February 8, 2024

Bank of Japan

Japan's Economy and Monetary Policy

Speech at a Meeting with Local Leaders in Nara

UCHIDA Shinichi

Deputy Governor of the Bank of Japan

(English translation based on the Japanese original)

Introduction

It is my pleasure to have the opportunity today to exchange views with leaders in administrative, economic, and financial areas in Nara Prefecture. I would like to take this chance to express my sincere gratitude for your cooperation with the activities of the Bank of Japan. Before hearing from you, I will explain Japan's economic activity and prices, as well as the Bank's conduct of monetary policy.

I. Economic Developments

I would like to first express my sorrow for the lives lost in the Noto Peninsula Earthquake and extend my condolences to all those affected. I hope that restoration and reconstruction will progress as swiftly as possible. Regarding the economic impact of the earthquake, in terms of production, many factories were damaged, but thanks to the efforts of people on the ground, a growing number of these are resuming operations. There are many factors that continue to warrant close attention, including the impact on local tourism and consumer sentiment. The Bank will do its utmost to maintain financial functioning and ensure smooth settlement of funds, while closely monitoring the local situation through its Head Office, branches, and local offices, including the Kanazawa Branch.

Let me start with Chart 1. Japan's economy has recovered moderately. It is expected to grow at a pace above its potential growth rate, with the projected growth rates being at 1.8 percent for fiscal 2023, 1.2 percent for fiscal 2024, and 1.0 percent for fiscal 2025.

Looking at Chart 2, corporate profits have been at record-high levels for both large firms and small and medium-sized firms. In this situation, business fixed investment plans indicate that the year-on-year rate of increase in investment will be 12 percent for fiscal 2023, mainly led by investment to address labor shortages, that related to decarbonization, and digital-related investment.

Meanwhile, although the pace of recovery in overseas economies has slowed, they are projected to grow moderately, albeit with variation across countries and regions. Turning to Chart 3, in the United States, the inflation rate has declined to around 3 percent without being accompanied by a significant economic slowdown, and a soft landing scenario has become the prevailing view in the market. While it is necessary to stay vigilant, since it will still take time for the inflation rate to drop to the 2 percent goal, I think that the trade-off between economic growth and inflation has eased, somewhat increasing the flexibility of monetary policy. The Chinese economy is facing adjustment pressure in the labor and real estate markets. Meanwhile, it has large room for monetary and fiscal policy, and attention is warranted on whether the economy can use such policy room to make necessary adjustments and achieve stable growth.

Chart 4 presents developments in the household sector in Japan. Employee income has risen, mainly due to an increase in nominal wages, but it has not caught up with price rises. As for private consumption, consumption of services (red line) such as travel and dining-out has increased, supported by pent-up demand, i.e., demand that had been suppressed during the pandemic. On the other hand, with regard to food products and daily necessities, which have seen large price increases, households' defensive attitudes toward spending have been observed, such as a shift toward inexpensive products. This has led to a decline in nondurable goods (green line). The pace of increase in overall private consumption (blue line) is currently moderate. In terms of its outlook, given that pent-up demand is projected to gradually wane, a major key lies in improvement in household income stemming from wage hikes.

II. Wage and Price Situation

Current Situation of and Outlook for Prices

I would now like to talk about wages and prices while referring to Chart 5. The year-on-year rate of increase in the consumer price index (CPI) for all items less fresh food was 2.3 percent for December last year. Looking at the breakdown, the contribution of energy (white bars) has been negative, mainly due to the government's measures to reduce the household burden of higher energy prices. The positive contributions of food products (light blue bars) and other goods (dark blue bars) have decreased as the pass-through of cost increases has peaked out. On the other hand, the contribution of services (pink bars) has been on a moderate uptrend. Although this is largely attributable to the rise in hotel charges driven by inbound tourism demand, prices of other services have also gradually started to rise.

As for the outlook, it is projected that, while the pass-through of cost increases will continue to wane, prices such as of services will rise, accompanied by wage increases. Through fiscal 2025, underlying inflation is likely to increase gradually toward 2 percent, supported by a virtuous cycle between wages and prices. With such a switching of the main driving force, the year-on-year rate of change in the CPI for all items less fresh food is likely to be 2.8 percent for fiscal 2023 and thereafter is projected to be at around 2 percent; specifically, 2.4 percent for fiscal 2024 and 1.8 percent for fiscal 2025.

Virtuous Cycle between Wages and Prices

In order to realize this outlook, the virtuous cycle needs to intensify in both directions, from prices to wages and from wages to prices. As for the first direction, the question is whether wages will rise in line with an increase in prices. On this score, in terms of the macroeconomic environment, Japan has seen more favorable developments than last year. As I mentioned earlier, corporate profits have been at high levels and, as shown in Chart 6, labor shortages have become increasingly acute. As a reference inflation rate, the CPI figure for the previous year on a calendar-year basis is available at the time of the annual spring labor-management wage negotiations. The rate of increase in the CPI was 2.5 percent for 2022 and was higher for 2023, at 3.2 percent.

At the meeting of general managers of the Bank's branches held last month, a number of managers reported that moves by firms to implement wage hikes have been gaining momentum earlier than last year. Still, there remain uncertainties on this front, as many firms are of the stance that, in determining the specific extent of wage hikes, they will take account of factors such as the situation for their competitors. The views of firms in each region are summarized in the January 2024 *Regional Economic Report* released on the day of the meeting. The Bank will continue to gather information through its nationwide network consisting of the Head Office, branches, and local offices. Moreover, developments in the annual spring labor-management wage negotiations will become clear in due course also in the form of actual figures. The Bank will carefully examine developments in wage hikes, including the points just mentioned.

The second direction concerns whether firms will reflect wage increases in their selling prices. As Chart 7 shows, although figures for firms' outlook for selling prices for one year ahead have declined as raw material costs have started to come down, those for five years ahead have remained at relatively high levels. It appears that, when setting selling prices, firms will factor in their expectation that labor costs will continue to rise. Moreover, the CPI, developments of which I explained earlier, shows that services prices have increased moderately recently.

On the other hand, firms reported that, unlike raw material costs, labor cost increases are difficult to pass on to selling prices. I think it is true that many firms are facing that kind of challenging situation. That said, corporate profits being at high levels and data on labor share suggest that, at least from a macroeconomic perspective, there has been some degree of labor cost pass-through. The labor share of firms has declined recently, including for small firms. If firms had been unable to pass on last spring's wage increases to prices at all, their profits would have contracted and the labor share would have increased. I think that this indicates the possibility that the situation varies among firms and the importance of appropriate cost pass-through in business-to-business transactions.

On this second direction, there is no event that can be an indicator comparable to the annual spring labor-management wage negotiations. However, the Bank will make a comprehensive judgment based on factors such as price developments, mainly for services prices, and developments in private consumption that support them. In addition, the reports from branch managers gave me the impression that industries and firms that have been able to pass on wage increases to prices have tended to raise wages more. Although that may seem obvious, it shows that progress in the first direction and that in the second are two sides of the same coin. Keeping this perspective in mind, I would like to examine these two directions alongside one another.

III. The Bank's Conduct of Monetary Policy

Next, I will explain the Bank's conduct of monetary policy. Please take a look at Chart 8. For the past two years or so, the year-on-year rate of increase in the CPI has been above the Bank's 2 percent target. However, this is mainly due to cost-push factors from overseas, which is not a desirable situation. The Bank aims to achieve the 2 percent target in a sustainable and stable manner, accompanied by wage increases. To this end, it has continued with large-scale monetary easing by setting the short-term policy interest rate at minus 0.1 percent and pushing long-term interest rates down to low levels under the framework of yield curve control.

