March 6, 2019

Bank of Japan

Economic Activity, Prices, and Monetary Policy in Japan

Speech at a Meeting with Business Leaders in Yamanashi

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(English translation based on the Japanese original)

Introduction

Thank you for giving me this opportunity to exchange views with you and for having taken the time to be here despite your busy schedules. It is indeed a great honor to be here today. Please allow me to express my gratitude for your great cooperation with the business operations of the Bank of Japan, particularly of the Kofu Branch.

The Bank introduced quantitative and qualitative monetary easing -- or QQE for short -- in April 2013 with the aim of achieving the inflation target of 2 percent, and since then has strengthened the QQE framework.

Today, I first would like to explain the achievements thus far of the Bank's monetary easing measures, excluding those regarding prices, and then describe recent developments in the economy and prices.

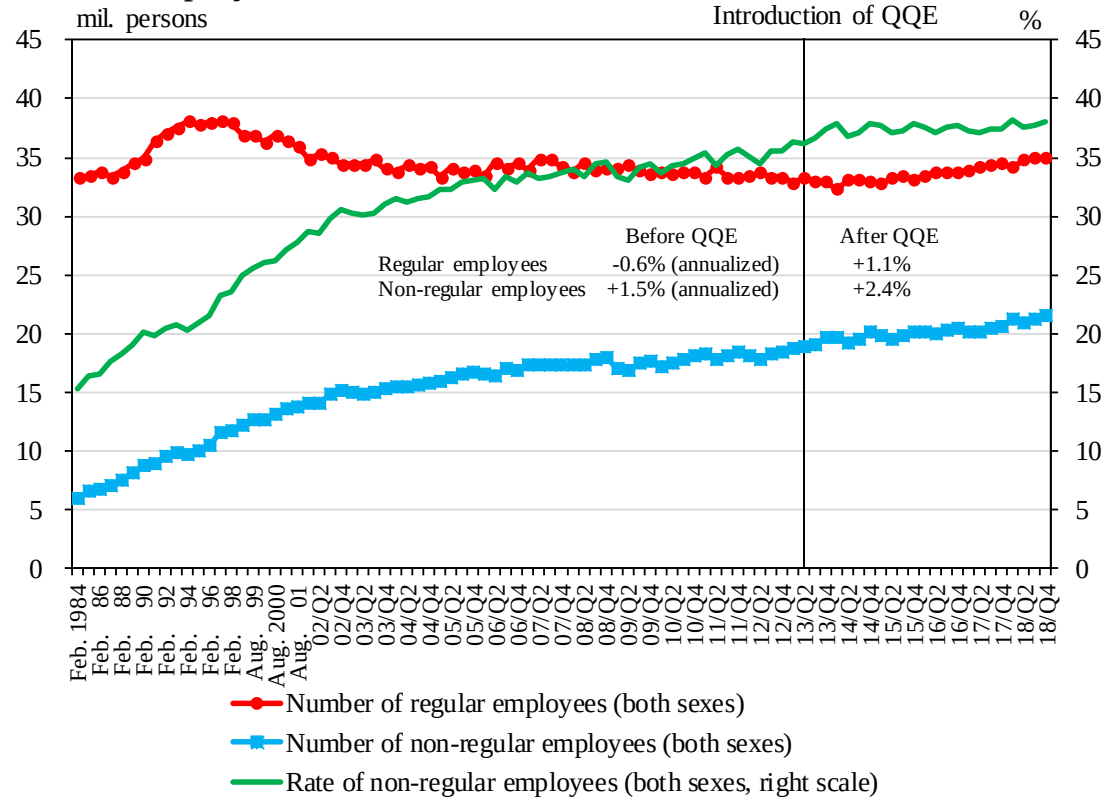
I. The Achievements of Monetary Easing

Improvements in Employment

The first thing that should be mentioned as an achievement of monetary policy is the improvement in employment.[1] Chart 1 shows the number of regular and non-regular employees. As can be seen, at the start of QQE, it was primarily non-regular employment that increased. However, since around the beginning of 2015, regular employment also has expanded. Moreover, the share of non-regular employees (non-regular employees divided by all employees excluding executives), which had been rising, also has leveled off.

[1] Regarding how monetary easing lifts productivity, see Yutaka Harada, "Economic Activity, Prices, and Monetary Policy in Japan: Speech at a Meeting with Business Leaders in Ishikawa," Bank of Japan, July 2018.

Chart 1 Employment



Note: Regular employees and non-regular employees exclude executives of companies and corporations. The figures for "Before QQE" and "After QQE" show the annualized growth rates of employees from 2008/Q1 to 2013/Q1 and those from 2013/Q1 to 2018/Q4, respectively.

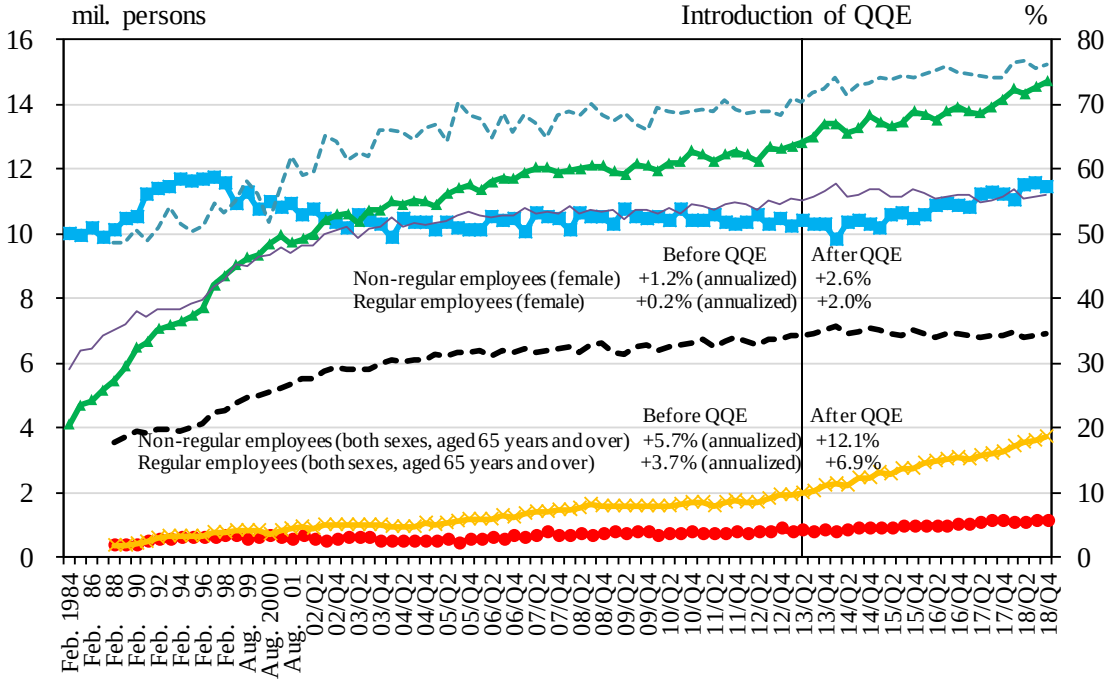
Source: Ministry of Internal Affairs and Communications, "Labour Force Survey."

Improvements in Employment of Women and the Elderly

Chart 2 shows that the employment of both women and the elderly (those aged 65 years and over) has been growing. Nevertheless, despite women's entry into the labor market, most women work part-time, and I am well aware of the criticism that there are few women in top positions in Japan. According to the World Economic Forum's Global Gender Gap Index (2018), which measures the degree of gender equality, Japan ranks only 110th among 149 countries. However, some progress is being made. As can be seen in Chart 2, the number of women in regular employment has been increasing. Moreover, the proportion of women who are non-regular employees, which had been rising, has remained flat since the start of QQE. This means that the number of women gaining experience at work and

moving into managerial positions also should increase. In fact, the share of managerial positions occupied by women has been on a rising trend.[2]

Chart 2 Employment of Women and the Elderly



Note: Regular employees and non-regular employees exclude executives of companies and corporations. The figures for "Before QQE" and "After QQE" show the annualized growth rates of employees from 2008/Q1 to 2013/Q1 and those from 2013/Q1 to 2018/Q4, respectively.

