September 2, 2025
Bank of Japan

Japan's Economy and Monetary Policy

Speech at a Meeting with Local Leaders in Eastern Hokkaido

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(English translation based on the Japanese original)

Introduction

Thank you for joining us today. Thank you also for your support for the Bank of Japan and its Kushiro Branch and Obihiro Office.

I. Economic Activity and Prices

Let me begin by discussing the outlook for Japan's economic activity and prices. One factor that could sway the outlook is the direction taken by the new U.S. administration.

The Philosophy and Policies of the New U.S. Administration

Eight months have passed since the new U.S. administration took office, and I tend to believe I have learned a lot about its approaches. However, the unexpected developments I face almost daily make me realize that there are still things to be learned.

So, I am still in the process of formulating my view, but if I could offer some personal and tentative reflections, I would argue that there are three characteristics that define the current administration's way of thinking.

First, the administration adopts a holistic approach and treats political, economic, and cultural matters, as well as domestic and international affairs, as integral parts of a single, inseparable policy agenda.

Second, while it is highly flexible in its tactical decisions, switching its approaches as situations evolve and choosing when to press ahead, pause, or make temporary retreats, the administration remains persistent in its strategic choices about what it ultimately aims to attain.

Third, it is unfettered from conventional wisdom and orthodoxy, focuses on facts that define the locus and sources of power, and explores opportunities that have thus far not been exploited.

Consider, for instance, trade policy. Our textbooks teach early on that the rationale for preserving a free trade system lies in the principle of comparative advantage -- each country

specializes in what it produces best, thereby promoting an international division of labor, enhancing global economic efficiency and growth, and ultimately benefiting all countries. The conclusion, therefore, is that the global community should work together to pursue a positive-sum game. This is part of the foundational logic of the Washington Consensus, and I believe it contains much truth.

However, this framework does not necessarily capture all aspects of the matter. A superpower tends to possess a market large enough for its trade policy to influence import prices. It also has sufficient leverage to deter retaliatory tariffs from trading partners. According to the theory of optimal tariffs, for such superpowers, imposing moderate tariffs may improve the terms of trade and be more advantageous than forgoing tariffs.[1]

Moreover, given today's geopolitical environment, it is increasingly important to consider economic security and ensure strategic autonomy and indispensability.

Additionally, some argue that the most efficient economic system is not necessarily ideal in terms of fairness and distribution, and that a government's redistribution policies may not be sufficiently effective. This kind of argument may become more relevant as we face increasing social and economic divides.

Even considering tariffs alone, one may thus detect a confluence of various elements: an economic goal (i.e., better terms of trade), foreign policy considerations (economic security), and a political agenda (fairness and distribution). An element of cultural protest against intellectual elites may be at play as well, alleging that they have defended neoliberal systems and the resultant extreme inequality on the grounds of economic efficiency. Tariffs may thus be seen as a manifestation of a broad, transversal movement involving economics, diplomacy, politics, and culture.

In this light, discussing U.S. policy solely in terms of tariffs is too narrow an approach. A more holistic perspective on the policy is needed to assess the medium- to long-term

[1] Nicholas Kaldor, "A Note on Tariffs and the Terms of Trade," *Economica* 7, no. 28, (1940): 377-80.

outlook for Japan's economic activity and prices. That said, given that I am not an expert in politics, diplomacy, or culture, in the remarks that follow, let me focus on the near-term effects of tariff policy.

The Impact of Tariff Policy

Even the narrower task of identifying the channels and assessing the degree of impact U.S. tariff policy has on Japan's economic activity and prices is not easy.

First off, it is not simple even to assess the impact of the direct channel, in that U.S. tariffs make Japanese exports difficult.

If a Japanese exporter chooses to maintain export prices, selling prices in the United States will be raised by the amount of the tariffs, and demand may go down. On the other hand, if the exporter chooses to lower export prices to avoid hikes in U.S. selling prices, its profit margins will be squeezed.

In practice, however, the full manifestation of tariff impacts can be delayed. Exporters may record a temporary increase in sales if there is a front-loading of exports ahead of a tariff hike. If importers maintain resale prices relying on existing inventories, demand for the products may not be immediately affected.

Uncertainties are not limited to the timing and lags of tariff impacts. For example, if the product in question is an essential item, and the Japanese exporters compete mainly against exporters in jurisdictions facing similar tariff rates, sales may not decline much even in the case where the cost increase due to tariffs is passed on to U.S. customers.

Moreover, since 2021, although the Japanese yen has depreciated significantly, in general, Japanese firms have kept their U.S. dollar-denominated export prices largely unchanged, which has translated into higher yen-denominated export prices (Chart 1). While conditions are likely to vary by firm, Japanese exporters as a whole may have greater leeway in their pricing policy today than during the period in the past when they suffered from the yen's extreme appreciation.

Another transmission channel we need to look at is the one through uncertainty. The planned U.S. "reciprocal tariff" rate on Japan has progressed from 0 percent to 24 percent, then 10 percent, 25 percent, and then to 15 percent. The tariff rates announced for China and Southeast Asian economies, where the competitors and production bases of Japanese manufacturers are located, have also fluctuated. These uncertainties make it extremely difficult for Japanese manufacturers to decide where, when, and how much to produce, export, and invest.

Japan and the United States struck a trade deal in July. This is a major step forward toward alleviating the uncertainties the Japanese economy faces. Nevertheless, negotiations between the United States and some other countries are still ongoing, and some of the specific conditions on sector-specific tariffs have not been decided. The transmission of trade policy to national economies is also uncertain. Overall, it can be said that the global economy still faces a heightened level of uncertainty.

The third potential channel involves a broader slowdown in the global economy, particularly in the U.S. economy, which would lead to lower Japanese exports. Tariffs could raise import prices in the United States, pushing up inflation and dampening consumption. Heightened uncertainties constrain economic activity.

Indeed, the International Monetary Fund (IMF) projected in July a growth rate of the global economy for 2025 that was lower by 0.3 percentage points than the projection it released in January, and stated that risks to the outlook are tilted to the downside. The projection for the growth rate of the U.S. economy was lower by 0.8 percentage points (Chart 2).

U.S. growth in the second quarter, however, was stronger than expected (Chart 3 [left-hand panel]). Moreover, the impact of tariff policies on U.S. consumer prices has not been conspicuous so far (Chart 3 [middle panel]). Nevertheless, as tariff revenue in the United States has jumped already and the producer price index (PPI) for processed goods appears to have picked up, it is argued that exporters will eventually raise export prices, importers' inventories will turn over, tariffs will be passed on, and the effects on consumer prices will become clear.

It is also argued that uncertainty regarding tariffs may have already started to affect household and business sentiment and employment in the United States (Chart 3 [right-hand panel]). Should the inflationary effects of tariffs become more visible, the impact on consumer spending could be further deepened. The effects of changes in immigration policies have also been a topic of discussion.

On the other hand, some argue that if the U.S. administration sets tariff rates in line with the theory of optimal tariffs and uses the resulting revenue for domestic tax cuts, the net impact on the U.S. economy could be positive. Others anticipate positive effects of factors such as the acceleration of the AI revolution, deregulation, changes in environmental policy, and the fall in energy prices.

