Mr. Matsushita discusses recent monetary and economic conditions in Japan and comments on the Bank of Japan's monetary policy management Speech by the Governor of the Bank of Japan, Mr. Yasuo Matsushita, to the Research Institute of Japan in Tokyo on 5/11/97.

I. Introduction

It is a great honor to be invited by the Research Institute of Japan to address this distinguished audience.

It has been one year since I last attended this gathering in November 1996. Looking back at the economic developments in Japan over the past year, economic growth temporarily accelerated from the latter half of 1996 through the spring of 1997, helped to some extent by increased demand ahead of the rise in the consumption tax rate in fiscal 1997. Since April this year, however, economic growth has been decelerating partly reflecting the lingering effects of the rise in the consumption tax rate. During this period, business sentiment seems to have become more cautious. Today, I would like to give views of the Bank of Japan on the present condition of and on the outlook for the Japanese economy. I will also discuss the Bank's thinking behind its monetary policy management.

I would then like to use the remaining time to discuss the Bank's views on some of the comments and questions the Bank has been receiving recently concerning the prolonged easy money policy, by which the official discount rate has been maintained at 0.5 percent for more than two years. Through my explanation, I hope to gain your better understanding on the Bank's aims in its monetary policy management.

II. Recent Monetary and Economic Conditions and the Bank's Monetary Policy Management

A. The Present Condition of and the Outlook for the Domestic Economy

Let me first discuss the domestic economic condition. Japan's economic growth has been decelerating since April 1997 partly reflecting the impact of the rise in the consumption tax rate that took place that month. In addition to the continuing decrease in public investment since autumn 1996, household spending such as personal consumption and housing investment has also dropped significantly since April 1997. As regards personal consumption, outlays on services such as those provided by the travel industry have been increasing moderately. However, outlays on goods have remained sluggish, as indicated by the sales of automobiles and household electric appliances as well as department store and chain store sales, although there are signs of a slight recovery. In addition, housing investment in terms of housing starts has declined more recently to 1.3 million from the 1.6 million per annum level that existed until spring 1997.

Several factors are responsible for such declines in household spending. The first is the strong and persistent reaction to the significantly increased demand ahead of the rise in the consumption tax rate. The increase in sales in the consumer goods- and housing-related industries from the latter half of 1996 had been taken as a strong indication of a sustainable recovery. In hindsight, those sales in fact included a significant amount of demand for household spending that would most likely have taken place later this year had the hike in the tax rate not been scheduled. The second factor, which to some extent had been anticipated, is the slowdown in the growth of real disposable income of households -- nominal income less tax payments and income erosion due to inflation -- following the rise in the consumption tax rate and the discontinuation of the special tax reduction. In addition, it seems undeniable that consumer confidence has weakened somewhat.

This decline in household expenditure since spring 1997, which was greater than had initially been anticipated, created excess inventories in certain sectors of consumer goods- and housing-related industries. These sectors have been required to reduce excess inventories since summer 1997 and, as a result, industrial production has leveled off. These developments in household expenditure and industrial production have resulted in a more cautious business sentiment.

The question is whether these developments in household expenditure and industrial production will undermine the momentum of economic recovery, or in other words, whether the declining personal consumption and housing investment will affect other demand items such as business fixed investment, thereby placing further downside pressure on the economy. The answer lies in the current strength of the self-sustained recovery in the private sector, and this is precisely what the Bank has carefully attended to over the past two years. As this is the most important factor when judging the outlook for the economy, I would like to give the Bank’s views in some detail.

I will start off by discussing what is meant by the momentum of a self-sustained economic recovery, and then move on to the Bank’s assessment of the present force of the self-sustained recovery as compared to that in 1995, when the Bank lowered the official discount rate to 0.5 percent. Lastly, I will use these points to examine the actual developments in demand and production, and assess the outlook for the economy.