Source: Ministry of Internal Affairs and Communications, "Labour Force Survey."

Moreover, Chart 2 also shows that employment of the elderly has been growing. However, in the case of the elderly, the share of non-regular employees has been rising. The reason is likely that many are hired as temporary or part-time workers after reaching retirement age.

[2] For details, see Ministry of Health, Labour and Welfare, *FY2017 Basic Survey of Gender Equality in Employment Management* (available only in Japanese), July 2018.

Because Japan's population is aging, this means that it is unlikely that the share of non-regular employees in employment as a whole will decrease. However, looking at employees between 15 and 64 years of age, the share of non-regular employees has been declining since around 2014.

While it is difficult for the elderly to obtain regular employment, the fact is that more and more are gaining the opportunity to work. In September 2017, the government launched the "Council for Designing a 100-Year Life Society," and in June 2018 it released the report "[B]asic [D]esign for the Human Resources Development Revolution," calling for increased employment of the elderly.[3]

At the same time, however, the proliferation of the notion of a "100-Year Life" may have made people aware of the longevity risk again, which may have led to the rise in the savings rate, or in other words, the decline in the consumption rate, which I will talk about later.

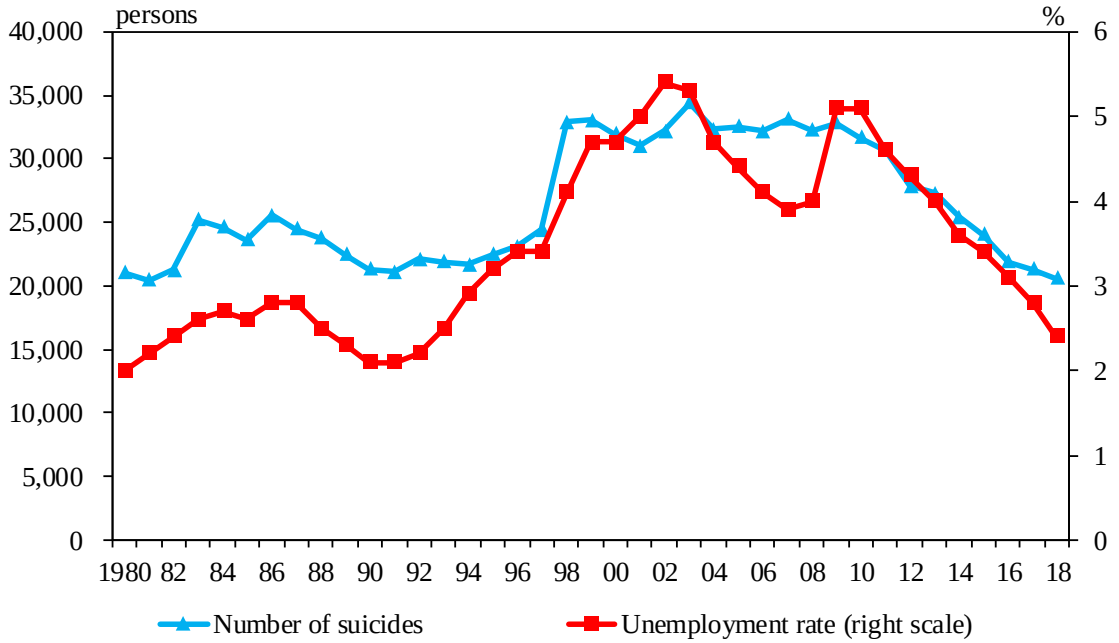
Decrease in Suicides

When unable to find a job in the face of a difficult employment situation, being under such stress causes one to question their worth to society. Indeed, studies show that suicides increase in tandem with a rise in the number of unemployed.[4] Assuming that this is true, suicides should decrease if the unemployment rate were to decline. Chart 3, which shows the number of suicides and the unemployment rate, indicates that the two are linked: as the unemployment rate rises, the number of suicides increases, and vice versa. While I do not think that suicides are caused by economic problems alone, what is clear is that the number of suicides per year has fallen by 7,000 or more since 2012 as a result of the upturn in the economy and the decline in the unemployment rate.

[3] At the G-20 Symposium "For a Better Future: Demographic Changes and Macroeconomic Challenges" held in January 2019, seven out of 13 speakers stressed the importance of labor force participation by the elderly in overcoming demographic challenges posed by the aging population.

[4] See, for example, Yasuyuki Sawada, Michiko Ueda, and Tetsuya Matsubayashi, *Economic Analysis of Suicide Prevention Towards Evidence-Based Policy-Making*, Singapore: Springer, 2017.

Chart 3 Unemployment Rate and Suicides

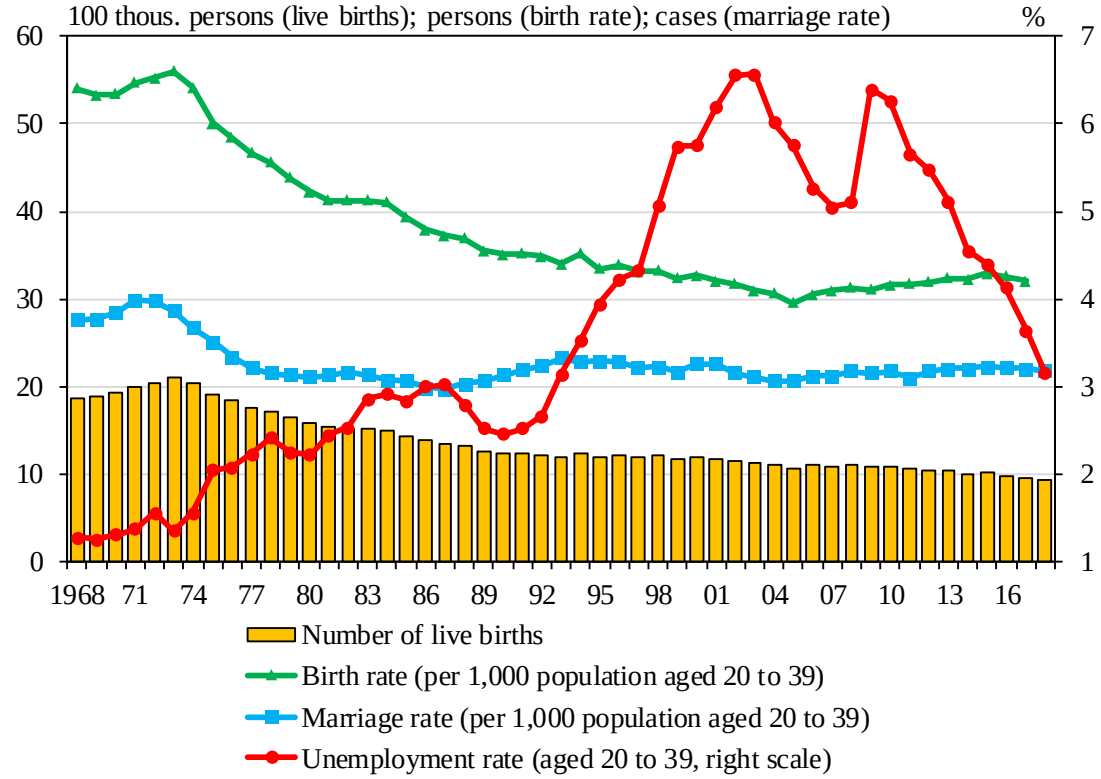


Sources: National Police Agency, "Suicide Statistics"; Ministry of Internal Affairs and Communications, "Labour Force Survey."

Slight Increase in the Birth Rate

I think that a small improvement in the birth rate also has been achieved. Chart 4 shows the unemployment rate, the marriage rate, and the birth rate for the population of 20- to 39-year-olds. It is a well-known fact that the marriage rate and the birth rate are correlated, as is more or less evident from the chart.

