Ryuzo Miyao: Economic activity, prices, and monetary policy

Speech by Mr Ryuzo Miyao, Member of the Policy Board of the Bank of Japan, at a meeting with business leaders, Gifu, 18 April 2013.

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Introduction

Thank you for giving me this opportunity to exchange views with people representing Gifu Prefecture, who have taken time to be here despite their busy schedules. Allow me to also express my gratitude for your cooperation with the activities of the Bank of Japan's Nagoya Branch.

Today, I will review economic activity and prices in Japan, whose economy has stopped weakening and has shown some signs of picking up, and then discuss the Bank's monetary policy. My concluding remarks will touch briefly on the economy of Gifu Prefecture. Following my speech, I would like to listen to your views on the actual situation of the local economy and to your candid opinions.

I. Recent developments in economic activity and prices

A. Economic activity through the end of 2012: firms' defensive stance

I would like to begin by looking back at developments in overseas economies and Japan's economy over the past few years, through the end of 2012. The following two developments can be highlighted as the main features of this period.

First, the outlook for overseas economies had been highly uncertain due to their prolonged deceleration. Even though several years had passed since the Lehman shock, overseas economies remained unable to emerge from the phase of post-crisis adjustment; that is, the chronic economic downturn. Subsequently, these economies were struck by multiple waves of significant shocks, including the worsening of the European sovereign debt problem and concern about a potential disintegration of the euro, as well as a delayed recovery in the employment situation and the fiscal problem in the United States. As a result, investors' risk aversion and preference for safe assets heightened in global financial markets, and the yen's appreciating trend continued. The downturn in overseas economies was also reflected in developments in the world economic growth rate (Chart 1).

Second, reflecting such severe conditions in overseas economies and global financial markets, business activities in Japan, particularly fixed investment, became cautious. With a high degree of uncertainty regarding the outlook, Japanese firms focused on taking a defensive stance, holding back or postponing fixed investment while maintaining relatively high profits and internal reserves (Chart 2). At the same time, stock prices and the potential growth rate of Japan's economy also remained depressed (charts 3 and 4).

It must be noted that the continuation of such a defensive stance can cause deflationary sentiment to become firmly fixed and impair the economy's growth potential. In order to make Japanese firms shift from such an excessively defensive stance and allow the economy to regain its growth potential, it is essential to put forward various regulatory and institutional reforms as well as a wide range of investment, such as in capital and human resources.

In this regard, it is encouraging to see that Japanese firms' growth expectations and appetite for fixed investment have been maintained. For example, according to the Cabinet Office's *Annual Survey of Corporate Behavior (Fiscal 2012)*, firms' forecasts for real growth rates over the next three and five years, respectively, were at a level exceeding 1 percent and also above the current potential growth rate, which is estimated to be in the range of 0–0.5 percent. Moreover, with business fixed investment plans remaining solid, postponed investment projects are likely to have accumulated considerably, indicating that firms' growth expectations remain resilient.

Furthermore, business sentiment has started to pick up and corporate profit prospects have begun to improve, triggered by the correction in the yen's appreciation and the rise in stock prices since the end of 2012. Although uncertainty regarding the world economy still exists, serious tail risks such as a potential disintegration of the euro have receded and the outlook for overseas economies has been on an improving trend. Reflecting these developments, firms are gradually beginning to enjoy an environment in which they can show their "animal spirits" – that is, their entrepreneurship – and carry out business fixed investment.

B. Japan's economy: showing some signs of picking up

In these circumstances, Japan's economy has finally stopped weakening and has shown some signs of picking up. Overseas economies remain in a deceleration phase on the whole, but the U.S. and Chinese economies are heading toward a pick-up. In this situation, Japan's exports have stopped decreasing. As for domestic demand, business fixed investment continues to show some weakness on the whole, as the result of investment that is weak in manufacturing and solid in nonmanufacturing. In contrast, public investment has continued to increase, and housing investment has generally been picking up. Private consumption has been increasingly resilient. Reflecting these developments in demand both at home and abroad, industrial production has stopped decreasing and has shown some signs of picking up.

With regard to the outlook, Japan's economy is expected to return to a moderate recovery path, mainly on the assumption that domestic demand will remain resilient, partly due to the effects of various economic measures, and that growth rates of overseas economies will gradually pick up. To elaborate on this, exports are expected to pick up, led by the recovery in the U.S. and Chinese economies. As for domestic demand, it is expected that public investment will continue trending upward, supported by the effects of various economic measures, and that housing investment will continue to generally pick up. Resilience in private consumption is expected to increase gradually, assisted mainly by an improvement in consumer sentiment. Business fixed investment – a crucial factor of domestic demand – is projected to remain somewhat weak for the time being in manufacturing, but follow a moderate increasing trend thereafter, partly due to investment related to disaster prevention and energy. In these circumstances, it is anticipated that production will pick up.

Japan's economy is thus expected to gradually pick up. However, uncertainties remain over the economic outlook, such as downside risks associated with overseas economies, and I am paying greater attention to the downside risks.

Meanwhile, the year-on-year rate of change in the consumer price index (CPI) for all items less fresh food has been slightly negative, due to the reversal of the previous year's movements in durable consumer goods. As for the outlook, it is likely to remain slightly negative in the short run. This is because over the next few months, while weak economic recovery in 2012 would put downward pressure on prices, upward pressure from factors such as the depreciating trend of the yen is likely to be offset by the downward pressure brought about by the reversal of the rises in prices of televisions and crude oil in 2012. However, the year-on-year rate of change in the CPI is expected to return to around 0 percent, as the downward pressure caused by the reversal of price rises in 2012 subsides, and then become positive, assuming that the negative output gap narrows accompanied by a recovery in the economy.

