Economic Activity, Prices, and Monetary Policy in Japan

Speech at a Meeting with Local Leaders in Miyagi

February 19, 2025

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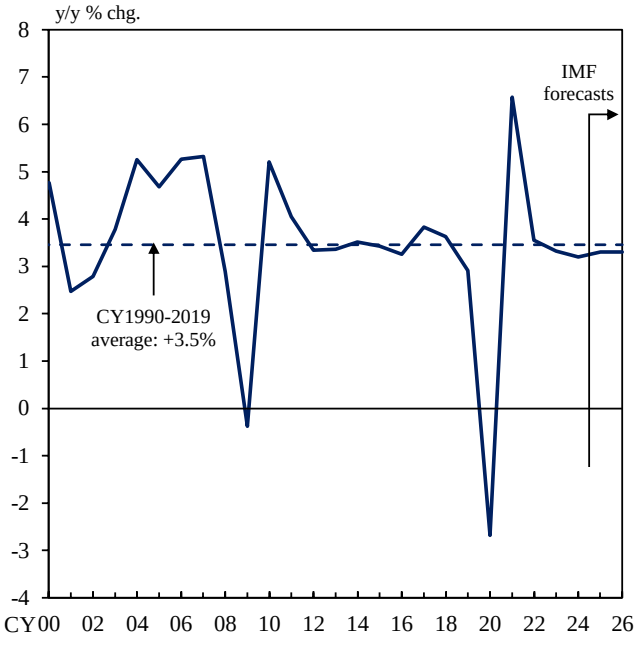
Member of the Policy Board
Bank of Japan

Chart 1

Developments in Overseas Economies (IMF's January 2025 WEO *Update*)

Global Growth Rate

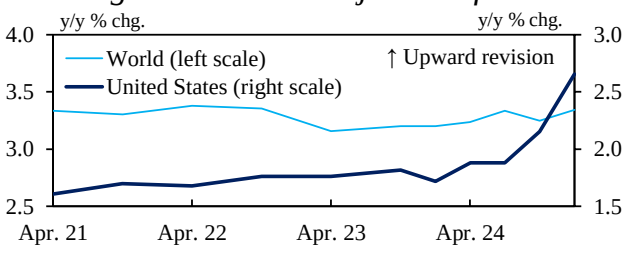


Major Economies' Growth Rates

y/y % chg., % points

	CY 2023	CY 2024	CY 2025 [Forecast]	CY 2026 [Forecast]
World	3.3	3.2	3.3 (0.1)	3.3 (0.0)
Advanced economies	1.7	1.7	1.9 (0.1)	1.8 (0.0)
United States	2.9	2.8	2.7 (0.5)	2.1 (0.1)
Euro area	0.4	0.8	1.0 (-0.2)	1.4 (-0.1)
Emerging market and developing economies	4.4	4.2	4.2 (0.0)	4.3 (0.1)
China	5.2	4.8	4.6 (0.1)	4.5 (0.4)

Changes in Growth Projections for 2025

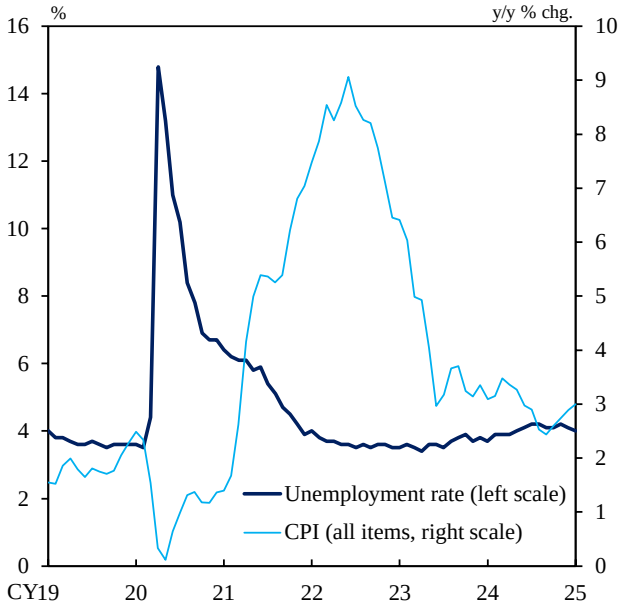


Note: In the table, figures in brackets are the differences from the forecasts in the October 2024 *World Economic Outlook* (WEO).
Source: IMF.

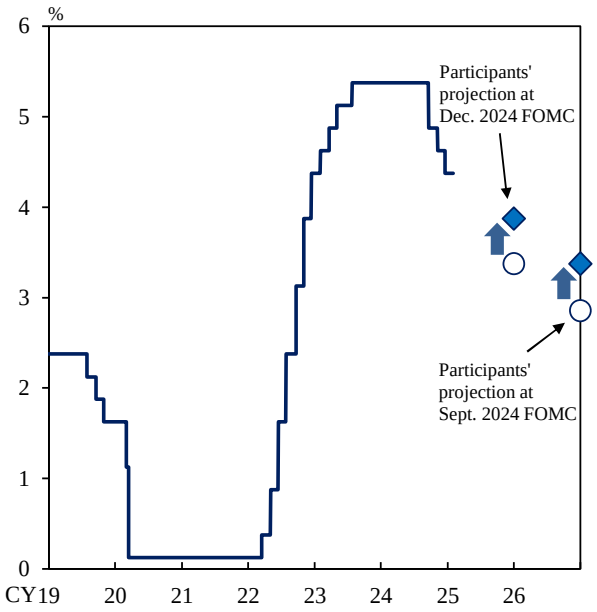
Chart 2

The U.S. Economy

Employment and Prices



Policy Interest Rate



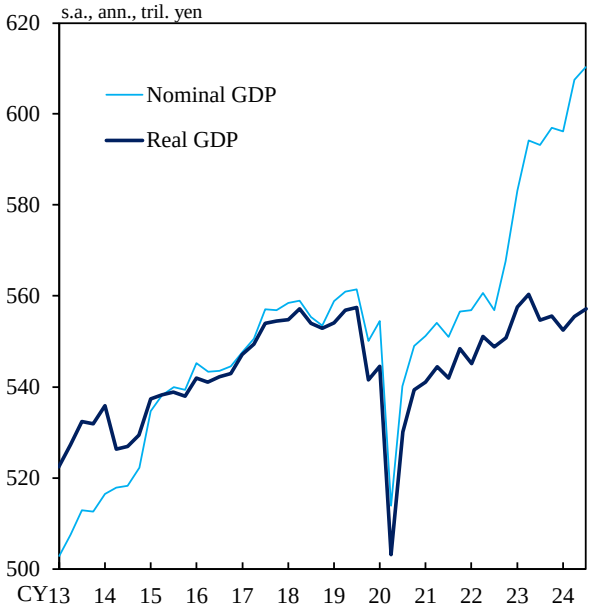
Note: In the right panel, figures are the medians of the target ranges for the federal funds rate. Figures for participants' projections are the medians of all participants' projections at the FOMC meetings.

Sources: Bloomberg; BLS; FRB.

Chart 3

GDP and Outlook for Economic Activity and Prices

GDP



Outlook for Economic Activity and Prices (January 2025 Outlook Report)

y/y % chg.