Chart 4 Rates of Unemployment, Marriage, and Birth



Note: For 1975 onward, the birth rate is calculated as the number of live births to mothers aged 20 to 39 divided by the population aged 20 to 39. For 1974 and earlier, the birth rate is calculated as the total number of live births divided by the population aged 20 to 39. The marriage rate is calculated as the total number of marriages divided by the population aged 20 to 39.

Sources: Ministry of Internal Affairs and Communications, "Labour Force Survey"; Ministry of Health, Labour and Welfare, "Vital Statistics."

Let us take a closer look at this. The birth rate per 1,000 population aged 20 to 39 (hereafter birth rate), which previously had been on a declining trend, has been rising since 2005 along with the decline in the unemployment rate.

The bar graph in the chart illustrates this trend in terms of live births per population (hereafter live births). Note how, when comparing two age groups with the same birth rate, the number of live births increases for the age group with a greater number of constituents. Given that second-generation baby boomers (children of baby boomers born between 1947 and 1949) reached their average marriage age sometime between 1995 and 2000 or, if we take the rise in the average marriage age into account, sometime between 2000 and 2005, the number of live births subsequently would have increased had there been a reversal in the

birth rate around this time. There turned out to be no such increase, however. The reason is that, during the approximate period from 1995 to 2005 and in the few years after the outbreak of the global financial crisis in 2008, young people of this generation were not able to find stable employment due to the so-called employment ice age, which led them to think twice about marriage and having children.[5,6] Put differently, had QQE been introduced at an earlier stage, second-generation baby boomers would not have had to cope with the repercussions of the employment ice age, likely resulting in an increase in the number of live births from around 1995.

Improvement in Government Finances

An improvement in employment means that incomes increase. Firms hire people because their profits are rising. When employment grows, both profits and wages increase. When there is an increase in profits and wages -- that is, the income of the country as a whole -- the government's tax revenue also rises. Chart 5 shows the general government fiscal balance (relative to GDP) and government debt (also relative to GDP). While Japan's fiscal situation is severe, its deficit in fiscal 2017 shrank to 2.7 percent of GDP. Compared with a deficit of 8.3 percent in fiscal 2012, this is an improvement of about 5.5 percentage points. The reason is that the economy has been doing well and the government's tax revenue has been increasing. The increase in tax revenue due to the consumption tax hike from 5 to 8 percent is said to amount to about 8 trillion yen (1.5 percent of GDP). While the remaining improvement of 4.0 percentage points is partly attributable to the effects of a positive turnaround in overseas economies, it owes in large part to the improvement in the economy

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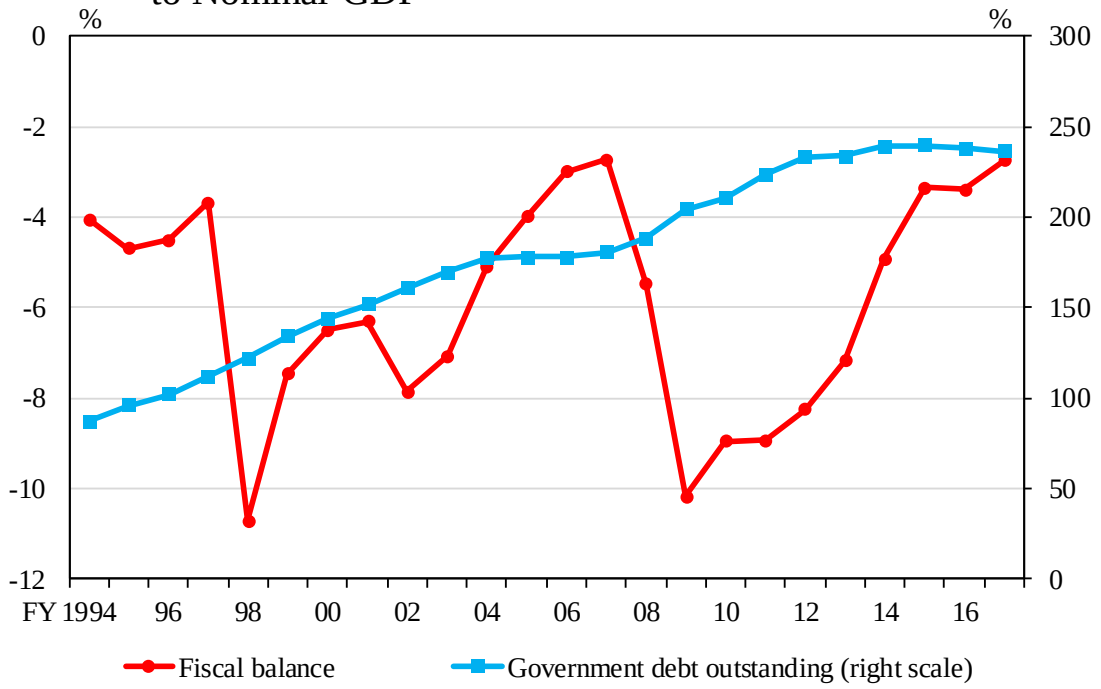
[5] For details on the employment ice age, see Genda Yuji et. al, *Shūshoku hyōgaki sedai no keizai shakai e no eikyō to taisaku ni kansuru kenkyū iinkai hōkokusho*, Research Institute for Advancement of Living Standards, November 2016.

[6] In his recent book, former Bank of Japan Governor Shirakawa argues that the immediate response of many major Japanese firms to the large demand shock brought about by the bursting of the bubble and the outbreak of the global financial crisis in 2008 was to reduce graduate recruitment and increase non-regular employment. During this so-called employment ice age, the young bore the brunt of the employment adjustment. University graduates entering the labor market during this time -- the so-called second-generation baby boomers -- found it difficult to accumulate sufficient skills as young workers, leading to lower income levels, which in turn has had a lasting social impact including an increase in the rate of those who are unmarried and the consequent decrease in the number of births (available only in Japanese). Shirakawa Masaaki, *Chūō Ginkō* (Tokyo: Toyo Keizai, 2018), p. 112.

as a result of QQE. Moreover, the ratio of government debt to GDP also has declined slightly from its peak of 239 percent in fiscal 2015.

Chart 5 Fiscal Balance and Debt of General Government Relative to Nominal GDP



Source: Cabinet Office, "System of National Accounts."

Decline in Personal Income Inequality

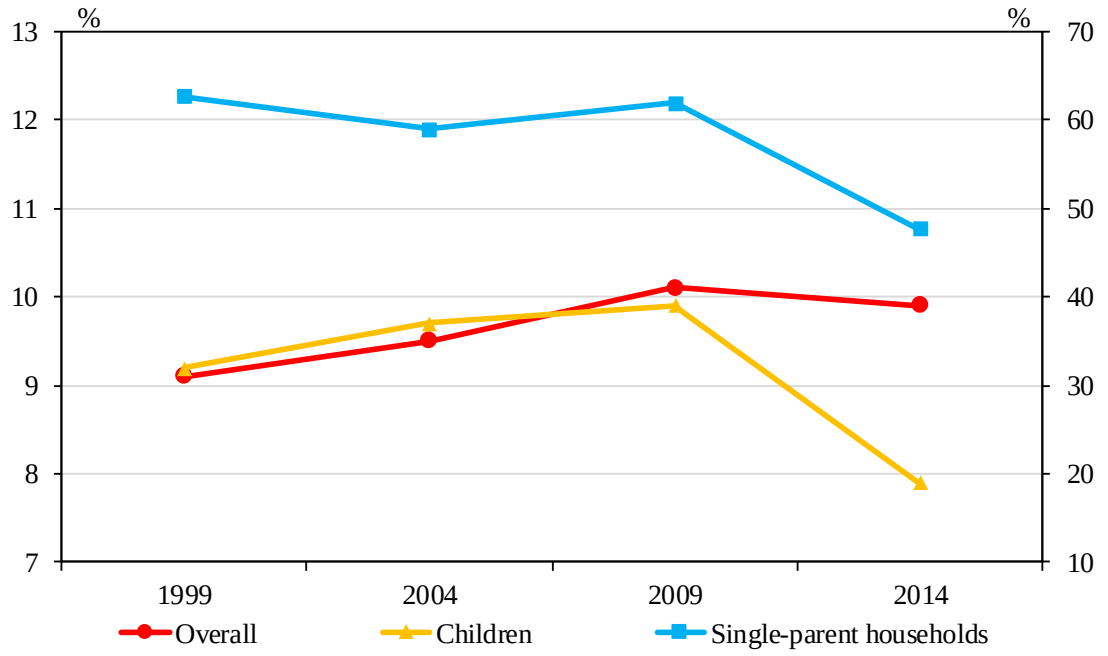
Furthermore, income inequality has declined. Results of statistics show that income inequality in terms of equivalized disposable income has declined.[7,8] Meanwhile, Chart 6

[7] See Statistics Bureau, Ministry of Internal Affairs and Communications, "Analytical [Results of] Income Distribution," *2014 National Survey of Family Income and Expenditure* (available only in Japanese), October 2016.