The strength of self-sustained recovery of the private sector can be considered as the strength of the cyclical force inherent in the private sector. With this force, a build up of economic activity should lead to improved business sentiment, which, in turn, should lead to increased earnings and income. The rises in earnings and income should eventually encourage sustained growth in business fixed investment and personal consumption, respectively. When the strength of the self-sustained recovery, or the momentum of this cyclical force, is very weak, there is a risk that private-sector activity might begin to decline, particularly if unable to absorb the negative impact of such exogenous factors as external demand and fiscal policy. However, when there is a reasonable measure of strength in the self-sustained recovery, the inherent force can be expected to withstand the negative impact and put the economy back on the recovery path, despite being temporarily decelerated. In this case, the negative impact is contained and the private sector’s economic outlook and investment attitude remain firm. As the pressures created by those exogenous factors subsequently subside, economic recovery should gradually become apparent.

I will now turn to my second point, that is, assessment of the strength of Japan’s self-sustained recovery. The Japanese economy began to recover in late 1993 from a recession that followed the collapse of the “bubble” economy. In early 1995, however, the recovery paused, and there were even concerns about the occurrence of a deflationary spiral. In view of these circumstances, drastic monetary and fiscal policy measures were adopted. While the halt was directly attributable to the negative effects of the rapid appreciation of the yen, it was also due to the fact that the strength of the self-sustained recovery in the private sector was yet too weak to overcome the downward pressures from outside the private sector. It is true that the economy had been on a recovery trend since late 1993. However, we at the Bank judge that because firms' profitability as well as capacity utilization had remained at a low level, the shock of a sudden appreciation of the yen applied the brakes to the economic recovery.

The important issue now is how much strength there is in the recent economic recovery in Japan. Balance-sheet adjustment and adjustment of industrial structure are still in process. This being the case, we at the Bank do not believe that the self-sustained economic recovery has gained sufficient strength. This is precisely why we have maintained the official discount rate at a low level since September 1995. In the course of the gradual economic recovery over the past two years, however, the level of economic activity has doubtlessly been rising steadily, gradually adding to the strength of the self-sustained economic recovery.

Specifically, there has been some progress in balance-sheet adjustment and industrial restructuring as corporate profits continued to increase. The manufacturing sector, especially large manufacturers, have achieved a higher than average level of profitability, although the profitability of the nonmanufacturing sector remains low. According to the results of the "*Tankan* -- Short-Term Economic Survey of Enterprises in Japan", firms feel that there have been declines in the excessiveness of production capacity and employment. This implies that while business fixed investment increased over the past two years, excessive accumulation of capital stock has been avoided. Judging from these points, the force of the self-sustained economic recovery has clearly strengthened compared to 1995, at which time there were concerns about a deflationary spiral.

Thirdly, I would like to discuss the outlook for demand, production, and income based on the aforementioned assessment of the self-sustained economic recovery.

As for final demand, personal consumption and housing investment continue to be sluggish in general and public investment is expected to follow a declining trend. Employment, however, continues to be on a trend of gradual recovery. Firms plan to increase the number of newly hired graduates in fiscal 1998 for the second consecutive year. Although the growth of the household sector's real disposable income is expected to slow, any substantial income erosion should be avoided owing to the increase in employment. Therefore, provided that there is no serious deterioration of consumer confidence, personal consumption should gradually move toward recovery as the initial impact of the rise in the consumption tax rate diminishes.

Meanwhile, net exports and business fixed investment continue to increase. Exports have increased significantly since the latter half of 1996, reflecting the depreciation of the yen until spring 1997. Imports, after having increased rapidly until mid-1996 due partly to a growth in imports from the overseas subsidiaries of Japanese manufacturers, have leveled off recently reflecting the depreciation of the yen.

Under these circumstances, the key issue for the time being is how the recent currency and financial instability in Southeast Asia will affect Japan's exports and imports and its economy as a whole. In view of the progress in the horizontal division of labor and expansion of trade and capital transactions between Japan and other Asian countries, this matter requires due attention.

