

# Toshihiko Fukui: A review of the Bank of Japan's conduct of monetary policy

Statement by Mr Toshihiko Fukui, 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, Tokyo, 18 April 2003.

\* \* \*

## Introduction<sup>1</sup>

The Bank of Japan (hereafter, the Bank) submitted its Semiannual Report on Currency and Monetary Control for the first half of fiscal 2002 to the Diet in December 2002. I am pleased to have this opportunity to present an overall review of the Bank's conduct of monetary policy.

It has been almost a month since I assumed the governorship of the Bank on March 20, 2003. The Bank is determined to utilize all of its intellectual resources and expertise and do its utmost as a central bank, in order to put Japan's economy back on a sustainable growth path and overcome deflation.

## I. Developments in Japan's economy

Economic activity in Japan remains flat as a whole. This is because, while business fixed investment has started to recover, there has been greater uncertainty about the economic outlook mainly reflecting developments overseas, especially the effects of the situation in Iraq.

Looking at the economic outlook in more detail, with overseas economies following a gradual recovery path, exports and production are expected to resume their upward trend, which in turn will initiate the momentum for a recovery.

However, there is uncertainty regarding the outlook for the United States and other overseas economies. Japan's economy is very likely to lack the momentum for a self-sustained recovery for some time, taking into account persistent downward pressure on the economy stemming from the excessive labor input and debts.

Regarding prices in Japan, with the rise in import prices and an improved supply-demand balance in materials industries, the decline in domestic corporate goods prices has, on the whole, almost come to a halt. Consumer prices have been declining gradually, but looking forward, the pace of decline is expected to become somewhat slower due to the effects of (1) the rise in crude oil prices, and (2) the changes in the system of social security and indirect taxes.

## II. Financial developments

Financial markets have been generally stable, including through the fiscal year-end at the end of March 2003, reflecting ample liquidity provision by the Bank.

However, stock prices continue to be volatile, against the background of uncertainty about the economic outlook both at home and abroad. In particular, the weakness in banks' stock prices is becoming conspicuous, mainly reflecting market participants' severe view of the profitability of Japanese financial institutions.

In corporate finance, the financing conditions of firms are accommodative on the whole, but the environment continues to be severe for firms of relatively low creditworthiness.

---

<sup>1</sup> Governor Fukui made the same statement regarding the *Semiannual Report on Currency and Monetary Control* for the first half of fiscal 2002 before the Committee on Financial Affairs, House of Councillors, on April 17, 2003.

### III. Conduct of monetary policy

For almost a month now, I have taken the initiative to address the following two problems: first, to prevent any immediate crisis taking into account the developments in Iraq; second, to strengthen the effectiveness of monetary easing for the longer term.

The Bank has been closely monitoring how the development of the situation in Iraq would affect the economy, especially through the stock and foreign exchange markets, and provided a large amount of additional liquidity to ensure financial market stability with the approach of the fiscal year-end. In addition, the Bank has decided for the time being to apply the official discount rate to the Lombard-type lending facility on any business day, suspending the restriction on the maximum number of days for such use. Use of this lending facility enables financial institutions that hold current accounts with the Bank to borrow funds from the Bank at need within the value of collateral submitted.

Reflecting the above measures, liquidity concern in the money market has been dispelled, and there was no significant disruption at the turn of the fiscal year.

In its future conduct of monetary policy, the Bank considers it an important task to ensure that the provision of ample liquidity leads to a revitalization of economic activity and the overcoming of deflation. Based on this understanding, the Bank is examining the basic framework for the conduct of monetary policy, with a view to enhancing the transparency of monetary policy and strengthening the transmission mechanism of monetary easing.

The Bank's current quantitative easing policy has contributed significantly to ensuring financial market stability and to preventing the economy from falling into a deflationary spiral. However, the financial intermediary function of banks has been weak and economic activity has yet to be sufficiently stimulated.

It is apparent that the nonperforming-loan (NPL) problem is the largest impediment to the effectiveness of the financial intermediary function in the financial system. Thus, it is essential for the private sector and policymakers to coordinate their efforts to resolve the NPL problem.

At the same time, it is very important for the Bank to improve its promotion of smooth corporate financing and its implementation of money market operations to strengthen the transmission mechanism of monetary easing, against the background of the banks' weak financial intermediary function, which is an important route for the transmission of the effects of monetary policy.

In light of this, the Bank has decided, as a temporary measure, to examine the possible purchase of asset-backed securities (ABSs), including asset-backed commercial paper, mainly backed by those assets related to small and medium-sized firms.

ABSs are marketable securities into which pools of specific assets such as accounts receivable held by firms are converted. The ABS market in Japan is still in the process of development. However, nurturing the development of the ABS market is expected to provide various merits in corporate finance, in particular enabling small and medium-sized firms to exploit an alternative route of raising funds to bank borrowing.

The Bank hopes that the transmission mechanism of monetary easing will be strengthened through the Bank's support for the establishment and development of financial markets that will be able to provide new financing channels.

The Bank is currently working on a specific design for the ABS purchasing scheme which would contribute to the development of the ABS market, gathering opinions from market participants.

Financial markets are basically expected to be initiated by the private sector and to evolve autonomously. For this reason, the Bank's outright purchases of private debts such as ABSs are unprecedented measures for a central bank.

Therefore, the Bank will determine the specific design of the purchasing scheme, considering the following: to what extent the purchase will strengthen the transmission mechanism; whether or not the purchase will distort market mechanisms; and how to maintain the financial soundness of the Bank and ensure its ability to conduct monetary policy in the future.

#### **IV. Purchase of stocks held by commercial banks**

Although the measure does not fall directly within the province of monetary policy, the Bank started to purchase stocks held by private banks in November 2002, with a view to further reducing the market risk pertaining to these stocks. The total amount of stocks purchased as of April 10, 2003 was 1,209.0 billion yen.

The purchasing of stocks is one of the actions taken by the Bank aimed at the early restoration of the soundness of the financial system. Such restoration of the soundness of the financial system is considered indispensable in strengthening the transmission mechanism of monetary policy.

#### **Conclusion**

Japan's economy is undoubtedly confronting important challenges.

The environment surrounding Japan's economy faces significant changes such as progress in information and communication technology and the rapid rise of emerging economies as well as economic maturation and globalization.

Faced with such drastic changes, the Bank believes that the existing economic model, which supported Japan's postwar economic growth, needs to be replaced, and that the driving force of the new model should be innovations, both in technology and knowledge. The Bank considers it essential for the private sector, the government, and the Bank to coordinate their efforts toward the same goal in order for Japan's economy to adapt itself boldly to the new environment.

The Bank will continue to do its utmost to carry out its mission of achieving price stability and maintaining an orderly financial system.