March 2, 2026

Bank of Japan

Japan's Economy and Monetary Policy

Speech at a Meeting with Local Leaders in Wakayama

HIMINO Ryozo

Deputy Governor of the Bank of Japan

(English translation based on the Japanese original)

Introduction

Good morning, everyone. Thank you for joining us today.

Macro Economy: A Diagram

Today, I would like to share my thoughts on Japan's economic activity, prices, and monetary policy. Given that these subjects involve a multitude of topics, I have prepared an overview diagram to indicate the interrelationships among the topics and how each topic fits into the overall story (Chart 1).

The diagram might appear a bit like a mandala at first glance. Mandalas were first brought to Japan by the high priest Kukai, who opened his head temple 50 kilometers east of here. According to Kukai, some things are too intricate to explain merely in words, but once visualized in an illustration, they instantly become clear.[1] I could not resist the temptation to pay a small homage to Kukai while here in Wakayama.

The diagram is a visual representation of the five key equations that form the backbone of the standard macroeconomic model known as the dynamic aggregate demand-aggregate supply, or AD-AS, model.[2] In the diagram, endogenous variables are arranged in a circular manner, with relatively stable exogenous variables placed toward the center and more short-lived variables positioned on the outer edge. Additionally, I've included a number of arrows: solid black arrows indicate additive relationships in the equations while double-lined arrows indicate subtractive relationships.

I'll proceed clockwise from economic activity in the upper-left quadrant, to prices in the upper-right, and then to money and finance at the bottom.

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[1] Kukai, *Goshōrai mokuroku* [Catalogue of the items brought to Japan] (806).

[2] The left part of the diagram corresponds to the aggregate demand equation, the top left represents the Phillips curve, the top right reflects adaptive expectations, the bottom right illustrates the Taylor rule, and the bottom indicates the Fisher equation.

I. Economic Activity

Demand Shocks and GDP

Let us begin with economic activity, represented in the upper-left quadrant of the mandala diagram (Chart 2 [left-hand panel]). You'll notice three arrows pointing toward GDP. These are to illustrate that the level of economic activity, or GDP, fluctuates above and below Japan's potential GDP, which can be considered the cruising speed of the economy. Two key factors contribute to these fluctuations: first, demand shocks originating from outside normal economic circulation, and second, financial conditions, which reflect the state of monetary tightening or easing.

The Bank's January 2026 *Outlook for Economic Activity and Prices* (Outlook Report) described Japan's economic outlook as follows (Chart 2 [right-hand panel]):

> 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.

This statement refers to two types of demand shock: (1) negative demand shock arising from trade policy developments around the world, including the impact of U.S. tariff policy on exports from Japan; and (2) positive demand shock, which pertains to the impact of government economic measures that are expected to stimulate demand.

The statement also refers to accommodative financial conditions, but I will address this subject later, in my discussion of money and finance.

How will all these factors translate into the trajectory of Japan's GDP? Unfortunately, our past projection missed the mark (Chart 3 [left-hand panel]). Before the Trump administration announced tariff policies in April last year, the Bank anticipated that Japan's GDP growth rates for fiscal 2025 and 2026 would be around 1 percent. Immediately following the tariff announcement, however, we significantly revised these forecasts

downward. Over time, we gradually adjusted the projections upward and, in our most recent outlook, ultimately brought them back to the pre-tariff announcement levels. In other words, the demand shock turned out to be less severe than we initially anticipated.

Why did our forecast miss the mark? It was not due to developments in trade policies: Even in our earlier projections, we had assumed that there would be some level of progress in international trade negotiations and that there would be no major disruptions of global supply chains. The key reason was the unanticipated resilience of the U.S. economy.

We were not alone in underestimating this. Even the U.S. Federal Reserve initially revised its GDP growth projections downward following the tariff announcements, only to raise them later on (Chart 3 [right-hand panel]). Moreover, the recently published advance estimate of the actual GDP growth rate surpassed even the latest projections.

There seems to have been two primary reasons behind this strong performance in the U.S. economy.

Firstly, a significant portion of the tariff burden was absorbed by U.S. firms, instead of being passed on to consumers, which kept prices from rising as much as expected (Chart 4 [left-hand panel]). This, in turn, prevented a major slowdown in consumer spending.

Secondly, in the United States, AI-related investment by hyperscale tech firms skyrocketed, though non-IT-related investment stalled (Chart 4 [middle and right-hand panels]).

Last October, the Bank believed that Japan might struggle to benefit from the demand generated by the AI boom, given that it does not excel in cutting-edge semiconductors to the extent that Taiwan or South Korea does. At a meeting in January, however, many of the general managers of the Bank's branches reported on the spillover effects extending across regions and industries, from air conditioners for data centers to semiconductor manufacturing equipment. Both direct exporters and their subcontractors were positively impacted.

Potential GDP and the GDP Gap

Is Japan's current GDP above or below the economy's cruising speed, i.e., its potential GDP? In our mandala diagram, this concept is depicted to the top-right of GDP, and labeled as the GDP gap. A positive GDP gap indicates that the economy is overheating somewhat, suggesting a shortage of supply capacity of labor or capital. Conversely, a negative GDP gap points to economic stagnation with excess supply capacity.

According to Bank staff estimates, the current GDP gap (output gap) is around zero (red line in Chart 5). Although not shown here, estimates from the Cabinet Office reach a similar conclusion.

If this is correct, we can infer that the Japanese economy is neither overheating nor stagnating and that labor and capital, on the whole, are neither severely strained nor excessively idle.

I wonder if this comports with what it feels like to run a business in this region. According to the Bank's *Tankan* survey (Short-Term Economic Survey of Enterprises in Japan), firms have reported substantially positive business conditions, with ongoing improvements. Labor shortages, which are most pronounced in nonmanufacturing sectors, have reached levels of severity not seen since the bubble economy era. Combining survey data on labor shortages with survey results on equipment shows that supply capacity is decidedly under strain (blue line in Chart 5). Indeed, order backlogs continue to accumulate, especially in sectors like construction and machinery.

Does this mean that the economy is overheated? The Consumer Confidence Index compiled by the Cabinet Office has stayed well below the level seen in past recovery phases (green line in Chart 5). Though not shown here, the Bank's *Opinion Survey on the General Public's Views and Behavior* (Opinion Survey) provides a similar picture. In the Bank's *Regional Economic Report*, analyses of regional economies by the Bank's branches and Head Office generally characterize the situation as "picking up" or "recovering moderately" -- phrases that fall a few notches below terms like "expanding." It seems that many people in Japan still do not believe the economy is particularly strong at this point.

What is behind such seemingly contradictory sentiments? I do not have a definitive answer, but one potential explanation could be that the economy is growing under the broader context of a shrinking population, leading to a sense of supply capacity shortage existing alongside a sense of stagnation. A growing perception gap on economic recovery among regions, income levels, and levels of assets held may also have contributed to this duality.

II. Prices

Next, let us turn our attention to prices, moving to the yellow section in the upper-right quadrant of the mandala diagram (Chart 6).