If we take a look at Japan's trade with Asian countries, Japan's exports to Thailand have decreased significantly. However, there have not been any notable declines in exports to other neighboring countries. In addition, Japan's other export markets such as the United States maintain solid economic growth. On the foreign exchange market, the yen has appreciated against Southeast Asian currencies following their shift to a floating exchange rate system. However, the yen has, overall, remained in a stable range reflecting a gradual depreciation against the U.S. dollar. Thus, Japan's export environment as a whole continues to be favorable, and the currency and financial instability in Southeast Asia has, so far, not affected the fundamental trend of Japan's exports in any significant way.

In addition, Southeast Asian countries have been adopting various measures, some of which are internationally coordinated. On November 1, it was announced that the International Monetary Fund (IMF) and other international organizations have agreed on a financial package for Indonesia. In the foreign exchange markets, the monetary authorities of Japan, Singapore, and Indonesia have confirmed that they will cooperate to stabilize the Indonesian currency. The Bank of Japan strongly hopes that these and similar measures taken by other countries will soon restore monetary and financial stability in these countries and encourage a smooth economic adjustment. The Bank will continue to observe developments carefully.

With regard to business fixed investment, this is likely to continue to expand as a whole against the backdrop of sustained growth in corporate profits. Firms' projections of earnings in fiscal 1997 indicate that smaller nonmanufacturing firms anticipate a decline in profits for the first time in four years, strongly affected by a decline in public investment and in personal consumption. In the manufacturing sector, however, both large and smaller firms expect a continued rise in earnings and profits partly supported by solid export performance. In addition, large nonmanufacturing firms project sustained growth in profits following the favorable results in the manufacturing sector. Some of these profitable firms recently revised their earnings outlook downward because of the recent deceleration in domestic demand. However, on the whole, earnings and profits remain on an upward trend.

Against the backdrop of such developments in profits, overall investment plans in fiscal 1997 seem to be firm, especially in the manufacturing sector, although business fixed investment of smaller firms in the nonmanufacturing sector is expected to remain at a low level. In view of the aforementioned profit trend, the positive outlook for returns on investment, and the strong demand for information-related investment, it is fair to expect that business fixed investment will continue to increase.

As I have discussed, the Bank believes that the trend of economic recovery has not been undermined on account of gradual improvements in corporate profits, employment, and income. The Bank, therefore, expects that as personal consumption recovers, inventory adjustment will progress and the economy will resume a gradual recovery.

However, it is apparent that the virtuous circle in which increased production leads to larger income, which in turn stimulates spending, has weakened due in part to the effects of fiscal tightening. Should recovery in household expenditure be delayed, thus prolonging economic deceleration, the strength of the self-sustained economic recovery might be impaired. Bearing this possibility in mind, the Bank will watch cautiously economic developments in the coming days, including such points as the pace of recovery in personal consumption, progress in inventory adjustment, and developments in business and household confidence.

B. Recent Monetary Condition

Looking at the recent monetary condition in Japan, stock prices dropped sharply at the end of October amid a worldwide decline in stock markets triggered by the Hong Kong market. The impact on the prices seems to have subsided in the markets, however, owing to rebounds in the Southeast Asian markets.

The Bank has been informed that Sanyo Securities has decided to take legal measures to liquidate its affiliated entities, and that due to losses on credits extended to these affiliates, it has become difficult for Sanyo Securities to continue ordinary business.

On November 3, Sanyo Securities filed with the Tokyo District Court an application for the commencement of reorganization proceedings. In response to the application, the District Court has issued an asset preservation order halting the company's repayment activities, but has allowed for exceptions with regard to such activities as return of customer property. The Bank has been informed that customer property, including cash deposited by customers, will be protected and that the property will be returned swiftly with the support and cooperation of relevant parties, including the Securities Deposit Compensation Fund (a fund established for compensating customers' losses in the event of a failure of a member securities company) and the main banks of Sanyo Securities.

