

## **Yutaka Yamaguchi: Thinking behind current monetary policy**

Speech by Mr Yutaka Yamaguchi, Deputy Governor of the Bank of Japan, at the Japan National Press Club, Tokyo, on 4 August 2000.

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I am honored to be invited today to the Japan National Press Club. I once heard a joke that a central banker can deliver a speech to members of this esteemed Club, who are well known for their barrage of sharp questions, only when the economy is performing satisfactorily and he is confident enough to answer any questions. I am here today, not because this is the case, but because I think it is a good opportunity to elaborate on our thinking behind current monetary policy and ask for your comments. The main purpose of my remarks today is to present an overview of the zero interest rate policy by reviewing various discussions at past monetary policy meetings with respect to the termination of the zero interest rate policy.

### **I. Economic developments after the zero interest rate policy was adopted**

Let me begin by briefly explaining what the zero interest rate policy is. It was in February 1999 that the Bank of Japan effected the zero interest rate policy. At the time, Japan's economy was on the verge of falling into a deflationary spiral which was a vicious circle combining price declines and economic recession. In response, the Bank of Japan decided to guide the short-term interest rate, specifically the uncollateralized overnight call rate, down to virtually zero by flexibly providing ample funds to the money market. Then, in April 1999, the Bank decided to continue the zero interest rate policy until such time it could be ascertained deflationary concern had been dispelled. Chart 1 shows the development of market interest rates since April 1999. To the best of my knowledge, I cannot think of any precedents in financial history, either at home or abroad, where a central bank has guided short-term interest rates down to virtually zero and maintained that level for a long period. Short-term interest rates are the key variable in the transmission mechanism of monetary policy and a central bank influences them by controlling reserves in the money market, thereby affecting various aspects of the overall economy. Thus, guiding short-term interest rates down to virtually zero means that the central bank has used its traditional policy tool to the maximum extent possible.

A variety of economic indicators suggest that Japan's economy is on a recovery path, albeit moderate. Chart 2 compares recent economic conditions with those in February 1999. For example, the year-on-year growth rate of real GDP increased from minus 0.4% in the first quarter of 1999 to plus 0.7% in the same quarter of 2000, and industrial production growth rose from minus 3.8% in the first quarter of 1999 to plus 7% in the second quarter of 2000. Business sentiment in terms of the Tankan diffusion index for all industries and sizes of firms has substantially improved from minus 44 in March 1999 to minus 18 in June 2000. And, the consensus forecast of the private sector for real GDP growth for this fiscal year has been revised upward from 0.8% at the beginning of this year to 1.5% recently. Moreover, June's Tankan survey showed that corporate profits were expected to mark a double-digit increase for two consecutive years in fiscal 1999 and 2000. While inflation in terms of WPI is slightly above the previous year's level, that in terms of CPI is slightly below.

There are a number of factors responsible for the moderate economic recovery. First and foremost is the implementation of several important policy measures to restore financial system stability. Public funds were injected into major banks to strengthen their capital base and a legal framework was established to speed up the bankruptcy process. Under such circumstances, financial institutions themselves are striving to reconstruct their management. The second factor is support from macroeconomic policy, which includes both fiscal policy of the government and the zero interest rate policy of the Bank of Japan. The third factor is the upturn of overseas economies. In addition to the expansion in the United States and Europe, Asian economies have been recovering rapidly after overcoming currency and financial crises. The fourth factor is the boom in the high-tech and IT-related

business areas. Whether trends like the IT revolution witnessed in the United States will spread to Japan depends on how firms and individuals as users take advantage of information technology. Japanese producers related to high-tech business have swiftly responded to the rapid increase in demand both at home and abroad, and an increasing number of them have been expanding investment reflecting the tightening supply and demand conditions.

It is natural that economic recovery leads to the question of whether the zero interest rate policy should be terminated. As I mentioned, the Bank of Japan announced in April 1999 that it would continue the zero interest rate policy until deflationary concern had been dispelled. Discussions at subsequent monetary policy meetings have disclosed that such deflationary concern would be dispelled if we became confident that economic recovery was led by private demand. As has been described in the minutes of these meetings, members of the Policy Board have closely examined economic and financial conditions to determine whether deflationary concern has been dispelled. Though the minutes of the 17 July meeting are yet to be released, the statement issued immediately after the meeting in Chart 3 said that the majority of the Policy Board considered that Japan's economy was approaching a stage where deflationary concern might be dispelled. However, it also said that some views were expressed that before reaching a final decision to lift the zero interest rate policy, it was desirable to ensure the firmness of economic conditions including employment and household income. Moreover, it was pointed out that the Board needed to ascertain how the so-called Sogo problem would affect market sentiment.

## **II. Points at issue relating to the termination of the zero interest rate policy**

As you know, there are arguments for and against the termination of the zero interest rate policy as evidenced in newspaper editorials of recent months as well as the opinions of business leaders, economists, and market participants. Such a division of opinions is usually the case every time the question of raising interest rates is brought up after a period of prolonged monetary easing. In May 1989 when interest rates were last raised in the midst of the bubble economy, very few articles in newspapers and magazines had supported it before the raise. Needless to say, at past monetary policy meetings, we have carefully examined various points related to the pros and cons of lifting the zero interest rate policy. Let me now discuss some of the important points at issue.

