

Japan's Economy: Current Situation, Outlook, and Challenges

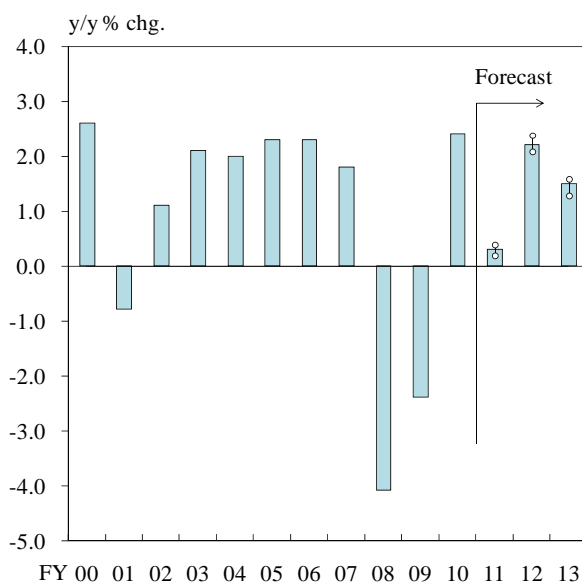
November 28, 2011

Masaaki Shirakawa
Governor of the Bank of Japan

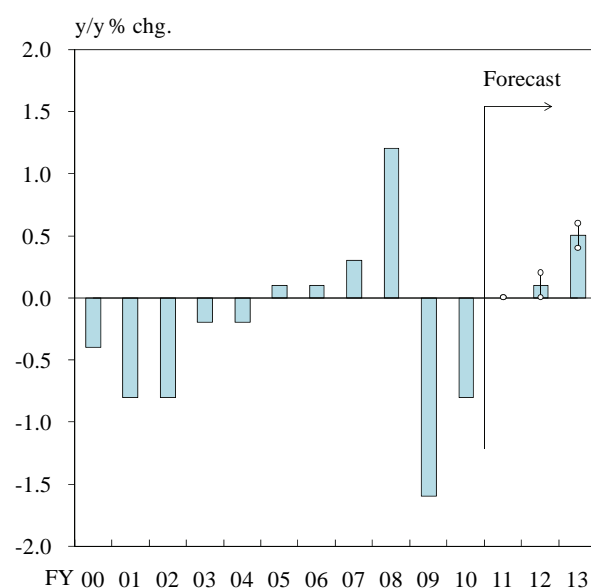
Chart 1

The Bank of Japan's Economic and Price Forecasts

A. Real GDP



B. CPI (all items less fresh food)

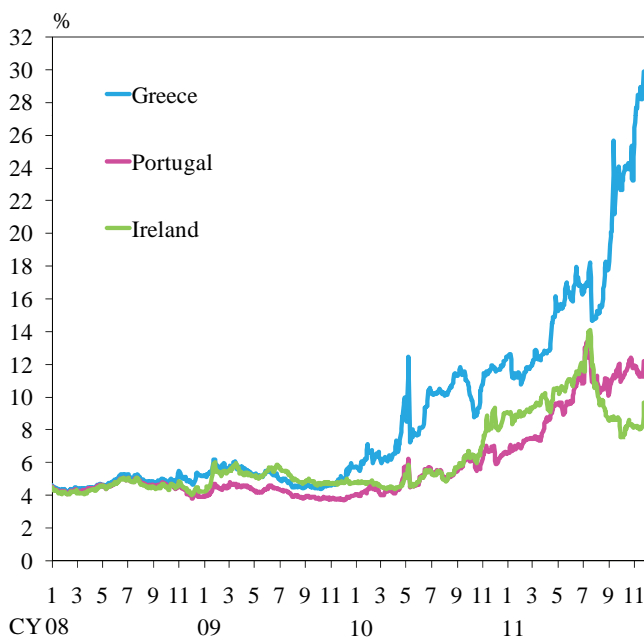


Note: The forecast bars show the median of Policy Board members' forecasts, and the white dots show the range of forecasts of the majority members (excluding the highest figure and the lowest figure from the point estimates, to which each member attaches the highest probability of realization) presented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

