November 18, 2024

Bank of Japan

Japan's Economy and Monetary Policy

Speech at a Meeting with Business Leaders in Nagoya

UEDA Kazuo

Governor of the Bank of Japan

(English translation based on the Japanese original)

Introduction

It is my great pleasure to have the opportunity today to exchange views with a distinguished gathering of business leaders in the Tokai region. I would like to take this chance to express my sincerest gratitude for your cooperation with the various activities of the Bank of Japan's Nagoya Branch.

The Bank makes a projection for Japan's economic activity and prices every quarter, which is released in the *Outlook for Economic Activity and Prices* (Outlook Report). Today, I would like to talk about the Bank's view on Japan's economic activity and prices and explain its thinking behind the recent conduct of monetary policy, with reference to the latest Outlook Report decided at the Monetary Policy Meeting (MPM) held in October.

I. Economic Activity and Prices

Current Situation of and Outlook for Economic Activity

Let me start by talking about economic developments. Japan's economy has recovered moderately, although some weakness has been seen in part.

Looking at the corporate sector, the positive developments of an improvement in corporate profits leading to an increase in business fixed investment have continued. As shown in Chart 1, business sentiment in the September *Tankan* (Short-Term Economic Survey of Enterprises in Japan) improved slightly overall for both large and small firms, although sentiment in some industries was negatively affected by the typhoon seen at the end of August. Corporate profits have been on an increasing trend, including for small and medium-sized firms. Business fixed investment plans for fiscal 2024 show that firms have maintained an active investment stance. Looking at a breakdown of business fixed investment, a key feature of the current phase is that, in addition to investment induced by the increase in domestic and external demand, investment for future growth -- such as research and development (R&D) investment and investment related to digitalization and decarbonization -- has increased. Long-term investment projects are likely to be less susceptible to short-term demand fluctuations, and thus it is highly likely that business fixed investment will continue on an increasing trend.

Next, let me turn to the household sector. Looking at private consumption in Chart 2, since last year, due to the impact of price rises, consumption of nondurable goods such as food products and daily necessities has been declining and indicators of household sentiment have been relatively weak. Recently, however, the overall trend in private consumption has returned to a moderate increasing trend. The reason for this positive -- albeit not strong -- development in private consumption seems to be the clear increase in nominal wages, on the back of a rise in scheduled cash earnings reflecting the results of this year's annual spring labor-management wage negotiations and an increase in summer bonuses supported by high levels of corporate profits.

As described, income has been rising in both the corporate and household sectors, and the virtuous cycle in which this rise leads to higher spending is gradually intensifying. Since these developments will likely continue to gain momentum, the Bank projects in the latest Outlook Report that real GDP will continue to grow at a rate of around 1 percent in the next fiscal year and beyond, as shown in Chart 3.

Current Situation of and Outlook for Prices

Next, I will move on to developments in prices. As shown in Chart 4, the year-on-year rate of increase in the consumer price index (CPI) for all items excluding fresh food was 2.4 percent in September 2024. Looking at the breakdown, the year-on-year rates of increase in the prices of food products and of other goods, which had been pushing up overall prices substantially until last year, have continued on a declining trend as the impact of the past rise in import prices has eased. On the other hand, the year-on-year rate of increase in the prices of services, in which labor costs account for a larger share of costs than in goods, has been stable. This indicates that the driving force for price increases has been shifting from cost-push factors stemming from the rise in import prices to domestic wage increases. The preliminary October CPI data for Tokyo's 23 wards, which are released ahead of the national data, also indicate price revisions for a variety of items, including services, that were carried out mainly on the back of wage increases -- "beginning-of-the-period price hikes" in the second half of the fiscal year.

Looking at the outlook for prices, the year-on-year rate of increase in the CPI for all items excluding fresh food is likely to be 2.5 percent for fiscal 2024 and then be at around 2 percent for fiscal 2025 and 2026. While the effects of a pass-through to consumer prices of cost increases led by the past rise in import prices are expected to continue to wane, inflationary pressure stemming from wage increases is projected to strengthen as an improvement in economic activity and solid growth in wages continue. It appears that underlying inflation -- that is, the trend in inflation excluding short-term fluctuations due to, for example, the rise in import prices -- is currently below 2 percent. That said, underlying inflation is likely to continue rising moderately and, in the second half of the projection period through fiscal 2026, to be at a level that is generally consistent with the price stability target of 2 percent.