While the Bank regrets the failure of Sanyo Securities, the Bank acknowledges it crucial that investors be protected and the stability of the securities market be secured through the efforts of relevant parties in order to maintain confidence in the Japanese financial system at home and abroad.

If I may now turn to developments in lending by financial institutions, there have recently been views that financial institutions may have become too cautious with their lending, and this as a result may be constraining the economic activity of private businesses. I would like to briefly discuss the Bank's present views on this point.

It is true that an increasing number of financial institutions are strengthening risk management and attaching more importance to profitability in order to improve the soundness and efficiency of their management and operations. More specifically, they are revising their screening systems to assess more rigorously the creditworthiness of borrowers. They are also establishing lending rate structures that adequately reflect creditworthiness. These efforts are essential to financial institutions if they are to accommodate themselves to the ongoing financial globalization and deregulation over the long run. However, it may appear to firms that financial institutions have significantly shifted their lending attitude, or have suddenly adopted a very strict lending policy.

Having said that, financial institutions maintain a positive lending stance toward firms showing sound business performance. In fact, the *Tankan* survey indicates that while an increasing number of firms in certain sectors feel that the lending attitude has become "severe", more firms feel that the attitude remains "accommodative". The average lending rates of financial institutions have been linked to market rates at historically low levels.

In view of these circumstances, it is fair to assume that the recent slow growth in lending by financial institutions is due to weak demand for funds arising against the background of decelerating domestic demand. Therefore, the Bank considers that the lending attitude of financial institutions is, at the moment, not constraining business activity, nor militating against the economy.

The Bank will continue to monitor carefully the lending activity of financial institutions focusing on (1) whether the stance of financial institutions is reaching a point where even firms maintaining sound management find it difficult to borrow; and (2) whether squeezed lending is leading to a general rise in interest rates.

C. Monetary Policy Management

After the effects of the rise in the consumption tax rate are excluded, prices can be seen to have remained generally stable and are expected to remains so for some time.

In managing monetary policy under such a monetary and economic situation, the Bank believes it appropriate to continue to watch developments carefully with an emphasis being placed on further strengthening the foundation of the economic recovery.

III. Bank’s Thinking Behind Its Continued Easy Stance of Monetary Policy

A. The Effects of Monetary Easing

I would like to use the remaining time to discuss the Bank’s views on some of the comments and questions the Bank has been receiving in relation to the prolonged low level of interest rates.

First, there have been questions about the effects of monetary easing -- that is, although low interest rates are conducive to improving corporate profits, it seems that businesses are simply using those earnings to repay their debts, and therefore, the desired effects of stimulating economic activity, such as increasing investment, have not been achieved. Some even say that the low interest rates are only delaying the structural adjustment of the Japanese economy.

If we take a look at the actual figures of corporate profits and business fixed investment, cash flow of firms -- hat is, retained earnings plus depreciation -- increased by approximately ¥7 trillion in the two years since fiscal 1995, when the official discount rate was lowered to 0.5 percent. Business fixed investment also increased by approximately ¥7 trillion, commensurate with the growth in corporate profits. During this two-year period, the low interest rates have helped to improve the profitability of investment and to support corporate profits. Therefore, the Bank believes that low interest rates have had the effect of generating an appropriate increase in business fixed investment.

It should be noted, however, that in past phases of economic recovery, firms borrowed from financial institutions to expand their business fixed investment in addition to using their cash flow. This time, however, few firms have increased bank lending or issued bonds for this purpose. Rather, in quite a few cases, firms have used the increase in profits to repay their debt.

Thus, there has been no significant acceleration of business fixed investment when compared to past recovery phases. One factor behind this seems to be the various structural adjustment pressures that the Japanese economy faces today, notably persistent balance-sheet adjustment pressures.

