February 13, 2026

Bank of Japan

Economic Activity, Prices, and Monetary Policy in Japan

Speech at a Meeting Held by the Kanagawa Keizai Doyukai

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(English translation based on the Japanese original)

Introduction

It is my pleasure to have the opportunity to address you today at the meeting held by the Kanagawa Keizai Doyukai. I would like to take this chance to express my sincere gratitude for your cooperation with the activities of the Bank of Japan.

Today, I would like to talk about Japan's economic activity and prices, and the Bank's conduct of monetary policy, while sharing my own views. Afterward, I look forward to hearing your questions and opinions.

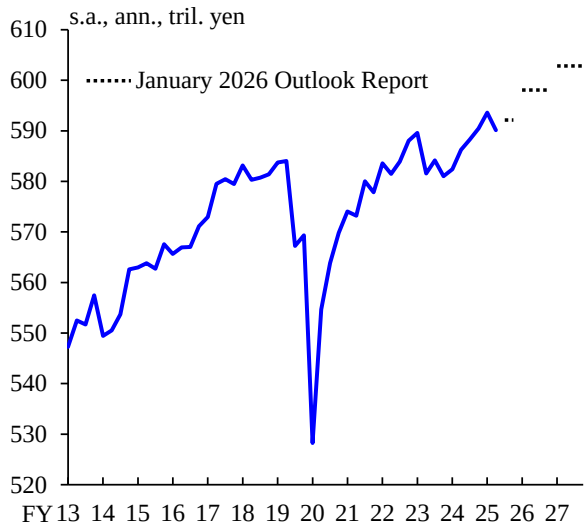
I. Economic Activity and Prices

A. Current Situation and Outlook for Economic Activity in Japan

I will begin by talking about developments in economic activity in Japan. The Bank assesses that the economy has recovered moderately, although some weakness has been seen in part.

Looking back over the past year, the announcement of a new U.S. tariff policy last April led to significant uncertainty regarding its impact on Japan's economy. In this situation, the Bank had to make revisions to its forecasts for real GDP growth, as shown in Chart 1. In terms of the medians of the Policy Board members' forecasts -- as presented in the January 2025 *Outlook for Economic Activity and Prices* (Outlook Report) -- the forecast for Japan's real GDP growth rate was 1.1 percent for fiscal 2025 and 1.0 percent for fiscal 2026, indicating that Japan's economy was expected to see relatively firm growth. However, given the U.S. tariff policy announced in April, the Bank's forecasts were revised substantially downward in the April Outlook Report, to 0.5 percent for fiscal 2025 and 0.7 percent for fiscal 2026. That said, uncertainty regarding U.S. tariff policy decreased markedly thereafter, as many countries and regions, including Japan, reached agreements in trade negotiations with the United States. With regard to developments in business sentiment, firms have maintained a proactive stance to an extent that I find surprising. For instance, the diffusion index (DI) for business conditions in the *Tankan* (Short-Term Economic Survey of Enterprises in Japan) has stayed at a favorable level, as indicated in Chart 2.

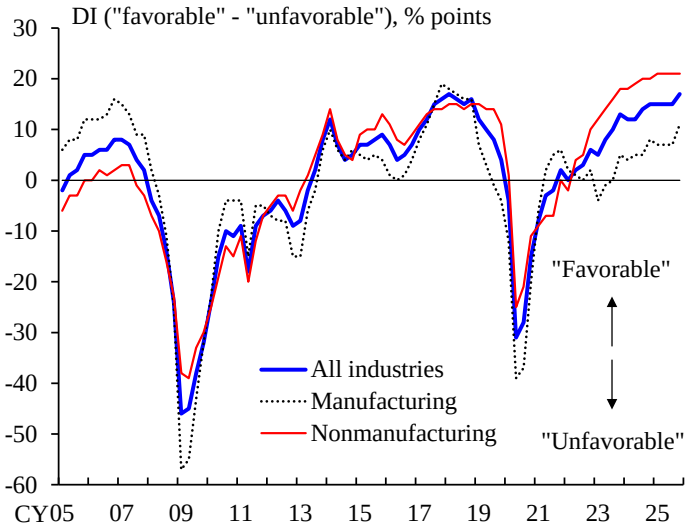
Chart 1: The Bank's Forecasts for Real GDP



	Projected Growth Rate of Real GDP				
	January 2025	April 2025	July 2025	October 2025	January 2026
FY 2025	1.1%	0.5%	0.6%	0.7%	0.9%
FY 2026	1.0%	0.7%	0.7%	0.7%	1.0%
FY 2027	—	1.0%	1.0%	1.0%	0.8%

Note: Forecasts are the medians of the Policy Board members' forecasts. Real GDP values for 2025/Q4 onward are calculated by multiplying the actual figure for fiscal 2024 by all successive projected growth rates for each year.
Sources: Cabinet Office; Bank of Japan.

Chart 2: Business Conditions DI



	March 2025	June 2025	September 2025	December 2025
All industries	15	15	15	17
Manufacturing	7	7	7	11
Non-manufacturing	21	21	21	21

Note: Figures are based on the *Tankan*, and are for all enterprises.
Source: Bank of Japan.

Chart 3 shows how global economic growth forecasts evolved in the *World Economic Outlook* (WEO), compiled by the International Monetary Fund (IMF). Following the downward revisions in the April 2025 WEO, which was released shortly after the U.S. tariff policy announcement, global real GDP growth rate figures for both 2025 and 2026 have continued to be revised upward, returning in the January 2026 WEO *Update* to the levels projected prior to the tariff policy announcement. Similarly, the Bank revised its forecasts for Japan's real GDP growth in the January 2026 Outlook Report for both fiscal 2025 and 2026 to broadly the same levels as projected in the January 2025 Outlook Report, which was released before the U.S. tariff policy announcement.

Chart 3: IMF Forecasts for Global Growth

Major Economies' Real GDP Growth Rates

y/y % chg.

	CY 2024	CY 2025 [Projection (Jan.-Oct. 2025); Estimate (Jan. 2026)]					CY 2026 [Projection]				
		As of Jan. 2025	As of Apr. 2025	As of July 2025	As of Oct. 2025	As of Jan. 2026	As of Jan. 2025	As of Apr. 2025	As of July 2025	As of Oct. 2025	As of Jan. 2026
World	3.3	3.3	2.8	3.0	3.2	3.3	3.3	3.0	3.1	3.1	3.3
Advanced economies	1.8	1.9	1.4	1.5	1.6	1.7	1.8	1.5	1.6	1.6	1.8
United States	2.8	2.7	1.8	1.9	2.0	2.1	2.1	1.7	2.0	2.1	2.4
Euro area	0.9	1.0	0.8	1.0	1.2	1.4	1.4	1.2	1.2	1.1	1.3
United Kingdom	1.1	1.6	1.1	1.2	1.3	1.4	1.5	1.4	1.4	1.3	1.3
Japan	-0.2	1.1	0.6	0.7	1.1	1.1	0.8	0.6	0.5	0.6	0.7
Emerging market and developing economies	4.3	4.2	3.7	4.1	4.2	4.4	4.3	3.9	4.0	4.0	4.2
China	5.0	4.6	4.0	4.8	4.8	5.0	4.5	4.0	4.2	4.2	4.5
India	6.5	6.5	6.2	6.4	6.6	7.3	6.5	6.3	6.4	6.2	6.4

Source: IMF.

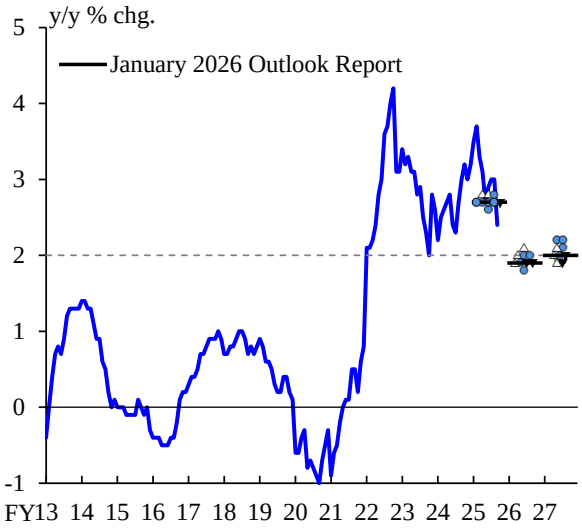
Given these circumstances, Japan's economy is likely to continue growing moderately, with overseas economies returning to a growth path, and as a virtuous cycle from income to spending gradually intensifies, supported by factors such as the government's economic measures and accommodative financial conditions,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

B. Current Situation and Outlook for Prices in Japan

Projection in the Outlook Report

I will now talk about prices in Japan. As shown in Chart 4, with moves to pass on wage increases to selling prices continuing, the year-on-year rate of increase in the consumer price index (CPI) for all items excluding fresh food has been at around 2.5 percent recently, due to the effects of the rise in food prices, such as rice prices, and other factors.

Chart 4: The Bank's Forecasts for the CPI



	Projected Rate of Increase in the CPI				
	January 2025	April 2025	July 2025	October 2025	January 2026
FY 2025	2.4%	2.2%	2.7%	2.7%	2.7%
FY 2026	2.0%	1.7%	1.8%	1.8%	1.9%
FY 2027	—	1.9%	2.0%	2.0%	2.0%

Notes: 1. Figures are the CPI for all items less fresh food, excluding the effects of consumption tax hikes.
2. The locations of ●, △, and ▼ in the chart indicate the figures for each Policy Board member's forecasts. The risk balance assessed by each Policy Board member is shown by the following shapes: ● indicates that a member assesses "upside and downside risks as being generally balanced," △ indicates that a member assesses "risks are skewed to the upside," and ▼ indicates that a member assesses "risks are skewed to the downside." The dotted black lines show the medians of the Policy Board members' forecasts.
Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

As was the case with the forecasts for real GDP growth, from April 2025 the Bank had to make revisions to its forecasts for CPI inflation, taking account of the uncertainty caused by U.S. tariff policy. Chart 4 shows that the Bank's forecast presented in the January 2025 Outlook Report for the year-on-year rate of increase in the CPI for all items excluding fresh food was 2.4 percent for fiscal 2025 and 2.0 percent for fiscal 2026, indicating that the rate of increase in the CPI was expected to continue to exceed the 2 percent price stability target. However, the Bank revised its forecast for fiscal 2026 downward to 1.7 percent in the April Outlook Report. This was because the Bank had factored in, for example, the risk of wage increases for fiscal 2026 being pushed down to a certain extent by sluggish growth in corporate profits due to the impact of U.S. tariff policy. That said, as I mentioned earlier, firms have maintained a proactive stance, and in this situation, it is expected that, following the

solid wage increases last year, a wide range of firms will continue to raise wages steadily in fiscal 2026. Given these circumstances, in the January 2026 Outlook Report, the Bank revised its fiscal 2026 forecast for CPI inflation for all items excluding fresh food, bringing it to broadly the same level as the forecast made prior to the U.S. tariff policy announcement.

