

# Toward Strengthening the Competitiveness and Growth Potential of Japan's Economy

*Speech at the Executive Member Meeting of the Policy Board of Nippon Keidanren (Japan Business Federation) in Tokyo*

February 28, 2013

Masaaki Shirakawa  
Governor of the Bank of Japan

---

## Contents

Introduction

- I. The Aim of Economic Policy
- II. The Need to Strengthen Competitiveness and Growth Potential
- III. Outline of the Course of Future Measures
- IV. Regulatory and Institutional Reforms, Corporate Governance Reform, and Social Values
- V. Relationship with Prices
- VI. The Will to Reform
- VII. Conduct of Monetary Policy by the Bank of Japan

Final Remarks

Chart 1

The Bank of Japan introduced the "price stability target" and set it at 2 percent, based on its recognition that efforts to strengthen the competitiveness and growth potential of Japan's economy will make progress.

### Introduction of the "Price Stability Target" (Jan. 2013)

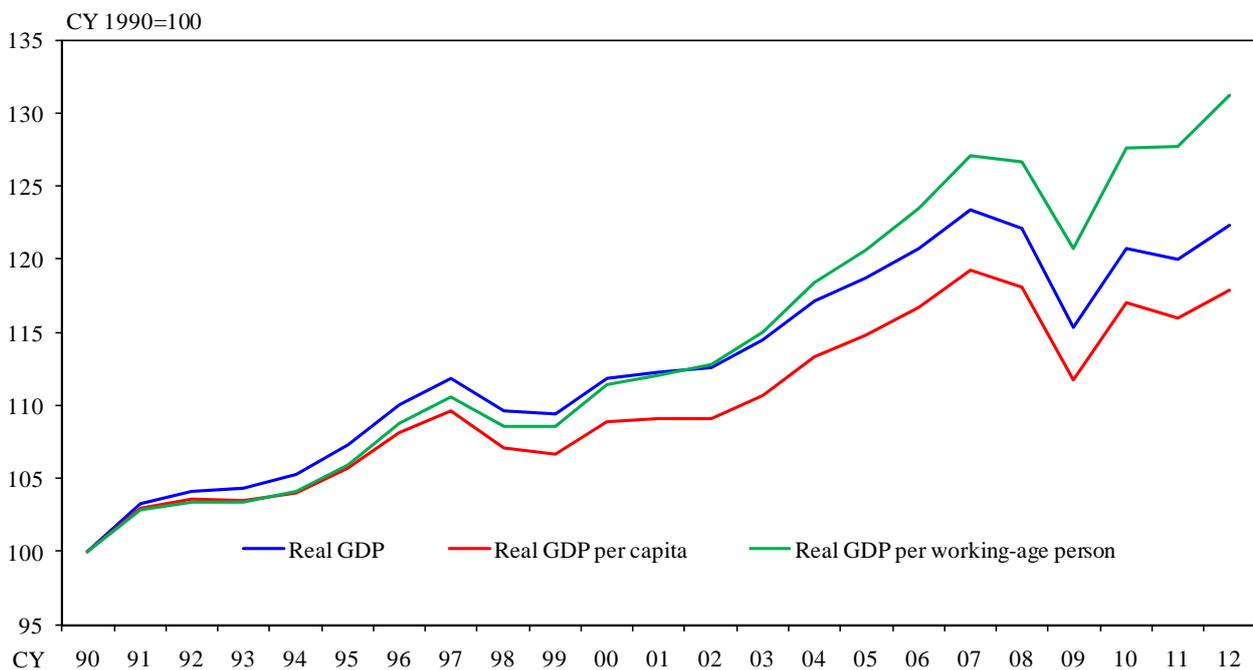
- The Bank recognizes that the inflation rate consistent with price stability on a sustainable basis will rise as efforts by a wide range of entities toward strengthening competitiveness and growth potential of Japan's economy make progress. Based on this recognition, the Bank sets the price stability target at 2 percent in terms of the year-on-year rate of change in the consumer price index (CPI).
- Under the price stability target specified above, the Bank will pursue monetary easing and aim to achieve this target at the earliest possible time. Taking into consideration that it will take considerable time before the effects of monetary policy permeate the economy, the Bank will ascertain whether there is any significant risk to the sustainability of economic growth, including from the accumulation of financial imbalances.

1

Chart 2

The key aim of macroeconomic policy is to raise real GDP in a sustainable manner.

### Japan's Real GDP



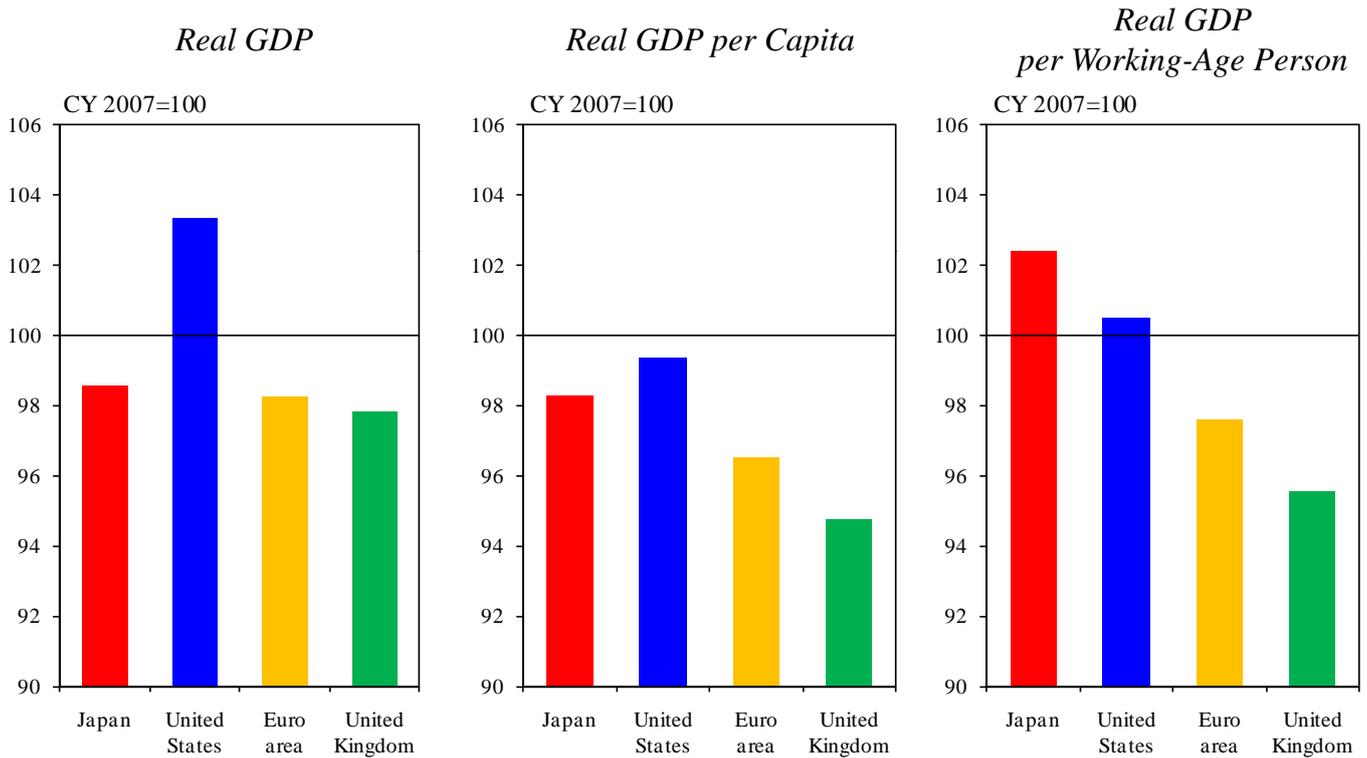
Notes: 1. Working-age person refers to those from 15 to 64 years old.

2. Population figures for 2012 are extrapolated using the growth rates for 2011.

Sources: Cabinet Office; World Bank.

2

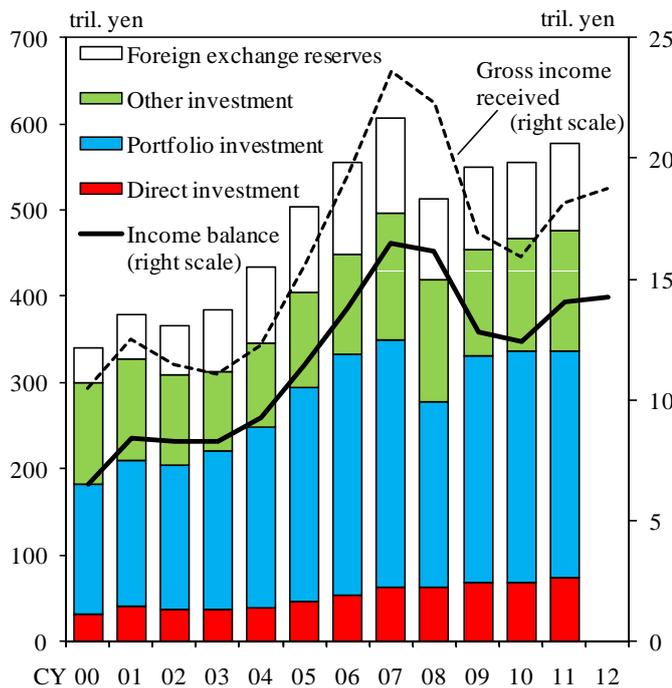
Chart 3 When adjusting for the effects of the population decline, a different picture emerges from developments in real GDP following the Lehman shock.



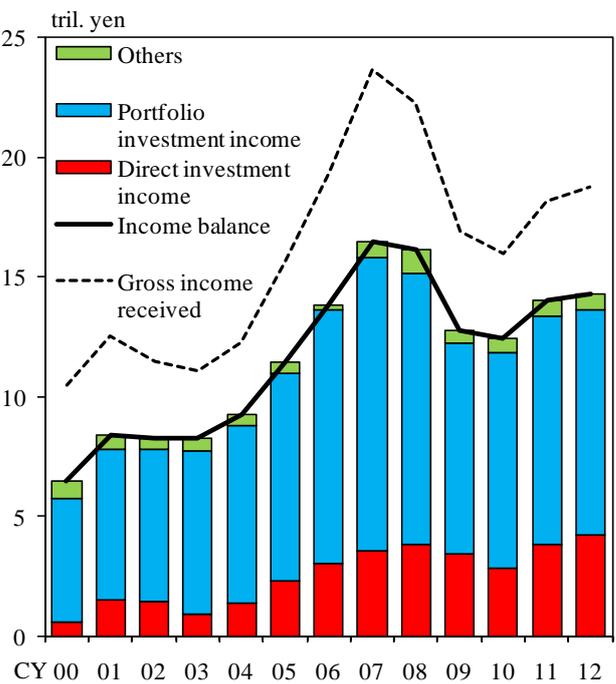
Notes: 1. Figures are for 2012/Q4 calculated on the assumption that the average for 2007 is 100.  
 2. Population figures for 2012 are extrapolated using the growth rates for 2011.  
 3. Working-age person refers to those from 15 to 64 years old.  
 Sources: Cabinet Office; BEA; ONS; Eurostat; World Bank.

Chart 4 Profits from outward investment by Japanese firms have been increasing.

Amount Outstanding of Outward Investment Assets and Income Balance



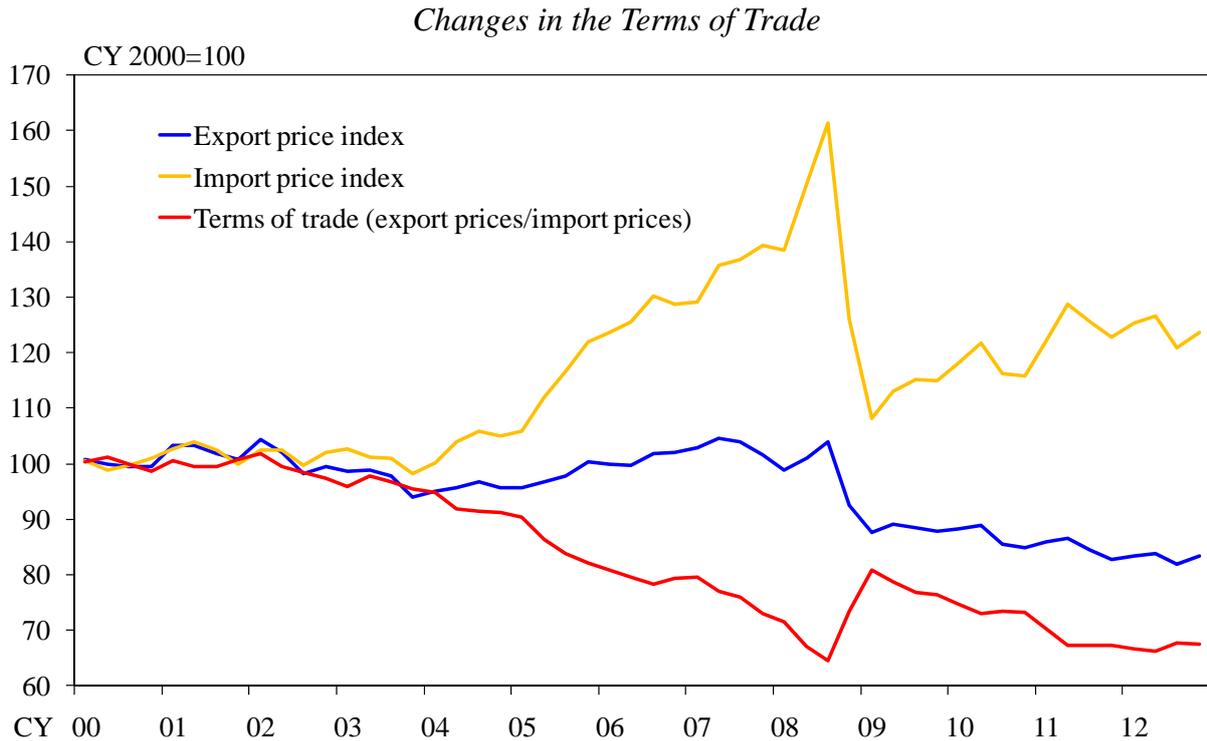
Income Balance



Source: Bank of Japan.

