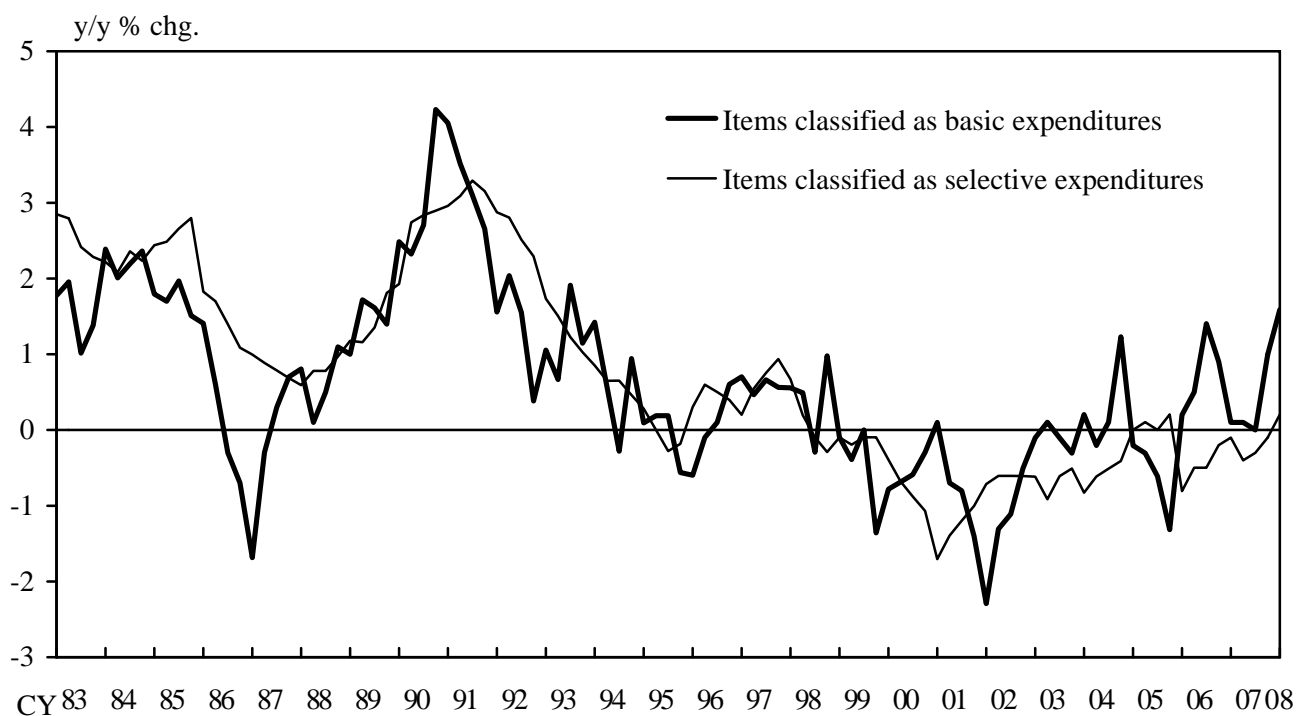
Note: Figures are based on all-size enterprises. The *Tankan* has been revised from the March 2004 survey.

Figures based on the previous data sets are up to the December 2003 survey. Figures on a new basis are from the December 2003 survey.