	Real GDP	CPI (less fresh food)	CPI (less fresh food and energy)
Fiscal 2024	+0.5	+2.7	+2.2
As of October 2024	+0.6	+2.5	+2.0
Fiscal 2025	+1.1	+2.4	+2.1
As of October 2024	+1.1	+1.9	+1.9
Fiscal 2026	+1.0	+2.0	+2.1
As of October 2024	+1.0	+1.9	+2.1

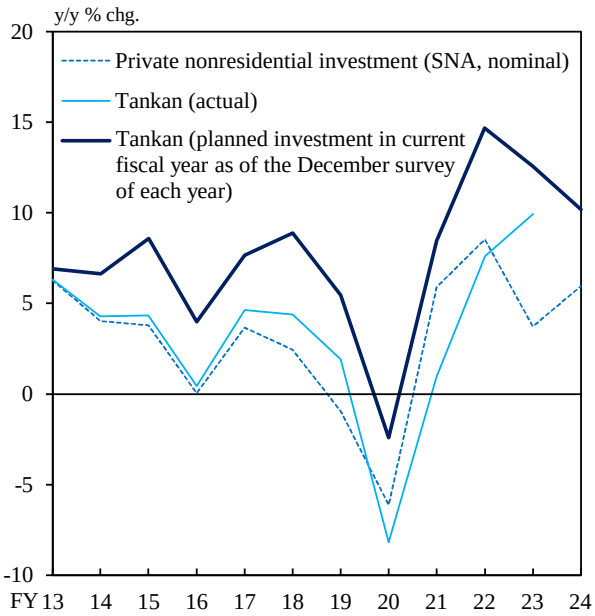
Note: In the right table, figures indicate the medians of the Policy Board members' forecasts (point estimates).

Sources: Cabinet Office; Bank of Japan.

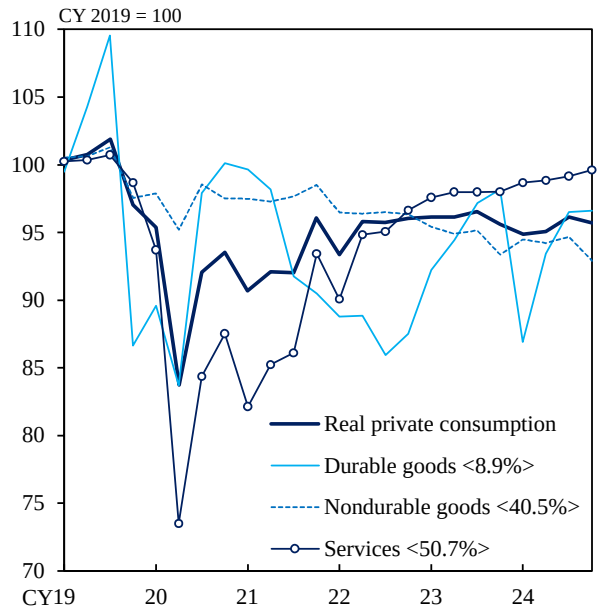
Chart 4

Corporate Sector and Private Consumption

Planned and Actual Business Fixed Investment



Real Private Consumption



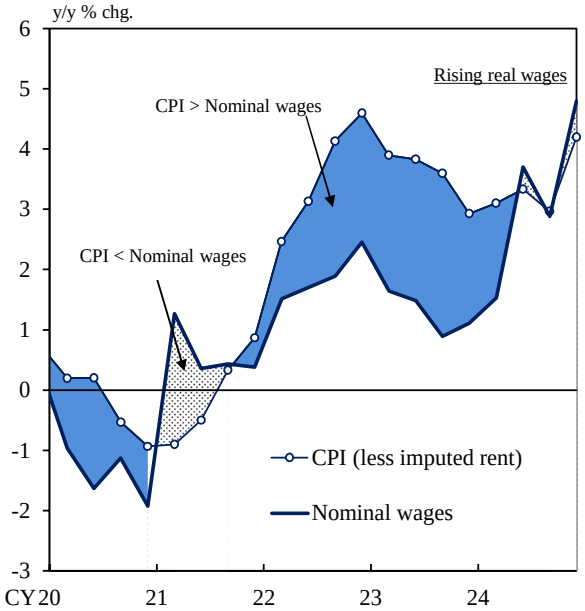
Notes: 1. In the left panel, the *Tankan* figures are for all industries including financial institutions. The figures include software and R&D investments and exclude land purchasing expenses. R&D investment is not included before the March 2017 survey. The figure for private nonresidential investment for fiscal 2024 is the 2024/Q2-Q3 average.
2. In the right panel, figures for real private consumption are the real Consumption Activity Index (travel balance adjusted) based on Bank staff calculations, which exclude inbound tourism consumption and include outbound tourism consumption. Figures in angle brackets show the weights in the index.

Sources: Cabinet Office; Bank of Japan.

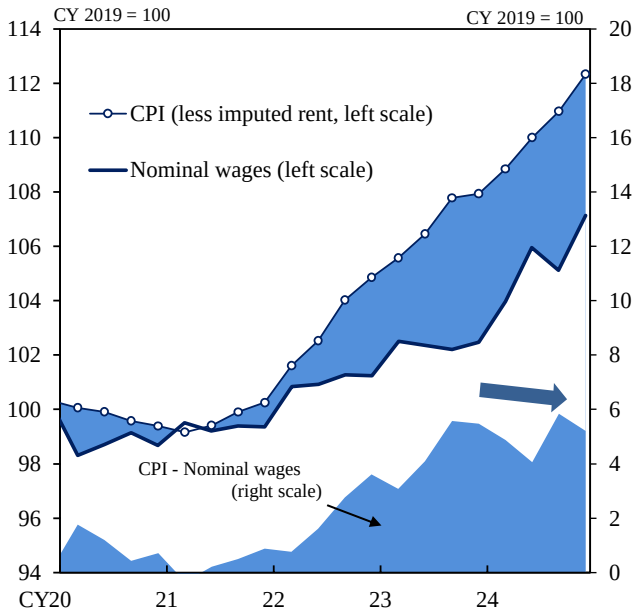
Chart 5

Nominal Wages and Prices

Yearly Change



Estimated Level



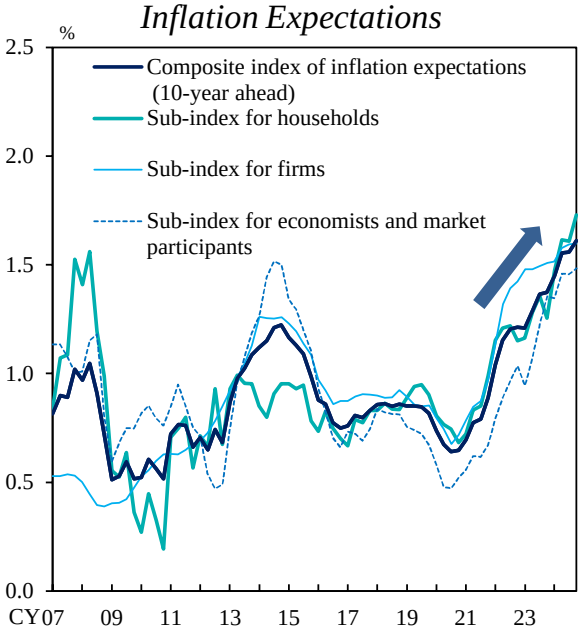
Notes: 1. Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February. Figures for 2024/Q4 are those for December.
2. In the right panel, figures for nominal wages are seasonally adjusted.

Sources: Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications.