Regarding the outlook for CPI inflation, the Bank's baseline scenario is as follows. The year-on-year rate of increase in the CPI for all items excluding fresh food is likely to decelerate to a level below 2 percent in the first half of 2026, with the waning of the effects of the rise in food prices, such as rice prices, and partly due to the effects of government measures to address rising prices. However, it is likely that the mechanism in which wages and prices rise moderately in interaction with each other will be maintained, and that underlying CPI inflation will continue rising moderately. Thereafter, since it is projected that a sense of labor shortage will grow as the economy continues to improve and that medium- to long-term inflation expectations will rise, it is expected that underlying CPI inflation and the rate of increase in the CPI for all items excluding fresh food will increase gradually and, in the second half of the projection period -- that is, from the second half of fiscal 2026 through fiscal 2027 -- be at a level that is generally consistent with the price stability target.

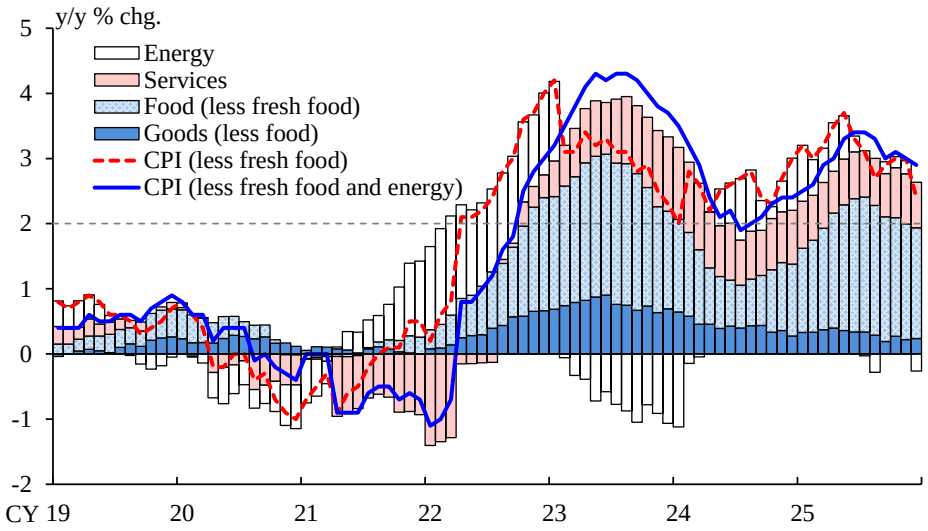
My View: A Shift to Stickier Inflation

Meanwhile, I believe that inflation has recently been shifting into an endogenous and sticky state, as the mechanism the Bank is aiming for, in which wages and prices rise moderately in interaction with each other, has been maintained. In this context, underlying CPI inflation has recently reached approximately 2 percent, and I believe it is quite possible that, as early as this spring, the price stability target of 2 percent can be judged to have been achieved if it is confirmed with a high degree of certainty that wage growth in 2026 will be in line with the price stability target for the third consecutive year. I think the Bank will then need to carefully examine various data and information to determine whether underlying CPI inflation, without showing further upward deviation, aligns well with the Bank's goal of sustainable and stable achievement of the 2 percent price stability target.

As shown in Chart 5, the year-on-year rate of increase in the CPI for all items excluding fresh food has been above 2 percent for the past 45 months. By component, price developments in

goods other than food have moderated, with their inflation rate declining. However, given that domestic consumer prices have become more susceptible to the yen's depreciation through import prices, future price developments warrant attention as the yen is currently back on a depreciating trend. In addition, as firms continue to raise wages, there is a strong

Chart 5: Consumer Prices



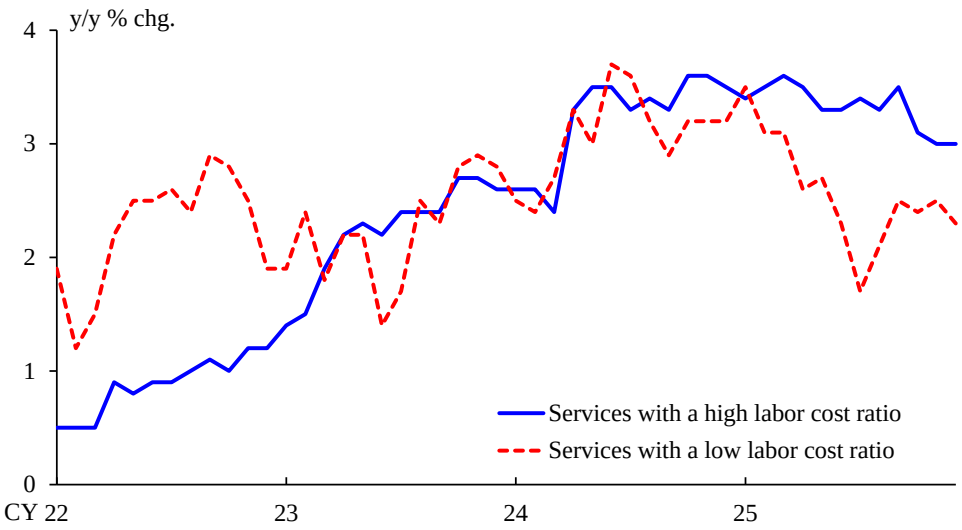
Source: Ministry of Internal Affairs and Communications.

possibility that higher labor costs at each stage from production, distribution, and to retail will continue to be passed on to goods prices. Please refer to Chart 6, which shows price developments in services with high and low labor cost ratios, measured by the services producer price index (SPPI).[1] As seen in the chart, the inflation rate for services with a high labor cost ratio has been high recently, suggesting that increased labor costs have been pushing overall prices upward. Looking ahead, it is expected that, as the mechanism in which

[1] Price indices for services with high and low labor cost ratios are derived using the following classification. Services covered by the SPPI are grouped into 11 categories that can be continuously tracked over a long period of time, taking into account changes in item classification from past bases to the current base year. These categories are then classified into two groups -- services with either high or low labor cost ratios -- benchmarked against the SPPI's overall labor cost ratio (average for 2019-2020: 32.7 percent). Services with a high labor cost ratio include road passenger transportation, overland freight transportation, marine cargo handling, packing for freight, information services, and sewage and waste disposal. Services with a low labor cost ratio include finance and insurance, real estate services, railroad passenger transportation, water passenger transportation, communications services, broadcasting services, and leasing and rental. For details on the classification, see Yutani, T. et al., "Special Aggregate Index of the Services Producer Price Index (SPPI) Based on Labor Cost Ratio," *Bank of Japan Review Series*, no. 2024-E-6 (June 2024).

wages and prices rise moderately in interaction with each other is maintained, increases in labor costs, including upstream costs, will continue to be passed on to goods prices.

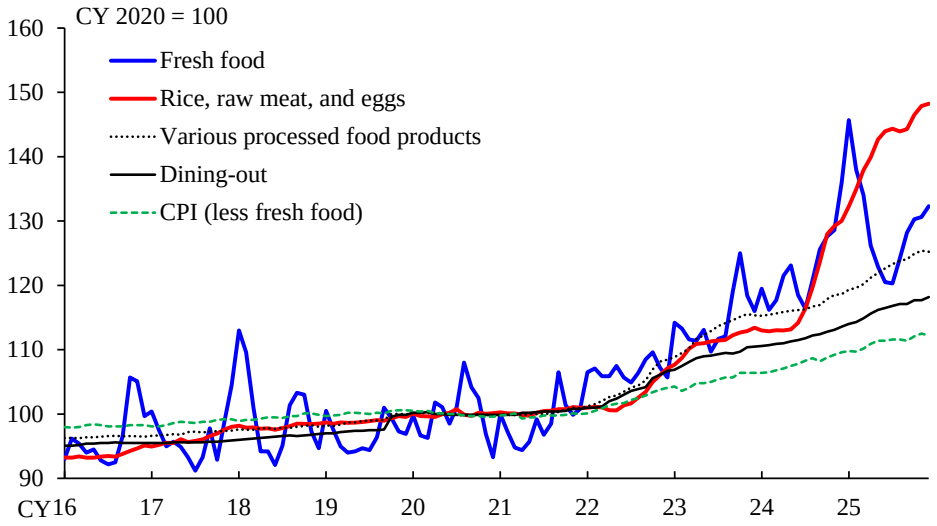
Chart 6: Services with High and Low Labor Cost Ratios



Source: Bank of Japan.

As shown in Chart 7, food prices have seen sustained increases since 2022. Prices for fresh food, rice, eggs, and other food items have continued to rise, and this has led to higher prices for processed food and dining-out. While the price increases for fresh food, rice, eggs, and

Chart 7: Consumer Prices (Food)



Note: "Various processed food products" consists of food excluding fresh food, rice, raw meat, eggs, and dining-out.
Source: Ministry of Internal Affairs and Communications.

other food items largely resulted from temporary supply-side factors, inflation as a whole could remain relatively high, even with changes in the items for which prices rose. This is mainly attributable to the effects of (1) an increase in various costs, including fertilizer, utility, and shipping costs; (2) higher labor costs at each stage from production to retail, which I mentioned earlier; (3) lower supply capacity due to labor shortages; and (4) adverse weather conditions caused by climate change. In addition, even if the price increases for fresh food, rice, eggs, and other food items are indeed temporary, I believe that the spillovers to the price of processed food and dining-out are unlikely to occur all at once, since firms pass on higher costs to their prices gradually, and spillovers therefore usually take place over a certain period. In addition, higher food prices have a significant impact on households' inflation expectations, and this could further push up prices. While I expect the rate of food price increases to moderate, given the points I just mentioned, I believe it is highly likely that food prices will continue to rise to some extent, rather than returning to the state seen until 2020, where prices barely increased.

