

Japan's Economy and Monetary Policy

Speech at a Meeting with Local Leaders in Oita

December 6, 2023

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Introduction

I. Economic Activity and Prices

Developments since the Pandemic in Japan, the United States, and the Euro Area

What We Have Heard from Japanese Firms on Their Pricing Practices

What Statistics Tell Us on the Relationship between Firms' Price-Setting Behavior and Inflation

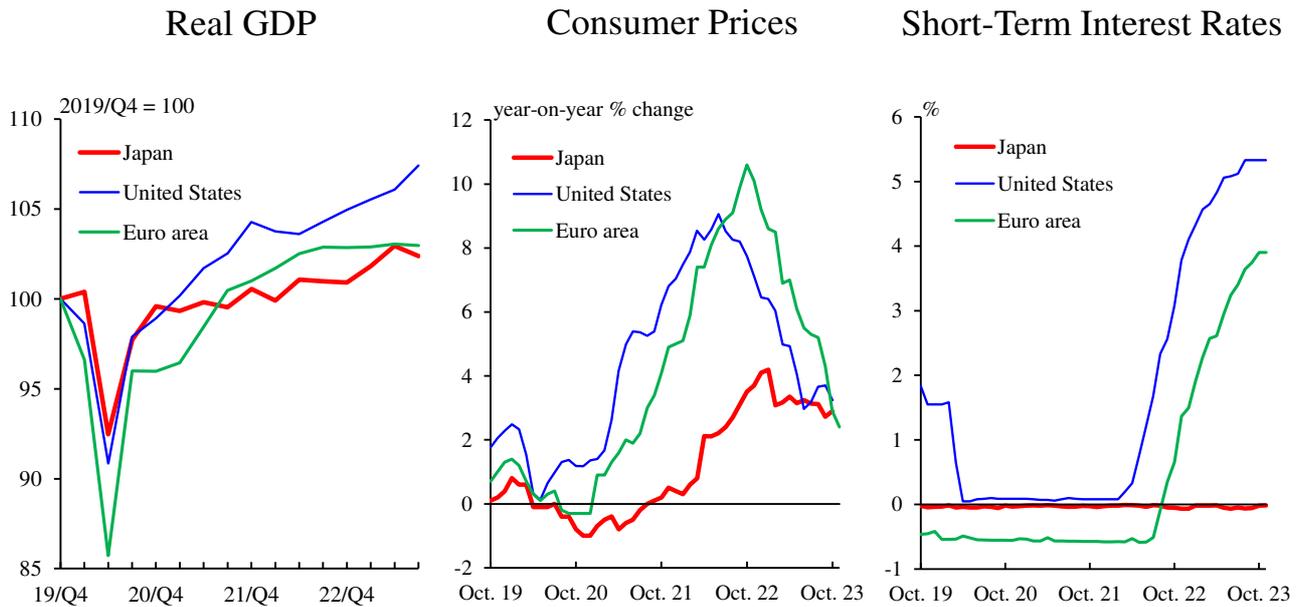
II. Monetary Policy

Patiently Continuing with Monetary Easing

What Would Happen If an Exit from the Large-Scale Monetary Easing Starts in the Future?

Conclusion

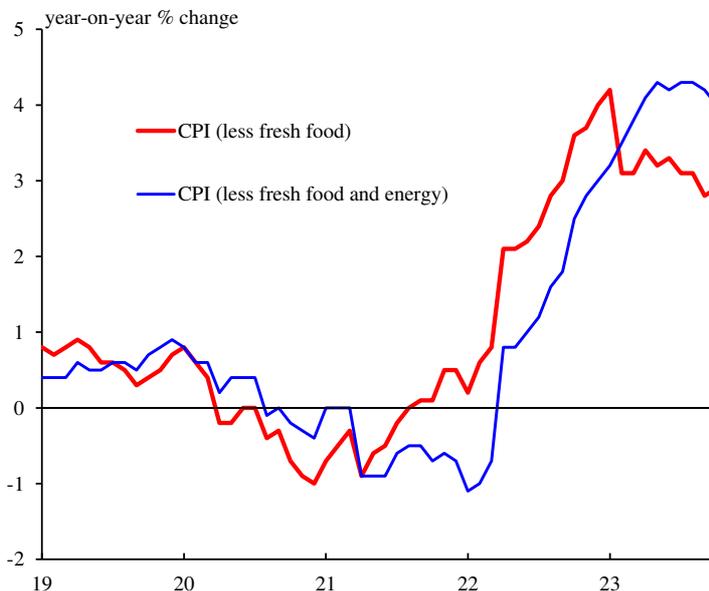
Recent Developments in Japan, the United States, and the Euro Area



