

The Outlook and Challenges for Japan's Economy

Speech at a Meeting with Business Leaders in Osaka

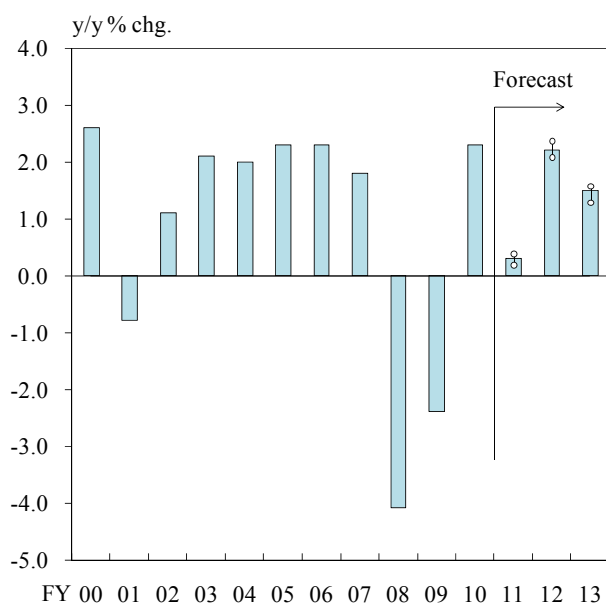
October 31, 2011

Masaaki Shirakawa
Governor of the Bank of Japan

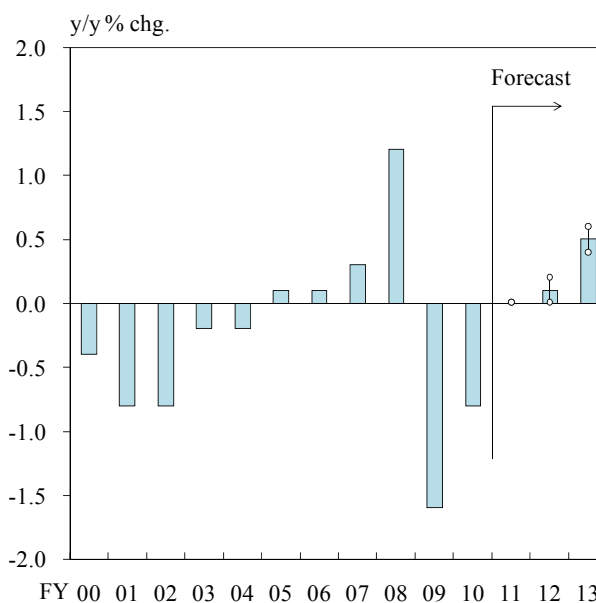
Chart 1

The Bank of Japan's Economic and Price Forecasts

A. Real GDP



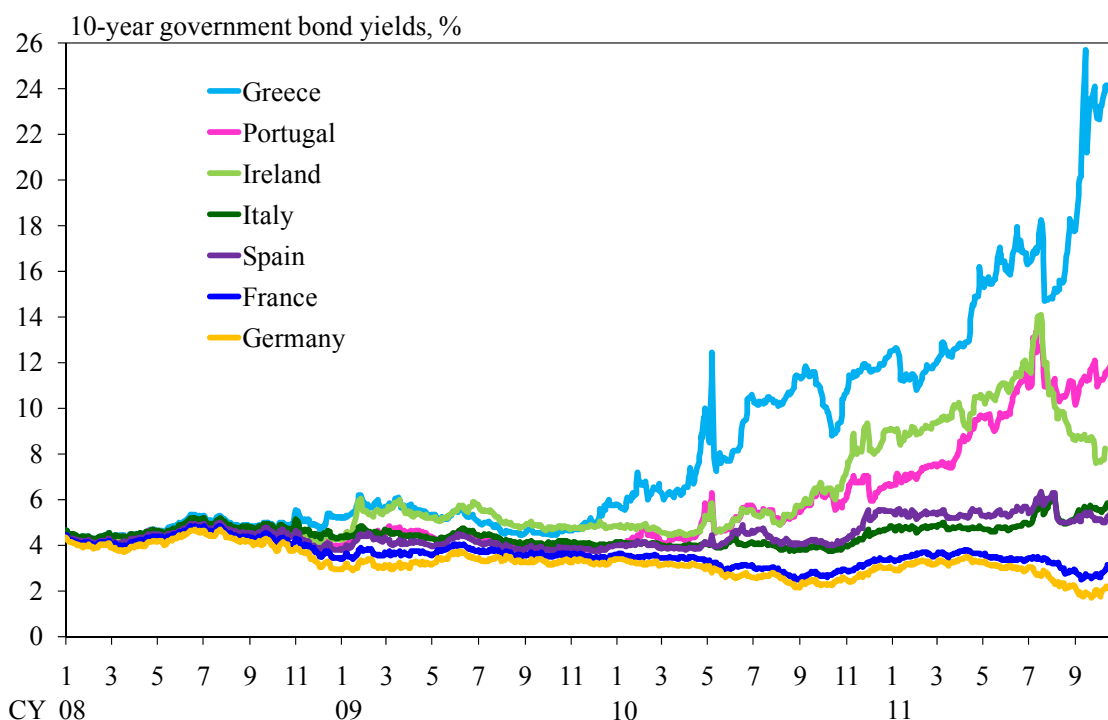
B. CPI (all items less fresh food)



