November 12, 2026

Bank of Japan

Economic Activity, Prices, and Monetary Policy in Japan

Speech at a Meeting with Local Leaders in Nagasaki

ASADA Toichiro

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(English translation based on the Japanese original)

I. Current Situation and Outlook for Economic Activity and Prices

Economic Activity

The Bank of Japan assesses the current situation of Japan's economy as follows: "Japan's economy has recovered moderately, although some weakness has been seen in part, partly due to the impact of the situation in the Middle East." To elaborate on this point, I would like to examine several elements of the economy, starting with developments in overseas economies.

Regarding overseas economies, uncertainties heightened considerably in spring 2026, reflecting the situation in the Middle East, but since then, real economic activity has not seen a significant downward deviation on the whole (left panel of Chart 1). Against this backdrop, the Bank assesses that "overseas economies have grown moderately on the whole, although some weakness has been seen in part." Looking at international commodity prices, crude oil prices have been at fairly high levels, as the situation in the Middle East remains unclear, but they have fallen below their peak levels reached in April (right panel of Chart 1). On the other hand, copper prices have remained elevated, partly reflecting strong global AI-related demand.

Examining the trends in external demand for Japan's economy amid these overseas developments, the effective exchange rate of the yen has been on a depreciating trend recently (left panel of Chart 2). In this situation, exports have increased moderately (right panel of Chart 2). By type of goods, increased exports of IT-related goods and capital goods, reflecting solid global AI-related demand, have been the driving force of overall exports.

Corporate profits have been at high levels, supported by (1) the solid increase in global AI-related demand, (2) resilience in domestic demand, and (3) progress in the pass-through of cost increases to selling prices reflecting this resilience (left panel of Chart 3). Business sentiment has also been at a more favorable level (right panel of Chart 3). Reflecting solid corporate profits, business fixed investment has been on a moderate increasing trend, despite being affected by a rise in construction costs (left panel of Chart 4). Moreover, business fixed investment plans in the *Tankan* (Short-Term Economic Survey of Enterprises in Japan) have shown an overall solid increase in investment (right panel of Chart 4).

Moving on to consumption, the employment and income situation, which is important when assessing private consumption, has improved moderately. Labor market conditions have remained tight, as indicated by the unemployment rate being at a low level of around 2.5 percent (left panel of Chart 5). Under these circumstances, wages have continued to increase steadily, albeit with fluctuations (right panel of Chart 5). The year-on-year rate of increase in scheduled cash earnings has been at around 3 percent, as the wage growth rate in terms of the rate of base pay increases for 2026 turned out to be around the same level as in the previous year, as a result of the annual spring labor-management wage negotiations. Special cash earnings (bonuses etc.) have maintained their firm growth, as seen in summer bonuses for 2026 increasing from the previous year, supported by the high levels of corporate profits. In addition, the minimum wage had its second-largest increase on record this year. Moreover, the year-on-year rate of change in real wages has been positive since the turn of 2026, supported by the growth in nominal wages.

Private consumption has been resilient against the background of the improvement in the employment and income situation, despite the impact of factors such as price increases (Chart 6). Given recent data, however, I personally believe consumption has not necessarily been strong. The breakdown of real GDP for the April-June quarter of 2026 shows that private consumption has remained almost flat, although I understand that this is due to a number of institutional factors. Developments in the Consumption Activity Index (CAI) also suggest that it is appropriate to consider private consumption as being more or less flat. The Bank assesses private consumption as being resilient, and in this sense, I would not go so far as to say private consumption has been weak; however, I believe it is currently not so strong that it will be the driving force of Japan's economic growth as a whole.

Prices

Next, I would like to explain price developments. With the aforementioned rise in commodity prices since the turn of 2026, the year-on-year rate of change in Japan's import price index on a yen basis has been significantly positive, due to a rise in the rate of increase in the index on a contract currency basis -- reflecting the situation in the Middle East and global AI-related demand -- as well as to the impact of the yen's depreciation (left panel of Chart 7). The year-on-year rate of increase in the producer price index (PPI), which is based on corporate

transaction prices, has marked a high rate of around 7 percent, reflecting price increases in the upstream of the supply chain (right panel of Chart 7). The key issue is how fast and to what extent price rises in the upstream and midstream exert upward pressure on consumer prices in the downstream.

Let us look at developments in the consumer price index (CPI). Despite the effects of the government's measures to reduce the household burden of higher energy prices, the year-on-year rate of increase in the CPI for all items excluding fresh food has been at around 2 percent recently, as the effects of the rise in import prices have been emerging, with moves to pass on wage increases to selling prices continuing (left panel of Chart 8). The rate of increase in the CPI for all items excluding fresh food and energy has been at around 2.5 percent recently, despite slower growth in food prices that surged in the previous year. As another CPI figure published by the Bank, the rate of increase in the CPI for all items excluding fresh food and institutional factors -- such as the government's measures to reduce the household burden of higher energy prices and the provision of free education -- has been in the range of 3.0-3.5 percent (right panel of Chart 8).

Recent estimates of inflation levels differ noticeably depending on whether institutional factors are excluded or not. In terms of the relevance to real economic activity, while I believe it is important to examine price developments that consumers are actually facing, there is a certain degree of rationality in excluding institutional factors to capture the trend in consumer prices. Moreover, in considering the conduct of monetary policy, it is crucial to grasp developments in underlying inflation, which I will explain later in the section on monetary policy conduct.

Outlook and Risks

I would now like to discuss the outlook and risks for economic activity and prices.

