March 8, 2017
Bank of Japan

Japan's Economy and Monetary Policy

Remarks at the Ninth Japan Securities Summit in London

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It is a great honor to have the opportunity today to be a panel member at the ninth Japan Securities Summit.

Japan's economy had been suffering from deflation for more than 15 years, since the late 1990s, with the year-on-year rate of change in the consumer price index (CPI) being about zero or slightly negative. In such circumstances, the Bank of Japan has been conducting monetary policies in various unconventional ways for nearly 20 years (Chart 1).

Looking back, in 1998, now nearly 20 years ago, Japan's policy interest rate -- which at that time was the uncollateralized overnight call rate -- already had been lowered to close to zero, at 0.25 percent. Given that economic activity and prices did not improve even in this situation, the Bank introduced a zero interest rate policy in February 1999. Thereafter, it introduced a quantitative easing policy, in which the operating target was the outstanding balance of current accounts at the Bank. Later, it also implemented a comprehensive monetary easing policy, in which it purchased assets such as CP, corporate bonds, exchange-traded funds (ETFs), and Japan real estate investment trusts (J-REITs). The Bank continues to make these asset purchases to the present, and with respect to ETFs and J-REITs, it has significantly increased the amount of purchases since 2013. Meanwhile, it also introduced the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth as well as the Fund-Provisioning Measure to Stimulate Bank Lending, and these also continue to this day. As illustrated, the Bank has pursued monetary easing by making full use of various means. As a result, accommodative financial conditions have been realized in Japan. Such accommodative financial conditions have underpinned the economy, and the Bank's large-scale fund-provisioning measures have contributed -- in certain phases -- to maintaining financial system stability and preventing the economy from falling into a deflationary spiral. Nevertheless, it is true that at the same time there continued to be mild deflation. Therefore, the Bank made a strong and clear commitment to ensuring the economy's exit from deflation -- which had lasted for nearly 15 years -- and began large-scale monetary easing to fulfill the commitment. This is Quantitative Qualitative Monetary Easing (QQE), which continues through to the present.

The Bank also introduced the price stability target in January 2013 and set it at 2 percent in terms of the year-on-year rate of change in the CPI. At the same time, the government and the Bank released a joint statement, in which they emphasized their policy coordination. I view this as extremely important, because it indicated the determination by the government and the Bank to work together in order to overcome deflation and achieve sustainable economic growth. The Bank then introduced QQE in April 2013. After increasing the amount of its asset purchases further in 2014, it adopted a negative interest rate policy in January 2016 and introduced QQE with Yield Curve Control in September of that year.

Since the introduction of QQE, the basic mechanism of monetary easing itself has not changed; that is, (1) pushing down the entire yield curve through the Bank's large-scale purchases of Japanese government bonds (JGBs), and (2) raising inflation expectations through the Bank's strong commitment to the 2 percent price stability target. The transmission mechanism envisaged by the Bank is that these factors will lead to a reduction in real interest rates, thereby producing positive effects on Japan's economic activity and prices (Chart 2). Under QQE, the underlying trend in the CPI (all items less fresh food and energy) turned positive and has been in such territory for more than two and a half years; this leads to the judgment that Japan's economy has reached a state of being no longer in deflation, which is commonly defined as a sustained decline in prices (Chart 3).

Furthermore, the Bank introduced last year QQE with Yield Curve Control as a means of strengthening the past framework for monetary easing. My understanding is that there are two points as the background to this decision. First, although QQE has produced its intended effects, the price stability target of 2 percent has not been achieved, and therefore a more effective framework was necessary.

Second, while it was confirmed that the combination of large-scale purchases of JGBs and the negative interest rate policy was effective in influencing the entire yield curve, there was concern over a possibility that this combination could in some cases push down the yield curve more than necessary, thereby having a negative impact on financial functioning.

Under "yield curve control," which is the major component of the new framework, the Bank is able to conduct monetary policy in an effective and flexible manner by taking account of the economic, price, and financial conditions -- including the impact on the functioning of financial intermediation -- as it directly targets long-term interest rates.

Another component of the new framework is an "inflation-overshooting commitment." With this commitment, the Bank aims to raise inflation expectations by demonstrating its strong determination.

