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Bank of Japan

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

Speech at a Meeting with Local Leaders in Mie

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(English translation based on the Japanese original)

I. Economic Activity and Prices

I will begin by talking about 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 April 2025 *World Economic Outlook* (WEO), the International Monetary Fund (IMF) projects that the global economy will be heavily affected by U.S. tariff policy, while also highlighting further downside risk (Chart 1). However, looking at hard data, recent economic indicators suggest that the U.S. economy has grown moderately, despite concerns about the impact of tariff policy. While the Federal Reserve has kept its policy interest rate unchanged since the January 2025 Federal Open Market Committee (FOMC) meeting, some market participants expect it to start cutting the policy rate again (Chart 2). As for the outlook, I am of the view that a sharp economic slowdown triggered by credit contraction, which was common during past economic downturns, is unlikely, owing to the sound balance sheets of households, firms, and financial institutions, among other factors. Instead of a serious recession, I have been expecting the U.S. economy to grow only at a slower pace than its potential growth rate, mainly affected by a deterioration in consumer sentiment. Still, it is necessary to bear in mind that such an economic slowdown depends on the policies of the U.S. administration, and hence there are extremely high uncertainties, both upside and downside. Even if the economy remains robust at the moment, the longer concerns about tariffs remain, the greater the downward pressure on economic activity could become, due to heightened uncertainty, and thus it is necessary to carefully examine the situation from a long-term perspective. Meanwhile, as I will elaborate later, since it took office, the new U.S. administration has given priority to policies, such as tariffs, that have a negative impact on economic growth. If it were to pursue policies that have a positive impact on economic growth, such as reducing domestic taxes, the growth rate of the U.S. economy could be higher than expected. With regard to overseas economies, Europe, the United States, and China and other emerging economies have all leaned toward accommodative policies on both the fiscal and monetary fronts. With the same policy direction adopted around the world, attention is also warranted on the possibility that this could, in combination, exert greater-than-expected upward pressure on economic activity and prices.

The aforementioned impact of U.S. tariff policy will likely push down Japan's economy through such channels as a slowdown in overseas economies, a decline in domestic corporate profits and the associated slowdown in wage increases, and postponement of firms' and households' spending due to increased uncertainty. Against this backdrop, the Bank of Japan revised downward its outlook both for the GDP growth rate and prices in the April 2025 *Outlook for Economic Activity and Prices* (Outlook Report), compared with those presented in the January Outlook Report (Chart 3).

Nonetheless, in Japan's corporate sector, corporate profits have remained on an improving trend recently. Based on the Japanese Trade Union Confederation's (Rengo) sixth aggregate results, high levels of wage increases have also been agreed in the 2025 annual spring labor-management wage negotiations (Chart 4). In the household sector, private consumption has maintained its moderate increasing trend 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 5). The inflation rate has been increasing recently due to the rise in food prices, such as rice prices (Chart 6). However, private consumption is expected to continue increasing moderately, with wage increases catching up with higher prices, reflecting the rise in wage growth and downward pressure on inflation mainly exerted by a decline in import prices.

Looking at medium- to long-term inflation expectations of various economic entities to assess underlying inflation, expectations have continued to rise steadily (Chart 7). In addition, the growth in the GDP deflator -- which indicates domestic inflationary pressure and had been mainly led by unit profits -- has increasingly been driven by a rise in unit labor costs since 2024, reflecting wage increases. As a result, the growth rates of unit profits and unit labor costs are becoming balanced, and signs of homemade inflation have finally emerged in that inflationary pressure is stemming not only from import price factors but from domestic factors. In this regard, high levels of wage increases agreed in the 2025 annual spring labor-management wage negotiations suggest that these trends will likely continue.

With firms facing supply-side constraints due to labor shortages -- in other words, a shift to a "labor shortage economy," firms' wage- and price-setting behavior has been active. As far as

recent domestic developments suggest, I believe Japan's economy is at a stage where the price stability target is close to being achieved. Although I expect that this scenario will remain broadly unchanged even after the announcement of reciprocal tariffs in April, I would like to closely monitor whether the momentum toward achieving the price stability target, which has finally started to operate, will not be dampened by U.S. tariff policy. In particular, given the transmission channels to Japan's economy of the impact of U.S. tariff policy, I think it is necessary to pay attention to whether any adverse impact of tariff policy will materialize in terms of the following four points. 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 toward 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. I am paying particular attention to the possibility of significant market volatility, depending on the expectations for the new U.S. administration's policies as described in the fourth point.

II. Recent Conduct of Monetary Policy

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

The Bank decided to raise the policy interest rate to around 0.5 percent in January 2025. This is because the Bank judged 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.

As I mentioned earlier, as far as domestic factors suggest, the price stability target is close to being achieved. In this situation, real interest rates, particularly the short-term rate, have been significantly negative, and accommodative financial conditions have been maintained (Chart 8). Against this background, I consider that the Bank should continue to shift gears as appropriate; that is, proceed with further adjustment of the degree of monetary accommodation if it is confirmed that positive corporate behavior -- such as solid business

fixed investment, sustained wage hikes, and a continued price pass-through of cost increases -- is being maintained.

Yet, with the likelihood of a deceleration in the U.S. economy due to the impact of tariff policy, careful monitoring continues to be warranted on the risk that the divergence in monetary policy stance due to the difference in economic cycles between Japan and abroad could bring about high volatility in financial markets, particularly foreign exchange markets. In fact, looking back on its previous five cycles of policy interest rate hikes, excluding the most recent one, since Japan's shift to a floating exchange rate system in the 1970s, the Bank turned to rate cuts after the Federal Reserve cut its rate. In this sense, if the Federal Reserve resumes its rate cuts, that may reduce the flexibility of the Bank's monetary policy. Having said that, as I mentioned earlier, the U.S. economy is unlikely to see a serious recession, and the current situation is different from the periods after the collapse of the dot-com bubble around 2000 and following the Global Financial Crisis in the late 2000s. Under these circumstances, I believe that the Bank is currently only pausing its policy interest rate hike cycle and should continue to make a gear shift after a certain period of "wait and see." There is persistent speculation of a rebound in U.S. inflation due to the imposition of reciprocal tariffs. With the likelihood of policy interest rate cuts diminishing, the Federal Reserve's policy conduct warrants attention through this summer.

Given that uncertainties regarding various U.S. policies remain high, I believe that the Bank is required to conduct monetary policy in a more flexible manner without being too pessimistic. This is because the Bank may need to nimbly shift back to the rate hike cycle in response to policy changes in the United States, in addition to taking action in the case of increased downward pressure on the economy. At the same time, to maintain the momentum toward achieving the price stability target, which has finally come close, I believe that the Bank also needs to maintain its current accommodative monetary policy stance and thereby support the economic activity of firms and households, so that their behavior does not become overly negative.

At the June 2025 Monetary Policy Meeting (MPM), the Bank conducted an interim assessment of the plan for the reduction of its purchase amount of Japanese government bonds

(JGBs), taking into account the opinions collected from market participants. 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, maintaining the amount and pace of the reduction decided in July 2024 (Chart 9). 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. By reducing JGB purchases, this plan is intended to normalize the JGB market and improve its functioning. Since the turmoil of bond markets at home and abroad in April 2025, yields on super-long-term JGBs have risen significantly, and market fragmentation has in turn occurred between the super-long-term zone and shorter maturity zones. At the same time, market correlations have been disrupted, as seen in the rapid widening of swap spreads (Chart 10). Risk premiums have risen in particular segments of the yield curve, and the results of the latest May 2025 *Bond Market Survey* suggest a substantial decline in the degree of bond market functioning. As background to these developments, it has been pointed out that life insurers' demand for super-long-term JGBs has been marginal and that it has become difficult for dealers to engage in market making due to market volatility. Thus, I believe that the Bank should proceed with the reduction in its JGB purchases based on supply and demand conditions and liquidity of JGBs by maturity, with a view to improving the functioning of the market as a whole.

The Bank's plan for the reduction of its purchase amount of JGBs stipulates that, in principle, long-term interest rates are to be formed in financial markets, and that the Bank will reduce its purchase amount of JGBs in a predictable manner, while allowing enough flexibility to support stability in the JGB market. In my view, the Bank's JGB purchases thus far have served to hold back the amount of JGBs in the market by increasing the Bank's JGB holdings. In contrast, the reduction in purchases will supply the market with some portion of JGBs that 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 with one of the largest supplies of JGBs compared to the past. Chart 11 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 the Bank's 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 represents, in effect,

the supply of JGBs to the market. Thus, the impact of the reduction in the Bank's JGB purchases is reflected in this chart. As can be seen, there has been an increase in the supply of JGBs to the market since the start of the reduction in the Bank's JGB purchases in 2024, and the figure for fiscal year-end 2025 is estimated to reach a level comparable to that in the 2000s, when the annual change in the outstanding amount of JGBs in the market peaked. Given this, to prevent instability associated with the increase in the supply of JGBs to the market, I believe it is necessary to adjust the amount of the reduction and carefully examine how the market responds.

A rise in the risk premium on super-long-term JGBs tends to induce a deterioration in market functioning, with volatility spilling over to the entire yield curve. It should be noted that this may unintentionally give rise to the risk of monetary tightening effects transmitting widely across the market. Also, the formation of the risk-free yield curve in a stable JGB market serves as support for Japan's financial infrastructure. Needless to say, the reduction in the Bank's JGB purchases does not aim at giving considerations to the fiscal situation. That said, as I mentioned earlier, since the reduction in purchases in effect supplies the market with JGBs, I believe it is also necessary, from the perspective of improving the functioning of the market as a whole, to ensure the stability of the market while maintaining close communication among authorities. Looking back over the past year, there have been some unexpected changes in the market structure, such as the weakening investment demand for super-long-term JGBs. Given this, I believe it is necessary for the Bank to conduct another interim assessment of the plan for the reduction of its purchase amount of JGBs at the June 2026 MPM, and make amendments depending on the circumstances.

III. Looking Back at a Half Century of Trade Friction and Its Impact on Japan's Economy

U.S. tariff policy has been drawing a great deal of attention. As I mentioned earlier, the Bank revised downward its outlook for the GDP growth rate and prices in the April 2025 Outlook Report in view of the tariff policy. The various policies of the new U.S. administration have drawn comparisons with those known as the Nixon shock of 1971. Thus, looking back at Japan-U.S. trade friction since the 1970s, I would like to present my views from a historical

perspective on the possible downward pressure on economic activity caused by the recent U.S. tariff policy.

U.S. Current Account and Trade Deficits from a Long-Term Perspective

What must always be taken into account when discussing Japan-U.S. trade friction over the past half century is the existence of the U.S. current account deficit (Chart 12). To start with, the background to the 1971 Nixon shock was the intention to stem the outflow of gold reserves resulting from the continuing U.S. current account deficit. The main cause of this deficit, which has continued for over half a century, is the trade deficit. From the 1980s to the 1990s, the U.S. trade deficit was mainly with Japan and (West) Germany, but Japan accounted for the overwhelming proportion of the overall deficit (Charts 13 and 14). At its peak in 1991, Japan's share of the U.S. trade deficit reached 53 percent, leading observers to frame the U.S. trade deficit issue as a Japan-U.S. trade issue. At the time, foreign exchange markets were expected to function as a venue to correct the current account deficit, and the exchange rate adjustment pressure caused the yen and the deutsche mark to appreciate in Japan and (West) Germany, which both recorded a trade surplus. In this situation, the U.S. dollar/yen exchange rate drew particular attention.