Regarding the outlook for economic activity, economic growth is likely to slow somewhat in the near term in Japan, due to the rise in energy and raw material prices since early spring reflecting the impact of the situation in the Middle East. However, Japan's economy is expected to continue growing moderately, albeit at a decelerated rate, as the economy is likely

to be underpinned by, for example, the government's various measures -- such as those to reduce the household burden of higher energy prices -- and accommodative financial conditions, in addition to the increase in global AI-related demand. From 2027 onward, the economic growth rate is likely to rise moderately, since it is projected that the adverse effects of high energy and raw material prices will wane and that a virtuous cycle from income to spending will gradually intensify.

As for the outlook for prices, the year-on-year rate of increase in the CPI is likely to accelerate to a level clearly above 2 percent from the second half of fiscal 2026, mainly affected by the rise in energy prices to date, the increase in global AI-related demand, and the recent depreciation of the yen. Thereafter, with the waning of the effects of high crude oil prices, the rate of increase is expected to decline toward around 2 percent in the second half of the projection period of the October 2026 *Outlook for Economic Activity and Prices* (Outlook Report).

There are three major risk factors regarding the outlook for economic activity and prices: the impact of the situation in the Middle East, developments in AI-related demand, and the effects of developments in foreign exchange rates. Although the direction of each risk varies, the overall risk balance assessed in the October Outlook Report is that "risks to economic activity are generally balanced," while risks to the outlook for the CPI "are skewed to the upside."

Offering my own perspective on these risks, I believe it is necessary to pay attention to the possible effects of past policy interest rate hikes on real economic activity. While there are indeed several upside risks to prices, I consider that the extent to which the risk factors could actually push up prices is uncertain, and that it is also necessary to closely monitor the effects of policy rate hikes on prices through any downturns in real economic activity. I will address these points further in the next section on monetary policy conduct.

II. Conduct of Monetary Policy

Financial Conditions and Underlying Inflation

The Bank decided to raise the policy interest rate at its Monetary Policy Meetings (MPMs) held in June and September 2026, bringing the rate to 1.25 percent for the first time in around three decades (left panel of Chart 9).

In examining the effects of policy interest rate hikes on real economic activity, nominal interest rates show that bank lending rates and issuance yields for CP and corporate bonds have increased due to a rise in market interest rates, implying that the degree of accommodation in financial conditions has been reduced (right panel of Chart 9). On the other hand, real interest rates in the short-term zone -- which affect economic activity substantially -- have been negative; financial conditions thus still seem to be accommodative (left panel of Chart 10). Real interest rates in the medium- to long-term zone appear to have entered positive territory, but even under these circumstances, the diffusion index (DI) for firms' financial positions in the *Tankan* suggests that these positions have shown no deterioration so far and have remained at favorable levels (right panel of Chart 10). Nevertheless, together with the cumulative effects of policy interest rate hikes implemented to date, I believe it is necessary to closely monitor the effects of rate hikes on real economic activity, such as firms' financing conditions and household loans, since in my view it is likely to take one year or more for the impact of a rate hike to become clear.

Another important factor when considering monetary policy is the trend in prices. In this regard, medium- to long-term inflation expectations are at around 2 percent, and underlying CPI inflation is at a level that is generally consistent with the price stability target of 2 percent (Chart 11). The October 2026 Outlook Report points out the following: "When the Bank was in the process of raising underlying CPI inflation toward 2 percent, downside risks to prices warranted considerable attention. However, there has recently been a shift in the phase of monetary policy, and looking ahead, it is necessary to pay due attention to keep the risk of underlying CPI inflation deviating upward to a level above the price stability target of 2 percent from materializing and thereby exerting an adverse impact on the economy afterward" (Chart 12).

In light of these developments, the Outlook Report states that it is appropriate to 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. With these points in mind, I would now like to present my views on monetary policy.

My Views on the Conduct of Monetary Policy

At the June and September MPMs mentioned earlier, I voted against raising the policy interest rate. The reason is that, as noted in the statements released after the meetings, with the inflation rate being below 2 percent recently, I considered that it could not necessarily be said that the economic situation was strong, and it was therefore desirable for the Bank to maintain the policy rate level. At the July and October MPMs, I voted for keeping the policy rate unchanged.

Let me explain the background to my position. According to standard macroeconomic theory, the rationale for raising the policy interest rate to address actual price rises or the risk of rising prices is that higher interest rates exert downward pressure on consumption and investment, thereby reducing upward pressure on prices. In light of this, I believe that a key issue for the decision whether to raise the policy interest rate depends on which should be given greater weight: the impact on the economy of inflation expected in the future, or the downside impact on the economy of the rate hike.

Regarding the impact of policy rate hikes on the economy, downside risks may not be particularly large when financial conditions are extremely accommodative, since they will likely remain accommodative even after a policy rate hike. On the other hand, it should be noted that downside risks to the economy posed by a policy rate hike will gradually increase if the continued rate hikes have tightened financial conditions or have reduced the degree of accommodation.

The neutral interest rate is an indicator used to assess whether the current level of interest rates is accommodative or not. The Bank estimates that the natural rate of interest is currently around slightly above minus 1 percent to plus 0.5 percent. The neutral interest rate -- which is calculated by adding the expected rate of inflation to the natural rate of interest -- is

therefore estimated to be around slightly above 1 percent to 2.5 percent. While the estimated range is quite broad, the policy interest rate is already within this range. Given this, although financial conditions have been accommodative, the degree of accommodation seems to be gradually diminishing. In other words, policy interest rate hikes are now becoming more likely to have a larger impact on real economic activity than when the Bank began to raise the policy rate, which was clearly below the neutral interest rate. Considering in particular that, as I mentioned earlier, real economic activity -- especially private consumption -- has not necessarily been strong recently, I believe due attention should be paid to the risk that policy rate hikes will slow the economy and thereby push down underlying inflation.

