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Bank of Japan

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

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(English translation based on the Japanese original)

I. Economic Developments at Home and Abroad

I will begin my speech by talking about recent developments in and the outlook for overseas economies.

Overseas economies have grown moderately on the whole thus far, although some weakness has been seen in part, reflecting trade and other policies in each jurisdiction (Chart 1). These economies have been exposed to greater downside risks and extremely high uncertainties. This is chiefly a reflection of U.S. tariff hikes, which have given rise to concerns over a decline in trade transactions and, in turn, have led to, for example, stronger cost-cutting pressure among firms and a growing wait-and-see approach to business fixed investment. Starting with the U.S. economy, real GDP for the January-March quarter of 2025 marked negative growth of minus 0.3 percent on an annualized quarter-on-quarter basis, partly reflecting the front-loading of imports in advance of the tariff hikes. So far, the U.S. consumer price index (CPI) has not shown the impact of the tariff hikes, registering a year-on-year increase of 2.3 percent for April 2025. However, markets have experienced a rise in long-term interest rates and a decline in stock prices, and there are concerns over a possible resurgence of inflation and deterioration in corporate profits. These factors, among others, have cast a shadow over business and consumer sentiment, fueling anxieties over an economic downturn. I am particularly attentive to how the impact of U.S. tariff hikes will unfold, as there are high uncertainties over future developments. Federal Reserve Chair Powell stated that the impact of the tariff hikes on inflation could be short-lived -- reflecting a one-time shift in the price level, while it was also possible that the inflationary effects could be more persistent. The euro area economy has experienced a decline in industrial strength, with firms constraining investment and costs remaining high, among other factors. Although the growth rates for Germany and France have recovered, registering positive growth for the January-March quarter of 2025 for the first time in two quarters, there are concerns that the euro area economy may continue to stagnate, mainly reflecting U.S. tariff hikes. Regarding the Chinese economy, one matter of concern is that economic stagnation may become prolonged, mainly due to sluggish domestic demand and a decrease in exports caused by intensifying trade friction. While housing accounts for the bulk of Chinese household assets, housing prices have continued to decline moderately, and nationwide housing inventories amount to 5-6 years' worth relative to sales. This situation is expected to take a long time to

recover. In light of these developments, I have some concerns about the outlook. Namely, local governments may not see improvement in their fiscal conditions, labor market issues -- such as downward pressure on wages and the high youth unemployment rate -- may remain unresolved for the time being, private consumption on the part of households may continue to exhibit strong thriftiness, and inward direct investment may also remain sluggish. Although China's real GDP for the January-March quarter of 2025 registered a high year-on-year growth rate of 5.4 percent, the contribution of domestic demand to real GDP was low, at 3.3 percentage points. The Chinese economy has shown a strong deflationary trend, with nominal GDP growth falling below real GDP growth for two consecutive years. Moreover, U.S.-China trade friction has been growing. Under these circumstances, it would seem challenging for the Chinese economy to achieve the government's growth target of around 5 percent. While ASEAN economies have improved moderately as global demand for IT-related goods has recovered, there are concerns that their growth potential may wane. One reason for this is that these economies are highly dependent on trade with China and the United States. Another reason is that some ASEAN economies have moved past the so-called demographic bonus period, in which the proportion of the working-age population increases, and have fallen into the "middle-income trap," where a decline in price competitiveness becomes an impediment to growth. In light of this situation, as well as the impact of U.S. tariff hikes, I am concerned that Japanese firms may face intensified competition with price-competitive Chinese firms, not only in China but also in the ASEAN and Japanese markets. Some progress has recently been seen in the U.S.-China trade negotiations, but future economic developments would still seem to warrant attention.

Let me move on to recent developments in Japan's economic activity and prices. The economy has recovered moderately, although some weakness has been seen in part. In my view, the economy is now facing mounting downward pressure, due to the implementation of U.S. tariff policies. Turning to developments to date, in the corporate sector, exports and industrial production have continued to be more or less flat as a trend, although there has been some front-loading due to the increase in U.S. tariffs. Corporate profits have been on an improving trend. Business fixed investment has also been on a moderate increasing trend, due to growing demand for investment such as labor-saving investment and investments associated with digital transformation (DX) and green transformation (GX). Although steady recovery in

Japan's economy has continued so far, there are greater uncertainties stemming from the U.S. tariff policies, which could pose serious challenges for the country. Against this background, some firms forecast a decline in their profits for fiscal 2025. I am closely monitoring future developments, as to whether firms will shift their stance back in the direction of contracting their businesses by cutting costs. With respect to the household sector, the income situation has improved moderately, as seen in the year-on-year wage growth remaining at around 2-5 percent since May 2024, albeit with fluctuations. However, there seems to be a polarization between (1) growth-oriented firms, particularly large ones -- which are making "virtuous" wage hikes -- and (2) other firms, particularly small ones -- which have trailed behind in terms of recovering earning power and are making "defensive" wage hikes. Although the momentum for wage increases has accelerated, it could weaken depending on the impact of the U.S. tariff policies. Thus, future developments in wage growth warrant close monitoring. While the Bank of Japan's April 2025 *Outlook for Economic Activity and Prices* (Outlook Report) assessed that private consumption had maintained a moderate increasing trend, I believe that it has lacked momentum, mainly due to the impact of price rises and households' thriftiness. Turning to prices, although the effects of a pass-through to consumer prices of cost increases led by the past rise in import prices have waned, the year-on-year rate of increase in the CPI for all items excluding fresh food has been in the range of 3.0-3.5 percent recently, amid significant ongoing rises in rice prices, moderate ongoing rises in services prices reflecting factors such as wage increases, and the scaling back of government measures to reduce the household burden of higher energy prices.

As for the outlook, Japan's economic growth is likely to be moderate, as trade and other policies in each jurisdiction lead to a slowdown in overseas economies and a decline in domestic corporate profits and other factors, although accommodative financial conditions are expected to provide support (Chart 2). As for prices, the rate of increase in the CPI is likely to decelerate from the second half of fiscal 2025. This reflects the expectation that the effects of the past rise in import prices and the recent rise in the prices of rice and other food -- which have pushed up the inflation rate so far -- will wane. Still, there are various risks to the outlook. In particular, it is extremely uncertain how trade and other policies in each jurisdiction will unfold and how overseas economic activity and prices will react to these policies. It is therefore necessary to pay due attention to the impact of these developments on

financial and foreign exchange markets and on Japan's economic activity and prices. I will explain my view on this point later.

II. Conduct of Monetary Policy in Line with the State of the Economy's Return to a Growth Path

The purpose of the Bank of Japan's monetary policy is to achieve the 2 percent price stability target in a sustainable and stable manner, thereby contributing to the sound development of the national economy. Factors such as U.S. monetary and trade policies and developments in overseas economies and exchange rates impact economic activity and prices in Japan, and thus require consideration. However, I believe what is essential in the conduct of monetary policy is to contribute to improvement in Japan's economic fundamentals from a medium- to long-term perspective in line with the state of economic recovery, as the economy faces low growth and low profitability due to changes in the industrial structure and demographic developments. Keeping this view in mind and drawing from my own experience, I will overview topics such as the changes in Japan's industrial structure from a somewhat long-term perspective.

A. Changes in Japan's Industrial Structure and the State of Economic Recovery

During the Showa era's post-war period of rapid economic growth, Japan's export industries quickly flourished in a weak yen environment by capitalizing on an abundant labor force; firms in these industries realized high performance, high quality, and low prices via a business model of mass production and vertical integration. Household income also continued to experience rapid growth. Meanwhile, as firms pursued greater production efficiency, a system of lifetime employment and seniority-based wages took shape. Trade friction subsequently broke out between Japan and the United States, while the yen began to appreciate rapidly following the 1985 Plaza Accord. This led firms, especially large ones, to actively expand their overseas sites.

As Japan entered the Heisei era in 1989, even under a strong yen, it seemed as if the bubble economy offset the downturn in export industries. However, as advances in IT drove greater digitalization and globalization worldwide, business models involving a horizontal division of labor proved increasingly superior. In this situation, the international competitiveness of

Japan,¹ which globally ranked first until 1992, gradually declined as Japanese firms trailed behind in restructuring their business portfolios (Chart 3). Corporate profits deteriorated, due in part to the collapse of the bubble economy in early 1992 and the financial system crisis. These developments prompted large firms with high productivity to actively invest overseas and relocate their supply chains to China, Southeast Asia, and other countries and regions, in pursuit of lower costs and higher growth. On the other hand, in Japan, large firms reformed their cost structures by, for example, closing factories, downsizing, constraining investment, encouraging voluntary retirement, and cutting wages. The trends of cutting costs and constraining investment also spilled over to small firms, which faced dwindling orders as well as intensified price competition. As a result, despite an aging and declining population, the issue of labor shortages did not surface (Chart 4). While some firms offered voluntary retirement, many prioritized employment over wages and hoarded excess labor. Consequently, these firms made little headway with restructuring their business portfolios to strengthen their ability to create added value. Under these circumstances, intensified price competition among existing businesses led to lower growth and profitability for domestic industries, and Japan's economy fell into deflation, in which it was difficult for wages and prices to rise. The ensuing three decades of an economy oriented toward contraction, characterized by a deflationary mindset and cost-cutting, gave rise to a persistent vicious cycle in which private consumption and business fixed investment grew sluggish. Firms grew more cautious in their wage- and price-setting behavior, falling behind in terms of the investment in research and development (R&D) and software that could enhance their capacity for innovation (Chart 5). Thriftiness among households also seemed to take root. Despite once being referred to as a processing trade country, Japan's earning power waned, due in particular to a decline in the export value of industrial products, as well as to higher energy costs that reflected, for example, increased imports of mineral fuels (Chart 6). Under these circumstances, wage growth, even at large firms, fell in comparison to the Group of Seven (G7) countries and major Asian economies, and the wage profile flattened, giving rise to a state where workers no longer aspired to be senior managers (Chart 7). This led to Japan's wages falling to the lowest level among the G7 countries (Chart 8). In this situation, the economy stagnated for a protracted period in the

¹ The *IMD World Competitiveness Yearbook* published by the International Institute for Management Development (IMD) shows that Japan ranked first in international competitiveness until 1992, but is now ranked quite low, in 38th place.

wake of the bubble's collapse. Subsequently, large-scale monetary easing and flexible fiscal policies helped to bring about a situation where Japan's economy is no longer in deflation. However, Japanese firms trailed behind in restructuring their business models, resulting in a wider wage level gap between Japan and other countries, namely the United States, Canada, Germany, France, and the United Kingdom.

Let me now turn to the current Reiwa era, which started in 2019. The rise in global inflation and the yen's depreciation after the onset of the COVID-19 pandemic gave rise to inflation in Japan as well, sparked by a rise in import prices. Firms, large ones in particular, have achieved stronger earning power due to their implementation of business portfolio restructuring. This has facilitated more dynamic corporate management, yielding several outcomes: nominal GDP amounting to more than 600 trillion yen, wage growth exceeding 5 percent for two consecutive years,² and business fixed investment totaling more than 100 trillion yen. Moreover, some firms have been actively investing in growth areas with the aim of enhancing their growth potential in global markets. They have done so in the form of, for example, mergers and acquisitions (M&As) and investment in human capital and R&D.³ Labor shortages have generated new investment demand. For instance, firms now show demand for investments associated with labor saving and DX as a means of making up for previous delays in digitalization. CPI inflation for all items excluding fresh food has remained above 2 percent for about three years, registering 3.2 percent for March 2025, and the year-on-year wage growth has remained at around 2-5 percent for about a year, albeit with fluctuations (Chart 9). In light of these developments, I believe Japan has reached a point where the momentum for wage increases can be expected to take hold, causing wages and prices to rise as corporate profits expand.