Inflation Rate

Two arrows are pointing toward the inflation rate in the diagram: one from the GDP gap and the other from the supply shock. The arrow pointing from the GDP gap signifies that, if the economy is overheating, it will likely exert upward pressure on prices, whereas if the economy is stagnant, it will exert downward pressure. The arrow pointing from the supply shock represents the influence of exogenous factors. For example, higher crude oil prices or the yen's depreciation could push import prices higher, increasing inflationary pressure. Conversely, government measures to cut gasoline taxes or to make high school tuition effectively free could exert a downward influence on prices.

The Bank currently estimates the fiscal 2025 inflation rate for all items excluding fresh food to be around 2.7 percent. This is the result of a combination of high inflation for food excluding fresh food, which is well above the 2 percent price stability target, and more moderate average inflation for other goods and services, which runs below 2 percent. This has placed a major burden on households, as reflected in the Opinion Survey, where 57 percent of respondents stated that their standard of living has become worse off.

The question is whether these high prices, specifically, the rise in food prices, are the result of supply shocks, or whether the GDP gap is to blame. Considering that the prices of other goods and services remain relatively stable in comparison to food, and that the GDP gap is estimated to be around zero, it seems reasonable to attribute the primary cause to

food-specific supply shocks, such as the domestic situation surrounding rice and price hikes in the global commodity market for items like cocoa and coffee.

Given this, the January Outlook Report offers the following perspective:

> The year-on-year rate of increase in the consumer price index (CPI, all items less fresh food) is likely to decelerate to a level below 2 percent in the first half of this year, 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.

On the other hand, research shows that over 60 percent of firms cited rising logistics and labor costs as factors contributing to their decision to raise food prices.[3] Hence, it is possible that supply shocks alone are not entirely to blame and, if so, the effects of the rise in food prices might take more time to subside than anticipated in the Outlook Report. That said, the rate of increase in the January CPI for all items excluding fresh food decelerated to 2.0 percent, which seems to align with the view presented in the Outlook Report.

Underlying Inflation and Inflation Expectations

Let's move onto the concept of underlying inflation, which is illustrated just to the right of the inflation rate on our mandala diagram. Underlying inflation refers to the level at which inflation would settle once the effects of temporary demand and supply shocks subside.

One might wonder why prices still rise over time without demand or supply shocks. This phenomenon can be explained by a mechanism in which wages and prices rise moderately in interaction with each other. Once people begin to believe that prices will rise at a certain rate each year, workers will demand and employers will accept the necessity of wage increases in line with anticipated inflation and productivity growth. Firms will find it necessary to raise selling prices to offset rising labor costs while taking into account productivity gains, and consumers' reaction to the price pass-through may, in turn, be affected by the situation regarding wage growth, further reinforcing the cycle. Over time,

[3] Data from a survey on price revisions by 195 major domestic food manufacturers for March 2026, conducted by the Teikoku Databank.

barring any shocks, inflation rates tend to stabilize at a level aligned with these shared expectations.

Referring back to our diagram, the arrow pointing from inflation expectations toward the inflation rate, with inflation expectations depicted in the interior of underlying inflation, illustrates how expectations shape actual prices and underlying inflation. The arrow pointing in the opposite direction suggests that such expectations are formed based on the accumulated experience of past inflation.

There are various methods to measure underlying inflation, but they can broadly be categorized into two main approaches. The first approach identifies the underlying trend by filtering out the effects of volatile or temporary shocks (Chart 7 [left-hand panel]). The second approach estimates inflation expectations held by firms, households, and market participants by using surveys or market data (Chart 7 [middle panel]).

Furthermore, given the aforementioned mechanism behind underlying inflation, it should also be useful to look at the extent to which the rate of wage growth exceeds the rate of productivity growth (Chart 7 [right-hand panel]).

I think that, overall, the three graphs just reviewed allow us to be reasonably confident that underlying inflation has been steadily rising. As to whether underlying inflation has reached the price stability target of 2 percent, however, while one might broadly assess that it is already close to 2 percent, I feel that asserting that the rate has reached 2 percent for certain may still be premature.

Following the earlier section projecting that the actual inflation rate will temporarily fall below 2 percent, the Outlook Report states (Chart 8 [left-hand panel]):

> 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 (all items less fresh food) will increase gradually and, in the second half of the projection period,[4] be at a level that is generally consistent with the price stability target.

The Highlights of the Outlook Report released by the Bank contain an infographic illustrating this forecast using the image of a staircase (Chart 8 [right-hand panel]). A figure descending from the top of the stairs represents the actual inflation rate, while another figure climbing up the stairs from below symbolizes underlying inflation. Over time, they are both expected to converge on a plateau marked with the 2 percent price stability target, and continue to proceed generally consistent with that level.

The difference between underlying inflation and the price stability target can be termed the inflation gap, as depicted at the right side of the mandala diagram. The view presented in the Outlook Report should mean that this gap is slightly negative at present, but that it will approach zero going forward.

III. Monetary Policy

One of the Bank's primary responsibilities is to tighten monetary policy when an overheated economy fuels inflation and, conversely, to ease policy when a stagnating economy pushes down prices. The goal is to maintain price stability by avoiding both excessive inflation and deflation, thereby keeping the economy on a sustainable growth path. Indeed, Article 2 of the Bank of Japan Act stipulates that: "The Bank of Japan conducts currency and monetary control, aiming at achieving price stability, thereby contributing to the sound development of the national economy."

Interestingly, monetary policy was also a cornerstone of the Kyoho Reforms carried out in the early 18th century by Tokugawa Yoshimune, who first became the lord of the Wakayama region and then ruled Japan as the eighth Tokugawa Shogun (Chart 9 [left-hand panel]). He maintained a tight monetary stance during the early years of his reign, but later

4 The projection period refers to the period from fiscal 2025 to fiscal 2027, i.e., from April 2025 to March 2028.

shifted to a more accommodative policy. In those times, the only means of adjusting monetary conditions was through the reminting of currency (Chart 9 [right-hand panel]). This made it impossible to implement monetary policy flexibly; during the 35 years encompassing Yoshimune's reign as a shogun and then as an influential retired shogun, there was only one major policy shift. He did not have the flexibility today's monetary policy has.

Policy Interest Rate

The principle of tightening monetary policy when the economy overheats and upward pressure is exerted on prices, and vice versa, is depicted in our mandala diagram by the two arrows connecting the GDP gap and inflation gap to the policy interest rate (Chart 10).

For instance, if a negative demand shock pushes down GDP and turns the GDP gap negative, a central bank would typically reduce the policy rate. In the case of a supply shock, on the other hand, the approach would be more indirect. Take the example of the yen's depreciation leading to a rise in import prices. Governor Ueda commented on this topic in a press conference he gave in January 2026. Please refer to the supply shock part of the diagram and then move clockwise as I note what he said:

> A weaker yen naturally raises import prices and temporarily pushes up inflation. A critical factor to observe is the degree of pass-through to domestic prices against the backdrop of firms recently becoming more agile in adjusting prices and wages. It is also essential to monitor how such movements in domestic prices might affect inflation expectations, which, in turn, could impact underlying inflation.

