

## Masaru Hayami: Toward Revitalization of Japan's Economy

Speech by Mr Masaru Hayami, Governor of the Bank of Japan, at the Keizai (Economic) Club, Tokyo, 29 January 2002.

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### Introduction

I am grateful to have the opportunity to talk to this meeting. Japan's economy will enter a critical phase this year to establish a basis for sustainable growth by pushing forward with structural reforms in the economy and by restoring a sound financial system. Today I would like to express my views frankly from the standpoint of the central bank on what needs to be done for Japan's economy to revitalize it in the rather longer term.

### I. Economic and Financial Developments in 2001

#### A. *Economic Developments in and outside Japan*

First, I would like to look back briefly on economic developments in and outside Japan in 2001, a year in which Japan and the global economy were in a very severe situation.

When I made a speech last time to this Club in December 2000, I pointed to two downside risks to Japan's economy that needed careful monitoring: first, developments in overseas economies, the U.S. economy in particular; and second, the volatile movements in stock markets. What I emphasized was that due attention should be paid to a possible downswing of the economy arising from these risks especially when the economy had structural problems and was vulnerable to external shocks. Unfortunately, these downside risks actually materialized in 2001.

The most notable feature of economic developments in 2001 was a simultaneous slowdown of economies worldwide against the background of global adjustments in information and communications technology (ICT)-related industries. And in September 2001, the tragic terrorist attacks occurred in the United States. The authorities responsible for macroeconomic policy were compelled to deal with both economic deceleration and the negative shocks to their economies.

The worldwide decline in demand for ICT-related goods caused a significant fall in exports and production in Japan from early 2001. This led to adjustments in the corporate sector, as seen in a decrease in corporate profits and business fixed investment. These adjustments then spread to affect employment and income conditions in the household sector, and recently they have been exerting downward pressure on private consumption.

However, some positive signs have been observed very recently. Global inventory adjustments in ICT-related industries have made progress gradually. Accordingly, shipments of semiconductors worldwide are showing signs of bottoming out, and some semiconductor prices are recovering. Exports of East Asian countries, which had declined earlier than those of other areas, are starting to show signs of bottoming out. In financial markets overseas, stock prices and long-term interest rates generally indicate an expectation of economic recovery in the near future.

It is, however, still uncertain whether the progress of inventory adjustments in ICT-related goods will be followed by a recovery of final demand overseas. Thus, we need to monitor carefully whether overseas economies, especially the United States, will recover steadily.

In Japan, weakness in final demand such as business fixed investment and private consumption has become conspicuous, and the severe adjustment phase will inevitably continue for some time. On the other hand, conditions for exports are showing some positive signs. In addition, inventory adjustments, especially those in ICT-related goods, have been making progress gradually. Accordingly, downward pressure on production arising from inventories is expected to be fading.

Given the positive factors such as the subsiding downward pressure on exports and production together with the negative factors such as intensified adjustments spreading to the household sector, Japan's economy will enter a critical phase in the near future in terms of finding a way to recover.

## **B. Adoption of the New Monetary Easing Framework**

Next, I will outline the Bank's conduct of monetary policy since the beginning of last year.

In early 2001, we forecasted that Japan's economy would have to undergo severe adjustments, given the simultaneous slowdown of economies worldwide.

In addition to the severe economic outlook, we were in a very difficult position in regard to room for further policy actions. There was almost no room for further rate reduction because the call rate, which was our operational target, was as low as 0.25 percent at the beginning of 2001 due to the series of drastic monetary easing measures taken in the 1990s.

In this situation, we adopted a new policy framework for monetary easing in March 2001. We changed the main operating target from call rates to a quantitative indicator of liquidity, that is, the outstanding balance of current accounts at the Bank of Japan, and we have substantially increased the balance.

Because this was a very drastic easing measure and was unprecedented in the history of central banking worldwide, we had to consider various issues very carefully before deciding it. Above all, it was uncertain whether and how expansion of liquidity provision in a situation where the rate is virtually zero percent would influence the economy. Needless to say, the mechanism through which such an expansion affects the economy has not been demonstrated either theoretically or empirically.

It is particularly important to gain public confidence to make monetary policy effective. Public confidence in economic policy is hard to gain in the short term. First of all, the authorities should faithfully explain to the public the expected effects and risks of each policy measure to be taken. Then, people will monitor the effects achieved and how the risks turn out, and verify whether they have been in line with the authorities' explanation. Public confidence can be gained only through continuous efforts to fulfil the requirement to be accountable. Thus, the authorities should be careful not to introduce measures in a piecemeal manner based on the shortsighted idea that "it is better to do something than nothing."

