Haruhiko Kuroda: The Bank of Japan's Semiannual Report on Currency and Monetary Control

Statement by Mr Haruhiko Kuroda, Governor of the Bank of Japan, before the Committee on Financial Affairs, House of Representatives, Tokyo, 26 March 2013.

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Introduction

The Bank of Japan submits to the Diet its *Semiannual Report on Currency and Monetary Control* in June and December. Most recently, the Bank submitted the report for the first half of fiscal 2012 on December 7, 2012. I am pleased to have this opportunity to talk about recent developments in Japan's economy and present an overall review of the Bank's conduct of monetary policy.

I. Economic and financial developments in Japan

First, I will explain economic and financial developments in Japan.

Japan's economy has remained relatively weak since summer 2012 mainly against the background of the deceleration in overseas economies, but some positive signs have recently been observed. The Bank currently assesses that the economy has stopped weakening. Three factors can be pointed out as underlying developments behind this change in the economic situation.

First, overseas economies – the U.S. and Chinese economies in particular – have begun to show signs of emerging from their deceleration phase. The U.S. economy has been on a moderate recovery trend with increasing firmness, while the balance-sheet repair weighing on the economy has gradually been mitigated. Private consumption has been increasing moderately and housing investment has been showing clear signs of picking up, as the employment situation follows an improving trend. Business fixed investment, which had been constrained, shows signs of picking up. The Chinese economy, albeit with some fluctuations in exports, appears to be emerging from its deceleration phase supported by firm domestic demand, with firmness in private consumption and rises in infrastructure investment. Meanwhile, economic activity in Europe continues to recede slowly as business fixed investment and private consumption have been declining partly due to the effects of fiscal austerity and the tightening of financial conditions, although further deterioration in business and household sentiment is coming to a halt.

Second, business and household sentiment has been improving mainly on the back of the recent depreciation of the yen and the rise in stock prices. In global financial markets, investors' risk aversion remains abated, partly due to progress made in policy responses regarding the European debt problem since last summer and to the fact that the U.S. "fiscal cliff" at the beginning of this year was avoided. Nevertheless, developments including the situation surrounding the European debt problem – particularly discussions on the support package for Cyprus and developments in Italy following the general election – require continued attention.

Third, factors that had been exerting downward pressure on the economy, such as the effects of the decline in car sales due to the ending of subsidies for purchasers of environmentally friendly cars and the effects of the recent bilateral relationship between Japan and China, have fallen off or diminished.

Under these circumstances, exports appear to stop decreasing. Business fixed investment has shown some weakness on the whole, although resilience has been observed in nonmanufacturing. In contrast, public investment has continued to increase, and housing investment has generally been picking up. Private consumption has remained resilient, supported mainly by demand from the elderly. Reflecting these developments in demand both at home and abroad, industrial production has stopped decreasing.

With regard to the outlook, the pick-up in Japan's economy is expected to become more evident around mid-2013, mainly against the background that domestic demand remains firm partly owing to the steady implementation of various economic measures and that overseas economies gradually emerge from the deceleration phase.

Financial conditions in Japan are accommodative. In terms of interest rates, the overnight call rate has remained at an extremely low level, and firms' funding costs have been hovering at low levels. With regard to credit supply, firms have continued to see financial institutions' lending attitudes as being on an improving trend. Issuing conditions for CP and corporate bonds have remained favorable on the whole. As for credit demand, firms have shown signs of increasing their demand mainly for working capital and funds related to mergers and acquisitions. In these circumstances, firms have retained their recovered financial positions on the whole.

On the price front, the year-on-year rate of change in the consumer price index (CPI, all items less fresh food) is around 0 percent. For the next few months, it is expected to turn negative due to the reversal of the previous year's movements in energy-related and durable consumer goods. Thereafter, however, the year-on-year rate of change in the CPI is expected to start a moderate increasing trend as the aggregate supply and demand balance continues a moderate improving trend with Japan's economy on a moderate recovery path.

