

Masaaki Shirakawa: Recent developments in Japan's economy and the conduct of monetary policy

Statement by Mr Masaaki Shirakawa, 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, 13 March 2009.

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Introduction

I am pleased to have this opportunity to present an overall review of the Bank of Japan's conduct of monetary policy. The Bank submitted to the Diet its *Semiannual Report on Currency and Monetary Control* for the second half of fiscal 2007 on June 10, 2008 and that for the first half of fiscal 2008 on December 12, 2008. Today I would like to talk about recent developments in Japan's economy and the conduct of monetary policy.

I. Developments in Japan's economy

Japan's exports have been decreasing substantially reflecting a slowdown in overseas economies, and domestic demand has become weaker against the background of declining corporate profits and the worsening employment and income situation in the household sector. Financial conditions have remained tight, as shown by, for example, a continued increase in the number of firms, especially small firms, reporting that their financial positions are weak and lending attitudes of financial institutions are severe. Under these circumstances, economic conditions have deteriorated significantly and are likely to continue deteriorating for the time being.

On the price front, domestic corporate goods prices have been decreasing, mainly due to the drop in international commodity prices. The year-on-year rate of increase in the CPI (excluding fresh food) has recently moderated reflecting the declines in the prices of petroleum products and the stabilization of food prices, and, with increasing slackness evident in supply and demand conditions, will likely become negative in the future.

There are risks to the outlook for economic activity and prices. Much depends on global financial conditions as well as developments in overseas economies, and particular attention will need to be paid to the downside risks to economic activity. In addition, there is the risk of a further weakening in domestic private demand if firms' medium- to long-term growth expectations decline and pressures to adjust capital stock and employment increase.

If financial conditions should tighten further, pressures acting to depress economic activity from the financial side might become more marked and the adverse feedback loop between financial and economic activity might intensify. Turning to prices, there is a possibility that the inflation rate will decline further if downside risks to economic activity materialize or commodity prices fall. In this case, the risk of a decline in the medium- to long-term inflation expectations of firms and households would warrant attention.

II. Conduct of monetary policy

Since fall 2008, when the turmoil in global financial markets and in the U.S. and European financial systems increased in severity, the Bank, in order to support the economy from the financial side, has taken monetary easing measures in the following three areas: reductions in the policy interest rate, provision of ample liquidity to stabilize financial markets, and facilitation of corporate financing. Regarding the policy interest rate, the Bank reduced it twice in October and December 2008, and currently encourages the uncollateralized overnight call rate to remain at around 0.1 percent. In order to ensure stability in financial

markets, the Bank, as part of the coordinated measures of central banks, has been conducting U.S. dollar funds-supplying operations whereby funds are provided with no explicit ceiling on the total amount. The Bank has also continued to provide ample liquidity in yen, taking measures such as actively purchasing Japanese government securities under repurchase agreements and increasing the amount of outright purchases of Japanese government bonds (JGBs). To facilitate corporate financing, the Bank has expanded the range of corporate financing instruments eligible as collateral, and has conducted special funds-supplying operations to facilitate corporate financing through which, taking corporate debt as collateral, it provides unlimited funds at a low interest rate.

The Bank has also implemented measures exceptional for a central bank, such as outright purchases of CP and corporate bonds.

Meanwhile, the Bank resumed purchases of stocks held by financial institutions in February 2009, to support financial institutions' future endeavors to reduce market risk associated with stockholdings and thereby ensure the stability of the financial system.

III. The future conduct of monetary policy

The outlook for economic activity and prices is highly uncertain at present. The Bank will continue to carefully assess the future outlook for economic activity and prices, closely considering the likelihood of its projections as well as risk factors, and to exert its utmost efforts as a central bank to facilitate the return of Japan's economy to a sustainable growth path with price stability.