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Bank of Japan

Oil Price Shocks, Inflation, and Monetary Policy in Japan

Opening Remarks at the 2026 BOJ-IMES Conference Hosted by the Institute for Monetary and Economic Studies, Bank of Japan

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We are pleased to welcome all of you, distinguished speakers and guests, to the 2026 BOJ-IMES Conference. Thank you very much for your participation.

The theme of this year's conference is "Monetary Policy from New Perspectives." I am sure that supply shocks loom large in everyone's mind. They are not a new phenomenon but at least have become more frequent. Whether a new perspective is truly needed, I leave it for debate — but revisiting past experience is, I think, an indispensable starting point.

I do not have a new perspective to offer at this point. Instead, let me go through Japan's experience with major energy shocks during the last five decades and offer some food for discussion.

Since the 1970s, the global economy has been hit by significant spikes in energy prices, especially oil prices, as shown in Chart 1. There are five notable incidents: the first oil shock of 1973, the second oil shock of 1979, the oil price surge of the mid-2000s leading to the 2008 Great Financial Crisis, Russia's invasion of Ukraine in 2022, and the recent conflict in the Middle East.

However, the response of Japan's consumer price index (CPI) to oil price increases was different from episode to episode, to which I now turn.

Let me begin with the first oil shock. The first oil shock came in late 1973. In Chart 2 we can detect a typical wage-price spiral in 1974, with both reaching about the 20-30% range. But Japan's inflation problem had started before that. Inflation was already close to 10% in early 1973, and wage growth was close to 20%. It was already an economy with significant inflationary momentum.

It is sometimes said that monetary policy was slow to react. There is some truth to this, especially for the period preceding the oil price increases. But after inflationary pressures became visible, the Bank of Japan (BOJ) did tighten policy. The key point is that the tightening came after high inflation dynamics had already developed. Also, the degree of tightening was clearly inadequate given the near 20% inflation.

The most important transmission channel was wages. The oil shock fed into domestic wages and prices. The 1974 spring wage negotiations produced very large wage increases, and firms passed higher labor and input costs into prices. Inflation expectations rose further. In this way, an external relative-price shock became a broader wage-price spiral.

The economy contracted sharply in early 1974: the deterioration in Japan's terms of trade, the squeeze on real income, weaker corporate profits, tighter monetary policy, and the correction of earlier overheating. Eventually, recession and policy tightening helped bring inflation down, but only at a large cost.

The second oil shock, shown in Chart 3, around 1979 and 1980, was also large. Yet the inflation outcome was far more moderate.

One reason was that monetary policy responded more promptly. But this is not the whole story. The initial conditions were very different. Inflation was lower. Wage behavior was more restrained. Firms and labor unions had learned from the painful experience of the first oil shock. There was a stronger recognition that trying to fully compensate for inflation associated with higher oil prices through nominal wage increases could produce another inflationary spiral.

The exchange rate also mattered. Before the second oil shock, Japan had experienced substantial yen appreciation. This helped reduce import prices more generally and created a more favorable starting point. In addition, Japanese firms had begun to improve energy efficiency and reduce oil dependence.

Thus, the second oil shock slowed the economy and raised inflation, but it did not produce the same wage-price spiral. Monetary policy was important, but it worked in an environment where wages, expectations, exchange rates, and structural adjustment were all more favorable.

Let me turn to the third episode: the mid- to late-2000s. During this period, oil and commodity prices rose substantially. Japan's inflation rate increased somewhat, and the BOJ ended quantitative easing in 2006 and raised the policy rate modestly in 2006 and 2007. Yet inflation remained low, especially the core, which remained in negative territory for almost the entire period, as shown in Chart 4.

Why was the outcome so different from the 1970s? The answer is that Japan had fallen into a deflationary equilibrium by this time. Given the experience of deflation since the late 1990s, firms were reluctant to raise prices. Households had become used to stable or falling prices. Wages were weak. Inflation expectations remained low. The economy was recovering, but not strongly enough to transform wage and price-setting behavior.

