December 4, 2013

Bank of Japan

Recent Economic and Financial Developments, and Monetary Policy

Speech at a Meeting with Business Leaders in Hakodate

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I. Introduction

On April 1, 2013, the Bank of Japan's Hakodate Branch celebrated its 120th anniversary. I would like to take this opportunity to express my sincere gratitude for your long-term cooperation with the activities of the Hakodate Branch. In today's speech, I will begin by focusing on economic and financial developments in Japan and abroad, as well as the Bank's recent monetary policy. I will then touch briefly on the economy of southern Hokkaido. Following my speech, I would like to hear your views on actual conditions in the local economy and on the Bank's conduct of monetary policy.

II. Current Situation of and Outlook for Japan's Economy and the Global Economy

A. Outlook for the Global Economy

The general outlook for the global economy had temporarily become somewhat cautious due to the instability in global financial markets toward this summer. The global economy, however, is expected to gradually improve as global financial markets as a whole have regained stability, despite still showing nervousness.

Specifically, with regard to the direction of U.S. monetary policy, speculation among investors about an earlier-than-expected reduction by the Federal Reserve in the pace of its asset purchases became heightened from around late May 2013. This triggered instability in global financial markets, as evidenced by the simultaneous declines in stock prices, bond prices, and in the value of currencies in some emerging economies. The forecast for global economic growth presented in the *World Economic Outlook* released by the International Monetary Fund (IMF), which had continued to be revised downward in the recent past, was revised further downward in October, mainly for emerging economies (Chart 1). This revision to the global economic forecast was mainly due to the revisions made to the outlook for emerging economies while that for advanced economies as a whole was left unchanged, and this seems to have certain implications for the outlook for the global economy, mainly in terms of risk factors.

More specifically, the U.S. economy is on a recovery path, albeit at a moderate pace, against the background of progress in households' balance-sheet adjustments and an improvement in the housing market. The European economy is starting to pick up against the backdrop of the amendments in the fiscal austerity policy and the bottoming out of business and household sentiment (Chart 2). The Chinese economy has also been expanding at a stable pace from this summer since the authorities -- while taking the stance of pursuing a better quality of economic growth -- have been implementing a small-scale economic package to prevent the economy from slowing down further (Chart 3). Emerging economies' financial markets continue to show nervousness on the whole, but recently have regained stability because the Federal Reserve's reduction in the pace of its asset purchases was postponed (Chart 4). Improvement in the U.S. and European economies, as well as positive developments that are within the scope of stable growth in the Chinese economy, both of which have gradually been exerting positive effects on economies such as those of South Korea and Taiwan, have contributed to somewhat brightening the outlook for the global economy in the short term.

Under such circumstances, regarding risk factors in the short term, I am focusing especially on (1) the outcome of the postponed fiscal problem in the United States and (2) the possible destabilization in global financial markets that may occur at around the time when the Federal Reserve reduces the pace of its asset purchases. Regarding the first factor, the political situation in the United States continues to require vigilance. As for the second factor, I am concerned that, although global market participants have factored in the postponement of the Federal Reserve's reduction in the pace of its asset purchases, the timing of such reduction is uncertain and they continue to speculate on when the Federal Reserve will actually make this move.

In the medium term, I am concerned about the recent disinflationary trends and possible declines in potential growth rates both in the United States and Europe. A disinflationary trend has recently become evident, especially in the euro area (Chart 5). As background to this, the fall-off of the effects of (1) the previous year's energy price hike and (2) the increase in the value-added tax rate is often pointed out. Moreover, there are other factors, such as (1) a decline in wages seen in some peripheral countries; (2) financial institutions' balance-sheet adjustments; (3) the malfunctioning of financial intermediation due to the decline in asset prices; and (4) the sluggish economic activity, which in part reflects the effects of the aforementioned factors. All four of these factors are common to what Japan had experienced during the post-1990s period of deflation.

Although these disinflationary trends have exerted some effects on short-term inflation expectations so far, medium- to long-term inflation expectations remain intact. Such expectations in the United States and the euro area seem to be stable at around 2 percent (Chart 6). In light of Japan's experiences, however, a persistently low inflation rate entails a risk that people's expectations might change, leading to a decline in medium- to long-term inflation expectations in line with the actual inflation rate. Concerns over deflation in the United States are not yet as high as those in the euro area, but I consider it necessary to keep in mind the risk that not only short-term inflation expectations but also medium- to long-term expectations for the United States might decline given that the actual inflation rate has recently been below the level in the Federal Reserve's outlook, partly due to the declining trend in energy prices brought about by the so-called shale gas revolution.

Regarding the potential growth rates that I have raised as another concern for the medium term, it has been pointed out from various quarters that there is a possibility of potential growth rates in advanced economies being somewhat lower than those before the 1990s, in reflection of the slowdown in the pace of increase in labor input and in technological innovation.[1] The recent growth rates in emerging economies are lower than those prior to the Lehman shock, and there is much argument on whether the low growth rates are caused by cyclical or structural factors. If the decline in the potential growth rates has not been particularly significant, the current disinflationary trends seen in the United States and the euro area are due to the slack persisting in production capacity and in the labor market. And thus it can be said that the disinflationary pressure will start to weaken as this slack dissolves. But another interpretation is that the recent decline in the potential growth rates caused not only a decline in the natural rate of interest, but also a decline in the inflation rate that is consistent with developments in the natural rate of interest.

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[1] For a recent example, see Dave Reifschneider, William Wascher, and David Wilcox, "Aggregate Supply in the United States: Recent Developments and Implications for the Conduct of Monetary Policy," Finance and Economics Discussion Series 2013-77, Federal Reserve Board, November 2013.

As I have stated, depending on how the potential growth rates are understood, the inflation outlook -- and consequently the implications for macroeconomic policy -- can change. In this sense, the change in the Federal Reserve's communication regarding the aforementioned reduction in the pace of its asset purchases is noteworthy. Let me explain this in detail. Although the Federal Reserve uses the unemployment rate and inflation rate as major benchmarks to determine the reduction in the pace of its asset purchases, it had seemed to me that, considering the series of messages from the Federal Reserve, it did not initially place much emphasis on the fact that the actual inflation rate remained below the longer-run goal it had set. However, it caught my attention that the Federal Reserve pointed not only to the general economic situation and fiscal problem as the reasons for postponing the reduction in the pace of its asset purchases in September 2013, but also to the inflation rate undershooting its longer-run goal. Also, I find it interesting that the Governing Council of the European Central Bank (ECB) surprisingly decided to reduce its policy rates in November on the grounds that the inflation rate had declined by more than it expected, and that it revised the price outlook downward. Central banks in major economies are seeking the optimal policy mix in a low-inflation environment, but it looks as though they are on a path similar to the one that the Bank has followed for years to this point.

B. Outlook for Japan's Economy

Japan's economy has been recovering moderately. While it will be affected by the two scheduled consumption tax hikes, the economy is likely to continue growing at a pace above its potential, as a trend, on the assumption that the global economy will follow a moderate growth path (Chart 7).

I would like to explain this assessment of the current situation of and outlook for Japan's economy in line with the baseline scenario presented in the *Outlook for Economic Activity and Prices* (hereafter the Outlook Report) released on October 31, 2013. Japan's economy registered high growth of around 4 percent on an annualized basis in the first half of 2013. This growth was led by strong domestic demand; for example, (1) public investment continued to increase as positive effects of various economic measures came to take hold fully and (2) private consumption remained resilient, reflecting an improvement in consumer sentiment supported by the depreciation of the yen and a rise in stock prices. According to the first preliminary estimate for the July-September quarter of 2013, the real GDP growth rate decelerated after recording high annualized growth rates of around 4 percent for two consecutive quarters, mainly due to a decrease in exports, with private consumption being more or less flat on the whole. Since the turn of 2013, exports have been picking up at a somewhat slower pace, reflecting signs of weakness observed in some emerging economies, and there has been a contrast between the performance in domestic and external demand. In this regard, the current economic recovery is quite unique compared to the recovery phases after World War II, which typically were led by increases in exports and production. However, in the short term, exports are expected to increase moderately thanks to a pick-up in overseas economies, and domestic demand is likely to retain its resilience due to the front-loaded increase in demand prior to the consumption tax hike. In this situation, real GDP growth rates are expected to rise again from the October-December quarter of 2013 through the January-March quarter of 2014, and the real GDP growth rate for fiscal 2013 is expected to reach close to 3 percent.

The growth rate for fiscal 2014 is likely to dip temporarily in the April-June quarter due to a decline in demand subsequent to the front-loaded increase in the previous quarters. However, I do not expect an economic downturn such as what we experienced at the time of the previous consumption tax hike in 1997. This is because the current economic situation differs in some aspects from that of the previous tax hike. Specifically, (1) the government is preparing an economic package with a total size of about 5 trillion yen; (2) emerging economies, some of which suffered from simultaneous declines in stock prices, bond prices, and in the value of their currencies this year, are becoming resilient to negative shocks compared to 1997, when the Asian currency crisis occurred, due to the establishment of backstops such as the accumulation of foreign reserves; and (3) Japan's financial system has been stable as a whole. Given these factors, domestic demand is likely to maintain firmness as external demand is expected to increase. After the second half of fiscal 2014, Japan's economy is likely to continue growing at a pace above its potential as a virtuous cycle among production, income, and spending will be maintained. The median of the Policy Board members' forecasts for fiscal 2014 remains more or less unchanged from that in the July 2013 interim assessment. This is because foreign and domestic factors are expected to offset each other; while a decline in the forecast for global economic growth, mainly for emerging economies, as shown in the IMF's *World Economic Outlook* released in October 2013, will exert negative effects on Japan's external demand, the government's economic package will produce positive effects on the economy. Another consumption tax hike is expected in October 2015, but the background to the economic outlook for fiscal 2015 remains basically the same as that for fiscal 2014, and the median of the Policy Board members' forecasts for fiscal 2015 is unchanged from that in the July 2013 interim assessment.

It should be noted, however, that this economic outlook is based on the assumption that global financial markets will remain stable on the whole. Specifically, (1) the reduction in the pace of asset purchases by the Federal Reserve, which was postponed once, will be smoothly executed and will not cause turmoil in global financial markets; (2) international commodity markets will remain stable despite retained geopolitical risks in the Middle East; (3) the European sovereign debt problem will not cause turbulence in the financial markets; and (4) the U.S. economy will not experience turmoil stemming, for example, from a long-term government shutdown or default on government debt. If any of these assumptions collapses, this would affect Japan's economy to a considerable degree through turmoil in global financial markets. In addition, I personally would like to keep paying close attention to the possibility of declining potential growth rates in major economies, including the U.S. economy, and the associated disinflationary trends in the U.S. and European economies.

C. Outlook for Prices in Japan

As revealed in the minutes of the Monetary Policy Meeting held on October 31, 2013, I cast a dissenting vote regarding the descriptions of the outlook for prices in the Outlook Report, so I may not be in the right position to explain the baseline scenario of the outlook for prices in Japan. Thus, in the following section, I would like to express my views on prices by pointing out the main differences between my views and the baseline scenario.