C. Path toward achieving the 2 percent price stability target

I will next discuss the outlook for the somewhat longer term. In January 2013, the Bank decided to introduce the "price stability target" and take a decisive step forward to enhance monetary easing with the aim of achieving this target at the earliest possible time. One of the main reasons behind this decision is that it has become possible to envisage the path toward reaching the 2 percent target, in a situation where the achievement of 1 percent inflation in fiscal 2014 has come into sight in terms of the median of the Policy Board members' forecasts of the year-on-year rate of change in the CPI.

In what follows, I present a baseline scenario for the path toward achieving the 2 percent price stability target, focusing on several specific points. In creating a future scenario, it is necessary to take into account various factors, but I place particular importance on the following points.

First, the world economy is expected to stabilize and grow through 2014. The latest projections by the International Monetary Fund (IMF) show that the growth rate of the world economy will increase gradually to around 4 percent through 2014 on an annual basis. In these projections, cautious views on the European economy are maintained, as represented by the forecast for 2013 of slightly negative growth, while steady recovery is expected in the U.S. economy and emerging economies in Asia.

Second, as the world economy, especially the U.S. economy, recovers steadily, it is likely that investors' risk-taking will continue to be active – the so-called risk-on – as a trend and that U.S. long-term interest rates will rise moderately. These factors will underpin the demand for risk assets as well as affect foreign exchange rates by putting pressure on the U.S. dollar to appreciate against the yen.

Third, demand for business fixed investment in Japan, which has been restrained, will emerge as the world economy moves toward normalization and thereby reduces associated uncertainty. Developments since the end of 2012, such as an upturn in business sentiment and projected improvement in corporate profits, together with the effects of monetary easing by the Bank, will probably encourage firms to make positive efforts.

Fourth, the potential growth rate of Japan's economy is likely to increase moderately. Productivity will improve if business fixed investment is made and obsolete facilities and factories are replaced by ones equipped with new technologies. Moreover, if institutional and regulatory reforms are conducted in fields such as agriculture, energy, and medical care with a vigorous trade policy implemented, then efforts to strengthen the growth potential and competitiveness of the economy will progress further. In view of these prospective factors, it is reasonable to expect a moderate increase in the potential growth rate, which seems to be in the range of 0–0.5 percent at present.

Fifth, the public's inflation expectations will likely rise gradually. These expectations are affected by developments in actual inflation rates, the medium- to long-term trend of inflation rates, and the prospects for economic recovery. It is not unrealistic to assume a rise in the public's inflation expectations if deflationary sentiment is dispelled, the actual inflation rate rises, and prospects for sustainable economic recovery become widely acknowledged under the 2 percent price stability target, together with the effects of monetary easing by the Bank.

Let me briefly summarize what I have covered. The path toward achieving the 2 percent price stability target can be described as follows (Chart 6). First, the normalization of overseas economies will bolster the recovery trend in Japan's exports and production, thereby increasing corporate profits. Second, the continued risk-on trend and gradual rise in U.S. long-term interest rates, as well as strong monetary easing by the Bank, will support accommodative financial conditions, reflected even in asset prices and foreign exchange rates. Third, this will encourage firms' positive initiatives to make fixed investment and implement structural reforms, which will in turn bring a gradual rise in the potential growth rate of Japan's economy. Fourth, on the expectation of sustainable economic recovery, firm household spending should be maintained and prices should gradually increase accompanied by the narrowing of the negative output gap. Fifth, the public's inflation expectations will rise gradually, and in this situation the inflation rate is likely to rise above 1 percent during fiscal 2014 – more specifically, as of January 2013, the median of the Policy Board members' forecasts of the year-on-year rate of change in the CPI for fiscal 2014 is

0.9 percent. And sixth, thereafter, in a situation where the virtuous circle of a five-stage path is maintained, economic recovery will be sustained and the public's expected rate of inflation and the medium- to long-term trend inflation rate will likely increase further toward 2 percent. As a result, the actual inflation rate is projected to continue to rise, approaching the 2 percent price stability target. As illustrated, the 2 percent target will likely be achieved as the inflation rate rises in balance with a sustainable economic recovery.

It should be noted that, during the 2003–2006 period, Japan experienced the same virtuous circle as the path I have just described. During this period, the prospect of resolving banks' nonperforming-loan problem almost came into sight, and with the tailwind of recovery in overseas economies, there was progress in firms' efforts to make arrangements to resolve the "three excesses," in employment, capital stock, and debt, as well as in efforts to implement structural reforms and spend on new investment. These efforts were strongly supported from the financial side by policies implemented at that time, such as decisive monetary easing policy – namely, quantitative easing policy. Subsequently, the medium- to long-term trend inflation rate rose (charts 1–5). In short, during the 2003–2006 period, Japan experienced a virtuous circle of recovery in overseas economies, aggressive monetary easing, progress in structural reforms, a rise in the potential growth rate of the economy, and an increase in the medium- to long-term expected rate of inflation.

Looking back at price developments during that period, prices were under downward pressure, mainly from the effects of adjusting excess labor, or reducing labor costs, and the inflow of inexpensive imported goods. Consequently, prices did not rise sufficiently to overcome deflation. This time, however, strong negative shocks to prices are unlikely to occur in addition. Therefore, if the virtuous circle I mentioned earlier does indeed begin to operate, prices are likely to swing upward.

II. Monetary policy

A. Conduct of monetary policy

Let me now discuss the Bank's efforts to enhance monetary easing. At the Monetary Policy Meeting (MPM) held on April 3 and 4, 2013, the Bank decided to introduce the "quantitative and qualitative monetary easing" in order to achieve the price stability target of 2 percent in terms of the year-on-year rate of change in the CPI at the earliest possible time, with a time horizon of about two years. Specifically, the Bank's monetary easing consists of the following measures (Chart 7).