[8] Equivalized disposable income is obtained by adjusting the quotient of household disposable income and the square root of the number of household members. In its international comparisons, the Organisation for Economic Co-operation and Development (OECD) uses the Gini coefficient (see footnote 11) and the relative poverty rate for each country calculated on the basis of equivalized disposable income.

shows the trend in the relative poverty rate.[9] As the chart shows, the relative poverty rate has declined, regardless of whether we look at the overall rate, the child poverty rate, or the poverty rate of single-parent households. Since most single-parent households are single-mother households, the chart indicates that the poverty rate of single mothers has declined from 62.0 percent in 2009 to 47.7 percent in 2014. While it is shocking that the poverty rate for single mothers is close to 50 percent, I view the rate's decline to this extent as a substantial achievement.[10]

Chart 6 Relative Poverty Rate



Sources: Ministry of Internal Affairs and Communications, "2014 National Survey of Family Income and Expenditure."

[9] The relative poverty rate of a country is the proportion of its household members whose equivalized disposable income falls below the poverty line (one-half the median equivalized disposable income). Inequality has fallen from 2009 to 2014 in terms of the Gini coefficient for equivalized disposable income. For details, see *2014 National Survey of Family Income and Expenditure* (available only in Japanese).

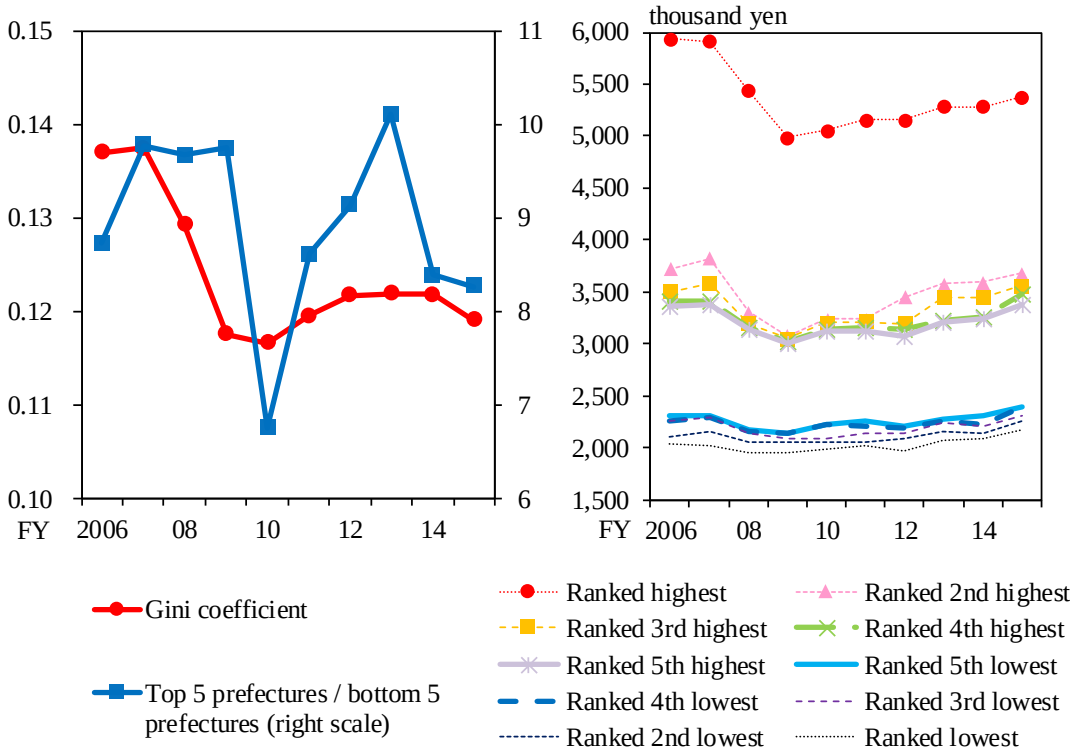
[10] Similarly, the relative poverty rate, the child poverty rate, and the poverty rate of single working-age households with at least one child have all declined from 2012 to 2015. See Ministry of Health, Labour and Welfare, *Summary Report of Comprehensive Survey of Living Conditions 2016*, June 2017.

Decline in Regional Income Inequality

Regional income inequality also has been declining. The left panel of Chart 7 shows the ratio of the average per capita prefectural income of the top five prefectures weighted by population to that of the bottom five prefectures weighted by population (top five prefectures divided by bottom five prefectures) and the Gini coefficient of prefectural income.[11] The chart seems to exhibit that, after dipping in fiscal 2010 following the outbreak of the global financial crisis in 2008 (reflecting the decrease in income in wealthier regions), inequality increased again; however, compared to fiscal 2012, the year before the introduction of QQE, inequality appears to have decreased. In other words, regional income inequality is falling. Moreover, as seen in the right panel of Chart 7, income both in the top five and the bottom five prefectures is growing, which is why it cannot be said that inequality has been falling because the top prefectures other than Tokyo -- with the highest income level in Japan -- have become poorer. While I would not go so far as to say that the decline in inequality is due solely to QQE, I think it can be said that the decline is due to the benefits of the economic expansion extending to all regions. However, it also is argued that the decline in regional inequality is not necessarily something to celebrate. The reasoning for this is that Tokyo has fallen behind in the competition among major global cities, as evidenced by the fact that the average per capita income in Tokyo today is still lower than in fiscal 2007.

[11] The Gini coefficient represents the degree of concentration in the distribution of income, etc., and is an indicator to measure inequality. The closer the coefficient is to zero, the smaller the extent of inequality, and the closer it is to one, the greater the extent. Here, the Gini coefficient is calculated on the basis of population-weighted per capita prefectural incomes.

Chart 7 Regional Income Inequality Measured by Per Capita Prefectural Income



Source: Cabinet Office, "System of Prefectural Accounts."