Chart 15 shows historical developments in the U.S. dollar/yen exchange rate and Japan-U.S. trade friction. Trade friction occurred mainly in the textiles and steel industries in the 1970s, but this shifted to automobiles and household electrical appliances in the 1980s, and spread to semiconductors in the 1990s. Turning to foreign exchange markets, monetary authorities aimed to improve the trade balance and agreed on concerted market intervention to rectify the U.S. dollar's appreciation under the Plaza Accord in 1985. Furthermore, in 1995, which can be said to be the peak of Japan-U.S. trade friction in that decade, the yen appreciated to a level of nearly 80 yen against the U.S. dollar.

My view is that the Japan-U.S. trade friction that intensified from the 1970s, and its consequences, are related to Japan's long-term stagnation following the collapse of the bubble economy. In other words, I believe that the post-bubble long-term stagnation was caused by the following 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 caused mainly by trade friction. Looking back once again, Japan's economy continued to experience low growth from the 1990s, following the collapse of the bubble economy. Although a variety of structural factors, including demographic changes, contributed to the slowdown in growth, I believe that the major cause was the change in corporate behavior in the post-bubble period. To elaborate, let us take a look at Chart 16, which is also relevant to the two main factors I have just mentioned. As the chart shows, in the context of significant asset deflation, an increasing number of firms sought to pursue management with minimum assets by paring down assets on their balance sheets and reining in investment. Many more firms also engaged in business restructuring, in which they held down margins and personnel expenses in their income statements to cope with mounting international competition mainly caused by trade friction. For individual firms, these moves were a rational response to the changing business conditions. From a macroeconomic perspective, however, this approach caused Japan to fall into a shrinking equilibrium due to the "fallacy of composition" -- assuming that what is true of one member of a group is true for the group as a whole. In the pursuit of management with minimum assets and business restructuring, firms not only reined in business fixed investment but also suppressed investment in human capital. These developments together are considered to have brought down Japan's potential growth rate for a prolonged period.

Let me elaborate on asset deflation, which is the first main factor behind Japan's long-term stagnation following the collapse of the bubble economy. At its peak in the 1980s, Japan accounted for nearly half of global market capitalization. Due to its growing presence in the asset market, as well as the fact that it accounted for nearly half of the U.S. trade deficit at the time, Japan was increasingly seen as an economic threat, and this is likely what made trade friction even more acute. Subsequently, from the 1990s, stock prices in Japan fell sharply and real estate prices stagnated (Chart 17). A significant decline in capital bases in real terms drove firms to curtail investment and reduce interest-bearing debt. In addition, firms' concerns over funding stemming from post-bubble financial system instability led to hoarding cash and deposits. Historically, European countries and the United States also experienced asset deflation during the Great Depression in the 1930s, and so did some Scandinavian countries in the early 1990s. It has been pointed out that, for these countries, it was the expansion in external demand arising from currency depreciation that contributed to

recovery in economic activity. For example, the departure from the gold standard, among other factors, resulted in currency depreciation at the time of the Great Depression, leading to an expansion in external demand that helped the countries overcome deflation. In some Scandinavian countries in the early 1990s, the boost to demand arising from German reunification, in addition to currency depreciation, played a similar role.

In contrast, in Japan, despite the asset deflation, the harsh competitive environment vis-à-vis overseas economies, in which it was difficult to depend on external demand, was prolonged, mainly due to trade friction. This is the second main factor that caused the post-bubble long-term stagnation, which led firms to engage in business restructuring. In the aftermath of World War II, Japan had a geopolitical benefit for many years from the tailwind of global trade, serving as the manufacturing hub for the Western bloc. However, after the fall of the Berlin Wall in 1989, the geopolitical environment shifted, with the Soviet Union losing its power. Japan started to be seen as an economic threat, and this led trade friction with the United States to become intensified more than ever. The yen, meanwhile, appreciated rapidly in foreign exchange markets (Chart 15). While trade friction involved not only Japan but also West Germany until the 1980s, Japan became the sole target in this conflict following German reunification, and this situation is also considered to have played a significant part in creating an environment in which it was difficult to depend on external demand. Japanese firms across a wide range of sectors, including those in the automobile industry, were called on to shift their production sites overseas, leading to a hollowing out of domestic industries. In the semiconductor sector, for example, trade friction led to a placement of quotas that forced Japanese firms to curtail their share of production, resulting in a shift of major semiconductor production sites to other Asian economies, such as South Korea and Taiwan.¹ Thus, while Japan's presence was suppressed, being regarded as an economic threat, the rise of emerging economies -- especially those in Asia -- was promoted. China's entry into the World Trade Organization (WTO) in 2001 can be understood in this context. To sum up, under the trade friction until the 1990s, Japan, which accounted for the lion's share of the U.S. trade deficit,

¹ Under the Japan-United States Semiconductor Agreement concluded in 1986 and 1991, the United States requested Japan to set a minimum target for the foreign share in the Japanese semiconductor market. It has been suggested that, partly as a result of this, Japan's share of semiconductor production, which stood at around 70 percent in the first half of 1980s, declined drastically from the 1990s.

was hampered not only by the continued appreciation of the yen but also by direct measures such as export quotas and voluntary export restraints.

The upshot is that, despite the yen's appreciation, Japanese firms left their export prices unchanged to maintain price competitiveness. This led to the entrenchment of a situation where these firms needed to pursue management aimed at business restructuring and to hold down margins while being cautious about raising wages. In this situation, firms chose to absorb increases in the price of raw materials over the long term by cutting costs rather than by passing the higher costs on to selling prices, and they eventually grew accustomed to this practice as being the norm. As a result, starting with export-oriented manufacturers at the top of the supply chain, cost reduction spread broadly across multiple layers of affiliated firms that maintained vertical corporate ties. On this score, U.S. and European firms achieved a horizontal division of labor by capitalizing on global supply chains, and focused on areas with high added value, such as planning and development. Meanwhile, many Japanese manufacturers continued with a business model of vertical integration and focused on maintaining existing manufacturing processes, which likely gave further impetus to cost reduction. Japanese firms prioritized maintaining employment over raising employee wages and consequently established a work-sharing kind of approach to setting wages. In other words, firms maintained existing employment as far as possible, mainly of full-time employees, while holding back on new hiring and restraining wage increases.² A series of events took place around this time that were emblematic of the situation.³ In 2002, a major Japanese automaker decided on zero base pay increases, which was dubbed a "shock." In December of that year, the Japan Business Federation (Keidanren) declared an end to annual spring labor-management wage negotiations. Moreover, Rengo announced in 2003 that it would not make unified demands for base pay hikes. It took nearly two decades for this situation to be reversed, until the significant rise in base pay achieved in 2023.

² It has been pointed out that the restraint on new hiring made it difficult for the generation entering the job market in the 1990s and early 2000s to find employment and swelled the ranks of non-regular employees -- a period referred to as the employment ice age.

³ See Watanabe, T., *Bukka o kangaeru: Defure no nazo, infure no nazo* [Thinking about prices: The mystery of deflation and inflation] (Tokyo: Nikkei Business Publications, 2024). In this book, the author offers the hypothesis that, following the Japan Federation of Employers' Associations (Nikkeiren) indicating its stance in 1995 of advocating restraints on wages, labor and management held down wage hikes in exchange for protecting full-time employment.

In sum, my assessment is that, although Japanese firms weathered past trade friction and the cost competition with firms overseas due to the yen's appreciation by means of restructuring, mainly in terms of wages, and of cost reduction, including involving affiliates, this had the side effects of creating the norm that wages and prices do not rise and of bringing on the employment ice age. It also likely ushered in a decline in Japan's potential growth rate stemming from a lack of investment.

Shift Away from Past Trade Friction, and Improvement in Asset Prices

Let us take a look at the situation in recent years. Since the 2010s, the asset deflation that led firms to pursue management with minimum assets on their balance sheets has improved significantly, as asset prices have risen, mainly in the stock and real estate markets (Chart 17). Firms have also managed to shift away from business restructuring, with the dissipation of the continued excessive appreciation of the yen that drove severe international competition in terms of firms' income statements. The landscape of trade friction has also changed significantly. Japan's share of the U.S. trade deficit has recently fallen to 6 percent, a tremendous change from the early 1990s, when it accounted for more than 50 percent (Charts 13 and 14). Today, with Japan finding itself in a very different geopolitical position compared with the period around 1990, production sites have been brought back home out of concern over economic security, as exemplified by the shoring up of semiconductor production in Kumamoto and Hokkaido prefectures. This context is entirely different from when Japan was the target of U.S. "containment" strategies, so to speak, during the trade friction of the 1990s.

On the other hand, it has taken a long time to shift the persistent norm that wages and prices do not rise. An estimate shows that a shift in the corporate behavior mired in such a norm could take longer than expected, perhaps the decade it takes to form the next generation.⁴ On this point, it has been suggested that, in addition to the lower funding costs transmission channel, the financial and capital markets channel (stock prices and foreign exchange rates)

⁴ Taking an estimate using stock prices as an example, the following speech refers to the possibility that it may take time to recover from a long-term negative experience in the post-bubble economy: Takata, H., "Economic Activity, Prices, and Monetary Policy in Japan," speech at a meeting with local leaders in Miyagi, February 19, 2025, https://www.boj.or.jp/en/about/press/koen_2025/ko250219a.htm.

was also significantly effective in translating the benefits of lower interest rates into an improvement in the output gap (Chart 18). These findings indicate that the Bank's monetary easing was likely to have contributed to the shift away from the asset deflation and the so-called six headwinds -- including the headwind of the yen's appreciation -- both of which had prompted the changes in corporate behavior in the post-bubble economy.⁵ I believe that the Bank's patient continuation of monetary easing over many years, and the resulting support for rises in asset prices and for the 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.

Consideration of the Impact of Recent U.S. Tariff Policy

I have looked back on the history of trade friction over the past half century since the 1970s. On this basis, I would now like to present my views on the recent U.S. tariff policy. Although the policy is intended to bring manufacturing back to the United States, given that the country capitalizes on global supply chains and maintains high productivity through business models involving a horizontal division of labor, reshoring of U.S. manufacturing could actually result in restraining wages. For this reason, let me first note that I think it will be difficult for the United States to sustain high tariffs.⁶

As seen in the IMF's forecasts presented in Chart 1, various institutions and firms, including market participants, have recently revised down their economic outlook in response to the

⁵ 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.

⁶ Although the tariff policy is also intended to reduce trade deficits, mainstream economics holds that elimination of constant current account deficits, or correction of external imbalances, should be achieved gradually through market mechanisms. It has been pointed out that policy intervention or any action that could undermine confidence in the currency will hinder the path to smooth correction. In *Gendai nihon keizai: Makuroteki tenkai to kokusai keizai kankei* [The modern Japanese economy: In relation to macroeconomic and global economic developments] (Tokyo: University of Tokyo Press, 1988), Professor Ryutaro Komiya argues that the U.S. current account deficit is attributable to its macroeconomic balance and undersaving, and that the impact of a single country's exchange rate adjustments is limited.

