

## Toshihiko Fukui: The Japanese economy

Summary of remarks by Mr Toshihiko Fukui, Governor of the Bank of Japan, at the National Securities Industry Convention, Tokyo, 18 September 2003.

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As you are aware, economic activity in Japan continues to be virtually flat. Recently, however, some signs of apparent recovery are being observed.

Business fixed investment is recovering gradually against the background of an upturn in corporate performance—a trend evident particularly among large manufacturers. As for the export environment, the likelihood is gradually increasing that the growth rate of the U.S. economy will accelerate and that the East Asian economies as a whole will resume a growth trend. Furthermore, business and household sentiment is getting a boost from the substantial rise in stock prices from their low levels during the early spring.

Thus, it is likely that exports and production will gradually resume an upward trend, triggering a virtuous circle leading to a moderate self-sustained recovery in domestic demand.

The extent and strength of recovery based on this scenario of export and production growth need to be monitored closely, as they could be affected adversely by ongoing structural adjustments, such as firms' reduction of excess debts and labor costs.

With regard to financial markets, long-term interest rates are increasing along with the rise in stock prices. Long-term rates normally move in response to market participants' prospects for the economy. In the short term, however, they may move erratically in response to various other factors. The Bank of Japan, for its part, will monitor closely the overall trend of financial markets, watching, for example, any developments in long-term rates that are not in line with economic activity.

Next I will touch on the Bank's monetary policy. The Bank has provided liquidity in a flexible and proactive manner in response to various cases of rising uncertainty under the framework of quantitative monetary easing. As a result, I believe the Bank has been able to prevent various risk factors from exerting a negative impact on the economy through heightened liquidity concerns.

Needless to say, the Bank will do its utmost to support the Japanese economy. It will maintain the policy of quantitative monetary easing to ensure the progress of economic recovery, supplying sufficient liquidity and strengthening the working of the transmission mechanism of monetary easing.

The Bank remains firmly committed to maintaining the current quantitative easing policy until the year-on-year increase in the consumer price index (CPI) becomes stably zero or above. This is a clear and specific pledge aimed at actual CPI data made public each month, and not the prospect of it. I would like to emphasize this point, although I am aware that it has been stated explicitly on several occasions in the past.

As I have explained, the Bank's commitment to easy monetary policy is unequivocal. However, the role of financial markets in delivering its commitment effect through the entire economy is equally great and not to be discounted. A key factor behind their role, I believe, is the "price discovery function." In other words, the determination of market prices and interest rates at levels that reflect the degree of relevant risks is the most important premise for the efficient distribution of funds required by firms and households. Further refinement of the price discovery function through development of innovative transactional techniques in an environment of enhanced market liquidity should lead to more efficient funds allocation and, hopefully, more active investment by the private sector.

In this connection, markets for new securitization products such as asset-backed securities (ABSs) have grown in recent years. I strongly hope that securities firms, the main players in the securities market, and other relevant institutions will continue to utilize their ingenuity in developing new and innovative financial instruments that will further invigorate financial markets.

The Bank, for its part, has recently started purchasing ABSs to help support this market. It is unprecedented for a central bank to directly accept the credit risk pertaining to private-sector debt, and this is, therefore, a move that we hope will act as a "catalyst" for the autonomous development of the ABS market.

Next, I would like to turn to Japan's financial system, which, though still under serious strain, appears to be gradually improving its soundness.

Nonperforming loans (NPLs) held by financial institutions as a whole remain the most crucial issue. The economic value of loans is being appropriately evaluated. And based on this evaluation, appropriate provisioning and write-offs are being promoted. Currently, efforts are being made to enhance concerted action by both the financial and industrial communities.

It is notable that parties concerned are becoming increasingly aware of the necessity to utilize corporate managerial resources in achieving structural reforms, rather than wastefully abandoning them. While the work of the Industrial Revitalization Corporation, a public entity, is getting into full swing, unassisted and voluntary actions on the part of the private sector are also growing more widespread.

Moreover, from the viewpoint of reforming Japan's economy and industrial structure, which forms the basis of the economy, it is essential that new and innovative value-added products and services be created. It is important, therefore, for large numbers of entrepreneurs, the creators of new businesses, to emerge. The price discovery function of the market, pointed out earlier, comes into play in this connection. As a part of facilitating the environment, it is essential that risk capital be provided through the channel of the price discovery function to such entrepreneurs. The mediation of risk capital between investors and industries is one of the fundamental roles performed by the securities industry. Needless to say, herein also lie major business opportunities. I would like to add here my expectation that the securities industry takes a further step forward in this regard now that there is felt to be an ever-increasing need for industrial restructuring.

At the same time, there exists an undiminished expectation that the securities industry, as a major player in the financial markets, will continue in its efforts to further invigorate the markets. One of the means to achieve this objective would be the improvement in transparency and smooth functioning of the market by enhancing clarity in presenting risk-return relationships to customers of the securities firms. I believe that increased competition between securities companies and other financial institutions in providing varied and dependable credit intermediation services strengthens the financial system as a whole and thereby helps improve the structure of the economy.

It is evident that securities companies themselves must improve their managerial capabilities if they are successfully to perform such an important role. At present, the stock market is showing some buoyancy in terms of both price and volume. I trust, however, that the securities industry will not loosen its resolve and that it will continue to target creativity and higher efficiency.

The Japanese economy as well as the financial system is still burdened with a number of difficulties. Nevertheless, lights of hope, though dim at present, are on the horizon. The Bank, for its part, will continue to do its utmost to ensure that these lights do not fade.