Note: The forecast bars show the median of Policy Board members' forecasts, and the white dots show the range of forecasts of the majority members (excluding the highest figure and the lowest figure from the point estimates, to which each member attaches the highest probability of realization) presented in the October 2011 *Outlook for Economic Activity and Prices*.

Sources: Cabinet Office, "National Accounts"; Ministry of Internal Affairs and Communications, "Consumer Price Index"; Bank of Japan.

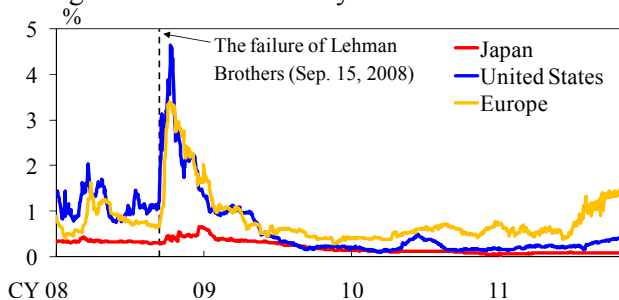
The euro area continues to face strains surrounding the sovereign debt problem, and yields on peripheral countries' government bonds have risen further since summer 2011.



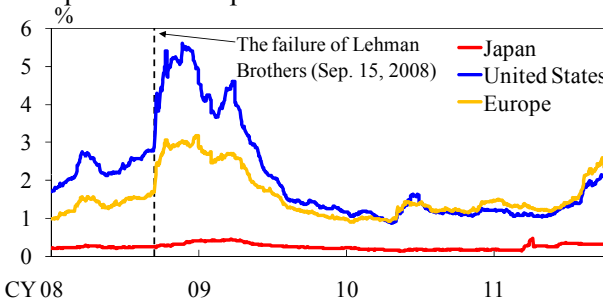
Note: Data for yields on Irish bonds have been discontinued as of October 11, 2011 due to the suspension of market issuance since October 2010.
Source: Bloomberg.

On the back of the sovereign debt problem in Europe, banks' and firms' funding rates are increasing in the U.S. and Europe. The rates in Japan remain stable at low levels.

A. Degree of Strain in Money Markets



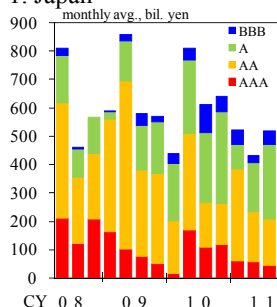
B. Spreads on Corporate Bonds



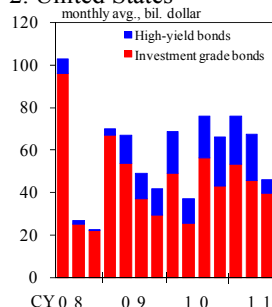
Notes: 1. The degree of strain in money markets is 3-month Libor minus yields on 3-month government securities. Data for German government securities are used for Europe.
2. The spreads on corporate bonds (rated AA) are corporate bond yields minus government bond yields.