When the new framework of monetary easing was adopted in March 2001, I believed that the Bank should continue to faithfully fulfil its duty of accountability. In other words, the Bank should explain the necessity of entering uncharted territory by taking unprecedented measures given the severe economic outlook, together with the fact that the effects were uncertain to some extent, and try to gain the public's understanding.

Monetary policy cannot directly generate demand nor can it be a substitute for measures to advance structural reforms. Also, its stimulative effects on the economy will be very limited in the quantitative sense in the situation where interest rates, both on short- and long-term instruments, are at their lowest possible levels and cannot decline further.

When the Bank decided the new frameworks in March 2001, I believed that the Bank should continue to make best efforts on its part, and should continue to call strongly for the structural reforms that are indispensable and also one of the prerequisites to make monetary easing effective. In other words, the Bank decided to take such drastic and unprecedented easing measures ahead of structural reforms, in the hope that other measures would follow to advance structural reforms significantly.

The Bank of Japan had already taken easing measures twice in February 2001. Since March 2001, the Bank has decided on as many as four further easing measures, under the new framework of monetary easing. In view of further deterioration of the economy and financial conditions, we decided, in December 2001, to expand the balance of current accounts at the Bank and utilize new financial instruments such as asset-backed securities as tools for the Bank's market operations and as eligible collateral.

## **C. Experiences in the Course of the Unprecedented Monetary Easing**

As the Bank has continued its unprecedented monetary easing, it has accumulated experience with regard to its effects.

A series of monetary easing measures since 2001 has been effective to a certain degree in reducing short-term interest rates and in alleviating anxiety about liquidity.

The overnight call rate is currently as low as 0.001-0.003 percent. This is lower than the level of 0.02-0.03 percent under the "zero interest rate policy."

Moreover, the Bank's ample provision of funds and its strong commitment in terms of policy duration that the Bank would continue the new monetary easing framework until the inflation rate registers stably zero percent or above have led to a decline in longer-term interest rates. For example, the interest rate on one-year Japanese government securities is also very close to zero, at 0.001 percent recently.

In the aftermath of the terrorist attacks, liquidity problems did not arise in Tokyo markets, due to the Bank's ample provision of funds. Also, there was no serious disruption in trading and settlement at the end of 2001 when concerns over the financial system heightened reflecting the failure of several large firms. And currently, there is no liquidity shortage in sight as we move toward the end of the fiscal year in March 2002.

However, expanding the quantity of liquidity provision as seen in the balance of current accounts has not yet markedly affected economic activity, prices, or people's expectations.

Under the new monetary easing framework, monetary base has expanded drastically by as much as 15 percent or more year on year. This is the largest growth since the hyperinflation period at the first oil crisis in the 1970s, except for the period when there was the irregular factor of the "Year 2000 Problem." Private banks' lending, however, remained sluggish, and economic growth and prices have continued to be on a downtrend.

Strong monetary easing and large-scale fiscal spending were employed continuously during the 1990s. Reflecting such monetary easing, monetary base and money stock continued to increase at a fairly rapid pace compared to the level of economic activity. Japan's economy, however, failed to return to a sustainable growth path. This clearly demonstrates that monetary easing cannot change banks' lending attitude, economic activity, and prices when there are various structural problems, such as the nonperforming-loan (NPL) problem, in the economy.

These experiences under the unprecedented monetary easing highlight how grave Japan's structural problems are. I believe it is necessary to accept this fact and have a constructive debate about what should be done to change this situation. Based on such thoughts, the Bank of Japan has been emphasizing that the primary tasks to be accomplished for revitalization of Japan's economy are advancing structural reforms in the economy and industry, and restoring the soundness of Japan's financial system. I now would like to move on to these two issues of structural reforms and the financial system.

## **II. Structural Reforms and Japan's Economy**

### **A. Goals of Structural Reforms**

Japan and other industrialized countries are facing intense international competition arising from rapid industrialization of emerging economies such as those in East Asia.

As a country develops and grows wealthier and accordingly the level of people's income rises, it will constantly be exposed to stronger competition from countries with lower wages. This is a natural development for industrialized countries, and they must accept it as inevitable challenges. They need to continue adapting flexibly to change by industrial restructuring and fostering high value-added industries to lead the economy.

