

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

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# 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

## *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

## *Excessive Appreciation of the Yen*

Decline in prices = Increase in the value of the yen

- ⇒ Excessive appreciation of the yen against other key currencies
- ⇒ Negative on export, companies move outward, domestic investments decline

# 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 moderate 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)

# 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)



# 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."

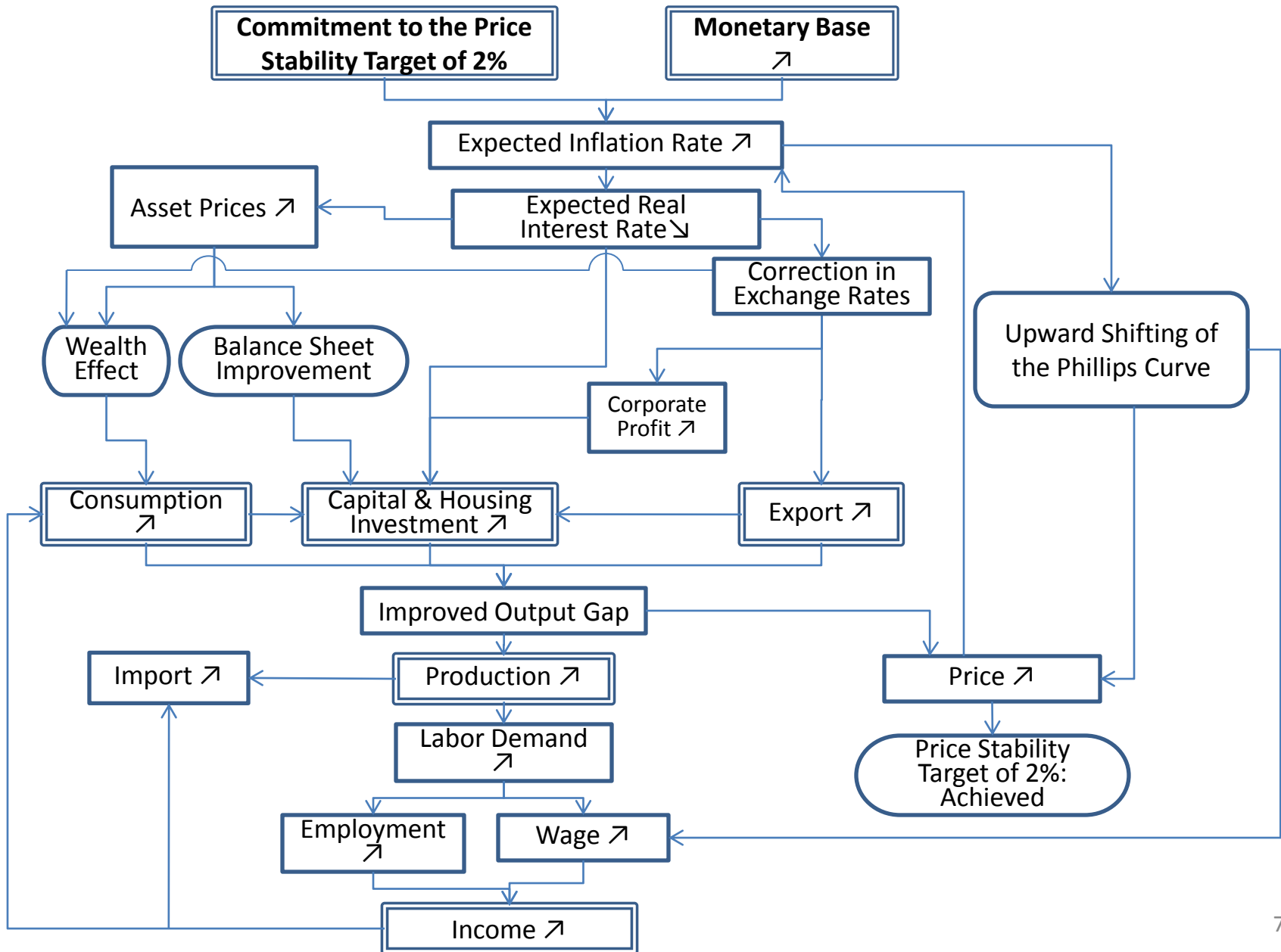
### Actions

- **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

Chart 6

# Transmission Channels of the QQE



# 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

# Stock Price and Exchange Rate



Source: Bloomberg.

