Masaru Hayami: The economy - recent developments and challenges

Speech by Mr Masaru Hayami, Governor of the Bank of Japan, at Kisaragi-kai, Tokyo, 30 May 2002.

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Introduction

There have finally been some positive signs that Japan's economy has begun to stabilize as we enter the new fiscal year. However, our more than ten years of experience tells us that sustainable growth cannot be realized unless growth potential is strengthened through productivity growth. While economic activity is showing signs of improvement, we should not be complacent. Rather we should take advantage of this favorable development and further promote structural reform through specific measures. Such efforts will no doubt augment resilience of our economy through rejuvenating business activity and improving consumer confidence. In this sense, this fiscal year will be crucial for our economy in order to return to a sustainable and stable growth path. Today, I would like to review recent economic developments and monetary policy management, followed by some of the main issues our financial system now faces.

Recent economic developments

Developments in domestic and overseas economies

Amid the synchronous deceleration in world economies, Japan's economy continued to deteriorate from the beginning of last year. Yet, the pace of deterioration has recently somewhat moderated, with production starting to pick up reflecting an increase in exports and the progress of inventory adjustment against the backdrop of a recovery in overseas economies.

The US economy had been confronting a contraction phase since around end-2000 such as retrenchment in the information-technology (IT) sector, and the tragic events of early September further increased uncertainty. However, due to stabilizing forces such as the progress of inventory adjustments in the IT sector and resilient consumer spending as well as effects of monetary and fiscal policy stimulus, there have been increasing signs recently that the US economy is beginning to recover. In March, the Federal Reserve Board thus revised its assessment for the foreseeable future from saying that "the risks are weighted mainly toward conditions that may generate economic weakness" to "the risks are balanced" with respect to prospects for price stability and sustainable economic growth.

In response to indications of US economic recovery, exports and production in East Asian economies, which are highly dependent on exports to the US, have started to increase and the decline in domestic demand is nearing an end. European economies are also showing some signs of recovery.

Japan's economy has also basked in this movement toward recovery in overseas economies, as evidenced by increased exports to East Asian countries and the US. Inventory adjustments have further progressed in many industries, leading to a gradual recovery in production. But we have yet to see unequivocal movement toward the recovery of domestic demand, which will play a key role for a sustainable recovery. Capital investment continues to decline and consumer spending remains sluggish because of the cumulative worsening of the employment and income environment.

April 'Outlook Report'

What is the outlook for Japan's economy? The Bank of Japan released, exactly one month ago, 'Outlook and Risk Assessment of the Economy and Prices' - the so-called 'Outlook Report' - which gives the standard scenario for the economy for about one year ahead and entailing risk factors.

The economic outlook for fiscal 2002 and early fiscal 2003 described in the report can be summarized as follows.

First, should the recovery in exports and production continue, it will lead to an improvement in corporate profits and capital spending, particularly in the manufacturing sector. Therefore, the standard scenario for Japan's economy is that the economy is expected to stop deteriorating towards the latter half of fiscal 2002.

Second, even though this might be the case, it will take some time for the export and production recovery in the manufacturing sector to spread to the economy as a whole, including the non-manufacturing sector, small firms, and households. This is because, given the high level of labor's relative share (wages/value added output), the corporate sector continues to pursue restructuring efforts and thus persistent pressure on employment and wages is expected to remain. Consequently, even after the economy stops deteriorating, an autonomous recovery is not likely to gain much momentum.

Third is the outlook for price developments under the aforementioned prospects for the economy. Indications of change have also been emerging on the price front recently. The Domestic Wholesale Price Index (WPI), which represents upstream developments in the price transmission process, has been leveling off reflecting the progress of inventory adjustments and rise in oil prices, thereby narrowing the decline in the index on a year-on-year basis. How such changes affect overall price developments, the Consumer Price Index (CPI) in particular, deserves our deliberate review. As I previously mentioned, however, it will take some time for domestic demand to exhibit a distinct recovery, and supply-side factors such as the import of low-priced goods, technological advances, and deregulation are likely to remain forces pushing prices down. How wage declines affect service prices will also warrant attention. Bearing these factors in mind, it will likely take a long period before various price indexes, especially CPI, turn positive on a year-on-year basis.