U.S. tariff policy. These downward revisions were made even in the absence of significant deterioration in current economic developments, on the assumption that downward pressure on economic activity will materialize in the future. This approach can be likened to a "planned suspension" of public transportation; in other words, the outlook has been revised down preemptively ahead of the advent of the "typhoon" of reciprocal tariffs. Therefore, if the underlying assumption were to be revised, the economic outlook might accordingly change significantly. On this point, among the public policy commitments outlined by the new U.S. administration, the details of fiscal policy are still unclear. Partly because of this, various institutions' and firms' economic outlook appears to have factored in more of an economic deceleration caused by the tariff measures (Chart 19). It should be kept in mind that fiscal policy measures, such as tax cuts, and deregulation, all of which are included in the administration's commitments, could contribute to boosting future U.S. economic growth.

Here, let me reconfirm the direct impact of tariff impositions, with reference to supply and demand curves. Let us take a look at Chart 20. As shown in the left panel, the imposition of a tariff causes an upward shift in the supply curve, resulting in an increase in the price level from P_0 to P_1 and a decrease in the sales volume from S_0 to S_1 . As U.S. importing firms bear the burden of tariffs, U.S. consumers are also expected to bear the burden in the form of tariffs being passed on to selling prices (denoted by (1) in the left panel). Exporting firms will also bear a burden in the form of the drop in income arising from the imposition of tariffs (denoted by (2) in the left panel). The extent to which the burden of tariffs is passed on to U.S. consumers will depend on the price elasticity of demand for the products in question. For necessities for which domestic alternate production is difficult within the United States, the slope of the demand curve tends to be vertical, making it easier for tariffs to be passed on to prices. Meanwhile, if exporting firms do not pass on tariff hikes to prices, as some of them have announced recently, sales volumes will not change, and firms will need to pay significant costs equivalent to tariffs (denoted by (3) in the left panel). The right panel of Chart 20 shows the impact of tariff impositions from the perspective of exporting countries. In a manner corresponding to the left panel, a decline in sales volume due to higher prices, that is, a downward shift in the demand curve -- or a demand shock -- occurs, putting the economy under deflationary pressure. In sum, for exporting countries on which tariffs are imposed, if they pass on higher tariffs to prices, they will see a fall in demand (denoted by (2) in the left

panel), and if they do not, they will need to pay the costs equivalent to tariffs (denoted by (3) in the left panel), either way shouldering a significant burden.

Next, I would like to compare the trade friction until the 1990s with the recent U.S. tariff policy. Let me first reiterate what Japan went through under the trade friction. As was shown in Chart 14, Japan had an overwhelming presence in the U.S. trade deficit. In addition to the yen's appreciation, this resulted in direct measures by the U.S. government, such as imposing export quotas and encouraging voluntary export restraints on Japanese products. Although they were not the imposition of tariffs per se, these measures likely caused the upward shift in the supply curve, as shown in the left panel of Chart 20, and Japan alone faced deterioration in its competitive environment. To maintain competitiveness vis-à-vis other economies in the U.S. market, Japanese firms kept their U.S. dollar-denominated selling prices unchanged despite the yen's appreciation, and thereby avoided the price pass-through. Consequently, they faced a severe impact to the extent that they had to bear the burden denoted by (3) in the left panel of Chart 20. They dealt with this burden by reducing costs through business restructuring, under which they held down wages and margins. In fact, research has shown that price markups of Japanese firms remained significantly suppressed compared with other countries for a long time.⁷

By contrast, unlike the trade friction until the 1990s, recent U.S. tariff policy targets a wide range of countries and regions, so that Japan is not the only one affected. Moreover, as a result of Japan's industrial advances over around three decades, some industries -- such as automobiles, semiconductors, and basic materials, including steel and chemicals -- have seen an increase in the weight of products for which alternate production is limited within the United States. In this situation, the price elasticity for their products may have declined. Therefore, it will likely be easier for Japanese firms to pass on the recent tariff hikes to selling prices than it was in the past. Although the imposition of tariffs will inevitably have an impact in the form of lower demand, the extent of the impact is unlikely to be greater than what Japan went through in the 1990s. In addition, if tax cuts and other fiscal policy measures are implemented in the United States, depending on their specifics, an increase in U.S.

⁷ See Aoki, K. et al., "Determinants of Price Markups at Japanese Firms and Implications for Productivity," *Bank of Japan Working Paper Series*, no. 24-E-15 (December 2024).

consumers' purchasing power could, combined with the impact from improved asset prices, drive recovery in the sales volume from S_1 to S_0 by shifting the demand curve upward, as shown in Chart 21. Thus, the impact on Japan's economy, particularly corporate profits, will likely be limited, at least compared with the period of trade friction around 1990. In this context, the tariff policy is unlikely to bring about the kind of corporate behavior that leads to a shrinking equilibrium, such as restraining wages, which was once common in Japan.

I would also like to point out that improvement in Japanese firms' financial positions has made them more resilient to global shocks. As Chart 16 illustrates, in terms of their balance sheets, firms have seen a reduction in debt, in addition to an improvement in asset prices; they have reduced excessive interest-bearing debt since the collapse of the bubble economy and thus achieved a rise in their capital adequacy ratios and an improvement in their financial positions, with their interest burden falling to the extent that interest income exceeds interest expenses (Chart 22). In terms of income statements, Chart 23 shows that corporate profits expanded more than eightfold in fiscal 2023 over the second half of the 1990s, reaching the highest level on record of around 80 trillion yen, and a further expansion is likely for fiscal 2024. The current situation of corporate profits remaining at high levels differs from the economic recovery phase in the 2000s, and this has led to an increase in the overall level of corporate value. It can be said that Japanese firms have built up their resilience against shocks by lowering their break-even points over more than three decades to weather the adverse business environment brought about by trade friction and to withstand even a significant appreciation of the yen. I also think that Japan can be regarded as being a forerunner in that it is one of the few countries that has experience in addressing trade friction.

Summary: Japan's History as a Forerunner in Addressing Trade Friction

As I noted earlier, the key to a further gear shift in monetary policy is the sustainability of positive corporate behavior. It is necessary to closely examine whether the impact of U.S. tariff policy will cause Japanese firms' corporate behavior to revert to the pursuit of management with minimum assets and business restructuring seen in the post-bubble period. Chart 24 is a conceptual diagram of how expansion in corporate profits is spreading across the economy. From a macroeconomic perspective, corporate profits have expanded significantly due to factors such as the efforts of firms and the improved competitive

environment in international markets. From a microeconomic perspective, however, the use of corporate profits as a source for wage hikes and price pass-through to business partners has been limited due to the norm that wages and prices do not rise. Firms have channeled most of their profits into dividends and foreign investment, and have also limited their domestic business fixed investment. This situation has been improving since 2023 owing to some government initiatives, and it is expected that this improvement will benefit households, small and medium-sized firms, and regional firms equally, thereby achieving a virtuous cycle. Taking U.S. tariff policy into consideration, I will be paying close attention to whether there is any disruption of these improvements.

Looking back again at trade friction over the past half century, Japan's real economy experienced downturns from the 1990s under historically unprecedented situations -- such as the collapse of the bubble economy and mounting international competition. In this context, firms built up their resilience against shocks by reducing the size of their balance sheets and engaging in business restructuring. Likely side effects of this, however, were the shrinking equilibrium as a result of factors such as a long-term lack of investment and the norm that wages and prices do not rise. Japan is finally beginning to break free of this norm not only because of the unconventional monetary measures that the Bank implemented ahead of other central banks, but also because of the "big pushes" that helped to change firms' price-and wage-setting behavior over the past few years. However, concerns have also arisen over whether recent U.S. tariff policy will disrupt these improvements. In fact, in the midst of economic recovery in around 2000 and in the mid-2000s, Japan's economy ended up experiencing several "false dawns,"⁸ or temporary economic recoveries, interrupted by global demand shocks. My expectation is that Japan will see a "true dawn" this time; I will pay close attention to whether "this time is different" and it will actually materialize.⁹

⁸ 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.

⁹ 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.

Meanwhile, looking back at the trade friction over the half past century also reveals that Japan was a forerunner in addressing trade friction by withstanding situations far more stressful than what we face today. Moreover, it is necessary to make an objective assessment of the differences from the past, not least the improvement in firms' financial positions over the 30 years since the collapse of the bubble economy. In this sense, I believe being overly pessimistic also poses a considerable risk. To reiterate, my view is that the Bank needs to support economic activity for the time being by maintaining its current accommodative monetary policy stance. At the same time, I believe that the Bank should gradually and cautiously shift gears in its monetary policy, based on the recognition that it has finally reached the point of returning from the implementation of unconventional monetary measures to policy conduct that is in line with what is seen in normal times, and that the "true dawn" is in sight. In doing so, the Bank will closely monitor developments in U.S. tariff policy and its impact on Japan's economy.

Thank you.



Economic Activity, Prices, and Monetary Policy in Japan

Speech at a Meeting with Local Leaders in Mie

July 3, 2025

TAKATA Hajime

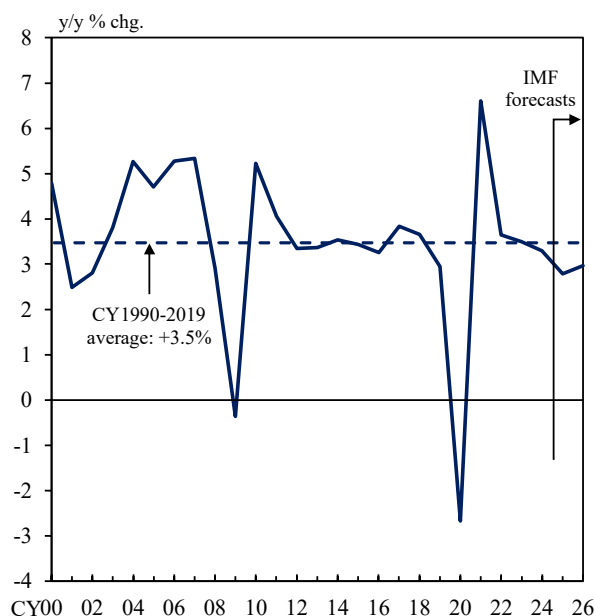
Member of the Policy Board

Bank of Japan

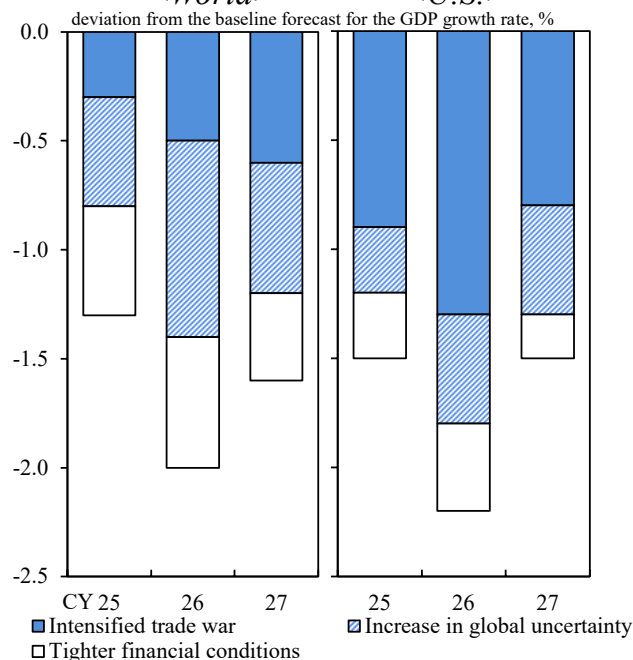
Chart 1

Developments in Overseas Economies (IMF's April 2025 WEO)

