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Bank of Japan

Economic Activity, Prices, and Monetary Policy in Japan

Speech at a Meeting Held by the Kagoshima 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 Kagoshima 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.

I will begin my speech by talking about recent developments in economic activity and prices in Japan and then move on to discuss the conduct of monetary policy, while offering my personal views. I hope my explanations regarding these points will help you better understand the overall picture of the factors the Bank is paying attention to in its conduct of monetary policy.

I. Economic Activity and Prices

U.S. Tariff Policy

Before discussing developments in economic activity and prices, I would first like to touch on some events that have taken place over the past year. In the 10 months since I was appointed as a member of the Policy Board in July 2025, two major events have given rise to problems internationally, both of which involve the United States.

The first is tariff policy under the current administration. There were concerns in Japan not only over a decline in the share of Japanese products sold in the United States, but also over the broader possibility of a downturn in the U.S. economy triggering a global economic slowdown. The left panel of Chart 1 shows developments in U.S. private consumption in real terms, adjusted for inflation, and the middle panel presents the employment situation. Economic conditions in the United States are clearly reflected in consumption and employment. Compared to Japan, people in the United States tend to spend more when the economy is flourishing, and firms tend to lay off workers when it is not. Also, unlike in Japan, it is quite normal for workers to move to another company, so being laid off is generally not too much of a concern. Hence, the employment situation is quickly reflected in data, and serves as a clear indicator of economic conditions. As is evident from the chart, consumption and employment in the United States have been more or less solid, despite showing some weakness.

Japanese and some European automakers responded to the additional tariffs by bearing the increased costs themselves while keeping selling prices in the United States unchanged, but such cases were quite exceptional. As shown in the right panel of Chart 1, higher tariffs have in general led to an increase in U.S. import prices. The solid line represents import prices including tariffs; the recent decline is partly a result of a reduction in tariff rates following the U.S. Supreme Court's ruling that the tariffs were unconstitutional.

Estimates indicate that the additional tariffs have been passed on to selling prices for consumers in the United States. At any rate, statistical data have hardly indicated a reduction in the country's trade deficit -- one of the stated aims of U.S. tariff policy. This makes it highly likely that U.S.-based firms and households in the United States will end up shouldering the burden of additional tariffs.

If another aim of the tariff policy was to bring overseas production back to the United States, I believe the policy's effectiveness has been limited, in part a reflection of high personnel expenses in the country. Setting aside the outcomes the tariff policy has ultimately produced, neither higher inflation nor deceleration in economic activity -- both of which were initially feared to be potential side effects of the policy -- has been observed in the United States.

Now, I would like to talk about the impact of U.S. tariff policy on Japan's economy. Although economic growth should ideally be assessed using GDP, quarterly GDP data often show large fluctuations. Since there is a time lag before annualized GDP data are released, for the sake of timeliness, let me refer to the Bank's survey on business conditions in the *Tankan* (Short-Term Economic Survey of Enterprises in Japan). Please take a look at the left panel of Chart 2. The survey covers approximately 9,000 firms, ranging from large to small firms, with a high response rate of basically over 99 percent. According to the most recent results, the diffusion index for business conditions -- the proportion of firms responding that business conditions were "favorable" minus the proportion of those responding that they were "unfavorable" -- stood at a positive 18 across all industries, registering the index's highest level in 35 years since 1991.

The right panel of Chart 2 is an indicator, also released by the Bank, that combines various data to represent overall consumption in Japan. This indicator also shows a gradual improvement in consumption.

In sum, although the whole world has wrestled with the issue of U.S. tariff policy since spring 2025, unexpectedly, the issue appears to be winding down without causing any economic disruption in Japan. I believe, for many people, attention has now shifted to the Iran situation, which is the second major international event that has taken place in the past 10 months.

The Iran Situation

While U.S. tariffs have primarily impacted sectors that have high export volumes to the United States -- such as automobiles and large machinery -- the Iran situation is expected to have far broader repercussions. Unlike tariffs, this situation involves a physical constraint, in which the global supply of crude oil and natural gas has tightened, placing central banks worldwide in an unusually difficult decision-making environment. This is because energy shortages could induce both a deceleration in economic activity and a rise in inflation.

The effects of the closure of the Strait of Hormuz need to be broken down into two aspects: prices and quantity. Normally, prices rise when there is a shortage of supply. What is notable in the present case, however, is that prices are rising even while supply remains adequate. This is particularly evident in the case of liquefied natural gas (LNG) prices. Drawing on my previous role at Mitsubishi Corporation, a general trading company, I would like to elaborate a little on this point.

During the oil shocks of the 1970s, oil-fired power generation accounted for around 70 percent of Japan's energy mix. Today, however, LNG and coal each make up about 30 percent of the mix -- around 60 percent combined -- while oil-fired power is limited to a fairly small share of the mix, mainly used to meet peak demand. As for LNG, only imports from Qatar and Abu Dhabi pass through the Strait of Hormuz and, because contracts with Qatar are down from their previous levels, imports from these two countries only account for around 6 percent of Japan's total supply. The largest sources of Japan's LNG are Australia and Malaysia, with additional imports coming from Sakhalin in Russia and from the United States. Moreover,

many of Japan's LNG import contracts are long-term agreements, spanning around 20 years. This is because LNG production requires massive facilities costing trillions of yen to cool natural gas to minus 162 degrees Celsius for liquefaction, and investment in such projects can only move forward once long-term sales commitments are secured. There is therefore no near-term cause for concern that lower import volumes to Japan would disrupt power.

Prices, however, raise a different concern. Since LNG was originally introduced in Japan as a substitute for petroleum, and because Asia lacked its own natural gas pricing benchmark, many contracts are linked to Middle Eastern crude oil prices. Because LNG prices in Japan are calculated from the import prices of Middle Eastern crude oil recorded in Japan's *Trade Statistics*, changes in crude oil import prices are reflected in LNG prices with a time lag of around four months. In any case, a significant increase in LNG prices is unavoidable in the near future. As a result, although Japan generates electricity and gas using LNG, not crude oil, the prices of both will inevitably rise. This is the concern that primarily relates to prices.

In the case of crude oil, Japan's dependence on the Middle East has increased, partly as a result of a reduction in Russian imports following that country's invasion of Ukraine. Amid the unrest in Iran, Japan is currently facing a situation in which slightly more than 70 percent of its crude oil imports pass through the Strait of Hormuz. Even if Japan scrambles to find alternatives, it will have to contend with fierce global competition. In the event that releasing petroleum reserves and securing alternative sources of supply prove unable to meet demand, transportation fuel derived from crude oil -- such as gasoline, jet fuel, diesel, and marine heavy fuel oil -- will be in short supply. Petroleum-based chemicals could face even tighter shortages than fuels, potentially affecting everything from automobile parts to the food trays found in supermarkets. The crude oil shortage may also impact the data center construction boom, since the polyvinyl chloride (PVC) used to insulate electric wires might become scarce as well.

Given how widespread plastic products have become over the past 50 years, the possibility that the impact on everyday life this time around could be more serious than the first oil shock in 1973 warrants attention.

Inflation

I would like to move on to inflation in Japan. Please refer to Chart 3, which shows developments in the consumer price index (CPI) for all items. While the effects of factors such as consumption tax hikes in 2014 and 2019 can be observed, the CPI inflation rate often turned negative in the wake of the 2008 Global Financial Crisis, indicating that Japan's economy was truly in deflation. Recently, however, the economy has fully transitioned into inflation. The CPI inflation rate has most recently been on the decline, but this is because rice prices have stabilized and because there have been effects from the abolition of the provisional gasoline tax rate and measures to make high school tuition effectively free.

Inflation can be driven by various factors. One example is heightened demand, as seen in the surge in hotel charges in Japan. These charges have risen drastically, due mainly to the effects of increased inbound tourism. Conversely, inflation can also stem from supply shortages. A typical example is inflation caused by limited production capacity stemming from labor shortages.

Apart from normal changes in the supply and demand balance, temporary shocks can also lead to inflation. Typical examples include supply shocks, such as a surge in the price of unprocessed food and the recent spikes in crude oil prices. Such supply shocks can trigger cost-push inflation. During the COVID-19 pandemic, both demand and supply shocks occurred simultaneously.