Clearly, developments in the U.S. economy warrant close attention.

The fourth possible channel is through the financial markets. The markets went through a volatile phase in early April. Although market sentiment has now largely returned to the state seen before April, continued close monitoring of the financial markets is also warranted.

We have looked at the four potential channels of the impact of tariff policy and the possibility that the actual economic impact could prove to be larger or smaller than initially expected. How, then, has the impact materialized in Japan?

Prices of Japanese automobile exports to the United States have fallen sharply. The Bank's *Tankan* (Short-Term Economic Survey of Enterprises in Japan) shows that firms in certain industries have revised downward their assessments of business conditions and profit projections. We often hear from business leaders that they are concerned about the outlook.

Nonetheless, at the macroeconomic level, export prices on a contract currency basis have been stable. Although it is difficult to assess export volumes, as there has been some front-loading and a subsequent decline, their level overall has stayed close to historically high levels. Industrial production has also been flat. Business sentiment, firms' profit

projections, and their fixed investment plans remain elevated (Chart 4). A material impact on wage increases for the current fiscal year and on the level of summer bonuses has not been seen. Private consumption has also been resilient.

The most plausible explanation for this is that tariff effects are taking time to surface. An alternative interpretation is that the effects are smaller than initially feared. On the other hand, the impact may prove to be larger than anticipated. Moreover, the U.S. administration may roll out policies we have yet to foresee. We need to keep all these scenarios in mind.

Considering what I have explained, our baseline scenario assumes that the effects of trade policies will eventually materialize, leading to a slowdown in overseas economies and a decline in domestic corporate profits. In this situation, although factors such as accommodative financial conditions are expected to provide support, Japan's economic growth is likely to moderate. That said, there are risks in both directions: the impact could be smaller or larger than expected. At the moment, the risk of a larger-than-expected impact may deserve greater attention. Over time, however, with overseas economies returning to a moderate growth path, Japan's economic growth rate is likely to rise.

Outlook for Prices

Let us now turn to the outlook for prices. Our baseline scenario at this point is as follows: The actual inflation rate, driven notably by a rise in rice prices and its transmission to other items, currently exceeds the 2 percent price stability target by a considerable margin, but will decline in due course. Meanwhile, the underlying inflation rate remains below 2 percent, but is gradually rising and approaching 2 percent. The rise may experience some temporary halts, but the mechanism in which wages and prices rise in interaction with each other will be maintained and eventually push up the underlying inflation rate to 2 percent.

When we say that the underlying inflation rate is currently below 2 percent, some find this argument confusing while others question its validity, pointing out that actual inflation has remained above 2 percent for more than three years now and often stayed even above 3 percent.

Underlying inflation rate refers to the inflation trend excluding the effects of temporary fluctuations -- that is, the rate toward which inflation is expected to settle once the effects of transitory shocks fade.

Let me illustrate this with the latest consumer price index (CPI) data (Chart 5). In July, the headline CPI inflation rate stood at 3.1 percent, materially exceeding the 2 percent target. This figure reflects downward effects from the introduction of subsidies on gasoline and other items. These effects will be temporary in terms of their negative contribution to the year-on-year inflation rate. However, within the 3.1 percent headline CPI inflation rate, food prices contributed by 2.1 percentage points. The food price hike is largely due to a surge in rice prices and its transmission to other items; this could also be considered to involve temporary elements. Excluding such temporary upward and downward elements may help in assessing the underlying trend. When excluding food and energy prices to eliminate the effects of gasoline subsidies and rice price surges, the inflation rate is 1.6 percent, still short of the 2 percent target.

In practice, identifying which elements are temporary and which are underlying, and choosing what to exclude and what to include in assessing underlying inflation require difficult judgments. To make estimations more robust, the Bank employs multiple analytical approaches. In addition to excluding volatile items, we use structural models to estimate trend inflation and monitor medium- to long-term inflation expectations among households, firms, and market participants. Synthesizing these methods, we have found that, while the underlying inflation rate hovered between 0 and 1 percent in the 2010s, it has recently approached 2 percent. That said, we do not yet consider it to have reached the 2 percent mark.

Accordingly, while actual inflation is currently elevated, our main scenario envisions that it will decline as temporary factors dissipate.

Looking back, starting from 2021, we observed global commodity price hikes, including in the prices of crude oil and wheat, followed by the yen's depreciation, both of which pushed

import prices upward. Since 2023, the import price index has declined, but domestic supply shocks on fresh food and then on rice have successively driven up prices.

Over this period, we have witnessed a pattern in which temporary inflationary factors are successively replaced by new ones.

Yet, this string of temporary upward shocks may well be coincidental, and a downward shock could be forthcoming. Some may argue that, indeed, the downward impact on prices from U.S. tariff policy is already in the pipeline.

That said, allow me to explore two alternative interpretations.

The first relates to conditions in Japan. One hypothesis is that, in an era when deflationary norms were prevalent in society, temporary downward shocks had a strong disinflationary impact. More recently, however, falling import prices and other downward shocks have had limited effect, while temporary upward shocks have exerted a broader impact. Behind these changes in the effects of downward and upward shocks, several underlying developments may be at work, including labor shortages, evolving attitudes toward pricing and cost pass-through among firms and consumers, and rising inflation expectations.

Among the three potential underlying developments, let us look at the effects of labor shortages.

The output gap in the Japanese economy is currently estimated to be around zero, implying that the economy's supply capacity and aggregate demand are broadly balanced. However, according to the Bank's *Tankan* survey, firms report limited spare production capacity and acute labor shortages (Chart 6 [left-hand panel]).

The Bank's staff estimated the industry-specific elasticity in substitution between capital and labor.[2] The estimation exercise found low elasticity in a significant number of

[2] Bank of Japan, "(Box 2) Labor Supply Constraints and the Substitutability between Capital and Labor," *Outlook for Economic Activity and Prices*, January 2025.

industries, particularly in the nonmanufacturing industries such as hotels and restaurants (Chart 6 [right-hand panel]). Labor shortages might not always be offset by expanding capital investments in these industries.

Lower slack in the economy tends to push up inflation. A chart illustrating this relationship is known as the Phillips Curve. The output gap is usually used on the horizontal axis to show the level of slack, but to focus on the link between labor shortage and inflation, I have added a version using unemployment rates on the horizontal axis, as was done in the original Phillips Curve presented in A. W. Phillips's 1958 paper (Chart 7).[3] This representation seems to show the relationship more explicitly. It also appears that we are now operating in a steeper portion of the curve.

Upward pressure on wages and prices may therefore be greater than suggested by the estimated output gap.

It is not a simple matter, however, to identify whether underlying trends are interacting with temporary shocks. True, structural changes often emerge first as idiosyncratic phenomena localized only in weak-link segments, not as clear system-wide trends. Many idiosyncratic phenomena, however, are genuinely temporary. If we inadvertently interpret them as initial signs of structural shifts, policy responses may become unnecessarily erratic.