Looking back at price developments up to the present, the year-on-year rate of change in the consumer price index (all items less fresh food; hereafter prices) has been moving in line with the baseline scenario against the backdrop of the depreciation of the yen, the hike in energy prices, and bottoming out in prices of digital appliances. Prices have already risen to close to 1 percent.

However, the effects of these factors are likely to wane after having hit the peak in the July-September quarter of 2013, if we assume that foreign exchange rates and energy prices will be unchanged from the current level. Thus, even if the effects on prices of improvement in the output gap due to the high economic growth in the first half of 2013 appear in fiscal 2014, it seems unrealistic to expect prices to continue rising significantly above the 1 percent level achieved in fiscal 2013 given the recent flattened Phillips curve (Chart 8). This is why my outlook for prices for fiscal 2014 and 2015 is weaker than the median of the Policy Board members' forecasts.

Of course, my cautious outlook for prices also contains upside risks. After the bursting of the bubble economy, Japan rarely experienced an "inflationary period" in which prices exceeded the 1 percent level on a year-on-year basis, except for a period of time in 2008. The cases of prices exceeding 1 percent were only temporary because these were examples of cost-push inflation caused by the depreciation of the yen and high energy prices. Accordingly, inflation expectations did not shift upward at that time. If inflation of around 1 percent lasts for a certain period, the expectation formation of households, firms, and markets might change, leading to a significant upward shift in inflation expectations. This is because such expectations tend to be adjusted by the actual inflation rate.

This holds true in the case of relatively short-term inflation expectations, however, and it is highly uncertain whether a short-term rise in the actual inflation rate could affect medium- to long-term inflation expectations (Chart 9). On top of that, given that short-term inflation expectations might have become stickier due to the deflation that has lasted for nearly 15 years, there is greater uncertainty over long-term inflation expectations.

The results of various surveys conducted on households, firms, economists, and bond market participants reveal a rise in their inflation expectations as a whole. However, in most of these surveys, it is hard to discern accurately the degree to which this is caused by the increasing probability of the consumption tax hikes. As for breakeven inflation (BEI) rates -- that is, the expected inflation rates calculated from the yield differentials between fixed-rate and inflation-indexed bonds -- my personal view is that these rates are not necessarily appropriate for representing the inflation expectations of Japan's economy or financial markets as a whole. This is because BEI rates are also susceptible to the aforementioned consumption tax hike problem. In addition, (1) they are possibly affected by changes in the liquidity risk premium on inflation-indexed bonds to a non-negligible degree due to the limited market liquidity of those bonds, and (2) BEI rates are also affected by the inflation expectations of some foreign investors who expect a rise in inflation (Chart 10). The BEI rates of 10-year inflation-indexed bonds with a guarantee at maturity (deflation floor) issued from October 2013 have been around 100 basis points. It is worth noting that the BEI rates calculated by these bonds will remain at such a low level for the next ten years even with the two consumption tax hikes in 2014 and 2015 totaling 5 percentage points.

Regarding upside risks to the price outlook, I am paying close attention to wage developments as well. Labor unions tend to put emphasis on maintaining their employee headcount rather than increasing wages. Given this, it is a striking change to see both the progress of three-way discussions among the government, employers, and labor unions and the evidence that some business leaders who are influential in industry have recently taken a positive stance toward raising base salaries, reflecting the government's persuasive efforts. It is an important first step for the discussions to work as a catalyst to change the negative expectations that "wages will not increase" into positive ones.

However, in order to change people's expectations, it is important that an increase in base salaries should not merely be a one-time event but continue for several years, and/or that people form expectations for such a continuation. Taking into consideration the structural downward pressure on scheduled cash earnings that stems from the recent increase in the number of part-time employees who work for short hours and the rising trend in the ratio of part-time employees to total employment, it is doubtful whether a rise in base salaries, mainly of full-time employees at some large firms, will constitute a significant wage rate hike from a macroeconomic viewpoint (Chart 11). Some statistics show that the share of large firms' personnel expenses to total personnel expenses accounted for only about 25 percent in Japan as of fiscal 2012 (Chart 12).

It is also worth mentioning the image of the labor market if wages were to increase considerably in Japan, even if such increases are made mostly by large firms. The wage Phillips curves for Japan and the United States -- with the unemployment rate on the x-axis and the wage inflation rate on the y-axis -- imply the possible changes that could occur in the labor market when wages increase considerably in Japan (Chart 13).

Generally speaking, in the United States, if employment adjustments are needed, firms cut their employee headcount instead of wages in order to close unprofitable businesses in an expedient manner. As a result, nominal wages continue to grow at a rate of about 2-4 percent irrespective of the phase of the economic cycle, and the U.S. economy has a structure that makes it hard to fall into deflation, since excess labor supply is unlikely to be maintained. In Japan, on the contrary, employment adjustments through dismissals have been limited so far, and adjustments in personnel expenses have been executed mostly through wage reductions. This means that the Japanese labor market has a structure whereby the consolidation and reorganization of inefficient businesses tend to take longer and the share of labor in income distribution tends to remain at a high level; this slows the economy's metabolism and allows excess labor supply to be retained. Thus, in Japan, sharing the cost of employment adjustments thinly and broadly in the labor market seems to be a factor of mild deflation.

In order to realize sustainable increases in base salaries in Japan regardless of the economic situation, business leaders should be aware that they will have to face an increase in fixed costs, particularly during a recession. This might increase their incentives to cut employees, although not as drastically as in the United States, to realize increases in base salaries and avoid a rise in fixed costs at the same time. As a consequence, these moves might lead to an increase in volatility in the unemployment rate. In this case, the wage Phillips curve for Japan may flatten as in the United States; that is, increases in fixed costs might be adjusted using the employee headcount rather than wages.

Taking into account these points, sustainable increases in nominal wages may raise the inflation expectations of households, firms, and market participants, turn people's deflationary mindset toward positive inflation expectations, and lead to overcoming deflation becoming more likely. At the same time, however, it should be noted that the social cost of employment adjustments might increase due to heightened volatility in the unemployment rate. There is no free lunch, because an increase in wages boils down to the problem of how to distribute national income between compensation of employees and operating surplus. Economic growth is therefore indispensable to raising wages in a society as a whole (Chart 14).

III. Recent Conduct of Monetary Policy

A. Pursuing Quantitative and Qualitative Monetary Easing

It has been eight months since the Bank introduced quantitative and qualitative monetary easing (QQE) on April 4, 2013. Since then, Japan's economic activity and prices have basically followed the expected path, in line with the baseline scenario in the Outlook Report. It should be noted that, although price developments have started to become upbeat, the inflation rate has only risen to close to 1 percent. Given the downside risks that I mentioned earlier, we are only halfway to realizing the price stability target. The Bank will continue with QQE steadily, with the aim of achieving the price stability target of 2 percent (Chart 15).

With regard to the relationship between the economic outlook and monetary policy, the median of the Policy Board members' forecasts for economic activity provided in the October 2013 Outlook Report factors in the effect of the two scheduled consumption tax hikes. Japan's economy is likely to continue to see high growth at a pace above its potential through fiscal 2014 and 2015, even taking into account temporary declines due to the consumption tax hikes. As long as the effect of the consumption tax hikes on the real side of the economy is projected to be just a temporary swing in demand and within the scope of the Bank's expectations, the Bank will not have to launch any additional preemptive measures.

Let me turn to the relationship between the price outlook and monetary policy. There is a large gap between the baseline scenario in the Outlook Report and market consensus, and many market participants seem to be expecting that a future downward revision to the baseline scenario will trigger further strengthening of the monetary easing. It might not be appropriate for a policymaker to make comments on every single view held by market participants, but let me say just a few words to avoid any misunderstanding. The Bank does not assume a particular linear path toward reaching the 2 percent inflation rate. For example, the 1.3 percent inflation rate, which is the median of the Policy Board members' forecasts for fiscal 2014 presented in the Outlook Report, is not an intermediate target toward achieving the 2 percent target. It should also be noted that, with implementation of QQE, the Bank intends to shift people's expectations via a marked change in its monetary policy through an initial bold move, after which it would adopt a wait-and-see stance to carefully monitor the permeation of policy effects. This means that the Bank is breaking away from the incremental approach adopted under the comprehensive monetary easing. That being said, I understand that this is the time to carefully monitor the emergence of policy effects, taking account of the future economic and price conditions.

It should also be noted that, on April 4, the Bank took all possible policy measures that would be available for the time being. Therefore, additional easing measures, if any, could be counterproductive in terms of shifting people's expectations. It is true that the Bank has reiterated in its statement released after Monetary Policy Meetings that it "will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate." My understanding is that the downside risks described here refer to tail risks, including significant turbulence in global financial markets that would be comparable to the Lehman shock and the European sovereign debt crisis, and do not concern such trivial matters as a small divergence of the outlook for economic activity and prices from the baseline scenario.

B. Price Stability Target and Conduct of Monetary Policy

Although I cast a dissenting vote on the introduction of the price stability target at the January 2013 Monetary Policy Meeting, I have approved of the policy commitment regarding the target since April, with the exception of the description of the price outlook in the Outlook Report. This is because I understand that the price stability target should be regarded as a flexible framework, and that it is not necessary to consider 2 percent as a rigid target.

Let me elaborate on this point. As noted in the policy statement, "the Bank will continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner." In terms of "aiming to achieve the price stability target" and "maintaining that target in a stable manner," it is almost impossible to stably maintain the inflation rate specifically at 2 percent, given the time lag required for the permeation of monetary policy effects and uncertainty regarding such permeation. Rather, the 2 percent price stability target should be regarded as a flexible concept in which there is an allowance for a certain range for upward and downward deviations of the actual inflation rate from the target, similar to other central banks' frameworks of inflation targeting. In this regard, the Bank does not intend just to achieve the 2 percent price stability target at all costs, but instead aims to bring about a situation where the national economy achieves sound development and prices rise moderately in a balanced manner as improvement in the employment situation brings wage hikes. I understand that the 2 percent price stability target should be regarded as representing such a desirable situation.

C. Challenges Related to Forward Guidance

As any policy is accompanied by both pros and cons, a policy is carried out based on the judgment that the former will surpass the latter. Similarly, as shown in the minutes of the Monetary Policy Meeting on April 3 and 4, 2013, QQE was decided after carefully weighing the associated pros and cons. This weighing reflects the subjective value judgments, and therefore some who put emphasis on the adverse effects of QQE criticize it as reckless because it was decided without discussions on an exit strategy. Others point out that the Bank should explain more clearly the path to an exit -- that is, provide clearer forward guidance.

Although these criticisms and comments are somewhat understandable, one of the purposes of QQE is to shift people's expectations, which had been diminished by the chronic deflation. Discussions on an exit strategy at this point could lead to a contradiction of this policy intention. In other words, discussing an exit strategy when launching a new policy could create the same situation as making fire with one hand while at the same time extinguishing it with the other. It should also be noted that, as evidenced by the Federal Reserve's decision in September 2013 to postpone the reduction in the pace of its asset purchases, efforts to enhance policy transparency and secure policy flexibility may create a tradeoff. That is, improving transparency does not necessarily yield desirable results. Rather, too much information from a central bank might be difficult for market participants to digest, and could eliminate the central bank's flexibility in responding to a change in economic and price conditions. Based on this idea, I am of the position that the Bank should show its guidance in a flexible and appropriate manner in response to changes in the outlook for economic and price conditions.

