Hirohide Yamaguchi: Economic slowdown and monetary easing

Speech by Mr Hirohide Yamaguchi, Deputy Governor of the Bank of Japan, at the Asian Affairs Research Council, Tokyo, 24 September 2012.

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Introduction

Thank you for giving me an opportunity to speak at the Asian Affairs Research Council special lecture in front of distinguished members who are active in a wide range of areas.

For half a century since 1964, the Council has been, through its various kinds of research and studies about the Asia and Pacific region, contributing to the deepening of mutual understanding and harmonious development of the region. The year 1964 was when the Tokyo Olympics were held and when Japan joined the Organisation for Economic Co-operation and Development. Japan's trade balance turned into a clear surplus from that year and continued to be in surplus for 47 years up to 2010. The year 1964 could be said as a milestone for Japan's economy.

In September 1964, the Annual Meetings of the International Monetary Fund (IMF) and the World Bank Group were held in Tokyo. Half a century since then, Japan's economy has grown significantly and, amid globalization, a linkage between Japan and the rest of the world has been further closely interrelated. In the week after next, from Tuesday, October

9, the Annual Meetings of the IMF and the World Bank Group will be held in Tokyo for the second time. The Bank of Japan, together with the Ministry of Finance, is preparing for the Meetings as a host country. About 20 thousand participants and concerned parties from all over the world are expected to join, and many conferences and seminars on the global economy, financial systems and other various issues are to be held. In order to let people know further about Japan's economy, the best way is to let them actually see Japan. I believe many of you are already planning to participate, and hope that you will seize the opportunity for a lively exchange of views.

Today I will talk under the theme of the "Economic Slowdown and Monetary Easing." In the first half, I will present an overview of the current state and outlook for the global economy and Japan's economy. In the second half, based on such things about the economies at home and abroad, I will explain the Bank of Japan's conduct of monetary policy. To summarize the thrust of my speech in advance, there are five points. First, looking at overseas economies, due to the effects of the European debt problem, business sentiment has become cautious in many countries and regions, mainly in the manufacturing sector, and the economies have moved somewhat deeper into a deceleration phase. Future uncertainty remains high. Second, in considering the background to the slowdown in overseas economies, it might be better not to focus only on the effects of the European debt problem, but to view from a broader perspective. Namely, we need to have the following big picture in mind. During the period up to the mid-2000s of the so-called Great Moderation, a bubble was generated in advanced countries and they are still suffering from the balance-sheet adjustments after the burst of the bubble. In emerging economies, as an excess supply capacity of a low cost labor force, which was a factor in supporting the Great Moderation, becoming low, it has become difficult to simultaneously achieve economic growth and price stability. Third, Japan's economy registered relatively high growth in the first half of 2012, but the pick-up in economic activity has come to a pause, reflecting the weak developments in overseas economies. Economic activity is expected to level off more or less for the time being. Fourth, in response to a weaker outlook for economic activity, the Bank of Japan further enhanced monetary easing at the Monetary Policy Meeting held last week so that the future economy will not deviate from the orbit of "returning to the sustainable growth path with price stability." Fifth, in order for Japan's economy to overcome deflation, in addition to such support from the financial side, it is important to make efforts to strengthen growth potential and take advantage of accommodative financial conditions. After explaining those issues, I will answer to some of the questions raised about this time's monetary easing.

I. Current state and outlook for overseas economies

Let me start with the current state of the global economy. Overseas economies have moved somewhat deeper into a deceleration phase. While the global economy has been on a deceleration phase, it seems that the extent of deceleration has recently increased mainly in manufacturers in many countries and regions.

Current state of the European economy

The European economy is currently in a deceleration phase. Three years have already passed since concern over the government debt was recognized in international financial and capital markets, and, at present, the problem has not been limited to Greece, Portugal, and Ireland, which have already been receiving support from the European Union (EU) and the IMF but also spread over to major southern European countries, including Spain and Italy. In those countries, due to a rise in government bond yields, namely, a decline in government bond prices, financial institutions' assets have deteriorated, which has led to a rise in funding costs and instability of financial positions. As a result, financial conditions surrounding firms and households have worsened, posing pressure to suppress economic activity. Such deterioration in the real economy and concern over the financial systems have been fed back to the fiscal problem through a decline in revenue and an increase in support for financial institutions. In such a way, in Europe, a vicious cycle of public finance, the financial system, and the real economy has been at work, mainly in peripheral countries. Therefore, the stagnation in the European economy has been protracted, and that has recently been spread to core countries, including Germany, mainly in terms of business sentiment. The growth rate of the euro area economy has been negative for three consecutive quarters.