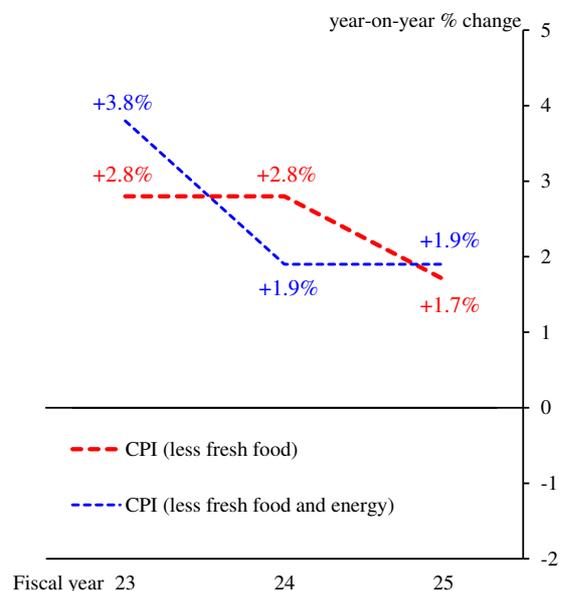
Notes: 1. In the middle chart, figures for Japan are the CPI for all items less fresh food, excluding the effects of the consumption tax hike, while those for the United States and the euro area are the CPI for all items.
 2. In the right-hand chart, figures for each economy are as follows: for Japan, the uncollateralized overnight call rate; for the United States, the effective federal funds rate; for the euro area, EONIA before 2020 and €STR thereafter.
 Sources: Cabinet Office; Ministry of Internal Affairs and Communications; Bank of Japan; ECB; BEA; BLS; Bloomberg.

Recent and Forecasted Inflation Rates of Japan

Recent Developments



Forecasts by the Bank of Japan Outlook Report, October 2023



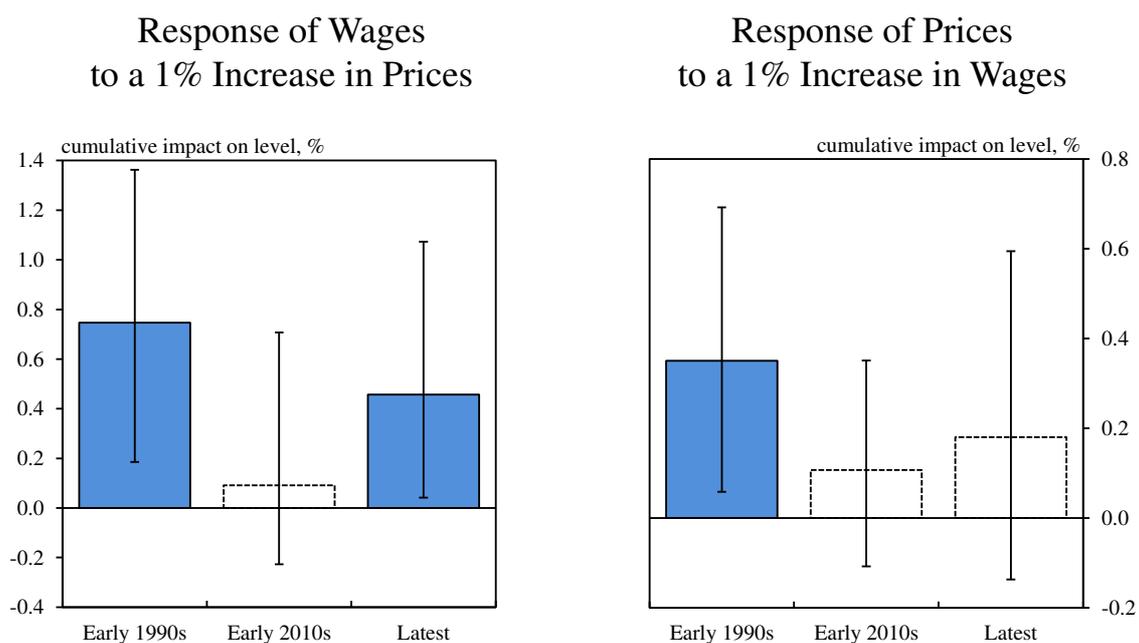
Note: In the right-hand chart, figures are the medians of the Policy Board members' forecasts.
 Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