Global Growth Rate



Impact of Risk Scenarios on GDP
<World> <U.S.>

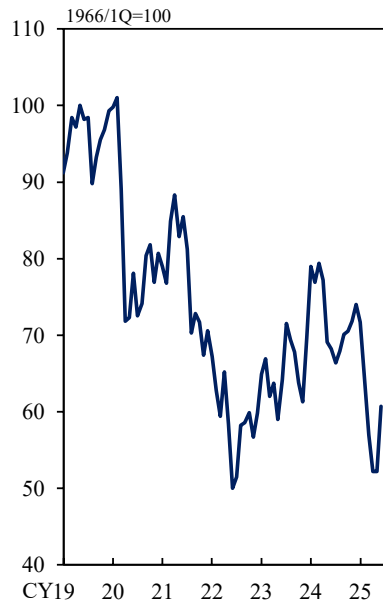


Note: In the right panel, for details of the assumptions of each scenario, see Box 1.1. of the April 2025 *World Economic Outlook* (WEO).

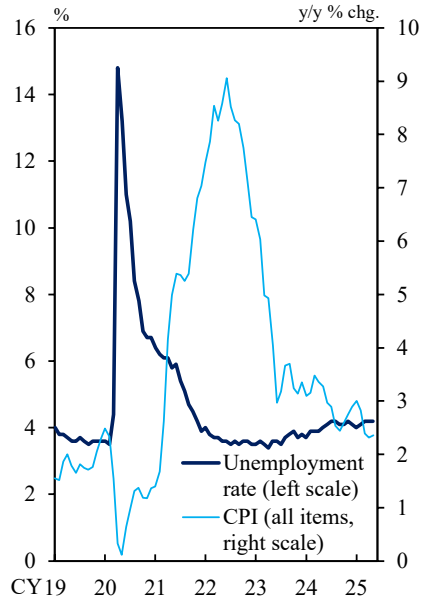
Source: IMF.

The U.S. Economy

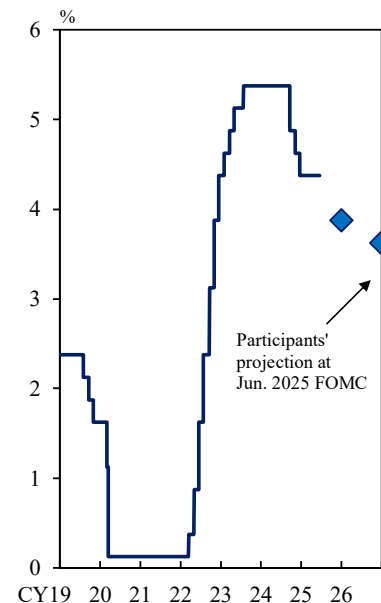
Consumer Confidence



Employment and Prices



Policy Interest Rate

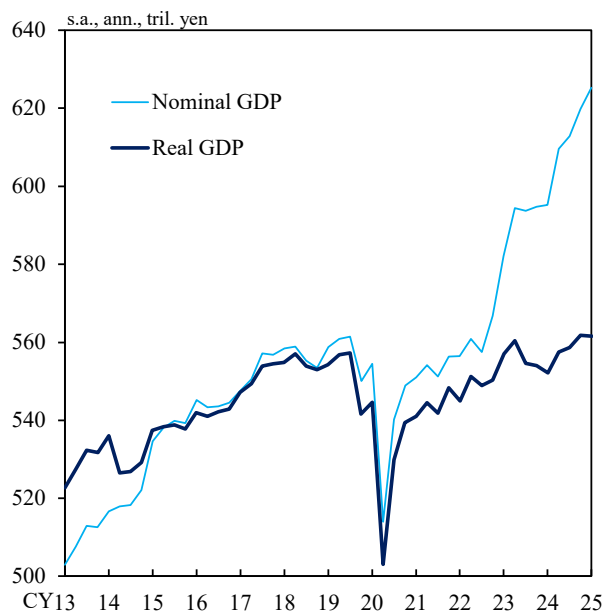


Note: In the left panel, figures are from the University of Michigan's consumer sentiment index. In the right panel, figures are the medians of the target ranges for the federal funds rate. Figures for participants' projections are the medians of all participants' projections at the FOMC meetings.

Sources: Bloomberg; BLS; FRB; University of Michigan.

GDP and Outlook for Economic Activity and Prices

GDP



Outlook for Economic Activity and Prices
(April 2025 Outlook Report)

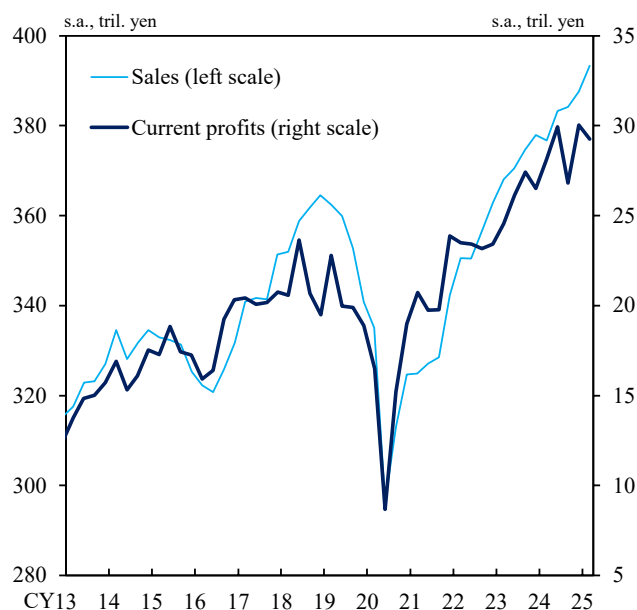
	y/y % chg.		
	Real GDP	CPI (less fresh food)	CPI (less fresh food and energy)
Fiscal 2025	+0.5	+2.2	+2.3
As of January 2025	+1.1	+2.4	+2.1
Fiscal 2026	+0.7	+1.7	+1.8
As of January 2025	+1.0	+2.0	+2.1
Fiscal 2027	+1.0	+1.9	+2.0
As of January 2025	-	-	-

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

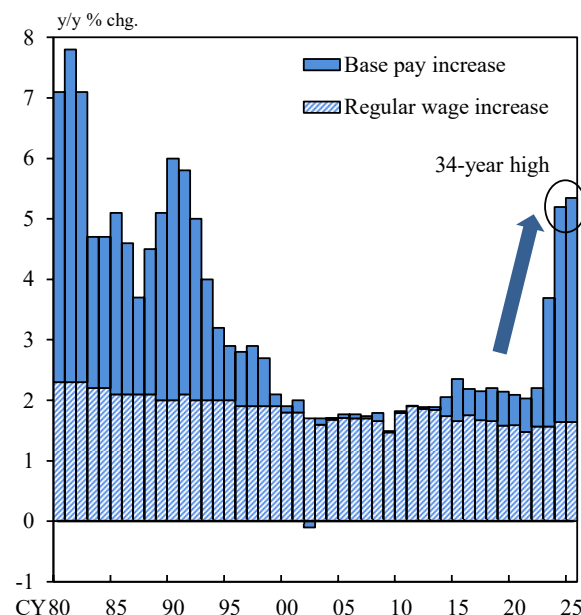
Sources: Cabinet Office; Bank of Japan.

Corporate Sector and Wage Growth

Corporate Profits



Wage Growth Rate

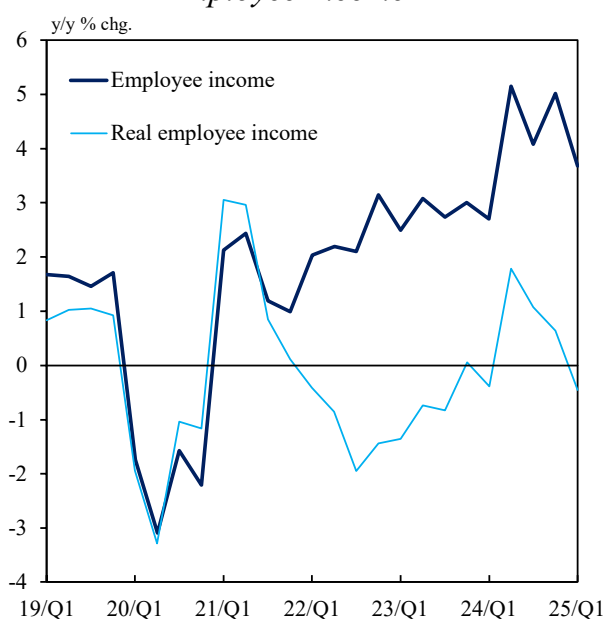


Notes: 1. In the left panel, figures are based on the *Financial Statements Statistics of Corporations by Industry, Quarterly*. Excluding the finance and insurance industries.
2. In the right panel, figures from 1980 to 2014 are those published by the Central Labour Relations Commission, while those from 2015 to 2025 are figures released by Rengo. Figures for 2025 are based on Rengo's sixth aggregate results.

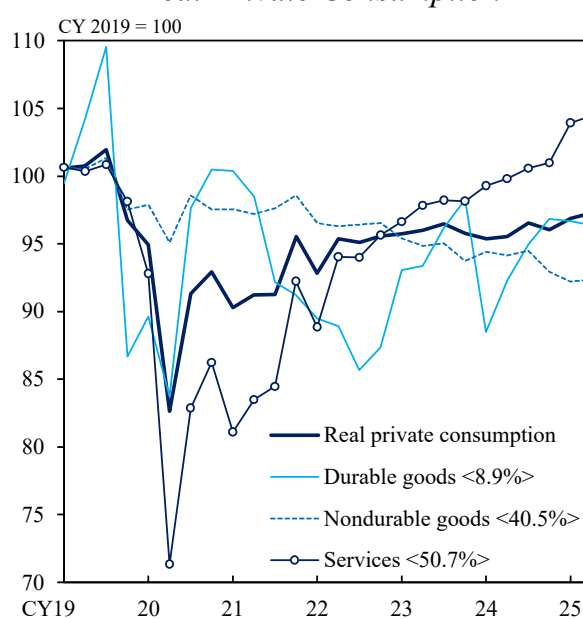
Sources: Central Labour Relations Commission; Japanese Trade Union Confederation (Rengo); Ministry of Finance.

