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Bank of Japan

**Economic Activity, Prices,
and Monetary Policy in Japan**

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TAKATA Hajime

Member of the Policy Board

(English translation based on the Japanese original)

I. Economic Activity and Prices

I will begin with developments in economic activity and prices.

Overseas economies have grown moderately on the whole, although some weakness has been seen in part, reflecting trade and other policies in each jurisdiction. In the January 2026 *World Economic Outlook* (WEO) *Update*, the International Monetary Fund (IMF) revised upward its forecast for global growth from the April 2025 WEO, which had incorporated the significant impact of U.S. tariff policy, and from its subsequent October WEO (Chart 1). In addition, as shown in Chart 2, the upward revision in January 2026 has fully offset the downward revision in April 2025. Regarding the U.S. economy, despite initial concerns that domestic demand might decline due to the impact of reciprocal tariffs imposed in April 2025 by the Trump administration, the actual impact has been limited. Specifically, although there has been a slowdown in U.S. employment, corporate profits for IT-related firms in particular have improved. Amid anxiety about the future, deep-rooted concerns over consumption and investment remain but, buoyed by solid asset prices, consumption has been firm. In light of the slowdown in employment, the Federal Reserve cut its policy interest rate in September, October, and December 2025 (Chart 3). Meanwhile, wages and income have been robust, and AI investment has remained at a high level. I am of the view that a sharp economic slowdown triggered by credit contraction, which was common during past economic downturns in the United States, is unlikely, in light of stable financial conditions and the sound balance sheets of households, firms, and financial institutions. From the start of 2025, what might be called a "north wind" policy predominated in the United States -- i.e., a policy that, like the north wind in Aesop's fable, tends to favor pressure over persuasion, as represented by U.S. tariff policy in particular. Such a policy exerts a negative impact on economic growth. However, in 2026, given the expectation of tax cuts and the expansion in investment spurred by deregulatory initiatives, the situation in the United States appears to be shifting to a "sun" policy, which prefers persuasion and exerts a positive impact on economic growth. Large-scale tax refunds coming out of the One Big Beautiful Bill Act are also poised to make a positive contribution.¹ Moreover, because the unfolding of U.S. trade policy has engendered

¹ The One Big Beautiful Bill Act is a large-scale tax reform act passed in the United States in July 2025. The act includes permanent extensions of tax cuts introduced during the first Trump administration, substantial revisions to clean energy tax credits provided under the Inflation Reduction Act, and changes to international tax regulations.

a global sense of risk regarding the outlook for economic activity, other economies are also leaning toward adopting accommodative policies on both the fiscal and monetary fronts. Altogether, this is likely in turn to push up global economic activity.

Global Economic Environment in 2026

In my view, the global economic environment will go through a shifting phase in 2026, in which the movement toward recovery begins to gain momentum. This view is grounded in the fact that economies around the world have simultaneously adopted the same policy direction, namely, they have employed expansionary monetary and fiscal policies. From a macroeconomic perspective, such expansionary policies are expected to bring about an uplift in economic activity as is, from a structural perspective, increased investment fueled by the global AI boom. The present circumstance is similar to the period six years ago, in 2020, when economic stimulus measures from both monetary and fiscal sides were adopted simultaneously around the world during the COVID-19 pandemic. The worldwide harmonization of economic policies -- or, the synchronization of economic cycles -- can be said to occur when a global sense of risk emerges, such as the pandemic crisis in 2020 and the imposition of reciprocal tariffs by the Trump administration in 2025. Chart 4 shows the stance of monetary policy worldwide. As can be seen, after some tightening in 2022 and 2023, the various countries and regions went through a phase of monetary easing during 2025, cutting policy interest rates in a synchronized manner. This situation is similar to 2020, when policy interest rates were all lowered globally. At the same time, as shown in Chart 5, fiscal expansion has taken place in regions such as the United States, Europe, and China, producing expansionary effects in combination with monetary accommodation. Also, as was the case in 2020, these developments will likely serve as factors pushing up economic activity on a global basis. As a consequence, even though there were initial concerns about a global economic slowdown in 2025, currently, the possibility of an excess uplift in economic activity and ensuing inflationary pressure warrants attention, with expansionary monetary and fiscal policies being employed simultaneously and the additional new contribution of AI investment. Looking back at the period since 2020, the global economy initially stagnated as the pandemic caused a halt in the flow of people and logistics; from 2022, however, economic activity recovered and prices soared worldwide. Since the flow of people and logistics has returned, the global economy at this point is expected to see an early recovery from 2026 onward,

underpinned by the additional contributions of accommodative monetary and fiscal policies and the global AI boom. In fact, markets have started to factor in a potential shift to policy interest rate hikes by some central banks. Market expectations improved rapidly from the end of 2025 to the beginning of 2026, and stock prices have registered historical highs simultaneously in various markets. This may be owing to the contributions of accommodative monetary and fiscal policies employed around the world.

Japan's Economic Environment in 2026

The impact of U.S. tariff policy was initially expected to push down Japan's economy. The economic outlook for Japan from spring 2025 may be likened to a "planned suspension" of public transportation, in that the outlook was revised downward preemptively in anticipation of being hit by the "typhoon" of reciprocal tariffs beginning in April 2025 under the Trump administration (Chart 6). In reality, however, the Bank of Japan's December 2025 *Tankan* (Short-Term Economic Survey of Enterprises in Japan) revealed no slowdowns in the economy as a whole, while anecdotal information suggests that many view the impact of tariffs as being smaller than anticipated. In Japan's corporate sector, corporate profits for fiscal 2025 are projected to be at high levels, and the levels of wage increases to be agreed in the 2026 annual spring labor-management wage negotiations are likely to remain as high as in 2025 (Chart 7). Given the likelihood of seeing high levels of wage increases for three consecutive years in 2024, 2025, and 2026, the expectation is that a new norm for wages will become established and wage hikes will thereby take hold. Moreover, the Japan Business Federation (Keidanren) has expressed its stance that base pay increases should be considered the standard for wage negotiations. In the household sector, private consumption has been resilient against the background of an improvement in employee income, despite weakness in consumer sentiment due to the impact of price rises and other factors (Chart 8). These developments suggest that there has been no change in the structure in which an improvement in the employment and income situation underpins private consumption. The inflation rate has recently been above 2 percent due to a rise in rice and other food prices (Chart 9). Private consumption is expected to continue increasing moderately, however, with wage increases catching up with higher prices.

Looking at medium- to long-term inflation expectations of various economic entities to assess underlying inflation, expectations have continued to rise steadily (Chart 10). The fact that the national benchmark for the degree of increase in the minimum wage was raised to 6 percent for fiscal 2025 -- up a percentage point from fiscal 2024 -- also suggests that wages will increase. Moreover, as prefectures compete to raise their minimum wage levels to an extent that surpasses the national benchmark, the national weighted average of the minimum wage has risen by as high as 6.3 percent, which symbolizes a change in the norm for prices. The recent stance of labor unions toward base pay increases also warrants attention, in light of their view that such increases should aim to compensate not only for inflation in the preceding fiscal year but also inflation in prior years that has not been fully reflected in wages, and of the fact that the unions have taken a forward-looking approach in anticipation of future inflation.

As firms face supply-side constraints due to labor shortages -- in other words, a shift to a "labor shortage economy" -- their wage- and price-setting behavior has been active. With wage hikes taking hold, inflationary pressure is increasingly being driven by domestic factors. Under these circumstances, overall prices have been rising even amid a fall in energy prices, and the year-on-year rate of increase in the consumer price index (CPI) for all items excluding fresh food has remained at 2 percent and above for nearly four years, since April 2022 (Chart 9). Given that there has already been a shift away from the deflationary norm, combined with a rise in inflation expectations, I believe that, as far as recent domestic developments suggest, Japan's economy is at a stage where the price stability target is almost achieved.

Assessment of the Impact of U.S. Tariffs on Japan

Since the announcement of reciprocal tariffs in April 2025, I have closely monitored whether or not U.S. tariff policy will dampen the momentum toward achieving the price stability target in Japan. To this end, I have paid attention to the following four points in examining the transmission channels to Japan's economy of the impact of U.S. tariff policy. First, whether business fixed investment will weaken, due to heightened uncertainty. Second, whether exports will become sluggish, given a global economic slowdown caused by U.S. tariff policy. Third, whether a decline in corporate profits will restrain the momentum for wage increases in 2026, while also restraining selling prices. And fourth, whether the yen will appreciate

amid speculation over various policies of the U.S. administration, thereby pushing down corporate profits and import prices, for example. In other words, my focus has been on whether or not Japan's economy runs the risk of returning to deflation.

Let me assess how these four points have played out up to this point, about a year since the imposition of U.S. reciprocal tariffs in April 2025. With regard to the first point, no pronounced weakness in business fixed investment was suggested by the December 2025 *Tankan*. What caught my attention in particular was that investment plans for large manufacturers, which are considered to be susceptible to the impact of reciprocal tariffs, remained at high levels. In relation to the second point, the IMF revised upward its forecast for global economic growth in the January 2026 WEO *Update*, following an upward revision in October 2025, and the semiconductor cycle has also been on an uptrend, including in emerging economies. As for the third point, corporate profits for the first half of 2025 saw a decline for the manufacturing industry in particular but, partly reflecting the impact of the yen's depreciation, no notable developments among exporting firms have been confirmed that were weaker than expected. I would also like to point out that improvement in the financial position of Japanese firms as a result of longstanding business restructuring has made them more resilient to global shocks. As shown in the left panel of Chart 11, corporate profits expanded almost tenfold in fiscal 2024 compared to the second half of the 1990s, reaching their highest level on record of around 90 trillion yen. Japanese firms have built up resilience against shocks by lowering their break-even points over more than three decades to withstand even the yen's appreciation brought about by trade friction. Since autumn 2025, moreover, the earnings revision index, which indicates the degree of revision to firms' earnings forecasts, has been positive -- as shown in the right panel of Chart 11 -- and forecasts of corporate profits for fiscal 2025 have been revised upward. Considering this, corporate profits could show a year-on-year increase even for the full fiscal year.

Chart 12 presents a conceptual diagram of how growth in corporate profits is spreading across the economy. While corporate profits have expanded significantly from a macroeconomic perspective, several challenges have arisen at the microeconomic level. Specifically, wage hikes and price pass-through to business partners have been limited, due to the norm that wages and prices do not rise easily, and domestic business fixed investment has also been

limited. The government has taken policy actions to address this situation, including holding joint meetings on wage increases between representatives of the government, labor, and management, and implementing measures to promote price pass-through. The recent revision of the Subcontract Act, aiming at improving transaction practices, is also a supportive factor boosting Japan's economy as a whole.²

I have been concerned about the fourth point, namely, the possibility that markets may become volatile depending on expectations for the U.S. administration's policies, but the U.S. economy has so far avoided deterioration. Although the Federal Reserve moved to cut the policy interest rate in September 2025, the yen saw no appreciation and the U.S. economy remained resilient. Given this, the Federal Reserve paused its policy interest rate cuts at the January 2026 Federal Open Market Committee (FOMC) meeting.

In sum, my view on the four points of concern is that the fear of Japan's economy returning to deflation has been dispelled, as positive developments among firms in Japan have continued and as overseas trade policies potentially constraining such developments are unlikely to become a significant downside factor. Discussions that assume achievement of the price stability target therefore need to take place. Thus, in 2026, I believe it is necessary to move the focus more to upswings in prices, in light of expectations that overseas economies will go through a major shift, in which the movement toward recovery begins to gain momentum.

From the Long "Frozen Era" toward the Prospect of a "True Dawn"

In the midst of economic recovery around 2000 and in the mid-2000s, following the collapse of the bubble economy in Japan, global demand shocks resulted in several "false dawns,"³ or

² Effective from January 1, 2026, the Subcontract Act has been revised and renamed the Act on Proper Transactions with Small and Medium-Sized Entrusted Business Operators, commonly known as the Fair Transactions Act. The revision expands the scope of applicable transactions and business operators, strengthens measures to ensure fair dealings in transactions involving small and medium-sized entrusted business operators, and enhances protections for the interests of small and medium-sized subcontracting firms.

³ Shirakawa, M., "Way Out of Economic and Financial Crisis: Lessons and Policy Actions," speech at the Japan Society in New York, April 23, 2009, https://www2.boj.or.jp/archive/en/announcements/press/koen_2009/ko0904c.htm.

temporary economic recoveries, in the context of the behavior of Japanese firms and households. My expectation is that Japan will see a "true dawn"⁴ this time around; in other words, "this time is different," and we will see a situation that transcends the former norm that wages and prices do not rise easily. Looking back, the starting point of Japan's long-term stagnation in the wake of the bubble economy was around 1990. I believe that the long-term stagnation was caused by two main factors: (1) asset deflation, and (2) a prolonged business environment in which it was difficult to depend on external demand due to, for example, the yen's appreciation, brought about mainly by trade friction. As shown in Chart 12, my understanding is that, although Japanese firms weathered past trade friction and cost competition with firms overseas stemming from the yen's appreciation by means of restructuring, mainly in terms of wages, and of cost reduction, including involving affiliates, this had the side effect of creating the norm that I mentioned earlier.

Chart 13 shows developments in the Nikkei 225 Stock Average and the U.S. dollar/yen exchange rate. After peaking in 1989, the Japanese stock market entered a downtrend in complete isolation from the rest of the world, characterized by prolonged situations of asset deflation and a super-strong yen. This is what I call Japan's "frozen era," lasting for more than two decades, in which the economy fell into a deflationary state as if under a frozen spell. As shown in Chart 14, in the context of asset deflation, firms were inclined to pursue management with minimum assets, reducing the size of their balance sheets and reining in investment. At the same time, amid the yen's appreciation sparked by trade friction, firms continued to engage in business restructuring, in which they held down prices and wages in terms of income statements. While such management with minimum assets and business restructuring were survival strategies for individual firms, pursuing them persistently for more than a decade led to a shrinking equilibrium -- specifically, a deflationary equilibrium. With a view to "unfreezing" the rigid mindset that formed in this context, the Bank has conducted monetary easing for many years, including the large-scale monetary easing it started in 2013. With these efforts, a path toward an exit from the deflationary equilibrium has finally taken shape.