I should note that the Bank's current attempt -- namely, aiming to achieve the 2 percent price stability target within about two years to overcome deflation -- is unprecedented. This attempt to push up the inflation rate within a fixed timeframe is completely different from the conventional philosophy of forward guidance, which expects to influence longer-term interest rates by committing to continuing monetary easing as long as necessary and thereby bringing forward future demand. Thus, it is not appropriate to categorize the Bank's current monetary policy as "traditional" forward guidance, as currently implemented by other central banks such as the Federal Reserve and the ECB (Chart 16).

In addition, forward guidance entails the dynamic inconsistency problem (or time inconsistency problem) -- that is, even if a central bank commits to continuing the policy as long as necessary, this commitment might be broken at some point. The notable example is that global financial markets became unstable after Chairman Bernanke of the Federal Reserve indicated a specific schedule for reducing the pace of its asset purchases in late May 2013. In this regard, other major central banks that adopt unconventional monetary policies are facing new challenges as to how to ensure the effectiveness of their forward guidance. That is to say, these central banks will keep trying to determine what kind of commitment is needed to make the public and market participants believe that such commitment will be fulfilled.

D. Toward Accumulating the Monetary Base

The Bank has disclosed its monetary base target and balance sheet projections up until the end of 2014 as part of its efforts to achieve the price stability target with a time horizon of about two years. According to the projections, the expected amounts outstanding of the monetary base and Japanese government bonds (JGBs) at the end of 2014 are around 270 trillion yen and around 190 trillion yen, respectively. The amounts outstanding of both the monetary base and JGBs have been accumulated almost in line with the Bank's projections, and they are within range of reaching the amounts projected for the end of 2013, to 200 trillion yen and 140 trillion yen, respectively (Chart 17).

However, whether or not the Bank will be able to accumulate the target amount of the monetary base as expected depends on the stance of financial institutions with regard to making bids for the Bank's market operations. This stance could change, reflecting not only economic factors, such as economic and financial developments as well as current and future levels of interest rates, but also non-economic factors; for example, the extent to which financial institutions are allowed to increase their current account deposits at the Bank from the viewpoint of their investor relations policies. Therefore, there is substantial uncertainty over the future accumulation of the monetary base in a situation where financial institutions already hold huge amounts of excess reserves at the Bank. Moreover, this uncertainty will heighten as the level of excess reserves increases. In other words, QQE is not a kind of monetary policy that can be continued forever. Despite these difficulties, the Bank will address any challenges and accumulate the amount outstanding of the monetary base to accomplish the commitment it announced on April 4, 2013. I appreciate your kind understanding regarding the Bank's efforts.

IV. Concluding Remarks

Lastly, I would like to touch on economic activities in southern Hokkaido. This region is rich in tourism resources including Hakodate, a popular tourist destination in Japan, as well as Lake Onuma at the base of Hokkaido-Komagatake, which is one of the so-called new three views of Japan. There is also a fishing ground -- one of the major grounds in Japan -- that is surrounded by four bodies of water: the Sea of Japan, Tsugaru Strait, the Pacific Ocean, and Funka Bay. Southern Hokkaido is also blessed with mild weather compared with other regions in Hokkaido, owing to the warm ocean currents. Taking advantage of these rich resources, this region has a competitive edge in tourism, fishery, and agricultural industries. The manufacturing sector, which includes (1) seafood processing that utilizes marine resources; (2) ceramics, stone, and clay products taken from limestone quarries; and (3) a shipbuilding industry with the largest dock in Hokkaido, also underpins the economy by making the most of the regional characteristics.

At the same time, I hear that the economy of southern Hokkaido faces the challenges of an aging population and a population drain from the region, and thus developing a growth strategy that takes advantage of regional strengths and implementing such strategy promptly have been urgent matters. Efforts in this regard are already underway, such as attracting foreign visitors from other Asian countries, hosting various conventions and events that make the most of regional characteristics, activating the urban district of Hakodate, and developing a support system for exporting high-quality agricultural and marine products. In the meantime, the start of operations for the Hokkaido Shinkansen line in fiscal 2015 is expected to have a large impact on the region's economy. To take advantage of this opportunity, the private and public sectors have already started making joint efforts to promote the tourism industry with a view to fostering future cooperation with Aomori Prefecture.

In the medium- to long-term perspective, there have already been discussions about creating new industries and employment, such as (1) research regarding the marine energy business that utilizes the tidal currents of Tsugaru Strait and (2) the Hakodate Marine Bio Cluster program -- a joint project by industries, government, and academia to enhance the value of marine resources in the region through technological innovations. To support these efforts, it is encouraging that financial institutions in this area are actively engaged not only in financing but also in providing solutions, such as business matching services. I hope each effort based on your ingenuity and hard work bears fruit, and that southern Hokkaido will achieve prolonged economic growth.

Charts

Speech at a Meeting with Business Leaders in Hakodate

Notes: Charts are based on data released on or prior to November 29, 2013.

Outlook for the Global Economy

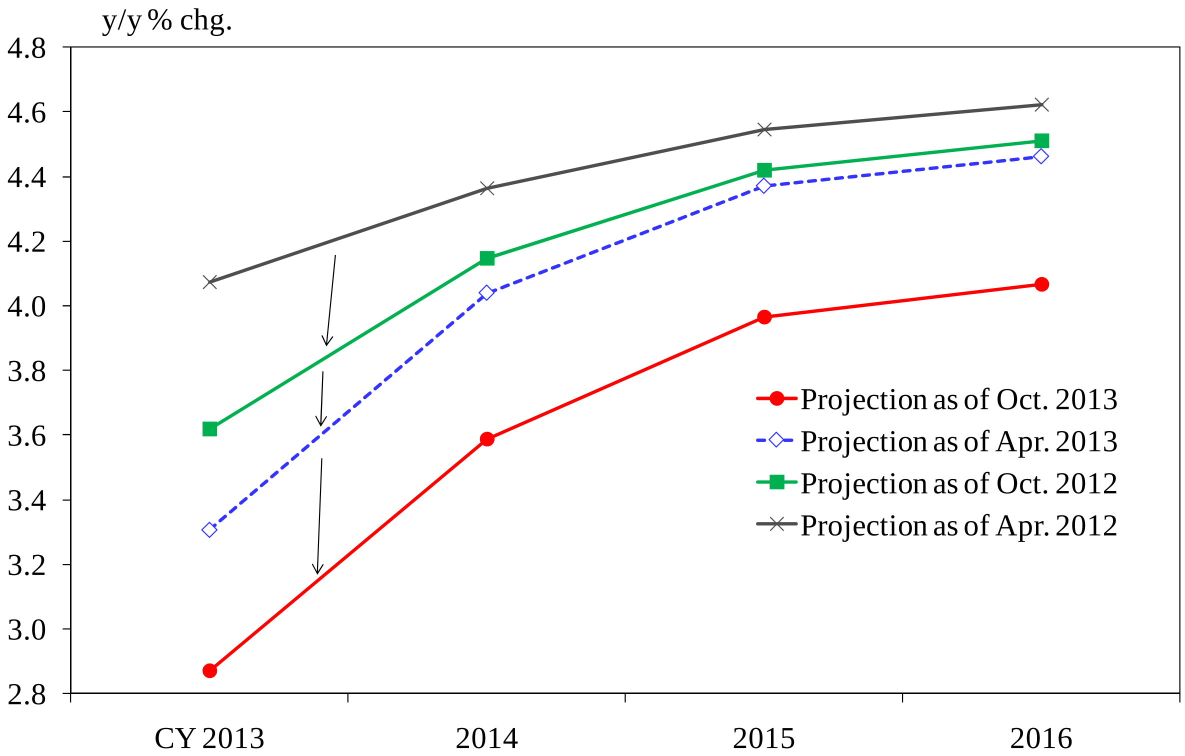
(1) IMF Projections (as of October 2013)

real GDP growth rate, y/y % chg.

CY	2011	2012	2013 projection	2014 projection
World	3.9	3.2	2.9 (-0.3)	3.6 (-0.2)
Advanced economies	1.7	1.5	1.2 (0.0)	2.0 (0.0)
United States	1.8	2.8	1.6 (-0.1)	2.6 (-0.2)
Euro area	1.5	-0.6	-0.4 (0.1)	1.0 (0.0)
Japan	-0.6	2.0	2.0 (-0.1)	1.2 (0.1)
Emerging market and developing economies	6.2	4.9	4.5 (-0.5)	5.1 (-0.4)
Developing Asia	7.8	6.4	6.3 (-0.6)	6.5 (-0.5)
China	9.3	7.7	7.6 (-0.2)	7.3 (-0.4)
Brazil	2.7	0.9	2.5 (0.0)	2.5 (-0.7)

Notes: 1. Figures are calculated using GDP based on purchasing power parity (PPP) shares of the world total from the International Monetary Fund.
2. Figures in parentheses are the difference from the July 2013 *World Economic Outlook* projections.

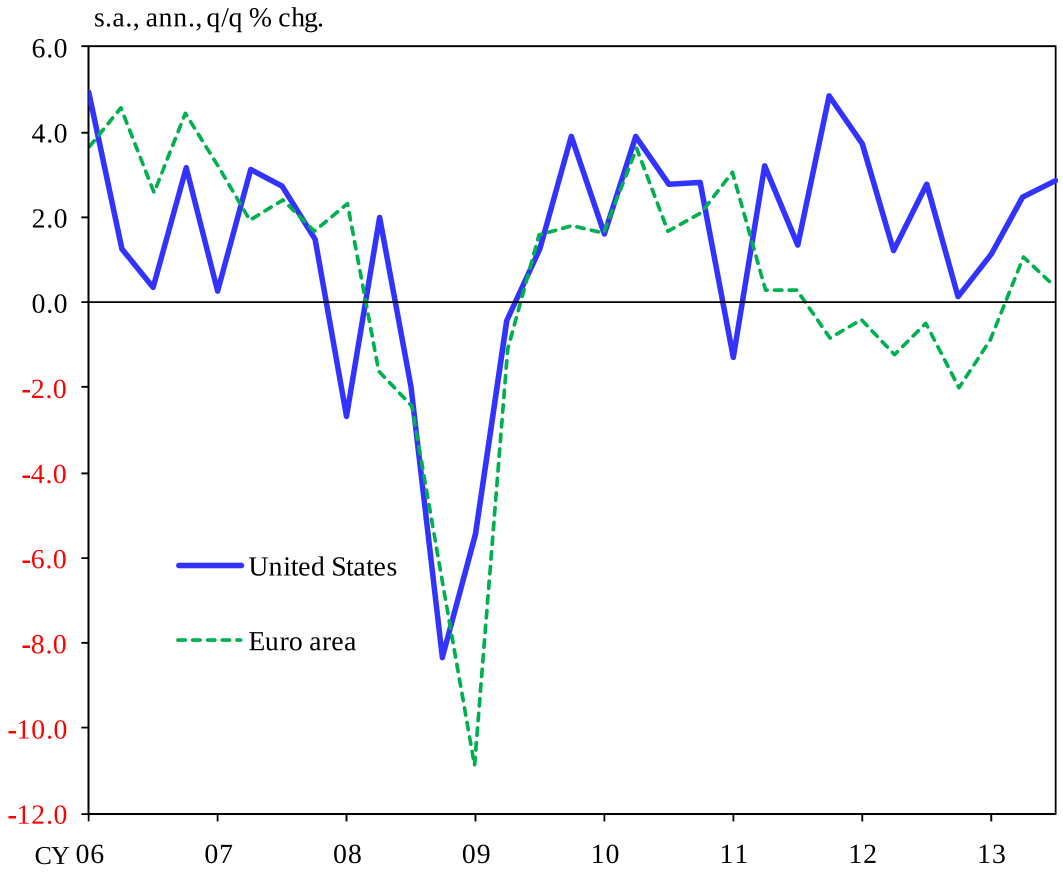
(2) Transition in IMF Projections



Source: International Monetary Fund.

