

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 December 16, 2008

Introduction

The Bank of Japan submitted to the Diet its *Semiannual Report on Currency and Monetary Control* for the second half of fiscal 2007 on June 10, 2008 and that for the first half of fiscal 2008 on December 12, 2008. I am pleased to have this opportunity to present an overall review of the Bank's conduct of monetary policy.

I. Developments in Japan's Economy

Japan's exports have decreased due to the slowdown in overseas economies. With the deterioration in corporate profits and households' employment and income situation, domestic private demand, particularly business fixed investment and private consumption, has weakened. In sum, Japan's economic activity has been increasingly sluggish.

Indicators of production, employment, and private consumption have all been weak. The results of the Bank's December *Tankan* (Short-Term Economic Survey of Enterprises in Japan), which were released yesterday, also clearly indicated the severity of economic conditions in terms of business sentiment and fixed investment plans.

On the price front, the three-month rate of decrease in domestic corporate goods prices has been large, mainly due to the drop in international commodity prices. The year-on-year rate of increase in the CPI (excluding fresh food) is around 2 percent against the background of the increase in prices of energy and food. CPI inflation is expected to moderate reflecting the declines in the prices of petroleum products and the stabilization of food prices.

Regarding the financial side, investors have become increasingly risk averse reflecting disruptions in global financial markets. As a result, funding conditions in the CP and corporate bond markets have tightened, as indicated by the wider credit spreads on CP and

corporate bonds and the difficulty faced by firms in issuing either. Moreover, an increasing number of firms, not only small but also large ones, have reported that their financial positions are tight and lending attitudes of financial institutions are severe. Thus, financial conditions in Japan are rapidly becoming less accommodative on the whole.

There are risks to the outlook for economic activity and prices. Global financial markets remain under intense strain, although there has been some improvement in money markets in response to the various measures taken so far by governments and central banks. In this situation, due attention should be paid to the fact that there are downside risks to economic activity depending on developments in global financial markets and overseas economies. In addition, if financial conditions in Japan, as reflected in lending attitudes of financial institutions and issuing conditions in the CP and corporate bond markets, should increase in severity, pressures acting to depress economic activity from the financial side might become more marked. Turning to prices, there is a possibility that the inflation rate will decline further if downside risks to economic activity materialize or commodity prices fall further.

II. Conduct of Monetary Policy

As I have explained, the outlook for economic activity and prices is uncertain at present. In this situation, the Bank will carefully assess the future outlook for economic activity and prices, closely considering the likelihood of its projections as well as factors posing upside or downside risks, and will implement monetary policy appropriately. For the time being, it is particularly important to pay attention to downside risks to economic activity, such as those that may arise from developments in the U.S. and European financial systems and in global financial markets and the consequent downward pressure.

Since early autumn, when the turmoil in global financial markets and in the U.S. and European financial systems increased in severity, the Bank has continued to make efforts, by employing various measures, to ensure market stability and maintain accommodative financial conditions. Specifically, against the background of the worldwide decline in U.S. dollar liquidity, the Bank introduced U.S. dollar funds-supplying operations as part of the coordinated measures of central banks in September and thereafter expanded such operations. As for yen funds, the Bank has introduced a complementary deposit facility to

further facilitate the provision of sufficient liquidity, and has been providing funds for over the year-end with more frequency and in larger amounts than last year. In addition, the Bank has been actively purchasing CP and Japanese government securities under repurchase agreements, thereby ensuring market stability. Furthermore, with a view to facilitating corporate financing, the Bank has expanded the range of corporate bonds and loans on deeds it accepts as eligible collateral and has decided to introduce a new operation through which financial institutions can borrow low-interest funds from the Bank against corporate debt. Under this new operation, there will be no explicit ceiling on the total funds available, although the maximum loans available will not exceed the value of the corporate debt pledged as collateral.

The Bank will continue to make efforts to ensure market stability by conducting appropriate money market operations such as the provision of sufficient funds during the run-up to the calendar and fiscal year-ends.