⁴ Nakaso, H., "Japan's Way toward Strong, Sustainable, and Balanced Growth: Assessment of the potential of the Japanese economy suggests the sun also rises," speech at a meeting hosted by the Japan Society and the City of London Corporation in London, October 5, 2017, https://www.boj.or.jp/en/about/press/koen_2017/ko171005a.htm.

In terms of the transmission of monetary policy, the Bank has indicated that, in addition to the traditional bank-centered intermediation channel through deposits and lending, in which lower interest rates improve the output gap, the financial and capital market channels (stock prices and foreign exchange rates) have also come to play a major role, as shown in Chart 15.⁵ This suggests that the Bank's monetary easing, by influencing the markets, is likely to have contributed to the shift away from asset deflation and the so-called six headwinds -- including the headwind of the yen's appreciation -- all of which prompted changes in corporate behavior in the post-bubble economy.⁶ I believe that the Bank's patient continuation of monetary easing over many years, along with its influence on the financial and capital markets -- which contributed to an improvement in asset prices and to a reversal in the excessive appreciation of the yen -- laid the groundwork for reaching the inflection point of the norm shift, marking a historic change since the collapse of the bubble economy. Building on this groundwork, it can be said that, from 2022, the "big push" that originated abroad acted as the final blow to dispel the norm in Japan.⁷ Furthermore, a new norm has now started to form, with base pay increases remaining high every year since 2023 and a high projected increase for 2026 as well.

As I explained, for many years since the 2000s, the Bank has patiently continued with monetary easing, supporting the normalization of both corporate and household behavior, which had fallen into a shrinking equilibrium. Consequently, corporate behavior has finally turned positive, as indicated in Chart 14. Moreover, as shown in Chart 16, bank lending has increased, suggesting that firms' latent appetite for investment, including for mergers and acquisitions, has begun to surface. My assessment that the price stability target is almost

⁵ For more details, see "Assessment for Further Effective and Sustainable Monetary Easing," Bank of Japan, March 19, 2021.

⁶ The following have been pointed out as the six headwinds faced by Japanese firms: the yen's appreciation; delayed negotiations on economic partnership agreements; high corporate tax rates; rigidity in the labor market; environmental regulations; and high electricity costs. For details, see, for example, Cabinet Office, *Annual Report on the Japanese Economy and Public Finance 2021 -- Towards a resilient Japanese economy: Accelerating innovation towards an economic society with strength and flexibility*, September 2021. This report is a summary of the Japanese original.

⁷ "Big push" is a term often used in development economics. It refers to a shift from one type of equilibrium to another, triggered by a major shock. The global trend of economic recovery starting in 2022 may have caused a historical shift away from the wage and price norm in Japan.

achieved reflects this shift to positive corporate behavior and the way in which such behavior has taken hold. The broad recognition that Japan's economy is already no longer in deflation also appears to be fostering a common understanding that the price stability target is almost achieved.

II. Recent Conduct of Monetary Policy

Let me now present my views on the Bank's future conduct of monetary policy.

The Bank decided to raise the policy interest rate to around 0.75 percent in December 2025, judging it appropriate to adjust the degree of monetary accommodation from the perspective of sustainable and stable achievement of the price stability target of 2 percent, as Japan's economic activity and prices had been developing generally in line with the Bank's outlook and the likelihood of realizing the outlook had been rising.

Even after this policy interest rate hike, real short-term interest rates have been significantly negative in Japan and accommodative financial conditions have been maintained (Chart 17). In cautiously examining the timing of another gear shift in monetary policy, I have paid attention to overseas factors, particularly those associated with tariff policy, and have concluded that initial concerns over these factors have abated.

Assessment of Monetary Policy Stances in Japan and Abroad

Still, given a possible deceleration in the U.S. economy owing to the impact of tariff policy, I consider it important, based on many years of history, to also carefully monitor the risk that the divergence of monetary policy stances between Japan and abroad could bring about high volatility in financial markets, particularly foreign exchange markets. In fact, since Japan's shift to a floating exchange rate system in the 1970s, there have been repeated correlations between the monetary policies of Japan, the United States, and Europe. Looking back on the previous five cycles of policy interest rate hikes from the 1970s under the floating exchange rate system, excluding the most recent one, the Bank of Japan raised its rate during the Federal Reserve's rate hike cycle, and also moved to cut rates after the Federal Reserve did. Hence, there was a possibility that the Federal Reserve's resumption of rate cuts would hinder the flexibility of the Bank of Japan's monetary policy. Having said that, as the U.S. economy is

currently unlikely to see a recession, the situation now is different from the periods after the collapse of the dot-com bubble around 2000 and in the wake of the Global Financial Crisis in the late 2000s. The Federal Reserve decided to cut its policy rate in 2025, but that decision was made in the context of risk management; moreover, U.S. long-term interest rates subsequently bottomed out and the yen's appreciation was avoided. Therefore, I believe that this latest rate cut, unlike cases seen repeatedly in the past, will not act to constrain rate hikes in Japan.

In short, monetary policy stances in Japan and abroad have moved in the opposite direction, with Japan raising its policy interest rate and other countries lowering their rates through 2025. For many years, including under the negative interest rate policy, Japan's interest rates were the lowest in the world, but today, as shown in Chart 18, the level of nominal interest rates no longer ranks the lowest globally. As shown in Chart 19, however, when comparing real interest rates -- that is, the nominal policy interest rate minus the inflation rate -- the rates in Japan remain at the lowest level in the world. Chart 20 shows the interest rate differentials between Japan and the United States in both nominal and real terms. Given that some participants in foreign exchange markets have recently paid attention to not only nominal but also real interest rate differentials, it is necessary to monitor price developments transmitted through exchange rates.

The economic environment could shift in 2026, from the phase of a global convergence toward policy interest rate cuts seen in 2025 to an interest rate hike cycle. As was shown in Chart 4, in 2020, when countries and regions converged toward rate cuts, it took more than a year before the global economy recovered and rate hikes began, owing partly to a halt in the flow of people and logistics. This time, however, the combination of worldwide AI investment and the boost provided by monetary and fiscal policies could spur a quicker transition to a cycle of global rate hikes. When interest rates started to rise globally in 2022, the Bank kept its policy interest rate unchanged to continue providing financial support to the economy, as the norm of prices and wages not increasing easily was still in effect. As a result, building on the effects of prolonged large-scale monetary easing, the global recovery from 2022 spilled over into Japan in the form of higher energy and food prices. This "big push" helped unfreeze

the existing norm and give impetus to prices and wages, paving the way for the termination of large-scale monetary easing in 2024.

Today, the norm of prices not increasing easily has already been dispelled. In addition, medium- to long-term inflation expectations have risen, as suggested by Chart 21, which shows the BEI (break-even inflation) rate calculated using inflation-indexed Japanese government bonds (JGBs). Considering these factors, price increases now have a greater tendency to generate second-round effects. Moreover, it is necessary to bear in mind the risk that Japan might face greater-than-expected upswings in prices if overseas factors that push up prices emerge. In light of expectations in 2026 for a fourth round of wage increases, mainly in the form of base pay increases, I believe the Bank should make a further gear shift, and engage in communication that assumes that the price stability target is almost achieved.

Consideration on the Neutral Interest Rate

The neutral interest rate is currently a focus of attention in the markets. I was involved in the bond market for more than 40 years from the 1980s and, during that time, experienced the policy interest rate hike cycle that took place from the late 1980s to the early 1990s. However, the concept of the neutral interest rate was never a topic of market discussion in those days. Since the neutral interest rate and the natural rate of interest underlying it are important from a theoretical perspective, the Bank has estimated the level of the natural rate of interest, as shown in Chart 22. During a policy rate hike cycle, I consider the neutral interest rate as akin to a mountain about to be climbed. That is, a certain level of preparation is required whether the destination is a towering eminence like Mount Fuji or a smaller mountain like Mount Takao, but the equipment needed for the climb naturally differs. Just as it is important to know what kind of mountain is involved, I believe a common understanding of a certain benchmark for the neutral interest rate is needed, including a concept of what the rate actually is.

In practice, however, the neutral interest rate is difficult to identify; I have previously likened it to a rainbow -- something that is visible from afar but which vanishes when getting closer. In the United States and Europe, the neutral interest rate has been a standard concept since the 1990s, informed by past economic cycles. Japan, on the other hand, was in its own deflationary trend during that time, and there is debate over the efficacy of deriving estimates

from data from that period. It is difficult to compare a large country like the United States, where it is possible to estimate the neutral interest rate based on the domestic economic environment, with a country like Japan, where it is harder to assume such a possibility. In other words, it is necessary to take into account the fact that the neutral interest rate in Japan tends to be substantially influenced by the overseas environment. Given these circumstances, if economic recoveries and policy interest rate hikes occur globally from 2026 onward, there is a risk of the Bank unintentionally falling behind the curve. In practice, market participants tend to focus on the peak level of the policy interest rate -- i.e., the terminal policy rate -- and therefore there is also a risk if the two rates were to be confused.

Underlying Inflation and Headline Inflation

During Japan's prolonged deflationary period, it was necessary that the Bank -- in terms of communicating with the markets -- patiently continue with monetary easing as long as the shrinking equilibrium -- in other words, the norm of wages and prices not increasing easily -- remained in place, on the basis that underlying inflation had not yet reached the price stability target, even if headline inflation exceeded 2 percent. I would like to explain the relationship between underlying inflation and headline inflation using the analogy of frozen food and a microwave oven. For a long time, ever since the collapse of the bubble economy, I have thought of Japan's price situation as being somewhat like frozen food. To try to unfreeze it, the Bank has been "heating it in the microwave." On several occasions from the 2000s, the surface appeared to have defrosted, only to freeze over again each time it was removed from the microwave -- put differently, there were a series of "false dawns" in which the center was never truly heated through. If underlying inflation corresponds to the temperature at the center, the situation can be illustrated as follows: even when the surface temperature -- meaning headline inflation -- rose, the temperature at the center -- that is, underlying inflation -- did not rise high enough. However, with the patient continuation of monetary easing for many years laying the necessary groundwork, global inflationary pressure since 2020 has likely heated the center of the frozen food. It is from this perspective that I now see Japan's economy as having almost achieved the price stability target and am thus expecting a "true dawn." That said, attention is warranted on the possibility that, once the center has warmed up, the economy will become more susceptible and respond more quickly to external warming forces. To use a different analogy, water with ice floating in it

remains at zero degrees, but once the ice has melted in the warming process, the overall water temperature rises rapidly.

Importance of Exiting from Large-Scale Monetary Easing

At the January 2026 Monetary Policy Meeting (MPM), I proposed that the Bank raise the policy interest rate to 1.0 percent as a further gear shift to adjust the degree of monetary accommodation. My reasoning was as follows. The norm that wages and prices do not rise easily has now been dispelled, underlying inflation has risen, as mentioned earlier, and Japan's economy has returned to normal. Given this situation, I came to believe that it was vital to address the situation focusing on the current level of headline inflation. Considering that the once deeply entrenched norm has waned and that the price stability target is almost achieved, I felt it was necessary to gradually raise the policy interest rate. Furthermore, with an expected shift in overseas interest rate environments, I thought it necessary from a forward-looking perspective to continue adjusting Japan's real interest rates, which remain significantly lower than the rates seen overseas.

Monetary policy in Japan is now at a point of exiting from many years of large-scale monetary easing, and I recognize that how smooth this exit is will determine how that easing will come to be judged. With respect to the conduct of monetary policy, I view that a "true dawn" is finally within sight and, on this basis, consider the Bank to be in the process of gradually shifting gears. The reason behind this is that the behavior of firms has turned positive. As shown in Chart 23, various indicators suggest that financial conditions even now remain accommodative, and that the significantly negative real interest rates have sparked activity in corporate lending across a wide range of industries. I recognize that it is necessary to conduct further rate hikes in a gradual manner, rather than aiming to reach the expected neutral interest rate, after thoroughly gauging the degree of accommodation, informed not only by developments overseas but also by a broad set of data and information on domestic financial conditions.

Reduction in JGB Purchases and the JGB Market

A key consideration in the strategy for exiting from large-scale monetary easing is the JGB market, which is drawing growing attention from market participants. Having worked in the

JGB market from the 1980s, I would like to briefly look back at past developments and consider where the market stands at present. Chart 24 shows developments over the past 40 years in the yield of 10-year JGBs, which stands in as an indicator of long-term interest rates. Looking back over these four decades, long-term interest rates rose to a peak in 1990 but then followed a downtrend after the collapse of the bubble economy. Yields remained at low levels as the Bank undertook substantial JGB purchases under the large-scale monetary easing it started in 2013 and then introduced yield curve control (YCC) in 2016. The situation shifted in 2024, as large-scale monetary easing reached the point of exit.

Given that the price stability target is almost achieved and that the norm of prices and wages not increasing easily has been dispelled, I believe YCC, with which the Bank controlled long-term interest rates for many years, fulfilled its historical role in 2024; now is the time to head toward marketization and normalization. Therefore, I think the Bank needs to aim to shift away from the deterioration in JGB market functioning caused by its large-scale JGB purchases and move toward normalization by reducing its purchases. At the same time, considering the current size and composition of the Bank's balance sheet, I believe that -- with a view to adjusting the degree of monetary accommodation -- the Bank is at a phase where it should deliberate on reducing the size of the balance sheet.