Economic Developments in the United States and the Euro Area

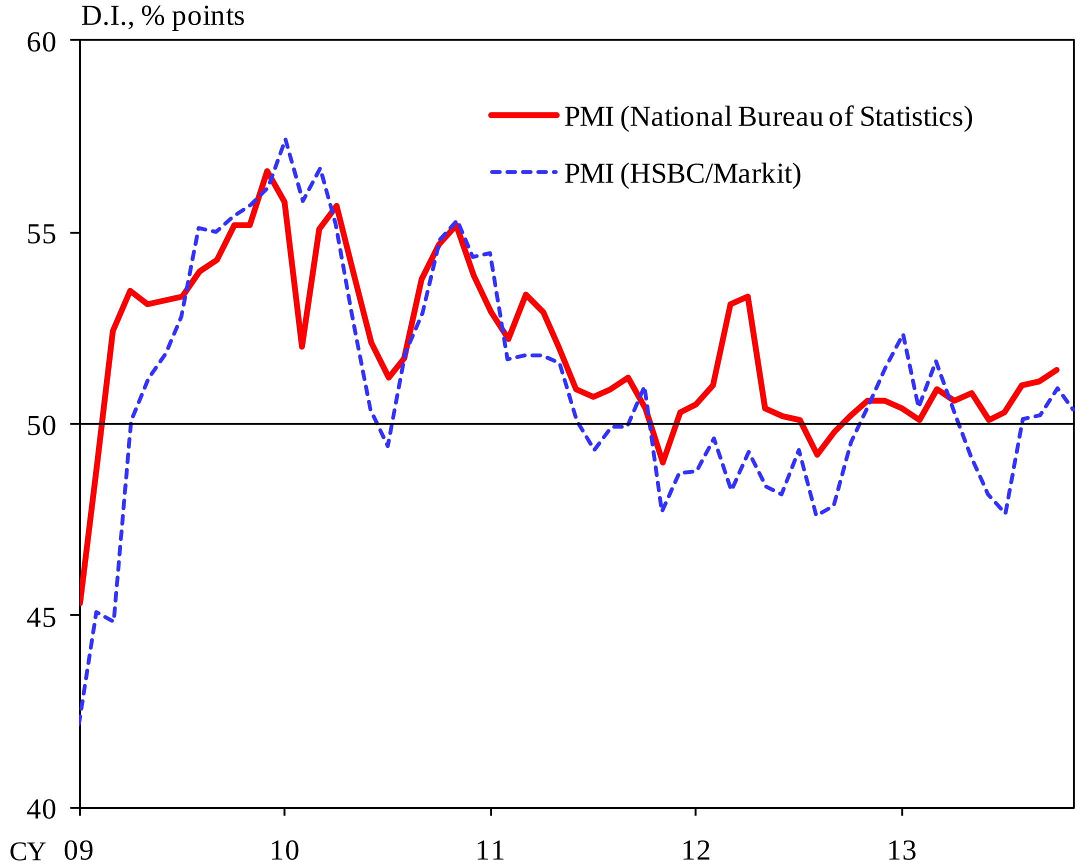
Real GDP Growth Rates in the United States and the Euro Area



Sources: U.S. Bureau of Economic Analysis; Thomson Reuters.

Economic Developments in China

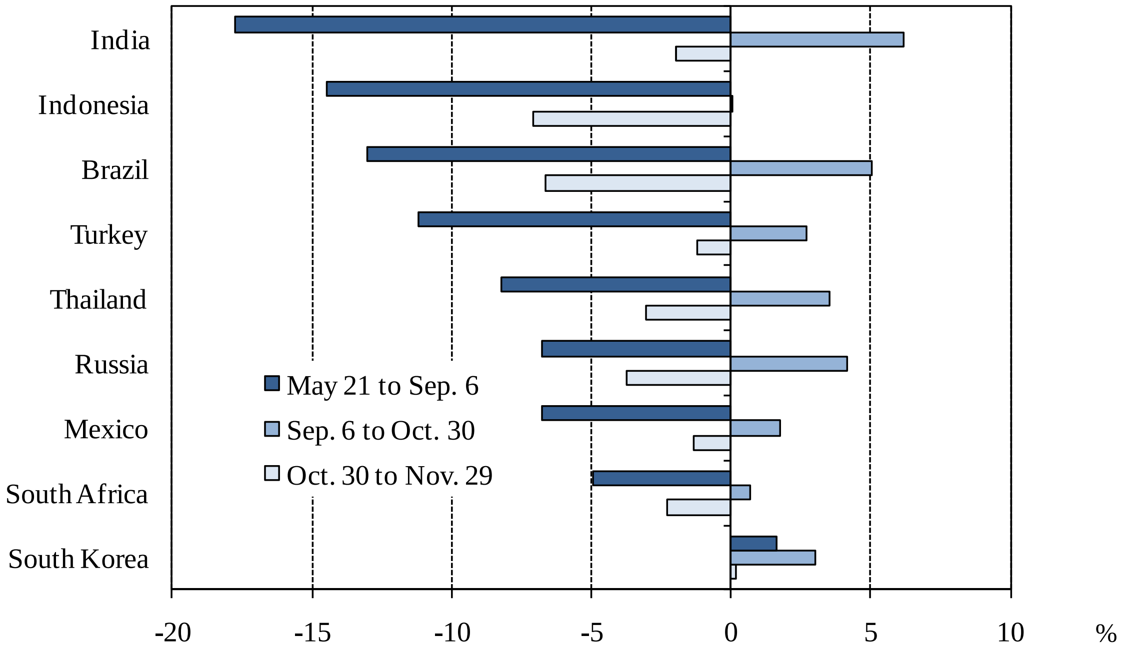
Manufacturing PMI in China



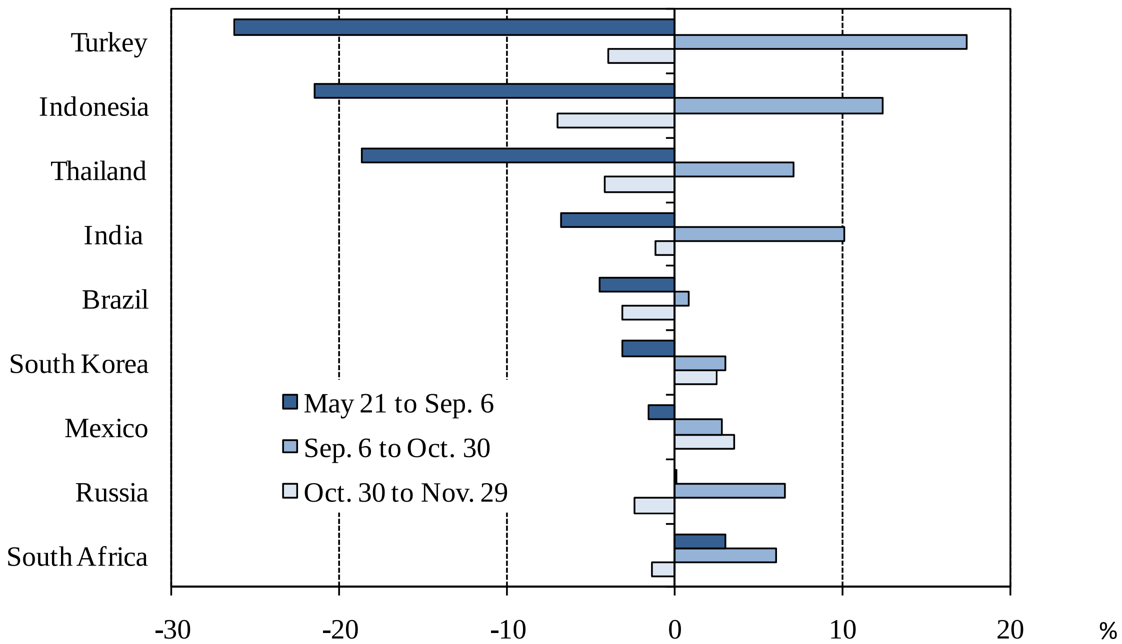
Sources: CEIC Data; Markit (© and database right Markit Economics Ltd 2013. All rights reserved).

Exchange Rates and Stock Prices in Emerging Economies

(1) Rate of Change in Selected Currencies against the U.S. Dollar



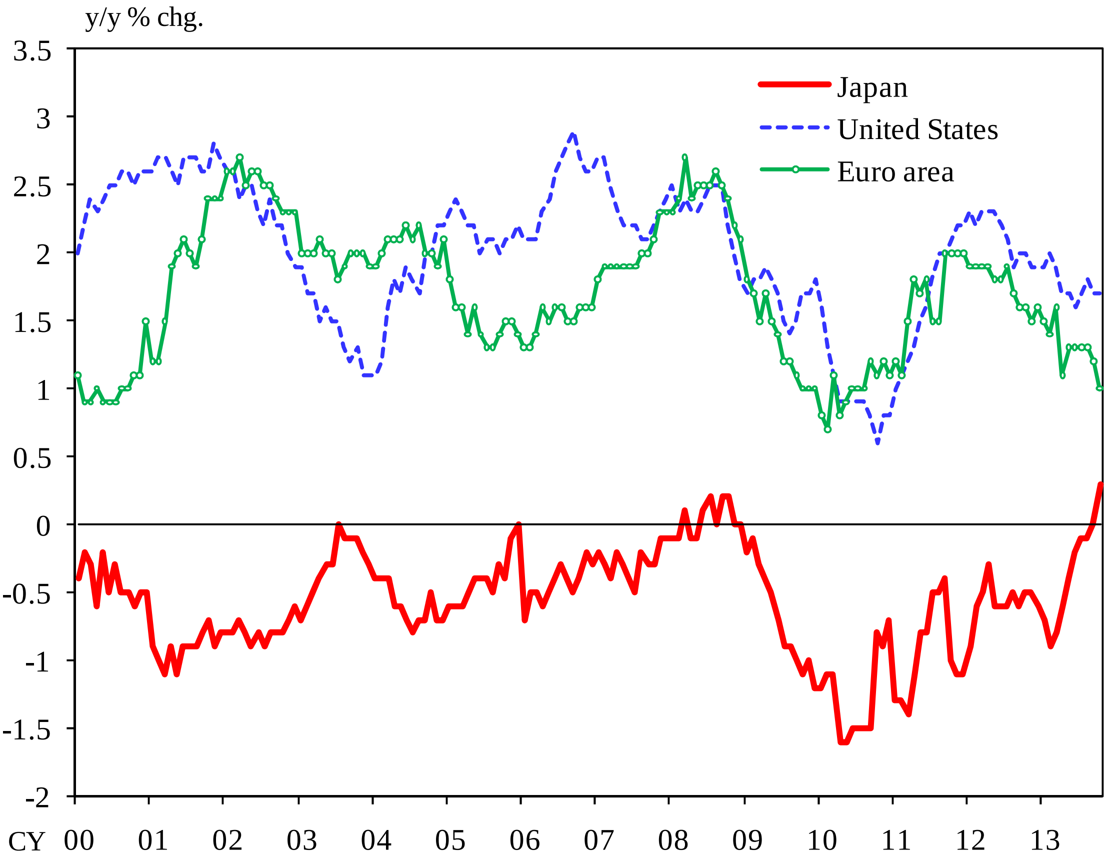
(2) Rate of Change in Selected Stock Prices



Source: Bloomberg.