In the outlook I described earlier, it is expected that the year-on-year rates of increase in the CPI both for all items less fresh food and for all items less fresh food and energy will be at around 2 percent through fiscal 2025. This is based on the projection that Japan's economy will continue recovering moderately and the virtuous cycle between wages and prices will intensify. In other words, the 2 percent target is expected to be achieved in a desirable manner accompanied by wage increases. The likelihood of realizing this outlook has been gradually rising, although there remain high uncertainties over future developments.

Going forward, the Bank will monitor developments in the virtuous cycle between wages and prices by carefully examining various data and information. On this basis, if sustainable and stable achievement of the 2 percent target comes in sight, the large-scale monetary easing will have fulfilled its role and the Bank will explore whether it should be revised. Given that this large-scale easing has been in place for more than 10 years, regardless of the timing of policy revision, the Bank needs to devise both communication and market operations so as not to create discontinuity in financial markets before and after the revision. From this perspective, it is important for the Bank to explain its basic thinking on potential revisions to individual measures, as far as is possible. In what follows, I would like to share what I can say at this point regarding questions that have often been asked by economists and journalists recently.

Policy Interest Rate

The first question is how to set the short-term policy interest rate if the Bank terminates its negative interest rate policy. Before introducing this policy, the Bank applied a 0.1 percent interest rate to the excess reserves in current accounts held by financial institutions at the Bank. The uncollateralized call rate in the money market hovered in the range of 0 to 0.1 percent as a result of arbitrage transactions between financial institutions that held the accounts and those who did not. If the Bank were to bring this situation back, this would mean a 0.1 percentage point interest rate hike, since the current uncollateralized call rate is in the range of minus 0.1 to 0 percent. Let me point out that this issue is associated primarily with how to maintain the functioning of the money market.

With respect to the impact on the economy, a more critical issue is the subsequent path of the short-term policy interest rate. The Bank's basic thinking is to examine the current situation of and outlook for economic activity and prices, and then set the policy interest rate at an appropriate level so that CPI inflation will be at around the 2 percent target. On this basis, the actual path naturally depends on future economic and price developments. That said, given the outlook I explained earlier, even if the Bank were to terminate the negative interest rate policy, it is hard to imagine a path in which it would then keep raising the interest rate rapidly. The Bank would, I think, maintain accommodative financial conditions even if the termination were to take place. As Chart 9 shows, the market currently is assuming a very gradual path for the policy interest rate. The Bank refers to such views incorporated in financial markets when making assumptions on the policy interest rate to prepare its outlook for economic activity and prices. Nonetheless, the Bank does not project that inflation will significantly exceed 2 percent. As shown in Chart 10, the current situation is that Japan's real interest rates have been substantially negative and financial conditions have been highly accommodative. This situation is not expected to change much.

On the other hand, some are of the opinion, especially among overseas market participants and economists, that in a state where inflation is 2 percent, the nominal interest rate that is neutral to the economy should be 2 percent even if the natural rate of interest is 0 percent in real terms. Or, based on this, some suggest that if the desired policy interest rate is calculated using a simple method like the Taylor rule, this would yield a much higher figure.

I will not try to argue here which view is correct, and would like to reiterate that it all depends on future economic and price developments. On this basis, let me suggest that it is a bit difficult to assess the situation in Japan through analogies with Europe and the United

States. As Chart 11 shows, in both the United States and the euro area, inflation was above 8 percent when central banks began raising their policy interest rates in 2022, which gave rise to a significant risk of undermining people's confidence that inflation would be at around 2 percent over the medium to long term. The current inflation situation in Japan is markedly different. Another difference with Europe and the United States, where medium- to long-term inflation expectations have been anchored at 2 percent, is that those expectations in Japan are still in the process of climbing toward 2 percent. This means that an accommodative monetary policy is needed to lift inflation expectations further and to be mindful of the risk that they would fall again. Developments in Japan's financial markets seem to have been influenced by these inflation dynamics that are different from Europe and the United States, the fact that inflation expectations have not been anchored at 2 percent, and by uncertainties associated with these factors. Conversely, if Japan's inflation dynamics are to change going forward -- which is what the Bank aims for, as I will explain in more detail later -- market views could shift, depending on the speed of the change among other factors. Furthermore, it could be said that, in changing Japan's inflation dynamics, the Bank will maintain accommodative financial conditions.

Yield Curve Control and Purchases of Exchange-Traded Funds (ETFs) and Other Assets

Another question involves the possible revision to the yield curve control framework. As this framework is a form of quantitative easing (QE) implemented through government bond purchases, simply terminating it is not the end of the story. Regardless of whether the framework will be terminated or be continued in some way, the Bank must consider how to proceed with subsequent Japanese government bond (JGB) purchases and how to maintain the stability of markets during that process. In this sense, the conduct of yield curve control and subsequent JGB purchases are part of a continuing process. Under the current framework, the amount of these purchases is determined endogenously by targeting the level of interest rates. If the Bank terminates or changes this framework, it will consider the best way to indicate how it will conduct JGB purchases, taking account of market conditions at that point in time and forecasting developments down the road. Of course, if the Bank does revise the framework, it will incline more toward letting interest rates be determined by the market. In doing so, however, it will take careful measures so as not to create discontinuity before and after the revision, and will make sure that the amount of JGB purchases will not change significantly and interest rates will not rise rapidly.

In addition, the Bank has purchased ETFs and Japan real estate investment trusts (J-REITs) as part of its large-scale monetary easing. However, once sustainable and stable achievement of the 2 percent target comes in sight and the Bank revises the large-scale monetary easing, it would be natural to discontinue these purchases. In this regard, three years ago, in March 2021, the Bank changed its guidelines for asset purchases, resolving to make purchases flexibly in a prioritized manner during times of market instability. Since then, the purchase amount of these assets has been small; the Bank bought 210 billion yen in ETFs and no J-REITs last year. Even if the Bank discontinues these purchases and leaves price formation entirely to the market, it is likely that the impact on factors such as market conditions will not be significant. Of course, the treatment of the ETFs and J-REITs already held by the Bank is another matter; due to the extremely large scale involved, the Bank would need to take time to consider that issue.

IV. A Turning Point for Japan's Economy

Let me move on to the next topic. Japan's economy is at a crucial turning point for overcoming deflation. In what follows, I would like to talk about changes currently unfolding in the context of the history of Japan's economy since the 1990s, and consider the implication of these changes on business management.

Economic Stagnation and Deflation in Japan

Let us take a look at Chart 12. After entering the 1990s, Japan experienced the bursting of the bubble economy and a subsequent financial crisis. It also struggled to address a declining population and adapt to the globalization brought about by the rise of emerging economies. As a result, Japan's economic growth rate declined as a trend, and the economy fell into a state of chronic demand shortages. The inflation rate turned negative in 1998, and deflation persisted for 15 years. In terms of monetary policy, even lowering interest rates to 0 percent could not generate sufficient easing effects and this failed to raise the inflation rate. The government carried out massive fiscal spending to make up for demand shortages and implemented various subsidies and public credit programs to protect employment through preventing corporate bankruptcies. In this situation, it was natural for firms to protect themselves by accumulating internal reserves and building up cash and deposits rather than making forward-looking investment. In particular, the Global Financial Crisis (GFC) in 2008 had a severe impact on firms that had taken risks until then, including in terms of investment. This further strengthened firms' tendency toward falling into a shrinking equilibrium, as they came to think of creating a cost structure that enables them to withstand the next possible shock, instead of extending their businesses.