The Bank has attempted to make expectation formation more forward-looking through QQE. In reality, however, before the forward-looking expectation formation fully took hold, the observed inflation rate declined, due mainly to the fall in crude oil prices. As a result, people's inflation expectations also declined in an adaptive manner. Therefore, I consider that, in order to achieve the price stability target of 2 percent, it is absolutely necessary to raise inflation expectations and promote a shift in expectation formation toward a more forward-looking direction. The inflation-overshooting commitment is a means to this end.

Inflation expectations are, so to speak, the sense of price trends among individuals and firms, and to change such expectations is not an easy task. This is even more the case with a country like Japan that has experienced protracted deflation. When QQE was introduced, the Bank set a time frame of about two years to achieve the price stability target in order to emphasize its strong and clear commitment to ensuring the economy's exit from deflation. Therefore, it may seem like it has taken a long time for the Bank to achieve this target. On the other side of the coin, only four years have passed since the target was set. Needless to say, this does not mean that taking a long time to meet the objective is acceptable. First, it remains important to have the Bank's strong commitment to achieving the price stability target and express it in various different ways. Then, under the highly accommodative financial conditions maintained by the Bank in addition to the large-scale economic stimulus package implemented by the government, I consider it essential to enhance private demand by further accelerating efforts in both the public and private sectors to strengthen the growth potential.

In fact, such efforts already have been undertaken by both the public and private sectors. In this context, the government decided the Japan Revitalization Strategy 2016 in June 2016 and launched the 10 strategic public-private joint projects, in which the public and private sectors share knowledge and strategy, and cultivate new promising markets (Chart 4). Looking at the list of projects may leave an impression that it is an all-around list of challenges facing Japan's economy. I believe that what the economy needs now is to implement various initiatives simultaneously to overcome many such challenges. What I mean is that, while these initiatives may look like "a little bit of everything," firmly promoting them in order to achieve economic revitalization in an omnidirectional manner, and thereby revitalizing Japan's economy, is necessary. I think that this will lead to an increase in growth expectations, and ultimately to a rise in inflation expectations.

For Japan's economy, the third largest in the world, ending deflation and returning to a sustainable growth path will also have significant meaning for the global economy. The Bank will maintain highly accommodative financial conditions, with a view to achieving the price stability target of 2 percent, and ensure the overcoming of deflation. I believe that highly accommodative financial conditions, combined with the initiatives of the public and private sectors just mentioned, will give a boost to firms' investment and efforts for improving productivity. Let me conclude by emphasizing that ensuring the exit from deflation in Japan will lead to a more dynamic and stronger economy.

Thank you for your attention.