In the meantime, the European authorities have been taking various policy measures. In July, a financial support measure to inject public funds into Spanish financial institutions was compiled, and in the beginning of September, the European Central Bank (ECB) introduced a new program to purchase government bonds with a maturity of between one and three years, with no ex ante quantitative limits on the size of purchases. However, in starting purchases of government bonds, the ECB is going to make some conditions. For example, the issuer countries of bonds to be purchased will have to accept monitoring by the EU and the IMF on the progress of fiscal consolidation. Thanks to those various policy responses, stability has been maintained in interbank funding markets, and investors' risk aversion has abated somewhat in international financial and capital markets as a whole.

The policy responses by the ECB and other policy authorities are indispensable for containing the vicious cycle of public finance, the financial system, and the real economy. However, in order to resolve the European debt problem fundamentally, it is necessary for countries whose fiscal sustainability has been a cause for concern to make some progress in meeting the challenges such as fiscal consolidation, strengthening medium- to long-term growth potential, and reinforcing the stability of the financial system. In addition, for Europe as a whole, integrating fiscal policy and banking supervision of the nations is an unavoidable challenge. None of these challenges is easy to meet and thus it is likely that high uncertainty will continue to surround future progress.

Speaking of risks associated with the European debt problem, there is a risk that stagnation in the real economy might become protracted under the vicious cycle of public finance, the financial system, and the real economy, and there is a risk that a financial crisis might occur due to concern over the financial system. Put simply about the recent developments in

Europe, it can be summarized that the risk that stagnation in the real economy, including the spillover to core countries, might become protracted has still been large, while the risk that a financial crisis might occur has subsided due to various policy responses.

Current state of the U.S. economy

Let me turn to the United States. The U.S. economy has been on a modest recovery trend with a moderate increase in private consumption, including automobile sales, and signs of a pick-up in the housing market. However, there have been weak developments. Improvement in employment has been slow and, amid economic adjustment in Europe being protracted, business sentiment, mainly of manufacturers operating globally, has recently become cautious and an increase in business fixed investment has been slowing.

Against such a backdrop, the Federal Reserve has recently decided to keep the target range for the federal funds rate at 0 to 1/4 percent and changed the outlook for the duration in which exceptionally low levels for the federal funds rate are likely to be warranted, from “at least through late 2014” to “at least through mid-2015.” In addition, it has decided to purchase mortgage-backed securities (MBS) issued by governmental financial institutions, called agency MBS, at a pace of 40 billion dollars per month until the outlook for the labor market improves substantially in a context of price stability.

In the United States, while balance-sheet adjustments due to the burst of a housing bubble have been progressing to a certain degree, it has steadfastly remained. In such a situation, in addition to the effects of the European debt problem, there are no prospects for a solution to the so-called fiscal cliff problem and there is an increasing awareness about uncertainty of fiscal consolidation over time. Those factors are likely to continue to constrain economic activity for the time being through growing cautiousness in household and business sentiment. While the U.S. economy is expected to continue recovering partly supported by accommodative financial conditions, the pace of recovery for the time being is likely to be only moderate.

Current state of the Chinese economy

Next is China. While the Chinese economy has been growing at a relatively high rate, the state of slowdown has become protracted. It has been pointed out that, in the background, there are a slowdown in exports to Europe and a deceleration in private real estate investment due to the effects of past monetary tightening and policy measures to control real estate transactions. With final demand at home and abroad declining, pressure for inventory adjustments in the raw material industry and a wide range of areas has recently been increasing, which has been spreading to production in the manufacturing industry.

In China, as the authorities were taking policy responses, including monetary easing and advancement of infrastructure investment, the economy was considered to gradually accelerate the pace of growth if those effects would manifest themselves. While I believe such a scenario is still maintained, the slowdown has been lingering longer than expected and it is certain that the time when economic activity gets out of the state of slowdown will be deferred. While it is due mainly to greater-than-expected stagnation in the European economy, which is the largest trading partner, there might be a more structural problem. One is that the policy authorities seem to be hesitant about stepping on the gas pedal toward economic growth. That might be due to a bitter experience that a large-scale fiscal spending and monetary easing after the Lehman shock led to a rise in prices and a surge in real estate prices. A simultaneous achievement of both economic growth and price stability is a common challenge to many emerging and commodity-exporting economies, which I will talk about in detail later. Another reason might be that, in China, as a result of continued growth for a long period led largely by public investment and business fixed investment, industries, mainly the raw material industry, have been carrying a structural problem of excessive investment, and the balance between supply and demand has been prone to be lost. In the process of China’s transition from high growth to sustainable growth, an answer to the question on how to change the balance between investment and consumption, domestic and external demand, urban and rural areas, and coastal and inland areas is yet to be found, and that might have been increasing uncertainty about the future economic activity.