First, with a view to pursuing the quantitative monetary easing, the Bank decided to change the main operating target for money market operations from the uncollateralized overnight call rate to the monetary base. On this basis, the Bank will conduct money market operations so that the monetary base will increase at an annual pace of about 60–70 trillion yen.

Second, with a view to putting downward pressure on interest rates across the yield curve, the Bank decided to increase its purchases of Japanese government bonds (JGBs) and extend their maturity. That is, the Bank will purchase JGBs so that their amount outstanding will increase at an annual pace of about 50 trillion yen. In addition, the Bank decided that JGBs with all maturities including 40-year bonds will be made eligible for purchase, and the average remaining maturity of the Bank's JGB purchases will be extended from slightly less than three years at present to about seven years – equivalent to the average maturity of the amount outstanding of JGBs issued.

Third, with a view to lowering risk premia of asset prices, the Bank decided to purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding will increase at an annual pace of 1 trillion yen and 30 billion yen, respectively.

Fourth, the Bank decided to continue with the quantitative and qualitative monetary easing, which consists of the above measures I have just explained, with the aim of achieving the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. The Bank will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate.

Fifth, the Bank decided to terminate the Asset Purchase Program and temporarily suspend the so-called banknote principle as it implements these measures.

These measures are very drastic, and I would like to point out the main features, as follows.

First, the Bank fundamentally reconstructed the framework of monetary policy, bearing in mind the importance of clearly communicating to the markets and the public its aggressive monetary easing stance to achieve the price stability target of 2 percent. To this end, the Bank first made a clear commitment to achieving the price stability target of 2 percent at the earliest possible time, with a time horizon of about two years, and as a new framework for achieving this target, it introduced a new guideline for money market operations with the monetary base set as the main operating target.

Second, the Bank had previously been strengthening its monetary easing gradually while examining the effects of easing. This time, however, it took all possible measures that were considered necessary at present.

Third, the Bank took very drastic measures both in terms of the scale (quantity) and contents (quality) of its asset purchases. On the quantity side, the Bank will double the monetary base in two years – that is, it will conduct money market operations so that the monetary base will increase at an annual pace of about 60–70 trillion yen. The Bank will more than double the amount outstanding of its JGB holdings – an item that accounts for the largest part of the Bank's balance sheet expansion – by purchasing JGBs at a level such that their amount outstanding will increase at an annual pace of about 50 trillion yen. As a result, the Bank will be purchasing JGBs on an exceedingly large scale: the monthly flow of JGB purchases is expected to exceed 7 trillion yen on a gross basis, which is an amount equivalent to about 70 percent of the monthly average of newly issued JGBs (Chart 8). On the quality side, the Bank will more than double the average remaining maturity of JGB purchases in order to exert stronger influence on longer-term interest rates in general. In addition, it will almost double the pace of ETF purchases to further lower risk premia of asset prices (Chart 9).

It should be noted that the Bank decides and assesses at the MPMs paces of increase in the monetary base as well as JGB and ETF purchases on an annual flow basis, and if calculated on a stock basis, the monetary base and the amounts outstanding of JGBs as well as ETFs will double in two years. The ratio of the monetary base to nominal GDP is expected to increase to about 57 percent by the end of 2014. This not only stands out above the other advanced economies, but also is more than three times larger than the ratio before the Lehman shock.

The Bank is fully aware that its massive JGB purchases and provision of the monetary base far exceed market expectations. Therefore, it is vital to have the cooperation of market participants, such as counterparties' active bidding in the Bank's market operations. In this regard, the Bank has set up forums for enhanced dialogue with those market participants in order to exchange views pertaining to money market operations and market transactions more generally. As part of such attempts, it held the first meeting for the purpose of exchanging views with market participants last week.

B. Issues to be considered regarding the quantitative and qualitative monetary easing

I will next present my views on several issues regarding the quantitative and qualitative monetary easing I have just mentioned.

1. Why was the monetary policy framework changed at this time?

Ever since the price stability target of 2 percent was introduced in January 2013, I have been submitting a proposal for additional monetary easing – in the belief that it was necessary to demonstrate the Bank's firmer determination to achieve the target at the earliest possible time – stating that "The Bank, aiming to achieve the price stability target of 2 percent in terms of the year-on-year rate of change in the CPI, will continue with a virtually zero interest rate policy until it judges the achievement of the price stability target to be in sight. By doing so, as well as continuing with purchases of financial assets, the Bank will further pursue aggressive monetary easing." At the same time, I also considered it necessary to change the framework of monetary policy, mainly because of the following. First, the operational burden of the Asset Purchase Program was increased, as seen in the frequently occurring undersubscription in the Bank's fixed-rate funds-supplying operation against pooled collateral under the program. Second, if the Bank were to purchase longer-term JGBs in order to reduce such burden, this would require the consolidation of JGB purchases conducted through the program with those conducted for facilitating money market operations. Moreover, my consideration was that, if the Bank were to go so far as to change the monetary policy framework, the most effective timing would be after the installation of new leadership at the Bank. Through the discussion made at the April 3–4 MPM, I reached the conclusion that the measures for large-scale JGB purchases and their maturity extension were expected to generate stronger monetary easing effects than the proposal I had been submitting, in that they would further put strong downward pressure on the entire yield curve. Taking into account the associated costs and risks – which I will touch upon later – I voted for the introduction of the quantitative and qualitative monetary easing.