Changes in Firms' Wage- and Price-Setting Behavior

Stage 1	Firms reflect higher import prices in selling prices.
Stage 2	Firms reflect higher general price levels in wages.
Stage 3	Firms reflect higher labor costs in selling prices.
Stage 4	Firms' pricing policies become more diverse, facilitating firms to explore strategies of selling more attractive products and services at commensurate prices, not just good products and services at low prices.

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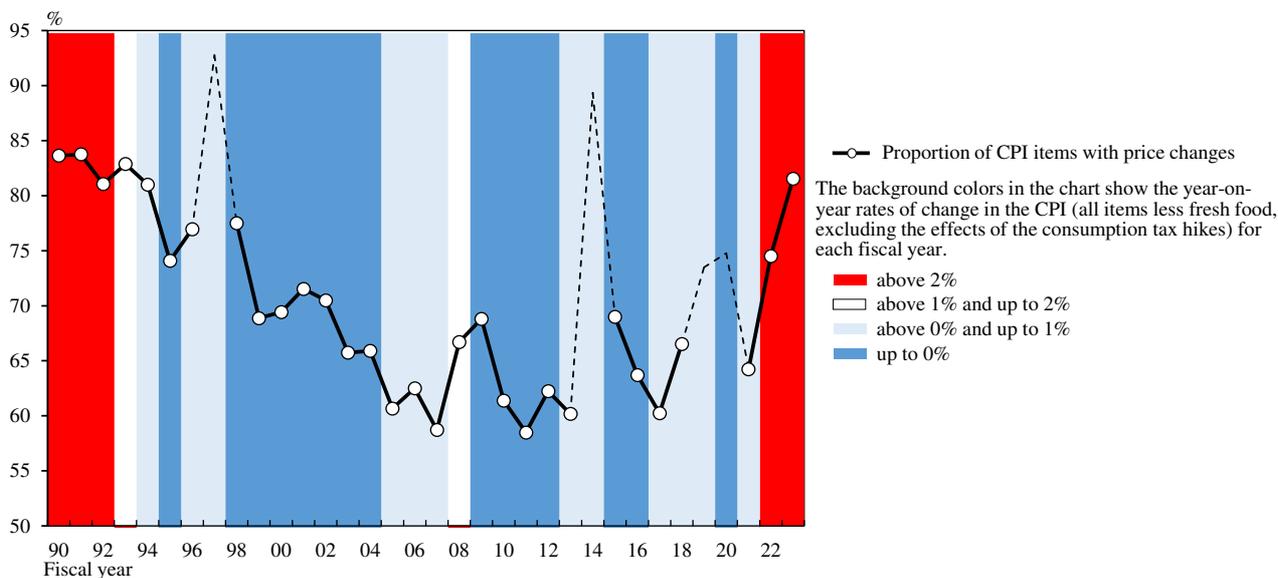
Feedback between Wages and Prices



Notes: 1. Figures show the estimation results of a time-varying parameter VAR model consisting of the output gap, nominal wages, and the CPI (less fresh food). Import prices are added as an exogenous control variable. The CPI figures are staff estimates and exclude temporary factors.
 2. Figures are 4-quarter cumulative impulse responses. The bands indicate the 75 percent confidence intervals, while the broken lines indicate that the results are not statistically significant.
 3. Figures for the early 1990s are as of 1991/Q2, those for the early 2010s are as of 2012/Q2, and the latest figures are as of 2023/Q2.
 Sources: Ministry of Internal Affairs and Communications; Cabinet Office; Ministry of Health, Labour and Welfare; Bank of Japan.

