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Bank of Japan

Japan's Economy and Monetary Policy

Speech at a Meeting with Local Leaders in Saitama

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(English translation based on the Japanese original)

Introduction

Good morning. I am delighted to be here in Saitama to discuss recent economic developments and their implications for monetary policy.

I. Recent Economic Developments

Let me begin by discussing four key factors affecting the Japanese economy: the Middle East conflict, AI-related demand, foreign exchange rates, and financial conditions (Chart 1). The rise in crude oil prices stemming from the Middle East conflict exerts downward pressure on the economy while pushing prices upward. The increase in global AI-related demand drives upward pressure on both the economy and prices. The depreciation of the yen has both upward and downward effects on the economy, while pushing prices upward. Lastly, accommodative financial conditions provide upward support to both the economy and prices. I will discuss the four factors one by one and then assess the combined implications for economic activity and prices.

The Middle East Conflict

First, about the Middle East conflict.

The Bank of Japan publishes its *Outlook for Economic Activity and Prices* (Outlook Report) on a quarterly basis. On February 28, the United States began attacks against Iran, and the Bank, in the Outlook Report published at the end of April, presented one baseline scenario and three risk scenarios (Chart 2 [left-hand panel]).

Let me list them from the most benign one to the least. First, a rapid resolution scenario, which envisioned a swift resolution of the conflict leading to a decline in crude oil prices quicker than the futures market expectations at the time.

Second, the baseline scenario, which anticipated gradual easing of the conflict, crude oil price decline in line with the futures market expectations, and no material global supply chain disruptions. Specifically, it assumed that the price of Dubai crude oil would decline from around 105 U.S. dollars per barrel, as was observed in April, to the range of around 70-80 dollars during fiscal 2028.

Third, an elevated oil price scenario, wherein crude oil prices were assumed to remain around the 105-dollar level through the end of 2026.

Fourth, a supply chain disruption scenario, which assumed that the shock would affect both prices and availability, leading to significant disruptions to the production activities of Japanese firms.

The crude oil futures markets provide the most objective basis for reference, and I believed it reasonable to set the baseline scenario in line with them. At the same time, I also assigned significant probability to the elevated oil price scenario and non-negligible probability to the supply chain disruption scenario.

There were several reasons for my pessimistic view. First, one-seventh of the world's total crude oil supply passes through the Strait of Hormuz, and the quantitative impact of the current conflict could be among the highest in history. Second, given the developments leading to that point, including the revocation of the Iran nuclear deal by the United States, it seemed unlikely that the United States and Iran would reach a sustainable and stable agreement. Third, I assumed that restoring trust in the safety of maritime navigation and rehabilitating damaged production facilities would require significant additional time, even if an agreement was reached.

Fortunately, my concerns were proven misplaced. Developments from April to June were not only far from the elevated oil price scenario but, in fact, were closer to the rapid resolution scenario than the baseline scenario (Chart 2 [right-hand panel]). I did not foresee either oil rerouting via the Red Sea, increased supply from the United States and other countries, releases of oil reserves including by Japan, China's pivot to coal as an energy source, or the contents of the 14-point U.S.-Iran agreement.

In July, however, the conflict escalated, and the Houthi threatened to blockade the Red Sea. The situation at the time more closely resembled the baseline scenario or the elevated oil price scenario.

Nevertheless, the earlier concerns over the supply chain disruption scenario have significantly diminished. Both government announcements and estimates derived from past vessel movements and other data suggest that the volume of crude oil imports is likely to remain at around pre-conflict levels (Chart 3 [left-hand and middle panels]). Japan's petroleum reserves in recent months have been stable at high levels (Chart 3 [right-hand panel]). Naphtha has been successfully procured from alternative sources such as the United States and Algeria. Though the rice shortage from 2024 to 2025 was amplified by inventory hoarding at various stages of the supply chain, recurrence of such amplification was avoided for petrochemical products, thanks in part to the government's painstaking interventions.

To summarize, although uncertainty surrounding the Middle East conflict remains high, it appears increasingly likely that the trajectory of oil prices will lie somewhere between the baseline scenario and the elevated oil price scenario. Downward pressure on the economy and upward pressure on prices will therefore materialize, but the risk of availability problems causing major economic downturns has diminished.

Increase in Global AI-Related Demand

Let me turn to AI-related demand.

AI-related capital investment in the United States began to soar explosively around 2024. Currently, the annual amount of IT-related capital investment across the United States amounts to approximately 1.7 trillion dollars (or around 270 trillion yen; Chart 4 [left-hand panel]). The five hyperscalers (Amazon, Microsoft, Alphabet, Meta, and Oracle) alone are expected to make capital investments amounting to 0.8 trillion dollars (around 130 trillion yen) in 2026, and much of this new investment is estimated to be AI related.

In our October 2025 Outlook Report, we assessed that Japanese firms were not yet in a position to fully capitalize on AI-related demand, unlike their Taiwanese or South Korean counterparts, who excel in the export of graphic processing units (GPU) and other data center-related products. Even thereafter, although the prices of Japanese exports have been rising, given that export volumes have not increased significantly, our view had been that, while AI-

related demand benefits the revenues and stock prices of AI names, its spillover across the broader economy would remain limited.

Such views may need to be reconsidered. The price increases in AI-related exports have reached a scale that can have a material macroeconomic impact. The import price index (on a contract currency basis) for July rose by 17 percent year-on-year (Chart 4 [middle panel]), while the export price index (also on a contract currency basis) increased by 10 percent year-on-year (Chart 4 [right-hand panel]). The main cause of the rise in import prices was higher prices for crude oil and petrochemical products. Conversely, the largest contributor to the rise in export prices was AI-related products. Indeed, items whose prices rose most on a month-on-month basis in July include MOS memory integrated circuits, precision measuring instruments, and semiconductor manufacturing equipment. The AI buildout is partially offsetting the deterioration in Japan's terms of trade caused by the energy price hike.

Moreover, spillover from the AI buildout seems to be spreading across the broader economy. At the branch managers' meeting the Bank convened in July, managers reported about local companies that command high global shares in semiconductor manufacturing equipment or in relevant parts. Managers also related anecdotes of rather remote chains of events benefiting the local economy. Sales of power shovels have been boosted due to a surge in copper mining activity, which has been caused by increased demand for copper wiring to build data centers. Korean and Taiwanese tourists visiting Japan are spending more than before. One banker from a regional financial institution told a manager that, when visiting customer firms, it often came as a surprise that many of these firms were benefiting from the AI buildout.

The increased demand arising from the AI buildout will exert upward pressure on both economic activity and prices. Furthermore, the global market prices of items such as memory chips and copper wiring are rising in reflection of global supply and demand conditions, giving additional upward push to prices in Japan. For example, we are currently seeing significant price hikes for personal computers. The AI buildout exerts upward price pressure from both demand- and supply-side channels.