B. State of Japan's Economic Improvement

Next, I will elaborate a little further on the state of improvement in Japan's economy. Let me start by taking a look at the figures for operating profits, labor share, and business fixed

² Wage growth here indicates the rate of total wage increase based on the fifth provisional aggregate results of the 2025 annual spring labor-management wage negotiations compiled by the Japanese Trade Union Confederation (Rengo).

³ "Human capital" is a term coined to express the idea that human resources are valuable for corporate management.

investment for the April-December period on a cumulative basis in the *Financial Statements Statistics of Corporations by Industry, Quarterly* (Chart 10). Operating profits per employee -- an indicator of firms' earning power -- continued to rise up through 2024, registering a 10 percent year-on-year increase for 2024. The labor share reached 59 percent for 2024, which is lower than the 61 percent for 1990, during the bubble economy. This indicates that firms' capacity for raising wages has improved. In particular, large firms experienced favorable operating profits per employee for 2024, roughly doubling from the level for 1990 during the bubble. Large firms also saw a rise in business fixed investment for 2024, up by around 20 percent from the level for 2018, before the outbreak of the pandemic. The labor share of these firms reached 43 percent, down by 10 percentage points from the level recorded during the bubble economy. At the same time, large firms are facing the need to resolve certain issues, such as (1) distortions in the wage structure caused by expanded mid-career hiring, and (2) the income gap between Japan and other major economies. All these developments create the expectation that many large firms will continue to raise wages at high rates (Chart 11). Turning to small firms, which account for about 70 percent of employment in Japan, operating profits per employee also registered a year-on-year increase of 11 percent for 2024, partly because these firms were able to pass on costs to prices at a higher rate (Chart 10).⁴ Their labor share was down slightly, to 74 percent. Although this still represents a high level, the decline indicates that the capacity for raising wages has improved among small firms as well. It seems to have been difficult for small firms with capital of 10 million yen or more but less than 50 million yen (hereafter, small firms with lower capital) to both raise wages as a defensive step and increase business fixed investment, despite making up a large share of employment. Among these firms, operating profits per employee as well as wages and bonus payments rose, but these levels are still only 13 percent and 57 percent of the levels found among large firms, respectively. Business fixed investment per employee among small firms with lower capital decreased for two consecutive years; the level here stands at 14 percent of that of large firms, and the gap between the two groups is widening in this regard. Since these small firms have trailed behind their larger counterparts in increasing earning power, I think

⁴ According to a September 2024 follow-up survey on the Price Negotiation Promotion Month organized by the Small and Medium Enterprise Agency, the rate of passing on costs to prices among small firms was about 50 percent -- an improvement of around 4 percentage points from the previous survey. More specifically, the rate of passing on labor costs was about 45 percent -- an improvement of around 5 percentage points.

the hurdle for sustained wage increases has remained high. However, looking at small firms with capital of 50 million yen or more but less than 100 million yen (hereafter, small firms with higher capital), which account for over 10 percent of employment in Japan, both business fixed investment and operating profits have risen on a per employee basis, and these firms have lower labor share than small firms with lower capital. This suggests that a relatively large number of firms with higher capital are growth-oriented. While the impact of U.S. tariff policies is of concern, if the January-March 2025 *Financial Statements Statistics of Corporations by Industry, Quarterly* show rises in business fixed investment and operating profits not only for large and medium-sized firms but also for small firms, which employ about 70 percent of the country's workforce, I believe this will be a step forward to achieving a growth-oriented economy driven by wage increases and investment.

Turning to prices, the year-on-year rate of increase in the CPI for all items excluding fresh food has remained above 2 percent for about three years (Chart 9). The GDP deflator increased at a year-on-year rate of 2.9 percent for the October-December quarter of 2024, exceeding 2 percent for eight consecutive quarters. This indicates that firms have continued to pass on cost increases to prices. Looking at the March 2025 CPI, however, the rate of increase in all items excluding food (other than alcoholic beverages) and energy was 1.6 percent, and the rate of increase in general services was 1.4 percent. This means that the former rate has remained below 2 percent for about a year, and the latter for about six months. Japan still seems to have a low risk of falling into sticky wage inflation -- a state where the pass-through of higher wages to prices results in an upward spiral of prices. However, regarding price rises for food, including rice, attention should be paid to the possibility that these rises could affect underlying CPI inflation by way of changes in household sentiment and inflation expectations. Thus, I will continue to carefully monitor price developments.

Next, let me turn to developments in wage hikes, starting with a look back at 2024. According to the final aggregate results of the 2024 annual spring labor-management wage negotiations compiled by the Japanese Trade Union Confederation (Rengo), the year-on-year rate of increase in base pay was 3.6 percent for firms on the whole, and the total wage increase was 4.5 percent for firms with less than 300 union members (to elaborate, these firms include small firms with relatively large business scale). On the other hand, the March 2025 *Monthly*

Labour Survey showed that the year-on-year rate of increase in scheduled cash earnings was 2.6 percent for 2024 in terms of the monthly simple arithmetic average, and a June 2024 survey by the Japan Chamber of Commerce and Industry (JCCI) found that the total wage increase for small firms was 3.6 percent for fiscal 2024. Although both of these figures were about 1 percentage point lower than Rengo's results, all of these wage developments have heightened my expectation for higher rates of wage increases in 2025. Using Rengo's results and comparing the rate of increase in wages for firms on the whole and for firms with less than 300 union members, in terms of developments since 1990, for a while there was little difference between the two groups after the bubble period (Chart 11). The difference started to grow in 1995 and, while it temporarily shrunk during the pandemic, it has expanded again since 2023, amid increasingly acute labor shortages following the pandemic. Narrowing this wage gap still appears challenging, given that the gap in firms' earning power and capacity for raising wages has been widening. According to the *Financial Statements Statistics of Corporations by Industry, Quarterly*, operating profits per employee among small firms were 40 percent of those of large firms for the April-December period of 1990, during the bubble, but were a mere 13 percent for the same period of 2024 (Chart 10). Rengo's fifth provisional aggregate results of the 2025 annual spring labor-management wage negotiations showed that, on the back of favorable business performance, the average year-on-year rate of increase in wages was 5.3 percent and the rate of increase in base pay was 3.8 percent, both of which were higher than the previous year's wage hikes. While the impact of U.S. tariff policies is of concern, I am paying attention to whether the momentum of wage hikes at large firms will spill over to small firms. To bridge the wage gap between large and small firms, I believe small firms need to improve their earning power and capacity for raising wages through management efforts, including expanding business fixed investment to boost productivity and accelerating structural reforms to step up the scale of their businesses. I will elaborate on this point later.

Currently, there are concerns that the implementation of U.S. tariff policies will have serious adverse effects, including a deterioration in profits in the automobile sector, one of Japan's core industries, as well as a downturn in the global economy (Chart 12). In this context, Japan's economy is facing mounting downward pressure. Business fixed investment, which is necessary to boost productivity, is no exception here. The March 2025 *Tankan* (Short-Term

Economic Survey of Enterprises in Japan) showed that the year-on-year rate of increase in planned investment for fiscal 2024 remained relatively high, reflecting firms' higher demand for investment in new areas such as labor saving, DX, and GX. Increasingly, however, firms are taking a wait-and-see approach to fixed investment, with some postponing their investment plans. This is a factor of higher-than-expected U.S. tariffs, including a 25 percent tariff on automobile imports, a 10 percent tariff on imports from almost all U.S. trading partners, and an additional 14 percent country-specific tariff on imports from Japan (suspended until July 8). Labor shortages and rising costs are also causing delays to business fixed investment. If these developments become more widespread, this could hinder productivity improvements and cause supply-side constraints, thereby leading firms to move their supply chains offshore.

C. Conduct of Monetary Policy in Line with the State of Economic Recovery

As discussed so far, Japan is at a critical juncture in terms of whether it can make a transition away from an economy oriented toward cost-cutting to a growth-oriented economy driven by wage increases and investment, without reverting to deflation. As I mentioned earlier, many large firms are expected to continue to raise wages at high rates. Given this, several factors are key to the establishment of wage increases, which form the cornerstone for Japan's growth strategy: (1) increasing the earning power and capacity for raising wages of small firms to make sustained wage increases possible and, to this end, (2) implementing business fixed investment to boost productivity, and (3) pursuing structural reforms to step up the scale of their business. In my view, the Bank should aim to conduct monetary policy in line with the pace of Japan's economic growth. As the impact of U.S. tariff policies is currently a widely shared concern, it is necessary to carefully gauge developments in corporate profits, business fixed investment, wage hikes, and other factors. Therefore, I believe it is appropriate for the Bank to maintain its current monetary policy for the time being.

Looking ahead, I believe it is also important for the Bank to conduct monetary policy to reflect progress in Japan's transition to a growth-oriented economy driven by wage increases and investment. As Japan faces an aging and declining population as well as low economic growth, firms are showing high demand for overseas investment and tend to be subject to strong pressure to move their supply chains offshore. For these firms to enhance their growth

potential in the global economy, increasing their earning power and capacity for raising wages is essential. To achieve this, because they operate in an advanced economy, Japanese firms need to work to develop sophisticated technologies and generate innovation. In addition, they need to strengthen their core businesses by adding higher value to products and services and implementing structural reforms. On the path toward establishing the wage increase momentum, in which wages and prices rise as corporate profits expand, I am carefully monitoring any changes in the situation, including whether firms' capacity for raising wages will improve at a higher pace as more firms expand investment, thereby boosting growth in their operating profits.

Comparing Japan's GDP growth rate with that of the United States, the simple average of the year-on-year growth rate from 2010 to 2019 was 2.4 percent for the United States and 1.2 percent for Japan (Chart 13). For the pandemic and post-pandemic period from 2020 to 2024, the United States maintained a growth rate of 2.4 percent, whereas Japan's growth rate fell to 0.2 percent. This means the difference in GDP growth between the two countries has expanded to more than 2 percentage points, revealing the lack of momentum in Japan's recovery from the pandemic. While the yen has remained weak, the possibility that the yen's depreciation will be retraced if the U.S. economy deteriorates warrants attention. In the April 2025 Outlook Report, the median of the Policy Board members' forecasts for the real GDP growth rate was that, after reaching 0.7 percent for fiscal 2024, it will decline to 0.5 percent for fiscal 2025 (Chart 2). Given the extremely high uncertainties in play, my view is that it is appropriate for the Bank to conduct monetary policy deliberately to reflect the actual state of economic recovery. If the Bank rushes to raise the policy interest rate even during an economic slowdown, this could dampen both consumption and investment, with a lag. It should be noted that consumption expenditure is high among households headed by members in the prime of their working lives, and many of these households bear a sizable amount of debt (Chart 14). These households may be forced to rein in consumption if higher interest payments outpace the increase in real disposable income. Similarly, firms with a large amount of debt may be forced to cut costs and curb fixed investment as they struggle to pass on higher interest payments to prices, out of concerns that price hikes could lead to a downturn in sales. Furthermore, U.S. tariff policies may cause deterioration in corporate profits, triggering a vicious cycle of lower demand and prices. For these reasons, the Bank will make policy

decisions deliberately and appropriately while examining developments in wage hikes, domestic consumption, and domestic demand for investment.

III. Toward Sustainable Economic Growth that Overcomes Structural Issues

I would now like to share my personal views from a medium- to long-term perspective on the structural issues facing Japan's economy, as well as on the "dynamism" of firms, employment, and households needed to achieve sustainable economic growth.

