Opening Remarks

by Kazuo Ueda,
Governor of the Bank of Japan

I. Introduction

We are pleased to welcome all of you, distinguished speakers and guests, to the 2025 BOJ-IMES Conference. Thank you very much for your participation.

The first BOJ-IMES Conference was held in 1983, and while it was held biennially in some cases, this year marks the 30th edition. Since its inception, the conference has brought together participants from central banks, international institutions, and academia, providing a valuable platform for candid and active discussions on central banking in the context of the evolving global landscape.

The theme of this anniversary conference is "New Challenges for Monetary Policy." I have just returned from the G7 meeting in Canada, where many of my colleagues expressed confidence in the progress made toward fulfilling their mandates, though they also acknowledged new challenges such as heightened trade policy uncertainty and dealing effectively with more frequent supply shocks.

To be honest, I felt slightly left out, though not for the first time, because here in Japan we are still grappling with the longstanding challenge of achieving our 2 percent inflation target in a sustainable manner, while being mindful of the implications of the zero lower bound of policy interest rates.

That said, the nature of our challenge has evolved considerably in recent years. We are now closer to the target than at any time during the last three decades, though we are not quite there. Our recent path has been affected in a unique way by supply shocks.

With that in mind, I would like to take a few minutes to reflect on how our experience has evolved and how it compares with that of other countries. I hope that this perspective will provide some useful background for the discussions to come during the conference.

II. Challenges for the bank's monetary policy

Inflation rates

Let me begin with the current state of consumer price inflation. Chart 1 shows the headline inflation rates in Japan, the euro area (EA), and the United States (US). Inflation surged sharply in the EA and the US during 2021–2023. As has been widely documented, a significant part of this surge was driven by supply shocks, which, while temporary by nature, proved to have more persistent effects than initially thought. The subsequent decline in inflation in these economies reflects both the unwinding of those shocks and the effects of monetary tightening by the ECB and the Fed.

In contrast, Japan experienced a delayed inflationary response, likely due to infla-

tion expectations having remained anchored at low levels. However, unlike in the EA and the US, inflation in Japan has not moderated significantly since peaking around the start of 2023. As we will see shortly, this period has coincided with a gradual rise in inflation expectations.

More recently, inflation in Japan has picked up again, driven primarily by increases in food prices, most notably rice prices. Over the past 12 months, rice prices have surged by 98 percent, and the price of non-fresh food has risen by 7.0 percent.[1]

In sum, Japan has been hit by two substantial adverse supply shocks. As a result, its current inflation rate exceeds that of both the EA and the US.

Policy rates

Turning now to policy rates, as shown in Chart 2, Japan's policy rate remains the lowest among the three economies, at 0.5 percent, markedly lower than in the US, where the rate is above 4 percent.

Chart 3 presents real policy rates, calculated as the nominal rate minus the headline inflation rate. In both the EA and the US, real rates are above zero, reflecting inflation rates above target. In contrast, Japan's real policy rate remains deeply negative, despite a similarly positive inflation gap from the inflation target. These broad features of inflation and interest rates are well known.

The difficult question is: Why has the Bank of Japan maintained such an accommodative stance, even after three years of inflation exceeding 2 percent? The Bank has argued that underlying inflation remains below 2 percent. This naturally leads to the question: What constitutes underlying inflation?

In principle, it refers to inflation excluding temporary factors. But in practice, there is no perfect data series that capture this concept. Instead, it must be judged from the totality of data and information on the economy, making communication with the public challenging. We have often faced harsh criticism for a perceived lack of clarity.

Inflation expectations

One variable we closely monitor to assess underlying inflation is inflation expectations. Although less elusive than the concept of underlying inflation, using inflation expectations also raises questions such as: Whose expectations matter most, and over what horizon?

In Chart 4, I have selected commonly used measures of medium- to long-term inflation expectations for Germany and the US, along with a weighted average of medium- to long-term expectations of various agents in Japan.[2]

For Germany and the US, inflation expectations have remained remarkably stable within a 2–3 percent range, anchored near the inflation targets, even during the nearly 10 percent inflation episodes of 2022–2023.[3] This stability likely reflects the public's confidence in their central banks' ability to maintain price stability.

1. Non-fresh food accounts for 22.3 percent of the consumption basket.
2. Regarding how the composite index of inflation expectations is constructed, see Osada, M. and T. Nakazawa, "Assessing Measures of Inflation Expectations: A Term Structure and Forecasting Power Perspective," Bank of Japan Review Series, 2024-E-4, 2024.
3. The implications for the US economy of the recent sharp rise in household long-term inflation expectations are yet to be determined.