Private Consumption

Employee Income



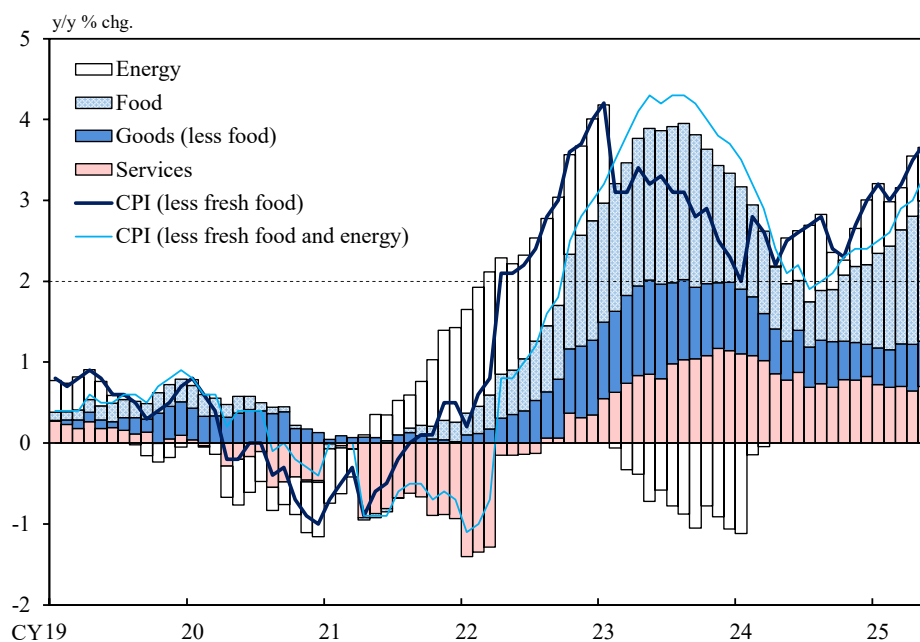
Real Private Consumption



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*) $\times$ 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. Figures for 2025/Q1 are March-April averages.
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. Figures for 2025/Q2 are those for April.

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

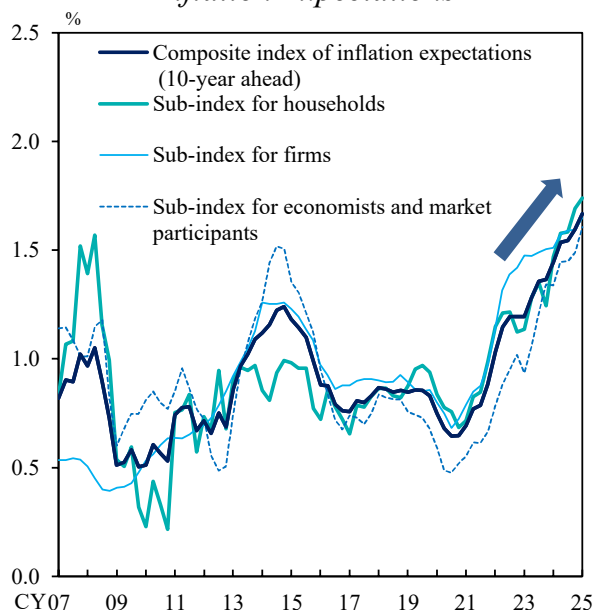
CPI Inflation



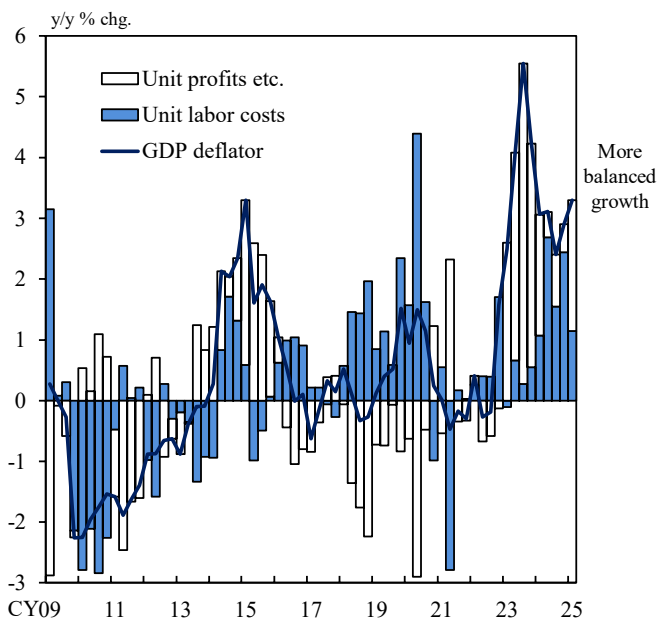
Source: Ministry of Internal Affairs and Communications.

Inflation Indicators

Composite Index of Inflation Expectations



GDP Deflator



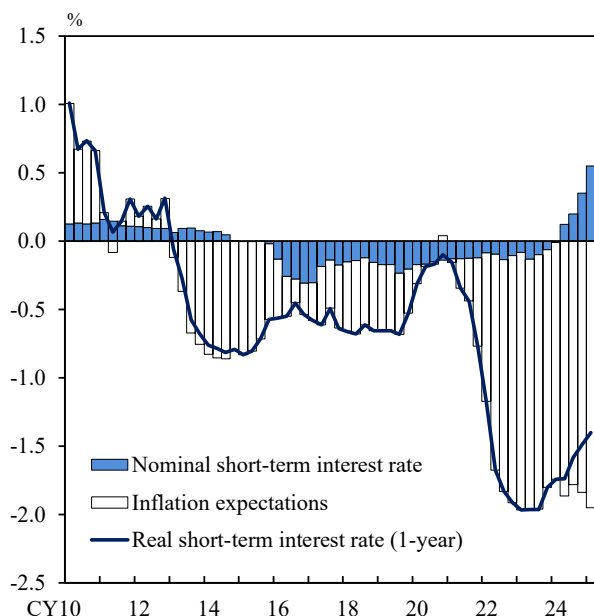
Notes: 1. In the left panel, the composite index is calculated by extracting the common components, based on the first principal component, of the inflation expectations of firms, households, and economists and market participants. For details of the calculation method, see Box 4 of the April 2024 Outlook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

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

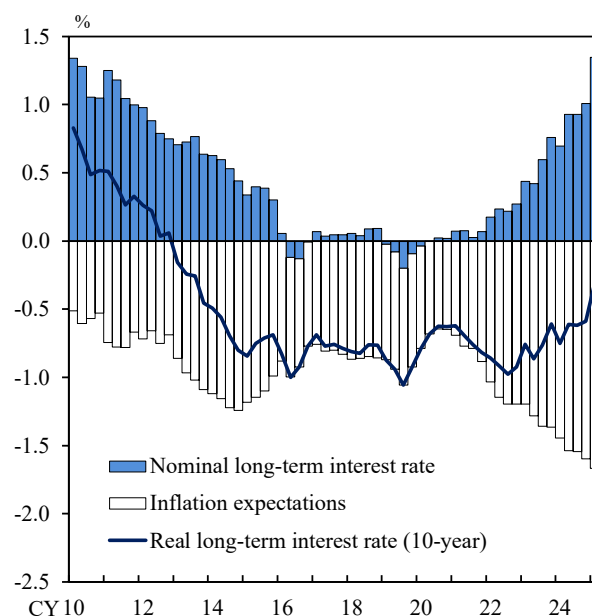
Sources: Bloomberg; Cabinet Office; Consensus Economics Inc., *Consensus Forecasts*; QUICK, *QUICK Monthly Market Survey <Bonds>*; Bank of Japan.

Real Interest Rate

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

Plan for the Reduction of the Purchase Amount of JGBs

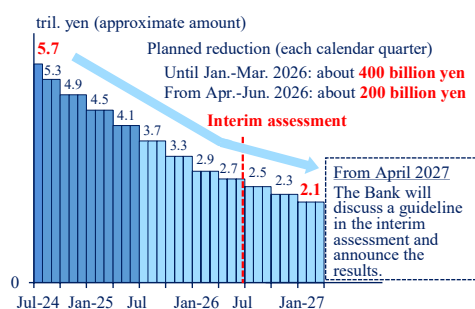
1. Long-term interest rates: to be formed in financial markets in principle
2. JGB purchases: appropriate for the Bank to **reduce its purchase amount of JGBs in a predictable manner**, while **allowing enough flexibility** to support stability in the JGB markets

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

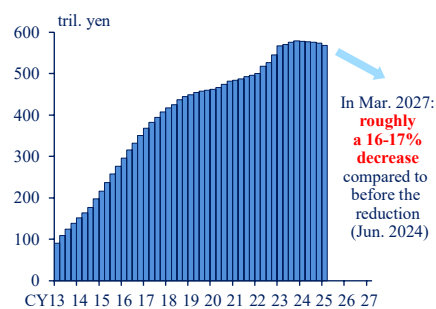
- Until January-March 2026 : about **400 billion yen** (the reduction plan decided in July 2024 will be maintained)
- From April-June 2026 to January-March 2027: about **200 billion yen**
- The Bank will **gradually reduce** its purchase amount so that it can improve the functioning of the JGB markets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

Reduction in a Predictable Manner

Amount of monthly JGB purchases



The Bank's JGB holdings

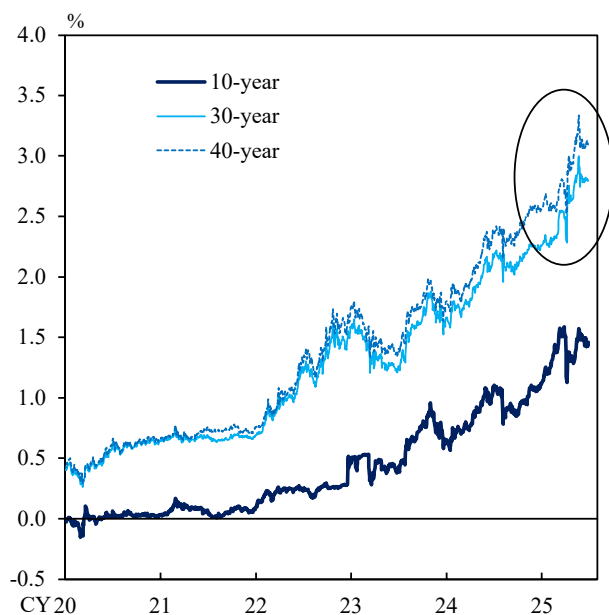


Allowing Enough Flexibility

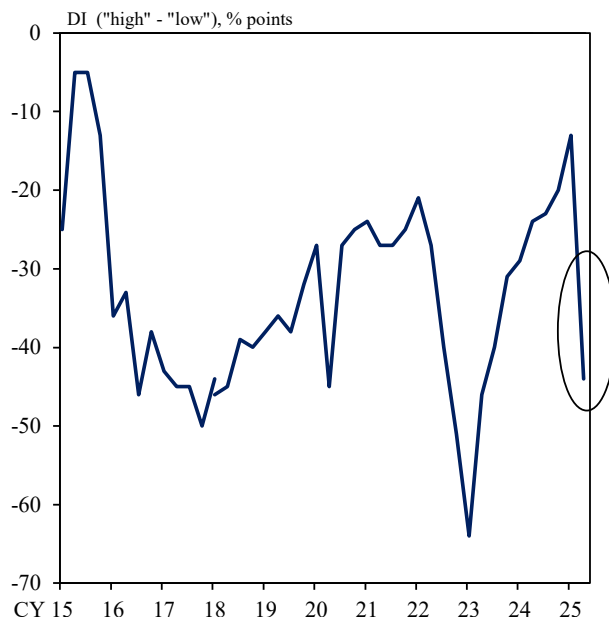
1. The Bank will **conduct an interim assessment of the plan at the June 2026 MPM**.
2. In the case of a rapid rise in long-term interest rates, the Bank will make nimble responses by, for example, increasing the amount of JGB purchases.
3. The Bank is prepared to amend the plan at the MPMs, if deemed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