In this regard, with respect to outright purchases of JGBs, the Bank decided in June 2024 to reduce its purchase amount. It then conducted an interim assessment of the reduction plan at the June 2025 MPM. Based on the assessment, the Bank decided to continue to cut down its monthly purchase amount by about 400 billion yen each calendar quarter until January-March 2026 (Chart 25). Thereafter, the amount of purchases will be reduced by about 200 billion yen each calendar quarter, so that it will be about 2 trillion yen in January-March 2027. The Bank's JGB reduction plan stipulates that, in principle, long-term interest rates are to be formed in financial markets, and that the Bank will reduce its JGB purchase amount in a predictable manner, while allowing enough flexibility to support stability in the JGB market.

Moreover, from the perspective of maintaining smooth market functioning, I believe the Bank should take time and be prudent in reducing its JGB purchases. Purchases thus far had served to lower interest rates through the stock effect, in which the total amount of JGBs in the

market is held back by increasing the Bank's JGB holdings. Conversely, the reduction in purchases will supply the market with some portion of the JGBs the Bank has purchased to date, in effect resulting in an increase in the amount of JGBs in the market. Taking this into consideration, it can be said that the market is in a phase of seeing one of the largest supplies of JGBs compared to the past. Chart 26 shows historical developments in the net issuance of JGBs, representing the annual change in the outstanding amount of JGBs issued. By deducting the annual change in the Bank's JGB holdings -- which factors in the amount of its JGB purchases that year -- from the net JGB issuance, the annual change in the outstanding amount of JGBs in the market can be derived, which in effect represents the supply of JGBs to the market. The chart indicates the extent to which the reduction in the Bank's JGB purchases has led to an increase in the outstanding amount of JGBs in the market relative to the 1980s. I believe it is necessary to closely examine developments in the JGB market, as the annual change in the outstanding amount of JGBs for fiscal 2025 is estimated to exceed the record high level in the early 2000s.

The JGB Market and Risk Premiums

Let us return to Chart 24. Looking back at the trend in long-term interest rates since the 1980s and the term spread over that period -- here, the difference between the 10-year JGB yield and the policy interest rate -- a term spread in excess of 2 percent existed as a risk premium until the introduction of large-scale monetary easing. Under large-scale monetary easing, by contrast, the term spread continued to be compressed by the stock effect of the Bank's JGB purchases and expectations generated by YCC. If the term spread truly reflects the risk premium on JGB investments, in addition to expectations of higher short-term interest rates, investors may come to demand a certain level of risk premium for bearing an interest rate risk, now that the exit from large-scale monetary easing is under way and the JGB market has begun to function normally again. Moreover, in addition to the aforementioned reduction in the Bank's JGB purchases, the loan-deposit gap at deposit-taking financial institutions is an important factor to consider when projecting developments in the JGB market. As shown in Chart 27, the large loan-deposit gap has supported demand for JGBs so far, but an increase in lending could narrow this gap, reducing the capacity of deposit-taking financial institutions to invest in JGBs.

I would like to note that, during the process of normalizing monetary policy, it is desirable for the Bank to avoid causing market volatility that significantly exceeds the risk premium demanded by market participants. Needless to say, the reduction in the Bank's JGB purchases does not aim at giving consideration to the fiscal situation. That said, since the reduction in purchases in effect supplies the market with JGBs, I believe it is also necessary, in terms of the functioning of the market as a whole, to ensure stability and thereby avoid causing excessive volatility. If such volatility were to occur, there is a risk of the JGB market experiencing a deterioration in functioning or becoming dysfunctional, which would necessitate an appropriate response. The history of the JGB market since the 1980s in Japan has been one of building a well-functioning market in step with financial liberalization. Careful handling is required in this sense to maintain this vital component of capital market infrastructure.

Looking back over the past year, there have been some unexpected structural changes in the market, such as weakening investment demand for super-long-term JGBs. Given this, I believe it is necessary to carefully examine the situation in view of the interim assessment of the JGB reduction plan at the June 2026 MPM. Moreover, since supply and demand conditions for super-long-term JGBs in particular are expected to remain of concern, it is necessary to keep a close eye on developments in long-term interest rates and to communicate effectively with the market while taking into account the behavior of financial institutions. At the same time, to maintain the smooth functioning of the JGB market, the Bank needs to monitor the situation carefully in close cooperation with the issuing authority, based on their respective roles. In exceptional circumstances, the Bank may also need to consider a flexible response, including purchases of JGBs.

Thank you.



Economic Activity, Prices, and Monetary Policy in Japan

Speech at a Meeting with Local Leaders in Kyoto

February 26, 2026

TAKATA Hajime

Member of the Policy Board

Bank of Japan

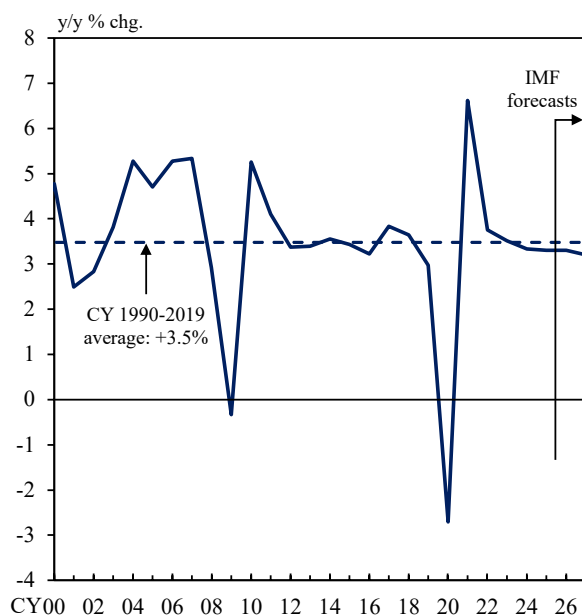
Chart 1

Developments in Overseas Economies:

IMF's January 2026 WEO *Update* (1)

(Upward revisions to growth projections have continued globally)

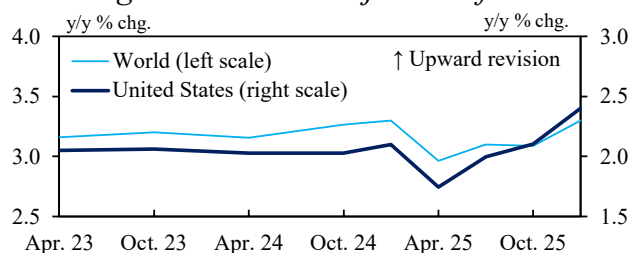
Global Growth Rate



Growth Rates in Major Economies

	y/y % chg., % points			
	CY 2024	CY 2025	CY 2026 [Forecast]	CY 2027 [Forecast]
World	3.3	3.3	3.3 (0.2)	3.2 (0.0)
Advanced economies	1.8	1.7	1.8 (0.2)	1.7 (0.0)
United States	2.8	2.1	2.4 (0.3)	2.0 (-0.1)
Euro area	0.9	1.4	1.3 (0.1)	1.4 (0.0)
Emerging market and developing economies	4.3	4.4	4.2 (0.2)	4.1 (-0.1)
China	5.0	5.0	4.5 (0.3)	4.0 (-0.2)

Changes in Growth Projections for 2026



Note: In the table, figures in brackets are the differences from forecasts in the October 2025 *World Economic Outlook* (WEO).

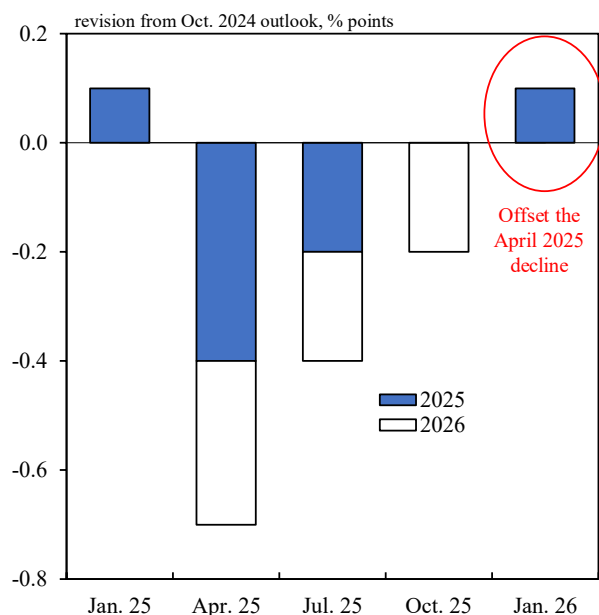
Source: IMF.

Developments in Overseas Economies:

IMF's January 2026 WEO Update (2)

(Increase in global growth is projected to fully offset the April 2025 decline)

Revisions to the Global Economic Growth Outlook



IMF Comments on the January 2026 WEO Update

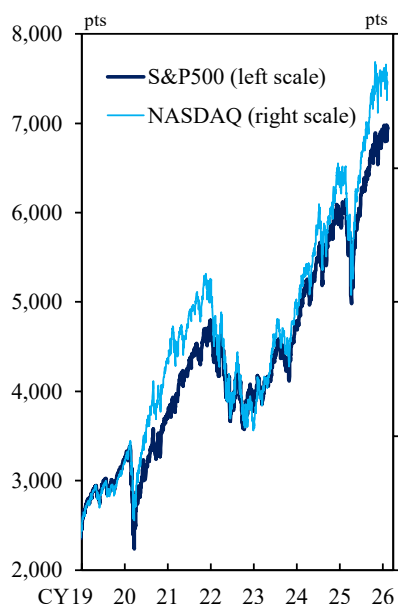
- Global economic growth continues to show resilience despite the tariff shock and heightened uncertainty.
- Consequently, current growth projections are **broadly unchanged from a year earlier**.
- This strength reflects a confluence of factors, including easing trade tensions, **increased fiscal stimulus, accommodative financial conditions, and the continued surge in investment in the IT sector, especially in AI.**

Source: IMF.

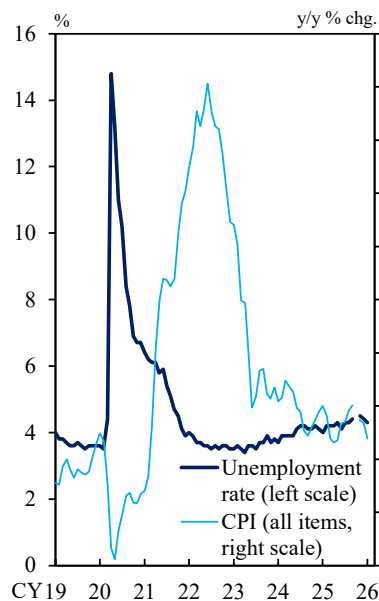
U.S. Economy

(U.S. economy remains firm amid policy rate cuts despite weak employment)

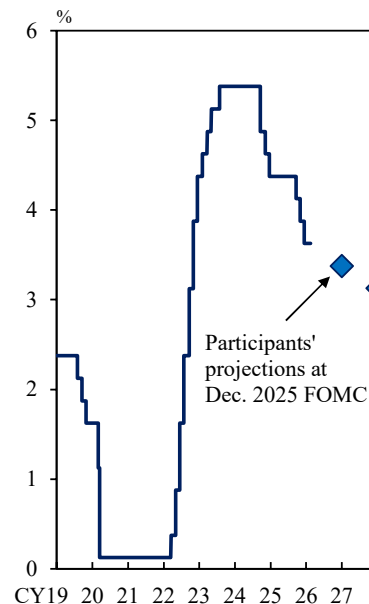
Stock Prices



Employment and Prices



Policy Interest Rate



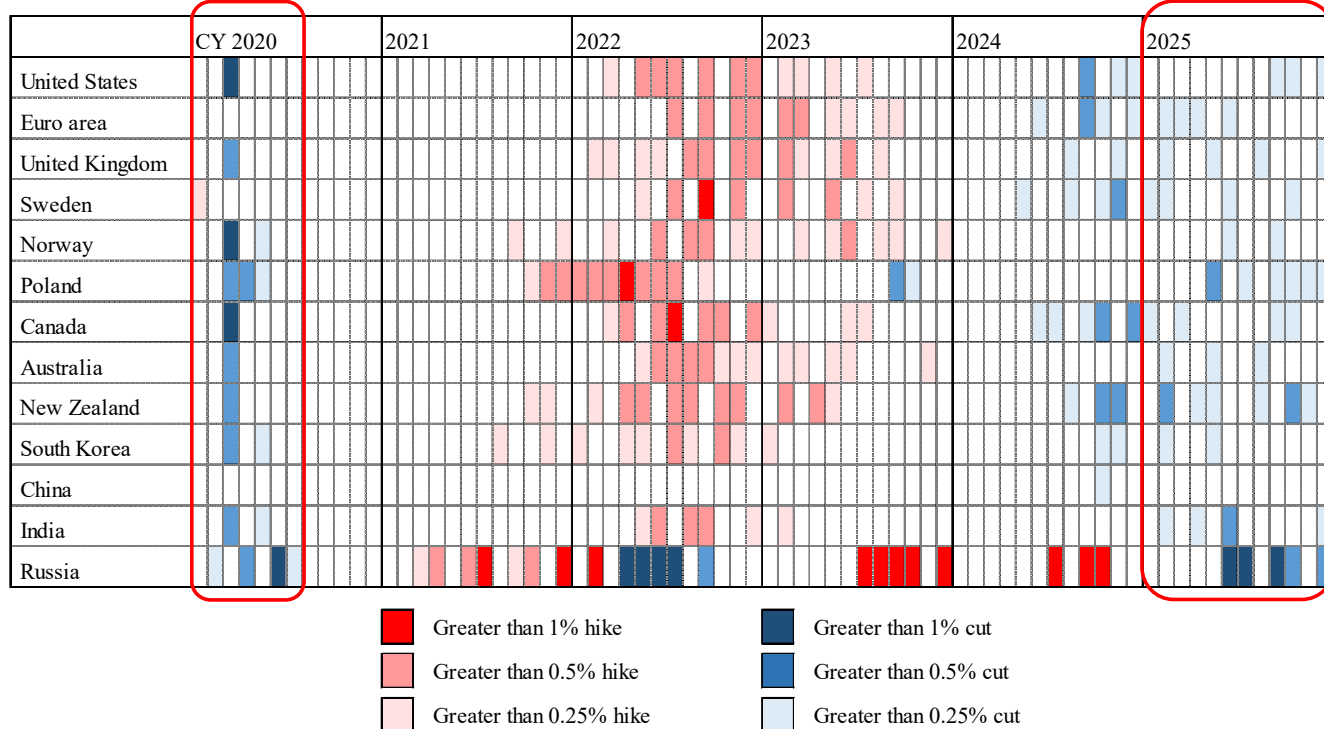
Note: In the right panel, figures are medians of the target ranges for the federal funds rate. Figures for participants' projections are medians of all projections at FOMC meetings.