Chart 5

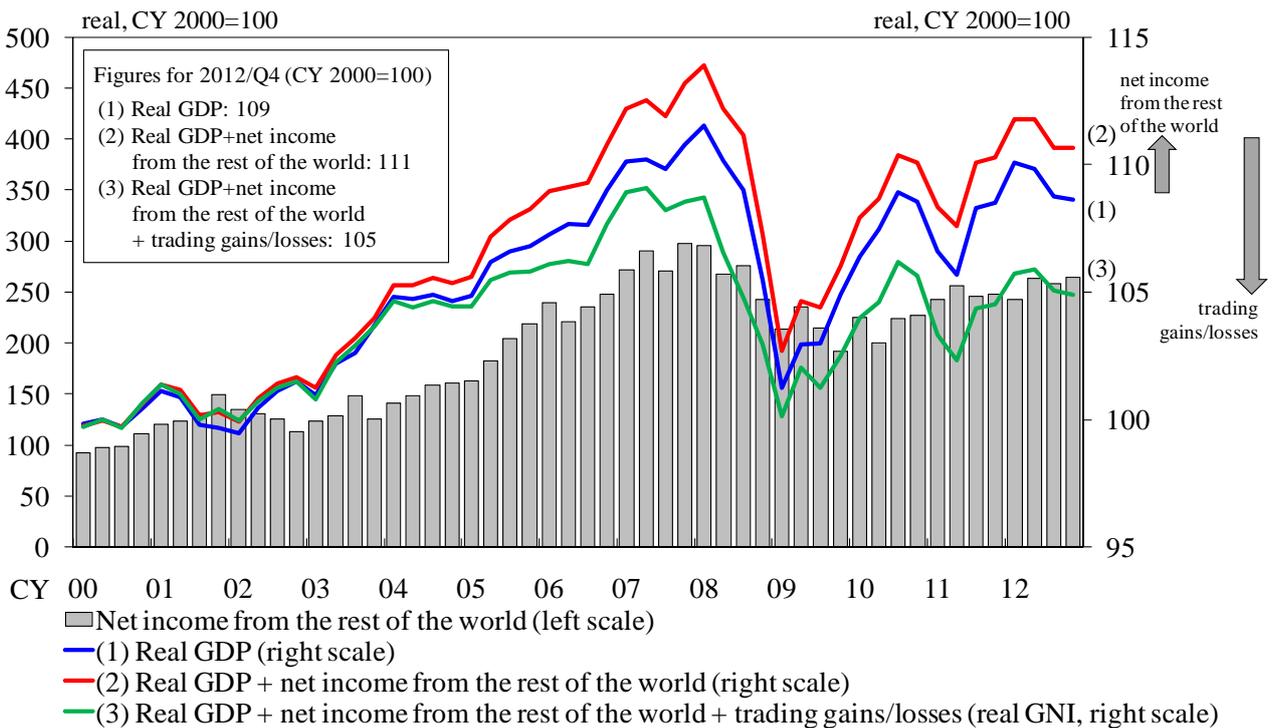
## Japan's terms of trade have been deteriorating.



Note: Both export and import price indices are based on the GDP deflator.  
 Source: Cabinet Office.

Chart 6

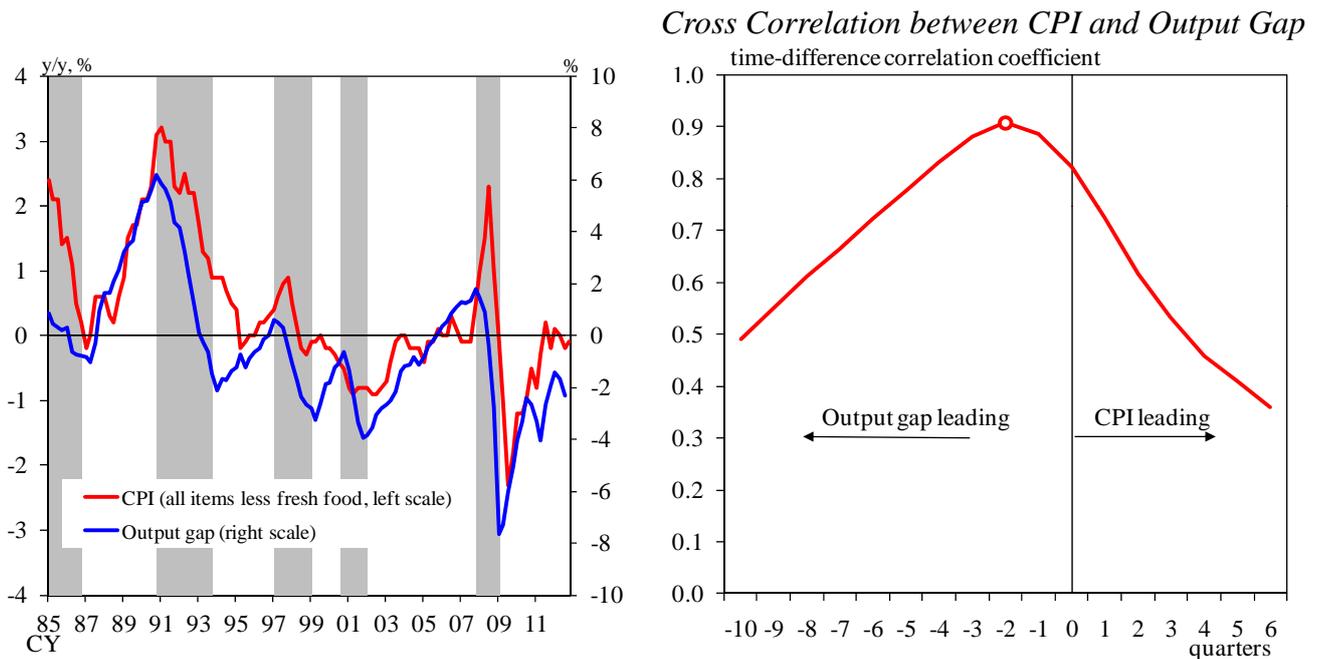
## Real GNI depends on developments both in net income from the rest of the world and in trading gains/losses.



Note: Trading gains/losses are changes in real income (purchasing power), reflecting changes in the terms of trade (export prices / import prices).  
 For example, when commodity price rises cause import prices to rise more than export prices, trading gains decline in reflection of deteriorated terms of trade.  
 To be specific, the definition of trading gains/losses is "nominal net exports / weighted average of export and import deflators - real net exports."  
 Source: Cabinet Office.

Chart 7

## Tightened demand-supply conditions resulting from economic improvement cause prices to rise, not the other way around.

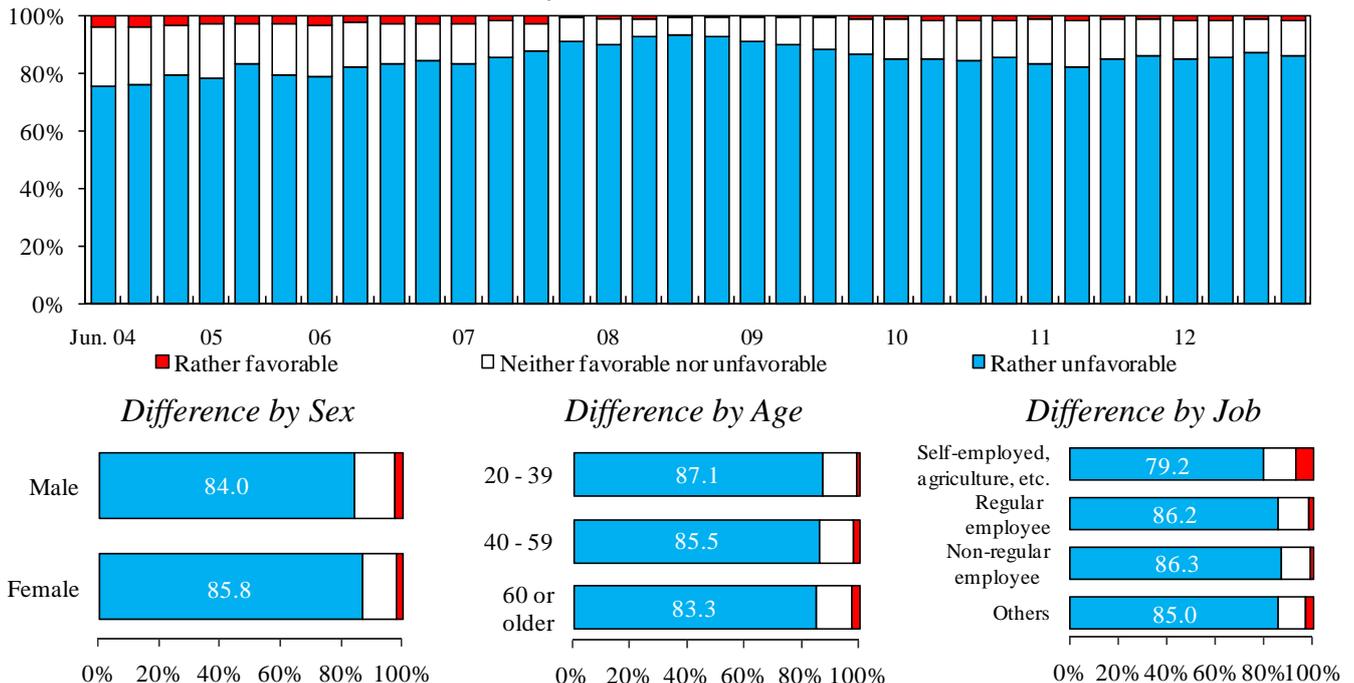


Notes: 1. Figures for the CPI are adjusted to exclude the effects of the consumption tax introduction in 1989 (3 percent) and the consumption tax hike in 1997 (from 3 to 5 percent).  
 2. The output gap is estimated by the Research and Statistics Department, Bank of Japan.  
 3. Shaded areas indicate recession periods.  
 4. Figures for the cross correlation are calculated using data between 1990/Q1 and 2012/Q3.  
 Sources: Ministry of Internal Affairs and Communications; Cabinet Office, etc.