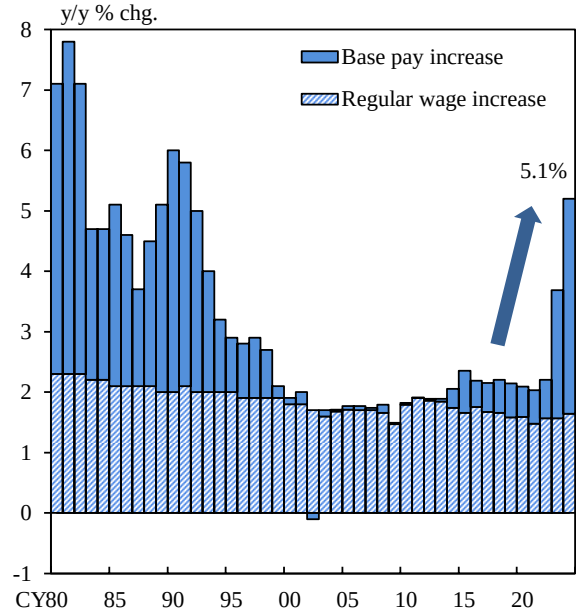
Chart 6

Inflation Expectations and Wage Growth Rate

Composite Index of Inflation Expectations



Wage Growth Rate



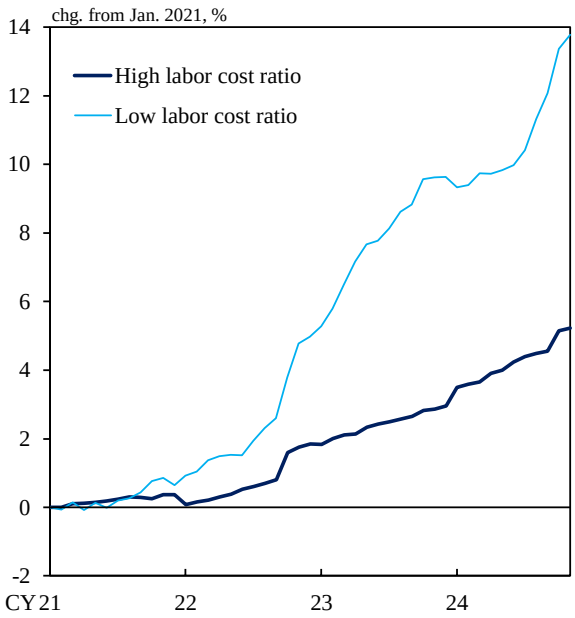
Notes: 1. In the left panel, the composite index is calculated by extracting the common components, based on the first principal component, of the inflation expectations of firms, households, and economists and market participants. For details of the calculation method, see Box 4 in the April 2024 Outlook Report.
2. In the right panel, figures from 1980 to 2014 are those published by the Central Labour Relations Commission, while those from 2015 to 2024 are figures released by Rengo.

Sources: Bloomberg; Central Labour Relations Commission; Consensus Economics Inc., *Consensus Forecasts*; Japanese Trade Union Confederation (Rengo); QUICK, *QUICK Monthly Market Survey <Bonds>*; Bank of Japan.

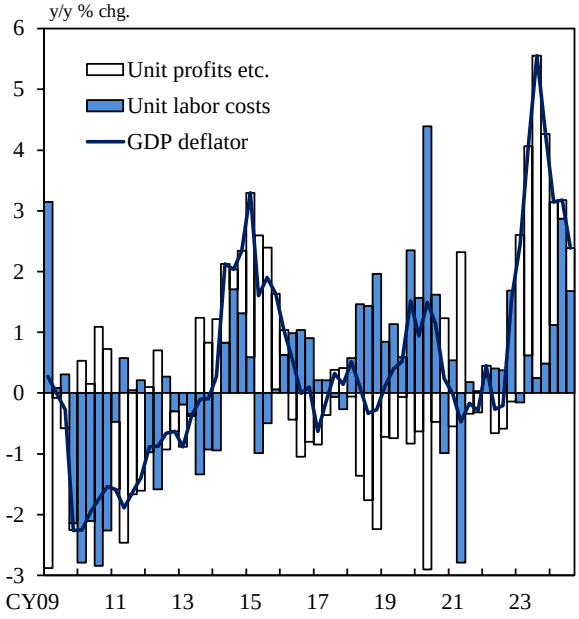
Chart 7

Higher Labor Costs and Prices

CPI by Labor Cost Ratio



GDP Deflator



Notes: 1. In the left panel, figures are based on Bank staff calculations using the CPI excluding fresh food, energy, imputed rent, and the effects of temporary factors. For details of the calculation method, see Box 5 in the January 2025 Outlook Report.
2. In the right panel, unit labor costs = nominal compensation of employees / real GDP.

Sources: Cabinet Office; Ministry of Internal Affairs and Communications.

Wage and Price Developments from Fiscal 2022 (From the Perspective of Three Phases)

1st phase — **Rise in imported raw material prices around 2022**

1st big push

Price pass-through of higher imported prices

2nd phase — **Relatively high wage hikes in the annual spring labor-management wage negotiations in 2023 and 2024, and expected in 2025**

2nd big push

Price pass-through of wage increases

3rd phase — **From fiscal 2025:**
Further spread to services prices
Rise in inflation expectations

Inflationary pressure due to domestic factors

➡ ***Toward achieving the price stability target***

Decision at the January 2025 MPM

Japan's economic activity and prices have been **developing generally in line with the Bank's outlook**, and **the likelihood of realizing the outlook has been rising**.

Medians of the Policy Board Members' Forecasts (y/y % chg.)

	Fiscal 2024	Fiscal 2025	Fiscal 2026
Real GDP	0.5 (-0.1)	1.1 (—)	1.0 (—)
CPI (all items less fresh food)	2.7 (+0.2)	2.4 (+0.5)	2.0 (+0.1)
CPI (all items less fresh food and energy)	2.2 (+0.2)	2.1 (+0.2)	2.1 (—)

Note: Figures in parentheses indicate changes from the October 2024 Outlook Report.

Wages

- Firms have expressed the view that they will **continue to raise wages steadily**, following the solid wage increases last year.

Prices

- With wages continuing to rise, **underlying CPI inflation has been increasing gradually toward 2 percent**.
- CPI inflation is likely to be at around 2.5 percent for fiscal 2025, due to the higher import prices stemming from the yen's depreciation etc.

Overseas economies

- Global financial and capital markets have been **stable on the whole**, while attention has been drawn to various uncertainties.

Adjusting the degree of monetary accommodation from the perspective of sustainable and stable achievement of the price stability target of 2 percent

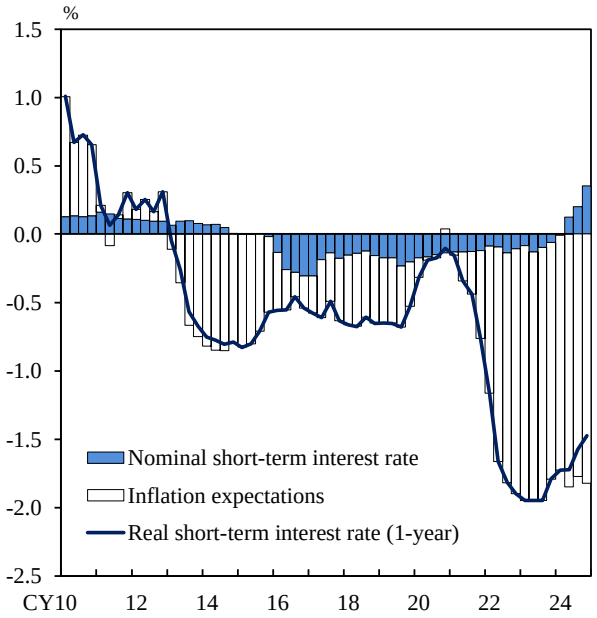
Short-term interest rate : raised to "around 0.5%"
(uncollateralized overnight call rate) (previously "around 0.25%")

- Real interest rates are expected to remain significantly negative, and accommodative financial conditions will continue to **firmly support economic activity**.
- If the outlook presented in the January Outlook Report will be realized, the Bank will accordingly continue to raise the policy interest rate and adjust the degree of monetary accommodation.