As shown in Chart 8, services prices appear to have been rising at a rate of somewhat below 2 percent year on year, but this is because housing rent and public services are included, both of which are considered to structurally follow developments in general prices with a significant time lag.[2,3,4] Services prices excluding these components -- which I refer to as

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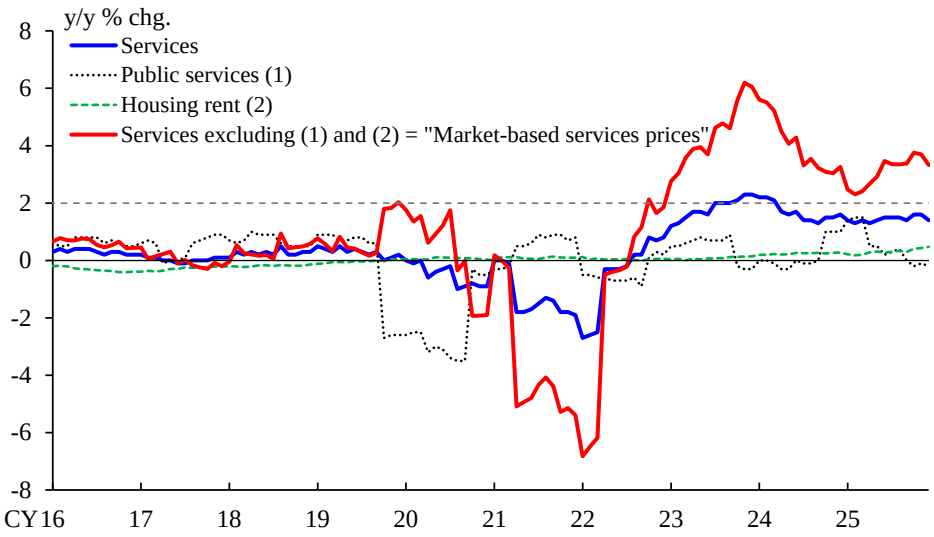
[2] Housing rent refers to private housing rent and imputed rent in the CPI.

[3] The small rate of increase in the year-on-year rate of change in Japan's CPI for housing rent has been attributed to the high institutional barriers against raising rent, and because surveys on housing rent include ongoing rents, the impact of increases in new contract rents made at the time of a change of resident is not fully accounted for. A downward bias in housing rent is also created by the fact that a quality adjustment to housing for rent in terms of deterioration from aging is not incorporated. It is important to note that these effects are reflected not only in private housing rent but also in imputed rent, which has a large weight in the CPI. On this point, the *Housing and Land Survey* shows that the annualized rate of increase in housing rent was at around 2 percent during the period from 2018 to 2023, indicating a discrepancy from that for private housing rent in the CPI, which was at around 0 percent. Taking into account the weight of housing rent in the CPI, it can be inferred that the year-on-year rate of increase in the overall CPI may be significantly higher in reality. The weight of private housing rent and imputed rent in services prices is 36 percent.

[4] Public services in the CPI include not only items under legal prices and ordinance-based prices, regulated either by the central or local governments, but also items under licensed prices, which require the approval of the central government for price changes, and items under notified prices, whose

"market-based services prices" -- have continued to see an increase of more than 2 percent, indicating that the mechanism in which wages and prices rise in interaction with each other has been operating. Furthermore, recently, the rate of increase in housing rent has also been rising gradually. The rate of increase in public services prices could accelerate, mainly reflecting the government's announcement of a revision of fees for services such as medical care, nursing care, and welfare for people with disabilities.

Chart 8: Consumer Prices (Services)



Notes: 1. "Public services" includes public housing rent, rent for the Urban Renaissance Agency, and rent for public corporations.
2. "Housing rent" consists of private housing rent and imputed rent.
Source: Ministry of Internal Affairs and Communications.

So far, I have shared my perspective on CPI developments by component. Underlying these developments are changes in firms' business stance and in firms' and households' inflation expectations. Looking ahead, unless there is a significant external shock, I believe it is highly likely that these changes will become structurally incorporated into Japan's economy. I will discuss these factors in detail.

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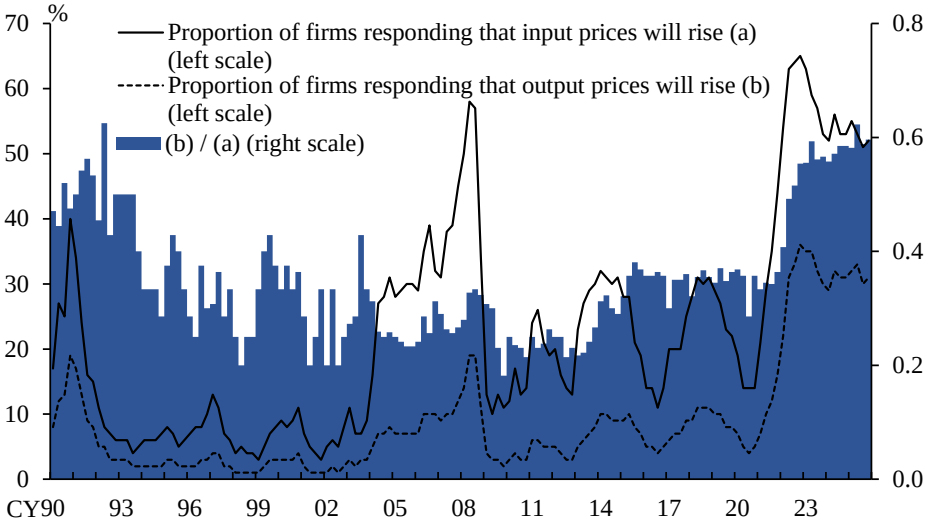
changes are reported to the government. One of the reasons why the rise in such administered prices in Japan has been sluggish is that government subsidies for supplementing revenues are constantly injected to public firms, and administered prices do not sufficiently reflect operating expenses and depreciation costs of equipment (see Box 4 of the July 2016 Outlook Report). The weight in services prices of public services (including public housing rent, rent for the Urban Renaissance Agency, and rent for public corporations) is 25 percent.

C. Changes in Firms' Business Stance

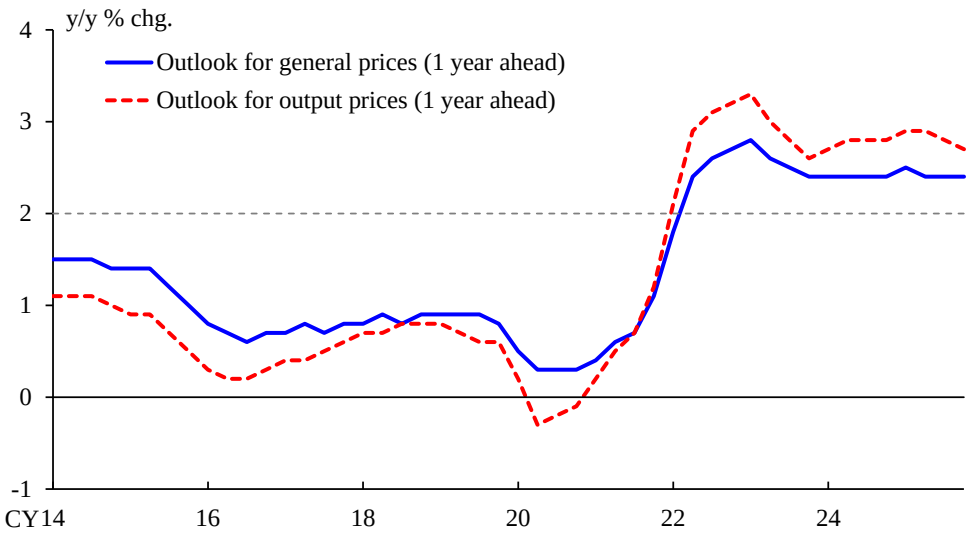
Let me start with the business stance firms have taken regarding price and wage setting. I was concerned that the adverse impact of U.S. tariff policy might lead firms' business stance to revert to the past stance observed during the deflationary and disinflationary periods, when wages and prices did not increase easily. In fact, firms have maintained a price-setting behavior that is more active than was observed in the past. Chart 9 shows the ratio obtained by dividing the proportion of firms responding in the *Tankan* that output prices would rise, by the proportion of firms responding that input prices would rise -- a rough indicator of firms' willingness to raise prices. From 2022, this indicator rose to the level last seen in the early 1990s, before the deflationary mindset took hold among firms, and has since remained at a relatively high level. Chart 10 presents developments in firms' one-year-ahead inflation outlook for general prices and for output prices for their products, both of which remain at high levels exceeding 2 percent. I am attentive to the fact that, until 2022, firms' stance was not to raise their product prices as much as the rise in general prices, but this stance has shifted since 2022 to raising their product prices more than the rise in general prices. I regard this shift as indicating more active price-setting behavior of firms.

Chart 9: Changes in Firms' Price-Setting Behavior



Note: Figures are based on the *Tankan*, and are for all industries and enterprises. There is a discontinuity in the data for December 2003 due to a change in the survey framework.
Source: Bank of Japan.