Chart 8

## A considerable portion of the Japanese public is not simply looking for a situation in which prices rise alone.

### Comments of Households on the Price Rise

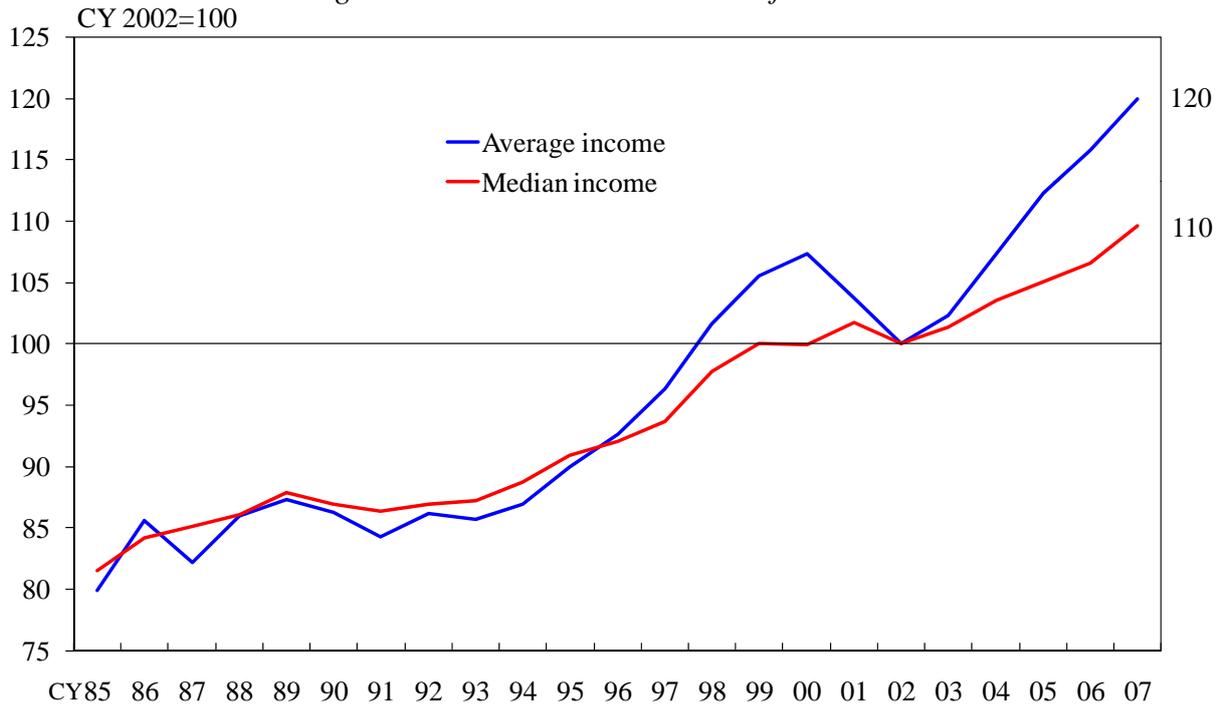


Notes: 1. Surveys were conducted in March, June, September, and December. Results of the questionnaires were obtained via the in-home survey method through June 2006, thereafter via the mail survey method.  
 2. Figures for differences by sex, by age and by job are newly calculated using raw data of the December 2012 survey.  
 3. "Self-employed, agriculture, etc." includes agriculture, forestry, fisheries, self-employed, working for a family business, and professional worker. "Others" includes full-time homemaker, student, unemployed, etc.  
 Source: Bank of Japan.

Chart 9

## Awareness of the situation surrounding income distribution has increased around the globe.

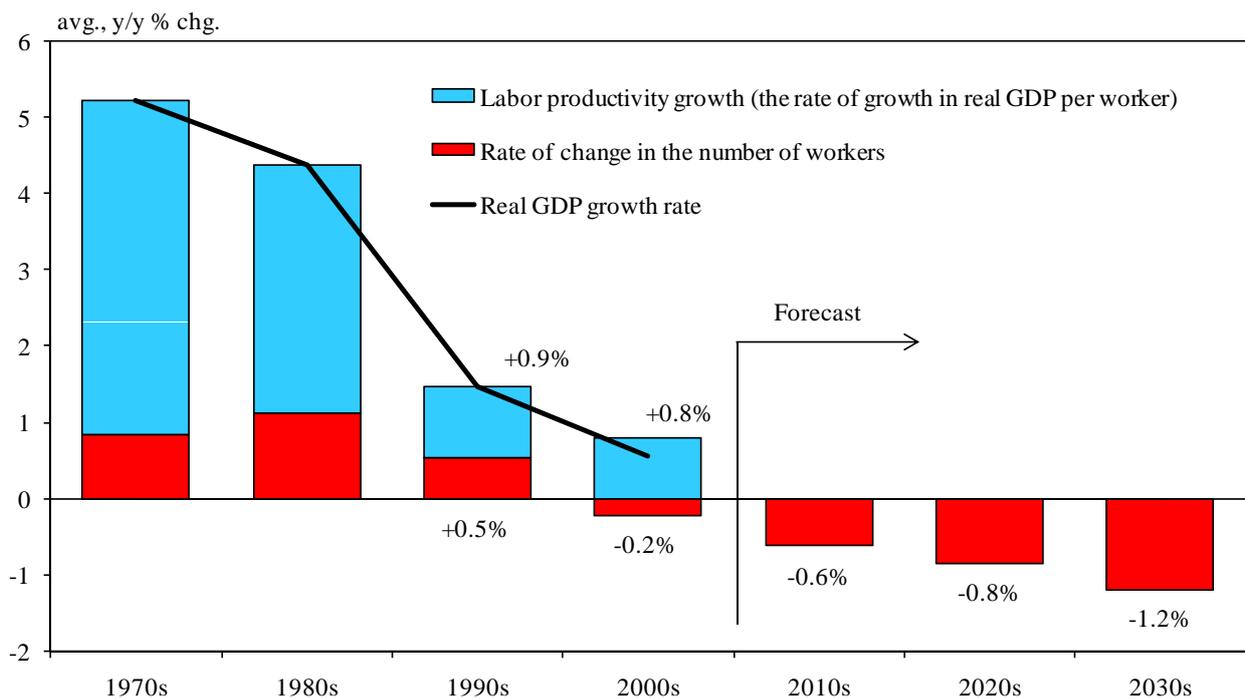
*Average Income and Median Income of U.S. Households*



Notes: 1. Median income is household income that represents the middle of a series of all household incomes arranged in order of size.  
 2. Figures for income are adjusted to exclude price fluctuations, transfers from the government to households, and taxes.  
 Source: Congressional Budget Office (CBO), "Trends in the Distribution of Household Income Between 1979 and 2007."

Chart 10

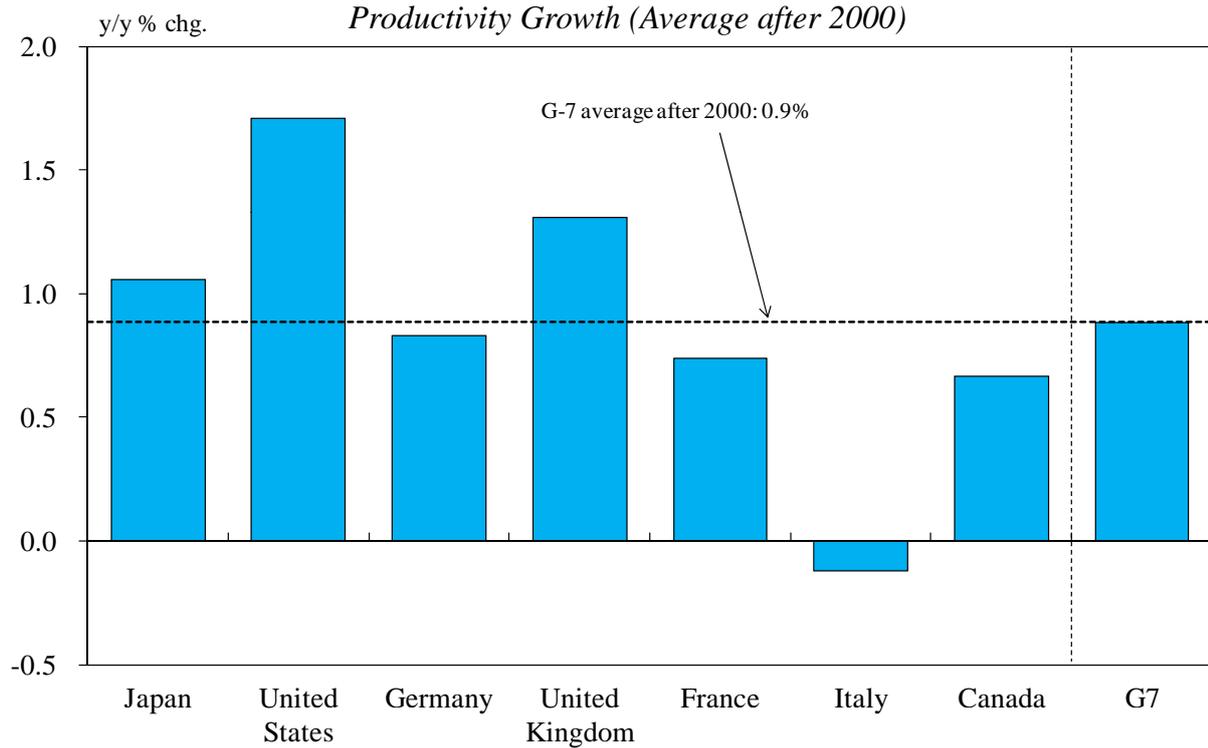
## A decline in the labor force population represents a considerably strong headwind facing Japan's economy.



Note: The rates of change in the number of workers from 2013 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 2012).  
 Sources: Cabinet Office; Ministry of Internal Affairs and Communications; National Institute of Population and Social Security Research.

Chart 11

Japan's labor productivity growth rate is comparable with those for the G-7 countries.

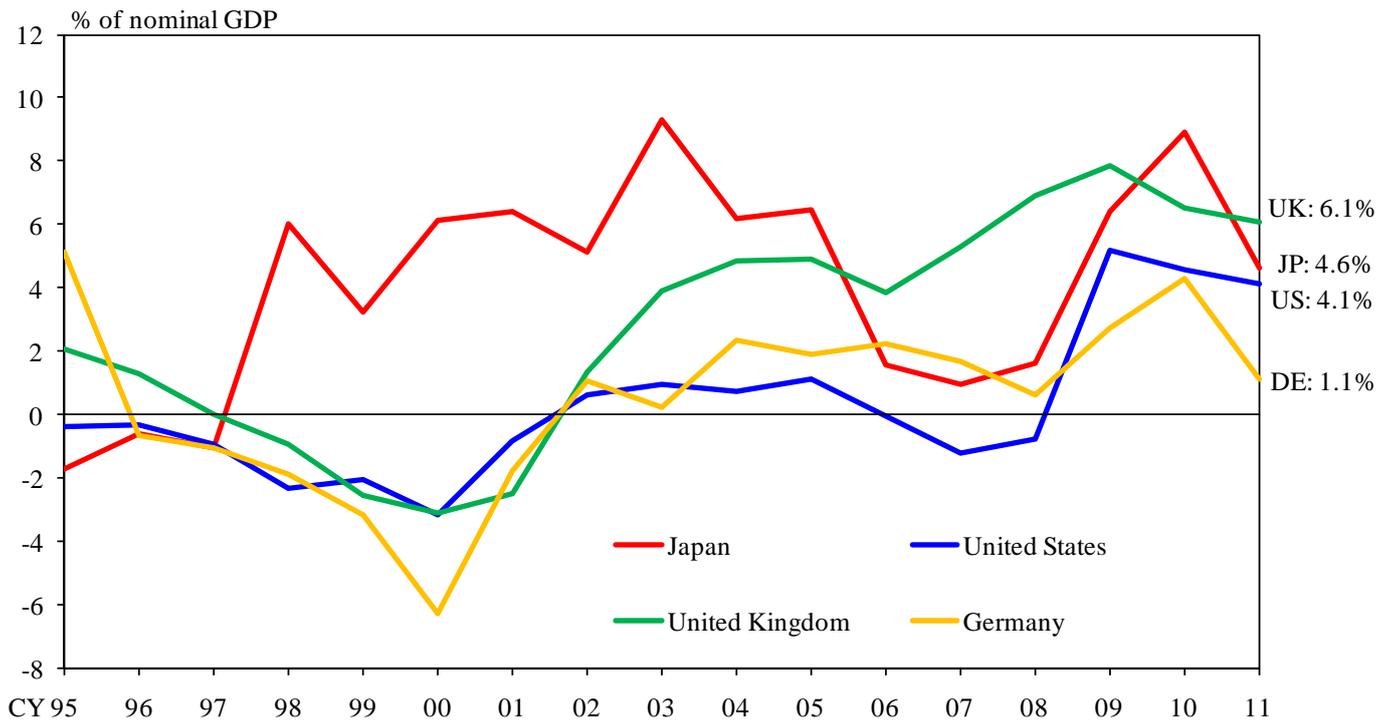


Notes: 1. Productivity = GDP / number of employees.  
 2. The productivity growth rate of the G-7 refers to the average of the seven countries.  
 Source: OECD.

Chart 12

A savings surplus by the corporate sector is a phenomenon now observed in other advanced countries as well.