A. Structural Issues Facing Japan's Economy

I would like to start by talking about the structural issues facing Japan's economy, which has been mired in a state of low growth. In my view, the major issues are (1) an industrial structure that is subject to low profitability, (2) the aging and declining population, (3) low labor mobility, and (4) the low profitability of household financial assets. Let me discuss these issues one by one.

First, as I mentioned earlier, Japan's industrial structure became increasingly subject to low profitability. The past rapid appreciation of the yen led firms to relocate their supply chains offshore and, in turn, brought about changes in Japan's industrial structure. Consequently, exports -- which involve providing value to outside Japan -- have seen slower growth than imports. Looking at changes in the composition of the nominal trade balance, Japan's trade balance has turned negative due to slower growth in the export value of industrial products and higher growth in the import value of, for example, mineral fuels (Chart 6). This has made Japan more susceptible to global inflation, which in turn has put greater downward pressure on domestic added value. As a result, operating profits per employee at small firms, which mostly do business in the domestic market and account for about 70 percent of employment, still fall below the level seen in the April-December period of 1990 during the bubble economy (Chart 10). Amid this situation, wage growth in Japan has remained sluggish among the G7 countries (Chart 8). While fiscal 2024 saw the highest wage increase rate in 33 years, the June 2024 JCCI survey suggested a polarization of wage hikes among small firms, which employ about 70 percent of the country's workforce, in terms of how they view wage increases. According to the survey, around 30 percent of small firms had implemented virtuous wage hikes backed by stronger performance, whereas about 40 percent had raised

wages as a defensive step to retain employees, even though this was not backed by their performance. The remaining 30 percent or so reported being undecided or having no plans to raise wages. This means that a large proportion of small firms -- about 70 percent of respondents -- had either implemented defensive wage hikes or were undecided or had no plans to raise wages. In dealing with this situation, many households have no choice but to become thriftier, out of vague concerns about the future. Let me reiterate that, while firms' capacity for raising wages has gradually improved, concerns remain about improvements in the earning power and capacity for raising wages of small firms, which have seen lower fixed investment for two consecutive years. Moreover, if U.S. tariff policies are prolonged, this could bring back a situation where, for example, corporate profits deteriorate, firms grow more cautious in their wage- and price-setting behavior, large firms become more selective about their business partners as they move to strengthen their value chains, Japan's multilayered subcontracting chains are streamlined, and domestic industries hollow out as production sites relocate to the United States.

Second, Japan's aging and declining population is a major cause of supply-side constraints and weak domestic demand. On the supply side, the working-age population has decreased by about 10 percent over the past three decades, and acute labor shortages are causing supply-side constraints (Chart 15). On the demand side, the number of pensioners has increased 2.4-fold, now accounting for around 30 percent of the overall population, and their income replacement ratio is just under 60 percent relative to their past wages. Moreover, pensioners have little expectation of future income growth. The working-age population that supports these pensioners has also not seen any growth in disposable income, reflecting a heavier social security burden.⁵ In this situation, households' purchasing power has stagnated and private consumption, which makes up over 50 percent of GDP, has exhibited ongoing thriftiness. For these reasons, Japan's potential growth rate remains mired in low growth.

Third, I would like to talk about the low labor mobility associated with Japan's employment practices. My interpretation of the results of the *Analysis of the Labour Economy 2024* is that, in the United States -- where the economy has been growing -- the main driver of wage growth

⁵ Japan's national burden ratio (the tax and social security burden as a share of national income) has roughly doubled from 24.3 percent in fiscal 1970 to 45.8 percent in fiscal 2024.

from 2001 to 2022 was productivity growth. By contrast, in Japan -- where the economy stagnated during this period -- the main driver of wage growth was firms' efforts to retain employees under the system of lifetime employment and seniority-based wages.⁶ Labor mobility in Japan remained lower than in the United States as a result (Chart 16). This impeded the growth of firms with high labor productivity, and pressure to raise wages did not increase. I believe this explains why household thriftiness intensified and the economy stagnated. Subsequently, in the wake of the 2008 global financial crisis, many large firms actively restructured their business portfolios and, along with strengthening their earning power, expanded mid-career hiring to reinforce their human capital, all of which led to the greater movement of labor to large firms (Chart 17). By comparison, the movement of labor to small firms is low. The number of M&As and third-party business successions involving small firms has been increasing: the former rose 7-fold between fiscal 2014 and 2021, while the latter increased 20-fold between fiscal 2014 and 2023. Combined, however, such transactions stand at around 5,000 cases per year, which is still low in my view. To compete with the innovativeness and price competitiveness of Chinese firms, which pivot at a rapid pace, growth-oriented small and medium-sized firms in Japan will need to accelerate structural reforms to step up the scale of their businesses -- such reforms are necessary to raise the productivity of these firms' core businesses and strengthen their ability to create added value -- and further strengthen their earning power and human capital.

Finally, I would like to talk about the low profitability of household financial assets. In the United States, where the economy has been growing, employee compensation accounts for about 70 percent of disposable income. By contrast, Japan's income structure is heavily dependent on employee compensation, which accounts for over 90 percent of household disposable income, despite the fact that wage growth has stagnated (Chart 18). This is because cash and deposits, which only generate low returns, make up more than 50 percent of household financial assets, while the share of equity and investment trusts -- that is,

⁶ The *Analysis of the Labour Economy 2024*, compiled by the Ministry of Health, Labour and Welfare, found that, in response to a 1 percentage point productivity increase, nominal wage growth rose by 0.78 percentage points in the United States, while in Japan it rose by only 0.44 percentage points. On the other hand, it was also found that, in response to a 1 percentage point increase in the job vacancy rate, nominal wage growth rose by 0.45 percentage points in the United States, while in Japan it rose significantly, by 1.54 percentage points.

investments in large firms with high productivity -- is only about 20 percent (Chart19). Thus, dividend income makes up only 3 percent of household disposable income (Chart 18). This highlights the problem of the structure of household income, in that the distribution of income from large firms with high productivity plays only a minuscule role. In light of this, and given that small firms account for about 70 percent of employment in Japan, the income of many households ends up depending heavily on the performance of small firms, and the consumption behavior of these households tends to become increasingly thrifty.

B. Improving the Dynamism of Firms and Employment to Make Industries Highly Profitable

I would now like to turn to the dynamism of firms, employment, and households needed to overcome the structural issues I mentioned earlier and achieve sustainable growth in Japan's economy. "Dynamism" here refers to the strong aspiration and capacity to bring about transformation. I believe that corporate dynamism will serve as the driving force in bringing prosperity to Japan.

The *IMD World Competitiveness Yearbook* shows that Japan ranked first in international competitiveness until 1992, but is now ranked quite low, in 38th place (Chart 3). In particular, Japan exhibits a marked difference in the growth of R&D expenses -- which are critical in terms of boosting international competitiveness -- compared with the United States and China (Chart 5). On a U.S. dollar basis, R&D expenses for 2023 stood at 955.6 billion in the United States and at 917.2 billion in China. Relative to 1991, these figures increased 6-fold and 100-fold, respectively, which is in line with U.S. and Chinese economic growth. In Japan, on the other hand, R&D expenses for 2023 amounted to 213.8 billion U.S. dollars, a mere 3-fold increase from 1991. Moreover, while software investment grew 11-fold in the United States from 1991 to 2023, Japan trailed behind, with investment growing only 5-fold over the same period, indicating a widening disparity between the two. Japanese firms' investment in human capital development has also been constrained compared with the U.S. and major European economies, albeit according to data of a decade ago (Chart 20). Thus, in my view, the decline in Japan's international competitiveness is mainly attributable to stagnation in the innovation required of advanced economies. This stagnation is the result of Japanese firms' price competition with emerging economies and their cost-cutting, due to the historical background

I explained earlier. In addition to expanding business performance, it is important for firms to make active investment in R&D, digitalization, and human capital to accelerate future growth, while providing greater value through generating innovation. I expect reforms to the industrial structure to accelerate, as human capital migrates to highly productive businesses, through continued expansion in investment, including firms' actions currently underway to foster and develop leading industries and strengthen human capital development. If firms improve their capacity for innovation to make Japan's industrial structure highly profitable and enhance international competitiveness, they will be able to capture growth in overseas markets to a greater extent. This, in turn, will generate sustainable demand for business fixed investment in Japan and promote industrial clusters. Such moves are expected to spill over across small and medium-sized firms. I am therefore also closely monitoring changes in the composition of the trade balance.

Developments in the three components of nominal wage growth, that is, the inflation rate (reflecting pressure to maintain living standards), the labor productivity growth rate (fruits of productivity gains), and changes in labor share (capacity for raising wages), show that the first two components have pushed up wages (Chart 21). Also, the decline in labor share suggests that firms have a higher capacity for raising wages. With increased investment in R&D, digitalization, and human capital, large and medium-sized firms in particular have seen growing corporate dynamism, in which wages continue to rise due to their stronger earning power and capacity for raising wages. For this trend to accelerate, however, more firms need to focus on and strengthen their core businesses and actively innovate to be able to compete with global firms in domestic and overseas markets. Simply replacing aging equipment will not generate innovation in a way that leads to raising the economy's potential growth rate. Therefore, it is important that firms strengthen their management resources and capacity for innovation through investments in growth areas -- including business fixed investment as well as investment in software, M&A, R&D, and human capital.

It is also important to support the development of small and medium-sized firms and startups that are growth-oriented or aspire to expand overseas. Many large firms started out as so-called unicorns and then grew rapidly. From fiscal 2011 to 2021, about 20 to 30 percent of medium-sized firms in the United States and Europe grew into large firms, but this proportion

in Japan was only about 10 percent,⁷ suggesting sluggish growth potential among small and medium-sized firms in Japan that form the backbone of domestic economic activity and investment (Chart 10). Addressing this situation in Japan requires a dynamism that allows the three types of firms laid out in the government's policies -- medium-sized firms aiming to grow into large firms, small firms aiming to reach annual sales of 10 billion yen, and startups aiming for rapid growth -- to attract talent and increase domestic investment, thereby driving growth in Japan's economy. As the government reinforces its policies to support growth-oriented small and medium-sized firms, I hope to see such dynamism emerge.

With labor shortages growing increasingly acute in Japan, it is vital that limited human capital move to more productive businesses, and that firms boost employee engagement through measures such as reskilling support, and in turn increase productivity. For firms to boost productivity and achieve profit growth, they need to secure the human capital necessary for technological innovation and for restructuring their business portfolios. It seems that labor shortages among large firms are spurring a movement of labor to these firms, and that the growth of startups is prompting a migration of labor from large firms to startups. As a result, the share of workers whose wages have increased due to job changes has been on a rising trend, generating employment dynamism (Chart 17).

For the momentum for wage increases to take hold, firms need to raise productivity by, for example, (1) providing value through products and services that customers need, (2) investing in labor saving and digitalization, and (3) making investments that lead to greater capacity for innovation. To this end, firms must pursue structural reforms to step up the scale of their businesses. This would involve the reinforcement of management resources, such as in the form of expanding the scale of operations and strengthening human capital through organic growth and M&As. The generational changes in corporate management that have started to take place also appear to be supporting such reforms. I hope that all these developments will

⁷ According to a document released by the Ministry of Economy, Trade and Industry on March 13, 2024 (available only in Japanese) regarding policies to promote the growth of medium-sized firms with high growth potential that lead regional economies, the share of firms growing from medium-sized to large firms in terms of employee numbers over a decade from fiscal 2011 to 2021 was 30 percent in the United States, 22 percent in Europe (the United Kingdom, France, and Germany), and 11 percent in Japan.

boost the dynamism of firms and employment and in turn lead to establishing the wage increase momentum, in which wages and prices rise as corporate profits expand.