As you are aware, many firms borrowed actively from financial institutions during the economic “bubble” period to engage in large-scale real-estate investment or securities investment. Following the bursting of the economic “bubble”, prices of real estate and stocks plunged. The borrowings, however, remained. Thus, on corporate balance sheets, there was a significant depreciation of assets at market value while liabilities remained unchanged. This resulted in a decrease in the net worth of firms -- that is, assets less liabilities -- and this in turn has limited the business risks that these firms can take on. Firms in this situation can rarely conduct active investment in plant and equipment that leads to the expansion of their business activity. This situation is often referred to as the “balance-sheet problem”.

When we look at the relationship between balance sheets and business fixed investment by sector and by the size of firm, large manufacturers are faced with only limited balance-sheet adjustment pressures since they did not take on large debts during the “bubble” period. These large manufacturing firms saw an early recovery in profits following the collapse of the economic “bubble”, and in fact, have been investing significant amounts in plant and equipment since fiscal 1995.

Smaller firms, however, especially those in the nonmanufacturing sector, continue to suffer heavy balance-sheet adjustment pressures, having borrowed heavily from financial institutions during the “bubble” period to invest in real estate. The ratio of financial liabilities to assets at market value of smaller nonmanufacturing firms remains at a high level. As these firms have been most strongly affected by industrial restructuring, their profits as a whole have been slow to recover. As a result, their business fixed investment has shown little signs of improvement.

Yet, it cannot be said that low interest rates have proved ineffective to alleviate firms’ balance-sheet problems. The only ways to alleviate the balance-sheet adjustment pressures is for firms to increase profits, and low interest rates have contributed broadly to improving firms’ profits. With increased profits, firms can repay borrowings and thereby recover their net worth. Also, a forecasted rise in a firm’s profits would facilitate the raising of capital by that firm. Thus, increasing profits is most effective in improving the financial strength of a firm, and the repayment of debt is an important process in allowing a firm to prepare for future business activity.

Although in the current phase of economic recovery, low interest rates have not yet triggered any significant rise in business fixed investment in the smaller nonmanufacturing firms, these rates have steadily contributed to establishing the foundation of the recovery by helping to improve firms’ financial strength. Including such indirect effects, the Bank believes that the low interest rates have in fact been firmly supporting the recovery of economic activity in the corporate sector.

I would now like to go on to another often raised question about whether low interest rates are delaying the structural adjustment. It is true that there may be firms that are managing to survive despite a deteriorating business performance, owing to lower interest rates alleviating the burden of paying interest. My view, however, is that structural adjustment of the economy is achieved not just through natural selection of firms, where those with extremely poor business performance are weeded out. Rather, I believe that it is achieved when the large number of firms with high growth potentials enhance their activities. Therefore, in order to promote structural adjustment, it is most important to pursue effective deregulation.

Monetary policy, by nature, is not aimed at promoting structural adjustment. It is to be managed in accordance with economic and price developments with the aim of achieving noninflationary, sustainable growth. However, monetary policy can realize a stable macroeconomic environment, that in turn would facilitate structural adjustment. This is because firms can confidently undergo forward-looking business transformation only when there is a stable macroeconomic environment. Also, as I have already stated, monetary easing has been contributing to the balance-sheet adjustment of firms.

The Bank believes that if interest rates were to be raised before economic activity has sufficiently firmed, it may affect not only troubled firms but also growing businesses. In view of the fundamentally weak earnings structure of venture businesses, which are expected to be the driving force of the structural reform, it can easily be imagined that an untimely raising of interest rates would make the progress of industrial restructuring even more difficult.

In other words, although monetary easing is not directly aimed at promoting structural adjustment, by providing a stable macroeconomic environment, it does support the management efforts of many firms with high growth potentials and thereby contributes to laying the foundation for structural adjustment. I very much hope to gain your understanding on the importance of this point.