Turning to the upside risks to prices, I believe that, as stated in the October 2026 Outlook Report, it is necessary to be attentive to the risk of adverse effects on Japan's economy if underlying inflation rises above 2 percent. On the other hand, I think that consumer prices, and ultimately underlying inflation, are subject to downside risks if the past and any future policy interest rate hikes lead to a deterioration in real economic activity. As the year-on-year rate of increase in consumer prices that households are actually facing has accelerated gradually but, partly due to the effects of government policies, is currently at around 2 percent, I consider it better to carefully assess developments in actual consumer prices before judging how far prices may rise and how likely it is that underlying inflation will in turn rise beyond 2 percent.

Based on these points, if the Bank is to raise the policy interest rate further, it will likely be under circumstances where higher wages spur demand-driven inflation and the mechanism in which wages and prices rise moderately in interaction with each other is thereby operating to a greater degree. In this regard, I consider it desirable that the year-on-year rate of change in real wages has remained positive since the turn of 2026, supported by substantial base pay increases for three consecutive years and by rising bonuses. However, with economic activity -- particularly private consumption -- not showing strong momentum for growth, I believe that the recent price increases have not necessarily been driven by demand factors. In this sense, I consider it necessary for the Bank to give due consideration to the pace of any policy rate hikes.

Change in the Pace of Sales of Exchange-Traded Funds

In closing, I would like to talk about the Bank's sales of exchange-traded funds (ETFs).

At the September 2025 MPM, the Bank decided to begin selling its holdings of ETFs, and has proceeded with the sales since January 2026. So far, it has been conducting these sales smoothly while avoiding a major impact on the market, and the trading value in the stock market has been expanding. Given these developments, the Bank decided at the October 2026 MPM to change the annual pace of sales, increasing the scale from about 0.05 percent to about 0.1 percent of the trading value in the market.

As a result, the pace of sales will increase from 330 billion yen per year to 860 billion yen per year, and the time required to complete the sales will shorten from 112 years to about 43 years. Nevertheless, the framework will remain the same in that a temporary adjustment in the sales amount or a suspension of sales may be made within the range of the annual pace of sales in response to changes in financial market conditions.

Thank you.

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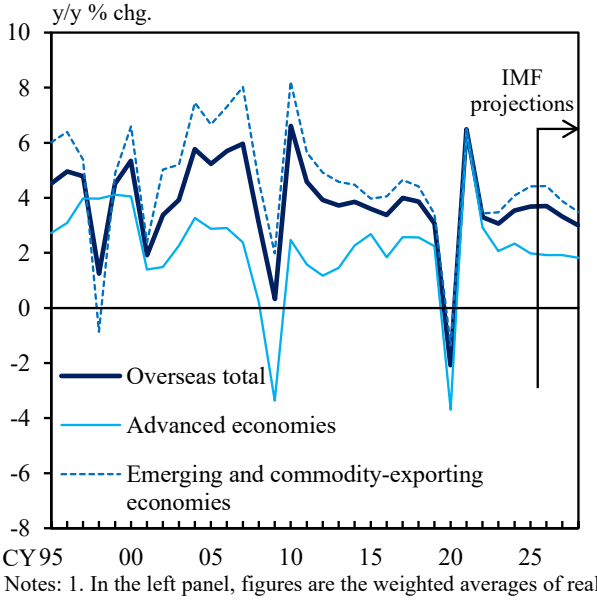
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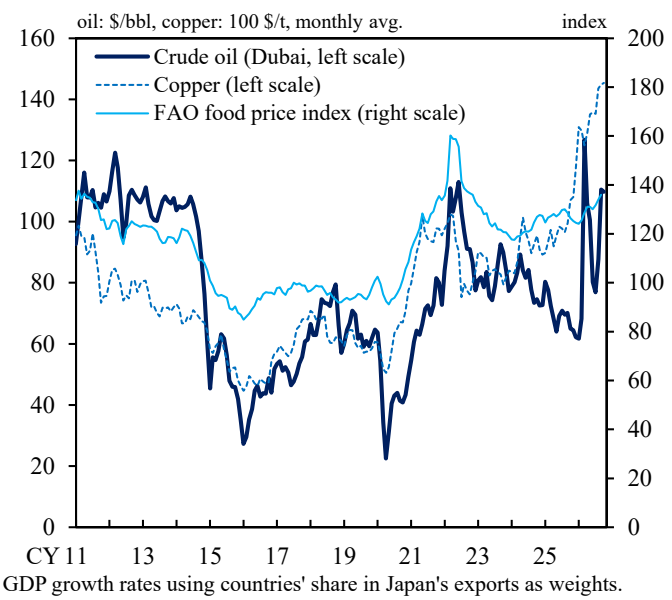
Chart 1

Overseas Economies and Commodity Prices

Overseas Economies



International Commodity Prices



Notes: 1. In the left panel, figures are the weighted averages of real GDP growth rates using countries' share in Japan's exports as weights. The real GDP growth rates are compiled by the IMF, and the rates from 2026 onward are its projections in the October 2026 *World Economic Outlook* (WEO). Figures for advanced economies are those for the United States, the euro area, and the United Kingdom. Figures for emerging and commodity-exporting economies are those for the rest of the world.

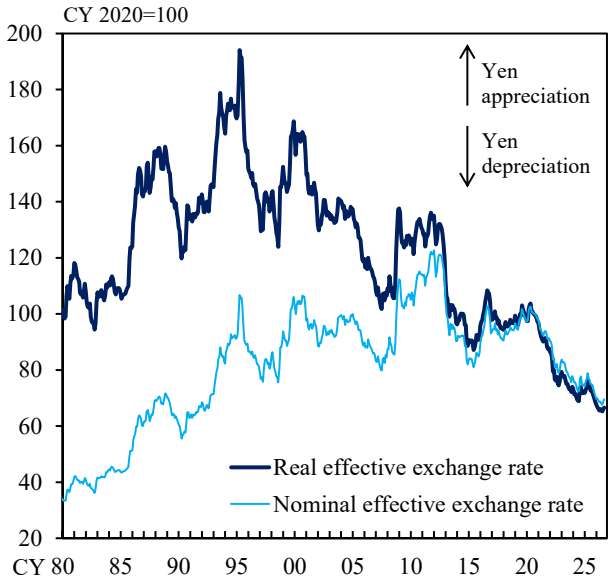
2. In the right panel, the FAO food price index is a price index comprising meat, dairy, cereals, vegetable oils, and sugar (CY 2014-2016 average=100).