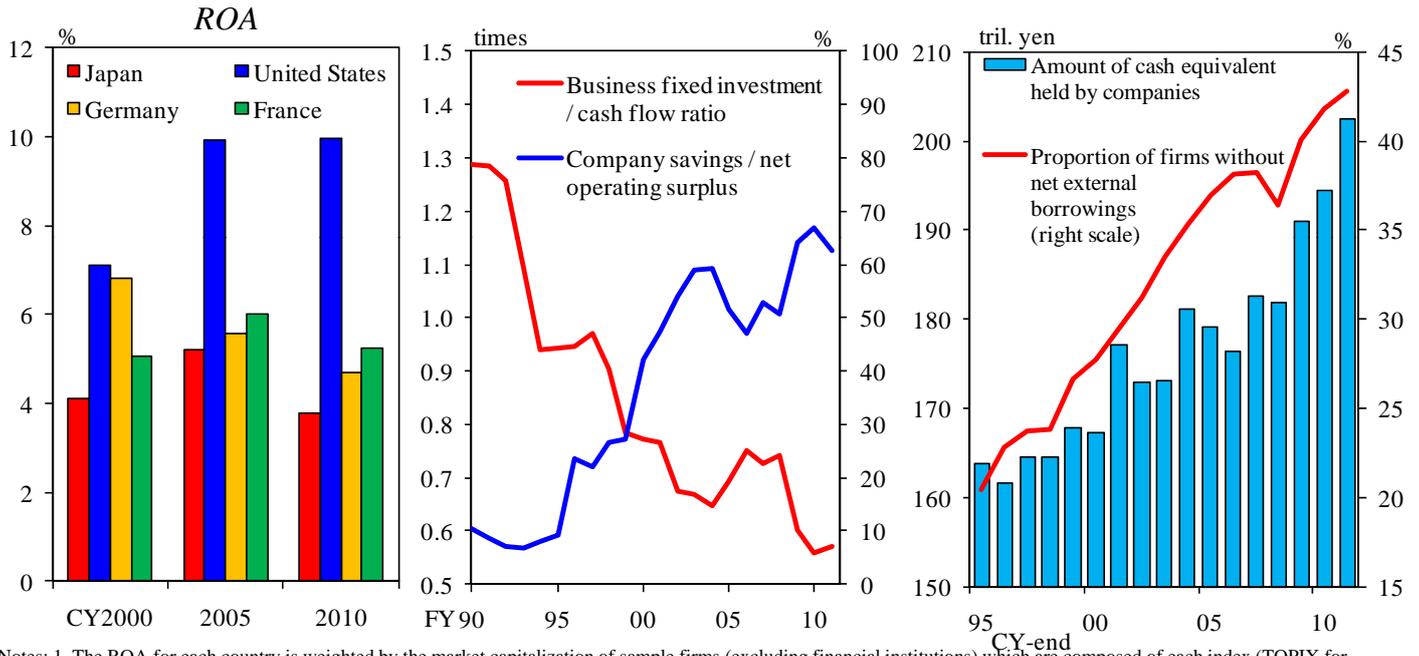
*Savings Surplus of the Corporate Sector*



Note: The corporate sector is calculated by removing two sectors -- general government and households -- from the domestic sector.  
 Sources: Cabinet Office; BEA; Eurostat; ONS.

Chart 13

## While their on-hand liquidity has increased, firms cannot muster enough confidence to invest at home.

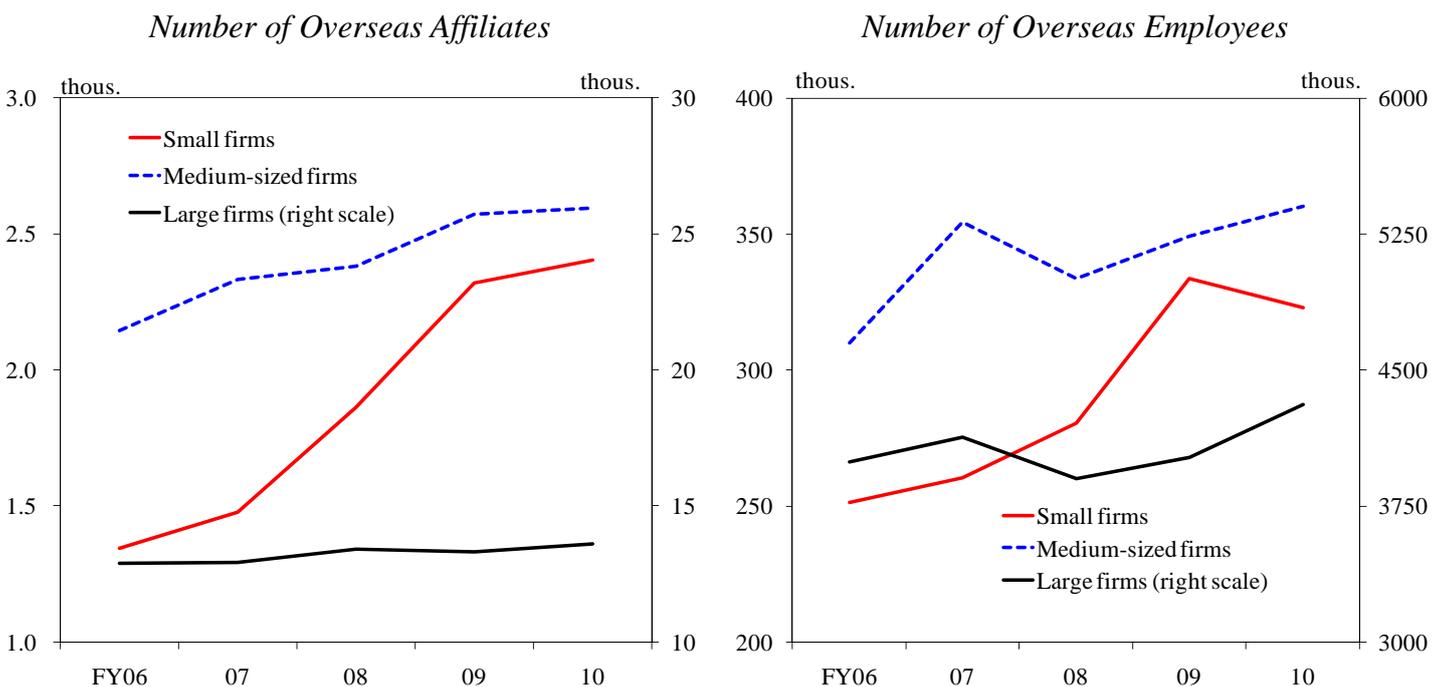


Notes: 1. The ROA for each country is weighted by the market capitalization of sample firms (excluding financial institutions) which are composed of each index (TOPIX for Japan, S&P for the United States, DAX for Germany, and CAC40 for France).  
 2. Sample firms for the middle and right-hand graphs are of all industries excluding finance and insurance.  
 3. Company savings/net operating surplus for up to 2000 refers to 2000 base figures.  
 4. Cash flow = depreciation expense + ordinary profit/2  
 5. Sample firms in the right-hand graph consist of 1,260 firms listed on the First or Second Section of the Tokyo Stock Exchange, with March year-ends, and for which data can be obtained consecutively from fiscal 1995 onward (excluding financial institutions). Firms without net external borrowings are those for which cash, deposits, and cash equivalents exceed their interest-bearing debt. Cash equivalents are short-term assets such as CP, CD, and bond investment trusts.

Sources: Bloomberg; Ministry of Finance; Cabinet Office.

Chart 14

## Expansion of Japanese firms' overseas business activities has spread to small and medium-sized enterprises.

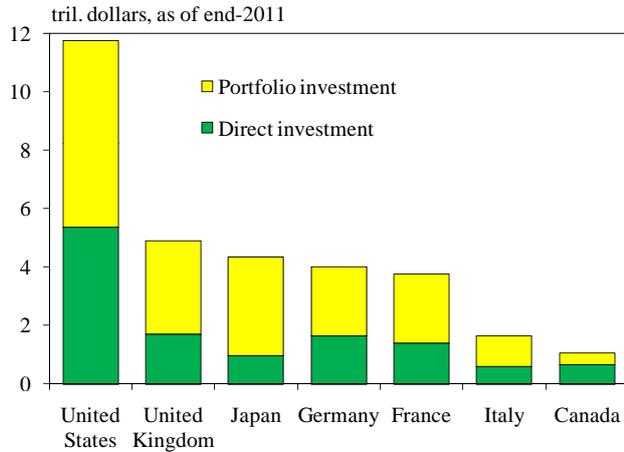


Source: Ministry of Economy, Trade and Industry.

Chart 15

The outstanding amount of Japan's foreign direct investment remains at a low level compared with that of other advanced countries.

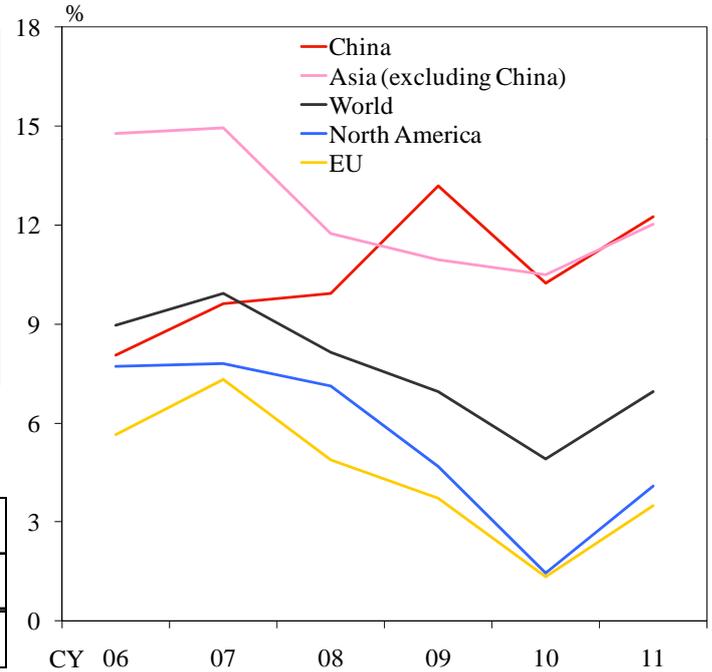
Outward Direct and Portfolio Investment Position



% of nominal GDP

Direct investment	42	133	57	67	85	59	18
Portfolio investment	36	70	17	46	51	36	31
Total	78	203	74	113	136	95	49

Japan's Rate of Return on Outward Direct Investment (by Region)

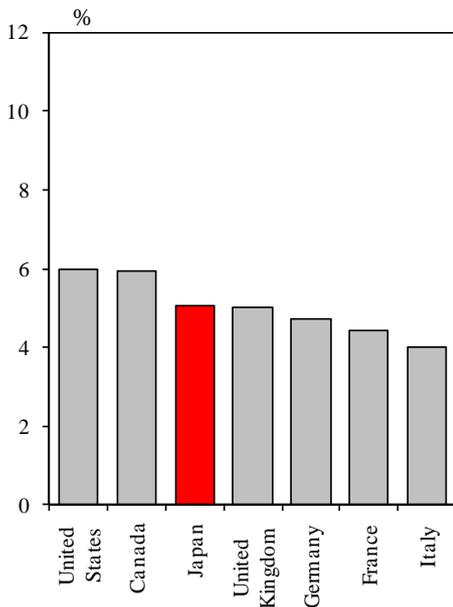


Note: Rates of return on outward direct investment are calculated by dividing the amount of total direct investment income by the direct investment position for the previous year-end. Sources: OECD; IMF; Bank of Japan.

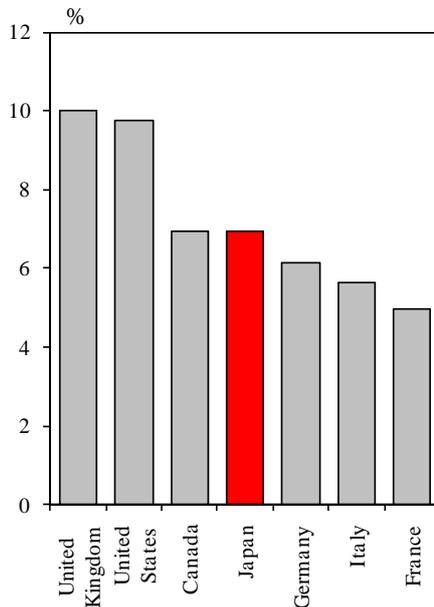
Chart 16

In terms of the profitability of foreign investment, Japan falls somewhat behind the United States.