Sources: Bloomberg; BLS; FRB.

Positive Contribution of Monetary Policy Across the World (Economies converged toward easing in 2025, as in 2020)

Similarly converged toward easing in 2020

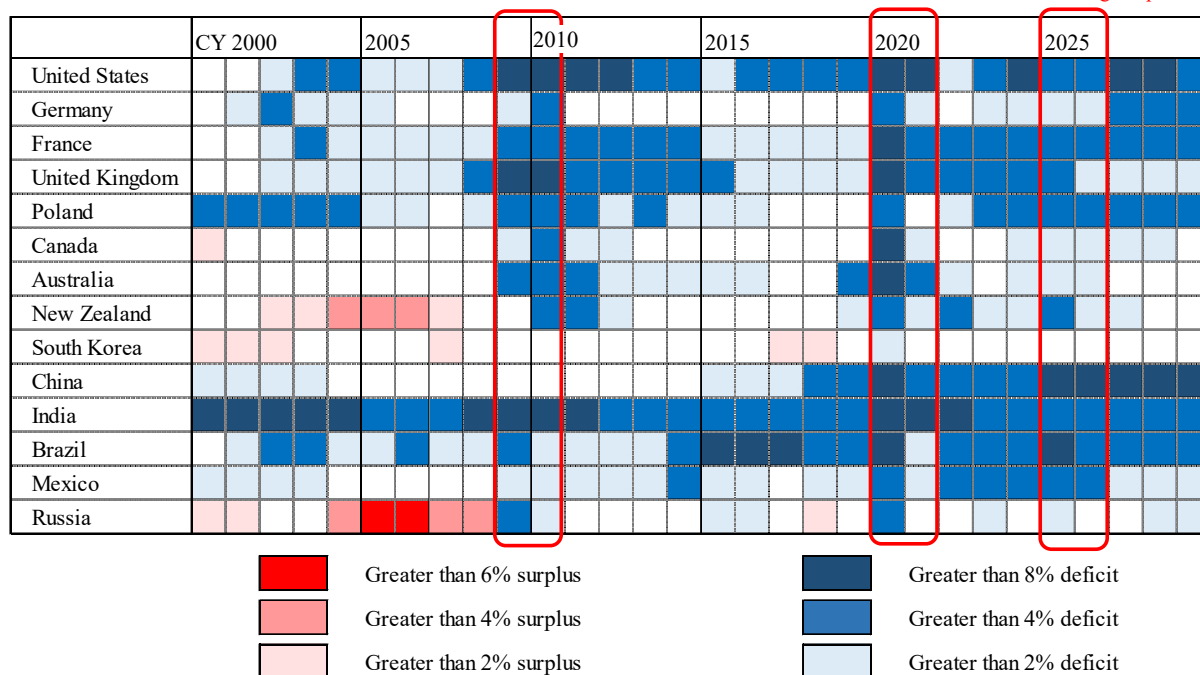
Converged toward easing in 2025



Sources: Overseas central banks.

Positive Contribution of Fiscal Policy Across the World (Global fiscal expansion has taken place since 2025, as seen during the COVID-19 pandemic)

Fiscal Balance (GDP Ratio, %) Global fiscal expansion similar to after the Global Financial Crisis and during the pandemic

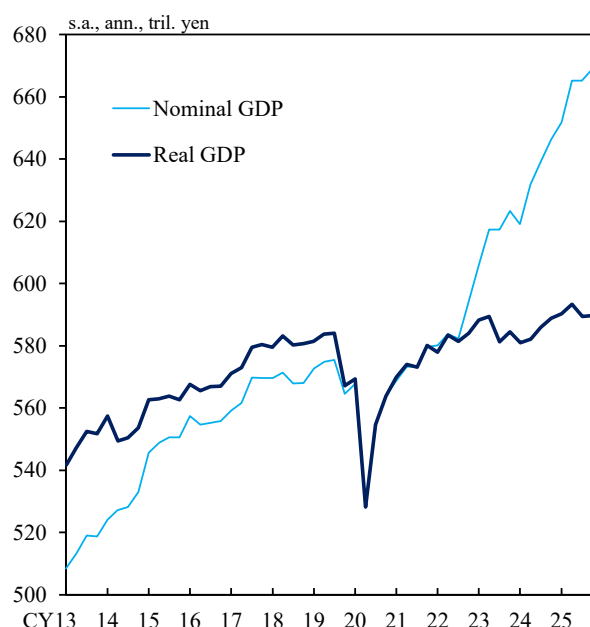


Source: IMF.

Japan's GDP and Outlook for Economic Activity and Prices

(Japan's economy is likely to improve moderately)

GDP



Outlook for Economic Activity and Prices

(January 2026 Outlook Report)

	y/y % chg.		
	Real GDP	CPI (less fresh food)	CPI (less fresh food and energy)
Fiscal 2025	+0.9	+2.7	+3.0
As of October 2025	+0.7	+2.7	+2.8
As of July 2025	+0.6	+2.7	+2.8
Fiscal 2026	+1.0	+1.9	+2.2
As of October 2025	+0.7	+1.8	+2.0
As of July 2025	+0.7	+1.8	+1.9
Fiscal 2027	+0.8	+2.0	+2.1
As of October 2025	+1.0	+2.0	+2.0
As of July 2025	+1.0	+2.0	+2.0

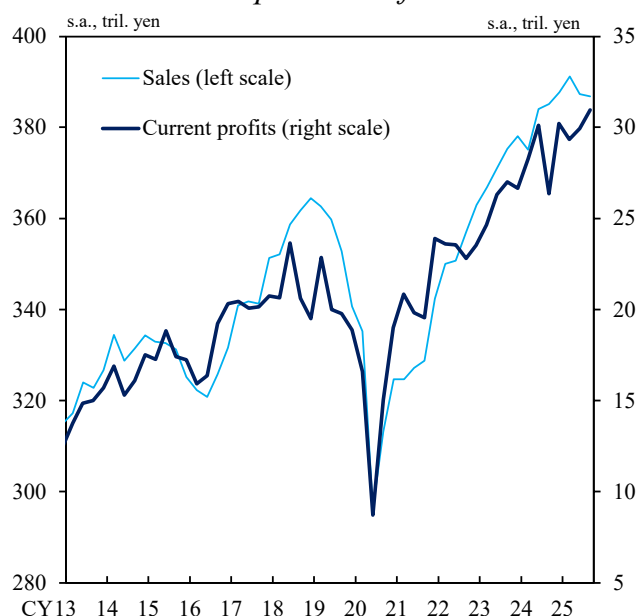
Note: In the right panel, figures indicate medians of Bank of Japan Policy Board members' forecasts (point estimates).

Sources: Cabinet Office; Bank of Japan.

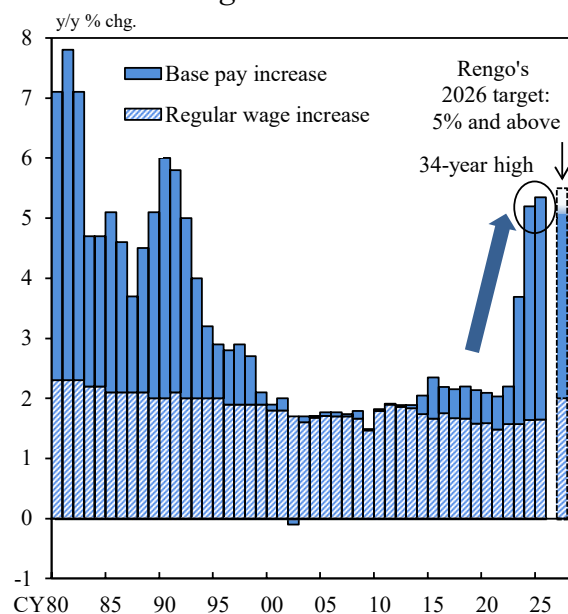
Corporate Sector and Wage Growth in Japan

(Corporate profits are at high levels and the wage growth rate remains at its highest level in 34 years since the bubble period)

Corporate Profits



Wage Growth Rate



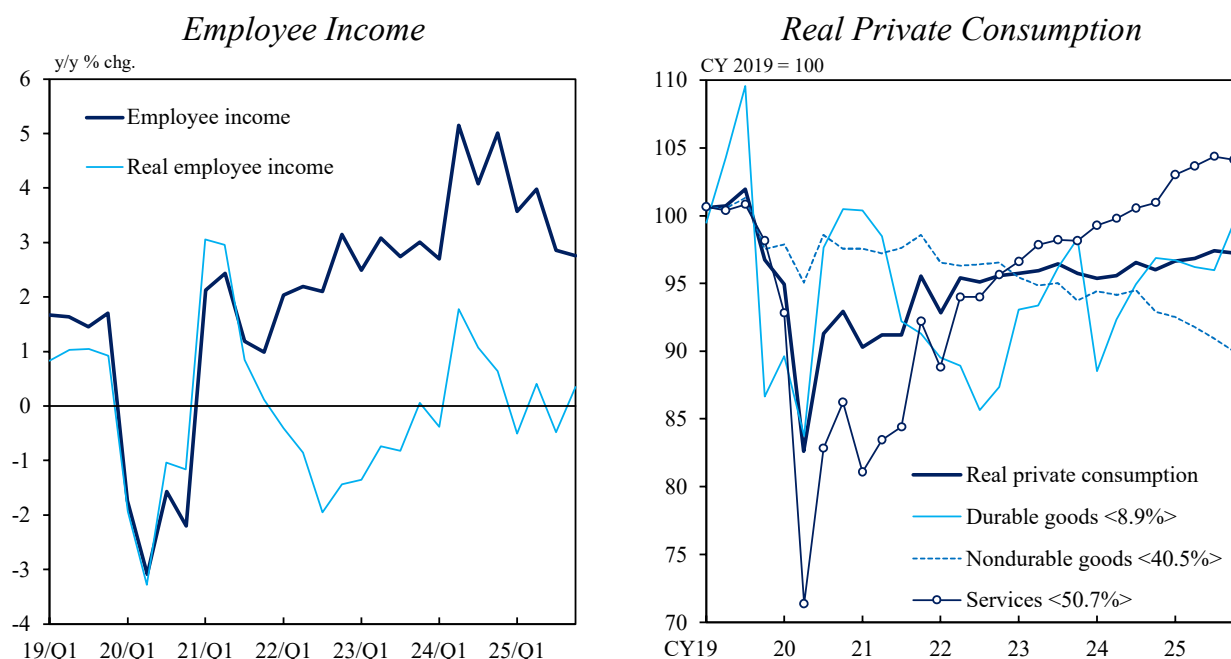
Notes: 1. In the left panel, figures are based on the *Financial Statements Statistics of Corporations by Industry, Quarterly* and exclude the finance and insurance industries.

2. In the right panel, figures from 1980 to 2014 are those published by the Central Labour Relations Commission; figures from 2015 to 2025 are those released by Rengo. Figures for 2026 are Rengo's targets for wage hikes for the 2026 annual spring labor-management wage negotiations.

Sources: Central Labour Relations Commission; Japanese Trade Union Confederation (Rengo); Ministry of Finance.

Private Consumption in Japan

(The employment and income situation has been resilient)



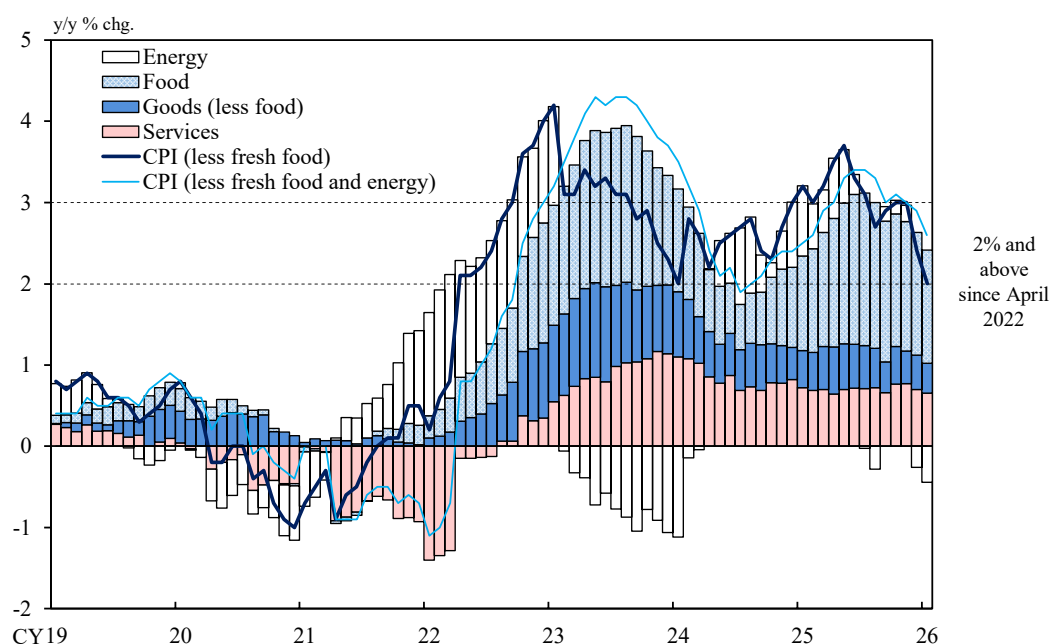
Notes: 1. In the left panel, Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February. Employee income = Total cash earnings (*Monthly Labour Survey*) × Number of employees (*Labour Force Survey*). Figures for real employee income are based on Bank staff calculations using the CPI (less imputed rent). Figures from the *Monthly Labour Survey* are based on continuing observations following the sample revisions.

