

Haruhiko Kuroda: Recent developments in Japan's economy, and observations on the European situation given Japan's experience during the 1990s financial crisis

Remarks by Mr Haruhiko Kuroda, Governor of the Bank of Japan, at the Paris Europlace Financial Forum, Tokyo, 25 November 2013.

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Introduction

I am honored to have this opportunity to speak before the Paris Europlace Financial Forum today.

In the following few minutes, after briefly touching on the recent developments in Japan's economy, I would like to go over what we can say about the European authorities' various initiatives from our experience of Japan's financial crisis in the 1990s, bearing in mind the recent European situation.

The developments in Japan's economy and prices

I would like to start off with the recent developments in Japan's economic activity and prices. The Bank of Japan introduced quantitative and qualitative monetary easing (QQE) in April this year with a view to bringing Japan's economy out of deflation, which has lasted for nearly 15 years. In the subsequent eight months, the Bank has been steadily pursuing this policy. Positive developments have been spreading in financial markets and the real economy, as well as in people's mindset and expectations. The QQE has steadily been exerting its intended effects. Japan's economy is recovering moderately, with a positive spillover from income to expenditure in the household and corporate sectors taking course. Looking ahead, a virtuous circle among production, income, and spending is expected to continue, and Japan's economy is projected to grow, as a trend, at a pace above its potential. On the price front, the year-on-year rate of increase in the consumer price index (CPI) for all items less fresh food has recently been accelerating to a range between 0.5 and 1.0 percent. With the prospect of an improvement in the aggregate supply and demand balance and a rise in medium- to long-term inflation expectations, the year-on-year rate of change in the CPI is likely to follow a rising trend. Therefore, Japan's economy has been following a path toward achieving the 2 percent price stability target as expected.

European situation

Now, let me briefly refer to the European situation. While details will be provided by Governor Noyer, our recognition is that the European economy is bottoming out and there are signs of a pick-up. As a recovery in the European economy is an essential factor not only for a sustained recovery of Japan's economy but also for the stability of the global economy as a whole, we are watching developments very carefully.

After European Central Bank (ECB) President Draghi's remarks in July 2012 and the introduction of the Outright Monetary Transactions (OMTs) by the ECB in September 2012, fluctuations in international financial markets triggered by developments in Europe seem to have declined substantially. Meanwhile, progress also has been made on the financial stability front, with preparations for the Asset Quality Review (AQR) and stress testing progressing ahead of the formation of the Single Supervisory Mechanism next year. Along these lines, we note that discussions on the need to arrange a public backstop in case of capital shortages resulting from the AQR and stress testing have been moving forward as well. While difficult issues may lie ahead, including establishment of a resolution framework, we are confident that the European authorities will produce appropriate policy responses.

In light of Japan's experience

Let me now move on to what we might be able to say based on our experience during the financial crisis in the 1990s in relation to the European authorities' initiatives. Of course, the situation the authorities face and the primary features of the problem are probably not completely the same as what Japan endured in the 1990s. Thus, I do not think that Japan's experience is wholly applicable, although I hope it will provide some insight.

The first point I would like to make is with regard to the difficulty of establishing an appropriate resolution framework. During Japan's financial crisis in the 1990s, the Japanese authorities were repeatedly criticized for acting too late. Admittedly, looking back, we could have acted more swiftly in some areas. However, there seem to be two factors behind the fact that it took time to establish an institutional framework. A trial and error situation was inevitable due to lack of a framework previously, and the overall process involved the need to gain understanding from the public. Measures to set up institutional frameworks, especially when it involves public money, are bound to take time. Coordination among various relevant parties to compile legislative measures has to be made, and the public's understanding of the necessity for such a framework has to be gained. Public understanding of a resolution framework involving public money becomes important, especially in a case where there is a need to actually use or modify such a framework.

While the establishment of a framework is taking place, financial markets tend to want immediate tangible results, and a gap between the timeframe of action by the market participants and that of the public authorities tends to emerge. Policymakers need to conscientiously and patiently deliver explanations in order to narrow the gap by as much as possible.

The second point I would like to make is with regard to the detection of financial imbalances. As the source of Japan's financial crisis in the 1990s was the bursting of the bubble that was generated in the late 1980s, active debate took place on how we can promptly recognize financial imbalances like the bubble. After the global financial crisis, the importance of having a macroprudential perspective has been underlined following a similar thought process. Based on past insights, the Bank has been examining whether there are financial imbalances using such techniques as "macro risk indicators" and "macro stress testing." Some of the results of such exercises have been included in our publications of the *Financial System Report*. In a number of countries including those in Europe, efforts have been made from macroprudential perspectives. In my view, it would be useful if we could share our discoveries and experiences so that we can better detect any future financial imbalances.

The third point is that, even if the banking sector's nonperforming asset problem has been solved, it could take time until funds are smoothly channeled to the real economy. In Japan's case, after the financial crisis in the 1990s, financial system stability issues were mostly addressed by the mid-2000s; however, firms' funding remained sluggish even after that. Against such a backdrop, the Japanese government implemented various policy measures. The Bank also provided support for corporate financing. Measures include expanding the range of eligible collateral to include asset-backed securities, purchasing asset-backed securities, commercial paper, and corporate bonds, and creating funds supplying facilities to support corporate financing. These measures did support corporate financing, especially in the face of a series of stress events such as the collapse of Lehman Brothers and the Great East Japan Earthquake in 2011. However, I have to admit that there are still a number of issues to be examined, such as to what extent a central bank should be involved in resource allocation and the effectiveness of individual measures. I understand that measures to promote lending to small and medium-sized firms are being contemplated in Europe. It also would be useful for us to share our findings and experiences in this field so that we will have a better understanding of what types of measures are appropriate in the area of corporate lending.

Concluding remarks

Regarding what I have talked about today, we do not have clear answers yet on such issues as the detection of financial imbalances or measures to revitalize corporate financing. These deserve further examination. It would be beneficial if, by using occasions like this event, we could accumulate our knowledge on those issues by also learning from the experiences of our European colleagues. By making use of views exchanged with you, the Bank, through bringing Japan's economy out of deflation that has lasted for nearly 15 years while maintaining the stability of the financial system, will contribute to sustainable growth of the global economy.

I would like to thank you very much for your kind attention.