

**Quantitative and Qualitative Monetary Easing
and its Transmission Mechanism:
Logic behind the First Arrow**

*Speech at a Meeting Held by the Kyoto Chamber of
Commerce and Industry (KCCI)*

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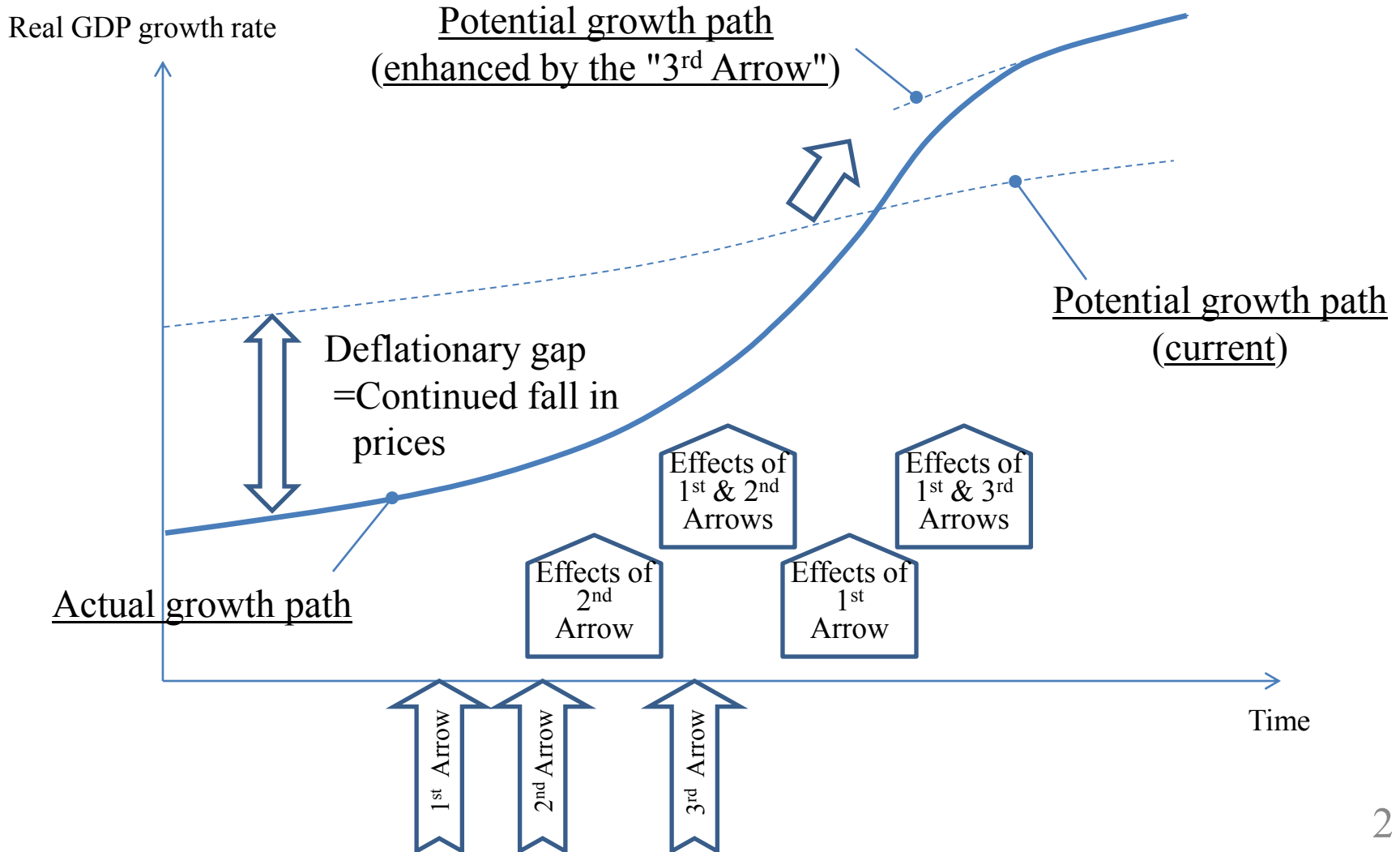
Deputy Governor of the Bank of Japan

Components of the "Three Arrows"

- "1st Arrow": Bold Monetary Easing
 - ✓ Close the negative output gap and put Japan's economy back on track to a sustainable growth path through achieving the price stability target of 2%.
- "2nd Arrow": Flexible Fiscal Policy
 - ✓ Underpin economic activity from the demand side until favorable effects from monetary easing permeate the economy.
- "3rd Arrow": Growth Strategy to Encourage Private Investment
 - ✓ Raising the potential growth path itself.

Respective Roles of the "Three Arrows"

▽ Complementary Relationship among the "Three Arrows"



Key Features of the QQE (1)

① Commitment to the Price Stability Target of 2%

- ✓ The Bank will achieve the "price stability target" of 2% in terms of the year-on-year rate of change in the consumer price index (CPI) at the earliest possible time, with a time horizon of about 2 years.

② Monetary Easing in Terms of Quantity

- ✓ Change the main operating target for money market operations from the uncollateralized overnight call rate to the monetary base.
- ✓ Conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 tril. yen.
 - ⇒ The monetary base is expected to double in 2 years.
(138 tril. yen <end-2012> → 270 tril. yen <end-2014>)

Key Features of the QQE (2)

③ Monetary Easing in Terms of Quantity and Quality

- ✓ Amount outstanding of JGB holdings: Annual increase of about 50 tril. yen.
(Net: about 4.2 tril. yen <Gross: more than 7 tril. yen>/month)
- ⇒ Amount outstanding of Bank's JGB holdings: More than double in 2 years.
(89 tril. yen <end-2012> → 190 tril. yen <end-2014>)
- ⇒ Average remaining maturity of JGB purchases:
slightly less than 3 years → around 7 (6 to 8) years.