In contrast, Japan's medium- to long-term inflation expectations were stuck around 0–1 percent from the late 1990s until 2013, when large-scale monetary easing was introduced. Inflation expectations rose above 1 percent in 2014, but fell back to the earlier range by 2016 and stayed there until 2021. Shorter-horizon expectations remained even closer to zero, reflecting the deeply entrenched nature of Japan's zero-inflation equilibrium.

Inflation expectations began to rise again in 2022, responding to global inflation dynamics and Japan's continued monetary easing. They now stand between 1.5–2.0 percent—the highest in 30 years, though still below the 2 percent target. In other words, we have managed to de-anchor expectations from zero, but have yet to re-anchor them at 2 percent. This is why we are still maintaining an accommodative policy stance.[4]

Central bank communications

Communicating this policy stance has been difficult, not only because of the inherent ambiguity in the notion of underlying inflation, but also due to the persistent gap between headline and underlying inflation, as shown in Chart 5. (For the time being, we treat inflation expectations as a proxy for underlying inflation.) The gap corresponds to the direct effects of the supply shocks and other temporary forces affecting headline inflation. While central banks respond primarily to underlying inflation, the public tends to react to headline inflation. This divergence has always existed to some extent, but its recent magnitude and persistence have been particularly problematic in Japan.

Central banks generally adopt a "look-through" approach to supply shocks, so long as supply shocks are not expected to affect underlying inflation. We also largely "looked through" the first round of supply shocks, i.e., the inflation of imported goods in 2022–2023. However, Japan's recent experience is unique: while headline inflation rose, underlying inflation rose as well. Increases in underlying inflation were driven not only by economic recovery from the pandemic and the tight labor market, but also by the supply shocks, as they fed into domestic prices and wages.

Now we are facing another round of supply shocks in the form of food price increases. Our baseline view is that the effects of food price inflation are expected to wane. However, given that underlying inflation is closer to 2 percent than a few years ago, we need to be careful about how food price inflation will impact underlying inflation.

As supply shocks become more frequent globally, the relationship between headline and underlying inflation will likely remain a major focal point for many central banks.

Way forward

In light of growing uncertainties, particularly those related to trade policy, we have recently revised down our economic and inflation outlook.

However, we continue to expect underlying inflation to gradually move toward 2

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4. Other proxies of underlying inflation exhibit mixed messages as to what the inflation level is. The rate of increase in base wages is around 3 percent, which is already at a level consistent with 2 percent inflation. Service price inflation has been subdued at 1.3 percent for all services, and at 1.5 percent for general services, as of April 2025.

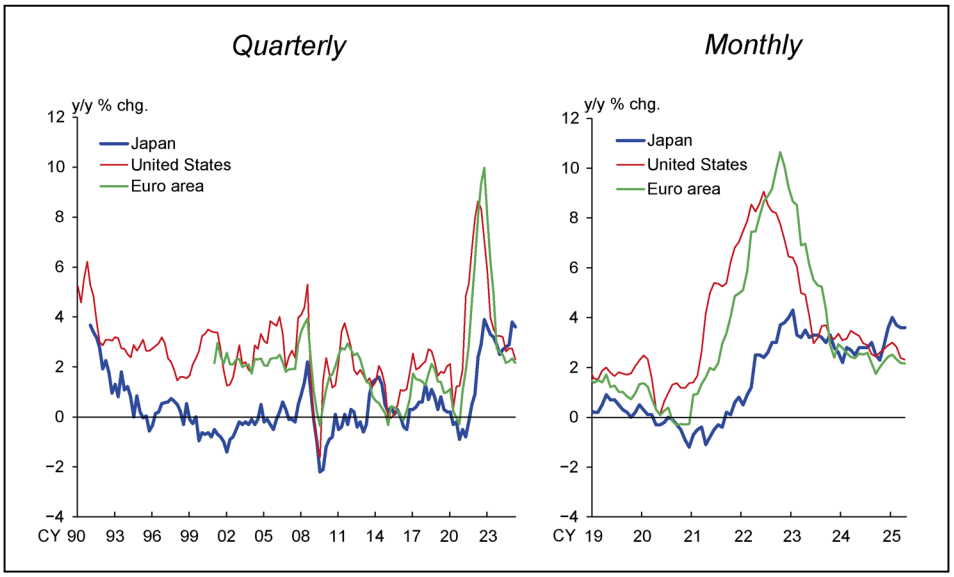
percent over the second half of our forecast horizon. As discussed in our quarterly *Outlook Report*, there are both upside and downside risks around the baseline scenario, and risks to economic activity and prices are skewed to the downside for fiscal 2025 and 2026. To the extent that incoming data allows us to gain more confidence in the baseline scenario, as economic activity and prices improve, we will adjust the degree of monetary easing as needed to ensure the achievement of the sustainable 2 percent inflation target. Considering the extremely high uncertainties, it is important for us to judge whether the outlook will be realized, without any preconceptions.