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Proportion of CPI Items with Prices Changes



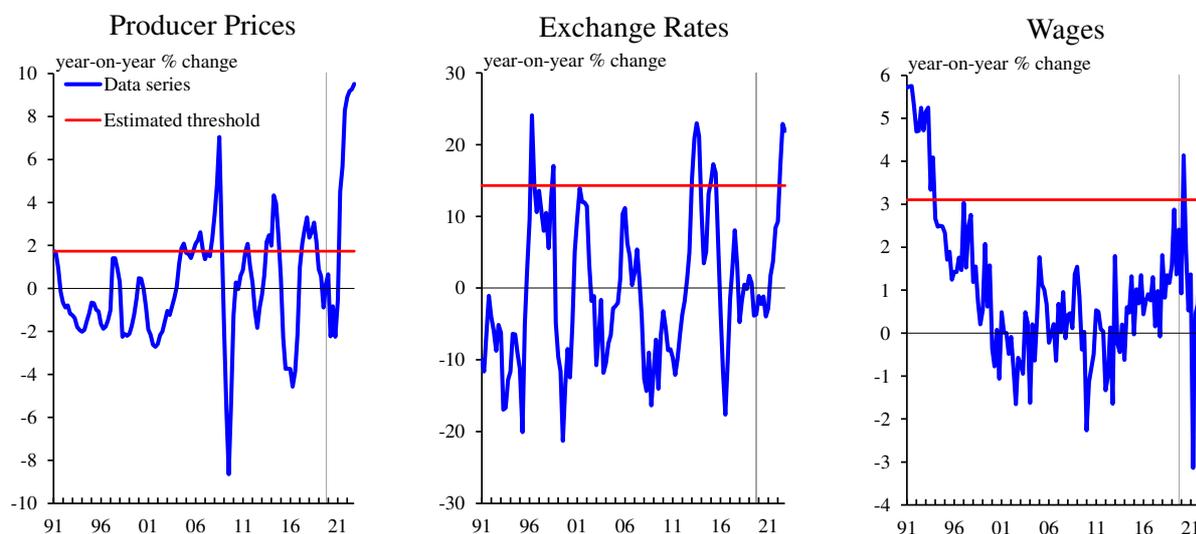
Notes: 1. Figures are the proportion of the weight of CPI items for which the year-on-year rates of increase or decrease were over 0.5 percent.
 2. Figures are calculated using the CPI for all items less fresh food and imputed rent.
 3. The broken lines show the periods that were affected by the consumption tax hikes (fiscal 1997, fiscal 2014, and from October 2019 to September 2020).
 4. The figure for fiscal 2023 is the April-October average.
 Source: Ministry of Internal Affairs and Communications.

Nonlinear Input Cost Pass-Through to Consumer Prices: A Threshold Approach

Sasaki, T., Yamamoto, H., and Nakajima, J., *Bank of Japan Working Paper Series* (May 2023)

- There is a statistically significant nonlinearity in that the pass-through to CPI inflation of increases in producer prices, exchange rates, and wages rises once the increase in each of these variables exceeds a certain threshold.

Estimated Thresholds

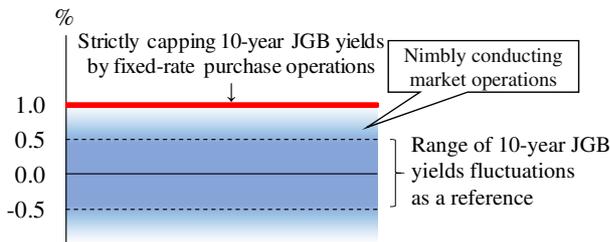


Note: The estimated thresholds are for CPI inflation (less fresh food and energy). The estimation period is from 1991 to 2019. The gray lines in the figures show the end of the estimation period.
 Sources: Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare; Bank of Japan; FRED.