Large-Scale Monetary Easing

It is evident that the fundamental solution to this issue was to strengthen Japan's growth potential. However, it takes time for this to bear fruit. In the meantime, the issue was compounded by the Great East Japan Earthquake in 2011, which gave rise to a situation known as the "six headwinds." In this situation, the Bank examined every possible action it could take in response and introduced large-scale monetary easing, starting with quantitative and qualitative monetary easing (QQE) in 2013. When both the potential growth rate and inflation expectations are low, the interest rate that is neutral to the economy becomes extremely low. Thus, making monetary easing effective enough requires significantly lowering interest rates. Something had to be done to overcome the zero lower bound on nominal interest rates. So, the Bank needed either to make short-term interest rates negative or to push down medium- and long-term interest rates. Consequently, it wound up implementing both. Of course, these measures come with side effects, and it is better to avoid such measures if possible. However, without introducing them, the question should have remained as to what ought to be done.

Moreover, overseas, the Federal Reserve introduced QE in the wake of the GFC, and many other central banks put unconventional policies in place. I think it is worth asking, from a historical perspective, to what extent the central banking community as a whole should have pursued these unconventional policies. That said, individual central banks had no choice but to operate in the given situation. In light of such circumstances at home and abroad, I believe that taking no unconventional action was not an option for the Bank of Japan. Of course, we will assess without any prejudice whether individual policy measures were appropriate by comparing their positive effects and side effects.

Labor Shortages and Global Inflation

As Chart 13 shows, under QQE and the subsequent negative interest rate policy and yield curve control, both short- and long-term real interest rates were significantly negative. Even though the natural rate of interest was low, this approach created fairly accommodative financial conditions. As a result, demand shortages were resolved and the unemployment rate declined substantially. On the labor supply side, employment rose considerably due to a higher labor force participation rate of women and seniors. Then, the scope for increasing labor supply in this way gradually narrowed, and the issue of labor shortage arose during the pre-pandemic period between 2017 and 2018.

As I just explained, monetary easing has provided a powerful stimulus to the economy, leading to an increase in demand and tight labor market conditions, which has prompted firms and other economic entities to take action. This is precisely the aim of the Bank's large-scale easing policy. Such an approach can be referred to as a "high-pressure economic strategy." From the very early stages of the large-scale monetary easing, the Bank argued that, in the process of overcoming deflation, competition over securing human resources was bound to intensify, so firms that took preemptive actions to address such environmental changes would be able to gain an advantage. Since it took time for this situation to unfold, the Bank's communication may have been a little too early to inform the decisions of firms, but in the end this became the major trend in Japan. In fact, responses to labor shortages may act as a driving force for business transformation and improvement in productivity, as suggested by the increasing number of firms that, for example, made labor-saving investment and discontinued inefficient or excessive services that were not profitable. Although these moves subsequently have become subtle due to the pandemic, they are likely to have continued as an underlying trend.

The recovery process from the pandemic has sparked global inflation, and this has brought about high prices driven by cost-push factors in Japan, akin to other countries and regions. This situation is not desirable, of course, but it led to last spring's wage hikes on the back of labor shortages. Given this background, the current tight labor market conditions are unlikely to change. Firms will need to incorporate this as they manage their businesses, including formulating pricing strategies.

Business Management in an Economy with Labor Shortages

Here, I believe that we have finally started to come up with a clue to resolving the fundamental issue of strengthening Japan's growth potential. Labor shortages may be distressing to individual firms, but they also bring opportunities. Specifically, labor shortages drive individual firms' transformation and improve the metabolism of the economy from the vantage point of working people, by prompting firms to build profit models that enable sustained wage hikes and to make efforts to attract people to work for them. Of course, since capitalism involves competition, this does not mean that it will benefit all. "Economic metabolism" usually has a positive connotation and, to my mind at least, is often used in a somewhat facile manner, but the hard reality is that it implies the exit of a certain number of firms from the market. Some firms may look back wistfully at the deflationary period, which allowed them to get by as long as they did not overextend themselves. Absent such dynamism, however, we cannot expect Japan's economy as a whole to recover its growth potential amid a declining population. Therefore, I think that a realistic solution will be to proceed with economic metabolism with minimum transition costs. Economic metabolism led by labor shortages entails relatively low transition costs, in that it is less likely to give rise to unemployment. Nevertheless, not everyone who was working may be able to find a new job right away, so this metabolism will still involve pain. In this sense, it is encouraging that, recently, there are an increasing number of cases in which firms pursue mergers and acquisitions as well as business succession because they are attracted to the employees who work for the target firms. I expect regional financial institutions -- which have close ties to local communities, including numerous firms -- to play the role of local networks.

Norm during the Deflationary Period

Meanwhile, in Japan's transition out of deflation, firms' business strategies have been hindered by the social behavior and norm in which people assume that wages and prices will not increase or change. Firms are of the view that, under this deflationary norm, it has been difficult for them to move in the direction of making better products and raising prices. However, it is not necessarily clear through which channels this norm has adversely affected the economy. From a theoretical perspective, it should be possible to change the relative prices of individual products regardless of the overall inflation rate.

Please take a look at Chart 14. One possible argument here is that changing this norm would make it easier for firms to adjust wages. Even now, firms sometimes remark that, since raising base pay would increase fixed costs, they would choose lump-sum payments for wage adjustments. This mindset assumes deflation or zero inflation. In economies in which inflation continues to be at around 2 percent every year -- for example, economies like Europe and the United States, as well as Japan in the 1980s -- even if a firm raises base pay too much in one year, this would not create an increase in its fixed costs because it can make up for this rise by adjusting base pay increases from the following year. Furthermore, if overall nominal wages increase every year, individual firms would be able to adjust wages more flexibly in line with factors such as their business performance or, for example, to attract younger workers or specialized human resources. This could be an advantage of changing the norm during the deflationary period. However, I am not entirely convinced that this alone would be a game changer for society.

While the narrative of the norm during the deflationary period often refers merely to the phenomenon where wages and prices do not increase, I believe that it is necessary to regard this norm as being more complex, involving underlying economic, social, and political structures. These structures include fierce competition among firms and chronic demand shortages, loose labor market conditions and anxiety about employment, and various safety nets that enabled firms to get by somehow. In particular, a decisive factor, in my view, was "the situation where firms could hire people without having to raise wages." Over the past 10 years, even though Japan's economy is no longer in deflation, it has been so hard to overcome this norm. I think that this is because it took a long time for the remaining scope of increasing labor supply to narrow and for a true "labor shortage economy" to come about.

In this sense, although the trigger has been cost-push factors originating overseas, wages in Japan have in fact been rising, and I feel that the stage is now being set for Japan's economy to change. We are now facing the opportunity to break out of the mindset and behavior of the deflationary period and bring about an economy where wages and prices increase. If firms devise business models that enable this, and people choose to work at firms that succeed in doing so, there would be an opportunity to realize an economy with greater overall growth potential. The Bank will conduct its monetary policy to maintain stable and accommodative financial conditions and support these changes so that they will take root. "A state with positive interest rates" will not be achieved merely through the Bank raising interest rates. It will only be possible if economic activity and prices improve, thereby realizing the situation where raising interest rates is appropriate.

V. Recent and Future Economic Activity in Nara Prefecture

Lastly, I would like to talk about the economy of Nara Prefecture, using Chart 15. The declining population has long been the greatest concern for all regions in Japan. In discussing the issue of labor shortage, sometimes opinions are divided or disagreement occurs. This may be because there is a mixture of regional issues, including population outflow, and the issue of labor market conditions in the national economy. That said, it is a matter of fact that Japan overall has been on a trend where labor market conditions have remained tight and where working people are becoming an increasingly valuable and scarce business resource. I assume that every regional economy is facing the task of finding ways to attract people to live and work there. In this regard, I believe that Nara Prefecture has outstanding appeal in several respects.