Chart 10: Firms' Inflation Outlook



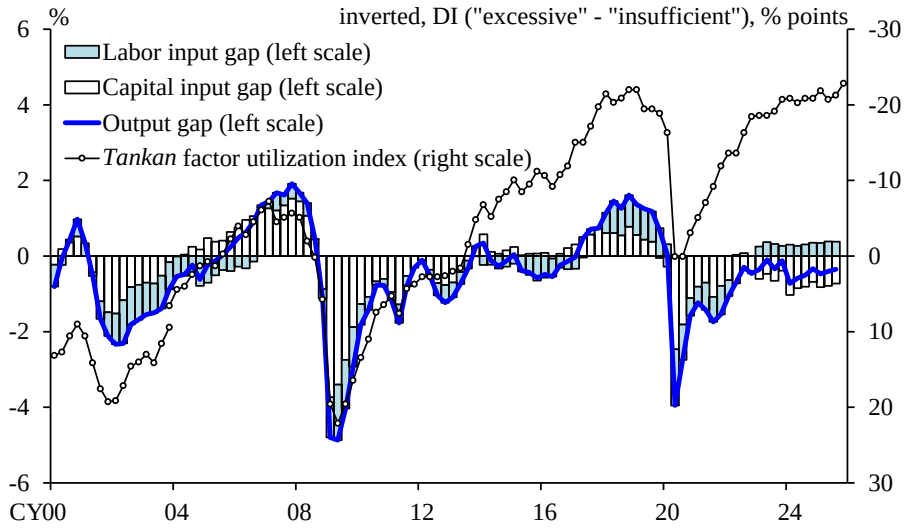
Note: Figures are based on the *Tankan*, and are averages of all industries and enterprises.
Source: Bank of Japan.

I think one reason why firms' price-setting behavior has become more active is that prices have been under upward pressure, as demand has outstripped potential supply capacity in the overall economy. In this regard, the output gap estimated by the Bank has been at around 0 percent recently, as shown in Chart 11, although this rate needs to be viewed with latitude, as estimates may differ depending on the estimation methods and are subject to estimation errors. So, does this mean that there has been neither upward nor downward pressure on prices? Looking at the breakdown of the output gap, the labor input gap has been positive (i.e., labor shortage), whereas the capital input gap has been negative (i.e., excessive production capacity) because production facilities have not been operating at full capacity. That said, such operation below full capacity is not necessarily due to a lack of demand but rather due largely to the shortage of labor needed to operate facilities sufficiently.[5] In the *Tankan*, recent developments in the DIs showing firms' perceptions of production capacity and employment conditions reveal that, while the share of firms responding that their labor capacity has been

[5] Anecdotal information includes the following. The accommodations industry noted that Japanese-style inns and western-style hotels inevitably had to limit occupancy rates due to labor shortages. The taxi industry noted that a shortage of drivers made it impossible to operate all vehicles even if they were available. The manufacturing industry noted that firms were unable to operate production facilities at full capacity due to labor shortages.

insufficient increased substantially, hardly any firms were experiencing excessive production capacity. This may explain the significant divergence between developments in the weighted average of the relevant DIs -- i.e., the *Tankan* factor utilization index -- and developments in the output gap estimated by the Bank.[6] Therefore, my view is that, although the tightness of supply and demand conditions differs between industries, the output gap is already in positive territory in reality and the lack of supply capacity is exerting upward pressure on prices, thus leading firms to adopt a more active price-setting behavior.

Chart 11: Output Gap



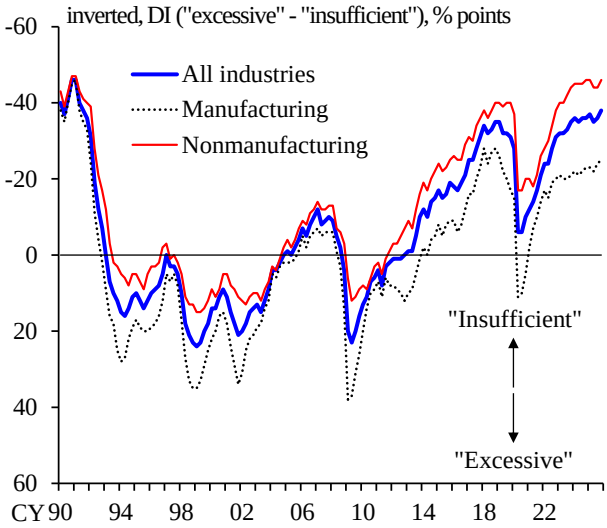
Notes: 1. Figures for the output gap are Bank staff estimates.
2. The *Tankan* factor utilization index is calculated as the weighted average of the production capacity DI and the employment conditions DI for all industries and enterprises. Capital and labor shares are used as weights. There is a discontinuity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

Furthermore, firms' wage-setting behavior is also assessed to have remained active. As shown in Chart 12, firms have continued to experience a strong sense of labor shortage. Corporate profits have remained at high levels on the whole, even after taking into account the impact of tariff policies. Firms' wage-setting behavior also appears to have remained active when examining factors such as the stances of labor and management on the annual spring labor-management wage negotiations and anecdotal information gathered through the Bank's Head Office and branches. As Chart 13 shows, wage growth achieved last year exceeded that in

[6] The *Tankan* factor utilization index is a composite indicator calculated using the weighted average of the production capacity DI and the employment conditions DI in the *Tankan*. It indicates whether firms sense an excess or a shortage in their production and labor capacity.

2024. Considering these circumstances, it seems highly likely that this year's wage growth will also reach a level in line with the price stability target of 2 percent.

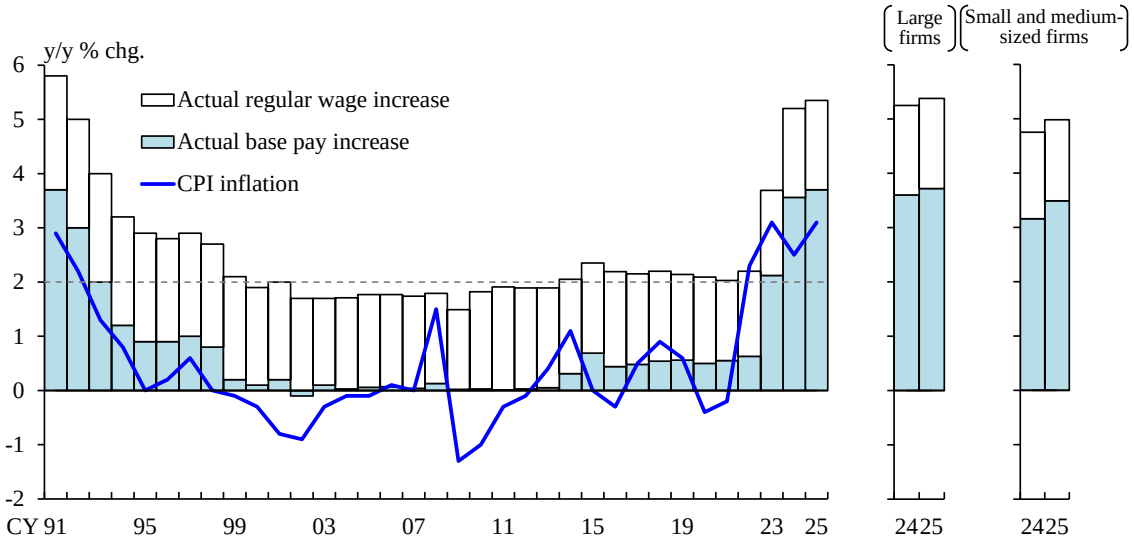
Chart 12: Employment Conditions DI



	March 2025	June 2025	September 2025	December 2025
All industries	-37	-35	-36	-38
Manufacturing	-23	-22	-24	-25
Non-manufacturing	-46	-44	-44	-46

Note: Figures are based on the *Tankan*, and are for all enterprises. There is a discontinuity in the data for December 2003 due to a change in the survey framework.
Source: Bank of Japan.

Chart 13: Results of the Annual Spring Labor-Management Wage Negotiations

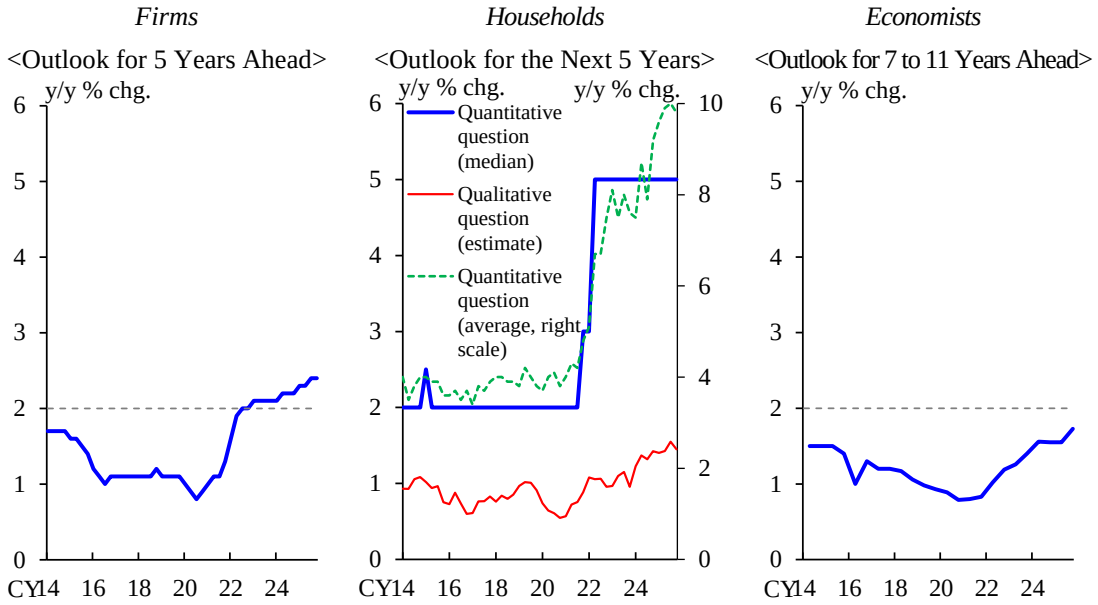


Notes: 1. Figures for CPI inflation are for all items less fresh food, excluding the effects of consumption tax hikes, on a calendar-year basis.
2. Figures for actual base pay increase and actual regular wage increase from 1991 to 2014 are those published by the Central Labour Relations Commission, while those from 2015 to 2025 are figures released by the Japanese Trade Union Confederation (Rengo). Figures are based on the wage negotiation results of labor unions for which the base pay increase is clear.
Sources: Central Labour Relations Commission; Ministry of Internal Affairs and Communications; Rengo.