Sources: Bloomberg; FAO; IMF; Ministry of Finance; Nikkei Inc.

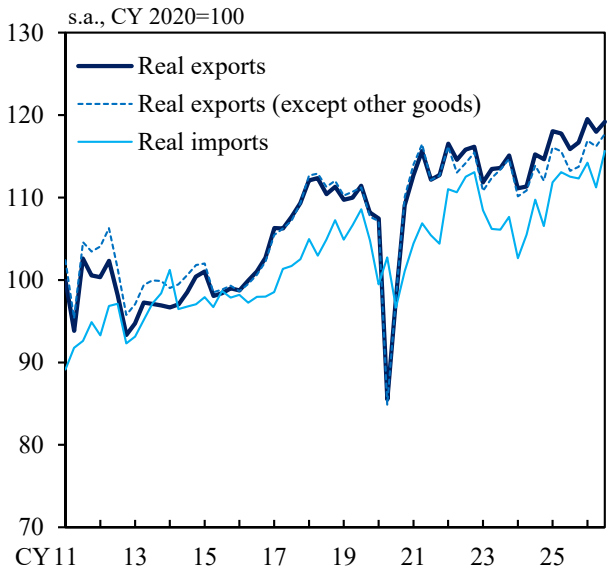
Chart 2

Exports and Imports

Effective Exchange Rates



Real Exports and Imports

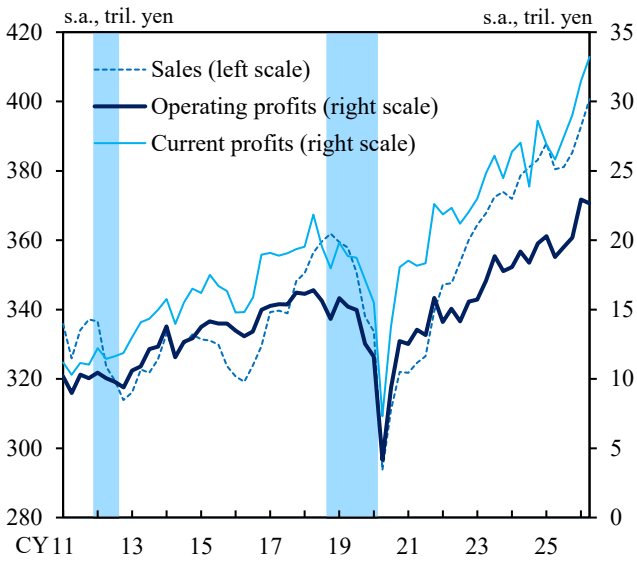


Notes: 1. In the left panel, figures are based on the broad effective exchange rate indices. Figures prior to 1994 are calculated using the narrow indices.
2. In the right panel, figures are based on Bank staff calculations. "Other goods" includes gold and re-export goods.
Sources: BIS; Ministry of Finance; Bank of Japan.

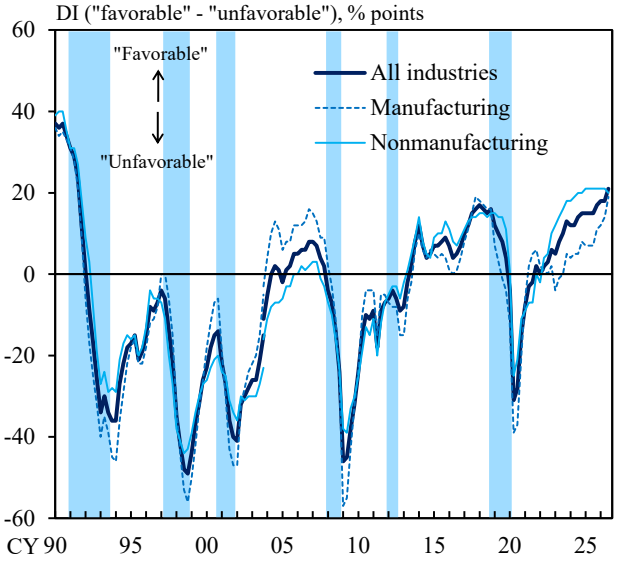
Chart 3

Corporate Sector

Sales and Profits



Business Conditions

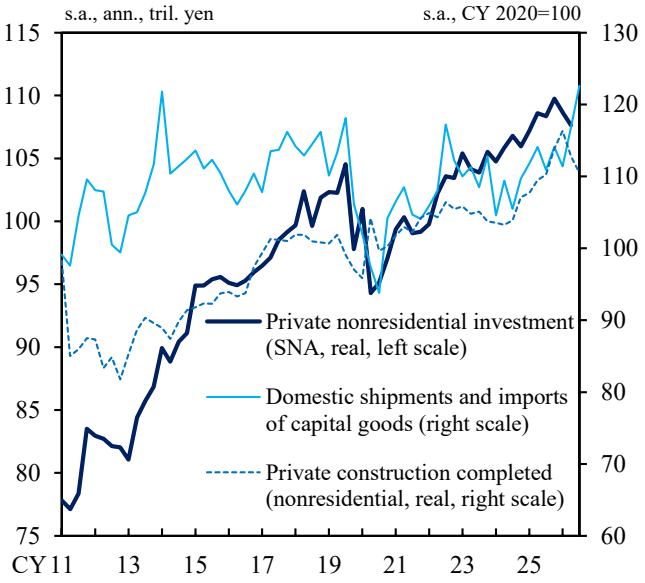


Notes: 1. In the left panel, figures are based on the *Financial Statements Statistics of Corporations by Industry, Quarterly*, and exclude "finance and insurance" and "pure holding companies."
2. In the right panel, figures are based on the *Tankan* and for all enterprises. There is a discontinuity in the data for December 2003 due to a change in the survey framework.
3. In both panels, shaded areas denote recession periods.
Sources: Ministry of Finance; Bank of Japan.