Next, I will elaborate a little further on inflation caused by limited production capacity on the supply side. At present in Japan, notable contributing factors are labor shortages and the rise in distribution costs. Until the Iran situation caused fuel prices to rise, the root cause of issues in Japan's logistics sector had lain in a shortage of drivers. The rise in distribution costs can thus also be attributed to labor shortages.

The left panel of Chart 4 indicates the data for the wages that closely approximate base pay. The solid line represents scheduled cash earnings excluding overtime pay and bonuses, while the dotted line represents total cash earnings including overtime pay and bonuses. Both indicators show growth rates of around 2 percent, although they have been on the rise over

the past two to three months, reaching around 3 percent. While scheduled cash earnings are probably closer to the original definition of base pay, at many Japanese firms, overtime pay is stable and bonuses are set in terms of a fixed number of months' worth of salary. In practice, therefore, the two indicators move more or less in parallel.

The wage increase of 5-6 percent mentioned in the annual spring labor-management wage negotiations in Japan includes seniority-related wage increases. In terms of how individuals feel in their daily lives, that is probably the more relevant figure. However, because a firm's workforce is constantly turning over, with older workers retiring and new graduates being hired, macro data such as scheduled cash earnings should be examined.

To digress slightly, under Japan's traditional lifetime employment system, as long as a person is employed as a stable, salaried worker, seniority-related wage increases soften the perceived impact of inflation and help workers deal with rising living costs, such as education expenses for children. During the period of deflation and low economic growth, the system allowed individuals' income to rise over time, even if wages did not increase for Japan as a whole. The fact that labor and management in Japan discuss wage increases on a basis that includes seniority-related wage increases may reflect this background. That said, this situation only applies while a person remains employed, and the lifetime employment system itself is gradually changing.

Next, the right panel of Chart 4 shows the year-on-year rate of increase in the costs of motor freight transportation for firms. Distribution costs have continued to rise at around 3 percent since regulations took effect in Japan in April 2024 that put upper limits on truck driver working hours, thus impacting freight capacity.

Accordingly, in broad terms, both personnel expenses and distribution costs have continued to rise by around 3 percent. Together with the effects of the yen's depreciation, these elements are currently forming the basis for inflation in Japan. Of course, personnel expenses and distribution costs are not the only components of production costs, so this does not directly translate into an overall 3 percent inflation rate.

Food Price Inflation

Let us now look at inflation from a consumer perspective. Rather than the inflation of goods traded within the corporate sector, what draws public attention is CPI inflation. The left panel of Chart 5 illustrates the breakdown of the CPI over the past few years, although I must admit that the bar graph may be a little too detailed to read. Specifically, the graph shows, in descending order, the contribution to the year-on-year rate of change in the overall CPI of the prices of (1) services such as communications, hotel services, and education; (2) goods excluding food and energy; (3) rice-related items, which consist of both rice itself and processed food that uses rice as an ingredient, such as box lunches, rice balls, retort foods, and rice crackers; and (4) food excluding rice-related items and fresh food, shown in dark blue.

The year-on-year rates of change in the prices of fresh food and energy have been below 0 percent. Because these two components exhibit large swings, they are often excluded when examining price developments. Since the turn of 2026, both have been negative, due in part to the effects of a decline in fresh food prices and the abolition of the provisional gasoline tax rate.

As you can see, higher food prices have had a significant impact on recent CPI inflation. To make this even clearer, the right panel of Chart 5 plots the year-on-year rates of change in the prices of some of the components in the left panel. The price surge in rice-related items is pronounced, reflecting an unprecedented rise in rice prices, which doubled from 2024 to 2025. Comparing the other three components, however, while the year-on-year rates of change in the prices of services and goods have both been stable in the range of 1-2 percent, the rate of change in the price of processed food that does not use rice as an ingredient rose in tandem with higher rice prices, and has subsequently continued rising at a high rate of 5 percent. This rate is also striking when compared with the Bank's price stability target of 2 percent.

Around four years ago, in addition to the yen's depreciation, import prices of food items such as wheat surged due to the impact of the situation in Ukraine. However, international commodity prices for unprocessed food, except for some items, have largely returned to pre-surge levels. Moreover, even if rice prices do not come down to the pre-surge levels, provided

that they remain flat, the CPI will not increase from the same month of the previous year. In other words, many assume that the current high inflation mainly driven by high food prices will subside, provided that rice prices stabilize.

However, if the year-on-year rate of change in the price of processed food that does not use rice as an ingredient remains high at 5 percent, the assumption that inflation will subside if rice prices simply stabilize would turn out to be too simplistic. People cannot avoid buying food, and the surge in rice prices might have made it easier for firms to raise other food prices. While the price of rice and crude oil has garnered attention, I consider that, from a long-term perspective, the price of food in general is a key determinant of future inflation.

II. Economic Indicators

Real Interest Rate

Next, I would like to explain some representative indicators the Bank is monitoring. Let me start with the two types of interest rates that are often referred to in relation to the Bank's monetary policy: the real interest rate and the neutral interest rate.

The real interest rate, calculated by subtracting the inflation rate from the nominal interest rate, is at a significantly negative level in Japan. This is easier to understand when considered in the context of actual economic activity. For example, increases in the value of real estate purchased through borrowings exceed the interest paid on the loans, and this could consequently set off a surge in real estate prices. Moreover, people who only hold cash experience a decline in the value of their assets. Given that Japan's economy is no longer in a deflationary period that would require negative interest rates, I believe the negative real interest rate situation should be addressed as soon as possible.

As with nominal interest rates, real interest rates have various maturities. As examples, Chart 6 presents the overnight call rate, the one-year rate, and the 10-year rate.

The Bank has set the uncollateralized overnight call rate as its policy interest rate, and raised this rate to 0.75 percent in December 2025. Subtracting the CPI for all items -- the latest March 2026 figure being 1.5 percent -- from the overnight call rate results in a figure of minus

0.75 percent. This is the real interest rate typically cited in newspapers. However, the CPI tends to include temporary fluctuations, and thus real interest rates can also fluctuate significantly. Given this context, what is often referred to is the real interest rate calculated over a one-year period. This rate is obtained by subtracting one-year inflation expectations -- calculated using a synthesis of multiple statistical data -- from the current yields on one-year Japanese government bonds (JGBs). This rate stands at approximately minus 0.86 percent, which is almost the same level as the uncollateralized overnight call rate at present.

The long-term real interest rate is also calculated in the same way, by subtracting 10-year inflation expectations from 10-year JGB yields. Most recently, it has turned slightly positive. While that is better than being negative, the fact that letting funds lie untouched for a decade generates only minimal profits could be taken to symbolize the current state of Japan's economy, which is showing only moderate growth.

Neutral Interest Rate

Although the neutral interest rate is an indicator that central banks always keep in mind in conducting monetary policy, this rate cannot be expressed as a specific figure.

The calculation of the neutral interest rate begins with estimating the natural rate of interest, which is the real interest rate that neither heats nor cools economic activity. As shown in the left panel of Chart 7, the natural rate of interest is estimated using various theoretical models, and the estimates fall within a fairly wide range. These are the latest figures, released in March. At the time they came out, it had been two and a half years since the previous release. The overall range has remained largely unchanged, and is estimated to be between minus 0.9 percent and plus 0.5 percent. The only change in the range from the previous estimation is that the lower end increased slightly, from minus 1.0 percent to minus 0.9 percent.

The natural rate of interest is the real interest rate after subtracting the inflation rate. Adding 2 percent, which is the Bank's price stability target, makes this rate nominal, somewhere in the range of 1.1 to 2.5 percent. This estimated range is what the media refers to as the neutral interest rate. Given that various methods are used to estimate the neutral interest rate and that

it can only be indicated within a fairly wide range, this rate is simply a reference. In particular, since policy interest rate hikes over the past two years have brought the rate close to the estimated range of the neutral interest rate, the Bank will need to more thoroughly examine factors such as prices, employment, and financial conditions in considering further rate hikes.