C. Improving Household Dynamism to Mitigate Concerns about the Future

As Japan relies on imports for most of its commodities and is confronted with globalized supply chains, I believe the country's economic structure is susceptible to global inflation. The year-on-year rate of increase in wages per employee has remained relatively high at around 2-5 percent, albeit with fluctuations, reflecting the highest wage increase rate in 33 years. As I explained earlier, however, the aging and declining population and delayed productivity improvements are leading to overall sluggishness in households' purchasing power, fueling their tendency toward thriftiness.

In an economic structure that is subject to low profitability, households' vague concerns about the future can be mitigated if growth-oriented firms, particularly large ones, take the lead in driving overall economic recovery, causing virtuous wage hikes to spread to other firms, particularly small ones, which employ a sizable proportion of the country's workforce and have trailed behind in terms of recovering earning power. Also necessary for mitigating such concerns is the kind of diversification in households' earning power as is seen in the United States, where employee compensation accounts for about 70 percent of disposable income while dividend income accounts for about 10 percent (Chart 18). Japan is, in fact, beginning to see an emergence of household dynamism. Some workers have achieved higher wages by changing jobs to join firms with higher productivity, moving away from lifetime employment practices where their wages tend to be overly dependent on business performance at the firm where they work (Chart 17). In addition, households have started to diversify their income sources, earning greater income from investments in large firms with high productivity by way of investment that takes advantage of the benefits of the new Nippon Individual Savings Account (NISA) program and that focuses on the long term, regular contributions, and risk diversification. I hope that, as these developments strengthen the earning power of households, this will feed into improved consumption patterns.

D. Expectations for Value-Added Services by Regional Financial Institutions to Support Growth

The growth of small firms, which account for about 70 percent of employment in Japan, is indispensable to raising wage levels nationwide. Regional financial institutions, which are rooted in their regions, are supporting various efforts to strengthen the earning power of local small and medium-sized firms, to restructure and revitalize regional economies struggling with population outflows, and to improve job satisfaction among workers. I expect regional financial institutions to provide greater support both to small and medium-sized firms to help strengthen and grow their core businesses and scale up their operations, and to startups to help them grow rapidly. To this end, these institutions need to provide value-added services, including in-depth business matching for M&As, third-party business succession, and alliances, by strengthening cooperation with support organizations such as the National Institute of Advanced Industrial Science and Technology (AIST), the Organization for Small & Medium Enterprises and Regional Innovation, the Japan External Trade Organization (JETRO), university research centers, and consulting organizations. Sustainable economic growth requires small firms to grow into medium-sized firms, medium-sized firms to grow into large firms, and startups to grow rapidly into unicorns, especially unicorns that use new technologies to generate new markets. The current sluggish funding for startups, in terms of both total funding and funding per firm, is evidence of a lack of momentum behind the creation of new markets, and my hope is for the steady implementation of the government's Startup Development Five-Year Plan (Chart 22).

The Bank of Japan will continue to conduct monetary policy as appropriate to support firms' management efforts, enhance the dynamism of firms, employment, and households, and guide the economy's return to a growth path.

Thank you.



Economic Activity, Prices, and Monetary Policy in Japan

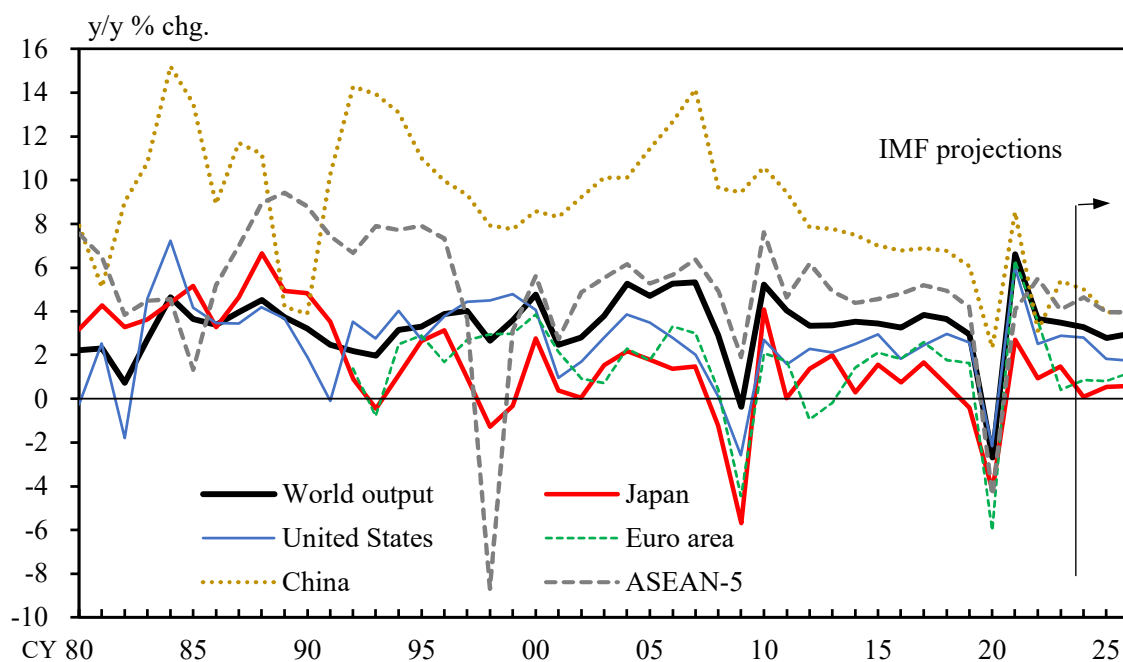
Speech at the Nishinippon Seikei Konwakai Meeting in Fukuoka

May 16, 2025

NAKAMURA Toyoaki
Member of the Policy Board
Bank of Japan

Chart 1

IMF Projections in the *World Economic Outlook* (April 2025)



Note: ASEAN-5 comprises Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

Source: IMF.

Forecasts of the Majority of the Policy Board Members

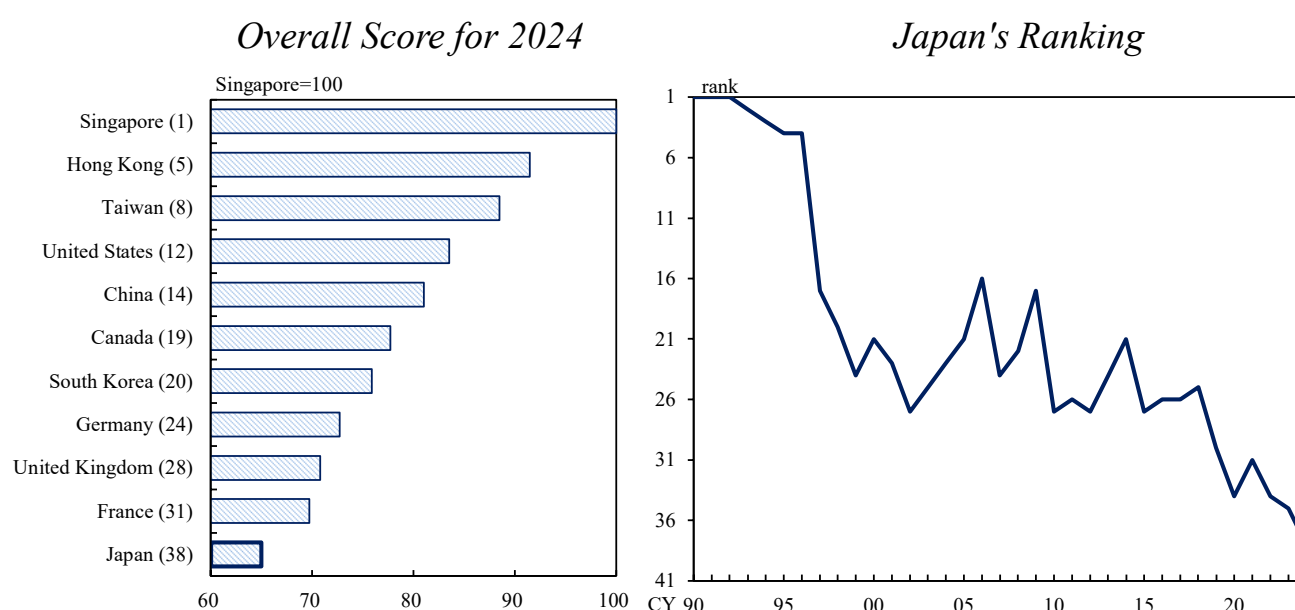
y/y % chg.

	Real GDP	CPI (all items less fresh food)	(Reference) CPI (all items less fresh food and energy)
Fiscal 2024	+0.7 to +0.7 [+0.7]	+2.7	+2.3
Forecasts made in January 2025	+0.4 to +0.6 [+0.5]	+2.6 to +2.8 [+2.7]	+2.1 to +2.3 [+2.2]
Fiscal 2025	+0.4 to +0.6 [+0.5]	+2.0 to +2.3 [+2.2]	+2.2 to +2.4 [+2.3]
Forecasts made in January 2025	+0.9 to +1.1 [+1.1]	+2.2 to +2.6 [+2.4]	+2.0 to +2.3 [+2.1]
Fiscal 2026	+0.6 to +0.8 [+0.7]	+1.6 to +1.8 [+1.7]	+1.7 to +2.0 [+1.8]
Forecasts made in January 2025	+0.8 to +1.0 [+1.0]	+1.8 to +2.1 [+2.0]	+1.9 to +2.2 [+2.1]
Fiscal 2027	+0.8 to +1.0 [+1.0]	+1.8 to +2.0 [+1.9]	+1.9 to +2.1 [+2.0]

- Notes: 1. Figures in brackets indicate the medians of the Policy Board members' forecasts (point estimates).
2. The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which they attach the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.
3. Each Policy Board member makes their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding the future conduct of policy.
4. The CPI figures for fiscal 2024 are actual values.