For example, it has easy access to major cities, an advantage in terms of business continuity, and clusters of advanced research and educational institutes, including the Keihanna Science City. Nara Women's University established a Faculty of Engineering and has been conducting research while cooperating with local firms. In addition to these human resources and location advantages, public-private actions to attract businesses have led to a high ranking for Nara Prefecture in terms of the number of new factory locations among prefectures in Japan.

Moreover, Nara Prefecture is blessed with a wealth of tourism resources, including three World Heritage sites and many other historical and cultural assets, lush natural landscapes, and cityscapes that are in harmony with these sites. It has also seen a wave of, for example, construction of facilities that draw on these valuable resources, such as luxury hotels that blend in with the natural beauty and accommodation facilities that utilize important cultural properties. In this situation, tourism that involves overnight stays can be expected to take hold in the region. Furthermore, Nara Prefecture has numerous inherited resources, ranging from traditional Japanese crafts, including ink and brushes used in Japanese calligraphy and bamboo whisks used in tea ceremonies, to local products with a long history, such as Yoshino cedar wood and Yamato vegetables. In recent years, while continuing to capitalize on its tradition, the prefecture has been actively developing new products and providing services unbound by conventional frameworks.

Nara Prefecture thus has been pushing forward with positive initiatives that capitalize on the region's appealing characteristics, including location, opportunities to tap into human resources, tourism resources, and traditional crafts. Let me conclude by offering my hope that the economy of Nara Prefecture will continue to flourish. Thank you very much for your attention.

Japan's Economy and Monetary Policy

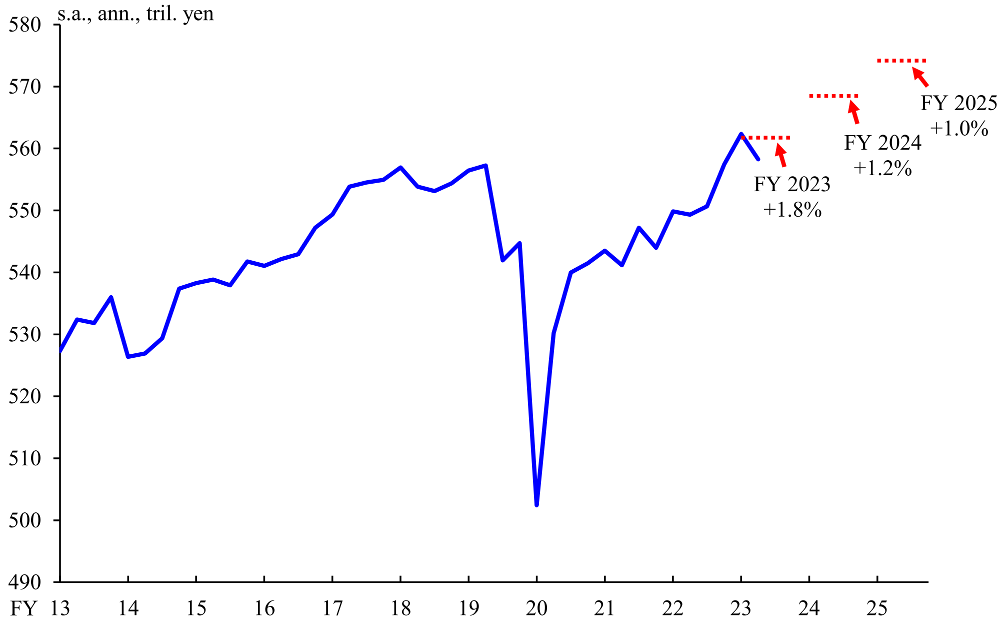
Speech at a Meeting with Local Leaders in Nara

February 8, 2024

UCHIDA Shinichi

Deputy Governor of the Bank of Japan

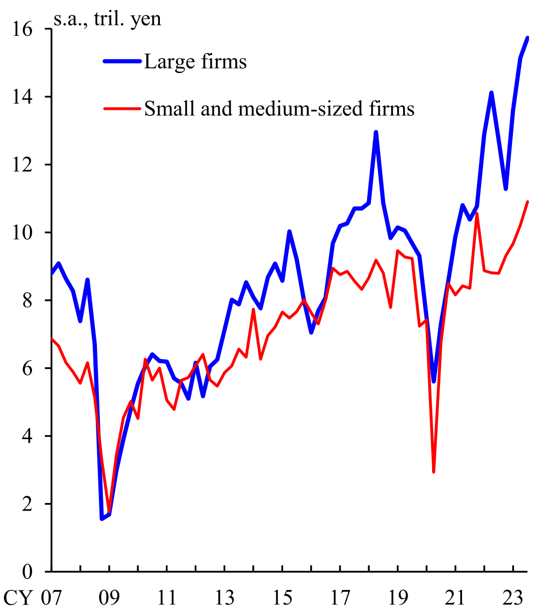
The BOJ's Forecasts for Real GDP (Jan. 2024 Outlook Report)



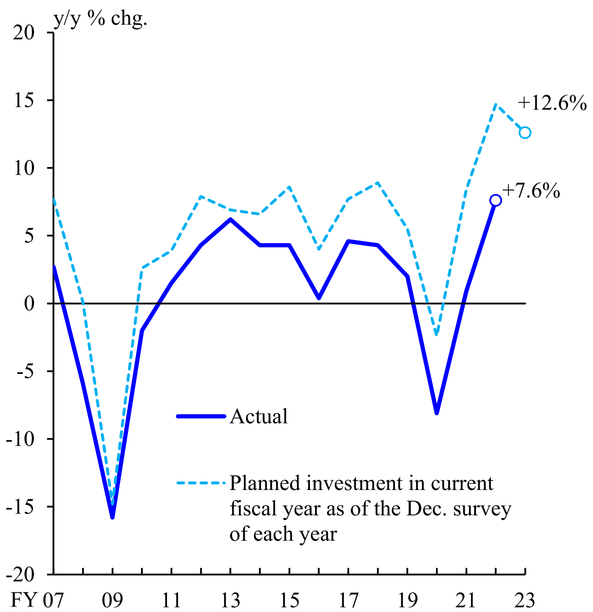
Note: The forecasts presented are the medians of the Policy Board members' forecasts. The values of real GDP for fiscal 2023 onward are calculated by multiplying the actual figure for fiscal 2022 by all successive projected growth rates for each year.
Sources: Cabinet Office; Bank of Japan.

Corporate Sector: Profits and Business Fixed Investment

Current Profits



Business Fixed Investment

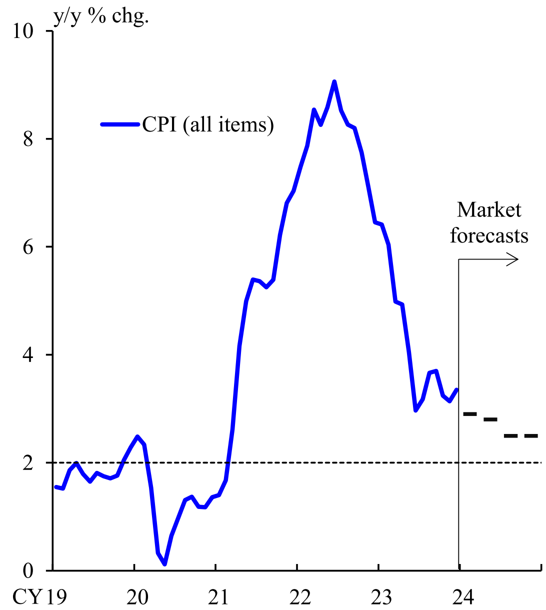


Notes: 1. In the left-hand chart, figures are based on the *Financial Statements Statistics of Corporations by Industry, Quarterly* and exclude "finance and insurance." Figures from 2009/Q2 onward exclude pure holding companies.
2. In the right-hand chart, figures are based on the *Tankan*, including software and R&D investments and excluding land purchasing expenses. R&D investment is not included before the March 2017 survey. Figures are for all industries including financial institutions.
Sources: Ministry of Finance; Bank of Japan.