The second alternative interpretation of the recent string of temporary upward shocks to prices is that they are the result of the global shift from the deflationary environment of the 2010s to an inflationary one in the 2020s.

Several explanations have been offered:[4] Deglobalization driven by geopolitical tensions is undermining cost efficiency attained through the international division of labor.

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[3] A. W. Phillips, "The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861-1957," *Economica* 25, no. 100 (1958): 283-299. In this paper, Phillips shows wage growth rate on the vertical axis.

[4] See, for example, Charles Goodhart and Manoj Pradhan, *The Great Demographic Reversal: Ageing Societies, Waning Inequality, and an Inflation Revival* (Palgrave Macmillan, 2020).

Demographic changes are leading to global labor shortages. Climate change and related policies are resulting in cost increases.

However, these arguments typically operate on longer time horizons. As such, it remains difficult to determine how much weight to put on them in forming our current assessment.

These two alternative perspectives imply upside risks to prices. On the other hand, downside risks may also need to be considered.

For instance, if trade policy shocks work to moderate Japan's economic activity via various channels as discussed earlier, the moderation will exert downward pressure on prices and wages. Exporting firms could reduce export prices to offset tariffs, and if this leads to these firms shifting back to the previous norm of prioritizing cost-cutting, this could stall the emerging mechanism in which wages and prices rise moderately in interaction with each other, which has been a key driving force behind the gradual rise in underlying inflation.

If trade policy shocks cause a global economic slowdown, this would depress crude oil and other commodity prices. Moreover, given that some countries already have significant excess production capacities, countries that lose access to the U.S. market may lower export prices to increase sales in other parts of the world, including Japan. These factors could also exert further downward pressure on Japan's price levels.

To date, we have not seen clear signs of such effects, but we cannot exclude the possibility that they could emerge in time.

In summary, our baseline scenario is that the impact of the recent surge in rice and other food prices will gradually subside, leading to a decline in headline inflation. Meanwhile, the underlying inflation rate is gradually approaching 2 percent, and although this progress may be temporarily stalled by slower economic activity due to tariff impacts, we expect it to eventually stabilize around levels consistent with our 2 percent price stability target. As noted, however, there are both upside and downside risks to this outlook (Chart 8).

II. Monetary Policy

Given the baseline scenario for Japan's economic activity and prices as well as the associated upside and downside risks, how should the Bank conduct monetary policy over the coming period?

Monetary Policy Outlook

Economic activity and prices are mainly driven by real interest rates, which are nominal interest rates minus inflation expectations. Despite the three policy interest rate hikes by the Bank thus far, real interest rates have remained at significantly low levels, as inflation has stayed strong.

Therefore, if the baseline scenario described earlier is realized, it would be appropriate for the Bank to continue, in accordance with improvement in economic activity and prices, to raise the policy interest rate and adjust the degree of monetary accommodation (Chart 9).

That said, as previously noted, there are risks to economic activity and prices in both directions. Without any preconceptions, we will continue to monitor the economy closely to see if the baseline scenario unfolds as expected.

In May, at the annual conference hosted by the Bank's Institute for Monetary and Economic Studies, we had the pleasure of welcoming President John C. Williams of the Federal Reserve Bank of New York. A renowned economist, President Williams has long studied monetary policy under uncertainty.

I took the opportunity to ask him what approach central bankers should take to cope with the current environment of heightened uncertainty.

His responses, as I understood them, may be summarized as follows: Uncertainty has always been the defining feature of the monetary policy landscape. Uncertainty does not tell us to go gradually or fast, or to take small steps or big steps. A lesson around uncertainty is

not to try to figure out exactly the optimum answer for a given forecast or a given model, but to think about an approach that works well across multiple scenarios that we can face.[5]

This, I believe, is an insightful and valuable perspective. Risk and uncertainty will never disappear from the landscape for policymakers. We must continually assess the balance of risks, both upside and downside, and respond in a timely and appropriate manner to ensure that, even if conditions deviate from the baseline scenario, the damage is reasonably well contained.

Plan for Reducing the Bank's Government Bond Purchases

In the 2010s, the Bank started to purchase long-term Japanese government bonds (JGBs) on a large scale as a means of monetary easing. In March last year, however, the Bank decided that guiding the short-term interest rate, rather than purchasing JGBs, was the primary tool in conducting monetary policy.

In July last year, the Bank adopted a plan to gradually reduce its JGB purchases, from a pace of around 6 trillion yen per month to around 3 trillion yen in the spring of 2026. This June, we conducted an interim assessment of the plan, and decided to extend the plan by another year, with the aim of reducing the monthly purchase amount further, to approximately 2 trillion yen in the spring of 2027 (Chart 10).

Since a portion of JGBs held by the Bank matures each month and is redeemed, the Bank's total JGB holdings will gradually decline as it reduces purchases according to the plan.

The balance sheet of a central bank could have an influence on the economy through both its asset and liability sides. The implications of a reduction in JGB purchases can be analyzed from multiple perspectives. I would like to share several of the considerations that guided my personal thinking when I participated in the decisions taken in March and July last year and again this June. Please note that these reflect my personal views. I suppose other members of the Policy Board may have other perspectives.

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[5] President Williams' responses appear toward the beginning of the video on the Bank's YouTube channel: (https://www.youtube.com/watch?v=1XLWWSoB_Ok).

First, would the reduction have direct effects on prices? The size of the Bank's liabilities is roughly equivalent to the sum of banknotes in circulation and deposits held by financial institutions at the Bank. This total is referred to as the monetary base. If the Bank reduces its holdings of JGBs, thereby shrinking the asset side of the balance sheet, the liability side and accordingly the monetary base will also contract.

Monetarists, who were dominant in the late 1970s amid U.S. inflation, maintained that changes in the monetary base lead to corresponding changes in the money stock, i.e., the total amount of deposits held at private financial institutions, and that the money stock in turn affects prices.

However, the absence of a stable relationship between these three variables became evident shortly after the Federal Reserve adopted monetary targeting.

That said, Claudio Borio and his colleagues at the Bank for International Settlements analyzed 70 years of data across 32 countries and found that the strength of the link between money growth and inflation depends on the inflation regime: it is one-to-one when inflation is high (above 5 percent) and virtually non-existent when inflation is low.[6] They caution that their findings say little about causality, but if policy were based solely on the experience of advanced economies during periods of stable inflation, and left excessive money in place unnecessarily, this might carry its own risks.

The second perspective focuses on the impact on economic activity. The size of the Bank's JGB holdings influences long-term interest rates via what is known as the stock effect. However, the Bank's analysis suggests that short-term interest rates have a far larger impact on the real economy than medium- or long-term rates, and that the effect of super-long-term rates is quite limited.[7] Therefore, as long as we have a room to adjust the short-term policy

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[6] Claudio Borio, Boris Hofmann, and Egon Zakrajsek, "Does Money Growth Help Explain the Recent Inflation Surge?," *BIS Bulletin*, no. 67, 26 January 2023.

