

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, 19 June 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 second half of fiscal 2012 on June 14, 2013. 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 been picking up as exports and industrial production have continued to improve against the background that domestic demand remains resilient. As for overseas economies, while the manufacturing sector shows a lackluster performance, they are gradually heading toward a pick-up as a whole. In this situation, exports have started picking up. Business fixed investment has been resilient in nonmanufacturing and appears to have stopped weakening on the whole. Public investment has continued to increase, and housing investment has generally been picking up. Private consumption has been resilient, assisted by the improvement in consumer sentiment. Reflecting these developments in demand both at home and abroad, industrial production has been picking up.

With regard to the outlook, Japan's economy is expected to return to a moderate recovery path, mainly against the background that domestic demand increases its resilience due to the effects of monetary easing as well as various economic measures, and that growth rates of overseas economies gradually pick up, albeit moderately.

Meanwhile, financial conditions are accommodative. The monetary base has increased significantly as asset purchases by the Bank of Japan have progressed, and firms' funding costs have been hovering at low levels. The year-on-year rate of increase in the amount outstanding of bank lending has been at around 2 percent, mainly due to increased demand for working capital and funds related to mergers and acquisitions. Issuing conditions for CP and corporate bonds have remained favorable on the whole.

Financial markets have shown somewhat volatile movements since late May, largely reflecting developments in overseas markets. Given that Japan's economy is on a steady path toward recovery, however, they are expected to gradually regain stability, reflecting positive momentum in economic activity.

On the price front, the year-on-year rate of change in consumer prices (all items less fresh food) has been negative, due to the reversal of the previous year's movements in energy-related and durable consumer goods. The rise in some market indicators of inflation expectations has come to a pause; however, indicators including the surveys conducted on households and economists suggest a rise on the whole. In May, the year-on-year rate of change in consumer prices in the Tokyo metropolitan area registered positive for the first time in four years and two months. Going forward, the year-on-year rate of change in consumer prices nationwide is likely to gradually turn positive.

There remains a high degree of uncertainty concerning Japan's economy, including the prospects for the European debt problem and the growth momentum of the U.S. economy as

well as the emerging and commodity-exporting economies. The Bank will continue to pay close attention to further developments, including those in financial markets.

II. Conduct of monetary policy

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

In April, the Bank introduced quantitative and qualitative monetary easing (QQE), aiming to achieve the price stability target of 2 percent in terms of the year-on-year rate of change in the consumer price index at the earliest possible time, with a time horizon of about two years. QQE represents a new phase of monetary easing, both in terms of quantity and quality. More concretely, first, the Bank changed its main operating target for money market operations from the uncollateralized overnight call rate to the monetary base. On top of this, it will double the monetary base in two years. Second, the Bank will purchase Japanese government bonds (JGBs) so that their amount outstanding will increase at an annual pace of about 50 trillion yen. As a result, the amount outstanding is also expected to double in two years. In addition, the average remaining maturity of the Bank's JGB purchases has been extended from slightly less than three years to about seven years. Third, the Bank will purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding will increase at an annual pace of about 1 trillion yen and about 30 billion yen, respectively. The Bank will continue with QQE, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. It will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate.

The transmission channels of QQE are as follows. First, the purchases of financial assets will exert influence on long-term interest rates and risk premia of asset prices. Second, a portfolio rebalancing effect, in which the investment behavior of financial institutions and institutional investors changes by increasing lending and/or shifting their portfolios to risk assets. Third, the clear commitment to achieving the price stability target at the earliest possible time and the continuation of massive purchases of assets are expected to drastically change the expectations of markets and economic entities. Through these channels, QQE will stimulate private demand and contribute to raising prices by improving the aggregate supply and demand balance and by raising inflation expectations.

Such conduct of monetary policy by the Bank will support the positive movements in economic activity and financial markets, contribute to a rise in inflation expectations, and lead Japan's economy to overcome the deflation that has lasted for nearly 15 years. The Bank will continue to conduct monetary policy as appropriate.