

Toshihiko Fukui: Review of Japan's economy

Statement by Mr Toshihiko Fukui, Governor of the Bank of Japan, concerning the Bank's seminannual report on currency and monetary control, before the Committee on Financial Affairs, House of Representatives, Tokyo, 2 August 2005.

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Introduction

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, albeit with adjustments in IT-related sectors.

In more detail, although the momentum of growth in exports, particularly to China, has been weak recently after the significant increases through the middle of 2004, industrial production is on a gradual uptrend as inventory adjustments in the IT-related sectors are progressing. Business fixed investment has continued to increase, as corporate profits have remained high and business sentiment has shown improvement again. Household income has been rising, albeit moderately, as the employment situation has been improving and wages have stopped declining. In this situation, private consumption has been steady.

Based on these developments, it can be said that the economy is emerging from its temporary pause.

As for the outlook, growth in exports is expected to accelerate gradually as overseas economies continue to expand, and domestic private demand is likely to continue increasing against the background of high corporate profits and the moderate rise in household income. The economy is therefore expected to follow a sustainable growth path, albeit at a moderate pace.

On the price front, as the output gap continues to narrow, domestic corporate goods prices have been increasing, mainly reflecting the effects of the rise in crude oil prices. They are likely to continue on an increasing trend, but the rate of growth is expected to slow for the time being. Consumer prices (excluding fresh food) have basically been declining slightly on a year-on-year basis, partly due to the reduction in electricity and telephone charges against the background of such factors as deregulation, and they are projected to continue falling slightly for the time being. However, they are expected to start increasing on a year-on-year basis at some point in late 2005 or early 2006, as the effects of temporary factors, such as the decline in rice prices and the reduction in electricity and telephone charges, fall off.

In the capital markets, stock prices have been firm on the whole and long-term interest rates have been stable. The environment for corporate finance is becoming more accommodative on the whole. That is to say, in a situation where the lending attitude of financial institutions is becoming more active, the rate of decline in lending by private banks has been diminishing at a moderate pace. Moreover, the environment in the capital markets for firms raising funds through CP and corporate bonds is favorable.

II. Conduct of Monetary Policy

The Bank has been providing ample liquidity through its conduct of the quantitative easing policy. The framework of the quantitative easing policy is based on two key elements. The first element is the Bank's provision of ample liquidity to the money market so that the outstanding balance of current accounts at the Bank substantially exceeds the amount of required reserves. The second is the Bank's commitment to firmly maintain this ample provision of liquidity 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. At the Monetary Policy Meeting (MPM) on July 27, 2005, the Policy Board decided to maintain the target range for the outstanding balance of current accounts held at the Bank at "around 30 to 35 trillion yen."

In the money market, reflecting the dissipating concern about financial system stability, liquidity demand among financial institutions has been declining and they are feeling more strongly that there is an abundance of liquidity. Given this situation, since the MPM held on May 19 and 20, 2005, the Bank has been allowing a temporary fall of the outstanding balance below the target range when it is judged, in the situation where the Bank is doing its utmost to provide funds while at the same time giving due consideration to the effects on the functioning of the market, that financial institutions' liquidity demand is exceptionally weak. The Bank's decision is intended to enable the quantitative easing policy to be conducted more smoothly, not to change its basic policy stance.

III. The Bank's Measures regarding the Financial System after the Full Removal of the Blanket Guarantee of Deposits

As I mentioned earlier, the financial system in Japan has been regaining stability, and the full removal of the blanket guarantee of deposits was carried out smoothly on April 1, 2005. Financial institutions are expected to amplify their efforts to develop innovative services tailored to customer needs, thus supporting economic activity. The Bank's basic stance regarding financial system policy is shifting its focus in response to this changing environment: from crisis management to, while maintaining overall system stability, supporting private-sector initiatives to provide more efficient and advanced financial services through, for example, improved management of risks and business activities.

In order to contribute to enhancing the functioning and robustness of the financial system, the Bank will actively encourage financial institutions' efforts to improve their business activities, and devise various ways to enhance its own business operations.

Conclusion

Japan's economy continues to recover in a situation where overseas economies continue to expand. As for the outlook, it is expected to move onto a path of sustainable, albeit moderately paced, growth.

The Bank will continue to carefully watch changes in the economic environment and will conduct monetary policy in an appropriate manner. In the current situation where the CPI remains on a slight downtrend, the Bank is determined to support Japan's economy from the financial side to achieve sustainable economic growth with price stability, by maintaining monetary easing in accordance with the commitment based on the CPI.

In addition to its efforts in conducting monetary policy, it has become increasingly important for the Bank to pursue more advanced services in a wide range of areas as well as ensure well-disciplined management to properly carry out the duties entrusted to it as the nation's central bank. In light of this, the Bank has formulated a Medium-Term Strategic Framework (MTSF) for fiscal 2005-2009, which sets out the Bank's management policy for the next five years. The Bank is committed to continuing its efforts, through the steady implementation of this MTSF, to retain public confidence and fulfill its mission of contributing to the sound development of the economy.