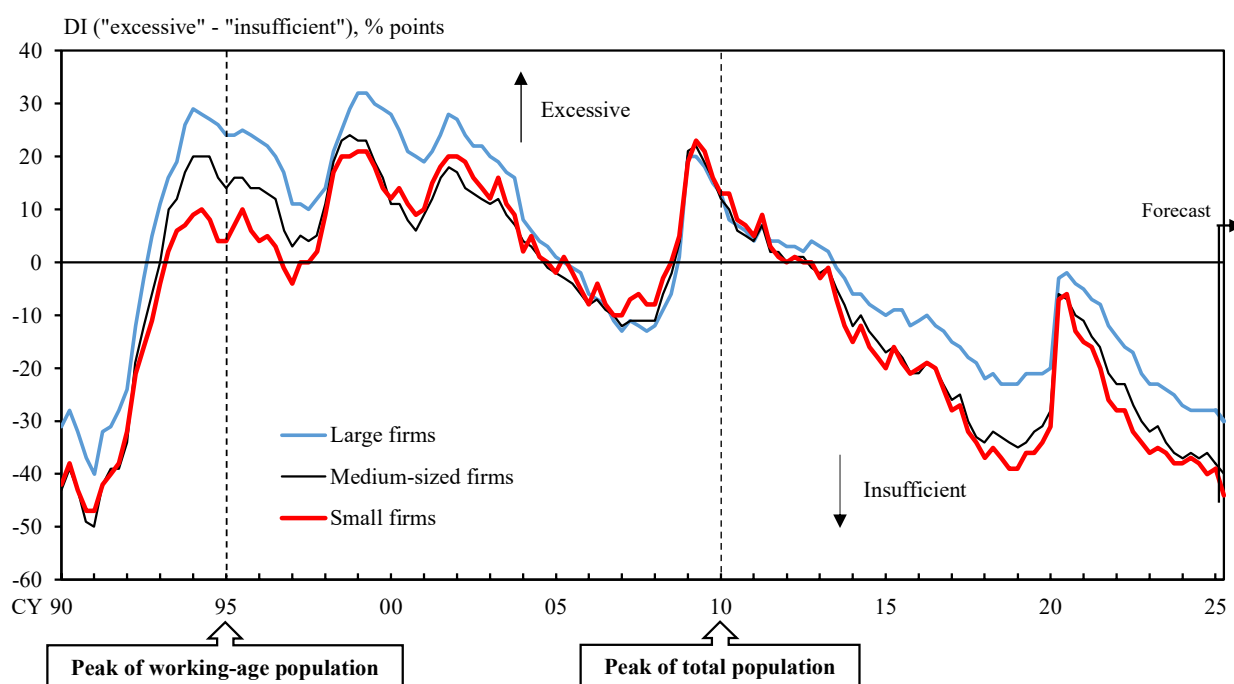
Source: Bank of Japan.

IMD World Competitiveness Ranking



- Notes: 1. In the left panel, figures in parentheses indicate the ranking of the economy out of all 67 economies analyzed.
2. In the right panel, there is a discontinuity in the data for 1997 due to a change in the survey framework.
- Source: IMD, "World Competitiveness Ranking 2024."

Diffusion Index (DI) for Employment Conditions

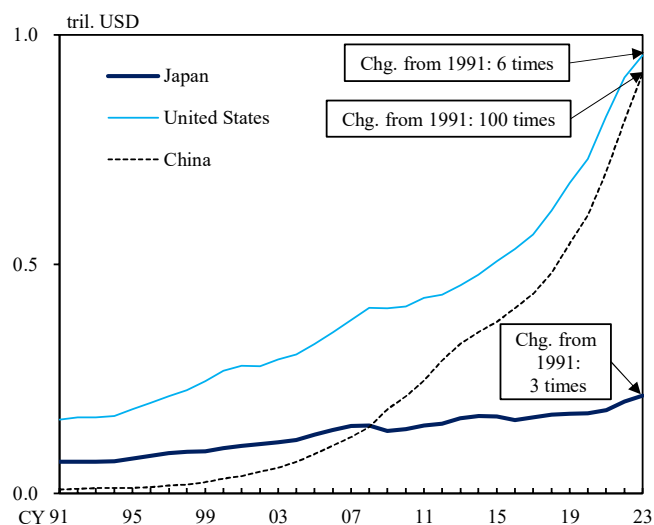


Note: Figures are for all industries, excluding financial institutions. Peaks of working-age population and total population are based on the *Population Census*.

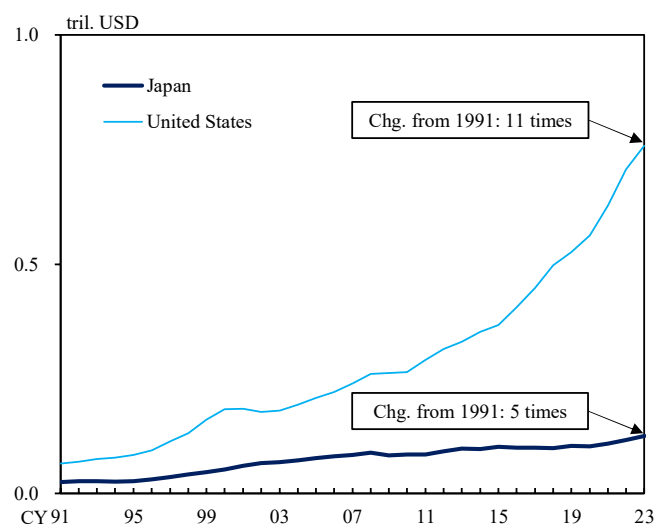
Source: Bank of Japan.

Investment in Innovation

R&D



Software Investment

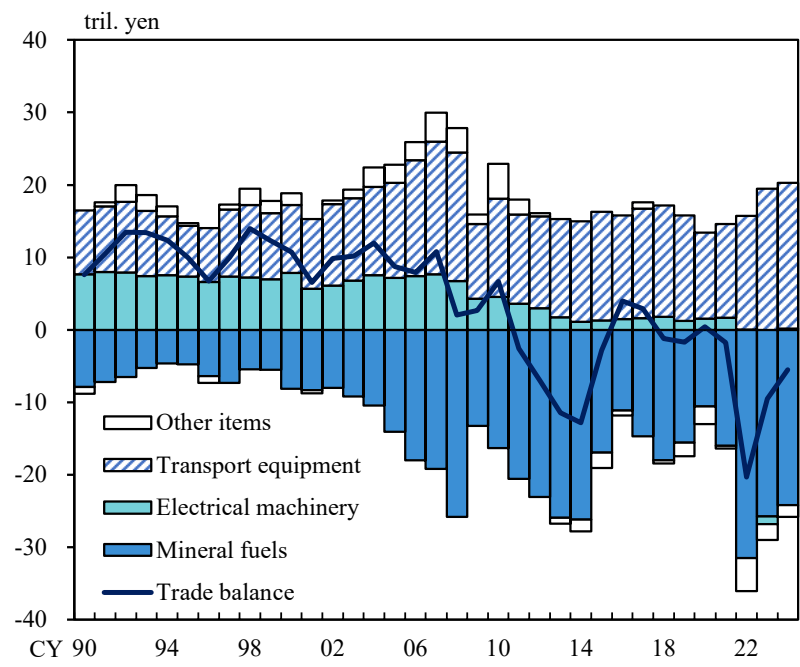


Note: Figures are nominal values denominated in U.S. dollars, converted using purchasing power parity (PPP).

Source: OECD.

Chart 6

Nominal Trade Balance

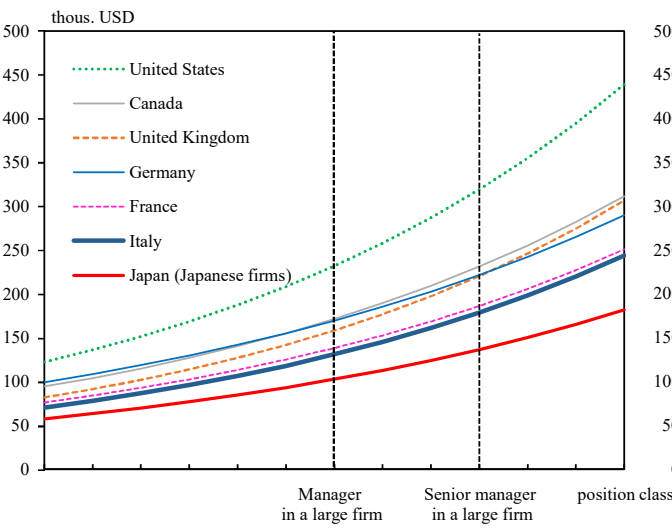


Source: Ministry of Finance.

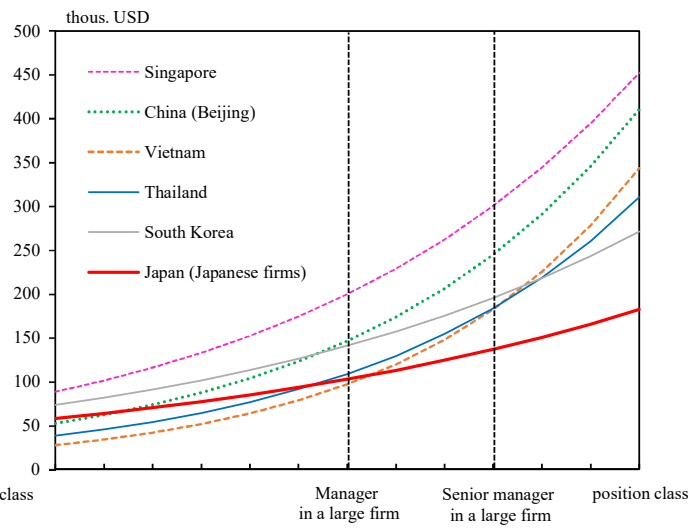
Chart 7

Annual Pay Comparison (as of 2024)

G7 Countries



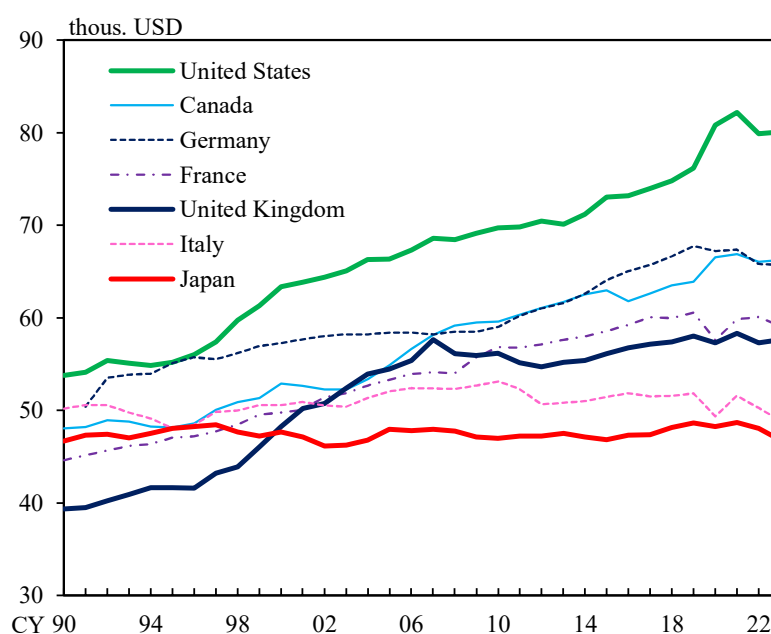
Asian Economies



Notes: 1. The horizontal axis shows the level of position class as defined by Mercer. Position classes below the executive level at large firms are shown in this chart. The further to the right, the higher the position class.
2. Figures include incentives paid for 100 percent achievement of performance targets and are the medians for each position class.