B. Monetary Easing and Income Distribution

Another set of comments and questions that the Bank often receives in relation to the low level of interest rates concerns the issue of income distribution. There have been comments that low interest rates are sacrificing the household sector, or that they are aimed solely at supporting the profits of financial institutions. As I have spoken on this subject on various occasions already, I will give only a brief explanation of the Bank’s views.

Monetary easing would have the impact of reducing interest earning on deposits and bonds while lowering interest payments on mortgage loans and other liabilities. As the household sector holds a larger amount of financial assets than financial liabilities, lower interest rates would in fact to reduce the net interest income. It would not be appropriate, however, to judge the effects of monetary easing based simply on the interest income. Lower interest rates stimulate economic activity by improving returns on investment, increasing corporate profits, and supporting asset prices. This in turn leads to an increase in employment and in employees’ income to thereby bring about a favorable impact on the household sector as a whole.

In fact, in the two years since fiscal 1995, when the series of monetary easing measures was implemented, employees’ income has increased steadily, and this increase has significantly exceeded the net decrease in interest income. This implies that the monetary easing, by stimulating economic activity, has had favorable effects on the entire household sector.

In reality, there are various types of households, and the Bank is fully aware that the situation has been extremely difficult for those households that are heavily dependent on interest income. However, I would like to emphasize that monetary policy should be managed from a macroeconomic perspective for the purpose of achieving a self-sustained economic recovery. When a self-sustained recovery is realized, benefits will accrue broadly to all sectors, including the household sector.

In relation to the profits of financial institutions, monetary easing was not implemented for the purpose of increasing financial institutions' earnings and the Bank has absolutely no intention of managing monetary policy to aid financial institutions.

The misunderstanding over the Bank's intentions seems to derive from the fact that operating profits of financial institutions tend to increase when interest rates decline. For example, in fiscal 1995, when there was a sharp decline in interest rates, operating profits of financial institutions rose significantly. This is partly due to the fact that when interest rates decline, the prices of their bond-holdings rise, and therefore, their profits on sales tend to increase. It is also due to the fact that lower interest rates are reflected immediately on the liability side, whereas their effects appear more slowly on the asset side, since the average length of maturity of assets, such as loans, tends to be longer than the average length of maturity of liabilities such as deposits.

However, these effects are only temporary. For example, once the effects of lower interest rates have worked their way through, sale of bonds will no longer generate new profits. Moreover, if interest rates begin to rise, the sale of bonds will start creating losses. In addition, maturity gap between assets and liabilities will cause profits to decline from the following accounting term reflecting declines in the returns on interest-earning assets, which follow the fall in the cost of financing liabilities. In fact, the operating profits of financial institutions, after rising significantly in fiscal 1995, leveled off in fiscal 1996. In fiscal 1997, they are likely to register a substantial decline as the effects of reduced interest rates will have diminished.

In the meantime, the net interest margin of financial institutions -- that is, the differential between financing costs and investment returns -- remains at a level equal to the average since the latter half of the 1980s. In other words, the decline in deposit interest rates has not permanently widened the interest margin for financial institutions, which is only the intermediate stage in the permeation of monetary-easing effects. Rather, the decline has subsequently lead to lower lending rates. Through these channels, the effects of monetary easing have been permeating steadily through the entire Japanese economy.

As I have explained, monetary policy is not aimed at supporting financial institutions, and it is not possible to control the earnings of financial institutions by means of monetary policy over an extended period. I would once again like to emphasize that monetary policy is to be managed in accordance with the overall economic condition for the purpose of ensuring price stability.

C. Monetary Policy Management from a Medium to Long-Term Perspective

I would like to turn to a third set of comments and questions received by the Bank related to its monetary policy management. It is a question of whether the official discount rate should have been raised sometime between 1996 and early 1997, when the economy was recovering.