Unlike in Europe and the United States, the policy interest rate in Japan is lower than the neutral interest rate, as shown in the right panel of Chart 7. Many other central banks around the world have recently continued to cut policy interest rates to bring them closer to the neutral interest rate, while the Bank has been raising its rate. The reason Japan alone has a policy rate that is below the estimated range of the neutral interest rate could be attributable to differences in the degree of impact from global inflation following the pandemic and in the responses to this inflation. As shown in Chart 8, post-pandemic inflation was not as high in Japan as it was in Europe and the United States. Japan was thus able to maintain a negative interest rate policy. There is also a view that Japan's mild inflation was attributable to the inability of firms to easily pass on higher raw material costs to selling prices because of prolonged deflation in this country.

Japan and other countries have been pursuing contrasting monetary policy in terms of raising or cutting the policy interest rate while sharing the same concerns about economic deterioration in the wake of the introduction of U.S. tariff policy. Japan's economy is in an even more complex situation: even if a response to inflation becomes suddenly necessary in the near future, the Bank's monetary policy will remain accommodative. To complete the normalization of monetary policy in Japan, I am convinced that the Bank needs to raise the policy interest rate further, so that it falls solidly within the estimated range of the neutral interest rate, thereby ensuring the flexibility needed to swiftly adjust the policy rate in either direction, depending on economic conditions.

Foreign Exchange Rates

In Japan, exchange rate policy is conducted under the authority of the government, and is not within the purview of the Bank's monetary policy. Therefore, the Bank does not set the policy interest rate with the intention of addressing the yen's depreciation directly.

Nevertheless, due attention should be paid to whether inflation triggered by the yen's depreciation may raise people's inflation expectations and, in turn, affect underlying inflation, which I will touch on later.

Wages

The wage growth rate is a key determinant of monetary policy. Economic activity can be stable only when there is a moderate cycle of firms passing on higher wages to selling prices and then responding to the ensuing inflation with wage increases. A situation where neither wages nor prices rise, as seen during Japan's deflationary period, and a situation where both rise excessively, as in the first oil shock, are both unfavorable for the economy.

As shown in Chart 9, the rate of change in real wages -- which is calculated by subtracting the inflation rate from the rate of change in nominal wages -- tends to be regarded as an important factor for households. Even if wages increase, household income will be negative on a net basis unless the wage hikes keep up with inflation. However, the year-on-year rate of change in real wages has finally turned positive. If inflation moderates to around the target level of 2 percent while wage hikes of around 3 percent continue, the rate of change in real wages will remain positive.

I often hear that the combination of wage increases and policy interest rate hikes is causing difficulties for firms. It is indeed not hard to imagine the significant challenges business owners are facing in raising wages, given labor shortages and the need to comply with the increase in the minimum wage in Japan. However, if the inflation rate cannot be contained at an appropriate level, this could lead to a vicious cycle in which firms have to further raise wages to retain workers. The Bank considers that, to ensure that the wage increases firms have managed to achieve are not in vain, it is important to manage the inflation rate through appropriate monetary policy and thereby maintain real wage growth.

Corporate Profits

Chart 10 shows data for corporate profits from the Bank's *Tankan*. Many argue that small firms have been generating low profits, partly due to a surge in raw material prices. However,

as implied by the chart, the net income of Japanese firms has increased steadily, and at a similar rate, regardless of firm size.

The graph shows firms' actual profits after tax up to fiscal 2024 and profit projections for fiscal 2025. Examining the data for actual profits after tax in five-year increments, those of small firms for fiscal 2024 were nearly five times the level of fiscal 2009 and nearly double the level of fiscal 2014 and 2019.

Wondering whether it might be the case that only firms in particular industries have been experiencing difficulties, I assessed the data broken down into around 30 sectors -- the smallest unit available in the *Tankan*. However, data for almost every sector and fiscal year showed increased profits. While it should be noted that the *Tankan* excludes micro firms, polarization between larger firms and smaller firms, a topic which is often bandied about, was not supported, at least by the *Tankan* data. From a macroeconomic perspective, it appears that favorable business performance has become more widespread across all firms, resulting in a decent level of accumulated reserves. Considering rising input prices, personnel expenses, and other costs, if small firms had been unable to pass on these cost increases to prices, their profits should have decreased. This leads me to believe that, overall, the cost pass-through by small firms has made progress to some extent. Of course, some might say that higher profits are attributable to the various efforts firms have taken to enhance profitability, such as steps to boost business efficiency.

Funding Conditions

It is also important to monitor whether or not policy interest rate hikes have adversely affected corporate financing.

Chart 11 shows how the amount outstanding has increased for direct financing to firms, which refers to CP and corporate bonds, and for indirect financing, which refers to bank lending. Neither indicator suggests that the recent policy interest rate hikes have dampened firms' appetite for funding -- on the contrary, they indicate an increased appetite. This can be seen as reflective of the typical situation where both the inflation rate and interest rates tend to rise

during times of economic growth. At the general trading company where I previously worked, gross profits and interest rates exhibited a clear positive correlation.

Underlying Inflation

Let me also discuss underlying inflation, which the Bank uses as a reference. Underlying inflation excludes fresh food prices, which fluctuate significantly, and temporary factors -- namely, the surge in rice prices, the recent crude oil shock, and the effects of government measures such as tax hikes and subsidies. It is an important concept in conducting monetary policy, which, in Japan, currently aims at achieving sustained inflation of 2 percent.

As with the natural rate of interest, underlying inflation cannot be expressed as a specific figure. In March 2026, for the first time in two years, the Bank updated the indicators for underlying inflation that it monitors on a regular basis. As presented in Charts 12 and 13, there are numerous types of indicators, such as those using statistical methods and those showing the inflation trend based on economic models, and developments in these indicators vary. That said, my overall impression is that, although it remains below 2 percent, the underlying inflation rate is drawing very close to the 2 percent target.

III. Recent Conduct of Monetary Policy

Policy Interest Rate

Lastly, I would like to discuss the Bank's monetary policy, focusing in particular on its policy interest rate and balance sheet.

As shown in Chart 14, the Bank has made an exit from the prolonged period of unprecedented monetary easing and has implemented four policy interest rate hikes since March 2024. Before each Monetary Policy Meeting (MPM), which is held eight times a year, the Bank's Policy Board members thoroughly examine a wide range of data, such as on business fixed investment and financial market conditions, in addition to the data I explained earlier.

As I mentioned in referring to real and neutral interest rates, financial conditions in Japan remain assuredly accommodative. Given this, the Bank will continue to raise the policy interest rate and adjust the degree of monetary accommodation in response to developments

in economic activity and prices as well as financial conditions, in the process of completing the normalization of monetary policy. As the behavior that took root during the period of deflation is now being unentrenched, Japan has clearly entered an inflationary phase. Therefore, what is vital from now on is to ensure that, through timely and appropriate policy rate hikes, the underlying inflation rate does not exceed 2 percent.

The rising prices of fuel and chemicals due to the Iran situation may turn out to be a temporary shock. Nonetheless, what is of concern is that the increase in fuel prices could further accelerate Japan's already mounting distribution costs, which have been driven primarily by labor shortages. Since logistics is deeply connected to domestic consumption, including retailing and services, its effects are far-reaching. This applies to food as well: in addition to higher domestic distribution costs, the rise in maritime shipping fees for imported raw materials and in the price of imported fertilizers are some factors that contribute to food price hikes. There are concerns that these factors may not be temporary shocks but rather represent more enduring trends that risk pushing up prices.

At the April 2026 MPM, there were mixed views among Policy Board members on whether to raise the policy interest rate immediately. I myself judged at the April MPM that the situation did not warrant a hasty policy rate hike. That said, if statistical data do not indicate clear signs of an economic downturn, I believe it is desirable to raise the policy rate at the earliest stage possible.

Balance Sheet

At the September 2025 MPM, the Bank decided on a guideline for the disposal of exchange-traded funds (ETFs).

Although the Bank began purchasing ETFs in 2010, most of its purchases were conducted under the quantitative and qualitative monetary easing (QQE), or unprecedented monetary easing, introduced in 2013. The left panel of Chart 15 shows developments in the amount outstanding of the Bank's ETF holdings. I previously worked for a stock-issuing firm as its chief financial officer, developing strategies for selling stocks to investors. Drawing on the insights gained from my experience, I would like to expand a little upon this point.