Japan, a More Open Country Today

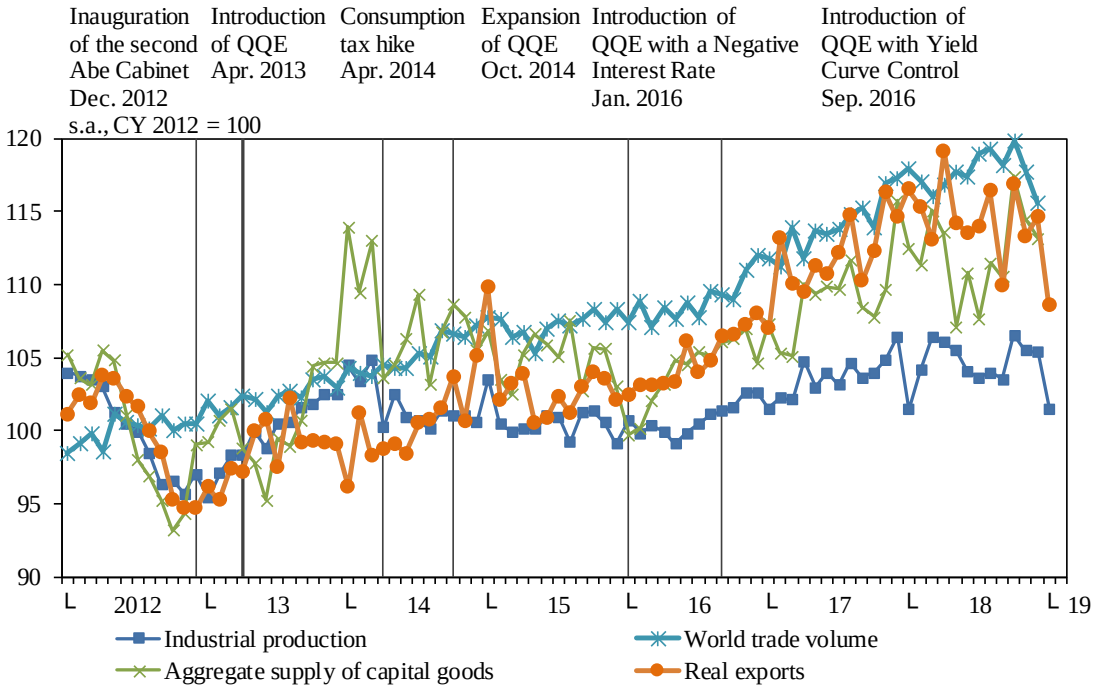
Lastly, with the economy continuing to grow, Japan appears to be becoming more interested in and open to foreign cultures, people, services, and products. Amid growing anti-free trade sentiments in many advanced economies, Japan concluded the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP, which came into effect in December 2018) and the Japan-EU Economic Partnership Agreement (EPA, which came into effect in February 2019). Japan is now a global standard bearer of free trade. Moreover, with the amendment to the Immigration Control and Refugee Recognition Act in December 2018, Japan is seeking to attract overseas workers and improve their employment conditions.

II. Recent Economic Developments

In my description of the achievements of monetary policy, I have focused so far on developments other than short-term economic indicators. I would now like to talk about recent economic developments.

Charts 8 and 9 provide an overview of key economic indicators. Almost all the indicators in Chart 8 -- for production, investment, and exports -- have been improving. Some of these were sluggish following the consumption tax hike in April 2014 and thereafter, particularly in the period from the second half of 2014 to the first half of 2016, when global trade volume was sluggish. However, there also are some indicators that are falling currently. I will elaborate on this later.

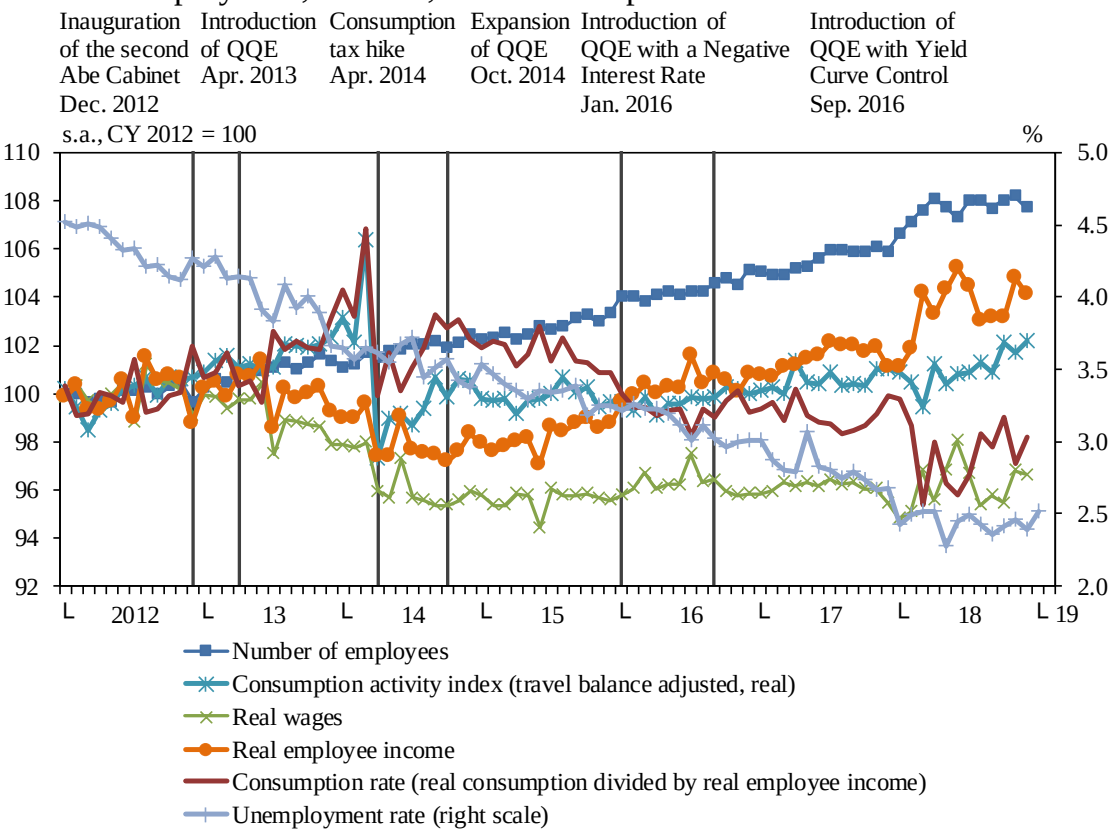
Chart 8 Production, Investment, Exports, and World Trade



Sources: Ministry of Economy, Trade and Industry, "Indices of Industrial Production," "Indices of Industrial Domestic Shipments and Imports"; CPB Netherlands Bureau for Economic Policy Analysis, "CPB World Trade Monitor"; Bank of Japan, "Developments in Real Exports and Real Imports."

Chart 9 looks at wages, employment, employee income, which is obtained by multiplying wages by the number of employees, and consumption.[12] The reason why real wages per worker have not increased is that the number of non-regular workers working short hours has increased. On the other hand, real employee income was sluggish only in fiscal 2014, the year of the consumption tax hike; apart from that, it has grown more or less steadily. The unemployment rate also has steadily declined.

Chart 9 Employment, Income, and Consumption



Note: Real employee income is calculated as the number of employees multiplied by real wages, which is total cash earnings deflated by the CPI (all items less imputed rent). The consumption rate is calculated as the consumption activity index (travel balance adjusted, real) divided by real employee income.
Sources: Ministry of Health, Labour and Welfare, "Monthly Labour Survey"; Ministry of Internal Affairs and Communications, "Consumer Price Index," "Labour Force Survey"; Bank of Japan, "Consumption Activity Index."

[12] In my past speeches, I defined real employee income as the number of regular employees multiplied by real wages based on the *Monthly Labour Survey*. However, taking into account the difference in the level of the number of regular employees for January 2018, I have redefined real employee income as the product of the number of employed based on the *Labour Force Survey* and real wages based on the *Monthly Labour Survey*.

Among the different indicators, the one showing the weakest improvement is real consumption. Consumption as measured by the consumption activity index is still below the level in 2013; that is, before the spike in demand due to the frontloading of purchases prior to the consumption tax hike. This is a bit strange given that real employee income, on which consumption expenditure rests, has been on a steady upward trend and exceeds the 2013 level, albeit with greater fluctuation since the start of 2018. One of the reasons that the consumption rate (consumption divided by employee income) as defined here has been falling is that disposable income has not increased as much as employee income due to the consecutive annual 0.354 percentage point increases in employee pension insurance premiums. However, because insurance premiums were not raised from 18.3 percent in September 2018 and will not rise any further, this should lead to a rise in the consumption rate in the future. Since it is difficult to imagine that the consumption rate will continue to fall forever, I think that consumption can be expected to recover.