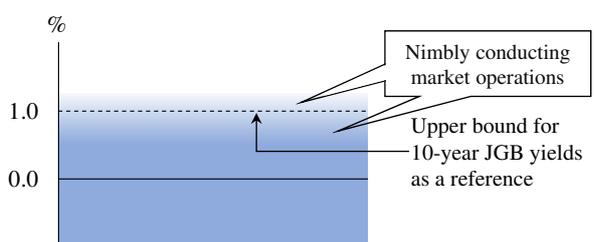
Further Increasing the Flexibility in the Conduct of Yield Curve Control (YCC) (Decided at the October 2023 Monetary Policy Meeting)

- The Bank will patiently continue with monetary easing under Yield Curve Control (the short-term policy interest rate: -0.1%, the long-term interest rate: around 0%), aiming to support Japan's economic activity and thereby facilitate a favorable environment for wage increases.
 - Toward the end of the projection period, the Bank expects that underlying CPI inflation will increase gradually toward achieving the price stability target of 2 percent, while this increase needs to be accompanied by an intensified virtuous cycle between wages and prices.
- With extremely high uncertainties surrounding economies and financial markets at home and abroad, the Bank judges that it is appropriate to increase the flexibility in the conduct of yield curve control, so that long-term interest rates will be formed smoothly in financial markets in response to future developments.

<Previous Conduct of YCC>

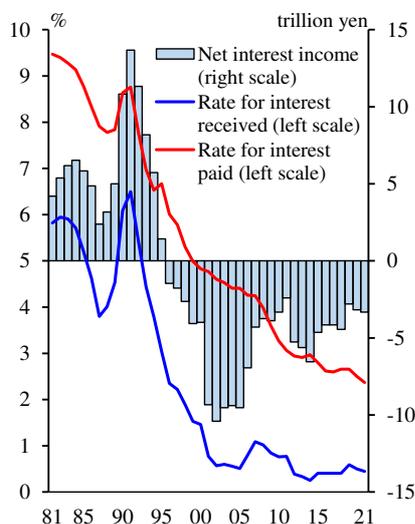


<Conduct of YCC after Further Increasing the Flexibility>

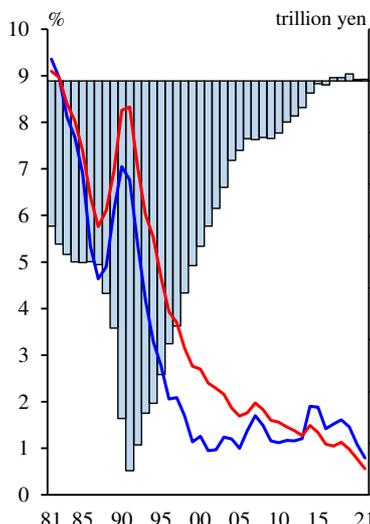


Impact of the Past Interest Rate Changes on Net Interest Income

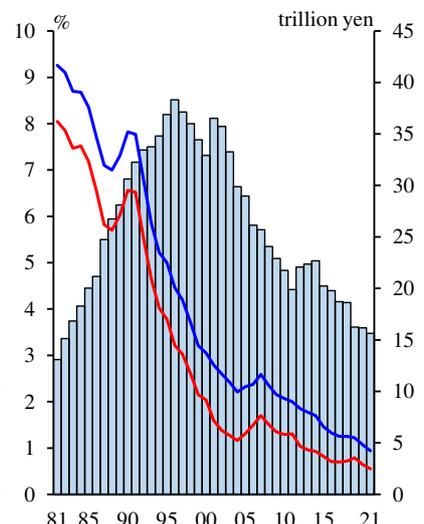
Household Sector



Corporate Sector



Financial Institutions



Monetary Policy Review from a Broad Perspective

1. Approach to Analyses

- The Bank will assess the effects of various unconventional monetary policy measures that have been implemented over the past 25 years in the context of interactions with developments in economic activity and prices at each point in time. In addition, it will analyze the impact of these measures on financial markets and the financial system, including their side effects.
 - Deepen understanding on (1) how various changes in the economic environment -- e.g., globalization and the declining and aging population -- have affected factors such as corporate and household behavior and the formation mechanisms of wages and prices and (2) the implications that the effects of these changes have had for monetary policy
 - Flexibly consider specific themes of the analyses during the course of the review

2. Approach to Exchanging Views and Other Initiatives

- The Bank will incorporate diverse expertise and take various initiatives with a view to enhancing the review's objectivity and transparency. Such initiatives include not only internal analyses but also those listed below.
 - Make use of existing series of materials, such as reports and surveys, and invite public comment
 - Exchange views on occasions such as meetings with local and business leaders
 - Hold discussions, such as at workshops (one held on December 4, 2023 and another scheduled for around May 2024)
 - Exchange views with foreign experts