

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 Councillors, Tokyo, 31 March 2005.

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Introduction

The Bank of Japan submitted its Semiannual Report on Currency and Monetary Control for the first half of fiscal 2004 to the Diet in December 2004. 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 still at a pause due to such factors as the ongoing adjustment in the production and inventory of IT-related goods. The underlying mechanism for economic recovery, however, continues to operate steadily and production, which was somewhat weak some time ago, has been more or less flat recently. The economy is therefore expected to emerge from this pause before long and to continue recovering and move to a sustainable growth path.

In more detail, overseas economies, particularly those of the United States and China, are expected to continue to be on an expanding trend. Adjustment in IT-related goods is likely to be completed before long, partly because manufacturers started adjustments at an early stage while demand was increasing. In light of this, exports and production are expected to increase. Corporate profits and business fixed investment are expected to remain on an increasing trend, as structural adjustment pressure stemming from firms' excess capacity and debt has been easing. In addition, household income has clearly stopped declining while the employment situation continues to be on an improving trend. Private consumption, therefore, is expected to show signs of a gradual increase.

Attention should, however, continue to be paid to developments in IT-related demand and crude oil prices, which have been at high levels recently, and their impact on the domestic as well as overseas economies.

On the price front, domestic corporate goods prices had been rising since the beginning of 2004, but they have been somewhat weak recently. As for the outlook, they are likely to become relatively strong again, due to the rise in the prices of crude oil and other commodities at home and abroad. Consumer prices (excluding fresh food, on a nationwide basis) continue to fall slightly on a year-on-year basis in a situation where they have been less responsive to the economic recovery, reflecting the increase in productivity and the restraint on labor costs by firms. Slight year-on-year falls in consumer prices are expected to continue for the time being, partly due to such factors as the effects of the reduction in electricity and telephone charges accompanying deregulation.

The money market remains stable overall against the background of the Bank's provision of ample liquidity. The full removal of blanket deposit insurance is scheduled for April 1, 2005. Concerns about the financial system have decreased significantly as financial institutions have made progress in regaining financial health. Financial institutions have been more confident in raising funds in the money market and their liquidity demand has decreased, as implied by the fact that, in the Bank's funds-supplying operations, there were cases where bids fell short of the Bank's offers.

In the capital markets, stock prices have been firm on the whole. Long-term interest rates have been generally stable, although there was a temporary rise.

The environment for corporate finance is becoming more accommodative on the whole. The lending attitude of financial institutions is becoming more accommodative, and their lending attitude as perceived by firms has also been improving. Under these circumstances, the rate of decline in lending by private banks has been diminishing at a moderate pace. Moreover, the fund-raising environment for firms in the capital markets through CP and corporate bonds remains favorable.

II. Conduct of monetary policy

The Bank has been conducting the quantitative easing policy with the outstanding balance of current accounts held at the Bank as the operating target. The Bank has been providing ample liquidity to the money market in accordance with the current target range for the outstanding balance of “around 30 to 35 trillion yen,” which is far above the amount financial institutions are obliged to hold at the Bank by law or arrangements with the Bank. This has contributed to maintaining the accommodative environment for corporate finance through maintenance of the stability of financial markets.

The Bank has made a commitment to maintain the quantitative easing policy until the year-on-year rate of change in the consumer price index (CPI; excluding fresh food, on a nationwide basis) registers zero percent or higher on a sustainable basis. This commitment has contributed to stabilizing market interest rates, and thus firms have been able to raise funds at low interest rates. The commitment’s positive effects through interest rates on the economy will strengthen as corporate profits increase with economic recovery.

III. The Bank’s measures regarding the financial system after the full removal of the blanket guarantee of deposits

As I mentioned earlier, the financial system in Japan has been regaining stability, and the blanket guarantee of deposits will be fully lifted on April 1, 2005. Financial institutions will be expected to amplify their efforts to develop innovative services tailored to customer needs, thus supporting economic activity. The Bank’s basic stance regarding financial system policy must shift its focus in response to this changing environment: from crisis management to supporting private-sector initiatives toward providing more efficient and advanced financial services via fair competition, while maintaining overall system stability.

In order to contribute to enhancing the functioning and robustness of the financial system, the Bank will actively encourage financial institutions’ efforts to improve their business activities, and devise various ways to enhance its own business.

Conclusion

Although Japan’s economy is at a pause, it is expected to continue recovering with the further expansion of overseas economies and progress in adjustment in IT-related goods. To ensure that this recovery will become sustainable, the Bank considers it essential that a wide range of economic entities continue to make efforts to revitalize the economy.

The Bank is determined to firmly support Japan’s economy from the financial side by maintaining monetary easing with the commitment based on the CPI, in the current situation where the CPI continues to fall slightly on a year-on-year basis.

It has become increasingly important for the Bank to pursue more advanced services in a wide range of areas as well as ensure well-disciplined management to properly carry out the duties entrusted to it as the nation’s central bank. In light of this, the Bank has for the first time formulated a Medium-Term Strategic Framework (MTSF) for fiscal 2005-2009, which sets out the Bank’s management policy for the next five years. The Bank is committed to continuing its efforts, through the steady implementation of this MTSF, to retain public confidence and fulfill its mission of contributing to the sound development of the economy.