II. Risks to Economic Activity and Prices

While so far I have talked about the current situation of and outlook for economic activity and prices, I think there are high uncertainties surrounding this baseline scenario. Two key factors regarding the outlook are (1) whether overseas economies will follow a moderate growth path and (2) whether wages will continue to rise and whether the virtuous cycle between wages and prices will continue to intensify. Let me discuss these two factors in turn.

Developments in Overseas Economies and Financial and Capital Markets

I will start by discussing the first factor: overseas economies. As shown in Chart 5, the International Monetary Fund (IMF) projects in its latest *World Economic Outlook* (WEO) that the global economy will sustain growth in the range of 3.0-3.5 percent through 2025, which is more or less unchanged from its previous projection in July. While the baseline scenario for overseas economies going forward is that they will continue to register moderate growth, whether this scenario will be realized continues to warrant attention. At the Group of Twenty (G20) meeting held last month, participants shared the view that uncertainties regarding the outlook for the global economy have heightened recently.

Regarding the U.S. economy, there was a series of indicators this summer suggesting a slowdown in the labor market. Since then, some statistics have shown positive developments, and it has become more likely that the economy will achieve a soft landing, in which the inflation rate declines toward 2 percent while a significant slowdown in the economy is avoided. Nevertheless, it is necessary to continue to carefully monitor the situation. Productivity in the U.S. economy has increased since the COVID-19 pandemic, partly due to growth in the number of business startups in new industries and the active use of artificial intelligence (AI). In addition, the rising number of immigrants among other factors has increased the labor supply, and the economic trend in the United States seems to be firm. Having said that, excess savings accumulated in the United States during the pandemic, which have been one of the factors supporting solid private consumption there, have declined, and the possibility that the impact of rapid policy interest rate hikes to date will push down economic activity in the country, with a lag, continues to warrant attention. On the other hand, the risk of developments in the opposite direction cannot be ruled out -- that is, a resurgence of inflation as a result of, for example, future economic developments and policy conduct. The Bank of Japan will carefully assess developments in the U.S. economy, keeping both upside and downside risks in mind.

Turning to the Chinese economy, the markets there, particularly the real estate market, have continued to undergo adjustments and the effects of these adjustments have spread to private consumption. Although the economy is projected to continue to see moderate growth, reflecting government support and other factors, there are high uncertainties surrounding the future pace of growth. Moreover, exports in China have increased on the back of a rise in inventory adjustment pressure on some goods brought about by the developments in domestic demand I just mentioned, and it is necessary to pay attention to factors including the effects of this increase in exports on other economies.

Attention to geopolitical risks also continues to be warranted. Depending on factors such as the course of the situation surrounding Ukraine and the Middle East, downward pressure on overseas economies could heighten, while the prices of grains and other commodities could also fluctuate significantly. From a somewhat long-term perspective, the heightened geopolitical risks could change the trend of globalization, which has supported the growth of the global economy to date.

Global financial and capital markets have shown nervousness from the summer onward. Market sentiment has improved more recently, mainly because concerns over the U.S. economy have receded. That said, the markets remain susceptible to, for example, economic indicators of the various economies and media reports regarding geopolitical risks. The Bank of Japan will continue to pay attention to whether fluctuations in global financial and capital markets will affect economic activity and prices in Japan.

Virtuous Cycle between Wages and Prices

Next, I would like to turn to the second factor, whether wages will continue to rise and whether the virtuous cycle between wages and prices will continue to intensify.

The environment surrounding wages is shown in Chart 6. Labor market conditions have been tight for firms across a wide range of industries and sizes, partly due to the structural factor of demographic changes. In particular, large firms are increasingly eager to hire regular employees, and labor shortages, especially of younger employees, have become more pronounced. Corporate profits, as explained earlier, have continued on an improving trend. Meanwhile, the minimum wage for this fiscal year increased by more than 5 percent year on year, the largest increase on record, and is expected to continue to rise, which would prompt wages in general to rise as well.

In October, the Japanese Trade Union Confederation (Rengo) announced its basic policy for next year's annual spring labor-management wage negotiations, calling for all firms to raise wages by 5 percent or more and for labor unions -- such as those for small and medium-sized firms -- to actively demand wage increases to address wage disparities. In addition, positive statements have come from the management side, mainly of large firms, that they will continue to implement solid wage hikes. Due in part to initiatives to date by both labor and management, nominal wages have steadily increased since 2022. However, looking at scheduled cash earnings of full-time employees in the *Monthly Labour Survey*, for example, the cumulative increase so far has yet to catch up with the increase in prices over this period.