### ***Is private consumption recovering?***

The first point is whether or not we can conclude that the economy as a whole has fully recovered while a recovery of private consumption has yet to be confirmed. Indeed, the current economic recovery has been driven mainly by an improvement in the corporate sector. While June's Tankan survey shows that the ratio of current profits to sales in the manufacturing industry for fiscal 2000 is expected to recover to 4.01%, which is slightly higher than the average of 3.84% since fiscal 1980, the recovery of the household sector has been delayed. The underlying trend of private consumption is determined by consumer sentiment and employee income. While consumer sentiment has been improving against such a background as receding concerns over financial system stability and stock prices, employee income has only very recently stopped declining. Thus, we cannot yet confirm a recovery of private consumption as a whole.

Nevertheless, if we look more broadly at the situation Japan's economy faces including such big challenges as the balance sheet adjustment of the corporate sector and the transformation of industrial structure, in the current recovery process we consider it quite logical that an improvement in the corporate sector precedes that in the household sector. In Chart 4, labor's share of income has shown a significant increase, which on the other hand means a substantial decrease in return on capital since the bursting of the bubble. Needless to say, capital is an important factor of production supporting economic development. If capital cannot generate sufficient returns for a long period, it will become difficult for firms to raise capital. In such a case, firms cannot help but improve return on capital by reducing various costs including labor. The need to improve return on capital has become especially pressing for firms directly exposed to pressure from the global financial market. In other words,

restructuring of the corporate sector is a prerequisite for sustainable growth of the overall economy including the household sector.

In view of the need to improve return on capital, it is unlikely that household income and private consumption will significantly increase for the time being. Of course, if labor's share of income declines substantially, the resultant stagnation of private consumption will hamper the recovery of the overall economy. Therefore, a delicate balancing of income distribution is the key to a full-fledged economic recovery. In this regard, though the number of employees is still below that of a year ago, supply and demand conditions in the labor market have somewhat tightened as evidenced by the increase in job offers. Wages, which had been decreasing for the past two to three years, have this year increased on a year-on-year basis.

We sometimes discuss the relation between corporate profits and household income metaphorically likening it to the relation between the water level in a dam and the release of water from it. If we can clearly observe the rise in the water level, which signifies increasing corporate profits, the probability that water will be released from the dam rises, leading to an increase in household income and then an increase in private consumption. However, since it is not easy and takes time for firms to raise return on capital and improve their balance sheets, the release of water from the dam cannot increase significantly. Yet I think that if household income recovers even moderately, there is a higher probability that the economy will return to a growth path led by business fixed investment. If I may interpret the thinking of members of the Policy Board behind the statement of 17 July, the majority would like to confirm with more confidence that such a mechanism is at work.

### *Are prices declining?*

The second point is whether or not it can be maintained that deflationary concerns have been truly dispelled when CPI and the GDP deflator are still falling. As Chart 5 shows, these price indexes are declining while WPI has recently begun to exceed the prior-year level. Such movements in CPI and the GDP deflator may provoke an argument that not only has deflationary concern not been dispelled, but that the economy is actually in a deflationary state. The reason we are afraid of deflation is because once the economy falls into a deflationary spiral, which is a vicious circle where price declines depress economic activity in turn leading to downward pressure on prices, it is very difficult to escape from it. To avoid such a situation, in February 1999 the Bank adopted the zero interest rate policy, which was a drastic monetary easing measure. All this shows that how to interpret the decline in CPI and the GDP deflator is an important issue and we have been carefully examining it.

A close look at the movement of price statistics may not always lead to a full understanding of what price changes indicate. This is because various price indexes often move in different directions or temporarily their movement does not appear consistent with the movement of other economic indicators. For example, take the latter half of 1988, which is the peak of the bubble period. While the economy was strong, measured prices were extremely stable. Another example is 1991, immediately after the bursting of the bubble. Notwithstanding the fact that the economy entered a serious recession, inflation marked a peak. Furthermore, in 1996 while the GDP deflator traced its largest decline of the 1990s, GDP growth recorded its highest figure in the post-bubble period. These examples underscore the importance of assessing the movement of price indexes in relation to the overall economic situation. The current decline in CPI is partly attributable to such structural changes as those in the distribution system in addition to the past appreciation of the yen and the falling prices of consumer durables. It is also due to the decrease in unit labor cost, which is often observed in the early stage of economic recovery. In the early stage of recovery, productivity rises as idle resources are brought back into use, unit labor cost declines, and then downward pressure on prices is seen. The phenomenon of the decline in labor costs and prices coupled with higher growth was observed in 1987 and 1996. It appears that the factors behind this phenomenon have been partly responsible for the recent decline in prices, particularly in the GDP deflator.

On the other hand, it may be possible to argue that any price declines would eventually lead to the danger of the economy falling into a deflationary spiral. However, if the recent decline in CPI had entailed danger of a deflationary spiral, corporate profits would have declined leading to a decrease in

business fixed investment and employment, whereas, in fact, we have observed increases in both corporate profits and business fixed investment. Moreover, such a danger would have adversely influenced the labor market through the supply and demand of goods and services, but, as a matter of fact, wages have stopped declining. To sum up, I do not think it appropriate to judge whether or not the economy might fall into a deflationary spiral simply by looking at the decline in CPI and the GDP deflator alone.

