



peaked in July 2022 (+49.2%). During this period, the yen depreciated rapidly against the U.S. dollar from 114.13 yen to 136.63 yen, so the peak of the yen-based import price index was delayed by eight months relative to the contract currency-based index. With a time lag, import price inflation propagated to domestic corporate prices (peak in December 2022) and was passed on to consumer prices (peak in January 2023). As a result, real wages in Q1 2023 declined YoY for the fourth consecutive quarter. This rapid deterioration in the income environment drew national attention to the need for wage increases and to the virtuous cycle between prices and wages. Chapter 2, Section 1 presents the theoretical and empirical frames of the price-wage virtuous cycle. First, in order for wages to rise sustainably, it is fundamental to first increase the level of activity in the economy as a whole before raising prices. For this to happen, strong growth in private demand, mainly household consumption and private capital investment, is indispensable. Second, an increase in labor productivity is essential for wages to rise, the key to which is the expansion of production facilities through capital investment.

Japan's capital equipment growth has lacked momentum. However, supported by the accommodative financial environment that has prevailed over the past decade, the performance of large companies in particular has improved, and capital investment has remained strong. The key will be for this to spread to small and medium-sized enterprises (SMEs), leading to a further increase in capital equipment and productivity in the macroeconomy as a whole. The source of robust capital investment will be sustained growth in household consumption. Wage increases are indispensable for this purpose.

A virtuous cycle between prices and wages is a mechanism by which the demand and supply sides of the macroeconomy mutually exert a positive influence on each other. In Japan, capital investment is currently growing against the backdrop of a labor shortage and the digital transformation (DX) accompanying improvements in artificial intelligence (AI). This situation, coupled with a recovery in consumption following the COVID-19 pandemic, should continue to generate sustained increases in productivity and wages, creating a virtuous cycle between prices and wages. In addition, the creation of high-value-added products and the premiumization of value-added products are important when considering the improvement of productivity.