

Masaru Hayami: Remarks on the Bank's view of Japan's recent economic and financial developments

Statement by Mr Masaru Hayami, Governor of the Bank of Japan, concerning the Bank's Semiannual Report on Currency and Monetary Control (before the Committee on Financial Affairs, House of Representatives, on 19 July 2002), Tokyo, 5 August 2002.

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Introduction¹

The Bank of Japan submitted its Semiannual Report on Currency and Monetary Control for the second half of fiscal 2001 to the Diet in June 2002. I appreciate this opportunity to present an overall review of the Bank's recent conduct of monetary policy.

Today, I would like to make some remarks on the Bank's view of Japan's recent economic and financial developments and on the thinking behind our recent conduct of monetary policy.

I. Developments in Japan's Economy

Japan's economy continued to deteriorate throughout 2001 and into early 2002, reflecting the rapid deceleration of the world economy due to adjustment in IT-related industries. After the spring of 2002, however, the pace of the deterioration moderated, reflecting the recovery in overseas economies. Recently, Japan's economy has almost stabilized as a whole with an increasing upward impetus from exports and production, and an improvement in corporate profits and business sentiment. Employment conditions continue to improve, albeit marginally, with an increase in overtime hours worked and in new job offers. In contrast, private demand, a key factor for a sustainable recovery of the economy, has not displayed any clear movement toward recovery. Business fixed investment continues to decrease, and private consumption remains weak as a whole.

As for the economic outlook, if overseas economies continue to recover, the stabilization of Japan's economy will become more secure as the increase in exports and production will underpin domestic private demand through the improvement in corporate profits. However, considering that forces restraining the economy, such as excessive employment and debt, are still persistently at work, momentum for a self-sustaining recovery will be subdued for some time. In addition, uncertainty regarding external conditions which supported the recent economic recovery is rising somewhat amid a fall in stock prices in the United States and worldwide as well as depreciation of the U.S. dollar.

Regarding prices in Japan, domestic wholesale prices have been generally leveling off, due partly to the effects of the increase in import prices in the past and of the completion of inventory adjustment. The pace of year-on-year decline in domestic wholesale prices has been slowing gradually. On the other hand, consumer prices continue to decline at a moderate pace. With regard to the outlook, the slower growth in imports of consumer goods is expected to alleviate the downward pressure on prices to some extent. However, as I mentioned earlier, momentum for a recovery in domestic private demand is expected to be weak, and factors such as technological innovation, deregulation, and streamlining of distribution channels will continue to restrain prices. Given the situation, prices as a whole are expected to follow a moderate downtrend for the time being.

II. Financial Developments

Financial markets were unstable toward the end of March 2002, reflecting market participants' nervousness due to growing concern about the stability of the financial system in the period immediately before the removal of blanket deposit insurance. Regarding corporate financing, the lending attitude of private banks became more cautious, and the financing conditions of firms with high credit risks, especially small firms, gradually became more severe.

¹ Governor Hayami made a statement regarding the Semiannual Report on Currency and Monetary Control for the second half of fiscal 2001 before the Committee on Financial Affairs, House of Councillors, on July 4, 2002.

Financial markets have gradually regained stability on the whole since April 2002, as the economy improved slightly. In the corporate bonds and CP markets, the issuing environment has been improving recently. This suggests that investors' stance toward taking credit risk is starting to improve. Financing conditions of firms with relatively high credit risks, however, remain severe. Hence, developments in the behavior of financial institutions and corporate financing continue to require close monitoring.

Japanese stock prices have been somewhat weak since mid-June 2002, reflecting the fall in U.S. stock prices. The yen has become stronger against the U.S. dollar. If these developments go so far as to cause financial markets to become significantly unstable, Japan's economy, which is on an improving trend, will be negatively affected. Thus, developments in financial markets also require close monitoring.

III. Recent Conduct of Monetary Policy

The Bank adopted a new framework for money market operations at the Monetary Policy Meeting in March 2001. The main operating target was the "quantity" of liquidity, i.e., the amount of the outstanding balance of current accounts at the Bank as the uncollateralized overnight call rate had declined to low levels close to zero percent and there was hardly any room left for further easing using orthodox monetary policy measures. Under the new framework, the Bank has been conducting drastic monetary easing, unprecedented in the history of central banking at home and abroad.

The Bank has devised means of funds provision and broadened the range of eligible collateral with a view to making the effects of monetary easing permeate into corporate financing.

As a result, interest rates have been at extremely low levels. For example, in addition to overnight call rates, short-term interest rates with relatively longer maturity declined to close to zero percent. The year-on-year growth rate of the monetary base increased considerably, by 20-30 percent.

The Bank's conduct of monetary policy has played an important role in preventing further deterioration of the economy by securing stability in financial markets when Japan's economy was under significant stress due to adjustment in IT-related industries worldwide, the terrorist attacks in the United States, and increasing concern about the stability of the financial system.

However, it is also true that business fixed investment and household spending have not been fully revitalized in a situation where Japan's economy is facing various structural problems. In order to make the monetary easing fully effective and achieve a full-scale economic recovery, it is essential to accomplish the following. Private demand must be generated by advancing structural reforms on the economic and industrial fronts through tax reform and implementation of concrete measures to revitalize the economy. At the same time, it is also vital to strengthen the financial system and ensure its stability by resolving the nonperforming-loan problem.

Conclusion

Japan's economy is about to undergo its third cyclical recovery since 1990. In the past two recovery phases, the economy lost its momentum due to the slowdown of overseas economies and concern about the stability of the financial system. As a result, private demand could not expand autonomously and sustainably on the whole. Bearing that experience in mind, the Bank strongly hopes that action to tackle structural reforms will be pursued tenaciously in a variety of fields to establish a basis for the sustainable growth of Japan's economy.

The Bank is determined to continue to do its utmost from the both of the following viewpoints as a central bank. First, it will make efforts to stabilize financial markets and ensure permeation of the effects of monetary easing through provision of ample liquidity so that Japan's economy will exit from deflation. And second, the Bank will endeavor to prevent systemic risk from materializing as "the lender of last resort."