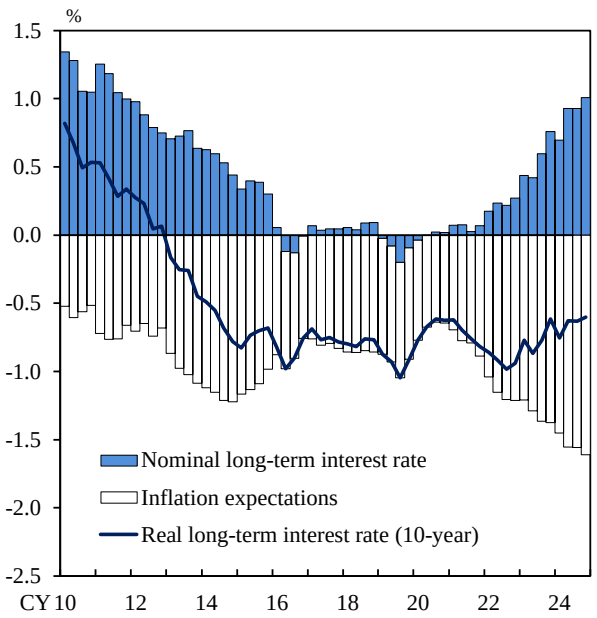
Chart 10

Real Interest Rate

Real Short-Term Interest Rate (1-Year)



Real Long-Term Interest Rate (10-Year)



Note: Figures for real interest rates are calculated by deducting inflation expectations from JGB yields for each maturity. Figures for inflation expectations are based on Bank staff calculations using the expectations of various economic entities (firms, households, and experts) at different horizons. Specifically, the data used in the calculations are as follows: for firms, the *Tankan*; for households, the *Opinion Survey on the General Public's Views and Behavior*; for experts, the *QUICK Survey*, the *Consensus Forecasts*, and inflation swap rates.

Sources: Bloomberg; Consensus Economics Inc., *Consensus Forecasts*; QUICK, *QUICK Monthly Market Survey <Bonds>*; Bank of Japan.

Chart 11

Review of Monetary Policy from a Broad Perspective: Developments in Economic Activity, Prices, and Financial Conditions

Since the latter half of 1990s: prolonged moderate deflation

- **Chronic demand shortages** with **a decline in the natural rate of interest**
  - Conventional monetary policy measures were unable to sufficiently stimulate the economy due to the effective lower bound on nominal interest rates.
  - The decline in the natural rate of interest was attributable to factors such as asset prices falling and growth expectations taking a downward turn after the burst of the bubble economy; firms becoming more cautious in their risk-taking, particularly due to the Global Financial Crisis; and demographic changes.
- Downward pressure on prices due to globalization and IT innovations
- **Entrenchment of behavior and a mindset based on the assumption that wages and prices will not increase easily**

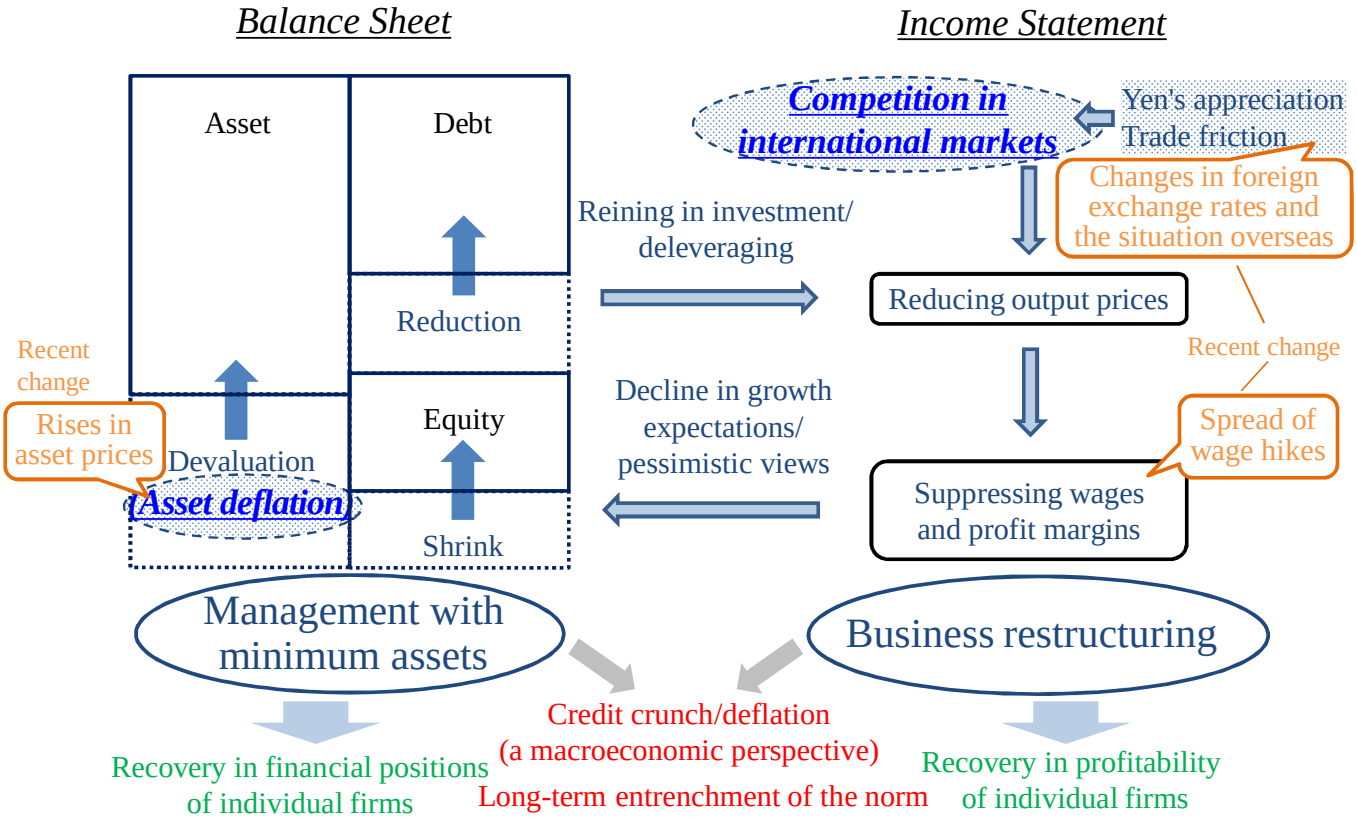
Since 2013: moved out of the state of deflation

- The chronic shortage of demand abated, mainly due to large-scale monetary easing and fiscal stimulus packages, as well as changes in the external environment
- Inflation expectations rose somewhat, and **the rate of change in prices turned positive but remained below 2 percent**
  - There remained room for increases in the labor supply, such as from women and seniors.
  - It took time for the behavior and mindset based on the assumption that wages and prices will not increase easily to change.

In the 2020s: changes since the COVID-19 pandemic

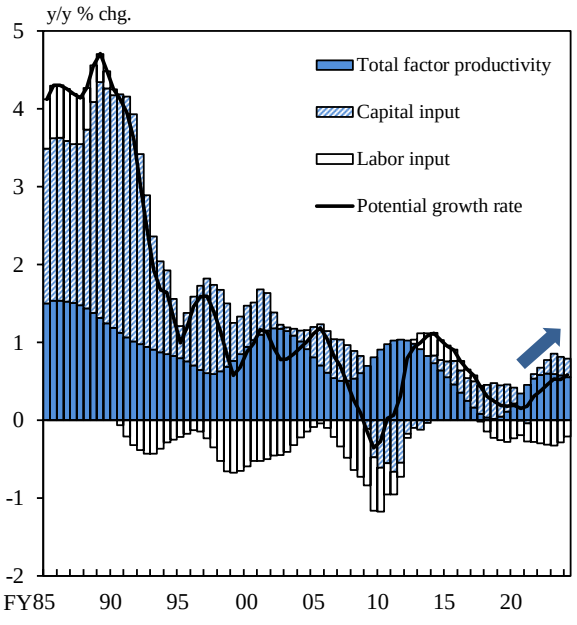
- Firms' **behavior has shifted more toward raising wages and prices**
  - Labor shortages became more pronounced (shrinkage of the room for additional labor supply and increased number of employed persons due to monetary easing and other factors).
  - Import prices rose significantly and government measures were taken to support firms to pass on higher input prices to their selling prices and raise wages.