In this environment, higher oil prices mainly operated as a tax on real income. They raised costs for firms and prices for consumers, but they did not generate a sustained rise in wages or expectations. The result was a modest increase in headline inflation, but little change in underlying inflation.

Finally, let me turn to the most recent episode, beginning around 2021. At one level, this was again an external cost shock. Energy and food prices rose, global supply chains were disrupted, and Russia’s invasion of Ukraine intensified pressures on commodities. For Japan, yen depreciation further amplified the rise in import prices.

But unlike in the mid-2000s, energy and food price inflation did not remain merely a temporary relative-price shock. Price increases became broader. Firms became more willing to pass on higher costs. Wage growth also began to rise, especially through the spring wage negotiations. Inflation expectations moved up from very low levels. These points are shown in Chart 5.

What made this episode different? First, the shock was broader. It was not just oil. It included energy, food, logistics, and imported materials. When many firms face rising costs at the same time, the barrier to raising prices becomes lower. Another way of saying this is it came during a global demand recovery from the shutdown related to the Covid-19 pandemic.

Second, yen depreciation amplified the shock. In the second oil shock, prior yen appreciation had cushioned import prices. In the recent episode, yen depreciation worked in the opposite direction.

Third, the labor market was tighter. Japan's demographic structure meant that labor shortages were becoming more persistent. This changed the environment for wage bargaining.

Fourth, price and wage norms began to change. For decades, firms and households had behaved as if prices and wages would not rise much. But repeated and visible price increases weakened that norm. Firms became more willing to raise prices, and workers became more willing to demand wage increases.

For these reasons, the recent episode became more persistent than the oil price surge of the mid-2000s. Still, Japan has not experienced an early 1970s-style wage-price spiral. Medium- to long-term inflation expectations have shifted only modestly upward from a long-entrenched near-zero level to a range of 1.5–2+%, depending on the measure. This stands in contrast to the United States and Europe, where inflation expectations were already meaningfully positive when the shocks hit — leaving much less room between the starting point and high inflation significantly above 2%.

The policy implication of all this seems to be that central banks should not look at oil prices in isolation. The same oil price increase can have very different effects depending on wages, expectations, demand, and exchange rates. That is, initial conditions matter enormously. If inflation expectations are already high and wages are accelerating, the risk of second-round effects is large. If expectations are very low and wages are stagnant, even a large cost shock may not raise underlying inflation.

Thus, the boundary between temporary and persistent inflation is not mechanical. A temporary shock can become persistent if it changes wages, expectations, and price-setting behavior. Conversely, a large shock can remain temporary if those channels do not activate.