Overall picture of the global economy

While I have explained Europe, the United States, and China, respectively, that will not suffice to see the overall picture of the global economy. There are other elements, including challenges advanced countries are commonly faced with and challenges emerging economies are faced with, that should be understood in the overall picture of the global economy.

In order to consider the challenges common to advanced countries, let us go back to the period up to the mid-2000s, which was called the "Great Moderation." At that time, as various favorable factors including a rise in emerging economies and technological innovation in finance overlapped, extremely favorable economic conditions of high growth, low inflation, and low interest rates continued for a long period. Against such a backdrop, an optimistic view on the economic outlook spread globally and an investment boom and a boost of demand for consumer durables surfaced in the United States and Europe. On the financial front, financial institutions' risk-taking attitude became aggressive, and a rapid bloat in credit and a rapid increase in leverage took place. In short, an excess was generated both on the real economy and financial front, and such excesses were finally corrected by the Lehman shock.

Subsequently, the experience the United States, Europe, and other advanced countries had is that, once a large-scale bubble bursts and a financial crisis occurs, economic adjustment becomes protracted and, in the meantime, the economy is forced to grow at a low rate – a phenomenon repeated over and over in history. In the United States, substantial impairment of households' balance sheets due mainly to the subprime mortgage problem has made a recovery in the U.S. economy a sluggish one. In Europe, amid an optimistic mood called "europhoria," which is a word coined by combining "euro" with "euphoria," loose fiscal management in Greece and excessive real estate investment in southern Europe took place, and left a severe problem in the balance sheets of the governments and financial institutions. In the process of balance-sheet adjustments, economic activity will not recover as wished. An economy that is unlikely to accelerate and remains vulnerable to the downside will continue for a long period. Without recognizing that fact, frustrations of "why the growth rate is not increasing despite those policy responses" or "why the unemployment rate does not decline" are prone to surface. It seems that both the United States and Europe are yet to identify "a normal pace of economic growth" in the balance-sheet adjustment process. That seems to have induced difficult problems of heightening expectations for economic policy and social unrest or dissatisfaction. While it might be somewhat too much to say, from such a viewpoint, there is in a sense a commonality among dissatisfaction among young people in Spain for a high unemployment rate, demonstrations against fiscal austerity in Greece, and repeated conflicts on fiscal management in the United States. At least, resulting increased reliance on central banks in the United States and Europe is an obvious tendency.

In the meantime, China and other emerging economies were affected by a plunge in advanced economies immediately after the Lehman shock, but they subsequently restored growth at an early stage on the back of buoyant domestic demand and have been growing at somewhat high rates. The continued capital inflow to emerging economies, while advanced countries have been continuing monetary easing and providing ample funds, seems to have also been boosting domestic demand in emerging economies. Recently, contribution to the global economic growth by advanced countries has been declining markedly and that by emerging economies has been increasing. According to the IMF, the proportion of advanced countries and emerging economies in world GDP has shifted substantially from "7 to 3" to "5 to 5" in the past 30 years.

While emerging economies have been leading the global economy, they have been faced with a new challenge after the Lehman shock. That is a simultaneous achievement of high growth and price stability. One important element that supported the "Great Moderation" was a dramatic increase in the world's supply capacity due to emerging economies' industrialization on the back of an ample and inexpensive labor force. However, demand in emerging economies increased accordingly and that resulted in putting constant upward pressure on commodity prices and food prices. In addition, for example in China, while development in inland areas has progressed, a mechanism, in which an increase in the labor force was covered by a population inflow from rural to urban areas, has recently been changing. As a labor population as a whole is expected to decline in the future, labor supply will become more prone to fall short than in the past, and inflationary pressure might also stem from that aspect.

At present, in response to the pressure of economic slowdown from Europe and other advanced countries, emerging economies have been taking policy responses, including monetary easing, but it has been difficult to take drastic measures as the economy has been susceptible to inflationary pressure. There is uncertainty as to when those policy effects will surface in emerging economies and the pace of growth will accelerate. As crop prices have recently been surging, a simultaneous achievement of economic growth and price stability is likely to continue to be a challenge for emerging economies.