Of course, on an individual basis, many firms, particularly small and medium-sized ones, have reported that the profit environment has been challenging and that continuing to raise wages is difficult. For wage hikes to spread to these firms and a wide range of other firms, it is critical to ensure that increases in wage costs are appropriately reflected in selling prices and, more generally, that wages and selling prices are set on the assumption that both wages and overall prices will continue to rise moderately. Please take a look at Chart 7. Indicators of inflation expectations and other factors suggest that the view that prices will rise moderately over the medium to long term is gradually taking hold among households and firms. Moreover, among firms, there is also a growing recognition of the need to raise wages to address labor shortages. The Bank will pay attention to developments in labor-management wage negotiations going forward and to how wage increases will affect prices, particularly with regard to whether prices of services, in which labor costs account for a large share of costs, will rise firmly.

I think that achieving the environment in which both wages and prices rise moderately will be of great benefit to Japan's economy, as it will make it easier for firms to take positive actions. On this basis, to strengthen the economy, it is essential for productivity in Japan as a whole to increase, through initiatives by firms in particular to capitalize on this environment, and for higher productivity to feed into a sustained rise in real wages. In this regard, I consider it very encouraging that investment in anticipation of future growth, as mentioned earlier, has increased further recently, including in digital-related areas. The Bank will support such positive actions by firms through the sustainable and stable achievement of the price stability target of 2 percent.

III. The Bank's Conduct of Monetary Policy

Next, I will talk about the Bank's conduct of monetary policy.

The Bank changed its large-scale monetary easing framework this March, discontinuing the negative interest rate policy and yield curve control, judging that it was now within sight that the price stability target of 2 percent would be achieved in a sustainable and stable manner. In July, the Bank then decided on a plan for the reduction of its purchase amount of

Japanese government bonds (JGBs) and raised the target level of the short-term interest rate to around 0.25 percent.

Regarding the future conduct of monetary policy, if the outlook for economic activity and prices that I have outlined today is realized, the Bank will accordingly continue to raise the policy interest rate and adjust the degree of monetary accommodation.

However, monetary policy will continue to firmly support economic activity. Please take a look at Chart 8. Monetary policy affects economic activity mainly through changes in real interest rates, that is, nominal interest rates minus the expected rates of inflation. Looking at the levels of real interest rates, since nominal interest rates have been maintained at extremely low levels despite favorable price developments, real interest rates have been negative and even lower than in the 2010s, and thus the degree of monetary accommodation can be judged to have actually increased. Going forward, I think that gradually adjusting the degree of accommodation in line with improvement in economic activity and prices will support long-term economic growth and contribute to achieving the price stability target in a sustainable and stable manner.

The actual timing of the adjustments will continue to depend on developments in economic activity and prices as well as financial conditions going forward. The Bank needs to pay due attention to various risk factors, such as those pointed out in the latest Outlook Report, including the course of overseas economies, particularly the U.S. economy, and developments in financial and capital markets. On this basis, it also needs to examine how these factors will affect the outlook for Japan's economic activity and prices, the risks surrounding them, and the likelihood of realizing the outlook. At each MPM, the Bank will make policy decisions based on its latest assessment of the current state of and outlook for economic activity and prices with reference to, for example, the data and information available at the time of each meeting.

Concluding Remarks

In closing, I would like to touch on initiatives conducted with an eye to the future in the Tokai region.

The Tokai region has been a *monozukuri* (manufacturing) center with strong supply chains, especially in the automobile industry. Capitalizing on these strengths, the region has led the growth in Japan's economy through various innovations.

Firms in the region have actively invested in R&D with an eye to the future. An emerging trend is the growing momentum toward open innovation through collaboration with universities, startups, and other entities, and financial institutions have supported these initiatives. The local government also has become involved, and as part of its efforts to further promote the collaboration of industry, government, academia, and finance, one of the largest startup support centers in Japan opened in the Tokai region in October. Moreover, a global startup event is planned to be held here for the first time next year.

Promoting innovation is important not only in terms of growth in Japan's economy through higher productivity, but also in terms of addressing medium- to long-term issues, including climate change. Achieving carbon neutrality requires innovation across a wide range of areas. In the Tokai region, various initiatives have made steady progress, such as the electrification of vehicles, the more widespread utilization of hydrogen and ammonia technologies for decarbonization in society, and carbon recycling -- that is, making efficient use of carbon dioxide as a resource.

I would like to close today by expressing my hope that the efforts of the Tokai region will bear fruit, and that its economy will continue to develop and lead the way in the sustainable growth of Japan's economy. Thank you very much for your attention.