Based on such argument, the Policy Board has closely monitored and examined the deterioration in the supply and demand balance, and the risk of price declines stemming from weak demand. Conceptually, the supply and demand balance in Japan's economy as a whole could be described by such indicators as the output gap. The problem is that it is difficult to accurately estimate the output gap. The difficulty is common to many industrial countries, and the main reason is that the speed of technological innovation has become so fast that it is not easy to measure the economic value of capital. As a result, we face a situation where the estimated output gap cannot explain the fluctuation in prices. For example, in 1998 and 1999, calculations based on traditional models produced large output gap estimates, and not a few economists thus forecast considerable price declines. The actual price decline, however, was not so large as the forecast. On the other hand, the supply and demand balance perceived by firms reported in the Tankan survey has greatly improved during the past year. These observations suggest that in order to grasp the change in the supply and demand balance, we should not only apply the estimated output gap deduced from conventional methodology but also make full use of the information regarding the supply and demand balance for individual goods and services.

Let me summarize my view. First, it is very difficult to accurately estimate the output gap, which is the degree of excess supply in macroeconomic terms. Second, it is likely that the potential growth rate has recently declined substantially as a result of stagnant investment over the past ten years. Thus, even if aggregate demand only grows moderately for one to two years, the supply and demand balance should improve, which is indeed evidenced by economic developments since last year. Third, whether the output gap continues to narrow depends on prospects for economic recovery led by private demand. If we become confident of such a recovery, moderate declines in some price indexes should not necessarily be interpreted as a supply and demand imbalance or manifestation of the risk of a deflationary spiral.

### ***Excessive corporate debt and the financial system problem***

The third point is whether or not the economy will exhibit a robust recovery in a situation where firms are burdened with excessive debt and banks still hold a large amount of non-performing assets. Indeed, one of the major factors behind the sluggishness of Japan's economy during the 1990s was balance sheet adjustment at firms and banks. We fully recognize the gravity of the excessive debt held by firms, especially those in the construction, real estate, and distribution industries, not to mention the non-performing assets held by banks. In fact, we experienced a serious financial system crisis in 1997 and 1998 characterized by a large-scale credit crunch and the financial sector exerting strong downward pressure on economic activity. Thus, it is extremely important to incorporate the assessment of financial system into economic outlooks. This is one reason we believe that the economic recovery is more likely to be moderate rather than robust.

It is also true that financial system stability has been significantly restored as a result of the injection of capital into major banks in March 1999. With improved creditworthiness and receding concern over liquidity, banks are once again competing to win good customers. According to the Tankan survey, firms have reported a gradual relaxation in the lending attitude of banks. While we may be far from a situation where many banks aggressively assume credit risk with appropriate risk control systems in place and strongly support economic growth, we are not in a situation where the lending attitude of banks is so cautious that it would hamper economic recovery. Therefore, while there remain industries and firms burdened with excessive debt, I think it possible to expect a recovery, though not as speedy as in previous recoveries, of the overall economy as momentum for new growth intensifies reflecting the progress of technological innovation.

Another reason we care about the debt problem is that when large firms like Sogo collapse, the market sometimes becomes extremely nervous. It should be noted that the impact of a shock differs from case to case. For example, the case of Sogo is special in that its reconstruction framework was suddenly changed. In any event, if there are no problems in the financial system, the collapse of an individual firm is likely to be perceived as an isolated case. At the moment, we need to closely monitor whether there is the risk that the market may suddenly turn nervous, and this is, in my view, one of the factors that should be rightly taken into account in the conduct of monetary policy.

### ***The relationship between structural adjustment and monetary policy***

Since the release of the statement on 17 July, there have been various comments to the effect that the Bank of Japan should continue the zero interest rate policy until concern of large-scale bankruptcies disappears and structural adjustment is completed. There have also been comments to the contrary, namely, that the continuation of the zero interest rate policy is delaying the progress of structural adjustment. This brings me to my fourth point relating to the termination of the zero interest rate policy, the relationship between it and structural adjustment.

Regarding the view that the Bank should continue the zero interest rate policy until structural adjustment is completed, we do not think this necessary. In discussing this, we need to distinguish between the potential growth rate and the cyclical and short-term growth rate of Japan's economy. In recent years, it is often said that the potential growth rate of the US economy has been boosted by the IT revolution. But it should be pointed out that it took a long time before IT was applied to business and resulted in improved productivity. Similarly, it will take a long time before structural reform promoted by Japanese firms leads to improved productivity and higher potential growth. Here, it should be noted that various forces other than structural adjustment influence the economy. And hence, even if the potential growth rate is low, the economy will be able to grow strongly with the cyclical growth rate exceeding the potential growth rate. This, I think, is the business cycle.

To deal with the decline in potential growth stemming from structural factors, a policy targeted to solve structural problems and firms' own efforts for restructuring are indispensable. There is no other way. In short, monetary policy cannot replace structural policy.

