

**Quantitative and Qualitative Monetary
Easing
and
Japan's Recent Economic and Financial
Developments**

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Price Stability Target and QQE

Policy Framework for Sustainable Economic Growth
Under Stable and Moderate Inflation

Price Stability Target
= 2 % y/y rate of change in the
consumer price index (CPI)

Means to achieve
the Price Stability Target

Quantitative and
Qualitative Monetary
Easing (QQE)



Why is Deflation Problematic?

Deflation

= Persistent Decline in Prices

≡ Situation in which the Economy is in a Vicious Cycle of Price Decline and Recession (Deflationary Recession)



Q: What is the Problem of Persistent Decline in Prices?

Why is Deflation Problematic?

Decline in Aggregate Demand due to Deferred Spending

The more you wait, the more goods and services available at the same price
(value of cash and deposits increases just by holding them)

- ⇒ Firms and households defer investment and consumption
- ⇒ Aggregate demand declines
- ⇒ Vicious cycle of price declines and recession

Increase in Effective Debt Burden

Decline in prices = Increase in the value of money for goods and services
= Increase in the effective debt burden for borrowers

- ⇒ Willingness of firms and households to borrow declines
- ⇒ Aggregate demand declines
- ⇒ Vicious cycle of price declines and recession

Why is Stable and Moderate Inflation Desirable?

Increase in Aggregate Demand due to Rejuvenated Spending

Persistent increase in prices

(Value of cash and deposits increases just by holding them)

⇒ Stimulates consumption and investment

⇒ Aggregate demand increases

⇒ Expanded production, better employment situation

⇒ A virtuous cycle of a buoyant economy and inflation

~~Hyper-inflation~~

- Decline in real income and real value of savings
- Unexpected income transfer from creditors to debtors
- High interest rates and difficult fund-raising
- ∴ Economic turmoil

Advantages of Inflation Targeting Policy

In order to achieve stable and moderate inflation...

⇒ Inflation Targeting

Enhancing Policy Credibility and Predictability

- Specific numerical target for the future inflation rate
 - ⇒ Enhanced transparency, accountability and credibility in monetary policy
- Forecast of price levels becomes easier
 - ⇒ Better environment for economic activities

Preventing Hyperinflation

- Commitment to prevent both inflation above the target and deflation (i.e., Commitment to prevent hyperinflation is already embedded in the framework)

Two Pillars of the QQE

Quantitative and Qualitative Monetary Easing

Commitment

Clear commitment that the BoJ "will achieve the price stability target of 2 % at the earliest possible time, with a time horizon of about 2 years."

Actions

- **Increase in Quantity**
Increase monetary base* at annual pace of about ¥60-70 trillion (mainly through purchases of JGBs)
- **Change in Quality**
Purchasing assets with higher risk profile (JGBs with longer duration, ETFs and J-REITs)

*Money supplied to the financial system directly by the central bank

Working on Expected Real Interest Rates

Real costs of borrowing,
taking into account price changes
(Borrowers' subjective expectations)