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Introduction

I. Economic Activity and Prices

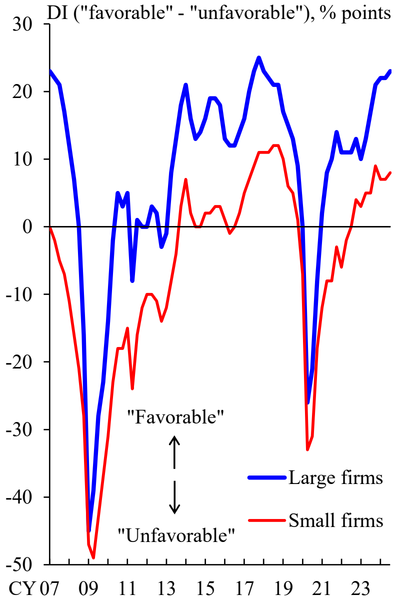
II. Risks to Economic Activity and Prices

III. The Bank's Conduct of Monetary Policy

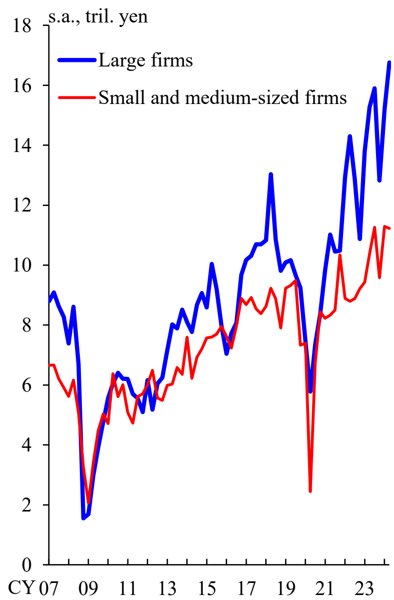
Concluding Remarks

Corporate Sector

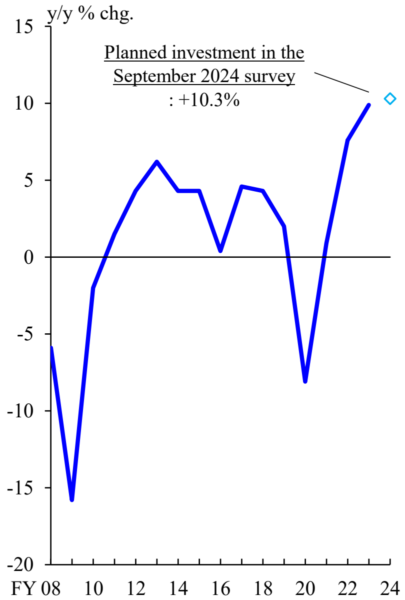
Business Conditions (Tankan)



Corporate Profits



Business Fixed Investment

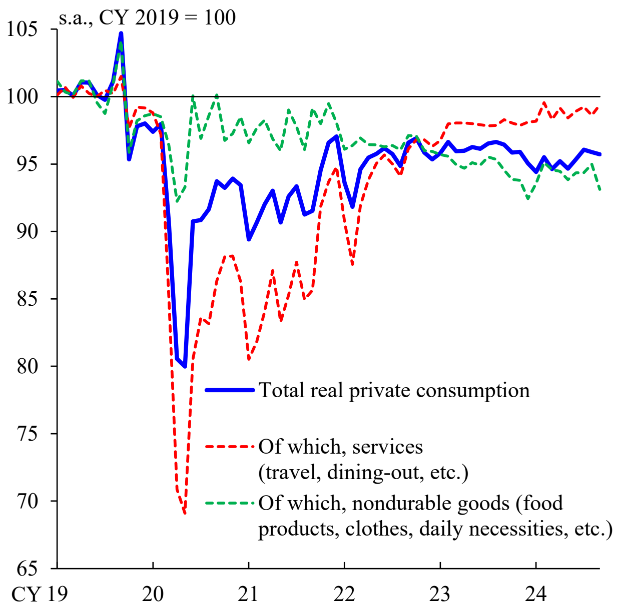


Notes: 1. In the middle chart, figures are current profits based on the *Financial Statements Statistics of Corporations by Industry, Quarterly* and exclude "finance and insurance." Figures from 2009/Q2 onward exclude pure holding companies.
2. In the right-hand chart, figures are based on the *Tankan*, 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.