Foreign Exchange Rates

Next, let me discuss developments in the foreign exchange market (Chart 5).

I hear a wide range of views about the depreciation of the yen. The Japan Chamber of Commerce and Industry conducted a survey among its member small and medium-sized enterprises (SMEs) in March, and 41.5 percent of respondents stated that the depreciation of the yen had a greater impact on their business than rising interest rates, significantly outpacing the 25.6 percent who felt the opposite. I also increasingly hear from executives of large Japanese firms operating globally that the shrinking size of the Japanese economy in U.S. dollar terms may disadvantage them in the global competition over large-scale capital investments, natural resource extraction rights, and strategic mergers and acquisitions. Indeed, the size of Japan's economy, when converted at market exchange rates, was more than four times greater than that of the United Kingdom in the mid-1990s, but the two economies are nearly the same size today. According to a public opinion survey conducted by the public broadcaster NHK (Japan Broadcasting Corporation) this July, 61 percent of respondents believed that the depreciation of the yen had a negative impact on the Japanese economy, significantly outweighing the 22 percent who thought it had a positive impact.

The depreciation of the yen may benefit the earnings of global companies and may boost spending by tourists from abroad, but can squeeze the profits of SMEs via increased import prices. It can also push up consumer prices and thus lower the real income of households. We will closely monitor how all these channels work.

Following the policy interest rate hike by the Bank in June, I often heard comments arguing that the rate hike did not help rectify the weak yen. Some concluded that it did not work because the Bank had not raised rates earlier, lost the opportunity to demonstrate that the Bank would not let its policy stay behind the curve, and failed to secure confidence in monetary policy. Others concluded that the June rate hike was just in vain.

I usually respond to these comments as follows: Monetary policy does not target exchange rates, but exchange rates have an impact on economic activity and prices. The pass-through from exchange rates to prices seems to be getting stronger, and the pass-through can influence

underlying inflation through changes in inflation expectations. These are important factors to consider in conducting monetary policy.

I have, however, often sensed that this response fails to satisfy many and leaves them feeling unconvinced. Later in the speech, I would like to add some discussion on this and other related matters.

Financial Conditions

Finally, let me discuss financial conditions. At the Monetary Policy Meeting in June, the Bank raised the policy rate to 1 percent, reaching the highest level in 31 years (Chart 6 [top-left panel]).

During the deflationary period, because sales and wages remained flat or shrank, borrowers felt significant repayment burdens even with a zero or negative policy rate. On the other hand, since prices were not rising, the purchasing power of deposits was preserved. Interest did not accrue much to their savings, but households were less likely to find their savings falling short to purchase a desired house or to fund their retirement if they succeeded in saving the initially targeted amount.

In contrast, in an era of 2 percent inflation, sales and wages also tend to grow, and so does borrowers' ability to repay, mitigating nominal interest payment burden under the 1 percent policy rate. On the other hand, interest accruing to deposits may fall short of the inflation rate and may not be enough to maintain the real purchasing power of savings. By the time households have saved their target amount, the amount will have fallen short of housing prices or the cost of living in retirement.

In short, firms and households may find that, in terms of the way interest rates affect their business or life plans, a 1 percent interest rate in a non-deflationary environment is in fact lower than zero or negative rates in a deflationary environment.

Real interest rates remain negative, particularly in the short- to medium-term range (Chart 6 [top-right panel]). Financial institutions maintain an aggressive lending stance (Chart 6

[bottom-left panel]), and the growth rate of banks' loan balances is picking up (Chart 6 [bottom-right panel]). These indicators show that financial conditions remain accommodative. The accommodative conditions will continue to firmly support economic activity.

Following the policy rate hike in June, we have been asked if it increases the burden on SMEs and the working generation with mortgage loans, and if increased interest payments put a strain on public finances.

Nominal interest repayments will indeed increase. However, I would like to offer three perspectives to consider. First, the ability to repay should also improve, supported by increases in sales and wages. Government revenue will also increase in line with the rise in nominal GDP. Second, while low rates that are not commensurate with inflation or economic conditions might be to borrowers' advantage, they put strains on depositors. When assessing a change, one tends to focus on the comparison with the recent conditions, but one should also think what would constitute a normal condition. Third, and perhaps most importantly, raising rates in a timely manner will help avoid inflation acceleration and abrupt rate hikes in the future, and may ultimately be in the best interests of SMEs, mortgage borrowers, and public finances.

Economic Outlook

Next, I would like to discuss current economic conditions and the outlook.

Current economic conditions seem to be solid. The June *Tankan* (Short-Term Economic Survey of Enterprises in Japan) revealed strong business conditions for both large enterprises and SMEs (Chart 7 [left-hand panel]). Corporate profits remain at historically high levels, and business fixed investment plans project growth comparable to last year, starting from an already elevated level. Consumer sentiment remains somewhat weak, but actual household consumption remains resilient (Chart 7 [right-hand panel]). Consumer sentiment may have been affected by price increases, but consumption seems to be supported by robust wage growth, which continues under the tightest labor market conditions since the 1980s' bubble economy era.

Looking ahead, as discussed, although the rise in crude oil prices is expected to push down economic activity, earlier concerns over a significant economic downturn reflecting the situation in the Middle East have diminished. Japan's economy is likely to be underpinned by factors such as the government's various measures and accommodative financial conditions, in addition to an increase in global AI-related demand. Japan's economy is thus expected to continue growing moderately, albeit at a decelerated rate.

From fiscal 2027 onward, Japan's economic growth rate is expected to rise moderately, since it is projected that the adverse effects of high crude oil prices will wane and that the virtuous cycle from income to spending will gradually intensify.

Following the policy interest rate hike in June, I was asked about the consistency between the rate hike and the government's efforts to bolster public and private investment and raise Japan's potential growth rate, as the rate hike may work to restrain investment.

On this point, I would first like to stress that the rate hike is an adjustment in the degree of monetary accommodation, not a tightening.

Furthermore, during times of insufficient demand, supporting overall investment may have played a role in saving the economy from a downward spiral. However, to raise the potential growth rate in an era of supply-side shortages, I consider it crucial to allocate resources efficiently, prioritizing high-efficiency and strategically-promising investments, by letting the resource allocation function of the interest rate mechanism work.

We now increasingly hear that labor shortages and surging material costs are constraining investment. Achieving price stability through the appropriate conduct of monetary policy is also important from the perspective of supporting the expansion of growth investment.

Price Outlook

Regarding prices, the inflation rate remained below the price stability target of 2 percent in the first half of this year (Chart 8).

This was due to a combination of several factors. In the chart, the contribution of rice prices is shown in red, and other food items in pink, indicating that the deceleration in food price inflation, which previously accelerated due to the rise in rice prices, has contributed to lower overall inflation. Additionally, as indicated in green for institutional factors in the chart, central and local governments' policy measures, such as subsidies for gasoline and electricity costs, as well as free tuition for private high schools, have also contributed to curbing price increases.