Let me now turn to the contrary comments that the zero interest rate policy has been holding back structural adjustment. We also hear related comments that the zero interest rate policy has been generating various kinds of moral hazard, both socially and economically. It is true that the zero interest rate policy, which provides the market with ample funds to guide the overnight rate to virtually zero, could create a situation where banks and firms have become less sensitive to borrowing costs and liquidity risks. Indeed, it is through this effect that the policy supports economic recovery and promotes structural reform. At the same time, it cannot be denied that the policy may tend to delay structural reform by making economic agents with a large amount of debt less conscious of borrowing costs and liquidity risks. Of course, I do not think it appropriate to lift the zero interest rate policy to prevent moral hazard. Let me make it clear that the termination of the zero interest rate policy depends on whether we can be confident that the economic recovery is being primarily led by private demand.

### ***Is the termination of the zero interest rate policy consistent with fiscal policy?***

The fifth point is the relation between the termination of the zero interest rate policy and the government's fiscal policy stance. Some argue that a stimulus from the monetary policy side is essential and it is premature to terminate the zero interest rate policy because no further stimulus from fiscal policy can be expected considering the significant deterioration in the government's fiscal position. Others argue that, when the government formulates a supplementary budget to stimulate the economy, fiscal policy aimed at achieving an economic recovery led by private demand and the Bank's monetary policy should be harmonized.

Of course, the Bank of Japan never ignores the government's fiscal policy stance when conducting monetary policy. As I have reiterated many times, we will not terminate the zero interest rate policy unless we feel confident that the economic recovery is led by private demand. Chart 6 shows the

contribution of private demand and government expenditure to the year-on-year growth of real GDP, which indicates that the driving force behind the economy has steadily shifted from government expenditure to private demand, and the GDP growth rate has been gradually rising. The Bank of Japan will terminate the zero interest rate policy only when it feels confident that an economic recovery led by private demand is in prospect, and I believe this is consistent with what the government is aiming at.

### ***Impairing the proper functioning of the market mechanism***

The sixth point relates to the functioning of the market mechanism. There is a view that the proper functioning of the financial market has been impaired by the zero interest rate policy and that it should be restored by terminating the policy. In fact, we too were worried about the impairment of market functions when adopting the unprecedented zero interest rate policy in February 1999. Therefore, we took a cautious approach in guiding the overnight call rate to zero by confirming the proper functioning of the market mechanism on the way. In retrospect, it is my tentative assessment at this point in time that the impairment of market functions turned out to be smaller than anticipated. The overnight call rate is not exactly zero percent, though as close to zero as can be, and long-term interest rates are above zero. Under such a configuration of interest rates, the market mechanism is functioning.

The contraction of the call market is often cited as an example to evidence impairment of the market mechanism. This reflects the fact that, as the interest rate on ordinary deposits has been higher than the call rate, investors have transferred funds from the call market to ordinary deposits. Under such circumstances, a sudden withdrawal of funds by investors from ordinary deposits would cause instability in the liquidity position of banks which have received these deposits, and might eventually influence the formation of the overnight call rate. However, this problem cannot be a decisive factor in determining whether to terminate the zero interest rate policy.

### ***Interest income of pensioners***

The seventh and last point is the fact that the zero interest rate policy is having a negative effect on economic agents who largely depend on interest income, such as pensioners. Obviously interest income from financial assets has fallen significantly under the zero interest rate policy, and we are well aware of the fact that the policy is adversely affecting households that depend heavily on interest income. The elderly hold a relatively large amount of financial assets as evidenced by the fact that about half of the total financial assets of individuals is held by those aged 60 and over, and whose earned income is not much. As a result, the elderly are most affected as low interest rates have continued for a long period, and we sympathize with their situation.

However, let me emphasize that raising interest rates would not solve the problem. Households can earn interest income from their deposits because banks obtain interest income on their loans. In other words, the source of interest income received is economic growth, and interest income will not be generated if the economy does not grow. Viewed from a different angle, economic growth and increased employment opportunities would ensure the stability of household income. Household income primarily consists of employee income, which accounts for more than 70% of national income. By reviewing these facts, I hope you will understand the imminent need to achieve a sustainable economic recovery led by private demand.

### **III. Monetary policy under uncertainty**

So far I have presented the majority view of the Policy Board on issues related to the termination of the zero interest rate policy. The Bank of Japan has recently stated that Japan's economy is coming to a stage where the condition for lifting the zero interest rate policy is being met. However, since there are no inflationary risks, some argue that termination of the zero interest rate policy is unnecessary, besides which the risks involved in termination are unknown. We have been discussing the conduct of monetary policy, always bearing in mind the risks of both termination and continuation of the zero

interest rate policy. The difficulty inherent in the conduct of monetary policy stems from the fact that a clear decision, whether or not to change interest rates, has to be made under uncertainty with inherently limited information on the outlook and the mechanism of the economy.

Among various metaphors about the central bank, I remember one that says a central bank is like a driver on a winding road with a misted up windshield and rearview mirrors and an inaccurate speedometer. I think this well describes the essence of some of the difficulties that central banks face in conducting monetary policy. The economic outlook corresponds to the misted up windshield, and the limitation of economic statistics to the rearview mirrors and inaccurate speedometer. And the various risks that the economy faces correspond to the winding road. A central bank driving a car under such conditions has to stay alert to anticipated risks while making use of the lessons obtained from past experiences. With this comment as an introduction, let me present my personal view on the meaning of discussing the termination of the zero interest rate policy at a time when we do not observe any imminent risk of inflation.