In relation to this standard scenario, the Outlook Report identifies risk factors which might induce deviation both on the upside and downside. Recently, downside risk triggered by overseas economies has certainly diminished substantially, but it is undeniable that the outlook for overseas economies is still difficult to pin down. In particular, sustainability of the recovery of the US economy is still uncertain given the low personal savings rate of the household sector, the high level of household debt, and existing pressure to adjust capital stock in the private sector. A somewhat weak US stock market of late might mirror market participants' lack of confidence with respect to prospects for corporate profits. Due attention continues to be required for the global economic implications of developments in oil prices and instability in some emerging economies. In addition, while the yen depreciated against the dollar from the end of last year, it has started to appreciate since early spring this year. Some correction of the once optimistic prospects for the US economy and expectations for the recovery of Japan's economy might be factors behind such a development. Careful monitoring is thus also warranted with respect to developments in the foreign exchange market and international capital flows.

Domestic factors, including the resilience of domestic demand, effects from the disposal of non-performing loans (NPLs) and structural reform, as well as prospects for long-term interest rates and stock prices should also be deliberately assessed. A detailed explanation of each of these factors is in the main text of the Outlook Report 1. What I would like to convey today is that these domestic factors are closely related. For example, the disposal of the NPLs of financial institutions and structural reform of the economy are two sides of the same coin, and are also deeply related with financial market and asset price developments. On the one hand, should long-term interest rates rise in the absence of an economic recovery or stock and land prices plunge, there would be an adverse impact on the management of financial institutions and their financial intermediary function, which would result in hampering the smooth pursuit of structural reform on the corporate front. On the other hand, how positively the disposal of NPLs and structural reform developments will be received by the financial markets offers a key to the smooth implementation of structural reform.

The NPL problem, structural reform of the economy, and asset price and financial market developments are eventually critical factors which have a decisive influence on the resilience of the recovery of domestic private demand. Firms and households can only reactivate spending such as investment and consumption when clear prospects of a demand recovery following the resolution of various structural problems are in sight, future uncertainties with respect to employment and wages are dissolved, and a stable financial environment is in place.

Such thinking again highlights the importance of structural reform, through which resources will be efficiently reallocated and growth potential strengthened. As assumed in the standard scenario, our economy is expected to stop deteriorating led mainly by improved exports and production, but there still remain various structural adjustment pressures. In other words, cyclical factors and structural factors are locked in battle. I will now address this issue.

Business cycle and structural problem

Cyclical recovery and structural problem

Although our economy has followed a daunting road since the 1990s after the bursting of the bubble, there were some periods when the economy expanded. According to the government's official business cycle turning point, there were two recovery phases: from the end of 1993 and also the beginning of 1999. During the former, after experiencing a temporary standstill due to effects stemming from the rapid appreciation of the yen in spring 1995, the economy realized more than 3% growth in 1996. In retrospect, the economy entered a recovery phase triggered by monetary easing and fiscal expansion after the bursting of the bubble, followed by an increase in personal consumption and capital investment partly supported by the prevalence of mobile phones and personal computers. The economy rapidly deteriorated in the latter half of 1997 against the backdrop of a slowdown in overseas economies due to the Asian crisis, increased uncertainty with respect to the domestic financial system, and downward pressure from the fiscal front.

The next recovery phase, from the beginning of 1999 to the latter half of 2000, is still clear in our memories. Against the backdrop of the global boom of information technology (IT), exports played a leading role and capital investment centering on IT-related industries also increased. However, since adjustment pressure in the IT-related area had intensified worldwide before domestic consumption, another engine of the economy, gained momentum, Japan's economy deteriorated again after entering 2001.

What the two recovery phases in the 1990s have in common is that although the economy started to recover there was no autonomous and sustainable expansion of private demand as a whole. This was principally because the economy was directly hit by a cyclical slowdown in overseas economies and was also vulnerable to shocks such as financial system instability. The fundamental reason for such vulnerability is that excess debt, facilities, and employment, which firms had shouldered during the bubble period, were not thoroughly resolved, and forward-looking business activities which might have led to an increase in productivity and strengthened competitiveness, did not appear. This can be interpreted as the NPL problem in the banking sector not having been completely solved. Such a problem becomes increasingly difficult to solve once the economy enters a downturn and tends to get caught in a vicious circle.

Our economy is about to see the third recovery phase since the bursting of the bubble. As I mentioned previously, recent developments can be interpreted as a cyclical movement triggered by the progress of inventory adjustment worldwide in IT-related sectors. However, a precious lesson derived from our experience in the 1990s is that the autonomous and sustainable growth of domestic private demand can never be achieved without an improvement in growth potential. In other words, structural reform of the economy and strengthening of the financial system are more important than anything else in order to see current cyclical recovery movements develop into full-scale economic growth.