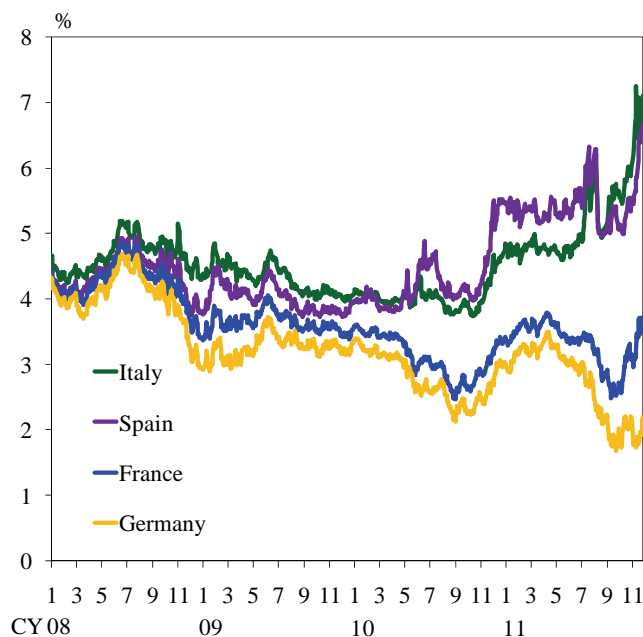
Sources: Cabinet Office, "National Accounts"; Ministry of Internal Affairs and Communications, "Consumer Price Index"; Bank of Japan.

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

A. Yields on Peripheral Countries' Bonds



B. Yields on Core Countries' Bonds



Note: 10-year government bond yields. Data for yields on Irish bonds for October 12 onward are 9-year government bond yields.
Source: Bloomberg.

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.

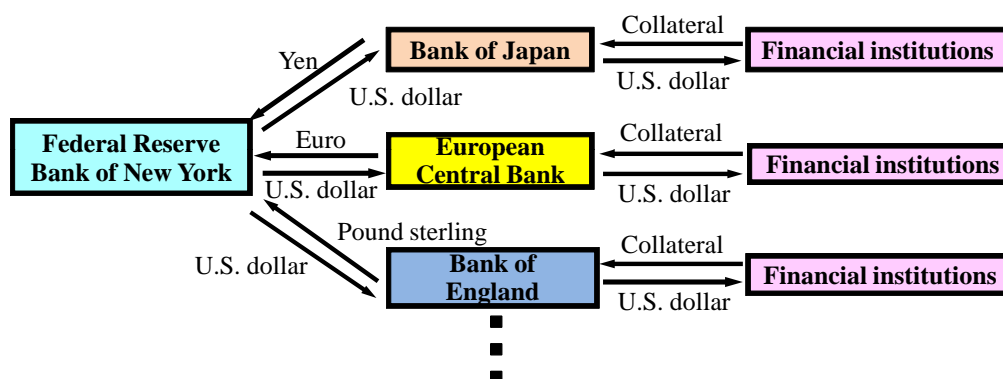
trillion yen

	Started in Oct. 2010	Mar. 2011	Aug. 2011	Oct. 2011	Amount outstanding as of Nov. 20
Total size	About 35	About 40	About 50	About 55	40.7
JGBs	1.5	2.0	4.0	9.0	2.2
T-Bills	2.0	3.0	4.5	4.5	2.8
CP	0.5	2.0	2.1	2.1	1.4
Corporate bonds	0.5	2.0	2.9	2.9	1.4
ETFs	0.45	0.9	1.4	1.4	0.8
J-REITs	0.05	0.1	0.11	0.11	0.06
Fixed-rate operation	30.0	30.0	35.0	35.0	32.0

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

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, the 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.