[7] Bank of Japan, *Comprehensive Assessment: Developments in Economic Activity and Prices as well as Policy Effects since the Introduction of Quantitative and Qualitative Monetary Easing (QQE)*, September 2016.

rate up and down, easing or tightening should primarily be conducted by guiding the policy rate, and not by adjusting the JGB purchase amount.

Third, the Bank's purchases and holdings of JGBs affect the functioning of the JGB market. The Bank conducted a review of monetary policy from a broad perspective and published the outcome at the end of last year. According to the review's findings, bid-ask spreads begin non-linear widening when the share of the Bank's outstanding holdings of an individual JGB issue exceeds 50 percent. Moreover, once the share exceeds 70 percent, an increase in the Bank's purchases can even reduce overall market trading volumes (Chart 11 [left-hand and middle panels]). Currently, the Bank's holdings exceed these thresholds for many issues (Chart 11 [right-hand panel]).

To restore sound functioning of the JGB market, it is desirable to bring these levels down. The smaller the Bank's new purchases, the faster this ratio will decline. However, if hasty reductions in purchases result in a rapid rise in long-term interest rates and in the need to conduct an ad-hoc increase in the purchase amount, fixed-rate purchase operations, or the Funds-Supplying Operations against Pooled Collateral, this could harm market functioning even more. The Federal Reserve's experience in 2019, when it had to suspend its balance sheet reduction amid market disruptions, serves as a useful guide here, suggesting the need to balance the two goals of recovering market functioning and maintaining market stability.

Fourth, there may be effects on the functioning and stability of the banking system. When the Bank of Japan purchases JGBs from the market, it pays for them by crediting the reserve accounts that financial institutions hold at the Bank. Once these reserves are created, even if the ownership changes, the overall quantity of reserves in the banking system cannot be changed by the financial institutions' choices. Currently, reserves at the Bank occupy around one fifth of financial institutions' total assets. Perhaps they significantly exceed institutions' need.

At the same time, financial institutions require a certain level of reserves at the Bank for liquidity management purposes. As the Federal Reserve often emphasizes, an excessive reduction of reserve balances could pose risks to financial stability and market stability. The

stock of JGBs held by the Bank of Japan changes more slowly than the flows of monthly purchases, and the reserves financial institutions hold at the Bank are unlikely to become excessively low in the near term. Nonetheless, as we move forward with the purchase amount reduction, it may be warranted to start exploring the JGB monthly purchase amount consistent with appropriate reserve levels.

Fifth, the Bank's balance sheet affects its financial position. Effects on the Bank's financial position should not be a primary consideration in policy decisions. However, as the Bank's balance sheet grows larger, its financial volatility becomes greater. I do not believe that the current size of the Bank's balance sheet presents a serious risk of the Bank recording negative equity. Moreover, negative equity does not impede the Bank's ability to conduct monetary policy.

Nevertheless, from the standpoint of maintaining confidence in the Bank and minimizing risks in this regard, it would be prudent to reduce the size of the balance sheet over time.

These perspectives may be usefully considered in designing the Bank's plan to reduce its JGB purchases. I believe the plan should be based on the principle that long-term interest rates are to be formed in financial markets and should provide predictability while allowing enough flexibility to support market stability.

The Bank's balance sheet also includes exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) on the asset side. While the Bank still purchases JGBs, it decided in March last year to discontinue purchases of ETFs and J-REITs. Although JGBs have maturities, these other assets do not, and simply discontinuing purchases will not automatically reduce their outstanding amount.

Previously, the Bank also had on its balance sheet the stocks it had purchased from financial institutions for financial stability purposes. The Bank sold these purchased stocks over a long period of time so as to minimize the market impact, successfully completing the process in July. Building on the knowledge acquired through this process, we will think about how to deal with outstanding ETFs and J-REITs.

On the Economy of Eastern Hokkaido

Lastly, let me say a few words about the economy of Eastern Hokkaido.

Each region of Eastern Hokkaido, such as Nemuro, Kushiro, and Tokachi, has its own characteristics and, building on these characteristics, each has attained unique economic development. I understand that new initiatives are being undertaken to make further headway with the achievements made so far (Chart 12).

For example, the agricultural industry is pushing forward with digital transformation utilizing self-driving and other farm machinery. The fisheries sector is experimenting with marine- and land-based aquaculture. At the spaceport that opened as the first private-sector facility of its kind in Asia, the launch and landing of a reusable vertical rocket was successfully carried out. Other examples include the revitalization of hot springs towns, the development of large-scale port facilities capable of accommodating large cargo vessels, and the redevelopment of urban districts. Beyond these, numerous other initiatives are being pursued through the efforts of many.

The economy's growth will also be supported by recent developments such as the designation of the Hidakasanmyaku-Erimo-Tokachi National Park, Japan's largest national park; the opening of the 410-kilometer-long Hokkaido East Trail; and the extension of the Trans-Hokkaido Expressway.

I would like to express my deep respect for these efforts and offer my wishes for continued progress in the region's economy.

This concludes my remarks. I now look forward to engaging in an exchange of views. I am keen to hear your views about current business conditions, to learn about the initiatives you are taking, and to elicit your opinions and feedback on the policies and activities of the Bank.