Chart 9

## Household Assets

		2012				2013				Amounts outstanding in December-end 2013 in trillion yen (percentage ratio in parentheses)
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Amounts outstanding (End of period, trillion yen)		1,520	1,518	1,513	1,552	1,579	1,602	1,609	1,645	
C h a n g e s ( %)	Total assets	1.3	0.5	1.6	3.2	3.8	5.5	6.4	6.0	1,645 (100.0)
	Currency and deposits	2.2	1.8	1.9	2.0	1.7	2.1	2.1	2.3	874 ( 53.1)
	Bonds	-8.4	-7.9	-8.7	-9.3	-8.1	-9.0	-8.6	-7.7	30 ( 1.8)
	Investment trust beneficiary certificates	-4.9	-11.3	2.0	13.3	20.1	29.0	33.0	28.4	79 ( 4.8)
	Shares and other equities	3.0	-3.4	0.6	15.0	21.4	39.9	51.9	38.5	155 ( 9.4)
	Insurance and pension reserves	0.9	1.1	1.8	2.5	2.1	2.3	2.5	2.4	439 ( 26.7)
	Others	1.1	2.1	3.8	5.3	4.2	5.3	4.0	7.4	69 ( 4.2)

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

Chart 10

# Business Fixed Investment

## <Private Non-Residential Investment>

s.a.; q/q % chg.

2013				2014
Q1	Q2	Q3	Q4	Q1
-2.0	1.0	0.7	1.4	4.9

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	8.9
(excluding transport equipment)	4.9	0.2	-0.9	6.3	11.2

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

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

## <Machinery Orders>

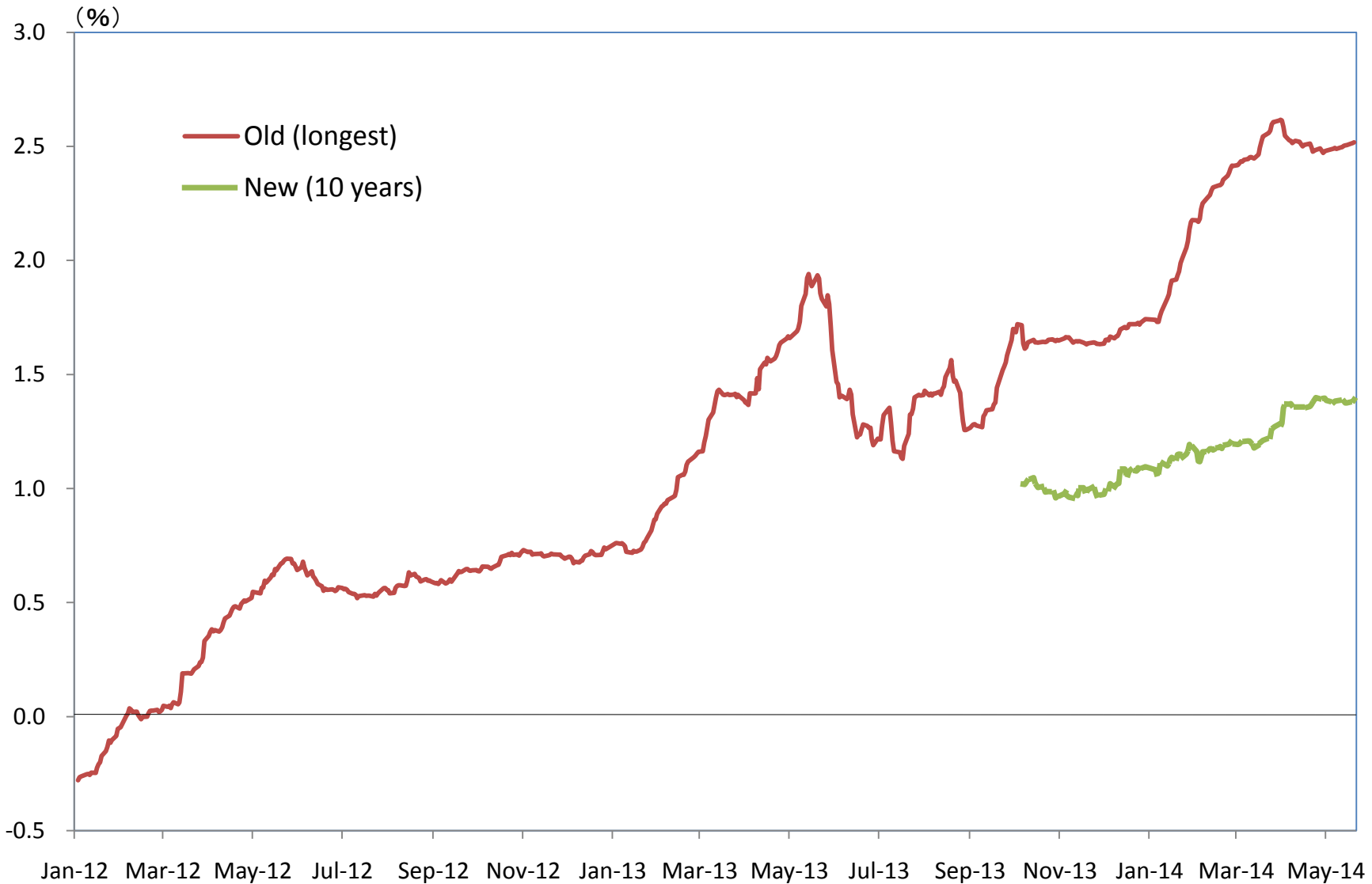
s.a.; excluding volatile orders; q/q % chg.