In terms of the mandala diagram, this comment by the governor may be interpreted to show how the Bank monitors the effects of supply shocks as they are transmitted to the inflation rate, inflation expectations, and underlying inflation.

Why, then, does monetary policy require additional monitoring steps before reacting to supply shocks, while responding more directly to demand shocks? The difference has to do with the transmission path of policy changes, as illustrated in the diagram. Traveling

through the lower left side of the diagram, a shift in the policy interest rate first impacts GDP, and is then transmitted through the upper left side of the diagram before influencing the inflation rate.

Governor Ueda was asked about the difference between supply and demand shocks in a press conference last July. Again, please refer to the diagram as I note his response:

> If inflation is driven by strong demand pressure, responding with monetary tightening is a good fit. It can cool an overheated economy while simultaneously curbing inflation.
>
> Currently, however, a considerable share of elevated prices stems from supply-side factors. Addressing such inflation by raising rates could potentially cool an economy that is not overheating to begin with. This might lead to reduced income, resulting in lower spending, including spending on food, which in turn, could suppress food prices. We may want to ask ourselves if such an approach is truly desirable.

In addressing inflation driven by demand shocks, monetary policy can directly counteract the causes of inflation by influencing GDP. In contrast, responding to inflation driven by supply shocks could inadvertently disrupt GDP, even though it is not the source of the problem.

Moreover, as might be anticipated from the difference in the length of the channels,[5] empirical studies show that GDP reacts relatively quickly to shifts in the policy interest rate, whereas it takes longer for prices to respond.[6] Hence, when addressing temporary supply shocks, it is possible that the effects of the shocks may have already dissipated by the time

[5] Some of the arrows in the diagram merely represent definitions and involve no time lags, but many others work through the reactions of economic agents and are thus not instantaneous.

[6] See, for example, Christina D. Romer and David H. Romer, "A New Measure of Monetary Shocks: Derivation and Implications," *American Economic Review* 94, no. 4 (September 2004): 1055-84.

the policy measures take effect. It is therefore often more prudent to confirm underlying inflation when responding to supply shocks.

How should this general framework be applied to current conditions in Japan?

As I mentioned earlier, the inflation gap remains slightly negative at present but is expected to approach zero in the future. This would suggest that, while the Bank's policy remains somewhat accommodative, it should gradually shift to a more neutral stance through moderate policy rate hikes.

The Bank's Outlook Report assumes that the GDP gap will gradually widen in positive territory from the current near-zero level, which would also argue for gradually raising the policy interest rate. As I mentioned earlier, however, there are divergent views on the GDP gap. While some see the current supply capacity shortage (the blue line in Chart 5) as evidence that the true GDP gap is higher than estimated and argue for less gradual rate hikes, others consider the economy to still be stagnant (the green line in Chart 5) and see no need to rush.

Last December, the Bank raised its policy interest rate from 0.5 percent to 0.75 percent. This decision has met with mixed reactions: Some have criticized it as coming too late, while others deemed it premature. The divergent perspectives on the GDP gap I just described may be among the reasons for this disparity.

What, then, should the level of the policy interest rate be, if the Bank assesses that monetary policy needs to be, for example, slightly accommodative, given the GDP gap and the inflation gap?

In the diagram, two arrows lead to the policy interest rate; one from the natural rate of interest and another from inflation expectations. The natural rate of interest is the real interest rate that is neutral to economic activity, in that it will cause the economy neither to accelerate nor decelerate; the sum of the natural rate of interest and inflation expectations would be a nominal rate neutral to economic activity. Accordingly, if the policy rate is set

slightly below that rate, monetary policy will be slightly accommodative. As shown in the diagram, such a policy rate would correspond to a real interest rate slightly below the natural rate of interest, which in turn would lead to slightly accommodative financial conditions.

Natural Rate of Interest and Financial Conditions

Now let's try out the math using numbers. The current policy interest rate is 0.75 percent. In line with the view in the Bank's Outlook Report, let's assume that inflation expectations will move toward 2 percent. The real interest rate should then be slightly below minus 1 percent.

Bank staff have constructed several econometric models to estimate the natural rate of interest, with results suggesting that it lies somewhere between around negative 1 percent and positive 0.5 percent. With the real interest rate slightly below negative 1 percent, current financial conditions should be considered slightly accommodative if the true natural rate is around negative 1 percent. If the true natural rate is around positive 0.5 percent, however, current financial conditions should be assessed as being highly accommodative.

As there is such a wide range in their estimates, these assessments alone would not allow us to say for certain whether December's 0.25 percent rate hike was premature, overdue, or perfectly timed. Similarly, this makes it difficult to judge when the next rate hike would be appropriate.

How should we proceed from here?

The prewar American economist John H. Williams once remarked, "The natural rate is an abstraction; like faith, it is seen by its works."[7] The impact of rate hikes trickles through the economy in stages, starting from changes in financial markets and adjustments in banks' rate settings and lending behavior, and then affecting corporate investment decisions and household savings and investment. These processes ultimately translate into changes in economic activity and prices.

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[7] John H. Williams, "The Monetary Doctrines of J. M. Keynes," *Quarterly Journal of Economics* 45, no. 4 (1931): 547-87.

By examining the qualitative information we gain from interviews with our contacts as well as statistical data, the Bank constructs a clearer picture of how each step is working. These observations inform its view on the locus of the natural rate of interest.

In other words, pursuing two approaches in tandem would enable the Bank to make grounded policy decisions: it should monitor how changes in the real interest rate affect financial conditions to find clues for assessing the natural rate of interest, while comparing the real interest rate with the model estimation of the natural rate to gauge the degree of monetary easing or tightening.

Looking at some data on current financial conditions, we find that, while corporate funding costs have risen (Chart 11 [upper left-hand panel]), firms' returns on assets have also increased and remain significantly higher than their funding costs (Chart 11 [upper right-hand panel]). As a result, for the corporate sector as a whole, it would continue to make sense to borrow money for use in business investment. Furthermore, surveys of corporations indicate that banks' lending attitudes and firms' overall financing conditions remain accommodative (Chart 11 [lower left-hand panel]). Growth in outstanding bank lending is accelerating, while the outstanding amounts of CP and corporate bonds have also been growing at a steady, elevated pace (Chart 11 [lower right-hand panel]).

These data would imply that the impacts of recent rate hikes remain limited for now, and that financial conditions are still accommodative. That said, since available statistics always emerge with a time lag, I am keen to hear your sense of current financial conditions.

The January Outlook Report outlines the Bank's approach to the conduct of monetary policy as follows (Chart 12 [left-hand panel]):

> 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. With the price stability target of 2 percent, it 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.

The aforementioned Highlights of the Outlook Report provide another infographic to help illustrate this (Chart 12 [right-hand panel]). The illustration shows that the driver's right foot is still on the accelerator. However, with the 2 percent inflation goal approaching, the driver is depicted as beginning to ease off the pedal while carefully monitoring the three indicators on the dashboard: economic activity, prices, and financial conditions.