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Chart 1

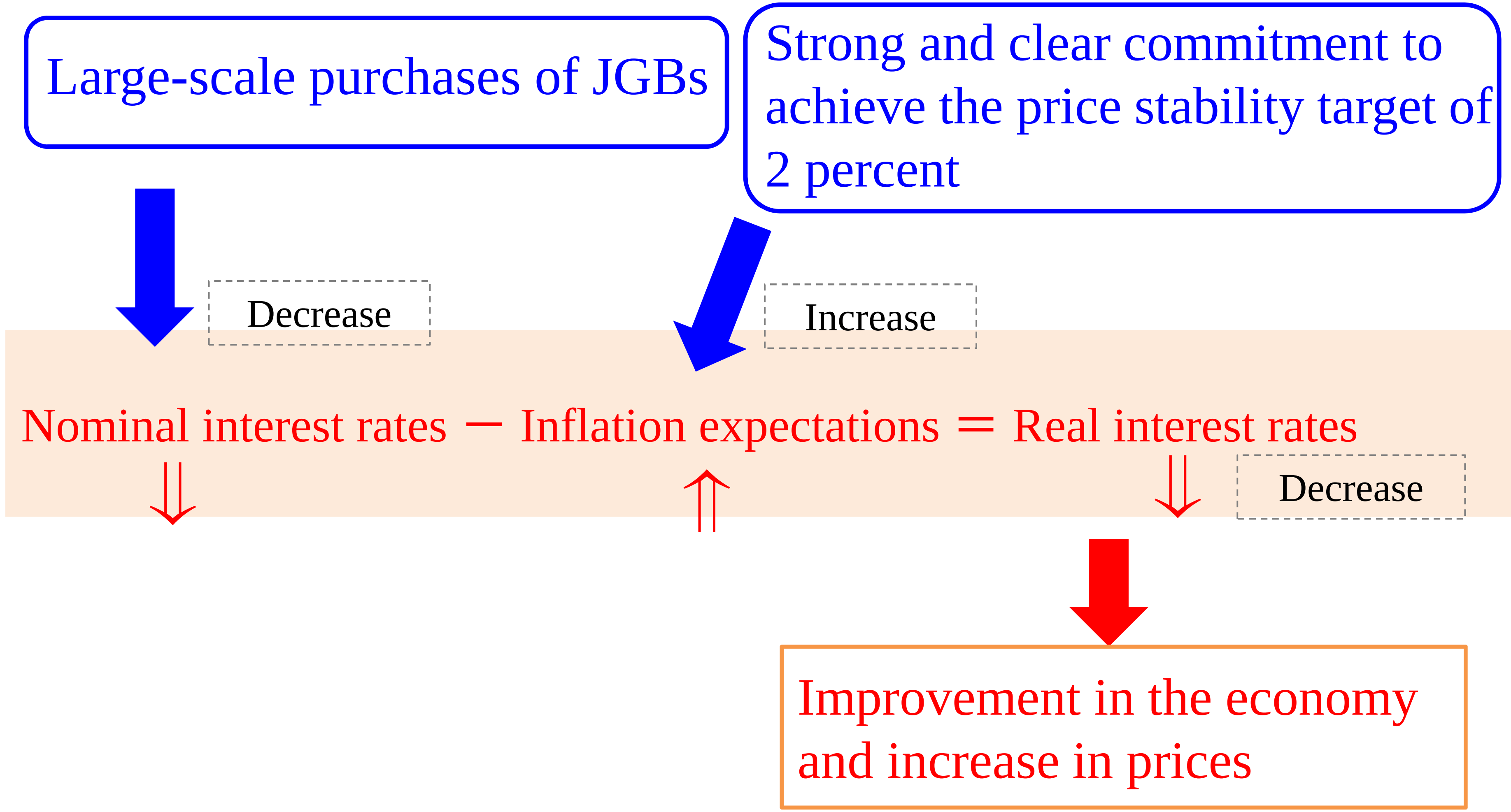
Changes in the Bank's Monetary Policy Management

Feb 1999	Introduction of the zero interest rate policy（- Aug 2000）
Mar 2001	Introduction of the quantitative easing policy（- Mar 2006 ）
Mar 2006	Release of "The Bank's Thinking on Price Stability"
Dec 2009	Release of "Clarification of the 'Understanding of Medium- to Long-Term Price Stability'"
Oct 2010	Introduction of the comprehensive monetary easing policy
Feb 2012	Introduction of the "price stability goal in the medium to long term"
Jan 2013	Introduction of the "price stability target" of 2 percent
〃	Release of "Joint Statement of the Government and the Bank of Japan on Overcoming Deflation and Achieving Sustainable Economic Growth"
Apr 2013	Introduction of Quantitative and Qualitative Monetary Easing (QQE)
Oct 2014	Expansion of QQE
Jan 2016	Introduction of QQE with a Negative Interest Rate
Sep 2016	Introduction of QQE with Yield Curve Control