2. What kinds of transmission channels are assumed?

The assumed transmission channels under the quantitative and qualitative monetary easing are as follows. The large-scale JGB purchases will create several transmission channels: (1) a channel to influence the entire yield curve; (2) one to influence asset prices such as stock prices and real estate prices; (3) one to induce portfolio adjustments by banks and institutional investors, such as increased demand for lending and risk assets; and (4) one to exert influence on inflation expectations. These channels are closely interrelated. For example, the first channel triggers the second and third channels, while the second and third channels reinforce each other (Chart 10).[1]

The main developments that are expected to occur through the channels I have mentioned are as follows. Through the first channel, firms' and households' borrowing costs will be reduced. Through the second channel, there will be a rise in firms' capital raising and fixed investment, as well as in households' consumption and net exports. Through the third channel, there will be a shift from investment in government securities to banks' credit and investment in risk assets. Through the fourth channel, real interest rates will decrease and thereby underpin spending activity in the economy. As a result, we ultimately could expect to see positive effects transmit to developments in economic activity and prices.

3. What do we mean by "expectations"?

In relation to the transmission effects I have just described, the measures decided at the April 3–4 MPM emphasize the influence on "expectations." I will explain what these "expectations" mean. There are three types to consider.

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[1] As a derivative of the third channel, we could expect a transmission channel through an "international spillover." Specifically, as a result of international portfolio adjustments, if an inflow of funds occurs in foreign countries, such as through foreign bond investment, and revitalizes overseas economies, this would feed back as benefits to the domestic economy through a rise in demand overseas and an increase in profits of globally active firms.

The first type is expectations for future monetary policy. The measures decided at the MPM presented the prospects for paces of increase in the monetary base and JGB purchases, as well as the time frame for continuing these actions. These in turn will increase the predictability of future polices, and thereby enhance the overall effects of the transmission channels I have mentioned.

The second type is inflation expectations, which I pointed out in my earlier reference to the fourth transmission channel.

The third type is expectations for a virtuous circle. Specifically, this refers to the expectations that a virtuous circle of future sustainable economic recovery and a rise in the inflation rate will emerge, as developments through the transmission channels become visible. As I described in the first half of this speech, if the scenario of aiming to achieve 2 percent CPI inflation will gradually materialize in line with the intended path, the public will actually sense this development and raise its level of confidence regarding the economic activity and price outlooks. Consequently, spending will increase due to a rise in expectations for income increases, together with a rise in the inflation rate and inflation expectations, which will in turn underpin and strengthen the virtuous circle of the economy as a whole.

Taking account of each of these three aspects, I consider it important to influence expectations.

4. Why was the main operating target for money market operations changed to the monetary base?

Under the quantitative and qualitative monetary easing, indicators that represent the direction of overall quantity could be the monetary base, the outstanding balance of current accounts at the Bank, and the size of the Bank's balance sheet. Among them, the monetary base represents the amount of currency the Bank directly supplies – namely, the sum of banknotes in circulation and current account balances at the Bank – and is a clear concept in economics. The Bank judged it appropriate to introduce the monetary base as the main operating target for money market operations in order to communicate its policy stance clearly to the markets and the public as well as to enhance policy effects.

Generally speaking, when the "quantity," such as the monetary base, is used as a policy variable, controlling quantity could cause interest rates to fluctuate to some extent. The framework introduced at the April 3–4 MPM is highly distinctive in that it involves not only the control over the increase in the amount of currency, but also the decision on the purchases of financial assets such as JGBs and risk assets. In short, the new framework simultaneously pursues two channels: the general transmission channel triggered by low interest rates resulting from large-scale JGB purchases; and the channel exerting influence on inflation expectations by introducing control over the amount of currency. In doing so, the framework aims to convey a strong message to overcome deflation and further enhance policy effects.[2]

Let me note that, under this framework, the Bank becomes able to conduct more flexibly the operations for short-term assets, excluding JGBs and risk assets. As downward pressure will be put on the entire yield curve, interest rates with short-term maturities are likely to remain at very low levels.

5. Until when will the new monetary policy be continued?

Under the price stability target, the Bank has made a commitment to achieving 2 percent inflation at the earliest possible time. It is not the case that the price stability target is fulfilled

[2] In the United States, in the 1979-1982 period, an operating procedure of controlling monetary aggregates called "non-borrowed reserve" targeting was adopted in order to curb high inflation at that time. This measure is considered to have played a role in conveying a strong message to eliminate high inflation by going so far as to change the operating procedure with the aim of achieving the objective of addressing the issue. As a result, inflation was curbed.

once the targeted inflation is achieved at a single point in time. Rather, it is necessary to maintain the targeted level in a stable manner. Therefore, with a view to clarifying this purpose, the new framework is indicative of the Bank's commitment that it will continue with the quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. This means that, even if the inflation rate reaches 2 percent at one point, if the Bank judges it necessary to maintain that situation in a stable manner, it will continue the quantitative and qualitative monetary easing, while the opposite is also true. Having said this, I believe that the Bank decided at the April 3–4 MPM all the necessary measures to meet its commitment to achieving the 2 percent price stability target at the earliest possible time, with a time horizon of about two years.

6. Are risks and costs considerable?

It is true that the quantitative and qualitative monetary easing entails some risks. The markets may become unstable temporarily if risk-taking by some investors becomes excessive. The risks to the Bank's balance sheet will increase, and it might take considerable time to exit from the monetary easing. However, I believe that the quantitative and qualitative monetary easing is indispensable to achieving the price stability target at the earliest possible time. Taking into account Japan's current situation of protracted deflation, this measure should be pursued as long as benefits are considered to exceed costs, even if various risks are entailed.

In the course of pursuing this measure, with a view to ensuring sustainable recovery in the economy, the Bank will carefully examine risk factors such as market conditions and developments in economic activity and prices.

On this point, in the statement released on April 4, 2013, it is noted that the Bank will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate. This contains the ideas presented in the statements released after the previous MPMs and in the joint statement with the government that the Bank will ascertain whether there is any significant risk to the sustainability of economic growth, including from the accumulation of financial imbalances. The change of expression does not imply that the need to perceive risks has been reduced.