Moreover, if industrialized countries can continue to foster such promising industries, this will bring about an expanding equilibrium in the global economy through, for example, development of new markets and establishment of an efficient international division of labor. Japanese manufacturers have increased the share of production carried out overseas, and this has recently become a matter of concern, being viewed as a hollowing-out of Japanese industry. However, the share for Japanese manufacturers stands at around 15 percent, which is lower than U.S. and European manufacturers' share of around 20-30 percent. Manufacturers' shifts to overseas production could adversely affect certain regions or industries in the short term. However, we cannot stop firms' moves to utilize an international division of labor more efficiently amid globalization. Furthermore, these movements could bring benefits to the economy as a whole, in the medium to long term.

In fact, in the 1990s the United States and Europe achieved fair growth using innovations in ICT-related areas. I would like to point out that the United States and the United Kingdom had

advanced reforms since the 1980s to realize small and efficient government. The Continental European countries had also made efforts to address structural reforms toward monetary union.

In contrast, grave problems including the NPL problem had mounted in Japan's economy, in the course of the emergence of the "bubble" economy of the 1980s and its bursting in the early 1990s, and Japan fell behind other industrialized countries in dealing with structural problems.

The key to a brighter economic outlook for the medium to long term is whether a sufficient number of high-productivity industries or projects that can point a direction for the economy will emerge in the private sector. To revitalize Japan's economy, it is essential to create the conditions where private initiatives and vigor are fully encouraged.

The Council on Economic and Fiscal Policy, of which I am a member, drafted blueprints of structural reforms last year, such as the Solid Policy Framework and the Medium-Term Economic and Fiscal Perspectives. Detailed measures as well as progress in their implementation will be discussed further. I believe that the most fundamental yardstick to be applied to evaluate each policy measure will be whether it could work to stimulate private demand.

This year, issues concerning the taxation system and government financial institutions will be discussed in the council.

In the discussion regarding the tax system, the conventional principles of taxation, that it should be fair, neutral, and simple, will continue to apply. In addition, new perspectives will be vital in deciding on its reforms, for example, whether the tax reform can stimulate free and creative economic activity in the private sector, and whether the new system would comply with globalization of economies and corporate activities.

Since the beginning of the 1990s, government financial institutions have increased their share in the total lending to the private sector, especially loans extended to large firms, and it has now reached around 20 percent. If their share of lending is too large, the market mechanism may not work properly in the setting of lending rates. Moreover, the developments of capital markets can be held back because large firms will likely rely on government lending. In vitalizing the economy utilizing the market mechanism, the reform of government financial institutions is also one of the essential tasks. I think such reform should be advanced by letting the private sector do what it can do. In this regard, one reasonable way to do this would be to change the functions of government financial institutions to focus mainly on guarantee and refinancing.

## **B. "Pain" Accompanying Structural Reforms**

There are those who, while acknowledging the need to undertake structural reforms, ask whether some policy measures could "alleviate the pain" accompanying structural reforms in the short term. We fully understand the background to such opinions given the current severe economic situation and the negative impact of structural reforms in the short term.

Many people talk about "alleviating the pain of structural reforms," but the meaning is often unclear because it gives scope for various interpretations. It is sometimes used to mean stopping structural reforms or simply postponing facing the "pain."

In evaluating various policy measures proposed for alleviating the "pain" of structural reforms, I feel it is necessary to examine them from the viewpoint of whether they are consistent with the ideal socio-economy to be achieved by structural reforms.

For example, in the process of consolidating firms and restoring the soundness of Japan's financial system, bank lending is likely to decrease and lending spreads will expand reflecting credit risk. Under these circumstances, calls for financial institutions to increase their lending volumes are likely to emerge. We also sometimes hear extreme requests to the central bank to lend directly to firms.

However, in the process of restoring the soundness of Japan's banking system, lending rates must be adjusted to appropriate levels according to the risks on loans, and loans to inefficient firms must be reduced. Needless to say, any contraction of corporate financing must not go so far as to make it difficult for viable firms to obtain financing. In viewing these points, I believe the following measures are very important. First, it is necessary to encourage the entry of new firms into the market as well as increase the pace of industrial restructuring, which will be accompanied by withdrawal of nonviable firms from the market. Second, it is also useful to foster new ways of financial intermediation, in addition to indirect financing. For this reason, the Bank of Japan is making efforts to develop financial

markets to improve funds intermediation by utilizing new financial instruments, such as asset-backed securities, as tools for market operations and as eligible collateral.