My View on Corporate Behavior in the Post-Bubble Period

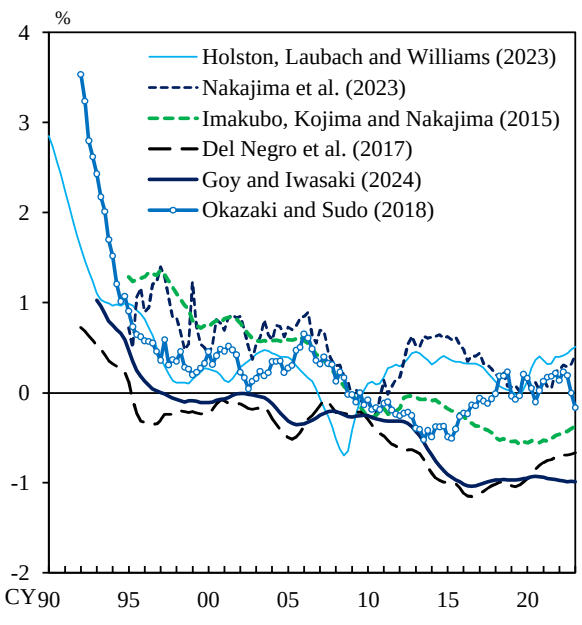


Potential Growth Rate and Natural Rate of Interest

Potential Growth Rate



Natural Rate of Interest

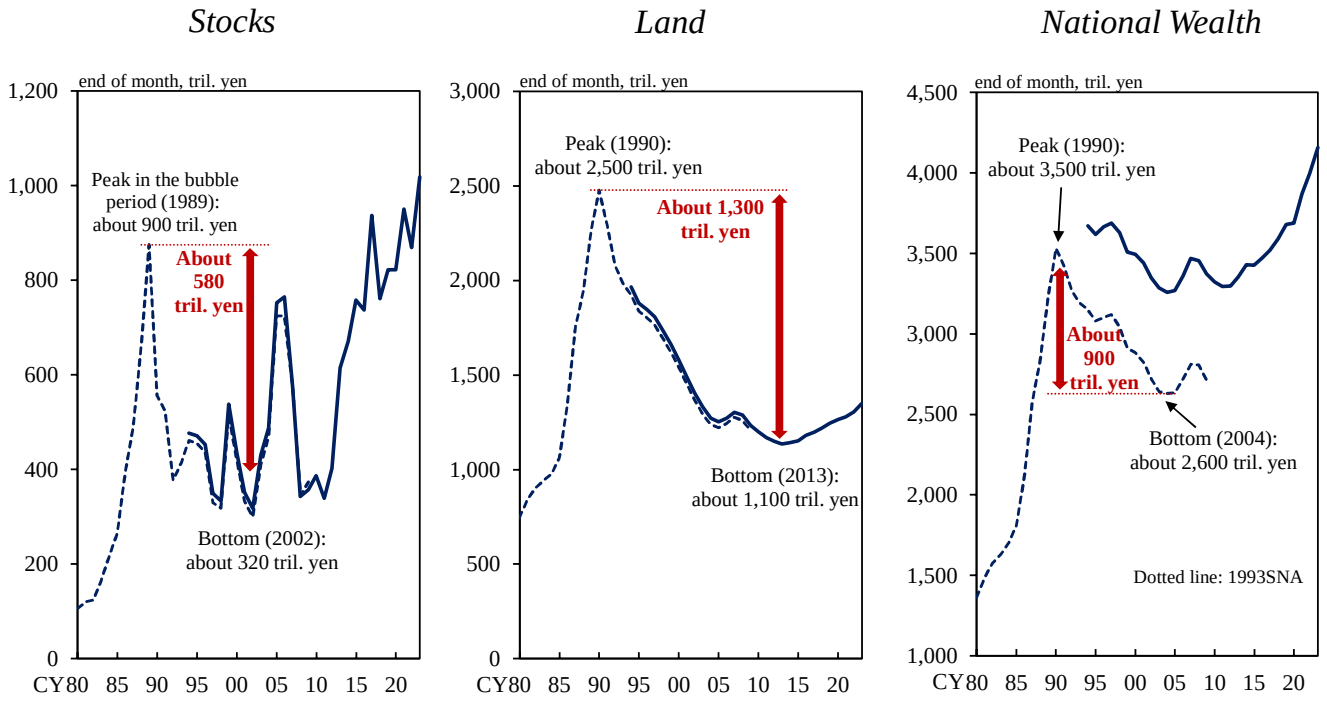


Notes: 1. In the left panel, figures are Bank staff estimates.
2. In the right panel, the estimates are based on Bank staff calculations using the models proposed in the respective papers.

Sources: Bloomberg; Cabinet Office; Consensus Economics Inc., *Consensus Forecasts*; Ministry of Finance; Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications; Bank of Japan.

Chart 14

Asset Prices and National Wealth



Note: Figures are based on the SNA. Dotted lines are based on the 1993SNA (benchmark year: 2000).
Source: Cabinet Office.

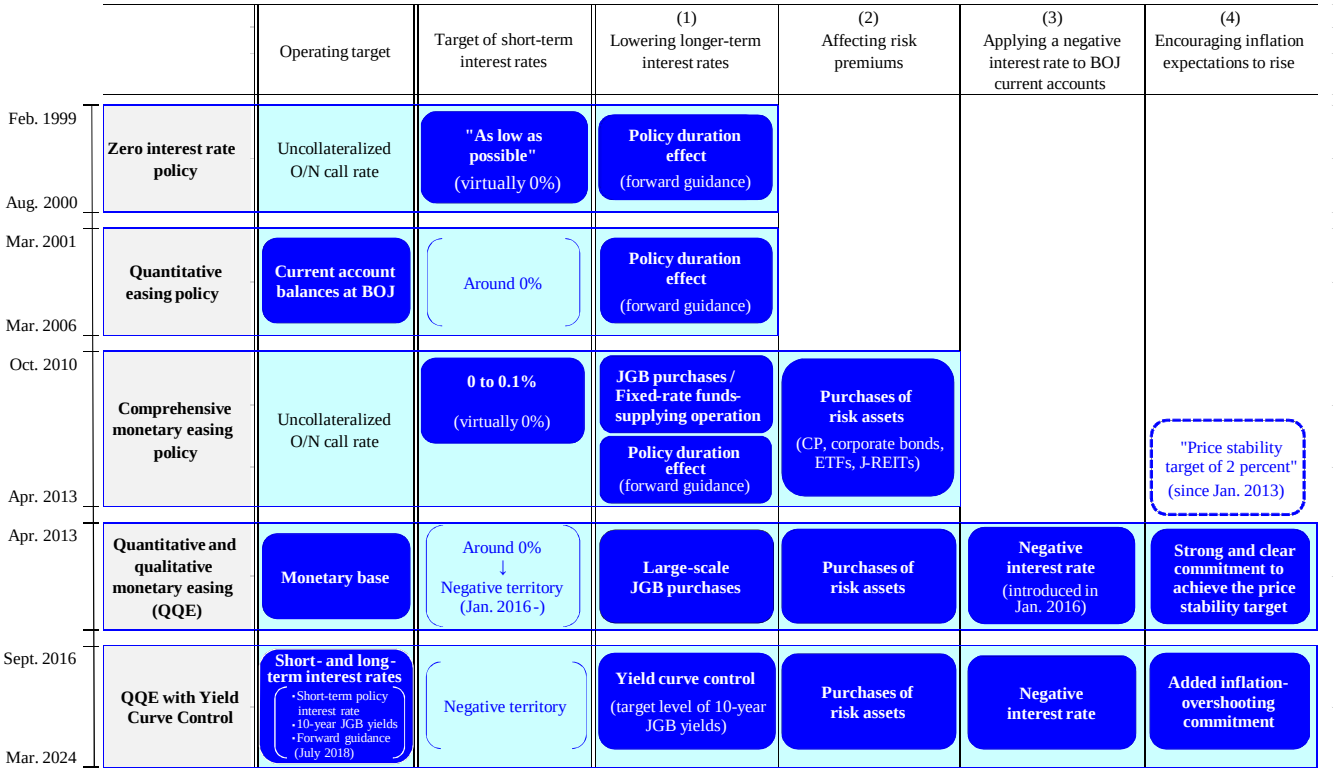
Chart 15

U.S. Dollar/Yen

Source: Bank of Japan.