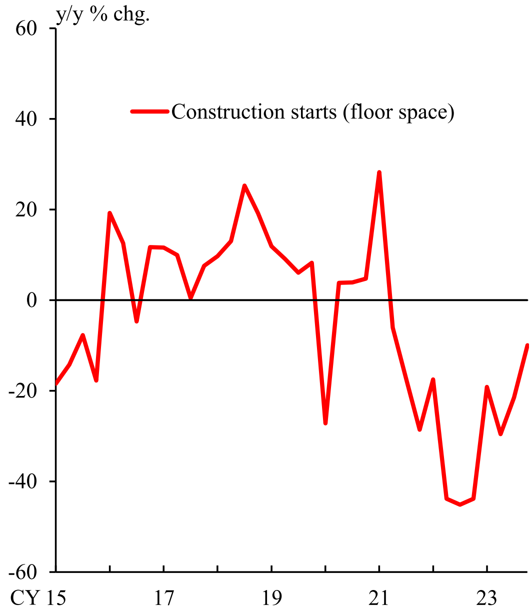
Chart 3

Overseas Economies

Consumer Prices in the United States



Real Estate Market in China

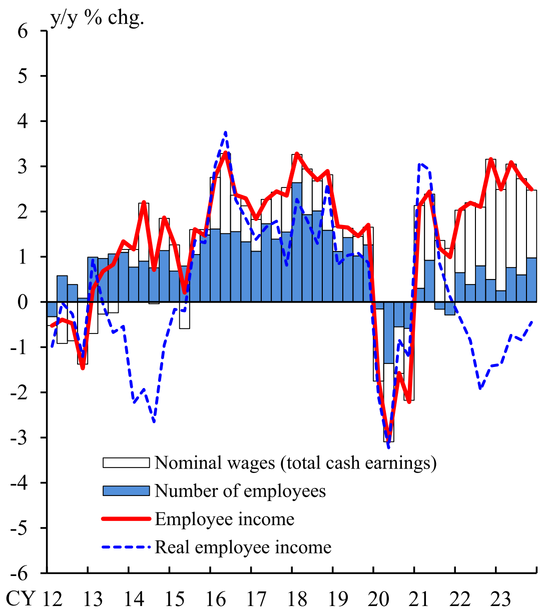


Sources: Bloomberg; Haver; CEIC.

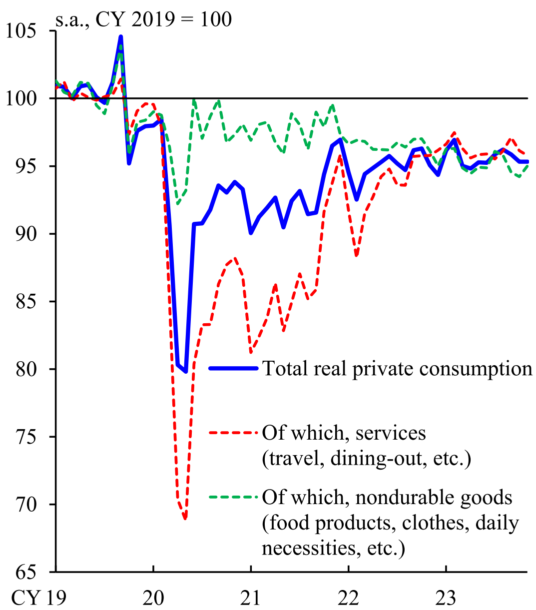
Chart 4

Household Sector: Employee Income and Private Consumption

Employee Income



Private Consumption

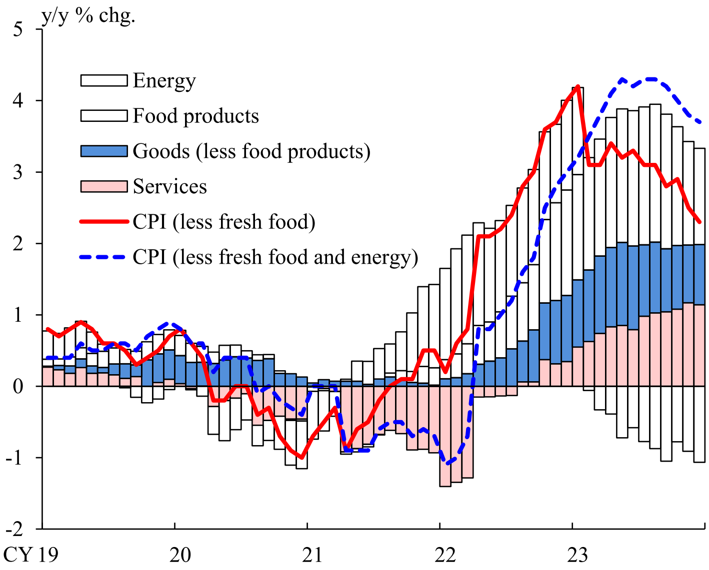


Notes: 1. In the left-hand chart, Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February. Employee income = Total cash earnings (*Monthly Labour Survey*) × Number of employees (*Labour Force Survey*). Figures from 2016/Q1 onward are based on continuing observations following the sample revisions of the *Monthly Labour Survey*. Those for real employee income are based on staff calculations using the CPI (less imputed rent). Figures for 2023/Q4 are those for December.
2. In the right-hand chart, figures for total real private consumption are the real Consumption Activity Index (travel balance adjusted) based on staff calculations, which exclude inbound tourism consumption and include outbound tourism consumption.

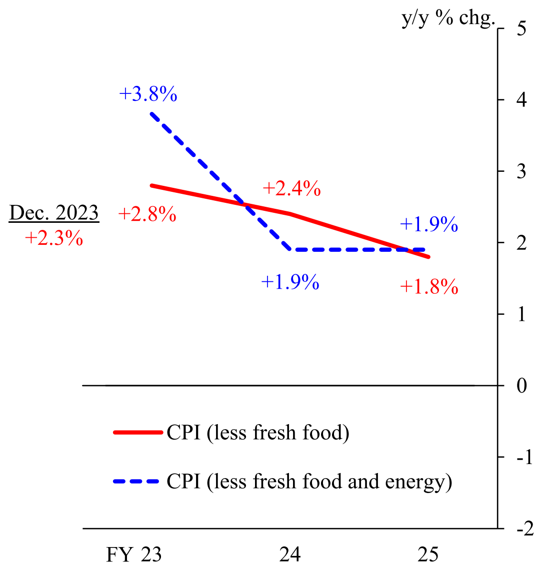
Sources: Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications; Bank of Japan.

The BOJ's Forecasts for the CPI (Jan. 2024 Outlook Report)

Developments over Time



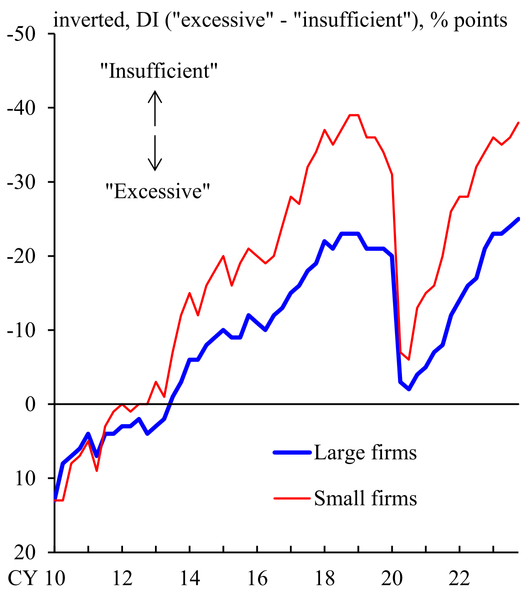
Forecasts



Note: In the right-hand chart, figures are the medians of the Policy Board members' forecasts.
Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

Spillovers from Prices to Wages

Firms' Perception of Labor Shortage



CPI Inflation

y/y chg.