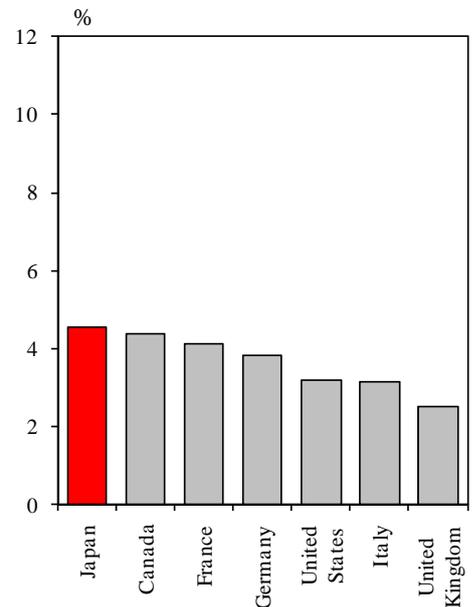
Rate of Return on Outward Investment (Direct and Portfolio Investment)



Rate of Return on Direct Investment



Rate of Return on Portfolio Investment

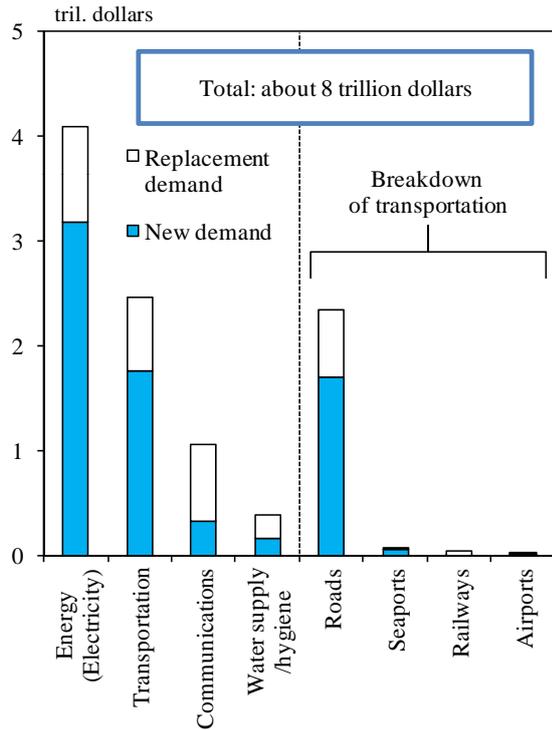


Note: Figures are for 2011. Rates of return are calculated by dividing the amount of total investment income by the investment position for the previous year-end. Source: IMF.

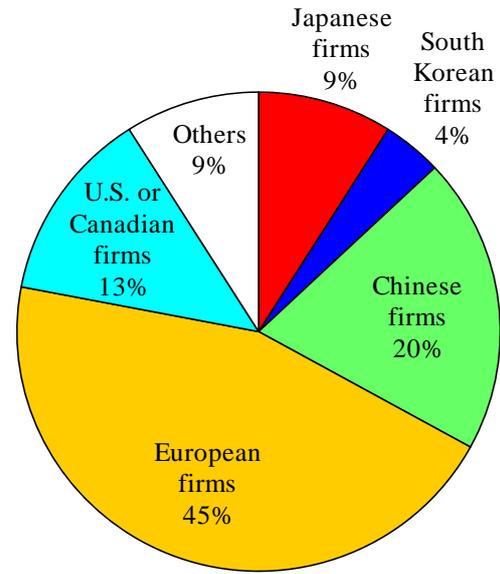
Chart 17

Huge potential demand in the area of building core infrastructure exists in Asia.

Investment Demand on Infrastructure in Asia



Share of Companies in Infrastructure Order (CY2011)

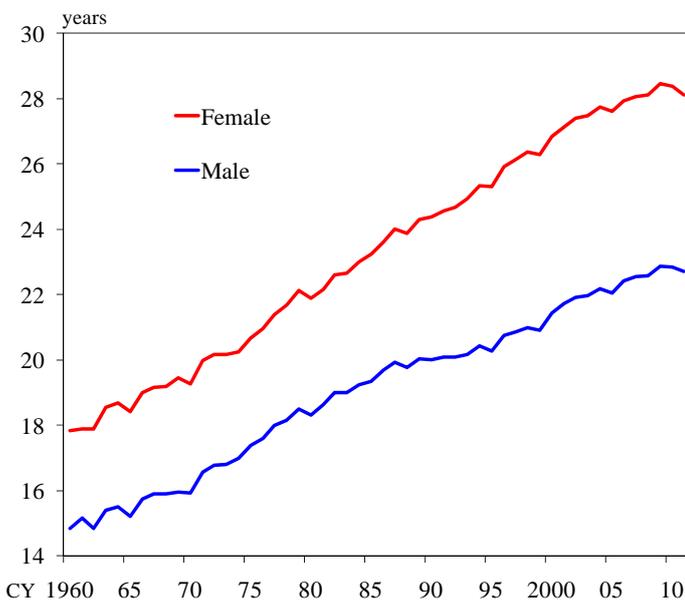


Note: Figures for investment demand are the accumulated value from 2010 to 2020. Sample countries are 30 countries or regions located in the Asia-Pacific region. Sources: Ministry of Economy, Trade and Industry; Asian Development Bank.

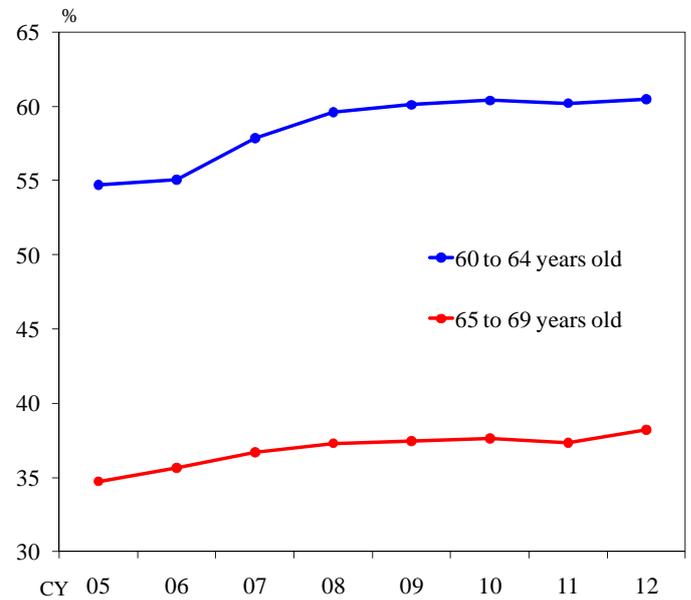
Chart 18

The labor participation rate of the elderly has increased in recent years.

Life Expectancy of 60 Year-Olds



Labor Participation Rate of the Elderly

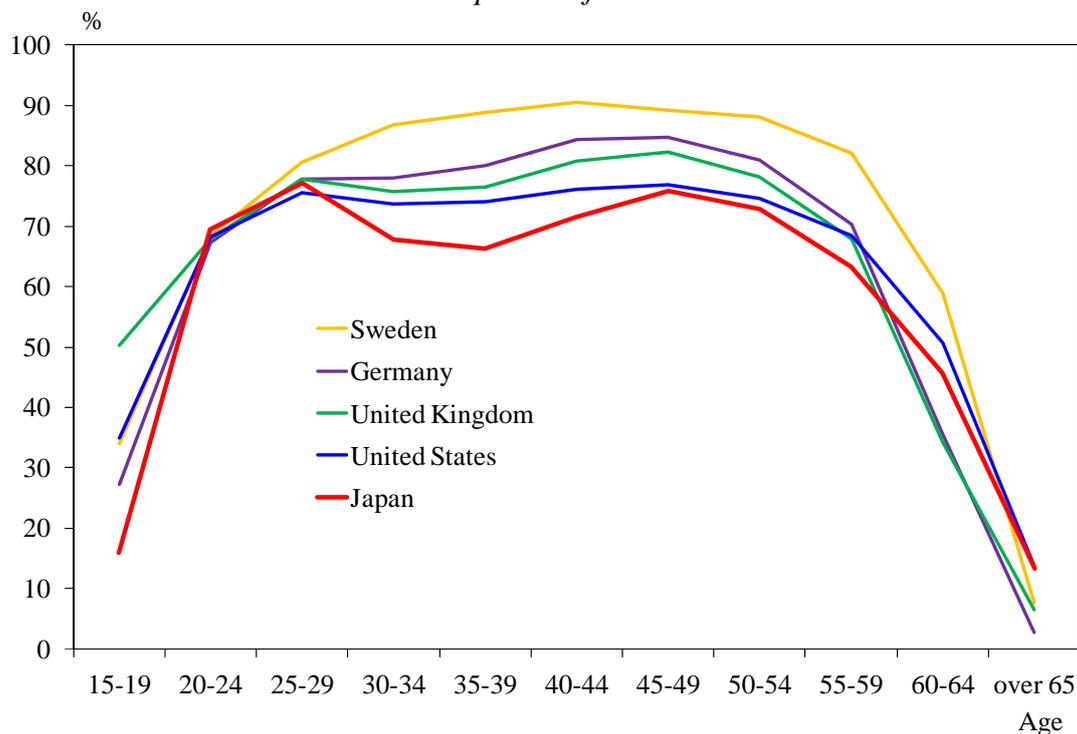


Sources: Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare.

Chart 19

The labor participation rate of women remains at a relatively low level compared with other advanced economies.

*Labor Participation of Women in 2010*



Sources: Ministry of Internal Affairs and Communications; OECD.

Chart 20

Expenditure in medical and nursing care has increased at a pace lower than that of population aging in Japan.

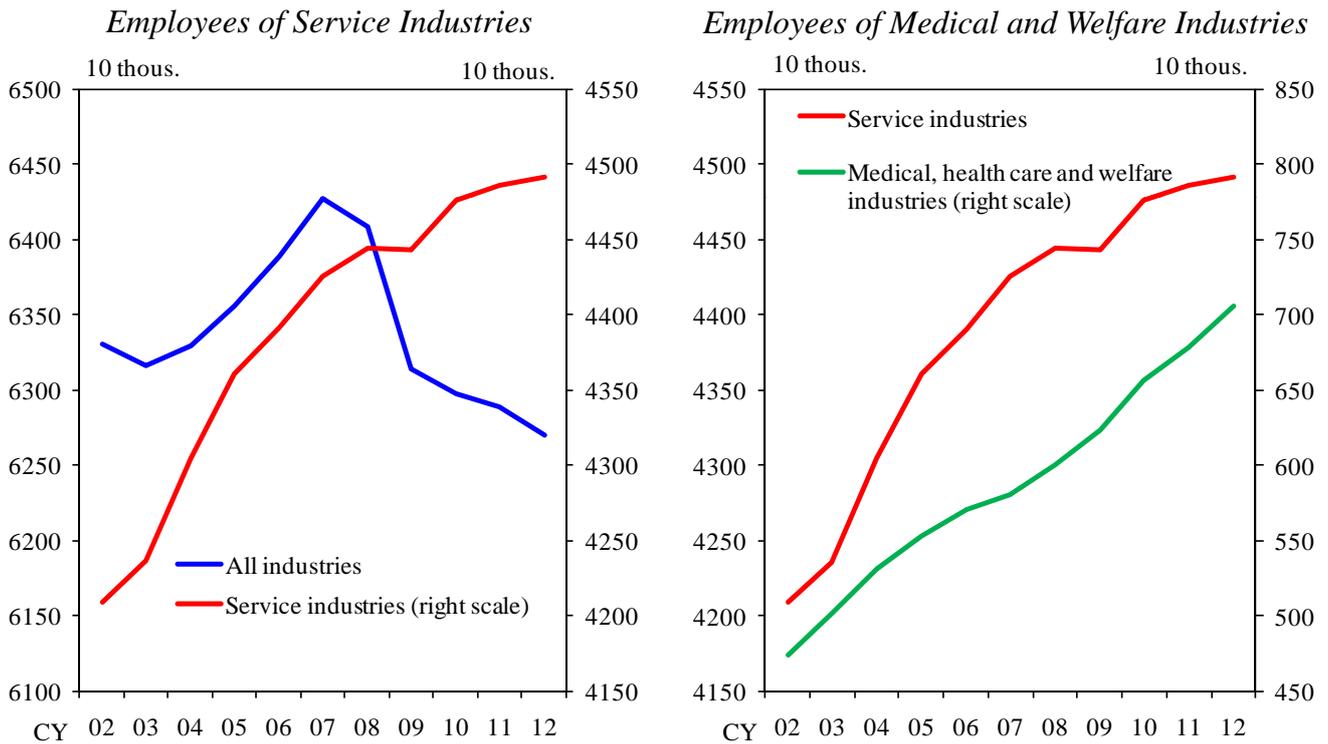
*Population Aging and Expenditure in Medical and Nursing Care*

	Japan	Germany	United States	France	United Kingdom
Population aged 65 and over (Change from 2000 to 2009, percent)	29	24	13	9	9
Expenditure in medical and nursing care (Change from 2000 to 2009, percent)	17	31	82	98	49

Sources: United Nations; OECD.