Inflation Rates in Major Economies

Core CPI Inflation Rates in Japan, the United States, and the Euro Area

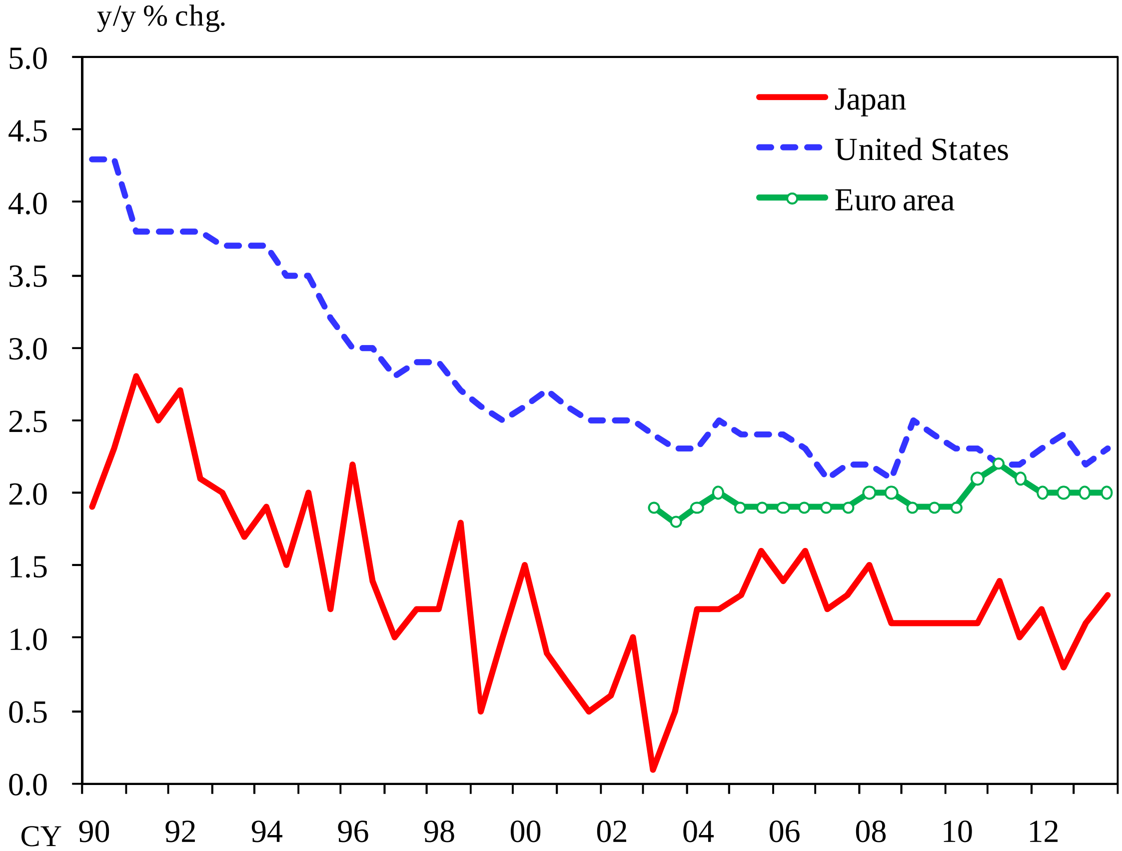


Note: The core CPI in the United States includes all items excluding food and energy. The core CPI in the euro area includes all items excluding energy and unprocessed food. The core CPI in Japan includes all items less food (less alcoholic beverages) and energy.

Sources: Ministry of Internal Affairs and Communications; Eurostat; Bloomberg.

Medium- to Long-Term Inflation Expectations in Major Economies

CPI Projections for 6-10 Years Ahead <Consensus Forecasts>



Note: Survey is conducted every April and October.

Source: Consensus Economics Inc.

"Outlook for Economic Activity and Prices" (as of October 2013)

Forecasts of the Majority of Policy Board Members

y/y % chg.

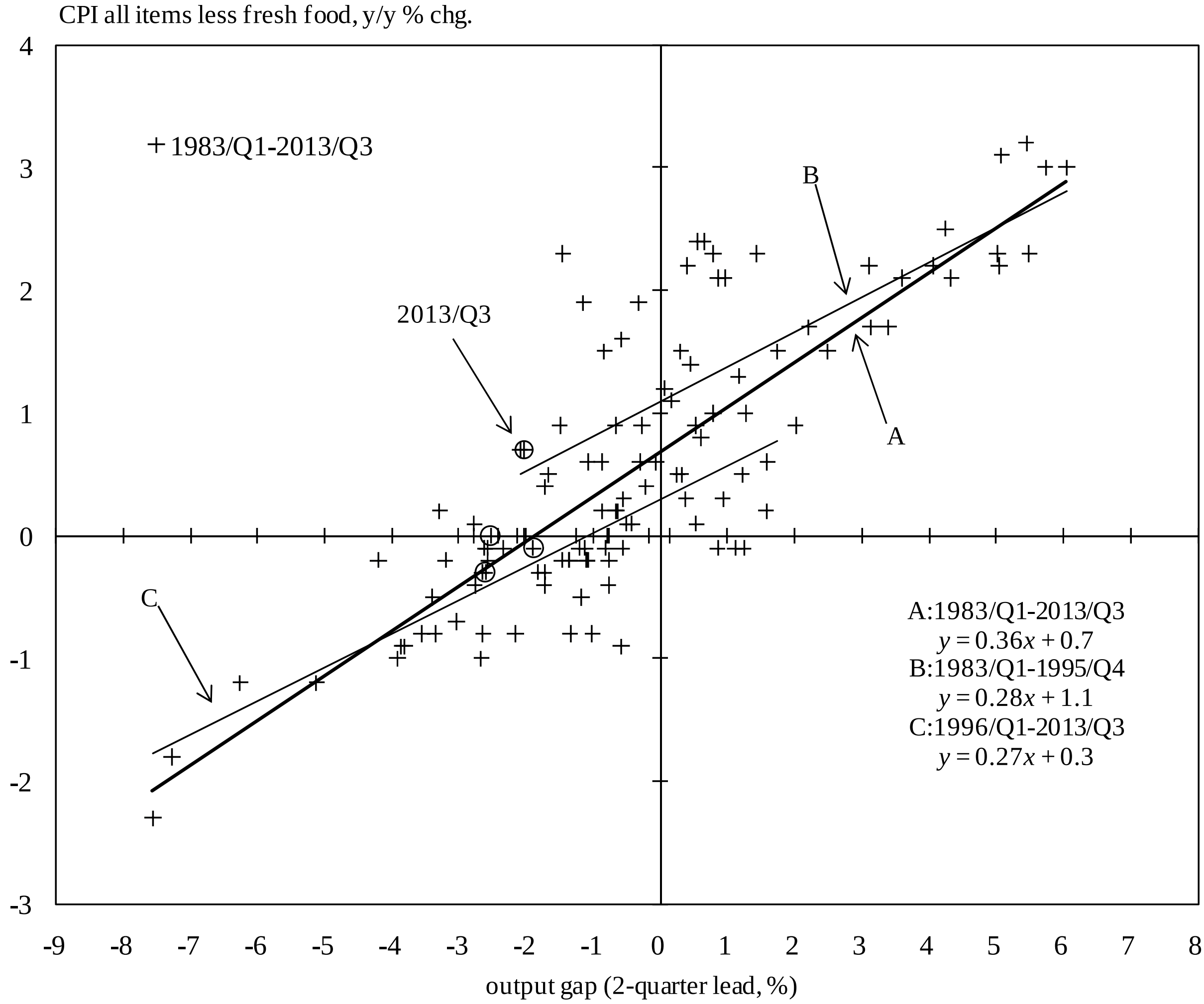
	Real GDP	CPI (all items less fresh food)	Excluding the effects of the consumption tax hikes
Fiscal 2013	+2.6 to +3.0 [+2.7]	+0.6 to +1.0 [+0.7]	
Forecasts made in July 2013	+2.5 to +3.0 [+2.8]	+0.5 to +0.8 [+0.6]	
Fiscal 2014	+0.9 to +1.5 [+1.5]	+2.8 to +3.6 [+3.3]	+0.8 to +1.6 [+1.3]
Forecasts made in July 2013	+0.8 to +1.5 [+1.3]	+2.7 to +3.6 [+3.3]	+0.7 to +1.6 [+1.3]
Fiscal 2015	+1.3 to +1.8 [+1.5]	+1.6 to +2.9 [+2.6]	+0.9 to +2.2 [+1.9]
Forecasts made in July 2013	+1.3 to +1.9 [+1.5]	+1.6 to +2.9 [+2.6]	+0.9 to +2.2 [+1.9]

Note: Figures in brackets indicate the median of the Policy Board members' forecasts (point estimates).

Source: Bank of Japan.