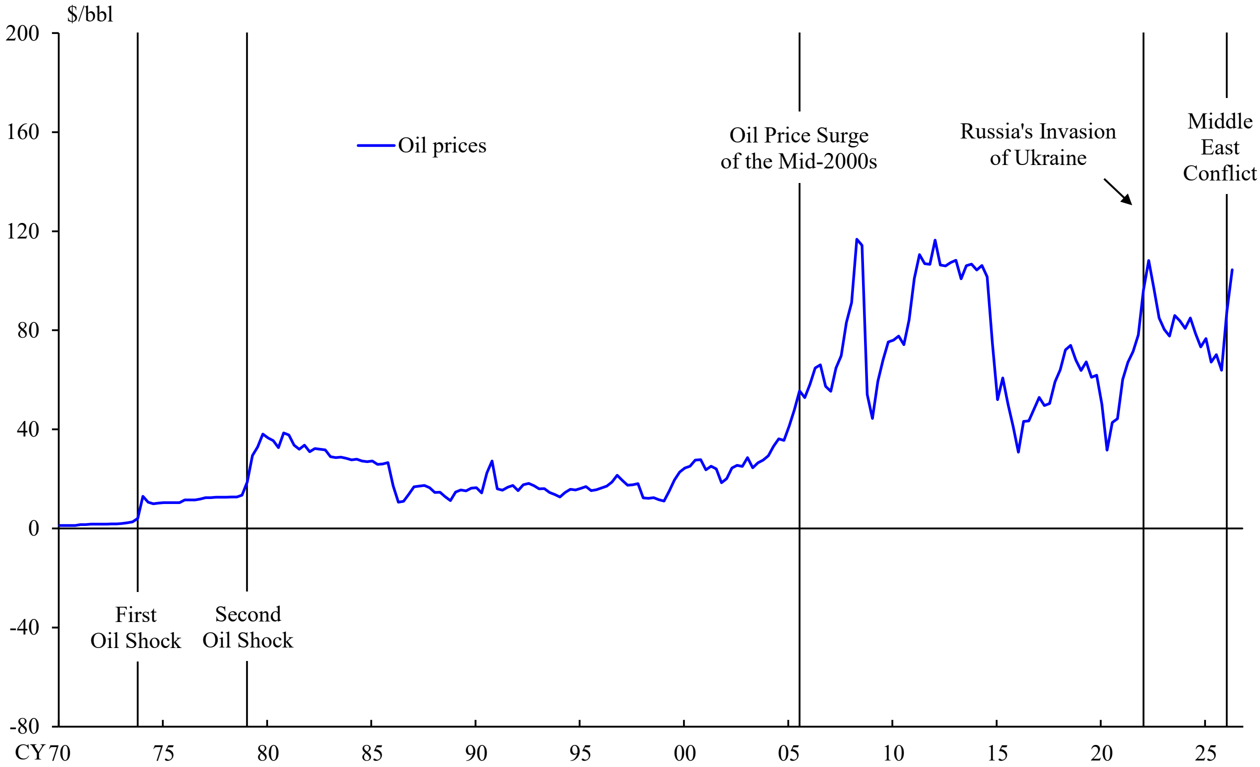
Let me conclude. Japan's experience shows that oil price shocks are never just oil price shocks. They are tests of the entire inflation regime.

In the first oil shock, the regime was already inflationary, and the shock intensified it. In the second, the economy had learned from the first, and the shock was contained. In the mid-2000s, the regime had shifted to a deflationary one, and the oil price surge could not change it. In the recent episode, the shock was broad and persistent enough to help move Japan away from the old deflationary norm, though not into an early 1970s-style inflation spiral.

We are actually facing a fifth oil price shock. What are the important initial conditions that will matter for the evolution of the economy from here? What inflation regime are we in now? And, what is the best response from central banks around the world, including the BOJ? I look forward to hearing your views on these points during the conference.

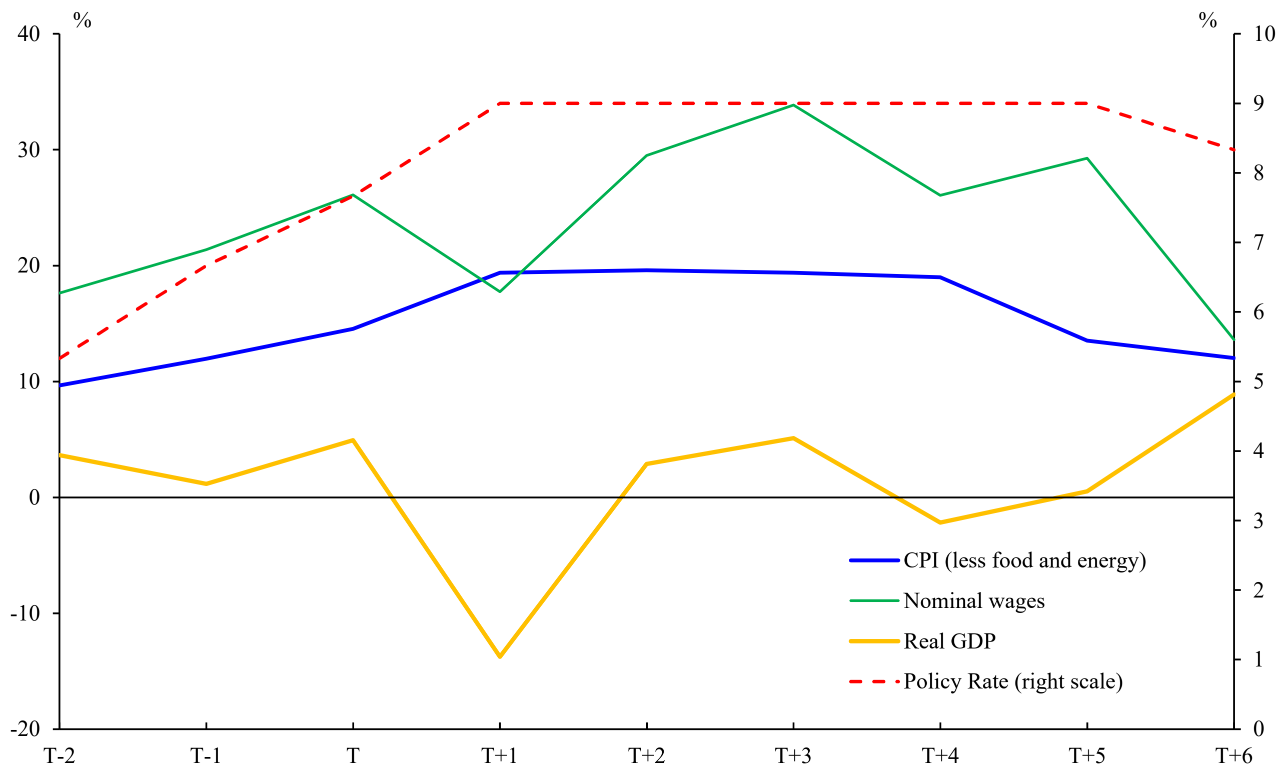
Thank you.