Limitations of the Diagram

Now, let me touch on an important aspect our mandala diagram fails to cover. While the diagram shows that the policy interest rate influences financial conditions through the relationship between the natural rate of interest and the real interest rate, other channels exist as well. When the policy rate, which is a short-term interest rate, is adjusted, it typically impacts longer-term interest rates, foreign exchange rates, and stock prices. These market movements, in turn, affect economic activity and prices in various ways.

This makes it essential to closely monitor market developments. However, the way financial markets respond to monetary policy depends on numerous factors and is far from straightforward. Reacting to every fluctuation in the market could lead to the Bank being second-guessed by speculators. Rather, the Bank should make it a priority to gain confidence of market participants that it is duly conducting monetary policy in line with developments in economic activity and prices.

Let me also add a few words in terms of locating monetary policy within the broader context of economic policy. It is said that economic policymaking rests on three pillars: fiscal policy, monetary policy, and structural policy. In the mandala diagram, however, it might appear at first glance as though monetary policy takes center stage; the diagram incorporates fiscal policy as supply and demand shocks, and structural policy as changes in potential GDP and the natural rate of interest, but these policies are not explicitly depicted. Let me be clear that this does not reflect my inherent bias as a central banker but, rather, the diagram borrows from the framework employed in standard textbooks of macroeconomics.

Why, then, do the textbook models place monetary policy at the center? Fiscal policy typically operates with objectives that extend beyond economic and price stability, encompassing broader government-wide goals. Structural policy, meanwhile, is both difficult to quantify and operates on a much longer time horizon. These challenges make it difficult to incorporate either fiscal or structural policy as endogenous variables within economic models. Consequently, this framework may conveniently serve as a practical starting point for economic analysis, but should not be taken to reflect the relative importance of fiscal, monetary, and structural policies.

For example, as I have mentioned several times today, despite a number of signs indicating supply capacity shortage, it seems that Japan's economy has not grown in a way that many would be satisfied with. An effective solution to this would be to enhance the potential GDP, an area where structural policy can play an important role.

Seeing the Totality of the Interplay between Economic Activity, Prices, and Money and Finance

At this point, we've completed an overview of the interplay between economic activity, prices, and money and finance. You may have wondered why I couldn't have just distilled these topics down into a more straightforward framework.

However, there are several benefits in trying to see the economy in its entirety, as an evolving, interconnected circulation system.[8]

First, doing so may help us detect economy-wide stories that underlie the individual movements of indicators. For example, it may help us notice when cracks start appearing in the broader outlook, no matter where they first appear.

Second, we can be attentive to indirect impacts and feedback loops arising from shocks and policy measures, in addition to their immediate impacts.

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[8] See Himino Ryozo, *Ekikyō nyūmon: Kōshi ga Girishia higeki wo yondara* [Introduction to the *I Ching*: what if Confucius read Sophocles] (Tokyo: Bungeishunju Ltd., 2011).

Third, it may help us better interpret indicators. Every economic indicator comes with an inherent margin of error. In some cases, an indicator moves due to changes taking place in long-term trends, and in others, it moves due to temporary factors. By looking at how different indicators relate to one another and move within the broader system, we can better grasp the nature of such moves.

Federal Reserve Chair Jerome Powell has repeatedly emphasized that monetary policy decisions should be based on "the totality of incoming data." I fully subscribe to his emphasis on totality.

Conclusion

Before I conclude, I would like to share my favorite story about two notable figures from Wakayama. It is the story of Yamanoi Kanae, a Confucian scholar, and Tokugawa Yoshimune, whom I mentioned earlier (Chart 13).

Yamanoi Kanae was born in the area that is now the city of Kainan in Wakayama Prefecture. He studied at a local school before moving to Kyoto, and finally made the journey on foot to Edo, where he became a disciple of the renowned philosopher Ogyu Sorai.

Yamanoi dedicated himself to critically examining classical Confucian texts, relying primarily on ancient manuscripts and rare books preserved at the Ashikaga School. He compiled the fruits of his rigorous scholarship in his groundbreaking work, the *Textual Critique of the Seven Classics and Mencius* (*Shichikei Mōshi kōbun*, Chart 13 [left-hand panel]).

This book was presented to Tokugawa Yoshimune. Greatly impressed by the innovative nature of Yamanoi's work, Yoshimune personally ordered the book to be printed on special paper produced in Mino Province and had the title calligraphed by one of the most distinguished calligraphers of the time. He then instructed the Nagasaki magistrate to export it to China.

The book gradually began to garner attention in China, with multiple orders coming in through merchants sailing back and forth between Nagasaki and China. When the Qianlong Emperor of the Qing dynasty launched the project of compiling the *Complete Library of the Four Treasuries*, this work by Yamanoi was submitted by a prominent Chinese bibliophile and ultimately included in the compilation (Chart 13 [upper right-hand panel]). Furthermore, Ruan Yuan, the eminent scholar of evidential research and prominent statesman, went on to publish a reprinted edition of the *Textual Critique* in China (Chart 13 [lower right-hand panel]).

According to the famous Japanese sinologist Yoshikawa Kojiro, Chinese scholars, stimulated by Yamanoi's work, began to engage extensively in textual criticism six to seven decades after his book was first exported.[9]

Kano Naoki, another great sinologist, while studying records from Yoshimune's time, offered the following reflections:

> How spirited they were! Even now, more than a century on, reading about the resolve of people at the time, including the shogun who aimed to export academic knowledge on Chinese classics from Japan to China, fills me with a sense of exhilaration.[10]

Yoshimune was depicted as the "Wild One Shogun" in a popular TV drama series in Japan. It seems that, in addition to being the wild one in the realm of politics, he was a wild trailblazer in the academic world as well.

Thank you for your attention.

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[9] Yoshikawa Kojiro, *Koten ni tsuite* [On classics] (Tokyo: Kodansha Ltd., 2021).

[10] Kano Naoki, "Yamanoi Kanae to Shichikei Mōshi kōbun hoi" [Yamanoi Kanae and the Textual Critique of the Seven Classics and Mencius and its Supplements] in *Shinagaku bunso* [Collected essays on Sinology] (Tokyo: Misuzu Shobo Ltd., 1973).