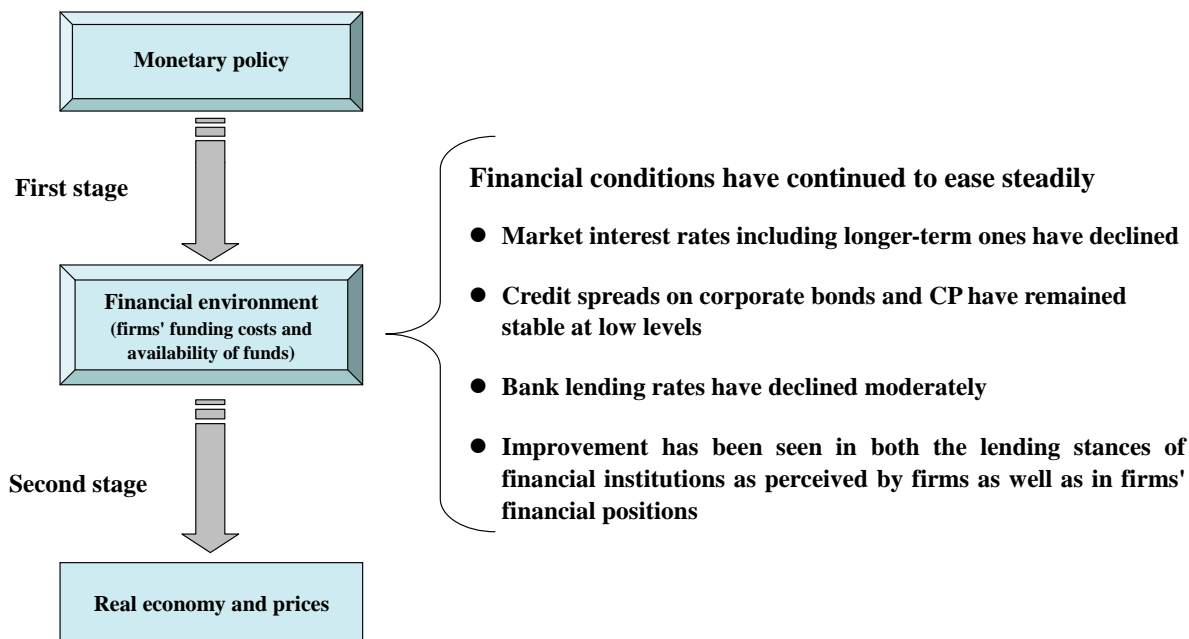
4

Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth

Existing Framework (June 2010)
<ul style="list-style-type: none"> ○ Provision of funds against collateral such as government securities to financial institutions, equivalent to the actual amount of lending and investment carried out with a view to strengthening the foundations for economic growth, over a long term (one year; maximum duration of 4 years) and at a low rate (currently 0.1 percent). ○ Latest amount outstanding of loans: 3 trillion yen (maximum amount: 3 trillion yen)
New Line of Credit (June 2011)
<ul style="list-style-type: none"> ○ Total amount of loans: 500 billion yen (set separately from the 3 trillion yen ceiling in the existing framework) ○ Eligible investments and loans: <ul style="list-style-type: none"> A. Equity investments (investments and loans with equity-like features) B. Loans without real estate collateral or guarantees (including asset-based lending (ABL))

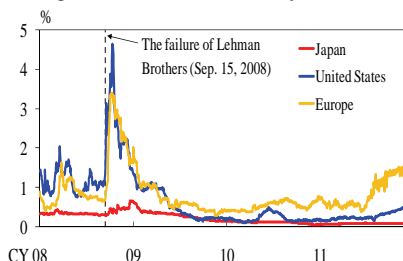
5

Transmission Mechanism of Monetary Policy

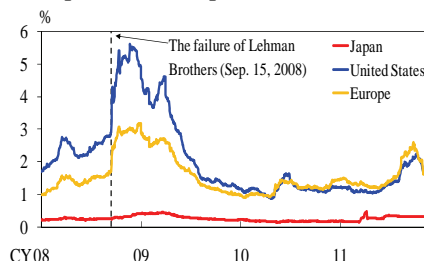


On the back of the sovereign debt problem in Europe, banks' and firms' funding conditions have become increasingly severe in the U.S. and Europe. Meanwhile, those in Japan have continued to ease steadily.

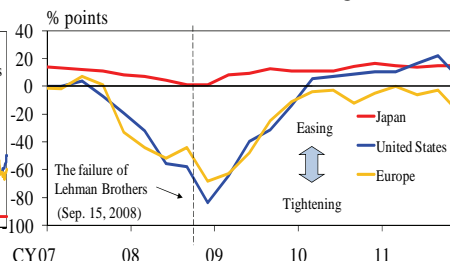
A. Degree of Strain in Money Markets



B. Spreads on Corporate Bonds



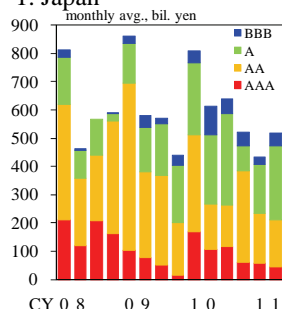
C. Financial Institutions' Lending Stance



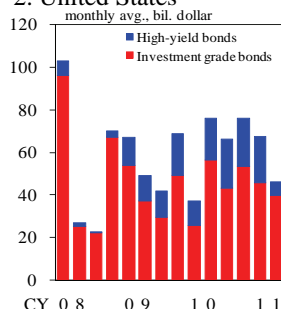
Notes: 1. The degree of strain in money markets is 3-month Libor minus yields on 3-month government securities. Data for German government securities are used for Europe.
 2. The spreads on corporate bonds (rated AA) are corporate bond yields minus government bond yields.
 3. Financial institutions' lending stance is the average of the DIs for large, medium-sized, and small firms for Japan, large and medium-sized firms for the United States, and large firms for Europe.