D. Changes in Firms' and Households' Inflation Expectations

Next, I will discuss developments in inflation expectations, shown in Chart 14. I believe that, when considering future price developments, the focus should be placed on the inflation expectations of firms and households, who are the actual drivers of economic activity. Firms'

Chart 14: Inflation Expectations



Notes: 1. Figures for firms in the left panel are based on the *Tankan*, and are averages of all industries and enterprises.
2. Figures for households in the middle panel are based on the *Opinion Survey on the General Public's Views and Behavior*. Figures for the quantitative question are based on numerical values for expected inflation rates provided by respondents, and the average of those is calculated by excluding 0.5 percent of the highest and lowest figures, respectively, in order to avoid extremes. Figures for the qualitative question are estimated using the modified Carlson-Parkin method, quantifying the results of the 5-choice question, asking respondents their expectations for whether and to what degree prices will go up or down.

Sources: JCER, *ESP Forecast*; Bank of Japan.

inflation outlook for general prices in the *Tankan* has continued to rise moderately, with their inflation outlook for five years ahead remaining above 2 percent. Regarding inflation expectations of households, the results of the Bank's *Opinion Survey on the General Public's Views and Behavior* show that both the median and average of households' inflation outlook for the next five years have remained significantly above 2 percent, although bias in expected price levels should be taken into account.[7] Unlike the United States and Europe, where

[7] This survey included a qualitative question asking respondents to indicate their outlook for prices by choosing options such as prices "will go up slightly" or "will go up significantly." When inflation expectations are estimated using the responses to this question to adjust for bias in household expectations, the latest estimates suggest that inflation expectations have remained at a level of around 1.5 percent. Compared with the levels observed prior to 2023, this represents only a modest increase, whereas the median and average responses to quantitative questions have risen sharply. Given this, I feel that estimates based on qualitative responses may be underestimated. For example, even if people

inflation expectations have been stable at around 2 percent, Japan has seen inflation expectations rise from a low level. In that sense, I have been paying attention to whether any further rise is more than expected.

II. Conduct of Monetary Policy

In what follows, I would like to share my perspective on the Bank's conduct of monetary policy, while also touching on its history.

A. Developments in Policy Conduct

The Bank conducts monetary policy with the aim of achieving the price stability target of 2 percent in a sustainable and stable manner. Since the changes in the monetary policy framework decided at the March 2024 Monetary Policy Meeting (MPM), the Bank has returned to conventional monetary policy, employing the guidance of the short-term interest rate as a primary policy tool. The Bank intends to adjust the degree of monetary accommodation in response to an increase in the likelihood of achieving the price stability target; after setting the target level of its short-term policy interest rate at around 0 to 0.1 percent at the March 2024 MPM, it raised the target level to around 0.25 percent at the July 2024 MPM, to around 0.5 percent at the January 2025 MPM, and further to around 0.75 percent at the December 2025 MPM. As for the future conduct of monetary policy, given that real interest rates are at significantly low levels, if the outlook for economic activity and prices presented in the January Outlook Report is 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.

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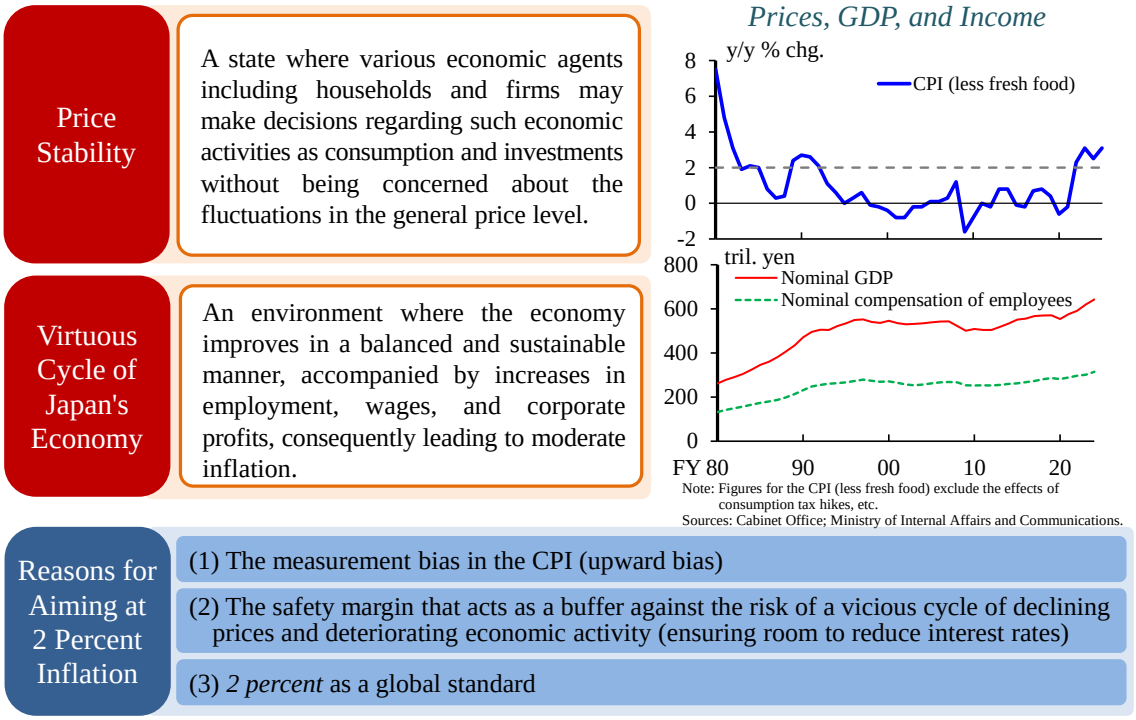
with high inflation expectations, like respondents saying that prices "will go up significantly," have increased their expectations further, they are only able to choose the same response, since there is no higher category than "will go up significantly," and this induces a downward bias.

B. Price Stability

In the first place, what does "price stability" mean? As shown in Chart 15, it is conceptually defined as "a state where various economic agents including households and firms may make decisions regarding such economic activities as consumption and investments without being concerned about the fluctuations in the general price level."[8] It is not necessarily true that the lower the inflation rate, the better. Looking back at the period when Japan was experiencing deflation, there emerged a vicious cycle of declining prices, falling sales and profits, stagnating wages, sluggish consumption, and further price declines. Accordingly, GDP and employee income in nominal terms remained subdued during this period. In order to overcome such a deflationary trend and realize a virtuous cycle in Japan's economy, it is essential that the economy improve in a balanced and sustainable manner, accompanied by increases in employment, wages, and corporate profits. With this economic improvement in place, prices are expected to rise moderately.

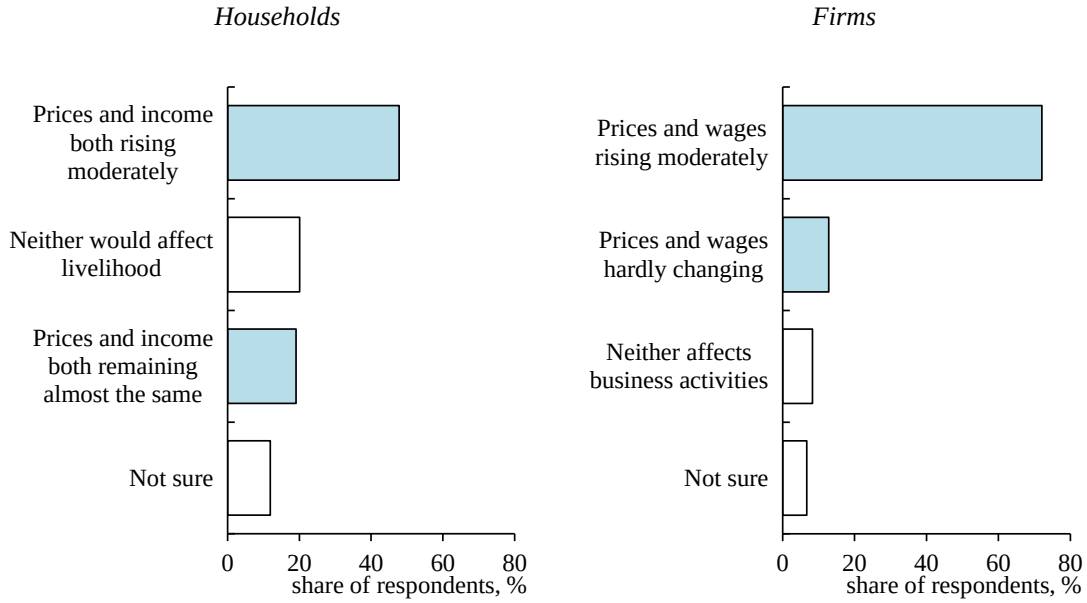
Chart 15: Desired State of the Economy



[8] Bank of Japan, "The 'Price Stability Target' under the Framework for the Conduct of Monetary Policy," January 22, 2013.

Chart 16 shows the response of households and firms when asked about their preferences regarding prices, income, and wages. The most common response from both households and firms was that they preferred a situation in which both prices and income (wages) rise moderately. After a long period in which both prices and wages hardly changed, Japan's economy has finally transitioned to a situation in which they both rise. It is vital to establish these rises at favorable levels that can be described as moderate.