C. Volume of Corporate Bond Issuance

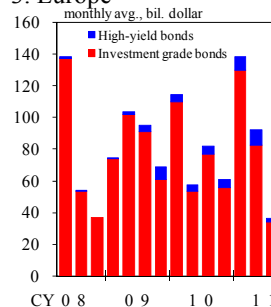
1. Japan



2. United States



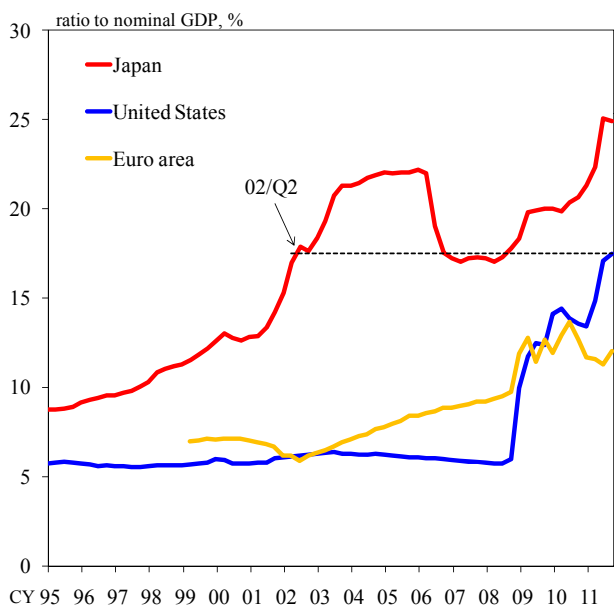
3. Europe



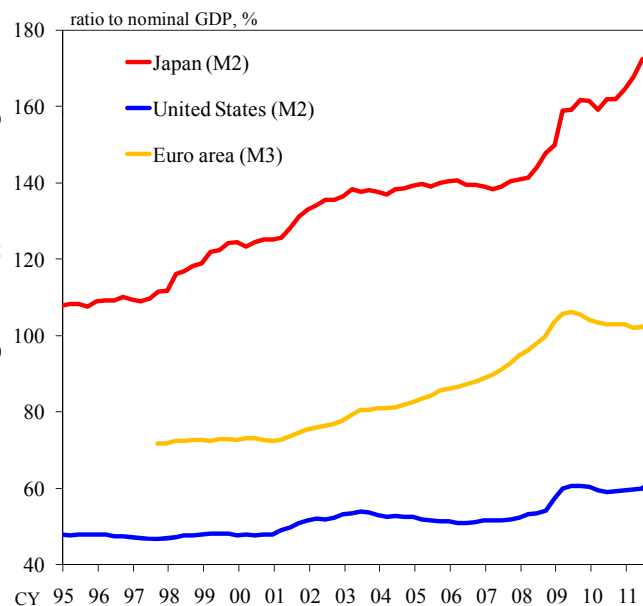
Note: Based on the launch date. Bonds issued by banks are excluded for Japan, and some government-guaranteed bonds are excluded for the U.S. and Europe.
Sources: Bloomberg; Japan Securities Dealers Association; I-N Information Systems; Thomson Reuters.

Japan's money supply as a ratio to nominal GDP has been at a high level compared to the U.S. and Europe, and recently increased further.