Japan's Economy and Monetary Policy

Speech at a Meeting with Local Leaders in Wakayama

March 2, 2026

HIMINO Ryozo
Deputy Governor of the Bank of Japan

Chart 1

Macro Economy: An Overview

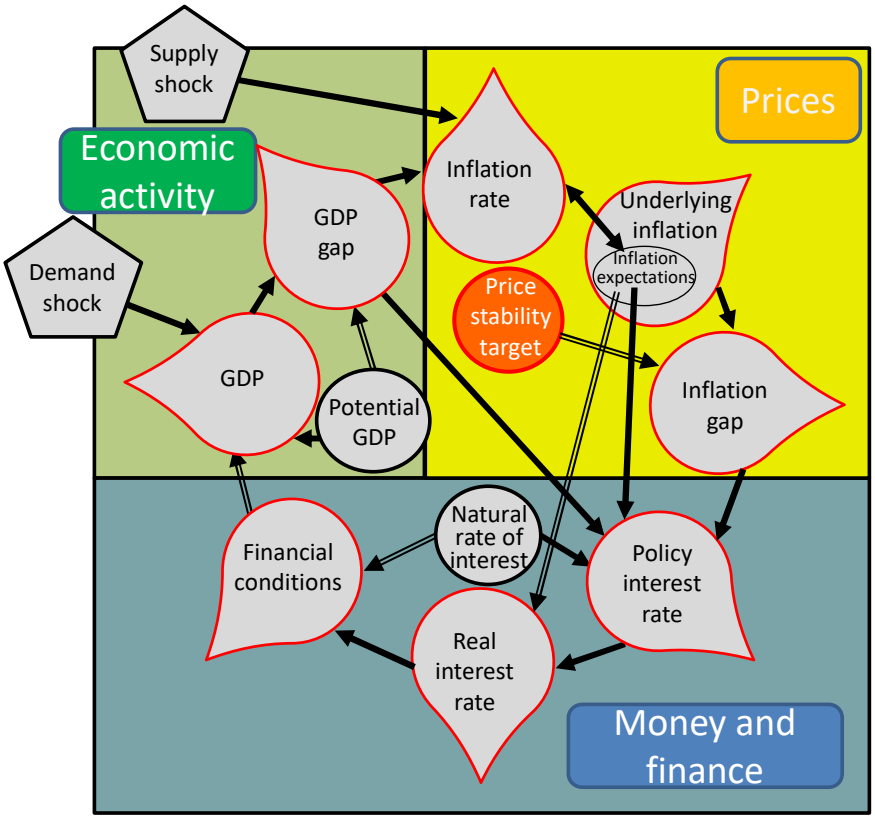
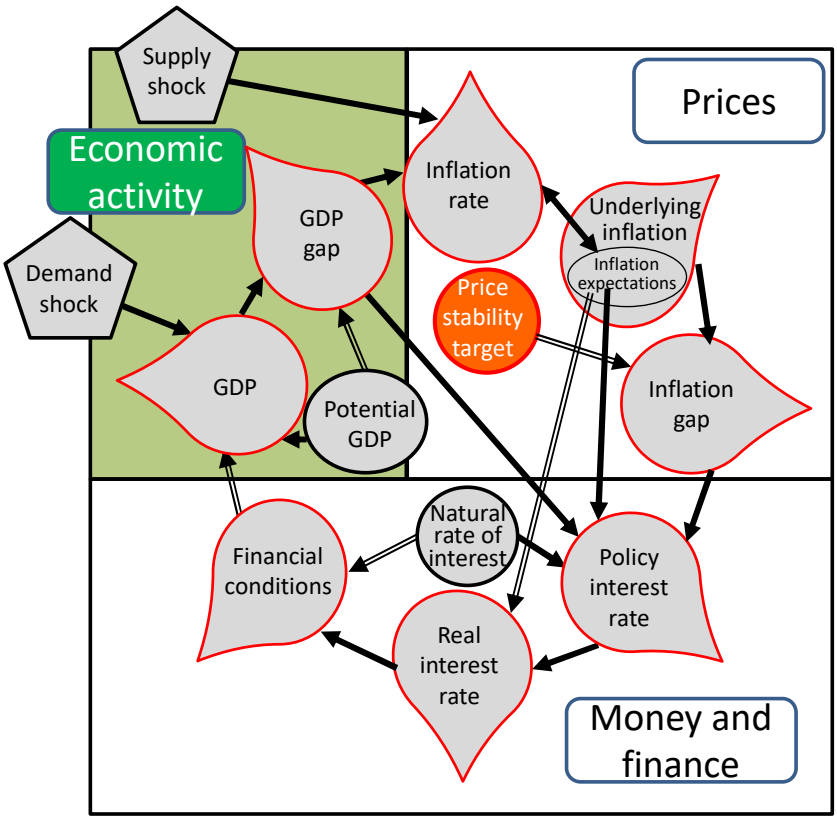


Chart 2

Overview of Economic Activity



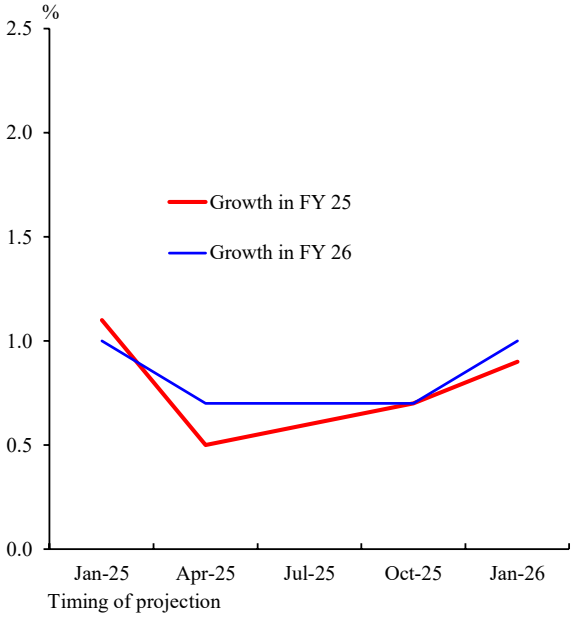
The Bank's January 2026 Outlook Report

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.

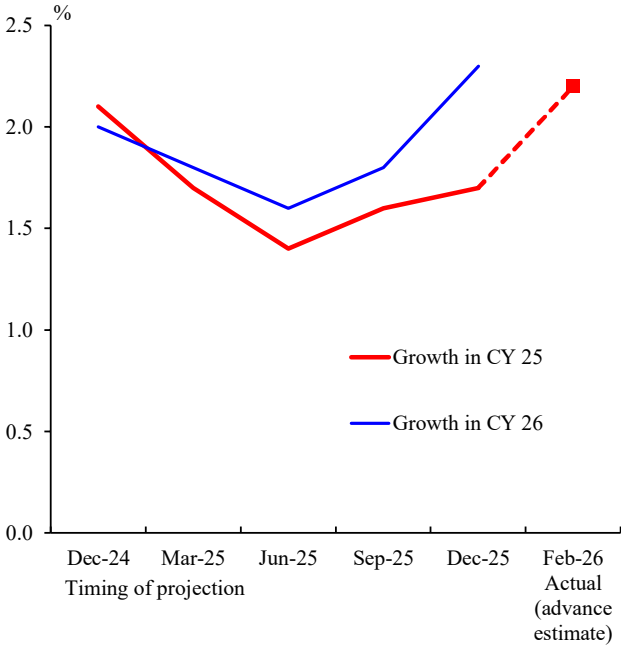
Chart 3

Changes in GDP Growth Projections

Japan
(Median of BOJ Policy Board)



United States
(Median of FOMC Participants)

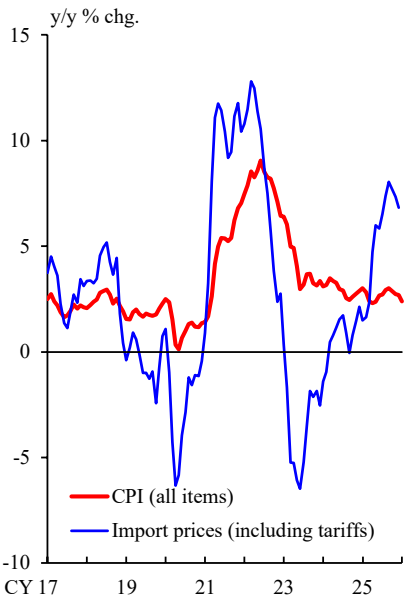


Sources: Bank of Japan; Federal Reserve; BEA.

