# Flash Economics

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# Will there be inflation in Japan?

When examining both observed and expected inflation in Japan, one is struck by the rise in inflation since the spring of 2022. This surge in inflation is partly due to higher energy prices, but core inflation has also increased significantly.

This is linked to accelerating wages in Japan, coupled with a decline in labour productivity—particularly noticeable in the manufacturing sector—developments that can be explained by the country's rapidly ageing population.

The emergence of inflation in Japan presents a challenge for the central bank, which continues to maintain abnormally low short-term interest rates (0.5%) and long-term rates (around 1.5%), despite inflation standing at 3.5% to 4%, well above its 2% target.

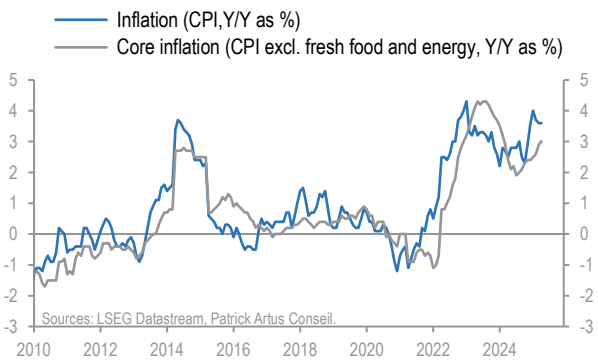
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## Sharp rise in inflation in Japan since 2022

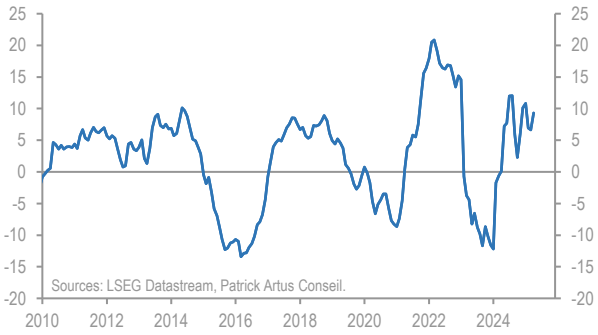
Chart 1 illustrates the evolution of overall and core inflation in Japan.

Chart 1
Japan: Inflation and core inflation (as %)




It shows that headline inflation reached nearly 4% at the beginning of 2025, while core inflation stood at 3%. Of course, energy prices have risen sharply (Chart 2), but core inflation has also clearly accelerated.

Chart 2
Japan: Energy consumer price index (Y/Y as %)




When looking at various measures of expected inflation (Chart 3), a marked rise in inflation expectations can also be observed starting from 2022.

Chart 3
Japan: Household inflation expectations for the year ahead (as % of responses)



Long-term inflation swaps in Japan (Chart 4) also display an upward trend.

Chart 4
Japan: 10-year inflation swap (as %)

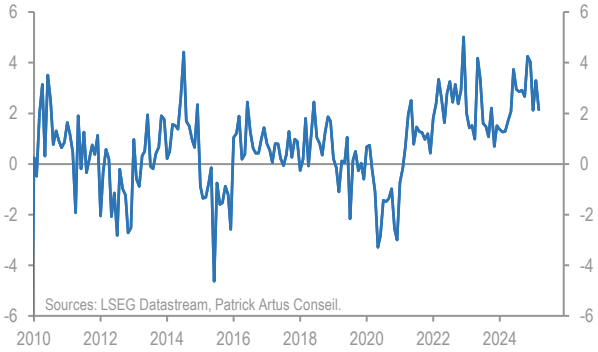



## Causes of the rise in inflation in Japan

The increase in inflation in Japan stems from two main developments:

- The acceleration in wage growth (Chart 5);

Chart 5
Japan: Nominal wage (Y/Y as %)




- The decline in labour productivity since 2018, particularly in the manufacturing sector (Charts 6A/B).

Chart 6A
Japan: Labour productivity in the overall economy
(2010.Q1 = 100)

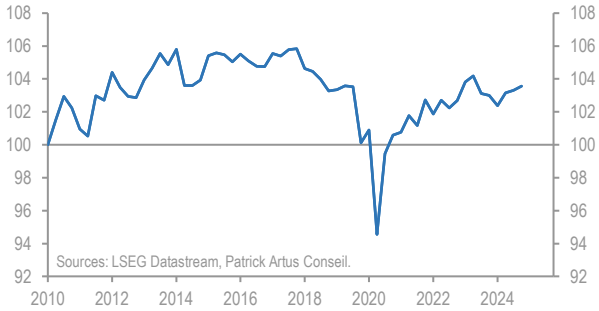
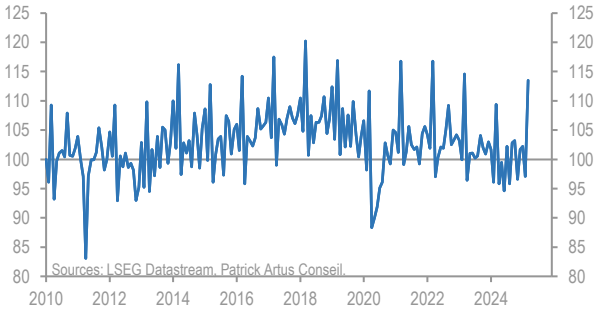



Chart 6B
Japan: Labour productivity in the manufacturing sector
(2010.M1 = 100)



Both trends are likely linked to the **shrinking working-age population** (**Chart 7**) **and the ageing of the labour force** (**Chart 8**), which are placing considerable strain on the labour market and contributing to declining productivity.