Some of these downward factors, however, are temporary. The increase in petrochemical prices has been passed relatively quickly from upstream crude oil importers to midstream intermediate goods suppliers, but the pass-through from downstream providers of final goods and service to consumers is yet to come. Rising semiconductor prices, driven by the increase in global AI-related demand, and the recent depreciation of the yen are also expected to contribute to price increases, in particular in durable goods. Taking these factors into account, it is expected that CPI inflation will move up and stay above 2 percent in the second half of fiscal 2026.

Following our decision to raise the policy rate in June, I was asked why the Bank raised the rate when CPI inflation was still below the price stability target of 2 percent. I was also asked why the Bank prioritized concerns about inflation when the United States and Iran were moving toward an agreement and crude oil prices had started to decline.

Simply replying that inflation will exceed 2 percent again in the second half of the fiscal year or that crude oil prices have gone up again is, in my view, inadequate.

At the press conference held on the occasion of a meeting with local leaders in Wakayama in March, I commented as follows: "The Bank had thus far been slow to adjust the degree of monetary accommodation, despite the headline inflation rate being around 3 percent, because underlying inflation remained below 2 percent. Going forward, however, there is a high likelihood that the Bank will raise rates even when the headline inflation rate is below 2 percent, if underlying inflation is deemed to be approaching 2 percent. It may be that neither approach sounds intuitive, but I hope you will see that the two are consistent with each other

in that they both focus more on underlying inflation than on the current headline inflation." In June, we indeed raised the rate in line with the latter approach.

Underlying inflation refers to the inflation rate that would be realized once temporary factors, such as fluctuations in crude oil or rice prices, subside. It serves as a key concept in assessing inflation outlook. While it cannot be precisely determined, we explore it employing various approaches, and use the findings to guide the conduct of monetary policy. We do carefully analyze and study the CPI statistics, but, in making policy decisions, we place greater emphasis on underlying inflation, which is inherently less exact but more forward-looking. I will provide additional explanation on this point later.

For now, let me show you some of the indicators we look at when exploring underlying inflation. The first group consists of indices that are adjusted to exclude the effects of temporary factors (Chart 9 [left-hand panel]). The second group includes indices based on surveys and market data that measure the medium- to long-term inflation expectations of firms, households, and investors (Chart 9 [middle panel]). The third group comprises indicators that help us understand the forces driving underlying inflation, such as wage trends (Chart 9 [right-hand panel]), the estimated output gap, and weighted diffusion indices (DI) from surveys regarding shortages of labor and production facilities.

For a long time, we have asked ourselves whether underlying inflation is moving up and whether it will reach and stabilize at 2 percent. However, given the movement of these indicators, I believe we are entering a phase where we will also need to bear in mind the possibility of underlying inflation exceeding 2 percent in addition to these considerations when making policy decisions.

II. Monetary Policy

The aforementioned outlook for economic activity and prices informs the future conduct of monetary policy (Chart 10). Given that underlying inflation has been approaching 2 percent and financial conditions have been accommodative, I believe the Bank should continue to raise the policy interest rate and adjust the degree of monetary accommodation in accordance with developments in economic activity, prices, and financial conditions.

The timing and pace of adjustment should be chosen by examining the likelihood of the baseline scenario of the outlook for economic activity and prices being realized, and the risks to the outlook, including the impact of the situation in the Middle East, the expansion in AI-related demand, and developments in foreign exchange rates.

In particular, it is important to stabilize underlying inflation at a level around 2 percent. If underlying inflation deviates upward to a level above the price stability target of 2 percent, that would have an adverse impact on the economy, and we should pay greater attention to the upside risk to prices than in the past. In-depth deliberations should be held at each Monetary Policy Meeting with these perspectives in mind.

Since the Bank raised the policy rate in June, I have had conversations with many people and received a variety of questions. Today, I have tried to share with you some of my responses to those questions in the course of discussing recent economic and price developments. My previous conversations make me guess, however, you might have found my responses unduly indirect and cumbersome. On social media, we are accustomed to seeing clear, concise, and straightforward assertions and argumentation, and my responses are indeed no match for them.

In the case of school exam questions, there is typically one correct answer, and one earns full marks by proving its validity as concisely as possible. However, monetary policy needs to be approached from multiple perspectives. To identify the policy path that best ensures price stability and thereby contributes to the sound development of the national economy, policymakers evaluate outlooks and risks considering conditions of various economic actors, multiple time horizons, and a variety of potential external scenarios. A simple answer may successfully capture the essence of the matter in some cases, but may omit key considerations in others.

The key players in building a strong and prosperous economy are private firms and individuals. The government is the key promoter of their efforts. The role of monetary policy is to support these key players -- firms, households, and the government -- and ensure that their efforts do not lead to significant imbalances in the overall economy. As a result, central bank narrative tends to be abstract and indirect in discussing the future shape of the economy.

The government has a wide range of policy tools that can be tailored to address specific issues faced by specific players, such as infrastructure building, regulatory reforms, subsidies, tax benefits, investments, loans, and guarantees. By contrast, monetary policy has only one tool and three choices; raising, keeping, or cutting the policy rate. Although monetary policy affects individual households and firms differently, our explanations tend to take the form of: "Given the overall state of the economy, we believe this policy will ultimately prove to be in the best interest of the Japanese people."

In other words, while we talk a lot about various positive and negative factors from multiple perspectives, we tend to be abstract and indirect and are unable to provide responses tailored to specific conditions of individual firms and households.

These tendencies are enough to make our stories less attractive, but I believe that the biggest challenge in our communication lies in the matter of time horizons. To make policy decisions, the Bank monitors the current economic and price conditions and assesses the baseline scenario for the outlook and the risks involved. Monitoring current conditions is fundamental to the assessment of the outlook and risks, but the policy debate tends to put more weight on the future outlook and risks.

Why should the Bank so much emphasize the future outlook and risks in making policy decisions when households and firms struggle with the immediate challenges they face today?

Monetary policy has an impact on financial markets, economic activity, and prices across various time horizons (Chart 11).

The financial markets react within seconds, or even in nanoseconds. There is a compelling body of research, however, suggesting that some effects appear over time.¹ Focusing solely

¹ For example, see Pascal Paul, "The Time-Varying Effect of Monetary Policy on Asset Prices," *The Review of Economics and Statistics* 102, no. 4 (October 2020) for stock markets, and Martin Eichenbaum and Charles L. Evans, "Some Empirical Evidence on the Effects of Shocks to Monetary Policy on Exchange Rates," *The Quarterly Journal of Economics* 110, no. 4 (November 1995) for foreign exchange markets.

on immediate reactions may risk losing sight of the whole range of implications of a policy change.