There remains a high degree of uncertainty concerning Japan's economy, including the prospects for the European debt problem, the momentum toward recovery for the U.S. economy, the possibility of emerging and commodity-exporting economies making a smooth transition to the sustainable growth path, and the effects of the recent bilateral relationship between Japan and China. Recent developments in financial markets appear to assume that the global economy will emerge from the deceleration phase and pick up. The Bank will continue to carefully examine whether the uncertain factors surrounding the global economy will be dispelled smoothly.

II. Conduct of monetary policy

Next, I will explain the Bank's conduct of monetary policy.

Japan's economy has suffered from deflation for nearly 15 years. This is an extraordinary situation even on a global scale. A vicious cycle – where a decline in prices causes wages and profits to contract, thereby reducing investment and consumption, consequently leading to a further decline in prices – has been causing a deterioration in Japan's economy. Overcoming deflation at the earliest possible time is the most critical issue facing Japan's economy.

Ensuring price stability is the mandate of the central bank, and the role of the Bank in overcoming deflation is extremely important. The Bank has engaged in a wide range of efforts – from implementing the zero interest rate policy and the quantitative easing policy, to pursuing monetary easing consisting of comprehensive monetary easing, ensuring financial market stability, and providing support to strengthen the foundations for economic growth in more recent years – but fallen short of overcoming deflation. There are many factors – both at home and abroad – exerting downward pressure on prices in Japan: an increase in cheap imports from overseas, increased distribution efficiency mainly due to deregulation, and the consequent low-price strategies of firms as well as an increased preference among households for low prices. Notwithstanding these factors, it is the Bank's mandate as the central bank to achieve price stability by addressing them. Indeed, no other country in the world is undergoing such a prolonged period of deflation. The government announced, for overcoming deflation and achieving economic revitalization, a "three-pronged strategy" – consisting of bold monetary policy, flexible fiscal policy, and a growth strategy that encouraged private sector investment – and swiftly undertook responses including the emergency economic measures. An upturn in stock prices was recently observed, as a positive response to such efforts and in expectation of an economic recovery.

Of particular significance is the joint statement released this January, in which the government and the Bank clearly set their respective tasks and announced their determination to accomplish those tasks with responsibility. This marks a significant step toward overcoming deflation and achieving sustainable economic growth. The Bank introduced a “price stability target” of 2 percent in terms of the year-on-year rate of change in the CPI, and decided that under the price stability target it would pursue monetary easing and aim to achieve this target at the earliest possible time. The Bank believes that the achievement of this target, without delay, is its mission of utmost importance.

So far the Bank – with a view to overcoming deflation – has been purchasing a variety of assets such as sovereign debt as well as corporate bonds, CP, exchange-traded funds (ETFs), and real estate investment trusts (REITs). While such purchases go beyond the domain of traditional central bank operations, the scale and type of assets to be purchased have not been sufficient to materialize a strong commitment to achieving 2 percent inflation at the earliest possible time. We need to pursue bold monetary easing both in terms of quantity and quality.

Moreover, given that there is little room for the interest rate to decline, it is imperative to work on market expectations in the conduct of monetary policy. Through communication with the market, we need to make clear that we have adopted the uncompromising stance that we will do whatever is necessary to overcome deflation.

Furthermore, ensuring cooperation with the government is also important. The effect of monetary policy will be reinforced by maintaining consistency with the government’s economic policies. According to the joint statement released by the government and the Bank, they will strengthen their policy coordination and work together in order to overcome deflation early and achieve sustainable economic growth with price stability. The government will flexibly manage fiscal policy, formulate measures to strengthen the growth potential and competitiveness of Japan’s economy, and promote measures aimed at achieving fiscal consolidation in the medium to long term. For its part, the Bank will on its own responsibility pursue monetary easing with a view to achieving the price stability target at the earliest possible time. Parallel to monetary easing, if the government can take initiatives to create real demand and improve wages and employment through the expansion of consumption and investment, this is expected to contribute to generating a virtuous cycle that will eventually lead to price increases. To avoid an increase in interest rates on the back of declining confidence in fiscal management, it is also important to take measures aimed at achieving fiscal consolidation in the medium to long term. We expect the government to take appropriate actions in line with the joint statement.

For the future conduct of monetary policy, we will continue to examine the most effective policy measures, at the Monetary Policy Meetings, by making full use of the Bank’s resources, while assessing the effect on the market through the examination of economic and price developments.