

Toshihiko Fukui: Developments in Japan's economy and an overall review of the central bank'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 and House of Representatives, 1-2 November 2007.

* * *

Introduction

The Bank of Japan submitted its *Semiannual Report on Currency and Monetary Control* for the second half of fiscal 2006 to the Diet on June 8, 2007. 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 is expanding moderately.

Exports have continued to increase due to the expansion of overseas economies. Business fixed investment has also continued to trend upward against the background of high corporate profits. The positive effects of the strength in the corporate sector have been feeding through moderately into the household sector. Although nominal wages per worker have been somewhat weak, employee income has been rising moderately with the increase in the number of employees. The positive effects of the strength in the corporate sector have also continued to be passed on via various other channels, for example, increased dividends. In this situation private consumption has been firm. With the rise in demand both at home and abroad, production has continued to be on an increasing trend.

Looking forward, Japan's economy is likely to continue its sustained expansion with a virtuous circle of growth in production, income, and spending in place. However, instability in global financial markets stemming from the U.S. subprime mortgage problem continues, and there is uncertainty regarding global economic developments, for example downside risks to the U.S. economy. Although overseas economies, taken as a whole, are likely to keep expanding as growth in economies other than the United States is likely to remain high, developments in global financial markets and the global economy continue to warrant attention.

On the price front, the three-month rate of change in domestic corporate goods prices has been positive, mainly due to the rise in international commodity prices. The year-on-year rate of change in the consumer price index (excluding fresh food) has been around 0 percent. From a longer-term perspective, however, it is projected to continue to follow a positive trend as the output gap continues to be positive.

As for financial conditions, the environment for corporate finance has been accommodative. In the CP and corporate bond markets, the issuing environment has been favorable. The lending attitudes of private banks have continued to be accommodative. Under these circumstances, the amount outstanding of lending by private banks has been increasing moderately, and the amount outstanding of CP and corporate bonds issued has been above the previous year's level.

II. Conduct of monetary policy

Regarding the conduct of monetary policy, the Bank's basic thinking has been that (1) given the extremely accommodative financial conditions, the level of interest rates is to be raised if Japan's economy is to follow a path of sustainable growth under price stability, and (2) the

pace of increase in interest rates should be determined in accordance with improvements in the economic and price situation without any predetermined view. Weak inflationary pressures have given the Bank latitude in conducting monetary policy. The actual interest rate adjustments have therefore been slow based on a thorough assessment of the future path of the economy and prices and its likelihood, as well as both upside and downside risks.

The Bank's basic thinking in this regard will remain the same in the conduct of future monetary policy. In other words, while confirming that Japan's economy remains likely to follow a path of sustainable growth under price stability and assessing relevant upside and downside risk factors, the Bank will adjust the level of interest rates gradually in accordance with improvements in the economic and price situation. The Bank is determined to conduct monetary policy appropriately based on careful assessment of economic activity and prices as well as the situation of financial markets at home and abroad, thereby contributing to sustainable economic growth under price stability.

III. Disposal of stocks purchased from financial institutions

The Bank implemented a stock purchasing program, which was not a monetary policy measure, between November 2002 and September 2004. Through this program, the Bank purchased stocks held by financial institutions in order to encourage them to reduce their market risks associated with stockholdings. The total book value of the stocks held by the Bank under this program was approximately 1.6 trillion yen as of the end of September 2007, and the Bank has started to dispose of these stocks in the market from October 2007 as scheduled. In disposing of them, the Bank will strive to avoid any financial losses and also to minimize the impact on the stock market by carefully spreading its sales out over a period.

Conclusion

Let me close my remarks by noting that in the latest issue of the *Outlook for Economic Activity and Prices*, which was decided and released on October 31, the Bank presented its assessment of economic activity and prices and its basic thinking on the future course of monetary policy that I have explained today.