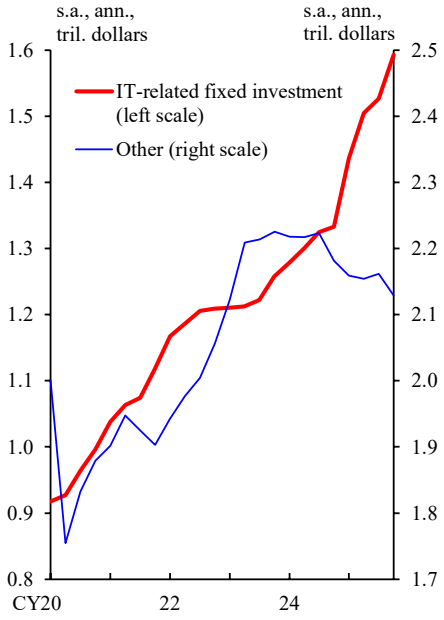
Chart 4

U.S. Economy

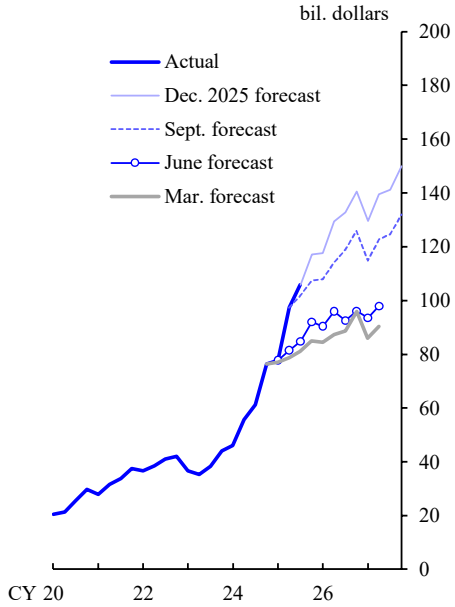
Prices



Real Business Fixed Investment



Capital Expenditures by Hyperscalers



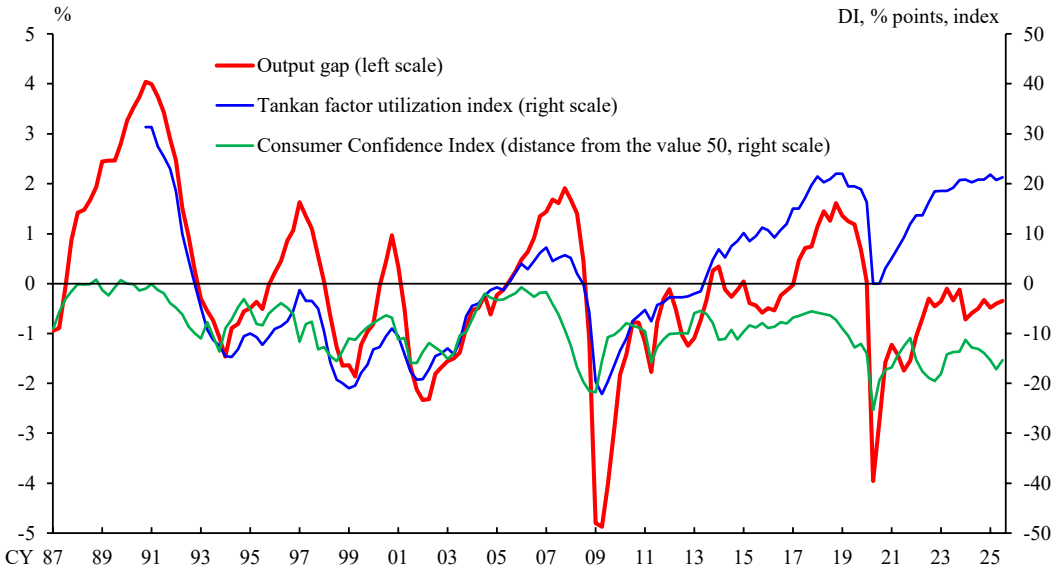
Notes: 1. In the left-hand chart, import prices (including tariffs) are based on staff calculations using published import price figures and the effective tariff rates. Figures for October 2025 is linearly interpolated using figures for September and November.
2. In the middle chart, IT-related fixed investment is the sum of software investment, information processing equipment (within machinery investment), and data centers (within construction investment). Based on staff calculations.
3. In the right-hand chart, figures are the sum of capital expenditures of Alphabet, Amazon, Meta, Microsoft, and Oracle. Forecasts are aggregated by S&P Global Market Intelligence from analysts' forecasts that mainly reflect information published by the companies.

Sources: Haver; S&P Global Market Intelligence.

I. Economic Activity

Chart 5

GDP Gap (Output Gap)



Notes: 1. The *Tankan* factor utilization index represents the weighted average of the production capacity DI and the employment conditions DI. The capital and labor shares are used as weights. Figures are calculated by deducting the proportion of enterprises responding "excessive" from the proportion of those responding "insufficient," and thus their signs are reversed from those presented in the *Tankan*.

2. Figures for the Consumer Confidence Index are seasonally adjusted.

3. The end point of the horizontal axis is 2025/Q3.

Sources: Bank of Japan; Cabinet Office.