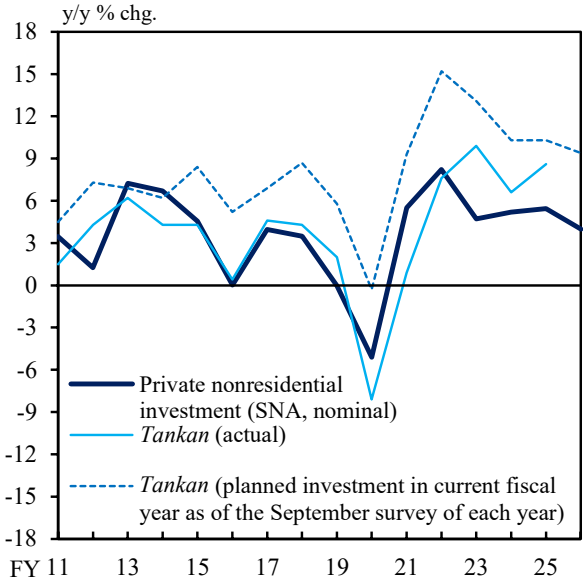
Chart 4

Business Fixed Investment

Coincident Indicators



Planned and Actual Investment

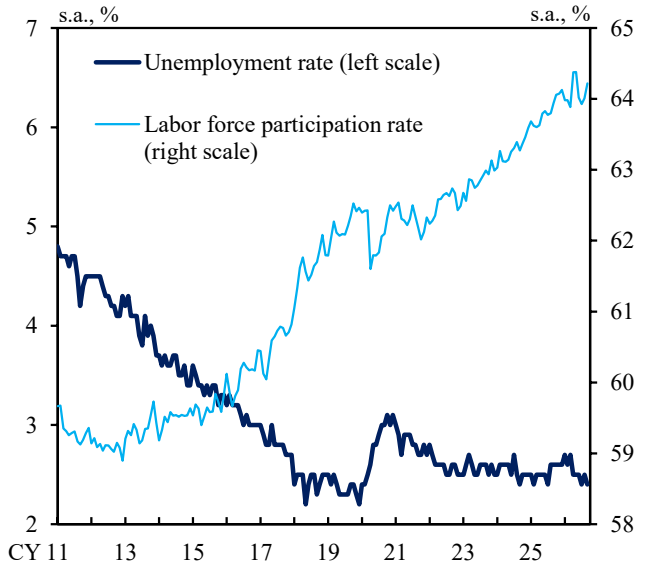


Notes: 1. In the left panel, figures for real private construction completed are based on Bank staff calculations using the construction cost deflators, and the figure for 2026/Q3 is the July-August average.
2. In the right panel, the *Tankan* figures include software and R&D investments and exclude land purchasing expenses. R&D investment is not included before the March 2017 survey. The figures are for all industries including financial institutions.
Sources: Cabinet Office; Ministry of Economy, Trade and Industry; Ministry of Land, Infrastructure, Transport and Tourism; Bank of Japan.

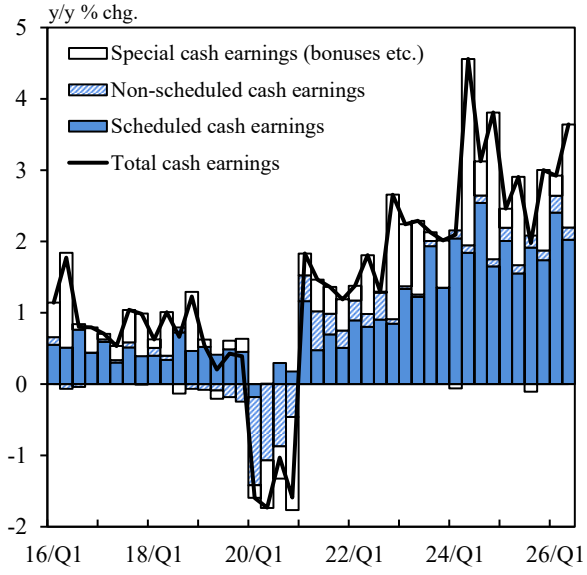
Chart 5

Employment and Income Situation

Unemployment Rate and Labor Force Participation Rate



Nominal Wages

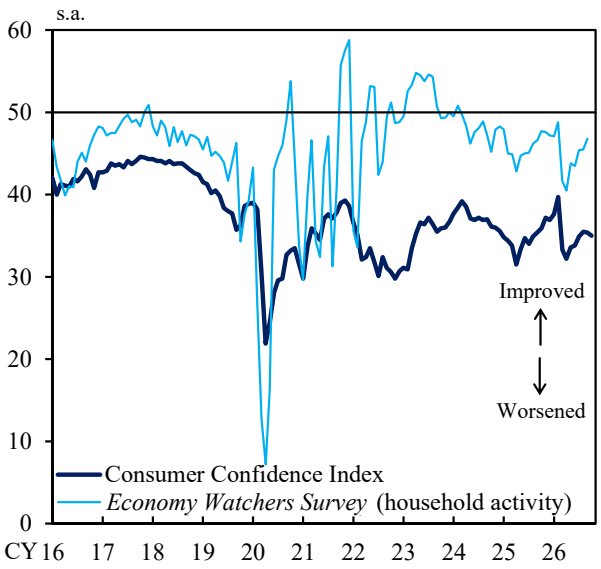


Note: In the right panel, figures are based on continuing observations following the sample revisions.
Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.
Sources: Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications.