④ Monetary Easing in Terms of Quality

- ✓ Amount outstanding of ETF holdings: Annual increase of about 1 tril. yen.
(1.5 tril. yen <end-2012> → 3.5 tril. yen <end-2014>) ▪ ▪ ▪ 2.3 times in 2 years
- ✓ Amount outstanding of J-REIT holdings: Annual increase of about 30 bil. yen.
(0.11 tril. yen <end-2012> → 0.17 tril. yen <end-2014>)

Key Features of the QQE (3)

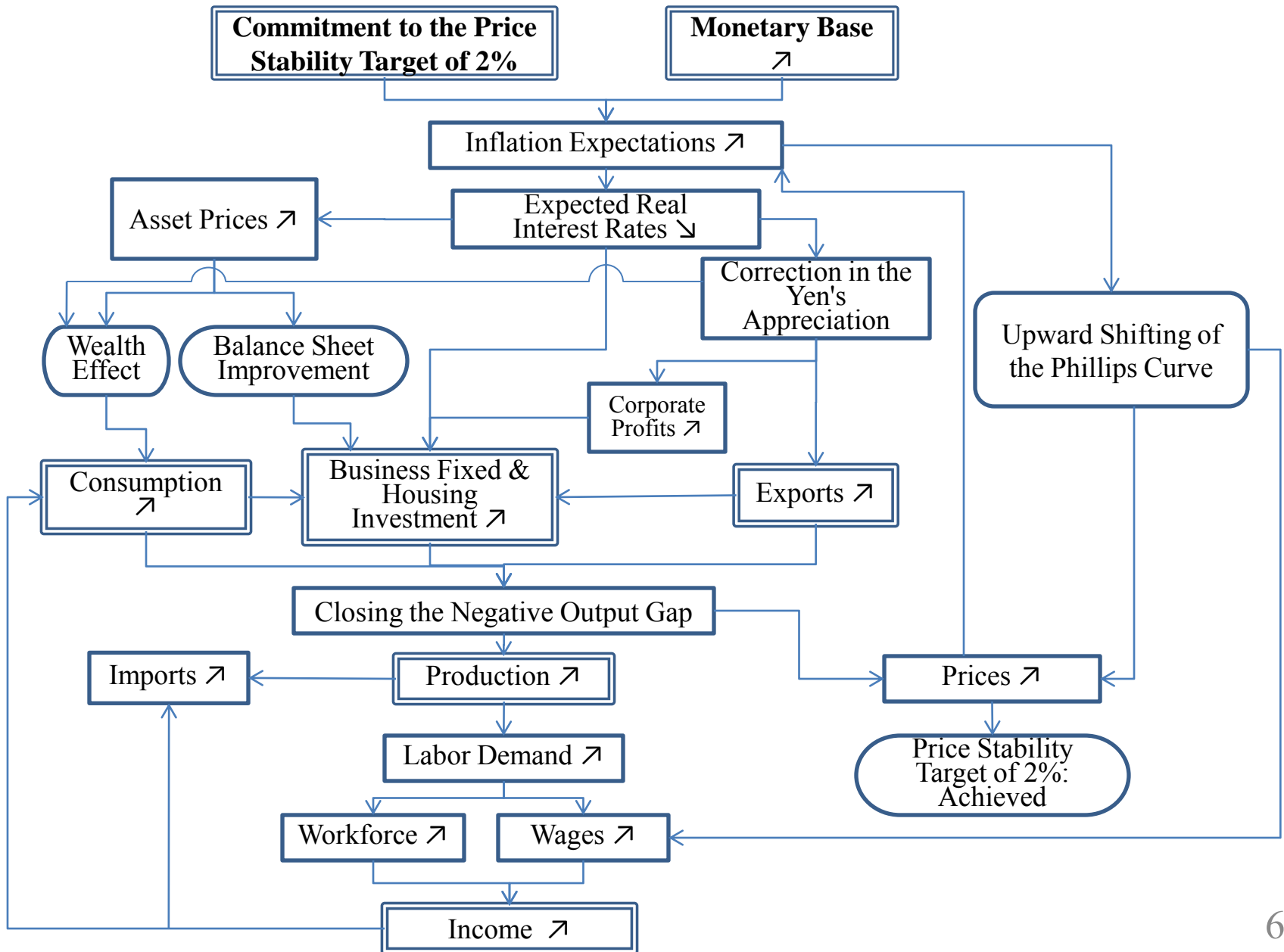
⑤ Commitment regarding the Continuation of the QQE

- ✓ The Bank will continue with the QQE, aiming to achieve the "price stability target" of 2%, as long as it is necessary for maintaining that target in a stable manner.

⑥ Enhanced Dialogue with Market Participants

- ✓ The Bank will set forums for enhanced dialogue with market participants in order to exchange views pertaining to money market operations and market transactions more generally.

Transmission Channels of the QQE



Transmission Channels of the QQE (cont.)