II. Prices

Chart 6

Overview of Prices

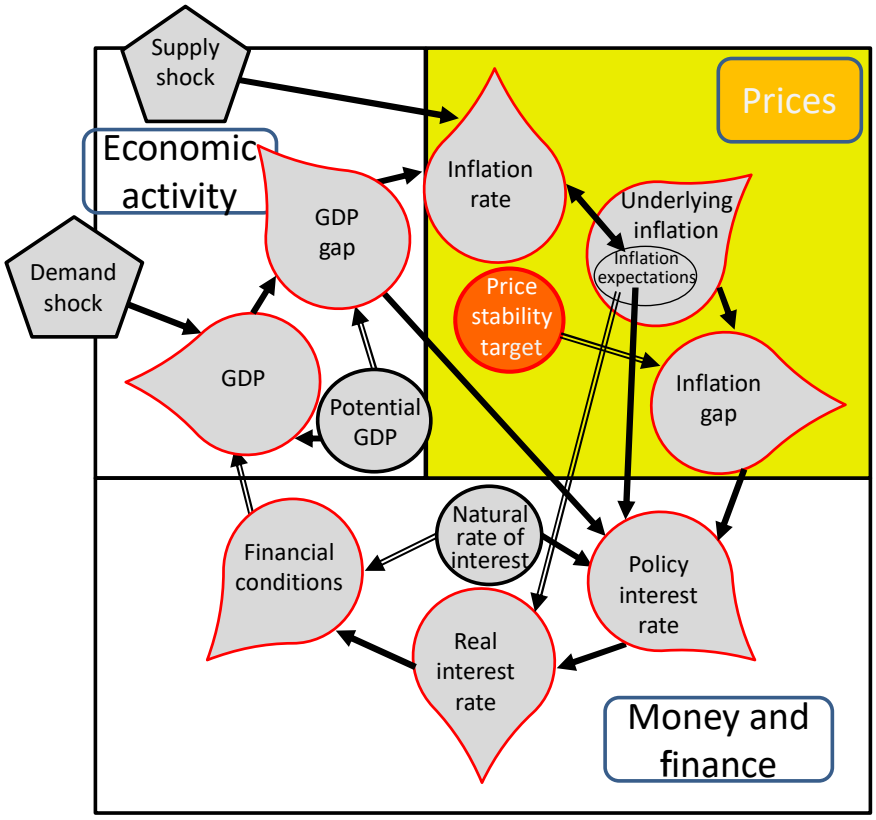
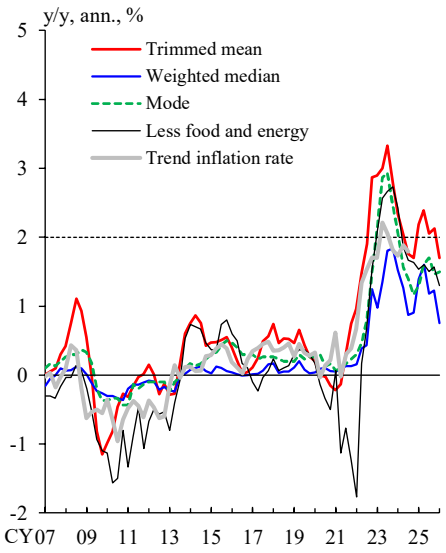


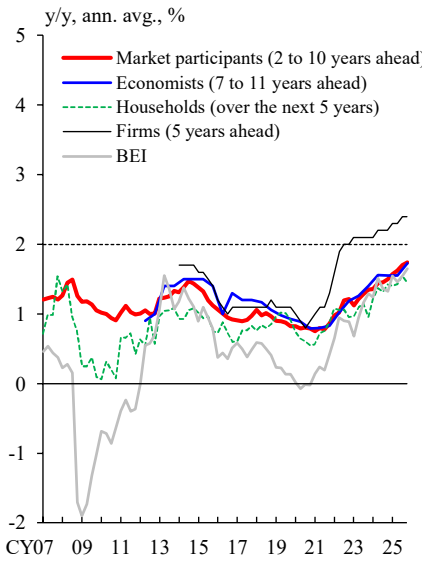
Chart 7

Indicators Related to Underlying Inflation

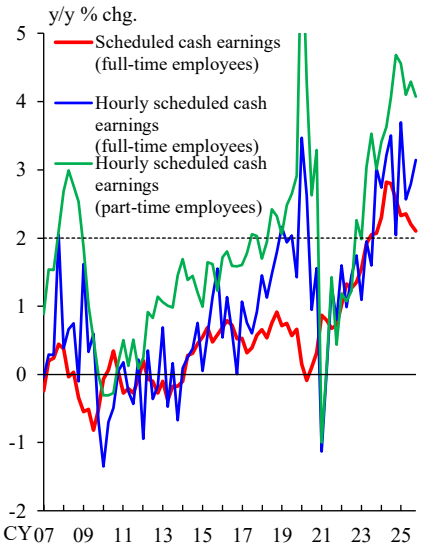
Indicators/Estimates excluding Temporary Factors



Inflation Expectations



Nominal Wage Growth



Notes: 1. In the left-hand chart, for details on the trend inflation rate, see Takatomi et al. (2026), "What Drives Trend Inflation in Japan?: A Trend-Cycle BVAR Decomposition Approach." The latest figures for other items are as of January 2026.
2. In the middle chart, "market participants" shows data from the "QUICK Monthly Survey <Bonds>" and "economists" shows the forecasts of forecasters surveyed for the *ESP Forecast.* Figures for "households" are from the *Opinion Survey on the General Public's Views and Behavior*, estimated using the modified Carlson-Parkin method for a 5-choice question. Figures for "firms" show the inflation outlook of enterprises for general prices (all industries and enterprises, average) in the *Tankan.* The BEI (break-even inflation) rate is a composite of new and old inflation-indexed Japanese government bonds (10-year and the longest-term bonds).
3. In the right-hand chart, Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February. Figures from 2016/Q1 onward are based on continuing observations following the sample revisions. Figures for hourly scheduled cash earnings (full-time employees) are seasonally adjusted.

Sources: Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications; Cabinet Office; Bank of Japan; QUICK "QUICK Monthly Survey <Bonds>"; JCER "ESP Forecast"; Bloomberg.

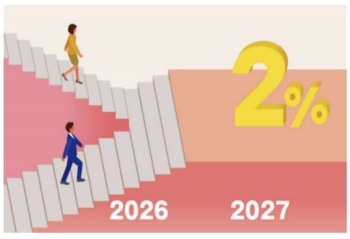
Chart 8

The Bank's January 2026 Outlook Report

The year-on-year rate of increase in the consumer price index (CPI, all items less fresh food) is likely to decelerate to a level below 2 percent in the first half of this year, 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 (all items less fresh food) will increase gradually and, in the second half of the projection period, be at a level that is generally consistent with the price stability target.

Highlights of the Outlook Report



The Shogun's Monetary Policy

Shogun Tokugawa Yoshimune
Reign: 1716-1751

Reminted Gold Coin
(*Genbun Koban*)

Sources: Wakayama City Museum; Bank of Japan Currency Museum.