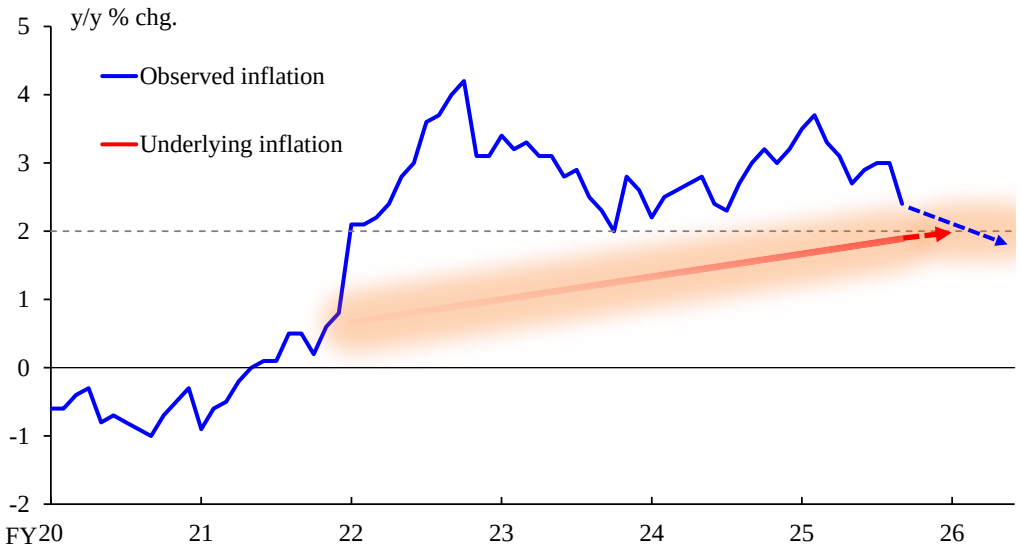
Chart 16: Preferences regarding Prices, Income, and Wages



Note: Figures for households are based on the *Opinion Survey on the General Public's Views and Behavior* (September 2024 Survey). Those for firms are based on the *Survey regarding Corporate Behavior since the Mid-1990s*.
Source: Bank of Japan.

As shown in Chart 17, observed inflation has remained above 2 percent for 45 months, but the underlying trend in prices cannot be judged to have taken hold at 2 percent thus far. Therefore, the Bank has maintained accommodative financial conditions while gradually adjusting the level of its policy interest rate. Observed inflation will likely decline to around 2 percent or, in some cases, may fall below 2 percent. On the other hand, as I mentioned earlier, the underlying trend in prices has been gradually increasing, and the time may have almost come to judge that the trend has taken hold at 2 percent. To achieve the 2 percent price stability target in a sustainable and stable manner, in addition to monitoring observed inflation, which fluctuates significantly due to temporary factors, the Bank needs to comprehensively assess the underlying trend in prices and conduct monetary policy so that the trend takes hold at 2 percent.

Chart 17: Observed and Underlying Inflation: A Visual Overview



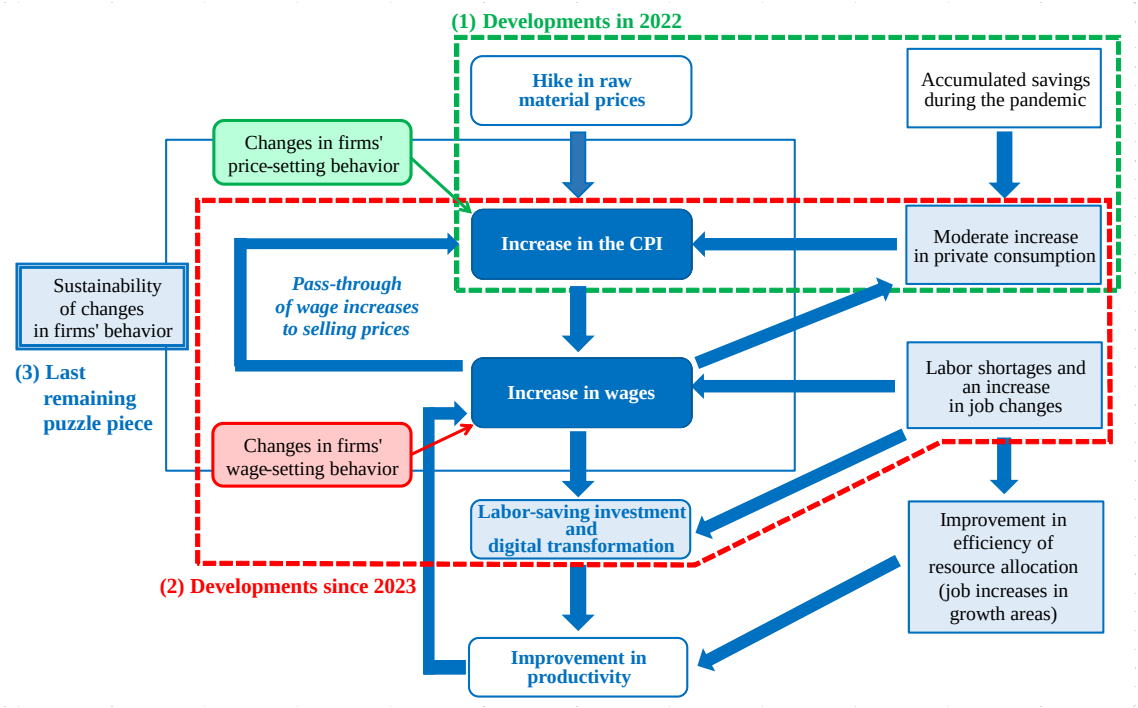
Note: Figures for observed inflation are the CPI for all items less fresh food.
Source: Ministry of Internal Affairs and Communications.

C. Mechanism in Which Wages and Prices Rise Moderately in Interaction with Each Other

The key to achieving a situation in which both prices and income (wages) rise moderately is whether the mechanism shown in Chart 18 operates. As I said earlier, I believe that firms' price-setting behavior has changed on the whole, despite some differences, from the one observed during the deflationary and disinflationary periods.

From my perspective, firms have also changed their wage-setting behavior, and the mechanism in which wages and prices rise moderately in interaction with each other has been operating; this can be observed in wage increases, the pass-through of these increases to selling prices, and resilient consumption backed by the increase in wages. In determining whether the 2 percent price stability target has been achieved, I would argue that the last piece of the puzzle is the sustainability of this mechanism. As I mentioned earlier, I believe it is quite possible that, by the time the warm weather arrives this spring, the 2 percent price stability target can be judged to have been achieved if it is confirmed that wage growth will be in line with the price stability target for the third consecutive year.

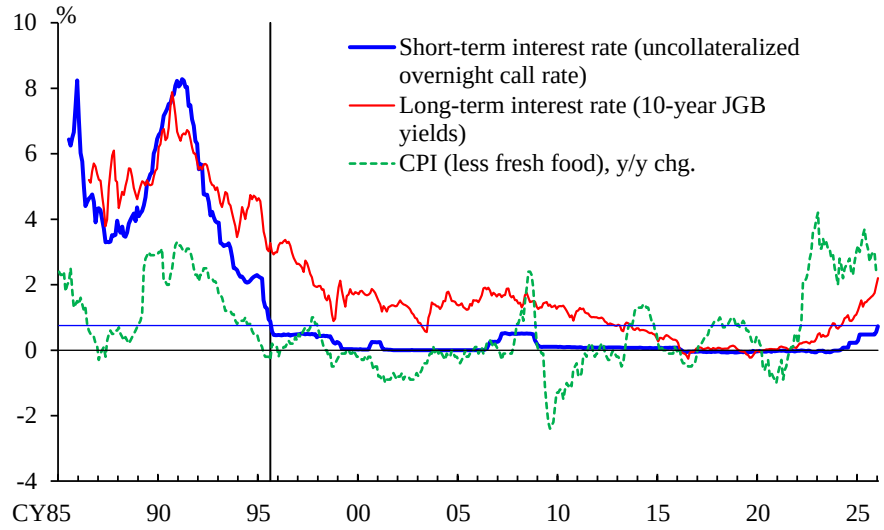
Chart 18: Mechanism in Which Wages and Prices Interact with Each Other



D. Interest Rates and Their Impact on Economic Activity

Now, let me look back at the Bank's monetary policy since the 1990s, with reference to Chart 19. The Bank raised its policy interest rate to 0.75 percent in December 2025 -- the highest

Chart 19: Interest Rates and Consumer Prices



Note: Figures for the CPI (less fresh food) exclude the effects of consumption tax hikes.
Sources: Ministry of Finance; Ministry of Internal Affairs and Communications; Bank of Japan.

level in three decades since 1995. While this marks a return to a level not seen for quite some time, it should be noted that the economic environment differs significantly between 1995 and today; back then, the year-on-year rate of change in the CPI for all items excluding fresh food was at around 0 percent, whereas it now exceeds 2 percent.

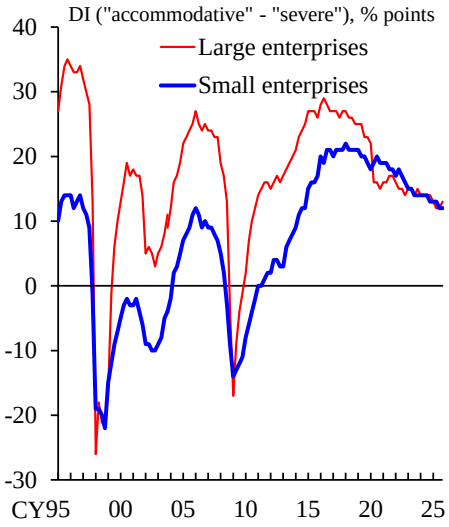
From the second half of the 1990s, Japan entered a state without meaningful interest rates. With the start of the Bank's zero interest rate policy and its introduction of the negative interest rate policy, short-term interest rates declined to 0 percent and then into negative territory. Meanwhile, the Bank had also kept long-term interest rates at low levels through unconventional measures, including its commitment aimed at generating policy duration effects, quantitative easing, and yield curve control. Amid sluggish economic growth and mounting financial instability in the wake of the bubble's collapse, I think that monetary easing was indeed effective to some extent in supporting the economy in the course of moving into the state without meaningful interest rates. Regarding the effects of further monetary easing once Japan reached that state, there were positive effects in terms of the repricing of assets such as higher stock and real estate prices and a correction of the excessive appreciation of the yen. However, looking back to when I was a financial practitioner, I could not conceive that a marginal decline in interest rates stimulated business fixed investment or otherwise invigorated corporate activity. My understanding is that the function of interest rates -- in terms of raising or lowering interest rates to adjust demand and affect prices -- was extremely limited in the state without meaningful interest rates.