It is relatively easy to measure the time needed between a policy rate hike and revisions in deposit and lending rates offered by financial institutions. Lending rates tied to short-term market rates adjust promptly. In recent cases, demand deposit rates and short-term prime rates typically take around two months before being raised. The interest rates for new floating-rate mortgages are adjusted later, and the applicable interest rates for existing floating-rate mortgages tend to rise even more slowly. Even when the applicable rates are revised, many mortgages are subject to mechanisms that would delay changes in the monthly repayment amount, such as the so-called 5-year rule. New interest rates for fixed-rate loans only take effect when new lending is made or when loans are refinanced.

Changes in financial and capital markets and in deposit and lending rates in turn affect the behavior of households and firms. While some households and firms may adjust their behavior only when they get new rates applied, others may act in anticipation. Therefore, the extent and the speed at which economic activity is affected are even more difficult to predict than changes in the market or in deposit and lending rates.

It also takes time for monetary policy to affect prices. While changes in exchange rates are relatively quickly transmitted to import prices, the peak effect on producer prices is said to occur roughly three months later, and the peak effect on consumer prices around six months later. Recently, price pass-through has become swifter than in the past, and the lags today may be shorter than was conventionally assessed, but a certain lag should still exist. It takes more time for rate changes to affect economic activity, and thereby the output gap, and then pricing. The channel via wage increase would take even longer.

There is significant variation in the results of academic research on the lag,² but many overseas central bankers' speeches seem to assume that, after a monetary policy shock, the

² Valerie A. Ramey, "Macroeconomic Shocks and Their Propagation," in *Handbook of Macroeconomics*, vol. 2 (2016).

impact on economic activity and prices gradually gets stronger and takes about one to two years to peak.

For this reason, we often say that "given the time required for the transmission of the effects of monetary policy, the Bank conducts monetary policy by monitoring current economic and price conditions and assessing the baseline scenario for the outlook and the risks involved."

Allow me to offer a crude analogy. Imagine a large bus with an accelerator and a brake, which can affect the speed of the bus only gradually and over time. Passengers naturally want to reach the destination as quickly as possible, but too high a speed risks an accident, and slamming on the brakes can injure passengers. Moreover, unfortunately, when the speed gets too slow, the accelerator becomes ineffective. This last point is what Japan experienced during the deflationary era.

If I say monetary policy resembles the accelerator and the brake, it may disappoint those who expect an all-powerful panacea, which can quickly cure every disease in economic activity, prices, and financial markets. However, even if it isn't a cure-all, having an accelerator and brake makes a significant difference, compared to not having them at all. Wise use of these tools should enable us to reach our destination as quickly as possible without excessively increasing the risk of accidents. I believe effective use of monetary policy can prevent the national economy deviating from the path of sound development.

Although the speed of the bus has been fluctuating because of the frequent changes in the slope of the road, the speed which would be realized should the road stay flat (underlying inflation) has been approaching the target speed set in advance (2 percent). As we are still pressing on the accelerator (financial conditions have been accommodative), I believe we will need to ease off in a timely manner (continue to raise the policy interest rate and adjust the degree of monetary accommodation) while carefully checking the road conditions ahead, the weather forecast, and other information (developments in economic activity and prices as well as financial conditions) (Chart 10, first paragraph).

Conclusion

Two years ago, the Bank of Japan began issuing new banknotes. The new 10,000-yen note features a portrait of Eiichi Shibusawa, a native of Saitama Prefecture (Chart 12 [top-left panel]).

Shibusawa contributed to the establishment of Japan's currency unit, the yen, and he also devised the plan to transition the various feudal domain currencies issued across the country to the new currency, the yen, on the day of the abolition of the feudal domains and the establishment of prefectures (Chart 12 [top-right panel]).

The healthy circulation of money depends on a sound banking system. Shibusawa played a leading role in creating the national banking system. He launched and ran the First National Bank and helped the establishment of national banks across the country.

After this, the Satsuma Rebellion broke out, leading the government to finance its war expenditures through the issuance of a large amount of government notes and national-bank notes, which were both inconvertible. This form of fiscal financing led to rampant inflation, which caused hardship for many employees and pensioners, while disrupting economic activity and trade. Facing this turmoil, the Meiji Government decided that the establishment of a central bank was essential for stabilizing the value of the currency. Thus in 1882, the Bank of Japan Act was enacted and the Bank began its operations.

Shibusawa, despite being the founder of the First National Bank and a key supporter of many national banks, worked hard to centralize the authority to issue banknotes in the Bank of Japan. In his memoirs, Shibusawa referred to the decision to establish the Bank in 1882, and recollected as follows (Chart 12 [bottom panel]):³

The problem was, as I have previously mentioned, that each private bank chartered under the National Bank Act then held the right to issue banknotes. Even upon the

³ "Uyatankai danwa hikki: Dai nana kai" [Record of gatherings for rainy-night talks: The seventh meeting] in *Shibusawa Eiichi denki shiryō: Bekkan* [Collected biographical materials of Eiichi Shibusawa: Supplement], vol. 5.

expiration of their business term in twenty years, such banks could maintain this right should they choose to extend their operations. This posed the issue that the banknotes issued by the central bank might be perceived on equal footing with those of the private banks, thereby failing to inspire confidence and secure general acceptance among the public. Thus, it was deemed indispensable to mandate that all national banks cease their issuance of banknotes upon the expiration of their charter.

On the occasion, I exerted considerable effort to address this matter, persuading Messrs. Rin'nosuke Yamanaka and Zenjiro Yasuda, who are highly calculating, and others, while also prevailing upon Mr. Miwa, who was opposed to the move, to give his consent. . . . The transition was successfully achieved in 1883 without any particular controversy, based just on directions. It scarcely drew the attention of the general populace, but was a profound reform. . . .

The above episodes demonstrate that Shibusawa is a truly fitting figure to appear on the Bank of Japan notes.

The core role of the Bank of Japan is to ensure that everyone can use the yen as a currency with confidence and efficiently. With broad vision and strategic foresight, Shibusawa, a giant figure from Saitama, played a pivotal role in each critical juncture of the development of the yen. Both for the Bank and for Japan's economy, he remains a precious pioneer.

Thank you for your attention.

