

Toshihiko Fukui: A review of the Bank of Japan's conduct of monetary policy

Statement by Mr Toshihiko Fukui, Governor of the Bank of Japan, concerning the Bank's Semiannual Report on Currency and Monetary Control, before the Committee on Financial Affairs, House of Representatives, Tokyo, 23 March 2004.

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Introduction

The Bank of Japan submitted its *Semiannual Report on Currency and Monetary Control* for the first half of fiscal 2003 to the Diet in December 2003. I am pleased to have this opportunity to present an overall review of the Bank's conduct of monetary policy.

I. *Developments in Japan's economy*

Japan's economy is recovering gradually. Exports have recently increased substantially, and business fixed investment continues its path of recovery. Reflecting these developments, industrial production has also been increasing. The decline in household income is gradually coming to a halt, and private consumption is currently showing some positive movements. As for the outlook, Japan's economy is anticipated to continue recovering moderately, reflecting the projection that overseas economies will continue growing relatively fast and final demand, particularly exports and business fixed investment, will continue recovering.

The features of Japan's current gradual recovery are as follows. First, reflecting the steady recovery of the world economy led by IT-related demand worldwide and the high growth of the Chinese economy, Japan's exports are increasing substantially. A virtuous cycle is starting to operate in the economy initiated by the increase in exports, leading to an increase in production and corporate profits, and then to a recovery of business fixed investment.

Second, firms' efforts to tackle their structural problems such as excess debt and labor are finally starting to show results. Large manufacturers' profitability has improved considerably as a result of streamlining of business operations and restructuring of industries, although adjustment pressure remains at nonmanufacturers and small firms. As for the Japanese financial system, there are some encouraging signs that, especially at major banks, various efforts to restore banks' financial soundness are paying off, although the system is still in a difficult situation as a whole.

Given this economic situation, domestic corporate goods prices are recently rising due mainly to the strengthening of overseas and domestic commodity prices, and are expected to continue increasing for some time. The year-on-year rate of change in consumer prices (excluding fresh food) has been close to zero percent, while temporary factors such as the rise in rice prices have exerted upward pressure, and is likely to be around zero percent for the time being. However, consumer prices are basically projected to continue falling slightly, since the imbalance between supply and demand in the economy remains considerable despite a gradual improvement.

Financial markets have been stable on the whole, even during the approach of the fiscal year-end at the end of March 2004 as the Bank has been providing ample liquidity. The environment for corporate finance is becoming somewhat more accommodative on the whole, although it remains severe for firms with high credit risks. The lending attitude of private banks has been slightly more accommodative, and the issuing environment in the corporate bond and CP markets continues to be favorable.

II. *Conduct of monetary policy*

The main features of current monetary easing policy are as follows. First, the Bank has been providing ample liquidity to the money market, with the outstanding balance of current accounts at the Bank as the operating target for money market operations. Second, the Bank is committed to maintaining the quantitative easing policy until the consumer price index (excluding fresh food, on a nationwide basis, hereafter the core CPI) registers stably zero percent or an increase year on year. And third, the Bank is working to strengthen the transmission mechanism to ensure that the effects of monetary easing permeate through the economy. The Bank has been implementing additional measures since the autumn of 2003, as in the past, in line with these three main features.

With regard to the Bank's provision of funds to the money market, it raised the upper limit of the target balance of current accounts at the Bank by 2 trillion yen in October 2003, to provide scope for conducting money market operations in a more flexible manner. In addition, in January 2004, the Bank raised the target range for the outstanding balance of current accounts at the Bank by 3 trillion yen to around 30 to 35 trillion yen in order to reaffirm its policy stance of overcoming deflation and to ensure a continued recovery.

Regarding its commitment to maintain the quantitative easing policy, the Bank released a more detailed description in October 2003. That is, the commitment to maintain the quantitative easing policy until the core CPI registers stably zero percent or an increase year on year is underpinned by the following two conditions. First, it requires not only that the most recently published core CPI should register zero percent or above, but also that such tendency should be confirmed over a few months. Second, the Bank needs to be convinced that the prospective core CPI will not be expected to register below zero percent. There may be cases, however, that the Bank will judge it appropriate to continue with quantitative easing even if these two conditions are fulfilled. The Bank considers that this clear commitment is contributing greatly to the appropriate formation of interest rates in financial markets.

With regard to strengthening the transmission mechanism of monetary easing effects, the Bank has devised various measures including methods related to money market operations, partly with a view to contributing to the development of financial markets from a long-term perspective. As part of this effort, in July 2003, the Bank started outright purchases of asset-backed securities (ABSs). In January 2004, the Bank amended the terms and conditions for the outright purchases of ABSs, so that its aim would be achieved more effectively, taking into account the opinions of market participants. The total amount of ABSs purchased to date has reached around 500 billion yen. The Bank has also been hosting a workshop on securitization with market participants to encourage a constructive exchange of opinions to support the development of the ABS market.

III. Purchases of stocks held by commercial banks

The Bank started to purchase stocks held by commercial banks from November 2002 to reduce the risk that stock price fluctuations might impact negatively upon the business management of individual financial institutions, potentially resulting in instability of the financial system as a whole. The Bank increased the maximum total amount of stock holdings it can purchase from banks to 3 trillion yen from 2 trillion yen in March 2003, and in September 2003 extended the period for purchasing stocks from banks by one year to the end of September 2004. The total amount of stocks purchased by the Bank as of March 10, 2004 was 1,928.8 billion yen.

Conclusion

In contrast to a year ago, positive signs are steadily increasing in Japan's economy. At the same time, however, there remain many tasks in achieving sustainable growth of the economy and overcoming deflation. The Bank is also fully aware that there is a disparity in the level of business confidence between large firms and small firms, manufacturers and nonmanufacturers, and metropolitan and other areas. The Bank considers it essential that a wide range of economic entities, such as firms, financial institutions, and policymakers, continue to make efforts to revitalize the economy now when a virtuous cycle is starting to work, so that the momentum for recovery spreads throughout Japan's economy.

The Bank will continue to do its utmost to put the economy back on a sustainable growth path and overcome deflation, by firmly supporting the positive movements in the private sector from the financial side.