

Masaaki Shirakawa: Recent developments in Japan's economy and the conduct of monetary policy

Statement by Mr Masaaki Shirakawa, 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, 9 August 2011.

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Introduction

The Bank of Japan submitted to the Diet its *Semiannual Report on Currency and Monetary Control* for the second half of fiscal 2010 in June 2011. I am pleased to have this opportunity to talk about recent developments in Japan's economy and present an overall review of the Bank's conduct of monetary policy.

I. Economic and financial developments in Japan

I will first explain economic and financial developments in Japan.

Japan's economic activity has been picking up steadily as the supply-side constraints caused by the earthquake disaster have eased due to efforts from concerned parties. As for the outlook, Japan's economy is expected to return to a moderate recovery path with production regaining traction, backed by an increase in exports and a rise in demand for restoring capital stock.

However, the Bank recognizes that the economic outlook entails considerable uncertainty and judges that recent developments call for closer attention to downside risks. In the United States, concern over fiscal consolidation has not dissipated in financial markets even though the debt ceiling problem has settled for the present, and views on the economic outlook have become more cautious. The sovereign debt problem in peripheral European countries still warrants attention and emerging economies face the challenge of achieving price stability and economic growth at the same time. As such, the prospect of overseas economies entails a high degree of uncertainty. There is a possibility that these developments in overseas economies and the ensuing fluctuations in the foreign exchange and financial markets will have adverse effects on business sentiment, and consequently on economic activity in Japan.

On the price front, the year-on-year rate of change in the CPI has been slightly positive.

The Bank recognizes that the year-on-year rate of change in the CPI is likely to be revised downward with the base-year change scheduled this month. Taking the scheduled revision also into consideration, it appears that it will still take some time to achieve price stability. Meanwhile, the finance ministers and central bank governors of the G-7 made clear yesterday that, in response to the recent strains on global financial markets, they would remain in close contact and cooperate as appropriate, ready to take action to ensure stability and liquidity in financial markets.

II. Conduct of monetary policy

Next, let me explain the Bank's conduct of monetary policy.

First, the Bank has been pursuing powerful monetary easing through comprehensive monetary easing. Under the comprehensive monetary easing framework, the Bank encourages a decline in longer-term market interest rates and a reduction in various risk premiums through the Asset Purchase Program. At the Monetary Policy Meeting held last week, the Bank, with a view to responding to the downside risks to the economy that I

described earlier, decided to increase the total size of the Program by about 10 trillion yen, to about 50 trillion yen.

Second, the Bank has been making efforts to ensure financial market stability.

Third, in order to meet the biggest challenge for Japan's economy, which is the strengthening of the foundations for economic growth, the Bank has been providing funds to private financial institutions that make lending and investment consistent with the policy goal. The funds are provided against collateral such as government securities, at a very low interest rate. With a view to making this framework more effective, in June 2011 the Bank decided to establish a 500 billion yen new line of credit, through which it extends loans to financial institutions for their equity investments and the so-called asset-based lending (ABL).

The Bank recognizes that Japan's economy faces the critical challenge of overcoming deflation and returning to a sustainable growth path with price stability. Based on such strong recognition, the Bank will continue to consistently make contributions as the central bank through the three-pronged approach that I have explained.