A. Monetary Base



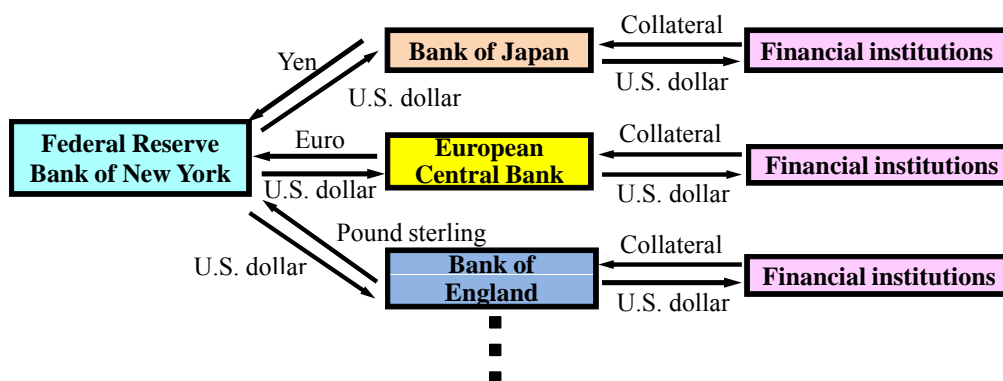
B. Money Stock



Notes: 1. The latest data are as of 2011/Q3. Nominal GDP for Japan and the euro area are the 2011/Q2 data.
 2. Monetary base is the sum of banknotes in circulation, coins in circulation, and current account deposits at a central bank.
 Sources: Cabinet Office, Bank of Japan, FRB, BEA, ECB, and Eurostat.

Central banks in major economies have strengthened the frameworks for providing U.S. dollar liquidity.

A. The Basic Scheme of U.S. Dollar Funds-Supplying Operations

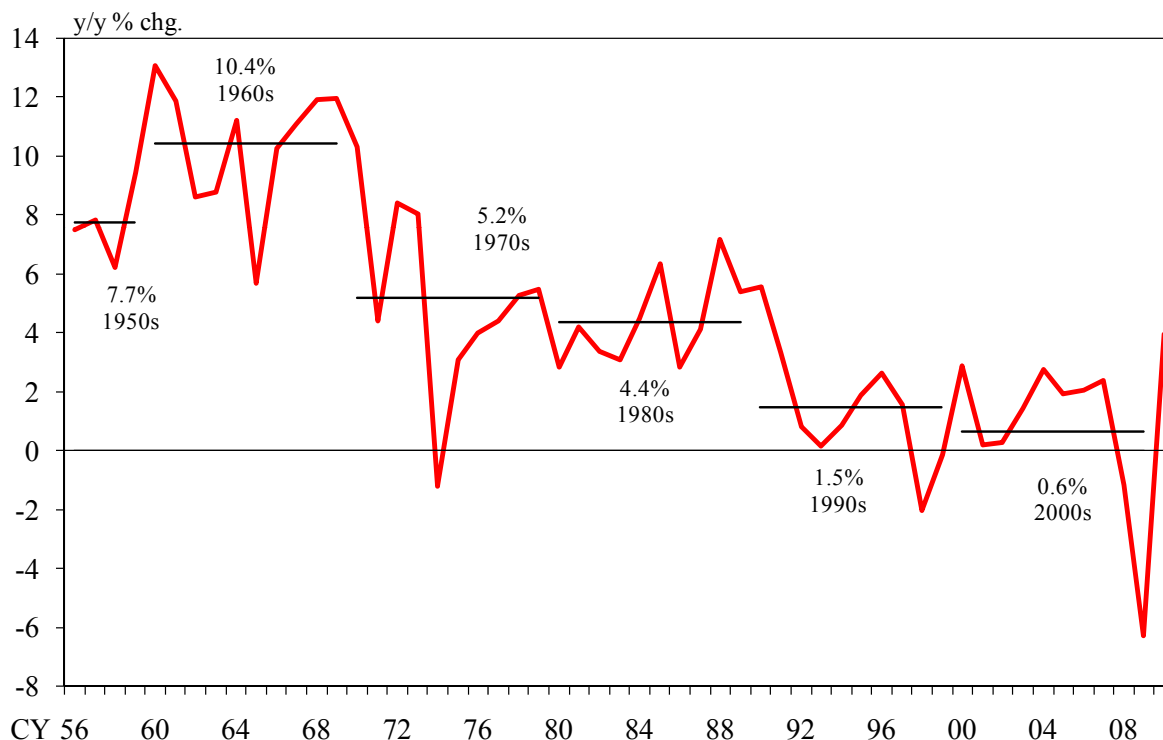


- A coordinated measure among six central banks in the U.S., Japan, U.K., Europe, Switzerland, and Canada.
- Introduced in September 2008 immediately after the Lehman shock and ended in February 2010.
- Reestablished in May 2010 in response to the increased strains in U.S. dollar short-term funding markets in Europe.