(1) Deflationary Expectations

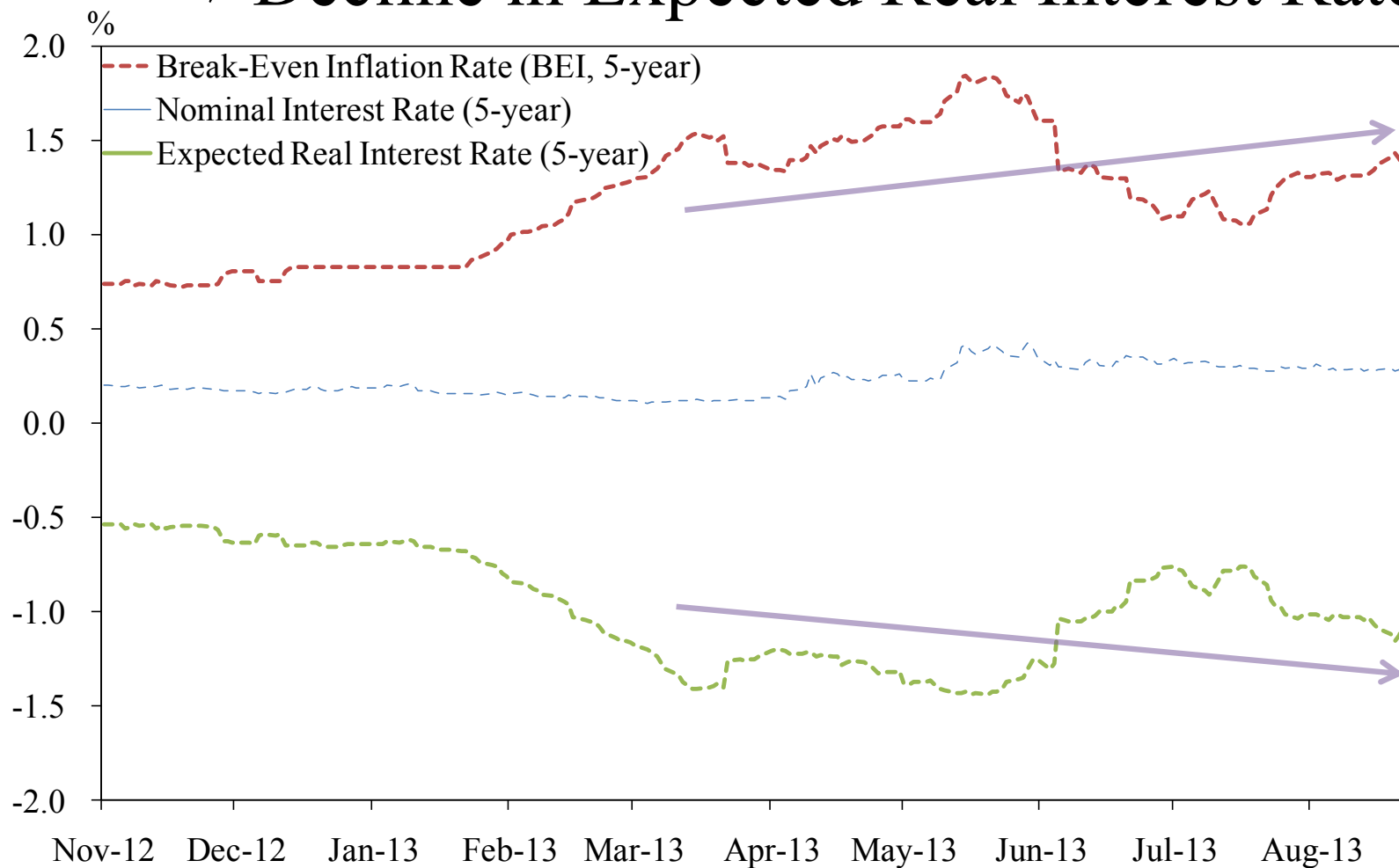
⇒ Inflationary Expectations

- Price Stability Target: 2%.
- Time Horizon: At the earliest possible time, with a time horizon of about 2 years.
- Stabilizing the actual inflation rate around the target.

Transmission Channels of the QQE (cont.)

(2) Rise in Inflation Expectations

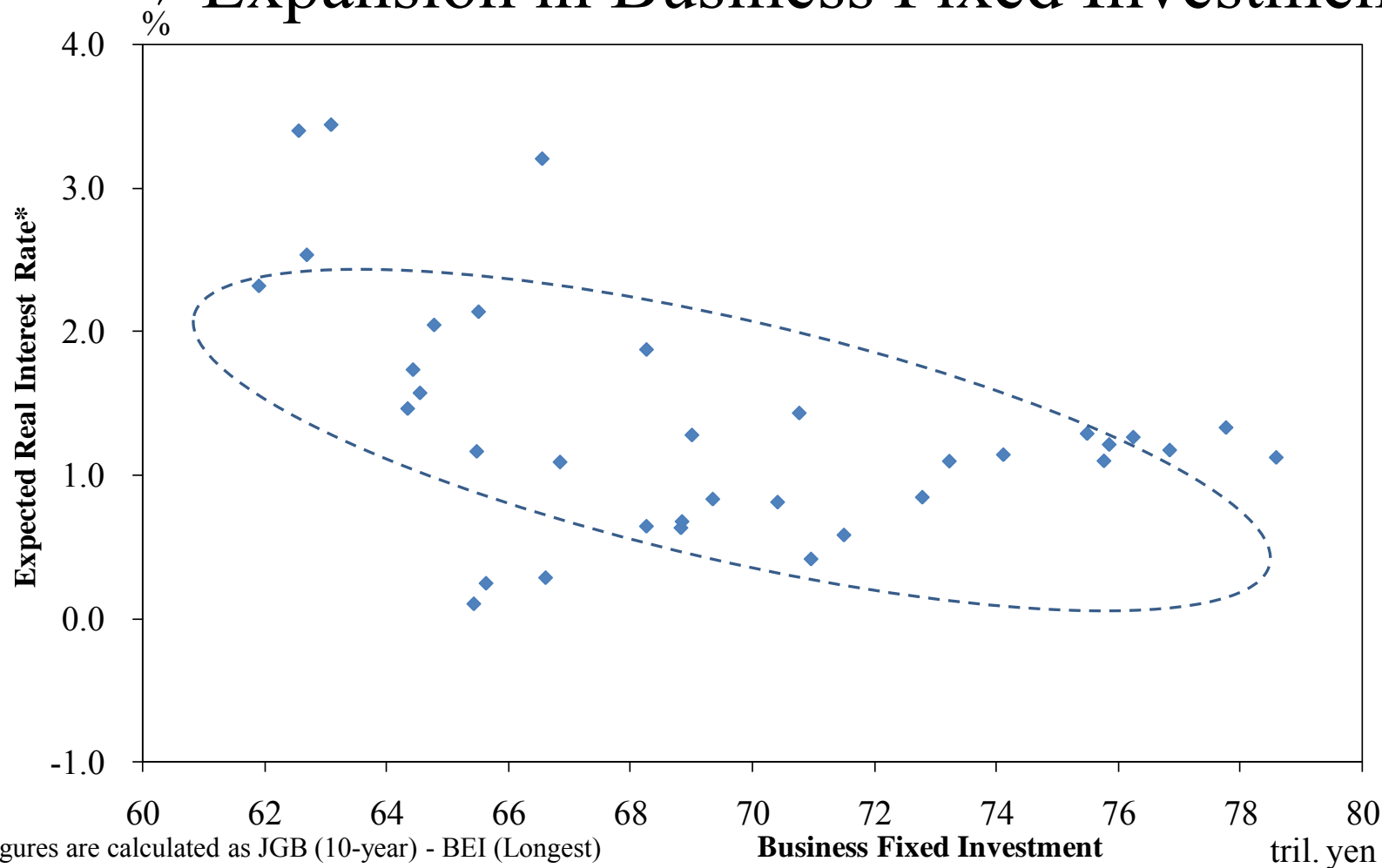
⇒ Decline in Expected Real Interest Rates



Transmission Channels of the QQE (cont.)

