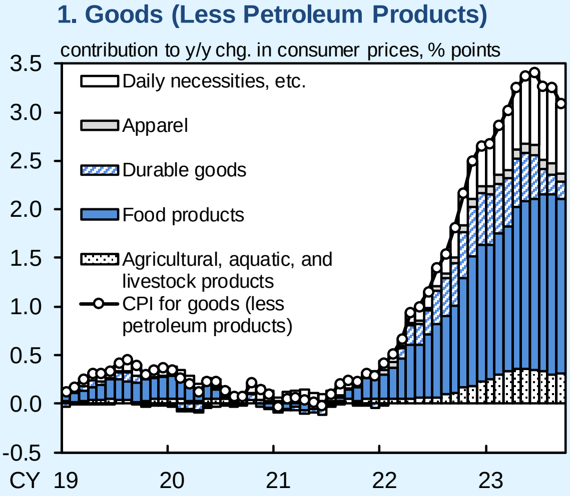
(Box 2) Firms' Outlook for Costs and Cost Pass-Through

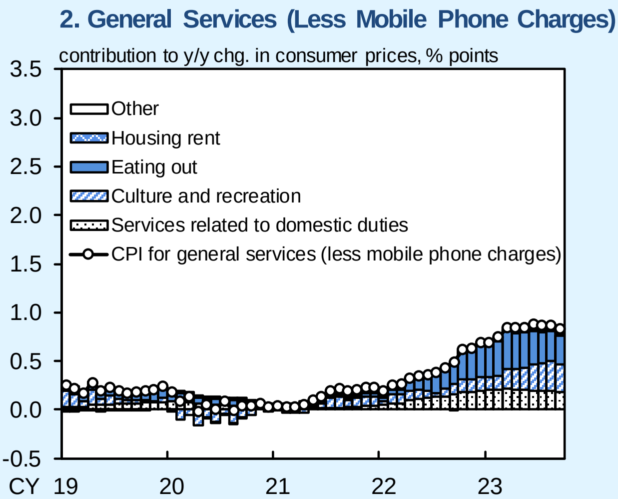
The year-on-year rate of change in the CPI (all items less fresh food and energy) has continued to show relatively high growth, although the pace of increase has decelerated (Chart 37). Price rises have continued to be noticeable, mainly for food and daily necessities that use a large proportion of imported raw materials. This suggests that firms have continued to pass on past cost increases to prices, even with the year-on-year rate of change in import prices being negative since this spring (Chart B2-1).

One of the possible reasons for this is that firms have not fully reflected the actual developments in input costs in producing their outlook for costs, partly because of extremely large fluctuations in import prices since last year. In this regard, firms' outlook for costs at the time of making their annual plans is estimated for each sector, using their actual business plans and other data. The results show that firms in sectors such as food and daily necessities, which experienced large increases in costs last fiscal year, projected that cost increases would continue at relatively high rates for this fiscal year as well (Chart B2-2). Such outlook for high costs at the time of making annual plans has likely contributed to firms' prolonged moves to pass on cost increases to prices of items such as food and daily necessities, even with somewhat stable import prices.

However, upward pressure of raw material costs has already started to dissipate in a wide range of transaction stages of supply chains, reflecting

Chart B2-1: CPIs for Goods and Services





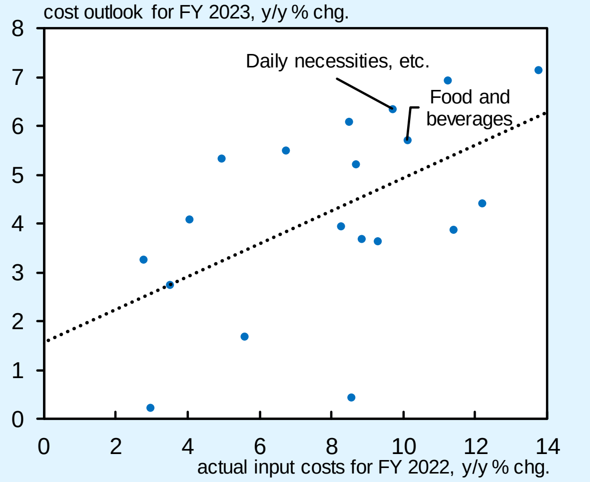
Source: Ministry of Internal Affairs and Communications.
Notes: 1. Figures are the contribution to changes in the CPI (less fresh food and energy). Figures are staff estimates and exclude mobile phone charges and the effects of the consumption tax hike, policies concerning the provision of free education, and travel subsidy programs.
2. Figures for services related to domestic duties include services related to housing repairs and maintenance.