Monetary policy

Monetary policy over the past year

Let me now turn to the issue of monetary policy management.

One year and two months have passed since the Bank adopted a new monetary policy framework which aims at 'quantity' - the outstanding balance of current deposit accounts (reserves) held at he Bank - as its main operating target. The past 14 months can be characterized as a period when not only economic activity but also financial markets have been under enormous stress stemming from such factors as the further deterioration of the economy, the tragic events in the US, and increased financial system uncertainty in the face of the partial ending of the blanket guarantee with respect to deposits. Amid these economic and financial developments, the Bank timely and flexibly took monetary easing measures such as increasing the target reserve amount. Such policy management has played a substantial role in ensuring financial system stability, thereby preventing the economy from further deteriorating.

Conditions for exerting monetary easing effects

However, we have to face the reality that even such drastic monetary easing has not been sufficiently effective in igniting private demand.

To understand this point, it is perhaps useful to review actual developments in the financial markets and real economy. In the financial markets, not only the overnight call rate but also short-term interest rates have been at extremely low levels. For example, the yield of one-year short-term government bonds is less than 0.01%, virtually a zero interest rate, in the secondary market. The financing environment has been more or less favorable for firms. Credit spread, which is the difference between yields on CP and corporate bonds issued by major private firms and those on government bonds, generally widened from last autumn centering on firms with a lower credit rating but has recently started to gradually narrow. Although a severe financing environment continues for small and medium-sized firms, it would seem that such deterioration is nearing an end.

One noted development of late is the high growth of monetary base which shows the amount of money directly provided by the Bank. Year-on-year growth of monetary base exceeded 10% from September 2001 and has been around 30% since entering 2002. Such recent high growth matches that during the runaway inflation period immediately after the first oil shock.

Overall, financial conditions in Japan have been extremely easy. But the growth rate of the economy and various price indexes has been negative. In other words, despite an extremely accommodative financial environment, real economic activity has not been rejuvenated.

Various structural adjustment pressures lie in the background, which can be summarized from the viewpoint of firms, the financial system, and households as follows. First, on the part of firms, they cannot activate business activity such as capital investment no matter how easy monetary conditions are since the problems of excess debt and industrial structure are yet to be solved. Second, forces to lift the economy from the financial side are not likely to emerge since the intermediary function of financial institutions has been eroded against the backdrop of the NPL problem. Third, households are cautious to increase spending even under easy monetary conditions because of uncertainties with respect to the future course of the public pension and social security system.

For the Bank's monetary easing to exert powerful effects, it will be necessary to solve such problems. Once fund demand related to economic expansion emerges, effects of current monetary easing will materialize before our very eyes. Based on such a view, I have been repeatedly emphasizing the importance of strengthening the financial system and promoting structural reform of the economy.

The Bank conducted research through its branch network to discover new approaches taken by firms in the various regions. According to this research, in the wake of deregulation and proactive efforts by firms, nationwide we are seeing an increase in new entries to new business areas including the environment, nursing care, and health care. For specific examples, please refer to the report I recently made to the Council on Economic and Fiscal Policy 2. To foster such new developments and ensure that they bear fruit, it is important not only to promote deregulation decisively, but also for private firms to take advantage of new business chances utilizing their management resources to the extent possible.

Now, let me move to another important issue, that is, the financial system problem.

Recent developments and challenges facing the financial system

Current assessment of the financial system

The blanket guarantee for time and savings deposits was terminated in April this year and will be totally terminated for all deposits from April 2003. Simply put, the world will shift from perfect protection of depositors with the public sector shouldering the burden to self-responsibility in principle, and, in this sense, fiscal 2002 will be a turning point for Japan's financial system.

It is ten years since the first bankruptcy of a financial institution was resolved by deposit insurance in April 1992. Six years have passed since the framework of government guarantee was introduced to the deposit insurance system, and four years have passed since a framework to cover losses was established by the government. In the meantime, deposits with failed financial institutions have been fully protected. In addition, various arrangements have been devised for the sake of financial system stability such as the injection of public funds to financial institutions and establishment of safety nets with respect to securities and insurance companies.