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Introduction

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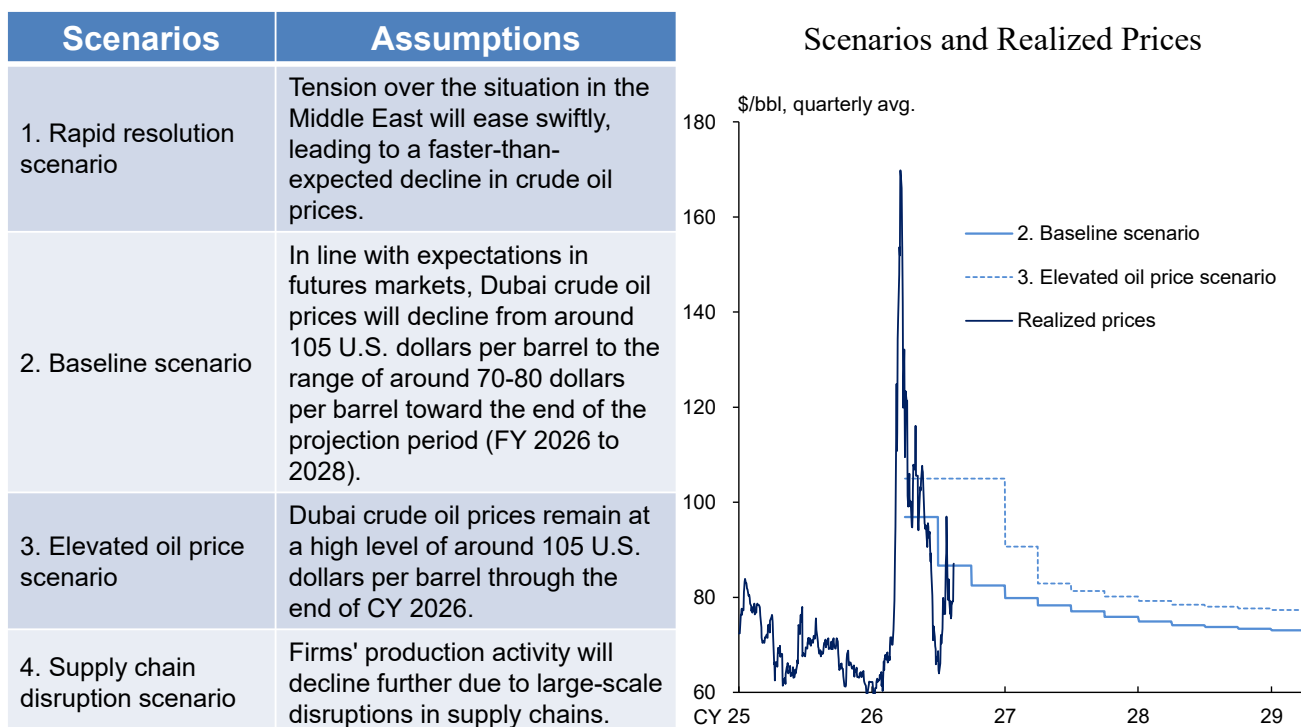
Conclusion

How Four Factors Affect Economic Activity and Prices

	Impact on economic activity	Impact on prices
Rise in crude oil prices stemming from the Middle East conflict	↓	↑
Increase in AI-related demand	↑	↑
Depreciation of the yen	↑ ↓	↑
Accommodative financial conditions	↑	↑

1

Oil Price Scenarios in the April 2026 Outlook Report



Note: The scenarios in the left-hand table summarize those presented in the April Outlook Report. Scenario 1 corresponds to the last risk regarding the situation in the Middle East on pages 6-7; Scenario 2 corresponds to the assumption for the baseline scenario described in footnote 2, and is also shown as the baseline scenario in Chart B3-1; Scenario 3 corresponds to the first risk on page 5 and the risk scenario shown in Chart B3-1; and Scenario 4 corresponds to the second risk referred to on page 6.

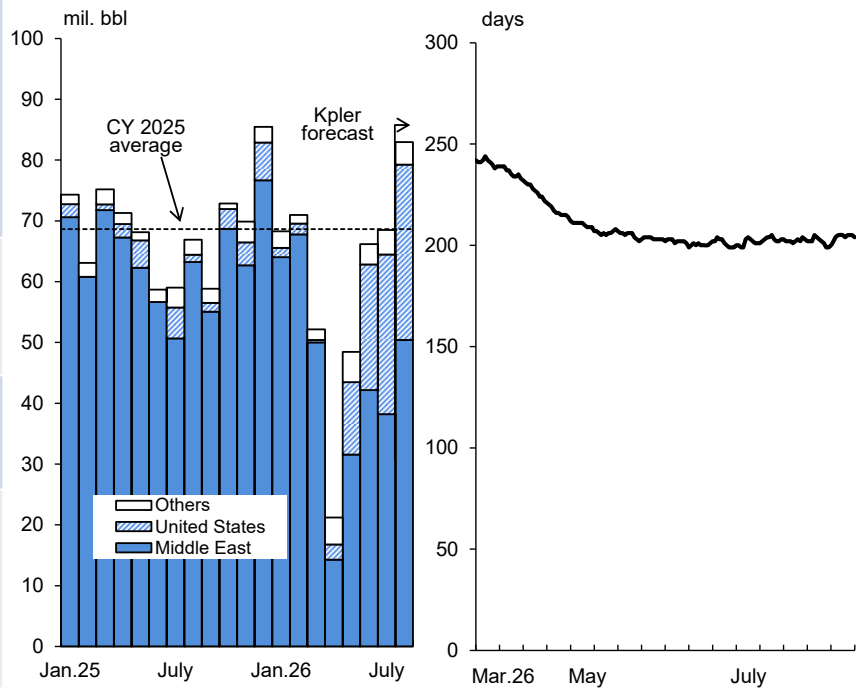
Sources: Bank of Japan; Bloomberg; Nikkei Inc.

2

Alternative Procurement of Crude Oil

Progress in Alternative Procurement

For April	Approximately 25% of the required quantity procured (Expanded procurement sources beyond the Middle East and the United States to include Central and South America as well as the Asia-Pacific region)
For May	Approximately 60% (Expanded procurement sources to include Central Asia)
For June	Approximately 80% (Expanded procurement sources to include Africa)
For July	Approximately 100% (In particular, procurement from the United States was more than ten times the average monthly volume of the previous year)



Notes: 1. In the middle chart, the Kpler forecast is based on past vessel movements and other data (as of August 21), and is subject to revision.

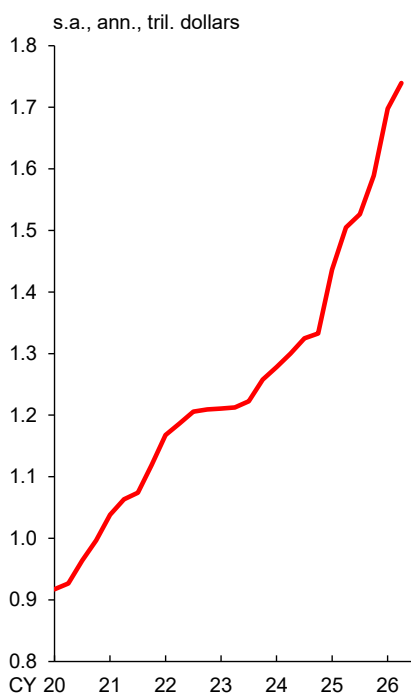
2. In the right-hand chart, the figures for petroleum reserves from June 29 onwards are based on preliminary estimates from the Ministry of Economy, Trade and Industry.

Sources: Ministry of Economy, Trade and Industry; Cabinet Office, "Annual Report on the Japanese Economy and Public Finance 2026"; Kpler.