(3) Decline in Expected Real Interest Rates

⇒ Expansion in Business Fixed Investment



*Figures are calculated as JGB (10-year) - BEI (Longest)

at the end of the previous quarter.

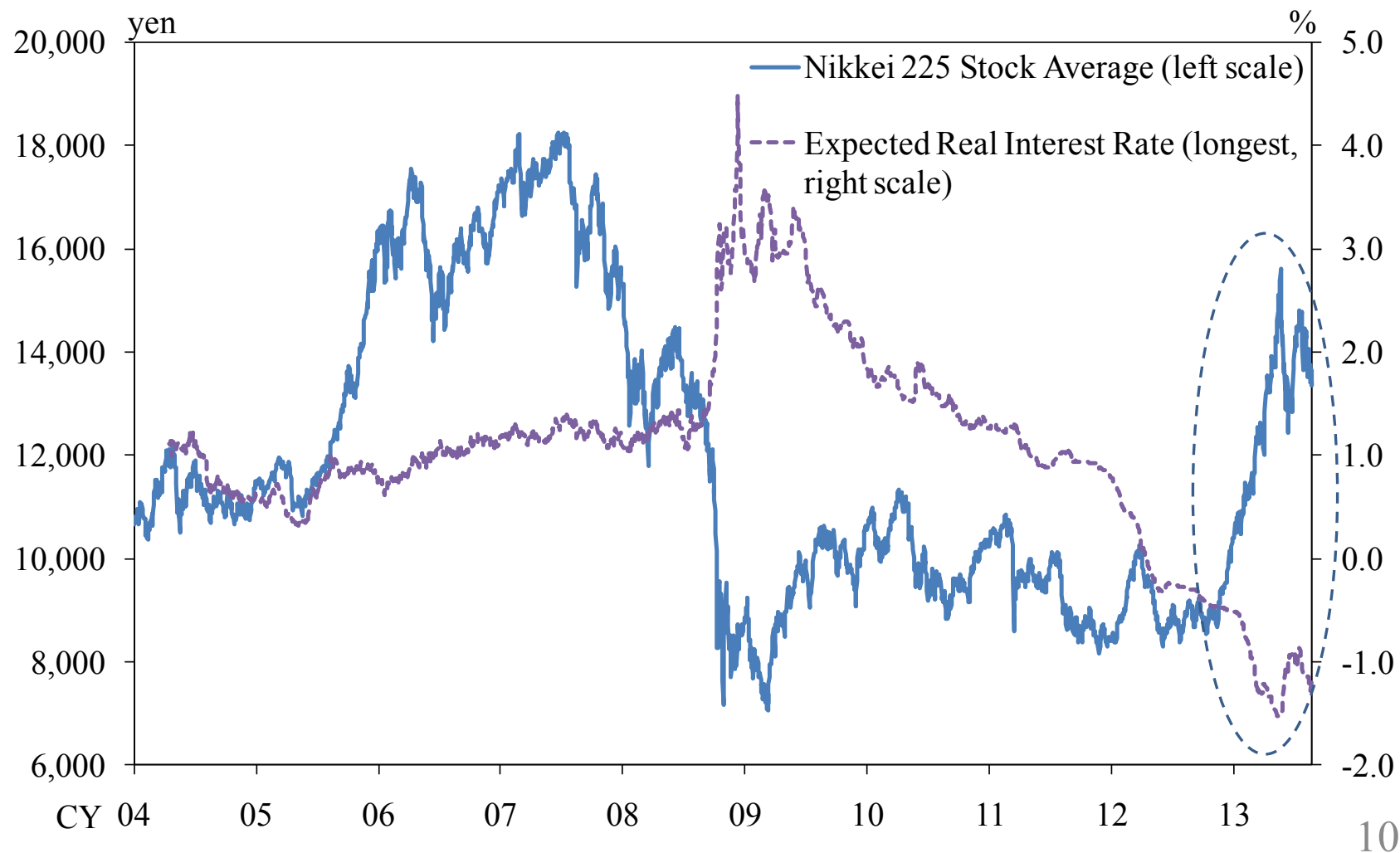
Data: 2004/2Q-2013/2Q.

Sources: Cabinet Office, "National Accounts"; Bloomberg.

Transmission Channels of the QQE (cont.)