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

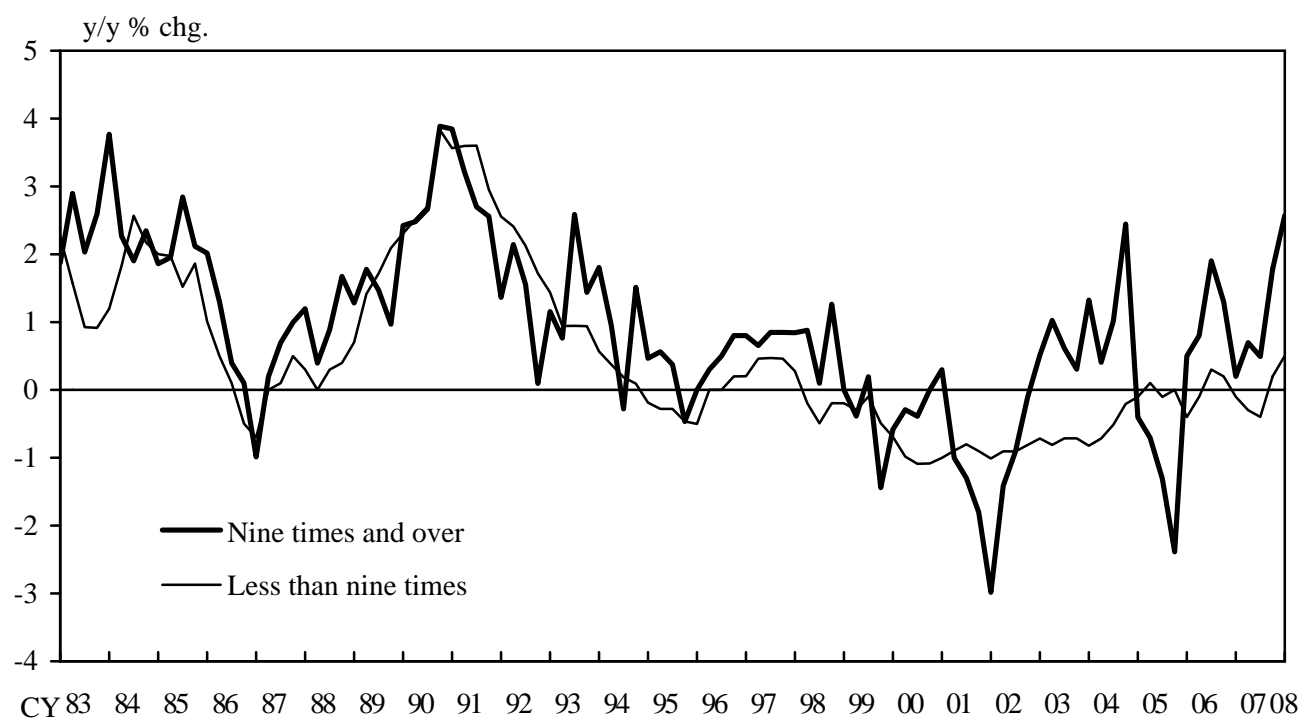
## Consumer Price Index by the Characteristics of Items

### (1) Index by Commodity Groups Classified According to Elasticity to Living Expenditure



Note: CPI items are classified into two categories based on the expenditure elasticity of items (an indicator which shows the percentage change in each item when total expenditures change by 1 percent) : namely, items whose elasticity is less than one are regarded as basic expenditures (such as food products and electricity) and items whose elasticity is one or over are regarded as selective expenditures (such as personal computers).

### (2) Index by Annual Purchase Frequency Classes



Source: Ministry of Internal Affairs and Communications, "Consumer Price Index."

## Economic Assessment by Region (Regional Economic Report)

Region	Assessment in April 2008	Revision of assessment from January to April	Assessment in January 2008
Hokkaido	Economic activity continues to be somewhat sluggish.	Unchanged	Economic activity is somewhat sluggish.
Tohoku	The economy seems to have stopped recovering.	Slightly downward	The economy as a whole continues to recover gradually.
Hokuriku	The economy is slowing.	Slightly downward	The economy is recovering gradually, although there seems to be some sluggishness.
Kanto-Koshinetsu	The economy is slowing slightly.	Slightly downward	The economy is on a moderate expansion trend.
Tokai	The economy is expanding gradually, although the pace of growth has become slower recently.	Slightly downward	The economy is expanding gradually.
Kinki	The economy is expanding gradually, although the pace of growth in some economic activity seems to be slowing.	Slightly downward	The economy is expanding gradually.
Chugoku	The economy continues to recover as a whole, although there seems to be some weakness.	Slightly downward	The economy continues to recover as a whole.
Shikoku	Economic recovery has become somewhat sluggish.	Slightly downward	The economy continues to pick up gradually.
Kyushu-Okinawa	The economy seems to have stopped recovering.	Slightly downward	The economy continues to recover gradually.

Note: The Regional Economic Report (summary) is available on the Bank of Japan's web site ([http://www.boj.or.jp/en/type/ronbun/chiiki\\_rep/chiiki0804.htm](http://www.boj.or.jp/en/type/ronbun/chiiki_rep/chiiki0804.htm)).

Source: Bank of Japan, "Regional Economic Report (Summary) April 2008."