Monetary policy should, by its very nature, be monitored over a long period of time. In addition, I believe it is not appropriate for the Bank, which is in charge of monetary policy management, to give its own assessment casually. Today, therefore, I would like to explain the basic thinking underlying the Bank's monetary policy management, including that on the recent interest-rate policy.

The drastic monetary easing measures the Bank implemented in September 1995 -- including the lowering of the official discount rate to 0.5 percent -- was aimed at preventing the occurrence of a deflationary spiral and was intended to place the Japanese economy on a path of self-sustained recovery by strengthening corporate and household confidence in the economy. Since the beginning of 1996, the Japanese economy has recovered moderately. In the course of the recovery, the concern for a possible deflationary spiral has been gradually dispelled, and the confidence of the corporate and household sectors has been gradually regained. Looking back, it appears that the recovery in early 1996 was supported significantly by the series of monetary easing measures and government economic packages adopted in autumn 1995. It also cannot be denied that the growth rate from the second half of 1996 through spring 1997 was boosted by a significant step-up in demand ahead of the rise in the consumption tax rate. Under these circumstances, it was too soon to conclude that the private sector had gained sufficient strength to achieve a self-sustained recovery on its own while dealing with the impact of fiscal tightening. If the monetary support were to have been discontinued before the economy had gained adequate strength, it would have become more difficult to attain a self-sustained recovery. This is precisely why the Bank has maintained its easy stance of monetary policy since September 1995.

In connection with the Bank's current stance of monetary policy management, I would like to mention another important point. The Bank aims to achieve price stability and thereby noninflationary, sustainable economic growth over a medium to long term. Accordingly, it is necessary to predict economic developments and to take fully into consideration the time required for monetary policy effects to spread throughout the economy when managing monetary policy. Were we to implement monetary policy merely to respond to the immediate economic condition, it may only amplify economic fluctuations.

For example, when the Bank takes monetary policy measures in response to immediate improvements in economic activity, this action could carry two conceivable risks. The first is the risk that at the time the economic upturn is confirmed, prices may already have started to rise. Considering the time necessary for monetary policy effects to permeate throughout the economy, the central bank must act more pre-emptively, as it is too late to take action after price rises have been confirmed. The other is the risk that the strength of recovery is insufficient although economic activity may have started to improve. Monetary tightening under such circumstances may impair the force of recovery that had at last started to grow. In other words, monetary tightening at this time will be premature.

Thus, it is extremely important that monetary policy be managed from a medium to long-term perspective. With this in mind, the Bank, in its management of monetary policy, has emphasized accurate prediction of economic and price developments rather than the economic condition at the time. Further, in accurately predicting these developments, the Bank has focused on the strength of the self-sustained recovery in the private sector.

This does not mean, however, that the Bank is not carefully monitoring the potential risks arising from the prolonged easing of monetary policy. It is particularly important for the Bank to constantly verify that the low interest rates are not expanding the potential risk of inflation. In the past, there were times when the effects of monetary easing amplified rapidly, increasing abruptly the risk of inflation. In view of the time needed for monetary policy effects to permeate, the task of assessing potential risk cannot be neglected.

As I stated earlier, the Bank judges that there is no large risk of inflation at the moment. We at the Bank continue to seek appropriate policy decisions from a medium to long-term perspective by accurately identifying the risk of price movements.

IV. Conclusion

I very much hope that my discussion today has helped you understand the key points in the Bank's monetary policy management. The Bank will continue to make the utmost effort to manage monetary policy properly to achieve price stability.

If I may add to what I have said with regard to the monetary and economic conditions in Japan, the Bank believes it is important to strengthen corporate and household confidence in the economy in order to gain a clearer outlook for economic recovery. The recent cautious business sentiment seems to reflect the concerns held by firms over the ongoing structural adjustment, the completion of which is taking longer than expected. This being the case, I believe the important challenge for the Japanese economy continues to be the implementation of structural measures including deregulation and liquidation of real estate.