Chart 16

Transition of the Bank of Japan's Monetary Policy



Source: Bank of Japan.

Chart 17

Introduction of Unconventional Monetary Policies

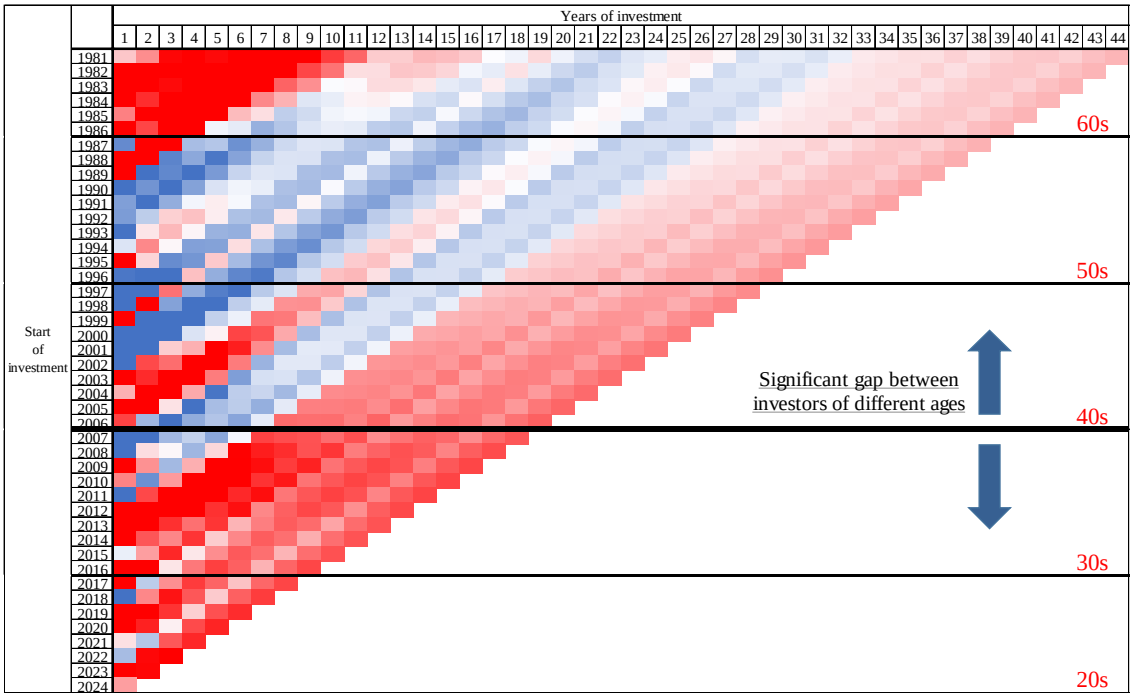
	BOJ	FRB	ECB
Zero interest rate policy	February 1999	December 2008	July 2012
Quantitative easing policy	March 2001	November 2008	May 2009
Negative interest rate policy	January 2016	—	June 2014
Yield curve control (target level of 10-year JGB yields)	September 2016	—	—

Notes: 1. The underlined dates indicate that the Bank of Japan was the first to introduce the policies.
2. The date of the introduction of the ECB's zero interest rate policy is when the deposit facility rate was set at 0 percent. The dates for the FRB's and the ECB's quantitative easing policies are when they announced their decisions to purchase mortgage-backed securities (MBS) and covered bonds, respectively.

Sources: ECB; FRB; Bank of Japan.

Chart 18

Cumulative Returns from Investment in Japanese Stocks by Age of Investors



Period with negative cumulative returns (percentage)

60s average: 38%

50s average: 50%

40s average: 32%

30s average: 9%

20s average: 11%

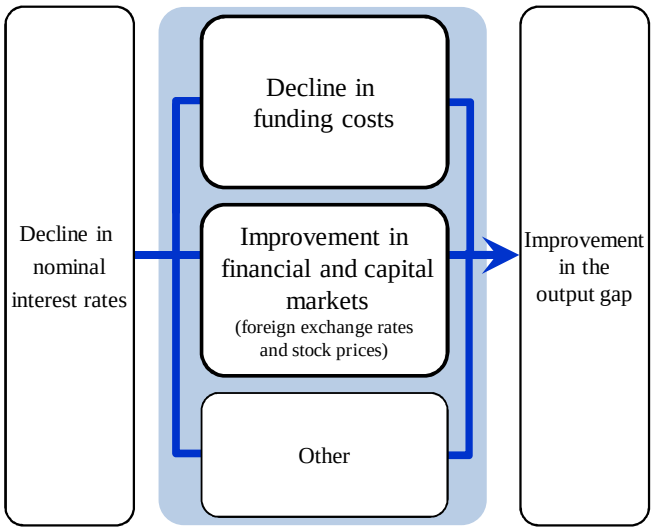
Note: Cumulative returns are estimated as of the end of 2024 by age of investors, based on the assumption that a fixed amount of the Nikkei 225 Stock Average is purchased every month from the beginning of the year. Red shows positive returns and blue shows negative returns. Darker shadows show larger positive or negative returns. Percentages for the period with negative cumulative returns are calculated by dividing "years with negative cumulative returns as of the year end" by "total years of investment."

Source: Bloomberg.

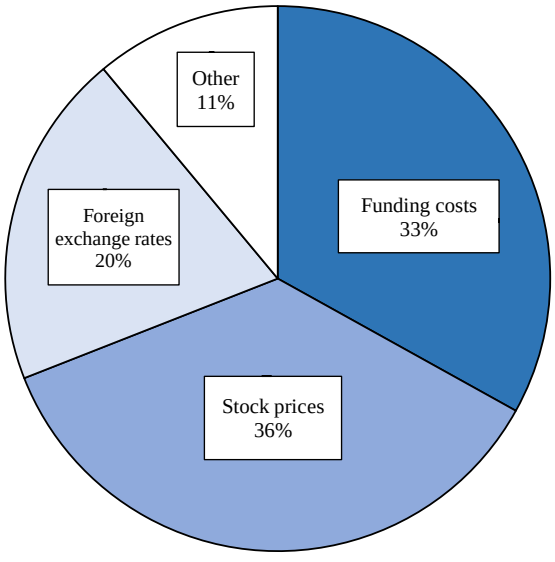
Chart 19

Transmission Channels of Lower Interest Rates

Overview



Improvement in the Output Gap (Breakdown by Channel)