D. Volume of Corporate Bond Issuance

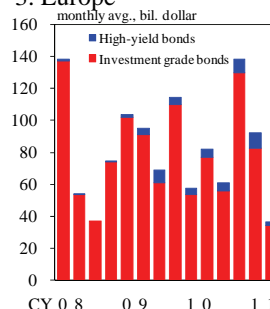
1. Japan



2. United States



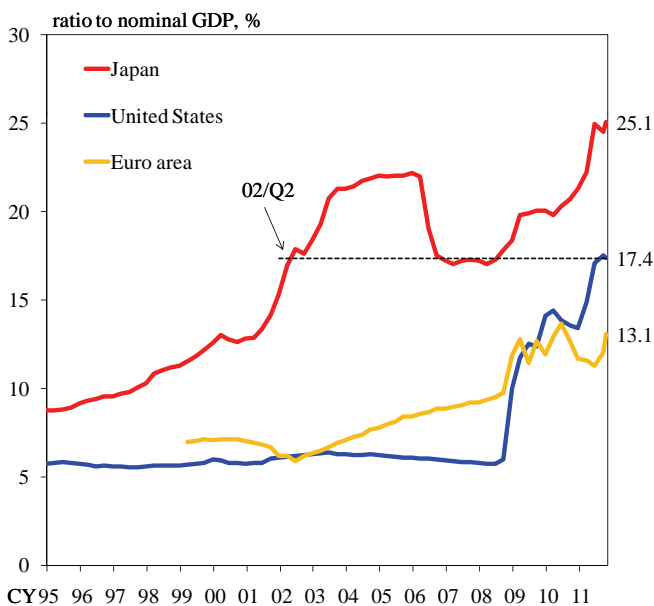
3. Europe



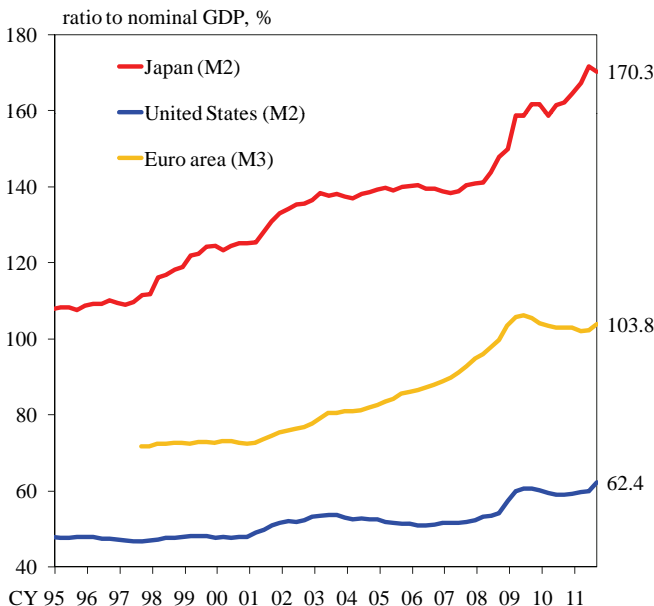
Note: Based on the launch date. Bonds issued by banks are excluded for Japan, and some government-guaranteed bonds are excluded for the U.S. and Europe.
 Sources: Bloomberg; Bank of Japan; FRB; ECB; Japan Securities Dealers Association; I-N Information Systems; Thomson Reuters.