The Bank has often been criticized for holding ETFs alongside investors for an extended period, with the claim that this is rather unconventional and distorts market functioning. With regard to corporate governance, however, unlike with strategic stockholdings, the trust banks conduct fair voting at shareholders' meetings in connection with stocks held via ETFs. Some question the delegation of such voting, but I think the more serious issue would be if the Bank as a shareholder were to be actively involved in corporate management. I do not believe the Bank's holding of ETFs, which accounts for only about 8 percent of the total market capitalization of the Prime Market of the Tokyo Stock Exchange (TSE), would undermine corporate governance to begin with.

As many of the ETFs the Bank initially purchased were those that tracked the Nikkei 225 Stock Average available on the market, this tended to skew the ETF constituents. Since the Nikkei 225 Stock Average is a simple average of the stock prices of only 225 firms selected out of around 1,600 firms listed on the TSE Prime Market, ETFs that track the Nikkei 225 by definition do not hold stocks issued by firms that have not been selected as Nikkei 225 constituents and, conversely, purchase in greater proportion the stocks of Nikkei 225 constituents with limited issuance or that are high-priced. In actuality, the Bank previously held more than an 8 percent share of the total amount outstanding of certain stocks or had no holdings of some other stocks. To correct for this issue, the Bank went on to increase the share of its purchases of ETFs that track the Tokyo Stock Price Index (TOPIX).

As for how firms received the Bank's ETF purchases, in the case of ETFs that track the TOPIX, all stock prices rise by the same proportion, so the relative impact is neutral. Both performance evaluations of institutional fund managers and stock-based compensation for corporate executives -- which has recently become common in Japan -- are based on the relative performance of a firm's stock price versus the TOPIX. The Bank's purchases thus seem to have provided no real advantages in that regard. For these reasons, the purchases were viewed primarily as a way of influencing the overall financial markets.

There appears to be a range of opinions regarding the fact that it will take over 100 years for the Bank to complete the disposal of its ETFs. Let me explain how the Bank decided on the pace of its sales. Prior to commencing the sales of ETFs, the Bank already had experience in

selling financial instruments to the market. Specifically, to help financial institutions break free from management risks brought about by a fall in stock prices, the Bank in the 2000s purchased around 2 trillion yen of the stocks of private-sector firms that had previously been held by financial institutions, thereby preventing the sales of these stocks in the market. Unlike the aforementioned ETFs that track the TOPIX, these stocks were held by several banks independently, and the issuing firms were likely to have appreciated the Bank's purchases. The Bank sold the purchased stocks constantly over the past nine years or so, completing their disposal in July 2025. The Bank's disposal of these stocks seems to have received little market attention. In view of this, the guideline for the disposal of ETFs set in September 2025 was based on the Bank's judgement that the disposal would not plunge the market into turmoil, provided that the pace of sales of ETFs is generally equivalent to that of the stocks formerly purchased from financial institutions. A simple calculation suggests that, at this pace, it will take over 100 years for the Bank to dispose of its ETFs. The Bank's ETF holdings carry a book value of 37 trillion yen -- which is considerably different in scale from the stocks the Bank disposed of. The Bank is thus proceeding with the utmost caution with its disposal of ETFs, since this could have a significant impact on the market depending on the pace of disposal.

JGBs

Lastly, let me touch on JGBs. The Bank's JGB holdings account for about 50 percent of the amount outstanding of JGBs issued, which is higher than the proportion of government bonds held by central banks in other advanced economies. Given this, the Bank has been gradually reducing the amount of its JGB purchases in a manner that supports stability in the JGB markets. At the peak, the Bank's annual JGB purchases amounted to over 130 trillion yen, but this level will be cut down to slightly less than 30 trillion yen in fiscal 2027. Thus, given that the annual issuance of government securities, including JGBs and short-term treasury discount bills, amounts to 180 trillion yen, the proportion of the Bank's JGB purchases to the total issuance will fall substantially.

Unlike ETFs, since JGBs carry maturities, the amount outstanding will decrease simply by dint of the Bank reducing the amount of its purchases. This implies that the amount outstanding of the Bank's JGB holdings will decline considerably faster than is the case for

ETFs. As shown in the right panel of Chart 15, since the pace of reduction by March 2027 has already been fixed, the Bank's JGB holdings, which peaked out at nearly 590 trillion yen, will be reduced by almost 20 percent by then. The Bank will need to rigorously examine the pace of its JGB purchases after March 2027 while monitoring market conditions.

This does not necessarily mean that the balance sheet ought to be reduced to levels prior to the implementation of QQE. In the wake of the 2008 Global Financial Crisis, liquidity regulations for financial institutions worldwide have tightened, and demand for central bank reserves has been changing. Taking this trend into account, the Bank will ascertain what the appropriate size of its balance sheet is.

Thank you.

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Speech at a Meeting Held by the Kagoshima Keizai Doyukai

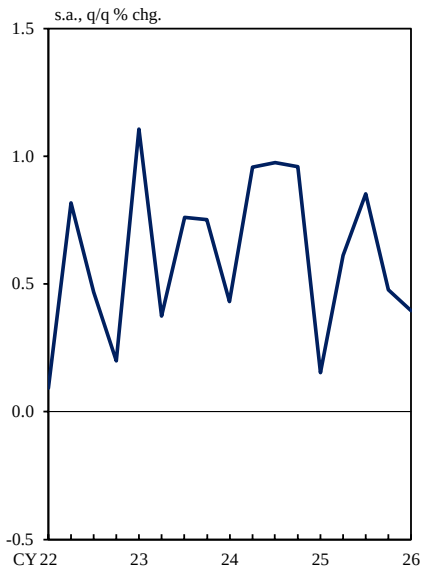
May 14, 2026

MASU Kazuyuki
Member of the Policy Board
Bank of Japan

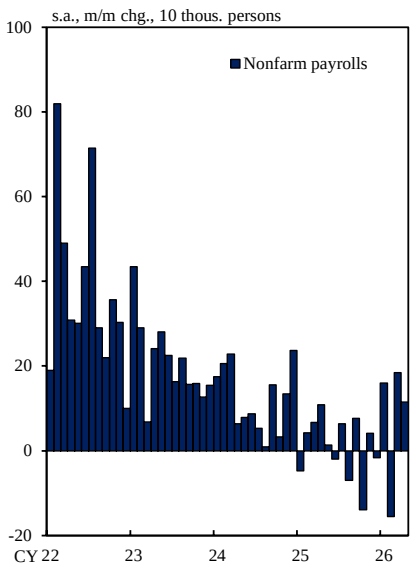
Chart 1

U.S. Economy

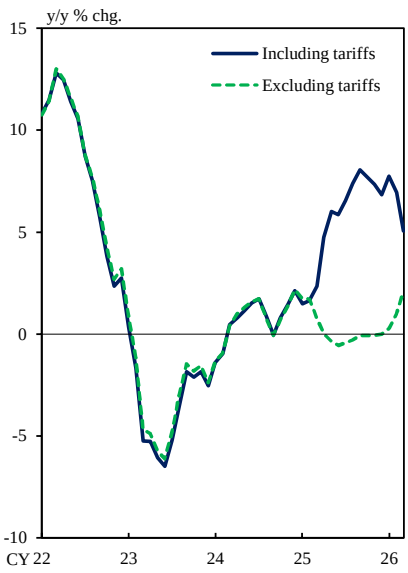
Real Private Consumption



Number of Employees



Import Prices



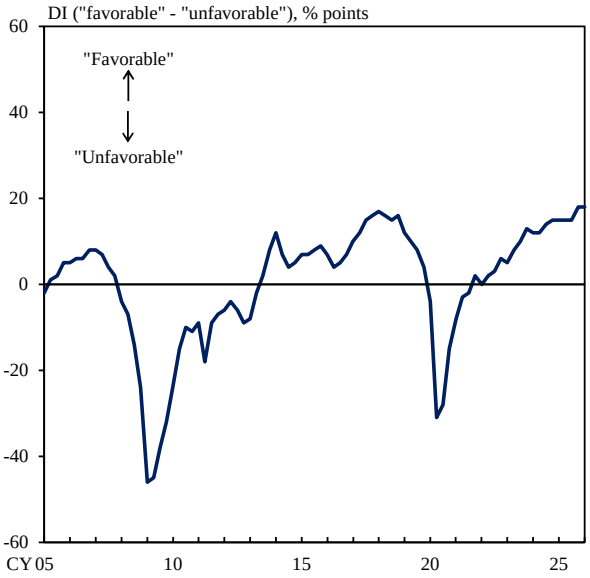
Note: In the right panel, figures for October 2025 are linearly interpolated using figures for September and November. Figures including tariffs are based on Bank staff calculations using published import price figures and the effective tariff rates.