2013				2014
Q1	Q2	Q3	Q4	Q1
-0.0	6.8	4.8	1.9	4.2

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

Chart 11

## BEI for Inflation-Indexed JGBs

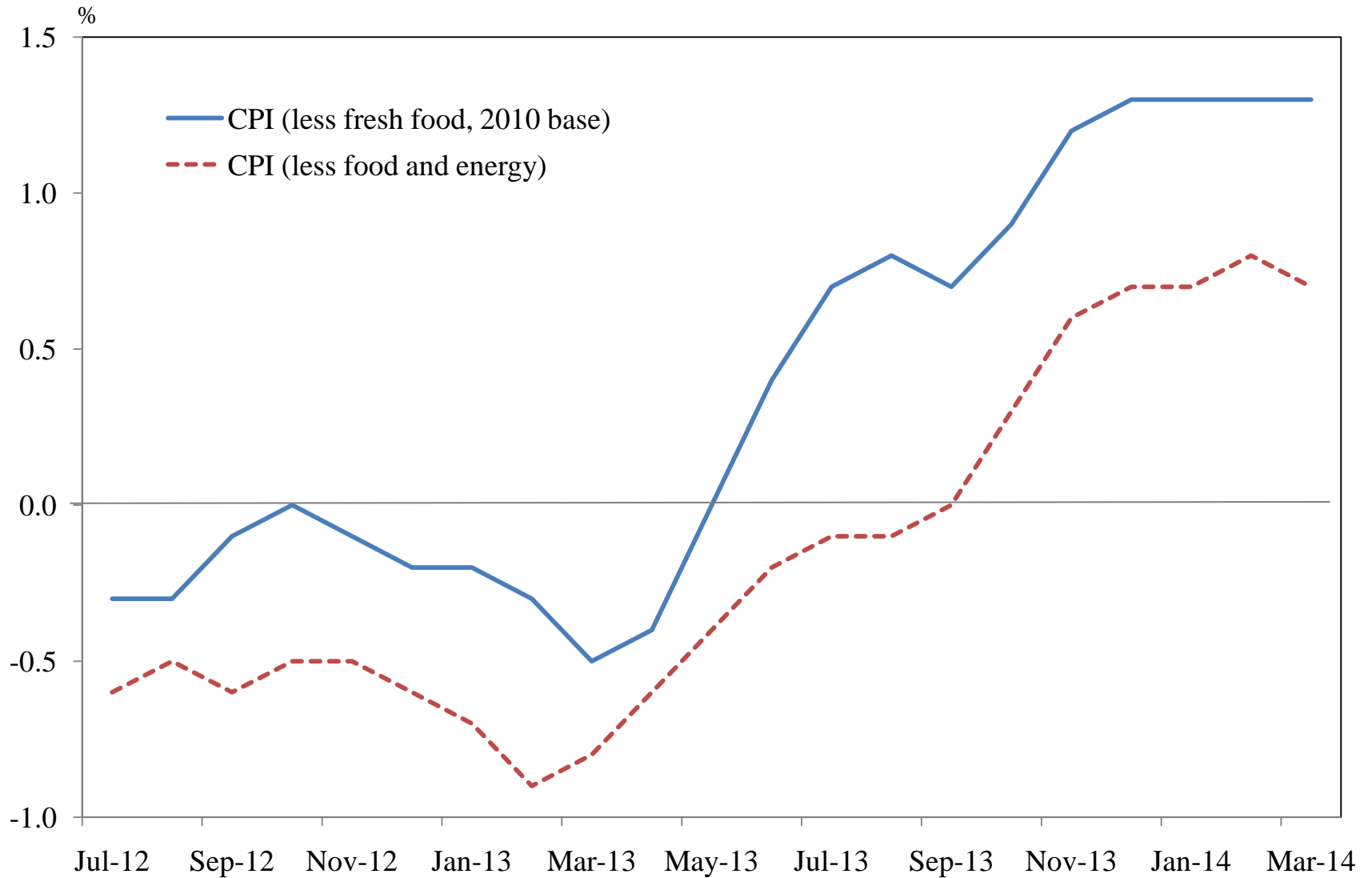


Jan-12 Mar-12 May-12 Jul-12 Sep-12 Nov-12 Jan-13 Mar-13 May-13 Jul-13 Sep-13 Nov-13 Jan-14 Mar-14 May-14  
Source: Bloomberg.

Note: Yield spreads between fixed-rate coupon-bearing JGBs and inflation-indexed JGBs. Inflation-indexed JGBs issued since October 2013 are designated as “new,” while the rest as “old.” Figures for “old (longest)” are calculated using yield data for issue No. 16 of the inflation-indexed JGBs, which matures in June 2018.

