

Statement by Masaaki Shirakawa, Governor of the Bank of Japan, concerning the Bank's *Semiannual Report on Currency and Monetary Control* before the Committee on Financial Affairs, House of Councillors, on April 12, 2011

Introduction

The Bank of Japan submitted to the Diet its *Semiannual Report on Currency and Monetary Control* for the second half of fiscal 2009 and the first half of fiscal 2010 in June and December 2010, respectively. I appreciate having this opportunity to talk about recent developments in Japan's economy and present an overall review of the Bank's conduct of monetary policy.

It is now just over one month since the Great East Japan Earthquake. The disaster claimed many precious lives and many people are still missing. I would like to express my sincere condolences to the victims of the earthquake. Moreover, many continue to face severe hardship. I would like to offer my heartfelt sympathy to those who are suffering.

I. The Bank of Japan's Response to the Earthquake Disaster

I will first explain the Bank of Japan's response to the earthquake disaster.

The Bank, in cooperation with private financial institutions, has been taking all possible measures, including dealing with the demand for cash in the areas affected by the disaster, in order to maintain the financial intermediation functioning and secure smooth fund settlement. With a view to ensuring stability in financial markets, the Bank has also provided extremely ample amounts of funds to sufficiently meet demand in the markets. On the next business day after the earthquake, it further strengthened monetary easing. Specifically, it decided to increase the amount of asset purchases, mainly of risk assets, by about 5 trillion yen to about 10 trillion yen. That brings the total size of the Asset Purchase Program to about 40 trillion yen, including the provision of funds through the fixed-rate funds-supplying operation. Moreover, at the Monetary Policy Meeting held last week, the Bank judged it necessary to introduce a funds-supplying operation that provides financial institutions in disaster areas with longer-term funds in order to support their initial response efforts to meet the future demand for funds for restoration and rebuilding. It also

judged it appropriate to broaden the range of eligible collateral for money market operations with a view to ensuring that financial institutions in the disaster areas have sufficient financing capacity. Concrete proposals for these two measures are currently being drafted and the Bank will decide the specifics at the Monetary Policy Meeting to be held at the end of this month.

II. Economic and Financial Developments in Japan

Next, I will explain recent economic and financial developments.

Japan's economy is under strong downward pressure, mainly on the production side, due to the effects of the earthquake disaster. The earthquake has sharply dampened production in some areas by damaging production facilities, disrupting supply chains, and constraining electric power supply; exports and domestic private demand have been affected accordingly.

As for financial developments since the earthquake, the functioning of financial intermediation and payment and settlement has been steadfastly maintained thanks to the strenuous efforts of those involved. Japan's core payment and settlement systems, including the Bank of Japan Financial Network System, or BOJ-NET, have been functioning as normal, and smooth fund settlement has been secured. Financial markets have been stable as a whole. Following such a devastating disaster, maintaining stable payment and settlement systems and stability in financial markets is extremely important. Meanwhile, financial conditions have generally continued to ease, while weakness has been observed in the financial positions of some firms, mainly small ones, since the earthquake.

As for the outlook, Japan's economy is likely to remain under strong downward pressure, mainly on the production side, for the time being. However, the fundamental conditions that supported Japan's economic recovery prior to the earthquake -- namely, the high growth of the global economy underpinned by the expansion of emerging economies -- remain in place. Therefore, Japan's economy is expected to return to a moderate recovery path -- as supply-side constraints are mitigated and production regains traction -- backed by an increase in exports reflecting the improvement in overseas economic conditions and by a rise in demand for restoring capital stock. Having said that, the Bank fully recognizes that

there is considerable uncertainty about the possible effects of the earthquake disaster on Japan's economy. Therefore, the Bank considers it necessary to examine developments in the economy carefully.

On the price front, the year-on-year rate of decline in the CPI (excluding fresh food) has continued to slow, and the year-on-year rate of change is expected to become slightly positive in the near future. The Bank recognizes that the year-on-year rate of change in the CPI is likely to be revised downward with the base-year change scheduled for August 2011.

Let me turn to risks to the outlook I have mentioned.

In the area of economic activity, there are some upside risks such as faster growth in emerging and commodity-exporting economies due to robust domestic demand and capital inflows from overseas. However, there are downside risks associated with developments in global financial markets and uncertainties, albeit reduced, about the outlook for the U.S. and European economies. Moreover, as I mentioned before, there is high uncertainty about the possible effects of the earthquake disaster on Japan's economy. Meanwhile, the Bank is paying attention to the rise in international commodity prices as a risk factor. On the one hand, the high growth in emerging and commodity-exporting economies that lies behind the rise in international commodity prices would lead to an increase in Japan's exports; on the other hand, a decline in real purchasing power resulting from the deterioration in the terms of trade could reduce private domestic demand in Japan.

Regarding the outlook for prices, there is a possibility that inflation will rise more than expected if international commodity prices increase further, while there is also a risk that the rate of inflation will deviate downward from the Bank's projection due, for example, to a decline in medium- to long-term inflation expectations.

III. Conduct of Monetary Policy

Lastly, let me explain the Bank's conduct of monetary policy.

In order for Japan's economy to overcome deflation and return to a sustainable growth path

with price stability, the Bank has continued to consistently make contributions as the central bank through the three-pronged approach of pursuing powerful monetary easing consisting of comprehensive monetary easing, ensuring financial market stability, and providing support to strengthen the foundations for economic growth.

The Bank will continue to carefully examine the outlook for economic activity and prices, including the possible effects of the disaster, and take appropriate policy actions as necessary.