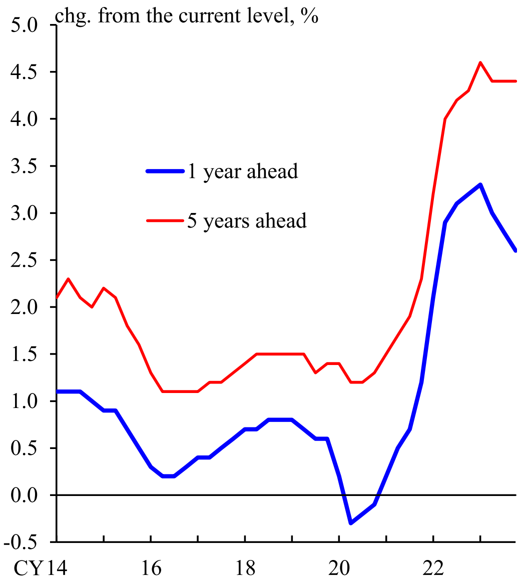
	All items	All items less fresh food
CY 2022	2.5%	2.3%
CY 2023	3.2%	3.1%

Note: In the left-hand chart, figures are the employment conditions DI in the *Tankan*.
Sources: Bank of Japan; Ministry of Internal Affairs and Communications.

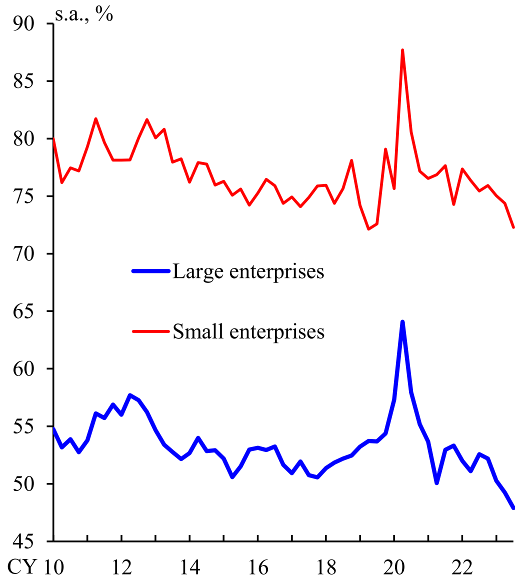
Chart 7

Spillovers from Wages to Prices

Firms' Outlook for Output Prices in the Tankan



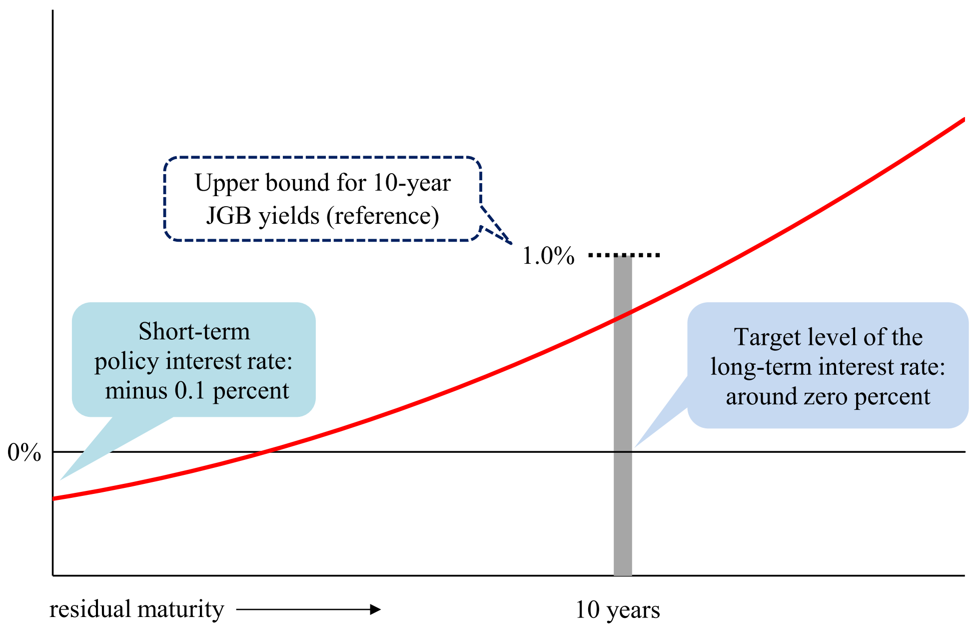
Labor Share



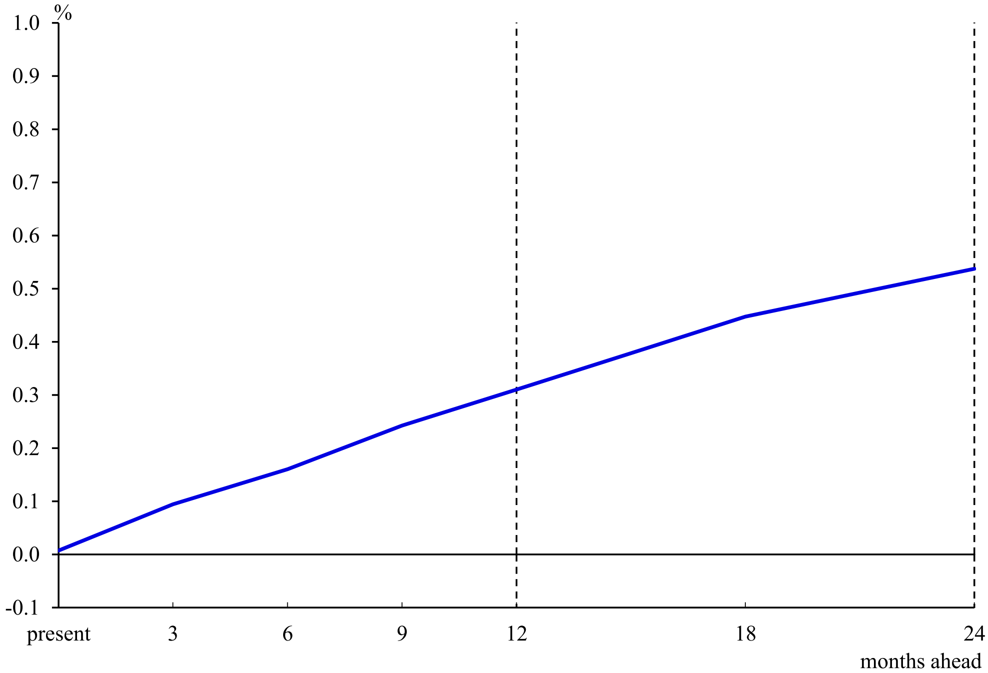
Note: In the right-hand chart, figures are based on the *Financial Statements Statistics of Corporations by Industry, Quarterly* and exclude "finance and insurance" and pure holding companies.
Sources: Bank of Japan; Ministry of Finance.