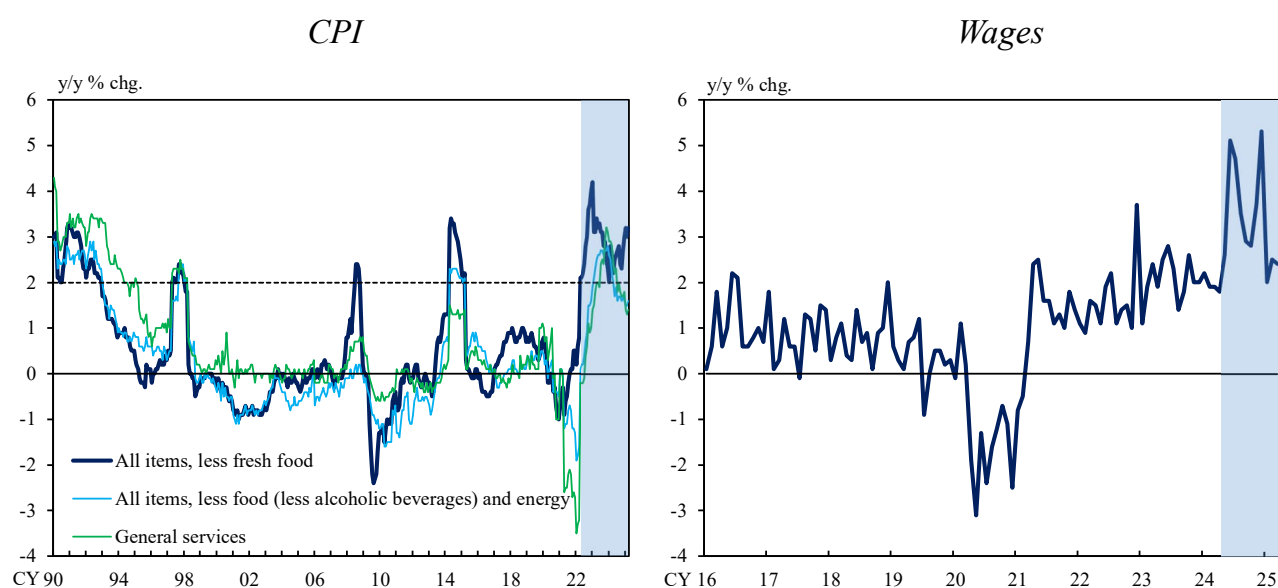
Source: Mercer, 2024 Total Remuneration Survey.

Wage Inflation Comparison among G7 Countries



Note: Figures are nominal values denominated in U.S. dollars, converted using PPP.
Source: OECD.

CPI and Wages

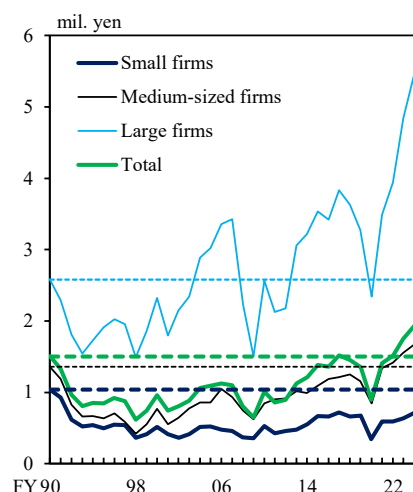


Note: In the right panel, figures are year-on-year percentage changes in total cash earnings based on continuing observations following the sample revisions of the *Monthly Labour Survey*.

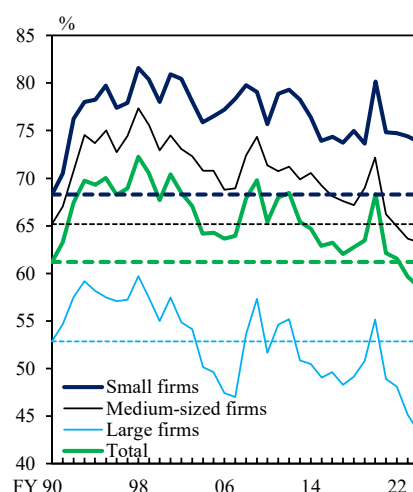
Sources: Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications.

Firms' Earning Power and Capacity for Raising Wages

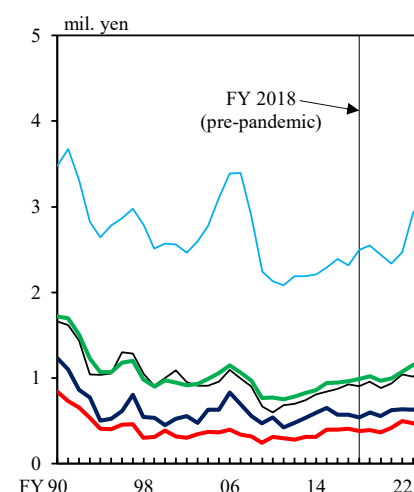
Operating Profits per Employee



Labor Share



Fixed Investment per Employee



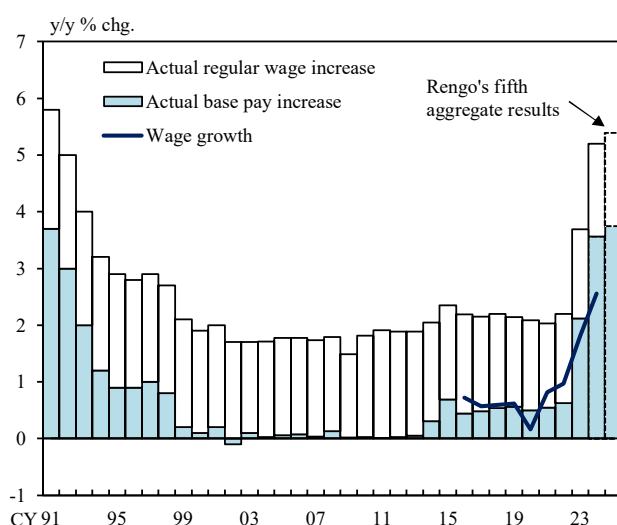
Notes: 1. Figures are based on the *Financial Statements Statistics of Corporations by Industry, Quarterly*, and exclude the finance and insurance industries. Large firms are commercial corporations with capital of 1 billion yen or more. Medium-sized firms are commercial corporations with capital of 100 million yen or more but less than 1 billion yen. Small firms are commercial corporations with capital of 10 million yen or more but less than 100 million yen. Figures for each fiscal year cover the April-December period. The dotted lines indicate the figures for the April-December period of 1990.

2. Labor share = personnel expenses / (operating profits + personnel expenses + depreciation expenses).

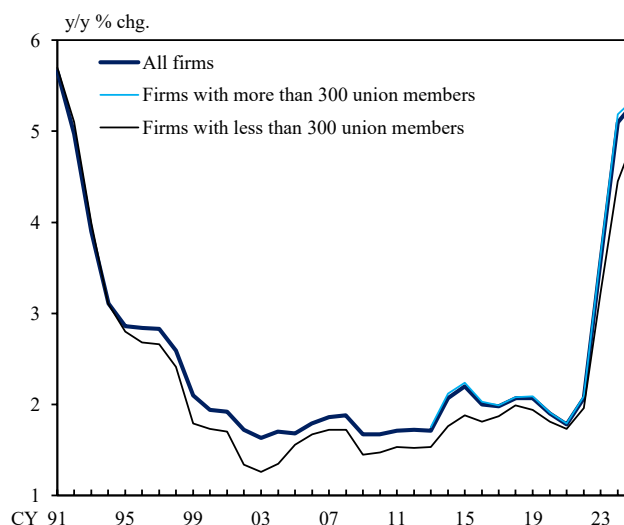
Source: Ministry of Finance.

Results of Annual Spring Labor-Management Wage Negotiations, Developments in Scheduled Cash Earnings

Breakdown of Wage Increases



Wage Increases by Firm Size



Notes: 1. In both panels, figures from 1991 to 2014 are those published by the Central Labour Relations Commission, while figures from 2015 to 2024 other than those for wage growth are figures released by Rengo. The figures for 2025 are from Rengo's fifth aggregate results. In the right panel, figures are for the total wage increase (the sum of the actual base pay increase and the actual regular wage increase).

2. In the left panel, figures for wage growth are monthly averages of year-on-year percent changes in scheduled cash earnings based on continuing observations following the sample revisions of the *Monthly Labour Survey*.

Sources: Central Labour Relations Commission; Ministry of Health, Labour and Welfare; Rengo.

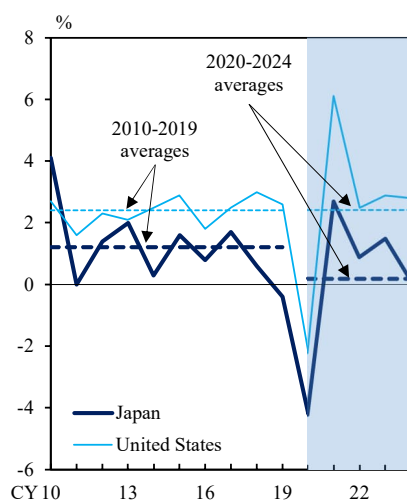
Impact of Trade Policies on Japan's Economic Activity and Prices

Channel	GDP	Inflation
(1) Weaker global demand	↓	↓
(2) Decrease in exports	↓	↓
(3) Decrease in corporate profits	↓	↓
(4) Exchange rate fluctuations	↕	↕
(5) Supply-chain disruptions, etc.	↓	↑

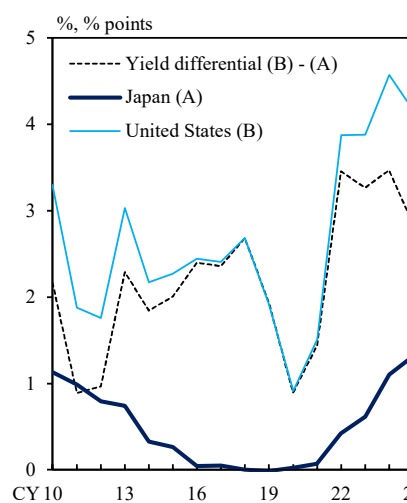
Source: Bank of Japan.

Macro Financial and Economic Indicators

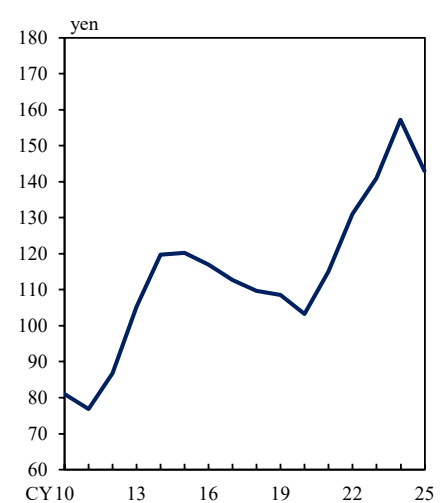
Real GDP



10-Year Government Bond Yields



U.S. Dollar/Yen

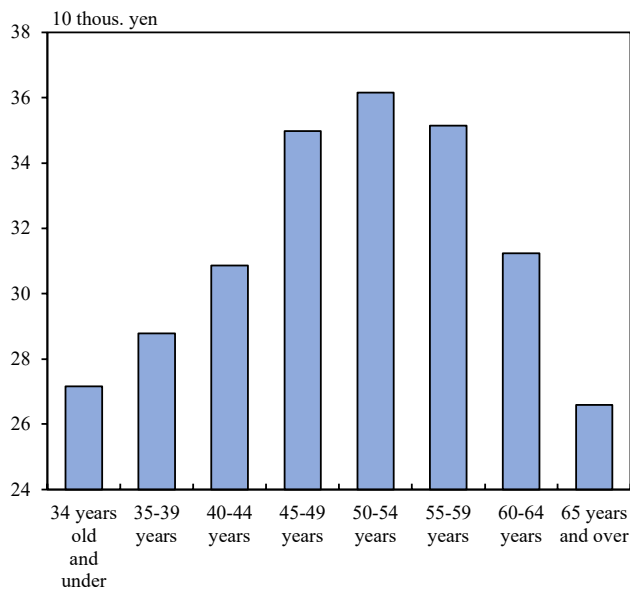


Note: In the center and right panels, latest data are as of end-April 2025.