7. Is the alternative to the "banknote principle" necessary?

At the April 3–4 MPM, the Bank decided to temporarily suspend the so-called banknote principle until it achieved the price stability target. However, it is not necessary to repudiate the underlying concept of the principle that the amount of banknotes in circulation – namely, the Bank's long-term liabilities – should be backed by the purchasing of JGBs – that is, long-term assets. I understand that the Bank should resume the purchases in line with the banknote principle in the future.

In order to prevent concerns over fiscal dominance from arising following the temporary suspension of the banknote principle, it is important for the government to ensure the market credibility of its stance toward achieving fiscal consolidation. In this regard, in the joint statement by the government and the Bank released in January, it is clearly stated that, in strengthening coordination between the government and the Bank, the government would steadily promote measures aimed at establishing a sustainable fiscal structure with a view to ensuring the credibility of fiscal management. I strongly expect that such efforts will make steady progress.

8. Summary of recent policy decisions

The decisions made at the April 3–4 MPM have great significance. Under the framework of "comprehensive monetary easing," which had been adopted for the past two and a half years, the Bank had been strengthening monetary easing through various unconventional measures while examining the effects of such easing. This has contributed to underpinning Japan's economy, but the economy has failed to exit from a period of deflation.

It should be noted that, because of this experience of the comprehensive monetary easing, the Bank could decide on a new policy of the quantitative and qualitative monetary easing at the April 3–4 MPM. It is true that the decision, which includes the purchases of JGBs on such an unprecedented scale, entails a certain degree of risk, but I am sure that this will produce effects that would more than offset such a risk. The Bank will strongly pursue the quantitative and qualitative monetary easing in order to achieve the price stability target of 2 percent at the earliest possible time, with a time horizon of about two years.

At the same time, if regulatory and institutional reforms as well as economic growth policies implemented by the government make progress and the growth potential of the private sector increases, this will further enhance the effects of the quantitative and qualitative monetary easing. Initiatives in such areas are steadily being undertaken, and I have great expectations that further progress will be made.

Concluding remarks: the economy of Gifu prefecture

My concluding remarks will touch on the economy of Gifu Prefecture.

In my view, *monozukuri*, or manufacturing, has long been a prosperous and key industry in Gifu Prefecture. For example, the proportion of workers in the manufacturing sector accounts for 24.1 percent, which is the fifth highest level in Japan. The current main manufacturing industries include transportation equipment such as motor vehicle parts and aircraft, electronic parts such as integrated circuit packages, and general machinery such as machine tools as well as molds and dies. At the same time, traditional local industries prevail throughout the prefecture, including (1) knives made in Seki City, which is recognized as the hub of Japanese cutlery production; (2) *Mino* paper, one of the best known types of Japanese paper, which is famous for its quality; (3) *Mino* ceramic ware, which accounts for about half of the dishware produced in Japan; and (4) *Ichii Ittobori*, yew wood carvings characterized by a fine grain. I believe that one characteristic of the prefecture is that such traditional craftsmanship has been passed on to current manufacturing industries – for example, of fine ceramics and health food such as royal jelly.

In addition to this accumulation of traditional industries, Gifu Prefecture enjoys favorable geographical conditions. Situated in the center of Japan, it has good access in terms of transportation and distribution not only to the Tokai region, but also to the Tokyo metropolitan area and Kansai region. In recent years, an extension of the expressway network, including the Tokai-Kanjo Expressway, has further improved its accessibility. The prefecture's other strengths are its hard ground, the low risk of tsunami, and its bountiful freshwater resources. Due to such advantages, the number of new factories in the prefecture has been ranked among the highest levels in Japan, at fourth and eighth place in 2011 and 2012, respectively. Investment in distribution centers is also prominent, with signs of remarkable future progress becoming evident.

Through efforts to make use of these characteristics and advantages, as well as foster new areas with growth potential, I expect that further progress will be made in the prefecture with *monozukuri*.

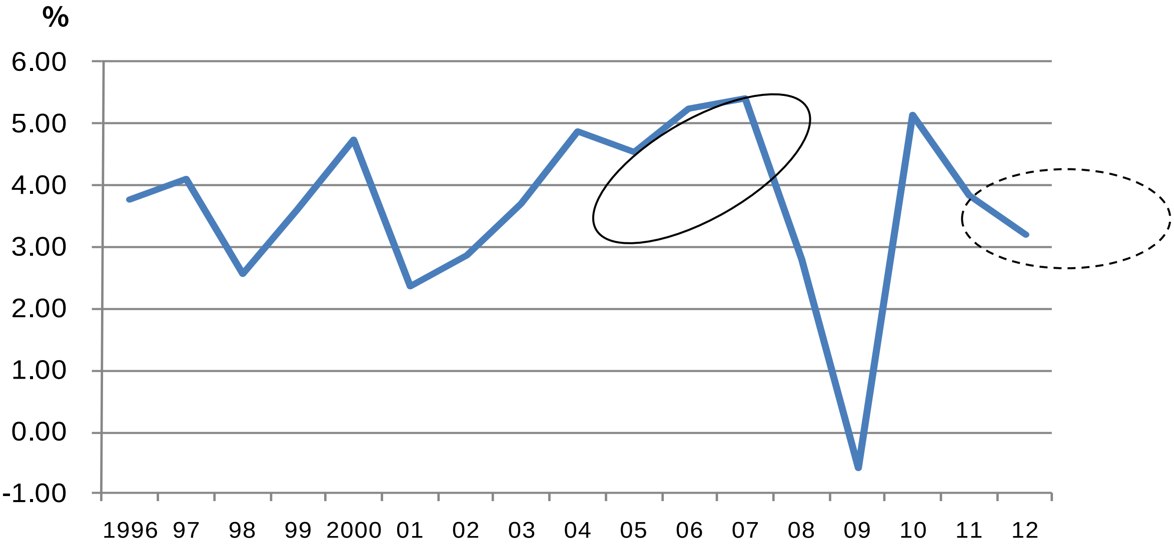
The Hida region, especially Takayama City, is well known as an international tourist destination that attracts a number of visitors not only from Japan but also overseas. This is the result of strenuous efforts made throughout the community, such as advertising campaigns overseas to invite tourists, a helpful visitor information center, informative brochures, and multilingual signposts. From 2011 to 2012, the number of tourists from abroad dropped because of the accident at the Fukushima nuclear power plant and the developments in relations between Japan and China. However, international tourists have been coming back of late. I expect that efforts to attract tourists both from Japan and overseas will further promote development of the tourist industry in the region.