Degree of Bond Market Functioning

Yields on Long-Term and Super-Long-Term JGBs



DI for the Degree of Bond Market Functioning

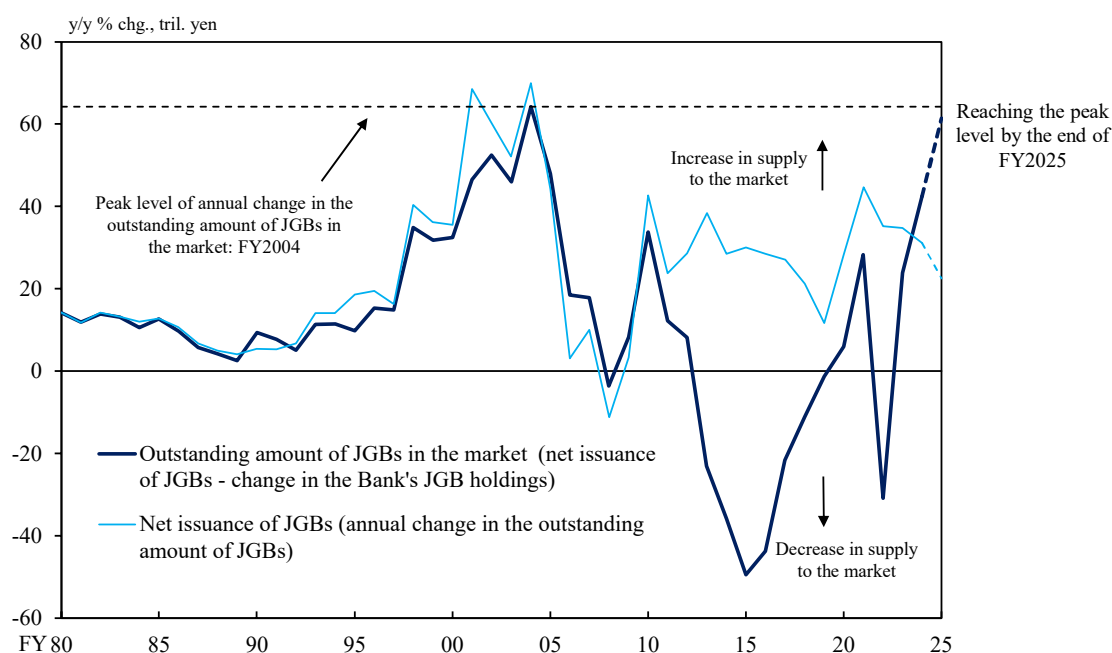


Note: In the right panel, the survey from February 2018 onward includes responses from major insurance companies, asset management companies, etc., in addition to those from eligible institutions for the Bank's outright purchases and sales of JGBs. Regarding the figures for February 2018, the reference data, which are based on responses only from eligible institutions for the Bank's outright purchases and sales of JGBs, are also indicated.

Sources: Ministry of Finance; Bank of Japan.

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

(Supply of JGBs to the market surged due to the reduction in the Bank's purchases)



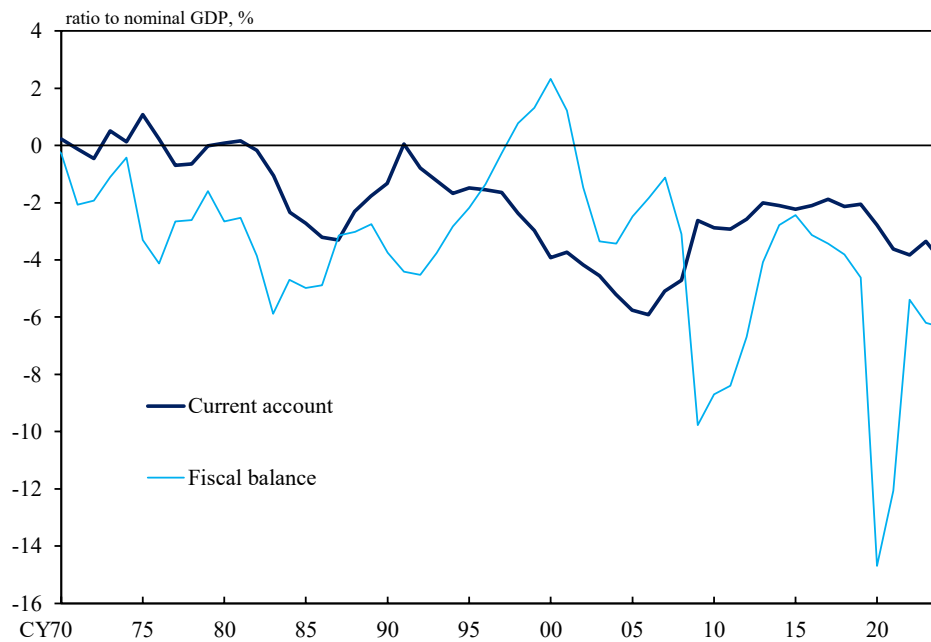
Notes: 1. Figures are on a book value basis and exclude short-term government securities.

2. Figures for FY2025 are estimated using the Cabinet Office's *Economic and Fiscal Projections for Medium to Long Term Analysis* (January 2025) and the Bank's plan for the reduction of the purchase amount of JGBs.

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

U.S. Current Account

(Focus should be on the future course of twin deficits:
current account and fiscal deficit)

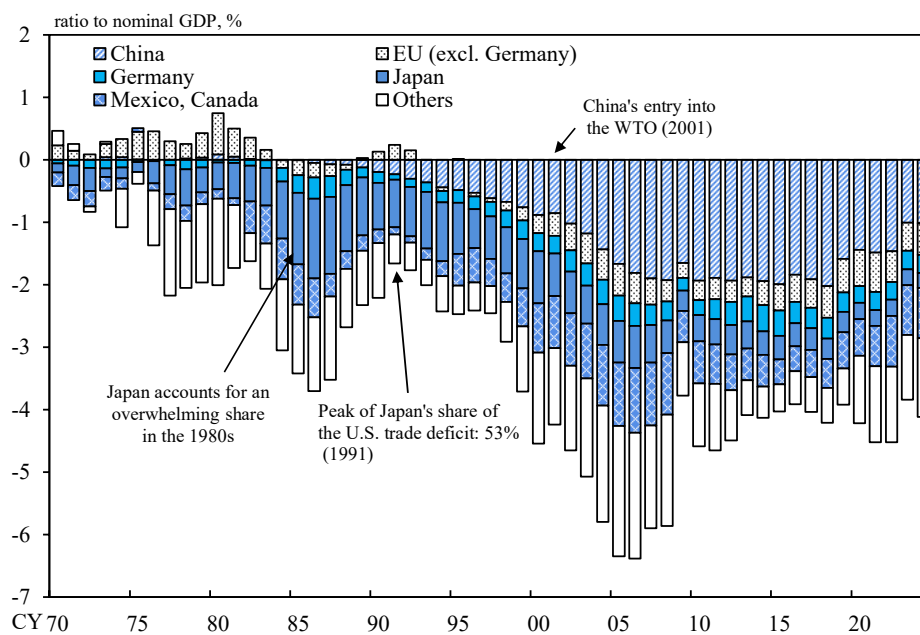


Note: Figures for fiscal balance is on a fiscal-year basis.

Sources: Bureau of Economic Analysis (BEA); Congressional Budget Office (CBO).

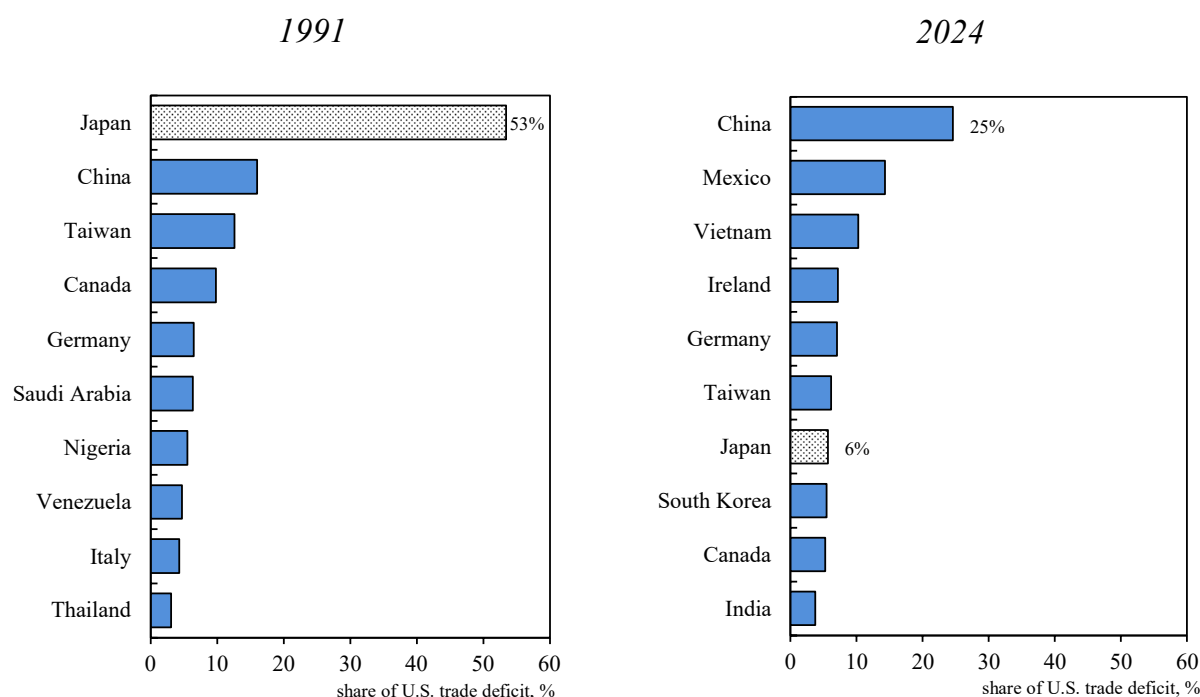
U.S. Trade Balance by Country

(Japan accounted for over half of U.S. trade deficit around 1990)