(4) Decline in Expected Real Interest Rates

⇒ Rise in Asset Prices

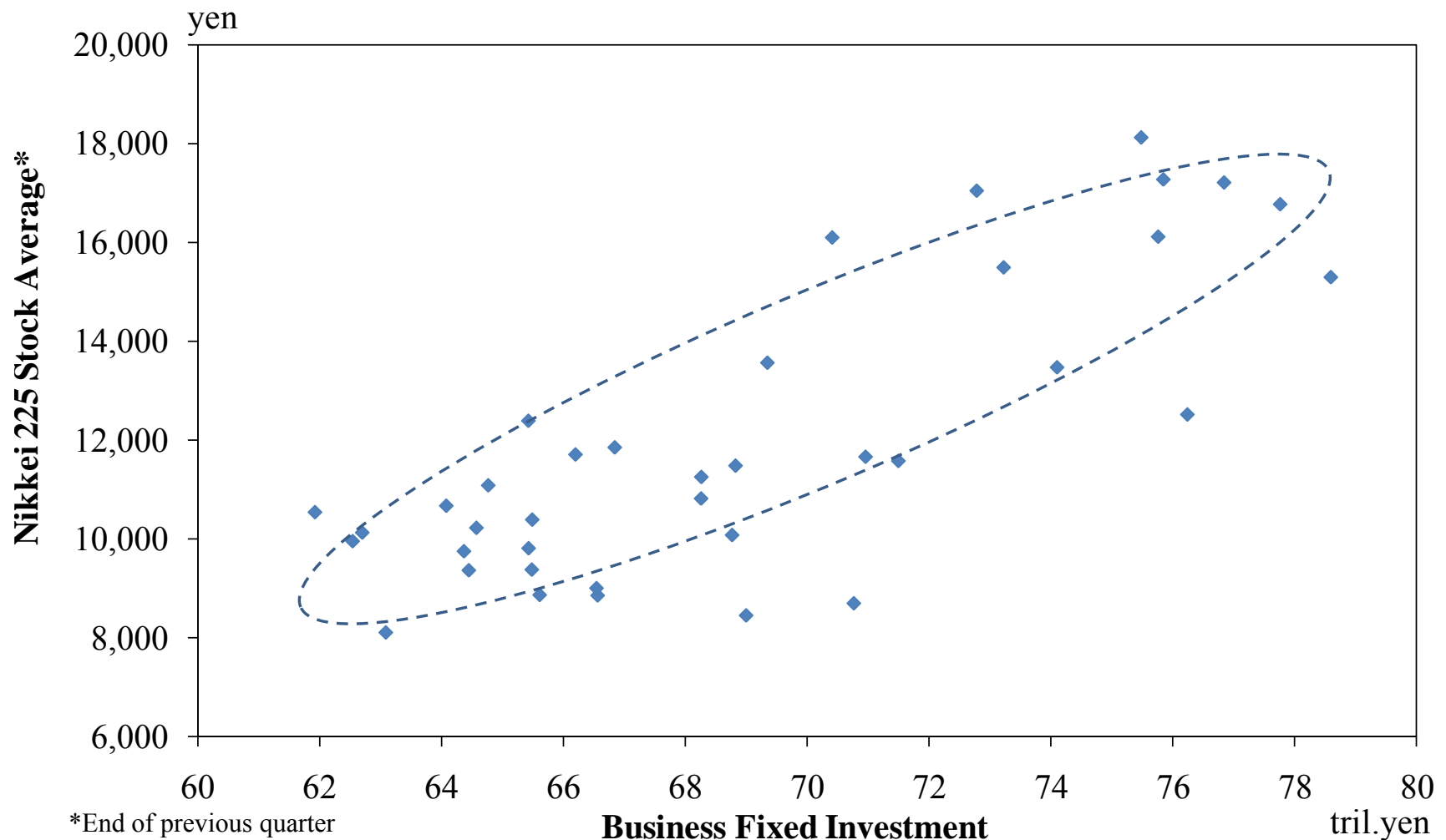


Source: Bloomberg.

Transmission Channels of the QQE (cont.)

(5) Rise in Asset Prices

⇒ Increase in Business Fixed Investment



*End of previous quarter

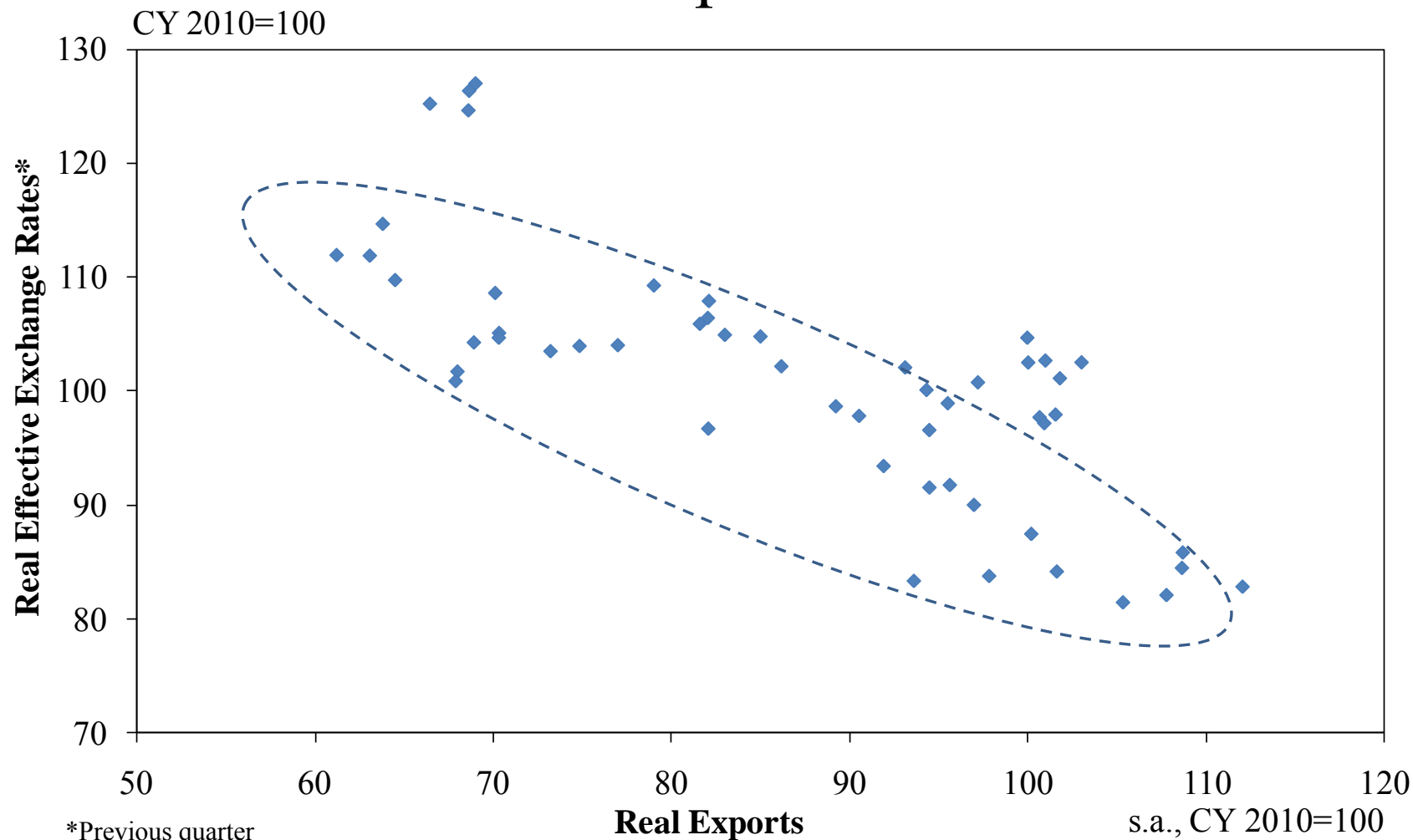
Data: 2003/4Q-2013/2Q.