The Bank will continue to provide support as much as possible as the central bank, so that efforts in each economic sector of the prefecture will pay off.

Note: Charts are based on data released prior to April 15, 2013.

(Chart 1)

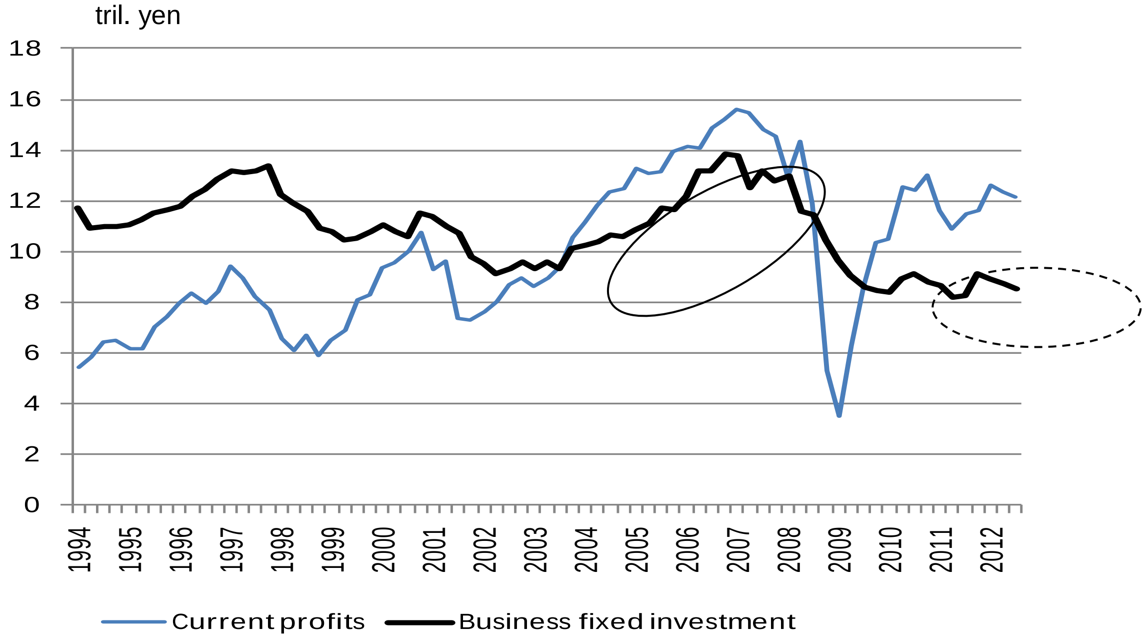
World Economic Growth Rate



Source: IMF, "World Economic Outlook."

(Chart 2)

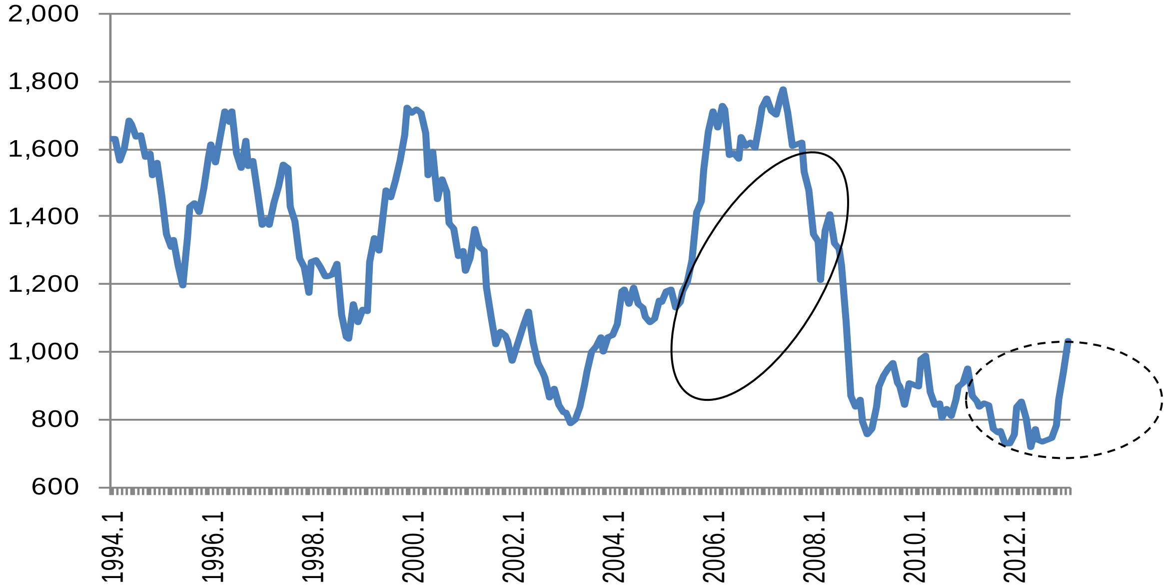
Corporate Profits and Business Fixed Investment



Source: Ministry of Finance, "Financial Statements of Corporations by Industry."