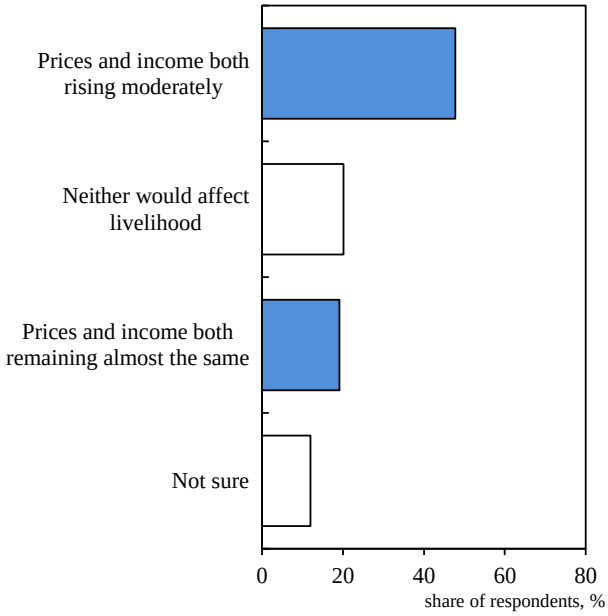
Notes: 1. Figures are based on a VAR model with coefficient restrictions using eight variables: output gap, interest rates (3-month), interest rate spreads (2-year minus 3-month, 5-year minus 2-year, 10-year minus 5-year), aggregate funding costs, nominal effective exchange rates of the yen, and stock prices.
2. Aggregate funding costs are the weighted average of bank lending rates and issuance yields for CP and corporate bonds.
3. In the right pie graph, figures show the 5-year cumulative effects.

Sources: Bloomberg; Bank of Japan; etc.

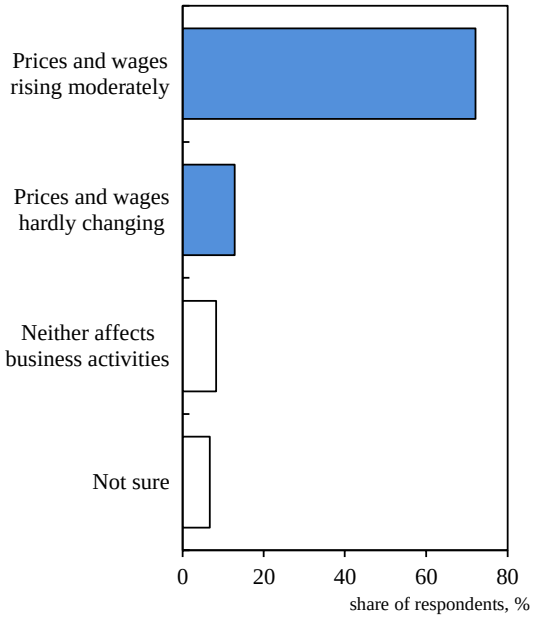
Chart 20

Preferable State of Prices, Income, and Wages

Households (Opinion Survey)



Firms (Large-Scale Corporate Survey)



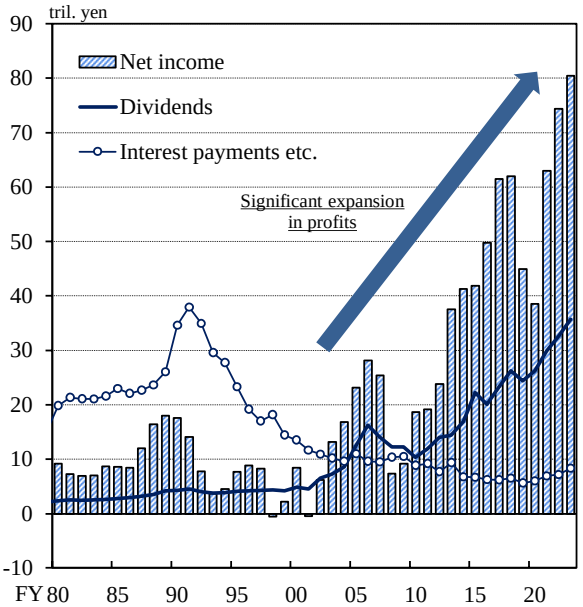
Note: For details of the left and right panels, see the *Opinion Survey on the General Public's Views and Behavior* (September 2024 Survey) and the *Survey regarding Corporate Behavior since the Mid-1990s*, respectively.

Source: Bank of Japan.

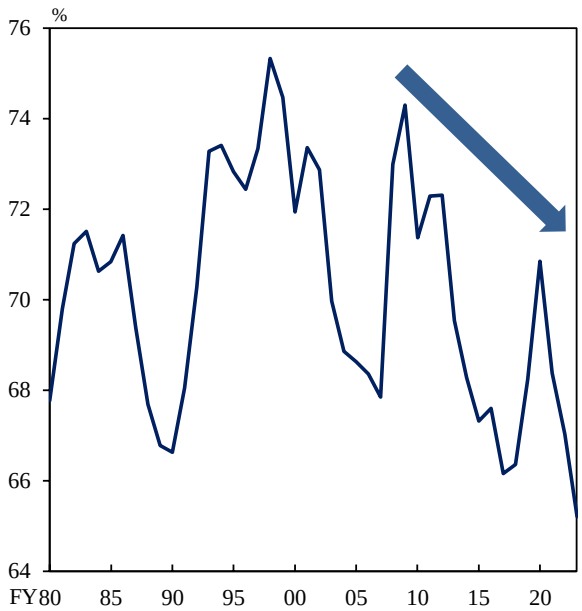
Chart 21

Corporate Profits

Corporate Profits and Returns to Investors



Labor Share



Notes: 1. Figures are based on the *Financial Statements Statistics of Corporations by Industry, Annually*, and exclude the finance and insurance industries.
2. Labor share = personnel expenses / value-added. Value-added = operating profits + personnel expenses + depreciation expenses.

Source: Ministry of Finance.