Chart 21

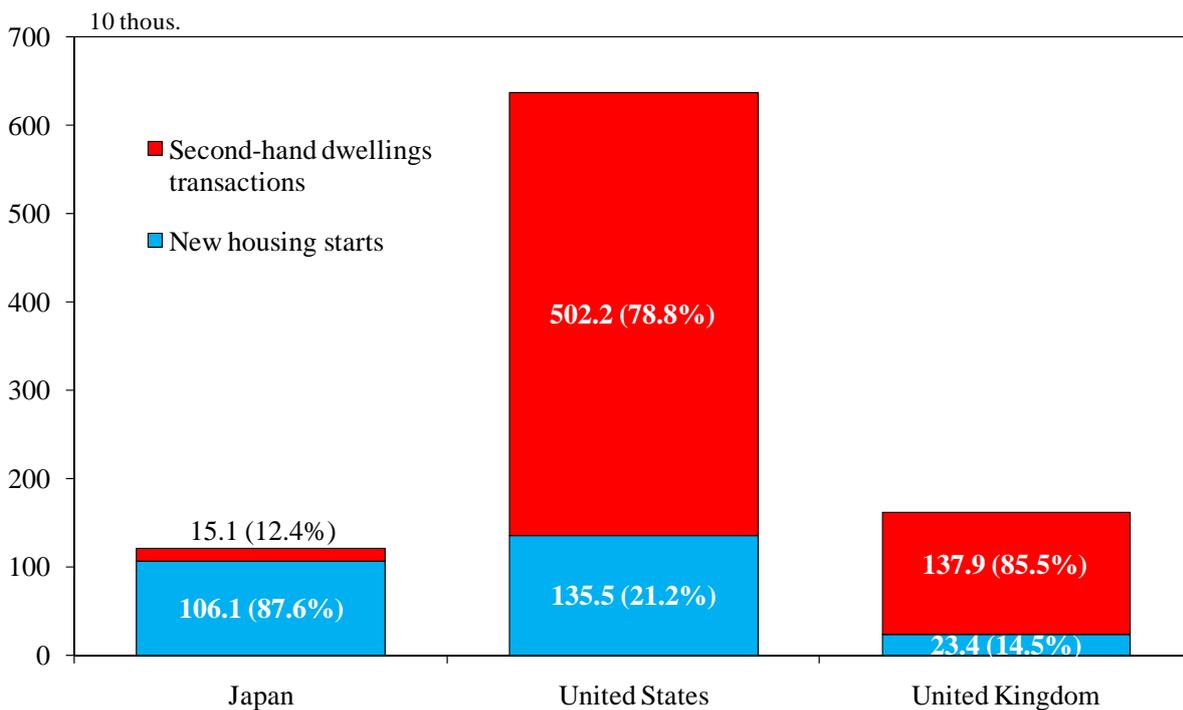
The service sector, including medical and welfare industries, are offering increased employment opportunities.



Note: Service industries include all industries other than the manufacturing, agriculture, forestry and fisheries, mining, and construction industries.  
 Source: Ministry of Internal Affairs and Communications.

Chart 22

Japan's secondary housing market is smaller than other countries.

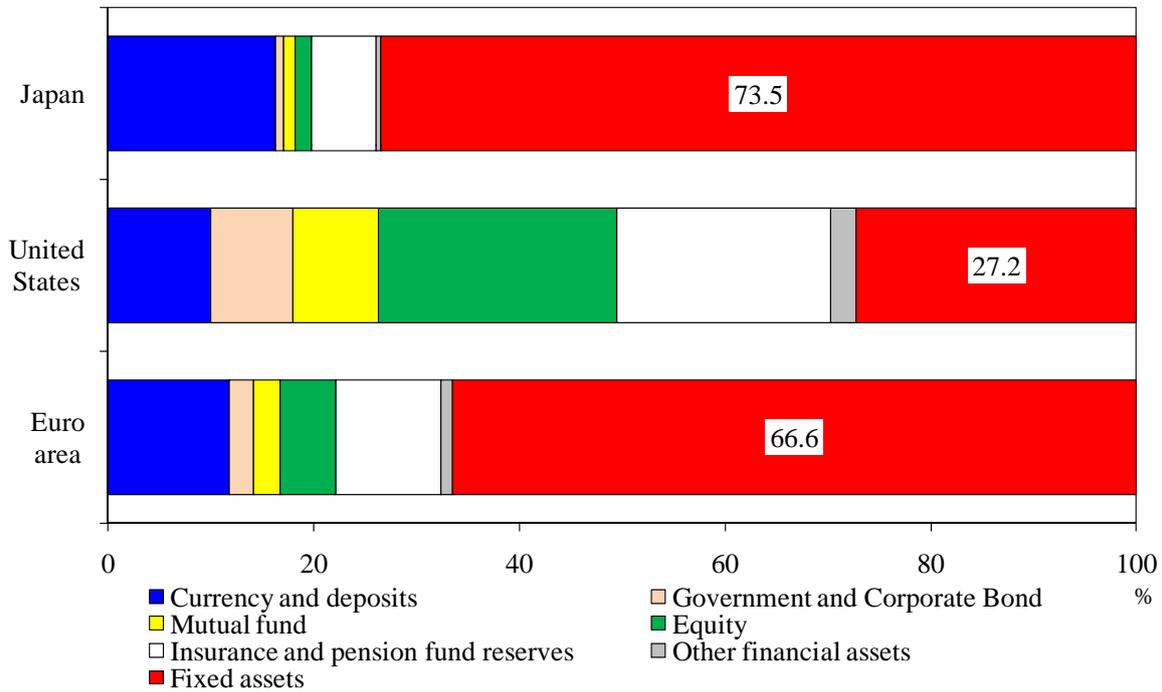


Notes: 1. Figures are for 2007. Those in parentheses represent each share.  
 2. For the United Kingdom, the number of second-hand dwellings is derived by subtracting the number of new dwellings from the total housing market.  
 Sources: Ministry of Land, Infrastructure, Transport and Tourism; U.S. Census Bureau; U.K. Department for Communities and Local Government.

Chart 23

The share of residential assets among Japanese household assets tends to be high.

*Breakdown of Household Assets*

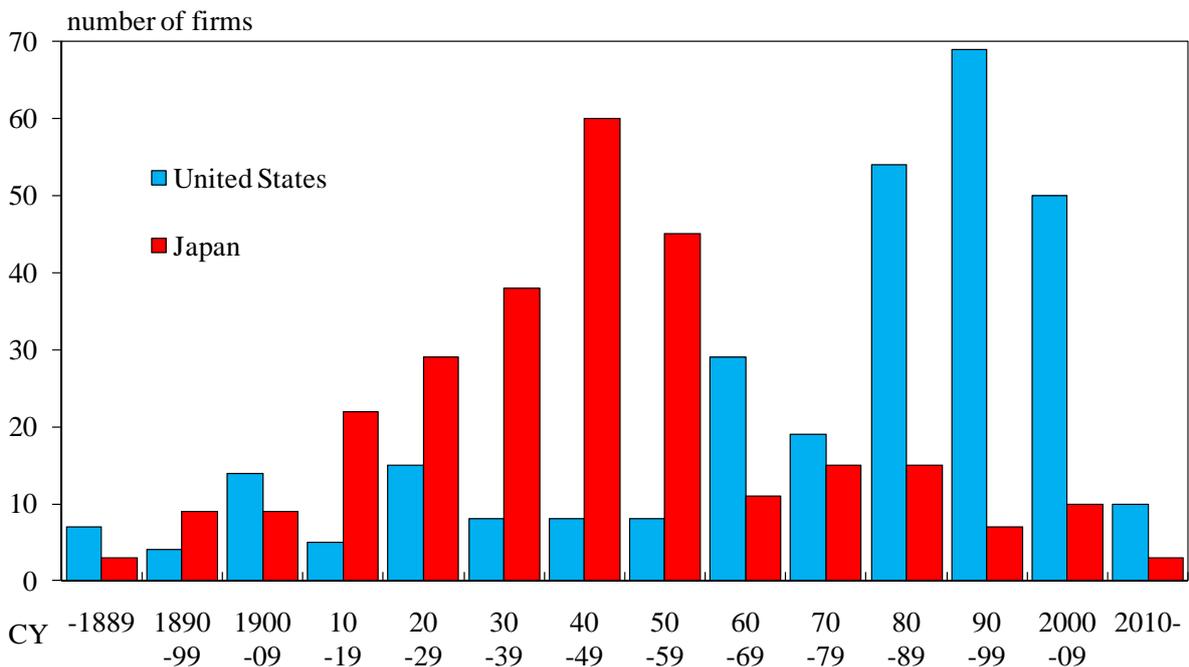


Note: Figures are as of end-2010.  
Sources: Ministry of Internal Affairs and Communications; FRB; Eurostat.

Chart 24

Compared with the United States, Japanese large-cap firms have longer corporate histories.

*Establishment Year of Top 300 Large-Cap Firms*



Note: Figures are based on the top 300 large-cap firms as of end-2012. Those for Japan for 2000 onward, however, exclude the establishment of stock-holding companies.  
Source: Thomson Reuters.

Chart 25

Looking at developments in the stock market after the Lehman shock, comparatively small firms have been performing relatively well.

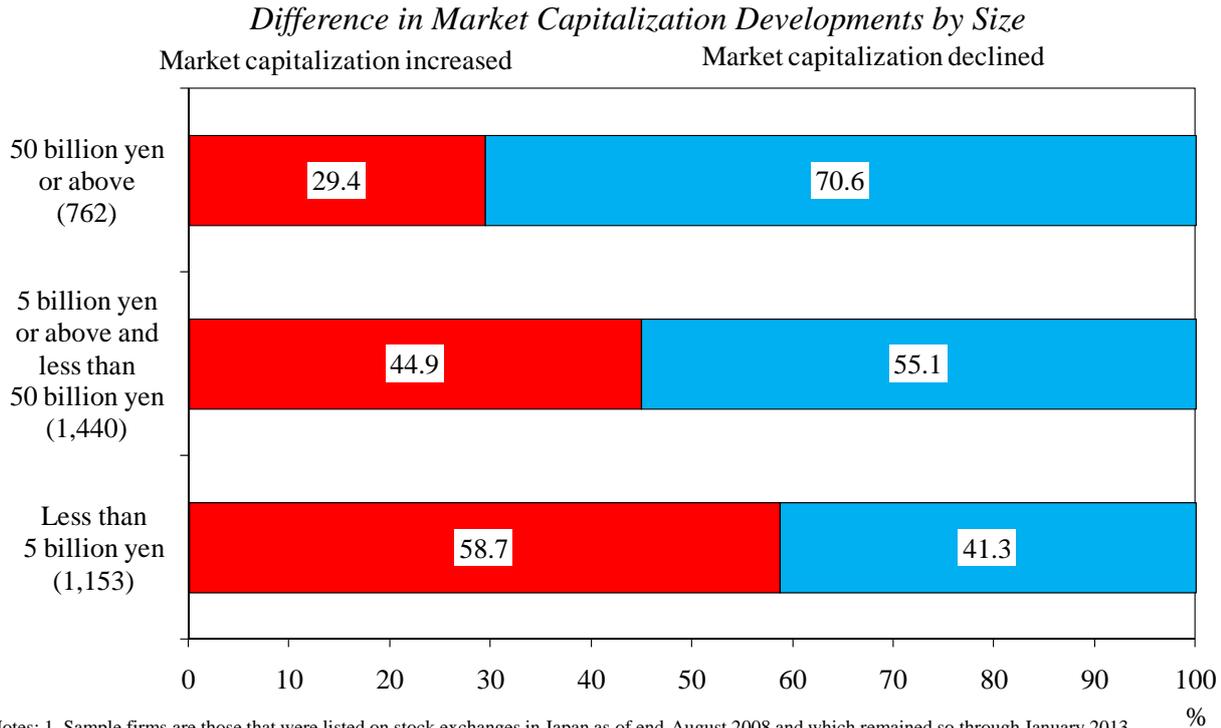
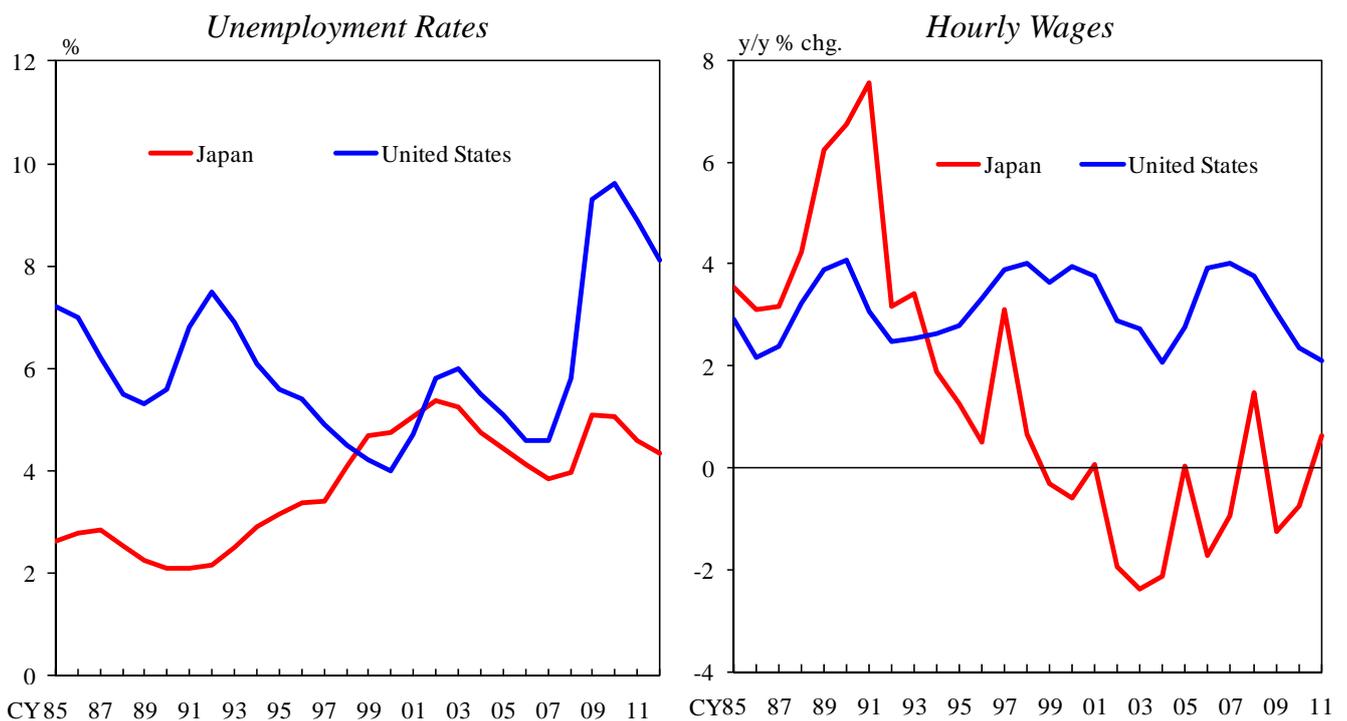