(Chart 3)

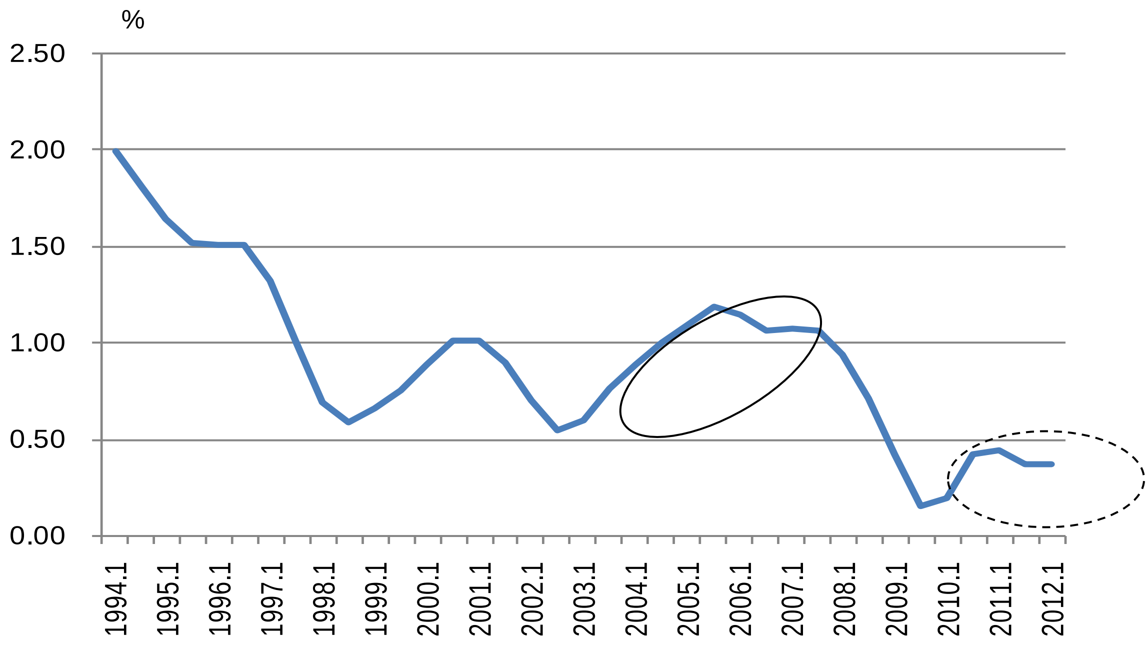
Stock Prices (TOPIX)



Source: Bloomberg.

(Chart 4)

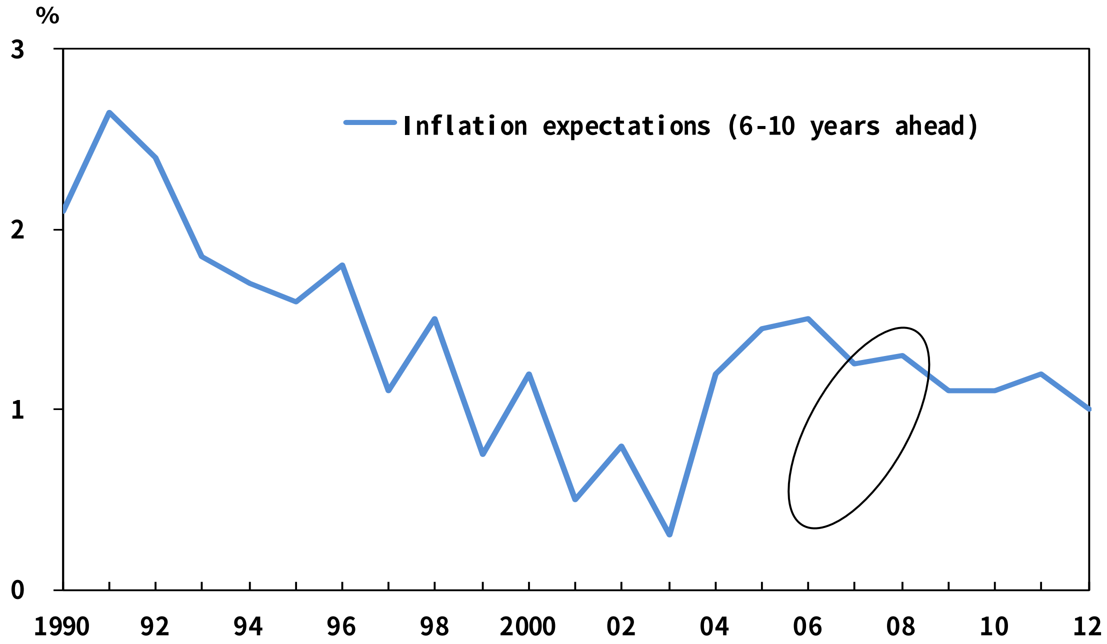
Potential Growth Rate of Japan's Economy



Source: Bank of Japan.

(Chart 5)

Medium- to Long-Term Expected Rate of Inflation



Note: Figures for inflation expectations are based on the averages of the April and October results of the Consensus Forecasts, a survey conducted on private sector forecasters.
Source: Consensus Economics Inc., "Consensus Forecasts."

(Chart 6)

Path toward Achieving the 2 Percent Inflation Target

Expected change in situation	Effects on economic activity and prices
(1) Normalization of overseas economies	→Bolster the recovery trend in Japan's exports and production
(2) Gradual increase in U.S. long-term interest rates	→Support accommodative financial conditions (asset prices and foreign exchange rates)
(3) Business fixed investment and structural reforms	→Gradual rise in the potential growth rate
(4) Expectation of sustainable economic recovery	→Gradual rise in prices with narrowing of the output gap
(5)Rise in the public's inflation expectations	→1% inflation accompanied by (1) through (4)
(6) Virtuous circle of a five-stage path	→2% inflation with the rise in the trend inflation

(Chart 7)

Quantitative and Qualitative Monetary Easing (QQE)

1. Adoption of the monetary base control

● The monetary base will increase at an annual pace of about 60-70 tril. yen.