In such way, the global economy has moved somewhat deeper into a deceleration phase, with the effects of the European debt problem combined with unique factors various countries and regions have been involved in – namely, a great challenge of balance-sheet adjustments in advanced countries and that of searching for a sustainable growth path in emerging economies. As mentioned earlier, with the U.S. economy continuing to recover moderately and policy effects gradually surfacing in the Chinese economy, the global economy is likely to get out of a deceleration phase, but the exit has been deferred.

II. Current state and challenges of Japan's economy

Let me move on to Japan's economy. As I have just explained, overseas economies have moved somewhat deeper into a deceleration phase. As a result, exports and industrial production have been relatively weak. The month-on-month rate of change in real exports has been negative for four consecutive months since May due to a weakness in exports to Europe and China, and, against such a backdrop, industrial production declined again in July relative to the April-June quarter, following a decline in the April-June quarter relative to the previous one. On the other hand, domestic demand has been resilient mainly supported by reconstruction-related demand. Public investment has been clearly increasing and business fixed investment has been on a moderate increasing trend with an improvement in corporate profits. Private consumption has been resilient with improving employment and housing investment has generally been picking up. However, there have recently been somewhat weak indicators in private consumption. While that is partly due to a weather factor, a sluggish pace of growth in overtime wages mainly in the manufacturing industry due to weak production and a decline in summer bonuses might have contributed to constraining consumption from the income side. While an application for receiving subsidies for eco-friendly cars ended at the end of last week, last minute demand was not observed. That was partly because efforts by car sellers after ending of the application, including a rebate in place of the subsidies and the release of popular fuel-efficient new-models, had been anticipated, but it perhaps should be interpreted as a sign that pre-consumption of future demand has reached its limit. As for business fixed investment, while it is likely to continue increasing as a trend, attention should be paid to whether there are any effects of a global deterioration in business sentiment. While domestic demand as a whole is likely to maintain its firmness, it might be difficult to expect domestic demand to have power to offset the weakness in external demand and further elevate economic activity.

As explained, Japan's economy registered relatively high growth in the first half of 2012, supported by the firmness in domestic demand, but the pick-up in economic activity has come to a pause, reflecting the developments in overseas economies. Economic activity is expected to level off more or less for the time being. On the price front, the year-on-year rate of change in consumer prices excluding volatile food has been around 0 percent and was minus 0.3 percent in July as the earlier fall in crude oil prices has been exerting downward pressure. The year-on-year rate of change in consumer prices is expected to remain at around 0 percent for the time being.

Regarding risks, there remains a high degree of uncertainty about the global economy, including the European debt problem, the momentum toward a recovery in the U.S. economy, and a simultaneous achievement of price stability and economic growth in emerging and commodity-exporting economies. Furthermore, attention should be paid to the effects of financial and foreign exchange market developments on economic activity and prices.

III. The bank's conduct of monetary policy

Comprehensive Monetary Easing

Based on the state of the economy at home and abroad, let me turn to the Bank's conduct of monetary policy.

The Bank recognizes that Japan's economy faces the critical challenge of overcoming deflation and returning to a sustainable growth path with price stability, and has been pursuing powerful monetary easing. As powerful monetary easing is pursued within the framework of Comprehensive Monetary Easing, let me first briefly explain the framework.

It was October 2010 when Comprehensive Monetary Easing was introduced and about two years have passed since then. The basic reason for the introduction was, amid the policy rate virtually becoming 0 percent, to further generate easing effects. The specifics of the framework were as follows. First, the Bank has been encouraging the policy rate of the overnight rate in the uncollateralized call market, namely, an interest rate of a quite short-term of one-day borrowing, to move at around 0 to 0.1 percent, which can be said as virtually 0 percent. Second, the Bank introduced financial assets purchasing program named an Asset Purchase Program (hereafter referred to as "the Program") and under the Program has been purchasing short-term and long-term government securities as well as a wide range of risk assets, such as commercial paper (CP), corporate bonds, exchange-traded funds (ETFs), and Japan real estate investment trusts (J-REITs). That has been a measure, through influencing longer-term interest rates and risk premiums, to urge the effects of monetary easing to spread steadily over to firms' funding costs. Third, the Bank has been aiming at 1 percent in terms of the year-on-year growth rate in consumer prices for the time being and made a commitment to continuing its powerful monetary easing through the pursuit of virtually zero interest rate policy and purchases of financial assets until it judges the 1 percent goal to be in sight. By a central bank making a commitment to continuing monetary easing for a long period, there will be momentum for pushing down the entire yield curve, including longer term yields.