The development of such arrangements has, of course, been closely related to various problems associated with the bursting of the bubble and many financial institutions being forced to fail. In fact, the number of financial institutions - banks, shinkin banks, and credit cooperatives - has decreased by more than 30% from about 1,000 ten years ago to less than 700 at present, partly reflecting the progress of integration such as mergers.

In our estimation, the amount of NPLs to be disposed of by financial institutions, that is the sum of write-offs and loan-loss provisioning, has reached more than 80 trillion yen over the past ten years. This figure suggests that financial institutions have disposed of a substantial amount, more than 17% of the loans they held ten years ago. Stated differently, with the NPL problem unresolved, Japan's financial system has significantly contracted in terms of the number of players and volume of assets.

However, despite the painful experience of the past ten years, we have yet to restore credibility in our financial system that still receives harsh criticism from both home and abroad.

Financial statements for fiscal 2001

In fact, all major banks went into the red as shown in their financial statements released last week. Such results evidence that major banks have continued to dramatically dispose of their NPLs in an amount more than their operating profits, which should be taken positively. However, at the same time, the results also remind us of the severe situation Japanese financial institutions now face.

In addition, financial institutions do not have enough of a buffer left due to the past disposal of NPLs and decline in stock prices. For them, the source of revenue that can be used for the disposal of future NPLs is basically operating profit, and, in this regard, an improvement in profitability is an extremely important challenge which financial institutions urgently need to tackle.

Challenges for the financial system

Bearing such a situation in mind, I would like to summarize the challenges the system now faces.

There are two challenges. One is the NPL problem. The outstanding balance of NPLs has not shown any marked decrease and new NPLs continue to emerge at a high rate.

The other relates to the profitability of financial institutions or, more broadly, to financial system infrastructure and markets.

These two challenges are mutually related and we need to tackle them simultaneously in order to restore financial system credibility both at home and abroad and to regain strength.

Recent developments of the non-performing loan problem

I would like to start with the NPL problem.

When discussing the NPL problem, we should also look at the borrower side, since the claims of financial institutions are the debts of firms. There are various background factors to the NPL problem depending on the environment surrounding corporate management. The main factors behind the generation of NPLs just after the bursting of the bubble have been the excess debt of firms and the price decline in real estate purchased, but factors stemming from structural changes in industries have gradually became dominant in recent years. The number of firms which are forced to undergo drastic restructuring is expected to increase from now on as structural reform progresses, and there is concern that banks' loan assets will deteriorate in the process.

To make loans to small and medium-sized firms becomes an important future challenge. In response to the 'special inspections' conducted by the Financial Services Agency since last year, various measures such as the drawing up of management rehabilitation plans and organization changes through mergers have been taken by large firms carrying a large amount of debt and seeing a noticeable weakening of business performance. Although careful follow-up will be necessary with respect to rehabilitation plans, it is arguably one step forward from the viewpoint of the disposal of NPLs and corporate rehabilitation.

Measures have increasingly been adopted for small and medium-sized firms such as rehabilitation under the Civil Rehabilitation Law and out-of-court procedures based on the activities of newly established sections within individual banks to exclusively support the rehabilitation of client firms. However, as a whole, small and medium-sized firms, especially those in the non-manufacturing sector, are facing harsh business conditions and how to cope with the situation has become a big challenge also for the sake of restoring credibility in the financial system.

Effective capital adequacy ratios take into account unrealized gains and losses on land and shares, and, looking at them as indicators to see the actual financial conditions of borrowing firms, we find that the current level for all firms is about 30% lower than that before the bubble period, confirming the decline in management strength.

And, looking at the ratio by size of firm, the effective capital adequacy ratio of large firms is about the same as before the bubble period, but that of small and medium-sized firms has declined to almost half. Particularly noteworthy is that, within the category of small and medium-sized firms, those in the non-manufacturing sector such as distribution, services, and construction are in a more severe situation than those in the manufacturing sector.

Given the fact that about 80% of Japan's labor force works for small and medium-sized firms, the NPLs of small and medium-sized firms are a serious problem.