Sources: Cabinet Office, "National Accounts"; Bloomberg.

Transmission Channels of the QQE (cont.)

(6) Correction in the Yen's Appreciation

⇒ Increase in Exports



*Previous quarter

Data: 2000/1Q-2013/2Q.

Source: Bank of Japan.

Transmission Channels of the QQE (cont.)

(6) Correction in the Yen's Appreciation

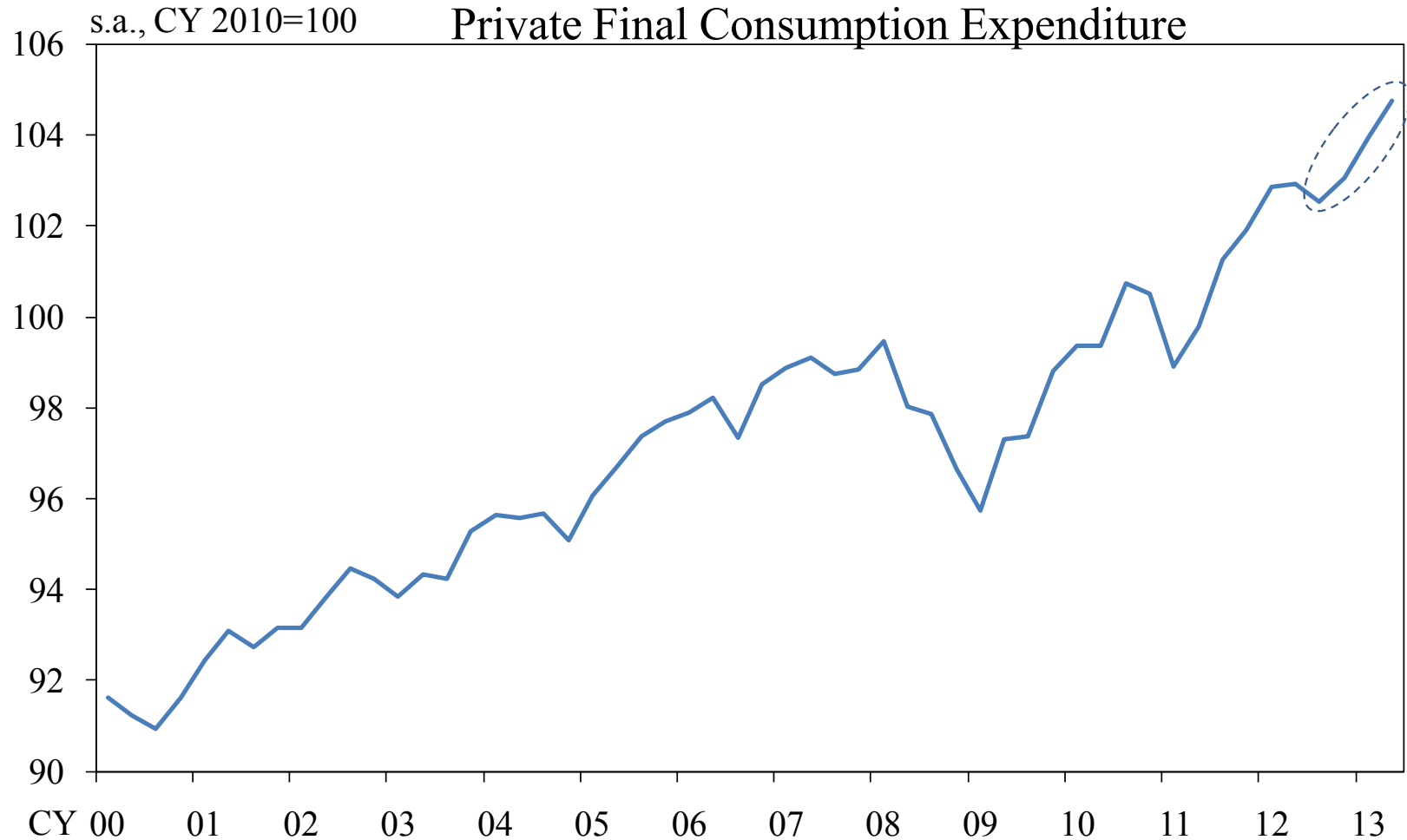
⇒ Increase in Exports



Transmission Channels of the QQE (cont.)