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

A. Monetary Base

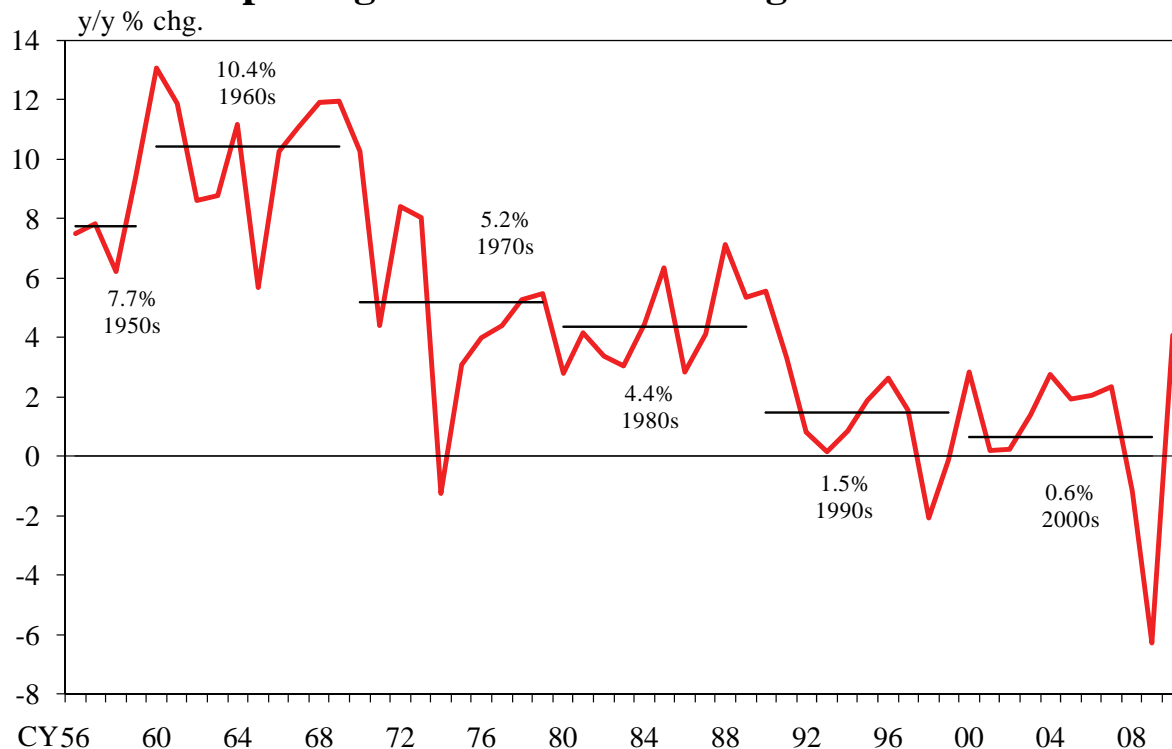


B. Money Stock



Notes: Monetary base is the sum of banknotes in circulation, coins in circulation, and current account deposits at a central bank.
 Money stock (M2) is the sum of cash and deposit money deposited in financial institutions including domestic banks.
 Sources: Cabinet Office, Bank of Japan, FRB, BEA, ECB, and Eurostat.

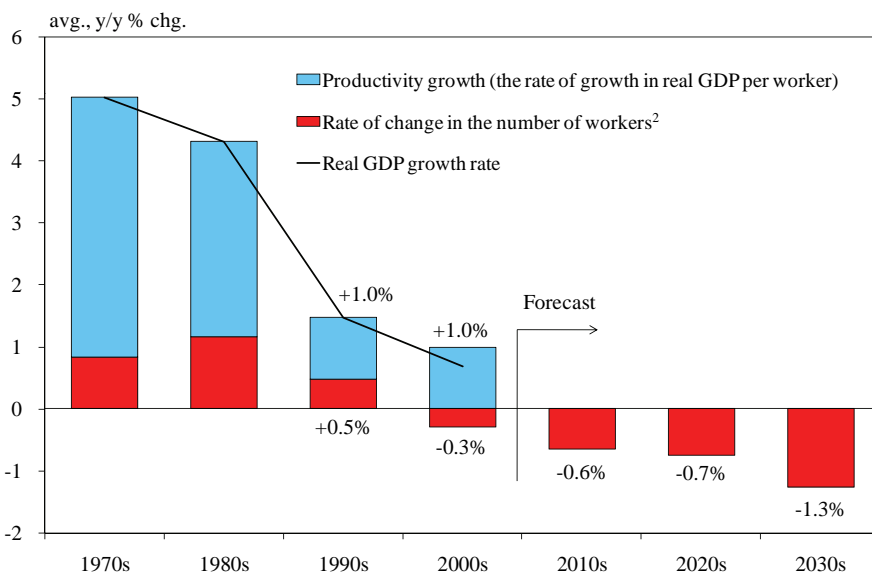
Japan's growth rate is trending down.



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."

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

A. Decomposition of Real GDP Growth in Japan¹



B. Productivity Growth of G-7 Countries (2000s)³

Country	%
Japan	1.5
United States	1.7
Germany	0.9
France	0.9
United Kingdom	1.5
Italy	-0.1
Canada	0.7

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).

3. To eliminate the effects of the financial crisis after the failure of Lehman Brothers, figures are the average growth rates from 2000-2008.

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"; OECD.