2. In the right panel, figures for real private consumption are the real Consumption Activity Index (travel balance adjusted) based on Bank staff calculations, which exclude inbound tourism consumption and include outbound tourism consumption. Figures in angle brackets show the weights in the index.

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

CPI Inflation in Japan

(Inflation has remained at 2% and above for nearly four years)



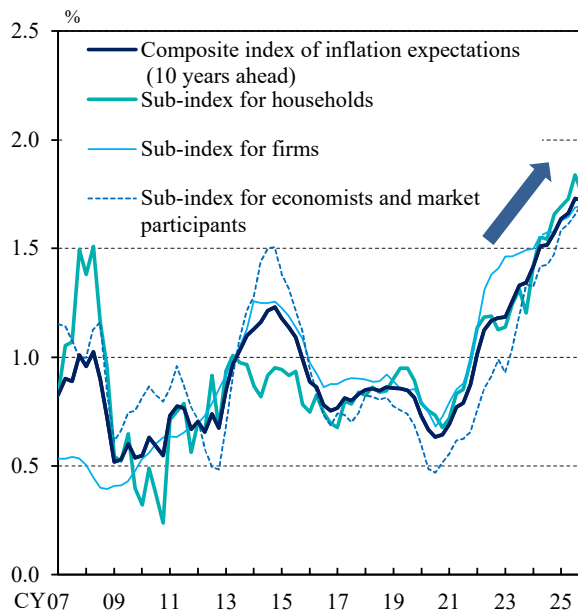
Source: Ministry of Internal Affairs and Communications.

Inflation Indicators for Japan

(Inflation expectations have continued to rise moderately)

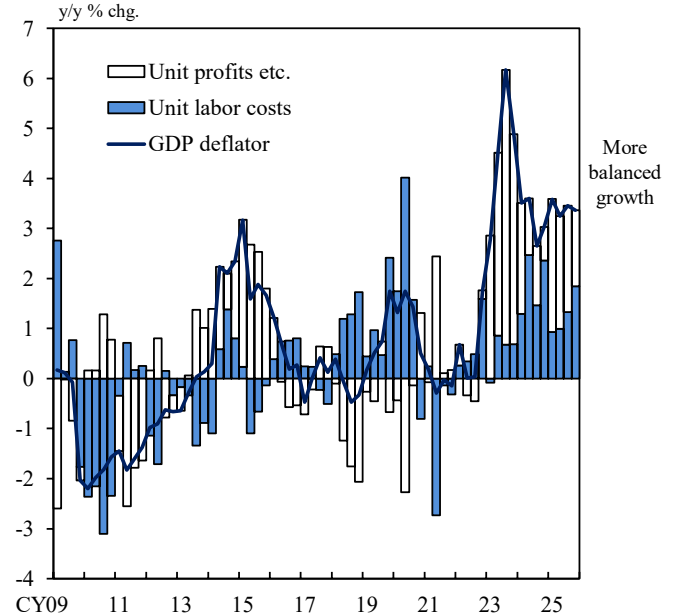
Composite Index of Inflation Expectations

(Medium- to long-term inflation expectations of various economic entities)



GDP Deflator

(Reflection of domestic inflationary pressure)



Notes: 1. In the left panel, the composite index is calculated by extracting common components, based on the first principal component, of the inflation expectations of firms, households, and economists and market participants. For details of the calculation method, see Box 4 of the April 2024 Outlook Report.

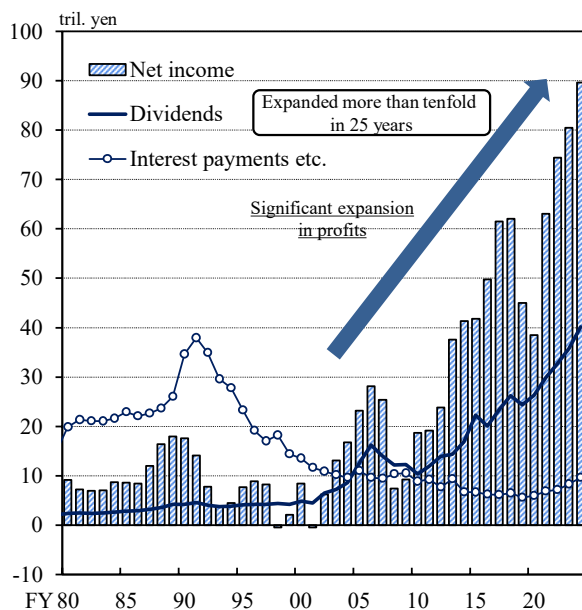
2. In the right panel, unit labor costs = nominal compensation of employees / real GDP.

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

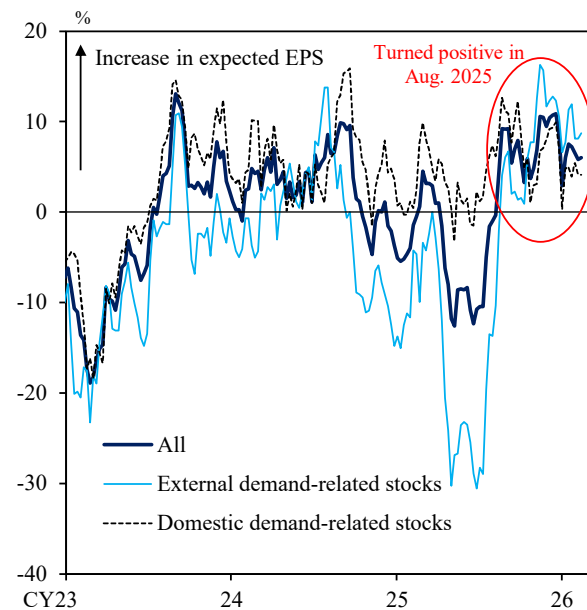
Rapid Expansion in Japan's Corporate Profits

(Corporate profits are at historical high levels and expectations of improvement have remained high since the second half of 2025)

Corporate Profits



Earnings Revision Index (TOPIX)



Notes: 1. In the left panel, figures are based on the *Financial Statements Statistics of Corporations by Industry, Annually*, and exclude the finance and insurance industries.

2. In the right panel, the earnings revision index is calculated as the ratio of the difference between (1) the number of listed firms for which analysts' estimates of 12-month forward earnings per share (EPS) were revised upward from the preceding month and (2) the number of listed firms that saw downward revisions.

Sources: LSEG Datastream; Ministry of Finance.

Chart 12

My View on Mechanism of Expanding Corporate Profits and Ensuing Challenges

(Expanding corporate profits have spilled over to households, SMEs, and regional firms)

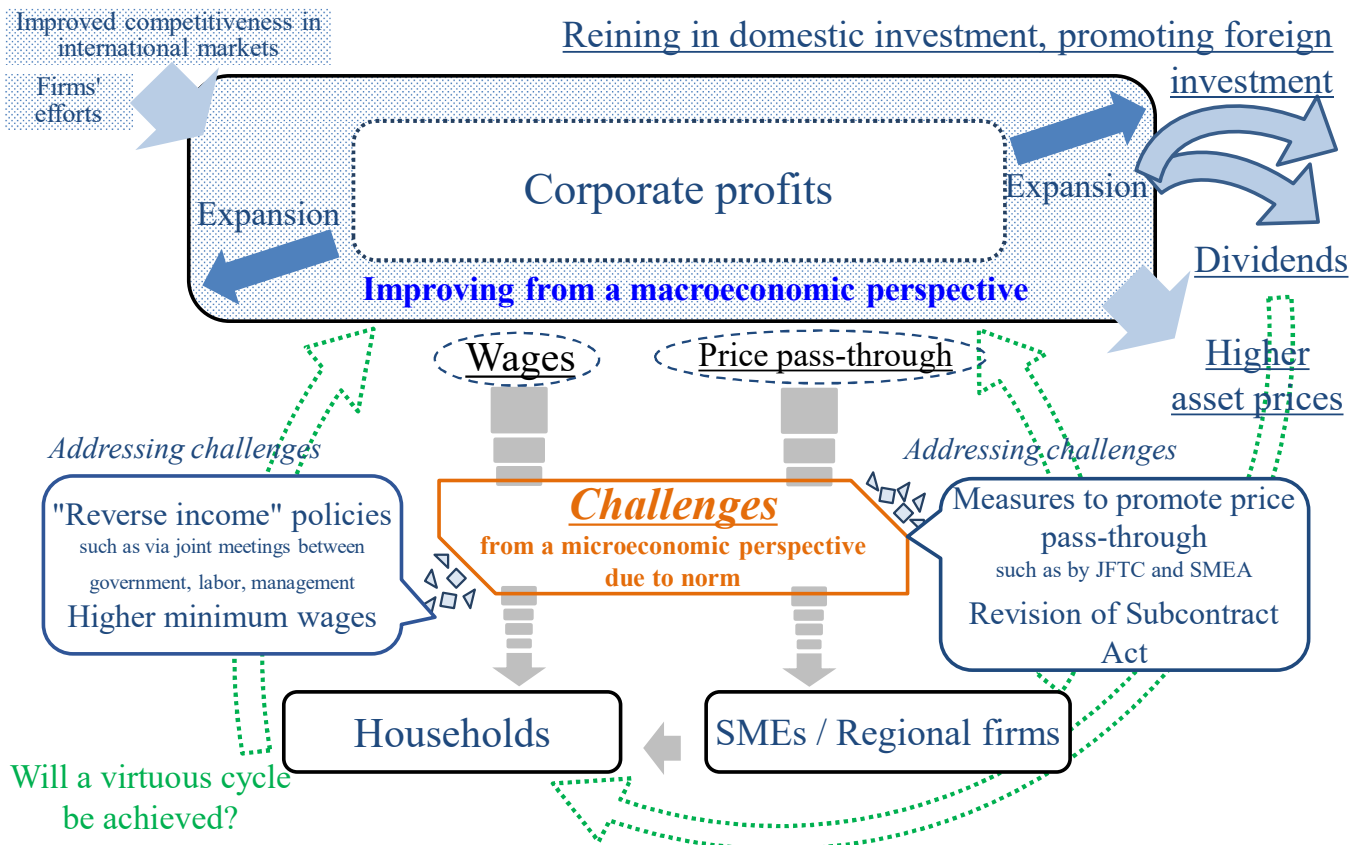
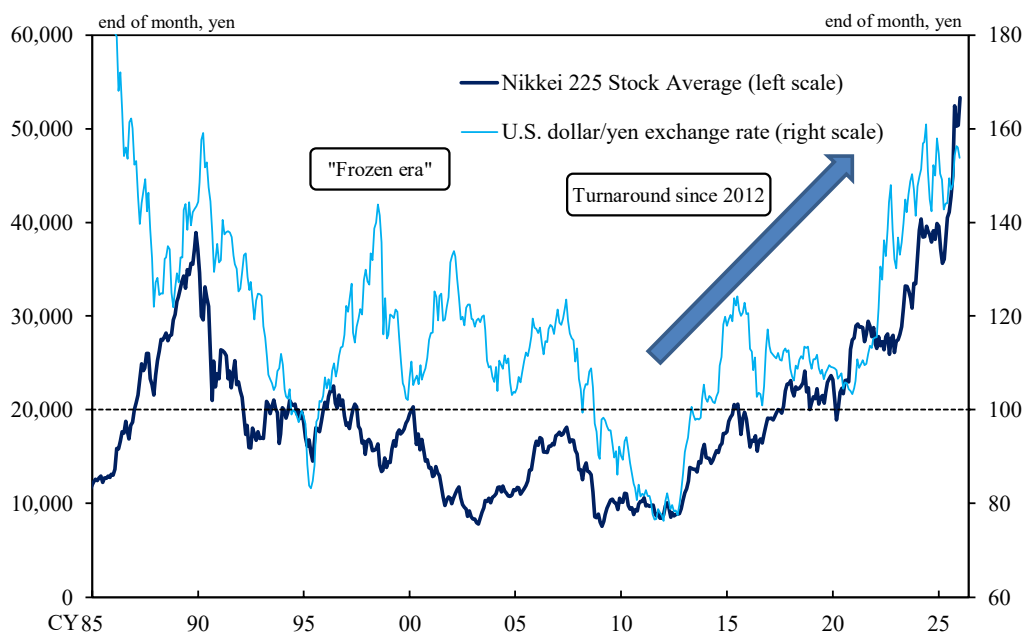