Subjective forecast
based on respective
price projections

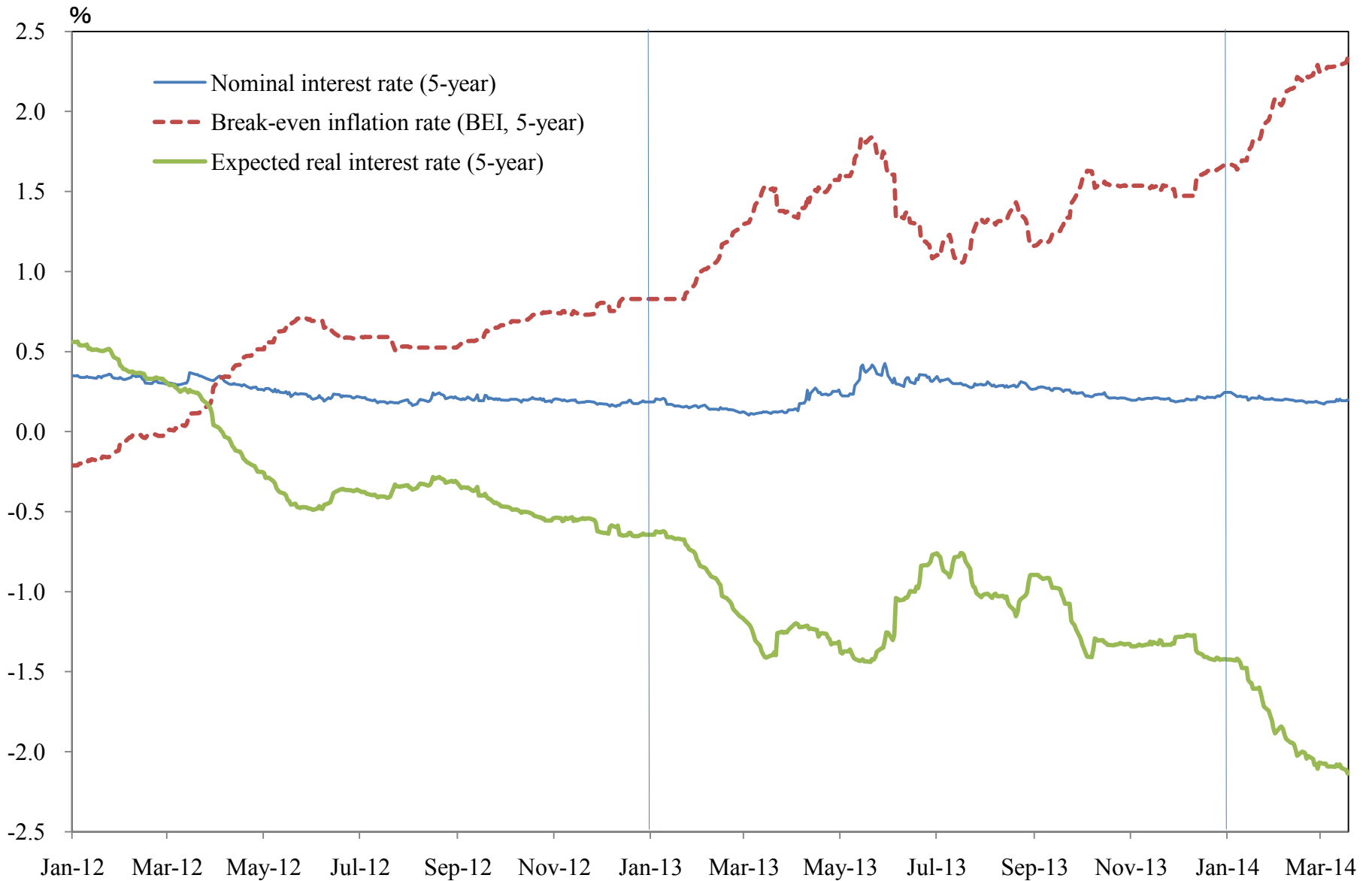
Visible in financial
markets or over the
counter

Expected real interest rates = Nominal interest rates
— Expected rates of inflation