III. Concluding Remarks

In opening this conference, I have shared some thoughts on the challenges for monetary policy in Japan. While many of these challenges are specific to Japan's unique situation, there are also areas of common concern where we can learn together: the concept and measurement of underlying inflation and inflation expectations, how best to communicate policies anchored in such concepts, and managing monetary policy under frequent supply shocks.

I hope the discussions over the course of this conference will shed light on these critical issues and offer valuable insights for the global central banking community.

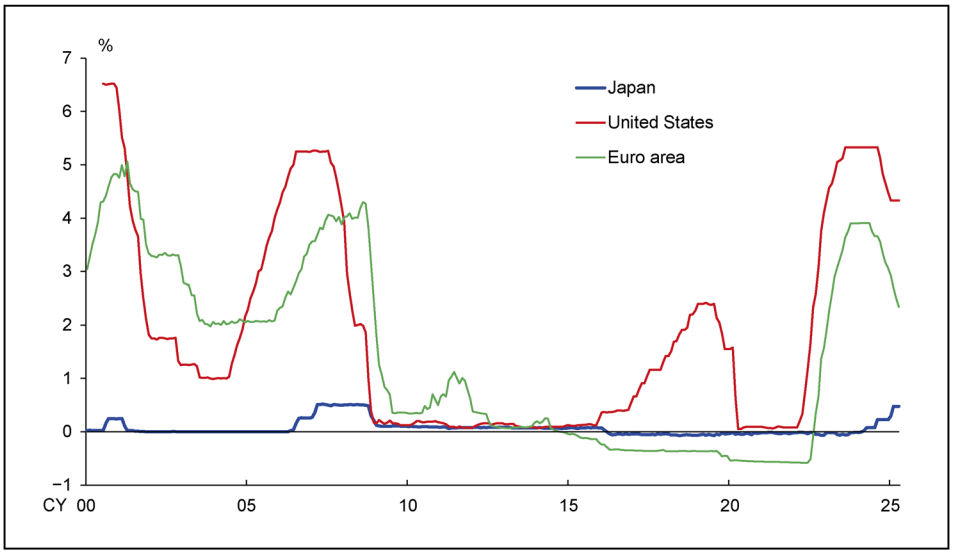
Chart 1 Headline Inflation



Note: Figures for Japan are CPI (all items, excluding the effects of the consumption tax hikes). Figures for the United States and the euro area are CPI (all items) and HICP (all items), respectively. Figures for 2025/Q2 are those for April.

Sources: Ministry of Internal Affairs and Communications; Haver.

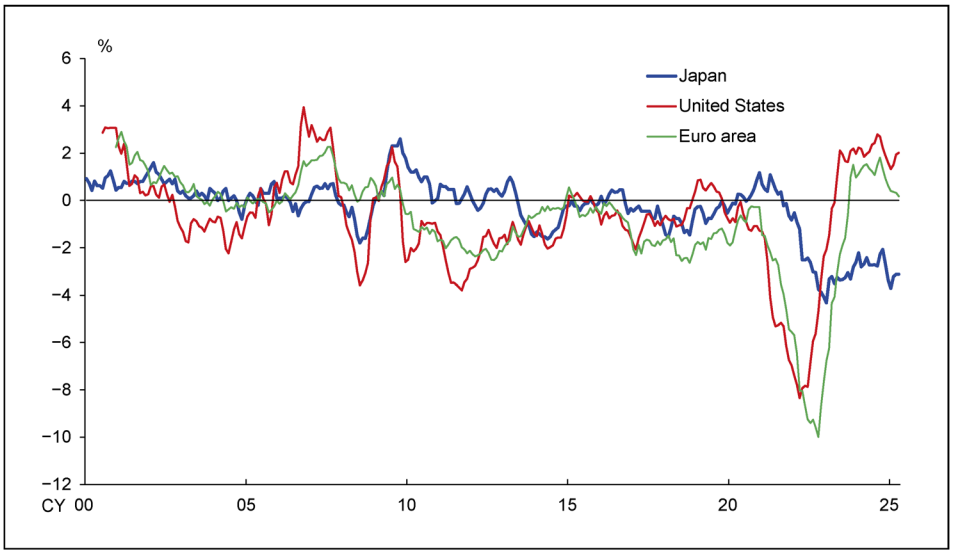
Chart 2 Policy Rates



Note: Figures for each economy are as follows: for Japan, the uncollateralized overnight call rate; for the United States, the effective federal funds rate; for the euro area, EONIA before 2020 and ESTR thereafter.