Things to be considered when dealing with small and medium-sized firms

Since the management of small and medium-sized firms varies, the actual management conditions at individual firms should be carefully grasped by considering different aspects. For example, one should look at not only the indicators used in assessing large firms, such as the capital adequacy ratio, but also the financial position of owners, business areas, human resources, and skills. Therefore, financial institutions should have more thorough dialogue with individual small and medium-sized firms than in the case of large firms with respect to their financial conditions and management prospects. In the case of Japan, financial institutions extend loans to a firm as a whole, known as corporate lending, rather than to individual projects as in the US. Consequently, the viability of the firm becomes an important factor when assessing the adequacy of each loan or conducting ex-post assessment. Since small and medium-sized firms have limited access to direct financing and almost exclusively rely for funding on bank borrowing, careful follow-up of individual cases becomes all the more important for financial institutions. In this regard, as has already started in some cases, it might be a meaningful approach in the process of dialogue between firms and financial institutions if financial institutions disclosed their credit rating of borrowing firms, share points of concern, and together explore ways to solve them. Such an approach might contribute to putting in place risk-based loan pricing for financial institutions.

At any rate, bearing in mind the economic outlook for the foreseeable future and progress of structural reform, we should anticipate that, at least for some time to come, there is the risk new NPLs will emerge and existing NPLs further deteriorate. In this regard, it is critical that financial institutions are well prepared for such risks and review in a timely fashion their classification of borrowers and collateral conditions, and make appropriate provisions.

Removal of non-performing loans from the balance sheet

As a matter of course, increasing provisioning is not enough to overcome the NPL problem. Based on dialogue with borrowing firms, financial institutions need to remove NPLs from their balance sheets if the borrowing firms are not likely to be rehabilitated. The Financial Services Agency released a guideline regarding the disposal of NPLs which states that newly generated NPLs should be disposed of within three years, with, in principle, 50% being disposed of within one year and most removed from the balance sheet within two years.

At the same time, in the event financial institutions themselves cannot cope with firms which are likely to be rehabilitated, the functions of the Resolution and Collection Corporation (RCC) have been strengthened, such as by the establishment of an investment fund. From now, financial institutions will be requested to make efforts to utilize their own know-how as well as such arrangements.

In order to rejuvenate our economy as a whole, it is my strong hope that concerned parties will make every effort to realize the rehabilitation of firms which are viable but facing difficulties due to pressures stemming from structural adjustment.

Treatment of insolvent/undercapitalized financial institutions

As a result of such disposal of NPLs and their removal from balance sheets, insolvent financial institutions have no choice but to exit from the market. In such cases, non-viable financial institutions should be disposed of in an orderly manner.

Even in cases where financial institutions have excess assets, it becomes necessary to expand the business base and improve profitability through measures such as merger if they are not likely to survive on their own from a medium- to long-term perspective. As previously mentioned, although the number of financial institutions has already decreased substantially, further integration should not be ruled out if necessary. The government recently announced it would consider merger promotion measures and I hope they will be implemented expeditiously.

Thorough preparation is also needed to avoid credibility in the financial system being substantially eroded or system stability questioned in the process of disposing of NPLs. The idea that appropriate measures, including the injection of public funds, might be necessary in such a case is what I have repeatedly advocated.

At the same time, the Bank, together with government measures such as capital injection, is ready to discharge its responsibility as lender of last resort in providing liquidity when deemed necessary to maintain financial system stability.

Introduction of fixed asset impairment accounting

My bottom line thinking is as I have explained so far, and now I would like to consider challenges for financial institution management from different viewpoints such as the accounting system, which is a financial system infrastructure, and also strengthening the profitability of financial institutions.

The precise amount of NPLs has always been a matter of debate, and thus various improvements have been made such as clarification of the definition of NPLs and also the recognition process centering on the introduction of self-assessment.

However, for financial institutions to precisely grasp detailed conditions of borrowers, it is imperative that balance sheets correctly reflect their financial conditions. The improvement of accounting rules is quite an important task in order to pursue dialogue between financial institutions and borrowing firms. Although Japan’s accounting rules recently underwent substantial change because of, for example, the introduction of mark-to-market accounting for financial products, there still remain challenges, especially the introduction of fixed asset impairment accounting.

When the profitability of fixed assets is lower than anticipated, fixed asset impairment accounting rules require firms to recognize differences from initial plans as losses, thereby aiming at narrowing divergence between balance sheets and the actual business conditions of firms. The Business Accounting Council released an exposure draft this April and fixed asset impairment accounting rules are scheduled to be introduced from fiscal 2005. The introduction of the new accounting rules will impact corporate management, but in view of their significance I hope for their early introduction following thorough discussion.

It goes without saying that such accounting principles are also applied to financial institutions. Because of balance sheet regulations, especially capital adequacy requirements, accounting rules have extremely important meaning for financial institutions.