On the other hand, direct financing of firms by a central bank is an apparent deviation from its designated role. Moreover, such operations are not consistent with the objective of structural reforms, which is reviewing financing through government financial institutions in order to ensure full utilization of the market mechanism and private initiatives.

As a measure to alleviate the "pain" of structural reforms, there are also calls for artificially controlling the exchange rate of the yen so that it depreciates.

Since the end of December 2001, the yen has depreciated to around 130-135 yen against the U.S. dollar. In the short term, such movements of the exchange rate reflect the view of market participants who are increasingly expecting a recovery of the U.S. economy while becoming more concerned about the structural problems of Japan's economy. One concern is that some insist that the currency authority should cause the yen to depreciate by artificial means. However, it is not at all feasible to control exchange rates artificially where the flow of foreign exchange transactions and capital movements are liberalized. Moreover, if Japan with its large economy were to artificially lower the value of its currency in order to resolve its own economic problems, the credibility overseas of its overall economic policies and currency could be damaged.

Foreign exchange rates reflect the market's evaluations of the economic performance of each country in the medium or long term. If Japan were not able to foster high value-added industries, or if foreign exchange markets believed Japan unable to do so, market forces would work in the direction of yen depreciation. However, this means that economic adjustments would take place by diminishing Japan's purchasing power. Structural reforms are not at all intended to cause adjustments in this pessimistic way.

It is therefore desirable that foreign exchange rates move stably reflecting fundamentals of the economy. A depreciation of the yen will not solve the problems of Japan's economy that must be overcome.

We have sometimes been asked whether there is a way to stop the downtrend of prices during the structural reforms. We have also received suggestions that prices should be made to increase so that structural reforms can be implemented smoothly.

First of all, I want to stress that we have already made a strong commitment to continue the current framework of monetary easing until the inflation rate registers stably zero percent or above, and we have been implementing drastic easing measures unprecedented in the history of central banking. Therefore, criticism that the Bank is tolerating price falls or deflation is a complete misunderstanding.

At the same time, the basic relationships between structural reforms and prices must be correctly understood. The recent price decline is attributable to various factors such as technological innovation, deregulation, and an increase in low-priced imports. But above all, the major factor is that Japan's economy was not able to achieve a full-scale recovery in the 1990s and that the negative output gap expanded due to lack of demand.

Needless to say, there is a strong correlation between economic activity and prices. First, the level of economic activity and the balance of supply and demand change, and then prices respond to these changes. In short, prices rise after economic recovery begins, and not vice versa.

Structural reforms aim to directly tackle the problems that have long prevented a sustained growth of the economy and improvement in productivity, and thus boost private demand. Needless to say, structural reforms are chosen and supported by the people, and they are indispensable for Japan's economy to return to a sustainable growth path in the medium to long term. In the short term, however, downward pressures on prices are inevitable if the economy must endure a low growth rate temporarily in the course of structural reforms and fiscal consolidation, because the negative output gap would widen as a result. An increase in prices, if it were the sole objective, could be achieved by a significant fiscal expansion that could tighten in the balance of supply and demand. However, this would be inconsistent with the objective of structural reforms.

It may seem contradictory, but I believe that the most effective and credible prescription to alleviate the pain accompanying structural reforms is to steadily implement reform measures and to gain the confidence of economic entities and the markets regarding the objective and the direction of the reforms.

If, by undertaking solid structural reform measures, households' concerns about future pension and social security systems are reduced, and if firms foresee an increase in productivity in the future, spending activities of firms and households will be stimulated. And furthermore, if Japan's efforts in tackling structural reforms are received favorably by financial markets, we can expect some positive effects of structural reforms to appear much earlier, for example, via a rise in Japanese stock prices. For this reason, I attach great importance to clearly explaining the schedules of concrete reform measures and visibly demonstrating their expected effects so that people can have confidence in them.

### **III. Issues concerning Japan's Financial System**

#### **A. Current Condition of Japan's Financial System**

I would like to move on to discuss Japan's financial system, another important part of structural reform of Japan's economy.

First, let us take a look at overall stock prices. Until September 11 last year, the U.S. and Japanese stock markets had trended the same way. However, Japanese stocks have become weaker since October, and the two markets started to trend in a different direction. In the meantime, the structure of stock markets has been changing. The presence of foreign investors in Japanese stock markets has been increasing. For example, the volume of stock transactions by foreign investors has been increasing year on year at the Tokyo Stock Exchange (TSE), while the daily turnover of transactions at the TSE has maintained a considerable amount of some 600 to 800 million shares. Amid weakening stock prices and the changing structure of stock markets, I hope that Japanese stock markets will become more transparent and fair through various measures such as the recently tightened regulations on short sales of stocks.