Downward
Pressure
by the QQE

Chart 8

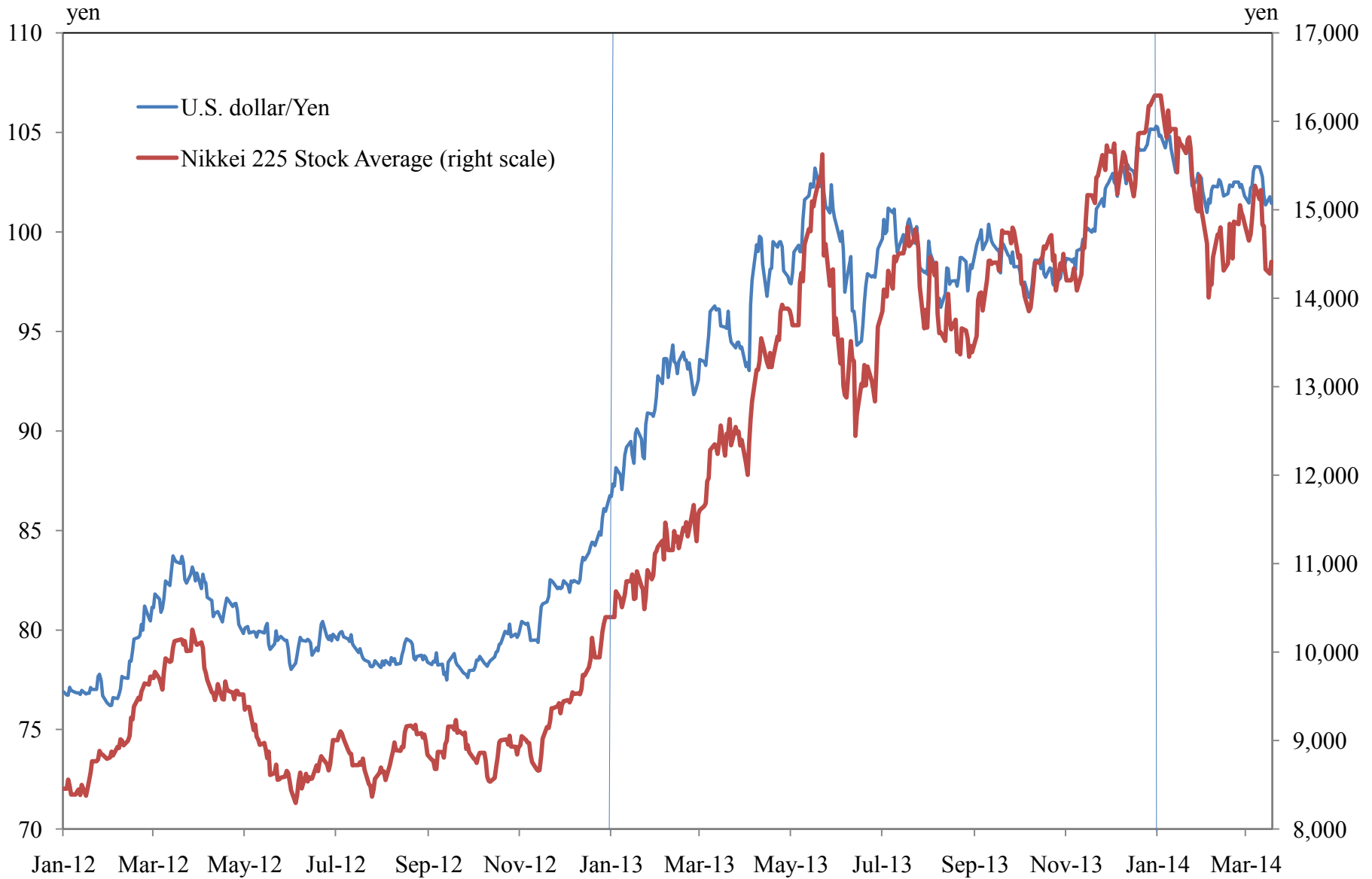
Interest Rates and Inflation Expectations



Source: Bloomberg.

Chart 9

Stock Price and Exchange Rate



Source: Bloomberg.

Chart 10

Household Assets

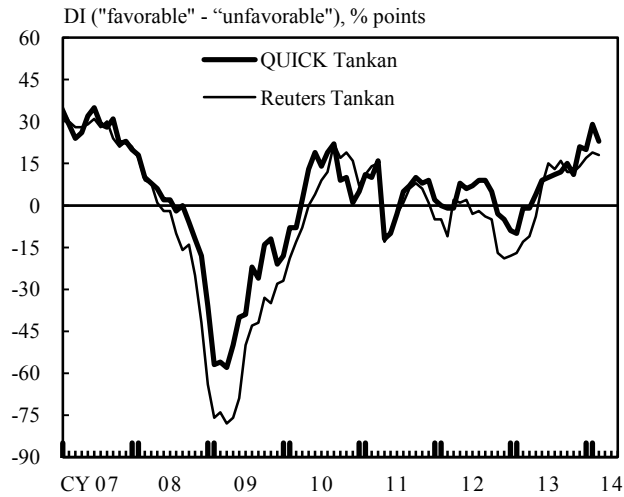
		2011	2012				2013			Amounts outstanding in September-end 2013 in trillion yen (percentage ratio in parentheses)
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
Amounts outstanding (End of period, trillion yen)		1,500	1,517	1,514	1,509	1,544	1,568	1,592	1,598	
C h a n g e s (%)	Total assets	-0.1	1.1	0.2	1.5	2.9	3.4	5.1	5.9	1,598 (100.0)
	Currency and deposits	2.0	2.2	1.8	1.9	2.0	1.7	2.1	2.1	856 (53.5)
	Bonds	-12.0	-8.4	-7.9	-8.7	-9.3	-8.0	-9.0	-8.7	30 (1.9)
	Investment trust beneficiary certificates	-10.7	-4.9	-11.3	2.0	13.3	20.1	29.0	33.0	75 (4.7)
	Shares and other equities	-6.3	0.9	-5.4	-1.4	11.3	15.1	32.5	43.8	135 (8.5)
	Insurance and pension reserves	0.2	0.9	1.1	1.8	2.5	2.4	2.6	2.8	437 (27.3)
	Others	-2.1	-0.4	-1.0	3.6	4.0	3.6	6.8	5.1	66 (4.1)