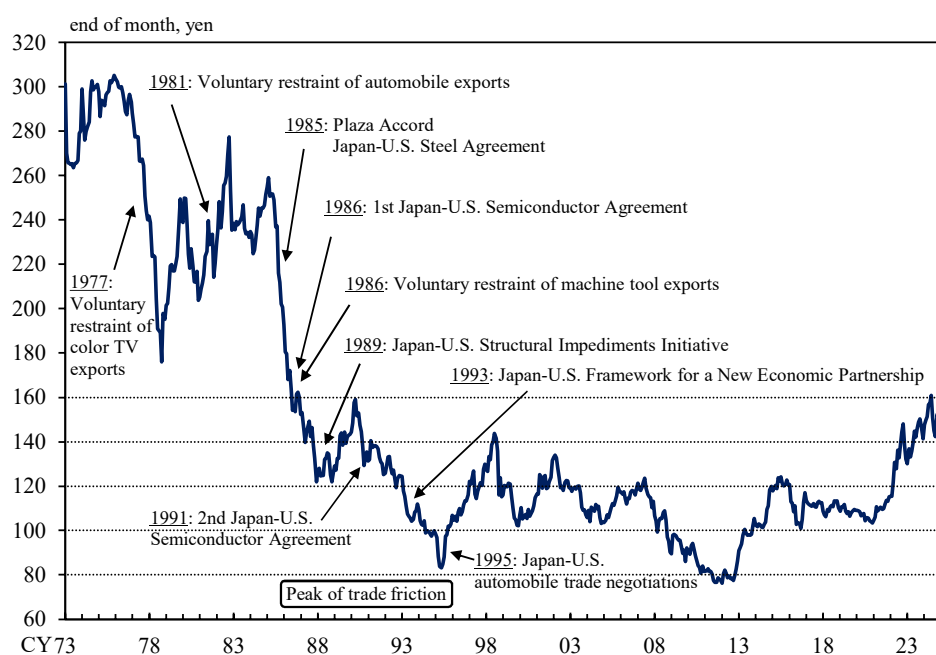
Sources: BEA; IMF.

Largest Shares of U.S. Trade Deficit by Country/Region (China has replaced Japan)



Source: IMF.

Historical Developments in U.S. Dollar/Yen Exchange Rate and Japan-U.S. Trade Friction (Trade friction reached its peak in the early 1990s)



Note: The descriptions of events in Japan-U.S. trade friction are based on *White Paper on International Economy and Trade 2019*, etc.
Sources: Ministry of Economy, Trade and Industry; Bank of Japan.

My View on Corporate Behavior in the Post-Bubble Period

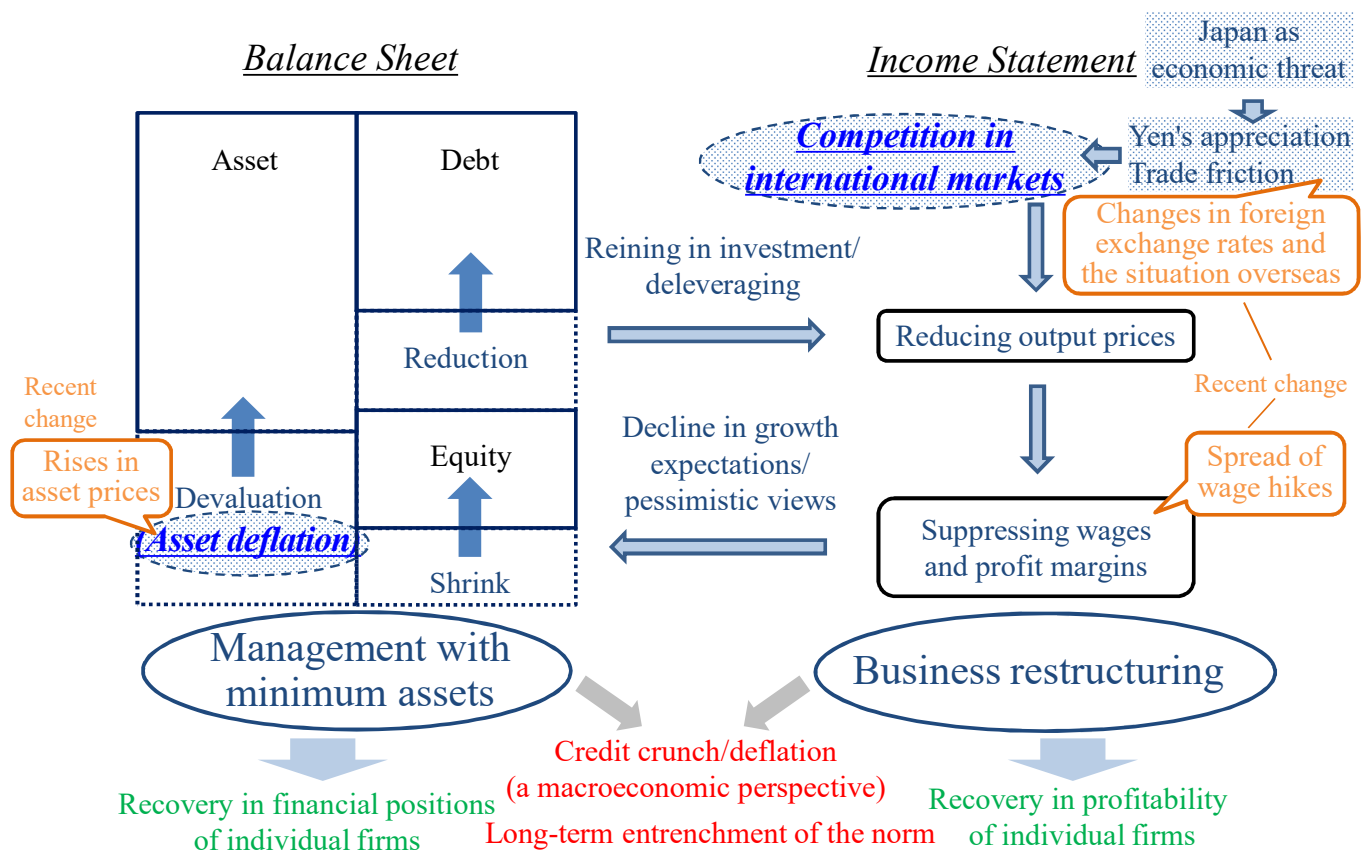
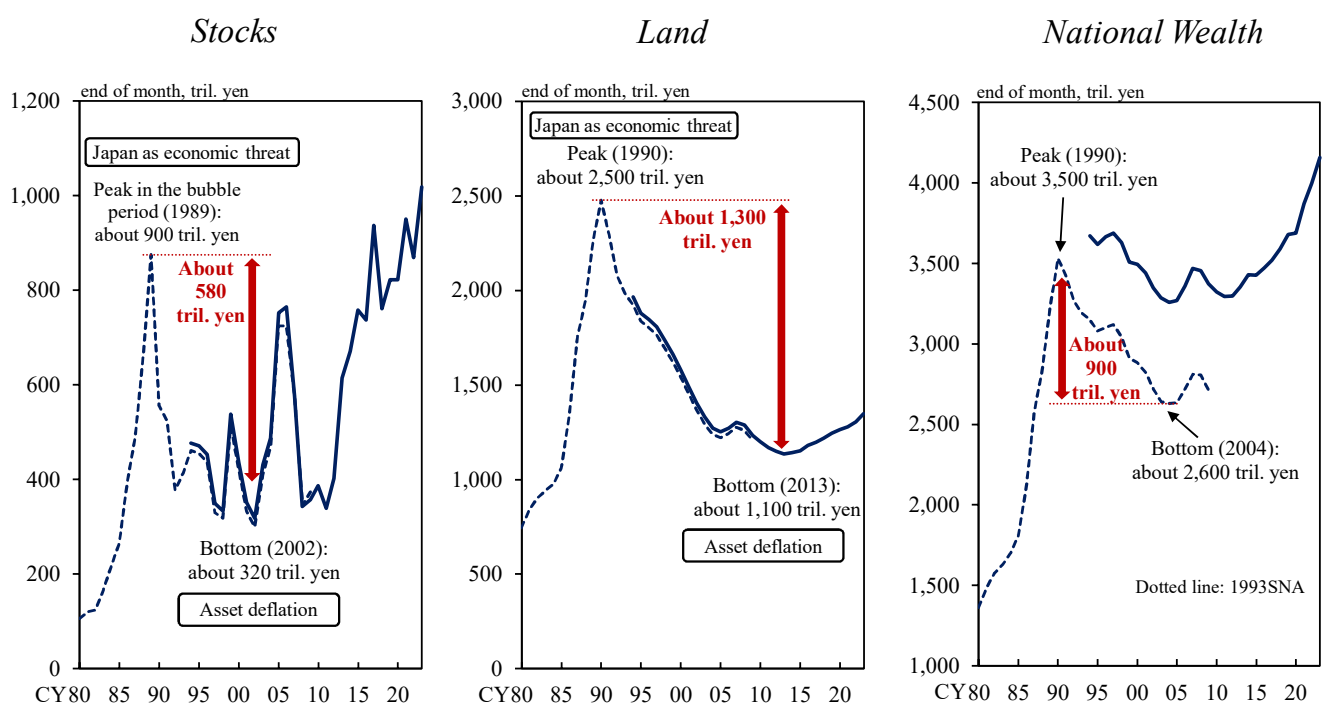


Chart 17

Asset Prices and National Wealth

(Japan was seen as an economic threat but then fell into asset deflation)

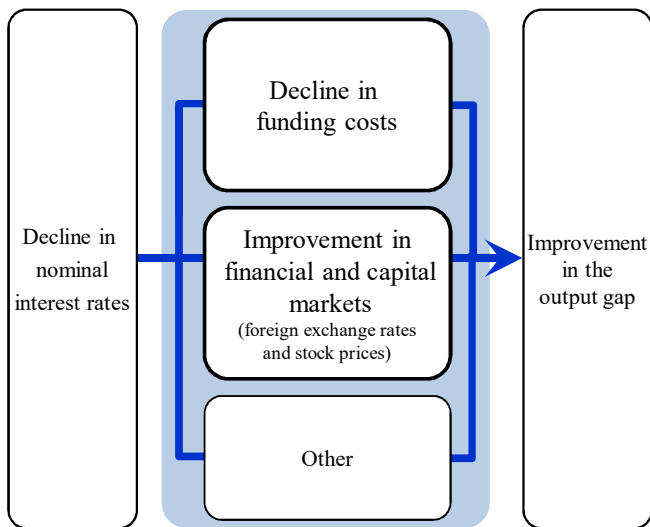


Note: Figures are based on the SNA. Dotted lines are based on the 1993SNA (benchmark year: 2000).