Overview of Money and Finance

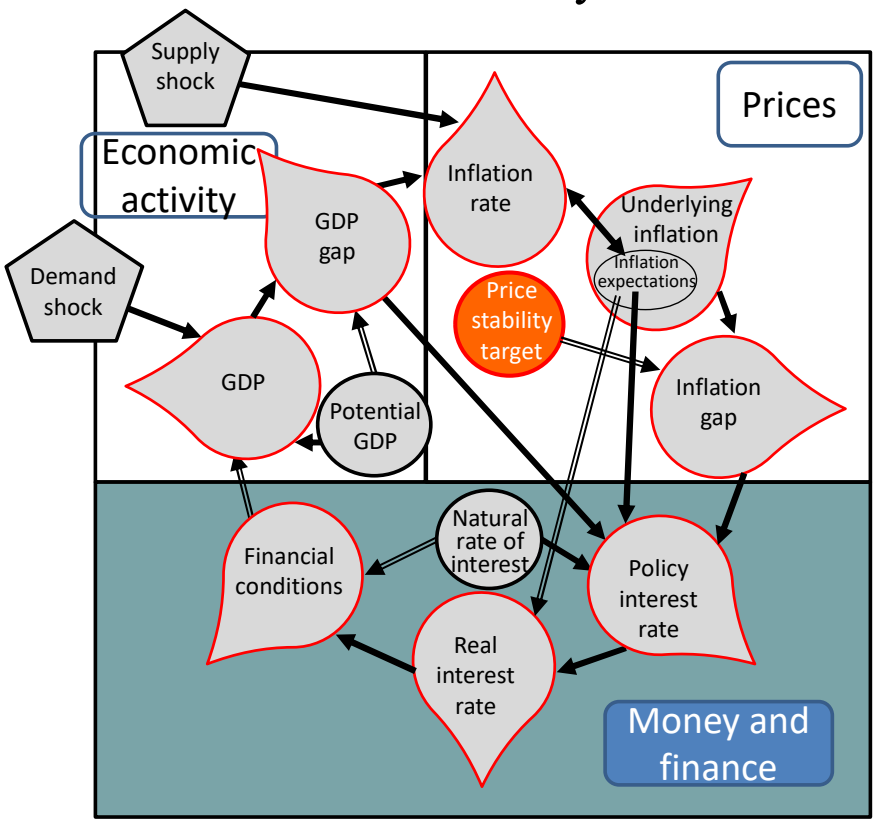
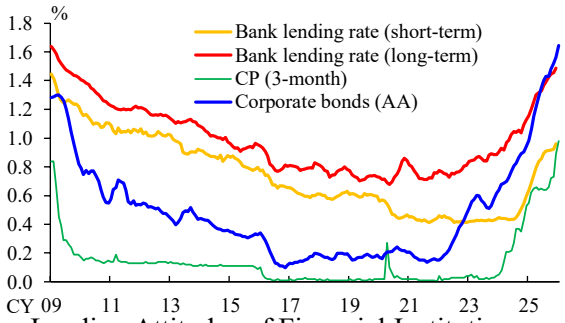


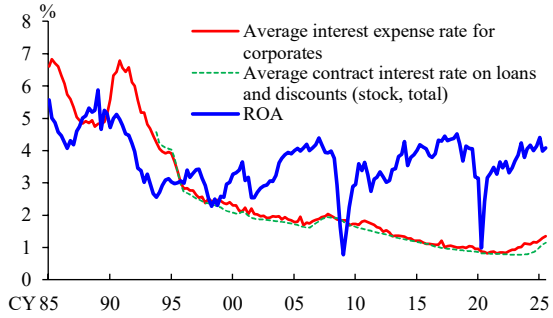
Chart 11

Financial Conditions

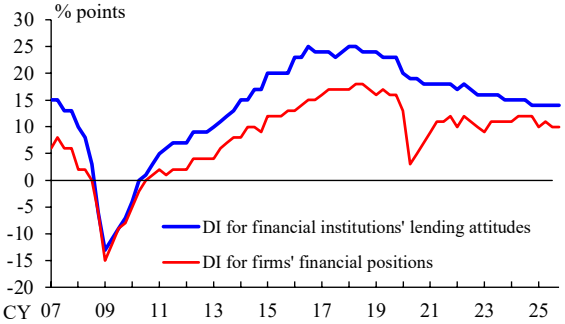
Corporate Funding Rates



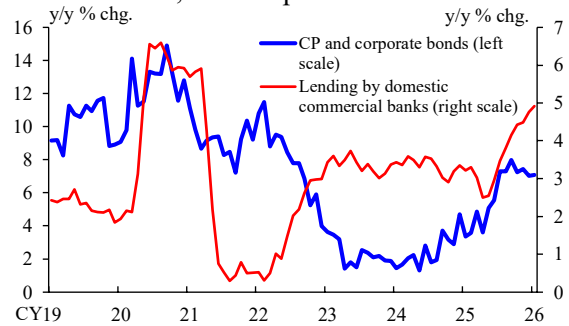
Funding Costs and Profitability



Lending Attitudes of Financial Institutions and Firms' Financial Positions (*Tankan*)



Growth in Outstanding Bank Lending, CP, and Corporate Bonds



Notes: 1. In the top-left chart, bank lending rates and corporate bonds represent 6-month backward moving averages. The CP issuance yields refer to a-1-rated CP (those up through September 2009 refer to CP rated a-1 or higher). The corporate bond issuance yields cover domestically issued corporate bonds, excluding those issued by financial institutions.

2. In the top-right chart, ROA is calculated as operating profits divided by total assets. The average interest expense rate for corporates is calculated as interest payments divided by interest-bearing debt. Figures for the solid lines are based on the *Financial Statements Statistics of Corporations by Industry, Quarterly*, and are seasonally adjusted.

3. In the bottom-right chart, lending by domestic commercial banks represents a monthly average. CP and corporate bonds are as of the end of the period.

Sources: Bank of Japan; Ministry of Finance; Japan Securities Depository Center; Capital Eye; Japan Securities Dealers Association; I-N Information Systems; Bloomberg.

Chart 12

The Bank's January 2026 Outlook Report

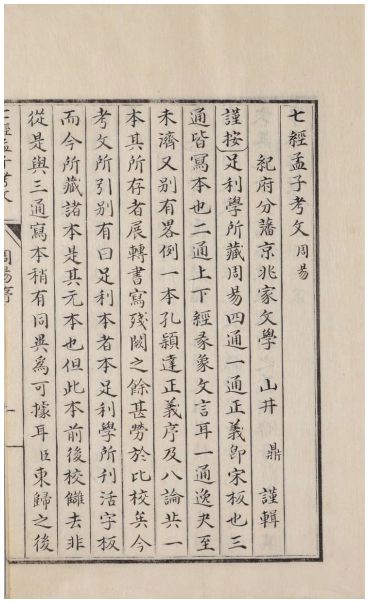
As for the conduct of monetary policy, given that real interest rates are at significantly low levels, if the aforementioned outlook for economic activity and prices will be realized, the Bank, in accordance with improvement in economic activity and prices, will continue to raise the policy interest rate and adjust the degree of monetary accommodation.

With the price stability target of 2 percent, it 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.

Highlights of the Outlook Report

Textual Critique of the Seven Classics and Mencius
by Yamanoi Kanae

… published in Japan
during the time of Yoshimune,

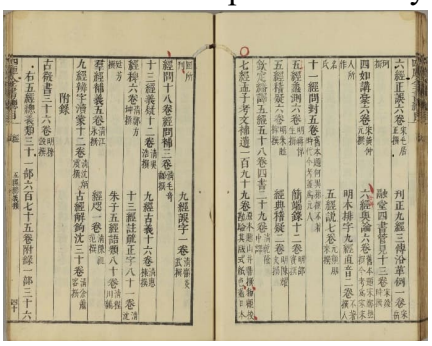


七經孟子考文 周易

紀府分藩京兆家文學 山井 鼎 謹輯

謹按足利學所藏周易四通一通正義即宋板也三通皆寫本也二通上下經彖象文言耳一通逸犬至未濟又別有畧例一本孔穎達正義序及八論共一本其所存者辰轉書寫殘闕之餘甚勞於比校矣今考文所引別有曰足利本者本足利學所刊活字板而今所藏諸本是其元本也但此本前後校讎去非從是與三通寫本稍有同異爲可據耳旦東歸之後

… included in a Chinese emperor's literary compilation,



… and reprinted in China by an eminent scholar.