In this regard, the Basle Committee on Banking Supervision, an international forum on bank supervision, is considering revising international capital adequacy requirements with a view to implementing revised requirements from end-2006.

The most important point of the revision is the introduction of a mechanism that recognizes any deterioration in the value of loan assets at an early stage and that requires a proportional increase in capital corresponding to such deterioration or the risks adhering to projects. Under the current Basel Capital Accord, financial institutions are required to hold 8% of capital against corporate loans, while the new Accord tries to estimate the probability of default according to the business conditions of borrowing firms and imposes required capital based on such estimates. Leading banks in Western countries have already adopted practices to promptly recognize any deterioration in the value of loan assets within their credit risk management framework.

There is still some time until the implementation of the new Basel Capital Accord, but the idea that bank capital should be held as a cushion for risks corresponding to the business conditions of borrowers seems quite reasonable, and I believe it necessary that Japan's financial institutions should, regardless of the existence of regulations, actively pursue sophistication of such risk management.

Strengthening of profitability

As far as bank management goes, risk-based pricing is as important as holding capital to cover risks.

Stated another way, it is important to secure lending profit margins. In the business world, it seems quite reasonable for financial institutions to receive interest from borrowing firms based on negotiations and the risks involved. However, in order to do so, it is quite important for financial institutions to reach an understanding with the borrowers who pay the interest.

For example, in the US, many firms ranging from large firms to those with lower credit ratings and medium-sized firms, widely issue corporate bonds to obtain funding, and a resale market for loan assets is in place. Yields of corporate bonds issued and those in the secondary market for loan credits are mutually arbitraged with lending rates, thus forming an environment in which lenders and borrowers can easily agree with respect to interest rate conditions. Improvement in terms of direct access by small and medium-sized firms to capital markets and expansion of the secondary market for loan credits including NPLs are also important tasks in Japan. Once a secondary market for loan credits starts to function, removal of NPLs from balance sheets can be made more efficiently, and will have a positive effect in improving capital efficiency. And, It is important to continue improving the secondary market for loan credits by exerting steady efforts to reduce legal costs such as by standardizing contract formats and simplifying the procedure to transfer legal rights.

From the viewpoint of strengthening conviction with respect to interest rate setting, some point out that credit assessment by Japanese financial institutions has put too much emphasis on judging whether there is default risk or not and has disregarded viewpoints such as the probability of default and what interest rate would be necessary to make a loan profitable. In order to set interest rates based on credit risks, I hope our financial institutions will take a more forward-looking attitude in dialogue with their customers.

From the viewpoint of improving financial institutions' profitability, there are other important tasks. To begin with, cost reduction and retreat from unprofitable business sectors are fundamental ways of increasing profits, and thus financial institutions should constantly review their business and drastically pursue such measures if deemed necessary. In addition, not to go as far as seeing entry to other business sectors, I believe that chances to develop various financial services are substantially increasing with the arrival of a full-fledged high-tech society. Individual financial institutions will be rewarded if they use their ingenuity and make unremitting efforts toward improving the quality of their financial services.

The issue of public financing

Of course there is a problem which cannot be solved through responses by financial institutions alone and that is the existence of public financing. The existence of institutions that provide public financing is extremely large in Japan compared with other countries and there are not a few areas in which they compete with private financial institutions. Viewed from the aspect of setting appropriate loan rates to cover risks, it seems necessary to review the role of government-affiliated financial institutions. Structural reform should proceed based on the idea that business activity be left to the private sector to the fullest extent possible.

Concluding remarks

Today, I have talked about recent economic developments and financial system problems. With respect to economic developments, I have explained that our economy has finally started to witness some cyclical bright signs. On the financial system front, I have explained that, under a new environment where the blanket guarantee of deposits is scheduled to be terminated, there still remain many challenges financial institutions have to tackle. What I wanted to emphasize most in today's speech is that, for our economy to realize autonomous and sustainable growth, we should not be complacent about the cyclical improvement of the economy but seriously tackle resolution of the NPL problem and structural reform of the economy. These are the important challenges which Japan's economy could not accomplish during the 1990s and which have been carried over to the 21st century.

I believe that, if not only the government but also financial institutions, private firms, and each and every citizen make efforts to derive and enhance the growth potential of Japan's economy, we can form the foundation for renewed economic development. The Bank of Japan will continue to make every effort on the monetary policy front to achieve price stability and sustainable economic growth, as well as to discharge its responsibility as a central bank from the viewpoint of financial system stability.