Japan's Economy and Monetary Policy

Speech at a Meeting with Local Leaders in Eastern Hokkaido

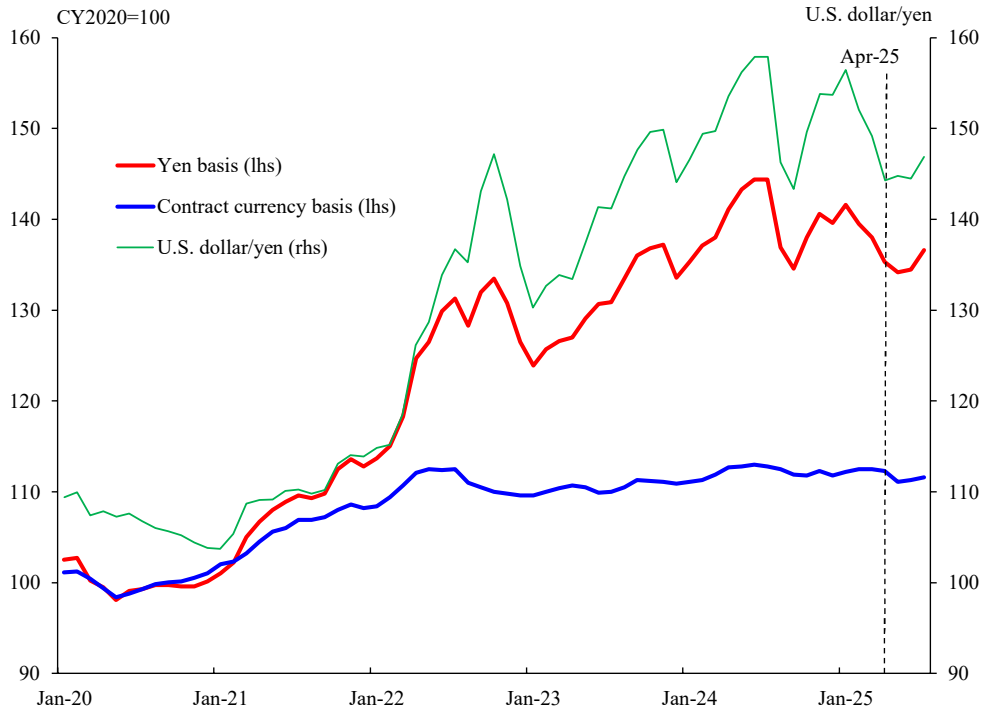
September 2, 2025

HIMINO Ryozo

Deputy Governor of the Bank of Japan

Chart 1

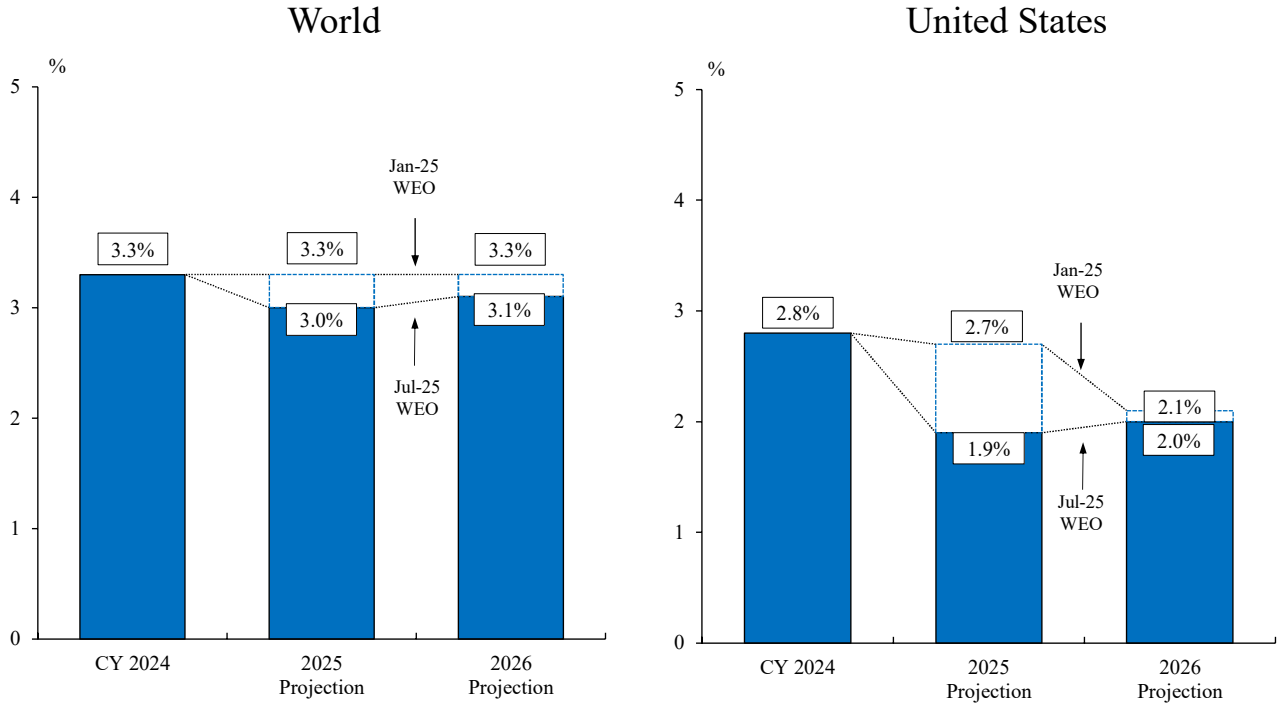
Prices of Exports from Japan



Source: Bank of Japan.

Chart 2

IMF World Economic Outlook (WEO) Growth Projections

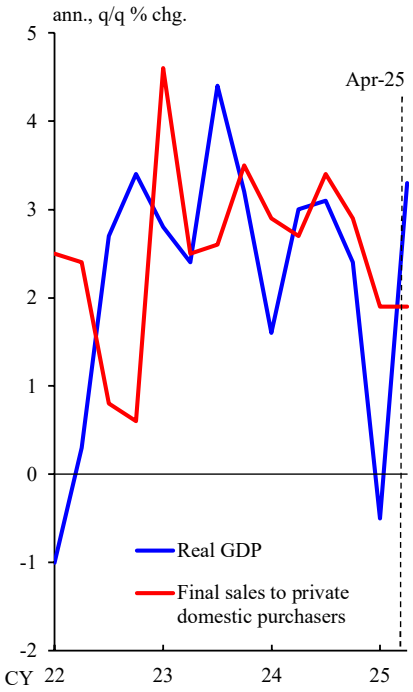


Source: IMF.

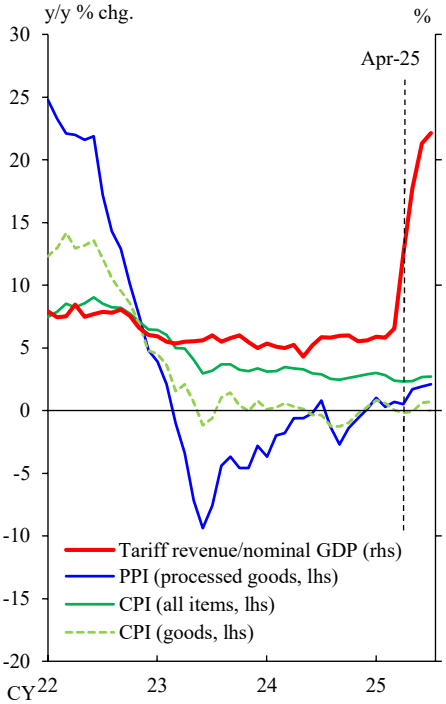
Chart 3

U.S. Economy

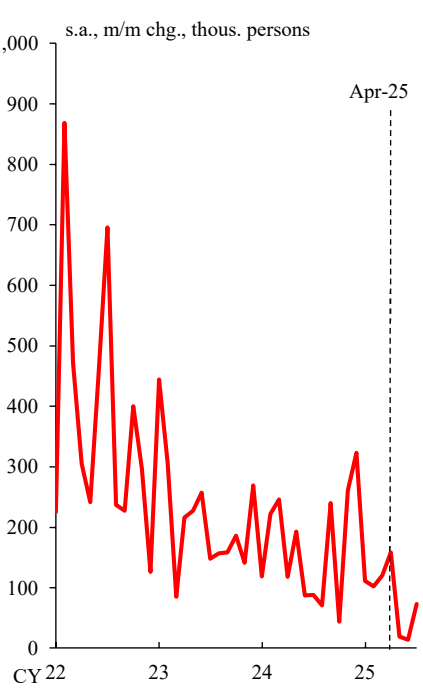
Real GDP



Tariff Revenue and Prices



Nonfarm Payroll Employment

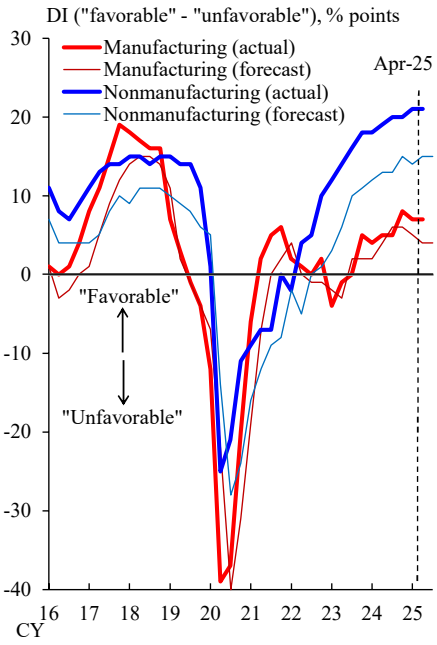


Note: In the middle panel, nominal GDP is calculated by dividing the value for each year by 12.
Sources: U.S. Department of the Treasury; U.S. Census Bureau; Bureau of Economic Analysis; Bureau of Labor Statistics.

