

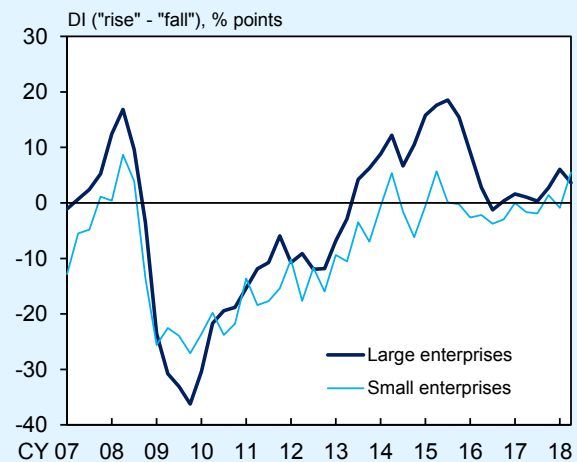
(Box 3) Firms' Cautious Price-Setting Stance

Even though input prices have been rising and labor costs have been increasing moderately but steadily, the rate of increase in the CPI has remained relatively moderate. This is likely because, in a situation where households' tolerance toward price rises has not been increasing easily (Box 2), firms are maintaining their cautious stance toward raising prices for fear of losing customers, mainly in sectors related to consumption.

In fact, the composite output prices DI consisting of "retailing," "services for individuals," and "accommodations, eating and drinking services," which are closely linked to household consumption, has been more or less flat over the past few years (Chart B3-1). Partly against this background, looking at a histogram depicting year-on-year rates of change in the prices of individual items making up the CPI shows that the mode continues to be at 0 percent (Chart B3-2). This differs from the United States and Germany, suggesting that the price-setting stance of Japanese firms remains cautious (Chart B3-3).

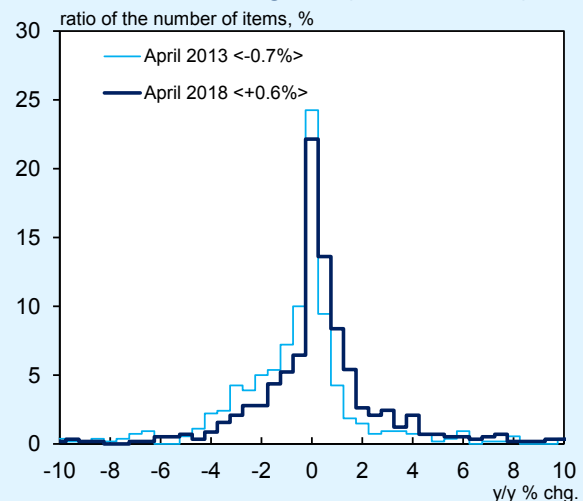
Why is firms' price-setting stance so cautious? Looking at the results of a survey of firms conducted in 2013, the reasons why firms do not pass on cost increases to sales prices include that they put priority on their long-term relationships with business partners and consumers, that competitors are not raising prices, and their fear that doing so would lead to a reduction in sales volume (Chart B3-4). Similar

Chart B3-1: Output Prices in Consumption-Related Sectors



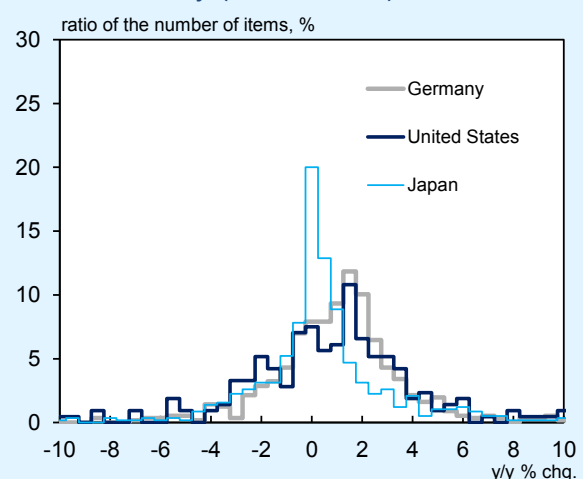
Source: Bank of Japan.
 Note: Based on the *Tankan*. Calculated as the weighted average of the DI for changes in output prices in "retailing," "services for individuals," and "accommodations, eating & drinking services." The number of reporting enterprises is used as weights.

Chart B3-2: Histogram (CPI all items)



Source: Ministry of Internal Affairs and Communications.
 Note: Figures in angular brackets show year-on-year rates of change in the CPI (all items).

Chart B3-3: Comparison of Japan, the U.S., and Germany (March 2018)



Sources: Ministry of Internal Affairs and Communications; BLS; Destatis.

views were voiced in interviews with firms recently conducted by the Bank's Head Office, branches, and local offices, indicating that many firms continue to be cautious about raising their prices (Chart B3-5).

However, amid this situation, firms' stance seems to be shifting gradually toward further raising prices. In fact, the aforementioned output prices DI has been rising recently (Chart B3-1). Moreover, compared to 2013, the histogram of the rate of change in the prices of individual items has shifted to the right (Chart B3-2). Interviews with firms also indicate that there are a number of cases where firms successfully raised prices (Chart B3-5).

Chart B3-4: Reasons for Not Passing On Cost Increases to Sales Prices



Source: Cabinet Office (2013), "Annual Report on the Japanese Economy and Public Finance 2013."
 Note: Based on a survey of 3,030 listed and 2,970 non-listed firms conducted by the Cabinet Office (2013).

Chart B3-5: Interview Responses by Firms (The Bank's Regional Economic Report)

- Since competitors have recently intensified their price-cutting strategies, we may also cut sales prices further in the future (a supermarket in Sendai).
- Since drugstores are expanding their lineup of food items, competition in the retail sector is intensifying. As a result, our sales are not good and it is difficult to raise sales prices (a supermarket in Nagoya).
- Consumers have a deep-rooted cost-saving mentality and we are losing customers to low-price retail businesses such as drugstores and online retailers (a supermarket in Kyoto).
- We are feeling the threat of other types of retail businesses that have intensified their price-cutting strategies at the expense of profits, and thus we have cut the sales prices of several hundred items, especially private-brand products (a supermarket in Hiroshima).
- With the number of dual-income households increasing, the demand for ready-made meals is growing as households need to save time on domestic chores. Against this background, we have raised our sales prices by about 10 percent and revised our selection of products, mainly of box meals and delicatessens. Our sales have remained good even after the price increases (a supermarket in Nagasaki).
- Given the rising cost of food ingredients such as beef and the increase in personnel expenses both for full-time and part-time workers, we have raised sales prices this year. Due to the firm demand for dining-out services, however, the number of customers has not changed very much, and our sales have increased (an eating/drinking establishment in Osaka).
- Since the occupancy rate of our hotel has remained high due to an increase in the number of foreign guests, we have gradually raised the rates we charge (a hotel in Okayama).

Source: Bank of Japan.
 Notes: 1. Extracted from the July 2018 *Regional Economic Report*.
 2. The parentheses show the industry of the interviewee and the Bank branch.