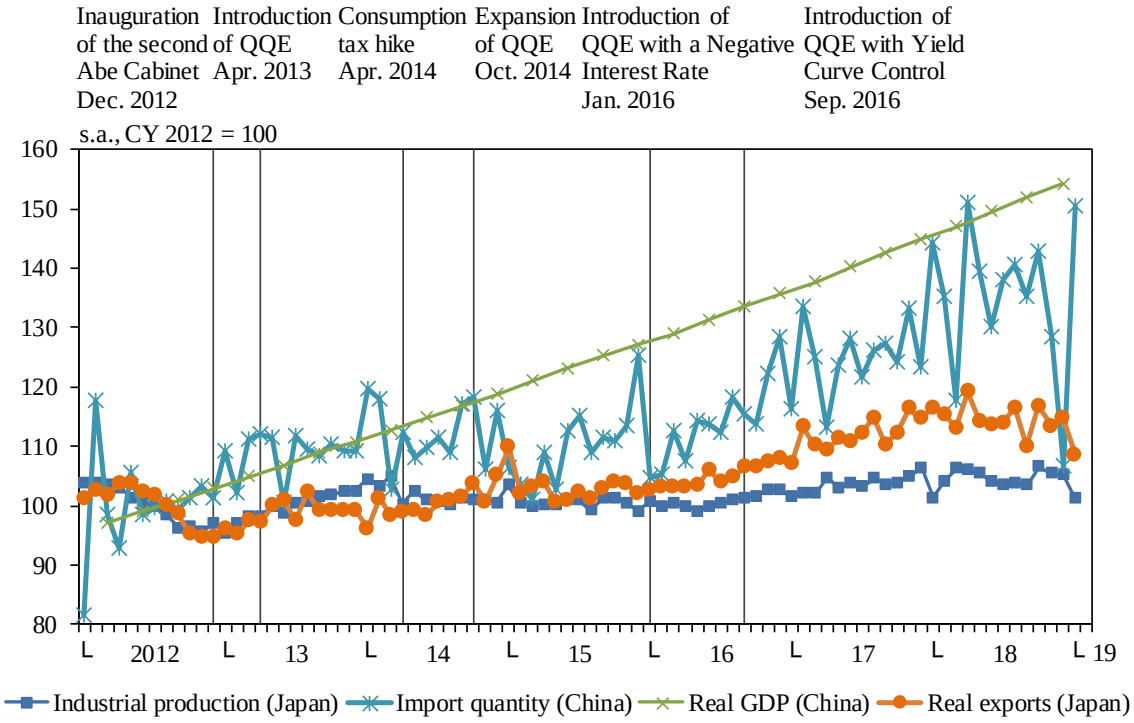
As mentioned earlier, the economy has been recovering due to QQE. However, there is concern about the risk of a deterioration in economic activity going forward due to the fall in stock prices since the end of 2018. Often, a decline in stock prices is seen as a harbinger of a future decline in economic activity. While this is the case, stock markets frequently seem to overreact to such risks, and whether this leads to deterioration in economic activity warrants careful monitoring.

Given the risks to economic activity going forward, there certainly are a number of issues to consider, such as the conduct of economic policy in the United States, trade friction between the United States and China, the United Kingdom's exit from the European Union (EU), developments in the European economy, and the slowdown of the Chinese economy. Among these, I would like to take a closer look at the Chinese economy.

While trends in the Chinese economy are often discussed in terms of real GDP, the decline in the growth rate appears neat -- having been level or declining by 0.1 percentage point every quarter -- and thus there are doubts as to whether GDP figures are an accurate representation of developments in economic activity. Chart 10 shows the level of China's real GDP (quarterly) and import quantity as well as Japan's industrial production and

exports. Keeping in mind that GDP and imports correlate with each other in general, while the chart shows that there is no such correlation in the case of China, Japan's production and exports are linked with China's import quantity. This means that, if China's import quantity were to decrease further, this would be cause for concern regarding the outlook for Japan's production and exports.

Chart 10 Correlation of Economic Activity between China and Japan



Sources: Ministry of Economy, Trade and Industry, "Indices of Industrial Production"; Bank of Japan, "Developments in Real Exports and Real Imports"; National Bureau of Statistics of China, "National Accounts"; Haver Analytics.

If the risks I explained earlier were to materialize, I think it would be necessary to implement additional monetary easing without delay through quantitative, qualitative, and interest rate policy measures.

Meanwhile, until last year, there had been debate on financial imbalances and a potential bubble. However, because stock prices have dropped substantially since then, it would be rather unreasonable to argue that there are financial imbalances in the stock market now.

III. The Bank's Monetary Easing Policy and the Profitability of Private Banks

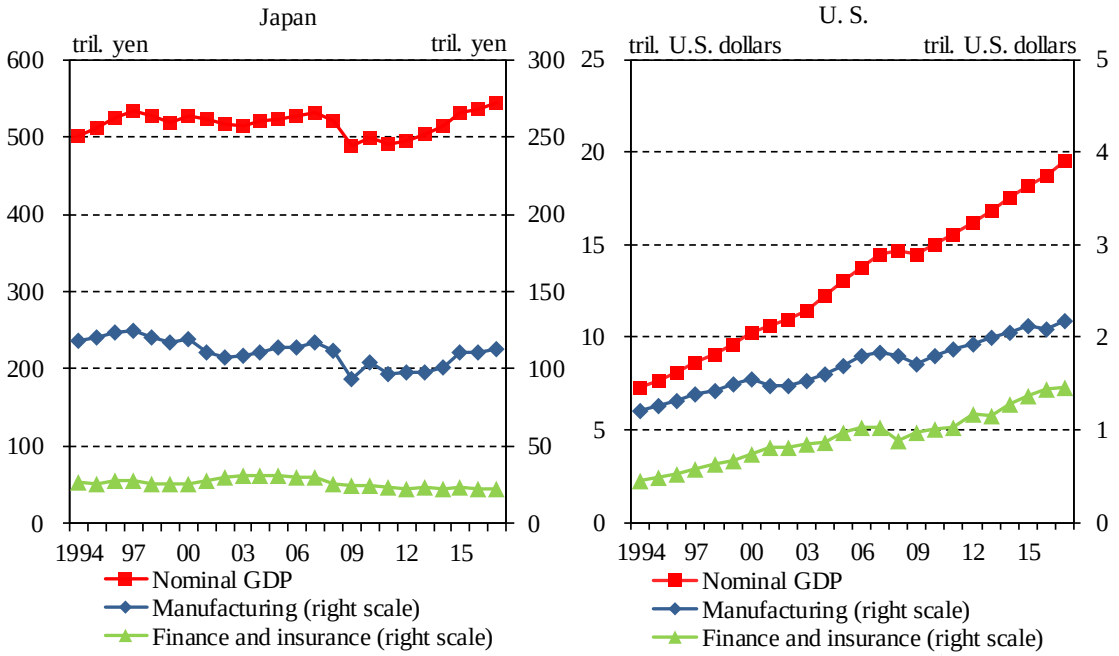
While QQE has led to the long-term, structural, and short-term improvements in the economy that I have described, it also has been argued that a prolonged period of monetary easing has undermined the profitability of financial institutions. I would like to explain my views on this.[13]

First of all, since bold monetary easing has produced favorable results for Japan's economy as a whole, I feel that it is a bit curious that the same cannot be said about financial institutions.

Chart 11 shows nominal GDP of the financial and insurance industry (hereafter, financial industry) and the manufacturing industry, as well as overall nominal GDP of Japan and the United States. The chart shows that, whereas in the United States, the financial industry's GDP has been growing along with the growth in overall nominal GDP, in Japan, the financial industry's GDP has been particularly stagnant amid the sluggishness of nominal GDP overall. Next, let us look at how nominal GDP has recovered since 2009, the trough following the outbreak of the global financial crisis in September 2008. Following the drop in 2009, Japan's nominal GDP stagnated until 2012 but then recovered from 2013, when QQE was introduced. While nominal GDP of the manufacturing industry has been recovering along with the recovery in overall nominal GDP, that of the financial industry does not appear to have recovered. However, as shown in the table underneath the chart, the financial industry's GDP, which had been decreasing at an annual rate of 2.5 percent until 2012, stopped contracting following the introduction of QQE. This shows that, if nominal GDP grows, the financial industry's GDP also is likely to grow.