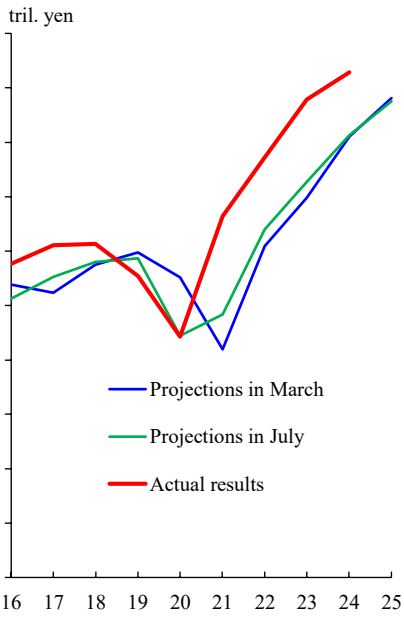
Chart 4

Business Conditions of Japanese Firms (*Tankan*)

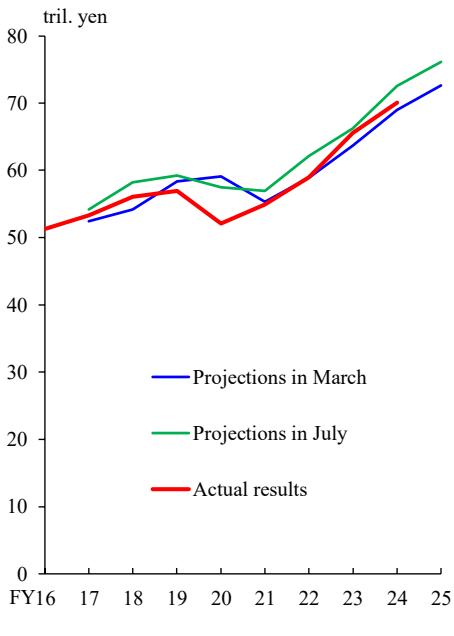
Business Conditions



Corporate Profits



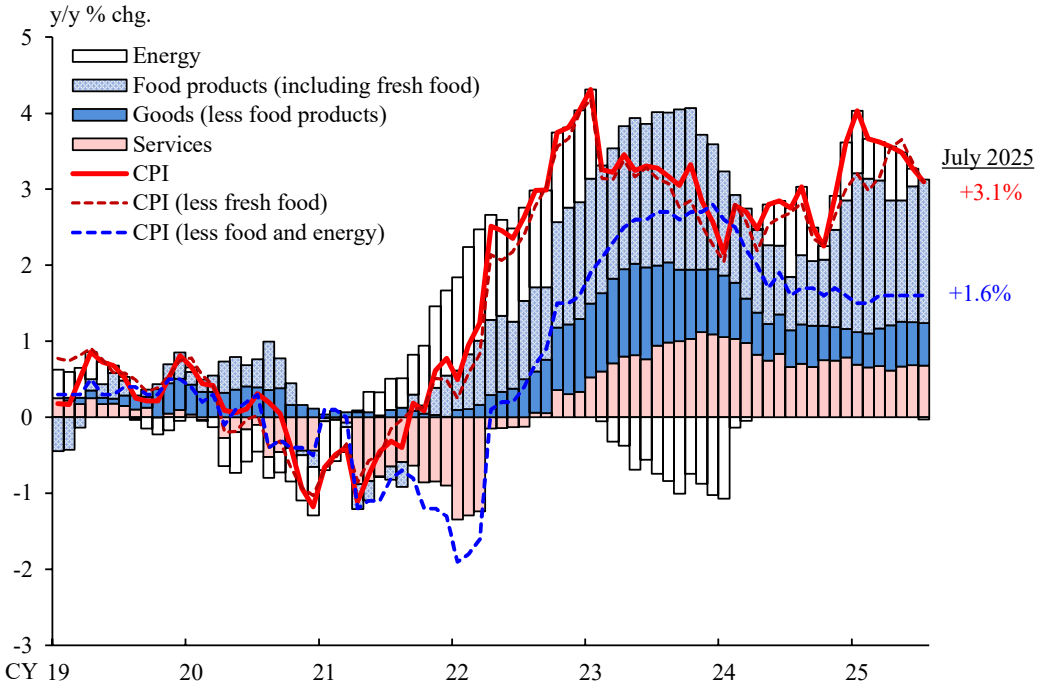
Business Fixed Investment



Note: In the left-hand panel, figures are for all enterprises. The latest figures for actual results are for June 2025, and the latest figures for forecasts are for September.
In the middle and right-hand panels, figures are for all industries and enterprises.
Figures in the right-hand panel include software and R&D investments and exclude land purchasing expenses.
Source: Bank of Japan.

Chart 5

Consumer Price Index

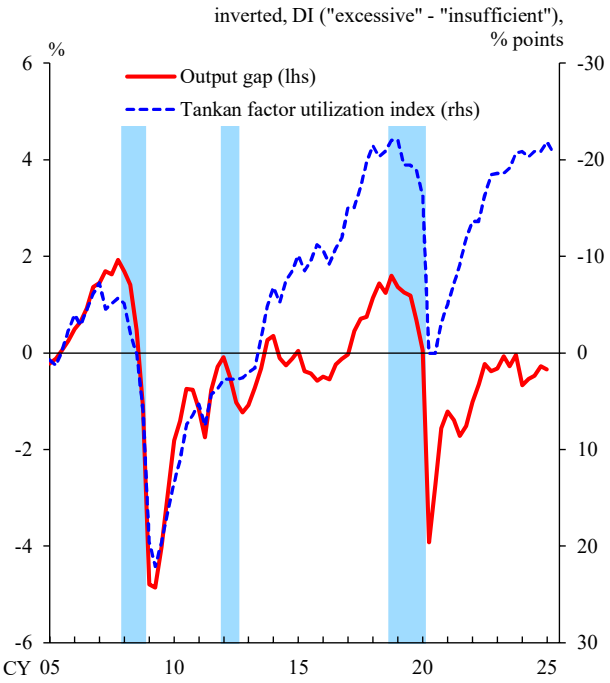


Source: Ministry of Internal Affairs and Communications.