(7) Rise in Asset Prices

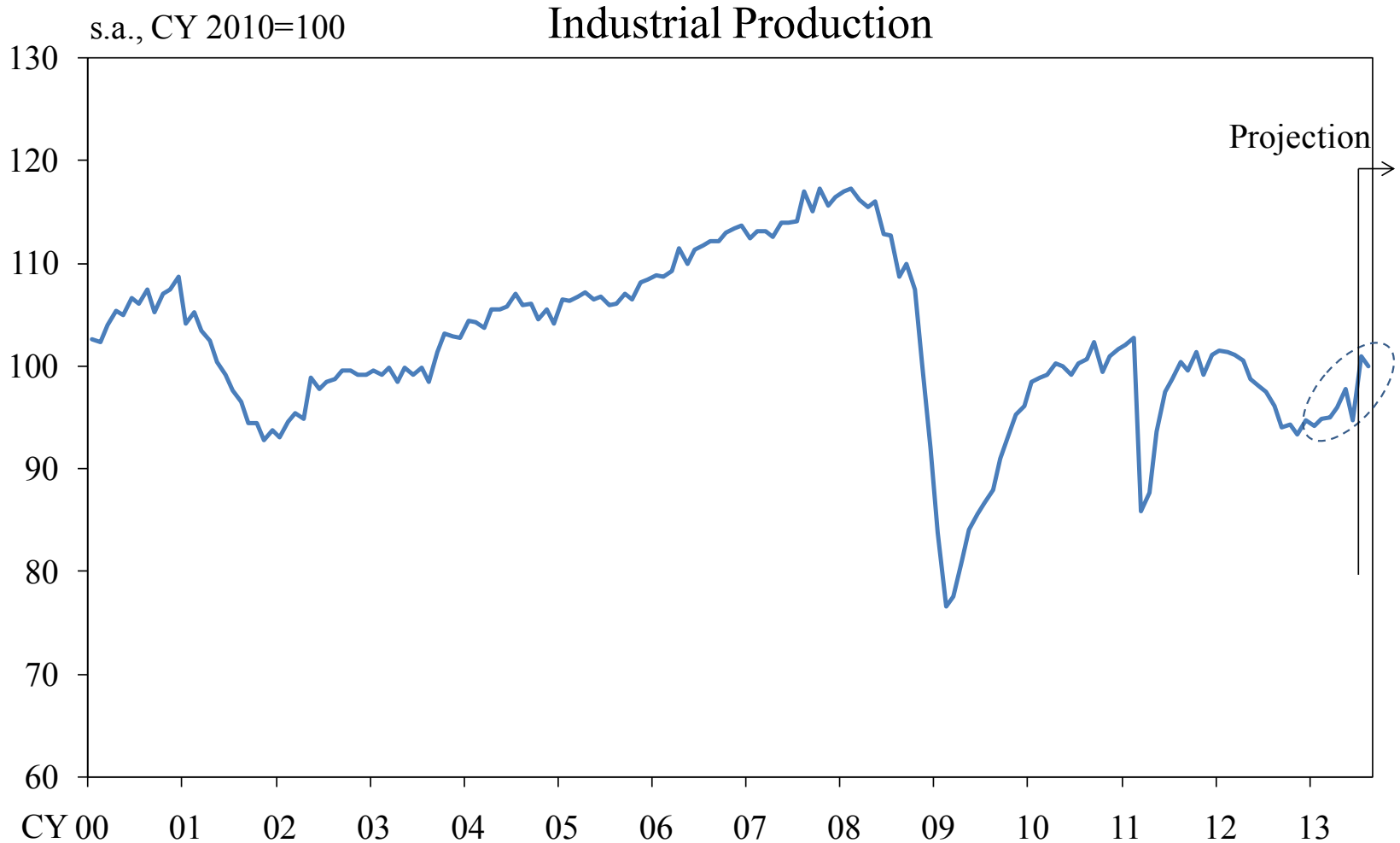
⇒ Rise in Consumption



Transmission Channels of the QQE (cont.)