Now, if we take a look at stock prices by industry, we see a clear trend. While stock prices of firms in electrical appliances and transportation equipment industries are rising, stock prices of those in construction, real estate, and banking industries are falling. The trend shows that market participants are taking a harsher view of Japan's financial system.

Three factors seem to determine the weakness of bank stocks. First, the banking sector is suffering from the NPL problem. Second, there has been a series of failures of borrower firms and there are concerns that such failures might continue. It should also be noted that more time is required for restructuring of borrower firms amid business reorganization in the banking industries. And third, unwinding of cross-shareholding is progressing due to introduction of mark-to-market accounting.

The biggest concern is the NPL problem of Japanese financial institutions, which places a heavy burden on Japan's economy overall.

Japanese financial institutions have been making efforts in various ways to resolve this problem. In the past decade, many have disposed of an amount of NPLs exceeding their annual operating profits each year. However, the amount outstanding of NPLs has not declined as the amount of new NPLs has been more than that of ones disposed of.

For some time after the bursting of the "bubble," a large majority of NPLs were loans extended to nonbanks and firms in the real estate and construction industries. Recently, however, NPLs are increasingly emerging from loans extended to firms in service industries such as retail, as well as some in manufacturing industries. It seems that new NPLs are emerging in the industries challenged by structural adjustments.

The emergence of NPLs implies progress in structural adjustments. In this regard, not only financial institutions, the lenders, but also borrower firms are required to implement major reforms of their business management for the resolution of the NPL problem.

#### **B. Financial Institutions' Measures to Address the NPL Problem**

The NPL problem, which is related to both financial institutions and borrowers, should be addressed primarily by the former. In fact, large banks announced the major steps they would take to achieve the projected results of disposal of NPLs for fiscal 2001 in autumn 2001 when announcing their financial results for the first half of fiscal 2001.

The major steps include (1) larger disposal of NPLs than planned for before the start of fiscal 2001, (2) further cost-cutting, (3) review of their lending conditions, especially interest rates, in light of different credit qualities of borrowers, and (4) improvement of profitability by way of these steps. These steps are highly welcome, and I hope that they will be elaborated into concrete measures and implemented promptly so that the markets' confidence in Japanese financial institutions will be restored.

In the last phase of the resolution of the NPL problem, the removal of NPLs from financial institutions' balance sheets is necessary in addition to loan-loss provisioning.

Financial institutions are increasingly promoting liquidation of their loans by selling them to third parties while instituting reconstruction proceedings against distressed firms under the Civil Rehabilitation Law. For example, some Japanese banks are making use of the "investment funds for corporate reconstruction," which also includes foreign investment funds, for financial resources and expertise on how to liquidate their NPLs. Moreover, it is expected that methods that have not been common in Japan, such as debt equity swaps, will be used. It is also expected that the Resolution and Collection Corporation (RCC) will be utilized more, as its functions to reconstruct firms have been strengthened, and its terms and conditions for purchases of loans have been made more flexible through recent amendments to the Financial Reconstruction Law.

I hope that the use of various measures will speed up the disposal of NPLs.

There is a view that if banks were to speed up their disposal of NPLs too much, the economy could be negatively affected. To some extent, NPLs are simply the result of an economic slump. But, as I mentioned earlier, many are loans extended to firms in industries facing structural adjustments. If banks postpone the disposal of their NPLs, this could delay the structural adjustments, and ultimately delay the revitalization of the overall economy. Further, the resolution of the NPL problem, which has been placing a burden on financial institutions' business, could have great significance in that it would contribute to restoring the financial intermediary function, an essential part of the infrastructure of the economy. If, however, the disposal of NPLs is delayed, this might threaten the stability of the entire financial system through a further decline in markets' confidence in the soundness of Japanese banks.

### **C. *The Importance of Strengthening Profitability***

Next, I would like to share with you another important task that Japanese financial institutions are working at, that of improving their profitability. As financial institutions have been required to dispose of NPLs amounting to more than their annual operating profits, their financial strength has been weakened. To recover their financial strength, the disposal of NPLs--a legacy of the past--alone is not sufficient. They need to improve their profitability.

To improve financial institutions' profitability in the long run, the financial institutions themselves need to establish new business models. I understand that this is easier said than done, but there seems to be room for further improvement. Financial institutions should first identify areas where they have an advantage over other competitors, and develop a business strategy taking full advantage of their strong areas, and reallocate their business resources.

