

## **Toshihiko Fukui: Overall 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, 11 January 2008.

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### **Introduction**

The Bank of Japan submitted its *Semiannual Report on Currency and Monetary Control* for the first half of fiscal 2007 to the Diet on December 11, 2007. 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 as a trend, although the pace of growth seems to be slowing mainly due to the drop in housing investment.

Housing investment has dropped substantially, affected by the revised Building Standard Law coming into force. With higher materials prices, business sentiment has become somewhat cautious. Exports, however, have continued to increase in a situation where overseas economies continue to expand with momentum being gained across a wide range of economies. Business fixed investment has also continued to trend upward against the background of generally high corporate profits. Inventories have been more or less in balance with shipments, and there has not been adjustment pressure on production capacity and labor. With regard to the household sector, although nominal wages per worker have been somewhat weak, employee income has been rising moderately with the increase in the number of employees. In this situation, private consumption has been firm. Reflecting the rise in domestic and external demand, production has continued to increase.

These developments seem to indicate that a virtuous circle of growth in production, income, and spending has basically remained in place. Therefore, Japan's economy is expected to continue expanding moderately, although for the time being the pace of growth is likely to slow in a situation where housing investment is likely to remain sluggish.

Global financial markets, meanwhile, have remained unsettled due to the U.S. subprime mortgage problem. The functioning of markets for securitized products has deteriorated significantly in the United States and Europe, and stock markets have continued to be unstable worldwide. Moreover, uncertainty regarding global economic developments, for example, downside risks to the U.S. economy, has been increasing. The Bank considers it necessary to continue to monitor carefully developments in global financial markets and the global economy, as well as the effects from the rise in materials prices, such as the surge in crude oil prices.

The three-month rate of change in the domestic corporate goods price index has been positive, mainly due to the rise in international commodity prices. The year-on-year rate of change in the consumer price index (excluding fresh food) became positive in October 2007, registering 0.1 percent in that month and 0.4 percent in November. As for the outlook, it is projected to follow a positive trend due to the rise in prices of petroleum products and food products in the short run and the positive output gap in the longer run.

As for financial conditions, the environment for corporate finance has been accommodative. In the CP and corporate bond markets, the issuing environment has been favorable as a whole, although issuance spreads on those issued by firms with low credit ratings have expanded slightly. The lending attitudes of private banks have continued to be

accommodative. Under these circumstances, the amount outstanding of lending by private banks has been increasing moderately, and the amount outstanding of CP and corporate bonds issued has been above the previous year's level.

## **II. Conduct of monetary policy**

Regarding the conduct of monetary policy, the Bank's basic thinking has been that (1) given the extremely accommodative financial conditions, the level of interest rates is to be raised if Japan's economy is to follow a path of sustainable growth under price stability, and (2) the pace of increase in interest rates should be determined in accordance with improvements in the economic and price situation without any predetermined view.

The Bank will continue to conduct appropriate monetary policy while confirming that Japan's economy remains likely to follow a path of sustainable growth under price stability by monitoring economic activity and prices as well as the situation of financial markets at home and abroad and thoroughly assessing relevant upside and downside risk factors.

## **III. Disposal of stocks purchased from financial institutions**

Although it was not a monetary policy measure, the Bank implemented a stock purchasing program between November 2002 and September 2004. Through this program, the Bank purchased stocks held by financial institutions in order to encourage them to reduce their market risks associated with stockholdings. The Bank has started to dispose of these stocks in the market from October 2007, and the book value of the remaining stocks held by the Bank was approximately 1.5 trillion yen as of the end of December 2007. In disposing of them, the Bank has been extremely careful to avoid any financial losses and also to minimize the impact on the stock market by carefully spreading its sales out over time.