We often hear the argument that monetary policy should be changed only when the risk of inflation becomes evident. At first glance this argument appears reasonable since the target for monetary policy is price stability. As a matter of fact, in the bubble period of the late 1980s, the conduct of monetary policy was based on this argument. From 1986 through 1988, the economy grew at an annual rate of 5%, asset prices soared, and the general price level was extremely stable. Under such circumstances, the Bank of Japan could not find an opportunity to preemptively correct the low interest rate policy at the time. It was only in May 1989 when inflationary pressure became obvious to everybody that the Bank could raise the official discount rate. Since history never exactly repeats itself, we cannot claim that we have fully experienced all the various situations when monetary policy might be changed once inflationary pressure becomes evident. It should also be pointed out that today's situation, which is heavily burdened with the aftermath of the bursting of the bubble, is vastly different from the situation during the bubble period. With these caveats, we should ask ourselves what are the lessons learned from the experience of the late 1980s in today's context? Let me mention two points.

First, the policy change in response to a clear and present risk of inflation would inevitably be monetary tightening, and, moreover, cumulative interest rate hikes would probably be needed as was the case in 1989 and 1990. In view of the very high amount of government bonds outstanding, for example compared with the late 1980s, the capital loss on these government bonds caused by higher interest rates would, other things being equal, pose much larger problems for the economy. We must thus avoid, to the extent possible, monetary policy that forces the central bank to raise interest rates rapidly and substantially at a later stage because it could destabilize the economy and the financial system.

Second, if the zero interest rate policy continues for a long period even after the economy clearly recovers, more economic agents will tend to conduct activities based on the expectation that current extremely low interest rates will be sustained indefinitely. This is what happened in the bubble period, leading to an enormous waste of resources which continues to inflict pain on us today. I do not at all advocate a higher probability that a similar situation would occur on a similar scale. What I would like to mention is that the current situation of financial markets, where, for example, the premium on credit risk is suppressed by the liquidity effect of the zero interest rate policy, could include the potential risk of creating the misallocation of resources.

Then, when is appropriate timing for adjusting interest rates before inflation risk becomes a matter of concern? If we can come up with a perfectly accurate economic outlook as well as the time needed for the policy effect to permeate the economy, we should conduct farsighted and preemptive policy at the right time on an appropriate scale. This is always an ideal vision for central banks. In fact, the Bank of Japan has been making efforts to accurately analyze the past, present, and future economy. Though we make policy judgments based on these analyses, admittedly we conduct monetary policy under great uncertainty with limited second sight as well as imperfect data and information just like the metaphor of the car driver. This is a brutal fact that central banks all over the world, including the Bank of Japan, must face.

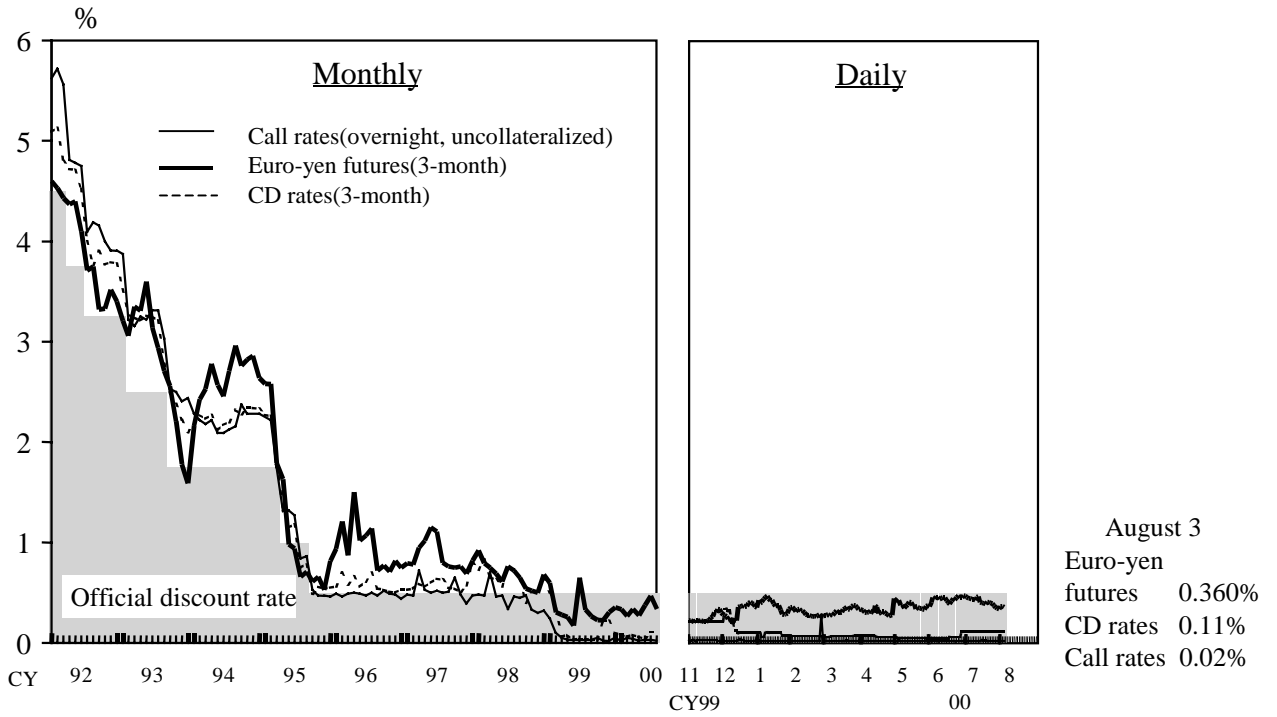
There are central banks that visibly incorporate this uncertainty into the modus operandi of the conduct of monetary policy. For example, the Bank of England forecasts inflation, not by a single figure, but by a probability distribution. We can thus easily understand how great uncertainty is in predicting, for example, the growth rate and inflation for 2002. If we have to humbly accept such uncertainty even after we try our utmost to make accurate economic forecasts, one useful approach might be to confirm the degree of economic improvement and adjust monetary easing accordingly in order to realize sustainable growth. As a digression, the Taylor Rule, the most well known of policy rule theories, attracts attention internationally and is actively studied. This Rule advocates the smooth adjustment of interest rates while paying attention to the output gap and fluctuation in prices, which seems to be based on a similar policy philosophy to what I have just described.