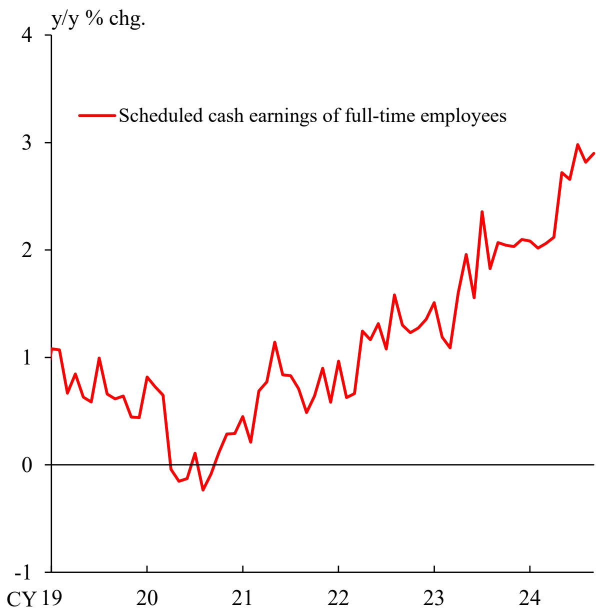
Sources: Bank of Japan; Ministry of Finance.

Household Sector

Private Consumption



Nominal Wages



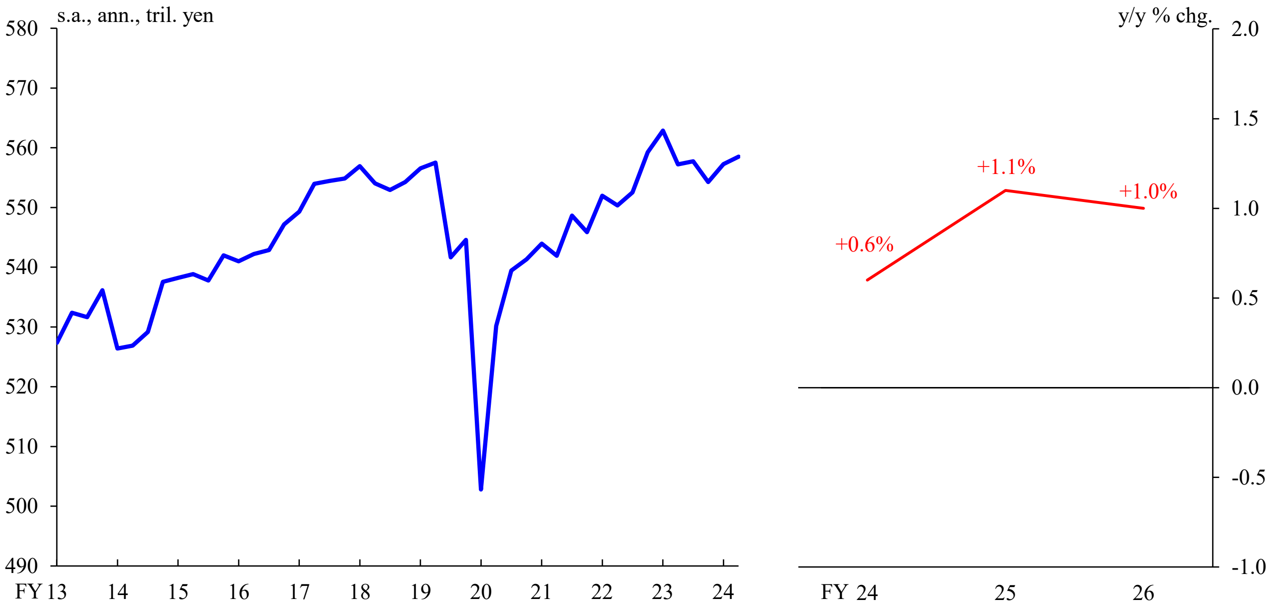
Notes: 1. In the left-hand chart, figures for total real private consumption are the real Consumption Activity Index (travel balance adjusted) based on staff calculations, which exclude inbound tourism consumption and include outbound tourism consumption.
2. In the right-hand chart, figures are based on continuing observations following the sample revisions.