Oil Prices and Notable Incidents



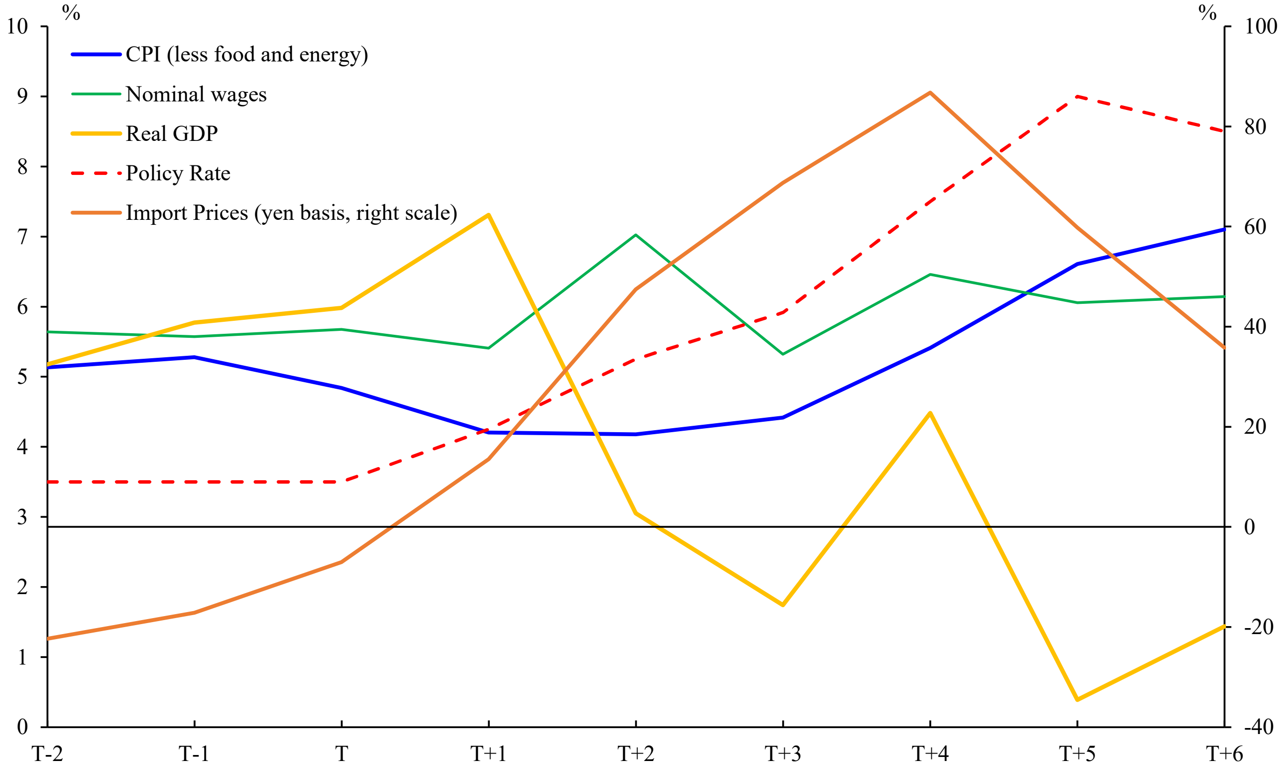
Note: Oil prices are Dubai crude oil prices.
Sources: Nikkei NEEDS; World Bank.