Chart 8

The BOJ's Monetary Policy



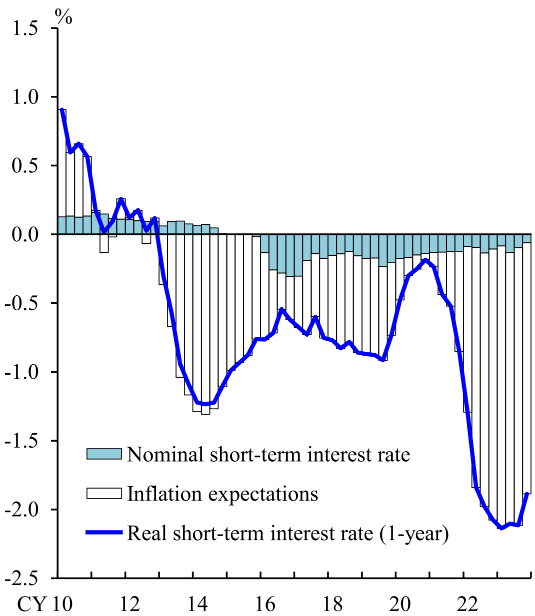
Market Expectations for the BOJ's Policy Interest Rate



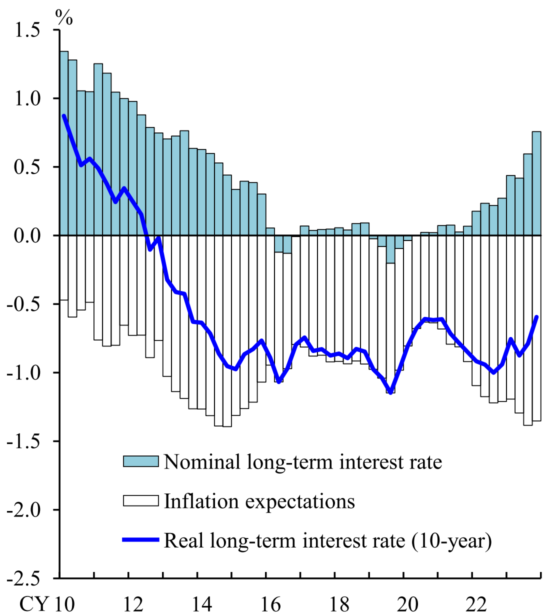
Note: The figure for the present is the 3-month yen OIS rate. Figures for 3, 6, and 9 months ahead are 3-month forward rates, those for 12 and 18 months ahead are 6-month forward rates, and that for 24 months ahead is a 12-month forward rate, all calculated from the yen OIS rates. The figures are those as of February 5, 2024.
Source: Bloomberg.

Real Interest Rates

Real Short-Term Interest Rate (1-Year)



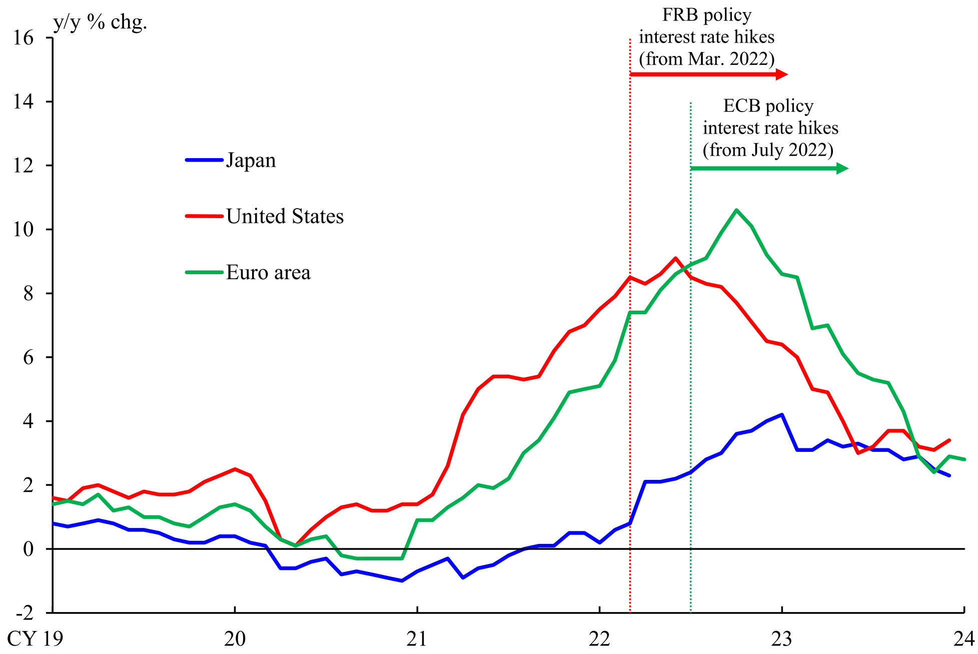
Real Long-Term Interest Rate (10-Year)



Note: Figures for real interest rates are calculated by deducting inflation expectations from JGB yields for each maturity. Figures for inflation expectations are based on staff calculations using those of various economic entities (firms, households, and experts) by length of term. Specifically, the 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: Bank of Japan; QUICK, "QUICK Monthly Market Survey <Bonds>"; Consensus Economics Inc., "Consensus Forecasts"; Bloomberg.

Chart 11

Consumer Prices in Japan, the U.S., and the Euro Area

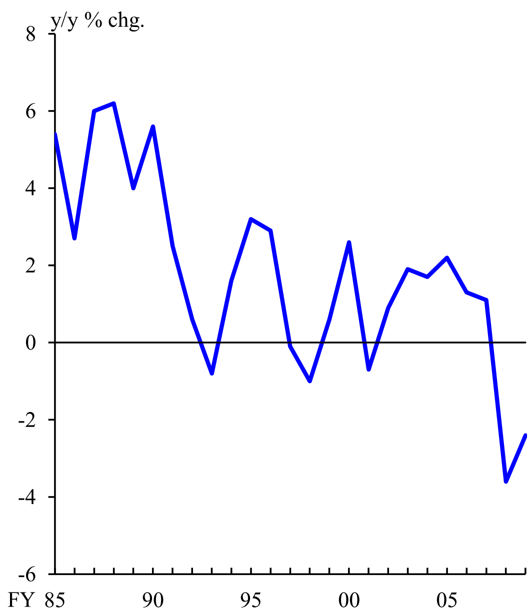


Note: Figures for Japan are the CPI for all items less fresh food, excluding the effects of the consumption tax hike, while those for the United States and the euro area are the CPI for all items.
Sources: Bank of Japan; Federal Reserve (FRB); European Central Bank (ECB); Ministry of Internal Affairs and Communications; Haver.