Chart 13

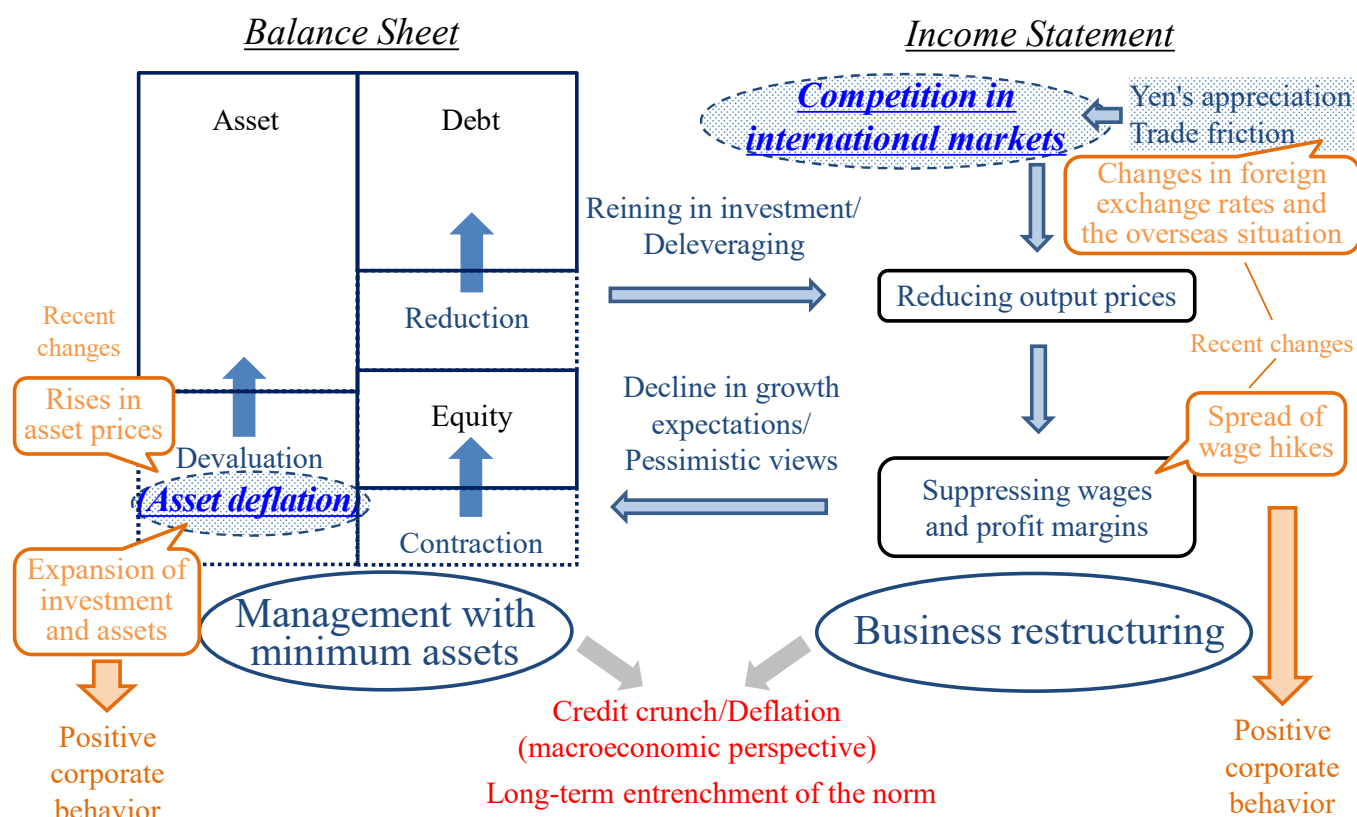
Stock Prices and Exchange Rates

(Both have turned around since 2012 from the "frozen era" that started in the 1990s)



My View on Corporate Behavior in the Post-Bubble Period

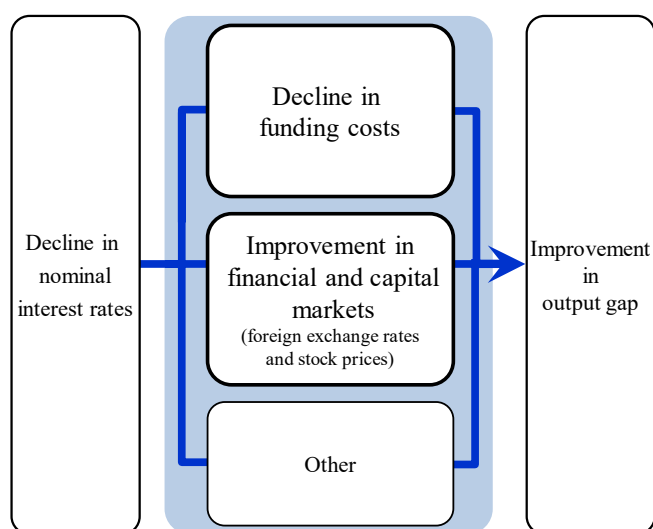
(Corporate behavior has turned positive from shrinking equilibrium)



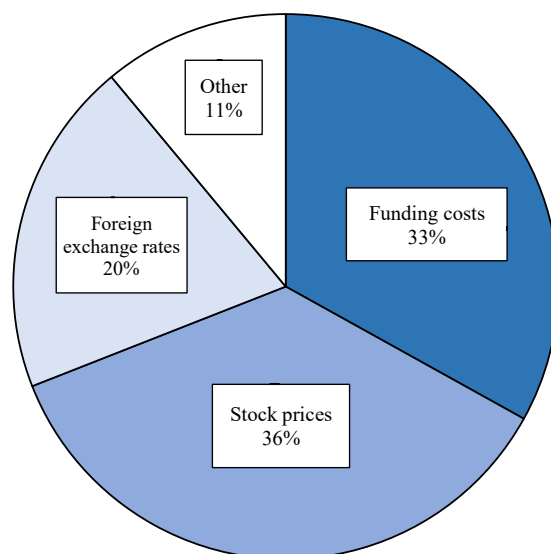
Transmission Channels of Lower Interest Rates

(Financial and capital market channels, via stock prices and foreign exchange rates, are important)

Overview



Improvement in Output Gap (Breakdown by Channel)

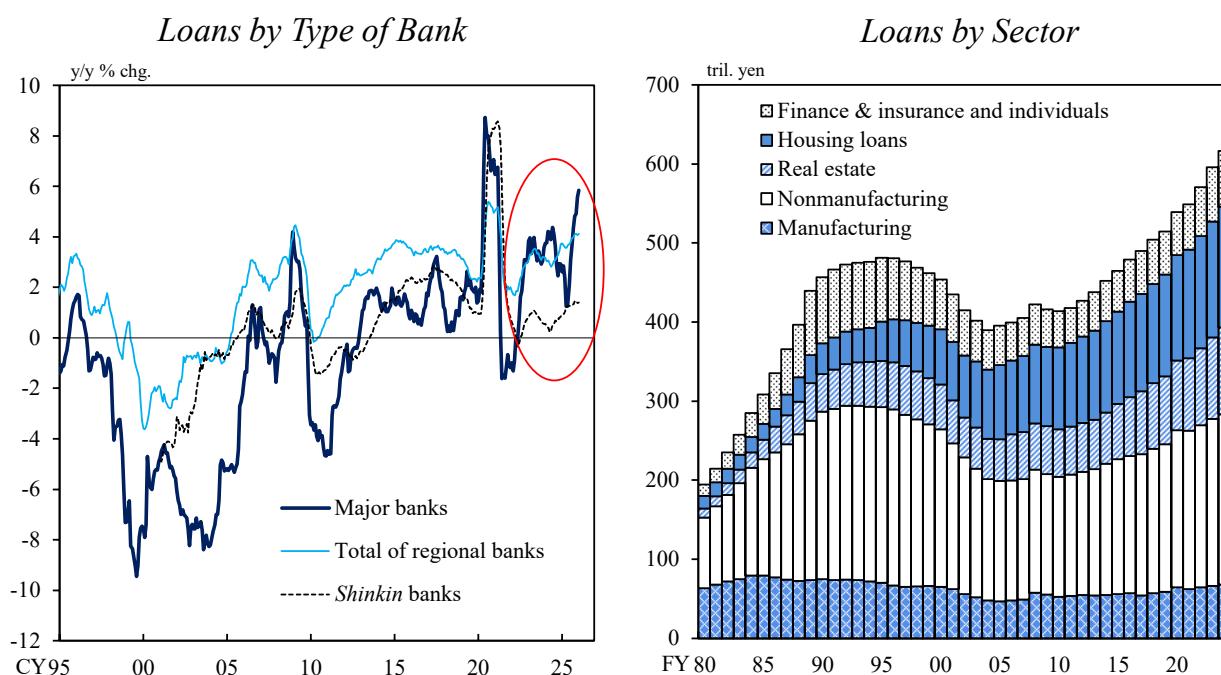


- Notes:
- Figures are based on a VAR model with coefficient restrictions using eight variables: output gap, interest rates (3-month), interest rate spreads (2-year minus 3-month, 5-year minus 2-year, 10-year minus 5-year), aggregate funding costs, nominal effective yen exchange rates, and stock prices.
 - Aggregate funding costs are the weighted average of bank lending rates and issuance yields for CP and corporate bonds.
 - In the pie graph, figures show 5-year cumulative effects.

Sources: Bloomberg; Bank of Japan; etc.

Bank Lending in Japan

(Bank lending mainly among major banks shows signs of increase)

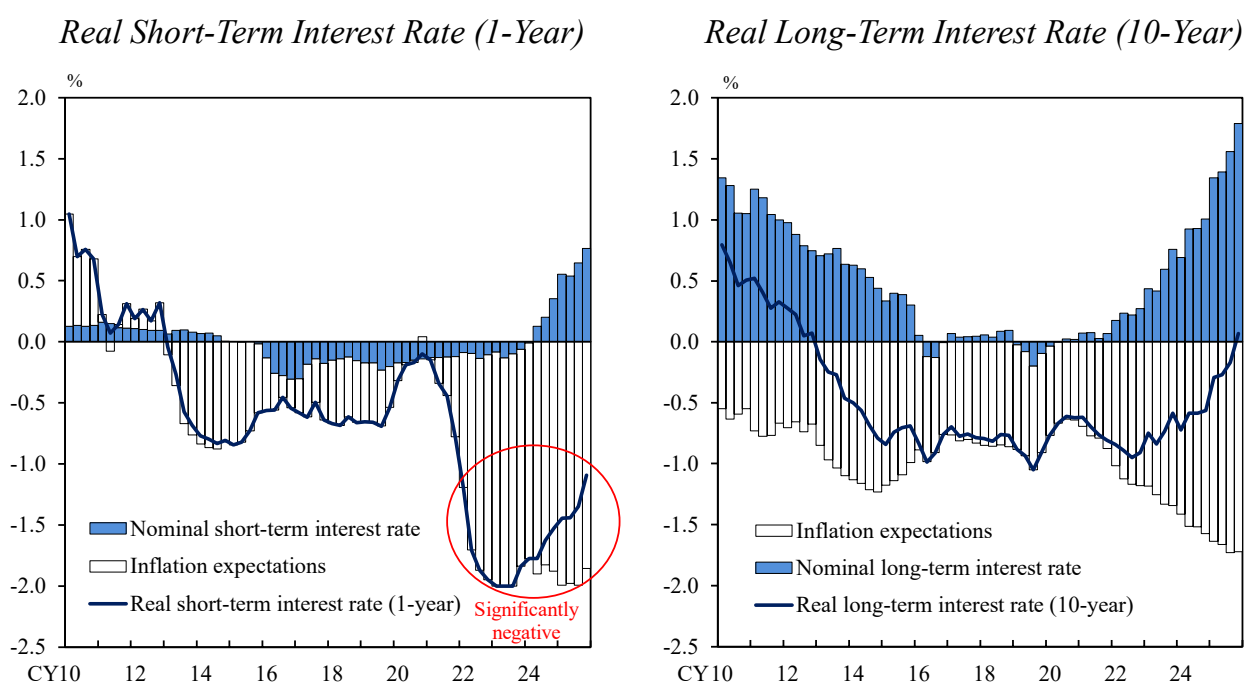


Notes: 1. In the left panel, figures include loans to local governments and individuals.
 2. In the right panel, figures are for domestically licensed banks (banking accounts of domestic branches). Figures for "nonmanufacturing" exclude real estate and finance and insurance, and figures for "finance & insurance and individuals" exclude housing loans.

Source: Bank of Japan.

Real Interest Rate in Japan

(Short-term rate in particular has remained significantly negative)



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 Bank staff calculations using the expectations of various economic entities (firms, households, and experts) at different horizons. Specifically, data used in the calculations are as follows: for firms, the *Tanken*; 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: Bloomberg; Consensus Economics Inc., *Consensus Forecasts*; QUICK, *QUICK Monthly Market Survey <Bonds>*; Bank of Japan.

Global Nominal Interest Rate Map

(Japan's nominal interest rates are no longer at the lowest level in the world)

%

	Policy rate	1-year	2-year	3-year	4-year	5-year	6-year	7-year	8-year	9-year	10-year	11-year	12-year	13-year	14-year	15-year	20-year	30-year	40-year
Switzerland	0.00	0.08	-0.13	-0.04	0.02	0.08	0.17	0.19	0.20	0.24	0.27	0.30	0.32	0.35	0.38	0.41	0.52	0.48	0.41
Japan	0.75	1.05	1.29	1.44	1.60	1.69	1.88	1.97	2.10	2.18	2.21	2.42	2.63	2.83	3.04	3.25	3.05	3.44	3.67
Denmark	1.60	1.86	1.76	2.05	2.14	2.23	2.30	2.37	2.44	2.53	2.61	2.63	2.66	2.68	2.70	2.72	2.82	3.12	
Sweden	1.75	1.88	1.87	1.98	2.10	2.21	2.26	2.30	2.40	2.49	2.59	2.62	2.66	2.69	2.73	2.76	2.93		
Germany	2.15	1.99	2.05	2.06	2.20	2.34	2.35	2.50	2.56	2.64	2.76	2.83	2.91	2.99	3.07	3.15	3.32	3.44	
France	2.15	2.06	2.13	2.28	2.44	2.65	2.76	2.93	3.08	3.21	3.35	3.44	3.53	3.62	3.72	3.81	4.01	4.32	
Spain	2.15	2.06	2.08	2.29	2.29	2.40	2.60	2.82	2.90	3.08	3.14	3.23	3.33	3.42	3.52	3.61	3.72	4.03	
Portugal	2.15	2.04	2.09	2.19	2.28	2.53	2.64	2.82	2.86	3.00	3.12	3.19	3.26	3.34	3.41	3.48	3.68	3.91	
Austria	2.15	2.04	2.10	2.22	2.37	2.51	2.62	2.73	2.83	2.95	3.05	3.12	3.20	3.27	3.35	3.42	3.65	3.74	3.77
Italy	2.15	2.07	2.13	2.35	2.57	2.67	2.90	3.00	3.17	3.33	3.37	3.46	3.54	3.63	3.72	3.80	4.09	4.30	
Ireland	2.15	2.24	2.06	2.08	2.22	2.40	2.38	2.50	2.69	2.77	2.86	2.96	3.06	3.16	3.26	3.36	3.46	3.69	
Netherlands	2.15	2.11	2.04	2.16	2.28	2.34	2.46	2.59	2.65	2.74	2.83	2.90	2.97	3.04	3.12	3.19	3.31	3.49	
Finland	2.15	2.22	2.10	2.20	2.37	2.48	2.61	2.71	2.81	2.92	3.04	3.12	3.21	3.30	3.39	3.48	3.59	3.82	
Canada	2.25	2.32	2.48	2.50	2.64	2.80	2.89	2.99	3.08	3.17	3.26	3.29	3.33	3.36	3.40	3.44	3.61	3.73	
China	3.00	1.35	1.41	1.42	1.50	1.59	1.63	1.68	1.72	1.77	1.81	1.86	1.91	1.95	2.00	2.05	2.36	2.30	
United Kingdom	3.75	3.58	3.59	3.65	3.75	3.83	4.00	4.00	4.29	4.35	4.42	4.57	4.71	4.76	4.80	4.84	5.10	5.23	5.20
United States	3.75	3.43	3.41	3.45	3.53	3.61	3.71	3.81	3.89	3.98	4.06	4.11	4.17	4.23	4.29	4.35	4.64	4.70	
Australia	3.85	4.18	4.23	4.27	4.29	4.36	4.43	4.55	4.60	4.68	4.75	4.79	4.83	4.88	4.94	4.99	5.18	5.24	
Norway	4.00	4.07	4.08	4.09	4.11	4.13	4.16	4.19	4.22	4.24	4.27	4.28	4.28	4.28	4.28	4.28	4.29		
India	5.25	5.65	5.77	6.05	6.32	6.43	6.62	6.67	6.68	6.67	6.68	6.84	6.87	7.01	7.03	7.11	7.23	7.47	7.50



Note: Figures are as of February 13, 2026. Some figures are estimated by linearly interpolating missing values.
Source: Bloomberg.