The First Oil Shock (T=Q4:1973)



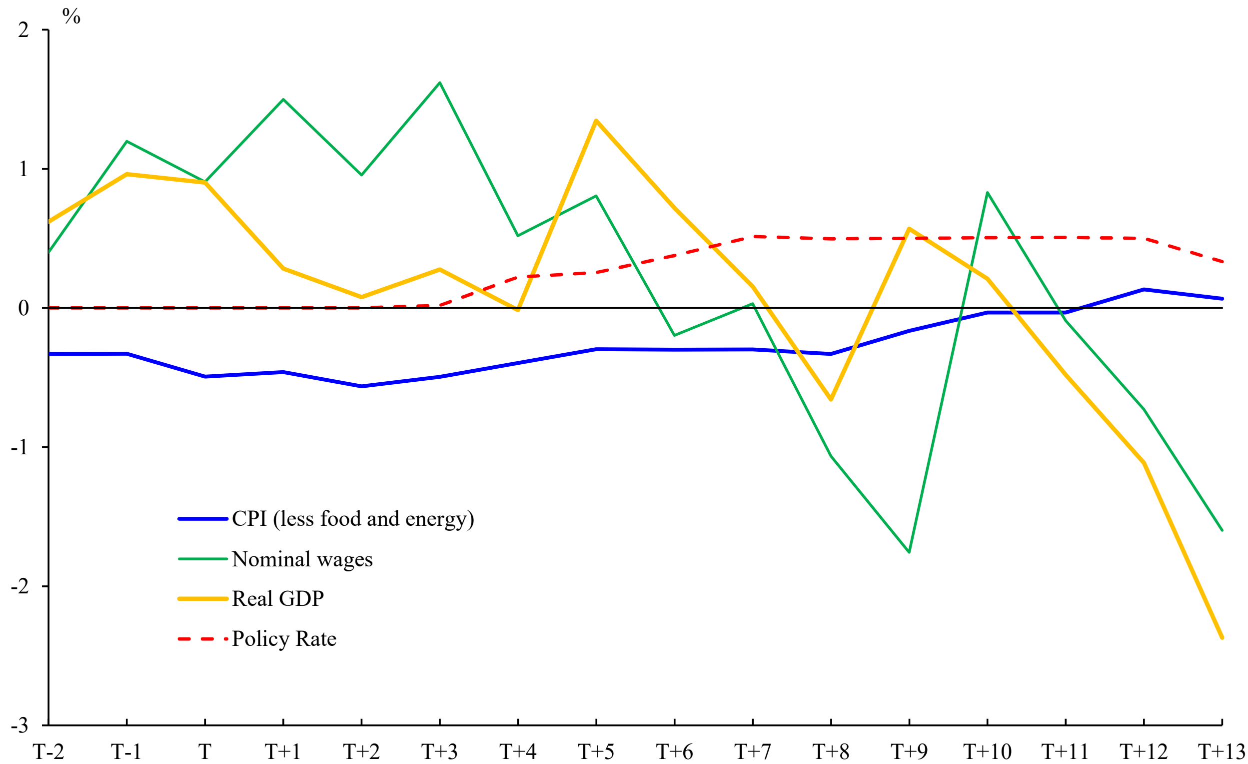
Note: Policy rate is the Official Discount Rate. Real GDP is expressed as quarter-on-quarter annualized growth rate; CPI and nominal wages are year-on-year percent changes.
Sources: Bank of Japan; Cabinet Office; Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications.