Chart 26

Japan has prioritized securing employment, reducing costs largely by cutting back wages.

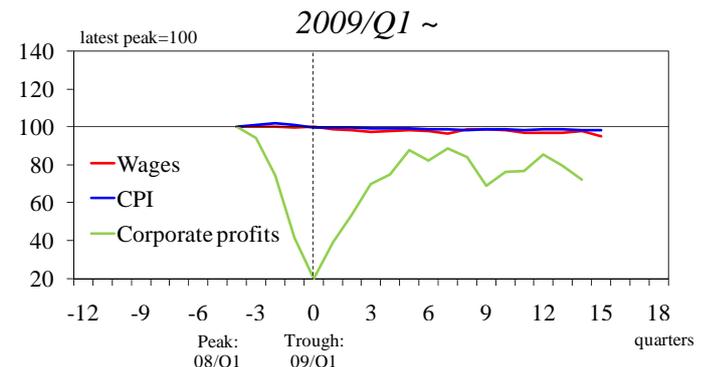
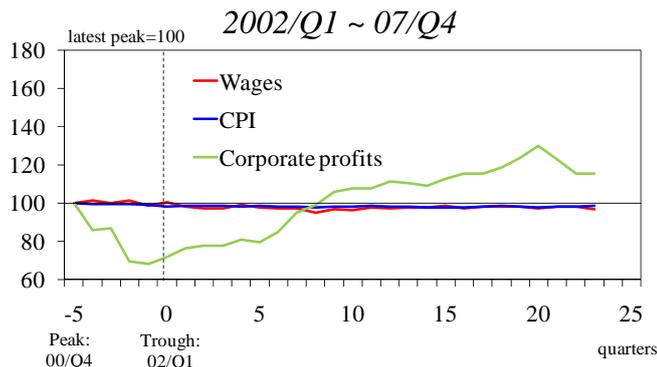
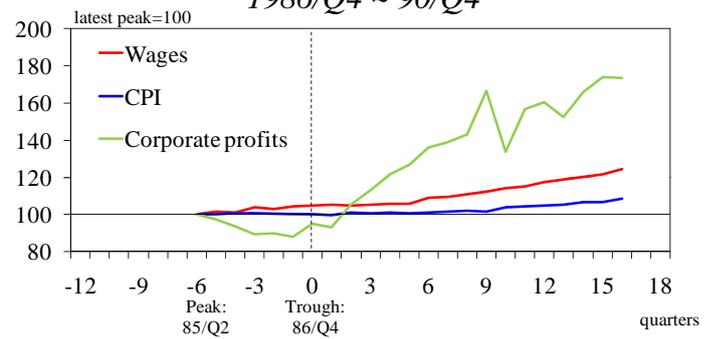
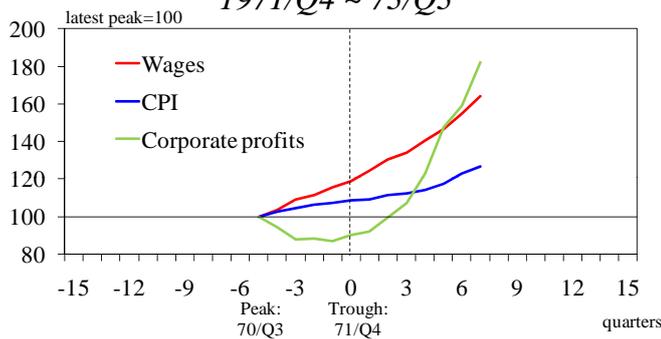


Sources: Cabinet Office; Ministry of Internal Affairs and Communications; BLS.

Chart 27

As firms' profitability has been declining recently, neither wages nor prices have changed materially.

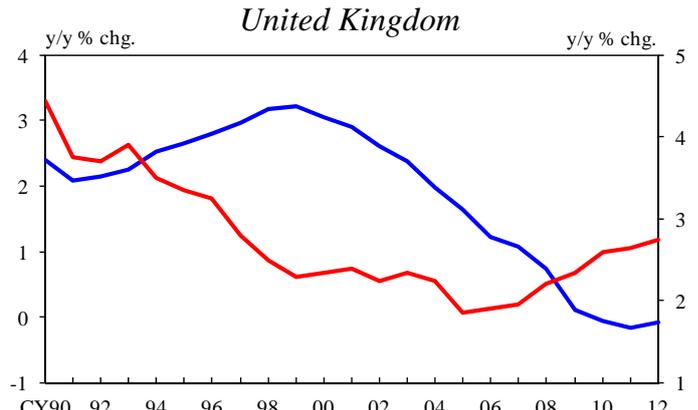
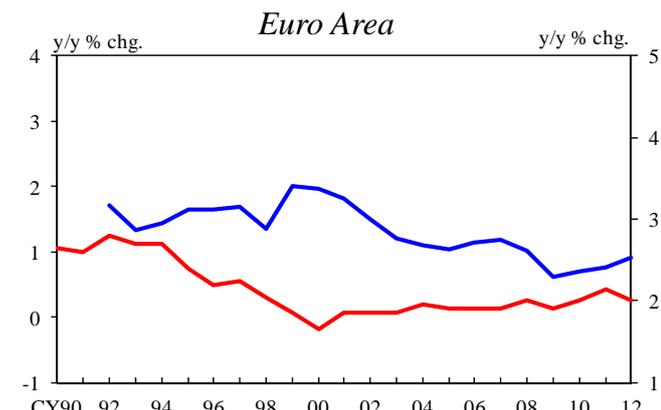
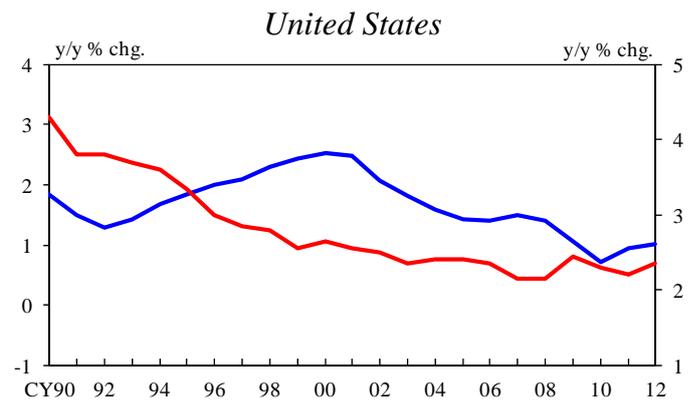
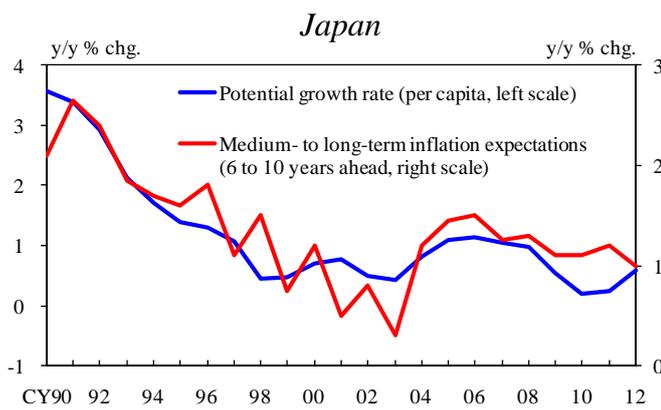
*Developments in Corporate Profits, Wages, and Prices following Cyclic Peaks*  
 1971/Q4 ~ 73/Q3      1986/Q4 ~ 90/Q4



Note: "Wages" refers to hourly cash earnings (monthly labour survey base, establishment with 30 or more employees, all industries). "CPI" refers to CPI for all items. "Corporate profits" refers to operating profit figures in "Financial Statements Statistics of Corporations by Industry, Quarterly" (all size, all industries).  
 Sources: Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications; Ministry of Finance; Cabinet Office.

Chart 28

There is a clear positive correlation between inflation expectations and potential growth rates in Japan.



Sources: Cabinet Office; Consensus Economics Inc., "Consensus Forecasts"; CBO; OECD, etc.

## Changes in global investors' risk aversion significantly affect developments in financial markets.

### Long-Term Yield Spreads over German Government Bond Yields %

	Beginning of 2011	July 24, 2012	Recent
Italy	1.8	5.4	3.4
Spain	2.5	6.4	3.9
Greece	9.6	26.8	9.7

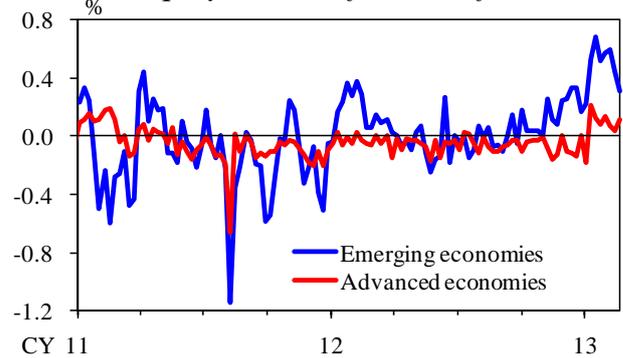
### Equity Prices

	Beginning of 2011	July 24, 2012	Recent
Japan (Nikkei 225)	10,398.1	8,488.1	11,254.0
United States (Dow Jones)	11,670.8	12,617.3	13,900.1
Euro area (Euro STOXX)	2,839.4	2,151.5	2,570.5
Emerging economies	100.0	85.3	95.4