A hundred and eighteen years have passed since the Bank of Japan was established. And, yet, it is also a “young” central bank as it was reborn two years ago under the new Bank of Japan Law, and thus no track record has yet been established. I believe a good track record will be won by calmly evaluating economic and financial conditions, fully explaining decisions and implementing them, and giving due consideration to constructive criticism from those who know the importance of having a central bank which can be trusted.

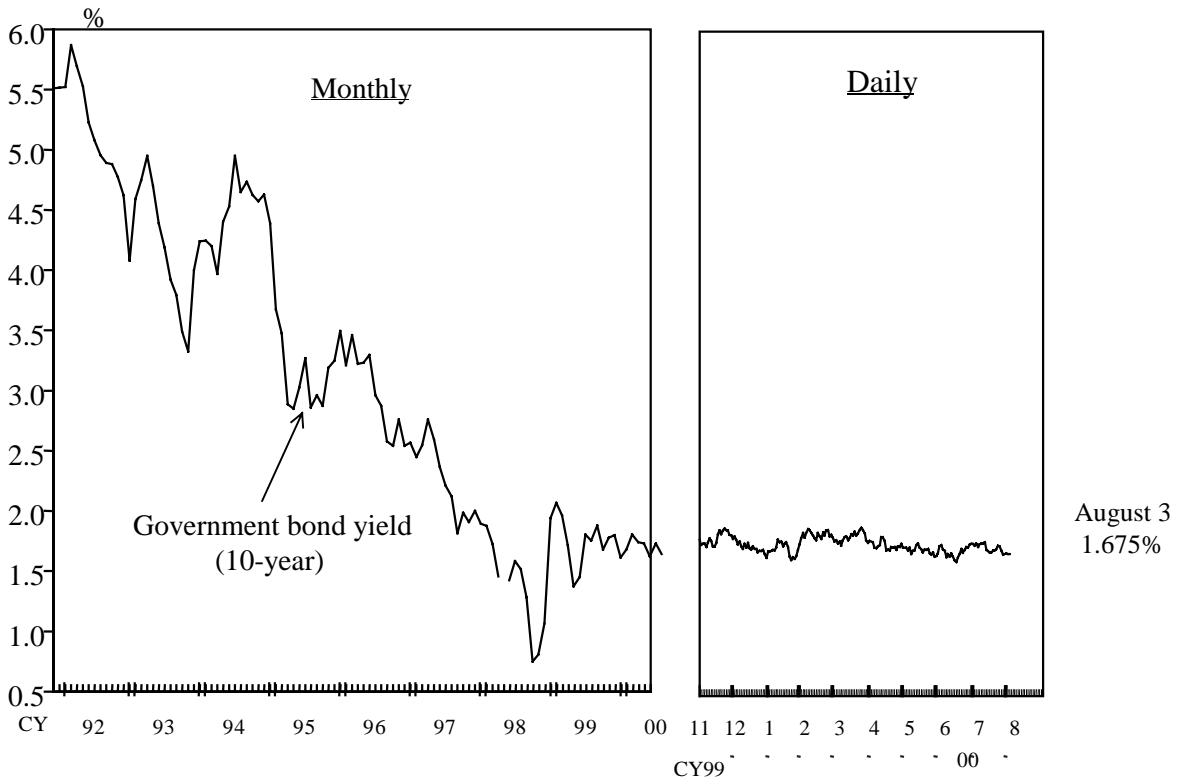


Chart 1  
Interest rates

(1) Short-Term



(2) Long-Term



Sources: Bank of Japan; Tokyo International Financial Futures Exchange;  
Japan Bond Trading Co., Ltd.