Source: Bank of Japan, "Flow of Funds."

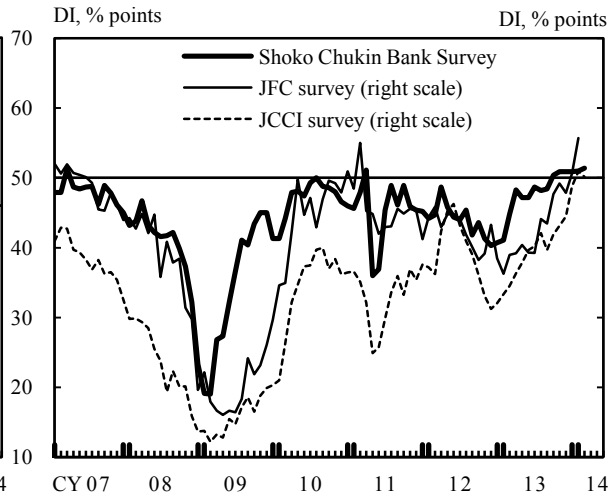
Chart 11

Business Sentiment

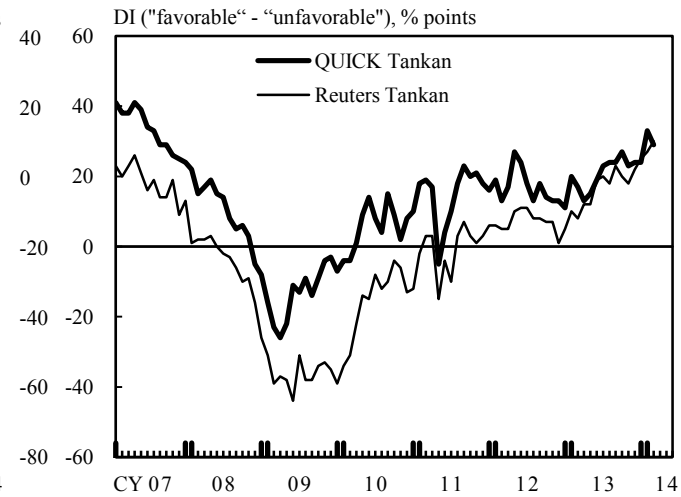
< Large Manufacturing Enterprises >



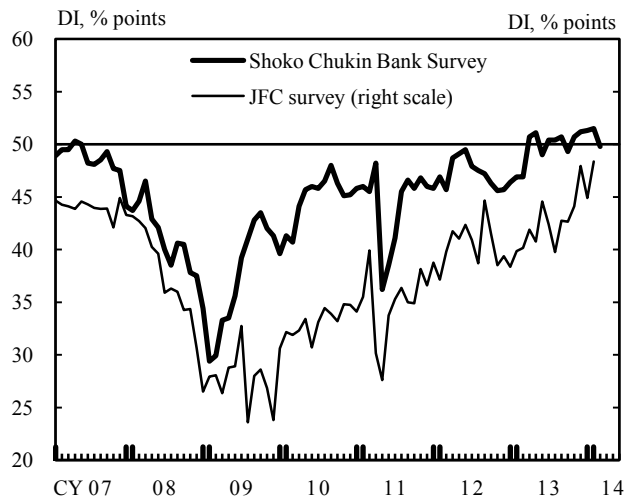
< Small Manufacturing Enterprises >



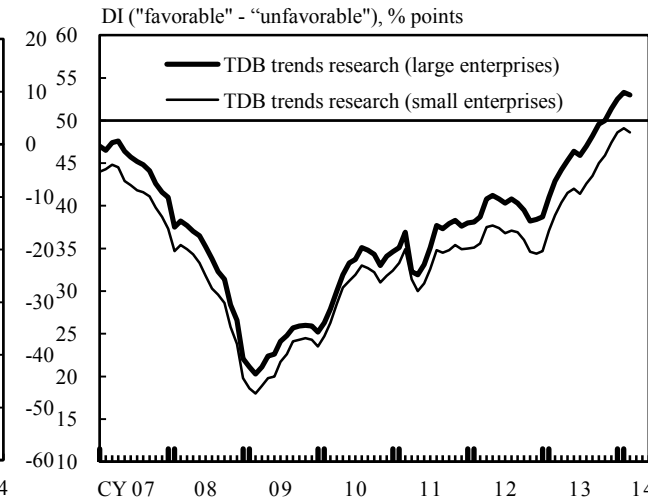
< Large Nonmanufacturing Enterprises >



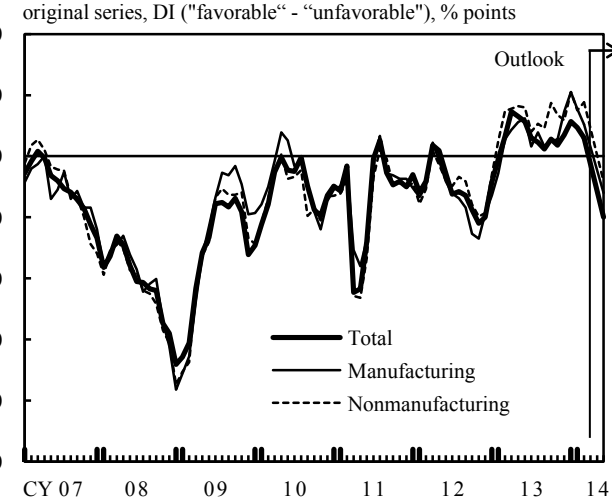
< Small Nonmanufacturing Enterprises >



< All Industries >



< Reference: Economy Watchers Survey >



Sources: QUICK, "QUICK Tankan"; Thomson Reuters, "Reuters Tankan"; Teikoku Databank; JCCI; JFC; Shoko Chukin Bank; Cabinet Office.

Business Fixed Investment

<Private Non-Residential Investment>

s.a.; q/q % chg.

2012	2013			
Q4	Q1	Q2	Q3	Q4
-0.9	-0.9	1.0	0.1	0.8

Source: Cabinet Office, "National Accounts."

<Domestic Shipments and Imports>

s.a.; q/q % chg.

	2013				2014
	Q1	Q2	Q3	Q4	Q1
Domestic Shipments and Imports	6.3	-4.3	1.9	6.4	11.8
(excluding transport equipment)	4.9	0.2	-0.9	6.3	17.8

Source: Ministry of Economy, Trade and Industry, "Indices of Industrial Domestic Shipments and Imports."

Note: Figures for 2014/Q1 are those of January.

<Machinery Orders>

s.a.; excluding volatile orders; q/q % chg.