2. Increase in JGB purchases and their maturity extension

● With a view to encouraging a further decline in interest rates across the yield curve, the Bank will purchase JGBs so that their amount outstanding will increase at an annual pace of about 50 tril. yen.

● JGBs with all maturities will be made eligible for purchase, and the average remaining maturity of the Bank's JGB purchases will be extended from slightly less than 3 years to about 7 years -- equivalent to the average maturity of the amount outstanding of JGBs issued.

3. Increase in ETF and J-REIT purchases

● With a view to lowering risk premia of asset prices, the Bank will purchase ETFs and J-REITs so that their amounts outstanding will increase at an annual pace of 1 tril. yen and 30 bil. yen, respectively.

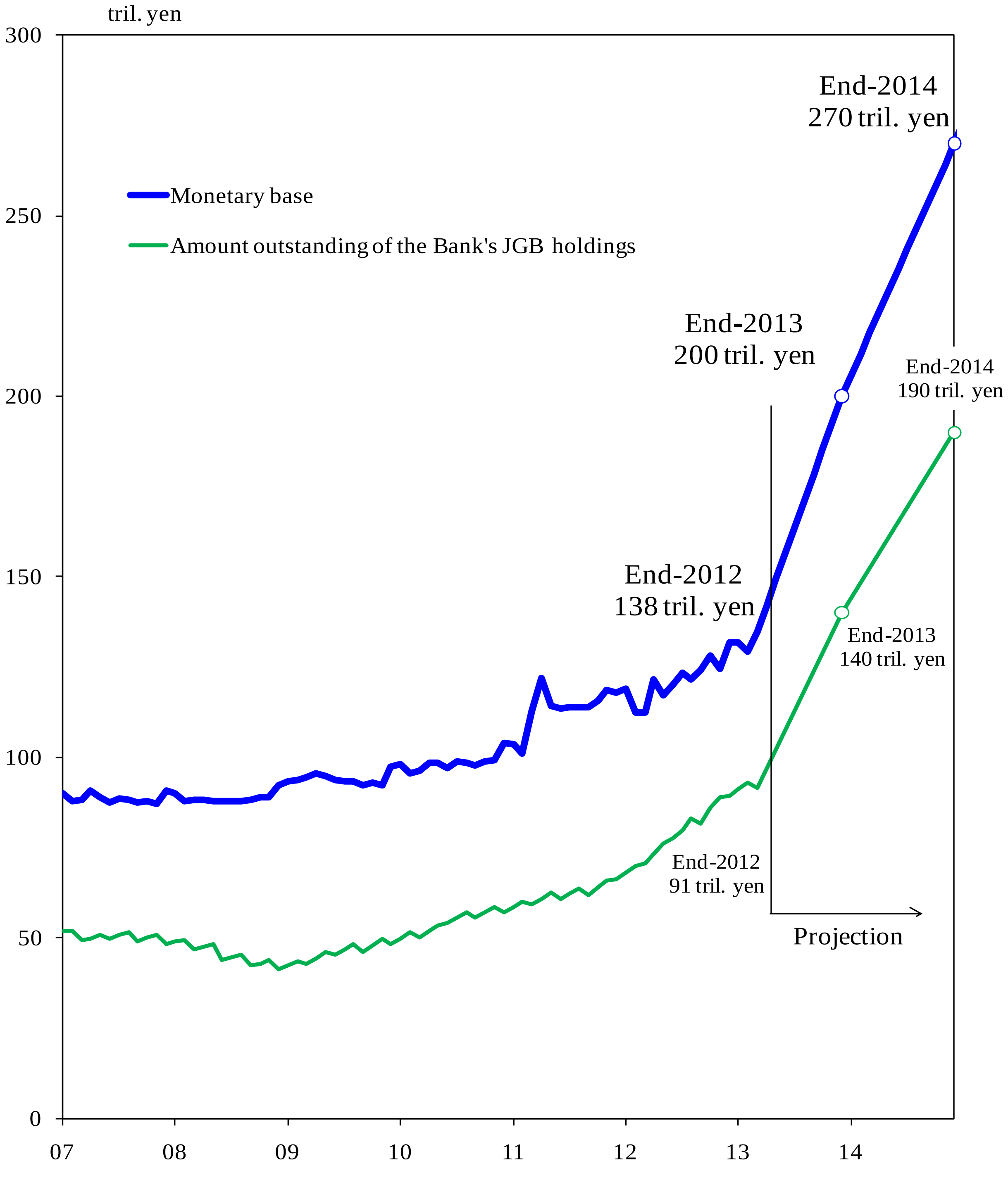
4. Continuation of the QQE

● The Bank will continue with the QQE, aiming to achieve the price stability target of 2%, as long as it is necessary for maintaining that target in a stable manner.

● The Bank will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate.

(Chart 8)

Expansion in the Monetary Base and JGB Purchases



(Chart 9)

Balance Sheet Projections

tril. yen

	End-2012 (actual)	End-2013 (projected)	End-2014 (projected)
Monetary base	138	200	270

Breakdown of the Bank's Balance Sheet

		End-2012 (actual)	End-2013 (projected)	End-2014 (projected)
	JGBs	89	140	190
	CP	2.1	2.2	2.2
	Corporate bonds	2.9	3.2	3.2
	Exchange-traded funds (ETFs)	1.5	2.5	3.5
	Japan real estate investment trusts (J-REITs)	0.11	0.14	0.17
	Loan Support Program	3.3	13	18
Total assets (including others)		158	220	290
	Banknotes	87	88	90
	Current deposits	47	107	175
Total liabilities and net assets (including others)		158	220	290

(Chart10)

Transmission Channels