[13] What is described hereafter owes in large part to Harada Yutaka, "Kin'yū kanwa seisaku no kōka wa kin'yū kikan ni mo todoku," *Shūkan Kin'yū Zaisei Jijyō*, October 8, 2018.

Chart 11 Nominal GDP of the Financial Industry: Comparison between Japan and the United States



Average Annual Growth Rate of Nominal GDP after the Global Financial Crisis (%)

	Japan		United States	
	2009-12	2012-17	2009-12	2012-17
Nominal GDP	0.4	1.9	3.9	3.8
Manufacturing	1.4	3.0	4.2	2.5
Finance and insurance	-2.5	0.1	6.4	4.7

Sources: Cabinet Office, "System of National Accounts"; U.S. Bureau of Economic Analysis.

Turning to nominal GDP figures for the United States in Chart 11, overall nominal GDP has continued to grow after the global financial crisis and, in line with that, nominal GDP figures for the manufacturing and financial industries also have been growing. Furthermore, there is no change in the growth trend after 2012 like the one seen in Japan's case. This is because the Federal Reserve conducted bold monetary easing immediately following the global financial crisis. Meanwhile, while the fact that the growth rate of the financial industry exceeds that of overall nominal GDP likely reflects the entrepreneurial spirit of the U.S. financial industry, if nominal GDP had not grown in the first place, I think that the growth rate of the financial industry also would have been lower.

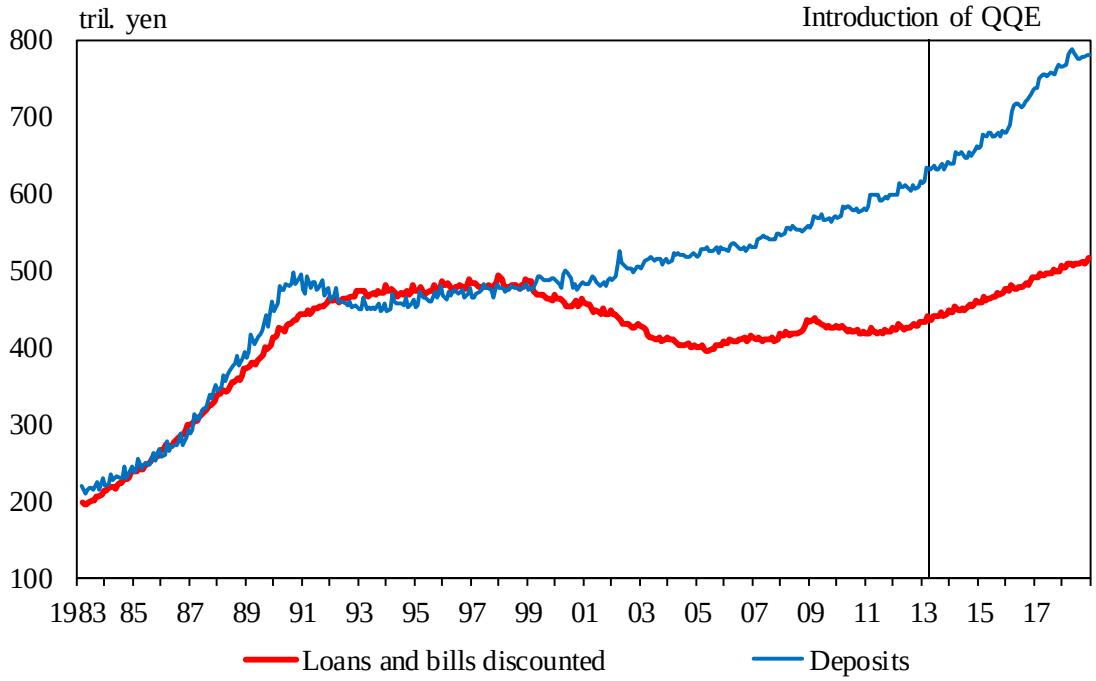
The bold monetary easing policy, which aims at achieving the price stability target of 2 percent, has led to an improvement in employment, a rise in wages, and an increase in corporate profits, as seen in the rise in stock prices. Since nominal GDP is the sum of all

wages and profits, an increase in wages and profits naturally means that nominal GDP also increases. If nominal GDP increases, banks' nominal GDP also can be expected to increase. Moreover, the business conditions of firms borrowing money from banks also should improve, so that among them would be firms that want to borrow more. Credit costs also have declined as a result.

Monetary Easing Is Creating Demand for Loans

Chart 12 shows the loans and deposits of domestic banks. Starting with loans, these followed a declining trend after the collapse of the bubble economy. While in the wake of the introduction of quantitative easing (QE) in 2001 it took a while for loans to start increasing, they soon started to do so after the introduction of QQE. While loans have increased by 74 trillion yen from March 2013 to December 2018, deposits have increased by as much as 147 trillion yen. For banks, deposits can be regarded as their "products" and loans as their "sales." The difference between "sales" and "products" represents "inventory." An increase in deposits in excess of the increase in loans thus is equivalent to an increase in inventories. What is needed, then, is a reduction in inventories. The fundamental reason for financial institutions' difficulties is that they are accumulating funds but there are no borrowers.

Chart 12 Loans and Deposits of Private Banks in Japan



Note: Domestically licensed banks are banks established under Japanese legislation. Figures exclude those for Japan Post Bank.
Source: Bank of Japan, "Financial Institutions Accounts."

Policy Tightening Does Not Guarantee a Steepening of the Yield Curve

A decline in interest rates brought about by bold monetary easing results in a deterioration in private banks' profitability -- this most likely is the case because of the assumption held by many in the financial communities that the yield curve will steepen, the term spread will increase, and hence the loan interest rates will increase when the Bank raises interest rates. Given that private banks borrow short-term debt and finance longer-term lending, their profits grow if the term spread increases. This is not to say, however, that the term spread increases with every rise in the interest rate.[14] Whether the yield curve flattens or steepens when short-term interest rates are raised depends on the economic situation as well as the market's view of monetary policy at the time. Therefore, it is not necessarily the case that the yield curve will steepen if short-term interest rates are raised.

[14] Regarding details of the relationship between policy changes and the yield curve, see Yutaka Harada, "Economic Activity, Prices, and Monetary Policy in Japan: Speech at a Meeting with Business Leaders in Ishikawa," Bank of Japan, July 2018.

If Prices Decline, So Will Interest Rates

If prices decline, so will nominal interest rates. Given that the real growth rate normally declines under such circumstances, so does nominal GDP, or the product of prices and real production. A decline in nominal GDP represents economic deterioration. This means that credit costs -- costs resulting from bankruptcies of borrowing firms -- will rise, demand for loans will decrease, and ultimately interest rates will decline.[15]

One factor that has a significant impact on financial institutions' profitability is the fact that many people today have a sufficient amount of cash and deposits, which has naturally caused the number of borrowers to decrease. Another is credit costs -- in other words, the devaluation costs of impaired assets. Sales growth for borrowing firms is expected to be weak without nominal GDP growth, and their loans could very well turn into nonperforming ones.

Following the introduction of QQE, the nominal GDP growth rate, which had been negative since the global financial crisis, has turned positive. Looking back, Japan's nominal GDP, which had posted more or less negative growth since 1998, resumed positive growth from 2004 as the economy enjoyed the effects of QE introduced in 2001. The significant economic downturn that began in 2008 is attributable to the global financial crisis and not necessarily due to the Bank's decision to discontinue QE, although I must admit that there should have been a better time to cease monetary easing than before the storm. Barring the implementation of both QE and QQE, Japan's nominal GDP growth would have remained in negative territory this whole time since 1998. To make an educated guess, financial institutions' profitability could have deteriorated much further than it actually did.