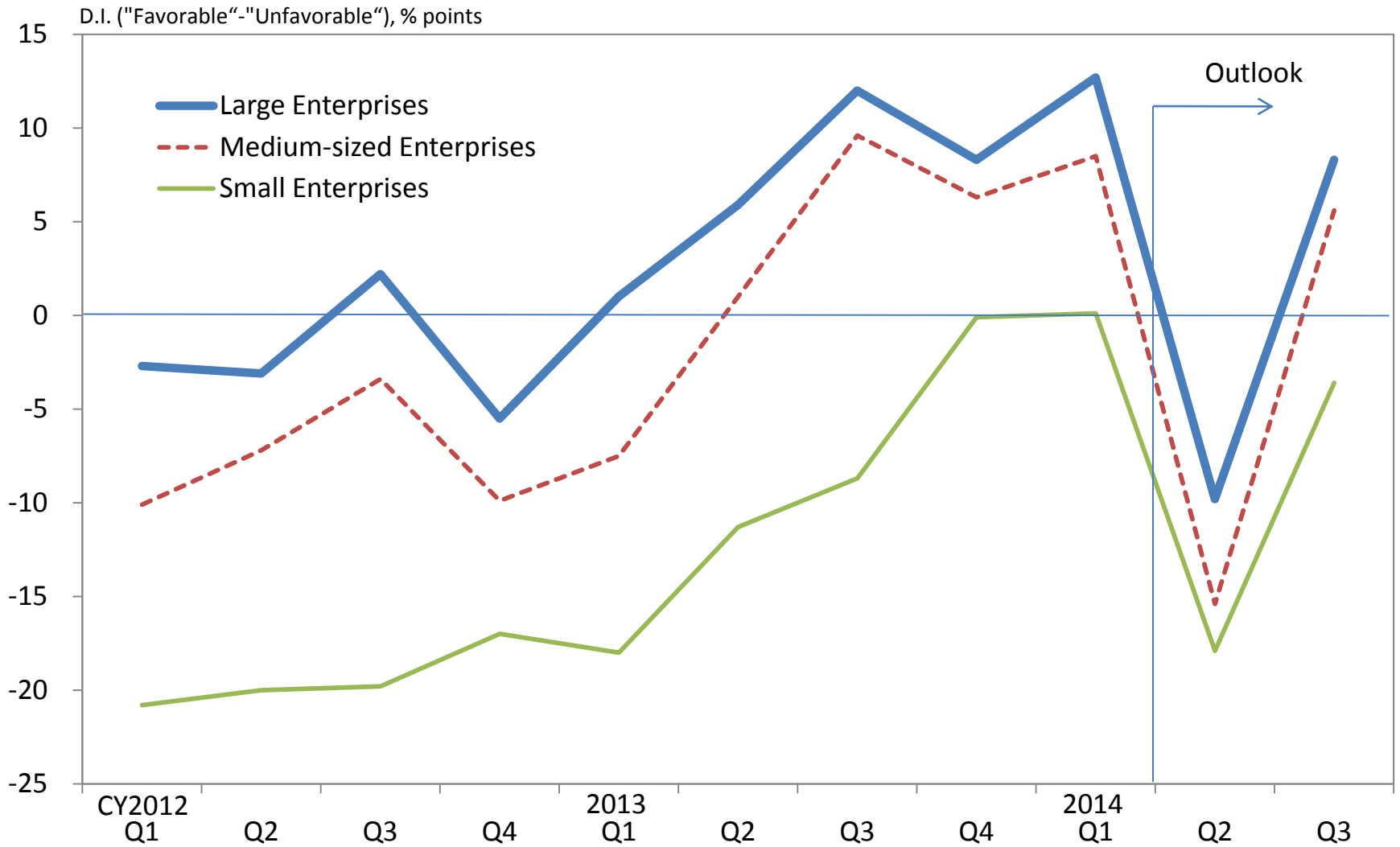
2013				2014
Q1	Q2	Q3	Q4	Q1
-0.0	6.8	4.3	1.5	4.0

Source: Cabinet Office, "Orders Received for Machinery."

Note: Figures for 2014/Q1 are those of January.

