

Toshihiko Fukui: Europe's single currency and Japan's contributions to Asian development

Speech by Mr Toshihiko Fukui, Governor of the Bank of Japan, on the occasion of dinner in the French Embassy, Tokyo, 11 June 2003.

* * *

I. Fighting deflation

I am very happy to be invited to speak at this Euro 50 banquet. My relationship with Europe dates back to thirty years ago. At that time, I was working for the Bank of Japan's Paris office. I vividly remember those days, especially when I took a walk in the streets of Paris, painted with so much history, culture and esprit, and when I took a rest reading books in the relaxing atmosphere à la Place des Vosges. Actually, I asked Ambassador Montferrant to look at a photograph I had taken there when he visited me recently in my office.

I was appointed Governor of the Bank of Japan three months ago. On the same day with my assuming office, the war in Iraq started. As I will explain in more detail later, I am thinking that the globalization could be really fruitful, only if, on its process, we are able to overcome conflicts between different values and jointly to create new values. The outbreak of the war, however, seemed to expose the flip side of this process. Moreover, it increased uncertainty in the world economy, and therefore I had to prepare myself for a rocky start in taking up my new duties.

Good news as you see, the Iraqi War came to an end quickly and the accompanying uncertainty is now waning, but the situation remains to be difficult. The governments and central banks all over the world are far from being reassured that the economy will return rapidly to sustained economic growth.

We at the Bank of Japan are waging a tough war against deflation. Indeed, it is at the top of our policy agenda. I have spent a total of about 40 years working in the central bank and for virtually all of that period the emphasis has been placed on how to prevent inflation. However, both globalization and the advances in IT have intensified the global trend towards disinflation and created a new awareness among central banks that they must deal symmetrically with both inflation and deflation.

We at the Bank of Japan stand on the front line of the war against deflation. However, we have used up the greatest weapon in a central bank's arsenal, that is interest rates, which have all declined to virtually zero in our short-term markets. Thus, in the spring of 2001 we stepped into new territory, where no central bank has ever ventured, namely "quantitative easing". Here, there are two important points. The first is to set quantitative targets in the form of outstanding balance of current account deposit with the Bank and then to aggressively supply abundant liquidity into financial markets. The second is to make a commitment to maintain such an accommodative policy stance until the Consumer Price Index registers a year on year increase of zero percent or above on a sustainable basis. The fundamental aim of this point is to lower long-term interest rates across the board by borrowing future monetary easing through the commitment. Furthermore, we are now exploring ways to improve the transmission mechanism of monetary policy so that the beneficial effects of quantitative easing can more smoothly penetrate every corner of the economy.

Obviously, the war against deflation will not be won with monetary policy alone. All economic agents must review the legacies of past high growth period and make every effort to enlarge the capacity to create value added. It has become clear to us that we will only find a way out of deflation when the efforts of the private sector, the government, and the Bank of Japan generate synergies in this endeavor.

II. Interest in Europe

I fear my introductory remarks might have been getting too long, so I will move on. In October 1970, shortly after I arrived in Paris, the Werner Report came out, officially advocating economic and monetary union in Europe.

Frankly speaking, as an outsider, I considered the grand idea of the economic and monetary union, however grand it would be, to be no more than an "adventurous experiment". No one could tell where it would go. Therefore, I was profoundly moved to witness the introduction of the Euro in January 1999

and the conversion of all cash to Euro last year. The EMU was not just another “experiment”. The people of Europe gathered their wisdom and courageously marched forward to turn a dream into reality. In this regard, we must remember in particular the efforts that were made to overcome the “Euro pessimism” of the late seventies and early eighties.

To me, the single currency symbolizes many things. The first is the great potentiality that Europe has in terms of “creating history”. I have nothing but respect for the strong leadership and the persistent efforts that were exerted to complete this job, a job requiring 50 or 100 years to accomplish. Second is the strong desire for peace that has been underlying the spirit of solidarity ever since the European Coal and Steel Community. Having suffered through repeated, terrible wars, the people of Europe have a strong resolution never to go to war again. Third is the emphasis on “social discipline” that underpins the solidarity of Europe. I think this is particularly well embodied in the Stability and Growth Pact and the efforts to ensure independence of the ECB.