Chart 12

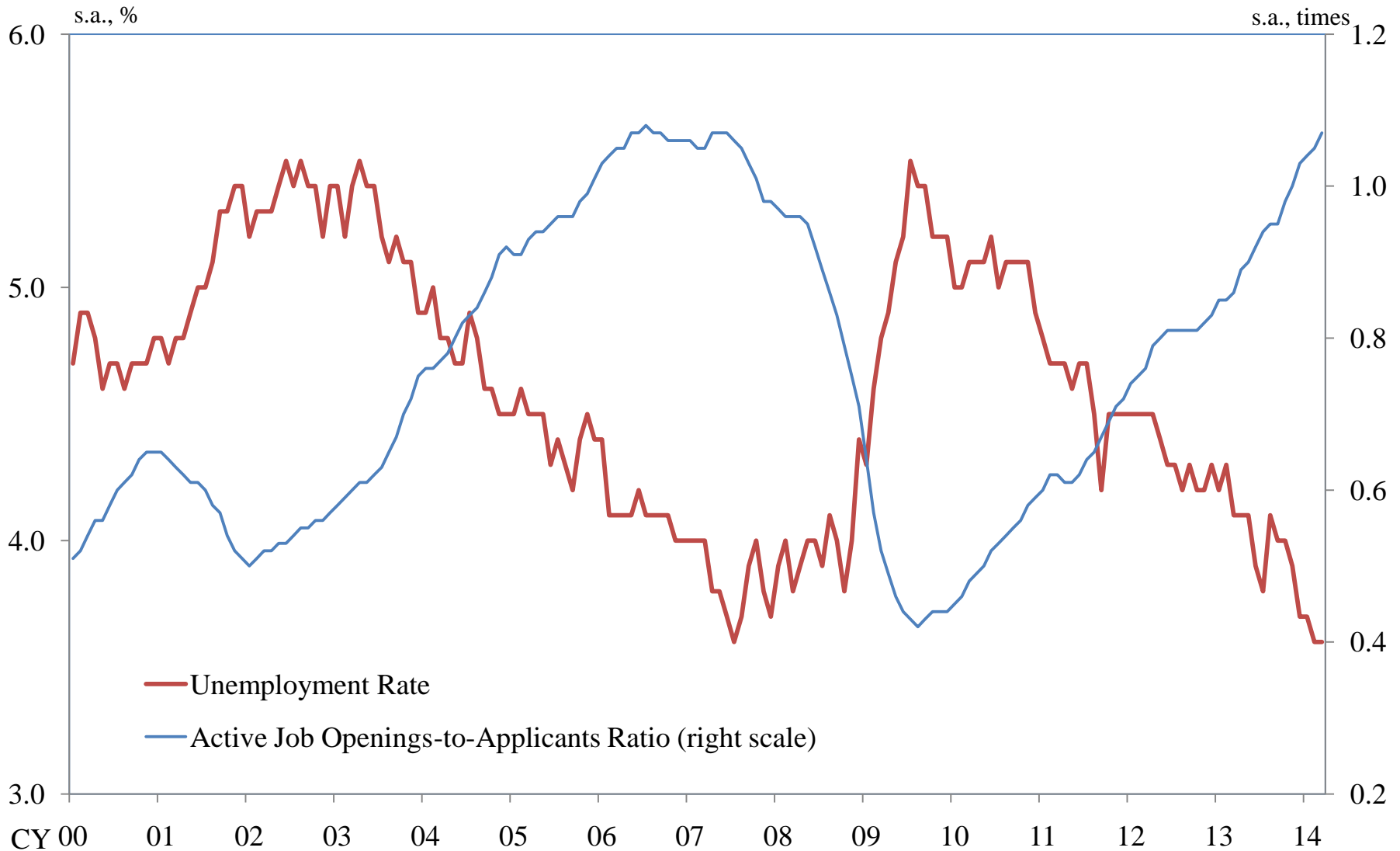
# Consumer Prices



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

Chart 13

# Employment Conditions



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

Chart 14

# Real GDP Growth

s.a.; q/q % chg.

	2013				2014
	Q1	Q2	Q3	Q4	Q1
Real GDP	1.2	0.9	0.3	0.1	1.5
<Annual rate>	<4.9>	<3.5>	<1.3>	<0.3>	<5.9>
Private Consumption	1.0	0.7	0.2	0.4	2.1
Residential Investment	1.8	0.8	3.3	4.3	3.1
Non-Resi. Investment	▲2.0	1.0	0.7	1.4	4.9
Government Consumption	0.9	0.7	0.2	0.3	0.1
Public Investment	4.5	6.4	6.9	1.2	▲2.4
Exports	4.3	2.9	▲0.7	0.5	6.0
Imports	1.1	1.8	2.4	3.7	6.3

Source: Cabinet Office, "National Accounts."

## Forecasts of Policy Board Members

y/y % chg.

	Real GDP	CPI (all items less fresh food)	Excluding the effects of the consumption tax hikes
FY 2014	<u>+1.1</u>	+3.3	<u>+1.3</u>
FY 2015	<u>+1.5</u>	+2.6	<u>+1.9</u>
FY 2016	<u>+1.3</u>	+2.8	<u>+2.1</u>

\*Figures indicate the median of the Policy Board members' forecasts (point estimates) as of April 2014.



Chart 16

# Respective Roles of Monetary Policy and Growth Strategy