Source: Haver.

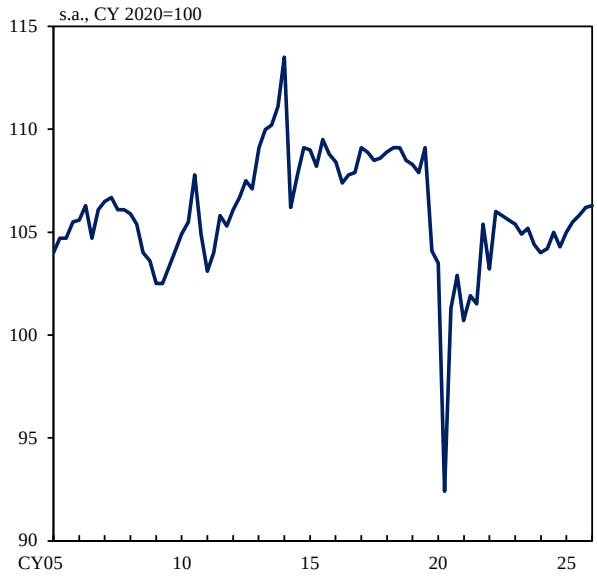
Chart 2

Japan's Economy

Business Conditions



Consumption Activity Index (Travel Balance Adjusted)



Notes: 1. In the left panel, figures are based on the *Tankan* and are for all industries and enterprises.
2. In the right panel, figures exclude inbound tourism consumption and include outbound tourism consumption, and are based on Bank staff calculations.

Source: Bank of Japan.

Chart 3

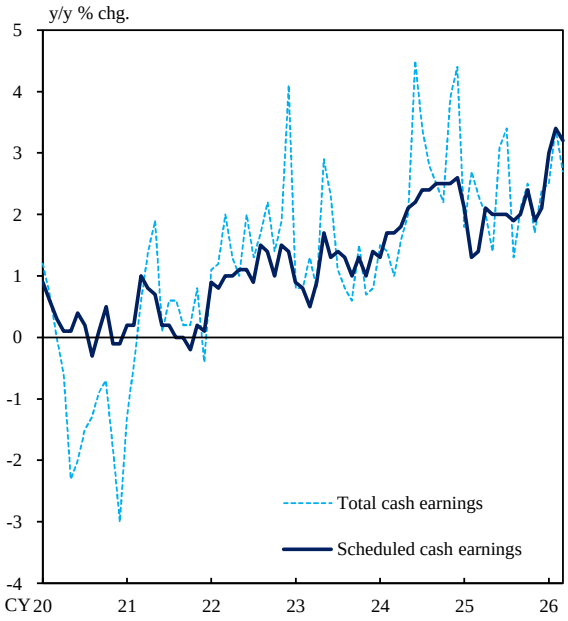
Japan's CPI Inflation

Source: Ministry of Internal Affairs and Communications.

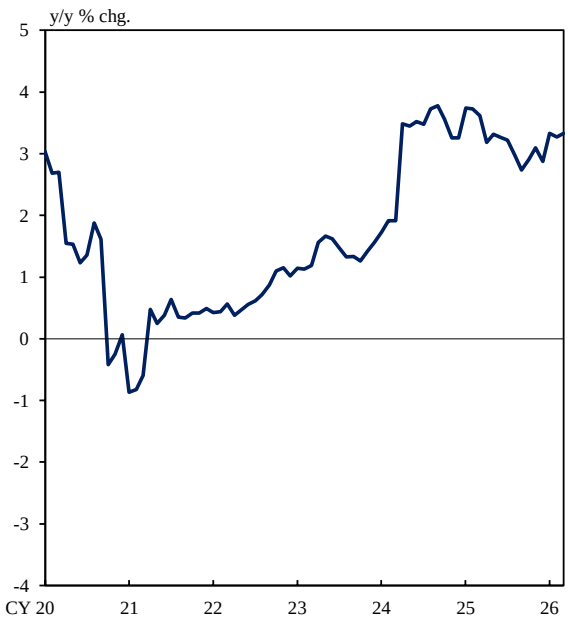
Chart 4

Wages and Distribution Costs in Japan

Wages



Distribution Costs



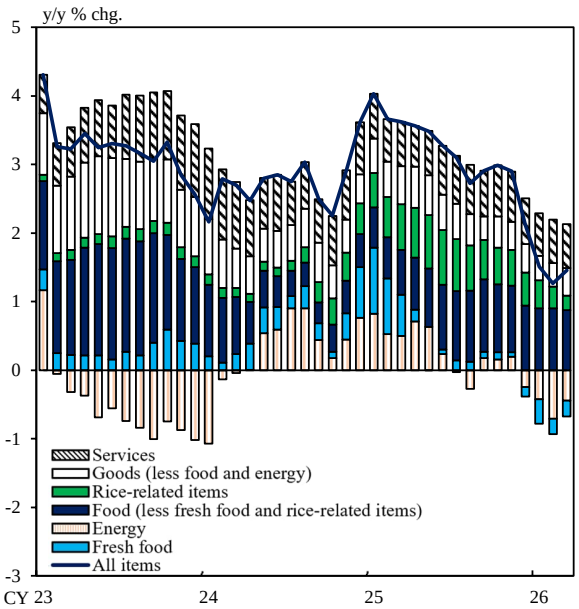
Note: In the right panel, figures for distribution costs are the weighted averages of the following items in the services producer price index: motor freight transportation (agriculture, forestry & fishery and food products), motor freight transportation (mineral and chemical products), motor freight transportation (metal and machinery products), and motor freight transportation (light and miscellaneous industrial products).

Sources: Ministry of Health, Labour and Welfare; Bank of Japan.

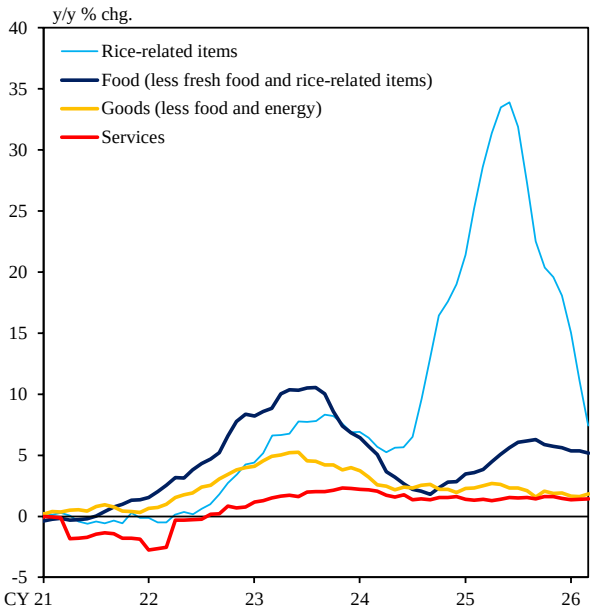
Chart 5

Japan's CPI Inflation

Contribution to CPI



Food, Goods, and Services



Note: "Rice-related items" consists of non-glutinous rice, mochi or rice cakes, *daifukumochi* or rice cakes stuffed with sweetened bean jam, *sembei* or Japanese crackers, sushi (box lunches), box lunches, rice balls, frozen cooked rice, and aseptic packaged cooked rice.