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

Chart 3

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

Developments over Time *Forecasts*

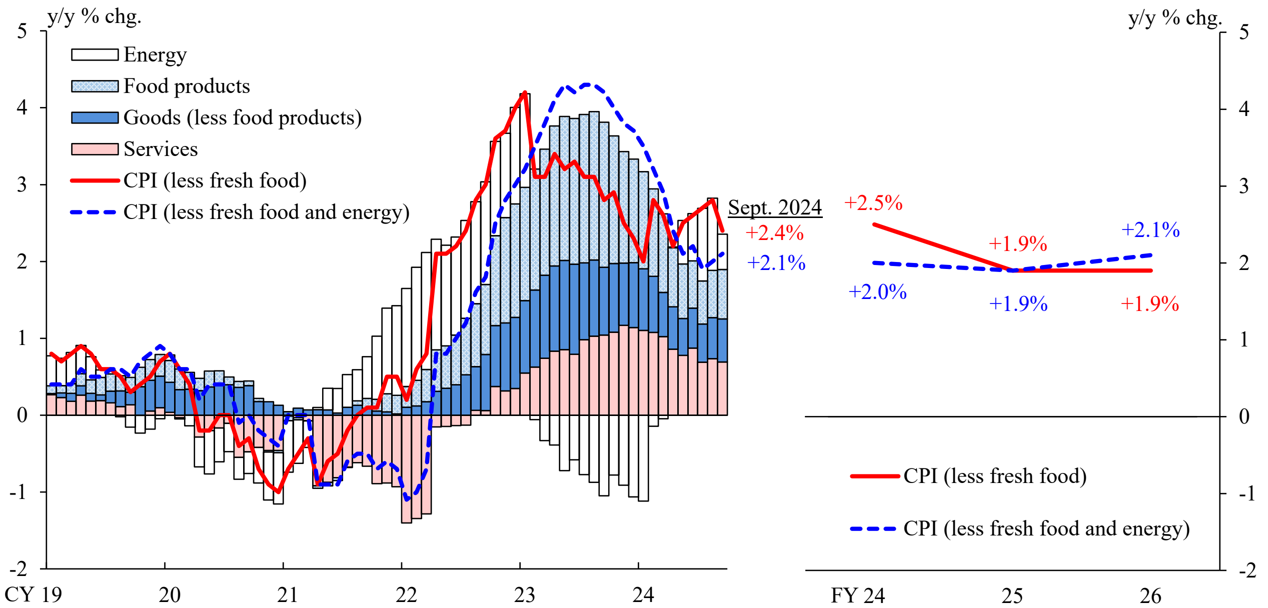


Note: In the right-hand chart, the forecasts presented are the medians of the Policy Board members' forecasts.
Sources: Cabinet Office; Bank of Japan.

Chart 4

Developments in Consumer Prices

Developments over Time *Forecasts*

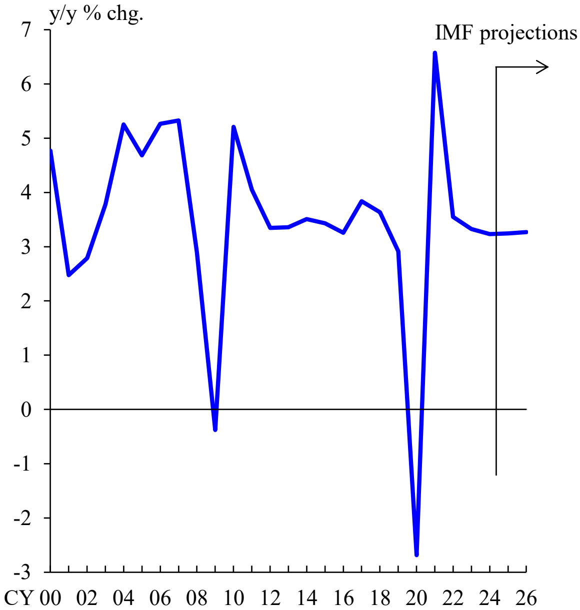


Note: In the right-hand chart, the forecasts presented are the medians of the Policy Board members' forecasts in the October 2024 Outlook Report.
Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

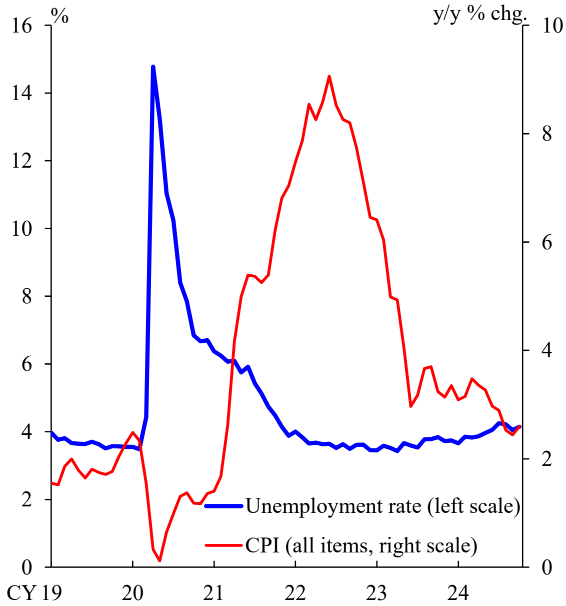
Chart 5

Overseas Economies

Global Growth Rate (IMF's October 2024 WEO)