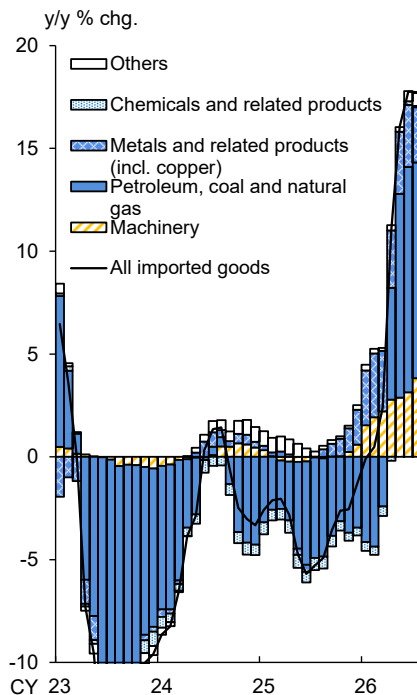
3

Increase in Global AI-Related Demand

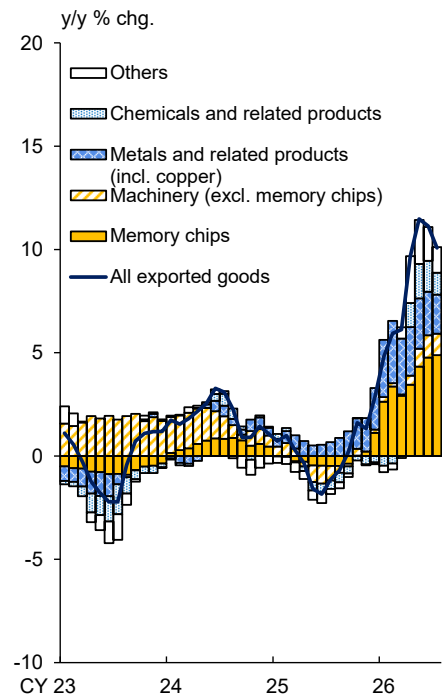
IT-Related Fixed Investment in the United States



Japan's Import Prices (Contract Currency Basis)



Japan's Export Prices (Contract Currency Basis)



Note: In the left-hand chart, IT-related fixed investment is the sum of software investment, information processing equipment (within machinery investment), and data centers (within construction investment). Figures are in real terms.

Sources: Bank of Japan; Haver.

4

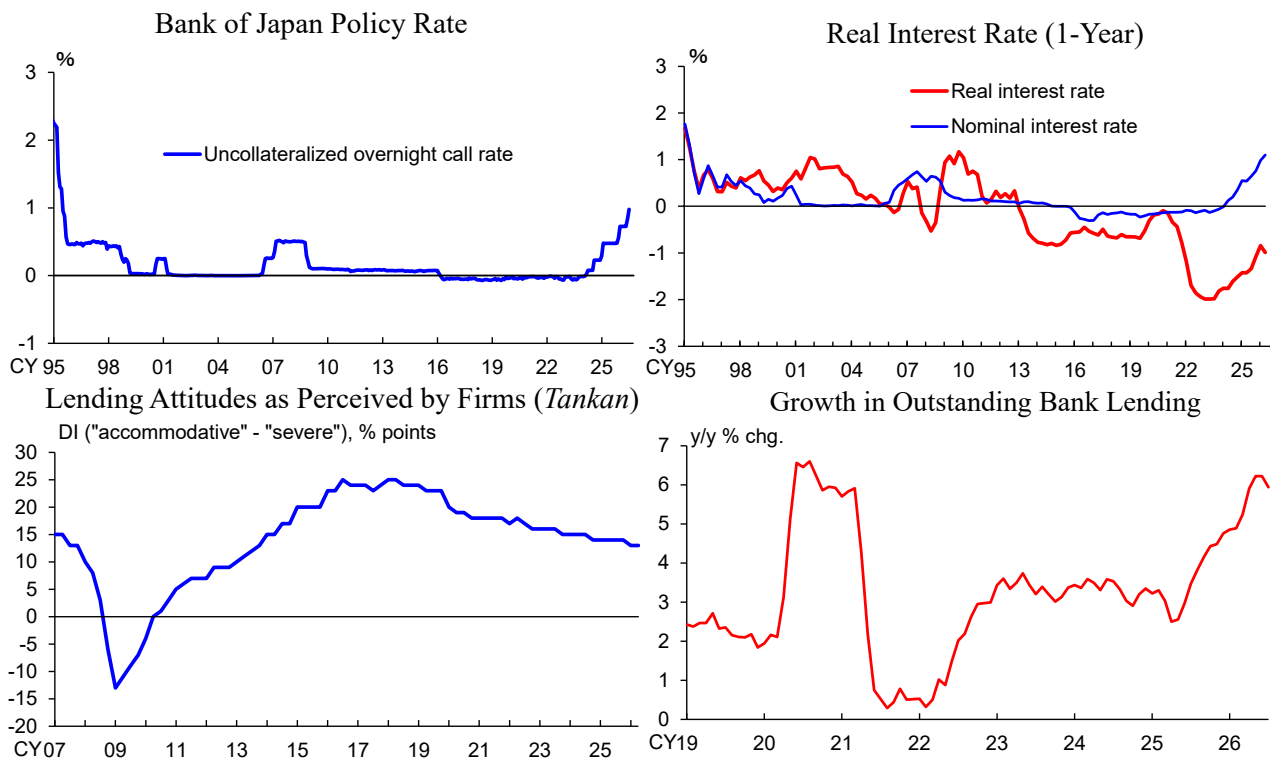
Foreign Exchange Markets



Source: Bloomberg.

5

Financial Conditions



Notes: 1. Regarding the top-left chart, from 1998, the uncollateralized overnight call rate was explicitly designated as the target for money market operations. From March 2001 to March 2006, the target was the outstanding balance of current accounts held at the Bank of Japan. From April 2013 to September 2016, the monetary base was the target. From September 2016 to March 2024, the interest rate applied to the Policy-Rate Balances of current accounts held by financial institutions at the Bank was set as the short-term policy interest rate.