Background to the enhancement of monetary easing

At the Monetary Policy Meeting held last week, the Bank further enhanced monetary easing. Specifically, first, the Bank decided to increase the total size of the Program by about 10 trillion yen, from about 70 trillion yen to about 80 trillion yen. The completion of the purchases under the Program was extended for six months and the purchases will continue until around the end of 2013. Second, the Bank decided to remove the minimum bidding yield, which used to be set at 0.1 percent per annum, for the outright purchases in order to ensure smooth purchase of the Japanese government bonds (JGBs).

Looking at the developments in economic activity and prices that led to the decisions, as explained earlier, while overseas economies have moved somewhat deeper into a deceleration phase, the pick-up in economic activity has come to a pause and is expected to level off more or less for the time being. The year-on-year rate of change in the CPI excluding volatile food is to hover at around 0 percent for the time being. In the meantime, attention should be paid to the effects of financial and foreign exchange market developments on economic activity and prices.

Until recently, the Bank had judged that, from a longer term perspective, Japan's economy would return to the moderate recovery path as domestic demand remained firm and overseas economies gradually emerged from the deceleration phase. And, the year-on-year rate of change in the CPI excluding volatile food would start to gradually increase and was likely to reach 1 percent in the not so distant future from fiscal 2014 onward.

However, taking into account the current developments in economic activity and prices, the time of "overseas economies to gradually emerge from the deceleration phase" and the time of "Japan's economy to return to the moderate recovery path" are both likely to be delayed. While to what extent the delay will be is not clear amid continued high uncertainty concerning China and other overseas economies, roughly speaking, it is likely to be about six months. If things had remained as they were, Japan's economy would have been on the verge of deviating from the assumed orbit of "return to the moderate growth path with price stability." To avoid that, the Bank judged it necessary to further strengthen monetary easing this time. The aim of the measures this time is, by pursuing powerful monetary easing, inclusive of the measures this time, to bring back the outlook for economic activity and prices in the long run to the orbit of returning to a sustainable growth path with price stability.

Specifics of the enhancement of monetary easing

As mentioned earlier, the Bank decided this time to increase the total size of the Program substantially by about 10 trillion yen. Based on the recognition of the current state of economic activity and prices, the Bank considered that a large amount of funds would be necessary in order to prevent the outlook for economic activity and prices in the long term from deviating from the orbit of returning to the sustainable growth path with price stability. While there was a choice to increase additional purchases in risk assets, as the current financial conditions in Japan were not in a situation in which risk premiums increased due to investors' anxiety or risk aversion, the Bank opted to increase purchases of short-term and long-term government securities. By increasing purchases of those by about 5 trillion yen each, the Bank aimed at influencing the entire yield curve. Japanese firms' funding structure, unlike that of the United States in which the proportion of long-term corporate bonds and mortgage loans are high, has a characteristic of a high proportion of bank loans of three years or less. In particular, bank loans of one year or less account for about one-third of new loans, and there are also long-term loans with variable rates. Taking into account such structure of corporate finance, the effects on the entire yield curve, and financial institutions' sense of security in their funding, the Bank considers that purchasing government securities with a remaining maturity of three years or less in a balanced manner will be effective in further spreading monetary easing effects.

While the increase in the outstanding amount of the Program was to be completed by the end of June 2013, it is extended to be completed by the end of December 2013. Given the economic situation, the Bank has judged it necessary to beef up the aforementioned "commitment to continuing monetary easing for a long period" by extending the accumulation period of the Program.

In addition, while the minimum bidding yield for purchases of the JGBs and corporate bonds was set at 0.1 percent, the Bank has decided to remove it. With the Bank pursuing monetary easing, the bidding yield for the JGB issuance as well as actual market transaction rates up to three years have often fallen below 0.1 percent. To that end, in the purchases of the JGBs, aggregate bids falling short of the Bank's offers, or the so-called undersubscription, has taken place. While such phenomenon itself is an indication that monetary easing has been spreading powerfully, in order to further ensure purchases of financial assets, the Bank has decided to remove the minimum bidding yield. By combining an increase in the total size of the Program and the removal of the minimum bidding yield, the Bank believes that the effects of monetary easing will occur more powerfully.