### Nominal Effective Exchange Rates

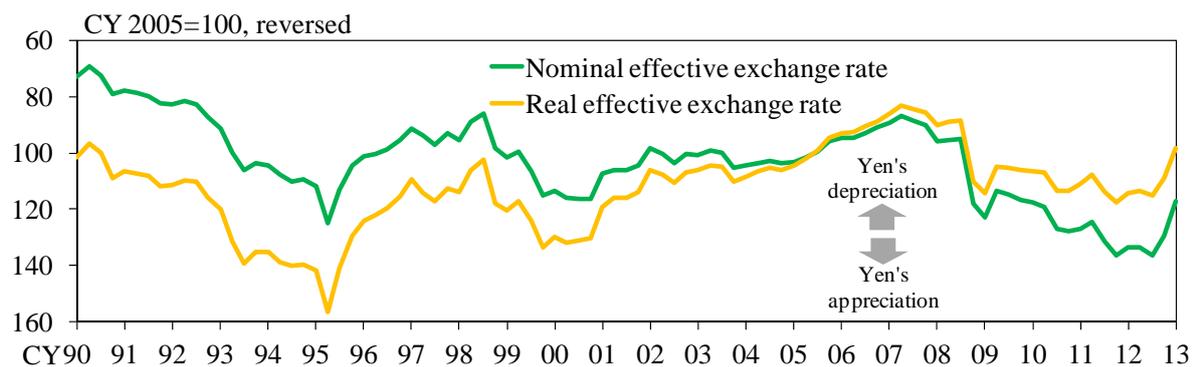
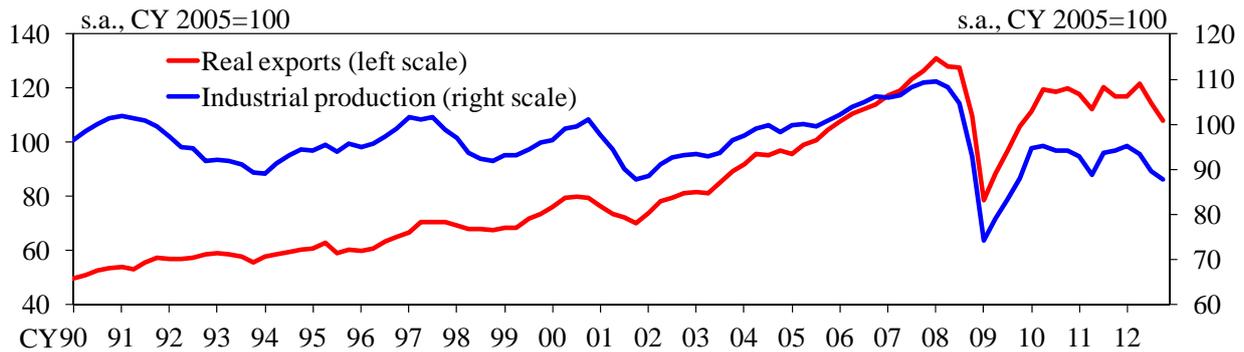
	January 2011 → July 2012	July 2012 → January 2013
Yen	+ 6.3	- 13.9
U.S. dollar	+ 3.2	- 2.6
Euro	- 4.8	+ 5.4
Pound sterling	+ 4.4	- 2.3
Korean won	- 1.2	+ 6.5

### Equity Funds Inflows/Outflows



Notes: 1. Figures for equity prices for emerging economies are taken from the MSCI Emerging Markets Index, adjusted such that the figure for the beginning of 2011 is 100.  
 2. Figures for "Equity Funds Inflows/Outflows" are calculated using each fund's net money flow data divided by its total assets.  
 Sources: Bloomberg; EPFR Global; BIS.

## Exports and production increased during the mid-2000s when the yen depreciated.

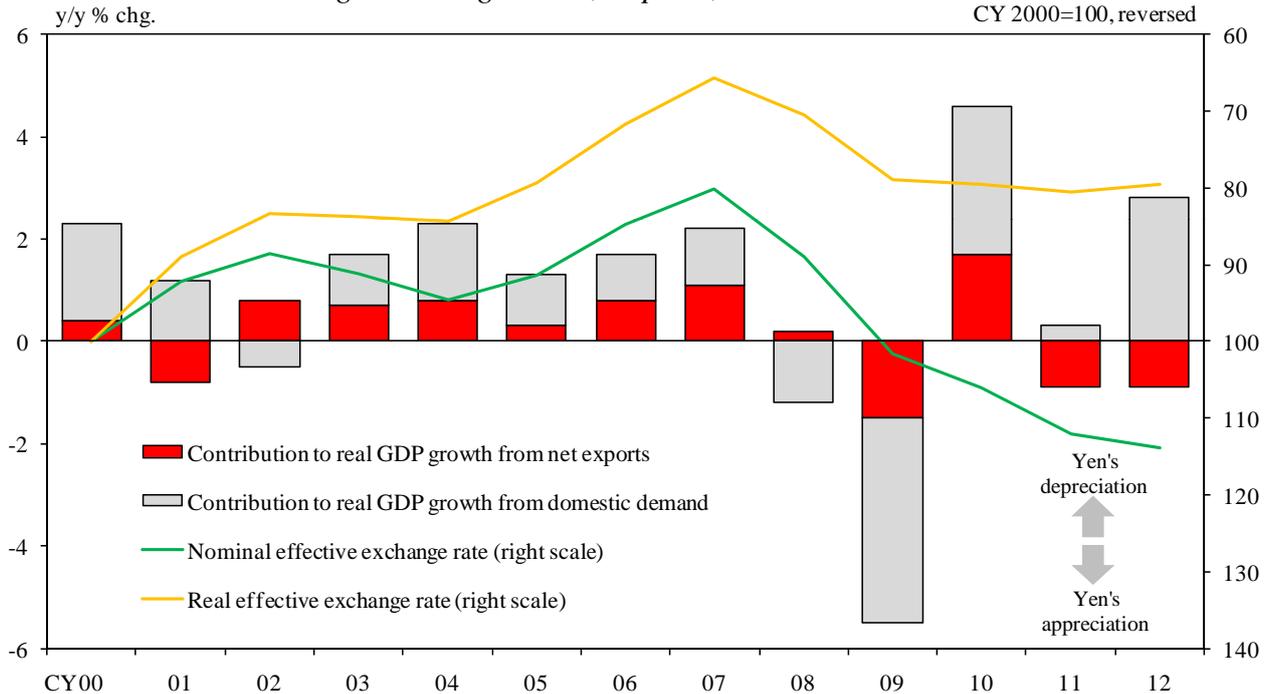


Sources: Ministry of Economy, Trade and Industry; Bank of Japan; BIS.

Chart 31

## The medium- to long-term growth rate has not risen.

### Foreign Exchange Rates, Exports, and Real GDP Growth



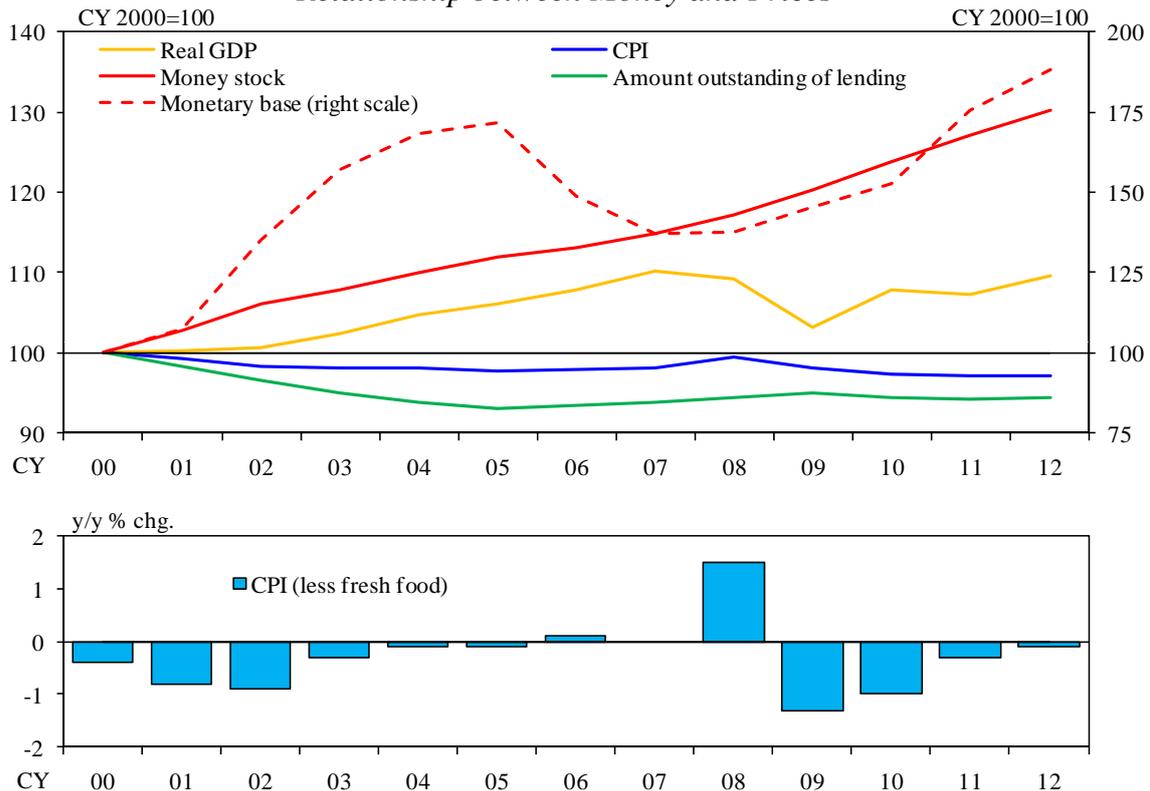
Notes: 1. The nominal effective exchange rate is an indicator that measures the overall value of individual currencies. It is derived by calculating the weighted average of each currency's exchange rate against other currencies using the annual value of each country's trade with its counterparties as its weights.  
 2. The real effective exchange rate is an indicator of a country's overall international competitiveness, calculated as follows. First, each of the exchange rates of the country's currency against other currencies (i.e., nominal exchange rates) is deflated by the price indices of those countries to calculate the real exchange rate. Then, the weighted average of the real exchange rates is calculated using the annual value of each country's trade with its counterparties as its weights.

Sources: Cabinet Office; BIS.

Chart 32

## Money is increasing.

### Relationship between Money and Prices



Sources: Cabinet Office, Ministry of Internal Affairs and Communications; Bank of Japan.

Chart 33

The Bank of Japan has provided considerable funds through large-scale purchases of JGBs. Private financial institutions have been increasing their JGB holdings rather than lending.

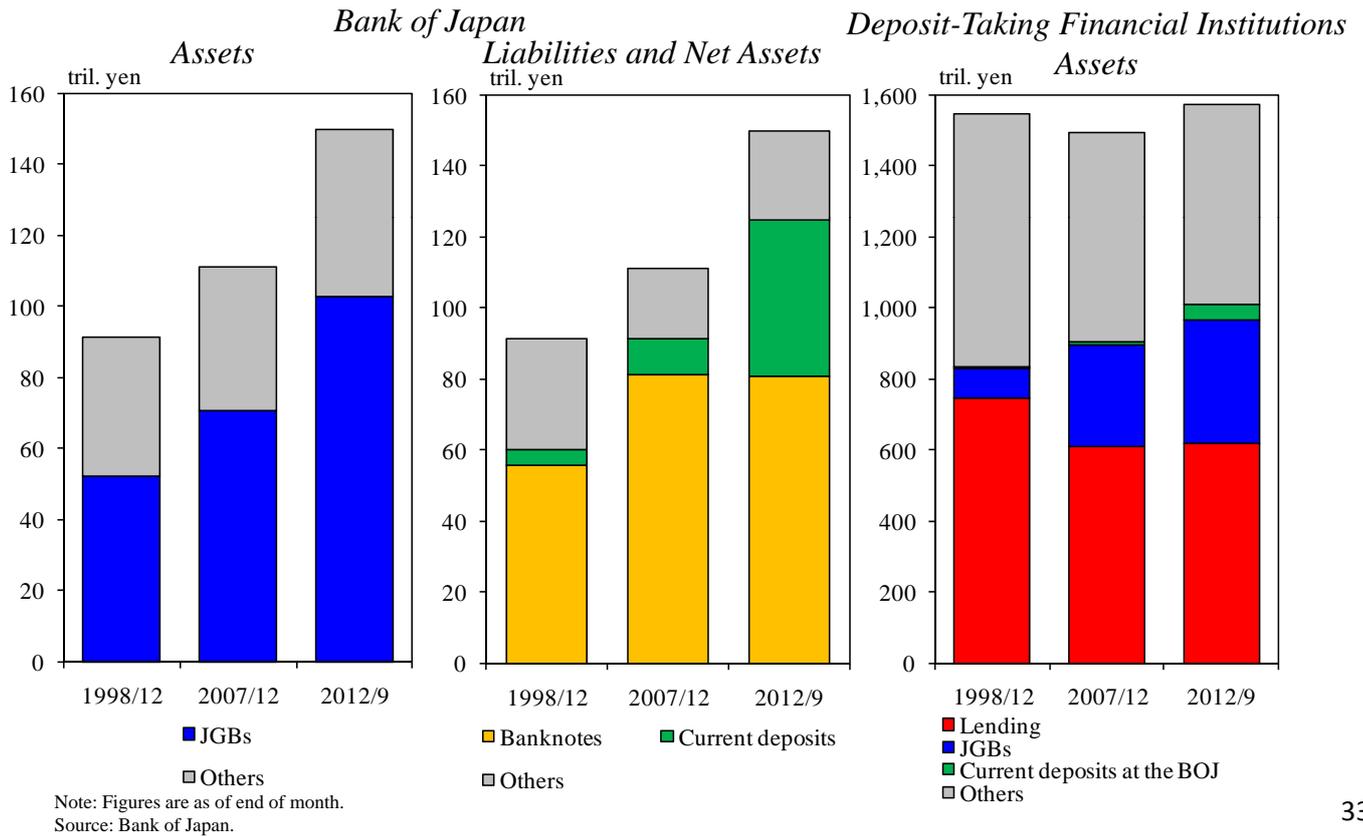


Chart 34

The Bank of Japan will supply additional funds amounting to over 60 trillion yen in the next two years.

