

Toshihiko Fukui: Semiannual report on currency and monetary control

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, 16 June 2006.

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Introduction

The Bank of Japan submitted its *Semiannual Report on Currency and Monetary Control* for the second half of fiscal 2005 to the Diet on June 9, 2006. 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 steadily.

Exports and industrial production have continued to increase. Business fixed investment has continued to increase against the background of high corporate profits. This strong corporate performance is benefiting the household sector. The number of employees has been increasing steadily in a situation where firms were more aware of the shortage of labor, and wages have also been rising gradually as a trend. As a result, household income has continued rising moderately. With this steady improvement in the employment and income situation, private consumption has been on an increasing trend.

Looking forward, exports are expected to continue rising against the background of further expansion of overseas economies. Domestic private demand is likely to continue increasing against the background of high corporate profits and the moderate rise in household income. Japan's economy is likely to experience a sustained period of expansion, with domestic and external demand and also the corporate and household sectors well in balance in an environment in which a virtuous cycle of production, income, and expenditure will operate.

There are various risks concerning future developments in Japan's economy. For example, prices of international commodities such as crude oil have remained at high levels. In this situation, whether the world economy, especially the U.S. economy, can maintain sustainable growth while containing inflationary risks warrants attention.

On the price front, domestic corporate goods prices have continued to increase, mainly reflecting the rise in international commodity prices, and are expected to keep increasing for the time being. The year-on-year rate of change in the consumer price index (CPI; excluding fresh food, on a nationwide basis) turned slightly positive in November 2005 and has been posting relatively clear increases since January 2006. The conditions of persistent excess supply have been dispersed, and the output gap currently seems to be close to zero. The year-on-year rate of change in the CPI is projected to continue to follow a positive trend, as the output gap is likely to gradually become positive.

As for the financial environment, the environment for corporate finance continues to be accommodative. The rate of increase in the amount outstanding of lending by private banks is accelerating in a situation where private banks have been maintaining a proactive lending posture and the decline in credit demand in the private sector has come to a halt. In the corporate bond and CP markets, the issuing environment continues to be favorable.

Large fluctuations have recently been observed globally in financial markets. The Bank will closely monitor developments in financial markets and their effects on economic activity.

II. Conduct of monetary policy

As I explained in my statement to this Committee in March 2006 concerning the Bank's previous *Semiannual Report on Currency and Monetary Control*, the Bank terminated the quantitative easing policy and shifted the operating target of money market operations from the outstanding balance of

current accounts at the Bank to the uncollateralized overnight call rate at the Monetary Policy Meeting (MPM) held on March 8 and 9, 2006. Since then the Bank has been maintaining the guideline for money market operations that the Bank will encourage the uncollateralized overnight call rate to remain at effectively zero percent, and at the MPM held on June 14 and 15, decided to maintain this guideline.

The Bank has been reducing the outstanding balance of current accounts based on the guideline, paying due attention to the stability of the money market. Through this process, the uncollateralized overnight call rate has been stable at around zero percent, despite small temporary increases. In the call market, the volume of transactions has been gradually increasing.

The Bank has explained its basic thinking regarding the future conduct of monetary policy together with the projection for economic activity and prices in the *Outlook for Economic Activity and Prices* published at the end of April 2006 as follows. As long as Japan's economy experiences a sustained period of expansion, with domestic and external demand and also the corporate and household sectors well in balance, it seems probable that the accommodative financial conditions ensuing from very low interest rates will be maintained for some time following a period in which the uncollateralized overnight call rate is at effectively zero percent. Through and beyond this stage, the Bank will adjust the level of interest rates gradually in the light of developments in economic activity and prices. The timing of a policy change and the level of interest rates will depend on developments in economic activity and prices from this time on, and there is no predetermined view regarding the future path of monetary policy at this point.

The Bank is determined to conduct monetary policy appropriately in the light of developments in economic activity and prices, and contribute to sustainable economic growth with price stability.