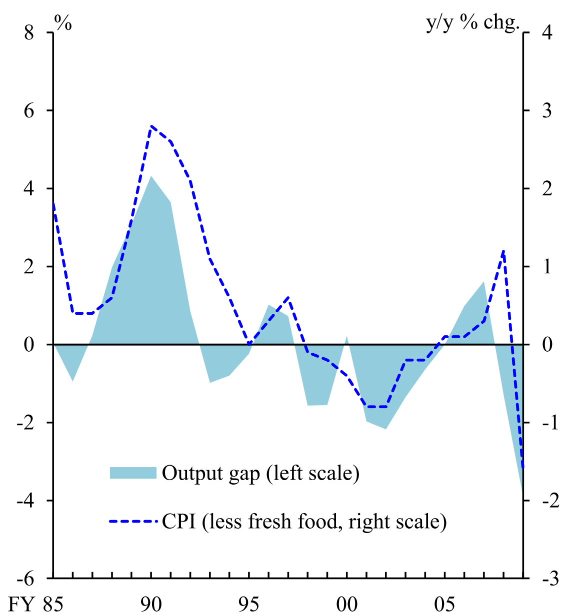
Chart 12

Japan's Economy in the 1990s and 2000s

Real GDP Growth Rate



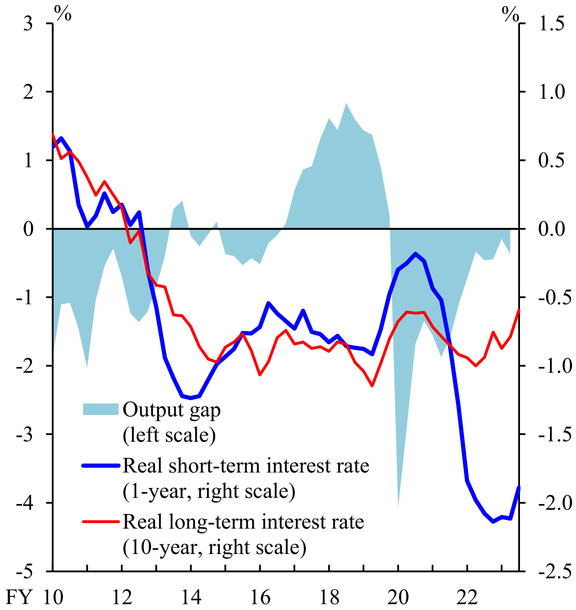
Output Gap and CPI



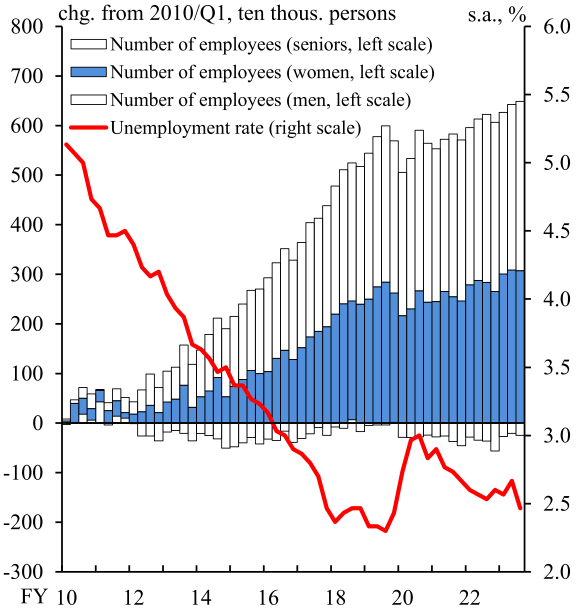
Note: In the right-hand chart, figures for the CPI exclude the effects of the consumption tax hikes, and those for the output gap are staff estimates.
Sources: Cabinet Office; Bank of Japan; Ministry of Internal Affairs and Communications.

Japan's Economy since the 2010s

Output Gap and Real Interest Rates

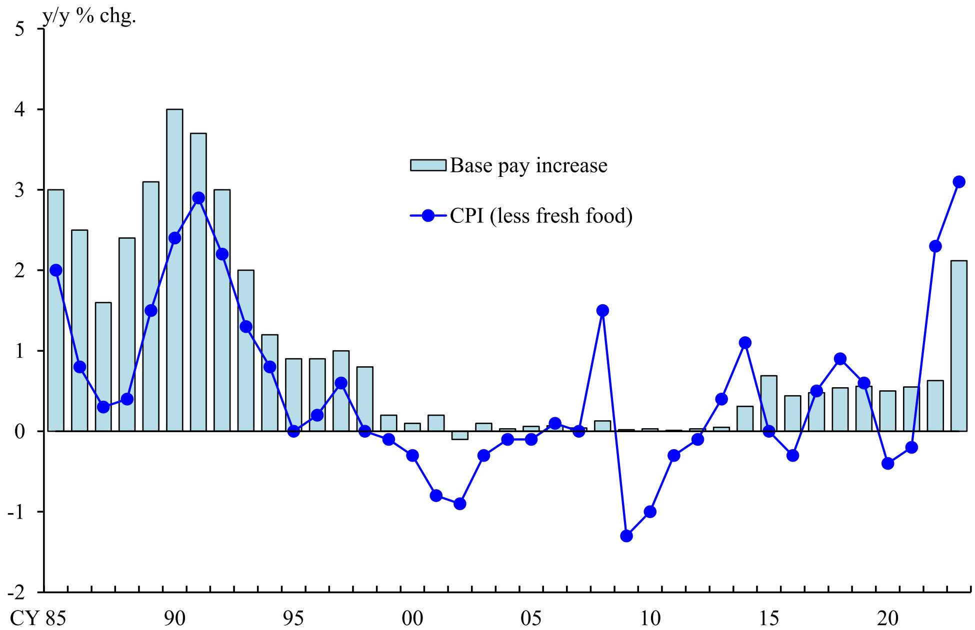


Labor Market



Notes: 1. In the left-hand chart, figures for the output gap are staff estimates. As for the real interest rates, see the note for Chart 10.
2. In the right-hand chart, figures for women and men are for employees aged between 15 and 64, while those for seniors are for employees aged 65 and over.
Sources: Bank of Japan; QUICK, "QUICK Monthly Market Survey <Bonds>"; Consensus Economics Inc., "Consensus Forecasts"; Bloomberg; Ministry of Internal Affairs and Communications.

Base Pay Increase and Prices

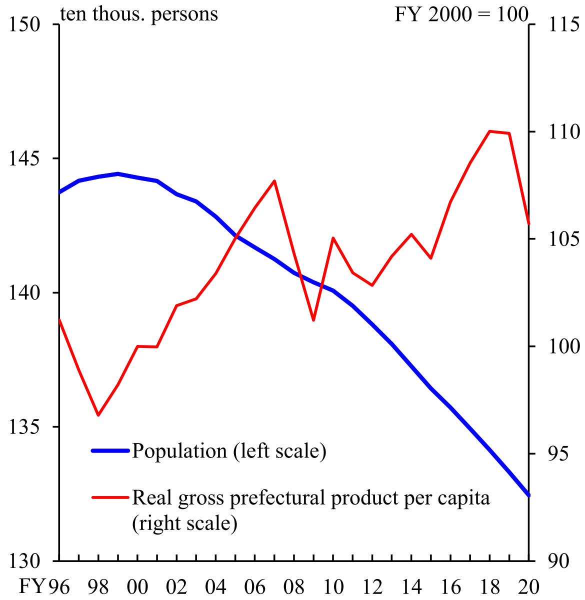


Notes: 1. Figures for base pay increase from 1985 to 2014 are those published by the Central Labour Relations Commission, while those from 2015 to 2023 are figures released by Rengo.
2. Figures for the CPI exclude the effects of the consumption tax hikes.
Sources: Ministry of Internal Affairs and Communications; Central Labour Relations Commission; Japanese Trade Union Confederation (Rengo).

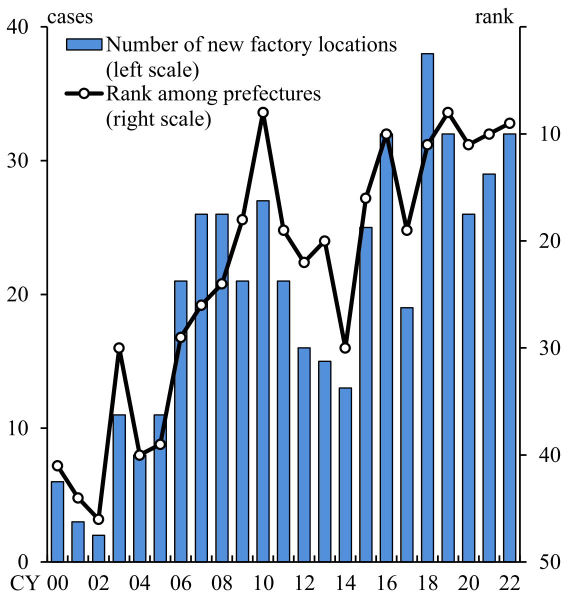
Chart 15

Economic Activity in Nara Prefecture

Population and Gross Prefectural Product per Capita



Number of New Factory Locations



Sources: Ministry of Economy, Trade and Industry; Cabinet Office.