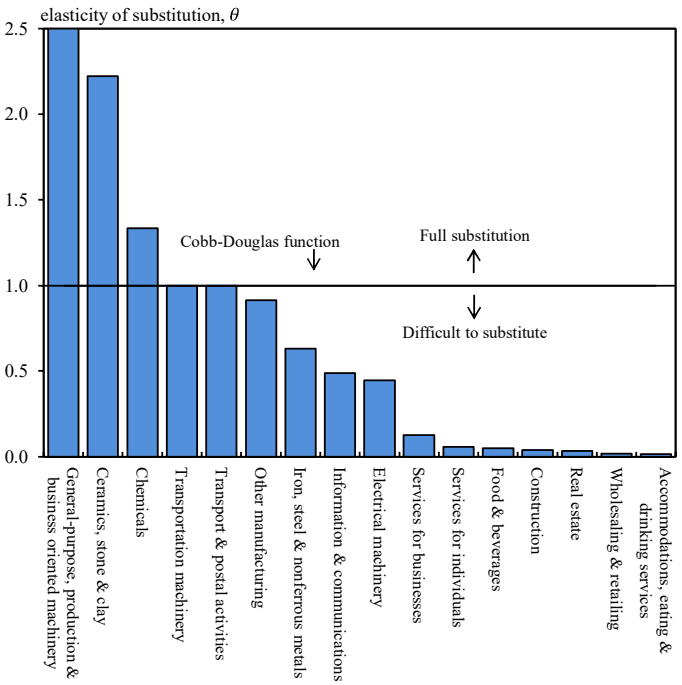
Chart 6

Output Gap and Labor Shortages

Output Gap



Capital-Labor Substitutability by Industry



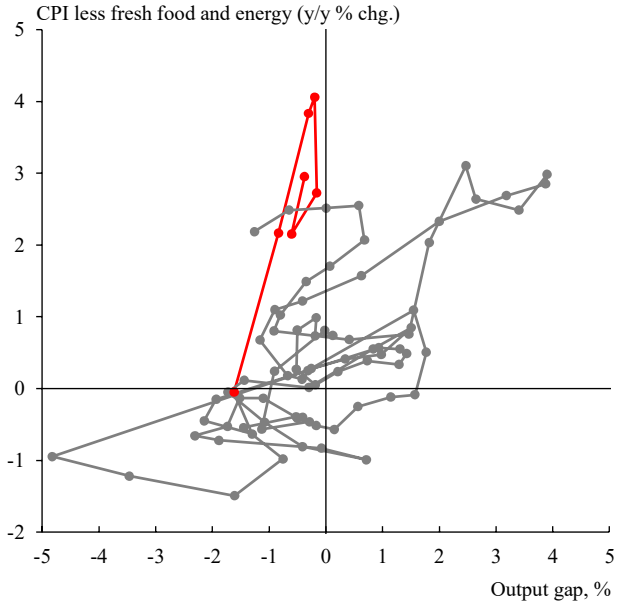
Notes: 1. In the left-hand panel, figures for the output gap are staff estimates. The *Tankan* factor utilization index is calculated as the weighted average of the production capacity DI and the employment conditions DI for all industries and enterprises. The capital and labor shares are used as weights. Shaded areas denote recession periods.
2. In the right-hand panel, figures for the elasticity of substitution are calculated by estimating CES production functions by industry using the following variables from the *Financial Statements Statistics of Corporations by Industry, Quarterly*: value added, tangible fixed assets (excluding construction in progress), and the number of employees. Value added is the sum of operating profits, personnel expenses, and depreciation expenses. The estimation period is from 2000/Q1 to 2024/Q2.

Sources: Ministry of Finance; Cabinet Office; Bank of Japan.

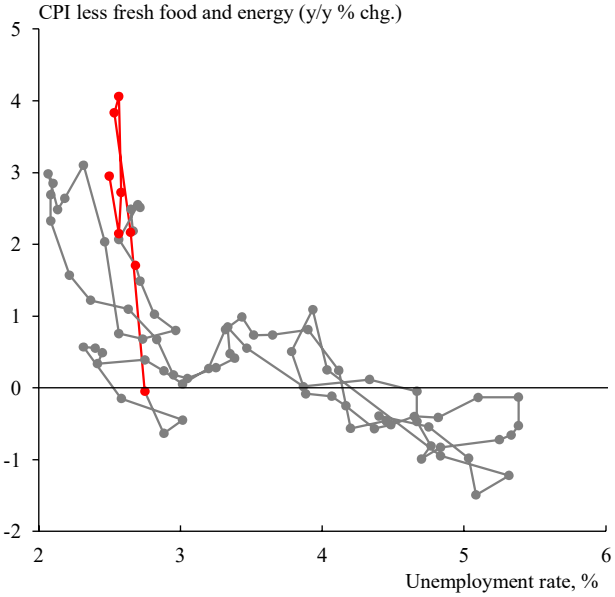
Chart 7

Phillips Curve

Output Gap and Prices



Unemployment and Prices



Note: Figures are biannual from 1983 to 2025. The red lines show developments from 2022 onward.
The output gap and unemployment rate are six months ahead of the CPI.
Sources: Bank of Japan; Ministry of Internal Affairs and Communications.

Chart 8

Outlook for Economic Activity and Prices

Outlook Report (July 2025)

Outlook for Economic Activity

- Japan's economic growth is likely to moderate, as trade and other policies in each jurisdiction lead to a slowdown in overseas economies and to a decline in domestic corporate profits and other factors. Thereafter, Japan's economic growth rate is likely to rise, with overseas economies returning to a moderate growth path.

Outlook for Prices

- Underlying CPI inflation is likely to be sluggish, mainly due to the deceleration in the economy. Thereafter, however, underlying CPI inflation is expected to increase gradually, since it is projected that a sense of labor shortage will grow as the economic growth rate rises.
- In the second half of the projection period, underlying CPI inflation is likely to be at a level that is generally consistent with the price stability target.

Medians of the Policy Board Members' Forecasts

(y/y % chg.)

	Fiscal 2025	Fiscal 2026	Fiscal 2027
Real GDP	0.6 (+0.1)	0.7 (—)	1.0 (—)
CPI (all items less fresh food)	2.7 (+0.5)	1.8 (+0.1)	2.0 (+0.1)
CPI (all items less fresh food and energy)	2.8 (+0.5)	1.9 (+0.1)	2.0 (—)

Assumptions: 1. Negotiations between jurisdictions will progress to some extent.
2. Significant disruptions of global supply chains will be avoided.
Note: Figures in parentheses indicate changes from the April 2025 Outlook Report.

Risks to the Outlook

- There have been positive developments in trade and other policies, such as negotiations between Japan and the United States resulting in an agreement.
- That said, high uncertainties remain regarding negotiations between jurisdictions and the impact of trade and other policies on economic activity and prices at home and abroad.

Risk balance

- Risks to economic activity are skewed to the downside for fiscal 2025 and 2026.
- Risks to prices are generally balanced.