The Bank has raised its policy interest rate since March 2024 to 0.75 percent, but my view is that the impact of the policy interest rate hikes on Japan's overall economy has so far been extremely limited. At least, my impression is that, overall, there have been few reports that interest rate hikes have led to restraining economic activity, such as firms' suspension of fixed investment due to higher interest rates. Of course, the impact of interest rate hikes varies among individual firms and households, and this aspect warrants careful monitoring. That said, in the *Tankan*, firms' financial positions and financial institutions' lending attitudes as perceived by firms indicate that financial conditions have remained significantly accommodative, as shown in Chart 20. Judging from this situation, my understanding is that

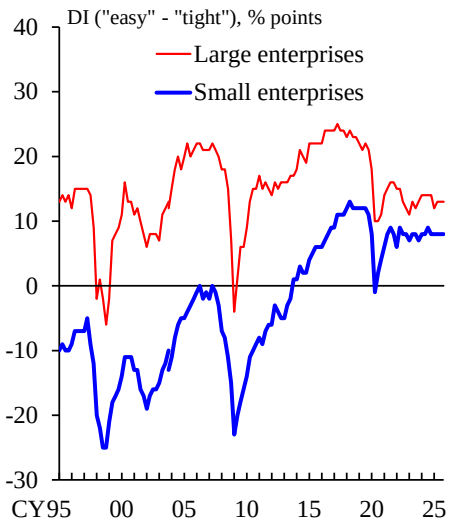
there is still considerable distance to the neutral interest rate level; in other words, even if the Bank raises its policy interest rate, financial conditions will remain accommodative.

Chart 20: Lending Attitudes of Financial Institutions and Firms' Financial Positions

Lending Attitudes of Financial Institutions as Perceived by Firms



Firms' Financial Positions

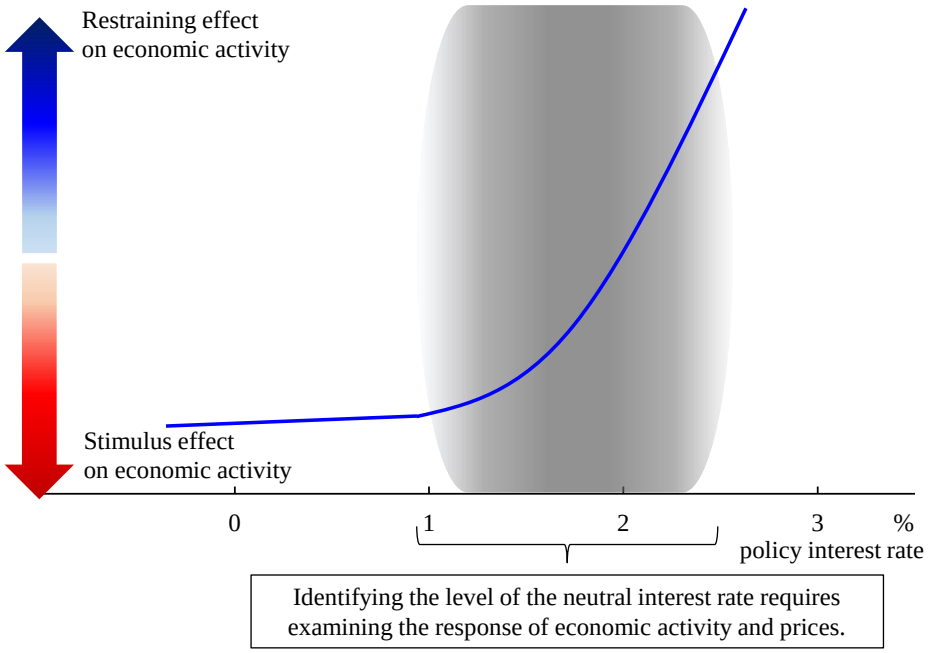


Note: Figures are based on the *Tankan*, and are for all industries. There is a discontinuity in the data for December 2003 due to a change in the survey framework.
Source: Bank of Japan.

Chart 21 shows the relationship between the policy interest rate and economic activity that I have just explained. This is a simple representation of my understanding, based on my perceptions as a financial practitioner before becoming a member of the Bank's Policy Board and on my experience over the past few years. When the policy interest rate is below 1 percent, a rate hike will only very marginally affect the waning of the economic stimulus effect of monetary easing. As the policy interest rate exceeds around 1 percent, the stimulus effect begins to gradually weaken, and once it exceeds the neutral interest rate, the restraining effect on economic activity gradually gains strength. What I would like to emphasize here is the conception of the neutral interest rate -- the sum of the natural rate of interest, which is the real interest rate level that is neutral to economic activity and prices, and the expected rate of inflation. As I have previously stated, my sense is that the neutral interest rate should be at least around 1 percent. However, the natural rate is not directly observable, and estimates vary widely depending on the methodology used. Furthermore, because most of the data used to estimate the natural rate are drawn from the deflationary and disinflationary periods, there

is a high likelihood that a certain degree of bias has arisen, posing challenges to precise estimation. Therefore, in my view, the only way to determine where the level of the neutral interest rate actually stands in the territory of 1 percent and over is to examine the response of economic activity and prices as the Bank raises the policy interest rate. In doing so, it is important to remain attentive to the views of people on the frontlines of business, to household opinions, and to anecdotal information from firms. I would like to assess the current policy interest rate relative to the neutral interest rate by carefully ascertaining, for example, to what extent the views are increasing and becoming widespread that firms put fixed investment on hold if interest rates rise by this much, or that households are cautious about purchasing a home for the time being given the burden of housing loan interest payments.

Chart 21: Effects of the Policy Interest Rate on Economic Activity: A Visual Overview Based on Experience as a Financial Practitioner

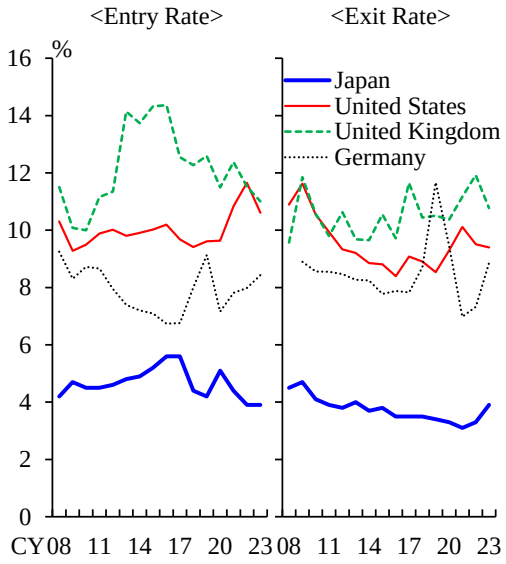


At the same time, I feel it should be kept in mind that the state without meaningful interest rates, where interest rates are below 1 percent, caused the side effects outlined in Chart 22. As shown in Chart 23, the entry and exit rates of firms in Japan are lower than in other economies. Moreover, the Bank of Japan's government bond holdings are by far larger than

Chart 22: Side Effects Relating to Interest Rate Functions in a State without Meaningful Interest Rates

(1) Weakening of the hurdle rate function of interest rates	The hurdle rate function acts to urge firms to concentrate their business resources to businesses with high added value that generate profitability that is higher than borrowing interest rates, thereby improving the efficiency of resource allocation. ⇒ In a state without meaningful interest rates, it is likely that the channeling of funds into businesses with relatively low productivity has impeded improvement in the efficiency of resource allocation.
(2) Weakening of the signaling effects of interest rates	The level of long-term yields on JGBs and how it changes provide a signal for how the market sees factors such as the future state of economic activity and prices and the government's fiscal condition. ⇒ The signaling effects have not been fully exerted.

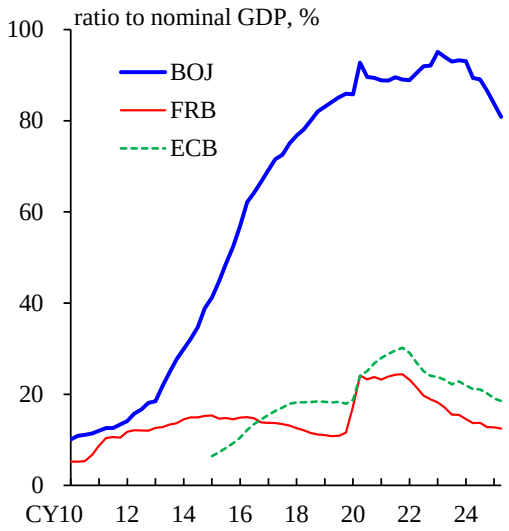
Chart 23: Entry and Exit Rates in Major Economies



Note: Figures for Japan are on a fiscal-year basis. There is a discontinuity between the figures for Germany up to 2020 and those from 2021 onward due to changes to the definition.
Sources: Eurostat; Small and Medium Enterprise Agency; U.K. Office for National Statistics; U.S. Census Bureau.

those of other central banks, as indicated in Chart 24. While it would be going too far to say that all of these are attributable to the state without meaningful interest rates, it should be borne in mind that such a state may have at least been one contributing factor. Attention is also warranted on the possibility that the negative effects of the state without meaningful interest rates may become larger in the future, as further side effects materialize at a later date. I believe that the Bank should therefore continue to carefully examine the side effects on financial market functioning, on the functioning of financial intermediation, and on the supply side of the economy as exemplified by the entry and exit rates of firms. As another topic of relevance, the Bank should carefully follow whether prolonged monetary easing gives rise to problems; for example, how the excessive depreciation of the yen, continued high inflation, and a rise in real estate prices affect the economy and people's livelihoods.

Chart 24: Government Bond Holdings of Major Central Banks



Sources: Cabinet Office; Eurostat; Federal Reserve Board; U.S. Bureau of Economic Analysis; Bank of Japan.