Phillips Curve

Phillips Curve (CPI All Items Less Fresh Food)



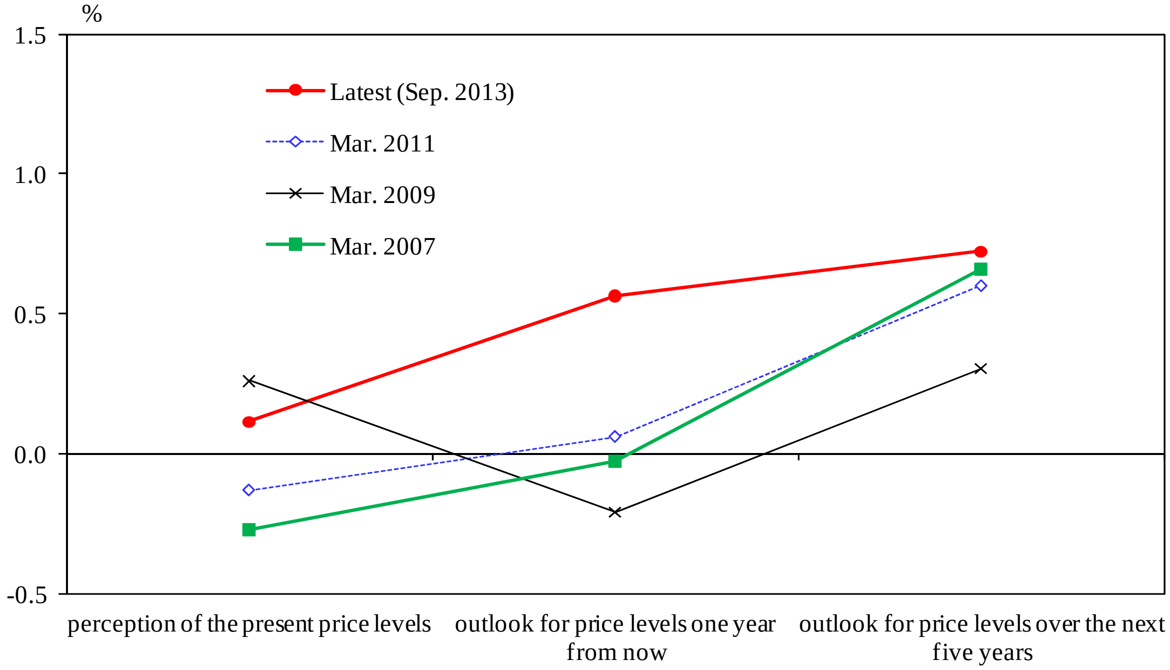
Notes: 1. The circled marks are the latest four positions.

2. Figures for the CPI are adjusted to exclude the effect of changes in the consumption tax rate.

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

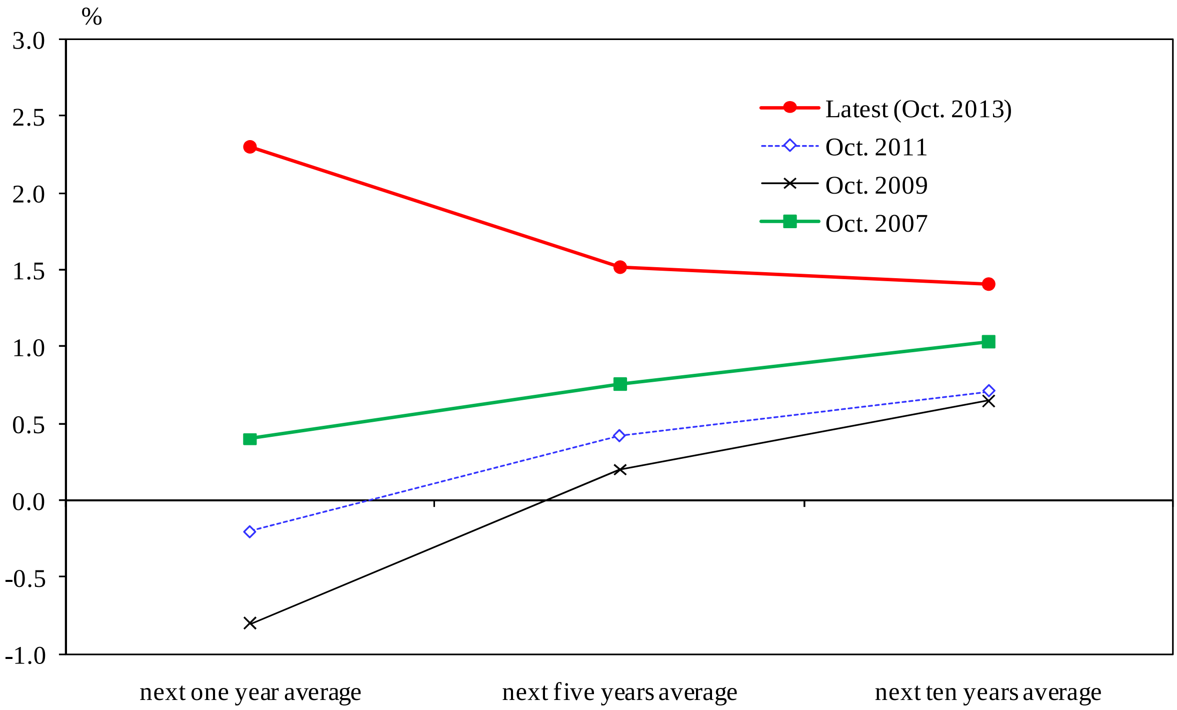
Short-Term and Medium- to Long-Term Inflation Expectations

(1) Households <Opinion Survey on the General Public's Views and Behavior>



Note: Figures from the June 2013 survey exclude the effects of the scheduled consumption tax hikes.

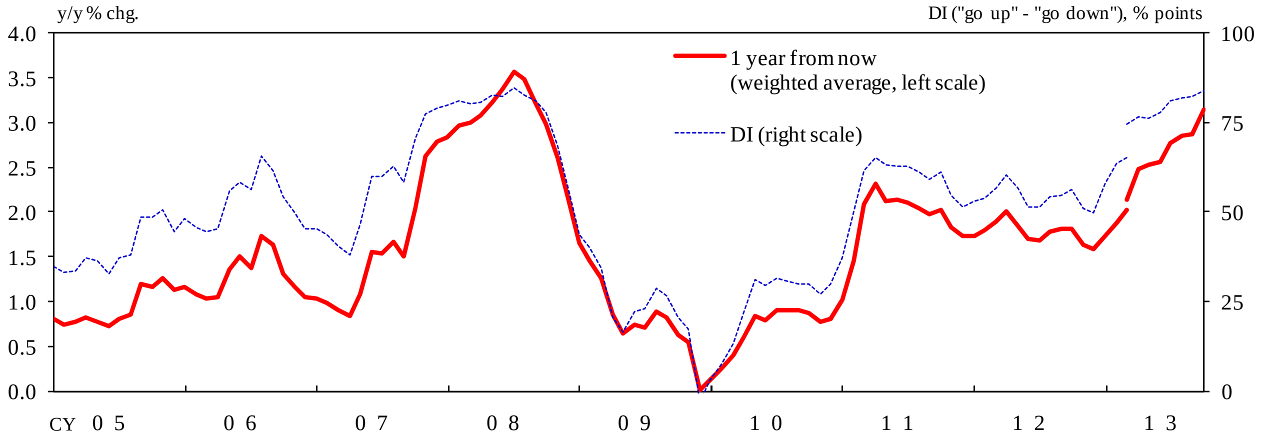
(2) Economists <Consensus Forecasts>



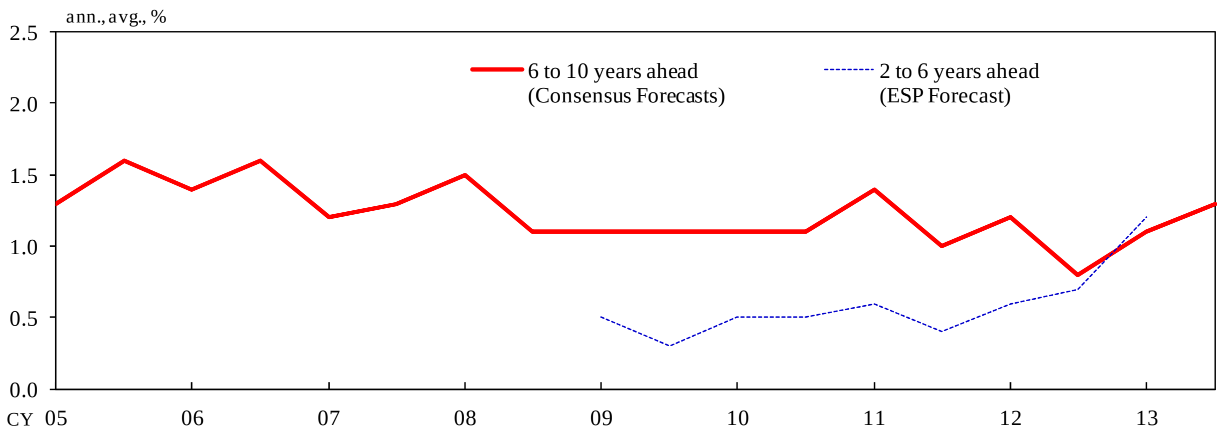
Sources: Bank of Japan; Consensus Economics Inc.

Inflation Expectations by Economic Entity

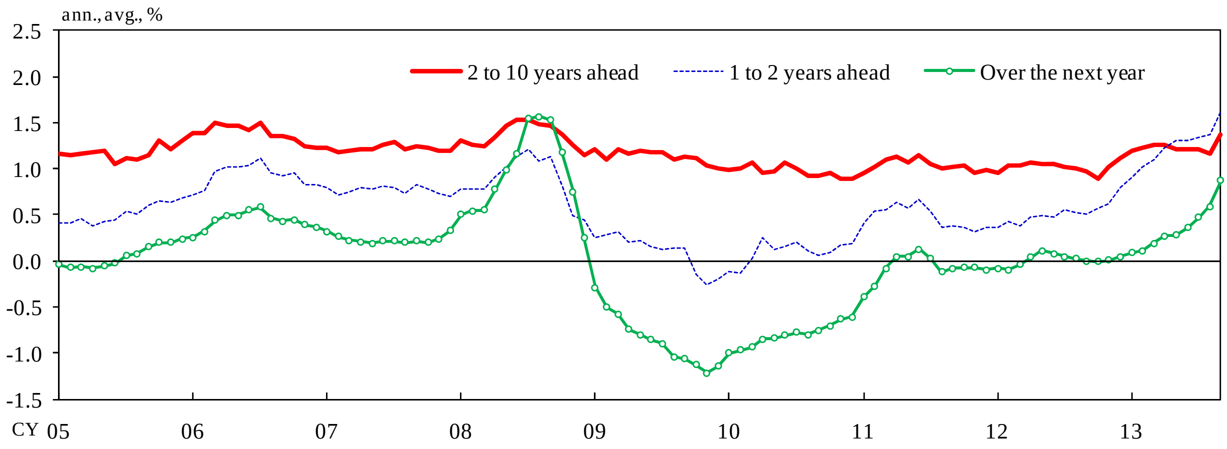
(1) Households <Consumer Confidence Survey>



(2) Economists[1]



(3) Market Participants <Quick Bond Monthly Survey>[2]