**Chart 7**
**Japan: Population aged 15 to 64 (as % per year)**

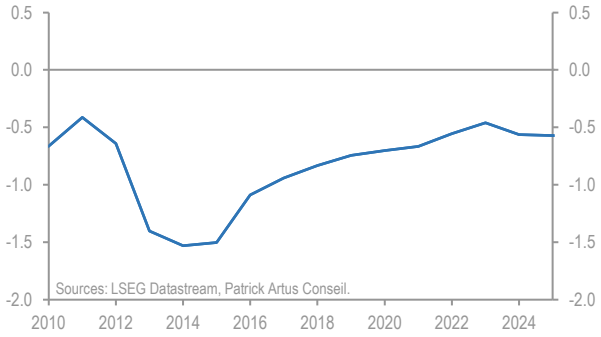
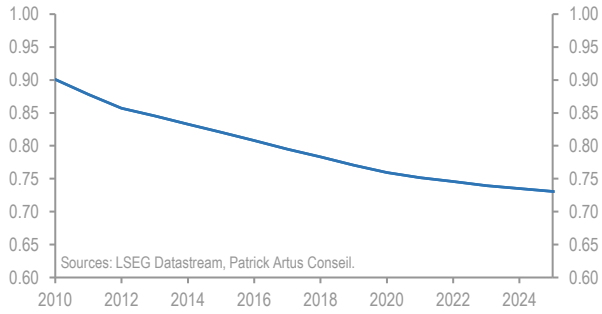
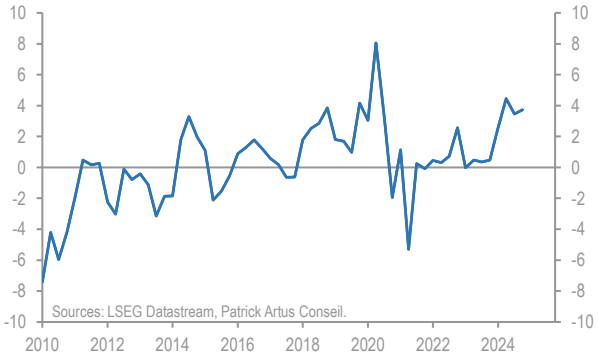



**Chart 8**
**Japan: ratio between population aged 15 to 39 and population aged 40 to 64**




As a result, since 2018—except for the COVID period (2020–2021)—there has been a strong rise in unit labour costs (**Chart 9**).

**Chart 9**
**Japan : Unit labour costs (Y/Y as %)**




## Summary: The Bank of Japan's response

The Bank of Japan continues to maintain very low short-term interest rates (**Chart 10**), but **no longer systematically controls 10-year interest rates**, a policy it upheld until 2024. Nevertheless, the 10-year rate remains significantly below the forward 10-year rate (**Chart 11**).

**Chart 10**
**Japan: Bank of Japan base rate (as %)**

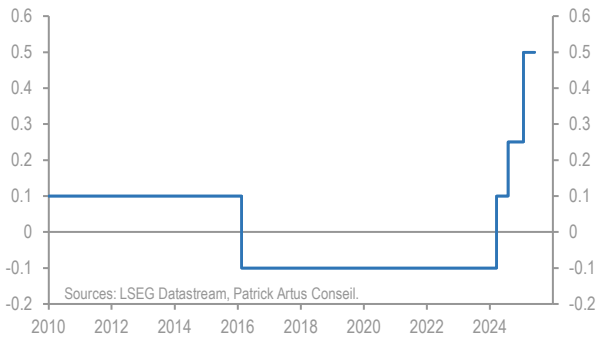



**Chart 11**
**Japan: Interest rate on 10-year government bonds (as %)**



**The Bank of Japan has an inflation target of 2%**. However, it appears to be responding slowly to inflationary developments, allowing **real interest rates to become deeply negative**. The rise in inflation in Japan is likely to be persistent, driven by demographic ageing and declining productivity.

Is the Bank perhaps seeking to encourage a depreciation of the yen (**Chart 12**), which would boost exports and GDP? (Japan's GDP growth in 2024 was only 0.12%)?

**Chart 12**
**Japan: Exchange rate against the dollar (USD 1 = JPY...)**




Or might it be trying to facilitate the financing of the large stimulus package approved in mid-December 2024, amounting to €136 billion? If so, this would suggest a policy of *fiscal dominance*—a plausible strategy given that Japan's public debt stood at 238% of GDP at the end of 2024.

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