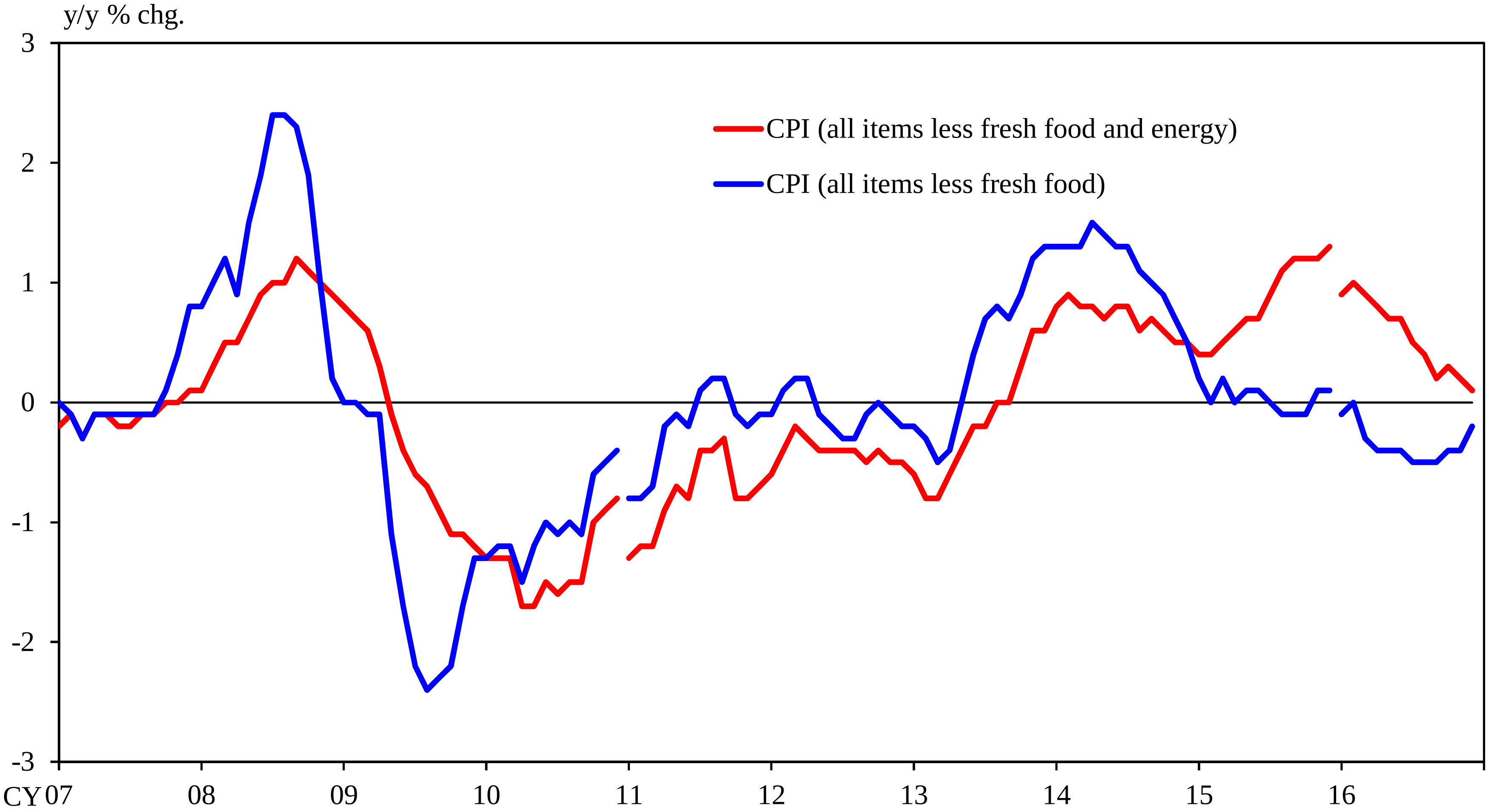
Chart 2

Mechanism of QQE

Quantitative and Qualitative Monetary Easing (QQE)



Consumer Prices



Notes: 1. Figures for the CPI (all items less fresh food and energy) are calculated by the Research and Statistics Department, Bank of Japan.
2. Figures for the CPI are adjusted to exclude the estimated effects of changes in the consumption tax rate.

Source: Ministry of Internal Affairs and Communications.

Chart 4

The 10 Strategic Public-Private Joint Projects toward GDP of 600 Trillion Yen

1. The fourth industrial revolution
2. Toward a world leading healthcare country
3. Overcoming environmental and energy constraints and expanding investments
4. Changing sports to a growth industry
5. Revitalizing markets for transaction of existing houses and reform
6. Improving productivity in the service industry
7. Bringing about revolution among small and medium-sized firms and micro firms
8. Promoting proactive agriculture, forestry and fishery, as well as reinforcing exports
9. Realizing Japan as a tourism-oriented country
10. Taking measures to stimulate domestic consumer sentiment

Source: "Japan Revitalization Strategy 2016" (Cabinet Decision, June 2, 2016)