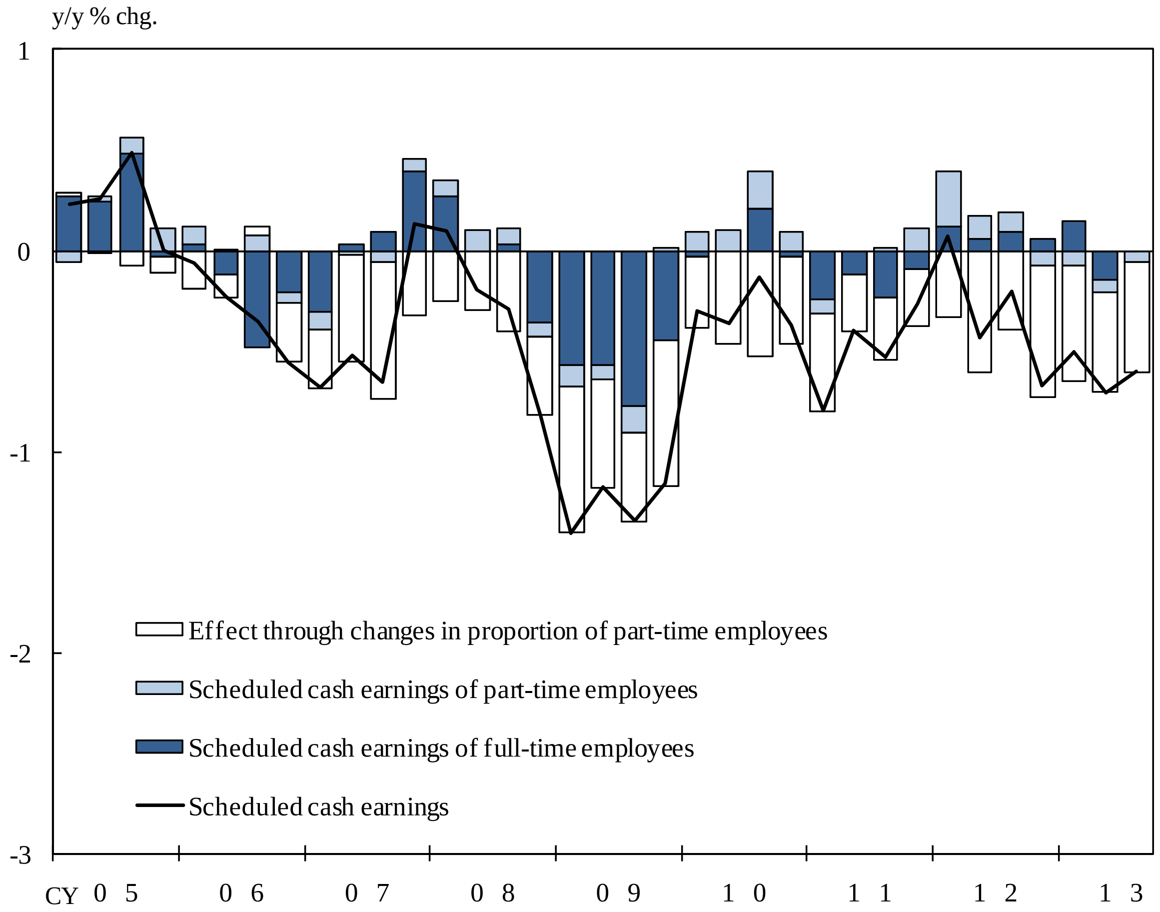


Notes: 1. Figures for the ESP Forecast exclude the effects of the scheduled consumption tax hikes.
2. From the September 2013 survey, the Quick Bond Monthly Survey has asked respondents to include the effects of the scheduled consumption tax hikes.

Sources: Cabinet Office; Consensus Economics Inc.; Japan Center for Economic Research; QUICK.

Wages

Breakdown of Scheduled Cash Earnings

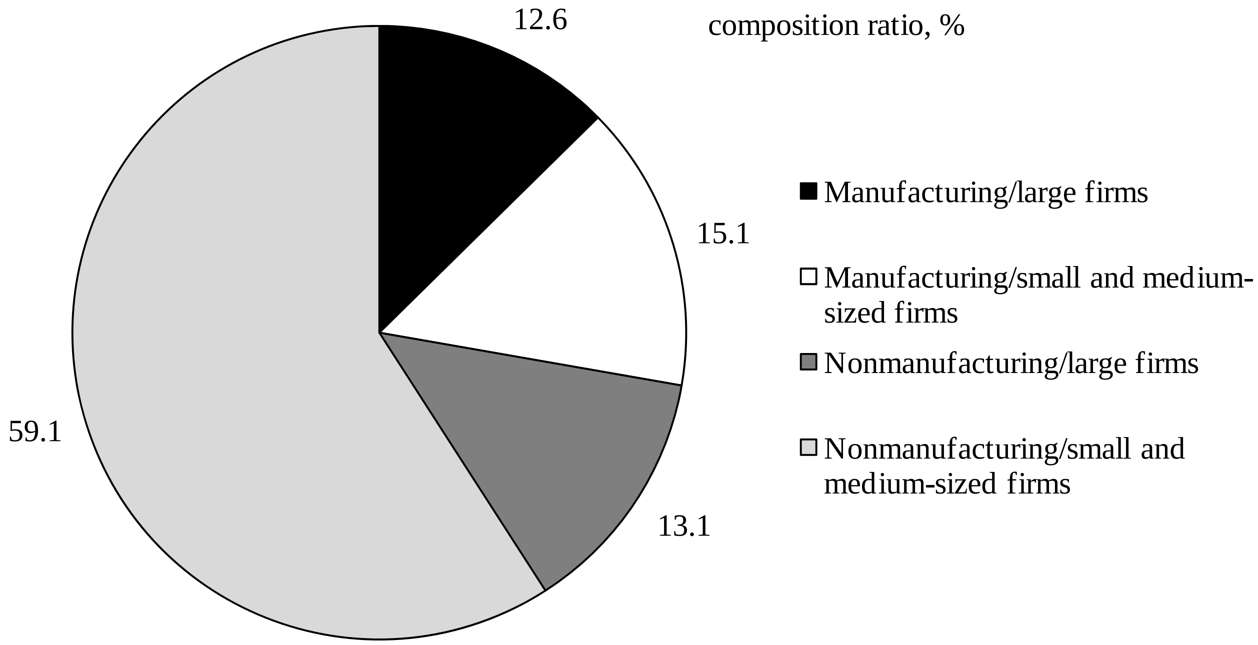


Notes: 1. Data are for establishments with at least five employees.
2. Figures for 2013/Q3 are those of September.
Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.
3. Contributions from scheduled cash earnings of full-time employees and those of part-time employees are calculated as "scheduled cash earnings of each type of employee (y/y chg.)" times "proportion of the corresponding type's scheduled cash earnings to the previous year's total." Contributions from the effect created through changes in the proportion of part-time employees are the residuals.

Sources: Ministry of Health, Labour and Welfare.

Personnel Expenses by Industry and Firm Size

Composition Ratio of Personnel Expenses by Industry and Firm Size



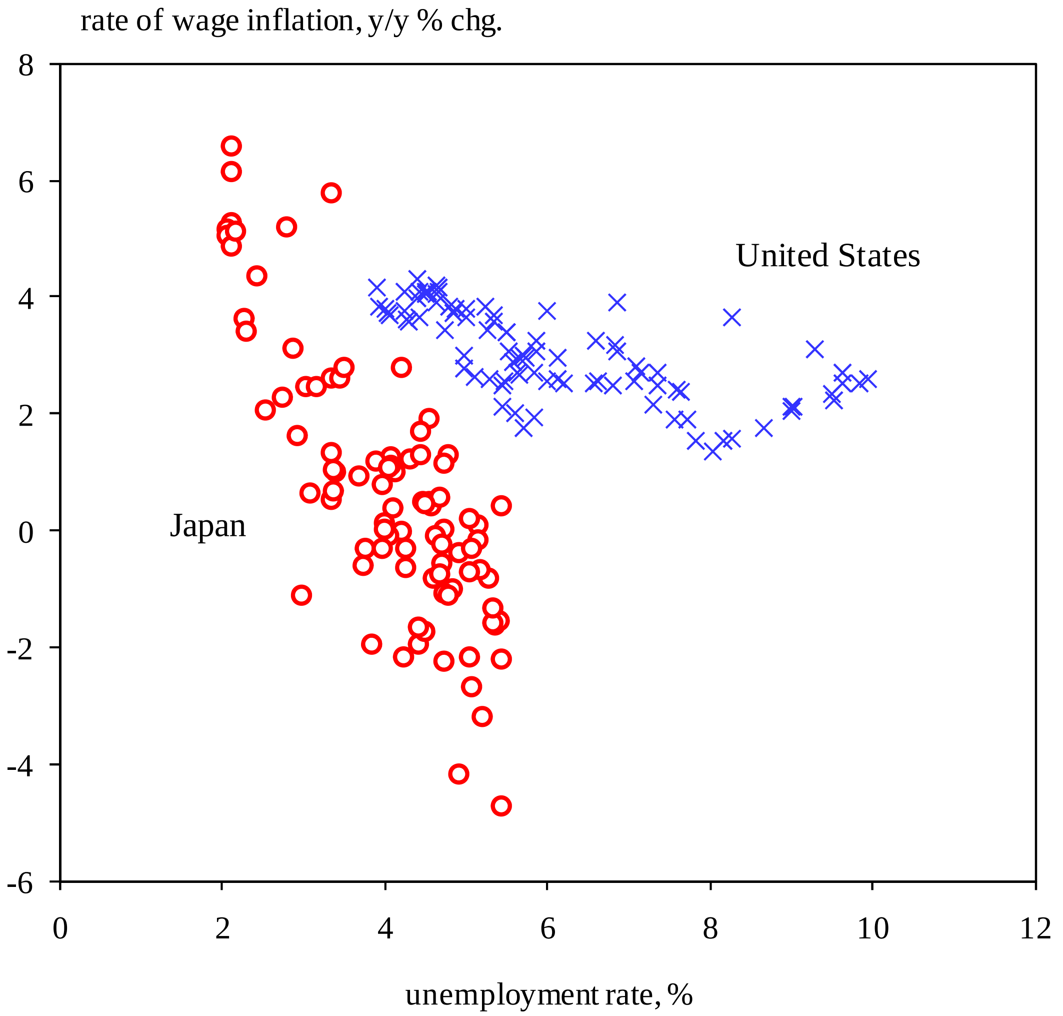
Notes: 1. "Large firms" consists of firms with capital of 1 billion yen or over. "Small and medium-sized firms" consists of firms with capital of less than 1 billion yen.

2. "Personnel expenses" includes directors' remuneration, bonus for directors, salaries and wages, bonuses for employees, and welfare expense.

Source: Ministry of Finance.