Chart 2  
Economic developments

	Around Feb. 1999		Recent
• <b>Real GDP</b> (changes from a year earlier)	-0.4% (1999/Q1)	→	+0.7% (2000/Q1)
• <b>Domestic Private Demand</b> (changes from a year earlier)	-2.0% (1999/Q1)	→	+2.1% (2000/Q1)
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• <b>Industrial Production</b> (changes from a year earlier)	-3.8% (1999/Q1)	→	+7.0% (2000/Q2)
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• <b>Business Conditions (<i>Tankan</i>)</b> (DI; "favorable"-“unfavorable”)	-44 (1999/Mar.)	→	-18 (2000/Jun.)
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• <b>Domestic Wholesale Price Index</b> (changes from a year earlier)	-2.1% (1999/Q1)	→	+0.3% (2000/Q2)
• <b>Consumer Price Index</b> (excluding perishables, changes from a year earlier)	-0.1% (1999/Q1)	→	-0.3% (2000/Q2)

<Ref.1> Forecasted Real GDP Growth Rate for FY 2000

December, 1999	→	June, 2000
+1.0%	→	+1.6%
(average of 39 institutions)		(average of 25 institutions)

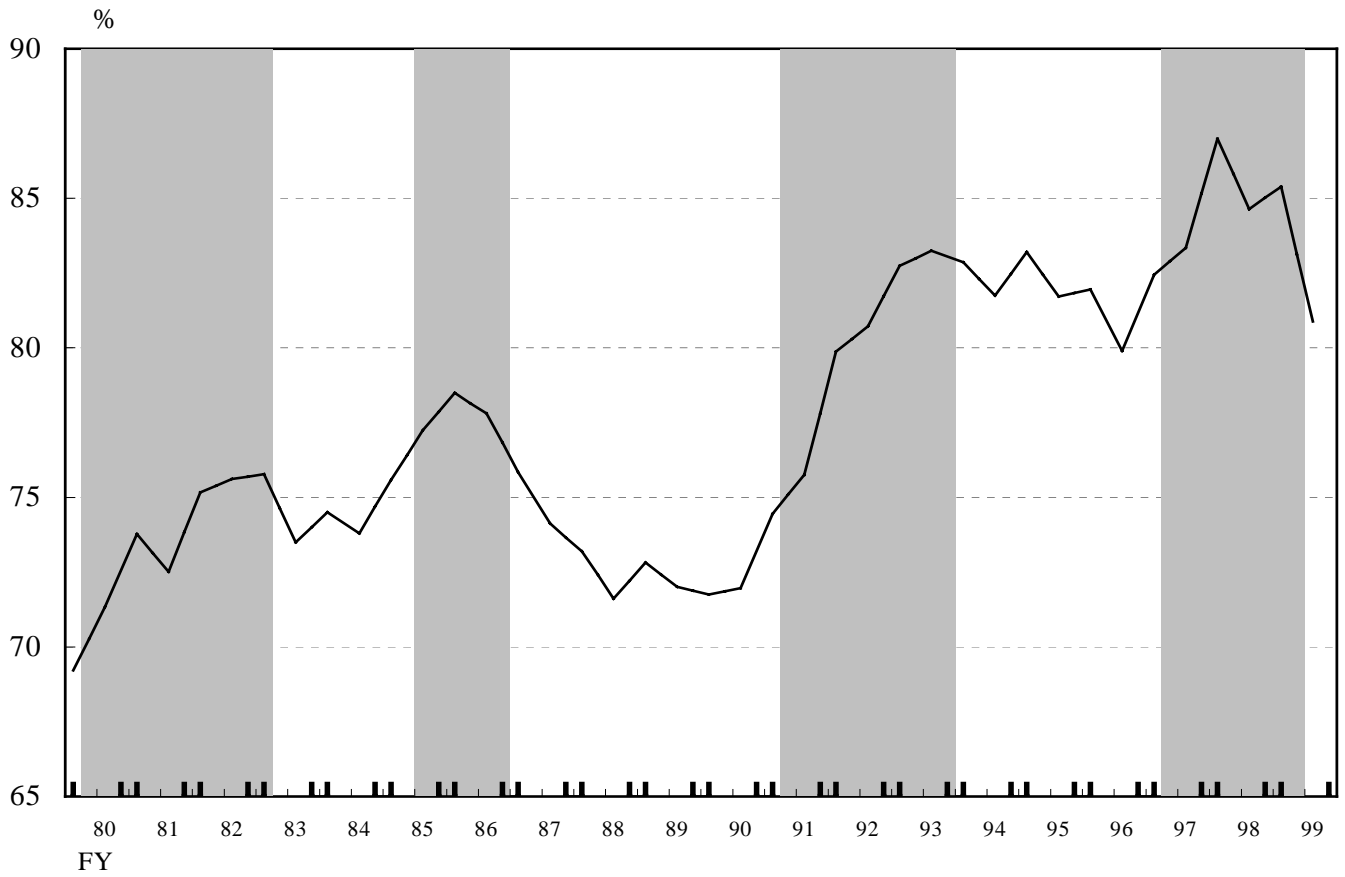
<Ref. 2> Growth Rate of Current Profits (*Tankan*, All Enterprises, All Industries)