Chart 13

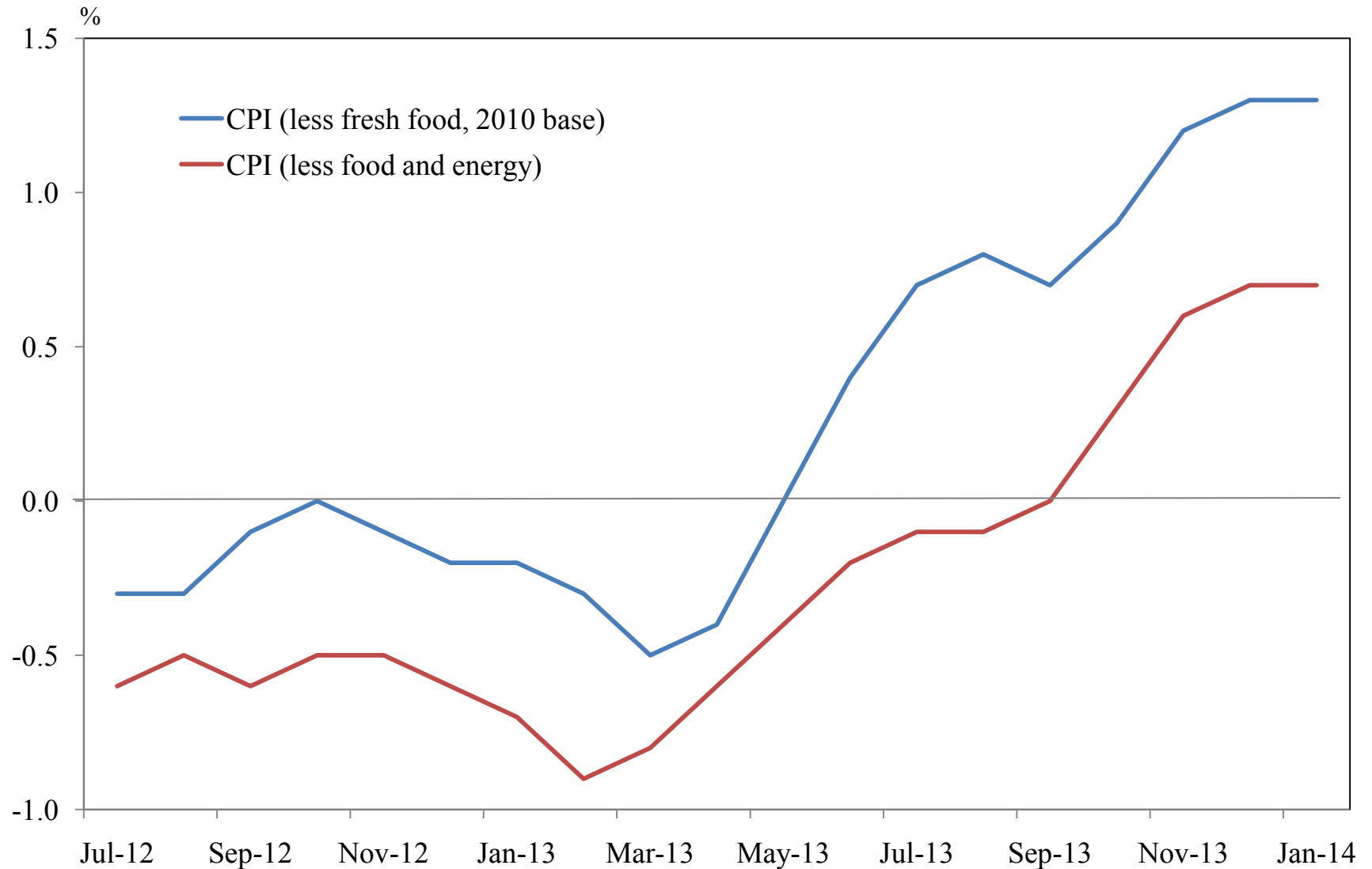
Business Outlook Survey



Source: Cabinet Office and Ministry of Finance, "Business Outlook Survey."