B. The Decision Made in September 2011

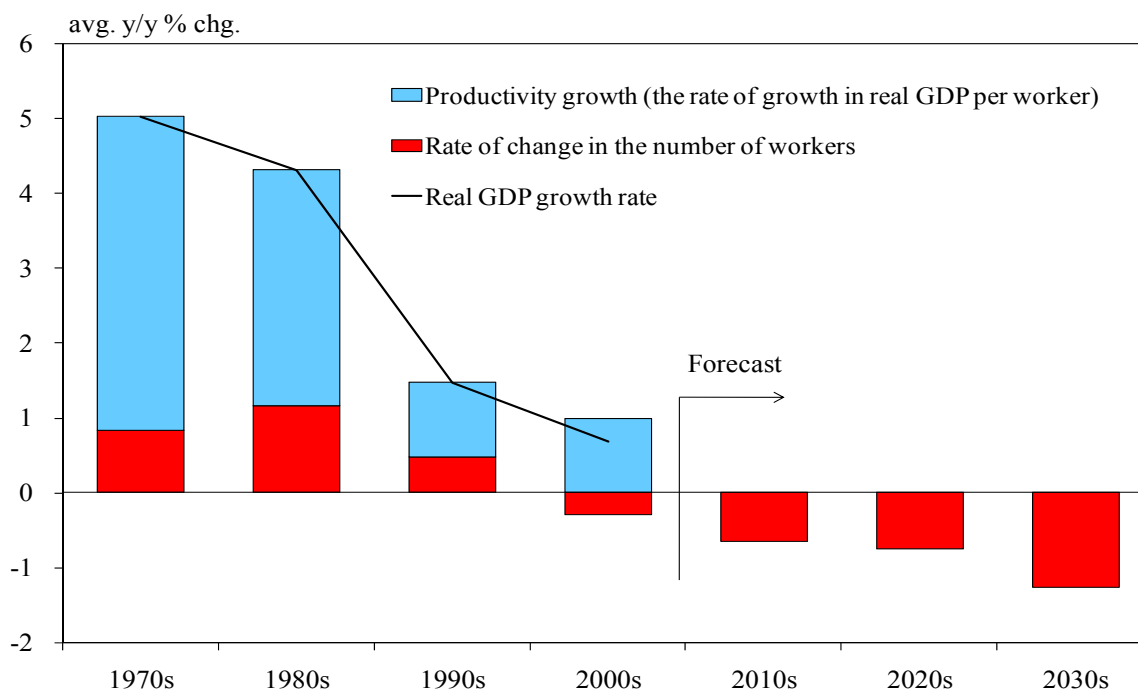
- ✓ On September 15, three central banks in Europe (the Bank of England, the European Central Bank, and the Swiss National Bank) and the Bank of Japan announced the conduct of U.S. dollar liquidity-providing operations over the year-end.
- ✓ These three central banks decided to introduce the 3-month operations in addition to the ongoing weekly 7-day operations with a view to fully ensuring the funding of financial institutions in Europe. The Bank of Japan, which had already conducted 3-month operations, decided to bring forward the conduct of such operations covering the year-end in coordination with measures taken by European central banks.

Japan's growth rate is trending down.