Business consolidation and reorganization through various measures such as mergers, establishment of bank holding companies, and business alliances have become common in the financial sector in the past few years. Business reorganization is taking place in various different forms, such as mergers between financial institutions beyond the confines of their own corporate groups, integration of trust bank business and that of securities business within financial groups, and plans for super-regional banks. The most important thing is for financial institutions to find ways to take full advantage of business reorganization to reform their business management.

I hope that financial institutions' efforts to improve their profitability will contribute to pushing forward both the disposal of NPLs and the corporate rehabilitation, and to revitalizing the financial system. The progress in NPL disposal, corporate rehabilitation, and financial system revitalization will bring about positive synergy effects, such that markets' confidence in financial institutions will be restored, which in turn will have positive effects on stock prices.

It cannot be denied, however, that it will take time for measures implemented by financial institutions to have positive effects.

#### ***D. Injection of Public Funds and the Ending of the Blanket Guarantee on Bank Deposits***

As the disposal of NPLs progresses, we need to prepare for an emergency where concerns about the stability of the financial system as a whole are raised despite the efforts made by financial institutions. The amended Deposit Insurance Law, which came into effect in April 2001, states that in such an event, the Prime Minister may, following deliberation by the Council for Financial Crisis, acknowledge the necessity of injecting public funds.

It is necessary to expeditiously advance the resolution process of financial institutions that cannot reconstruct their business.

In addition to the injection of public funds by the Government, if it is necessary from the viewpoint of maintaining the stability of the financial system, the Bank will for its part fulfil its responsibility of providing liquidity as the lender of last resort, which is one of its fundamental roles.

As the last topic on the financial system, I would like to comment on the ending of the blanket guarantee on bank deposits scheduled for the end of this March.

There is little time left before the ending of the blanket guarantee on bank deposits. I hope that each financial institution will further accelerate the resolution of various business management problems and regain the market's confidence, thereby enabling smooth transition to the limited guarantee system. Then, things would go back to the way they should be.

#### **Conclusion**

I have talked about the tasks for Japan's economy and the thinking behind the policy of the Bank of Japan.

I have to admit that we are still only halfway to the goal of a revitalized economy, and the path ahead will not be smooth. But I am not pessimistic about the potential of Japan's economy and its future course in the medium to long term.

For example, Japan's personal financial assets have reached around 1,400 trillion yen. As the largest holder of net external assets of 1.2 trillion U.S. dollars that amount to almost 30 percent of annual GDP, Japan is receiving huge investment income from these assets, as a part of Japan's current account surplus that amounts to 2-4 percent of annual GDP since the 1980s. And I believe we also have ample potential in terms of technical background to cope with new businesses such as ICT-related industries.

The purpose of advancing structural reforms is to revitalize such potential so that it materializes in a visible form. In doing so, we have to face a low growth rate, declining prices, and "pain" such as increasing unemployment and bankruptcies in the short term. However, we have to bear in mind that such a painful process is inevitable if Japan is to demonstrate its potential and establish a basis for new development in the long run.

I would like to conclude my speech by making two important points regarding the conduct of economic policies during the process of structural reforms.

First, from the viewpoint of minimizing the short-term pain of structural reforms, it is important to withdraw some positive effects of structural reforms as early as possible by steadily advancing specific measures.

And second, since a low growth rate and declining prices would be inevitable temporarily, macroeconomic policies during the period of intensive structural reforms should aim at preventing these from leading to a deflationary spiral.

Given the relationships between the economy and prices as I explained earlier, the economy can be expected to exit from the downtrend of prices if it can achieve sustainable growth led by private demand after the period of intensive adjustments. However, the future positive effects of structural reforms might not be achieved if the economy were to fall into a deflationary spiral where price falls and a decrease in demand accelerate in interaction with each other.

In order to prevent such a deflationary spiral, it is important to improve the content of fiscal spending to stimulate private demand effectively, and to provide a better safety net for the unemployed. It is also essential to strengthen the financial system.



The Bank of Japan will continue to make the utmost effort to maintain the stability of the financial markets and enhance penetration of the monetary easing effect into the economy by continuing to provide ample liquidity. With regard to the financial system, the Bank will also perform its duty as the lender of last resort if necessary. As I stated at the beginning of this speech, this year will be especially important for Japan's economy. I would like to conclude my speech by restating our firm stance on the revitalization of Japan's economy.

Thank you for your attention.