U.S. Economy

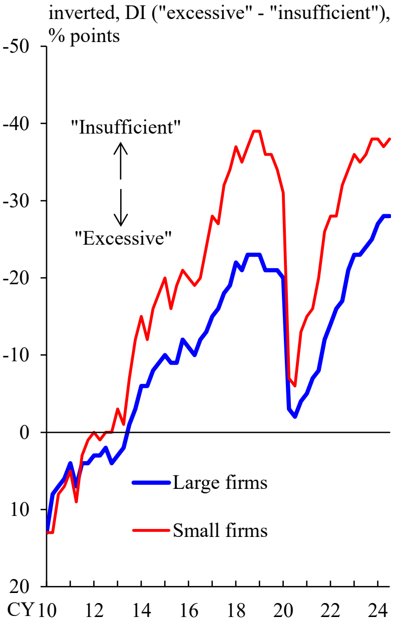


Sources: IMF; Haver.

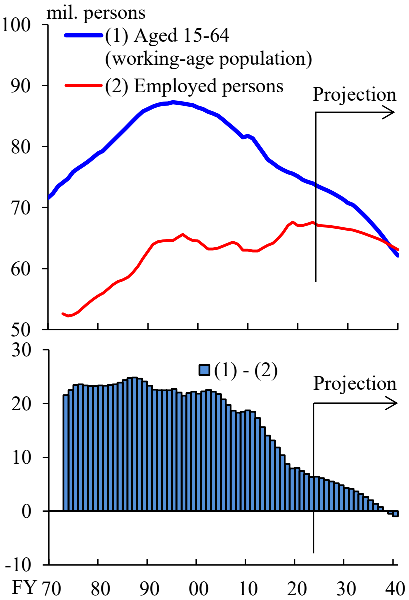
Chart 6

Environment Surrounding Wages

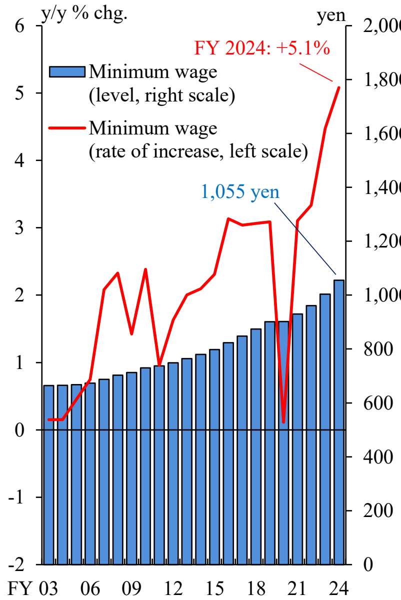
Labor Market Conditions



Projection for Labor Input



Developments in the Minimum Wage



Notes: 1. In the left-hand chart, figures are the employment conditions DI in the *Tankan*.
2. In the middle chart, the projection for the working-age population is by the National Institute of Population and Social Security Research. The projection for the number of employed persons is calculated based on projections by the Japan Institute for Labour Policy and Training.
3. In the right-hand chart, figures for the minimum wage are national weighted averages.

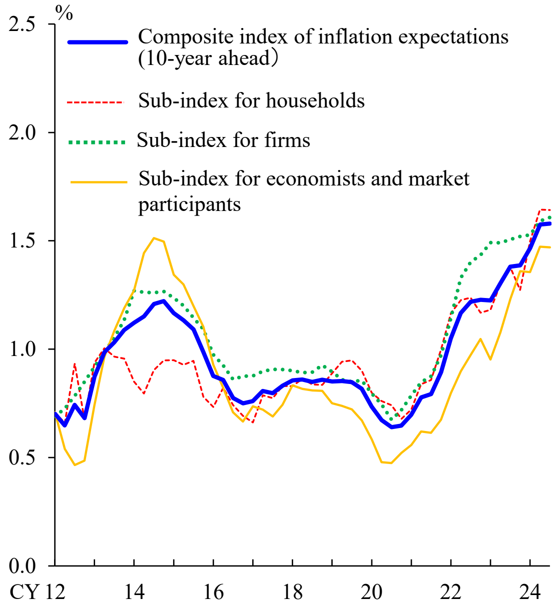
Sources: Ministry of Internal Affairs and Communications; National Institute of Population and Social Security Research; Japan Institute for Labour Policy and Training; Bank of Japan; Ministry of Health, Labour and Welfare.