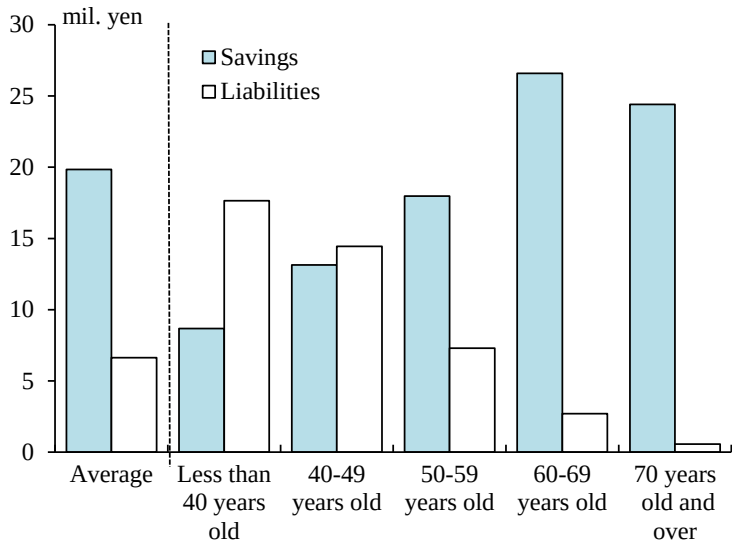
E. Impact of Interest Rate Hikes on Various Economic Agents

I would also like to consider the impact on various economic agents of raising the short-term interest rate. To put it simply, since net borrowers pay interest and net savers receive interest, raising the short-term interest rate increases the burden on net borrowers and increases interest income for net savers. Therefore, the impact of raising the short-term interest rate differs depending on, for example, whether a household has a housing loan, whether a firm has borrowings, whether borrowings are on a floating rate or fixed rate basis, or whether

savings exceed borrowings. Furthermore, I think it is necessary to pay attention to the channels through which short-term interest rate hikes affect economic activity, while also extending the focus beyond interest rates to monitor the changes in the economic and price situation that led to the rate hikes, such as increases in corporate sales and profits, in employee income, and in prices of assets, including homes.

For example, looking at household savings and liabilities by age group of the household head in Chart 25, because many households in their 40s or younger have housing loans, they have larger liabilities, while those in their 50s or older have larger savings than liabilities. Thus, for the average household, disregarding individual differences, interest rate hikes tend to increase the burden on households in their 40s or younger and be more beneficial for those in their 50s or older. When considering the impact of interest rate hikes on households with housing loans however, it is also necessary to take into account the following facts. First, many households with a housing loan are working households, some of which benefit from wage increases. Second, while this may not immediately translate into profits, there have been many cases where the value of a home purchased with a housing loan has increased.

Chart 25: Household Savings and Liabilities

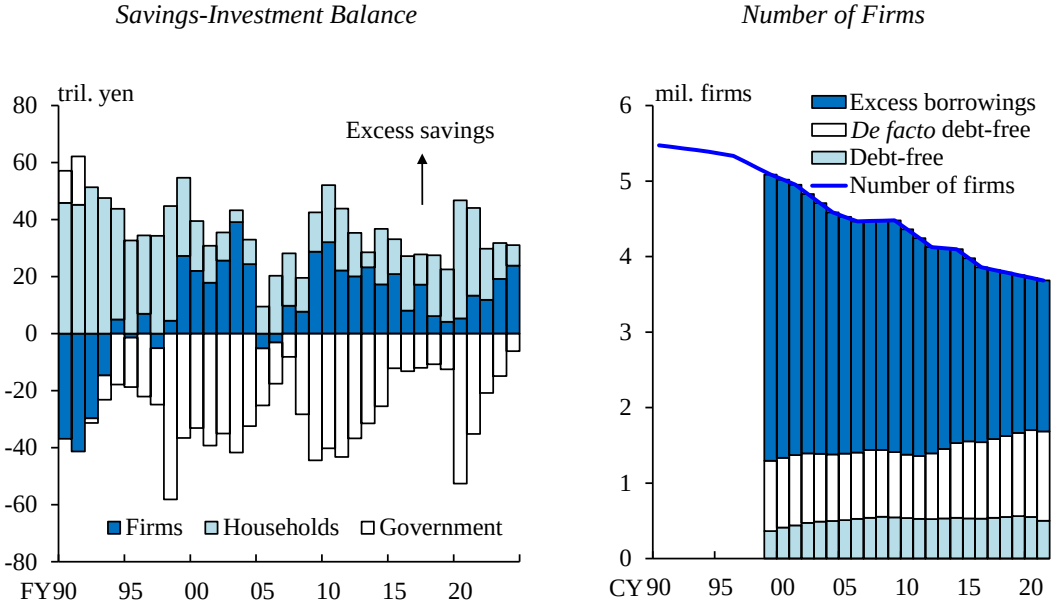


Note: Figures are 2024 averages for two-or-more-person households.
Source: Ministry of Internal Affairs and Communications.

Households in their 50s or older have significant net savings -- although, of course, the amount of savings varies by household -- and their interest income is expected to increase in line with a rise in deposit interest rates. Moreover, with an increase in stable interest income, households that have been reluctant to withdraw the principal of their deposits, preferring to save up for retirement, are less likely to face the need to make significant withdrawals.

Turning to the corporate sector, while firms have long been net savers on a flow basis, reducing borrowings and accumulating funds on hand, the proportion of debt-free or *de facto* debt-free firms -- defined as firms whose cash and deposits exceed their total amount of borrowings -- has been increasing, as shown in Chart 26. Hence, at the macro level, the corporate sector is likely to be more resilient to the impact of short-term interest rate hikes than in the past. In addition, solid corporate profits are expected to mitigate the effects of higher interest payments if the outlook for Japan's economy mentioned earlier is realized -- namely, that the economy will grow at a pace above its potential growth rate, as the mechanism in which wages and prices rise moderately in interaction with each other is maintained.

Chart 26: Firms' Financial Condition

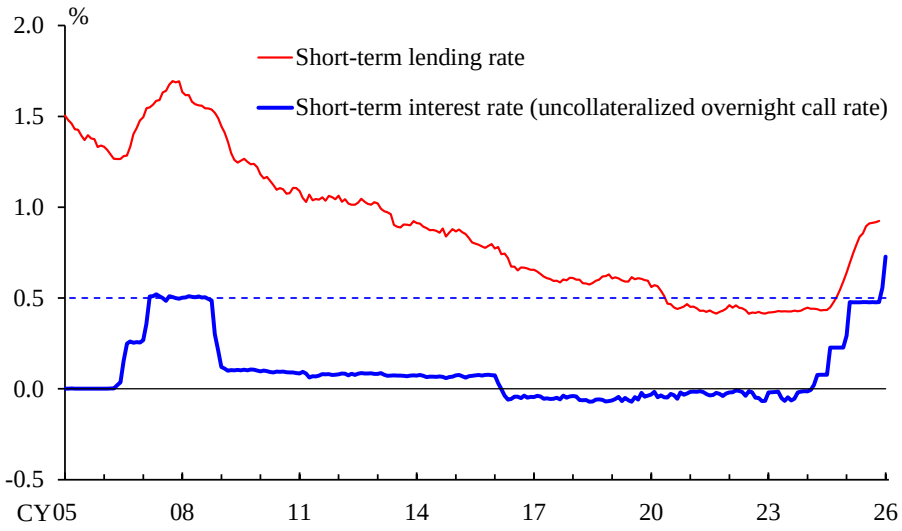


Notes: 1. In the left panel, figures are based on the *Flow of Funds Accounts*.
2. In the right panel, figures show the number of privately owned establishments from the *Economic Census for Business Frame* and the *Economic Census for Business Activity* (figures up until 2006 are from the *Establishment and Enterprise Census*), interpolated for years with no data; the number is decomposed using the shares of each category of firm for each year based on data from Teikoku Databank. Figures cover privately owned establishments (single-unit establishments and head offices).
Sources: Ministry of Internal Affairs and Communications; Small and Medium Enterprise Agency; Teikoku Databank; Bank of Japan.

Interest rate hikes will also have an impact on the government. Speaking in general terms, it is important to steadily secure market confidence in fiscal management.

I would also like to touch on developments in the level of lending rates of commercial banks. Please refer to Chart 27. In 2007 and 2008, which includes the period when the short-term policy interest rate was 0.5 percent, short-term lending rates were in the range of 1.5-1.7 percent. In November 2025, when the short-term policy interest rate was also 0.5 percent, short-term lending rates were only at around 0.9 percent. While credit costs are lower than in 2007 and 2008, I am of the view that interest rate spreads on loans are narrowing more significantly than can be explained solely by this factor. The same can be said for housing loans. Needless to say, with the rise in the short-term policy interest rate in December 2025, close attention is warranted on how lending rates develop. That said, my prediction is that short-term lending rates will remain relatively low compared to the past.

Chart 27: Market Interest Rates and Lending Rates



Note: Lending rates indicate average contract interest rates on new loans and discounts of domestically licensed banks (6-month backward moving averages). Figures are yen-denominated loans on the banking book, excluding loans to financial institutions.
Source: Bank of Japan.

Conclusion

In my view, the mechanism the Bank is aiming for, in which wages and prices rise moderately in interaction with each other, has been maintained, and in this situation, inflation is becoming endogenous and sticky, with its main driver shifting from higher raw material prices to

increased labor costs. Earlier, I said that the definition of price stability is "a state where various economic agents including households and firms may make decisions regarding such economic activities as consumption and investments without being concerned about the fluctuations in the general price level." At present, however, many households are struggling with the increased cost of living, while many firms are struggling with higher input prices, and I personally do not think it can be claimed that Japan is experiencing price stability as defined. Japan's economy must avoid returning to the deflationary or disinflationary period -- when both prices and wages hardly changed -- due to premature monetary tightening. At the same time, persistent inflation that cannot be described as moderate must also be avoided. As the final step in the monetary easing it has pursued for many years, the Bank will carefully examine data on Japan's economic activity and prices, as well as various anecdotal information, and conduct monetary policy in a timely and appropriate manner so that it can successfully reach its goal of sustainable and stable achievement of the 2 percent price stability target.

I would like to conclude by expressing my hope for the further development of the economy of Kanagawa Prefecture and the continued success of everyone who supports the regional economy.

Thank you.