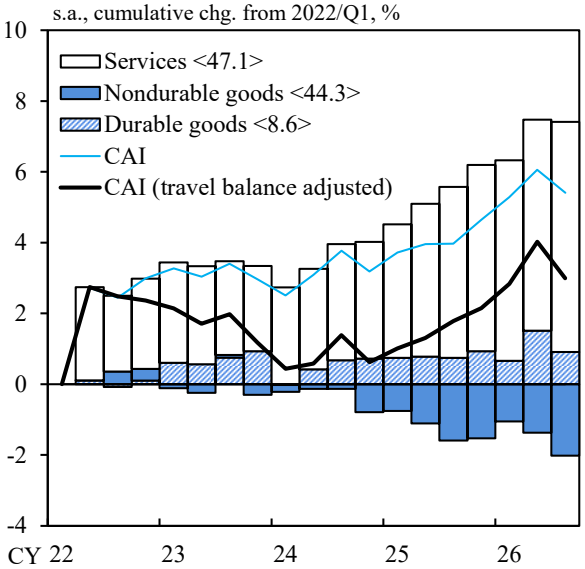
Chart 6

Private Consumption

Confidence Indicators



Consumption Activity Index (CAI, Real)



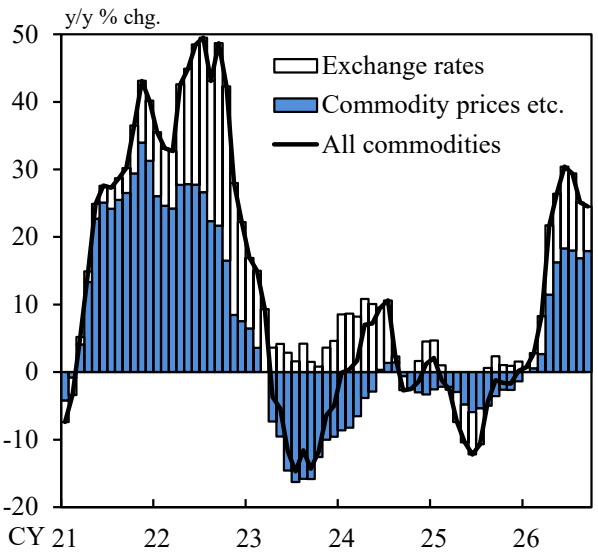
Notes: 1. In the left panel, figures for the *Economy Watchers Survey* are those for the current economic conditions DI.
2. In the right panel, figures are based on Bank staff calculations. Figures for the CAI (travel balance adjusted) exclude inbound tourism consumption and include outbound tourism consumption. "Nondurable goods" includes goods classified as semi-durable goods in the SNA. Figures in angle brackets show the weights in the CAI. Figures for 2026/Q3 are July-August averages.

Sources: Cabinet Office; Bank of Japan; etc.

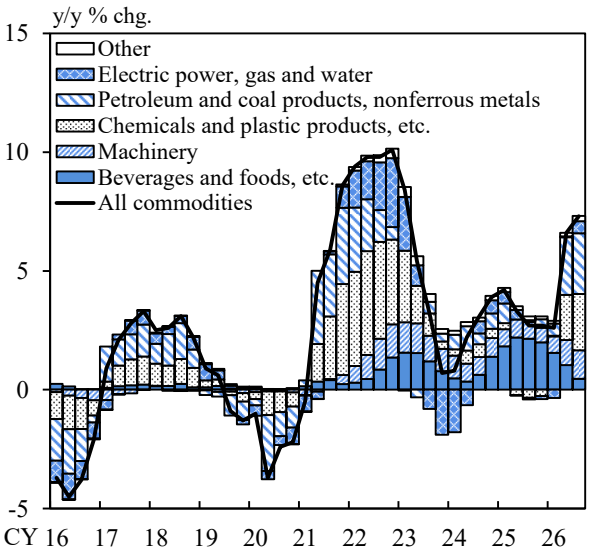
Chart 7

Current Situation of Prices (1)

Import Prices (Yen Basis)



Producer Price Index



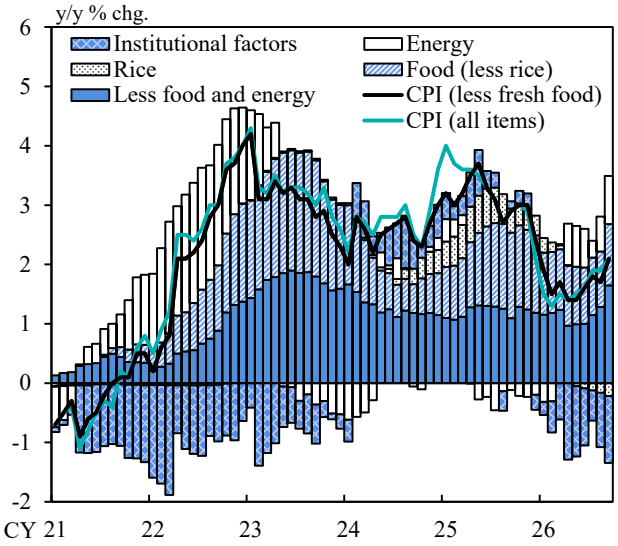
Notes: 1. In the left panel, the contribution of changes in commodity prices etc. is calculated using changes in the import price index on a contract currency basis. The contribution of changes in exchange rates is calculated using the difference between the import price index on a yen basis and that on a contract currency basis.
2. In the right panel, figures exclude the effects of the consumption tax rate change. Figures for "beverages and foods, etc." include agriculture, forestry and fishery products.

Source: Bank of Japan.