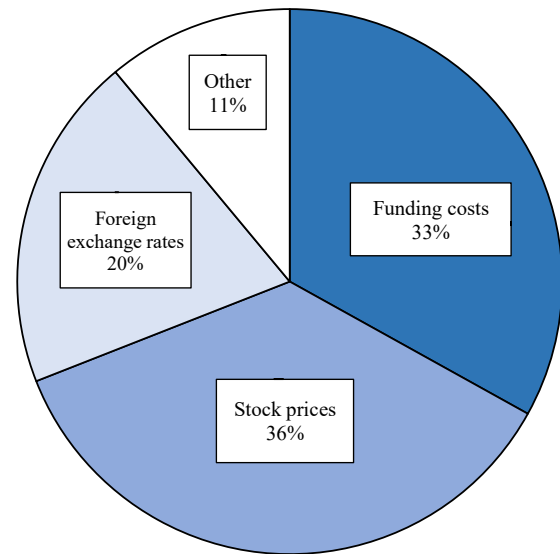
Source: Cabinet Office.

Transmission Channels of Lower Interest Rates

Overview



Improvement in the Output Gap
(Breakdown by Channel)



- Notes: 1. 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 exchange rates of the yen, and stock prices.
 2. Aggregate funding costs are the weighted average of bank lending rates and issuance yields for CP and corporate bonds.
 3. In the right pie graph, figures show the 5-year cumulative effects.

Sources: Bloomberg; Bank of Japan; etc.

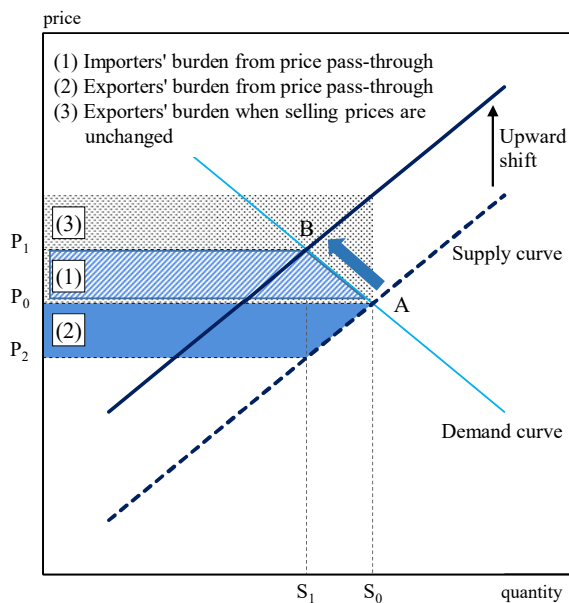
Policy Status of the New U.S. Administration

	Policy Status under the New Administration
Tariffs	• Imposition of reciprocal tariffs on all trading partners (10-50%), based on the results of America First Trade Policy investigations • China: 54% (of which additional 24% tariffs have been suspended) • Canada and Mexico: 25% (excl. USMCA-compliant goods) • Steel and Aluminum (50%), Automobiles (25%)
Immigration	• Declaration of a national emergency and initiation of procedures to control entry and deport undocumented migrants
Budget	• Permanent extension of Trump tax cuts and enactment of additional tax cuts under deliberation in the Senate and the House of Representatives • Cuts to government spending (establishment of the Department of Government Efficiency [DOGE], offer of early retirement to federal workers)
Deregulation, etc.	• Declaration of a national energy emergency, promotion of oil and gas field development • Cancellation of EV mandates, withdrawal from the Paris Agreement • Easing of regulations on financial institutions (temporary shutdown of the CFPB, etc.) • Elimination of 10 existing regulations for each new regulation issued

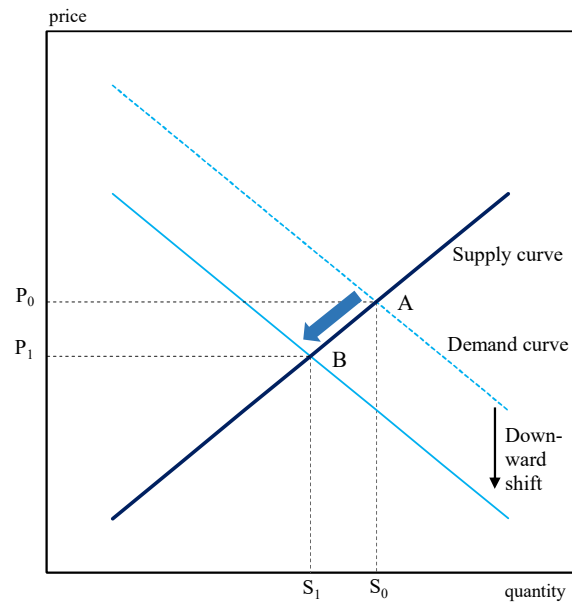
(Sources) White House; news reports, etc.

Impact of Tariffs: Supply and Demand Curves (1)

Tariff-Imposing Country: Supply Shock



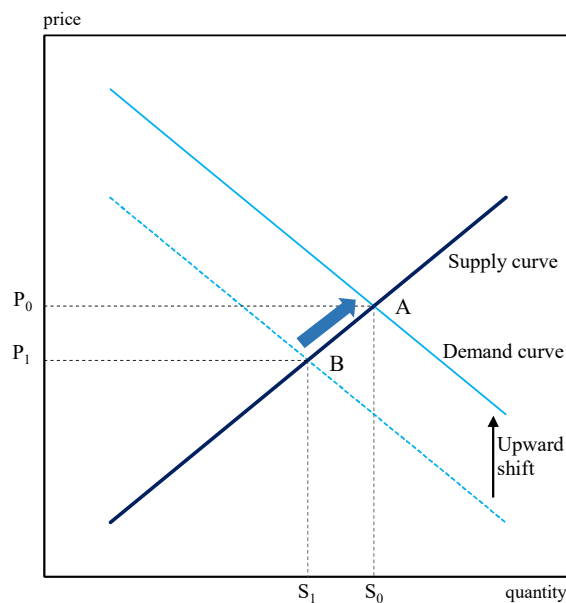
Tariff-Imposed Country: Demand Shock



Note: The charts are based on Krugman, P., Obstfeld, M., and Melitz, M., *International Trade: Theory and Policy*, 10th ed. (Pearson, 2014), etc.

Impact of Tariffs: Supply and Demand Curves (2)

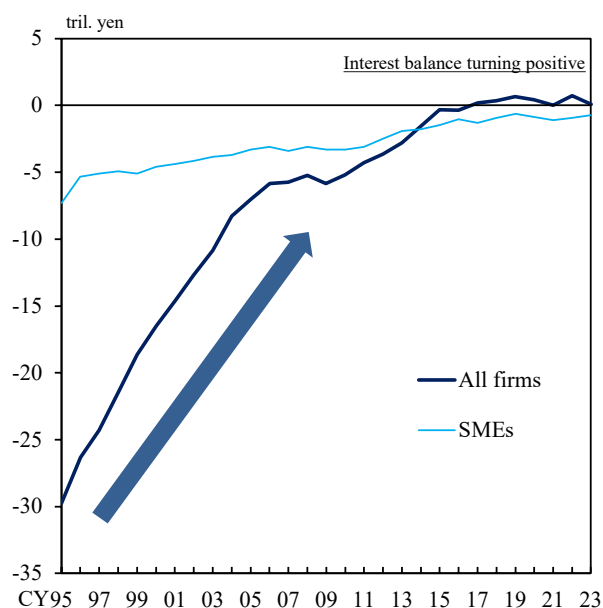
*Tariff-Imposed Country:
Increased Demand Due to Fiscal Policy Measures in the Export Destination*



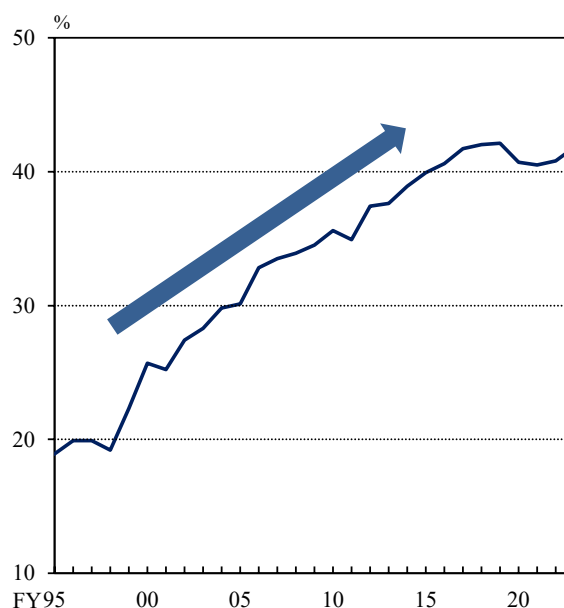
Note: See the note on Chart 20.

Improvement in Corporate Finance

Interest Balance



Capital Adequacy Ratio

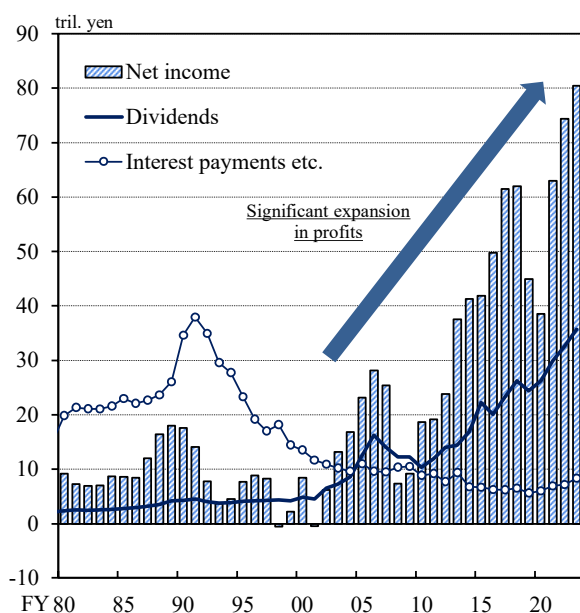


Note: Interest balance for small and medium-sized enterprises (SMEs) in the left panel includes dividend income.

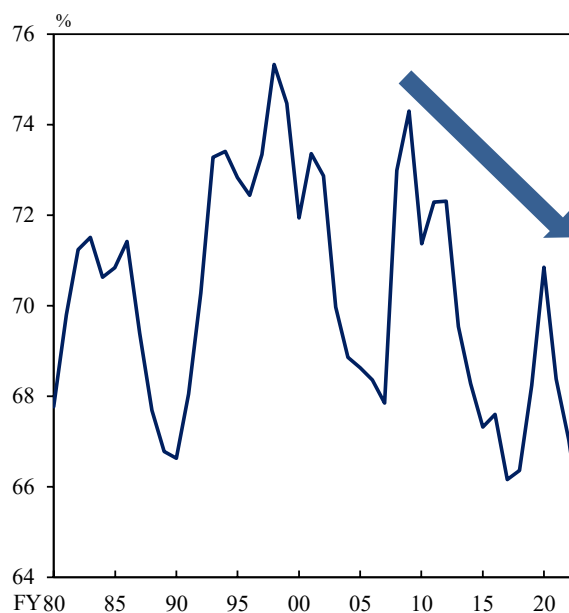
Sources: Cabinet Office; Ministry of Finance.

Rapid Expansion in Corporate Profits

Corporate Profits and Returns to Investors



Labor Share



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

2. Labor share = personnel expenses / value-added. Value-added = operating profits + personnel expenses + depreciation expenses.

Source: Ministry of Finance.

My View on Mechanism of Expanding Corporate Profits and Ensuing Challenges