Wage Phillips Curves for Japan and the United States

Rates of Wage Inflation and Unemployment for Japan and the United States

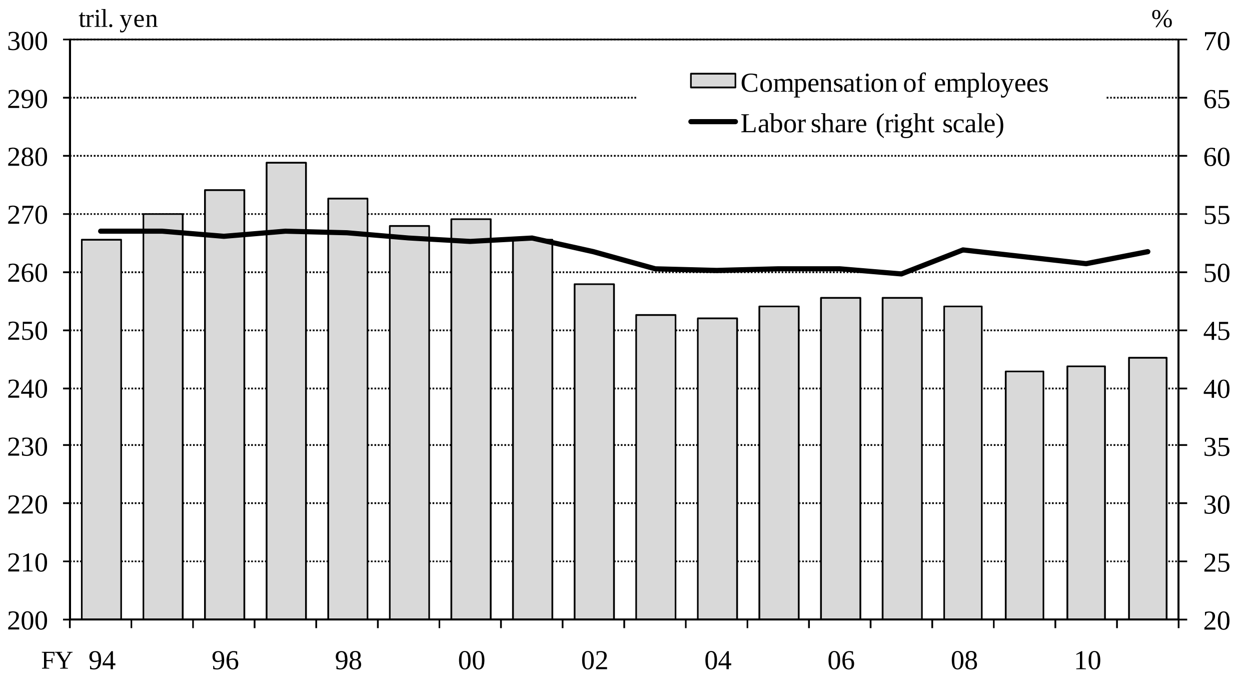


Notes: 1. The period covers 1985/Q1 through 2013/Q3.
2. The wage is the hourly wage for establishments with 30 or more employees.

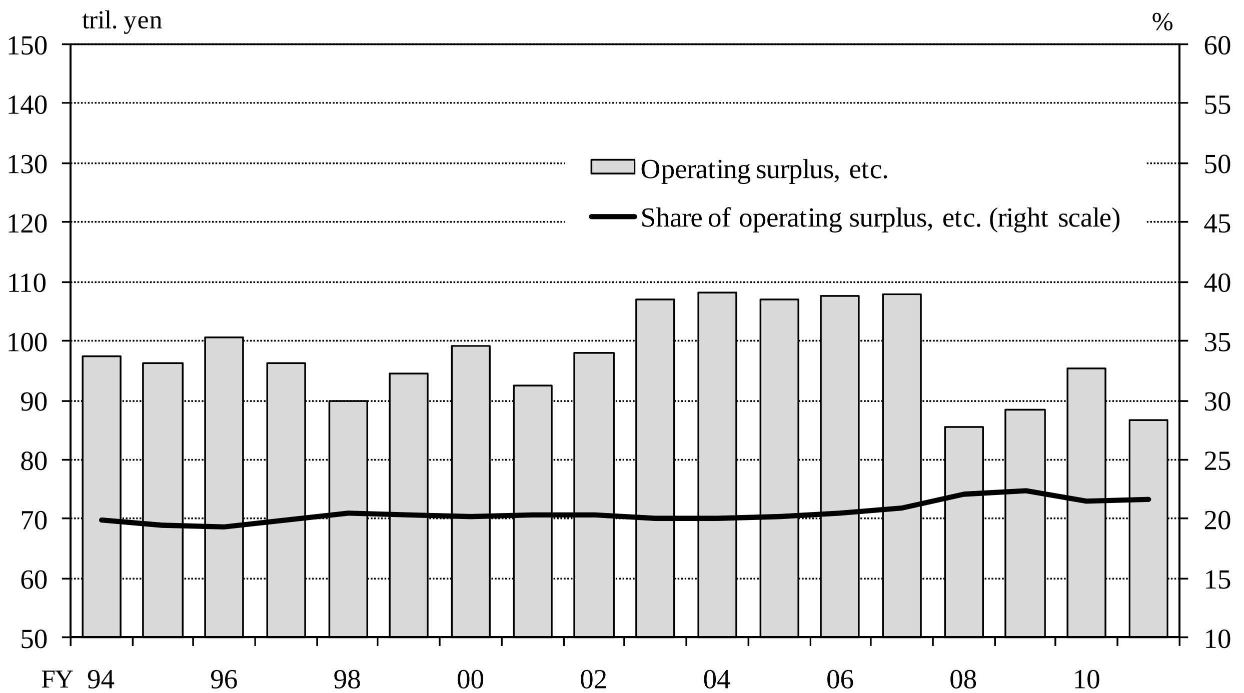
Sources: Ministry of Health, Labour and Welfare; U.S. Bureau of Labor Statistics; Haver Analytics.

Labor Share and Share of Operating Surplus

(1) Compensation of Employees and Labor Share



(2) Operating Surplus and Share of Operating Surplus, etc.



Note: "Operating surplus, etc." includes operating surplus and mixed income.
Source: Cabinet Office.

Quantitative and Qualitative Monetary Easing (QQE)

1. Adoption of the monetary base control

● The monetary base will increase at an annual pace of about 60-70 tril. yen.

2. Increase in JGB purchases and their maturity extension

● With a view to encouraging a further decline interest rates across the yield curve, the Bank will purchase JGBs so that their amount outstanding will increase at an annual pace of about 50 tril. yen.

● JGBs with all maturities will be made eligible for purchase, and the average remaining maturity of the Bank's JGB purchases will be extended from slightly less than three years to about seven years -- equivalent to the average maturity of the amount outstanding of JGBs issued.

3. Increase in ETF and J-REIT purchases

● With a view to lowering risk premia of asset prices, the Bank will purchase ETFs and J-REITs so that their amounts outstanding will increase at an annual pace of 1 tril. yen and 30 bil. yen, respectively.

4. 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.

● The Bank will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate.

Forward Guidance Practices among Major Economies

(1) Forward Guidance in the United States

The Federal Open Market Committee (FOMC) . . . currently anticipates that this exceptionally low range for the federal funds rate [0 to 0.25 percent] will be appropriate at least as long as

- ■ the unemployment rate remains above 6.5 percent,
- ■ inflation between one and two years ahead is projected to be no more than a half percentage point above the FOMC's 2 percent longer-run goal,
- ■ and longer-term inflation expectations continue to be well anchored.

(2) Forward Guidance in the United Kingdom

■ The Monetary Policy Committee (MPC) intends not to raise Bank Rate from its current level of 0.5 percent at least until . . . the unemployment rate has fallen to a threshold of 7 percent, subject to the conditions below.

- ✓ in the MPC's view, it is more likely than not, that CPI inflation 18 to 24 months ahead will be 0.5 percentage points or more above the 2 percent target,
- ✓ medium-term inflation expectations no longer remain sufficiently well anchored, and
- ✓ the Financial Policy Committee (FPC) judges that the stance of monetary policy poses a significant threat to financial stability that cannot be contained by the substantial range of mitigating policy actions available to the FPC.

If any of these knockouts were breached, the above-mentioned guidance would cease to hold.

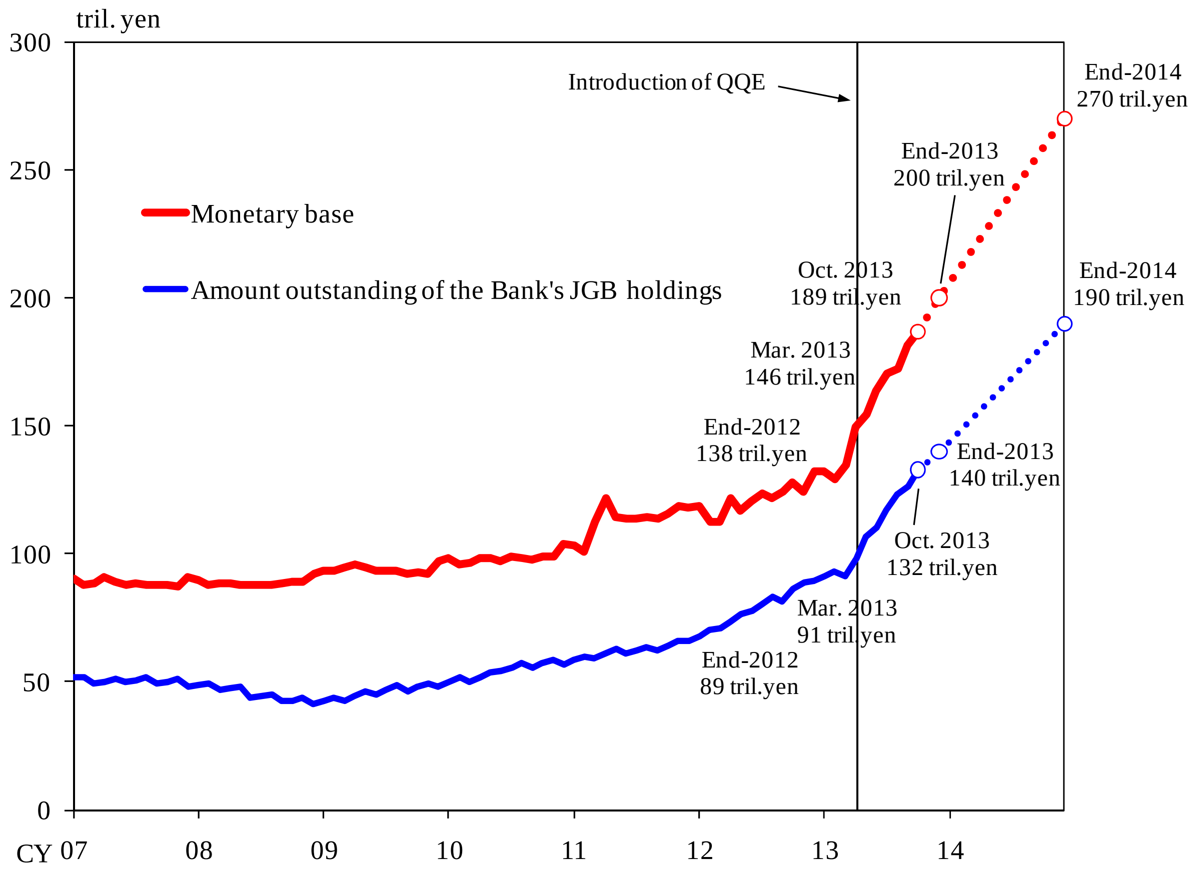
(3) Forward Guidance in the Euro Area

■ The Governing Council expects the key ECB interest rates to remain at present or lower levels for an extended period of time. This expectation is based on the overall subdued outlook for inflation extending into the medium term, given the broad-based weakness in the real economy and subdued monetary dynamics.

Sources: Federal Reserve; Bank of England; European Central Bank.

Expansion in the Monetary Base and JGB Purchases

Monetary Base Target and Increase in JGB Purchases



Source: Bank of Japan.