As the current amount outstanding of the Program is about 60 trillion yen, hereafter, toward the scheduled amount of 80 trillion yen by the end of 2013, the Bank will accelerate its purchase schedule to further accumulate 20 trillion yen of financial assets. The Bank will continue to proceed with monetary easing in a continuous manner by steadily increasing the amount outstanding of the Program.

Accommodative financial conditions

Then through what transmission channels will this time's measures influence economic activity and prices and "ensure the return of Japan's economy to the sustainable growth path"?

First of all, since the measures are to increase the amount of purchase by the Program and to enable the Bank to purchase the JGBs at a yield level of 0.1 percent or lower, they will add further downward pressure on market interest rates. That will encourage a decline in financial institutions' lending rates and influence interest rate formation in various financial markets, thereby making financial conditions surrounding firms and households more accommodative. That is an effect that could be clearly confirmed in two years' experience of Comprehensive Monetary Easing.

Under the Bank's powerful monetary easing, Japan's financial conditions are accommodative. Since the introduction of the Program, longer term market interest rates have been steadily declining. Looking at the yields of the government securities, in a manner of spreading from short-term to long-term, yields up to about three years have already been hovering at an extremely low level of about 0.1 percent. A 5-year yield has also declined to about 0.2 percent. Such a decline in market interest rates has encouraged a decline in firms' funding costs and increased a sense of security for funding. According to a survey on firms about their cash management and financial institutions' lending stance, diffusion indexes have clearly improved to the levels better than the average since 2000. Issuing conditions of CP and corporate bonds have generally been favorable and banks' average contracted interest rates on new loans and discounts have been at about 1 percent for both short and long terms, which are at historically low levels of even lower than those during the period of quantitative easing policy in the first half of the 2000s. Against such a backdrop, average interest payment on firms' interest bearing debt has declined to around

1.5 percent. That is an extremely low level compared with firms' return on asset (ROA) being around 3.0–3.5 percent. Consequently, firms can now borrow a sufficient amount of funds at much lower interest rates than their own profitability.

In such a way, as for the effects monetary policy exerts on the real economy, it can be said that the effects of monetary easing have thoroughly spread in terms of the first stage of transmission from monetary policy to financial conditions. What is important for Japan's economy is that firms and households take advantage of the accommodative financial conditions and increase investment and spending aggressively. By that, the second stage of transmission from financial conditions to the real economy will be strengthened.

Efforts to take advantage of accommodative financial conditions

In that regard, currently, as firms are not confident about their future profits environment, they have not necessarily been able to take full advantage of such accommodative financial conditions. What becomes important here is the efforts to strengthen growth potential. If strengthening growth potential actually proceeds and growth expectations for Japan's economy pick up, the outlook for firms' profits will increase or the expected rate of return of investment will increase, which will lead to positive developments like firms' investment. If that happens, accommodative financial conditions will further exert their effects. Once such virtuous cycle starts, inflation will be more likely to rise through an improvement in aggregate supply and demand balance.

In such efforts to strengthen growth potential, it goes without saying that private economic entities will play the most important role. Recently, as seen in an increase in consumption by the elderly and in renewable energy-related investment, the move to convert challenges Japan's economy is faced with into an opportunity to tap new demand has been gradually taking place. It is important to grow such bud of growth and nurture it to a larger market. In doing so, the role of financial institutions in providing funds necessary for firms' activity, including in their startups, and the role of the government in preparing an environment that facilitates firms' activity, including promotion of deregulation, are also important. Also the Bank, from the viewpoint of making utmost contribution that a central bank can do, has been implanting the extraordinary "Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth" since June 2010.

The measure is for the Bank to provide long-term funds at a low interest rate to financial institutions carrying out lending and investment that contribute to Japan's economic growth, and the total amount of line of credit has now reached 5.5 trillion yen, inclusive of the U.S. dollars. While the measure is an extraordinary one, given the intrinsic role of a central bank, the reason the Bank dares to do it is that the Bank expects the measure to play the role of a "catalyst" in strengthening growth potential. In addition to the impact of actually providing funds, significance of sharing the recognition that strengthening growth potential is important is not small at all. In fact, since the introduction of the measure, there have been not a few examples of promoting voluntary initiatives toward strengthening foundations for economic growth, such as some financial institutions setting up a dedicated fund for the regions' promising businesses.

If such efforts further develop and, as the moves to take advantage of the current accommodative financial conditions increase, the effects of monetary easing will be further exerted. While accommodative monetary conditions have reached a state of saturation as I have explained earlier, from the viewpoint of taking advantage of such accommodative financial conditions, a strong possibility still remains for monetary easing exerting greater effects.