FY 1999 (Actual)	→	FY 2000 (Forecast)
+24.2%	→	+13.1%

Chart 3  
**On the current monetary policy**  
17 July 2000, Bank of Japan

- (1) At the Monetary Policy Meeting held today, the Bank of Japan decided to maintain its “zero interest rate policy”.
- (2) The Policy Board views that Japan’s economy is recovering gradually, with corporate profits and business fixed investment continuing to increase. The Policy Board also judges that the economy is likely to recover gradually led mainly by business fixed investment, unless there are major adverse external shocks.
- (3) With regard to the prices, the Policy Board views that the downward pressure on prices stemming from weak demand is declining significantly while an economic recovery is expected to continue moderately.
- (4) Given the above considerations, the majority of the Policy Board views that Japan’s economy is coming to a stage where deflationary concerns are dispelled, which the Board have clearly stated as the condition for lifting the zero interest rate policy.
- (5) At the Meeting, however, some views were expressed that before reaching a final decision to lift the zero interest rate policy, it was desirable to ensure the judgment on the firmness of economic conditions including employment and household income. Besides, it was pointed out that the Board needed to see how the commencement of reconstruction proceedings of Sogo Co. could affect market developments and business sentiments.
- (6) Taking account of these factors, the Policy Board decided, by majority vote, on the maintenance of the zero interest rate policy.

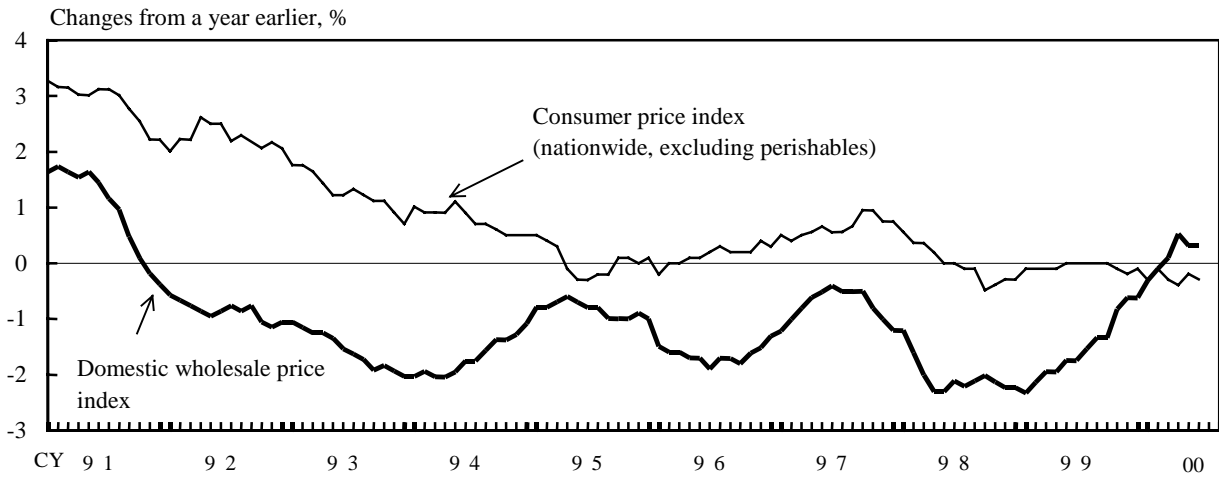
Chart 4  
**Labor's share of income**



- Notes: 1. Labor's share of income = personnel expenses / (personnel expenses + operating profits).  
 2. Data are taken from the Financial Statements Statistics of Corporations by Industry, Quarterly (total).  
 3. Shaded areas represent recession periods.

Chart 5  
Price developments

**(1) Consumer price index & domestic wholesale price index**



Notes: Excluding the effects of the consumption tax hike in April 1997 on the assumption that prices of all taxable goods fully reflect the rise of the tax rate.

**(2) GDP deflator**



**(3) Nominal wage per person**

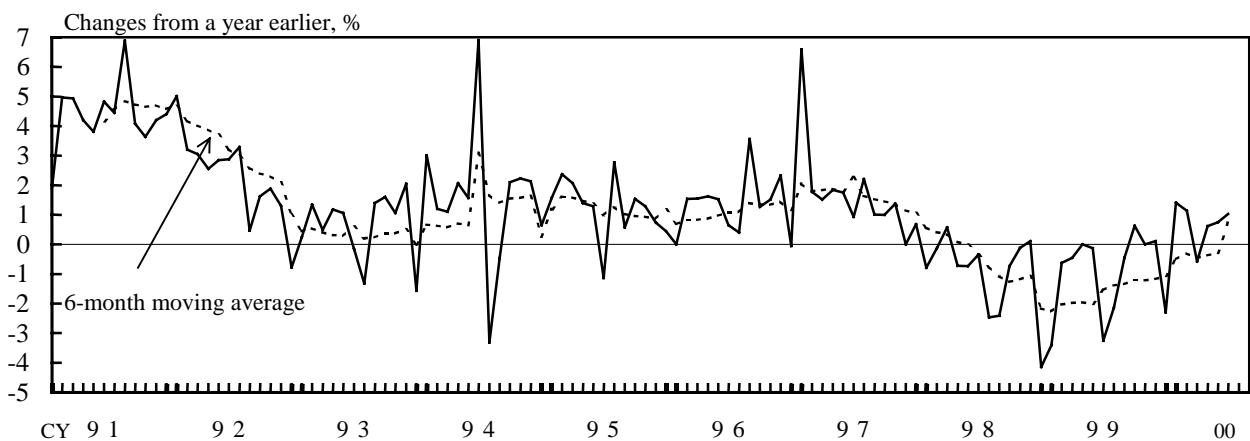


Chart 6  
Contribution of private and public demand to real GDP