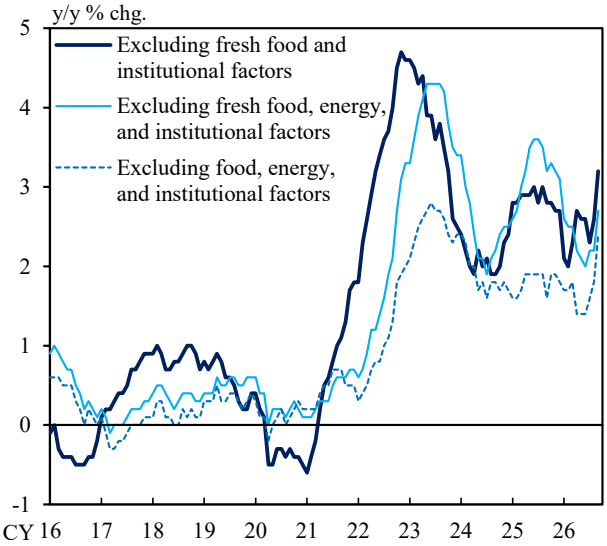
Chart 8

Current Situation of Prices (2)

CPI (Less Fresh Food)



CPI Excluding Institutional Factors



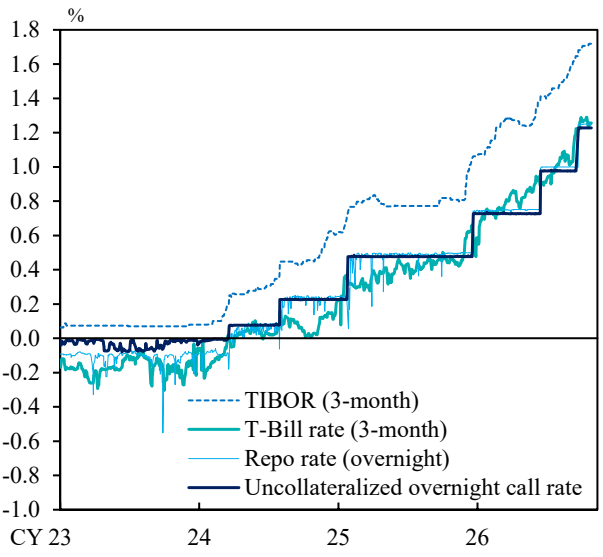
Notes: 1. In the left panel, figures for energy consist of those for petroleum products, electricity, and gas, manufactured & piped. Figures for food (less rice) exclude fresh food and alcoholic beverages.
2. In both panels, institutional factors = the effects of the consumption tax rate change and policies concerning the provision of free education (including the free school lunches starting in April 2026) + measures to reduce the energy cost burden (such as gasoline prices, electricity charges, and gas charges) + the reduction in mobile phone charges in 2021 + travel subsidy programs. Figures are Bank staff estimates.

Sources: Ministry of Internal Affairs and Communications; Bank of Japan; etc.

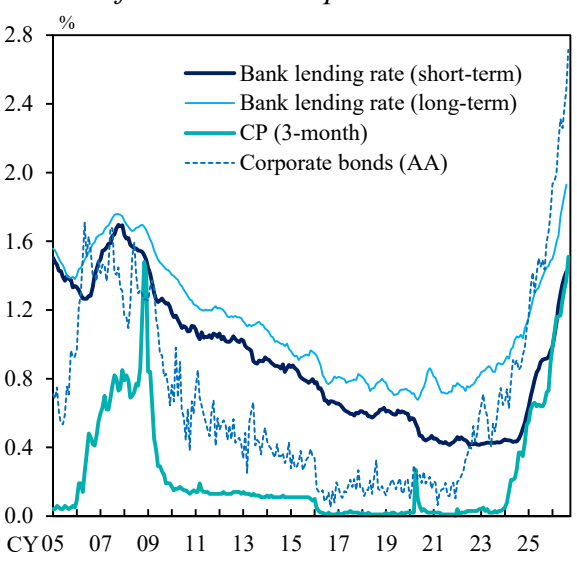
Chart 9

Financial Conditions (1)

Short-Term Interest Rates



Bank Lending Rates and Issuance Yields for CP and Corporate Bonds



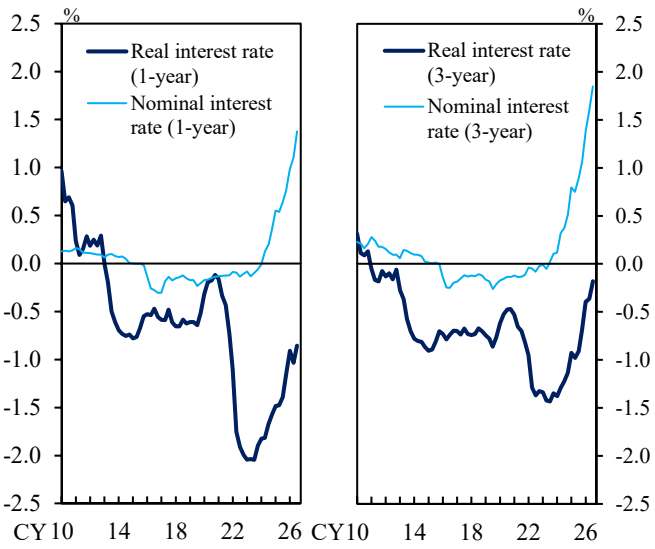
Notes: 1. In the left panel, figures for the repo rate are the *Tokyo Repo Rate*.
2. In the right panel, figures for issuance yields for CP up through September 2009 are the averages for CP (3-month, rated a-1 or higher). Those from October 2009 onward are the averages for CP (3-month, rated a-1). Figures for issuance yields for corporate bonds are the averages for domestically issued bonds launched on a particular date. Bonds issued by banks and securities companies, etc. are excluded. Figures for bank lending rates are 6-month backward moving averages.