Chart 22

My View on Mechanism of Expanding Corporate Profits and Ensuing Challenges

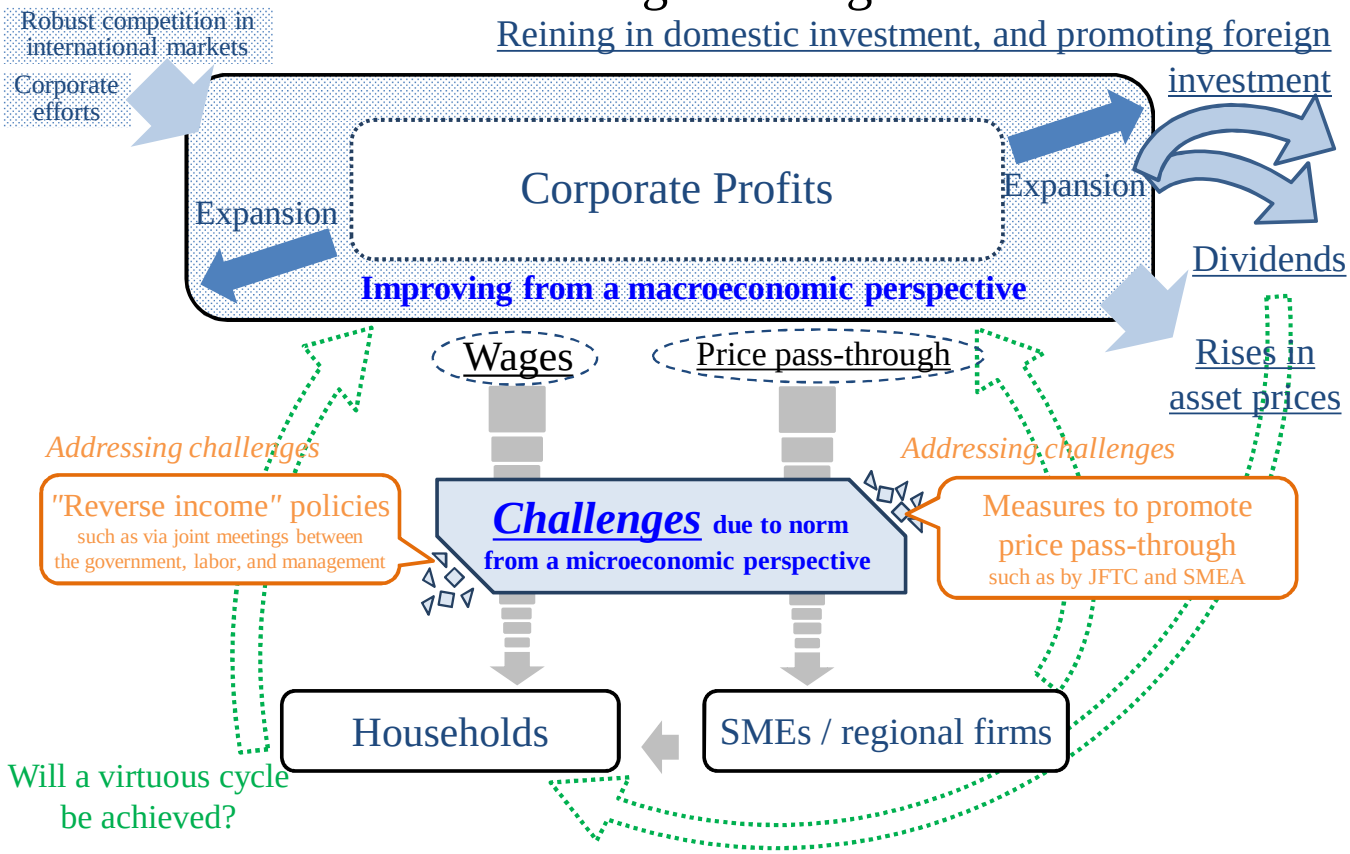
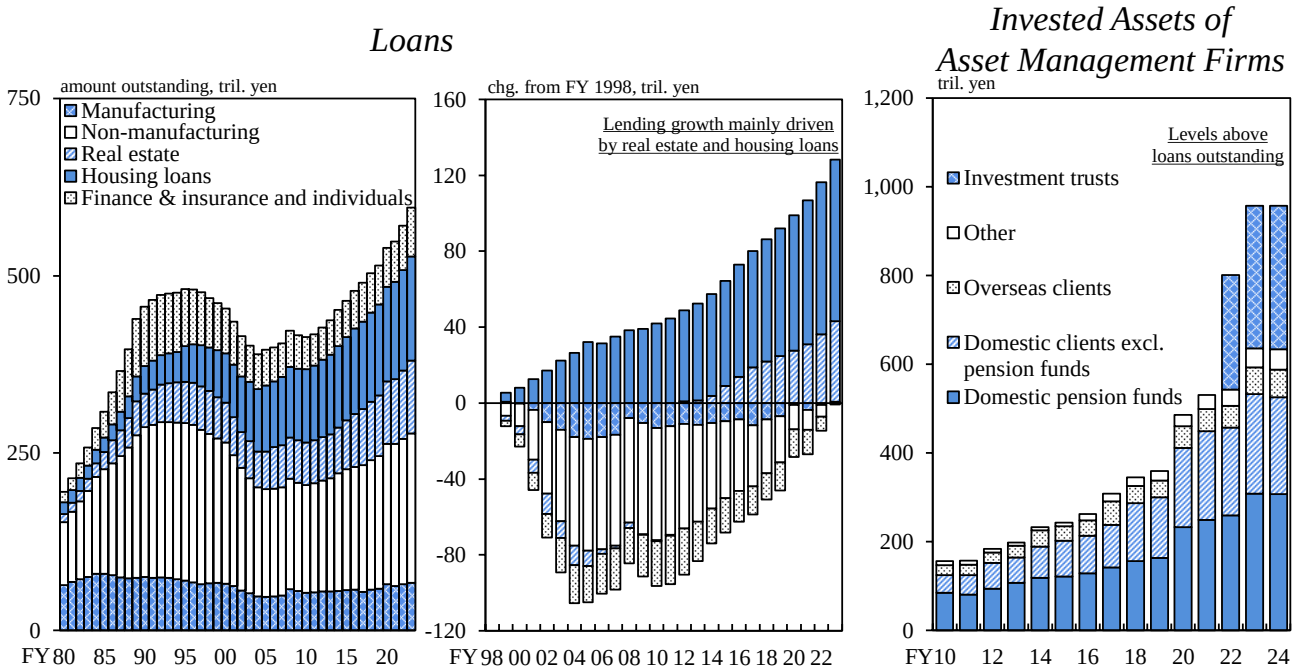


Chart 23

Changes in Financial Intermediation

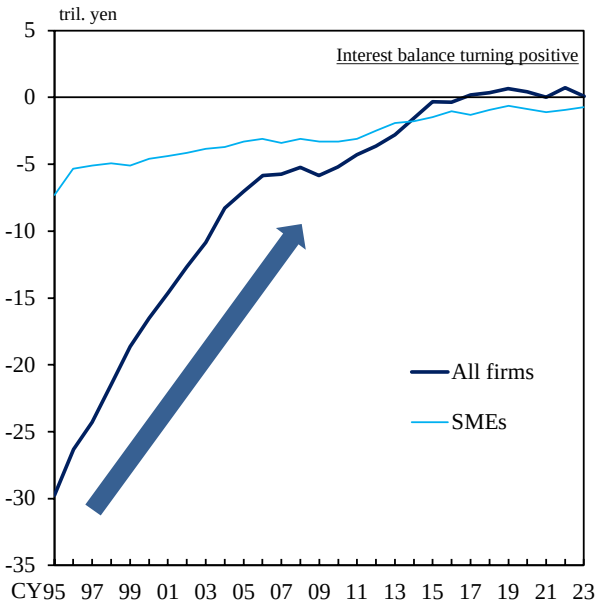


Notes: 1. In the left and center panels, figures cover domestically licensed banks (banking accounts of domestic branches). Figures for "non-manufacturing" exclude real estate and finance and insurance, and figures for "finance & insurance and individuals" exclude housing loans.
2. In the right panel, figures for "overseas clients," "domestic clients excl. pension funds," and "domestic pension funds" are assets for discretionary businesses. Figures for fiscal 2024 are those for the end of September 2024. Figures for "investment trusts" are from fiscal 2022 onward due to data constraints.

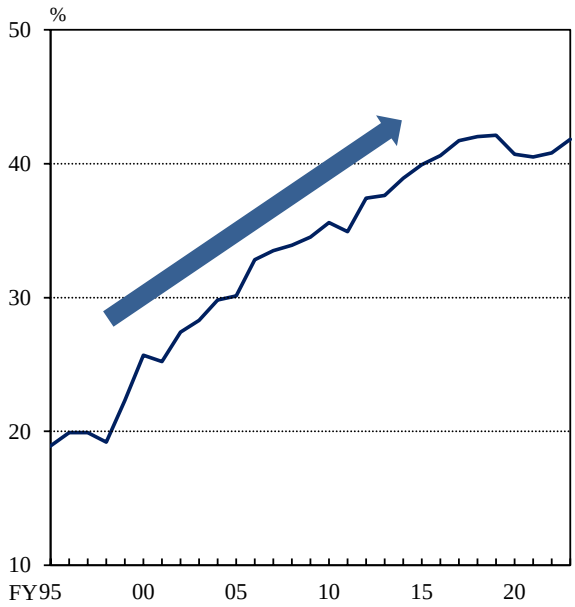
Sources: Japan Investment Advisers Association; Bank of Japan.

Improvement in Corporate Finance

Interest Balance



Capital Adequacy Ratio



Note: Interest balance for small and medium-sized enterprises (SMEs) in the left panel includes dividend income.
Sources: Cabinet Office; Ministry of Finance.