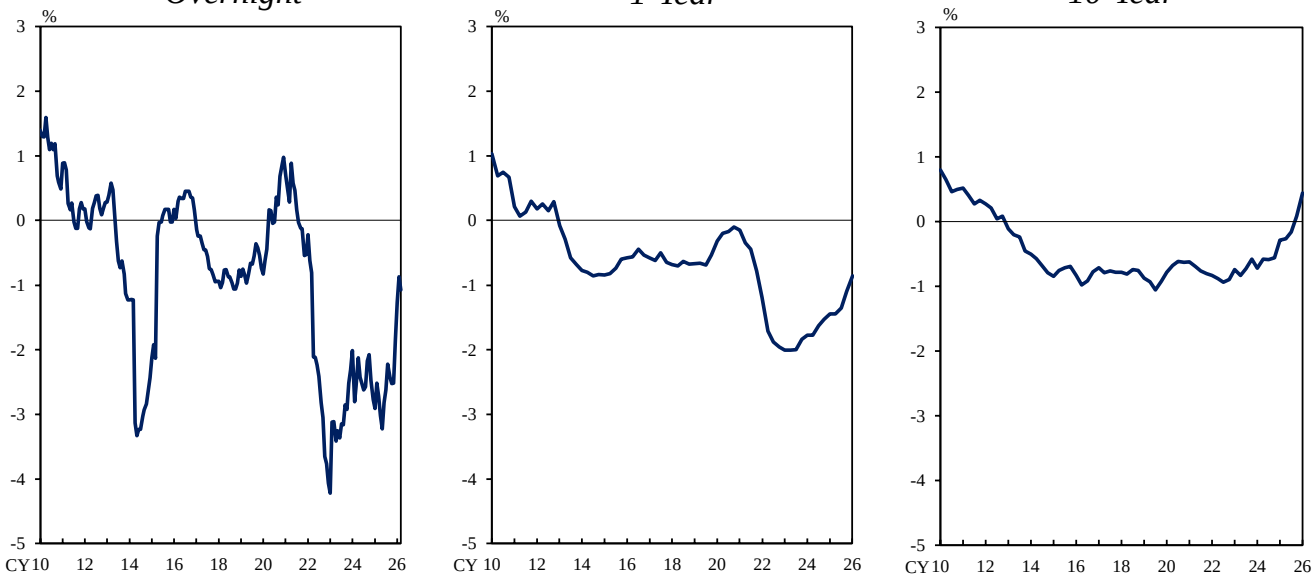
Source: Ministry of Internal Affairs and Communications.

Chart 6

Real Interest Rate in Japan

(Real interest rate = Nominal interest rate – Inflation rate)

Overnight *1-Year* *10-Year*



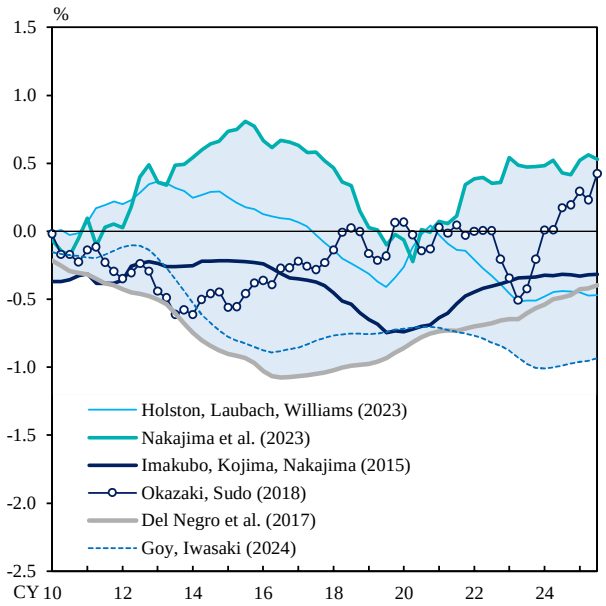
Notes: 1. In the left panel, figures for the real interest rate are calculated by deducting the year-on-year rate of change in the CPI (less fresh food) from the uncollateralized overnight call rate.
2. In the middle and right panels, figures for real interest rates are calculated by deducting inflation expectations from JGB yields for each maturity. Figures for inflation expectations are based on Bank staff calculations using the expectations of various economic entities (firms, households, and experts) at different horizons. Specifically, data used in the calculations are as follows: for firms, the *Tankan*; for households, the *Opinion Survey on the General Public's Views and Behavior*; for experts, the *QUICK Survey*, the *Consensus Forecasts*, and inflation swap rates.

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

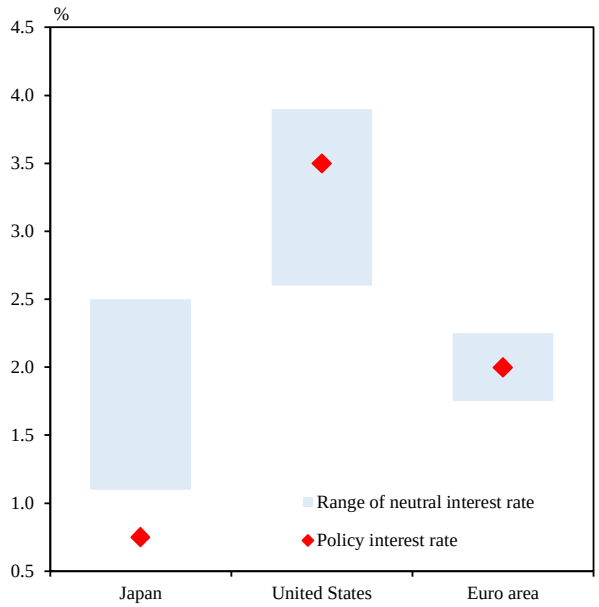
Chart 7

Natural Rate of Interest, Neutral Interest Rate, and Policy Interest Rates

Natural Rate of Interest in Japan



Range of Neutral Interest Rate and Policy Interest Rates of Major Central Banks

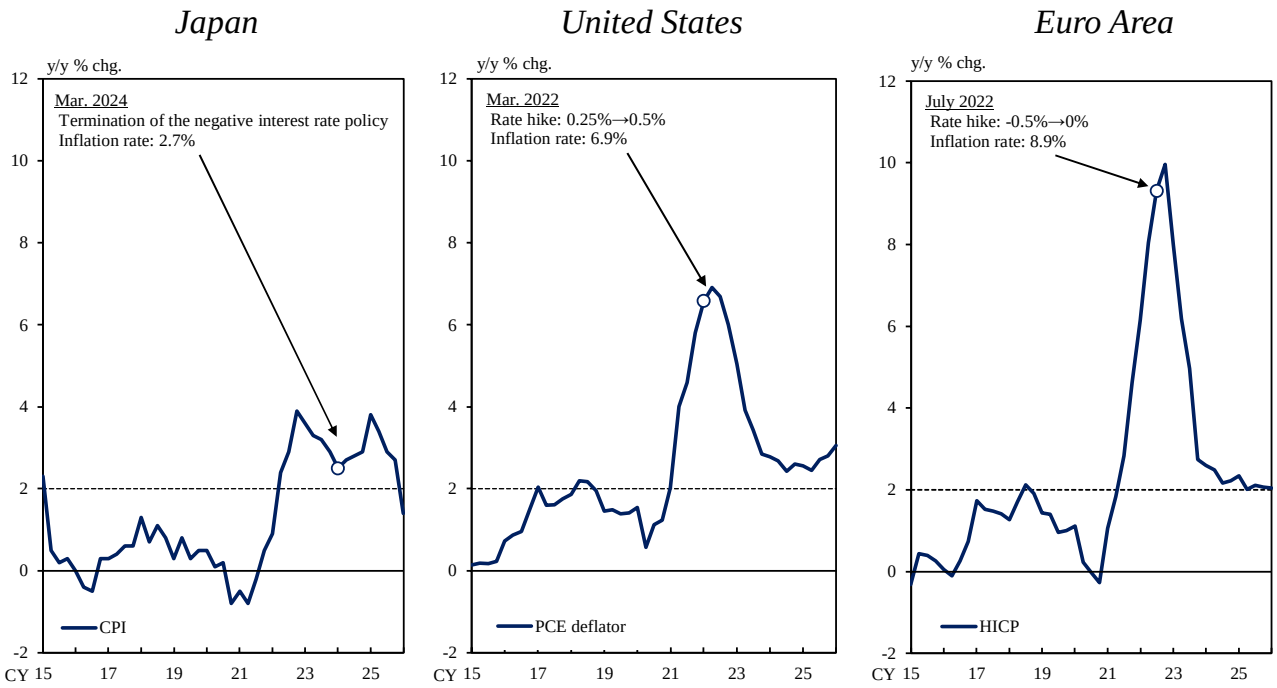


Notes: 1. In the left panel, estimates are based on Bank staff calculations using the models proposed in the different papers listed. The shaded area shows the estimated range of the natural rate of interest.
2. In the right panel, as the Federal Reserve does not officially publish the range of the neutral interest rate, the range for the United States is based on the Federal Open Market Committee (FOMC) members' longer-run projections for the federal funds rate in the Summary of Economic Projections released after the March 2026 FOMC meeting. The estimated range of the neutral interest rate for the euro area refers to the figures in the European Central Bank's (ECB's) *Economic Bulletin*, Issue 1, 2025.