Assessment of the economy and the timing of monetary easing

As for this time's measures, I have explained a grand view of the assessment of underlying economic activity and prices and the aim, the specifics of the measures, assumed transmission channels, and the importance of strengthening growth potential to utilize them. In the following, I will answer to some questions raised related to the measures taken this time.

First, the question on "why the Bank decided monetary easing at this time's Monetary Policy Meeting." That originates both from a view that "the past assessment of the economy might have been too optimistic" and a view that "the Bank could have waited until it checked the result of the *Tankan* survey to be released at the beginning of October and it conducted the full examination in the *Outlook Report* scheduled for the end of October."

As for the assessment of the economy, in recent months, it has been said that the deceleration phase of overseas economies has been continuing on such occasions as

Governor's press conferences, speeches, and interviews. Against such a backdrop, it has been confirmed that the extent of deceleration has recently increased in many countries and regions, mainly in the manufacturing industry, and that the phenomenon has been clearly spreading to Japan's exports and industrial production. The weaker-than-expected developments in the global economy in the meantime were, as shown in a deterioration in business sentiment indicators, beyond many people's expectations, including us.

As for the question on what cases the Bank will make policy responses in, I myself mentioned at various opportunities that "when the outlook turns out to be weaker than expected or the risk associated with it intensifies, the Bank will not hesitate to implement additional monetary easing." The Bank, not only in the Monetary Policy Meeting to publish the *Outlook Report* but also in every Meeting decides on the conduct of monetary policy by examining the baseline scenario of the outlook for economic activity and prices as well as risk factors surrounding it based on available information. As a result of such examination at the latest Meeting, the Bank judged that the scenario it assumed had been delayed or weaker than expected. As long as there is such judgment, there is no reason to procrastinate a policy response. In such a way, the decision this time was quite an orthodox one in line with the basic concept expressed at various opportunities. The further enhancement of monetary easing decided this time, together with the cumulative effects of the past measures, will ensure the return of Japan's economy to a sustainable growth path with price stability. Then, in the *Outlook Report* scheduled to be released at the end of October, based on new indicators and developments being added by then, the outlook for economic activity and prices as well as risk factors are to be examined comprehensively.

As for the Bank's decision on enhancement of monetary easing at this timing, there have been comments, for example, from market participants that "the Bank has followed central banks in the United States and Europe." Each country's central bank has been striving to pursue optimal policy according to each country's economic and financial situation, and does not consider taking policy action following another country's central bank. As long as the economy itself has been interrelated globally, there is a good chance that the economies of countries and regions simultaneously become weaker than expected and, as a result, each country's or region's central bank takes the same kind of response at the same period. As for this time's policy actions, amid a sense of slowdown in the global economy becoming stronger than widely predicted, it appears to be the case that major central banks have examined the situation of each country or region and have respectively chosen responses deemed appropriate.

As a policy stance going forward, the Bank has clarified its view that "[t]he Bank continues to conduct monetary policy in an appropriate manner. The Bank will also do its utmost to ensure the stability of Japan's financial system, while giving particular attention to developments in global financial markets." As has been the case, the Bank will examine the outlook for economic activity and prices as well as risk factors, and, when judged necessary, respond decisively and flexibly.

Comparison with overseas central banks

In relation to monetary easing by overseas central banks, we sometimes receive an opinion that "the Bank should pursue bolder monetary easing, like the Federal Reserve, by purchasing assets without setting a ceiling and a time limit or clarifying the duration for the zero interest rate."

In that regard, as said before, a central bank strives to choose the most effective policy measure or policy framework based on policy challenges and the financial and economic situation of each country or region. While there are various differences in policy conduct between the Bank of Japan and the Federal Reserve, both share the view of doing its utmost as a central bank to achieve respective goal. It might not be desirable to argue which central bank is bolder, based on the difference in specific monetary easing measures.

To be somewhat specific, let me point out three things. First, the relationship with policy challenges. The Bank, with the recognition that Japan's economy is faced with the critical challenge of overcoming deflation and returning to the sustainable growth path with price stability, has been purchasing various assets, including risk assets, and, at the same time, ventured into taking an extraordinary measure, as a central bank, to support strengthening foundations for economic growth. Central banks of major countries are choosing policy responses in line with challenges each central bank is faced with.

