

Toshihiko Fukui: Overall 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 Councillors, Tokyo, 28 October 2004.

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Introduction

The Bank of Japan submitted its *Semiannual Report on Currency and Monetary Control* for the second half of fiscal 2003 to the Diet in June 2004. I am pleased to have this opportunity to present an overall review of the Bank's conduct of monetary policy.

I. Developments in Japan's economy

Japan's economy continues to recover. Overseas economies, one of the factors behind this recovery, are maintaining their expansion, although decelerating somewhat from their high growth so far. In the United States, growth in private consumption has decelerated due partly to the rise in crude oil prices. The pace of increase in the number of employees has also slowed compared with early spring. However, it appears that momentum for economic expansion is being maintained, since corporate profits and business fixed investment have been increasing. East Asian economies, particularly the Chinese economy, continue growing relatively fast.

Amid these developments in overseas economies, Japan's exports and production have been on a rising trend, albeit at a slightly slower pace, leading to an improvement in corporate profits and an expansion in business fixed investment. This virtuous cycle is a factor behind the current economic recovery.

Another factor behind the economic recovery is the considerable progress being made in dealing with structural elements such as excessive capital stock, debt, and labor in the corporate sector, and the vulnerability in the financial system, all of which had delayed the recovery of the Japanese economy. As a result of the progress in these adjustments, corporate profits have increased substantially and the employment situation has been improving.

Looking forward, Japan's economy is expected to continue recovering with the ongoing expansion of overseas economies and the easing of structural adjustment pressure in Japan, although attention should be paid to factors such as the effects of the significant rise in crude oil prices on both the domestic and overseas economies and developments in global IT-related demand.

On the price front, domestic corporate goods prices have been rising due to the strengthening at home and abroad of the prices of commodities such as crude oil and to the improvement in supply and demand conditions. Consumer prices (excluding fresh food, on a nationwide basis), in contrast, continue to fall slightly on a year-on-year basis partly because the increase in productivity and the restraint on labor costs by firms have absorbed the effects of the rise in commodity prices.

The money market remains stable overall against the background of the Bank's provision of ample liquidity. In the capital markets, long-term interest rates rose somewhat toward the middle of 2004, but have been moving at around 1.5 percent recently. Stock prices have been generally firm with the ongoing economic recovery.

The environment for corporate finance is becoming more accommodative on the whole, although it remains severe for firms with high credit risks. The lending attitude of private banks is becoming more accommodative, and the lending attitude of financial institutions as perceived by firms has been improving. The pace of decline in credit demand in the private sector is becoming somewhat moderate. Under these circumstances, the rate of decline in lending by private banks has basically been diminishing. Moreover, the fund-raising environment for firms in the capital markets through CP and corporate bonds remains favorable, and the amount outstanding of CP and corporate bonds issued continues to be above the previous year's level.

II. Conduct of monetary policy

The Bank has been conducting the quantitative easing policy with the outstanding balance of current accounts held at the Bank as the operating target. In accordance with the current target range for the outstanding balance of “around 30 to 35 trillion yen,” the Bank is providing ample liquidity to the money market. The Bank has also made a commitment to maintain the quantitative easing policy until the year-on-year rate of change in the consumer price index (CPI; excluding fresh food, on a nationwide basis) registers zero percent or higher on a sustainable basis.

The Bank’s commitment has contributed to stabilizing market participants’ projection of future interest rates, and thus market interest rates have been stable. In this situation, firms have been able to raise funds at low interest rates. The commitment’s positive effects through interest rates on the economy will strengthen as corporate profits increase with economic recovery.

With these policy effects in mind, the Bank has firmly maintained its quantitative easing policy with the commitment based on the CPI.

The Bank has been making efforts to make credit intermediation in the market more diversified and efficient so that monetary easing effects permeate throughout the economy, and these efforts are expected to improve the Japanese financial and capital markets in the long term. As part of such efforts, the Bank started to purchase asset-backed securities (ABSs) in summer 2003, and the total amount of ABSs purchased to date has reached around 1.5 trillion yen.

In addition, in May 2004, with a view to enhancing the liquidity of Japanese government securities (JGS) markets, the Bank introduced a facility which temporarily provides the markets, as a secondary source, with JGSs held by the Bank when market participants experience difficulties in securing specific issues. The Bank has been making a wide range of efforts to improve the infrastructure of financial markets and will continue to do so.

III. Purchases of stocks held by commercial banks

The Bank had been purchasing stocks held by commercial banks since November 2002 to reduce the risk that stock price fluctuations might impact negatively upon the business management of individual financial institutions, potentially resulting in instability of the financial system as a whole. This program was wound up at the end of September 2004. The accumulated total of stocks purchased by the Bank amounted to 2,018.0 billion yen.

Conclusion

Japan’s economy is expected to continue recovering with the ongoing expansion of overseas economies. To ensure that this recovery will become sustainable and to overcome deflation, the Bank considers it essential that a wide range of economic entities continue to make efforts to revitalize the economy.

The Bank is determined to firmly support Japan’s economy from the financial side by maintaining monetary easing with the commitment based on the CPI even in a situation where the economy continues to recover.