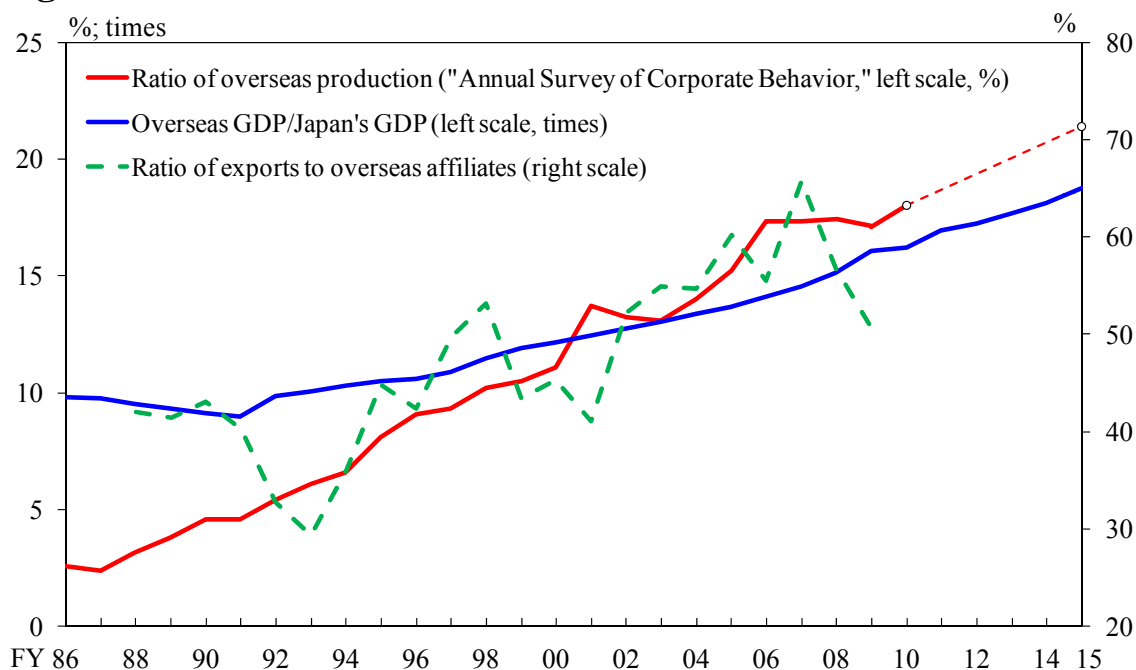
Note: Data up to 1980 are based on the 68SNA (System of National Accounts), while those from 1981 are based on the 93SNA.
 The average for the 1950s is the average from 1956 to 1959.
 Source: Cabinet Office, "National Accounts."

The sluggishness of labor productivity growth and the decline in working-age population affects the long-term downtrend in Japan's growth.



Notes: 1. Data are on a fiscal-year basis.
 2. The rates of change in the number of workers from the 2010s onward are calculated using the projected future population (medium variant) and the projected labor force participation rates (assuming that the labor force participation rates in each age/sex group remain the same as those in 2009).
 Sources: Cabinet Office, "National Accounts"; Ministry of Internal Affairs and Communications, "Labour Force Survey"; National Institute of Population and Social Security Research, "Population Projections for Japan: 2006-2050."