II. Risks to Economic Activity and Prices

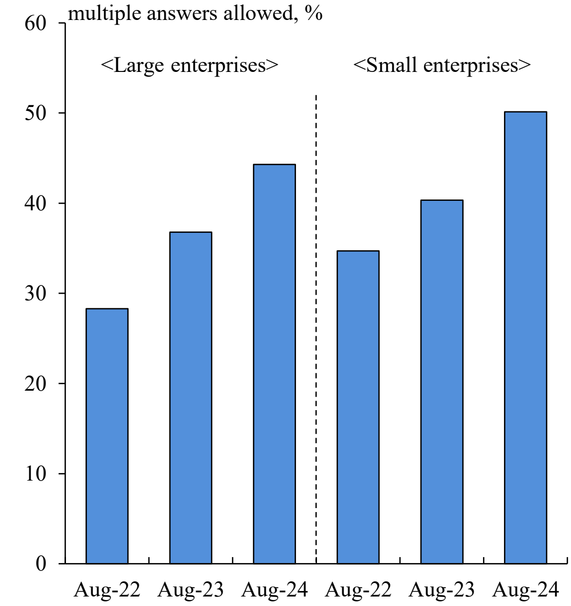
Chart 7

Changes in Firms' and Households' Mindset Regarding Wages and Prices

Inflation Expectations



Share of Establishments That Are Planning to "Improve Wages" to Address Labor Shortages



Notes: 1. For details of the approach on which the left-hand chart is based, see Box 4 of the April 2024 Outlook Report.
2. In the right-hand chart, figures are based on the *Survey on Labour Economy Trend*. Figures represent the share of establishments that answered that they are planning to "improve working conditions (wages) of current employees" as a measure to address labor shortages for the year ahead. Large enterprises are enterprises with 1,000 or more employees. Small enterprises are enterprises with 30 to 299 employees.

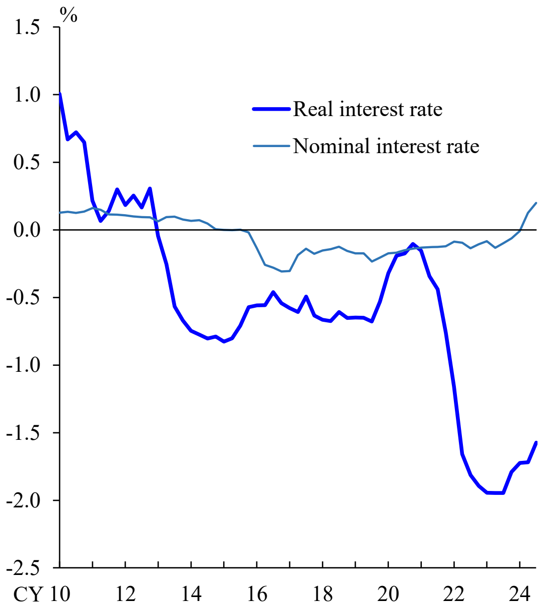
Sources: Ministry of Health, Labour and Welfare; Bank of Japan; QUICK, "QUICK Monthly Market Survey <Bonds>"; Consensus Economics Inc., "Consensus Forecasts"; Bloomberg.

III. The Bank's Conduct of Monetary Policy

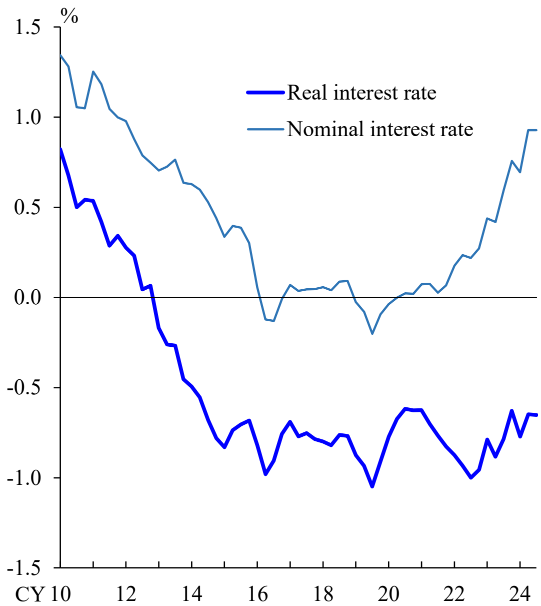
Chart 8

Financial Conditions

Real Interest Rate (1-Year)



Real Interest Rate (10-Year)



Note: Figures for the real interest rate for each maturity are calculated as government bond yields minus the composite index of inflation expectations (staff estimates) for the corresponding maturity.

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