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Macroeconomic Policy Management in Light of Changes in the Price and Interest Rate Environment[1]

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The Japanese economy has continued to recover moderately since the COVID-19 pandemic. Although long-term interest rates have recently been rising, financial markets, including interest rates, are influenced by a wide range of factors. While closely monitoring their developments, it is important for the government to **steadily implement the policies set out in Basic Policy on Economic and Fiscal Management and Reform 2026 and Japan's Growth Strategy** in order to realize a"Strong Economy." At the same time, **it is important to communicate transparently the objectives of these policies, the assumptions underlying economic and fiscal management, and the associated risks, while maintaining close communication with market participants**. Based on these considerations, we offer the following recommendations.

（Current Developments in the Economy, Interest Rates, and Prices）

- Looking at recent economic developments, the second preliminary estimate of GDP for the April-June quarter of 2026 indicates that **final demand remains firm**, and that **the economy continues to recover moderately**. The current recovery **could potentially become the longest expansion period** in the postwar era. While downside risks are accumulating, including higher import prices and procurement costs, economic activity has maintained a considerable degree of resilience, supported in part by efforts to diversify procurement sources in response to developments in the Middle East and changes in the global trade environment.
- Globally, amid accelerating inflation driven by rising oil prices, **demand for long-term financing has been increasing in both the public and private sectors**, particularly for investments in AI, semiconductors, data centers, and infrastructure, **contributing to an upward trend in long-term interest rates**. In Japan, long-term interest rates have also been influenced by domestic economic and price conditions, monetary policy, supply and demand in the government bond market, and overseas interest rate developments, and have **recently remained at around 3 percent**.
- Consumer price inflation has recently moderated, partly reflecting the effects of policy measures. Comparing consumer price inflation (headline CPI) with wage growth, as measured by total cash earnings in the Monthly Labour Survey, **real wages** increased by 2.1 percent year-on-year[2] as of

[1] This document is a policy proposal submitted for discussion by the expert members at the Council on Economic and Fiscal Policy.

[2] Adjusting for the downward effect associated with the sample replacement in the January Monthly Labour Survey (−0.5 percentage points), real wage growth would be in the mid-2 percent range. At the same time, it should be noted that headline consumer price inflation has been reduced by policy measures.

July and **have remained positive for eight consecutive months since last December**. However, increases in producer prices since March, attributable in part to developments in the Middle East, **may be passed through to consumer prices in the future**. **Accordingly, close attention should be paid to trends in underlying inflation and inflation expectations**. In addition, because food accounts for a larger share of consumption among low- and middle-income households, **it is noteworthy that food prices in Japan have risen at a faster pace than overall prices and wages over roughly the five years since the COVID-19 pandemic**.

（Assessment of the Economic Impact of Rising Interest Rates）

- With regard to rising interest rates, **it is important to recognize that their impact differs depending on the circumstances facing individual economic agents**. Attention should also be paid to the fact that interest rate changes may affect both firms and households through a variety of transmission channels, including asset prices.
- **In the household sector**, **households in 30s and 40s age group account for a large share of mortgage borrowers**, and the effects of higher interest rates may emerge only with a time lag. At the same time, **for the household sector as a whole**, financial assets exceed financial liabilities, meaning that **interest income may increase through higher deposit rates and other channels**[3]. However, **these effects vary depending on households' asset and liability positions, as well as their age and income levels**. The implications for household consumption therefore warrant careful monitoring.
- **In the corporate sector**, many firms continue to report that financial conditions are accommodative, and **overall financing conditions remain accommodative** at present. Nevertheless, the effects of higher interest rates differ across firms depending on their size, financial position, and borrowing structure. Accordingly, **attention should be paid to the possibility that such effects may become apparent only with a lag**.

（Policy Responses）

- **Long-term interest rates fluctuate in response to a wide range of factors, including domestic and global economic and price developments, monetary policy, and supply and demand conditions in the government bond market**. Accordingly, **their effects on households, businesses, and public finances should be carefully monitored**. The Bank of Japan is expected to conduct appropriate monetary policy, taking account of economic, price, and financial developments, with a view to achieving the sustainable and stable realization of the 2 percent price stability target.
- **As the institution responsible for macroeconomic management, the government needs to**

[3] As a mechanical calculation, if the interest rate on household deposits (¥1,018 trillion as of the end of March 2026) were to rise by 0.5 percentage points, household interest income would increase by approximately ¥5 trillion.

conduct economic and fiscal policy appropriately so as to achieve both sustained economic growth and price stability. In this regard, it is important that medium- to long-term inflation expectations become anchored at around 2 percent. While **respecting the Bank of Japan's autonomy in currency and monetary control**, the government and the Bank of Japan should **share an understanding of economic and price developments** and maintain **close coordination** while fulfilling their respective roles.

- It is important to **raise private-sector expectations for economic growth and encourage private investment**. During the FY2027 budget formulation process, growth-enhancing measures, including the"Strong and Prosperous Japan" Investment Framework, should be carefully examined and steadily implemented. In doing so, **expenditures that were previously included in supplementary budgets will also be incorporated into the initial budget**. Therefore, care should be **taken to avoid disruption arising from changes in the timing and pattern of budget execution**.
- Even as the government undertakes a fundamental review of the inflation-relief measures that have previously been financed through supplementary budgets, **if circumstances arise,** or are expected to arise, **that could have a significant impact on the Japanese economy**, such as disruptions in the global economy, **the government should respond in a timely and targeted manner**, making flexible use of contingency reserves and other available instruments as appropriate. In addition, **issues such as cartels and opportunistic price increases** linked to higher inflation should be addressed rigorously and appropriately.
- From the perspective of mitigating the increased burden on low- and middle-income households, **the reduction of the consumption tax rate on food and beverages and the subsequent introduction of the working individuals' burden relief support benefit** should be implemented steadily. At the same time, in order to maintain fiscal credibility, **the tax rate should be restored to its original level without fail two years** after the reduction takes effect.
- **With respect to support for households with outstanding mortgage loans that are affected by higher interest rates**, **measures have already been introduced, including the addition of refinancing into fixed-rate mortgages to the scope of interest-rate reduction assistance for households with children and other eligible groups** under the FY2025 supplementary budget, and **the enhancement of mortgage tax relief for existing homes, particularly for households with children**, under the FY2026 tax reform. These measures **should be actively publicized** so that eligible households can make full use of them.
- In addition, with a view both to establishing a stable investor base for Japanese Government Bonds (JGBs) and to meeting households' asset-building needs, **consideration should be given to revising the features of retail government bonds and introducing preferential measures, including the design of new products**, with the necessary measures taken to enhance the attractiveness of JGBs.