stable import prices. Looking at the final demand-intermediate demand (FD-ID) price indexes, the indexes for stages 3 and 4 of the ID -- relatively downstream stages of the production process -- suggest that upward pressure of costs at these stages has waned. In addition, the rates of change in these indexes compared to three months earlier, which indicate short-term inflation momentum, have been at around 0 percent recently (Chart B2-3). In this situation, the growth rate of intermediate input costs, which are input costs for firms that conduct business-to-consumer transactions, has also decelerated clearly (Chart B2-4).[20] Considering these factors, as firms' outlook for costs will become stable, it is likely that the effects of cost pass-through, led by the past increase in import prices, will wane gradually, although they will remain in the short run.

While crude oil prices have risen recently, prices of metals and grains have been stable to this point. If this situation continues, a significant rise in costs in a wide range of sectors -- such as that seen last fiscal year -- will likely be avoided, although it is necessary to continue to pay close attention to future developments in prices of commodities, including grains. In addition, given that cost structures differ among sectors, close monitoring is required on the effects of cost fluctuations on prices.

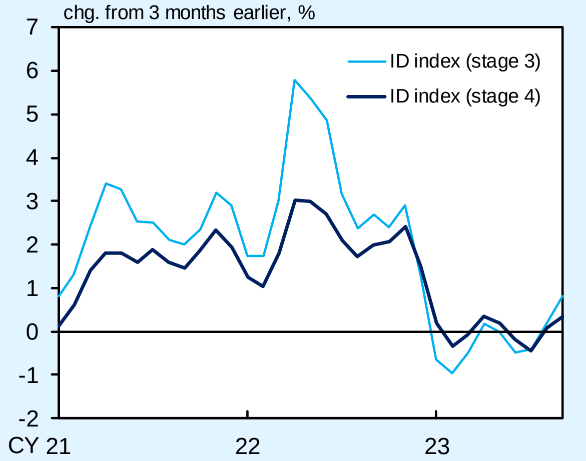
[20] To measure the intermediate input costs for the production of consumer goods and services, excluding fresh food and energy, the intermediate input cost index is estimated based on the transaction structure in the input-output tables. For details, see Box 3 in the April 2022 Outlook Report.

Chart B2-2: Firms' Cost Outlook



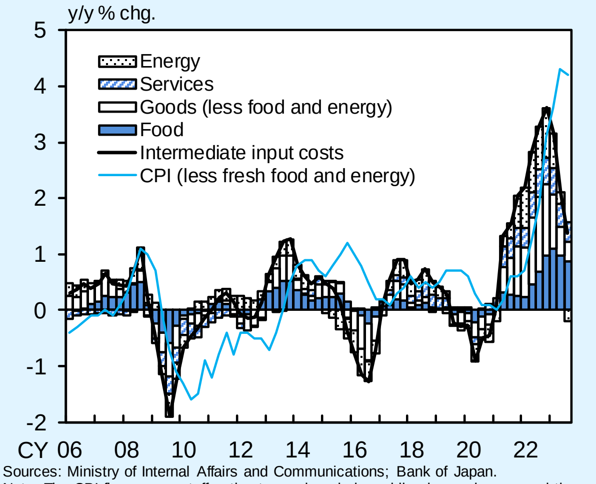
Sources: Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare; Bank of Japan; Nikkei NEEDS-Financial QUEST.
Notes: 1. Actual input costs for fiscal 2022 are the sum of intermediate input costs and wage costs.
2. Figures for the cost outlook for fiscal 2023 are first calculated at the firm level using figures for firms' outlook for output prices in the *Tankan* and listed firms' outlook for cost of sales ratios estimated from their business plans such as operating profits, etc. The figures are then aggregated at the industry level using firms' sales as weights.

Chart B2-3: FD-ID Price Indexes (All Commodities)



Source: Bank of Japan.

Chart B2-4: Intermediate Input Costs



Sources: Ministry of Internal Affairs and Communications; Bank of Japan.
Note: The CPI figures are staff estimates and exclude mobile phone charges and the effects of the consumption tax hikes, policies concerning the provision of free education, and travel subsidy programs. Intermediate input costs are calculated by multiplying the intermediate input ratio of each sector in the *2015 Input-Output Tables for Japan* by price data from the corporate goods price index (CGPI) or the services producer price index (SPPI) and then taking the weighted average using consumption expenditure shares as weights.