Chart 9

Future Conduct of Monetary Policy

Outlook Report (July 2025)

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

Chart 10

Plan for the Reduction of the Purchase Amount of JGBs (June 2025 MPM)

1. Long-term interest rates: to be formed in financial markets in principle
2. JGB purchases: appropriate for the Bank to reduce its purchase amount of JGBs in a predictable manner, while allowing enough flexibility to support stability in the JGB markets

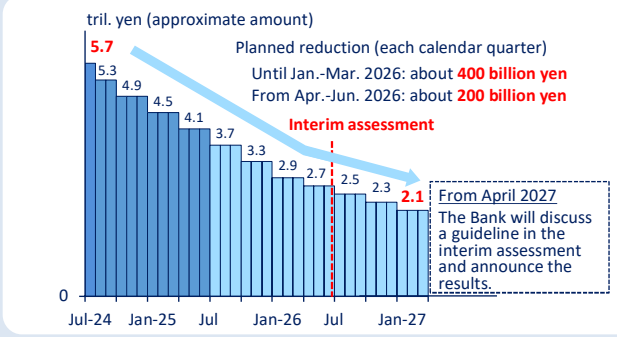
In principle, the Bank will reduce the planned amount of its monthly purchases of JGBs each calendar quarter as follows.

- Until January-March 2026 : about 400 billion yen (the reduction plan decided in July 2024 will be maintained)
- From April-June 2026 to January-March 2027 : about 200 billion yen

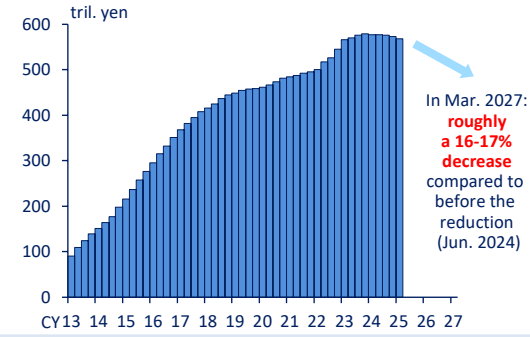
➢ The Bank will gradually reduce its purchase amount so that it can improve the functioning of the JGB markets in a manner that supports stability in the markets.

Reduction in a Predictable Manner

Amount of monthly JGB purchases



The Bank's JGB holdings

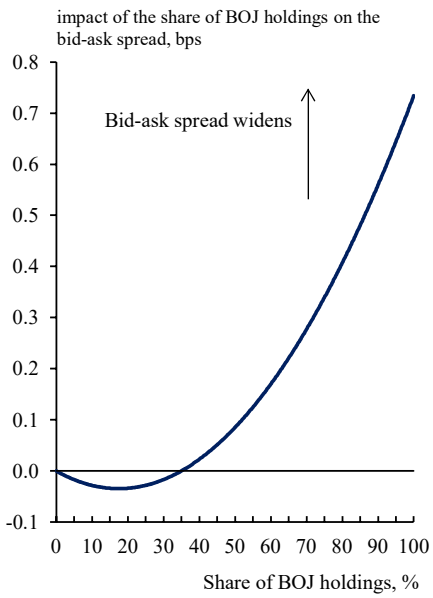


Allowing Enough Flexibility

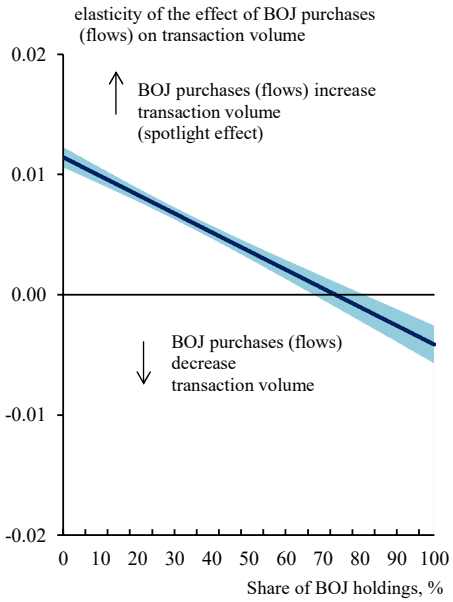
1. The Bank will conduct an interim assessment of the plan at the June 2026 MPM.
2. In the case of a rapid rise in long-term interest rates, the Bank will make nimble responses by, for example, increasing the amount of JGB purchases.
3. The Bank is prepared to amend the plan at the MPMs, if deemed necessary.

Functioning of JGB Market

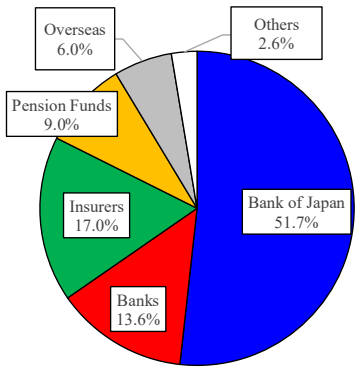
Share of BOJ Holdings and Spread



Share of BOJ Holdings and Transaction Volume

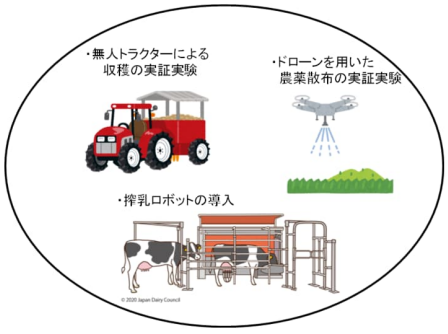


Share of JGB Holdings <End of Fiscal 2024>



Note: In the left-hand and middle panels, the share of BOJ holdings is calculated for each issue number.
In the middle panel, the shaded area denotes the 99 percent confidence interval.
Sources: QUICK; Japan Bond Trading; Ministry of Finance; Bank of Japan.

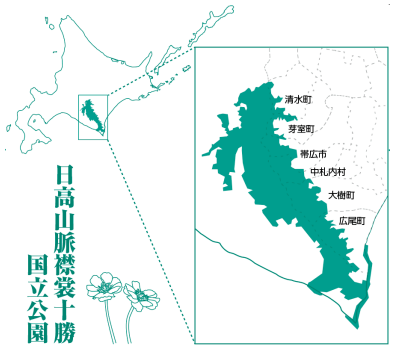
Digital Transformation of Agriculture Industry



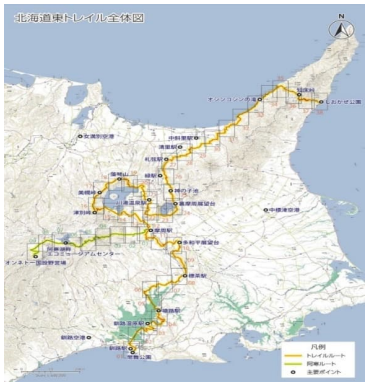
Hokkaido Spaceport

Kushiro Port

Hidakasanmyaku-Erimo-Tokachi National Park



Hokkaido East Trail



Extension of Trans-Hokkaido Expressway

Sources: Japan Dairy Council; Taiki Town; Kushiro City; TOYO Inc.; Doto Trail Club.