Chart 14

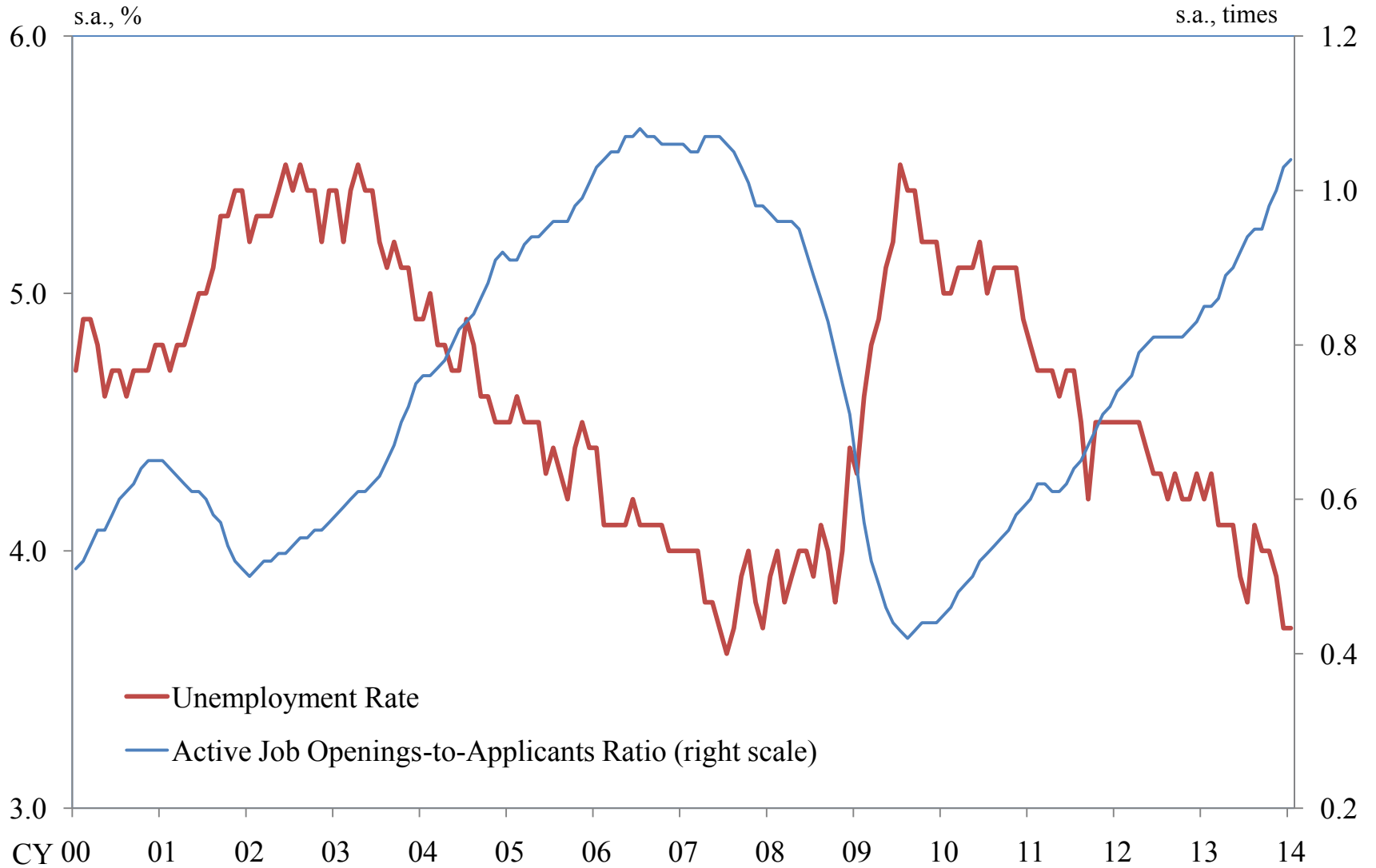
Consumer Prices



Source: Ministry of Internal Affairs and Communications, "Consumer Price Index."

Chart 15

Employment Conditions



Sources: Ministry of Internal Affairs and Communications, "Labour Force Survey";
Ministry of Health, Labour and Welfare, "Report on Employment Service."

Chart 16

Real GDP Growth

s.a.; q/q % chg.

	2012		2013			
	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP	▲0.9	0.0	1.1	1.0	0.2	0.2
<Annual rate>	<▲3.7>	<0.1>	<4.5>	<4.1>	<0.9>	<0.7>
Private Consumption	▲0.3	0.4	1.1	0.6	0.2	0.4
Residential Investment	1.1	2.3	1.7	0.9	3.3	4.1
Non-Resi. Investment	▲3.3	▲0.9	▲0.9	1.0	0.1	0.8
Government Consumption	0.4	0.8	0.6	0.9	0.2	0.5
Public Investment	1.2	0.4	3.2	6.8	7.2	2.1
Exports	▲3.8	▲2.9	4.2	2.9	▲0.7	0.4
Imports	▲0.3	▲1.9	1.1	1.8	2.4	3.5

Source: Cabinet Office, "National Accounts."

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
FY 2013	+2.5~+2.9 <+2.7>	+0.7~+0.9 <+0.7>	
FY 2014	+0.9~+1.5 <+1.4>	+2.9~3.6 <+3.3>	+0.9~+1.6 <+1.3>
FY 2015	+1.2~+1.8 <+1.5>	+1.7~+2.9 <+2.6>	+1.0~+2.2 <+1.9>

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

About Kitakyushu's economy

Kitakyushu's economy has been recovering moderately.

After developing Chikuho coalfield and establishing the first government-owned Steel Works, Kitakyushu's economy has grown as one of the leading industrial zones in Japan, comprising the steel, automobile, and electric machinery industries.

City of Kitakyushu is one of the world leading cities in the area of environmental preservation. Recently, City of Kitakyushu has been in the spotlight as a city of industrial tourism.