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

Chart 8

Inflation Rates

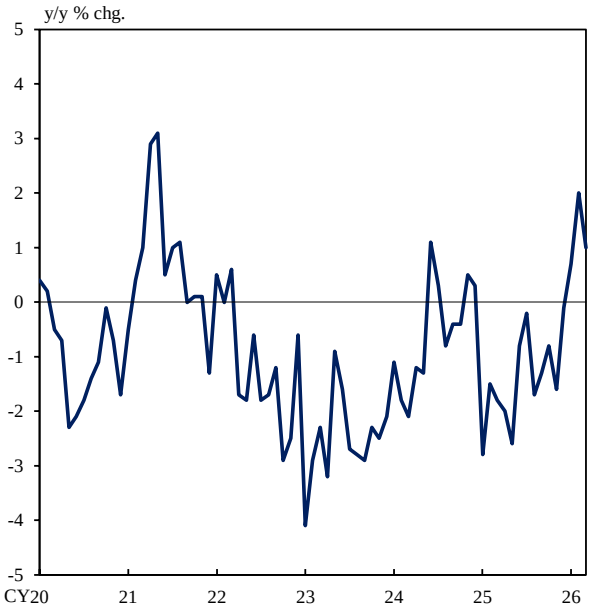


Note: Inflation rates are calculated based on consumer prices for all items. The policy interest rate for the United States is the upper limit of the federal funds target range. The rate for the euro area is the ECB deposit facility rate.

Sources: Haver; Ministry of Internal Affairs and Communications.

Chart 9

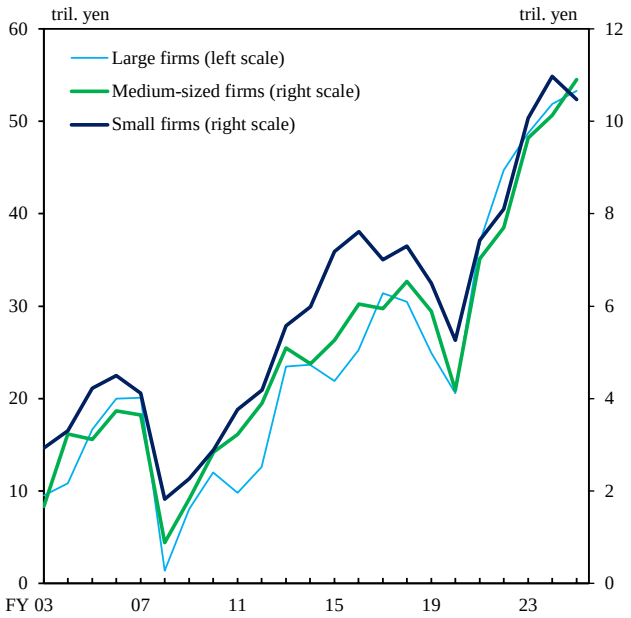
Japan's Real Wages



Source: Ministry of Health, Labour and Welfare.

Chart 10

Net Income of Japanese Firms



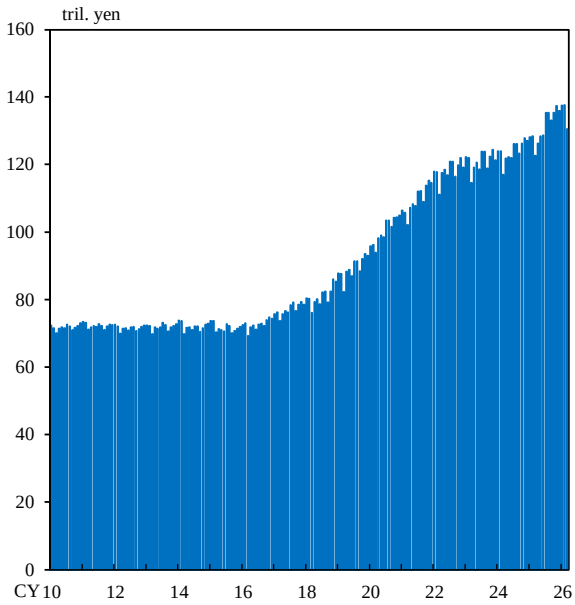
Note: Figures are based on the *Tankan* and are for all industries excluding financial institutions. Figures for fiscal 2025 are estimates as of March 2026.

Source: Bank of Japan.

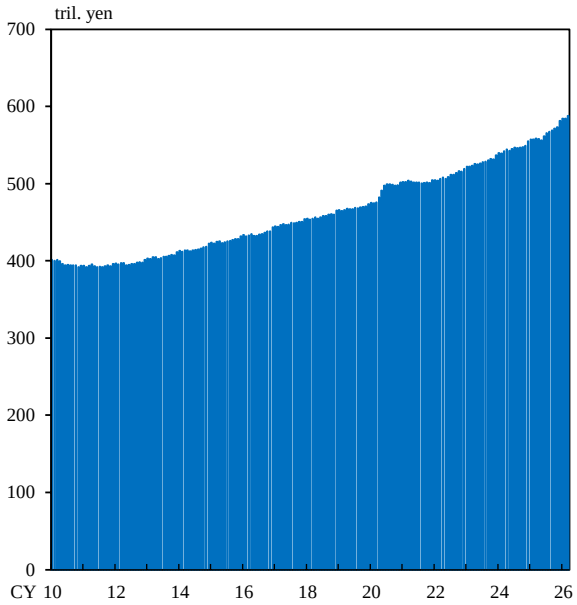
Chart 11

Amounts Outstanding of CP, Corporate Bonds, and Bank Lending

CP and Corporate Bonds



Lending by Domestic Commercial Banks



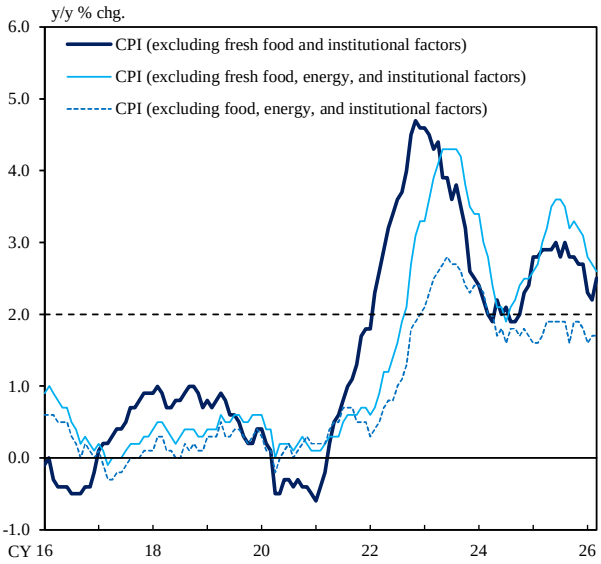
Note: Figures in the left panel are those at the end of the period. Figures in the right panel are monthly averages.

Sources: I-N Information Systems; Japan Securities Dealers Association; Japan Securities Depository Center; Bank of Japan.

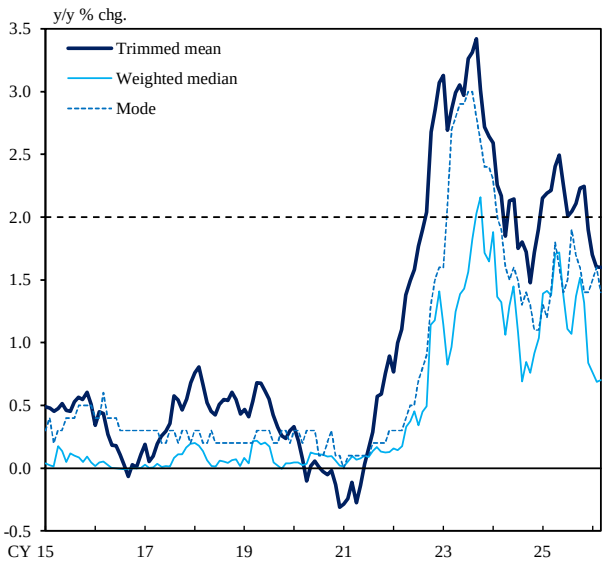
Chart 12

Underlying Inflation (1)

CPI Excluding Institutional Factors



Trimmed Mean etc.