Global Real Interest Rate Map

(Japan's real interest rates are at the lowest level in the world)

%

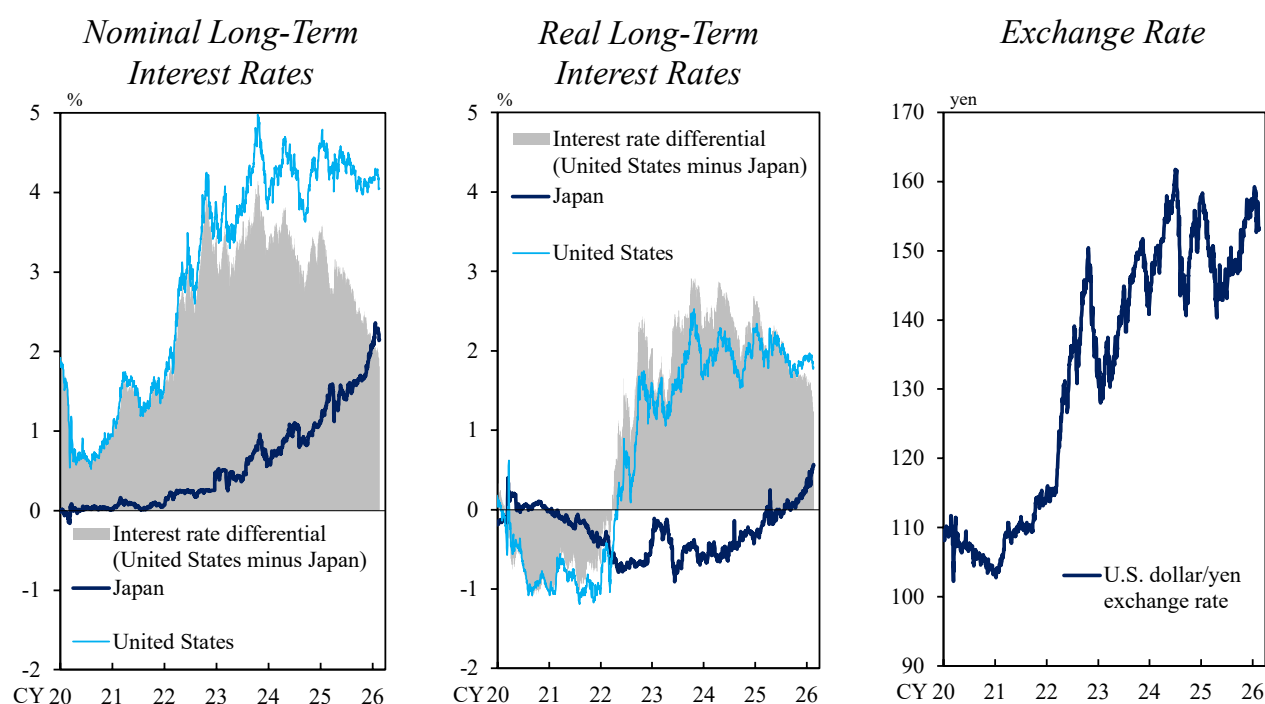
	Policy rate	1-year	2-year	3-year	4-year	5-year	6-year	7-year	8-year	9-year	10-year	11-year	12-year	13-year	14-year	15-year	20-year	30-year	40-year
Japan	-1.39	-1.09	-0.86	-0.70	-0.54	-0.46	-0.26	-0.17	-0.05	0.04	0.07	0.28	0.48	0.69	0.90	1.10	0.91	1.30	1.53
Switzerland	-0.56	-0.48	-0.69	-0.60	-0.54	-0.47	-0.38	-0.37	-0.36	-0.31	-0.29	-0.26	-0.23	-0.20	-0.18	-0.15	-0.04	-0.08	-0.14
Denmark	-0.46	-0.19	-0.30	-0.01	0.09	0.18	0.25	0.32	0.39	0.47	0.56	0.58	0.60	0.62	0.64	0.66	0.77	1.06	
Netherlands	-0.30	-0.34	-0.41	-0.29	-0.17	-0.11	0.01	0.14	0.20	0.30	0.38	0.45	0.52	0.60	0.67	0.74	0.86	1.04	
Austria	-0.18	-0.29	-0.23	-0.11	0.04	0.18	0.29	0.40	0.50	0.62	0.72	0.79	0.87	0.94	1.02	1.10	1.32	1.41	1.44
Portugal	0.02	-0.08	-0.03	0.06	0.16	0.41	0.52	0.69	0.74	0.88	1.00	1.07	1.14	1.21	1.28	1.35	1.56	1.78	
Spain	0.13	0.03	0.05	0.27	0.27	0.38	0.58	0.80	0.88	1.06	1.11	1.21	1.30	1.40	1.49	1.59	1.70	2.01	
Italy	0.14	0.06	0.12	0.34	0.56	0.66	0.88	0.99	1.16	1.31	1.36	1.44	1.53	1.62	1.70	1.79	2.07	2.29	
Sweden	0.15	0.28	0.27	0.38	0.50	0.61	0.66	0.70	0.80	0.89	0.99	1.02	1.06	1.09	1.13	1.16	1.33		
Finland	0.21	0.28	0.16	0.26	0.43	0.54	0.67	0.77	0.87	0.99	1.10	1.19	1.28	1.37	1.45	1.54	1.66	1.89	
Canada	0.22	0.29	0.45	0.47	0.61	0.77	0.86	0.96	1.05	1.14	1.23	1.26	1.30	1.33	1.37	1.41	1.58	1.70	
Germany	0.39	0.24	0.29	0.30	0.45	0.59	0.59	0.74	0.80	0.89	1.00	1.08	1.16	1.23	1.31	1.39	1.56	1.68	
Ireland	0.49	0.58	0.40	0.42	0.56	0.74	0.72	0.85	1.03	1.11	1.20	1.30	1.40	1.50	1.60	1.70	1.80	2.03	
France	0.62	0.53	0.60	0.76	0.91	1.12	1.24	1.40	1.55	1.69	1.82	1.91	2.00	2.10	2.19	2.28	2.48	2.79	
Australia	0.83	1.16	1.21	1.25	1.27	1.33	1.40	1.52	1.58	1.66	1.73	1.76	1.80	1.86	1.91	1.97	2.16	2.22	
India	1.20	1.60	1.72	2.01	2.27	2.39	2.58	2.62	2.64	2.62	2.64	2.79	2.83	2.97	2.99	3.06	3.18	3.42	3.45
United Kingdom	1.20	1.04	1.05	1.10	1.21	1.28	1.46	1.46	1.74	1.80	1.87	2.02	2.17	2.21	2.25	2.30	2.56	2.68	2.65
United States	1.32	0.99	0.98	1.01	1.09	1.17	1.28	1.38	1.46	1.54	1.62	1.68	1.74	1.80	1.86	1.92	2.21	2.26	
Norway	1.60	1.67	1.68	1.69	1.71	1.73	1.76	1.79	1.82	1.84	1.87	1.88	1.88	1.88	1.88	1.88	1.89		
China	2.32	0.67	0.73	0.74	0.83	0.91	0.95	1.00	1.04	1.09	1.14	1.18	1.23	1.27	1.32	1.37	1.68	1.62	



Note: Figures are as of February 13, 2026. Some figures are estimated by linearly interpolating missing values. Figures are adjusted to real terms using the IMF's CPI forecast for each country (2026).
Sources: Bloomberg; IMF.

U.S.-Japan Interest Rate Differential and Exchange Rate

(Both nominal and real interest rate differentials have attracted market attention)

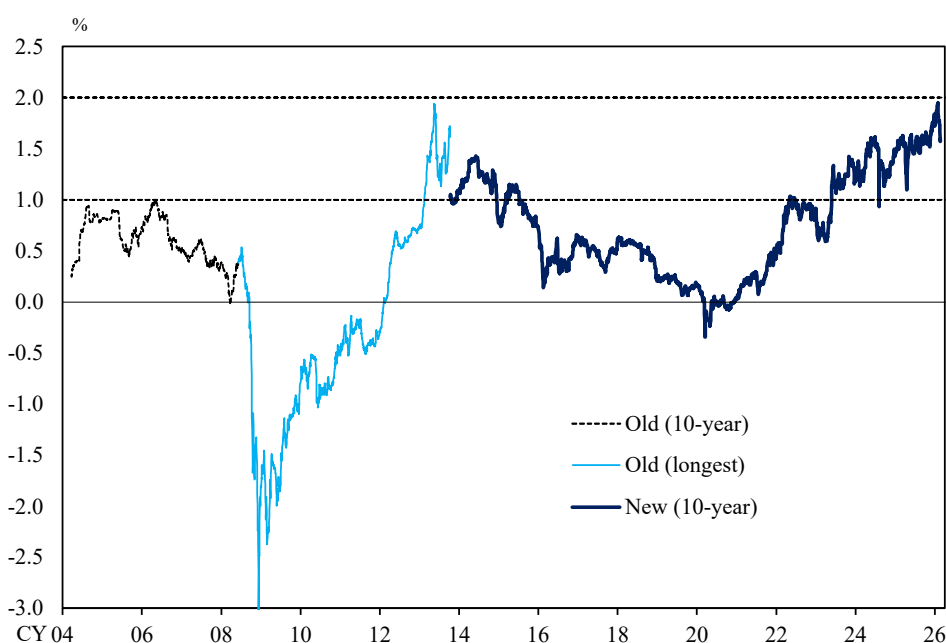


Note: Real long-term interest rates are calculated using nominal long-term interest rates and BEI (break-even inflation) rates.

Sources: Bloomberg; FRB.

BEI for Inflation-Indexed JGBs: Inflation Expectations

(BEI rate for inflation-indexed JGBs is at a historically high level of around 2%)

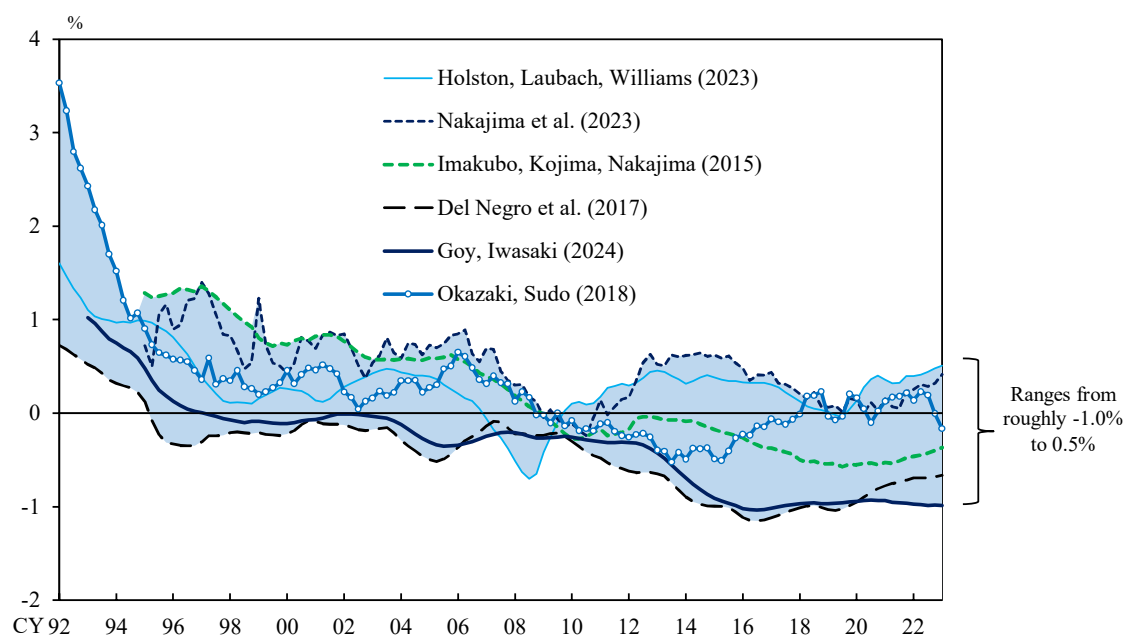


Note: Inflation-indexed JGBs issued since October 2013, which have a principal protection feature, are designated as "new," while those issued from March 2004 to June 2008 are designated as "old." Figures for "old (longest)" are calculated using yield data for issue No. 16 of inflation-indexed JGBs, which were issued in June 2008 and matured in June 2018.