(8) Increase in Aggregate Demand

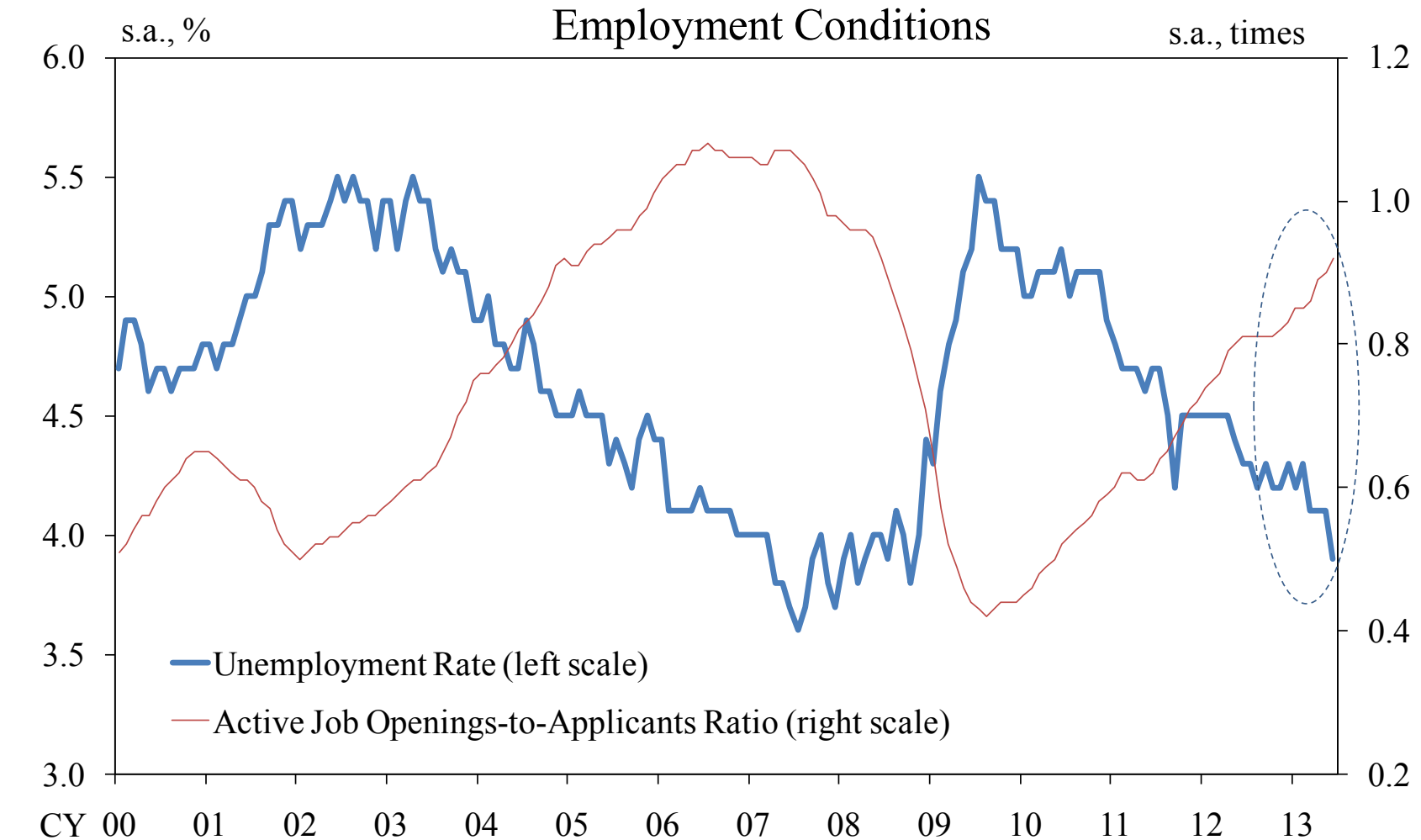
⇒ Increase in Production



Transmission Channels of the QQE (cont.)

(9) Increase in Production

⇒ Rise in Employment



Sources: Ministry of Internal Affairs and Communications, "Labour Force Survey";
Ministry of Health, Labor and Welfare, "Report on Employment Service."

Transmission Channels of the QQE (cont.)

(10) Rise in Employment

⇒ Increase in Employee Income



Sources: Ministry of Internal Affairs and Communications, "Labour Force Survey";

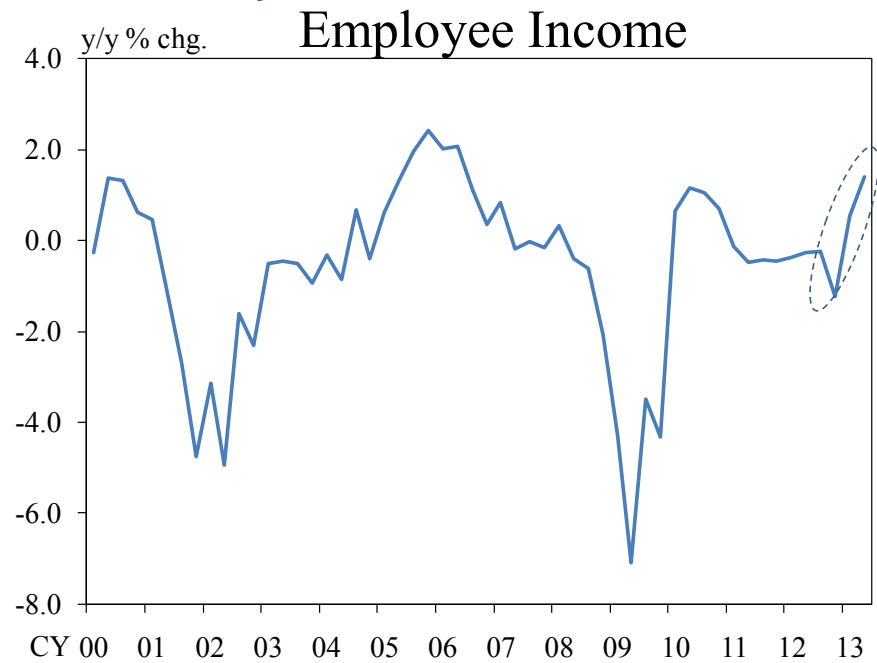
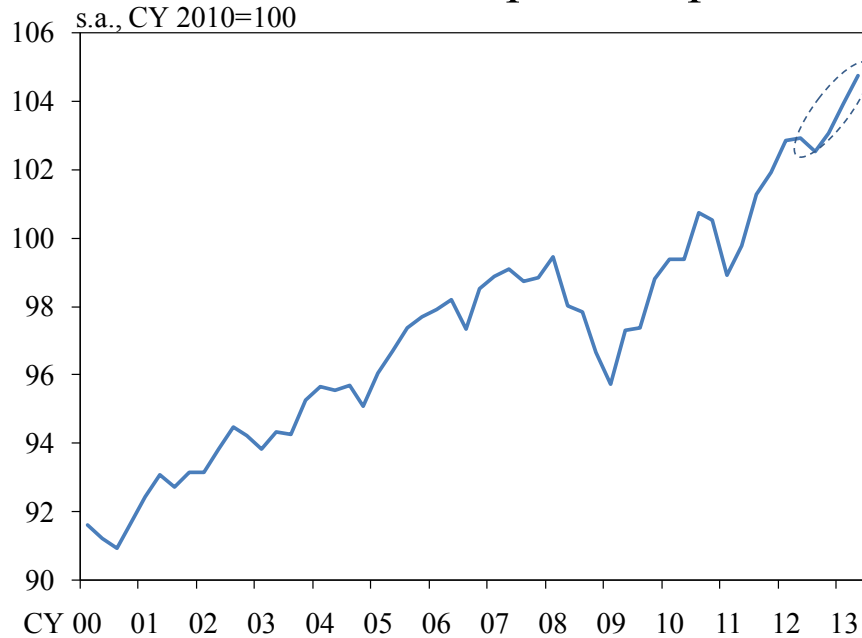
Ministry of Health, Labor and Welfare, "Monthly Labour Survey."

Transmission Channels of the QQE (cont.)

(11) Increase in Employee Income

⇒ Rise in Consumption

Private Final Consumption Expenditure



Transmission Channels of the QQE (cont.)

(12) Inflation Rate Starts to Rise

⇒ Rise in Inflation Expectations

- ✓ CPI (less fresh food) turned positive (+0.4%, y/y) in June 2013, for the first time in 14 months after April 2012.

(13) Rise in Inflation Expectations

⇒ Amplified Cycle

[from Channels (2) through (12)]

⇒ Actual Inflation Rates to Approach the Price Stability Target of 2%