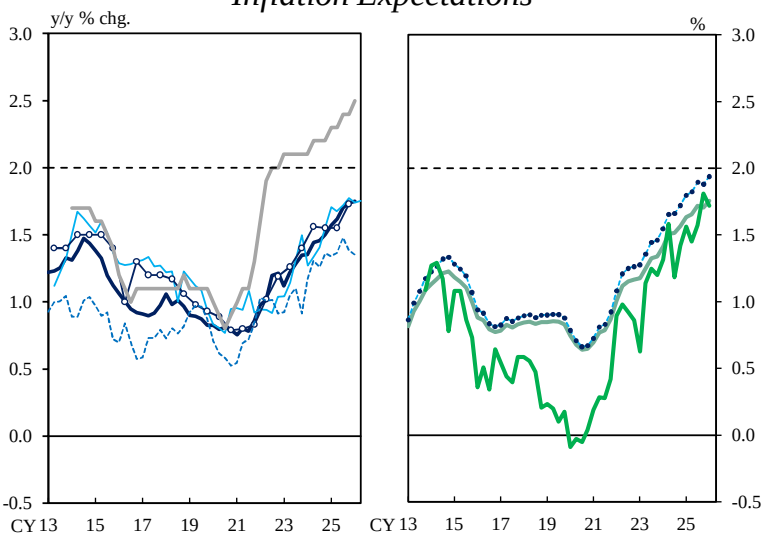
Note: Institutional factors include the effects of the consumption tax hike, policies concerning the provision of free education, measures to reduce the energy cost burden (such as gasoline prices, electricity charges, and gas charges), the reduction in mobile phone charges in 2021, and travel subsidy programs. Figures are Bank staff estimates.

Sources: Ministry of Internal Affairs and Communications; etc.

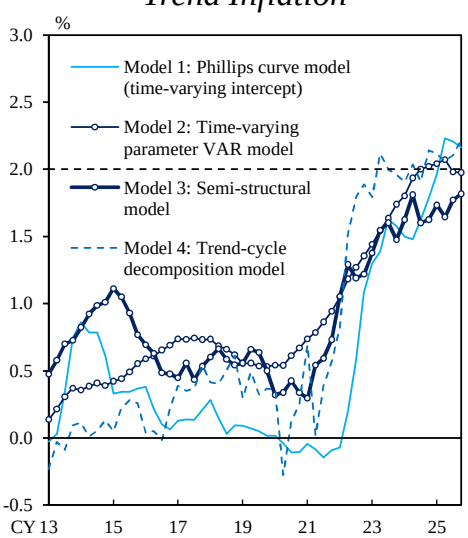
Chart 13

Underlying Inflation (2)

Inflation Expectations



Trend Inflation



Market participants (QUICK, 2 to 10 years ahead)
Economists 1 (6 to 10 years ahead)
Economists 2 (7 to 11 years ahead)
Households (over the next 5 years)
Firms (5 years ahead)
Composite index of inflation expectations (PCA[i])
Composite index of inflation expectations (PCA[ii])
BEI (break-even inflation) rate: yield spread between fixed-rate coupon-bearing JGBs (10-year) and inflation-indexed JGBs (10-year)

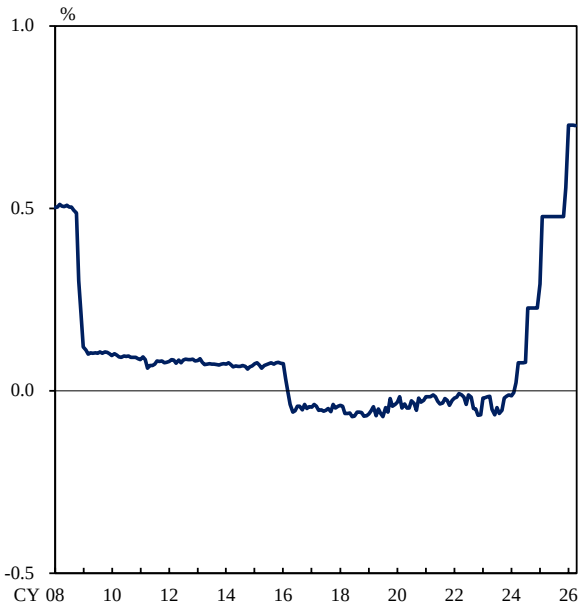
Notes: 1. In the left panel, "Economists 1" shows the forecasts of economists in the *Consensus Forecasts*. "Economists 2" shows the forecasts of forecasters surveyed for the *ESP Forecast*. Figures for households are from the *Opinion Survey on the General Public's Views and Behavior*, estimated using the modified Carlson-Parkin method for 5-choice questions. Figures for firms show the inflation outlook of enterprises for general prices (all industries and enterprises, average) in the *Tankan*.

2. In the middle panel, composite indexes of inflation expectations are for 10-year-ahead expectations. They are calculated using principal component analysis (PCA).

Sources: Bloomberg; Consensus Economics Inc., *Consensus Forecasts*; JCER, *ESP Forecast*; Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications; QUICK, *QUICK Monthly Market Survey <Bonds>*; Bank of Japan.

Chart 14

Japan's Policy Interest Rate

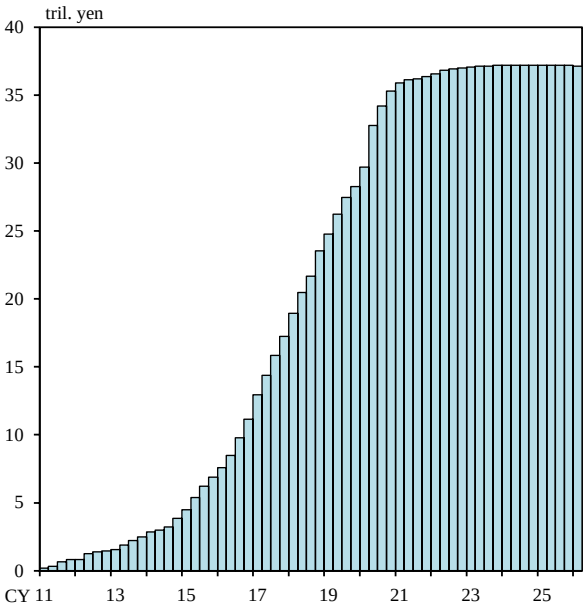


Note: Figures are the uncollateralized overnight call rate.
Source: Bank of Japan.

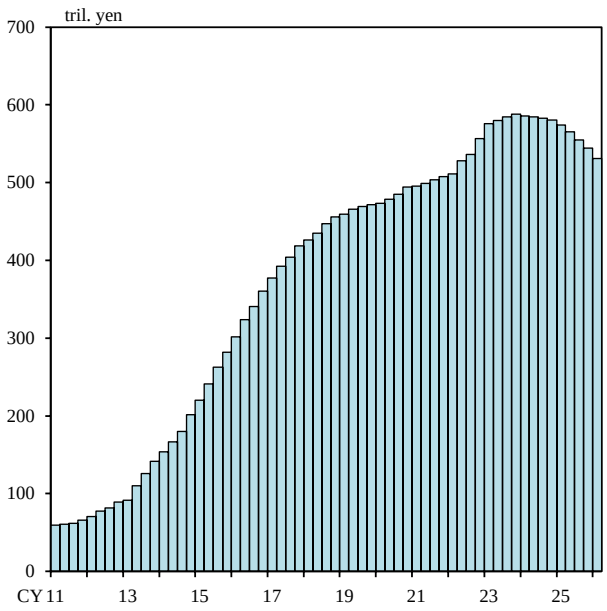
Chart 15

The Bank's Balance Sheet

ETF Holdings



JGB Holdings



Source: Bank of Japan.