Sources: Bloomberg; QUICK.

Estimates of Japan's Natural Rate of Interest Underlying the Neutral Interest Rate

(Estimates range from roughly -1.0% to 0.5%)



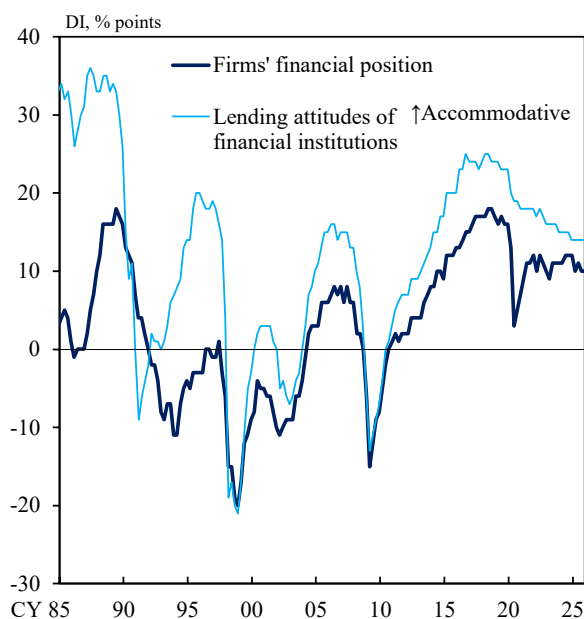
Note: Estimates are based on Bank staff calculations using the models proposed in the different papers listed. The shaded area shows the estimated range of the natural rate of interest.

Sources: Bloomberg; Cabinet Office; Consensus Economics Inc., *Consensus Forecasts*; Ministry of Finance; Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications; Bank of Japan.

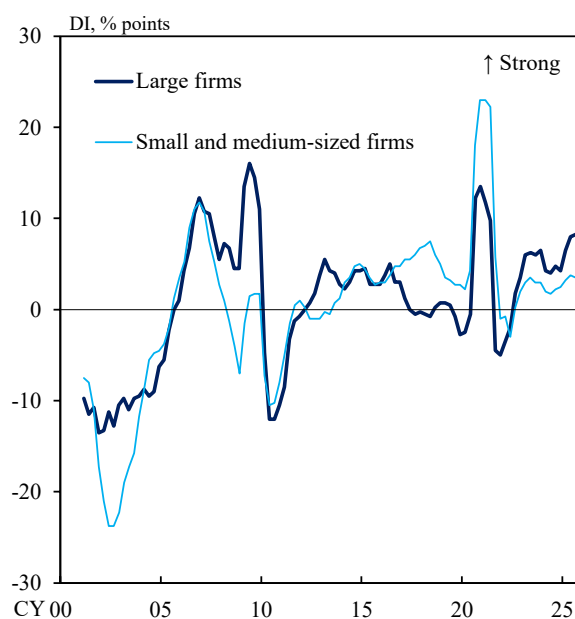
Financial Conditions in Japan

(Financial conditions based on firms' financial positions and demand for funds have remained accommodative)

Financial Conditions as Perceived by Firms (Tankan)



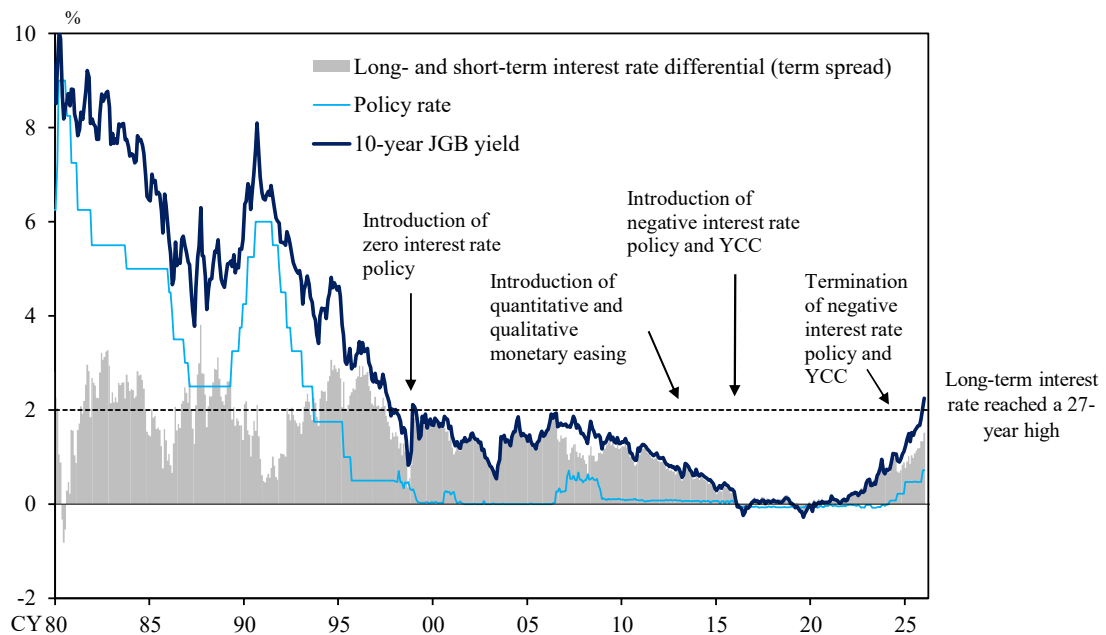
Demand for Funds as Perceived by Financial Institutions



Note: In the right panel, figures are 4-quarter backward moving averages.
Source: Bank of Japan.

Developments in Japan's Long- and Short-Term Interest Rates

(Term spread reflects the risk premium on JGB investments)



Notes: 1. Figures for the policy interest rate before 1998 are the basic discount rate and basic loan rate (official discount rate), and those for 1998 onward are the uncollateralized overnight call rate.

2. Figures for 10-year JGB yields before 1987 are over-the-counter quotes.

Sources: Ministry of Finance; Bank of Japan.

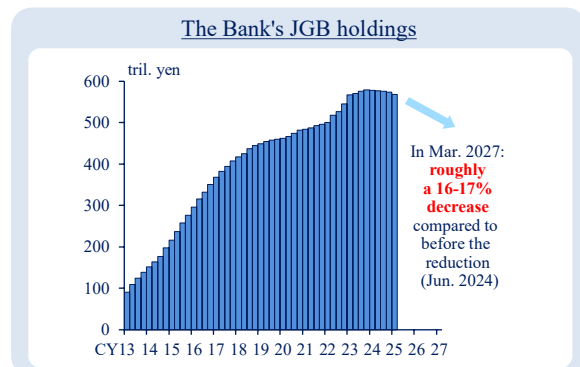
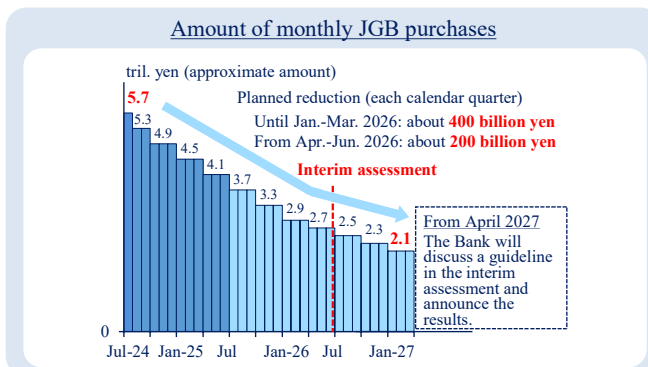
Plan for the Reduction of the Purchase Amount of JGBs

1. Long-term interest rates: to be formed in financial markets in principle
2. JGB purchases: appropriate for the Bank to **reduce its purchase amount of JGBs in a predictable manner**, while **allowing enough flexibility** to support stability in the JGB markets

In principle, the Bank will reduce the planned amount of its monthly purchases of JGBs each calendar quarter as follows.

- Until January-March 2026 : about **400 billion yen** (the reduction plan decided in July 2024 will be maintained)
- From April-June 2026 to January-March 2027: about **200 billion yen**
- The Bank will **gradually reduce** its purchase amount so that it can improve the functioning of the JGB markets in a manner that supports stability in the markets.

Reduction in a Predictable Manner

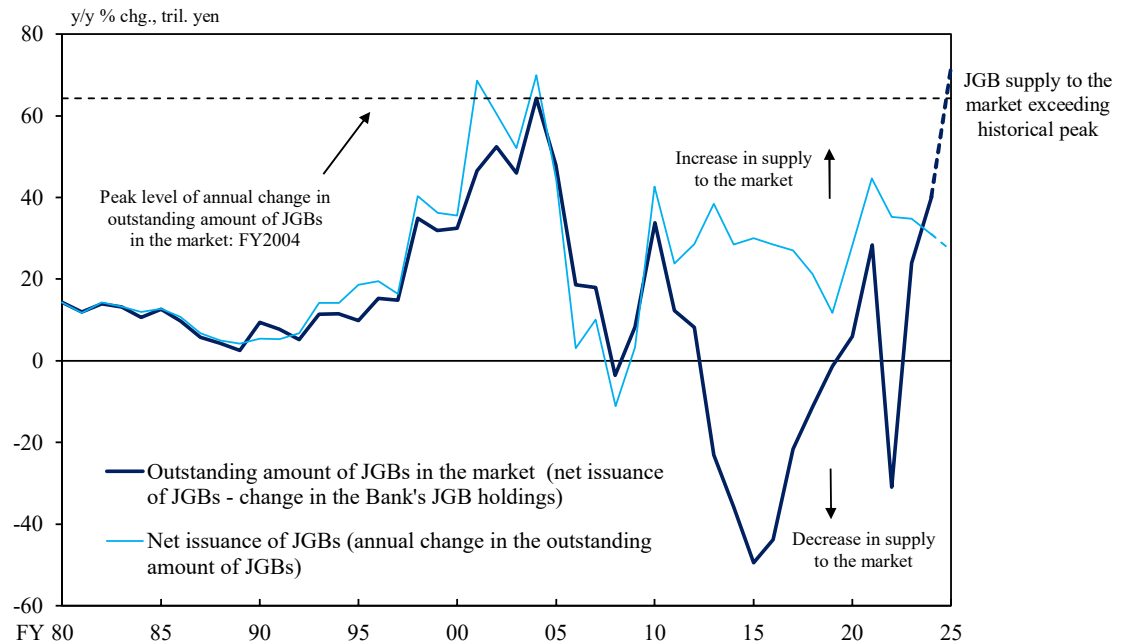


Allowing Enough Flexibility

1. The Bank will **conduct an interim assessment of the plan at the June 2026 MPM**.
2. In the case of a rapid rise in long-term interest rates, the Bank will make nimble responses by, for example, increasing the amount of JGB purchases.
3. The Bank is prepared to amend the plan at the MPMs, if deemed necessary.

Historically Large Annual Change in Outstanding Amount of JGBs in the Market

(JGB supply to the market is estimated to exceed the historical peak due to a reduction in the Bank's purchases)



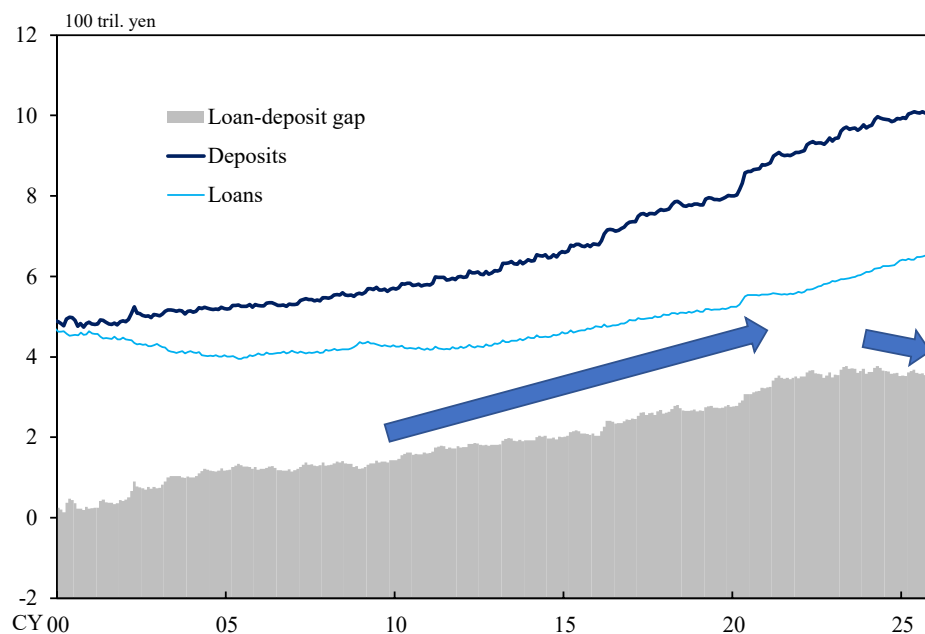
Notes: 1. Figures are on a book value basis and exclude short-term government securities.

2. Figures for fiscal 2025 are estimated using the Ministry of Finance's JGB issuance plan for that fiscal year, the revision to the previous fiscal year's plan, and the Bank's plan for the reduction of JGB purchases.

Sources: Cabinet Office; Ministry of Finance; Bank of Japan.

Developments in Loan-Deposit Gap in Japan

(Loan-deposit gap supporting JGB demand has narrowed, marking a historical turning point)



Note: Figures are for domestically licensed banks.

Source: Bank of Japan.