When private banks call for interest rate rises, this is an indication of their belief that the yield curve will steepen and the term spread will increase with a rise in interest rates. However, as I have explained, the facts prove that a rise in interest rates does not guarantee a steepening of the yield curve. Moreover, if monetary easing is discontinued, prices will decline, the economy will deteriorate, and nominal interest rates will decline. Financial

[15] For more on this point, see Harada Yutaka, "Naze nihon no kinri wa hikui no ka," *Keiki to saikuru*, no. 62, Japan Association of Business Cycle Studies, November 2016.

institutions seem to expect that, in the case of a rise in interest rates, only the rates on investment will increase without any changes in foreign exchange rates as well as prices of stocks and bonds, or a decline in firms' willingness to borrow. I am afraid this is not realistic.

Rather, premature policy tightening in the past caused economic deterioration, a decline in both prices and production, and lowered interest rates in the long run. It can be said to have played a role in creating the challenges faced by the financial industry today.

IV. The Economic Outlook and the Price Stability Target of 2 Percent

I mentioned earlier that the economy currently may be weak, and the same can be said about prices. Even so, if the economy continues to recover, the labor market will tighten and prices eventually will rise. There are some hurdles to overcome in achieving stable price rises, however.

First is the difficult situation the economy currently faces, as you are already familiar with. Looking back at Japan's past trends, the economy often would enter a recession when the sluggishness of the global economy held back exports, leading to a decline in business fixed investment and consumption. While a typical example of this is the recession following the outbreak of the global financial crisis in 2008, the stagnation in Japan's economy from the latter half of 2015 also can be said to have been affected significantly by the sluggishness of the global economy, especially China.

Second is consumption tax hikes. Tax hikes could push the economy into recession, and a resultant decrease in demand could push down prices. Regarding the hike scheduled to take place in October 2019, its effects are likely to be smaller than those of the previous hike in April 2014 due to the following reasons: the rate increase -- from 8 percent to 10 percent -- is smaller than that of the previous hike; a reduced tax rate will be applied to some items; permanent measures such as those concerning the provision of free education will be implemented; and a variety of measures are to be taken so as to smooth out the effects of the front-loaded increase in demand and its fallback. However, the effects of the previous tax hike, which many economists expected to be limited, have proved significant and

lasting.[16] A decline in demand, such as the one seen after the previous hike, naturally would contain inflation.

Third is price declines associated with the scheduled consumption tax hike. Measures concerning the provision of free education will be implemented alongside the hike. The Bank estimates that the measures' effects on the year-on-year rate of change in the consumer price index (CPI) for all items less fresh food will amount to minus 0.3 percentage point for fiscal 2019 and minus 0.4 percentage point for fiscal 2020. Meanwhile, the Bank estimates that the hike will push up the year-on-year rate of change in the CPI for all items less fresh food for fiscal 2019 and 2020, each by 0.5 percentage point. The upcoming tax hike is thus a key factor affecting prices. As it is evident that consumption tax hikes exert both positive and negative effects on the CPI, these effects should be taken into account when speaking in this context.

Another factor -- although not directly related to the consumption tax hike -- is a reduction in mobile phone-related prices. At the moment, a precise figure cannot be given as to how large its impact will be, but an estimation by private economists shows that the reduction will push down the year-on-year rate of change in the CPI for all items less fresh food by 0.5 to 1.0 percentage point.[17] Assuming that this estimation is correct, achievement of the 2 percent price stability target inevitably would be delayed.

Regardless of these setbacks, I am not too pessimistic. These are no different from tax cuts, and people's real income increases by an amount equivalent to the degree of price declines. Hypothetically, at times when everyone feels that the economy has been booming, extra money arising from the provision of free education and a reduction in mobile phone-related prices would be spent immediately, which would lead to inflation through a demand increase, whereas in today's economy, it likely will take time for demand to increase. Extra

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[16] See Miyazaki Hiroshi, "Shōhi zeiritsu hikiage no eikyō ga yosougai ni ōkikatta no wa naze ka," chap. 6 in *Abenomikusu no shinka*, ed. Harada Yutaka and Masujima Minoru (Tokyo: Chuokeizai-sha, 2018).

[17] For more on this estimation, see Kobayashi Shunsuke and Yamaguchi Akane, "2018-nen jyūgatsu zenkoku shōhisha bukka," Daiwa Institute of Research, November 2018, https://www.dir.co.jp/report/research/economics/japan/20181122_020468.html.

money will not disappear into thin air, however. These factors are capable of delaying the achievement of the price stability target but do not hamper the achievement itself. This also could be said about other price declines, including those in crude oil prices. Nevertheless, there is a risk that the current sluggishness in observed prices will spill over to inflation expectations, further delaying inflation.

My Thinking on the Bank's Policy Change on July 31, 2018

Lastly, I would like to explain my views regarding the Bank's policy change in 2018. At the Monetary Policy Meeting held on July 31, 2018, with a view to strengthening the framework for continuous powerful monetary easing, the Bank (1) introduced forward guidance for policy rates, stating that "the Bank intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time, taking into account uncertainties regarding economic activity and prices including the effects of the consumption tax hike scheduled to take place in October 2019" and (2) decided that, under yield curve control, "the [10-year JGB] yields may move upward and downward to some extent mainly depending on developments in economic activity and prices." With regard to long-term yield movements, Governor Kuroda stated in the press conference given after the Monetary Policy Meeting that the Bank would conduct monetary policy while bearing in mind that the yields might move upward and downward at about double the range observed until then of around plus or minus 0.1 percent.

I opposed the proposal for this policy change for the following reasons.

First, as for forward guidance, I considered that this should not be related to timing but rather to economic indicators in such a way that it further clarified its relationship with the price stability target. In other words, it was my view that the conduct of monetary policy should be data-dependent, not calendar-based. From this viewpoint, regarding the expression "for an extended period of time," I viewed it as appropriate to add such phrases as "unless prices show stronger movements than currently anticipated." Let me note that, at the time, there was strong anticipation in the market of an early interest rate hike regardless of the consumption tax hike scheduled in October 2019. I therefore thought that it was reasonable to convey the message that such an early interest rate hike was not possible. To

take a step further and strengthen this message, and to respond flexibly when there are changes in economic developments, I considered, as just mentioned, that it should be emphasized that the forward guidance ought to be data-dependent. This is based on the thinking that, if the economy deteriorates more than anticipated, additional easing measures will be necessary while, on the contrary, if it improves, it will be necessary to weaken monetary easing.

Second, I also opposed allowing the long-term yields to move in a more flexible manner; namely, because it was too ambiguous as the guideline for market operations. Prior to the policy change, the guideline that the Bank will purchase JGBs so that the long-term yields will remain at around 0 percent meant that, if the economy improved further, the Bank would increase its JGB purchases to maintain the yields at around 0 percent and thereby strengthen the monetary easing effects. Given this, announcing at this point that "the yields may move upward and downward to some extent" would in fact weaken such effects.

Concluding Remarks

I have reviewed the achievements of the Bank's QQE introduced in 2013.

First, I talked about its long-term effects, centering on the improvement in employment. Women and the elderly have made advances in society, Japan's fiscal situation has improved in the long run, and it is expected that the number of suicides will decline and the birth rate will rise. I also noted that such improvement in the economic situation is accompanied by a decline in income inequality.

Second, I explained that short-term economic indicators have been improving continuously. However, consumption has been weak relative to the increase in income, and downside risks to the economy have been increasing since the end of 2018.

Third, I pointed out the relationship between QQE and the profitability of private banks. What I think is strange is that, in the eyes of bank managers at least, although Japan's economy as a whole has been improving due to QQE, the positive effects of QQE have not been felt among financial institutions.

Fourth, I described the economic outlook and the price stability target of 2 percent. In addition to the consumption tax hike, measures concerning the provision of free education are to be implemented, the latter of which will directly cause a decline in prices. Nonetheless, I am not too pessimistic because, while the hike is in itself a tax increase, measures concerning the provision of free education are no different from tax cuts. In relation to economic activity, tax increases are a cause for concern but tax cuts produce positive effects. However, if the economy deteriorates to the extent that achieving the 2 percent price stability target in the long term becomes difficult, I view it as necessary to strengthen monetary easing without delay.

Thank you for your attention.