The Second Oil Shock (T=Q1:1979)



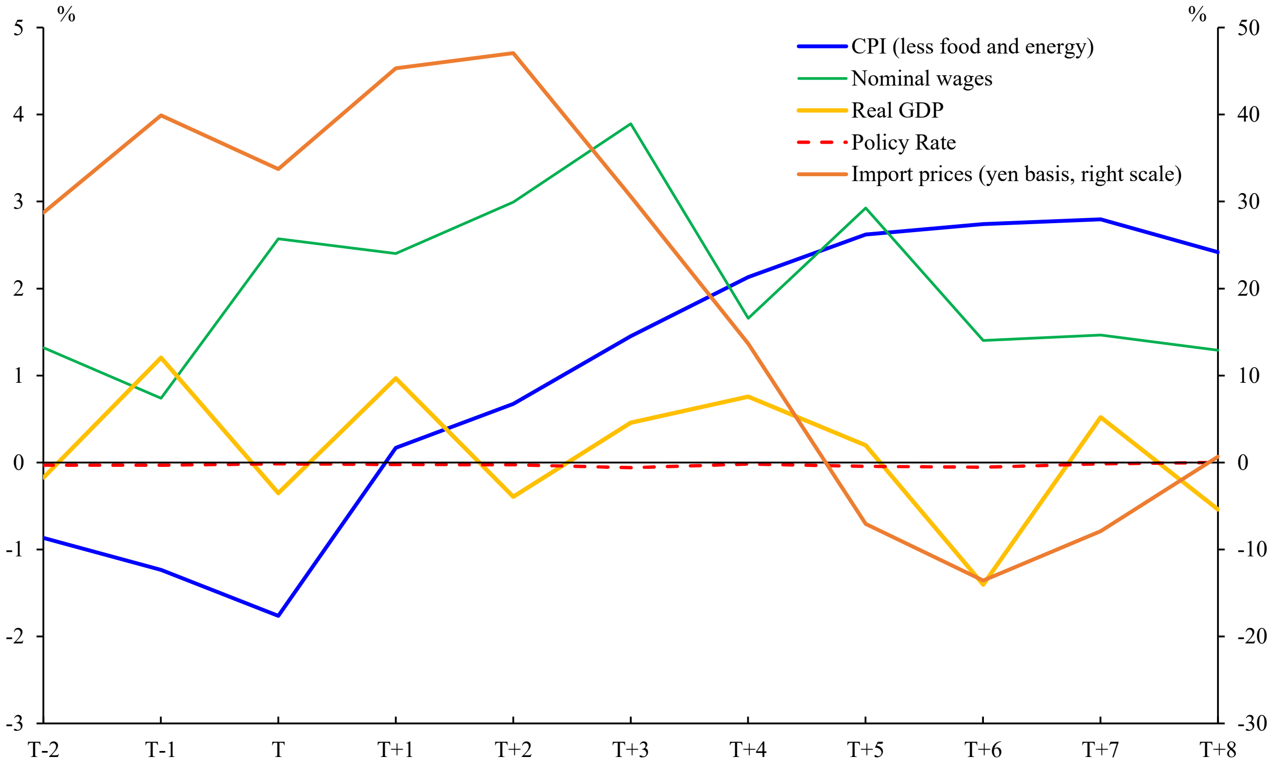
Note: Policy rate is the Official Discount Rate. Real GDP is expressed as quarter-on-quarter annualized growth rate; CPI, nominal wages, and import prices are year-on-year percent changes.
Sources: Bank of Japan; Cabinet Office; Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications.

The Oil Price Surge of the Mid-2000s (T=Q3:2005)



Note: Policy rate is the uncollateralized overnight call rate. Real GDP is expressed as quarter-on-quarter percent change; CPI and nominal wages are year-on-year percent changes.
Sources: Bank of Japan; Cabinet Office; Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications.

Russia's Invasion of Ukraine (T=Q1:2022)



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