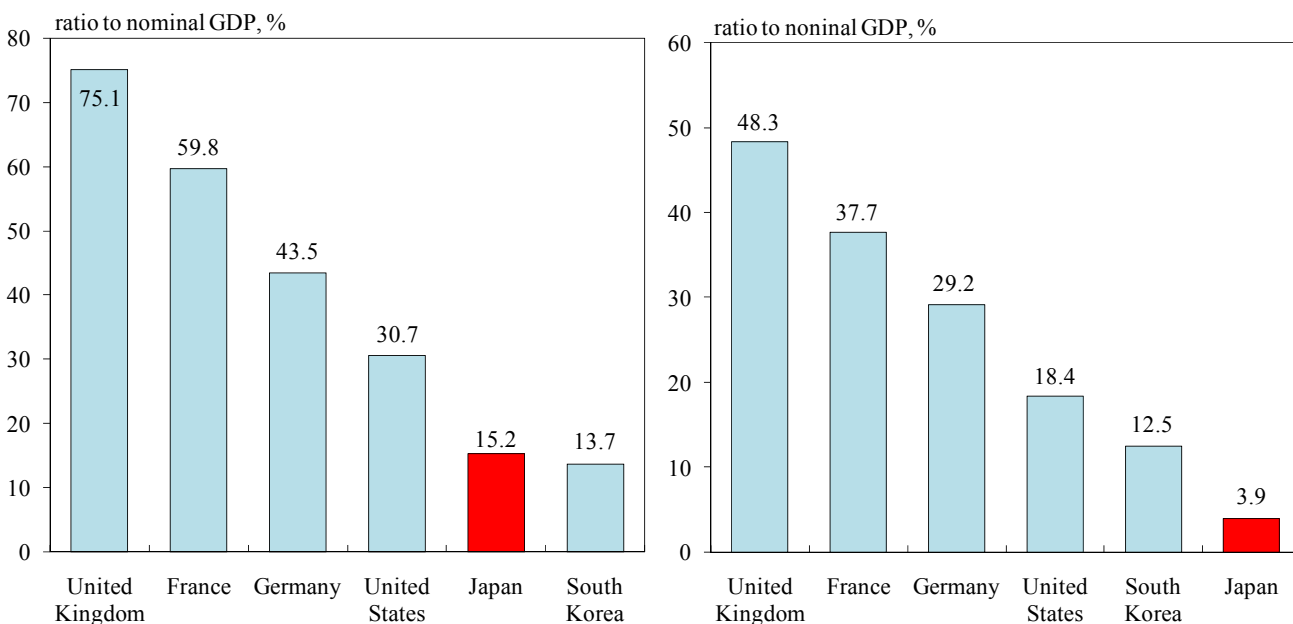
The overseas production ratio has been increasing due to the expansion of overseas demand. The ratio of exports to overseas affiliates has also been rising overall.



Notes: 1. For the ratio of overseas production ("Annual Survey of Corporate Behavior"), the figure for fiscal 2010 is the forecast and data from fiscal 2011 are linearly interpolated by using the fiscal 2015 outlook.
 2. Taken from the "World Economic Outlook (calendar year basis)." Data from 2010 are IMF estimates.
 Sources: Cabinet Office, "Annual Survey of Corporate Behavior"; Ministry of Economy, Trade and Industry, "Survey of Overseas Business Activities"; IMF, "World Economic Outlook."

Japan's outward and inward foreign direct investment as a ratio to GDP greatly falls short of other advanced economies.

A. Outward Foreign Direct Investment Stocks B. Inward Foreign Direct Investment Stocks



Note: Data are as of 2010.
 Source: OECD.

The Bank of Japan's Conduct of Monetary Policy

Pursuing Powerful Monetary Easing via the Comprehensive Monetary Easing

- Implementing the virtually zero interest rate policy.
- Committed to continuing the virtually zero interest rate policy until it judges that price stability is in sight on the basis of the "understanding of medium-to long-term price stability."^[Note]

[Note] On the basis of a year-on-year rate of change in the CPI, a positive range of 2% or lower, centering around 1%.

- Establishing the Asset Purchase Program

Ensuring Financial Market Stability

Providing Support to Strengthen the Foundations for Economic Growth

➤ Increase in the Asset Purchase Program

- The Program has had three increases, expanding to about 55 trillion yen from the initial size of about 35 trillion yen (the latest increase was decided on October 27).
 — The increased purchases are to be completed by around the end of 2012.

trillion yen

| | Started in Oct. 2010 | Mar. 2011 | Aug. 2011 | Oct. 2011 |
|----------------------|----------------------|-----------|-----------|-----------|
| Total size | About 35 | About 40 | About 50 | About 55 |
| JGBs | 1.5 | 2.0 | 4.0 | 9.0 |
| T-Bills | 2.0 | 3.0 | 4.5 | 4.5 |
| CP | 0.5 | 2.0 | 2.1 | 2.1 |
| Corporate bonds | 0.5 | 2.0 | 2.9 | 2.9 |
| ETFs | 0.45 | 0.9 | 1.4 | 1.4 |
| J-REITs | 0.05 | 0.1 | 0.11 | 0.11 |
| Fixed-rate operation | 30.0 | 30.0 | 35.0 | 35.0 |

Note: In addition to purchases under the Program, the Bank regularly purchases JGBs at the pace of 21.6 trillion yen per year.