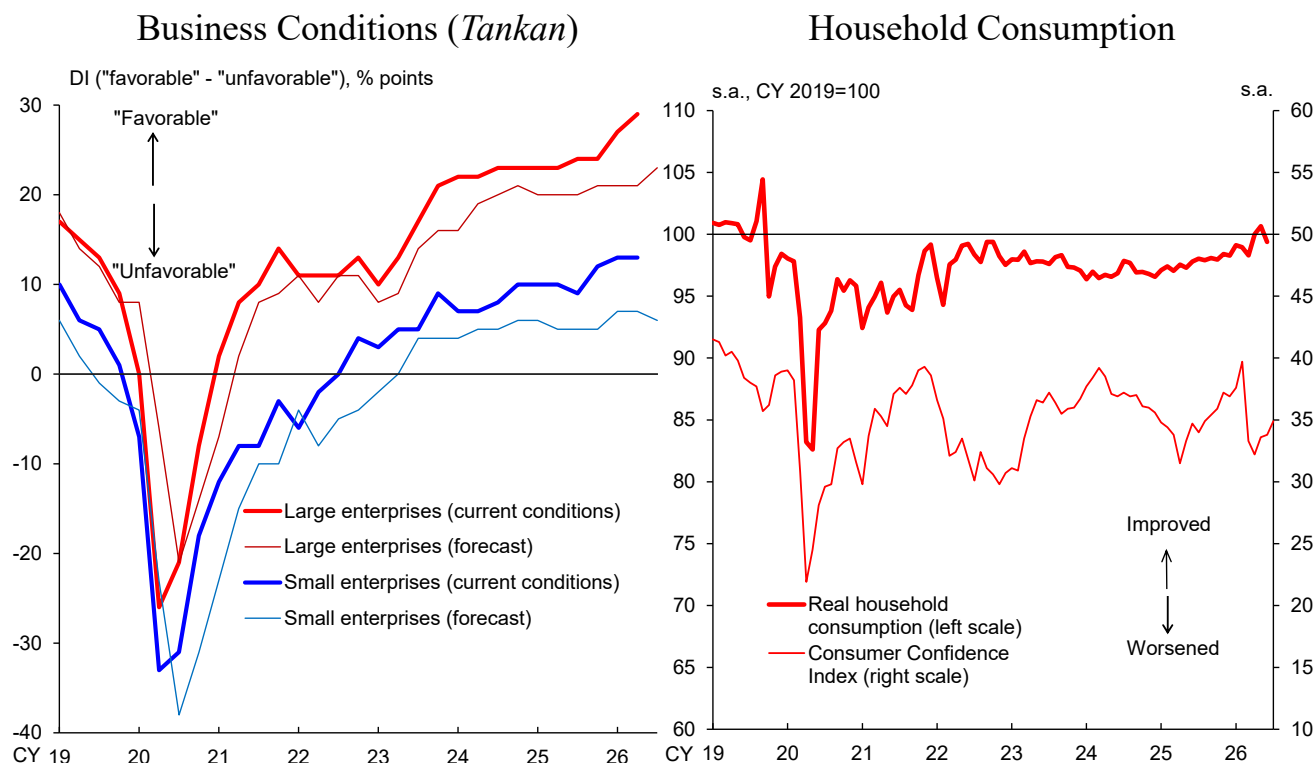
2. In the top-right chart, figures for the real interest rate are calculated as government bond yields (1-year) minus the composite index of inflation expectations (staff estimates).

3. In the bottom-right chart, figures represent the monthly average of lending by domestic commercial banks.

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

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Economic Activity

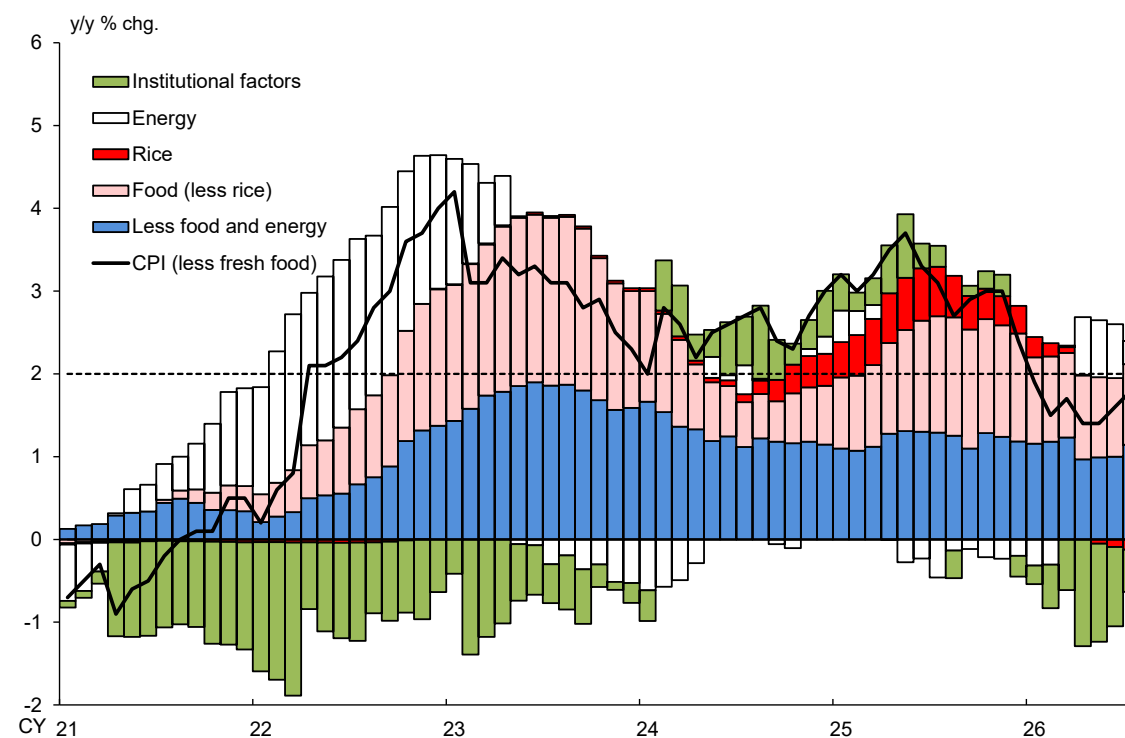


Note: In the right-hand chart, figures for real household consumption are the real Consumption Activity Index (travel balance adjusted), excluding inbound tourism consumption and including outbound tourism consumption (staff calculations).

Sources: Cabinet Office; Bank of Japan.

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Consumer Price Inflation



Notes: 1. Figures for energy consist of those for petroleum products, electricity, and gas. Figures for food (less rice) exclude fresh food and alcoholic beverages.

2. Institutional factors are the sum of the effects of the consumption tax rate change and policies concerning the provision of free education (including the free school lunches starting in April 2026), measures to reduce the energy cost burden (such as gasoline prices, electricity and gas charges), the reduction in mobile phone charges in 2021, and travel subsidy programs. Figures are staff estimates.

Sources: Ministry of Internal Affairs and Communications, etc.