Sources: Bank of Japan; ECB; FRED.

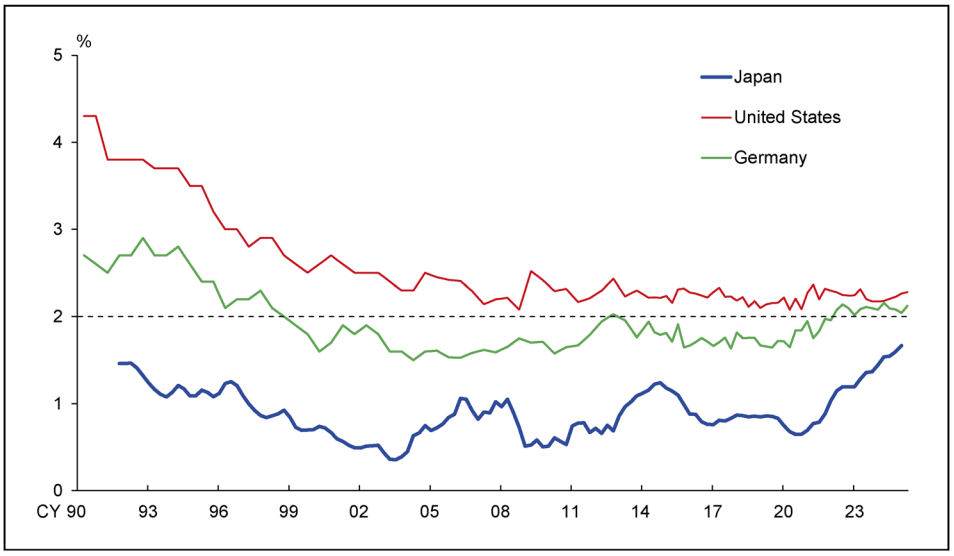
Chart 3 Real Policy Rates



Note: Real policy rates are calculated as nominal policy rates (shown in Chart 2) minus headline inflation (shown in Chart 1).

Sources: Bank of Japan; ECB; FRED; Haver; Ministry of Internal Affairs and Communications.

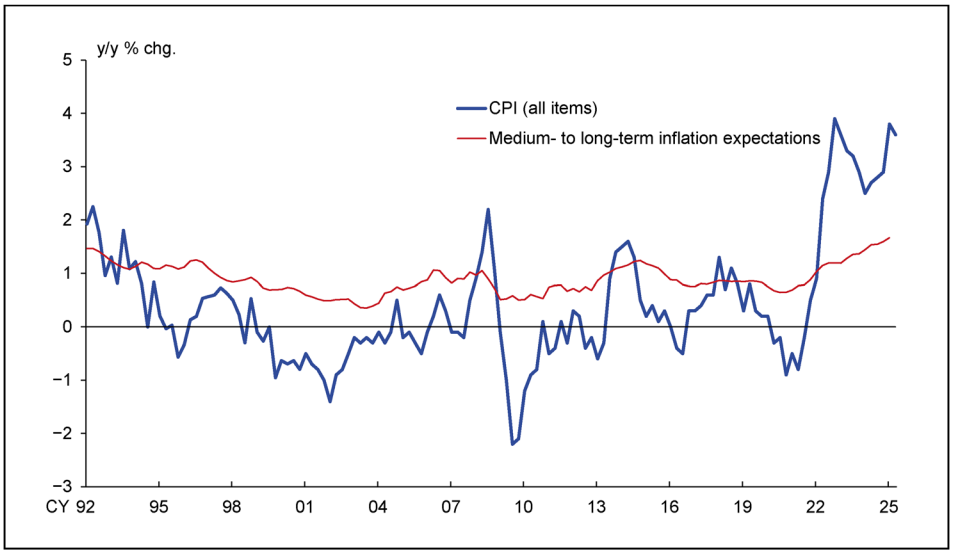
Chart 4 Medium- to Long-term Inflation Expectations



Note: Figures for Japan are the composite index of inflation expectations (staff estimates, 10-year ahead). Figures for the United States and Germany are the forecasts in the Consensus Forecasts (6 to 10 years ahead).

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

Chart 5 Japan's Inflation and Inflation Expectations



Note: The blue line represents CPI (all items, excluding the effects of the consumption tax hikes). The red line represents the composite index of inflation expectations (staff estimates, 10-year ahead).
Sources: Bloomberg; Consensus Economics Inc., "Consensus Forecasts"; QUICK, "QUICK Monthly Market Survey ⟨Bonds⟩"; Bank of Japan; Ministry of Internal Affairs and Communications.