I am also much interested in the future of the enlarged EU. Recently, the “Convention on the Future of Europe” chaired by former French President Valéry Giscard d’Estaing, advocated the drafting of a “European Constitution,” the creation of a “European presidency,” and a reduction in the number of seats on the European Commission. Although this recommendation adds weight towards political union, I also find it extremely significant in light of the awareness that our age must “overcome conflicts of values”.

And on the economic front, I look forward to seeing how the people of Europe will lead the EU’s integrated market into an ever larger entity in a form that is always open to the outside and in harmony with globalization.

III. Japanese contributions to the further development of Asia

Compared to Europe’s long history in working towards regional integration, cooperation and coordination in Asia are still at their early stage, and a clear vision for the future has yet to emerge. In this we are different from the Americas, too, which have set a course towards the achievement of the Free Trade Area of the Americas.

Asia is characterized by its diversity. We have a large number of ethnic groups, languages, religions, and cultures, and there are considerable differences in our stage of economic development. Asia has a long way to go before it could ever be considered as an “optimum currency area”.

But diversity is also Asia’s strength. Economies with their own comparative advantages can and do create layers of linkages through trade and direct investment, which produce a dynamism of growth. And this has enabled Asia to emerge as one of the world’s growth centers. China has achieved remarkable economic growth over the past several years, and it has given new momentum to dynamic international divisions of labor and global economic growth. China has such an enormous production capacity that other countries sometimes perceive it as a “threat,” but, at the same time, it should be noted that the Chinese big domestic markets are increasingly providing demand and business opportunities to the neighboring countries. From this point of view, the sustainability of Chinese economic growth has become an indispensable factor for autonomous expansion of the Asian economy as a whole, particularly the East Asian economy.

At present, with the exception of worries about SARS, conditions in Asia look relatively good. Economies in the East Asian region have been growing at an increasingly rapid pace. For example, the ratio of intra-regional trade to nominal GDP for the nine East Asian economies has more than doubled from 8% in the late eighties to 17% today. This ratio is roughly the same as that of the EU.

At the beginning of my remarks I said that globalization was a process through which we overcome conflicting values and jointly create new values. The dynamism of Asia seems to embody this. That is, Asia is a place where different values come into contact with each other and create new knowledge in the process.

Against this background, Japan is making progress steadily in its structural reforms, aiming at reaching the final goal that it will become a home of high value added, a hub for gathering, creating and transmitting information that will contribute to further development of Asia as a whole.

Here, let me discuss again the central bank job. In 1991, Asian central banks established EMEAP (Executives’ Meeting of East Asia-Pacific Central Banks), which serves as a forum for the regular exchange of information and views among them. Over the weekend, I attended my first EMEAP

governors' meeting, and what I took away from that meeting was the increasing complexity of the challenges that face central banks in East Asia, challenges that cannot be solved with domestic remedies alone. Along with this, I also perceived a growing momentum for central banks to pool their wisdom and act together to solve these challenges.

These efforts are beginning to bear fruit. At the beginning of this month, EMEAP announced the project of the Asian Bond Fund which will invest part of the foreign reserves held by East Asian central banks in Asian bonds, thereby serving as a catalyst to greater activity on fixed income markets in the region. The Bank of Japan supports this initiative and will actively participate in the fund.

Both dialogue and cooperation among East Asian central banks have only just begun. It is too early to tell whether this dialogue and cooperation will eventually lead to regional integration. Even if it does, the orientation of that integration is unlikely to be the same as Europe's in view of the historical and economic differences between the two regions.

However, if we take an optimistic look at the future, our steady efforts may result in the formation of an open, flexible and surprisingly well-organized regional economic zone within the context of "future globalization of complexity".