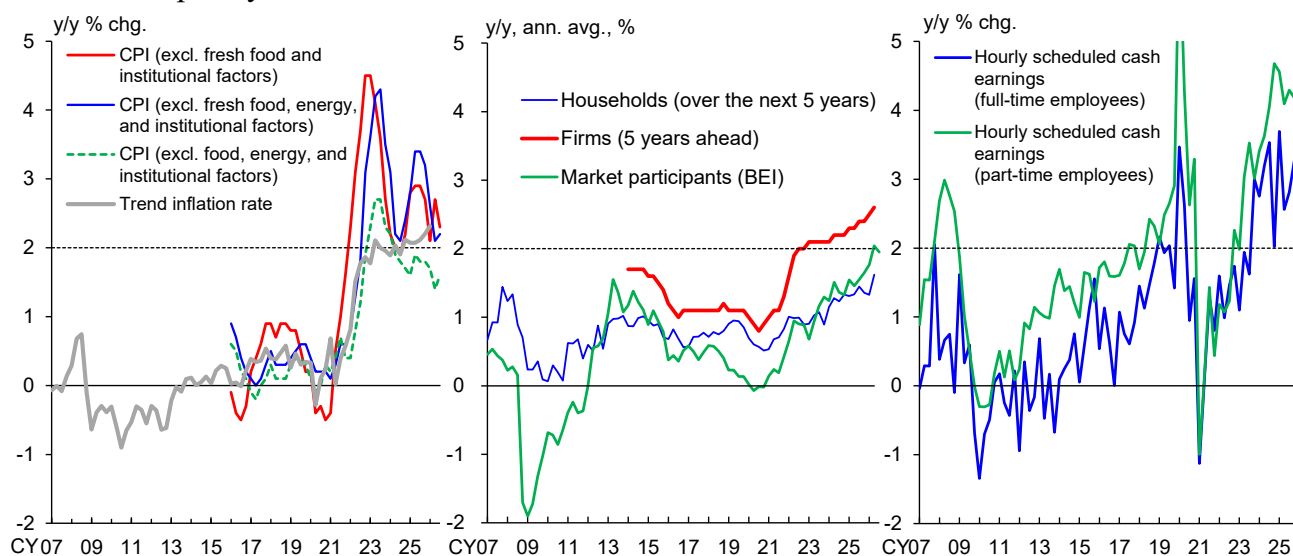
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Indicators Related to Underlying Inflation

Indicators/Estimates excluding
Temporary Factors

Inflation Expectations

Nominal Wage Growth



Notes: 1. In the left-hand chart, for details on the trend inflation rate, see Takatomi et al. (2026), "What Drives Trend Inflation in Japan?: A Trend-Cycle BVAR Decomposition Approach."

2. In the middle chart, figures for "households" are from the *Opinion Survey on the General Public's Views and Behavior*, estimated using the modified Carlson-Parkin method for a 5-choice question. Figures for "firms" show the inflation outlook of enterprises for general prices (all industries and enterprises, average) in the *Tankan*. The BEI (break-even inflation) rate is a composite of new and old inflation-indexed Japanese government bonds (10-year and the longest-term bonds).

3. In the right-hand chart, Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February. Figures from 2016/Q1 onward are based on observations common to samples before and after the sample revisions. Figures for hourly scheduled cash earnings (full-time employees) are seasonally adjusted.

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

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The Bank's July 2026 Outlook Report

As for the conduct of monetary policy, given that underlying CPI inflation has been approaching 2 percent and financial conditions have been accommodative, the Bank will continue to raise the policy interest rate and adjust the degree of monetary accommodation, in response to developments in economic activity and prices as well as financial conditions.

In this regard, it will consider the timing and pace of adjustment, while examining the likelihood of realizing the baseline scenario of the outlook for economic activity and prices and the risks to the outlook, including the impact of the situation in the Middle East, the expansion in AI-related demand, and developments in foreign exchange rates.

In particular, the perspective of stabilizing underlying CPI inflation at a level around 2 percent becomes important in order to keep the risk of underlying CPI inflation deviating upward to a level above the price stability target of 2 percent from materializing and thereby exerting an adverse impact on the economy afterward.

With the price stability target of 2 percent, the Bank will conduct monetary policy as appropriate from the perspective of sustainable and stable achievement of the target.

Monetary Policy Transmission

Policy rate hike



One year later



Two years later



△ Market interest rates, including the uncollateralized overnight call rate

△ Interest rates on market rate-linked loans

☐ Deposit rates

☐ Short-term prime rates

☐ Base rates for new mortgage loans

☐ Applicable interest rates for existing floating-rate mortgage loans

Impact on economic activity and prices

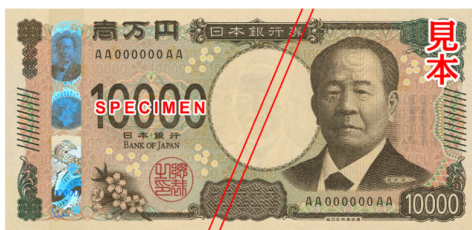
Notes: 1. Regarding the timing of increases in deposit rates, short-term prime rates, and mortgage loan interest rates, the chart provides a rough illustration of the timing of rate revisions based on information gathered through hearings conducted after the policy interest rate hike in December 2025. The timing may vary depending on (i) the timing of the policy rate hike and the reference month for rate revision, and (ii) decisions made by individual banks.
2. For floating-rate housing loans with equal principal and interest payments, rules to prevent a rapid hike in payments are often applied, including the "5-year rule," which delays changes in the monthly repayment amount, and the "125 percent rule," which caps an increase in the monthly repayment amount.

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Conclusion

Chart 12

Shibusawa's Role in the Development of the Yen



	Development of the currency system in the Meiji era
1871 (Meiji 4)	New Currency Act Abolition of the feudal domain system ... introduced new currency units (<i>yen, sen, rin</i>) ... collected old currencies issued by feudal domains
1872 (Meiji 5)	National Bank Act ... allowed to establish private banks ... amended in 1876 (Meiji 9) to allow private banks to issue inconvertible banknotes
1882 (Meiji 15)	Bank of Japan Act of 1882 ... established the Bank of Japan as the central bank
1883 (Meiji 16)	Amendment of the National Bank Act ... ended the issuance of banknotes by private banks

The problem was, as I have previously mentioned, that each private bank chartered under the National Bank Act then held the right to issue banknotes. Even upon the expiration of their business term in twenty years, such banks could maintain this right should they choose to extend their operations. This posed the issue that the banknotes issued by the central bank might be perceived on equal footing with those of the private banks, thereby failing to inspire confidence and secure general acceptance among the public. Thus, it was deemed indispensable to mandate that all national banks cease their issuance of banknotes upon the expiration of their charter.

On the occasion, I exerted considerable effort to address this matter, persuading Messrs. Rin'nosuke Yamanaka and Zenjiro Yasuda, who are highly calculating, and others, while also prevailing upon Mr. Miwa, who was opposed to the move, to give his consent. . . . The transition was successfully achieved in 1883 without any particular controversy, based just on directions. It scarcely drew the attention of the general populace, but was a profound reform. . . .

-- "Uyatankai danwa hikki: Dai nana kai" [Record of gatherings for rainy-night talks: The seventh meeting] in *Shibusawa Eiichi denki shiryō: Bekkan* [Collected biographical materials of Eiichi Shibusawa: Supplement], vol. 5.

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