

Toshihiko Fukui: Semiannual Report on Currency and Monetary Control (Bank of Japan's overall review)

Statement of a speech 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, 10 May 2007.

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Introduction

The Bank of Japan submitted its *Semiannual Report on Currency and Monetary Control* for the first half of fiscal 2006 to the Diet on December 12, 2006. 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 expanding moderately.

Exports have continued to increase due to the expansion of overseas economies. Business fixed investment has also continued to increase against the background of high corporate profits and generally favorable business sentiment. The positive influence of the strength in the corporate sector has been feeding through into the household sector. As firms have been increasingly feeling a shortage of labor, the number of employees has continued to increase steadily and household income has continued to rise moderately. In this situation, private consumption has been firm. With the rise in demand both at home and abroad, production has been on an increasing trend and inventories as a whole have been more or less in balance with shipments.

Looking forward, Japan's economy is likely to experience a sustained period of expansion with a virtuous circle of production, income, and spending in operation. The Bank will, however, continue to pay close attention to developments in overseas economies, including the United States, as well as crude oil prices.

On the price front, domestic corporate goods prices have recently been more or less at three-month-earlier levels. They are expected to increase in the immediate future mainly due to the rebound in international commodity prices. The year-on-year rate of change in the consumer price index (CPI; excluding fresh food) has been around zero percent due to the drop in crude oil prices, but from a longer-term perspective it is projected to continue to follow a positive trend as the output gap continues to be positive.

As for financial conditions, the environment for corporate finance has been accommodative. In the corporate bond and CP markets, the issuing environment has been favorable. The lending attitudes of private banks have continued to be accommodative. Credit demand in the private sector has been rising. Under these circumstances, the amount outstanding of lending by private banks has been increasing.

II. Conduct of monetary policy

The Bank changed the guideline for money market operations at the Monetary Policy Meeting (MPM) in February, raising the uncollateralized overnight call rate target to around 0.5 percent. This policy adjustment was made in line with the framework for the conduct of monetary policy introduced in March 2006.

The Bank reviewed the outlook for Japan's economy based on data and information on domestic and overseas economies available at the time of the MPM in February. Its assessment at that meeting was as follows: the CPI is likely to increase as a trend as the economy continues to expand moderately; and with the prospects of the economic and price situation improving, the stimulative effect of monetary policy, if the policy interest rate were kept unchanged, could gradually increase, and if the expectation takes hold, in such a situation, that interest rates will remain low for a long time regardless of developments in economic activity and prices, there is a medium- to long-term risk of larger swings and of inefficient allocation of resources as firms and financial institutions over-extend themselves.

The Bank judged at the MPM in February that it was appropriate to adjust the level of the policy interest rate in order to maintain a desirable course of economic activity and prices. This policy action will still keep the monetary environment very accommodative, and the Bank believes that it will contribute to ensuring price stability and achieving sustainable growth in the medium to long term.

The Bank presented its basic thinking on the future course of monetary policy in the April 2007 *Outlook for Economic Activity and Prices*, along with the outlook for economic activity and prices. In sum, while confirming that Japan's economy remains likely to follow a path of sustainable growth under price stability and assessing relevant risk factors, the Bank will adjust the level of interest rates gradually in accordance with improvements in the economic and price situation. The Bank is determined to conduct monetary policy appropriately in the light of developments in economic activity and prices, and contribute to sustainable economic growth under price stability.