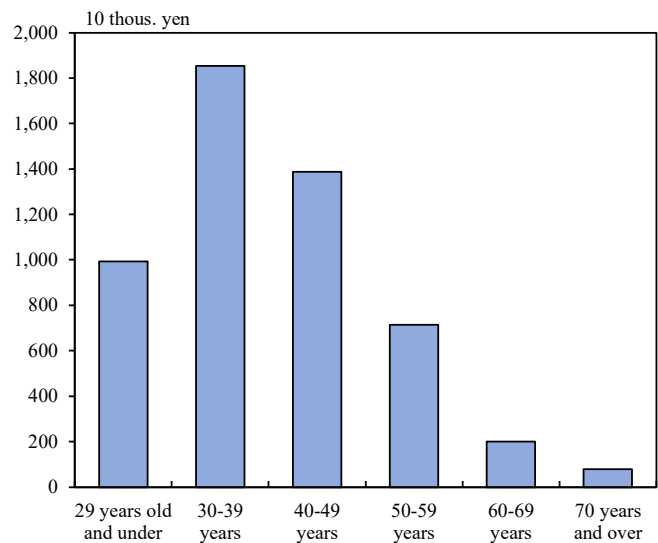
Sources: Bloomberg; Cabinet Office; U.S. Bureau of Economic Analysis (BEA).

Household Circumstances by Age Group of Head

Consumption Expenditure (as of 2024)



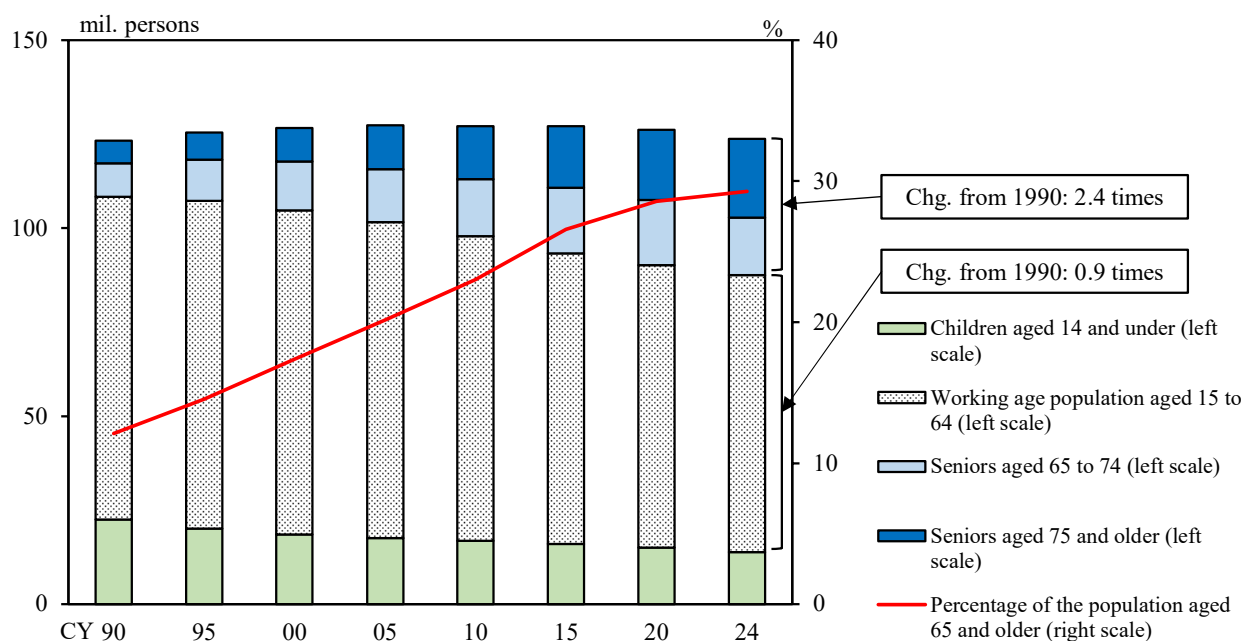
Debt Balance (as of 2023)



Note: Figures in the left panel are average monthly expenditures for two-or-more-person households; those in the right panel are debt balances for two-or-more-person households.

Source: Ministry of Internal Affairs and Communications.

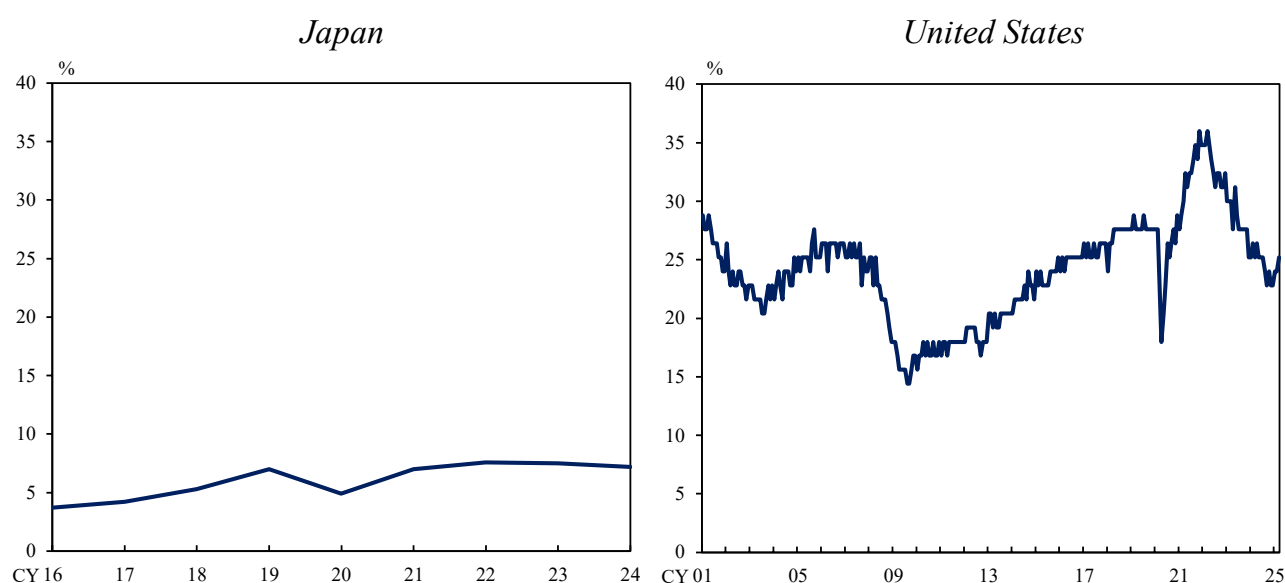
Japan's Demographic Composition



Note: Figures through 2020 are based on the *Population Census* and those for 2024 are based on the provisional estimates of *Population Estimates* (as of December 1, 2024).

Source: Ministry of Internal Affairs and Communications.

Job-Switching Rates

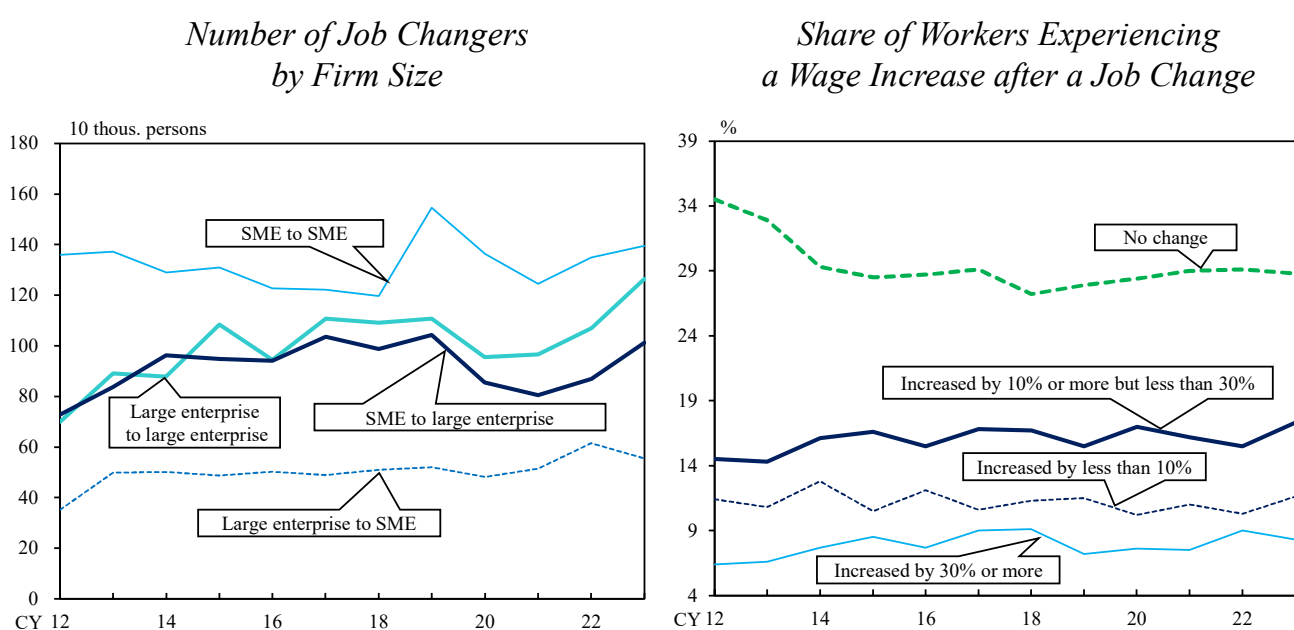


Notes: 1. The left panel shows the share of regular employees in their 20s to 50s who switched jobs in the past year.

2. The right panel shows annualized figures for the number of monthly quits as a percent of employment.

Sources: Mynavi, *Job Change Trends Survey 2025 (2024 Results)*; U.S. Bureau of Labor Statistics (BLS).

Labor Mobility and Wages

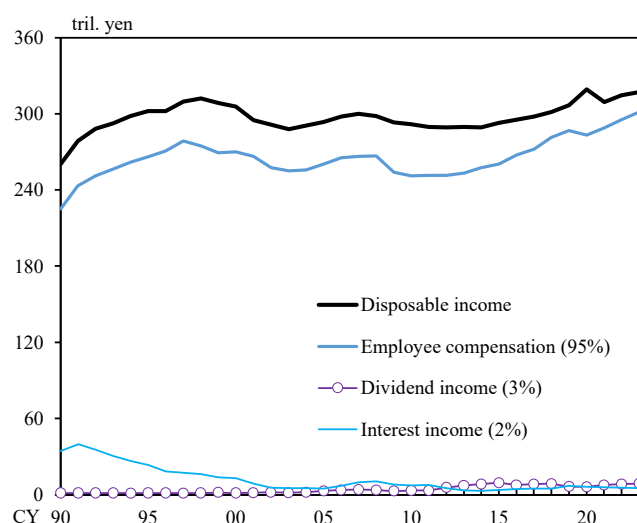


Note: In the left panel, small and medium-sized enterprises (SMEs) are firms with 5-299 employees. Large enterprises are firms with 300 employees or more.

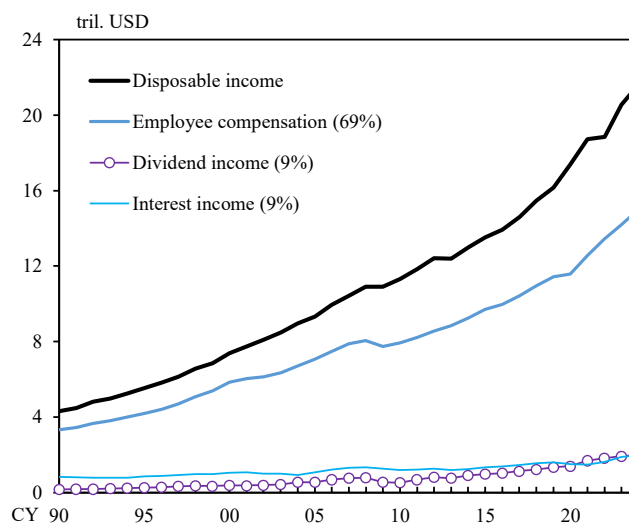
Source: Ministry of Health, Labour and Welfare.