Second, about a ceiling and time limit. While the Bank has set a ceiling and time limit for the Program, they have been increased or extended from time to time. What started initially at about 35 trillion yen in the total amount and to be completed by the end of 2011 has now become a much larger and much longer easing measure than initially planned, with the total amount of about 80 trillion yen and to be completed by the end of 2013. Regardless of whether there is a predefined ceiling or time limit, the idea of strengthening monetary easing if those are judged insufficient in achieving a policy objective is the same in every central bank.

Third, how to show the duration for maintaining the virtual zero interest rate. The Bank, while presenting the outlook for economic activity and prices of two to two and a half years ahead, has clearly made a commitment to pursuing powerful monetary easing through measures, including the virtually zero interest rate policy and purchases of financial assets, until it judges "the price stability goal in the medium to long term" for the time being of 1 percent in terms of the year-on-year rate of change in the CPI to be in sight. From a perspective of practical effects, we recognize that there is not a great difference between such approach and the Federal Reserve's approach, which specifically shows the duration for maintaining the zero interest rate on the basis of the outlook for economic activity and prices at a certain point and change the duration in accordance with subsequent changes in the outlook.

Therefore, it seems to be no significant difference in the basic idea and effects of policy conduct between major central banks, albeit some difference in specific ways of conduct.

Purchase of government bonds and confidence in currency

Finally, in relation to the Bank's decision to increase the purchase of the JGBs, we sometimes receive concern that "the Bank's massive purchase of government bonds is fiscal monetization by a central bank and eventually confidence in currency will not be maintained." Let me touch on that point.

At present, the Bank has been purchasing the JGBs according to two different objectives. One is the purchase of the JGBs corresponding with the trend increase in demand for banknotes associated with economic growth. In that case, as long as the purchase corresponds with the trend increase in demand for banknotes, it is rational to hold not short-term assets but long-term government bonds. And in light of the thrust of such purchase, the outstanding amount of banknotes issued is set as the ceiling of the JGB purchases. The other purchase of the JGBs is through the Program, which I have repeatedly mentioned today. As those purchases are decided based on monetary policy judgment to influence longer-term interest rates and other rates, there is no such condition that the total size of the purchases should be kept within the amount of banknotes issued.

The outstanding amount of the JGBs held by the Bank has increased from about 66 trillion yen at the end of 2011 to about 84 trillion yen at present, coming to exceed the outstanding amount of banknotes issued. That is due to an increase in the JGB purchases through the Program under pursuing powerful monetary easing. As it is expected that the outstanding amount of the JGBs held by the Bank will increase to about 92 trillion yen at the end of 2012, it will be an increase of about 26 trillion yen in one year. Given that this year's issuance of special deficit-financing bonds is about 38 trillion yen, it can be said that, the Bank's purchase of the JGBs has already reached to a substantial size.

If by any chance such massive purchase of the JGBs is interpreted, apart from the necessity in monetary policy conduct, as aiming at fiscal monetization, confidence in the Bank could be eroded considerably and long-term interest rates could rise substantially. That will affect significantly the government which issues the JGBs and financial institutions which hold the JGBs, thereby could impair the stability of the financial system and the real economy. In order to avoid such things, the Bank considers it important to firmly convey the idea to the market that the Bank will not carry out fiscal monetization. In addition, so that the market can always check the Bank's actions, the Bank will continue to disclose the state of purchases under the Program in a transparent manner.

Concluding remarks

I have spent quite a time talking about the current state and outlook of the global economy and Japan's economy, and the Bank's conduct of monetary policy based on them. In conclusion, let me briefly touch on the prospects of Asian economies and Japan's economy.

Japan's economy was faced with a structural challenge of declining growth potential due to rapid aging and has long been struggling to overcome it. As mentioned earlier, recently there have been increasing moves to seize it as an opportunity to tap new demand. Such moves have been factors underpinning the relatively resilient domestic demand. If such moves continue in Japan, it will have a significant meaning for the Asian economy as a whole in the future. That is because aging is a problem that other Asian countries also have to be faced with in the not so distant future. As the income levels of Asian emerging economies rise, the potential market size of business for the elderly has a chance of expanding dramatically. To utilize the fruits of the efforts to tap demand of the elderly that has accumulated in Japan as a result of facing the challenge ahead of other countries, namely, to utilize the wisdom of maintaining and improving the vitality of the economy even with aging in Asian markets will not only raise the growth potential of Japan but also enhance the economic and social sustainability of other Asian countries and lead to benefits for the Asian economy as a whole. Those are not limited to the problem of aging. I recognize that it will become increasingly important to have a perspective that Japan's efforts to overcome various challenges will lead to global benefits.