Sources: Bloomberg; Capital Eye; I-N Information Systems; Japan Securities Depository Center; JBA TIBOR Administration; Bank of Japan.

Chart 10

Financial Conditions (2)

Real Interest Rate



Firms' Financial Positions



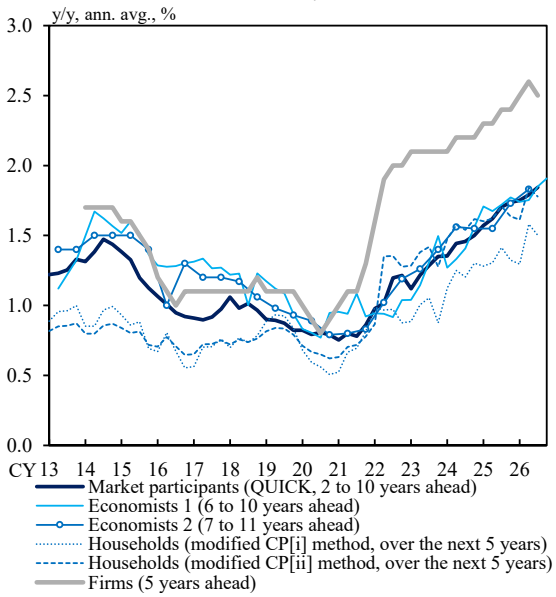
Notes: 1. In the left two panels, figures for real interest rates are calculated as nominal government bond yields minus the composite index of inflation expectations (Bank staff estimates) for the corresponding maturity.
2. In the right panel, figures are based on the *Tankan* and are for all industries. There is a discontinuity in the data for December 2003 due to a change in the survey framework.

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

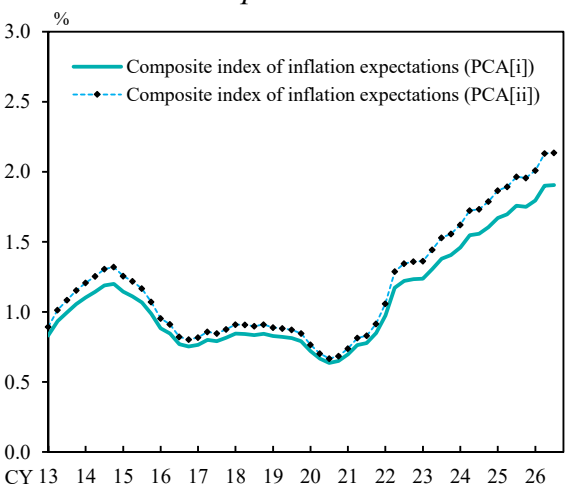
Chart 11

Inflation Expectations

Survey



Composite Indexes



Notes: 1. For details, see Bank of Japan, Monetary Affairs Department, "The Concept and Measurement of Underlying Inflation," *Bank of Japan Review Series*, no. 26-E-5 (March 2026).
2. In the left panel, figures for households (modified CP[i] method) are from the *Opinion Survey on the General Public's Views and Behavior*, estimated using the modified Carlson-Parkin method for a five-choice qualitative question. The modified CP[ii] method additionally accounts for time variation in the distribution of responses.
3. In the right panel, the composite indexes of inflation expectations are Bank staff estimates and are obtained by extracting the common component, using principal component analysis (PCA), from the inflation expectations of households (modified CP[ii] method), firms, and experts.

Sources: Bloomberg; Consensus Economics Inc., *Consensus Forecasts*; JCER, *ESP Forecast*; QUICK, *QUICK Monthly Market Survey <Bonds>*; Bank of Japan.

Outlook Report (October 2026)

<Baseline Scenario of the Outlook for Economic Activity and Prices>

Economic Activity

FY 2026
Continue growing moderately, albeit at a decelerated rate
(↓) rise in energy and raw material prices since early spring
(↑) AI-related demand, wage increase, government's measures, etc.

FY 2027 onward
Economic growth rate is likely to rise moderately
(↑) waning adverse effects of high energy and raw material prices
(↑) intensified virtuous cycle from income to spending

Prices (less fresh food)

In the first half of the projection period
Accelerate to a level clearly above 2 percent
(↑) rise in crude oil prices, rise in the prices of semiconductors and other items, depreciation of the yen

In the second half of the projection period
Decline toward around 2 percent
(↓) waning effects of high crude oil prices

Underlying CPI inflation is at a level that is generally consistent with the price stability target of 2 percent, and is expected to remain at around that level

- With a sense of labor shortage continuing to be strong, the mechanism in which wages and prices rise moderately in interaction with each other has been operating
- Medium- to long-term inflation expectations are at around 2 percent

<Policy Board Members' Forecasts>

y/y % chg., medians of forecasts

	FY 2026	2027	2028
Real GDP	0.7 (+0.1)	0.7 (-0.1)	0.8 (-)
CPI (less fresh food)	2.5 (-)	2.6 (+0.2)	2.0 (-)
CPI (less fresh food and energy)	2.4 (-0.1)	2.7 (+0.1)	2.3 (+0.1)

Note: Figures in parentheses indicate changes from the July 2026 Outlook Report. Figures do not take into account the impact stemming from the proposed reduction in the consumption tax on food and beverages.

<Risks to Economic Activity and Prices>

Risks
The situation in the Middle East, developments in AI-related demand, developments in foreign exchange rates, etc.

Risk Balance
- ✓ Economic activity: generally balanced
- ✓ Prices: skewed to the upside
- ✓ **There is a risk that** medium- to long-term inflation expectations will rise and **underlying CPI inflation will deviate upward to a level above the price stability target of 2 percent**, given that firms' behavior has been shifting more toward raising wages and prices and there are various factors that could drive up prices.