Household Disposable Income

Japan



United States

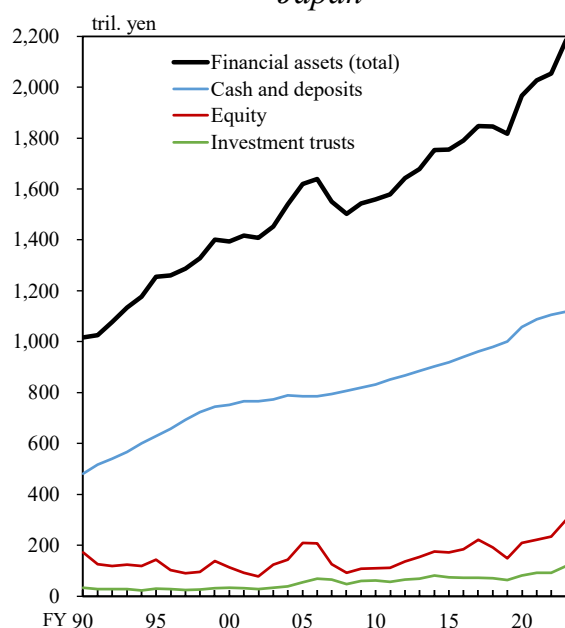


Note: Figures for Japan before 1994 are calculated using year-on-year percentage changes in each item based on the benchmark year of 2000. Figures in parentheses represent the ratio to disposable income, and are as of 2023 for Japan and as of 2024 for the United States.

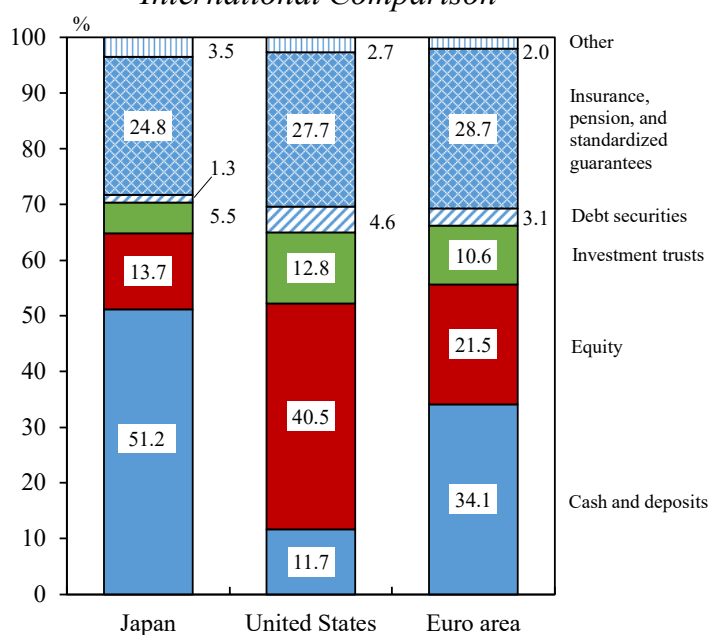
Sources: BEA; Cabinet Office.

Household Financial Assets

Japan



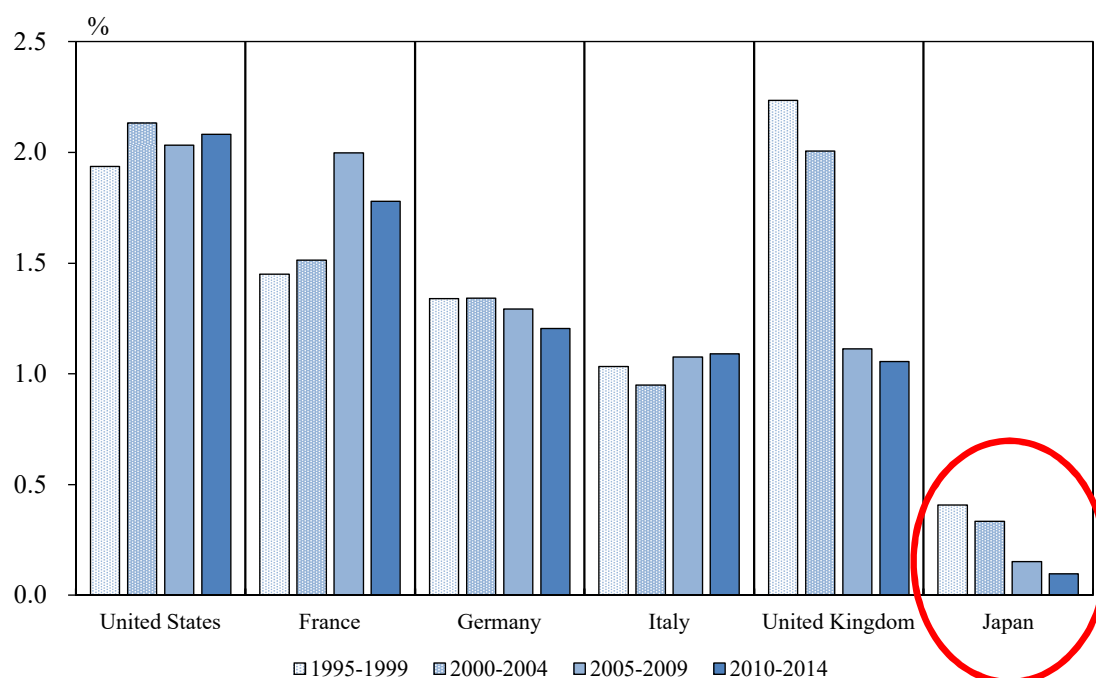
International Comparison



Note: In the right panel, figures are as of end-March 2024. Figures for the United States and the euro area are based on "Flow of Funds: Overview of Japan, the United States, and the Euro area," released by the Bank's Research and Statistics Department on August 30, 2024.

Source: Bank of Japan.

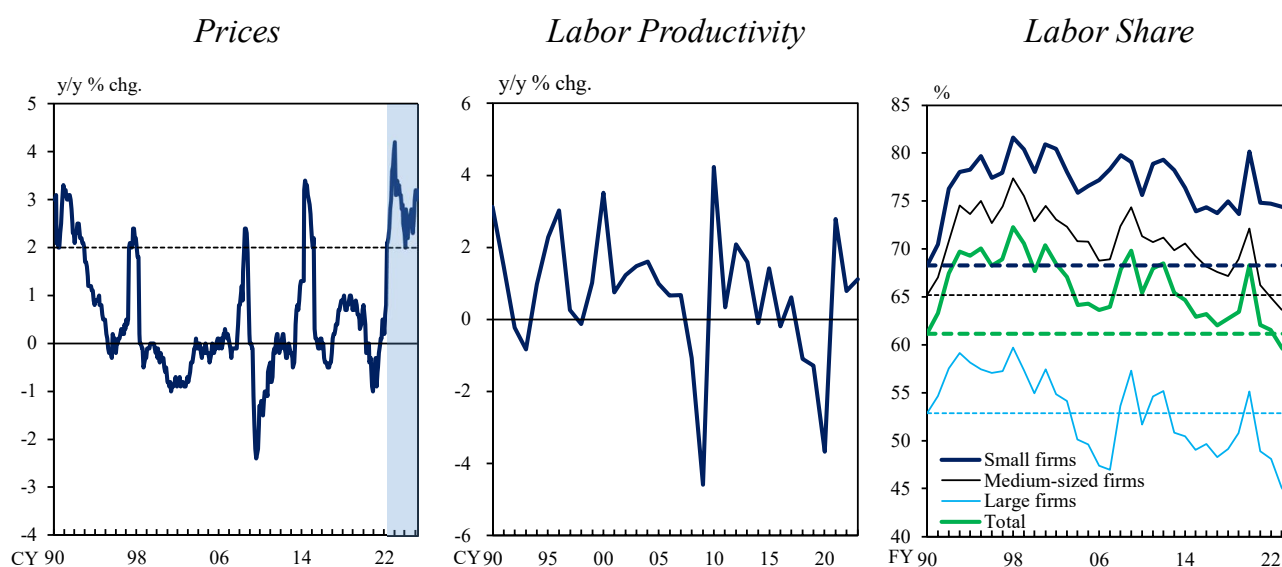
Ratio of Firms' Human Resource Development Costs to GDP



Note: Figures are estimated by Professor MIYAGAWA Tsutomu (Gakushuin University) based on the System of National Accounts (SNA) compiled by the Cabinet Office, Japan Industrial Productivity (JIP) Database, and INTAN-Invest Database.

Source: Ministry of Health, Labour and Welfare.

Components of Wage Growth



Notes: 1. Figures for prices are the CPI (all items less fresh food). Figures for labor productivity are GDP per person employed.

Figures for labor share are based on the *Financial Statements Statistics of Corporations by Industry, Quarterly*, and exclude the finance and insurance industries. Large firms are commercial corporations with capital of 1 billion yen or more.

Medium-sized firms are commercial corporations with capital of 100 million yen or more but less than 1 billion yen.

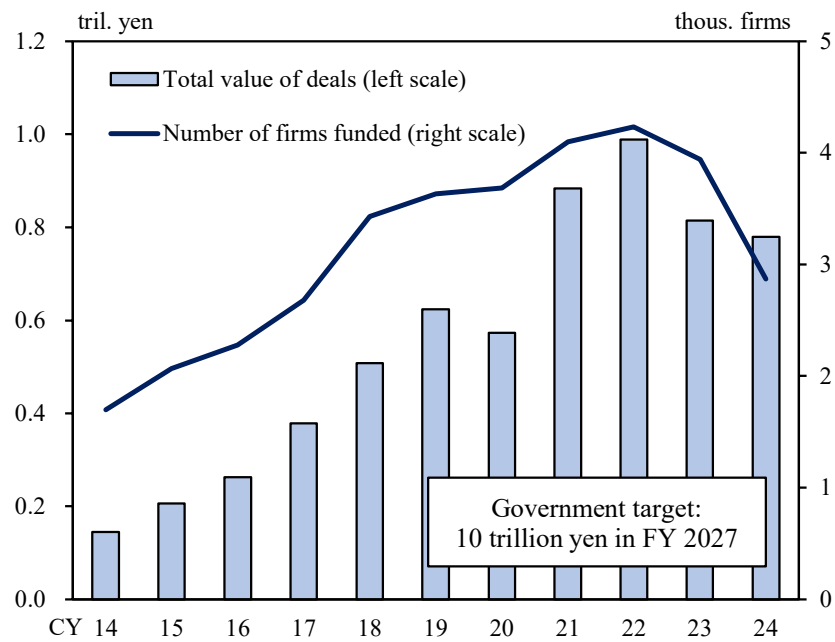
Small firms are commercial corporations with capital of 10 million yen or more but less than 100 million yen. Figures for

each fiscal year cover the April-December period. The dotted lines indicate the figures for the April-December period of 1990.

2. Labor share = personnel expenses / (operating profits + personnel expenses + depreciation expenses).

Sources: Ministry of Finance; Ministry of Internal Affairs and Communications; OECD.

Startup Funding in Japan



Note: The total value of deals is defined as follows: for unlisted startups, the amount of funds raised since their establishment to the time of the survey, in terms of equity or other financial instruments that may be converted into equity; for startups that launched initial public offerings (IPOs), the amount of funds raised immediately before the IPO.

Source: Speeda, *Japan Startup Funding Report 2024*.